Guide to Venture Capital and Private Equity Term Sheets

BRAZIL
LAVCA Model Documents and Industry Guides

The Latin American Venture Capital Association produces localized Latin American versions of model legal documents on the basis of those drafted by the National Venture Capital Association and the British Venture Capital Association. These standardized documents aim to reflect best practices and educating industry newcomers on how investments can be structured, terms and terminology, and the broader investment process. Documents are intended to serve as a starting point only, should be tailored to meet specific requirements, and should not be construed as legal advice for any particular facts or circumstances. We strongly recommend that each reader seek independent advice from local counsel on the appropriate legal and tax structure of each specific investment.

These documents are produced by members of the LAVCA Legal Committee, with peer review and contributions from local partner organizations, and drafted in Spanish or Portuguese and English. Please consult www.lavca.org for a full list of available documents and an update on new works in production.

Guide to Venture Capital and Private Equity
Term Sheets  BRAZIL

Based on “A Guide to Venture Capital Term Sheets” by the British Venture Capital Association
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I Introduction

Brazil is one of world’s leading emerging economies, and has recently received the investment grade status (Standard & Poor’s - April, 2008)\(^1\). In that scenario, venture capital (VC) and private equity (PE) are investment vehicles with an especially appealing risk/return profile and potential for substantial positive impact on the Brazilian economy – in funding for company growth, increase in tax revenues, and job creation. VC and PE are engines able to transform intellectual property and entrepreneurial drive into economic wealth.

VC/PE are well-established avenues of financing for companies, primarily in the earlier stages of their lives. No two transactions will have the same commercial terms throughout, but the ‘structure’ of different terms will often be very similar.

The aim of this Guide is to:

1. present an outline of how deals are structured;
2. illustrate terms and conditions typically used in a term sheet;
3. analyze the investment process in general; and
4. provide basic knowledge, before searching for investors, for those who are not totally familiar with the VC/PE investment process.

We hope that the overall framework here presented will assist those who are trying to raise capital as well as contribute to understanding of the commercial implications of offered terms. This in turn should expedite the negotiation of term sheets and completion of the investment process.

\(^1\) “Investment grade” is a grade given by rating agencies that indicates the capacity of a country to pay off its internal and external debts.
The selection of terms addressed by this Guide may not be appropriate for every investment, but should cover most of the terms typically used in Brazil. Information provided by this Guide does not constitute legal advice and is not intended to do so. Persons in need of legal advice related to a subject discussed in this guide should contact a lawyer who is qualified to practice in that area of law. In seeking legal advice in any of the areas addressed by this Guide, companies and entrepreneurs should carefully select the professionals they choose to represent them in such legal matters and are solely responsible for this decision.

II 12 STEPS BEFORE TALKING TO INVESTORS

1) Raising capital with VC and PE is about growing a business

VC and PE are only some of the many tools available to raise capital for new projects. They are paid to run calculated risk with third party’s money in growth opportunities, companies that have a chance to multiply their sizes as they succeed in the marketplace – and lead to attractive returns on the initial investment when an exit occurs. Be aware that you will have to share with them the guidance of the business. Do not expect free money, it certainly comes with strings attached.

2) Put yourself in the investor’s shoes and criticize your own proposals

Investors have at least three key vectors in mind when selecting a company’s proposal: a strong management team, a rapidly growing market segment, and clear vision of the company’s future. Make sure you can address these three elements before knocking on third parties’ doors.

3) Know your audience

Even in Brazil, there is an active and diversified private capital market. There are plenty of funds and individuals willing to invest in good financial opportunities. However, not all investors are alike – for example, they can differ on certain deal characteristics (e.g. size of the round, opportunity to assume control or an executive position, etc) and risk aversion (e.g. maturity of the company, market segment).

It is extremely important to know who are the investors and what is their investment profile. This is key to help you find the right type of investor for each growth phase of your business.

4) Prepare a business plan and an executive summary

The very first step in asking for capital is to establish a connection with a potential investor. Once you have mapped the industry and know which investors might be interested in your proposal, contact them. For this initial contact, you will need to prepare an “executive summary” or a “teaser” on your company. Focus your summary on highlighting your business, the market segment opportunity you have identified, and why you will succeed. Your summary should be a four-page-document (or less) that can be sent by e-mail and does not cover any confidential information.

The “executive summary” should be the first few pages of your Business Plan (BP). A BP is a vehicle for stating a company’s growth strategies (i.e., describes the
management team, marketing strategies, product definitions, competition environment, investments going forward, cash requirements, etc). A BP doesn’t need to be 100 pages long, but has to be meaningful and present your unique niche.

One of the most important pieces of your BP is the financial projections. While VC/PE investors are certainly looking for growth opportunities, do NOT try to simply inflate growth expectations – it can backfire on you. Business Plan projections often become the established budget after the investment, and the entrepreneur – as management, -- will be evaluated based on his/her performance against this budget. Additionally, projecting exponential sales growth without a grounding in true logic will not increase the company’s valuation. Investors commonly make their own projections, so present projections you are ready to bet on and be prepared to defend them with facts. A good way of assuring robustness in your plan is to build it from the bottom up (from your resources to the revenues) and challenging your results tops down (from the total addressable market segment to your segment share of it).

5) Value your business and set your negotiating boundaries

Techniques used by investors to value potential deals do not vary much. Naturally each investor will have its own risk factor to use as a discount – try to take that into consideration. Define what range of valuations will be your comfort zone. Set a price you believe in. Commonly, your valuation is already above the investor’s, so be ready for negotiation. Also bear in mind that entrepreneurs and investors generally have very different perceptions of risk.

6) Beware: it costs time and real money to raise capital

Internet go-go years are long gone and investors tend to spend much more time in the investigation process (talking to clients, doing background checks, visiting the target company, seeking external references, etc). A regular round tends to last 4 months in the best case scenario, and can take as long as 1 year.

In general, expenses companies incur in order to promote a round, such as legal, accounting, audit, etc., are not refunded by the investors. Also, it is common for transaction fees to also be charged to company (e.g. investor’s legal expenses, antitrust filings, public registration of guarantees, etc). Keep this is mind and work on clarifying the limits of such expenses with investors.

7) You will need experienced legal advice

Lawyers will assist the entrepreneur by interacting with the legal representative of potential investors. Your interaction with lawyers will increase exponentially as you evolve in the process of raising money, so commit to getting it right. First and foremost, when hiring your own lawyer you should seek counsel with strong expertise in Corporate Law, preferably with previous experience in VC/PE transactions. In Brazil, not many law firms currently have a strong practice in this field, and the ones that do are often significantly expensive. Research well; negotiate a cap (limit) on the total hours a law firm should work on the project and try to get a good deal upfront, limiting your risk. Other professionals involved in VC/PE transactions in Brazil may provide referrals to suitable law firms and discuss their experience with them.
8) Get ready for a road show

Now that raising capital is for real, get ready to hit the road. You will have to make presentations of your business plan, participate in meetings, and present the team that will execute the project with you. Remember, it is crucial that someone from the company take the lead for the fund-raising process. Normally, one of the founders – acting as CEO or a CFO – must dedicate significant time to the process (in most cases, 100% of their available time is required).

9) Be prepared to start negotiations and open your company for external scrutiny

Formal negotiation process generally starts with a document called a “term sheet,” which states the terms and conditions investors would require in order for continuing the process. Normally there is a time window within the term sheet for both sides to reach an agreement on its final version – after that it can be renewed or negotiation ends. Term sheets can sometimes require exclusivity from your side. A VC/PE investment round is usually led by one investor, who would put together and coordinate a syndicate of investors either before or after the term sheet is agreed upon.

Once everyone agrees on basic terms and conditions, the due diligence process begins. You can optimize this process by having main contracts already organized and all legal and tax documentation updated. Many companies create a due diligence book, containing copies of the generally required documentation ready to be presented to investors upon request. Sometimes an independent auditor and a lawyer are hired – at company’s expense – to evaluate all the company’s potential liabilities (regarding labor, taxes, etc). The outcome of such analysis is then incorporated into the negotiations.

10) Be prepared for changes in governance

If this is your first move towards sharing ownership of your company, realize investors will require significant changes in governance and transparency – even if you maintain the majority of voting power.

Investors look for a balanced Board of Directors where their opinions can be voiced and heard. They will ask for board seats and require veto rights over some matters and/or establish some kind of supermajority – qualified quorum – for approving critical decisions. The rationale behind these requirements is to preserve the investment from changes into company’s strategies that have no consensus at Board level.

11) Understand the different roles of the entrepreneur, the CEO and the shareholder

There are characteristic differences between business run by an entrepreneur/founder and those run by a CEO. It might be hard to detect immediate change, but as time goes
by, you may feel that decisions cease being “impulsive” and become more structured, and perhaps demand commitment from different stakeholders.

Traditionally, successful entrepreneurs are swift to make decisions and often centralize command in their own hands. While crucial in the very early stages of a business, as company matures, this monolithic command structure might jeopardize a company’s growth. A time will come when a CEO is required to run the business in coordination with directors and accountable to a board. It is customary that at a point during the life of a company, the founder(s) will step down from managerial position. Founders often remain involved in strategic decisions through the board of directors and delegate the day-to-day business to a professional management team.

Shareholders have obvious interests in growing value, but they are (and should be) generally less engaged with day-to-day company operations. Shareholders give executive management the freedom and authority necessary to execute the business plan. What role do you want to play?

12) Take a long vacation with your family prior to doing the first step (this might be your last one for a while!)
III The Investment Process

A Basic Corporate Structure

In order to explain some of the concepts contained in this Guide, this next section follows a company through several stages of its life cycle from establishment to its Series A funding round. This example should not be taken as representing a standard process or typical valuations and ownership percentages. The scenario will be different at every stage of each investment situation and will need to be handled on an individual basis.

1. STEP ONE:

‘NewCo Ltda.’ is a company whose main business is based on the exploitation of intellectual property developed by a scientist (“Founder”). Founder’s best friend (“Angel”) agreed to invest a certain amount of cash in NewCo Ltda. in return for a 50% quota holding in the business. The capital structure of NewCo Ltda. is as set out in Box 1.

Box 1. Capital structure for NewCo Ltda. following establishment of the company and assignment of intellectual property.

<table>
<thead>
<tr>
<th>Start-Up–NewCo Ltda.</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of Quotas</strong></td>
<td><strong>Cash or cash equivalent invested at R$1 per quota</strong></td>
</tr>
<tr>
<td>Founder 50</td>
<td>R$50</td>
</tr>
<tr>
<td>Angel 50</td>
<td>R$50</td>
</tr>
<tr>
<td>Undiluted Share Capital 100</td>
<td>R$100</td>
</tr>
</tbody>
</table>

With the help of Angel and Founder's network of contacts, NewCo Ltda. then successfully attracted the investment of a VC/PE company or fund (Seed Investor) specialized in investing at very early stage companies.

2. STEP TWO:

Based upon the world class reputation of the Founder, the strength of the intellectual property and the potential market segment for the products arising from the technology, Seed Investor and the NewCo Ltda. agree that the pre-money valuation (see paragraph 2 in Section IV) for its business is R$200,000. From discussions between the Seed Investor and NewCo Ltda., it is also agreed that the company needs to raise R$200,000...
to enable it to carry out some key experiments to establish the proof of principle for the technology and therefore enable it to raise its next funding round. The Seed Investor also requires that NewCo Ltda. be transformed into a NewCo S.A. This new corporate structure provides more transparency for shareholders and promotes better corporate governance practices, while avoiding further complex corporate changes before a public offering and allowing increased flexibility in the capital structure. Investor also requires the establishment of a stock option plan (see paragraph 21 in Section IV) in order to help attract new staff to join NewCo S.A. With these parameters agreed to, the capital structure of NewCo S.A. following investment by the Seed Investor is as set out in Box 2.

