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How Startup Valuation Works

Alliance of Angels

Top 10 Angel Group

- Group of 140+ Angel Investors based in Seattle
- Invest $10M into 20 Pacific NW companies each year
- Total $100M+ invested, 100+ active portfolio companies

- Founded in 1997, non-profit member organization
- Members invest individually, nearly every member has made an angel investment in the last 2 years

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Alliance of Angels - Sponsors

K&L GATES

CTC | myCFO
BMO | A part of BMO Financial Group

petersonsullivan LLP
Certified Public Accountants
& Advisors

JLL®

Seattle Bank

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When do you need to value your startup?

1. When you are raising money

2. When you are selling the company

3. When you are pricing options for your employees (409A)

Startup Valuation: 2 Key Factors

1. How much money do you need to raise?

2. How much of your company should you sell?

How much money do you need to raise?

- Get to operating milestones necessary to raise your next round at a significantly higher valuation → 18 months "runway"
- Get to where no further outside capital is needed → cash flow positive

How much of your company should you sell?

- Most entrepreneurs sell between 15-35% of their company when raising money from angels

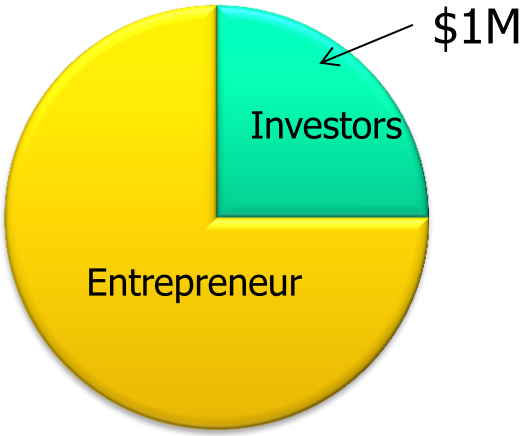
- Sell too much too soon → excessive dilution

- Useful resource: Ownyourventure.com

Simple Fundraising Example

Raising $1M

Sell 25% of your company



Post-money valuation (valuation after fundraising) = ??

Simple Fundraising Example

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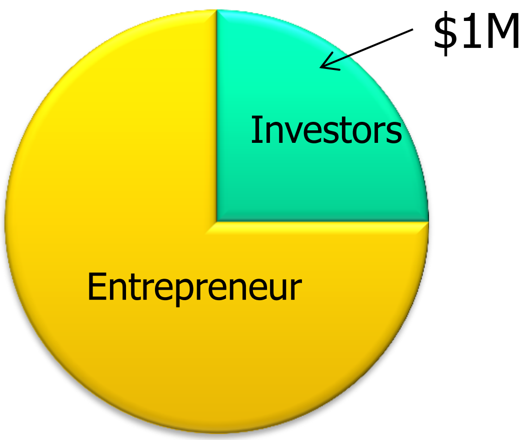


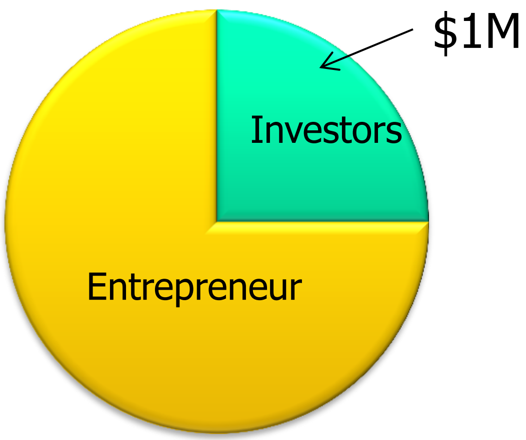
Post-money valuation (valuation after fundraising) = $4M

Pre-money valuation (valuation before fundraising) = ??

Simple Fundraising Example

Raising $1M

Sell 25% of your company

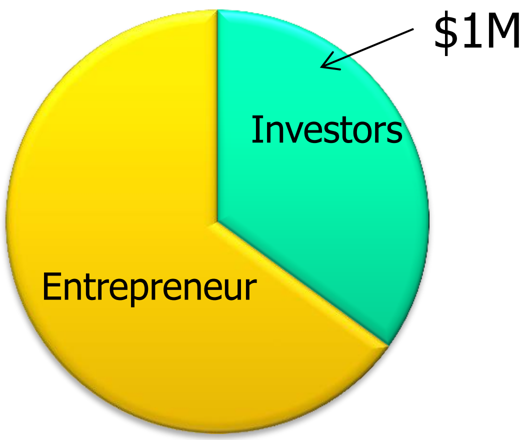
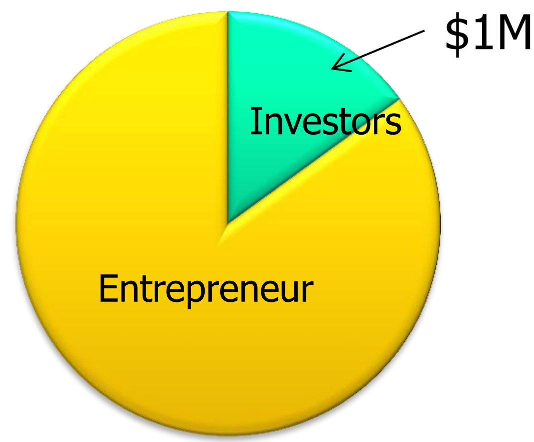


