

**FENWICK**



**Convertible Debt Terms –  
Survey of Market Trends  
2019/2020**

## Overview

Every year, 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 previous 15-month period. This year, our regular report covers January 1, 2019 to March 31, 2020 and we have added a comparison of this period to Q2 2020 as an addendum.

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.

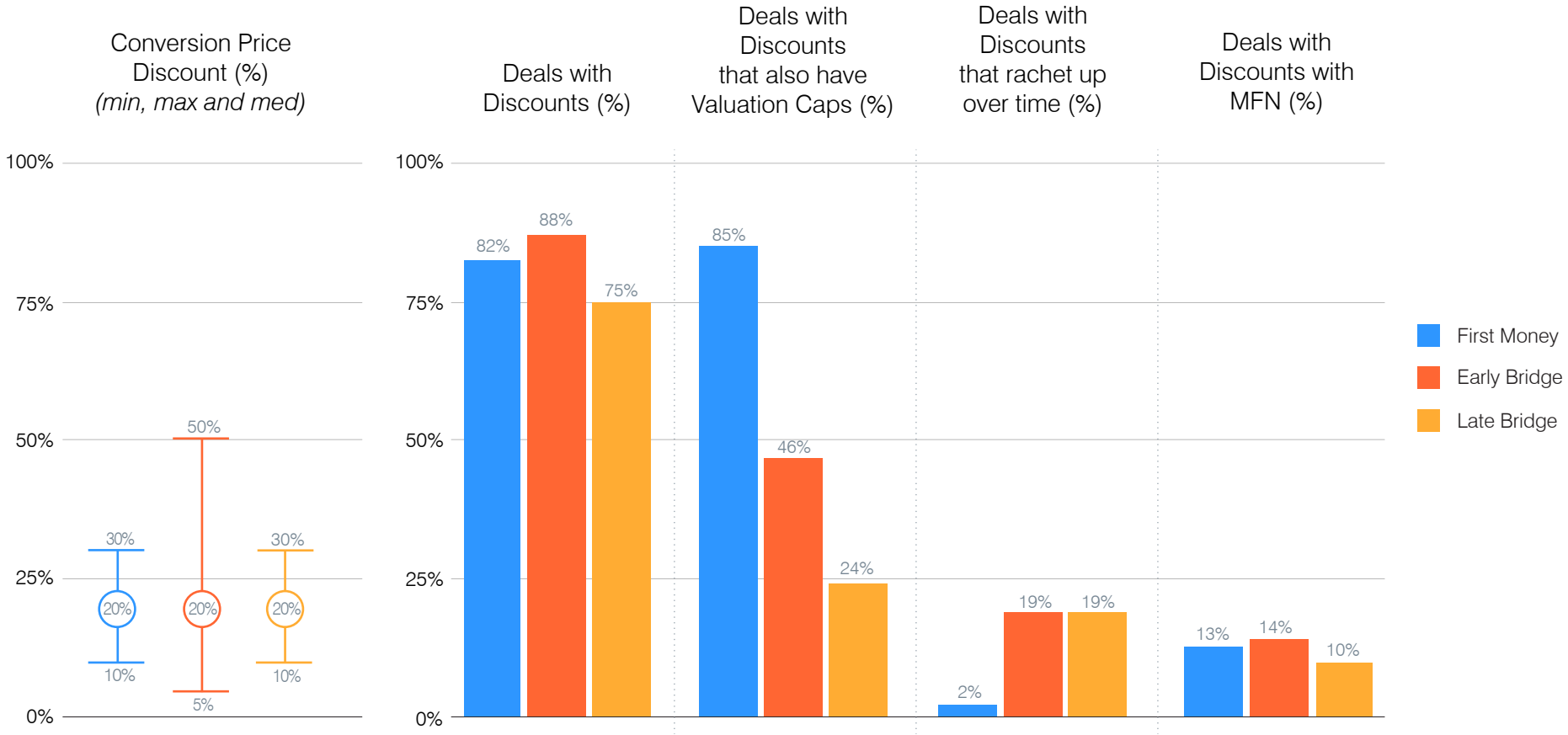
# The Basics

From 2018 to 2019 deal size is down overall (from \$1.62M to \$1.58M), late stage deals being the exception.



