MassCEC Investments Division
Follow-On Investment Policy

The MassCEC Investments Division makes awards to cleantech companies to directly support the creation, development, growth and success of clean energy technologies, jobs and companies. The Investments Division's programs and activities are also designed to attract external capital to cleantech, fill funding gaps, provide investment returns, promote the deployment of clean technologies and the reduction of energy consumption and energy costs, and strengthen the clean energy ecosystem and attractiveness of Massachusetts for cleantech companies. The purpose of the Follow-On Investment Policy is to provide guidance for the circumstances and the extent to which MassCEC should consider participating in follow-on financings for its existing portfolio companies.

The MassCEC Investments Division recognizes that it commonly provides equity and debt investments into companies which are pre-profitable and often pre- or early revenue. As such, it is expected that most of these companies will be seeking additional rounds of financing in the ordinary course of their growth and expansion. In addition, these companies commonly have unforeseen follow-on funding needs resulting from unexpected opportunities or setbacks or delays in the growth of their business. It is common industry practice for investors in early stage companies to have capacity to provide some follow-on funding; by having a clear mandate and policy for participating in follow-on financings, MassCEC is increasing its value as an investor and is helping to attract more capital to these early stage rounds. MassCEC has concluded that its participation in these financings has a significant impact on portfolio companies, generates a positive signaling effect to new and existing investors, and is one of the most high-leverage uses of MassCEC capital in terms of attracting external capital, filling funding gaps, and leveraging internal personnel resources.

Subject to MassCEC staff's discretion to waive certain criteria or consider other factors on a case-by-case basis, MassCEC will generally consider participating in follow-on financings if <u>all</u> of the following conditions are satisfactorily met:

1. **Minimum Business Requirements.** The company continues to meet the definition of a Massachusetts-based company operating in the clean energy sector, in accordance with MassCEC's enabling legislation.

2. **Achieving Goals of the Investment Division.** The company's business plan continues to provide a compelling case for supporting the Investment Division's goals of advancing clean technologies and/or creating or preserving a significant number of clean energy jobs.

3. **MassCEC's Participation in the Financing is Impactful.** MassCEC may invest at any stage of a follow-on financing if its participation has a meaningful impact on: attracting capital from other investors; filling funding gaps for the company; or preserving the value for MassCEC of an existing investment (e.g., due to a pay-to-play provision). The impact would be considered "meaningful" if MassCEC staff expects that its participation in the financing would significantly reduce the time and difficulty for fundraising, which can be a significant distraction for company management; and/or significantly improve the value or reduce the risk of MassCEC's overall investment in the company. MassCEC may choose to commit early on in a fundraising process, if staff feels that this early commitment is meaningful to the success and expediency of the fundraising, or MassCEC may choose to wait to see how successful the company is with the investment community, prior to committing to a follow-on financing.

4. **Attractive Investment Terms.** MassCEC would receive competitive terms for its follow-on investment, with a reasonable probability of generating an attractive risk-adjusted return on its investment. In evaluating this criterion, staff may consider the return on its cumulative investment as well as current and future rights and benefits.

If MassCEC staff is satisfied that the above conditions have been met, staff may recommend a follow-on investment in an amount appropriate to achieve conditions #3 and #4 above. MassCEC would generally target to invest its fully-diluted, pro rata share of a follow-on round, but staff would exercise discretion to invest more or less than its pro rata share based on the attractiveness of the investment and the funding need of the company.

After conducting a rigorous due diligence process at its initial investment, and then being actively involved with the companies from that point on, the due diligence process for follow-on investments is less lengthy than that of a new investment. Staff carefully reviews the business, commercial, and financial achievements of the company during the follow-on due diligence process, with particular focus on the progress made since the initial investment as compared to plan. In-depth review of historical and projected financials, with a strong emphasis on cash runway of the proposed follow-on investment round, are conducted. MassCEC would

target a soft cap of $500,000 in cumulative follow-on financing per company, a general philosophy which will be communicated to companies up-front. On a case-by-case basis, MassCEC may consider exceeding this soft cap. In those cases, the prospective investment will be brought to the Investments Committee for discussion.

Depending on the size of individual follow-on investments, Board approval may be required. Staff would plan to discuss all follow-on investments over $100,000 with the Investments Committee. As with other investments, MassCEC would always have the ability to proceed directly through the appropriate approval process, Board or otherwise, if schedules do not allow for a prior review by the Investments Committee.

Additional Follow-On Considerations for Seed Investments (Early-Stage Note Program)
In addition to follow-on investments in traditional portfolio companies, MassCEC manages Seed Investments, an early-stage convertible note program that considers follow-on investments. Guidelines are below.

