

Lecture 15: Costs and Valuation

Guest Lecturer:
David Locke
MA Weatherbie & Co

Outline

- What public information is available for use
- Common problems with business plans
- Standard numbers
- Valuation and pieces of the pie
- What do VCs and angels look for
- Benchmark companies for projects

Public information sources

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- SEC Edgar databases
 - 10-K (annual reports)
 - 10-Q (quarterly reports)
 - S-1 or S-3 (public offering documents)
- Lexis Nexis
 - wire-service news reports
- Yahoo! Finance
 - fairly comprehensive site for press releases, stock quotes, other company info

Common problems with business plans

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- Addressable market opportunity
 - understand the actual market size
 - “If we can get 1% of a \$10 billion market....”
- Competition
 - who are they
 - how well are they financed
 - why won’t they eat your lunch
- Marketing & customer support costs
 - are ALWAYS under-estimated
 - just because you build it....

How to estimate marketing & support

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- Use comparable benchmarks
 - how much do similar companies spend
- How much CAN you spend
 - if you make \$10 of gross profit per customer, you can't spend \$100 to acquire him and have him making ten \$15 phone calls to your service center
- Calculate the net present value (NPV) of the customer relationship
 - NPV is the discounted value of the lifetime cash flows you'll receive

Examples

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- Comparable benchmarks
 - ISPs spent ~\$200 to get a customer
 - E*Trade and other online brokers spend ~ \$300
 - PeaPod, CDNow, Pets.com are spending over \$100
 - Amazon spends about \$25 per new customer
- How much CAN these companies spend
 - CDNow gets \$10 in gross profit per order; how much longer will they be in business acquiring \$10 for \$100?
- Customer NPV
 - Earthlink charges \$20 per month. At \$10 variable cost per month (telecom & support), and a 2-year average life, customer is worth about \$200

Valuation and pieces of the pie

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- How does a company get valued?
 - When you figure it out, tell me ;^)
- Variables in assessing valuation
 - Quality of the idea
 - Quality of the people
 - Size of the market opportunity
 - Competitive landscape
 - Development stage (start-up; working product; paying customers; etc.)
 - Comparable company valuations
- Valuing early-stage businesses more art than science

What is a “quality idea”

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- Large, unmet market need
 - define a customer’s “pain”
 - it’s not enough that its “cool”
 - VCs generally assume you need a 10x cost advantage to get people to “switch”
- The concept can be described to investors AND customers in an elevator

What VCs want

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- Company addresses \$10 billion market
- Management has successfully built at least four \$1 billion businesses before
- Paying customers
- No competition
- Impenetrable patent position
- 99% of the equity for buying you coffee

Benchmark companies for projects

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- Sophium
 - MediaMetrix, Gemstar, Cybergold, NetCentives, LifeMinders, MyPoints
- RF transmitter
 - Sensormatics
- Bus on time
 - MapQuest, Vicinity, Abacus Direct, others listed for Sophium above
- Home body
 - eMachines, NetPliance, NetZero, FreeServe

Benchmark #s for revenue

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- Revenue
 - The preferred link is \$50-100 per thousand (CPM), or about 5-10 cents per unit.
 - Inserts 10 - 50 cents the insert itself probably costs \$2-3
 - eMachines
 - \$10 in advertising revenue per machine total in this year;
 - \$30-50 per machine once they prove to that their model works.