FENWICK & WEST

Convertible Debt Terms– Survey of Market Trends

2018/2019

Overview

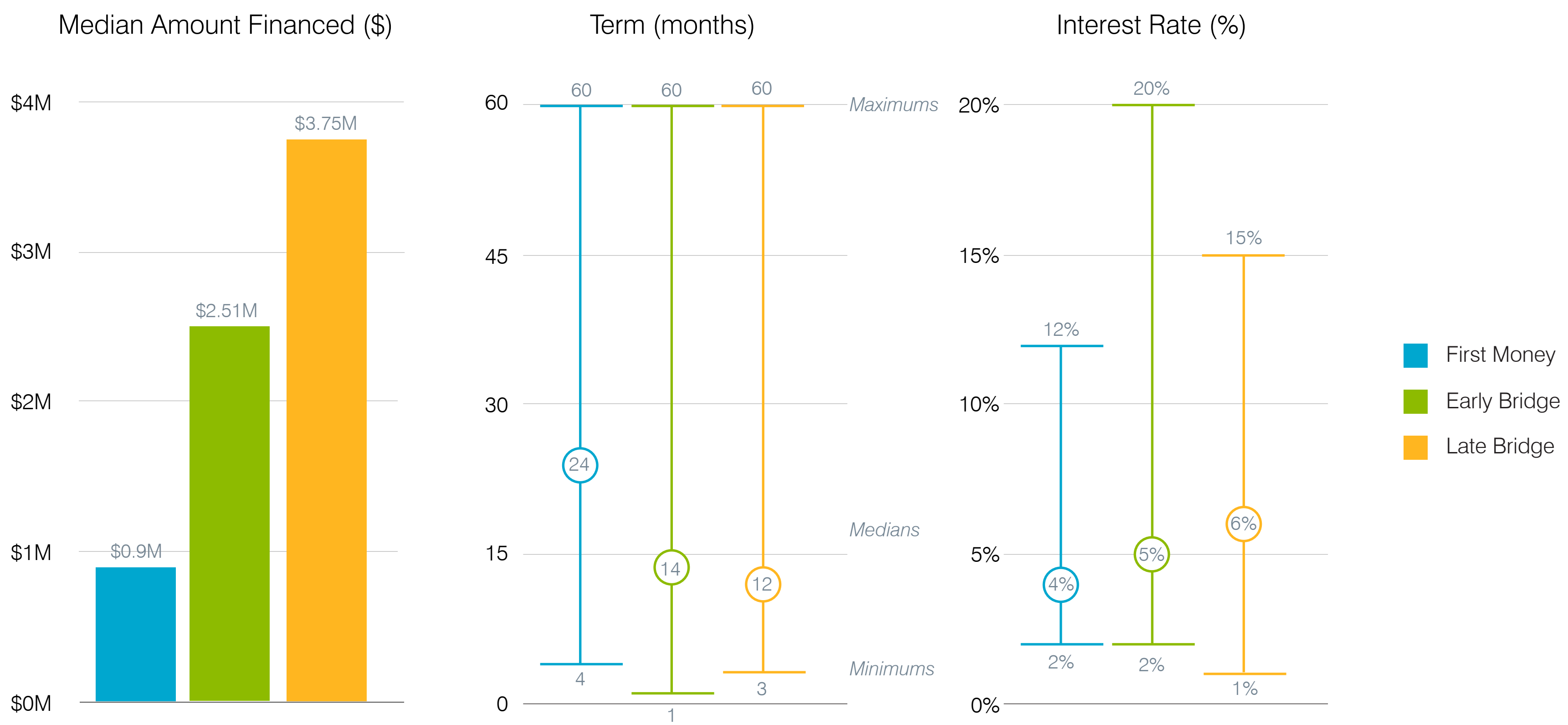
JAN 2018 – MAR 2019

In this report, we compile market data on convertible debt terms based on an analysis of over 100 issuer-side convertible debt transactions deals handled by Fenwick over the 15-month period from January 1, 2018 to March 31, 2019. 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.

