

**Form:**

Term Sheet for Potential Investment by Strategic Investor

**Description:**

This is a very detailed term sheet for a prospective Preferred Stock investment in a private company, coupled with a strategic agreement and warrants. This tends to be very pro-investor oriented and is more detailed than most term sheets.

**[Name of Company]**  
**TERM SHEET FOR POTENTIAL INVESTMENT**

Series [ ] Preferred Stock

Confidential

This term sheet summarizes the principal terms with respect to a potential private placement of equity securities of \_\_\_\_\_ (the "Company") by a group of investors (the "Investors") led by \_\_\_\_\_ ("Strategic Investor"). 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," "Exclusivity," "Expenses," "Due Diligence" and "No Other Agreements" 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," "Exclusivity," "Expenses," "Due Diligence" and "No Other Agreements" below.

The Company and the investors are discussing a private placement of shares of Preferred Stock on the following terms:

AMOUNT OF INVESTMENT	Approximately \$ _____ to \$ _____
VALUATION OF THE COMPANY	\$ _____ pre-money valuation on a fully diluted basis*
TYPE OF SECURITY	Shares of the Company's Series __ Preferred Stock ("Series __ Preferred"), convertible into shares of the Company's Common Stock.
PRICE PER SHARE	\$ _____ ("Original Purchase Price").

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\* This includes an increase in the Company's Stock Option Plan to \_\_\_\_\_ shares, so that the Company shall have sufficient authorized number of options for employees, officers, directors and consultants for 12 months after the sale of the Series \_\_ Preferred.

POST-FINANCING CAPITALIZATION

	Common Stock Equivalent <u>Number of</u> <u>Shares</u>	<u>(%, fully-diluted)</u>
Common Stock		
Series A <sup>1/</sup>		
Series B <sup>1/</sup>		
[Series C <sup>1/</sup> ]		
[Series D <sup>1/</sup> ]		
Warrants <sup>2/</sup>		
Outstanding Options		
Reserved Options <sup>3/</sup>	_____	
Total		<u>100.00%</u>

- <sup>1/</sup> \_\_\_\_\_ Converts on 1 to 1 basis
- <sup>2/</sup> \_\_\_\_\_ Consists of \_\_\_\_\_, \_\_\_\_\_ and \_\_\_\_\_.
- <sup>3/</sup> \_\_\_\_\_ Includes expansion of the Company's stock option pool by \_\_\_\_\_ shares.

RIGHTS, PREFERENCES  
PRIVILEGES AND RESTRICTIONS  
OF PREFERRED STOCK

(1) Dividend Provisions. The holders of the Preferred will be entitled to receive dividends at the rate of 8% of the 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 Preferred (based on the number of shares of Common into which the Preferred is convertible on the date the dividend is declared). Dividends on Preferred will be in preference to dividends paid on the Common. Dividends on the Preferred will be noncumulative.

(2) Liquidation Preference. In the event of any liquidation or winding up of the Company, the holders of Preferred Stock will be entitled to receive in preference to the holders of Common Stock an amount equal to their original issue prices plus all declared but unpaid dividends (if any). The Preferred Stock will be participating so that after payment of the original issue prices to the holders of Preferred Stock, the remaining assets shall be distributed pro-rata to all shareholders on a common equivalent basis.

A merger, acquisition or sale of substantially all of the assets of the Company in which the shareholders of the Company do not own a majority of the outstanding shares of the surviving corporation shall be deemed a liquidation.

(3) Optional Conversion. The holders of Preferred Stock will have the right to convert Preferred Stock at the option of the holder, at any time, into shares of Common Stock. The Series \_\_\_ Preferred Stock shall initially be convertible on a 1 for 1 basis. The conversion rate shall be subject from time to time to antidilution adjustments as described below.

