Valuation Metrics and Drivers in Today's Economy

September 19, 2012

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Speakers

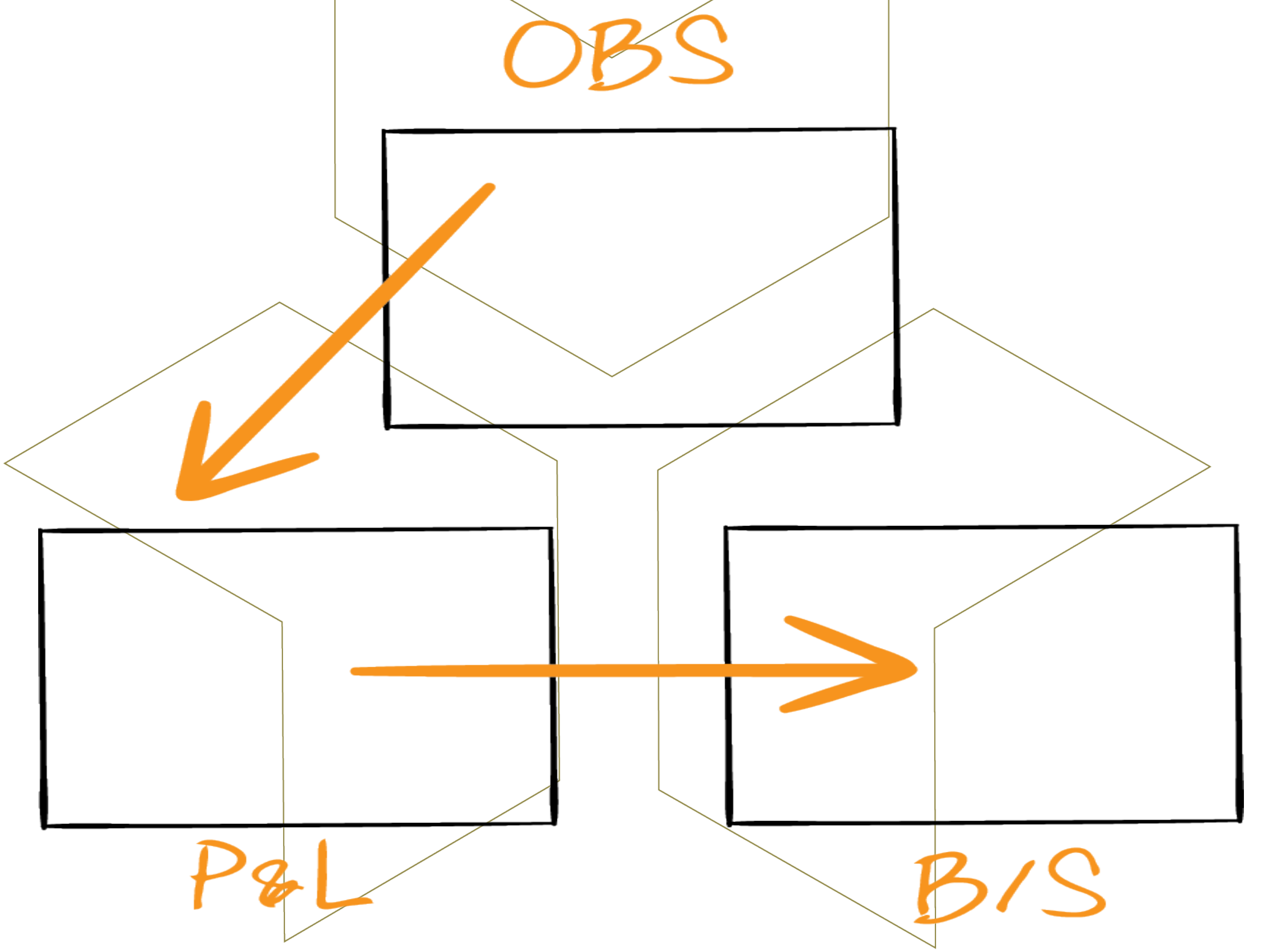
- Adrian Bray, Assay
- Tony Yeh, Silicon Valley Bank
- Jim Goldhawk, RoseRyan
- Jim Chapman, Foley & Lardner LLP

Agenda

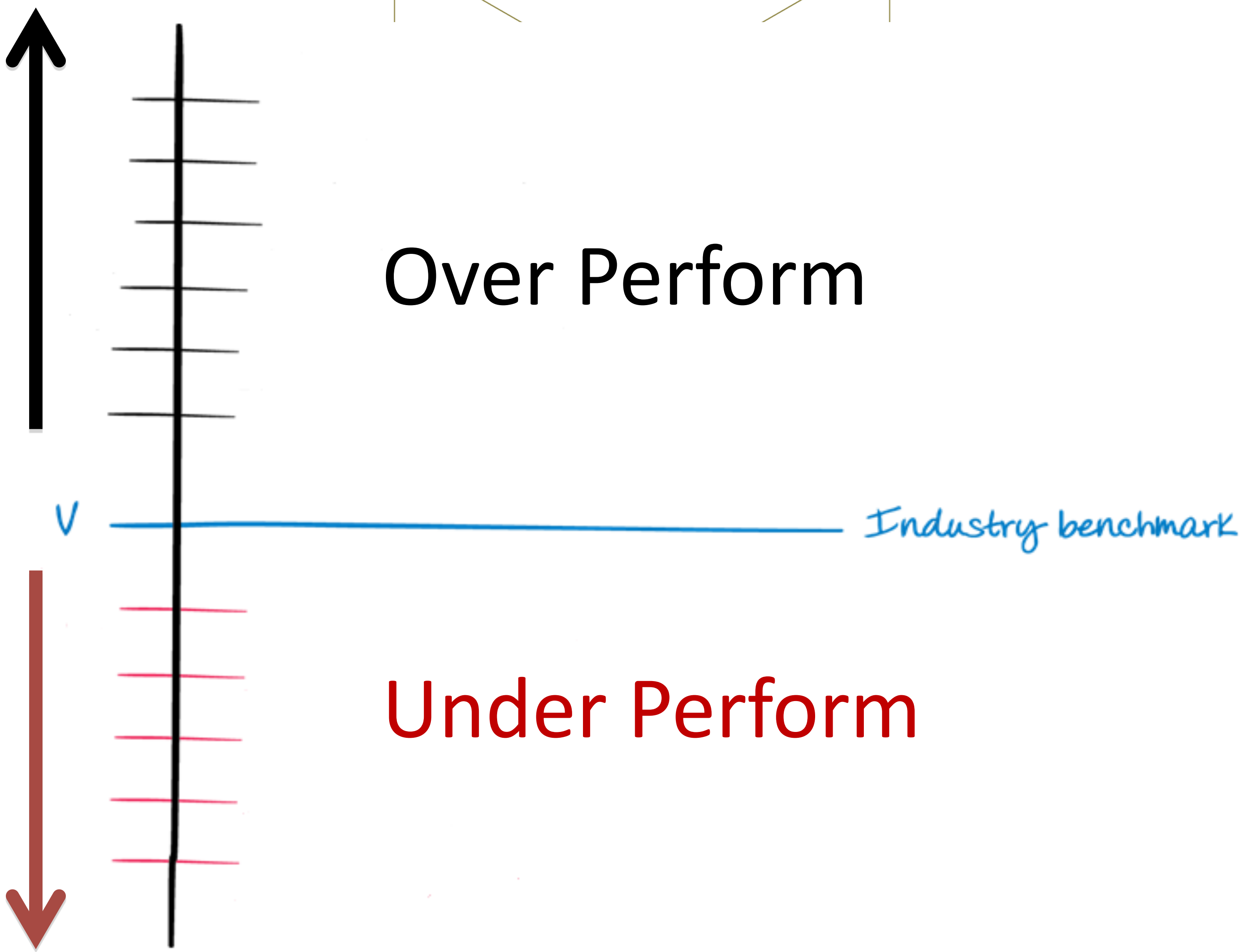
▪ Welcome/Objectives	Vince Timoney, Silicon Valley Bank
▪ Off the Balance Sheet	Adrian Bray, Assay
▪ Valuation Trends in Technology	Tony Yeh, Silicon Valley Bank
▪ Get your Financial House in Order	Jim Goldhawk, RoseRyan
▪ The Legal Side of Building Value	James Chapman, Foley & Lardner
▪ Q&A	All

