

**ANATOMY OF A TERM SHEET
VENTURE CAPITAL: AN OVERVIEW OF TRENDS,
STRATEGIES AND STRUCTURAL ISSUES**

**PRESENTED BY
ANDREW J. SHERMAN, ESQ.**

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**ANDREW J. SHERMAN, ESQ.
McDermott, Will & Emery
600 13th Street, N.W.
Washington, DC 20005
Phone: (202) 756-8610
Fax: (202) 756-8087
ajsherman@mwe.com**

Venture Capital: An Overview of Trends, Strategies and Structure

Owners and managers of early-stage growing companies often have mixed views toward the institutional venture capital industry. On one hand, they welcome the money and management support they desperately need for growth, but fear the loss of control and various restrictions that are typically placed on the company by the investment documents. In order to achieve the delicate balance between the needs of the venture capitalist and the needs of the company, business owners and managers must understand the process of obtaining venture capital financing.

Three Types of Venture Capitalists

In general, there are three different types of traditional institutional pools of venture capital, though in recent years the lines between the three may be blurring. These include:

Public and Private International Venture Capital Firms. These firms are typically organized as limited partnerships which themselves seek capital from venture investors, trusts, pension funds, insurance companies, among others. They in turn manage and invest in high-growth companies. Venture capital firms tend to specialize in particular niches, either by the business's *industry, territory* or *stage of development*. Their investors expect a certain success Return on Investment (ROI), which is critical to the firm's future ability to attract additional capital and track record.

SBIC/MESBIC. The Small Business Investment Act, enacted in 1958, established a national program for licensing privately owned small business investment companies (SBIC). Minority-Enterprise IBIC's were added by a 1972 amendment to the Act. Although the SBIC program has experienced some difficulty, it currently remains an integral part of the organized venture capital community. The program allows the SBA to grant licenses to certain types of venture capital firms that are eligible to borrow money from the Federal Government at very attractive rates in exchange for certain restrictions on deal structures as well as the types of businesses which the SBIC can provide capital.

Corporate Venture Capital Divisions. These include venture-capital divisions established by large corporations such as Intel and Motorola, usually in hopes of funding small companies that have technology or resources that larger companies want or need. The investment is often structured more like a quasi-joint venture, because corporate venture capital often brings more to the table than just money, such as access to the resources of these large companies. Corporate venture capital efforts typically revolve around the corporation's goals to incubate future acquisitions; gain access into new technologies; obtain intellectual property licenses; provide work for unused capacity; technology entrepreneur thinking to current corporate staff; final hours for excess cash; and break into new markets.

NARROWING THE FIELD

Preparation is the key to obtaining an initial meeting with the institutional venture capitalist. There are three central components to the preparation process: business and strategic planning; effective networking; and narrowing the field.

A well-written Business Plan and financing proposal is a necessary prerequisite to serious consideration by any sophisticated source of capital. Effective networking means using professional advisers, commercial lenders, investment bankers and consultants who may be able to assist you to get the Business Plan into the hands of the appropriate venture capitalists. Institutional sources of capital are often flooded with unsolicited, “non-introduced” plans that are more likely to end up in a wastebasket than before an investment committee. Remember that the average venture capital firm will see thousands of business plans per year, provide a return phone call on only a few dozen candidates and may actually close only four to six deals per annum, so you need to find ways to increase your chance of survival as the field of choices rapidly narrows. Finally, most venture capitalists have certain investment preferences regarding which companies they will include in their investment portfolio. These preferences may be based on the nature of the company's products and services, geographic location, projected rates of return, stage of development or amount of capital required. Rather than waste precious resources by blindly sending business plans to any and all venture capitalists in your region, take the time to research the venture-capital industry to match the characteristics of the proposed investment with the investment criteria of the targeted firm.

It may turn out that your company's stage of development will determine which kind of venture capital investor you'll approach, and the structure of the financing you'll receive, so it's important to identify which stage of business development financing you require before embarking on the search for capital.

The first level is *seed* financing, in which small amounts of capital are provided to the company for initial product feasibility studies, development, market research, refinement of strategies and other preliminary analyses.

The next level of financing is *start-up* or *early stage financing*, which is generally for completion of product development, recruitment of a management team, refinement of the long-term business plan and the commencement of marketing efforts. Recent capital market trends have had most venture capitalists investing in later-stage companies and companies already in their portfolios, with a greater emphasis on the company's ability to generate current income and return to the investors.

