

Term Sheet (Neutral to Investors and Issuer)

The sample term sheet provided below reflects the "neutral" form of language for each term as analyzed in Chapter Three of Term Sheets and Valuations. For a complete analysis and range of language incorporating the three perspectives, Term Sheets and Valuations may be a helpful reference. The assumption is that each term in a term sheet can be written to be "investor-favorable," "neutral," or "company-favorable" and provides analysis of the language of each term when written from these three perspectives. This represents "neutral" to both parties.

[COMPANY]

[DATE]

MEMORANDUM OF TERMS FOR PRIVATE PLACEMENT OF EQUITY SECURITIES

[] Ventures, L.P., and [] (the "Investors") are prepared to invest \$[] in [] (the "Company") under the terms contained in this term sheet. With the exception of the section of this agreement relating to expenses, this term sheet is a non-binding document prepared for discussion purposes only, and the proposed investment is specifically subject to customary stock purchase agreements, legal due diligence, and other conditions precedent contained herein, all satisfactory to the Investors in their sole discretion.

[Other Company or deal-specific terms.]

New Securities Offered: Newly issued shares of the Company's Series [A] Preferred (the "Preferred")

Total Amount Raised: \$[]

Number of Shares: [/ To be determined to result in the Post-financing Capitalization below.]

Purchase Price Per Share: [\$ / To be determined to result in the Post-financing Capitalization below (the "Original Purchase Price").]

Post-Financing Capitalization:

Common Stock

Founders:

[NAME]

[NAME]

Sub-Total []

Stock Option Program

[CEO] []

[Others] []

Sub-Total []

Preferred Stock

[] Ventures, L.P., []

[Co-Investor(s)] []

Sub-Total []

Total Common Equivalent []

Total Enterprise Value [_____]

Dividend Provisions

The holders of the Series [A] Preferred shall be entitled to receive non-cumulative dividends in preference to any dividend on the Common Stock at the rate of 8 percent of the Original Purchase Price per annum, when and as declared by the Board of Directors. The Series [A] Preferred also will participate pro rata in any dividends paid on the Common Stock on an as-converted basis.

Liquidation Preference

In the event of any liquidation or winding up of the Company, the holders of the Series [A] Preferred shall be entitled to receive in preference to the holders of the Common Stock a per share amount equal to the Original Purchase Price plus any declared but unpaid dividends (the "Liquidation Preference"). After the payment of the Liquidation Preference to the holders of the Series [A] Preferred, the remaining assets shall be distributed ratably to the holders of the Common Stock and the Series [A] Preferred on a Common Stock equivalent basis; provided that the holders of Series [A] Preferred will stop participating once they have received a total liquidation amount equal to [three] times the Original Purchase Price. 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.

Redemption

Redemption at Option of Investors

At the election of the holders of at least [two thirds] of the Series [A] Preferred, the Company shall redeem the outstanding Series [A] Preferred in three equal annual installments beginning on the [fifth] anniversary of the Closing. Such redemptions shall be at a purchase price equal to the Original Purchase Price plus declared and unpaid dividends.

Conversion

The holders of the Series [A] Preferred shall have the right to convert the Series [A] Preferred, at any time,

into shares of Common Stock. The initial conversion rate shall be 1:1, subject to adjustment as provided below.

Automatic Conversion

The Series [A] Preferred shall be automatically converted into Common Stock, at the then applicable conversion price, (i) in the event that the holders of at least two thirds of the outstanding Series [A] Preferred consent to such conversion or (ii) upon the closing of a firmly underwritten public offering of shares of Common Stock of the Company at a per share price not less than [2 times the Original Purchase Price] per share and for a total offering with gross proceeds to the Company of not less than \$25 million (a "Qualified IPO").

Anti-dilution Provisions

The conversion price of the Series [A] Preferred will be then subject to a weighted average adjustment (based on all outstanding shares of Preferred and Common Stock) to reduce dilution in the event that the Company issues additional equity securities (other than the reserved employee shares described under "Employee Pool") at a purchase price less than the applicable conversion price. The conversion price will also be subject to proportional adjustment for stock splits, stock dividends, recapitalizations, and the like. This anti-dilution protection is subject to a play-or-lose provision that provides that adjustments will be made to the Series [A] Conversion Price only if the Series [A] holder participates in such dilutive offering to the extent of its pro rata equity interest in the Preferred. Any investor who does not participate in a future financing forfeits the benefits of dilution protection [for all future rounds of financing/only for that financing round].

