

Overview of Convertible Instruments

Part I: General

CONVERTIBLE LOAN NOTE ("CLN")



Origination

- Traditionally used as a form of convertible debt financing by companies.
- No standard form and terms vary.



Length

- Varies.



Description

- Typically a short term debt that may be converted into shares at a later date.
- Typically at a discounted conversion price.
- These are typically unsecured debts.



KEEP IT SIMPLE SECURITIES ("KISS")



Origination

- Spearheaded by 500 Startups as an alternative to SAFE.
- The debt version bears a closer resemblance to CLN.
- Subsequently varied by various law firms/venture capital firms.



Length

- Approximately 9 pages.



Description

- A convertible instrument used by early stage companies to document seed or pre-seed investments from investors.
- KISS-es in a given series tends to have identical terms.
- These are typically unsecured debts.

CONVERTIBLE AGREEMENT REGARDING EQUITY ("CARE")



Origination

- Standard form released by VIMA.
- Includes a recital stating that the parties agree that neither party has modified the standard form - other than to fill in blanks or pick options.



Length

- Approximately 12 pages.



Description

- A convertible instrument that allows an investor to either receive shares or cash upon the occurrence of certain events.
- These are typically unsecured debts.

Overview of Convertible Instruments

Part II: The Investment

CONVERTIBLE LOAN NOTE ("CLN")



Conditions to Investment

- Typically included, such as:
 - delivery of corporate resolutions;
 - execution of waivers; and
 - entry into formal employment agreements.



Drawdown on Investment

- Varies - single or multiple drawdowns.



Maturity Feature

- Negotiable. Investors typically seek a 1-year maturity date from the date of the loan.



Early Repayment of Investment Amount

- Varies.
- The company may or may not be able to prepay the investment amount.



Warranties

- Varies.
- Company warranties may be included e.g., that the company is not aware of litigation.



Transfer

- Varies.
- Founders should request for a restriction on the assignment of the CLN.

KEEP IT SIMPLE SECURITIES ("KISS")



Conditions to Investment

- Typically not found.
- However, some KISS variations include conditions similar to those in CLNs, or state that X amount of KISS must be raised in that series for the KISS to be valid.



Drawdown on Investment

- Silent - KISS variations contemplate single or multiple drawdowns.



Maturity Feature

- Typically 18 months.



Early Repayment of Investment Amount

- Silent.



Warranties

- Fundamental warranties and additional warranty on intellectual property included.
- Investors represent and warrant that they have the relevant investment experience.



Transfer

- Expressly permitted.
- Founders should ask for a carve-out and limit the group of potential transferees (which could include competitors).

CONVERTIBLE AGREEMENT REGARDING EQUITY ("CARE")



Conditions to Investment

- Typically not found.



Drawdown on Investment

- Contemplates a single drawdown.



Maturity Feature

- Contains a 'maturity' feature - parties are free to specify the specific timeline.



Early Repayment of Investment Amount

- Silent.



Warranties

- Fundamental warranties included.
- Additional warranty that the consideration will be used in accordance with the business plan or budget included.



Transfer

- Can be transferred or assigned without the company's consent to the investor group.

Overview of Convertible Instruments

Part III: The Conversion

CONVERTIBLE LOAN NOTE ("CLN")



Trigger Event for Conversion

- Varies.
- In simple terms, an equity financing event is a fundraiser or 'round'.
- If an equity financing event occurs, the investor either has to, or has the option to, subscribe for shares. Equity financing event can be further differentiated into a qualifying equity financing event and a non-qualifying equity financing event.



Liquidity/Exit Event

- If an exit event occurs, the investor can opt to convert the loan into shares or request for the repayment of the investment amount.



Optional Conversion

- The investor may opt to convert the shares after a certain long-stop date even if any of the trigger events have not yet occurred.



Class of Conversion Shares

- Varies.
- Some documents state that the investment amount will be converted to the 'highest' class of shares – though you should query what this actually means.

KEEP IT SIMPLE SECURITIES ("KISS")



Trigger Event for Conversion

- Upon the closing of the next equity financing event, KISS will be converted into conversion shares calculated by dividing the purchase price by the conversion price.



Liquidity/Exit Event

- If an exit event occurs, the investor can opt to convert the loan into shares or be repaid the investment amount.



Optional Conversion

- The 'majority in interests' may at any time on or after the maturity date opt to convert the shares.



Class of Conversion Shares

- Conversion shares are issued on the same terms and conditions as those sold in the next equity financing round.

CONVERTIBLE AGREEMENT REGARDING EQUITY ("CARE")



Trigger Event for Conversion

- If the company surpasses the minimum equity raise amount, the loan automatically converts into preference shares at a discounted price.



