

Form: Venture Capital Term Sheet

Description: This is a sample term sheet for investment by venture capitalists in a Series B Convertible Preferred Stock round of financing in a company.

Orientation: This form tends to be pro-venture capitalist oriented.

[ABC, Inc.]

Summary of Principal Terms for an Offering of Series B Preferred Stock

Company:	[ABC Inc.] (the “Company”)
Amount:	[\$5,000,000]
Type of Security:	Series B Convertible Preferred Stock
Number of Shares:	[1,000,000]
Price per Share:	[\$5.00] (the “Original Purchase Price”). The Original Purchase Price represents a fully-diluted pre-money valuation of [\$50] million.
Investors:	[SD Venture Fund] and its affiliated funds (collectively referred to as the “Investors”)
Anticipated Closing Date:	_____
Pari Passu:	Except as set forth below, the Series B Preferred Stock (the “Preferred”) will be treated as pari passu with the Series A Preferred of the Company (the “Prior Preferred” with the Preferred and Prior Preferred collectively referred to as the “Series Preferred”).
Dividends:	The holders of the Preferred shall be entitled to receive out of legally available funds, dividends at a rate of [8%] of the Original Purchase Price per annum, payable when, as and if declared by the Board of Directors. Dividends shall not be cumulative.
Liquidation Preference:	In the event of any liquidation, dissolution or winding up of the Company, the holders of the Series Preferred shall be entitled to receive in preference to the Common Stock (the “Common”) an amount payable in cash equal to the Original Purchase Price for the Preferred and the original purchase price for the Prior Preferred plus declared and unpaid dividends (the “Liquidation Preference”). After the payment of the Liquidation Preference to the holders of the Series Preferred, the remaining assets shall be distributed ratably to the holders of the Common and the Series

Preferred (assuming the conversion of all Preferred Stock).

A merger, reorganization or other acquisition type transaction in which control of the Company or all or substantially all of its assets is transferred will be treated by holders of the Series Preferred as a liquidation.

Redemption: At the election of the holders of a majority of the Preferred, the Company shall redeem the outstanding Preferred shares in two equal installments beginning on the fifth anniversary of the Prior Preferred closing date. Such redemptions shall be made pari passu with the Prior Preferred (assuming the Prior Preferred holders have elected to be redeemed), and the price for the Preferred shall be equal to the Original Purchase Price plus declared and unpaid dividends.

Conversion: The holders of the Preferred have the right, at any time, to convert into shares of Common. The number of shares of Common into which each share of Preferred may be converted will be determined by dividing the Original Purchase Price by the conversion price. The initial conversion price will be equal to the Original Purchase Price. The conversion price will be subject to adjustment as set forth in “Antidilution Provisions”.

Automatic Conversion: In the event of: (1) an underwritten public offering of shares of the Company at a total offering of not less than [\$15 million] at a price per share not less than [three (3) times] the Original Purchase Price (a “Qualifying IPO”); or (2) the consent of the holders of at least a majority of the then outstanding shares of Preferred, the Preferred will be automatically converted into Common at the then applicable conversion rate.

Antidilution Provisions: Proportional adjustment for stock splits, stock dividends, recapitalizations, and the like. The conversion price will be adjusted on a weighted average basis (based on all outstanding shares of Series Preferred and Common Stock) for issuances of additional equity securities at a purchase price below the then effective conversion price (subject to standard exceptions).

Voting Rights: The holders of a share of the Preferred will have a right to that number of votes equal to the number of shares of Common issuable upon conversion of the Preferred.

Protective Provisions: The Series Preferred votes on an as-converted basis, but also has a class vote as provided by law. The consent of a majority of the Series Preferred, voting as a single class, shall be required for the following actions: (i) any amendment or change to the rights,

preferences, privileges or power of the Series Preferred; (ii) any action that authorizes, creates or issues shares of any class of stock having rights, preferences or privileges superior to or on parity with the Series Preferred; (iii) any increase or decrease in the authorized number of shares of the Series Preferred or Common; (iv) any merger or consolidation of the Company with one or more other corporations in which the stockholders of the Company immediately after such merger or consolidation hold stock representing less than a majority of the voting power of the outstanding stock of the surviving corporation and any sale of all or substantially all of the assets of the Company; (v) any amendment or waiver of any provisions of the Company's Articles of Incorporation (the "Articles") or Bylaws that affects the rights of the Series Preferred; (vi) the payment of any dividend on the Common Stock; and (vii) other protective provisions to be set forth in the Articles.

The consent of a majority of the Preferred, voting as a separate series shall be required for the following actions: (i) any amendment or waiver of provisions of the Company's Articles or Bylaws that adversely affects the rights, preferences and privileges of the Preferred; and (ii) any action that authorizes, creates or issues shares of stock having rights, preferences or privileges superior to or on a parity with the Preferred.

