UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON

MARK E. PHILLIPS,

Plaintiff,

v.

THE EXECUTOR OF THE ESTATE OF ROBERT MORRIS ARNOLD, JANE DOE ARNOLD, wife of the late Robert M. Arnold and their marital community composed thereof;
JULIA DE HAAN,
JEFFREY ALAN SMYTH,
JUANITA MARY JARDINE, aka JAN MARY WALLACE, aka SARAH BLAIR, aka JOAN REARDON, aka JARDINE MARY WALLACE, AND aka ROB L. SCRUGGS;
CHRISTOPHER ERIC LUNDVALL, and DOES 1-25,

Defendants.

Case Number:

COMPLAINT

1. **Computer Fraud and Abuse Act (18 U.S.C. §1030 *et seq.*);**
2. **Breach of Contract;**
3. **Tortious Interference with Contract;**
4. **Fraud;**
5. **Conspiracy;**
6. **Trespass to Chattels; and**
7. **Conversion;**
8. **Indemnity.**

JURY DEMAND

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Plaintiff Mark E. Phillips files this complaint for damages against Robert Morris Arnold and Jane Doe Arnold, Julia De Haan, Jeffery Alan Smyth, Juanita Mary Jardine aka Jan Mary Wallace and Christopher Eric Lundall, and Does 1-25 (collectively "defendants"), and upon information and belief alleges as follows:

INTRODUCTION

This case arises out of a series of investments by Robert M. Arnold in companies owned and operated by plaintiff Mark E. Phillips; namely MOD Systems, Inc. (hereinafter "MOD") and Banana, Inc. (hereinafter "Banana"). Mr. Phillips had developed highly sensitive and confidential technology applications used in interstate commerce, including low-level cryptography for the music and entertainment industries, as well as for the mobile payment industry. After the investment of Mr. Arnold, Mr. Phillips was able to further refine the technology licensed to MOD to the point that Toshiba Corporation, NCR, Inc., and Deluxe Entertainment, Inc. agreed to invest an additional $35 million in MOD. At about the same time, Banana had executed a development deal in the country of Bolivia that would license its technology to allow cell phone customers to make payments using their cell phones, a tremendous potential market where "point of payment" infrastructure was terribly underdeveloped. Defendant Jan Wallace is an accomplished con artist and fraud who has specialized in "advising" start-up companies and then uses her inside information to trump up charges against the company officers so she can assume control. Defendants Jeff Smyth and Julia De Haan are the lawyer and accountant, respectively, of Mr. Arnold. Mr. Arnold recently passed away, so plaintiff names his successor in interest, the Executor of the Estate of Robert M. Arnold as a defendant. All the defendants were motivated variously by personal greed, ego, an attorney's desire to gain an unfair negotiating

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advantage for his client in a takeover attempt, and fraud. Defendants schemed and caused to be filed an unfounded and unsupported "Derivative Claim" against plaintiff and his companies in an attempt to enrich themselves of the MOD Series A investment. Defendants also conspired to illegally access plaintiff's personal computers and accounts, stole confidential personal information, interfered with plaintiff's access to his own computers and data, converted the information in the computers to their own uses, and used the stolen information and data to cause plaintiff harm, violating multiple state and federal laws. This Complaint seeks to recompense plaintiff for all of the damages suffered as a result of defendants' actions.

THE PARTIES

1. Plaintiff Mark E. Phillips is an individual and a resident of King County, State of Washington. He is the founder and at various times was the majority shareholder of MOD and Banana, businesses organized under the laws of the State of Washington with their principal places of business in King County, State of Washington. He is the sole shareholder of A Dot Corporation.

2. A Dot Corporation is a private corporation organized under the laws of the state of Washington with its principal place of business in King County, Washington. A Dot was Mr. Phillips' "technology incubator," where he would develop technology, write code and manufacture hardware to be used in future business projects.

3. Defendant Executor of the Estate of Robert Morris Arnold is an individual and a resident of King County, State of Washington, and is the successor in interest to Robert M. Arnold, including legal responsible for any claims made against the Estate of Robert M. Arnold. Mr. Arnold was a well-known "angel investor" in the Seattle,

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Washington area. It is believed that Mr. Arnold had invested more than $55 million in approximately 100 start-up companies in the Seattle area, and was an investor in two of plaintiff's corporations; MOD and Banana.

4. Defendant Jane Doe Arnold is the wife of defendant Mr. Arnold and the owner of that portion of Mr. Arnold's community estate as identified under the laws of the State of Washington.

5. Defendant Julia De Haan is a resident of King County, State of Washington, and a licensed accountant practicing in the Seattle area. Ms. De Haan is an advisor to Mr. Arnold and at various times herein held a power of attorney on Mr. Arnold's behalf. It is believed that Ms. De Haan was defendant Mr. Arnold's primary adviser and manager of the "start-up" investment portfolio.

6. Defendant Jeffrey Alan Smyth is a resident of King County, State of Washington, and a licensed attorney practicing in the Seattle area. Mr. Smyth is legal counsel for Mr. Arnold and the attorney who filed the "derivative claims" against plaintiff and his companies.

7. Defendant Jan Wallace, aka Jan Jardine (and other various pseudo-names) is a citizen of Canada who resided in Scottsdale, State of Arizona, at the time of the conduct alleged herein. It is believed that Ms. Wallace had interests in various businesses in the United States and abroad at the time, even though she had entered the country under a "visitor" visa and was legally barred from working. It is further believed that Ms. Wallace has returned to live in Canada.

8. Defendant Christopher Eric Lundvall was a resident of King County, State of Washington, at the time of the conduct alleged herein. Mr. Lundvall was a former employee of plaintiff Mr. Phillips and A Dot. It is believed that Mr. Lundvall currently lives in the former Soviet republic, Kazakhstan.

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9. Doe defendants 1 thru 25 are individuals who acted in concert with the named defendants in their illegal and tortious conduct, and whose identities or conduct are unknown to plaintiff at this time. When such identity or conduct is discovered, plaintiff will seek leave of court to amend the complaint.

JURISDICTION AND VENUE

10. This Court has subject matter jurisdiction pursuant to 28 U.S.C. §1331.

11. This Court has supplemental jurisdiction over the state law claims pursuant to 28 U.S.C. §1367, as they form part of the same case or controversy as the federal Computer Fraud and Abuse Act claim.

12. This court has diversity jurisdiction over the state law claims against Ms. Wallace pursuant to 28 U.S.C. §1332(a)(3), as Mr. Phillips and Ms. Wallace are residents of different states, and the amount in controversy exceeds $75,000.

13. This court has diversity jurisdiction over the state law claims against Mr. Lundvall pursuant to 28 U.S.C. § 1332(a)(3), as Mr. Phillips and Mr. Lundvall are residents of different states, and the amount in controversy exceeds $75,000.

14. This Court has personal jurisdiction over all defendants because each defendant conducts business activities in this jurisdiction, voluntarily entered into written contracts within this jurisdiction, and has caused harm to Mr. Phillips within this jurisdiction.

15. Venue is proper in this district pursuant to 28 U.S.C. §§ 1391(b) and (c) because defendants have substantial contacts with and/or the majority of the pertinent witnesses may be found in this district; many of the events giving rise to this lawsuit have arisen and continue to occur in this district; and defendants have committed the majority of their alleged tortious acts in this district.

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FACTUAL ALLEGATIONS
MOD and Banana Corporation

16. Plaintiff Mark Phillips founded MOD in 2005 along with Anthony Bay. Mr. Bay contributed $50,000 towards the new company with Mr. Phillips contributing office space, staff, computer and other equipment, cash, and his personal credit to support the new company in an amount estimated to be $3 million.

17. Mr. Phillips also contributed a stream of income due and owing to A Dot Corporation from work done on other, unrelated projects; which income supported MOD after its formation. Over time, Mr. Phillips also set up a line of credit using his personal credit that MOD could access, as well as loaned MOD more than $1 million dollars.

18. Plaintiff Mr. Phillips was the majority shareholder of MOD and its CEO as well as its Chief Technology Officer up until his ouster from the company in 2009.

19. MOD was a technology company that licensed Mr. Phillips' intellectual property in order to create an efficient system to deliver digital video content to consumers via an SD card.

20. Plaintiff Mr. Phillips founded Banana in 2006. Mr. Phillips was its sole shareholder and director until defendant Mr. Arnold's investment in Banana in 2006.

21. Banana was set up to hold certain of Mr. Phillips' intellectual property that was used to design a system to allow consumers to make purchases using their cellular telephones. It was anticipated that this technology would be especially useful in countries that lacked a comprehensive and extensive monetary infrastructure.

22. Plaintiff Mr. Phillips founded A Dot Corporation in 2003. A Dot was set up to develop certain computer technologies that would be used in products designed for consumers. A Dot was Mr. Phillips "technology incubator" that allowed him to develop different technologies that would have applications with computers and smart

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devices. For example, A Dot was hired by Microsoft to develop and write code for its smart watches.

23. As Mr. Phillips' intellectual property and technology increased, he planned to set up different corporations that would license certain of his intellectual property to develop and market certain, related products. This general plan for technical development led to the formation of MOD and Banana; each designed to license specific intellectual property to develop and market distinct products.

24. MOD, Banana and A Dot are parties to various inter-company and service agreements that govern the sharing of resources, including staff and intellectual property. These agreements do not permit any employee of one company to access the computers of another company without specific authorization.

25. The data encryption work performed by Mr. Phillips, A Dot, MOD, and Banana for digital entertainment, digital technology, and financial transactions is so sensitive that each company controlled access to its own computers and strictly limited access to their computers. No defendant had permission, implicit, tacit, implied or otherwise to access any of the computers at any of the companies of MOD, Banana, and A Dot.

Mr. Arnold invests in MOD, Banana

26. After a series of negotiations, defendant Mr. Arnold agreed to invest in both MOD and Banana. On October 13, 2006, he signed a Subscription Agreement with MOD, a true and correct copy of which is attached hereto as Exhibit "A." At the same time, Mr. Arnold entered into a Subscription Agreement with Banana, a true and correct copy of which is attached hereto as Exhibit "B."

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27. Both Subscription Agreements contained specific language regarding the operations of the companies. Each contained a specific language about the all aspects of the investment. For example, defendant Mr. Arnold accepted all responsibility for due diligence prior to his investment in Section 1.6 "Investor Responsibility for Due Diligence" at page 3. Mr. Arnold also agreed that he had been provided all documents necessary in order to evaluate the investment, including all documents requested of MOD and Banana in Section 3.1 "Availability of Information" at page 4.

28. Additionally, Mr. Arnold was warned that MOD (and Banana) was a start up company with no significant earning history or profitability. He was specifically notified on page A-4 that "Our principal members and management will continue to exert a substantial amount of control in the operation of our business." Later in that section, he agreed that "No investment in the company should be made unless the investor is willing to entrust all aspects of our management and operations to Mark Phillips and Anthony Bay." There is little doubt that Mr. Arnold understood Mr. Phillips had wide latitude to do whatever he thought necessary for the success of the companies, including, but not limited to, the development of technology, the business direction of the companies, and the expenditure of company assets.

29. Mr. Arnold employed agents and employees to review the Subscription Agreements in detail before entering into the agreements, including, but not limited to, defendant Ms. De Haan and Cole Younger. Mr. Arnold voluntarily and knowingly signed these agreements. In negotiating on behalf of Mr. Arnold, it is believed that all actions taken by Ms. De Haan were within the course and scope of her agency relationship with Mr. Arnold. By entering into the agreements, defendant Mr. Arnold ratified the actions of his agent, Ms. De Haan, and the other agents who acted on his behalf.

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A Dot's Computers

30. A Dot purchased and owned dozens of computers, including servers that are housed in the same server room as MOD's servers. The names of some of A Dot's computers are DOTSERVER, DOTDEVSQL, DOTDEV, DOTSHARE, DOTMETAWAL, DOTBUILD, as well as other computers with "DOT-designated" serial numbers, purchase records, or asset tags. These computers comprise both physical machines as well as "sub-computers" in the form of computer "real estate" located on large servers.

31. A Dot owned several portable "laptop" computers.

32. A Dot owned storage tapes and other storage devices, mainly housed in the server room shared with MOD at MOD's offices. These computers were separate from Mr. Phillips' capital contribution to MOD at its inception.

33. In addition to the physical computers that Mr. Phillips and A Dot owned, they also licensed computer software for its exclusive use, including the accounting program QuickBooks, Microsoft's Developer Network development applications, operating systems, and desktop productivity applications including Microsoft Outlook, Microsoft Word, and Excel.

34. All computers owned and operated by A Dot are connected to the Internet and/or are used in interstate commerce.

35. A Dot's computers are all password-protected, locally encrypted, server encrypted or require server authentication to access. Plaintiff and former A Dot/MOD employees had full access to A Dot's passwords and data until March 2009, when the passwords were changed without Mr. Phillips' or anyone from A Dot's permission.

36. During the time that Mr. Phillips was MOD's CEO up until March 2009, his assistants Rachel Huffman, Lauren Kronmiller and Josette Jenkins had Mr. Phillips' permission to access the A Dot Computers for the sole purpose of accessing Mr.

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Phillips' calendar, contacts and emails located on the Phillips/A Dot server and/or its computers. They had no permission to access Phillips/A Dot's substantive data, work product for clients, accounting records, or other business records.

37. In addition to Mr. Phillips's assistants, two junior level MOD information technicians, Michael Striecher and Stephen Borges, had access to Phillips/A Dot's passwords for the sole purpose of being able to reboot and/or restore the computers in the event of an emergency or as part of their routine, pre-approved maintenance. At no time did these two junior employees have permission to access any substantive data or information belonging to A Dot or Mr. Phillips.

Wallace Steals Passwords and Invades A Dot's Computers

38. Ms. Wallace, who styles herself at times as a fundraiser for start-up companies and at other times as the CEO of shell companies, managed and marketed with her business associate, Nevada attorney Kyleen Cane, was introduced to Mr. Phillips as someone who could help him raise additional funds to help MOD and his other businesses expand.

39. In 2007 and 2008, Ms. Wallace and Mr. Phillips spent a substantial amount of time together, and, in addition to the business relationship that Ms. Wallace had with MOD, A Dot, Banana and Mr. Phillips, a personal relationship developed between the two. While Mr. Phillips was busy preparing for the Toshiba investment, Ms. Wallace was using her business and personal relationship with Mr. Phillips to gain access to all of Mr. Phillips' property in order to glean information about MOD, A Dot, Banana, and the other companies and to illegally access the computers of MOD, A Dot, Banana, and the other companies.

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40. At no time was Ms. Wallace given permission to access any of the data on any of the computers for any of the companies by Mr. Phillips or any other person.

41. It is believed that Ms. Wallace gained unauthorized access to the computers of all the companies by copying down passwords she found or stole from documents or computers, or by surreptitiously observing passwords being typed into portable computers.

42. Ms. Wallace also attempted to ingratiate herself with Mr. Phillips' assistants and it is believed that some of the confidential and protected information she obtained was gleaned either surreptitiously from them or by creating some ruse to get the information. She is an experienced and accomplished con.

43. Starting in the spring of 2008, Ms. Wallace has boasted to various individuals that she had gained access to all of A Dot's computers and had used that access on numerous occasions for her personal purposes, and that she has given the information to others, including some defendants, most notably, defendant Mr. Smyth.

44. The personal relationship between Ms. Wallace and Mr. Phillips ran hot and cold. There were many occasions of warmth when expensive gifts and travel was indulged, as well as many instances of anger and verbal abuse. Sometime in 2008, Ms. Wallace became extremely angry with Mr. Phillips because he did not award her any stock in MOD during a substantial Series A financing in which Toshiba Corporation, NCR, Inc., and Deluxe Entertainment Services Group, Inc. invested $35 million. It is believed that around this time, Ms. Wallace hacked into A Dot's computers and stole confidential information from them for the specific purpose of extracting an extorted payment or shares in MOD from Mr. Phillips. Ms. Wallace also had the ability to manipulate data on the computers, and it is believed that she did so on several occasions.

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45. Ms. Wallace, unable to extort money from Mr. Phillips, contacted defendant Mr. Arnold, his attorney, defendant Mr. Smyth, and his accountant, defendant Ms. De Haan, and offered them access to the information she had illegally copied/obtained.

46. While Ms. Wallace had possession of one A Dot computer, on or about September 2008, she lied to Mr. Phillips and other A Dot employees, telling them that the computer was "locked" and "not opened." In truth, Ms. Wallace accessed the computer without authorization using stolen passwords, and emailed confidential, protected documents to her own email address and possibly others. Internet and temporary file creation logs for the dates and times in question confirm that Wallace breached the computers' security and hacked into A Dot's system. Other computer records, including computer access logs, permission logs, RAID disk mirroring monitoring records, file and power logs also verify access to A Dot's computers by a person without Mr. Phillips or A Dot's approval.

47. Mr. Phillips learned of or became aware of the conduct of Ms. Wallace, in March of 2010 and caused to be filed a complaint on behalf of A Dot against the offending parties which complaint was dismissed without prejudice after plaintiff was taken into custody following his arrest.

Wallace Invades Mr. Phillips' Personal Computers and Accounts

48. Without authorization from Mr. Phillips, Ms. Wallace accessed his personal computers and personal accounts, including his G-mail account. It is believed and alleged that she gained access to Mr. Phillips' passwords through the same, surreptitious means as she accessed the passwords to the A Dot accounts. Mr. Phillips'

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personal accounts were similarly protected by passwords, but these passwords were not shared nor given to any other person at MOD or any of the other companies.

49. Between 2006 through 2009 defendant, Ms. Wallace would access Mr. Phillips' personal information and then email the documents she found to her own email account. It is believed that Ms. Wallace then erased the email that "sent" Mr. Phillips' personal information to her own account to conceal her theft and access from Mr. Phillips.

50. The information that Ms. Wallace accessed and stole was personal and, in turn, confidential. For example, Ms. Wallace stole personal emails between plaintiff Mr. Phillips and his mother and sister. More importantly, Ms. Wallace accessed Mr. Phillips personal financial information, including statements from his money managers. The stolen statement would be used against him by the defendants in seeking to force him to settle their unfounded claims against him.

51. Between the summer of 2008 through early 2010, defendant Mr. Lundvall was an employee of plaintiff Mr. Phillips and A Dot. Mr. Lundvall enjoyed a close relationship with Mr. Phillips and would often perform unique tasks on behalf of Mr. Phillips for which he was paid. For example, Mr. Lundvall traveled to Ms. Wallace's house to set up her computers, configure her wireless, and ensure that Mr. Phillips/A Dot computers were secure.

52. After the personal relationship between Ms. Wallace and Mr. Phillips ended in the summer of 2007, Mr. Lundvall was dispatched as Mr. Phillips' envoy to recover Mr. Phillips' personal possessions from Ms. Wallace, including a 2007 Aston Martin automobile.

53. It is believed that Mr. Lundvall, using his close relationship with Mr. Phillips, surreptitiously gleaned passwords and other personal information from Mr.

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Phillips. It is further believed that Mr. Lundvall shared the passwords and personal information that he stole from Mr. Phillips with defendant Ms. Wallace.

54. In winter of 2009 and beginning of 2010, Mr. Lundvall changed loyalty from Mr. Phillips to Ms. Wallace and in particular, to Ms. Wallace's teenage daughter, Chloe Jardine-Cutler. Either unbeknownst to Ms. Wallace, or at her urging, Mr. Lundvall entered into a consensual, sexual relationship with Ms. Wallace's underage, teenage daughter. This fact became important after it was later discovered, in early 2010, that Mr. Lundvall and Ms. Wallace conspired to set up a "rape for hire" scheme against Mr. Phillips.

55. On three separate occasions between March and April 2010, Ms. Wallace made a report to Phoenix and Seattle law enforcement agency that Mr. Phillips had "hired" Mr. Lundvall to "rape" her daughter, Chloe, and that Mr. Phillips would then pay Mr. Lundvall upon the completion of the "rape." Defendant Ms. Wallace first attempted to use this "rape for hire" conspiracy to extort money from Mr. Phillips, and, when that proved unsuccessful, as proof to law enforcement of Mr. Phillips' criminal conduct.

56. At the time that defendant Ms. Wallace made the allegations against Mr. Phillips, she knew or should have known that those allegations were false. The Assistant United States Attorney who prosecuted Mr. Phillips was forced to acknowledge the existence of the "Wallace/Lundvall Rape For Hire Conspiracy" during a custody hearing. A true and correct copy of that hearing is attached hereto as Exhibit "E."

57. Mr. Phillips did not learn of Ms. Wallace's unauthorized access to his personal accounts and computers and the theft of his personal information until January 2013, when he was released from custody and able to review all the documents

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from his criminal trial. Included in the hundreds of thousands of separate documents is a report from the CART team of the FBI, which documents the unauthorized access of Mr. Phillips' personal accounts and computers by Ms. Wallace, Mr. Lundvall and Mr. Smyth. Discovery from the criminal case has also shown that Ms. Wallace shared the stolen information directly with Mr. Arnold, Ms. De Haan and Mr. Smyth.

Wallace Gives Stolen Data to Cane and Smyth

58. Without authorization from Mr. Phillips/A Dot, Ms. Wallace showed data she stole from Mr. Phillips and A Dot computers, including confidential banking and accounting records belonging to Mr. Phillips/A Dot, to her long-time business associate, Ms. Cane, an attorney, who Ms. Wallace herself had recommended and helped seat on MOD's board of directors. Wallace also showed the data to Mr. Bay. She is believed to have manipulated some of the data she stole before delivering it to others, including defendants Mr. Smyth and Ms. De Haan.

59. Ms. Wallace has boasted to third parties that she was able to "steal" protected data from A Dot computers over a period of several months and that she gave this stolen data to Mr. Smyth, who as Mr. Arnold's attorney was frequently at odds with MOD's management over various issues, including the ownership of Mr. Phillips' intellectual property and corporate control issues. Ms. Wallace was motivated to steal and then use the stolen information and data from the plaintiff' computers by sheer greed and revenge. Ms. Wallace had already tried, on several occasions, to extort more money from plaintiff; and, she was aware of the value of the Series A financing from Toshiba, et al to Mr. Phillips and to MOD.

60. Ms. Wallace was incensed at Mr. Phillips when he rejected any attempt to grant stock and or options in MOD to Ms. Wallace following the Series A financing

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deal. She not only argued repeatedly and vehemently with Mr. Phillips, but threatened him and told third parties that she would "ruin [and destroy] him." Additionally Ms. Wallace wanted revenge against Mr. Phillips, who had again unilaterally ended their turbulent, tumultuous personal relationship in December 2007; a relationship that Ms. Wallace fostered solely to gain access to Mr. Phillips' assets and to enrich herself.

61. In March 2008, Ms. Wallace contacted Mr. Arnold and was put in contact with Mr. Smyth. It is believed that Ms. Wallace offered to share the information she had stolen from A Dot computers with Mr. Smyth. According to Mr. Smyth's statements to the FBI in January of 2011, he met with Ms. Wallace in December 2008, January 2009, and again in December 2009 in Seattle or at her home in Arizona and downloaded stolen information on a thumb drive, or received e-mails and documents he knew to be stolen. Over the same period of time, third parties have witnessed Mr. Smyth and Ms. Wallace engaged in a personal flirtatious and drunken relationship, further cementing their conspiracy against plaintiff.

62. Defendant Mr. Smyth knew that the information he received from Ms. Wallace was "stolen" from Mr. Phillips, that Ms. Wallace was not authorized to access the Phillips/A Dot computers, and that she was not authorized to share any information or data that she had illegally acquired.

63. However, Mr. Smyth also lied to law enforcement officials during that interview. In what is believed to be an effort to downplay his contacts with defendant Ms. Wallace, Mr. Smyth denied that messages sent from his cell phone, titled "Jeff's iPhone," were not from "his" cellular phone; and, in fact, denied owning an iPhone at that time. A true and correct copy of that interview with Mr. Smyth is attached hereto as Exhibit "O."

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64. Ms. Wallace has stated to third parties and testified in federal court that she accessed computers and stole data from them upon Mr. Smyth's specific request for certain data. During the 2008 time period when MOD was engaged in the $35 million Series A financing round from Toshiba and others, Mr. Smyth was attempting to improve Mr. Arnold's bargaining position as an existing shareholder, in large part by using data that Ms. Wallace stole from Phillips/A Dot computers. Mr. Smyth was desperate to improve Mr. Arnold's position during negotiations because the MOD Subscription Agreement specifically warned Mr. Arnold that any subsequent investor would gain priority over Mr. Arnold's investment, and that Mr. Arnold's shares would be diluted with the new investment. Both of these would occur and did occur with the Toshiba/NCR/Deluxe/Phillips investment.

The Sordid Wallace/Cane History

65. Ms. Wallace was introduced to plaintiff as a "fund raiser" and a corporate adviser to start-up companies. She held herself out as the CEO of several companies as well as a corporate consultant. She is none of the above. She is an accomplished con artist, liar and fraud.

66. Ms. Wallace, a Canadian citizen, was in the United States on a "visitor's visa," making her ineligible to work or earn money. To get around this prohibition, she used up to six different social security numbers, kept most of her money off shore, and hid behind a plethora of corporate identities and structures.

67. Ms. Cane, the former Michael Cane also known as Michael Eiselman, a male lawyer, leads a law firm in Nevada, Cane Clark LLP, that holds itself out as specializing in corporate transactions and securities matters.

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68. Ms. Wallace's ties to her co-conspirator and partner, Ms. Cane, go back as early as 1996. For over a decade they have been involved in various ventures. In almost all instances in which Ms. Cane represented Ms. Wallace and her companies, they have been sued for questionable transactions and/or fraud.

69. More relevant, Ms. Wallace has a distinct modus operendi for assuming control of small or start-up corporations. She and her partner, Ms. Cane, perfected their scheme over the years.

70. Ms. Wallace's motivation for turning the stolen Phillips/A Dot information over to Ms. Cane is believed to be in furtherance of one of their long-running schemes to gain control of MOD and Banana. In the past, Ms. Wallace and Ms. Cane, working in concert and sometimes with the participation of others, target companies desiring to go public, force them into shell companies in a reverse merger (sometimes laden with undisclosed or mis-described debt instruments that latter are "called" by Wallace or her cohorts after the transaction is consummated), cause "whistleblower" complaints against company executives often involving a pattern of allegations involving sexual misconduct or drug abuse, instituting sham litigation review committees or audit committees, installing members of their own small group of cronies on the boards of the target companies and/or the sham litigation/audit committees, and ultimately taking over the companies.

71. The scheme (as documented by publicly available securities records and legal pleadings in other cases involving Dynamic Associates, Legal Access Technologies, MW Medical, Secured Diversified Investments, Davi Skin, among many others) commonly involves bankrupting the companies and/or issuing large amounts of securities to connected parties, and sending assets offshore into nominee bank accounts in the Cayman Islands and Bermuda.

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72. Companies affiliated with Wallace and/or Cane have been or are the targets of government investigation in securities fraud and money laundering schemes. Wallace, Cane and/or their business associates usually end up in control of the companies they target. MOD, Banana, and A Dot are believed to have become targets of this fraud ring starting as early as 2007.

73. The nefarious activities of Ms. Wallace and Ms. Cane have resulted in over a dozen lawsuits and investigations. A brief summary of their activities can be found in the whistle blower complaint filed with the IRS by forensic accounting expert, Dennis Mandell. A true and correct copy of Mr. Mandell's complaint is attached hereto as Exhibit "D."

