OffRoad Investment Primer
By Marc H. Morgenstern, Esq.

The deal world is rich in highly specialized, frequently colorful, vocabulary. The words are highly evocative but can be confusing to people who don't know the language. The terminology can have different connotations, depending on context, and different meanings region-by-region. This primer is intended to level the playing field by providing a comprehensive introduction to the language of private equity deals.

Accredited Investor: For SEC purposes (including Regulation D private placements), high net worth investors (individuals and entities) are designated as accredited investors. Generally, individuals (not entities) are Accredited Investors if they have either : an individual net worth (or joint net worth with their spouse) of $1,000,000, or an individual income in excess of $200,000 (or $300,000 with spouse) in each of the two most recent years and reasonably expect an income of $200,000 (or $300,000 with spouse) in the current year. Private placements made exclusively to Accredited Investors can be sold to an unlimited number of accredited investors.

Accrual: an accounting procedure that records (recognizes) income or expense on a company's financial statement at the time the income or liability event occurs (i.e., the exchange of goods or services) rather than when it ***fix pronoun reference*** is either paid or received in cash.

Accumulated Dividend: a dividend that a company owes to an investor but that is not paid currently. Dividends frequently accumulate for a fixed period (e.g., two years) to permit a company to retain cash to grow the business. Alternatively, Dividends may be payable in full only in the event of a liquidity event (i.e., Sale, IPO, or Redemption) and accumulate until such time. Accumulated Dividends are reflected on a company's balance sheet.

All or None Offering: a securities Offering that does not close unless all, but not less than all, of the securities offered are actually purchased. This contrasts with a pure Best Efforts Offering in which no guaranteed minimum sale of securities must occur before the offering closes.

Antidilution: contractual provisions that protect an investor from certain consequences when a dilution event occurs, such as a subsequent sale by the company of additional equity securities. Generally, such contractual provisions provide either price protection or maintenance of proportionate ownership protection. The most frequent forms of Antidilution provisions are Full Rachet or Weighted Average.

Articles of Incorporation: (See Certificate of Incorporation).

Asset: Things of value owned by a company are assets. Assets can be tangible (i.e., physical), such as inventory, land, buildings, or equipment, or they may be intangible (i.e., things a company has a legal right or claim to), such as accounts receivable or intellectual property rights.

Audited Statement: a financial statement that has been examined by an independent auditor who has expressed an opinion on the financial statement based on an audit. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. Audits are conducted in accordance with generally accepted auditing standards and are designed to obtain reasonable assurance about whether the financial statements are free of material misstatement. An Audited Statement represents a higher level of accountant involvement than a Review Statement or a Compilation Statement. Outside investors and banks frequently require companies to obtain Audited Statements as a condition to an investment or a loan.

Best Efforts Offering: an offering in which the Underwriter has no obligation to purchase any securities not sold. The Underwriter's commitment is limited to using its best efforts to sell as many securities as possible at the price agreed to between the company and the Underwriter. (See also *Mini/Maxi Offering.)*

Blank Check Preferred Stock: shares of Preferred Stock that have been authorized (but not issued) by a company, but the specific rights and preferences of which have not yet been fixed. The Board of Directors can establish the specific rights and preferences of one or more Offerings of Blank Check Preferred Stock, including liquidation preferences, dividend rates, and voting rights without receiving additional stockholder approval provided that the rights and preferences are within the limits established in the company's Certificate of Incorporation or by agreement. The existence of Blank Check Preferred Stock permits a company to structure, offer, and sell a financing quickly and privately because the Board of Directors can negotiate the terms of a new issue of securities directly with the purchaser (or purchaser's agent) without additional stockholder authorization.

Blue Sky Laws: state securities laws. Companies selling securities must comply with the securities laws of all states in which the company offers or sells securities.

Board of Directors: the individuals whose collective legal responsibility it is to manage the business and operations of a corporation. As a practical matter, most Boards of Directors provide oversight authority over management who run the day-to-day operations of company. The Certificate of Incorporation and Bylaws establish the number of Directors for each company, either a fixed number (usually an odd number so that voting deadlocks don't occur), or a range (e.g. five to nine, as determined by the stockholders).

Bylaws: a company's charter document that governs basic corporate activities, internal procedures, and certain of the substantive (as opposed to procedural) rights relating to stockholders' meetings and voting rights, meetings of the Board of Directors and their authority, election and duties of officers, indemnification, and other matters.

C Corporation: a company the federal income tax status of which is subject to Subchapter C of the Internal Revenue Code. C Corporations owe federal income taxes based on the income of the company as an entity, and the taxes are paid by the company. Unlike the shareholders of an S Corporation, the shareholders of a C corporation do not pay taxes on the corporation's income. (See S Corporation.)

Call Rights: the ability of the call right holder to purchase securities either at a specified price or upon specified terms and conditions, and pursuant to an agreed pricing formula. A Call is the opposite of a Put. (See Put Rights.)

Certificate of Incorporation: a company's basic organizational document, filed with the Secretary of State in the state of incorporation. The Certificate generally reflects the name, location, and purpose of a company; the number, classification, rights, and preferences of a company's capital stock; and voting authority of the Directors with respect to related party transactions and Redemptions. In some states, the Certificate of Incorporation is referred to as the Articles of Incorporation.

Class: the division of a company's capital stock into different groups, with each separate class (i.e. group) having specified rights designated in the company's Certificate of Incorporation. Classes of capital stock may also be divided into Series.

Cold Comfort Letter: a letter provided by a company's independent accountants confirming financial information in the Offering Memorandum and detailing the procedures followed by the accountants at the request of the Underwriter or placement agent.

