

Term Sheet Templates for Early Stage Investments

- Ordinary Shares
- Preferred Shares
- Convertible Loan

October 2006

Term Sheet Templates

This folder includes three term sheet templates which New Zealand Venture Investment Fund Limited engaged Simpson Grierson to prepare to provide a resource available to all early stage investors and to promote greater consistency in the terms and documentation used.

The term sheets contain key investment terms which should be considered by an early stage investor, whether they be an angel, venture capitalist or other type of early stage investor.

Ordinary Shares Template

The first term sheet is for an investment in ordinary shares which will rank equally with the other ordinary shares issued by the company. Angel groups typically invest in ordinary shares (although some will seek terms which are closer to the terms typically sought by venture capital investors, in which case they may invest in preferred shares).

Preferred Shares Template

The second term sheet is for preferred shares and incorporates variable terms commonly sought by venture capital investors in New Zealand and overseas. The preferences include preferential dividend rights, liquidation preferences and redemption rights. In some cases all of these preferences will apply, while in others, the preferred shares will only have some of these preferences. The preferred shares are invariably convertible to ordinary shares at the option of the investor and have all of the rights of ordinary shares in addition to the preference rights.

Convertible Loan Template

The third term sheet is for a convertible loan. Often an earlier stage investor will provide some initial funds under a convertible loan while the business case and

plan for a more substantial investment is being developed or pending satisfaction of a condition precedent to the more substantial investment. The convertible loan may be secured or unsecured, and may convert to either ordinary shares or preferred shares. Where a more substantial investment is intended to follow the convertible loan, the loan will convert to the same class of shares as that more substantial investment.

Variables And Options

All of the term sheets contain a number of variables and options. They also contain footnotes to provide guidance on options which may not be self evident.

The templates seek to strike a balance between workable plain English documents and adequate coverage of most of the key variables of terms typically included in those term sheets. They do not contain exhaustive examples of possible terms or the potential variations of those terms, but rather represent what we regard as most typical.

We would be very happy to assist you with any queries you may have in respect of the use of the term sheets or the options contained in them. We can also assist you with the substantive investment documentation which reflects the terms contained in the term sheets.

Contact

If you require assistance, please contact Andrew Lewis at Simpson Grierson:

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TERM SHEET

FOR ISSUE OF ORDINARY SHARES BY

[] LIMITED

(Company)

General notes: *This term sheet applies if the investment is in ordinary shares. Refer to alternative term sheets if preferred terms required or if the investment is structured as a loan convertible to equity. The more optional provisions appear in italics and instructions appear in bold italics. Refer to footnotes at the bottom of each page for comments on some of the optional provisions.*

This document (**Term Sheet**) summarises the principal terms of a proposed investment in the Company (**Investment**). This Term Sheet is not legally binding except for the terms stated in part B of this Term Sheet and there will be no obligation to issue or subscribe for shares in the Company until a binding investment agreement (**Investment Agreement**) is signed by the parties.

PART A: INVESTMENT TERMS (non-binding)

Business: The [proposed] business of the Company relating to [describe business] (**Business**).

Amount of investment: [Up to¹] \$ [] [(subject to achievement of milestones)] (**Investment Amount**).

[Minimum Available Investment]: *The minimum amount available for investment by the Investor[s] must be \$[]².*

Investor[s]: [**Insert name(s) of investor[s]**] or [The persons identified in Appendix 2 [and other members of the [] investment syndicate who agree to participate in the Investment]³] (**Investor[s]**).

Key People: [**Insert names of founder(s)/key people**] (**Key People**⁴).

Pre-money valuation: The investment is based on a pre-financing valuation of \$[].

Type of Shares: [Series A⁵] ordinary shares (**Shares**).

Issue Price: \$[] per Share.

Number of Shares: [Up to] [].

¹ Words "up to " generally apply if investment is tranching and milestones or conditions apply for subsequent payments.

² Applicable if investment is by a syndicate and either, indicative commitments are yet to be received for the full Investment Amount or there is potential for some Investors to withdraw while others proceed (e.g. if they are not happy with the outcome of due diligence etc).

³ Applicable for a syndicate investment where all of the participants are yet to be confirmed.

⁴ The term "Founders" is more common than "Key People", but latter term may be more accurate in indicating the people and who are important who may not be limited to the original founders of the Company (see later provisions relating to conditions precedent and restrictions on share transfers).

⁵ May be appropriate to distinguish from other ordinary shares to the extent shares confer some special rights (e.g. anti-dilution, drag and forced liquidation).