74. Ironically, Banana, using the codename MetaWallet, had software algorithms that detected and identified the sophisticated money laundering scheme that Cane and Wallace employed in their illicit activities, which information was used as the basis for Mr. Mandell's IRS Whistleblower Complaint. This is ironic given defendant Ms. De Haan's confusion as to the value of the Phillips intellectual property and her subsequent efforts with Ms. Wallace and Mr. Smyth to "dupe" Mr. Arnold into attempting to destroy Mr. Phillips and the companies in which he, Mr. Arnold, was an investor.

Smyth Uses Stolen Phillips and A Dot Data To Attempt Settlement with Phillips, MOD

75. As defendant Mr. Arnold's attorney, defendant Mr. Smyth has had numerous occasions over several years to review MOD documents that clearly delineate MOD's relationship with A Dot and other companies, including Banana. In addition, Mr. Smyth would have received or should have received from Mr. Arnold, all

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agreements and transactions that Mr. Arnold, as a shareholder, would have received and reviewed.

76. Among the many ways in which Mr. Smyth was made aware of A Dot's independent corporate status from MOD and other companies is Mr. Smyth's review on behalf of Arnold of the May 2006 and October 2006 MOD Common Stock Agreements, and the June 2006 Banana Common Stock Agreement, wherein Arnold explicitly acknowledged A Dot's separate existence from MOD and Banana and the sharing of MOD's physical office resources, including its office space, computers and staff, by A Dot.

77. In particular, during the 2008 Series A financing, Mr. Smyth on behalf of Mr. Arnold demanded and reviewed numerous documents making it explicitly clear that A Dot's intellectual property residing on its computers belongs to A Dot and its customers, and solely to Banana, MOD or any other entity. In addition, this information was contained, and fully disclosed, in the Subscription Agreements entered into by Mr. Arnold with both MOD and Banana.

78. It is believed that defendant Ms. De Haan, who managed Mr. Arnold's investments in start-up companies, realized that the investments which totaled $55 million, were worth close to nothing. In fact, the only two investments that appeared to have any market value were Mr. Arnold's investments with Mr. Phillips in MOD and Banana.

79. It is believed that Ms. De Haan was under pressure from Mr. Arnold and his family to mitigate any losses from the start-up investment fund. Seeing the valuations of MOD and Banana following the Series A investment by Toshiba, et al., along with the private, confidential information from Ms. Wallace, gave Ms. De Haan an idea of how to cover up her negligence and incompetence in investing in and

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managing the start-up fund - she would steal the money and the companies from Mr. Phillips.

80. It is believed that Mr. Smyth was hired to represent Mr. Arnold at the recommendation and behest of Ms. De Haan. It is believed that Mr. Smyth was chosen because he would accept the obvious lies and falsehoods told by Ms. Wallace, and that he would agree to take possession of confidential information and data he knew to be stolen from plaintiff. It is further believed that Mr. Smyth agreed to work with Ms. De Haan to "dupe" Mr. Arnold as to the true facts regarding the start-up investments and the claims of Mr. Arnold vis-à-vis MOD and Banana.

81. Mr. Smyth, using information he knew was stolen by Ms. Wallace from Mr. Phillips' and A Dot's computers, then attempted to force Mr. Phillips to "give" his majority shareholdings in MOD to Mr. Arnold, threatening that otherwise, Mr. Arnold would sue MOD and Mr. Phillips personally, using the stolen information in his case to smear Mr. Phillips and his colleagues. Mr. Phillips refused to accede to this extortionate use of his and A Dot's stolen personal, confidential data.

82. On behalf of Mr. Arnold, Mr. Smyth on December 18th, 2008 delivered to MOD a draft shareholder derivative complaint improperly coupled with a direct shareholder complaint against MOD and Mr. Phillips. The draft complaint was laden with information stolen from A Dot's computers by Ms. Wallace, which Mr. Smyth knew was stolen.

83. Defendants Mr. Smyth and Ms. De Haan were aware of the valuations of both MOD and Banana, as well as the intellectual property owned and licensed by Mr. Phillips. The valuations were completed concurrent with the Series A due diligence. A true and correct copy of the valuations of MOD, Banana, and the Phillips' Intellectual Property are attached hereto as Exhibits "F," "G" and "H," respectively.

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84. After delivering his draft complaint, Mr. Smyth again attempted to extract a settlement from MOD and Mr. Phillips, demanding that MOD force Mr. Phillips to hand over stock in MOD sufficient to give to Mr. Arnold a 51% interest in the company (worth over $60 million) in exchange for Mr. Arnold's agreement not to file his complaint. Mr. Smyth further demanded $5 million in royalties from intellectual property owned or controlled by Mr. Phillips, again basing his demands upon leverage he felt he had from data stolen from Mr. Phillips' and A Dot's computers by Ms. Wallace. Mr. Smyth further demanded that Mr. Phillips turn over all stock in Banana Corporation (worth $60 million) to Mr. Arnold, Banana's only other shareholder. Mr. Smyth also demanded in writing that several employees loyal to Mr. Phillips be fired immediately, most or all of whom happened to be key witnesses to Ms. Wallace's theft of Mr. Phillips' and A Dot's property and her subsequent conduct in attempting to leverage the stolen information to her and others' advantage.

85. Ironically, the demands by Mr. Smyth total an amount that roughly redeems Mr. Arnold's essentially worthless "start-up" investment fund, a fund directed, managed and operated by defendant Ms. De Haan.

The Defendants Conspire

86. In early 2008, defendant Ms. Wallace approached Mr. Arnold and it is believed entered into an agreement to provide Mr. Arnold and his agents and designees, Ms. De Haan and Mr. Smyth, with the confidential and protected data that she has stolen from Phillips/A Dot's computers.

87. The defendants agreed to use the information in an attempt to force Mr. Phillips to relinquish control of both MOD and Banana and ultimately to give up substantial amounts of the equity that he held in both corporations.

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88. To accomplish their goals, Mr. Smyth uses the stolen information to level baseless allegations against Mr. Phillips.

89. As a result of the allegations, defendant Ms. Wallace recommends that Mr. Phillips appoint her co-conspirator, Ms. Cane, to the MOD board of directors Demand Review Committee.

90. As a further result of the allegations, Mr. Phillips was forced to place his MOD shares into a "voting trust," with Ms. Cane as the trustee. At no time did Ms. Cane ever disclose to plaintiff her extensive and detrimental conflicts of interest. It is believed that Ms. Cane had no intention of complying with her fiduciary responsibilities on behalf of Mr. Phillips, but, instead, planned all along to continue the conspiracy with Ms. Wallace to assume control of MOD and then access its capital for their own, personal gain.

91. In furtherance of the conspiracy, defendants Ms. Wallace, Ms. De Haan, and Mr. Smyth reported Mr. Phillips' "misconduct" to the FBI and the United States Attorney's Office in Seattle. Each of these defendants, in subsequent interviews with federal law enforcement officials, lied about various aspects of their dealings with Mr. Phillips, about important details of their "association," and about their own interests in the demise of Mr. Phillips. Among the many prevarications, one of the most telling is the claim that defendant Ms. Wallace first contacted defendant Mr. Arnold's office in December of 2008. In fact, the defendants met and began to conspire before March 2008. This is important because Toshiba had already given MOD a "loan" of $4 million and was set to complete the Series A financing later that year for the full $35 million. The defendants misrepresented the date to the federal officials because it would become obvious that they were reporting the "wrongful" conduct of Mr. Phillips to be able to oust him from MOD.

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92. Ms. De Haan gave an interview with the FBI that is nearly a complete fabrication. Although she was Mr. Arnold's "attorney in fact" and headed up Mr. Arnold's "due diligence" in the MOD and Banana investments, she told the FBI that she didn't believe that Mr. Phillips invested any money in MOD, that she believed the intellectual property owned by Mr. Phillips had been "included" in the Arnold Subscription Agreement, that she was not sure of the value of the Phillips intellectual property, and that she "smelled a rat" with the MOD investment. A true and correct copy of the FBI summary of statement is attached hereto as Exhibit "P."

Smyth's Use of Stolen Data In Other Venues and Arnold Breaches the Subscription Agreements

93. As described above, Mr. Smyth used stolen Phillips and A Dot data procured for him by Wallace to attempt to force MOD to grant his client Mr. Arnold the majority of Mr. Phillips' shares in MOD. When that attempt failed, Mr. Smyth used the stolen information in his lawsuits against MOD and Banana and against MOD executives Kenn Gordon, Douglas Lower and Mr. Phillips on Mr. Arnold's behalf. At all times relevant herein, Mr. Smyth has been aware that his legal pleadings against these parties are predicated, in large part, upon stolen and/or manipulated documents taken from Mr. Phillips' and A Dot's computers without their permission, as well as the lies from Ms. Wallace.

94. Mr. Smyth held numerous meetings over several months in 2008 and 2009 with Ms. Wallace, including meetings where Ms. Wallace was observed physically taking Phillips/A Dot computers to meetings with Mr. Smyth. At no time has either Ms. Wallace or Mr. Smyth been authorized to access Phillips or A Dot computers for any purpose.

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95. Following some of these meetings between Ms. Wallace and Mr. Smyth, in October and November 2008 Ms. Wallace relayed messages from Mr. Smyth to Mr. Phillips, claiming to be negotiating on behalf of Mr. Arnold. Ms. Wallace attempted to convince Mr. Phillips to give 50% of his MOD shares to Mr. Arnold as part of a deal she would broker. Ms. Wallace stated that she was using her personal attorney, Claire Ambrosio, to be her messenger to deliver documents to and from Mr. Smyth.

96. In January, 2009 after Mr. Smyth served his draft complaint upon MOD, Ms. Wallace again attempted to convince Mr. Phillips to settle with Mr. Arnold (presumably on behalf of Mr. Smyth) for 50% of his shares in MOD, and that if he did, Mr. Smyth would not file the threatened complaint against MOD and Mr. Phillips. Again, Mr. Phillips refused these indirect demands from Smyth.

97. Mr. Smyth has continued to use data stolen from Phillips/A Dot's computers as leverage in negotiations with Phillips, MOD and their representatives, attempting to coerce a settlement of Mr. Arnold's claims. For example, during a meeting with Mr. Phillips in March, 2009, a meeting demanded by Ms. Cane, Mr. Bay and MOD's then-attorneys at Lane Powell, to attempt to settle Mr. Arnold's claims against Mr. Phillips, they pulled documents from a folder that are believed to be Mr. Phillips' private bank documents (stolen directly from Mr. Phillips' and/or A Dot's computers by Ms. Wallace and provided by Mr. Smyth to Ms. Cane and Mr. Bay), and "confronted" Mr. Phillips with the allegation that he had engaged in financial wrongdoing related to A Dot. Mr. Phillips' attorneys at the time, Anthony Gewald and Ronald Braley of Lasher Holzapfel Sperry & Ebberson witnessed Ms. Cane, Mr. Bay and the Lane Powell attorney's presentation of materials stolen from Mr. Phillips' and/or A Dot's computers, which documents were described as originating from Mr. Smyth and Ms. Wallace, at the meeting.

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98. In April, 2009 after Mr. Phillips had stepped aside from his role as MOD's CEO, in a meeting with Mr. Smyth and Ms. De Haan, Mr. Smyth's law partner Chris Mason held up what he purported to be Mr. Phillips' personal brokerage statement (stolen from Mr. Phillips' and/or A Dot's computers) and said words to the effect that "money will make this [i.e., Mr. Arnold's claims] go away." Mr. Phillips' then-attorneys, Anthony Gewald and Ronald Braley, witnessed this attempted use by Mr. Smyth and his partner of stolen documents from Mr. Phillip's and/or A Dot's computer system.

99. Mr. Smyth, on behalf of Mr. Arnold, in February 2009 filed a verified shareholder derivative lawsuit against MOD and Banana Corporation, of which Mr. Arnold and Mr. Phillips were then the only shareholders. A true and correct copy of the verified derivative lawsuit, signed by defendant Mr. Arnold, is attached hereto as Exhibit "C."

100. It is believed and alleged that Mr. Smyth and Ms. De Haan "duped" defendant Mr. Arnold, misrepresenting facts and/or using stolen data and information from both Mr. Phillips and A Dot computers so that Mr. Arnold would "verify" a complaint that had obvious, patent factual errors.

101. For example, one such "verified" lie in the February 2009 lawsuit was the "fact" that Mr. Phillips was embezzling from MOD $15,000 to $25,000 per month through Ms. Wallace's company, Meteor, to a bank account in the Netherlands purportedly controlled by Mr. Phillips, when in fact, no such transactions had ever occurred. Mr. Smyth and Ms. Wallace fabricated this allegation to smear Mr. Phillips and pressure him to relinquish his majority control of MOD and Banana. When Mr. Phillips refused to relinquish money or property, Ms. Wallace and later Mr. Smyth both sent copies of the lawsuit to John Cook of TechFlash.com.

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102. Following his filing of the lawsuit, in an attempt to extract a settlement of Mr. Arnold's claims against Banana, Mr. Smyth sent Banana's attorney James Smith of Smith Hennessey PLLC an email that had been stolen from an A Dot/Banana computer.

103. On March 10, 2010 after dismissing his derivative lawsuit against Banana with prejudice, Mr. Smyth filed another complaint against Banana, A Dot and others. In this new complaint, Mr. Smyth made several allegations clearly based upon data stolen from A Dot's computers, which Mr. Smyth either solicited or received knowing that it was stolen. For example, Mr. Smyth alleged in his complaint against Banana that his "investigation has revealed" that A Dot (wholly owned by Mr. Phillips) had at an unspecified point in time transferred money abroad. These conclusions are drawn solely from A Dot data stolen by Ms. Wallace and/or others acting at the direction of Mr. Arnold's agents. At the time he made these allegations on March 12, 2010, Mr. Smyth was fully aware that the data he based his complaint upon was fraudulently obtained from A Dot, its rightful owner.

104. Mr. Smyth has no independent or lawful basis to allege many of the allegations in the Banana complaint, other than documents stolen from A Dot's computers.

Mr. Phillips' Substantial Damages

105. Mr. Phillips has been substantially damaged as a result of the tortious conduct in this case. Plaintiff has been damaged by having to expend substantial time, money, and resources to realize and be able to prove that the defendants not only improperly accessed Phillips/A Dot computers, but then stole protected, confidential data and information which was then used against Mr. Phillips.

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106. Mr. Phillips was forced to hire computer technicians to assess the damage to Phillips/A Dot's portable computers and to investigate the status of A Dot's larger computers, as well as the amount and quality of data stolen by defendants, which remains in the control of defendants and their cohorts.

107. Mr. Phillips has particularly been damaged by defendant Mr. Arnold's breach of the MOD and Banana Subscription Agreements. By filing the unfounded and frivolous derivative claims, as well as in settlement negotiations, defendants Mr. Arnold, Mr. Smyth and Ms. De Haan made it clear they intended to extort Mr. Phillips of his entire holdings in MOD and Banana and $8.5 million in cash. Their tortious conduct has had its foreseeable, intended consequences. Mr. Phillips has lost his interest in MOD and MOD has ceased to exist as a viable concern.

108. As a further result of defendants' tortious conduct, MOD and Banana, once valued at $123 million and $60 million, respectively, are now essentially worthless. Additionally, Mr. Phillips had licensing agreements for the use of his intellectual property with MOD in the amount of $5 million and a license agreement with Banana in the amount of $2.5 million. These licensing agreements have never been paid. And all intellectual property contributed to MOD for majority stock was ignored when voted.

109. Mr. Phillips was further damaged as a result of the computer breaches caused by defendants in that A Dot is required by contract to inform many contractual counterparties – including several prominent digital media companies – of the fact of such breaches and the resolution of the computer breaches. A Dot, having begun its assessment of the damage perpetrated by Defendants' invasion of its computers, is in the process of contacting all A Dot clients to inform them of Defendants' data breaches, Defendants' access to and possession of data stolen from A Dot, and the fact that other recipients of the stolen property who are not named as Defendants (including Cane,

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Ambrosio, Lane Powell, Fenwick & West, and others) may be making use of the stolen property.

110. Some of Phillips/A Dot's computers are believed to have been reformatted, overwritten, imaged and copied, all of which affect the integrity of any data remaining and effectively destroy much or all of the original data, including data belonging to Phillips/A Dot's clients.

111. As a further consequence of defendants' tortious conduct, plaintiff has suffered significant loss of income of $500,000 per year, plus 30% performance bonus. Mr. Phillips' employment contract with MOD has not been honored as a proximate result of defendants' conduct and allegations.

112. Mr. Phillips' monetary damages are believed to exceed $100,000,000.

First Cause of Action
Breach of the Computer Fraud and Abuse Act, 18 U.S.C. §1030
(Against All Defendants)

113. Plaintiff repeats and incorporates by reference each allegation in paragraphs 1 through 112 as if set forth fully herein.

114. All of Phillips/A Dot's computers are protected computers involved in interstate commerce within the meaning of the CFAA.

115. By their actions, each and every named defendant and Does 1-25 acting in concert with them either directly accessed Phillips/A Dot's protected computers or instructed such computers to be accessed without either Phillips or A Dot's knowledge or authorization.

116. Defendants, including Does 1-25, have violated the Computer Fraud and Abuse Act, 18 U.S.C. §1030(a)(2)(C), by intentionally and without authorization accessing one or more protected computers belonging to Phillips/A Dot, and by

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obtaining information from such protected computers, including but not limited to confidential banking and accounting records belonging to Phillips/A Dot and pertaining to Phillips/A Dot's clients.

117. Defendants, including Does 1-25, have violated the Computer Fraud and Abuse Act, 18 U.S.C. §1030(a)(4), by knowingly, and with intent to defraud Phillips/A Dot, accessing one or more protected computers belonging to Phillips/A Dot without authorization, and by means of such conduct furthering the intended fraud and obtaining one or more things of value, including but not limited to confidential banking and accounting records belonging to Phillips/A Dot.

118. Defendants, including Does 1-25, have violated the Computer Fraud and Abuse Act, 18 U.S.C. §1030(a)(5)(B), by intentionally accessing one or more protected computers belonging to Phillips/A Dot without authorization, and as a result of such conduct, recklessly causing damage to Phillips/A Dot, including but not limited to impairing the integrity and availability of data and/or information belonging to Phillips/A Dot and its clients by hacking into Phillips/A Dot's computers and changing its passwords without Phillips/A Dot's permission.

119. Defendants, including Does 1-25, have violated the Computer Fraud and Abuse Act, 18 U.S.C. §1030(a)(5)(C), by intentionally accessing one or more protected computers belonging to Mr. Phillips and A Dot without authorization, and as a result of such conduct, recklessly causing damage and loss to plaintiff, including but not limited to impairing the integrity and availability of data and/or information belonging to Phillips/A Dot and its clients by hacking into Phillips/A Dot's computers and changing its passwords without Phillips/A Dot's permission, and by causing plaintiff to incur damage and loss in the form of costs associated with expending substantial time,

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money, and resources to identify the scope of the damage to Phillips/A Dot and the extent of defendants' fraud and theft.

120. Does 1-25, or some of them, are liable for some or all of the specified breaches of the Computer Fraud and Abuse Act because some of them instructed others to breach A Dot's computers, which itself has been held to violate the Computer Fraud and Abuse Act even where the defendants did not physically hack into or illegally access the computers themselves.

Second Cause of Action
Breach of Contract (MOD, Banana)
(Against Defendant Robert Arnold)

121. Plaintiff repeats and incorporates by reference each allegation in paragraphs 1 through 112 as if set forth fully herein.

122. Defendant willingly and knowingly entered into a Subscription Agreement as an investor in MOD on October 13, 2006. *See* Exhibit "A" attached hereto. As a result of the Agreement, defendant Mr. Arnold invested $3.5 million in MOD in return for a number of shares of the corporation.

123. Defendant willingly and knowingly entered into a Subscription Agreement as an investor in Banana on July 7, 2006. *See* Exhibit "B" attached hereto. As a result of the Agreement, defendant Mr. Arnold invested $5.5 million in Banana in return for a number of shares of the corporation.

124. Defendant was specifically advised that MOD, Banana had numerous and important inter-corporation and service agreements with "related" companies also owned by plaintiff.

125. Defendant was specifically informed of the fact that Mr. Phillips and his other corporate entities owned certain intellectual property that would be licensed to

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allow MOD to develop set top boxes which would allow consumers to quickly and efficiently download digital content. Defendant was also specifically informed that Mr. Phillips would be licensing additional technologies related to payment systems for mobile devices.

126. Defendant specifically consented, by entering into both Subscription Agreements, to allow Mr. Phillips unfettered discretion in the operation, development and management of the corporations.

127. Defendant Mr. Arnold breached those Subscription Agreements by filing a verified Derivative Complaint against MOD, Banana, plaintiff and others in February 2009. The verified complaint contained numerous falsehoods and misrepresentations and was based, in part, on stolen, confidential information, and sought to stop the very conduct that Mr. Arnold had already ratified.

128. Defendant Mr. Arnold claims to have filed the complaint "on behalf of the shareholders" which was a ruse, as his demand was only for an increase in his own share holdings. The sad irony is that by filing the complaint on "behalf of the shareholders," he destroyed the company, making the total "shareholder value" worthless.

129. The destruction of the corporations was a foreseeable result of defendant Mr. Arnold's breach of the contract, which, in fact, was his goal all along if he could not own and control the corporations in their entirety.

130. As a result of defendant's wrongful conduct, plaintiff Mr. Phillips has been damaged by the loss of his equity shares in MOD, by the loss of MOD as an on-going concern, and by the loss of his annual salary as a MOD officer and employee.

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131. As a result of defendant's wrongful conduct, plaintiff Mr. Phillips has been damaged by the loss of Banana as an on-going concern, and by the loss of his service agreement as a Banana consultant.

132. As a result of defendant's wrongful conduct, Mr. Phillips has been forced to expend significant sums to pay for lawyers to defend him in the wrongful actions brought by defendant. Mr. Phillips requests reimbursement of all attorneys' fees as approved by that written Agreement entered into by defendant.

133. As a proximate cause of defendant's wrongful, intentional and fraudulent conduct, plaintiff has suffered damages as alleged above according to proof at trial.

Third Cause of Action
Tortious Interference With Contract (MOD)
(Against All Defendants)

134. Plaintiff repeats and incorporates by reference each allegation in paragraphs 1 through 112 as if set forth fully herein.

135. Defendants, and all of them, were aware that plaintiff Mr. Phillips and defendant Mr. Arnold had entered into a Subscription Agreement with MOD and that Mr. Phillips was the majority shareholder and CEO of MOD. *See* Exhibit "A" attached hereto.

136. Defendants, and all of them, were also aware that plaintiff Mr. Phillips had entered into a series of contracts with other corporate entities, including but not limited to AnythingBox, MOD, and Banana, among others that entitled him to fees and payment for the licensing of his intellectual property. *See* Exhibits "I", "J", and "K" attached hereto.

137. Defendants, and all of them, were also aware that plaintiff Mr. Phillips had entered into a series of contracts with MOD, to wit, an Employment Agreement,

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Subscription and Contribution Agreement, and Shareholder Agreement dated October 17, 2008. *See* Exhibit "L", "M", and "N" attached hereto.

138. Defendants, and all of them, knew or should have known that their theft of plaintiff's confidential and personal information, their conspiracy to use the information, and their false, baseless accusations against plaintiff Mr. Phillips would interfere with the contracts between Mr. Phillips and Mr. Arnold, Mr. Phillips and MOD, and Mr. Phillips and AnythingBox.

139. Defendants, and all of them, knew or should have known that their theft of plaintiff's confidential and personal information, their conspiracy to use the information, and their false, baseless accusations against plaintiff Mr. Phillips would interfere with the contracts between Mr. Phillips, A Dot, AnythingBox, Banana, MOD, Toshiba, NCR and Deluxe Entertainment.

140. Among the acts of defendants that interfered with the contracts identified above, defendants filed baseless claims of wrongdoing against plaintiff, caused the MOD board of directors to institute a "review committee," and used Mr. Phillips' personal, private information in an attempt to force Mr. Phillips to relinquish his interests and shares in MOD and A Dot, and made false allegations of wrongdoing against Mr. Phillips as detailed herein.

141. Plaintiff believes and on that basis alleges that defendants intended to interfere with the contracts identified herein based upon their greed and envy, as well as their desire to cover up their incompetence and negligence resulting in losses in the Arnold investment fund, to try to "step into" or assume the contractual rights and benefits of plaintiff.

142. Defendants, and all of them, knew or should have known that their conduct would substantially interfere with the contractual rights of plaintiff, and, in

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fact, the defendants' conduct was intended to interfere with the contractual rights of plaintiff.

143. As a result of defendants' wrongful conduct, plaintiff has been significantly damaged by the loss of their contractual rights, which has led to the loss of Mr. Phillips' interest in MOD, and all other corporate interests. In addition, plaintiff has been further damaged by defendant's wrongful conduct because he has lost all contractual rights of those agreements with MOD, AnythingBox, including the Employment Agreement and the Licensing Agreement.

144. As a further result of defendants' wrongful conduct, plaintiff has been forced to expend significant amounts to retain and employ attorneys in an effort to protect his stolen information and defend themselves against baseless accusations.

145. The acts of defendants, and all of them, were done with the specific intent to harm plaintiff or take property from plaintiff, and were malicious and without conscious regard for the rights of plaintiff. As such, plaintiff is entitled to an award of punitive damages in an amount to be determined at trial.

146. Plaintiff has been damaged in a significant amount, and should be awarded compensatory damages in an amount to be proven at trial.

Fourth Cause of Action
Tortious Interference With Contract (Banana)
(Against All Defendants)

147. Plaintiff repeats and incorporates by reference each allegation in paragraphs 1 through 112 as if set forth fully herein.

148. Defendants, and all of them, were aware that plaintiff Mr. Phillips and defendant Mr. Arnold had entered into a Subscription Agreement with Banana and that

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Mr. Phillips was the majority shareholder and CEO of Banana. See Exhibit "B" attached hereto.

149. Defendants, and all of them, were also aware that plaintiff Mr. Phillips had entered into a series of contracts with other corporate entities, including but not limited to AnythingBox, MOD, and Banana, among others that entitled him to fees and payment for the licensing of his intellectual property. See Exhibit "I" attached hereto.

150. Defendants, and all of them, knew or should have known that their theft of plaintiff's confidential and personal information, their conspiracy to use the information, and their false, baseless accusations against plaintiff Mr. Phillips would interfere with the contracts between Mr. Phillips and Mr. Arnold, Mr. Phillips and Banana.

151. Defendants, and all of them, knew or should have known that their theft of plaintiff's confidential and personal information, their conspiracy to use the information, and their false, baseless accusations against plaintiff Mr. Phillips would interfere with the contracts between Mr. Phillips, A Dot, AnythingBox, Banana, MOD, Toshiba, NCR and Deluxe Entertainment.

152. Plaintiff believes and on that basis alleges that defendants intended to interfere with the contracts identified herein based upon their greed and envy, as well as their desire to cover up their incompetence and negligence resulting in losses in the Arnold investment fund, to try to "step into" or assume the contractual rights and benefits of plaintiff.

153. Defendants, and all of them, knew or should have known that their conduct would substantially interfere with the contractual rights of plaintiff, and, in fact, the defendants' conduct was intended to interfere with the contractual rights of plaintiff.

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154. As a result of defendants' wrongful conduct, plaintiff has been damaged by defendant's wrongful conduct because he has lost all contractual rights of those agreements with Banana, including the Licensing Agreement.

155. As a further result of defendants' wrongful conduct, plaintiff has been forced to expend significant amounts to retain and employ attorneys in an effort to protect his stolen information and defend themselves against baseless accusations.