(4) Automatic Conversion. The Series \_\_\_ Preferred Stock will

be automatically converted into Common upon (i) the closing of an underwritten public offering of shares of Common Stock of the Company at a public offering price per share (prior to underwriting commissions and expenses) that values the Company after the offering of at least \$100 million in an offering of not less than \$20 million and at a per share price of at least **[twice] [three]** times the Original Purchase Price, before deduction of underwriting discounts and registration expenses (a “Qualifying IPO”) or (ii) approval of 66-2/3% of outstanding Series \_\_ Preferred Stock.

(5) Antidilution. Proportional antidilution protection for stock splits, stock dividends, combinations, recapitalizations, etc. The conversion price of the Series \_\_ Preferred Stock shall be subject to adjustment to prevent dilution, on a weighted average basis, in the event that the Company issues additional shares of Common or Common equivalents (other than up to \_\_\_\_\_ employee shares) at a purchase price less than the conversion price.

(6) Voting Rights. The holders of Preferred Stock will have a right to that number of votes equal to the number of shares of Common Stock issuable upon conversion of Preferred Stock.

## REGISTRATION RIGHTS

(1) Demand Rights: If investors holding at least 30% of Preferred Stock (or Common issued upon conversion of the Preferred Stock or a combination of such Common and Preferred Stock) request that the Company file a Registration Statement for at least 30% of their shares (or any lesser percentage if the anticipated gross receipts from the offering exceed \$5,000,000) the Company will use its best efforts to cause such shares to be registered; provided, however, that the Company shall not be obligated to effect any such registration prior to the earlier of (i) **[12 months after closing date] [some specific date]**, or (ii) within one year following the effective date of the Company’s initial public offering. The Company shall not be obligated to effect more than three registrations under these demand right provisions.

(2) Company Registration: The holders of registration rights shall be entitled to “piggy-back” registration rights on registrations of the Company or on demand registrations of any later round investor subject to the right, however, of the Company and its underwriters to reduce the number of shares proposed to be registered pro rata in view of market conditions. Any cutbacks shall first be from any Founder and management shares.

(3) S-3 Rights: Holders of registration rights shall be entitled to an unlimited number of demand registrations on Form S-3 (if available to the Company) so long as such registration offerings are in excess of \$1 million; provided, however, that the Company shall only be required to file three Form S-3 Registration Statements on demand of the holders of Preferred Stock every 12 months.

(4) Superior Registration Rights: No shareholder of the Company shall be granted registration rights superior to those of the Preferred Stock without the consent of the holders of at least 50% of the Common issued or issuable upon conversion of the Preferred Stock. If superior registration rights are granted, the Company shall grant the same registration rights to the holders of Preferred Stock.

(5) Expenses: The Company shall bear registration expenses (exclusive of underwriting discounts and commissions) of all demands, piggybacks, and S-3 registrations. The Company will pay the reasonable fees of special counsel to the selling shareholders.

(6) Transfer of Rights: The registration rights may be transferred provided that the Company is given written notice thereof and provided that the transfer (a) is in connection with a transfer of all securities of the transferor, (b) involves a transfer of at least \_\_\_\_\_ shares (or the entire original investment position of the transferor), (c) is to constituent partners or members or (d) is to transferees who agree to act through a single representative.

(7) Termination of Registration Rights: The registration obligations of the Company will terminate on the earlier of five (5) years after the IPO or, with respect to any holder of registration rights who holds less than 1% of the outstanding stock of the Company, at such time as all registrable securities of such holder are freely tradeable immediately in one transaction pursuant to Rule 144.

(8) Market Standoff: In connection with the IPO, each holder of registration rights will be required not to sell or otherwise dispose of any securities of the Company (except for those securities being registered) for a period of 180 days following the effective date of the registration statement for such offering if so requested by the underwriters of such offering; provided that, all 1% or more holders, all directors and all officers are so bound and provided further that any early release from this standoff provisions shall be pro rata to all holders bound by the market standoff provision.

(9) Other Provisions: Other provisions shall be contained in the Registration Rights Agreement with respect to registration rights as are reasonable, including cross-indemnification (subject to the provision that under no circumstances shall a selling shareholder's liability exceed the amount of net

proceeds received by such shareholder on sale of his shares), the period of time in which the Registration Statement shall be kept effective, underwriting arrangements, the ability of the Company to delay demand registrations for up to 90 days (S-3 Registrations for up to 60 days) and standard information and inspection rights.

