# TERM SHEET

## FOR SERIES "A" ROUND OF FINANCING OF XCORP

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| Amount of Investment: | $3,000,000 | |
| Investors: | ABC Ventures<br>XYZ Capital | |
| Type of Security: | Series A Convertible Preferred Shares | |
| Premoney Valuation: | $7,000,000[1] | |
| Capital Structure Following Series A Round: | Existing holders of Common Shares | 55% |
| | Employee Stock Option Plan | 15%[2] |
| | Holders of Series A Preferred Shares | 30% |
| | Total | 100% |

Use of Proceeds: The Company shall use the proceeds from this financing for working capital purposes.

Dividends: The Company will not pay dividends on its shares of Common Shares or any other class of shares which is junior to the Series A Preferred Shares unless a like dividend is paid on all shares

***The following annotations are prepared by Fasken Martineau DuMoulin and are designed to help the reader better understand the various elements of a traditional VC term sheet:***

1. Equals the value the new investors are placing on the enterprise prior to their investment. Usually, all of the outstanding shares of the company, together with any outstanding options and warrants or other rights to buy shares of the company and any additional shares which may be reserved under the option pool, will be included in this premoney valuation.

2. The number of shares available under the employee stock option plan ("ESOP") that venture capital investors will accept tends to range between 10% and 20% of the outstanding number of shares of the company (on a fully diluted, as-if converted basis). This percentage is calculated including the Series A Preferred Shares being sold in the financing. The actual number of shares available under an ESOP can depend on a number of things, including the industry that the company is in, but is primarily related to the number and types of hires that the company will need to make in the foreseeable future. Thus, a company that has a complete management team at the time of the Series A round will likely need a smaller pool than a company that has one or more top management hires to make (each of whom may cost the company a significant amount of options or shares from the pool).

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| | of Series A Preferred Shares on a pro rata "as converted" basis.[3] |
| Conversion: | Each share of Series A Preferred Shares shall be convertible, at any time, at the option of the holder, into Common Shares, at an initial conversion ratio of one Common Share for each share of Series A Preferred Share. Mandatory conversion of the Series A Preferred Shares upon execution of an underwriting agreement in connection with an underwritten public offering of Common Shares of the Company by a reputable underwriter acceptable to the Investors at a price which equals or exceeds five times the purchase price per share of the Series A Preferred Shares and where the aggregate gross proceeds received by the Company exceeds $25 million (a "Qualified Public Offering")[4]. |
| Antidilution: | The terms of the Series A Preferred Shares will contain standard "weighted average" antidilution protection with respect to the issuance by the Company of equity securities at a price per share less than the applicable conversion price then in effect, subject to standard and customary exceptions.[5] The conversion rate of the Series A Preferred Shares into common shares will be adjusted appropriately to account for any share splits, recapitalizations, mergers, combinations and asset sales, stock dividends, and similar events. Antidilution protection shall |

3. Often, venture capital investors also ask for an "accruing" dividend of between 8% and 10% or so per annum. This dividend "accrues" and is not payable unless (i) declared by the Board, (ii) there is a liquidation event (a sale of the company is considered a liquidation event, but an IPO usually isn't), or (iii) the preferred shares are redeemed. The accruing dividend is a protective device intended to provide a minimum rate of return but is usually forfeited in the event of an IPO or otherwise upon conversion of the preferred shares to common shares. (The theory is that in such cases the return on the investment will be more than the minimum which the accruing dividend provides. Therefore, the protection is not needed and is forfeited). There are a number of varieties of accruing dividends, including those that are payable in cash and those payable in additional shares of preferred shares. Also, although a basic "accruing dividend" involves a simple interest calculation, sometimes a so-called "cumulative" accruing dividend is requested, and it involves compound interest calculations.

4. Preferred shares should convert into common shares automatically at the company's IPO. The special rights generally accorded to preferred shares sold to early-stage investors could create problems for a public company.

5. These provisions are designed to protect an investor against "equity" dilution (later sales of shares at a price lower than what the investor paid). Although the "weighted average" version is the most common, an alternative is "full ratchet" antidilution protection. Full-ratchet antidilution protection is far more advantageous to the investor (but punitive to the company) than weighted average, but it is usually reserved for very early-stage deals or other situations where there is significant concern as to whether the valuation will hold up over the long term. Put simply, weighted-average antidilution protection accounts more accurately for the actual dilutive effect which a particular issuance has on the investor's equity position in the company. Full-ratchet antidilution protection, on the other hand, treats all later share issuances below the investor's purchase price as if they were the same, regardless of the number of shares issued.

not be triggered by the issuance of up to 1,000,000 Common Shares (or options therefor) issued in accordance with the Company's ESOP.

