



Convertible Debt Terms – Survey of Market Trends 2017/2018

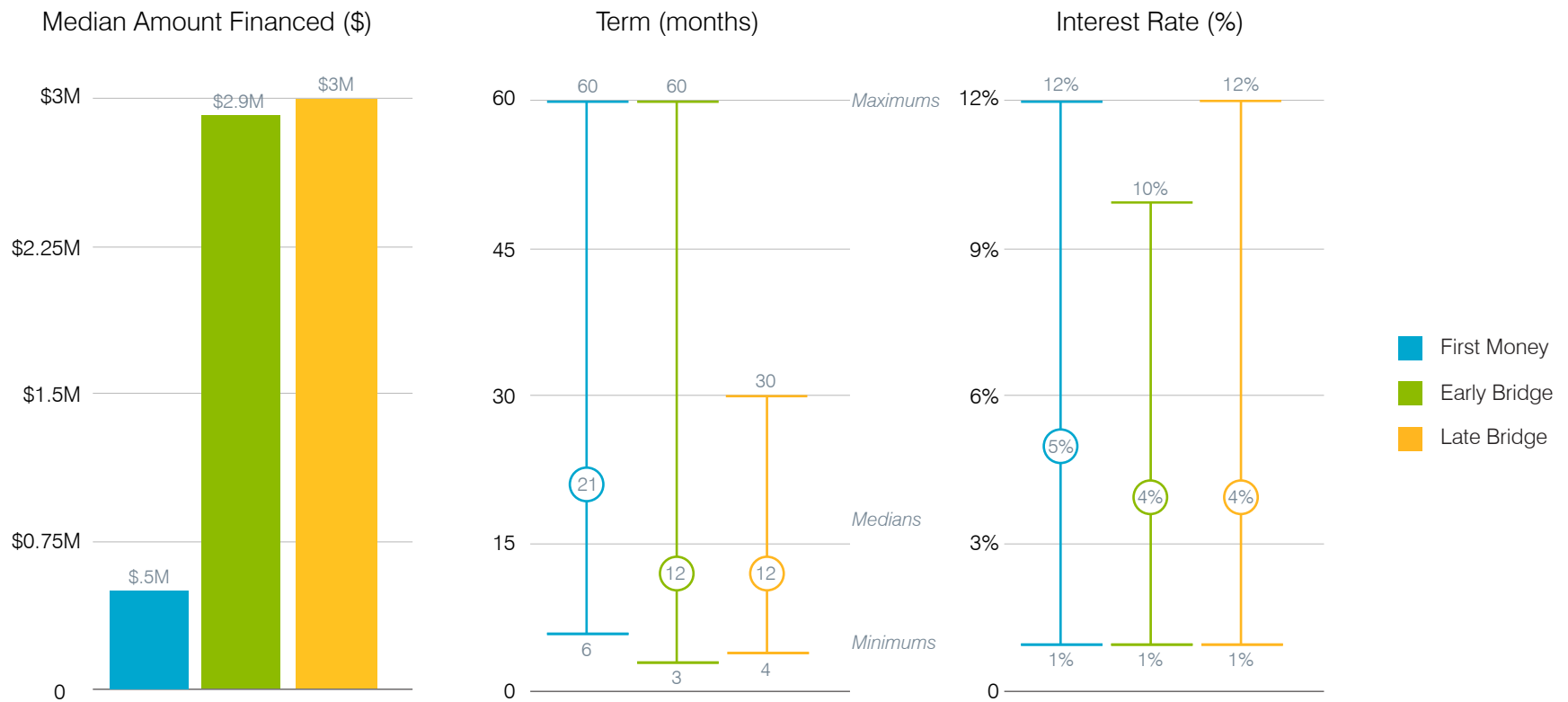
Overview

In this report, we compile market data on convertible debt terms based on an analysis of over 100 issuer-side convertible debt transactions handled by Fenwick over the 15-month period from Jan. 1, 2017 through March 31, 2018. The data is based on deals deemed to be “typical” in structure and does not include any SAFE transactions.

