

Series B Convertible Preferred Stock Term Sheet

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Summary of Terms for Private Placement of Series B Preferred Stock of _____ Inc.

The following is a summary of the basic terms and conditions on which _____, Inc., a North Carolina corporation (“_____” or “the Company”), proposes to sell shares of Series B Convertible Preferred Stock to certain investor(s) (the “Investors”) in a private placement, subject to completion of all appropriate due diligence investigations.

I. Investment

(1) Total Amount to be Raised: \$ _____ (including the conversion of all outstanding Convertible Promissory Notes in the aggregate principal amount of \$ _____ (the “Notes”). A minimum first closing (the “First Closing”) of \$ _____ (including the conversion of the Notes). A second closing to take place no later than 30 days.

(2) Type of Security: Series B Convertible Preferred Stock (“Series B Preferred Stock” or “Series B Preferred Shares”)

(3) Price per Share: \$ _____ (Based upon any pre-closing stock splits, as necessary)

(4) Fully Diluted Pre-money Valuation at Closing: \$ _____

(5) Investors in Series B Preferred Stock (the “Investors”) and the total amount to be invested are as follows:

a)	\$ _____	Shares
b)	\$ _____	Shares
c)	\$ _____	Shares

(6) Closing Date: The First Closing is estimated to occur on or before _____, 20xx.

II. Option Pool

A stock option pool of _____ of the outstanding shares on a post Series B financing basis, on a fully diluted basis, shall be reserved for distribution to employees, directors, and consultants. An option pool of shares is factored into the _____ million pre-money valuation.

III. Rights, Preferences, Privileges and Restrictions of Series B Convertible Preferred Stock

(1) Dividend Provisions

Dividends shall be payable pro rata on the Series B Preferred Stock based on the number of shares of Common Stock into which they are convertible, but only if and when declared by the Company's Board of Directors. No dividends shall be paid on any Common Shares unless comparable dividends are paid on all of the Series B Preferred Stock and all shares of the Series A Convertible Preferred Stock (the "Series A Preferred Stock") based on the number of Common Shares into which they are convertible.

(2) Liquidation Preference

In the event of any liquidation or winding up of the Company, the holders of the Series B Preferred Stock, *pari pasu* with the holders of the Series A Preferred Stock, shall be entitled to receive in preference to the holders of Common Stock the amount at which the Series B Preferred Stock and the Series A Preferred Stock, as the case may be, was purchased from the Company plus any accrued but unpaid dividends. The remaining balance of the proceeds from the liquidation will then be allocated to the Series B Preferred Stock, the Series A Preferred Stock, and the Common Stock holders on an as-converted basis. At the option of the holders of the Series B Preferred Stock and the Series A Preferred Stock, a merger, sale of all or substantially all of the assets of the Company, reorganization or other transaction in which control of the Company is transferred may be treated as a liquidation, dissolution or winding up for purposes of the liquidation preference. This liquidation preference will expire if the Company is liquidated at a value of greater than \$48 million. In the event of liquidation above \$48 million proceeds from the liquidation will then be allocated to Series B Preferred Stock, Series A Preferred Stock, and Common Stock holders on an as-converted basis.

(3) Redemption

Commencing five (5) years after the original date of issuance of the Series A Preferred Stock (i.e., _____), the Company shall redeem the Series B Preferred Stock in three equal annual amounts, one-third of the invested amount per year. Accrued, but unpaid dividends are to be paid with the final payment. If the Company has insufficient funds to fully pay the redemption, then subsequent funds shall be applied to the redemption. This redemption shall be at the option of the Investors.

(4) Conversion

The holders of the Series B Preferred Stock shall have the right to convert the Series B Preferred Stock at the option of the holder, at any time, into shares of common stock of the Company at the conversion rate of one-to-one (1 : 1) or the conversion rate then in place. Any accrued but unpaid dividends will also have the right to be converted at the option of the company.

(5) Automatic Conversion

The Series B Preferred Stock shall be automatically converted into Common Stock, at the then applicable conversion rate, in the event of an underwritten public offering of shares of the Company's stock at a per share public offering price (prior to underwriting commissions and expenses) of not less than \$ _____ per share (adjusted for stock splits, dividends and combinations) and for a total offering of not less than \$ _____ million.

(6) Anti-dilution Provisions

The conversion price of the Series B Preferred Stock shall be subject to appropriate adjustment in the event of a stock split, stock dividend or similar event; and shall be adjusted on a weighted average basis to prevent dilution, in the event that the Company sells additional shares of Common Stock, preferred stock or convertible debt convertible into Common Stock or preferred stock (other than shares which are presently authorized and, which may be issued from time to time to employees, consultants or directors in an

amount not to exceed shares) at a purchase price less than the applicable conversion price of the Series B Preferred Stock.

