

NGI

TERM SHEET & DUE DILIGENCE

- How to provide information?
- Main components of a Term Sheet
- Due diligence checklists

WHAT IS A TERM SHEET?

- **Term Sheet** is a **non-binding** document between founder(s) and investor(s) that outlines basic terms and conditions of an investment
- It does **not guarantee** an investment. It serves as a basis for **further discussions** and **more detailed legally binding documents** (i.e investment agreement, shareholders agreement, share purchase agreement).
- In the process of raising an investment, a Term Sheet is formed after successful consultations between founder(s) and (lead) investor(s). Usually, it is agreed upon **before due diligence**.

Raising an investment



MAIN COMPONENTS OF A TERM SHEET (1)

○ Investment specific information:

- **Investment size** - amount of money that investor(s) allocate to the company with the expectation of a positive return
- **Equity distribution** – different parties' ownership share of the company
- **Value of the company** – company's total value, estimated cost to purchase company
- **Capital structure** - mix of debt and equity used to finance company's assets and operations

MAIN COMPONENTS OF A TERM SHEET (2)

○ Shares:

- **Liquidation preference** - clause in a contract that dictates the payout order in case of a corporate liquidation
- **Dilution** – company’s issuance of additional stock that results in a decrease in existing stockholders' ownership percentage of that company.
- **Pre-emption** – the right to purchase a company’s new shares before they are offered to anyone else
- **Founder vesting** - a process by which founder “earns” stock over a period of time depending on performance and commitment
- **Tag along and drag along** - tag-along rights give minority shareholders negotiating rights in the event of a sale, drag-along rights force the minority shareholders to accept whatever deal is negotiated by majority shareholders.

MAIN COMPONENTS OF A TERM SHEET (3)

○ Other agreed terms:

- **Board seats** – executive committee that jointly supervises activities of an organization
- **Closing conditions** – events that must take place or tasks that must be completed before the transaction the agreement provides for can be consummated
- **Confidentiality** – keeping sensitive information private; non-disclosure of sensitive information



The specific contents and conditions of the Term Sheet differ from transaction to transaction

FAQ 1/2

Q: Can the term sheet phase be skipped and can a round be closed without it?

A: Yes, but it is recommended to have at least something like a term sheet, since it serves as a warrant that all parties understand the main terms of the round in the same way.

Q: Should all the investors sign the term sheet?

A: Not necessarily, but it is recommended to have some written confirmation that the investor has understood the terms of the round and what is the planned sum of investment. Sometimes the term sheet serves as good validation of investor commitment.

Q: Who prepares a term sheet?

A: Usually, the (lead) investor prepares the term sheet for the startup, but it is also possible that a startup prepares a basic term sheet to outline the basic conditions of an investment.

FAQ 2/2

Q: What is the timeline from Term Sheet to funding?

A: The timeline varies from deal to deal but tends to be longer with bigger investments. Next steps include the Due Diligence as well as compiling and signing the investment documents. For early-stage companies this process can take 2-3 months.

Q: Should the startup hire a lawyer to compile the term sheet?

A: Usually, it is a good idea to involve a legal specialist, when negotiating the terms. However, if you are using model documents commonly used in your country and you feel confident in the terminology then you may opt out of involving a lawyer.

Q: Do you sign a term sheet in each funding round?

A: Usually, a term sheet is signed at each funding round.

SOURCES

WHAT IS DUE DILIGENCE

- **Due Diligence (DD)** is a process undertaken before an investment **to understand the investability of the company.**
- It is used to **verify** information, expectations and data about an investment.
- In the process of **Due Diligence** different documents (e.g. business plan, intellectual property) need to be provided. It is recommended to arrange the documents in a **virtual data room** (e.g. Google Drive) for more convenient managing. The data room structure (folders, documents) should match the structure of DD checklist.
- There is **no single process** for Due Diligence. The depth and the format of Due Diligence differs from investor to investor.
- For earlier stage investments the DD may cover only limited set of legal documents, deck and budget combined with interviews.