Collateral: security given by a borrower to a lender in connection with a loan to insure that the lender is repaid. Lenders frequently accept collateral in tangible Assets such as inventory, accounts receivable, real property, or buildings and less commonly take intangible Assets such as patents or trademarks as collateral. In the event that the borrower cannot repay the loan when due, or for other reasons that may constitute an Event of Default, the lender, after complying with the loan agreement and applicable law, has the right to take possession of the collateral, sell it, and apply the net proceeds (i.e., the cash received after payment of costs of sale) to the loan repayment.

Come Along Rights: See Co-Sale Rights.

Co-Sale Rights: an investor's right to sell the investor's own securities at the same time and on the same price, terms, and conditions as another stockholder (generally the controlling stockholder or key management). These rights are also referred to as Tag Along Rights or Come Along Rights and usually are eliminated in connection with a Qualifying IPO.

Common Stock: the most junior security of a company that represents the residual economic and ownership interest in a company after payment of all superior claims. Preferred Stock, Subordinated Debt, Secured Debt, and general trade obligations (i.e., trade payables) all get paid prior to any proceeds to Common Stockholders. Each share of Common Stock represents a proportionate interest in the company. There can be different Classes or Series of Common Stock with different rights including voting or dividend differences.

Compilation Statement: the minimum level of financial statement preparation by an accountant. A compilation statement verifies only the mathematical accuracy of the financial information presented to the accountant by management. A compilation financial statement involves no testing of receivables, inventory, or other Assets or verification by the accountant preparing the compilation statement. Compilation statements lack footnotes and other disclosures found in an Audited Statement or Review Statement.

Consent: permission from different individuals or entities. A company must obtain the Consent (or Waiver) from a specified percentage of those stockholders who are contractually protected by a Covenant to take certain actions otherwise restricted by covenant. In a different context, the company's accountants consent to the inclusion of their audit reports on prior year's financial statements in an Offering Memorandum or Prospectus.

Convertible Debt: debt that can be converted from debt to equity, usually at the option of the debt holder. Convertible Debt provides the debt holder with preferred protection as a creditor of a company, but with the potential to convert the debt to Common Stock if the value of the Common Stock on conversion exceeds the principal and interest owed by the company to the debt holder. Convertible Debt is conceptually similar to Convertible Preferred Stock, but since

Convertible Debt is a debt security rather than an equity security and, therefore, the Convertible Debt would be repaid prior to Preferred Stock in the event of a Sale or liquidation.

Convertible Preferred Stock: a form of Preferred Stock that grants the holder the right (but not the obligation) to convert the preferred stock into Common Stock. Convertible Preferred Stock generally has a Liquidation Preference in an amount equal to the original Purchase Price, plus any Accumulated Dividends. Dividends on Convertible Preferred Stock may be paid currently or accumulated depending on the particular company. Under certain circumstances, generally on a Qualified IPO, Convertible Preferred Stock automatically converts to Common Stock for several reasons. First, Underwriters prefer that a Public Company not have more than one Class of stock so that all of the company's stockholders are on equal standing. Secondly, when a company goes public, the preferred stockholder has achieved a major private equity investment goal of Liquidity and no longer needs the economic and contractual protection provided by Preferred Stock.

Conversion Price: the price at which a Convertible Security can be converted (exchanged) into another security. If a $100 convertible note has a conversion price of $5.00, then the holder of the convertible note can exchange the note for 20 shares of Common Stock (i.e., the amount of the Debt divided by the Conversion Price). Conversion Prices are subject to change to protect an investor based on the application of Antidilution clauses. If the Conversion Price is decreased to $4.00 from $5.00 as a result of applying an Antidilution clause, then the holder of the $100 convertible note can exchange the note for 25 shares of Common Stock (i.e., the amount of the debt divided by the reduced conversion price).

Convertible Security: securities that permit the holder to acquire an equity interest by converting (i.e., exchanging) the original security into Common Stock. Common examples of convertible securities are Options, Warrants, Convertible Preferred Stock, or Convertible Debt. Most convertible securities are convertible at the election of the holder. For holders of Convertible Preferred Stock, the conversion right permits the preferred stockholder to choose between receiving a Liquidation Preference on the preferred stock or converting the preferred stock to Common Stock. Conversion only occurs if the value of the Common Stock obtained on conversion exceeds the Liquidation Preference.

Covenants: the affirmative or negative contractual agreements of a company in favor of specified investors (i.e., in favor of a particular class of Preferred Stock or Subordinated Debtholders). Affirmative covenants mandate positive actions a company will perform. Common examples include compliance with all laws, maintaining corporate existence, and providing specific financial information to investors. Negative covenants specify actions a company will not take without Consent. Common negative covenants include making an acquisition, incurring additional funded Debt, or spending more than an agreed annual amount on capital expenditures. If a company breaches a covenant, the violation usually constitutes an Event of Default thereby creating default rights and remedies in favor of the investors. A company that violates its covenants or wants to take an action prohibited by a covenant can do so without breaching the agreement provided that the company obtains the Consent or Waiver of the contractually specified percentage of investors who are protected by the Covenant.

CPA: a Certified Public Accountant.

Cumulative Dividend: See Accumulated Dividend.

Cumulative Voting: the right of a stockholder to vote jointly in the election of Directors, and cast all of the stockholder's aggregate votes for one or more Directors rather than casting the same number of votes for each Director. Thus, if a stockholder owns 10 shares, and three Directors are being elected, the stockholder has an aggregate of 30 votes (i.e., the number of shares times the number of Directors being elected). The stockholder can cumulate votes and cast all 30 votes in favor of one Director, or split the 30 votes among the three Directors in the stockholder's discretion. The right to cumulative voting is frequently eliminated in a company's Certificate of Incorporation. In a company without cumulative voting, the same stockholder would only have the right to cast ten votes for or against the election of each Director. Cumulative voting increases the ability of a minority investor to obtain representation on the Board of Directors.

