

Cooley

Early Stage
Term Sheets

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attorney advertisement

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Snapshot

#1 IPO firm for a Decade

More VC-backed IPOs
than any other firm over
the last decade

Top Tier for Global Financings

Top 3 most active law firms Globally
and in the US

PitchBook (2017)

Top tier for VC + Startups

Nationally recognized as Tier 1 for
Venture Capital and Startups

Chambers USA
Legal 500

Best Value

Named the “best of
the best” at providing
value for the dollar

BTI Consulting (2017,
2018)

Counsel to Disrupters

Represent more than 1/2 of the
companies on Inc.'s Top 15
Companies of 2016

Counsel 40% of the US companies
on the Wall Street Journal's Billion
Dollar Startup Club list

Noteworthy Clients

Represent 9 of Fast Company's Top 10
“Most Innovative Companies of 2017”

Fast Company

COOLEY GO

- Information, tools and advice for entrepreneurs
 - Generate core legal documents
 - Series Seed note and equity financing documents
 - Read substantive posts addressing issues arising at different growth stages
 - Access our venture financing data and deal terms
- It is completely free
- cooleygo.com



The People's Choice Award

Cooley is proud to be the first
US law firm to win a People's
Choice for Cooley GO

Today's Topics

- SAFEs
- Convertible Notes
- Valuation Issues
- Equity Terms
 - Board of Directors
 - Liquidation Preferences
 - Option Pools & Vesting
- More Than Just Valuation!
 - Protective Provisions
 - Redemption Rights
 - Preemptive Rights
 - and so much more!

SAFE – Simple Agreement for Future Equity

- Developed by Y Combinator for the earliest of companies
- The simplest documentation – one form, six pages
- An agreement to give the investor stock or cash in the future
- Now looks a lot like a convertible note without term or interest
- Rarely seen outside Silicon Valley
- Still a security and you must follow the accredited investor rules
- More info at www.CooleyGO.com

Convertible Notes

- Key items of negotiation
 - Interest Rates (4-8%) converts into more stock, not paid in cash
 - Maturity Date (12 to 24 months)
 - Conversion Discount (20-25%)
 - Valuation Cap – (generally relevant at 2X+ valuation growth)
 - Payment in lieu of conversion on a sale (200%)
- You can generate a term sheet and docs on CooleyGO

Valuation Details – Base Case

| | | | | |
|--------------------------------------------------|--------------------|--------------|-------------|---------------|
| “Pre-Money” Valuation: | \$7,000,000 | | | |
| Post-Financing Option Pool: | 20.0% | | | |
| Total Financing of: | \$3,000,000 | | | |
| \$7M "pre-money <u>including options</u>" | | Before Money | After Money | After Options |
| New Investors: (@\$0.714/share) | 4,200,000 | 0.0% | 37.5% | 30.0% |
| Option Pool: | 2,800,000 | 0.0% | 0.0% | 20.0% |
| Founders: | 7,000,000 | 100.0% | 62.5% | 50.0% |
| | 14,000,000 | 100.0% | 100.0% | 100.0% |

How the Discount and Cap Compute

- Assume Company sold \$1.0M of Convertible Notes
 - 5% interest, 25% discount, \$5M cap, 12 months outstanding
- \$2.0M Series Seed at a \$10M post (still a total of \$3M used)
 - Only you have to convert the notes with interest and discount
- Noteholders get 14% rather than 10% for \$1.0M
- Caps typically come into play if pre-money is $>2X$ cap
- Great planning tool: <http://ownyourventure.com/equitySim.html>

Valuation Details – with a Note (no cap)

| | | | | | |
|--------------------------------------------------|--------------------|-----------------|------------------|---------------|-------------|
| “Pre-Money” Valuation: | \$8,000,000 | | | | |
| Post-Financing Option Pool: | 20.00% | | | | |
| New Financing of: | \$2,000,000 | \$0.6570 | per share | | |
| \$8M "pre-money <u>including options</u>" | | Before Money | After Money | After Options | Value |
| New Investors: | 3,044,140 | 0.00% | 25.00% | 20.00% | \$2,000,000 |
| Note Conversion | 2,130,898 | 0.00% | 17.50% | 14.00% | \$1,400,000 |
| Option Pool: | 3,043,000 | 0.00% | 0.00% | 20.00% | \$1,999,251 |
| Founders: | 7,000,000 | 100.00% | 57.49% | 46.00% | \$4,599,000 |
| | 15,218,038 | 100.00% | 100.00% | 100.00% | \$9,998,251 |

Series Seed or Series A Terms

- Other Key Issues
 - Board of Directors
 - Liquidation Preferences
 - Option Pool size
 - Founder Vesting
- Generating Series Seed docs on www.CooleyGO.com
 - Make sure you understand each term, even if you don't use the docs

Board of Directors – Key Terms

- Size of board
- “Founder” representation vs. CEO
- VCs vs. outsider appointments
- Voting agreements

Liquidation Preferences

- Non-Participating – Investors must choose between Common and Preferred
 - This has become the predominant form of preference
- “Fully” Participating - 1X plus share of what is distributed to Common Stock
 - Now more common in later rounds (C+)
 - The investors do not need to choose to convert in order to get preference and participation
- Capped-Participation – 1X plus share of what is distributed to Common Stock, unless a cap is reached (e.g. 3X total); investors must choose to convert to avoid being capped.
- What do you mean more than 1X!
 - Rare on West Coast; Utilized in late or down rounds

Liquidation Preferences

Let's go with the simple numbers we had earlier.

