



## NACO Common Docs

In Q1 of 2017, NACO created a task force of members and stakeholders, including leading law firm partners, to develop nationally applicable and accepted best practices for structuring Angel stage deals.

The goal of the project was to develop standards that guide investors to structure deals that:

- Align the interests of the investor and investee;
- Position the company for future investment and growth;
- Protect the rights of the investor;
- Reduce the friction inherent in negotiating deal terms;
- Advisor Agreements;
- Automated Template tools.

The following organizations partnered with NACO and provided the necessary resources to make this initiative possible.

National Best Practice Partners:



Founding Partners



## STANDARD NACO TERM SHEET for CONVERTIBLE LOAN

[DATE]

### A - MINIMUM REQUIRED TERMS

**1. Issuer**

[Name] (the “Corporation”)

**2. Business**

The Corporation is a [City]-based [Insert brief description of business].

## A - MINIMUM REQUIRED TERMS

### 1. Issuer

[Name] (the “Corporation”)

### 2. Business

The Corporation is a [City]-based [*Insert brief description of business*].

### 3. Financing

The Corporation is proposing to borrow through a convertible loan of no less than \$[1,000,000] (the “Convertible Loan” or the “Financing”) from a group of lenders (the “Lender” or “Lenders”).

### 4. Closing Date

The Financing will close on or about [Date] (the “Closing Date”), on which date the Corporation and the Lenders will execute one or more Convertible Loan Agreements.

### 5. Use of Proceeds

The Corporation will use the net proceeds of the Convertible Loan to complete the first release of its product, fund marketing activities and general corporate purposes.

### 6. Capitalization

The Corporation’s share capital consists of common shares (“Common Shares”) and options to purchase Common Shares (“Options”) [*describe other classes of shares, if any*]. As of the date of this term sheet, the Corporation has [2,000,000] Common Shares issued and outstanding, [200,000] Options are reserved under the Corporation’s Share Option Plan (of which [150,000] have been granted).

There are no other securities of the Corporation outstanding. A capitalization table is attached as a schedule to this term sheet.

### 7. Maturity Date

The maturity date will be [•] months from the Closing Date which is [Date] (the “Maturity Date”). Principal and unpaid accrued interest on the Convertible Loan will be due and payable on the Maturity Date.

### 8. Interest

[6-8 is the normal range]% per annum. Interest will accrue, be compounded and calculated monthly, and may be converted into Common Shares of the Corporation on the same terms as the principal.

### 9. Conversion

(A) If the Corporation completes a private placement of equity securities for gross proceeds of at least \$[1,000,000] in one or multiple closings (excluding any indebtedness converted pursuant to the Convertible Loan) (a “**Significant Financing**”), then at the closing of such Significant Financing all of the Convertible Loan and accrued interest (together the “**Conversion Amount**”) will be automatically and concurrently converted into equity securities of the same class as those issued in the Significant Financing at a price equal to the lower of:

- (i) the price paid per equity security in the Significant Financing; and
- (ii) the pre-money price per equity security (on a fully diluted basis) of the Corporation assuming a pre-money valuation of CDN\$[ • ](the “**Capped Price**”),

less a [10 - 30]% discount to the final conversion price, and otherwise on the same terms and conditions as the investors under the Significant Financing.

(B) Upon an amalgamation, merger, reorganization or sale of shares of the Corporation which results in a change of control, an initial public offering of equity securities of the Corporation or a sale of all or substantially all of the Corporation's assets (each a “**Change of Control**”), the Conversion Amount will be automatically and concurrently converted into the senior most class of issued and outstanding shares of the Corporation at a price equal to the lower of:

- (i) the price per the senior most class of issued and outstanding shares of the Corporation based on the valuation given in connection with the event triggering the Change of Control; and
- (ii) the Capped Price,

securities of the Corporation or a sale of all or substantially all of the Corporation's assets (each a "**Change of Control**"), the Conversion Amount will be automatically and concurrently converted into the senior most class of issued and outstanding shares of the Corporation at a price equal to the lower of:

- (i) the price per the senior most class of issued and outstanding shares of the Corporation based on the valuation given in connection with the event triggering the Change of Control; and
  - (ii) the Capped Price,
- less a **[10 - 30]**% discount to the final conversion price.
- (C) The Conversion Amount may also be converted into the senior most class of issued and outstanding shares at the Lender's sole option at any time prior to the Maturity Date (or after the Maturity Date unless previously converted or repaid in full) at a price equal to the lower of:
- (i) the lowest price per the senior most class of issued and outstanding shares of the Corporation based on the valuation given in its most recent external equity financing; and
  - (ii) the Capped Price,
- less a **[10 - 30]**% discount to the final conversion price.

