



Centex Telemanagement, Inc.

Introduction

As Peter Wendell drove from his home in San Francisco to his office in Menlo Park, he thought about the issues which he and his associate, Jeff Drazan, needed to discuss at a meeting later that morning. Peter Wendell was president of Sierra Ventures Management Company, which had been formed in 1982 to manage the investment activities of a group of related venture capital funds. Collectively, these funds had over \$75 million invested in over 45 different early stage companies. Wendell also served as one of the general partners of the Sierra Ventures Limited Partnership. Jeff Drazan had been hired by Wendell in January 1984 as an associate.¹ (See **Exhibit 1** for a copy of Jeff Drazan's resume.)

Although Wendell and Drazan worked out of the same office in Menlo Park, Wendell had not seen Drazan since an informal outing in San Francisco on July fourth, ten days previously. Drazan had been spending five, and sometimes six, days each week at the San Francisco offices of one of Sierra's portfolio companies, Centex Telemanagement, Inc. Sierra, in the person of Drazan, had "discovered" Centex in December 1984 and had made a \$350,000 equity investment in the company in May 1985. Further equity infusions were dependent on several contingencies and it was two of these contingencies which Wendell needed to discuss with Drazan.

At the time of closing on May 1, 1985, Sierra had agreed to provide an additional \$650,000 in equity and a guarantee for \$1 million of debt as soon as a well-qualified chief executive officer was identified, recruited and hired. Shortly after making the equity investment, Drazan, Wendell and John Stevens, one of the founders of Centex, had hired Bill White, president of Venture Resources (a leading Silicon Valley executive search firm), to assist in the process of identifying candidates for the CEO position. White responded very quickly with a lengthy list of potential candidates. A search committee had been formed, consisting of White, Drazan, Wendell, and Stevens, who was then serving as Centex's chief executive officer.

The search for a new chief executive officer was now focused on Peter A. Howley, 45, currently general manager of a \$40 million telecommunications subsidiary of Citizens Utilities Company. Background information on Howley is provided in **Exhibit 2**. Drazan, Wendell, and Stevens had first met Howley at a White-arranged meeting several weeks earlier. Wendell had been very impressed with Howley, his background, and his references. Drazan spent the next several

¹ For more information on Peter Wendell and Sierra Ventures, refer to Harvard Business School case #286-008.

This case was prepared by Associate for Case Development David H. Knights, as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. The figures in this case have been disguised.

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weeks trying to get to know Howley better by familiarizing him with the day-to-day operations of Centex. Drazan had visited Howley in Arizona and had spent six hours on a 104-degree Sunday afternoon at an out-of-the-way Denny's coffee shop describing the potential of Centex and the outstanding opportunity it represented for Howley.

Howley requested increasing amounts of data from Drazan over the next few weeks. Reference checks on Howley reinforced Drazan's and Wendell's early impressions. White developed sufficient enthusiasm for Howley that he said he would waive his \$35,000 search fee and, instead, take equity in Centex if Howley would sign on.

Howley had been to San Francisco and had met the founders and management of Centex. Information on the backgrounds of the four Centex founders is provided in **Exhibit 3**. John Stevens was willing to turn over the day-to-day management to another individual, though he was going to remain an active participant in the company's operation. He felt that he could work very well with Howley. The founders also realized that the conclusion of the executive search process would trigger the second stage of equity financing.

Wendell wanted to talk with Drazan about renting a plane so that they could fly to the remote airport in Arizona where Howley liked to meet them. Howley was well known in his community and did not want to start local speculation by being seen with Drazan and Wendell. Wendell was anxious to recruit Howley and reach a definitive deal with him.

A second element in Sierra's multistaged financing package was that Sierra would assist Centex in obtaining receivables financing and even act as a lender of last resort. Although the original business plan of Centex indicated a need for at least a \$2 million equity investment, Wendell and Drazan had carefully analyzed Centex's proposed uses of the funds and concluded that a large portion could be raised in the form of debt with receivables as collateral. This would potentially cut Sierra's financial exposure in half, because Centex had a good collection history on their receivables. Therefore, Wendell was prepared to have Sierra go so far as to provide some portion of this debt itself, as long as it was secured against receivables. Wendell had initiated discussions with the Bank of America's high-technology lending group in Sunnyvale, California, and an important meeting was forthcoming. Wendell wanted to discuss with Drazan the status of Centex's receivables and to finalize the presentation they were going to make to the bank.

Since Sierra Ventures had introduced the Bank of America to other successful companies, Wendell felt they might be enticed into bank-rolling Centex as well. While Wendell felt that Sierra's secured debt money would be reasonably safe as a loan to Centex, he would much rather let the bank handle the debt and use Sierra's extra million for the next promising deal. Wendell and Drazan had structured the deal with Centex so that Sierra got a large equity stake (54% of the company) in Centex for their \$1 million equity investment and for seeing that a \$1 million line of credit was provided. Thus, there was a lot of leverage in getting the Bank of America rather than Sierra to lend the \$1 million, with Sierra's assurances. Besides, Wendell thought that having a significant line of credit from the Bank of America would give Centex a strong appearance of credibility which might be helpful to the company in other business dealings.

Wendell had been in the office no more than ten minutes when the phone rang and his secretary announced that it was Drazan calling from Centex's offices in San Francisco. Wendell knew what the call meant; something unexpected had come up and Drazan was going to need to stay at Centex longer than he had expected to that morning. Wendell spoke with Drazan and learned that revenue for the first ten days of July had been nearly 40% of July's projected revenue of \$310,000. See **Exhibit 4** for pro forma income statement and balance sheet projections for Centex. Drazan needed to spend a few more minutes with Victor Majewski, the chief financial officer of Centex, and then he would leave for Menlo Park. Majewski had worked at Centex for less than one month and was in the process of gaining familiarity with some of the systems which Drazan had set up. Drazan had served

as interim chief financial officer of Centex after Sierra's investment and before Majewski had been recruited.

Wendell was pleased with the news from Drazan, and with the possibility of hiring Howley as chief executive officer. However, he was concerned with the amount of time which he and Drazan had devoted and were continuing to devote to Centex. If each \$1.0 million that Sierra invested required as much management time as this particular one did, Wendell would either have to hire a very large and expensive professional staff, or take far longer to invest the funds Sierra's various organizations had raised. As Wendell was also involved at the time as an active director of six other public and private companies in the Sierra portfolio, each of which had their own challenges and rewards, the thought of devoting so much time to Centex made him pause.

Sierra Ventures and Jeff Drazan

Sierra Ventures was organized as a California limited partnership in July 1982, and Sierra Ventures Management Company was established to manage Sierra's day-to-day investing activity. While Sierra Limited Partnership's initial assets and capitalization were only \$16 million, the limited partnership had already done well and the general partners began actively raising and managing other related pools of money and technology investments. A list of representative technology-related investments in Sierra's portfolio as of mid-year 1985 is provided in **Exhibit 5**.

