Venture Terms in the Light of COVID-19

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SOME FUNDAMENTAL OBSERVATIONS

	Before COVID-19	Early indications after COVID-19	Our expectations for Q3 and Q4 2020
Investors	– Record high number of VCs and assets under management. – Increase in number of CVCs.	– No significant changes. There are still a lot of active investors with capital to deploy.	– No significant changes. – New funds may have a more narrow investment scope.
Investment Activity	– Strong deal activity and deal volume. – Competition for term sheets.	– No significant decrease in number of deals or deal value. – Increase in internal bridge rounds to extend runway. – Startups look at postponement of equity financing rounds and alternatives (see below at page 8). – Tendency towards smaller investments.	– VCs to invest at a slower pace. Some funds to take a ”wait and see” approach. – The bar has been raised. We expect more startups to get a ”no”. – Increase in internal bridge rounds. – Fewer ”fear of missing out” deals. – Slower investment processes. – Smaller ticket sizes from investors.
VC focus	– Team – Business model – Technology – Scalability – Traction – Market – Exit routes – ESG	– Some funds to focus on short term profitability over growth. – VCs to focus on own existing portfolio companies and save powder for ”winners”. – VCs to be more cautious/risk adverse. Some particularly exposed sectors (such as startups within travel, leisure, events, entertainment, restaurants, hospitality, retail etc.), experience increasing difficulties in raising capital. – Increased focus on risk mitigation. – Focus on business case, product, market etc. to fit into “new normal” and new global trends. – ESG has temporarily been given a lower priority.	– We expect the early indications that we have seen during COVID-19 to continue. – VCs to focus on own existing portfolio companies and save powder for ”winners”. – VCs to be more cautious/risk adverse. Some particularly exposed sectors will experience increasing difficulties in raising capital. – Increased focus on risk mitigation. – Focus on ESG will be more relevant than ever (see below at page 8).
Deal terms	– Strong tendency towards more ”founder-friendly’’ terms.	– Tendencies towards more ”investor-friendly’’ terms to bridge valuation gap, downside protection, risk mitigation and ensuring control (see following pages).	– We expect the early indications that we have seen during COVID-19 to continue. We expect the deal terms to be more “middle of the road” compared to the “founder-friendly” starting point we had before COVID-19, in particular with respect to staggered deals, preference rights, anti-dilution, and control provisions.
Exits	– Strong exit market.	– Stagnated exit market.	– More normalized level of M&A and IPO transactions end Q3/Q4, in particular within tech and biotech, however, depending on foreign markets to open up (in particular Germany, UK and US).

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FINANCIAL TERMS

	Before COVID-19	Early indications after COVID-19	Our expectations for Q3 and Q4 2020
Valuations	– Red hot valuations. – Probably in late cycle environment/heated market.	– Tendency towards lower valuations. – Decrease in competition for term sheets. – Increased valuation gap. – Correction of market or COVID-19 related? Probably acceleration of correction.	– We expect the early indications that we have seen during COVID-19 to continue.
Financing rounds	– One tranche payment.	– Tendency towards staggered deals (tranches/milestones). – Tendency towards smaller investments.	– We expect the early indications that we have seen during COVID-19 to continue.
Liquidation Preference Rights	– Pre-seed/seed: common or 1x non-participating. – A-rounds: 1x non-participating or common.	– Tendency towards more investor-friendly liquidation preference rights (senior rights, interests, multiples and participating liquidation preference rights (double dip).	– Liquidation preference rights are amongst the first items to be required by investors. – We expect to see more participating liquidation preference rights and multiples/interest on non-participating liquidation preference rights; however, we do not expect to see a re-introduction of the very "investor-friendly" liquidation preference rights we saw 10 years ago with multiples on participating liquidation preferences.
Anti-dilution	– Pre-seed/seed: None or broad-based weighted average. – A-rounds: None or broad-based weighted average.	– Tendency towards requiring anti-dilution (broad-based) as a standard. – Still possible for founders to cap the anti-dilution and require "pay to play".	– We expect more VCs to have anti-dilution in their standard terms. – 10 years ago full ratchet anti-dilution provisions were not unusual. We do not expect to see a reintroduction of full ratchet.
Future financing rounds	– Pro rata participation.	– No changes.	– We do not expect VCs to introduce super pro rata rights, but we may well see an increase in pick-up rights/gobble-up rights.
ESOP	– Pre-seed/seed: level of 10-20 percent. – A-round: level of 8-10 percent. – Outstanding warrants included in fully diluted capitalization.	– No changes.	– We may see warrant authorizations and ESOP established in financing round included in the fully dilution capitalization. – We do not expect VCs to introduce warrants to be allocated to investors in connection with the investment round.

