

How Do You Value a Startup Company with No Revenue?

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In today's age of great technological and entrepreneurial innovation, many people work for private companies where ownership interests such as common stock, restricted stock, stock options and profit interests have become a significant part of employee compensation. However, by their very nature, ownership interests in startup companies present unique valuation issues, as it may not be obvious how companies with no earnings (or even sales) may possess significant value. Yet the evidence is there; a quick look at the stock market will show companies with no earnings, such as CrowdStrike and Opendoor Technologies, have equity market capitalizations in the tens of billions of dollars. Even companies with no sales at all, such as American Lithium and CytoDyn, have equity market capitalizations ranging from hundreds of millions to over \$1 billion.

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Yet, it is often the case that when an interest in a privately-held company without earnings becomes part of a shareholder dispute or part of the discussion regarding equitable distribution in a divorce, people claim that the equity interests in the company have no value (and yet at the same time fight strenuously to keep the interests from the other party). For estate and gifting purposes, the IRS will expect professionally-derived and supportable values.

Valuing an equity interest in a company with no earnings presents unique problems. Experts may not be able to use common valuation methods such as the capitalization of earnings method or comparable companies' valuation multiples such as price/earnings or price/EBITDA ratios. Often a very low value based on the book value of equity is offered, although in many startup companies, the equity book value may be negative.

Skilled business valuation experts have several ways to deal with this challenge. They may ask questions such as whether the company has a business plan with a multiyear financial projection, whether the Company has outside investors, or whether the Company has valuable assets or technologies. The experts could consider the application of one of the methods described below:

1. **Discounted Cash Flow Method** - If the business plan's financial projection anticipates either profitability or a liquidity event at the end of the projection (such as the sale of the company), the valuation expert could determine the company's value using a discounted cash flow model that employs an appropriate discount rate to account for the risk of not meeting the projections.
2. **Equity Transactions Method** - If outside investors have invested in a company on an arm's length basis, the price at which they bought shares may be evidence of value.
3. **Comparable Companies Method** - If the company has significant sales but has not yet reached profitability, multiples of Enterprise Value/Sales derived from comparable public companies can be used as an indication of value.
4. **Net Asset Method** - Often used to produce a floor or minimum value, this method considers the prices at which the individual assets of the company could be sold in an orderly liquidation. For many startups, this value may not be reflected on the balance sheet, but require a valuation of intangible assets such as trade names, patents, or technological know-how.
5. **Option Pricing Method** - This method uses the Black-Scholes option pricing model or other option models to value the equity. It examines the potential upside for an equity by examining the volatility of comparable industry companies.

For a company with no sales, many of the above methods could be used, with the exception of the Enterprise Value/Sales multiple method. Yet even this could be adapted for use if future sales can be forecast with reasonable precision. A future value can be predicted from expected sales in future years, then discounted back to present value using an appropriate risk-adjusted rate.

Finally, questions may arise if a company has multiple classes of debt, preferred stock, equity, warrants and options. How would you value, say, a Class B Preferred stock in a company with multiples classes of stock and options? Fortunately there is a valuation experts can use: a well-developed allocation methodology based on options theory to handle this problem.

While valuing companies with no earnings (or sales) can be difficult, it may be done with reasonable accuracy by using the established methods accepted by the Courts and the IRS. An Anchin valuation specialist can help you with these issues, providing analysis, reports and expert testimony as required. [Contact Ray Dragon, MBA, MS, ASA](#) or your Anchin Relationship Partner to discuss your valuation needs.

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