\$3MM financing on a \$7MM pre-money that included the 20% pool.

| | | | | |
|-------------------------------------------|--------------------|--------------|-------------|---------------|
| "Pre-Money" Valuation: | \$7,000,000 | | | |
| Option Pool: | 20.00% | | | |
| Total Financing of: | \$3,000,000 | \$0.7140 | per share | |
| \$7M "pre-money including options" | | Before Money | After Money | After Options |
| New Investors: | 4,200,000 | 0.00% | 37.50% | 30.00% |
| Option Pool: | 2,800,000 | 0.00% | 0.00% | 20.00% |
| Founders: | 7,000,000 | 100.00% | 62.50% | 50.00% |
| | 14,000,000 | 100.00% | 100.00% | 100.00% |

Liquidation Preferences

- Sale without Participating Liquidation Preference

| | | | |
|-------------------------------------------|---------------------|-------------------------------------------|---------------------------|
| Sale in 13 months | | \$7M "pre-money including options" | |
| Total Sales Price | \$20,000,000 | | |
| \$7M "pre-money including options" | | After Options | Effective Proceeds |
| New Investors: | 4,200,000 | 30.00% | \$6,000,000 |
| Option Pool: | 2,800,000 | 20.00% | \$4,000,000 |
| Founders: | 7,000,000 | 50.00% | \$10,000,000 |
| | 14,000,000 | 100.00% | \$20,000,000 |

Liquidation Preferences

- Sale with Liquidation Preference

| Sale in 13 months | | \$7M "pre-money including options" | |
|--------------------------|-------------------------------|-------------------------------------------|---------------------------|
| Total Sales Price | \$20,000,000 | | |
| | Liquidation Preference | Remaining Balance | Effective Proceeds |
| New Investors: | \$3,000,000 | \$5,100,000 | \$8,100,000 |
| Option Pool: | \$0 | \$3,400,000 | \$3,400,000 |
| Founders: | \$0 | \$8,500,000 | \$8,500,000 |
| | \$3,000,000 | \$17,000,000 | \$20,000,000 |

- Investors get their original amount first
 - Remaining Balance split among all stockholders
 - Net is investors get 2.7X return on 2X deal.

Option Pools and Vesting

- Option Pools

- Typically specified as a % of the fully diluted
- Best if you have a plan and “budget”

- Vesting

- Term (4 years is typical) and “cliff” (1 year)
- Founders and re-vesting
- Single and double triggers for accelerating vesting
 - Single: “The company is sold.”
 - Double: “The company is sold and you are fired.”

Other Key Points to Negotiate

- No Shop
 - One of the only binding terms in the term sheet
 - Confidentiality is the other
- Information Rights
 - Definition of a “Major Investor”
 - Time for audited financials?

What The Heck Are These?

- Protective provisions
 - Investors control the future of most major decisions
- Participation rights
 - A dual edged sword
- Drag -along rights
 - One for all, and all for one
- Redemption rights
 - Rarely included, even rarer to use

The Boilerplate

- Registration Rights
 - Impact is far into the future (potentially) or when you are at the IPO stage
- Dividend Rights
 - Preferences
 - Cumulative vs. non-cumulative
 - When, if, how, maybe
- Co-Sale Rights
 - Everyone gets out at the same time

Ken Rollins

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Mr. Rollins has a general corporate transactional practice, representing emerging and late stage private companies and public companies in a wide range of corporate and securities matters, including private financings, public offerings, mergers and acquisitions, tender offers, strategic collaborations, commercial agreements, corporate governance matters, and employment and compensation arrangements. He also advises venture capital firms in connection with financings and other transactions. Mr. Rollins is counsel to companies in diverse industries, including information technology, biotechnology, medical device, retail, semiconductor, software and cleantech. His clients range from start-ups to public companies with hundreds of millions of dollars in annual revenues.

Mr. Rollins received a JD from the University of Virginia School of Law in 2002, where he served as Senior Managing Editor of the Virginia Tax Review and was awarded the John M. Olin Economics Scholarship. In 1998, he received a BA in Accounting from Southern Utah University where he was selected as valedictorian and named the 1998 Scholar of the Year. Mr. Rollins is a member of the State Bar of California.



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