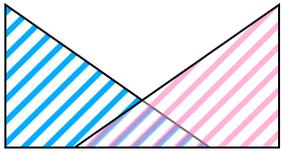


Capitalization Tables: who owns what and how much

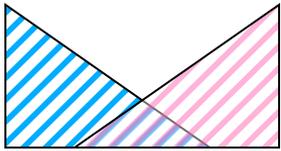
Rana K. Gupta
President
kwydk, LLC



Cap table: who owns what

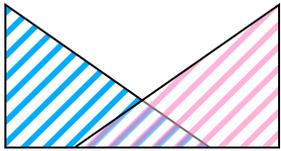
- If you're a sole proprietor, a cap table is not required
- As soon as equity is divided between two or more parties, bring out the cap table!
- The equity backbone of the company
- Debt is not recorded on a cap table*
- Primarily details the number of shares held by each party and why

* See note about convertible notes and dividends



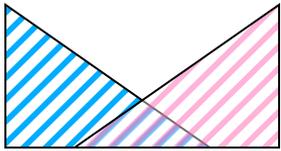
Many parties contribute to the cap table

- Parties who own shares or options
 - Employees
 - Founders shares
 - Options
 - Investors
 - Those who've written a check
 - Vendors or customers who have received options (warrants) in lieu of cash
 - Option pool – yes, it's its own line on a cap table
 - Options available
 - Options distributed but not purchased



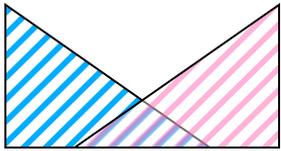
The cap table tells a story

- Nature of financiers
 - Angels
 - VCs
 - FFF
 - Corporate
 - Employees
- Rounds of financing
 - Seed
 - A Round
 - B Round
- Events
 - Founders
 - Additions to the team
 - License (if equity plays a part)
 - Partnerships (should equity play a part)
 - Formation of option pool
 - Option grants



More on the story

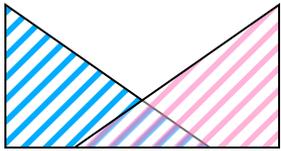
- Success (or not) of the company as stock price rises, stays the same or falls
- Clearly delineates the nature of participation in the company's equity story
 - Amount
 - Timing
 - Participants
- ***Shows management's responsibility in managing equity***



Building blocks of the cap table

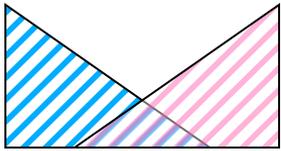
- Pre-money value
 - Negotiated figure – good luck
 - A figure the entrepreneur and investor agree to that defines the value of the company before any investment
 - Entirely subjective
 - Comparables may (should) be brought in as part of the negotiation
 - More often, it's the investor backing into a valuation given a possible ROI
- Investment
 - The amount of money investors will spend to buy shares of the company
- Post-money value
 - Pre-money + Investment
 - The new value of the company the day you accept the check!!
 - **THIS is the where entrepreneurs fail to understand the consequences of the Round's Pre-Money Valuation**

$$\begin{array}{r} \text{Pre-Money Valuation} \\ + \quad \text{Investment} \\ \hline \text{Post-Money Valuation} \end{array}$$



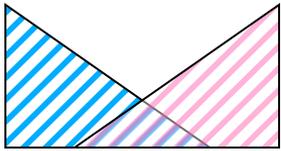
Terms of a Round, negotiation and the Cap Table

- Pre money valuation is a stated dollar figure
 - “we [the investors] say you’re value is \$500,000”
- Investors are juggling:
 - Pre-money
 - Post money
 - Invested capital
 - Investor percent ownership, post money
- Percent ownership
 - Many investors have a minimum percentage threshold they must own
 - With that as a start, other variables are determined
- **Terms not included in the cap table:**
 - **Liquidation preference**
 - **Dividend – unless and until those dividends purchase shares**
 - **Anti-dilution**



