SFU BUS314 CAPITALIZATION and VALUATION

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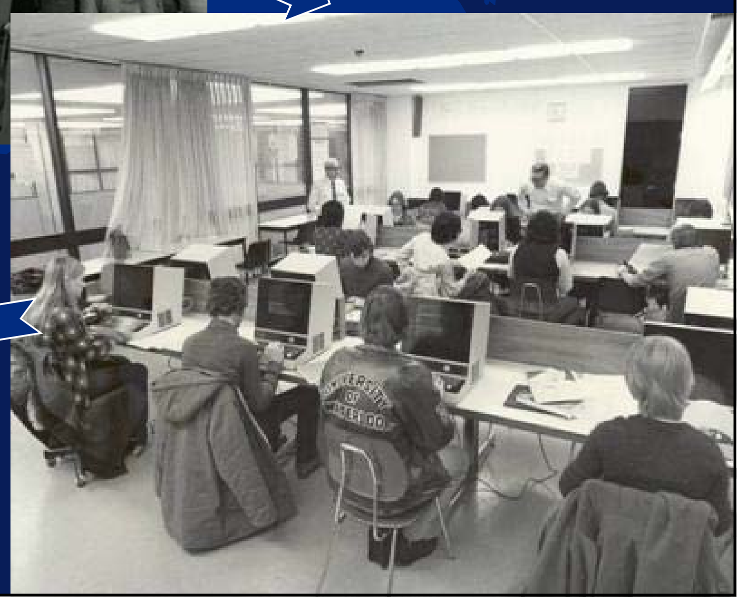
Mike Volker

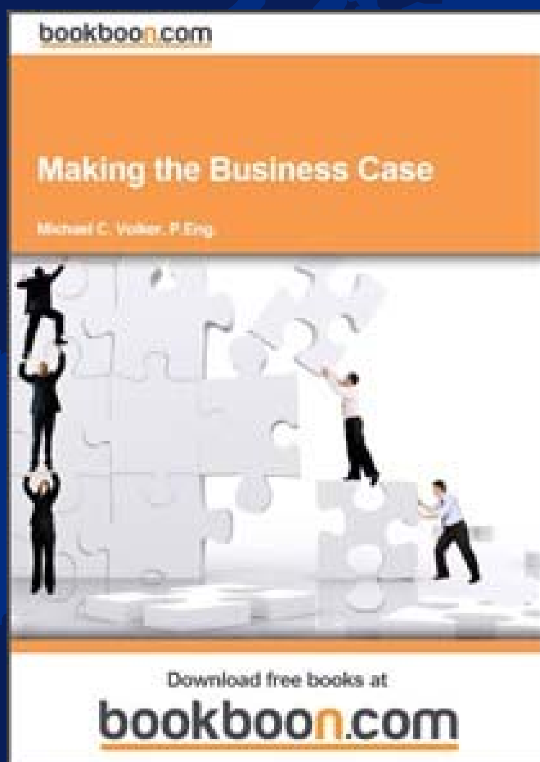
SFU Simon Fraser University

www.mikevolker.com

Business Case: Keypunch Cards to CRT Terminal



Why I wrote this book



How much do I need?

- How much to cashflow? (cash based) (check:http://www.sfu.ca/~mvolker/biz/cashflow.htm)
- How much to Proof of Principle? (milestone based)
- How much for first 1-2 years? (time based)
- How much can I get? (constraint based)

One of My First Deals

Dear Mike:

RE: Investment Offer

We are prepared to make an investment in RIM on the following basis:

1. Cash Investment of $30,000.00 for 15% of the common shares in RIM.

2. RIM must qualify as an eligible SBDC investment.

3. We can grant a re-purchase option on the basis of our original investment returning 40% per annum.

4. We would become a party to your shareholders' agreement. (or failing that, we can draft a new agreement)

This Offer is valid until 15 November 1988.

Please indicate your acceptance by returning a signed copy of this letter.

Thank you and kind regards,

M.C.Volker, President.
550100 Ontario Ltd.

