



Miller Center
for Social Entrepreneurship

Term Sheet for Variable Dividend



Santa Clara University

www.scu.edu/MillerCenter

[COMPANY NAME]

TERM SHEET FOR VARIABLE DIVIDEND REDEEMABLE PREFERRED STOCK (DEMAND DIVIDEND)

THIS TERM SHEET outlines the principal terms of a proposed financing for [Company Name] (hereafter, the “**Company**”), a [State] [entity type] by [Investor] (hereafter, the “**Holder**”). This Term Sheet does NOT constitute a binding agreement among the parties and instead is intended solely to outline the material terms and conditions to be incorporated into definitive agreements and such other agreements, documents and instruments related to this transaction.

The term “**Holders**” as used herein will mean all holders of the Demand Dividend (as defined below) issued by the Company under the terms herein (the “**Financing**”).

Offering Terms

Company:	[Company Name], a [State] ¹ [entity type]
Amount of Financing:	Up to a maximum of \$[200,000] ²
Type of Security:	A Variable Dividend Redeemable Preferred Stock (the “ Demand Dividend ”)
Number of Shares:	Up to [200,000] shares at \$[0.30] ³ per share, based on a pre-money valuation of \$[3,000,000].
Qualifying Investors:	Offered to accredited investors only. [Investors shall be required to complete and sign the Company's form of investor questionnaire.]
Anticipated Closing Date:	A final closing is anticipated to occur on or about [June 30, 2014].
Business Plan:	The Company shall include an outline of projected spending, revenue, and capital use covering at least the Debt Term (as defined below) of this Demand Dividend and attach such plan as Exhibit A hereto (the “ Business Plan ”). The Business Plan may be amended only with the written consent of a majority-in-interest of the Holders. The Business Plan is hereby incorporated into the terms of this Term Sheet.
Capitalization:	A chart of the proposed post-Financing capital structure of the Company shall be attached as Exhibit B hereto.
Use of Proceeds:	Proceeds from the Financing will be used to fund the Company's Business Plan. Proceeds from the investment may not be used to satisfy debt obligations, unless included in the Business Plan.

Charter

Dividends: ⁴	Dividends will be payable on the Demand Dividend when and if declared by the Board of Directors and are non-cumulative. After
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¹ For certain tax considerations of investments in non-US Companies, see Tax Addendum.

² [BM: I've reflected a \$200k investment into a (pre-money) \$3MM Company for illustrative purposes.]

³ [BM: Per share price directly affected by Company valuation. To discuss potential effect on valuing Common Stock for tax purposes, i.e., employee stock compensation.]

⁴ The Demand Dividend's right to dividends can affect the US federal income tax treatment of the Company and the Holders, as described in the Tax Addendum.

completion of the Dividend Holiday (as defined below), Holders will be entitled to receive, prior to the payment of dividends to holders of the common stock of the Company (the “**Common Stock**”), []% of the Free Cash Flow (as defined below) of the Company on a quarterly basis, until total dividends paid on the Demand Dividend have reached the Total Obligation (as defined below). The Demand Dividend shall participate with dividends and distributions paid on the Common Stock, until total dividends paid on the Demand Dividend have reached the Total Obligation.

Liquidation Preference:⁵

In the event of any liquidation, dissolution, or winding up of the Company, the Holders will be entitled to receive the greater of: (i) a liquidation preference equal to the Total Obligation, or (ii) a right to participate *pro rata* in the liquidation proceeds to the Common Stock [up to [X] times the amount of the original Financing].

The following transactions will be treated as a liquidation of the Company: (i) a merger or consolidation of the Company in which its shareholders do not retain a majority of the voting power in the surviving corporation, (ii) a sale of all or substantially all of the Company’s assets (including the exclusive licensing of the Company’s intellectual property), or (iii) the closing of a firmly underwritten public offering of Common Stock.

Total Obligation:

The aggregate payment obligated to the Holders by the Company in connection with the Demand Dividend will be [2] times the amount of the original Financing. For clarity, such amount shall include any dividends paid on the Demand Dividend.

Dividend Holiday:

Dividend obligations to the Demand Dividend will not commence until [12] months *after* the Closing Date.

Redemption:

All outstanding Demand Dividend shares shall be redeemed on [DATE AT LEAST 7 YEARS⁶ FROM CLOSING DATE]. The redemption price shall be equal to the Total Obligation. [Additionally, up to 50% of the Demand Dividend shares shall be redeemable at the option of the Holders, upon an election by at least a majority-in-interest of the Holders, at any time after [DATE AT LEAST 7 YEARS FROM THE CLOSING DATE] at a redemption price equal to the *pro rata* portion of the Total Obligation].

