



The Rising Tide Program

The Basics of Cap Tables

September 14, 2016

Trevor Chaplick,
Partner, Greenberg Traurig

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- Yes, you'll get the slides
- We're recorded, so come back and listen again

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OUR SPEAKER



Trevor Chaplick
Shareholder
Greenberg Traurig

- Washington D.C. based
- Experienced Securities attorney
- Practice focused on representing technology and growth companies, underwriters, private equity firms, and venture capital funds.
- Domestic and international experience with both public and private companies.
- CPA in the state of Virginia, experience with Arthur Andersen LLP
- Prior legal experience with Proskauer Rose, Wilson Sonsini

Topics We'll Explore Today

- What Role Cap Tables Play in Early Stage Financing
- How Angels Should Use Cap Tables
- Key Terms and Variables to Understand
- Case Study: One Company over Multiple Rounds

ACA: The Basics of Cap Tables

Objectives of this Webinar:

- Explain the purpose of a capitalization table (“Cap Table”)
- Discuss how Cap Tables are used in connection with financings and thereafter
- Show how a Cap Table is created and used through a case study
- The case study will walk through three financings and illustrate the effect on founders and angels from dilution
- We will conclude by showing two different M&A scenarios illustrating how a Cap Table is used for the allocation of proceeds from a sale of the company

Designed to build upon the ACA presentation on Cap Tables given earlier this year.

Today will involve a detailed case study using an excel spread sheet

Q&A if we have time at the end

Our primary objective is to give you a higher level of comfort with Cap Tables.

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Start with the Basics: what is a Cap Table?

Why do investors sometimes refer to it as a “Pro Forma Cap Table”?

When and how are they used?

Basic Principle for Financings: Cap Tables should quantify your ownership

North Star: Negotiation of Pre-money valuation (PMV) is really negotiation of your ownership percentage in the Company. Ownership percentage is a function of PMV and Aggregate Dollars Invested (ADI).

Key Formula: $(ADI) \div (PMV + ADI) = \text{Ownership Percentage}$

For venture investments, your ownership percentage = the percentage resulting from this basic formula.

Any option pool increase should NOT affect your ownership percentage from the above formula

These basic rules of the road should apply at every stage of financing regardless of industry sector.

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For Cap Table purposes, you only need to remember two things:

1. It is the increase in the option pool that you negotiate, and
2. Such increase should NOT affect (i.e. decrease) your percentage interest based on the formula we discussed.

Again, remember your North Star: $(ADI) \div (PMV + ADI) = \text{Ownership Percentage}$

The negotiation of the increase in the option pool is ultimately subject to negotiation based on the circumstances but several variables will affect the discussion

All else being equal, a reasonable rule of thumb is that the increase in the option pool should be sufficient to cover all prospective hires for the period the aggregate financing proceeds are projected to cover.

It is important to remember that this percentage can vary significantly based on the individual circumstances

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Background: We will use an excel spreadsheet beginning with the formation of a company and walk through an angel seed financing and two subsequent preferred stock financings. We will show you how a Cap Table is calculated for each such financing event. We will conclude with an M&A event showing the distribution of proceeds assuming two different scenarios of sale proceeds.

Scenario #1: First Funding with Series Seed Preferred Stock

- Initial issuance of common stock in equal shares to founders
- Pre-money valuation of \$3,000,000
- Aggregate investment by angels of \$1,000,000 in Series Seed Preferred Stock
- Post-money options + pool of 15% of capitalization
- Post-money value of \$4,000,000
- Series Seed Preferred is “non-participating” preferred

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Scenario #2: Second Funding with Series A Preferred Stock

- Pre-money valuation of \$10,000,000 (increase in valuation of \$6 million from prior round)
- Aggregate investment by institutional investors of \$8,000,000 in Series A Preferred Stock
- Conversion of \$2,000,000 of outstanding bridge debt based on the price per share of Series A Preferred
- Total proceeds from investment and bridge conversion of \$10,000,000
- Warrants for 100,000 shares of Common Stock issued to bridge note holders issued on a pre-money basis
- Post-money options + pool of 20% of capitalization
- Post-money value of \$20,000,000
- Series A Preferred “non-participating” preferred
- Senior in priority to Series Seed Preferred

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Scenario #3: Third Funding with Series B Preferred Stock

- Pre-money valuation of \$15,000,000 (decrease in valuation of \$5 million from prior round)
- Aggregate investment by institutional investors of \$15,000,000 in Series B Preferred Stock
- Post-money options + pool of 15% of capitalization
- Post-money valuation of \$30 million
- Operation of “ratchet” of Series A Preferred for price-based anti-dilution protection (adverse impact of dilution on founders and Series Seed Preferred investors)
- Series B Preferred has “participating” preferred right
- Senior in priority to both the Series Seed Preferred and Series A Preferred

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Sale Scenario #1: Sale of Company for Net Proceeds of \$50,000,000

- Need to first follow the order of priority for the preferred
- Each preferred series needs to be tested for payment of preference vs. the amount payable upon conversion
- Series B Preferred also needs to test whether its participation cap applies
- The foregoing process is referred to as the preferred “waterfall”
- Note that neither Series Seed Preferred or the Series A Preferred receives enough to justify being paid on an as-converted basis
- The participation cap for the Series B Preferred is not applicable either

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Sale Scenario #2: Sale of Company for Net Proceeds of \$100,000,000

- Both Series Seed Preferred and Series A Preferred receive more upon conversion than the amount of preference
- Series C Preferred return is limited by the 3X cap on participation
- At \$100M net proceeds, the Series C Preferred is in the “dead zone”, i.e. it is not receiving enough proceeds to justify conversion
- Excess amount otherwise payable to Series C Preferred is allocated to all other holders of common stock and to the Series Seed Preferred and Series A Preferred as each such series converts