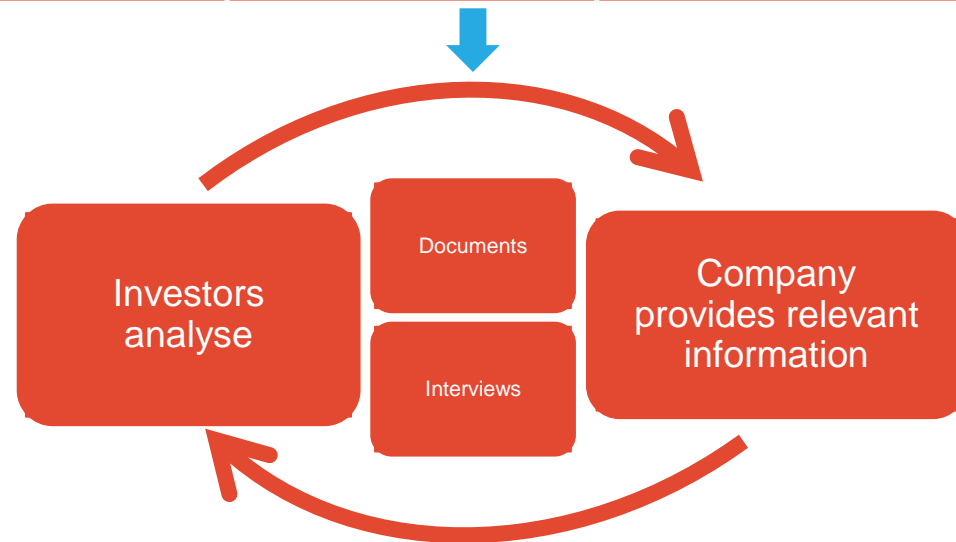
DUE DILIGENCE IN THE INVESTMENT PROCESS

Raising investment



Early stage companies by their nature have little information to analyse and therefore Due Diligence might be centered around some key topics like

- **Team**
- **Market**
- **Basic legal**
- **IP (depending on the business)**



During DD investors usually conduct interviews with the team, clients and earlier investors.

EXAMPLE DD CHECKLIST FOR EARLY-STAGE COMPANIES

- **Legal DD**
 - Detailed Legal Information about the company
 - Intellectual Property
 - Material Agreements
- **Team and Governance**
 - Founder DD
 - Information Regarding Employees and Employee Benefits
 - Option Pool
- **Technical DD**
 - Product demonstration and description (demo video or a recording, written description)
 - Does the company have a patented technology? If yes add the list of patents.
- **Financial DD**
 - Provide financial statements and financial forecast, explaining key assumptions
 - The cap table of the company
 - Accounting documents (Balance Sheet, Income Statements, Cashflow Statements)

HOW TO PROVIDE INFORMATION

○ Dataroom

- Gdrive or DP folder
- Add Table of Contents
- Add FAQ

○ Interviews

- Who of the customers might be ready to talk?
- Who are the relevant industry experts to talk to?
- Who are the (existing) investors to talk about the company?
- Show how you have learned from your mistakes.

NB! NDA is almost always a barrier. If possible, do not use it!

DD DATAROOM EXAMPLE

Dropbox / Due Diligence

Upload

Create

Follow



Name ↑

1. Corporate matters	☆
2. Share capital and shareholders	☆
3. Financing	☆
4. Suppliers and customers	☆
5. Management, employees and advisors	☆
6. Intellectual property, IT and data processing	☆
7. Other Agreements	☆
8. Legal and regulatory	☆
9. Other relevant information and documents	☆
FAQ.docx	☆
Table of Contents.xlsx	☆

- Exercise **proper housekeeping** and keep your documents organised.
- Using a **standard Due Diligence list** and keeping your documents organised may speed up the investment process.
- The lead investor may send you their requested Due Diligence structure and list.
- **The FAQ and Table of Contents** documents are not a must, but rather a „nice to have“.

DUE DILIGENCE CHECKLISTS

EBAN

- Due Diligence template
- Due Diligence checklist

VC-list (USA)

- Due Diligence checklist

SOURCES

- [Investopedia 1](#)
- [Corporate Finance Institute](#)
- [Investopedia 2](#)
- [CFA Institute](#)
- [Investopedia 3](#)
- [Investopedia 4](#)
- [SynVestCapital](#)
- [Strictly Business 1](#)
- [Strictly Business 2](#)
- [Investopedia 5](#)
- [Investopedia 6](#)
- [500 Startups](#)
- [Startup Estonia Due Diligence checklist](#)