Due Diligence Process/Checklist

TEDCO staff will use the following Due Diligence Process/Checklist for evaluating companies being considered for a Gap Investment. Upon completion of the process, the staff member will complete a formal Investment Recommendation Memorandum and present that recommendation to TEDCO's Investment Committee for consideration. In the event that TEDCO is following the investment of a trusted lead investor, TEDCO staff may rely on the due diligence package obtained from the investor.

I. Evaluate Management

The management team should be evaluated. Resumes or CVs from executive staff should be obtained and references should be checked to validate work history and level of experience. Previous employers, company staff, board members, and company partners should be interviewed and a Google search should be conducted. It is important to ensure that the management team is representing itself appropriately, that the team is intelligent, is inspiring, uses good judgement, and that they are honest and have integrity. Google is a good resource to determine if there are any issues that have come up in the press regarding members of the management team. If any hint of legal or credit problems is discovered, this would need to be further investigated. If the team has received prior investment, investors should also be interviewed.

II. Business Opportunity

Most of the business opportunity should be vetted prior to the initiation of the due diligence process – during the company selection process; nevertheless, assumptions the company is making in each of the following areas should be validated. Many of the **assumptions will be validated through conversations with customers, potential customers, competitors, and industry experts**.

- Problem/Demand

  Does the company properly represent the problem in the market that is creating demand? Why is the problem not being adequately addressed by current products or the status quo?

- <u>Market Assessment</u>

  The size of the market should be validated with a bottom-up assessment. Other factors such as emerging market trends should also be identified and evaluated. Any relevant analyst's reports or other helpful information should be provided.

- <u>Competitive Analysis</u>

  An assessment of the competitive landscape should be performed to ensure that it is accurately described by the company. Customers should be contacted to validate the company's claims about the advantages of its products relative to the competition. Questions about the perception of the company's product disadvantages should also be asked. A validation that the company's intellectual property provides a sufficient competitive advantage and barrier to entry for competitors should be performed.

- <u>Barriers to Entry</u>

  For any barriers to entry – regulatory, freedom-to-operate, or other barriers, a risk assessment should be performed.

- <u>Technology Validation</u>

  Clear and sufficient validation of the technology should be provided. If necessary, experimental data should be evaluated by someone knowledgeable in the scientific area. Any risks associated with the technology, its development, or its application as a product should be documented.

- <u>Value Proposition</u>

  The company's value proposition should be validated by speaking to current customers. If a product is not yet on the market, potential customers should be able to validate the value of the company's product based on assumed product features and a targeted sale price.

- <u>Target Market and Entry Strategy</u>

  An assessment of the company's selection of its initial target market and secondary markets should be performed. An evaluation of the company's rationale for this segment and its strategy to acquire customers should be conducted.

- Revenue and Pricing Model

  The company's pricing strategy should be validated either through revenue traction or discussion with customers. The revenue model should be assessed including the cost of customer acquisition, sales cycle, and other factors to ensure that the model is viable.

- Distribution

  Product manufacturing and distribution partners should be identified and in place. Critical partners should be contacted to validate commitment. Any distribution/marketing contracts should be evaluated.

- Growth strategy

  The company should have a clear plan to scale the business. Growth assumptions including cash flow and financing requirements should be validated.

- Capital requirements

  The company should provide a description of how it will use the funds being requested in the current round. The description should include a time horizon and key inflection points associated with future financings. It should also include a hiring plan for the use of the TEDCO Gap Investment funds. The hiring plan should consist of the titles of the new positions, approximate salary and benefits amounts, and proposed hiring timelines. The company's financing plan should be evaluated to ensure that it is appropriately matched with achievable milestones. Strategies for follow-on investment and an exit should be validated by talking to potential late-stage investors or acquirers.

- Exit Opportunities

  The company should provide a description of its exit strategy including comparables for similar companies in the same industry vertical.