**Box 2**: Capital structure following seed round.

<table>
<thead>
<tr>
<th>Seed Round</th>
<th>NewCo S.A.</th>
<th>Cash or cash equivalent invested</th>
<th>Number of 'A' Shares issued at this round</th>
<th>Undiluted Total Voting Ordinary Shares and 'A' Shares Options</th>
<th>Fully Diluted Equity</th>
<th>Value of Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Founder(s)</td>
<td>R$50</td>
<td>0</td>
<td>50</td>
<td>0</td>
<td>50</td>
<td>R$100,000</td>
</tr>
<tr>
<td>Angel</td>
<td>R$50</td>
<td>0</td>
<td>50</td>
<td>0</td>
<td>50</td>
<td>R$100,000</td>
</tr>
<tr>
<td>Seed VC</td>
<td>R$200,000</td>
<td>100</td>
<td>100</td>
<td>0</td>
<td>100</td>
<td>R$200,000</td>
</tr>
<tr>
<td>Option Pool</td>
<td></td>
<td></td>
<td></td>
<td>20</td>
<td></td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>R$200,100</td>
<td>100</td>
<td>200</td>
<td>20</td>
<td>220</td>
<td>R$400,000</td>
</tr>
</tbody>
</table>
B  Basic Legal Structure

1.  Company’s Location

Several items should be taken into consideration when deciding where to set up a business: local expertise, support network, clients, cost, market segment needs and size, tax benefits, enforceability of law, and many others. When investors analyze your business they will also make suggestions according to their needs and previous experience. In some cases, investors may require you to change your corporate structure and even create a holding company and subsidiaries elsewhere.

Brazilian regulation is very flexible and allows the implementation of several different corporate structures, even abroad. Companies are usually established in Brazil, but in some cases investors and entrepreneurs agree it would be financially preferable to transfer or establish the business in a tax haven country.

It is important to note that complex corporate structures require sophisticated support and expenses can increase exponentially when establishing them. A thorough analysis of the company’s market, growth opportunities and estimated transaction and maintenance costs should be well addressed before a decision is made to establish a new corporate structure.
2. Applicable Law

Although a company may be established in a certain country, the involved parties always have the opportunity to decide that a different law shall govern certain contractual aspects of a transaction.

It is quite common that, depending on the operation, international transactions include documents which bear diverse governing law provisions, (i.e., Brazilian law for general corporate documents and Delaware law for specific confidentiality agreements). They are generally chosen according to the degree of confidence and flexibility of the legislation, as well as enforceability and reliability of the legal system. It is important to mention, however, that terms, conditions and structures of VC/PE deals usually found in jurisdictions outside Brazil can be accommodated with relative ease to Brazilian corporate legislation. Brazil also scores high in comparison to other countries ranked in LAVCA’s 2007 Scorecard on the Private Equity and Venture Capital Investing Environment for Latin America and the Caribbean.

IV Investment Documentation

1. Term Sheet

Generally, during an investment process the first document to be elaborated is a term sheet. A term sheet is a relatively short document (e.g. 3-10 pages) that outlines the key terms and conditions of a proposed investment. Though the transaction’s legal structure should be reviewed by a lawyer, business issues need to be negotiated by the entrepreneur himself. The document that outlines the results of such negotiation is the “term sheet”. The concept of a term sheet is to put in laymen’s terms the rights and obligations of each party involved in the transaction and create a framework to aid in drafting the definitive investment documents. With the exception of certain clauses -- commonly those related to confidentiality, exclusivity, counsel and expenses -- provisions of a term sheet are not usually intended to be legally binding, especially keeping in mind that slight changes to the text will be implemented throughout the investment process. In addition to being subject to negotiation, a term sheet will usually contain certain conditions that will need to be met before the investment is
completed. These are known as “conditions precedent” (see paragraph 26 in Section IV).

Once agreed to by both parties, the term sheet is used by lawyers as a basis for drafting the investment documents. Ideally, the more detailed the term sheet, the fewer the issues that will need to be agreed to during the drafting process. This process can be complex and working with lawyers familiar with VC/PE transactions is recommended in order to minimize timeframe and costs.

2. Other Documents

Following on an agreed term sheet, main documents needed for an investment round in most of Latin America, as well as Brazil, generally include a Subscription Agreement, a Shareholders' or Investors' Rights Agreement and Bylaws.

a) Subscription Agreement:

The subscription agreement will usually contain details of the investment round, including numbers and classes of subscribed shares subscribed, payment terms as well as representations and warranties on the condition of the company. These representations and warranties, which consist of legal statements about the current company’s status (see paragraph 13 in Section IV), will be qualified by a schedule of exceptions, or a disclosure schedule, as well as supporting documents that specifically set out any issues founders believe investors should know prior to the completion of the investment.

b) Shareholders’ Agreement:

A shareholders' or investors' rights agreement will usually contain investor protections, including consent rights (see paragraph 15 in Section IV), rights to board representation, restrictions on transfer of shares and non-compete restrictions. The provisions of this agreement will hopefully be used as the basis for corresponding provisions for subsequent funding rounds. The By-laws will include the rights attached to the various share classes, procedures for the issuance and transfer of shares and the holding of shareholders and board meetings.

c) Corporate By-Laws:

By-laws set forth the various share classes and the rights attached to them, corporate governance structures, rights and obligations of officers, persons or groups within the corporate structure as well as provide rules for routine matters. Some of the protective provisions in the shareholders' agreement may instead be contained or even repeated in the By-laws. The decision to include terms in one or both of these documents may be jurisdiction specific, based primarily on corporate law restrictions (e.g. some jurisdictions limit the rights that can be attached to clauses in the By-laws), enforceability concerns (in the event that such enforceability depends on third party knowledge of existing rights) and confidentiality concerns (By-laws typically must be filed as a public document with a relevant company registry while the other investment documents are often kept confidential).
V Term Sheet – Terms and Conditions

1. Type of share

A VC/PE investor will normally subscribe for a class of shares to which may be attached certain rights not shared by the founders or angels. VC/PE investors require these additional rights because in most cases they are investing much larger sums than the founders (whose investment usually takes the form of good ideas, time and a small amount of “seed money”) and at a much higher valuation. VC/PE investors will also, in general, have less control over the company’s day-to-day operations than the founders, who typically remain closely involved in management.

If a share class with special rights attached to it already exists at the time of an investment round, the new round of investors will typically create a new series of shares to distinguish the rights (voting, financial, etc.) that attach to their series from those that attach to all prior series of shares. Distinguishing the rights enjoyed by different series is common practice because the investments made at the time of each series’ creation are usually based on different company valuations and circumstances and, consequently, have different risk profiles.

As per current Brazilian legislation\(^2\), preferred shares generally do not have voting rights attached, though they bear, by law, preferred dividends and/or reimbursement of capital (with or without a premium). However, under Brazilian law a voting agreement is a document that may provide additional benefits to preferred shareholders with restricted voting rights.

A voting agreement will usually contain investor protection provisions (see paragraph 14, Section IV), rights to board representation and even non-compete restrictions. It is common that such provisions are used as benchmarks for corresponding provisions in other transaction agreements (i.e. in the Bylaws) and/or on subsequent funding rounds.

2. Valuation and milestones

VC/PE investors will agree with the founders on a valuation for the company prior to the new investment round (the Pre-money Valuation). The Pre-money Valuation is used to determine the price per share to be paid by investors on the completion of the new investment round (the Purchase Price). The Purchase Price is calculated by dividing the Pre-money Valuation by the fully diluted number of shares of the company immediately prior to the time of completion.

In the example in Section III, the pre-money valuation agreed to is R$200,000 and immediately prior to completion there are 100 shares. The value of those shares, and therefore the Purchase Price of the incoming investor, is R$200,000/100, which equals R$2,000 per share.

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\(^2\)Brazilian corporate laws (Law No. 6404 of 15 December 1976, as amended).
Fully-diluted usually includes shares that have been issued by the company, shares allocated to the employee option pool (see paragraph 21 below) and any other shares which the company could be required to issue through options, warrants, tax and labor liabilities, convertible debt or other commitments. The Pre-Money Valuation should be distinguished from the Post-Money Valuation, which refers to the valuation of the company immediately following (and which includes the investment proceeds from) the new round. Therefore, following completion of the example in Section III, NewCo S.A. has an Undiluted Post-Money Valuation of R$400,000 represented by R$200,000 pre-money valuation and R$200,000 of investment. A Fully Diluted Post-Money Valuation is R$440,000 i.e. R$2000 x (200 shares + 20 Options).

Quite often, VC/PE investors will not wish to make all of their investment on completion. Instead they will invest in tranches, subject to various technical and/or commercial targets (Milestones) being met. These Milestones will be set out in the Subscription Agreement. Failure to meet a Milestone does not automatically mean that the investors will not provide the additional money, but it may mean that they will seek to negotiate different terms for these amounts.

Sometimes a mechanism, termed a Ratchet, is used to adjust the respective shareholdings of the investors and the founders depending on either the company's performance or the level of returns on an exit (Exit Ratchet). This technique is principally used to find a bridge between widely differing views of a company's value, or to provide additional incentives/rewards to the founders for delivering excellent returns to the investors. Ratchets can be complicated in operation and, due to tax issues and potential conflicts of interest between founders, the company and other shareholders down the road, must be very carefully thought through.

### 3. Dividend rights

VC/PE investors often invest in early stage companies that are experiencing an intense growth phase. The objective is to grow the business and its value in order to realize a return on invested capital (ROIC) – typically targeting a multiple of the amounts invested - upon exit. In most cases such companies should be reinvesting all profits (without which a dividend cannot be paid) to continue growing the company, rather than paying dividends to shareholders. In Brazil, as long as the company is profitable, shareholders have the right to receive annual dividends. Nevertheless, investors sometimes require a reduction on the amount of dividends distributed, which may be limited or even suspended for a period of time.

There are a number of ways to reduce or restrict the amount of dividends to be distributed: the most usual is by establishing a small percentage of dividends within the company’s By-laws.\(^3\)

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\(^3\)In Brazil, according to Law 10.303/01, as amended, if dividends are not provided at the company’s By-laws and the Board decides to include a provision on the subject matter, a minimum dividend of 25% of the company’s net profit applies.
In addition to a preferred dividend, VC/PE investors typically require that non-voting preferred shares be entitled to enjoy a pro rata share of any dividends paid to the voting ordinary shares on top of any dividend preference paid only to the non-voting preferred shares.

In some cases, **escalating dividend provisions** can be used to encourage the company to work towards an exit and to help its investors recover some of their investment if the company fails. These provisions require the company, if it has not achieved a successful exit (see paragraph 18 below) within a certain period of time, to declare and pay cumulative dividends to non-voting preferred shareholders at rates that increase each year.

4. **Liquidation preference and “deemed liquidation”**

The liquidation preference is a right that is generally required by VC/PE investors in recognition of the risk they bear on their capital contribution. While there are many variations, the liquidation preference typically provides that, in the event that the company is liquidated or subject to a deemed liquidation (see below), the investors will receive a certain amount of the proceeds before any other shareholders. This preference amount may be equal to the amount of the investment made, or a multiple thereof and it is subject to legal requirements similar to those of a redemption (see item 5 below).