Debt: an amount owed by someone (i.e., the debtor) to another (i.e., the creditor). Also referred to as a Liability. Debt owed by a company to a financial institution or an investor in a transaction in which the company that does not provide Collateral to the lender is unsecured Debt. When the Debt is secured by Collateral, the Debt is referred to as Secured Debt. Common forms of debt securities are notes or bonds. (See also Subordinated Debt).

Demand Registration Rights: an investor's contractual right to demand that the issuer register specified Restricted Securities with the SEC and the state securities agencies so that the Restricted Securities become registered and freely tradeable. Typically, registration costs are paid by the company. Demand registration rights force a company to file a Registration Statement permitting the holder to conduct a Public Offering of the holder's securities. Generally, Demand Registration Rights are available only after a company's IPO to facilitate the Sale of Restricted Securities that cannot otherwise be sold without registration.

Dilution has two common meanings. From an accounting perspective, Dilution is the net difference between the Purchase Price per share paid by a new investor to buy a security from the company compared to the tangible book value per share of the company prior to the Offering. From an investor perspective, Dilution is also the change to an investor's percentage ownership in a company that results from a subsequent issuance of additional equity securities.

Directors: the individuals whose legal responsibility is to manage the business and operations of a company. See Board of Directors.

Dividend: the distribution of earnings from a company to its stockholders, either in cash or stock. Cash dividends are usually ordinary income to the recipient and are not deductible by the company. Dividends to holders of Preferred Stock are calculated at a contractually agreed rate and may be paid currently or may accumulate (See Accumulated Dividends). Dividends to holders of Common Stock vary based on the earnings, cash needs, and prospects for the company.

Drag Along Rights: the right of a security holder to force another security holder to sell his or her stock (usually in connection with a Sale of the company) provided that the person being dragged receives the same price, terms, and conditions for the security being sold as the person exercising the Drag Along Rights. Drag Along Rights facilitate the ability to sell 100 percent of a company's securities to a buyer, thereby eliminating any minority investors. Many buyers are only willing to buy a company that the buyer can completely own. Drag Along Rights rights are eliminated in connection with an IPO.

Due Diligence: the responsibility of entities or individuals involved in a securities Offering to investigate the information in the Offering Memorandum or Prospectus to provide a reasonable basis for believing that the information contained is true and that the offering documents do not omit to state a material fact.

Enterprise Value refers to the total capitalized value of a company consisting of its total Debt and Equity. If a company's Equity consists of 100,000 shares with a value of $10.00 each, and the total Liabilities (including all accrued Liabilities and funded Debt) is $500,000, then the Enterprise Value of the company is $1,500,000, i.e. the sum of the Equity value of $1,000,000 and $500,000 of Debt. The value of the stockholders' stake in the company, however, is only the equity value of $1,000,000.

Equity: has three meanings. Equity is the opposite of Debt and represents the residual economic ownership or claims in a company after the claims of all creditors have been satisfied. Common Stock and Preferred Stock are each classified as an equity security. From an accounting perspective, equity (or stockholders' equity) is a company's Net Worth (i.e., the difference between a company's Assets and its Liabilities). From a corporate finance perspective, the equity value of a company is the total value of its capital stock (i.e., the sum of the value of all classes of Common Stock and Preferred Stock).

Event of Default: the failure of a company to satisfy its contractual agreements and covenants in loan agreements and Mezzanine Securities documents. Common Events of Default include failure to pay principal, interest, or Dividends when due; violation of the company's representations, warranties, or Covenants; or becoming insolvent. Securities documents provide that upon an Event of Default, investors have specified remedies that can be exercises, including increased interest rates or dividends, the ability to take possession of collateral, or, in the extreme cases, the ability to control the company through electing a majority of the Board of Directors. Certain Events of Default can be remedied by payment of money or otherwise, and companies sometimes have contractual rights to fix the default within a specified time period called the cure period or the grace period. If the Event of Default is remedied within the cure period, then the company is no longer in default and the remedies are no longer available. Some Events of Default constitute breaches of trust that cannot be restored, such as the intentional violation of a Covenant by a company. For these latter kinds of Events of Default there are usually no cure periods or method for the company to get back in compliance so that all of the investors' remedies are exercisable.

Exercise Price: the price that must be paid by a security holder in order to convert a Convertible Security. The Exercise Price is also referred to as the Strike Price. If an option holder's Exercise Price is $.50, then the option holder must pay the company $.50 in order to exercise the Option and purchase Common Stock. If a warrant holder has an exercise price of $2.25, then the warrant holder must pay the company $2.25 to exercise the Warrant and thereby exchange the Warrant for Common Stock. The Exercise Price can be nominal ($.001) or significant, and frequently relates to the purchase price of another security purchased in the same Offering or at the same time.

Exit Strategies: the process by which the holder of a security in a Private Company achieves Liquidity. Unlike Public Companies, no trading market exists for the resale of securities in private companies. The normal Exit Strategies for an investor in a Private Company are a Sale, IPO, Redemption, or sale of the individual security to another stockholder. Registration Rights are designed to help investors achieve Liquidity by facilitating the sale of Restricted Securities after a Private Company goes public. Put rights are designed to permit investors to cause an issuer to effect a Redemption of the investor's securities, while the company is still private.

Fair Market Value: the cash price that a willing buyer will pay to a willing seller for an Asset. The Fair Market Value of a company generally assumes the value of the company as and ongoing business. The Fair Market Value of an individual security represents a proportionate interest in the Fair Market Value of the company. Depending on the context and the contractual agreement, the Fair Market Value of a security may (or may not) be adjusted or discounted to reflect factors such as Liquidity, minority interest, voting rights, right to control management, and capital structure.

Float: See Public Float.

