BUSINESS VALUATION 101

FEBRUARY 19, 2021

ILLINOIS BUSINESS CONSULTING GROUP

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SERRA VENTURES

THE SERRA TEAM

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SERRA FAMILY OF FUNDS

86 PORTFOLIO INVESTMENTS

11 EXIT TRANSACTIONS

59 ACTIVE COMPANIES

$100 MILLION

IN ASSETS UNDER MANAGEMENT FOR FUND I, II, & III; TWO SIDE CAR FUNDS; SERRA AG TECH; AND CO-INVESTMENT FROM LPS

SERRA RELATIONSHIPS

200+

UNIQUE LIMITED PARTNERS

CO-INVESTMENTS WITH OVER 80 VENTURE FUNDS

RELATIONSHIPS WITH 25 ACCELERATORS & INCUBATORS

SERRA DISTINCTIVES

DEEP RELATIONAL NETWORK

SERRA HAS DEVELOPED A STRONG AND GROWING NETWORK WITH ACCELERATORS, VENTURE FUNDS, INFLUENCERS.
GREAT NETWORK = BEST OPPORTUNITIES.

RIGOROUS EVALUATION PROCESS

SERRA EVALUATES 1000 DEALS PER YEAR, RESULTING IN BEST-IN-CLASS PORTFOLIO CONSTRUCTION.

ENTREPRENEURIAL COACHING

SERRA'S TEAM OF FORMER TECH ENTREPRENEURS PROVIDES ROBUST HANDS-ON ASSISTANCE TO PORTFOLIO TEAMS.

TRANSPARENCY, INTEGRITY, EXCELLENCE

THE SERRA TEAM IS STRONGLY COMMITTED TO DOING BUSINESS ANCHORED BY TIMELESS CORE VALUES.

TIM'S BUSINESS VALUATION BACKGROUND

- Formerly an Accredited Senior Appraiser, American Society of Appraisers.
- McGladrey & Pullen Firmwide Business Valuation Director.
- Author, McGladrey & Pullen Business Valuation Practice Aid.
- Member, National AICPA Committee on Business Valuation Services.
- Over 500 business valuation projects

KEY SITUATIONS INVOLVING BUSINESS VALUATION

RAISING CAPITAL: AT WHAT VALUE WILL THE INVESTMENT TAKE PLACE?

STOCK OPTION PLANS: AT WHAT VALUE WILL OPTIONS BE GRANTED?

SHAREHOLDER BUY-OUT:
AT WHAT VALUE WILL THE PARTIES AGREE TO BUY OUT EACH OTHER?

SALE/LIQUIDITY EVENT: WHAT PROCEEDS CAN BE EXPECTED?