The remaining proceeds are often then shared among the other shareholders. There are numerous ways in which this may be affected, but the most common are:

- the remaining proceeds are shared pro rata, according to shareholding percentage, among all the shareholders (in which case the investors are considered fully participating—i.e. after receiving their liquidation amount, investors also participate fully with the other shareholders in sharing the remaining proceeds);

- after payment of the liquidation preference amount, the other shareholders may 'catch up' by receiving an amount equal to the amount paid by them or credited as paid by them for their shares, thereafter the proceeds being shared out on a pro rata basis between all shareholders (in which case the non-voting preferred shares are considered "simple participating").

The size and structure of the liquidation preference will be negotiated to reflect the risk inherent in each investment round: the higher the risk, the higher the required return. Many factors (including the valuation of the company) will be considered in this calculation.

VC/PE investors usually require that the liquidation preference applies not only in connection with a liquidation or winding-up of the company, but also in the case of a **deemed liquidation**, a term usually defined to include a merger, acquisition, change of control or consolidation of the company, or a sale of all or most of its assets, but sometimes also includes an initial public offering (IPO) or a Qualified Exit (see paragraph 18 below).
The example below shows what would happen if there were liquidity events at the value of R$200,000 or R$1,000,000 in each of the following scenarios (all of which assume a fully participating liquidation preference based upon the issued share capital following the seed round described in Box 2 of Section III):

- where there is no liquidation preference attached to the ‘A’ Shares
- 1 x liquidation preference
- 2 x liquidation preference

<table>
<thead>
<tr>
<th>Liquidated Preference</th>
<th>Percentage Shareholding</th>
<th>R$200,000 Liquidity Event Cash Return</th>
<th>R$1,000,000 Liquidity Event Cash Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investor</td>
<td>50%</td>
<td>R$100,000</td>
<td>R$500,000 (preference) R$400,000 (share in R$800,000 balance)</td>
</tr>
<tr>
<td>None</td>
<td></td>
<td>R$200,000</td>
<td>R$400,000 (preference) R$300,000 (share in R$600,000 balance)</td>
</tr>
<tr>
<td>1x</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2x</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Angel</td>
<td>25%</td>
<td>R$50,000</td>
<td>R$250,000</td>
</tr>
<tr>
<td>None</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1x</td>
<td></td>
<td>0</td>
<td>R$200,000</td>
</tr>
<tr>
<td>2x</td>
<td></td>
<td>0</td>
<td>R$150,000</td>
</tr>
<tr>
<td>Founder</td>
<td>25%</td>
<td>R$50,000</td>
<td>R$250,000</td>
</tr>
<tr>
<td>None</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1x</td>
<td></td>
<td>0</td>
<td>R$200,000</td>
</tr>
<tr>
<td>2x</td>
<td></td>
<td>0</td>
<td>R$150,000</td>
</tr>
</tbody>
</table>

In this example, in the event that the company is only sold for R$200,000, the investor will only get his money back if he has negotiated a liquidation preference so that the first R$200,000 from such an event goes to the investor. For a sale at R$1,000,000, the calculation works so that in the event of 1x preference the first R$200,000 goes to the investor and then the remaining R$800,000 is shared pro-rata in accordance with the shareholding, in this case 50:25:25.

5. Redemption

The right of redemption is the right to demand, under certain conditions, that the company buy back its own shares from its investors at a fixed price -- a form of reimbursement of the amount invested. Such a right can be used to ensure that
the VC/PE investors recover some or all of their investment if a company has not been able to achieve a successful exit (see paragraph 18 below) within a certain period of time. A company’s failure to redeem its shares when requested might result in the investors gaining improved rights, such as enhanced voting rights.

A right of redemption is not appropriate for every investment and it is subject to certain legal restrictions in Brazil. Nevertheless, “redemption-like” structures can be implemented under documents governed by Brazilian law. One of the commonly used available alternatives is the negotiation of a selling right, a so-called “put” on investors’ shares (i.e., purchased by the founders at a fixed price with the company’s assets as guarantee of payment).

Where VC/PE investors hold a non-voting preferred class of shares and it is permitted to convert these to voting ordinary shares, they generally require the right to convert them at any time, at an initial conversion ratio of 1:1. Conversion is normally delayed until exit so that investors are able to avoid losing the rights attached to the non-voting preferred class of shares.

This conversion ratio will be adjusted to take account of any reorganization of a company's capital structure. In some jurisdictions, this conversion ratio can be adjusted to provide for a form of anti-dilution protection (see paragraph 8 below). If a dilutive event has occurred and this ratio has been increased, the investor may choose or may be compelled to convert its non-voting preferred shares into voting ordinary shares immediately prior to a liquidity event (such as a trade sale or an IPO).

6. **Automatic conversion of non-voting preferred share class/series**

In most cases, investors will be required to convert all of their non-voting preferred shares into voting ordinary shares prior to a company listing its shares on a publicly traded exchange. VC/PE investors often require an automatic conversion mechanism for all share classes, effective immediately prior to an IPO. As a matter of fact, an automatic conversion mechanism is a Bovespa requirement in certain IPO categories, such as Novo Mercado. Investors will only want this conversion mechanism to work where an IPO is likely to provide a sufficient opportunity for them to dispose of their shares (liquidity) after the expiration of any lock up periods. Accordingly, investors usually define certain criteria in advance that must be met for an IPO to trigger automatic conversion (usually referred to as a Qualified IPO), e.g., only offerings on certain exchanges, by recognized national underwriters, at a valuation exceeding a certain threshold and raising at least a minimum amount of gross proceeds. Otherwise, non-voting preferred shareholders would risk having their shares converted and losing all of their preferential rights even if the company lists its shares at a low value on a minor exchange.

7. **Anti-dilution (or price protection)**

VC/PE investors often require anti-dilution protection rights to protect the value of their stake in the company, if new shares are issued at a valuation that is
lower than that at which they originally invested (a \textit{down round}). This protection usually functions by applying a mathematical formula to calculate a number of new shares which the investors will receive, for no or minimal cost, to offset the dilutive effect of the issue of cheaper shares.

There are several variations of the formula, each providing different degrees of protection. These include \textit{full ratchet} protection, which will maintain investors' full percentage ownership at the same level or at the same value in down rounds. Other versions of the formula, provide some compensation for the \textit{dilution}, but allow the ownership percentage to fall: the most common of these is \textit{weighted average}. The level of protection required by an investor depends on several factors, including the valuation of the company at the time of the investment and the perceived exposure to further financing requirements.

While the basic concept remains the same, there are several different mechanisms used in Brazil to create this protection. Though the mechanism of adjusting the conversion ratio of non-voting preferred shares to voting ordinary shares to adjust for dilutions can be used in Brazil, other methods, including the issue of shares for a nominal sum or "bonus" shares, are also used. The latter might involve the granting of options (or "warrants" as they are sometimes referred to), which are only exercisable if the anti-dilution provision is triggered.

In the example set out in Box 2 of Section III, if the project did not proceed as well as expected and as time came to raise another round from new investors it emerged that these potential new investors were only prepared to invest at a pre-money valuation (for them) of R$200,000, this would imply that they would only pay R$1,000 per share (R$200,000/200). However, the existing investors paid R$2000 per share. Therefore, under full anti-dilution provisions, the shareholding by existing investors would be adjusted in order to issue them new shares, the effect of which would be to bring the price they paid for the 'A' shares to R$1,000 per share.

The result of the full anti-dilution provisions is that existing investors would have to be issued a further 100 shares to bring their shareholding to 200, for which they paid a total of R$200,000 equaling R$1000 per share. In terms of the overall shareholding this brings the ownership of the business between the founders, angels and investors to 50 shares – 50 shares: 200 shares or 16.6%: 66.6% (a change from 50 shares: 50 shares: 100 shares or 25%: 25%: 50%).

8. \textbf{Founder shares}

Founders and senior management are usually central to VC/PE investors’ decision to put money into a company. Having decided to put money behind a management team in which they have confidence, investors are usually keen to ensure that this team remains in place to deliver its business plan. Therefore, it is often the case that founders and key managers (and sometimes all shareholders/employees who leave the company within a certain period of time) are required to offer to sell their shares back to the company or to other shareholders. The price paid for the shares may depend upon circumstances of
departure – it may be at market value if the founder/manager is deemed to be a good leaver, or it might be considerably less in the case of a bad leaver. A bad leaver may be someone who has breached his contract of employment, or it may also be someone who resigns from the company within a particular period. The Board often retains the right to determine whether to implement the bad leaver provisions.

In addition – or as an alternative – to good leaver/bad leaver provisions, investors may require that shares held by founders who are employees or consultants be subject to a vesting schedule in order to provide incentives for the founders not to leave employment with the company in the short term. The effect of this is that anyone holding such shares must be employed or engaged as a consultant by the company for a certain period of time if that person is to obtain unrestricted ownership of all of their shares. Within that period shares may vest on a straight-line basis or on another negotiated basis. Sometimes founders have different vesting schedules in recognition of their different levels of contribution to the company.

In NewCo it was decided that the founder's 50 shares would vest on a straight-line basis over 4 years, with the first year's allocation vesting on the completion of the VC/PE investment.

<table>
<thead>
<tr>
<th>Number of Shares</th>
<th>0 months – 12 months</th>
<th>12 months – 24 months</th>
<th>24 months – 36 months</th>
<th>36 months – 48 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Vesting %</td>
<td>12.5</td>
<td>12.5</td>
<td>12.5</td>
<td>12.5</td>
</tr>
<tr>
<td>Cumulative Vesting %</td>
<td>12.5</td>
<td>25</td>
<td>37.5</td>
<td>50</td>
</tr>
</tbody>
</table>

If a founder leaves within the requisite period, he will keep only that proportion of his shares that are deemed to be vested. In this example, if the founder left between 12 and 24 months, 25 shares or 50 per cent of the shareholding would have vested. The remaining shares that are unvested lose their value, either by being bought back by the company for a nominal amount or converted into deferred shares that have no attached rights. It may be decided that on certain events such as death or incapacity or where a founder's employment may terminate through no fault of their own, the vesting schedule is accelerated either partially or fully. The Board may retain the right to determine such issues at the time, in the light of circumstances.

9. **Pre-emption rights on new share issues**

If the company makes any future share offering, a VC/PE investor will require the right to maintain at least its percentage stake in the company by participating in the new offering up to the amount of its pro-rata holding, under the same terms and conditions as other participating investors. This *pre-emption right* is automatically provided for by law in Brazil.
If the new offering is based on a company valuation lower than that used for an investor’s prior investment, that investor may also receive shares under its anti-dilution rights (see paragraph 8 above). Certain issues will be usually exempted from the pre-emption rights, including the issue of anti-dilution shares and the issue of shares on the exercise of share options.

10. **Right of first refusal, right of first offer, co-sale and tag along rights**

These are contractual terms between shareholders that are usually included in the By-laws and Shareholders Agreement. If one shareholder wishes to dispose of shares that are subject to a *right of first refusal* (ROFR) and/or a *right of first offer* (ROFO), it must first offer these shares to those other shareholders who have the benefit of the ROFR or ROFO.

In a ROFR, after an offer to buy shares is made by a third party to a shareholder, the shareholder must share the offer’s terms with the other existing shareholders, who can then decide whether they wish to match the offer or execute it for a higher price.

A ROFO is essentially a ROFR in reverse. It is the right of a selling shareholder to make an offer to the other shareholders. If such offer is refused, then the shares may be to third parties under the same terms originally offered.

There are usually certain exceptions to the ROFR or ROFO, such as the right of individuals to transfer shares to close relatives and trusts, and investors to transfer shares freely to third parties, to each other or within an investor's group. The requirement to go through a ROFR or ROFO process may add several weeks to the timescale for selling shares.