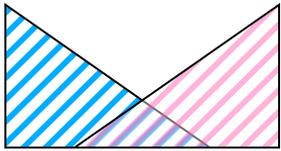
Cap tables come in all shapes and sizes

- All include the number of shares
 - Cap table more than anything conveying ownership
- Not all include the dollars invested
 - I disagree with this
- There are no two identical cap table formats



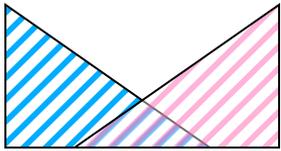
Good cap table governance

- Keep ALL documentation:
 - Board resolutions and minutes
 - Offer letters
 - Start and stop date for all employees (vesting)
 - Signatures of option agreements
 - Consultant agreements (if equity involved)
- Update cap table with every alteration in equity and date the table
- Suggestion: assign co-ownership of the table to your counsel and possibly your Comptroller



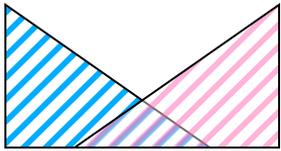
* Convertible note and bridge financing

- Resides as debt on the balance sheet until it converts into equity
- Therefore, not recorded on the cap table!
 - I like to create a tab with any notes and arithmetic pertaining to a Note
 - Same with dividends
- That conversion event could be:
 - Next round of financing
 - Acquisition
 - Maturity of the Note
 - Other agreed upon event such as an investment of non-dilutive financing
- Allows investors to defer having to value the company
- Usually offers a discount to the next equity event
 - A 15% discount example
 - If the next round is raised at \$1/share, the Note holders will buy in at \$0.85/share
 - reward for taking the up front risk before the Round was raised

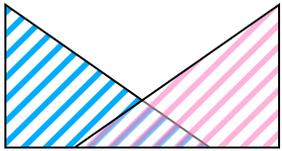


Using the cap table for scenario analysis

- What will the company look like IF we
 - Raise a B Round
 - Raise a B Round and convert a note
 - Raise a B Round, convert a note and include the interest from the Note
 - Raise a B Round, convert a note and include the interest from the Note and dividends from the A Round preferred investors
 - Raise the next Round a higher or lower stock price
- Sell the company for X, 2X, 3X
 - Then the cap table can help with liquidation preferences
 - Last money in is always paid first (after debt of course)



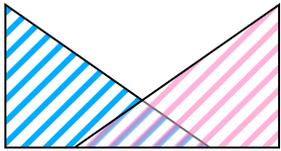
- Let's turn our attention to building a Capitalization Table



Two scientists decided to start a company

	Units	Investment	%
Sci Fo 1			60.0%
Sci Fo 2			40.0%
Total			100%

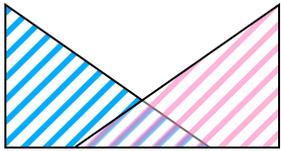
Editorial: DO NOT split the company 50, 50
- problem if one leaves
- good leadership



They negotiated a deal with a CEO

	Units	Investment	%	50%
CEO			50.0%	
Sci Fo 1			30.0%	
Sci Fo 2			20.0%	
Total			100%	

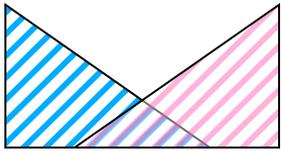
- CEO receives 50% of the company
- Diluting the Founders by 50%



To prepare to add a Board of Directors, they added an Option Pool

	Units	Investment	%	4.80%
				95.20%
CEO			47.6%	
Pool			4.8%	
Sci Fo 1			28.56%	
Sci Fo 2			19.04%	
Total			100%	

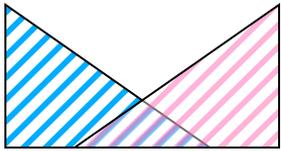
- The Pool is 4.8% of the company
- All parties are equally diluted



