

MGT 481 F2022 - Happy Go Fun Time Non-Graded Quiz on Friends and Family

One illustration of how friends and family investments work for you and your BFFs.

You are negotiating a round of friends and family investment from your rich uncle. You will get an investment from him of \$100,000 as a Simple Agreement for Future Equity (SAFE) with a 20% discount on share price and a \$2M cap on the pre-money valuation when a future round of investing establishes a share price.

1. How many shares does your uncle own right now?

Zero shares. Your uncle will not own any shares until a price has been set for the company in the future when it is easier to establish a valuation for your company. When the share price is established, the SAFE investment will CONVERT into equity based on how much money was invested, any discount rates or caps set on valuation, and the share price established by the professional investor.

2. An angel investor provides \$500,000 to you in exchange for 10% of your company. Your company is now worth \$5M. What is the share price that has been established in this round of investing?

The first things we need to know are the pre-money valuation and how many founder shares have already been issued. We need to look at the cap table to see (hypothetically for this example) that the founders own 9,000,000 shares. Those 9,000,000 shares are worth \$4.5 million. Divide the pre-money valuation by the number of shares already issued and you get $\$4.5\text{M} / 9\text{M shares} = \$0.50 / \text{share}$.

3. How much of the company does your uncle's \$100,000 buy?

With a discount of 20% with no cap, the share price your uncle pays is $\$0.50(1-0.2) = \$0.50 * 0.8 = \$0.40/\text{share}$. $\$100,000 / \$0.40/\text{share} = 250,000 \text{ shares}$.

But we also assumed there is a cap of \$2M on the pre-money valuation used to determine F&F SAFE investment to shares. The \$2M pre-money valuation cap creates a

share price for conversion of $\$2M/9,000,000$ shares = $\$0.22/\text{share}$. This value is less than the share price you would get with a 20% discount off the share price established by the $\$4.5M$ pre-money valuation, which would be $\$0.50 * (1-20\%) = \$0.40/\text{share}$, so the $\$2M$ cap will be used to set the share price for your rich uncle. F&F get the shares for $\$0.22$ each. Then the F&F investors get $\$100,000 / \$0.22 = 454,545$ shares.

4. How many shares does the angel investor get?

The angel investor invests $\$500,000$ at a share price of $\$0.50$. Therefore, the angel investor receives $\$500,000/\$0.50 = 5M$ shares.

5. By the way, what is the value of the friends and family investment now that the angel's investment has been made?

F&F own 454,545 shares. The new share price is $\$0.50$ based on the agreed-upon pre-money valuation. **F&F's investment is now worth $454,545 \times \$0.50 / \text{share} = \$227,272.50$.**