# Appendix 6.3.2
## Common Sections of Terms Sheets[1]

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| Summary of Financing | This opening section summarizes the contents of the term sheet and provides an overview of the transaction being proposed. It usually includes:<br>• The name of the investors<br>• The name of the company<br>• The amount of financing being offered<br>• The number of newly issued shares<br>• The purchase price per share<br>• The post-financing capitalization structure (which enables the reader to calculate the pre-money and post-money valuation).<br><br>Any milestones that must be met for the release of funds will also be outlined in this section. Linking funding to milestones set by investors allows investors to more closely monitor company progress and manage their downside risk. However, such milestones may be perceived as a red flag to a company wary of relinquishing too much control and/or forfeiting its flexibility to adjust the operating plan as new information becomes available. |
| Dividend Provisions | Dividend provisions outline the conditions for when/if dividends will be paid. They also address issues such as whether dividends will be cumulative or non-cumulative, and the priority order in which dividends will be paid to shareholders. As with most sections of the term sheet, dividend provisions can be considered investor favorable, neutral, or company favorable, depending on how they address these issues. |
| Liquidation Preference | The liquidation preference outlines the terms governing the transaction if a company is closed down. While preferred shareholders will be given priority over common shareholders, the term sheet often takes this one step further by defining a multiple on the value of their initial investment that preferred and common shareholders will receive. According to these terms, the multiple promised to the preferred shareholders would be paid before any proceeds would be given to other shareholders. |
| Redemption | A redemption clause is used to associate a finite number of years (usually five to eight) with an investment. In essence, it forces an exit for investors at a defined point in time if a liquidity event has yet to occur. The terms outlined within a redemption clause specify the time frame associated with the exit, as well as the specific terms |

  

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| | governing the rate and price at which shares will be repurchased from investors. |
| Registration Rights | Registration rights outline the rights of preferred investors in forcing the company to register its stock for public offering under SEC rules. Essentially, they give investors another mechanism for creating an exit, if market conditions are perceived as favorable.[2] The issues addressed in this section include the number of registrations that the company is obligated to complete, the period of time in which these registrations are required, and the economic cost of going through the registration. |
| Conversion and Automatic Conversion | When a conversion happens at the time of an IPO or acquisition, it is generally accepted that preferred shares will convert to common shares on a 1:1 basis. The reasons for including this clause in the term sheet is to give preferred shareholders a mechanism for converting to common shares if the IPO is likely to generate a return higher than the one stipulated in the liquidity preference section. The automatic conversion clause describes other variables in the event of an IPO, such as the amount of money that will qualify the IPO as acceptable to the preferred shareholders. Its purpose is to ensure that any automatic conversion price (or amount-raised hurdle) is set high enough to make forced conversion attractive. |
| Dilution | One of the single most important issues to investors, as a company grows, is how new rounds of financing will affect the value of their investment on a per share basis. Dilution clauses stipulate how conversion prices will be calculated if future rounds of financing are dilutive to preferred shareholders. If future stock is issued at a price lower than the current round, an anti-dilution clause helps ensure that preferred investors continue to hold an equal (or near equal) percentage of ownership in a company without committing more capital.[3] There are two primary approaches for structuring anti-dilution clauses: full-ratchet and weighted-average.<br><br>Full-ratchet provisions are the most favorable anti-dilution clauses to investors. Under this approach, the conversion price is adjusted to ensure that the new price factors in the total amount of capital invested, and preserves the full percentage ownership of the preferred shareholders, typically at the expense of common shareholders and/or individuals holding stock options in the company.[4] With the weighted-average approach, the conversion price is calculated on a weighted-average basis, therefore only partially offsetting the effect of dilution.[5] As a result, it is considered more favorable to the company and common stock holders. |
| Right of First Refusal | The right of first refusal gives preferred investors the right to exercise influence over the sale of any shares (preferred or |

  

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| | common) within the company. Typically, investors use this clause to retain the ability to purchase shares or restrict their sale. |
| Voting Rights | Voting rights are included in term sheets to ensure that all shares are treated equally in the event that a shareholder vote is called. Typically, one vote per share is granted for both preferred and common stock. |
| Protective Provisions | Protective provisions outline the percentage of preferred shareholder approval needed for a company to take certain actions. The purpose of this clause is to help prevent common shareholders from diluting the power of preferred shareholders or "selling the company out from under them."[6] Actions potentially covered under protective provisions include the issuance of new stock, major financial transactions (merger, sale, payment of dividend), or other events affecting the course of a company's business (reorganization, amendments to the company's certificates of incorporation, increase or decrease in the size of the board). |
| Information Rights | Information rights define what and how much information about the company is shared with investors. Under the terms most favorable to investors, companies must provide access to almost any document or system (audited or unaudited, financial or otherwise) as part of the standard inspection and visitation rights afforded to preferred shareholders. In more neutral scenarios, investors are regularly provided with, for example, audited annual financial statements and unaudited quarterly financial statements. Access to monthly financials and the company's operating plan are other items that may or may not be included in the term sheet. |
| Board Composition | The board composition clause outlines the number of board seats and how they will be filled. Typically, companies seek to build a board with representation by both common and preferred stock holders. Investor-favorable composition would give the preferred shareholders majority control. A more neutral arrangement might give preferred shareholders (investor) and common shareholders (company management) an equal number of seats, with one additional seat granted to a mutually agreed- upon independent participant. |
| Employee Matters | From an investor's perspective, the conditions outlined in this section are designed to help retain important managers and employees while limiting the amount of power they exercise over the stock of the company. Issues typically addressed under employee matters include the number of shares of common stock reserved for option pools and other employee programs, vesting periods for common shares, restrictions on the sales of common stock by employees, the determination of whether life insurance policies will be taken out for key executives, and directors' insurance. |

  

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| Conditions Precedent | This section outlines what steps must be taken before the financing deal proposed in the term sheet can be finalized. For example, it may specify that due diligence must be completed, including a review of the company's operating plan, IP strategy, regulatory strategy, clinical trials plan, and other relevant documentation. It may also require the completion of IP, confidentiality, and non-compete agreements with employees; review of the company's compensation, stock allocation, and vesting programs; and board approval. This section may also contain an exclusivity (or "no shop") provision, which bans discussions between the company and other investors for a defined period of time. |
| Expenses | This section outlines which expenses, for due diligence and legal counsel, are to be paid for by the company upon closing. |

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[1] Derived in part from Chapter 3 of *Term Sheets and Valuations*, by Alex Wilmerding, and used with permission. Copyright © 2006 Thomson Reuters/Aspatore.
[2] Ross Jaffe, "Introduction to Venture Capital," October 6, 2004.
[3] Alex Wilmerding, *Deal Terms* (Aspatore Books, 2003) p. 63.
[4] Ibid., p. 64.
[5] Ibid., p. 65.
[6] Jaffe, op. cit.

  