

NewCo Sale of Series C Preferred Stock

Summary of Terms and Conditions

1. General

- 1.1 Issuer NewCo (the “Company”)
- 1.2 Investors XXX I, L.P. and its affiliates (“Investor”) and other investors acceptable to Investor (collectively the “Investors”)
- 1.3 Amount of Financing An aggregate of \$XXX, of which Investor will invest \$XXX and other mutually acceptable investors must invest a minimum of \$XXX (the “Other Investors”). The minimum must be collectively committed in order to effect the transaction (the “Closing”).
- 1.4 Type of Security Series C Convertible Preferred Stock (the “Series C Preferred”), initially convertible on a 1:1 basis into shares of the Company’s Common Stock (the “Common Stock”).
- 1.5 Valuation The price per share (the “Original Purchase Price”) will be calculated based upon a fully-converted, fully-diluted pre-money valuation of \$XXX.
- The pre-money valuation includes the equity value of the option pool and any pre-existing warrants such as those associated with any bridge financings.
- 1.6 Employee Option Pool The Company will reserve up to a total of [Total Number or Percentage of Shares of Common Stock reserved for issuance under Employee Plans] shares of common stock for issuance to officers, directors, employees and consultants of the Company. These shares (of which approximately [Number or Percentage of Shares of Common Stock which have already been issued] have been issued as reflected on the Capitalization Table hereto), will be issued from time to time under such stock option agreements or plans, restricted stock purchase agreements, or other options, arrangements, contracts or plans as are recommended by the senior management of the Company and approved by the Compensation Committee of the Board of Directors of the Company.
- 1.7 Capitalization Table See “Capitalization Table” below.

1.8 Use of Proceeds

The proceeds from the sale of the Series C Preferred will be used for working capital and general corporate purposes and not to reduce any outstanding indebtedness (other than ordinary course trade payables) or to make payments to stockholders or other affiliates of the Company (other than accrued deferred compensation to employees not to exceed approximately \$XXX in the aggregate as of Mo XX, 2003, which amount may increase by not more than approximately \$XXX in the aggregate for each two week period thereafter). [Pro Investor add: "in accordance with a budget to be delivered to the Investors prior to the Closing" or "pursuant to the Company's business plan as previously provided to the Investors".]

1.9 Anticipated Closing Date XXX

2. Terms of Series C Preferred Stock

2.1 Dividends

The holders of the Series C Preferred shall be entitled to receive compounded, accruing dividends in preference to any dividend on the Common Stock at the rate of 8% of the Original Purchase Price per annum, which shall accrue whether or not declared or paid by the Board of Directors and payable when and as declared by the Board of Directors. The holders of Series C Preferred also shall be entitled to participate pro rata in any dividends paid on the Common Stock on an as-converted basis.

2.2 Liquidation Preference

In the event of any liquidation or winding up of the Company, the holders of the Series C Convertible Preferred Stock [and Series YYY Preferred] (collectively, the "Preferred Stock") shall be entitled to receive in preference to the holders of the Common Stock [add: preference to earlier series, etc., possibly pari passu], a per share amount equal to their respective Original Purchase Price plus any accrued but unpaid dividends (the "Liquidation Preference"). After the payment of the Liquidation Preference to the holders of the Preferred Stock, the remaining assets shall be distributed ratably to the holders of the Common Stock and the Preferred Stock on an as-converted basis. A merger, acquisition, sale of voting control or sale of substantially all of the assets of the Company in which the shareholders of the Company do not own a majority of the outstanding shares of the surviving corporation shall be deemed to be a liquidation (or "Change of Control").

2.3 Conversion

The holders of the Series C Preferred shall have the right to convert the Series C Preferred, at any time, into shares of Common Stock. The initial conversion rate shall be 1:1, subject to adjustments to reflect stock dividends, stock splits and similar events as provided herein.

2.4 Automatic Conversion

The Series C Preferred shall be automatically converted into Common Stock, at the then applicable conversion price, (i) in the event that the holders of at least a majority of the outstanding Preferred Stock consent to such conversion or (ii) upon the closing of a firmly underwritten public offering of shares of Common Stock or securities convertible into Common Stock of the Company at a per share price not less than five times the Original Purchase Price (as adjusted for stock splits, dividends and the like) per share and for a total offering of not less than \$XX million (before deduction of underwriters commissions and expenses) with a nationally recognized underwriter (a "Qualified IPO").