Voting Rights

The Series [A] Preferred will vote together with the Common Stock and not as a separate class except as specifically provided herein or as otherwise required by law. Each share of Series [A] Preferred shall have a number of votes equal to the number of shares of Common Stock then issuable upon conversion of such share of Series [A] Preferred.

Protective Provisions

For so long as at least [one-half of the shares originally issued] shares of Series [A] Preferred remain outstanding, consent of the holders of at least two thirds of the Series [A] Preferred shall be required for any action that (i) alters or changes the rights, preferences, or privileges of the Series [A] Preferred; (ii) increases or decreases the authorized number of shares of Common or Preferred Stock; (iii) creates (by reclassification or otherwise) any new class or series of shares having rights, preferences, or privileges senior to or pari passu with the Series [A] Preferred; (iv) results in the redemption of any shares of Common Stock (other than pursuant to equity incentive agreements with service providers giving the Company the right to repurchase shares upon the termination of services); (v) 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; or (vi) amends or waives any provision of the Company's Certificate of Incorporation or Bylaws relative to the Series [A] Preferred.

Board Composition and Meetings

The size of the Company's Board of Directors shall be set at [five]. The Board shall initially comprise [], [], [], [], and []. At each meeting for the election of directors, the holders of the Series [A] Preferred, voting as a separate class, shall be entitled to elect one member of the Company's Board of Directors, the holders of Common Stock, voting as a separate class, shall be entitled to elect two members, and the remaining directors will be mutually agreed upon by the Common and Preferred. It is anticipated that the Company's CEO will occupy one of the remaining seats. Board of Directors meetings will be held at least four times per year. Until the Company is profitable or the Board otherwise agrees, Board meetings will be targeted for every two months, or six times per year.

Special Board Approval Items

Board approval will be required for:

1. Hiring of all officers of the Company.
2. Any employment agreements (approval by a majority of disinterested Directors, or a Compensation Committee when established).
3. Compensation programs including base salaries and bonus programs for all officers and key employees (approval by a majority of disinterested Directors or a Compensation Committee when established).
4. All stock option programs as well as issuance of all stock and stock options (approval by a majority of disinterested Directors or a Compensation Committee when established).
5. Annual budgets, business plans, and financial plans.
6. All real estate leases or purchases.
7. Execution of entrance obligations or commitments, including capital equipment leases or purchases, with total value greater than \$[] and which are outside the most recent business plan or budget approved by the Board of Directors.

Information Rights

So long as an Investor continues to hold shares of Series [A] Preferred or Common Stock issued upon conversion of the Series [A] Preferred, the Company shall deliver to the Investor audited annual financial statements audited by a Big Five accounting firm and unaudited quarterly financial statements. So long as an Investor holds not less than [one quarter of the Shares originally issued] shares of Series [A] Preferred (or [one quarter of the Shares originally issued] shares of the Common Stock issued upon conversion of the Series [A] Preferred, or a combination of both), the Company will furnish the Investor with monthly financial statements compared against plan and will provide a copy of the Company's annual operating plan within 30 days prior to the beginning of the fiscal year. Each Investor shall also be entitled to standard inspection and visitation rights. These provisions shall terminate upon a public offering of the Company's Common Stock.

Registration Rights

Demand Rights: If Investors holding more than 50 percent of the outstanding shares of Series [A] Preferred, including Common Stock issued on conversion of Series [A] Preferred ("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; provided, however, that the Company shall not be obligated to effect any such registration prior to the third anniversary of the Closing. The Company shall have the right to delay such registration under certain circumstances for one period not in excess of ninety (90) days in any twelve (12) month period.

The Company shall not be obligated to effect more than two (2) registrations under these demand right provisions, and shall not be obligated to effect a registration (i) during the one hundred eighty (180) day period commencing with the date of the Company's initial public offering, or (ii) if it delivers notice to the holders of the Registrable Securities within thirty (30) days of any registration request of its intent to file a registration statement for such initial public offering within ninety (90) days.

Company Registration: The Investors shall be entitled to "piggy-back" registration rights on all registrations of the Company or on any demand registrations of any other investor subject to the right, however, of the Company and its underwriters to reduce the number of shares proposed to be registered pro rata in view of market conditions. If the Investors are so limited, however, no party shall sell shares in such registration other than the Company or the Investor, if any, invoking the demand registration. No shareholder of the Company shall be granted piggy-back registration rights that 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 two thirds of the Registrable Securities.

