Deal Analysis and Investment Cases

Interview preparation summary · VC track

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INT.VD.1.a · Evaluating a deal

Run a sourcing and screening funnel that says no quickly, and structure a venture investment memo around what must be true for the company to return the fund.

A venture deal starts as a funnel, and the discipline is to say no quickly and cheaply. Sourcing comes from founder referrals, co-investors, operators, accelerators and outbound work on themes the fund has mapped. Screening tests fit first (stage, cheque size, sector, geography, ownership on offer), then the few things that can kill a venture outcome: a market too small to produce an exit that matters to the fund, a team with no reason to win, or a price that breaks the arithmetic. The memo is then a decision document built on what you must believe: why now, team, market, product and traction, round terms, the exit size and route needed to return the fund, key risks and the diligence still open. The usual mistakes are a memo that describes the company well but never says what has to be true, and a screen that rewards a polished deck over evidence. Interviewers listen for a clear funnel, honest reasons for passing and the exit arithmetic.

WORKED EXAMPLE: COSTING A SOURCING FUNNEL AT A SEED FUND

A small seed fund sees 480 inbound decks a year. It passes 75% at a ten-minute screen, holds a 45-minute first call with 40% of the survivors, a two-hour second meeting with 25% of those, and writes a 25-hour memo for half of those. Two-thirds of the memos end in a signed investment. Count each stage, the hit rate and where the hours go, and say what the partner should change. Convention: whole numbers, no time spent on deals that were lost to a rival.

Answer: 480 decks become 120 screened, 48 calls, 12 second meetings, 6 memos and 4 investments, a 0.83% hit rate; the 150 memo hours (52% of 290) are the lever, so apply the kill criteria before the memo.

> **Interview tip:** Give the funnel in numbers and then say what you would change. Interviewers are checking that you screen on fit and exit size, not on how much you liked the founder's deck.

INT.VD.1.b · Evaluating a deal

Negotiate a venture term sheet by separating price, economics, control and process, and compare offers on effective pre-money rather than headline valuation.

A term sheet is a negotiation over price, economics, control and process, and the headline valuation is only one line. Economic terms include the pre-money, the option pool sitting inside it, liquidation preference and participation, anti-dilution and pro rata. Control terms include the board, protective provisions, information rights, vesting and drag-along. Process terms include the no-shop (exclusivity), the expiry date and the conditions to closing. The sharpest test of price is the effective pre-money: the headline pre-money less the unallocated pool that must exist after the round, because a pool created before the money arrives dilutes only the existing holders. Good investors protect what the fund truly needs (target ownership, a seat or observer, information, a clean preference) and trade the rest, because founders remember how a lead behaved when others were competing. The usual mistake is to win or lose on the headline number while participation, a large pool or a long no-shop quietly changes who gets paid and who has options.

WORKED EXAMPLE: TWO OFFERS WITH DIFFERENT POOLS

A founder holds two seed term sheets, both raising 5m. Offer A: 20m pre-money with an unallocated option pool of 12% of the post-money, created inside the pre-money. Offer B: 18.5m pre-money with a pool of 4% of the post-money, also inside the pre-money. Compare the investor's ownership, the pool and the effective pre-money. Convention: no pool exists today, everything else is identical.

Answer: Effective pre-money is 17.0m for Offer A and 17.56m for Offer B, so the lower headline is the better price for the founders, and the investor owns 20.0% against 21.3%.

> **Interview tip:** Always convert competing headlines to effective pre-money before comparing them, and say which side of the table you are speaking for. It shows you know where the real price sits.

INT.VD.1.c · Evaluating a deal

Price a venture deal against the ownership the fund needs by turning the cheque, the post-money and later dilution into the exit value required to return the fund.

Venture pricing is read through ownership rather than a multiple of earnings. The cheque divided by the post-money valuation gives entry ownership, and ownership at exit is entry ownership multiplied by the share retained through later rounds, for example 0.80 times 0.85 times 0.88 if three rounds dilute by 20%, 15% and 12%. Dividing the proceeds the fund needs by exit ownership gives the exit value required, and a fund-returner is an investment whose proceeds equal the fund, so the required exit is the fund size over exit ownership. Raising the price raises the required exit in proportion to the post-money, whatever the dilution. This is why funds set ownership targets by stage and test whether a credible exit from a bottom-up market view clears the bar. Pro rata can hold ownership later but costs reserves at higher prices. The usual mistake is to admire the company and ignore what the price and dilution do to the exit it must reach.

WORKED EXAMPLE: WHAT EXIT DOES A 3M CHEQUE NEED TO RETURN A 120M FUND?

A 120m fund can invest 3m in a seed round at a 15m post-money valuation. It expects later rounds to dilute existing holders by 20%, 15% and 12%, and it will not use pro rata. Find the entry ownership, the ownership at exit and the exit value that returns the whole fund once, then repeat at a 25m post-money. Convention: ignore preferences and fees; proceeds equal ownership times exit value.

Answer: 20.0% at entry becomes 11.97% at exit, so the company must exit at about 1.0bn to return the fund; at a 25m post-money it must exit at about 1.7bn.

> **Interview tip:** Say the formula in one breath: cheque over post-money, times what survives dilution, then fund size over that. Then name the market evidence that would make the exit credible.

