

VENTURE CAPITAL

I. WHO ARE THE VC'S

- WHAT IS THEIR FOCUS → STAY WITHIN THEIR SCOPE, CONTEXT AND SPACE, AS WELL AS EARLY STAGE OR LATE STAGE, GEOGRAPHY → SOME FIRMS HOOK IN W/ LOCALITIES, SIZE OF INVESTMENTS.
- REPUTATION → HAVE THEY SUCCESSFULLY INVESTED IN START UPS PREVIOUSLY, TRACK RECORD. LOOK AT THE SIZE OF THE FUND. LOOK AT THEIR INVESTOR PROFILE, ARE THEY HANDS ON OR HANDS OFF.
- LP STRUCTURE → WANT YOU TO BE A C CORP SO YOUR LOSSES DON'T PASS THRU.
- MOTIVATION → MONEY. CAN YOUR PLAN DELIVER THE RATE OF RETURN.

II. LAWYERS

- MISTAKES COST YOU; DO IT RIGHT. FIND LAWYER W/ TRANSACTIONAL EXPERTISE AS WELL AS TECHNICAL COMPETENCE. FIND A FIRM THAT CAN FLOAT YOUR PLAN. REPUTATION IS IMPORTANT.

III. WHERE DO YOU BEGIN

A. BUSINESS PLAN

- TECHNOLOGY OR SERVICE HOOK
- POTENTIAL MARKET SIZE → BE SPECIFIC ABOUT TARGET SIZE
- COMPETITORS AND COMPARABLES
- RESEARCH AND DEVELOPMENT
- FINANCIAL PROJECTIONS → WHEN WILL YOU BE PROFITABLE
- MANAGEMENT TEAM

B. BEGIN SHOPPING YOUR DEAL

- YOU MUST GET A FACE TO FACE MEETING
- DUE DILIGENCE → SEND IN TECHNOLOGIST TO REVIEW YOUR CODE, LAWYERS TO REVIEW CORP. STRUCTURE.

C. VALUATION

- USE EVERYTHING YOU CAN TO UPWARDLY ADJUST YOUR VALUATION.
- DICTATES THE PRICE PER SHARE

IV. STOCK AND CAPITAL STRUCTURE

DEBT

PREFERRED C

PREFERRED B

PREFERRED A

} EITHER SENIOR OR PARI PASSU.

COMMON

$$PPS = \frac{\text{PRE-}\$ \text{ VALUATION}}{\text{CAPITALIZATION}}$$

INCREASE IN OPTION POOL → VC WILL TRY TO GET YOU TO TAKE THIS PRE-MONEY.

B. DIVIDENDS / DOCUMENTS → THE TERM SHEET TURNS INTO THESE DOCS:

1. CHARTER / CERTIFICATE OF INCORPORATION
2. PURCHASE AGREEMENT
3. INVESTORS RIGHTS / REG. RTS
4. STOCKHOLDERS / ROR

C. DIVIDENDS

1. DIVIDENDS ACCRUE ANNUALLY BUT ARE NEVER PAID
2. IF A DIVIDEND IS DECLARED FOR B, C WILL GET MONEY TOO.
3. THIS IS PURELY HYPOTHETICAL

D. LIQUIDATION PREFERENCE

1. PREFERRED → AMOUNT INVESTED PLUS ACCRUED DIVIDENDS OR CONVERT TO COMMON STOCK.
2. PARTICIPATING PREFERRED → THEY GET THE AMOUNT INVESTED PLUS ACCRUED DIVIDENDS AND CAN CONVERT → "DOUBLE DIP"
3. ENTREP: NEGOTIATE A CAP

E. CONVERSION

1. 1 SHARE OF PREFERRED =
$$\frac{OIP \text{ (ORIGINAL ISSUE PRICE)}}{ACV \text{ (APPLICABLE CONV. VALUE)}}$$

ACV: TWO WAYS:

a) FULL RATCHET: NEW PRICE PER SHARE
THIS DOES NOT ACCOUNT FOR HOW MUCH DILUTION HAS OCCURRED.

b) WEIGHTED AVG.:
$$\frac{(P1 * Q1) + (P2 * Q2)}{Q1 + Q2}$$

P1 → LAST PRICE PAID

P2 → NEW PRICE X NEW SHARES

Q1 + Q2 = TOTAL CAPITALIZATION AFTER

2. ~~#~~ CONVERSION IS AUTOMATIC AT IPO, ALTHOUGH VC'S HAVE LEVERAGE OVER WHEN YOU GO PUBLIC. IF YOU'RE ONLY RAISING \$20M, THEY MAY NOT SIGN ON.
→ DOUBLE DIP GOES AWAY.