Seed Investments awards are made in two tranches: an upfront Phase 1 Award, and a milestone-based Phase 2 Award. The Phase 2 Award can be triggered in one of two ways:

- An applicant may submit a formal application for a Phase 2 Award once it has demonstrated significant progress or completion of its Phase 1 milestones. If the company's key milestones have changed during the Phase 1 Award period, however, the company would not be disqualified from receiving a Phase 2 Award, as MassCEC seeks to maintain flexibility and allow an awardee to pursue the path that is in the best interests of its business. However, the company must have met all of its reporting requirements and communicated any milestone changes to MassCEC in its monthly written updates. It is in MassCEC's sole discretion to make the Phase 2 Award, and is subject only to CEO approval.
- Alternatively, if the awardee achieves a Qualified Financing (as defined in the Convertible Note Agreement) prior to completion of Phase 1 milestones, MassCEC can waive the milestone completion and allow the awardee to submit a Phase 2 application for consideration. Achieving a Qualified Financing round ($750K or more) serves as validation of a company's technical and commercialization progress and ability to attract capital. As such, a Qualified Financing serves as a proxy for the potential realized by completing the Phase 1 milestones, thereby accelerating the Phase 2 award consideration for applicable companies. If approved, MassCEC would make the Phase 2 Award concurrently with the closing of the Qualified Financing, in the same security. In

order to make this award, the company must demonstrate that with the Qualified Financing, it can achieve similar milestones that would have been expected under the Phase 1 Award and set meaningful milestones for the Phase 2 Award. The Phase 2 Award is subject only to CEO approval.

In addition, per its Convertible Note Agreement with each awardee, MassCEC has an Additional Investment Right to invest in the Qualified Financing, at its sole discretion. Because the companies have already been through a rigorous competitive process and have established a relationship with MassCEC over the course of their award, with at least monthly check-ins and reporting requirements mimicking those of a traditional portfolio company, MassCEC would follow its standard follow-on process outlined above for these investments. This means each would be required to meet the four criteria outlined above and, if over $100,000, would be presented to the Investments Committee.

MassCEC staff may choose to waive its Additional Investment Right and instead pursue a standard new investment, typically $500,000 - $600,000, in a Seed Investments awardee in the Qualified Financing. MassCEC would choose to make this larger investment due to increased impact on the round, proven performance of the company, a level of risk that is commensurate with a standard new equity investment, or a combination of these factors. Separately, MassCEC may exercise its Additional Investment Right and still pursue a standard new investment in a later financing round. In both cases, MassCEC staff would follow its standard new investment process, with CEO approval, Investments Committee review and full Board approval, as required. An investment of this type would not fall under the follow-on policy.

Because follow-on investments will be decided on a case-by-case basis in accordance with this policy, and circumstances of follow-on financing requests are likely to vary widely across companies, a few illustrative examples are included below to clarify these guiding principles.

Scenario 1: *A portfolio company is seeking follow-on financing and has shifted its focus away from cleantech. Its technology may still have some potential cleantech applications, but it is not a primary focus for the company. MassCEC would likely NOT participate in this follow-on.*

Scenario 2: *A portfolio company is raising its next round of financing as anticipated, but is having trouble raising the full amount needed. MassCEC still believes the technology and business model are sound, and MassCEC's participation would serve as a catalyst to encourage other*

investors to participate in the round. In this situation, MassCEC is likely to participate in the follow-on.

Scenario 3: A portfolio company is raising its next round of financing as anticipated and has garnered significant investor interest. The round is likely to be oversubscribed. As long as MassCEC's investment would not be severely diluted by not participating, MassCEC would likely NOT participate in this follow-on.

Scenario 4: A portfolio company is raising an internal round of financing or bridge financing and is dependent on having a majority participation from its existing investors in order to have a successful fundraising. The financing will help the company reach a major milestone, and MassCEC still believes the technology and business model are sound. MassCEC's participation would serve as a catalyst to encourage other investors to participate in the financing. In this scenario, MassCEC is likely to participate in the follow-on.

Scenario 5: A portfolio company is struggling and seeking to raise financing to continue operating in order to reach an acquisition or other major event. In this scenario, MassCEC would need to carefully weigh the pros and cons of participating in a financing, evaluating what the company is likely to achieve with MassCEC financing versus the likely outcome if MassCEC does not participate. Even though significant risk remains in this scenario, if there is a higher probability of recovering some or all of its investment, with the alternative being that most or all of the investment would be lost, MassCEC would consider participating in this type of follow-on.

Scenario 6: A portfolio company is raising a large (i.e., >$10M) later-stage financing, such as a Series C or Series D round. In this situation, MassCEC's potential participation would likely not play a significant role in completing the financing. As long as MassCEC's investment would not be severely diluted by not participating, MassCEC would likely NOT participate in this follow-on.

Scenario 7: A Seed Investments awardee has successfully completed its Phase 1 and Phase 2 Awards, and has met milestones to MassCEC's satisfaction. The company plans to raise a round of $750K or larger, generally composed of angels or other small investors, but has a funding gap remaining, so a $150K Additional Investment Right commitment from MassCEC would have a significant impact on the round, in both size and signaling effect. MassCEC is optimistic about the company's prospects. In this scenario, MassCEC is likely to participate.