- Capital Structure:** The capitalisation of the Company immediately prior to investment and after investment of the Investment Amount will be as set out in the table in Appendix 1 (**Capitalisation Table**).
- Conditions Precedent:
(for Investor['s][s] benefit)**
- Due diligence being completed to the satisfaction of the Investor[s].
 - Agreement to a business plan which comprises an agreed budget (**Agreed Business Plan**).
 - *[Agreement on milestones which must be achieved for disbursement of post Settlement Date tranches of the Investment Amount (**Milestones**)].*
 - Final approval of each Investor's *[board]* or *[Investment Committee]* (as applicable).
 - Completion of the Investment Agreement and all existing holders of shares or options in the Company agreeing it supersedes any existing agreements between them.
 - Capitalisation of all outstanding loans *[other than the loan(s) of \$ from []]* and that capitalisation resulting in the pre-investment capitalisation shown in the Capitalisation Table.
 - Completion of employment or contractor agreements(s) with the *[Key People]* *[[] and []]* on terms acceptable to the Investor[s] (and which include suitable non compete covenants).
 - All relevant officers, consultants and contractors (including all Key People assigning (in a form acceptable to the Investor[s]) all intellectual property linked to the Business or proposed future business.
 - Agreement on the identity of *[insert number]* *[an]* *[independent director[s]]* *[and]* *[a chairman]*.
 - Agreement on the parameters of an employee share option plan for the key officers, employees and contractors of the Company (including the Key People) to purchase up to [%] of the Company's post money capital (**ESOP**).
 - Evidence that any third party consents or other authorisations required to complete the investment have been obtained.
 - ***[Insert any other specific conditions precedent⁶].***

⁶ Consider other specific conditions precedent which should be specified (e.g. members of investment syndicate making commitments equivalent to at least the minimum required investment). However in this respect there is sufficient protection for Investors in the general due diligence condition and the non-binding nature of Term Sheet.

Anticipated Settlement Date: [*Insert date*] or [5] business days after satisfaction of all conditions precedent in the Investment Agreement (actual settlement date being referred to as **Settlement Date**)

Disbursement of Investment Amount: The Investment Amount will be subscribed for Shares [*in one sum on the Settlement Date*] **or** [*in the instalments as specified in the Agreed Budget (and applied solely to expenditure as specified in the Agreed Budget or otherwise approved by the Investor[s])*] **or** [*as follows*]:

- [\$] on Settlement Date;
- [\$] when [*insert Milestone etc*]

[*provided each instalment will be at the Investor['s][s'] option if a Milestone due by the relevant date has not been achieved*]⁷.

[Anti-dilution: *The number of shares held by the Investor[s] will be increased (by the issue of further shares at nominal consideration to the Investor[s]) on a [full] [weighted average] ratchet basis if any new shares are issued at a price less than the issue price for the Shares (other than pursuant to an approved ESOP [or a rights issue in which the Investor[s] participate pro-rata]*⁸.

Board: The Board will initially consist of:

Chairperson [(no casting vote)]	[]
Investor['s][s] representative(s)	[]
[Founders] [Other shareholders] representative(s):	[]
Independent director(s)	[]

The Board will meet [*monthly*]

[*The Chairman will be paid \$[] per annum/meeting*], [*any independent directors will be paid \$[] per annum/meeting*] and [*the [Investor] [other] directors will be paid \$[] per annum/meeting*]⁹ [*but otherwise attendance at Board meetings will not be remunerated*].

Protective Provisions: Prior approval of the Investor director(s) is required for any of the following in relation to the Company:

- issues of equity, options or any instruments

⁷ Of the 3 variables, the latter 2 options which allow for tranching will usually be preferred with third option being most preferred from Investor['s][s] perspective as payments are contingent on milestones.

⁸ Anti-dilution protection is standard for preference shares but should also be considered for ordinary shares. Full ratchet will effectively reprice the Investor['s][s] shares (by issuing additional shares to the Investor[s]) at the lower issue price of the "down round" while a weighted average ratchet will reprice at the weighted average of each price (accordingly to respective amounts subscribed). Full ratchet is most favourable for the Investor[s]. Another issue is whether anti-dilution protection extends to a rights issue offered pro-rata to all shareholders if the Investors do not take up their pro-rata share (or whether they have to "pay to play").

⁹ Usually the only directors fees will be (at most) a modest meeting fee will be paid to the Investor directors only.

convertible to equity (other than issues already contemplated by the Investment Agreement);

- any [*major*] transaction or transaction involving the disposal of a material proportion of the Company's assets;
- any transaction or arrangement likely to have the effect of the Company acquiring rights or interests or incurring obligations or liabilities not specifically identified in the Agreed Business Plan, the value of which is greater than [*\$10,000*];
- any other material departure from the Agreed Business Plan;
- any transactions with a related party of the Company or any shareholder or officer;
- any borrowings, guarantees, indemnities or other contingent commitments;
- appointment or removal of the CEO, CFO or any other Key Person [*or any other employee*];
- approval of subsequent budgets and business plans or any material amendments to or departures from the Agreed Business Plan; or
- any change to accounting policies [*or the auditor*].

Financial statements, reporting:

Unaudited [*monthly and*] quarterly statements and [*un*]audited annual accounts, in all cases accompanied by reports covering all material aspects of the Company's progress.