## RIGHT OF FIRST REFUSAL

The holders of Preferred Stock shall have the right in the event the Company proposes an equity offering of any amount to any person or entity (other than for a strategic corporate partner, employee stock grant, equipment financing, acquisition of another company) to purchase all or any portion of such shares pro rata in proportion to their ownership stake in the Company based on outstanding shares.

The Company has an obligation to notify all holders of Preferred Stock of any proposed equity offering of any amount.

If the holders of Preferred Stock do not respond within 21 days of being notified of such an offering or decline to purchase all of such securities, then that portion which is not purchased may be offered to other parties on terms no less favorable to the Company for a period of 90 days. Such right of first offering will terminate upon an underwritten public offering of shares of the Company.

In addition, the Company will grant the holders of Preferred Stock any rights of first refusal granted to subsequent purchasers of the Company's equity securities to the extent that such subsequent rights are superior, in good faith judgement of the Company's Board of Directors, to those granted in connection with this transaction.

## PROTECTIVE PROVISIONS OF THE PREFERRED AS A CLASS

So long as Preferred Stock remains outstanding, the Company shall not, without the vote or written consent of at least **[66-2/3%] [a majority]** of the holders of Preferred Stock, (i) authorize or issue any equity security senior to or pari passu with the Preferred Stock as to voting rights, dividend rights, redemption rights or liquidation preferences (ii) increase the number of authorized shares of capital stock of the Company (iii) change the authorized number of Directors (iv) amend its Certificate of Incorporation or Bylaws in a manner that would adversely alter or change the rights, preferences or privileges of any Preferred Stock (v) purchase or redeem any shares of Preferred Stock or Common Stock, other than the repurchase of shares from officers, directors, employees or consultants on terms approved by the Board or (vi) pay or declare any dividends or other distributions with respect to the Common or Preferred Stock. Written consent of **[66-2/3%] [a majority in interest]** of the Preferred shareholders, voting as a single class, shall be required for (a) any merger, consolidation, or other corporate reorganization, (b) any transaction or series of transactions in which in excess of 50% of the Company's voting power is transferred or in which all or substantially all of the assets of the Company are sold, or (c) permit any

subsidiary of the Company to sell any securities to a third party.

PROTECTIVE PROVISIONS FOR THE SERIES \_\_ PREFERRED

The consent of the holders of at least [66-2/3%] [a majority in interest] of the outstanding Series \_\_ Preferred will be required for any action which would: (i) amend or repeal any provision of, or add any provision to, the Company's Certificate of Incorporation or Bylaws to change the rights of the Series \_\_ Preferred, or increase or decrease the number of authorized shares of the Series \_\_ Preferred; (ii) create any new series or class or shares having a preference or priority as to voting rights, dividend rights, redemption rights or liquidation preferences over that of the Series \_\_ Preferred; (iii) create any bonds, notes or other obligations convertible into, exchangeable for or having option rights to purchase shares of stock with any preference or priority as to voting rights, dividend rights, redemption rights or liquidation preferences over that of the Series \_\_ Preferred; (iv) reclassify any class or series of Common into shares with a preference or priority as to voting rights, dividend rights, redemption rights or liquidation preferences over that of the Series \_\_ Preferred; or (v) apply any of its assets to the redemption or acquisition of any shares of Common, except from employees, advisors, officers, directors and consultants of the Company on terms approved by the Board.

BOARD OF DIRECTORS

The Board of Directors shall consist of \_\_\_\_\_ (\_\_) members. The holders of a majority of the Series \_\_ Preferred shall be entitled to elect one (1) member of the Company's Board of Directors. The remaining directors shall be elected as follows: one (1) member elected by the Series \_\_ Preferred; one (1) member elected by \_\_\_\_\_; one (1) member elected by \_\_\_\_\_; [and one (1) member elected by Strategic Investor], and \_\_\_\_\_.