Wendell, who had spent ten years at IBM before founding Sierra, felt reasonably comfortable working with these portfolio companies, but was continually trying to strengthen Sierra's technical and managerial depth. Two of his initial partners, who worked in Sierra's New York City office, had strong backgrounds for venture capital investing in terms of financial experience, but they lacked operating experience and technological expertise.

Wendell had known both partners since their undergraduate days at Princeton University. One had gone on to become a Baker Scholar at the Harvard Business School and a vice president of mergers and acquisitions at Morgan Stanley. Another had been named a Rhodes Scholar while at Princeton, subsequently completed the JD/MBA degree program at Harvard, and worked with a very wealthy and successful investor in the energy industry. To this group, Wendell was able to recruit a technology-oriented general partner, Vincent Tobkin. Tobkin had earned both a bachelor and master's degree studying computer science and semiconductors at MIT, earning both degrees in less than four years, and compiling a near-perfect academic average. He subsequently earned a JD/MBA at Harvard, ran a start-up company of his own, worked for several prestigious electronics firms, and was elected a partner at McKinsey & Company.

Shortly after Sierra's inception, the stock market's appetite for initial public offerings began to grow dramatically. During late 1982 and through 1983, five of the companies in which Sierra and its related organizations were lead investors, completed initial public offerings. One of these companies, fortunately the one in which Sierra had the largest investment, did phenomenally well and the stock had thus far risen 500% from its offering price.

Wendell had long been active in fund raising for Princeton University, which he had attended on full financial need scholarship as an undergraduate. As Wendell witnessed some of Sierra's early success, it occurred to him that the "carried interest" of the general partners in the funds' outcome might ultimately be of considerable value. Wendell gained the concurrence of his two Princeton partners to donate to Princeton ten percent of the after-tax worth of their carried interest. William G. Bowen, Princeton's president whom Wendell and his partners knew well, greeted this gesture with great enthusiasm. Princeton was in the midst of a capital fund-raising campaign and Bowen viewed this gift as an opportunity to demonstrate to the older, well-heeled alumni that even younger alumni were willing to aggressively support Princeton. The gift received front-page

coverage, in the campaign newsletter, including a photo of the three Sierra general partners who had attended Princeton with President Bowen. (See **Exhibit 6** for the announcement of Sierra's gift.)

Coincidentally, Jeff Drazan had also attended Princeton University. He had graduated in 1980 with a degree in engineering and had gone to work for AT&T/Bell Labs immediately after graduation. He worked in New Jersey but lived in Manhattan and was able to take courses at N.Y.U. for an advanced business degree. He had an interest in shifting his career to venture capital. Knowing this, his father contacted him after receiving the campaign newsletter and suggested that he get in touch with Sierra Ventures. Drazan sent a letter and a copy of his resume to Wendell in Menlo Park.

Wendell was extremely interested when he received Drazan's resume because he believed that there were a large number of attractive investment opportunities in the telecommunications area following the break-up of the Bell System. Drazan's engineering education and his Bell Labs experience made him a very appealing candidate. He was also very familiar with the UNIX programming language, which Wendell believed would be increasingly important in coming years. Drazan had held several line management jobs with hire/fire experience and also had been involved with various applications of technology, not just basic technology itself. On his next trip to New York, Wendell contacted Drazan and set up an interview. What started as a breakfast meeting ended with Drazan's acceptance of Wendell's offer of an associate position later that evening. As Drazan was very close to completing the requirements for his M.B.A. degree, it was determined that he would work on a part-time basis for the first few months. Drazan worked three days each week at the Menlo Park office and then flew to New York for his courses. Sierra agreed to pay for his tuition and plane flights. While in New York, Drazan also had a chance to familiarize himself with the Sierra partners and staff located there. This situation lasted from early 1984 until June, at which point Drazan moved to San Francisco and began working full time.

In February 1984, Wendell had Drazan review a business plan which involved a telecommunications concept somewhat similar to Centex's. An entrepreneur proposed starting a business around shared tenant services. The plan was very capital intensive in that it required the purchase of expensive telecommunications switches to put in the basements of large office buildings. In addition to the problem of capital intensity, there was a high degree of risk from obsolescence. Drazan was not excited by the prospects for this particular venture, but he did ask the entrepreneur if he had considered trying to work with the local BOC (Bell Operating Company) to lease equipment right at the phone company's central office to provide the same service. Drazan was familiar with lease rates from his AT&T tariff schooling and thought this approach might have several advantages. The entrepreneur was not interested in pursuing that approach. Drazan worked with the idea for a few days before shifting to the review of other business plans. The cover memo from Drazan's review of this proposal is presented in **Exhibit 7**.

Drazan's next contact with a telecommunications concept of this kind occurred in December 1984. Drazan was attending a Venture Capital Conference luncheon in San Francisco. He happened to overhear a conversation between Fred Glynn, a telecommunications consultant and one of the three original founders of Centex, and another conference participant. Drazan introduced himself to Glynn and they discussed the idea of helping smaller businesses construct shared private networks using phone company-provided, rather than independently purchased, facilities. Glynn and his three partners had begun looking for venture capital funding in October 1983. Indeed, Sierra Ventures had been one of the over-100 firms which had received a copy of the Centex business plan. However, it had apparently been sent to Sierra's New York office before Drazan joined the firm and the plan never got reviewed. By the end of 1984 the Centex management group had despaired of receiving funding from a professional venture capital firm. Many firms had questioned the quality of Centex's management team and few appeared to appreciate the potential benefits of Centex's approach.

The environment for venture capital funds was far more difficult in 1984 than it had been in 1983. Valuations of private, start-up companies had dropped from their high 1983 levels and there

were fewer initial public offerings. Forecasts for 1985 were for more of the same difficult environment.

As a result of his prior experience, Drazan was able to grasp the subtleties of the underlying concept on which Centex was hoping to capitalize. Drazan therefore agreed to work with Glynn and actively evaluate Centex for potential funding by Sierra. After his first visit to the company, it was clear to Drazan that the company and its management would require a lot of work simply to make it presentable to Wendell and Tobkin. Drazan discussed Centex with Wendell in December and, although Wendell was initially skeptical, he told Drazan to spend whatever time he needed to pursue the opportunity.

Centex Telemanagement, Inc.

Centex Telemanagement, Inc., was not exactly a high-technology company; there was no elusive, mystical technology to which the founders had exclusive access. It was a telecommunications management services company. In effect, Centex helped smaller businesses reconstruct the telecommunications system which had been in place before the break-up of AT&T. This was accomplished by leasing a switch from the local telephone company and long haul facilities from the various carriers on behalf of Centex's customers. These customers were members of a "Joint User Group." Small- and medium-sized businesses derived the greatest benefit from subscribing to the Centex service. Typically, these companies were unable to take advantage of the reduced costs that high-volume telecommunications users enjoyed. Centex brought together its members to take advantage of these reduced costs. Centex also provided other services that individual customers would have trouble justifying or even obtaining on their own. Wendell had recently read in the business press an article which discussed a shift in telecommunications trends where large companies were buying cost-effective bulk facilities from the phone company and thereby reducing their costs considerably. Centex's idea of helping groups of small companies have a similar opportunity seemed to make good sense.