If a shareholder wishes to dispose of shares that are the subject of a *tag along right*, the other shareholders who benefit from the right can insist that the potential purchaser agrees to purchase an equivalent percentage of their shares, at the same price and under the same terms and conditions. This may have the effect of making the shares more difficult to sell.

Under a *co-sale* right, investors will usually be able to require that an offer be made for their shares by anyone whose purchase of shares will give it control of the company.

A VC/PE investor’s decision to invest in a company is often based largely on the strength of the technical and management experience of the founders and management. It does not want these individuals to dispose of their shares in the company while it remains an investor. Consequently, investors frequently require a ROFR as well as co-sale/tag along rights on any sale of shares by a founder or key managers. Indeed they may sometimes require a prohibition on founders and key managers selling shares for a stated period.

In Brazil the investor class will sometimes create a ROFR on each other’s shares. This practice can be unpopular as it can make investors’ shares more difficult to sell (less liquid) and potentially less valuable as a prospective buyer.
may often be reluctant to make an offer for shares that can be pre-empted by someone else.

11. **Drag along or Bring along**

A *drag along* provision (sometimes called *bring along*) creates an obligation for all shareholders of the company to sell their shares to a potential purchaser if a certain percentage of the shareholders (or of a specific class of shareholders) vote to sell to that purchaser. Often in early rounds drag along rights can only be enforced with the consent of those holding at least a majority of the shares held by investors. These rights can be useful in the context of a sale where potential purchasers may want to acquire 100% of the shares of the company in order to avoid having responsibilities to minority shareholders after the acquisition.

VC/PE investors may require that certain exceptions are included in drag-along provisions for situations when they cannot be obligated to sell their shares. Among these are drag-along sales where the investors will not receive cash or marketable securities in return for their shares or will be required to provide to the purchaser representations and warranties concerning the company (or indemnify those given by the company or the founders) or *covenants* (such as non-compete and non-solicitation of employees).

12. **Representations and warranties**

VC/PE investors expect appropriate *representations and warranties* to be provided by key founders and management and, in jurisdictions where it is allowed, the company. The primary purpose of the representations and warranties is to provide the investors with a complete and accurate understanding of the current condition of the company and its past history to allow for an accurate evaluation of the risks of investing in the company prior to subscribing for its shares. The representations and warranties will typically cover areas such as the legal existence of the company (including all share capital details), the company’s financial statements, the business plan, assets (in particular intellectual property rights), liabilities, material contracts, employees and litigation.

It is very rare that a company is in a perfect state! The warrantors have the opportunity to set out issues that ought to be brought to the attention of the new investors via the *disclosure letter* or schedule of exceptions. This is usually provided by the warrantors and discloses detailed information concerning any exceptions to or carve-outs from the representations and warranties (e.g., specific company assets, contracts, shareholders, employees, etc.). If a matter is referred to in the disclosure letter, the investors are deemed to have notice of it and will not be able to claim for breach of warranty with respect to that matter.

Investors expect those providing representations and warranties for the company to back this information with a contractual obligation to reimburse the investors in the event that the representations and warranties are inaccurate – or if there are exceptions to them that have not been fully disclosed. There are usually
limits to the exposure of the warrantors, which are a matter for negotiation when documentation is being drawn up, and vary according to the severity of the breach, the size of the investment and the financial resources of the warrantors.

13. Voting rights

VC/PE investors will have certain consent and voting rights that attach to their class of shares (see paragraph 15 below). If there is a voting agreement in place, non-voting preferred shares may have equivalent voting rights to voting ordinary shares in a general meeting, though it is also possible that they may carry more than one vote per share under certain circumstances.

Where an appropriate event has occurred that triggers a change in the conversion ratio, the number of votes that the investors’ shares will carry for any subsequent general shareholder vote will often be automatically adjusted to reflect the change in the conversion ratio at the time of the vote.

14. Protective provisions and consent rights (Class rights)

VC/PE investors in an investment round normally require that certain actions cannot be taken by the company without the consent of the holders of a majority (or other specific percentage) of their class or series of shares (Investor Majority). Sometimes these consent rights are split between consent of an Investor Majority, consent of the Investor Director(s) or consent of the Board. Typically what requires Investor Majority consent and what requires Investor Director consent would relate to major changes in the company such as those set out in the paragraph below whereas operational matters that need more urgent consideration by the Board would be left for Board consent. Alternatively, each of the largest investors may have specific consent rights. The purpose of these rights is to protect the investors from the company taking actions that may adversely affect the value of their investment.

The types of actions covered include (among many others): changes to share classes and share rights, changes to the company’s capital structure, issuance of new shares, mergers and acquisitions, the sale of major assets, winding-up or liquidating the company, declaring dividends, incurring debts above a certain amount, appointing key members of the management team and materially changing the company’s business plan. These shareholder rights are particularly important for investors who do not appoint a director to the board of directors (see paragraph 16 below).

Note that in Brazil, as well as in some other Latin American jurisdictions, local company law requires that the decision to make certain actions covered by consent rights remain the unfettered right of the Board of Directors. In such cases, the Bylaws of the company will usually require that the level of majority needed for a Board decision concerning these actions include the agreement of an appropriate number of the Directors appointed by the investors.

Alongside these consent rights, there are usually various undertakings or covenants given by the company or the founders to do certain acts. Typically these acts include taking steps to protect intellectual property, applying
investment monies in accordance with the business plan and maintaining appropriate insurance. Other types of covenants are described in the sections below headed "Information rights" (see paragraph 17) and "Confidential information, intellectual property assignment and management non-compete agreements" (paragraph 20).

15. **Board of Directors/Board Observer**

VC/PE investors require that the company has an appropriate Board of Directors. In accordance with what is regarded as Brazilian corporate governance best practice, investors usually prefer the Board to have a majority of *non-executive directors* (i.e. directors who are not employees of the company). Although a majority of non-executives may be impractical for small companies, it is usual for such companies to have at least one or two non-executives. One or more of the non-executive directors will be appointed by the investors under rights granted to them in the investment documentation. Some corporate strategic investors will never appoint a director due to potential conflicts of interest and liability issues. Corporate strategic investors will instead require the right to appoint a Board Observer, who can attend all Board Meetings, but who will not participate in any Board decisions. The Board of Directors tends to meet once a month, a schedule particularly adhered to by early-stage companies with "active" investors on the Board.

In many cases, investors will require that the Board has a *Remuneration or Compensation Committee* to decide on compensation for company executives, including share option grants (see paragraph 21 below). These committees will be made up entirely or of a majority of non-executive Directors and will include the directors appointed by the investors. Each of these committees should have its own mandate set out in writing. Similarly, investors may require an *Audit Committee*, which is independent from the Board and has the duty to oversee the company’s management and the financial report.

As with all directors, by law the Investor Directors' responsibilities are to act in the interest of the company rather than as a representative of the funds that they manage. Often VC/PE capitalists separate the investment decisions for the funds invested in the companies from the Investor Director's decisions in order to avoid conflicts of interests for the Investor Director. This is typically done by having another investment executive representing the funds' interests when dealing with the company with respect to the Investor Consent matters.

16. **Information rights**

In order for VC/PE investors to monitor the condition of their investment, it is essential that the company provide them with certain regular updates concerning its financial condition and budgets, as well as a general right to visit the company and examine its books and records. This sometimes includes direct access to the company's auditors and bankers. These contractually defined obligations typically include timely transmittal of audited annual financial statements, annual budgets, and non-audited monthly and quarterly financial statements.
17. Exit

VC/PE investors want to see a path from their investment in the company to an exit, most often in the form of a disposal of its shares following an IPO or by participating in a sale. Sometimes the threshold for a liquidity event (see paragraph 4 above) or conversion (see paragraph 6 above) will be a Qualified Exit. If used, it will mean that a liquidity event will only occur and conversion of non-voting preferred shares will only be compulsory if an IPO falls within the definition of a Qualified Exit. A Qualified Exit is usually defined as a sale or IPO on a recognized investment exchange that in either case is of a certain value to ensure the investors get a minimum return on their investment.

Consequently, investors usually require undertakings from the company and other shareholders that they will endeavor to achieve an appropriate share listing or trade sale within a limited period of time (typically 5-7 years depending on the stage of investment and the maturity of the company). If such an exit is not achieved, investors often build in structures which will allow them to withdraw some or all of the amount of their investment (see paragraphs 3 and 5 above).

18. Registration rights

Registration rights are a securities law concept that is alien to many Latin American companies and investors. The registration process involves the company whose shares are to be publicly offered providing significant amounts of information about its operations and financial condition, which can be time consuming and costly.

Unlike in Latin American jurisdictions where all of a company’s shares usually become tradable upon a public listing, a company registering shares to be traded in the US is not required to register all of its outstanding shares. Any shares that are left unregistered can only be traded under very restricted circumstances, which can greatly diminish their value. Consequently, investors in the US or in companies that may consider pursuing a listing in the US, usually require the company to enter into a Registration Rights Agreement. Among other things, this gives the investors rights to demand registration of their shares (Demand Rights) and to have their shares registered along with any other shares of the company being registered (Piggy-back Rights) and allocates costs and potential liabilities associated with the registration process.

19. Confidential information, intellectual property assignment and management non-compete agreements

It is good practice for any company to have certain types of agreements in place with its employees. For technology start-ups, this generally includes Confidentiality Agreements (to protect against loss of company trade secrets, know-how, customer lists, and other potentially sensitive information), Intellectual Property Assignment Agreements (to ensure that intellectual property developed by academic Institutions or by employees before they were employed by the company will belong to the company) and Employment Contracts or Consultancy Agreements (which will include provisions to ensure
that all intellectual property developed by a company’s employees belongs to the company). Where the company is a spin-out from an academic Institution, the founders will frequently be consultants of the company and continue to be employees of the academic Institution, at least until the company is more established.

Investors also seek to have key founders and managers enter into Non-compete Agreements with the company. In most cases, the investment in the company is based largely on the value of the technology and management experience of the management team and founders. If they were to leave the company to create or work for a competitor, this could significantly affect the company’s value. Investors normally require that these agreements be included in the Investment Agreement as well as in the employment/consultancy agreements with the founders and senior managers, to enable them to have a right of direct action against the founders and managers if the restrictions are breached.

20. **Employee share option plan**

An employee share option plan (ESOP) is a plan that reserves and allocates a percentage of the shares of the company for share options to current and future employees of the company (and certain other individuals) at the discretion of a management committee. It is common that such options be subject to vesting periods, which is a schedule, based on time or performance, whereby options become exercisable (i.e., 33.3% per year over three years, 20% per year in case a business milestone is met).

The intention of the ESOP is to provide an incentive for the employees by allowing them to share in the financial rewards resulting from the success of the company. Investors typically want 10-20% of the share capital of the company to be reserved in an ESOP creating an "option pool." The company will then be able to issue the shares under the plan without requiring further approval from the investors. Founders and other management with significant shareholdings may be excluded from participating in the ESOP.

Experience shows that local counsel needs to be involved in the early stage of structuring an ESOP. Do not underestimate the many and sometimes unexpected labor, tax and foreign exchange consequences of implementing an ESOP.

21. **Transaction and monitoring fees**

VC/PE investors are usually paid a fee by the company to cover internal and external costs incurred in connection with the investment process.

