Financial Workshop

Dilution over time, equity split, and valuation methodologies

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Hi! I’m Tarik

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Valuation and Dilution Over Time

What is it, why it’s important, what is “normal”
Valuation Considerations

- Pre-Money | Raise | Post-Money
- Simple Math
  - Pre-Money Valuation: $2M
  - Raise: $1M
  - Post-Money Valuation: $3M
  - Quick Quiz:
    - $1M in exchange for 25% of your business?
    - Pre-Money vs. Post-Money?
- Option Pool
- Valuation Over Time
  - Why Dilution is OK
What is the Right Amount per Round

- Investor has to have enough skin in the game
  - They get diluted down too
  - “Seeking 5x in 3 years or 10x in 5 years”
    - Reality:
      - Seeking more earlier on
      - A little less later on
- Rule of Thumb:
  - 25% per round
  - 3-4 rounds
- What should founders end up with?
  - Hint: You’re probably not the next Zuck (statistically speaking)
Dilution – Founding Team

- Inception – 100%
  - Founding Team
    - Founder 1: 25%
    - Founder 2: 25%
    - Founder 3: 25%
    - Founder 4: 25%

*NOTE: Founding team should never split equity directly down the middle (i.e. 50/50, 25/25/25/25, etc.).
Can result in stalemate
Dilution – Founding Team (with Employee Option Pool)

- Founding Team
  - Founder 1: 20%
  - Founder 2: 20%
  - Founder 3: 20%
  - Founder 4: 20%
  - Option Pool: 20%

Founding Team With Employee Option Pool – STILL $25,000
Dilution - Founding Team (with Employee Option Pool)

- **Seed Stage**
  - Seed Investor: 25%
  - Founder 1: 15%
  - Founder 2: 15%
  - Founder 3: 15%
  - Founder 4: 15%
  - Option Pool: 15%

Seed Round - $250,000
Dilution – Series A

- Series A
  - Series A Investor: 25%
  - Seed Investor: 19%
  - Founder 1: 11%
  - Founder 2: 11%
  - Founder 3: 11%
  - Founder 4: 11%
  - Option Pool: 11%
Dilution – Series B

- **Series B**
  - Series B Investor: 25%
  - Series A Investor: 19%
  - Seed Investor: 14%
  - Founder 1: 8%
  - Founder 2: 8%
  - Founder 3: 8%
  - Founder 4: 8%
  - Option Pool: 8%
Dilution – Series C

- Series C
  - Series C Investor: 25%
  - Series B Investor: 19%
  - Series A Investor: 14%
  - Seed Investor: 11%
  - Founder 1: 6%
  - Founder 2: 6%
  - Founder 3: 6%
  - Founder 4: 6%
  - Option Pool: 6%
Series C Investor Perspective

- Series C → $20M Investment
- Seeking
  - 5X in 3 Years; or
  - 10X in 5 Years
- Equates to
  - $100M RETURN in 3 Years; or
  - $200M RETURN in 5 years
- A $20M investment at 25% equity stake, seeking
  a startup valuation upon EXIT:
  - $400M in 3 Years; or
  - $800M in 5 Years
Exit - Why Dilution is OK

- Series C → $20M Investment =
  - $400M Exit in 3 years
  - $800M Exit in 5 years
- ROI
  - Series C Investor: 25% = $100 - 250M
  - Series B Investor: 19% = $75 - 150M
  - Series A Investor: 14% = $56 - 112M
  - Seed Investor: 11% = $42 - 84M
  - Founder 1: 6% = $25 - 50M
  - Founder 2: 6% = $25 - 50M
  - Founder 3: 6% = $25 - 50M
  - Founder 4: 6% = $25 - 50M
  - Option Pool: 6% = $25 - 50M
Vesting and Equity Splits

What is it, market standards, and how to determine equity splits.
Vesting

• Why Vest?
• 2 Main Reasons
  • Incentivizes team
  • Removes dead weight
• EVERYONE VESTS
  • Founders – set up a vesting schedule and include yourself in it along with your team
  • Money doesn’t vest
    • You may WILL have to restart the vesting process again with VCs
Vesting