The efforts of the founders of Centex had been directed towards implementing the service concept of their business plan by getting the first switch operational and a user base built. They believed that once the concept was tested, it would be relatively simple to add additional switches and achieve rapid growth. They projected a company with \$30 million in annual revenues within three years of leasing the first switch.

However, raising money to finance the initial stages of the business proved to be troublesome for Centex's founders. They were very involved with daily operations, which was critical in order to guarantee a high level of service to the present customers. Coupled with the problem of raising funds for future growth was the short-term problem of insufficient cash flow.

Jim Gallaway had joined Centex in December 1983 with primary responsibility for raising capital. He also provided the necessary telecommunications technical expertise. A chronological description of Centex's fund-raising efforts is provided in **Exhibit 8**. Gallaway had been successful to the extent that Centex survived an initial period without any revenue and was able to cover the upfront expenses associated with the installation of Centex's first switch.

The Santa Clara Switch

The Santa Clara switch, Centex's first, had been ordered in December 1983 and was placed in service in April 1984. Centex's arrangement with the local telephone company called for prepayment of a \$12,000 installation fee per switch. A deposit of two times the expected monthly usage was also required. This deposit was due thirty days before the switch went into service. The deposit in the

Santa Clara case amounted to \$10,000. Centex paid the installation fee and Jon Wilcox, a Centex co-founder, personally guaranteed a letter of credit for the amount of the deposit.

In early 1984 Gallaway had encouraged a friend and former business associate from Los Angeles to visit the company and consider making an investment. The friend had not taken any action after his first visit. However, he returned in December and was so impressed with the progress which the company had made that he invested \$50,000 and brought in friends for an additional \$224,000. This group purchased shares of common stock at \$2.25 per share.

When this money came in, Centex decided to order two more Centrex switches, one in San Francisco and the second in Los Angeles. Centex hoped to make the San Francisco switch available to customers by July 1985 and to provide service with the Los Angeles switch by December 1985.

Jeff Drazan and Centex Telemanagement, Inc.

One of the first things which Drazan did in his attempt to get a better understanding of Centex was to order the installation of a line for Sierra's office. Centex's switch in Santa Clara was able to serve Menlo Park. The cost of installation was a one-time charge of \$70 per line. The company's marketing position at that time was that the user could expect phone costs at least 25% less than direct distance dialing rates. The quality of the connection was promised to be equivalent to AT&T and the regional phone companies. Centex passed through the actual costs it incurred in obtaining services for the joint users and added a management fee.

Centex's lack of a chief financial officer and also a significant lack of forward planning by the management group were problems which Drazan immediately spotted. The financial accounting and reporting systems which Centex used were wholly inadequate for the size of firm which the founders, and by this time Drazan, expected Centex might be. Drazan developed a Lotus 1-2-3 model for the income statement and the balance sheet of the business. He contacted customers and regulators in order to learn more about the business. With Drazan's help, Centex developed a marketing brochure to increase exposure and make the user representative's job easier. Drazan also recruited four second-year Stanford business school students who were seeking a project for their "Forming New Ventures" course. The students spent the spring semester rewriting the original Centex business plan. Throughout these various projects, the Centex founders and management had come to appreciate the depth of Drazan's knowledge, his resourcefulness, and his personal energy level. But there had also been friction. For one thing, Stevens and Drazan were more than 30 years apart in age. Drazan was bright and his mind moved quickly. As discussions and negotiations continued for weeks, and then months, Drazan occasionally grew impatient with Centex's progress.

Centex's relationship with the local phone company and the phone company's plans for telecommunications switches were critical for the future viability of Centex. One of the goals which the Centex management group had set, and which Drazan was actively trying to help them achieve, was to insure that the local telephone company understood that Centex was a manager of telecommunications services. It was important that Centex not be confused with a reseller or a carrier, like an MCI or a Sprint. Drazan met with phone company officials on numerous occasions to discuss the issue. The local telephone company finally agreed that it would handle its relationship with Centex through its major accounts organization, just like any other large customer.

The single Santa Clara switch had produced \$60,000 in revenue in January 1985. Revenue for March was \$100,000 and Stevens was convinced that this figure would grow by 35% each month for at least the next six months. The help from Sierra Ventures, primarily in the form of Jeff Drazan's daily presence in Centex's offices, was appreciated by Centex's management but it was not sufficient to pay the company's bills. The four founders had come to trust that Drazan, Wendell, and Sierra were serious about investing but they had not as yet seen any cash. They had done their own due diligence on Sierra Ventures and realized that they were dealing with a top-notch fund. Sierra had a

particularly strong record of dealing with early stage service businesses and had achieved some dramatic results with these types of businesses. Sierra's contribution would go beyond merely short-term financing and would be important for Centex's long-term viability. However, the founder's previous experience with the professional venture capital community, and the difficult conditions prevailing in the venture capital industry, caused them also to consider other financing options. Centex's success at raising money from a group of private investors near the end of 1984 made the founders believe that it could be done again if need be.

Sierra Ventures and Centex Telemanagement, Inc.

Jeff Drazan provided Wendell with reports of Centex's progress on a frequent basis. From these discussions they came to a better understanding of the nature of the business and of the company's future potential. In late January, Wendell, Tobkin, and Drazan had met for several hours one Sunday afternoon to outline remaining questions and concerns they had about Centex. Over the next few weeks, research on these questions continued to produce positive answers. Faced with the prospect of Centex raising money from other sources, Wendell, Tobkin, and Drazan decided to offer the company a deal in February 1985. They did not want to create a situation where Drazan's contribution of time and effort to Centex's growth was diluted or even went unrewarded. Centex's revenues were beginning to grow sharply, and Wendell felt Sierra should act.

The first offer contained a number of "subject-to's," the primary one being that another venture capital fund had to commit to take at least a quarter of the deal. Sierra Ventures offered a \$2.0 million deal for 54% of Centex's equity. Of the \$2.0 million, \$1.0 million was to take the form of equity and the other \$1.0 million was either going to be a guarantee for that amount of debt or, in fact, the debt itself.

Wendell and Drazan believed that Centex would eventually require \$6.0 million in private financing over its first several years. Wendell hoped to involve another venture capital firm for the sake of lessening Sierra's financial exposure both in the early stages and as Centex's growth required further equity infusions. There were also several other considerations. One was to broaden the range of managerial talent upon which Centex could draw, on the operations level and also for positions on the board of directors. Wendell believed that the deal could potentially be very rewarding for the early venture capital investors. Sierra would also gain additional experience and exposure for itself by bringing in a partner. Finally, the equity stake available was sufficiently high that even if Sierra split it with another fund, they would still own a very significant piece of the company.

