

# International series A rounds

David Miranda

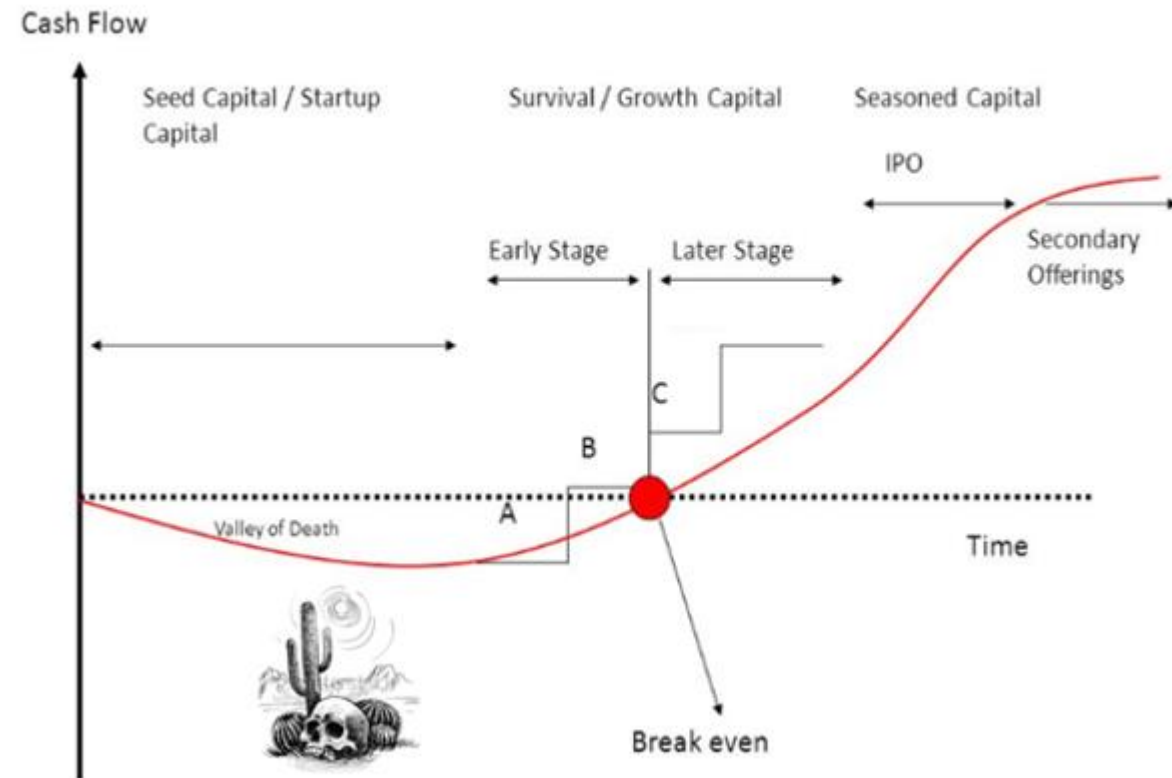
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# Investment stages

- Founders
- Friends & Family
- Business Angels
- Risk capital:
  - ✓ Venture Capital (no control)
  - ✓ Private Equity (control)
- Industrial investors
- Markets (Stock Exchange)