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GOVERNANCE

	Before COVID-19	Early indications after COVID-19	Our expectations for Q3 and Q4 2020
Board seat	– Investors to obtain a board seat for an ownership percentage of approximately 10 percent. – Tendency towards requiring professional board members (particularly in A+ rounds).	– Tendency towards lowering the threshold for being entitled to appoint a board member. – Increase in tendency for professional or independent board members even in earlier rounds.	– We expect the early indications that we have seen during COVID-19 to continue.
Special approval rights	– Material decisions to require investor consent/consent from an investor majority. – Tendency towards leaving operational decisions out of material decision catalogue.	– Tendency towards investor requiring separate veto rights on material decisions. – Tendency towards larger material decision catalogues (also to include operational decisions).	– We expect the early indications that we have seen during COVID-19 to continue.
Execution rights	– Tendency towards leaving out right to execute future financing round.	– No changes.	– No changes.
Voting rights	– One vote per share.	– No changes.	– No changes. We do not expect VCs to introduce super voting rights.
Pay to play	– Usually, we do not see an automatic loss of rights, if an investor does not participate in a future financing round.	– Investors will, in general resist pay to play provisions. However, it may be a tool internally amongst the investors to keep co-investors at their toes.	– We expect the early indications that we have seen during COVID-19 to continue.

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KEY MAN CLAUSES

	Before COVID-19	Early indications after COVID-19	Our expectations for Q3 and Q4 2020
Lock-up	– Usually founders are subject to a lock-up period of 3-4 years.	– No changes.	– No changes.
Key Man Clauses	– Usually founder shares are subject to reverse vesting over 36 or 48 months (possibly with a 12 months cliff). – Tendency towards accepting that a minority part of founder shares are vested upfront. – All shares to be sold in a bad leaver scenario at low valuation and unvested shares to be sold in a good leaver scenario at FMV.	– No changes.	– No changes. – Of course, VCs will evaluate founders' actions, performances and omissions during the COVID-19 crisis. However, we do not expect to see an increase in terminations of key men as a consequence of COVID-19.
Founder restrictions	– Non-compete and non solicitation for 12-24 months.	– No changes.	– No changes.

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TRANSFER OF SHARES

	Before COVID-19	Early indications after COVID-19	Our expectations for Q3 and Q4 2020
Right of first refusal	– Usually, investors have a pro rata right of first refusal.	– No changes.	– We do not expect VCs to introduce super pro rata rights, but we may well see an increase in pick-up rights/gobble-up rights.
Tag-along	– Usually, sale of shares above a certain threshold triggers a tag-along right for the other shareholders.	– No changes.	– No changes.
Drag-along	– Usually, a large majority (including investor) may force through a trade sale. – Valuation floors are not unusual.	– Investors to have a say in exit processes.	– We expect the early indications that we have seen during COVID-19 to continue.

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INVESTMENT TERMS

	Before COVID-19	Early indications after COVID-19	Our expectations for Q3 and Q4 2020
Due diligence	– Tendency towards light due diligence in pre-seed and seed rounds. – Tendency towards high level due diligence in A-rounds.	– Tendancy towards a more compehensive due diligence, both commercial, financial and legal to mitigate risks.	– We expect the early indications that we have seen during COVID-19 to continue.
Warranties	– Tendency towards Company and founders to provide warranties. – Tendency towards short-form/designated warranty catalogue.	– Tendency towards more comprehensive warranty catalogue.	– We expect the early indications that we have seen during COVID-19 to continue.
Indemnification	– Tendency towards accepting low liability cap for founders (1x-3x yearly salary).	– No significant changes.	– We may see investors push for raising the founders' personal liability cap.

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OTHER PERSPECTIVES

	Before COVID-19	Early indications after COVID-19	Our expectations for Q3 and Q4 2020
Alternatives to equity rounds	– Convertible Loans – SAFE and HATCH notes – Bank financing – Venture debt	– Clear tendency that founders try to extend their runway and postpone financing rounds until late 2020/early 2021, in particular for late stage companies. – Government backed relief packages in most countries. – Very difficult to obtain bank loans, even for late stage companies. – Increase in venture debt rounds and revenue-based financing (particularly abroad).	– We expect the early indications that we have seen during COVID-19 to continue.
VC reputation	– Investors to protect reputation. – Risk of losing out on next Unicorn. – Differences compared to 2010, because of number of active funds and available capital.	– In a relatively small market such as Scandinavia, the reputation risk may well keep some VCs from introducing too "investor-friendly" terms.	– We expect the early indications that we have seen during COVID-19 to continue.
ESG	– Significant increase in ESG, both when evaluating portfolio companies, in management of portfolio companies and in reporting requirements.	– Theoretically, ESG is still top of the agenda, but a lot of investors and companies have been in "survival mode" and have temporarily been focusing more on adapting business case, strategies, sales etc. to "new normal".	– We have already seen first signs of ESG being back on top of the agenda and we expect this focus to increase and become equally important, if not more important than before. – Focus on ESG and financial returns as non-contrasting.
Lessons learned?		– Both founders and investors to prepare for "new normal", when it comes to business case, sales channels, strategies, products, demands etc. – As well as VCs will look at founders' performances and actions during COVID-19, founders will, especially in a relatively small market such as Scandinavia, look at how VCs acted during the COVID-19 crisis. – Investors not to overplay their hand. Founders and the market have a strong memory.	– Startups that are unable to cope with or are unprepared for "new normal" face difficulties in raising capital. – Startups in particularly exposed sectors face difficulties in raising capital. – We have not seen and do not expect to see investors push for very "investor friendly" terms. We expect to see a correction of some of the terms (staggered deals, preference rights, anti-dilution, control etc.) to be more "middle of the road", but we do not expect a hard turn in venture deal terms towards the deal terms we saw 10 years ago.

Thank you for your time!

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