Valuation = Profit X Multiple

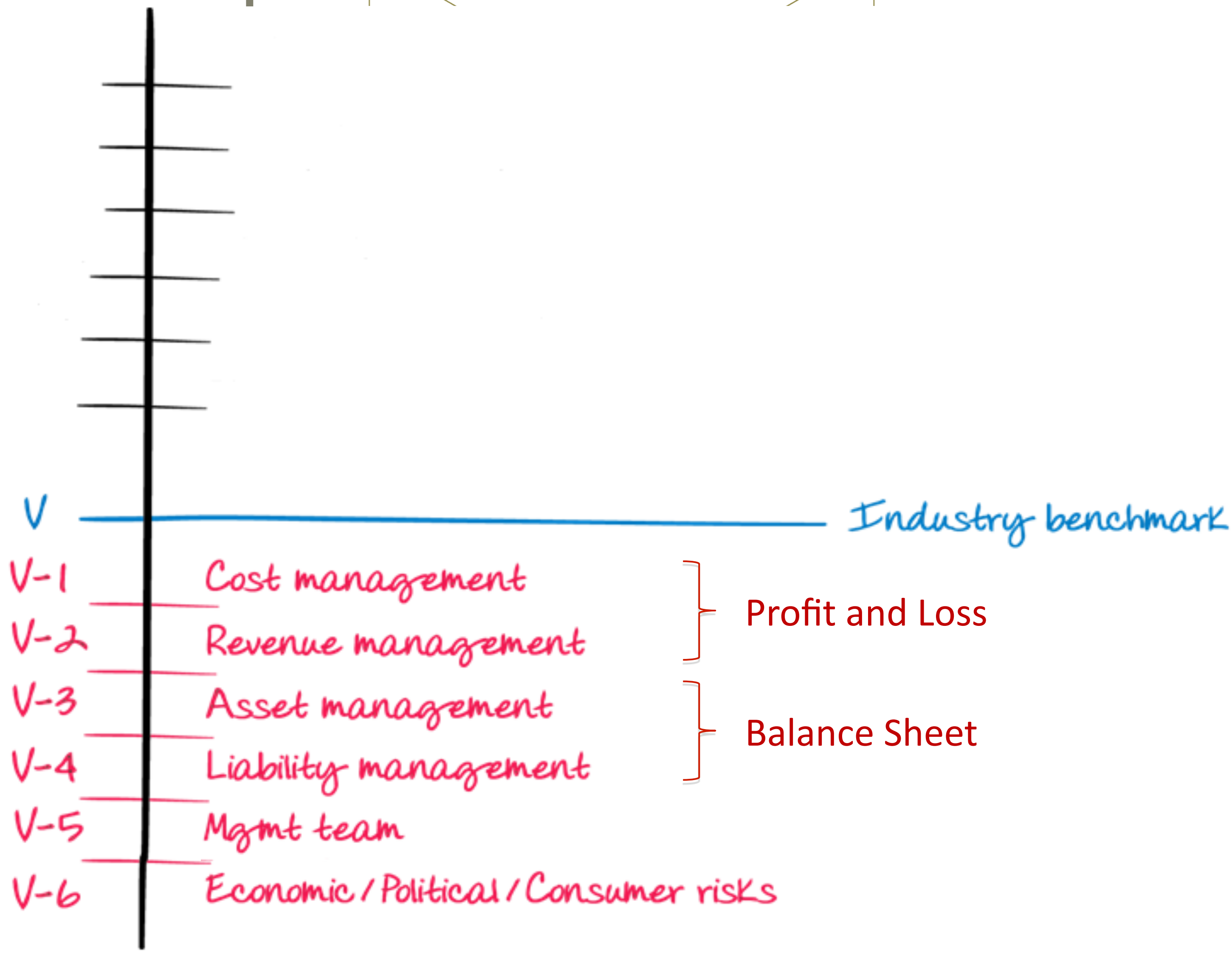
Income Follows Assets



Multiple Driver Architecture



Multiple Driver Architecture



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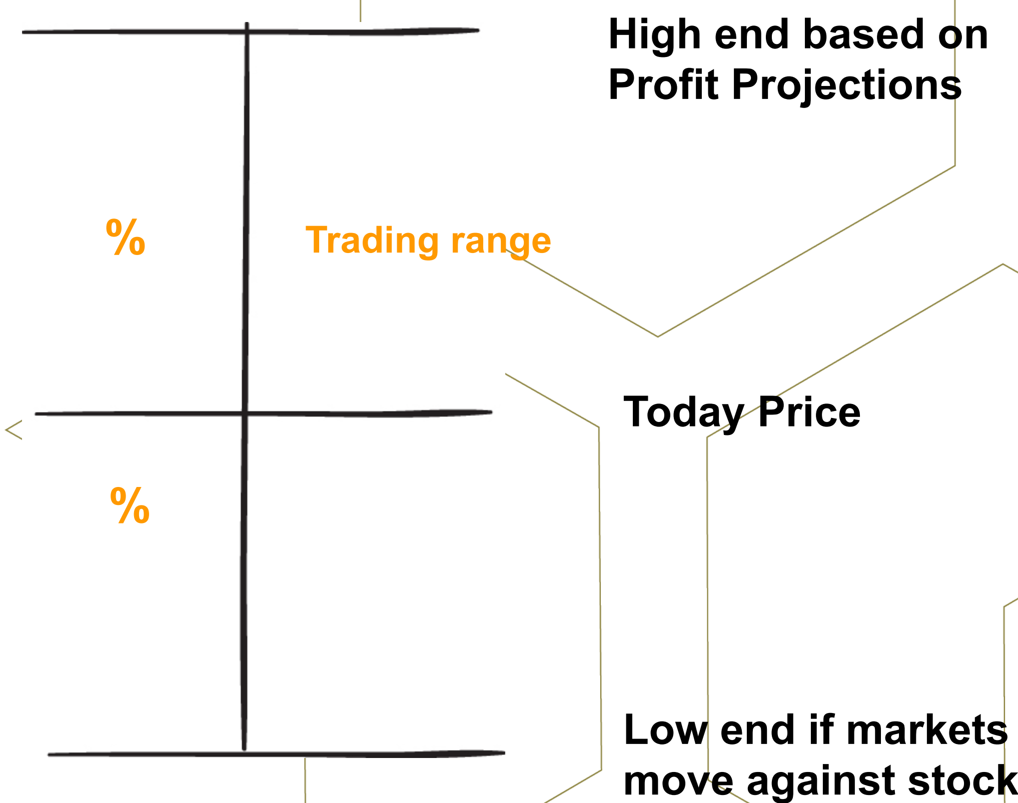
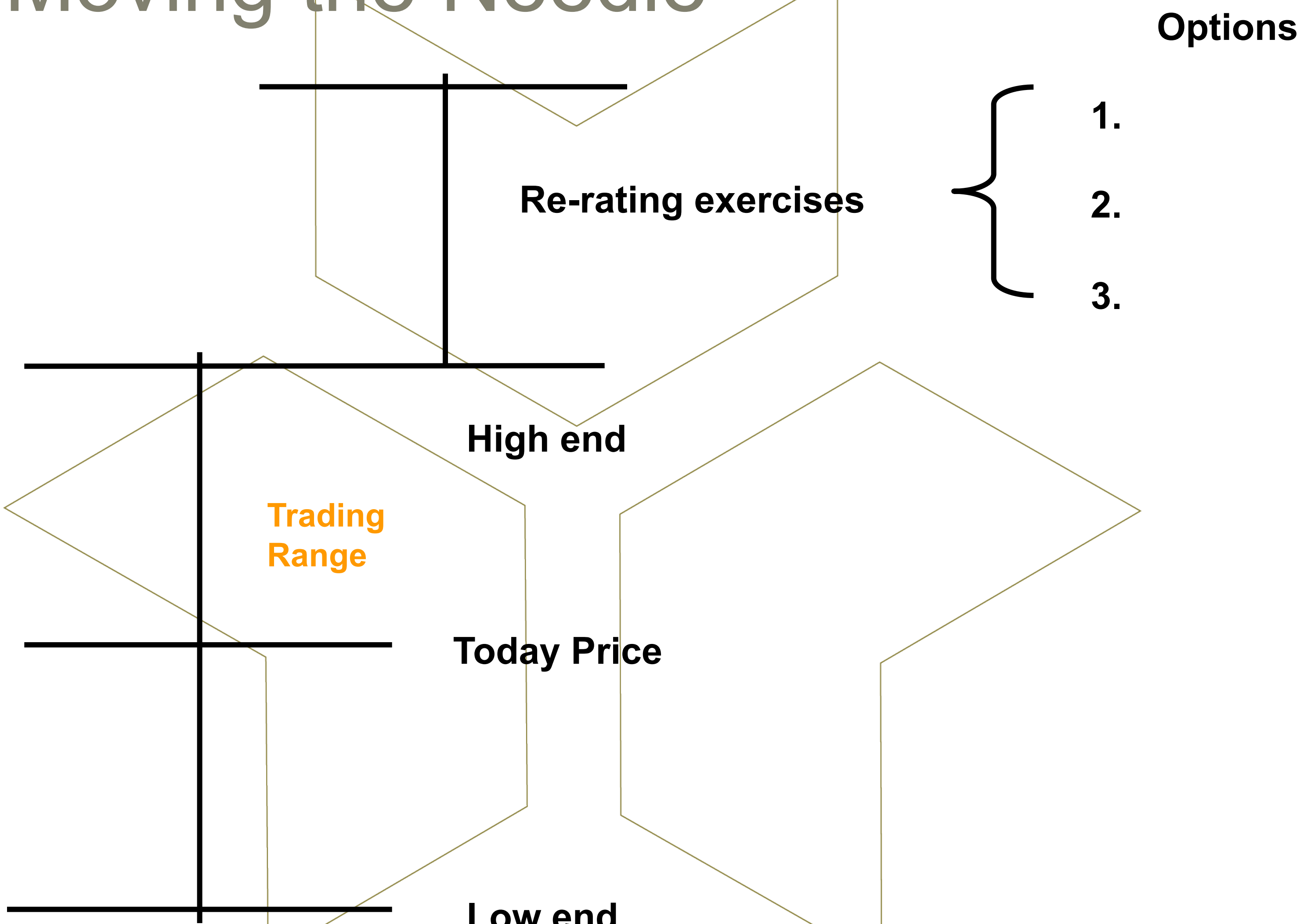
Multiple Driver Architecture

V+7	Scale	
V+6	Position & brand architecture	
V+5	Channel extension	
V+4	Product extension	
V+3	Product innovation/IP	
V+2	Systems / infrastructure	
V+1	Talent / capability / culture	
V	Industry benchmark	
V-1	Cost management	Profit and Loss
V-2	Revenue management	Profit and Loss
V-3	Asset management	Balance Sheet
V-4	Liability management	Balance Sheet
V-5	Mgmt team	
V-6	Economic / Political / Consumer risks	

Why does it matter?