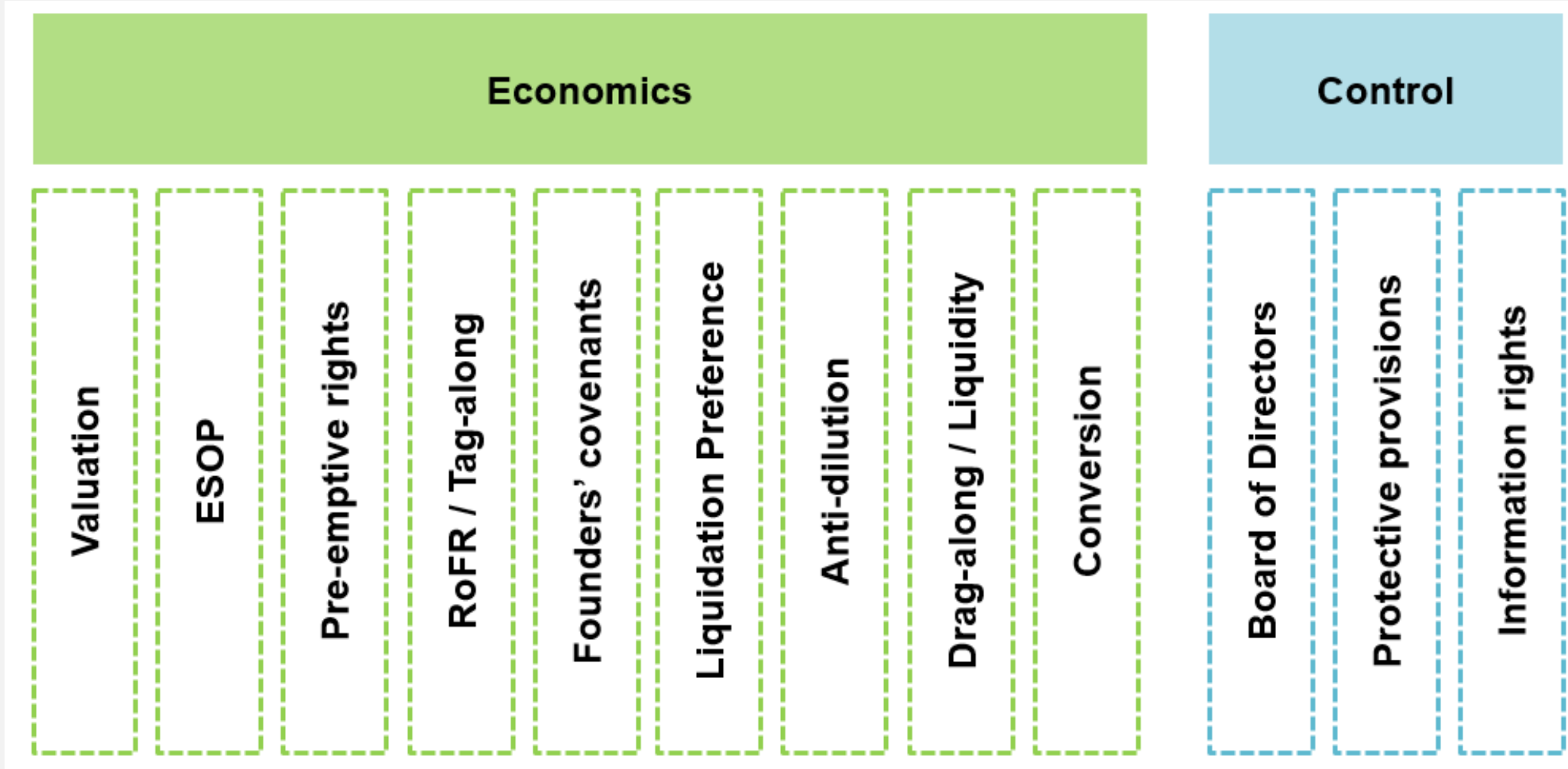
## Financing Lifecycle – Scale-up Ventures



## Negotiating the Term Sheet - What is a Term Sheet?

- Key finance document
- The more comprehensive, the better
  - ✓ Avoid references to customary market practice or TBD
  - ✓ Lawyers' guide to prepare the investment documents (Investment Agreement and Shareholders Agreement)
- Generally non-binding
  - ✓ Obligation to negotiate in good faith
  - ✓ Binding provisions (confidentiality, no-shop...)

# Breaking down the Term Sheet



## Description of the offer

- Company valuation
  - ✓ Fully diluted premoney valuation (all-in)
    - Capital FD = shares + ESOP + convertibles
    - The investors' math is simple  $\longrightarrow$  % share capital (FD) =  $\frac{\text{Investment Amount}}{\text{Company Valuation}}$
- Investment amount
  - ✓ Price Per Share (PPS) =  $\frac{\text{Premoney Valuation}}{\text{Fully Diluted Share Capital}}$
- Capitalization table
  - ✓ Pre-money / Post-money
  - ✓ Includes ESOP Pool (allocated / unallocated)
  - ✓ Founders must have skin in the game
- Brief reference to customary representations and warranties and indemnity provisions
- Which counsel leads the drafting of the binding investment documents

