

Fast Track, Inc. (A)

Fast Track, Inc. had been searching for venture capital backing for several months, and was in pressing need for a significant cash infusion to sustain its development efforts. In late-2003, the entrepreneur had several meetings with Venture Analysis Group, the managers of Venture Analysis Funds. The fund managers had received an unsolicited business plan from Fast Track, and found the concept sufficiently interesting to warrant further evaluation.

In December, Venture Analysis notified the entrepreneur that it was preparing a proposal for financing the venture and that the proposal would address the perceived financing needs and valuation that Fast Track management had been discussing. The proposal (Exhibit 1) arrived just before the start of the winter holidays. Although many of the terms in the proposal are common in venture capital financings, the proposed agreement was more complex than anything the parties had been discussing. Among other factors, the financing proposal included a complex liquidation preference, a mandatory redemption provision, a re-purchase provision, registration rights, a strong anti-dilution right, and an exclusive negotiation provision with a substantial penalty.

It quickly became apparent to Fast Track management that they would need to work carefully through the proposed agreement to understand it fully and to know how to respond. Recognizing that the proposed financing structure provided the investor with a number of options, members of the team raised a variety of questions. Under what conditions, for example, might the preferred stock investors be expected to convert voluntarily to common? What would cause them to exercise their option to force a sale after five years or after six years, or to exercise their proposed put option in lieu of forcing a sale or doing neither? Additionally, what would lead them to exercise their demand registration rights? The proposal also left a number of choices to the entrepreneur. In that regard, when would it make sense to sell outright or liquidate, as opposed to going public? Also, might there be times when the exclusive negotiation provision would become a problem?

Clearly, the asymmetric assignments of rights and returns under different conditions and at different times could mean that the parties' incentives would not always be aligned. Fast Track management wondered if there were any particularly acute potential conflicts.

To address these questions they would need to consider the allocation of value under a variety of scenarios involving going public, being sold, or liquidating at various times when key decisions would need to be made and with various levels of success in terms of overall valuation of the company at each time. They would also have to consider the possible effects of needing to raise additional capital in the short-run at a lower valuation

Finally, Fast Track management wondered what the proposal implied about the confidence that Venture Analysis had in the project. As one means of assessment, they felt it would be useful to compare the results under various scenarios between the proposed deal and an alternative where each party would hold identical common stock claims.

Management wondered how they should respond to the proposal and, in particular, what changes, if any, they should request.

Exhibit 1

Summary of Proposed Terms

Fast Track, Inc.

This term sheet summarizes the proposed principal terms of the following agreements:

- (1) Purchase of \$5 million to \$7 million of Series A Convertible, Redeemable Participating Preferred Stock (“Series A Preferred Stock”) of Fast Track, Inc. (the “Company” or “Fast Track”), by one or more venture capital investment funds managed by Venture Analysis Group (the “Funds” or “Venture Analysis”) to fund product development, market development, other operating expenses, capital expenditures, and for general corporate purposes.
- (2) The Series A Preferred Stock Purchase Agreement.
- (3) Exclusive Dealings with Venture Analysis

Except for the terms in Section III below, which shall survive the termination or expiration of this term sheet, these terms do not constitute any form of binding contract, but rather are solely for the purpose of outlining those terms pursuant to which definitive agreements may ultimately be entered into. The investment is contingent upon, among other things, the satisfactory completion of due diligence and verification and confirmation of items represented to Venture Analysis by Fast Track in written or oral form and the negotiation and execution of the preferred stock purchase agreement (containing customary closing conditions, terms, covenants, representations, warranties, etc.). It is understood by all parties that any investment by the Funds is contingent upon receiving approval from the investment committees of the Funds.

I. Series A Preferred Stock

A. Investment

Funds controlled by Venture Analysis and its partners will invest \$5 million to \$7 million in the form of Series A Preferred Stock into Fast Track, Inc. at a pre-money valuation of \$20 million to \$30 million (to be determined).

