Decoding the Healthcare Tech Term Sheet: A Practical Guide to Understanding the Money Behind the Medicine

OCT 28, 2025 • PAID

Disclaimer: The views and opinions expressed in this essay are solely my own and do n reflect the positions, strategies, or opinions of my employer or any affiliated organizat

Abstract

This essay provides a comprehensive exploration of term sheet mechanics for healthcare technology investments, examining the critical components that defir relationship between founders and investors. The abstract outlines the key areas covered: valuation methodologies specific to health tech companies, including b traditional and SAFE note structures; preference stack architecture and its implications for exit scenarios; pro rata rights and their strategic importance; an dilution provisions and their mathematical impact on ownership; and the interp between governance terms and operational control. The essay draws on specific examples from recent healthcare technology financings to illustrate how seemin minor term sheet provisions can create major downstream consequences for bot founders and investors. Special attention is paid to health tech-specific considerations, including regulatory risk allocation, data security provisions, an customer concentration clauses that differentiate these deals from standard soft investments.

Table of Contents

Decoding the Healthcare Tech Term Sheet: A Practical Guide to Understanding the Money Behind the Medicine

When I first started evaluating healthcare technology investments, I made the ro mistake of thinking that a higher valuation always meant a better deal for found watched a brilliant digital health CEO celebrate closing a Series A at what seem like an impressive valuation, only to realize eighteen months later that the prefe stack and participation rights meant her common stock was effectively worthles any exit scenario below three hundred million dollars. The company eventually s for one hundred and eighty million, the investors made a healthy return, and the founders walked away with less than the junior engineers who had joined on sta equity packages. This experience crystallized an important truth: in venture-bac healthcare technology, the terms matter as much as the price, and sometimes the matter considerably more.

The complexity of term sheets has grown substantially over the past decade, particularly in healthcare technology where regulatory uncertainty, longer sales cycles, and higher capital requirements create additional layers of negotiation. U consumer software companies that might bootstrap to profitability, most healthc technology companies require sustained venture investment to navigate FDA clearance processes, achieve HIPAA compliance, build out security infrastructur survive the interminable procurement cycles that characterize hospital and healt system sales. This capital intensity means that founders will typically go throug multiple financing rounds, each adding new investors with potentially different incentives and each adding new layers to the capitalization table that can drama affect outcomes.

Understanding term sheets is not merely an academic exercise for healthcare entrepreneurs. The structure of your financing directly impacts your ability to r future rounds, your flexibility in strategic decisions, and ultimately the economi outcomes for you and your team. For investors, particularly those new to healthc technology, appreciating the nuances of term sheet construction is essential to protecting returns in a sector where binary outcomes are common and where the from product-market fit to profitable exit can span a decade or more. The goal o essay is to demystify the key components of healthcare technology term sheets, providing both founders and investors with a practical framework for negotiatin deals that create alignment rather than future conflict.

Let me start with valuation, which despite being the headline number in most financing announcements, is actually one of the more malleable concepts in vent capital. When a company raises a Series A at a seventy million dollar post-money valuation, what does that actually mean? The answer depends entirely on the structure of the security being purchased. In a traditional priced round, investor purchase preferred stock at a specific price per share, and the valuation is calcul by multiplying that price by the fully diluted share count. This seems straightfo until you start unpacking what “fully diluted” means and which securities count toward that total.

The rise of SAFE notes and convertible instruments has added another layer of complexity to valuation discussions. A SAFE note, or Simple Agreement for Futu Equity, allows investors to provide capital that converts into equity at a future p round, typically with either a valuation cap or a discount to the future round pri Many early-stage healthcare technology companies now raise their first several n dollars through SAFE notes before doing a traditional priced round. The appeal obvious: SAFE notes are faster to close, involve less negotiation, and defer the difficult valuation conversation until the company has more traction. However, t proliferation of SAFE notes has created cap table complexity that many founder not fully appreciate until they sit down to model their Series A.

