

THE EXIT WATERFALL

The moment of truth. The company sells. Money flows in. Now — who gets paid, how much, and in what order? Plus two complete case studies from the real world, explained like you are ten years old.

Company

NovaSpark, Inc.

Series

Part 4 of 4

Concepts

Waterfall · Pref Stack · Conversion · Participation

Case Studies

2 — Success & Near-Miss

WHAT IS THE EXIT WATERFALL?

The single most important concept every founder and

employee needs to understand

You have spent years building the company. A buyer — or the public market — agrees to pay a big number. Champagne corks fly. And then someone like me sits down with a spreadsheet and starts allocating the proceeds. What happens next determines how much of that big number you actually take home. That process is called the **liquidation waterfall** — and it almost never works the way people expect.

A waterfall is exactly what it sounds like. Money flows in at the top and cascades down through layers. Each layer fills up before the water flows to the next. In startup finance, those layers are defined by the types of stock people hold — preferred stock at the top, common stock at the bottom. The rules that govern each layer were written into your term sheets years ago, long before anyone knew whether the company would succeed or fail.



FIFTH-GRADER VERSION

Imagine a birthday cake with five tiers. The person on the top tier gets served first and gets as much as they want. Then the next tier gets served. Then the next. If the cake runs out before reaching the bottom tier — tough luck, bottom tier. In a startup exit, the investors at the top of the waterfall (preferred stockholders) get their slice first. Founders and employees at the bottom only get cake if there is enough left. The size of the cake is the exit price. The rules about who eats first are the liquidation preferences.

THE FOUR LAYERS EVERY CAP TABLE HAS

| LAYER | WHO IS HERE | |
|---------|---|--------|
| Layer 1 | Debt holders, creditors, secured lenders | |
| Layer 2 | Latest preferred stockholders (Series B, C, D) | S |
| Layer 3 | Earlier preferred stockholders (Seed, Series A) | |
| Layer 4 | Common stockholders: founders, employees, ESOP | Last - |

THE TWO KEY DECISIONS THAT CHANGE EVERYTHING

Before we run the numbers, you need to understand two terms that will determine the shape of every waterfall calculation you ever see.

| TERM | |
|--------------------------------|--|
| Non-Participating Preferred | |
| Participating Preferred (Full) | Investor gets their liquidation |
| Capped Participating Preferred | Investor |
| Conversion to Common | Preferred stockholders can always choo |

NOVAPARK SELLS FOR \$200 MILLION

Walking through every dollar, layer by layer, person by person

Let us use NovaSpark's post-Series C recap cap table from Part 2 as our starting point. The company has turned itself around after the down round. Growth is strong. A strategic acquirer — **Enterprise Systems Corp** — offers to buy the entire company for **\$200,000,000 in cash**. The board votes yes. The deal closes.

Here is the cap table going into the exit, and the critical information about each preferred class's terms.

| SHAREHOLDER | SHARES (FD) | % FD |
|---|-------------|-------|
| You (CEO / Founder) | 5,000,000 | 11.5% |
| Priya (CTO / Co-Founder) | 3,000,000 | 6.9% |
| Employees + ESOP (vested) | 9,000,000 | 20.8% |
| Redwood Ventures (Seed) | 2,500,000 | 5.8% |
| Apex Capital (Series A) | 3,701,000 | 8.5% |
| Meridian Growth Partners (Series B — converted) | 3,460,000 | 8.0% |
| Fortis Ventures (B-2 — converted) | 6,921,000 | 16.0% |

| | | |
|-----------------------------|-------------------|-------------|
| Vantage Partners (Series C) | 9,783,000 | 22.6% |
| TOTAL | 43,365,000 | 100% |



KEY FACTS BEFORE WE START

Total exit proceeds: **\$200,000,000**. Total liquidation preferences: **\$44,500,000** (Redwood \$2.5M + Apex \$12M + Vantage \$30M). Meridian and Fortis converted to common in the recap — they get no liquidation preference. Vantage has a participating preferred with a 2× cap, meaning they get their \$30M back first, then participate in upside until they have received 2× their investment (\$60M total) — then stop participating and common holders get everything else.

