# VALUATION ANALYSIS REPORT

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### 1. Valuation Rationale

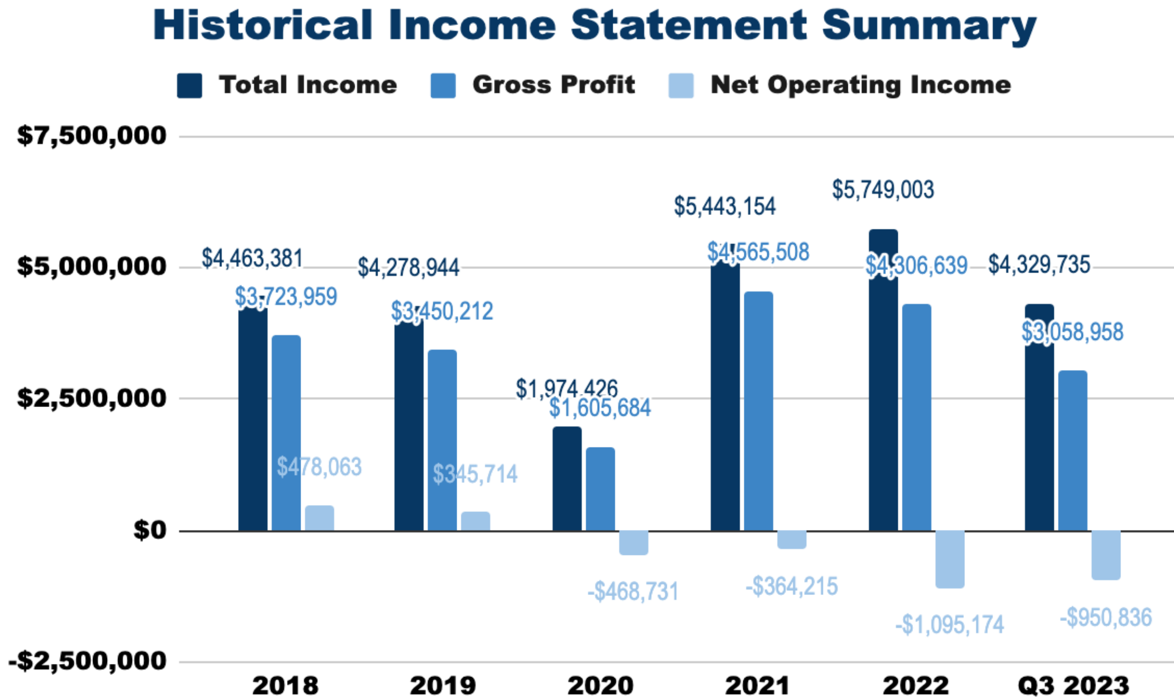
We rely on three primary methods of valuation for companies: 1) market multiple, 2) discounted cash flow (DCF), and 3) comparables analysis. For ******, a market multiple approach is the most appropriate method given both the company's long operating history and its consistency in its financial performance. However, given the company's ongoing operational adjustments and growth ambitions, we feel that historical performance is not necessarily indicative of future performance. Therefore, we've also employed a DCF analysis to represent that future potential. We feel that a comparable company approach is unnecessary given the available financial performance data.

The analysis should be contextualized within current macroeconomic trends that may affect startup valuations between years. For example, if the company's primary product were a low-cost, consumer discretionary product, a valuation in 2017 would likely be higher than an identical company's valuation today due to the state of the markets, inflation, and consumer spending. These three components collectively flow into a final valuation range that we believe the company would fairly fall within.

Finally, the valuation is checked against dilution metrics to create a financing recommendation. In other words, we evaluate if the valuation is reasonable given the company's current capitalization, targeted raise, and expected investor return minimum. This step will also allow further guidance regarding the company's current and future financing rounds and operating plans. For example, founder dilution by 50% may be acceptable if the company is expected to exit in the near future without any additional financing, but would be difficult to defend from the founders' perspective if the company were likely to need multiple more external financing rounds before an exit event. In this case, the valuation is only malleable within the range provided (which is why this step comes after a final valuation and a conclusion is reached). For example, maybe the company in this example needs to raise fewer dollars with more near-term goals. However, the dilution analysis does not impact the valuation analysis. In other words, we will not change our valuation recommendation based on dilution implications.

