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TERM SHEET
FOR SERIES A ROUND OF FINANCING OF XCORP

Amount of Investment:	\$3,000,000
Investors:	ABC Ventures XYZ Capital
Type of Security:	Series A Convertible Preferred Stock
Premoney Valuation:	\$7,000,000 ¹
Capital Structure Following Series A Round:	
	Existing holders of Common Stock 55%
	Option Pool 15% ²
	Holder of Series A Preferred Stock 30%
	Total 100%
Use of Proceeds:	The Company shall use the proceeds from this financing for working capital purposes.
Dividends:	The Company will not pay dividends on its shares of Common Stock or any other stock which is junior to the Series A Preferred Stock unless a like dividend is paid on all shares of Series A Preferred Stock on a pro rata “as converted” basis. ³

1. Equals the value the new investors are placing on the enterprise prior to their investment. Usually, all of the outstanding stock of the company, together with any outstanding options and warrants or other rights to buy stock of the company and any additional shares which may be reserved under the option pool, will be included in this premoney valuation.

2. The size of the option pool that venture capital investors will look for tends to range between 15% and 30% of the capital structure of the company. This percentage is calculated including the shares of Series A Preferred Stock being sold in the financing. The actual size of the pool can depend on a number of things, including the industry that the company is in, but is primarily related to the number and types of hires that the company will need to make in the foreseeable future. Thus, a company that has a complete management team at the time of the Series A round will likely need a smaller pool than a company that has one or more top management hires to make (each of whom may cost the company a significant amount of options or stock from the pool).

3. Often, venture capital investors also ask for an “accruing” dividend of between 8% and 10% or so per annum. This dividend “accrues” and is not payable unless (i) declared by the Board, (ii) there is a liquidation event (a

Conversion: Each share of Series A Preferred Stock shall be convertible, at any time, at the option of the holder, into shares of Common Stock, at an initial conversion ratio of one share of Common Stock for each share of Series A Preferred Stock. Mandatory conversion of the Series A Preferred Stock upon the effectiveness of a registration statement covering a firmly and fully underwritten public offering of Common Stock of the Company by a reputable underwriter acceptable to the Investors at a price which equals or exceeds five times the purchase price per share of the Series A Preferred Stock and where the aggregate gross proceeds received by the Company exceeds \$25 million (a “Qualified Public Offering”)⁴.

Antidilution: The terms of the Series A Preferred Stock will contain standard “weighted average” antidilution protection with respect to the issuance by the Company of equity securities at a price per share less than the applicable conversion price then in effect, subject to standard and customary exceptions.⁵ The conversion rate of the Series A Preferred Stock into common stock will be adjusted appropriately to account for any stock splits, recapitalizations, mergers, combinations and asset sales, stock dividends, and similar events. Antidilution protection shall not be triggered by the issuance of up to 1,000,000 shares of Common Stock (or options therefor) issued in accordance with the Company’s Stock Option Plan.

sale of the company is considered a liquidation event, but an IPO usually isn't), or (iii) the preferred stock is redeemed. The accruing dividend is a protective device intended to provide a minimum rate of return but is usually forfeited in the event of an IPO or otherwise upon conversion of the preferred stock to common stock. (The theory is that in such cases the return on the investment will be more than the minimum which the accruing dividend provides. Therefore, the protection is not needed and is forfeited). There are a number of varieties of accruing dividends, including those that are payable in cash and those payable in additional shares of preferred stock. Also, although a basic “accruing dividend” involves a simple interest calculation, sometimes a so-called “cumulative” accruing dividend is requested, and it involves compound interest calculations.

4. Preferred stock should convert into common stock automatically at the company’s IPO. The special rights generally accorded to preferred stock sold to early-stage investors could create problems for a public company.

5. These provisions are designed to protect an investor against “equity” dilution (later sales of stock at a price lower than what the investor paid). Although the “weighted average” version is the most common, an alternative is “full ratchet” antidilution protection. Full-ratchet antidilution protection is far more advantageous to the investor (but punitive to the company) than weighted average, but it is usually reserved for very early-stage deals or other situations where there is significant concern as to whether the valuation will hold up over the long term. Put simply, weighted-average antidilution protection accounts more accurately for the actual dilutive effect which a particular issuance has on the investor’s equity position in the company. Full-ratchet antidilution protection, on the other hand, treats all later stock issuances below the investor’s purchase price as if they were the same, regardless of the number of shares issued.

Voting Rights:

On all matters submitted for stockholder approval, each share of Series A Preferred Stock shall be entitled to such number of votes as is equal to the number of shares of Common Stock into which such shares are convertible. In addition, the Company shall not, without the prior consent of the holders of at least a majority of the then issued and outstanding Series A Preferred Stock, voting as a separate class:

- a) issue or create any series or class of securities with rights superior to or on a parity with the Series A Preferred Stock or increase the rights or preferences of any series or class having rights or preferences that are junior to the Series A Preferred Stock so as to make the rights or preferences of such series or class equal or senior to the Series A Preferred Stock.
- b) pay dividends on shares of the capital stock of the Company.
- c) effect any exchange or reclassification of any stock affecting the Series A Preferred Stock or any recapitalization involving the Company and its subsidiaries taken as a whole.
- d) repurchase or redeem, or agree to repurchase or redeem, any securities of the Company other than from employees of the Company upon termination of their employment pursuant to prior existing agreements approved by the Board of Directors of the Company.
- e) enter into any transaction with management or any member of the board of directors, except for employment contracts approved by the Board of Directors and transactions entered at arms-length terms which are no less favorable to the Company than could be obtained from unrelated third parties.
- f) effect any amendment of the Company's Certificate of Incorporation or Bylaws which would materially adversely affect the rights of the Series A Preferred Stock.
- g) incur or guarantee debt in excess of \$100,000.
- h) voluntarily dissolve or liquidate.