



TaylorWessing

Session #3

Webinar

20 March 2024



TaylorWessing

Tips and tricks for your financing round

Securing external financing from business angels and VC investors

20 March 2024 | Dr. Niclas von Woedtke, MBA



Agenda

- 1 Market Overview
- 2 Available Financing Instruments
- 3 Typical VC Requirements
- 4 Deal Terms / Recent Developments
- 5 “Trick Box”



1 | **Market Overview**

Turbulent times

Where Are We

- Ongoing armed conflicts in Ukraine and most recently Israel
- Global supply chain bottlenecks
- High energy prices
- Rising interest rates + inflation
- Collapsing banks (SVB, Credit Suisse)
- Nervous capital markets / hardly any IPOs – **any signs of a turnaround?**



FIERCE Biotech

Biotech - Research - Medtech - CRO - Special Reports - Fierce 50

BIOTECH

Week of IPO success stories suggest biotech has reached 'recovery phase' in 2024

By Max Bayer, Gabrielle Masson · Jan 26, 2024 10:21am

biotech IPO | IPO | ArriVent Biopharma | CG Oncology

Tubulis

Millionen für Krebstherapie-Spezialisten

Die Biotech-Firma sammelt 128 Millionen Euro ein und will damit neue Wirkstoffe marktreif machen.

Effects on VC Financing Rounds (1/2)

- VC funds raise less
- **GER**: Number / volume of financing rounds has declined noticeably:
 - *minus 49% in DE (1st half of 2023 / EY Start-Up Monitor)*
 - *US investors are increasingly withdrawing from Europe*
- Collapsing banks (SVB, Credit Suisse)
- Valuation corrections lead to write-offs in portfolios of VC funds (up to 50%)



Effects on VC Financing Rounds (2/2)

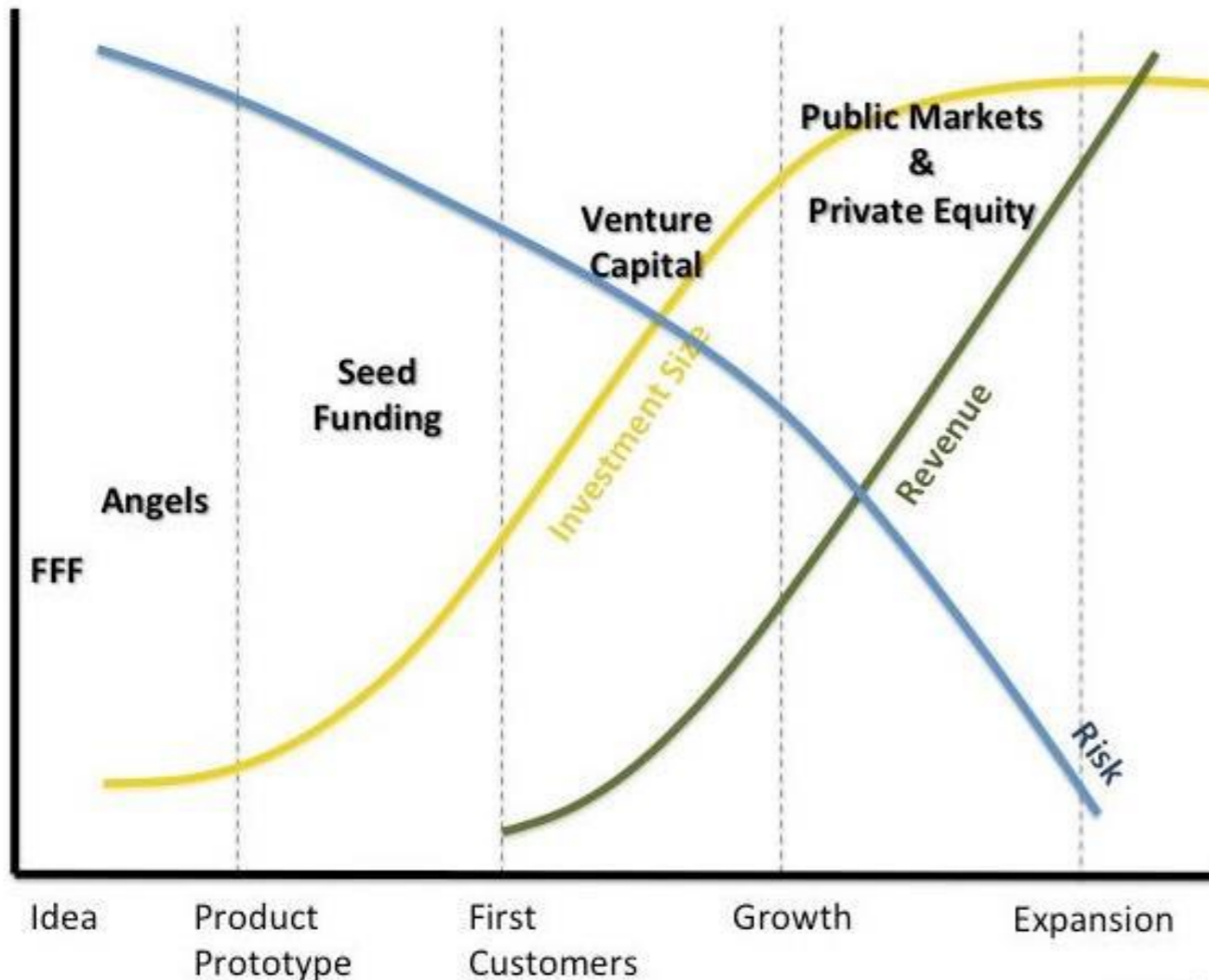
- Few financing rounds from Series B onwards
- Seed / Early stage financing quite robust (up to Series A rounds)
- „Blockbuster“ themes: AI and ESG
- Other strong sectors: Cyber security; life sciences (Biotech / Healthtech)
- Capitalintense B-2-C business models: Dire prospects for fundraising



