# Contents

**Acknowledgments** ix  
**Introduction**  
What You Don’t Know About Valuation Will Cost You Money 1  
**Chapter 1**  
Using Facebook, Twitter, and LinkedIn to Explain VC Valuation Gains and Losses: How VCs, Angels, Founders, and Employees Give Up Investment Cash Flow Every Day 13  
Did Valuation Ignorance Cost ConnectU (and the Winklevosses) $50MM? 14  
An Expert Doesn’t Need a 409A Valuation When He or She Has a Certificate and Basic Math 15  
Valuing Facebook’s Common Stock Compared to Preferred Stock in Minutes 16  
What the Winklevosses Would Have Seen in Any 409A Valuation Report 19  
Deriving a Discount for Lack of Marketability for Valuations 27  
Facebook at $80 Billion Valuation versus Enron at $80 Billion Valuation 35  
Deal Terms, Waterfalls, and the Pre-Money Myth 36  
The Pre-Money Myth 44  
Summary 56  
**Chapter 2**  
Should Venture-Backed Companies Even Consider a DCF Model?: Introducing the Life Science Valuation Case: Zogenix 57  
Zogenix: Company Background Summary and Highlights 58  
Leaping Forward Just 20 Months, the Company Files for an IPO 64  
Order of Valuations Presented in This Case 67
Chapter 3
Valuation Methods versus Allocation Methods Regarding Zogenix 69
Separating Enterprise Value from the Allocation of That Value 69
Valuing Total Equity 72
Using Future Value (FV) and Present Value (PV) to Value Future Cash Flows Today 79
Summary 82

Chapter 4
Applying the Typical DCF Model to a Venture-Backed Company Hardly Ever Works 85
The Gordon Growth Model 85
High Growth Limits the Gordon Growth Model 87
Dividend Irrelevance and Capital Structure Irrelevance 90
Using Comparables (Generally Market Multiples) to Generate a Terminal Value 91
Actual Differences between Angels and VCs versus Perceived Differences 100
Applying Valuation Methods and Allocation Methods at Inception 102
Summary 104

Chapter 5
“Enterprise Value” + “Allocation Methods” = Value Destruction: Undervaluing Companies and Overvaluing Employee Options 107
Most 409A Valuations Undervalue the Company and Simultaneously Overvalue Employee Stock Options 107
Did Auditors Drive Valuators to Overvalue Employee Stock Options? 109
Most 409A Enterprise Value Calculations Ignore the “Takeover” Value of Preferred 113
The Realistic Range of Possibilities Depends on Who the Investors Are 119
Overstating Returns and Understating Returns on the Same Asset (Simultaneously) 125
What Happens to Fund IRRs When You Assume Book Value Equals Market Value? 128
The Real Cost of Fair Value, Fair Market Value, and Enterprise Value 132
Yahoo! Case 137
## Contents

### Chapter 6
**Why You Should D.O.W.T. (Doubt) Venture Capital Returns—Option Pool Reserve**
- Unissued Option Pools 159
- Value Conclusion Elements Impacted by Option Pool Reserve Assumptions 161
- Impact on Parties Relying on Assumptions of VC Investments 176

### Chapter 7
**If Valuation Can’t Make You Money, Do You Really Need It?: Learning Practical Applications from Kayak.com**
- Applying Studies to Real-World Cases 186
- Important Questions to Ask 213
- Summary 223

### Chapter 8
**Don’t Hate the Appraiser (Blame the Auditor Instead)**
- Interview with Jeff Faust, AVA 226
- Summary 236

### Chapter 9
**Don’t Blame the Auditors (Blame the Practice Aid Instead): 409A Valuation Professionals Discussing Topic 820 (FAS 157) with VC CFOs**
- Introduction to the Expert Panelists 238
- The Auditor’s Valuation “Bible” 239
- SAS101 Tests, POWERMS, and OPMs 240
- POWERMS and rNPV/eNPV Models 243
- Subjectivity and the POWERM (or “Power”) Method 243
- Finding Inputs for the OPM Model 245
- Enterprise Values versus Allocations 246
- Next Round Pricing and Topic 820 248
- Different Ways of Treating Granted, Unvested, and Reserved Options 250
- Valuing Warrants in Venture-Backed Companies 252
- Quantifying Qualitative Inputs to Value Conclusions for VC-Funded Companies 253
- Discounts for Lack of Marketability (DLOM) and Venture-Fund Portfolios 254
- Sharespost, SecondMarket as Market Inputs 258
- Summary 262