

What is a Pro Forma Cap Table and How Can it Help My Venture Capitalist?

A pro forma cap table shows the financial metrics of a company at current prices and after an initial investment. The spreadsheet combines information about the business to summarize the current market value of its stock, the net worth per share, the annual dividend rate, and the diluted earnings per share over time. It then models the effect of an initial investment of capital on net worth and equity. The spreadsheet can be used for multiple regression analysis to estimate the impact of initial price changes on value after the investment is made.

A pro forma cap table can be used to represent shares of ownership in a company as a fraction of total ownership. The fraction represents the proportion of total shares outstanding vs. the total number of shares authorized. This information is necessary to determine the exercise price for the shares of ownership. Determining this information can help investors budget for the number of shares they wish to buy.

Most investors use the standard Excel spreadsheet to produce their pro forma cap table. One reason for this is that it provides a consistent look to the data. Most people are accustomed to working with rounding to the nearest whole number. Using a standard Excel spreadsheet where rounding is used can lead to rounding values that are off-kilter, inaccurate, or difficult to interpret.

Most investors report their ownership structure, including common equity and preferred stock, as either retained earnings or retained cash. Two12 prefer to report retained earnings as the primary method of financing for their businesses. This is because it allows them to provide the necessary cash flow data to their fund managers without having to wait for future dividends. A pro forma cap table can be used to model the effect of any proposed modifications to the existing financing. An investor may report a new capital structure where he or she receives funds from the Board of Directors or from equity investors.

Some investors, however, prefer to use the conventional method of computing capital gains and losses by dividing net worth by outstanding shares, also known as outstanding equity. The investor may also choose to purchase shares from the proceeds of a mortgage or from another lender. One disadvantage of the conventional pro forma cap table involves converting the total number of shares outstanding to net worth. This may not be an issue if the majority of the investors are wealthy investors.

To avoid the potentially unpleasant tax implications of a financed investment, it is often desirable to consult an accountant or business professional who has experience determining the tax consequences of owning shares in a company. Most small businesses are not treated as financial corporations. Investors in these types of businesses are not entitled to obtain double taxation relief under the current laws. An investor who becomes involved in a financing round that results in an increase in the value of the enterprise may be subject to UBIT, which is defined as the pre-tax profit realized by the financing round.

Determining the value of an enterprise is not a simple task. There are many mathematical calculations involving many complex factors that must be made prior to the issuance of a stock purchase order for such a venture capital financing round. The use of a pro forma cap table can be very helpful to a venture capital financing broker or underwriter who must make these calculations in a timely manner. The calculation of potential EBIT (earnings before interest and taxes) can take several days, but it is usually possible to submit the information needed in less than one day.

One other advantage of using a pro forma cap table for computing the ownership and EBIT percentages of a venture is that the calculations are simplified. It is not difficult to calculate the values of equity dilution and ownership for a company that has only two founders, but it is much more difficult to calculate the value of dilution when the company has only one founder and multiple shareholders. In addition, because of potential dilutions due to stock splits and the existence of hidden equity (such as founder stock or preferred stock), computing EBIT percentages can become quite complicated. When there are multiple shareholders, the dilutions can be mitigated somewhat by ensuring that all shares of common stock or common equity capital are owned by the same individual or entities. However, when a corporation is composed of multiple founder/vice-chairmen and multiple members, calculating the value of dilution must be performed based upon the information available to the accounting firm and, if necessary, the services of an investment management professional who is experienced with the application of the different methods of equity dilution to buy-sell situations and to individual stocks.