

Potential Investor Screening & Preliminary Exit Valuation:

Consulting a Medical Startup of Advanced Technological Innovation in
Preparation for its Second Fundraising Round

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INTRODUCTION	3
THE CHALLENGE	3
SOLUTION	3
POTENTIAL INVESTOR LONG AND SHORT-LIST DEVELOPMENT	3
DETERMINING VALUATION RANGE	4
EXIT OPPORTUNITIES	5
LEARNING OUTCOMES	5

Introduction

This public document intends to summarize the process and findings of my Capstone Project developed for my Master's degree in Finance at Central European University. Due to the confidential nature of the project, below I will refer to the co-founder of the company as "project owner" or "the Client" and will refer to the company as "the Company". Based on our discussion taking place on 2020.02.10., I understood that the client is considering to raise additional financing to fund its product development and market entry. The Company is developing a breakthrough medical technology device aiming to provide a niche solution to the market of stroke survivors who suffer from central nervous system damage.

The challenge

After a throughout discussion with the client about the current and most relevant challenges and objectives of the Company, we determined that the most value would be created by providing assistance in the Company's upcoming fundraising round. The two main areas in which the client was seeking assistance were the following: (1.) development of potential investor shortlist and investor screening and (2.) providing preliminary exit valuation. The development of the potential investor short-list started with the discussion of the key investment requirements and screening factors provided by the client.

Solution

Potential investor long and short-list development

First, a long-list of potential investors had to be developed based on the discussed requirements and screening factors. The main sources of information used for that purpose were two startup-focused databases (1.) CrunchBase and (2.) Pitchbook. CrunchBase includes information on startup investments and funding, founding members, individuals in leadership positions, mergers and acquisitions, news, and industry trends. Originally built to track startups, the website contains information on public and private companies on a global scale. During the research, the client purchased access for CrunchBase Pro in order to further facilitate research. CrunchBase Pro is (designed for professionals) offers more in-depth search capabilities, market trend analytics, and alerts to track industries, companies, and investors. Similar to CrunchBase, Pitchbook is a subscription-only database that includes advanced analytical that help users make sense of the

information it collects. The database provides high-level insight into early-stage companies, investors, deals, mergers and acquisitions, funds, advisors and management.

Other than the two databases listed above, an advanced desktop research was also conducted in order to map the market of potential investors more accurately, with special focus on medtech-focused VC investors and business angels located in Europe. Additional advanced desktop research was also conducted in order to map the market of potential investors more accurately, with special focus on medtech-focused VC investors and business angels located in Europe. As for the development of the long-list, key screening factors included only geographies and focus of investment. The number of potential investors identified in the investor long-list was 117. In order to develop the short-list of preferred investors, additional factors of screening have been determined in order to narrow down the list down to around 10. These factors included (1.) track record, (2.) number of relevant investments, (3.) composition of investment team, (4.) investment strategy and (5.) ability to provide strategic support.

Determining valuation range

Although there are multiple ways to value a company, valuing an early-stage venture brings unique challenges. Many startups have little or no revenue for years and uncertain market environments can make estimations and forecasts about future results very complicated as market validation is yet to be conducted. For mature businesses with steady earnings, a DCF-based valuation could provide an accurate estimation of value, but for pre-revenue startups without established financials and little or no market feedback, an estimation-based approach such as a DCF model would hardly result in a reliable output. The decision of doing a multiples-based valuation has been made based on a mutual agreement with the client. By conducting a multiples-based valuation, one can determine the multiples paid for more mature businesses operating in the same industry/niche, providing ground for what the company could be worth 5 years from now if important milestones of maturity are reached. Also, by adjusting their financial forecast over time, the client will be able to adjust the Company's FY2025 sales figure (the basis of the valuation) and configure the provided valuation range more easily than in case of a complicated DCF model with thousands of variables. Although market multiples are expected to change in the upcoming 5 years, multiples can also be easily updated using the mentioned sources. Determining the Company's peers brought a lot of challenges since the client's unique approach to tackle spastic

hand paralysis and rehabilitate nerve system damage made it hard to draw comparison to other market participants on a purely technological basis. Rather than trying to find similar solutions, comparable companies were searched for on a 'problem-basis'. This means that peers were considered by assessing similarities of the challenge/opportunity (consequences of stroke) they intend to address rather than the type of solution provided. Additional screening factors included market-fit, similarity of business model, and similarity business lifecycle. In order to determine a realistic and bias-free valuation range, precedent transaction screenings were extended with collecting public multiples as well. An industry-wide screening of medical technology transactions was also conducted to provide further ground for determining the appropriate valuation range.

Exit opportunities

In order to complement the report, additional assistance was given in researching possible exit opportunities by screening active buyers of medical technology companies. Other than conducting research on possible buyers, key success factors affecting the success of a potential exit were also analyzed. Such factors included strategic milestones the Company has to reach in order to increase its value and relevance on the market, making it an attractive target for future buyers. The research for potential buyers was conducted using two main databases: (1.) Capital IQ and (2.) Merger Market. Other than searching for companies that acquired businesses similar to the client's, additional desktop research has been conducted to identify the 20 biggest medical device companies globally. In order to avoid considering medical technology companies that operate mostly in software and R&D, I reviewed the annual reports of the top 40 medical technology companies and ranked them in accordance to their medical device-related sales figures, derived from their sector-specific breakdowns presented in their Income Statements. Once completed, I took the top20 list and searched for the number of relevant M&A deals executed by the listed companies in order to provide additional insight to the client about the willingness to purchase of these companies.

Learning outcomes

The project was a good learning opportunity, with many challenges and opportunities to think creatively. Valuing early-stage companies can be challenging, but by applying the right approach, value can be created. I enjoyed working with the client, who was satisfied with the output.