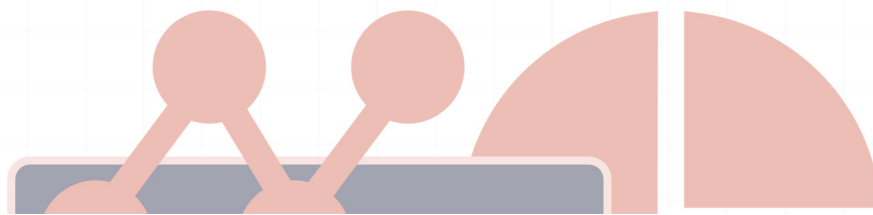
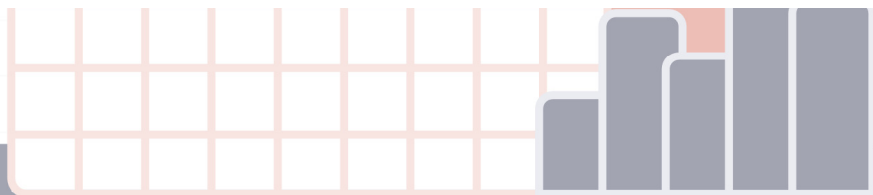


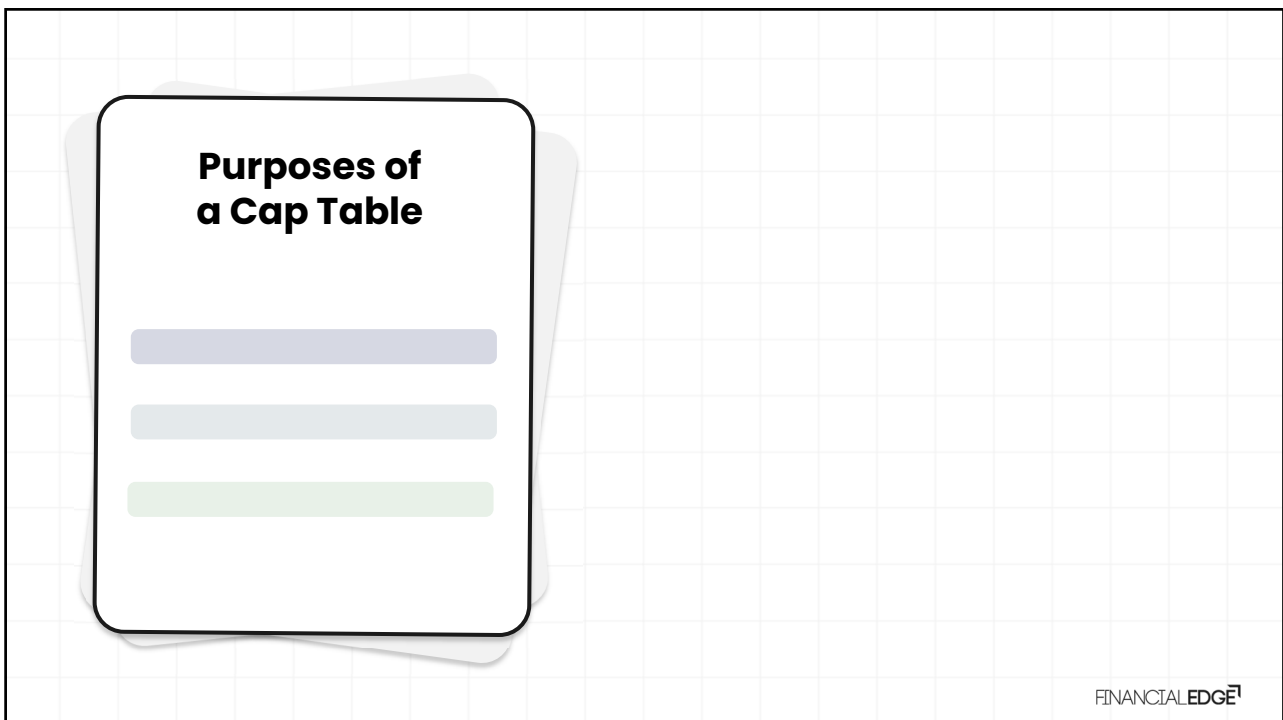
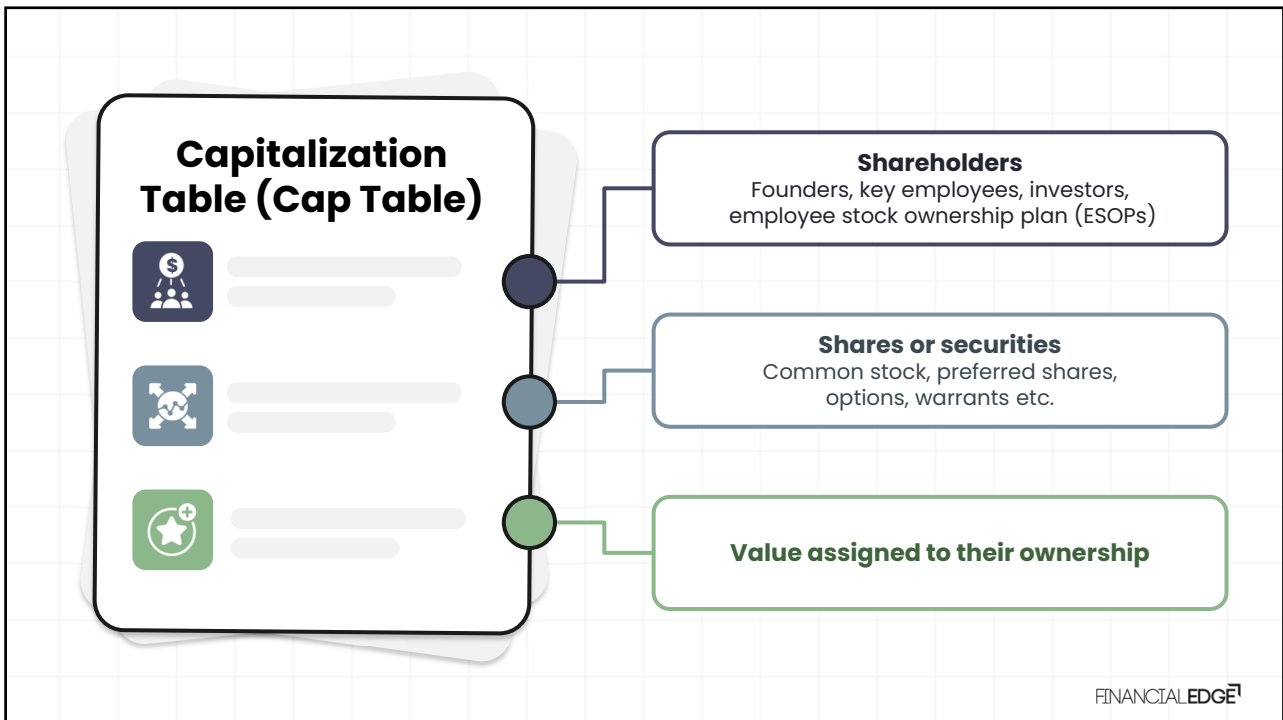


