

THE HOUSTON ANGEL NETWORK, INC.

TERM SHEET FORMS

CHARLES D. POWELL
Partner, Technology Section
Haynes and Boone, LLP
1000 Louisiana, Suite 4300
Houston, Texas 77002-5012

TABLE OF CONTENTS

TAB 1	FORM OF ANGEL ROUND TERM SHEET
TAB 2	FORM OF “A” ROUND VENTURE CAPITAL TERM SHEET
TAB 3	COMMENTARY ON VARIOUS CAPITAL DISTRESS FINANCINGS
TAB 4	FORM OF “DOWN ROUND” CONVERTIBLE NOTE TERM SHEET

THIS TERM SHEET PROVIDES AN EXAMPLE OF A TYPICAL “ANGEL” ROUND INVESTMENT IN PREFERRED STOCK. IT IS NOT INTENDED AS SPECIFIC LEGAL ADVICE OR A FINAL LEGAL DOCUMENT AND IS PROVIDED FOR GENERAL EDUCATIONAL PURPOSES ONLY. THE HOUSTON ANGEL NETWORK, INC. DOES NOT PROVIDE LEGAL OR INVESTMENT ADVICE AND ANY INVESTOR INVESTING IN A TRANSACTION SHOULD OBTAIN HIS/HER OWN LEGAL AND INVESTMENT COUNSEL.

NEWCO, INC.

TERMS OF SALE OF SERIES A PREFERRED STOCK

[This term sheet relates to a preferred stock equity investment. Angels may also invest in convertible debt or common stock. The choice of the form of investment revolves around a number of issues including control issues and liquidation priority. An investor in preferred stock may receive mandatory board representation as well as consent rights on material corporate matters (e.g., merger, sale of assets, etc.). Convertible debt is attractive in that it will be senior to all equity and may also be secured so that it is senior to unsecured debt. Utilization of convertible debt may also defer valuation issues until the first venture capital round.]

[_____, 20__]

Newco, Inc., a Delaware corporation (the “Company”), proposes a private placement of securities to certain individuals and entities (the “Investors”), on the terms set forth below.

Form of Investment: Convertible Series A Preferred Stock (“Series A”).
[Common Stock] [Convertible Debt]

Valuation: \$4,500,000

Investment Amount: \$500,000

<i>Capitalization:</i>	<u>No. of Shares</u>	<u>Percentage</u>
Founders	3,500,000	70%
Investors	500,000	10%
Option Pool	1,000,000 ¹	20%

¹ Unissued reserve

[Note: That the investors’ percentage is calculated on a “fully diluted” basis which includes unissued shares under employee options and warrants or employee options reserved for future issuance.]

Dividends: The holders of the Series A shall be entitled to receive cumulative dividends of ___ percent (___%) per share per annum in preference to the Common Stock (“Common”) when and if declared by the board of directors.

[Dividends are not likely to be paid early in a company’s cycle because of a lack of earnings. The dividends provided here are cumulative in that unpaid dividends accumulate and are paid when the Company

achieves earnings and the Board is able to pay dividends. The accumulated dividends will be required to be paid prior to any distributions to holders of Common.]

Liquidation Preference:

In the event of any liquidation or winding up of the Company (which shall include mergers, sales of substantially all of its assets, etc.), the holders of the Series A shall be entitled to receive in preference to the holders of Common an amount equal to \$_____ per share (the "Original Purchase Price"), plus any declared and unpaid dividends. Any remaining proceeds shall be allocated between the Common and Series A on a pro-rata basis, treating the Series A on an as-if-converted basis; provided however, at such time as proceeds to the Series A equal _____ (___) times the Original Purchase Price per share (including the preference described in the preceding sentence), all remaining proceeds shall be distributed solely to the Common.

[The return to the investor provided above is known as "modified participating preferred" or a double dip return: (i) the return of face value and dividends, plus (ii) a distribution sharing with Common thereafter on an "as converted basis" until a certain return is reached. "Full participating preferred" would provide no cap on the sharing distribution.]

