Workshop: Valuation Deep Dive

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WHAT IS VALUATION?

- Price at which you buy into shares of a company.
- Reflection of what you think that company is capable of achieving.

AS A COMPANY MATURES, THE WAY WE ASSES VALUATION CHANGES.
LIFE-CYCLE, SOURCES OF FUNDS & VALUATION

- **Seed**
  - Founders Savings
  - Friends and Family

- **Start-up**
  - Angels

- **Early Growth**
  - Venture Capital

- **Sustained Growth**
  - Private Equity

- **Pre-Revenue**
  - Market benchmarks, Burkan Method, convertible notes

- **Revenue**
  - Relative valuation, Dilution analysis

- **Profitable**
  - Intrinsic valuation, DCF

SALE / IPO
EARLY STAGE VALUATIONS
VALUATIONS – Early Stage

Early stage companies...

- Have little to no revenue
- Have minimal traction and proof points
- Have unproven business models
- Are often not more than an idea

SO HOW DOES ONE DETERMINE VALUATION?
VALUATIONS – Early Stage

RULES OF THUMB:

• Total fundraise should dilute company by 15 – 25%, for seed stage deals
• Plan for future fundraises and calculate in your dilution
• Unallocated employee option pool set to 15% after each financing
• Make sure founders and early team members have significant ownership to keep them in the game

PRE MONEY + CAPITAL INVESTED = POST MONEY

$2M Pre + $500K = $2.5M Post

20%
## VALUATIONS – Early Stage

### GEOGRAPHIC BENCHMARKS?

<table>
<thead>
<tr>
<th>Region</th>
<th>Average Valuation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Silicon Valley</td>
<td>$4.8m</td>
</tr>
<tr>
<td>Turkey</td>
<td>$4.3m</td>
</tr>
<tr>
<td>Russia</td>
<td>$3.3m</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>$2.8m</td>
</tr>
<tr>
<td>Ukraine</td>
<td>$1.7m</td>
</tr>
<tr>
<td>UAE</td>
<td>$2.0-2.5m</td>
</tr>
</tbody>
</table>

### OTHER FACTORS

- **Investor syndicate**
  - Who are the other investors?
  - Strategically advantageous that add value

- **Competition**
  - Difficult to get into the deal
  - Market dynamics & pricing at play

- **Comps**
  - What valuations have similar companies raised at?

- **Market**
  - Considering the regional / economic dynamics of the overall market
VALUATIONS – Early Stage

- Valuation does not reflect the intrinsic value of the company
- It shows how much of the Company the Investor gets for the investment.
- The Burkan Method:

TEAM + IDEA + MARKET

PRODUCT + RELATIONSHIPS

Arabnet, https://angel.co/valuations
VALUATIONS – Kicking the can down the road...

- Convertible notes allow early investors to defer valuation
- Angels provide loans to that are then converted into equity in the next investment round
- Agreed discount on that valuation and/or valuation cap
- Logic is that a better informed, more institutional investor (i.e. a VC firm) is in a better position to set the initial valuation

KEY TERMS

- Discount rate: 15-25%
- Valuation cap: Soft-sounded from VC’s
GROWTH STAGE VALUATIONS
**VALUATIONS – Growth Stage – Comparable Metrics**

Revenue generating companies with traction in its core market and growing monthly

Comps: Understanding the *multiple*

- Find similar companies
- Figure out their valuation to revenue ratio – the “multiple”
- Multiple your company’s revenue by the “multiple”

MULTIPLE = Enterprise Value
Revenue, earnings, users, etc.
VALUATIONS – Growth Stage – Dilution Analysis

• By the time the company reaches its growth stage, should have meaningful performance data
• This allows for meaningful forecasting
• Goal is to project where you need to be for an exit:

1. What type of sales can the company achieve in the next 3-4 years?
2. How much money will the company need to raise to achieve that?
3. At that sales level, what kind of exit could I assume?
4. To get a 5x return, my share of those exit proceeds need to be...
5. Then in this current round, the company should be valued at...
LATER STAGE VALUATIONS
At a later stage, companies are intrinsically valued, as there will be clear visibility around the cash generating abilities of the company.
CASE STUDY - WASHMEN
Many aspects of determining a valuation is subjective – the angel and the entrepreneur will have two different views.

