

EARLY STAGE FINANCING TERM SHEETS

October 27, 2006

Fred Greguras
fgreguras@fenwick.com
(650) 335-7241

Zero2IPO Workshop
Beijing, China

FENWICK & WEST LLP



OVERVIEW

- **Assumes Caymans, BVI, US or other non-domestic China Corporation**
- **Seed Financing Terms**
- **Issues in China Venture Capital Deals**
- **Venture Capital Financing Terms**



EARLY STAGE FINANCINGS

- **Seed Financing**
 - Friends, Family, Angels
 - Quick, Simple, Cheap
 - Type of Security –what the investor requires
- **Corporate Partner**
 - Valuation
 - “Strings attached”
- **Venture Capital**
 - Market validation and economic scalability
- **Role of a Term Sheet**
 - Specification or blue print
 - Point discussions vs. entire term sheet



SEED FINANCINGS: USE OF COMMON STOCK

- **Must value the company**
- **Pricing of common stock must be same for all sales at or about the same time. Cannot grant options to employees for \$0.01 and sell shares of common stock to seed investors for \$1.00 at the same time**
- **Selling common stock is not generally used because of the dilutive effect**
 - **Consider number of shares at \$0.01 per share needed to be sold to raise even \$100! (10,000 shares)**
- **Objective is to keep the common stock price low as long as possible to motivate employees and other service providers with stock options**



SEED FINANCINGS: USE OF PREFERRED STOCK

- Requires a pre-money valuation for the company. Investors will buy a percentage of the company
- Series A round can be complicated and expensive even if raising a small amount of money. Cost may be disproportionate to amount raised
- Defer a preferred stock financing if possible when a small amount of money is being raised



SEED FINANCINGS: USE OF CONVERTIBLE NOTES

- Issue convertible notes for “next financing” preferred stock
- Defers valuation decision and keeps the financing simple and low cost
- Discount on conversion rate (or warrants) is often used as a “sweetener” for the investors to take the risk
- Sample term sheet for a convertible note financing



ISSUES IN CHINA VENTURE CAPITAL DEALS



Issues we sometimes see:

- Investment may be made in installments based on milestones in larger deals
- Deeper IP due diligence for some types of investment like chip sets
- More personal accountability with founders' representations and warranties
- More control over actions of the company with a greater number of protective provisions that require Preferred Stock approval such as budget approval, spending outside the budget, related party payments, drag-along right, etc.
- More debt like such as mandatory cumulative dividends
- Sometimes broad redemption provisions
- Reincorporation in the Caymans

SERIES A FINANCINGS PRE-MONEY VALUATIONS

- **\$4 – 7M approximate range**
- **Valuation and founder vesting are usually the key issues**
- **Pre-money valuation may be the same or slightly greater than the amount invested which means investors may own about 50% on a fully-diluted basis**
- **Fully-diluted means (1) outstanding stock, plus (2) outstanding options, plus (3) option reserve, plus (4) any other outstanding equity**



START UP, INC. CAP TABLE AS OF NOVEMBER 1, 2006



- **Common Stock**
 - Authorized: 10M shares
 - Outstanding: 4M owned by founders
 - Option Pool: 2M shares
 - 200K granted, none exercised
 - 1.8M available for grant
- **No preferred stock authorized**
- **Ownership: founders own 100% on an outstanding share basis and 67% on a fully-diluted share basis**
- **Fully diluted: 4M + 2M = 6M**
- **Cap table should look conventional**

SERIES A FINANCINGS POST-FINANCING CAP TABLE



- On a fully-diluted basis, resulting cap table may be:
 - 40-50% Preferred stock
 - 30-40% Founders common stock (with vesting restarts and other vesting pressure)
 - 20-25% Option pool – common stock
 - means founders are outvoted on an outstanding share basis. Series A may own more than 50% on an outstanding share basis
- Term sheet is 40/40/20

SERIES A FINANCINGS CONTROL



- **Control of company**
 - Board of Directors: 1 vote per member
 - Preferred Stock protective provisions
 - Common Stock protections
- **Board tends to be 5 persons**
 - 2 represent preferred stock
 - 2 represent common stock
- **Selection of 5th director is critical**
 - Selected by other directors
 - Selected by outstanding shares
 - Industry expert, independent
- **Scope of protective provisions**

