Funding and Valuation

IBBT seminar April 18, 2012

Some quotes on Valuation

- Price is what you pay, Value is what you get
- whatever a damn fool will pay for (find a bigger fool)
- more art than science
- forecasting is difficult, especially about the future
- don’t confuse me with the numbers
- you name it, we’ve got it (valuation by objectives)

always remember *The Golden Rule*

Misconceptions about Valuation

- **Myth 1: A valuation is an objective search for “true” value**
  - All valuations are biased. The only questions are “how much” and “in which direction” one is biased.
  - The direction and magnitude of the bias in your valuation is directly proportional to who pays you and how much you are paid.
- **Myth 2: A good valuation provides a precise estimate of value**
  - There are no precise valuations.
  - The payoff to valuation is greatest when valuation is least precise.
- **Myth 3: The more quantitative a model, the better the valuation**
  - One’s understanding of a valuation model is inversely proportional to the number of inputs required for the model.
  - Simpler valuation models do much better than complex ones.

source: prof. A. Damodaran Spring 2012

Categories of Valuation

Looking backward	Looking forward
• History	Future
• Actuals	Estimates
• Closed financial accounts	Business Plan / scenarios
• Balance sheet (*foto*)	Profit & Loss statements (*film*)
• Conservative	Optimistic
• Break up	Going concern
• Values at low end	Top range values
• More mature business	Early stage companies

Net Asset Value

Multiples

Discounted Cash Flows

Balance Sheet

<u>ACTIVA</u> *(use of funds)*

Fixed Assets

- Intangibles
- Tangible fixed assets

Current Assets

- Inventory, WIP
- Trade Creditors
- Cash

<u>PASSIVA</u> *(origin of funds)*

Equity

- Capital
- Past earnings/losses

Liabilities

- Long Term Debt
- Short Term Debt
- Trade Debtors

Corrected Net Asset Value

- NAV = all assets – all liabilities and provisions
- Corrections for
  - market versus book value (+/-)
  - doubtful debtors
  - not booked provisions (costs, claims, taxes, etc)
  - off balance items (mortgages, options, unfunded pension plans, etc)
  - non-marketable intangibles (consolidation differences, goodwill, etc)
- Problems with NAV method

Profit & Loss Statement

Sales

- COGS (*Cost of Goods Sold*)

Gross Margin

- Personnel costs
- Services and other goods
- Other operating costs

EBITDA

(*Earnings Before Interest, Taxes, Depreciation and Amortisations*)

- Depreciation, Amortisations

EBIT

- Financial Result
- Extra-ordinary Result

EBT

- Taxes

Net Result

Net Cash Flow = Net Result + Non-Cash items (Depreciation, Amortisations)

Discounted Free Cash Flows

- Company = vehicle to create money
- DCF = Present Value of all future Free Cash Flows
  - *real* money *flowing* in/out the business
  - Net Earnings (can be) manipulated
    - accounting methods
    - fiscal items
    - financial structure of company
    - EBITDA proxy for CF: EV/EBITDA (better is NOPLAT)
  - Free: after Investments (capex) and Change in NWC, what is left over to decide on: re-invest (to suppliers), distribute (dividend to shareholders) or improve balance sheet (savings or pay off debt to bank)
  - PV: discounting at
    - WACC
    - Riskfree rate + risk premium
    - expected internal return rate (IRR)

Rule of thumb: *doubling over 5-4-3 years > IRR = 15%-19%-26%*

Importance of the Business Plan

- PRE MONEY Valuation < DCF < BP
- MONEY BP determines your cash need

=> POST MONEY % you are left with

- Reality check
- Work out different Scenarios: best/worst case
- Focus on Sales Plan: explain an investor in detail how you will get to those revenues
- Avoid Hockey Stick diagrams (try log scale for exponential growth)

Where to find Funding

- YOU: **F**ounders
- **F**riends, **F**amily and (other) **F**ools
- Business Angels (BAN, Win-Win)
- crowd
- government (grants, subsidies, PMV)
- VCs and PE funds
- stock markets

- *banks: unlikely* (maybe leasing)
- *local – global*
- *smart money*

How to pitch to an investor

- Elevator pitch: 10/20/30 rule (slides/minutes/font)
- Problem – Solution
- Explain how you will SELL (spending is easy)
- Deal with your ‘Elephant in the room’
- Keep your ‘Skeleton in the closet’… for a while

👍 Story, Momentum, Drive, Humor, Realism, Local Link

👎 Hyperbole, Name Dropping, Hockey Sticks, Salary

Sources: Guy Kawasaki, Mark Suster, Fred Wilson

How to stay owner of your company
(i.e. *keep the highest % post money*)

1) Increase your Valuation
   - get started!
   - beef up your business plan (stay realistic)
   - focus on relevant sector KPIs
   - select the right peer group (comparable listed/traded companies)
   - bring forward the Break Even point
2) Lower your Funding need
   - limit, postpone and cut costs
   - postpone call for committed capital
3) Negotiate Term Sheet – LOI – Shareholders Agreement
   - classes of Shares
   - prefer (convertible) Loans over Equity
   - milestones for later conversion
   - beware of typical VC clauses (exit preference, anti dilution, put options, etc)

☞ **hire a PE consultant**

Further references

- Valuation: Damodaran (NYU)
- Starting-up: Mark Suster, Fred Wilson
- Business Plan: McKinsey > BAN (NL translation)
- risk capital players: VLAO (BE); EVCA (EU)
- government help: PMV, agentschapondernemen.be

- fun reading: Ray Kroc: *Grinding it out*, W. Elsschot: *Cheese*

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