Where deals are distinguished by stage, “First Money” preceded any issuance of preferred stock, “Early Bridge” followed either a Series Seed or Series A round, and “Late Bridge” followed any round of preferred stock Series B or later.

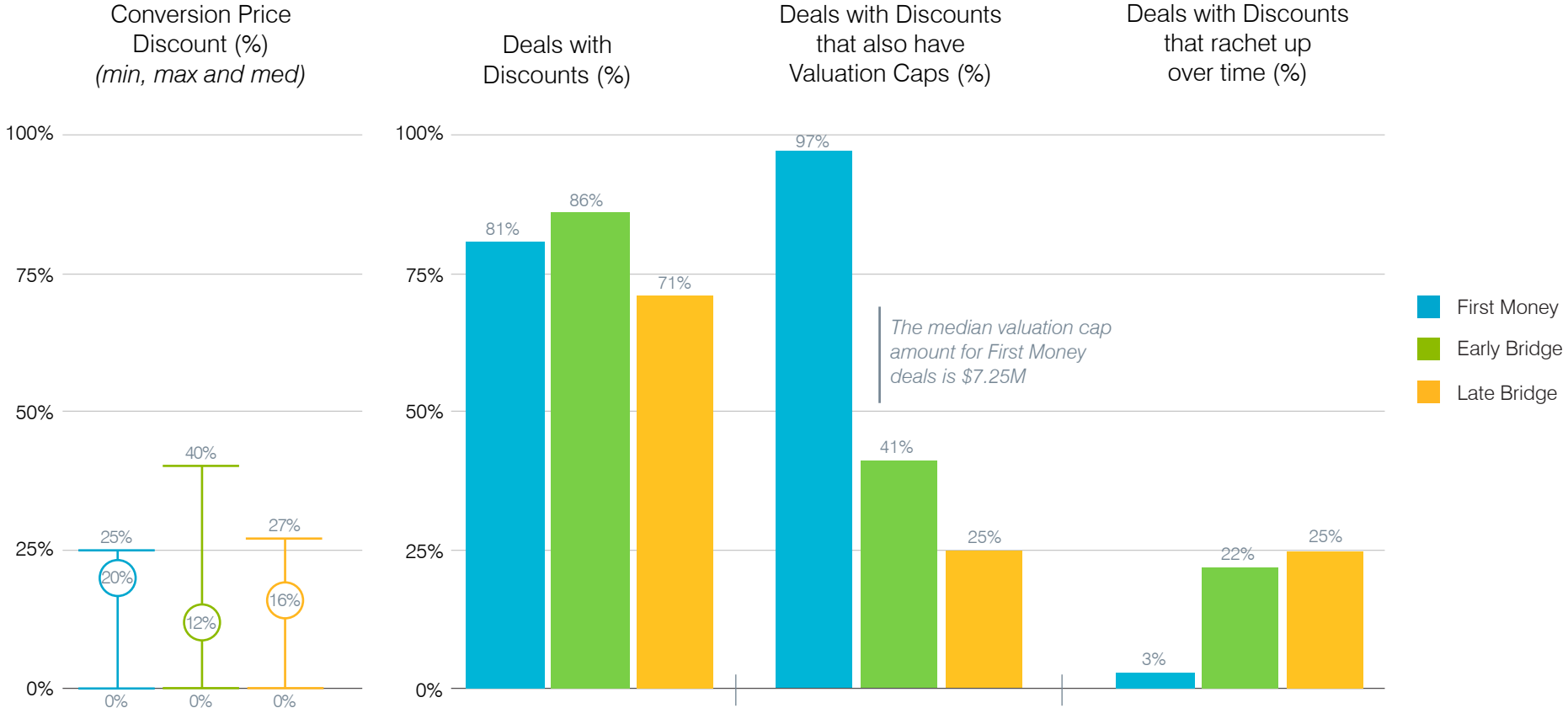
The Basics

Year over year, the only notable change in basic deal terms has been that deal sizes have increased. The median overall deal size this year is up 40% (from \$1 million to \$1.4 million).



