MGT 816 · The Private Firm CFO

Fundraising: Process, Term Sheets, SAFEs

+ Venture Debt and the Working-Capital Peg

What the terms cost you, and what happens to the price when the company is sold.

Session 11 · Monday, October 12, 2026 · Prof. John Barrios · Yale SOM

Today's plan

1. **The process** — when to raise, what investors screen, the kit, and diligence. (16 min)
2. How funds work — posted reading (slides 8–15). We skip it in class.
3. **Instruments & terms** — notes, SAFEs, a 15-minute venture-debt sidebar, and liquidation preferences computed live. (38 min)
4. **Selling the company** — the working-capital peg and stock vs. asset sale. (16 min)

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Today is the last new exam material. PS2 solutions post on Canvas after the 4:10 section, and they are on the exam.

Wednesday: the peg negotiation, IPO in brief, a PS2 walkthrough, and the course wrap. None of it is new exam material.

PS2 is the model investors ask for

- PS2's monthly driver model **is** the "3–5-yr financial model" investors demand.
- It goes to **data-room folder 3 of 6**: deck, budget, **model**, historicals, cap table, legal.
- Diligence re-checks every assumption, the same check you ran on the AI-built model in S07.
- Logistics: graded within the week; solutions on Canvas after the 4:10 section — **not across sections today**.
- Exam note: the PS2 solutions are on the final — deferred-revenue timing, driver trees, sensitivities.

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When to raise (and when not to)

- **No choice** — you need the cash to survive.
- **It's easy** — hot sector, strong recent momentum, good cycle.
- **The price is good.**
- **The right partner shows up.**

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Raise when the money buys speed. Raising only to survive is the weakest position to negotiate from.

What investors screen

- ✓ **TAM & market growth** — how big can this get.
- ✓ **Founders / team** — domain expertise, technical depth.
- ✓ **Repeatable go-to-market.**
- ✓ **Unit economics** — CAC / LTV / payback (S06).
- ✓ **Competitive dynamics & network effects.**
- ✓ **Exit paths & horizon.**
- ✓ **Reasonable valuation** — then bid investors off one another.

From S06: CAC / LTV / payback

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The stage lens: what matters when

Stage	What investors weigh	Typical revenue
Seed	Team + idea + early evidence	Pre-revenue
Series A	Team + market + early traction	$0–5M (all over the map)
Series B–C	Financial metrics, growth vs. burn, mgmt quality	B ≈ $3–15M · C ≈ $5–30M
Late (C–E)	Exit horizon + financials	Scaled

Ranges are conventions, not rules — pre-revenue Series B's exist.

The CFO's fundraising kit ★

Materials

- Teaser + long deck
- Detailed monthly budget
- **3–5-yr financial model** (the PS2 model)
- Historical financials
- Optional one-pager
- **No formal business plan**

Deck contents

- Idea · vision · team
- Competition · TAM
- Go-to-market
- Unit economics
- Traction (+ forecasts if later-stage)

The funding-source map

Earlier ——▶ Later

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Early

- Bootstrapping / savings
- Friends & family
- Seed accelerators
- Equity crowdfunding
- Angels & angel groups
- SBIC / gov't loans
- VCs

Later

- VCs
- Corporate VCs
- Banks
- Private equity

Posted reading — not covered in class

Early money: bootstrap, friends & family, accelerators

Bootstrap

- Fundraising is slowest when info asymmetry is highest; many skip it.

Friends & family

- Signals people believe in you; take only money they can lose; complicates relationships in **both** outcomes; long holding periods.

Accelerators (YC / Techstars)

- $25–150K for 5–7%; mentorship + demo day. Pro: de-risk, network. Con: equity cost, time, weak-signal programs.

Angels and equity crowdfunding

- **Angels** — wealthy individuals; first stop for many.
- **Strategic angels** decide fast and lend credibility.
- Avoid a long tail of small checks — communication cost, future-round complications.
- Big active checks are fine even if not strategic.
- **Crowdfunding:** Kickstarter (products) · GoFundMe (individuals) · **AngelList** (equity syndicates — some VCs run syndicates).