Next is *first-stage* financing, which usually funds the first phase of the full-scale manufacturing, marketing and sales. It is also at this stage that any missing components of the management team are completed. *Second-stage* financing is typically for a company that has begun its production and distribution, has established inventories, contracts and accounts receivable, but now needs working capital to fuel expansion. *Third-stage* financing is usually for a company that is already operating at a profit, but needs capital to research and develop new products, expand its physical facilities or make a significant increase in sales and marketing efforts. Finally, in *bridge financing*, venture capitalists will provide capital to a company which expects to go public within the next 12 months, but requires

additional working capital to bridge the gap. Firms will also consider providing capital to finance mergers and acquisitions, joint ventures, leveraged management, buy-outs or recapitalization, efforts to "go private" or other kinds of transactions, if the return on investment meets their criteria..

PREPARING FOR THE MEETING WITH THE VENTURE CAPITALISTS

If your business plan submission survives the rigid initial review of most institutional venture capital firms, then the key to your first meeting and success thereafter is **PREPARATION!** Keep in mind the following points:

- Have a dress rehearsal. You need to rehearse your presentation many times, using a “moot court.” This involves different audiences asking different questions, replicating the actual meeting that you’ll have with the managers of the venture capital firm. Make sure your rehearsal audiences (such as lawyers, accountants, business school professors, and entrepreneurs who have raised venture capital) have the background and the training to ask the right questions (including the tough ones) and be able to critically evaluate your responses. Do your homework on the venture capital firm and learn what their “hot buttons” may be so that you can address key issues in your presentation. As the saying goes, “You never get a second chance to make a first impression.” The rehearsals will help you survive the first meeting and get to the next steps. Be prepared for the tough questions and don't be scared, intimidated or upset when the really hard ones start flying at you. If the venture capital firm's team doesn't ask tough questions, then they are not "engaged" into your presentation. If they are not engaged enough to beat you up a little, then there will probably be no next steps and no deal.
- Have a mentor. It's always helpful to have a venture-capitalist coach or mentor who has himself either raised venture capital or been an adviser on or negotiated venture-capital transactions. The mentor or coach can help stay focused on the issues that are important to the venture capitalists and not be wasting their time. The mentor can reassure you during the difficult and time-consuming process, teach you to remain patient, optimistic and level-headed about the risks and challenges that you face.
- Have a detailed game plan - Prepare a specific presentation that isn't too long or too short (usually 15 minutes is about right). Don't attempt to “read” every word of your business plan or put every historical fact of your company on a Power Point slide. Keep it crisp and focused and be prepared for questions and to defend your key strategic assumptions and financial forecasts. Remember that every minute counts. Even the small talk at the beginning of the meeting is important because the seasoned venture capitalist is sizing you up, learning about your interests and looking for the chemistry and the glue that is key to a successful relationship.
- Have your team available to meet the venture capitalist. Don't overlook the “personal” component of the evaluation. In many cases it can be the most important factor considered in the final decision. The four “Cs”—camaraderie, communication, commitment and control (over your ego)—may make or break the outcome of the meeting. Any experienced venture

capitalist will tell you that, at the end of the day, the decision depends on the strength of the people who will be there day to day to execute and manage the future of the company. The venture capitalist will look for a management team that's educated, dedicated and experienced (and ideally has experienced some success *as a team* prior to this venture). The team should also be balanced, with each member's skills and talents complementing each other so that all critical areas of business management are covered—from finance to marketing and sales to technical expertise.

- Have passion but not rose-colored glasses. Many entrepreneurs fail to make a good impression in their initial meeting with the venture capitalist because they come on too strong or not strong enough. The experienced venture capitalist wants to see that you have a passion and commitment to your company and to the execution of the business plan. However, he or she does not want to be oversold or have to deal with an entrepreneur who is so enamored of an idea or plan that he or she can't grasp its flaws or understand its risks.
- Have a way to demonstrate your personal commitment to the project. All venture capitalists will look to measure your personal sense of commitment to the business and its future. Generally, venture capitalists won't invest in entrepreneurs whose commitment to the business is only part-time or where their loyalty is divided among other activities or ventures. In addition to fidelity to the venture, the investor will look for a high energy level, a commitment to achievement and leadership, self-confidence, and a creative approach to problem solving. You will also have to demonstrate your personal financial commitment by investing virtually all of your own resources into a project before you can ask others to part with their resources. Remember, any aspect of your personal life, whether it's good, bad or seemingly irrelevant, may be of interest to the venture capitalist in the interview and due diligence process. Don't get defensive or be surprised when the range of questions are as broad as they are deep—venture capitalists are merely trying to predict the future by learning as much as possible about your past and current situation.
- Have an open and honest exchange of information. One sure deal killer for venture-capital firms is if you try to hide something from your past or downplay a previous business failure. A seasoned venture capitalist can and will learn about any skeletons in your closet during the due diligence process, and will walk away from the deal if they find something that should have been disclosed to them at the outset. A candid, straightforward channel of communication is critical. A previous business failure may be viewed as a sign of experience, provided that you can demonstrate that you've learned from your mistakes and figured out ways to avoid them in the future. On a related note, you must demonstrate a certain degree of flexibility and versatility in your approach to implementing your business plan. The venture capitalists may have suggestions on the strategic direction of the company and will want to see that you are open-minded and receptive to their suggestions. If you're too rigid or too stubborn, they may view this as a sign of immaturity or that you're a person with whom compromise will be difficult down the road. Either one of these can be a major deal "turn-off" and a good excuse to walk away.

