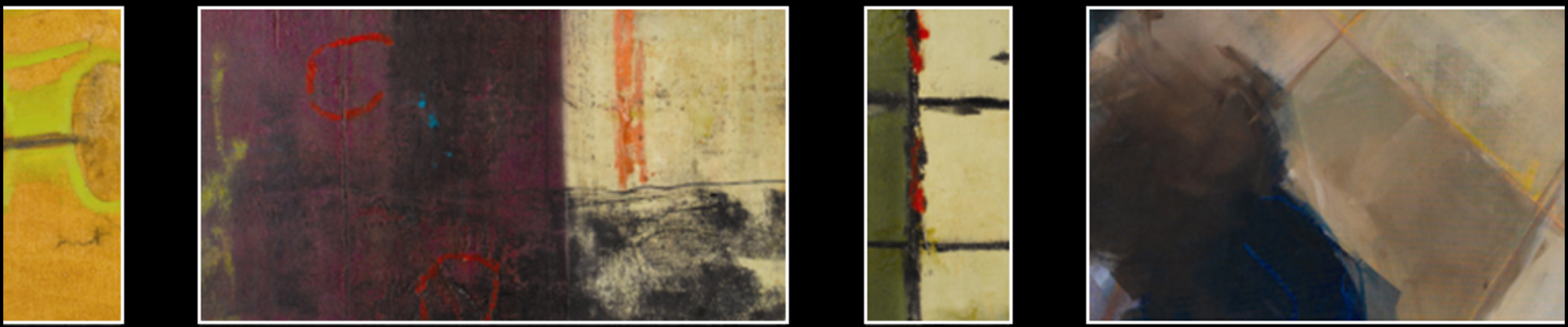

# Term Sheet Basics

Matt Bower
mwbower@varnumlaw.com

VARNUM
ATTORNEYS AT LAW

# Topics

- What is a Term Sheet?
- Key Elements of a Series Seed Term Sheet
- Key Elements of a Convertible Debt Term Sheet
- A Word about Convertible Equity (SAFE)

VARNUM
ATTORNEYS AT LAW

# PART I
# What is a Term Sheet?

# What is a Term Sheet?

- A term sheet is a bullet-point document outlining the material terms and conditions of a business agreement.

- After a term sheet has been executed or approved, it guides legal counsel in the preparation of proposed final documents.

# PART II
# Key Elements of a Series Seed Term Sheet

# Series Seed

**TERMS FOR PRIVATE PLACEMENT OF SERIES SEED PREFERRED STOCK OF**
**[*Insert Company Name*], INC.**

**[Date]**

The following is a summary of the principal terms with respect to the proposed Series Seed Preferred Stock financing of [___________], Inc., a [Delaware] corporation (the "***Company***"). Such summary of terms does not constitute a legally binding obligation. Any other legally binding obligation will only be made pursuant to definitive agreements to be negotiated and executed by the parties.

| | |
|---|---|
| **Offering Terms** | |
| Securities to be Issued: | Shares of Series Seed Preferred Stock of the Company (the "***Series Seed***"). |
| Aggregate Proceeds: | $[__________] in aggregate. |
| Investors: | Accredited investors approved by the Company (the "***Investors***"). |
| Price Per Share: | Price per share (the "***Original Issue Price***"), based on a pre-money valuation of $[____], including an available option pool of [___]%. |
| Liquidation Preference: | One times the Original Issue Price plus declared but unpaid dividends on each share of Series Seed, balance of proceeds paid to Common. A merger, reorganization or similar transaction will be treated as a liquidation. |
| Conversion: | Convertible into one share of Common (subject to proportional adjustments for stock splits, stock dividends and the like) at any time at the option of the holder. |
| Voting Rights: | Votes together with the Common Stock on all matters on an as-converted basis. Approval of a majority of the Preferred Stock required to (i) adversely change rights of the Preferred Stock; (ii) change the authorized number of shares of Preferred Stock; (iii) authorize any new class of series of Preferred Stock having rights senior to or on parity with Preferred Stock; (iv) redeem or repurchase any shares (other than pursuant to the Company's right of repurchase at original cost); (v) declare or pay any dividend; (vi) liquidate, dissolve including any change of control; or (vii) change the authorized number of directors. |
| Documentation: | Documents will be based on Series Seed Preferred Stock documents published at www.seriesseed.com. |
| Financial Information: | Investors who have invested at least [$_________] ("***Major Investors***") will receive standard information and inspection rights and management rights letter. |
| Participation Right: | Major Investors will have the right to participate on a pro rata basis in subsequent issuances of equity securities. |
| Board of Directors: | Two directors elected by holders of a majority of common stock. One director elected by holders of a majority of Series Seed. |
| Expenses: | Company to reimburse counsel to investors for a flat fee of $10,000. |
| Future Rights: | The Series Seed will be given the same rights as the next series of Preferred Stock (with appropriate adjustments for economic terms). |
| Founder Matters | Each founder shall have four years vesting beginning [_______]. Full acceleration upon "Double Trigger." Each Founder shall have assigned all relevant IP to the Company prior to closing. |

VARNUM
ATTORNEYS AT LAW

# Series Seed

**TERMS FOR PRIVATE PLACEMENT OF SERIES SEED PREFERRED STOCK OF [*Insert Company Name*], INC.**

**[Date]**

The following is a summary of the principal terms with respect to the proposed Series Seed Preferred Stock financing of [___________], Inc., a [Delaware] corporation (the "***Company***"). Such summary of terms does not constitute a legally binding obligation. Any other legally binding obligation will only be made pursuant to definitive agreements to be negotiated and executed by the parties.

VARNUM
ATTORNEYS AT LAW

# Series Seed

- Terms:
  - Securities to be Issued (Series Seed or Series AA)
  - Aggregate Proceeds (How much are you going to raise?)
  - Investors (Accredited Investors)

# Series Seed

- Terms:
  - Price Per Share

| | |
|---|---|
| Price Per Share: | Price per share (the "***Original Issue Price***"), based on a pre-money valuation of $[_____], including an available option pool of [___]%. |

  - Pre-Money Valuation = the valuation of a company prior to financing.
  - If the Pre-Money Valuation is $3M and the investors invest $1M, the Post-Money Valuation is $4M (Investors own 25%).

# Series Seed

- Terms:
  - Price Per Share

| | |
|---|---|
| Price Per Share: | Price per share (the "***Original Issue Price***"), based on a pre-money valuation of $[____], including an available option pool of [___]%. |

  - Pre-money valuation is on a ***fully-diluted basis***.
  - The Option Pool ***decreases*** the per share price.
  - Only the Common Stock get diluted by the Option Pool.

VARNUM
ATTORNEYS AT LAW

# Series Seed

- Terms:
  - Liquidation Preference (Participating v. Non-Participating).

| | |
|---|---|
| Liquidation Preference: | One times the Original Issue Price plus declared but unpaid dividends on each share of Series Seed, balance of proceeds paid to Common. A merger, reorganization or similar transaction will be treated as a liquidation. |
| Conversion: | Convertible into one share of Common (subject to proportional adjustments for stock splits, stock dividends and the like) at any time at the option of the holder. |

# Series Seed

- Terms:
  - Voting Rights

| | |
|---|---|
| Voting Rights: | Votes together with the Common Stock on all matters on an as-converted basis. Approval of a majority of the Preferred Stock required to (i) adversely change rights of the Preferred Stock; (ii) change the authorized number of shares of Preferred Stock; (iii) authorize any new class of series of Preferred Stock having rights senior to or on parity with Preferred Stock; (iv) redeem or repurchase any shares (other than pursuant to the Company's right of repurchase at original cost); (v) declare or pay any dividend; (vi) liquidate, dissolve including any change of control; or (vii) change the authorized number of directors. |

  - Common and Preferred vote together but…
  - Preferred get ***veto*** over certain major actions.

# Series Seed

- Terms
  - Board of Directors (Founder Friendly):

| | |
|---|---|
| Board of Directors: | Two directors elected by holders of a majority of common stock. One director elected by holders of a majority of Series Seed. |

  - Board of Directors (Investor Friendly):
    - One Common
    - CEO
    - One Investor
    - Second Investor
    - Outside Director

VARNUM ATTORNEYS AT LAW

# Series Seed

- Terms:
  - Information Rights
  - Participation Rights ("Major Investors will have the right to participate on a pro rata basis in subsequent issuances of equity securities.")
  - Expenses ("Company to reimburse counsel to investors for a flat fee of $10,000.")
  - Future Rights.

# Series Seed

- Terms:
  - Founder Matters

| | |
|---|---|
| Founder Matters | Each founder shall have four years vesting beginning [________]. Full acceleration upon "Double Trigger." Each Founder shall have assigned all relevant IP to the Company prior to closing. |

  - Reverse Vesting
  - "Double Trigger"
  - IP Assignment
  - Dividends
  - Redemption

# PART III:

## Key Elements of a Convertible Debt Term Sheet

# Convertible Debt

- Terms:
  - Amount of Financing (Minimum Investment?)
  - Interest Rate
  - Maturity
  - Conversion Events
    - Next Equity Financing
    - Corporate Transaction
    - Maturity

# Convertible Debt

- Terms:
  - Conversion Price
    - Equity Financing
      - Discount (20%?)
      - Cap ($3M?)

(i) with respect to a Next Equity Financing Conversion, the price that is the lesser of (A) [DISCOUNT RATE]% (the "**Discount**") less than the lowest price per share of shares sold in the Next Equity Financing and (B) the price per share implied by a US$[AMOUNT] pre-money valuation, calculated based on the Company's fully diluted capitalization immediately prior to the closing of the Next Equity Financing;

    - Corporate Transaction
    - Maturity

# Convertible Debt

- Terms:
  - Prepayment
  - Security
  - Priority (i.e. Subordinate to Bank Financing?)
  - Amendments and Waivers (i.e. "Requisite Noteholders")
  - Expenses

VARNUM
ATTORNEYS AT LAW

# PART IV:
# A Word About Convertible Equity (SAFE)

# SAFEs

- What is a SAFE?
  - **S**imple **A**greement for **F**uture **E**quity.
  - Similar to Convertible Debt but without the Debt.
  - Same as Convertible Debt, SAFEs have a cap, discount, and conversion price.
  - **No Interest Rate or Maturity Date**.

# SAFEs

- Why use a SAFE?
  - Debt instruments have requirements – including regulations, interest accrual, maturity dates, the threat of insolvency and in some cases, security interests and subordination agreements. These requirements can have unintended negative consequences.

# SAFEs

- Why use a SAFE?

    - A safe is intended to be simple for both companies and investors, with the usual path to agreement requiring the negotiation of only one item – the "valuation cap."

# SAFEs

- Why use a SAFE?
  - A simple equity security has the potential to become standardized, and a standardized form has the benefits of certainty and speed, which in turn results in lower transaction costs for companies and investors.

# Questions

VARNUM
ATTORNEYS AT LAW