How to Maneuver Venture Capital

Charlie Bass

April, 2007
U.S. Venture Capital Investment by Year

Avg. $M per Deal
Why do you want to be an entrepreneur?

- Money is good, but not a sufficient reason
- How much do you want to succeed?
- You need passion, maybe obsession
- Don’t risk more than you afford to lose
What are your accomplishments?

• Have you built a product?
• A team?
• A company?
• How are your references?
• Do you really know what is going on in your field?
  – You have to live it
  – Age matters
What is the idea?

- Elevator speech –
  - product
  - market
  - value proposition
- “The Player”
How far along are you?

- **Idea**
  - No one will sign an NDA, so what is your protection?

- **Prototype**
  - Definitely helps, especially to nail concept

- **Revenue**
  - From whom?
  - Why?
  - Do they define the market?

- **Profit**
  - Why are you raising private $$?
What is your role?

What if you reach your personal limitations?

• Are you open to bringing in a CEO?

• Your only assurance (insurance) is your value to the enterprise
How much $$?

• **Now**
  - <$1M - find an angel
  - >$10M - it’s going to be a stretch

• **Later**
  - It’s expected and may help your case
  - You’ll be kept on a short leash
  - There needs to be a meaningful milestone for the next round
Is there a business plan?

• How long is it?
  – Be prepared for it not being read

• Powerpoint/Video
  – More important than a document

• Pro forma financials
  – Assumptions
  – Everything will be discounted
Who is the competition?

- Nobody? Then maybe there is no market
- Google? Reconsider
- Yahoo? Not what it once was
- Microsoft? Like IBM circa 1985
Alternative ways of accomplishing the same thing?

• Is this faster, smaller, cheaper, more complete, more robust, targeted ......

• Or - excuse the expression - a paradigm shift?

• A solution looking for a problem?
Can you go public?

• The bar is significantly higher than in ‘99-’00
  – Now it takes revenue, not just clicks

• Transparency is essential
  – Minimize disclosures, lease-backs, in-laws, ...

• Can you afford it?
  – Process costs $200,000
    • Underwriters will take 6–7% off the top
Can you be acquired?

- Why would you be?
  - Product
  - Customers
    - They need to love you
  - Distribution
    - Often the barrier to entry
  - People
Who will give you $$?

• Every firm has a profile
  – Early vs. late stage
  – Pre-IPO
• It isn’t necessarily what they say
  – Look at investments over last 3-4 years.
• Now how do you find them?
  – And meet them
    • Over the transom won’t work
• Or they find you
  – Associates spend their time reading blogs
## Most active venture investors
### Full-year 2006

<table>
<thead>
<tr>
<th>Firm</th>
<th>Location</th>
<th># of deals</th>
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<th>Location</th>
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<td>Ignition Partners</td>
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<td>Tech Coast Angels</td>
<td>Laguna Hills, CA</td>
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<td>Edison Venture Fund</td>
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<td>Dallas, TX</td>
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<td>DCM - Doll Capital Management</td>
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<td>ARCH Ventures</td>
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<td>Goldman, Sachs &amp; Co.</td>
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<td>vSpring Capital</td>
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<td>VantagePoint Venture Partners</td>
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<td>Rustic Canyon Partners</td>
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<td>Enterprise Partners Venture Capital</td>
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Resources - Do your homework

National Venture Capital Association
- www.nvca.org

- Pricewaterhouse Money Tree
  - www.pwcmoneytree.com

- Venture Economics
  - www.ventureeconomics.com
Again – how much do you want or need?

• There’s a sweet spot for each firm
  - Below $2M
    • Angels
  - $2M–$4M
    • Small VC specializing in start-ups
  - $4M–$10M
    • Large VC specializing in early stage
  - $10M–$25M
    • Large VC specializing in later stage
  - >$25M
    • Large Partnerships specializing in late stage
Investors usually like to have company

• Like anyone, VC would like to minimize risk
  – The more deep pockets the better
• They will locate other investors, but you will have to close them
• Some top-tier firms prefer to go it alone
• If there is only one, you better like them and keep them happy
Meet the partners

• Who is your champion?
• How are decisions made?
• Look at titles
  – Founding Partner
  – Managing Partner
  – Venture Partner
• What are the hot buttons?
  – Ask your champion what to expect
• It’s show time
Next steps

• Open Issues
• References
  – Personal
  – Experts
  – Customers
• We’ll call you
Due diligence

• How can you tell anybody cares
  – Calling references
  – Scheduling consultants
  – Returning calls
• It’s hard to get a “no”
A lead investor is worth their weight in gold

- You’re known by the company your keep
- Get a term sheet, preferably more than one
- You want a feeding frenzy
- You put the deal together, not the investors
What is the deal?

