

Capitalization of the Venture: Founding & Funding

BIO Entrepreneurship Boot Camp
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Why Lawyers Like Start-Ups



regulatory filings (federal and state)

licensing agreements

stock purchase documents; stockholders agreements

employment/consulting agreements;
stock option plans

articles of incorporation; by-laws

Why all the Docs

Memory What did we agree to?

Governance Who gets to decide what

Exit Who gets what (and in what order)

Disputes See “Memory” above

In the Beginning . . .

Formation

why?

In the Beginning . . .



**Value Proposition
for Investors**

The Value Proposition

how good is the story

Entity structure, equity distribution, employee compensation are understandable, appropriate and consistent with typical arrangements

Risks associated with technology development and product acceptance have been identified, and strategies for minimizing them are sensible

Estimates of market size, timeline to market entry; pace of acceptance (and scale of reimbursement) are credible

The Value Proposition

how good is the story

Entity structure, equity distribution, financing terms, employee compensation are understandable, appropriate and consistent with typical arrangements

Risks associated with technology development and product acceptance have been identified, and strategies for minimizing them are sensible

Estimates of market size, timeline to market entry; pace of acceptance (and scale of reimbursement) are credible

The Value Proposition – what matters

Novel

Not
Novel



In the Beginning . . .

Formation

what?