INT.VD.2.a · After the deal

Decide on a follow-on investment by judging its marginal expected return, its signalling effect and the reserves available, not the blended multiple on the position.

A follow-on is a new investment decision made with more information and at a higher price, so it is judged on its own expected return and not on how well the first cheque is doing. The pro rata right gives the fund the option, not the duty, to buy its share of a future round and hold its ownership. Reserves are set at fund level before the first cheque, and the reserve ratio (reserves relative to initial cheques) varies by stage. The marginal test takes the extra ownership bought, the dilution still to come, a range of exit values with probabilities, and divides the expected proceeds by the new cheque. Also weigh the signal: a new lead often expects insiders to participate, and non-participation tells the market something. Reserves usually belong with companies that have hit their milestones, not with rescues. The common errors are quoting the blended multiple, which includes a cheap first cheque, and sunk-cost reasoning about money already spent.

WORKED EXAMPLE: MARGINAL VERSUS BLENDED RETURN ON A PRO RATA CHEQUE

A fund invested 2.0m for 20% at a 10m post-money. The Series A raises 8m at a 32m pre-money, so 40m post-money. Pro rata would hold the fund at 20%. Later rounds will dilute holders by a further 30%. Exit outcomes: 400m with 30% probability, 100m with 30%, nothing with 40%. Compare the marginal multiple on the follow-on with the blended multiple on the whole position. Convention: ignore preferences, fees and timing.

Answer: The pro rata cheque is 1.6m and its marginal expected multiple is 2.6x, against a blended 5.8x on the position; judge the follow-on on the 2.6x.

> **Interview tip:** Quote the marginal multiple and compare it with what a new initial cheque would earn. Mention the signal to other investors as a second factor, not the main one.

INT.VD.2.b · After the deal

Assess a bridge, a down round or a recapitalisation by sizing the runway, working through the anti-dilution effect and asking whether the reset plan deserves new money.

When a company misses its plan the fund faces a bridge, a down round or a recapitalisation. A bridge is a small financing, often a convertible note or SAFE from insiders, that buys time to a defined milestone; size it to reach that milestone plus the months needed to raise the next round, and ask what will be different at the end. A down round prices shares below the

previous round. It can trigger anti-dilution: full ratchet resets the earlier conversion price to the new price, while broad-based weighted average adjusts it only partly, using the new money and the whole share count. Pay-to-play clauses force holders to invest or lose protection. A recapitalisation resets the cap table, preference stack and sometimes the option pool. The test is whether the new plan would be a good investment at the new price if the fund had no history. The usual mistake is to protect the old mark rather than judge the reset.

WORKED EXAMPLE: WEIGHTED AVERAGE ANTI-DILUTION IN A DOWN ROUND

A company has 24.0m fully diluted shares, including 6.0m Series A shares bought at 1.00 each. It now raises 4m at 0.50 per share, issuing 8.0m new shares. Series A has broad-based weighted average protection. Find the new Series A conversion price and ownership, and compare with no protection and with full ratchet. Convention: Series B shares are fixed at 8.0m, so ignore the circularity of price setting.

Answer: The adjusted price is 0.875 and Series A rises from 18.75% to 20.9% under weighted average, against 31.6% under full ratchet.

> **Interview tip:** Explain the formula in words: the lower the new price and the larger the round relative to the company, the bigger the adjustment. Then say what you would negotiate in the reset.

INT.VD.2.c · After the deal

Evaluate an exit route (acquisition, IPO or secondary sale) and decide when to hold, sell or write off a position using proceeds after preferences, timing and discount rates.

Most venture exits are acquisitions, often with part of the price in escrow, an earn-out or stock; an IPO is rarer, needs scale and delivers cash only after a lock-up; a secondary sale transfers shares to another investor, usually at a discount to the last mark, and returns cash earlier. What the fund receives depends on the waterfall: preferred holders take their preference or convert, whichever is higher, so low prices can pay investors very differently from the ownership percentage. A sale-or-hold decision compares the sale price with the expected value of holding, discounted at a rate that reflects risk, time and the fund's need for distributions (DPI). A write-off is recorded when there is no credible path to recover cost, for example when runway ends and no round or buyer appears; carrying zombies at the last round price overstates TVPI. The usual mistakes are multiplying ownership by headline price and treating unrealised marks as returns.

WORKED EXAMPLE: SELL HALF A POSITION AT 80% OF THE MARK, OR HOLD?

A fund holds a stake marked at 12m that cost 2m. A buyer offers to purchase half at 80% of the mark. If the fund keeps that half, it expects an exit in four years: 25% chance of 30m, 40% chance of 7.2m and 35% chance of nothing. Compare the sale with the expected value of holding at discount rates of 25% and 15%. Convention: ignore tax, fees and costs of the sale.

Answer: The sale gives 4.8m now against 10.38m expected in four years, so it is worth taking if the discount rate is above 21.3%, and holding is better below that.

> **Interview tip:** State the break-even discount rate and then say which fund circumstances put you above or below it. A rule such as always sell at a discount or never sell below the mark is the weak answer.

Summary of the Charta interview-preparation topic. Companies and figures in the examples are invented. Draft content, not yet expert reviewed.