**[INVESTOR]**

**[COMPANY]**

**TERM SHEET**

**[REVENUE BASED FINANCING – STOCK]**

**[VARIABLE DIVIDEND REDEEMABLE PREFERRED STOCK FINANCING][[1]](#footnote-2)**

\_\_\_\_\_\_\_\_\_ \_\_, 202\_

This Term Sheet (this **“Term Sheet”**) summarizes the principal terms of a proposed variable dividend redeemable preferred stock financing (the **“Financing”**) of \_\_\_\_\_\_\_\_\_\_\_\_\_, a corporation organized and existing under the laws of Delaware (the **“Company”**).[[2]](#footnote-3) Except as set forth below under *“Counsel and Expenses”* and *“No-Shop; Confidentiality”*, and below with respect to governing law, each of which shall constitute a binding agreement of the parties, no legally binding obligations will be created by this Term Sheet unless and until definitive agreements, if any, are executed and delivered by all parties. This Term Sheet is not a commitment to invest and is conditioned on the completion of legal and financial due diligence and the preparation of definitive documents relating to the Financing satisfactory to the Investor (as defined herein). This Term Sheet is governed in all respects by the laws of the State of Delaware, without regard to principles of conflicts of laws thereof or of any other jurisdiction which would require the application of any laws other than those of the State of Delaware.[[3]](#footnote-4)