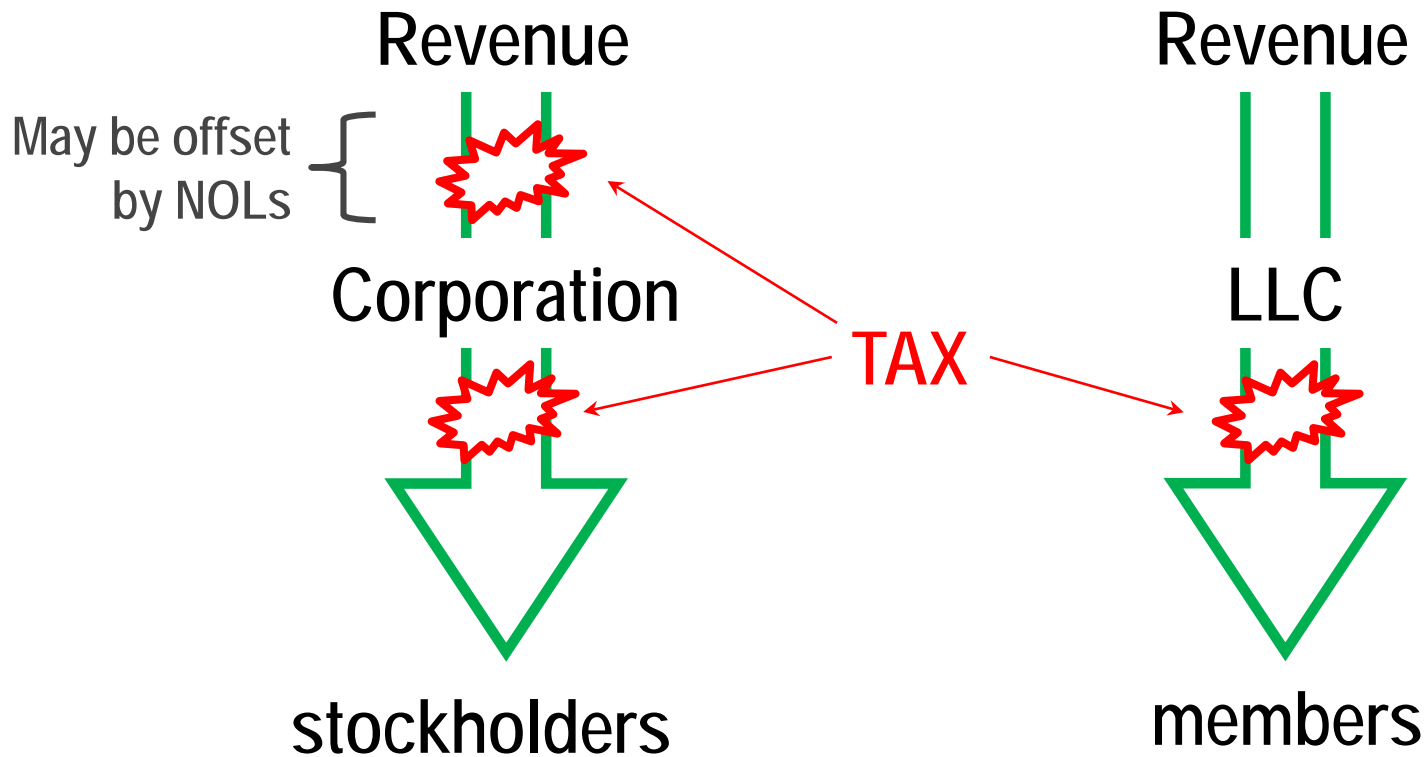
Types of Entities

"C" Corporation (C-COR)	the default choice; well-understood capital & operational structure; M&A/IPO advantages
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Limited Liability Company (LLC)	tax advantages (esp. for partial exits); simplified operational structure (ex. members as employees)
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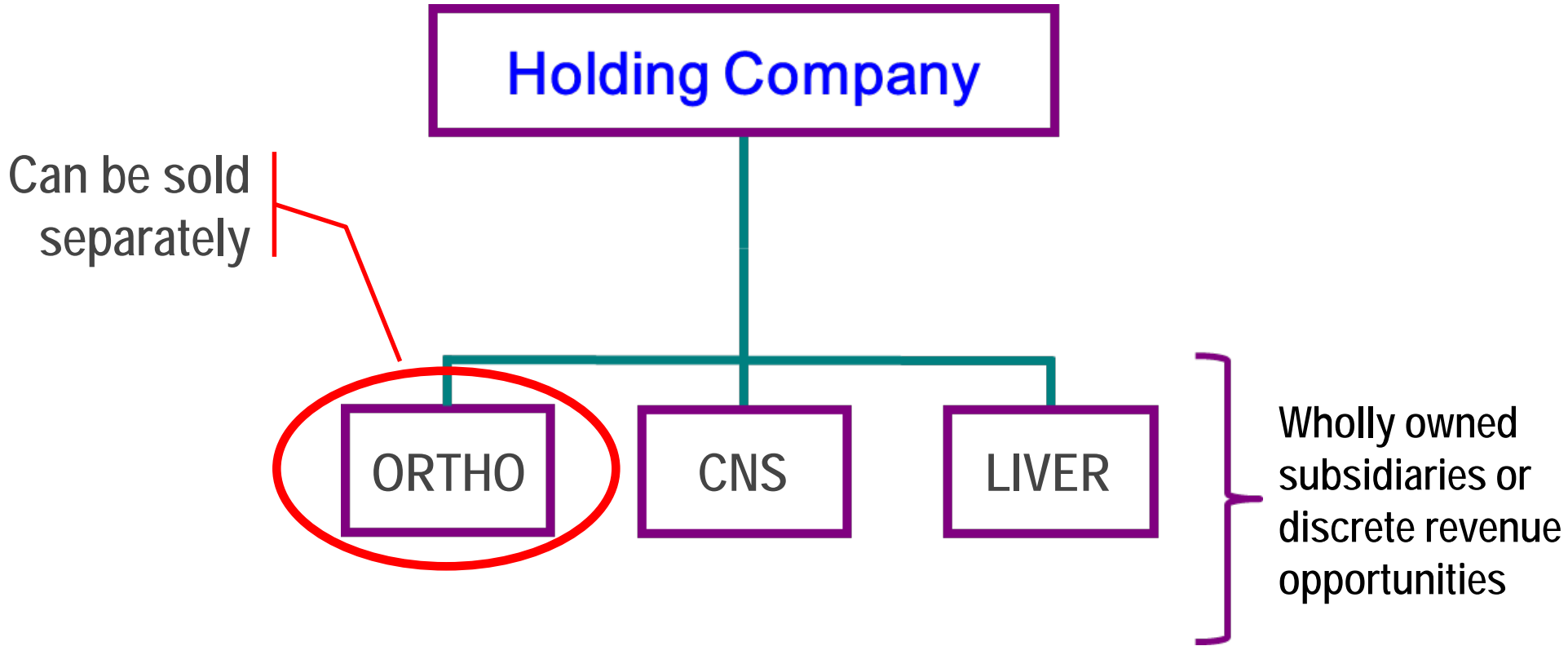
Also, where to incorporate/organize?

Taxation Models



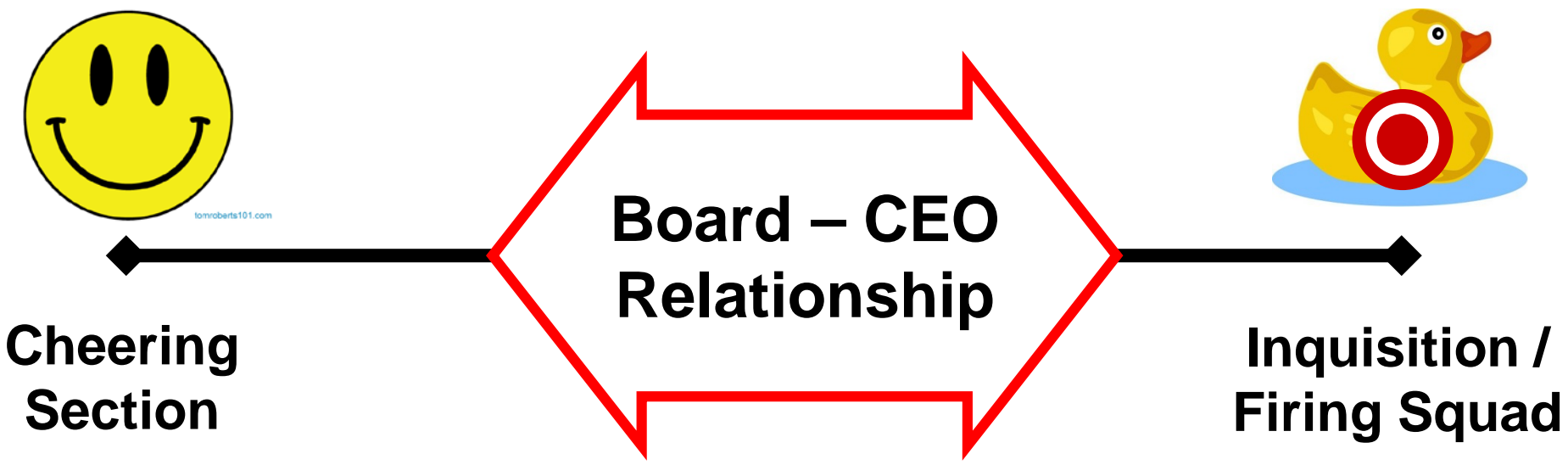
but, cap. gains tax "forgiveness" for "C" corp. stock sale (IRC§1202)

LLC Model for Discrete IP/Product Assets



also, consider IRS perspective on employees as members

Governance (and the Board – CEO relationship)



Influenced by: timely communication (esp. bad news; adherence to Board policies)

The Early Life of the Company

Stage	Goals
Launch	<i>establish governing structure; allocate ownership interests (establish control over IP)</i>
Financing	<i>Money (could also establish key relationships in financing & tech. development)</i>
R&D (&C)	<i>enable/accelerate technology development, market entry</i>

