Decoding pre-money & post-money valuation

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Business valuation is the process of determining the current (or projected) worth of an asset or a company. There are many techniques used for doing a valuation. Some of the important inputs considered while carrying out the valuation exercise are business's management, business model, future earnings and profit margins, size of the market, scalability of the business, funds required to achieve growth, competition, market share etc.

Typically, business valuation is carried out when a company is looking to raise funds, one or more of the existing shareholders are looking for an exit, sale / acquisition of a business or part of business, merger with another company, issuing ESOPs to employees etc.

What's the Difference between Pre-Money and Post-Money valuation

Pre-money valuation refers to the value of a company excluding the latest round of funding. Pre-money valuation indicates the value of a Company before it the next round of investment.

Post-money valuation refers to the value of a company after it raises money. This includes the latest round of funding.

For example, if an investor is willing to invest INR 20,000,000 and the pre-money valuation is INR 80,000,000, then the post-money valuation will be INR 100,000,000 and investor will get a 20% stake for the investment.

Post-money valuation = Pre-money valuation + Investment amount

Taking the above example further, assume that the Company has paid up capital of INR 1,000,000 and the no of issued shares is 100,000.

Particulars	Amount (in INR)
Pre-money value	80,000,000
No of shares	100,000
Pre-money value per share (80,000,000 / 100,000)	800
Investment amount	20,000,000
No of additional shares issued (20,000,000 / 800)	25,000
Post-money no of shares (100,000 + 25,000)	125,000
Post-money value (125,000 X 800)	100,000,000
Stake for fresh investment (25,000 / 125,000)	20%

Alternatively, if an investor is willing to invest INR 20,000,000 and the post-money valuation is INR 80,000,000, then the pre-money valuation will be INR 60,000,000 and investor will get a 25% stake for the investment.

Pre-money valuation = Post-money valuation - Investment amount

Particulars	Amount (in INR)
Post-money value	80,000,000
Investment amount	20,000,000
Pre-money value	60,000,000
No of shares	100,000
Pre-money value per share (60,000,000 / 100,000)	600
Investment amount	20,000,000
No of additional shares issued (20,000,000 / 600)	33,333
Post-money no of shares (100,000 + 33,333)	133,333
Post-money value (133,333 X 600)	80,000,000
Stake for fresh investment (33,333 / 133,333)	25%

As you can see from the above examples, the valuation method used can affect the stake for fresh investment. This is because of the amount of value given to the company before fresh investment.

If a company is valued at INR 80,000,000, the value is high if it is pre-money than if it is post-money because the pre-money valuation does not include the investment amount of INR 20,000,000. There is variance in percentage stake due to the difference in the way value is calculated. Therefore, it is important to know which value is being quoted during the negotiation.

Further, in case where there is no fresh infusion of capital, the Pre-money valuation and Post-money valuation are the same.

If an investor is willing to invest INR 20,000,000 buy to stake from one of the existing shareholders at a pre-money valuation is INR 80,000,000 then investor will get a 25% stake for the investment.

Post-money valuation = Pre-money valuation + Investment amount

80,000,000 = 80,000,000 + 0

Particulars	Amount (in INR)
Pre-money value	80,000,000
No of shares	100,000
Pre-money value per share (80,000,000 / 100,000)	800
Investment amount (No fresh investment)	0
No of additional shares issued (0 / 800)	0
Post-money no of shares (100,000 + 0)	100,000
Post-money value (100,000 X 800)	80,000,000
No of shares to be transferred (20,000,000 / 800)	25,000
Stake for secondary sale (25,000/ 100,000)	25%

There are also cases where promoters ignore these valuation concepts and negotiate the valuation based on assumption. Due to this, they end up giving up a higher stake to the investor.

Therefore, it is important that you do a working on pre & post-money valuation when you are looking to raise funds for your company.