*Note: in the case of (C) if no 'price' can be established, the Corporation and Lenders will have to refer a valuation decision to an independent third party evaluator to establish a fair market value (FMV) for the Common Shares in order to determine the conversion price.*

*It may also be useful to provide for automatic conversion of all indebtedness under the Financing if approved by a majority-in-interest of all Lenders.*

*Optional:*

- (D) *The Conversion Amount will automatically be converted into Common Shares on the Maturity Date at a price equal to the lower of:*
- (i) *the lowest price per share of the Corporation based on the valuation given in its most recent external equity financing; and*
  - (ii) *the Capped Price,*
- however, where no such external equity financing has occurred after the Closing Date, the price will be the Capped Price. An external financing is a financing which includes investors other than the current directors, officers and employees of the Company completed after the Closing Date.*
- less a **[10 - 30]**% discount to the final conversion price.*

## **10. Prepayment**

The Corporation does not have the right to prepay any indebtedness without the prior written consent of each Lender or, but may prepay all indebtedness under the Financing with approval of [**•**%] of the Lenders.

## **11. Information**

The Corporation will provide the Lenders with the following:

- (a) annual reviewed (or audited, if available) consolidated financial statements for the Corporation (including its income statement, balance sheet and cash flow statement) within 90 days of the Corporation's financing year-end;
- (b) management prepared (in accordance with GAAP) quarterly financial statements within 30 days of the end of each quarter and accountant prepared year-end financial statements (audited if required by law, but if waived Notice to Reader at a minimum) within 90 days of each fiscal year end;
- (c) quarterly management reports within 30 days of the end of each quarter;
- (d) a (board-approved) budget at the start of each fiscal year and any amendments thereto; and
- (e) any other document reasonably requested by the Lender.

*Optional:*

- (f) *reports and updates that the Lenders may reasonably ask for from time to time;*
- (g) *access to a metrics platform (Hockeystick, Klipfolio, Google Docs) to share regularly updated data (if appropriate for business); and*
- (h) *monthly updates.*

If a voting trust is in place this information will be shared with the trustee who will disseminate among the Lenders that are bound by the voting trust.

## **12. Events of Default**

The Convertible Loan Agreement will include standard Events of Default provisions, including but not limited to insolvency/bankruptcy, material and unremedied breach of

share regularly updated data (if appropriate for business); and  
(h) monthly updates.

If a voting trust is in place this information will be shared with the trustee who will disseminate among the Lenders that are bound by the voting trust.

## **12. Events of Default**

The Convertible Loan Agreement will include standard Events of Default provisions, including but not limited to insolvency/bankruptcy, material and unremedied breach of agreements, criminal offense or material breach of law that has a material effect on the Corporation, and failure to make any payment when due. Upon an Event of Default all of the Conversion Amount and obligations of the Corporation to the Lenders under the Convertible Loan will be immediately due and payable.

## **13. Vesting**

All Common Shares and share equivalents (including options) issued to founders and certain other key persons will be subject to customary vesting provisions that, to the extent they are not in place, will be incorporated in founder and key person employment agreements, the execution of which will be a condition precedent to closing.

## **14. Due Diligence**

This term sheet does not provide a description of material information sufficient to describe the business and affairs of the Corporation. Lenders may conduct such due diligence inquiries as they consider appropriate and will be provided access, subject to standard confidentiality provisions, to material documentation and information concerning the business, the Corporation and its respective management and third party advisors. Lenders should, in conjunction with their professional advisers, make their own assessment of the merits and risks of the Convertible Loan.