Financing (Documentation)

Document	Purpose
Term Sheet (usu. <i>non-binding</i>)	<i>Preliminary terms of investment: pre-investment valuation; class & rights of stock to be sold; issue price; board representation; closing conditions (due diligence; aggregate investment commitment)</i>
Purchase Agreement, etc.	<i>Definitive investment terms; ancillary agreements; company reps & warranties; pre- & post-closing conditions</i>

Financing (Documentation – equity round)

Document	Purpose
Stockholders Agreement	Rights/Obligations applicable to all Stockholders <i>(i.e., restrictions on transfer of shares; designation of board nominees & election of directors, etc.)</i>
Investor Rights Agreement	Rights/Obligations applicable to Investors <i>(i.e., preemptive purchase rights, protective provisions, registration rights, etc.)</i>
<i>Right of First Refusal & Co-Sale Agreement</i>	<i>allow Company and then stockholders to purchase selling stockholders' shares; require stockholders to sell shares along with selling stockholders</i>
<i>Voting Agreement</i>	<i>require stockholders to vote on certain matters (esp. election of directors, but can require votes on other matters)</i>

Financing (Key Investment Terms – Preferred Stock)

Term	Function	Purpose
Liquidation Preference	Return of initial investment (+ dividends) ahead of general distribution to stockholders	Downside protection (if just 1X) Upside benefit (if > 1X)
Anti-Dilution	Downward adjustment of initial issue price if future round priced lower	Downside protection against over-valuation of the company for the initial investment
Voting Rights	Board representation Protective provisions	Ability to influence (maybe control) future key decisions about the business & exit

Financing (Key Securities Laws)



The Rules:

SEC ("1933 Act") – exemption from registration

State "Blue Sky" requirements – prior registration?

Keep it simple
Keep it accurate

➡ Investor Disclosures – material facts; no material omissions

"Accredited" Investors

private-private vs. public-private offerings (Rule 506(b) vs. 506(c)*)

*(e.g., www.verifyinvestor.com)

Financing (what matters)

What	Why
Valuation	<i>Establishes relative equity interest acquired by new investors (may trigger anti-dilution rights of older investors – a “down round”)</i>
Capitalization	<i>Establishes relative voting rights and liquidation preferences of all stockholders</i>

Financing (Valuation)

"Pre-Money"	\$6,000,000	60%	Represents value attributed to all shares sold or reserved (i.e., options) pre-financing
Investment	\$1,000,000	10%	Principal + interest of conv. notes
	\$3,000,000	30%	New money
"Post-Money"	\$10,000,000	100%	Represents value attributed to all shares sold or reserved (i.e., options) post-financing, at financing issue price

How determined – negotiation; benchmarking

Financing (Therapeutic Valuation Metrics)*

Seed Round - in millions

Pre-Money	Capital Raise	Post-Money
6.5 +/- 2.3	0.9 +/- 0.8	7.4 +/- 3.1

|----- ~15 months -----|

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- Proof of concept with IND candidates
- Selection of clinically relevant animal model(s)

1st Round - in millions

Pre-Money	Capital Raise	Post-Money
9.6 +/- 7	6.9 +/- 7.7	16.5 +/- 14.7

|----- ~19 months -----|

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- Rodent and non-rodent tox data
- Selection of IND enabling compound

2nd Round - in millions

Pre-Money	Capital Raise	Post-Money
35.7	13.2 +/- 13.9	48.9 +/- 13.9

|----- ~17 months -----|

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- Human safety (Phase I)
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3rd Round - in millions

Pre-Money	Capital Raise	Post-Money
50.0	17.3 +/- 17	67.3 +/- 17

|----- ~13 months -----|

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- Efficacy studies in patients
- Patient dose range studies (Phase IIb)

4th Round - in millions

Pre-Money	Capital Raise	Post-Money
148.3	29.8	178.1

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- Phase III
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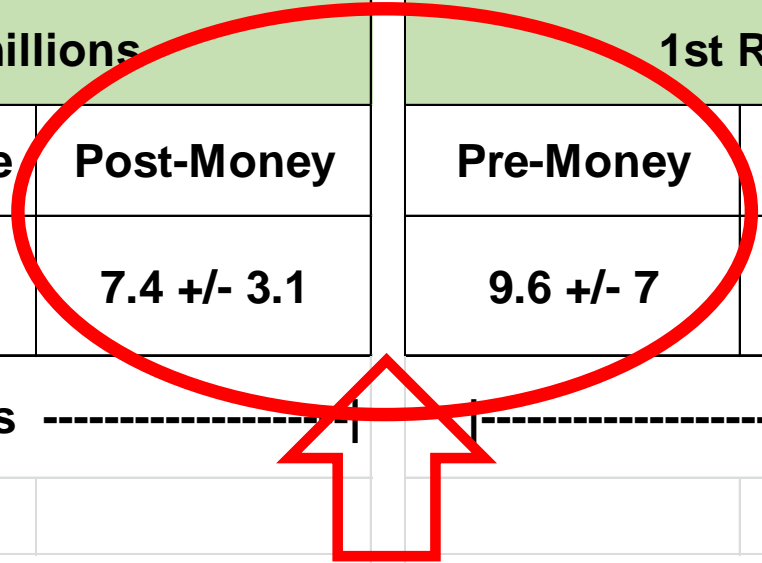
Exit Details

Capital Raise	Exit Value	Months
~70	~226.7	~60-84 months

*data compiled by and made available through Pittsburgh Life Sciences Greenhouse

Financing (Therapeutic Valuation Metrics)

Seed Round - in millions			1st Round - in millions		
Pre-Money	Capital Raise	Post-Money	Pre-Money	Capital Raise	Post-Money
6.5 +/- 2.3	0.9 +/- 0.8	7.4 +/- 3.1	9.6 +/- 7	6.9 +/- 7.7	16.5 +/- 14.7
----- ~15 months -----			----- ~19 months -----		
<ul style="list-style-type: none"> • Proof of concept with IND candidates • Selection of clinically relevant animal model(s) 			<ul style="list-style-type: none"> • Rodent and non-rodent tox data • Selection of IND enabling compound 		



Where are we going with all of this?