STEP 1: PAY THE LIQUIDATION PREFERENCES

STEP 1 - LIQUIDATION PREFERENCES PAID OUT (IN SENIORITY ORDER)

| | |
|----------------------|---------------|
| Total Exit Proceeds: | \$200,000,000 |
|----------------------|---------------|

Senior Preferred Paid First (Series C - Vantage)

| | |
|------------------------|---------------|
| Vantage 1× preference: | -\$30,000,000 |
|------------------------|---------------|

| | |
|-------------------------------|---------------|
| Remaining after Vantage pref: | \$170,000,000 |
|-------------------------------|---------------|

Junior Preferred Paid Next

| | |
|---------------------|---------------|
| Apex 1× preference: | -\$12,000,000 |
|---------------------|---------------|

| | |
|------------------------|--------------|
| Redwood 1× preference: | -\$2,500,000 |
|------------------------|--------------|

| | |
|----------------------------------|---------------|
| Remaining after all preferences: | \$155,500,000 |
|----------------------------------|---------------|

STEP 2: SHOULD PREFERRED INVESTORS CONVERT OR TAKE THEIR PREFERENCE?

Now each preferred investor faces a choice. They can take their liquidation preference and walk away. Or they can convert their preferred shares to common shares and participate in the remaining \$155.5M pool alongside everyone else. The rational choice is whichever gives them more money. Let us run the math for each.

STEP 2 - CONVERSION ANALYSIS: SHOULD EACH PREFERRED CONVERT?

If all preferred convert, the remaining \$155.5M is split across ALL 43,365,000 shares

Value per common share if all convert: $\$155,500,000 \div 43,365,000 = \$3.585/\text{share}$

Redwood Ventures (2,500,000 shares)

Take preference: \$2,500,000

Convert to common: $2,500,000 \times \$3.585 = \$8,962,500$

Redwood converts → gets \$8,962,500 (better by \$6,462,500)

Apex Capital (3,701,000 shares)

Take preference: \$12,000,000

Convert to common: $3,701,000 \times \$3.585 = \$13,268,085$

Apex converts → gets \$13,268,085 (better by \$1,268,085)

Vantage Partners (9,783,000 shares - Participating, 2x cap = \$60M max)

Take preference only: \$30,000,000

Participate (pref + pro-rata share of remainder):

Preference: \$30,000,000

Pro-rata of \$155.5M: $(9,783,000 \div 43,365,000) \times \$155.5M =$
\$35,076,000

Total before cap: \$30M + \$35.1M = \$65,076,000

2× cap = \$60,000,000 → Vantage is capped at \$60,000,000

Vantage participates up to cap → receives \$60,000,000

STEP 3: FINAL DISTRIBUTION – EVERY DOLLAR ACCOUNTED FOR

Now we know each preferred investor's election. All preferred converts to common except Vantage, who participates up to their \$60M cap. We now allocate the remaining proceeds after satisfying the Vantage participation. The remaining pool for all common (including converted preferred) is \$200M – \$60M = \$140M, divided among the fully diluted common shares excluding Vantage.

STEP 3 – FINAL DISTRIBUTION ACROSS ALL SHAREHOLDERS

| | |
|---|---------------|
| Total Proceeds: | \$200,000,000 |
| Less: Vantage (participation up to 2× cap): | -\$60,000,000 |
| Remaining for all other shareholders: | \$140,000,000 |

Shares splitting \$140M: all 43,365,000 FD shares minus Vantage's
9,783,000 = 33,582,000

Value per share: $\$140,000,000 \div 33,582,000 = \4.168 per share

Individual Payouts

| | |
|-----------------------------------|--------------|
| You (5,000,000 shares × \$4.168): | \$20,840,000 |
|-----------------------------------|--------------|

| | |
|---------------------------------------|--------------|
| Priya (3,000,000 × \$4.168): | \$12,504,000 |
| Employees/ESOP (9,000,000 × \$4.168): | \$37,512,000 |
| Redwood (2,500,000 × \$4.168): | \$10,420,000 |
| Apex (3,701,000 × \$4.168): | \$15,424,000 |
| Meridian (3,460,000 × \$4.168): | \$14,421,000 |
| Fortis (6,921,000 × \$4.168): | \$28,848,000 |
| Vantage (participation cap): | \$60,000,000 |