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Posted reading — not covered in class

Getting to VCs: the warm-intro game

- VCs invest **LPs' money, not their own** — (bridge to Part 2).
- Route in via advisors / network for a **warm intro**.
- No path? Go through the **CEO of a portfolio company**.
- Cold email ≈ noise.

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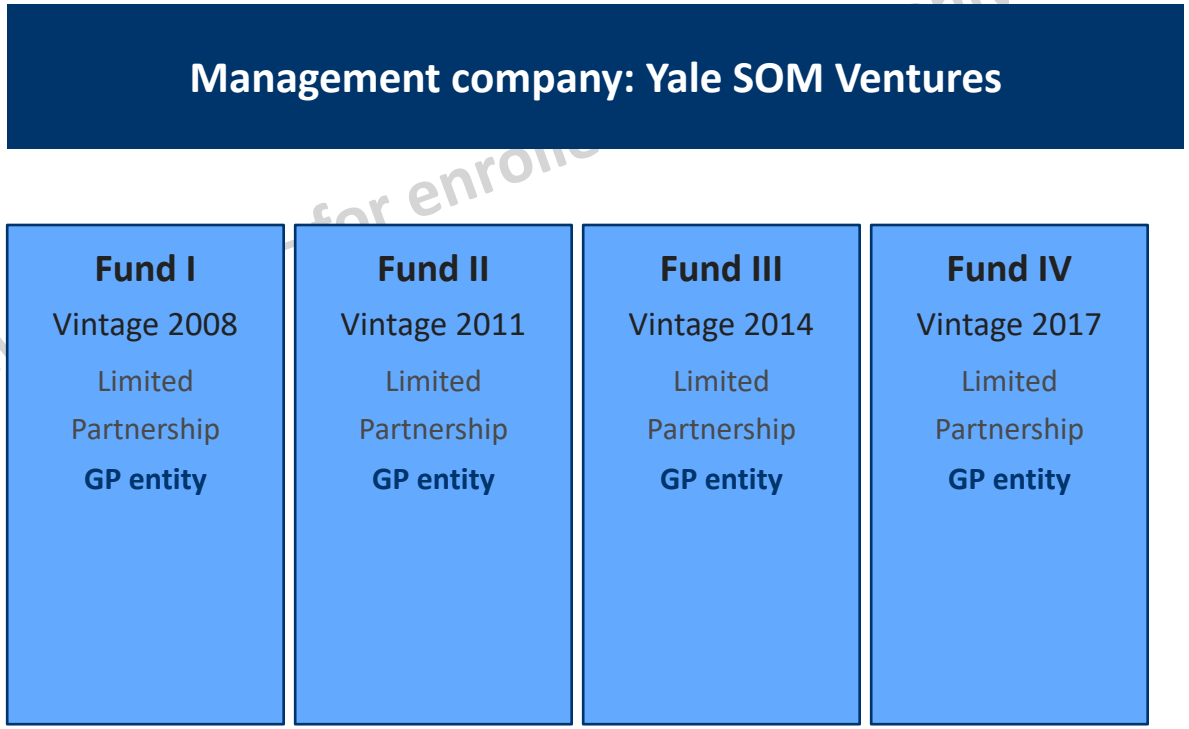
Posted reading — not covered in class

Part 2 · Posted reading · How the other side of the table works

Your investor has investors.

Inside the fund: LPs, GPs, and the 10-year clock

- LPs commit upfront; capital **called** as deals happen.
- Fund life **10 yrs** (+1–3 extensions).
- Investment period **5 yrs** — often 2–3 in practice.
- Liquidity pressure in **years 8–10** → your investor's fund age shapes YOUR exit timeline.



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How funds make money: 2-and-20

- **~2% annual management fee** on committed capital — steps down after the investment period; collected by the management company.
- **~20% carried interest** on profits — **only after returning contributed capital** (PE adds hurdle rates).
- Portfolio counts: VC **20–30**/fund; seed **50–75**.

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What returns they need from YOU

Stage	Ownership target	Return expectation
Early (Series A)	15–25%	40–50% IRR
Growth	~10%	4–5× · 30–40% IRR
Late	—	2–3× · 20–30% IRR

Your ask must let their math work — a $2B-TAM pitch can't 5× a $100M check.