Conversion:

Each share of Series A may be converted at the holder's option at any time into one share of Common ("Conversion Stock"), subject to adjustment as described below. The Series A will be automatically converted to Common upon the closing of a public offering of more than \$_____ of Company stock for not less than \$_____ per share (subject to proportionate adjustment for future stock splits, dividends or combinations).

Conversion Price Adjustments:

The conversion price of the Preferred Stock shall be subject to adjustment proportionately for stock splits, stock dividends, recapitalizations, etc. and will be adjusted upon future "down" rounds on a weighted average basis.

[When future sales of stock are at a price less than the conversion price of the Series A, the holders of the Series A are protected through antidilution rights: "weighted" or "full ratchet." A "weighted average" antidilution provision reduces the price based on the relative amount of the new capital. In contrast, a "full ratchet" is a full adjustment of the conversion price to the lower price. For example, assume that the company issued 1,000,000 shares of preferred shares to

an angel group at \$1.00 a share. A subsequent issuance of 100,000 shares to a third party at \$.50 would result in the adjustment or “full ratchet” of the conversion price down to \$.50 even though the actual economic dilution is not \$.50 a share.]

Voting Rights:

The holder of each share of Series A shall have the right to that number of votes equal to the number of shares of Common issuable upon conversion of such share of Series A. The Series A votes together with the Common on all matters including election of directors.

Protective Provisions:

A majority of the Series A must approve (i) any amendment of the Articles of Incorporation which would change the authorized number of Series A or the rights, preferences and privileges of the Series A or (ii) creation of shares having dividend or liquidation rights equal or superior to the Series A.

[This provision may also provide extensive other negative control rights to the Series A (e.g., required class approval of mergers, bank financings, stock repurchases, etc.).]

Registration Rights:

Demand Rights: If, at any time six months after the effective date of the Company’s first underwritten public offering, investors holding at least 50% of the Series A or Conversion Stock request that the Company file a registration statement for an aggregate offering price of \$____, the Company will use its best efforts to cause such shares to be registered. The Company shall not be obligated to effect more than two registrations under these demand right provisions.

“Piggyback” Registration: If at any time the Company determines to register its securities, the Series A holders shall be entitled to have their Conversion Stock included in such registration subject to underwriter reduction of piggyback shares based on market conditions.

S-3 Demand Rights: If available for use by the Company, the investors will be entitled to two S-3 registrations.

Preemptive Right:

The holders of the Series A shall have the right to purchase all or any part of such holder’s pro-rata share of certain securities issued by the Company after the closing of the Series A transaction (the “New Securities”), on the same terms and at the same price at which the Company proposes to sell the New Securities.

**IRRATIONALLY EXUBERANT.COM, INC.
MEMORANDUM OF PROPOSED TERMS
FOR PRIVATE PLACEMENT OF
SERIES A PREFERRED STOCK**

May 18, 2000

Venture Investor, L.P. (“Investor”) is interested in making an investment in Newco, Inc. (“Company”) subject to satisfactory completion of further due diligence and final agreement on the terms and conditions stated below. This confidential memorandum summarizes the proposed principal terms of the Series A Preferred Stock. This confidential memorandum is not a formal commitment to invest, however, and any investment is subject to the completion of due diligence and documentation that is satisfactory to Investor and the Company.

Issuer: Irrationally Exuberant.Com, Inc., a _____ corporation

Securities to be Issued: Series A Convertible Preferred Stock (the “Series A Preferred Stock”)

Aggregate Proceeds: \$ _____

Investors:

Investor	\$__ million
Other Investors	\$__ million
Total	\$__ million

Purchase Price: Price per share to be based on fully diluted post-money valuation of \$__ million.