TOTAL CHECK: \$200,969,000 ≈ \$200,000,000 ✓ (rounding differences)

| SHAREHOLDER | % FD | TOTAL INVESTED | EXIT PROCEED |
|-----------------------------|-------------|---------------------|-----------------------|
| You (CEO / Founder) | 11.5% | \$5,000 (par value) | \$20,840,000 |
| Priya (CTO / Co-Founder) | 6.9% | \$3,000 (par value) | \$12,504,000 |
| Employees + ESOP (avg) | 20.8% | varies | \$37,512,000 |
| Redwood Ventures (Seed) | 5.8% | \$2,500,000 | \$10,420,000 |
| Apex Capital (Series A) | 8.5% | \$12,000,000 | \$15,424,000 |
| Meridian (converted, B) | 8.0% | \$35,000,000 | \$14,421,000 |
| Fortis Ventures (B-2) | 16.0% | \$20,000,000 | \$28,848,000 |
| Vantage Partners (Series C) | 22.6% | \$30,000,000 | \$60,000,000 |
| TOTAL | 100% | \$99,508,000 | ~\$200,000,000 |

A GOOD EXIT WITH ONE PAINFUL LESSON

The founders made \$20M and \$12M respectively — remarkable outcomes. The employees collectively received \$37.5M in cash. Most investors made money. **Except Meridian**, who invested \$35M at the Series B peak and received only \$14.4M back — a \$20.6M loss. This is what happens when an investor leads at a high valuation, survives a down round by converting to common in a recap, and then exits below their entry price. The recap in Part 2 was Meridian's fatal compromise. They traded their liquidation preference for a haircut, hoping for a much larger exit. At \$200M, it was not enough to recover their investment. At \$500M, they would have been whole.

CHAPTER 03 · CASE STUDY 01

CASE STUDY ONE: THE HERO EXIT

A SaaS company sells for \$480M — who gets life-changing money and who just gets their money back

01

CASE STUDY · THE HERO EXIT

CLEARPATH ANALYTICS, INC.

B2B data analytics SaaS · Founded 2017 · Acquired by DataCore Corp for \$480M in Year 7 · All preferred was non-participating · Clean waterfall

| | | |
|-----------------------------------|------------------------------|----------------------------------|
| EXIT PRICE \$480M | TOTAL RAISED \$58M | TOTAL PREF STACK \$58M |
| PREF TYPE All Non-Part. | FOUNDED 2017 | YEARS TO EXIT 7 Years |

ClearPath Analytics was founded in 2017 by **Diana** (CEO) and **Felix** (CTO) to bring machine-learning-powered analytics to mid-market retail companies. They raised a clean, disciplined cap table over four rounds, always negotiating non-participating preferred — a detail that would pay enormous dividends at exit.

| SHAREHOLDER | SHARES (FD) | % FD | INVEST |
|----------------------------|-------------------|-------------|---------------------|
| Diana (CEO/Founder) | 8,000,000 | 22.2% | |
| Felix (CTO/Founder) | 5,000,000 | 13.9% | |
| Employees + ESOP | 8,400,000 | 23.3% | |
| Seed Round Investors | 2,800,000 | 7.8% | \$3,000,000 |
| Series A (Horizon VC) | 4,400,000 | 12.2% | \$15,000,000 |
| Series B (Summit Partners) | 7,400,000 | 20.6% | \$40,000,000 |
| TOTAL | 36,000,000 | 100% | \$58,000,000 |

THE WATERFALL AT \$480M

CLEARPATH - EXIT WATERFALL AT \$480,000,000

Total proceeds:

\$480,000,000

Step 1: Should any preferred take their preference or convert?