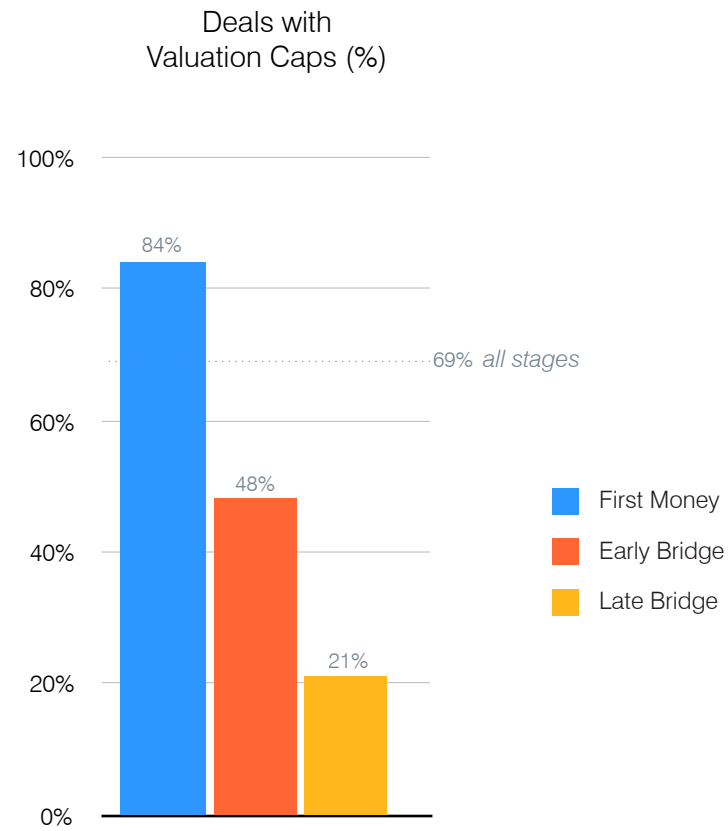
# Conversion Discounts

Conversion discounts continue to be frequently used, 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 but this is less common in later stage deals. 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

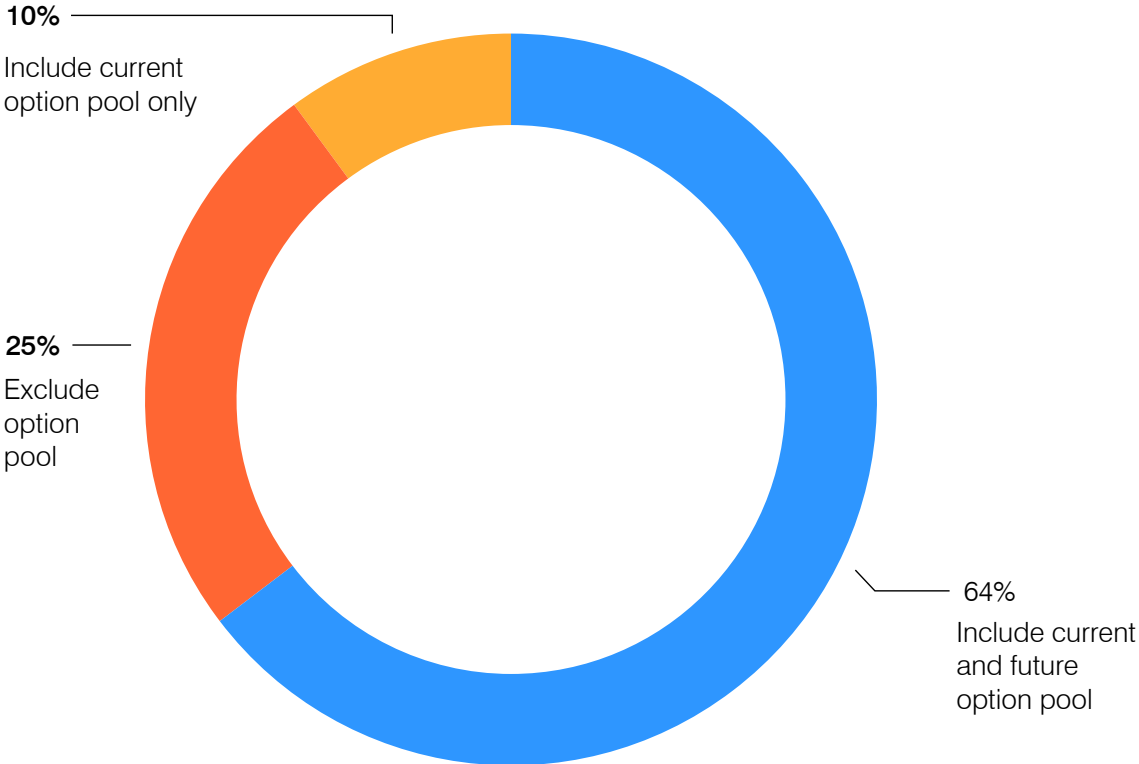
Only 12% of deals used a valuation cap as a standalone provision in the absence of a conversion discount, and, like the conversion discount, they are most commonly seen in early stage note deals. In fact, this year saw quite sizeable decreases in the use of valuation caps in Bridge rounds, decreasing in Early Bridge rounds from 71% to 48% and in Late Bridge rounds from 41% to 21%.