156. The acts of defendants, and all of them, were done with the specific intent to harm plaintiff or take property from plaintiff, and were malicious and without conscious regard for the rights of plaintiff. As such, plaintiff is entitled to an award of punitive damages in an amount to be determined at trial.

157. Plaintiff has been damaged in a significant amount, and should be awarded compensatory damages in an amount to be proven at trial.

Fifth Cause of Action
Fraud
(Against Defendants Arnold, De Haan and Smyth)

158. Plaintiff repeats and incorporates by reference each allegation in paragraphs 1 through 112 as if set forth fully herein.

159. Defendants Mr. Arnold, Mr. Smyth and Ms. De Haan made certain representations to plaintiff in reviewing, revising and consenting to the various agreements between the parties.

160. Representations made by Ms. De Haan or Mr. Smyth on behalf of Mr. Arnold were made with his express or implied consent or authority as his agents, attorneys and advisers. Mr. Arnold personally represented to plaintiff that he would support him in his business efforts and honor their contractual relations. Each defendant knew these representations to be false at the time they were made.

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161. Those representations by these defendants were false and made to induce plaintiff to do certain things in reliance upon these representations; namely, to lull plaintiff into believing that Mr. Arnold and his agents would honor the written agreements and support Mr. Phillips.

162. Defendant Mr. Arnold had no intention of honoring those obligations and duties to which he consented. In fact, it appears that Mr. Arnold, alone and in concert with his agents, Ms. De Haan and Mr. Smyth, as well as in concert with Ms. Wallace, upon learning of the success of MOD and its investment from Toshiba, planned to remove Mr. Phillips from MOD and to take as much of his contractual and property rights as possible.

163. Plaintiff reasonably relied upon these representations to his detriment.

164. As a result of his reliance, plaintiff was significantly damaged in an amount to be proven at trial. The acts of defendants, and all of them, were done with the specific intent to harm plaintiff or take property from plaintiff, and were malicious and without conscious regard for the rights of plaintiff. As such, plaintiff is entitled to an award of punitive damages in an amount to be determined at trial.

Sixth Cause of Action
Fraud
(Against Defendants Wallace and Lundvall)

165. Defendant Ms. Wallace made incalculable misrepresentations and misstatements of material facts. Her entire life is a fabrication. No interaction between Ms. Wallace and plaintiff was honest. It is believed that Ms. Wallace, from the inception of their relationship, planned to steal from plaintiff anything of value that she could acquire either by herself or in concert with others. Ms. Wallace claimed to be a business consultant, a start-up adviser, an investment facilitator, as well as his girlfriend.

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166. Ms. Wallace knew these representations to be false at the time she made them, and never intended to honorably or morally comply with any promise made to plaintiff.

167. Defendant Mr. Lundvall and defendant Ms. Wallace made representations that were false to both plaintiff and to law enforcement authorities. Mr. Lundvall told Mr. Phillips that he would help him retrieve his 2007 Aston Martin, computer data and interface with Ms. Wallace, when in fact, he was conspiring with Ms. Wallace against Mr. Phillips.

168. Both Mr. Lundvall and Ms. Wallace made material misrepresentations to law enforcement authorities regarding a "rape for hire" scheme involving Ms. Wallace's underage teenage daughter.

169. Both defendants knew these statements to be false at the time they made them.

170. Plaintiff justifiably and reasonably relied upon the promises and misrepresentations of the defendants to his detriment, including trusting them, allowing them access to his home and office, and divulging important information and confiding in them.

171. The acts of defendants, and all of them, were done with the specific intent to harm plaintiff or take property from plaintiff, and were malicious and without conscious regard for the rights of plaintiff. As such, plaintiff is entitled to an award of punitive damages in an amount to be determined at trial.

172. As a proximate cause of the defendants' wrongful, intentional and fraudulent conduct, plaintiff has suffered damages as alleged above according to proof at trial.

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Seventh Cause of Action
Conspiracy
(Against All Defendants)

173. Plaintiff repeats and incorporates by reference each allegation in paragraphs 1 through 112 as if set forth fully herein.

174. The defendants, and all of them, did knowingly and willfully conspire and agree to a plan of action that was designed and intended to cause plaintiff harm and to damage him.

175. The goal of the conspiracy was to wrongfully possess or steal as much of plaintiff's property as possible, thus enriching themselves at plaintiff's expense. Specifically, defendant Ms. Wallace intended to defraud plaintiff into giving her shares in MOD for her "consulting" services. When this proved unsuccessful, Ms. Wallace conspired with her long time partner, Ms. Cane, as well as defendants Mr. Arnold, Ms. De Haan, Mr. Smyth and Mr. Lundvall to remove Mr. Phillips from any management or ownership role in MOD and Banana in order to enrich themselves at Mr. Phillips' expense.

176. The defendants took several steps to accomplish these goals, including but not limited to, the following actions:

(a) Stealing, or causing to be stolen personal and confidential information belonging to plaintiff and A Dot;

(b) Using the stolen information in an effort to force plaintiff to relinquish his positions as CEO of MOD and Banana;

(c) Using the stolen information in an attempt to extort plaintiff;

(d) Prevaricating and lying to federal investigators about Mr. Phillips' conduct;

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(e) Breaching Agreements with plaintiff by filing frivolous and unfounded lawsuits.

177. As a proximate cause of Defendant's wrongful, intentional and fraudulent conduct, plaintiff has suffered damages as alleged above according to proof at trial.

Eighth Cause of Action
Trespass to Chattels
(Against All Defendants)

178. Plaintiff repeats and incorporates by reference each allegation in paragraphs 1 through 112 as if set forth fully herein.

179. Mr. Phillips, through his wholly owned corporate entity, A Dot, owns and operates valuable chattels, including its computers and computer system, which also includes licensed computer programs, such as QuickBooks and Microsoft Outlook used by Phillips and A Dot personnel.

180. By their acts described above, Defendants have trespassed Phillips/A Dot's computer system, without justification or authorization by A Dot or Mr. Phillips, and thereby interfered with plaintiff's right to possess and operate his chattels during the time period when the computers were wrongfully accessed.

181. Defendants have, after hacking into Phillips/A Dot's computers, changed its passwords or ordered that its passwords be changed without A Dot's or Mr. Phillips' permission, thereby substantially interfering with plaintiff' right to enjoy his chattels without interference.

182. As a proximate cause of Defendant's wrongful, intentional and fraudulent conduct, plaintiff has suffered damages as alleged above according to proof at trial.

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Ninth Cause of Action
Conversion
(Against All Defendants)

183. Plaintiff repeats and incorporates by reference each allegation in paragraphs 1 through 112 as if set forth fully herein.

184. Defendants willfully have interfered with Mr. Phillips' computers owned and exclusively used by A Dot, and have taken possession of A Dot computers at different points in time from 2008 through the present. The possession of A Dot's computers by the defendants, and all of them, was and is to the exclusion of Mr. Phillips and A Dot, and has prevented plaintiff from any use or enjoyment of the computers during the time that defendants possessed them.

185. As a proximate cause of defendants' wrongful, intentional and fraudulent conduct, plaintiff has suffered damages as alleged above according to proof at trial.

Tenth Cause of Action
Contractual Indemnity
(Against Defendant Robert Arnold)

186. Plaintiff repeats and incorporates by reference each allegation in paragraphs 1 through 112 as if set forth fully herein.

187. Defendant Robert Arnold entered into a written agreement with MOD, Banana.

188. That written agreement contains specific clauses requiring defendant Mr. Arnold to indemnify Mr. Phillips under certain circumstances. Specifically, section 1.7 of the MOD and Banana Subscription Agreement entitled "Indemnification" outlines the duties of Mr. Arnold to indemnify Mr. Phillips. See Exhibit "A" and "B" attached hereto.

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189. The claims made by defendant Mr. Arnold in the derivative lawsuit are not personal claims, but are claims filed on behalf of the "shareholders." See Exhibit "C" attached hereto.

190. As such, the claims in the derivative lawsuit are of the nature that defendant Mr. Arnold is required to indemnify plaintiff by operation of the contracts. Mr. Arnold's original lawsuit against MOD has caused damage to Mr. Phillips and MOD, requiring MOD to retain lawyers and expend funds in its defense. MOD, in turn, was required to defend Mr. Phillips and provide a defense against Mr. Arnold's baseless claims.

191. Plaintiff requests an order that defendant Mr. Arnold be required to indemnify plaintiff for any and all costs associated with the "derivative lawsuit," including but not limited to attorneys' fees, costs, and any other fees allowed under the contract.

PRAYER FOR RELIEF

192. WHEREFORE, plaintiff, Mr. Phillips, prays for judgment against defendants, jointly and severally, as follows:

193. For an immediate injunction protecting those computers identified herein as belonging to plaintiff that are in the possession of defendants;

194. For a prohibitory injunction barring Defendants from in any way accessing plaintiff's computers, or using information stolen from plaintiff, for any purpose, and an order that defendants return all computers belonging to Mr. Phillips, MOD, Banana, and A Dot identified herein or through further discovery;

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195. For a mandatory injunction requiring all persons in possession of data stolen from plaintiff to return such to plaintiff immediately and certify that they have kept no copy or forwarded it to others;

196. For actual and consequential damages in an amount to be determined at trial, but believed at this time to exceed $100,000,000;

197. For the imposition of a constructive trust upon Defendants' ill-gotten gains as a result of the tortious activities detailed above, and disgorgement of said gains;

198. For an order naming plaintiff Mark Phillips as the sole owner and shareholder of MOD, Inc.;

199. For exemplary damages for Defendants' misconduct in an amount to be determined at trial;

200. For attorney's fees to the extent permitted by law or by contract;

201. For costs of suit; and

202. Such other and further relief as this Court deems just.

DEMAND FOR JURY TRIAL

Under Fed.R.Civ.P. 38(b), plaintiff demands jury trial of all issues raised by the Complaint.

Date: March 11, 2013

LAW OFFICE OF REED YURCHAK



By:_____
REED YURCHAK, WSBA No. 37366
Attorney for Plaintiff

LAW OFFICE OF REED YURCHAK
40 Lake Bellevue Dr. #100
Bellevue, WA 98005
TELE: 425-941-6659; FAX: 425-654-1205

VERIFICATION

MARK PHILLIPS hereby declares as follows:

I am the Plaintiff named hereinabove. I have personal and testimonial knowledge of the facts set forth below and am competent to be a witness herein.

I have read the foregoing Complaint, know the contents thereof and believe the same to be true.

I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct to the best of my knowledge.

DATED this 11th day of March, 2013

mark phillips

MARK PHILLIPS

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EXHIBITS

A. MOD Systems Subscription Agreement dated October 13, 2006

B. Banana Corporation Subscription Agreement dated July 7, 2006

C. Robert M. Arnold Individual and Derivative (MOD and Banana) Verified Complaint Against Mark Phillips, Kenn Gordon, and Anthony Bay filed on February 18, 2009

D. Dennis Mandell's IRS Form 211 Against Jan Wallace dated February 12, 2010

E. United States v Mark Phillips, Detention Review Hearing, Assistant United States Attorney Arvind Swaminathan admission to the Court of the existence of a Wallace/Lundvall Extortion Scheme on April 15, 2010

F. MOD Systems Common Stock Valuation dated August 19, 2008

G. Banana Corporation Common Stock Valuation as of June 16, 2006

H. Mark Phillips' Patent Valuation dated October 29, 2007

I. Phillips Banana License Agreement dated on June 20, 2006

J. Phillips AnythingBox License Agreement effective on April 25, 2008

K. Phillips MOD License Agreement dated on October 17, 2008

L. Phillips MOD Employment Agreement dated on October 17, 2008

M. Phillips MOD Subscription and Contribution Agreement dated on October 17, 2008

N. Phillips MOD Shareholder Agreement dated on October 17, 2008

O. Jeff Smyth 302 Interview with the FBI on January 18, 2011

P. Julia de Haan 302 Interview with the FBI dated February 16, 2011

EXHIBIT “A”

MOD SYSTEMS INCORPORATED

SUBSCRIPTION AGREEMENT

$5,000,000

COMMON STOCK OFFERING

MOD Systems Incorporated
720 Third Avenue, Suite 1100
Seattle, WA 98104
Attn: Mark Phillips, Chief Executive Officer
Email: markp@modsystems.com

INSTRUCTIONS FOR INVESTING

If you wish to purchase shares of Common Stock of MOD Systems Incorporated and, if applicable, related warrants, please:

(1) Complete the Subscription Agreement by initialing the appropriate space(s) on **page 7** and by providing the information requested on **pages 9 and 10**;

(2) Sign and date your completed Subscription Agreement; and

(3) Deliver your completed Subscription Agreement and your check made payable to "MOD Systems Incorporated" to Mark Phillips or mail them to:

MOD Systems Incorporated
720 Third Avenue, Suite 1100
Seattle, WA 98104
Attn: Mark Phillips, Chief Executive Officer

* * * * *

When the Company has accepted your Subscription Agreement, an officer will sign it and return a copy to you, together with a stock certificate representing your shares and, if applicable, a warrant representing your right to purchase shares of common stock of the Company described herein.

If you have any questions in completing the Subscription Agreement, please call Mark Phillips at (206) 973-1099.

YOU SHOULD CAREFULLY REVIEW THIS SUBSCRIPTION AGREEMENT AND PARTICULARLY THE RISK FACTORS DESCRIBED IN ATTACHED EXHIBIT A.

SUBSCRIPTION AGREEMENT

This Subscription Agreement (this "***Agreement***") is made by and between MOD Systems Incorporated, a Washington corporation (the "***Company***"), and the undersigned (the "***Investor***"), who hereby subscribes for the number of shares of the Company's Common Stock ("***Common Stock***") set forth below (the "***Shares***").

In consideration of the Company's agreement to sell the Shares to the Investor upon the following terms and conditions, the Investor hereby agrees, represents and warrants as follows:

Section 1
Subscription

1.1 **Purchase of Shares; Minimum Investment; Warrants.**

(a) The Investor subscribes for the number of Shares set forth on the signature page below at a price of $3.50 per Share. The Investor understands that the minimum investment that will be accepted by the Company in this offering is $500,000. The Company's Board of Directors, in its sole discretion, may reduce this amount for certain otherwise qualified investors.

(b) As part of this offering, the first subscriber who has his, hers or its subscription accepted by the Company and purchases at least 142,857 shares of Common Stock pursuant to this offering shall receive a warrant to purchase 20,000 shares of Common Stock, in substantially the form of attached Exhibit B (a "***Warrant***"). Notwithstanding the foregoing, at such time that the Company has received and accepted a subscription from an investor in this offering who purchased at least 142,857 shares of Common Stock, the right to receive any warrants to purchase shares of Common Stock by any subsequent subscriber in this offering shall terminate and be null and void. As of May 27, 2006, the Company had issued the Warrant in accordance with this Section 1.1(b).

(c) With this Agreement, the Investor encloses a check payable to the order of MOD Systems Incorporated in full payment for the Shares.

1.2 **Offering Size and Duration.** The Company intends to raise up to $5,000,000 in this offering, and reserves the right, in its sole discretion, to increase or decrease the size of this offering. This offering shall terminate on November 1, 2006, unless earlier terminated by the Board of Directors of the Company.

1.3 **Documents Provided to the Investor.** The Investor acknowledges that the Company has made available to the Investor (i) a copy of the Company's Articles of Incorporation, as amended through the date hereof (the "***Articles***"); (ii) a copy of the Company's Confidential Business Plan dated May 23, 2006; (iii) Schedule of Exceptions to the Company's representations and warranties set forth in Section 4 below, as set forth on attached Exhibit C (the "***Schedule of Exceptions***"); and (iv) the Risk Factors, in the form of attached Exhibit A.

1.4 **Acknowledgements by the Investor.** The Investor understands and acknowledges that:

(a) The Company may accept or reject this Agreement, in whole or in part, in its sole and absolute discretion.

(b) This Agreement is and shall be irrevocable except that the Investor shall have no obligations hereunder, other than those set forth in Section 1.5, in the event this Agreement is rejected by the Company. This Agreement and the rights, powers and duties set forth herein shall be binding upon the Investor, the Investor's heirs, estate, legal representatives, successors and assigns and shall inure to the benefit of the Company, its successors and assigns.

(c) Checks received from the Investor will be immediately available to the Company upon acceptance of this Agreement by the Company. The Investor's funds will not be subject to escrow pending receipt of a minimum amount. Failure of the Company to obtain sufficient subscriptions for Shares may jeopardize the Company's ability to meet its objectives.

(d) No federal or state agency has made any finding or determination as to the fairness of this offering for investment, or any recommendation or endorsement of the Securities (as defined below).

(e) Because there is no public market for the Company's capital stock, the offering price for the Shares was determined by the Company arbitrarily and does not bear any relationship whatsoever to the Company's assets, book value, shareholders' equity, net worth or any other established criteria of value.

(f) Because no public market for the Shares or other securities of the Company is expected to develop, the economic risk of the investment must be borne indefinitely by the Investor.

(g) The Company may, in the future, raise additional amounts through the sale of securities with a price less than, and rights superior to, those offered to the Investor.

(h) No assignment, sale, transfer, exchange or other disposition of the Securities can be made except in accordance with transfer restrictions described in this Agreement and in accordance with applicable law.

(i) The Company has relied upon the information set forth in this Agreement to qualify for exemptions from federal and state securities registration requirements.

1.5 **Confidential Nature of Information.** The information provided to the Investor regarding the Company is confidential and non-public, and the Investor agrees that all of the information will be kept in confidence by the Investor and neither used to the Investor's personal benefit (other than in connection with the Investor's investment decision) nor disclosed to any third party; provided, that this obligation does not apply to any such information that: (i) is part of the public knowledge or literature and is readily accessible as of the date of this Agreement; (ii) becomes part of the public knowledge or literature and, hence, readily accessible by publication; or (iii) is received from third parties and that the Investor does not reasonably believe (a) to be confidential information or (b) to have been disclosed in violation of such third parties' duties of confidentiality they owe the Company. The Investor agrees to promptly return

all materials containing Company confidential information, and copies of such materials in whatever medium, in the event that the Company rejects this Agreement.

1.6 **Investor Responsibility for Due Diligence Investigation.** The Investor acknowledges that Investor must rely upon Investor's own examination of the Company, and the terms of this offering, including the merits and risks involved in making an investment decision regarding the Securities. The Company is solely responsible for the content of any statements made to the Investor with respect to the business of the Company, its management or its financial condition or the terms of this offering. The Company has not received from its legal counsel, accountants or professional advisors any independent valuation of the Company or any of its capital stock, or any opinion as to the fairness of the terms of this offering or the adequacy of disclosure of materials pertaining to the Company or the offering. Consequently, the Company's legal counsel or other professional advisors should not be looked to for any assurance that there have not been material omissions or misstatements in the offer and sale of the Securities or that the interests of investors have been adequately taken into account in the structure or terms of this offering.

1.7 **Investor Indemnification of the Company.** The Investor hereby agrees to indemnify and hold the Company harmless from any and all liabilities or damages incurred by the Company arising as a result of any false statement or misrepresentation made by the Investor in this Agreement including, but not limited to, liabilities or damages incurred in connection with the loss of exemptions from securities registration requirements.

1.8 **"Market Stand-Off" Agreement.** The Investor hereby agrees that Investor shall not, to the extent requested by the Company or an underwriter of securities of the Company, sell or otherwise transfer or dispose of or engage in any other transaction regarding any Shares or other shares of capital stock of the Company then owned by the Investor for up to one hundred eighty (180) days following the effective date of a registration statement of the Company filed under the Securities Act of 1933, as amended (the "***Securities Act***"), or such longer period (not to exceed 18 days) after the expiration of the 180-day period, as the underwriters of the Company shall request in order to facilitate compliance with NASD Rule 2711. The Investor hereby agrees to enter into a separate agreement with respect to the subject matter of this Section 1.8 if so requested.

Section 2
Risk Factors

In addition to the information contained in this Agreement, the risk factors described on the attached Exhibit A should be considered carefully in evaluating the Company, its business and an investment in the Shares, the Warrant and the shares of Common Stock issuable upon exercise of the Warrants, if applicable (collectively, the "***Securities***"). The Investor is aware that the Company is an early stage enterprise with a limited operating history in a highly competitive market. **The Securities are highly speculative in nature, and investors in this offering face a substantial risk that they will lose all or part of their investments, or that their investments will generate an inadequate return.** The list of risk factors described on the attached Exhibit A represent management's view of the principal risks facing the Company as of October 6, 2006.

This list does not purport to be an exhaustive catalog of all possible risks associated with an investment in the Company.

Section 3
Investor Representations and Warranties

The Investor hereby agrees, represents and warrants as follows:

3.1 **Availability of Information.** The Company has made available to the Investor, or to the Investor's attorney, accountant or representative, all documents that the Investor has requested, and the Investor has requested all documents and other information that the Investor has deemed necessary to consider respecting an investment in the Company. The Company has provided answers to all questions concerning the offering and an investment in the Company. The Investor has carefully considered and has, to the extent the Investor believes necessary, discussed with the Investor's professional legal, tax and financial advisers and Investor's representative (if any) the suitability of an investment in the Company for the Investor's particular tax and financial situation. All information the Investor has provided to the Company concerning the Investor and the Investor's financial position is correct and complete as of the date set forth below, and if there should be any material adverse change in such information prior to the acceptance of this Agreement by the Company, the Investor will immediately provide such information to the Company. The Investor acknowledges that it has received all information that the Investor has requested regarding the current and proposed relationship between the Company, A Dot Corporation and Hello Twice Corporation, including the contractual relationships, the overlap of management, and the sharing of resources among such entities. The Company has provided answers to all questions concerning the relationships among the Company and such other entities.

3.2 **Securities Restricted.**

(a) The Investor knows that the Securities have not been registered under either federal or state securities laws, and the Investor represents and warrants that the Investor is purchasing the Securities for investment for Investor's own account and not on behalf of any other person, nor with a view to, or for resale or other distribution of, the Securities.

(b) The Investor also understands that the Company is under no obligation and has no intention to register the Securities or to take any actions to make available exemptions from the registration requirements of state and federal securities laws, and that the Securities cannot be sold or otherwise distributed in the absence of an exemption from such registration requirements.

(c) The Investor also understands that the Securities may be transferred only on one of the following conditions: (i) the Securities have been made subject to effective registration under the Securities Act and any applicable state securities laws; (ii) the Company has received an opinion of counsel from the Investor satisfactory to the Company that the Securities may be transferred without registration under the Securities Act or such laws; or (iii) the Securities and Exchange Commission and any applicable state securities regulatory

agency have issued in respect to such transfer a "no action" letter or equivalent interpretive opinion.

(d) The Investor also consents to the placement of a legend on all certificates representing the Securities in substantially the following form:

> **The securities represented by this certificate have not been registered under the Securities Act of 1933, as amended, or any state securities laws, and may not be offered, sold, transferred, encumbered, or otherwise disposed of except upon satisfaction of certain conditions. Information concerning these restrictions may be obtained from the corporation or its legal counsel. Any offer or disposition of these securities without satisfaction of said conditions will be wrongful and will not entitle the transferee to register ownership of the securities with the corporation.**

3.3 **Investment in Not Readily Marketable Securities Not Disproportionate.** The Investor's overall commitment to investments that are not readily marketable is not disproportionate to the Investor's net worth. The Investor's investment in the Securities will not cause such overall commitment to become excessive.

3.4 **Adequate Net Worth.** The Investor has adequate net worth and means of providing for the Investor's current needs and personal contingencies to sustain a complete loss of the investment in the Company at the time of investment, and the Investor has no need for liquidity in the investment in the Securities.

Section 4
Company Representations and Warranties

The Company hereby represents and warrants that, except as set forth in the Schedule of Exceptions, as of October 6, 2006:

4.1 **Organization and Qualification.** The Company is a corporation duly incorporated and validly existing under the laws of the State of Washington.

4.2 **Capitalization.** The capitalization of the Company consists of the following:

(a) **Common Stock.** A total of 25,000,000 authorized shares of Common Stock, 10,285,714 shares of which are issued and outstanding

(b) **Preferred Stock.** A total of 5,000,000 authorized shares of preferred stock of the Company, none of which are issued and outstanding.

(c) **Options, Warrants, Reserved Shares.** Except for outstanding options to purchase up to 904,695 shares of Common Stock granted under the Company's 2005 Stock Option Plan, there are no options, warrants, rights (including conversion or preemptive rights) or agreements for the purchase or acquisition from the Company of any shares of its capital stock or

any securities convertible into or ultimately exchangeable or exercisable for any shares of the Company's capital stock.

4.3 **Due Authorization.** All corporate action on the part of the Company, its officers, directors and shareholders necessary for the authorization, execution, delivery of, and the performance of all obligations of the Company under, this Agreement, and the authorization, issuance, reservation and delivery of the Warrants, if applicable, and all of the Shares being sold under this Agreement has been taken, and this Agreement, when executed by the Company, will constitute, valid and legally binding obligations of the Company, enforceable in accordance with their respective terms, except as may be limited by (i) applicable bankruptcy, insolvency, reorganization or others laws of general application relating to or affecting the enforcement of creditors' rights generally and (ii) the effect of rules of law governing the availability of equitable remedies.

4.4 **Litigation.** There is no action, suit, proceeding, claim, arbitration or investigation ("***Action***") pending, or, to the Company's knowledge, currently threatened against the Company or, to the Company's knowledge, against any officer, director or employee of the Company in connection with such officer's, director's or employee's relationship with, or actions taken on behalf of, the Company. The Company is not a party to or subject to the provisions of any order, writ, injunction, judgment or decree of any court or government agency or instrumentality and there is no Action by the Company currently pending or that the Company currently intends to initiate.

4.5 **Compliance with Law and Charter Documents.** The Company is not in violation or default of any provisions of the Articles or its Bylaws, and, to the Company's knowledge, except for any violations that individually and in the aggregate would have no material adverse impact on the Company's business, financial condition or results of operations, the Company is in compliance with all applicable statutes, laws, regulations and executive orders of the United States of America and all states, foreign countries or other governmental bodies and agencies having jurisdiction over the Company's business or properties.

4.6 **Regulation D.** The Company will timely file a Notice of Sale of Securities on Form D with federal and, to the extent necessary or applicable, state securities regulators indicating the Company's reliance upon the exemption from registration provided by Rule 506 of Regulation D promulgated under the Securities Act ("***Regulation D***"). The Company has not taken any action that would preclude reliance upon such exemption, including any general solicitation under Section 502(c) of Regulation D. In making the foregoing representation, Investor acknowledges that the Company has relied upon the Investor's representations and warranties set forth in this Subscription Agreement to qualify for such exemptions from registration.

Section 5
Status as an Accredited Investor

By initialing the appropriate space(s) below, the Investor represents and warrants that Investor is an "***Accredited Investor***" within the meaning of Regulation D. The Investor is an Accredited Investor, if he, she or it is:

____ (a) A director or executive officer of the Company;

_✓_ (b) A natural person whose individual income exceeded $200,000 in each of the past two years, or whose joint income with spouse exceeded $300,000 in each of those years, and who reasonably expects to receive at least the same level of income in the current year;

_✓_ (c) A natural person whose individual net worth, or joint net worth with his or her spouse, exceeds $1,000,000, and whose net worth will exceed $1,000,000 on the date of the Company's acceptance of this Agreement;

____ (d) An organization or entity consisting solely of natural persons who meet the requirements specified in (a), (b) or (c) above;

____ (e) A trust, corporation or partnership with total assets in excess of $5,000,000 not formed for the specific purpose of acquiring the Shares;

____ (f) Investor is another type of "accredited investor" as that term is defined in Regulation D, namely _____.

INVESTOR MUST INDICATE THE APPLICABLE CATEGORY OR CATEGORIES BY INITIALING EACH APPLICABLE SPACE ABOVE; IF JOINT INVESTORS, BOTH PARTIES MUST INITIAL.