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| --- | --- |
| **Issuer:** | \_\_\_\_\_\_\_\_\_\_\_, a corporation organized and existing under the laws of the State of Delaware (the **“Company”**). |
| **Investor:** | \_\_\_\_\_\_\_\_\_\_\_, [a \_\_\_\_\_\_\_\_\_\_ organized and existing under the laws of the State of \_\_\_\_\_\_\_\_] [a natural individual] (the **“Investor”**).[[4]](#footnote-5) |
| **Security:** | Shares of the Company’s Variable-Dividend Redeemable Preferred Stock, \_\_\_\_\_ par value per share (the **“Redeemable Preferred Stock”**)[[5]](#footnote-6). [Of these shares, [\_\_\_%] (the “**Redemption Percentage**”) shall be subject to redemption as provided herein.] |
| **Investment** **Amount:** | The Investor shall invest an aggregate of $\_\_\_\_\_\_ (the **“Investment Amount”**) at the Closing (as defined herein) to purchase \_\_\_\_ shares of the Redeemable Preferred Stock.  |
| **Price per Share:** | An amount equal to $\_\_\_\_\_\_ per share of Redeemable Preferred Stock.[[6]](#footnote-7)  |
| **Total Obligation:** | For purposes of this Term Sheet, the **“Total Obligation”** is an amount equal to the product of (i) \_\_\_[[7]](#footnote-8) *multiplied by* (ii) the Investment Amount (i.e., $\_\_\_\_\_\_\_). The Total Obligation, when expressed on a per share basis is equal to $\_\_\_\_\_\_\_ per share of Redeemable Preferred Stock. The Total Obligation represents the maximum amount that the Company shall be obligated to pay to the Investor with respect to the Redeemable Preferred Stock, whether through the payment of Preferred Dividends (as defined herein), payments in respect of Mandatory Redemptions (as defined herein) or the making of Discretionary Early Payments (as defined herein). The difference between (i) the Total Obligation, and (ii) the Investment Amount, is referred to herein as the **“Investment Return”**. |
| **Use of Proceeds:** | The Company shall use the net proceeds received by the Company from the sale of Redeemable Preferred Stock to the Investor for working capital and general corporate purposes. [The Company shall not without the consent of the Requisite Holders (as defined herein) use the proceeds of the sale of Redeemable Preferred Stock to repay indebtedness of the Company or redeem outstanding equity securities of the Company]. [[8]](#footnote-9) |
| **Preferred** **Dividends; Redemption**[[9]](#footnote-10)**:** | Beginning with the [earlier of (a)] [last day of the calendar [month] [quarter] [year] immediately succeeding the calendar [month] [quarter] [year] in which the [gross revenues] [net profits] of the Company equals or exceeds $\_\_\_\_\_\_,] [and (b)] [the \_\_\_ month anniversary of the date of the Closing] (the **“Redemption Trigger Threshold Date”**)[[10]](#footnote-11), and following the Redemption Trigger Threshold Date on the last day of each succeeding calendar [month] [quarter] [year] until the Total Obligation has been reduced to zero, the Company shall: 1. pay preferential dividends (**“Preferred Dividends”**) on the Redeemable Preferred Stock on a pro rata and pari passu basis in an aggregate amount equal to the Available Redemption Funds (as defined below) for the relevant calendar [month] [quarter] [year] until the total Investment Return has been reduced to zero; and thereafter
2. redeem shares of Redeemable Preferred Stock [up to the Redemption Percentage] from the holders thereof (“**Mandatory Redemptions**”) on a pro rata and pari passu basis in an aggregate amount equal to the Available Redemption Funds for the relevant calendar [month] [quarter] [year], until the Investment Amount has been reduced to zero.][[11]](#footnote-12)
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| **Preferred Dividends** **Reduce** **Total Obligation:** | Each payment of Preferred Dividends and each Mandatory Redemption payment by the Company shall reduce the aggregate Investment Return or the Investment Amount (as applicable), and Total Obligation, in each case, on a dollar-for-dollar basis.  |
| **Available** **Redemption Funds:** | With respect to any calendar [month] [quarter] [year], the **“Available Redemption Funds”** for such calendar [month] [quarter] [year] which the Company must apply to pay Preferred Dividends or Mandatory Redemption payments to the holders of Redeemable Preferred Stock shall be equal to \_\_\_\_% of the Company’s [Net Revenue][[12]](#footnote-13) (as defined herein) for such period. [As used herein, the Company’s **“Net Revenue”** with respect to any calendar [month] [quarter] [year] means the net revenue of the Company and its consolidated subsidiaries for such period, determined on a cash basis.][[13]](#footnote-14)Following the end of each calendar [month] [quarter] [year], the Company shall deliver to the holders of Redeemable Preferred Stock a statement (the **“Available Redemption Funds Statement”**) setting forth for the relevant calendar [month] [quarter] [year] the Company’s calculation in reasonable detail of the Available Redemption Funds paid to the holders of Redeemable Preferred Stock for such calendar [month] [quarter] [year] and the Company’s [Net Revenue] [Free Cash Flow] [Gross Revenue] for such calendar [month] [quarter] [year] based on which such Available Redemption Funds were calculated. Together with the Available Redemption Funds Statement, the Company shall share with the holders of Redeemable Preferred Stock copies of the financial statements and other documentation and information upon which the Company’s calculations set forth therein are based. Within \_\_\_ days following receipt of the Available Redemption Funds Statement, the holders of a majority of the issued and outstanding Redeemable Preferred Stock (the **“Requisite Holders”**) may by notice in writing to the Company setting forth their objections in reasonable detail object to some of all of the calculations set forth therein. If the Requisite Holders do not deliver such a notice of objection within such \_\_ day period, then the holders of Redeemable Preferred Stock will be deemed to have accepted the Available Redemption Funds Statement and it shall be binding for all purposes absent manifest error. If the Requisite Holders deliver such a written notice of objection within such \_\_\_ day period, then the Requisite Holders and the Company shall negotiate in good faith for at least \_\_ days to resolve any differences. After the end of such \_\_ day negotiating period