Exit Details		
Capital Raise	Exit Value	Months
~70	~226.7	~60-84 months

Certificate of Incorporation – Stock Classes

ARTICLE VI

A. CLASSES OF STOCK; RANK.

1. Designation of Series. The aggregate number of shares of stock that the Corporation shall have the authority to issue shall be 63,000,000 shares, consisting of (a) 35,000,000 shares of Common Stock, \$0.001 par value per share (“Common Stock”), and (b) 28,000,000 shares of Preferred Stock, par value \$0.001 per share, 13,000,000 shares of which shall be designated Series A Convertible Participating Preferred Stock (the “Series A Preferred Stock”), 5,000,000 shares of which shall be designated Series B Convertible Participating Preferred Stock (the “Series B Preferred Stock”) and 10,000,000 shares of which shall be designated Series C Convertible Participating Preferred Stock (the “Series C Preferred Stock”). The original issuance price of the Series A Preferred Stock shall be \$1.04 per share (the “Original Series A Issue Price”), the original issuance price of the Series B Preferred Stock shall be \$1.126 per share (the “Original Series B Issue Price”), and the original issuance price of the Series C Preferred Stock shall be \$1.5055 per share (the “Original Series C Issue Price”). The Series A Preferred Stock, the Series B Preferred Stock and the Series C Preferred Stock are referred to collectively as the “Preferred Stock”.

Certificate of Incorporation – Stock Classes

Authorized Shares

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Certificate of Incorporation – Liquidation

2. Liquidation.

(a) Series C Liquidation Amount. In the event of any liquidation, dissolution or winding up of the Corporation (each such event, a “Liquidation Event”), either voluntary or involuntary, the holders of Series C Preferred Stock shall be entitled to receive, prior and in preference to any distribution of any of the assets of the Corporation to the holders of Junior Shares, by reason of their ownership thereof, an amount per share equal to the sum of (i) One Hundred Percent (100%) of the Original Series C Issue Price (as adjusted for any stock splits, stock dividends, reverse stock splits, stock combinations and other similar capitalization changes) (such sum, the “Series C Liquidation Amount”). If upon the occurrence of a Liquidation Event, the assets and funds legally available for distribution to stockholders shall be insufficient to permit the payment to all holders of Series C Preferred Stock of the full Series C Liquidation Amount, then the entire assets and funds of the Corporation legally available for distribution to stockholders shall be distributed ratably among the holders of Series C Preferred Stock based on the preferential amounts each such holder is otherwise entitled to receive.

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“Liquidation Event”
Includes M&A exits

Liquidation
Preference Amount

Seniority in
Liquidation

Certificate of Incorporation – Capitalization / Liquidation Key Terms

Term	Meaning / Significance
Authorized Capital	Total number of shares of all classes of stock which the Company is authorized to issue under its Certificate of Incorporation (i.e., <u>can</u> issue (with necessary board/stockholder approval), but is neither required to nor necessarily will issue)
Issued & Reserved Shares	Shares of all classes of stock which the Company has issued or has reserved for future issuance (in connection with exercise of warrants or options) – basis for calculating relative ownership interest on either voting of “fully diluted” (i.e., considering all equity interests that are or could be outstanding) basis

Certificate of Incorporation – Capitalization / Liquidation Key Terms

Term	Meaning / Significance
Liquidation Event	Typically a transaction in which the Company's outstanding capital stock is sold by the stockholders to an acquirer, but can include equity financings resulting in existing stockholders holding less than a majority of all issued shares (see definition in Certificate of Incorporation) – in essence, the transaction triggering entitlement to receive Liquidation Preference
Liquidation Preference	Amount payable to holder of a share of preferred stock upon a "Liquidation Event" – usually equals sum of amount paid to the Company to purchase the share plus accrued dividends (if any) payable with respect to that share; can be some multiple of that amount (i.e., "2X Liquidation Preference")
Liquidation Seniority	Reflecting the order in which Liquidation Preferences are paid, where the Company has established multiple classes of preferred stock; critical where exit amount does not cover all Liquidation Preferences payable