SERIES A FINANCINGS TERM SHEETS



- **Sample term sheet**
 - Non-binding
 - Period for acceptance
- **Precedential impacts on future rounds**
- **No shop – item 16, page 8**
- **Pre-money valuation – item 1, page 1**
- **Price per share – item 6, page 2**
 - Impact of option pool – as pool size increases Series A price per share decreases
- **Vesting – item 13, page 7. What about founders?**
- **Liquidation preference – applies in an acquisition – item 7, page 2 (participating/3x)**
 - Initial
 - Non-participating
 - Participating (with and without cap)

LIQUIDATION PREFERENCE EXAMPLE (I)



- **Startup, Inc. is acquired for \$40M**
- **Series A LP is for \$4M, participating, no cap
Series A owns 50% and common stock owns 50% of the outstanding shares**
- **Distribution:**
 - 1) \$ 4M to Series A (initial)
 - 2) \$18M to Series A,
\$18M to common stock
 - 3) Series A receives a total of \$22M. Common stock gets \$18M

LIQUIDATION PREFERENCE EXAMPLE (II)



- **Startup, Inc. is acquired for \$40M**
Series A LP is for \$4M, participating, 3X cap
Series A owns 50% and common stock owns 50% of the outstanding shares
- **Distribution:**
 - 1) \$ 4M to Series A (initial); next \$18M to Series A, \$18M to common stock but Series A capped at 3X or \$12M
 - 2) Conversion to common stock scenario-50% is \$20M
 - 3) Series A will elect to convert so will receive \$20M as compared to \$22M in a no cap situation. Common stock gets \$20M.

SERIES A FINANCINGS TERM SHEETS



- Board composition – item 12, page 6
- Antidilution protection
 - Purpose is to adjust investors price if stock is sold at a lower price
 - Conversion Price decreases; investors will get more Common Stock
 - Weighted average rather than full ratchet – item 7, page 2 bottom
 - “Ratchet” conversion price down to new sale price
 - Exclusions

ANTIDILUTION PROTECTION



■ Weighted Average

- Difference in price (new sale vs. prior rounds) “weighted” by number of shares (new shares vs. prior shares)
- Broad Based Weighted Average
 - Includes outstanding shares, options, warrants, other rights
- Narrow Based
 - Includes outstanding shares only

ANTIDILUTION EXAMPLES

- **100 shares fully diluted**
 - 40 Series A
 - 40 Founders
 - 20 Option pool
- **Post Series A valuation of \$100.**
- **New purchase of 10 shares at \$0.50 per share. Total of \$5 paid.**



ANTIDILUTION EXAMPLES (continued)



■ Ratchet

- 40 Series A shares now convertible into 80 shares of Common Stock
- Result is Series A owns 57% of the company on a fully-diluted basis.

■ Broad Weighted Average

- Total shares $100+10 = 110$
- Post money plus amount paid for new shares = 105
- $110/105 = 1.05$
- 40 Series A shares now convertible into $1.05 \times 40 = 42$ shares of Common Stock

■ Narrow Weighted Average (outstanding shares only)

- Total shares $80+10 = 90$
- Post money + amount paid = 85
- $90/85 = 1.06$
- 40 Series A shares now convertible into $1.06 \times 40 = 42.4$ shares of Common Stock

DRAG-ALONG RIGHTS



- **Drag-along Rights – Item 17, page 8**
 - **Purpose is to provide investors with control over having liquidity through an M&A**
 - **Board and Preferred stock approve the transaction**
 - **Acquiror not affiliated with any major investor**
 - **Base valuation for the acquisition**

SERIES A FINANCINGS TERM SHEETS



- **Investors right of first refusal on new issuances – item 10, page 5**
 - Purpose is to provide investors the right to keep their ownership percentage in the company through additional investment
 - Exclusions

- **Registration rights – item 9, page 4**
 - Purpose is to provide liquidity in a public offering
 - Note “equivalent” language
 - Piggyback (also for founders)
 - Demand
 - S-3
 - Payment of expenses
 - Exclusions

SERIES A FINANCINGS TERM SHEETS



- **Right of first refusal and co-sale on founder's stock – item 14, page 7**
 - **Purpose is to provide investor the right to purchase a founder's shares if the company doesn't purchase or sell shares on the same terms if the founder is permitted to sell**
 - **Carveouts: gifts to immediate family**
 - **Exclusions: minimal sales allowed (5-10%)**



