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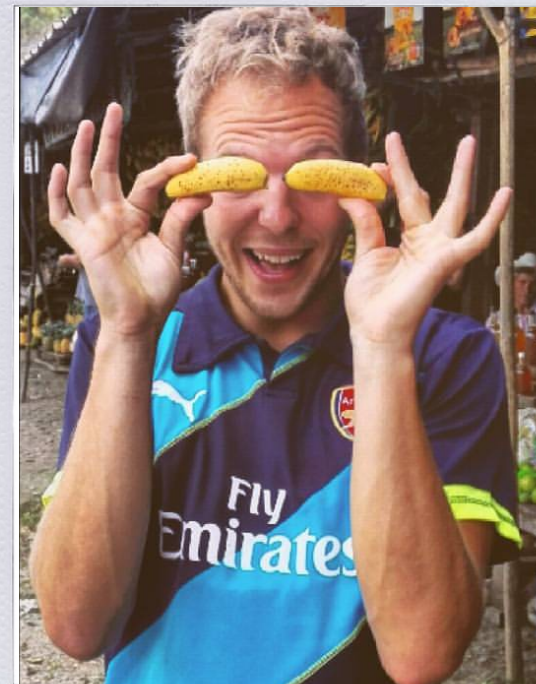
NAVIGATING THE **TERM** **SHEET**

Department for International Trade Belgium
16 Dec 2020

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I'M **SEB**

- VC @ BALDERTON
- MICROMOBILITY SURVIVOR
- RECOVERING CONSULTANT
- LOVER OF BANANAS
- ~~EXILED BELGIAN~~



I'M GOING TO TALK ABOUT 4 THINGS

1. **WHO** WE ARE
 2. **WHAT** IS A TERM SHEET & **WHY** DOES IT MATTER
 3. WHAT ARE THE KEY **PROVISIONS**
 4. HOW TO APPROACH A TERMSHEET **NEGOTIATION**
- 
- A glowing lightbulb with a cracked glass globe, symbolizing ideas and negotiation. The lightbulb is the central focus, with a warm orange glow emanating from its filament. The glass globe is shattered, with many sharp, dark fragments floating around it, suggesting a process of breaking down or refining an idea. The background is a dark, textured blue-grey.

1. WHO WE ARE

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**WE BELIEVE THE NEXT EUROPEAN
GIANT WILL BE A TECHNOLOGY
COMPANY**

20 YRS

Investing in Europe

220+

Companies invested

\$400M

Our latest fund
(mostly Series A)

B.