- Have a big market and a big upside. Make sure your Business Plan and your presentation adequately demonstrates the size of your potential market(s) and the financial rewards and healthy margins that strong demand will bring to the bottom line. A venture capitalist who suspects that your product or service has a narrow market, limited demand and thin margins will almost always walk away from the deal. If your target market is too mature with already established competitors, then the venture capitalist may feel the opportunity is too limited and will not produce the financial returns that they expect. They're looking for a company that has a *sustainable competitive advantage*, demonstrated by a balanced mix of products and services that meet a *new* market need on both a domestic and overseas basis. Remember that most venture capitalists want a 60% to 80% return for seed and early-stage or post-launch deals and at least a 25% to 35% return on latter-stage and mezzanine level investments. When the S&P 500 offers 30% returns and when the average investor can double his or her money with investments in lower-risk companies like General Electric and Intel, then your Business Plan and presentation had better demonstrate that the venture capitalists' money will be better served in your company.
- Have an understanding of what really motivates the venture capitalist's decision. David Gladstone, a seasoned venture capitalist and author of the *Venture Capital Handbook*, writes: "I'll back you if you have a good idea that will make money for both of us." That one sentence captures the essence of the venture capitalist's decisionmaking process. You must have a *good idea*—one that's articulated in a business plan that truly expresses the risks and opportunities and how your management team will influence the odds of success and survival. But then, it must make money for *both* of you. The venture capitalist wants deals where both the investors *and* the entrepreneurs can enjoy the upside and the scale is not weighted in favor of one over the other. Finally, the *I'll back you* component reminds you that in exchange for capital and wisdom, the venture capitalists expect to have some controls and "checks and balances" built into the structure of the deal, the governance of the company and protection in the documents to ensure that their investment and ability to participate in the growth and success of the company are protected.
- Have an exit strategy - The saying "Begin with the end in mind," clearly applies to venture capital deals. Investors aren't looking for a long-term marriage; they will be very focused on how you intend to get their original investment and return on capital back to them within four to six years. Your business plan and oral presentation should include an analysis and an assessment of the likelihood of the three most common exit strategies, namely: an initial public offering; a sale of the company; and a redemption of the venture capitalists' shares of the company by the company directly. Other exit strategies include restructuring the company, licensing the company's intellectual property, finding a replacement investor or even liquidating the company.

Due Diligence is A Two-Way Street

At the same time that your Business Plan is under the microscope during the venture capitalist's evaluation and due diligence, you should be assessing the prospective venture capitalist's strengths and weaknesses. As long as the capital markets remain strong, your ability to be selective in choosing which venture capital proposal will be acceptable will remain available. Consider the following questions when determining whether the venture capital firm fits into your current and projected requirements:

- How well does this firm know your industry? How often does it work with companies that are at a development stage similar to yours? To what extent has it worked with owners and managers of more seasoned companies in a turnaround situation?
- What assistance can the venture capitalist bring to you in terms of management expertise, industry contacts and support services?
- What is the reputation of this firm within the financial community? If this firm is to serve as the "lead investor," then how effective will it be in helping to attract additional co-investors? Has the firm asked for any special reward or compensation for serving as lead investor? What effect will this have on the willingness of other co-investors to participate?
- Will this firm be able to participate in later rounds of financing if the company continues to grow and needs additional capital?

To answer these questions, you should speak with investment bankers, attorneys, accountants and other venture capitalists who are familiar with this particular firm. Most important, you should speak with owners and managers of other companies in the investor's portfolio, to determine the level of support, conflict and communication typically provided by the firm and be sure to talk to both successful and unsuccessful portfolio companies. Find out how the venture capitalist reacted to companies that got into trouble, not just those that outstripped projections.