Capitalization Tables



What is a Capitalization Table?





Purposes of a Cap Table

Founders and Employees



Ownership percentage and **dilution**

UPDATED – When a **new round of capital** is raised or a **dilutive event** occurs

FINANCIALEDGE⁷

Purposes of a Cap Table

New Investors



Equity Ownership

Preference Shares (if any)

Company Valuation

FINANCIALEDGE⁷

Purposes of a Cap Table

All Shareholders



What ownership might be **worth at exit**

FINANCIALEDGE⁷

Dilution

The reduction in the **percentage ownership stake** of each shareholder whenever **new shares** of the company are issued.

New shares are issued to **new investors, employees or advisors**

They each receive a **"slice of the pie"**

Founders own **<100%**

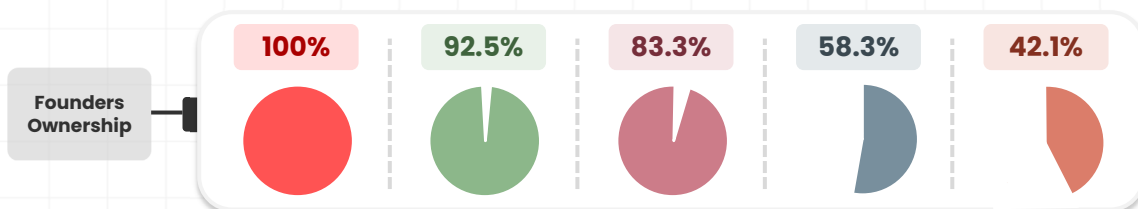
Founders are **most impacted** and **protective** of the number of **shares** they are **willing distribute**

