



Early Financings **New Ventures Competition**

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About Fasken Martineau DuMoulin LLP

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Overview

The initial corporate matters you need to consider in building your technology company:

- ② Initial Corporate Structuring Issues.
- ② Allocating Founders Shares.
- ② Preparing a Financing Plan.
- ② Sourcing Seed Capital.
- ② Allocating Stock Options.
- ② Financing a New Venture.



Initial Corporate Structuring

Incorporation – U.S. v. Canada v. Offshore; Canada because:

- ⑥ Financing Issues - Investors don't like offshore companies.
- ⑥ Government grants – In most cases, only available to Canadian companies.
- ⑥ Taxation and Employment issues - Are simpler if you are building the company here.

B.C. (BCBCA) v. Federal (CBCA):

- ⑥ Either BC Business Corporations Act (BCBCA) or Canada Business Corporations Act (CBCA) are fine and both are investor friendly.



Initial Corporate Structuring – cont'd

Create a structure with:

- ⦿ Unlimited number of common shares.
- ⦿ Unlimited number of “blank-cheque” preferred shares.

Financiers dictate financing terms:

- ⦿ Debt vs. equity, price, preferences, terms of SHAG, etc.

If you can, avoid:

- ⦿ Issuing secured debt.
- ⦿ Using shareholders' loans.
- ⦿ Using multiple share classes.
- ⦿ Incorporating offshore.



Founders' Shares

What are Founders' Shares?:

- ⦿ Large block of shares issued at a low price to position the Founders.
- ⦿ To recognize their “sweat equity” contribution.

What class of shares should they be?:

- ⦿ Common shares.
- ⦿ Preferred shares for sophisticated investors.

At what price should they be issued?:

- ⦿ Nominal - \$0.0001 to \$0.01 per share.



Founders' Shares – cont'd

To whom should they be issued?

- ⦿ Founders and senior officers.
- ⦿ Not to employees or outside investors.

Common mistakes in allocating Founders' shares:

- ⦿ Not setting aside enough Founders' shares at time of incorporation: 4.0M – 8.0M.
- ⦿ Not setting aside some Founders' shares for future additions to the management team: set aside 15% - 25%.
- ⦿ Not vesting the Founders' shares: 2 - 4 years, or providing for “reverse-vesting”.
- ⦿ Issuing them to the wrong people.



Preparing a Financing Plan

Determine a “Road-Map” for financing:

The company determines its developmental “milestones”:

- ⦿ What they are.
- ⦿ By when they will be met.
- ⦿ How much funding is needed to meet them.

The milestones are integrated with the budget and a timeline to determine how many tranches of financing will be needed and when.

This info is used to prepare a sample capital structure table - a “road map” for the financing trail (e.g. – to raise \$5.0M).



Sources of Financing – Debt/Grants

Non-equity financing might come from:

- ⑥ **Government grants/credits/refunds:**
 - ⑥ VCC Program.
 - ⑥ NRC, IRAP, TPC, SRED.
 - ⑥ Telefilm Canada and other industry specific organizations.
 - ⑥ Environmental/“green” grants.
- ⑥ **Quasi-governmental organizations like:**
 - ⑥ BC Innovation Council, Business Development Bank of Canada etc.



Sources of Financing - Equity

Initial (equity) seed financing may come from:

- ⦿ The “Founders”.
- ⦿ Their “Friends and Family”.

Follow on rounds (pre-public) from:

- ⦿ Angels.
- ⦿ Venture Capitalists.
- ⦿ Investment bankers (both private and institutional).
- ⦿ Underwriters (i.e. brokers).
- ⦿ **Public financing - Initial Public Offering.**
- ⦿ **Strategic Partners.**



Sources of Equity Financing – Revisited

⦿ Categories of Financiers:

⦿ Founders:	Variable
⦿ Friends and Family:	\$50K – \$150K
⦿ Angels:	\$250K - \$500K
⦿ Venture Capitalists:	\$1.0M - \$3.0M
⦿ Underwriters:	\$1.0M - \$5.0M
⦿ Strategic Partners:	Variable

⦿ Match potential investors with your Financing Plan to maximize chance to secure investment.



Securities Legislation

Requirement:

- ⦿ If you distribute a security, you must:
 - ⦿ file a prospectus
- OR
- ⦿ Rely on exemption from prospectus requirement



Exemptions

- ② Family, Friends and Business Associates
- ② Accredited Investor
- ② Private Issuer
- ② Offering Memorandum



Family, Friends & Business Associates Exemption

Can sell securities in any amount without any disclosure to:

- ④ Director, senior officer or control person
- ④ Family member of a director, senior officer or control person



Family, Friends & Business Associates Exemption (cont'd)

- ④ Close personal friend or close business associate of a director, senior officer or control person
- ④ No limit on number of purchasers or amount that can be raised



“close personal friend” or “close business associate”

- ④ Has known the director, senior officer or control person for a “sufficient period of time”
- ④ Is in a position to assess the capabilities and trustworthiness of the director, senior officer or control person



Accredited Investor Exemption

- ⑥ “accredited investors” can purchase any securities in any amount at any time
- ⑥ No limit on number of purchasers or amount that can be raised
- ⑥ Either public or private companies, partnerships, etc.