22. **Confidentiality**

All exchanges of confidential information between potential VC/PE investors and the company need to be subject to a confidentiality agreement. This agreement should be executed as soon as discussions with company about a potential investment begin. If this has not been done then a confidentiality restriction should be included in the Term Sheet.
23. **Exclusivity**

Once a term sheet is signed, VC/PE investors will undertake various types of due diligence on the company (due diligence may be any or all of the following types: technical, commercial, legal and financial). Investors will usually provide the company with a list of areas they would like to evaluate and information they would like to receive. The process can take several weeks or even months and the investors may also use third party advisors to assist them in the process (e.g. lawyers, accountants and consultants). The due diligence process will involve expense and therefore the investors will not want to discover that, while they are incurring this expense, the company accepts investment from other investors. To protect themselves, some investors will ask for an exclusivity period during which the company is prohibited from seeking investment from any third parties. A breach of this obligation will result in the company and founders incurring a financial penalty.

24. **Enforceability**

With the exception of clauses dealing with confidentiality, transaction fees and exclusivity, the provisions of a signed Term Sheet will not be intended to be legally binding.

25. **Conditions Precedent**

A full list of conditions to be satisfied before investment will be included in the Term Sheet. A VC/PE investment will usually be conditional on not only the negotiation of definitive legal documents, but also on the satisfactory completion of due diligence and approval by the Investment Committee of each of the VC/PE investors.

Satisfactory completion of due diligence can include conclusion of commercial, scientific and intellectual property due diligence, a review of current trading and forecasts, a review of existing and proposed management service contracts, a review of the company's financial history and current financial position, either a full legal review or one targeted on specific areas and, if it is not already in place, obtaining *key man insurance* and satisfactory references and checks on key employees.

It is also common for investors to require the founders and senior management to sign up to employment or consultancy agreements in a form approved by the investors. In the case of investment from VC trusts or PE funds it will also be a condition that before they invest the appropriate tax clearance has been obtained from the Inland Revenue.
VI Venture capital and Private Equity glossary of terms

Angels: High net worth individuals who provide seed money to very early-stage companies, usually investing their own money rather than that of institutional or other investors.

Anti-dilution provisions: Provisions which protect the holder's investment from dilution as the result of later issues of shares at a lower price than the investor paid by adjusting the option price or conversion ratio or issuing new shares (see paragraph 8 in Section IV above).

As Converted Basis: The determination of non-voting preferred shares rights, such as vesting and participation in a dividend, on the basis that those shares have been converted into voting ordinary shares, taking account of whatever adjustments might be necessary.

Audit Committee: A committee whose members are not part of the board of directors. Responsible for overseeing the management and financial reporting, as well as to report to the management or the shareholders, as the case may be, any fraudulent activity that may come to the Committee’s attention.

BOVESPA: Brazil’s Stock Exchange. It keeps a system of negotiation, adjusted to its members and the accomplishment of transactions of purchase and sale of securities, registered in the CVM.

Bridge Loan, Bridge Finance or Bridge Round: A loan or equity investment to provide financing for a relatively short time period until the issuer can complete a longer term financing such as a public offering or new investment round.

Burn Rate: The rate at which a company is consuming cash each month.

By-Laws: Regulations, ordinances, rules or laws adopted by an association or corporation or the like for its internal governance. Bylaws define the rights and obligations of officers, persons or groups as well as routine matters within a company.

Capitalize: Converting a debt owed to a company into equity (see paragraph 3 in Section IV above).

Capitalization table (Cap table): A spreadsheet listing all shareholders and holders of options and any other securities, along with the number of shares, options and convertible securities held (see Box 1 and Box 2 in Section III above).

Carried Interest: The portion of any profits realized by a VC/PE fund to which the fund managers are entitled, in addition to any returns generated by capital invested by the fund managers. Carried interest payments are customary in the VC/PE industry. Also known as “the carry”.

Completion or Closing: In the context of a VC/PE investment round, the release of investment funds to the company and the issuance of shares to the investors following execution of the investment documents and verification that all necessary conditions have been fulfilled.
**Co-investment:** See Syndication.

**Conversion:** The act of exchanging one form of security for another security of the same company, e.g., non-voting preferred shares for voting ordinary shares, debt securities for equity (see paragraph 6 in Section IV above).

**Conversion Ratio:** The ratio indicating the number of underlying securities that can be acquired upon exchange of a convertible security, e.g., the number of voting ordinary shares into which non-voting preferred shares are convertible (see paragraph 6 in Section IV above).

**Convertible Debt:** A debt obligation of a company convertible into shares.

**Convertible Non-Voting Preferred Shares:** Non-voting preferred shares convertible into voting ordinary shares.

**Co-Sale:** A mechanism to ensure that if any shareholders have an opportunity to sell some or all of their shares (which sale would result in a "change of control" of the company) the investors are given the opportunity to sell all of their shares (see paragraph 11 in Section IV above).

**Covenants:** Undertakings given to the investors by the company and sometimes the founders to do or not do certain acts (see paragraph 15 in Section IV above).

**Cumulative dividends:** A dividend which accumulates if not paid in the period when due and must be paid in full before other dividends are paid on the company's voting ordinary shares (see Dividends in Section IV above).

**Cumulative Non-Voting Preferred Shares:** A form of non-voting preferred shares which provides that if one or more dividends is omitted, those dividends accumulate and must be paid in full before other dividends may be paid on the company's voting ordinary shares (see paragraph 3 in Section IV above).

**CVM:** Brazilian Commission of Securities.

**Debt/Equity Ratio:** A measure of a company's leverage, calculated by dividing long-term debt by voting ordinary shareholders' equity.

**Debt Financing:** Financing by selling notes or other debt instruments.

**Deed of Adherence:** An agreement that purchasers of shares (new or existing) may be required to sign to ensure they are bound by the terms of an Investment Agreement.

**Deemed Liquidation or Liquidity Event:** Term used to describe trigger events for a liquidation preference. Usually defined to cover, among other things, a merger, acquisition, change of control or consolidation of the company or a sale of all or most of its assets (see paragraph 4 in Section IV above).

**Default:** Failure to discharge a contractual obligation, e.g., to pay interest or principal on a debt when due.
**Demand Registration Rights (US):** The contractual right of a security holder to require an issuer to file a registration statement to register the holder's securities so that the holder may sell them in the public market without restriction (see paragraph 19 in Section IV above).

**Dilution:** The process by which an investor's percentage holding of shares in a company is reduced by the issuance of new securities (see paragraph 8 in Section IV above).

**Directors & Officers Insurance:** Directors and Officers (D&O) Insurance is professional liability coverage for legal expenses and liability to shareholders, creditors or others caused by actions or omissions by a director or officer of a company.

**Disclosure Letter:** A letter given by the founders, and maybe other key members of the management team, and the company to the investors setting out exceptions to the representations and warranties.

**Discounted Cash Flow (DCF):** An investment appraisal technique that takes into account both the time value of money and also the total profitability of a project over a project's life.

**Divestment:** The disposal of a business or business segment.

**Dividends:** When a company makes a profit, it can pay part of these profits to its shareholders in the form of cash, additional shares or other assets. Such payments are known as dividends (see paragraph 3 in Section IV above).

**Down Round:** A round of VC/PE financing in which the valuation of the company is less than the previous round (see paragraph 8 in Section IV above).

**Drag Along/Bring Along:** A mechanism ensuring that if a specified percentage of shareholders agree to sell their shares, they can compel the others to sell ensuring that a prospective purchaser can acquire 100% of a company (see paragraph 12 in Section IV above).

**Due Diligence:** The process of researching a business and its management prior to deciding whether to proceed with an investment in a company (see paragraph 26 in Section IV above).

**Early stage capital:** Finance for companies to initiate commercial manufacturing and sales, following receipt of seed capital.

**Earnings:** Profits after expenses.

**EBIT/EBITDA:** Earnings before interest and taxes/earnings before interest, taxes, depreciation and amortization: financial measurements often used in valuing a company.

**Employee Share Option Plan (ESOP):** A scheme to enable employees to acquire shares in the companies in which they work (see paragraph 21 in Section IV above).
**Equity**: Ownership interest in a company represented by shares.

**Exclusivity Agreement**: Often negotiated by a syndicate of investors, an agreed period of exclusivity during which the company and/or its existing shareholders cannot negotiate with others for investment into the company.

**Exercise price**: The price at which an option or warrant can be exercised.

**Exit mechanism**: Term used to describe the method by which a VC/PE investor will eventually sell out of an investment (see paragraph 18 in Section IV above).

**Exit strategy**: Potential scenarios for liquidating an investment while achieving the maximum possible return. For VC/PE-backed companies, typical exit strategies include Initial Public Offerings (IPOs) and acquisitions by or mergers with larger companies (see paragraph 18 in Section IV above).

**Flotation**: To obtain a listing or IPO on a stock exchange (see paragraph 18 in Section IV above).

**Follow-on Investment Round**: An additional investment by existing and/or new investors, which may be provided for in documentation relating to the initial investment.

**Founder Shares**: Shares issued to the founders of a company, usually at a low price in comparison to that paid by investors (see paragraph 9 in Section IV above). See also **Sweat Equity**.

**Full Ratchet**: Anti-dilution provisions that apply the lowest sale price for any voting ordinary shares (or equivalents) sold by the company after the issuing of an option or convertible share as being the adjusted option price or conversion price for those options or shares (see paragraph 8 in Section IV above).

**Fully diluted share capital**: The issued share capital of a company if all options and other rights to subscribe for shares are exercised.

**Fully Participating**: Term sometimes used to describe a liquidation preference which entitles beneficiaries to receive a priority initial fixed payment and share pro rata with other share classes in any remaining proceeds (see paragraph 4 in Section IV above).

**GAAP (Generally Accepted Accounting Principles)**: Rules and procedures generally accepted within the accounting profession.

**Good leaver/bad leaver**: A criteria applied to a shareholder employee who is ceasing to be employed to determine whether his shares should be subject to a compulsory sale, and if so, at what price (see paragraph 9 in Section IV above).

**Independent or Outside Director**: A non-executive member of the Board of Directors who is not an employee of a company nor affiliated with a controlling stockholder of a company. The definition of "independent" may be further defined in different countries or markets (see paragraph 16 in Section IV above).
**Information Rights**: The contractual right to obtain information about a company, attend board meetings, etc., typically received by VC/PE investing in privately held companies (see paragraph 17 in Section IV above).

**Initial Public Offering (IPO)**: The sale of shares to the public by a company for the first time. Prior to an IPO, companies that sell shares to investors are considered "privately held." This is the first time that a company has tried to raise funds on a "public" market such as a stock exchange. Terms used to describe this are "flotation", "float", "going public", "listing" when a company obtains a quotation on a stock market (see paragraph 18 in Section IV above).

**Institutional Investor**: An organization whose primary purpose is to invest assets owned by the organization or entrusted to them by others. Typical institutional investors are banks, pension funds, insurance companies, mutual funds and university endowments.

**Intangibles**: The non-physical assets of a company that have a value, e.g., intellectual property rights including trademarks and *patents*.

**Intellectual Property (IP)**: Legal term used to describe the patents, licenses, copyrights, trademarks and designs owned by a company (see Section III above).

**Internal Rate of Return (IRR)**: An accounting term for the rate of return on an asset. It is defined as the interest rate that equates the present value of future returns to the initial investment. It is greatly affected by the timing of the exit.

**Investment Agreement**: This is a summary of the main terms of the investment into the company. Typically it will describe the amounts and types of shares to be issued and the specific rights of the investors such as veto rights and information rights (see Investment Agreements in Section II above).

**Key Man Insurance**: Insurance obtained by the Company on the lives of key employees, usually the chief executive officer and the person or persons ultimately responsible for continuing to develop the technology (see paragraph 26 in Section IV above).