# Does the Option Pool Count?

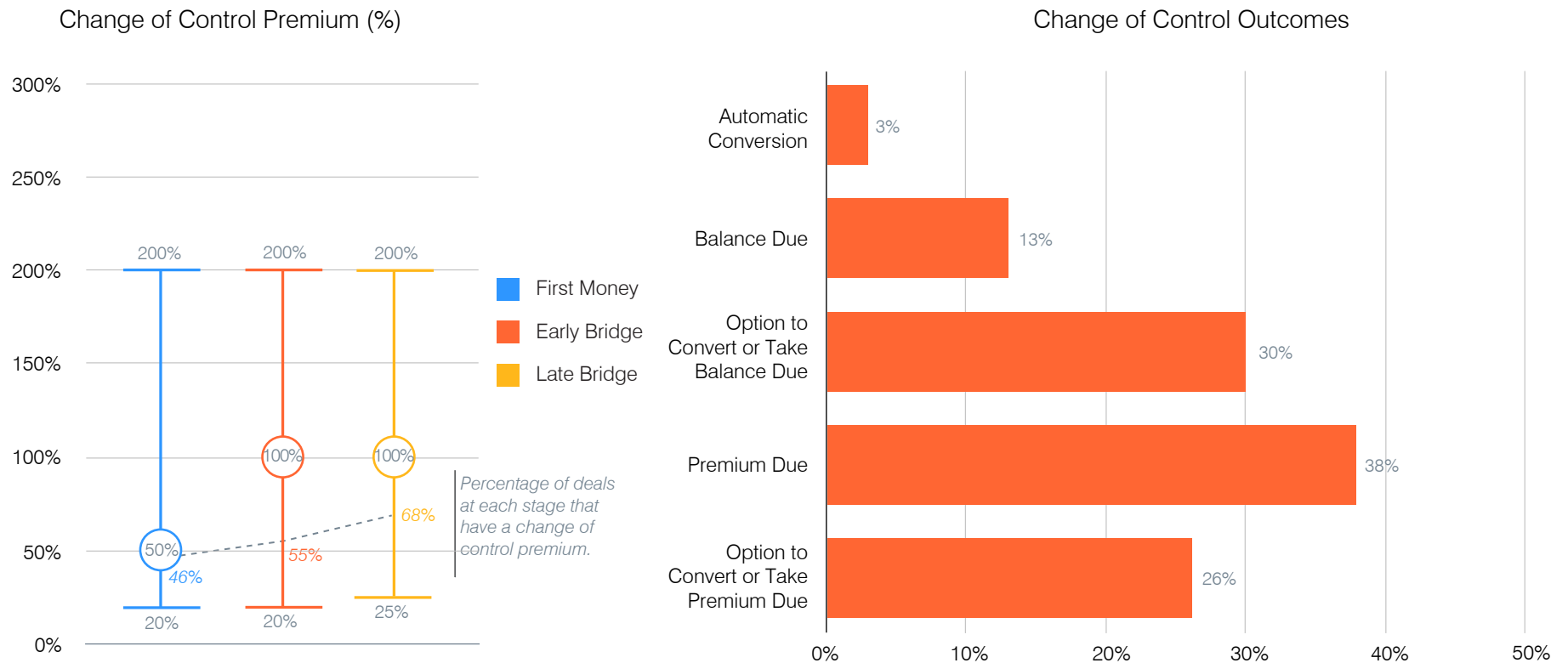
In cases of conversion under a cap, most deals specify that the option pool will be included in the concept of “common stock equivalents” or “fully-diluted stock” of the issuer. The most common formulation includes the current option pool and whatever is reserved in connection with the next qualified financing. A less common formulation is to include shares that are reserved for issuance under the current option plan, but to exclude any increases. One-quarter of deals exclude the option pool entirely.