2.5 Anti-dilution Provisions

[Time Frame, e.g. "Prior to an IPO" or "Up to 3 years following Closing", etc.], the conversion price of the Series C Preferred will be subject to ["full ratchet"] ["weighted average"] adjustment to prevent dilution in the event that the Company issues additional shares of Common Stock, convertible securities or warrants or grants stock options or issues other common stock equivalents (other than Excluded Stock, as defined below) at a purchase price less than the applicable conversion price and which closes any time that the Series C Preferred is outstanding.

[Alternative for Full Ratchet Adjustment] [In such event, the conversion price of the Series C Preferred will be reduced to such lower price of the Subsequent Offering in order to prevent dilution.] [Investors: Consider providing for full ratchet for a period of time followed by weighted average.] [Note to Practitioner: To keep the term sheet brief, you may wish to use alternative #1, especially if the parties to the transaction are sophisticated and familiar with the terms. Otherwise alternative #2 is more specific and may be used. Also, the term "weighted average" is sometimes referred to as "half ratchet".]

[Pro Company: The above anti-dilution rights shall be contingent upon the holders of Series C Preferred continuing to participate at a level equal to or greater than the lesser of their pro rata allocation or one (1) times their original investment amount cumulatively, in future equity financings within a 36 month period from closing.]

"Excluded Stock" shall mean (1) securities issuable upon conversion of any of the Series ___ Preferred, (2) securities issued upon the conversion of any debenture, warrant, option or other convertible security outstanding at the time of the closing, (3) securities issuable upon a stock split, a stock dividend or any subdivision of shares of Common Stock, provided that the securities issued pursuant to such stock split, stock dividend or subdivision are limited to additional shares of Common Stock, (4) [up to an aggregate of [Number of Shares]] shares of Common Stock (or options to purchase such shares of Common Stock) issued or issuable to officers, employees or directors of, or consultants to, the Company pursuant to any stock purchase or option plan or other employee stock bonus arrangement as approved by the Company's Board of Directors, (5) securities issuable pursuant to a firm commitment underwritten public offering, (6) any securities issued by the Company in connection with any strategic alliance, joint venture or licensing agreement where the parties to such venture are not financial investors provided that the issuance of such securities does not exceed [Percentage]% of the total number of shares of Common Stock issued and outstanding on a fully-diluted and fully-converted basis, (7) any securities issued by the Company in connection with any acquisition and (8) [Add additional specific definitions of Excluded Stock as necessary].

2.6 Adjustments

In the event of any stock splits, stock dividends or combinations, an adjustment will be made such that the holders of Series C Preferred will hold the same relative ownership position after such action as they had immediately prior to such action.

2.7 Redemption

[Alternative 1]: The Series C Preferred is not redeemable. [Note: This may not be acceptable to the Company if the Investors are receiving coupon payments on the Series C Preferred.]

[Alternative 2 Pro Investors]: The Company will redeem the Series C

Preferred upon demand of holders of [Percentage]% of the Series C Preferred after [Date]. [Alternative 3 - add staggered redemption] Such redemption to be [Percentage]% of the total Series C Preferred in each of the years [List Years] [Pro Investors add: with dividends accruing until the date of redemption on the unredeemed or unconverted shares]. The redemption price will be paid by the Company in cash and will be equal to the Liquidation Amount, [Pro Investors add: including accrued but unpaid dividends]. To the extent that the Company may not at any such date legally redeem the Series C Preferred, such redemption will take place as soon as legally permitted. No currently outstanding class or series of capital stock of the Company shall be redeemed prior to the Series C Preferred. [Note: Practitioner will also need to describe in Redemption provision if redemption rights of all other classes of stock are subordinate to or pari passu with the Series C Preferred.]

