



ANGEL VENTURE FORUM – DC

**YOU ARE OFFERED A TERM SHEET,
NOW WHAT?**

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Why Sign a Term Sheet?

- Presented by Angel or VC after initial due diligence and determination of interest
- Establishes valuation
- Summarizes basic deal terms
- Minimizes area of dispute in definitive documentation
- Flushes out problems before sunk deal costs grow large



Angel vs. VC Term Sheet

- Angel Term Sheet (if provided) much simpler than VC Term Sheet
- Typically outlines terms for convertible debt transaction
 - Avoids early valuation determination
 - Usually seeks some form of discount into Series A round



Venture Capital Term Sheet – Major Issues

- **Economics** (dividing the pie on exit)
- **Control** (who is going to pilot the ship)
- **Shareholder Rights** (protecting the investment and getting to the exit)



Economics

- **Pre-Money Valuation** (% of company received for the investment).
- **Type of security** (Preferred Stock vs. Common Stock).
- **Dividends** (Cumulative vs. Non-cumulative).



Valuation

- Percent of company that VC receives
- “Pre-money”
- “Post-money”
- Impact of options



Factors Influencing Pre-Money Value

- Market Opportunity (size of market, etc),
- Strength of the Team (Experience vs. Enthusiasm),
- Strength of the IP (or other barriers to entry),
- Strength of the Competition,
- Exit Opportunities (obvious purchasers),
- Competition among investors.



Type of Security

- Preferred Stock vs. Common Stock
 - Fully Participating Preferred (1x or greater),
 - Capped Participation (1.5x to 10x),
 - Non-participating Preferred.



Dividends

- Cumulative
 - Similar to interest accruing on a note, the dividends accrue to the liquidation preference.
 - Cumulative dividends erode ownership % over time (unless only payable in cash).
- Non-Cumulative (no dividend rights unless dividends are declared).



Control

- Board representation (a voice, equality or control).
- Voting of shares:
 - Board election/representation
 - Protective shareholder voting rights (changes to organizational documents, sale of equity or debt, sale of the company or material assets, etc)
 - Sale of the company (drag-along rights)



Shareholder Rights

- Protecting the Investment:
 - Anti-dilution protections,
 - Participation/Preemptive Rights,
 - Restrictions on Transfer of Shares:
 - Right of first offer/refusal
 - Co-sale rights (i.e., the right to “tag along”).



Shareholders Rights

- Getting to the Exit:
 - Demand Registrations Rights
 - Redemption Rights



Shareholders Rights

- Other Rights:
 - Information and inspection
 - Indemnification of officers/directors
 - Key man life insurance
 - Board observers



Other Issues

- Founder Employment Agreement
- Vesting of Founder's Shares through a Stock Restriction Agreement
- 83(b) elections



Thank you for joining us!

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