THE BERKUS METHOD

The 'Berkus Method', named after its inventor, <u>Dave Berkus</u>, a well-known Californian angel investor. As the Berkus Method was developed back in the 1990s, it has been adjusted and updated to reflect modern market dynamics.

As Dave Berkus states:

"The original matrix is too restrictive and should be a suggestion rather than a rigid form."

Let us walk through in a nutshell the calculation formula that Berkus created as this is still used internationally.

QUANTITATIVE AND QUALITATIVE FACTORS

As known, the main challenge with early-stage company valuation is the lack of revenue numbers and, even if there is a product on the market, it is almost always an MVP. Most methods of valuating a company rely on revenue and profit projections. However, only very few early-stage startups fulfil or outperform their initial financial projection, which is why quantitative valuation models often do not lead to an accurate result.

The Berkus Method attempts to circumvent the problem of quantifying something, which is not (yet) possible to quantify by using both qualitative and quantitative factors to calculate valuation based on five elements:

- Valuable business model (base value)
- Available prototype (reducing technology risks)
- Abilities of the founding or management team (reducing implementation risks)
- Strategic Relationships (reducing market risks)
- Existing costumers or first sales (reducing production risks)

In the first step, we need to give each of the above-mentioned elements a monetary value. A maximum value that can be assigned to a single element is $500000, since that leads to a maximum pre-revenue valuation of up to $2.5 Million. The reason for this is that Berkus sets a "soft cap" of $25 Million valuation in the 5th year of business, giving the investor a ten-times return potential over the investment´s life span.

We prepared a simple calculator, based on the steps of the Berkus Method that showcases an example valuation along key parameters for a fictional early-stage startup. By selecting the different parameters and adjusting the maximum added values you can see how the pre- and post-money valuation changes.

As the example shows, we have a total startup pre-money valuation of EUR 1.35m. This particular fictitious startup has a very promising team (serial entrepreneurs) and has; therefore, received the highest value (EUR 390k) in this category. The founding team is essential for the future success of a startup or, referring back to Bill Payne, the creator of the Scorecard Method, he states: *"In building a business, the quality of the team is paramount to success. A great team will fix early product flaws, but the reverse is not true."*

The available prototype of our example startup is solid and was developed based on the findings of the MVP, reducing the technological risk for the investor, which is why it was awarded with a value of EUR 290k. The business model as well as the quality and the potential of the idea itself is fairly average (EUR 250k). Also, a couple of large corporates declared their interest in working together with the startup, which is why we allocated EUR 245k to the Strategic Relationship value driver. The IP for the product is still pending (EUR 180k).

As a general practice, if everything works out well for the startup and the investor, the company will achieve sustainable sales and the Berkus Method is replaced by other, more quantitative, valuation procedures in the following fundraising rounds.