

KEY TERMS IN AGREEMENTS WITH PRIVATE EQUITY INVESTORS

**7th International Venture Capital Forum
Athens, 28 June 2006**

AGENDA

Where are these terms usually documented?

Which are the most common terms included (and why)?

Which are the issues that require special attention?

THE TERMS OF THE AGREEMENT APPEAR ON VARIOUS DOCUMENTS BOTH PRIOR TO AND FOLLOWING THE INVESTMENT

Before the investment

- **Term sheet, Letter of intent, Memorandum of understanding, Heads of agreement**

After the investment

- **Articles of incorporation, Shareholders agreement. Share purchase agreement**

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THE TERMS OF AGREEMENT OUTLINE THE PARTNERSHIP BETWEEN THE ENTREPRENEUR & THE INVESTORS

- 1. Board of Directors**
- 2. Veto rights**
- 3. Ratchet**
- 4. Right of first refusal**
- 5. Put και call options**
- 6. Tag along, drag along, priority selling rights**
- 7. Sale of the entity at a price lower than initial valuation (Bad Sale)**
- 8. Other terms**

BOARD OF DIRECTORS

- **How many Directors is it consisted of?**
- **How many Directors are appointed by the Investors?**
- **How does the number of Investors' appointees fluctuate according to the level of their participation in the share capital?**
- **How many votes is every Director (including the President) entitled to?**
- **Voting Majority**
- **Number of members required for decision making**

VETO RIGHTS

- **Loans**
- **Investments**
- **Guarantees**
- **Corporate mission, operations, geographical presence**
- **Mergers & Acquisitions**
- **IPO**
- **Dividend policy**
- **Management remuneration package**
- **Annual Business Plan & Budget**
- **Corporate Headquarters**
- **Stock options of existing shareholders**

RATCHET

- **It enforces the transfer of shares from:**
 - **The investor to the entrepreneur (upside)**
 - **The entrepreneur to the Investor (downside)**
- **Conditional enforcement upon the achievement (or not) of predetermined targets**
 - **Revenues**
 - **EBITDA**
 - **Net asset value**
- **Applied separately or jointly**
- **The degree of achievement of the predetermined targets is usually certified by Certified Auditors**
- **Restrictions**
 - **Time**
 - **Maximum share to be transferred**

