Lecture 15: Costs and Valuation

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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

- 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

- 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

- 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

- 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 average life, customer is worth about $200
Valuation and pieces of the pie

• 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”

• 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

- 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

- 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

- 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.