Do Common Stock Equivalents Include Reserved Stock?



# What Happens in a Change of Control?

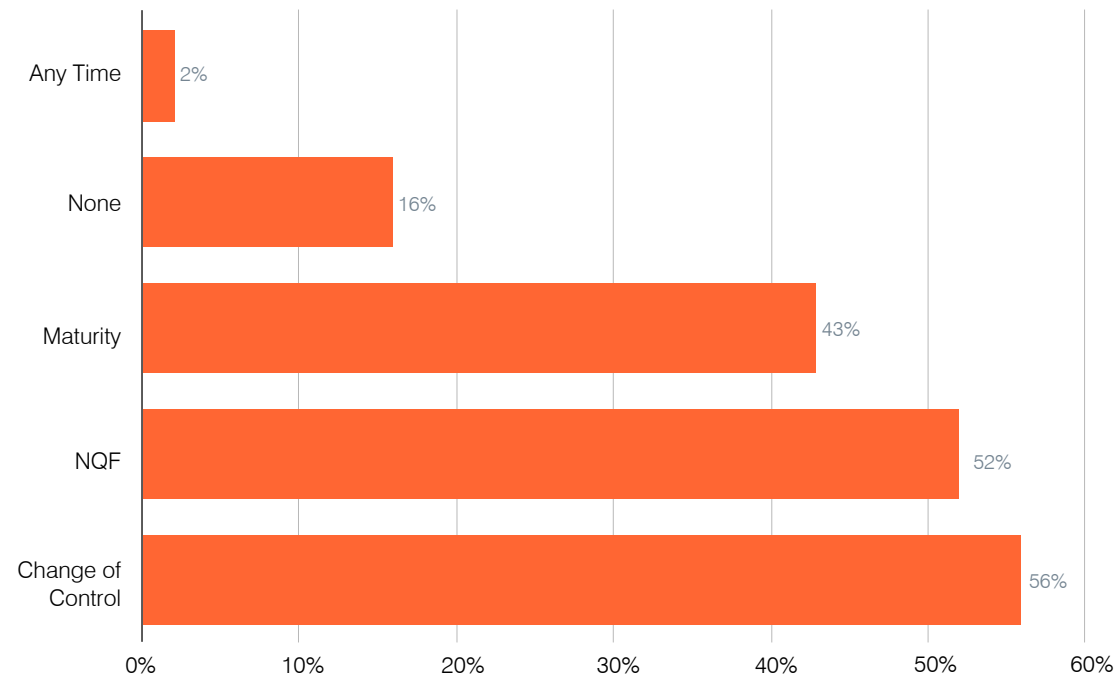
On a sale of the company, most deals provide for a premium payout that is a multiple on top of the repayment of the principal balance. Also note that 56% of deals offer the holder the option to convert into stock.



## 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, 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 16% of deals contain no optional conversion terms.