1. WHO WE ARE

WE INVEST IN CATEGORY-DEFINING STARTUPS WITH GLOBAL AMBITIONS

Open Finance



Retail, re-defined



Thoughtful Food



Software for the Modern Enterprise



Efficient Mobility



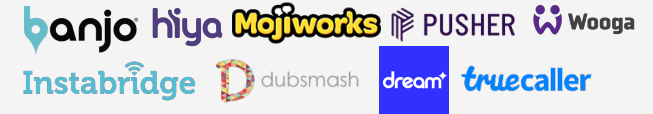
Data-driven Health



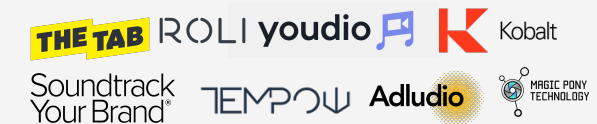
Future of Work & Education



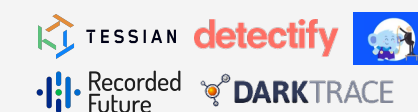
Mobile & Gaming



Media & Music



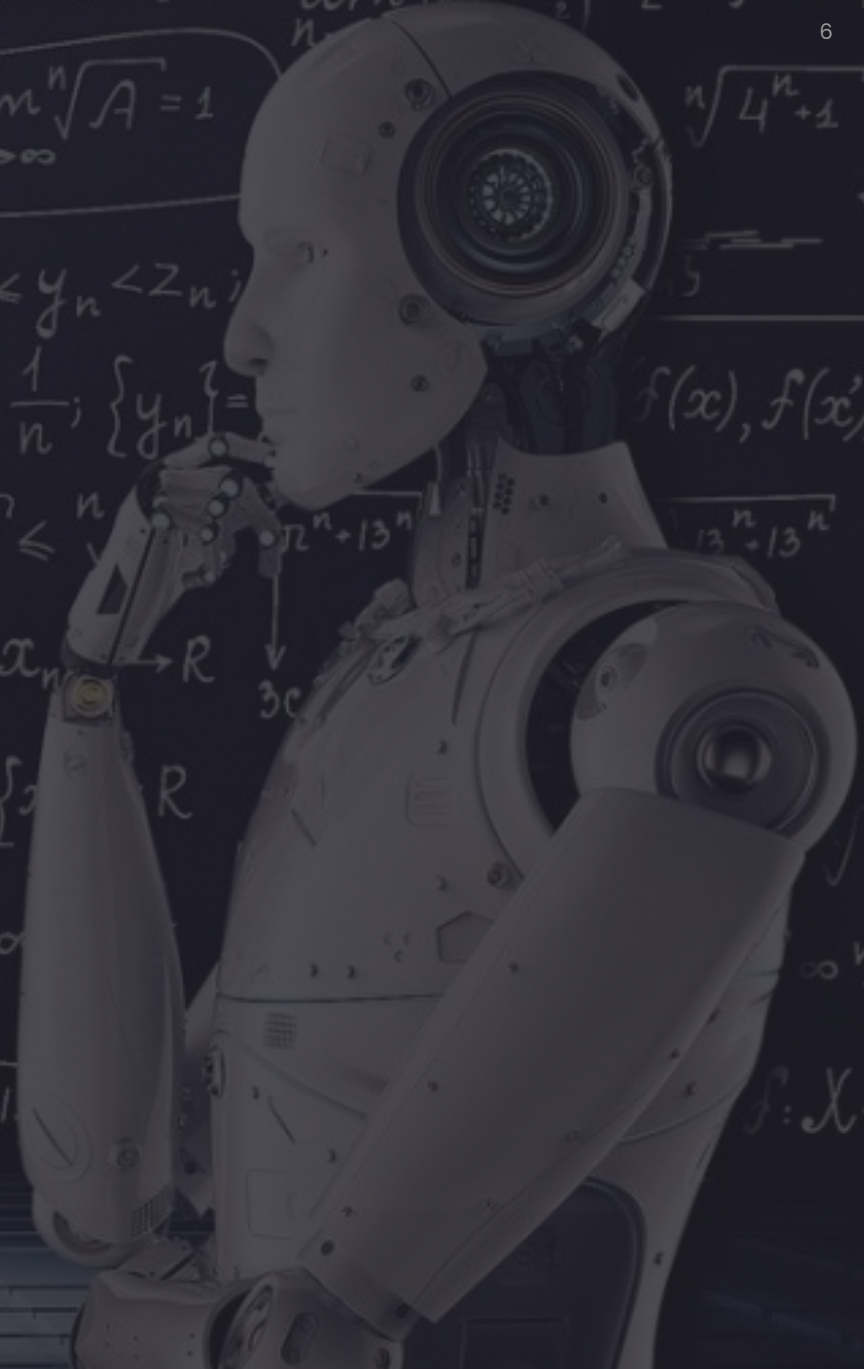
A more Secure Internet



2. WHAT IS A TERM SHEET AND WHY DOES IT MATTER?

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WHAT IS A TERM SHEET & WHY DOES IT MATTER



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2. WHAT IS A TERM SHEET AND WHY DOES IT MATTER?