Pre-emptive rights and Drag and Tag along:

In addition to usual pre-emptive rights, drag and tag along rights will apply if any shareholder(s) wish to sell more than [*50%*] of the Company shares [*including a majority of the Investor[s]/[s'] shares*]¹⁰ (in aggregate) to a third party [*or if the Investor[s] wish to sell all of their shares,*]¹¹ so:

- the selling shareholders may require the minority to sell all of their shares on the same terms; or
- the other shareholders may require the selling shareholder(s) to obtain an equivalent offer from the purchaser to acquire the shares of the other shareholders;

Tag along rights will apply as between the Investor[s] for any sale of Company's Shares by any one of them.

¹⁰ If the Investor[s] held less than 50%, may require this protection against being "dragged" by other shareholders.

¹¹ Consider if the Investor[s] should have the right to "drag" other shareholders for desired exit, irrespective of whether they hold more than 50% of the shares or whether they need sufficient support from ordinary shareholders to achieve a 50% threshold. Also consider whether 50% is the appropriate threshold or whether it should be higher.

- Key People Escrow:** Except with the consent of the Investor directors the Key People are not permitted to dispose of any shares for a period of [3] years from Settlement Date, with the exception of:
- a sale in an IPO or other transaction approved by the Investor[s] where the Investor[s] have the opportunity to sell on identical terms; or
 - a transfer to their respective wholly owned and controlled entities or to immediate family.
- Key Man Insurance** The Company will procure and maintain (for the Company's benefit) key man life insurance policies in the amount of [\$1,000,000] on the [life][lives] of [] [each of the Key People].
- Warranties** Without limiting usual warranties for similar investments as will be contained in the Investment Agreement, the Company [and [Key People] [or name warrantors] will warrant that (except as disclosed [and to the best of their knowledge and belief])¹²:
- all intellectual property and other rights necessary to pursue the Business are the full legal, beneficial and unencumbered property of the Company;
 - the Company has no actual or contingent liabilities not specified in the statement of financial position provided to the Investor[s] and such statement provides a true and fair view of the Company's position; and
 - all other information provided to the Investor[s] is true, accurate and complete in all material respects.
- [The maximum liability of each individual warrantor will not exceed \$50,000].¹³
- Forced Liquidation Process/Redemption:** If the Company has not carried out either an IPO or trade sale within 5 years from the Settlement Date (or such longer period as the Investor[s] and the Company may agreed) the Investor[s] may require the Company to commence a liquidation process by way of public offering, trade sale or liquidation.
- [Other key terms:** *Insert other key terms as required e.g. will Investor[s] have rights relating to further capital raisings?*

¹² Consider carefully whether a knowledge qualifier is acceptable for all 3 warranties mentioned. Preference is to leave this out of term sheet and deal with the issue on a warranty by warranty basis in the Investment Agreement negotiation.

¹³ A dollar cap is usual if individuals are required to join in warranties.

PART B: LEGALLY BINDING TERMS

Exclusive Period: For a period of [90] days from the date of signing this Term Sheet, (**Exclusivity Period**) none of the Company, its shareholders, directors, officers, contractors or employees will conduct any discussions whatsoever with any third party regarding any investment in the Company, except as may be approved by the Investor[s] in their discretion.

[Broken Deal Fee: *If the Investment is offered within the Exclusivity Period pursuant to an Investment Agreement which contains the terms of this Term Sheet (and is otherwise in the Investor['s][s'] usual form) but is declined by the Company or if the Company breaches the preceding exclusivity requirement, the Company will pay [\$] to the Investor[s] as full compensation for all costs (including opportunity costs) incurred by the Investor[s]].*

Confidentiality: The contents of this Term Sheet, and the fact that one has been issued, may only be disclosed by the Company to its shareholders, directors and advisers or other person(s) approved by the Investor[s] (on a need to know basis).

[Guarantee: [] [and] *guarantee the Company's obligations in this Part B].*

[Investor['s][s] Representative[s]: [] [and] *represent(s) [he/she has] [they have] authority to bind [insert relevant Investor[s] they represent] in respect of all matters relating to the Investment]]¹⁴.*

To confirm your acceptance of this Term Sheet, please sign and date the duplicate of this Term Sheet and return it to me.

SIGNED on behalf of the Investor[s] [by the Investor['s][s] Representative[s]]:

Name: **Name:**

Date: **Date:**

Signature **Signature**

¹⁴ May be applicable for an investor syndicate.

APPENDIX 1
Capitalisation Table

Class of Security	Pre-money (Term Sheet signing)		Post-money at Target			
	Shares	%age	Cash-in	\$ per share	Share	%age
Shares						
Founders	[]	[]%	\$()	[]	[]	[]
Investor[s]			Up to \$()	[]	Up to []	[]
Options						
ESOP	[]	[]			[]	[]
Others?	[]	[]			[]	[]
Total fully-diluted		100%	[\$]			100%

APPENDIX 2
Committed Investor[s]

Investor	Amount

TERM SHEET

FOR ISSUE OF PREFERRED SHARES BY

[] LIMITED

(Company)

General notes: *This term sheet applies for an investment in preferred shares which confers preferential dividend rights and the right to return of capital in priority to the ordinary shares. Refer to alternative terms sheets if the investment is in ordinary shares or is structured as a loan convertible to equity. The more optional provisions appear in italics and instructions appear in bold italics. Refer to footnotes at the bottom of each page for comments on some of the optional provisions.*

This document (**Term Sheet**) summarises the principal terms of a proposed investment in the Company (**Investment**). This Term Sheet is not legally binding except for the terms stated in part B of this Term Sheet and there will be no obligation to issue or subscribe for shares in the Company until a binding investment agreement (**Investment Agreement**) is signed by the parties.

