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**“Gotcha”  
Deal Terms/Features to  
Watch For**

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# Topics

- “Pre-Money Valuation” vs. “Post-Money Valuation”
- Skeleton’s in the Cap Table
- Preemptive (e.g. participation) Rights
- Valuation “Caps” On Conversion
- Non-Converting Debt – Priority Upon Liquidation

# “Pre-Money Valuation” vs. “Post-Money Valuation”

- Pre-money Valuation is used to determine the pre share purchase price for an equity financing

- The *per share* price for the financing = 
$$\frac{\text{Pre Money Valuation}}{\text{Shares Outstanding (prior to the Financing)}}$$

- Shares outstanding is typically “*fully diluted*”
- “Fully diluted” usually includes
  - (1) outstanding shares, as converted to common stock after accounting for any conversion rate adjustment that results from the financing (e.g. anti-dilution protection);
  - (2) shares reserved for exercise of outstanding equity awards (e.g. options);
  - (3) shares reserved for future equity awards (e.g. the available “pool”) – including any increase to the pool that will occur in connection with the financing; and
  - (4) shares reserved for the exercise/conversion of other outstanding securities, including SAFEs, convertible notes, and warrants.

# “Pre-Money Valuation” vs. “Post-Money Valuation”

- Post-money valuation = *Shares Outstanding after Financing* × *Per Share Price in Financing*
  - Shares outstanding is typically “*fully diluted*”
  - Post-money valuation may not equal Pre-money valuation + Amount invested in financing if:
    - Convertible/exercisable securities were issued in the financing for no additional consideration
      - e.g. issuing warrants will increase post-money valuation before being exercised
    - All of items (1)-(4) on prior slide were not included in the pre-money valuation
      - e.g. option pool was increased in connection with financing but not included in pre-money valuation

# Example Pro-Forma for Valuation Calculations

Example Company				
Capitalization Table				
Series A Financing Pro Forma				
	Pre-Financing		Post-Financing	
	Shares Outstanding/ Reserved	% Fully Diluted	Shares Outstanding/ Reserved	% Fully Diluted
Common Stock Outstanding	7,000,000	87.50%	7,000,000	60.87%
Common Warrants	5,000	0.06%	5,000	0.04%
Options Outstanding	495,000	6.19%	495,000	4.30%
Available Option Pool	500,000	6.25%	1,500,000	13.04%
<b>Total Common Stock</b>	<b>8,000,000</b>	<b>100.00%</b>	<b>9,000,000</b>	<b>78.26%</b>
Series A Issued upon SAFE Conversion			1,000,000	8.70%
Series A Issued for New Money			1,000,000	8.70%
Series A Warrants Issued in Financing			500,000	4.35%
<b>Total Preferred Stock</b>	<b>0</b>	<b>0.00%</b>	<b>2,500,000</b>	<b>21.74%</b>
<b>Total Fully Diluted Capitalization</b>	<b>8,000,000</b>	<b>100.00%</b>	<b>11,500,000</b>	<b>100.00%</b>
Series A Share Price	\$ 1.00			
Pre-Money Valuation	\$10,000,000			
Amount of New Investment			\$1,000,000	
Post-Money Valuation			\$11,500,000	

# Skeleton's in the Cap Table

- Watch for things that “blow up” or cause a “death spiral” in the cap table
- Examples include:
  - Anti-dilution shares for prior advisors, incubators, etc
  - Warrants or other securities that are for a set % or valuation
  - Other promises of % ownership that live through or beyond the financing
- These make it extremely difficult to determine a share price based on valuation, because the fully-diluted shares outstanding keeps going up as the price goes down and/or they require the investors to take unexpected dilution

# Preemptive Rights

- Allows investors the right to keep % ownership through future rounds (by investing more)
- Sometimes disappear after your first failure to invest at *pro rata* in a future round
  - Keep some “dry powder” for future investments
- Most often can be waived by less than 100% of rights holders
- Frequently only available for investors above a certain \$\$ threshold (e.g. not all small investors have these rights)

# Valuation “Caps”

- Included in unpriced rounds (e.g. SAFE, convertible debt)
- Increasing in popularity among early-stage investors
- Allows investors to set maximum valuation level without actually setting valuation for current round
- Effectively places a maximum conversion price on the security
- But, influences future valuation

# Watch out for Non-Converting Debt

- In Liquidation/Dissolution (in general):
  - **First:** Secured Debt
  - **Second:** Unsecured Debt
  - **Last:** Equity (e.g. stockholders)
- Consider for:
  - Maturity dates
  - Equity investments
- But... “equity like instruments”

# Resources

- [www.cooleygo.com](http://www.cooleygo.com)

# Questions

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