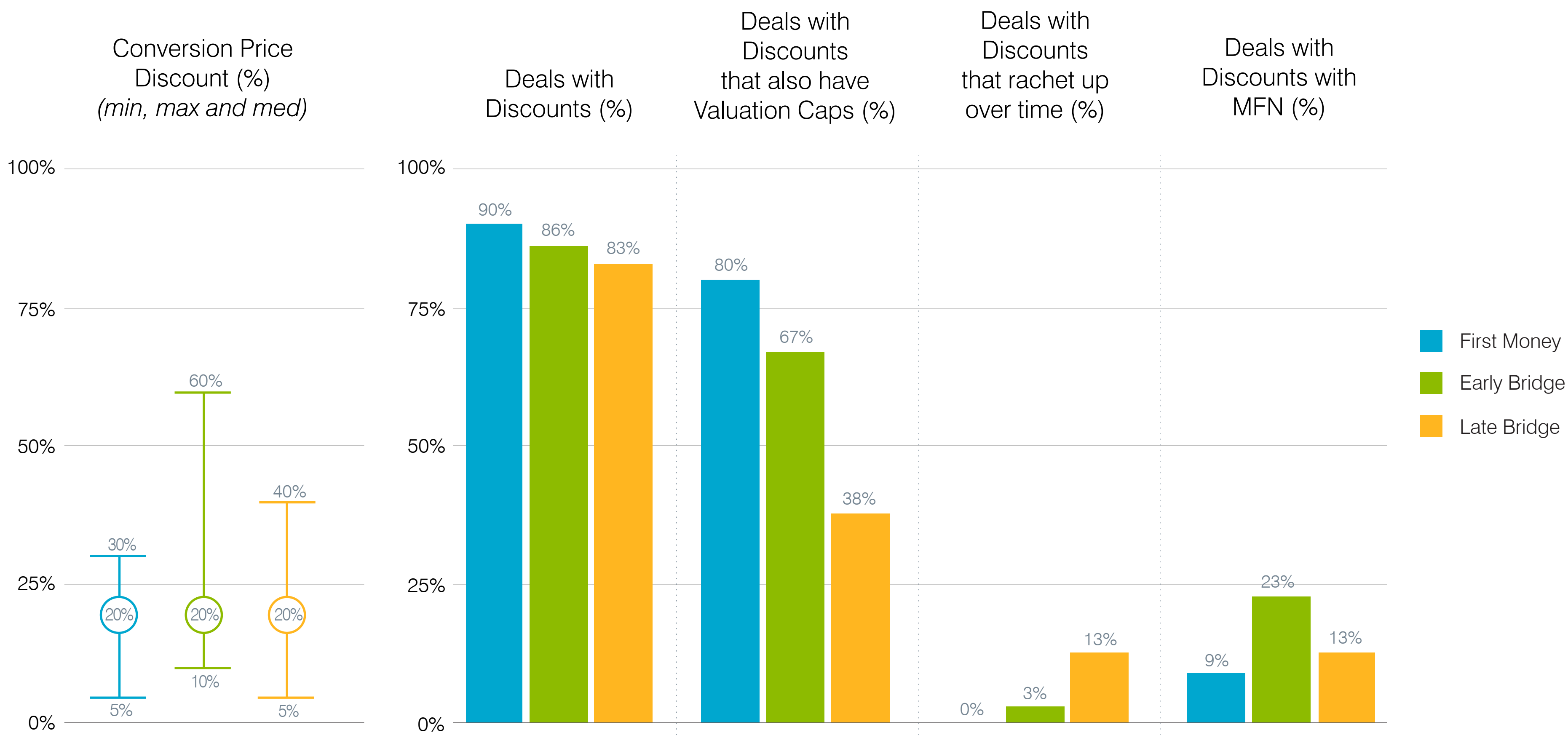
The Basics

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 14% (from $1.4M to $1.6M). This follows an even larger increase last year (from $1M to $1.4M). It should be noted that all of this year's increase was in the First Money and Late Bridge categories. Early Bridge deals actually decreased in median size (from $2.9M to $2.5M).



Conversion Discounts

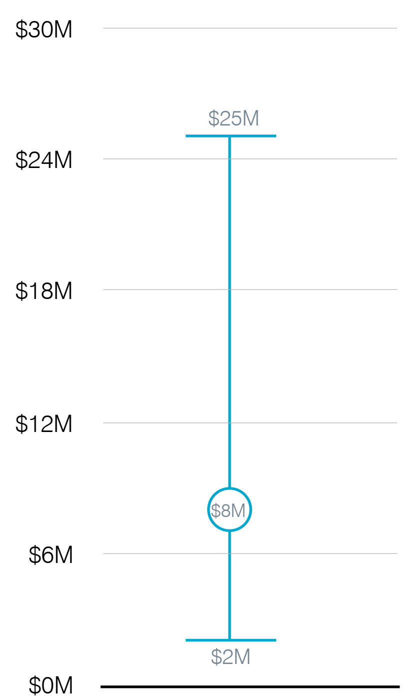
Conversion discounts are increasingly common, even in later-stage debt issuances. For first money issuances, most deals with conversion discounts pair them with valuation caps to give investors "lower of" pricing and this formulation is more common this year in Bridge deals as well. In Late Bridge deals, valuation caps are less common, but a substantial number of the conversion discounts are paired with other protections, such as provisions whereby the discount ratchets up over the term of the note or provisions guaranteeing the noteholder "most favored nation" status vis-a-vis any later investor.



