

Tech Coast Angels

San Diego Chapter

Pro Rata Rights

with JEREMY NEILSON // October 2020

Elements of Pro Rata Rights



- What are Pro Rata Rights
- How do Pro Rata Rights add value
- How are Pro Rata Rights obtained
- Structuring and Administration



What are Pro Rata Rights



Pro-rata rights are the legal right to invest more capital when the company raises follow-on funds. Usually this is at a higher valuation than in previous rounds. This legal right may need to be negotiated, and it is usually offered to “major purchasers,” which are investors with significant equity positions. Pro Rata rights tend to have their most value when they are available for multiple rounds of financing.



Pro Rata Rights = Juice



- Upon initial investment: investments are what they are
- For example: If you invest in Uber...it is Uber and a fantastic return will be the outcome
- Pro Rata Rights are how you juice your returns



Uber Pro Rata Juice



- Seed Stage investment: 3,000,000% return
 - \$5,000 investment = \$15M



Source: <https://officechai.com/startups/extraordinary-returns-early-investors-will-make-ubers-ipo/>

Uber Pro Rata Juice



- Seed Stage investment: 3,000,000% return
 - \$5,000 investment = \$15M
- Series A investment: 1,700,000% return
 - \$5,000 investment = \$8.5M



Uber Pro Rata Juice



- Seed Stage investment: 3,000,000% return
 - \$5,000 investment = \$15M
 - Series A investment: 1,700,000% return
 - \$5,000 investment = \$8.5M
 - Series B investment: 1,000% return
 - \$5,000 investment = \$55K
- TOTAL \$23.55M



Uber Pro Rata Juice



- Seed Stage investment: 3,000,000% return
 - \$5,000 investment = \$15M
- Series A investment: 1,700,000% return
 - \$10,000 investment = \$17M



Uber Pro Rata Juice



- Seed Stage investment: 3,000,000% return
 - \$5,000 investment = \$15M
 - Series A investment: 1,700,000% return
 - \$10,000 investment = \$17M
 - Series B investment: 1,000% return
 - \$15,000 investment = \$165K
- TOTAL \$32.165M



How are Pro Rata Rights Obtained



Major Investor Rights

Major Purchaser Dollar Threshold” means \$500,000

- Company will permit each Major Purchaser to examine its books and to discuss the Company’s affairs, finances and accounts with its officers
- Major Purchaser has the right of first refusal to purchase the Major Purchaser’s Pro Rata Share

How are Pro Rata Rights Obtained



Everyone Gets Some

“Pro Rata Rights Agreement” means a written agreement between the Company and the Investor giving the Investor a right to purchase its pro rata share of private placements of securities by the Company occurring after the Equity Financing, subject to customary exceptions. Pro rata for purposes of the Pro Rata Rights Agreement will be calculated based on the ratio of (1) the number of shares of Capital Stock owned by the Investor immediately prior to the issuance of the securities to (2) the total number of shares of outstanding Capital Stock on a fully diluted basis, calculated as of immediately prior to the issuance of the securities.

How do Pro Rata Rights Work?



Example:

“You invest \$50k in a seed round at a \$5mm cap and own 1% of the company. The next round is a \$3mm round at \$9mm pre, \$12mm post. If you don’t participate, you will be diluted 25% and will then own 0.75% of the company. On the other hand, if you buy 1% of the round, a \$30k investment, you will continue to own 1% of the company. Your ‘pro-rata right’ in this situation is a \$30k allocation in the next round.”

How are Pro Rata Rights Obtained



Side Letter

XYC Fund shall have a right of first offer to purchase up to the greater of (i) 25% or (ii) \$700K in aggregate purchase price, of any Equity Securities the Company proposes to sell or issue following the date of this letter agreement until immediately following the consummation of the Company's next sale of Equity Securities from which it receives gross proceeds of at least \$1,000,000.00...

How do Pro Rata Rights Work?



Example II:

“You invest \$250k in a seed round at a \$5mm cap and own 5% of the company. If the next round is a \$3mm round at \$9mm pre, \$12mm post, and if you buy 25% (side letter) of the round, you would be investing \$750k.



4 Approaches

- Pass
- Use the current vehicle
- New SPV
- Third Party SPV



Follow-on Investment Rights

At times the Fund's investment in a Portfolio Company by its terms gives rise to preferential rights, requests to purchase additional shares in that Portfolio Company's future offerings, or a general right of first refusal (collectively, "**Follow-on Investment Rights**"). **The Fund hereby assigns and delegates all Follow-on Investment Rights to the Organizer.** In the event that the Fund, as a holder of Portfolio Company Securities, is presented with the opportunity or request to make additional or "follow-on" investments in that Portfolio Company, the Fund may make those follow on investments; provided, however, the Organizer may, in its sole discretion, organize one or more additional entities with additional members for the purpose of making that follow on investment and may extend any investment opportunity to the Members at its own discretion....



4 Approaches

- Pass
- Use the current vehicle
- New SPV
- Third Party SPV



Peter Thiel~

“Biggest mistake ever was not to do the Series B round at Facebook. General lesson: Whenever a tech startup has a strong up round led by a top tier investor, it is generally still undervalued. The steeper the up round, the greater the undervaluation.”

THANK YOU

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Interested in working with Assure?

Reach out to Rob Lusk
rlusk@assure.co