

Investment Terms:

How Venture Capitalists Structure Investments

Getting Ready for
Equity™

New York, NY

October 20, 2009



Durham, NC

New York, NY

San Francisco, CA

www.sjfventures.com

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SJF invests in and assists high-growth companies that positively impact the world



Investment Terms – Session Goals



- Understand the role of the term sheet
- Become familiar with the term sheet and due diligence process
- Gain exposure to typical terms and term sheet issues, differences between angel and institutional round

RESOURCES:

- Glossary of equity investment terms
- Sample Series A Preferred equity term sheet
- Sample term sheet capitalization table

TERM SHEET - Overview



- ❑ Defines the principal terms of a proposed investment
 - Investing entities and \$ amount being invested
 - Valuation of the company, which determines ownership percentages
 - Other financial terms: dividends, other return enhancers, redemption, dilution, stock option pool...
 - Other conditions: board of directors, management team recruitment requirements, protective provisions ...

- ❑ Part of building a relationship, how it is done is a good indicator for the future

- ❑ Get a good lawyer, one who has done venture capital deals

TERM SHEETS: A MARRIAGE CONTRACT

❑ DATING (BEFORE THE TERM SHEET)

- Summary, plan, financials, projections, meetings, conference calls, references

❑ ENGAGEMENT (AFTER THE TERM SHEET)

- Legal documents, further due diligence

❑ WEDDING (CLOSING AND FUNDING THE DEAL)

- Not all deals make it to the altar!

❑ MARRIAGE (UNTIL EXIT DO US PART)

- Board meetings, growth, acquisitions, mis-steps, corrections, additional funding, exit



CONDITIONS TO TYING THE KNOT



- ❑ ADDITIONAL DEBT FINANCING
- ❑ EQUITY CO-INVESTORS OR SYNDICATE
- ❑ MANAGEMENT CHANGES OR NEW RECRUITS
- ❑ USES OF FUNDS – Acquisitions, marketing, expansion
- ❑ DUE DILIGENCE

TERM SHEET: Team Issues

- ❑ CEO, FOUNDER, FAMILY MGMT ISSUES
- ❑ NEW RECRUITS
- ❑ MANAGEMENT CONTRACT, NON-COMPETES
- ❑ STOCK OPTION PLAN
 - Incentives available for additional mgmt team members or full team
- ❑ BOARD OF DIRECTORS
 - Designate seats for management, investors, independent directors
 - Voting rights for management and investor classes
 - Establish committees



THE BELLS AND WHISTLES – PREFERRED STOCK



□ DIVIDENDS

- 7% to 12% is common, cash or stock, sometimes compounding, usually accrues and paid at exit event

□ LIQUIDATION PREFERENCE

- Venture capitalists often get one times their investment back before participating pro-rata with other shareholders

□ ANTI-DILUTION RIGHTS FOR FUTURE FINANCINGS IF THEY OCCUR AT A LOWER VALUATION

- Weighted average ratchet adjustment is most common

□ CONVERSION RIGHTS

- Ability to convert preferred stock to common stock in event of IPO or other exit valuation hurdle

THE BELLS AND WHISTLES, continued

REPS AND WARRANTIES

- Statement of facts, opinions, estimates

WARRANTS

- Additional stock purchase options at predetermined price or valuation adjustments based on milestones

FEES

- Legal fees typically paid by company out of investment proceeds, sometimes additional management fees

NO SHOP

- Prevents company from negotiating with other investors during a specified due diligence period

RIGHT OF FIRST REFUSAL, TAG ALONG OR CO-SALE

- Investors' rights to participate in future financings



FRIENDLY DIVORCE?

→ REDEMPTION CLAUSE



- Defines right of investor to redeem investment, typically five years
- Not typically exercised, right time to exit usually evident to all
- If exercised, what are the teeth?
- How is the price set – greater of purchase price + dividends, market valuation, valuation multiple?
- Term for the pay-out if a recapitalization?
- How about a call as well as a put?

PROTECTIVE PROVISIONS



- ❑ ACTIONS THE BOARD MUST APPROVE, SUCH AS...
 - Creating new series or classes of equity or changing their rights
 - Pay dividends or repurchase securities
 - Amend the Certificate of Incorporation or Bylaws
 - Incur debt or capital expenditures over a certain amount
 - Merge, consolidate, lease license or sell significant assets
 - File for bankruptcy, dissolve, or liquidate
 - Increase or decrease size of Board of Directors
 - Hire or fire executive officers

CAPITALIZATION TABLE

9/10/2008

Green Company, Inc. Capitalization Table

Company Shareholder	Prior to Series A Issuance		After Series A Issuance	
	% of fully diluted shares	Number of Shares	% of fully diluted shares	Number of Shares
Founder A	62.50%	2,500,000	41.67%	2,500,000
Founder B	37.50%	1,500,000	25.00%	1,500,000
Preferred A shareholders			33.33%	2,000,000
	100.00%	4,000,000	100.00%	6,000,000

- \$4MM pre-money valuation
- \$2MM in VC financing for 33% ownership
- \$6MM post-money valuation
- 6,000,000 shares outstanding at \$1/share



CAP TABLE INCLUDING STOCK OPTIONS

9/10/2008 **Green Company, Inc. Capitalization Table with Stock Options**

	<i>Prior to Series A Issuance</i>		<i>After Series A Issuance</i>	
Company Shareholder	% of fully diluted shares	Number of Shares	% of fully diluted shares	Number of Shares
Founder A	62.50%	2,500,000	37.5%	2,500,000
Founder B	37.50%	1,500,000	22.5%	1,500,000
Employee stock option plan			10.0%	670,000
Preferred A shareholders			30.0%	2,000,000
	100.00%	4,000,000	100.00%	6,670,000

- \$4MM pre-money valuation
- Extra 670,000 shares added for employee stock option plan
- \$2MM in VC financing for 30% ownership (after option plan included)
- \$6.67MM post-money valuation
- 6,670,000 shares outstanding at \$1/share



SJF Example: Solar Portfolio Company



Locations:	VT HQ; Offices in OR, NY, MA, MD, CO & Ontario
Business Description:	groSolar is a national integrator, installer, and distributor of solar photovoltaic and hot water systems.
SJF Investment:	SJF led \$2.25MM A round with Calvert, Allco Financial in 10-06, closed \$23MM Series B & C with NGP Energy Technology Partners 2007-2008
Cleantech Innovation:	National brand, install and distribute multiple solar technologies, building national dealer network with marketing, supply chain logistics, training and technology advantages
Highlights:	<ul style="list-style-type: none">▶ 10X revenue growth from 2006 to 2009▶ Closed on three acquisitions in OR, CA and MD▶ One of the top five residential solar installers nationwide and very active in commercial and distribution business lines



SUMMARY



- ❑ AN EQUITY INVESTOR WILL BE A CO-OWNER OF THE COMPANY
- ❑ COMPANY MANAGEMENT SHOULD DILIGENCE THE INVESTOR
- ❑ FINDING THE RIGHT MATCH IS ESSENTIAL
- ❑ EXPECT IT TO TAKE TIME, PLAN AHEAD FOR EQUITY RAISE

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