## **15. Closing Conditions**

Closing of the Financing will be subject to customary closing conditions, including but not limited to:

- (a) minimum Financing raised;
- (b) completion of due diligence;
- (c) execution of employee and key person employment agreements which include vesting provisions (if applicable), NDAs and IP assignment (and may include key person insurance);
- (d) appointment of board of directors;
- (e) confirmation that the Corporation is a Canadian Controlled Private Corporation (CCPC);
- (f) completion of all legal documentation and corporate minute book being up to date;
- (g) establishment of a [new] [amended] Share Option Plan; and
- (h) no material adverse change.

*A number of these are optional and will often depend on each situation, they will need to be negotiated in each investment case.*

## **16. Subscriptions**

**The Convertible Loan is only available to accredited investors and friends, family or close business associates, in reliance on an exemption from the prospectus requirements in Canada as outlined in National Instrument 45-106.**

The minimum commitment is \$[50,000] per Lender. Individual commitments will not be scaled back in case of an oversubscription.

## **17. Documentation**

On the Closing Date, the Corporation and the Lenders will execute and deliver Convertible Loan Agreements and such other documents as are necessary to complete the Financing.

## **18. Cost and Legal Counsel**

The Corporation agrees to bear its own costs and cover Lenders legal costs up to a maximum of \$[●] in the aggregate.

or

Each party to this term sheet agrees to bear its own legal costs.

## **19. Confidentiality**

The Corporation and the Lenders will refrain from publicity and not disclose any information

**18. Cost and Legal Counsel**

The Corporation agrees to bear its own costs and cover Lenders legal costs up to a maximum of \$[●] in the aggregate.

or

Each party to this term sheet agrees to bear its own legal costs.

**19. Confidentiality**

The Corporation and the Lenders will refrain from publicity and not disclose any information concerning this term sheet, including its existence, without the written approval of the other party, except as required by law and provided that the parties may disclose information to their accountants, legal counsel and other professional advisors.

**20. Expiry**

This term sheet expires at [Time] on [Date].

**21. Binding Nature**

This term sheet is non-binding, except for Sections 18, 19, 20, 21 and 22, which are intended to be binding and which will survive termination of this term sheet.

**22. Governing Law**

**This term sheet is governed by the laws of [Province] and applicable federal law of Canada.**

**B - EXTENDED TERMS**

**B1. Lenders**

[Name] and other investors acceptable to the Corporation (collectively the “Lenders” and each a “Lender”). The Lenders will appoint a single investor to lead the Financing with the Corporation (the “Lead Lender”). The Lead Lender (in consultation with the other Lenders) shall finalize the terms of the Financing, as described herein.

**B2. Security**

The security offered to the Lenders will consist of the following:

- (a) general security agreement from the Corporation providing a security interest in all present and after-acquired personal property, subject to permitted prior charges; and
- (b) the postponement and subordination of all shareholders loans in favour of the Lenders.

**B3. Exclusivity**

From the date of acceptance of this term sheet until the earliest of (a) the Closing Date (b) the formal termination of negotiation by both the Lenders and the Corporation, the Corporation will not directly or indirectly solicit, initiate or participate in any discussions or negotiations with, or encourage or respond to any inquiries or proposals by any persons, Corporation or group other than the Lenders, concerning any financing or sale of the Corporation without prior approval of the Lenders.

*Option: add a time limit to this period, e.g. 90 days.*

**B4. Board of Directors**

The Corporation’s board of directors currently consists of [two] directors. Upon completion of the Convertible Loan, the board of directors will be increased in size to [three] directors, and the Lenders will have the right to appoint [one] of the [three] directors.

or

The Lenders will have the right to appoint an observer.

*Board appointment rights are not as common for convertible loan, financings, as for subsequent equity rounds.*

**[Signature Page Follows]**

Yours truly,

**[CORPORATION]**

*subsequent equity rounds.*

**[Signature Page Follows]**

Yours truly,

**[CORPORATION]**

Per: \_\_\_\_\_  
Name:  
Title:

ACCEPTED AND AGREED \_\_\_\_\_, 20 \_\_\_\_.

**[INVESTOR]**

Per: \_\_\_\_\_  
Name:  
Title: