Contents

1. Public Company Assignment 1
2. Options 1
2.1. ISO, NSO, oh-no! 3
3. Eero 4

1. Public Company Assignment

- Lets first look at the companies you were not allowed to choose:

	Price	Shares Out.	Market Cap	Net Inc (MM)	# of Employees	Profit per employee
AAPL	164	16,500	2,706,000	94,680	154,000	614K
AMZN	3,225	500	1,612,500	34,364	1,608,000	21K
GOOG	2,722	732	1,992,504	76,033	156,000	487K
FB/Meta	216	2,895	625,320	39,370	71,900	547K
NetFlix	380	455	172,900	5,110	11,300	452K
Twitter	37	865	32,005	-221	7,500	(29K)
Microsoft	300	7,600	2,280,000	61,271	181,000	338K

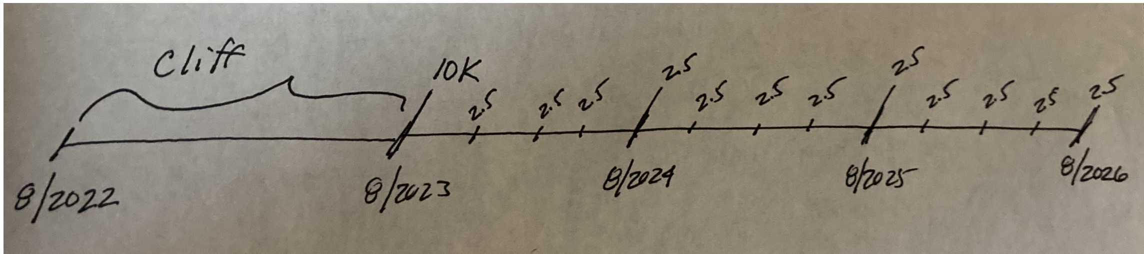
- This is the *profit* per employee – after all the benefits, costs and salary.
- What does this tell us (besides the fact that they are monopolies?)
- How does this compare to your company?

2. Options

- The most common type of pre-exit equity compensation is a stock option.
- In this section we will go over how stock options work.
- Note that there are tons of variations of how this work, but this is the basic idea. While the terminology is used everywhere, companies often have some choice on specific implementation.
- Terminology:
  - **Option**: The right to *purchase* a stock at a particular price. Note that you still must purchase the stock itself.
  - **Strike Price**: The price that you must pay to purchase the stock.
  - **Exercise**: The act of purchasing the stock, or converting the option into an actual stock.
  - **Vest**: Synonym for “earn”. The “Vesting period” is the time period you earn your stock options. When a stock option is “vested” it means you are now allowed to exercise it.

- **Cliff**: When the first portion of your option grant vests
- **Grant**: The contract that you have with the company.

- Example:
  - You will receive 40K options with a 1 year cliff, quarterly vesting, a 5-cent strike price over 4 years.
  - Lets say you start working on 8/1/2022.
  - You do not vest any options until 8/1/2023.
  - On 8/1/2023 you earned $\frac{40{,}000}{4} = 10,000$ options.
  - Each quarter thereafter you vest another $\frac{40{,}000}{16} = 2,500$ options.



  - Example #1: You leave on 5/1/2023 (9 months): You have zero equity.
  - Example #2: Leave on 9/1/2023 (2 years in): 20,000 options vested.

- What about when you leave?
  - The company is legally required to provide you with a 30 day *option exercise window.* In other words you have 30 days to decide if you wish to exercise your options.
  - Many companies will provide longer option exercise windows (sometimes even as long as 10 years!), but it is up to the company and they can change this at any time.

- How do I exercise?
  - If you decide to exercise you have to pay the company the strike price associated with that option.
  - In Example #2 above, if you decided to exercise all of your options you would have to pay $\$.05 \cdot 20,000 = \$1,000$.
  - In other words, you write a check to your company and receive the stock at this point.

- Tax-treatment

- The stock that you receive has a *value*, hopefully greater than the strike price. If a company gives you something, that is called “income” and is taxed accordingly.
- Exercising an option is generally a taxable event and the income you get is the difference between the value of the stock and the exercise price (sometimes called the spread).
- If, for example, the value of the stock is $20 at the time you exercised your options then you would be taxed for $20,000(20.00 - .05) = \$399,000$.
- If it was taxed as ordinary income and your marginal tax rate was 32% then you would be on the hook for a tax bill of $128K.
- If the company is still private you will not be able to sell that stock.
- This is what happened in the *Uber Handcuffs* article and this is often called **golden handcuffs**.

- In the last few years, companies have moved to change some of the ways that they handle option transactions to minimize some of the impact on employees. However, the key mechanics are the same and, if you are getting equity as part of your compensation, you should be aware of this.
- The article *What I wish I had known before joining a unicorn* also goes into some of the same issues.

2.1. ISO, NSO, oh-no!

- There are actually two types of commonly used options:
- Non-qualified Stock Options (NSO)
  - Can be given to anyone
  - Tax treatment is what is mentioned above
  - Commonly given to advisors, board members, etc.
- Incentive Stock Options (ISO)
  - Employees only
  - Generally tax-preferable and, because of this, used more commonly, but has some gotchas.
  - Specifically, if you **exercise and hold for more than a year** than rather than paying income tax you pay capital gains tax.
  - Capital gains is lower than income tax.
  - **HOWERVER:** There is something called the Alternative Minimum Tax (”AMT”) which was set up in 1969 to make sure that high earners would pay a minimum amount of tax.

  - Not everyone pays AMT. It's like a flag on your taxes – if you hit it you do everything different.
  - The way that you hit AMT is by having sufficient income, but without paying that much in taxes.
  - The difference between fair market value and the strike price is *i*ncluded in the calculation for AMT, even if you buy and hold. Meaning that it's possible for it to trigger AMT and put you in an AMT Trap.
- Mentally, what this means is that while ISOs "should" have a favorable tax treatment it's quite common for any sizeable win to trigger the AMT and thus dampen this tax advantage.
- This is NOT a class on taxes. Next week, on your quiz you can ignore everything about AMT and focus on the timeline we did previously.

3. Eero

- Founded in 2015
- Mesh routers
- At the time they came out, their product was pretty magical:
  - Very easy to set up
  - "Mesh" to easily add nodes
  - A bit of "-as-a-service" magic where things automatically update
- First mover advantage in the space.
- Money raised over time:

		Round	Cum. Raised
Founded	2/2015	5MM	5MM
Series A	11/2015	35MM	40MM
Product Launch	1/2016		
Series B	5/2016	50MM	90MM
Series C	12/2017	40MM	130MM
Debt Round	Early 2018	10MM	140MM
Amazon Buys for 97MM	2/2019		

- Money Story:
  - Seed round built a POC for roughly 5MM (hardware is expensive)
  - Series A got them to launch (probably marketing and prepaying for hardware orders)
  - Series B is 18 months later

- Series C is another 18 months later

- At the time that they were purchased there were 5 classes of shareholders:
  (1) **Debt Holders:** Paid in full ($40MM)
  (2) **Investors:** All of them lost money (at least 16% per article), but it's actually probably worse. After paying debt holders there is only ($97 - 40 = 57MM$) left. Total investments were around $130MM. Meaning they only recovered 44% of their investment. And Founder carve out!
  (3) **Founders:** Carved out of around 10% of the amount post debts (estimated at a slightly different number of $54MM, due to transactions costs).
  (4) **Executives:** Retention Bonus and salary
  (5) **Employee Pool:** Average employee strike price is around $3, but the value of the stock was $.03. The average exercise lost $2.97!

- What happened? They seemed to have every thing going in their favor: expanding market, really well received product?
  - Their major competitors owned distribution (Apple / Google). Afforded them price performance.
  - Apple / Google were also okay with losing money
  - Eero was getting killed (their margins) b/c selling at best buy.