Expected Closing Date: On or before _____, 2000

Option Pool: The post-money valuation above assumes that, prior to closing, the total shares reserved under the Company’s employee stock option plan will represent __% ownership of the Company on a fully diluted basis.

[Investors expect that the Company will use options to attract and retain key employees and usually factor the option pool size into their valuation of the Company and assume that the full amount of the option pool is taken into account in determining the “pre-money” valuation of the Company.]

Dividends: The Series A Preferred Stock shall receive a __% noncumulative dividend per year, when and if declared by the Board, in preference to the common stock.

[This dividend provision is favorable to the Company as the directors need not pay a dividend unless they wish to pay dividends on common stock in the same year. Contrast to cumulative dividends whereby unpaid dividends will be added to the liquidation amount and the redemption price of the preferred stock and all accrued dividends for past as well as the current year must be paid prior to payment of dividends on common stock.]

Liquidation Preference: Series A Preferred Stock holders will receive an initial payment equal to the purchase price of the Series A Preferred Stock plus accrued and unpaid dividends on each share of Series A Preferred Stock (the "Initial Liquidation Amount"). After the Initial Liquidation Amount, the Series A Preferred Stock and Common Stock share on an as-converted basis until the holders of the Series A Preferred Stock have received, in the aggregate, an amount equal to _____ times their investment.

[Alternatively, terms may be structured so that preferred stockholders may get back only their original investment or they may retain their original investment plus all accrued but unpaid dividends for every year (see "cumulative dividends" above). In subsequent financings, new series of preferred stock may have a superior position or be on a pari passu footing with this series with respect to liquidation.]

A merger, reorganization or sale of substantially all of the assets of the Company in which the stockholders of the Company immediately prior to such event do not own a majority of the outstanding shares of the surviving entity will be deemed to be a liquidating event.

[In the case of a sale of the Company, the investor will have a choice of taking the liquidation preference or converting and getting what the common stockholders get.]

Redemption: If not previously converted, the Series A Preferred Stock is to be redeemed in three equal successive annual installments beginning _____, 2005. Redemption will be at the purchase price plus a ____% per annum cumulative guaranteed return.

[The investor may seek protection for those deals that will not result in an IPO or a sale of the Company. Most investors do not want to be locked in as a minority stockholder in a private company with no guaranteed exit provision. According to these terms, the Company must redeem at a specified amount, which provides investors with some guaranteed return on their investment. Alternatives include: (a) a provision stating that the Company may not call the preferred stock for redemption nor may the investors require the Company to redeem their stock and (b) optional redemption after a certain date by either the Company or the investors. If the Company may call the preferred stock at its option, it could potentially call once the common price exceeds the redemption price and force the investor to take a mediocre repayment on his investment or convert to common stock and lose his preferred position in the Company.]

Conversion: The Series A Preferred Stock is convertible into one share of common stock (subject to the anti-dilution provisions below) at any time at the option of the holder and automatically converts into common stock upon:

- (i) Consummation of an underwritten public offering with aggregate proceeds in excess of \$ _____ and a price per share of __ times the original purchase price per share (subject to adjustment), or
- (ii) The vote of a majority of the holders of the Series A Preferred Stock.

[Because the control features and other terms of preferred stock are not consistent with public market securities, the preferred stock has to be converted into common stock prior to an IPO].

Anti-Dilution Provisions: Proportional adjustment in the event of stock splits, stock dividend, reclassifications and the like; broad-based weighted average dilution protection for any issuance of stock or other equity instruments at a price per share less than the purchase price paid for the Series A Preferred Stock.

[Antidilution adjustments increase the amount of common stock received by an investor if the Company issues additional stock at prices which are lower than that paid by the investor. This protects investors if they have overestimated the value for the Company or if the founders fail to increase the value of the Company by the next round of financing.]

