Term Sheet Overview & Investment Structures

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About Me

Managing Director – NYC Seed – Seed Fund in NYC
  • Launching Alpha Prime

Founder of Overlap.cc

Teach at Columbia Business School
Basic Terminology

*Post-money valuation* = Pre-money valuation + capital to be raised

*Price per share* = Pre-money valuation / “fully-diluted” pre-money shares

*Fully-diluted shares* = outstanding common stock + outstanding preferred stock (as converted) + options and warrants (as exercised) + unallocated option pool
Convertible Debt - Basic Terms

Amount of raise

Interest rate – (6-8% current market rate)

Maturity date (theoretically, repayment date)
  • 36 months

When/how converts to equity
  • Trigger of time or amount invested

Valuation is set upon conversion
  • Discount to next round AND/OR
  • Cap on valuation
  • Risk premium
Convertible Debt Pros and Cons

Convertible debt advantages

- Simpler (and less costly)
- Postponement of valuation discussion
- Passive investor involvement

Convertible debt disadvantages

- VCs don’t like them – “dumb money”
- Miscalculation of timing of next round - Extensions
- Miscalculation of financing strategy
- Use of SAFE - Simple agreement for future equity
- Like a Warrant – the right to buy stock in the future
- No term, no interest rate
The Basic Equity Documents

Term Sheet

1. Certificate Of Incorporation
2. Indemnification Agreement
3. Investor Rights Agreement
4. Management Rights Letter
5. Legal Opinion
6. Right of First Refusal and Co-Sale Agreement
7. Stock Purchase Agreement
8. Voting Agreement
Equity – Basic Terms

• No repayment obligation
• Liquidation preference
• Valuation established at time of investment
• Stockholder rights (voting, board rights)
Additional Equity Terms

Financial terms:

• Preferred equity / liquidation preference
• Dividends (accrued vs. declared)
• Anti-dilution protection
• Down round – adjust conversion
• Redemption rights
• Put shares back to company
Additional Equity Terms

Contractual terms:

• Preemptive/participation rights
  • Right to Participate Pro Rata in Future Rounds
• Board representation
• Special voting rights
• Vesting
Valuation Considerations

Valuations increase as perceived risk decreases

Methodologies tend to be stage-specific

Stages:

- Seed stage (Seed) - pre-revenue
- Second stage (Series A) - customer adoption
- Expansion / later stage (Series B, C, etc.) - revenue, EBITDA
# Types of Investors

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<thead>
<tr>
<th></th>
<th>Friends &amp; Family</th>
<th>Angels</th>
<th>VC</th>
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<tbody>
<tr>
<td>Up to $500K:</td>
<td>✓</td>
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<td>$500K to $1.5MM:</td>
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<td>More than $1.5MM:</td>
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Criteria of Investment

Angel
• Strength of the team, personal relationship
• Interesting, big idea

Seed-stage
• Strength and depth of management team
• Market opportunity / scalability
• Basic proof points
• Time to market
• Capital needs
Criteria of Investment

Second stage (Series A)
- Concept proven - user acceptance or paying customer
- Momentum / BUZZ
- Management team
- Market opportunity (and volatility)

Expansion/later stage (Series B, C and beyond)
- Revenue performance
- EBITDA
- Growth trajectory
- Sales performance (sales cycle, backlog, etc.)
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