Running the process: seed vs. Series B+

Seed / early

- Hard to raise without an experienced-founder halo
- Often no lead — company-led rounds on a **capped SAFE** (“set the cap, keep raising; raise the cap, keep raising”)
- Strategic angels decide fastest
- A lead VC forces everyone else to decide

Series B+

- You are **either fundraising or you are not** — formal raises in short spurts
- Otherwise “we'll raise next quarter” (everyone wants to feel early, no one wants to be rushed)
- Growth buckets they sort you into: break-even & fast · fast & burning · slow & break-even

Posted reading — not covered in class

Pre-emptive rounds & the partnership pitch

- **Pre-emptive round:** efficient if it closes (one partner, no roadshow) — **but** diligence-then-no risk, no competitive pressure, fewer VCs know you next time.
- Some firms always try to pre-empt; if it kicks off a process, line up enough warm funds.
- **Partnership pitch:** the Monday partner meeting gates the term sheet.
- Firms hate issuing term sheets their partnership might kill; unsigned / valuation-blank sheets exist.

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Diligence and the data room ★

- Investors call **customers, vendors, industry references**.
- Be ready with **up-to-date financials, cap table, customer lists** — and answer fast (responsiveness is itself a signal).
- They can ask anything — "would you step aside for a CEO hire?"
- Build the **data room once**, reuse every round.

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it becomes the M&A data room (S12)

Part 3 · Instruments & terms

Notes, SAFEs, venture debt and preferred stock, and what each term costs the founders.

The instrument menu by stage ★

Stage	Typical instruments
Start-up / Seed	Convertible note · SAFE · preferred
Series A–C	Preferred (convertible notes for bridges)
Pre-IPO	Preferred (occasionally structured for a set return)

Bridge notes carry a "why did they need a bridge?" stigma — avoid if possible.

Convertible notes in one slide

- Debt that **converts into the next priced round**.
- Conversion **discount** (~20%) and/or **valuation cap** + accrued interest.
- Two uses: seed substitute (cap ≈ shadow valuation) · bridge (stigma per slide 20).
- Downsides: maturity date · interest → tax friction · securities-law cleanup.

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SAFEs: the seed default

- **Simple Agreement for Future Equity** (Y Combinator).
- An agreement to issue equity later — **not debt, not yet equity**.
- No maturity, no interest.
- Variants: cap · discount · uncapped.
- Stacking: sequential SAFEs at rising caps ($3M → $5M → $8M → $10M).

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SAFEs aren't on the cap table yet — but they dilute exactly like equity when they convert.

Sidebar 1 · Where does a SAFE sit on the balance sheet? ★

SIDEBAR · 15:00

The idea

- A SAFE is economically a **warrant** that converts into the next round → sits in the **equity section, not debt**.
- Caveat: many auditors record SAFEs as a **liability** under ASC 480, because a sale before conversion can require a cash payout. A liability, but still **not debt**.

At issuance:

Dr Cash …… XX
  Cr Paid-in-Capital—SAFEs (warrant treatment) …… XX

On conversion:

Dr PIC—SAFEs …… XX
  Cr Preferred Stock + APIC …… XX

Convertible note = debt (interest accrues) until it converts.

SAFEs add zero debt to the balance sheet, but they still dilute the founders when they convert.

Sidebar 2 · Venture debt: what it is, who writes it

SIDEBAR · 15:00

Debt for venture-**backed** companies that lack standalone creditworthiness — raised alongside / just after an equity round (equity de-risks the loan).

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	Banks	Specialty finance
Structure	Revolvers + term loans	Term loans, larger checks
Rate	Near prime / SOFR-plus	~9–13%
Covenants	Covenant-heavy, downside-focused	Few covenants, upside via warrants

Why CFOs use it: extend runway between rounds with less dilution than equity.

Sidebar 3 · Term loans and warrant coverage ★

SIDEBAR · 15:00

Features

- Issued at par
- **Senior, collateralized (incl. IP)**
- 3–4-yr maturity
- **Warrant coverage 8–12% of loan → ~1–3% dilution**
- Strike = last preferred price

1. $2M loan × 12% coverage = $240,000 of warrants
2. ÷ strike $1.00 = 240,000 shares
3. 240,000 ÷ 24,240,000 shares ≈ 1.0% dilution

Venture debt costs interest plus a small slice of ownership through the warrants.