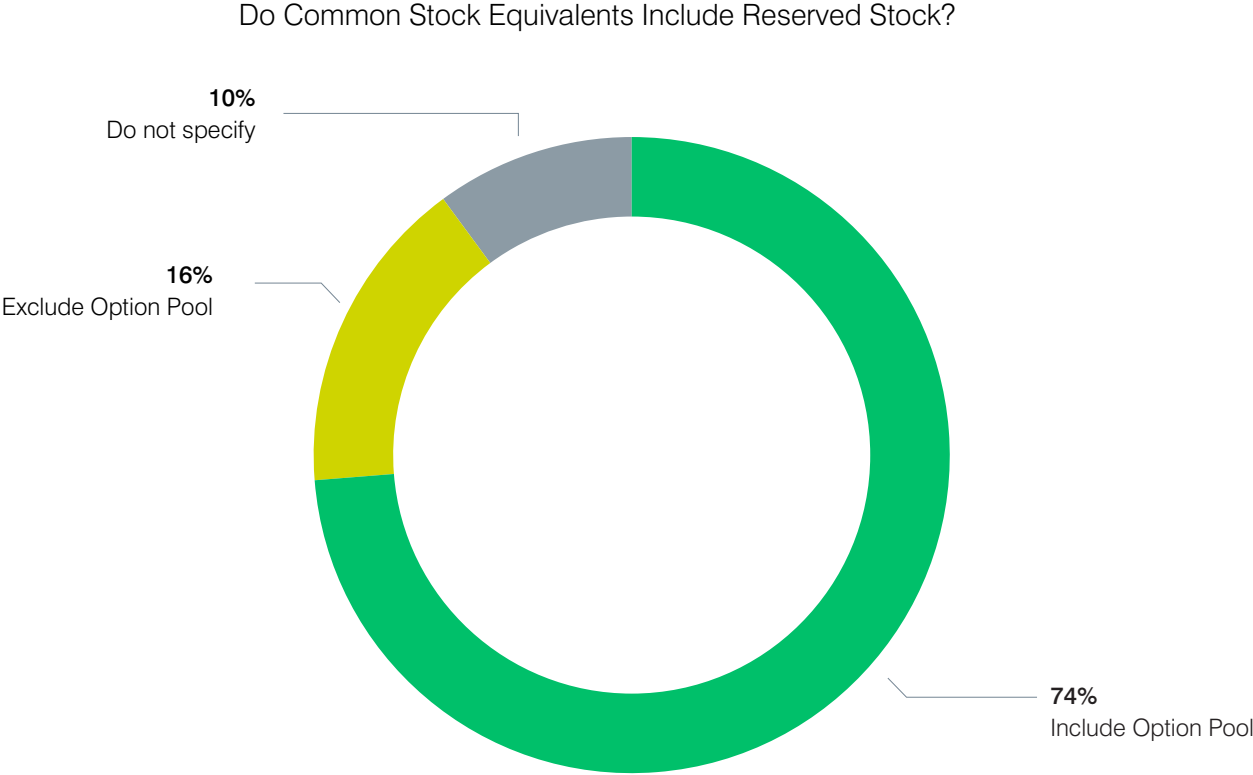
Conversion Discounts

Conversion discounts are increasingly common, even in later-stage debt issuances. For First Money issuances, almost all deals with conversion discounts pair them with valuation caps to give investors “lower of” pricing. In Bridge deals, valuation caps are much less common, but a substantial number of the conversion discounts have provisions whereby the discount ratchets up over the term of the note. (Only 8% of deals used a valuation cap as a standalone provision in the absence of a conversion discount).