either the Company or the Requisite Holders may elect to engage a firm of regionally recognized independent public accounts mutually acceptable to them to resolve all remaining issues in dispute. Such firm’s determination of the Available Redemption Funds and [Net Revenue] [Free Cash Flow] [Gross Revenue] for the relevant [month] [quarter] [year] will be binding and conclusive for all purposes and the fees and expenses of such firm shall be borne equally by the Company and the holders of Redeemable Preferred Stock. If the Available Redemption Funds for the relevant [month] [quarter] [year] as so mutually agreed or determined by such firm is less or more than the amount set forth in the Available Redemption Funds Statement and previously paid by the Company to the holders of Redeemable Preferred Stock then the Company shall pay such difference to the holders of Redeemable Preferred Stock or the holders of Redeemable Preferred Stock shall return such difference to the Company, as applicable, promptly following such mutual agreement or determination, as applicable.[[14]](#footnote-15)  |
| **Discretionary** **Early Payments:** | In addition to, and not in lieu of or substitution for the Preferred Dividends and Mandatory Redemption payments the Company is required to pay to the holders of Redeemable Preferred Stock as set forth above, at any time and from time to time, the Company may pay to the holders of Redeemable Preferred Stock, on a pro rata and pari passu basis, additional amounts as preferred dividends (in order to pay down the Investment Return) or redemption payments (in order to redeem shares for the Investment Amount once the Investment Return has been reduced to zero) (**“Discretionary Early Payments”**) which shall reduce the Investment Return or the Investment Amount (as applicable), and the Total Obligation on a dollar-for-dollar basis. Any such Discretionary Early Payments may be made by the Company without premium or penalty. [[15]](#footnote-16) |
| **Redemption in Full****of Redeemable** **Preferred Stock:**  | Subject to any exercise by the holders of Redeemable Preferred Stock of the Outside Date Redemption rights as described below, at such time as the Company has paid Preferred Dividends and Mandatory Redemption payments and/or Discretionary Early Payments equal in the aggregate to the Total Obligation, [all] shares of Redeemable Preferred Stock [up to the Redemption Percentage] shall be fully redeemed and cease to be issued and outstanding.  |
| **Outside Date:** | The \_\_\_ month anniversary of the Closing shall be referred to as the **“Outside Date”**.  |
| **Outside Date Redemption: [[16]](#footnote-17)** | If, at any time from and after the Outside Date, the Company has not paid the holders of Redeemable Preferred Stock an amount at least equal to the Investment Amount, then the Requisite Holders may require the Company, by written notice to the Company, to mandatorily redeem [all] shares of Redeemable Preferred Stock [up to the Redemption Percentage] then held by the holders of Redeemable Preferred Stock on a pro rata and pari passu basis at a total redemption price equal to the difference between (a) the Investment Amount, and (b) the aggregate amounts paid by the Company to the holders of Redeemable Preferred Stock through the mandatory redemption date in respect of Preferred Dividends or Mandatory Redemption payments and Discretionary Redemption Amounts. Upon payment of such redemption price by the Company to the holders of Redeemable Preferred Stock, [all] shares of Redeemable Preferred Stock [up to the Redemption Percentage] shall be fully redeemed and cease to be issued and outstanding.  |
| **Dividends:** | As provided herein under *“Negative Covenants”*, the Company shall not pay dividends on, or redeem its common stock or other shares of its capital stock (other than payments on the Redeemable Preferred Stock as provided herein) without the Requisite Holders’ prior written consent. Where permitted, holders of Redeemable Preferred Stock shall participate with dividends and distributions paid on common stock, on a pro rata and pari passu basis, and such participatory dividends shall not reduce or otherwise affect the computation of the Total Obligation. |
| **Liquidation Preference:** | In the event of any liquidation, dissolution or winding up of the Company, the holders of Redeemable Preferred Stock will be entitled to be paid on a pro rata and pari passu basis, and on a senior basis and prior to any payments with respect to the holders of the Company’s common stock or any other class of the Company’s capital stock, out of the assets of the Company available for distribution to the holders of its capital stock, an amount equal to the greater of:(a) the difference between (i) the Total Obligation, and (ii) the total amount of Preferred Dividends, Mandatory Redemption payments and Discretionary Early Payments actually paid by the Company to the holders of Redeemable Preferred Stock through the date of such liquidation, dissolution or winding up of the Company (the **“Remaining Total Obligation”**), and(b) an amount representing the same per-share liquidation proceeds payable to holders of the Company’s common stock [, up to [\_\_\_] times the Investment Amount].[[17]](#footnote-18)A merger or consolidation (other than one in which stockholders of the Company own a majority by voting power of the outstanding shares of the surviving or acquiring corporation) or a sale, lease, transfer, exclusive licenseor other disposition of all or substantially all of the assets of the Company or the closing of a firm commitment underwritten public offering of the Company’s common stock, in each case, will be treated as a liquidation event (a “**Deemed Liquidation Event**”) and the proceeds received by the Company in a Deemed Liquidation Event and available for distribution to holders of its capital stock shall be applied as set forth in the immediately preceding paragraph to the senior and priority payment to holders of Redeemable Preferred Stock of an amount equal to the Remaining Total Obligation. The Company will not be a party to a transaction that constitutes a Deemed Liquidation Event unless the terms of the agreements and other documents relating to such transaction duly provide for and observe and distribute the proceeds therefrom in accordance with the liquidation preference of the Redeemable Preferred Stock set forth herein.  |
