Valuation aspects in Venture Capital Fund raising

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Venture Capital Finance

- It provides seed funding or first phase start up money
- Purely finance investor- Return expectation around 20 to 70% depending on the stage of investment
- Return expectations are based on the perception of risk
- International Private Equity and Venture Capital Valuation (IPEV) Guidelines (Oct,2006) says that
- ***"The valuer will select the valuation methodology that is the most appropriate and consequently make valuation adjustments on the basis of their informed and experienced judgment. This will include consideration of facts such as:***
  - relative applicability of the methodologies used given the nature of industry and current market conditions
  - Quality and reliability of the data used in each methodology
  - Comparability of enterprise or transaction data
  - the stage of development of the enterprise; and
  - any additional considerations unique to the subject enterprise".

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Why focus on valuation?

At the time of investment, valuation is the core determinant of return for investors.

What is the problem?

Most entrepreneurs and investors have oblique points of view—in other words, their views don't intersect.

What is divergence?

Divergence is the difference between the growth rate of the company's valuation and the valuation of the shares investors receive due to dilution by subsequent investors and other factors. Even in successful ventures, divergence, in fact, tends to be between 3x and 5x.

Valuation aspects

Explicit Valuation	Implicit Valuation
• Full dilution • Investor's initial percent ownership • Money • Post money valuation • Pre money valuation	Mainly warrants are used • Warrant coverage • Strike price • Stock choice • Warrant life • Kicker versus substantive change • Effect on the valuation

Valuation aspects

- They may prefer “First Chicago Method” (allocating different probabilities to various possible business scenarios and to arrive at a common value) to determine the business value.

- Coverage of their investment in terms of physical assets

- Relevant valuation techniques
  - Discounted cash flow
  - Replacement cost method
  - P/E multiple (as guiding data)


Thank you