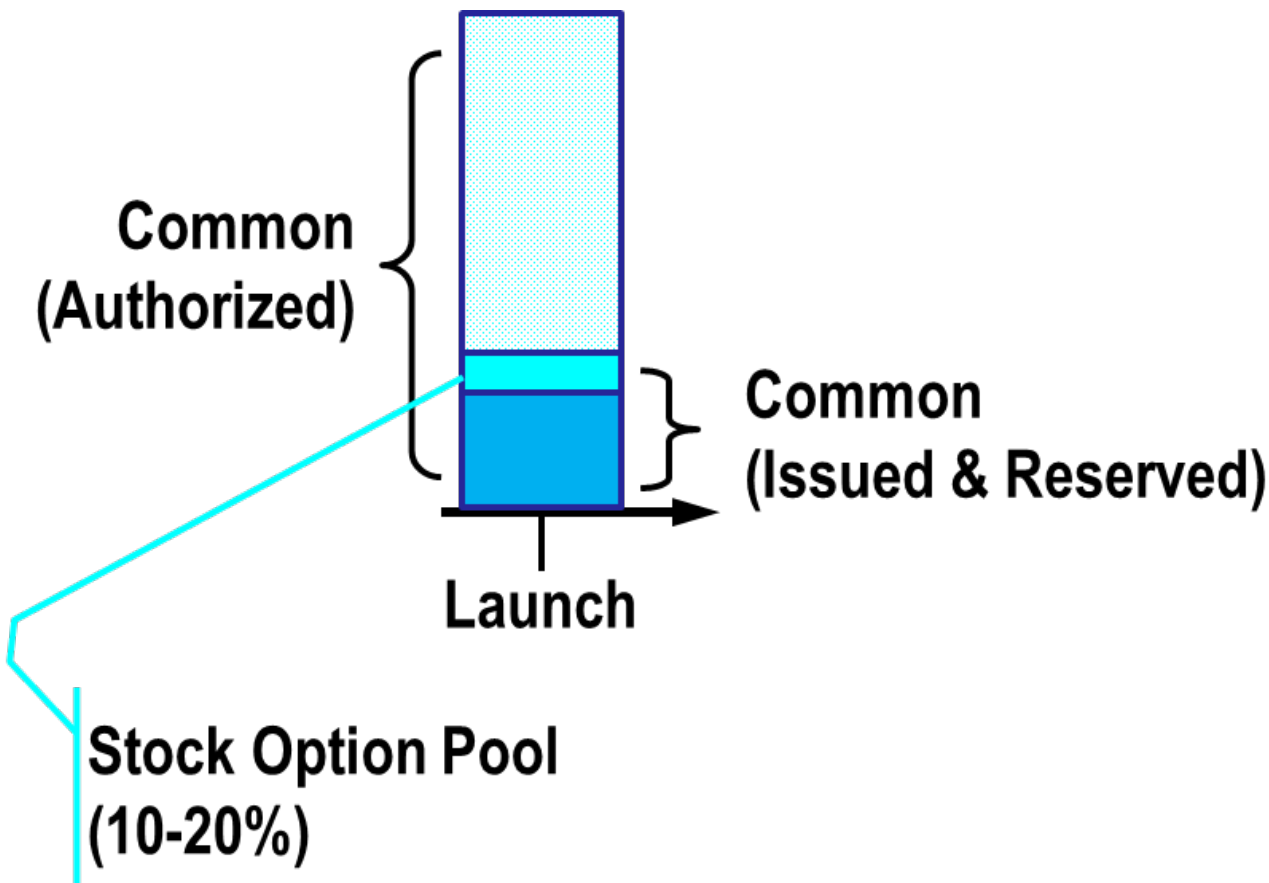
The “Participation” Reward



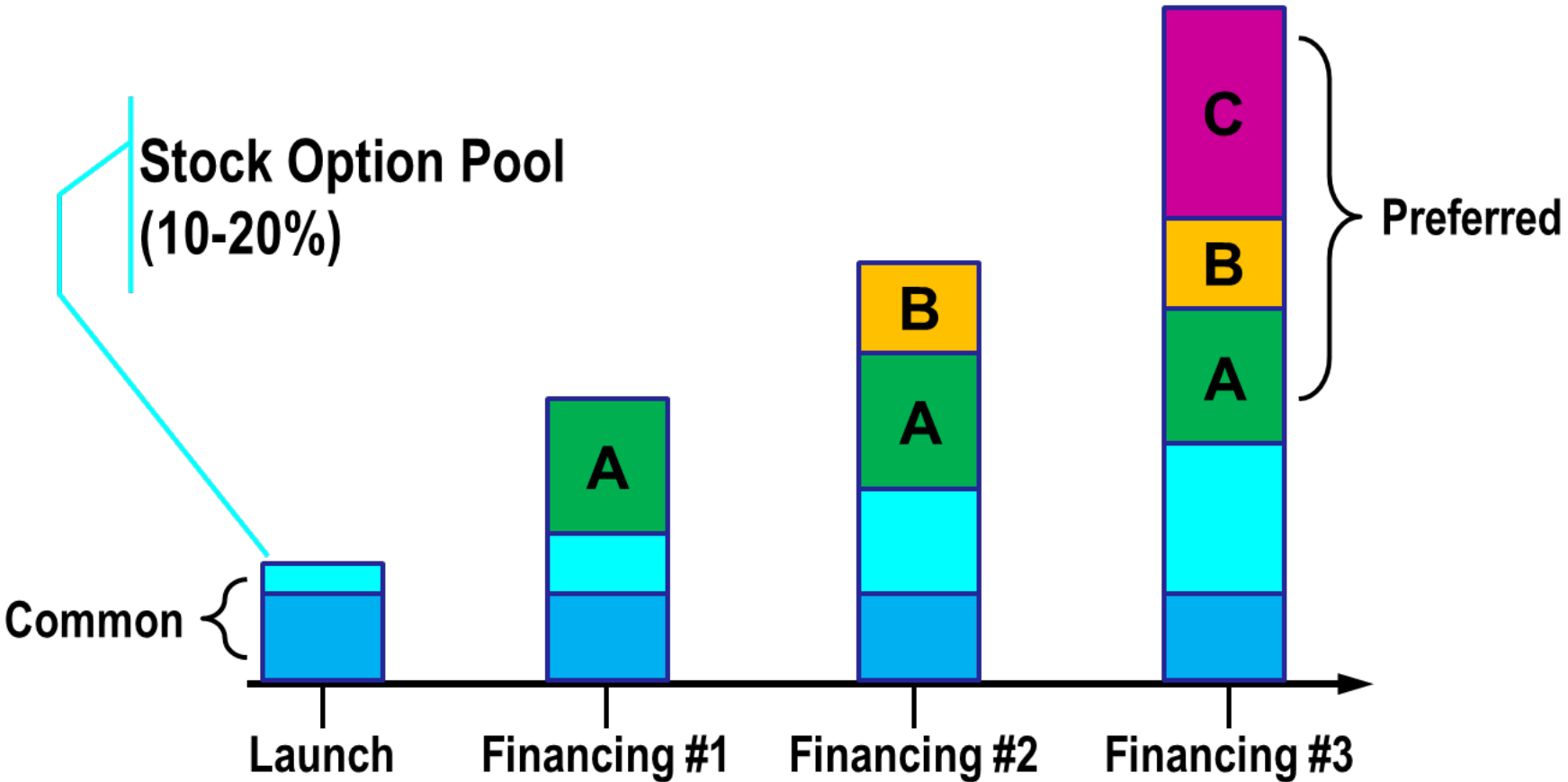
“Participating” Preferred Stock Payout = Liquidation Preference Amount + pro rata portion (calculated with common stock on conversion of all preferred stock to common) of Exit proceeds remaining after all junior Preferences paid