PROPRIETARY INFORMATION AND INVENTIONS AGREEMENT

Each officer, director, and employee of the Company has entered into a confidentiality and inventions assignment agreement including non-solicitation of employee provisions for a period of one year after employment. The Founders and each consultant developing work for the Company have also executed such an agreement.

VESTING:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

QUALIFIED SMALL BUSINESS STOCK:

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The Company will represent and warrant that there is no condition preventing the Series \_\_ Preferred Stock from being "Qualified Small Business Stock" as defined in Section 1202(c) of the Internal Revenue Code of 1986, as amended. The Company will covenant that it will use reasonable best efforts to avoid actions or circumstances that would cause the Series

\_\_ Preferred Stock to cease to constitute “Qualified Small Business Stock”.

**RIGHT OF FIRST REFUSAL AND CO-SALE AGREEMENT**

The Founders will enter into a right of first refusal and co-sale agreement pursuant to which, if the Founders propose to sell all or a portion of any of their shares to a third party, they must either permit the holders of the Series \_\_ Preferred at their option (i) to purchase such stock on the same terms as the proposed transferee, or (ii) sell a proportionate part of their shares on the same terms offered by the proposed transferee. Such right will terminate upon the closing of a Qualifying IPO.

**PURCHASE AGREEMENT:**

The investment shall be made pursuant to a Stock Purchase Agreement acceptable to the Company and the Investors, which agreement shall contain, among other things, representations and warranties of the Company with respect to intellectual property, financial statements, litigation, previous employment, outside activities, Year 2000, the Company's standard 4-year stock option vesting (with one year cliff), covenants of the Company reflecting the provisions set forth herein, appropriate conditions of closing, including an opinion of the counsel for the Company, and other terms. The rights of the Series \_\_ Preferred will not be less in any manner than the rights of the existing series of Preferred Stock.

**MARKETING AGREEMENT:**

The negotiation, finalization and execution of a [**Marketing Agreement**] [**Licensing Agreement**] [**other agreement**] on terms mutually acceptable to the Company and Strategic Investor is a condition to Strategic Investor's participation as an investor.

**[OBSERVATION RIGHTS:**

**Strategic Investor shall have Board observation rights pursuant to Strategic Investor's standard Board Observation Rights letter, separately provided to the Company.]**

**[IPO PARTICIPATION:**

**Each Investor who purchases at least \$\_\_\_\_\_ million of shares shall have the right, exercisable no later than 15 days prior to the close of the Company's IPO, to purchase up to \$\_\_ million of shares in the IPO at the price initially offered to the public less the underwriter's discount. Such shares shall be fully registered and tradable without restriction. Such sale shall be conducted in compliance with applicable securities laws. If for any reason the Company is unable to sell such shares to the Investors because of securities law reasons, the Investors shall receive five-year warrants to purchase shares of Common Stock with the same dollar amount of securities and purchase price, containing customary provisions and net issuance rights to the holders.]**

**EXPENSES:**

The Company will pay the legal fees of outside counsel to Strategic Investor in connection with its investment and the [**Marketing Agreement**] [**Licensing Agreement**] [**other agreement**], payable by wire transfer at the closing as a condition to closing, in the fixed amount of \$35,000 plus actual out-of-pocket expenses.

CORPORATE ISSUES:

The Company will execute Strategic Investor's standard letter, separately provided to the Company, acknowledging Strategic Investor's unrestricted right to pursue other similar opportunities and not be restrained in its ability to conduct business.

CONFIDENTIALITY:

The existence and terms of this Term Sheet, and the fact that negotiations and discussion may be ongoing between the Company, Strategic Investor and the Investors, are strictly confidential and may not be disclosed by the Company to anyone except the Company's directors, senior executive officers and legal counsel.

DUE DILIGENCE:

The Company shall fully cooperate in connection with the Investors' due diligence review. Among other matters, satisfactory due diligence review is a condition for the Investors' commitment to move forward on the transaction.