NEGOTIATING AND STRUCTURING THE VENTURE CAPITAL INVESTMENT

The negotiation and structuring of most venture capital transactions depends less on "industry standards", "legal boilerplate" or "structural rules-of-thumb" and more on the need to strike a balance between your needs and concerns and the venture capitalist's investment criteria. Initial negotiations and alternative proposed structures for the financing will generally depend on an analysis of the following factors:

Your Main Concerns

- Loss of management controls;
- Dilution of your personal stock;
- Repurchase of your personal stock in the event of employment termination, retirement or resignation;

- Adequate financing;
- Security interests being taken in key assets of the company;
- Future capital requirements and dilution of the founder's ownership; and
- Intangible and indirect benefits of venture capitalist participation, such as access to key industry contacts and future rounds of capital

Their Main Concerns

- Your company's current and projected valuation;
- Level of risk associated with this investment;
- The fund's investment objectives and criteria;
- Projected levels of return on investment;
- Liquidity of investment, security interests and exit strategies in the event of business distress or failure ("Downside Protection");
- Protection of the firm's ability to participate in future rounds if company meets or exceeds projections ("Upside Protection");
- Influence and control over management strategy and decisionmaking;
- Registration rights in the event of a public offering; and
- Rights of first refusal to provide future financing

Concerns for Both of You

- Retention of key members of the management team (and recruitment of any key missing links);
- Resolution of any conflicts among the syndicate of investors (especially where there is a lead investor representing several venture capital firms);
- Financial strength of the company post-investment; and
- Tax ramifications of the proposed investment.

**SAMPLE TERM SHEET –
FOR DISCUSSION PURPOSES ONLY**

XYZ, INC.
SALE OF SERIES A CONVERTIBLE PREFERRED STOCK
TERM SHEET

Confidential

This term sheet summarizes the principal terms with respect to a potential private placement of equity securities of XYZ, Inc. (the “Company”) by a group of investors (the “InvestorCo”). This term sheet is intended solely as a basis for further discussion and is not intended to be and does not constitute a legally binding obligation except as provided under “Confidentiality” below. No other legally binding obligations will be created, implied, or inferred until a document in final form entitled “Stock Purchase Agreement,” is executed and delivered by all parties. Without limiting the generality of the foregoing, it is the parties intent that, until that event, no agreement shall exist among them and there shall be no obligations whatsoever based on such things as parol evidence, extended negotiations, “handshakes,” oral understandings, or courses of conduct (including reliance and changes of position), except as provided under “Confidentiality” below. The Company and the Investors are discussing a private placement of shares of Series A Convertible Preferred Stock on the following terms:

Issuer: XYZ, Inc. (the "Company")

Investors/Amount of Investment: InvestorCo, or one or more designees of InvestorCo, and certain other investors to be determined for an amount up to \$_____ million with an initial closing of \$_____. The Company and InvestorCo shall have the right to approve all members of the investment syndicate and such approval shall not be unreasonably withheld.

Type of Security: Shares of the Company’s Series A Convertible Preferred Stock (“Series A Preferred Stock”), convertible into shares of the Company’s Common Stock (“Common”). Upon conversion, but prior to a public sale, the Common into which the Series A Preferred Stock has been converted will be referred to as Conversion Shares.” (Assume no existing preferred.)

Number of Shares: Up to _____ shares of Series A Preferred Stock

Founders: _____ and (“Founders”)

Price Per Share: \$_____ per share (“Original Purchase Price”).

Capitalization of the Company:

	Current	%	Post-Financing	%
Common	_____	____%	_____	____%
Convertible Debt (Common)	_____	____%	_____	____%
Convertible Debt (Series A Preferred)	_____	____%	_____	____%
Series A Preferred	_____	____%	_____	____%
Options	_____	____%	_____	____%
	_____	____%	_____	____%

Rights, Preferences, Privileges:

(1) Dividend Provisions: The holders of the Series A Preferred Stock will be entitled to receive dividends at an annual rate of 8% of the then Original Purchase Price whenever funds are legally available and when and as declared by the Board. No dividend shall be paid on the Common at a rate greater than the rate at which dividends are paid on Series A Preferred Stock (based on the number of shares of Common into which the Series A Preferred Stock is convertible on the date the dividend is declared). Dividends on Series A Preferred Stock will be in preference to dividends paid on the Common. Dividends on the Series A Preferred will be cumulative.