Founders: the individuals who started a company. Frequently founders are also key management and the controlling stockholders for a Private Company.

Full Ratchet: a downward change in the Conversion Price (or Exercise Price) of a Convertible Security. For a full ratchet Antidilution clause, the Conversion Price of the Convertible Security is reduced to the exact price at which any subsequent security of the issuer is sold at a lower price, regardless of the amount of subsequent securities sold. If an investor purchased Convertible Preferred Stock that is initially convertible at $5.00 per share and the company subsequently sells even a single share of stock (Common Stock or Preferred Stock) at $2.00 per share, then, as a result of applying the Full Ratchet, the investor has the right to convert the investor's own Convertible Preferred Stock at $2.00 per share rather than $5.00 per share. Generally, a Full Ratchet is not available if the stock purchased at a lower price is sold under the company's Stock Option Plan.

Fully Diluted: the total number of shares of Common Stock outstanding. To calculate the Common Stock on a Fully Diluted basis, assume that in addition to all of a company's currently issued and outstanding Common Stock, all Convertible Securities are converted into Common Stock, thereby creating the maximum number of issued and outstanding shares of Common Stock. All Stock Options that are currently exercisable by the holder (i.e., stock options that have Vested and whose current value exceeds the Exercise Price) are treated as if the option has been exercised and the Common Stock issued. Similarly, Convertible Debt is treated as if the Debt has been converted to Common Stock and the Common Stock issued.

GAAP: Generally accepted accounting principles.

Green Shoe: the Underwriter's over-allotment allocation in a securities Offering, a standard feature of a Public Offering. This gives an Underwriter the right (but not the obligation) to purchase additional stock in connection with a Public Offering. The Green Shoe is typically an additional 15 percent of the agreed-upon underwriting amount. The theoretical purpose of the over-allotment allocation is to permit the Underwriter to stabilize the aftermarket for the companies' securities during the period immediately following a Public Offering, and is universally exercisable by the Underwriter at any time during the thirty days following the IPO, including at the IPO closing. By purchasing additional securities available pursuant to the Green Shoe and immediately re-selling the stock to the public, thereby increasing the Public Float, the Underwriter can maintain a balance between the demand for a company's stock and the supply of stock available to satisfy the demand.

*Haircut. (*See Underwriter's Cut Back.)

Holding Period: the period of time an investor is treated as the owner of a security for purposes of calculating the results under, or availability of, treatment of the security under the Internal Revenue Code or SEC rules. As a general rule, longer holding periods create better results for investors under both tax and securities rules. Frequently, the holding periods for tax and securities purposes are calculated differently and in both cases produce results that may surprise investors. For example, if an investor buys stock and pays for it with a promissory note, the holding period under SEC Rule 144 does not commence until the note is paid in full rather than from the date the stockholder pays for the security by issuing the promissory note. For capital gains purposes, seemingly similar circumstances produce very different results. The holding period of Common Stock purchased pursuant to an Option with a significant Exercise Price commences only when the stock is purchased (i.e., converted) rather than when the Option is obtained. This holding period differs from that of Common Stock purchased pursuant to a Convertible Security. In the latter case, the holding period commences when the convertible security is originally purchased rather than when the conversion is effected.

IPO: the initial Offering of a company's securities to the public pursuant to a Registration Statement filed with the SEC.

Issuer: the entity whose securities are being sold.

Junior Debt: (See Subordinated Debt*)*

Key Man Life Insurance: life insurance on the life of a key executive that is payable to the company. Companies buy key man life insurance in order to minimize the possible disruption that would be caused to a business on the death of a key employee. The insurance proceeds are typically used to help attract new executives, redeem either the stock of investors or the deceased, or for other corporate purposes.

Liability: an amount owed by a company, including short-term and long-term liabilities. Short-term liabilities are Debt that must be paid within twelve months), such as amounts owed to suppliers (accounts payable), employees, and tax authorities. Long-term liabilities are Debt that is due beyond one year, such as debt and lease obligations.

Liquidation Preference: the amount of money an investor is entitled to receive prior to any distribution to holders of Common Stock. For Preferred Stockholders, the liquidation preference is always an amount equal to the Purchase Price. Frequently, Liquidation Preferences also include the amount of any Accumulated Dividends. Liquidation Preferences can be shared between separate Classes of stock, or separate Classes can have different priorities of payment. Different series of Preferred Stock may each have a Liquidation Preference in proportion to their respective Purchase Prices. If Series A Preferred Stock invested $5,000,000 and Series B Preferred Stock invested $10,000,000, and had respective Liquidation Preferences equal to their respective Purchase Prices, the in a Sale or liquidation for less than $15,000,000 (i.e., the sum of their Liquidation Preferences), two results would be common:

The Liquidation Preferences could be Pari Passu. For example, if the total funds available on Sale were only $9,000,000, then 3,000,000 would to Series A and $6,000,000 to Series B, i.e., the available liquidation proceeds are shared in the same proportion as the respective Liquidation Preferences. Series A gets one-third of the proceeds since $5,000,000 is one-third of the $15,000,000 total Liquidation Preference.

The Liquidation Preferences could be ranked. In this case, Series B Preferred Stock would have a Liquidation Preference that ranks ahead of Series A Preferred Stock since Series B made their investment after Series A. In this latter set of circumstances, holders of Series B Preferred Stock would receive the entire $9,000,000 available for distribution.

Liquidity: the ability of a security holder to convert a security to cash or to a security that is the equivalent of cash. Different Assets have different levels of liquidity ranging from highly liquid assets such as letters of credit, certificates of deposit, or money market funds to relatively illiquid assets such as Restricted Securities or real estate. Unlike securities in a Public Company that an investor can convert to cash by selling at any time, Restricted Securities in a Private Company can be converted to cash only under limited circumstances (generally on an IPO, Sale, Redemption, or a private sale to another stockholder.)