While Drazan concentrated on the due diligence process and strengthening Centex's internal structure, both he and Wendell contacted other venture capital firms. Drazan also contacted several of Sierra's other portfolio companies in the Santa Clara area as possible customers for the Centex service. By conducting his own research and from discussions with several consulting firms, Drazan attempted to determine the likely market size for the first telecommunications switch and also for subsequent switches. By the end of March 1985, Drazan had made considerable progress and believed that the company's prospects were very good.

Wendell and Tobkin also shared the view that Centex Telemanagement had the potential to be considerably greater than \$30 million in annual sales. In fact, it appeared that the first three California switches alone might generate this level of revenue. There appeared to be opportunity for additional California switches plus, of course, the other 49 states. Other venture capital funds, however, were not particularly excited about Centex. First, different from Sierra, few other funds had substantial experience, or had made substantial money, with service businesses. Second, few funds had much enthusiasm, or much expertise, to share the work that would be required to get Centex launched. Third, as the venture capital environment had continually deteriorated over the prior eighteen months, many funds already had a substantial number of "work-out" situations present in their portfolios. The prospect of a further drain on the time of the general partners in the form of

managing a portfolio company was not attractive. Wendell soon concluded that Sierra should use its time and efforts strengthening Centex, not helping Centex explain itself to other skeptical venture capitalists. By strengthening Centex, the company would ultimately become sufficiently attractive that it would have little difficulty attracting other investors. Besides, Sierra's most successful investment to date had been a situation in which Sierra provided the only outside capital—\$3 million in a single deal—a service business that others had questioned. This other investment looked like it might net Sierra \$15 million or more.

As Wendell and Drazan had gotten more involved with Centex since Sierra's first offer in February, they had become convinced that the company should have a valuation in the range of \$.45 per share. In general, the venture capital community in 1985 was attaching lower valuations to emerging growth companies than it had in 1983. Also, while the Sierra partners had developed enthusiasm for Centex's service offering, the value of the company lay mostly in the future implementation of the service, not so much in what had been done to date. Centex would not have real value until it had developed sufficient economies of scale and internal control systems to be a clear industry leader with superior economics to would-be competitors. Since it was also clear that later rounds of financing would be necessary before a public offering could occur, the pricing of this round needed to be low enough to allow for perhaps several rounds of increasingly higher prices. The task of convincing the four founders and representatives of the private investors that the \$2.25 per share valuation was too high was very difficult.

In April, Sierra and Centex worked out a new arrangement whereby the deal was no longer contingent on a second venture capital fund. From Centex's standpoint, they could not afford to wait indefinitely for Sierra's promised investment to materialize. On Sierra's part, Drazan was continuing to provide valuable assistance to Centex without any form of compensation for these efforts for Sierra. The Centex founders were also again giving serious consideration to a private "Reg A" financing. Wendell decided to draw on Sierra's financial resources to solve Centex's short-term cash needs and effectively lock in a valuation of the company which reflected the current situation. Sierra offered to make a loan to Centex of \$350,000 at the prime interest rate and lock-up terms for the full \$2 million investment. See **Exhibit 9** for details of this loan.

As a first step towards this full \$2 million investment, Drazan and Wendell needed to straighten out a legal problem with the various classes of stock before the debt could be converted into equity. Centex's first law firm had not made any distinction between the stock owned by the four founders and that purchased by later investors. The lawyers had also failed to provide the investors with the right of first refusal or "downward ratchets"² for later stock issues. Drazan and Wendell suggested Centex secure a new law firm. The stock held by the founders constituted the class of common stock. The lawyers then created various series of convertible preferred stock, to be called Series A, B, etc.

The problems with the classification of the stock actually provided Wendell with a means to partially appease the private investors. When they had purchased their shares at \$2.25, they had received a warrant for an additional share at the same price. Stevens, on behalf of the founders, proposed to Wendell that the shares owned by the private investors be converted share-for-share into Series A preferred, with no change in the implicit price (\$2.25). But as a concession, Sierra would have to allow them to exercise their warrants at the same price per share as Sierra agreed to pay for its equity stake in Centex, which looked like it would be about \$.45 per share. Since the number of warrants outstanding was less than a tenth the number of shares Sierra would be buying, Sierra agreed to this concession.

² A downward ratchet is a provision often found in venture capital stock purchase agreements which allows an investor to receive additional shares in the company if a later round of financing is secured at a lower price.

The approximate price of \$.45 per share was discussed with Centex management throughout April. As noted above, the private investors would be able to exercise their warrants for Series B preferred, which Wendell proposed to price at the \$.45 figure. The group of private investors, comprised of twenty individuals, would pay \$100,000 (222,222 warrants @ \$.45 each) for 222,222 shares of Series B convertible preferred. As it turned out, the entire group exercised this option.

As the end of April neared, it appeared that Stevens and the other three founders of Centex Telemanagement were beginning to realize that Sierra's range of possible valuations was, in fact, realistic in light of the current venture capital environment.

Sierra and Centex appeared to be close enough to agreement for Wendell to schedule a closing with the lawyers for May 1, 1985. On the day before the closing Drazan thought that it would be a good idea for his secretary to meet Centex management in person after nearly four months of speaking with them on the telephone. When Drazan arrived at the San Francisco office, John Stevens said that he would like to speak with him privately. When they were alone in Stevens' office, Stevens announced that the deal was off. Stevens said that he and the other founders felt that \$.45 per share substantially undervalued the company. Although they were impressed with all that Sierra had done, they believed that private investors would pay several times the \$.45 price. Drazan was shocked.

On several occasions Drazan and Wendell had done a "make-or-buy" analysis in order to arrive at an appropriate valuation for Centex. Drazan was convinced that for approximately the same amount of money at which the Sierra deal valued Centex, Sierra could find another management team who might be starting a similar company. Drazan gathered his papers, making sure to get the box of diskettes which contained nearly all of Drazan's computer programs, and left with his secretary. He was not exactly sure what he should do next.

Stevens was equally shocked by Drazan's rather sudden reaction. He had known that Drazan had conducted an in-depth analysis of their business and also that Drazan had been more than partially responsible for the direction their business was taking. He had also been aware all along that, in Centex's fragile infancy, the barriers to entry were not as high as they would be after Centex had economies of scale.

Both Stevens and Drazan put in calls to Wendell, who was in Washington, D.C. at the time attending the annual meeting of the National Venture Capital Association. After listening to both Drazan and Stevens in separate conversations, Wendell felt the original deal could be salvaged with minor modifications. He quickly conferred with his partner, Vince Tobkin, who suggested that only if the company performed exceptionally well should a sweetener be added. Specifically, he and Wendell proposed that if the company actually did as well as the founders felt it might, then Sierra would retroactively raise the price it paid for Centex stock by 50%, from \$.45 per share to \$.67. A number of conditions, with regard to revenue, operating margins, and cash utilization, over the ensuing five-month period were established. If, in fact, these conditions were met, then Sierra would have to add \$500,000 in cash and the same amount to the loan guarantee in order to maintain control of 54% of Centex's equity. The \$.45 Series B preferred owned by Sierra Ventures would be recapitalized as \$.67 Series C preferred. Thus, all of Sierra's cumulative \$1.5 million cash investment would be priced at \$.67 per share. Additionally, Sierra agreed to make the initial \$350,000 investment an equity investment rather than a loan.

