

Negotiating Your Series A Term Sheet

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Aaron Terwey

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- This presentation does not constitute legal advice.
- This presentation does not establish any attorney-client relationship.
- You should contact your attorney to obtain advice with respect to any particular issue or problem.

Objective

- Provide a basic understanding of some of the most heavily negotiated Series A terms and the most common Series A terms

Series A Fundamentals

- Usually a company's first equity round of funding
 - Seed rounds are typically done with SAFEs
- Usually 1 lead investor, with some room for follow on investors (usually current Seed investors)
- For the most part, Series A documents are drafted using the forms promulgated by the National Venture Capital Association (NVCA)
 - <https://nvca.org/resources/model-legal-documents/>

Deal Term Classifications

- Economic:
 - Valuation
 - Dividend
 - Liquidation Preference
 - Anti-Dilution
 - Available Option Pool
 - Participation/Pro-Rata Right
- Non-Economic:
 - Board Composition
 - Protective Provisions
 - Management/Information Rights

Economic Terms - Dividend

- A dividend is an amount paid on a share of stock
 - Series A usually has a dividend preference
 - This means it gets paid a certain amount before the common stock
- Most common: “when and if declared by the Board”
 - Reality: rarely, if ever, declared by the Board
 - Investors generally prefer surplus cash be reinvested into the company
 - Avoid accruing dividends
- If a set/specific amount, usually 6-8% of the price

Economic Terms - Liquidation Preference

- What does the Series A get upon a liquidation event
- Most common: non-participating (downside protection)
 - Greater of original investment amount or pro rata with common
- Least common: participating (double dipping)
 - Original investment amount and then pro rata with common
 - Variation: participating with cap
 - Original investment amount, then pro rata with common up to set multiple, remainder to common

Economic Terms - Anti-Dilution

- Down round protection
- Most common: broad-based weighted average
 - Takes into account the size of the down round and preferred → common conversion ratio is adjusted proportionately
- Least common: full ratchet
 - Does not take into account the size of the down round and preferred → common conversion ratio is adjusted to the down round \$/share

Economic Terms - Pro Rata Participation

- Provides investors with the right to purchase their pro rata portion of stock sold in next equity financing
 - Usually limited to major investors
 - Gobble up for fully-exercising major investors

Economic Terms - Available Option Pool

- Minimum percentage of stock available in option pool for hiring/performance incentives
- Increase occurs prior to the close of the Series A
 - Investors don't want to be immediately diluted by increasing the available option pool post-close
- Depends on where the company is in terms of hiring
 - If no significant hiring planned post-closing, negotiate for smaller available pool
 - Smaller pool = less founder dilution
- Median: 10%

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Non-Economic Terms - Board Composition

- Board is responsible for making the company's strategic decisions and hiring/firing management
- Founders usually maintain control of the board post-Series A
- Most common structure: 3 total (2 common; 1 Series A)
 - Sometimes: 3 common
 - Sometimes: 5 total
 - Avoid even number to prevent deadlock

Non-Economic Terms - Protective Provisions

- Specified fundamental actions the company cannot take without certain approval:
 - % of Series A Investors - set at a % that requires lead investor approval; or
 - Series A Director; or
 - Both

Non-Economic Terms - Protective Provisions (cont)

- Series A Investor Protective Provisions:
 - Liquidation event;
 - Amend charter/bylaws adversely to Series A;
 - Increase number of Series A or create new class with same seniority as Series A;
 - Repurchase/redeem stock unless from former employee/consultant;
 - Change board size;
 - Incur debt in excess of \$x;
 - Create/sell/issue tokens/cryptocurrency; and
 - Create or hold subsidiary stock

Non-Economic Terms - Management/Info Rights

- Right to receive financials and inspect the company
 - Information rights usually limited to major investors
 - Major investor threshold usually set at threshold that would include lead investor, even if lead investor sold some of its stock
 - Considerations: GAAP/audited financials
- Management Rights Letter
 - Required by some funds to comply with VCOC

Term Sheet Terms

- Reimbursement of Lead Investor Counsel Expenses
 - 85% of Series A deals
 - Median: \$30,000
- No Shop/Confidentiality
 - Exclusivity period
 - Usually 30 days

Term Sheet Signed. Now What?

- Sprint to the Finish Line
 - Data Room/Legal Due Diligence
 - Document Drafting/Negotiation
 - Disclosure Schedules
 - Signature Collection
 - Closing
- Median: 37 days from term sheet execution to closing

Questions?



Contact Info

- hello@atrium.co