**2. Market Multiple Analysis**

The average annual revenue, gross profit, and net income for ****** between 2018 and 2022 was approximately $4.38M, $3.53M and -$318.5K, respectively. This information is summarized in the chart below:




****** faced substantial challenges during the COVID-19 pandemic, which led to disruptions in their operations, a 54% decline in revenue from the prior year, and unprecedented losses. Prior to the pandemic, the company maintained net profit margins near 6%. However, the pandemic brought their business to a standstill, and while revenue recovered within 12 months, the company continues to struggle to return to profitability. 2023, particularly in Q4, symbolizes a period of growth and reconciliation for the company as it works to rebuild from the impact of the pandemic. The company is on track to achieve $5.77M in revenue this year, but this comes at the expense of greater losses, approaching $1.49M.

While the company's growth overall through the last 5 years has fluctuated, this is largely due to a single uncontrollable event, and the recovery over the last 3 years has been steady. Given the relative consistency between 2022 and 2023, we feel that using the estimated 2023 financial metrics is suitable for the multiples approach. Because the company has seen significant losses over the last 3 years, we will use a revenue multiple as opposed to an EBITDA multiple. However, it should be noted that an EBITDA multiple is highly preferred as an indicator of the company's operating ability. Because losses are a result of the company's normal operations (as opposed to heavy investments into future growth which is often acceptable for early stage startups) and considering that the company is relatively mature, we will use the lower end of the

revenue multiple range, and will note this caveat that some investors may feel more comfortable in using an EBITDA multiple despite a negative valuation.

We researched appropriate revenue multiples in the food operations and service industry and found a wide variation in revenue multiples. On average, our research indicates an appropriate valuation lies in the range of 1.5x to 3x revenue. The use of a revenue multiple should be weighted based on the net profit margin, expected in the range of 7% to 8%. However, ****** has historically demonstrated profitability in the range of 6.65% to -25.43%. Ignoring this profitability-based weighting, these multiples would yield valuations in the range of $8.66M to $17.31M.

- https://eqvista.com/revenue-multiples-by-industry/
- https://microcap.co/restaurant-industry-valuation-multiples/
- https://sevenrooms.com/en/blog/restaurant-profit-margins/

### 3. Discounted Cash Flow Analysis

We conducted a financial projection and DCF valuation analysis to bring more technical context to the market multiple analysis. Firstly, below is a list of the assumptions we made to complete the financial projections and resulting DCF:

*Balance Sheet and Cash Flow Assumptions*

All balance sheet and cash flow assumptions are based on current (September 30, 2023) financial statements reported by the company's management team.

- Beginning Cash Balance is set as $72,645
- The company will raise $3,000,000 in equity capital in Q1 2024
- As current assets (excluding Cash & Cash Equivalents) exceeds current liabilities, other current assets are set to $0, and current liabilities are set to $1.3M (calculated as the difference between current liabilities and current assets (excluding Cash & Cash Equivalents). This also includes recategorization of a Wells Fargo Business Line of Credit which is currently organized as a non-current liability.
    - Finally, the current liability account is set to $0 and all short-term debts are refinanced with a 10 year loan bearing 6% interest.
- Additionally to the short-term debt refinancing, the company has the following outstanding debt obligations based on an updated debt schedule:

| **Debt Financing Activities** | Date of Financing | Principal | Term (Quarters) | Interest Rate | Quarterly Payment |
|---|---|---|---|---|---|
| PIDC ****** 60332 | Pre-Existing | $39,713.25 | 3 | 2.75% | $13,420.18 |
| PIDC PPP | Pre-Existing | $25,833.43 | 7 | 0.00% | $3,690.49 |
| PIDC ****** 67217 | | | | | |
| SBA EIDL Loan | Pre-Existing | $51,310.00 | 3 | 6.00% | $17,618.98 |
| United Bank *7465 | Pre-Existing | $157,053.00 | 113 | 3.75% | $2,259.58 |
| United Bank *7466 | Pre-Existing | $40,368.01 | 3 | 7.00% | $13,929.69 |
| | Pre-Existing | $75,451.53 | 5 | 8.00% | $16,007.68 |