PREFERRED STOCK PROTECTIVE PROVISIONS



- Purpose is to require investor approval for certain actions – item 7(6), page 3 (13 actions)
 - Amend Articles/Bylaws
 - Create new series/Reclassify old series
 - Merger/Sale of Assets/Liquidation
 - Declare/Pay Dividend
 - Change Size of Board
 - Budget and spending
 - Others – avoid business micromanagement
- Series vs. Class Approval
 - Majority (or 2/3) of all Preferred Stock
 - Majority (or 2/3) of Series “X” Stock

SUMMARY

- **China venture capital deals usually have more control provisions of various types**
- **Larger financings are often made in installments based on milestones**
- **Founders are sometimes asked for representations and warranties to make them more personally accountable**
- **Deeper IP due diligence for some types of investment**
- **Investors often will require reincorporation in the Caymans if not already there**



THIS TERM SHEET SUMMARIZES THE PRINCIPAL TERMS OF THE PROPOSED FINANCING OF STARTUP, INC. (THE “COMPANY”). THIS TERM SHEET IS FOR DISCUSSION PURPOSES ONLY. EXCEPT FOR ITEM 16 BELOW, THERE IS NO OBLIGATION ON THE PART OF ANY NEGOTIATING PARTY UNTIL A DEFINITIVE STOCK PURCHASE AGREEMENT IS SIGNED BY ALL PARTIES. THE TRANSACTION CONTEMPLATED BY THIS TERM SHEET IS SUBJECT TO THE SATISFACTORY COMPLETION OF DUE DILIGENCE. THIS TERM SHEET DOES NOT CONSTITUTE EITHER AN OFFER TO SELL OR AN OFFER TO PURCHASE SECURITIES.

**MEMORANDUM OF TERMS FOR OFFERING
OF SERIES A PREFERRED STOCK**

October 27, 2006

VALID FOR ACCEPTANCE UNTIL 5:00 P.M. OCTOBER 30, 2006 PST

This memorandum summarizes the major terms of a private placement of Series A Preferred Stock of **Startup, Inc.** (the “Company”), an exempt company formed under the laws of the Cayman Islands. All dollar amounts are U.S. dollars.

Proposed Private Placement

- 1. Pre-money Valuation:** \$6,000,000
- 2. Amount of Investment:** \$4,000,000
- 3. Investors:**
- 4. Type of Security:** Series A Preferred Stock
- 5. Number of Preferred Shares:** 4,000,000

The post-financing capitalization of the Company will be as follows on a fully-diluted basis:

	<u>Shares</u>	<u>%</u>
Founders (Common Stock)	4,000,000	40
Stock Option Pool (Common Stock)	2,000,000	20
Series A Investors	<u>4,000,000</u>	<u>40</u>
Total:	10,000,000	100

**FOR EDUCATIONAL PURPOSES ONLY
FRED GREGURAS
FENWICK & WEST LLP
fgreguras@fenwick.com**

6. **Price Per Preferred Share:** \$1.00

7. **Rights, Preferences, Privileges and Restrictions Of Series A Preferred Stock:**

(1) Dividend Provisions: The holders of the Series A Preferred Stock will be entitled to receive noncumulative dividends in preference to Common Stock at the rate of 6% per annum when and if declared by the Company's Board of Directors (the "**Board**").

(2) Liquidation Preference: In the event of any liquidation, dissolution or winding up of the Company, the holders of the Series A Preferred Stock will be entitled to receive in preference to the holders of Common Stock an amount equal to \$1.00 per share plus declared and unpaid dividends. After the full liquidation preference on all outstanding shares of Series A Preferred Stock has been paid, any remaining funds and assets of the Company legally available for distribution to stockholders will be distributed, pro rata among the holders of the Series A Preferred Stock and Common Stock on an as-converted basis until the holders of Series A Preferred Stock have received three times (3X) the original purchase price for the Series A Preferred Stock.

A merger or reorganization or consolidation of the Company in which the Company's stockholders do not retain a majority of the voting power in the surviving entity, or a sale of all or substantially all the Company's assets, will each be deemed to be a liquidation, dissolution or winding up of the Company.

(3) Conversion: The holders of the Series A Preferred Stock will have the right to convert the Series A Preferred Stock, at the option of the holder, at any time, into shares of Common Stock at the rate of 1:1, subject to weighted average antidilution protection and adjustment for stock split, combination, recapitalization and the like. There shall be no antidilution protection for the issuances excluded under Right of First Refusal below.

(4) Automatic Conversion: The Series A Preferred Stock will be automatically converted into Common Stock, at the then applicable conversion rate, in the event of either (i) the closing of a bona fide underwritten public offering of shares of the Company with gross proceeds to the Company (prior to underwriter commissions and expenses) of not less than \$20 million (a "**Qualified IPO**") or (ii) the election of holders of a majority of the outstanding Series A Preferred

Stock.