- #1 How much of the Company for how much $$
- Scenarios based on stage
  - Idea (partial team)
  - $2M-$4M for 50%
  - Prototype (complete team)
  - $4M-$6M for 50%
  - Revenue
  - $10M-$20M for 30%
  - Pre-IPO
  - $20M-$40M for 20%
After the financing

• Early stage, first financing
  - Preferred - 50%
  - Common - 30%
  - Option Pool - 20%
  - Guess who loses ground on the next financing?

• At least until Mgmt is below 10%
What terms can you expect?

• Get a good lawyer
• Normal terms
  – Preferred (exit)
  – Directors
    • Pick the partner
  – Dividends
    • Sweetens a bad exit
• Bad terms
  – Participating preferred
  – Full Ratchet
MEMORANDUM OF TERMS
FOR PRIVATE PLACEMENT OF SERIES A PREFERRED STOCK
OF SOLOPOINT INC.

March 12, 2007
Version 1.1

This memorandum summarizes the principal terms of the proposed financing of SOLOPOINT, Inc. (the "Company").

OFFERING TERMS

Issuer: SOLOPOINT, Inc., a California corporation

Amount of Financing: At a minimum $4,000,000.00 and up to $4,500,000.00

Equity Securities to be Issued: Series A Preferred Stock (the "Series A Preferred").

Purchase Price: $0.292 per share (the "Original Purchase Price") of Series A Preferred. The Original Purchase Price represents a fully-diluted pro-money valuation of $4,400,000. Included in this valuation is an Employee Stock Option Pool (ESOP) of 21% of the shares outstanding after the closing of the Series A Preferred financing.

Purchasers: VC Ventures $2,000,000
Fund #2 $2,000,000
Others up to $200,000 including conversion of outstanding bridge loans

TOTAL $4,500,000

Additional investors must be mutually acceptable to the Company and the Purchasers.

Closing Date: The anticipated closing (the "Closing") is expected to occur before April 1, 2007, by which time all conditions precedent set out below will have been satisfied.
SOLOPOINT Inc. Capitalization Table Assuming $4.4M Series A

<table>
<thead>
<tr>
<th></th>
<th># of Existing Shares</th>
<th># of Post Financing Shares</th>
<th>$ Invested</th>
<th>% Equity</th>
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<td>Common outstanding</td>
<td>8,742,778</td>
<td>8,742,778</td>
<td>19,709</td>
<td>29%</td>
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<tr>
<td>ESOP</td>
<td>2,000,000</td>
<td>6,326,614</td>
<td>-</td>
<td>21.1%</td>
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<td>Series A Preferred</td>
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<td></td>
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<tr>
<td>VC Ventures</td>
<td></td>
<td>6,850,819</td>
<td>2,609,609</td>
<td>22.7%</td>
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<tr>
<td>Fund #2</td>
<td></td>
<td>6,850,819</td>
<td>2,609,609</td>
<td>22.7%</td>
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<tr>
<td>Others (bridge conversion)</td>
<td></td>
<td>1,355,783</td>
<td>409,609</td>
<td>4.5%</td>
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<tr>
<td>Total</td>
<td>12,700,445</td>
<td>30,136,313</td>
<td>5,159,709</td>
<td>180.0%</td>
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**TERMS OF SERIES A PREFERRED STOCK**

*Dividends:* Annual 6% per share dividend on the Series A Preferred in priority to any other dividend of any class of share, payable when and if declared by the Board in cash upon Liquidation or Redemption and in the form of additional shares of Common Stock of the Company upon conversion of the Series A Preferred; dividends are not cumulative.

*Liquidation Preference:* Except as provided below, in the event of any liquidation or winding up of the Company, the holders of the Series A Preferred Stock shall be entitled to receive $0.292 per share plus any declared but unpaid dividends, in preference to the holders of Common Stock.

Thereafter, the assets will be distributed pro rata to all holders of Common Stock and Series A Preferred Stock until Series A holders have received 3 times their investment.

A merger of the Company with or into any other corporation or a sale of all of the issued shares or of all or substantially all of the assets of the Company shall be treated as liquidation.

*Conversion:* Convertible into one share of Common Stock (subject to anti-dilution adjustments summarized below).

Automatically converts into Common Stock upon consummation of a firmly underwritten public offering of
Common Stock at a price of at least $0.60 per share with aggregate proceeds of at least $15,000,000 or the vote of 66% of the outstanding shares of Preferred Stock.

**Antidilution Adjustments:**

Conversion ratio of the Series A Preferred adjusted on a proportional basis for subdivisions, combinations and dividends and on a broad-based weighted average basis (fully diluted) for issuances below the conversion price of the Series A.

**Voting Rights:**

The Series A Preferred will vote together with the Common Stock and not as a separate class or series except as specifically provided herein or as otherwise required by law.