- The company does not have any capital expenditures planned and currently holds the following non-current assets on its balance sheet with the accompanying depreciation schedules:

| **Fixed Assets** | Purchase Date | Opening Value | Salvage Value | Dep Timeline (Qts) | Opening Acc Dep |
|---|---|---|---|---|---|
| Art | Pre-Existing | $11,804 | $11,804 | 1 | $0.00 |
| Depreciable Assets | Pre-Existing | $31,073 | $0.00 | 28 | $44,202.47 |
| Furniture and Equipment | Pre-Existing | $260,95 | $0.00 | 28 | $44,202.47 |
| ****** - Lease Equipment | Pre-Existing | $85,294 | $85,293.90 | 1 | $0.00 |
| ****** - Leasehold/Buildout ****** 2 | Pre-Existing | $432,190 | $0.00 | 120 | $44,202.47 |
| Franchise Fee ****** | Pre-Existing | $7,510 | $0.00 | 120 | $44,202.47 |
| Terminal E Vehicles | Pre-Existing | $461,310 | $0.00 | 20 | $44,202.47 |
| WinKitchen - Leasehold/Buildout | Pre-Existing | $25,200 | $0.00 | 20 | $52,805.17 |
| | Pre-Existing | $247,121 | $0.00 | 120 | $61,505.76 |

*Income Statement Assumptions*

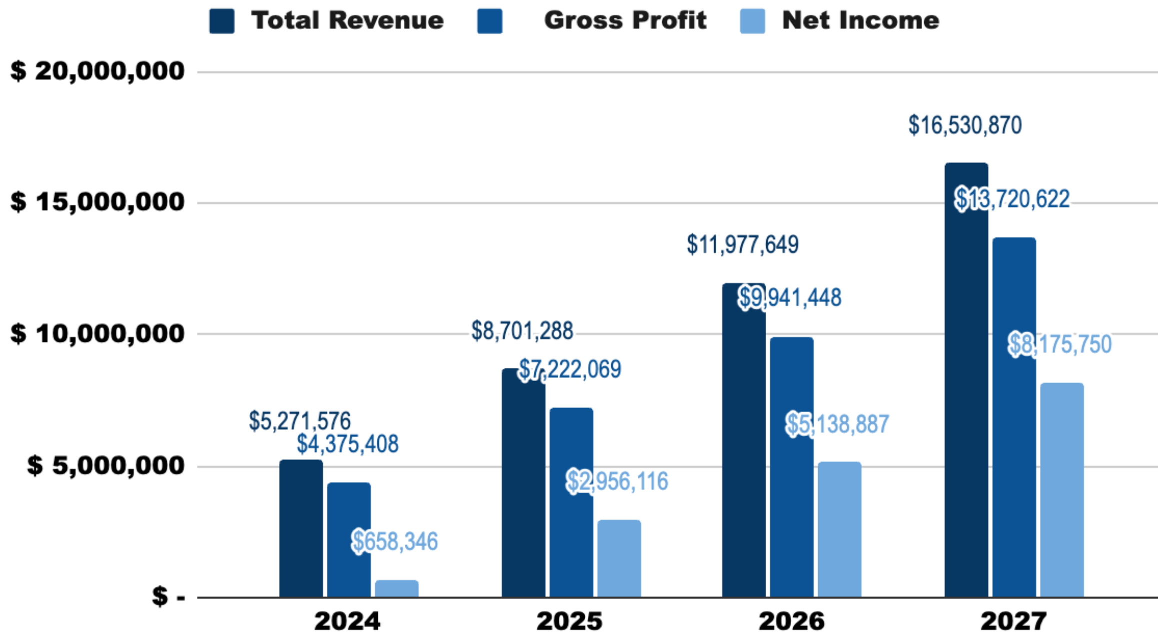
Income statement assumptions are based on current (September 30, 2023) financial statements reported by the company's management team, adjusted to match changes to the company's operational plan moving forward. The analysis which these assumptions are based on can be found here

