**Bits & Bytes, LLC[[1]](#footnote-1)  
Representative Valuation Case[[2]](#footnote-2)**

Bits & Bytes is a computer reseller/refurbisher operating in Sandy, Utah. The firm brings in used computer equipment from leasing companies, call centers, large corporations, computer retailers, etc. and sells them exclusively through EBay. The firm most often purchases hardware in lots, brings the systems into their offices to assess its viability, separates assessed systems between salable complete systems or separate components, often breaking systems down to individual items (motherboards, ram, etc.) before listing for sale on EBay. Purchases are paid in cash at the time of delivery and all sales are processed through EBay and/or PayPal.

The firm has evidenced the ability to sell 70% of the viable systems or components it brings in within 30 days and another 20% within 60 days. Its primary constraint is the availability of used systems at reasonable prices.

The reselling of whole systems and component parts result in gross margins of 40% and 48% respectively. The firm’s operating expenses, exclusive of cost of goods sold are estimated at 36% of revenues. Firm revenues, by category, expenses, margins, etc. for 2013 through 2019 are stated below.

The firm was capitalized by a $10,000 investment from the founder representing 1,000,000 shares of outstanding common stock. There are three key managers, each of whom have received options for 5,000 shares for each of the last three years (2016-2018) for a total of 15,000 shares per manager. Strike prices were arbitrarily set at are noted as $10, $11, and $15 for each year, respectively. The options may be exercised no earlier than 3 years and no later than 8 years from date of issue (December 31 of the year in which they were issued). The firm also has a preferred shareholder with an original claim of $40,000 at a 12% dividend rate, which dividends have been reinvested each year rather than taken (2013). The preferred stake was issued based on an estimated equity value of $400,000 (10% stake). The owner of the space the firm leases, a family member, accepted warrants for 15,000 shares at a price of $2 per share in lieu of a market rent for the firm’s first three years of operation. The firm took on a credit line collateralized against the business and the founder’s primary residence in its first year of operations to acquire inventory. As of the end of 2018, that credit line had a balance of $303,500 and an interest rate of 12%. The firm has no other long-term debt.

Bits & Bytes founder has estimated 2019 revenues at $1,500,000, 20% higher than 2018, with a gross margin of 45% and operating margin of 17% - to date the firm is virtually on track to meet these figures. The firm has expanded its employee base to 12 full-time and 3 part time workers, of which three are managers. The managers have an average annual salary of $40,000 plus stock option bonus and benefits. The remaining workers are paid hourly at an average rate of $15 per hour and are not extended benefits of any kind. The firm pays marketing fees to EBay of approximately 6% of expected revenues and pays another 2 ½% in credit card processing fees. The owner takes no salary but estimates approximately $65,000 in personal expenses are run through the company’s accounts each year.

The firm’s growth plans include expanding into the used cell phone/smart device market with expected 2020 revenues of $400,000 in this space. The firm has recently signed an agreement to purchase $85,000 in used units from T-Mobile on which it anticipates revenues of $225,000. It has also agreed to purchase all of the used computer equipment resulting from that firm’s remodeling of more than 1,800 stores across the country, amounting to $1,080,000 in cost of goods sold alone. The transaction is expected to be fulfilled over the 2019-2021 operating years.

Bit & Bytes has a very thin balance sheet. It has expensed all of its furniture and equipment (no depreciable assets) and its only liability is its credit line; it pays all of its bills in-full each month (no A/P). The asset side of the balance sheet has cash and inventory with no A/R. Owner’s Equity includes those items noted in the paragraph discussing the firm’s capitalization.

The firm is considering a $5,000,000 equity infusion from Opportunity Capital, a venture capital firm to capitalize on opportunities both the firm’s founder and the VC firm see in the used electronics components market. The transaction would require all preferred shareholders to convert their shares to common and the warrant and options holders to exercise their rights or forfeit them. The firm’s CEO has admitted to the warrant and options holders that their “investments” are likely out of the money given the firm’s current value estimates. In response to which the warrant holder has threatened to sue, see that they’ll likely never receive anything for the three years rent exchanged for the warrants. The options holders have threatened to leave the firm given that their salaries are each approximately $20,000 under market wages. Opportunity Capital is requiring the founder settle these potential claims out of his equity stake in the firm prior to the transaction closing.

The firm’s shareholders have informally valued their equity shares based on a 2x Sales multiple each year and expect a valuation for 2019 will show meaningful improvement over prior years. Opportunity Capital insists on using a more credible valuation method with market and income based valuations more in line with market expectations.

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| --- | --- | --- | --- | --- | --- |
| **Annual Equity Valuation Estimates** | | | | | |
| **2018** | **2017** | **2016** | **2015** | **2014** | **2013** |
| 2,192,110 | 1,643,076 | 1,292,692 | 1,053,263 | 904,019 | 722,891 |



1. This Valuation Case is representative of actual firms for which live valuation estimations have been performed by the author and/or Associates. The names, locations, and quantitative details have been altered to protect the subject firms’ privacy. [↑](#footnote-ref-1)
2. Developed by Richard Haskell, PhD (rhaskell@westminstercollege.edu), Gore School of Business, Westminster College, SLC, U T, (2019). [↑](#footnote-ref-2)