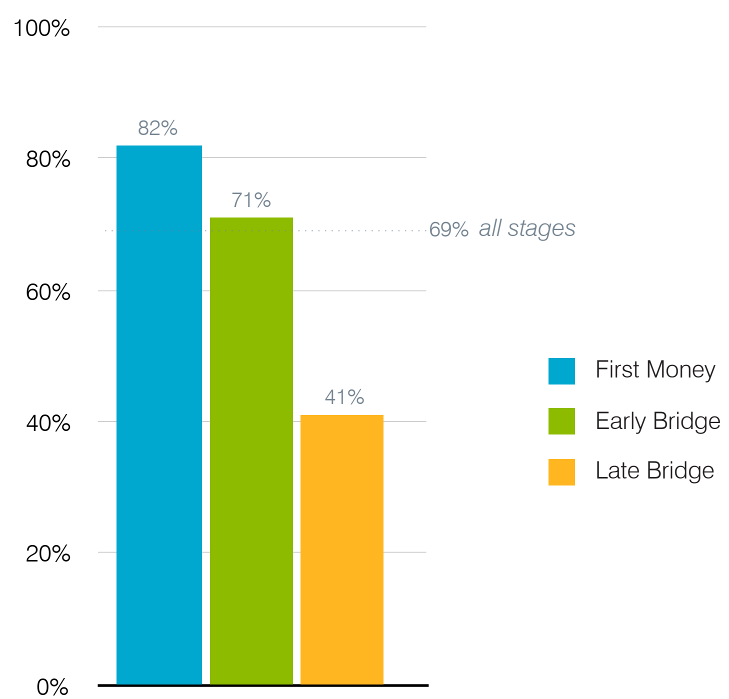
Valuation Caps

Only 11% of deals used a valuation cap as a standalone provision in the absence of a conversion discount, and, like the conversion discount, they are most commonly seen in early stage note deals. In First Money rounds, where the median financing size is ~$1M, the size of the cap ranged from $2M - $25M, with a median of $8M.

Valuation Cap for
First Money ($)



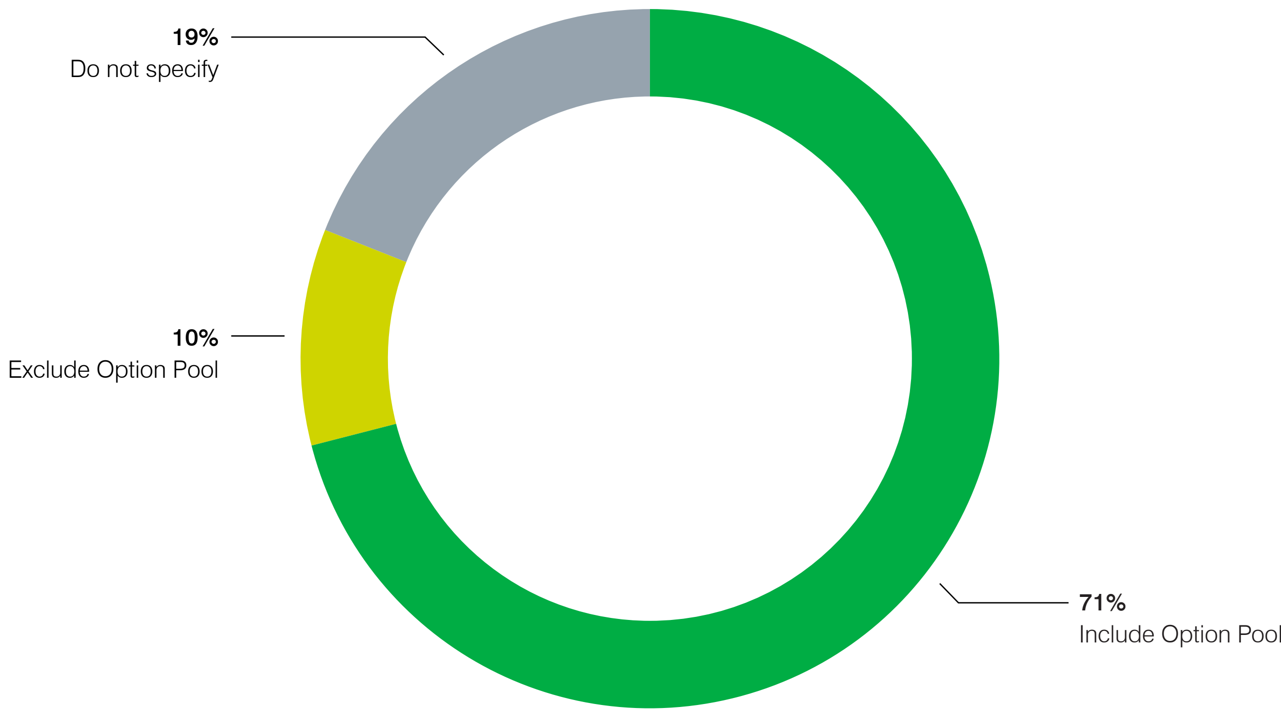
Deals with
Valuation Caps (%)