“accredited investor”

- ⑥ Corporation, limited partnership, trust or estate with net assets of \$5 million
- ⑥ Individual with cash and financial assets over \$1 million
- ⑥ Individual whose net income exceeds \$200,000 (\$300,000 with spouse) in each of the past 2 years



“financial assets”

- ④ Meaning of financial assets
- ④ Does **not** include real property



Private Issuer Exemption

Can sell securities in any amount without any disclosure to:

- ④ Director, officer, employee or control person
- ④ Family member of a director, senior officer or control person



Private Issuer Exemption (cont'd)

- ④ Close personal friend or close business associate of a director, senior officer or control person
- ④ Current holder of designated securities
- ④ Accredited investor
- ④ Person or company that is not the public



“private issuer”

- ④ Not a reporting issuer
- ④ Common shares are subject to restrictions on transfer
- ④ Fewer than 50 shareholders
- ④ Has only distributed its common shares to persons listed in exemption



Offering Memorandum Exemption

Issuer can sell securities to anyone in B.C. in any amount if Issuer:

- ④ Delivers an offering memorandum in the prescribed form
- ④ Obtains a signed Risk Acknowledgement from the purchaser



Risk Acknowledgement

- ④ Clear, blunt statement of risks of investing in exempt market securities
- ④ Issuer must give a copy of the signed Risk Acknowledgement to purchaser prior to making investment



Liability for Misrepresentation

If the offering memorandum contains a misrepresentation, the purchaser has:

- ⦿ A right of action for rescission
- ⦿ A right of action for damages



Other Exemptions

- ④ Employees
- ④ Permitted consultants



Capitalization Table

Founders' Round

	No. of Shares	Price	Funds Raised
Founders (3)	6,000,000	\$0.0001	\$600
Type of Investor (?)	?	?	?
Type of Investor (?)	?	?	?
Type of Investor (?)	?	?	?
Type of Investor (?)	?	?	?
Total:	<u>6,000,000</u>		<u>\$ 600</u>



Capitalization Table

Friends & Family Round

	No. of Shares	Price	Funds Raised
Founders	6,000,000	\$0.0001	\$600
Family and Friends	400,000	0.25	100,000
Type of Investor (?)	?	?	?
Type of Investor (?)	?	?	?
Type of Investor (?)	?	?	?
Total:	6,400,000		\$100,600



Stock Options

What are stock options?:

- ⑥ The right to purchase a number of shares at a predetermined price.
- ⑥ Used to incent the team building the Company.

How many should be issued?:

- ⑥ 10% - 30% of issued share capital.

At what price should they be issued?:

- ⑥ Last round of financing or higher.



Stock Options – cont'd

Companies must plan for growth and make a notional allocation of their options.

Allocate stock options by category:

- ⦿ Senior Management: 35% - 50%
- ⦿ Remaining Employees: 25% - 35%
- ⦿ Board of Directors: 13% - 20%
- ⦿ Board of Advisors: 2% - 5%
- ⦿ Contingency: 10% - 15%

Companies should:

- ⦿ Integrate Stock Option Plan with their HR Plan.
- ⦿ Vest all options over 2 – 4 years.

Capitalization Table

Stock Option Plan Added

	No. of Shares	Price	Funds Raised
Founders	6,000,000	\$0.0001	\$600
Family and Friends	400,000	0.25	100,000
Type of Investor (?)	?	?	?
Type of Investor (?)	?	?	?
Type of Investor (?)	?	?	?
Total:	6,400,000		\$100,600
Option Plan	1,500,000	n/a	n/a



Capitalization Table

Angel Round

	No. of Shares	Price	Funds Raised
Founders	6,000,000	\$0.0001	\$600
Family and Friends	400,000	0.25	100,000
Angels	1,200,000	0.35	420,000
Type of Investor (?)	?	?	?
Type of Investor (?)	?	?	?
Total:	7,600,000		\$520,600
Option Plan	1,500,000	n/a	n/a



Capitalization Table

Series “A” VC Round

	No. of Shares	Price	Funds Raised
Founders	6,000,000	\$0.0001	\$600
Family and Friends	400,000	0.25	100,000
Angels	1,200,000	0.35	420,000
Venture Capitalists	3,000,000	0.50	1,500,000
Type of Investor (?)	?	?	?
Total:	9,600,000		\$2,020,600
Option Plan	1,500,000	n/a	n/a



Capitalization Table

\$5.0M Raised

	No. of Shares	Price	Funds Raised
Founders	6,000,000	\$0.0001	\$600
Family and Friends	400,000	0.25	100,000
Angels	1,200,000	0.35	420,000
Venture Capitalists	3,000,000	0.50	1,500,000
VC/IPO	3,000,000	1.00	3,000,000
Total:	13,600,000		\$5,020,600
Option Plan	1,500,000	n/a	n/a



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