| **Accelerated Redemption** **Events:** | The following shall constitute **“Accelerated Redemption Events”** hereunder. Upon the occurrence and during the continuation of any such Accelerated Redemption Event, the Requisite Holders may by written notice to the Company require the Company to mandatorily and immediately redeem [all] outstanding Redeemable Preferred Stock [up to the Redemption Percentage] from the holders thereof on a pro rata and pari passu basis for an aggregate redemption price equal to the amount of the then Remaining Total Obligation. 1. The Company fails to pay any amount in respect of Preferred Dividends, Mandatory Redemption payments or other required redemption payments to the holders of Redeemable Preferred Stock when due and such failure remains uncured \_\_ days following written notice of such failure to the Company by any holder of Redeemable Preferred Stock;[[18]](#footnote-19)
2. The Company breaches in any material respect, any affirmative covenant in favor of the holders of Redeemable Preferred Stock, and such breach (if capable of cure) continues uncured \_\_ days following written notice of such breach from any holder of Redeemable Preferred Stock;
3. Consummation of a Deemed Liquidation Event or other change of control, including by means of a direct sale of shares by stockholders of the Company to a third party;[[19]](#footnote-20)
4. Consummation of an initial public offering of the Company’s common stock or other shares of the Company’s capital stock;[[20]](#footnote-21)
5. [If there is no Available Redemption Funds for an agreed number of consecutive [months] [quarters] [years] where Available Redemption Funds is calculated as a percentage of Gross Revenue];[[21]](#footnote-22)
6. Any voluntary or involuntary liquidation, dissolution or winding up of the Company; [and]
7. Customary bankruptcy and insolvency-related events; [and]
8. [Other Appropriate Accelerated Redemption Events May be Negotiated]
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| **Voting Rights:**  | Except as may be required by applicable law, shares of Redeemable Preferred Stock shall be non-voting with respect to matters that come before the stockholders of the Company at any annual or special meeting or stockholders for action by written consent or otherwise.[[22]](#footnote-23)  |
| **Board** **Observer Rights:** | For as long as shares of Redeemable Preferred Stock[, that are included in the Redemption Percentage,] held by the Investor remain outstanding, the Investor shall be entitled to designate one (1) representative of the Investor to attend meetings of the Company’s Board of Directors in the capacity of a non-voting observer. In the event the Investor ceases to hold shares of Redeemable Preferred Stock, the Requisite Holders shall be entitled to designate one (1) representative of the Requisite Holders to attend meetings of the Company’s Board of Directors in the capacity of a non-voting observer.[[23]](#footnote-24) |
| **Information** **and Access Rights:** | Holders of Redeemable Preferred Stock will be granted access to the facilities and personnel of the Company and its subsidiaries during normal business hours and with reasonable advance notification. The Company will deliver to each holder of Redeemable Preferred Stock, (i) annual, quarterly, [and monthly] financial statements, and other information as determined by the Board of Directors; [and] (ii) thirty days prior to the end of each fiscal year, a comprehensive operating budget forecasting the Company’s revenues, expenses, and cash position on a month-to-month basis for the upcoming fiscal year (the **“Budget”**)[; and (iii) promptly following the end of each quarter an up-to-date capitalization table]. The Company shall also provide to holders of Redeemable Preferred Stock such other information relating to the financial condition, business, prospects, or corporate affairs of the Company and its subsidiaries as any such holder may from time to time reasonably request; provided, however, that the Company shall not be obligated to provide information (i) that the Company reasonably determines in good faith to be a trade secret or confidential information (unless covered by an enforceable confidentiality agreement, in a form acceptable to the Company); or (ii) the disclosure of which would adversely affect the attorney-client privilege between the Company and its counsel. |
| **Negative Covenants:** | The Definitive Documents (as defined herein) shall provide that, without first obtaining the prior written consent of the Requisite Holders, the Company shall not, and shall not cause or permit its subsidiaries to:[[24]](#footnote-25)1. *Amendments to Charter and Bylaws.* Amend, alter or repeal any provision of the Company’s Certificate of Incorporation or Bylaws.
2. *Liquidation, Dissolution and Winding-Up.* Liquidate, dissolve or wind-up the business and affairs of the Company, effect any merger or consolidation or any other Deemed Liquidation Event or consent to any of the foregoing.
3. *Redemptions and Dividends.* Purchase or redeem (or permit any subsidiary to purchase or redeem) or pay or declare any dividend or make any distribution on, any shares of capital stock of the Company other than (i) redemptions of or dividends or distributions on the Redeemable Preferred Stock, (ii) dividends or other distributions payable on the Common Stock solely in the form of additional shares of Common Stock, and or (iii) repurchases of stock from former employees, officers, directors, consultants or other persons who performed services for the Corporation or any subsidiary in connection with the cessation of such employment or service at no greater than the original purchase price thereof.
4. *Subsidiaries.* Create, or hold capital stock in, any subsidiary that is not wholly owned (either directly or through one (1) or more other subsidiaries) by the Company or permit any subsidiary to create, or authorize the creation of, or issue or obligate itself to issue, any shares of any class or series of capital stock, or sell, transfer or otherwise dispose of any capital stock of any direct or indirect subsidiary of the Company, or permit any direct or indirect subsidiary to sell, lease, transfer, exclusively license or otherwise dispose (in a single transaction or series of related transactions) of all or substantially all of the assets of such subsidiary;