DEFINING THE TERM SHEET

TERM SHEET	
Company:	[_____], a Delaware corporation.
Securities:	Series A Preferred Stock of the Company ("Series A").
Investment Amounts:	\$_ million from [_____] ("Lead Investor") \$_ million from other investors
Valuation:	Convertible notes and safes ("Convertibles") convert on their terms into shadow series of preferred stock (together with the Series A, the "Preferred Stock"). \$_ million post-money valuation, including an available option pool equal to [%] of the post-Closing fully-diluted capitalization.
Liquidation Preference:	1x non-participating preference. A sale of all or substantially all of the Company's assets, or a merger (collectively, a "Company Sale"), will be treated as a liquidation.
Dividends:	6% noncumulative, payable if and when declared by the Board of Directors.
Conversion to Common Stock:	At holder's option and automatically on (i) IPO or (ii) approval of a majority of Preferred Stock (on an as-converted basis) (the "Preferred Majority"). Conversion ratio initially 1-to-1, subject to standard adjustments.
Voting Rights:	Approval of the Preferred Majority required to (i) change rights, preferences or privileges of the Preferred Stock; (ii) change the authorized number of shares; (iii) create securities senior or <u>pari passu</u> to the existing Preferred Stock; (iv) redeem or repurchase any shares (except for purchases at cost upon termination of services or exercises of contractual rights of first refusal); (v) declare or pay any dividend; (vi) change the authorized number of directors; or (vii) liquidate or dissolve, including a Company Sale. Otherwise votes with Common Stock on an as-converted basis.
Drag-Along:	Founders, investors and 1% stockholders required to vote for a Company Sale approved by (i) the Board, (ii) the Preferred Majority and (iii) a majority of Common Stock [(excluding shares of Common Stock issuable or issued upon conversion of the Preferred Stock)] (the "Common Majority"), subject to standard exceptions.
Other Rights & Matters:	The Preferred Stock will have standard broad-based weighted average anti-dilution rights, first refusal and co-sale rights over founder stock transfers, registration rights, pro rata rights and information rights. Company counsel drafts documents. Company pays Lead Investor's legal fees, capped at \$30,000.
Board:	[Lead Investor designates 1 director. Common Majority designates 2 directors.]
Founder and Employee Vesting:	Founders: [_____] . Employees: 4-year monthly vesting with 1-year cliff.
No Shop:	For 30 days, the Company will not solicit, encourage or accept any offers for the acquisition of Company capital stock (other than equity compensation for service providers), or of all or any substantial portion of Company assets.

A term sheet is a high-level doc that sets out:

- the proposed **investment provisions**
- the valuation of your company
- the terms pertaining to the investment
- **what you can expect from the firm in addition to the financing**

Often these are only one or two pages long.

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2. WHAT IS A TERM SHEET AND WHY DOES IT MATTER?

DEFINING THE TERM SHEET

What the term sheet is

- Summary of proposed key terms for investment for negotiation
- Strong signal of intent – once accepted parties will normally not rescind it
- Template that legal teams will use to draft a binding agreement

