Pointers for Term Sheet & Deal Negotiation

ENET
February 18, 2020
Golden Seeds Nationwide Angel Network & Independently Managed Venture Funds
Golden Seeds Investment History

Cumulative Golden Seeds’ Investments

Total equity investment in Golden Seeds’ Funded Companies

Angels
Funds

$127M
GS

$1.2B Follow-on
7 Steps in the Investment Process

1. Screening
2. Due Diligence
3. Structuring the Deal
4. Term Sheet
5. Closing
6. Monitoring Investment
7. Exit
Ultimately make investments in <3% of companies that apply
Calculating Returns on a Given Investment

- Potential exit multiples or valuation
- Pre-money valuation
- Size of current round of financing
- Size of anticipated future rounds of financing
- Seniority and preferences

Percentage ownership of the company at the time of exit is what determines the return on investment – for founders and investors.
Balance Sheet Hierarchy (Waterfall analysis) Drives Investor (and Founder) Returns

**Balance Sheet Hierarchy**

- Payroll & Taxes
- Secured Creditors (debt)
- Unsecured Creditors (debt)
- Preferred Stock (equity)
- Common (equity)
The Term Sheet is a High-Level Agreement in Principle on Deal Terms

- Pre-money valuation and size of round
- Minimum close
- Pre-money option pool
- Liquidation preference
- Board composition and representation
- Voting by class of stock
- Conditions of closing
Deal terms address important areas of value creation

Deal Economics
- What is expected return on investment?
- How are gains shared?
- What can be done to reduce risk on less than ideal exit?

Management & Governance
- Who is at the table and involved in key decisions?
- How to avoid behavior that might damage company?

Value Protection
- How to ensure value of their investment doesn’t get diminished?
- How to ensure no one gets liquidity ahead of given investor class?

Liquidity
- What are the mechanisms to ensure return of capital in all possible scenarios?
## Term sheets highlight important areas of negotiation

<table>
<thead>
<tr>
<th>Deal Economics</th>
<th>Management &amp; Governance</th>
<th>Value Protection</th>
<th>Liquidity</th>
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<tbody>
<tr>
<td>Valuation</td>
<td>Duration and termination of investment</td>
<td>Conversion</td>
<td>Redemption</td>
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<td>Amount of investment</td>
<td>Voting rights</td>
<td>Anti-dilution</td>
<td>Registration rights</td>
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<tr>
<td>Liquidation Preference</td>
<td>Board seats</td>
<td>Pre-emptive rights</td>
<td>Drag along rights</td>
</tr>
<tr>
<td>Cap Table (including option pool)</td>
<td>Founders &amp; Management Vesting</td>
<td>Information rights</td>
<td>Tag along rights</td>
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Term sheets get translated into Deal Documents

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“Deal Docs”
1. Stock Purchase Agreement
2. Voting Rights Agreement
3. Right of First Refusal, Co-Sale Agreement
4. Certificate of Incorporation
5. Investor Rights Agreement
6. Founders Stock Agreement

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## Deal documents define deal terms

<table>
<thead>
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<th>Voting Agreement</th>
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<tr>
<td>* Size of round</td>
<td>▲ Board seats and control</td>
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<tr>
<td>* Pre-money valuation</td>
<td>■ Rights to block founder transfers</td>
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<tr>
<td>* Option Pool (pre- or post-money)</td>
<td>■ Drag-along rights</td>
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<th>Investor Rights Agreement</th>
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<td>▫ Anti-dilution Protection</td>
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<td>▲ Information rights</td>
<td>▲ Liquidation Preference</td>
</tr>
<tr>
<td>◆ ProRata/Participation</td>
<td>◆ Dividends</td>
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<tr>
<td>▲ Board seats and control</td>
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<tr>
<td>■ Approval/Control rights</td>
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<td>■ Redemption rights</td>
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<th>ROFR and Co-Sale Agreement</th>
<th>Founder Stock Agreement</th>
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<td>■ ROFR and CoSale Rights</td>
<td>▲ Founder vesting</td>
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<td>▲ Founder non-competes</td>
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Adapted from [https://seraf-investor.com/compass](https://seraf-investor.com/compass)
Term Sheet Negotiations

*Should Start During Due Diligence*

**Soon Enough:**
To identify any potential deal breakers

**Late Enough:**
To determine if should proceed with the deal
Closing Thoughts

- Remember it is a negotiation process
- Educate yourself
  - ENET
  - The Capital Network
  - NVCA
- Work from standard NVCA documents (available on their website)
- Avoid non-standard terms to extent possible
- Start as you would like to proceed

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