S-3 Rights: Investors shall be entitled to two (2) demand registrations on Form S-3 (if available to the Company) so long as such registered offerings are not less than \$500,000.

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 \$15,000).

Transfer of Rights: The registration rights may be transferred to (i) any partner or retired partner of any holder which is a partnership, (ii) any family member or trust for the benefit of any individual holder, or (iii) any transferee who acquires at least [one eighth of the shares originally issued] shares of Registrable Securities; provided the Company is given written notice thereof.

Lock-Up Provision: If requested by the Company and its underwriters, no Investor will sell its shares for a specified period (but not to exceed 180 days) following the effective date of the Company's initial public offering; provided that all officers, directors, and other 1 percent shareholders are similarly bound.

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.

Right of First Refusal

Investors holding at least [one eighth of the shares originally issued] shares of Registrable Securities shall have the right in the event the Company proposes to offer equity securities to any person (other than securities issued pursuant to employee benefit plans or pursuant to acquisitions) to purchase their pro rata portion of such shares. Any securities not subscribed for by an eligible Investor may be reallocated among the other eligible Investors. Such right of first refusal will terminate upon a Qualified IPO.

Conditions Precedent

This proposal is non-binding, and is specifically subject to:

1. Completed due-diligence reviews satisfactory to [Investor] and Investors' counsel, specifically including review of [Investor Counsel].
2. Customary stock purchase and related agreements satisfactory to [Investor] and Investors' counsel,

including stock option plan.

- Both the Company and Investors will negotiate exclusively and in good faith toward an investment as outlined in this proposal and agree to "no-shop" provisions for reasonable and customary periods of time.

Purchase Agreement

The investment shall be made pursuant to a Stock Purchase Agreement reasonably 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, including an opinion of counsel for the Company. The Stock Purchase Agreement shall provide that it may only be amended and any waivers thereunder shall only be made with the approval of the holders of two thirds of the Series [A] Preferred. Registration rights provisions may be amended or waived solely with the consent of the holders of two thirds of the Registrable Securities.

Employee Matters

Employee Pool: Upon the Closing of this financing there will be [] shares of issued and outstanding Common Stock held by the Founders and an additional [] shares of Common Stock reserved for future issuance to key employees. Promptly after the Closing, Messrs. [] and [] will be granted incentive stock options from the [] share pool in the amount of [] shares each exercisable at \$0.10 per share, which options will vest in accordance with the following paragraph.

Stock Vesting: All stock and stock equivalents issued after the Closing to employees, directors, consultants and other service providers will be subject to vesting as follows: [20 percent to vest at the end of the first year following such issuance, with the remaining 80 percent to vest monthly over the next four years.] The repurchase option shall provide that upon termination of the employment of the shareholder, with or without cause, the Company or its assignee (to the extent permissible under applicable securities law qualification) retains the option to repurchase at cost any unvested shares held by such shareholder.

The outstanding Common Stock currently held by the Founders will be subject to similar vesting terms, provided that the Founders shall be credited with two years of vesting as of the Closing, with their remaining unvested shares to vest monthly over three years.

Restrictions on Sales: The Company shall have a right of first refusal on all transfers of Common Stock, subject to normal exceptions.

Proprietary Information and Inventions Agreement: Each officer and employee of the Company shall enter into an acceptable proprietary information and inventions agreement.

Co-Sale Agreement: The shares of the Company's securities held by [], [], [] and [] (the "Founders") shall be made subject to a co-sale agreement (with certain reasonable exceptions) with the holders of the Series [A] Preferred such that the Founders may not sell, transfer or exchange their stock unless each holder of Series [A] Preferred has an opportunity to participate in the sale on a pro rata basis. This right of co-sale shall not apply to and shall terminate upon the Company's initial public offering.

Key-Man Insurance: The Company shall procure a key-man life insurance policy for [] in the amount of \$1,000,000, naming the Company as beneficiary.

Closing Date

[DATE] (the "Closing Date").

Legal Counsel

The Company shall select legal counsel acceptable to [Investor] ([]). Unless counsels agree otherwise, Investors' counsel [] shall draft the financing documents for review by Company counsel.

Expenses

The Company shall pay the reasonable fees for one special counsel to the Investors, expected not to exceed \$[25,000 - \$35,000], and for Company counsel.

Finders

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

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