PART A: INVESTMENT TERMS (non-binding)

Business: The [proposed] business of the Company relating to [**describe business**] (**Business**).

Amount of investment: [Minimum Amount] \$ []
[Maximum Amount \$ []] (where the investment can proceed at any amount between the Minimum Amount and Maximum Amount specified by the Investors before the Settlement Date and the final investment amount can be increased by the Investors at any time within [period] from the Settlement Date to any amount not exceeding the Maximum Amount)¹
[such amount[s] being subject to achievement of milestones]²
(**Investment Amount**).

Investor[s]: [**Insert name(s) of investor[s]**] or [The persons identified in Appendix 2 [and other members of the [] investment syndicate who agree to participate in the Investment]³] (**Investor[s]**).

Key People: [**Insert names of founder(s)/key people**] (**Key People**)⁴.

Pre-money valuation: The investment is based on a pre-financing valuation of \$[].

Type of Shares: Preferred voting shares (**Shares**).

Issue Price: \$[] per Share.

Number of Shares: [Up to] [].

¹ Applicable if investment is by a syndicate and either, indicative commitments are yet to be received for the full Investment Amount, or, there is potential for some Investor[s] to withdraw while others proceed (e.g. if they are not happy with the outcome of due diligence etc). Allow investment to proceed at any amount more than the minimum and for Investors to increase the committed investment amount at any time prior to expiry of a specified period after settlement.

² Applicable if investment is tranching and milestones or conditions apply for subsequent payments.

³ Applicable for a syndicate investment where all of the participants are yet to be confirmed.

⁴ The term "Founders" is more common than "Key People", but latter term may be more accurate in indicating the people who are important and who may not be limited to the original founders of the Company (see later provisions relating to conditions precedent and restrictions on share transfers).

- Capital Structure:** The capitalisation of the Company immediately prior to investment and after investment of the Investment Amount will be as set out in the table in Appendix 1 (**Capitalisation Table**).
- Conditions Precedent:
(for Investor['s][s]
benefit):**
- Due diligence being completed to the satisfaction of the Investor[s].
 - Agreement to a business plan which comprises an agreed budget (**Agreed Business Plan**).
 - *[Agreement on milestones which must be achieved for disbursement of post Settlement Date tranches of the Investment Amount (**Milestones**)].*
 - Final approval of each Investor['s] [s] [board] or [Investment Committee] (as applicable).
 - Completion of the Investment Agreement and all existing holders of shares or options in the Company agreeing it supersedes any existing agreements between them.
 - Capitalisation of all outstanding loans [*other than the loan(s) of \$ from []*] and that capitalisation resulting in the pre-investment capitalisation shown in the Capitalisation Table.
 - Completion of employment or contractor agreements(s) with the [Key People] [] [] on terms acceptable to the Investor[s] (and which include suitable non compete covenants).
 - All relevant officers, consultants and contractors (including all Key People assigning (in a form acceptable to the Investor[s]) all intellectual property linked to the Business or proposed future business.
 - Agreement on the identity of [**insert number**] [an] [*independent director*][s] [and] [*a chairman*].
 - Agreement on the parameters of an employee share option plan for the key officers, employees and contractors of the Company (including the Key People) to purchase up to [%] of the Company's post money capital (**ESOP**).
 - Evidence that any third party consents or other authorisations required to complete the investment have been obtained.
 - [**Insert any other specific conditions precedent**⁵].

⁵ Consider other specific conditions precedent which should be specified (e.g. members of investment syndicate making commitments equivalent to at least the minimum required investment). However in this respect there is sufficient protection for Investor[s] in the general due diligence condition and the non-binding nature of Term Sheet.

Anticipated Settlement Date: [*Insert date*] or [5] business days after satisfaction of all conditions precedent in the Investment Agreement (actual settlement date being referred to as **Settlement Date**).

Disbursement of Investment Amount: The Investment Amount will be subscribed for Shares [*in one sum on the Settlement Date*] **or** [*in the instalments as specified in the Agreed Budget (and applied solely to expenditure as specified in the Agreed Budget or otherwise approved by the Investor[s])*] **or** [*as follows*]:

- [\$] on *Settlement Date*;
- [\$] when [*insert Milestone etc*]

[*provided each instalment will be at the Investor[s][s'] option if a Milestone due by the relevant date has not been achieved*]⁶.

Preferred Dividend: The Shares will have priority for an annual dividend equivalent to []% of the amount subscribed for the Shares (which will compound until paid) (**Preferred Dividend**) [*and will also participate pro-rata in any further dividend paid on the ordinary Shares*]⁷.

Liquidity Event Preference: If the Company is liquidated or a significant liquidity event occurs (including a merger or Share issue resulting in a change of control or a sale of a majority of the Company's assets) the Shares will receive (in preference to any distribution to the ordinary shareholders and in addition to payment of any outstanding Preferred Dividends) [*insert number if multiple preference applies times*] the total amount subscribed for the Shares (**Preference Amount**)⁸. [*The ordinary shareholders will then receive an amount equivalent to \$[] per Share*]⁹ [*and any balance available for distribution will be distributed pro-rata to [all shareholders including the Investor[s]] [the ordinary shareholders]*]¹⁰.

Conversion: The Shares may be converted on a 1 for 1 basis to ordinary Shares (subject to any anti-dilution adjustment as below) at any time at the option of the holder(s) and will automatically convert [*when the Preference Amount has been paid*] [*if the Investor[s] would receive more than the Preference Amount in a distribution if the Shares were ordinary shares*]¹¹.

Anti-dilution: The conversion price will be subject to a proportionate

⁶ Of the 3 variables, the latter 2 options which allow for tranching will usually be preferred with third option being most preferred from Investor[s][s'] perspective as payments are contingent on milestones.

⁷ A preferred dividend may apply in addition to, or in lieu of, the entitlement to participate in any ordinary dividends. However early stage companies will not usually pay dividends, this is largely academic and the accumulated preferred dividends will just be added to the liquidity event preference.

⁸ A one time preference is more usual. However up to 3 times is not uncommon, particularly if there is insufficient value in the existing business to justify the shareholding percentage being retained by the ordinary shareholders. Other relevant factors include the value add the Investor[s] will provide and the counter-balancing effect of the ESOP.

⁹ A catch-up for ordinary shareholders is usual if the preference Shares also participate in the residue (see comment in 10), particularly if a multiple preference applies.

¹⁰ The liquidity event preference will usually be structured so the preference Shares either get:
(a) the higher of the Preference Amount or the pro-rata distribution which would apply if all Shares are treated equally; or
(b) both (i.e. the Preference Amount and a pro-rata distribution of the residue).

¹¹ The first option applies if 10(a) applies while the second option applies for 10(b).

adjustment for any Share splits, Share dividends or similar capital adjustments and will be adjusted on a [full] [weighted average]¹² ratchet basis for any Share issue at an issue price less than the issue price for the Shares (other than pursuant to the approved ESOP [or a rights issue in which the Investor[s] participate pro-rata].

Board:

The Board will initially consist of:

Chairperson [(no casting vote)]: []

Investor['s][s'] representative(s): []

[Founders] [Other shareholders]: []
representative(s)

Independent director(s): []

The Board will meet [monthly]

[The Chairman will be paid \$[] per annum/meeting], [any independent directors will be paid \$[] per annum/meeting] and [the [Investor] [other] directors will be paid \$[] per annum/meeting]¹³ [but otherwise attendance at Board meetings will not be remunerated].

Protective Provisions:

Prior approval of the Investor director(s) is required for any of the following in relation to the Company:

- issues of equity, options or any instruments convertible to equity (other than issues already contemplated by the Investment Agreement);
- any [major] transaction or transaction involving the disposal of a material proportion of the Company's assets;
- any transaction or arrangement likely to have the effect of the Company acquiring rights or interests or incurring obligations or liabilities not specifically identified in the Agreed Business Plan, the value of which is greater than [\$10,000];
- any transactions with a related party of the Company or any shareholder or officer;
- any borrowings, guarantees, indemnities or other contingent commitments;
- appointment or removal of the CEO, CFO or any other Key Person [or any other employee];

¹² Full ratchet will effectively reprice the Investor[s] Shares on conversion at the lower issue price of the "down round" while a weighted average ratchet will reprice at the weighted average of each price (accordingly to respective amounts subscribed). Full ratchet is most favourable for the Investor[s]. Another issue is whether anti-dilution protection extends to a rights issue offered pro-rata to all shareholders if the Investor[s] do not take up their pro-rata Share.

¹³ Usually the only directors fees will be (at most) a modest meeting fee will be paid to the Investor directors only.

- approval of subsequent budgets and business plans or any material amendments to or departures from the Agreed Business Plan; or
- any change to accounting policies [*or the auditor*].

Financial Statements, Reporting:

Monthly cashflow statements, quarterly statements and [un]audited annual accounts, accompanied by reports covering all material aspects of the Company's progress [*in the case of the quarterly and annual statements*].

Pre-emptive rights and Drag and Tag along:

In addition to usual pre-emptive rights, drag and tag along rights will apply if any shareholder(s) wish to sell more than [50%] of the Company Shares [*including a majority of the Investor[s]'s Shares*]¹⁴ (in aggregate) to a third party [*or if the Investor[s] wish to sell all of their Shares,*]¹⁵ so:

- the selling shareholders may require the minority to sell all of their Shares on the same terms; or
- the other shareholders may require the selling shareholder(s) to obtain an equivalent offer from the purchaser to acquire the Shares of the other shareholders.

Tag along rights will apply as between the Investor[s] for any sale of Company's Shares by any one of them.

