

VENTURE CAPITAL LP

REVISED TERM SHEET – FIRST ROUND OF VENTURE CAPITAL

20 August 20xx

PCI, Inc.

66 Sutton Business Park
The Twilight Zone

Issue:

Venture Capital LP ("VC") and/or any member of its corporate group ("the VC Group") will purchase up to \$2,500,000 Series A Convertible Preferred Stock ("Series A") newly issued by PCI, Inc. (the "Company") at a price per share of \$1.00 (the "Purchase Price"). In addition, other investors shall purchase at least \$4,500,000 but not more than \$7,000,000 of newly issued Series A at the Purchase Price.

The shares of Series A will be convertible at any time at the option of the holder into common shares of the Company ("Common Stock") on a one-for-one basis, adjusted for future share splits.

The Purchase Price equates to a pre-money valuation of \$15.1 million. The calculation is based on 8,100,000 fully diluted shares of Common Stock. If the number of shares issued, or stock awards/options authorized increases before the closing the price per share for Series A Convertible Preferred Stock shall be reduced so that the pre-money valuation is unchanged.

The Series A Convertible Preferred Stock shall be referred to herein as the "Preferred Stock."

Dividend:

The Preferred Stock is entitled to an annual \$_____ per share dividend, payable when and if declared by the Board of Directors, but prior to any payment on Common Stock; dividends are not cumulative. *[Note: the dividend provision above is not onerous for a company: the directors need not pay a dividend unless they wish to pay dividends on Common Stock in the same year. In a scenario more favorable to investors, dividends may be participating (i.e., preferred stockholders to receive additional dividends ratably with common stockholders once all preferences have been satisfied) and/or cumulative (i.e., unpaid dividends will be added to the liquidation amount and the redemption price of the preferred stock and all accrued dividends for past as well as the current year must be paid prior to payment of dividends on common stock.)]*

Liquidation Preference:

The Series A will have a liquidation preference so that proceeds on a merger, sale or liquidation (including non-cumulative dividends) will first be paid to the Series A and will include a 10% per annum compounding

guaranteed return calculated on the total amount invested. Upon completion of an additional round of funding of at least \$3,000,000 the compounding guaranteed return feature will expire. The liquidation preference will cease to operate if the proceeds due to Series A, on a merger, sale or liquidation on an as-converted basis, exceed the proceeds that would be due under the liquidation preference. *[Alternatively, terms may be structured so that preferred stockholders may get back only their original investment or they may retain their original investment plus all accrued but unpaid dividends for every years (see "cumulative dividends" in Section 2 above) or they may share the remainder ratably on an as-converted basis with common stockholders only after their preferences and all common stock liquidation amounts have been paid. (2) In subsequent financings, new series of preferred stock may have a superior position on liquidation or be on a pari passu footing with this series with respect to liquidation. (3) Liquidation may be defined in the term sheet to include acquisition of the Company or its merger into another entity, with the classification of such event as a liquidation or not at the investors' option at time of the merger.]*

- Use of Proceeds: The funds raised by Series A will be used principally for general working capital purposes.
- Voting Rights: The holders of the Series A shall have the right to vote with the Common Stock on an as-if-converted basis.
- Redemption: If not previously converted, the Series A is to be redeemed in three equal successive annual installments beginning January 20, 2005. Redemption will be at the purchase price plus a 10% per annum cumulative guaranteed return. *[Note: While going public or an acquisition usually connote a clear "success", the investor must also consider the case in which the Company only achieves moderate success and management is content to keep things going as a private Company. According to these terms, the company must redeem at a specified amount which provides investors with some guaranteed return on their investment. Alternatives include: (a) a provision stating that the Company may not call the Preferred Stock for redemption nor may the investors require the Company to redeem their stock and (b) optional redemption after a certain date by either the Company or the investors. If the Company may call the Preferred Stock at its option, it could potentially call once the common price exceeds the redemption price and force the investor to take a mediocre repayment on his investment or convert to common and lose his preferred position in the Company.]*
- Registration Rights: Two U.S. demand registrations, subject to \$3 million and 500,000 share

trigger, unlimited piggybacks, and evergreen S-3 if requested and possible all at company expense. *[In order to have a public offering the Company must file a registration statement with the Securities and Exchange Commission. Because the investor can not be assured of controlling the Board of Directors of the Company (after all that is what the entrepreneur fears will happen), the investor usually negotiates for "demand registration rights" under which the Company contractually agrees to file a registration statement on the demand of the investor. The number of "demands" is negotiated, with the Company saying that one is enough and the investor arguing for two or more. Conceptually the granting of demand registration rights is a big deal for the Company because of the time and cost involved if those rights are invoked- it can easily cost \$200,000 or more to file a registration statement. In reality, it is a rare case when registration is demanded against the desires of management- after all management has to go on the "road show" and make a good presentation to the mutual fund managers and brokers who will be buying the stock. In addition, the investor usually receives "piggyback" registration rights under which the investor's shares are included in any "primary registration" statement (where the company is selling its own stock) or in any "secondary registration" where the Company is filing a registration statement to permit others to sell.]*

Pre-emptive Rights:

Holders of the Preferred Stock will be granted rights to participate in future equity financings of the Company based upon their pro-rata, as-if-converted, ownership of the Company. *[Note: This right is typically granted to investors to ensure that the Company does not negotiate new financings with new players without offering to deal with the present investors. Sometimes investors are required to take "all or none" of the new financing.]*

Automatic Conversion:

