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Legal Strategies in Preparing for the Next Round of Financing

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Leading a MedTech Company in
Turbulent Economic Times
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What We'll Talk About

- Raising Capital in a Downturn
- State of PE Industry
- Start-Ups' Response?
- The Next Financing Round – What Will It Be?
- Management and Planning Strategies in Anticipation of Need for Financing
- Up or Even Rounds
- Down Round Terms
- Down Round Issues

Raising Capital in a Downturn

- The Downturn
 - How long? How deep?
 - Losses, risks, but also opportunities
- What's a start-up to do?
 - “Last Man Standing”

State of PE Industry

- VC Industry
 - VC Investments down in 2008, more in Q4
 - VC fundraising down more
 - VC exits through the floor
- Other PE
 - Hedge-funds dramatically impacted
 - Rounds late '07 and early '08 – unlikely
 - Strategic/corporate
 - Venture debt
 - Angel activity

State of PE Industry

- Consequences
 - Fewer new portfolio companies
 - Commitment to seeing good companies through
 - Dumping the laggards
 - Lower valuations
 - Investor conservativeness - “choking up on the bat”
 - Public market comparables down
 - Concern about recession’s effect on companies’ results
- Raising private capital now
 - It’s gotten tougher – cost of capital has gone up
 - But –
 - “\$29B”
 - << Angel capital

Start-Ups' Response?

- How should start-up companies react?
- Be calm but pragmatically ruthless
- Extend runway: cash burn rate – cut aggressively
 - Outlast competition
 - Postpone capital raise
- E.g. –
 - Hiring freeze? Of course, but . . .
 - Nonessential positions
 - Comp reductions
 - Cram your space until it hurts, or downsize

Start-Ups' Response? (Cont'd)

- Biggest challenge? Human psychology
 - Zillow users survey
- So –
 - Strategic mindset – better to be late to the party than to be early and run out of money
 - Circumstances can change quickly in downturn
 - Don't spend until forced
 - Line item budget review at least monthly
 - Company mindset, not just CEO – total buy-in
 - Multiple burn scenarios

Start-Ups' Response? (Cont'd)

- Alternative Business Plans
 - Plan A - Grand slam
 - Plan B
 - Product subsets, down-market
 - Short sales cycle
 - Plan C
 - Sell services?
 - Government research grants?
 - SBIR
 - Recovery funds

The Next Financing Round – What Will It Be?

- Up, Down or Even
- What's a Down Round?
- Alternatives to Down Rounds
 - Make do with cash on hand
 - Angel investments
 - Sale

Planning Ahead

- Management and Planning Strategies in Anticipation of Need for Financing
 - Whose Strategies? Different constituencies may have different interests
 - Plan ahead
 - Try to find new outside investor
 - Recent comparables
 - Strong board including disinterested outside directors



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Down Round Terms

- Tranche Structures
- Multiple Liquidation Preferences
- Anti-Dilution

Down Round Terms

- Pay-to-Play
- Cramdown

Down Round Terms

- Term Enhancement for “Playing” Current Investors
 - Repricing
 - Exchange of preferred stock for new preferred
 - Other
- Management/Key Employee Retention Devices

Down Round Issues

- “Interested” Directors
 - Business Judgment Rule
 - Entire Fairness Test
- Solutions - Procedural Steps
 - Independent and disinterested Board committee
 - Approval by disinterested directors/shareholders
 - Rights offering to existing shareholders