[EXCLUSIVITY:

**Neither the Company nor any of the Company's directors, officers, employees, agents or representatives will solicit, encourage or entertain proposals from or enter into negotiations with or furnish any nonpublic information to any other person or entity regarding the possible sale of the Company's stock. The Company shall notify Strategic Investor promptly of any proposals by third parties with respect to the acquisition of the Company's stock and furnish it the material terms thereof. The Company shall deal exclusively with Strategic Investor with respect to any such possible transaction and Strategic Investor shall have the right to match such proposed transactions in lieu of such third parties. This right shall last for a period of 30 days from the date hereof.]**

NO OTHER AGREEMENTS:

This term sheet represents the entire understanding and agreement of the parties with respect to its subject matter, and supersedes any prior or contemporaneous representations, understanding or agreements between STRATEGIC INVESTOR and the Company. This term sheet and any related transactions may only be amended or documented in a writing signed by both parties who are signatories hereto.

ADDITIONAL ISSUANCES:

Strategic Investor shall have the right to veto issuances of any shares of capital stock of the Company to the following entities for equity financing purposes at any time before the earlier to occur of the IPO or [date]: **[any travel agency (whether on-line or off-line) and any financial services company.] [refine as necessary]**

WARRANTS:

The Company will issue a warrant containing the following terms to Strategic Investor concurrently with the closing of the purchase of the Preferred:

- (a) Warrant to purchase shares of Series \_\_ Preferred Stock convertible to Common Stock.
- (b) Exercisable in **[number of tranches]** in whole or in part at any time and from time to time from the date of grant through the expiration of the particular tranche. The exercise price and vesting of each tranche is set forth below:  
**[insert details of the tranches-exercise price, number of shares, and term]**
- (c) All tranches exercisable in whole or in part from and after the date of issuance until maturity of the particular tranche.
- (d) Method of exercise includes “net issuance” or “cashless exercise” rights.
- (e) Antidilution adjustments of the exercise price and number of shares subject to the warrant for events such as merger, stock split, reclassification, stock dividend.
- (f) Underlying preferred should be authorized and should be subject to antidilution protection during the term of the warrant.
- (g) Warrants may be transferred by Strategic Investor in conformity with applicable securities laws.
- (h) Registration rights comparable to those applicable to the Preferred will apply to the common stock obtained upon conversion of the Preferred Stock issuable upon exercise of the warrants.
- (i) Parties agree to treat and report for all purposes the warrant as part of Strategic Investor’s concurrent investment in the Preferred Stock pursuant to the Preferred Stock Purchase Agreement between the Company and Strategic Investor. The parties will not treat the Warrant and the shares as being granted or issued as property transferred in connection with the performance of services or otherwise as compensation for services rendered.
- (j) **[Most Favored Nations. If Company enters into any other transaction with [another party] [a competitor] with provisions which, taken as a whole, are more favorable than the provisions available to Strategic Investor in the transaction of which the Warrant is a part, then Strategic Investor shall be entitled to the benefits of the other agreement. Company will not enter into a transaction with [another party] [a competitor] more favorable than the provisions available to Strategic Investor in the transaction of which this Warrant is a part, then Strategic Investor shall be entitled to the benefits of the other agreement. Company will not enter into a transaction with [another party] [a competitor] in which Company agrees to issue equity or rights to acquire equity where the provisions in such transaction are more favorable than those available to Strategic Investor.]**
- (k) Strategic Investor will be entitled to receive a stock purchase agreement with representations and warranties

and customary closing documents including disclosure schedule and opinion of counsel at time of warrant exercise. Strategic Investor shall be entitled to do customary due diligence prior to the exercise of the warrant.

COUNSEL TO THE COMPANY:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

COUNSEL TO STRATEGIC INVESTOR:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

EXPECTED CLOSING DATE

\_\_\_\_\_

Date: \_\_\_\_\_

Strategic Investor

Company

By: \_\_\_\_\_

By: \_\_\_\_\_

Title: \_\_\_\_\_

Title: \_\_\_\_\_