1. 3 REVENUE SHARE AGREEMENT (DEBT-BASED)

Brief Description

A Revenue Share Agreement ('RSA") is a quasi-equity financing instrument (also called revenue-based loan) where periodic repayments are based on a percentage of the revenues up to a predetermined return on the investment ("Cap" or "Multiple").

The RSA allows for higher level of flexibility because the repayments are not tied to a monthly amount or interest rate, but they fluctuate with the company's revenues allowing for greater flexibility. 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 it will allow the investment to be repaid faster.

The RSA debt-based allows to retain ownership and control of the company, avoiding equity dilution or interferences in the management by external parties.

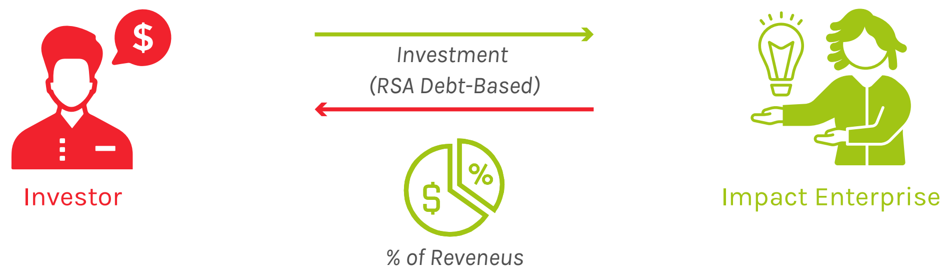

Figure 1.4 - "RSA Debt-Based", source: Roots of Impact.

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

Purpose/Fit	Enabling for mission-aligned growth without equity dilution and requirement for exit
Can replace	Equity or debt (dependent on stage and purpose of investment)
Risk/Return Profile	Medium Risk/Average Return[18]
Enterprise Lifecyle	Early-growth stage (post-revenue)
Maturity	Agreed between investors and borrowers based on a pre-defined multiple

Defining Criteria

- **Interest rate:** Unlike a loan or a convertible note, a Revenue Share Agreement has no fixed interest rate.
- **Periodic repayments:** They are based on a fixed percentage of revenues, or alternatively profit, cashflow or other financial indicators. The frequency is usually annually or biannually.
- **Revenue share:** It represents the percentage of the 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.
- **Multiple/Cap:** It represents how many times the initial investment ("Multiple") or the total amount ("Cap") the enterprise shall repay.
- **Flexibility:** A Revenue Share Agreement has a flexible repayment period, until reaching a pre-defined multiple (e.g. 1.5x initial investment).
- **Return on capital:** The investor's return on capital is dependent on the timing of the repayments. Hence, the faster the sales growth, the greater the return for the investor.

18 The return depends on the behaviour of the underlying financial metric and on the speed of which money is repaid back.

- **No collateral requirement:** Typically, there is no requirement for collateral but simply a convincing revenue history or high potential for future sales given proof of concept[19] or past traction.

Interesting Variants and Options

- Honeymoon[20], also known as grace period. Useful to provide the enterprise with the needed time to reach efficient scale.
- A final repayment date for the remainder can be agreed upon. In this case the enterprise has to pay the investor the remainder (balloon payment) for reaching a pre-defined multiple (e.g. 1.5x) on this final repayment date.
- Straight interest rate that is enhanced with a "royalty kicker", i.e. a percentage of revenues payable to the investor on top of the straight repayment (which dilutes some of the advantages for the enterprise, mentioned before).
- Conversion to equity or participation rights in future rounds of funding (see convertible note).
- The loan could be combined with business development services in order to prepare the entrepreneur ("the borrower") for loan monitoring, business growth, capital infusion, and help to reduce the risk of default.
- The investor could be provided with the option to convert his or her investment to a normal loan upon achievement of a specific revenue level. In that way, the enterprise will pay back as they would do with a traditional loan schedule, thereby providing the creditor with interest principal payments. This variant offers the possibility to put a cap on the amount of money the enterprise will have to pay to the investors, and it helps them to make more accurate future financial projections.

19 Proof of Concept ("PoC") is the evidence of technical feasibility of a business model and practicability of an idea or of a new project. It is usually carried out to demonstrate that a project has potential to be developed further.

20 The repayment is deferred by a predetermined duration, usually ranging from 10 to 24 months, in order to allow the enterprise to accelerate its growth and generates revenues and profits

- The Revenue Share Agreement can be used in combination with subordination of the loan, thus allowing the impact enterprise to attract further funding and investors (subordinated debt[21]).
- Linking financial rewards to the achievement of impact, for example reducing the multiple/cap or the revenue share – see "Examples of relevant terms" below.

Example of Revenue Share Agreement Debt-Based structures

- Straight (or Open Ended) Revenue Loans: A percentage of the revenues is periodically repaid until a certain multiple of investment is reached.
- Convertible Revenue Loans: A percentage of the revenues is periodically repaid, and the remainder can be converted to equity.
- Final Repayment Date Revenue Loans: The remainder has to be repaid until a final repayment date.

21 In the event of liquidation or bankruptcy the subordinated debt ranks below the other debt instruments. Therefore, all the other creditors' claims must be met before starting to pay the owner of a subordinated debt.

Examples of relevant terms (as formulated in a contract):	
Revenue share	In exchange for the Financing Amount, the Company shall make (quarterly) payments equal to (5%) of Revenue to the Investor until the Repayment Amount is paid in full. The initial payment will begin at the earlier of (i) the end of the first quarter in which the Company generates (gross) revenues of (USD 80,000); or (ii) (12) months (grace period) from signing of the term sheet.
Mulitiple/Cap	• The outstanding amount will be considered paid in full when the Company has paid the investor the Repayment Amount, defined as the original investment amount multiplied by (2x) (Multiple). • In the event the Revenue Share Agreement Debt-Based facility has been in effect for a period of (5) years without full repayment, the Company must repay (2x) the outstanding amount at the subsequent end of quarter.
Optional: Link to Impact Performance	• The pre-defined multiple of (2x) is reduced by (0.1) for every (1,000 units of social outcomes) achieved by the company up to a threshold of minimum (1.2x). • 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%).

Main Advantages

- Enterprise and investor both benefit in case of strong revenue growth (alignment of interest).
- Pre-defined exit: self-liquidation through achieving of pre-defined repayment level.
- Straightforward implementation without notary.
- No periodic pre-defined payment amount and no or less requirement for collateral.
- No dilution of ownership.
- It provides the investors with early returns from the investment instead of waiting for an exit.
- There is no time waste on valuation questions.

Main Challenges

- Payments based on revenue share reduces the free cash flow during scaling phase.
- The investor relies heavily on the company's future earnings.
- Additional risk if revenue falls below expectations because it will extend the time of repayments (in case of Straight Revenue Loans) or creates a high repayment obligation at maturity (in case of Final Repayment Date Revenue Loans).
- There is an upper constraint on return in terms of multiple of investment, due to the nature of the structure of the Revenue Share Agreements.

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