Accepted by: ______________ this 6 day of OCTOBER, 1988.
per Research in Motion

Recent Trends

- Canadian pre-money seed round valuations in 2015:
  Median Valuation = $2.5M
  Mean Valuation = $3.3M
- Failure rates very high
  (60%-80% fail in first five years)
- Exits (liquidity) taking >> 10 years
- Dilute 30% on each round (regardless of round size)

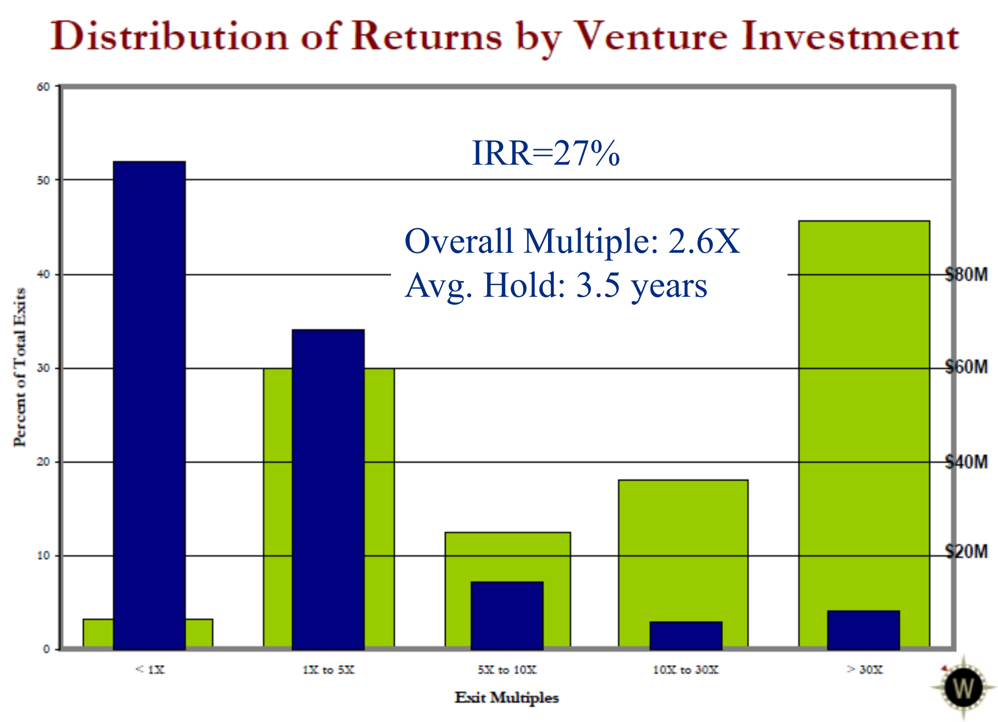
Valuations are Market Driven

- Exit Values drive current valuations
  (i.e. what value today will give a 10X on exit?)
- Wiltbank Survey: 2.6X in 3.5 years (28% IRR)

<u>MULTIPLES vs IRR:</u>

2X in 5 years = 15%
5X in 5 years = 38%
10X in 5 years = 58%
10X in 10 years = 26%
50X in 10 years = 48%
100x in 5 years = 151%

Angel Investing 101



Study by Rob Wiltbank, Willamette Univ.

Valuation Rules of Thumb

- Revenue multiple (too broad; industry specific) and/or Cash Flow (usually not applicable to startups)
- Based on size of round: 3X to 4X investment ($500K Round implies a $1.5M-$2M valuation)
- Exit Value (Negotiate 1/10 to 1/30 of Exit Value)

Venture Capital Method

- Investment — $1 million
- Exit Year — 5th year
- Revenue (Yr 5) — $20 million
- Net Profit (Yr 5) — $2 million (10%)
- P/E (industry) — 15X
- Company Value — $30 million
- ROI Req’d — 60% (i.e.10X)
- Exit Proceeds — $10 million (10 X $1 m)
- % ownership — 33%
- Pre-$$ Valuation — $2 million, ($3M post)

Business Plan Reality Checks

- Beware the Hockey Stick Curve!
  Fact: 0.5% of startups (8,849 in US)
  achieved $50 million sales in 6 years
- Define the Market Precisely:
  Kiss of Death:
  “we will get 1% of the market”
  Goal:
  Own Your Market (read Regis McKenna)
  (Harvard Business Review)

“Typical” Cap Table

		CAP TABLE			
	StartUp	**Angel Round**	**VC Round**	**Exit**	**Gain**
Founders/Mgmt	$0 (100%)	$0 (75%)	$0 (37%)	$11.25M	1000X
Angels		$250K (25%)	$250K (12%)	$3.75M	15X
VCs			$3M (50%)	$15M	5X
Market Cap	$0	$1M	$6M	$30M	