Key People Escrow:

Except with the consent of the Investor directors the Key People are not permitted to dispose of any Shares for a period of [3] years from Settlement Date, with the exception of:

- a sale in an IPO or other transaction approved by the Investor[s] where the Investor[s] have the opportunity to sell on identical terms; or
- a transfer to their respective wholly owned and controlled entities or to immediate family.

Key Man Insurance:

The Company will procure and maintain (for the Company's benefit) key man life insurance policies in the amount of [\$1,000,000] on the life of [*each of the Key People*].

Warranties:

Without limiting usual warranties for similar investments as will be contained in the Investment Agreement, the Company [*and Key People*] [**or name warrantors**] will warrant that (except as disclosed [*and to the best of their knowledge and belief*]¹⁶):

- all intellectual property and other rights necessary to pursue the Business are the full legal, beneficial and unencumbered property of the Company;

¹⁴ If Investor[s] held less than 50%, may require this protection against being "dragged" by other shareholders.

¹⁵ Consider if Investor[s] should have the right to "drag" other shareholders for desired exit, irrespective of whether they hold more than 50% of the Shares or whether they need sufficient support from ordinary shareholders to achieve a 50% threshold. Also consider whether 50% is the appropriate threshold or whether it should be higher.

¹⁶ Consider carefully whether a knowledge qualifier is acceptable for all 3 warranties mentioned. Preference is to leave this out of term sheet and deal with the issue on a warranty by warranty basis in the Investment Agreement negotiation.

- the Company has no actual or contingent liabilities not specified in the statement of financial position provided to the Investor[s] and such statement provides a true and fair view of the Company's position; and
- all other information provided to the Investor[s] is true, accurate and complete in all material respects.

[The maximum liability of each individual warrantor will not exceed [\$50,000]¹⁷.

**Forced Liquidation
Process/Redemption:**

If the Company has not carried out either an IPO or trade sale within 5 years from the Settlement Date (or such longer period as the Investor[s] and the Company may agree) the Investor[s] may require the Company to commence a liquidation process by way of public offering, trade sale or liquidation.

[Other Key Terms:

Insert other key terms as required e.g. will Investor[s] have rights relating to further capital raisings?

PART B: LEGALLY BINDING TERMS

Exclusive Period:

For a period of [90] days from the date of signing this Term Sheet, (**Exclusivity Period**) none of the Company, its shareholders, directors, officers, contractors or employees will conduct any discussions whatsoever with any third party regarding any investment in the Company, except as may be approved by the Investor[s] in their discretion.

[Broken Deal Fee:

If the Investment is offered within the Exclusivity Period pursuant to an Investment Agreement which contains the terms of this Term Sheet (and is otherwise in the Investor['s][s'] usual form) but is declined by the Company or if the Company breaches the preceding exclusivity requirement, the Company will pay [\$] to the Investor[s] as [full] compensation for all costs (including opportunity costs) incurred by the Investor[s].]

Confidentiality:

The contents of this Term Sheet, and the fact that one has been issued, may only be disclosed by the Company to its shareholders, directors and advisers or other person(s) approved by the Investor[s] (on a need to know basis).

[Guarantee

[] [and] guarantee the Company's obligations in this Part B].

**[Investor['s][s']
Representative**

[] [and] represent(s) [he/she has] [they have] authority to bind [insert relevant Investor[s] they represent] in respect of all matters relating to the Investment]]¹⁸.

The parties respectively acknowledge the intended investment terms described in Part A and agree to be bound by the terms in Part B.

SIGNED on behalf of the Investor[s] [by the Investor['s] [s'] Representative]:

¹⁷ A dollar cap is usual if individuals are required to join in warranties.

¹⁸ May be applicable for an investor syndicate.

Name:

Name:

Date:

Date:

Signature

Signature

Signed on behalf of [] Limited by:

Director

Director:

Date:

Date:

Signature

Signature

[Signed on behalf of *[insert Guarantors]*

Name:

Name:

Date:

Date:

Signature

Signature]

APPENDIX 1
Capitalisation Table

Class of Security	Pre-money (Term Sheet signing)		Post-money at Target			
	Shares	%age	Cash-in	\$ per share	Share	%age
Shares						
Existing Shareholders (ordinary)						
<i>List</i>	[]	[]%	Up to \$[]	[]	Up to []	[]
	[]	[]%	Up to \$[]	[]	Up to []	[]
	[]	[]%	Up to \$[]	[]	Up to []	[]
Investor[s] (preferred)						
<i>List</i>	[]	[]%	Up to \$[]	[]	Up to []	[]
	[]	[]%	Up to \$[]	[]	Up to []	[]
	[]	[]%	Up to \$[]	[]	Up to []	[]
Options						
ESOP	[]	[]			[]	[]
Others?	[]	[]			[]	[]
Total fully-diluted		100%	[\$]			100%

APPENDIX 2
Committed Investor[s]

Investor	Amount

TERM SHEET

FOR ISSUE OF CONVERTIBLE LOAN BY

[] LIMITED

(Company)

General notes: *This term sheet applies if an investment is initially structured as a loan convertible to equity. Refer to alternative term sheets for ordinary or preference shares (one of which will usually be attached to describe equity terms which will take effect on conversion). The more optional provisions appear in italics and instructions appear in bold italics. Refer to footnotes at the bottom of each page for comments on some of the optional provisions.*

This document (**Term Sheet**) summarises the principal terms of a proposed loan to the Company (**Loan**). This Term Sheet is not legally binding except for the terms stated in part B of this Term Sheet and there will be no obligation to proceed with the loan until a binding agreement (**Loan Agreement**) is signed by the parties.

