



Terms and Trends in Preferred Stock Financings

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Key Venture Capital Terms

- Price
- Liquidation Preference
- Voting and Board Provisions
- Drag-Along Provision
- Anti-Dilution Provisions
- Redemption Rights
- Restrictions on Founders
- Other Terms



Price

- *Priced round: A financing where equity/preferred stock is issued for fixed price*
- *Pre-money valuation/Per share price*
- *Market trends:*

*Up rounds (i.e., price increase from prior round) (Q1 2020):
~ 83% of deals*

*Up rounds (Q1 2010):
~ 50% of deals*

Liquidation Preference

- Think of it as a “Sale of the Company proceeds” preference
- Preferred gets first proceeds -- the "preference"
- 1x vs. multiple preferences
- Participating vs. non-participating



Non-Participating Preferred

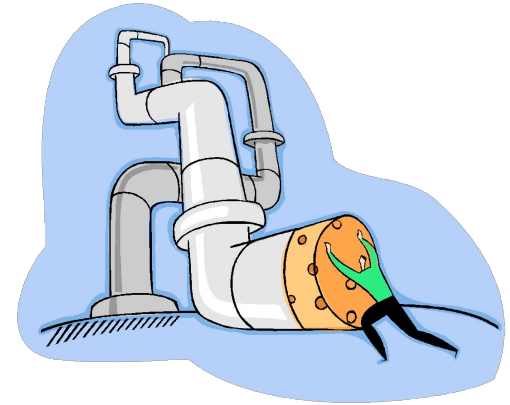
- Most company favorable term (founders and employees)
- Preferred gets liquidation preference (1x, 2x) - but nothing more
- Common gets the rest
- Investors get downside protection only

Participating Preferred

- Most investor favorable term
- Preferred gets liquidation preference
- Then participates with Common (as-converted) in distribution of all remaining proceeds
- Investors get preferred return in all situations

Capped Participation

- *A compromise*
- *Preferred gets its preference, then participates*
- *But participation right is capped (2x, 3x, 5x, etc.)*
- *After cap is achieved, remaining proceeds go to Common*
- *Investors get preferred return in down and moderately successful exits*



Liquidation Preference –Market Trends

Series B and later (Q1 2020):

Senior preference ~ 30-35% of deals

Series B and later (2010):

Senior preference ~ 50% of deals



Liquidation Preference – Market Trends

Participating vs. non-participating (Q1 2020):

Participating: ~ 20% of deals

Participating vs. non-participating (2010):

Participating: ~ 50% of deals

Liquidation Preference – Market Trends

Multiple liquidation preference (Q1 2020):

2x-3x: ~ 8% of deals

Multiple liquidation preference (Q1 2010):

2x-3x: ~ 23% of deals

- ***Late stage financings predominate***
- ***Less common in early rounds due to precedential impact***

Voting

- Preferred votes with Common on as-converted basis
- Separate right to elect board member(s)
- Protective provisions (usually in the Charter)
 - All preferred voting together
 - Separate series votes (consider precedential impact)
- Operational covenants (IRA)



Protective Provisions

Protective provisions require separate vote of preferred for specified transactions

- Amending Articles of Incorporation or Bylaws
 - Any amendment vs. adverse effect
- Creating or issuing senior or pari passu security
- Sale of the Company or all or substantially all assets
- Redemptions, repurchases, declaration or payment of dividends
- Voluntary dissolution or liquidation



Drag-Along Provision

- *Triggers upon achievement of threshold approvals*
 - *Typically Board + threshold % of preferred*
- *Drags stockholders into a sale of the Company*
- *Included in significant majority of all financings*



Price-Based Anti-Dilution Provisions

- No price-based anti-dilution protection (very rare)
- Broad-based weighted average (Company favorable) – In most deals
- Narrow-based weighted average (more Investor favorable)
- Ratchet (most investor favorable) - Rare
 - Issuance of even one share can trigger



Anti-Dilution Provisions – Market Trends

Broad-based Weighted Average (Q1 2020):

100% of deals

Broad-based Weighted Average (2010):

91% of deals

Pay-to-Play

- A "stick" to induce investment in subsequent rounds
- If Investor does not invest pro rata amount then preferred converts
- Preferred converts into either:
 - Shadow series of preferred stock, having reduced rights;
OR
 - Common stock

Pay to Play – Series B and Later

Pay to Play (Q1 2020):

~ 8% of deals

Pay to Play (2010):

~ 13% of deals

Redemption Rights

- Investors' option to force repurchase
- Option typically triggers 3-5 years out
- Cost; Cost plus; Fair market value
- Very rarely exercised

Redemption – Market Trends

Redemption rights included (Q1 2020):

~ 13% of deals

Redemption rights included (2010):

~ 25% of deals

Restrictions on Founders

- Vesting restrictions
- Drag along obligation
- Right of first offer in favor of Company and Investors
- Co-Sale rights to Investors



Other Rights

- Board observation rights (if no Board seat)
- Registration rights
- Right of first offer/preemptive rights
- Expense reimbursement



Questions?



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