2.8 Voting Rights

Series C Preferred stock votes on an as-converted basis on all matters. Approval of at least a 51% of the Series C Preferred stock outstanding, voting together, is required on any matter that:

- (A) alters or changes the rights, preferences or privileges of the Series C Preferred;
- (B) increases or decreases the authorized number of shares of Series C Preferred stock;
- (C) creates (by reclassification or otherwise) any new class or series of shares having rights, preferences or privileges senior to *[Pro Investors - add: or on a parity with]* the Series C Preferred;
- (D) results in the sale of any security at a common-equivalent price less than that paid for the Series C Preferred, other than shares in the Employee Pool;
- (E) results in any merger, other corporate reorganization, sale of control, or any transaction in which all or substantially all of the assets of the Company are sold, except that consent shall not be required if the Company is the surviving corporation *[Pro Investors add - and less than [Percentage]% of the Company's outstanding stock on a fully-converted and fully-diluted basis is issued to the acquired entity]* or if such transaction is a mere reincorporation;
- (F) results in a material change in the Company's line(s) of business [or enters the Company into material business activities not contemplated in the original business plan presented to the holders of Series C Preferred];
- (G) results in the Company acquiring the stock, assets or business of any other entity in any form of transaction;
- (H) amends the Company's charter or bylaws;
- (I) results in the repurchase or redemption of equity securities, or payment of dividends or other distributions on equity securities (other than the redemption of Series C Preferred);
- (J) results in the sale, transfer or encumbrance of the Company's technology other than licenses granted in the ordinary course of business;

[Any other negotiated protective provisions]. [*Practitioner Note: Practitioner may wish to have some of the above provisions terminate upon similar circumstances which may terminate the Investors anti-dilution and participation rights (See: Anti-dilution and Participation Rights and Rights of First Refusal).*]

2.9 Board of Directors

The size of the Company's Board of Directors shall be set at 5. The Board shall initially be comprised of 2 members selected by the holders of Common Stock, a nominee selected by the Series C Preferred, [and a nominee selected by the Series YYY Preferred], which nominee shall be determined by Investor. The remaining vacancy shall be an independent person mutually acceptable to the four initial directors.

At each subsequent meeting for the election of directors, the holders of the Series YYY Preferred, voting as a separate class, shall be entitled to elect one member of the Company's Board of Directors, the holders of the Series C Preferred, voting as a separate class, shall be entitled to elect one member of the Company's Board of Directors who shall be designated by Investor, two directors shall be elected by the holders of the Common Stock, and the remaining director shall be an outside director mutually acceptable to the holders of the Preferred Stock and the holders of the Common Stock.

The board shall appoint a Compensation Committee of three directors, including two of the Investor board member nominees, to set compensation, including option grants or other equity compensation and salaries of all employees over \$150,000.

The Company will reimburse the Board designees for all reasonable expenses they incur in attending Board meetings or other Board duties.

The following items will require approval by the Board of Directors by either unanimous written consent or a majority vote at a meeting:

- (A) hiring of all officers of the Company;
- (B) annual budgets and financial plans;
- (C) all real estate purchases or leases;
- (D) entrance into any unbudgeted obligations or commitments, including capital leases or purchases, with total value greater than \$50,000;
- (E) repayment of shareholder debt;

2.10 Information Rights

So long as the Investors continue to hold shares of Series C Preferred or Common Stock issued upon conversion of the Series C Preferred, the Company shall deliver to the Investors audited annual and unaudited quarterly and monthly financial statements. The Investors shall assist the Company in implementing systems and engaging professional service providers to assist in preparing such financial statements. Each Investor shall also be entitled to standard inspection and visitation rights. These provisions shall terminate upon a Qualified IPO.

2.11 Demand Rights

Commencing on the earlier of (i) 180 days after the initial public offering of the Company's equity securities pursuant to a registration statement prepared and filed with the Securities and Exchange Commission pursuant to the Securities Act of 1933, as amended, or (ii) the date which is the first anniversary of the Closing, if Investors holding more than 50% of the outstanding shares of Preferred Stock, including Common Stock issued upon conversion of Preferred Stock ("Registrable Securities"), request that the Company file a Registration Statement having an aggregate offering price to the public of not less than \$5,000,000, the Company will use its best efforts to cause such shares to be registered. The Company shall not be obligated to effect more than two registrations under these demand right provisions.

2.12 Company Registration

The holders of Preferred Stock shall be entitled to "piggy-back" registration rights, subject to a pro rata cut-back by the underwriters; provided, however, if any holder of Preferred Stock is cut-back, no party shall sell shares in such registration other than the Company. No shareholder of the Company shall be granted piggyback registration rights which would reduce the number of shares includable by the holders of the Registrable Securities in such registration without the consent of the holders of at least a majority of the Registrable Securities.

