

Angel Term Sheet Evolution

Bellingham Angel Education Breakfast

November 17, 2009

Basil Peters

Angel Syndication

- It's surprising to see how fast interest is growing in in Angel syndication, or co-investment
- It's still very early days, and
- We are just starting to figure it out
- Co-investment requires that we have widely held, common views, on term sheets

Angels are Different from VCs

- Angel investing today is at about the same stage of development as traditional Venture Capital was in the early 1980s.
- In the '80s, I attended VC workshops where they worked on standard term sheets
- We are all still learning how different angels are from traditional VC funds
- We need term sheets optimized for angels

Angel Term Sheet Evolution

- A couple years ago here in Bellingham Bill Payne presented the full National Venture Capital Association term sheet – a full featured, “Heavy Pref” share term sheet
- I am going to describe the “One Page Exchangeable Share” term sheet that has often been used by angels in Vancouver
- Dan will introduce his new, designed for Angels, “Light Pref Share” term sheet

Term Sheets and Corporate Structure

- The term sheet is the most important agreement between the company and investors
- It establishes the framework for their interaction and the company governance
- Has a significant impact on the success of the entire company
- And on the prospects for a successful exit

Term Sheets Can Kill

- One of my frustrations is finding a promising company that I would like to invest in
- That has been using a term sheet that is completely inappropriate - or detrimental
- And having to spend months of hard work to build consensus among the founders, board, lawyers and other investors to change it
- The wrong term sheet can be deadly

Origins of the One Page Term Sheet

- I started to develop the One Page Term Sheet while I was CEO of BC Advantage Funds – a seed stage venture capital fund
- My strategy was to co-invest with Angels
- That required a common term sheet
- Mike Volker and David Raffa helped a lot
- I've used it over a dozen times and it has not gotten me into trouble - yet

Lots of Interest in Term Sheets

The screenshot shows the Web Log Storming interface for 'AngelBlog 2009 Only.wls'. The 'Parameters' tab is active, displaying a report titled 'Visitors accessed page'. The report shows a list of files accessed by visitors, sorted by count. The top file is '/the_one_page_term_sheet.html' with 4449 sessions.

File	Count
/the_one_page_term_sheet.html	4449
/startups_the_essential_to_do_list.html	3734
/how_vcs_block_exits.html	3633
/why_vcs_block_good_exits.html	3249
/share_vesting.html	2542
/how_to_find_an_angel_investor_in_vancouver.html	2217
/venture_capital_funds_how_the_math_works.html	2070
/capital_structure_projection_for_angel_investors_and_entrepreneurs.html	2013
/is_angel_or_vc_financing_best.html	1941
/venture_capital_exit_times.html	1884
/startup_funding_sources_of_financing.html	1782
/vc_return_numbers_are_bogus.html	1772
/angel_investors_vcs_and_entrepreneurs_gaps_in_understanding.html	1765
/share_register.html	1753
/dont_blow_the_biggest_deal_of_your_life.html	1714
/convertible_note.html	1688
/exit_strategy_selling_a_business_can_increase_its_value_by_50pct.html	1654
/exchangeable_shares.html	1620
/exit_strategies_acquisitions_are_usually_under_30_million.html	1573
/exits_with_vc_and_angel_investors.html	1549
/angels_finance_27_times_more_start-ups_than_vcs.html	1487
/index.html	1485
/venture_capital_firms_are_too_big.html	1475
/exit_strategy_its_a_great_time_to_sell_a_tech_company.html	1458

Files: 584 Sessions: 39729

This report shows pages accessed by visitors. Count represents number of sessions, not number of hits. In other words, if session contains multiple hits to same page it is counted only once. Click on item to see sessions that contain hits to particular page.

Foundational Philosophies

- The One Page Term Sheet:
- Assumes good governance and corporate structure
- Is based on alignment and fairness
- KISS (and on one piece of paper)
- Online for anyone to use at:
www.AngelBlog.net/The_One_Page_Term_Sheet.html

Capital Structure Alternatives

- Some angels have been using the National Venture Capital Association “Heavy Preferred” term sheet - unfortunately
- Angels also used convertible debt – which is almost never fair to the investors
- Common shares create the best alignment, governance and KISS
- Exchangeable shares – the “best of all”?

The Exchangeable Share

- Well established legal mechanism – but not previously applied in this situation
- Straight common shares, unless
- A subsequent investor negotiates something better
- Then it can be exchanged, on a one-for-one basis - at the investor's option
- Valuation does not change – just terms

Share and Option Vesting

- All stock options, and all nominally priced previously issued shares, will vest on the following basis:
- 50% of the shares will vest daily and linearly over a three year period; and
- The other 50% will not vest unless and until there is a sale of the Company
- Vesting accelerates on a sale

Liquidity Event – Drag Along

- To ensure that a return can be provided to all of the shareholders
- The investors require a "drag-along" right be added to the Company's constating documents
- To allow the holders of 51% of all the issued shares of the Company to cause the sale of the Company – think carefully about this

Investor Rights

- Investors have the right of first refusal to participate in future financings
- Any changes to the capital structure, new shares, options or debt requires the approval of the majority of the investors in this round
- Think carefully about what majority is required

Reporting to Shareholders

- The company will send a CEO Update monthly to all shareholders
- Financial statements will also available upon request
- Frustratingly difficult to enforce

Legal Costs and Confidentiality

- The Company will pay the legal costs of the Fund not to exceed \$6,500, plus taxes and disbursements
- The Company will keep confidential this Term Sheet and all discussions with the Fund for a period of two years

The Board of Directors

- Total of five members: the CEO, one nominee of the Fund,
- And three independent of management
- That the Company and the Fund agree on
- Each director must have made a meaningful investment in the Company
- If you believe in the board, common shares are just fine - you don't need preferreds

Challenges with Boards Today

- My writing on term sheets and corporate structure was based on my belief that a good board would always be in place
- That worked well up until recently
- In the past five years it has become much more difficult to build and retain an excellent board for an early stage company
- Causing me to re-think term sheets

Where The One Page Works Well

- The One Page Term Sheet works well if:
- Total capital required is between \$0.5 million and a few million
- Then the company plans to exit
- There will always be a very good board
- A Heavy Preferred financing is not contemplated

When Dan's Light Pref is Better

- My thinking is evolving
- I still like the One Page Term Sheet
- But I am not confident about companies' abilities to recruit and retain a good board
- Many modern companies don't need much money, so its even harder to build a board
- In many current situations the Dan Rosen Light Pref term sheet is better