Value per share if ALL convert: $\$480M \div 36,000,000 =$
\$13.33/share

Seed preference vs. conversion: $\$3M$ vs. $2,800,000 \times \$13.33$
 $= \$37.3M \rightarrow$ CONVERT

Series A preference vs. conversion: $\$15M$ vs. $4,400,000 \times$
 $\$13.33 = \$58.7M \rightarrow$ CONVERT

Series B preference vs. conversion: $\$40M$ vs. $7,400,000 \times$
 $\$13.33 = \$98.6M \rightarrow$ CONVERT

All preferred investors convert to common –
preferences are irrelevant at this exit size

Step 2: Split \$480M across all 36,000,000 shares
equally

Value per share: $\$480,000,000 \div 36,000,000 = \13.33
per share

Individual Payouts

Diana (8,000,000 \times \$13.33):

\$106,640,000

Felix (5,000,000 \times \$13.33):

\$66,650,000

Employees + ESOP (8,400,000 \times \$13.33):

\$111,972,000

Seed Investors (2,800,000 \times \$13.33):

\$37,324,000

Horizon VC / Series A (4,400,000 × \$13.33):

\$58,652,000

Summit Partners / Series B (7,400,000 × \$13.33):

\$98,642,000

MEET THE PEOPLE BEHIND THE NUMBERS



DIANA

CEO · FOUNDER

Shares **8,000,000**

Exit Proceeds **\$106,640,000**

Cost Basis **~\$8,000 (par)**

Tax (83b + LTCG) **~\$21.3M**

Keeps After Tax **~\$85M**



FELIX

CTO · FOUNDER

Shares **5,000,000**

Exit Proceeds **\$66,650,000**

Cost Basis **~\$5,000 (par)**

Tax (83b + LTCG) **~\$13.3M**

Keeps After Tax **~\$53M**



YUKI

VP ENGINEERING · EMPLOYEE
#4

Options (ISO) **600,000**

Strike Price **\$0.60**

Gain per Share **\$12.73**

Total Pre-Tax **\$7,638,000**

Tax (LTCG 20%) **~\$1.5M**

Keeps After Tax **~\$6.1M**



MARCUS

SENIOR DESIGNER · EMPLOYEE
#18

Options (NQSO) **80,000**

Strike Price **\$2.40**

Spread at Exit **\$10.93/share**

Total Pre-Tax **\$874,400**

Ordinary Income **~\$322,000**

Tax **(37%)**

Keeps After Tax

~\$552,400



FIFTH-GRADER VERSION - WHY THIS WORKED SO WELL

Remember the birthday cake with tiers? In this exit, the cake was SO large that even after paying the top tiers, there was far more than enough for everyone. In fact, the investors at the top chose to skip their reserved slice and join the bottom tier — because the bottom tier was getting bigger pieces. That is what "convert to common" means. When the cake is big enough, all the special rules become irrelevant. Everyone just shares equally. That is the best possible outcome from a founder's perspective, and it is what negotiating non-participating preferred makes possible.

KEY LESSON FROM CASE STUDY 1

NON-PARTICIPATING PREFERRED IS WORTH FIGHTING FOR

Diana and Felix's single best negotiating win across all four funding rounds was insisting on non-participating preferred each time. In a \$480M exit, the difference between non-participating and full participating preferred would have cost the founders and employees tens of millions of dollars. The investors still made extraordinary returns — Seed investors returned 12.4×, Series A returned 3.9×, Series B returned 2.5×. Everyone won. That is what a well-structured clean cap table produces.

CASE STUDY TWO: THE NEAR-MISS

A company sells for \$95M — and most employees receive almost nothing because of the preference stack

02

CASE STUDY · THE NEAR-MISS / CAUTIONARY TALE

BLAZE COMMERCE TECHNOLOGIES, INC.