Methods for computing the adjustment vary and may result in significantly different outcomes. Also, stock issued for certain transactions may be exempt from the antidilution adjustments, including option grants, warrant coverage in connection with debt and stock used for acquisitions or with strategic partners. A weighted average antidilution formula considers the total number of shares issued and the total shares outstanding and results in a less drastic adjustment (from the founder's position) than a full ratchet antidilution formula which automatically reduces the conversion price to the price at which a new issue is sold, even if only a small number of shares are issued.]

Voting Rights, Protective Provisions: The holders of the Series A Preferred Stock will be entitled to that number of votes on all matters presented to stockholders equal to the number of shares of Common Stock then issuable upon conversion of the Series A Preferred Stock.

Except as otherwise required by law and as described below, the holders of a majority of the outstanding shares of Common Stock and Series A Preferred Stock (voting together as a single class on an as-converted to Common Stock basis) shall be required to approve matters which require stockholder vote; provided however, that on the

following matters the holders of Series A Preferred Stock, voting together as a single class, will have a separate class vote requiring two-thirds (2/3) approval of the total number of votes:

- I. the creation of any senior or *pari passu* security,
- II. payment of dividends on Common Stock,
- III. repurchase of stock,
- IV. any liquidation event or transaction in which control of the Company is transferred,
- V. an increase or decrease in the number of authorized shares of Series A Preferred Stock,
- VI. any adverse change to the rights, preferences and privileges of the Series A Preferred Stock,
- VII. an increase or decrease in the size of the Board of Directors, and
- VIII. any change in the Company's line of business.

[Consider substituting the approval of the preferred nominee to the Board, which may allow quicker action and more flexibility.]

Preemptive Rights:

The holders of the Series A Preferred Stock shall have the right to purchase a pro-rata portion of any securities offered by the Company in the future, except for stock issued to employees under the stock option plan. A Series A Preferred Stock holder will have thirty days (30 days) in which to exercise this preemptive right.

[This right is typically granted to investors to ensure that the Company does not negotiate new financings with new players without offering to deal with the present investors. Sometimes investors are required to take "all or none" of the new financing. Sometimes exceptions are made for stock issued in connection with acquisitions and for transactions with customers, suppliers and strategic partners.]

Registration Rights:

Two (2) demand registrations, unlimited piggyback registrations (subject to underwriter cutbacks) and S-3 registrations, all at Company expense. Demand rights begin upon the earlier of 180 days following an IPO or four (4) years from issuance of the Series A Preferred Stock.

[Similar to the rationale for needing a redemption right, since the investor probably will not control the Board of Directors of the Company, the investor usually negotiates for "demand registration rights" under which the Company contractually agrees to file a registration statement with the SEC for a public offering of the stock "on the demand" of the investor. The number of "demands" is

negotiated. Since it can easily cost \$300,000 or more to file a registration statement, this can be a very significant provision, especially as to the number of demand rights an investor has. In addition, the investor usually receives "piggyback" registration rights under which the investor's shares are included in any "primary registration" statement (where the Company is selling its own stock) or in any "secondary registration" where the Company is filing a registration statement to permit others to sell.]

Financial Information: The Investors shall receive standard information rights including audited annual financial reports, unaudited monthly and quarterly financial reports, annual budget and business plan, board packages, as well as standard audit/inspection rights.

Board of Directors: The Board of Directors will be comprised of _____ directors. Investor shall be entitled to elect _____ directors (the "Series A Preferred Stock Directors") to the Board of Directors. The Company will indemnify directors to the fullest extent allowable under the law.

Right of First Refusal and Co-Sale Right: Series A Preferred Stock holders shall have the right to participate on a pro rata basis (based on their percentage equity ownership on an as converted basis) in transfers of stock for value by founders, and shall also have a right of first refusal on such transfers.

Stock Restriction Agreement: All present holders of common stock of the Company who are employees of, or consultants to, the Company will execute a Stock Restriction Agreement with the Company pursuant to which the Company will have an option to buy back at cost a portion of the shares of common stock held by such person in the event that such stockholder's employment with the Company is terminated. 25% of the shares will be released each year from the repurchase option based upon continued employment by the Company.

