ADJUSTED BACKSOLVES?

MY COMPANY IS STILL PRE-REVENUE, AND I HAVEN'T RAISED A ROUND OF FINANCING IN TWO YEARS. HOW DO YOU VALUE MY STOCK?

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Scalar

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Here at Scalar, we believe every valuation should be treated as a unique case. Many of our clients are generating revenue, growing steadily, and produce positive operating income.

However, we also work with many pre-revenue companies who are unsure about their future financial performance. In these cases, typical valuation methods (eg., cost, market, and income approaches) would not be appropriate. Often times, a backsolve is the most relevant methodology.

> "How do you value a pre-revenue startup company?"

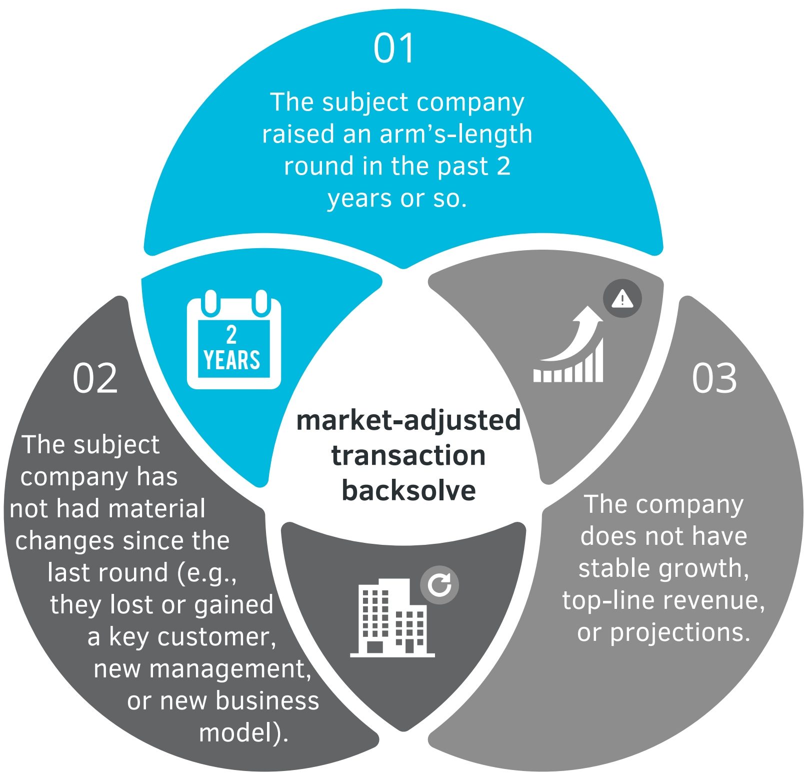
WHAT IS A BACKSOLVE?

The transaction backsolve method is an application of option-based valuation. If the subject company recently raised money via an arm's-length transaction, the price paid by investors is considered a relevant indication of value. For example, if a Series A was raised at **$1.00**/share, we backsolve to find an equity value that returns a share value for Series A at **$1.00** while taking into account the different economic preferences (eg., liquidation rights, participation rights, seniority, and dividends) of all the classes of stock. This is achieved by using the Black-Scholes option-pricing method.

Typically, the backsolve method is only considered if the transaction occurred within one year. However, with pre-revenue startup companies, this still may be the best indication of value—even if the transaction occurred more than a year ago.