- Angels will always want the lowest cost basis; founders want the lowest dilution.
- The entrepreneur and the angel will engage in negotiations to agree on a price.
WASHMEN

- Washmen is a mobile-based laundry and dry clean service. Washmen offers timely pick-ups and drop-offs within 30 minute time slots that are most convenient to its customers.

THE SITUATION

- Washmen is fundraising – seeking $3M at $12M Valuation

- This means Washmen is selling 20% of the company to external investors
  - $3M / ($12M + $3M) = 20%

- We are assembling a group of angels to invest in Washmen - we need to determine whether $12M is a fair valuation.

*All figures are for demonstration purposes only*
Introduction to Washmen
## WASHMEN IN NUMBERS

### CUSTOMER BEHAVIOR

- **$33** Average Order Size
- **2.75x** Recurrence Per Month
- **$25** Customer Acquisition Costs
- **$450** Lifetime Value

### PERFORMANCE

- **$75K** Monthly Sales (April ‘16)
- **20,000** Items Washed (March ‘16)
- **1,400** Users (March ‘16)
- **20%** Target Gross Margin

### WHAT DO WE LOOK AT?

- **3** Impressive Founders
- **40%** Growth in Sales Mom (Feb ‘16 to Mar ‘16)
- **27%** Increase in Users Mom (Feb ‘16 to Mar ‘16)

### GROSS MARGIN BREAKDOWN

- **28% Logistics**
- **20%** Gross Margin for Washmen
- **40%** Laundromat
- **12% Others**

Source: Company and GS India Rising May 4 2015
## WASHMEN – Relative valuation

<table>
<thead>
<tr>
<th>Cities</th>
<th>Dubai</th>
<th>New York</th>
<th>Dubai</th>
</tr>
</thead>
<tbody>
<tr>
<td>Launch</td>
<td>2012</td>
<td>Nov-14</td>
<td>Nov-15</td>
</tr>
<tr>
<td>Funding</td>
<td>USD 4.5m to date</td>
<td>USD 3.1m to date</td>
<td>USD 400k to date</td>
</tr>
<tr>
<td>Investors</td>
<td>MENA Venture Investments, individual angels</td>
<td>Ludlow Ventures, Initialized Capital, 500 Startups, Funders Club, Soma Capital, Altair Capital, ind. angels</td>
<td>Individual angels</td>
</tr>
<tr>
<td>Incubator</td>
<td>None</td>
<td>Y Combinator</td>
<td>Flat6Labs</td>
</tr>
<tr>
<td>Full time employees</td>
<td>65</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>Items washed per day</td>
<td>c.1800</td>
<td>~3,500</td>
<td>~1000</td>
</tr>
<tr>
<td><strong>Monthly revenue</strong></td>
<td><strong>USD $135k</strong></td>
<td><strong>USD $200k</strong></td>
<td><strong>USD $75k</strong></td>
</tr>
<tr>
<td>Monthly compound growth</td>
<td>35%</td>
<td>30%</td>
<td>40%</td>
</tr>
<tr>
<td>Contribution margins</td>
<td>15%</td>
<td>23%</td>
<td>20%</td>
</tr>
</tbody>
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Annualized revenue is commonly used to compare relative valuation

*All figures are for demonstration purposes only – these are dummy numbers.*
WASHMEN – Dilution analysis

Sales of $100k/month

Sales of $2.5m/month
• Multiple of 3.5x
• Valuation of $105m

Initial investment

Series B

Series C

Exit

<table>
<thead>
<tr>
<th>Amount</th>
<th>Dilution</th>
<th>Your stake</th>
</tr>
</thead>
<tbody>
<tr>
<td>$3m</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>$5m</td>
<td>16%</td>
<td>17%</td>
</tr>
<tr>
<td>$10m</td>
<td>15%</td>
<td>14%</td>
</tr>
</tbody>
</table>

Initial investment

Series B

Series C

Exit

Work-backwards so that you will get a 5x return based on how the company will grow.
FINAL THOUGHTS
KEY TAKE-AWAYS

- Valuation is subjective and depends largely on your view of market potential & management’s ability to execute

- Ultimately, the valuation of a capital raise is supply-demand driven

- There are a number of ways that investors can assess the soundness of the valuation of a potential investment