2.13 S-3 Rights

The Investors shall be entitled to unlimited demand registrations on Form S-3 (if available to the Company) so long as such registered offerings are not less than \$2,000,000.

2.14 Expenses

The Company shall bear registration expenses (exclusive of underwriting discounts and commissions) of all such demands, piggy-backs, and S-3 registrations (including the expense of one special counsel of the selling shareholders not to exceed \$40,000).

2.15 Other Provisions

Other provisions shall be contained in the Investor Rights Agreement with respect to registration rights as are reasonable, including cross-indemnification, the period of time in which the Registration Statement shall be kept effective, and underwriting arrangements.

2.16 Pre-emptive Rights

The holders of Series C Preferred will have a right to purchase shares in other equity offerings made by the Company (except for Excluded Stock, as defined in Anti-dilution) in order to maintain the same fully-diluted ownership in the Company. [Pro Investors: The holders of Series C Preferred will have the right to purchase any under-subscribed pro rata shares of other shareholders]. This right will terminate upon the Company's IPO.

[Pro Company: Notwithstanding anything contained in the Investors' Rights Agreement to the contrary, the written notice of an offer to purchase newly issued shares to which a participation right applies need not be given prior to the purchase by the party intending to purchase the newly issued shares, provided such offer is sent within [Number of Days] days thereafter and remains open for a [Number of Days] day period from the receipt thereof, and further provided that the Company has set aside a number of shares sufficient to satisfy the obligations of the Company pursuant to this participation right.]

The Company will have the right of first refusal to purchase any shares offered for sale by [List of Sellers, i.e. officers, founders, 5% shareholders or all shareholders]. Should the Company not exercise this right in full, said shares must then be offered to holders of Series C Preferred on a pro rata basis. Excluded from the right of first refusal shall be shares transferred for estate planning purposes.

[Pro Company: The above participation rights and rights of first refusal shall be contingent upon the Investors continuing to participate for their full pro rata share in any financing or sale. Any Investor who does not participate for its full pro rata share in any financing or sale will forfeit its participation right for all future rounds of financing or sales.] [Note: the above termination provision is also called 'pay to play.']

[Pro Company: The above participation rights and rights of first refusal shall terminate upon a change in control of the Company. A Change of Control shall be deemed to have taken place upon the occurrence of any of the following events: (a) a merger or consolidation in which the Company's stockholders immediately prior to the transaction do not own, directly or indirectly, at least 50% of the voting capital stock of the surviving corporation; (b) the acquisition in a single transaction or series of related transactions of more than 50% of the Company's outstanding voting capital stock by a single person, entity or group or persons or entities acting in concert, in each case who did not own at least [Percentage]% of the stock in the Company on the date of the first issuance of Series __ Preferred; or (c) the sale or transfer of all or substantially all of the assets of the Company.]

2.17 Purchase Agreement

The investment shall be made pursuant to a Stock Purchase Agreement and an Amended and Restated Investor Rights Agreement reasonably acceptable to the Company and the Investors, which agreements shall contain, among other things, appropriate representations and warranties of the Company, covenants of the Company reflecting the provisions set forth herein and appropriate conditions of closing, including an opinion of counsel for the Company.

2.18 Co-Sale Agreement

The shares of the Company's securities held by any 5% or greater shareholders shall be made subject to a co-sale agreement (with certain reasonable estate-planning exceptions) with the Investors such that such shareholders may not sell, transfer or exchange their stock unless the holders of the Preferred Stock have an opportunity to participate in the sale on a pro-rata basis. This right of co-sale shall terminate upon a Qualified IPO.

2.19 Limitations on Transfer

None of the current shareholders of the Company may transfer their shares of Common Stock (with certain reasonable estate-planning exceptions) for a period of twelve (12) months following the Closing. Thereafter, all vested shares of Common Stock owned by the current shareholders shall be subject to a right of first refusal (subject to normal exceptions), pursuant to which any current shareholder wishing to sell shares of Common Stock must first offer them for sale to the Company and to the Investors before they may be sold to a third party.

2.20 Participation in Sale

Each of the current shareholders of the Company shall agree that if the holders of the Preferred Stock wishes to sell in excess of a majority of their interest in the Company to an unaffiliated third party, then the current shareholders shall, upon the request of such holders, agree to sell a pro-rata portion of their shares of Common Stock to the third party on the same terms, including price.