B. Type of Security: Series A Preferred Stock

Series A Convertible, Redeemable, Participating Preferred Stock, senior in liquidation preference to the common stock, subject to mandatory redemption by the Company 6 ½ years after the date of this investment, unless previously converted, and containing such other features as described below.

The Series A Preferred Stock will earn cumulative dividends at a rate of 7%. The cumulative dividends shall be payable at redemption, sale, or liquidation, and shall be payable in cash or additional Series A Preferred Stock. Series A

Preferred Stock shall be senior to the common stock and other preferred stock in the event of liquidation, sale, or merger of the Company.

C. Conversion Features:

1. The Series A Preferred Stock will convert into common stock on a one-for-one basis. The Holder shall have the right to convert at any time.
2. Automatic Conversion Event for Series A Preferred Stock: Upon a firm underwritten public offering by a national investment bank, covering primary sale of common stock completed on or before January 31, 2007, with net proceeds of at least \$25 million at a price of 400% or more of the initial valuation (“qualified offering”).
3. Anti-dilution Protection for Series A Preferred Stock: Full ratchet adjustment for stock splits, stock dividends, recapitalization or any dilutive financing (where any new stock will be issued at less than the price of the Series A Preferred Shares); or the issue of shares at a price below that paid by the holders of Series A Preferred Stock.

D. Voting Rights:

Holders of Series A Preferred Stock shall have the number of votes equal to the largest number of full shares of common stock into which such Series A Preferred Stock may be converted.

E. Sale or Liquidation Preference:

In the event of any sale, merger, liquidation, or winding up of the Company, (except for a transaction which values the Company’s stock at a price of 400% or more of the original conversion price) the holders of the Series A Preferred Stock shall be entitled to receive in preference to the holders of any other equity security, common or preferred, an amount equal to two times the purchase price value of the preferred plus accrued and unpaid dividends. The remaining proceeds will then be allocated between the common and the preferred shareholders on a pro rata basis, treating the preferred on an as-if converted basis.

F. Mandatory Redemption:

The Series A Preferred Stock and accrued but unpaid dividends will be subject to mandatory redemption 6 ½ years after the date of this investment, unless previously converted. The redemption will be made in equal payments over the following six quarters, with the first payment due 6 ½ years after the date of this investment, unless previously converted. In addition, if the Company fails to redeem the Series A Preferred Stock when due, the conversion price will decrease at the rate of 5% per quarter, starting from the due date of the

redemption of the Series A Preferred Stock. Any missed redemption payments will trigger this 5% conversion price adjustment for the unredeemed portion.

G. Protective Provisions:

The Company needs consent of the holders of the Series A Preferred Stock to take the following actions:

1. merge or sell all or the majority of the Company's assets;
2. amend the Certificate of Incorporation or Bylaws;
3. pay or make any dividends or distributions on or redemptions of any equity securities other than dividends to preferred stock outstanding at the time of this term sheet, and only then if the Series A Preferred is paid current on all dividends and redemptions;
4. incur funded indebtedness in excess of \$5 million;
5. engage an investment bank, consultant, or other advisor for the purpose of raising capital or refinancing securities or indebtedness;
6. engage in any transaction that could involve a conflict of interest or that involves dealings between the Company, insiders, or affiliates.

Compensation and audit committees of the board of directors will consist of three members; one representative of the Series A Preferred holders, one representative of management, and one outside board member. The compensation committee will determine matters related to management compensation.

H. Sale of the Company

If, on the fifth anniversary of the closing of this proposed transaction, the Company has not completed an initial public offering; or otherwise completed or entered into an agreement with an underwriter to complete an initial public offering; or otherwise completed or entered into an agreement to sell or merge the Company, the Series A Preferred shareholders shall have the right to initiate the process of seeking an acquirer of the Company. If this right is exercised, the Board of Directors shall retain a competent investment banker to seek the maximum attainable value for the Company over the ensuing six month time period. If the Series A Preferred shareholders waive this right on the fifth anniversary of this proposed transaction, they shall have the same right, exercisable one time only, on the sixth anniversary. On the sixth anniversary, the Series A Preferred shareholders may elect to put their shares to the Company at fair market value in lieu of exercising their right to sell the Company.