Section 6
Miscellaneous

6.1 **Governing Law; Venue.** The parties agree that this Agreement, and any disputes arising under this Agreement, will be governed by and construed in accordance with the laws of the state of Washington, without giving effect to any conflict of laws principle to the contrary. The parties agree that venue for any dispute arising under this Agreement will lie exclusively in the state or federal courts located in King County, Washington, and the parties irrevocably waive any right to raise *forum non conveniens* or any other argument that King County, Washington is not the proper venue. The parties irrevocably consent to personal jurisdiction in the state and federal courts of the state of Washington.

6.2 **Consent to Electronic Notice.** In the interests of speed, convenience and minimizing expenses, the Investor understands that the Company would prefer to use email as its principal method of communication with its shareholders. The Washington Business Corporation Act permits use of email for notices to shareholders if a shareholder agrees. By providing its preferred email address in the space set forth below, the Investor hereby agrees that email notices for all Company notices and mailings are acceptable. If no email address is provided below, the Company will continue to use the Investor's street address for all such notices and mailings.

6.3 **Company's Address.** An Investor completing and executing this Agreement should deliver it, together with a check in the amount of the Investor's subscription, to "MOD Systems Incorporated," or mail them to Mark Phillips at:

720 Third Avenue, Suite 1100
Seattle, WA 98104

[Signature pages follows]

Number of Shares: 1,142,857

Total Price: $4,000,000
($3.50 per Share)

Robert M. Arnold
Name as you would like it to appear on Stock Certificate

Indicate ownership as:

X	(a)	Individual	
____	(b)	Community Property	
____	(c)	Joint Tenants with Right of Survivorship	**) All parties**
____	(d)	Tenants in Common	**) must sign**
____	(e)	Corporate	
____	(f)	Partnership	
____	(g)	Trust	

1001 4th Ave Plaza, Ste 4710 Address of Residence (or Business, if not an individual)	Address for Sending Notices (if different)
Seattle, WA 98154 City, State and Zip Code	City, State and Zip Code
206.358.0334 Telephone Number	Telephone Number

The Investor is a resident of, or (in the case of an entity) is organized under the laws of, the State of Washington.

Investor's Taxpayer ID or Social Security No.: [redacted]

Citizen of: U.S.A.

E-mail Address: maureenschoen@msn.com

The Investor, by his or her signature below, or by that of its authorized representative, confirms that the Investor has carefully reviewed and understands this Subscription Agreement.

IN WITNESS WHEREOF, the Investor has executed this Subscription Agreement as of OCT 13, 2006.

INVESTOR (if individual):

Robert M Arnold.
Signature

RobertM. Arnold
Name (type or print)

Signature of Co-Signer (if any)

Name of Co-Signer (type or print)

INVESTOR (if entity):

Name of Entity

By: _____

Name: _____

Its: _____

AGREED AND ACCEPTED as of OCT 13, 2006.

MOD SYSTEMS INCORPORATED

By: _____
Mark Phillips, Chief Executive Officer

Exhibit A

Risk Factors

In addition to the information contained in other materials you have received regarding MOD Systems Incorporated, a Washington corporation (the "***Company***"), and the Company's common stock ("***Common Stock***"), the following factors should be considered carefully in evaluating the Company, our business and an investment in the Common Stock and, if applicable, warrants to purchase Common Stock ("***Warrants***"). **The Common Stock is highly speculative in nature, and investors in this offering face a substantial risk that they will lose all or part of their investments**. The following list of risk factors is a collection of the more serious risks known to the Company's management, but it does not purport to be an exhaustive catalog of all possible risks associated with an investment in the Company. **If any of the following risks were to occur, our business, financial condition and operating results would likely suffer.**

Risks Related to Our Operations

We have limited operating history, making it difficult for you to evaluate our business and your investment.

We were incorporated in April 2005, and have a limited history of operations. Our lack of significant operating history makes predicting our future performance and financial results, extremely difficult and does not provide investors with a meaningful basis for evaluating an investment in the Company. The Company has limited product and service offerings and has not generated any significant revenues to date. There can be no assurance that the Company will ever be able to achieve or sustain profitable operations or that it will ever generate revenues.

We have minimal revenues and a history of losses.

We have generated minimal revenues since inception. To achieve revenue growth and profitability, we must, among other things: (i) respond effectively to competitive developments, (ii) attract, retain and motivate qualified employees, and (iii) successfully launch our product offerings. There can be no assurance that our strategies will be successful or that we will experience increased revenues, become profitable or have positive cash flow at any time in the future.

Our success is dependent on a product or service which continues to be developed.

Because we have not yet fully developed all of our contemplated product and service offerings, we cannot assure you that we will be able to successfully develop such products or services, that such products or services will offer the features or functionality demanded by the market and our target customers, or that such products or services will be developed or made commercially available in a timely manner or ahead of competitors. We cannot assure you that our target customers will use our products or services or will pay for them at the price that we expect, or at a level that would provide the Company a reasonable level of profitability or any

profitability whatsoever.

The termination of our contract with Starbucks could have a material adverse effect on our business.

On June 2, 2006, the Company received a letter from Starbucks Corporation ("***Starbucks***") pursuant to which Starbucks alleged that the Company had breached its Development, Licenses and Services Agreement with Starbucks (the "***Starbucks Agreement***"). Such letter also stated that Starbucks was evaluating alternatives with regard to its rights under the Starbucks Agreement. As of October 6, 2006, Starbucks had not terminated, and we continue to perform under, such agreement. We intend to cooperate with Starbucks to find a mutually agreeable solution to the allegations raised in their letter. If we are unable to adequately resolve these issues, Starbucks could terminate the Starbucks Agreement and its strategic alliance with us, which could have a material adverse effect on our business. In addition, if the Starbucks Agreement is terminated, while we are hopeful that we will be able to arrange one or more favorable strategic alliances, there can be no assurance that we will be successful in establishing similar strategic alliances, that proposed products will be successfully commercialized under any alliance, or that we will derive any revenues from such arrangements. If strategic alliances fail to develop, our business, financial condition and results of operations would be materially and adversely affected.

Our success is highly dependent upon the widespread acceptance of our products, services and solutions.

As is typical of any new and rapidly evolving market, demand and market acceptance for products and services are subject to a high level of uncertainty and risk. Moreover, because the market for digital media delivery solutions is relatively new and rapidly evolving, it is difficult to predict its future growth rate, if any, and its ultimate size. If the market for our products or services fails to develop, develops more slowly than we expect or becomes saturated with competitors, or if our products or services do not achieve or sustain market acceptance, our financial condition would be materially and adversely affected.

Because we expect to derive substantially all of our future revenue from digital media delivery solutions, any failure by us to satisfy customer demands or to achieve more widespread market acceptance will seriously harm our business.

Our revenue projections are primarily based upon estimates of customer size and service needs. As a result, if for any reason revenues from our products and services do not grow as rapidly as we anticipate, our operating results and our business will be significantly impaired. If we fail to meet the needs of our target customers, or if our product or service does not compare favorably in price and performance to competing solutions, our growth will be limited. We cannot assure you that we will achieve market acceptance of our products or services.

Our financial projections are based upon assumptions and may not have any relation to our actual performance, future revenues or income.

Because any forecasted financial projections that we may provide are based on our estimates and are dependent on a number of assumptions, which we believe to be reasonable on

the basis of the limited information presently known to us, there can be no assurance that such projections or estimates will have any relation to our actual performance, future revenues or income. Further, these assumptions necessarily reflect matters of judgment and speculation; therefore, it is likely that our actual results of operations will vary from the forecasts provided, possibly to a significant degree.

A failure to protect our intellectual property could adversely affect our ability to compete effectively.

To protect our rights to our intellectual property, we intend to rely on a combination of patent, trademark and copyright law, trade secret protection, confidentiality agreements and other contractual arrangements with our employees, affiliates, clients, strategic partners and others. The protective steps we plan to take may be inadequate to deter misappropriation of our proprietary information. We may be unable to detect the unauthorized use of, or take appropriate steps to enforce, our intellectual property rights.

We plan to file patent and trademark applications, as we deem appropriate, to protect our proprietary technology and brand names. However, effective patent, trademark, copyright and trade secret protection may not be available to us or available in every country in which we offer or intend to offer our services. Failure to adequately protect our intellectual property could harm our brand, devalue our proprietary content and affect our ability to compete effectively. Further, defending our intellectual property rights could result in the expenditure of significant financial and managerial resources, which could materially adversely affect our business, results of operations and financial condition.

Defending against intellectual property infringement claims could be very expensive for us, which could harm our business and financial condition.

Although we intend to conduct our business in such a way that our proprietary rights will not infringe on the intellectual property rights of others, other parties may assert infringement claims against us or claims that we have violated a patent or infringed a copyright, trademark or other proprietary right belonging to them. Since the industry in which we operate is a relatively new area, there may be patent applications on file that we are unaware of and that would interfere with our ability to pursue our contemplated business or develop and sell our contemplated products and services. We may find it necessary to license third-party intellectual property for some of our products or services. There is no assurance that licenses needed to execute our contemplated business will be available to us, or on terms that are reasonable or do not adversely impact our business. We cannot assure you that our efforts to avoid infringement of the intellectual property rights of others will be adequate to protect us from infringement claims. Any infringement claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources on our part, which could materially adversely affect our business, results of operations and financial condition.

We are heavily dependent on the services of certain key personnel and we have an incomplete management team.

Our future success depends to a significant degree on the continued service of certain key

personnel. Our success also depends on certain personnel yet to be hired. Loss of their services, or failure to recruit appropriate business and technical personnel or consultants, would be significantly detrimental to our prospects. The loss of their services could also have a material adverse effect on our business, financial condition, and results of operations. We anticipate that we will need to add additional personnel with technical and management skills in the near future as we pursue the growth of our business. There is intense competition for highly qualified personnel in the area of our business. Accordingly, there can be no assurance that we, as a thinly capitalized early-stage organization, will be able to attract or retain the qualified personnel necessary for the development of our business.

Risks Related to this Offering

We are thinly capitalized and you are likely to experience substantial dilution from future offerings and from option grants given to our employees and consultants.

There can be no assurance that we will be successful in raising adequate amounts of capital on reasonable or acceptable terms. The additional amounts needed will vary depending upon the particular strategies adopted. It is impossible for us to estimate at this time what amounts of additional capital may be required in the future, or what valuations and per-share pricing might be attainable in future financings. If we cannot find adequate capital on reasonable terms, you will face a significant risk of losing your investment in its entirety.

You will likely experience a dilution in your ownership percentage of our securities resulting from additional rounds of financing and from future grants of stock options to attract and retain our key employees and consultants. Further, due to uncertain future staffing levels, it is impossible to estimate how much more of our equity might be eventually set aside for future grants to such key employees and consultants. Finally, if we should be unable to obtain additional capital in future financings, we would not have sufficient funds to continue development and testing of our products and services and may be forced to cease operations because it is unlikely that we will become cash flow profitable with the funds raised in this offering.

Our principal members and management will continue to exert a substantial amount of control in the operation of our business.

As of October 6, 2006, Mark Phillips and Anthony Bay own approximately 97.2% of our outstanding capital stock, with Mr. Phillips owning over a majority of such capital stock. Their holdings will have the effect of giving them a substantial degree of control of the Company for an indefinite period of time. They will be able to significantly influence or control the election of the members of our Board of Directors and significantly influence or control the outcome of corporate actions requiring member approval, such as mergers, acquisitions, or sale of all or substantially all of our assets. No investment in the Company should be made unless the investor is willing to entrust all aspects of our management and operations to Mark Phillips and Anthony Bay.

Potential Conflicts of Interest and Related Investments.

Mr. Phillips has an equity stake in each of A Dot Corporation ("***Dot***") and Hello Twice Corporation ("***HT***"). Mr. Phillips and Kenn Gordon, who is an executive officer of the Company, are also significantly involved in the operations and management of these two entities. HT is currently involved in discussions concerning a strategic transaction. Moreover, many of the employees of the Company may provide consulting services to HT in the near future. The operations and activities of each of HT and/or Dot may distract from Mr. Phillips, Mr. Gordon and/or the Company's employees' attention, which may hinder the Company's success.

We are currently contemplating entering into a transaction with Mr. Phillips pursuant to which Mr. Phillips would transfer or license to us certain assets received by Mr. Phillips as part of the bankruptcy of FullPlay, Inc. in exchange for additional shares of our capital stock. The Company, at the direction of Anthony Bay, our Chairman of the Board, and Mr. Phillips have not (i) completed discussions, (ii) identified all of the proposed affected assets or (iii) determined the number or type of equity securities that may be issued to Mr. Phillips in connection with such transaction. If such transaction is completed, you may experience dilution in your ownership percentage of the Company.

There is no public market for our capital stock.

There is no public market for our capital stock, and the shares of Common Stock have not been registered under the Securities Act or any state securities laws. Furthermore, we cannot assure you that a public market for our securities will ever develop at any time in the future. Other sources of possible liquidity for investors may include a sale of the Company, or the purchase of securities by the Company or one of our investors, but there is likewise no certainty whether or when any such liquidity might be created. Accordingly, our securities should only be purchased as a long-term investment as security holders may not be able to liquidate their investments promptly in the event of an emergency or for any other reason.

DUE TO THESE FACTORS, AND OTHERS DESCRIBED ELSEWHERE OR NOT PRESENTLY FORESEEN, THE PURCHASE OF THE SHARES OF COMMON STOCK AND WARRANTS OFFERED HEREBY INVOLVES AN EXTREME DEGREE OF RISK. THE SHARES OF COMMON STOCK AND WARRANTS SHOULD ONLY BE PURCHASED BY INVESTORS WHO CAN AFFORD TO SUSTAIN A TOTAL LOSS OF THEIR INVESTMENT AND WHO HAVE NO NEED FOR LIQUIDITY WITH RESPECT TO THIS INVESTMENT.

Exhibit B

Form of Warrant

Exhibit C

Schedule of Exceptions

This Schedule of Exceptions is made and given pursuant to Section 4 of the attached Subscription Agreement by and between MOD Systems Incorporated, a Washington corporation (the "***Company***"), and a purchaser of the Company's Common Stock (the "***Agreement***"). Any terms defined in the Agreement shall have the same meaning when used in this Schedule of Exception as when used in the Agreement unless the context otherwise requires.

The section numbers in this Schedule of Exceptions correspond to the section numbers in the Agreement; however, any information disclosed herein under any Schedule number shall be deemed to be disclosed and incorporated into any other section number under the Agreement where such disclosure would be appropriate and where the purpose of disclosure in another section is readily apparent on the face of the disclosure.

Certain information set forth herein is included solely for informational purposes and may not be required to be disclosed pursuant to the Agreement. The disclosure of any information herein shall not be deemed to constitute an acknowledgment that such information is required to be disclosed in connection with the representations and warranties made by the Company in the Agreement and shall not create any covenant on the part of the Company in addition to the covenants and obligations under the Agreement. Inclusion of any item in any section herein (1) does not represent a determination by the Company that such item (a) is material (nor shall it be deemed to establish a standard of materiality) or (b) did not arise in the ordinary course of business, and (2) shall not constitute, or be deemed to be, an admission to any third party concerning such item by the Company.

Section 4.2 – Capitalization:

The Company is currently negotiating a consulting arrangement with an individual who would also join the Company's Board of Directors (the "***Board***") as Vice-Chairman. Under the proposed terms of this arrangement, such individual would receive options to purchase Common Stock of the Company ("***Common Stock***") representing 6% of the fully diluted capital stock of the Company as of the date of the grant. One-half of such options would vest monthly over three years until such consulting arrangement has been terminated. The remaining one-half of such options would vest upon the achievement of certain milestones to be determined by such individual and the Company. The Company expects such negotiations to be completed by October 31, 2006.

The Company is currently contemplating entering into a transaction with Mr. Phillips, the Company's majority shareholder, Chief Executive Officer and member of the Board, pursuant to which Mr. Phillips would transfer or license to the Company certain assets received by Mr. Phillips as part of the bankruptcy of FullPlay, Inc. in exchange for additional shares of capital stock of the Company. The Company, at the direction of Anthony Bay, the Company's

Chairman of the Board and independent director, and Mr. Phillips have not (i) completed discussions, (ii) identified all of the proposed affected assets or (iii) determined the number or type of equity securities that may be issued to Mr. Phillips in connection with such transaction.

Section 4.4 – Litigation:

On June 2, 2006, the Company received a letter from Starbucks Corporation ("***Starbucks***") pursuant to which Starbucks alleged that the Company had breached its Development, Licenses and Services Agreement with Starbucks (the "***Starbucks Agreement***"). Such letter also stated that Starbucks was evaluating alternatives with regard to its rights under the Starbucks Agreement. As of October 6, 2006, Starbucks had not terminated, and the Company continues to perform under, such agreement. The Company intend to cooperate with Starbucks to find a mutually agreeable solution to the allegations raised in such letter.

FIRST AMENDMENT TO SUBSCRIPTION AGREEMENT

This First Amendment to Subscription Agreement, dated as of October 9, 2006 (this "***First Amendment***"), amends that certain Subscription Agreement dated May 27, 2006 (the "***Purchase Agreement***"), by and between MOD Systems Incorporated, a Washington corporation (the "***Company***"), and the undersigned (the "***Investor***"). Capitalized terms not otherwise defined herein will have the meanings set forth in the Purchase Agreement.

RECITALS

A. The Company was previously authorized to sell and issue up to 1,428,571 shares of Common Stock (the "***Shares***") at a price of $3.50 per share, and to issue to the first subscriber of at least 142,857 shares of Common Stock in such offering a warrant to purchase 20,000 shares of Common Stock (the "***Common Stock Offering***"). The Investor purchased 285,714 shares of Common Stock pursuant to the Purchase Agreement.

B. Pursuant to the Purchase Agreement, the Company was authorized to sell, at any time prior to July 15, 2006 (the "***Offering Deadline***"), up to the balance of the authorized Shares not sold prior to the Offering Deadline.

C. In order to induce additional investors to purchase Shares, the Company has determined it is in the best interest of the Company and its shareholders to extend the Offering Deadline to November 1, 2006, and the Company and the Investor desire to amend the Purchase Agreement to reflect this change in the terms of the Common Stock Offering.

AGREEMENT

NOW, THEREFORE, the parties hereby agree as follows:

1. Section 1.2 of the Purchase Agreement is hereby amended and restated in its entirety to read as follows:

> "1.2 **Offering Size and Duration.** The Company intends to raise up to $5,000,000 in this offering, and reserves the right, in its sole discretion, to increase or decrease the size of this offering. This offering shall terminate on November 1, 2006, unless earlier terminated by the Board of Directors of the Company."

2. Except as amended hereby, the Purchase Agreement shall remain in full force and effect.

3. This First Amendment may be executed in any number of counterparts, each of which, when so executed and delivered, will be deemed an original, and all such counterparts together will constitute one and the same instrument.

IN WITNESS WHEREOF, the Investor has executed this First Amendment as of the date set forth above.

INVESTOR:

Robert M. Arnold
Signature

Robert Arnold
Name (type or print)

Signature of Co-Signer (if any)

Name of Co-Signer (type or print)

COMPANY:

MOD SYSTEMS INCORPORATED

By: _____

Name: _____

Its: CEO

EXHIBIT “B”

BANANA CORPORATION

SUBSCRIPTION AGREEMENT

$5,000,000

COMMON STOCK OFFERING

Banana Corporation
720 Third Avenue, Suite 1100
Seattle, WA 98104
Attn: Mark Phillips, Chief Executive Officer
Email: markp@modsystems.com

INSTRUCTIONS FOR INVESTING

If you wish to purchase shares of Common Stock of Banana Corporation and, if applicable, related warrants, please:

(1) Complete the Subscription Agreement by initialing the appropriate space(s) on **page 7** and by providing the information requested on **pages 9 and 10**;

(2) Sign and date your completed Subscription Agreement; and

(3) Deliver your completed Subscription Agreement and your check made payable to "Banana Corporation" to Mark Phillips or mail them to:

Banana Corporation
720 Third Avenue, Suite 1100
Seattle, WA 98104
Attn: Mark Phillips, Chief Executive Officer

* * * * *

When the Company has accepted your Subscription Agreement, an officer will sign it and return a copy to you, together with a stock certificate representing your shares and, if applicable, a warrant representing your right to purchase shares of common stock of the Company described herein.

If you have any questions in completing the Subscription Agreement, please call Mark Phillips at (206) 973-1099.

YOU SHOULD CAREFULLY REVIEW THIS SUBSCRIPTION AGREEMENT AND PARTICULARLY THE RISK FACTORS DESCRIBED IN ATTACHED EXHIBIT A.

SUBSCRIPTION AGREEMENT

This Subscription Agreement (this "***Agreement***") is made by and between Banana Corporation, a Washington corporation (the "***Company***"), and the undersigned (the "***Investor***"), who hereby subscribes for the number of shares of the Company's Common Stock ("***Common Stock***") set forth below (the "***Shares***").

In consideration of the Company's agreement to sell the Shares to the Investor upon the following terms and conditions, the Investor hereby agrees, represents and warrants as follows:

Section 1
Subscription

1.1 **Purchase of Shares; Minimum Investment; Warrants.**

(a) The Investor subscribes for the number of Shares set forth on the signature page below at a price of $0.60 per Share. The Investor understands that the minimum investment that will be accepted by the Company in this offering is $250,000. The Company's Board of Directors, in its sole discretion, may reduce this amount for certain otherwise qualified investors.

(b) As part of this offering, any subscriber who has his, hers or its subscription accepted by the Company and purchases at least; a) 833,333 shares of Common Stock pursuant to this offering shall receive a warrant to purchase 83,333 shares of Common Stock, or; b) 1,666,667 shares of Common Stock pursuant to this offering shall receive a warrant to purchase 250,000 shares of Common Stock, in substantially the form of attached Exhibit B (a "***Warrant***").

(c) With this Agreement, the Investor encloses a check payable to the order of Banana Corporation in full payment for the Shares.

1.2 **Offering Size and Duration.** The Company intends to raise up to $5,000,000 in this offering, and reserves the right, in its sole discretion, to increase or decrease the size of this offering. This offering shall terminate on July 15, 2006, unless earlier terminated by the Board of Directors of the Company.

1.3 **Documents Provided to the Investor.** The Investor acknowledges that the Company has made available to the Investor (i) a copy of the Company's Articles of Incorporation, as amended through the date hereof (the "***Articles***"); (ii) a copy of the Company's Confidential Business Plan dated June 16, 2006; and (iii) the Risk Factors, in the form of attached Exhibit A.

1.4 **Acknowledgements by the Investor.** The Investor understands and acknowledges that:

(a) The Company may accept or reject this Agreement, in whole or in part, in its sole and absolute discretion.

(b) This Agreement is and shall be irrevocable except that the Investor shall have no obligations hereunder, other than those set forth in Section 1.5, in the event this Agreement is rejected by the Company. This Agreement and the rights, powers and duties set forth herein shall be binding upon the Investor, the Investor's heirs, estate, legal representatives, successors and assigns and shall inure to the benefit of the Company, its successors and assigns.

(c) Checks received from the Investor will be immediately available to the Company upon acceptance of this Agreement by the Company. The Investor's funds will not be subject to escrow pending receipt of a minimum amount. Failure of the Company to obtain sufficient subscriptions for Shares may jeopardize the Company's ability to meet its objectives.

(d) No federal or state agency has made any finding or determination as to the fairness of this offering for investment, or any recommendation or endorsement of the Securities (as defined below).

(e) Because there is no public market for the Company's capital stock, the offering price for the Shares was determined by the Company arbitrarily and does not bear any relationship whatsoever to the Company's assets, book value, shareholders' equity, net worth or any other established criteria of value.

(f) Because no public market for the Shares or other securities of the Company is expected to develop, the economic risk of the investment must be borne indefinitely by the Investor.

(g) The Company may, in the future, raise additional amounts through the sale of securities with a price less than, and rights superior to, those offered to the Investor.

(h) No assignment, sale, transfer, exchange or other disposition of the Securities can be made except in accordance with transfer restrictions described in this Agreement and in accordance with applicable law.

(i) The Company has relied upon the information set forth in this Agreement to qualify for exemptions from federal and state securities registration requirements.

1.5 **Confidential Nature of Information.** The information provided to the Investor regarding the Company is confidential and non-public, and the Investor agrees that all of the information will be kept in confidence by the Investor and neither used to the Investor's personal benefit (other than in connection with the Investor's investment decision) nor disclosed to any third party; provided, that this obligation does not apply to any such information that: (i) is part of the public knowledge or literature and is readily accessible as of the date of this Agreement; (ii) becomes part of the public knowledge or literature and, hence, readily accessible by publication; or (iii) is received from third parties and that the Investor does not reasonably believe (a) to be confidential information or (b) to have been disclosed in violation of such third parties' duties of confidentiality they owe the Company. The Investor agrees to promptly return all materials containing Company confidential information, and copies of such materials in whatever medium, in the event that the Company rejects this Agreement.

1.6 **Investor Responsibility for Due Diligence Investigation.** The Investor acknowledges that Investor must rely upon Investor's own examination of the Company, and the terms of this offering, including the merits and risks involved in making an investment decision regarding the Securities. The Company is solely responsible for the content of any statements made to the Investor with respect to the business of the Company, its management or its financial condition or the terms of this offering. The Company has not received from its legal counsel, accountants or professional advisors any independent valuation of the Company or any of its capital stock, or any opinion as to the fairness of the terms of this offering or the adequacy of disclosure of materials pertaining to the Company or the offering. Consequently, the Company's legal counsel or other professional advisors should not be looked to for any assurance that there have not been material omissions or misstatements in the offer and sale of the Securities or that the interests of investors have been adequately taken into account in the structure or terms of this offering.

1.7 **Investor Indemnification of the Company.** The Investor hereby agrees to indemnify and hold the Company harmless from any and all liabilities or damages incurred by the Company arising as a result of any false statement or misrepresentation made by the Investor in this Agreement including, but not limited to, liabilities or damages incurred in connection with the loss of exemptions from securities registration requirements.

1.8 **"Market Stand-Off" Agreement.** The Investor hereby agrees that Investor shall not, to the extent requested by the Company or an underwriter of securities of the Company, sell or otherwise transfer or dispose of or engage in any other transaction regarding any Shares or other shares of capital stock of the Company then owned by the Investor for up to one hundred eighty (180) days following the effective date of a registration statement of the Company filed under the Securities Act of 1933, as amended (the "***Securities Act***"), or such longer period (not to exceed 18 days) after the expiration of the 180-day period, as the underwriters of the Company shall request in order to facilitate compliance with NASD Rule 2711. The Investor hereby agrees to enter into a separate agreement with respect to the subject matter of this Section 1.8 if so requested.

Section 2
Risk Factors

In addition to the information contained in this Agreement, the risk factors described on the attached Exhibit A should be considered carefully in evaluating the Company, its business and an investment in the Shares, the Warrant and the shares of Common Stock issuable upon exercise of the Warrants, if applicable (collectively, the "***Securities***"). The Investor is aware that the Company is a start-up stage enterprise with a limited operating history in a highly competitive market. **The Securities are highly speculative in nature, and investors in this offering face a substantial risk that they will lose all or part of their investments, or that their investments will generate an inadequate return.** The list of risk factors described on the attached Exhibit A represent management's view of the principal risks facing the Company as of June 19, 2006. This list does not purport to be an exhaustive catalog of all possible risks associated with an investment in the Company.

