



# Introduction to Convertible Notes

October 1, 2021

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# Why do Company's choose Convertible Notes?

- Is not tied to underlying valuation
- Much simpler than an equity financing
- Common industry practice; see **COOLEY GO**



# Key Difference from SAFE

- It is a debt instrument with a claim (typically unsecured) on the Company's assets



# Key Terms and Trends of Pre-Equity Financing Notes

- Interest Rate (~5%)
- Length to Maturity (~18 months)
- Qualified Financing Terms
- Conversion Discount (~20%)
- Valuation Cap (present in 76% of deals, ~8x)
  - Key Consideration: What is included in fully diluted share count?

# Conversion Mechanics – Shadow Series?

- What type of Security will the Noteholders Receive?
  - Same Security as the Investors in the Equity Round (32%)
  - Shadow Series (same terms but with lower OIP) (64%)
  - Combination (4%)

# Conversion Mechanics – Convertible Note Shuffle

- How will the conversion price per share be determined (assuming discount triggered)?
  - Option #1: Pre-Money
  - Option #2: Post-Money (exclusive of Notes)
  - Option #3: Post-Money (inclusive of Notes but not the discount)
  - Typically up to the new lead investor
- Example: Assume \$8m Pre; \$2m New Cash and \$1m in Notes
  - Option 1: PPS based on fixed pre-money of \$8m, thus post money = \$8m + \$2m + \$1m + discount = **\$11m+**
  - Option 2: PPS based on fixed post money of **\$10m**
  - Option 3: PPS based on fixed post money of **\$11m**

# What Happens on Change of Control?

- Is there a change of control premium or is the Noteholder simply paid back (plus accrued interest)?
  - 66% of deals included premiums with average premium ~200%
- Noteholder could have the option to convert to Common Stock at agreed to valuation.

# Other Considerations

- What happens at Maturity?
  - Obligation to repay is triggered (but not required unless called)
  - Option of Noteholder to be repaid or convert
  - Automatic Conversion
  - Company's should ensure there is an ability to convert after Maturity Date without Noteholder consent
- Amendment requirements
- Most Favored Nation
- Security Interests (0%)
- Warrants (~7%)
- Preemptive Rights
- Information Rights
- Board/Observer Rights



# Questions?

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