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EQUITYZEN™

Secondary Markets for Private Company Shares

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Agenda

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I. Introduction

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Dawn Belt

Dawn Belt is an attorney at Fenwick & West LLP, a leading law firm based in Silicon Valley. Her practice includes start-up counseling, venture capital financings, mergers and acquisitions, initial public offerings, SEC compliance and corporate governance.

Dawn holds a JD/MBA from the University of California, Berkeley law and business schools (Boalt Hall and Haas) and a B.A. in Economics and American Studies from Stanford University.

Dawn works with many high growth technology companies including Dropbox, Facebook, GoPro, Nimble Storage and ServiceNow.

Prior to joining Fenwick & West, Dawn worked as an economic consultant specializing in the valuation of technologies and business ventures.

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Shriram Bhashyam

Shri is co-founder and head of legal affairs at EquityZen; A marketplace for pre-IPO investments. Previously, Shri was an attorney at Shearman & Sterling LLP, a New York-based global law firm.

In addition to EquityZen's legal matters, Shri manages transaction structure and execution, and is involved with product and business development.

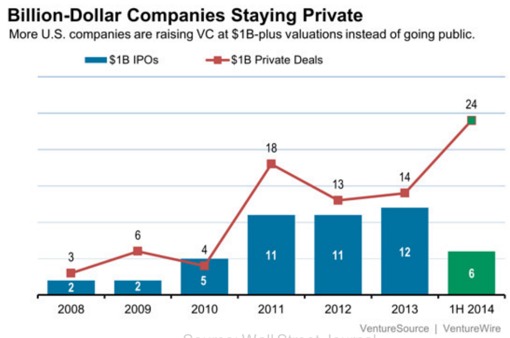
At Shearman & Sterling, Shri advised market participants on regulatory, transactional, and trading and markets issues, with a particular focus on U.S. broker-dealer and securities regulation.

Why Secondaries Matter

- Investors
  - Companies are staying private longer
  - More value captured in Private over Public Markets
- Employees
  - Shareholder net worth is increasingly concentrated in illiquid private stock
  - Shareholder liquidity needs are not in line with the liquidity timeline of Company

Companies
  - Companies increasingly want to avoid/delay IPO
  - Compounds employee liquidity issues

Companies Staying Private Longer



Source: Wall Street Journal

Median time to IPO exit for venture-backed companies was 3.1 years in 2000 and 7.4 years in 2013 (source: NVCA).

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II. Secondaries 1.0

- Early Private Sales
- Active Trading on Platforms
- Issuer Response

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Early private sales

- Pre-late 2000s, rare one-off transactions
  - Limited information on private companies
  - Too costly to find buyers and sellers
  - Limited knowledge on how to execute sales
- Most common transfer restrictions:
  - No transfer of options
  - No transfer of unvested shares
  - Company right of first refusal (ROFR) on vested shares

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Active Trading on Platforms

- Development of active markets
- Consumer-facing companies: Facebook, Zynga, Twitter
- SecondMarket & SharesPost
  - Platforms for sellers and buyers
  - Aggregated some publicly available information
  - Facilitated transactions for a fee

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Secondaries 1.0

- Secondary market participants
  - Buyers included individuals, investment funds and fraudsters
  - Sellers included existing stockholders, current and ex-employees
- Massive distraction to companies
  - Administrative, legal, employee morale/incentive and other issues
- Companies started organizing or sanctioning specific programs as an alternative
  - Input on buyers, sellers, process and messaging

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III. Current Alternatives

- Transfer Restrictions
- Deal Structures

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Transfer Restrictions

- In addition to standard and existing transfer restrictions, issuers imposed the following:
  - Blanket company approval rights over proposed share transfers
  - Board approval of proposed share transfers conducted via platforms, portals, websites, or brokers.
    - Board approval is a high hurdle to cross for a single shareholder secondary transaction.
- These new restrictions have been imposed in
  - Exercise agreement/ stock option agreement
  - By-laws (most employees are not aware of the by-laws or that there are material terms in there that impact their rights)

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Transfer Restrictions

- Other responses by issuers:
  - Establishing a policy of non-approval of share transfers unless conducted pursuant to company-sanctioned tender offer or buyback.
  - Allow one-time liquidity for a portion of holdings in exchange for a promise to not seek liquidity until company exit.
  - Paying a bonus at time of departure in exchange for a promise to not seek liquidity until company exit.
  - Allowing liquidity in exchange for accepting all future amendments to by-laws and other equity-impacting documents.
    - Future restrictions then added via amendment are applicable to the shareholder who didn't have such restrictions in place.

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Deal Structures

- Tender Offers
  - Company Tender: Company issues preferred shares to new investor and uses proceeds to purchase common from employees (and others).
  - Third Party Tender: New outside or existing investor purchases common from employees (and others).
  - Predetermined Price per share
    - Fees may be spread over sellers
  - Maximum # of shares
  - Usually capped at a % of vested shares
  - Potential difference for Current Vs. Former Employees

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Deal Structures

- Option Financing
  - Other alternatives for employees include funds (e.g. ESOFund) that partner with current or ex-employees to help them pay for the exercise and tax liability of their options.
  - Shareholder receives Funds to cover Exercise and pay AMT Tax
  - May also receive small, additional cash surplus
  - Fund receives Liquidity Preference (1-2x) of investment
  - The Fund takes percentage of the upside (10 – 40%)
  - Some providers also use a loan structure

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Deal Structures

- Pledging
  - An alternative structure by which the legal ownership of the shares is not transferred but full economic interests change hands
  - The structure is a derivative collateralized by physical shares through a pledge
  - Triggers the ROFR
    - Or, transfers the ROFR to the lender – which lenders don't generally find acceptable
  - No impact to the cap table
  - No change to shareholder count
  - No transfer of voting or information rights

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IV. Legal Considerations

- Unregistered Securities
- 10b5 Liability
- Contractual Restrictions
- Lock-ups

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Legal Considerations

- Private company shares are unregistered securities, so stock sales need an exemption:
  - Rule 144: 1 year holding period for non-reporting companies.
  - "Section 4(1)1/2" exemption
    - Substantial compliance with Regulation D
  - Blue Sky (state securities) compliance
  - Companies will often require legal opinions from sellers

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Legal Considerations

- Rule 10b-5 liability
  - Potential asymmetrical information issues when sellers are employees or company insiders
- Contractual Restrictions
  - Company's right of first refusal
  - Investors' right of first refusal (and co-sale)
  - Blanket transfer restrictions
  - Only vested shares may be transferred
  - What restrictions travel with the shares?
- Market Standoff (180 Days post-IPO)

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V. Business Considerations

- Impact of Secondaries on Companies
- Impact of lack of liquidity

Business Considerations

- New shareholders on the cap table
  - Administrative burden for issuer
  - Companies are required to become public reporting companies if they exceed 2,000 stockholders or 500 non-accredited stockholders, not including stockholders who receive shares through an equity incentive plan.
    - JOBS Act allowed for increased flexibility (previously was 500 stockholders overall)

Business Considerations

- Information Leakage
  - New shareholders means transfer of voting, information, and control rights
  - Concern in individual transaction where company cannot control flow of information or the buyer
- Unknown Buyers
  - Purchaser may be adverse to issuer's interests

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Business Considerations

- Employee Issues
  - Equity compensation aligns employees' and company's interests.
  - If an employee 'cashes out' it may create out of work distractions and disincentivize.
  - However, employees with a high net worth on paper struggle to meet real-life financial needs.
  - Employee liquidity can have a significant impact on morale and retention
  - Does employee liquidity further align or misalign incentives?

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Business Considerations

- Resource Allocation
  - Secondary Transactions take significant mind share in terms of negotiation, paper work, and legal fees.
  - These are not efficient ways to spend time and money as a growing, private company.

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VI. Secondaries 2.0

Developing a secondary market solution that addresses concerns of all stakeholders

- Will secondary liquidity gain greater embrace from the ecosystem?
- Liquidity as a compensation tool for issuers
- Growth of crowdfunding

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VII. Conclusion and Q&A

- Thank You!
- Questions?

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