- After consolidating redundant revenue streams created by inconsistent accounting standards and removing revenue streams which will no longer be active in 2024 (either due to contracts ending or abandonment), the company has 7 revenue streams:
    - ****** is a fixed fee contract yielding $111,225 in revenue per quarter with no QoQ growth, but the contract will be ending in Q2 2025. The company expects this contract to renew immediately with a 10% increase to overall contract value, yielding $122,348 in revenue per quarter
    - ****** sales are expected to grow at a consistent rate from historical performance starting at $287, 292 in revenue in Q1 2024 and growing at a rate of 6.8% QoQ (30.1% YoY)
    - Management Fees from miscellaneous contracts are expected to generate $250,000 in sales in Q1 2024 and grow at a rate of 5% QoQ (21.55% YoY)
    - ****************** as a relatively new revenue stream, is expected to grow at a logarithmic rate starting at $250,000 in Q1 2024 and following the growth equation $- a\, log(x) + b$ with a = 0.8 and b = 0.7 and a 10% minimum QoQ growth rate
    - Profit Distributions from the ****** Joint Venture are expected to restart (after working down pre-payments over the last one to two years), in Q1 2024 at $60,000 and grow at a rate of 10% QoQ (46.41% YoY)
    - Management Fees from the ****** Joint Venture, based on a percent of

revenue rather than profit, is expected to start in Q1 2024 at $20,000 and grow at a rate of 5% QoQ (21.55% YoY)

- All combined Costs of Goods Sold are set at 17% of revenue
- Variable expenses include Credit Card Fees (1.11% of revenue), Insurance (1.65% of revenue), Office Expense/Supplies (1.15% of revenue), Professional Fees (5% of revenue), ****** Royalties (7.75% of ****** revenue), and Miscellaneous SG&A (6.3% of revenue)
- Fixed expenses include payroll at $589,750 / quarter (this was adjusted to include recent layoffs and reductions to executive salaries which are not yet represented in historical financial statements), and rent expense at $100,000 per quarter

These assumptions provide us with projections consistent with long-term historical performance but deviating from short-term historical performance. It should be noted that the company has slowly been recovering from the effects of COVID19, and these assumptions are grounded in actual operational changes. These projections also include steady growth moving into 2027. The company financials are summarized in the chart below:



**This yields a total enterprise value via DCF analysis of approximately $17,845,371.** Other relevant factors and variables used in the weighted average cost of capital portion of the DCF analysis are below. These numbers were based on industry averages and weighted with specific considerations regarding ******.