E-commerce SaaS · Founded 2018 · Sold to RetailMax Corp for \$95M in Year 6 · Heavy preference stack · Participating preferred · Most employees saw very little

EXIT PRICE

\$95M

TOTAL RAISED

\$72M

TOTAL PREF
STACK

\$72M

PREF TYPE

Participating

FOUNDED

2018

PEAK VALUATION

\$310M (Ser C)

Blaze Commerce raised aggressively during the 2020–2021 boom, accepting terms they did not fully scrutinize — including full participating preferred with no caps on their Series B and C. When the market cooled, growth slowed,

and the best exit available was \$95M — significantly below the peak valuation of \$310M at the Series C. What follows is a cautionary tale about what full participating preferred does in a compressed exit.

| SHAREHOLDER | SHARES (FD) | % FD | INVESTMENT |
|---------------------------|-------------------|-------------|---------------------|
| Kai (CEO/Founder) | 6,000,000 | 15.8% | |
| Nour (CTO/Founder) | 4,000,000 | 10.5% | |
| Employees + ESOP | 6,800,000 | 17.9% | |
| Seed Round | 2,200,000 | 5.8% | \$2,000,000 |
| Series A (First Light VC) | 4,000,000 | 10.5% | \$8,000,000 |
| Series B (Momentum Fund) | 7,600,000 | 20.0% | \$22,000,000 |
| Series C (Peak Capital) | 7,400,000 | 19.5% | \$40,000,000 |
| TOTAL | 38,000,000 | 100% | \$72,000,000 |



THE PROBLEM HIDING IN PLAIN SIGHT

Total liquidation preferences: **\$72,000,000**. Exit price: **\$95,000,000**. After paying all preferences, only **\$23,000,000** remains for all common stockholders. But with full participating preferred, Series B and C do not stop at their preference — they also participate in the remaining \$23M alongside common. Watch what happens.

THE WATERFALL AT \$95M – STEP BY STEP

BLAZE COMMERCE – EXIT WATERFALL AT \$95,000,000

Total proceeds:

\$95,000,000

Step 1: Pay all liquidation preferences (in seniority order)

Series C (Peak Capital, senior): -

\$40,000,000

Series B (Momentum Fund): -

\$22,000,000

Series A (First Light, non-part): -

\$8,000,000

Seed (non-participating): -

\$2,000,000

Remaining after all preferences:

\$23,000,000

Step 2: Check – do Seed and Series A convert to common?

Value per share if Seed/A convert: \$23M splits across all 38M shares

But wait – Ser B and C are participating so they also get a share of the \$23M

$\$23M \div 38,000,000 = \0.605 per share (for the participating pool)

Seed converts? $\$0.605 \times 2,200,000 = \$1,331,000$ vs. taking pref \$2,000,000 → takes preference

Series A converts? $\$0.605 \times 4,000,000 = \$2,420,000$ vs. taking pref \$8,000,000 → takes preference

Both Seed and Series A take their preference – they

do NOT convert

Step 3: Distribute remaining \$23M among participants

Participants: Common (16,800,000 sh) + Ser B part.

(7,600,000 sh) + Ser C part. (7,400,000 sh)

Total participating shares: 31,800,000

Value per participating share: $\$23,000,000 \div$

$31,800,000 = \$0.7233/\text{share}$

Final Payouts

Seed (took pref):

\$2,000,000

Series A (took pref):

\$8,000,000

Series B (pref \$22M + part \$5,497,000):

\$27,497,000

Series C (pref \$40M + part \$5,352,000):

\$45,352,000

Kai (6,000,000 × \$0.7233):

\$4,339,800

Nour (4,000,000 × \$0.7233):

\$2,893,200

Employees/ESOP (6,800,000 × \$0.7233):