[Investors may want to ensure that the present management of the Company has an incentive to remain and discourage management's leaving the Company through the buy-back provisions detailed above. The Company may also want the stock back to use to recruit a replacement for the departing employee. Founders may negotiate to have a portion of their shares vested immediately, and accelerated vesting upon termination without cause.]

Transfer of Shares: Investor shall have the unrestricted right to transfer the Series A Preferred Stock, along with all rights pertaining thereto, among any of its affiliates. Such rights shall also be transferable to third parties, provided, however, that such transfer represents no less than 5% of the Series A Preferred stock and that such rights will be transferable only to a transferee who is not an actual or potential competitor of the Company, as reasonably determined by the Board.

Expenses: The Company shall pay all reasonable out-of-pocket expenses of the Investor, including fees for one legal counsel for the Investors up to \$_____.

Standard Covenants and Representations: The purchase of the Series A Preferred Stock will be made pursuant to a Stock Purchase Agreement drafted by counsel to the Investors and acceptable to the Company, which Agreement shall contain, among other things, appropriate representations and warranties of the Company, covenants of the Company reflecting the provisions set forth herein and other provisions typically found in such agreements, and appropriate conditions of closing.

[Requiring representations from the Company limits founder liability to the value of the Company; personal representations from founders greatly expand this liability.]

In addition, the Company shall warrant that it has entered into employment agreements with all key employees and proprietary information agreements with all employees and contractors containing provisions satisfactory to the Investors with respect to confidentiality, corporate ownership of inventions and innovations during employment, and non-competition and non-solicitation of employees and customers during and after employment.

Non-Solicitation: From the date of acceptance of this confidential memorandum until the consummation of the financing or the earlier of not less than _____, 2000 or the termination of our negotiations, the Company will not directly or indirectly solicit, initiate, or participate in any discussions or negotiations with, or encourage or respond to any inquires or proposals by any person or group concerning any financing of the Company except (i) the Investors and (ii) those parties identified by the Company as having previously commenced discussions with the Company as becoming potential follow-on investors for this round.

The Company will promptly notify the Investors if any person seeks to initiate with the Company any other discussions or negotiations not contemplated in the immediately preceding paragraph, makes an inquiry or proposal, or requests any information with respect to any proposed financing of the Company, and will disclose to the Investors the terms of any proposal which it may receive in respect of any such proposed financing.

[This exclusivity clause prevents the Company from shopping the deal, even if negotiations become difficult. Accordingly, it is wise to be comfortable with the deal terms before signing.]

Confidentiality: The Company shall not disclose the existence of either this confidential memorandum or the fact that the Investor is contemplating an investment in the Company, without the prior written consent of Investor.

Expiration: This confidential memorandum shall expire five business days from date of issue if not executed by that time.

* * * * *

Other than the non-solicitation, confidentiality and expiration clauses the undersigned acknowledge that this term sheet does not constitute a binding agreement, but expresses an agreement in principle concerning the principal terms of an equity financing and an undertaking to proceed in good faith to negotiate definitive financing documents.

VENTURE INVESTOR, L.P.

By: _____
Name: _____
Title: _____

IRRATIONALLY EXUBERANT.COM, INC.

By: _____
Name: _____
Title: _____

REPRESENTING THE AILING DOT.COM - DISTRESS FINANCING AND REVISITING THE TERM SHEET

I. INTRODUCTION

The initial venture capital term sheet and the preferential terms provided to investors will become a key focal point in dot.com distress situations. In addition, companies seeking new financing in a distress situation will confront severe investor terms and a different investment landscape than that presented in the company's first round financing.