• Typical Vesting
  • Length of Vesting
    • 3-4 Years
  • Cliff
    • 1 Year
  • Post Cliff Vesting Schedule
    • Monthly / Quarterly
• Triggers
  • Accelerated Vesting
How to Determine Equity Split

- “50 / 50” not a good idea
- Have the uncomfortable conversation early
- Multiple ways to calculate
  - Examples
    - Simulation Tools
    - Dynamic Equity
## Founders Suite Calculation

### Determining Founders Shares Simulation Tool

<table>
<thead>
<tr>
<th>Enter Name of Founders</th>
<th>Nathan</th>
<th>Todd</th>
<th>Name</th>
<th>Name</th>
<th>Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>Founder #1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Founder #2</td>
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<tr>
<td>Founder #3</td>
<td></td>
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<tr>
<td>Founder #4</td>
<td></td>
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</tr>
<tr>
<td>Founder #5</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

For each Founder, rank their attribute on a scale of 1 to 10 (i.e. If one founder came up with the idea, he/she would receive a 10 out of 10); See results on next tab, "Founder Split"

<table>
<thead>
<tr>
<th>Idea Contribution</th>
<th>Enter Weight</th>
<th>10%</th>
<th>9</th>
<th>2</th>
</tr>
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<tbody>
<tr>
<td>Plan Development</td>
<td>20%</td>
<td>4</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Domain Expertise</td>
<td>20%</td>
<td>6</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Network/Connections</td>
<td>35%</td>
<td>9</td>
<td>5</td>
<td></td>
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<tr>
<td>Level of Commitment to Project</td>
<td>10%</td>
<td>3</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Leadership Responsibilities</td>
<td>5%</td>
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<td>3</td>
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</table>

100%
Dynamic Equity

- Month 1 Investment
  - Time
    - Bill (Seasoned Exec):
      - 100 hours @ $200/hour = $20,000
    - Frank (Young Talent):
      - 100 hours @ $100/hour = $10,000
  - Capital
    - Bill - $5,000
      - Cash has higher value (harder to save $5K than earn $5K)
      - Relative value 4x = $20,000
## Dynamic Equity

<table>
<thead>
<tr>
<th></th>
<th>BILL</th>
<th>FRANK</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>TIME</td>
<td>20,000</td>
<td>10,000</td>
<td>30,000</td>
</tr>
<tr>
<td>CASH</td>
<td>20,000</td>
<td></td>
<td>20,000</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$40,000</td>
<td>$10,000</td>
<td>50,000</td>
</tr>
</tbody>
</table>

**EQUITY**  
- 80%  
- 20%  
- 100%

**Dynamic Equity Split After Month 1**
Dynamic Equity

- Month 2 Investment
  - Time
    - Bill: 100 hours @ $200/hour = $20,000
    - Frank: 100 hours @ $100/hour = $10,000
    - Sally: 100 hours @ $100/hour = $10,000
  - Equipment
    - Sally - $10,000
      - Equipment has higher value (but not as high as money)
      - Relative value 2x = $20,000
## Dynamic Equity

<table>
<thead>
<tr>
<th></th>
<th>BILL</th>
<th>FRANK</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>TIME</td>
<td>20,000</td>
<td>10,000</td>
<td>30,000</td>
</tr>
<tr>
<td>CASH</td>
<td>20,000</td>
<td></td>
<td>20,000</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$40,000</td>
<td>$10,000</td>
<td>50,000</td>
</tr>
<tr>
<td>EQUITY</td>
<td>80%</td>
<td>20%</td>
<td>100%</td>
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</table>