I. Incentive Option Pool

Up to 20% of the shares of the Company, on a post investment basis, will be reserved for incentive options for management, key employees, and other key

persons. The exercise price for the options will be no less than the price per share of this round of investment. Oversight of the option pool will be by the compensation committee of the Board of Directors.

J. Investor Right of Co-Sale:

Usual and customary investor right of co-sale.

II. Series A Preferred Stock Purchase Agreement

A. Closing:

The parties shall use their best efforts to close within 60 days of the signing of this term sheet.

B. Conditions of Closing

1. Venture Analysis's satisfactory legal review of intellectual property agreements and contracts.
2. Venture Analysis's satisfactory review of the financial statements and accounting policies, and receipt of a satisfactory management letter from the Company, including representations and warranties.
3. Venture Analysis's verification and confirmation of information presented by Fast Track in either written or oral form.
4. Venture Analysis's completion of satisfactory due diligence.
5. Venture Analysis's satisfactory review of management employment contracts.
6. Any and all existing indebtedness will be converted to equity prior to the closing and be included as part of the pre-investment valuation.

C. Covenants:

Usual and customary covenants for a preferred stock financing.

D. Expenses:

Upon closing of an investment in the Company by the Venture Analysis Funds, the Company will pay all of the Venture Analysis Funds' reasonable legal expenses related to closing (not to exceed \$20,000).

E. Amendments and Waivers:

Consent of Venture Analysis is required to amend or waive any provision of the Series A Preferred Purchase Agreement.

F. Registration Rights:

Usual and customary for a stock offering – one demand registration right and one unlimited piggyback right.

G. Representations of Seller:

Fast Track, Inc. will agree to standard financial and business representations and warranties, including a representation that all material facts relating to the business have been fully disclosed. Fast Track, Inc. will represent that there has been no material adverse change in the business, its assets, or its prospects prior to the closing. The Company represents that no dividend payments are due or will be paid prior to closing of the investment.

H. Opinion of Counsel:

The purchase agreement will provide for delivery of a legal opinion of the counsel of Fast Track, Inc. relating to the transaction contemplated by this term sheet.

I. Board of Directors:

Directors: the Series A Preferred stockholders will nominate XX board members, the common stock holders will nominate XX board members and XX directors will be nominated by mutual agreement of the Series A Preferred stockholders and the common stockholders. Meetings will take place at least six times a year. Non-local directors to be reimbursed for reasonable out of pocket expenses.

J. Management Team:

The Series A Preferred stockholders will have approval rights for all key management positions and employment contracts.

III. Exclusive Dealings

A. No-Shop Provision:

Upon the execution of this term sheet, Fast Track, Inc. agrees to deal exclusively with Venture Analysis and will terminate any discussions with any potential funding source or acquirer, until March 31, 2004 with respect to any transaction relating to the financing or acquisition of the Company, unless Venture Analysis has withdrawn its offer due to its failure to perform on its closing conditions.

B. Break up Fee:

If the Company agrees to enter into a transaction with respect to the financing of, or acquisition of, the Company before March 31, 2004 with any person or entity other than Venture Analysis, Venture Analysis will be entitled to a break up fee consisting of five-year warrants to purchase 20% of the common stock of the Company at a \$25 million valuation, unless Venture Analysis withdrew its offer due to its failure to perform on closing conditions. Additionally, the Company agrees to pay all of the Venture Analysis Funds' reasonable legal expenses related to this transaction (not to exceed \$20,000).

If Venture Analysis notifies the Company in writing that it is terminating negotiations with the Company before March 31, 2004, this paragraph is null and void.

C. Confidentiality:

The parties agree to keep the terms of this agreement confidential.

Partner, Venture Analysis Group

CEO, Fast Track, Inc.