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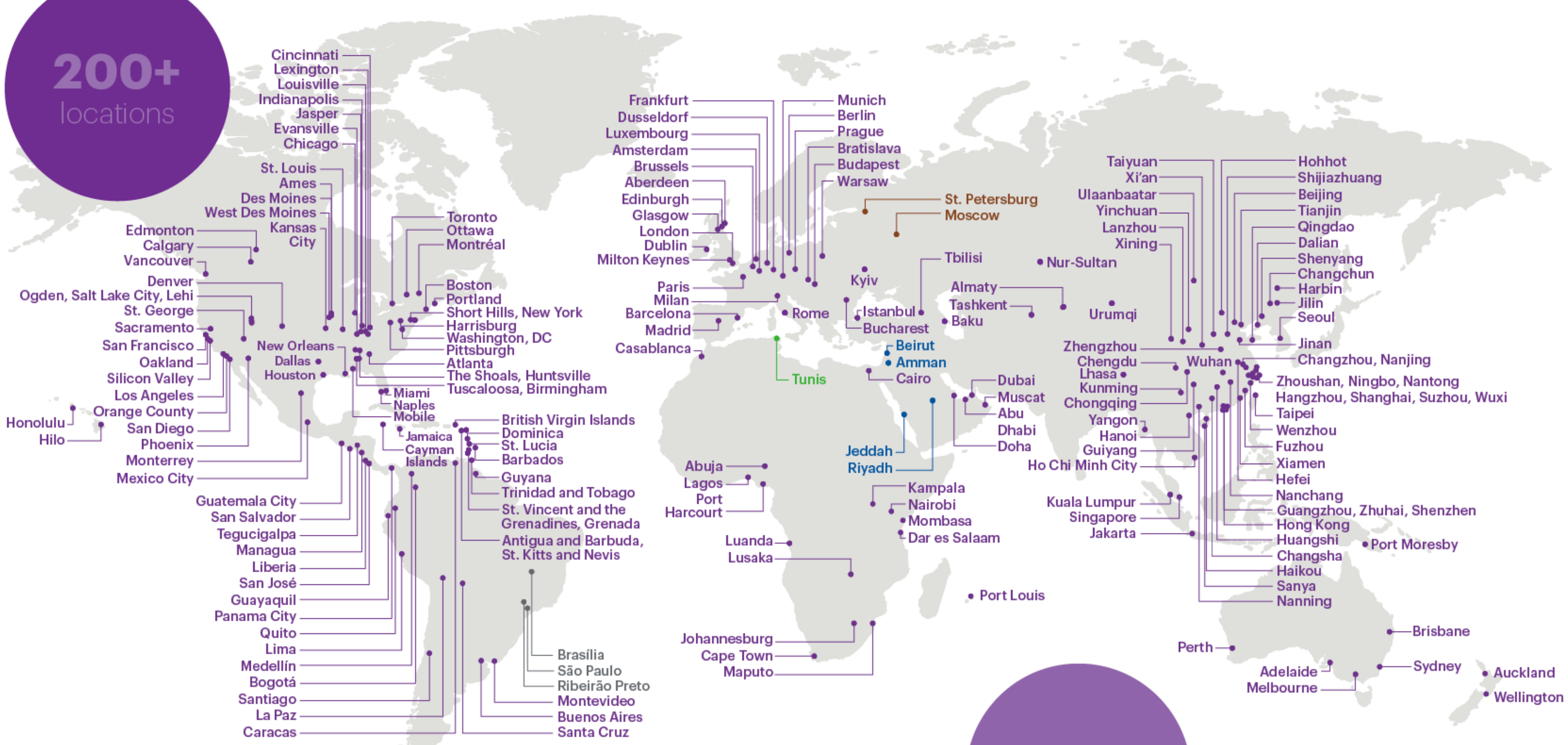
# STRUCTURING INVESTMENTS IN STARTUPS presented to NuFund Venture Group

**Amit Singh**
**Partner & West Coast Corporate Lead**

Grow | Protect | Operate | Finance

# Dentons by the numbers

**200+** locations




**80+** countries

Locations in purple represent Dentons offices.
Locations in blue represent associate firms, offices or special alliances as required by law or regulation.
Locations in green represent approved combinations that have not yet been formalized.
Locations in gray represent Brazil Strategic Alliance.
Locations in brown represent offices from which Dentons is separating.

