

# **MORGAN, LEWIS & BOCKIUS LLP**

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**Investor Issues for Later Stage Investments**

# Deal Trends

- Continued emphasis on experienced founders/management teams that can execute in a rapidly changing market
- Valuations decreasing in all sectors, especially for later stage companies with limited revenue traction.
- Recapitalization transactions will increase as later stage companies are forced to restructure.

# Deal Trends

- Increased interest in international deals and founding teams with international backgrounds and experience
- Down rounds are common and early stage investors are more likely to negotiate existing venture terms in later rounds of financing
- Imposing Pay to Play provisions is very common

# Deal Trends

- Redemption rights are increasingly common
- Cumulative dividends are increasingly common

# Current Deal Terms

## – Liquidation Preferences

- Frequently 2x in later rounds
- 3x is less common later rounds still tend to track existing preferences with pari passu treatment in many cases although this is changing as need for cash gives new investors greater leverage
- Priority for later rounds increasingly common

# Current Deal Terms

## – Participation

- Only relevant in a trade sale
- Frequently Fully-Participating
- 3x cap on participation is often negotiated, caps are less common in the current market
- Preferred Stock is always fully convertible

# Current Deal Terms

## – Anti-Dilution Protection

- Increased incidence of down-rounds
- Broadly-based Weighted Average formula has become standard
- More emphasis on Anti-Dilution and obtaining waivers in the negotiation process for down round

# Current Deal Terms

## – Control Rights

- Board Seats reserved to Preferred Stock
- Board Seat reserved for the CEO, not Common Stock
- Veto rights, particularly series votes, are important for later stage investors where insiders have a majority of the shares

# Current Deal Terms

## – Control Rights

- Can create specific Board approval rights for later round Board representative for next round or sale event

# Current Deal Terms

## – Veto Rights

- Major Question is Class v. Series Veto
- Typical Vetos include:
  - Alteration of Preferred Rights
  - Change in authorized Preferred Shares
  - Authorization of a senior or pari passu series
  - Redemption of stock
  - Asset sales or acquisitions
  - Dissolution, liquidation or bankruptcy

# Current Deal Terms

## – Drag Along Rights

- What percentage of shares can force a drag-along?
- Requires individual contractual obligations of shareholders'
- What conditions (e.g. valuation) apply to the right?
  - Difficulty of valuation is often an issue.

# Current Deal Terms

## – Drag Along Rights

- Drag-Along Rights are now market; can create carve out based upon deal size to protect minority investors

# Current Deal Terms

## – Other Terms

- Increased use of shareholder approvals for management decisions and operational issues.
- Valuation adjustments increasingly common for later stage companies with unrealistic revenue projections.