Voting Rights:

On all matters submitted for shareholder approval, each Series A Preferred Share shall be entitled to such number of votes as is equal to the number of Common Shares into which such shares are convertible. In addition, the Company shall not, without the prior consent of the holders of at least a majority of the then issued and outstanding Series A Preferred Shares, voting as a separate class:

a) issue or create any series or class of securities with rights superior to or on a parity with the Series A Preferred Shares or increase the rights or preferences of any series or class having rights or preferences that are junior to the Series A Preferred Shares so as to make the rights or preferences of such series or class equal or senior to the Series A Preferred Shares.

b) pay dividends on shares of the Company.

c) effect any exchange or reclassification of any shares affecting the Series A Preferred Shares or any recapitalization involving the Company and its subsidiaries taken as a whole.

d) repurchase or redeem, or agree to repurchase or redeem, any securities of the Company other than from employees of the Company upon termination of their employment pursuant to prior existing agreements approved by the Board of Directors of the Company.

e) enter into any transaction with management or any member of the board of directors, except for employment contracts approved by the Board of Directors and transactions entered at arms-length terms which are no less favorable to the Company than could be obtained from unrelated third parties.

f) effect any amendment of the Company's Certificate of Incorporation or Bylaws which would materially adversely affect the rights of the Series A Preferred Shares.

g) incur or guarantee debt in excess of $100,000.

h) voluntarily dissolve or liquidate.

i) effect any merger or consolidation of the Company with or into another corporation or other entity (except one in the holders of shares of the Company immediately prior to such a merger or consolidation continue to hold at least a majority of the outstanding shares of the surviving entity after the merger or consolidation) or sell, lease, or otherwise dispose of all or substantially all or a significant portion of the assets of the Company.

j) Change the size of the Board of Directors or change any procedure of the Company relating to the designation, nomination, or election of the Board of Directors.

k) Amend, alter, or repeal the preferences, special rights, or other powers of the Series A Preferred Shares so as to adversely affect the Series A Preferred Shares.

l) Make capital expenditures of more than $50,000 in a single expenditure or an aggregate of $100,000 in any twelve-month period.[6]

Liquidation Preference:

The holders of Series A Preferred Shares shall have preference upon liquidation over all holders of Common Shares and over the holders of any other class or series of shares that is junior to the Series A Preferred Shares for an amount equal to the greater of (i) amount paid for such Series A Preferred Shares plus any declared or accrued but unpaid dividends, and (ii) the amount which such holder would have received if such holder's Series A Preferred Shares were converted to Common Shares immediately prior to such liquidation. Thereafter, the holders of Common Shares will be entitled to receive the remaining assets. For purposes of this section, a merger, consolidation, sale of all or substantially all of the Company's assets, or other corporate reorganization shall constitute a liquidation, unless the holders of at least a majority of the Series A Preferred Shares vote otherwise.[7]

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6. Although there are venture capital investors that ask for other veto rights, this list covers some of the most frequently requested veto rights. You may not have to provide veto rights with respect to each of these matters. The key here is to try to limit veto rights to major corporate events and to try to avoid turning day-to-day operational matters into matters for a preferred shareholder vote. Thus, for example, (g) and (1) could be problematic if the dollar limits are too low. Often a compromise may be reached with respect to a request for a veto right on an operational matter by agreeing that such would be subject to the veto of the Series A Preferred Shares director but not at the shareholder level. That keeps the issue at the board level -- where it belongs.

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| Board of Directors: | The Board of Directors of the Company shall be composed of five members. Of these five members, the holders of the Series A Preferred Shares shall have the right to designate two directors (one of such two directors to be designated by ABC Ventures, the other by XYZ Capital), and the founders of the Company shall have the right to designate two directors. The remaining director shall be designated by such four directors.[8] |
| Options and Vesting: | All options held by founders, management, and employees shall vest over a four-year period. Change of control provisions to provide for no more than an additional 50% for founders and select management and one year for all others.[9] |
| Registration Rights: | Commencing on the earlier of three years from the closing or six months after the effective date of the Company's first public offering, holders of Series A Preferred Shares or Common Shares issued upon conversion thereof ("Registrable Shares") shall have the right to demand two "S-1" registrations with aggregate gross offering price in excess of $10,000,000, upon customary terms and conditions.<br><br>The holders of Series A Preferred Shares will also be entitled to "piggyback" registration rights on Company registrations.<br><br>The holders of Series A Preferred Shares will also be entitled to unlimited registrations on Form S-3 with at least $1,000,000 in aggregate gross offering price, on customary terms and conditions. |

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7. This is a so-called "straight" liquidation preference. An alternative is the "double dip" or "participating" liquidation preference, which provides that the preferred shares get an amount equal to its money back (plus any accrued dividends if there is an accruing dividend) and then participates with common shares on an "as converted basis." A double-dip liquidation preference is a pricing term most often seen in early-stage deals or in "down rounds."

8. Working out what the Board will look like following the Series A round will be one of the most important matters to deal with. Generally, the Series A investors will ask for and receive representation on the board. The questions will be how many seats do they get and what effect will that have on the founders' and management's board representation. In the end, everybody involved will need to participate in, and be satisfied with, the decisions regarding board structure.

9. Venture capital investors will likely impose a vesting schedule on options held by founders, management, and employees as a condition to investment. If options are not yet vested, they are subject to being lost if the person ceases to work for the company for any reason. Venture capital investors impose such vesting requirements in order to provide the company's people with a reason to stay with the company. Also, if a person ceases to work for the company for any reason, the nonvested shares are available for grant to his or her replacement. The theory here is, of course, that the best business plan is worth nothing without the people to execute it.

