UNIVERSITY OF WASHINGTON
Foster School of Business
ENTREPRENEURIAL FINANCE
Entre/Fin 557
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Term Sheets and Valuations

How, if at all, would you change the provisions in Accessline's proposed term sheet for the Series B preferred stock? Specifically, how would you change the:

Valuation: What do you think of AccessLine management's' suggested valuation? You may use the following estimates for revenue, based on projections by Accessline's founders and management, and a discount rate of 60%:

AccessLine management's forecast of revenue is 208, by the end of 1999. If price/revenue ratio of comparables (3.68) remains the same, the valuation by end of 1999 will be 208 * 3.68 = 765 million. With a 60% discount rate, the current valuation would be 765/(1+60%)^4 =117 million.

The current valuation suggested by AccessLine is 16 million for 13.4% of the Company. The total valuation is therefore 16/13.4% = 119.40, higher than the valuation of Apex.

With such a high valuation, investing AccessLine would be NPV negtive for Apex.

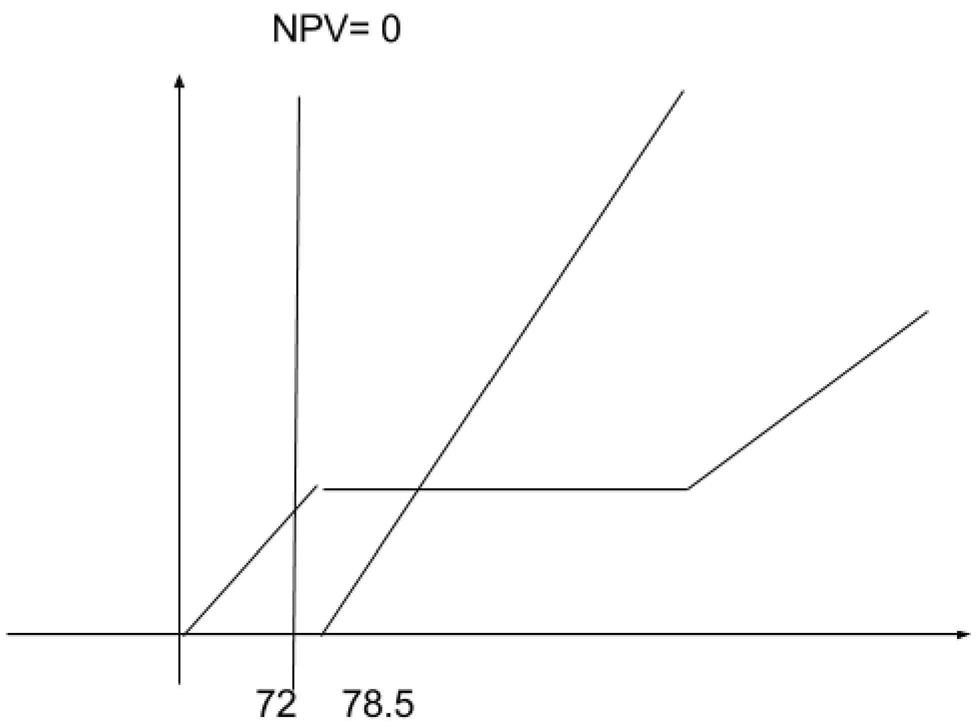
Rights and preferences of the Series B preferred stock: These rights and preferences *may* include: dividends, liquidation preference, conversion, voting rights, anti-dilution protections, board representation etc. You may ignore registration rights.

The following clauses wil be changed:

Liquidation Preference. A liquidation pferefence equal to **2.5** times of the Sales price per share plus …...

Board of Directors. Five total. Series A and B will each be entitled to elect two representative to the board. Founders will elect two representatives. The fifth representative will be jointly agreed upon by the rest of the representatives on the board.

Prepare adjusted waterfall diagrams that account for your proposed changes.



What is your rationale for your proposed changes to the valuation and terms? How do your changes alter the founders incentives and Apex's controls versus the proposed term sheet? Do these incentives and controls address the risks and opportunities facing Apex?
With a discount rate of 20% and 15.5 and 16 million investment, the valuation of the Company need to reach 72 million by 1999 to break even. It is desirable only that the founders are paid only when they have generated more value than the initial investment from the investors and the moderate 20% discount rate.

As we discussed, the key risk of the Company is that the technology becomes obsolete or challenged by other competitors. By providing proper incentives to the founders, our proposal ensures the Company will grow at a high speed to mitigate such risks.

The changes in board of directors will ensure investors collectively have an equal voting power as the founders. The fifth position in board of directors can be left empty. So, in essence, there is a deadlock in the board of directors, forcing more communication and better involvement of all parties.

Do you see any trade-offs between the valuation and the rights and preferences of the Series B preferred stock?
Yes. From the perspective of entrepreneur, if the liquidation of Series B is changed, he will get less payment when things do not go well. If the valuation is less, the entrepreneur will end up will less share of the Company and get less payment when things go really well. As both actions will redcue the payment the entrepreneur gets, in a typical negotiation, the VC cannot ask for both. In this case, we are asking more payment when things do not go well by

changing the liquidation preference, so we have to give the entrepreneur higher valuation than our expectation.

How does the Series A investors' power to veto a deal affect your proposed changes ?

Yes. As Series B investor, we are asking more favorable terms than Series A investor. In a scenario where things don't go well, Series B investor will be paid more comparing with Series A investors. Series A investors will likely to veto the deal and demand equal terms. If this is the case, the total return for the entrepreneurs will be further reduced, therefore, the entrepreneurs may demand higher valuation as a compensation.

How would you convince Dan Kranzler to accept your changes?

We will point to Dan Kranzler that our proposal is based on the idea of providing enough incentives for the entrepreneur to grow the Company so that everyone will be better off. As investors, we do not have control over the Company. Therefore we are demanding higher payments when things do not go well, which is a protection mechanism to our investment. On the other hand, Dan Kranzler have all the necessary capability and control to improve the operation of the business and to increase the company's growth. Therefore, Dan Dranzler should consider more about the best scenarios, under which the firm will have high valuation. As Apex is demanding protection, it is giving the entrepreneurs a higher valuation than it would originally accept, The final payment for the entrepreneurs will therefore be higher.