(2) Liquidation Preference: In the event of any liquidation, dissolution or winding up of the Company, the holders of Series A Preferred Stock will be entitled to be paid as follows: First, the holders of the Series A Preferred Stock shall be entitled to receive in preference to the holders of Common an amount (“Liquidation Preference”) equal to the Original Purchase Price plus any dividends declared on the Series A Preferred but not paid. Second, the holders of Series A Preferred Stock and the holders of Common will be entitled to receive pro rata, on a pari passu basis with the Series A Preferred Stock being deemed to have been converted to Common immediately prior to such liquidation, the remaining amounts or assets to holders of capital stock of the Company, provided that the holders of the Series A Preferred Stock shall not be entitled to receive pursuant to this sentence an amount in excess of three times the Original Purchase Price. The effectuation by the Company or third-party acquirors of a transaction or series of transactions in which more than 50% of the voting power of the Company is disposed of to a single person or group of affiliated persons or the consolidation or merger of the Company with or into any other corporation or corporations or the sale of all or substantially all of its assets shall be deemed to be a liquidation, dissolution or winding up for purposes of the liquidation preference.

(3) Conversion: A holder of Series A Preferred will have the right to convert Series A Preferred Stock, at the option of the holder, at any time, into shares of Common. The total number of shares of Common into which Series A Preferred may be converted initially will be determined by dividing the Liquidation Preference by the conversion price. The initial conversion price will be the Original Purchase Price. The conversion price will be subject to adjustment to reflect stock dividends, stock splits and similar events and as provided in paragraph (4) below. The Series A Stock will be automatically converted into Common, at the then applicable conversion price, in the event of (a) an underwritten public offering of shares of Common at a public offering price per share that would value the Company at not less than \$3.00 per share (subject to adjustment) in an offering of not less than \$10,000,000 or (b) the vote of the holders of two-thirds of the outstanding Series A Preferred Stock.

(4) Antidilution Provisions: The conversion price of the Series A Preferred Stock will be subject to adjustment (a) for stock dividends, stock splits, or similar events, and (b) on a weighted average basis to prevent dilution in the event that the Company issues additional shares at a purchase price less than the Original Purchase Price, as adjusted hereunder. No adjustment to the conversion price will occur for any issuance of additional shares at a purchase price in excess of the Original Purchase Price, as adjusted hereunder. Conversion prices will not be adjusted because of (a) conversion of Series A Preferred Stock, or (b) the issuance and sale of, or the grant of options to purchase, 10% shares of Common pursuant to the Company's employee stock purchase or option plans (the "Reserved Employee Shares").

(5) Voting Rights: Except as provided by law and with respect to election of Directors, a holder of Series A Preferred Stock will have the right to that number of votes equal to the number of shares of Common issuable upon conversion of its Series A Preferred Stock at the time the shares are voted. Election of Directors will be as described under "Board Representation" below.

(6) Protective Provisions: Without the written consent of at least one Series A Preferred Director, which consent will not be unreasonably withheld, conditioned or delayed, the Company will not agree to and the Board will not authorize any of the following matters: (1) approval of the Company's annual capital expenditure budget; (2) approval of the Company's annual performance budget; (3) incurrence of any indebtedness in excess of \$____; (4) incurrence of any lien upon any of its property or revenues in excess of \$____; (5) transactions with affiliates of the Company, provided that an affiliate shall not include a subsidiary of the Company, whether or not wholly-owned; (6) appointment or dismissal of the Company's Chief Executive Officer and any other member of senior management; (7) approval of the Chief Executive Officer's and each other member of senior management's respective employment arrangements; or (8) creation of a subsidiary other than a wholly-owned subsidiary.

Written consent of the holders of fifty-one percent (51%) of the Series A Preferred Stock will be required for: (1) authorization, creation and/or issuance of a senior class or series of equity securities over the Series A Preferred Stock or a parity class or series of equity securities; (2) amendments to the Certificate of Incorporation or By-Laws of the Company; (3) an increase or decrease in the size of the Board of Directors; (4) payment of dividends, or redemption or repurchase of stock or stock options; (5) liquidation or dissolution of the Company or the sale, lease or other disposal of all or substantially all of the Company's assets; and (6) any reorganization, consolidation or merger of the Company with another entity in which more than 50% of the voting power of the Company is transferred.