Consider a telemedicine platform that raises one million dollars on a SAFE note a ten million dollar cap, then another two million on a SAFE at a fifteen million cap, and finally closes a Series A at a thirty million dollar pre-money valuation. W the Series A closes, those SAFE notes convert into preferred stock, but at what r The first SAFE converts as if the company were valued at ten million dollars, me those investors get a significantly better price per share than the Series A invest The second SAFE converts at the fifteen million dollar cap. The dilution from th conversions means that the founders own less of the company than a simple calculation based on the Series A valuation would suggest. In practice, companie raise multiple SAFE notes at increasing caps often find themselves with twenty t thirty percent less ownership than they expected by the time they close their Ser For healthcare companies that may need to raise fifty to one hundred million dol or more to reach profitability, this early dilution compounds across multiple rou and can leave founders with surprisingly small stakes.

The mechanics of valuation caps versus discounts deserve particular attention b they create different incentive structures. A valuation cap sets a maximum valua which the SAFE converts, regardless of the actual valuation of the subsequent ro A discount, typically in the range of fifteen to twenty-five percent, gives SAFE investors a reduced price relative to the new investors. Caps protect early invest the company's valuation increases dramatically, while discounts are more founde friendly in high-growth scenarios because the investor's advantage is capped at t

discount percentage. In healthcare technology, where companies often need to ra substantial capital before demonstrating strong revenue growth due to regulatoı hurdles and long sales cycles, caps have become the norm. This makes sense fron investor perspective, given the risk and illiquidity of extremely early-stage inves but founders should understand that a ten million dollar cap SAFE is not the sa raising equity at a ten million dollar valuation. The SAFE investor gets the bene that cap while also getting the additional preferences and rights that come with whatever series of preferred stock the SAFE converts into.

This brings us to the preference stack, which is where term sheet complexity rea begins to impact economic outcomes. When investors purchase preferred stock, receive a liquidation preference, which means they get paid before common stockholders in an exit event. The standard liquidation preference is one-x non-participating, which means investors get back their investment amount or their pro rata share of the exit proceeds, whichever is greater. This seems reasonable: inve should at least get their money back before founders profit. The challenge emerg when companies raise multiple rounds at increasing valuations, each with its ow liquidation preference, and when those preferences include participation rights multiples above one-x.

Let me illustrate with a realistic healthcare technology scenario. A digital therapeutics company raises a five million dollar seed round, a fifteen million do Series A, a forty million dollar Series B, and an eighty million dollar Series C. Ea round includes a standard one-x liquidation preference. The company eventually for one hundred and fifty million dollars. In this scenario, the preference stack t one hundred and forty million dollars, which gets paid out first. Only the remain ten million dollars goes to common stockholders. Even though the company achi what sounds like a successful exit, the founders and employees see only a small fraction of the proceeds. If those founders owned twenty percent of the company fully diluted basis, you might expect them to receive thirty million dollars from exit, but in reality they receive only two million dollars because of the preferenc stack.

The situation becomes dramatically worse when preferences are participating ra than non-participating. Participating preferred stock receives its liquidation preference and then also participates in the remaining proceeds on a pro rata ba Using the same example, if the Series C was participating preferred, those invest would receive their eighty million dollar preference, and then also receive their p rata share of the remaining seventy million dollars. If they owned forty percent c company, they would get an additional twenty-eight million dollars, leaving only forty-two million dollars for all other stakeholders. Participating preferred is relatively rare in current venture markets, but it still appears in situations where investors have significant leverage, such as down rounds or when a company nee rescue financing. Healthcare technology companies, which often face binary tech or regulatory risks that can necessitate emergency funding, are particularly susceptible to accepting participating preferred terms when they have limited alternatives.

