Should Angels Be Able To Force Exits?

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HOW TO GET VALUE FROM THIS DEMO

- Use chat to submit questions
- Yes, you’ll get the slides and video
- We’re recording, so come back and listen again
- Contact Heather Krejci with questions: hkrejci@angelcapitalassociation.org

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Christopher Mirabile
Launchpad Venture Group

Mark Haddad
Foley Hoag
WHY WOULD ANGELS WANT TO FORCE AN EXIT?

• Concern that the exit window may close
• Liquidity & Returns
• Wind down a fund
• Recycle the money for other investments
• Disagreement with or lack of confidence in management
• Exhaustion, frustration endless pivots without success.
PARTIAL EXIT MIGHT BE ENOUGH

- Company share buy-back
- Dividend
- Secondary sale to new VC investor
- Partial sale to a strategic investor
WHAT ARE SOME TRADITIONAL METHODS?

• Redemption Rights
• Dividends
• Note Maturity dates
• Co-sale rights

• Board or Shareholder voting (comp committee)
• NVCA style Sale Rights
• Registration & IPO Demand Rights
ADVANTAGES & DRAWBACKS

Redemption Rights **Advantages:**

- Clearly lays out what is to happen
- Long term warning - no surprises
- Can be thoughtfully structured in advance
- Avoids taint or buyer suspicion because stipulated well in advance
- Brings parties to the table to negotiate
ADVANTAGES & DRAWBACKS

Redemption Rights **Disadvantages:**

- May not survive later financings
- Later investors may want their own superseding clause (and will insist your trigger date is not before theirs)
- Might arrive at exactly the wrong time – insufficient cash

- Don’t know who will be at the table when it arrives
- Manufactures a distracting crisis
- Often structured as all or nothing, so trigger threshold becomes critically important
ADVANTAGES & DRAWBACKS

Dividend Advantages:

• Can be thoughtfully structured in advance
• Can be designed to include or exclude common
• Can be paid in cash, common or preferred, cumulative or simple
• Preserves ownership position for later exit
• Accruing cumulative dividend holds management’s feet to the fire by slowly transferring ownership from common to preferred
ADVANTAGES & DRAWBACKS

Dividend Disadvantages:

• Tax inefficient relative to capital gains

• Sloppily drafted terms may surprise preferred by including common (or may surprise common by excluding them)

• Easily negotiated away by VCs in later rounds (more than warrants?)

• Cash dividend drains cash but does not consolidate cap table

• Accumulated dividend complicates capitalization structure and may act like a poison pill for a buyer

• Founders need to be educated on accumulating damage to be effective motivator
ADVANTAGES & DRAWBACKS

Note Maturity Date Advantages:

- Simple
- Instant liquidity, with interest
- Paid first – negotiating leverage in poor outcomes
- Legally enforceable (creditors rights at law)

Requirements consensus – majority of note-holders usually required to trigger payback
- Brings parties to the table; leverage from threat of insolvency
- Note “lending” can be doled out in tranches to maintain some control
ADVANTAGES & DRAWBACKS

Note Maturity **Disadvantages:**

• Hard to coordinate all note holders without an Inter-creditors Agr.

• Only provides liquidity for note holders

• Short time window

• Tax inefficient

• Only applies where last round was unconverted note

• Only works if note does not have auto-convert at maturity
Co-Sale **Advantages:**

- Fair proportional liquidity (assures founders cannot get liquidity ahead of investors)
- Agreed in advance

Co-Sale **Disadvantages:**

- You need a buyer
- Can be disagreements on pricing and terms
- Complex if multiple classes of stock (per share price?)
- May discourage buyer or depress price
ADVANTAGES & DRAWBACKS

Board/Shareholder Control Advantages:

• This is how voting is meant to work
• Directors have good information and perspective
• Legal documentation and corporate law will typically be clear and prescriptive on how it is to be done
Board/Shareholder Control Disadvantages:

- Vote not the same as having an exit buyer
- Directors with no investment dollars at risk may not vote with investors
- May not have enough control
- Fiduciary duties apply and may constrain
- Risk of liability for directors
- Complexity with coordinating shareholder votes
- May cause permanent rift between management vs board or preferred
ADVANTAGES & DRAWBACKS

NVCA Sale Rights **Advantages:**

- Right to force the company to hire a banker and test the market
- Can be customized to require certain price, or require sale if certain price is hit
- No surprises
- Gets everyone in alignment, well in advance
ADVANTAGES & DRAWBACKS

NVCA Sale Rights Disadvantages:

• Putting company up for sale is not the same as having a buyer
• Hard to sell if management is not bought in
• Distraction for management
• Not necessarily getting the best price, just good enough price
• Potentially significant cost to company (banker, legal fees, etc.)
ADVANTAGES & DRAWBACKS

Registration and/or IPO Demand Rights **Advantages:**

- IPO is the dream
- Strong leverage which can catalyze action
- Gets the company focused on preparing for IPO
- Lots of lead time
- Having your shares registered may mean no Rule 144 holding period or volume restrictions (if not an “affiliate.”)
ADVANTAGES & DRAWBACKS

Registration and/or IPO Demand Rights **Disadvantages:**

- Most companies would not be feasible for an IPO
- Rights may vest at a time when company is not ready
- Mostly relevant in forcing unicorn management to do IPO
- IPOs are expensive and public (banker leaks)
- May not be best valuation – market leery of Snap situations
OTHER METHODS & WAR STORIES?

What other methods have you seen?

Drawbacks or unintended consequences?
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# QUESTIONS (AND THANKING OUR PARTNERS)

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*Images of logos and names of companies.*
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