2 | Financing Instruments

Watch your cap table

Funding Life Cycle of Start-Ups



Pre-Seed / Seed Stage:

- Investors: Friends, family and fools (“3Fs”), business angels, VCs, rarely: Corporates
- Main objective: *Acquisition of IP rights, development of technology, preclinical testing*
- Investment amount: EUR 100-500k, VCs up to EUR 1-1.5m or more
- Financing instruments: Convertibles or equity rounds

Early Stage (Series A, B):

- Investors: VCs, family offices, corporates
- Main objective: *Further development of technology, clinical evaluation (Phases I, IIa and IIb)*
- Investment amount: usually EUR 5-15m or more
- Financing instruments: Equity rounds or venture debt

Growth Stage (Series C, D, etc.):

- Investors: VCs, family offices, corporates
- Main objective: *Extending clinical evaluation to larger patient groups, randomized control trials (Phase III)*
- Investment amount: from EUR 20m onwards
- Financing instruments: Equity rounds or venture debt

Financing Instruments (1/2)

- Priced equity rounds
- Debt financing (e.g., venture debt)
- Hybrids (especially convertible loans)
- SAFE notes
- “Bootstrapping“
- Public funding
 - *EU vs. domestic funding programs*
 - *Equity funding*
 - *Debt financing*
 - *(Research) grants (“Verlorene Zuschüsse”) → EXIST programs (see next slide)*

Financing Instruments (2/2)

- Research grants (cont'd)
 - EXIST programs administered by the Federal Ministry of Economic Affairs (BMWK):
 - ▶ EXIST *start-up grant*
 - ▶ EXIST *transfer of research*: 2 phases of funding (“Seed” / “Pre-Seed”) → (1) further development and refinement of research results, to test technical feasibility + development of business plan; (2) starting business operations and getting ready for external financing / Application through respective university or research cluster, e.g., Max Planck, Fraunhofer, Helmholtz, etc. (phase 1) and, subsequently, start-up (phase 2)
 - ▶ More information under: <https://www.exist.de/EXIST/Navigation/EN/Home/home.html>