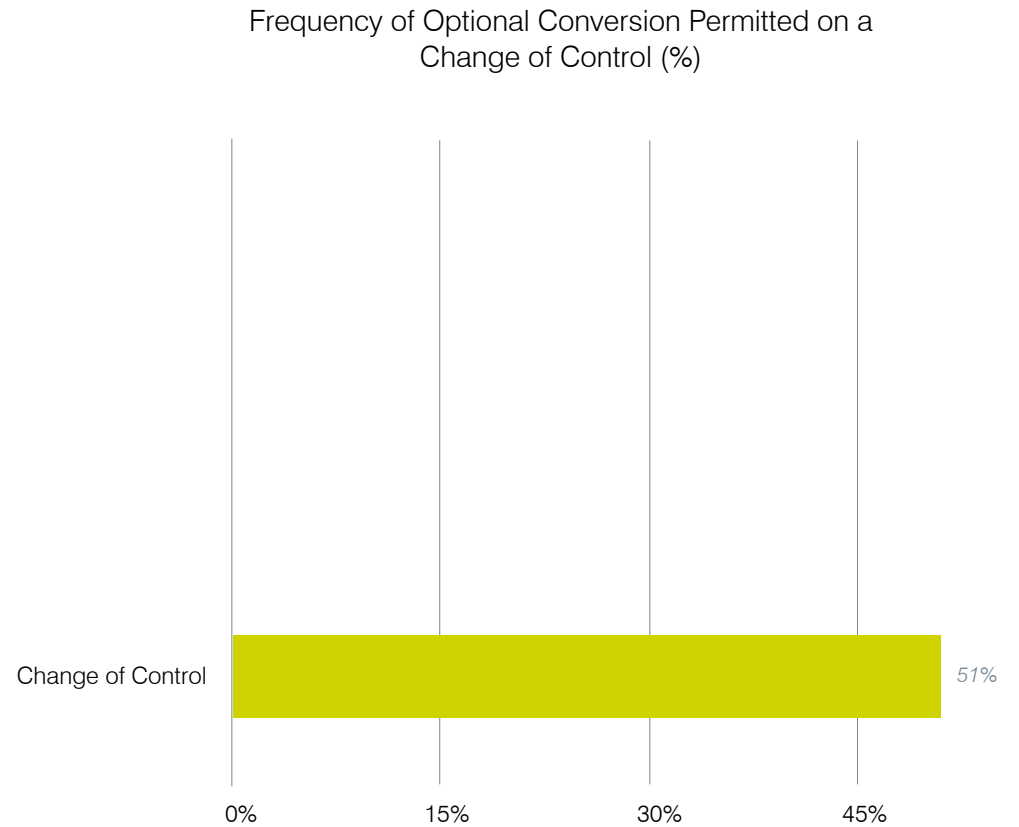
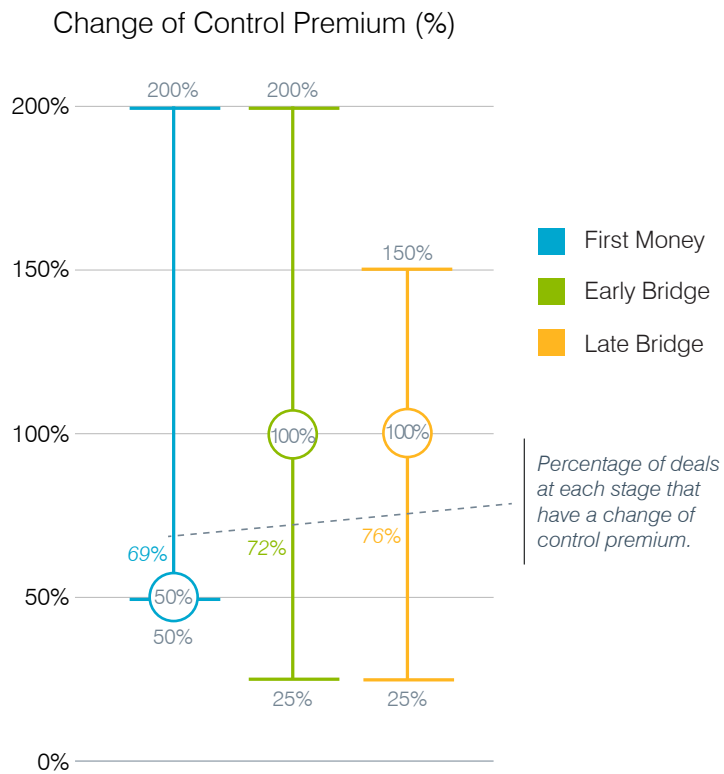
Does the Option Pool Count?