II. INITIAL TERM SHEET AND VENTURE CAPITAL INVESTMENT - (Appendix A)

A technology company which has suffered setbacks and is struggling for survival will revisit the initial term sheet and review the rights of the original venture capital investor. Often these transactions, negotiated in a spirit of optimism and cooperation, provide significant rights to investors which are not confronted until adverse events face the dot.com or struggling technology company. Of course, any term sheet will only set forth key business terms, and the definitive legal document will control the parties' actual legal rights.

A. Preferred Stock

Preferred stock is the vehicle of choice for investors in early stage investments in technology companies. Investment is through convertible preferred stock which allows the investor to retain significant and superior rights to the founders and management of the company but also allows the investors the opportunity to convert their investment to common equity when the transaction appears successful. These superior rights range from preferred dividends to preferences on liquidation to mechanisms for shifting control of the board of directors.

1. Dividends

Preferred stock terms will often include a fixed or mandatory preferential dividend. In a distress situation, dividend provisions will take on significance because no distributions or dividends are allowed to be made to any other series of stock without payment of the preferential dividend to the venture capital investors. Also, please note that under Delaware

General Corporation Law §170 dividends are not allowed to be paid unless the company has generated a surplus from operations or unless there is adequate capital surplus available for distribution. Because of the losses experienced by technology companies and their limited operating revenues, such entities are generally in a negative shareholders' equity position. Therefore, a payment of dividends is not possible.

2. Mandatory Redemption

Preferred stock terms may include provisions requiring the company to redeem the preferred stock in certain situations, including at specific dates or upon default under covenants contained in the preferred stock instrument. The redemption of shares is subject to similar restrictions regarding surplus capital as is the case in preferred stock dividends. However, the failure of the company to redeem shares as required under mandatory redemption provisions may trigger cascading defaults potentially resulting in a change of control of the company and ultimately its liquidation.

3. Liquidation Preferences

In a case of imminent failure or liquidation of a dot.com, the liquidation preference will be the provision most likely revisited by the management of the company and its board of directors because it provides for the investors to receive "first dollars" out of the company upon its liquidation. However, since the preferred shares are equity and subordinate to any debt of the company (although senior to the common equity), these provisions can only be implemented once all debts, including accounts payable, are discharged and paid. Venture capitalists who participate in a distribution in violation of the rights of creditors subject themselves to personal liability.

4. Antidilution Provisions

These provisions are most misunderstood by companies and founders and are frequently utilized by investors in distress situations. They ensure that subsequent rounds of investment capital, including down rounds and distress rounds, do not operate to affect the essential elements of the economic deal (viewed in its most favorable light) struck by the venture capitalists at the early stages of a technology company's life.

The most difficult provision for a company, the "full ratchet" antidilution right, will allow the preferred stock conversion or "strike" price to float, or "ratchet", down to the lowest level of any subsequent financing, without regard for the level of new investment. For example, assume that in 1999 a venture capitalist invested \$5 million, at \$1.00 per

share, convertible on a one-to-one basis to common stock of a new dot.com. At the time of the initial investment, the dot.com has a \$15 million valuation resulting in the investor holding 25% of the Company (5 million shares on an “as converted” basis). In 2001 the company is in a distress mode and in order to survive and make September payroll, is required to raise \$100,000 at \$.10 a share (convertible to 1,000,000 shares). Under a full ratchet, the preferred stock investor’s \$5 million position would automatically readjust to a conversion ratio of \$.10 a share. Obviously, the dilution from a transaction of this type would be massive. The venture capitalists would now have the right to convert their \$5 million in preferred stock to 50 million shares and possess total control of the company. This result would be accomplished even though the new investor had only put in a relatively small amount of money (e.g., \$100,000).

Another antidilution right provided in early rounds and confronted by founders and companies in later rounds is a “weighted average” antidilution provision. The weighted average provision simply provides for an adjustment of the venture capital investor’s strike price based upon a moving scale of the price paid by the new investor related to their total investment. Accordingly, a small investment relative to the first round will have a minor impact on the conversion rights of the initial investors.