Lock Up: an Underwriter's right to require holders of Restricted Securities to refrain from selling Restricted Securities during a specified period following the effective date of a Registration Statement filed by the company with the SEC, usually on an IPO but sometimes in connection with subsequent Public Offerings. This right is designed to minimize the availability of new stock for sale to the public to permit the company to facilitate the company's successful Public Offering. Also referred to as a Market Standoff.

Managing Underwriter: the investment banking firm that leads and controls the Underwriting Syndicate, including the investment banks that will be involved in selling the Public Offering. The Managing Underwriter is listed on the left side of the Prospectus.

Market Standoff: See Lock Up.

Mezzanine Securities has two common meanings. Mezzanine Securities refers generally to securities that have superior financial characteristics compared to those of Common Stock; usually, such securities have the characteristics of both debt and equity securities. Frequent examples of Mezzanine Securities are Subordinated Debt with Warrants or various forms of Convertible Preferred Stock (see Preferred Stock).The term Mezzanine Securities or a mezzanine financing is also used to describe the last Private Placement conducted prior to a company's IPO.

Mini/Maxi Offering: a Best Efforts Offering in which investors' funds are not accepted by the company unless a specified minimum number of securities (or dollar amount) is sold and in connection with which only a maximum number of these securities (or dollar amount) will be sold.

Net Worth: the difference between the Assets and Liabilities of an individual or an entity. If an investor owns stocks, bonds, a house, and other Assets worth $2,000,000 and has Liabilities of $500,000 (including mortgage amounts and accrued taxes on appreciated Assets stated at fair market value), then the investor has a net worth of $1,500,000. Similarly, if a company owns land, building, computers, and other tangible and intangible Assets with a cost basis for financial statement purposes of $10 million and has Liabilities of $9 million, then the company has a Net Worth of $1 million.

Non-Competition Agreements: A protective agreement between a company and its employees or consultant(s) stipulating that the employee/consultant will not compete with the company after termination of the employment arrangement. To be legally enforceable, non-competition agreements must have a specified (and reasonable) time period and geographic limitation. Non-competition agreements are also frequently entered into between the buyer and seller of a business. State law varies widely on the enforceability of non-competition agreements, although generally non-competition agreements are more enforceable in the context of buying businesses than in connection with employment arrangements.

Note: the evidence of Debt. If an investor or bank makes a loan to a company, the company issues a Note (i.e., a debt security) evidencing the debt and specifying the terms and conditions of the loan.

Offering: a distribution of securities from a company. An Offering can be a Public Offering, a Private Placement, or a distribution of securities otherwise exempt from the registration requirements of the Securities Act.

Offering Memorandum: the disclosure document delivered to investors in a Private Placement. Sometimes refers also to the Prospectus in a Public Offering.

OID: Original Issue Discount. This complicated tax concept requires that an issuer amortize the premium resulting from the difference between the price at which a debt instrument is purchased and the principal amount paid to the holder at maturity where the difference in the price paid and the premium to be received is certain in both timing and amount. OID calculations can apply to Subordinated Debt with Warrants (or Common Stock) or Preferred Stock, under certain circumstances. Investors who purchase securities subject to OID treatment will receive taxable income (and therefore use cash to pay taxes) despite their not receiving a corresponding current cash t. For Preferred Stock, OID is only received to the extent that the company has earning and profits during the accrual period.

Option refers to the right (but not the obligation) to acquire a security during a specified period by paying an agreed amount of money called the Exercise Price.The Exercise Price can be nominal ($.001) or significant.

Pari passu refers to an equal sharing among different groups. Separate Classes of Preferred Stock are frequently structured to be pari passu with respect to Liquidation Preferences or Dividends. As a consequence, on the Sale of a company, all of the pari passu preferred stockholders would receive distributions in the same proportions as their relative Liquidation Preferences rather than in the chronological order that the preferred stockholders purchased their respective stock. Frequently the later Rounds of Preferred Stock have Liquidation Preferences superior to earlier financing rounds so that the last capital invested is the first capital repaid, and the Liquidation Preferences are therefore not pari passu.

Participating Preferred Stock: Preferred Stock the holder of which has the right on Sale or liquidation first to receive an amount equal to the Liquidation Preference, and then to convert the Participating Preferred Stock into Common Stock so as to participate in the Sale or liquidation proceeds again on an as-converted basis as a Common Stockholder. The participating preferred stockholders' receive a return of their capital prior to the Common Stockholders.

Pay to Play: a situation in which the stockholder must participate in a subsequent Offering in order to benefit from certain Antidilution protections. If the stockholder does not purchase the stockholder's pro rata share in the subsequent Offering, then the stockholder loses the benefit(s) from the Antidilution provisions. In extreme cases, investors who do not participate in subsequent Rounds must convert to Common Stock thereby losing the protective provisions of the Preferred Stock . This approach minimizes the fears of major investors that small or minority investors will benefit by having the major investors continue providing needed Equity, particularly in troubled economic circumstances for the company.

Placement Agent: the broker-dealer who places securities in a Private Placement. Unlike an Underwriter, the placement agent does not purchase and then resell a security. Instead, the placement agent arranges for the direct sale of a security to the purchasers of the security.

Piggyback Registration Rights: an investor's right to have Restricted Securities registered with the SEC and sold in connection with a Public Offering in which the issuer is selling the issuer's own securities. Piggyback Rights are usually subject to Underwriter approval and they may be shared with other investors who also have Piggyback Rights. The investor pays the direct underwriting costs relative to the investor's shares being sold; generally the SEC filing and preparation costs are paid by the company that issues the securities.