PART A: LOAN TERMS (non-binding)

Business: The *[proposed]* business of the Company relating to [**describe business**] (**Business**).

Amount of Loan: *[Up to¹]* \$ []
[(subject to achievement of milestones)] (**Loan**).

Lender[s]: [**Insert name(s) of investor[s] or [The persons identified in Appendix 1 [and other members of the [] investment syndicate who agree to participate in the Loan]²**] (**Lender[s]**).

Key People: [**Insert names of founder(s)/key people**] (**Key People**³).

Purpose of Loan: The purpose of the Loan is to [**describe purpose of Loan**]. The Company may only use the Loan for this purpose.

Term: The Loan (if not converted) is repayable on demand after [] months from the Settlement Date.

Interest: Interest will only be payable if the Loan is not converted and if demanded by the Lender at the rate of []%⁴.

Conversion: The Loan may be converted [*in whole*] [*in part*] at the Lender[s][s] option at any time into [*preferred*] [*ordinary*] shares at the conversion rate (**Conversion Rate**) as set out below:

$$X = (1 + [\textit{Insert fraction}]^5 / 12)^n \times y$$

1 Words "up to" generally apply if loan is tranching and milestones or conditions apply for subsequent payments.

2 Applicable for a syndicate investment where all of the participants are yet to be confirmed.

3 The term "Founders" is more common than "Key People", but latter term may be more accurate in indicating the people and who are important who may not be limited to the original founders of the Company (see later provisions relating to conditions precedent and restrictions on share transfers).

4 The conversion formula compensates the Lender[s] for the time value of money if the Loan is converted. The Lender[s] will prefer not to be treated as having derived interest income if conversion occurs, however tax advice should be sought whether this conversion treatment excludes this.

Where:

x is the number of shares to be issued

n is the number of months (rounded up to the nearest month)
that the amount of principal of the Loan being converted has
been outstanding

y is the amount of Loan principal being converted.

[The Conversion Rate is subject to adjustment as set out in the
anti dilution paragraph below.]

The [**preferred**] [**ordinary**] shares will be issued on the terms
set out in **Appendix 1**⁶.

First ranking general security agreement over the Company in
the Lender['s][s] usual form (**Security**).

Security:

**Conditions Precedent:
(for Lender['s][s] benefit)**

- Execution of a term sheet for [**preferred**] [**ordinary**] shares substantially in the form attached as Annexure A.
- Approval of an agreed budget for application of the Loan (**Agreed Budget**).
- [*Agreement on milestones which must be achieved for disbursement of post Settlement Date tranches of the Loan (Milestones)*].
- Final approval of each Lender['s][s] [*board*] **or** [*Investment Committee*] (as applicable).
- Completion of the Loan Agreement and Security and all documents required to give full effect to these documents.
- Completion of employment or contractor agreements(s) with the [*Key People*] [[] and []] on terms acceptable to the Lender[s] (and which include suitable non compete covenants).
- All relevant officers, consultants and contractors (including all Key People assigning (in a form acceptable to the Lender[s]) all intellectual property linked to the Business or proposed future business.
- Agreement on the identity of [**insert number**] [*an*] [*independent director[s]*] [*and*] [*a chairman*] for the company.
- Evidence that any third party consents or other authorisations required to complete the Loan have been obtained.
- [**Insert any other specific conditions**

⁵ The fraction inserted will be equivalent to the interest rate percentage which applies if the Loan is repaid - e.g. if the interest rate is 15%, it will be 0.15.

⁶ Usually these terms will be set out in a term sheet for the relevant type of shares.

*precedents*⁷].

Anticipated Settlement Date: [*Insert date*] or [5] business days after satisfaction of all conditions precedent in the Loan Agreement (actual settlement date being referred to as **Settlement Date**).

Drawdown of Loan Amount: The Loan Amount will be drawn down [*in one sum on the Settlement Date*] **or** [*in the instalments as specified in the Agreed Budget (and applied solely to expenditure as specified in the Agreed Budget or otherwise approved by the Lender[s])*] **or** [*as follows*]:

- [\$] on *Settlement Date*;
- [\$] when [*insert Milestone etc*]

[*provided each instalment will be at the Lender['s][s'] option if a Milestone due by the relevant date has not been achieved*]⁸.

[Anti-dilution: *The conversion price of the Loan will be subject to adjustment on a [full] [weighted average] ratchet basis for issues of new equity in the Company at an issue price less than \$[] per share (other than pursuant to an approved ESOP)*⁹.]