**Dynamic Equity Split After Month 1**

<table>
<thead>
<tr>
<th></th>
<th>BILL</th>
<th>FRANK</th>
<th>SALLY</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>TIME</td>
<td>40,000</td>
<td>20,000</td>
<td>10,000</td>
<td>70,000</td>
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<tr>
<td>CASH</td>
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<td></td>
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<td>20,000</td>
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<tr>
<td>EQUIPMENT</td>
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<td>20,000</td>
<td></td>
<td>20,000</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$60,000</td>
<td>$20,000</td>
<td>$30,000</td>
<td>110,000</td>
</tr>
<tr>
<td>EQUITY</td>
<td>55%</td>
<td>18%</td>
<td>27%</td>
<td>100%</td>
</tr>
</tbody>
</table>

**Dynamic Equity Split After Month 2**
Equity Split Conclusion

- KISS Model
- Don’t be greedy
- It’s not going to be perfect
- Speak to the Experts
  - PACE
  - XLR8UH
  - Sultan Ventures
- Recruit an Expert!
Questions?
Valuation Methodologies
Valuation Methodologies

1. Related Transactions
   - Acquisitions/Financings
2. Public Comparables
   - SEC-disclosed performance benchmarks
3. Discounted Cash Flow (DCF)
   - The value of your future earnings (cash)

- Other Sources of Value
  - Intellectual Property, Team, Customers
DCF, ROI, NPV, IRR, LOL, FML

• DCF = Discounted Cash Flow
• ROI = Return on Investment
• NPV = Net Present Value
• IRR = Internal Rate of Return
Discounted Cash Flows

• Picking A Discount Rate
  • Startups seeking money: 50+ %
  • Early Startups: 40-60 %
  • Late Startups: 25-50%
  • Mature Companies: 15-25%

• Why high discount rates for new ventures:
  • Reduced marketability/liquidity
  • Limited number of investors willing to invest
  • Higher risk
  • Overly optimistic forecasts by enthusiastic founders.
What is the Right Amount per Round

- Investor has to have enough skin in the game
  - They get diluted down too
  - “Seeking 5x in 3 years or 10x in 5 years”
    - Reality – they’re seeking way more
- Rule of Thumb:
  - 25% per round
  - 3-4 rounds
- What should founders end up with?
  - Hint: You’re probably not the next Zuck (statistically speaking)
# How to Find Comps & Exit Metrics

<table>
<thead>
<tr>
<th>Comparables</th>
<th>Investments</th>
<th>Valuation</th>
<th>Year</th>
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<tbody>
<tr>
<td>Startup 1</td>
<td>Bought by Company 1</td>
<td>$170M</td>
<td>2009</td>
</tr>
<tr>
<td>Startup 2</td>
<td>$15M VC Fund 1 and VC Fund 2; $16.5M To Date</td>
<td>$60-100M</td>
<td>2012</td>
</tr>
<tr>
<td>Startup 3</td>
<td>$20M from VC Fund 3; $95M To Date</td>
<td>$80-200M</td>
<td>2013</td>
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<table>
<thead>
<tr>
<th>Acquiree</th>
<th>Acquired</th>
<th>Value</th>
<th>Description</th>
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<tbody>
<tr>
<td>Google</td>
<td>Bump</td>
<td>$35,000,000</td>
<td>BUMP: allows for photo sharing between mobile devices by motion of &quot;bumping&quot; phones</td>
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<tr>
<td>Dropbox</td>
<td>Mailbox</td>
<td>$100,000,000</td>
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<tr>
<td>Facebook</td>
<td>Instagram</td>
<td>$1,000,000,000</td>
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<tr>
<td>Ancestry</td>
<td>DNA assets of Sorensen</td>
<td>$11,700,000</td>
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<td>$14,500,000</td>
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<table>
<thead>
<tr>
<th>Total Dividends (6 Yrs)</th>
<th>Dividend ROI</th>
<th>Acquisition ($106M)</th>
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</thead>
<tbody>
<tr>
<td>$</td>
<td>8.3 X</td>
<td>$9,338</td>
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</table>

<table>
<thead>
<tr>
<th>Total Return</th>
<th>Multiple</th>
<th>IRR</th>
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<tbody>
<tr>
<td>$13,468</td>
<td>26.9 X</td>
<td>105%</td>
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Thank you!

• Questions?