III. Financial Model Assessment

The company should provide historical financials for the past three years and a five-year pro forma financial model. A full assessment of the model should be performed. The model should be consistent with the company's strategies and key assumptions should be validated as appropriate for the industry.

IV. Deal Structure

The company should provide a deal term sheet for the current round of financing. The deal structure should be evaluated to ensure that it provides an appropriate incentive for the founders/management, protects the interests of the current investors, and does not create problems for downstream investors. The deal terms and valuation should be comparable to similar deals in the industry and region. The other investors in the round should be interviewed regarding the deal and its associated risks. Comparisons should be made to the risks independently assessed by TEDCO.

V. Collect and Review Company Documents

The following list of documents should be requested from the company:

- Organizational Documents

  The company should provide all documents related to the formation of the company including company charter, charter amendments, bylaws, and any necessary state qualifications. The company should also provide a certificate of good standing from the State of Maryland, other states where the company has operations, and the state in which the company was formed (if not Maryland) just prior to any investment decision. The documents should be reviewed by legal counsel prior to any investment.

- Board and Stockholder Records

  All board meeting packages (e.g., presentations, updates, etc.) and and any written consents of the board should be provided. A list of all directors, advisors, and board observers should be included. The documents should be reviewed by legal counsel prior to any investment.

- Capitalization Documents

  All stock purchase agreements, option agreements, convertible notes, and other documents related to company financings should be provided along with a fully updated capitalization table and history/timeline of all financings. These documents should be reviewed to ensure that all stockholders are listed and that all terms associated with the issuance of equity or debt are in order.

- Employment Contracts/Employee Compensation/Stock Option Plans

  Employment contracts for executives and any documentation related to special compensation arrangements including, but not limited to, employee stock option plans and bonus compensation plans should be reviewed and deemed to be appropriate. Resumes for all key staff and executives should also be provided and reviewed.

- <u>Insurance</u>

  The company should provide a listing of all insurance policies and evidence that they are up-to-date. These should be reviewed to ensure that the company has the appropriate policies in place taking into consideration the sort of operations being conducted and the stage of the company.

- <u>Intellectual Property</u>

  A full listing of the company's intellectual property assets needs to be provided along with copies of patents, patent applications, prosecution history, copyright and trademark registrations, etc. The company should also provide copies of any associated license agreements, assignment documents, and other documents associated with intellectual property rights. For copyrightable materials and software, the company should be able to identify the source of all works of authorship/source code including any consulting or other agreements for non-employees who developed code and any software licenses associated with third party or open source software. For trade secrets, the company must provide documentation of its procedures/policies for ensuring secrecy. The company should also provide copies of any patentability opinions and/or other documents associated with freedom-to-operate analyses. These documents need to be reviewed to ensure that the company has clear title to its intellectual property. The documents also need to be reviewed to verify that the intellectual property is sufficiently broad and strong to provide the competitive advantage needed by the company to be successful and that the company is free to operate without the need of third party licenses that have not been secured.

- <u>Significant Contracts</u>

  The company should provide copies of any major contracts. This might include leases, partnership agreements, and agreements with customers. For customer contracts, only a random sampling of contracts (as selected by TEDCO) and/or contracts with the largest customers needs to be provided.

- <u>Regulatory Documents</u>

  For companies that are subject to federal or state regulations, e.g., the Food and Drug Administration, the company needs to provide documentation showing that it is in compliance with such regulations or a plan/timeline to achieve compliance. The company also needs to provide any documents associated with any adverse regulatory, litigation, or other action against it.

- Other Relevant Documents

  The company should provide documents related to any other material information associated with the company including, but not limited to, law suits, threats of law suits, and any other documents that might be material to understanding the risks associated with an investment in the company. Furthermore, a review of the aforementioned list of documents might lead to the requirement of other documents to address issues that arise in the due diligence process.

The staff member leading the due diligence review should make a listing of risks and strengths associated with each item on the list. The list should be used in creating the Investment Recommendation Memorandum.