The Rising Tide Program

Best Practice Series: The Key Points of Terms Sheets

November 18th, 2015

Katherine O’Neill, Jumpstart NJ
Ben Straughan and Jim Carroll, Perkins Coie

- Use chat to submit questions
- Yes, you’ll get the slides
- We’re recorded, so come back and listen again
- Mission: Fuel the success of angel groups and accredited individuals active in the early-stage landscape
- World's largest trade group for angel investors
  - 220+ angel groups
  - 13,000 accredited investors
  - Voice of accredited individuals, portals, and family offices
- 50 US states + Canada
- Research/education partner

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**Member Groups & Accredited Platforms**

- Golden Seeds
- Life Science Angels
- Nashville Capital Network
- FundersClub
- band of angels
- Angellist
- Alliance of Angels
- Launchpad Venture Group
- Tech Coast Angels
- TiE Angels
- Common Angels
- New York Angels
- Sierra Angels
- Houston Angel Network
- Ohio Tech Angels
- Sand Hill Angels

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Rising Tide Education Program

Founding Members:

Next Wave
Driving Diversity in Entrepreneurship and Angel Investing

Portfolia

Education Partners:

ACA
ANGEL CAPITAL ASSOCIATION

Support by:

Kauffman
The Foundation of Entrepreneurship
OUR SPEAKERS

Katherine O’Neill
Executive Director and Investor
JumpStart New Jersey Angel Network
- Angel Capital Association board member
- President of O’Neill Associates
- Active with the Forum of Executive Women and the New Jersey Technology Council

OUR SPEAKERS

Ben Straughan
Partner, Emerging Companies & Venture Capital
- A regular speaker on mergers and acquisitions, emerging companies and angel and venture financings
- Assists high-growth technology, venture-backed, and emerging and early-stage companies in industries including digital media mobile, gaming, e-commerce, media, consumer products, SaaS and hardware companies
- Seattle, WA
OUR SPEAKERS

Jim Carroll
Business Attorney

- Counsel in the firm's Emerging Companies & Venture Capital practice
- Represents start-up and high-growth technology companies in matters of corporate finance and securities, venture capital, mergers and acquisitions and corporate governance
- Seattle, WA

Topics We’ll Explore Today

- Key Terms to Understand
- Debt and Equity Financing Overview
- Which to Consider: Debt vs. Equity Debate
- Alternative Instruments: SAFEs
- How to Align Angel and Entrepreneur Interests
Key Terms to Understand

- **Pricing**: The value of the company; helps to determine what portion of the company you own. Many other terms flow from it.
- **Board and Information Rights**: Outlines the details for selecting who serves on Board of Directors or as an observer; also determines the information you receive from the company and how often you receive it.
- **Participation Rights**: These define an angel’s right to invest in future funding rounds. They help maintain your pro-rata ownership as additional investors come in if you choose to invest in the next round.
- **Liquidation Preference**: If the company is sold, this gives you – as a preferred shareholder – a payment of $X times your original purchase price, paid out before any other assets are paid to holders of common stock. 1X liquidation is a norm for angels.
- **Redemption Rights**: These rights can help angels to achieve liquidity by selling their shares back to the company if management wants to continue running the company but investors want out.

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Debt and Equity Financings - Overview

<table>
<thead>
<tr>
<th>Equity</th>
<th>Debt</th>
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<tbody>
<tr>
<td>• Common stock</td>
<td>• Convertible Debt</td>
</tr>
<tr>
<td>• Preferred stock</td>
<td>• Capped convertible debt</td>
</tr>
<tr>
<td>• Series seed</td>
<td></td>
</tr>
<tr>
<td>• Series A (B, C)</td>
<td></td>
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<tr>
<td>• Debt-like preferred</td>
<td>• Promissory note</td>
</tr>
<tr>
<td>• Convertible equity (e.g., SAFE)</td>
<td>• Secured promissory note</td>
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</tbody>
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Differences Between Instruments

<table>
<thead>
<tr>
<th>Equity</th>
<th>Debt</th>
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<tbody>
<tr>
<td>Establishes company valuation</td>
<td>Defers pricing decision, unless a capped note</td>
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<tr>
<td>Increases investor control</td>
<td>Less expensive to create legal docs</td>
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<tr>
<td>Mitigates investor risk</td>
<td>Faster to negotiate</td>
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<tr>
<td></td>
<td>Simpler, less complex terms</td>
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<tr>
<td>Dilutes founders</td>
<td>Usually no lead investor, no board seats given</td>
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<td></td>
<td>Less certainty for investors</td>
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<td>Can affect cash flow</td>
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Seed Financings