Multiple liquidation preferences above one-x create similar dynamics. A two-x liquidation preference means investors receive twice their investment amount be common stockholders see anything. In the digital therapeutics example, if the Se had a two-x preference, those investors would receive one hundred and sixty mil dollars from a one hundred and fifty million dollar exit, which is obviously impo In practice, they would receive the entire one hundred and fifty million dollars, a everyone else would receive nothing despite the company achieving a substantial Founders should view any liquidation preference above one-x as a significant red acceptable only in truly distressed circumstances where the alternative is shutdo

The interaction between preference stacks and company valuation trajectories explains why healthcare investors spend so much time thinking about exit scena and why they often push founders to be more aggressive about pricing future rou If a company raises at an eighty million dollar post-money valuation in its Series but the preference stack already totals one hundred and forty million dollars, th company needs to exit for well over one hundred and forty million dollars for co stockholders to see meaningful value. This creates pressure to maintain valuatio momentum across rounds, which can lead to increasingly difficult financing dyn

if the company hits operational challenges or if market conditions deteriorate. M
healthcare technology companies that raised at peak valuations during 2020 and
have found themselves unable to raise additional capital at flat or up rounds, for
them to either accept difficult terms in down rounds or to extend their runways
through expense cuts while hoping for improved conditions.

Anti-dilution provisions represent another critical term sheet component that ca
dramatically affect economics in down-round scenarios. When a company raises
money at a lower valuation than a previous round, existing investors with anti-di
protection receive additional shares to compensate for the reduction in their effe
price per share. The two main types of anti-dilution protection are full ratchet a
weighted average. Full ratchet anti-dilution reprices the investor's shares as if th
had invested at the new, lower price per share, regardless of how much money w
raised in the down round. Weighted average anti-dilution adjusts the investor's
per share based on a formula that considers both the new price and the amount
money raised.

Full ratchet anti-dilution is punitive to founders and should be avoided except in
most extreme circumstances. Imagine a healthcare AI company that raised a Seri
at a sixty million dollar post-money valuation with full ratchet anti-dilution
protection for the Series A investors. The company struggles with longer-than-
expected sales cycles and eighteen months later needs to raise a bridge round at
forty million dollar valuation. With full ratchet protection, the Series A investor
repriced as if they had invested at the bridge round price, which effectively trans
significant ownership from the founders and common stockholders to the Series
investors. In practice, full ratchet provisions can result in early investors owning
percent or more of a company after a down round, even if that down round was
relatively modest. This level of dilution destroys founder motivation and makes
nearly impossible to recruit key employees, which often leads to a death spiral.

Weighted average anti-dilution is far more reasonable and has become standard
most venture financings. The weighted average calculation considers how much
money is being raised at the lower price, which limits the dilutive impact on fou
There are two types of weighted average anti-dilution: broad-based and narrow-

Broad-based uses the fully diluted share count in its calculation, while narrow-b uses only the outstanding preferred stock. Broad-based weighted average is mor favorable to common stockholders and has become the market standard. For healthcare technology companies, where down rounds are not uncommon due to clinical trial setbacks, regulatory delays, or slower-than-expected provider adopt the difference between full ratchet and broad-based weighted average anti-dilut can mean the difference between maintaining a viable cap table and facing a situ where the founders own too little of the company to justify continuing.

Pro rata rights and super pro rata rights are often overlooked by founders but m enormously to investors, particularly smaller funds and angels who want to mair their ownership percentages across rounds. A pro rata right gives an investor the option to invest their proportional share in future financing rounds to avoid dilu If an investor owns ten percent of the company, their pro rata right allows them invest ten percent of any future round. Super pro rata rights allow investors to i more than their proportional share, typically up to some multiple of their pro ra amount. Major pro rata rights allow investors to purchase additional shares beyo their pro rata allocation, often calculated based on their initial investment rathe current ownership.

For healthcare technology investors, pro rata rights serve multiple functions bey simply maintaining ownership. They provide optionality, allowing investors to increase their investment in companies that are performing well while declining invest additional capital in underperformers. They also serve as a signaling mechanism: when existing investors exercise their pro rata rights, it signals confidence to new investors, while failure to exercise pro rata rights raises quest about what the insiders know. For this reason, founders should pay attention to rata participation in their rounds. If your Series A lead is not exercising their ful rata in your Series B, new investors will notice and will want to understand why.