**Map and figures include combinations approved and announced in 2022*

## Lawyer numbers

**12,200+**
Total number of lawyers and professionals

**15,200+**
All timekeepers

**20,000+**
Total number of people

# The work we do for our clients has brought Dentons global recognition:

**Corporate Law, National Tier 1**

**Best of the Best: Anticipates Client Needs**
**Top 3 Most Favored Global Law Firm**
***BTI Client Service A-Team, 2022***

**Ranked in more than 200 practices in *Chambers Global 2022***

**Innovation in the Business of Law: New Solutions North America**
***Financial Times 2021***

**#4 in their Global Elite Law Firm Brand Index 2022 Top 20**

# Amit Singh

## Partner and West Coast Corporate Lead

Amit heads the West Coast Corporate practice of Dentons, the largest law firm in the world.

Amit is highly skilled in business transactions. He focuses on venture capital and private equity transactions, mergers and acquisitions, joint ventures, technology transactions, and general corporate law for companies whose core value derives from intellectual property. In the hundreds of M&A, venture capital and other sophisticated business transactions he's led over the last two decades and as outside general counsel to life sciences and technology companies, Amit has immersed himself in his clients' businesses, providing practical legal advice in the context of the clients' overall business goals.

Amit has extensive experience counseling companies and investors in a broad range of industries, including life sciences, software, hardware, web3, communications and networking, Internet, manufacturing and distribution, and medical devices.

Amit is a frequent speaker and author on startups, venture capital and M&A and has written hundreds of thought leadership articles on his blog – www.startupblog.com.

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**EDUCATION**
New York University School of Law
LL.M. (Corporate Law) (1999)

University of California, Hastings
College of Law, J.D. (1998)

# GETTING STARTED

- Investor Deck
    - Barriers to Entry
    - Value Proposition
    - Size of Opportunity
        - Size
        - Growth Rate
- Management
- Amount Needed and Use of Proceeds
- Tranched - Based Financing

# INVESTOR TARGETS

- Angel/Incubator
  - Track Record
  - Mentoring Capability – How much time is available for the company?
- Venture Capital Funds
  - Industry Specialization
  - State of Company’s Development
  - Size of Investment Preferences
  - Compatibility of Personalities
  - Active vs. Passive Management Role
  - Syndication Ties to other Venture Funds for Additional Rounds of Financing
- Corporate/Strategic Investors
  - Added Value
  - Value of Logo Behind Startup
  - Choosing Your Partners/Also Choosing Your Enemies

# GOALS

- Investor Goals
  - Downside Protection
  - Upside Protection
  - VCs - Exit Within 5 Years
  - Corporate/Strategic – Access to IP/Markets
- Founders' Goals
  - Maintain Control
  - Capture Upside of their Efforts
  - Create Something
  - Make a Living and Have Long-Term Career

# Common Investment Structures

- Common Stock
- Series A Preferred Stock
- Series Seed Preferred Stock
- Convertible Notes
- SAFEs

# Common Stock

- Equity that receives all proceeds after paying debts and Preferred Stock
- No Liquidation Preference
- No Protective Provisions
- Simple
- Negotiate Valuation
    - Sets option price (cannot issue options with a lower strike price)
    - Could result in tax to founders if issued concurrently
    - No anti-dilution
- Eligible for QSBS Treatment
    - No federal tax if company has less than $50M in assets and is an operating company
    - Exclude greater of $10M or 10x investment if held for 5 years

# Series A Preferred Stock

- Converts into Common Stock
- Votes on an as-if-converted to Common Stock basis
- Dividend Preference
    - Cumulative vs Non-cumulative
- Liquidation Preference
    - Participating vs Non-participating
        - Cap vs no cap on participation right

# Series A Preferred Stock

- 1x Liquidation Preference Example
  - VC invests $1M for 20% of Company, and receives a 1x liquidation preference
    - Post Money Valuation = $5M
  - Sell Company for $20M
  - Non-Participating Preferred
    - VC receives greater of:
      - Investment Back = $1M; or
      - **20% of $20M = $4M**

