



100 Cummings Center, Suite 322J, Beverly, MA 01915, USA

lan.smith@portfoliopartnership.com

www.portfoliopartnership.com

## # 14 How Venture Capital/Private Equity Players Price Deals

At some point in your career you may encounter the VC or PE world. You might: sell a non-core subsidiary to them, use their funds to start a company, use their money to buy a company, or buy out your partners, or even take a company private from the public markets. Whatever the transaction, their pricing model seldom varies.

The VC needs to value the business before their money goes in and of course on exit. Depending on their perceived risk they will be shooting for an Internal Rate of Return (IRR) of 40% to 60% or in plain English they expect their money to produce a **compound** annualized rate of return of vast proportions. Now many of their deals will not work out so they need to aim high. In two tables below I have summarized a fictitious example based on many deals completed.

The target company is purchased for \$16m using valuation methods described in my previous Briefing Paper #4, let's assume this time it's based on an EBITDA multiple of 8 on \$2m. It is assumed to exit in 2014 for an EBITDA multiple of 10 on \$6m EBITDA. The VC exits the deals owning 65% of the equity. The VC expects to achieve an IRR of 47.85%.

Assumptions				
		\$m		
1	Acquisition Price	16	10	EBITDA Multiple 8 times \$2m
2	Working Capital	1	11	EBITDA Multiple on exit 10 on \$6m
3	Fees	1	12	VC controls 65% of equity on exit
	Total	18	13	Bank debt repaid prior to exit
	Funded by:		14	ULS coupon 8%
			15	Preference Dividend 10%
4	Unsecured Loan Stock	5.35		
5	Preference Shares	2.35		
6	Ordinary Shares	0.26		
7	Total VC Investment	7.96		
8	Management Equity	0.14		
9	Bank Finance	9.9		
	Total	18		

VC Returns						
		\$000				
	Opening 2009					
	Yr 0	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5
Initial Investment	(7800)					
<b>Receipts</b>						
ULS - Interest		428	428	428	428	428
Preference Dividends		235	235	235	235	235
ULS Repayments						5350
Preference Redemption						2350
Exit Proceeds						39000
Total Cash Flow	(7800)	663	663	663	663	47363
Discount Factor	1	0.64	0.41	0.26	0.17	0.11
DCF	(7800)	426	273	176	113	5174
<b>IRR</b>	<b>47.85%</b>					