Drazan, Stevens, the other founders, and Wendell's partners all agreed to the deal. A summary of the new terms is provided in **Exhibit 10**. A more detailed terms sheet for the proposed series of transactions is provided in **Exhibit 11**.

The closing marked the beginning of a new phase for Centex's management and Drazan and Wendell. The priorities shifted from securing financing to finding key managers. The first order of business was to hire a chief financial officer so that Drazan could devote more time to the pursuit of

other investment opportunities for Sierra. The search for a chief executive officer began simultaneously.

Shortly after the closing, Drazan was contacted by a consultant in San Francisco with whom he had worked in trying to determine Centex's market size. The consultant had recently attended a conference and had met an attorney from Washington, D.C. who was a telecommunications specialist. The consultant wondered whether the lawyer might be an excellent candidate for Centex's board of directors. Jeffrey Blumenfeld had been lead trial attorney for the U. S. Justice Department in the *United States vs. A.T.& T.* case. He had only recently left the Justice Department to start a private practice in association with another trial attorney from the same case. Drazan telephoned Blumenfeld and after a one-hour conversation decided to visit Blumenfeld in Washington for a more in-depth discussion. The following evening Drazan and Blumenfeld had dinner in Washington. Blumenfeld expressed serious interest in becoming involved with Centex. Drazan suggested that he meet Peter Wendell. Wendell held several meetings with Blumenfeld and Blumenfeld ultimately joined the board of Centex.

Drazan and the Centex founders led the search for a chief financial officer. Together they reviewed over two hundred resumes and identified a very strong candidate who had previously been employed as corporate controller of GTE Sprint. Victor Majewski was persuaded in the middle of June to assume Drazen's position at Centex. Majewski's arrival at Centex allowed Drazan to devote himself to other operating issues. Wendell worked with Majewski on preparations for Centex's presentation to the Bank of America.

It seemed to Wendell as the July 4 holiday approached that the situation at Centex was fast coming under control. Revenue for June had been \$260,000. Efforts were being made by Centex's management to make the position of chief executive officer attractive to the various candidates in order to reach the point where Sierra added the additional \$650,000 in equity and \$1 million debt facility. The founders were doing everything within their power to satisfy the three conditions which would cause the price of Sierra's stock to rise from \$.45 to \$.67. This was fine with Drazan and Wendell because they knew that the value of Centex would be at least proportionately greater if these conditions were met.

The last two weeks in July promised to be busy ones for Drazan and Wendell. Not only would Drazan and Wendell have to fly back to Arizona to try to close Peter Howley, but there was also a great deal of work to do in preparation for the presentation to the Bank of America. Wendell and Victor Majewski would make the actual presentation. However, as Drazan had served as chief financial officer of Centex, there was a great deal of information which he would need to help Majewski gather. Wendell also needed to make preparations for the transfer of \$650,000 from Sierra to Centex upon the hiring of a chief executive officer. The Centex founders recognized the substantial personal efforts of the Sierra partners and agreed that if the Sierra financing was ultimately culminated, Drazan would receive 60,000 shares of Centex common stock at \$.05/share and Wendell and Tobkin would each receive 40,000 shares.

Wendell had been extremely impressed with Peter Howley when he had reviewed his background and references and interviewed him in early July. Wendell wanted to discuss with Drazan the possible salary structure for the position. Certainly an executive of Howley's caliber would require stock options to consider moving to a \$3.0 million company after running a \$40.0 million company. Wendell had thought that options on about 350,000-400,000 shares at pennies a share would be required.

Wendell's concerns were related to how much more time he and Drazan would need to spend with Centex. The combination of the search for a chief executive officer and the securing of a line of credit led Wendell to believe that another four to six weeks' worth of full-time work at Centex lay ahead for Drazan. Centex Telemanagement, Inc., potentially had all the ingredients necessary for

great success. If the company turned profitable and came reasonably close to its revenue projections, Wendell felt Centex would be a viable IPO candidate within 18 months. Once fully capitalized with the proceeds of a public offering, Wendell felt the company had at least a shot of earning a market value in excess of \$100 million within five years. And Sierra was buying half the company today for about \$1 million. On the other hand, Wendell also knew that early stage companies, like Centex, inevitably developed unforeseen problems. And the investment of time by Sierra had been enormous, particularly in the context of having to invest and manage all the other high-technology investments. Wendell wondered what policy changes might be required at Sierra to enable the fund to succeed in its own right and to continue to provide an attractive career path for people like Jeff Drazan.

Exhibit 1 Resume of Jeffrey Drazan

EDUCATION	Princeton University, B.S.E. 1980 Majors Management Systems Engineering New York University, M.B.A. (expected August 1984) Major: Finance
WORK EXPERIENCE	AT&T Information Systems, Enhanced Network Services
June 1983–present	Marketing Manager—Identify marketing opportunities Net 1000 and other enhanced network products in the divested Bell Operating Companies. Direct the activities of project groups assigned to develop and implement Net 1000 services. Develop a corporate strategy for replicating new system implementations across relevant industry segments. Assist national account managers in the implementation of the Net 1000 sales strategy. Investigate and perform initial joint venture and third party contract negotiations.
Sept. 1982–May 1983	Information Systems Manager—Managed the systems engineering, hard-ware procurement, software development, training, implementation and maintenance of all UNIX, VMS and micro-based Net 1000 operations support systems. Interviewed and hired 15 entry level and senior systems programmers who delivered 5 major projects under my direction. They were: order entry, customer service, inventory, performance reporting and a graphics-based network control system.
March 1982–Aug. 1982	Staff Supervisor—Developed the near-term operations strategic plan. Defined the mission and staffed three second level management organizations. Selected vendors and supervised consultants whose services were required to design and install initial operations support systems. AT&T Long Lines—Manager Development Program
July 1981–Feb. 1982	Staff Supervisor—Managed the deployment of a five processor and 300 terminal MIS (customer assistance). Developed long-range force projections and maintenance methods. Provided NYC-based ETN project coordination. Contributed to a corporate strategy for migration to intercompany remote facility testing.
June 1980–June 1981	Operations Supervisor—Supervised the installation and testing of private line services by 10 union (CWA) employees. Increased productivity 50% by streamlining procedures and expanding training.
Sept. 1979–May 1980	Princeton University—Computer graphics lab instructor
TECHNICAL EXPERIENCE	Office Automation; Systems Analysis and Design; Minicomputers and Peripherals (DEC, CDC, IBM); Micro Computers (Wang, DEC, Fortune, Vector Graphics, Apple, IBM, ONYX); Distributed Processing and Telecommunications (Multiplexors, Modems, Cluster Controllers, Data Switches LANS); Software (C, APL, PL/1, FORTRAN, COBOL, FMS, DMBS); Operating Systems (UNIX, JES, MVS, VMS, CP/M, OS, DOS, P/OS)1 Protocols (2780/3780, 3270, ASYNCH, X.25 Packet Transport); Graphics-Based Monitoring and Control Systems; ANSI X12 (EDI-BDI); Voice Response Systems; Large Private Voice and Data Networks (ETN, BANCS, BISC0M).

Source: Sierra Ventures Management Company.

Exhibit 2 Background of Peter A. Howley

Peter A. Howley, 45, has spent the past eight years managing a \$40 million unit of Citizens Utilities Company. During Howley's tenure running Citizens' Arizona Telephone Division, revenue more than tripled from \$11 million to almost \$40 million and the unit was among the most profitable of Citizens' 14 operating divisions. Citizens, a \$250 million publicly traded company, has historically been one of the most profitable and financially sound companies in the country, increasing earnings every quarter for the past 40 years. Additionally, Citizens is one of the only 17 U.S. companies to simultaneously hold the highly coveted AAA bond ratings of both Standard and Poor's and Moody's rating services. Howley's division, which included regulated, deregulated, and nonregulated operations, had assets of over \$100 million and included over 300 management, technical, and clerical employees.

Earlier in his career, Howley spent 3-1/2 years at MCI during its founding years of operation. He was the MCI operations manager responsible for establishing and managing the initial two New York switching centers. Subsequently, Howley was made MCI's nationwide operations director. Previously at AT&T, Howley held a number of management positions in District Operations, data processing, and sales.

In connection with his responsibilities at Citizens, Howley also serves as president of the Rocky Mountain Telecommunications Association. He has authored a number of articles which have been published in prominent professional trade journals, as well as having spoken on industry topics to many groups on the local, regional, and national level. Howley holds a Bachelor of Science degree in Industrial Engineering from New York University and a Master's of Business Administration, specializing in Marketing, from the same institution.

Source: Press release, Sierra Ventures' files.

Exhibit 3 Background Information on the Four Founders

Centex Telemanagement was initially founded by Frederic Glynn, Jonathan Wilcox, and John Stevens in the spring of 1983 to acquire and manage regulated telephone services on behalf of members of Joint User Groups. Several months later Glynn, Wilcox and Stevens were joined by James Gallaway.

- Frederic Glynn was a telecommunications consultant in San Francisco. He had previously been employed by Fairchild Semiconductor. His initial interest in the underlying concept of Centex derived from his participation in a focus group conducted by the local telephone company. That group had been set up to examine ways in which the phone company might reposition in the market several of the services which were available to businesses.
- Jonathan Wilcox was a personal friend of Fred Glynn's and an attorney with a private practice. He and Glynn developed the original concept for Centex and made the earliest financial and economic projections.
- John Stevens was the senior member of the group of Centex founders. He had had a career as a professional manager. He had been one of the founders and an operating manager of Insurnet, a joint venture of Continental Insurance and Quotron.
- Jim Gallaway joined Centex Telemanagement in December of 1983. He was familiar with the technical aspect of the service which Centex was planning to offer. He had previously founded and run a telephone interconnect company.

Exhibit 4 Pro Forma Income Statement/Balance Sheet Projections**Pro Forma Income Statement Projections**

	June 1985	July	August	September	October	November	December
Total Revenue	\$271,800	\$310,500	\$372,800	\$474,400	\$623,500	\$793,300	\$959,600
–Cost of Service	<u>197,500</u>	<u>216,600</u>	<u>264,000</u>	<u>335,700</u>	<u>441,600</u>	<u>559,200</u>	<u>674,100</u>
Management Fee	74,300	93,900	108,800	138,700	181,900	234,100	285,500
–Operating Expenses	<u>191,600</u>	<u>228,800</u>	<u>323,800</u>	<u>325,800</u>	<u>384,000</u>	<u>460,200</u>	<u>433,300</u>
Earnings before Interest and Taxes	(117,300)	(134,900)	(215,000)	(187,100)	(202,100)	(226,100)	(147,800)

Pro Forma Balance Sheet Projections

Current Assets	\$517,800	\$636,700	\$1,311,600	\$1,338,100	\$1,302,400	\$1,364,200	\$1,494,900
Total Assets	766,700	920,100	1,617,000	1,660,700	1,683,300	1,767,800	1,924,300
Current Liabilities	516,700	799,300	983,600	1,146,800	1,355,300	1,666,900	1,971,400
Total Liabilities	691,200	949,300	1,133,600	1,296,800	1,505,300	1,816,900	2,121,400
Total Capital	75,500	(29,200)	483,400	363,900	178,000	(49,100)	(197,100)

Exhibit 5 Representative Investments of Sierra Ventures**Computer-Aided Design, Manufacturing and Engineering (CAD/CAM and CAE)**

- Analog Design Tools, Inc. (Menlo Park, Ca.)—CAE systems for analog designers
- CGX Corp. (Acton, Mass.)—CAD/CAM workstations
- Metagraphics, Inc. (Woburn, Mass.)—Input systems for building CAD/CAM databases
- Tasvir, Corp. (Mt. View, Ca.)—Mechanical CAD software for UNIX systems and the IBM AT

Computer-Based Service Businesses

- Environmental Testing and Certification Corp. (Edison, N.J.)—Toxic substance testing management
- The First Seminar Service, Inc. (Lowell, Mass.)—Centralized enrollments in executive seminars
- Unicon International, Inc. (Berkeley, Ca.)—Computer-based inspection system for the container shipping industry.

Computing and Information Technologies

- Saxby Computer Corp. (Sunnyvale, Ca.)—Very high-speed computing systems
- Sky Computers, Inc. (Lowell, Mass.)—Array processors
- Teradata Corp. (Los Angeles, Ca.)—High-performance relational database computing systems
- Tricom Systems Corp. (Hayward, Ca.)—Turnkey systems for auto repair and maintenance dealers

Medical Technologies

- Corporate Health Examiners (New York, N.Y.)—Comprehensive medical testing.
- Laserscope Corp. (Santa Clara, Ca.)—Surgical laser systems

Exhibit 5 (continued)**Office Automation**

- Datacopy Corp. (Mt. View, Ca.)—Electronic imaging systems
- Perfectdata Corp. (Chatsworth, Ca.)—Personal computer maintenance products
- Sidereal Corp. (Portland, Or.)—Communications terminal
- Speech Plus, Inc. (Mt. View, Ca.)—Voice synthesis systems

Semiconductors and Components

- Acrian, Inc. (Cupertino, Ca.)—Microwave semiconductor and modular devices
- American Fiber Optics Corp. (Signal Hill, Ca.)—Fully integrated optical fiber development and manufacturing
- Gigabit Logic, Inc. (Culver City, Ca.)—Gallium arsenide semiconductors
- Saratoga Semiconductor (Cupertino, Ca.)—Specialized low-power, high-speed semiconductor devices
- Sera Solar Corp. (Santa Clara, Ca.)—Photovoltaic devices

Telecommunications

- Centex Telemanagement, Inc. (San Francisco, Ca.)—Management of private network telecommunications services

Source: Sierra Ventures Management Company.

