Tips for Preparing the Financial Information included on the Application

1. **Returns to Investor (500 characters):** You want to take the total return the investor could get, and divide it by the amount of money you want them to invest. The result of that calculation is called an "X Multiple". An example of how to state the return as an X multiple follows.

   Example: "We think we can provide the investor a 4X return in investment."

   The 4X means they get back their original investment times 4. So a $100k investment will return $400k.

   But how do investors get repaid? Investors get repaid either from 1) your selling your business or 2) dividends. There are methods that explain how to value your venture from either method. Investors like the selling method best, but will consider a dividend method. Below I will outline how you can calculate investor's returns.

   The first thing to do is to estimate sales and costs for the business after four years. Estimate what you think your bottom line net income will be in year 4. With the sales and net income information, we can now estimate your venture's value, as well as the investor's "X multiple". Below is a spreadsheet that helps you do this and both methods are also described below. Once we have "X Multiple". So you can see the valuation methods in action, let's pretend you need $50k from investors, year four sales will be $1 million, and year 4 net income will be $100k. Here are the two methods.

   a. ***Selling the Venture Method***. Look up some publicly held companies in your industry. See what their PE (price/earnings) ratio is. Assume you can command 75% of that. Take your year 4 net income and multiply it by your proposed PE ratio.

      Example: Suppose you are in the retail fashion industry, and companies often sell for about 20X net income (a PE ratio of 20). 75% of that would be a 15X PE (20 x 75% = 15). Your firm would be worth $1,500,000 (15X your $100k net income). The investor's 25% share of that would be $375k ($1,500,000 * 25% = $375,000). $375k divided by $50k equals a 7.5X investor return ($375,000 / $50,000 = 7.5). If you doubleclick on the table below, you can calculate the X multiple for your venture using the "selling the venture" method. Just input your numbers into the yellow cells.

Selling the Venture Method		
Initial Investor request	$ 50,000	Yellow fields are numbers you provide
Percent equity you plan to give the investor	25%	
Year four Forecasted Sales	$ 1,000,000	
Year Four Forecasted Net Income	$ 100,000	
Industry Comp PE ratio	20	
Your venture's PE ratio	15	Grey fields are calculated for you
Your venture's proposed value	$ 1,500,000	
Investor's share of that value	$ 375,000	
Investor's X Multiple	7.5	

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b. ***Dividend method.*** Offer to pay a 25% dividend (of net income) in perpetuity to the investor (note: growth companies rarely pay more than 25% of net income as dividends). Assume some growth rate in net income (for example, 8%). Assume the economy will grow 3%. Divide your dividend amount (in dollars) by (8% - 3% = 5%). That will give you the value of paying a 25% dividend to the investor. Divide that amount by their initial investment, and that will give you your "X multiple".

Example: If net income is $100k, and you offer to pay a 25% dividend, the annual amount is $25k. Assuming net income grows 8% and the economy grows 3%, the value of that 25% dividend becomes $500,000 ($25,000 / 5% = $500,000). Assuming an initial investment of $50k, that equals a 10x return ($500,000 / $50,000 = 10). If you doubleclick on the table below, you can calculate the X multiple for your venture using the "dividend method".

Dividend Method		
Initial Investor request	$ 50,000	Yellow fields are numbers you provide
Percent dividend you plan to give the investor	25%	
Year four Forecasted Sales	$ 1,000,000	
Year Four Forecasted Net Income	$ 100,000	
Your estimated Growth rate after year four	8%	
Economic Growth rate	3%	
The value of your investor's dividend	$ 500,000	Grey fields are calculated for you
Investor's X Multiple	10.0	

You only need one method or the other, and the selling method is preferred. Your write-up might look like this.

Example: "Given that industry sales are forecasted to be $20 million in 2014, our analysis supports our enjoying year four sales of $1 million, with $100k in net income. Comparable firms in our industry enjoy a 20 PE ratio; conservatively, we think we'll command at least a 15 PE ratio when we sell the firm. As a result, we are confident that investors can earn a 7.5X return on their $50k investment."