Business Plan Extension:

If the Company is not able to redeem the Demand Dividend, the Company and Holders will make best efforts to agree on a business plan extension. The extension should cover a term sufficient to allow redemption of the Demand Dividend for the applicable *pro rata* portion of the Total Obligation. If the Company and Holders cannot mutually agree on a plan, the Company shall pay the Holders a minimum annual Free Cash Flow equal to four (4) times the average Free Cash Flow of the preceding eight (8) quarters until the Total Obligation is satisfied. In such event, the

⁵ The Demand Dividend’s right to proceeds on liquidation can affect the US federal income tax treatment of the Company and the Holders, as described in the Tax Addendum.

⁶ [BM: Some tax advisors may be uncomfortable treating an investment as stock for US federal income tax purposes if redemption is allowed prior to 10 years from issuance.]

annual cash flow shall be allocated quarterly in the same proportion as the prior year's quarterly cash flows.

Calculation of
Free Cash Flow:

Specific elements of the calculation for the purposes of this Financing shall be negotiated between the parties and included in the Business Plan. In general, Free Cash Flow shall be calculated as gross sales, less discounts, cost of goods sold, operating expenses approved under the Business Plan, and periodic payments of prior outstanding debt due within the reporting period (current quarter).

General Voting Rights:

At the time of the Financing, the Demand Dividend shall not have voting rights, except as set forth in "Voting for Directors," below.

[If, after the Dividend Holiday, the Company does not pay dividends on the Demand Dividend of at least []% of the original Financing for [2] consecutive quarters, each share of Demand Dividend will have the right to [15]⁷ votes and shall vote together with the Common Stock on all matters, *provided, however*, that the Demand Dividend may waive this voting right upon the written consent of a majority-in-interest of the Holders. The Demand Dividend shall revert to non-voting status upon the Company's payment of dividends on the Demand Dividend of at least []% of the original Financing for [2] consecutive quarters.]⁸

Voting for Directors:

The Holders will be entitled to one board seat on the Company's Board of Directors. Board meetings will be held quarterly until such time as the Board unanimously determines otherwise.

[If, after the Dividend Holiday, the Company does not pay dividends on the Demand Dividend of at least []% of the original Financing for [2] consecutive quarters, the Holders will be entitled to appoint the minimum number of additional seats on the Company's Board of Directors as is required to (after accounting for the existing Demand Dividend-appointed director) represent a majority, *provided, however*, that the Demand Dividend may waive this appointment right upon the written consent of a majority-in-interest of the Holders. The Demand Dividend shall revert to appointment of only one director upon the Company's payment of dividends on the Demand Dividend of at least []% of the original Financing for [2] consecutive quarters.]

Indemnification:

The Company will indemnify Board members to the maximum extent permitted by applicable law.

Protective Provisions:

So long as any Demand Dividend shares remain outstanding, the Company will not, without the written consent of a majority-in-interest of the Holders:

(i) liquidate, dissolve or windup the business and affairs of the Company, or effect any Deemed Liquidation Event (as defined in the Company's Certificate of Incorporation) or

⁷ [BM: This is the minimum vote required to control given the assumptions made in this draft.]

⁸ [BM: I envision that investors will have the option of pursuing this shareholder voting right and/or the board appointment right described below.]

consent to any of the foregoing; (ii) amend, alter, or repeal any provision of the Certificate of Incorporation or Bylaws; (iii) create or authorize the creation of or issue or obligate itself to issue shares of, any other security convertible into or exercisable for any equity security, having rights, preferences or privileges senior to or on parity with the Demand Dividend (iv) reclassify, alter or amend any existing obligation that is junior to or on parity with the Demand Dividend, if such reclassification, alteration or amendment would render such other obligation senior to or on parity with the Demand Dividend; (v) purchase or redeem or pay any dividend on any capital stock, other than Demand Dividend and stock repurchased from former employees or consultants in connection with the cessation of their employment/services, at the lower of fair market value or cost; (vi) create or hold capital stock in any subsidiary that is not a wholly-owned subsidiary or dispose of any subsidiary stock or all or substantially all of any subsidiary assets; (vii) merge or consolidate with another corporation in which the holders of the Company's voting equity securities immediately prior to the transactions own 50% or less of the voting securities of the surviving corporation; (viii) sell, license, encumber or dispose of all or substantially all of the Company's assets, technology or intellectual property; or (ix) except as set forth herein, increase or decrease the size of the Board of Directors.

