

Negotiating and Taking Money



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1

Panelists

Tyson McDowell

Managing Partner
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Victoria Lakers

CFO
Three Squared, Inc.

2

Opening Negotiation

- I'll provide handouts of my slides before we start, and
- This will be an interactive presentation where we will do what we can to provide the best value for your time in answering your questions

IF...

- You will make notes on the handouts with your questions, suggestions and key takeaways,
- You will not read ahead on the handouts, and
- You'll move to sit with either the investors or entrepreneurs side of the room.

3

Disclaimers

- I am not an attorney and nothing in this presentation should be considered as legal advice
- The ideas and structures discussed here are just generic typical methods. Each deal is unique and almost everything is open to negotiation (except those things governed by law)
- Just because all things are possible doesn't mean that all things are wise... seek counsel!
- This advice is free... and worth every penny.

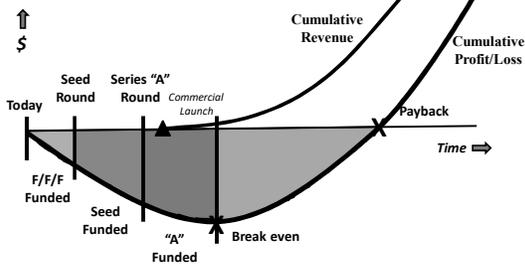
4

Negotiating and Taking Money

- Why Take Money from Investors
- Why Invest in Early Stage Companies
- Types of Investments and Instruments
- Term Sheet Terms
- Seeing A Deal from the Investor's Point of View
 - » ROI
 - » Accountability of Performance
 - » Risk Reduction
 - Control
 - Support
 - Reporting
- Negotiating the Deal
 - » Getting to "Yes"
 - » What you Should Strive For

5

Knowing When. Why. How. and How Much Money to Take



6

General finance Timing Guidelines

- Try to get as far as you can on pre-seed funding (F/F/F)
- Take only enough seed-funding to build company market value for reasonable Series-A funding round valuation
- **Example:** Seed Round of \$500K leads to \$2M A-round with pre-money valuation of \$8M
 - Series-A investment only buys 20% of company
- Try, after Series A, to maintain majority ownership by Founders, a 15-20% pool for key employees, leaving 30-35% for all investments

7

Types of Investment Deals

- | | |
|---|--|
| <p>– Non-Dilutive</p> <ul style="list-style-type: none"> » Gifts » Grants » Prizes » Handshake Loans » Credit Cards » Promissory/Other Loan Notes » Lines of Credit » Pre-sale product/service | <p>– Dilutive</p> <ul style="list-style-type: none"> » Convertible Notes » SAFEs » Warrants » Options » Shares » Partnerships |
|---|--|

8

Convertible notes

- A popular vehicle for early/seed investments
- Money loaned to the company now that will either be repaid with interest or converted to equity at a later time
- Pro:** Avoids having to set a company value early on
- Con:** Can be complicated and hard to understand and manage
- Warning:** Can dilute shares too much on conversion

9

Convertible Note Terms

- » **Principal:** The amount of money lent
- » **Interest Rate:** The interest rate to be paid on the Principal until Conversion
- » **Maturity Date:** The loan becomes due unless a Conversion has occurred by this date
- » **Conversion:** Automatic transfer of the amount owed on the day of a Qualifying Financing Event or other milestone to company shares per the terms of the note
- » **Qualifying Financing Event:** An agreed-upon event of capital infusion in the company (typically the sale of equity in a Priced Round at a certain minimum amount)
- » **Priced Round:** An investment event where a certain number of company shares are sold at an agreed upon price/share, thus setting the market capitalization value of the company
- » **Conversion Discount:** The discount percentage provided to the Note Holder upon Conversion from the per-share price paid by the Financing Event investors
- » **Max Value Cap:** The maximum pre-money value of the company that Convertible Note Holders will pay on a per-share basis

10

SAFEs

(Simple Agreement for Future Equity)

- A relatively new investment vehicle made popular by Y-Combinator and found more commonly in Bay Area deals
- Essentially a warrant (option to buy shares in the company at a discounted future value)
- **Pro:** Simpler than a Convertible Note
- **Con:** Doesn't provide the same level of company obligation to the investor

11

More about Convertible Notes and SAFEs



Cooley

Cooleygo.com

Cooley U



Dave Titus

12

Panel Discussion:

When, Why, How, and How Much Investment to Seek

13

Basic Early Investment Advice

- Don't take money until you need it
- Raising money always takes longer than you think it will
- Starting raising your next round the day after you close your previous round
- Keep it Simple!
- Don't raise too much too soon, but don't be afraid to take more than you ask
- Keep the number of investors small, if possible
- Be consistent with the same deal terms for all investors in a round
- Generally, you, as the Entrepreneur, should write up the Term Sheet
- Understand when you'll need to accept money only from Accredited Investors

14

Who is an Accredited Investor?

For most investors this means:

Net Worth exceeds
\$1,000,000 
 Not including primary residence

or

Income exceeds

 **\$200K**
Individual –
EACH of last 2 years

 **\$300K**
Joint with spouse –
EACH of last 2 years

*...or, a
Company
Insider*

15

Accredited Investor Certification

- In some cases, the Investor can self-certify
- Most of the time the Company needs to show "Reasonable Steps" to prove accreditation
 - 1) Principles Method: Judgment of the Investor's situation and background
 - 2) "Safe Harbor" Method:
 - Proof of Investor's income and/or assets
 - Third-party verification:



VerifyInvestor.com

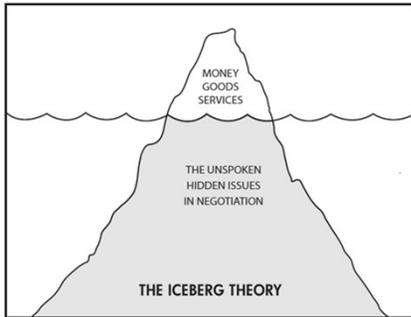
Panel Discussion:

Advise about Early Investments

You Get What You Negotiate



The Real Deal Being Negotiated

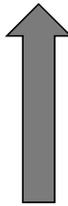


19

What's Going On in the Entrepreneur's Brain



- Desperate Need for Funding
- Fear of Failure
- Aching Desire to Launch/Grow Their "Baby"



YES!!!

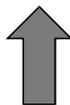
20

What's Going On in the Investor's Brain

- Greed
- Ego
- Social Pressure
- Altruism
- Love

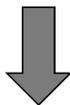


- Fear
 - Uncertainty
 - Doubt
- The "FUD Factor"



YES!!!

NO!!!



21

Some General Negotiating Tips

- Seek a Win-Win Deal
 - Short-term Adversarial Win-Lose will Hurt Later
- Be Knowledgeged
 - Do Your Homework
- Be Empathetic
 - See The Deal from The Other Side's Position
- Be Creative
 - Don't be Stuck in One Position
- Adapt Your Negotiating Flexibility
 - Gradually Increase Resistance to Concession
- Keep The Deal about The Deal, NOT About the Person
- Know your Best, Expected, and Walk-Away Outcome
- As an Entrepreneur, see yourself as the Buyer, not Seller 22



Panel Discussion:

Negotiating Advise

23

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Steve Morley
 Victoria Lakers
 Tyson McDowell

24