# Series A Preferred Stock (Cont'd)

- Participating Preferred
  - VC receives $1M Investment Back
  - Then, VC receives 20% of remaining $19M = $3.8M
- Results – VC Owns 20% of Company Receives:
  - Non-Participating Preferred – $4M (20% of Proceeds)
  - Participating Preferred - $4.8M (24% of Proceeds)

# Series A Preferred Stock (Cont'd)

- Can Justify a higher price than Common Stock price
- Valuation Issues – Determining Share Price
  - Pre-Money Valuation/Fully-Diluted Shares = Share Price
    - $10M Pre-Money Valuation (Company value before investment)
    - 5M Common Shares Outstanding
    - 2.5M Options Outstanding
    - 2.5M Options Reserved
    - Price Per Share = $10M/10M=$1
  - Option Pool Size (including in the fully-diluted shares)
    - Use Hiring Plan to Justify Size

# Series A Preferred Stock (Cont’d)

- Price Based Anti-dilution Protection
  - Full Ratchet
  - Weighted Average
    - Narrow Based (typically includes only common stock and common stock issuable on conversion in the denominator) – Investor favorable and atypical
    - Broad Based (typically also includes shares issuable upon exercise of options, warrants, etc. in the denominator) – Company favorable and more typical
  - Standard Carve-Outs

# Series A Preferred Stock (Cont'd)

- Detailed Representations and Warranties
- Protective Provisions
- Preemptive Rights
  - Standard Carve-Outs
- Redemption Rights (Rarely Granted)
- Drag-Along Rights

# Series A Preferred Stock (Cont'd)

- Rights of First Refusal
- Co-Sale Rights
- Registration Rights (Rarely Used)
  - Demand
  - Piggyback
  - S-3
- Information Rights
  - Inspection Rights
  - Financial Information
  - Management Rights Letter

# Series A Preferred Stock (Cont'd)

- Board Representation
    - Committees
    - Observers
- Because of Superior Rights - Less effect on option price
- Eligible for QSBS

# Series Seed Preferred Stock

- Non-participating
- Limited (But Effective) Protective Provisions
- No Anti-dilution Protection
- Limited Representations and Warranties
- Most Favoured Nations Clause
    - Get any favorable terms offered to others
- Eligible for QSBS
- Board Representation
- Drag-Along

# Convertible Notes

- Principal Amount Due on Maturity Date
- Interest Accrues
- Converts into Equity
  - Exit Event
  - Qualified Financing
- Valuation Deferred
  - Cap
  - Discount

# Convertible Notes

- 20% Discount (No Cap) Example
  - Investor invests $100K at early stage
  - Series A Financing at $100M valuation
  - Loan Converts at $80M
    - Investor gets .12% of equity ($100K/$80M) worth about $125K (.12% of $100M)
- $5M Cap (in same example)
  - Investor gets 2% of equity ($100K/$5M) worth almost $2M (2% of $100M)

# Convertible Notes (Cont’d)

- Protections?
  - No fiduciary duties owed to debt holders outside insolvency
  - Only protections are negotiated negative covenants
- Capital Gains Holding Period likely starts on note issuance
- Stock received on conversion eligible for QSBS

# Simple Agreement for Future Equity (SAFE)

- Similar to Convertible Note
  - Converts into a later round
    - Caps
    - Discounts
  - Liquidity Event – receive
    - Investment or
    - Shares of Common Stock (using cap/discount)
  - No Maturity Date
  - No Interest
  - Capital Gains Holding Period may not start until conversion to equity

# Other Issues

- Founder Vesting
  - Vesting Credit
  - Acceleration
    - Change of Control (Single vs. Double-Trigger)
    - Termination without Cause/For Good Reason

# Summary

- Series Seed vs Series A Preferred Stock
  - Simpler
  - No Anti-dilution Protection
  - Limited Representations and Warranties
  - Most Favored Nations
- SAFEs vs Convertible Notes
  - Simpler
  - No maturity date or interest rate
  - May be deemed an option - Capital Gains Holding Period may not start until conversion

# Thank you