All shareholders on the Cap Table will get **equally diluted**

Exceptions: anti-dilution rights / down rounds

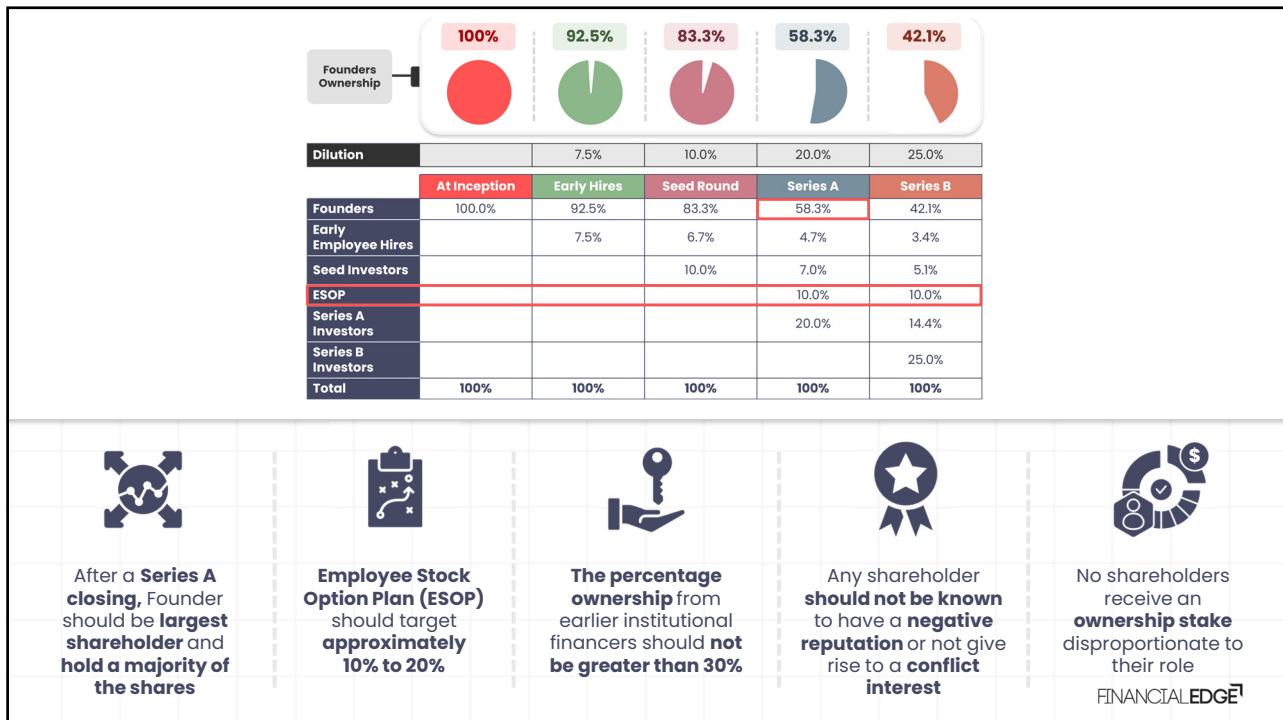
FINANCIALEDGE⁷

Cap Table – Fundamentals

FINANCIALEDGE¹

Dilution		7.5%	10.0%	20.0%	25.0%
	At Inception	Early Hires	Seed Round	Series A	Series B
Founders	100.0%	92.5%	83.3%	58.3%	42.1%
Early Employee Hires		7.5%	6.7%	4.7%	3.4%
Seed Investors			10.0%	7.0%	5.1%
ESOP				10.0%	10.0%
Series A Investors				20.0%	14.4%
Series B Investors					25.0%
Total	100%	100%	100%	100%	100%

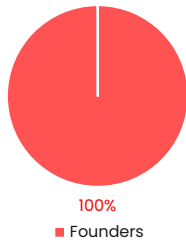
FINANCIALEDGE¹



Cap Table – Early Stage

Inception

Percentage Ownership



Shareholder	Class	%Stake
Founders	Common	100.0%
Total		100.0%

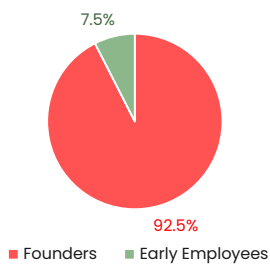


High Growth Companies

Very **rare** to see the founders
keep 100% of the business

Early Employee Option Pool

Percentage Ownership



Shareholder	Class	%Stake
Founders	Common	92.5%
Early Employees	Stock Options	7.5%
Total		100.0%

First dilutive event

Founders carve out an **Option Pool** for early employee hires – ESOP (Employee Stock Option Pool)

Why?



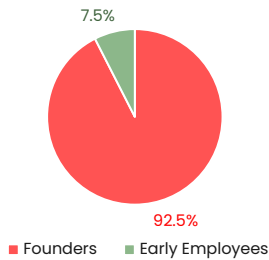
Hiring talented
key employees
is extremely
competitive



Founders need
talented employees
to quickly **develop**
and market test
their product

Early Employee Option Pool

Percentage Ownership



Shareholder	Class	%Stake
Founders	Common	92.5%
Early Employees	Stock Options	7.5%
Total		100.0%

First dilutive event

Founders carve out an Option Pool for early employee hires – ESOP (Employee Stock Option Pool)

Why?