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.

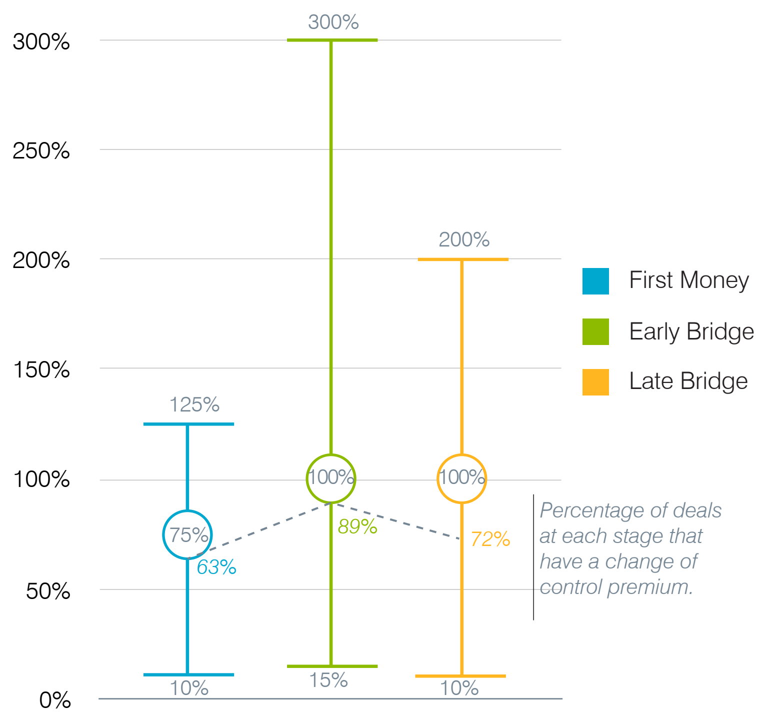
Do Common Stock Equivalents Include Reserved Stock?



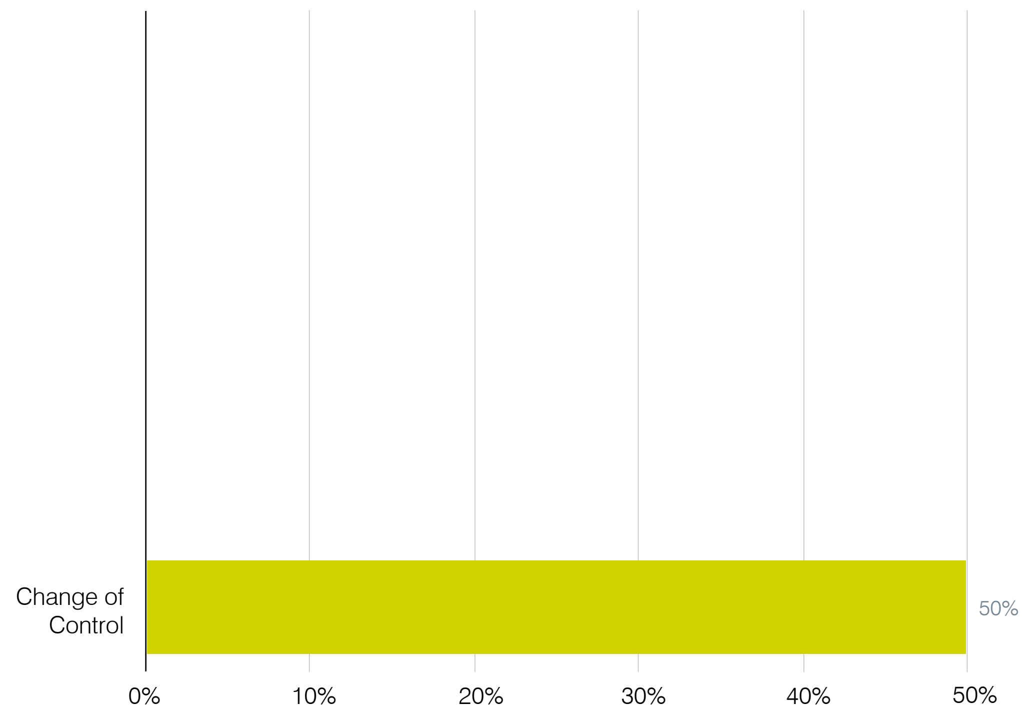
What Happens in a Change of Control?