In addition, the vote of at least sixty-six percent (66%) of all of the Series A Preferred Stock is required on (i) increases or decreases in the aggregate number of authorized shares of Common Stock or Series A Preferred Stock; (ii) exchanges, reclassifications or cancellations of all or part of the Series A Preferred Stock, (iii) changes in the rights, preferences, privileges or restrictions on the Series A Preferred Stock, (iv) creation of a new class or series of shares having rights, preferences or privileges senior to or on parity with the outstanding Series A Preferred Stock or increase in the rights, preferences or privileges or the number of authorized shares of any class having rights, preferences or privileges senior to or on parity with the Series A Preferred Stock, (v) cancellation or modification of dividends on the Series A Preferred Stock which have accrued but have not been paid, (vi) a merger, acquisition or sale of the Company or any transaction (i.e., sale of assets or shares of a subsidiary) any acquisition of stock in any entity or any investment) involving more than $100,000, (vii) amendments or waivers of any provision of the Company’s Certificate of Incorporation or Bylaws relative to the Series A Preferred, (viii) any action that results in the redemption of any shares of Common Stock (other than pursuant to equity incentive agreements with service providers providing for repurchase of shares upon termination of services), (ix) any increase or decrease in the authorized size of the Company’s Board of Directors, (x) any payment or declaration of any dividend on any shares of Common or Series A Preferred Stock, and (xi) as currently otherwise provided in the Company’s certificate of incorporation.
The founders agree that they will vote their shares in accordance with a majority of the Board of Directors regarding a merger, sale or acquisition of the company.

**Board of Directors:**

The Board of Directors shall consist of five (5) directors. The holders of the Common Stock shall have the right to elect two (2) members of the Board of Directors, one of which will be the CEO. The holders of the Series A Preferred Stock shall have the right to elect two (2) members of the Board of Directors. The fifth director shall be elected by the common and preferred voting as a single class and shall be an independent representative.

At the Closing, the Board of Directors shall consist of Mike _____, if CEO of the Company, Jim _____ (Common Stock representative), Jack ____ (Series A representative), and _____ THD (Series A representative).

The vote of both Series A representatives on the Board will be required to approve capital expenditures exceeding $100,000.

**Board Meetings:**

Shall be held monthly.

**TERMS OF PURCHASE AGREEMENT**

**Representations and Warranties:** Standard representations and warranties.

**Right of Pro Rata Participation:** Purchasers will have right to participate in future financings to maintain their pro-rata percentage of the Company’s shares then outstanding.

**Purchaser Counsel:** The Company will pay the reasonable fees and costs of one special counsel for the Purchasers, up to a maximum of $20,000.

**INVESTORS’ RIGHTS AGREEMENT**

**Registration Rights:** (a) Beginning five (5) years after the closing of the initial sale of the Series A Preferred, or 180 days after the Company’s initial public offering, two (2) demand registrations upon initiation by holders of more than 50%
of Preferred Stock. Expenses (other than underwriting discounts) paid by the Company.

(b) Unlimited piggybacks, subject to pro rata cutback to a minimum of 30% of the offering at the underwriter’s discretion, with possible complete cut-back on initial public offering. Expenses (other than underwriting discounts) paid by the Company.

(c) Two S-3 registrations of at least $500,000 per year once the Company is eligible for registration on Form S-3. Expenses paid by the Company.

(d) Agreement to provide for up to 180-day post initial public offering lock-up as may be required by the underwriters selected by the Company.

Financial Information:

The Purchasers shall have the right to receive audited annual financial statements. Purchasers of at least 1,000,000 shares of Series A Preferred will also be entitled to unaudited monthly and quarterly financial statements, and annual budget as well as standard inspection rights. Rights terminate on the Company’s initial public offering.

Transfer of Rights:

Registration or information rights can only be transferred to: (i) holders (after the transfer) of at least 1,000,000 shares; (ii) any partner or retired partner of any Purchaser which is a partnership; (iii) any member or former member of any Purchaser which is a limited liability company; or (iv) any family member or trust for the benefit of an individual Purchaser.

Lock-Up Provision:

Each Purchaser agrees that it will not sell its shares for a specified period (but not to exceed 180 days) following the effective date of the Company’s initial public offering, provided that all officers, directors, and other 1% stockholders are similarly bound.

Other Provisions:

Other provisions shall be contained in the Investors’ Rights Agreement with respect to registration rights as are reasonable, including cross-indemnification, the period of time in which the Registration Statement shall be kept effective, and underwriting arrangements.

EMPLOYEE MATTERS
**Founder Stock:**

At the closing, the founders shall offer 1/3% of their stock for repurchase to the company at cost in the event of their separation from the company, this right to lapse in monthly increments over the next 16 months.