The challenge with pro rata rights from a founder's perspective is that they can l the amount of money available for new investors in subsequent rounds. If your S A investors own forty percent of the company and all exercise their pro rata righ your Series B, only sixty percent of the round is available for new investors. This

make it harder to bring in new lead investors with sufficient ownership to justif effort of leading the round. For early-stage healthcare angels and seed funds, get strong pro rata rights is often more valuable than getting a large initial allocatio because it gives them the opportunity to concentrate capital in their winners as companies de-risk through later rounds.

Board composition and governance terms may seem less important than econom terms, but they fundamentally shape the relationship between founders and inve and can determine who controls key strategic decisions. Most venture-backed healthcare technology companies have three to seven board members, typically including one or two founders, two to three investor representatives, and one or independent board members. The specific composition matters because certain decisions require board approval, and because the board has fiduciary duties to shareholders, not just the investors who appointed them.

Protective provisions give investors veto rights over specific corporate actions, s selling the company, raising additional capital, changing the certificate of incorporation, or making acquisitions above a certain size. These provisions are reasonable and standard, but their specific construction can create challenges. I protective provisions require approval from holders of a majority of the preferre stock, then Series A investors can block transactions even if Series B and Series investors support them. More commonly, protective provisions require either ap from each series of preferred stock voting separately, or approval from a majorit the preferred stock voting together. The former gives each series of investors a v which can create holdout problems. The latter is more flexible but can allow late investors to override the preferences of earlier investors.

For healthcare technology companies, board composition has additional implica because of the technical and regulatory complexity of the business. Having boar members with deep healthcare expertise can be extraordinarily valuable when m decisions about clinical development strategy, reimbursement approaches, or go market sequencing. However, healthcare-focused investors may have their own s views about the right strategy, which can lead to founder-investor tension if tho views diverge. The best healthcare technology boards bring complementary expe

perhaps one investor with deep clinical knowledge, one with healthcare IT exper and one with later-stage growth and go-to-market expertise. Independent board members with operating experience in healthcare can also provide valuable perspective and can serve as mediators when founders and investors disagree.

Healthcare technology term sheets often include specific provisions that reflect t unique risks of the sector. Data security and HIPAA compliance provisions may require the company to maintain certain insurance policies, to undergo regular security audits, or to notify investors of any data breaches within specified timeframes. Given that a single significant data breach can destroy a healthcare technology company's reputation and result in massive fines, these provisions pr both founders and investors by ensuring the company takes security seriously. S term sheets include specific requirements around how patient data is stored and accessed, particularly for companies dealing with sensitive mental health or reproductive health information.

Regulatory milestone provisions tie certain investor rights or obligations to the company achieving specific regulatory clearances or certifications. For example, medical device company's term sheet might specify that if the company does not receive FDA clearance within eighteen months of the financing, investors have th right to force a sale of the company or to restructure the board. These provisions acknowledge the binary nature of certain healthcare regulatory pathways while g investors some protection against unlimited capital consumption pursuing an approval that may never come. From a founder perspective, regulatory milestone provisions should be carefully negotiated to ensure the timelines are realistic an the consequences of missing milestones are not draconian.

Customer concentration provisions are particularly relevant for healthcare techn companies because of the lumpiness of healthcare customers. Landing a contrac a single large health system can represent twenty or thirty percent of a young company's revenue, and losing that customer can be catastrophic. Some investor include provisions requiring board notification or approval before signing contr above a certain size or that would represent more than a specified percentage of revenue. These provisions can feel paternalistic to founders, but they reflect a

legitimate investor concern about the risk profile of the business. Healthcare technology companies with a single customer representing more than half their revenue trade at significantly lower valuation multiples than those with more diversified customer bases, which affects both exit opportunities and the compa ability to raise future rounds.

