1. 4 REVENUE SHARE AGREEMENT (EQUITY-BASED)

Brief Description

A Revenue Share Agreement ("RSA") Equity-Based is an alternative equity financing model which incorporates a predetermined distribution structure to investors based on revenues, for a specified period of time or up to a predetermined return on the investment ("Cap" or "Multiple").

As for the RSA Debt-Based, it allows for greater flexibility because the repayments are not tied to a monthly amount or interest rate, but they fluctuate with the company's revenues. Hence, when revenues are down due to seasonality or other unexpected factors, the repayment will be lower, and it will represent a smaller burden on the company's cashflow.

Conversely, when revenues are high, the repayment will scale with the increasing revenue base and will allow for the investment to be repaid faster.

Unlike RSA Debt-Based instruments which treat the revenue share payments as a mix of interest and principal payments, the RSA Equity-Based instruments include a predetermined liquidation mechanism in the form of an equity redemption-based exit.

The self-liquidating structure allows the investors to obtain a return on the investment without having to sell the shares to other investors or relying on subsequent rounds of financing to exit their investment. At the same time, the control of the company is maintained by the entrepreneur and the enterprise performance is matched with the return needs of the investors.

Emergency-Proof: This instrument is particularly relevant in difficult historical moments such as the Covid-19 crisis, when flexibility in repayments is critical to overcoming the severe social, financial, and economic challenges faced by enterprises.

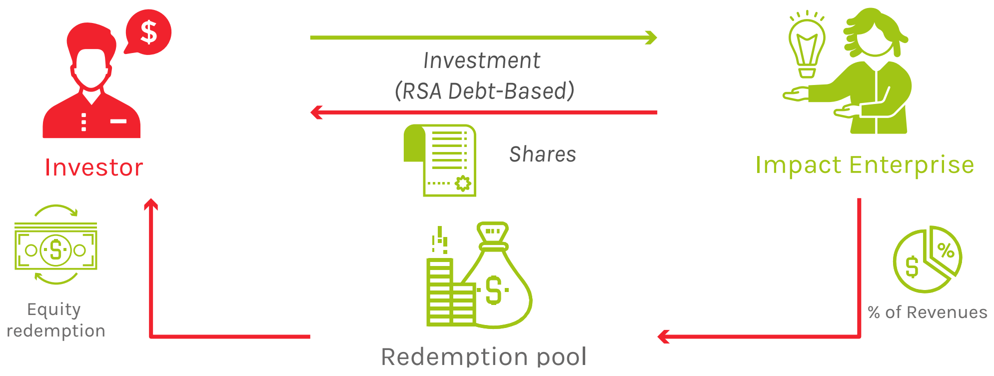

Figure 1.5 - "RSA Equity-Based", source: Roots of Impact.

Purpose/Fit	Enabling for equity-like terms without the need for an exit (share sale [22])
Can replace	Equity
Risk/Return Profile	Medium Risk/Average Return[23]
Enterprise Lifecyle	Early-growth stage (post-revenue)
Maturity	Agreed between investors and borrowers, or upon achievement of a pre-defined milestone

Defining Criteria

- **Revenue share:** It represents the percentage of revenue agreed that the company shall pay to the investor.
- **Revenues:** It represents the definition of revenues agreed with the company. An example is the definition of net revenues according to common accounting standards.
- **Payments:** Revenue Share Agreement (Equity-Based) requires ongoing payments (e.g. annually) based on a pre-determined percentage of revenues (or other financial metrics).

22 A share sale is the sale of parts of the firm or the firm as a whole by selling the shares to another investor

23 The return depends on the behavior of the underlying financial metric and on the speed at which the money is repaid

- **Multiple/Cap:** It represents how many times the initial investment ("Multiple") or the total amount ("Cap") the enterprise shall repay.

- **Profit distribution:** Redemption of equity and or revenue sharing often replaces the right to participate in profit distribution.

- **Self-liquidating:** Higher potential upside return from an exit is traded for more certain repayment terms and less risk (risk-adjusted return shift).

Interesting Variants and Options

- The cap for redemptions can be predetermined at inception as a specific multiple of the original investment price (most common).

- Instead of sharing revenues, it can be agreed to share positive cash flow or profits (Profit Share Agreement - quite similar to traditional equity).

- A redemption pool can be created by setting aside a percentage of revenue over time (similar to a sinking fund [24]). The redemption pool would allow the investors to receive a stable cashflow over the investment period and provide an even greater level of flexibility to the enterprise, enabling it to retain precious resources when it needs them the most. In fact, when revenues are high, the repayment will still scale with the increasing revenues (and the redemption pool will be filled in), whereas when revenues are low, the repayment will come partially or fully from the pool of money set aside.