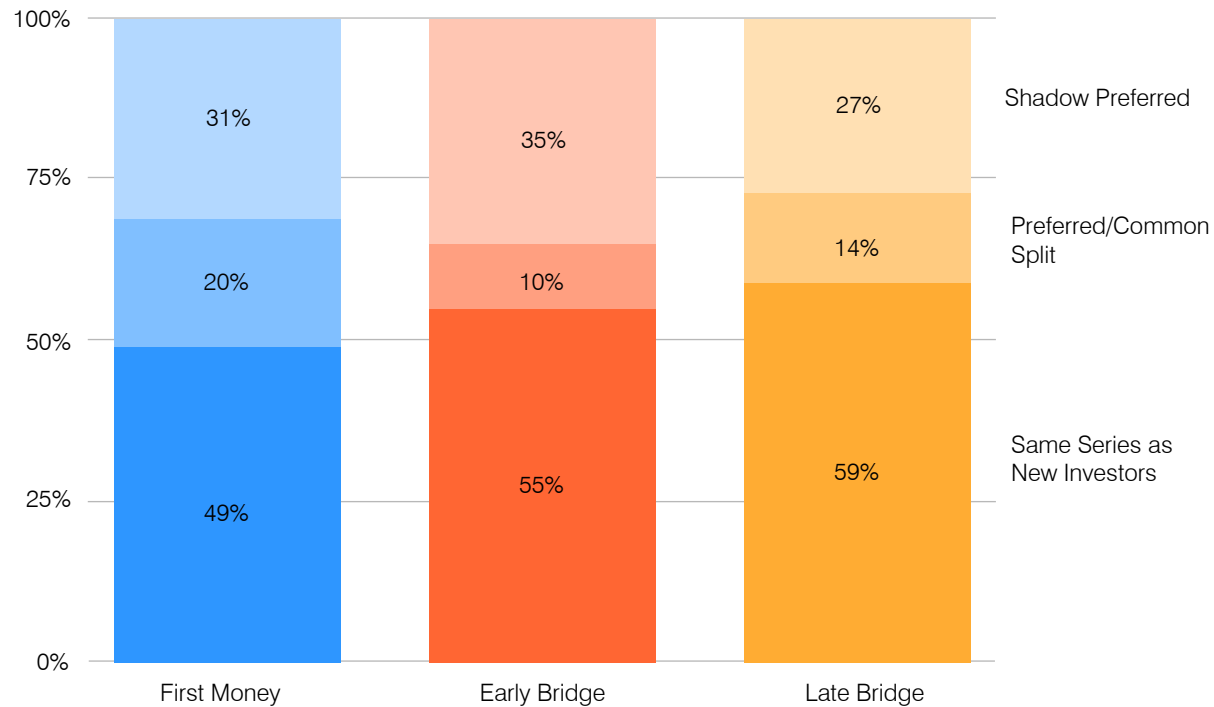
Frequency of Optional Conversion Provisions (%)





# 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”).



## How Does Q2 2020 Compare?

Compared to the prior period overall, Q2 2020 stood out with a noticeable skewing toward larger, later-stage deals. The interest rate was slightly higher; more deals used conversion discounts, less used valuation caps. The change of control premium amounts was largely the same, but premiums were given in fewer deals. More deals had an option to convert on a change of control. Deals with caps included current and future option pools in the denominator almost across the board and more deals addressed the liquidation preference windfall issue on conversion.

	Jan 19 – Mar 20 (all deals)	Q2 2020 (all deals)
Deal Size (median)	\$1.6M	\$2.2M
% Bridge (vs First Money)	56%	62%
Interest Rate (median)	5%	6%
Deals with Conversion Discounts	83%	92%
Deals with Valuation Caps	58%	50%
Size of Cap (median)	\$18.0M	\$50.0M
CoC Premium (Minimum)	20%	50%
Median	100%	100%
Frequency	54%	50%
Option to Convert on CoC	56%	62%
Deal includes some holder-optional conversion	84%	85%
If there's a cap, current and future option pool is included in the definition of "common stock equivalents" for calculating conversion price per share	64%	92%
Liquidation Preference Remedy on Conversion (where applicable)	47%	71%

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