

Convertible Loans

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AGENDA

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- **Convertible Loans: A definition**
 - **The main terms of convertibles**
 - **Convertibles vs Equity**
 - **Convertibles in action: When are convertible loans used?**
 - **Conclusion**

CONVERTIBLE LOANS

A Definition

Convertible loans are a way to invest or get cash quickly without having to manage a full capital increase and without defining a valuation now. We postpone this in the future but as such an investor takes a risk and need to be compensated for that.

Convertible loans are loans that will be converted into shares of the company later.

Convertible loans are a form of debt financing.

Bank loans need to be paid back. Convertible loans aren't designed to be paid back

CONVERTIBLE LOANS

Main terms

Investing in a convertible loan hence means to wait for a certain time until you become a shareholder.

The terms of the convertible loan define the compensation for that patience (interest rate) and for the additional risk that was taken by investing before the conversion event (discount).

CONVERTIBLE LOANS

Main terms I

Discount: Discount on shareprice at which loan converts into equity

Valuation Cap: Maximum valuation at which the conversion can take place

Valuation Floor: Minimum valuation at which the conversion can take place

Interest: Interest rate (usually a figure corresponding to current interest rates), that will accrue from the date of the investment until the conversion date.

CONVERTIBLE LOANS

Main terms II

Maturity Date: deadline when the loan can/has to be converted even if no “qualified financing” took place beforehand.

Qualified Financing Round: The size of the financing round that will trigger the conversion

Change of Control: Definition of course of action in case the company is acquired prior to the qualified financing round

CONVERTIBLES VS EQUITY

The main differences at a glance

CONVERTIBLES

- Debt
- No valuation
- Not (yet) a shareholder
- No voting rights
- Quick execution
- No shareholder protection

EQUITY

- Equity
- Valuation
- Shareholder
- Voting rights
- Requires notary meeting
- Shareholder protection (depending on share class)

WHEN DO CONVERTIBLES COME INTO PLAY?

Mainly for bridge rounds

Convertible loans are used mainly for bridge financing rounds, which as their name implies, bridge the gap between two equity financing rounds. These bridge rounds are usually smaller in size compared to the equity round. They just provide enough liquidity for the startup to reach the next milestone, putting it in a position to raise another equity round. The risk for the investor is, of course, that the milestone will not be achieved.

REASONS FOR A BRIDGE ROUND

Neutral/negative scenario

Company failed to reach key performance indicators or struggled to grow at the same speed as in the past.

The money it has raised in the past has proven not to be sufficient to reach the targets that would permit a new equity financing with a markedly higher valuation.

Mainly geared towards existing investors

REASONS FOR A BRIDGE ROUND

Positive scenario

However, a convertible loan can also be issued from a position of strength. If things are going well and there is a clear positive momentum, which means also a lot of interest from investors, a convertible can be used to raise additional capital without losing too much time talking to many different investors and haggling over valuation.

Since there is no need to discuss the valuation and find a consensus on it with investors, convertible loans are simpler than an equity round. There is also no need for a capital increase and a notary meeting, which makes the process faster and cheaper.

Sometimes, however, startups issue convertible loans as an addition to heavily oversubscribed financing rounds. Since they cannot (or do not want to) accommodate every investor interested in joining the equity round, they give them at least the possibility of already securing the position of future shareholders.

CONCLUSION

a convertible loan is a relatively quick and uncomplicated way for a startup to secure additional financing. Sometimes it's a lifeboat, in other cases, it's a good tool for successful entrepreneurs to raise capital without spending too much time on discussion. From the point of view of an investor, it is the entry ticket to becoming a shareholder in the next equity financing round.

TERMS

The most important terms in a Term Sheet

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- Valuation (Share Price)
 - Investment Amount
 - Shareclass
 - Liquidation Preference
 - Anti Dilution
 - Stock Option Plan (ESOP/PSOP)
 - Drag Along
 - Tag Along
 - Board Composition
 - Information requirements

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