\$4,918,440

CHECK: $\$2M + \$8M + \$27.5M + \$45.4M + \$4.3M + \$2.9M + \$4.9M =$

$\sim \$95M \checkmark$

WHO GOT WHAT – AND WHAT IT FELT LIKE





KAI

CEO · FOUNDER · 6 YEARS OF HIS LIFE

Exit Proceeds **\$4,339,800**

% of \$95M Exit **4.6%**

His % FD was **15.8%**

His % of proceeds **4.6% ≠ 15.8%**

After tax (~20%) **~\$3.5M**



AISHA

ENGINEER #5 · 5 YEARS · 120,000 NQSOS

Strike Price **\$1.80**

Value at Exit **\$0.7233**

Options **By –**
Underwater **\$1.077/share**

Exit Proceeds **\$0**

5-Year Outcome **Zero equity value**



RAJ

EARLY EMPLOYEE #2 · 7 YEARS · 400,000 ISOS

Strike Price **\$0.25**

Value at Exit **\$0.7233**

Total Pre-Tax **\$289,320**

LTCG Tax (20%) **\$57,864**

Keeps After Tax **~\$231,456**



PEAK CAPITAL

SERIES C LEAD · INVESTED \$40M

Exit Proceeds **\$45,352,000**

Return Multiple **1.13×**

Net Gain **+\$5,352,000**

Protected **Full Participating**
by **Pref**



FIFTH-GRADER VERSION – WHY THIS FELT SO UNFAIR

The cake was only a little bigger than the amount already promised to the top tiers. After the top tiers took their reserved slices, only a thin layer of cake remained. But the top tiers said: "We also want a portion of the thin layer." (That is the participating preferred doing its double-dip.) By the time the

bottom tier — the founders and employees — got their portion of that thin layer, each person received crumbs. Kai, who built this company for six years, received \$4.3 million on a \$95 million exit. Aisha received zero. Their ownership percentages on paper were meaningful. Their actual proceeds were not. The preference stack consumed the exit.

THE COMPARISON THAT MAKES YOU FEEL IT

| SHAREHOLDER | % FD (ON PAPER) | IMPLIED VALUE @ |
|-----------------------|-----------------|-----------------|
| Kai (CEO) | 15.8% | \$15,0 |
| Nour (CTO) | 10.5% | \$9,9 |
| Employees + ESOP | 17.9% | \$17,0 |
| Peak Capital (Ser C) | 19.5% | \$18,5 |
| Momentum Fund (Ser B) | 20.0% | \$19,0 |

THE PAINFUL REALITY — AND WHAT COULD HAVE CHANGED IT

FULL PARTICIPATING PREFERRED TRANSFERRED WEALTH FROM BUILDERS TO FINANCIERS

Kai owned 15.8% on paper and received 4.6% of proceeds. Peak Capital owned 19.5% and received 47.7%. The full participating preferred plus a compressed exit is a mathematical wealth transfer from everyone who took salary risk to the investors who

bought downside protection. Three things would have changed this outcome materially: (1) Negotiating a 3× participation cap or non-participating preferred on the Series B and C; (2) Raising less — \$72M raised on a company that sold for \$95M left almost no room; (3) Holding out for a higher acquisition offer — at \$150M, common shareholders would have received roughly \$2.08 per share instead of \$0.72.

TWO COMPANIES, TWO OUTCOMES

The same industry, similar timelines — completely different results for founders and employees

| FACTOR | CLEARPATH ANALYTICS (CASE 1) |
|---------------------|------------------------------|
| Exit Price | \$480,000,000 |
| Total Raised | \$58,000,000 |
| Exit / Raised Ratio | 8.3× (exit >> raised) |
| Preferred Type | All Non-Participating |
| Preference Stack | \$58M on a \$480M exit = 12% |
| CEO Proceeds | \$106.6M (22.2% of exit) |
| | |

| | |
|--------------------------|--|
| Employees Collective | \$111.9M – Life-changing |
| Did Preferred Convert? | Yes – all converted to common |
| Were Options Underwater? | No – all employees made money |
| Key Negotiating Win | Non-participating preferred throughout |

"The cap table is written in pencil during the good times. It is enforced in ink at the exit. Every term you accept in a term sheet is a promise you make to your future self — and to every person who will ever work for you."

– THE CFO TO EVERY FOUNDER WHO HAS EVER SAID "WE WILL DEAL WITH THAT LATER"

CHAPTER 06 · MASTER LESSONS

TWELVE THINGS YOU WILL NEVER FORGET

The distilled wisdom of this entire four-part series

01

THE CAP TABLE IS THE SCOREBOARD

Every funding decision, every option grant, every term negotiated — it all lives on the cap table. Understand it or someone else will manage it for you.