Post-Money Value: the value of a company's Equity immediately after a securities offering. The Post-Money Value is calculated by adding the Pre-Money Value to the net company cash proceeds derived from the sale of securities by the company and the receipt of cash from the sale. If a company has a Pre-Money Value of $100 million and conducts a $30 million IPO with all stock being sold by the company, then the company's post-money value is $130 million.

Pre-Emptive Rights: an investor's right to purchase the investor's pro rata (i.e., proportionate) share of any additional securities issued by a company. Pre-Emptive Rights generally do not arise from the sale of securities issued to employees, Directors, and consultants pursuant to agreed limits (frequently under a Stock Option Plan) or from the issuance of securities in connection with independent mergers or acquisitions with unrelated third parties.

Pre-Money Value: the value of a company's equity capital stock immediately prior to a securities Offering.

Preferred Stock: an equity security that has certain agreed preferences with respect to the distribution of cash when a company is sold, goes public, or is liquidated. Generally, Preferred Stock includes a Liquidation Preference. Usually, Preferred Stock also has preferred rights with respect to Dividends, rights to receive specified financial and operating information about the company, and protective provisions, such as affirmative and negative Covenants. Common variations of Preferred Stock include Convertible Preferred, Redeemable Preferred, and Participating Preferred.

Primary Offering: a sale of securities directly by a company from stock that was previously unissued. IPO's are frequently referred to as a Primary Offering, even though IPO's may involve the sale of securities by stockholders.

Private Company: a company that has not sold any securities in a Public Offering, or otherwise become subject to the reporting requirements of the Securities Exchange Act. Businesses that have raised money by selling securities in a Private Placement remain Private Companies even though outside investors are securities holders. Private Companies have no obligation to provide information about their business to the public or to their securities holders except to an extremely limited degree under state corporate law or except by contractual agreement with the investors. Because of various state and federal securities laws, there are no secondary trading markets for the securities of private companies.

Private Placement: a non-public (i.e., private) distribution of securities in an Offering that is exempt from the registration requirements of the Securities Act, usually to a limited number of sophisticated investors. Rule 506 Offerings are private placements that can be sold to an unlimited number of Accredited Investors.

Prospectus: the disclosure document section of a Registration Statement that is delivered to investors in a Public Offering. The prospectus is similar to an Offering Memorandum and contains SEC mandated narrative and financial information. The prospectus is Part I of a Registration Statement. Part II of a Registration Statement is filed only with the SEC and is not delivered to investors.

Public Company: a company that has sold securities to the public in an IPO or otherwise become subject to the reporting requirements of the 1934 Act. Public Companies must provide extensive, ongoing financial and narrative information about their business conditions, results, and prospects in annual, quarterly, and periodic reports that are filed with the SEC and available publicly. Trading in the securities of a Public Company is permitted subject to the provisions of the 1934 Act.

Public Float: the amount of Common Stock of a Public Company that is actually available for active trading in the public market. The calculation of a company's public float normally excludes securities held by officers, Directors, and affiliates. The Public Float also excludes securities that cannot be sold by agreement with the security holder. The smaller the Public Float, the less Liquidity is available to someone seeking to sell stock. Many institutional investors (i.e., pension funds and mutual funds that buy large amounts of securities) will not purchase securities in a company whose Public Float is below a minimum size because the institutional investor will lack the ability to easily and quickly sell large amounts of securities.

Public Offering: a securities Offering that has been registered with the SEC, and is sold to the public usually by an Underwriting Syndicate.

Purchase Price: the price paid by the initial holder of a security to the company that issued the security. For Preferred Stock, the Liquidation Preference is generally equal to the Purchase Price plus any unpaid Accumulated Dividends.

Put Rights: the right (but not the obligation) of a security holder to force someone else to purchase the put holder's securities at a designated time (e.g., five years after the security is purchased) or upon a specified occurrence (e.g. the company commits an Event of Default). The put price is either a fixed price or is set according to specified terms, conditions, and pursuant to an agreed pricing formula. A Put Right provides investors with a safety net: even if management or the controlling stockholders do not want to sell the company or take it public, the investor nonetheless has the ability to achieve liquidity by requiring the company to redeem the investor's security at a price or on the conditions set. A Put is the opposite of a Call. (See Call Rights.)

Qualified Small Business Stock: stock of qualifying domestic C Corporations as defined under Section 1202 of the Internal Revenue Code. To qualify, a corporation's gross Assets cannot exceed $50 million (on a tax basis) and at least 80 percent by value of the company's Assets must be used in the active conduct of one or more qualified trades or businesses. Section 1202 does not apply to S Corporations, limited liability companies, or limited partnerships. Qualified Small Business Stock held for at least five years qualifies for a reduced long-term capital gains rate on sale and is also the beneficiary of certain preferential rollover treatment after a Holding Period of six months.

Qualifying IPO: an IPO that has exceeded certain minimum, contractually agreed upon standards that frequently include one or more of the following:

- a minimum aggregate dollar amount (gross or net)
- a specified stock price (e.g., greater than $5.00)
- led by high quality Underwriter (e.g. National Underwriters)
- traded in an agreed trading market or exchange (NASDAQ, New York Stock Exchange, or American Stock Exchange)

These minimum standards for a Qualifying IPO protect preferred stockholders from converting from Preferred Stock to Common Stock in connection with an IPO that is too small, creates an insufficient Public Float or trading mechanism, or that has no meaningful public market or liquidity for the investor.

Ratchet provisions: Antidilution provisions.

Redemption: the repurchase of a security by the company that issued the security. Redemptions can be voluntary or mandatory. State laws vary considerably but usually they limit the amount of stock that can be redeemed by a company to an amount that will ot render the company insolvent nor impair the company's capital.