RIGHT OF FIRST REFUSAL

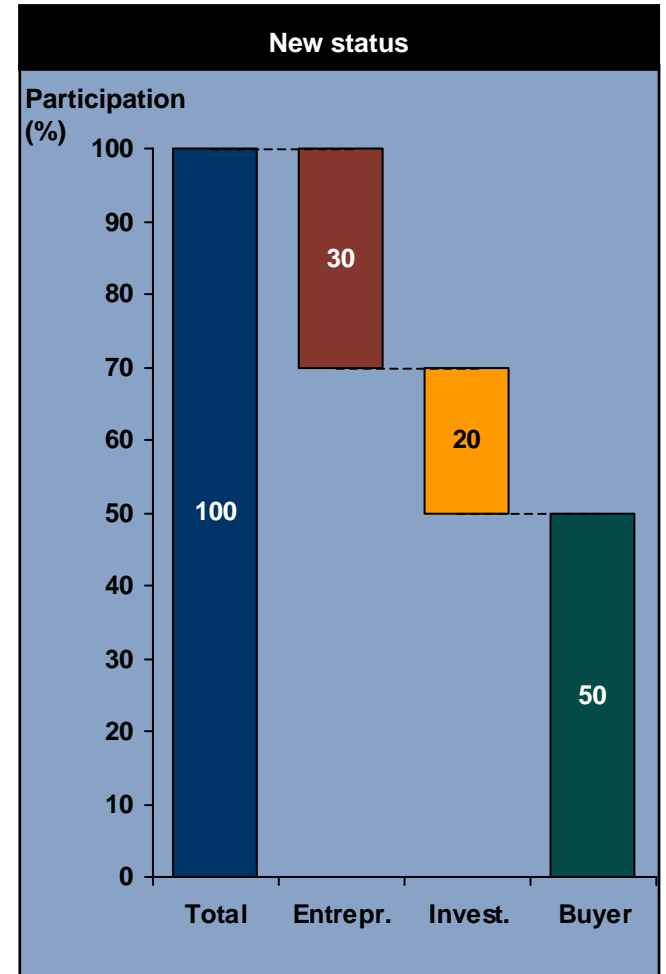
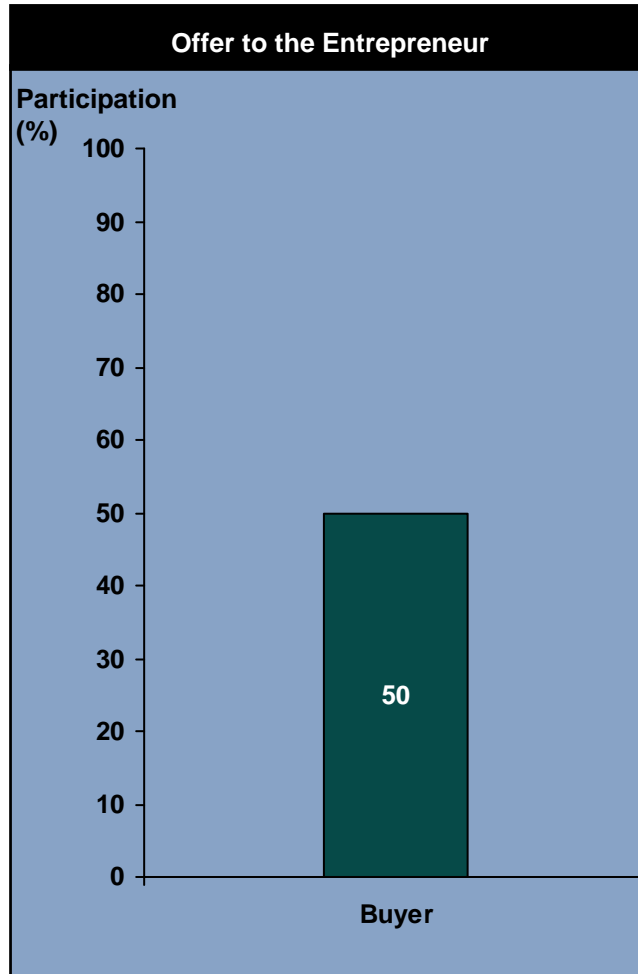
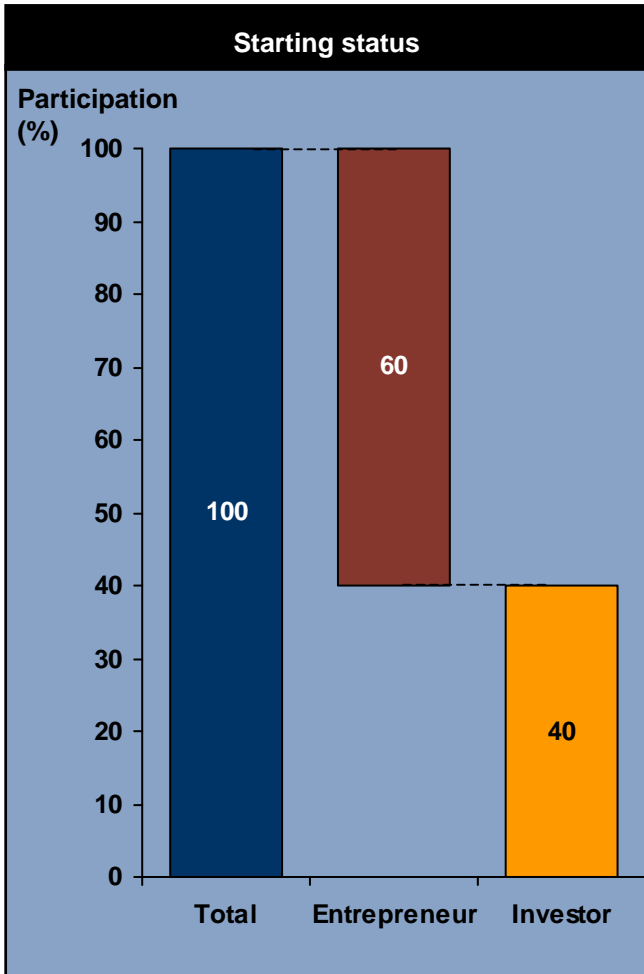
- **Two-stage process**
 - **If the entrepreneur receives an offer (by a third party) to sell either all or part of the controlled share capital, he needs to notify accordingly the investor by providing the terms and preferred timeline**
 - **The Investor may express his intention to buy the offered shares by paying the targeted price under the expressed terms and timeline**
- **This right is entitled to the entrepreneur, as well**
- **In case of refusal, the transaction with the third party can be concluded**
- **Venture capital firms can include affiliated companies or funds in the scheme**

