Enterprise and the Entrepreneur

Homework assignment for OmSys capital structure design (2019 version)

You and two other partners are going to form a business called OmSys. Your company specializes in setting up computer-based remote monitoring of sensing equipment with embedded systems. You and your partners have written a lot of software to make all of this work, but you don't sell the software after having concluded that there is no real money to be made in one-time software sales. Instead you design and build full turnkey systems that rely on your software, and you require your clients to sign expensive maintenance support contracts.

You are not the primary programmer for this group, but you are the only partner with any real business experience. You are the primary author for the group's business plan and, more important, you are providing $100,000 in seed capital. An Angel investor has also agreed to provide $100,00 but will not work for the company. The other partners are providing no money. The business was largely your idea and it is clear that you are going to be responsible for most of the business work, whereas the others will dedicate their efforts to the technical side of the business. The four of you sit down and you propose that OmSys Inc. be created with the following distribution of ownership:

You:	40%
Angel investor:	20%
Rachael:	20%
Soonlee:	20%

You have decided that you are going to strategically structure this company to raise money privately in two more steps, then attempt an IPO or put the company up for sale in five years. You explain to you partners that none of this may actually happen, but you want to set strategic business targets as though this is your intent. You all know that your $200,000 will last you no more than 6 months.

Your business plan anticipates that you will have net income of $6,000,000 in the fifth year of your business (you will have a $1,500,000 quarter). You have been told that an acceptable PE assumption for startups of this type is now around 40. You are therefore going to develop a corporate structure that meets the following assumptions:

1. You want to sell 25% of your company to first-tier financiers for between $1,000,000 and $1,500,000. $1,000,000 is the **minimum** you must have. You also want to offer a return of their investment of at least 25X.
2. You want to sell an additional 25% of the company to second-tier private placement financiers for about $4,000,000 (**minimum**) to $6,000,000. You want to promise them at least 20X to 30X.
3. On you IPO, you want to sell about 20% of your diluted company. You will assume a default IPO price of $18 to $25 per share, but are willing to change that considerably.
4. You will set aside 10% of the final (post-IPO) company of employee stock option plans.

These numbers are subject to adjustment after the capitalization plan is created. Create the capitalization plan.

Note: There is no precise answer for this case study. You have to tinker around with the numbers some to make this work.