



A Striking Explanation of VC Mechanics

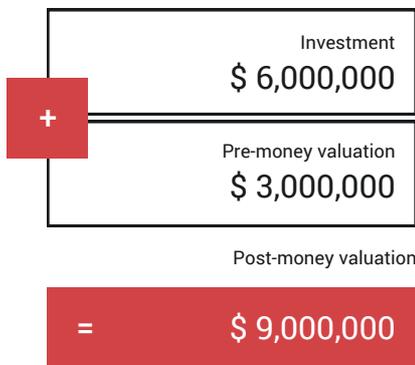


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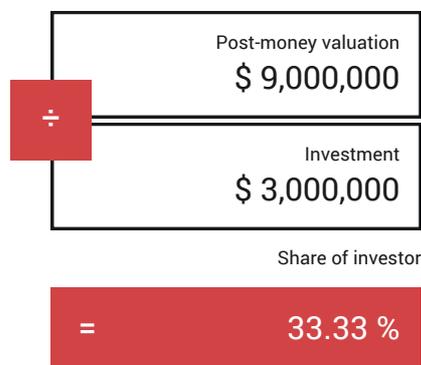
Financing Rounds - Basic

Based on a simple sample financing round, the infographics give an introduction to the basic concepts of startup funding.

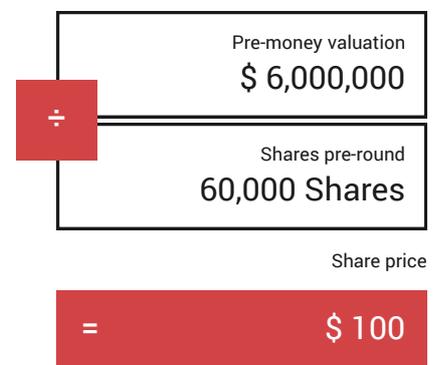
1) Post- money valuation



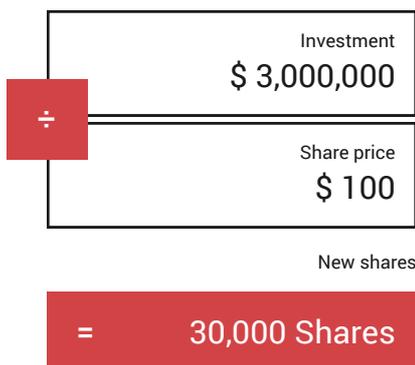
2) Share of investor



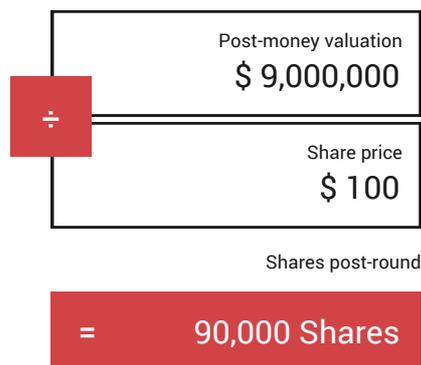
3) Share price at financing round



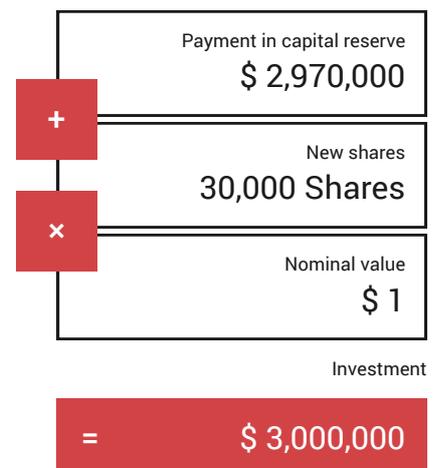
4) New shares issued in the current financing round



