

**SHOW ME THE MONEY:**  
**Raising Capital for the Start Up**

***SURGE***

Innovative resources for Start-Ups and Rapid Growth Enterprises

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# Discussion Leaders

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# Notes of caution

- This presentation is about the capitalization structures of corporations. It does not specifically address the capitalization of LLCs or other entities.
- Corporations are governed by the laws of the state in which they are incorporated and the laws of each state are different, so while some statements in this presentation may be true for some or most corporations, they are not necessarily true for all corporations.
- The statements in this presentation are general in nature but there are almost always exceptions to the rules.
- References to “Charter” means either the corporation’s Articles of Incorporation (MN) or Certificate of Incorporation (DE)

# What sources of financing are there?

- You
- Friends and family
- Angel investors
- Institutional investors
- Venture capital
- Private equity
- Banks
- Alternative lenders

# What types of financing are there?

- Debt
  - Bank financing
  - Mezzanine financing
  - Subordinated debt
  - Factoring
  - Asset based lending
  - SBA financing
- Equity

# What are the pros and cons of equity versus debt?

- Governance and Control
- Sharing information
- Costs
- Risk tolerance
- Tax considerations
- Timing of exit
- Access to expertise & networks

# What types of equity financing are there?

Equity financing involves the issuance and sale of shares of the Company's capital stock:

- **Common Stock**
  - Basic unit of capital stock
  - Rights generally defined by corporate law statutes
- **Preferred Stock**
  - E.g., *Series A Convertible Preferred Stock*
  - Usually has defined rights and “preferences” over Common Stock
  - Rights generally defined by the charter
  - Conversion rights / relationship to Common Stock
- **Convertible Securities**
- **Debt / Equity Hybrids – Convertible Promissory Notes**

# What should a company be doing to prepare for financing?

- Prepare a business plan with executive summary
  - Will help founder to critically analyze the business and improve ability to tell the story
- “PowerPoint” presentation
- Prepare financial models (using *reasonable* assumptions)
- Get organized! – make sure key agreements, corporate records are signed, complete and organized



# How do I value my company?

- No easy answers
- Analyze comparable companies at similar stages in similar markets
- Various financial methods (e.g., the VC Method bases valuation on expected rates of return at exit)
- Valuation often result of negotiation

# How much money should I raise and how much of my company should I sell?

- No one answer
- Business plan dictates your capital needs
- Fund milestones necessary to reach a significant inflection point in the value of the business
- 12-24 months of runway
- Cost and dilution trade offs
- Run the numbers, do financial modeling

# What is pre-money and post-money?

- Pre-money: value of company before new equity,
- Post-money: value of company after new equity
- Per share value: company value divided by “fully-diluted” number of shares

SURGE, Inc.				
Pre-Money Capitalization				
Stockholders	Shares			FD %
	Common Stock	Series A	Fully Diluted	
Founder 1	4,000,000	-	4,000,000	34.50%
Founder 2	2,500,000	-	2,500,000	21.56%
Founder 3	1,500,000	-	1,500,000	12.94%
Stock Options Issued	500,000	-	500,000	4.31%
Stock Option Available for Grant	500,000	-	500,000	4.31%
Option Pool Increase	2,595,000	-	2,595,000	22.38%
<b>Total Issued Shares</b>	<b>11,595,000</b>	<b>-</b>	<b>11,595,000</b>	<b>100.00%</b>
Series A Financing Details				
Pre Money value	3,000,000			
Price Per Shares	0.2587			
New Money	1,000,000			
New Shares	3,865,000			
Post-Money Capitalization				
Stockholders	Shares			FD %
	Common Stock	Series A	Fully Diluted	
Founder 1	4,000,000	-	4,000,000	25.873%
Founder 2	2,500,000	-	2,500,000	16.171%
Founder 3	1,500,000	-	1,500,000	9.702%
Stock Options Issued	500,000	-	500,000	3.234%
Stock Option Available for Grant	500,000	-	500,000	3.234%
Option Pool Increase	2,595,000	-	2,595,000	16.785%
New Investors (Series A)	-	3,865,000	3,865,000	25.000%
<b>Total Issued Shares</b>	<b>11,595,000</b>	<b>3,865,000</b>	<b>15,460,000</b>	<b>100%</b>

# What is a private placement (offering) memorandum and do I need it?

- Sales document
  - Tells your story & business plan
- Legal document
  - Sale of equity is generally covered by state and federal securities laws
  - Registration requirements, exception for private sales
  - The company and control persons (YOU!) can be held liable
  - Information material to an investor, no misleading information

# What terms will an investor require?

- **Friends & family**
  - Typically not very sensitive to terms – they’re investing in you.
  - Typically, common stock or convertible notes with company-favorable terms
- **Angel Investors**
  - Convertible debt with discount into next “qualified financing”
  - Preferred stock (sometimes referred to as “Series Seed Preferred”) that may contain the following rights:
    - Liquidation preference
    - Conversion rights with anti-dilution protection
    - Some class voting rights
    - Perhaps a board seat or observation rights

# What terms will an investor require (cont.)?

- **Venture Capital & Strategic Investors**
  - Almost certainly a preferred stock (e.g., Series A Preferred Stock)
  - Dividend rights/preferences
  - Liquidation preference (e.g., 1.0x, 2.0x, “participating preferred”)
  - Class voting rights (e.g., right to approve charter amendments, board size changes, issuances of senior equity, issuance of debt, major transactions, etc.)
  - Conversion rights with anti-dilution protection
  - Board seats
  - Co-sale, drag-along rights, preemptive rights, registration rights
  - If strategic, perhaps right of first negotiation on sale, etc.

# What is crowdfunding and can I do it?

- New Reg A+ offerings allow for sales to non-accredited investors using general solicitation.
  - Prospectus-like information required
  - SEC and state qualifications
  - Regulation heavy
- Proposed Regulation Crowdfunding (CF)
  - Dead at SEC?
- Cannot sell securities on Kickstarter

# Can I use the Internet to raise money?

- Using the Internet is considered a “general solicitation” under securities laws
- Not permitted if an “old fashioned” private placement under Reg. D/Rule 506
- New Rule 506(c) allows general solicitation if sales only to accredited investors
  - Company must “verify” investor status if relying on 506(c) (e.g., obtain tax returns, bank statements, etc.)
- Be careful if relying on this rule!



# Resources

- **Venture Deals** by Brad Feld and Jason Mendelson
- **National Venture Capital Association**  
[nvca.org](http://nvca.org)
- **SEC Business Forum on Small Business Capital Formation**  
[sec.gov/forms/registration-sbf](http://sec.gov/forms/registration-sbf)

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