Pre- and Post-Money Value

Pre-money value refers to the equity value of a company prior to a share capital increase, whilst post-money value already includes outside financing: the amount of capital raised. Therefore, pre- and post-money value represent different perspectives in timing (pre- and post-transaction).

When addressing the topic of valuation in the course of an intended share capital increase (e.g. initial public offering), then almost always a firm´s pre-money value is meant. This refers to the value of a firm´s equity prior to the proposed transaction.

When discussing a startup´s funding round with venture capital funds, however, then frequently also cross-reference to a firm´s post-money value may be made. This does make sense, because the actual cash put into a startup is the essential basis for implementing the business plan: A different (e.g. smaller) amount of funding would most likely result in a very different strategy or growth momentum. – Besides, when negotiating the terms of a funding round of a startup, then psychology, such as anchoring will also play a role: Whilst an investor may prefer pointing towards the relative "lower" pre-money value as point of reference, not least for psychological, tactical reasons, the founder consortium may stick to the relative "higher" post-money value. - Such implicit "gaps" may have serious implications, though, if hybrid instruments were considered in addition to a share capital increase, such as, for instance, convertible notes.

Regardless whether a startup or a significantly more mature firm contemplated a share capital increase, value creation illustrated by a positive share price momentum will depend upon the efficient allocation of the proceeds raised. Hence, if the transaction´s purpose is merely to amend a firm´s capital structure (with a business plan largely unchanged), then as per the Miller-Modigliani-Theorem the enterprise value will not change, at least not by much.

Empirical evidence suggests, though, that details actually do matter: For instance, as far as the composition of the Weighted Average Cost of Capital (WACC) is concerned, post-transaction one would observe a relative higher weighting of the Cost of Equity (CoE) component, whilst CoE itself actually expected to come down due to a lower beta (amid a lower earnings volatility). And, in case the issuer had any debt outstanding, then due to an anticipated decrease in the firm´s default risk (because of its lower leverage post-transaction), also cost of debt may actually decrease.

And, on top of this, if a share capital increase will enable a firm rolling out its business plan much more aggressively, then a value impact is almost assured. Having said this, though, post-transaction economics would have to be shared over an increased number of shares, which - technically - will result in a dilution of current shares outstanding.

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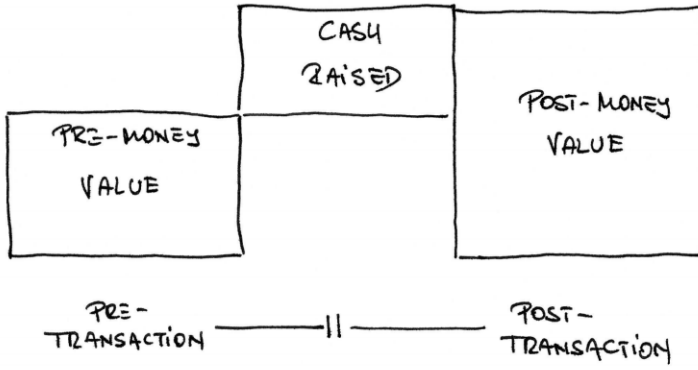

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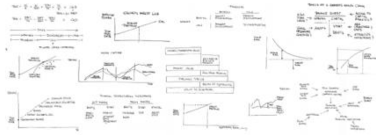

Corporate Finance Concepts

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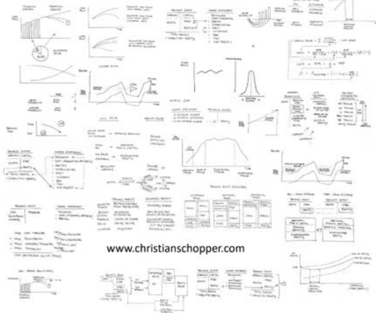

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