Sidebar 4 · Borrowing against receivables and MRR

SIDEBAR · 15:00

- **Revolver** = credit-card-like line; cheaper but more conservative than a term loan; borrowing base moves with collateral.
- **AR line:** advance rate against eligible receivables (**<90 days, no intercompany**); collections repay the line.
- **MRR line (SaaS):** credit ≈ **MRR × multiple (3–6×) × retention haircut**.

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AR lines are admin-heavy for a thin finance team — cost isn't only the rate.

Further reading: Bessemer Venture Partners, Guide to Venture Debt.

Economic terms: what sets the price ★

- **Valuation** — pre- vs. post-money (say which!).
- **Amount raised.**
- **Option-pool size & timing** — the pre-money shuffle (S02).
- → together these set **price/share** via the pro-forma cap table.
- **Liquidation preference** — money back first; senior vs. **pari-passu** (cleanest = pari-passu).
- **Participating vs. non-participating** — defined here, computed next.
- **Anti-dilution** — weighted-average (standard) vs. full-ratchet (harsh; Square's IPO ratchet — Wednesday).

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2× liquidation preference ≠ 2× participating.

Who gets what at a $10M exit?

NovaGrid raised a **$5M Series A at a $20M post-money (25%)**, **1× non-participating** preferred. The company sells for **$10M**. What does the Series A investor receive?

A) $2.5M (its 25%)

B) $5.0M

C) $6.25M

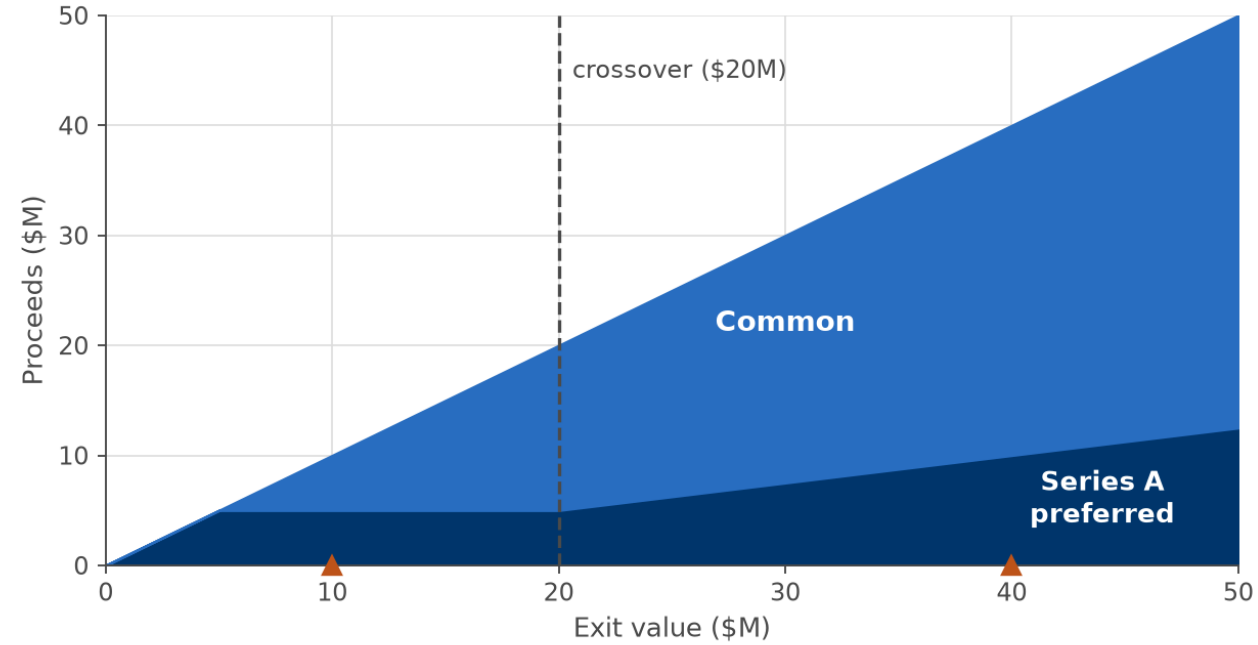
D) $10M

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And if the preferred were 1× participating?