Moving the Needle



VALUATION TRENDS AND INSIGHTS FOR TECHNOLOGY COMPANIES

Prepared by SVB Analytics

September 19, 2012

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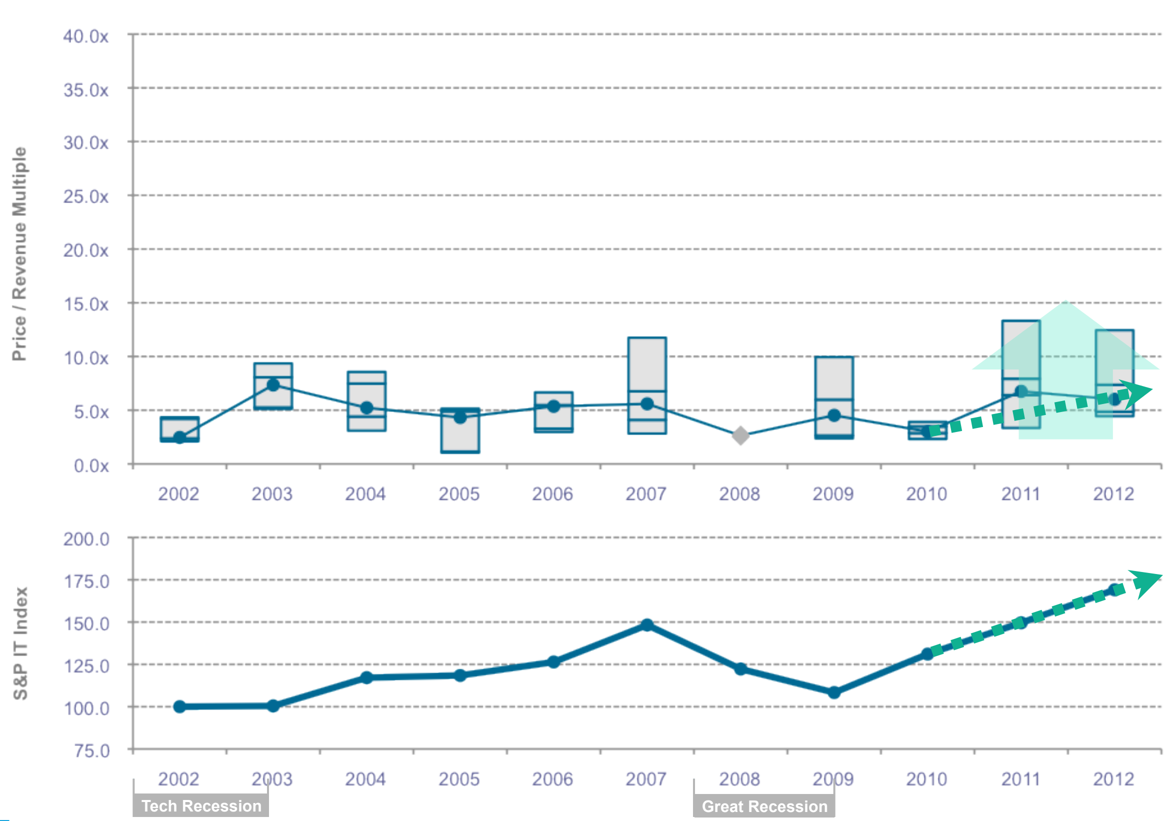
Silicon Valley Bank

IPO Multiples | 2002 – 2012

Trends of Price/Revenue multiples for IPO exits

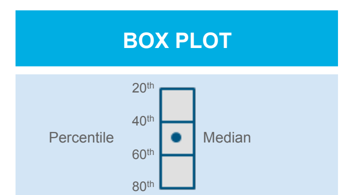


To a certain extent, the IPO valuations are a derivative of the S&P IT index. As the S&P Infotech index improves, so has IPO valuation multiples.

From the lows of the Great recession, improvements in IPO valuation multiples can be observed as

1)Median multiples have increased

2)Range of multiples have improved on the upside



SOURCE
Silicon Valley Bank, Capital IQ

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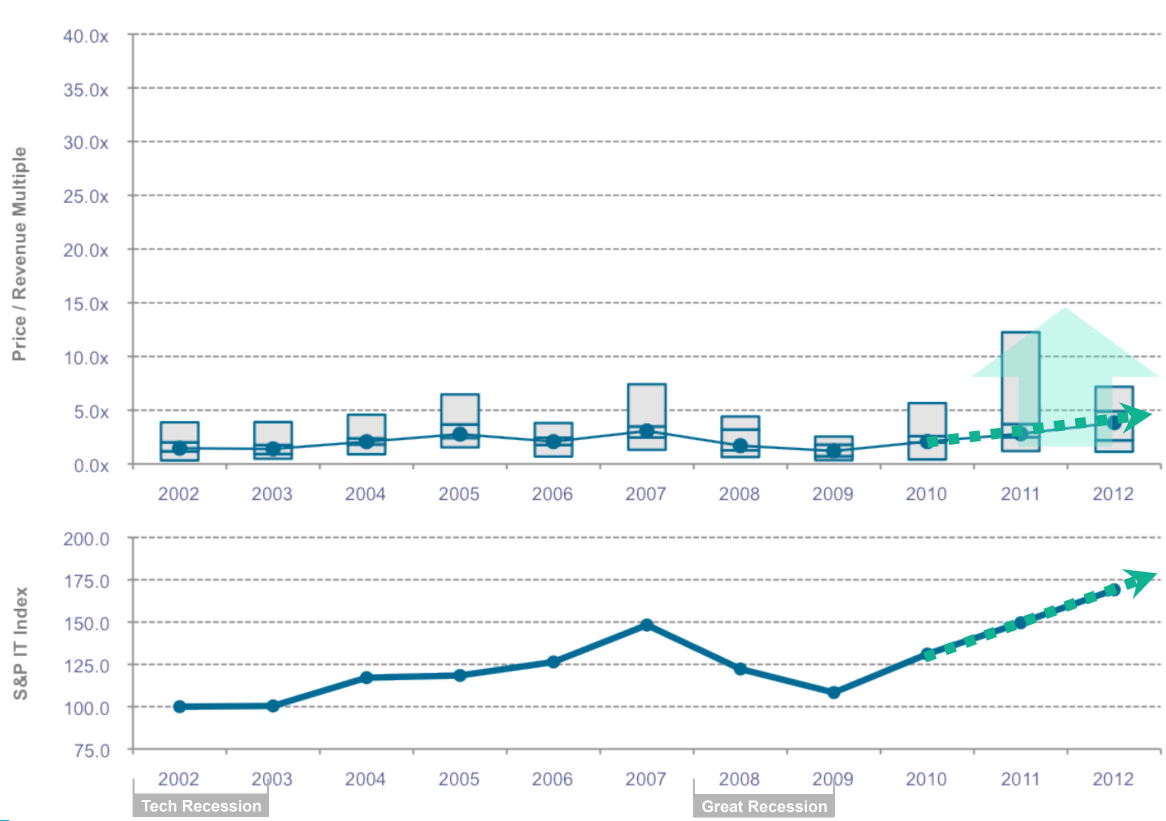
M&A Multiples | 2002 – 2012

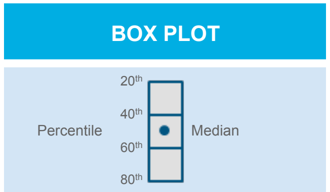
Trends of Price/Revenue multiples for M&A transactions



The acquisition multiples for technology companies, likewise, track the demand for publicly traded IT shares.

Compared to the IPO valuations, acquisition valuations appear even more tightly linked to the IT market.

Similar to the IPO multiples, we are observing increases in median multiples and multiple range expansion.