Here 'come the Board

	Units	Investment	%	4.80%
				95.20%
CEO			47.60%	
Pool			3.8%	
Dir 1			0.5%	
Dir 2			0.5%	
Sci Fo 1			28.56%	
Sci Fo 2			19.04%	
Total			100%	

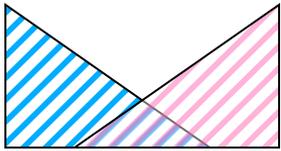
- Each Board member receives 0.5% of the company
- Options taken from the Pool
- Dilution is unchanged



Now the university joins the team with a 10% equity ownership

	Units	Investment	%	10%
				90.0%
CEO			42.8%	
Pool			3.42%	
Dir 1			0.45%	
Dir 2			0.45%	
Univ			10.0%	
Sci Fo 1			25.70%	
Sci Fo 2			17.14%	
Total			100%	

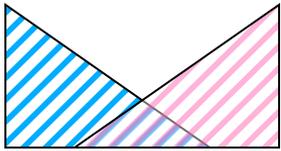
- They negotiate a license from the university
- All parties diluted by 10%
- This could have happened at any time up until this point
- **In fact, ANY of these events could happen in ANY order**
 - **Often the license happens with the two Sci Fos before the CEO is hired**



Let's add the shares now, to prepare for a financing

	Units	Investment	%
CEO	4,284,000		42.840%
Pool	340,000		3.420%
Dir 1	46,000		0.450%
Dir 2	46,000		0.450%
Univ	1,000,000		10.000%
Sci Fo 1	2,570,000		25.704%
Sci Fo 2	1,714,000		17.136%
Total	10,000,000		100%

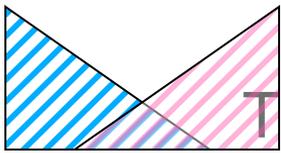
- Along the way, the Board decided the company will have 10,000,000 shares total, including options
 - This probably happened earlier but only showed up in the cap table now
 - This only further illustrates that creating a cap table is as much a function of style and necessity as it is finance



Oh HO! A Collaborator!

	Units	Investment	%
CEO	4,284,000		35.700%
Pool	340,000		2.833%
Dir 1	46,000		0.383%
Dir 2	46,000		0.383%
Univ	1,000,000		8.333%
Collaborator	2,000,000		16.667%
Sci Fo 1	2,570,000		21.417%
Sci Fo 2	1,714,000		14.283%
Total	12,000,000		100%

- They negotiated some sort of deal and agreed to give that Collaborator 2,000,000 shares of Common Stock in return
- They must've issued more shares
- All parties are diluted equally
- **That concludes our pre-investment story**



Different approach:

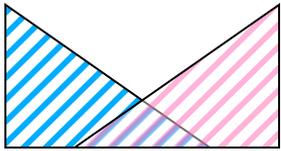
These guys **started** with shares and share value. They must have felt it added credibility

Founders Round -- Step 1 -- CEO and Scientific Founders Start Company

Price per Share	\$0.0001			
	<u>Shares</u>	<u>Investment</u>	<u>%</u>	<u>Value</u>
CEO	1,000,000	\$100	50%	\$100
Founder 1	500,000	\$50	25%	\$50
Founder 2	500,000	\$50	25%	\$50
Total Common Stock	2,000,000	\$200	100%	\$200

Issued and outstanding	2,000,000
Fully diluted	2,000,000
Raised in this round	\$200
Cumulative investment	\$200

- Some people start with shares not percentages
- Some even make the shares have a price when the Founders want to put money into the company
 - Share price of \$1.00 would've meant a \$2,000,000 Founders' investment!
- Who's company IS it? YOUR company
- **ANY of these events could happen in ANY order**



This is why you play the VC (equity) Game

<u>A Round</u>	<u>Investment</u>	<u>Shares</u>	<u>Ownership</u>	<u>VALUE</u>
Common		3,000,000	60%	\$3,000,000
A	\$2,000,000	2,000,000	40%	
Post Share	\$5,000,000	5,000,000	100%	
	\$1.00			

