How to Build a Simple VC Cap Table

Cap Table Mechanics

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VC term sheet review

- So far, we have covered:
  - The respective negotiating positions of venture capitalists and entrepreneurs
  - How capital return expectations, timelines, valuation, control rights and liquidity influence these negotiating positions
  - How term sheets are used to manage potential differences at time of investment

The VC cap table

- We now turn to the cap table:
  - The term sheet's impact on a cap table
  - The mechanics associated with adding a new investor
  - Debt conversion
  - Calculating price per share
  - Calculating ownership percentages

Cap Table Overview

- When analyzing a new investment round, a capitalization table ("cap table") provide a summary of various capital providers' ownership in the business
- In addition, a cap table typically includes an analysis of expected returns and proceeds to various providers of capital based on certain exit valuation assumptions
- Recall, the new investment determines the post-money valuation
  - Example: $25m investment for 25% ownership implies a post-money valuation of the business of $25m/25% = $100 million
- Pre money valuation is determined by subtracting the investment from the post money valuation
  - In the above example, the pre-money valuation is $100m - $25m investment = $75m

Sample Cap Table

Classes of shareholders

Total Shares & Ownership %

Startup.com - Cap Table Post Financing

New round October 2009	$8m
Pre-money valuation	$12m

	Share Capital							
Investor	Common	Series A	Series B	Options	Warrants	New Options (Pre)	NOSH	% Ownership
ABC Co.		40,739,801	8,543,828		115,568		49,399,197	43.4%
Individual Investors	338,149	797,113		1,134	49,025		1,185,421	1.0%
Hill Investors	-				17,830		17,830	0.0%
Bank of America	3,720			1,677	203		5,600	0.0%
New Investors			37,023,255				37,023,255	32.5%
Directors	210,070	520,649		89,465	8,376		828,560	0.7%
Founder	68,367	384,826		1,074,679	6,108		1,533,980	1.3%
CEO				1,142,942			1,142,942	1.0%
Other current employees	2,302			1,222,342	974		1,225,618	1.1%
Former employees	22,712			24,289	2,936		49,937	0.0%
Unallocated options				97,863		21,407,505	21,505,368	18.9%
Total	**45,320**	**42,442,389**	**45,567,083**	**3,654,391**	**201,020**	**21,407,505**	**113,917,708**	**100.0%**
% Total	57%	37.26%	40.00%	3.21%	0.18%	18.79%	100.00%	

Names / titles of investors; usually founders first followed by execs followed by investors

Potentially dilutive securities

Exercise 1: Impact of simple VC investment

- Assume VC asking for **40% of company** with investment of **$7 million**
- Company already has **500,000** outstanding shares

Please answer the following two questions

1. How many new shares does VC get with investment?
2. What would be the price per share issued?

Exercise 2: Impact of simple VC investment + option pool

- Same as before but now assume company needs to also **reserve 20% of shares for option pool**
- Remember that option pool usually comes out of founder pool - i.e. pre-money
- VC still wants **40%** with investment of **$7 million**
- Company already has **500,000** outstanding shares

Please answer the following two questions

1. How many new shares does VC get with investment?
2. What would be the price per share issued?

Exercise 3: Impact of additional VC round

- Same as before but now assume **another VC wants 10%** for **$5 million**
- Company still needs to **reserve 20% of shares for option pool**
- VC still wants **40%**
- Company already has **500,000** outstanding shares

Please answer the following two questions

1. How many new shares does VC get with investment?
2. What would be the price per share issued?

Exercise 4: Impact of convertible debt

- Company has **2,050,000** common shares, company also has **$1 million convertible debt**
- Convertible not reflected on cap table until conversion in next round at the new round price per share
- New investment round: **$2.5 million investment**
- Agreed upon pre-money valuation **$7.5 million** / post-money valuation **$10 million**

Please complete the following table:

	Shares	% ownership
Company shares	2,050,000	
Investor shares		
Convertible shares		
Total shares (post conversion)		
Price per share		

Extra credit: Recut the table assuming the convertible notes were given a 30% discount on the price per share for conversion purposes.

Exercises

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Exercise 1: Cap Table Calculations of Adding a New Investor

- Assume that you are venture capitalist, and are weighing a decision to invest in ABC Co.
- You are given their Series A cap table showing a $7.5M pre-money valuation and 2,050,000 common shares outstanding
- Today, the CEO has majority control with 61.0% (1,250,000 shares)
- There are three other investors: Investor 1 with 24.4% (500,000 shares), Investor 2 with 2.4% (50,000 shares) and Investor 3 with 12.2% (250,000 shares)
- There is no convertible debt or current outstanding options
- Model the Series B round assuming your firm is the only investor at $2.5M for 25% and the inclusion of a 20% option pool (pre-money)
- For discussion, how would you model option pool post-money?

Exercise 2: Cap Table Calculations of Debt Converting

- Building on Exercise 5:
  - Now assume $1 million in convertible debt
- Model impact of debt converting into common shares prior to new round
- Who is impacted by debt converting?
- For discussion, how would you model debt converting in current round? Why would new investors be against this? What is a potential scenario where this could happen? How would they attempt to counter dilution?

Exercise 3: Flow of Funds

- Let's discuss an example to highlight concept behind flow of funds:
  - Two investors, A and B (incidentally, also their series)
  - A invested $5M and owns 25% with a 1x participating preference and 2x cap
  - B invested $7.5M and owns 40% with a 1x participating preference and 3x cap
  - Preferences are stacked
  - Common owns rest
  - Company sells for $50M
  - How much does each investor get?

- Learned about the respective negotiating positions of venture capitalists and entrepreneurs
- Discussed how capital return expectations and timelines influence these negotiating positions
- Highlighted VC valuation method
- Identified how term sheets are used to manage potential differences at time of investment (e.g. control rights)
- Highlighted the term sheet's impact on a cap table
- Review cap table mechanics associated with adding a new investor, option pool, debt conversion, etc.
- Calculated price per share and ownership percentages
- Highlighted waterfall flow of funds