

Options for Structuring Promissory Note Securities – Bruce E. Methven.

There are many ways to structure securities to be sold in an offering. How they are structured requires balancing what is attractive to investors with what the company can live with.

The basic types of securities are debt and equity, but there can be a fair amount of blurring between the two.

Promissory notes generally have mandatory payments, so an offeror needs to be sure it can make those payments even if the business does not do as well as expected. Of course, notes can be structured for interest-only payments with a balloon payment at the end of the term, which can make it easier for the issuer. They can also have a profit percentage in addition to interest, which may be an added incentive for investors.

In addition, promissory notes can be convertible to equity at the holder's option or on the occurrence of specified events, such as going public; that also make the notes more attractive to investors. If there are conversion rights, the conversion price (and the type of equity into which the notes can be converted) can be specified as a fixed amount or by way of a formula based on revenues or profits, which can allow for additional returns for investors if the company does well.

Finally, promissory notes can either be unsecured or secured by the assets the company owns. The latter gives investors more assurance, but can make bank financing difficult unless the investor notes can be subordinated to bank loans.

Next time: Equity securities, especially preferred stock.

Bruce E. Methven

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