Section 3
Investor Representations and Warranties

The Investor hereby agrees, represents and warrants as follows:

3.1 **Availability of Information.** The Company has made available to the Investor, or to the Investor's attorney, accountant or representative, all documents that the Investor has requested, and the Investor has requested all documents and other information that the Investor has deemed necessary to consider respecting an investment in the Company. The Company has provided answers to all questions concerning the offering and an investment in the Company. The Investor has carefully considered and has, to the extent the Investor believes necessary, discussed with the Investor's professional legal, tax and financial advisers and Investor's representative (if any) the suitability of an investment in the Company for the Investor's particular tax and financial situation. All information the Investor has provided to the Company concerning the Investor and the Investor's financial position is correct and complete as of the date set forth below, and if there should be any material adverse change in such information prior to the acceptance of this Agreement by the Company, the Investor will immediately provide such information to the Company. The Investor acknowledges that it has received all information that the Investor has requested regarding the current and proposed relationship between the Company, A Dot Corporation and Hello Twice Corporation, including the contractual relationships, the overlap of management, and the sharing of resources among such entities. The Company has provided answers to all questions concerning the relationships among the Company and such other entities.

3.2 **Securities Restricted.**

(a) The Investor knows that the Securities have not been registered under either federal or state securities laws, and the Investor represents and warrants that the Investor is purchasing the Securities for investment for Investor's own account and not on behalf of any other person, nor with a view to, or for resale or other distribution of, the Securities.

(b) The Investor also understands that the Company is under no obligation and has no intention to register the Securities or to take any actions to make available exemptions from the registration requirements of state and federal securities laws, and that the Securities cannot be sold or otherwise distributed in the absence of an exemption from such registration requirements.

(c) The Investor also understands that the Securities may be transferred only on one of the following conditions: (i) the Securities have been made subject to effective registration under the Securities Act and any applicable state securities laws; (ii) the Company has received an opinion of counsel from the Investor satisfactory to the Company that the Securities may be transferred without registration under the Securities Act or such laws; or (iii) the Securities and Exchange Commission and any applicable state securities regulatory agency have issued in respect to such transfer a "no action" letter or equivalent interpretive opinion.

(d) The Investor also consents to the placement of a legend on all certificates representing the Securities in substantially the following form:

> **The securities represented by this certificate have not been registered under the Securities Act of 1933, as amended, or any state securities laws, and may not be offered, sold, transferred, encumbered, or otherwise disposed of except upon satisfaction of certain conditions. Information concerning these restrictions may be obtained from the corporation or its legal counsel. Any offer or disposition of these securities without satisfaction of said conditions will be wrongful and will not entitle the transferee to register ownership of the securities with the corporation.**

3.3 **Investment in Not Readily Marketable Securities Not Disproportionate.** The Investor's overall commitment to investments that are not readily marketable is not disproportionate to the Investor's net worth. The Investor's investment in the Securities will not cause such overall commitment to become excessive.

3.4 **Adequate Net Worth.** The Investor has adequate net worth and means of providing for the Investor's current needs and personal contingencies to sustain a complete loss of the investment in the Company at the time of investment, and the Investor has no need for liquidity in the investment in the Securities.

Section 4
Company Representations and Warranties

The Company hereby represents and warrants that, except as set forth in the Schedule of Exceptions, as of June 19, 2006:

4.1 **Organization and Qualification.** The Company is a corporation duly incorporated and validly existing under the laws of the State of Washington.

4.2 **Capitalization.** The capitalization of the Company consists of the following:

(a) **Common Stock.** A total of 100,000,000 authorized shares of Common Stock, 50,000,000 shares of which are issued and outstanding

(b) **Preferred Stock.** A total of 5,000,000 authorized shares of preferred stock of the Company, none of which are issued and outstanding.

(c) **Options, Warrants, Reserved Shares.** There are no options, warrants, rights (including conversion or preemptive rights) or agreements for the purchase or acquisition from the Company of any shares of its capital stock or any securities convertible into or ultimately exchangeable or exercisable for any shares of the Company's capital stock.

4.3 **Due Authorization.** All corporate action on the part of the Company, its officers, directors and shareholders necessary for the authorization, execution, delivery of, and the

performance of all obligations of the Company under, this Agreement, and the authorization, issuance, reservation and delivery of the Warrants, if applicable, and all of the Shares being sold under this Agreement has been taken, and this Agreement, when executed by the Company, will constitute, valid and legally binding obligations of the Company, enforceable in accordance with their respective terms, except as may be limited by (i) applicable bankruptcy, insolvency, reorganization or others laws of general application relating to or affecting the enforcement of creditors' rights generally and (ii) the effect of rules of law governing the availability of equitable remedies.

4.4 **Litigation.** There is no action, suit, proceeding, claim, arbitration or investigation ("***Action***") pending, or, to the Company's knowledge, currently threatened against the Company or, to the Company's knowledge, against any officer, director or employee of the Company in connection with such officer's, director's or employee's relationship with, or actions taken on behalf of, the Company. The Company is not a party to or subject to the provisions of any order, writ, injunction, judgment or decree of any court or government agency or instrumentality and there is no Action by the Company currently pending or that the Company currently intends to initiate.

4.5 **Compliance with Law and Charter Documents.** The Company is not in violation or default of any provisions of the Articles or its Bylaws, and, to the Company's knowledge, except for any violations that individually and in the aggregate would have no material adverse impact on the Company's business, financial condition or results of operations, the Company is in compliance with all applicable statutes, laws, regulations and executive orders of the United States of America and all states, foreign countries or other governmental bodies and agencies having jurisdiction over the Company's business or properties.

4.6 **Regulation D.** The Company will timely file a Notice of Sale of Securities on Form D with federal and, to the extent necessary or applicable, state securities regulators indicating the Company's reliance upon the exemption from registration provided by Rule 506 of Regulation D promulgated under the Securities Act ("***Regulation D***"). The Company has not taken any action that would preclude reliance upon such exemption, including any general solicitation under Section 502(c) of Regulation D. In making the foregoing representation, Investor acknowledges that the Company has relied upon the Investor's representations and warranties set forth in this Subscription Agreement to qualify for such exemptions from registration.

Section 5
Status as an Accredited Investor

By initialing the appropriate space(s) below, the Investor represents and warrants that Investor is an "***Accredited Investor***" within the meaning of Regulation D. The Investor is an Accredited Investor, if he, she or it is:

_____ (a) A director or executive officer of the Company;

_X_ (b) A natural person whose individual income exceeded $200,000 in each of the past two years, or whose joint income with spouse exceeded $300,000 in each

of those years, and who reasonably expects to receive at least the same level of income in the current year;

X (c) A natural person whose individual net worth, or joint net worth with his or her spouse, exceeds $1,000,000, and whose net worth will exceed $1,000,000 on the date of the Company's acceptance of this Agreement;

_____ (d) An organization or entity consisting solely of natural persons who meet the requirements specified in (a), (b) or (c) above;

_____ (e) A trust, corporation or partnership with total assets in excess of $5,000,000 not formed for the specific purpose of acquiring the Shares;

_____ (f) Investor is another type of "accredited investor" as that term is defined in Regulation D, namely _____.

INVESTOR MUST INDICATE THE APPLICABLE CATEGORY OR CATEGORIES BY INITIALING EACH APPLICABLE SPACE ABOVE; IF JOINT INVESTORS, BOTH PARTIES MUST INITIAL.

Section 6
Miscellaneous

6.1 **Governing Law; Venue.** The parties agree that this Agreement, and any disputes arising under this Agreement, will be governed by and construed in accordance with the laws of the state of Washington, without giving effect to any conflict of laws principle to the contrary. The parties agree that venue for any dispute arising under this Agreement will lie exclusively in the state or federal courts located in King County, Washington, and the parties irrevocably waive any right to raise *forum non conveniens* or any other argument that King County, Washington is not the proper venue. The parties irrevocably consent to personal jurisdiction in the state and federal courts of the state of Washington.

6.2 **Consent to Electronic Notice.** In the interests of speed, convenience and minimizing expenses, the Investor understands that the Company would prefer to use email as its principal method of communication with its shareholders. The Washington Business Corporation Act permits use of email for notices to shareholders if a shareholder agrees. By providing its preferred email address in the space set forth below, the Investor hereby agrees that email notices for all Company notices and mailings are acceptable. If no email address is provided below, the Company will continue to use the Investor's street address for all such notices and mailings.

6.3 **Company's Address.** An Investor completing and executing this Agreement should deliver it, together with a check in the amount of the Investor's subscription, to "Banana Corporation," or mail them to Mark Phillips at:

720 Third Avenue, Suite 1100
Seattle, WA 98104

[Signature pages follows]

Number of Shares: 8,333,333

Total Price: $5,000,000
($0.60 per Share)

Robert M. Arnold
Name as you would like it to appear on Stock Certificate

Indicate ownership as:

X	(a)	Individual	
____	(b)	Community Property	
____	(c)	Joint Tenants with Right of Survivorship	) **All parties**
____	(d)	Tenants in Common	) **must sign**
____	(e)	Corporate	
____	(f)	Partnership	
____	(g)	Trust	

1001 4th Ave Plaza, Ste 4710
Address of Residence
(or Business, if not an individual)

Address for Sending Notices
(if different)

Seattle, WA 98154
City, State and Zip Code

City, State and Zip Code

206.358.0334
Telephone Number

Telephone Number

The Investor is a resident of, or (in the case of an entity) is organized under the laws of, the State of Washington.

Investor's Taxpayer ID or Social Security No.: [redacted]

Citizen of: U.S.A.

E-mail Address: maureenschoen@msn.com

The Investor, by his or her signature below, or by that of its authorized representative, confirms that the Investor has carefully reviewed and understands this Subscription Agreement.

IN WITNESS WHEREOF, the Investor has executed this Subscription Agreement as of 7/7, 2006.

INVESTOR (if individual):

Robert M Arnold
Signature

Robert M. Arnold
Name (type or print)

Signature of Co-Signer (if any)

Name of Co-Signer (type or print)

INVESTOR (if entity):

Name of Entity

By: _____

Name: _____

Its: _____

AGREED AND ACCEPTED as of 7/7, 2006.

BANANA CORPORATION

By: Mark Phillips
Mark Phillips, Chief Executive Officer

Exhibit A

Risk Factors

In addition to the information contained in other materials you have received regarding Banana Corporation, a Washington corporation (the "***Company***"), and the Company's common stock ("***Common Stock***"), the following factors should be considered carefully in evaluating the Company, our business and an investment in the Common Stock and, if applicable, warrants to purchase Common Stock ("***Warrants***"). **The Common Stock is highly speculative in nature, and investors in this offering face a substantial risk that they will lose all or part of their investments**. The following list of risk factors is a collection of the more serious risks known to the Company's management, but it does not purport to be an exhaustive catalog of all possible risks associated with an investment in the Company. **If any of the following risks were to occur, our business, financial condition and operating results would likely suffer.**

Risks Related to Our Operations

We have limited operating history, making it difficult for you to evaluate our business and your investment.

We were incorporated in June 2006, and have a limited history of operations. Our lack of significant operating history makes predicting our future performance and financial results, extremely difficult and does not provide investors with a meaningful basis for evaluating an investment in the Company. The Company has limited product and service offerings and has not generated any revenues to date. There can be no assurance that the Company will ever be able to achieve or sustain profitable operations or that it will ever generate revenues.

We have no revenues and a history of losses.

We have generated no revenues since inception. To achieve revenue growth and profitability, we must, among other things: (i) respond effectively to competitive developments, (ii) attract, retain and motivate qualified employees, and (iii) successfully launch our product offerings. There can be no assurance that our strategies will be successful or that we will experience increased revenues, become profitable or have positive cash flow at any time in the future.

Our success is dependent on a product or service which continues to be developed.

Because we have not yet fully developed all of our contemplated product and service offerings, we cannot assure you that we will be able to successfully develop such products or services, that such products or services will offer the features or functionality demanded by the market and our target customers, or that such products or services will be developed or made commercially available in a timely manner or ahead of competitors. We cannot assure you that our target customers will use our products or services or will pay for them at the price that we expect, or at a level that would provide the Company a reasonable level of profitability or any profitability whatsoever.

Our success is highly dependent upon the widespread acceptance of our products, services and solutions.

As is typical of any new and rapidly evolving market, demand and market acceptance for products and services are subject to a high level of uncertainty and risk. Moreover, because the market for software and hardware is relatively new and rapidly evolving, it is difficult to predict its future growth rate, if any, and its ultimate size. If the market for our products or services fails to develop, develops more slowly than we expect or becomes saturated with competitors, or if our products or services do not achieve or sustain market acceptance, our financial condition would be materially and adversely affected.

Because we expect to derive substantially all of our future revenue from software and hardware, any failure by us to satisfy customer demands or to achieve more widespread market acceptance will seriously harm our business.

Our revenue projections are primarily based upon estimates of customer size and service needs. As a result, if for any reason revenues from our products and services do not grow as rapidly as we anticipate, our operating results and our business will be significantly impaired. If we fail to meet the needs of our target customers, or if our product or service does not compare favorably in price and performance to competing solutions, our growth will be limited. We cannot assure you that we will achieve market acceptance of our products or services.

Our financial projections are based upon assumptions and may not have any relation to our actual performance, future revenues or income.

Because any forecasted financial projections that we may provide are based on our estimates and are dependent on a number of assumptions, which we believe to be reasonable on the basis of the limited information presently known to us, there can be no assurance that such projections or estimates will have any relation to our actual performance, future revenues or income. Further, these assumptions necessarily reflect matters of judgment and speculation; therefore, it is likely that our actual results of operations will vary from the forecasts provided, possibly to a significant degree.

A failure to protect our intellectual property could adversely affect our ability to compete effectively.

To protect our rights to our intellectual property, we intend to rely on a combination of patent, trademark and copyright law, trade secret protection, confidentiality agreements and other contractual arrangements with our employees, affiliates, clients, strategic partners and others. The protective steps we plan to take may be inadequate to deter misappropriation of our proprietary information. We may be unable to detect the unauthorized use of, or take appropriate steps to enforce, our intellectual property rights.

We plan to file patent and trademark applications, as we deem appropriate, to protect our proprietary technology and brand names. However, effective patent, trademark, copyright and trade secret protection may not be available to us or available in every country in which we offer or intend to offer our services. Failure to adequately protect our intellectual property could harm our brand, devalue our proprietary content and affect our ability to compete effectively. Further,

defending our intellectual property rights could result in the expenditure of significant financial and managerial resources, which could materially adversely affect our business, results of operations and financial condition.

Defending against intellectual property infringement claims could be very expensive for us, which could harm our business and financial condition.

Although we intend to conduct our business in such a way that our proprietary rights will not infringe on the intellectual property rights of others, other parties may assert infringement claims against us or claims that we have violated a patent or infringed a copyright, trademark or other proprietary right belonging to them. Since the industry in which we operate is a relatively new area, there may be patent applications on file that we are unaware of and that would interfere with our ability to pursue our contemplated business or develop and sell our contemplated products and services. We may find it necessary to license third-party intellectual property for some of our products or services. There is no assurance that licenses needed to execute our contemplated business will be available to us, or on terms that are reasonable or do not adversely impact our business. We cannot assure you that our efforts to avoid infringement of the intellectual property rights of others will be adequate to protect us from infringement claims. Any infringement claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources on our part, which could materially adversely affect our business, results of operations and financial condition.

We are heavily dependent on the services of certain key personnel and we have an incomplete management team.

Our future success depends to a significant degree on the continued service of certain key personnel. Our success also depends on certain personnel yet to be hired. Loss of their services, or failure to recruit appropriate business and technical personnel or consultants, would be significantly detrimental to our prospects. The loss of their services could also have a material adverse effect on our business, financial condition, and results of operations. We anticipate that we will need to add additional personnel with technical and management skills in the near future as we pursue the growth of our business. There is intense competition for highly qualified personnel in the area of our business. Accordingly, there can be no assurance that we, as a thinly capitalized early-stage organization, will be able to attract or retain the qualified personnel necessary for the development of our business.

Risks Related to this Offering

We are thinly capitalized and you are likely to experience substantial dilution from future offerings and from option grants given to our employees and consultants.

There can be no assurance that we will be successful in raising adequate amounts of capital on reasonable or acceptable terms. The additional amounts needed will vary depending upon the particular strategies adopted. It is impossible for us to estimate at this time what amounts of additional capital may be required in the future, or what valuations and per-share pricing might be attainable in future financings. If we cannot find adequate capital on reasonable terms, you will face a significant risk of losing your investment in its entirety.

You will likely experience a dilution in your ownership percentage of our securities resulting from additional rounds of financing and from future grants of stock options to attract and retain our key employees and consultants. Further, due to uncertain future staffing levels, it is impossible to estimate how much more of our equity might be eventually set aside for future grants to such key employees and consultants. Finally, if we should be unable to obtain additional capital in future financings, we would not have sufficient funds to continue development and testing of our products and services and may be forced to cease operations because it is unlikely that we will become cash flow profitable with the funds raised in this offering.

Our principal members and management will continue to exert a substantial amount of control in the operation of our business.

As of June 19, 2006, Mark Phillips owns all of our outstanding capital stock. His holdings will have the effect of giving him a substantial degree of control of the Company for an indefinite period of time. He will be able to significantly influence or control the election of the members of our Board of Directors and significantly influence or control the outcome of corporate actions requiring member approval, such as mergers, acquisitions, or sale of all or substantially all of our assets. No investment in the Company should be made unless the investor is willing to entrust all aspects of our management and operations to Mark Phillips.

Potential Conflicts of Interest and Related Investments.

Mr. Phillips has an equity stake in each of A Dot Corporation ("***Dot***") and MOD Systems Incorporated ("MOD"). Mr. Phillips, who is an executive officer of the Company, is also significantly involved in the operations and management of these two entities. MOD is currently involved in discussions concerning a strategic transaction. Moreover, many of the employees of the Company may provide consulting services to MOD in the near future. The operations and activities of each of MOD and/or Dot may distract from Mr. Phillips and/or the Company's employees' attention, which may hinder the Company's success.

There is no public market for our capital stock.

There is no public market for our capital stock, and the shares of Common Stock have not been registered under the Securities Act or any state securities laws. Furthermore, we cannot assure you that a public market for our securities will ever develop at any time in the future. Other sources of possible liquidity for investors may include a sale of the Company, or the purchase of securities by the Company or one of our investors, but there is likewise no certainty whether or when any such liquidity might be created. Accordingly, our securities should only be purchased as a long-term investment as security holders may not be able to liquidate their investments promptly in the event of an emergency or for any other reason.

DUE TO THESE FACTORS, AND OTHERS DESCRIBED ELSEWHERE OR NOT PRESENTLY FORESEEN, THE PURCHASE OF THE SHARES OF COMMON STOCK AND WARRANTS OFFERED HEREBY INVOLVES AN EXTREME DEGREE OF RISK. THE SHARES OF COMMON STOCK AND WARRANTS SHOULD ONLY BE PURCHASED BY INVESTORS WHO CAN AFFORD TO SUSTAIN A TOTAL LOSS OF

THEIR INVESTMENT AND WHO HAVE NO NEED FOR LIQUIDITY WITH RESPECT TO THIS INVESTMENT.

Exhibit B

Form of Warrant

EXHIBIT "C"

SUPERIOR COURT OF WASHINGTON FOR KING COUNTY

ROBERT M. ARNOLD, derivatively on behalf of MOD SYSTEMS, INC. and BANANA CORPORATION, Plaintiffs, v. MARK PHILLIPS, KENNETH GORDON, JANE DOE GORDON, and the marital community composed thereof; ANTHONY BAY, JANE DOE BAY, and the marital community composed thereof; MOD SYSTEMS, INC., and BANANA CORPORATION, Defendants.	NO. **VERIFIED COMPLAINT** FOR BREACH OF FIDUCIARY DUTY; OPPRESSION OF MINORITY SHAREHOLDER; FRAUD; NEGLIGENT MISREPRESENTATION; CONVERSION; ACCOUNTING; VIOLATION OF WASHINGTON SECURITIES ACT; CORPORATE WASTE; CIVIL CONSPIRACY; DECLARATORY RELIEF; APPOINTMENT OF A CUSTODIAN; UNJUST ENRICHMENT; VIOLATION OF CORPORATE OPPORTUNITIES DOCTRINE; AND EMBEZZLEMENT

COME NOW Plaintiffs, Robert M. Arnold, a single man, ("Arnold"), individually and derivatively on behalf of MOD Systems, Inc., a Washington corporation ("MOD") and Banana Corporation, a Washington corporation ("Banana")(collectively the "Derivative Plaintiffs,") by and through their attorneys of record, Smyth & Mason, PLLC, and aver by way of their Verified Complaint for Breach of Fiduciary Duty, Oppression of Minority Shareholder, Fraud, Negligent Misrepresentation, Conversion, Accounting, Violation of Washington Securities Act, Corporate Waste, Civil Conspiracy, Declaratory Relief, Appointment of a Custodian, Unjust Enrichment, and Violation of Corporate Opportunities Doctrine (the "Complaint") as follows:

I. PARTIES

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Plaintiff Robert M. Arnold was at all times material hereto, a resident of the state of Washington and King County, Washington.

1. Defendant Mark Phillips ("Phillips") was at all times material hereto a resident of the state of Washington and doing business in King County, Washington.

2. Defendants Kenneth and Jane Doe Gordon were at all times material hereto, residents of the state of Washington and doing business in King County, Washington. All acts performed material hereto were done for the benefit of their marital community.

3. Defendants Anthony and Jane Doe Bay were at all times material hereto, residents of the state of Washington and doing business in King County, Washington. All acts performed material hereto were done for the benefit of their marital community.

4. Defendant MOD Systems, Inc., is a Washington corporation with its principal place of business in King County, Washington.

5. Defendant Banana Corporation, is a Washington corporation with its principal place of business in King County, Washington.

II. FACTS

A. Derivative Claim Allegations

6. Robert Arnold is a shareholder in each of the Derivative Plaintiffs, and was so at the time of the transactions and occurrences that form the basis of this Complaint. This action is not a collusive one to confer jurisdiction on a court of this state that it would otherwise not have. All of the other shareholders of the Derivative Plaintiffs are defendants in this action.

7. Arnold will adequately and fairly represent the interests of the Derivative Plaintiffs and their shareholders in enforcing and prosecuting its rights.

8. Based upon the facts set forth throughout this Complaint, applicable law and the longstanding rule that equity does not compel a useless and futile act, a pre-filing demand upon the Boards of Directors of the Derivative Plaintiffs to institute this action against the officers and board members of the Derivative Plaintiffs is excused as futile. Phillips is the only board member of Banana and is the named defendant in all counts herein. Phillips, Bay and Gordon make up a majority or the entire board of directors of MOD, are all defendants in this action and have committed the wrongful acts alleged herein.

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9. In addition to the reasons laid out above, a pre-filing demand would be a useless and futile act because:

a. The members of the Derivative Plaintiffs' Boards have demonstrated their unwillingness and/or inability to act in compliance with their fiduciary obligations and/or to sue themselves and/or their fellow directors and allies in the top ranks of the corporations for the violations of law complained of herein. These are people they have developed professional relationships with, who are friends and with whom they have entangling financial alliances, interests and dependencies, and therefore, they are not able to and will not vigorously prosecute any such action.

b. The Derivative Plaintiffs' Boards and senior management participated in, approved and/or permitted the wrongs alleged herein to have occurred and participated in efforts to conceal or disguise those wrongs from the Derivative Plaintiffs' stockholders or recklessly and/or negligently disregarded the wrongs complained of herein, and are therefore not disinterested parties.

c. The members of the Boards of the Derivative Plaintiffs have benefitted, and will continue to benefit, from the wrongdoing herein alleged and have engaged in such conduct to preserve their positions of control and the perquisites derived thereof, and are incapable of exercising independent objective judgment in deciding whether to bring this action.

10. Arnold has not made any demand on the shareholders of the Derivative Plaintiffs to institute this action since such demand would be a futile and useless act because defendant Phillips makes up a majority of the shareholders of both MOD and Banana.

B. Background of MOD Systems, Inc. and Banana Corporation

Mod Systems, Inc.

11. Prior to co-founding MOD Systems, Inc., Mark Phillips was Chief Technology Officer and Senior Vice President of Research and Development of Fullplay Media Systems, Inc. ("Fullplay"), when the company filed for bankruptcy. Fullplay's Liquidating Plan of Reorganization was approved on August 15, 2003.

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12. On or about April 6, 2005, POP Media Corporation was incorporated. Mark Phillips and Anthony Bay are shareholders and members of the Board of Directors of that company. Mr. Phillips is Chief Technology Officer, Chief Executive Officer and President of the company. Kenneth Gordon is Chief Operating Officer, Secretary and Vice President of the company. On July 5, 2005, POP Media Corporation changed its name to MOD Systems, Inc.

13. On or about March 20, 2006, Phillips, nominally for his own account, but possibly for the account of MOD, POP or Banana, purchased four abandoned patents from the Fullplay bankruptcy for $11,000.

14. MOD's business model focused primarily on the distribution and sale of digital media kiosks, which were to be placed in retail locations such as Starbuck's, Walgreen's, Target, Best Buy etc. Customers would select the media on-screen, such as movies and music, purchase the digital media at the kiosks, and then directly download the media to a portable storage device (such as an iPod) or flash memory card, or burn a DVD or CD.

15. In May of 2006, MOD sought to raise $5 million in a private stock offering and solicited Robert Arnold to invest.

16. Defendant Phillips, and possibly defendants Bay and Gordon, untruthfully represented to Mr. Arnold that MOD owned or controlled broad and valuable intellectual property rights which would enable it to exclusively exploit the digital media technology described above on a national and potentially global basis.

17. On information and belief, defendants, and each of them, materially misrepresented material aspects of MOD, its assets and its business plan to Arnold, or omitted to provide material information to Mr. Arnold regarding the above.

18. On or about May 27, 2006, a Subscription Agreement was signed wherein Mr. Arnold purportedly committed to purchase 285,714 shares of MOD common stock for $1 million ($3.50 per share).

19. By a First Amended Subscription Agreement, the offering period was extended through November 1, 2006, and Arnold committed to purchase 1,142,857 shares for $4 million ($3.50 per share).

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20. Between May 2006 and the present, Arnold has invested $3 million in MOD common stock, and acquired a total of 857,144 shares, or at the time, a 7.84% interest in MOD.

21. On or about June 16, 2006 the Bankruptcy Court in the Western District of Washington authorized the sale of all of Fullplay's remaining non-cash assets to Phillips, nominally for his own account, for an additional $2,500.

Banana Corporation

22. Banana Corporation was incorporated by defendant Phillips on June 16, 2006, with a trade name "Mettawallet" (three 't's).

23. On or about July 1, 2006, Banana entered into a Service Agreement with A-Dot Corporation, a company substantially owned and controlled by Phillips, whereby Banana promised to reimburse A Dot for costs in connection with the provision of intellectual property, "development services," and "general corporate services."

24. The Mettawallet technology purports to employ owned or controlled intellectual property, ostensibly owned or controlled by Banana, to enable "sachet purchasing" in poorer countries. By using pre-paid cellular telephone methodologies, persons who subsist on a cash-only basis can make purchases utilizing their cellular telephones.

25. Defendant Phillips, and possibly other unnamed co-coconspirators, represented to Mr. Arnold that Banana owned or controlled broad and valuable intellectual property rights which would enable it to the Mettawallet technology principally in third-world countries, and specifically in Bolivia.