SOURCE
Silicon Valley Bank, Capital IQ

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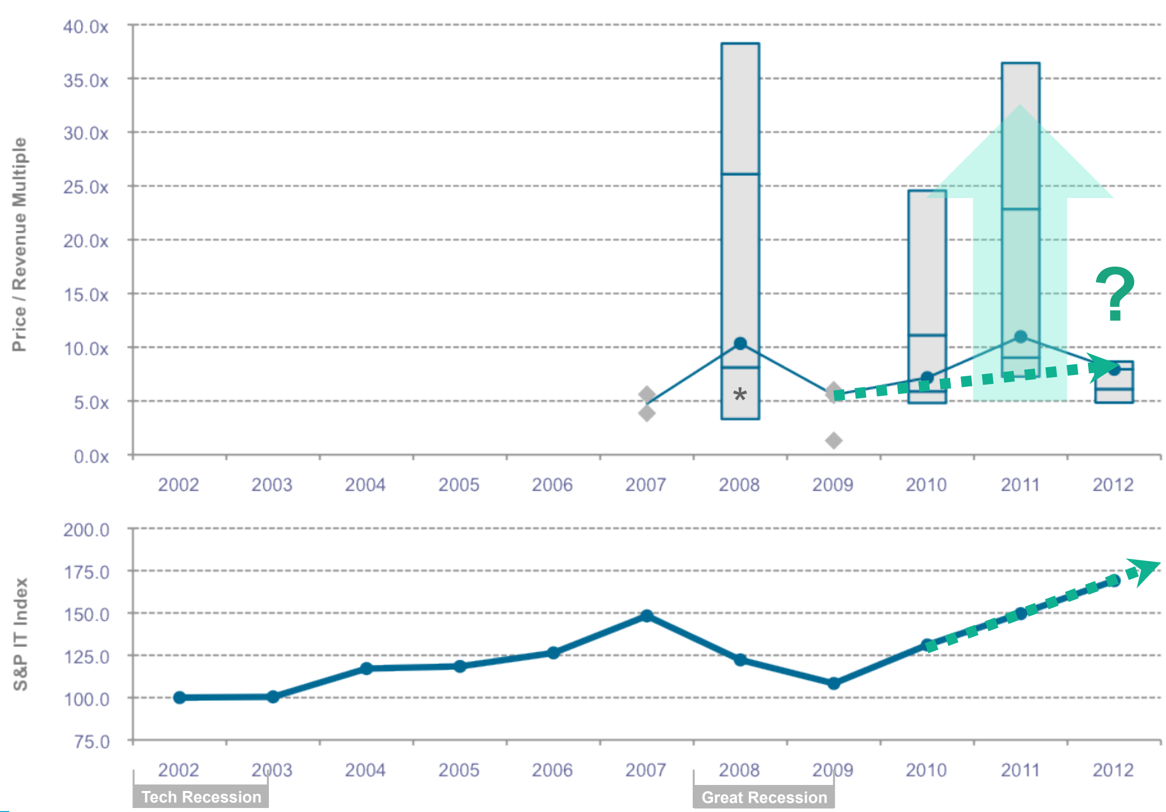
Funding Multiples | Post-money greater than $100 million, 2007 – H1.2012

Trends of Price/Revenue multiples for funding rounds with post-valuations greater than $100M



Large fundraising amounts by private companies often provide founders and initial investors with a partial exit event …

… however, valuation multiples for large fund raises by private companies do not have a tight link to the publicly traded markets.

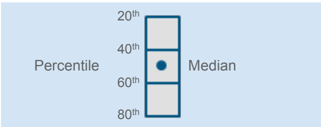
So what drives these valuations?

Is it revenue growth?

Or some other market factors?

** For 2008, most valuation fell into the lower bucket post Lehman's bankruptcy in September.*

BOX PLOT



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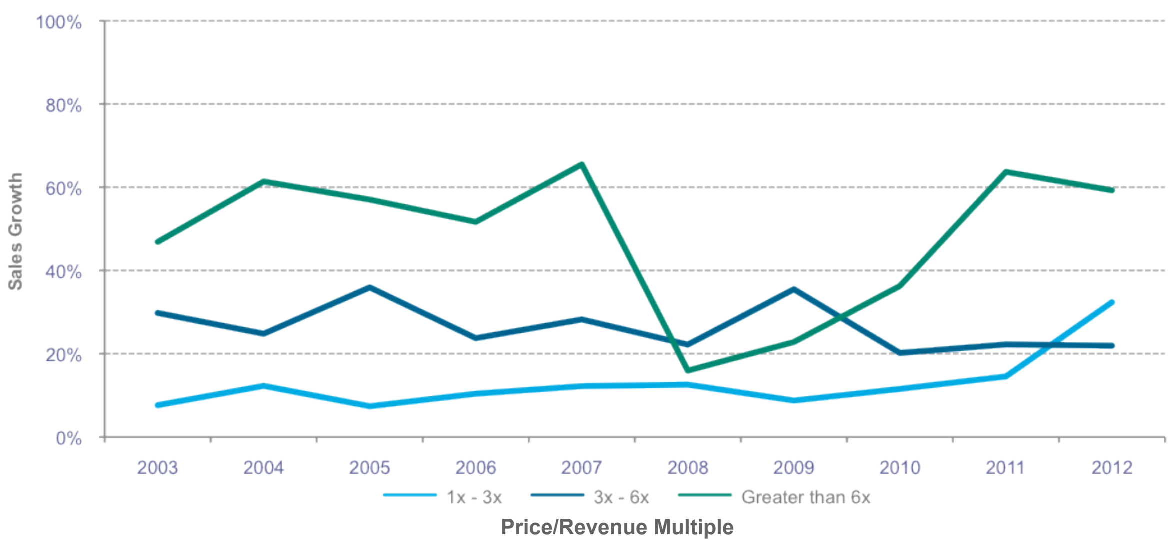
Sales Growth of Exited Companies | 2003 – 2012

Median sales growth rates of companies exiting within various Price/Revenue multiple tiers



Price/Rev Multiple	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
1x – 3x	7.6%	12.3%	7.4%	10.4%	12.2%	12.6%	8.8%	11.6%	14.5%	32.4%
3x – 6x	29.8%	24.8%	35.9%	23.7%	28.2%	22.2%	35.5%	20.2%	22.2%	21.9%
Greater than 6x	46.9%	61.4%	57.0%	51.7%	65.5%	15.9%	22.8%	36.3%	63.7%	59.3%

Although the median sales growth of companies in the different price/revenue buckets appear consistent with their respective multiple bucket, a more rigorous statistical analysis would show the effect to be modest, at best.

Investment banks often advise companies to focus on revenue growth. However, strong revenue growth explains less than 20% of the variation in exit/funding multiples (even when excluding the data points from 2008 & 2009). Many other factors come into play.

