

[Company Name]
[Company Address]
[City, State, Zip Code]
[Date]

[Shareholder Name]
[Shareholder Address]
[City, State, Zip Code]

Subject: Explanation of Shareholder Dilution Mechanism

Dear [Shareholder Name],

This letter serves to provide a formal explanation regarding the mechanism of shareholder dilution as it pertains to your equity holdings in [Company Name]. As the company continues to grow and seek further investment, it is important that all shareholders understand how new share issuances affect existing ownership percentages.

1. Definition of Dilution

Dilution occurs when the company issues new shares of stock. While the absolute number of shares you own remains the same, your percentage of ownership in the company decreases because the total number of outstanding shares has increased.

2. Why Dilution Occurs

The company typically issues new shares for the following reasons:

- Raising capital from external investors to fund expansion.
- Allocating shares to an Employee Stock Option Pool (ESOP) to attract talent.
- Settling convertible debt or warrants.

3. The Calculation Mechanism

The formula for calculating your diluted ownership is:

$$\frac{[Number\ of\ Shares\ You\ Own]}{[Total\ Number\ of\ Shares\ Outstanding\ After\ New\ Issuance]} = New\ Ownership\ \%$$

4. Impact on Value

Although your percentage of ownership may decrease, dilution is often intended to increase the overall valuation of the company. A smaller percentage of a significantly more valuable company can be worth more than a larger percentage of a smaller company.

5. Anti-Dilution Provisions (If Applicable)

[Insert details here regarding any "Pre-emptive Rights" or "Anti-dilution Clauses" if they exist in the Shareholders' Agreement. If none exist, state: "Please refer to the current Shareholders' Agreement regarding any specific rights held by your share class."]

If you have any questions regarding your specific shareholding or the technical aspects of this mechanism, please contact [Name/Department] at [Email/Phone Number].

Sincerely,

[Signature]

[Name of Officer]

[Title]

[Company Name]