3. Employee Matters

3.1 Option Vesting

The options issued to employees, will be subject to vesting as follows 25% will vest on the first anniversary of the Closing, with the remaining 75% to vest quarterly in equal installments over the next three years. In the event of a Change of Control, there will be a 50% acceleration of vesting.

The Compensation Committee of the Board of Directors will approve all options grants.

3.2 Founder Stock Vesting

Founder Stock shall follow the same vesting algorithm as "Option Vesting". For the purposes of this, XXX, YYY, and ZZZ shall be considered Founders.

3.3 Non-competition, Proprietary Information and Inventions Agreement

Each current officer, current employee shareholders and key employee shall enter into an acceptable non-competition, proprietary information and invention assignment agreement. Each current and former officer, employee and consultant of the Company shall enter into an acceptable proprietary information and inventions agreement.

3.4 Full Time Commitment

Each of the current employee shareholders will commit to devote substantially all of his or her business time to the affairs of the Company.

3.5 Key Person Insurance

The Company will obtain key person insurance on XXX, YYY, and ZZZ with the proceeds payable to the Company.

4. Other Matters

4.1 Exclusivity and Confidentiality

The Company hereby agrees not to initiate contacts with, negotiate with, or aid in the due diligence of any other potential investors or acquirers during a period of sixty (60) days from the execution of this term sheet, without the prior written consent of Investor.

The terms of this term sheet are to be kept confidential and are not to be disclosed to any person other than the Company's officers and directors and legal or financial advisors without the prior written consent of Investor.

This exclusivity period is granted in consideration of the due diligence effort conducted and to be conducted by Investor and/or the Investors.

4.2 Closing Conditions

The obligations of the Investors to purchase the Series C Preferred is subject to

- (i) completion of a satisfactory due diligence investigation of the Company
- (ii) the execution of the definitive Stock Purchase Agreement and Investor Rights Agreement
- (iii) the obtaining of all necessary consents to the transaction.

4.3 Finders

The Company and the Investors agree that there are no finders' fees associated with this transaction and shall each indemnify the other for any broker's or finder's fees for which either is responsible.

4.4 Expenses

The Company shall pay the reasonable out of pocket fees and expenses of the Investors, including the fees and expenses associated with drafting the documents, which will be done by the Investors' counsel.

All parties agree to use best efforts to minimize such costs.

4.5 QSBS Status

The Company shall provide a standard qualified small business representation and post closing covenant to provide information to the Investors as reasonably requested to cause the stock to qualify as qualified small business stock.

4.6 Directors and Officers Insurance

The Company's Certificate of Incorporation and Bylaws shall provide for indemnification of the Company's Directors and Officers to the maximum extent permitted by law. To the extent that such coverage is available on commercially reasonable terms, Company shall purchase, and at all times maintain, Directors and Officers liability insurance with coverage limits customary for similarly situated companies, but in no event less than \$2 million.

5. Capitalization Table

	<i>Before</i>	<i>Before %</i>	<i>After</i>	<i>After %</i>
Common Stock	1,000	20%	1,000	13%
Issued Options	1,000	20%	1,000	13%
Unissued Options	1,000	20%	1,000	13%
Series A Preferred	2,000	40%	2,000	25%
Series B Preferred	0	0%	3,000	38%
Fully-Diluted Common Stock Equivalents	5,000	100%	8,000	100%

The parties agree that other than the Expenses and Confidentiality and Exclusivity clauses, this Summary of Terms is non-binding. Both parties agree to use their best efforts to consummate a transaction on the terms set forth herein as soon as all due diligence, legal documentation, and other contingencies as noted in the Summary of Terms are completed to the satisfaction of Investor.

These terms are valid until XXX XX, XXXX, and may be accepted only by execution of this term sheet by an officer duly authorized to execute the same on behalf of the Company.

This agreement may be executed in counterpart.

Executed as of this XX day of XX, XXXX.

Target Inc.

By _____
Name:
Title:

Investor Inc.

By _____
Name:
Title:

OTHER INVESTORS

Name of Entity _____

By _____
Name:
Title:

Name of Entity _____

By _____
Name:
Title: