

CONVERTIBLE NOTES: Understanding the Key Terms



*Legal Strategies and Solutions
to Protect and Grow Businesses™*

Peter Papagianakis
Business Law Firm LLC

22 Jericho Turnpike; Suite 100-East
Mineola, NY 11501

t: 516-280-8600
f: 516-740-0761

e: pp@BLawFirm.com
web: www.BLawFirm.com

1375 Broadway (37 St.); Suite 300
New York, NY 10018

t: 646-862-1210
f: 646-292-5121

CONVERTIBLE NOTES: Understanding the Key Terms

- I. Background Basics**
- II. Benefits of Convertible Note vs Equity**
- III. Key Terms**
- IV. Ancillary Documents**
- V. Basic Securities Laws Issues**

CONVERTIBLE NOTES: Understanding the Key Terms

I. Background Basics

- Promissory note = obligation to pay loan unless it “converts”
 - √ generally when Series A financing occurs (“bridge” between seed stage and Series A)
- Angels (or certain F&F)

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II. Benefits of Convertible Note vs. Equity

- Avoid valuation (*but see* “Cap on valuation”)
- Avoid dilution (*but see* “Capitalization table”)
- Quicker funding because less documentation/ negotiations/attorney fees (*but see* “Seed Equity Documents”)

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III. Key Terms

- Principal amount
- Interest rate
- Maturity date
- Conversion*
- Conversion discount*
- Cap on valuation*
- Payoff upon pre-conversion exit/sale of company
- Unsecured (vs. secured)

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IV. Ancillary Documents

- Note Purchase Agreement
- Term Sheet

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V. Basic Securities Laws Issues

- Regulation D
- crowd-funding
- general solicitation