June

Valuation Pulse

Pre-Money Valuation

ONYX PARTNERS GROUP

Valuation Pulse

ideas for today *solutions for tomorrow*

BUSINESS VALUATION NEWSLETTER FOR BUSINES OWNERS

June 2018

When the Time Comes for A Capital Raise Pre-Money Valuation

Liquidity, capital raise, financing, seed money, all have different meanings but can have a significant impact on the value of your business, depending on when it is used. Terms like pre-money and post-money valuation get tossed around by groups such as venture capitalist, angel investors and private equity firms. How do you know which to use?

Pre-Money and Post-money valuations both have different meanings and purposes when valuing a business for raising capital. Each valuation will deliver a different value of your company before an investment is made. The raise will also have an impact on the percentage of ownership.

Pre-money valuation is the valuation that is conducted on your business prior to the capital raise. The post-money valuation is the capital that has been raised plus the current value of the business.

Sounds simple, right? Let's break down a hypothetical scenario.

There are 2 partners in a technology company. The partners own the company equally. Five years later, the founders get together and decided that they would like to take the business to the next level. In order to do so, the idea of raising capital is brought to the table. They find an investor who agrees that the tech company is valued $20,000,000. The investor agrees to invest, $7,000,000.

The founders' percentage in the tech company will depend on whether this is a $20,000,000 Pre-Money or Post-Money valuation. If the valuation is pre-money, the company is valued at $20,000,000 before the investment. After the investment, the value of the company would be $27,000,000. If the valuation includes the investment of $7,000,000, then the $20,000,000 valuation is post-money. *(exhibit 1)*

Pre-Money Valuation			Post-Money Valuation		
	Value	Percent		Value	Percent
Business Partners	$20,000,000	74.07%	Business Partners	$13,000,000	65.00%
Investor	$7,000,000	25.93%	Investor	$7,000,000	35.00%
Total	$27,000,000	100.00%	Total	$20,000,000	100.00%

exhibit 1

Based on the illustration above, the valuation method used, can affect the value of the business as well as the percentage of the ownership significantly.

In the pre-money illustration, the founders' interest in the company was 74%, which leaves the investor with a 26% stake in the company. Had this been a post-money valuation, the founder's percentage would have dropped to 65% and the investor would have increased to 35%.

For the remainder of this article, let's focus on Pre-Money valuation as oppose to Post-Money. Pre-money valuation will give an entrepreneur several things to consider. For starters, a pre-money valuation will allow the founder to understand how much of a raise is required to fulfill the raise purpose. But it will also show how much of the company they are willing to give to an investor.

Before the founder creates a number they believe is what they need from the raise, they should first seek a valuation analyst to provide them with a valuation of the company's current status. Each time the company decides to sell a portion of their company in exchange for capital, they should understand the pre-money valuation. This task will allow the founder to understand the amount needed from the raise and how much of the company they are willing to sell in order to receive capital.

A suggestion to founders, depending on your seed stage, investors are interested in more than just a catchy idea or sleek product. Investors are interested in knowing their exit strategy. Here are two valuation methods that VC and Angel investors will most likely look for when reading your pre-money valuation.

Two most common valuation approaches for pre-money valuation

(Discount Cash Flow)

DCF is a frequently used model to value a business. DCF stands for Discounted Cash Flow. The purpose of this model is to provide a forecast of the company's free cash flow discounted back to today's value, which is called the Net Present Value (NPV).

(Comparable Company Analysis)

The second valuation approach most commonly used is the comparable company analysis. This is a relative valuation method in which you compare the current value of a business to other similar businesses by looking at trading multiples such as P/E, EV/EBITDA along with several other ratios.

Both methods mentioned above are commonly used valuation approaches. However, there are other approaches that can be just as effective but depends on the company and the industry. That will help determine which approach is the best approach to use for your pre-money valuation.

Founders, as the company continues to grow, deal with several challenging situations. One of the most complicated decisions the founder may be confronted with as it pertains to the growth of the business, is whether they need to do a capital raise in order to take the business to the next level.

When raising capital, understanding the pre-money valuation brings along the conclusion of how much of your ownership you are willing to dilute is an important issue. Often, the founder needs to take a step back and look at the bigger picture. Meaning, owning a smaller percentage of a bigger business can be more lucrative than being the bigger fish in a smaller business. If the bigger business is your vision, take the necessary steps to prepare your business for a capital raise.

For a comprehensive overview of pre-money or post-money valuation for your business, contact Onyx Partners Group for professional valuation advice.

Stephen A. White, CVA has been in the financial industry for over 25 years and is a full-time valuation expert. He is the managing partner and founder of Onyx Partners Group where he specializes in valuation services for small and mid-size businesses. The valuation services cover a variety of areas such as ESOP, purchases and sales, buy sell agreements, SBA valuation and Family Offices.

stephen.white@opgbv.com
973-902-7828 opgbv.com
Twitter: @OPG_BV