



WHY CONVERTIBLES?

Many start-up company owners will definitely raise funds in the early stages of their business, but at the same time they are worried that new investors will dilute their control rights after entering, making them unable to control the future development of the company. In contrast, investors want to invest but they have concerns about the payback period of start-up companies, so in recent years, more and more convertible notes (or convertible bonds) have been utilized as financing tools in deal-making.

Convertible notes, also known as convertible bonds, generally have a validity period ranging from one to ten years. To put it simply, convertible notes are a bond with additional terms. When the stock price is higher than a certain price (that is, the exercise price), the creditor can choose the exercise clause to convert the bond into shares at the agreed exercise price. However, if the stock price never exceeds the strike price before the maturity, then it will remain as an ordinary bond, and the bond issuer will distribute coupons within the period.

Of course, readers with a clear mind should immediately have a question: *"How can there be a stock price if the start-up has not yet been listed?"*

That's right, just because there is no so-called "market price" for the equity value of a start-up company, it will be more difficult for investors to determine a valuation. People investing from the perspective of borrowing money at the beginning will make them feel safer. Investors will use convertible notes as a means of debt financing to support the company in the early stage, hoping that the company will be listed one day in the future. And if the company can successfully reach the listing stage, investors will convert their convertible notes into ordinary or preferred shares during the pre-ipo stage or after listing, and eventually exit with market stock prices if preferred.

As an example we can refer to the 2019 WeWork prospectus, which mentioned that in August 2018, WeWork issued a US\$1 billion convertible bond to SB WW Holdings (Cayman) Limited (a subsidiary of Softbank Cayman). As of July 2019, the entire \$1 billion principal amount of the convertible bond has been converted into 9,090,909 WeWork preferred shares at a conversion price of \$110 per preferred share.