The company will **not have to pay** all compensation in **cash**

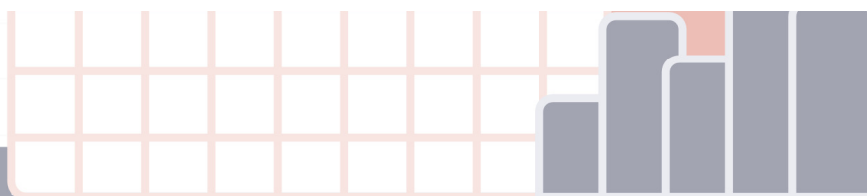


Employees incentivized to **work hard** and help **grow the company**

5% to 10% of the company's shares

FINANCIALEDGE⁷

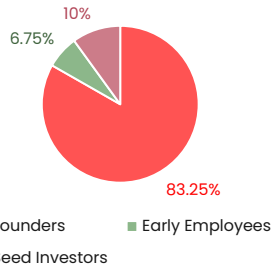
Cap Table – Seed Round



FINANCIALEDGE⁷

Capital Raise and Seed

Percentage Ownership



	At Inception	Early Hires	Seed Round
Founders	100.0%	92.5%	83.3%
Early Employee Hires		7.5%	6.75%
Seed Investors			10.00%



Capital Raise

New investors **offer money** to the business in exchange for **ownership stake**

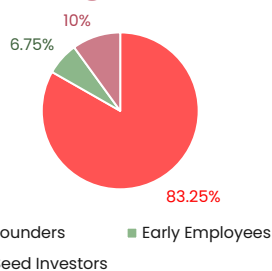
Company creates **brand new shares** for new investors

Founders retain **existing shares held**

FINANCIALEDGE⁷

Capital Raise and Seed

Percentage Ownership



	At Inception	Early Hires	Seed Round
Founders	100.0%	92.5%	83.3%
Early Employee Hires		7.5%	6.75%
Seed Investors			10.00%



Seed

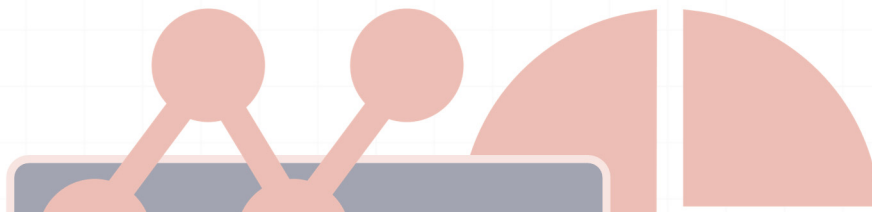
Early-stage investors
(Angel investors, family offices or seed funds)

Acquire **5% – 20%** of the company's shares

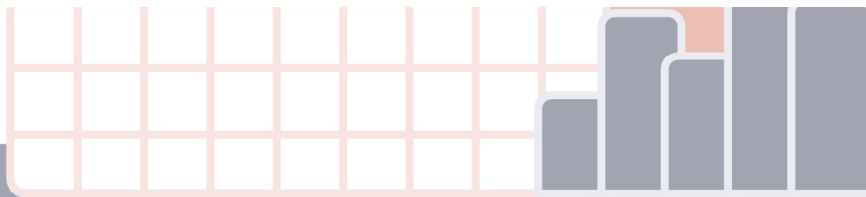
Company received **\$1m capital for 10%**

$$= 92.5\% \times (1 - 10\%) = 7.5\% \times (1 - 10\%)$$

FINANCIALEDGE⁷

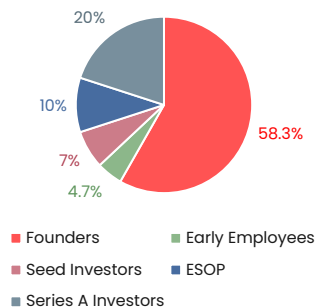


Series A Round

FINANCIALEDGE⁷

Series A

Percentage Ownership



After 12–24 months
(if a company scales successfully)

Next dilution event is the 1st Institutional round, or Series A Round



Often includes **capital injection** and **Employee Stock Option Plan (ESOP)** being set up for employees

FINANCIALEDGE⁷

Two Diluting Events

1



Shares **granted**
to ESOP



Number of **shares** given to
ESOP need to be **grossed up**

2



Shares created for Series A
investor in exchange for
capital injection

So the **desired allocation** is
held after the Series A injection

FINANCIALEDGE⁷

Series A Example

Series A

20%

ESOP

10% (post Series A investment)

$$\text{ESOP post money\%} / (1 - \text{Series A investment\%}) = 10\% / (1 - 20\%)$$

	At Inception	Early Hires	Seed Round	Create ESOP	Series A
Founders	100.0%	92.5%	83.3%	72.8%	58.3%
Early Employee Hires		7.5%	6.8%	5.9%	4.7%
Seed Investors			10.0%	8.8%	7.0%
ESOP				12.5%	10.0%
Series A Investors					20.0%

