Convertible Debt and its Pitfalls

- **What is it?**
  - A Promissory Note
    - Payable by Company; Non-Recourse to founders/officers
    - Convertible to stock: Common? Preferred?
      - It depends

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- **Convertible How?**
  - Automatically.
    - Why? So Company is not burdened permanently with debt
  - At holder's option
    - Before a deadline, after which conversion is automatic
- **Upon what event?**
  - Venture capital investment or exit event (M&A)
    - As long as event occurs by a deadline set in instrument

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- **Convertible to What?**
  - Preferred stock issued in VC's investment
  - At discount to valuation set in event
    - Fixed: 30%?
    - Variable discount depending on time of investment
      - Hopefully, declines along time line
- **If no VC investment occurs by deadline**
  - Convert to what? Common?
  - Preferred?
    - If so, pursuant to a term sheet

Convertible Debt and its Pitfalls

- **Pitfalls: Conversion How?**
  - At predetermined valuation
    - Should be low.
      Why? Because they didn't get their financing!
  - How determined? Check wording in conversion.
    - Should treat all options and outstanding convertible debt on an as converted basis (not just "issued stock").