## Features of the series A shares

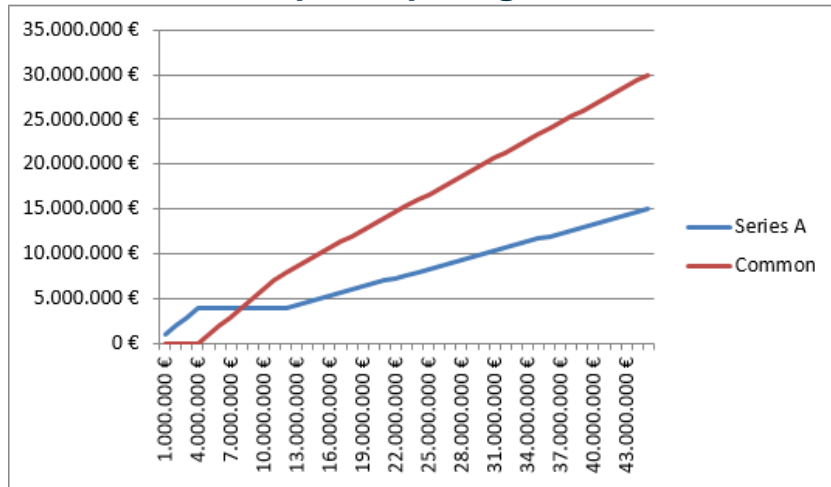
- They are usually the first series of preferred shares
  - ✓ Typically reserved to institutional investors (venture capital funds)
  - ✓ Carve-out: series seed preferred
  - ✓ Other series of preferred shares: series B, series C, series D...
- Preferred rights: liquidation preference and anti-dilution protection
- Other features: right to convert into common shares

# A dive into the liquidation preference

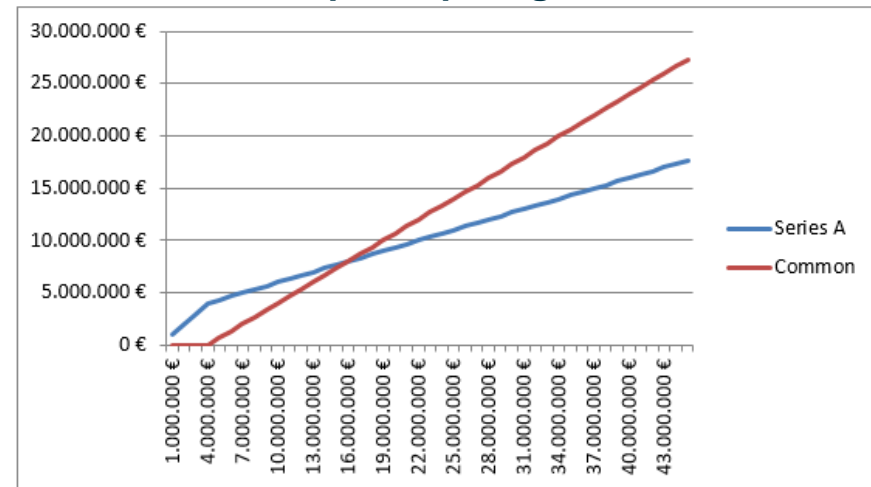
- Protection in case of low-return exit
  - Exit: liquidation of the company, sale of shares and sale of assets
  - Investors recover their investment (or a multiple of their investment) first: 1x, 2x, 3x...
- Non-participating vs participating
  - ✓ Pro-founder vs Pro-investor?
  - ✓ A middle ground: capped participating
- Don't forget the misalignment

<b>Series A</b>	4.000.000 €	33,33%
<b>Common</b>	8.000.000 €	66,67%
<b>Post-money</b>	12.000.000 €	100,00%

1x non-participating



1x participating

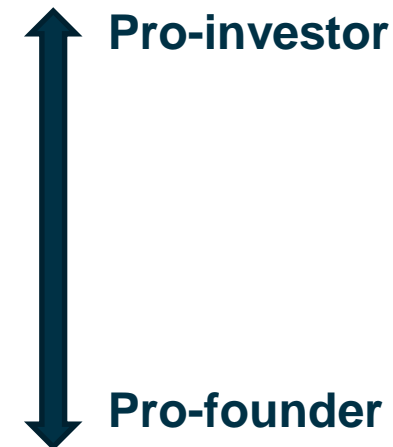


## And a dive into the anti-dilution protection

- A down-round implies a repricing of the series A shares
  - ✓ Don't confuse with pre-emptive rights (pro-rata rights)
    - Economic dilution vs political dilution
    - The venture capital game is about economics, not about control
  - ✓ The investors' shares lose value (on paper!)
  - ✓ Investors get compensated for the value lost with anti-dilution shares (shares at no consideration)
- Types of anti-dilution ratchets
  - ✓ Full ratchet – Shares repriced at series B PPS
  - ✓ Weighted average mechanisms – Shares repriced at a WA Price

$$\text{WA PPS} = \frac{(\text{Nr of Shares} \times \text{PPS Series A Shares}) + \text{Series B Capital Increase}}{\text{Nr of Shares} + \text{Nr.of Series B Shares}}$$