26. On or about July 7, 2006, a Subscription Agreement was signed, wherein Mr. Arnold is purported to purchase 8,333,333 shares of Banana common stock for a total of $5 million.

27. Between July 2006 and the present, Arnold has invested $5.5 million in Banana, and is currently the owner of thousands of shares of Banana.

28. On or about July 8, 2006, Banana entered into an independent contractor agreement with payment terms unknown, with unnamed co-conspirator Douglas Lower. Unnamed co-conspirator Maureen Lower, Mr. Lower's wife, worked at the time as Mr. Arnold's office manager and close, trusted associate.

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29. On or about October 26, 2006, Banana entered into independent contractor agreements with Daniel Bolstad, Kenneth Gordon, and Ed Miller, agreeing to compensate them $30,000 each.

30. On or about December 15, 2006, Phillips incorporated Metawallet Corporation, of which Phillips is president and Gordon is secretary. Metawallet registered the tradename "Metawallet" (two 't's). The incorporation documents list Mr. Arnold as a Metawallet shareholder, but Arnold himself has never signed or received any documents or communication related to Metawallet Corporation.

C. **Misuse or Misappropriation of Corporate Funds and Assets**

31. Between 2006 and the present, Phillips has used and continues to use MOD and/or Banana corporate funds for his own personal benefit, including the purchase and/or lease of his personal vehicle, the purchase of electronics for his own personal residence and as gifts, extensive non-business related travel and entertainment, the payment of rent for his personal residence, and recently, to pay Adrienne Lindhart compensation for dealing with his personal problems relative to his condominium in the Moseler Building, Seattle, Washington. This is not an exclusive list.

32. On or about February 16, 2007, Doug Lower borrowed $200,000 from Banana, and gave it a promissory note in return. On information and belief, this money was not loaned in the normal course of Banana's business, and the money has not been repaid.

33. On or about February 21, 2007, Phillips personally borrowed $100,000 from Banana and executed a promissory note in return. On information and belief, this money was not loaned in the normal course of Banana's business, and the money has not been repaid.

34. On or about February 27, 2007, Phillips, in his own name, filed a patent application for "Transactional Services Associated With Mobile Devices." On information and belief, this application and any intellectual property arising therefore was the property of MOD or Banana.

35. On or about September 25, 2007, Phillips acknowledged that MOD is the assignee of the interest in the patent application for "Transactional Services Associated With Mobile Devices." On information and belief, the assignment has not yet been consummated.

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D. Corporate Mis-Governance and Failure to Produce Business Records

36. On or about October 1, 2007, Banana was administratively dissolved due to a failure to file its annual list of officers and license renewal. Banana Corporation filed reinstatement documents with the Washington Secretary of State on February 18, 2008.

37. On or about July 21, 2008, Mr. Arnold requested information regarding Banana and MOD from Phillips. To date, the defendants have failed to provide Arnold with a full and complete response to his requests for documents and information regarding the Derivative Plaintiffs.

38. Since that time, both Mr. Arnold, his investment consultant Cole Younger, and his legal counsel have endeavored to obtain complete corporate records. Only selected and limited information has been received as of this writing.

E. The Toshiba and NCR Transaction

39. On or about September 24, 2008, David Douglas, acting as MOD's Chief Financial Officer, requested Mr. Arnold's shareholder approval of the following, *inter alia*: a Series A Preferred Stock Purchase Agreement between MOD, Toshiba Corporation ("Toshiba"), NCR Corporation ("NCR") and Deluxe Entertainment Services Group Inc. ("Deluxe"); an amendment and restatement of the MOD Articles of Incorporation; various "conflict of interest" transactions between MOD and Phillips (not Anthony Bay); an increase in the stock option pool from 3 million to 5 million shares; a Shareholder Agreement between MOD, Phillips, Bay, Toshiba, NCR and Deluxe (excluding Mr. Arnold); a Right of First Refusal and Co-Sale Agreement between MOD, Phillips, Bay, Toshiba, NCR and Deluxe; a Non-Assertion Agreement between Toshiba and MOD; a Freedom of Operation Agreement between Toshiba, MOD and Phillips; and an Employment Agreement with Phillips. These documents all relate to a transaction whereby Toshiba, NCR and Deluxe would acquire a substantial and controlling ownership interest in MOD (the "MTND transaction").

40 The company's notice of conflict solely identified a shareholder and director conflict of Mark Phillips. This was an affirmative misrepresentation. Anthony Bay was also a conflicted shareholder and director by virtue of the benefits he received as a result of the transaction, including under the new Shareholders' Agreement. As a result of the conflicts of both Phillips and Bay, the

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approval by Arnold was required by law for the MTND transaction to proceed, since Arnold was the largest shareholder entitled to vote on the transaction.

41. Prior to the MTND transaction Arnold held a 7.84% interest in MOD; Phillips held a 68.33% interest; Bay held a 22.88% interest and Warren Lieberfarb held a 0.65% interest. If the MTND transaction closed legally and successfully, Arnold's share would be diluted to 3.85% (or 2.68% after future stock warrants and preferred stock issues are taken into account).

42. The MTND transaction documents which were furnished to Arnold pre-closing, included components whereby: 1) a new class of Series A Preferred Stock in the amount of 11,900,000 shares were authorized; 2) MOD would issue 9,584,121 preferred shares to Toshiba and NCR in return for **$30 million** in cash at closing; and 3) conversion of previously executed convertible promissory notes in the approximate amount of **$5 million** in favor of Toshiba and Deluxe in return of issuance of an additional 1,597,353 preferred shares to Toshiba and 399,338 shares to Deluxe.

43. The MTND transaction, as described to Arnold, contemplated *inter alia* the granting of extensive new preferred share rights including the following: a) special dividend rights for preferred shares at the rate of $0.22 per share, before any dividends can be declared for common shareholders; b) pro rata distribution of any further dividends between holders of common and preferred shares; c) preference for the preferred shares in the event of a liquidation event for MOD, under which preferred shareholders first receive amounts equivalent to $3.1302 per preferred share (as adjusted for stock splits, dividends, etc.), plus payment first of any declared but unpaid dividends; d) pro-rata distribution of any further liquidation proceeds between the preferred and common shareholders; e) rights of preferred shareholders to convert preferred shares into common stock on favorable terms; and f) significantly enhanced voting rights for preferred shareholders over holders of common stock.

44. None of these additional benefits were conferred upon Mr. Arnold as a founding shareholder of the company.

45. Moreover, the MTND transaction as described pre-closing entitled NCR and Toshiba to "engage in the same or similar business activities or lines of business" as MOD, to compete against MOD, and to do business with any actual or potential competitor, customer or supplier of

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MOD. NCR and Toshiba are also expressly excused from any fiduciary responsibility for any of their actions involving breach of fiduciary duty owed to MOD and its shareholders.

46. The principle value proposition of Mr. Arnold's investment in MOD was in no way protected from this extraordinary invasion of exclusivity.

47. Under the MTND transaction, Toshiba was to be given very broad latitude to utilize MOD's intellectual property for its own interests, regardless of impact on MOD. Toshiba was authorized to independently utilize and disclose MOD's intellectual property information broadly, including to customers, potential customers and suppliers, subject to the entry into non-disclosure agreements with those to whom they disclose the information.

48. Mr. Arnold's proprietary interest in MOD's intellectual property was in no way protected from this disclosure right.

49. The MTND transaction grants the preferred shareholders rights of first refusal in the event Bay or Phillips elect to sell their common shares. It also grants Phillips and Bay a right of first refusal to purchase preferred shares.

50. Mr. Arnold was not given any form of right of first refusal or pre-emptive rights.

51. The MTND transaction, particularly the new Shareholder's Agreement, gives the preferred shareholders Phillips, and Bay the right to register their shares in the event of a IPO.

52. Mr. Arnold's shares were made ineligible to participate as registered securities in any future IPO.

53. The "Subscription and Contribution Agreement" provides Phillips with 11,401,196 shares of common stock, valued at $38,900,000 in return for the assignment of certain technology and intellectual property to MOD. Arnold's stock dilution occurs in significant part as result of this agreement. Under a companion "Licensing Agreement," Phillips receives *inter alia* payments totaling **$5 million over four years** in return for providing a perpetual exclusive and transferable license to certain of MOD's intellectual property. The Subscription and Contribution Agreement also terminates certain pre-existing licensing agreements between MOD and Phillips.

54. MOD failed to obtain any form of independent valuation of the intellectual property being acquired from Phillips. In its conflict notice as to Phillips, the company identified that notwithstanding the lack of independent evaluation, the board "had access to certain valuation

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information," which led it to conclude that the price being paid to Phillips was reasonable. The company has refused, however, to provide any information to Arnold – despite repeated requests – as to the nature of this alleged "valuation information." On information and belief, there was no such information or, if such information exists, it is not a reliable basis for estimating value.

55. On information and belief, Toshiba and/or NCR conducted their own valuation of the intellectual property being purchased from Phillips and concluded that the intellectual property had a valuation far less than the consideration paid to Phillips. On information and belief, Phillips and perhaps others, as well as company legal counsel, were aware of this discrepancy in valuation, but nevertheless failed to take steps to preclude payment of greater consideration to Phillips.

56. On information and belief, the intellectual property for which Phillips received consideration in the MTND transaction already belonged, in whole or in part, to entities other than Phillips, including but not limited to MOD and Banana Corporation. Notably, the MTND transaction documents provided to Arnold pre-Closing further show, inexplicably, that Phillips would not be required to fully reimburse the company for the consideration paid to him for the intellectual property if his warranties regarding the intellectual property proved false or unreliable.

57. On information and belief, Phillips deliberately engaged in a massive fraud against MOD, Banana, Arnold and remaining uninvolved shareholders of these entities by negotiating and receiving the consideration and rights paid to and conferred upon him by the MTND transaction. Members of the MOD and Banana boards of directors and their respective legal counsel knew or should have known through due diligence inquiry that this fraud was being perpetrated, and that Phillips was actively converting company assets and rights in this manner. They did nothing to prevent the fraud.

58. On information and belief, Phillips and his co-conspirators misrepresented to Mr. Arnold that some or all of the rights addressed in the preceding paragraph already belonged to MOD. In the alternative, the rights discussed above constitute a corporate opportunity of MOD which Phillips has usurped.

59. The MTND transaction also consists of an employment agreement between MOD and Phillips, whereby Phillips was to be paid a salary of **$500,000 per year** plus bonuses. Phillips

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is subject to termination only for cause, and if terminated without cause, was to receive two years' severance pay over one year.

60. Phillips is also granted a license to use, copy, modify, and distribute all MOD IP and technology that is derivative or an improvement of licensed IP for a royalty payment of 5% of his and his affiliate's net revenues.

61. As a result of the above provisions personally benefitting Phillips, he is an interested director and shareholder with respect to the MTND transaction.

62. Mr. Arnold declined to consent to the MTND transaction, and requested that the closing of the transaction be delayed until he returned to the United States from Eastern Europe, and his principle legal counsel returned to the United States from Tibet.

63. In addition, Mr. Arnold requested full documentation and other material information regarding the proposed MTND transaction before he could approve the transaction, but the information and complete documentation was withheld. For example, only a partial, incomplete copy of a draft agreement was furnished, even though the documents were already in final format. On information and belief, this information and documentation was withheld with specific intent to mislead and induce Mr. Arnold into believing the MTND transaction was bona fide when it was not. Legal counsel for MOD knew of Arnold's information requests and affirmatively participated in the refusal to provide full information to Arnold, refusal to delay closing to provide time for Arnold to assess the information, refusal to disclose Bay's conflict of interest, and decision to close the transaction around Mr. Arnold, with his tacit disapproval.

F. Embezzlement

64. Furthermore, on information and belief, in June 2008 Phillips caused MOD to enter into a consulting agreement with Meteor Consulting, whereby the latter would be paid between $15,000 and $25,000 per month.

65. The contract provides that the payments are to be made to an ING Bank account in the Netherlands, an account owned and controlled by Phillips alone.

66. On information and belief, MOD has been paying all or most of these consulting payments, ostensibly to Meteor, but actually to Phillips personally.

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67. On information and belief, MOD has not authorized, and is unaware, that Phillips is paying himself these sums. Accordingly, the payments constitute an embezzlement of corporate funds.

III. FIRST CAUSE OF ACTION - BREACH OF FIDUCIARY DUTY

68. Plaintiffs incorporate by reference the allegations contained in paragraphs 1 through 67 above as though fully set forth herein. This cause of action is asserted on behalf of Arnold, and derivatively on behalf of the Derivative Plaintiffs.

69. Phillips is an officer and director of MOD and as such owes fiduciary duties to Arnold who is a minority shareholder of MOD, and to MOD itself. Gordon is an officer of MOD and as such likewise owes Arnold and MOD fiduciary duties. Phillips and Bay are majority shareholders and directors of MOD and as such owe fiduciary duties to Arnold and MOD.

70. Phillips is an officer, majority shareholder and director of Banana, and as such owes fiduciary duties to Arnold who is a shareholder of Banana, and to Banana itself.

71. Phillips, Bay and Gordon breached their fiduciary duties through the acts alleged herein, proximately causing damage to Plaintiffs in the amounts to be proven at trial and including their reasonable attorney fees.

IV. SECOND CAUSE OF ACTION - OPPRESSION OF MINORITY SHAREHOLDER

72. Plaintiffs incorporate by reference the allegations contained in paragraphs 1 through 71 above as though fully set forth herein. This cause of action is asserted on behalf of Arnold.

73. Phillips and Bay hold a majority of the outstanding shares of MOD. Phillips holds a majority interest in Banana. Their actions, as described herein, including but not limited to actions taken in an effort to reduce the value of Arnold's interest in those companies, constitute burdensome, harsh, and wrongful conduct, a lack of probity and fair dealing in the affairs of a company to the prejudice of some of its shareholders, a visible departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.

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74. These actions have proximately caused damages to Arnold in amounts to be proven at trial, including attorney fees.

V. THIRD CAUSE OF ACTION - FRAUD

75. Plaintiffs incorporate by reference the allegations contained in paragraphs 1 through 74 above as though fully set forth herein. This cause of action is asserted on behalf of Arnold.

76. Phillips falsely represented material facts to Arnold or omitted to disclose material facts, which were all existing material facts, in an effort to induce him to invest in Banana and MOD. Phillips knew these representations and omissions to be false or misleading, and concealed the falsehood of the statements from Arnold with the intent to defraud Arnold or to induce his reliance.

77. Phillips intended to deceive and actually did deceive Arnold, who was ignorant of the falsity of these statements, had a right to rely upon and did rely upon those false statements omissions, and as a proximate result was damaged in amounts to be proven at trial, including attorney fees.

VI. FOURTH CAUSE OF ACTION - NEGLIGENT MISREPRESENTATION

78. Plaintiffs incorporate by reference the allegations contained in paragraphs 1 through 77 above as though fully set forth herein. This cause of action is asserted on behalf of Arnold and derivatively on behalf of the Derivative Plaintiffs.

79. Phillips, by and through his actions as stated herein, has supplied Arnold with false information, or has negligently omitted to furnish Arnold with material information, for guidance in business transactions, which misinformation was materially false, including but not limited to information regarding both MOD and Banana and the MTND transaction.

80. Arnold justifiably relied upon these representations made by Phillips, and this reliance was reasonable under the surrounding circumstances. Arnold has been proximately damaged in amounts to be proven at trial, including attorney fees.

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VII. FIFTH CAUSE OF ACTION - CONVERSION

81. Plaintiffs incorporate by reference the allegations contained in paragraphs 1 through 80 above as though fully set forth herein. This cause of action is asserted on behalf of Arnold, and derivatively on behalf of the Derivative Plaintiffs.

82. Phillips has willfully and without justification deprived Arnold of ownership of property and business rights by wrongfully depleting Arnold's interest in the Derivative Plaintiffs and converting the funds.

83. Through the mechanism of the Meteor Consulting contract, Phillips has and is continuing to convert cash from MOD systems to his own use, for which Phillips is derivatively liable to MOD.

VIII. SIXTH CAUSE OF ACTION - ACCOUNTING

84. Plaintiffs incorporate by reference the allegations contained in paragraphs 1 through 83 above as though fully set forth herein. This cause of action is asserted on behalf of Arnold.

85. Arnold, as a shareholder of the Derivative Plaintiffs, has a statutory right to an accounting of all operations and expenditures of the Derivative Plaintiffs. The Derivative Plaintiffs have an equitable right to an accounting based on the facts and circumstances enumerated above. Defendants are required to maintain all records relating to operations and expenditures of the Derivative Plaintiffs and an accounting of any transfer of assets and/or funds from or to the Derivative Plaintiffs, including, but not limited to, transfers to other corporations, entities and Defendants herein.

86. Plaintiff has demanded and now demands that a full and audited accounting regarding both MOD and Banana be instituted immediately.

IX. SEVENTH CAUSE OF ACTION - WASHINGTON SECURITIES ACT

87. Plaintiffs incorporate by reference the allegations contained in paragraphs 1 through 886 above as though fully set forth herein. This cause of action is asserted on behalf of Arnold.

88. Defendants disseminated or approved the materially false and misleading statements specified above, or committed the omissions, which they knew or should have

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known were, or deliberately disregarded that they were, misleading in that they contained materially false representations, and failed to disclose material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

89. As specified above, Defendants: (a) employed devices, schemes, and artifices to defraud, as detailed above; (b) made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and (c) engaged in acts, practices or courses of business which operated or would operate as a fraud or deceit upon Arnold.

90. Phillips acted as a controlling person of Banana and MOD within the meaning of RCW 21.20.430(3) as alleged herein. Because of his position as officer and director of Banana and MOD, and his ownership of Banana and MOD stock, Phillips had the power and authority to cause Banana and MOD to engage in the wrongful conduct complained of herein. Because of such conduct, Phillips is liable pursuant to RCW 21.20.430(3).

91. Gordon and Bay acted as controlling persons of MOD within the meaning of RCW 21.20.430(3) as alleged herein. Because of their positions as officers and directors of MOD, and their ownership of MOD stock, they had the power and authority to cause MOD to engage in the wrongful conduct complained of herein. Because of such conduct, Gordon and Bay are liable pursuant to RCW 21.20.430(3).

92. Arnold has suffered damages in that, in reliance on the integrity of the market and on the direct misrepresentations made by the Defendants to him, he paid artificially inflated prices for common stock in the Derivative Plaintiffs. Arnold would not have purchased common stock in the Derivative Plaintiffs at the prices he paid, or at all, if he had been aware that the market prices had been artificially and falsely inflated by Defendants' misleading statements or that the Defendants' misrepresentations were not true.

93. As a direct and proximate result of these Defendants' wrongful conduct, Arnold suffered damages in connection with his purchase of common stock in the Derivative Plaintiffs, in an amount to be proved at trial, for which damages defendants are jointly and severally liable.

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X. EIGHTH CAUSE OF ACTION - CORPORATE WASTE

94. Plaintiffs incorporate by reference the allegations contained in paragraphs 1 through 93 above as though fully set forth herein. This cause of action is asserted derivatively on behalf of the Derivative Plaintiffs.

95. By failing to properly consider the interests of the Derivative Plaintiffs and its shareholders, by failing to conduct proper supervision, and by giving away substantial corporate funds to Defendants for their own personal use and benefit, Defendants have caused the Derivative Plaintiffs to waste valuable corporate assets.

96. As a direct and proximate result of Defendants' corporate waste, defendants are jointly and severally liable to the Derivative Plaintiffs in an amount to be proved at trial.

XI. NINTH CAUSE OF ACTION - CIVIL CONSPIRACY

99. Plaintiffs incorporate by reference the allegations contained in paragraphs 1 through 98 above as though fully set forth herein. This cause of action is asserted on behalf of Arnold and derivatively on behalf of the Derivative Plaintiffs.

100. In committing the wrongful acts alleged herein, the Defendants in concert with certain as yet unnamed co-conspirators (including but not limited to Doug Lower and Maureen Lower) have pursued or joined in the pursuit of a common course of conduct and acted in concert with one another in furtherance of their common plan.

101. During all times relevant hereto, the Defendants collectively and individually initiated a course of conduct which was designed to and did: (i) conceal the fact that the Derivative Plaintiffs were allowing their directors and senior officers to divert substantial corporate funds to insiders and directors of the Derivative Plaintiffs; and (ii) cause Mr. Arnold, often without his knowledge or consent to pay additional investment funds to Banana or MOD, and, on information and belief, sometimes by way of forged checks.

102. The purpose and effect of the Defendants' common course of conduct was, among other things, to disguise their wrongful and unlawful acts as alleged herein and to unlawfully and wrongfully enhance their own executive and directorial positions and receive substantial compensation at the expense of Arnold.

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103. Each of the Defendants, in league with their unnamed co-conspirators, aided and abetted and rendered substantial assistance in the wrongs complained of herein. In taking such actions to substantially assist the commission of the wrongdoing complained of herein, each Defendant acted with knowledge of the primary wrongdoing, substantially assisted the accomplishment of that wrongdoing, and was aware of his or her overall contribution to and furtherance of the wrongdoing.

XII. TENTH CAUSE OF ACTION - DECLARATORY RELIEF

104. Plaintiffs incorporate by reference the allegations contained in paragraphs 1 through 103 above as though fully set forth herein. This cause of action is asserted on behalf of Arnold, and derivatively on behalf of the Derivative Plaintiffs.

105. Arnold has been requesting basic and fundamental business documents related to the Derivative Plaintiffs. Despite repeated requests, Arnold has been deprived of this information. Plaintiffs request a declaration by the Court that Defendants have violated Washington law by failing to provide Plaintiffs with documentation.

106. Further, the Articles of Incorporation and Bylaws of MOD and Banana and Washington corporate law may provide officers and directors with certain indemnities and costs of defense for their actions. Plaintiffs request that the Court declare that defendants Phillips, Gordon and Bay are not entitled to indemnity by the Derivative Plaintiffs as a result of their actions described herein, and are not entitled to payment of any of their costs of defense.

107. Plaintiffs further request the Court declare that the plaintiff Robert Arnold is entitled to indemnity under Washington law for his actions herein and that they are entitled to costs and attorney fees.

XIII. ELEVENTH CAUSE OF ACTION - CUSTODIAN/RECEIVER APPOINTMENT

108. Plaintiffs incorporate by reference the allegations contained in paragraphs 1 through 107 above as though fully set forth herein. This cause of action is asserted on behalf of Arnold, and derivatively on behalf of the Derivative Plaintiffs.

109. Phillips, Gordon and Bay's conduct as alleged herein has resulted in waste, looting, and destruction of the assets of the Derivative Plaintiffs, and continues to increase the exposure to the Derivative Plaintiffs and their shareholders to loss of investment value.

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110. Pursuant to RCW 23B.14.320 and RCW 7.60.020, Plaintiffs ask the Court to appoint a custodian or receiver to manage the affairs of the Derivative Plaintiffs in the best interest of their shareholders, and to cease the ongoing waste, looting and destruction of assets.

111. In the alternative, the Plaintiffs as that the court remove Mr. Phillips from all governance duties relative to Banana or MOD to preserve the assets of the companies.

XIV. TWELFTH CAUSE OF ACTION - UNJUST ENRICHMENT

112. Plaintiffs incorporate by reference the allegations contained in paragraphs 1 through 111 above as though fully set forth herein. This cause of action is asserted on behalf of Arnold, and derivatively on behalf of the Derivative Plaintiffs.

113. As a result of the actions described herein, Phillips, Gordon and Bay have had various benefits conferred upon them by Plaintiffs, with the appreciation and knowledge by them of those benefits, the acceptance and retention of which under the circumstances described herein, make it inequitable for these defendants to retain those benefits without the payment of their value.

114. Specifically, Phillips, Gordon and Bay have been unjustly enriched by the assets of the Derivative Plaintiffs that have been wrongfully disbursed to them and other entities of which they are owners and/or officers. As a result, Plaintiffs have been damaged in amounts to be proven at trial.

115. Furthermore, defendants have been unjustly enriched by the special benefits and considerations given to them in the MTND transaction.

116. Defendants should be held liable to Mr. Arnold and to derivative plaintiffs in an amount to be proved at time of trial for unjust enrichment and be ordered to make restitution.

XV. THIRTEENTH CAUSE OF ACTION - VIOLATION OF WASHINGTON CORPORATE OPPORTUNITIES DOCTRINE

117. Plaintiffs incorporate paragraphs 1 through 116 as if fully set forth herein.

118. Defendants Phillips, Gordon and Bay have violated and continue to violate the Washington Corporate Opportunities Doctrine by engaging in competing ventures independent of the Derivative Plaintiffs. Phillips has violated and continues to violate the Washington Corporate Opportunities Doctrine by purchasing and/or acquiring, and then selling or licensing

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intellectual property in his own name for his own personal financial gain. These opportunities lawfully belonged and belong to the derivative plaintiffs.

119. The Derivative Plaintiffs are financially viable and were at the time these ventures were undertaken.

120. The Derivative Plaintiffs were and are involved in competing ventures, and the Defendants' ventures would have been of interest to it.

121. Defendants should be held liable to the Derivative Plaintiffs for any and all revenues, including profits, earned by the independent ventures of Phillips, Gordon and Bay, or which would have been earned by the Derivative Plaintiffs had the Derivative Plaintiffs competently undertaken those opportunities.

XVI. FOURTEENTH CAUSE OF ACTION - INJUNCTION

122. Plaintiffs incorporate paragraphs 1 through 121 as if fully set forth herein.

123. Defendants' actions are continuing and are causing irreparable injury to plaintiff and the Derivative Plaintiffs.

124. Unless prohibited by action of this court, MOD and Banana will soon fail as going concerns, to the immediate and irreversible damage of plaintiffs.

125. This court should preliminarily and then permanently enjoin defendants in specific and enforceable manners designed to prevent continuing violations of law, as described in detail above.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs demand a trial and judgment as follows:

A. Judgment in their favor and against Defendants commanding performance of their corporate duties to provide information and documentation to Arnold;

B. Judgment in their favor for damages arising from their wrongful conduct as alleged herein, including an award of interest at the highest rate allowed by law and reasonable attorneys fees and costs;

C. A declaration and preliminary and permanent injunctions ordering Defendants to cease the waste, looting and destruction of the assets of the Derivative Plaintiffs.

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D. Entry of an Order appointing a receiver, custodian, or special fiscal agent to manage the affairs of the Derivative Plaintiffs, and/or removing defendant Phillips from all corporate governance.

E. That Defendants be directed to pay to Plaintiffs their reasonable costs and attorney fees to the extent permitted by law, including but not limited to the Washington Securities Act;

F. A decree commanding that all documents and records of the defendants be preserved and that no spoliation occur; and

G. Such other and further relief as the court deems equitable in the premises.

DATED this 17th day of December.

SMYTH & MASON, PLLC

By _____
Jeff Smyth, WSBA #6291
Attorneys for Plaintiffs

VERIFICATION

STATE OF WASHINGTON)
) ss.
COUNTY OF KING)

ROBERT M. ARNOLD, being first duly sworn upon oath, deposes and states:

I have read the foregoing Verified Complaint and know its contents.

I am a party to this action, and am authorized to make this verification for and on behalf of the Derivative Plaintiffs in this action, and I make this verification for that reason.

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I am informed of and believe that the matters stated in the Verified Complaint are true to the best of my knowledge and belief.

I declare under penalty of perjury under the laws of the state of Washington that the foregoing is true and correct to the best of my knowledge and belief.

Executed on this 16 day of December, 2008, at Seattle, Washington.