(5) Voting Rights: The holder of each share of Series A Preferred Stock will have the right to that number of votes equal to the number of shares of Common Stock issuable upon conversion of such share of Series A Preferred Stock.

(6) Protective Provisions: Consent of the holders of at least a majority of the Series A Preferred Stock, voting as a class, will be required for: (i) any action which alters or changes the rights, preferences or privileges of the Series A Preferred Stock materially and adversely; (ii) any authorization of shares of any class of stock having preference over or being on a parity with the Series A Preferred Stock; (iii) any merger or reorganization or consolidation of the Company with or into one or more other corporations in which the Company's stockholders do not retain a majority of the voting power in the surviving entity, or sale of all or substantially all the Company's assets; (iv) the liquidation or dissolution of the Company; (v) the declaration or payment of any dividend on the Common Stock (other than a dividend payable solely in shares of Common Stock) or any series of the Preferred Stock; (vi) incurring any debt or financial obligation in excess of US\$250,000 in the aggregate unless incurred pursuant to the then current business plan approved by the Investors; (vii) extending or guaranteeing any debt or financial obligation; (viii) capital expenditure in excess of US\$50,000 unless such is incurred pursuant to the then current business plan approved by the Investors; (ix) transaction with a related party other than employment arrangements; (x) approval or amendment of annual business plans and budgets; (xi) appointment, termination, or change of terms of employment, including an increase of more than 10% in the total compensation in a twelve (12) month period of the ten (10) most highly compensated employees of the Company; (xii) material change in accounting methods or policies or change of auditors; and (xiii) change in the principal business activities of the Company.

8. Information Rights

So long as an investor holds at least 500,000 shares of Series A Preferred Stock or Common Stock issued upon conversion of the Series A Preferred Stock ("Conversion Stock") (as adjusted for stock splits, stock combinations, etc.), the Company will furnish the investor with unaudited monthly financial statements plus annual budgets; provided, however, that the obligation of the Company to furnish monthly financial statements will terminate upon a public offering.

9. Registration Rights:

The following registration rights shall apply to an offering in the U.S., Hong Kong, AIM or elsewhere. References to U.S. offering provisions shall have the equivalent meaning in an offering in another jurisdiction. (1) Demand Rights: If, at any time after the fifth anniversary of the closing of this transaction (but not within six months of the effective date of a registration), investors holding at least 50% of the Registrable Securities (defined below) request that the Company file a registration statement for at least 10% of such shares (or any lesser number of shares if the anticipated aggregate offering price, net of underwriting discounts and commissions, would exceed \$15 million), the Company will use its best efforts to cause such shares to be registered. The Company will not be obligated to effect more than two registrations under this demand right provision; provided, that (a) the Company shall have the right, exercisable only one (1) time in any 12 month period, to delay a demand registration for a period not in excess of ninety (90) days if the Company certifies that it would be seriously detrimental to the Company's interests to effect such registration at that time and (b) the Company shall not be obligated to effect more than two registrations under this demand right provision. "Registrable Securities" will consist of shares of Common Stock issuable on conversion of the Preferred Stock.

(2) S-3 Demand Rights: Holders of Registrable Securities shall be entitled to registrations on Form S-3 (if available to the Company) unless: (i) the aggregate public offering price of all Registrable Securities to be sold in such registered offering is less than \$3,000,000; (ii) the Company certifies that it would be seriously detrimental to the Company's interest to effect such registration at that time, in which event the Company may defer the filing for up to ninety (90) days once during any 12 month period; or (iii) the Company has already effected two registrations on Form S-3 during the preceding 12 months.

(3) Company Registration: The holder of Registrable Securities will be entitled to "piggyback" registration rights on registrations of the Company, subject to the right, however, of the Company and its underwriters to reduce the number of shares proposed to be registered in view of market conditions; provided, however, that except in the Company's initial public offering, the Registrable Securities may not be cut back to less than twenty-five percent (25%) of the total number of shares included in the registration.

(4) Expenses: The registration expenses (exclusive of underwriting discounts and commissions) of the demand registrations and piggyback registrations will be borne by the Company, and all S-3 registration expenses and other expenses of registered offerings will be borne by the Company.

