BLACK BOX TECHNOLOGY, INC.

Term Sheet

These terms do not constitute any form of binding contract but rather are solely for the purpose of outlining the principal terms pursuant to which a definitive agreement may ultimately be entered into.

Security and Percentage of Equity:	1,000,000 shares of Series A Convertible Preferred Stock (the "Preferred") at an issue price of $2.00 per share ("Original Purchase Price"). The Preferred is convertible into Common Stock representing **[30%-70%]** of the outstanding securities of the Company on a fully diluted basis.
Valuation:	$2,000,000 pre-financing; $4,000,000 post-financing

TERMS OF THE PREFERRED STOCK:

Rights, Preferences, Privileges and Restrictions of Preferred Stock:

(1) Dividend Provisions:

(A) Current Dividend: Dividends shall accrue on each share of the Preferred at the rate of **[8%-15%]** per annum payable quarterly. No dividends shall be paid on the Common Stock until all accrued but unpaid dividends have been paid on the Preferred.

(B) Pari Passu Dividend: Preferred shall be entitled to dividends at the same rate as the Company's Common Stock when and as declared on the Common Stock, based on the number of whole shares of Common Stock into which the Preferred is convertible on the date any dividend is declared.

(C) Cumulative Dividend:
Dividends shall accrue on each share of Preferred on a cumulative basis at the rate of **[8%-15%]** per annum. Cumulative dividends shall be payable only in the event of a liquidation, dissolution or winding up of the Company or upon redemption. **[other alternatives - redemption only or liquidation only, not both; cumulative dividends shall be forfeited on a public offering (or acquisition)].**

ISSUES:

- Investor generally wants some guaranteed rate of return before Common Stock receives anything - paid on redemption or liquidation but typically forfeited on a public offering

(2) Liquidation Preference:

ISSUES:
- Priorities or parities of stock re liquidation preferences

(A) Amount of Preference:
In the event of any liquidation, dissolution or winding up of the among various classes Company, the holders of the Preferred will be entitled to receive in preference to the holders of any other class of capital stock an amount equal to the Original Purchase Price, **[plus all accrued but unpaid dividends]** (the "Liquidation Amount").

- Investor wants return of investment plus ability to share in upside

(B) Fully Participating Preferred:
After payment of the Liquidation Amount to the Preferred, Preferred and Common share in remaining proceeds available for distribution on an "as if converted" basis.

(C) Simple Preference: Thereafter Common Stock receives all residual amounts.

ISSUES:
- Investor can choose to receive return of investment as if he converted to Common or return of dollars invested in cash

(D) Cash-Out Election: At the election of the holders of a majority of the Preferred, a consolidation or merger of the Company or sale of all or substantially all of its assets or stock will be regarded as a liquidation, dissolution or winding up for purposes of the liquidation preferences **[*i.e.*, receives return of investment plus accrued, cumulative dividends].**

- Priority relative to earlier rounds of financing

(E) Priority in Liquidation:
(i) Last In-First Out: The Series B Preferred will be entitled to receive, in preference to the holders of Series A Preferred Stock and any other class of capital stock, payment in full of its Liquidation Amount upon any liquidation, dissolution or winding up.

(ii) Pari Passu: The Series B Preferred will share, pari passu based on aggregate invested dollars, with the holders of the Series A Preferred Stock in all assets available for distribution upon any liquidation, dissolution or winding up prior to payments made to the holders of any other class of capital stock.

ISSUES:
- This is the investor's exit if the Company's

(3) Redemption: The Company will redeem the Preferred **[in three equal annual installments]** commencing **[5-7]** years from the date of purchase by paying in cash a total amount performance is mediocre

- In subsequent rounds of financing there can also be priority issues relating to redemption

equal to the Liquidation Amount **[including accrued but unpaid dividends].**

(4) **<u>Put Right</u>:** In the event control of the Company is transferred to someone other than the existing shareholder group, the Investors shall have the right to put to the Company any or all of the Preferred at cost **[plus accrued but unpaid dividends]** or at a value mutually agreeable to the Investors and the Company, or in the absence of an agreement, at the average of the fair market value determinations of three professional appraisers selected by each of the Investors and the Company. Costs of appraisal will be borne by Company.

(5) **<u>Conversion</u>**: The Preferred is convertible at any time, at the option of the holder, into shares of Common at an initial conversion price equal to the Original Purchase Price. Initially, each share of Preferred is convertible into one share of Common. The conversion price will be subject to adjustment as provided in paragraph (7) below.