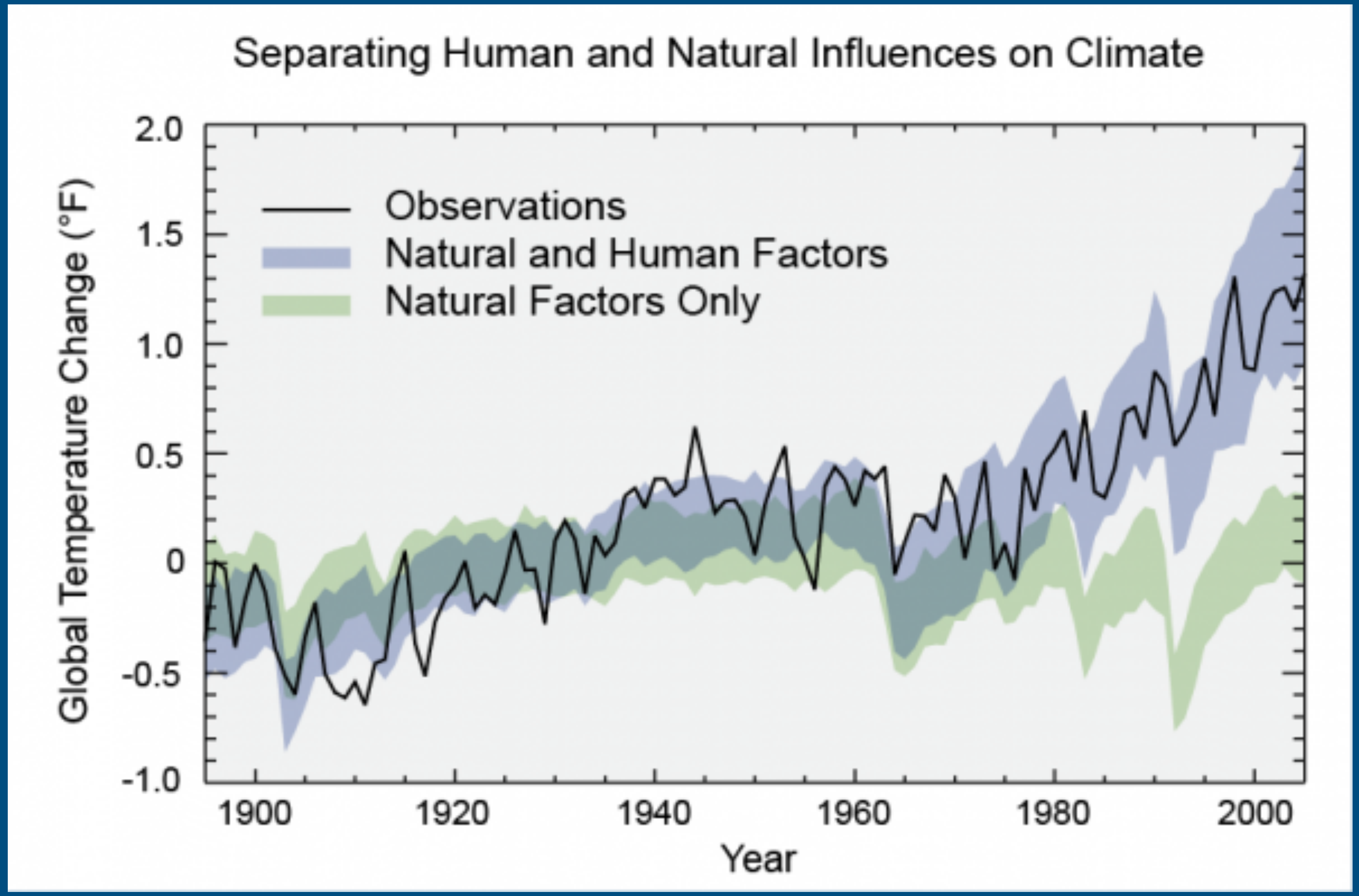
DIVISION SPIN OUT: DOES IT MAKE SENSE TO DIVEST A DIVISION OF SUBSIDARY FROM A VALUATION PERSPECTIVE?

BUSINESS VALUATION DEFINED

USING A COMBINATION OF ANALYTICAL TECHNIQUES, METHODOLOGIES AND COMMON SENSE TO DETERMINE THE FAIR MARKET VALUE OF A BUSINESS ENTERPRISE.

- The ultimate test of accuracy/validity of a business valuation is: AT WHAT VALUE DOES AN ACTUAL TRANSACTION CONSUMMATE?
- When a willing buyer and willing seller, neither acting under compulsion, come to an agreement on value, that meets the ultimate test.
- Everything else is conjecture, speculation, negotiation and posturing.

BUSINESS VALUATION: ART VS. SCIENCE



TRADITIONAL BUSINESS VALUATION METHODOLOGIES

INCOME

MARKET

ASSET

INCOME METHODOLOGIES

- These methods value a business based on its expected income or cash flow stream.
- Two most common measures of "income" are Sales Revenue and Earnings Before Interest, Taxes, Depreciation & Amortization (EBITDA)
- May use history (in some cases) as a base-line predictor of the future.
- Often involves preparation of detailed financial projections.
- Involves determination of some kind of RATE or MULTIPLIER to be applied against the selected income stream.