5. *Loans and Advances.* Make, or permit any subsidiary to make, any loan or advance to any person or entity, including, without limitation, any employee or director of the Company or any subsidiary, except advances and similar expenditures in the ordinary course of business [or under an employee stock or option plan approved by the Board of Directors].
6. *Interested Party Transactions.* Enter into, or permit any subsidiary to enter into any agreement, transaction, or arrangement, in each case, between the Company or a subsidiary, on the one hand, and any founder, director, executive officer or significant stockholder of the Company, on the other hand;
7. *Guarantees.* Guarantee, directly or indirectly, or permit any subsidiary to guarantee, directly or indirectly, any indebtedness, other than trade accounts of the Company or any subsidiary arising in the ordinary course of business;
8. *Investments.* Make any investment inconsistent with any investment policy approved by the Board of Directors.
9. *Indebtedness and Liens.* Create, or authorize the creation of, or issue, or authorize the issuance of any debt security or create any lien or security interest (except for purchase money liens or statutory liens of landlords, mechanics, materialmen, workmen, warehousemen and other similar persons arising or incurred in the ordinary course of business) or incur other indebtedness for borrowed money, including but not limited to obligations and contingent obligations under guarantees, or permit any subsidiary to take any such action with respect to any debt security lien, security interest or other indebtedness for borrowed money[, if the aggregate indebtedness of the Company and its subsidiaries for borrowed money following such action would exceed $\_\_\_\_\_ [other than equipment leases, bank lines of credit or trade payables incurred in the ordinary course].
10. *Founder and Executive Compensation.* Hire, terminate, or change the compensation of founders or executive officers, including approving any stock or stock option grants or to founders or executive officers.
11. *Budget.* Approve the Budget for any fiscal year of the Company.
12. *Changes to Business.* Change the principal business of the Company, enter into new lines or business, or exit the current line of business.
13. *Sales of Technology or Intellectual Property.* Sell, assign, license, pledge, or encumber material technology or intellectual property, other than licenses granted in the ordinary course of business.
14. *Certain Strategic Relationships.* Enter into any corporate, strategic relationship involving the payment, contribution, or assignment by the Company or to the Company of money or assets greater than $\_\_\_\_\_\_.
 |
| **Equity** **Participation Rights:[[25]](#footnote-26)** | If after the Closing and while the Redeemable Preferred Stock remains outstanding, the Company determines to issue or sell any additional equity securities or securities that are convertible into or exchangeable or exercisable for its equity securities, then the holders of Redeemable Preferred Stock shall have the right on a pro rata and pari passu basis to participate in such issuance or sale and purchase in the aggregate [up to \_\_\_% of the equity securities or convertible, exchangeable or exercisable securities] [a number of such equity securities or convertible, exchangeable or exercisable securities having a purchase price equal to \_\_\_ times the then Remaining Total Obligation] at the same price and on the same terms as are being offered by the Company to other purchasers. In the event that any holder of shares of Redeemable Preferred Stock chooses not to purchase its full allotment of any such equity securities or convertible, exchangeable or exercisable securities, then the remaining holders of Redeemable Preferred Stock shall have the right on a pro rata and pari passu basis to purchase any such remaining allotment.  |
| **No-Shop; Confidentiality:** | The Company and the Investor agree to work in good faith expeditiously towards the Closing. The Company agrees that it will not, for a period of \_\_\_ days from the date of execution and delivery of this Term Sheet, take any action to solicit, initiate, encourage or assist the submission of any proposal, negotiation or offer from any person or entity other than the Investor relating to the sale or issuance, of any of the capital stock of the Company or the acquisition, sale, lease, license or other disposition of the Company or any material part of the stock or assets of the Company and shall notify the Investor promptly of any inquiries by any third parties in regards to the foregoing. The Company will not disclose the terms of this Term Sheet to any person other than employees, stockholders, members of the Board of Directors and the Company’s accountants and attorneys, without the written consent of the Investor (which shall not be unreasonably withheld, conditioned, or delayed).  |
| **Closing:** | The closing of the purchase and sale of shares of Redeemable Preferred Stock contemplated hereby (the **“Closing”**) is expected to occur as soon as practicable following the execution and delivery of this Term Sheet by the parties. The parties agree to begin drafting and negotiating the Definitive Documents (as defined herein) in good faith promptly following the execution and delivery of this Term Sheet.  |
| **Purchase** **Agreement and Definitive Documents:** | The Financing, including the terms and conditions set forth in this Term Sheet and other customary terms and conditions that are not inconsistent with this Term Sheet shall be reflected in a definitive documents (the **“Definitive Documents”**) to be drafted, negotiated, and entered into by the Company and the Investor which shall include, without limitation, a Preferred Stock Purchase Agreement having customary representations, warranties, closing conditions, and covenants for transactions of this nature and an amended certificate of incorporation of the Company authorizing, and setting forth the terms and conditions of the Redeemable Preferred Stock.  |
| **Governing Law:** | Delaware.  |
| **Counsel** **and Expenses:** | The Company will reimburse [at the Closing] the Investor for the reasonable fees and expenses of counsel to the Investor in connection with the negotiation, execution and delivery of this Term Sheet and the definitive documents relating to the Financing [in an aggregate amount not to exceed $\_\_\_\_\_].  |