<u>ISSUES</u>:

- Investor wants the certainty of some guaranteed return, a sizeable offering, and the stability of a solid float in the aftermarket

(6) **<u>Mandatory Conversion</u>:** The Preferred will be automatically converted into Common, at the then applicable conversion price, in the event of **[a "firm commitment"]** underwritten public offering of shares of Common at a price per share that is not less than **[2 to 3 times the Purchase Price]** in a qualified public offering resulting in **[gross v. net]** proceeds to the Company of not less than **[$8-10 million]. [The Preferred is also automatically converted into Common in the event that fewer than [10%-30%] of the shares of Preferred as originally issued remain outstanding.]**

<u>ISSUES</u>:

- Investor wants protection against "price dilution" if Company sells shares *below* issue price to investor

(7) **<u>Antidilution Provisions</u>:** The conversion price of the Preferred will be subject to adjustment to prevent dilution in the event that the Company issues additional shares of convertible debt or equity securities (*other than* the Reserved Employee Shares described under "Reserved Employee Shares" below) at a purchase price less than the Original Purchase Price.

(A) **<u>Full Ratchet</u>:** The conversion price will be reduced to the price at which such additional shares are sold.

(B) **<u>Weighted Average Formula</u>:** The conversion price will be subject to adjustment on a weighted-average basis which takes into account dilutive issuances of additional shares at prices below the Investor's conversion price.
[Sample Calculation of weighted-average formula:

$$\frac{(CS/O \times CP) + CR}{CS/O + CS/I}$$

CS/O = Number of shares of Common Stock outstanding immediately prior to the dilutive transaction **[and assuming conversion of all classes of Preferred and exercise of all presently exercisable options or warrants to determine shares of Common Stock outstanding].**

<u>ISSUES</u>:
- What securities are included in formula?

CP = Conversion Price for each class or series of Preferred outstanding

CR = Total Consideration Received by the Company for the specific dilutive transaction

CS/I = Number of shares of Common or Common Equivalents actually issued or sold in the specific dilutive transaction

(8) **"<u>Play or Lose" Provisions</u>:** The Preferred will contain a "failure of participation" or "play or lose" clause: the anti-dilution protection be applied to adjust an investor's conversion price **only** if such investors participates in a future financing at a price **below the Original Purchase Price** to the extent of its *pro rata* equity interest in the Preferred (all classes taken together). Any investor who does not participate in a future financing forfeits the benefits of dilution protection **for all future rounds of financing [<u>ISSUE</u>: or for only that particular round of financing in which the investor does not participate].**

<u>ISSUES</u>:
- Whether "play or lose" provision applies on an all-or-nothing basis or applies on proportionate basis (*e.g.*, if investor plays for 1/2 of pro rata share, investor receives 1/2 of anti-dilution adjustment; and whether the "play or lose" provision applies to all future transactions or *just each transaction* in which an investor does not participate

(9) **Voting Rights:** The holders of Preferred will have the right to that number of votes equal to the number of shares of Common issuable upon conversion of the Preferred at the time the record for the vote is taken. Except with respect to matters which adversely affect the Preferred or as required by law, the Preferred and the Common shall vote together as a single class.

ISSUES:

- Investor wants to control liquidity events like a merger or acquisition
- Investor wants prior approval of events which impair his liquidity
- The Company does not want to give investors too strong a veto right

(10) **Protective Provision:** Consent of the holders of at least a **[majority *vs.* two-thirds]** of the Preferred shares will be required for:
(i) any sale by the Company of a substantial portion of its assets or stock, or any consolidation or merger of the Company with another entity
(ii) the creation of any senior or *pari passu* equity security control (excluding debt)
(iii) transactions in which control of the Company is transferred
(iv) repurchase or redemption of equity securities, or payment of dividends or other distribution on equity securities (other than the Preferred and employee stock repurchased pursuant to vesting agreements)
(v) sales, transfers or encumbrances of technology other than licenses granted in the ordinary course of business
(vi) liquidation, dissolution, recapitalization or reorganization

THE STOCK PURCHASE AGREEMENT:

Information Rights: The Company will timely furnish the Investors with annual audited and monthly **[and quarterly]** unaudited financial statements, an annual budget and business plan, and monthly **[and quarterly]** comparisons to the annual budget. **[The obligation of the Company to furnish monthly financial statements and other non-public information will terminate upon a public offering.]**

Observer Rights: Representatives of the Investors will have the right to receive notice of and attend all meetings of the Board of Directors and any committees, to visit with management of the Company, and to inspect the books and records of the Company.

