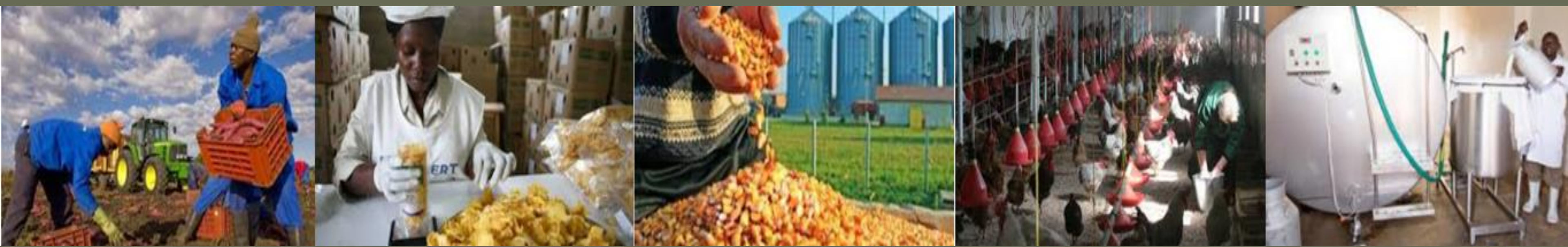

AGRI-PITCH COMPETITION: NEGOTIATIONS AND CLOSING INVESTMENT/FINANCING DEALS (TERMS SHEET)

AFRICA BUSINESS GROUP

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Presented by the Africa Business Group team

Global African Agribusiness Accelerator Platform (www.gaaap.biz)

AGENDA

Investment Process

Term Sheet
- Binding Provisions
- Basic Provisions
- Additional Provisions

Closing Remarks

INVESTMENT PROCESS

Preparation	First meeting	Advanced discussions	Due diligence	Closure	Post closure
Business plan Financials Legal Investor proposition Valuation and price Pitch deck.	Pitch Initial discussions.	Expression of interest Follow on discussions Share info (Bus. Plan, Financial model, etc.) Site visits Management presentation Negotiate valuations and terms of the transaction.	Financial DD Legal DD Commercial DD Management DD.	Sign definitive agreements (Eg.): - Shareholders agreement / Loan agreement - Subscription agreement - IP assignment agreement - Employee contracts.	Post closure formalities. Pay away.

NDA

Term Sheet

Transaction documents

TERM SHEET

When an investor decides to invest in your company, they will generally provide you with a **term sheet** (aka- LOI, MOU) which sets out the basic terms under which an investment will be made. Typically the terms will include such subjects as investment valuation, vesting, board/control, employee stock ownership plan, liquidity preferences, anti-dilution, dividends and legal documents. The **term sheet** forms the basis of the definitive agreements (i.e. road map). It’s non-binding.

BINDING PROVISIONS

Confidentiality	The term sheet has this clause wherein the sensitive information about the target company is protected from being shared by the Investor to third parties.
"No-Shop" Provision	This term sheet clause is to protect the Investor. In this clause, the target company is prohibited from searching for any other financing with any third party for a specific time. This provision helps Investors to save their time as well as their money by not getting involved in due diligence or negotiations with target companies who are already talking to other potential investors. Usually 30 – 60 days.

BASIS PROVISIONS

Type of Security Offered	The most important & essential provision of the term sheet is the **type of security offered** – equity, preference shares, warrants, etc and the price per share of that security. This is the initial deal term which is determined between the Investor & Target Company.
Capitalization & Valuation	The next part under the basic term sheet provision is **Capitalization & Valuation**. This clause decides the price per share for the Target Company. As preferred stocks have more attractive terms so they are preferred over equity by the Private equity investors. When an Investor makes an investment it shall analyze its investment based on "as a converted basis". As the name applies, "As-converted" is the number of shares that are outstanding plus the number of shares that would be outstanding when warrants and options of the target company are exercised and convertible securities are converted by the holders.
Pre-Money & Post Money Valuation	This term sheet clause also provides the information on **pre-money & post-money valuations** of the company. Pre-money valuation is the valuation which is based on the number of shares outstanding before the financing is done. Whereas, post-money valuation is based on the number of shares that will be outstanding post financing.
Dividend Rights	After capitalization, Term sheet would have a clause about the **Dividend rights** under basic provisions. It deals with the dividends to be paid. Dividends are paid either on a cumulative basis or noncumulative basis. Since Target companies are either start-ups or mid-level companies so they hardly give any dividends. Investors prefer cumulative dividends so the dividends keep accumulating and will be accounted for when preferred stocks are converted into common stock. This provision is important as it decides how much of common stock will go to preferred stockholders in the event of liquidation.

BASIC PROVISIONS

Liquidation Preference	Post Dividends, term sheet has the provision on **Liquidation preferences**. Preferred stockholders receive preference over common stock in case of liquidation. Generally, liquidation preferences would be equal to the amount invested. However, at times, it would be a multiple of the amount invested. This multiple can be in the range of 3 to 5 times of the amount invested. The target company should carefully understand the liquidation provisions before making the deal with Investor. This is so as a low valued company then on liquidation the common stockholders would get minuscule proceeds.
Conversion Rights	**Conversion rights** would be the next basic provision covered in the Term Sheet. This term sheet provision gives the investor the right to convert to common stock. This right is rarely utilized by investors in normal conditions as preferred stock have more value than the common stock at the time of liquidation. Investors convert their preferred stock into common stock prior to sale, merger or IPO of Target Company. Generally, when the company plans for an IPO, preferred stocks are automatically converted to common stock as underwriters do not prefer taking multiple classes of stock to the public.

