Key Factors Influencing Valuation

Valuation Process

- Valuation is not solely quantitative
- Qualitative factors also come into play
- A "contextual factor analysis", which describes in what context a valuation is taking place, is needed to properly value a company
- Contextual factors include cash flow (current and historical), who's involved, availability of capital, and the team
  - Many other factors

Contextual Factors

- Cash flow – historical, present, future
  - Current cash flow is most important
  - Future cash flow is unknown and primarily the result of efforts of the new owner
  - Amount of debt the cash flow can service
- Who's doing the valuation?
  - If VC, wants to keep value low
  - If entrepreneur, wants to push number up

Contextual Factors

- Public or private?
  - Public companies are valued higher due to liquidity in the market and better information
  - Private companies lack liquidity and provide limited information
- Availability of capital.
  - The greater capital available, the higher the valuations
  - Supply vs. demand – greater capital chasing, fixed number of opportunities will compete

Contextual Factors

- Is it a strategic or financial buyer?
  - Generally, strategic buyers value companies higher than financial buyers
  - Availability of capital for private equity funds may swing the pendulum
- Speculation
  - Value based on projected future performance can drive valuations up
  - "Hype vs. Hope"

Contextual Factors

- Company stage
  - Early stage = lower valuation
  - Less risk with later-stage companies
  - Best advice, develop product and market traction as long as possible before seeking outside capital
- Auction
  - Buyers bidding on company drives valuation
  - MSFT outbid Google/Yahoo for 1.6% of Facebook @ $240 million
    - Valuation $15 billion! 300 X revenue multiple!

Contextual Factors

- Economic conditions
  - Valuations increased 5 consecutive years to 2000
  - Coincided with sustained U.S. economic growth
- Reason for selling
  - Personal or business pressures?
  - Settle estate, owner death, etc.
- Tangible/intangible assets
  - Mfg. companies – tangible assets
  - Technology companies – intangibles

Contextual Factors

- Industry
  - Similar companies in different industries can have significantly differing valuations
  - Internet/e-commerce vs. the field
- Quality of management team
  - Startup experience valued in early stage companies
  - If existing team is viewed as weak, valuation can be lower

Summary

- Valuations of companies, particularly early stage valuations, are highly subjective
- Valuations are both quantitative and qualitative
- Contextual factors play a large role