Right of First Refusal to Purchase New Securities: If the Company proposes to offer additional shares (*other than* Reserved Employee Shares or shares issued in the acquisition of another company), the Company will **first offer all such shares to**

<u>**ISSUES**</u>**:** • True preemptive right to participate for *pro rata* share of Company equity *vs*. right to take entire financing	**the Investors and the holders of Series A Preferred Stock of the Company**. This right of first refusal will terminate upon an underwritten public offering of shares of the Company or a sale of all or substantially all of the capital stock or assets of the Company. **[<u>Play or Lose Provision</u>: If any Investor does not participate for its full pro rata share in any financing, then the Investor will forfeit its right of first refusal for all future rounds of financing.]**
Events of Default:	An Event of Default shall exist if any of the following occurs and is continuing: **(i)** Failure to pay the Preferred Stock dividend when due or the failure to make any liquidation or redemption payment which the Company is obligated to make.
<u>**ISSUES**</u>**:** • Board takeover rights for material breaches of the Stock Purchase Agreement, failure of redemption or liquidation preference	**(ii)** Failure to perform or observe any covenant contained in the stock purchase agreement. **(iii)** False or misleading warranties, representations, or other statements made by or on behalf of the Company in any material respect. **(iv) [Failure to make payment when due on any indebtedness or other security and/or if the Company is in default under any other financings agreements.]** **(v)** Voluntary or involuntary bankruptcy, receivership, assignment for the benefit of creditors, liquidation, acceleration of third party obligations, unsatisfied judgment in excess of $50,000.
Default Remedies:	If an Event of Default exists, the Investors holding a majority in interest of both classes of Preferred may at their option: **(i)** Declare redemption on the Preferred Stock immediately due and payable, and/or **(ii)** Elect a majority of the Board of Directors
The Stock Purchase Agreement:	The purchase of the Preferred will be made pursuant to a Stock Purchase Agreement drafted by counsel to the Investors, which agreement shall contain, among other things, customary and

appropriate representations and warranties of the Company, customary and appropriate affirmative and negative covenants of the Company, and appropriate conditions of closing, including an opinion of counsel to the Company reasonably satisfactory to the Investors.

<u>REGISTRATION RIGHTS AGREEMENT</u>:

<u>ISSUES</u>:
- Limit number of registrations
- Insist on minimum market value for a registration so Company does not waste dollars on a small registration
- Try to get investors to advance expenses for a demand registration

(1) **<u>Demand Rights</u>:** If on any **[two-four]** occasions **[(but not within 180 days of the effective date of any Company registration),]** Investors holding at least **[30%-60%]** of the Preferred (or Common issued upon conversion of the Preferred) request that the Company file a registration statement covering the Common Stock issuable upon conversion of the Preferred, the Company will use its best efforts to cause such shares to be registered as quickly as possible **[so long as the anticipated aggregate offering price, net of underwriting discounts and commissions, would exceed $2-5 million).]** The Company will not be obligated to effect more than **[two-four]** registrations (other than short-form registrations on Form S-3) under these demand registration right provisions.

(2) **<u>Short-Form Registrations on Form S-3</u>:** Holders of the Preferred (or Common Stock issued upon conversion of the Preferred) will have the right to require the Company to file **[an unlimited number *vs*. 2-4]** of short-form registration statements on Form S-3 **[but no more than one in any (9-12) month period and provided each registration on Form S-3 has a minimum market value of $500,000-$1,000,000).]**

<u>ISSUES</u>:
- Limit number of registrations
- Registration rights terminate 5-7 years after initial public offering
- Can Directors and officers participate in piggyback registrations

(3) **<u>Piggy-Back Registrations</u>:** The Investors will be entitled to unlimited **[vs. three-five]** "piggy-back" registration rights on all registrations of the Company, subject to the right of the Company and its underwriters to reduce the number of shares of the Investors proposed to be registered in view of market conditions. **[Piggy-back registration rights expire (five-seven) years after initial public offering.]**

ISSUES:
- Expenses of interim audit or special reviews borne by Investors
- Expenses of any registration abandoned or withdrawn by Investors are paid by Investors

(4) **Registration Expenses:** All registration expenses (exclusive of underwriting discounts and commissions, fees of more than one counsel for the selling shareholders, **[and the fees and expenses of any special or interim audit for any registration initiated by the Investors]** shall be borne by the Company. All other expenses of registered offerings shall be borne by the selling shareholders.