[Warrants:

The Investors shall also receive 5 year warrants in the amount of ____ Warrants for each share of Preferred purchased in this round of financing. The Warrants shall be exercisable for [Common Stock] [Series B Preferred Stock] at \$_____ per share. The Warrants shall contain a cashless exercise feature and customary representations, warranties and other terms.]

Representations and
Warranties:

Representations and warranties of the Company acceptable to the Investors.

Information and Registration
Rights:

The Investors shall receive standard information rights including audited financial reports, quarterly and monthly financial reports, and annual budget and business plan. The Investors shall receive standard inspection and visitation rights. Such rights shall terminate upon the closing of a Qualifying IPO. The Investors will have demand, piggyback and S-3 registration rights with expenses payable by the Company. The registration rights may be transferred to a transferee who acquires at least 25% of an Investor's shares. Transfer of registration rights to a partner or affiliate of the Investors will be without restrictions as to minimum share holdings.

Preemptive Right:	The Investors shall have a pro rata right, based on their percentage equity ownership, on a fully diluted basis, to participate in subsequent equity ownership, on a fully diluted basis, to participate in subsequent equity financings of the Company, subject to customary exclusions. Such right will terminate upon the closing of a Qualifying IPO.
Expenses:	The Company will pay reasonable legal fees (up to a maximum of \$_____) and expenses of counsel for the Investors, payable at the closing or payable if the Company elects not to proceed with this transaction.
Board of Directors:	Holders of the Preferred, voting as a separate series shall be entitled to elect one member of the Company's Board of Directors. The number of Board members shall be ____.
Confidentiality and Inventions Assignment Agreement:	Each employee shall have executed the Company's standard Confidentiality and Inventions Assignment Agreement in form approved by the Investors.
Right of First Refusal and Co-Sale Agreement:	The Investors shall receive standard information rights. Founders will enter into a right of first refusal and co-sale agreement pursuant to which any Founder who proposes to sell all or a portion of his shares to a third party (subject to standard exceptions) must either permit the holders of the Series Preferred at their option (i) to purchase such stock on the same terms as the proposed transferee, or (ii) sell a proportionate part of their shares on the same terms offered by the proposed transferee. Such right will terminate upon the closing of a Qualifying IPO.
Qualified Small Business Stock:	The Company represents and warrants that it qualifies as "Qualified Small Business" as defined in Section 1202(d) of the Internal Revenue Code of 1986, as amended (the "Code") and covenants that so long as the shares are held by the Investors (or a transferee in whose hands the Shares are eligible to qualify as Qualified Small Business Stock as defined in Section 1202 (c) of the Code), it will use its best efforts to cause the shares to qualify as Qualified Small Business Stock.
Closing Conditions:	The obligation of Investors to purchase the shares is subject, among other things, to (i) completion of and satisfaction of a due diligence investigation of the Company, (ii) the execution of definitive stock purchase agreements and other documentation between and among (and acceptable to) the Investors and the Company, including various representations and warranties, (iii) the obtaining of all requisite consents to the transaction and (iv) the receipt of an opinion of counsel to the Company in form and

substance acceptable to the Investors.

Exclusivity:

Neither the Company nor any of the Company's directors, officers, employees, agents or representatives will solicit, encourage or entertain proposals from or enter into negotiations with or furnish any nonpublic information to any other person or entity regarding the possible sale of the Company's stock. The Company shall notify the Investors promptly of any proposals by third parties with respect to the acquisition of the Company's stock and furnish the Investors the material terms thereof. The Company shall deal exclusively with the Investors with respect to any such possible transaction and the Investors shall have the right to match such proposed transactions in lieu of such third parties. This right shall last for a period of 30 days from the date hereof.

Confidentiality:

The existence and terms of this Term Sheet, and the fact that negotiations may be ongoing with the Investors, are strictly confidential and may not be disclosed to anyone except the Company's directors, senior executive officers, and legal counsel.

Pre-Closing Capitalization

Capitalization of the Company prior to the issuance of the Preferred is assumed to be as outlined below (on a fully diluted basis). Items affecting the capitalization include the adequacy of the post-financing employee stock option pool. Items affecting the capitalization may cause an adjustment to the Original Purchase Price.

<u>Type of Security</u>	<u>Common Stock Equivalent Shares</u>
Series A Preferred	[1,500,000]
Common Stock	[3,500,000]
Outstanding Options for Common Stock	[1,700,000]
Common Stock Reserved for Future Options	[500,000]
Total	[7,200,000]

This Term Sheet merely constitutes a statement of the present material intentions of the parties, but that except as set forth under the heading “Confidentiality,” “Expenses” and “Exclusivity” above as to which the parties intend to be legally bound, no legally binding agreement or obligation of any party are covered by this Term Sheet. A binding commitment with respect to the transactions (other than as set forth under “Confidentiality,” “Expenses” and “Exclusivity”) will result only upon the execution of definitive agreements, if any. No oral modifications to this principle shall be valid.

[ABC, Inc.] (“Company”)

By: _____

Title: _____

Date: _____

[SD Venture Funds] (“Investor”)

By: _____

Title: _____