Participation “Cap” – preferred holder entitled to either (i) the cap amount (i.e., 2X liq. pref.), or (ii) the amount payable if the preferred stock was non-participating (i.e., participates in the total proceeds with common stock on an as-converted to common stock basis

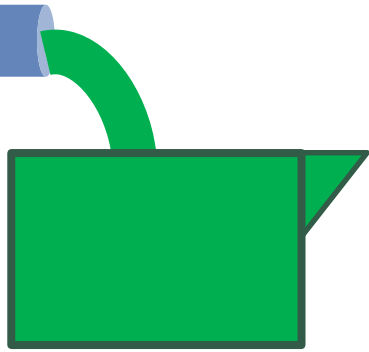
Financing (Capitalization)



Financing (future rounds)



Financing -- Liquidation “Waterfall”



-- Series C “Liquidation Preference”



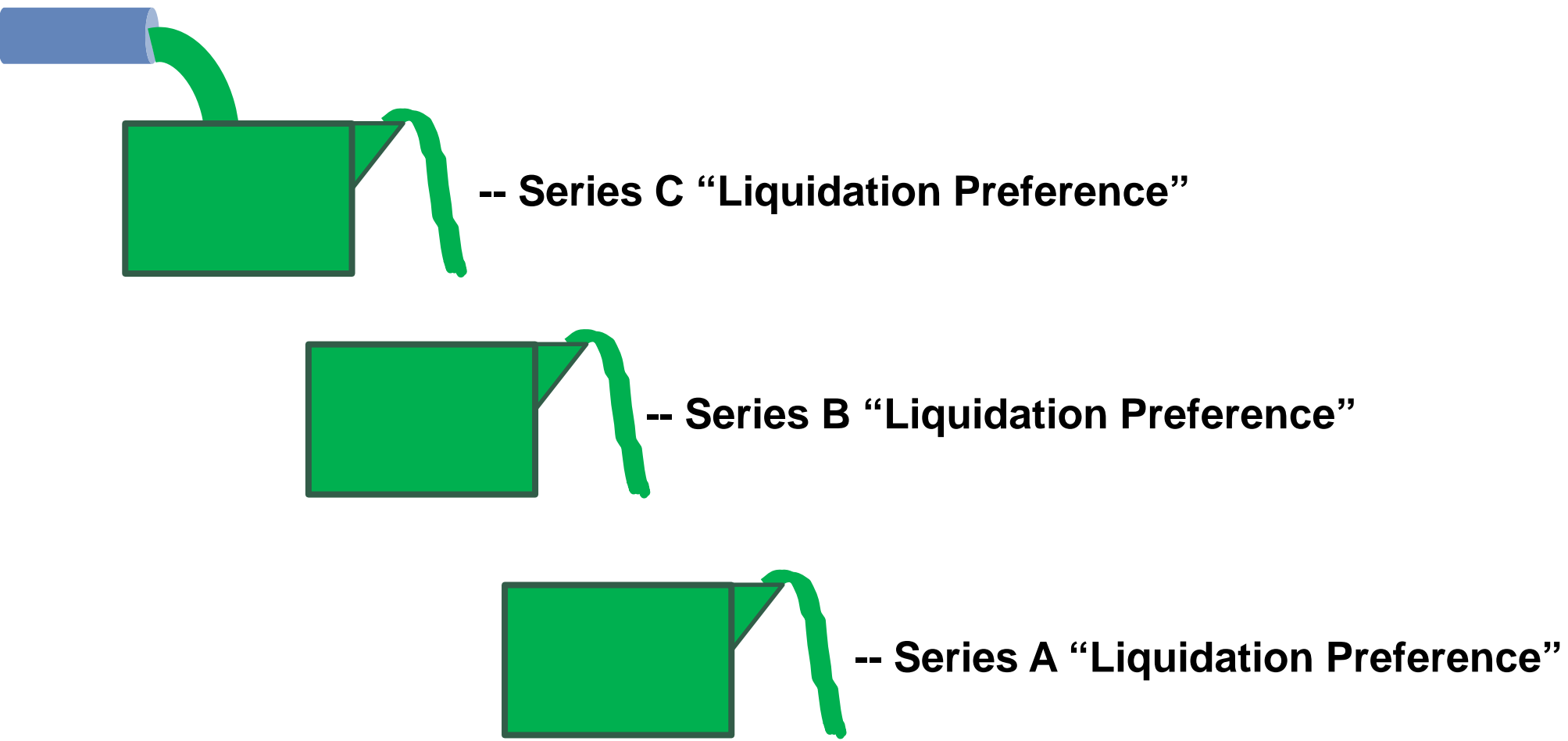
-- Series B “Liquidation Preference”