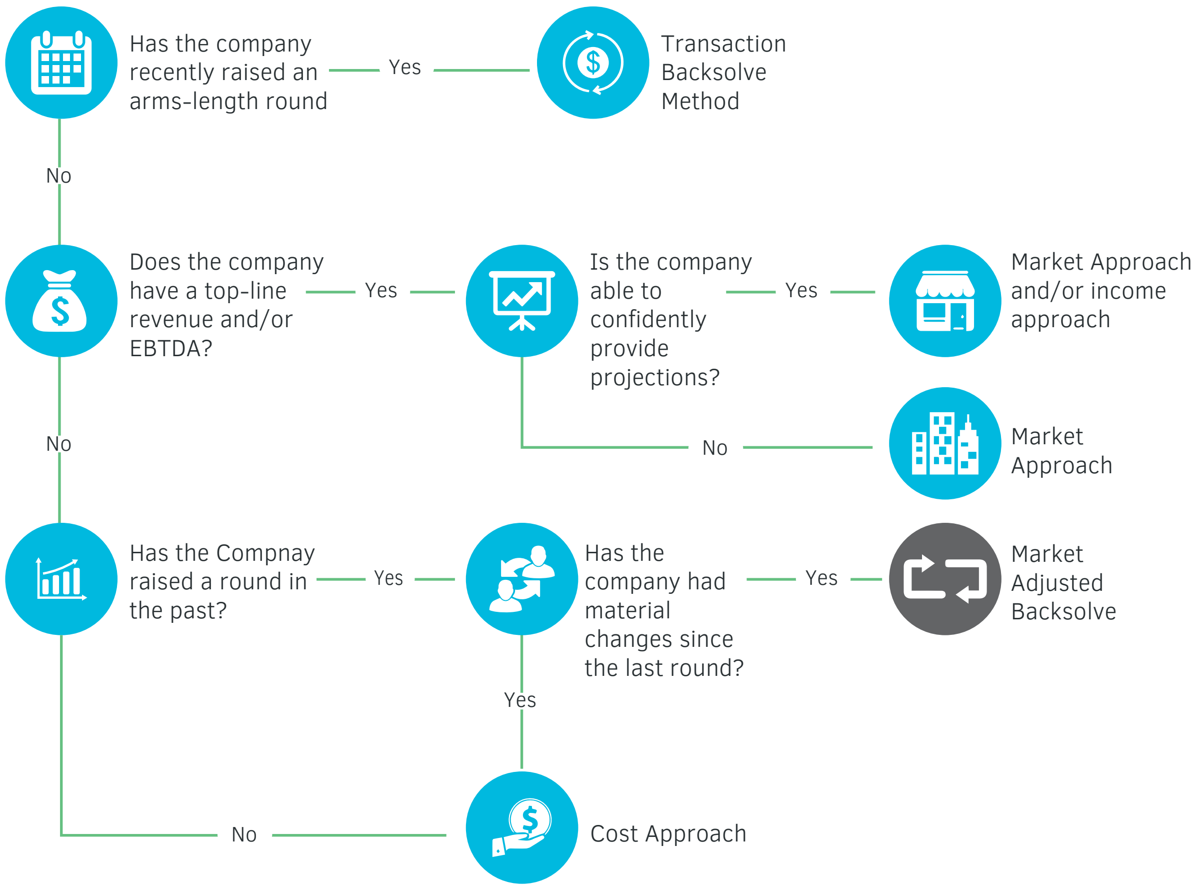
WHEN IS IT APPROPRIATE TO USE A MARKET-ADJUSTED TRANSACTION BACKSOLVE?

A market-adjusted transaction backsolve can be considered when the following requirements are met:



If the company meets the above requirements, then the backsolve (though outdated) may be the best indication of value. However, if the transaction occurred more than a year ago, the backsolve value will need to be adjusted to market.

Methodology Selection:



WHAT IS A MARKET-ADJUSTED TRANSACTION BACKSOLVE?

When adjusting a backsolve value to market, we perform the following steps:

01

Find public companies comparable to the subject that represents the market (looking at the size, financial metrics, business model, industry, etc.).

02

Analyze the growth of enterprise value and market cap in the comparable companies over the time period of the last round of fundraising to the valuation date. For example, if the valuation date is 6/30/2019 and the last round was raised on 12/30/2017, we would look at the growth of the market using the comparable companies between 12/30/2017 and 6/30/2019.

03

Select a market-adjustment rate. The median is most commonly used because it factors out the outliers in the dataset, but its usage depends on the industry and the attributes of the subject company. We may select the 25th, 75th, or other percentile depending on the subject company's performance compared to that of the market—this is a case-by-case decision.

04

Finally, we take the equity value found from a transaction backsolve and grow it by the selected growth metric.

The idea behind the adjusted-transaction backsolve is that the original investors had placed a value on the company at the time of the original raise, which still holds as a relevant indication of value. While the company has not made any significant changes to the business, it is still in line with the internal expectations from the original investors; therefore, a market adjustment is needed.