5) Shares post-round



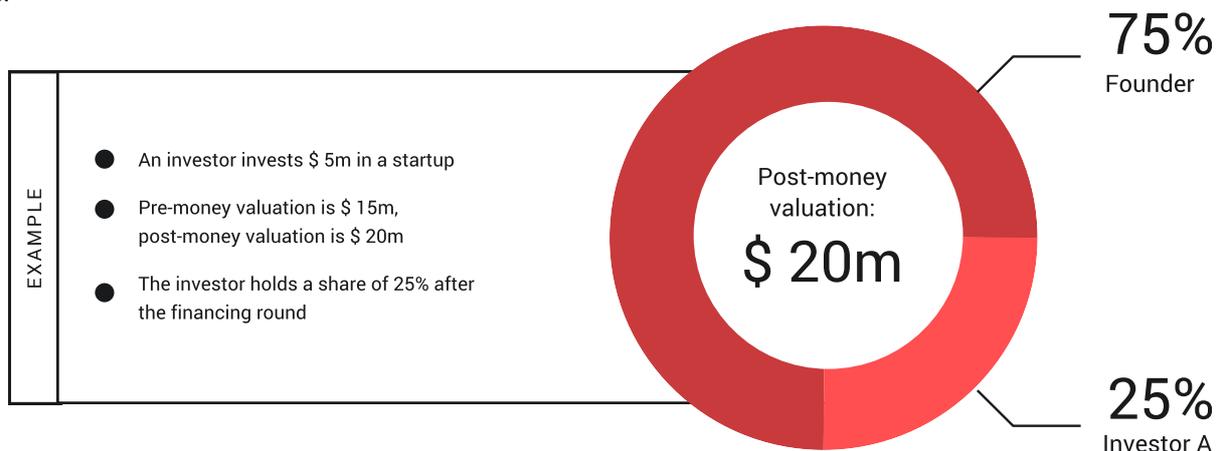
6) Investment amount split



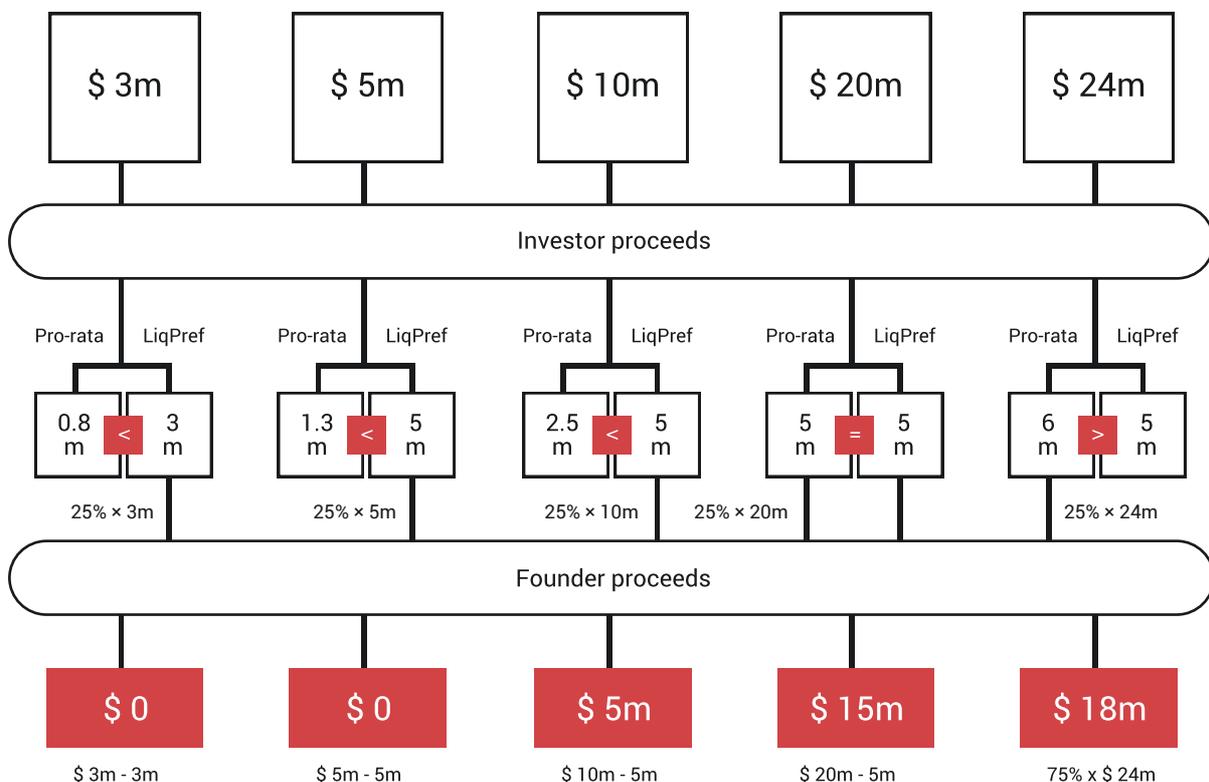
How a liquidation preference functions

1) 1 X Non-Participating Liquidation Preference

In case of an exit, investors with preferred shares receive the higher amount: Their investment OR their pro-rata share.