ROBERT M. ARNOLD

SUBSCRIBED AND SWORN TO before me this ____ day of December, 2008.

Notary Public
State of Washington
CHRISTINA WISE
My Appointment Expires Aug 31, 2011

(Print Name) Christina Wise
NOTARY PUBLIC in and for the State of Washington, residing at Kirkland
My appointment expires 8/31/2011

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EXHIBIT “D”

MILLER CHEVALIER

George M. Clarke, III
Member
(202) 626-1573
gclarke@milchev.com

February 12, 2010

VIA HAND DELIVERY

Internal Revenue Service
Whistleblower Office
SE: WO
1111 Constitution Ave. NW
Washington, DC 20224

Re: Form 211 Submission by Dennis Mandell

To Whom It May Concern:

Please find enclosed the completed Form 211 and related attachment and exhibits, which are being submitted to the Whistleblower Office on behalf of Dennis Mandell. We represent Mr. Mandell in connection with his Form 211 submission and ask that any communications regarding the submission, or any ensuing investigation, be directed to the undersigned. Thank you for your attention to this matter, and please contact us with any questions at your earliest convenience.

Best regards,

George M. Clarke, III

Form 211
(Rev. December 2007)

Department of the Treasury - Internal Revenue Service

Application for Award for Original Information

OMB No. 1545-0409

Date Claim Received:

Claim No. (completed by IRS)

1. Name of individual claimant

Dennis Mandell

2. Claimant's Date of Birth — Month [redacted] Day [redacted] Year [redacted]

3. Claimant's SSN or ITIN [redacted]

4. Name of spouse *(if applicable)*

5. Spouse's Date of Birth — Month Day Year

6. Spouse's SSN or ITIN

7. Address of claimant, including zip code, and telephone number

[redacted]

8. Name & Title of IRS employee to whom violation was reported

N/A

9. Date violation reported:

N/A

10. Name of taxpayer (include aliases) and any related taxpayers who committed the violation:

Jan Mary Wallace

11. Taxpayer Identification Number(s) (e.g., SSN, ITIN, or EIN):

[redacted]7593

12. Taxpayer's address, including zip code:

6929 E. Cheney Dr., Paradise Valley, AZ

13. Taxpayer's date of birth or approximate age:

54

14. State the facts pertinent to the alleged violation. (Attach a detailed explanation and all supporting information in your possession and describe the availability and location of any additional supporting information not in your possession.) Explain why you believe the act described constitutes a violation of the tax laws.

See attached.

15. Describe how you learned about and/or obtained the information that supports this claim and describe your present or former relationship to the alleged noncompliant taxpayer(s). (Attach sheet if needed.)

See attached.

16. Describe the amount owed by the taxpayer(s). Please provide a summary of the information you have that supports your claim as to the amount owed. (Attach sheet if needed.)

See attached.

Declaration under Penalty of Perjury
I declare under penalty of perjury that I have examined this application, my accompanying statement, and supporting documentation and aver that such application is true, correct, and complete, to the best of my knowledge.

17. Signature of Claimant

2/4/10
18. Date

MAIL THE COMPLETED FORM TO THE ADDRESS SHOWN ON THE BACK

STATEMENT OF FACTS

1. Jan Mary Wallace resides at 6929 E. Cheney Dr., Paradise Valley, Arizona. Her social security number is 765-14-7593.

2. Ms. Wallace has dual citizenship in Canada and purportedly in the Cayman Islands, but she is a resident alien and U.S. taxpayer.

3. Ms. Wallace is currently Chief Executive Officer, President, and a Director of Davi Skin, Inc. ("Davi Skin"), a thinly-capitalized, publicly-traded cosmetics company located either at 11990 San Vicente Blvd., Suite 300, Los Angeles, CA 90049 or 4223 Glencoe Avenue, Suite 130, Marina Del Rey, California.[1] Ms. Wallace is also President of Wallace Black Financial Services, a consulting company that assists firms with raising equity capital. Until January 17, 2008, Ms. Wallace also served as President, CEO, and a Director of Secured Diversified Investment, Ltd., a small publicly-traded company.

4. Ms. Wallace owns, directly or indirectly, and uses several offshore bank and securities accounts, as well as several offshore entities, to conceal her assets and trading profits from illegal penny stock "pump and dump" schemes and other activities.

5. Although the exact amounts at issue are unknown, Ms. Wallace has hidden substantial assets abroad, totaling millions of dollars. Upon information and belief, Ms. Wallace has not disclosed the existence of these assets or accounts to the Internal Revenue Service under Title 31 and has not reported the income generated in these accounts under Title 26.

6. Based on a Davi Skin Active Shareholder Report as of July 13, 2007 (issued by Davi Skin's transfer agent, Pacific Stock Transfer Company), attached hereto as Exhibit A, the

[1] For reasons unknown, Davi Skin has been unable to timely file its required disclosures with the Securities Exchange Commission ("SEC") for over a year.

four largest unrestricted common stock positions in Davi Skin were held by Arch Ltd., Hepburn Holdings Ltd., Sunshine Ltd., and The Chloe Group of Companies (Chloe is the name of Ms. Wallace's daughter).[2] All four of these companies are owned and/or controlled by Ms. Wallace, and all four have the same address: The LOM Building, 27 Reid St., Hamilton, Bermuda.

7. The LOM Building is owned and occupied by LOM Holdings, a Bermuda-based parent company of a group of financial services companies founded by brothers Brian Lines and Scott Lines. "LOM" stands for Lines Overseas Management. The Lines brothers and LOM Holdings are currently being sued by the SEC for engaging in illegal "pump and dump" penny stock scams. The complaint in this lawsuit, filed in 2007 in the U.S. District Court for the Southern District of New York, is attached hereto as Exhibit B. In addition to providing offshore brokerage services and administrative services for corporate nominees, the LOM group also provides offshore banking services. *See* <http://www.lom.com/>.

8. Ms. Wallace routinely wires funds to LOM Securities in Bermuda and the Cayman Islands as payment for administration of her corporate nominees Arch Ltd., Sunshine Ltd., Hepburn Holdings, Ltd., and The Chloe Group of Companies. *See* Exhibit C attached hereto. Ms. Wallace has wired funds to LOM using JP Morgan Chase and HSBC Bank USA as correspondent banks, with beneficiary banks including The Bank of Bermuda Limited (account number 1010-956504) and Bank of NT Butterfield (Bermuda) (account number 20.006.840.351501.100).

9. Ms. Wallace has also used and/or controls a firm named Bridge Street Services Limited in these transactions.

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[2] Another large Davi Skin shareholder, Artist House Holdings, Inc., based in Japan, sued Davi Skin and its principals in 2006 for securities fraud. According to a Form 8-K filed with the SEC

(footnote continued on next page)

10. Ms. Wallace uses these offshore entities to acquire free-trading shares in defunct, publicly-traded corporate shells. These shell entities are then sold to a private company in what is termed as a "reverse merger."[3] The transaction is a means of taking a private company public without the cost and scrutiny associated with an initial public offering.

11. After materially false information touting the merger and prospects for the new company is disseminated to the investing public (the "pump" phase), Ms. Wallace then causes her offshore corporate nominees (such as Arch Ltd., Hepburn Holdings Ltd., Sunshine Ltd., and The Chloe Group of Companies) to sell the free-trading shares of the company at an artificially-inflated price (the "dump" phase). Thereby, Ms. Wallace pockets substantial profits on the sale of the stock, and in turn avoids paying capital gains on the sales as the shares are sold by offshore nominees and the proceeds are retained in offshore accounts.

12. By her own admission under oath, Ms. Wallace has been sued at least six or seven times for fraud or similar malfeasance with respect to her roles in various public companies. In one such case, *Thomas & Wong General Contractor, Inc. v. Blume Law Firm, et al.*, Superior Court of Arizona (Maricopa County), CV No. 2005-051325, Mr. Edward Tarapaski testified under oath that Ms. Wallace maintains offshore bank accounts. An excerpted copy of the trial transcript is attached hereto as Exhibit D.

(footnote continued from previous page)
by Davi Skin on July 9, 2008 and signed by Ms. Wallace, the lawsuit was settled for $650,000.

[3] Upon information and belief, Ms. Wallace has a long-standing relationship with Cane Clark, LLP, a Las Vegas-based securities law firm well known as a facilitator of thinly-capitalized reverse-merger transactions. Also upon information and belief, Ms. Wallace has conspired with several individuals in her pump and dump activities, including Kyleen Cane, a principal of Cane Clark LLP, as well as Devi Johal and Mujit Johal. These individuals may use offshore banking and brokerage arrangements similar to Ms. Wallace's in order to conceal their activities.

13. Dennis Mandell, the whistleblower in this action, discovered the above information through an investigation of allegations of fraud associated with one of the companies Ms. Wallace appears to have intended to use as part of one of her pump and dump schemes.

LEGAL ANALYSIS

Based on the facts outlined above and upon information and belief, Ms. Wallace is in violation of two primary sets of rules administered by the IRS with respect to assets and transactions in foreign jurisdictions: (1) the foreign bank account reporting regime under 31 U.S.C. § 5314 and the regulations promulgated thereunder (commonly referred to as the "FBAR" requirements), and (2) the anti-deferral regime of subpart F of the Internal Revenue Code. These violations have resulted and continue to result in the material underreporting and fraudulent concealment of Ms. Wallace's income and assets and render Ms. Wallace subject to civil penalties and interest, as described below.

Although Ms. Wallace is a citizen of Canada and possibly the Cayman Islands, she is a legal resident of the United States, and as such, is a "United States person" for federal income tax purposes and therefore subject to U.S. taxation on her worldwide income. *See* I.R.C. § 7701(a)(30).

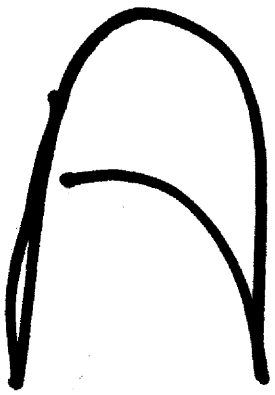
Pursuant to 31 U.S.C. § 5314 and 31 C.F.R. § 103.24, "[e]ach person subject to the jurisdiction of the United States . . . having a financial interest in, or signature authority or other authority over, a bank, securities or other financial account in a foreign country shall report such relationship to the [IRS] for each year in which such relationship exists . . . ." These provisions require that a Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR) be filed if the aggregate balances of such foreign accounts exceed $10,000 at any time during the year. As Ms. Wallace is subject to the jurisdiction of the United States, and upon information and belief has not disclosed the existence of substantial assets held in accounts with Bermudan and/or Cayman Islands banks, Ms. Wallace is in clear violation of 31 U.S.C. § 5134. Accordingly, pursuant to 31 C.F.R. § 103.57(g)(2), Ms. Wallace is subject to a penalty of up to

$100,000 for each violation (i.e., each failure to report a foreign account each year in which such account held more than $10,000 in assets).

Furthermore, I.R.C. § 951 requires that U.S. shareholders of controlled foreign corporations ("CFCs") include, on a current basis, their pro rata share of all subpart F income earned by the CFC in which they hold an interest. A "U.S. shareholder" for purposes of subpart F is a 10% or greater stakeholder in a foreign company. A company is a CFC if it is held more than 50% by U.S. shareholders. Upon information and belief, Ms. Wallace's corporate nominees managed by LOM Securities are held exclusively by herself and her immediate family members, and as such qualify as CFCs. Under I.R.C. § 952(a)(2), subpart F income includes all foreign base company income which in turn, under I.R.C. § 954(a)(1), includes all foreign personal holding company income. Section 954(c) defines foreign personal holding company income as, *inter alia*, dividends, interest, and gains from the sale of property such as stock or other capital assets. Accordingly, subpart F requires that Ms. Wallace include in her gross income all investment income and capital gains earned by her offshore entities. Upon information and belief, her failure to do so constitutes a violation of subpart F and is evidence of a willful attempt to evade her U.S. federal income tax obligations.

As a consequence of the violations described above, Ms. Wallace is subject to penalties and interest, in addition to the taxes due and owing. At a minimum, Ms. Wallace is subject to the I.R.C. § 6662 penalty for negligence or disregard of rules and regulations and/or substantial understatement of income tax, which imposes a penalty of 20% of the understatement attributable to the penalized conduct. Furthermore, Ms. Wallace may be subject to the civil fraud penalty of section 6663, which imposes a penalty of 75% of the understatement of tax liability due to fraud. The section 6663 penalty requires a showing of intent "to evade taxes known to be

due and owing by conduct intended to conceal, mislead, or otherwise [to] prevent the collection of taxes, [where] there is an underpayment of tax." *Nelon v. Commissioner*, T.C. Memo. 1997-49. Ms. Wallace's failure to disclose offshore accounts and the use of offshore entities to conceal her trading activities strongly suggests an intent on Ms. Wallace's part to defraud the IRS, in addition to concealing her illegal securities activities. Finally, Ms. Wallace is also subject to interest on back taxes and penalties at a rate of 3% plus the short-term federal rate. I.R.C. § 6621(a)(2). Interest began to accrue on the due dates of the returns for which there were understatements of tax liability. I.R.C. § 6601(e)(2)(B).



DAVI SKIN

Active Shareholder Report

2,249,825

Common Stock as of 7/13/2007

CUSIP NUMBER

Active Share Holders	565
Active Certificates	637
Free Trading Stock	5,926,598
Restricted Stock	8,684,610
Shares Outstanding	14,611,208

Stock Holder	Date Issued	Cert No	No of Shares	Status	Date Restr	Lost or Stolen
ABERDEEN HOLDINGS LTD INC THE LOM GROUP 27 REID ST HAMILTON, ON CANADA	08/22/2001	1960	33	R	08/22/2001	No
	Total Shares		**33**	**Total Certificates**		1
DENNIS ACKERMAN	02/25/1998	1345	1			No
	Total Shares		**1**	**Total Certificates**		1
ROBERT F. ACKERSON 60 KNOLLS CRESCENT AVE. BRONX, NY 10463-0000	02/25/1998	1074	1			No
	Total Shares		**1**	**Total Certificates**		1
WILLIAM ADAM 7584 BEL ARBOR TRL WEBSTER, NY 14580-9476	02/25/1998	1261	1			No
	Total Shares		**1**	**Total Certificates**		1
VMR AG C/O DEUTSCHE BANC ALEX BR 1635 MARKET ST 17TH FLOOR PHILADELPHIA, PA 19103	10/04/2000	1899	1,240	R		No
	Total Shares		**1,240**	**Total Certificates**		1
DONALD R AHO 1015 PINEWOOD DR PINECITY, NY 14571-0000	02/25/1998	1260	1			No
	Total Shares		**1**	**Total Certificates**		1
BERNHARD ALTENDEITERING ORCHIDEANSTER NORDHORN, GERMANY 48529	11/03/1998	1508	5	R		No
	Total Shares		**5**	**Total Certificates**		1
BABETTE ALTMAN 4850 WINTER HAVEN WAY ROSEVILLE, CA 95747-8252	02/25/1998	1329	1			No
	Total Shares		**1**	**Total Certificates**		1
DAVID AMMERMAN 75 PENN EST EAST STROUDSBURG, PA 18301-9026	02/25/1998	1089	1			No
	Total Shares		**1**	**Total Certificates**		1
LINDA C ANDERSON	12/20/2005	5210	2,909	R	12/20/2005	No
	Total Shares		**2,909**	**Total Certificates**		1

DAVI SKIN

Active Shareholder Report

Common Stock as of 7/13/2007

CUSIP NUMBER 238528 103

Stock Holder	Date Issued	Cert No	No of Shares	Status	Date Restr	Lost or Stolen
ARCH LTD.	04/03/2007	5309	573,847			No
* THE LOM BUILDING 27 REID STREET	**Total Shares**		**573,847**	**Total Certificates**		**1**
HAMILTON, BERMUDA HM11						
PETER ARDITA	02/25/1998	1214	1			No
1119 SAVOY DR	**Total Shares**		**1**	**Total Certificates**		**1**
MELVILLE, NY 11747-5281						
ARTIST HOUSE HOLDINGS INC	04/04/2006	5231	566,667	S	04/04/2006	No
3F YUSHIN BLDG 3-27-11 SHIBUYA	**Total Shares**		**566,667**	**Total Certificates**		**1**
SHIBUYA-KU, TOKYO JAPAN						
SYLVIA ASCHER	02/25/1998	1057	1			No
58 E 83RD ST APT 2-A	**Total Shares**		**1**	**Total Certificates**		**1**
NEW YORK, NY 10028-0000						
ASLAN DEVELOPMENT	12/01/2006	5276	3,333	R	12/01/2006	No
C/O DWYER SMITH LAW FIRM 8712 W. DODGE RD #400	**Total Shares**		**3,333**	**Total Certificates**		**1**
OMAHA, NE 68114						
470842538						
ASLAN MORTGAGE	12/01/2006	5274	2,800	R	12/01/2006	No
2242 SO. 156 CIR	**Total Shares**		**2,800**	**Total Certificates**		**1**
OMAHA, NE 68130						
911749681						
GENEVIEVE F. AUBRY	02/25/1998	1092	1			No
16 EDGEWOOD RD	**Total Shares**		**1**	**Total Certificates**		**1**
PEEKSKILL, NY 10566-0000						
BANKHAUS H AUFHAEUSER	10/12/1999	1661	41			No
KAT KAPITALBERATUNG TOELZERSTRASSE 23	10/12/1999	1662	41			No
GENEVA, SWITZERLAND 82031	**Total Shares**		**82**	**Total Certificates**		**2**
CHRISTINE AZZARELLO	05/15/2006	5233	800			No
& GREGORY AZZARELLO JTTEN	**Total Shares**		**800**	**Total Certificates**		**1**
339 SOUTH HOWARD						
PLAINFIELD, IL 60544 325443210						
GEORGE BALOGH	02/25/1998	1140	1			No
17 SOUTH DR	**Total Shares**		**1**	**Total Certificates**		**1**
GREAT NECK, NY 11021-0000						

DAVI SKIN

Active Shareholder Report

Common Stock as of 7/13/2007

CUSIP NUMBER 238528 103

Stock Holder	Date Issued	Cert No	No of Shares	Status	Date Restr	Lost or Stolen
ANTHONY S. HARRISON 2900 OAKHILL LN MOUNT DORA, FL 32757-9525 202-10-4242	02/25/1998	1135	1			No
	Total Shares		**1**	**Total Certificates**		1
TRACEY HARROW 1 HERON TERRACE CAMDEN RD CARSHALTON VILLAGE SURREY, UK SM5 2NS	11/16/1999	1727	5			No
	Total Shares		**5**	**Total Certificates**		1
HELEN HARVARD 4020 PRATT AVE. BRONX, NY 10466-0000	02/25/1998	1077	1			No
	Total Shares		**1**	**Total Certificates**		1
WILLIAM M. HEALEY JR 255 SOUNDVIEW AVE. WHITE PLAINS, NY 10606-0000	02/25/1998	1107	1			No
	Total Shares		**1**	**Total Certificates**		1
FANNING M. HEARON, JR	02/25/1998	1353	1			No
	Total Shares		**1**	**Total Certificates**		1
RUDOLF HEINZ NIEDENAU 82 FRANKFURT AM, GERMANY 60325	02/03/2000	1817	100	R		No
	Total Shares		**100**	**Total Certificates**		1
JOSEPH HEJNA 254 PENNSYLVANIA ST. BUFFALO, NY 14201-0000	02/25/1998	1250	1			No
	Total Shares		**1**	**Total Certificates**		1
* **HEPBURN HOLDINGS LTD** THE LOM BUILDING 27 REID STREET HAMILTON, BERMUDA HM11	04/03/2007	5310	573,847			No
	Total Shares		**573,847**	**Total Certificates**		1
FRAN HERRIDGE BOB HERRIDGE 18 ORCHARD DR ARMONK, NY 10504-0000	02/25/1998	1079	1			No
	Total Shares		**1**	**Total Certificates**		1
MARGERY H. HERRMANN 2202 THEALL RD RYE, NY 10580-1423 70286516	02/25/1998	1095	1			No
	Total Shares		**1**	**Total Certificates**		1

DAVI SKIN

Active Shareholder Report

Common Stock as of 7/13/2007

CUSIP NUMBER 238528 103

Stock Holder	Date Issued	Cert No	No of Shares	Status	Date Restr	Lost or Stolen
STRATEGIC GROUP LTD SUITE 41/42 VICTORIA HOUS 26 MAIN STREET PO BOX 743	01/04/2000	1781	461			No
	Total Shares		**461**	**Total Certificates**		**1**
COLLEEN SULLIVAN	02/25/1998	1343	1			No
	Total Shares		**1**	**Total Certificates**		**1**
HENRY L SUMMERS 1840 7TH AVE #5C NEW YORK, NY 10026-0000	02/25/1998	1056	1			No
	Total Shares		**1**	**Total Certificates**		**1**
HERMAN SUNA 75 NOBLE ST. LYNBROOK, NY 11563-0000	02/25/1998	1360	1			No
	Total Shares		**1**	**Total Certificates**		**1**
* **SUNSHINE LTD** THE LOM BUILDING 27 REID STREET HAMILTON, BERMUDA HM11	04/03/2007	5312	573,847			No
	Total Shares		**573,847**	**Total Certificates**		**1**
GEORGE M. SWEETMAN 34 MORSEMERE PLACE YONKERS, NY 10701-0000	02/25/1998	1108	1			No
	Total Shares		**1**	**Total Certificates**		**1**
ANDREW TABBAT 2218 THEALL ROAD RYE, NY 10850	02/25/1998	1122	1			No
	Total Shares		**1**	**Total Certificates**		**1**
GUS TAHMIN 48 FIELDCREST RD. CRESTWOOD, NY 10707-0000	02/25/1998	1113	1			No
	Total Shares		**1**	**Total Certificates**		**1**
MERCIAN / MAKOTO TAKEUCHI	04/07/2005	5126	10,000	S	04/07/2005	No
	Total Shares		**10,000**	**Total Certificates**		**1**
PETER P. TALLARINE 2286 CUSTOM VLG CT BELLMORE, NY 11710-0000	02/25/1998	1203	1			No
	Total Shares		**1**	**Total Certificates**		**1**

DAVI SKIN

Active Shareholder Report

Common Stock as of 7/13/2007

CUSIP NUMBER 238528 103

Stock Holder	Date Issued	Cert No	No of Shares	Status	Date Restr	Lost or Stolen
TAKAHIRO TASHIO	04/07/2005	5124	317,895	S	04/07/2005	No
	Total Shares		**317,895**	**Total Certificates**		1
MICHAEL TEDESCO	02/25/1998	1186	1			No
64 OLD TAPPAN RD.	**Total Shares**		1	**Total Certificates**		1
GLEN COVE, NY 11542-0000						
NORMAN L TESSIER	02/25/1998	1240	1			No
ROAD 1 BOX 185	**Total Shares**		1	**Total Certificates**		1
SHAPON SPRINGS, NY 13459-0000						
THE CHLOE GROUP OF COMPANIES	04/03/2007	5311	573,847			No
* THE LOM BUILDING 27 REID STREET	**Total Shares**		**573,847**	**Total Certificates**		1
HAMILTON, BERMUDA HM11						
JULIUS THELMO	02/25/1998	1210	1			No
62 LIVE OAK DR	**Total Shares**		1	**Total Certificates**		1
HOLBROOK, NY 11741-0000						
A. THORSON	02/25/1998	1062	1			No
551 MAIN ST. #W201	**Total Shares**		1	**Total Certificates**		1
NEW YORK, NY 10044-0000						
MICHAEL TIGHE	05/16/2005	5150	200			No
333 URIBE ST	08/15/2005	5163	300	R	08/15/2005	No
LAS VEGAS, NV	**Total Shares**		**500**	**Total Certificates**		2
DONALD A. TOY	02/25/1998	1051	1			No
45 SUTTON PLACE S APT 1414	**Total Shares**		1	**Total Certificates**		1
NEW YORK, NY 10022-2444						
069-28-5497						
SARNA TRADING	10/12/1999	1698	73			No
HOTTINGER STR 17	**Total Shares**		73	**Total Certificates**		1
ZURICH, SWITZERLAND CH-8032						
GEARY TRIGLETH	08/03/2004	5047	125,000	R	08/03/2004	No
2001 HEARTHSTONE DRIVE	**Total Shares**		**125,000**	**Total Certificates**		1
CARROLLTON, TX 75101						
447560247						



UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

BRIAN N. LINES;
SCOTT G. S. LINES;
LOM (HOLDINGS) LTD.;
LINES OVERSEAS MANAGEMENT LTD.;
LOM CAPITAL LTD.;
LOM SECURITIES (BERMUDA) LTD.;
LOM SECURITIES (CAYMAN) LTD.;
LOM SECURITIES (BAHAMAS) LTD.;
ANTHONY W. WILE;
WAYNE E. WILE;
ROBERT J. CHAPMAN;
WILLIAM TODD PEEVER;
PHILLIP JAMES CURTIS; AND
RYAN G. LEEDS,

Defendants.

Civil Action No._____

COMPLAINT

Plaintiff Securities and Exchange Commission (the "Commission") alleges:

SUMMARY OF ALLEGATIONS

1. This action concerns two separate, but similar, fraudulent schemes to manipulate the stock prices of two microcap companies, Sedona Software Solutions, Inc. ("Sedona") and SHEP Technologies, Inc. ("SHEP"). During the relevant periods, Sedona and SHEP shares were quoted and traded on the Over-the-Counter Bulletin Board ("OTCBB"). The schemes took place in 2002 and 2003, and involved the substantial participation of a Bermuda-based securities firm,

defendant LOM (Holdings) Ltd. ("LOM Holdings"), two of its managing principals, defendants Brian N. Lines and Scott G. Lines, and several of its subsidiaries: Lines Overseas Management Ltd. ("LOM Ltd."), LOM Capital Ltd. ("LOM Capital"), LOM Securities (Bermuda) Ltd. ("LOM Bermuda"), LOM Securities (Bahamas) Ltd. ("LOM Bahamas"), and LOM Securities (Cayman) Ltd. ("LOM Cayman") (collectively referenced herein as "LOM" or the "LOM Entities").

2. Both the Sedona and SHEP fraudulent schemes involved the undisclosed acquisition of publicly-traded shell companies, the use of LOM-controlled nominees to conceal beneficial ownership and control over Sedona and SHEP, the use of paid touters to promote Sedona and SHEP stock, and significant trading through the U.S. market in those stocks by defendants Brian Lines and Scott Lines, who are brothers. In the Sedona scheme, the Lines brothers' trading yielded approximately $1.5 million in illegal proceeds. In the SHEP scheme, trading by the Lines brothers and two of their customers, defendants W. Todd Peever and P. James Curtis, yielded approximately $4.3 million in illegal proceeds.

3. In the Sedona fraudulent scheme, defendant Anthony W. Wile ("Wile" or "Tony Wile"), a Canadian stock promoter, issued deceptive press releases and other promotional materials in early 2003 to create the misleading impression that his newly-formed private company, Renaissance Mining Corporation, Inc. ("Renaissance"), had acquired certain Central American gold mines and was a leading gold producer. At the same time, as part of the scheme, defendants Brian and Scott Lines had secretly acquired over ninety-nine percent of Sedona's outstanding shares through offshore nominees in order to merge the publicly-traded Sedona shell with Renaissance. Defendants Brian and Scott Lines also agreed to raise $6 million for Renaissance through a private placement of Renaissance stock through LOM's investment

###1

IN THE SUPERIOR COURT OF THE STATE OF ARIZONA
IN AND FOR THE COUNTY OF MARICOPA

THOMAS & WONG GENERAL CONTRACTOR, INC.,
Plaintiffs,

vs.