Liquidity/Exit Event

- If an exit event occurs, the investor will automatically be entitled to receive the event proceeds equal to the greater of:
 - (a) the consideration multiplied by the multiple; or
 - (b) the amount payable on the ordinary shares equal to the consideration divided by the liquidity price.



Optional Conversion

- The investor may at any time on or after the maturity date opt to convert the shares.



Class of Conversion Shares

- Conversion shares issued are preference shares with the same terms as the standard preference shares issued in connection with the closing of the equity financing round, other than:
 - (a) the per share liquidation preference and conversion price for price-based anti-dilution protection which will equal the discount price (?); and
 - (b) the basis for any dividend rights, which will be based on the discount price (?).

Overview of Convertible Instruments

Part IV: Additional Company Obligations

CONVERTIBLE LOAN NOTE ("CLN")



Most Favoured Nation Clause

- Varies.



Company Undertakings

- Varies.
- Certain agreements state that the company cannot engage in a series of corporate actions whilst the investment amount is outstanding, for example:
 - (a) creation of ESOP;
 - (b) issuance of new classes of shares; and
 - (c) acquisition of new businesses.

KEEP IT SIMPLE SECURITIES ("KISS")



Most Favoured Nation Clause

- If the company issues any convertible instruments, the company has to provide the investor with information on the price and terms.
- If the investor determines that the subsequent investment is more favourable, the investor may elect to exchange the KISS for a subsequent instrument.
- Subsequent variations of the KISS either make this clause optional or omit it.



Company Undertakings

- Silent.

CONVERTIBLE AGREEMENT REGARDING EQUITY ("CARE")



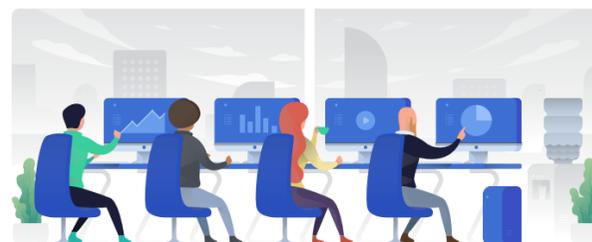
Most Favoured Nation Clause

- If the company issues any other CARE, the company has to provide the investor with a copy.
- If the investor determines that the terms of the other CARE is more preferable, the company has to amend the terms of the CARE to be identical to the subsequent CARE.



Company Undertakings

- Some company undertakings - relating to the shares allotted and the utilisation of the investment - are included.



Overview of Convertible Instruments

Part V: Investor Rights

CONVERTIBLE LOAN NOTE ("CLN")



Board Rights

- Varies.
- Certain investors have observer rights whilst the investment amount is outstanding.



Information Rights

- Varies.
- Certain investors have information rights e.g., access to balance sheets, financial statements and budgets on a quarterly basis.



Participation Rights

- Varies.
- Certain CLNs state that if the company issues further securities, the investor should have the right to participate in the subsequent equity financing round.

KEEP IT SIMPLE SECURITIES ("KISS")



Board Rights

- Silent.



Information Rights

- Granted for major investors e.g., those who invested more than the major investor threshold.



Participation Rights

- Only for major investors.

CONVERTIBLE AGREEMENT REGARDING EQUITY ("CARE")



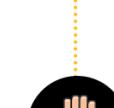
Board Rights

- Silent.



Information Rights

- Company provides investors with information rights relating to the business and the company as requested form time to time.



Participation Rights

- Silent.



Overview of Convertible Instruments

Part VI: Restrictions on Founders

CONVERTIBLE LOAN NOTE ("CLN")

Restrictions on Founders

- Varies.
- Restriction on transfer of founder shares and founder clawback provisions sometimes incorporated. These are not encouraged.

Founder Undertakings

- Varies.
- Certain CLNs include robust founder undertakings. These are not encouraged as founders should be provided with flexibility to operate.

Events of Default

- Varies.
- Certain CLNs include robust events of default. Each event of default should be scrutinised closely.

Dividend

- Varies, but typically silent.

KEEP IT SIMPLE SECURITIES ("KISS")

Restrictions on Founders

- Typically silent.

Founder Undertakings

- Typically silent.

Events of Default

- Typically silent.

Dividend

- Typically silent.

CONVERTIBLE AGREEMENT REGARDING EQUITY ("CARE")

Restrictions on Founders

- Typically silent.

Founder Undertakings

- Typically silent.

Events of Default

- Typically silent.

Dividend

- Dividend payable in certain circumstances i.e., outstanding ordinary shares that are not payable in ordinary shares.