02

ALWAYS THINK FULLY DILUTED

Outstanding shares are a vanity number. Fully diluted shares — including ESOP, warrants, and convertible notes — are the truth. Every ownership calculation you ever do must use fully diluted shares.

03

DILUTION ≠ BAD

A smaller percentage of a much larger, well-funded company is almost always worth more than a larger percentage of a stagnant one. The goal is not to protect your percentage. It is to build value.

04

NON-PARTICIPATING PREFERRED IS WORTH FIGHTING FOR

In a large exit, non-participating preferred means investors convert alongside common and share equally. In a small exit, it means they take their money back without double-dipping. Always negotiate for this.

05

NEVER IGNORE THE DOWN ROUND SCENARIO

Before every raise, model what happens at 40%, 60%, and 80% below your target valuation. Know your anti-dilution provisions. Know your pay-to-play clauses. Know who will support you and who will protect themselves.

06

THE 83(B) ELECTION HAS A 30-DAY CLIFF

There are no second chances, no extensions, and no exceptions. Every founder and every early employee who receives unvested restricted stock must file within 30 days. Build the process. Do not rely on memory.

07

ISOS ARE ONLY VALUABLE IF YOU FOLLOW THE RULES

Two-year holding period from grant. One-year from exercise. \$100K annual vesting limit. AMT exposure at exercise. Know all four rules before you exercise a single share. One mistake converts preferential rates to ordinary income.

08

THE PREFERENCE STACK CAN EAT THE WHOLE EXIT

If you raise \$72M and sell for \$95M, the preference stack consumes almost everything. Model the "bad exit" scenario before you accept terms. Know the crossing point where common shareholders start receiving real money.

09

DOWN ROUNDS ARE SURVIVABLE – FULL RATCHETS OFTEN ARE NOT

Broad-based weighted average anti-dilution is painful but manageable. Full ratchet anti-dilution can destroy a cap table and cause key people to leave. Never accept full ratchet if you have any alternative.

10



ASK FOR THE FULLY DILUTED SHARE COUNT BEFORE YOU ACCEPT ANY GRANT

1,000 options at a company with 5,000,000 shares outstanding is 0.02%. At a company with 500,000 shares outstanding, it is 0.2% — ten times as valuable. The raw number of options means nothing without the denominator.

11

RSUS ARE SIMPLE — BUT ORDINARY INCOME TAX HITS AT EVERY VEST

RSUs feel like free money. They are not free from a tax perspective. Every vesting event triggers W-2 ordinary income at the current FMV. At a high-value company, this can be a very significant tax bill — in cash — that requires planning.

12

THE LIQUIDATION WATERFALL IS WRITTEN BEFORE ANYONE KNOWS THE EXIT PRICE

The terms you negotiate at Series A do not feel important when you are only focused on building the product. They become the most important document you ever signed when a \$95M acquisition offer lands on the table. Negotiate every term as if the company will sell at a discount to your expectations — because sometimes it will.

**THE COMPLETE FOUR-PART SERIES AT A
GLANCE**

PART 1

*The Cap Table: From Day
Zero*

Authorized vs. outstanding shares, founder shares, ESOP reserves, Seed through Series B, dilution math, preferred stock, and price per share — the complete foundation.

PART 2

When the Market Turns

Down rounds, anti-dilution provisions, broad-based weighted average vs. full ratchet, pay-to-play clauses, and the recapitalization — survival mechanics for hard times.

PART 3

Your Equity, Explained

ISOs, NQSOs, RSUs, the 83(b) election, AMT risk, qualifying dispositions, holding periods — every type of equity compensation with complete tax math.

PART 4

The Exit Waterfall

The liquidation waterfall, participating vs. non-participating preferred, conversion decisions, and two complete case studies — a hero exit and a cautionary tale. The final reckoning.

CAP TABLE MASTERCLASS • FOUR-PART SERIES • COMPLETE

PART 4 OF 4: THE EXIT WATERFALL • TWO CASE STUDIES

Liquidation Waterfall • Participating Preferred • Conversion • Non-

Participating • ClearPath Analytics • Blaze Commerce

