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 or up to a predetermined return on the investment ("Cap" or "Multiple").

As with the debt-based RSA, it allows for greater flexibility because the repayments are not tied to a monthly amount or interest rate; they fluctuate with the company's revenues. When revenues are down due to seasonality or other unexpected factors, the repayment will be lower and represent a smaller burden on the company's cash flow. Conversely, when revenues are high, the repayment will scale with the increasing revenue base and allow the investment to be repaid faster.

Unlike debt-based RSA instruments, which treat the revenue share payments as a mix of interest and principal payments, equity-based RSA instruments include a predetermined liquidation mechanism in the form of an equity redemption-based exit. The self-liquidating structure allows investors to obtain a return on the investment without having to sell the shares to other investors or rely on subsequent rounds of financing to exit. At the same time, control of the company is maintained by the entrepreneur and enterprise performance is matched with the return needs of the investors.

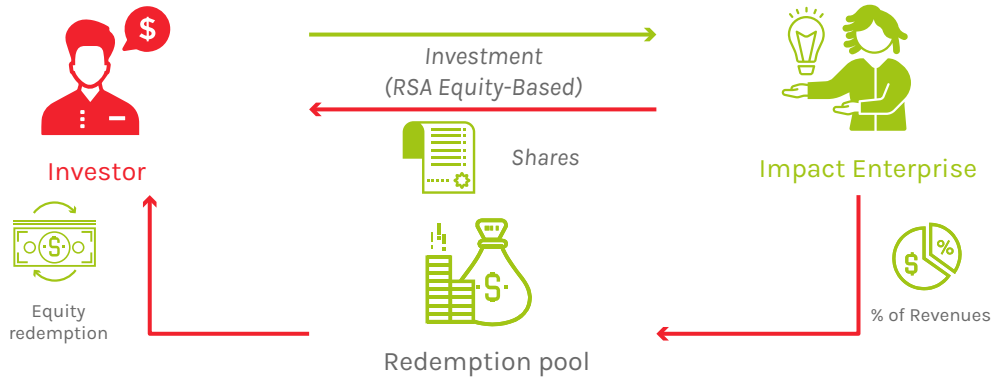


Figure 1.5 – "RSA Equity-Based", source: Roots of Impact.

Purpose/Fit	Enabling equity-like terms without the need for an exit[25]
Can replace	Equity
Risk/Return Profile	Medium Risk/Moderate Return[26]
Enterprise Lifecyle	Early-growth stage (post-revenue)
Maturity	Agreed between investors and borrowers, or upon achievement of a pre-defined milestone

Defining Criteria

1. **Revenue share:** The percentage of revenue agreed that the company shall pay to the investor.
2. **Revenues:** The definition of revenues agreed with the company. An example is the definition of net revenues according to common accounting standards.
3. **Payments:** The equity-based RSA requires ongoing payments (e.g. annual) based on a pre-determined percentage of revenues (or other financial metrics).
4. **Multiple/Cap:** How many times the initial investment ("Multiple") or the total amount ("Cap") the enterprise shall repay.
5. **Profit distribution:** Redemption of equity and/or revenue sharing often replaces the right to participate in profit distribution.
6. **Self-liquidating:** Higher potential upside return from an exit is traded for more certain repayment terms and less risk (risk-adjusted return shift).

Variants and Optional features

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

25 a share sale, i.e. the sale of parts of the firm or the firm as a whole to another investor

26 the return depends on the behaviour of the underlying financial metric and on the speed at which the money is repaid

- Instead of sharing revenues, it can be agreed to share positive cash flow or profits.[27]

- A redemption pool can be created by setting aside a percentage of revenue over time[28]. The redemption pool allows investors to receive a stable cash flow over the investment period and gives the enterprise even greater flexibility: when revenues are high, repayments scale with revenues and the pool is filled; when revenues are low, repayments come partially or fully from the money set aside.

- A redemption can also be carried out through recapitalisation: 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.

- As repayments are linked to the financial health of the company until a specified multiple is reached, the overall return is usually capped. Nevertheless, the investor can be given the possibility to participate in higher returns in the case of a successful traditional exit before maturity.

- A clause can be included in the term sheet to allow 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 can be included to allow participation in subsequent equity fundraisings (see Convertible Note or SAFE).

