

ANATOMY OF A VENTURE CAPITAL FINANCING TERM SHEET

INVENTUSLAW

The Global Technology Law Firm



VALUATION

- Valuation will determine the percentage of the Company to be sold for the specific \$ investment
- Pre-Money Valuation + New Investment = Post Money Valuation
- Post Money Valuation is based on “**fully diluted capitalization**”; i.e., denominator would include all the outstanding stock and all rights, warrants, and options to acquire stock, AND, typically, assuming conversion of all promissory notes, SAFE, etc.
- Methodology for valuation:
 - Factors: Revenues, Sales, Earnings; Comparables, Market Size
 - Do your homework on market and particular investor
 - Watch out for milestone based investments!

Pre-Money Valuation:

The Original Purchase Price is based upon a fully-diluted pre-money valuation of \$[] and a fully-diluted post-money valuation of \$[] (including an **option pool representing []%** of the fully-diluted post-money capitalization).

LIQUIDATION PREFERENCE

- “Downside Protection” for the investors: in the event of a liquidation, Preferred Investors get paid BEFORE holders of Common Stock [Founders, Employees, Advisors, and Consultants].
- As long as it is 1x, the Company and Founders should be fine.
- Watch out for “fully participating” liquidation preference. In that scenario, Investors get 1x off the top AND participate fully on their pro rata ownership.
- Every new round investor will typically want the same or better liquidation preference terms.

Liquidation Preference:

In the event of any liquidation, dissolution or winding up of the Company, the proceeds shall be paid as follows:

First pay **[one]** times the Original Purchase Price [plus accrued dividends] [plus declared and unpaid dividends] on each share of Series A Preferred (or, if greater, the amount that the Series A Preferred would receive on an as-converted basis).

The balance of any proceeds shall be distributed pro rata to holders of **Common Stock**.

VOTING RIGHTS

- Board Seats: Majority of the Board members make decisions; Shareholder Agreements provide Investors with the right to nominate Board seats despite having minority ownership.
- Control of the Board: is a key part of control of the company. Board makes the decision to hire and fire executive officers
- Protective Provisions: Veto rights that investors have over certain actions to be undertaken by the Company. ***Need to keep this list limited to only material actions.***
- Board Observer: Need to keep to a very limited number; only as needed. Must be non-voting.

Board of Directors:

At the initial Closing, the Board shall consist of [] members comprised of (i) [1 representative designated by []], as the lead Investor, (ii) 1 representative designated by the Founders, and (iii) the person then serving as the Chief Executive Officer of the Company, and (iv) [] person is who are not employed by the Company and who is mutually acceptable [to the Founders and Investors.

EXIT RIGHTS

- Drag Along Rights: Investors have a right to force a sale of the Business. This should be triggered only after a certain time [7] years; or require separate common stock approval

Drag Along: Holders of Preferred Stock and the Founders shall be required to enter into an agreement with the Investors that provides that such stockholders will vote their shares in favor of a Deemed Liquidation Event which is approved by the Board, the holders of a majority of of the outstanding shares of Preferred Stock, and the holders of a majority of of the outstanding shares of Common Stock [held by the Founders] (the “Electing Holders”).

- Redemption Rights: Investors have a right to force the Company to buy their shares at the then-fair market value. This should be triggered only after a certain time [7] years.
- Registration Rights. Right to force the Company to register the shares on an IPO. Not a big issue as long as the right is triggered only after [5] years.

FOUNDER RELATED MATTERS

- **Founder Vesting**: Typically 4 year vesting, on a monthly basis, starting from the time founders started providing full time services to the Company. Founders should negotiate appropriate **“acceleration”** terms to protect themselves in the event they are terminated by the incoming investors.
- **Right of First Refusal**: In the event a Founder is going to sell his/her shares to a third party buyer, the Investors have the right to purchase their pro rata portion of those shares, at the same price.
- **Co-Sale Rights**: In the event a Founder is going to sell his/her shares to a third party buyer, the Investors have the right to sell their pro rata portion of their shares, at the same price.
- **Founder Lock-In**: These are non standard; need to be carefully negotiated, including appropriate carve-outs.
- **Founder Representations and Indemnity**: ***Fight very hard against this!***
- **Founder Employment Terms**: Founders should get a written employment agreement after the initial round of venture funding.

MISCELLANEOUS RIGHTS

Participation Rights:

- Investors' right to purchase new shares to be issued by the Company.
- Need to limit this right to “major investors”.
- Need to limit this right to only their “pro rata” amounts.

Information Rights:

- Investors' right to receive certain financial information.
- Need to limit this right to “major investors”.
- Need to limit to what is possible without too much burden on the company and management; for example, should not agree to **audited financials**, unless the company is producing those in any event.
- Watch out! Should carve out for “**confidentiality**”, and where investors may have “**competitive investments**.”
- Some visitation rights, limited to major investors, is OK.

Registration Rights:

- Standard Registration Rights are OK.
- Highly unlikely to ever be triggered.

Dividends:

- Distribution to shareholders; typically, not a big issue as long as it is “non-cumulative”
Board approval.
- Typically between 5-8% per annum.