Reveal: payoffs at two exits ★

Exit	Non-part: investor	Non-part: common	Part: investor	Part: common
$10M	max($5M, $2.5M) = **$5.0M**	$5.0M	$5M + 25%×$5M = **$6.25M**	$3.75M
$40M	max($5M, $10M) = **$10.0M** (converts)	$30.0M	$5M + 25%×$35M = **$13.75M**	$26.25M



Illustrative — NovaGrid base case

Participation is a double dip — the investor never converts. Non-participating converts once exit > $20M (= $5M ÷ 25%, the crossover).

Exercise: preferred payoffs

Pairs, 4 minutes, calculators. Your Series A terms and two exit values are below. Compute the investor's and common's proceeds at BOTH exits under (a) 1× non-participating and (b) participating preferred. Bonus: at what exit value does the non-participating investor choose to convert?

Your terms: $6M raised at $24M post-money (25% ownership), 1× preference. Exits: $12M / $60M.

⏱ 4:00

Control terms: who decides ★

- **Pre-emptive / pro-rata rights** — keep your %.
- **Governance** — board make-up (S10).
- **Information rights** — financials cadence (the S10 board package becomes contractual).
- **Protective provisions** — class-vote vetoes over sales, new senior stock, budgets, debt.

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Economic terms set who gets paid. Control terms set who decides, and they can cost more than they look.

Exercise: term triage — economic or control?

90 seconds, pairs: sort each term into ECONOMIC (sets who gets paid / the price) or CONTROL (sets who decides). Write E or C.

- pre-money valuation
- board composition
- option-pool size & timing
- protective provisions
- 1× liquidation preference
- information rights
- participation
- pro-rata rights
- anti-dilution ratchet
- drag-along

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Part 4 · Selling the company: the peg and the structure

The working-capital peg is part of the price.

Cash-free, debt-free — and why the peg exists ★

Price is set **cash-free, debt-free**: seller keeps excess cash, pays off funded debt.

But the business must transfer with enough WC to keep running → buyer insists on a **peg**.

Without a peg, the seller strips WC: **hyper-collect AR · starve inventory · stretch AP**.

Biggest dollars where inventory is big: CPG, retail, manufacturing.

NWC = current assets – current liabilities.

Operating items: AR, inventory, AP, accruals.

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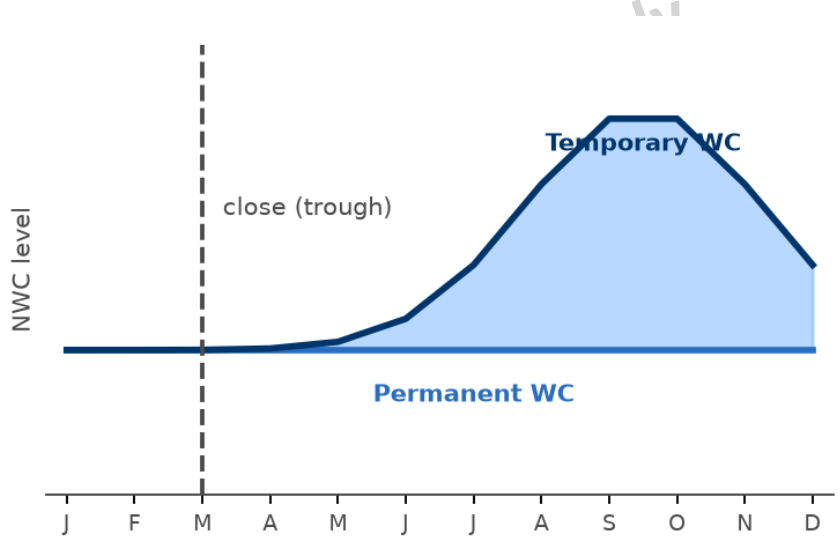
Peg mechanics: the true-up ★

Price agreed pre-close; **NWC moves daily** (seasonality).

Peg set from **trailing averages** or projected close level — subjective, therefore contentious.

Closing statement **90–120 days post-close**.

Adjustment is **dollar-for-dollar vs. the peg**: above → seller receives more; below → price comes down.