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Take-away Lessons

1. Use a Cap Table to discipline the negotiation process for both the calculation of price per share and your resulting ownership percentage
2. North Star: Negotiation of Pre-money valuation (PMV) is really negotiation of your ownership percentage in the Company
3. Key Formula: $\text{Aggregate Dollars Invested (ADI)} \div (\text{PMV} + \text{ADI}) = \text{Ownership Percentage}$
4. The increase in the option pool must be negotiated and calculated on a pre-money basis so that your ownership percentage is unaffected from the above formula
5. The amount of money raised and the terms of subsequent financings can have a dramatic dilutive effect on your ownership percentage and resultant share of proceeds in a sale of the company
6. A Cap Table spreadsheet can be a very valuable tool for both monitoring your investment during the life of a company and for calculating your share of any sale of the company

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Q & A Session

The Rising Tide Program

Additional Resources



<http://bit.ly/2cDmlls>



Podcast

<http://bit.ly/2cq5TDP>



Trevor's Contact Information



Trevor J. Chaplick
chaplickt@gtlaw.com
Direct: +1 202.331.3151
2101 L Street, N.W.
Suite 1000
Washington, DC 20037

Thank you!

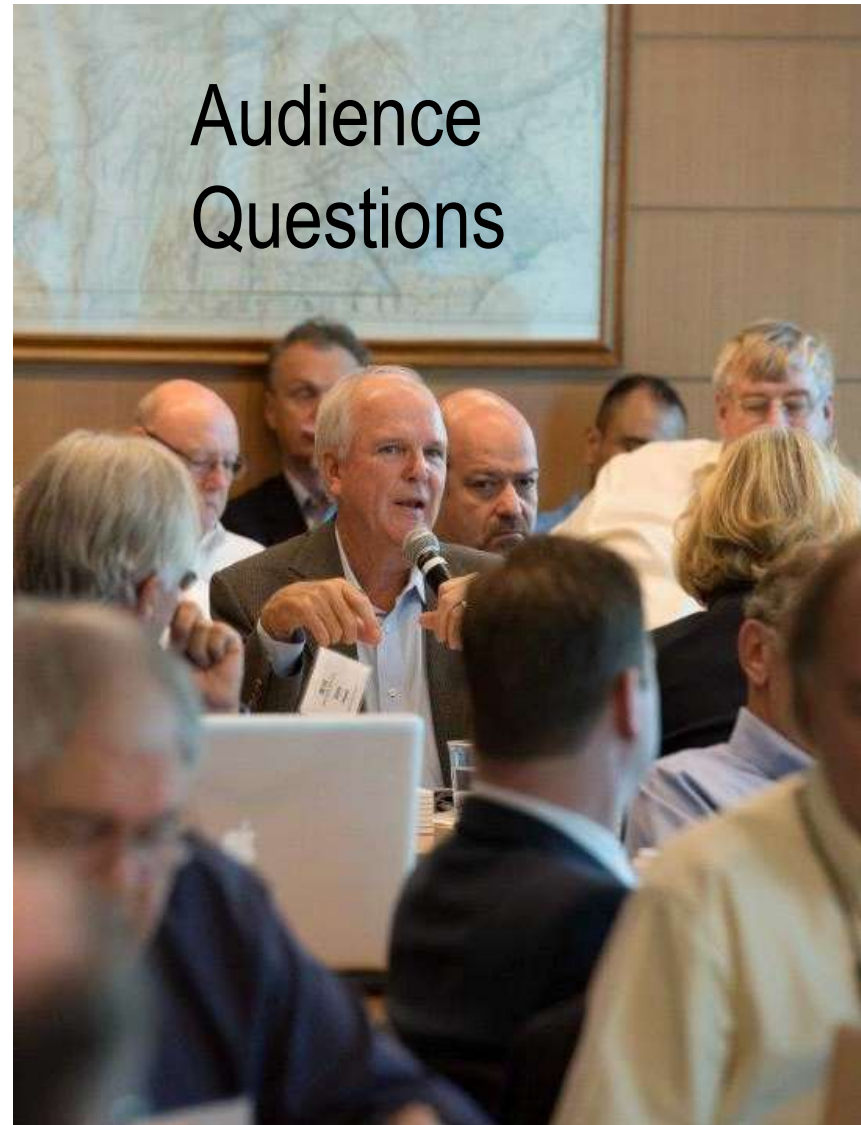
Upcoming Webinars

September 28, 2016: How Angels and
Entrepreneurs can Leverage NSF Grants

October 12: After the Check is Written: 7 Tactics
that Increase the Chance of Returns

October 26: Top Ten Things Early Stage
Companies Need to Know about Cybersecurity

Webinar programs archived
at: www.angelcapitalassociation.org/events/webinars/



Additional Resources



Forbes

Marianne Hudson
Executive Director
Angel Capital Association



<http://www.angelcapitalassociation.org/news-forbes/>



Inc.
Handbook of the American Entrepreneur

Christopher Mirabile
Managing Director, Launchpad;
Board Chair, Angel Capital
Association



<http://www.angelcapitalassociation.org/news-inc/>

Upcoming ACA Events

- September 22, 2016, Best of the Midwest, Minneapolis MN
- October 4, 2016, New England Regional, Boston, MA
- October 13, 2016, SW Regional Meeting, Phoenix AZ
- November 8 – 9, 2016, Angel Insights Exchange, Nashville TN
- <http://www.angelcapitalassociation.org/events/>



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