**Lead investor**: In a substantial investment, the whole risk is often shared among a syndicate. Normally, one investor will take the lead in negotiating the terms of the investment and managing due diligence (see Syndication below).

**License Agreement**: An agreement under which certain commercial and/or intellectual property rights may be used by the licensee. For example, the Institution may license intellectual property rights to the investee company.

**Liquidation or winding up**: The sale of all of a company's assets, for distribution to creditors and shareholders in order of priority. This may be as a result of the insolvency of the company or by agreement amongst shareholders (see paragraph 4 in Section IV above).

**Liquidation Preference**: A negotiated term of a round of VC/PE financing that calls for certain investors to have all or most of their entire investment repaid if the company
is liquidated. Often also triggered by a “deemed liquidation” (see paragraph 4 in Section IV above).

**Liquidity**: Converting an asset (such as shares) to cash (see paragraph 18 in Section IV above).

**Listing**: When a company’s shares are traded on a stock market it is said to be "listed" (see paragraph 18 in Section IV above).

**Lock-up**: A provision in the underwriting agreement between an investment bank and existing shareholders that prohibits corporate insiders and private equity investors from selling for a certain period of time following a public offering (usually 180 days after an IPO).

**Milestone**: A contractual target that must be met by the company. Often used by investors as a condition for releasing further amounts of financing. (See Valuation and Milestones in Section IV above).

**Net Present Value (NPV)**: The current value of future cash flows discounted back to today's date using a stated discount rate.

**NewCo**: Word often used to describe a newly formed investee company (see Section III above).

**New Money**: Investment funds coming from an investor who is not a current shareholder of the company.

**Non-executive director**: "Part-time" directors who share all the legal responsibilities of their executive colleagues on the board of a company. The general view is that they can operate as an *independent director* able to take a long-term view of a company and protect the interests of shareholders. An investor will often appoint a non-executive to a board as one way of monitoring its investment (see paragraph 16 in Section IV above).

**Non-Qualified IPO**: An IPO which is not a Qualified IPO.

**Novo Mercado**: Bovespa’s most popular listing category, which includes more than 70% of the Brazilian listed companies. It is an auto-regulation of the Brazil Stock Exchange and aims to preserve high ethical standards of negotiation, transparency and corporate governance. In general, its requirements are more stringent than those of the Brazilian Securities Law.

**Options**: The right, but not the obligation, to buy or sell a security at a set price (or range of prices) in a given period.

**Voting Ordinary Shares**: These are equity shares that are entitled to all income and capital after the rights of all other classes of capital and creditors have been satisfied.

**Outside Director**: See Independent or Outside Director.
**Par:** The nominal cash amount assigned to a security by the issuer. For an equity security, par is usually a very small amount that no longer bears any relationship to its market price.

**Pari Passu:** Equally, ratably, without preference. Generally used to describe securities that are to be treated as being of equal priority or preference.

**Participating Non-Voting Preferred Shares:** Non-voting preferred shares that entitle the holder not only to its stated dividend and liquidation preference, but also allows the holder to participate in dividends and liquidating distributions declared on voting ordinary shares.

**Patent:** The exclusive right to make, use, or sell an invention or a process for a specific period of time.

**Pay to play:** A provision that requires investors to participate in subsequent rounds or forfeit certain rights such as anti-dilution.

**Piggy-back Registration Rights (US):** Contractual rights granted to security holders giving them the right to have their holdings included in a registration statement if and when the issuer files a registration statement (see paragraph 19 in Section IV above).

**Post-Money Valuation:** The value of a privately held company immediately after the most recent round of financing. This value is calculated by multiplying the company's total (fully diluted) number of shares by the share price of the latest financing (see paragraph 2 in Section IV above).

**Pre-emption Right:** The right of an investor to participate in a financing to the extent necessary to ensure that, if exercised, its percentage ownership of the company's securities will remain the same after the financing as it was before. Sometimes also used as a term for a right of first refusal on shares of other investors (see paragraph 10 in Section IV above).

**Pre-Money Valuation:** The value of a privately held company prior to the most recent round of financing (see paragraph 2 in Section IV above).

**Put option:** A contract whereby the holder of the option has the right to sell to the grantor shares at a specific price (*strike price*) at some time in the future.

**Qualified IPO:** An IPO that gives the company a market capitalization of at least a certain amount (often a multiple of the valuation at the time of an investment) and is accompanied by a fully underwritten fund raising of a certain amount (see paragraph 7 in Section IV above).

**Recapitalization:** The reorganization of a company's capital structure by the infusion of new cash and/or the replacement of current shareholders by new ones. Recapitalization can be an alternative exit strategy for VC/PE investors.

**Ratchets:** A structure whereby the eventual equity allocations between the groups of shareholders depend on either the future performance of the company or the rate of return achieved by the VC/PE firm. This allows management shareholders to increase
their stake if the company performs particularly well (see paragraph 2 in Section IV above).

**Redeemable shares**: Shares that a company can be made to repurchase or that a company has the right to repurchase at a predetermined value (see paragraph 5 in Section IV above).

**Registration Rights (US)**: The contractual right of a shareholder to participate in the registration of the issuer's stock for resale in the public market (see Registration Rights in Section IV above).

**Remuneration Committee or Compensation Committee**: A committee of the board of directors responsible for reviewing and setting the remuneration of certain executive officers of the company. The remuneration committee may also be responsible for the allocation of share options to employees. A remuneration committee is typically comprised of a majority of independent directors of the company (see paragraph 16 in Section IV above).

**Representations and Warranties**: Terms in an investment or subscription agreement whereby usually the founders and key managers and (subject to local company law) the company give undertakings in respect of the past and present operating condition of a company. Examples include operating in a legal fashion, no bad debts, ownership of assets. Breach of warranty gives the investors the right to claim damages and, if it is sufficiently fundamental, may enable the investors to terminate the contract (see paragraph 13 in Section IV above).

**Restrictive covenants/non competes**: Undertakings given by founders/key management in the investment agreement and contracts of employment or consultancy agreements which restrict their ability to undertake activities which might compete with the company both during their employment/consultancy and post termination of employment in order to protect the business and the value of the company (see paragraph 20 in Section IV above).

**Right of First Refusal (ROFR)**: A contractual right, frequently granted to VC/PE investors, to purchase shares held by other shareholders before such shares may be sold to a third party (see paragraph 11 in Section IV above).

**ROI**: Return on investment (see paragraph 3 in Section IV above).

**Secured debt/loan**: Loan, where the lender, in the event of a failure to meet either an interest or principal payment, gains title to specific assets.

**Seed Capital**: Capital provided to allow a business concept to be developed, perhaps involving the production of a business plan, prototypes and additional research, prior to bringing a product to market and commercial large-scale manufacturing (see Section I above).

**Series**: A round of VC/PE financing. Each sequential round is distinguished by a letter: A, B, C, etc (see paragraph 1 in Section IV above).
Shareholders' Agreement/Investor Rights Agreement: Many of the rights between shareholders in a company are set out in its Bylaws. This is a public document that is filed at Companies House. In many cases shareholders will want to create rights and obligations between them that they would prefer to keep confidential. In such cases, rather than put those rights and obligations into a public document they will enter into private contractual arrangements, in a document such as a shareholders' agreement. If the agreement also includes terms relating to the subscription for shares it will often be referred to as the Investment Agreement (see Section II above).

Share Option: An agreement providing for the purchase or sale of shares of shares within a stipulated time and for a certain price (see paragraph 21 in Section IV above).

Strike price or Exercise price: The price of the underlying share at which a call or put option is exercisable.

Subscription Agreement: A subscription agreement sets out the terms upon which an investor will subscribe for shares in a company. If the agreement also includes terms relating to shareholders' rights it may also be described as an Investment Agreement (see above).

Sweat Equity: Equity (shares in a company) that is given to the founder of the company in recognition of the effort (sweat) that he has expended in getting the company started up (see Section III and paragraph 9 in Section IV above).

Syndication: An arrangement whereby a group of investors come together to invest in an investment proposition that they would not be prepared to consider individually whether because of risk or amount of funding required. There is however usually a lead investor (see Section II above).

Tag along rights: A mechanism to ensure that if one investor or founder has an opportunity to sell shares the other shareholders are also given that opportunity on a proportional basis. (see paragraph 11 in Section IV above).

Trade Sale: Sale of a company to another company. As a form of exit, it is an alternative to flotation and more common (see paragraph 18 in Section IV above).

Trade Secret: Information, such as a formula, pattern, device, or process, that is not known to the public and which gives the person possessing the information a competitive advantage. May sometimes include customer lists, marketing and/or business plans, and details of suppliers and customers.

Tranching: Investment made in stages; each stage being dependent on achievement of targets or milestones (see paragraph 2 in Section IV above).

Transfer Restrictions: Restriction of the sale of shares by founders, management or investors for a predefined period of time or until certain conditions have been fulfilled (see paragraph 11 in Section IV above).

Use of Proceeds: The purpose to which the company intends to use the funds raised from new investors. The investment documentation often stipulates that the funds must be used for this purpose.
**Vesting:** Where an employee or consultant has been granted rights to receive options or has been issued shares that are subject to his completing a specific length of service or achieving certain milestones, the options or shares will have vested when the period or milestone has been satisfied. Once vested the employee or consultant is entitled to exercise those options to obtain shares or to receive full rights to the shares (see paragraph 9 in Section IV above).

**Warrant:** Another word for an option to purchase a security. The term is generally used for options provided by the company to outside investors (as distinct from officers, employees, etc).

**Weighted Average:** Anti-dilution provisions that apply a weighted average formula to adjust the option price or conversion ratio of an early-round investor, based on the sale price and number of equivalent shares sold by the company after the issuing of the option or convertible security (see paragraph 8 in Section IV above).
VII  Example of a Brazilian Term Sheet for Series A round

INVESTORS/[COMPANY NAME]

CLASS A NON-VOTING PREFERRED STOCK

INDICATIVE TERM SHEET

___, 200__

The intent of this document (this “Term Sheet”) is to describe, for negotiation purposes only, some key terms of the proposed agreement between ___. (“___”), and [___] (the “Company”) and together with ___, (the "Parties").

25.1  Non-Binding – For Discussion Purposes Only
This Term Sheet is non-binding and is intended solely as a summary of the terms that are currently proposed by the Parties, except for the paragraph immediately below regarding confidentiality. A binding agreement will not occur unless and until all necessary corporate approvals have been obtained and the Parties have negotiated, approved, executed and delivered the appropriate definitive agreements. The Parties acknowledge that they neither intend to enter, nor have they entered, into any agreement to negotiate any definitive agreements pursuant to this Term Sheet, and either Party may, at any time prior to the approval, execution and delivery of such definitive agreements, propose different terms from those summarized herein or unilaterally terminate all negotiations pursuant to this Term Sheet for any reason and without any liability whatsoever to the other Party. Unless otherwise agreed to in writing, each Party shall be solely liable for all of its own fees, costs and other expenses in conjunction with negotiation and preparation of any definitive agreements pursuant to this Term Sheet.

Confidentiality
The terms and conditions described in this Term Sheet including its existence are confidential information and shall not be disclosed by either party to any third party. If either party determines that it is required by law to disclose information regarding this Term Sheet or to file this Term Sheet with the U.S Securities and Exchange Commission, the Brazilian Securities and Exchange Commission (Comissão de Valores Mobiliários – “CVM”), the Brazilian Antitrust Agency (Conselho Administrativo de Defesa Econômica – “CADE”) or any other relevant securities exchange, regulatory authority or governmental agency, it shall, a reasonable time before making any such disclosure or filing, consult with the other party regarding such disclosure or filing and seek confidential treatment for such portions of the disclosure or filing as may be requested by the other party.