PUT/CALL OPTIONS

- **Put option: It provides a party (usually the Investor) with the right to sell:**
 - **A specific share in the Shareholders' Capital of a company**
 - **At a predetermined time**
 - **At a predetermined price**
 - **The counterparty is obliged to buy**
- **Call option: It allows a party (usually the Investor) the right to buy**
 - **The counterparty is obliged to sell**
- **Put options reduce the downside risk and enhance the exit strategy of the Investors**
- **Call options allow the Investors to increase their participation in the venture (upside)**

TAG ALONG

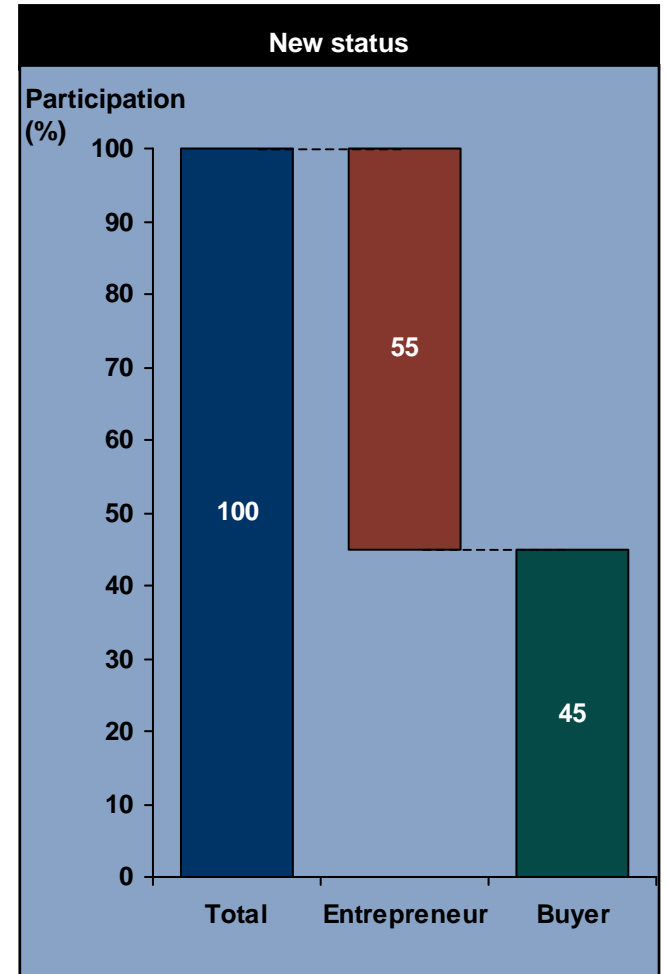
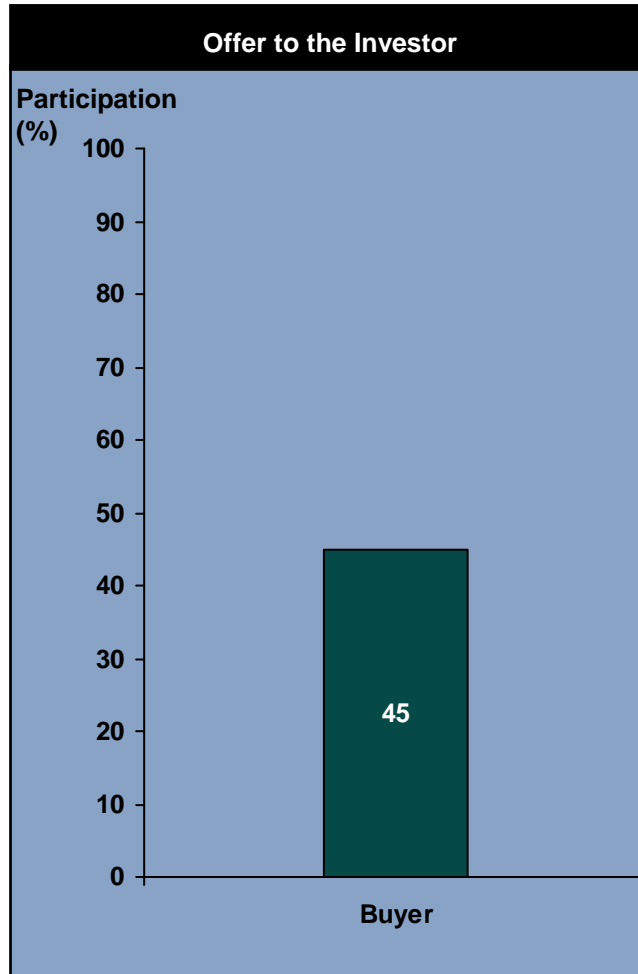
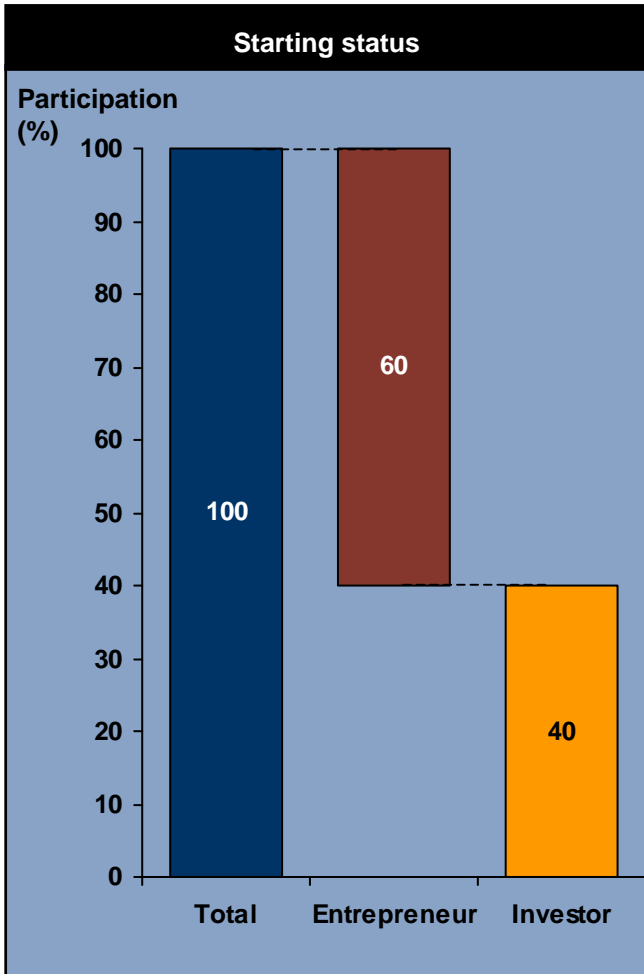
The Right of an Investor to Participate in an Offer Addressed to the Entrepreneur