Note: Sierra Ventures Management Company manages the technology investment activity of the Sierra Ventures Limited Partnership, Wood River Capital Corp., The Prospect Group, Inc., and Danville Resources, Inc., all of which are related organizations.

Exhibit 6 Announcement of Sierra Gift to Princeton University

3 young alumni pledge 10 percent of their future after-tax earnings from venture capital enterprise

"The Princeton experience was important to me personally and I feel I should respond in kind. That's motivated my involvement—sheer personal gratitude as well as overwhelming respect for what Princeton has done." —Peter C. Wendell '72.

"We all believe Princeton is a world class institution, and the people—faculty, students, and staff—are world class. We're in the business world and we know what it takes to build something and maintain it and have it grow and have impact, and we're very aware of what the Campaign means." —Gilbert H. Lamphere '74.

"Princeton stands for nothing but the best. It struck me when I landed on the campus for the first time from Colorado Springs. It was the first institution I had ever known which seeks to achieve nothing less than excellence. Princeton possesses an enormous diversity and a wealth of human talent. I'm forever changed because I was a part of the place." —Thomas A. Barron '74

Wendell, Lamphere, and Barron do more than talk about Princeton. They have pledged to Princeton 10 percent of their share of the after-tax capital gain from Sierra Ventures, a venture capital firm in which they are general partners.

These young alumni have made an extremely generous and very imaginative gift to Princeton," said President Bowen in announcing the gift. "Their allegiance and active support are impressive. We all hope that Sierra Ventures does extremely well."

Sierra Ventures is a technology-oriented venture capital fund. "Our initial capitalization is a little over \$16 million," says Wendell.

"Our current portfolio consists of a variety of emerging technology-oriented companies in the fields of computer-aided design, fiber optics, relational data base processors, environmental testing, office automation, and health care.

The amount of the partners' gift to Princeton will be determined by how well Sierra Ventures does. "The return rates of venture capital funds vary widely. Professionally managed funds often return at least 20 percent compound annual growth, but there is obviously a possibility that the fund could return virtually nothing," said Wendell.

Since the start of the fund, several of Sierra's companies have already gone public, so the paper value of the portfolio has shown an annual compound rate of growth well in excess of 100 percent.

"The trick now," said Wendell, "is to continue to work closely with those companies in our portfolio that are still private and to convert the 'paper' gains on the public companies to cash. If we can convert our current \$35 million position to cash and readily marketable securities by the end of our partnership, our gift to Princeton will be about \$250,000."

Wendell lives in San Francisco and works out of California's Silicon Valley. Lamphere and Barron live in New York. All three attended Harvard Business School as well as Princeton.

Wendell and Barron met in Dod Hall, while each was campaigning for the presidency of his class—Wendell for the senior class and Barron for the sophomore class. "I overheard someone giving my campaign speech," said Wendell. "He was calling for establishment of an undergraduate course information book."

Both of them were promoting the idea that the University should publish a comprehensive course information book containing reading lists, student evaluations, and professors' comments.

"The two of us sat down on the steps of Dod Hall and figured out how to put out a course guide—how to get the book lists, the interviews," said Barron.

We both won our elections but we lost our battle with the Registrar to get him to publish the book," said Wendell. "So Tom and I formed a profit-oriented student agency and published the book ourselves."

"We pulled the thing together by the skin of our teeth in a very short time, about eight weeks," Barron said. "We hired thirty students to do the interviewing on a contingency basis. We paid typists on an incentive basis—the more they produced the more they got paid. Our rooms were crawling with people and papers."

The book was a quick success. "The Registrar's office even bought twenty-five copies for its own use," Barron said. The pair blew the profits from the course guide on one dinner at Mama Leone's.

Barron majored in politics at Princeton and won the Pyne Prize and membership in Phi Beta Kappa. He was a Rhodes Scholar at Oxford before he went to Harvard where he earned both a law degree and a business degree.

Wendell graduated cum laude in politics and sociology. He was president of the sophomore and senior classes and chairman of the Honor Committee. He helped instigate reforms in the bicker process. One of his work-study jobs was serving as administrative assistant to Neil Rudenstine '56, who was then dean of students. He attended Harvard on leave from IBM, where he worked before and after he went to business school.

Lamphere graduated cum laude in economics and was governor of Ivy Club and chairman of *Business Today*. He worked as a vice president in the mergers and acquisitions department at Morgan Stanley & Company after business school, where he had met Wendell for the first time.

All three work as part of a group headed by Louis Marx Jr. '53, who is engaged in a variety of financial ventures. They plan to launch a new fund within the next few months. Lamphere and Barron are involved in natural resource investing and leveraged buyouts as well as technology investing. Wendell serves as president of Sierra Ventures and devotes most of his time to technology-oriented undertakings.

Exhibit 7 Review of Proposed Telecommunications Business

MEMORANDUM

DATE: February 17, 1984

To: Peter C. Wendell

From: Jeffrey M. Drazan

Subject: Integrated Systems Group

I have just reviewed the business plan for Integrated Systems Group. With the recent divestiture of the Bell Operating Companies (BOCs) and the increasingly competitive nature of the long-distance market, rates and tariffs within the industry are in a constant state of flux. Making the large capital investment which I.S.G. requires, in the face of this continuing uncertainty, seems dangerous.

This was a great idea several years ago, and is exactly how MCI was started. But as you know, MCI is now using its own long-distance facilities.

What I expect we will see at some point in the not-too-distant future, is a BOC offering of the same character as I.S.G.'s proposal. They will probably offer it as an extended centrex feature.

I would be happy to speak with the management at I.S.G. and allow them to present their position. There may be more to this plan than meets the eye. Please let me know how you would like to proceed.

(Jeff)

P.S. I will keep the business plan until I hear from you.

Source: Sierra Ventures.

Exhibit 8 Pre-Sierra Ventures Financing

1. John Stevens, Fred Glynn, and Jon Wilcox committed to invest \$50,000 each as start-up funds. Each contributed \$5,000 of this amount in July 1983;
2. By the end of October 1983, Stevens had invested an additional \$13,000, Wilcox \$12,000, and Glynn \$6,000;
3. Completed draft of business plan called for a private placement of \$499,999 under a SEC exemption. Offering was at \$2.25 per share with a three-year warrant for an additional share at the same price. In 1983, Centex found one investor with \$50,000 and a second with \$25,000;
4. Jim Gallaway joined firm in December 1983. He purchased 18,000 shares of common stock at \$.10 per share. He was made a director in March 1984. He paid \$5,000 for 400,000 shares from the pool owned by the three founders, thus making all four equal partners in the venture;
5. Between January and November 1984, the four founders provided capital to Centex in the following amounts;

Short-term loans:

John Stevens	\$23,000
Jon Wilcox	16,000
Jim Gallaway	15,000
Fred Glynn	3,000

Long-term loans:

Jim Gallaway	\$20,000
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6. The private placement offering continued to attract investors throughout 1984 at \$2.25 per share. A total of \$403,250 was raised from a variety of sources. Ten percent of this figure came from relatives of the founders, two users of the Centex service invested, and a Vietnamese family from Los Angeles invested \$10,000, which they brought to the closing in the form of cash in a shoebox.