-- Series A “Liquidation Preference”

Common + “Participating” Preferred

Financing -- Liquidation "Waterfall"



Common + "Participating" Preferred

Liquidation Waterfall -- \$60M Exit, Participating Preferred

Exit Proceeds	\$60,000,000	Amount remaining after payment of outstanding debt, etc.
Liquidation Preference Payouts	-\$10,000,000	Series C
	-\$5,000,000	Series B
	-\$5,000,000	Series A
Net Exit Proceeds	\$40,000,000	Amount to be distributed to Common + Participating Preferred on pro rata basis

Liquidation Waterfall -- \$60M Exit, Participating Preferred

	% of Issued Shares (as converted to Common)	Liquidation Preference	Distribution of \$40M Net Exit Proceeds	Total Distribution (~% of Exit)*	ROI
Series C	45%	\$10,000,000	\$18,000,000	\$28,000,000 (46.7%)	180%
Series B	25%	\$5,000,000	\$10,000,000	\$15,000,000 (25%)	200%
Series A	20%	\$5,000,000	\$8,000,000	\$13,000,000 (21.7%)	160%
Common	10%	N/A	\$4,000,000	\$4,000,000 (6.7%)	??%

Participation Cap "Indifference" – Series C Distribution

	% of Issued Shares (as converted to Common)	Total Distribution	Liquidation Preference	2X Cap Distribution
\$60M Exit	45%	\$27,000,000	\$10,000,000	\$20,000,000
\$40M Exit		\$18,000,000		\$20,000,000

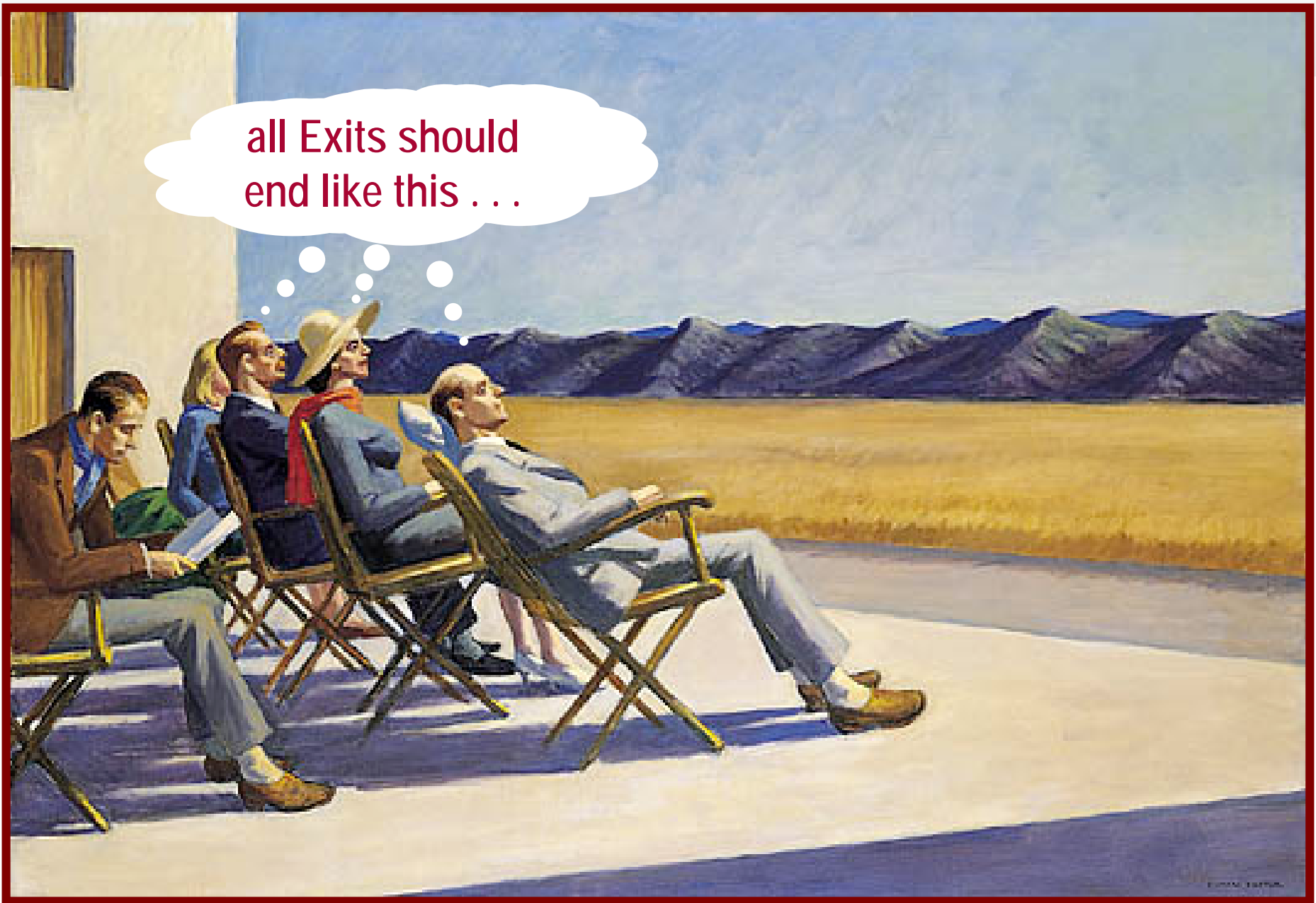
Participation Cap can leave more for Common Holders at higher Exit and leave less for Common Holders at lower Exit; also, disincentive for Preferred Holders with Cap to seek higher Exit until Exit return greater than Cap payout

