

Cooley

**Cooley U:
Series A Term Sheets –
Session 2**

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Today's Topics

- Valuation Issues
 - Pre-Money
 - Post-Money
 - Option Pools & Vesting
- More Than Just Valuation!
 - Liquidation & Dividend Preferences
 - Protective Provisions
 - Redemption Rights
 - Preemptive Rights
 - and so much more!

Valuation Details

| | | | | |
|--|--------------------|------------------|-------------------|----------------------|
| Valuation: | \$7,000,000 | | | |
| Post-Financing Option Pool: | 20.0% | | | |
| Total Financing of: | \$3,000,000 | | | |
| \$7M "pre-money <u>excluding</u> options" | | Pre-Money | Post-Money | Fully Diluted |
| New Investors: (@\$1.00/share) | 3,000,000 | 0.0% | 30.0% | 24.0% |
| Option Pool: | 3,250,000 | 0.0% | 0.0% | 20.0% |
| Founders: | 7,000,000 | 100.0% | 70.0% | 56.0% |
| | 16,250,000 | 100.0% | 100.0% | 100.0% |
| \$7M "pre-money <u>including</u> 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% |

Option Pools and Vesting

- Option Pools
 - Typically specified as a % of the fully diluted
 - Best if you have a plan and “budget”
 - Investors will frequently require specific vesting schedule
- 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.”

Liquidation Preferences

- “Fully” Participating – 1X plus share of what is distributed to Common Stock
 - Most common in Series A
 - 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
- Non-Participating – (now that is a unicorn!)
 - Snapchat has it, why not you?
- What do you mean more than 1X!
 - Rare on West Coast; Utilized in late or down rounds
- Why does this all matter? (See the next 3 slides!)

Liquidation Preferences

Let's go with the numbers we had earlier.

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

| | | | | |
|---------------------------------------|--------------------|-----------|------------|---------------|
| Valuation: | \$7,000,000 | | | |
| Option Pool: | 20.0% | | | |
| Total Financing of: | \$3,000,000 | | | |
| | | | | |
| \$10M fully diluted post-money | | Pre-Money | Post-Money | Fully Diluted |
| New Investors: | 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% |
| | <u>14,000,000</u> | 100.0% | 100.0% | 100.0% |

Liquidation Preferences

- Sale without Liquidation Preference

| Sale Time in 24 mos. | | | | | |
|----------------------|---------------|------------|-----------|--------|--------------|
| Total Sales Price: | \$20,000,000 | | Shares | | |
| | | Indicated | Issued & | | Revised |
| | Fully Diluted | Proceeds | Vested | | Proceeds |
| New Investors: | 30.0% | 6,000,000 | 4,200,000 | 46.2% | \$9,230,769 |
| Option Pool: | 20.0% | 4,000,000 | 1,400,000 | 15.4% | \$3,076,923 |
| Founders: | 50.0% | 10,000,000 | 3,500,000 | 38.5% | \$7,692,308 |
| | 100.0% | 20,000,000 | 9,100,000 | 100.0% | \$20,000,000 |

- However, not all options are granted or vested
 - This example assumes 50% founders vesting and 50% of pool vested
 - Typically a major point of deal negotiation

Liquidation Preferences

- Sale with Liquidation Preference
 - Straight 1X Participating Preferred (plain vanilla)

| Sale Time in 24 mos. | | | | |
|---------------------------|-------------------------------|----------------|---------------------------|--------|
| Total Sales Price: | \$20,000,000 | | | |
| | Liquidation Preference | Balance | Effective Proceeds | |
| New Investors: | \$3,000,000 | \$7,846,154 | \$10,846,154 | 54.2% |
| Option Pool: | \$0 | \$2,616,385 | \$2,616,385 | 13.0% |
| Founders: | \$0 | \$6,538,462 | \$6,538,462 | 32.7% |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| | \$3,000,000 | \$17,000,000 | \$20,000,000 | 100.0% |

- Investors get their original amount first
 - Remaining Balance split among all stockholders
 - Net is investors get over 3.5X return on 2X deal.

Other Key Points to Negotiate

- Board of Directors
 - “Founder” representation vs. CEO
 - VCs vs. outsider appointments
- No Shop
 - One of the only binding terms in the term sheet
 - Confidentiality is the other

What The Heck Are These?

- Protective provisions
 - Your investors control the future
- Redemption rights
 - Rarely included, even rarer to use
- Preemptive rights
- Drag -along rights
 - One for all, and all for one

The Boilerplate

- Information Rights
 - Definition of a “Major Investor”
 - Time for audited financials!
- 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

Other Things to Know

- What is a “Lead Investor”
 - Not a legal term
 - No compensation involved
- Costs and Fees
 - Company Counsel
 - Investor Counsel
- Making it go fast
 - Understanding your cap table!
 - Setting up a data room
 - Cleaning up your past
 - Communicating with your team