Exhibit 9 Terms of the April Financing Package

PROPOSAL

DATE: April 11, 1985

1. On closing—Monday, April 22, Sierra provides \$350,000 to Centex (calculated to be four months of financing at \$87,000). This is debt at prime; interest deferred until repayment or conversion of principal.
2. Company redoubles efforts to attain key operating benchmarks:
 - Engage management recruiter and commence CEO search.
 - Hire permanent CFO.
 - Get accounting systems cleaned up so management and investors have a current and accurate view of the company's financial performance from which plans and evaluations can be made.
 - Implement automated and timely billing system.
 - Trim marginal sales people (already done?)
 - Continue rapid sales growth, but only to the extent current accounting, billing, and control systems allow.
 - Hire a full-time, Bay Area-based marketing/sales VP.
 - Develop an attractive, realistic, up-beat business plan which will attract additional investors and management to the company.
3. As soon as mutually acceptable CEO is on board (if sooner than 120 days), Sierra exercises full round of financing per term sheet: \$1M equity/\$1M loan guaranty—converting \$350,000.
4. If at the end of 120 days, no CEO is on board, and Sierra does not fund the remainder of the terms sheet deal, then Sierra must lend the company additional money to carry it for another two months—\$175,000 at prime. This second loan is repayable after two months, from the proceeds of "Reg A Offering." The original \$350,000 is repayable, with accrued interest, November 30, 1985. If the company thinks it can raise "Reg A money" now, it should be significantly easier to raise this money 120 days from now when the company is larger, more controls are in place, and the company is more stable.
5. Jeff Drazan to serve immediately as senior V.P. of Finance and Planning and to be made a director. Peter Wendell and Vince Tobkin have board observation rights. When permanent CFO is hired, Jeff's role centers on planning and outside venture financing. Jeff and John Stevens to mutually approve all significant purchases (\$10K or more?) and hire/fire decision.

Exhibit 10 Capitalization of Centex

Sierra Ventures Management Company proposed the following multi-step financing package with the company:

1. An initial \$350,000 equity contribution at \$0.45/share buying slightly over a 20% stake in the company.
2. An additional \$650,000 equity contribution at \$0.45/share and a receivable guarantee of \$1 million will be provided by Sierra upon the hiring of a chief executive officer. Venture Resources, an executive recruiting organization in Sunnyvale, California, will be commissioned to assist the company in achieving this milestone. Consummation of this step of the financing package will provide Sierra with approximately a 54% ownership position.
3. An additional \$500,000 equity contribution and a \$500,000 addition to the receivable guarantee will be provided if the company achieves certain performance objectives during the period from May 1 to November 1, 1985. Specifically, the objectives are to achieve cumulative revenues over the stated period of \$3.3 million, a net operating loss not exceeding \$980,000 and a maximum draw on the receivable guarantee of \$150,000. Should the company meet these objectives, the aforementioned equity and receivable guarantees will be provided plus all preferred shares purchased under the Sierra financing package will be recapitalized at \$0.67 which translated into a 54% ownership stake in the company.
4. One of the conditions of Sierra's funding was that Centex would repay the debt owed to the four founders at the end of three years if the company had been profitable for the prior two quarters. The debt would accrue interest at prime plus 1%, but no payments of principal or interest would be made for at least three years from the closing date of Sierra's financing.

Exhibit 11 Details of the Private Placement Memorandum

Security	777,778 shares of Series B Preferred Stock. Warrant to purchase 1,458,796 shares of Series B Preferred Stock to be automatically exercised upon commencement of the full-time services of a President and Chief Executive Officer acceptable to the Investors, and to expire August 31, 1985, (the "First Warrant") at \$0.45 per share. If First Warrant is exercised, additional warrant to purchase 134,144 shares of Series B Preferred Stock at \$0.45 per share, or Series C Preferred Stock at \$0.67 per share if Company meets Performance Goals (the "Second Warrant"). Outstanding Series B Preferred Stock to be exchanged for Series C Preferred at \$0.67 per share if company reaches Performance Goals.
Proceeds	\$350,000 cancellation of all principal and accrued interest indebtedness on Demand Note at Closing. \$656, 458.30 (less any accrued interest on the Demand Note) in cash upon exercise of the First Warrant and \$1,000,000 guarantee of accounts receivable financing.
Loan	If the First Warrant is not exercised, the Investors will loan \$175,000 to the Company, due December 10, 1985.
Performance Goals	<p>If the Company meets the following performance goals by November 1, 1985, and the First Warrant has been exercised, the Investors will invest an additional \$500,000, the \$0.45 Series B Preferred Stock will be exchanged for Series C Preferred Stock at \$0.67 per share, and the guarantee will be increased to \$1,500,000:</p> <ul style="list-style-type: none"> – <i>May 1—November 1, 1985:</i> Gross revenue equal to or greater than \$3,300,000. – <i>May 1—November 1, 1985:</i> Net loss equal to or less than \$980,000. – Indebtedness Relating to Receivable Financing Minus Cash as of November 1, 1985 not in excess of \$150,000.
Financial Information	Standard rights to monthly and annual budget as well as standard inspection rights. Rights terminate on event of the Company's initial public offering.
Right of First Offer	<p>Investors will have a pro rata right of first offer with respect to all future financings. Right is limited to Investors owning at least 750,000 shares of Series B or Series C Preferred Stock. The founders will be entitled to a similar right on the following basis:</p> <ul style="list-style-type: none"> (a) If the proposed financing is to be at a price below \$0.45 per share (or \$0.67 per share if Company meets Performance Goals), the founders will be entitled to participate on a pro rata basis.

Exhibit 11 (continued)

- (b) If the proposed financing is to be at a price between \$0.45 (or \$0.67 per share if Company meets Performance Goals) and \$0.90 per share (or \$1.34 if Company meets Performance Goals), founders will be able to participate on a 75% pro rata basis up to a maximum of 10% of the total amount of the financing.
- (c) If the proposed financing will be at a price above \$0.90 per share (or \$1.34 if Company meets Performance Goals), founders will be able to participate on a 50% pro rata basis up to a maximum of 10% of the total amount of the financing.

Board of Directors	The current Board of Directors will appoint Jeff Drazan to the Board effective upon closing. Members of the Board upon exercise of First Warrant to be Peter Wendell, Jeff Drazan, John Stevens, one additional representative of the Investors and one additional representative of the founders.
Lockup	Upon request by the underwriter, the Preferred holders shall not transfer shares pursuant to Rule 144 beginning upon the date of the Company's initial public offering and continuing for 90 days thereafter; provided each officer and director of the Company shall agree to execute a similar agreement.
Expenses	If financing is consummated, Company will pay reasonable fees and expenses of special counsel to the Investors, not to exceed \$15,000.