
CVCA's Professional Development Event:

INVESTORS' APPROACH TO VALUATIONS

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CONCEPT OF FAIR VALUE

- “Fair Value is the amount for which an asset could be exchanged between ***knowledgeable willing*** parties in an arm’s length transaction”
- “Objective is to ***estimate*** the exchange price at which ***hypothetical*** market participants would agree to transact”
- Key words:
 - “ESTIMATE”
 - “HYPOTHETICAL”
- Fair value based on expectations – art vs. science

CHARACTERISTICS OF AN EARLY-STAGE ENTERPRISE WHICH MAKES VALUATION DETERMINATION DIFFICULT:

- Unproven management team
- Product not yet developed / incomplete product offering
- Unknown capital needs to complete product and to get to break even
- Lack of revenue / earnings
- Lack of proof of market adoption
- Significant penalty for failure
 - Clinical trial
 - Binary in nature
- Usually no appropriate comparison

PRICE OF RECENT INVESTMENT

- Most common approach to estimate fair value
- Length of period this method is appropriate?
- New round of financing:
 - Alter valuation of existing investment
 - New price setter (strategic)
 - Amount of investment
 - Different rights
- Always consider reduction in fair value during limited period
- Is there a better method to “estimate” fair value after appropriate period?

USE OF COMPARABLES

- Difficulties:
 - Finding the right comparable
 - Usually lacking key piece of information
 - Usually a key differentiating factor
 - Making comparable not “that” comparable
- First choice – a financing comparable
- Second choice – a merger / acquisition comparable
- Third choice – compare against public companies

PUBLIC COMPANY COMPARABLES

- With early stage companies, usually only comparable is “revenue” as investee not profitable
- Do you take private company discount?
- Do you take discount as not profitable?
- Early stage company revenue expected to “hockey stick” vs. public company expected revenue growth in the low teens
- Need to assess balance sheets – remove excess cash, adjust for debt, remove non-core business

WORDS OF WISDOM

- “Be practical”
- “Time, costs, usefulness”
- “Reliability”
- Depending on how fair value information is used and what for – spend little time on *estimating fair* value and more time on *creating real* value