



The Rising Tide Program

Best Practice Series: The Key Points of Terms Sheets

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EARLY STAGE
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- 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 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
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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



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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



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OUR SPEAKERS



Jim Carroll
Business Attorney

PERKINScoie
COUNSEL TO GREAT COMPANIES

- 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

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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

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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

Equity	Debt
<ul style="list-style-type: none"> • Common stock 	<ul style="list-style-type: none"> • Convertible Debt
<ul style="list-style-type: none"> • Preferred stock <ul style="list-style-type: none"> • <u>Series seed</u> • <u>Series A (B, C)</u> 	<ul style="list-style-type: none"> • Capped convertible debt
<ul style="list-style-type: none"> • Debt-like preferred 	<ul style="list-style-type: none"> • Promissory note
<ul style="list-style-type: none"> • <u>Convertible equity</u> (e.g., SAFE) 	<ul style="list-style-type: none"> • Secured promissory note

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Differences Between Instruments

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

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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

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Seed Financings (cont.) Equity Terms

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

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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?

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Alternative Instruments: SAFEs

- SAFE - Simple Alternative to Future Equity
- <http://www.ycombinator.com/documents/>
- 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

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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)

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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

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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

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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



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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.forbes.com/sites/mariannehudson/2014/09/10/simple-term-sheets-align-angel-investors-and-entrepreneurs-for-more-successful-deals/>

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

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

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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/



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Additional Resources



Forbes

Marianne Hudson
Executive Director
Angel Capital Association



<http://www.angelcapitalassociation.org/news-forbes/>



Inc.

Handbook of the American Entrepreneur

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/>



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