Description of Financing Round
Total round of R$[***], representing [***]% of the Company (post-financing) at an implied pre-
money Company valuation of R$[***]

**Securities to be Issued in Round**
[***] Convertible Class A non-voting preferred Shares (“Preferred Shares”) of the Company, initially convertible 1-for-1 into Common Shares, at a purchase price of R$[***] per share (same price for all investors)

The Purchase Price is calculated by dividing (1) the pre-money valuation by (2) the fully-diluted amount of Common Stock and “common stock equivalents” outstanding immediately before the Closing, including without limitation:

(a) All issues and outstanding Common Stock and Preferred Stock;
(b) All outstanding options to purchase Common Stock or Preferred Stock;
(c) All options available for issuance under the Company’s currently approved employee stock plan, as amended; and
(d) Any other outstanding commitments, contingent or otherwise, to issue shares or options, or including any and all securities or obligations convertible into Common Stock or Preferred Stock.

**Investors**

_____ : R$[***] for [***] Preferred Shares ([***]% of Company fully-diluted)
_____ : R$[***] for [***] Preferred Shares ([***]% fully diluted)
_____ : R$[***] for [***] Preferred Shares ([***]% fully diluted)

**Closing Date**
As soon as practicable, subject to appropriate closing conditions.

**Rights and Preferences of Class A Preferred:**

**Dividend Rights**
The Bylaws shall contemplate that the Class A Preferred would be entitled to an annual per share cumulative minimum dividend equal to at least ___% of the whole amount of the net profit, payable in every fiscal year that shows net profits, accumulated profits or profits reserves. The dividends would be cumulative and would be paid prior to payment of any dividend with respect to the Common Stock. After payment of the preferential dividend to the holders of the Class A Preferred, any further dividends would be paid *pari passu* to the holders of the Class A Preferred and the Common Stock on an as-converted basis. The Class A Preferred also would be entitled to capitalize *pari passu* with the holders described immediately above the credit related to any dividends declared by the Board on a pro-rata basis.

**Liquidation Preference**
In the event of any dissolution, liquidation, or winding up of the Company, the holders of the Class A Preferred would be entitled to receive, prior to any distribution to the holders of Common Stock, the nominal value of their shares plus a premium corresponding to ___% of the value of share capital volume plus all declared but unpaid dividends thereon. After the full preference amounts on all outstanding shares of Class A Preferred had been paid, any remaining funds and assets of the Company legally available for and the Common Stock on a pro rata, as-converted basis. If the Company had insufficient assets to permit payment of the preference amount in full to all Class A Preferred shareholders, then the assets of the Company would be
distributed ratably to the holders of the Class A Preferred in proportion to the preference amounts each such holder would otherwise be entitled to receive.

**Period of Holding of the Founders**
The Founders undertake not to sell, assign or otherwise transfer, directly or indirectly, wholly or partially their shares or the rights related thereto, including the pre-emptive rights for subscription of new shares, for a period of ___ from the date of subscription. In case of breach of the Period of Holding the Founders shall be subject to a punitive fine of ___% of the total investment made by Investors pursuant to this Financing Round.

The Founders ensure the Investors, the right to receive the amounts obtained by the disposition of the Shares of the Company to which they are entitled directly from the Acquirer(s). The sale of the Shares shall only be contracted between the Shareholder(s) involved in such transfer and the Acquirer in the event the latter expressly assumes in writing the irrevocable and irreversible obligation to pay the amounts to which the Investors are entitled, directly to the Investors.

**Put Option** (see paragraph 5, Section IV)
At any time after ___ months (Period of Holding of the Founders) from the signature of the final documents, or immediately, in the occurrence of the events listed below, the holders of the Class A Preferred will have the right to put to the Founders all or any portion of the Class A Preferred, in which case the Founders will be required to purchase such shares at an exercise price per Shares equal to 100% of the Purchase Price, calculated as the amount of the investment made by the Investors in US dollars, plus a monetary correction of the IGP-M (General Index of Market Prices), of Fundação Getúlio Vargas, to be substituted by an equivalent index in case IGP-M is extinct within the period of investment, plus all declared but unpaid dividends thereon to the date of the put is exercised. The option price would be proportionally adjusted for stock splits and the like and satisfactory collateral is provided to the Investors.

The events which will immediately give the Investors rights to the put option are:

(i) Change in the corporate control of the Company, amalgamation, spin-off, and merger, involving the Company, or another transaction or a series of transactions in which the Founding Shareholders cease to hold the majority of the voting capital of the resulting company;

(ii) Sale, lease, licensing or any other transfer of all or substantially all of the assets of the Company;

(iii) Any resolution taken by the shareholders at a General Meeting, approving the distribution of dividends in an amount higher than the minimum mandatory dividends of 25% of the net profits and higher than the minimum priority dividends on Class A Preferred shares;

(iv) Sale or disposal, by the Founding Shareholders, either directly or indirectly, of all or part of their Company Shares in violation of the right of first refusal and tag-along rights; and

(v) In the event of noncompliance with the reinvestment of dividends.

The put option price would be proportionally adjusted for stock splits, stock dividends, and the
like. If on the date the put option is exercised, the Founders or the Company cannot afford to pay the put due to economical or legal reasons then such shares should be bought as soon as the Founders or the Company has funds legally available therefore.

**Conversion Rights**
The Bylaws will contemplate that the holders of the Class A Preferred would have the right to convert the Class A Preferred into shares of Common Stock at any time. The initial conversion rate for the Class A Preferred would be 1-for-1.

**Automatic Conversion**
The Class A Preferred would automatically be converted into Common Stock, at the then applicable conversion rate, upon the closing of a firmly underwritten public offering of shares of Common Stock or a trade sale. In the event an IPO is held, the Company shall undertake all actions to go public, including the obtaining of registrations at the securities commission, stock exchanges, governmental authorities, CVM and the Bovespa, as well as for trading of the Company shares at a stock exchange market or over the counter market.

**Antidilution Provisions**
The conversion price of the Class A Preferred would be subject to adjustment on a Full Ratchet basis for issuances at a purchase price less than the then-effective conversion price with a carve-out for issuances of up to ___ shares of Common Stock to employees, officers or directors of the Company pursuant to stock purchase or stock option plans or agreements or other incentive stock arrangements approved by the Board. There would be proportional anti-dilution protection for stock splits, stock dividends, and the like.

**Voting Rights**
Each share of Class A Preferred grants their holders no voting rights. The Class A Preferred would only vote as a separate class at a Special Shareholders Meeting on matters related to the Protective Provisions.

**Protective Provisions**
None of the acts below may be performed without the prior approval of at least 2/3 of the outstanding Class A Preferred, voting separately as a class at a Special Shareholders Meeting:
(i) any amendment or change of the rights, preferences, privileges or powers of, or the restrictions provided for the benefit of, the Class A Preferred; (ii) any action that authorizes, creates or issues shares of any class of stock having preferences superior to or on a parity with the Class A Preferred; (iii) any action that reclassifies any outstanding shares into shares having preferences or priority as to dividends or assets senior to or on a parity with the preference of the Class A Preferred; (iv) any amendment of the Company's Bylaws that adversely affects the rights of the Class A Preferred; (v) any merger, consolidation, acquisition or similar transaction of the Company with one or more other corporations in which the shareholders of the Company immediately after such transaction or series of transaction would hold stock representing less than a majority of the voting power of the outstanding stock of the surviving corporation immediately after such transaction, or series of transactions; (vi) the sale of all or substantially all the Company's assets; (vii) the liquidation, dissolution or filing of a bankruptcy procedure by the Company; (viii) the declaration or payment of a dividend on the Common Stock (other than a dividend payable solely in shares of Common Stock) or the redemption or repurchase of any securities, except the put option on the Founders herein granted by the Company; (ix) any increase in the authorized number of or the issuance of any additional shares of Common Stock.
or Preferred Stock; (x) any increase or decrease in the authorized number of members of the Board of Directors of the Company; (xi) incurrence of indebtedness in excess of ___, or the equivalent in Brazilian reais, at the date of the transaction; (xii) any material changes in the Company's Business Plan; (xiii) entering into any transaction or business arrangement with a company or other legal entity in which an officer, Board member, executive, or principal shareholder of the Company has a financial interest; (xiv) any reduction and increase in the Company’s capital; (xv) issuance of convertible instruments by the Company; and (xvi) any change or removal of the independent auditor or any material change in the accounting policies, practices or principles; (xvii) any grouping or splitting of shares issued by the Company; and (xviii) any transactions or series of transactions with a significant tax impact on the Company.

**Terms of the Stock Purchase Agreement and Shareholders’ Agreement**

The purchase of shares of Class A Preferred would be made pursuant to a Stock Purchase Agreement and a Shareholders’ Agreement entered into among the Company, the Founders and the Preferred Share investors, which agreement would contain, among other things, customary representations, warranties and covenants by the Company and the Founders, and customary closing conditions, including the delivery of legal opinions provided in this Term Sheet.

**Board of Directors**

The Company's Bylaws would provide for a Board of Directors. The number of directors shall not be changed except by amendment to such By-laws approved by a vote of the Class A Preferred in accordance with the Protective Provisions described above.

___ shall have the right, at its election, to appoint a representative to attend all meetings of the Board and committees thereof as an observer. At any time from the date of subscription, ___ may express its intention of electing a Board member who may be the observer himself or another person appointed by ___.

**Use of Proceeds:**

Stock Purchase Agreement will require the Company to use the proceeds from the investment for ___.

**Preemptive Rights**

As established by the Brazilian Corporation Law (Law 6,404/76, as amended), each holder of Class A Preferred would have a preemptive right to subscribe for up to its pro rata share (in proportion to their shares owned) of any new equity securities offered by the Company, on the same price and terms and conditions as the Company offers such securities to other potential investors (with a right of over subscription if any holder of Class A Preferred elected not to purchase its pro rata share). The Class A Preferred would agree to waive such rights in connection with the issuance by the Company of up to ___ shares of Common Stock (or options therefore) issued to employees, officers or directors of the Company pursuant to stock purchase or stock option plans approved by the Board. The Class A Preferred shareholders would agree to waive such preemptive rights upon the closing of a Qualified IPO.

**Right of First Refusal**

The Company, each holder of Class A Preferred, the Founders and all other shareholders of the Company would enter into a Shareholders’ Agreement which would give the holders of the Class A Preferred first refusal rights providing that any Founder or key shareholder who proposed to sell all or a portion of his shares to a third party must permit the holders of the Class
A Preferred hereunder at their option to purchase such stock on the same terms as the proposed transferee. This right would terminate upon the closing of a Qualified IPO.

**Tag Along**

If any of the Founders sell, assign or otherwise transfer to third parties, directly or indirectly, wholly or partially, the shares they held, such Founder shall ensure Investors the right to sell their shares according to the same terms and conditions respecting the provisions established in the Right of First Refusal. The Tag Along obligations assumed by the Founders do not apply to the Investors, which may freely sell, through any type of transaction, their shares or rights related thereto to the shareholders or to third parties, without being subject to any of the provisions that regulate the Right of First Refusal or the Tag-Along Right established in this Term Sheet.

**Drag Along**

In case the Investors decide to sell or otherwise, transfer, directly or indirectly, all their shares to a third party or third parties, the Investors, upon prior request in writing, shall be entitled to sell all of the Founder’s shares in the same terms and conditions and price per share.