(7) Voting Rights

Except as set forth herein, each holder of Series B Preferred Stock shall have the right to that number of votes equal to the number of shares of Common Stock issuable upon conversion of the Series B Preferred Stock held by such holder and shall vote with the Common Stock.

(8) Protective Provisions

So long as at least 50 percent of the issued Series B Preferred Stock is outstanding, except as otherwise required by law and as described below, the holders of a majority of the outstanding shares of Common Stock, Series A Preferred Stock, and Series B Preferred Stock (voting together as a single class on an as-converted to Common Stock basis) shall be required to approve matters which require stockholder vote; provided however, that, on the following matters the holders of Series B Preferred Stock, voting together as a single class, will have a separate class vote requiring majority approval of the total number of votes:

- (i) the creation of any senior or pari pasu security
- (ii) payment of dividends on Common Stock
- (iii) repurchase of stock
- (iv) an increase or decrease in the number of authorized shares of Series B Preferred Stock,
- (v) any adverse change to the rights, preferences and privileges of the Series B Preferred Stock
- (vi) any other action materially affecting only the Series B Preferred Stock,
- (vii) any redemption, repurchase, or other acquisition for value of any of the Company's equity securities, other than from present or former consultants, directors, or employees pursuant to the terms of a stock option plan of the Company, and
- (viii) any change in the Company's line of business.

IV. Right of First Refusal

- (1) Right of First Refusal:** In the event that any of the existing shareholders, managers, employees or other shareholders propose to sell to a third party or parties a number of shares of their stock, then the stock to be sold will be offered first to the Company to purchase the shares on the same terms as the third-party offer. If the Company does not purchase any, or all, of the available shares, then the Series A and B Preferred Stock shareholders have the right to purchase the remaining portion at the same terms. If the Series A and B Preferred Stock shareholders and/or the Company do not purchase all of the shares, then they may be offered to the third party.
- (2) Preemptive Rights:** Each purchaser of Series B Preferred Stock in this financing will have a right of first refusal to purchase a pro rata amount of any Common Stock or securities convertible into Common Stock offered for sale by the Company, on the same terms and conditions and at the same price as offered to third parties, in order to maintain their pre-existing percentage interest in the stock of the Company. This right shall extend for a period of 21 days after the notification by the Company to the Series B Preferred Stock shareholders. Such right shall expire upon and shall not apply to an initial public offering of Common Stock, and shall not apply to: (i) shares issued under stock options plans approved by the Board of Directors in an amount not to exceed shares; or (ii) shares exchanged for assets or securities of another corporation in any acquisition of assets, merger, or other reorganization.
- (3) Co-Sale Rights:** Each purchaser of Series B Preferred Stock in this financing will have a co-sale right to sell shares in the event that any of the existing shareholders

propose to sell to a third party or parties a number of shares of their Common Stock or securities convertible into Common Stock.

This co-sale right also extends to the Company and existing shareholders if Series B Preferred Stock shareholders sell any of their stock. This clause does not apply to any holders of less than 10,000 shares of stock or any manager, board member, employee selling less than 10,000 shares of stock in any 12 month period. This number of shares will be adjusted for any stock splits, combinations, etc. authorized by the Company.

V. Registration Rights [There will be one Registration Rights Agreement, and the holders of the Series A Preferred Stock and the Series B Preferred Stock will have identical registration rights.]

(1) Demand Registration

Any time after the earliest of two (2) years after the Closing or three (3) months after initial registration (but not within six months of the effective date of a registration), Investors holding at least 40 percent of the Series B Preferred Stock or at least 40 percent of the Series A Preferred Stock (or Common Stock issued upon conversion of the Series A Preferred Stock or the Series B Preferred Stock, as the case may be) may request that the Company file a Registration Statement for their shares for a registered offering of the Company. 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) S-3 Registration

After two years from the signing of this agreement and when Form S-3 (or a successor form) is available, holders of at least one-third of the total amount of Series B Preferred Stock or at least one-third of the total amount of Series A Preferred Stock issued (or Common Stock issued upon conversion of Series B Preferred Stock or the Series A Preferred Stock as the case may be, or a combination thereof) wishing to sell a minimum of \$500,000 worth of Common Stock may demand registration of such shares on Form S-3 (or a successor form). Such registration shall be kept effective by the Company until the earlier to occur of such time as (i) all shares registered there under have been sold, (ii) the holders whose shares are registered thereon agree to terminate the registration, (iii) the registration rights of all such holders terminate, or (iv) ninety days. The Company shall not be obligated to effect more than three registrations under this provision and shall not be required to effect such a registration within the ten months following the effective date of any other registration statement (other than an S-8 or S-3 for employees' stock) or more than once in any fiscal year.