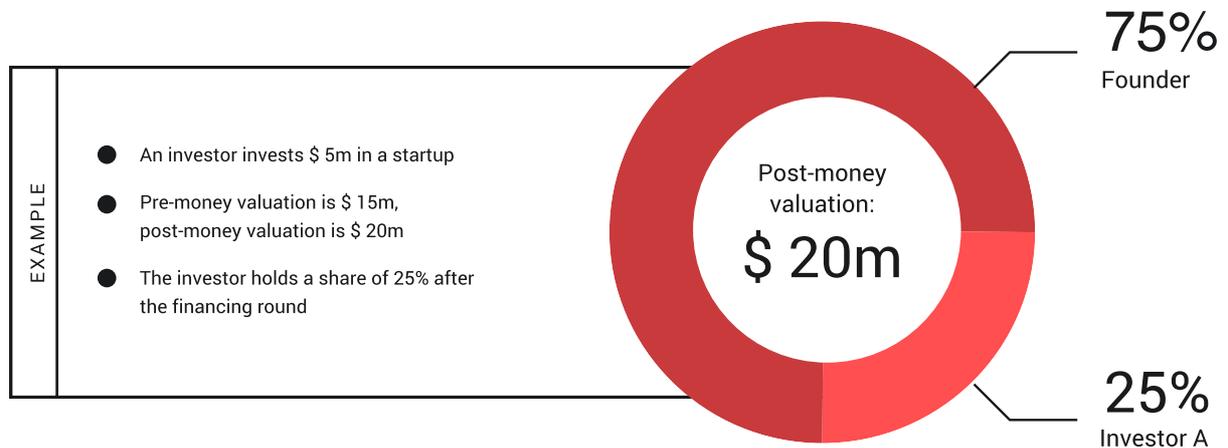
Distribution of Proceeds at Exit



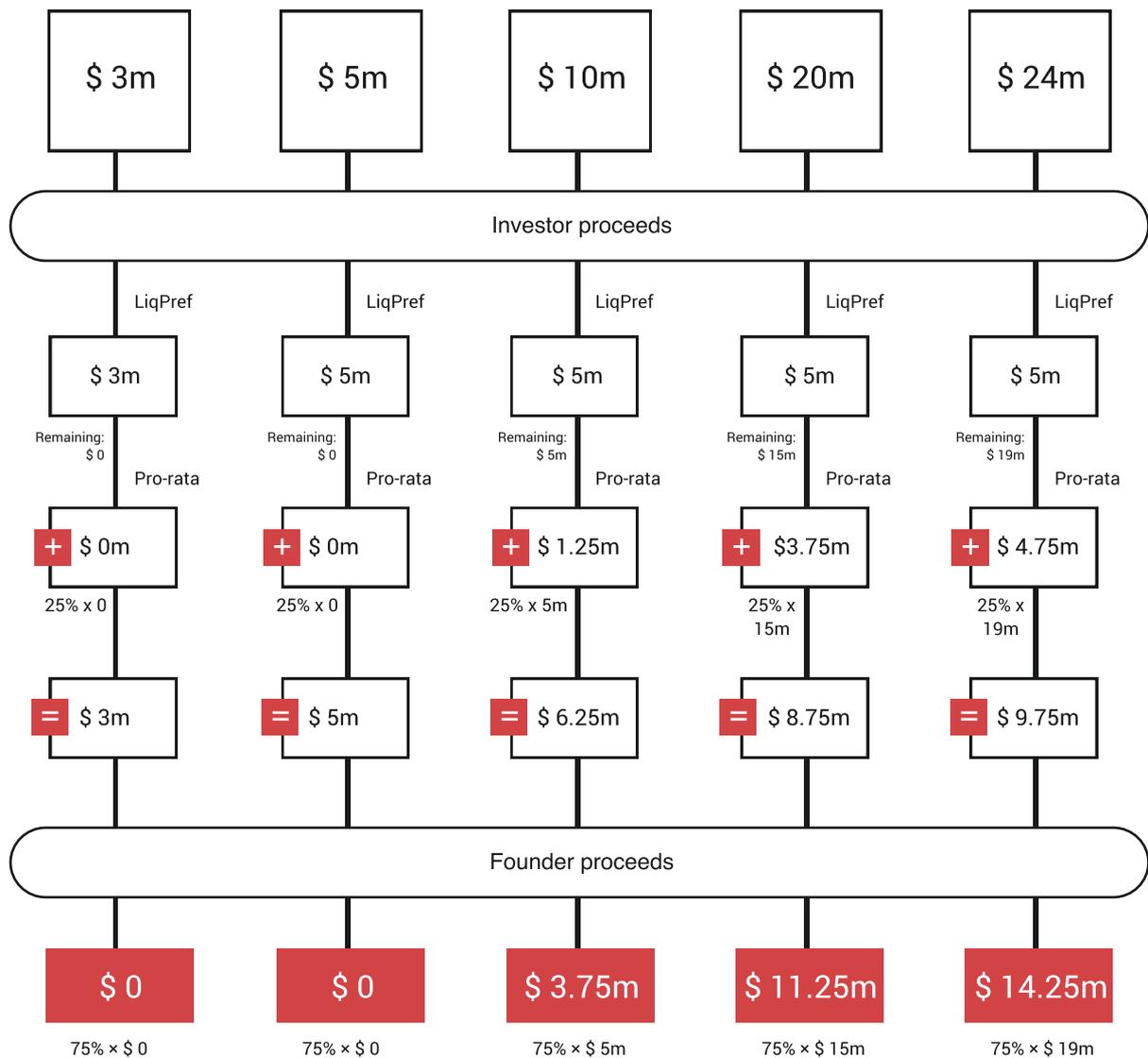
How a liquidation preference functions

2) 1 X Participating Liquidation Preference

In case of an exit, investors with preferred shares always receive their investment plus their pro-rata share of the remaining proceeds.



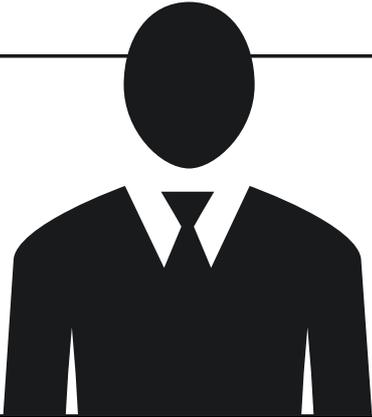
Distribution of Proceeds at Exit



ESOP

With an ESOP (“employee stock ownership plan”), key employees receive shares of their company to participate in a possible exit in the future as shown in the example below.

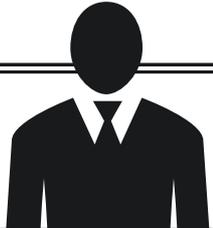
1) ESOP-Pool

EXAMPLE	<ul style="list-style-type: none">● An ESOP-pool with 10% of company shares is established. Shares are contributed by the investors and founders on a pro-rata basis.● An employee receives options out of the ESOP pool (for free), e.g. options on 0.5% of total company shares.		<p>The employee receives call options on 500 shares of the company. Each option grants the right to purchase a share in case of an exit for a specified price, the strike price.</p> <p>The strike price is set by the company and usually reflects the latest valuation (sometimes with a discount), e.g. \$ 300.</p>
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2) Exit

In case of an acquisition of the company, the key employee with ESOP has the right to exercise the call option.

EXAMPLE	<ul style="list-style-type: none">● An acquirer buys 100% of the company shares for \$ 50m. With 100.000 shares outstanding, the acquirer pays \$ 500 per share.● The proceeds are distributed pro rata to each shareholder; there are no liquidation preferences.
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Total proceeds when selling 500 shares	Cost of buying 500 shares for strike price	Proceeds for ESOP employee	
\$ 250,000 500 shares x \$ 500 purchase price	- \$ 150,000 500 shares x \$ 300 strike price	= \$ 100,000	

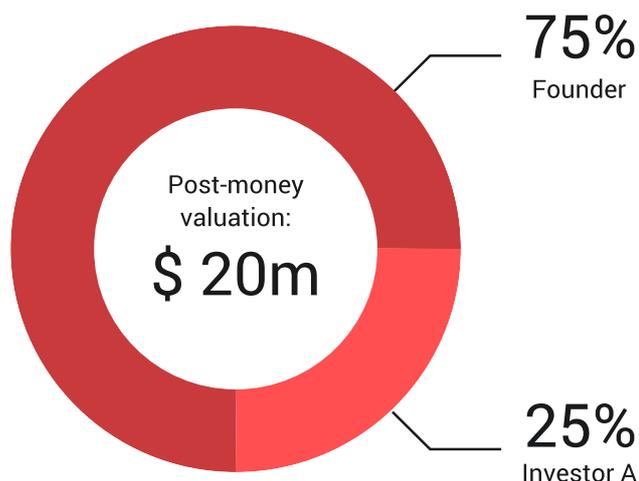
Anti-Dilution

In case of a downround, investors receive anti-dilution to protect their stake. The exact number of shares depends on the calculation methodology, as shown in the example below.

1) Series A

Round Structure

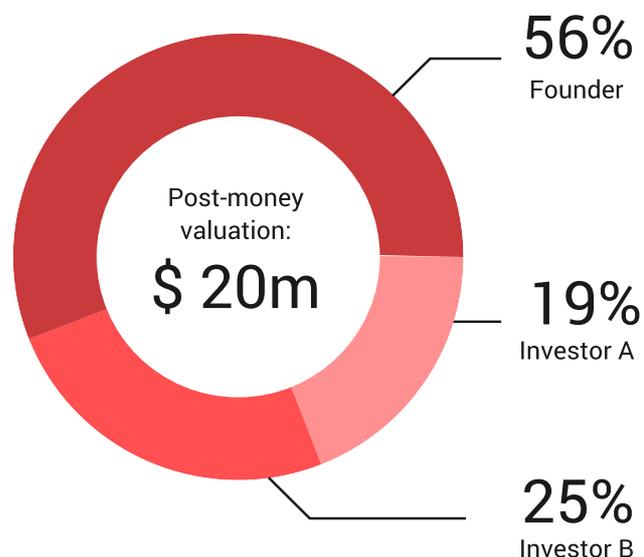
Pre-money valuation	\$ 15m
Investment Series A investor	\$ 5m
Post-money valuation	\$ 20m
Share price	\$ 600
Number of shares	33,333



2) Series B - Downround

Round Structure

Pre-money valuation	\$ 15m
Investment Series A investor	\$ 0
Investment Series B investor	\$ 5m
Post-money valuation	\$ 20m
Share price	\$ 450
Number of shares	44,444

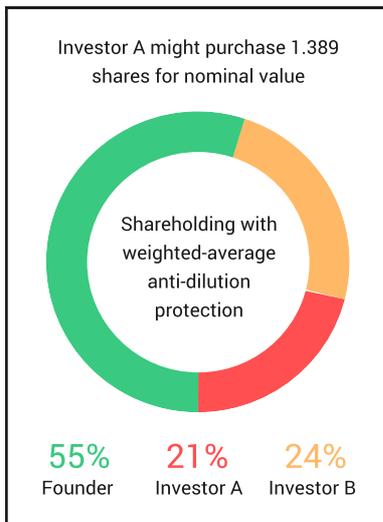


Anti-Dilution

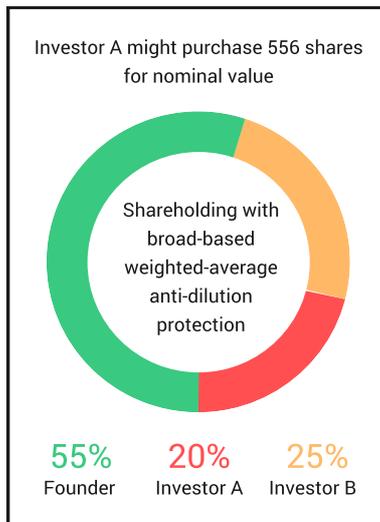
In case of a downturn, investors receive anti-dilution to protect their stake. The exact number of shares depends on the calculation methodology, as shown in the example below.

3) Calculation of Anti-Dilution Shares

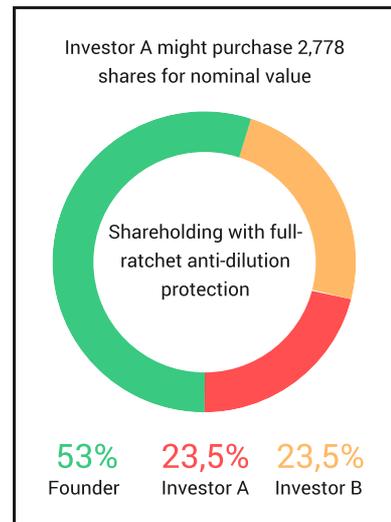
Narrow-Based Weighted-Average



Broad-Based Weighted-Average



Full-Ratchet



$$\# \text{ anti-dilution shares} = \frac{(\text{Share price Series A} - \text{Narrow-based weighted-average price}) \times \# \text{ Shares investor A}}{\text{Narrow-based weighted-average price}}$$

$$\# \text{ anti-dilution shares} = \frac{(\text{Share price Series A} - \text{Broad-based weighted-average price}) \times \# \text{ Shares investor A}}{\text{Broad-based weighted-average price}}$$

$$\# \text{ anti-dilution shares} = \frac{(\text{Share price Series A} - \text{Share price Series B}) \times \# \text{ Shares investor A}}{\text{Share price Series B}}$$

$$\text{Narrow-based weighted-average price} = \frac{(\text{Share price Series A} - \text{Share price Series B})}{(\text{Series A shares} + \text{Series B shares})}$$

$$\text{Broad-based weighted-average price} = \frac{(\text{Investment Series A} + \text{shares of founders @Series A price} + \text{Investment Series B})}{(\text{Series A shares} + \text{Series B shares})}$$



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