The Preferred Stock shall be automatically converted into Common Stock at the then applicable conversion rate (1:1 assuming no share splits) in the event of an underwritten public offering of shares of the Company at a total offering of not less than \$20,000,000 and at a per share public offering price of not less than three times the Series A purchase price per share, adjusted for splits. *[Because the control and others terms of a venture capital preferred are not consistent with public market securities, the Preferred Stock has to "disappear" (i.e., be converted into Common Stock) at the Initial Public Offering]*

Anti-Dilution:

Series A shall have weighted average anti-dilution, based on a weighted average formula to be agreed, for all securities purchased as part of this transaction (excluding shares, options and warrants issued for

management incentive and small issues for strategic purposes of under 100,000 shares). *[Note: Antidilution adjustments increase the amount of stock received by an investor if the Company issues additional stock at prices which are lower than that paid by the investor. Because there is no readily ascertainable independent market price for the stock, investors believe that they should be protected against having overpaid. Another rationale is that the entrepreneur should pay if he does not increase the value of the Company by the next round of financing. However, from the entrepreneur's side a decrease in the value of the Company could result from events beyond the entrepreneur's control- e.g. a stock market crash or a change in the law. Having said this, antidilution adjustments are almost always present in one form or another.]*

Note that the formulae used in these provisions decrease the conversion price of the Preferred Stock resulting in more shares of common stock per share of Preferred Stock upon conversion. The weighted average antidilution formula considers the total number of shares being issued as well as the per share price; contract this to the full ratchet antidilution formula which automatically reduces the conversion price to the price at which a new issued is sold, even if only a small number of shares are issued.]

Management Options:

Simultaneously with this transaction, one million new shares shall expand the Company's management incentive stock option pool - bringing the total number of shares issued and stock incentives (awards and options) authorized to 6,100,000. *[Note: investors usually factor the option pool size into their valuation of the Company and assume that the full amount of the option pool is taken into account in determining the "pre-money" valuation of the Company.]*

Rights of First Offer; Tag-Along:

The Company and the Investors will have a right of first refusal with respect to any employee's shares proposed to be resold. Alternatively, the Investors will have the right to participate in the sale of any such shares to a third party (co-sale rights), which rights will terminate upon a public offering.

Information Rights:

Monthly actual vs. plan and prior year. Annual budget 60 days before beginning of fiscal year. Annual audit by national firm. All recipients of financial statements to execute non-disclosure agreement acceptable to Company counsel. The aforementioned information rights shall be available to each holder of Preferred Stock for as long as such holder owns 220,000 shares of Preferred Stock or shares of Common Stock issued upon conversion of shares of Preferred Stock.

Negative Covenants:	Approval by holders of Preferred Stock of organic changes outside normal course of business and sale, liquidation or merger, increase in board seats or change election procedures, new shares senior to or on par with and all distributions (dividends, repurchases).
Board of Directors:	The Board will consist of ___ members. The holders of the Preferred Stock will have the right to designate ___ directors, the holders of the Common (exclusive of the Investors) will have the right to designate ___ directors, and the remaining ___ directors will be unaffiliated persons elected by the Common Stock and the Preferred Stock voting as a single class.
Stock Restriction Agreement:	All present holders of Common Stock of the Company who are employees of, or consultants to, the Company will execute a Stock Restriction Agreement with the Company pursuant to which the Company will have an option to buy back at cost a portion of the shares of Common stock held by such person in the event that such stockholder's employment with the Company is terminated prior to the date of employment. 25% of the shares will be released each year from the repurchase option based upon continued employment by the Company. <i>[Investors will want to ensure that the present management of the Company has an incentive to remain there; rewarding continued work at the Company by appreciation in the value of stock and discouraging the individual's leaving by the buy-back provisions detailed above are effective mechanisms to encourage long-term commitment.]</i>
Non-competition, Proprietary Information and Inventions Agreement:	Each officer and key employee of the Company designated by the Investors will enter into a non-competition, proprietary information and inventions agreement in a form reasonably acceptable to the Investors.
Expenses:	The Company shall pay the reasonable expenses of legal counsel to represent the Investors in the completion of the Preferred Stock Agreement and the completion of all due diligence, up to a maximum of \$_____.
Definitive Purchase Agreement and Due Diligence:	The purchase of the Series A will be made pursuant to negotiation of a definitive Series A purchase agreement. Additionally, the closing of this investment will be contingent on the satisfactory completion of VC's due diligence reviews and final investment committee approvals. Such due diligence reviews will include, but not be limited to, a professional review of all legal and financial contracts of the Company.
Closing:	The Company and VC agree to use their best efforts to close the

transaction on or about February 11, 20xx. It is agreeable to have a first closing of the transaction for \$7,000,000 of Series A and leave the transaction open for an additional 60 days post first closing to close up to \$10,000,000 of total Series A.

Other than that the Company hereby agrees to pay Investors' reasonable legal fees of up to \$25,000 in case a definitive agreement is not ultimately reached with VC (which agreement is legally binding) the undersigned acknowledge that this term sheet does not constitute a binding agreement, but expresses an agreement in principle covering the principal terms of an equity financing, and an undertaking to proceed in good faith to negotiate a definitive agreement.

This proposal remains open until 5:30 pm on the tenth day following the date of this termsheet, at which point it will be deemed to have been withdrawn.

AGREED AND ACCEPTED:

PCI, Inc.

By: _____

Date: _____

Venture Capital LP

By: _____

Date: _____