FOUNDERS / FUNDRAISING INSTRUMENTS

Convertible Note — Term Sheet

Annotated market-standard convertible note term sheet for a pre-seed or seed round.

Educational template — not legal or financial advice. Consult qualified counsel before use. Market terms vary by jurisdiction and by deal.

Summary of Terms

This term sheet summarizes the principal terms of a proposed investment by the Investor(s) named on the signature page (the "**Investor**") in [Company Name], Inc., a Delaware corporation (the "**Company**"), in the form of one or more convertible promissory notes (the "**Notes**"). This summary is for discussion purposes only. Other than the confidentiality and exclusivity provisions (if any are separately agreed), nothing in this document is binding, and no obligation to invest or to complete the financing arises until definitive Note purchase documents are executed.

Issuer

The Company issuing the Notes. The Notes are typically issued in one closing or in a series of closings over a defined window (commonly 60–120 days), all on the same terms, so that no investor in the round receives materially better economics than another.

> WHY THIS MATTERS A rolling close with inconsistent terms across investors is a recurring source of later disputes and a red flag in diligence at the next round — incoming counsel will ask whether every noteholder converted on identical terms.

> MARKET RANGE Single close is most common below USD 1M raised; a rolling close with a fixed cutoff date is standard for larger pre-seed/seed rounds raised over several months.

Principal Amount

The aggregate amount the Investor is committing to lend the Company under the Note, e.g., `USD 250,000`. The Note accrues interest on this principal from the date of issuance until it converts, is repaid, or matures.

> WHY THIS MATTERS The principal amount, not the pre-money valuation, is what a note actually specifies — a note has no valuation of the Company at the time it is signed, which is precisely why the discount and cap mechanisms below exist.

> MARKET RANGE Individual notes in a seed bridge commonly range USD 25,000–USD 500,000; total round size for a note-based bridge is typically USD 250,000–USD 2,000,000.

Maturity Date

The date by which the Note must convert, be repaid, or be extended by mutual agreement — typically 18–24 months from issuance. In practice, maturity is rarely enforced by demanding repayment; most notes that reach maturity without a priced round are extended, and demanding cash repayment from an early-stage company is usually not in either party's interest.

> `WHY THIS MATTERS` A maturity date that is too short (under 12 months) puts pressure on the Company to raise a priced round on an artificial timeline; too long (over 30 months) removes any real forcing function and can leave capital stranded with no conversion event in sight.

> `MARKET RANGE` 18–24 months is standard. Below 12 months is investor-aggressive; above 30 months is founder-friendly to the point most investors will push back.

Interest Rate

Interest rate: `5–8% per annum, simple interest` (typical for pre-seed/seed). Interest accrues on the outstanding principal but is rarely paid in cash before conversion — it typically capitalizes and converts into equity alongside the principal at the same discount/cap terms.

> `WHY THIS MATTERS` Accrued interest increases the number of shares the investor receives at conversion, which is easy for a founder to overlook when estimating dilution — a note outstanding for 18 months at 6% simple interest adds roughly 9% to the converting balance.

> `MARKET RANGE` 5–8% simple interest is standard. Rates set at or near the IRS Applicable Federal Rate (a floor to avoid the loan being treated as below-market for tax purposes) are common at the low end.

Conversion Discount

Discount rate: `10–25%`. At the next qualified priced equity financing (a "**Qualified Financing**," typically defined as a raise above a minimum threshold, e.g., USD 1,000,000, of new money), the Note converts into the same class of stock issued in that round, at a price equal to the round's price per share multiplied by (1 − discount).

> `WHY THIS MATTERS` The discount rewards the note-holder for taking early risk by giving them a better price than the new investors in the priced round — it only ever helps the note-holder relative to the round price, never the other way.

> `MARKET RANGE` 15–20% is most common. Below 10% is unusually founder-favorable; above 25% is aggressive and typically signals a later, riskier bridge rather than a clean seed.

Valuation Cap

Valuation cap: `typically 20–40% above the Company's current informal valuation for a pre-seed round`, e.g., USD 6,000,000–USD 8,000,000 on a company informally valued around USD 5,000,000. The cap sets the maximum effective valuation at which the Note converts, regardless of the actual price of the priced round — if the round prices above the cap, the Note converts as though the round had priced at the cap instead.

> `WHY THIS MATTERS` The cap and the discount both apply, and the Note converts at whichever produces the *lower* price per share (i.e., more shares for the investor) — a company that grows quickly between the note and the priced round will find the cap, not the discount, is what actually governs conversion.

> `MARKET RANGE` A cap set 20–40% above the last informal valuation marker is standard. No cap at all (an uncapped note) is founder-friendly and increasingly rare outside of insider bridges from existing investors.

Most Favored Nation (MFN)

If the Company issues additional convertible securities on terms more favorable to a subsequent investor before the Notes convert or are repaid, the Investor is entitled to elect those more favorable terms for their own Note.

> WHY THIS MATTERS MFN protects early, higher-risk note-holders from being disadvantaged by a later investor who negotiates a better cap or discount during the same bridge — without it, the earliest money in can end up with the worst terms.

> MARKET RANGE Standard on most seed notes. Investors sometimes request MFN rights survive until the Qualified Financing closes, not merely until the next note is issued — a reasonable ask, but negotiable.

Pro Rata Rights

The Investor is granted the right, but not the obligation, to purchase its pro rata share of new securities issued in future financing rounds, sufficient to maintain its percentage ownership as calculated at conversion.

> WHY THIS MATTERS Pro rata rights are what let a small early check maintain its ownership percentage as the company raises larger rounds — without them, every subsequent round dilutes the note-holder with no ability to defend their position.

> MARKET RANGE Standard for any check above roughly USD 25,000. Often capped to major investors only (a defined minimum check size) to avoid administrative burden from a long list of small pro rata holders.

Governing Law

The Notes and all related definitive documents are governed by the laws of the State of Delaware (for a Delaware C-corporation) or the relevant jurisdiction of incorporation, without regard to conflict-of-laws principles.

> WHY THIS MATTERS Delaware's body of corporate case law is deep and well-tested, which is exactly why the vast majority of US venture-backed companies incorporate there — disputes over convertible instruments have real, predictable precedent to draw on.

> MARKET RANGE Delaware is standard for US venture deals regardless of where the Company actually operates. A different governing law is not wrong, only unusual, and should prompt a specific question about why.

WORKED ILLUSTRATION — HOW THE NUMBERS INTERACT

A USD 200,000 note at a 20% discount and a USD 6,000,000 cap, outstanding 12 months at 6% simple interest, converts with USD 212,000 (principal + accrued interest) as the converting balance. If the priced round happens at an USD 8,000,000 pre-money valuation, the discount price would apply an effective USD 6,400,000 valuation (8,000,000 × 0.8) — but the USD 6,000,000 cap is lower, so the cap governs and the note converts as if the round had priced at USD 6,000,000, not USD 6,400,000 and not USD 8,000,000. The note-holder receives more shares than either the discount or the headline round price alone would have produced.

Reading This Term Sheet

A convertible note is a loan, not an equity purchase — that single fact explains most of its structure. The Company owes the principal (plus accrued interest) back to the Investor unless and until it converts into equity. The discount and cap are the two competing mechanisms that determine the price at which that conversion happens, and the Note always converts on whichever produces the lower effective price for the investor. Everything else in this term sheet — maturity, MFN, pro rata — exists to manage what happens if the priced round the Note is waiting for takes longer than expected, or never happens at all.

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