

***“Series A Preferred Light”
The Best Outcome for Angels & Startups***

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Today's Agenda

- Angels did not used to be disciplined (lazy)
 - Assumed they would be followed by VC, who would set terms
 - Sometimes common
 - Sometimes notes
- Striking a balance between protecting investors and being entrepreneur friendly
- The Four Steps to a Successful Term Sheet

Why did I do this?

- Terms were all over the board
- New “lead investors” frustrated (and called me several times a day during process)
- Final straw: one deal where “famous lawyer” did term sheet that was 40 pages (assigned to partner, who assigned to new associate). Took me 4 hours to find key terms
- Lawyers recommending Convertible Notes

Why Series A Preferred Light?

- Protects investor:
 - Mitigates downside risks (to the degree possible)
 - Shares upside
 - If done correctly, makes plan misses less disastrous
- Reasonable for entrepreneur
- Prepares company for future financings
 - VC
 - Future Angel rounds
- But... can be expensive (legal fees) and time consuming

Alternatives to Pfd A

- Convertible notes
 - Better for entrepreneur
 - Inexpensive
 - Limits upside for highest risk investors
 - Better than BAD Series A
- Common Stock
 - Very limited leverage
 - OK if company is great success and doesn't miss plan and entrepreneur has funded to great degree
 - No protection in future rounds

Key Take Away

- Everything flows from the valuation
- Pre- and post-money → price per share
 - Options in the pre-money
 - Warrants in the post


1st Step: Get on Same Page

- Understand entrepreneur needs and investor group needs
- Match the two
- Get deal done quickly with minimum distraction to company
- Never be afraid to walk away (or run away!)


1st Step: Get on Same Page (cont.)

- Prepare entrepreneur
 - Help guide business strategy and plan
 - Business goals and outcome (feature, product, ..)
- Getting the entrepreneur in touch with reality
 - Competitive position
 - Valuation
 - Impact of capital needs over time
 - Impact of taking outside money

Scenario 1



I read on the web that I should maintain a majority



And.. I want the board to be me and my 3 cofounders

You're Kidding.

OK. Why don't we also do common stock?

Of course, but you started it!

2nd Step: Mechanics

- Fixing the cap table
 - Pre-financing
 - Post-financing
- Guidance on other key terms
- Help with angel presentation
- Introduction to AoA staff
- Build the syndicate – intro to other Angels
- Organizing post-luncheon meetings

Impact of an Earlier Round on Cap Table

- Pre-financing cap table planning is critical
 - Earlier valuation is set too high
 - Ownership of earlier investors is too high
 - Founders friends and family are hurt
 - Anti-dilution triggered
- Need to fix up-front!

Scenario 2: The Cap Table Evolution

- Pre-deal cap table
- Option pool and impact
- Post-deal cap table
- Post money and next financing impact (assumed price for next round)
- Overall capital needs in all rounds
- Investor and company expectations by round

**This drives the return on the deal
& the future viability of the company!**

Pre- & Post Financing Capitalization

Type of stock	Pre-Financing		Post Financing	
	Number of shares	% Fully Diluted	Number of shares	% Fully Diluted
Common	1,000,000	51%	1,000,000	35%
Stock Options Granted	250,000	13%	250,000	9%
Pre-financing Stock Options Avail	500,000	26%	500,000	17%
New Stock Options	200,000	10%	200,000	7%
Series A Pfd Stock			731,250	26%
Warrants			182,813	6%
Total Shares	1,950,000	100%	2,864,063	100%

3rd Step: Negotiating Terms

- Valuation: Setting the price per share
- Represent the consortium of investors – “many investors – one negotiator”
- “Plain vanilla”: market standards
- Balance risk and reward for both investors and entrepreneurs
 - Impact of being too entrepreneur friendly
 - Impact of being too investor friendly

Term Sheet terms: at market

- Valuation
 - Seed stage: \$1-3M; post product/post revenue: \$2-8M
- Preferences
 - 1X participating preferred
- Board
 - Representation & balance
- Anti-dilution
- Discounts, warrants: only if earlier financing wrong
- Dividends: non-cumulative
- Vesting of founders shares

4th Step: Closing the Deal

- Compare final docs to term sheet
 - All OK?
 - Highlight differences and communicate to group
 - Investors' Counsel?
- Spreadsheet for close
- Track funds committed vs. pledged
- (Report to AoA!)



Questions and discussion