FINANCIALEDGE⁷



Key Stock Option Terms

FINANCIALEDGE⁷

Employee Stock Options

**Cliff (1-year)****Vesting Term (4-year)**

Effectively a 12 month
probation period



No stock options
awarded or granted

FINANCIALEDGE⁷

Employee Stock Options



Cliff (1-year)



After the Cliff, options are awarded **monthly**

$1/48^{\text{th}}$ x total options awarded

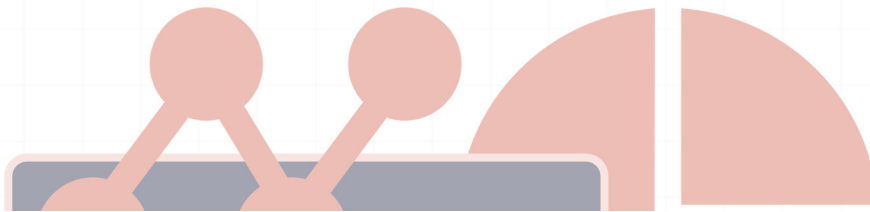


Vesting Term (4-year)

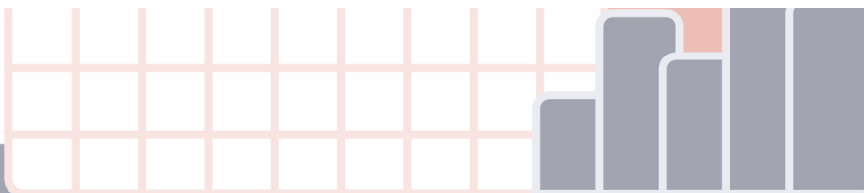
Example:

10,000 Share grant
4-year Vesting term
1-year Cliff

4-year term at:
2,500 shares per year ($10,000 \div 4$), or
208 shares per month ($10,000 \div 48$)

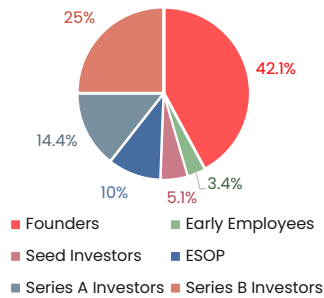
FINANCIALEDGE⁷

Series B Round

FINANCIALEDGE⁷

Series B

Percentage Ownership



Series B

25%

ESOP

$10\% / (1 - 25\%) = 13.3\%$

	At Inception	Early Hires	Seed Round	Create ESOP	Series A	Pool Refresh	Series B
Founders	100.0%	92.5%	83.3%	72.8%	58.3%	56.1%	42.1%
Early Employee Hires		7.5%	6.8%	5.9%	4.7%	4.6%	3.4%
Seed Investors			10.0%	8.8%	7.0%	6.7%	5.1%
ESOP				12.5%	10.0%	13.3%	10.0%
Series A Investors					20.0%	19.3%	14.4%
Series B Investors							25.0%

$$\text{ESOP post money\%} / (1 - \text{Series B investment\%}) = 10\% / (1 - 25\%)$$

FINANCIALEDGE⁷

Setting up a Complex Cap Table

FINANCIALEDGE⁷

Cap Tables typically show **more** than just ownership percentages.
The **components** of a cap table typically include:

FINANCIALEDGE⁷

What Does This Involve?



Complexity around the **number of shares** to issue to the ESOP



VC firms will make use of **external systems** and **advisors** to calculate the **correct number of shares** to issue

FINANCIALEDGE⁷



Liquidation Preference

FINANCIALEDGE⁷

**Liquidation
Preference**



Down Rounds



**Anti-Dilution
Measures**

FINANCIALEDGE⁷



Liquidation Preference



Determines how the company or the "pie" will be **divided in a liquidity event**



Preferred stockholders have **"preference"** over **common stockholders**

Examples:

Sale of the company

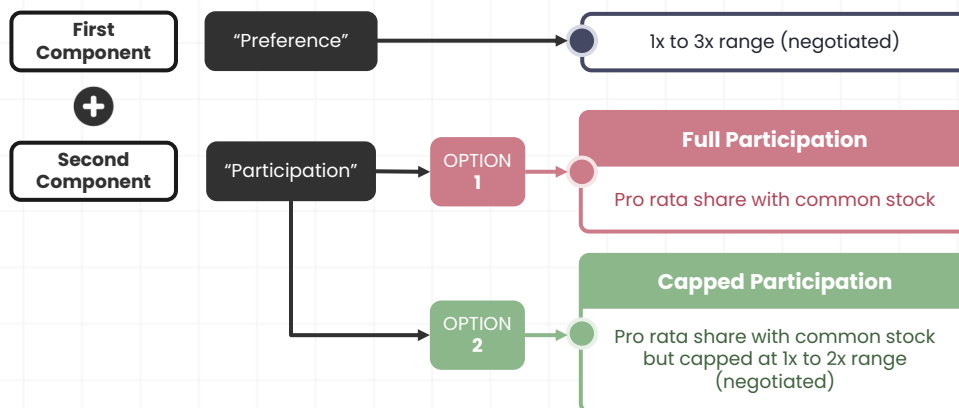
Merger

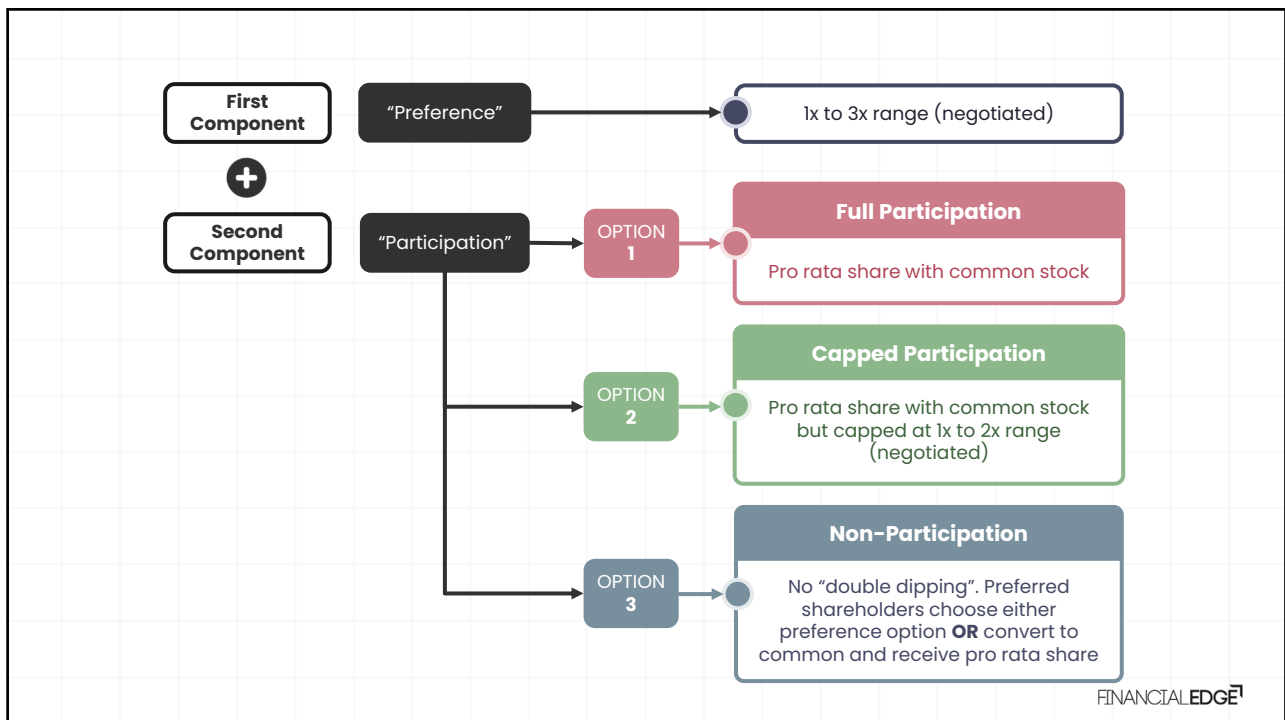
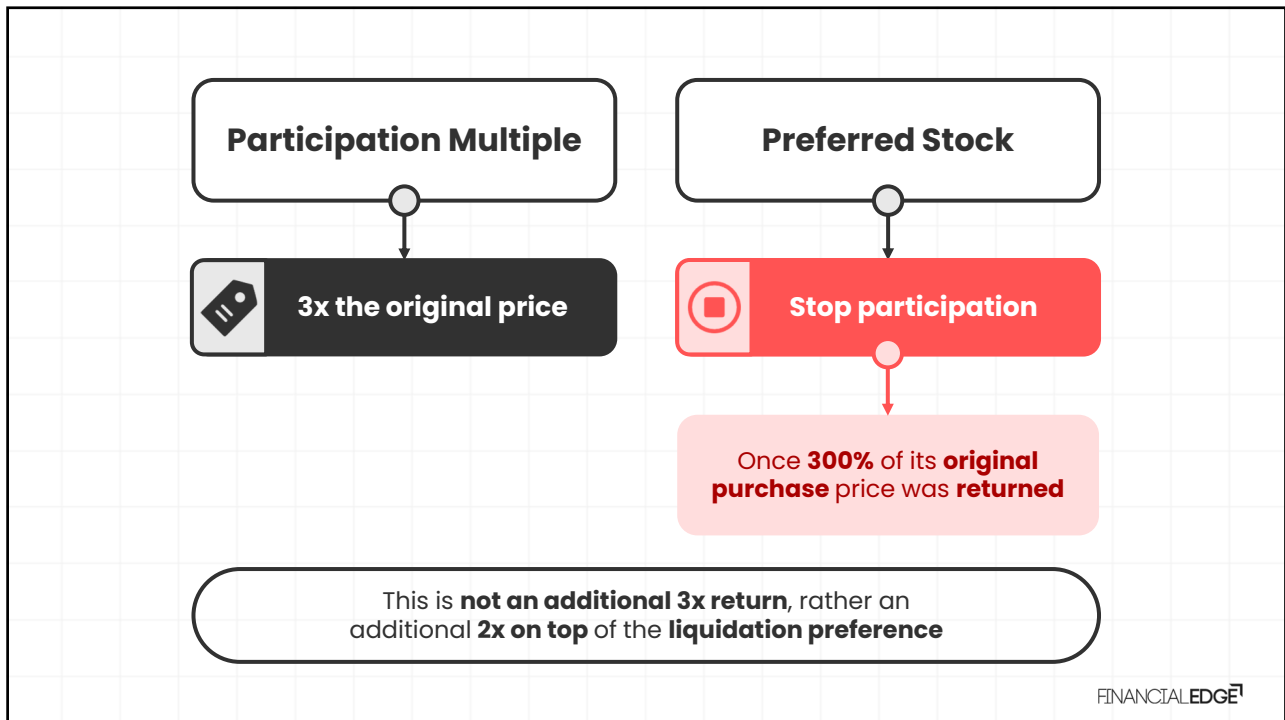
Change of control