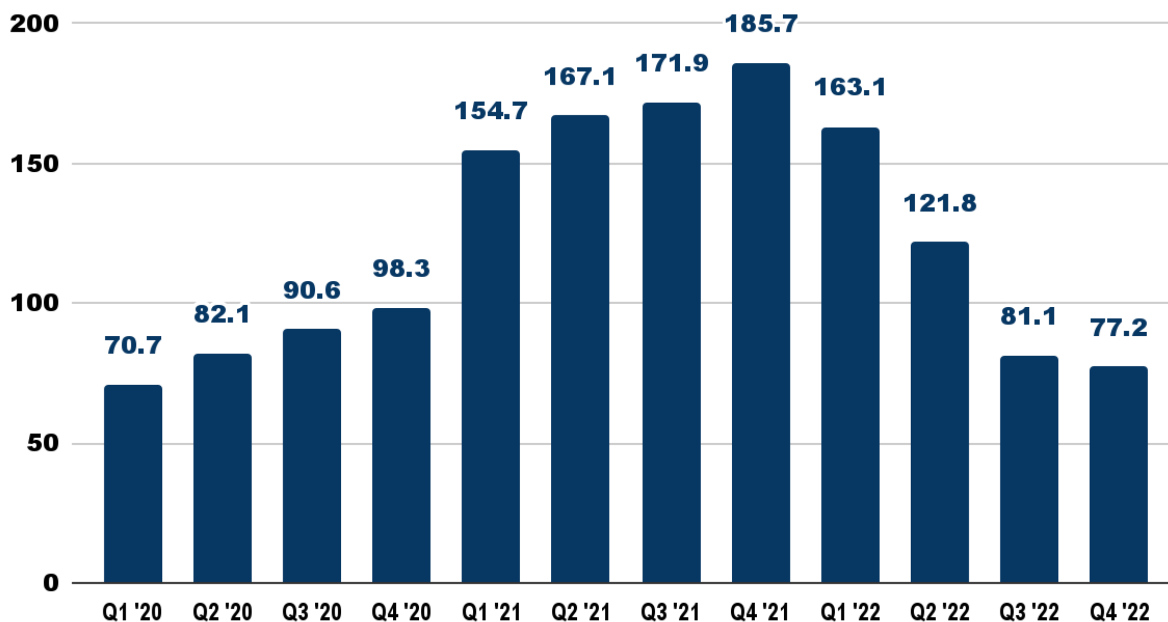
| **Target Capitalization Ratios** | |
|---|---|
| Debt as a % of Total Capitalization | 42% |
| Equity as a % of Total Capitalization | 58% |
| **Cost of Debt** | |
| Debt Financing Interest Rate | 7.33% |
| Corporate Tax Rate (Debt Shield) | 25% |
| Tax-Affected Cost of Debt | 5.50% |
| **Cost of Equity** | |
| Risk-Free Rate | 4.72% |
| Equity Risk Premium | 25% |
| Levered Beta | 1.41 |
| Cost of Equity | 39.97% |
| **WACC** | **25.5%** |

## 4. Macroeconomic Considerations

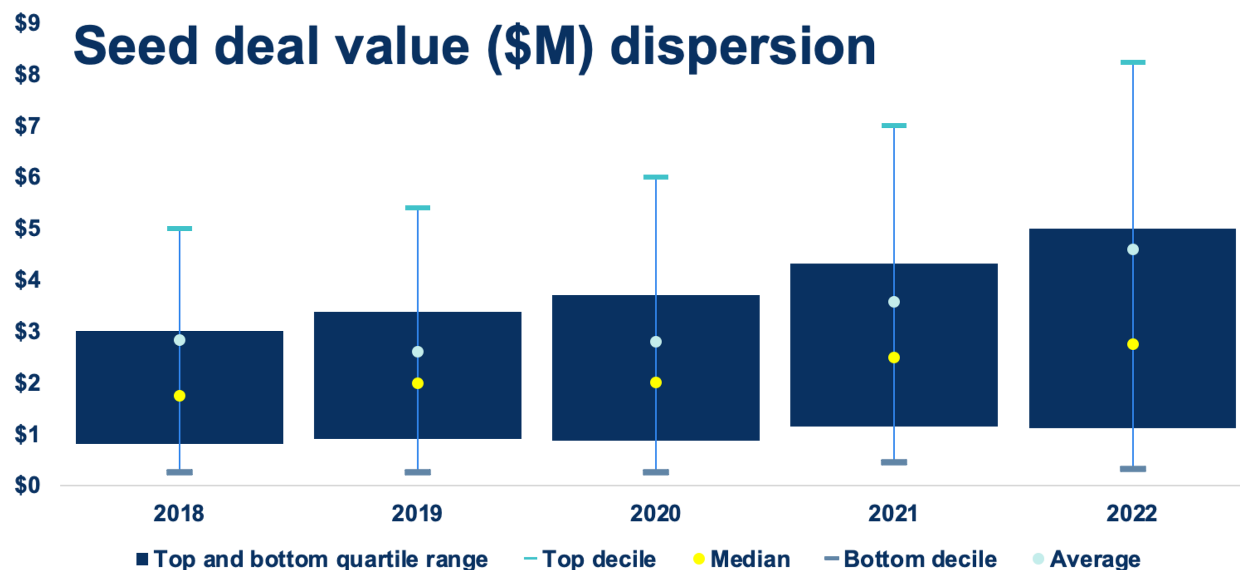
A deteriorating global economy has had a generally adverse effect on venture capital funding. As public equity markets saw historic declines, and even fixed income lost some of its safety with high volatility, venture capital has become increasingly more limited this year with Q4 2022 numbers coming in down 54% from the prior year. Publicly traded holdings in investment portfolios price by the minute, while private asset classes like venture capital experience less volatility as they price monthly or quarterly. As investors look to allocate capital to venture, it currently represents an overweight position in their overall portfolio due to the downside volatility in public markets. As a result, fewer dollars are flowing into the asset class and VC fundraising is expected to decline by $130 billion into 2023. While investors are currently allocating more to the fixed income markets, many predict a high probability of a recession which will lead the Fed to halt rate increases and reduce the attractiveness of a bond-market strategy.