(5) Transfer of Rights: The registration rights may be transferred (i) to partners and affiliates, (ii) to a transferee who acquires at least 100,000 shares of Preferred or Conversion Stock and (iii) in cases where less than 100,000 shares of Preferred or Conversion Stock are held, to a single transferee if all share holdings are transferred.

(6) Termination of Registration Rights: The registration rights shall terminate as to a holder if such holder can sell its shares under Rule 144 of the Securities Act of 1933, as amended.

(7) Market Standoff: Purchasers agree to 180-day lockup in connection with a Company IPO.

(8) Founders' Registration Rights: The Founders will have piggyback registration rights subordinate to those of the investors.

**10. Right of First Refusal
For New Company
Issuances:**

Each holder of more than 500,000 shares of Series A Preferred Stock (and/or Conversion Stock) (as adjusted for stock splits, stock combinations, etc.), shall have the right of first refusal to purchase up to its pro rata share (based on its percentage of the Company's outstanding shares of capital stock, calculated on an as-converted to Common Stock basis) of any equity securities offered by the Company ("New Securities") on the same price and terms and conditions as the Company offers such securities to other potential investors. "New Securities" shall not include (i) shares of Common Stock issued upon conversion of the Series A Preferred Stock; (ii) shares of Common Stock (and/or options or warrants therefore) that may be granted to employees, directors, contractors, consultants or advisors to the Company pursuant to incentive agreements, stock option plans, stock bonuses or awards, or incentive contracts, as approved by the Board; (iii) shares of Common Stock and/or Preferred Stock (and/or options or warrants therefore) that may be issued to strategic partners investing primarily in

connection with a commercial relationship with the Company, lenders, or lessors, in each case as approved by the Board, including a majority of the Preferred Stock Directors; and (iv) shares of Common Stock and/or Preferred Stock (and/or options or warrants therefore) that may be issued in connection with acquisitions by the Company of other entities or substantially all of their assets, in each case as approved by the Board. This right of first refusal will terminate immediately prior to the earlier of the closing of: (a) a Qualified IPO; (b) a merger or reorganization or consolidation of the Company with or into one or more other corporations in which the stockholders of the Company do not retain a majority of the voting power in the surviving entity), or (c) a sale of all or substantially all the Company's assets.

11. Purchase Agreement: The Purchase Agreement will contain such other provisions as are reasonable, including representations and warranties of the Company and the Founders, conditions to closing, etc., including without limitation, delivery of a customary opinion letter by counsel for the Company.

12. Board Composition: The Board will consist of 5 members.

So long as at least 50% of the shares of Series A Preferred Stock are outstanding (as adjusted for stock splits, stock combinations, etc.), the holders of Series A Preferred Stock will be entitled to elect two (2) members of the Board. So long as the holders of the Series A Preferred Stock are entitled, voting as a separate series, to elect directors, the holders of the Common Stock, voting together as a single class, will be entitled to elect two (2) members of the Board (initially the CEO and Founder One). Any directors not elected by the holders of a specified series or class of stock will be elected by the holders of the Common Stock and Preferred Stock, voting together as a single class.

The Company, the holders of Common Stock and the Series A Investors shall enter into a voting agreement which provides that: (i) Venture Capitalist One and Venture Capitalist Two each shall be entitled to designate one Series A director for so long as they hold a number of shares of capital stock of the Company equal to at least 50% of the shares of stock purchased in the Series A Financing (in each case as determined on an as-converted to Common Stock basis and adjusted for stock splits, stock combinations, etc.); (ii) the CEO and Founder shall hold the two Board seats to be filled by the vote of the Holders of Common Stock; and

(iii) _____ shall hold the Board seat to be filled by the vote of the holders of Common Stock and Preferred Stock, voting together as a single class. The initial directors upon the Closing of the Series A Financing will be _____ who will be chairman, two additional directors nominated by each of _____ and _____, and _____ and _____.

13. Standard Vesting:

Stock sold and options granted to employees will be subject to vesting over four years. 25% of the shares will vest at the end of the first year, with the balance to vest in equal monthly increments over the remaining three years; provided, however, that stock may be sold and options may be granted subject to a different vesting schedule if unanimously approved by the Board. The Company shall have a right to repurchase unvested shares upon termination of employment and a right of first refusal to purchase any shares of vested stock proposed to be transferred by an employee.