Post-money valuation (valuation after fundraising) = $4M

Pre-money valuation (valuation before fundraising)
= Post-money valuation – funds raised
= $3M

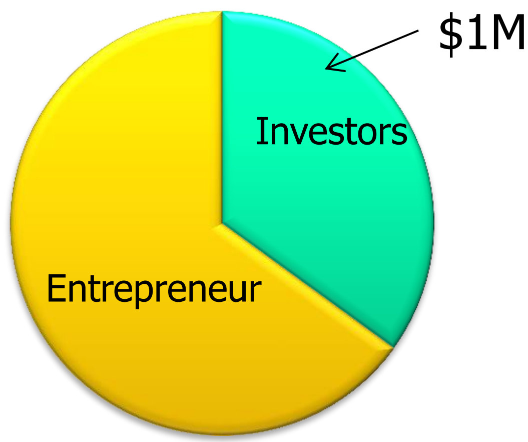
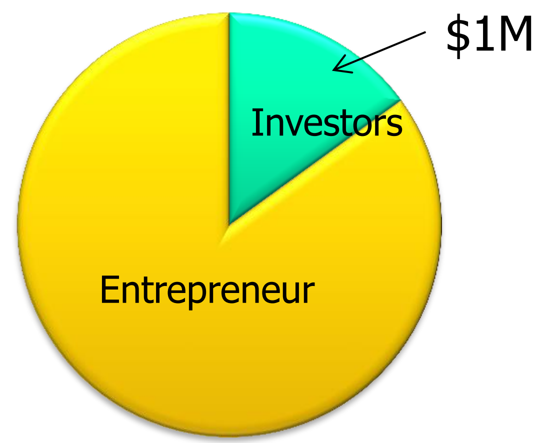
Calculating “reasonable” valuation range

Raising $1M, sell between 15-35% of company

% of company sold	35%	15%
		
Post Money Valuation	??	??
Pre Money Valuation	??	??

Calculating "reasonable" valuation range

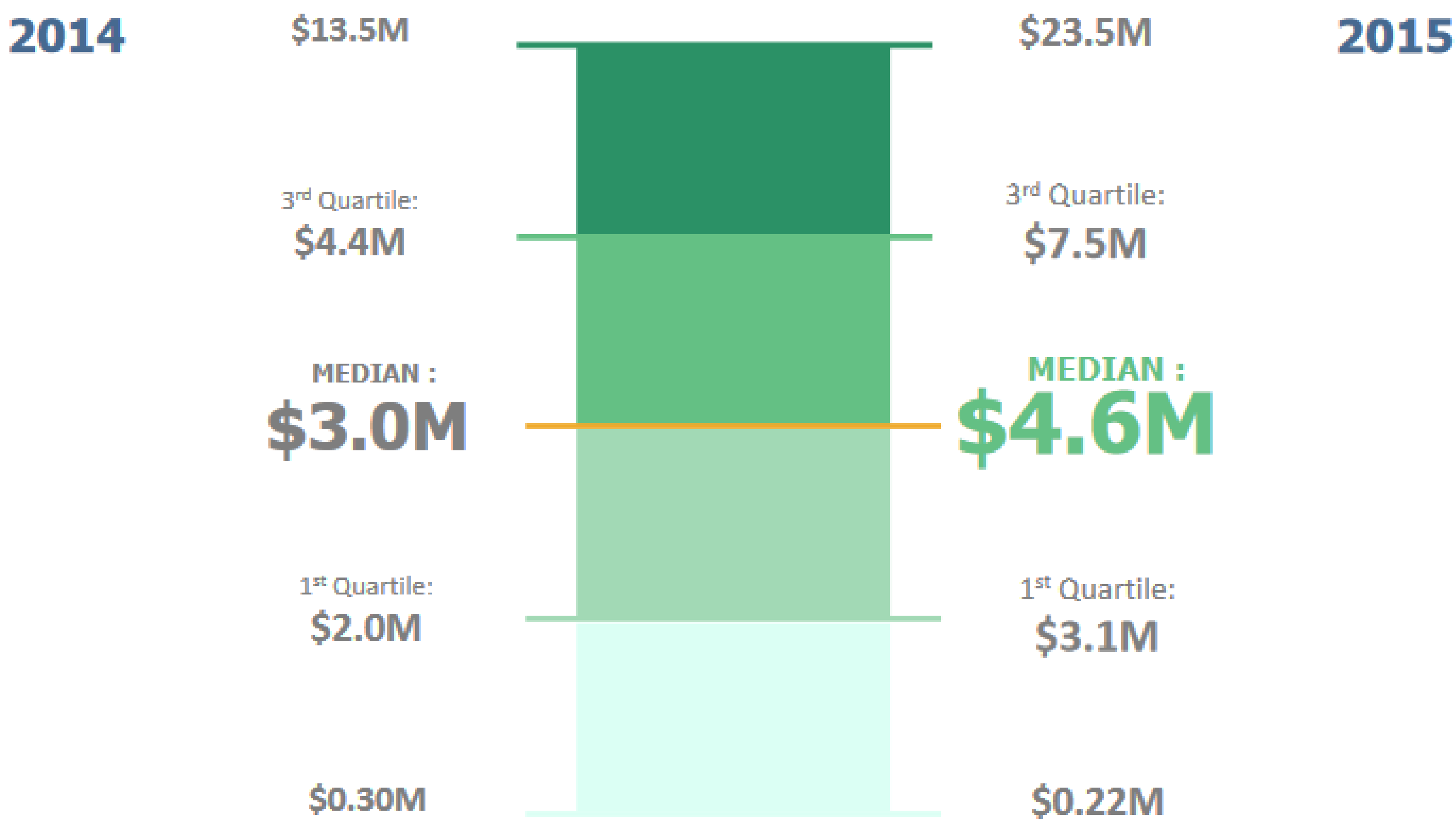
Raising $1M, sell between 15-35% of company