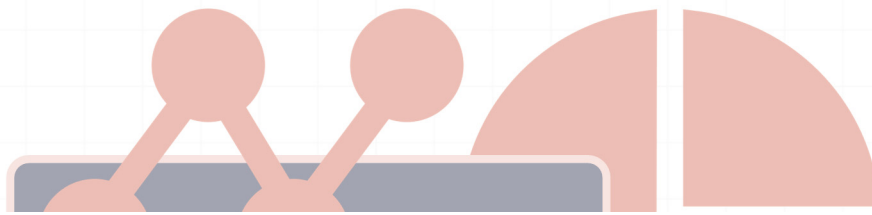
Bankruptcy (insolvency) or wind down

Not a Liquidation Event:

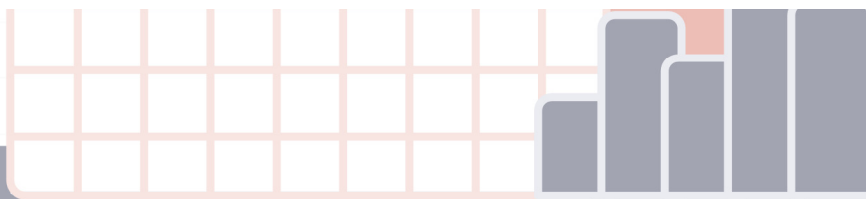
IPO

FINANCIALEDGE⁷FINANCIALEDGE⁷





Down Round

FINANCIALEDGE⁷

Down Rounds

Pre-Money valuation below previous post-money valuation

1

Company has **underperformed**

Failed to reach the **financial** and **operational** benchmarks established at the **last capital round**

2

Overall **valuations** have **dropped**

In a particular sector or more broadly in the tech sector due to **negative macro issues**

3

Shifting momentum in **investment markets**

From founder friendly terms to **investor friendly terms** to return to a balanced approach for **valuation**

4

A negative **internal company issue**

Impacting company's financials, such as a **lawsuit** or a **large asset write-down**

FINANCIALEDGE⁷



Negative investment environment creates an opportunity for companies to address

High cash burn

Cost inefficiencies

Growth strategy

VC Investors

Negotiate to include other favorable terms

Higher liquidation preference at 2 to 3x

Full participating preference feature

Enables new investors to get their **investment back** and **share pro rata**



Investors may be **lured back to invest** in the company at a more realistic valuation

Overcome challenges

Get back on track

FINANCIALEDGE⁷



Impact on Existing Shareholders:

Investment has **declined** in value

Absorb a **greater level of dilution** to raise the same amount of money



Impact on Venture Investors:

A **write-down** of the carrying value of the investment

A **drop** in the reported fund returns

FINANCIALEDGE⁷



Anti-Dilution Measures

FINANCIALEDGE⁷

Anti-Dilution Measures

Mechanisms that protect certain **VC Investors** from the **dilutive effects** that come from **future stock issuances**.



