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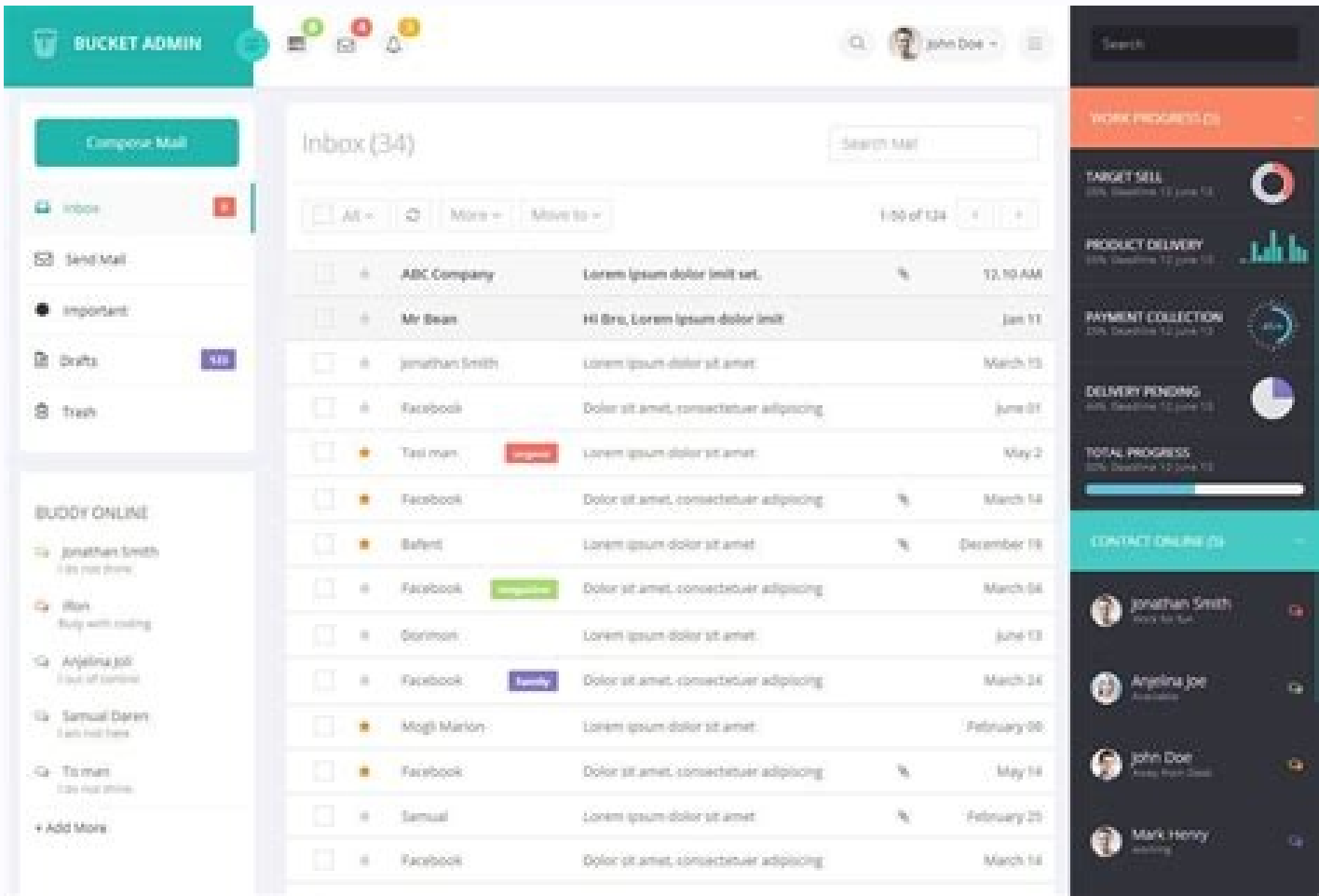

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Convertible note term sheet startup

	A	B	C	D	E
1	Convertible Note Calculator				
2				Input	
3	Pre-money	Shares	Value		
4	Pre-money	500,000	3,000,000		
5					
6	Convertible note	Amount	Discount	Cap	
7	Convertible note	108,000	20.00%	2,000,000	
8					
9	Investment	Pre-money	Investment	Post-money	
10	Valuation	3,000,000	1,000,000	4,000,000	
11					
12	Ownership	%	Shares	Value	
13	Investor	25.00%	176,180	1,000,000	
14	Noteholder	4.05%	28,541	162,000	
15	New ownership	29.05%	204,722	1,162,000	
16	Founders	70.95%	500,000	2,838,000	
17	Total	100.00%	704,722	4,000,000	
18					
19	Share price	Investor	Noteholder	Discount	
20	Share price	5.676	3.784	33.33%	

REAL NETWORKS (Ticker: RNWK)	12/31/2003 (000s)	12/31/2002 (000s)
Trade accounts receivable	\$2,313,740	\$130,018
Other current assets not displayed		
Accounts payable	\$6,865	\$7,830
Other current liabilities not displayed		
Non-current liabilities:		
Deferred revenue	4,581	12,446
Accrued loss on excess office facilities	24,099	22,110
Deferred rent	3,382	3,271
Convertible debt	100,000	—
Commitments and contingencies		
Total Non-current liabilities	132,042	37,827
Total shareholders' equity	366,486	349,765
Total liabilities and shareholders' equity	580,839	462,101