Observation Rights: The Lender[s] shall be entitled to send observer(s) to attend meetings of the Company's board (**Board**) (and to receive all information provided for or at such meeting), the Board on any such occasion to request a closed session in the event of a conflict of interest. If required by the Board, any observer must enter into a confidentiality agreement acceptable to the Company.

Protective Provisions: Prior approval of the Lender['s][s] director(s) is required for any of the following in relation to the Company:

- issues of equity, options or any instruments convertible to equity (other than issues already contemplated by the Loan Agreement);
- any [*major*] transaction or transaction involving the disposal of a material proportion of the Company's assets;
- any transaction or arrangement likely to have the effect of the Company acquiring rights or interests or incurring obligations or liabilities not specifically identified in the Agreed Budget, the value of which is greater than [\$10,000];

⁷ Consider other specific conditions precedent which should be specified (e.g. members of investment syndicate making commitments equivalent to at least the minimum required Loan). However there is sufficient protection for lender[s] in the general due diligence condition and the non-binding nature of Term Sheet.

⁸ Of the 3 variables, the latter 2 options which allow for tranching will usually be preferred with third option being most preferred from Lender['s][s] perspective as payments are contingent on milestones.

⁹ Anti-dilution protection is standard for preference shares but should also be considered for ordinary shares. Full ratchet will effectively reprice the Lender['s][s] shares (by issuing additional shares to the Lender[s] if they convert) at the lower issue price of the "down round", while a weighted average ratchet will reprice at the weighted average of each price (accordingly to respective amounts subscribed). Full ratchet is most favourable for the Lender[s].

- any material change in the Company's share ownership or control;
- any material transaction with a related party of the Company or any shareholder or officer;
- any borrowings, guarantees, indemnities or other contingent commitments or the granting of any security over the Company's assets;
- appointment of removal of the CEO, CFO or any other Key Person [*or any other employee*];
- approval of or any material amendments to or departures from the Agreed Budget, subsequent budgets and business plans; or
- any change to the Company's constitution.

Financial Statements, Reporting:

Monthly cashflow statements, quarterly statements and [*un*]audited annual accounts, accompanied by reports covering all material aspects of the Company's progress [*in the case of the quarterly and annual statements*].

Warranties:

Without limiting usual warranties for similar loans as will be contained in the Loan Agreement, the Company [*and [Key People] [or name warrantors]*] will warrant that (except as disclosed [*and to the best of their knowledge and belief*]¹⁰):

- all intellectual property and other rights necessary to pursue the Business are the full legal, beneficial and unencumbered property of the Company;
- the Company has no actual or contingent liabilities not specified in the statement of financial position provided to the Lender[s] and such statement provides a true and fair view of the Company's position; and
- all other information provided to the Lender[s] is true, accurate and complete in all material respects.

[*The maximum liability of each individual warrantor will not exceed \$50,000*].¹¹

[Other Key Terms:

Insert other key terms as required e.g. will Lender[s] have rights relating to subsequent capital raisings?

¹⁰ Consider carefully whether a knowledge qualifier is acceptable for all 3 warranties mentioned. Preference is to leave this out of term sheet and deal with the issue on a warranty by warranty basis in the Investment Agreement negotiation.

¹¹ A dollar cap is usual if individuals are required to join in warranties.

PART B: LEGALLY BINDING TERMS

Exclusive Period: For a period of [30] days from the date of signing this Term Sheet (**Exclusivity Period**), none of the Company, its shareholders, directors, officers, contractors or employees will conduct any discussions whatsoever with any third party regarding any investment in the Company, except as may be approved by the Lender[s] in their discretion.

[Broken Deal Fee: *If the Loan is offered within the Exclusivity Period pursuant to a Loan Agreement which contains the terms of this Term Sheet and is otherwise in the Lender[s][s'] usual form but is declined by the Company or if the Company breaches the preceding exclusivity requirement, the Company will pay [\$] to the Lender[s] as full compensation for all costs (including opportunity costs) incurred by the Lender[s].*

Confidentiality: The contents of this Term Sheet, and the fact that one has been issued, may only be disclosed by the Company to its shareholders, directors and advisers or other person(s) approved by the Lender[s] (on a need to know basis).

[Guarantee: [] [and] *guarantee the Company's obligations in this Part B.*

[Lender[s][s'] Representative: [] [and] *represent(s) [he/she has] [they have] authority to bind [insert relevant Lender[s] they represent] in respect of all matters relating to the Loan*¹².

To confirm your acceptance of this Term Sheet, please sign and date the duplicate of this Term Sheet and return it to me.

SIGNED on behalf of the Lender[s] [by the Lender[s][s'] Representative[s]:

Name: **Name:**

Date: **Date:**

Signature **Signature**

Signed on behalf of [] Limited by:

Director **Director:**

Date: **Date:**

Signature **Signature**

¹² May be applicable for an investor syndicate.

[Signed on behalf of *[insert Guarantors]*]

Name:

Name:

Date:

Date:

Signature

Signature

APPENDIX 1
Committed Lender[s]

Lender	Amount

APPENDIX 2
[Preferred] [Ordinary] Share Terms

(See attached Term Sheet)



**Simpson
Grierson**

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