Redeemable Preferred Stock: Preferred Stock that must be redeemed by the company at a fixed time and for a fixed amount, usually the amount of the invested capital (i.e., the Purchase Price) and dividends at an agreed rate. Redeemable Preferred Stock serves much the same purpose as Subordinated Debt since Redeemable Preferred Stock ranks below Equity but above Debt in the order of repayment on Sale or liquidation. Redeemable Preferred Stock is not convertible. (See also Convertible Preferred Stock.)

Registration Rights: the right of an investor to have Restricted Securities registered with the SEC. Registration Rights are either Demand Registration Rights or Piggyback Registration Rights. These rights are desirable for investors even after an IPO because an investor may not be able to sell large amounts of Restricted Securities quickly because of securities laws restrictions or market conditions.

Registration Statement: a disclosure document filed with the SEC in connection with registering specific securities under the federal securities laws. A registration statement includes mandated financial and narrative information, including the Prospectus.

Regulation D: the SEC safe harbor rules governing the terms and conditions for certain Private Placements, whose initial sale is exempt from SEC registration requirements, including Rule 506 Offerings.

Restricted Securities: securities sold in a Private Placement. Restricted Securities cannot be resold except pursuant to a Registration Statement or an applicable exemption from SEC registration such as Rule 144.

Review Statement: a financial statement that is prepared by a CPA that involves a lower level of testing than in an Audited Statement but involves more testing than a Compilation Statement. The CPA must be of the opinion that no material modifications would be made to the financial statement in order to conform to GAAP.

Right of First Refusal: See Pre-Emptive Rights.

Rounds: successive separate Private Placements by a company. The initial Private Placement is also called the first round of financing. Subsequent Private Placements are designated as the second round, third round, and so on. The final round prior to a Public Offering, usually conducted for the purpose of providing the company with enough cash to operate until the IPO takes place, is referred to as a Mezzanine Financing particularly for companies whose funding is provided by venture capital funds.

Rule 144: The SEC Rule that governs the resale of Private Placement securities (i.e. Restricted Securities) not sold in connection with a registered Public Offering. Generally, a person not affiliated with the issuer who has beneficially owned restricted securities for at least one year is entitled to sell, within any three-month period, a number of shares that does not exceed the greater of:

1 percent of the then outstanding shares of Common Stock, or

the average weekly trading volume in the Common Stock during the four calendar weeks preceding the date of the notice of sale that is required to be filed.

Rule 144 sales are also subject to certain concurrent notice requirements and manner of sale restrictions.

Rule 506 Offerings: private placements conducted under SEC Rule 506. Rule 506 Offerings can be sold to an unlimited number of Accredited Investors and are unlimited in dollar amount.

Sale: the sale of a company's business either by sale of all, or substantially all, of the company's Assets, sale of all of its stock, or merger.

S-1: the most complete Registration Statement filed by a company with the SEC. It is used when shorter form registration statements are not available to a company either because the company's financial characteristics require an S-1 or because the company has not been a Public Company for at least one year. Shorter form registration statements such as Form SB-1 and Form SB-2 can be utilized by small business issuers for both primary and secondary Offerings.

S-3: a Registration Statement that is shorter and less complete than an S-1 and is available to domestic issuers that have been a Public Company for at least one year and satisfy certain other requirements, particularly a significant Public Float. S-3 is also referred to as a shelf registration and may be kept current for a period of two years by updating the financial statements and noting any material changes.

S-8: a Registration Statement filed by an issuer to register employee benefit plans, including Stock Option Plans.

S Corporation: a company the federal income tax status of which is subject to Subchapter S of the Internal Revenue Code, and that is a tax pass through entity. Corporate income is treated as distributed to the company's stockholders (i.e., passed through) so that the federal income taxes on corporate income are owed by the stockholders individually in proportion to their ownership, rather than by the company. Because of the tax advantages, many Private Companies are S Corporations. There are numerous limitations on the number and type of stockholders an S Corporation can have. There are also significant restrictions on the type of securities that can be sold by an S Corporation, and most Mezzanine Securities generally cannot be issued by an S Corporation. Because of the limitations on the number of stockholders an S Corporation can have (75), no Public Companies can be S Corporations because the number of stockholders they have exceeds IRS restrictions for S Corporations.
SEC: the Securities and Exchange Commission, the primary federal agency that administers the federal securities laws.

Secondary Offering: the sale of securities by a selling stockholder rather than by the company. The term is also used to describe Public Offerings of a company subsequent to the IPO, even though most or all of the securities are being sold by the company.

Secured Debt: Debt the repayment of which is secured because the borrower has provided Collateral to the lender. Most companies' loans from banks are secured loans in which the company has given the bank Collateral including inventory, accounts receivable, and machinery and equipment.

Securities Act: the Securities Act of 1933, the federal statute that created the SEC and governs the original issuance of securities, including Private Placements, IPOs, and exempt transactions.

Securities Exchange Act of 1934: See 1934 Act.

1934 Act: the Securities Exchange Act of 1934, the federal statute that governs the resale and market activities of securities, including securities exchanges. The 1934 Act also details the ongoing reporting and information requirements for public companies and certain shareholders including the requirements governing the annual (Form 10-K), quarterly (Form 10-Q), and periodic (Form 8-K) reports to shareholders, and rules governing proxy solicitations and tender offers..

§1045: Section 1045 of the Internal Revenue Code that permits holders of Qualified Small Business Stock to defer capital gain from the sale of such stock after a holding period of more than six months to the extent that the investor uses the sale proceeds to purchase other Qualified Small Business Stock within 60 days of the sale.

§1202: Section 1202 of the Internal Revenue Code that provides a lower capital gains rate for qualifying holders of Qualified Small Business Stock whose Holding Period is more than five years.