It is expected that Series C and D rounds will see the most down rounds with regards to valuation, as these companies are the most starved for capital and the most overextended. As companies grapple with higher interest rates and stricter deal terms they will not be able to raise at their previous paces, or valuation levels. Fortunately, seed-stage startups are more insulated from public market volatility since they are further from an IPO and can bide their time until paths to liquidity reopen. In 2022, investors that traditionally allocate capital to late stage startups have moved upstream, targeting earlier stages and contributing to the development of a more robust pre-seed market. Amid the tepid public market conditions and the Fed's monetary tightening, seed deal metrics have increased quarter over quarter. At the same time, VC Funds are expected to exercise stricter due diligence of startups and limit growth in order to mitigate the risk of unsustainable valuations. Additionally, VC fundraising is expected to fall by $130 billion in 2023 as liquidity providers grapple with venture asset holdings which have become too large relative to other asset classes, which will put downward pressure on volume in 2023.

As it relates to the valuation of ******, the company should pursue the value that it would be worth in stronger economic conditions, but should also be aware that its ability to find a lead investor with those terms may be more limited than it has been in the past and should consider if limiting dilution is worth a potential inability to fundraise for the foreseeable future.




Data from: [Crunchbase]




Data from: Pitchbook

## 5. Conclusions and Recommendations

The results of our DCF and market multiple analyses are largely aligned. The market multiple analysis indicates that the company is likely worth 1.5x to 3x revenue. This would yield valuations in the ranges of $8.66M to $17.31M. However, the use of a revenue multiple should be weighted on net profit margin, expected in the range of 7% to 8%. Pre-pandemic, ****** has historically demonstrated profitability from 4.8% to 6.7%, and profitability has been significantly negative since the company started recovering. Therefore, we recommend weighting the revenue multiple more closely towards the lower end of the range. Furthermore, the DCF analysis yields an approximately $17.8M valuation which is in agreement with the upper end of the revenue multiple range. We should point out as well that we used a relatively high equity risk premium of 25% because the plan relies on several operational changes which, while based in reality and reasonable assumptions of actionable decisions, represent high risk assumptions in aggregate.

**Considering a blend of these two valuation methods, we believe that a fair pre-money valuation is in the range of $10,000,000 to $15,000,000.**

The best thing the company can do to improve its valuation is to continue growing YoY at a similar rate. Furthermore, the company should put additional operational emphasis on improving net operating income, especially as they already have a relatively strong gross profit margin. This will have a threefold benefit of improving the earnings multiple alone, allowing the analysis to be weighted more towards the revenue multiple, and improving the DCF valuation, both in risk and basic free cash flow.

An equity financing event in the planned size of $3,000,000 will dilute the existing shareholders by 16.67% to 23.08%, well within the range of the typical target of 20% ± 5% in any single financing round. However, this recommendation is typically provided to startups. In the case of Strother, which is a more mature company and where just one round of equity financing may be sufficient before an eventual exit, this level of dilution should be reconciled with specific growth capital investors, lower risk family offices and private equity. We feel that the company's plan to pursue debt and equity in parallel is warranted given the large short-term debt burden.