

# Capitalization Tables: who owns what and how much

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# 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

	<b>Units</b>	<b>Investment</b>	<b>%</b>
Sci Fo 1			60.0%
Sci Fo 2			40.0%
<b>Total</b>			100%

**Editorial:** DO NOT split the company 50, 50

- problem if one leaves
- good leadership

## They negotiated a deal with a CEO

	<b>Units</b>	<b>Investment</b>	<b>%</b>	<b>50%</b>
CEO			50.0%	
Sci Fo 1			30.0%	
Sci Fo 2			20.0%	
<b>Total</b>			<b>100%</b>	

- 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%	
<b>Total</b>			100%	

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

## Here 'come da Board...here 'come da Board

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

- 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%	
<b>Total</b>			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%
<b>Total</b>	<b>10,000,000</b>		<b>100%</b>

- 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%
<b>Total</b>	<b>12,000,000</b>		<b>100%</b>

- 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	<b>\$0.0001</b>			
	<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
<b>Total Common Stock</b>	<b>2,000,000</b>	<b>\$200</b>	<b>100%</b>	<b>\$200</b>

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	\$5,000,000	5,000,000	100%	
Share	\$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	\$15,000,000	9,500,000	100%	
Share	\$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	\$40,000,000	12,000,000	100%	
Share	\$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

<u>B Round</u>	<u>Investment</u>	<u>Shares</u>	<u>Ownership</u>
Pre money	<b>\$4,000,000</b>		
Common		3,000,000	40%
A	\$2,000,000	2,000,000	27%
B	\$2,000,000	2,500,000	<b>33%</b>
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	<b>\$4,000,000</b>			
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	<b>33.33%</b>	
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	<b>\$4,000,000</b>			
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	<b>\$2,000,000</b>	3,000,000	<b>33.33%</b>	
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