Senior Debt: Debt that has contractually superior rights compared to the Debt to another lender to a company. The superior rights can be with respect to priority of payment of principal or interest or both, as well as with respect to Collateral in which both the holder of the Senior Debt and Junior Debt have a security interest.

Series: a division of a Class of securities. Blank Check Preferred Stock is a class of security, frequently subdivided into separate series that are sold at different times and that have different liquidation rights, preferences, prices, voting rights, or conversion rights.

Stock Option Plan: a long-term performance incentive plan designed to assist a company and its stockholders by providing economic incentives to employees, Directors, and consultants to the company in the form of Options to acquire Common Stock of the company at a fixed price and during a fixed term. Stock Options are usually subject to Vesting restrictions so that the option holder has an incentive to remain with the company for at least the vesting period in order to receive all of the Options. Since Options have value only if the price of the Common Stock that can be acquired increases, the option holder has an additional incentive as an option holder, not just an employee, to help the company achieve operational and financial success.

Strike Price: See Exercise Price.

Subordinated Debt: Debt securities (also referred to as Junior Debt) that have granted superior rights in favor of another lender to the company (also called Senior Debt). The superior rights can be with respect to relative rights to receive payment of principal or interest (or both) or sharing rights with respect to Collateral. The most universal feature of Subordinated Debt is that on a Sale or liquidation of a company, the Senior Debt is repaid in full prior to any payments on the Subordinated Debt. Frequently, if the Senior Debt is in Default, the senior lender has the right to receive payment of principal and interest prior to the lender on the Junior Debt. The senior lender may stop the company from making any payments on the Subordinated Debt until the Senior Debt is no longer in default. The precise terms of the subordination and the relative rights of the Senior Debt and Junior Debt are agreed to contractually and are the subject of significant negotiation and variation.

Tag Along Rights: See Co-Sale Rights.

Term Sheet: an agreement between a financial intermediary and an issuer or between a venture capital firm and a company in which it is investing (a portfolio company) that outlines the basic business, financial, and operating terms that will form the basis for an investment. Term sheets can be long or short and generally are subject to the execution of longer documents that fully explain alll of the agreements between the parties (i.e., the definitive agreements). Common topics covered in a term sheet are capital structure and the nature, amount, and timing of the investment, Antidilution protection, composition of the Board of Directors, employment agreements, and Non-Competition Agreements with the Founders, Registration Rights, and investor Exit Strategies.

Treasury Stock: stock that has been issued by a company and then subsequently re-purchased by the company (i.e., in a Redemption), but that has not been retired and can therefore be re-issued (i.e., sold again) by the company.

Underwriter: the investment bank in a Public Offering that purchases SEC registered securities from a company and immediately re-sells them to public investors. There is generally a Managing Underwriter as well as an Underwriting Syndicate. The Managing Underwriter is listed on the left side of the Prospectus to indicate that this entity leads and controls the underwriting syndicate.

Underwriter's Cut Back: the right of an Underwriter to reduce the number of securities being sold in an Offering, generally the number of those securities being sold by selling stockholders. This right is designed to facilitate the company's Public Offering. The cut back is usually pro rata to all selling stockholders in proportion to the shares they intend to sell. Also referred to as a Haircut.

Underwriting Discounts and Commissions: the fees paid to the Underwriter(s) in connection with a Public Offering. Discounts and commissions do not include the costs of a Public Offering such as SEC filing fees, printing, legal, or accounting costs, or stock transfer taxes.

Underwriting Syndicate: investment banks that act as a group to market a Public Offering, purchase the securities from the issuer, and then re-sell the securities to the public.

Unit: a security that consists of two or more securities sold in combination to achieve a particular financial result, generally a financial result that is difficult to structure into a single security. A common example is a Unit consisting of one security that provides for protection of principal and an interest component (such as Subordinated Debt or Redeemable Preferred Stock) combined with a different security that has the potential for equity appreciation based on the success of the business, such as Options, Warrants, or Common Stock.

Venture Capital: Risk equity investing, generally in private equities of Private Companies, with a goal of achieving above-average long-term investment returns compensating for the investment risk. Venture capital includes investments in start-ups, expansion stage companies, and emerging growth companies. Venture capital investments are structured so that liquidity can be achieved, usually within three to seven years.

Vesting: the rate at which Options granted under a Stock Option Plan become exercisable by the Option holder. Most Stock Option Plans provide that Options vest (and therefore become exercisable by the Option holder) over a period of years so that the company gets the benefit of extended employment and performance from the Option holder. A common pattern is for Options to vest in equal percentages over 3-5 years, usually on the anniversary date of the Option grant. If the Option holder's relationship with the company ceases, then the Option holder forfeits the Options that have not yet become vested.

Waiver: the voluntary process by which investors relinquish a contractual right (such as a Covenant) usually by affirmative vote of at least a majority of the affected investors. The effect of granting a waiver is either that the issuer is not in breach of a contractual obligation or that the issuer can take an action that would otherwise be contractually prohibited.

Warrant: the right (but not the obligation) to acquire Common Stock during a specified period by paying an agreed amount of money. The Exercise Price of a warrant can be nominal ($.001) or significant.

Weighted Average: a form of Antidilution protection that adjusts the Conversion Price or the amount of securities into which a Convertible Security converts when a subsequent Offering of securities (Common Stock or Preferred Stock) is made at a lower price. Unlike Full Ratchet antidilution provisions, the weighted average price protection is effected by the size or amount of the subsequent issuance to reflect the actual adverse impact incurred by the security holder. The conversion price is reduced by applying a complicated formula based on the shares outstanding prior to the new issue of securities and the current conversion price, and on the amount of money received by the issuer divided by the number of Fully-Diluted shares of Common Stock outstanding after the new issue.

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All references to rules, regulations, or statutes are to such rules, regulations, or statutes as amended or modified.