Concept: temporary vs. permanent working capital.

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Every $1 of peg is $1 of purchase price, so setting the peg is a price negotiation.

What's in, what's out — and the escrow ★

Exclude **non-operating (excess) cash** — seller extracts it.

Exclude **seller-repaid debt** (e.g., bank loan) from the NWC definition.

Include **operating cash** if the business needs a float.

The **SPA spells out the exact computation** — accounts, policies, GAAP-consistency — to pre-empt disputes.

Typically **two escrows**: one for the WC true-up, one for reps & warranties (~12 months).

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Methodology consistency — peg basis ≡ closing-statement basis — is the clause that prevents most closing-statement fights.

The SurgeonWare true-up

MedVR acquires SurgeonWare. Peg = **$1.5M** (historical average); adjustment is dollar-for-dollar. At closing: current assets **$8.0M**, including **$250K excess cash the seller keeps**; current liabilities **$6.0M**, including a **$500K bank loan the seller repays**.

Does MedVR pay more or less — and how much?

A) pays $750K **less**

B) pays $500K **more**

C) pays $750K **more**

D) no adjustment

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Reveal: MedVR pays $750K more ★

MedVR acquires SurgeonWare. Peg = $1.5M; adjustment dollar-for-dollar. CA $8.0M (incl. $250K excess cash seller keeps); CL $6.0M (incl. $500K bank loan seller repays).

1. Adjusted NWC = (CA $8.0M − excess cash $0.25M) − (CL $6.0M − seller-repaid debt $0.50M)
2. = $7.75M − $5.5M = **$2.25M**
3. vs. peg $1.5M → **+$750K to the seller**

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Answer C — MedVR pays $750K more.

Above the peg, the buyer buys the extra working capital at face value.

Stock sale vs. asset sale ★

	Stock sale	Asset sale
Seller tax	Shareholders pay capital gains	C-corp: TWO layers — corporate ordinary + shareholder capital gains
Buyer basis	Inherits seller's basis (and liabilities)	Step-up in asset basis
Who prefers	Seller (single tax)	Buyer (step-up amortization)

S-corp and LLC sellers avoid the double tax, which is one reason PE buyers prefer LLCs (S03).

The step-up: why buyers pay more for asset deals ★

Buyer pays $40M for a target whose net asset tax basis is $10M. Asset deal (or an LLC purchase treated as an asset deal for tax; S03).

1. Step-up = $40M − $10M = **$30M** new depreciable/amortizable basis
2. Goodwill/intangibles amortize over **15 years** for tax
3. At a **25%** blended rate → **$7.5M** undiscounted future tax shield
4. ≈ **$4–5M in PV** across the 15 years

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The step-up is why buyers bid MORE for asset/LLC deals; the seller's C-corp double tax is why sellers resist. The two sides negotiate the difference.

S-corp/LLC targets deliver step-up without entity-level double tax (through §338(h)(10) or §336(e) elections).

Takeaways ★

1. Raise for speed, when it's easy, at a defensible price — kit ready: deck, budget, model, data room. ★
2. Instruments ladder by stage: SAFE/note → priced preferred → venture debt as dilution-light runway (warrants ≈ 1–3%). ★
3. A SAFE is equity-section paper — no interest, no maturity — but it dilutes like equity when it converts. ★
4. Preference before participation before conversion — know the payoff algebra at any exit value. ★
5. Economics decide who gets paid; control decides who decides — read both columns before signing. ★
6. The peg: price is cash-free, debt-free. Remove excess cash and seller-repaid debt, then true up dollar-for-dollar against the peg. ★
7. Asset deals: step-up = price − tax basis; tax shield = step-up × rate, amortized over 15 years; a C-corp seller pays tax twice. ★

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Backup — Exercise: preferred payoffs (1.5× wipeout case)

Pairs, 4 minutes, calculators. Your Series A terms and two exit values are below. Compute the investor's and common's proceeds at BOTH exits under (a) 1× non-participating and (b) participating preferred. Bonus: at what exit value does the non-participating investor choose to convert?

Your terms: $10M raised at $25M post-money (40% ownership), 1.5× preference ($15M). Exits: $15M / $50M.



4:00