- A redemption can also be carried out through recapitalization. Once the company is able to obtain traditional financing, conventional instruments (e.g. debt) can be used to buy back shares and reduce the company's outstanding position.
- Being the repayments linked to the financial health of the company and until reaching a specified multiple, the overall return is usually capped. Nevertheless, it could be introduced the possibility for the investor to participate in higher return in the case of a successful traditional exit before maturity.

- A clause can be included in the term sheet to account for higher flexibility in the event that the enterprise does not have adequate cash at its disposal to satisfy the repayments.

- A straight equity conversion option could be included to allow for participation in subsequent equity fund raisings (see convertible note or SAFE).

- Event of default clauses could be implemented if the enterprise does not reach predetermined levels of growth or impact metrics. In order to incentivize the focus on the impact mission, a clause could state that failing to meet specific impact metrics, could translate into a breach of the contract and therefore terminate the relationship. In that case, the firm obligation would be considered as "defaulted" and the subsequent claim on the paid-in capital would arise. Similarly, if the company fails to grow at a predefined rate, then the clause could oblige the company to terminate the relationship and repay back the invested capital. This variant enables to maximize the utility coming from the allocation of capital, in fact since investments are constraint and the number of needy enterprises is high, the clause allows the investor to hedge against the risk that a company fails to perform adequately (both in terms of growth and in terms of impact generated).

- Linking financial rewards to the achievement of impact, for example reducing the redemption cap or the revenue share – see "Examples of relevant terms" below.

Examples of Revenue Share Agreement Equity-Based structures

- **End-of-period equity redemptions:** Shares are redeemed at the end of the investment period through a mandatory repurchase of the equity stake based on the fair market value that could be calculated using, for instance, a third-party valuation.

- **Gradual equity redemptions:** Shares are gradually redeemed over the investment period at a predetermined price and recurrence based on a pool of cashflows previously set aside for periodic redemptions.

24 A sinking fund is a sum of money that is set aside as a reserve in order to soften the hardship of a large payment amount. It is usually used to pay off big debt disbursements like bonds.

- **Percentage-based dividends:** A dividend based on a specific percentage of profit (if the company is profitable) is paid until a target multiple is reached. After the investment period, outstanding shares are repurchased at their original price.

Examples of relevant terms (as formulated in a contract):	
Revenue share	In exchange for the Financing Amount, the Company shall make (quarterly) payment contributions equal to (5%) of Revenue to the Redemption Pool, which shall be utilised at termination of the contract to redeem the Redeemable Amount in full.
	The Revenue Share Agreement Equity-Based shall be gradually redeemed commencing any time at the earlier of (i) the end of the first quarter in which the Company generates (gross) revenues of (USD 50,000), or (ii) (12) months (Grace Period) from signing of the term sheet.
	The Revenue Share Agreement Equity-Based shall participate with distribution paid on Common Stock until total amount paid on the Revenue Share Agreement Equity-Based have reached the Redeemable Amount in full.
Mulitiple/Cap	The outstanding amount of the Revenue Share Agreement Equity-Based will be considered paid in full when the Company has redeemed 100% of the Redeemable Amount, defined as the original investment amount multiplied by (2x) (Multiple [25]).
	The outstanding amount of the Revenue Share Agreement Equity-Based will be considered paid in full when the Company has redeemed 100% of the Redeemable Amount, defined as the original investment amount increased by a specified return on investment of (12%).
Optional: Link to Impact Performance	The pre-agreed redemption cap (multiple of 2x) can be reduced by (0,1x) for every (1,000 units of social outcomes) achieved by the company up to multiple of (1x)
	Alternatively: The pre-agreed revenue share of (3%) is reduced by (0.125%) for every (1,000 units of social outcomes) achieved by the company up to a revenue share of (2%)

25 A multiple of the invested capital is used in order to define the overall expected return for the investor. In the case of a (3x) multiple, the enterprise will have to provide the revenue share until reaching (3) times the paid-in capital.

Main Advantages

- Since the repayment is calculated on the company's performance, the enterprise can avoid the burden that would come from fixed repayments during low sales periods.
- Revenue sharing is very easy to understand and to implement, e.g. (3%) of every revenue goes to the investor.
- It allows the investor to recoup part of the invested capital during the investment lifetime without having to wait for an investment exit.
- There are no periodic pre-defined payment amounts and no financial pressure from debt servicing.
- Enterprise and investor both benefit in case of strong revenue growth (alignment of interest).

Main Challenges

- Similar to equity instruments, there is no recovery provided in the case of bankruptcy. However, a clause could be implemented that would oblige the enterprise to set aside a percentage of revenue over time to create a pool of funds to be used in case of bankruptcy.
- Payments based on a revenue share reduce the free cashflow during scaling phase.
- The lack of familiarity with the instruments and the possible transaction costs coming from the legal work needed to structure the deal could be a concern.

Case studies and additional resources about Revenue Share Agreement (Equity-Based) can be found here.