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. Both the median amount of the premium and the number of deals giving a premium has remained steady. Also note that 50% of deals offer the holder the option to take the payout or convert into stock.

Change of Control Premium (%)

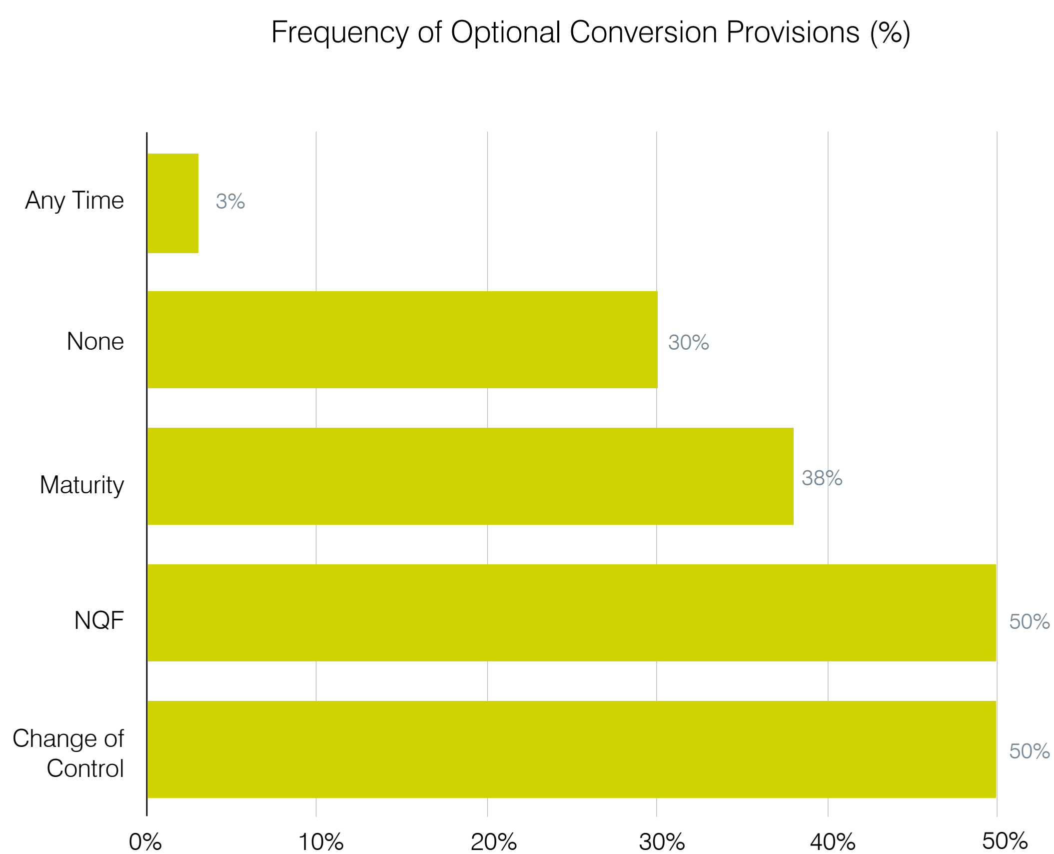


Frequency of Optional Conversion Permitted on a Change of Control (%)



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, 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. 30% 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.