BASIC PROVISIONS

Anti-Dilution Provisions	After conversion rights term sheet provides a clause for **Anti-Dilution** under the basic provision. This clause is inserted in the term sheet as a protection measure. The clause protects the Investor in the future if the company sells additional shares for subsequent financing at a price that is below the per-share price paid by investors. These provisions are such that if the subsequent financing happens at a lower price then conversion price of all shares that are purchased at a higher price is adjusted downward. This is done in such a way that percentage ownership of investors is maintained. This results in previous investors getting more shares and dilution of ownership of other holders who do not have price protection.
Board of Directors	Under basic provisions term sheet also have a clause on the **Board of Directors**. This clause deals with the number of directors that would be in the Board, from the investor side. Generally, a clause is added wherein if the required milestones are not achieved in stipulated time or if any pre-defined negative event occurs then the investor shall have the majority of directors in the Board. Target company and its founder should carefully study the structure of the board as will have to deal with the board when making any major corporate decisions. Many times a board representative from the investor group is more of a positive than negative. This is so as it can give a brilliant direction, particularly if the group has industry-specific experience. Term sheet would also have a provision on Information rights. Investors would require companies to provide “information rights”. These are ideally information related to financial statements, strategic plans, forecasts of the target company.

BASIC PROVISIONS

Redemption Clause	Sometimes basic term sheet provision also contains **Redemption clause**. This clause provides the Investor with liquidity. The provision is that the company is required to buy back the shares when it has the financial resources to do so. Redemption will generally only be considered when the company has become profitable but there are no opportunities for liquidity through a sale, IPO or recapitalization.
Transfer Restrictions	**Transfer restrictions** are restrictions placed on transferability. These term sheet restrictions are placed to ensure that shares are not sold to a party which the company does not want as their shareholders.
Pre-emptive Rights	**Pre-emptive rights** are those rights which give the shareholders a right to purchase new securities if any issued by the company. This term sheet provision is included in the term sheet so that investors can retain their relative percentage of total outstanding shares.
Rights of the First Refusal	**Rights of first refusal** are those rights wherein it is compulsory for the founders of the target company & the other shareholders to offer their shares first either to the company or to preferred shareholders. They can go to the third party only after refusal from the company or preferred shareholders.
Tag Along & Drag Along	If the sale to the third party goes to advanced stages of negotiation then **Tag along** rights give the Investor right to sell their shares too on a pro-rata basis. Under **Drag-along** rights, investors who have a specified percentage of shares (generally majority) and who have identified a third party as a buyer are required to include other shareholders to participate. In this scenario, minority shareholders are forced to participate. This term sheet provision helps in the sale of the company if favorable terms exist even if other shareholders do not favor the sale

ADDITIONAL PROVISIONS

Earnout Provision	Additionally, the term sheet has **Earnout provision** wherein founders & other shareholder receive additional payments based on the future performance of the businesses sold. So if they are able to reach a specified target, goal, specified earnings multiple or certain level of profitability then they qualify for earnout. Earnout provisions are quite common in LBO & recapitalization transactions. The inclusion of such term sheet provision reflects a reasonable expectation from an investor that the company is able to reach a point where it has made itself financially attractive. Obviously, the risk of proving so under this provision lies with the management of the target company. Therefore, as a target company earnout provisions should meticulously be studied and carefully negotiated with the Investor. One of the provisions in earnout is that the management shall be entitled to same only when they remain with the company for a specific time period, else they are forfeited. So the target company should accept the provision only if it plans to be with the company until the specified time. However, it’s not easier for the management as it is highly probable that differences may arrive between founders & the team brought in by the Investor investor or when the investor becomes too interfering in day-to-day affairs of the target company’s business. Additional term sheet provisions would include miscellaneous details such as fees to pay to Investor’s accountant, lawyers, experts carrying out the due diligence process, etc.

ADDITIONAL PROVISIONS

Conditions Precedent	**Conditions precedent** that is included in the term sheet would include information on what has to happen between the time from when the term sheet is signed and till the completion of the investment. This term sheet provision would include: ▪ Satisfactory completion of the due diligence process and ▪ Completion of the various legal agreements as required. This would include an agreement with the shareholders, and documentation of the warranties and indemnities. ▪ Sometimes condition precedent may specify that the target company should do certain specific things during that time period. This would include getting a contract with a specific customer (about whom you had mentioned to the Investor at the time of negotiation) or roping in a specific personality as Brand representative.

CLOSING REMARKS

Generate scarcity and interest:

- Best terms will come from competition
- Try to land multiple term sheets in a short window to increase your leverage and options.

Choose your investors wisely:

- Like a marriage with kids involved, you will be with them for a long time
- All money is not created equal –do reference checks on your investors with others they have funded

Choose your fights wisely:

- Make sure you know what really matters to you, and understand the market dynamics.
- Don't be afraid to ask "why do you need that?"

Choose your legal advisors wisely.

Things can get complicated. Hire a lawyer with experience. And do it early (before negotiating the term sheet!)

CLOSING

THANK YOU! MERCI! OBRIGADO

LOOKING FORWARD TO YOUR COMMENTS AND QUESTIONS?

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