Not surprisingly, a lower Discount Rate is more favorable to the existing stockholders. See It is important to remember that a Convertible Promissory Note represents a debt obligation of your company, unless, pursuant to its terms, the underlying principal amount and accrued and unpaid interest convert into shares of capital stock in connection with a future round of priced-equity funding that triggers the debt conversion. If you go it alone, then you might miss some key issues or terms that could have significant adverse effects on your company down the road. See Financing Fundamentals: Plan Your Company's Stock Financing Like a Pro! Contact us when you are ready to discuss your financing plans and to get started. We are here to help. See Financing Fundamentals: Equity Funding, Convertible Debt & Dilution. For many early-stage companies, a priced-equity round of funding may result in excessive equity ownership dilution to the founders if they cannot negotiate sufficiently high pre-money valuations. Tip – For more information, please check out our webinar on From Convertible Debt to Series A - Why Discounts, Caps and Dilution Matter, where we walk you through a Convertible Note Term Sheet from top to bottom. Tip – As the Aggregate Principal Amount increases, your company will have more indebtedness that either will (i) need to be paid back at the maturity of the Convertible Promissory Notes or (ii) covert into more shares of capital stock upon the closing of a future round of priced-equity funding that triggers the debt conversion. The Note Purchase Agreement and the individual Convertible Promissory Notes are the definitive legal documents that eventually will be prepared, negotiated and executed in order to document the convertible debt financing. Your startup likely will encounter some twists and turns along the way, and you certainly do not want an inadvertent default under the convertible debt documents to cause the effective sale of your company's assets to the convertible debt investors. For example, we strongly advise our startup clients to negotiate away any attempt by the investors to secure their indebtedness with the company's assets. Next Steps We assist many startup companies with their seed and later-stage financing rounds, whether Convertible Promissory Notes, SAFEs or priced-equity (e.g., Common Stock, Series Seed or Preferred Stock). Tip – The convertible note Valuation Cap is not the current valuation of your company, although you may find investors who try to negotiate it in that manner. The Valuation Cap is designed to provide an equity ownership backstop in order to help ensure that the convertible debt investors are not diluted excessively in connection with the future round of priced-equity funding that triggers the debt conversion. For example, with a Valuation Cap of \$10 million, the price per share for purposes of the debt conversion would be \$10 million divided by the pre-money equity capitalization. 2. See Oh Sheet! 5 Critical Issues for Your Next Financing Term Sheet. Related Posts Raising Money Using Convertible Debt Convertible Note [Examples and How It Works] 3. With the convertible note Maturity Date, you will want to make sure that the Maturity Date provides enough runway (e.g., at least two years – noting that longer is better for your company) to negotiate and close the future round of priced-equity funding that will trigger the debt conversion. A convertible debt financing often allows an early-stage company the opportunity to access seed funding quickly, while deferring the issue of pre-money valuation to a future round of priced-equity funding. How Do You Create a Convertible Note Term Sheet? Interest Rate Convertible debt is still debt, so it needs a convertible note Interest Rate, usually in the range from 5% to 10%. Aggregate Principal Amount The Aggregate Principal Amount simply is the total amount of investment that you plan to raise as part of the convertible debt financing, which will be the sum of the principal amounts of all of the Convertible Promissory Notes that are issued in connection with the convertible debt financing. A Convertible Note Term Sheet is the summary outline of the key terms for a convertible debt seed financing. We strongly recommend that you work with advisors who really know how to structure and negotiate startup and seed financing deals, including with experienced and focused startup legal counsel like us. Not surprisingly, a higher valuation cap is more favorable to the existing stockholders. The accrued interest resulting from the convertible note Interest Rate typically coverts with the principal into shares of capital stock in connection with the future round of priced-equity funding that triggers the debt conversion. Valuation Cap The convertible note Valuation Cap is another key term that determines how many shares of capital stock will result from the conversion of the outstanding convertible debt. Maturity Date The Maturity Date of the Convertible Promissory Note is another term that you will need to negotiate with a convertible debt financing. Accordingly, their debt will convert at a convertible note Discount Rate, usually from 10% to 25%, to the price per share paid by such later equity investors. 4. The convertible debt investors usually are taking on more investment risk at the seed investment stage relative to the later equity investors. Even though the Convertible Note Term Sheet is not legally binding, it does lay out the key terms of the convertible debt financing,

which typically do not change in the final financing documents unless the investors try to negotiate even better terms later. What are the Key Terms of a Convertible Note Term Sheet? Most convertible debt financings have a Valuation Cap, especially if you are negotiating with experienced angel investors. Once you have potential investors that are interested in investing, the Convertible Note Term Sheet will help you reach agreement on the most important financing terms before you take the time and expense to prepare the actual financing documents and seek related approval from the Board of Directors. Common practice is that the convertible debt financing documents will provide the investor with the better share conversion result when comparing the debt conversion resulting from the Discount Rate and the Valuation Cap. Five key terms that you should expect to negotiate in a Convertible Note Term Sheet: 1. Discount Rate The convertible note Discount Rate is a key term that determines how many shares of capital stock will result from the conversion of the outstanding convertible debt. Very carefully and thoughtfully, given that the Convertible Note Term Sheet is your best opportunity to negotiate the best financing terms for your company. It is important to remember that the Convertible Note Term Sheet typically is not binding on your company or the potential investors, except for limited provisions concerning confidentiality and expenses. As you approach potential investors, the term sheet will be a critical part of your seed financing toolkit, together with the executive summary and investor pitch deck.

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