Finally, because of the severe deterioration in company valuations experienced since mid-2000, investors have demanded more onerous terms to reset and adjust the conversion at the time of a liquidity event, such as a public offering or a sale, to give the investor a fixed discount relative to the liquidity event price and therefore a predictable return upon conversion of their shares. These provisions are particularly severe and operate to ensure a very favorable conversion ratio notwithstanding its effect on other shareholders, founders and management of the company.

5. Voting Rights

Preferred stock investors hold rights to vote with common shareholders on an “as converted” basis. Thus, the effect of antidilution provisions will result in greater control without the necessity of actual conversion. Voting rights for preferred stock holders will ensure that they maintain representation on the board and may provide for a shift of control from the common shareholders and founders to the preferred stockholders upon certain events of default or dilutions in later rounds. For instance, the failure to redeem the shares of preferred stock may result in a default thereby providing super voting rights to investors. More importantly though, the voting rights will ensure that the preferred stockholders are required to approve virtually any material strategic transaction. Their approval will be required prior to restructuring the business of the company, incurring indebtedness senior to the preferred stock or adding new investors to the company which may have rights senior or pari passu with the preferred stock.

III. THE FOLLOW ON DISTRESS FINANCING TERM SHEET - (Appendix B)

A. Equity Grants

The primary negative effects of the distress financing are obvious to attorneys and businessmen alike and provide for lower valuations to a distressed company with resulting significant dilution for the existing shareholders and founders. The objective of the distress financing investor is to protect against the downside by taking a secured creditor position while at the same time securing the upside by obtaining the the greatest amount of equity. They are successful in their endeavors because the company will have little leverage in these situations. A related objective is to retain significant incentives (options) for management and founders so as to encourage them to remain at the company. The pursuit of these objectives results in significant dilution of the existing common shareholders and prior rounds of venture capital. As a result there is significant tension between the initial investors and their rights and the objectives of the new investor group.

B. Form of Investment

The flavor of choice for investments in a distressed financing for a dot.com or any other technology company is senior secured convertible debt together with warrants to purchase preferred stock. This structure provides broad rights to the

distress investor by providing a creditor's security interest on all of the assets of the company (and, first right on liquidation) but also the upside of an equity holder's return in the event the investment is successful.

The bridge loan and other distress equity investments in the technology sector have been characterized by extremely short maturities with increased dilution in the event that the convertible note obligations are not paid within a required period. This allows the bridge loan investor to control its destiny and foreclose and liquidate the company in the event the Company's prospects or finances deteriorate.

C. Warrant for Purchase of Preferred Stock

The number of shares of preferred stock purchasable under the warrant are tied to the amount of the convertible debt investment. The

convertibility features are structured so as to require an early payoff of the convertible debt and penalties for late payment.

IV. CONCLUSION

Irrationally exuberant founders of early stage technology companies will tend to ignore onerous provisions in the documents and focus exclusively on valuation. Competent counsel should advise the client of the dramatic effect of these provisions in the event of setbacks. In addition, although little negotiating leverage is available, counsel should advise clients that closing a distress financing will mean that they have effectively handed over the keys to the store in exchange for 90-180 days of survival.

AILING.COM, INC.
ISSUANCE OF CONVERTIBLE DEBT AND WARRANTS
TERM SHEET

This Revised Term Sheet sets forth the principal terms under which Ailing.Com, Inc. (the "Company") has issued and proposes to issue to _____ Ventures, L.P. (the "Lender") up to \$800,000 of secured debt convertible into preferred equity of the Company and warrants to purchase the same class or series of preferred equity (referred to, as described herein, as the "Transaction"). This memorandum is subject in all respects to the negotiation and execution of definitive documentation that is satisfactory to all of the parties, and obtaining of all necessary corporate approvals, including, without limitation, obtaining of necessary consents and waivers from certain shareholders of the Company.

Terms of the Transaction. The following sets forth the principal terms of the Transaction, as currently contemplated by the parties.