(3) Piggy-back Registration

The Investors shall be entitled to "piggy-back" registration rights on all registrations by the Company of its Common Stock, subject to the absolute right, however, of the underwriters to reduce the number of shares proposed to be registered on behalf of all selling shareholders (on a pro-rata basis) in view of market conditions.

(4) Expenses

The registration expenses (exclusive of underwriting discounts and commissions or fees of counsel to the selling shareholders) of the demand, S-3 and piggyback registrations shall be borne by the Company.

(5) Transfer of Rights

The registration rights may be transferred to a transferee (i) who acquires at least 50 percent of any Investor's shares and (ii) who is not, in the Company's reasonable opinion, a competitor of the Company or a party who is demonstrably hostile toward the Company, provided the Company is given written notice of such assignment within 30 days after the transfer of the shares. Transfer of registration rights to a partner or member of an Investor shall be without restriction.

(6) Termination of Rights

All registration rights shall terminate as to a holder who holds one (1) percent or less of the outstanding shares of the Company's Common Stock (on an as-converted basis) when all of such holder's shares may be sold during a single three-month period under Rule 144.

(7) Other Provisions

Other provisions shall be contained in the Stock Purchase 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, underwriting arrangements and the like.

VI. Board Representation

Series B Preferred shareholders will be entitled to and represented by one seat on the Directors of the Company. This representation will be subject to the terms contained herein. The Board of Directors shall be indemnified by the Company, through the purchase of director's liability insurance, to the fullest extent of the law. All travel expenses in attending meetings and performing Company duties shall be borne by the Company. A Compensation Committee, consisting of Directors, majorities of whom are not officers or employees of the Company, will approve compensation packages for key managers of the Company, including the President. The number of Directors on the Board cannot be increased without the approval of a two-thirds majority of the Directors. The Board of Directors will initially be composed of the following: 1) two Series A Preferred representatives; 2) one Series B Preferred representative; 3) one management representative, _____, President and CEO; 4) one common stock representative, _____; and 5) two outside directors approved by the other Board members.

VII. The Stock Purchase Agreement

The investment shall be made pursuant to a Stock Purchase Agreement acceptable to the Company and the Investors, which agreement 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 which shall include qualification of the shares under applicable Blue Sky Laws, the filing of a Certificate of Amendment and/or Determination of Preferences to authorize the Series B Preferred Stock and delivery of opinions of counsel.

VIII. Covenants

(1) So long as an Investor continues to hold a minimum of _____ shares of Series B Preferred Stock or Common Stock issued upon conversion of the Series B Preferred Stock, the Company shall provide annual and quarterly financial statements. So long as an Investor holds at least 250,000 shares of Series B Preferred Stock (or of Common Stock issued upon conversion), such holder will be entitled to receive status reports and an annual business/operating plan. Such plan will have been approved by the Board of Directors. This right to financial information and plans shall terminate upon a public offering. The above-mentioned Investors will receive, upon request, financial statements and status reports including:

- a. Cash flow statements.
- b. Income statements.
- c. Balance sheets.
- d. Sales results.
- e. Cash flow, income and balance sheet forecasts.

(2) A mutually acceptable accounting firm will audit annual statements.

(3) The Company will prepare an annual business plan, with financial projections, for Board approval.

(4) There will be no material transactions with executive management or other shareholders without approval of the Board of Directors, including, but not limited to salaries, bonuses, stock purchases and options.

IX. Proprietary Information and Inventions Agreement

(1) Each officer, director and key employee of the Company shall have entered into a proprietary information and inventions agreement in a form reasonably acceptable to the Company and the Board of Directors. As part of this agreement, the founders, managers, employees and consultants associated with the Company agree to assign all of the technology, patents, etc., to the Company.

(2) The Company agrees to pursue the protection of all technology, including, the pursuit of all appropriate patents, copyrights, trademarks, etc.

X. Expenses

Upon the Closing of the financing, the Company will pay or reimburse the Investors for their reasonable legal expenses incurred in connection with the transaction. This reimbursement will not exceed \$ 10,000 in total from all Series B Preferred Investors. The Series B Preferred Investors will be obligated to arrive at an agreed distribution between all parties prior to submitting any request for reimbursement to the Company.

XI. Key Man Insurance

The Company shall take out key man life insurance on key employees, made payable to the Company. This will be at the determination of the Company and when affordable by the Company.

XII. Use of Proceeds

The Company intends to use the proceeds of this offering to expand its software development, to purchase equipment, to expand sales and technical support channels including international distribution and for working capital.

XIII. Finders

The Company and the Investors shall each indemnify the other for any finder's fees for which either is responsible.

XIV. Conditions for Closing

Any closing of this financing will be contingent on (i) completion of due diligence, (ii) required shareholder approval, (iii) modification of the Articles of Incorporation and by-laws as noted in this term sheet, (iv) no negative material changes in the business or operations of the Company and (v) completion of legal documentation.