In cases of conversion under a cap, most deals specify that the option pool will be included in the concept of “common stock equivalents” or “fully-diluted stock” of the issuer.



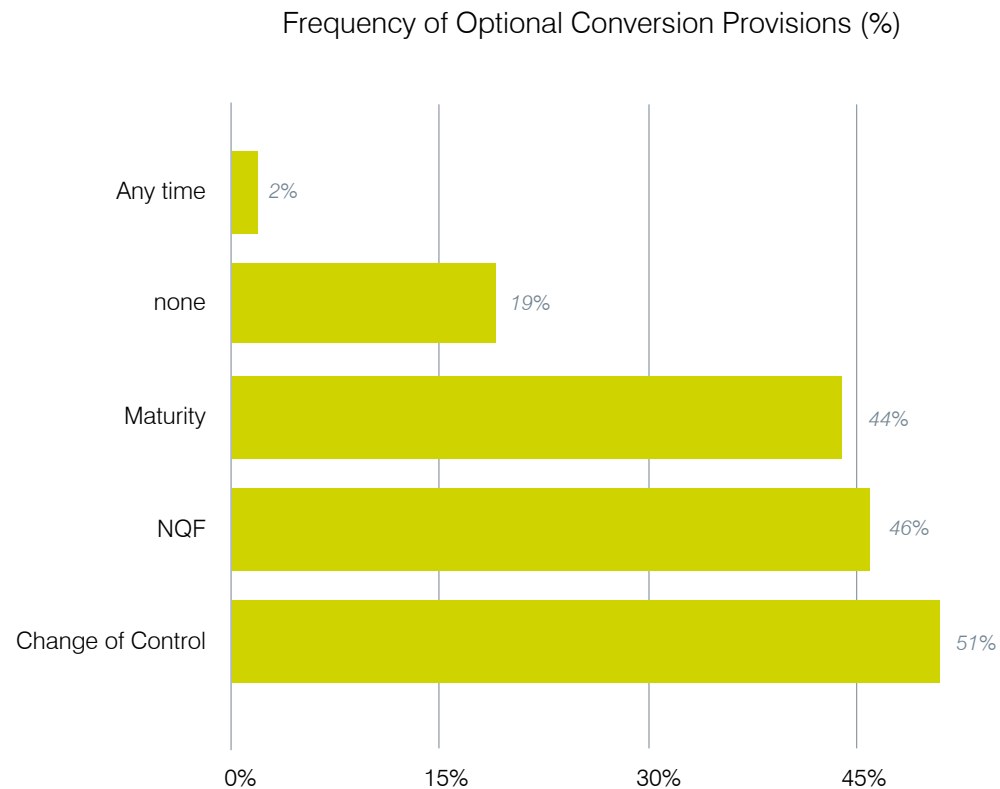
What Happens in a Change of Control?

On a sale of the company, most deals provide for a premium payout that is a multiple on top of the repayment of the principal balance. The amount of the premium has remained steady, but the number of deals giving a premium has trended up year over year. Also note that a slight majority of deals offer the holder the option to take the payout or convert into stock.