- Event of default clauses can be implemented if the enterprise does not reach predetermined levels of growth or impact metrics. To incentivise focus on the impact mission, a clause could state that failing to meet specific impact metrics constitutes a breach of contract and terminates the relationship, giving rise to a claim on the paid-in capital. Similarly, if the company fails to grow at a predefined rate, the clause could oblige the company to terminate the relationship and repay the invested capital. Since capital is constrained and the number of enterprises in need is high, this allows the investor to hedge against the risk that a company fails to perform adequately, both in terms of growth and impact generated.

- Examples of structures: End-of-period equity redemptions[29]; Gradual equity redemptions[30]; Percentage-based dividends[31].

PRACTICAL APPLICATION

Benefits and Considerations, Capital Providers

Benefits	Considerations
Self-liquidating exit: a return is obtained without selling shares to other investors or relying on subsequent financing rounds	Return is usually capped: higher potential upside from an exit is traded for more certain repayment terms
Part of the invested capital is recouped during the investment lifetime instead of waiting for an exit	Similar to equity instruments, no recovery is provided in the case of bankruptcy (unless a reserve-pool clause is implemented)
Enterprise and investor both benefit, up to the redemption multiple, in case of strong revenue growth (alignment of interest)	Heavy reliance on the company's performance and reporting
A redemption pool variant provides a stable cash flow over the investment period	Lack of familiarity with the instrument and possible transaction costs from the legal work needed to structure the deal

27 a share sale, i.e. the sale of parts of the firm or the firm as a whole to another investor

28 similar to a sinking fund, i.e. a reserve set aside to soften the hardship of a large payment

29 shares are redeemed at the end of the investment period through a mandatory repurchase of the equity stake based on fair market value, calculated for instance via a third-party valuation

30 shares are gradually redeemed over the investment period at a predetermined price and recurrence, based on a pool of cash flows previously set aside

31 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

Benefits and Considerations, Enterprises

Benefits	Considerations
Equity-like patient capital without the need for an exit, so the mission is not tied to a future trade sale or IPO	Payments based on a revenue share reduce free cash flow during the scaling phase
Control of the company is maintained by the entrepreneur	Lack of familiarity with the instrument can increase legal and structuring costs
Repayments are calculated on performance, avoiding the burden of fixed repayments during low-sales periods	Replacing profit-distribution rights with redemption mechanics requires careful design
Revenue sharing is simple in concept, e.g. (3%) of every revenue goes to the investor, with no financial pressure from debt servicing	Redemptions based on fair market value can be contentious if the valuation method is not fixed ex ante

Selection Criteria Checklist

Use to test whether a Revenue Share Agreement (Equity-based) is a good fit for a given deal.

- **Post-revenue:** the enterprise generates revenues that can support periodic redemption contributions.
- **No exit path required:** a trade sale or IPO is neither realistic nor desired, making a self-liquidating structure attractive.
- **Investor accepts capped return:** the capital provider trades exit upside for more predictable, cash-flow-based repayment.
- **Redemption mechanics fixed:** price, schedule and valuation method for redemptions are agreed at inception.
- **Legal and tax feasibility:** local corporate law permits share redemptions or buybacks in the intended form.
- **Reporting capacity:** the enterprise can produce reliable revenue and financial reporting for the investor.

Common Pitfalls

1. Leaving redemption pricing to future negotiation instead of fixing the mechanics ex ante, inviting valuation disputes.
2. Sizing the multiple or revenue share so high that redemption obligations create debt-like pressure on cash flow.
3. Overlooking local corporate-law limits on share buybacks and redemptions before structuring the deal.

Examples of Relevant Terms

As formulated in a contract; bracketed values are illustrative and negotiable.

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 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 in distributions paid on Common Stock until the total amounts paid on the Revenue Share Agreement Equity-Based have reached the Redeemable Amount in full.

Multiple/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). Alternatively: defined as the original investment amount increased by a specified return on investment of (12%). (A multiple of the invested capital defines the overall expected return for the investor: in the case of a (3x) multiple, the enterprise provides the revenue share until reaching (3) times the paid-in capital.)
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 down to a 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 down to a revenue share of (2%).

Other external case studies and additional resources about Revenue Share Agreement (equity-based) can be found **here.**