(Signature Page Follows)

**IN WITNESS WHEREOF**, the Company and the Investor have each duly executed this Term Sheet as of the \_\_\_ day of \_\_\_\_\_, 202\_.

 **[INVESTOR]**

 By: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

 Name:

 Title:

 **[COMPANY]**

 By: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

 Name:

 Title:

1. This Term Sheet has been prepared for the Revenue Based Financing (RBF) project and has been structured to be “equity like” as compared to an alternative Term Sheet published by the RBF project that is intended to be “debt-like” and approximate a variable interest loan. This Term Sheet and the Redeemable Preferred Stock contemplated hereby assumes that the Investor and Company desire to structure an investment by the Investor that is (1) non-dilutive, in that the Investor is counting on a staged buyback of some or all of its investment with a capped return and not to significantly dilute the residual equity ownership interest in the Company of the founders and other common stockholders; (2) treated as an equity (or equity-like) investment under most accounting systems; and (3) relatively founder friendly, while (4) protecting the Investor’s economic interest in its initial investment and primarily capped return expectations. Accommodating these elements yielded a balance between the investor protective vs. company favorable perspectives that intentionally is less protective of the Investor than would be a debt investment, but more protective of the Investor than would be a traditional equity investment. [↑](#footnote-ref-2)
2. For purposes of this Term Sheet, we have assumed that the issuer is a Delaware corporation. If the issuer is a corporation incorporated or organized under the laws of a jurisdiction other than Delaware, please consider engaging local counsel in such other jurisdiction. If the issuer is a limited liability company or other type of pass-through entity instead of a corporation, please note that tax consequences associated with ownership of equity in such a pass-through entity should be considered and careful attention should be paid to the terms of the limited liability company agreement or other governing documents of the pass-through entity. If the issuer is a non-U.S. entity, please consider engaging local counsel and, in any event, note that the corporate and other laws of non-U.S. jurisdictions may differ significantly from those of Delaware and other U.S. jurisdictions. [↑](#footnote-ref-3)
3. For purposes of this Term Sheet, we have designated Delaware law as the governing law given the assumption that a Delaware corporation will be the issuer. If this is not the case, the parties may consider application of the governing law of another jurisdiction. [↑](#footnote-ref-4)
4. For convenience, this Term Sheet assumes a single Investor will purchase all shares of Redeemable Preferred Stock for the entire Investment Amount. Throughout the document we introduce the concept of the “Requisite Holders” and provide that payments will be made, and other actions taken on a “pro rata and pari passu” basis to account for the possibility of transfers of the Redeemable Preferred Stock resulting in multiple holders. If the parties desire to provide for multiple initial purchasers of the Redeemable Preferred Stock at Closing or for an “Initial Closing” followed by “Subsequent Closings” as part of a more built-out financing round, then appropriate changes should be made to the closing and offering mechanics contemplated by this Term Sheet. [↑](#footnote-ref-5)
5. A founding assumption underlying this Term Sheet and the Redeemable Preferred Stock contemplated hereby is that the Investor is not primarily investing in (or betting on) the enterprise value of the Company. As such, the Investor is not dependent upon a sale of the company of initial public offering within any particular timeframe (or at all) vis-à-vis the Investor’s expectations around its return on the investment. Rather, the Investor is making a sum of capital available in exchange for the anticipated return of a capped multiple on that initial investment amount. Thus, this Redeemable Preferred Stock is not convertible into common stock of the Company as traditional preferred stock is often structured in traditional financings. The per share price reflected in this Term Sheet is not a reflection of some agreed “pre-money” or other value of the Company; rather it is a reference number used to calculate the Investor’s return. A significant deviation to this approach occurs if the parties agree to exclude a percentage of the Redeemable Preferred Stock from redemption, resulting in an “equity tail.” [↑](#footnote-ref-6)
6. Because the Redeemable Preferred Stock is a self-liquidating instrument that is structured based on the Company’s ability to generate Net Revenue or Free Cash Flow or Gross Revenues (as applicable), as opposed to achieve a liquidity event such as a sale of the company or an initial public offering, concepts such as pre-money and post-money valuation and conversion are not relevant. One key benefit of a revenue-based financing investment, as compared to a typical NVCA-style priced-round venture equity convertible preferred stock investment is that a revenue-based financing can obviate the need value the issuer and streamline negotiations between the parties, which can often get bogged down in differences of opinion as to valuation. [↑](#footnote-ref-7)
7. This is the return multiple cap; i.e. 1x, 2x, etc. [↑](#footnote-ref-8)
8. Insert any additional intentions or restrictions on use of proceeds, including, any agreed budget pursuant to which proceeds must be deployed or any particular project or initiative against which proceeds must be deployed. [↑](#footnote-ref-9)