"Price Based"



**"Contractual
Anti-Dilution Adjustment"**

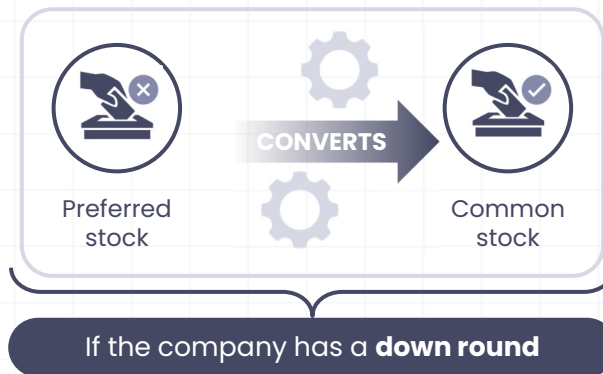
FINANCIALEDGE⁷



Anti-Dilution Measures



"Price Based"

FINANCIALEDGE⁷

Anti-Dilution Measures



"Price Based"

Converts at a 1:1 ratio

FINANCIALEDGE⁷

Anti-Dilution Measures

Cap Table Prior to Down Road

	# Shares	% Stake
Founders	6,000,000	66.7%
Series A Investors	3,000,000	33.3%
	9,000,000	100.0%

FINANCIALEDGE⁷

Anti-Dilution Measures

Adjust Series A Shares with Anti Dilution Provision

	Broad Based Wt. Avg.		Narrow Based Wt. Avg		Full Ratchet	
	# Shares	% Stake	# Shares	% Stake	# Shares	% Stake
Founders	6,000,000	62.2%	6,000,000	57.1%	6,000,000	44.4%
Series A Investors	3,642,857	37.8%	4,500,000	42.9%	7,500,000	55.6%
	9,642,857	100.0%	10,500,000	100.0%	13,500,000	100.0%

FINANCIALEDGE⁷

Anti-Dilution Measures

Cap Table Post Series B Down Round

	Broad Based Wt. Avg.		Narrow Based Wt. Avg		Full Ratchet	
	# Shares	% Stake	# Shares	% Stake	# Shares	% Stake
Founders	6,000,000	44.8%	6,000,000	42.1%	6,000,000	34.8%
Series A Investors	3,642,857	27.2%	4,500,00	31.6%	7,500,000	43.5%
Series B Investors	3,750,000	28.0%	3,750,000	26.3%	3,750,000	21.7%
	13,392,857	100.0%	14,250,000	100.0%	17,250,000	100.0%

FINANCIALEDGE⁷

Conversion Ratio



Weighted Average

Involves a **formula** that compares:

Vs.

The number of **shares issued** to new investors if they paid the **same price** as the earlier investors

The number of **shares issued** to the new investors at the **lower price**



Full Ratchet

"Broad-based" weighted average formula

Lessens the **dilution impact** on the common stockholders

"Narrow-based" weighted average formula

More favorable to the **investors**

FINANCIALEDGE⁷

Conversion Ratio



Weighted Average



Full Ratchet



Lowers the effective purchase price of the **protected stock** to the actual price paid in the **down round**

Results in a **larger conversion rate** adjustment than a weighted average provision

Founders could **lose** their **majority stake** and **control** of their company

Certain **stock issuances** are **excluded** from the anti-dilution mechanism:

Options issued to employees

Advisors or warrants – line of credit

FINANCIALEDGE⁷

Calculating Adjusted Conversion Ratio



= # Of shares outstanding prior to new down round



= Total investment in # new down round / prior conversion price



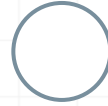
= # Of shares issued in the new down round

$$\text{Conversion price} = \text{Prior conversion price} \times \left(\frac{a + b}{a + c} \right)$$

FINANCIALEDGE⁷

Adjusting the Conversion Ratio

1



Founders

Diluted in all three down round scenarios

Broad based weighted average price provides better protection

No anti-dilution protection is the best option for founders

FINANCIALEDGE⁷

Adjusting the Conversion Ratio



2



Series A Investors

Diluted only under 1st and 2nd option

Much lower percentage dilution than founders

Full ratchet pricing option is better for Series A investors

FINANCIALEDGE⁷



Anti-Dilution Measures

Mechanisms that protect certain **VC Investors** from the **dilutive effects** that come from **future stock issuances**.



"Price Based"



"Contractual Anti-Dilution Adjustment"

FINANCIALEDGE⁷

Anti-Dilution Measures



"Contractual Anti-Dilution Adjustment"



Investors have the right to receive **shares of common stock** necessary to **protect them from dilution**



If in place for **early-stage Angel investors**, this would **need to be terminated** before VC investors invest

FINANCIALEDGE⁷

FINANCIALEDGE⁷
www.FE.training

Please do not redistribute these materials without the
express permission of Financial Edge Training.