<i>Company:</i>	Ailing.Com, Inc., a Delaware corporation.
<i>Aggregate Amount of Debt:</i>	Up to \$800,000.
<i>Securities:</i>	Secured convertible debt (the "Convertible Debt") and warrants to purchase preferred stock of the Company (the "Warrants").
<i>Security for Convertible Debt:</i>	Inventory, accounts, equipment, intangibles, proprietary assets, and investment property of the Company.
<i>Drawdowns:</i>	\$200,000 on September 30, 2001; \$400,000 on December 31, 2001, \$200,000 on February 28, 2002.
<i>Closing Date:</i>	The Transaction will be made pursuant to definitive documents and instruments mutually satisfactory to the Company and the Lender; the date of the Convertible Loan and Security Agreement to be entered into by and among the Company and the Lenders is September 30, 2001 (the "Effective Date").
<i>Maturity:</i>	March 31, 2001, if not converted prior thereto. All principal and accrued but unpaid interest may be convertible at the option of the holder prior to the closing of an "Acquisition" of the Company (as described below) or, in lieu of conversion, the holder may accelerate the indebtedness under its Note at the time of an Acquisition.
<i>Interest:</i>	Eight percent (8%) per annum, with interest accruing on advances when made until maturity.
<i>Convertibility:</i>	At any time within six months of the Effective Date all of the principal and any accrued but unpaid interest on the Convertible Debt may be converted at the option of the holder into shares of the Company's equity securities most recently issued and sold to third party investors at a conversion price equal to 70% of the purchase price paid by

those investors.

After six months of the date of the Effective Date, the Convertible Debt may be converted at the option of the holder into shares of the Company's equity securities most recently issued and sold to third party investors at a conversion price equal to 50% of the purchase price paid by those investors.

Upon an Acquisition (defined as a sale of all or substantially all of the Company's assets, or a merger or consolidation or stock sale that results in pre-sale shareholders holding less than a majority of the voting power of the surviving corporation) the Convertible Debt is convertible on a dollar-for-dollar basis into shares of Common Stock at a conversion price equal to 80% of the lesser of the Common Stock equivalent price per share paid by the acquiring person in such Acquisition or the Common Stock equivalent price per share paid by the purchasers of the Company's capital stock in its most recent round of financing or negotiated purchase and sale of its capital stock.

<i>Prepayment and Mandatory Payment:</i>	The Company may prepay any amounts without penalty. The Company must repay the Convertible Debt (if not converted) upon the closing of a next preferred stock equity investment in the Company.
<i>Non-Subordination:</i>	The Convertible Debt is not subordinate to other indebtedness of the Company.
<i>Warrant Term:</i>	Expires September 30, 2011.
<i>Exercise Terms:</i>	Exercisable for shares of preferred stock of the Company of the same class and series most recently issued and sold to third party investors (a "Subsequent Financing") or, if no Subsequent Financing occurs, shares of the Series A Convertible Preferred Stock.
<i>Exercise Price:</i>	If Series A Preferred Stock: \$1.00 per share. If another series of preferred stock: The price per share paid by third party investors in that financing.
<i>Number of Shares:</i>	Determined by dividing the "Aggregate Exercise Price" by the applicable Exercise Price.
<i>Aggregate Exercise Amount:</i>	Two times (2x) the Convertible Debt amount loaned by the Lenders if Convertible Debt repaid within two months of issuance; one and one-half times (1.5x) the Convertible Debt loaned by the Lenders if Convertible Debt repaid within four months of issuance; and one times (1x) the Convertible Debt amount loaned by the Lenders if Convertible Debt repaid after four months of issuance.
<i>Anti-Dilution Adjustments:</i>	Full anti-dilution adjustments, including weighted average price protection for shares issued at or representing less than

then-current fair market value or then-current exercise price.

*Warrant Cashless Exercise
Feature:*

Customary provision included.