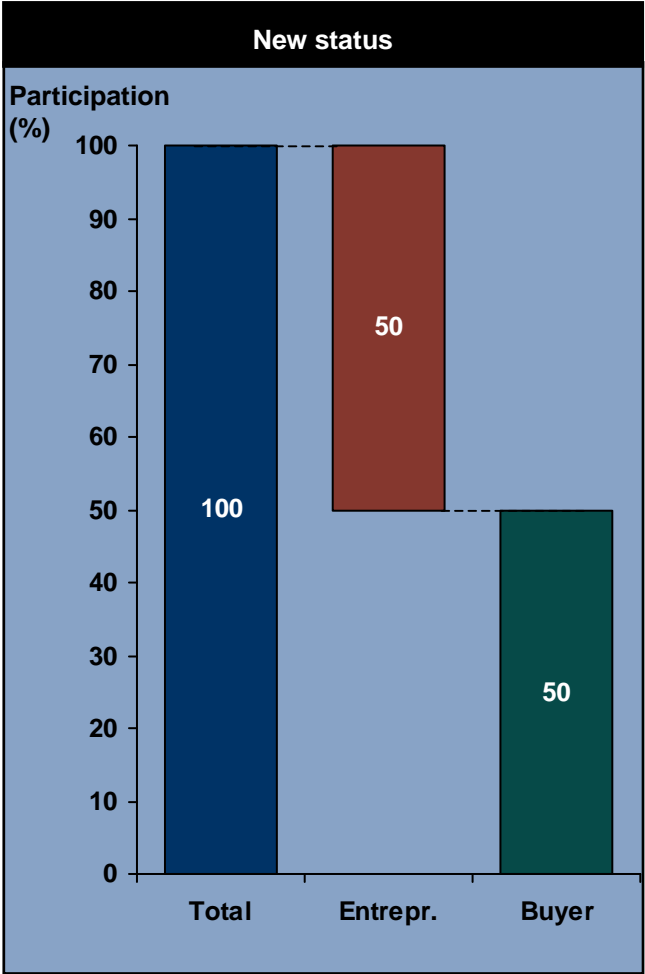
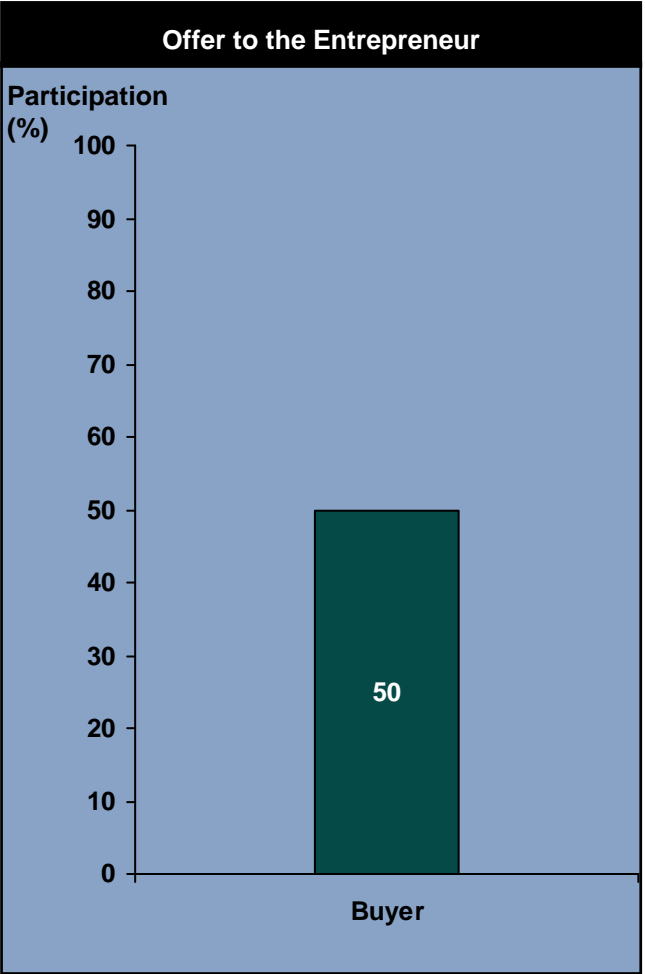
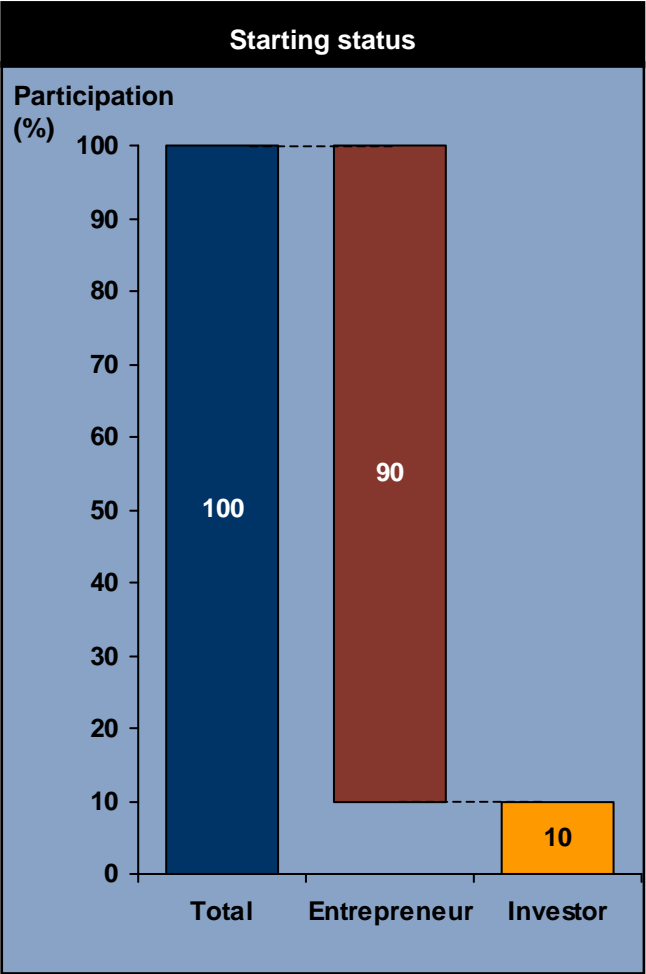
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DRAG ALONG