Convertible Debt/Convertible Equity Terms

- Maturity/outside date
  - Conversion
- Conversion on qualified financing
  - Definition
  - Discount (Formerly Warrants)
  - Cap
  - Standard preferred vs. shadow preferred – Liquidation Preferences
Seed Financings (cont.)
Equity Terms

- Liquidation preference
- Dividends
- Economic Antidilution & Registration Rights – if given to Series A
- Protective Provisions – minimum protections

Which should I use?

Debt or Equity?
Who sets the terms?
What if I’ve already taken money from friends and family?
How would an investor assess my value? Same as I do?
Alternative Instruments: SAFEes

- SAFE - Simple Alternative to Future Equity
  - Pays off on a sale or liquidation.
  - Converts on a preferred financing.
    - No minimum trigger.
    - Valuation cap but no discount.
  - Converts into shadow preferred.
  - No term; no interest rate.
  - Return investment or convert at cap on sale.

Unique features:
- Never expire
- IPO – cash out or convert to common at valuation cap

SAFE Instruments (cont’d)

- Potential Disadvantages:
  - No maturity/outside conversion date (Investor)
  - No clear priority over stockholders if Company insolvent (Investor)
  - “Shadow Preferred” (Investor and Company)
  - “Golden Ticket” – Permanent Pro-rata rights (Company)
  - Not grouped under one governing agreement for consistent terms and amendment (Company)
  - 409A valuation uncertainty (Company)
How To Best Align Angel and Entrepreneur Interests

- Be efficient with legal dollars – use standard forms and terms
- Avoid customization
- Consider impact of economic and control terms on angels in future rounds
- Choose terms that create incentive for founders

Key Takeaways for Angels

- If writing term sheet: priced rounds and preferred shares reflect your risk premium
- If you are participating in a convertible note round, a capped note is best
- Never take common shares unless you really want the investment
- SAFES are not friendly to investors
- Debt vehicles, for financing inventory, may be viable for some companies
- UNDERSTAND the “Waterfall” table of sale distribution
Key Takeaways for Entrepreneurs

- Money without connected investors to help the company to grow is bad money.
- **Always** use early stage deal accountants and attorneys as they understand the terms of the current financing rounds and can introduce you to funding sources.
- Investors are investing alongside of you to insure success
- UNDERSTAND the “Waterfall” table of sale distribution

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Speakers Contact Information

**Katherine O’Neill**
koneill@jumpstartnj.com
www.jumpstartnj.com

**Ben Straughan | Perkins Coie LLP**
B Straughan@perkinscoie.com
Office: +1.206.359.3333
Cell: +1.206.799.2323

**Jim Carroll | Perkins Coie LLP**
JamesTCarroll@perkinscoie.com
Office: +1.206.359.3853
Mobile: +1.410.279.8318

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Additional Resources

http://www.wsj.com/articles/startups-offer-unusual-reward-for-investing-1427944095

Perkins Coie Blog: http://www.startuppercolator.com


http://www.37angels.com/glossary/

http://www.fundingpost.com/glossary/venture-glossary.asp

Thank you!

Upcoming Webinars

December 2, 2015: Leadership Forum and Angel News - Members Only

December 16, 2015: Best Practice Series: Valuation of Pre-Revenue Companies

January 13, 2015: Experience from the Trenches: How Angels Use Accredited Investing Platforms

Webinar programs archived at: www.angelcapitalassociation.org/events/webinars/
Additional Resources

Marianne Hudson
Executive Director
Angel Capital Association
http://www.angelcapitalassociation.org/news-forbes/

Christopher Mirabile
Managing Director, Launchpad; Board Chair, Angel Capital Association
http://www.angelcapitalassociation.org/news-inc/

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Upcoming ACA Events

- February 22, 2016, Syndication Meeting, Irvine, CA
- March 9-10, 2016, NW Regional Meeting, Seattle, WA
- May 9 – 11, 2016: ACA Summit, Philadelphia, PA
- http://www.angelcapitalassociation.org/events/