Information Rights:

The Company will deliver to the Holders un-audited quarterly financial statements no later than 30 days, unless otherwise agreed to, following the close of such period and audited (or, at the sole discretion of the Company's Board of Directors, un-audited) annual financial statements no later than 180 days following the close of the fiscal year. Any discrepancies which caused a variation in payment to the Holder, based on inaccurate financial statements will be reimbursed within 30 days. The Company will also furnish the Holders with a copy of the Company's annual operating plan no later than 30 days prior to the beginning of the fiscal year. Each Holder will also be entitled to standard inspection and visitation rights, including the right to demand audited financial statements, at such Holder's expense and provided that such audit will not unduly burden the Company or interrupt the normal course of business. Additionally, a Holder may demand to see properly certified bank statements from the bank where the Company maintains its account upon demand, provided, however, that the Company shall not be obligated to provide such bank statements more frequently than once per 30 day period.

Participation Rights:

The Holders will be entitled to participate in any subsequent financing. The Holders will have the right to purchase an amount of securities issued in such financing equal to three times the remaining Total Obligation outstanding at the close of the subsequent financing. For the avoidance of doubt, if a Holder's share of the Total Obligation at inception of the Demand Dividend, as defined above, was \$100,000, the Company has repaid \$50,000 to such Holder, and the Company undertakes a

subsequent financing, such Holder will be entitled to purchase up to \$150,000 (3 x (\$100,000 - \$50,000)). Participation in any subsequent financing will be at the election of the Holders.

Other Matters

- Purchase Agreement:** The investment will be made pursuant to a Demand Dividend Purchase Agreement reasonably acceptable to the Company and the Holders, which agreement will contain, among other things, appropriate representations and warranties of the Company, covenants of the Company reflecting the provisions set forth herein and appropriate conditions of closing, including satisfactory completion of financial and legal due diligence.
- Amendments:** Amendments and waivers of the definitive Demand Dividend documentation (including any agreement upon or amendment to a Business Plan Extension) will require the written consent of a majority-in-interest of the Holders, except that no amendment or waiver shall affect any Holder in an adverse manner without the written consent of such Holder unless such amendment or waiver applies to all Holders in the same fashion.
- Currency:** All payments to Holders will be made in U.S. Dollars. The Company shall take reasonable measures to ensure payments to the Holders comply with both local and U.S. laws.
- Transfer of Rights:** Any rights accorded to the Holders may be transferred to (i) any partner or retired partner of any Holder which is a partnership, (ii) any member or former member of any Holder which is a limited liability company, (iii) any family member or trust for the benefit of any individual Holder, or (iv) any affiliated investment fund of a Holder; provided the Company is given written notice thereof and subject to applicable securities regulations.
- No Finder Fee:** The Holders and Company agree that the Company will not pay any broker or finder fees related to this financing, including any payments made as cash equivalents, and that any such fees paid by an Holder will be additional to the amount invested by such Holder in the financing and will not be reimbursed by Company.
- Conditions Precedent to Financing:** This Term Sheet is a non-binding document which expresses the present intent of the parties hereto. Closing of the transaction contemplated hereunder is subject to the approval of each of the Holders and to the satisfaction of the Holders' due diligence requirements, including financial and legal diligence, and the signing of mutually acceptable definitive agreements containing additional provisions customary in transactions of this type.

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF, the parties have executed this Term Sheet as of the date set forth below:

AGREED AND ACCEPTED:

[COMPANY NAME]

By: _____

Name: _____

Title: _____

Date: _____

AGREED AND ACCEPTED:

[INVESTOR]

BY: _____

NAME: _____

TITLE: _____

DATE: _____

EXHIBIT A

Approved Business Plan including Pro Forma X-Year Income and Cash Flow Forecast

EXHIBIT B

Proposed Capital Structure

Pre-Financing:

Company Valuation: [\$3,000,000]

Outstanding Shares: [10,000,000]

Post-Financing:

<u>Security</u>	<u># of Shares</u>	<u>% Ownership</u>
Common -- Founders:	[10,000,000]	[93.75%]
Demand Dividend:	[666,667]	[6.25%] ⁹
Total:	[10,666,667]	100.00%

⁹ [BM: DD ownership is dependent on Company's (pre-money) valuation.]