**Information Rights**

So long as the shares of Class A Preferred were outstanding, the Company would deliver to each holder of the shares of Class A Preferred, respectively:

(i) audited annual financial statements within 90 days after the end of each fiscal year;
(ii) audited quarterly financial statements within 45 days of the end of each fiscal quarter;
(iii) non-audited monthly financial statements within 30 days of the end of each month; and
(iv) an annual budget within 30 days after the end of each fiscal year, as well as any additional information requested by CVM.

For so long as the shares of Class A Preferred were outstanding, such holders would have standard inspection rights. These information and inspection rights would terminate upon the Qualified IPO. Following the Company's Qualified IPO, the Company would deliver to each holder of shares of Class A Preferred or Common Stock issued upon conversion of Class A Preferred, copies of the Company's Annual Informative (“IAN”), Standardized Financial Information (“DFP”) and Quarterly Information (“ITR”), as well as Annual Reports to Shareholders promptly after such documents were filed with the CVM and other applicable Securities and Exchange Commissions.

**Registration Rights**

The Company shall take all action required to go public, including the obtaining of registrations at the Securities Commission (Comissão de Valores Mobiliários – CVM) and the Stock Exchange, as well as for trading of the Company Shares at a Stock Exchange or over-the-counter market, so that the Investors may carry out a secondary distribution of the Shares held thereby in the Company, in accordance with the criteria and in the manner to be defined by the Investors. Any expenses incurred with such transaction and inclusion of the preferred shares shall be borne by the Company.

If Company makes available any type of share of its share capital at a stock exchange other than the Brazilian stock exchanges, the above agreed terms shall apply, being adapted, if necessary, according to the applicable law of each location and, in this case, the Investors shall have the right to also sell their preferred or converted shares as part of such trading, in a proportional and
preceding manner to any other shareholders.

**[FOREIGN EXCHANGE REGISTRY - SUGGESTION OF TERMS]**

1. **Expenses**: The Company would bear the registration expenses (excluding underwriting discounts and commissions but including all other expenses related to the registration) of all such demand.

2. **Transfer of Rights**: The registration rights may be transferred.

3. **Termination**: The registration rights would terminate 7 years after the closing of this financing and would not apply to any holder who can sell all of such holder's shares in any three-month period without registration pursuant to Rule 144 promulgated under the 1933 Act.

4. **Additional Registration Rights**: The Company would not grant registration rights to any other holder of the Company's securities superior to those granted to the holders of the Class A Preferred without the prior approval of the a majority of the Class A Preferred.

5. **Market Stand-Off**: The holders of Class A Preferred would agree, upon the request of the Company and the managing underwriter, to enter into an agreement to not sell shares of the Common Stock for 180 days following the Company’s initial public offering, so long as all directors, officers and 1% stockholders entered into similar agreements. The holders of Class A Preferred would have the right to be released pro-rata from such agreement in the event the underwriters released any other stockholders from similar agreements.

6. **Corporate Governance**: The Company will need to amend its charter in order to reflect a high standard of corporate governance practices.

In the event the Qualified IPO occurs on an exchange not in Brazil or in the US, the above provisions would be read to provide similar rights.

**Share Restrictions**
The Founders and the Investors agree that the shares subject to this Term Sheet shall not be offered to pledge or escrow, or in any manner granted as guarantee.

**Confidentiality and Disclosures**
The terms and conditions of the financing, including its existence, would be confidential information and would not be disclosed to any third party by the Company except as provided below. The Company would be able to disclose the existence of the financing, as well as Investor's investment in the Company, solely to the Company’s investors, investment bankers, lenders, accountants, legal counsel, bona fide prospective investors, and employees, in each case only where such persons or entities were under appropriate nondisclosure obligations. In addition, the Company would be able to disclose the fact that the investors have invested in the Company to third parties without the requirement for nondisclosure agreements. Within sixty (60) days of the Closing, the Company would be able to issue a press release disclosing that the investors have invested in the Company; provided that the release does not disclose the amount or other specific terms of the investment and the final form of the press release is approved in advance in writing by the investors. No other announcement regarding investors' investment in
the Company in a press conference, in any professional or trade publication, in any marketing materials or otherwise to the general public would be made without the prior written consent of the investors, which consent could be withheld at the sole discretion of the investors. The Company would also have the right to disclose to third parties any information disclosed by the investors in a press release or other public announcement. In the event of a disclosure required by law, including by the SEC or CVM, the disclosing party would use all reasonable efforts (and cooperate with the other party’s efforts) to obtain confidential treatment of materials so disclosed. Exchanges of information between the Company and the investors (including with any board observer) shall be governed by the Corporate Nondisclosure Agreement between the Company and the investors.

Confidential Information and Invention Assignment Agreement
Each key officer and employee of the Company would have entered into an acceptable confidential information and invention assignment agreement. The Company would use its best efforts to have the remainder of the employees and officers sign such an agreement.

Legal Fees
The Company would pay a flat fee of R$___ to investors for investors' expenses (whether external or internal) arising in connection with the transactions contemplated by this term sheet. The Company would pay such a fee to the investors, according to instructions (to be defined later) in the form of a certified check.

Brazilian Antitrust Agency – CADE
The Company and the Founders shall, severally and jointly, undertake full and exclusive liability for the compliance with any and all obligation arising from this Term Sheet before the Administrative Council of Economic Defense and other Brazilian antitrust bodies, according to the applicable law in force. The Company and the Founders hold the Investors harmless from any and all liabilities (and related costs, expenses, disbursements and/or payments) arising from or in any manner related to any CADE’s award, decision, order or any other CADE’s pronouncement, whether final or interlocutory, including, but not limited to a CADE’s decision that imposes fines or penalties and/or considers the submission as untimely and/or determines any restrictions to the transaction, including, but not limited to the reversion of the transaction or of any transaction related thereto, as well as regards any other transaction involving any of the Founders which CADE is or may be aware of, whether such transaction has been already submitted to CADE or not.

Other Terms Not Covered
In the event that any of the Company’s existing equity shareholders are entitled to any rights, privileges or protections on terms more favorable than those herein afforded to the Class A, the Class A Preferred and shall be entitled to the benefits of such more favorable terms and the Company’s Bylaws will be modified accordingly.

Freedom of Dealing
Investors or related entities shall not be prevented of making investments in any entity that might be considered competing, directly or indirectly, with the Company or its affiliates.

Governing Law
Brazil
Arbitration
Any disputes arising directly from this transaction shall be submitted to arbitration, which shall be binding on the Founders and Investors. Before instating arbitration proceedings, the parties shall, by mutual agreement, lay down the rules to be followed during arbitration proceedings, taking into account the nature of the dispute. If the parties fail to agree on the rules to be followed in arbitration proceedings, the parties agree to adopt the rules of the Arbitration Panel of the São Paulo State Industry Federation (Federação das Indústrias do Estado de São Paulo – FIESP). The arbitration proceedings shall be carried out in the City of São Paulo, State of São Paulo, Brazil, and shall be conducted in the English language by the FIESP Arbitration Panel.

Capitalization
The current capitalization of the Company on a fully-diluted basis as of the date of closing (immediately prior to the investment) and after investment will be as follows: ___

Employee Vesting
Options or Stocks issued to employees, directors and consultants under an Employee Stock Option Plan (the “ESOP”) would be subject to [vesting]/repurchase over four years. At least ___% of each Founder’s or Key Employee's (as applicable) shares would be subject to ___ years of vesting.

Each of the Founders and Key Employees has/will execute a Stock Restriction Agreement covering the options or shares from that ESOP held by such Founder or Key Employees which provides that any unvested options or shares from that ESOP may be repurchased by the Company for the original issue price in the event the employment of such Founder or Key Employees is terminated.

Due Diligence
Due Diligence will include, but is not limited to, accounting, tax, legal, as well as business, technical, operational, and economic evaluation of Company and its subsidiaries (if applicable). The Company shall provide The investors and its advisors with full access to all personnel, documentation and information needed to conduct the Due Diligence.

Conditions Precedent for Closing
Standard conditions precedent including, without limitation, completion of legal due diligence satisfactory to The investors in their sole and absolute discretion. In addition, prior to Closing, the Company shall deliver the following, in form and substance acceptable to The investors in their sole discretion:

1. Certified copy of the Company's Bylaws or articles of association duly filed at the local commercial registry; minutes of the Stockholder Resolutions and Meetings approving the transactions proposed herein; the resolution of the Company's Board of Directors approving and authorizing the issuance of all outstanding Common Stock of the Company; and the resolutions of the Company's Board of Directors approving and authorizing the execution of all Proprietary Information and Inventions Agreements, Employment Agreements and Non-Compete Agreements.

2. Copy of the relevant corporate documents, the relevant pages of the Company’s
Registered Share Register and a true and accurate shareholder table reflecting that the shares indicated above under Capitalization have been duly authorized and issued.

3. Copies of the Proprietary Information and Inventions Agreements or other similar agreements executed by all officers, employees and consultants of the Company who do not enter into an employment agreement with the Company.

4. Copies of executed Employment Agreements for key officers and/or a list of the key employers, officers and managers.

5. Copies of executed Non-Compete Agreements for officers, employees and consultants of the Company who do not enter into an employment agreement with the Company.

6. Execution by the Company of the Securities Purchase Agreement, Shareholders’ Agreement and other transaction documents satisfactory to the investors in their sole and absolute discretion.

7. Compliance by the Company with applicable laws, including securities laws.

8. Opinions of counsel for the Company with respect to the foregoing from Brazilian counsel.

9. A strategic business plan, including investment requirements and detailed 3-year financial projections, to be developed by the Company and approved by the Board of Directors prior to the closing.

10. Resolution and agreement satisfactory to the investors on the terms and conditions of all management and affiliated parties contracts;

11. All necessary legal or regulatory approvals;

12. No material adverse change in the facts regarding the Company and its prospects as represented to the investors.

13. Delivery of audited consolidating balance sheets, income statements, and statement of cash flows prepared in accordance with Brazilian GAAP, and with the ___ version of GAAP and non-audited consolidating balance sheets, income statements, and statement of cash flows prepared in accordance with Brazilian GAAP, and with the ___ version of
14. All of the capital stock of the Company must be fully paid up.

15. Copies of the following certificates: (i) Federal Taxes (Income Tax; Tax on Manufactured Products - IPI; Profit Participation Program - PIS; Social Security Financing Contribution - COFINS; Social Contribution); (ii) Debt Clearance Certificate - CND issued by the Brazilian Social Security Institute - INSS; (iii) Overdue Debts to the Federal Government; (iv) Clearance Certificate – CRS – FGTS Good Standing Certificate (FGTS Clearance Certificate); (v) State Taxes; (vi) Municipal Taxes (Tax on Services - ISS - License Fee); (vii) Federal Court Certificate; (viii) Civil Distributor Certificate (Cases under Way); (ix) Civil Distributor Certificate (Bankruptcy and Concordata); (x) Certificate issued by the Tax Execution Distributor (State and Municipal); (xi) Criminal Distributor Certificate; (xii) Labor Court Certificate; (xiii) Protest Office Certificate; (xiv) State Government Attorney’s Office/Prevention Sector/On-the-job Accidents Prosecutors’ Office; (xv) State Government Attorney’s Office/Consumer Affairs Prosecutors’ Office; (xvi) State Government Attorney’s Office/Environmental Affairs Prosecutors’ Office (public/civil investigations).

This Term Sheet supersedes all prior discussions and agreements between the Parties with respect to the subject matter hereof, and contains the sole and entire agreement between the Parties hereto with respect to the matters referred to immediately above.