9. This is the mechanic via which the Investor obtains its return of/on investment. [↑](#footnote-ref-10)
10. This Term Sheet includes the option for a grace period before the Company is required to begin making redemption payments on the Redeemable Preferred Stock. This period may be determined by reference to (i) a date certain following the Closing of the Investor’s purchase of the Redeemable Preferred Stock (ii) an agreed economic milestone (such as a specified level of gross revenues or net profits) after which the parties have agreed it is reasonable to expect the Company to begin making payments on the Redeemable Preferred Stock, or (iii) the earlier of the measures described in clause (i) and (ii). Note that including the date-certain trigger in (i) increases the possibility that both: (1) dividends may not be characterized as “dividends” for tax purposes, but rather as redemption payments (which isn’t necessarily tax inefficient, but raises tax accounting complexity for the company), and (2) the Company’s obligation to declare and pay the dividends may not be enforceable under Delaware law. [↑](#footnote-ref-11)
11. If shares of Redeemable Preferred Stock are outstanding less than 10 years before this (mandatory) redemption, this is a possibility the Redeemable Preferred Stock could be recharacterized as debt for tax purposes. This risk increases as the term shortens, with a significant possibility of recharacterization if the term is less than 5 years. Parties should consult with tax counsel and consider using a debt-based structure if their models contemplate share redemptions within these timeframes. [↑](#footnote-ref-12)
12. Note that the way the “Available Redemption Funds” are expressed will depend, in part, upon the bargain between the Company and the Investor and the Investor’s theory of investment. For example, if the Investor agrees to be paid out of Net Revenue or Free Cash Flow, that implies to some extent that the Investor is partnering with the Company and only expects to be paid to the extent that the Company experiences some measure of profit. However, if the Investor requires that it be paid back out of Gross Revenue, then the Investor is requiring payment of a percentage of each dollar the Company earns in revenue, whether or not the Company is profitable or has that capital to spare from its business and operations. These two approaches have obvious differences in terms of tone and approach to the transaction. [↑](#footnote-ref-13)
13. This definition is included as an example only, and we expect the parties will negotiate a specific definition that makes sense based on the Company’s business and operations on a case-by-case basis. It is possible for investors to use Net Revenue, Gross Revenue and Free Cash Flow on a GAAP basis for this calculation. s [↑](#footnote-ref-14)
14. This is a sample dispute resolution mechanism in the event the Investor and Company disagree on required payments/amounts. The Investor will want to closely monitor the Company’s financial results on a periodic basis as the level of Net Revenue or Free Cash Flow during any given period will determine whether and to what extent the Company will make payments on the Redeemable Preferred Stock. [↑](#footnote-ref-15)
15. This Term Sheet provides for the Company’s ability to use available cash to accelerate payments on the Redeemable Preferred Stock beyond amounts strictly required to be paid under the terms agreed by the parties. This allows the Company to fully-redeem the Redeemable Preferred Stock earlier than anticipated if that is desirable, and would result in an enhanced IRR for the Investor than would otherwise result from the anticipated payment schedule. Because the amount owed to the Investor is expressed as a multiple of the Investment Amount and a periodic interest or dividend rate is not contemplated, early payoff should not deprive the Investor of any economic benefit. [↑](#footnote-ref-16)
16. This provision provides the Investor a right to demand a minimal return that is less than the anticipated Total Obligation (i.e. return of the amount invested) in the event that the Company is unable to generate sufficient Net Revenues or Free Cash Flow or Gross Revenue (as applicable) to make sufficient dividend/redemption payments to return invested capital by an agreed outside date. This is an instance where the Term Sheets seeks to balance a company friendly posture with sufficient minimal investor protection. On the one hand, it might be provided that if by an outside date the Total Obligation has not been paid on the Redeemable Preferred Stock, then at such outside date, the Company would be obligated to redeem the Redeemable Preferred Stock for the entire unpaid Remaining Total Obligation. However, such an “outside date” concept triggering payment of the full Total Obligation ignores the principle that the Investor and the Company have mutually agreed that the Investor’s payments on the Redeemable Preferred Stock will come out of an agreed source of capital (i.e., Net Revenue or Free Cash Flow or Gross Revenue, as applicable). On this basis, an “outside date” concept triggering payment of the full Total Obligation seems to be potentially unduly punitive vis-à-vis the Company. Instead, the Investor’s right to determine at some outside date that it will protect its downside and accelerate redemption to receive only its return of capital, seems a fair compromise. [↑](#footnote-ref-17)
17. This Term Sheet provides for participation with the common stock in a liquidation in order to facilitate the parties’ ability to take the position that the Redeemable Preferred Stock is “participating preferred” for tax purposes, to ideally simplify tax reporting and avoid “phantom income.” Those tax rules, however, do not require uncapped participation, and so risk-tolerant parties may choose to implement a participation cap, provided it still results in a higher return than the Total Obligation mechanic. Parties should consult with tax counsel in considering a cap. (Additionally, an Investor negotiating for an “equity tail” should avoid the use of a cap.) [↑](#footnote-ref-18)