3 | Typical VC Requirements

The investor view

Typical VC Requirements

Business / Operational Aspects:

- Team / know-how (technology + product, subsequently regulatory ...) / experience (“Big Pharma”)
- (Unique) Technology
- IP situation
- Market size / viable exit strategies

Financial Aspects:

- Investments are minority stake investments (10-25% per round)
- Investment amounts depending on funding required to reach next stages of technology development / clinical testing; milestone plan
- Valuations
 - > Pre-revenue / early stages: Combination of (i) funding needed, (ii) acceptable dilution and (iii) market benchmarks;
 - > “Step-up” from round to round: ~ 1.5-2x (down-rounds not uncommon though in current market situation)

Valuation of Start-Ups

Aswath Damodaran (Professor of Finance at NYU) – “The Dark Side of Valuation”:

“Young companies pose the most difficult estimation challenges in valuation. A combination of factors – short and not very informative histories, operating losses and [...] high probability of failure – all feed into valuation practices that try to avoid dealing with the uncertainty by using a combination of forward multiples and arbitrarily high discount rates.”

4

Deal Terms / Recent Developments

Lawyers' stuff only? Not quite ...

Overview

Main (Legal) Documents

- Term sheet
- Cap table
- Investment agreement
- Shareholders' agreement
- MD service agreement, ESOP / VSOP terms and other ancillary documents

Timing / Funding

- From negotiating the term sheet up and until signing of long-form legal documents: 3-4 months, sometimes even longer (e.g., extensive due diligence by investor(s))
- Signing until receipt of cash: 4-6 weeks

TERM SHEET

This "Term Sheet" summarises principle terms and conditions of a proposed equity investment ("Seed Financing Round") by WOW Ventures and other investors into NEXT Big Thing GmbH ("Company"). Except as outlined below, this Term Sheet does not constitute a binding agreement but rather outlines proposed terms pursuant to which definitive agreements as set forth in **Annex A** may ultimately be entered into.

I. Establishment

- 1) Company** The Company shall have its seat in Hamburg, Germany, and shall be registered with the commercial register (*Handelsregister*) of the local court (*Amtsgericht*) of Hamburg, Germany.
- 2) Business** The business of the Company shall be the [●] ("**Business**")
- 3) Structure and shares** (i) [●] UG (haftungsbeschränkt), registered with the commercial register (*Handelsregister*) of the local court (*Amtsgericht*) of [●], Germany, under registration number [●] ("[●]"), an investment vehicle entirely held by [●] ("[●]"), (ii) [●] UG (haftungsbeschränkt), registered with the commercial register (*Handelsregister*) of the local court (*Amtsgericht*) of [●], Germany, under registration number [●] ("[●]"; [●] and [●] "**Founder Vehicle(s)**"), an investment vehicle entirely held by [●] ("[●]"; [●] and [●] "**Founder(s)**"),

NEXT Big Thing GmbH - Cap Table

Captable		Foundation		
Shareholder	Role	Ordinary Shares	%	Investment
Founder 1	Co-Founder	10.000	33,33%	10.000,00 €
Founder 2	Co-Founder	10.000	33,33%	10.000,00 €
Founder 3	Co-Founder	10.000	33,33%	10.000,00 €
Founder Stake		30.000	100,00%	30.000,00 €
ESOP		0	0,00%	- €
Angel Stake / Advisors / Employee Convertible		0	0,00%	- €
VC Stake		0	0,00%	- €
Total		30.000	100,00%	30.000,00 €

Where to Find What

Economic terms

Subject matter	Provisions in ...	Adressed in term sheet
(Pre-Money) Valuation, investment amount, share price	Investment agreement (IA)	✓
Investment structure (upfront vs. payment tranches)	IA	✓
ESOP / VSOP	IA	Only pool size, no T&C
Reps & warranties + remedies	IA	Only generic reference
(Super) Pro-rata rights	Shareholders' agreement (SHA)	✓
Anti-dilution protection	SHA	✓
Vesting provisions	SHA	✓
Share transfer provisions (ROFR, tag-along, lock-up)	SHA	Only generic reference
"Road to exit" (drag-along, exit/IPO process, etc.)	SHA	Only with respect to drag-majority
Liquidation preferences	SHA	✓

