
CVCA's Professional Development Event:

The Theory and Practice of Valuing Companies

February 22, 2007



APPROACH TO VALUATION

Agenda

I. Overview

II. Valuation Methodologies

III. PRIVEQ's Valuation Methodology

- Overview
- Private Companies
- Case Study

OVERVIEW

- Business valuation is an art as opposed to an exact science
- In the valuation of a business there is no precise answer but rather an “opinion of value”
- Price at which a business is sold is the result of negotiations and “deal-making” between the buyer and the seller and not the valuation process

VALUATION METHODOLOGIES

- Widely Used Methodologies:
 - Earnings Multiple
 - Price of Recent Investment
 - Net Assets/Book Value
 - Discounted Cash Flows
 - Industry Valuation Benchmarks
 - Public Company Comp Less Private Company Discount

VALUATION METHODOLOGIES (cont'd)

- Judgment should be used in choosing the appropriate valuation model
 - substance of the investment over the form
- More than one method used to cross-check or corroborate
- Applied consistently from period to period

PRIVEQ'S VALUATION METHODOLOGY – OVERVIEW

- Established documented policy
- Applied consistently from period to period
- Valuation documented in quarterly valuation report
- Any changes in methodology clearly stated in quarterly valuation report

PRIVEQ'S VALUATION METHODOLOGY – OVERVIEW

- Public Companies
 - valued at current market price less discounts
- Private Companies
 - Cost for the 1st year post investment
 - Adjusted for subsequent material changes or events
- Post 1st year
 - Earnings Multiple (corroborate with other methods)
 - Reason: PRIVEQ invests in established businesses with an identifiable stream of continuing earnings that can be considered to be maintainable

PRIVEQ'S VALUATION METHODOLOGY – PRIVATE COMPANIES

- Enterprise Value
 - Based on operating earnings and a reasonable earnings multiple
- Operating Earnings
 - Normally use most recent fiscal year's operating earnings
 - Alternatives considered
 - current run-rate
 - average over prior two years
 - forecasted level of earnings

PRIVEQ'S VALUATION METHODOLOGY – PRIVATE COMPANIES (cont'd)

- Definition of Operating Earnings
 - EBITDA less maintenance capex
- Criteria for Selection of appropriate Earnings Multiple
 - Industry dynamics
 - Company stage
 - Anticipated growth rates
 - Comparable multiples
 - Other company specific issues/opportunities

PRIVEQ'S VALUATION METHODOLOGY – PRIVATE COMPANIES (cont'd)

- Equity Value
 - LTD and Preferred Shares deducted from Enterprise Value
 - STD not deducted
 - Working capital adjusted to reflect a reasonable working capital ratio
 - Adjustment can be positive or negative
 - Adjust for other assets (add) or liabilities (deduct)

PRIVEQ'S VALUATION METHODOLOGY – PRIVATE COMPANIES (cont'd)

- Non-equity Holdings
 - Value equity separate from any debt/preferred shares
 - Debt and preferred shares are valued at cost plus accrued interest or dividends
- Warrants/Options
 - Value at implicit equity value
- Estimated costs of disposition are not included

PRIVEQ'S VALUATION METHODOLOGY – CASE STUDY

Background

- Service business
- Current investment is comprised of
 - Debenture \$1 million
 - Preferred Shares \$2 million
 - Equity – fully diluted 40%
- No recent financing rounds

PRIVEQ'S VALUATION METHODOLOGY – CASE STUDY (cont'd) Background (cont')

- The interest on the Debenture is 10% and is current
- Other LTD totals \$2.5 million
- The dividend rate on the preferred shares is 15% and is being accumulated. At the date of this valuation, total outstanding dividends were \$600,000
- There are no other outstanding preferred shares
- For the most recent fiscal year, the Company had EBITDA of \$4.5 million and maintenance capex of \$300,000

PRIVEQ'S VALUATION METHODOLOGY – CASE STUDY (cont'd) Background (cont'd)

- The Company has estimated excess working capital of \$1 million
- Industry multiples conservatively range from 5 to 6 times
 - To be realistic, used a 5.5 times multiple

PRIVEQ'S VALUATION METHODOLOGY – CASE STUDY (cont'd)

Valuation

Estimated EBITDA	\$ 4.5 million
Less: Maintenance Capex	<u>.3</u> million
	\$ 4.2 million
Multiple	<u>5.5</u> times
Enterprise Value	\$ 23.1 million
Less: Long-Term Debt	\$ (3.5) million
Preferred Shares	\$ (2.6) million
Add: Excess Working Capital	\$ <u>1.0</u> million
Equity Value	<u>\$ 18.0 million</u>
Equity Ownership (40%)	<u>\$ 7.2 million</u>

PRIVEQ'S VALUATION METHODOLOGY – CASE STUDY (cont'd)

Estimated Realizable Value:

Debenture	\$ 1.0 million
Preferred Shares (plus accrued dividends)	\$ 2.6 million
Equity	<u>\$ 7.2 million</u>
Total	<u>\$10.8 million</u>



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