Information and
Registration Rights:

(1) Information Rights: So long as an Investor holds Series A Preferred Stock (or Conversion Shares), the Company will deliver to such Investor annual audited and quarterly unaudited financial statements. So long as the Investor holds at least 25% of the capital stock (in the form of Series A Preferred Stock or Conversion Shares) held on the date of the Closing, the Company will timely furnish each Investor with annual budgets after such budgets have been approved by the Company's Board of Directors.

(2) Demand Rights: If, at any time after the earlier of the Company's initial public offering and the date three years from the purchase of the Series A Preferred Stock (but not within 180 days of the effective date of a registration), investors holding at least 25% of aggregate voting power of the Series A Preferred Stock

and Conversion Shares request that the Company file a Registration Statement for at least 25% of the Common issued or issuable upon conversion of the Series A Preferred Stock (or any lesser percentage if the aggregate offering price to the public would exceed \$5,000,000), 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 (other than on Form S-3) under these demand registration right provisions.

(3) Piggyback Registration: The Investors will be entitled to “piggyback” registration rights on registrations of the Company or on any demand registrations, subject to the right of the Company and its underwriters, in view of market conditions, to reduce or eliminate the number of shares of the Investors proposed to be registered.

(5) Registration Expenses: All registration expenses (exclusive of underwriting discounts and commissions and special counsel fees of a selling shareholder) shall be borne by the Company.

(6) Other Registration Provisions: Other provisions will be contained in the Investor Rights Agreement with respect to registration rights as are customary, including the agreement by the holders of the Series A Preferred Stock (if requested by the underwriter in connection with the initial public offering of securities of the Company) not to sell any unregistered Common they hold for a period of 180 days following the effective date of the Registration Statement of such offering.

Board Representation:	The authorized number of directors of the Company will be fixed at _____. The Board of Directors (the “Board”) shall include: (i) at least two (2) representatives designated by the Series A Preferred Stock (each a “Series A Preferred Director”); and (ii) three (3) representatives designated by the Founders (each a Founder-Director). InvestorCo shall be entitled to elect one of the Series A Preferred Directors in the event that InvestorCo (or its designees) purchases at least \$_____ of the Series A Preferred Stock.
Use of Proceeds:	The proceeds from the sale of the Series A Preferred will be used for working capital.
Employment Relationships:	The Company has or will have prior to the closing employment agreements with persons mutually agreed to by the Company and Investors (the “Management Team”).
Drag-Along Rights:	In the event that one or more holders of the capital stock of the Company holding more than 75% of the voting power of the capital stock of the Company (with the Series A Preferred Stock voting on an as converted to Common basis) accept an offer to sell all of their stock to a third party, and such sale is conditioned upon the sale of all remaining capital stock of the Company to such third party, all of the holders of the capital stock of the Company shall be required to sell their stock in such transaction, on the same terms and conditions.
Right of First Refusal:	In the event that the Company offers equity securities (other than Reserved Employee Shares, or upon conversion of outstanding Series A Preferred Stock, or upon exercise of outstanding options or warrants, or in connection with an acquisition or in a public offering), each Investor shall have a right of first refusal to purchase a pro rata percentage of shares in the new offering, based on the holder's percentage ownership interest in the Company.

Tag-Along Rights: In the event a Founder proposes to sell shares of the Company, each Investor will be entitled to participate in such sale by selling the same percentage of his stock as such Founder is selling of his stock.

Confidential Information and Inventions Assignment Agreement: Each officer, director and key employee of the Company will enter into a Confidential Information and Inventions Assignment Agreement in a form reasonably acceptable to the Company and the Investors.

The Stock Purchase Agreement: The purchase of the Series A Preferred, if consummated, will be made pursuant to a Stock Purchase Agreement (with exhibits) drafted by counsel to the Company and acceptable to the Investors. The Stock Purchase Agreement will contain, among other things, representations and warranties of the Company, covenants of the Company, and conditions to the obligations of the Investors.

Redemption: If the Series A Preferred Stock has not been converted to Common before December 31, 2005, the holders shall have the option to force the Company to redeem the Series A Preferred Stock in three equal yearly installments beginning March 1, 2006. The redemption amount shall be equal to the original Series A Preferred Stock purchase price, plus any accrued but unpaid dividends.

Voting Agreement: The Founders will enter into a voting agreement with the Investors to enforce their obligations hereunder.

Conditions of Closing: The closing for the purchase of the Series A Preferred will be conditioned upon:

- (1) Completion of due diligence to the satisfaction of the Investors in their sole discretion.
- (2) Execution by the Company of a Stock Purchase Agreement and related agreements satisfactory to the Investors in their sole discretion.
- (3) Compliance by the Company with applicable securities laws.
- (4) Opinion of counsel to the Company rendered to the Investors in form and substance satisfactory to the Investors.
- (5) Other material conditions, to be discussed.
- (6) Such other conditions as are customary for transactions of this type.
- (7) Execution by the Founders of a Voting Agreement.