SALES GROWTH

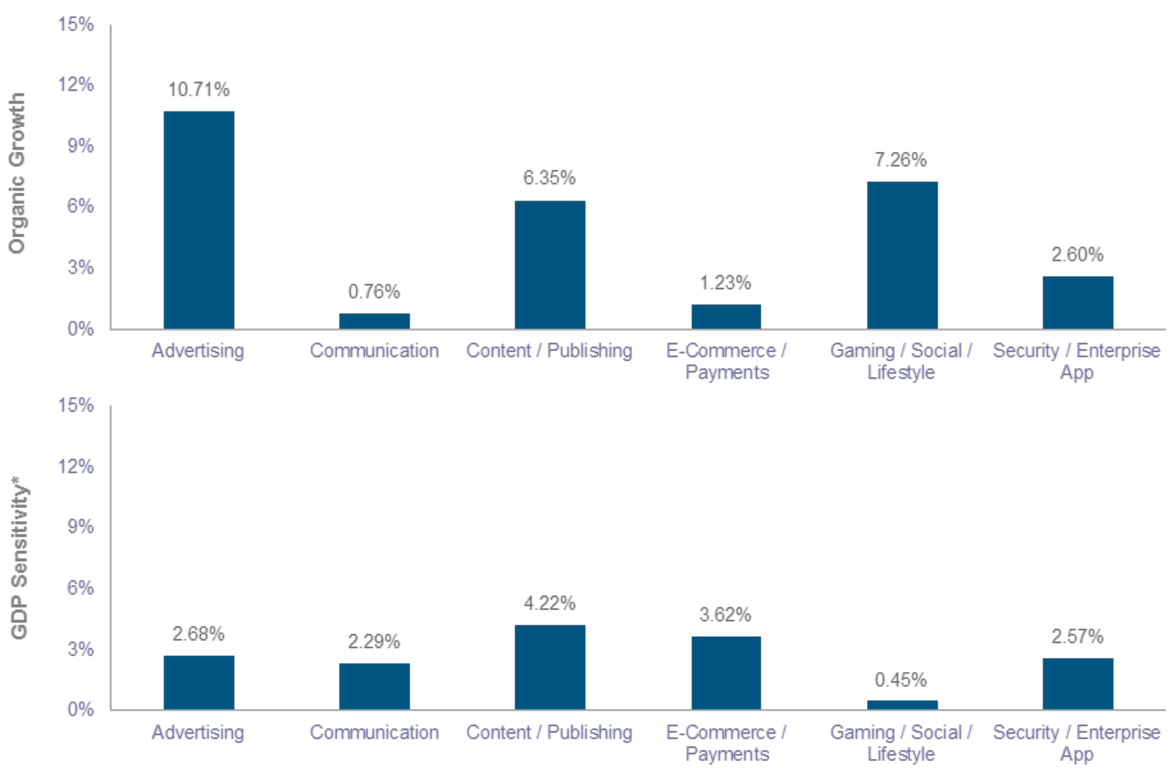
$$\text{SALES GROWTH} = \frac{\text{CHANGE IN NET REVENUE}}{\text{PRIOR PERIOD NET REVENUE}}$$

SOURCE
Silicon Valley Bank, Capital IQ

Silicon Valley Bank

Example: Organic Growth | "Recession Resistant" Sales Growth

Organic growth is highly valued by investors, GDP growth not so much (analysis from 2006 to 2012)



Organic growth is incremental sales that is driven by fundamental demand for a company's product; not reliant on general macro or sector economic activity.

"GDP sensitive" growth is based on the overall economy. As the economy slows, so does GDP derived sales.

In this example, the Gaming/ Social/Lifestyle niche's notable high organic growth and low economic sensitivity mix ("recession resistance") would be attractive to investors.

However, not all organic growth is equal.

** Advertising niche's 2.68:1 sensitivity implies that a 1% increase in GDP would spur a 2.68% increase in sales.*

SOURCE
Silicon Valley Bank

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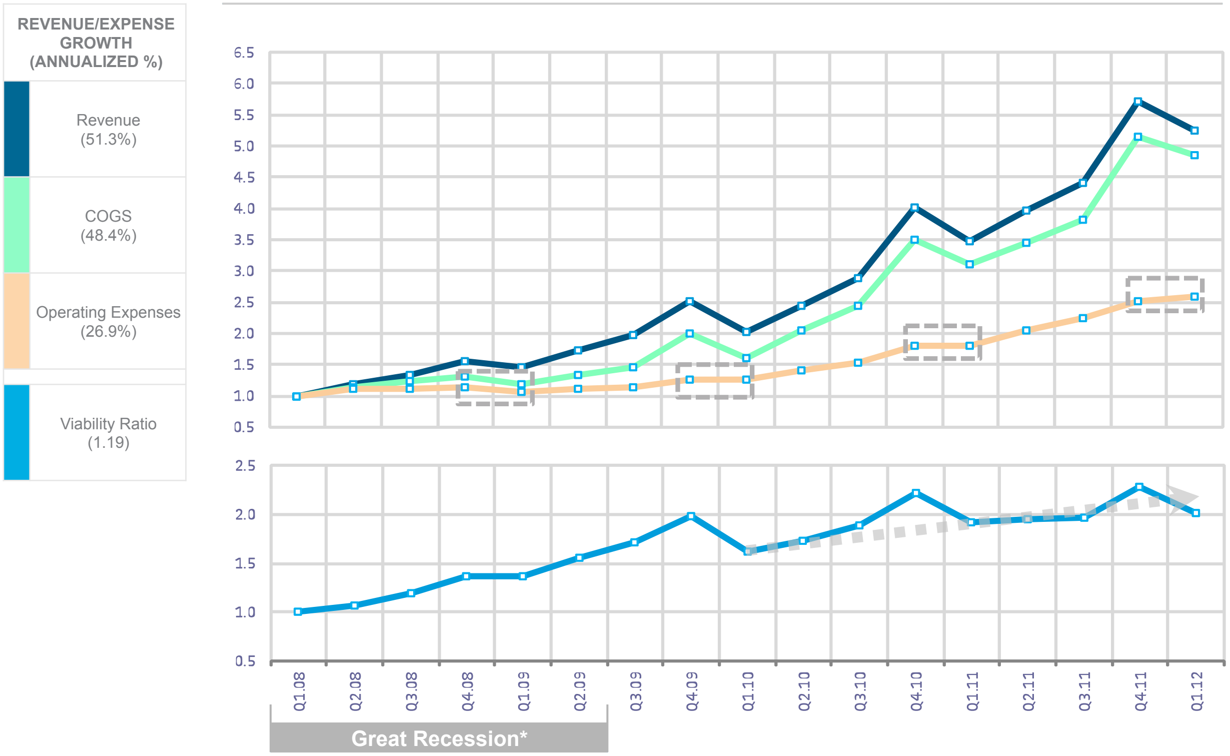
Example: Mobile Advertising | Achieving Sales Momentum

Momentum sales is viewed favorably by investors



In this example, the Mobile Advertising niche exhibits sales momentum: revenue is increasing at a faster rate than total expenses (in particular, operating expenses).

Advertising companies' ability to hold their operating expenses when they hit their Q1 lulls is highly suggestive of scalable business models. Expenses seem fixed when sales growth is happening, and can be quickly reigned in as needed.

An increasing cumulative viability ratio captures this effect.