Let me close with two case studies that illustrate how term sheet provisions play in real scenarios. The first involves a clinical decision support company that rais twenty million dollar Series B with participating preferred stock and a two-x liquidation preference because the company was struggling and the investors ha significant leverage. The company eventually turned around and was acquired fo hundred and thirty million dollars, which seemed like a success. However, the Se B investors received forty million dollars from their liquidation preference and t participated in the remaining ninety million dollars for an additional thirty-six million dollars, assuming they owned forty percent. This left only fifty-four mill dollars for all other stakeholders. The founders, who owned fifteen percent on a diluted basis, received only about eight million dollars from the exit, despite bui a company that sold for a meaningful amount. This structure created resentmen damaged relationships between the founders and the Series B investors, even tho technically the investors were simply exercising the rights they had negotiated.

The second case study involves a remote patient monitoring company that raised multiple SAFE notes before doing a priced round, and that included full ratchet dilution provisions in its Series A because the investors were concerned about th regulatory risk. When the company needed to raise a bridge round at a lower valuation, the full ratchet provision kicked in, and the founders saw their owner drop from twenty-five percent to twelve percent essentially overnight. This mass dilution demoralized the team and made it nearly impossible to recruit key exec who would have been essential to turning the company around. The company eventually shut down, and in retrospect, both the founders and the Series A inve recognized that the full ratchet provision had accelerated the company's demise creating a cap table that no longer made sense for anyone.

These examples underscore a fundamental truth about term sheet negotiation in healthcare technology: the best deals are those that create alignment between founders and investors across a range of potential outcomes. Terms that heavily investors in downside scenarios often backfire because they destroy founder motivation precisely when that motivation is most needed. Terms that heavily fa founders in downside scenarios leave investors feeling taken advantage of and le likely to provide the support and follow-on capital that struggling companies ne The goal should be to structure deals where both founders and investors do well company succeeds, where investors have some downside protection if the compa fails, and where no party has incentives that diverge dramatically from building term value.

For healthcare technology founders, this means understanding that the highest valuation is not always the best deal. A lower valuation with clean terms may cre better long-term outcomes than a higher valuation that comes with participating preferred, full ratchet anti-dilution, or other provisions that stack the deck heav toward investors. It means caring about the preference stack and modeling outc across a range of exit scenarios, not just the home run scenario where valuation multiples make the preferences irrelevant. And it means building relationships v investors who have experience in healthcare technology and who understand the specific challenges of the sector, because those investors are more likely to be reasonable partners when things get difficult.

For healthcare technology investors, it means being thoughtful about when aggr terms are truly necessary versus when they simply reflect leverage and might cre misalignment. It means recognizing that investing in healthcare technology requ patience and that terms which might make sense for a consumer software compa with a path to profitability in two years may not make sense for a digital health company that needs to navigate FDA clearance, build out a clinical evidence bas survive multi-year enterprise sales cycles. And it means understanding that in healthcare technology, where most value is created by companies that successful scale and achieve meaningful exits rather than by mitigating downside risk throu preferential terms, the most important thing is often to maintain founder motiva

and team cohesion through the inevitable challenges that every healthcare comp faces.

The term sheet is the foundation of the relationship between founders and inves and like any foundation, its quality and construction determine what can be bui top of it. Taking the time to understand these provisions, to model their impact different scenarios, and to negotiate thoughtfully is one of the highest-return activities for both founders and investors in healthcare technology. The complex can feel overwhelming, and the legal fees associated with proper diligence and negotiation can seem expensive for an early-stage company, but the cost of gettir these terms wrong is far greater than the cost of getting them right. As healthca technology continues to mature as an investment category, and as more generalis investors enter the space, having a shared understanding of these concepts beco increasingly important to maintaining the health of the ecosystem and ensuring capital flows to the best companies on reasonable terms.

If you are interested in joining my generalist healthcare angel syndicate, reach o treyrawles@gmail.com or send me a DM. We don't take a carry and defer annual for six months so investors can decide if they see value before joining officially. Accredited investors only.

2 Likes • 2 Restacks

← Previous

Nex

Discussion about this post

Comments Restacks

Write a comment...