The Company will bear all expenses related to all registrations and underwritings.

Affirmative Covenants: While any Series A Preferred Share is outstanding, the Company will:

a) maintain adequate property and business insurance.

b) comply with all laws, rules, and regulations.

c) preserve, protect, and maintain its corporate existence; its rights, franchises, and privileges; and all properties necessary or useful to the proper conduct of its business.

d) submit all filings and payments to the CCRA on a timely basis.

e) cause all key employees to execute and deliver noncompetition, nonsolicitation, nonhire, nondisclosure, and assignment of inventions agreements for a term of their employment with the Company plus one year in a form reasonably acceptable to the Board of Directors.

f) not enter into related party transactions without the consent of a majority of disinterested directors.

g) reimburse all reasonable out-of-pocket travel-related expenses of the Series A Preferred Shares directors.[10]

Financial Statements and Reporting: The Company will provide all information and materials, including, without limitation, all internal management documents, reports of operations, reports of adverse developments, copies of any management letters, communications with shareholders or directors, and press releases and registration statements, as well as access to all senior managers as requested by holders of Series A Preferred Shares. In addition, the Company will provide the holders of Series A Preferred Shares with unaudited monthly and quarterly and audited yearly financial statements, as well as an annual budget.

10. This list includes items frequently looked for by venture capital firms.

Redemption: Commencing with the date that is five years from the date of closing and on each one-year anniversary of such date thereafter, holders of at least a majority of the then issued and outstanding Series A Preferred Shares may request the Company to redeem their shares at a price equal to the original purchase price for such shares plus any declared but unpaid dividends, with 1/3 of the shares to be redeemed shall be redeemed on such redemption date, an additional 1/3 on the date that is one year from such date, and the remaining 1/3 on the date that is two years from such date.[11]

Right of First Refusal: Holders of Series A Preferred Shares shall have a pro rata right, based on their percentage of fully diluted equity interest in the company, with an undersubscription right up to the total number of shares being offered, to participate in subsequent share issuances.[12]

Right of First Refusal and Cosale: In the event that any of the Founders and existing executive management propose to sell their shares to third parties, the Company shall have the first right to purchase the securities on substantially the same terms as the proposed sale; the Series A Preferred Shareholders shall next have said right according to respective percentage ownership of Series A Preferred Shares or to sell proportionate percentage pursuant to cosale rights. Such rights shall terminate upon a Qualified Public Offering.

Other Provisions: The purchase agreement shall include standard and customary representations and warranties of the Company, and the other agreements prepared to implement this financing shall contain other standard and customary provisions. Definitive agreements will be drafted by counsel to the Investors. This term sheet is intended by the parties to be nonbinding.[13]

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11. This is simply a right to achieve liquidity in the event that the company does not otherwise reach a sale or IPO by the end of the selected time period. Since the company cannot redeem shares if to do so would render the company insolvent, this right is useful only in situations in which the company has become some sort of a sideways play. Usually the redemption price is the price paid for the shares plus the accruing dividend, if there is one. Occasionally, venture capital firms will request that the redemption price be at the greater of such price and the then fair market value of the shares. The only thing to watch out for here is to make sure that the company can pay the redemption out over time.

12. While this is generally asked for and received by venture capital investors (who can give you a yes or no quickly without the need for elaborate disclosure documents to comply with the securities laws), a company should, in my opinion, think about resisting this request if it comes from individual investors.

13. The term sheet should be nonbinding (with the exception only of the exclusivity provision, if there is one, and any provisions regarding confidentiality).

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| Expenses: | The Company will reimburse the holders of Series A Preferred Shares for reasonable legal fees in connection with the transaction, payable at closing and only in the event that the transactions contemplated by this term sheet are consummated, up to a limit of $25,000.[14] |
| Conditions to Closing: | Closing shall be subject to the standard and customary conditions, including the completion of due diligence and the delivery to the investors of a legal opinion of counsel to the Company, regarding standard and customary matters and satisfactory to the Investors and their legal counsel.[15] |

By:__________________________ By:__________________________

14. The amount of expenses included in this provision depends on where the lawyers are from. Make sure that there is a cap. You may also want to resist any request to pay ongoing fees for the cost of complying with requests for waivers, etc., after the closing (except to the extent to which the investors incur fees because the company breaches its obligations to them).

15. Be on the lookout for any exclusivity provisions in this clause. Usually, such exclusivity provisions require the company to refrain from taking an investment from anyone else for a set period of time after the term sheet is signed. While an exclusivity provision may be acceptable (and is often imposed), be sure to pay attention to the time period. It should be no longer than is necessary to complete the transaction, with a little extra time for possible delays. In my opinion, 30 days should be acceptable in most instances; 60 days is pushing it in most instances; and 90 days is probably unreasonable in almost all cases. Also, make sure that the exclusivity period automatically ends in the event that the deal is called off before the period expires.