VIABILITY RATIO

$$\text{VIABILITY RATIO} = \frac{\text{CHANGE IN NET REVENUE}}{\text{CHANGE IN OPERATING EXPENSES}}$$

SOURCE
Silicon Valley Bank

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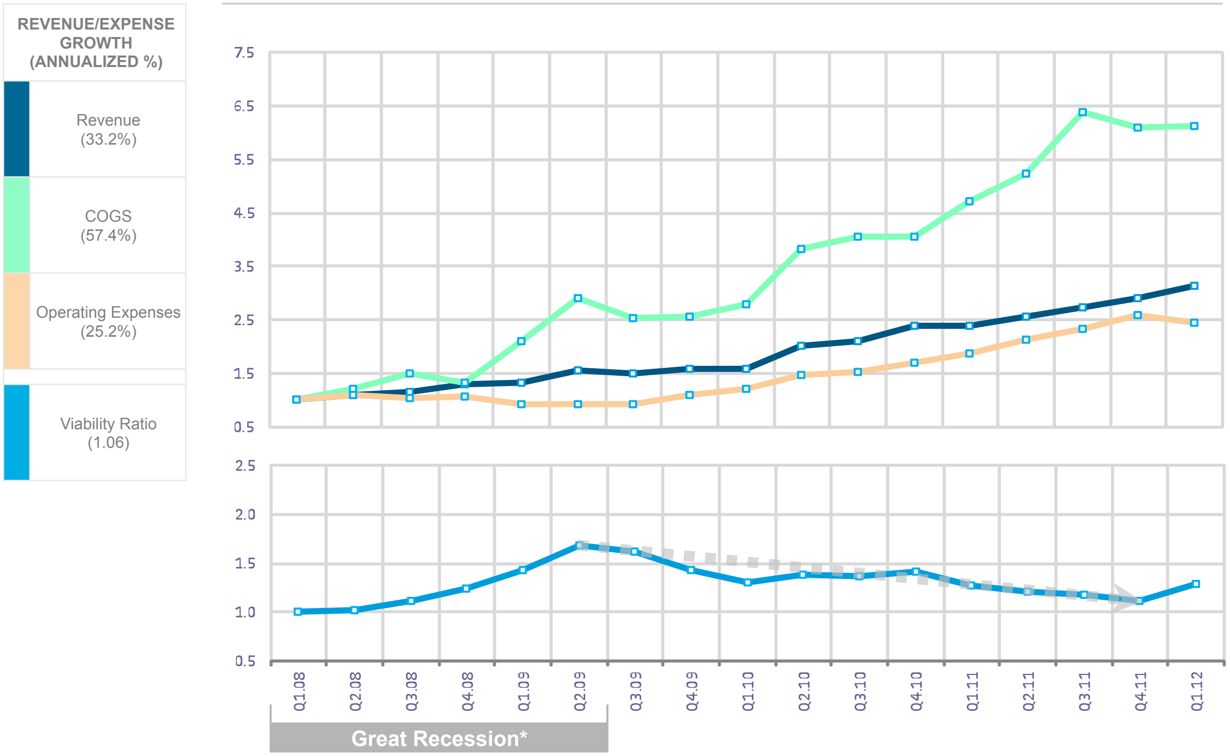
Example: Mobile Gaming/Social/Lifestyle | Ramping Sales

Sales driven by increased spending does not instill investor confidence



In this example, the Mobile Gaming/Social/Lifestyle niche exhibits sales ramping: user acquisition is very expensive (COGS) and does not scale. Companies aren't retaining users, they're having to reacquire customers over and over again. High COGS and OPEX are needed to maintain sales growth.

A decreasing cumulative viability ratio captures this effect.

VIABILITY RATIO

$$\frac{\text{CHANGE IN NET REVENUE}}{\text{CHANGE IN OPERATING EXPENSES}}$$

SOURCE
Silicon Valley Bank

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Lessons from the field | Value impacting

- We work with the CEOs and CFOs of nearly a thousand venture-backed companies per year in the technology, life sciences, and clean tech sectors; oftentimes, while they are either fundraising or immediately following a recent fundraising event
- This unique access provides real-time intelligence on the innovative technologies, markets, and business models that are commanding premium valuations, while learning and understanding our clients' challenges and resolutions

Generates a Good Valuation	Generates and Maintains a Premium Valuation
•Address the market as it exists today	•Address the market as it will exist in the future
•Bring a finished product to market	•Work with customers to test, learn, and iterate (e.g. 'The Lean Start-up')
•Pivot to chase customers where they're going	•Offer the experience and value to drive customers to you
•Acquire a lot of customers and charge them money	•Acquire valuable users, offer a compelling experience, and retain them
•Realize that changes in their industry create opportunity	•Realize changes in behaviors, across industries, have ripple effects (iPad)
•Do many things pretty well	•Do one thing exceptionally (land and expand)
•Generate one-time sales	•Cultivate a base of recurring revenue

SOURCE
Silicon Valley Bank

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Lessons from the field | Niche Specific Themes

Mobile / Apps

- Start-up costs are pretty low
- Hosting costs can escalate quickly as user base grows
- Users expect a lot, including not having to pay
- A one-way flow of content may not cultivate an engaged user base
- How to make it easy to discover and engage, but hard to leave?

SMB* Software as a Service

- Customer acquisition costs can be high
- Retention beyond a few months can be low
- Capital intensity is high up-front
- Repayment times can be long
- Sales cycles are shorter, decisions made faster (to come and go)

eCommerce

- The property that serves the ad may not get credit for creating the sale (see it on Facebook, buy it on Amazon)
- Amazon literally sells everything cheaper than you do
- Creating a custom-curated shopping experience appeals to users, and advertisers
- Mobile payments is a fragmented market that everyone's into. Consumers won't make the first move

SOURCE
Silicon Valley Bank

* SMB = Small to Medium Business

Silicon Valley Bank

Last thoughts | Factors Impacting Valuations

Company Specific

- Quality of Revenue (aside from just its growth), for example recurring versus one-time
- Profitability, or demonstrated path to profitability

Capital Markets based

- Performance of recent IPOs in the sector, or corollaries
- The number of recent IPOs in the sector, as a proxy for supply and demand
- Public investor appetites for high risk growth equities (similar to previous point)

Economy Related

- Overall macro economic conditions
- Sector specific economic conditions

SOURCE
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Get your financial house in order

Jim Goldhawk, Senior Consultant

RoseRyan

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- Experts save time and money

Due Diligence

- Anticipate intense scrutiny
  - Actual results
  - Budgets and forecasts
- Document/reconcile account balances
  - Basic internal controls
- Demonstrate a consistent view of the business
  - How you forecast and manage should be consistent with how you measure and report
- Understand your numbers as well as you know your technology and products

Time is of the essence

- Assume due diligence will feel chaotic
  - Deadlines
  - One-way information flow
  - Volume of information
    - Virtual warehouse
  - Unexpected questions, assumptions and conclusions
  - Helps build Schedule of Exceptions
- Plan adequate resources

GAAP

- Unaudited financial statements
  - Engage a qualified advisor to document compliance with GAAP
  - Write accounting memos for specialized GAAP
- Complex equity/debt structures
  - Record the transactions now!!
  - Best practice: Investigate the accounting during negotiations
- If an audit is needed, do it early

Reliable financial statements

- Lowers transaction risk to the buyer
  - Subsequent gains and losses either flow through the buyer’s income statement, or
  - Settle through an escrow account (to be absorbed by the seller)
- Provides a consistent view of the business to all stakeholders

Know your buyer

- Public or private?