Other Optional Conversion Scenarios

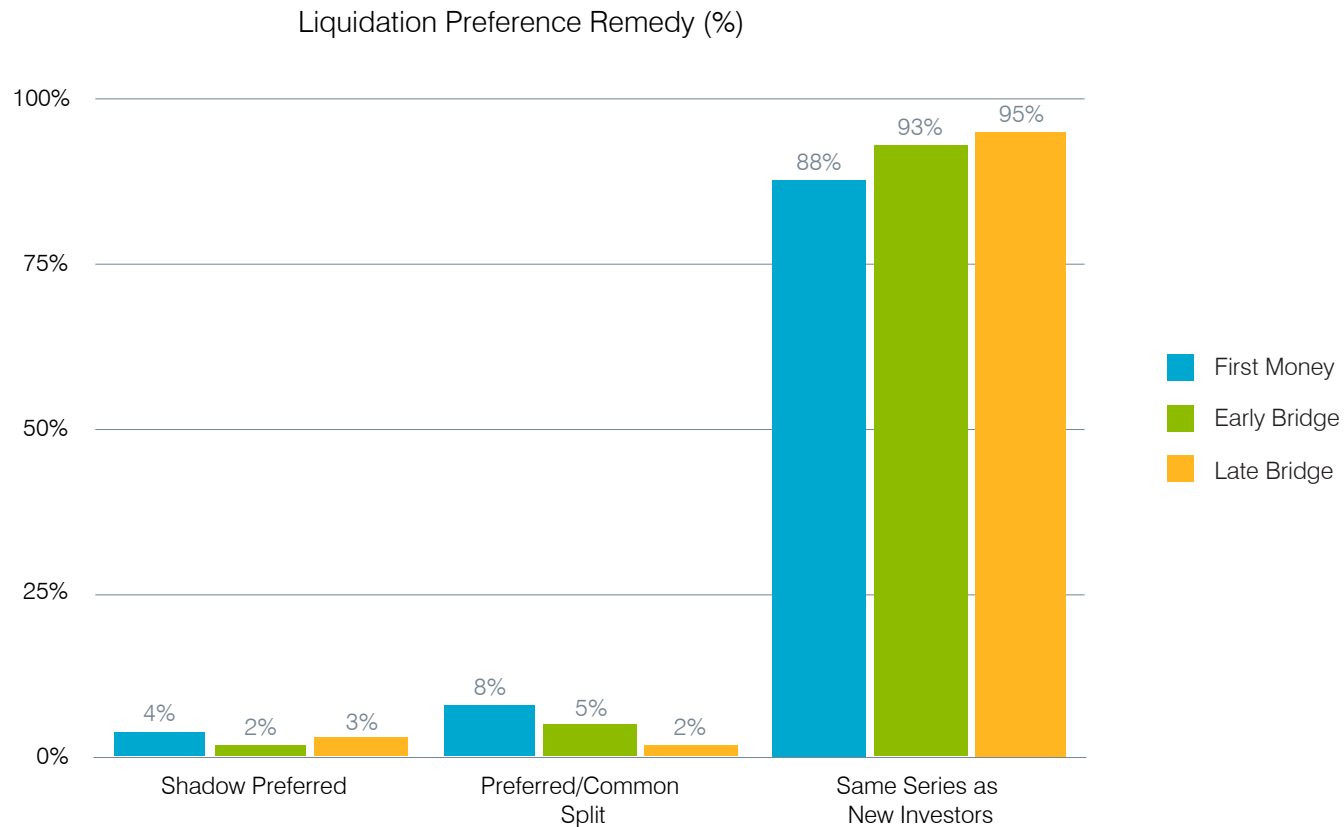
The standard formula for convertible notes provides for automatic conversion of the note into preferred stock in the next Qualified Financing (defined as financing that exceeds a specified value). Allowances for conversion at the option of the note holder vary widely. Only optional conversion on a change of control is a majority practice. However, many deals do contain one or more optional conversion scenarios—from allowing conversion at any time or in any subsequent financing (or Non-Qualified Financing) to allowing conversion at the maturity date. Only 19% of deals contain no optional conversion terms.



Liquidation Preference “Windfall” Remedy

When noteholders convert into the same series of preferred stock as is issued to purchasers in a company’s next round of financing, it can be argued that the converting holders get a windfall in terms of holding preferred stock with a liquidation price in excess of the actual price paid for the note.

This issue may be addressed either by having the converting holders receive a mix of common and preferred stock or by having them convert into a new series of preferred stock that is identical to the stock issued in the next round except as to liquidation price (often referred to as “shadow preferred stock”). However, conversion into the same series as the new investors is still the most common practice.





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