- Narrow Base → Nr. of Shares = Legal capital
- Broad Base → Nr. of Shares = FD capital





# Conversion of preferred shares

- Voluntary conversion
  - ✓ At any time
  - ✓ Liquidation proceeds as converted into common shares > Liquidation proceeds as preferred shares
    - Only in case of non-participating LP or capped participating LP
- Mandatory conversion
  - ✓ Qualified IPO
    - Underwriters' requirement
    - Why qualified?
      - IPO with minimum offering price and capital raise
      - Alternative markets vs. official stock exchanges
  - ✓ Majority vote of the relevant series of preferred shares

## Use of proceeds

- Money must go to the business
  - ✓ General working capital requirements
  - ✓ Development of the business in accordance with the business plan
  - ✓ Certain capex
- No buy-backs or repayment of loans

## Transfer of shares

- Lock-up periods
  - ✓ Founders and key people
- Pre-emptive rights
  - ✓ Primary transfers (by the company): issuance of new shares
- Rights of first refusal
  - ✓ Secondary transfers (by shareholders): transfer of shares in issue
- Tag-along
  - ✓ Right to sell all or part of the shares if other shareholder sells shares
  - ✓ Pro-rata tag-along vs full tag-along
- Drag-along
  - ✓ Obligation to sell shares if a (qualified) majority of (preferred) shareholders sell their shares

## Appointment rights

- It is time for a board of directors
- Warning: directors have fiduciary duties towards **all** the shareholders
  - ✓ Duty of diligence (incl. secrecy) and loyalty (interest of the company comes first)
- Types of directors
  - ✓ Investor Directors
  - ✓ Founder Directors
  - ✓ Independent Directors
- Other positions
  - ✓ Chairman – Calls the meetings, sets the agenda and leads discussions
  - ✓ Secretary – Company counsel
  - ✓ CEO (Executive Director) – Runs the company on a day-to-day basis
- To the extent possible, avoid nominative rights
  - ✓ The Shareholders Agreement must be a dynamic document

## Protective provisions

- Investors need to protect the value of their investment
  - ✓ Authorisation to company resolutions that may impact their economics
  - ✓ Day-to-day matters shall not be subject to investor's authorisation
  - ✓ List of matters that require investors consent
    - Board matters
    - GSM matters
  - ✓ Resolutions to be passed by legal majority + investors' consent
- Veto rights
  - ✓ Only for the investors
  - ✓ Run away from qualified majorities that may provide undesired veto rights to other shareholders
    - 81% of votes  $\neq$  veto right to preferred shareholders with 20% of capital
  - ✓ How to structure investor's veto rights
    - Investor Director Consent
    - Series A (Preferred) Majority Consent

## Founders covenants

- Covenant = obligation to give, do, do not do something
- Typical covenants
  - ✓ Permanence
    - 2 – 4 years
  - ✓ Non-compete and non-solicitation
    - During services / employment relationship and (up to) 2 years after termination
  - ✓ Enforcement
    - Vesting of founders' shares
      - Silicon Valley vesting: 4 years on a monthly basis with 1-year cliff
      - Must be consistent with permanence period
    - Customary good leaver / bad leaver provisions
      - Good leaver: maintains vested shares
      - Bad leaver: forfeits all shares

## Increase of ESOP pool

- Purpose of the ESOP
  - ✓ Compensate founders' dilution
  - ✓ Incentivise the team
- Stock options vs phantom shares
  - ✓ Stock options
    - Exercise after vesting – no need of a liquidation event
    - Ordinary income: difference between strike price and market value
  - ✓ Phantom shares
    - No exercise – payment upon liquidation event
    - Ordinary income: difference between the base price and market value
- Pre-money ESOP vs post-money ESOP
  - ✓ Who takes the dilution?

## Binding provisions

- Exclusivity
  - ✓ Duration: 1 -2 months
  - ✓ In return for investors devoting costs and efforts to the round
  - ✓ Incentivise the team
- Confidentiality
- Expenses
  - ✓ Company pays the investors' reasonable costs
    - Always cap the costs
- Law and jurisdiction
  - ✓ Spanish law vs foreign law
  - ✓ Jurisdiction in line with applicable law



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