  Note: Public buyers need quarterly financials
- Motivated buyer?
- Synergies?
- Financial standing/resources
- Culture
- Optimal tax structure
  - Offshore vs domestic

Building Valuation: Demystifying the Equation The Legal Side of Building Valuation and Making a Deal

James C. Chapman

Foley & Lardner LLP

September 19, 2012

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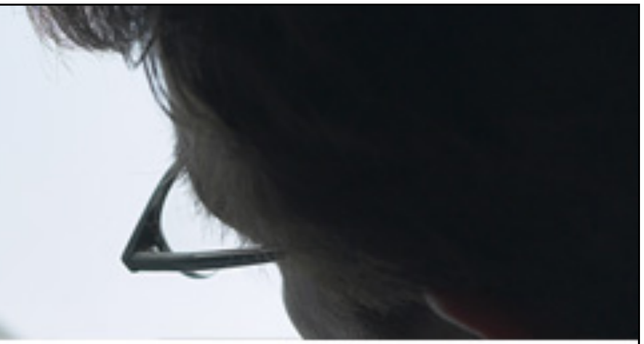
Risk Management for the Emerging Company



- Analytical framework
- Risks that can be safely ignored
- Risks that can be mitigated through simple changes in behavior
- Risks that can mitigated through insurance
- Risks to actively identify, monitor, and mitigate

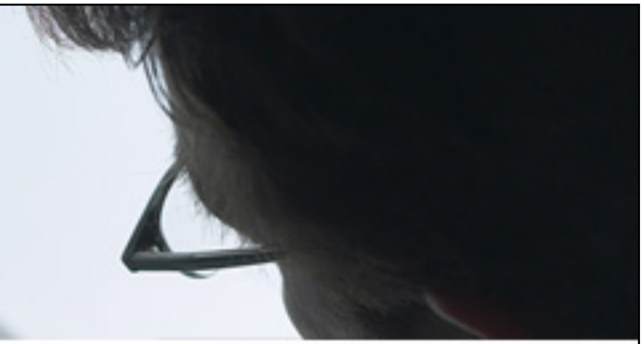
Basics

- Relationships among founders
- Employment law compliance
- Tax returns and withholdings
- Licenses and permits
- Board and shareholder meetings

Advanced

- Intellectual property – offensive/defensive use
- Trade secret protection plan
- Human resources
- Contract management
- Information technology and security
- Financial controls
- Regulatory compliance

Preparing the Business for Sale

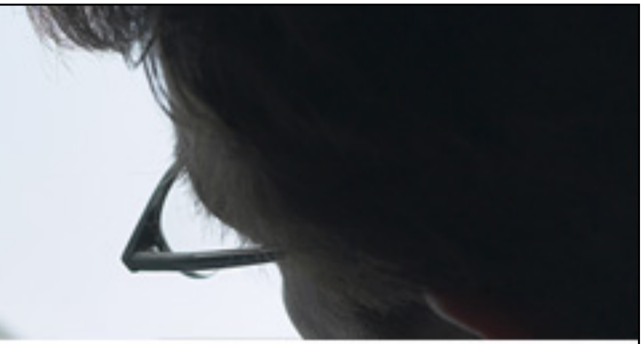


- Remove assets which seller wishes to retain or which may be objectionable to the buyer including condominiums or vacation homes, automobiles, or other company owned items;
- Ensure that the financial and corporate records are in good order;
- Seller should have up-to-date minutes of the meetings of the board of directors and a validly-elected board of directors;

Preparing the Business for Sale (cont'd)

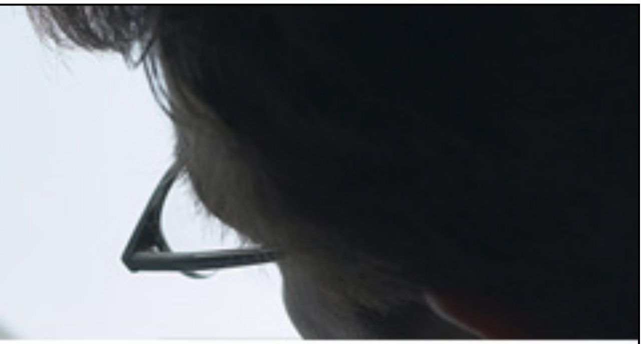
- Settle lawsuits or terminate unfavorable contracts before the seller's adversaries see the potential sale as added leverage;
- Thoroughly clean and organize the premises;
- Ensure that all shares of stock required to be issued have been issued and that all verbal agreements regarding future ownership are either honored or terminated in writing;

Preparing the Business for Sale (cont’d)



- Develop a comprehensive list of all of seller's assets;
- Create a list of all necessary governmental permits;
- Document all loans to or from shareholders and employees;
- Review the development of the company's technology to determine that no others have any ownership rights;

Preparing the Business for Sale (cont'd)



- Compile a list of the company's patents, trademarks, and copyrights;
- Compile information regarding the company's product and/or service warranties and warranty claims; and
- Compile information regarding the presence, use, storage, and disposal of hazardous materials.

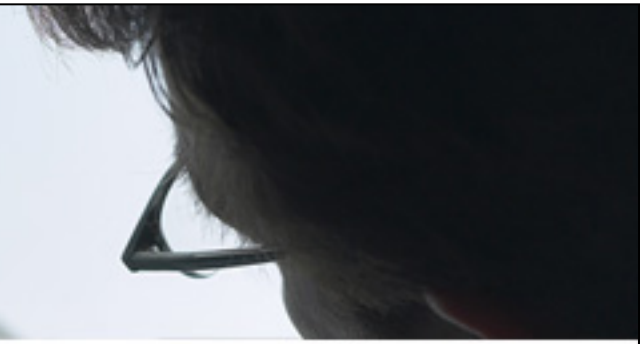
Deal Breakers and Obstacles

- Lack of integrity of management – cut too many corners
- The inability to establish clear title to assets – co-mingling
- High expectations of value – gap is too large
- Unreliability of financial statements or lack thereof – cannot justify price
- Ownership of the company itself – oral stock option commitments, former founders/partners

Deal Breakers and Obstacles (cont'd)

- Culture - differences between buyer and seller too great
- Employees – key employees will not go along or work for the buyer
- Customer concentration – 1 or 2 major customers
- Intellectual property challenges – does the seller own what it thinks it owns
- Tax problems – misclassifying employees as independent contractors

Common Mistakes Made by Sellers



- Sellers fail to prepare themselves for the time and emotional commitment required
- Sellers fail to adequately prepare the business for sale
- Sellers treat buyers as friends
- Sellers convince themselves that the transaction is completed when it has only just begun
- Sellers fail to develop a negotiation strategy prior to beginning negotiations

Questions?

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