14. Right of First Refusal and Co-Sale Agreement:

Each holder of more than 500,000 shares of Series A Preferred Stock (and/or Conversion Stock) (as adjusted for stock splits, stock combinations, etc.) (a "**Rightholder**") shall have a right of first refusal on the sale of shares of Common Stock held by Founder One and Founder Two which are not purchased by the Company pursuant to its right of first refusal, calculated on a pro rata basis, based on such Rightholder's percentage of holdings of capital stock of the Company held by all Rightholders. In addition, each Rightholder shall have a right of co-sale in connection with sales by Founder One and Founder Two; calculated on a pro rata basis, based on the Rightholder's percentage of holdings of capital stock of the Company held all participating Rightholders. The foregoing rights shall terminate immediately prior to the earlier of the closing of: (i) a Qualified IPO; (ii) any merger or reorganization or consolidation of the Company with or into one or more other corporations in which the stockholders of the Company do not retain a majority of the voting power in the surviving entity), or (iii) a sale of all or substantially all the Company's assets.

15. Closing:

The closing of this transaction is expected to occur on or before November 15, 2006.

- 16. Exclusivity:** Company agrees to give the Investors forty five (45) days exclusivity (“**Exclusivity Period**”) starting from the signing date of this Term Sheet. During the Exclusivity Period, the Company and its shareholders, without the express written permission of the Investors, shall not engage in any discussions, negotiations or conclude any transaction with any third party with respect to an equity transaction or investment regarding the Company.
- 17. Drag Along Rights** The Series A will have a drag along right in an acquisition of the Company in which the Board of Directors has approved the transaction and the consideration to be paid for the Company exceeds \$30,000,000.
- 18. Investor’s Counsel Fees:** The Company will bear the expenses of one counsel to the investors in an amount not to exceed \$30,000.
- 19. Counsel to the Company:** Fred Greguras and Joshua Sun
Fenwick & West LLP
801 California Street
Mountain View, CA 94040
(650) 988-8500

This Memorandum represents only the current thinking of the parties with respect to certain of the major issues relating to the proposed Series A financing. Therefore, except for item 16, it is understood and acknowledged that this Memorandum is not intended and will not be deemed to be a legally binding agreement among the parties for any purposes. All rights and obligations of the parties will be subject to negotiation and execution of definitive financing documents among the parties and completion of the other matters set forth above.

THIS TERM SHEET SUMMARIZES THE PRINCIPAL TERMS OF THE PROPOSED FINANCING OF STARTUP, INC. (THE “COMPANY”). THIS TERM SHEET IS FOR DISCUSSION PURPOSES ONLY. THERE IS NO OBLIGATION ON THE PART OF ANY NEGOTIATING PARTY UNTIL A DEFINITIVE AGREEMENT IS SIGNED BY ALL PARTIES. THIS TERM SHEET DOES NOT CONSTITUTE EITHER AN OFFER TO SELL OR AN OFFER TO PURCHASE SECURITIES.

Non-Binding Term Sheet

October 27, 2006

**Startup, Inc., a Cayman Islands company (the “Company”)
Convertible Note Financing**

1. **Term of Loan** – 12 months
2. **Minimum Amount of Notes** – Up to \$350,000 in convertible notes which may be issued in multiple closings (the “Notes”). The Notes will be unsecured.
3. **Interest** – 8%/year, simple interest.
4. **Conversion Features** – Principal and interest due under the Notes automatically converts into preferred stock of the Company of the same series and with the same contract rights as is sold in the Company’s next equity financing in which the Company raises at least \$1,000,000 (including conversion of Notes) (a “**Qualified Financing**”); *provided* that, if a Qualified Financing does not close prior to the Note maturity date, then the Notes shall no longer convert but rather shall be due and payable. Lenders will receive preferred stock in the Qualified Financing as a result of automatic conversion on the same terms and conditions as other investors except as provided below under Discount.
5. **Prepayment** – Company may prepay the Note and accrued interest at any time prior to a Qualified Financing.
6. **Discount** – Each lender will receive a discount of 20% on the price per share of preferred stock in the Qualified Financing when a Note is converted into preferred stock.
7. **Acquisition** – In the event that the Company is acquired prior to the earlier of the conversion of the Notes in a Qualified Financing or the maturity date, then each noteholder shall be paid an amount equal to 1.5 the principal outstanding under each Note within 30 days after such acquisition.
8. **Subordination** – The Notes shall be subordinated to any Company borrowings from banks or other financial institutions.
9. **Securities** – Each lender must be an “accredited investor” or qualify under another securities law exemption.

**FOR EDUCATIONAL PURPOSES ONLY
FRED GREGURAS
FENWICK & WEST LLP
fgreguras@fenwick.com**