INCOME METHODOLOGIES EXAMPLE: EBITDA MULTIPLIER

- EBITDA = $300,000
- Industry multiplier range = 3 to 5 X EBITDA
- Valuator selects 4X as the multiplier based on analysis of company tangibles and intangibles
- Calculation:

  $300,000 x 4.0 = $1,200,000 Entity Value

INCOME METHODOLOGY EXAMPLE #2: DISCOUNTED CASH FLOW

Valuator selects discount rate of 25% based on analysis of all company factors; prepares cash flow projections

Projected Cash Flow	25% Discount Factor	Calculation
Year 1 = ($100,000)	0.80	($80,000)
Year 2 = $0	0.64	0
Year 3 = $150,000	0.512	76,800
Year 4 = $425,000	0.4096	174,080
Year 5 = $600,000	0.3277	196,620
Year 6 & Beyond = $1,000,000	(Divide by .25) x .3277	$1,310,800
Deduct Debt		($150,000)
DCF Value		$1,528,300

Terminal value ($1,000,000/.25) x .3277 = $1,310,800

Calculation: DCF Sum = ($367,500) + Terminal value ($1,310,800) – Debt ($150,000) = $1,528,300 Entity Value

MARKET METHODOLOGIES

- These methods value a business based on comparison to similar companies or portions of companies being bought/sold in the marketplace.
- Requires access to information on COMPARABLE sales or sales of shares in companies which are sufficiently similar to the subject company.
- Can be quite difficult to find true comparables to the subject company
- Involves determination of some kind of RATE or MULTIPLIER from the comparable data, which is then applied against a selected income stream (as in the Income Methodologies).

MARKET METHODOLOGY EXAMPLE #1

- Net Revenue of Company $1,600,000
- Average Price/Revenue Ratios of Selected Publicly Traded Comparable Companies is 2.5
- Valuator applies Discount for Lack of Marketability of 40%
- Calculation:

  $1,600,000 * 2.5 * (1-.40) = $2,400,000 Entity Value

ASSET METHODOLOGIES

- These methods value a business based on the value of the assets.
- Common asset methods include the Book Value Method, Adjusted Book Value Method, Replacement Value Method and Liquidation Method.
- Can often be used to calculate a FLOOR value.
- Not terribly meaningful in most operating company situations.

ASSET METHODOLOGY EXAMPLE

	Book Value	Adjustment	Adj. Book Value
Cash	50,000	–	50,000
Accounts Receivable	250,000	(40,000)	210,000
Inventory	175,000	(20,000)	155,000
Fixed Assets	300,000	400,000	700,000
Intangible Assets	0	100,000	100,000
Total Assets	**775,000**	**440,000**	**1,215,000**
Accounts Payable	75,000		75,000
Long Term Debt	300,000		300,000
Total Liabilities	**375,000**	**0**	**375,000**
Net Equity	**$400,000**		**$840,000**

"RULES OF THUMB" METHODOLOGIES

- Differ from industry to industry
- Can be somewhat useful
- Need to be tested against other methods

An example:

Guy Kawaski's Law of Pre-Money Valuation

- For Each Engineer add $500,000
- For Each MBA subtract $250,000

VALUING THE TECH START-UP

- Traditional valuation methods are very difficult to apply to start-ups:
- Often, no revenue or EBITDA metrics; insufficient history
- No meaningful "comparables"
- Income/cash flow projections are very difficult or are suspect

A PRE-REVENUE, PRE-EBITDA VALUATION MODEL FOR START-UPS

KEY FACTOR	RATING	VALUE ASSIGNED
Team with tech and business talent; Experience a plus.	0 to 5	$0 - $500,000
Large scale market opportunity; Demonstrated customer need and interest.	0 to 5	$0 - $500,000
Disruptive technology; Novel I/P with freedom to operate	0 to 5	$0 - $500,000
Evaluation of Risks/Intangibles	0 to 5	$0 - $500,000

START UP RISKS FACED

TECHNOLOGY RISK

EXECUTION RISK

FINANCIAL RISK

I/P
FREEDOM-TO-OPERATE
COMPETITIVE RISK

MARKET RISK

EXCEPTIONS TO THE MODEL

- There are always exceptions to the model!
- Supply and demand of funding impacts the range of $0 to $500,000 assigned to each element of the model.
- A combination of the "right stuff" inherent in the start-up can impact the model.
- The ultimate test of "fair market value" is a willing buyer and willing seller coming to mutual agreement.

VALUATION TIPS AND TRAPS

- Understand that the Market for Start-up Capital is what ultimately sets your value
- Be flexible and willing to negotiate value with investors
- Remember that valuation is only one element of a successful term sheet foR funding....it's called a term sheet for a reason!
- A over-valued first round of financing can really mess things up down the road
- Seek professional guidance in establishing your valuation expectations

CONTACT INFORMATION

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