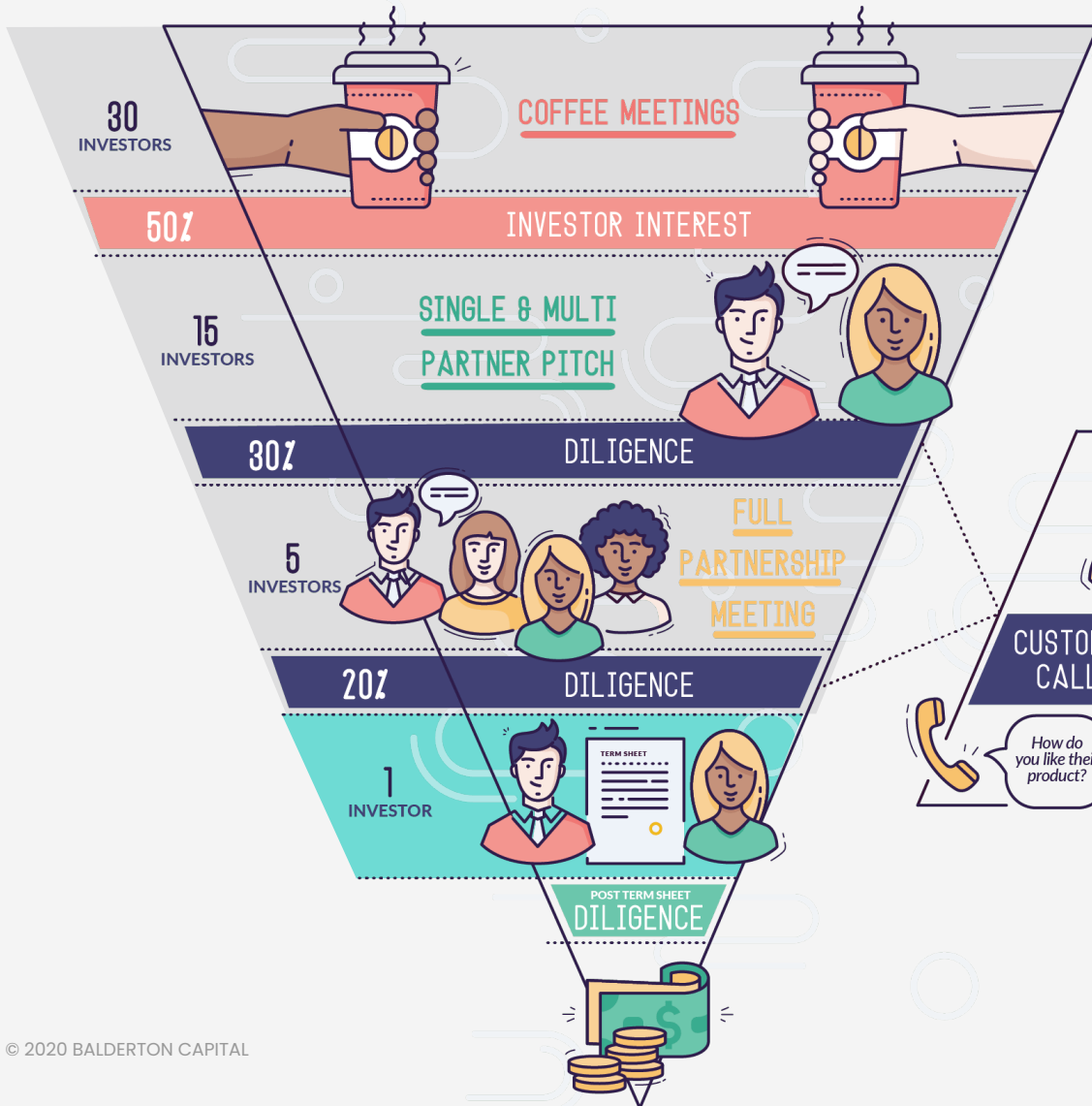
What it isn't

- NOT Binding legal document
 - Unless otherwise specified in the document
 - Shareholders Agreement, Articles of Association, ...
- Terms that you must accept at any cost
- Something you can't walk away from
 - Signed term sheets usually involve exclusivity

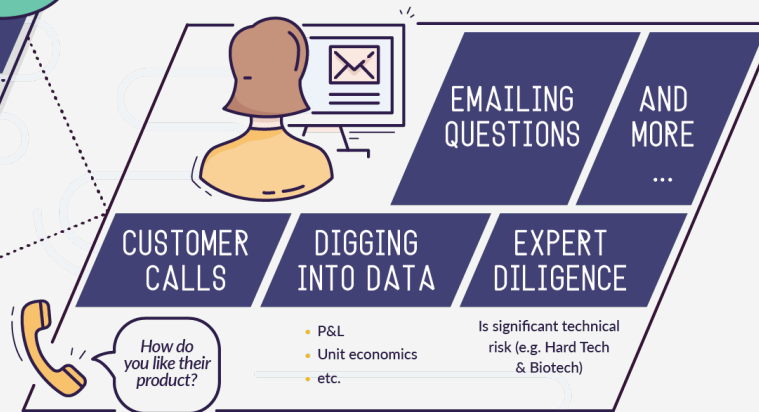
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2. WHAT IS A TERM SHEET AND WHY DOES IT MATTER?

WHERE DOES THE TERM SHEET FIT IN A TYPICAL INVESTMENT PROCESS



The term sheet is the transition from **assessing** an investment to **setting it up**.



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2. WHAT IS A TERM SHEET AND WHY DOES IT MATTER?

WHERE DOES THE TERM SHEET FIT IN A TYPICAL INVESTMENT PROCESS

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You're in the end-zone...

...but no touchdown yet!



You're "over the hump" (one or more candidates for lead investor)

Other investors need to choose whether to get on board or not

Terms offered are not final

Money is not in the bank (DD & terms)

3. WHAT ARE THE KEY PROVISIONS

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WHAT ARE THE **KEY PROVISIONS**?