- Try to get Investors to pay for their own counsel fees
- Investors lose registration rights when stock can be sold under Rule 144

(5) **Other Registration Provisions:** Other provisions with respect to registration rights as are reasonable, including cross-indemnification provisions, **[the Company's ability to delay the filing of the demand registration for a period of not more than [120-180] days,]** a "lockup" or "market standoff" agreement by holders of the Preferred (if requested by the underwriter in a public offering) not to sell any unregistered Common they hold for a period of **[120-180]** days following the effective date of the registration statement covering such offering, and the period of time in which the registration statement will be kept effective (90-180 days).

Board Representation:

The Board will consist of **[5-7]** members. **[Two]** directors will be representatives of the Investors; **[two]** directors will be representatives of management; at least **[one]** director will be an outside director. Directors will be elected annually. The Board will meet at least once every **[six weeks or two months.]**

Reserved Employee Shares:

ISSUES:
- Need a "basket" of shares to provide equity incentives to management and employees

The Company may reserve up to such number of shares of Common equal to **[10%-20%]** of outstanding capitalization, calculated on a fully-diluted basis, for issuance to employees, directors, officers and consultants of the Company, (the "Reserved Employee Shares"). The Reserved Employee Shares will be exempt from the anti-dilution formula protection. The Reserved Employee Shares will be issued from time to time under such incentive stock option or non-qualified stock option agreements or plans, stock restriction agreements or other options, arrangements, contracts or plans as are recommended by management and approved by a majority of the then present members of the Board, **[ISSUE: which**

approval shall include at least two of the three directors designated by holders of the Preferred].

Stock Restriction and Stockholders Agreements: **<u>ISSUES</u>:** • Whether management has to give back shares already earned	All present holders of Common Stock of the Company who are officers, employees or consultants of the Company will execute a Stock Restriction Agreement with the Company pursuant to which the Company will have an option to buy back <u>at cost</u> a portion of the shares of Common Stock held by such person in the event that such shareholder's employment with the Company is terminated prior to the expiration of 48 months from the date of employment. Each year, 25% of the shares will be released from the repurchase option based upon continued employment by the Company. In addition, the Company and the Investors will have a right of first refusal with respect to any such shares proposed to be resold, or, alternatively, the right to participate in the sale of any such shares to a third party, which rights will terminate upon a public offering.
Noncompetition, Nondisclosure and Assignment of Inventions Agreement:	Each officer and key employee of the Company will enter into a Noncompetition, Nondisclosure and Assignment of Inventions Agreement in a form reasonably acceptable to the Company and the Investors. Noncompetition period for officers and key employees will be (1 year-18 months) following termination of employment.
Key Man Insurance:	The Company will provide "Key Man" insurance on the life of [CEO, VP-Technology], each in the amount of ($1-2 million), the proceeds payable to the Company **[proceeds payable to Investors]**.
Co-Sale Rights:	Investor can participate <u>pro</u> <u>rata</u> in any transfer or sale by officers, founders or any (3%-5%) shareholder of any portion of their stock.
Expenses: **<u>ISSUES</u>:** • Cap on legal fees	The Company will bear the reasonable legal fees **[up to $__]** and other expenses of the Investors with respect to the consummation of the transaction. If the transaction is <u>not</u> consummated, each party will bear its own legal fees and expenses **[unless the transaction is not consummated by reason of the Company's refusal to proceed, in which case the Company shall pay the Investors' out-of-pocket expenses, including legal fees].**

Standstill:	From and after **[90-120 days]** from the date hereof until or the earlier mutual agreement between the Company and the Investors to terminate the understanding reflected by this term sheet, the Company shall not directly or indirectly solicit discussions or engage in negotiations with any potential investors other than the Investors concerning the possible acquisition of an interest in the Company (whether by way of merger, purchase of capital stock or purchase of assets).
Memorandum of Terms Only:	Except for the Standstill Section immediately above, this term sheet does not reflect any binding commitment on either the Investors or the Company's behalf to participate in a financing of the Company. Unless and until the Closing pursuant to a Stock Purchase Agreement duly executed by the parties, no party shall have any liability or obligation to the other with respect to the subject matter hereof.

Name of Lead Investor	Black Box Technology, Inc.
By:____________________	By:____________________
Title: ___________________	Title:___________________

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