The repurchase option shall provide that upon termination of the employment of a Founder, with or without cause, the Company or its assignee (to the extent permissible under applicable securities law qualification) retains the option to repurchase at cost any unvested shares held by Founder.

Founders and core team will sign two-year non-compete agreements with the Company, prior to the closing of the Series A funding round.

**Founder Loans:**

The Founders shall be permitted to redeem up to $20,000 in short-term loans previously made to the Company.

**Stock Vesting:**

All stock and stock equivalents issued after the Closing to employees, directors, consultants and other service providers will be subject to standard vesting provisions (25% at the end of the first year, remaining 75% to vest monthly over next three (3) years). The repurchase option shall provide that upon termination of the employment of the stockholder, with or without cause, the Company or its assignee (to the extent permissible under applicable securities law qualification) retains the option to repurchase at cost any unvested shares held by such stockholder.

**Restrictions on Sales:**

The Company’s Bylaws shall contain a right of first refusal on all transfers of Common Stock, subject to normal exceptions. If the Company elects not to exercise its right, the Company shall assign its right to the Purchasers. 66% percent of Series A Preferred Holders approve any transfer.

**Proprietary Information and Inventions Agreement:**

Each current and former officer, employee and consultant of the Company shall enter into an acceptable proprietary information and inventions agreement.

**Co-Sale Agreement:**

The shares of the Company’s securities held by the Founders shall be made subject to a Co-Sale Agreement (with certain reasonable exceptions) with the Purchasers such that the Founders may not sell, transfer or exchange...
their stock unless each Purchaser has an opportunity to participate in the sale on a pro-rata basis. Co-sale rights shall terminate upon a Qualified IPO.

OTHER MATTERS

Indemnification:
The Company will indemnify board members to the broadest extent permitted by applicable law and will indemnify each Purchaser for any claims brought against the Purchasers by any third party (including any other stockholder of the Company) as a result of this financing.

SBIC Letter
The company acknowledges that VC Ventures Fund II is an SBIC licensed by the Small Business Administration and agrees to supply a letter of representations which comply with the requirements of the SBIC Act of 1958, as amended, for small business investments by an SBIC.

Right to Complete Due Diligence and Investment:
For valuable consideration, receipt of which is hereby acknowledged, the Company agrees that VC Ventures shall have the right to complete its due diligence and to make an investment in the Company on the terms outlined herein and agrees to cooperate fully to assist VC Ventures in this regard. Once VC Ventures has notified the Company in writing that it has satisfactorily completed its due diligence and wishes to complete the investment (which must occur within 30 calendar days following execution of this term sheet) the Company and VC Ventures agree to cooperate fully and in good faith to complete this investment as expeditiously as possible thereafter.

Conditions Precedent to Financing:
This summary of terms is not intended as a legally binding commitment by the Purchasers, and any obligation on the part of the Purchasers is subject to the following conditions precedent:

1. Satisfactory completion of due diligence by the prospective Purchasers.

2. Negotiation and execution of mutually satisfactory investment and voting agreements and other investment documents, including Articles of Association.
3. Agreement with management on a mutually satisfactory
detailed Annual Budget and strategy document for the
Company, to be developed until Closing.

4. Key man insurance for each founder and CEO for
$1.5M minimum purchased within 90 days of close,
payable to the Company.

5. Execution by the Company of employment agreements
with the CEO and Founders of the Company to be
mutually agreed upon (which shall contain appropriate
non-competition and non-solicitation undertakings) and
the form of such agreements shall be satisfactory to the
Purchasers. In addition, the senior executives agree to
not acquire shares in or be involved in any way in a
company, which is a competitor of the Company.

6. Acknowledgement from Hewlett Packard Corp. that
their linking and distribution agreement with SOLOPOINT
is valid based on the funding date of the Series A, and
that the delay of the start of work on the agreement is
acceptable to them.

If the terms and conditions described above are acceptable to you, please so indicate by your
signature below. This proposal shall remain outstanding until 8:00 p.m. PST, March 16, 2007, at
which time it shall lapse if not previously accepted.

Purchasers:                                Issuer:

By: ________________________________        By: ________________________________

Jack                      Michael
Managing Director        CEO candidate
YC Ventures, Fund II L.P.  SOLOPOINT Inc.
Date: ________________________________

By: ________________________________        By: ________________________________

Name                      Jim
Title                     Founder
Purchaser #2               SOLOPOINT, Inc.
Date: ________________________________

Date: ________________________________
The Term Sheet

- Pay attention to details
- Pick your battles
- Don’t let it get stale
- The closing window
  - 30 days is possible
  - Over 90 days is a problem
Now you’ve closed a financing

• Are you sure?
• Don’t put the $$$ at risk
• Get a capital equipment loan
• Start working on the next round