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3. WHAT ARE THE KEY PROVISIONS

THERE'S A BALANCE OF **ECONOMICS** AND **GOVERNANCE**

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How the investment works

- \$ invested
- Valuation (pre/post)
- Liquidation preference
- Anti-dilution
- Option pool
- Pay-to-play
- Vesting

How the company is run

- Board members
- Board approvals
- Protective provisions
- Drag along

3. WHAT ARE THE KEY PROVISIONS

KEY ECONOMIC PROVISIONS: EXAMPLE

Provision	Explanation	Term Sheet 1	Term Sheet 2
Investment amount	<ul style="list-style-type: none"> – \$ invested – Can be mix of equity and CLN 	£4m	£4m
Pre-money valuation	<ul style="list-style-type: none"> – Defines dilution & investor shareholding – Defines dilution 	£8m	£8m
Post-money valuation	<ul style="list-style-type: none"> – <i>Fully diluted</i>: every outstanding share included in calculation 	£12m	£12m
Option pool	<ul style="list-style-type: none"> – Significantly affects valuation (& often overlooked) – Top up only includes unissued shares – New option pool often comes out of pre-money valuation 	20%	15%
Liquidation preference	<ul style="list-style-type: none"> – Investment usually in preference shares – Liq pref = who gets their \$ back first in case of a liquidation event 	1x participating	1x non-participating
Anti-dilution	<ul style="list-style-type: none"> – Investor protection against being diluted by new lowered valuation in new funding round – “Downside insurance” – Usually in down round inv. value will stay roughly the same (i.e. % increases) 	<p>Broad Based Weighted Average</p> <p><i>Value of preferred shares will be adjusted to a new weighted average price using the broad-based weighted average calculation</i></p>	<p>Full-ratchet</p> <p><i>In down-round, earlier round price adjusted to down round (i.e. you hand out more shares at lower value)</i></p>

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3. WHAT ARE THE KEY PROVISIONS

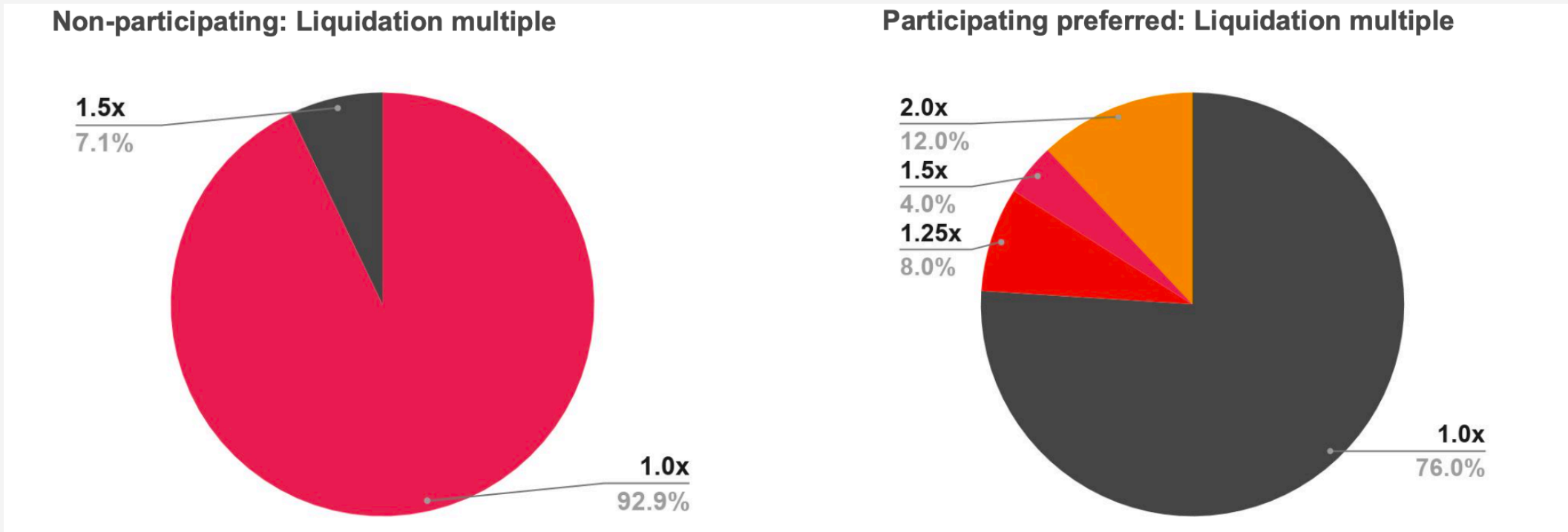
KEY ECONOMIC PROVISIONS: LIQUIDATION PREFERENCE

Provision	Term Sheet 1		Term Sheet 2	
Investment round	£4m on £8m pre-money	Investors: 33% Founders: 77%	£4m on £8m pre-money	Investors: 33% Founders: 77%
Exit valuation	£10m		£10m	
Liquidation preference	1x participating	<p>LiqPref: VC first gets £4m back (vs. just £3.3m)</p> <p>Participating: £10m - £4m = £6m 33% of £6m = £1.8m</p> <p>VC total exit: £4m + £1.8m = £5.8m</p>	1x non-participating	<p>LiqPref: VC first gets £4m back (vs. just £3.3m)</p> <p>Non-participating: end of calculations</p>
Outcome for Founders		<p>£10m exit - £5.8m = £4.2m</p>		<p>£10m exit - £4m = £6m</p>