Obligation of an Entrepreneur to Participate in an Offer Addressed to the Investor

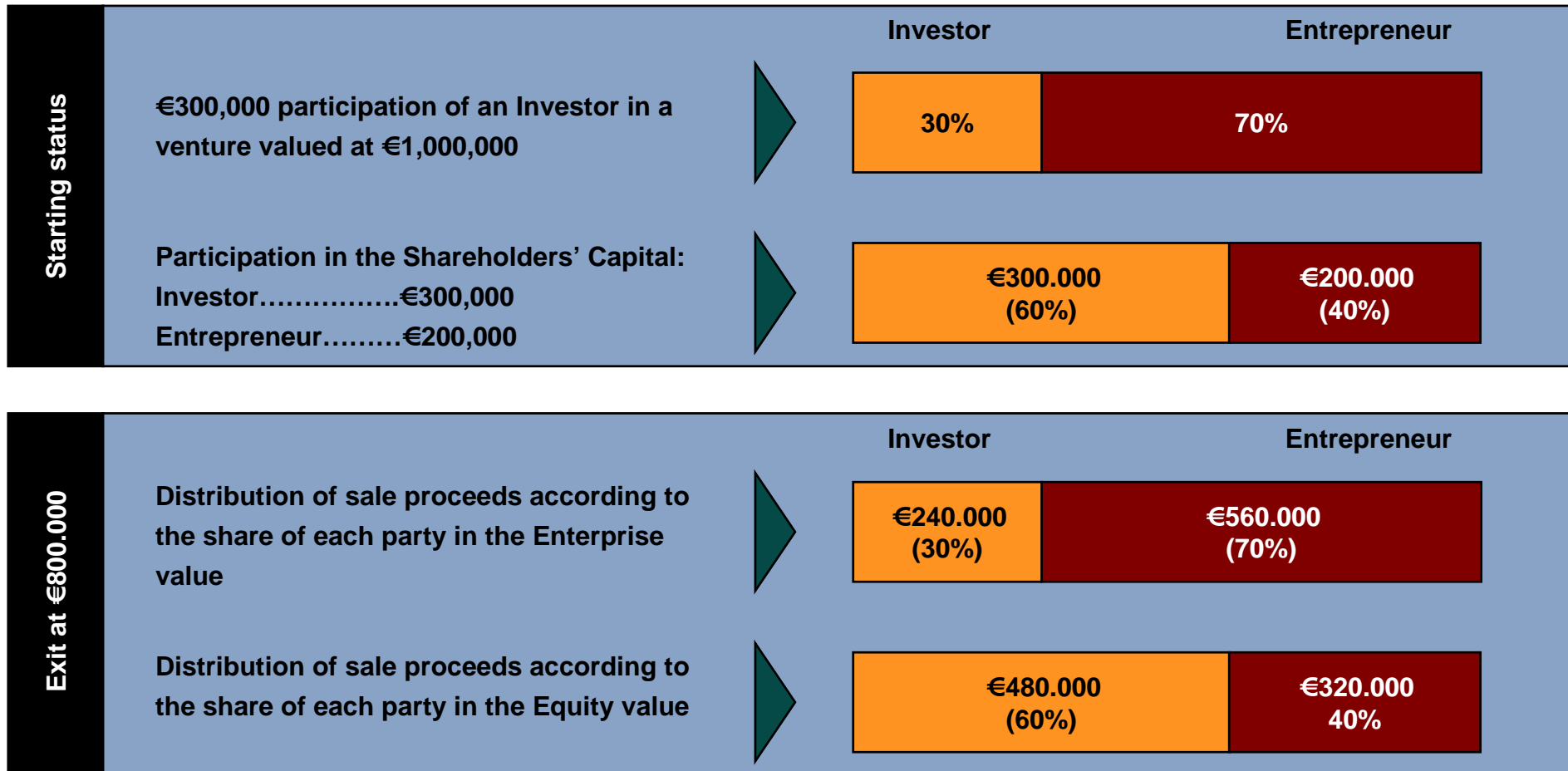


PRIORITY SELLING RIGHTS



BAD SALE

Distribution of Proceeds in the Event of a Sale Below Initial Valuation



OTHER TERMS

- **Transferability**
 - In the event of sale
- **Competitive restrictions**
 - Entrepreneurs are not allowed to participate in competing entities
 - Even after resignation/sale of their equity stakes
- **Management Team**
 - Participation in the company's management for certain time period
 - Indemnities in the event of breach of contract
- **Intellectual Property**
 - Transfer from the entrepreneur to the Company
- **Other terms**
 - e.g. liabilities from other activities of the entrepreneur

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THE ENTREPRENEUR'S MAJOR CONCERNS

- **Loss of management control**
- **Dilution of personal stock**
- **Buy-back of shares in case of termination of employment, resignation or retirement**
- **Satisfactory level of financing**
- **Encumbered assets (offered as collateral)**
- **Future capital expenditure and possible dilution**
- **Advantages stemming from the participation of a venture capital**
 - **Business Network**
 - **Management counseling**
 - **Later-stage financing**

THE INVESTOR'S MAJOR CONCERNS

- **Current & future valuation of the venture**
- **Risk embedded in the investment**
- **Investment criteria and objectives of the fund**
- **Investment rate of return**
- **Contingency plan in the event of unfavourable developments (downside protection)**
 - **Exit strategy**
- **Option to participate in later-stage financing (upside protection)**
- **Influence and control in strategy formulation & decision making**
- **Right of first refusal in subsequent rounds of financing**

THE MAIN CONCERNS OF THE TEAM

- **Retention of the main members of management team and enrichment with new talent**
- **Resolution of possible conflicts of interest in the case of a syndicate of venture capitalists**
- **Financial performance after the financing**
- **Tax complications due to financing**