% of company sold	35%	15%
		
Post Money Valuation	2.9M	6.7M
Pre Money Valuation	1.9M	5.7M

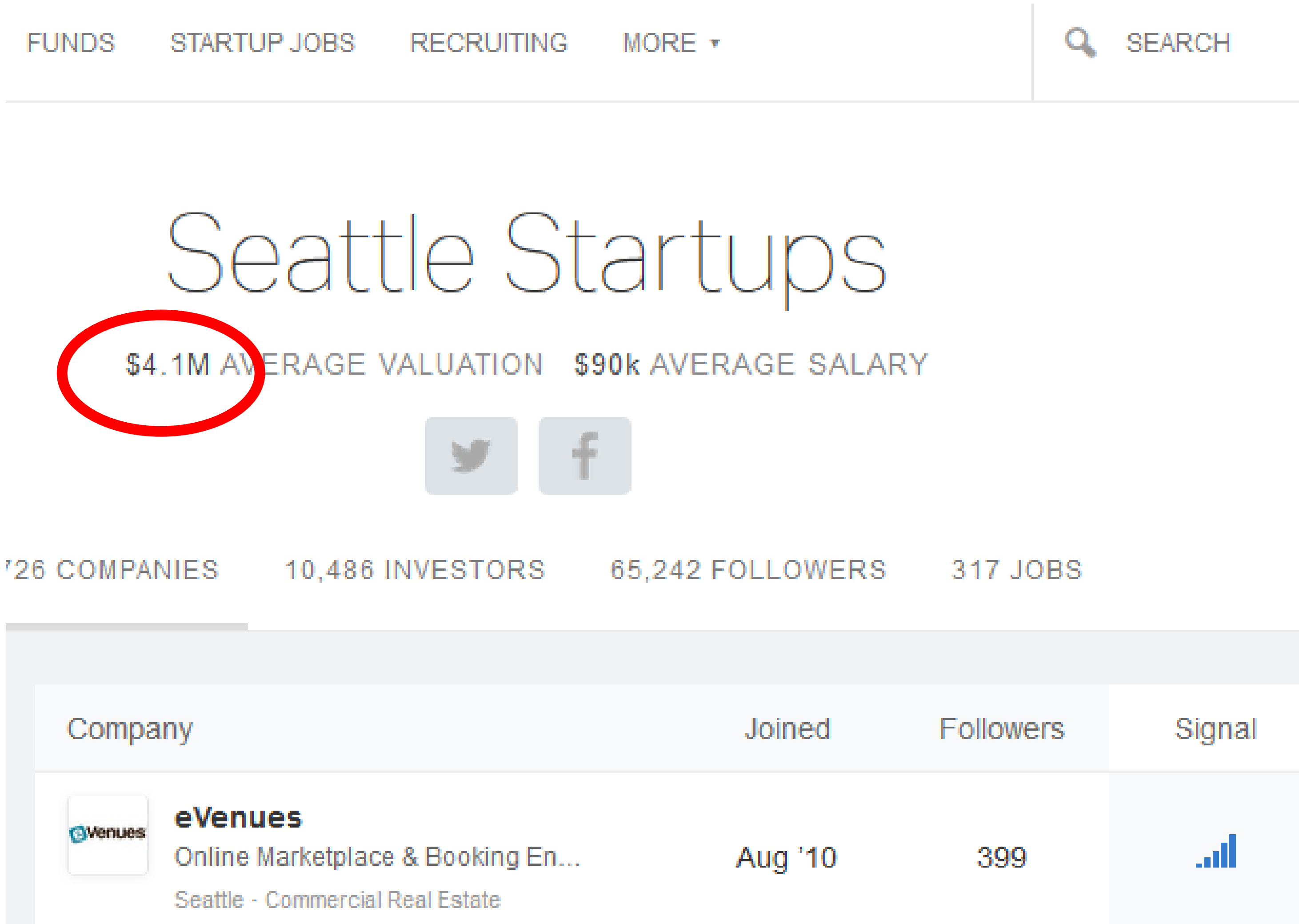
Startup Valuation: Comparables

- Halo Report
- AngelList
- PitchBook (need to pay)

Halo Report 2015
Median Seed Stage Pre-Money Valuation



AngelList (angel.co/Seattle)



Result of proposing “unreasonable” valuation

Too High

- Investors don’t engage
- Significant founder dilution if next round is a “down-round”

Too Low

- Poor investor <> entrepreneur incentive alignment
- Follow-on rounds may require re-cap

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Negotiating valuation with investors

- Partnership, not adversarial
- Use a third party framework, direct haggling is not likely to be productive
- Don’t forget about the other terms in your term sheet

  “You can have any valuation you want, if I get to set the rest of the terms.”

Framework #1: The Venture Capital Method

❶ Estimate the valuation of your company at exit (Terminal Value)

Today

Exit!

Time

❷ Ask your investors what their expected return is (e.g. 20x their money)

❸ Post-money valuation is the Terminal Value divided by your investors' expected return

Estimate the valuation of your company at exit (Terminal Value)

Terminal Value

=

Forecasted profit at exit year (from your own financial projections)

X

Price/earnings (P/E) ratio of acquired companies in similar industry (from M&A transaction database, public market analyst financials etc.)

Example – Calculating Terminal Value

- Exit Year = 5
- Profit (Year 5) = $2M
- P/E = 10x

Terminal Value = ??

Example – Calculating Terminal Value

- Exit Year = 5
- Profit (Year 5) = $2M
- P/E = 10x

Terminal Value = 2 X 10 = $20M

Summary: The Venture Capital Method

❶ Estimate the valuation of your company at exit (Terminal Value)