XL template on http://www.wutif.ca/companies.htm

Deferring the Valuation

- Use of Convertible Notes (or SAFEs)
- Convert to shares on first (big) round at discounted price
- More security/risk during startup period

Mitigating a (high) Valuation

- Post-investment adjustments
- Liquidation Preference
- Minimum ROI formula
- Call Options
- Put Options

Avoiding Valuation & Dilution

- Debt (loans, e.g. SRED Advances)
- Founder Guarantees for loans, credit
- Pre-payments (eg Kickstarter)
- Royalties on revenues (see timiacapital.com)

Some Issues & concerns

- Stock vs Stock Options and dilutions
- Subsequent financing round dilutions

Bottom Line:

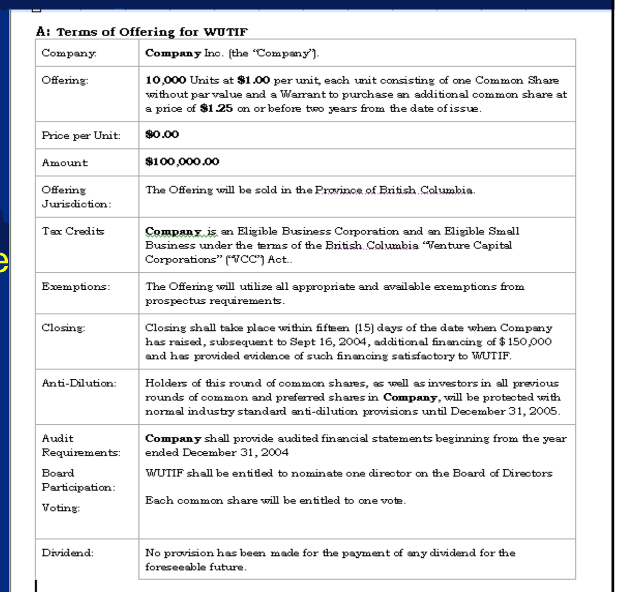
A $2M Seed Valuation and a $20M Exit Value does NOT mean a 10X return!! (more likely 3X)

Negotiable Deal Terms

- Downround protection – easy to do
- Liquidation preference – maybe
- Anti-dilution – only through participatory rights
- Exit Provisions: Put Options, vesting on sale
- Stage investments – define tranches
- Board participation (observer vs director)
- Convertible Instruments (Prefs or Notes) Issues:
  - Too small a discount given the risk
  - Not angelic (diverging interests)

The Terms Sheet?

- Offering:
  Common vs Conv Deb vs Prefs
- Valuation:
  Trading cash for futures
  Use accretive approach for performance
- Vesting for founders:
  50% Linear over 3-4 yrs
  50% on liquidity event
- Capital & Structure:
  avoid options – use trust shares
- Governance:
  board rep/independence
- Shareholders Agreement:
  standardize



A: Terms of Offering for WUTIF

Company:	**Company** Inc. (the "Company").
Offering:	**10,000** Units at **$1.00** per unit, each unit consisting of one Common Share without par value and a Warrant to purchase an additional common share at a price of **$1.25** on or before two years from the date of issue.
Price per Unit:	**$0.00**
Amount	**$100,000.00**
Offering Jurisdiction:	The Offering will be sold in the Province of British Columbia.
Tax Credits	**Company** is an Eligible Business Corporation and an Eligible Small Business under the terms of the British Columbia "Venture Capital Corporations" ("VCC") Act..
Exemptions:	The Offering will utilize all appropriate and available exemptions from prospectus requirements.
Closing:	Closing shall take place within fifteen (15) days of the date when Company has raised, subsequent to Sept 16, 2004, additional financing of $ 150,000 and has provided evidence of such financing satisfactory to WUTIF.
Anti-Dilution:	Holders of this round of common shares, as well as investors in all previous rounds of common and preferred shares in **Company**, will be protected with normal industry standard anti-dilution provisions until December 31, 2005.
Audit Requirements: Board Participation: Voting:	**Company** shall provide audited financial statements beginning from the year ended December 31, 2004 WUTIF shall be entitled to nominate one director on the Board of Directors Each common share will be entitled to one vote.
Dividend:	No provision has been made for the payment of any dividend for the foreseeable future.

See mikevolker.com for sample.

More Info:

www.mikevolker.com