Where to Find What

Control terms

Subject matter	Provisions in ...	Adressed in term sheet
<i>Establishment of board, composition and governance</i>	SHA	✓
Allocation of responsibilities among shareholders and board	SHA + rules of procedure	✓
<i>Qualified majorities for important shareholder matters</i>	SHA	✓
<i>Information / reporting rights</i>	SHA	Only generic reference (if at all)
IP transfer provisions	SHA	✗
<i>Pooling of minority shareholders</i>	SHA	✗
ESG compliance, specific US tax covenants, etc.	SHA	Occasionally
<i>Non-compete / non-solicitation</i>	SHA	Only with respect to duration

+ Exclusivity (+ potential break-up fee)

+ Cost coverage for investors

Overview on / Explanation of Terms (1/5)

Economic Terms

▪ *Investment structure*

- > Explanation: New shares are issued – against payment of the (i) nominal amount (number of shares x EUR 1.00) and (ii) the exceeding amount reflecting the agreed price per share, which is paid into the capital reserves of the Company (= total investment amount minus nominal amount; usually, in VC deals in the life sciences sector, the investment amount is paid out in tranches, which are subject to certain – operational and regulatory – milestones.
- > *What to watch out for*: Milestones should be realistic and be defined as clearly as possible, whilst allowing for sufficient flexibility to waive or adjust milestones; try to avoid scenarios where shares are issued all at once to the investor(s) (assuming payment of all tranches) and try to negotiate higher (subsequent) valuations and capital increases.
- > *Recent developments*: More investor push towards issuance of all shares with payment of first tranche; no subsequent valuation increases.

▪ ESOP / VSOP

- > Explanation: As part of the equity financing round, an employee participation program will be implemented, either through options to receive “real shares“ or as virtual payment claims only; pool size: ~ 10% of post-round capitalization table.
- > *Recent developments*: Legislative change with respect to Sect. 19a German Income Tax Act (*EStG*), which may pave the way for equity-based programs, although – due to complexity and added costs – doubtful.

Overview on / Explanation of Terms (2/5)

Economic Terms

- **Reps & warranties**
 - > Explanation: Statements by the Company, the founders and the existing shareholders with respect to the most important legal and business matters of the Company to provide overview and comfort to the investor(s); any potential violations (although very rare in practice) will be, to a lesser extent, compensated in cash and/or, predominantly, in additional shares.
 - > *What to watch out for*: Take negotiation and review of reps & warranties seriously; use knowledge qualifiers (at best only positive knowledge) where you are unsure; try to negotiate values for de-minimis and basket thresholds which cover the vast majority of potential claims.
 - > *Recent developments*: Catalogue of reps & warranties have become more extensive (may be even “over engineered” at times).
- **(Super) Pro-rata rights**
 - > Explanation: By default, shareholders may participate in future issuance(s) of shares to maintain shareholding percentage.
 - > *Recent developments*: Investors increasingly demand “super” pro-rata rights, sometimes even for a right to preempt the entire financing round and acquire 100% of the new shares, which gives them a de-facto blocking right with respect to new investors.
- **Anti-dilution protection**
 - > Explanation: Serves as investor protection in case new shares in subsequent financing round are issued at a lower price; different ways to calculate number of additional shares: (broad- or narrow-based) weighted average vs. full ratchet.
 - > *Recent developments*: Return to narrow-based weighted average (disregarding certain categories of shares) + pay-to-play

Overview on / Explanation of Terms (3/5)