Expenses: The Company and the Investors will each bear their own legal and other expenses with respect to the transaction (except that the Company will pay the fees and expenses of (a) counsel to the Investors and (b) consultants to the Investors, subject to a maximum aggregate amount for both (a) and (b) of \$_____). The Investors shall be entitled review by their attorneys of material agreements, at the Investors' sole cost and expense, following the transaction; provided, however, that the Company shall have no obligation to provide such information to Investors if the Company reasonably determines that the information contains confidential information of the Company.

Finders: The Company and the Investors each will indemnify the other for any finder's fees for which that party is responsible.

Closing: The initial closing of the sale of \$_____ of Series A Preferred Stock, if all conditions are met, is expected to occur on or before _____, 2001. The additional Series A Preferred Stock may be sold by the Company on a rolling basis thereafter.

Expiration of Proposal: This Term Sheet will automatically expire, and be of no further force or effect, if (1) the Investors have not received from the Company a copy of this letter acknowledged and agreed to by the Company on or before 5:00 p.m. Eastern Standard Time on _____, 2001 or (2) prior to any such receipt, the Investors orally or in writing, give notice of withdrawal hereof. In addition, the Proposal will expire if the Investors do not purchase the Series A Preferred Stock for cash by _____, 2001.

Confidentiality: The terms of the Proposal are confidential, and neither the contents of this letter nor the details of the Proposal may be shown or disclosed by the Company except to those individuals at the Company who have a need to know as a result of being involved in the proposed transaction and, after signing this Proposal, the Company may disclose the contents to other individuals who have a need to know as a result of being involved in the proposed transaction or to other individuals or entities for purposes of making such individuals or entities "Investors" in the Company's Series A Preferred Stock.

Counsel to the Investors: _____

Phone:
Fax:
Attn:

Counsel to the Company: McDermott, Will & Emery
600 Thirteenth Street, N.W.
Washington, D.C. 20005
Phone: (202) 756-8610
Fax: (202) 756-8087
Attn: Andrew J. Sherman, Esq.

THE FOREGOING SUMMARY SETS FORTH THE TERMS OF THIS LETTER OF INTENT, WHICH TERMS ARE NON-BINDING EXCEPT FOR THE CONFIDENTIALITY PROVISIONS WHICH SHALL BE BINDING AND SURVIVE EXECUTION OF THIS AGREEMENT.

Dated: _____, 2001

INVESTORCO

XYZ, INC.

By: _____
Name:
Title:

By: _____
Name:
Title:

Summary Biographical Information

Andrew J. Sherman, Esq. is an internationally-recognized authority on the legal and strategic aspects of entrepreneurship and business growth. A summary of his accomplishments include:

- Mr. Sherman is a senior partner with **McDermott, Will & Emery**, an international law firm with over 925 lawyers worldwide, where he manages a multi-million dollar corporate and transactional practice representing Fortune 1000 corporations as well as hundreds of technology-driven, netecentric and rapidly growing businesses. He chairs the firm's regional Emerging Business and Technology practice group as well as chairs the firm's international Franchising, Licensing and Distribution group. His current and previous clients include Intel, Apple Computer, America On-Line (AOL), Texaco, Panasonic, Revlon, Beatrice Foods, Sanyo, GAF, Caterpillar, Owens-Corning, Shell Oil, Sears, Metrocall, Bankers Trust, Household Finance Corporation, Pritzker Organization (Hyatt Hotels), MarchFirst (Whittman-Hart and CKS/USWeb), the Western Professional Hockey League and the Great Lakes Baseball League.
- He is the author of eleven (11) books on business growth, capital formation and the leveraging of intellectual property, including the best-selling and critically-acclaimed **Raising Capital** (Kiplingers, 2000), **The Complete Guide to Running and Growing Your Business**, (RandomHouse, 1997) and **Franchising and Licensing: Two Ways to Build Your Business**, (2nd edition) (AMACOM Books, 1999) and **FastTrack Growth Strategies** which is due for release in October of 2001.
- He has appeared as a guest and a commentator on all of the major television networks as well as CNBC's "Power Lunch," CNN's "Day Watch," CNNfn's "For Entrepreneurs Only," USA Network's "First Business," and Bloomberg's "Small Business Weekly" and various other regional and local television broadcasts as well as national and local radio interviews for National Public Radio (NPR), Business News Network (BNN), Bloomberg Radio, AP Radio Network, Voice of America, Talk America Radio Network and the USA Radio Network, as a resource on capital formation, entrepreneurship and technology development.
- He has served as an Adjunct Professor in the Masters of Business Administration (MBA) programs at the **University of Maryland** for twelve (12) years and at **Georgetown University** for six (6) years where he teaches courses on Entrepreneurship and Business Planning, Growth Strategies and New Venture Financing, and has won various teaching awards including the Krowe Award for Teaching Excellence in 2000.
- He serves as **General Counsel** to several of the nation and region's leading entrepreneurship organizations, including the **Young Entrepreneurs Organization (YEO)**, the National Foundation for Teaching Entrepreneurship (NFTE), the Let's Talk Business Network (LTBN) and the Morino Institute's Netpreneur program, since the inception of these organizations. He was one of the co-founders of the Washington, D.C. regional chapter of the Association for Corporate Growth and serves on the Inner Circle and as a key advisor to the Dingman Center for Entrepreneurship at the University of Maryland.
- Mr. Sherman is a frequent author and serves as a resource for articles in a wide variety of the nation's leading magazines, newspapers and websites including the **Wall Street Journal**, the **New York Times**, **Fortune**, **Investor's Business Daily**, **USA Today**, **Inc.**, **Nation's Business**, **Success**, the **Washington Post**, **Forbes**, **My Business**, **U.S. News and World Report**, **Business Week**, **Money**, **Legal Times**, **Washington Business Journal**, **Crain's**, **Entrepreneur**, CNNfn.com, Inc.com, Fortune.com, Office.com, MSNBC.com, and the Kauffman Center for Entrepreneurial Leadership's EntreWorld.org web sites.
- Mr. Sherman is the Chairman of the Professional Advisory Board of the **National Commission on Entrepreneurship** (NCE), the Chairman of the Technology and Innovation Committee for the **Washington Board of Trade's** Potomac Conference, serves on the Board of Directors of Youth Services America, the Research Institute for Small and Emerging Businesses (RISE Business), NFTE (Former Chairman 1993-1995), YEO, the **Washington Business Journal's** Editorial Advisory Board, **Inc. Magazine's** Business Consulting Services Advisory Board, the **Opportunity International** Board of Governors, the **Gazelles/Masters of**

Business Dynamics Advisory Board and serves on the advisory boards of several business incubators and early-stage and rapidly-growing technology companies.

- Mr. Sherman serves as an on-line columnist for two of the Internet's leading sites for small and emerging growth companies. He writes the "Can This Business Be Saved?" column for **FortuneSmallBusiness.com** as well as the "View from The Trenches" column for AOL's **Netbusiness.com** and serves as a key member of the **AOL Small and Emerging Business Champions Team**. He is also a frequent contributor to the Kaufman Center for Entrepreneurial Leadership's website, **EntreWorld.org**.
- He is a frequent national and international lecturer at business conferences where he has delivered speeches and lead seminars on entrepreneurship, capital formation, mergers and acquisitions, the protection and leveraging of intellectual property and business planning for organizations such as **Inc. Magazine** (Growing Your Company, Capital Formation and CEO Symposium Conferences), the **Association of Financial Professionals**, the **Young Entrepreneurs Organization**, the **National Restaurant Association**, **iBreakfast.com**, the **U.S. Chamber of Commerce**, the **New York Venture Group**, the **Dingman Center for Entrepreneurship**, **Netpreneur.org**, the **Baltimore-Washington Venture Group**, the **National Association of Credit Managers**, **PC Expo**, the **International Franchise Association**, **Microsoft's** Small Business Crossing Seminar Series, the **Regional Investment Bankers Association**, the **Collegiate Entrepreneurs Organization**, the **Association for Corporate Growth**, the **American Management Association**, the **Council for Growing Companies**, and various other international and regional business organizations.
- He is the developer and lecturer for several different business growth courses and seminar series, including serving as the author of two workbooks and videos for Kiplinger's, entitled **Growing Your Business** and **Corporate Transition Management and Exit Strategies**, as well as a four-part cyber-conference and workbook on **Mergers and Acquisitions** for the Association of Financial Professionals, a seminar series on **Strategies for Protecting Your Intellectual Property** for Padgett-Thompson, a series of conferences on **Growth-Oriented Distribution Strategies** for the American Management Association and a series of conferences on **Strategies for Doing Business Abroad** for the International Franchise Association.