<u>B Round</u>	<u>Investment</u>	<u>Shares</u>	<u>Ownership</u>	<u>VALUE</u>
Pre Money	\$10,000,000			\$6,000,000
Common		3,000,000	32%	
A	\$2,000,000	4,000,000	42%	
B	\$5,000,000	2,500,000	26%	
Post Share	\$15,000,000	9,500,000	100%	
	\$2.00			

<u>C Round</u>	<u>Investment</u>	<u>Shares</u>	<u>Ownership</u>	<u>VALUE</u>
Pre Money	\$30,000,000			\$12,000,000
Common		3,000,000	25%	
A	\$2,000,000	4,000,000	33%	
B	\$5,000,000	2,500,000	21%	
C	\$10,000,000	2,500,000	21%	
Post Share	\$40,000,000	12,000,000	100%	
	\$4.00			

*“Let us not talk falsely now. The hour’s
getting late”*

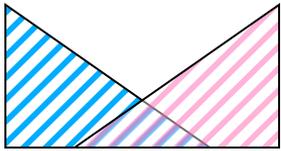
The following enumerate anti-dilution scenarios

- Pre-money of \$3,000,000
- A Round of \$2,000,000
- Post-money of \$5,000,000

- B Round of \$2,000,000

We'll now watch as this plays out under different anti-dilution terms

THIS is the important part – what happens more often – what no one wants to talk about

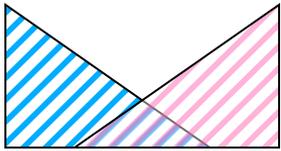


Let's look at anti-dilution and a down round

<u>A Round</u>	<u>Investment</u>	<u>Shares</u>	<u>Ownership</u>
Common		3,000,000	60%
A	\$2,000,000	2,000,000	40%
Post	\$5,000,000	5,000,000	100%
Share	\$1.00		

Regular Anti-Dilution – all parties diluted together

B Round	Investment	Shares	Ownership
Pre money	\$4,000,000		
Common		3,000,000	40%
A	\$2,000,000	2,000,000	27%
B	\$2,000,000	2,500,000	33%
Post	\$6,000,000	7,500,000	100%
% purchase	33.33%		
Share	\$0.80		



It gets worse

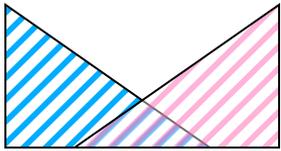
Weighted Average Anti-Dilution formula

$$CP_2 = CP_1 * (A+B)/(A+C)$$

CP1	Last Round Share Price
A	All shares before the Round
B	New Money/Previous Share Price
C	New Shares Issued

Wtd Avg

B Round	Investment	Shares	Ownership	Value
Pre money	\$4,000,000			
Common		3,000,000	38.71%	\$2,322,581
A	\$2,000,000	2,000,000	25.81%	
A adjustment		166,667	2.15%	
B	\$2,000,000	2,583,333	33.33%	
Post	\$6,000,000	7,750,000	1.0000	
New Shares issued	2,583,333			
Share	\$0.77			

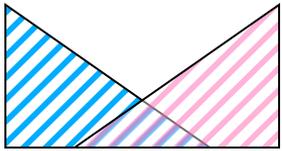


Worse still?

Full Ratchet Anti-Dilution

Jam everything into the pre-money and then
adjust for the investors

B Round	Investment	Shares	Ownership	Value
Pre money	\$4,000,000			
Common		3,000,000	33.33%	\$2,010,000
A	\$2,000,000	2,000,000	22.22%	
A adjustment		1,000,000	11.11%	
B	\$2,000,000	3,000,000	33.33%	
Post	\$6,000,000	9,000,000	1.0000	
Share	\$0.67			



The Cap Table tells your equity story

- Who owns what and why
- The events that shaped the ownership
- Your successes and failures to:
 - Achieve milestones
 - Manage your team
 - Manage your equity assets
 - Raise funds
 - Add value – as perceived by investors
- Type of investors