Economic Terms

- Vesting provisions
 - > Explanation: Legally, founder own their respective common shares; vesting scheme shall ensure that founders are economically incentivized to remain with the Company for the duration of the agreed vesting period (usually 36-48 months); depending on leaver event (“bad leaver” / “good leaver”) during such period, founders will receive certain compensation for their vested / unvested shares.
 - > *What to watch out for*: Definition of “bad leaver” cases.
 - > *Recent developments*: No specific changes; usual set-up at earlier stages still: 100% of the shares are subject to vesting; 48 months vesting, 12 months cliff.
- Liquidation preferences
 - > Explanation: LPs affect the way proceeds are distributed among the shareholders in a liquidity event (e.g., sale to “Big Pharma”); liquidation preferences entitle investors to receive a certain amount of the proceeds (1x or more of their invested money) prior to all other shareholders, most notably the founders; LPs can be designed as participating (*nicht anrechenbar*) or non-participating (*anrechenbar*) with respect to the distribution of the remaining proceeds among all shareholders.
 - > *Recent developments*: Multiples of 1.5x or more have become more common; participating LPs not yet (re-) established.

Overview on / Explanation of Terms (4/5)

Control Terms

- **Board composition / governance / rights**
 - > Explanation: Certain competencies of the shareholders' meeting will be allocated to a new – controlling – body, the advisory board; in addition the board will supervise the management and have to approve certain managerial decisions; usual composition / size at earlier stages: founders (1-2 members), investor(s) (1-2 members) + independent member.
 - > *Recent developments*: More push towards a “strong“ board, i.e., a board that is equipped with the authority to appoint/remove managing directors.
- **Qualified majorities for shareholder decision-making**
 - > Explanation: Statutory law requires 75% majority for changes to articles of association; in addition, certain important decisions at the level of the shareholders (especially decisions on capital measures and exit events) shall require approval from (qualified) majority of investor shareholders.
 - > *Recent developments*: Tendency to tighter catalogues of matters reserved for approval by investor shareholders.
- **Information rights**
 - > Explanation: Additional information rights will often include: (Un) Audited financial statements, monthly/quarterly management reports (including certain relevant KPIs), etc.
 - > *Recent developments*: More often ESG reporting required.

Overview on / Explanation of Terms (5/5)

Control Terms

- Pooling of minority shareholders

- > Explanation: Under German law, shares come with certain statutory rights, irrespective of the shareholding size. With numerous shareholders, cap table can become quite “messy” and shareholder alignment and decision-making quite burdensome. For this reason, minority shareholders (e.g., < 2%) should be “pooled”, either by setting up a pooling vehicle (usually in the form of limited partnership (*Kommanditgesellschaft*), or, contractually, by a pooling agreement, which assigns the decision-making of the pooled minority shareholders to a designated pool leader.
- > *Recent developments*: None.

- Non-compete / non-solicitation

- > Explanation: For the duration of their services and for a certain period beyond, founders will not be allowed to engage in competing activities, e.g., invest in or set up a company which is active in the same or a closely adjacent line of business. Non-compete in SHA comes in addition to non-compete in MD service agreement and usually relates to the respective founder being a shareholder in the Company (and thus having access to competitive intelligence which could be negatively exploited).
- > *Recent developments*: None, post-contractual non-compete varying between 12-24 months.

5 | “Trick Box”

Or: Mistakes you should definitely avoid ...

Our Top 11 Tips & Tricks

- > **Everyone** on board? For how long?
- > Sorting things out **amongst founders**
- > Get the **company set-up** right – right from the beginning
- > Keep your cap table **“clean”**
- > Be wary of the **“right” investors** at the right point in time
- > Be **prepared and organized**
- > Think twice before leaving the party or: Why **“term sheet hopping”** is not necessarily a good idea
- > **Concessions that can haunt you** down the road (or: *“Nach der Runde ist vor der Runde”*)
- > (Regulatory) Things that might **get in the way**
- > Build a **“circle of trust”**
- > And finally: **Raise as late as possible, and as soon as necessary**



Questions and discussion





17 April 2024 – 10 am

Session #4

**Consulting Agreements: Dos and
Don'ts**

Speaker



**Dr. Niclas v. Woedtke MBA
(Kellogg / WHU)**

Partner