Financing – “Non-Participating” Liquidation “Waterfall”*



Common + Preferred Converted to Common

*payout to holders of Preferred Stock on an “as converted” basis greater than Liquidation Preference amount



Capabilities

Best Lawyers

More than 60 lawyers listed, including 5 as Lawyer of the Year

100+

lawyers highly rated by Super Lawyers and Rising Stars

SERVICES

BUSINESS SERVICES
INTELLECTUAL PROPERTY
GOVERNMENT REGULATION
INTERNATIONAL LITIGATION

INDUSTRIES

CONSTRUCTION LAW
EDUCATION COUNSELING, LITIGATION AND INVESTIGATION SERVICES
ENERGY INDUSTRY GROUP
FINANCIAL SERVICES
FOOD AND BEVERAGE INDUSTRY
HEALTH CARE SERVICES
INVESTMENT FUNDS INDUSTRY GROUP
LIFE SCIENCES
MEDIA, COMMUNICATIONS AND ENTERTAINMENT
NONPROFIT ORGANIZATIONS AND FOUNDATIONS
PHARMACEUTICALS AND MEDICAL DEVICES
RETAIL INDUSTRY
TRANSPORTATION

Health Sciences

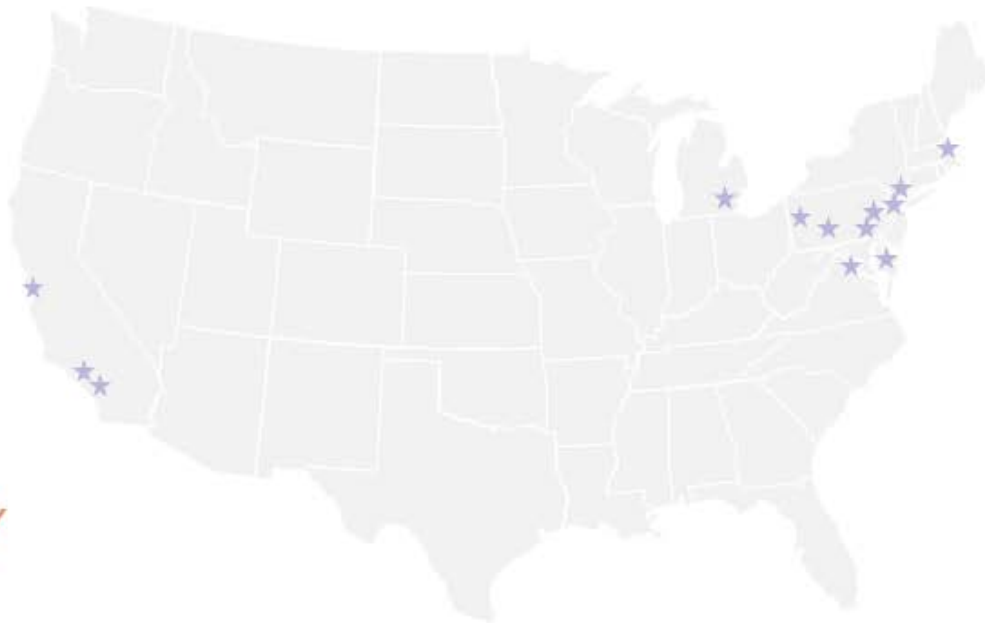
- ▶ more than 100 lawyers devoted to advising clients across the health sciences spectrum
- ▶ collaborate with each other and with clients to achieve remarkable successes
- ▶ understand the impact that advice and counsel in one area will have in other aspects of business – and on other members of the health sciences ecosystem

Key areas of practice

Acute Care Hospitals and Health Systems
Antitrust and Competition - Health Sciences
Digital Health
FDA Regulatory and Risk Management
Counseling
Fraud and Abuse Litigation and Investigations
Group Purchasing Organizations and Buying Cooperatives
Health Care Services
Health Care Transactions
Intellectual Property - Health Sciences
Life Sciences Transactions
Long-Term Care Organizations – Skilled Nursing and Senior Housing Facilities
Pharmaceutical and Medical Device Litigation and Counseling
Pharmacy Industry
State Attorney General Litigation
White Collar Litigation and Investigations

Locations

BERWYN
BOSTON
DETROIT
HARRISBURG
LOS ANGELES
NEW YORK
ORANGE COUNTY
PHILADELPHIA
PITTSBURGH
PRINCETON
SILICON VALLEY
WASHINGTON
WILMINGTON



Legal 500

Recommended firm for
Construction Litigation
and Pharma/Medical
Device Products
Liability

500+ lawyers

13 offices in U.S.

125 years of
serving clients

The Early Life of the Company

Stage	Documents
Launch	<i>Corp:</i> Articles/Certificate of Incorporation; Bylaws <i>LLC:</i> Operating Agreement <i>(Restricted Stock/Unit Agreement)</i> <i>(IP License Agreement)</i>
Financing	Term Sheet; Purchase Agreement <i>Corp:</i> Stockholders Agmt; Inv. Rights Agmt; (etc.) <i>LLC:</i> Amended & Restated Oper. Agmt
R&D (&C)	Development/License Agreement; JV Agreement

The Early Life of the Company - Launch

Document	Purpose
Articles/Certificate of Incorporation	<i>authorized capitalization; rights and preferences of each authorized stock class (esp. dividend, liquidation, anti-dilution); extraordinary voting rights of stock classes;</i>
Bylaws	<i>meetings & voting of stockholders and directors; offices and duties of officers</i>
Operating Agreement	<i>All of the above</i>
<i>IP License Agreement</i>	<i>establish authority to control use of IP</i>
<i>Restricted Stock/Unit Agreement</i>	<i>correlate future participation with equity interest</i>