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3. WHAT ARE THE KEY PROVISIONS

KEY ECONOMIC PROVISIONS: LIQUIDATION PREFERENCE



Notes

- Ca 70% of Seed – B rounds are non-participating
- Investment terms become “the Olympic minimum” – new investors in future rounds expect same terms as existing
- Participation is not worth higher valuation (in general)

Source: PwC Raise – VC Term Sheet Market Report 2020, n=94 with investments up to £25m

KEY **ECONOMIC** PROVISIONS: ANTI-DILUTION PREFERENCE

Provision	Term Sheet 2	
Investment round	£4m on £8m pre-money	Pre-round Investor 1: 33% (£4m/£12m) Founders: 77%
Next round valuation	£6m pre-money	Post-round: Investor 1: 40% (£4m/£10m) Founders: 60%
Anti-dilution	Full ratchet	

Full ratchet is **highly unconventional**

Founder & investor should believe that **current valuation is fair market value** (& be prepared to weather storms together)

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3. WHAT ARE THE KEY PROVISIONS

KEY **ECONOMIC** PROVISIONS: OPTION POOL, PAY-TO-PLAY, VESTING

As a general principle investors & founders should be aligned in success

Key ingredient is that everyone keeps batting for the team

Provision	Notes
Option pool	Pre/post-money: really a question of valuation Make sure you have enough to attract needed talent for next 1-2 rounds
Pay-to-play	If investor does not pro-rata, stock converts to common stock
Vesting	4y, 1y cliff normal for very early companies Fix in an early round – signalling + time starts ticking

3. WHAT ARE THE KEY PROVISIONS

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**GOVERNANCE:
BE PREPARED TO
SAIL ROCKY SEAS
TOGETHER**

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3. WHAT ARE THE KEY PROVISIONS

KEY GOVERNANCE PROVISIONS

Board members

- Very common in VC rounds
- Carefully select your board member – personal ‘click’ & expertise
- NED: make sure they are aligned with your goals

Board approvals & protective provisions

- Board approval sits below investor consent
- Protective provisions/investor consent
 - No consent: rare
 - Light: company wind-up, liquidation, changing articles
 - Full: share capital, IP, dividend, etc.
- Clear role delineation: day-to-day running of the company vs. board decisions

Drag, Tag & Co-Sale Rights

- In case of sale:
- Drag: If a specified % of shareholders want to go ahead, then all shareholders will be forced. Usually 75%
 - Tag: minority shareholders get right to sell at same price as majority

HOW TO APPROACH A TERM SHEET NEGOTIATION?

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4. HOW TO APPROACH A TERMSHEET NEGOTIATION

THE GOLDEN RULE: **BE A DISNEY PRINCESS (within reason)**

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The best way to have a smooth term sheet negotiation is to have **multiple offers on the table:**

- Time your investment round to have several term sheets
- Keep investors abreast
- Communicate your expectations on valuation, etc.

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4. HOW TO APPROACH A TERMSHEET NEGOTIATION

HOW TO NAVIGATE: **STAND UP FOR IMPORTANT ISSUES**

Do's

Focus on key round dynamics:

- Valuation (inc. option pool)
- Liq Pref
- Board composition & powers

Drive decision making

- Short exclusivity window (30-45d)
- Hammer out key terms early

Run through scenarios

- “Why would you like x provision?”
- What happens if X?

Seek friendly input (trusted later stage VCs)

Don'ts

Focus just on the TechCrunch article:

- Valuation is not everything (expectations)
- Aligned investor > Purely brand investor
- Talk about value-add beyond £

Get short-sided

- Only 1 exploding term sheet
- Take the 1st termsheet – try to get multiple

Accept that something is “market standard”

- “Why would you like x provision?”
- What happens if X?

Get the lawyers involved too quickly (first agree key terms)

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THANK YOU

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