Today

Exit!

Time

❷ Ask your investors what their expected return is (e.g. 20x their money)

❸ Post-money valuation is the Terminal Value divided by your investors' expected return

$$\boxed{\text{Post-money valuation} = \frac{\text{Terminal Value}}{\text{Investor Expected Return}}}$$

Exercise – The Venture Capital Method

- Exit Year = 5
- Profit (Year 5) = $5M
- P/E ratio = 15x
- Investor Expected Return= 20x
- Dollar amount being raised = $1M

Pre-money valuation = ?

Exercise – The Venture Capital Method

- Exit Year = 5
- Profit (Year 5) = $5M
- P/E ratio = 15x
- Investor Expected Return= 20x
- Dollar amount being raised = $1M

Terminal Value = (15 x 5) = $75M

Post money valuation = 75 ÷ 20 = $3.8M

Pre-money valuation = 3.8 – 1 = $2.8M

Framework #2: The Scorecard Method

1. Start with the average pre-money valuation for your startup (obtain from third party sources)

2. Identify set of critical factors and assign appropriate weights to each

3. Adjust the average pre-money valuation based on the weighted multiple of those factors

Example: List of Issues & Weights

Factor	Weight (sums to 100%)
Team	30%
Market Size	25%
Product	15%
Route to Market	10%
Competition	10%
Other	10%

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Example: The Scorecard Method

Factor	Weight	% of Normal	Reason	Weight x % of Normal
Team	30%	130%	Solid domain expertise	0.39
Market Size	25%	80%	Focused on a niche	0.20
Product	15%	120%	Disruptive innovation	0.18
Route to Market	10%	120%	Distributor signed	0.12
Competition	10%	110%	Weak, fragmented	0.11
Other	10%	80%	IP licensing concerns	0.08

Weighted Multiple of Factors = 1.08

Average pre-money valuation = $3.0M
Pre-money valuation = 3.0 x 1.08 = $3.2M

Contact Information

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