18. Note that this Redemption Acceleration Event is not triggered if the Company does not make payments on the Redeemable Preferred Stock because there is not available Free Cash Flow or Net Revenues out of which such payments may be made (which would seem punitive to us), but rather, this Redemption Acceleration Event is triggered if Free Cash Flow or Net Revenues does in fact exist or the Company is otherwise obligated to make payments on or redeem the Redeemable Preferred Stock and the Company breaches its obligation to make such payment or complete such redemption. [↑](#footnote-ref-19)
19. In addition to the stated liquidation preference of the Redeemable Preferred Stock set forth above, the Company should accrue an obligation to pay off and redeem the Redeemable Preferred Stock and satisfy the Total Obligation in the case of a change of control or Deemed Liquidation Event. The Redeemable Preferred Stock will, given its nature, not likely participate in such a Change of Control or Deemed Liquidation Event (i.e., an acquiror would not seek to acquire the Redeemable Preferred Stock) and, as such, should be fully redeemed (in much the same way indebtedness would accelerate) in the event of a Change of Control or Deemed Liquidation Event. [↑](#footnote-ref-20)
20. In addition to the stated liquidation preference of the Redeemable Preferred Stock set forth above, the Company should accrue an obligation to pay off and redeem the Redeemable Preferred Stock and satisfy the Total Obligation in the case of an initial public offering. The Redeemable Preferred Stock will, given its nature, not participate in upside or liquidity associated with an initial public offering and, as such should be fully redeemed (in much the same way indebtedness would accelerate) in the event of an initial public offering. [↑](#footnote-ref-21)
21. Consider that, where the Available Redemption Funds are expressed as a percentage of Gross Revenue (as opposed to Net Revenue or Free Cash Flow), if no Available Redemption Funds are generated for some number of months, it means that the Company effectively has zero revenues for that period of time. In such a case, consider whether it is equivalent to an insolvency situation and the Investor should have the right to accelerate a mandatory redemption at the Total Obligation. Whether this makes sense or is equitable may well depend upon whether or not the Company is “revenue-positive” at the time of the investment and upon the assumptions and projections of the parties at the time of the investment around the Company’s ability to generate revenues and the timing of the same. [↑](#footnote-ref-22)
22. As shares of Redeemable Preferred Stock, as discussed above, are not convertible into, or otherwise linked to the Company’s common stock (as is typical series convertible preferred stock in an NVCA-style venture equity financing), this Term Sheet provides that the Redeemable Preferred Stock is non-voting and instead relies on negotiated negative covenants and approval rights for protection. [↑](#footnote-ref-23)
23. This Term Sheet contemplates board observer rights for the holders of Redeemable Preferred Stock. In lieu of board observer rights, parties may want to consider the right of the holders of Redeemable Preferred Stock to designate a voting member of the Company’s Board of Directors. In such a case, attention should be paid to issues around fiduciary duties of director designees, indemnification and exculpation of (and D&O insurance to protect) director designees, and an appropriate mechanism whereby the holders of a sufficient majority of the outstanding voting capital stock of the Company will execute a voting agreement or similar undertaking to designate the designee of the holders of Redeemable Preferred Stock as a voting member of the Company’s Board of Directors. [↑](#footnote-ref-24)
24. Note that a sample/suggested list of Investor approval rights has been included for consideration by users of this Term Sheet. Additional approval rights may be negotiated and certain of these suggested approval rights may be disregarded, in each case, as appropriate for any particular financing transaction. Note that, where applicable, we have included language around approval rights borrowed from the NVCA forms in the expectation that such language will be familiar to, and readily accepted by, the parties to a transaction. [↑](#footnote-ref-25)
25. Typical “preemptive rights” or “pro rata rights” are intended to allow equity investors to participate in subsequent equity financings by the Company to purchase sufficient additional equity to prevent dilution of their ownership stake in the issuer through future equity financing rounds. Here, the holders of Redeemable Preferred Stock don’t actually own any particular ownership stake of the Company on a “look through” basis vis-à-vis the common stock (due to lack of a conversion feature). Accordingly, strictly speaking “preemptive rights” or “pro rata rights” aren’t required. However, as an added right associated with its investment the Investor may wish to negotiate a right to participate and purchase equity in future Company financings. If desired, this entitlement to participate in future equity financings can be expressed as an entitlement to purchase a specified percentage of equity to be issued or a portion of the equity to be issued having a specified value determined by reference to the amount invested in Redeemable Preferred Stock. [↑](#footnote-ref-26)