CV No. 2005-051325

BLUME LAW FIRM, et al.,
Defendants.

February 6, 2008
Phoenix, Arizona

BEFORE THE HONORABLE: ROBERT C. HOUSER, Judge

REPORTER'S TRANSCRIPT OF PROCEEDINGS
Jury Trial

Lisa H. Vitoff
Certified Court Reporter
CCR #50251

###2

A P P E A R A N C E S

FOR THE PLAINTIFFS:
MR. BRYAN F. MURPHY
Attorney at Law

FOR THE DEFENDANTS:
MS. CLAIR AMBROSIO
Attorney at Law

P R O C E E D I N G S

THE COURT: CV 2005-051325, Thomas and Wong Contractors,

Incorporated v Jan Wallace. This is the time set for continuation of trial. The record will show the presence of counsel, the parties, and members of the jury.

Good morning. You may proceed

MR. MURPHY: Plaintiff calls Gary Blume.

THE COURT: Well, all right. We were in the midst of reading some deposition testimony, I think, when we recessed last night. Are you going to interrupt that deposition testimony to call Mr. Blume and return to that?

MR. MURPHY: I would request we do so, since he's a live witness.

###3

THE COURT: All right, that's fine. Let's proceed.

Will you step forward and be sworn, please?

GARY R. BLUME,

having been duly sworn herein, took the stand and testified as follows:

DIRECT EXAMINATION

BY MR. MURPHY:

Q Thank you, your Honor.

Your full name, please?

A Gary R. Blume.

Q You're an attorney licensed in this state, sir?

A Yes.

Q You have represented Jan Wallace since the, oh, mid 1990s, is that correct, in various matters?

A I don't specifically recall. I worked for her for a while.

Q Sir, let me show you what has been marked for identification as Exhibit 42. Do you recognize this as invoices, the first dated March 14, 2003, the second dated May 12, 2003, the third dated June 17, 2003, regarding service related to, oh, the transaction with BDV Investments and Thomas and Wong?

A I do recognize these. They are records that are kept in the ordinary course of my business. But they do not all relate to Thomas and Wong.

###4

Q Fair enough. But they are accurate recitations of the time billed on those matters?

A Yes.

MR. MURPHY: I would offer Exhibit 42 into evidence, your Honor.

MS. AMBROSIA: I have no objection.

THE COURT: 42 is admitted.

BY MR. MURPHY:

Q Sir, I'm going to go to the first page of this exhibit. There are time entries on your invoice of March 14, 2003, as follows: March 6, 2003, Gary R. Blume, meeting with Jan and clients regarding drafting of promissory note, security agreement and discussion, preparation for meeting with forms and discussion at meeting. Then March 8, 2003, Gary R. Blume, meeting with client. Both of those for two hours.

Do you have a recollection of those meetings, sir?

A Not specifically.

Q Do you recall who was present in your offices on March 6, 2003, with regard to that meeting listed on the invoice?

A March 6th? No, I don't.

Q Do you recall who was present on March 8, 2003?

A Not specifically.

Q Was Jan present -- pardon me, was Jan Wallace present at both meetings, to the best of your recollection?

A I believe so. I'm just unsure of the dates.

A During the time of -- you asked me where I was during the time of the wire transfer; is that right?
Q Yes.
A I was in -- I believe I was in Korea, not in Brunei.
Q Do you know when you went to Germany with John Beardmore?
A I believe I left Korea about in the last week of April, near the end of April.
Q So you made the wire transfer before you went to Germany?
A I think so.
Q So both wire transfers were made prior to you going to Germany?
A I think there was three. One was in the beginning of April, I remember that.
And I think there was two more after that. I have a record of it, if you want me to take a look.
Q Did you sue the Lake Bank?
A I did, yes.
Q Is that lawsuit still going on?
A I don't know what the status of it. The last I heard there was technicality that was preventing it from going forward.
They recited some statute, and I don't know what

that statute really means. But right now it's not going forward. I think.
Q So you don't know if they've refiled against the Lake Bank?
A I don't know.
Q But you didn't get a judgment against them?
A No, I didn't.
Q And you haven't --
A It hasn't gone to court. I've been deposed in that lawsuit, but it hasn't gone to trial yet.
Q And again, what were your duties in regard to Jan Wallace?
A What does that mean?
Q Well, you testified that Jan Wallace had all these duties to you. She was the attorney, the --
A I was to supply the money, that's what I was there for, that's what I agreed to do.
Q But that was not -- you, you were not providing the money to Jan Wallace, you were providing the money to BDV?
A I think we've established that.
Q How much money did you pay Jan Wallace?
A I didn't pay her anything, but it looked like she paid herself a hell of a lot.
Q What do you mean by that comment?
A Well, you know, there is 50,000 bucks that went to

her, that I didn't know about, that I found out about later.
That's one of the reasons I filed this lawsuit.
Q Where does it show that the $50,000 went to Jan Wallace?
A That was told to me by Billy Cortegiano in the spring of '05.
And I asked Jan Wallace about it. She said that she had received $50,000. I was pretty upset about that.
Q But you knew that Jan Wallace had a contract with BDV?
A No, I didn't know she had a contract with BDV.
Q But that's what you said in the Homeland Security

report?
A No, it isn't.
Q I discussed the loan with Jan Wallace and learned that the Lake Bank would be put into a public company shell that she owned and was listed on the stock exchange.
A Yeah, there was some general conversation about that. I don't know at what stage it is.
And there was about a two-minute conversation, I told her I wasn't interested in anything about that.
Q In the public company, you weren't interested?
A Yeah.
MS. AMBROSIO: I have no further questions.
THE COURT: Mr. Murphy.

#100

CROSS-EXAMINATION

BY MR. MURPHY:
Q Sir, I want to clarify, there's a date at the top of this document, which is Exhibit 69, the submission that you made at the request of Homeland Security of September 3.
Is that when you created that document?
A I created the document in February of '03.
Q Let me go through some of the issues that were raised on examination.
You were asked a question at Page 2 about I discussed the loan with Jan Wallace and that Lake Bank would be put into a public company.
A Yeah.
Q Did she tell you she had an outstanding contract to do that?
A No.
Q Did she tell you that she was owed money by Lake Bank for that?
A No.
Q And that's what you put there, is as much as you knew about it?
A Yeah. That was a -- that conversation lasted about two seconds -- about two minutes.
That's not what I do, public companies are not what I do.

#101

Q Now, March -- let me go to the next page of this document, I believe it's Page 3 of Exhibit 69.
It starts March 6 '03: Jan Wallace, Ed Tarapaski, and John Beardmore meet at the law office of Gary Blume and draft and sign a promissory note attesting to the terms of our agreement.
Now, that was what you worked from -- you were working from memory at the time?
A Yeah.
Q Do you believe that's an accurate statement, in every respect, as you look at it today?
A No, it's not accurate.
Q What is inaccurate about the statement?
A The agreement was reached on the 6th of --
Could you put it back, please?
Q I beg your pardon?
A The agreement, the terms of the promissory note, were agreed to on the 6th.
And that's when the drafting, as I understood it, was going to start, but it was signed on the 8th of March, not the 6th.
Q Very well.
A Again, they told me not go into a lot of detail,

just to give it to them.
Q Sir, next page: Jan thought of most of this and I

#102

think she did a good job of protecting our interest. I really believe that she put our well-being ahead of any financial gain on her part.
Was that your feeling at the time you wrote this in February of 2005?
A Mostly it was.
Q What changed your mind about that, sir?
A The biggest thing was the detectives at Homeland Security.
Q Describe why you say that.
A Well, in the, in the first meeting they asked me if I could give them any more specific information.
And I said, well, I'll try to. And -- but I said I think Jan Wallace could give you some pretty specific information as well. And so that, that meeting ended.
And then I went to my second meeting with the detectives, and they said, "Well, I thought you told us that this Jan Wallace was going to provide us with a lot of information."
They said, "We interviewed her and she was guarded, aggressive, and evasive."
And so then they had me telephone her from their office and they put me on a tape recorder and they told me to ask her about the disbursements from this Cane and Associates.
So I dialed her number, her hand phone number, but she didn't answer the phone.

#103

Q Was it Homeland Security that first alerted you to the possibility that she might have not done things right?
A Yeah. They really had some strong suspicions about her.
Q Now --
A There was other things besides that as well.
Q Now, sir, there were some questions about Thomas and Wong, some suggestions that they were involved in some improper conduct.
Did Homeland Security investigate Thomas and Wong?
A Yes, they investigated them. That was the first thing they did, is they said they were going to investigate us. I said that's fine.
Then they asked me for permission to investigate my bank accounts. I said that's okay.
And then they asked me for permission to investigate Thomas and Wong's bank accounts six months before this and six months after.
And I told them I would have to phone Charlene Wong. And I did and they gave them permission.
Q Did you hear anything further from the Homeland Security about a problem with Thomas and Wong?
A No, I did not.
Q Sir, I'm going to -- I believe Page 6, the statement that was put in front of you, all of the due diligence was

#104

complete except for the viewing of the gold.
A Yes.
Q Now, sir, at that time, had you investigated whether Jan Wallace had completed the due diligence?
A Well, I asked her on several occasions, yes.
Q What had she told you?
A She said she had.
Q Was that the basis of the information that you had

when you wrote this report to Homeland Security?
A No. I found out other things since then.
Q Subsequently. But at the time you send that to Homeland Security, you were relying on the information that Jan Wallace had given to you?
A I'm sorry, could you --
Q At the time you made this statement to Homeland Security, you were operating on the information that had been given to you by Jan Wallace?
A A lot of it.
Q Did you subsequently investigate whether those conditions had been satisfied?
A Well, I found out other information, yeah.
Q For instance, did you ever find a certificate of insurance in favor of Thomas and Wong?
A No.
Q Did you ever find a safekeeping receipt in favor of

Thomas and Wong?
A No.
Q I'll rely on prior testimony to make sure that we move down the path.
Sir, there were some suggestions made that you drafted Exhibit 18, a promissory note of March 6, 2003 for $275,000. I'll put that up here.
Why did you hire Gary Blume, sir?
A To look after doing the legal work.
Q Did you do the legal work on this in any way?
A Not likely.
Q Did you draft that document, sir?
A No, I did not draft that document.
Q Do you have a clue who did?
A I don't know, but I saw it for the first time at Blume's office, so maybe he did.
Q Sir, let's go to the Homeland Security document, Exhibit 69. I'll go to the eighth page entry, under May 10, 2003.
I quote, "Time passed, and I was told the money was being held up in a Florida bank because the total melt was 12 million dollars and there was all kinds of paperwork to be completed.
I asked Jan why the money was in Florida.
She said, 'That was how the deal was structured with

the refinery and she was in direct contact with the bank and it would be released soon.'
I told her we should not be concerned with the whole 12 million dollars and just get our share released, which was only 1,875,000."
Also it continues -- I won't complete that paragraph.
Is that the information Jan Wallace gave you?
A Yes, that's the information she gave me.
Q Is that what you reported to Homeland Security?
A Yes. I don't know why they would send the money off shore, even though I know she's got bank accounts there. I have no idea why.
Q Let me to go to Page 43 of your deposition. You were asked some questions about that.
I'm going to try and squeeze this up a little bit. I think it's legible.
Down at Line 18.
And the answer was given, again, Jan was looking

EXHIBIT “E”

UNITED STATES DISTRICT COURT

WESTERN DISTRICT OF WASHINGTON

AT SEATTLE

UNITED STATES OF AMERICA,	)	NO. MJ10-135
Plaintiff,	)	
vs.	)	April 15, 2010
MARK E. PHILLIPS,	)	Seattle, Washington
Defendant.	)	

TRANSCRIPT OF DETENTION REVIEW HEARING
BEFORE THE HONORABLE JAMES P. DONOHUE
UNITED STATES DISTRICT COURT MAGISTRATE JUDGE

For the Plaintiff:	UNITED STATES ATTORNEY'S OFFICE BY: A. SWAMINATHAN, AUSA CARL BLACKSTONE, AUSA 700 Stewart Street Suite 5220 Seattle, WA 98101
For the Defendant:	DAVID BUKEY Attorney at law 1501-4th Avenue Suite 2150 Seattle, WA 98101
Pre-Trial Services:	Ms. Johnson
Court Reporter:	CATHERINE M. VERNON, CSR, RPR 3641 North Pearl Street Tacoma, WA 98407

(Proceedings transcribed from recorded proceedings; transcript produced with aid of computer)

(Defendant present, in custody)

THE CLERK: All please rise. The United States District Court for the Western District of Washington is now in session, the Honorable James P. Donohue presiding.

THE COURT: Good afternoon. Please be seated.

THE CLERK: Your Honor, this matter has been scheduled as a Detention Review Hearing in United States of America vs. Mark Phillips, Cause No. MJ10-135.

Would counsel please make their appearance for the record?

MR. SWAMINATHAN: Good afternoon, Your Honor, Aravind Swaminathan for the United States government.

MR. BLACKSTONE: Good morning, Your Honor, Carl Blackstone on behalf of the government.

THE COURT: Good morning -- excuse me, good afternoon, Mr. Swaminathan, and good afternoon, Mr. Blackstone.

MR. BUKEY: May it please the Court, David Bukey for Mr. Phillips, who is present in custody. At counsel table with me is my assistant, Ms. Shannon Stansell.

THE COURT: Good afternoon, Mr. Bukey, and Ms. Stansell, and good afternoon to you, Mr. Phillips.

We are here on the government's motion to review the previous Order I entered dated April 2nd relating to the government's request to detain Mr. Phillips pending trial in this matter.

As was indicated at the last hearing, the purpose of this

hearing would be basically to permit the matter of the detention, the continued pretrial detention of Mr. Phillips to be heard as though a hearing had not taken place because indeed a hearing had not taken place.

The -- I have reviewed the Indictment in this matter. I've also reviewed the government's Motion for Detention. I have reviewed Pretrial Services' initial report dated March 30th, 2010, April 2nd, 2010, and the Second Supplemental Pretrial Services report dated April 15th, 2010. I've also reviewed a Memorandum filed on behalf of Mr. Phillips dated April 15th, 2010.

Mr. Swaminathan, I'll hear first from you, please.

MR. SWAMINATHAN: Thank you, Your Honor. And just so the record is clear, I may have misheard Your Honor, but I -- there is no Indictment in this matter. Mr. Phillips has been charged with a Complaint. I imagine when Your Honor made reference to an Indictment --

THE COURT: You are absolutely -- thank you for clarifying. You're absolutely right. I was referring to the Complaint rather than an Indictment. Thank you.

MR. SWAMINATHAN: Your Honor, this comes up on the Defendant's motion to review the prior bond, the prior Detention Order that this Court entered.

I'd like to start, Your Honor, by giving you a little bit of background on this case. This case came to our attention

just less than a month ago. We met with lawyers from MOD Systems, Incorporated as well as a MOD shareholder. They expressed to us that they had been concerned with criminal wrongdoing and they presented in support of their allegations two very thorough reports. One was prepared by KPMG, which is an accounting firm that has an office in town. The other was prepared by the office of Lane, Powell which is a law firm. We were also provided with a set of documents supporting some of these conclusions, and based on this evidence we believed we had solid evidence that there was a scheme to defraud MOD as well as a related company and we -- we began to consider criminal charges. The lawyers and the individuals at MOD and the MOD shareholders, the MOD shareholder representative that we spoke with expressed to us concerns about Mr. Phillips' recent erratic behavior, extensive drug use, and other concerns for their own safety. Based on that information, Your Honor, and the fact that we believed we had solid evidence, we decided that we had to move quickly in this instance to proceed with criminal charges. And we did so in large part, Your Honor, because the victims and witnesses in this case had expressed serious concerns about their personal safety.

Now, one of those people, Your Honor, was Jan Wallace who several weeks ago entered an FBI office hysterical and pleading to talk with FBI agents. We met with her and her lawyer and she expressed concerns of her own safety. We had evidence that

corroborated those fears and although this was not the focus of our investigation, we continued to investigate Ms. Wallace's allegations.

Last -- yesterday evening or maybe early yesterday evening FBI agents spoke with Eric Lundval. Mr. Lundval --

THE COURT: With whom? I'm sorry, with whom?

MR. SWAMINATHAN: With Eric Lundval, Your Honor. Mr. Lundval is the individual who is referenced in the Pretrial Services report, supplemental report from April 2nd on page seven. And this involves the incident that happened in Arizona. As we talked to Mr. Lundval we -- we began to realize we did not have a full understanding of the events that transpired in Arizona. Among other things, Mr. Lundval we did not -- we were not aware that he actually has an intimate relationship with Ms. Wallace's daughter. We also found out that he told us yesterday or told F.B.I. agents yesterday that he and Ms. Wallace had hatched some kind of a scheme to extort Mr. Phillips from some money.

So, Your Honor, I come to you telling you -- asking you to do this, which is we don't understand exactly what happened in Arizona and because of those concerns that we don't understand the four corners of those events, we ask that you not consider anything having to do with Ms. Wallace or the incidents in Arizona when considering whether to detain or release Mr. Phillips on bond.

EXHIBIT “F”

SVB Analytics
A Member of SVB Financial Group

DRAFT FOR DISCUSSION PURPOSES ONLY

August 19, 2008

David Douglass
Vice President, Chief Financial Officer
MOD Systems Incorporated
720 Third Avenue, Suite 1100
Seattle, WA 98104

RE: Valuation of MOD Systems' Common Stock

Dear Mr. Douglass:

In response to the engagement letter executed on June 9, 2008, SVB Analytics, Inc. ("SVB Analytics" or "SVBA") has completed an analysis of MOD Systems Incorporated("MOD Systems" or the "Company") as of June 30, 2008 (the "Valuation Date") to determine both the fair market value ("FMV") and the fair value of the Company's Common Stock ("Common Stock") on a non-marketable, non-controlling interest basis.

This cover letter is intended to provide you with an overview of the purpose and scope of our analysis and our conclusions. Please refer to the attached report for a discussion and presentation of the analysis performed in connection with this engagement.

Purpose and Scope

Please note that this letter and its conclusions (the "Valuation" or the "Opinion") are intended to be used by the Board of Directors of MOD Systems for the exclusive purpose of compliance with IRC §409A and as an input for financial reporting purposes relating to SFAS 123(R) compliance. We make no representation as to the accuracy of this Valuation if it is used for any other purpose without the written consent of SVB Analytics. This Opinion should not be considered, in whole or in part, as investment advice by anyone. Please see Exhibit L of the report for limiting conditions.

Summary of Findings

Based on our analysis, it is our opinion that the value of the Common Stock of MOD Systems on a non-marketable, non-controlling basis as of the valuation date is:

$1.27 PER SHARE

SVB Analytics has based this Opinion on information provided and represented by the management of MOD Systems. This information included the state of product development, the financial history, future business plans, as well as information with respect to the capital structure and past financings. We did not independently verify the information provided to us and in that regard, the validity of the Valuation depends on the completeness and accuracy of the information provided to SVB Analytics by the Company.

Our review also included factors external to the Company such as the state of the development of their target markets and the pace of adoption of their chosen technology platforms. SVB Analytics applies valuation techniques and methods that rely on recommendations by the American Institute of Certified Public Accountants (AICPA) in their Audit and Accounting Practice Aid[1] and conform to generally accepted industry practices.

Our fee for this service has been paid in full prior to the delivery of this or a previous draft report and is therefore not contingent upon the opinion expressed herein. This report is subject to the terms and conditions of the Agreement as outlined in the engagement letter executed on June 9, 2008 between SVB Analytics, Inc. and MOD Systems Incorporated.

SVB ANALYTICS, INC.

Principal Appraiser
Brendan Kennedy
Managing Director

Contributing Appraiser
Steve Allan
Associate

[1] AICPA 2004, Valuation of Privately-Held-Company Equity Securities Issued as Compensation.

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1.0 Engagement Overview

1.1 Background

In response to the engagement letter executed on June 9, 2008, SVB Analytics, Inc. ("SVB Analytics" or "SVBA") has completed an analysis of MOD Systems Incorporated("MOD Systems" or the "Company") as of June 30, 2008 (the "Valuation Date") to determine both the fair market value ("FMV") and the fair value of the Company's Common Stock ("Common Stock") on a non-marketable, non-controlling interest basis.

1.2 Engagement Purpose and Scope

Please note that this letter and its conclusions (the "Valuation" or the "Opinion") are intended to be used by the Board of Directors of MOD Systems for the exclusive purpose of compliance with IRC §409A and as an input for financial reporting purposes relating to SFAS 123(R) compliance.

In October, 2004, the IRS issued new regulations (Internal Revenue Code §409A, or 409A) that require private companies to establish that stock options were not being issued "in-the money" or with an exercise price that is below "fair market value" as defined in IRS Revenue Ruling 59-60. To avoid an additional tax event and potential penalties, a formal "valuation opinion" is required every 12 months, or more often if there is a material change in either the business or the implied market value of the Common Stock. On April 10, 2007, the IRS issued final regulations, which went into effect on January 1, 2008.

Issued in December 2004 by the Financial Accounting Standards Board (FASB), SFAS 123(R) (or 123R) addresses the accounting for stock-based compensation such as stock options. The Statement supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees and requires that such transactions be accounted for using the fair value method. A key driver for that calculation is the fair value of the Common Stock. The American Institute of Certified Public Accountants (AICPA), in its Audit and Accounting Practice Aid Series, issued guidelines for the valuation of privately held company equity securities issued as compensation. SVB Analytics has followed these guidelines in its analysis and presentation of its conclusions.

We make no representation as to the accuracy of this Valuation if it is used for any other purpose without the written consent of SVB Analytics.

Please see Exhibit L for limiting conditions to this Opinion. This Opinion should not be considered, in whole or in part, as investment advice by anyone.

1.2.1 Value Definitions

SVB Analytics determines the fair market value of the Common Stock for 409A and 123(R) compliance using methodologies based on the AICPA valuation standards and the IRS requirement to consider "all relevant facts and circumstances." SVB Analytics derives the ultimate valuation of the Company's Common Stock from a valuation of the business as a whole. In determining a value of the business and its Common Stock, SVB Analytics uses the FMV standard defined by the IRS as:

> (T)he price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts. [2]

While similar in its definition, FASB defines Fair Value under SFAS 123(R) as:

> The amount at which an asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale.[3]

The FASB has recently issued new guidance for Fair Value determinations under Statement of Financial Accounting Standards No. 157 ("SFAS 157"). Under SFAS 157 (paragraph 5) Fair Value is defined as:

> (T)he price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.[4]

1.2.2 Scope of Analysis

SVB Analytics has based this Opinion on information provided and represented by the management of MOD Systems. Our review and analysis included, but was not necessarily limited to, the following steps:

- Interviews with Company management ("Management") concerning the assets, financial and operating history and forecasted future operations of the Company;
- Analysis of audited and/or unaudited historical and forecast financial statements, as applicable, and other financial and operational data concerning the Company;
- Review of corporate documents, including but not limited to capitalization summary of preferred and Common Shares, options and warrants;
- Analysis of the Company, its financial and operating history, the nature of its product technologies, and its competitive position;
- Analysis of the industry in which the Company competes as well as the state of the development of the Company's target markets and the pace of adoption of their chosen technology platforms;

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[2] IRS Revenue Ruling 59-60, Section 2.02
[3] SFAS 123R, Glossary Appendix E
[4] However, we note that SFAS 157 specifically excludes any fair value calculation which is completed under SFAS 123R.

- Research and analysis concerning comparable public companies and transactions involving comparable public and private companies;
- Analysis concerning the current economic conditions and outlook for the United States economy as well as applicable global economic conditions; and
- Analysis and estimation of the fair market value of the common equity on a non-marketable, non-controlling interest basis as of the valuation date.

1.3 Summary of Findings

Based on the result of our analysis, it is our opinion that the value of the Common Stock of MOD Systems is $1.27 per share as of June 30, 2008 on a non-marketable, non-controlling basis.

We did not independently verify the information provided to us and in that regard, the validity of the Valuation depends on the completeness and accuracy of the information provided to SVB Analytics by the Company. SVB Analytics applied valuation techniques and methods that rely on recommendations by the American Institute of Certified Public Accountants (AICPA) in their Audit and Accounting Practice Aid[5] and conform to generally accepted industry practices.

Our fee for this service has been paid in full prior to the delivery of this or a previous draft report and is therefore not contingent upon the opinion expressed herein. This report is subject to the terms and conditions of the Agreement as outlined in the engagement letter executed on June 9, 2008 between SVB Analytics, Inc. and MOD Systems Incorporated.

[5] AICPA 2004, Valuation of Privately-Held-Company Equity Securities Issued as Compensation.

2.0 Company Overview

The following sections provide an overview of the Company's history, products, services, facilities, management team, capital structure, and financial position.

2.1 Corporate Background

MOD Systems, Inc., based in Seattle, Washington, was co-founded by Anthony Bay and Mark Phillips in April 2005. The Company provides a comprehensive digital media technology and content platform that enables retailers to thrive in the digital media age.

2.2 Product/Services and Sales

MOD Systems' media-on-demand platform transforms retail stores into digital destinations from a vast digital content library and rich management controls to an engaging customer experience and eye catching overhead promotions to on-demand downloading and manufacturing.[6] The Company's platform is a flexible, multi-tiered content asset-programming tool, designed to enable large-scale endpoint integration that has all the components required to deploy a digital assets system. MOD Systems' platform, in market with leading global retailers, supports all content types and distribution scenarios, including manufacturing on-demand, delivery in optical or digital format, and hybrid online and in-store systems. With the Company's sophisticated software solution and interactive touchscreen kiosks, retailers can provide an engaging experience for consumers to quickly and easily buy content in a format that is portable and multi-device compatible.[7]

MOD Systems' technology allows retailers to supplement their physical inventory and adopt a long-tail business model. The Company's approach is based on managing digital content and delivering it flexibly, with a focus on large-scale deployments. With MOD Systems, retailers are positioned for the next generation of retail, supporting a wide range of consumer devices and delivery options including CD burning, direct-to-device, and wireless.[8]

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[6] News, June 2, 2008, "MOD Systems Joins the Store of the Future at EMA's Digital Media Day,"PR-inside.com http://www.pr-inside.com/mod-systems-joins-the-store-of-r620834.htm

[7] Ibid.

[8] Article, January 4, 2007, "Glass Houses | Manufacturing On Demand: A Synergistic Way to Survive," – Debbie Galante Block, eMediaLive http://www.emedialive.com/Articles/ReadArticle.aspx?ArticleID=12245

MOD Systems offers retailers:

- Unlimited content catalog – the Company has long-standing relationships with major Hollywood labels and studios, as well as many individuals, to get traffic-building hot new releases along with high value and long-tail content.
- Digital delivery – the Company's hosted, multi-tier delivery model minimizes the time to market and provide flexible deployment options – from sampling, to purchase, to digital delivery on-demand. With MOD Systems, consumers can search a virtual catalog of millions of digital assets to sample, buy, and download content directly to handheld devices such as MP3 players, SD cards, and phones as well as they can burn CDs or DVDs, complete with custom disc and jacket artwork – within minutes.
- Flexible and scalable design – the only purpose-built, enterprise scale infrastructure for secure, bulletproof delivery of any type of digital content to the end consumer.
- Engaging consumer experiences – deliver a customizable, brand-reinforcing experience using the MOD PODs to promote and sell content, or flexibly use PC based in-store kiosks which are able to tie in engaging editorial content on end caps or overhead displays run promotions or third party ads, product tutorials or infomercials on overhead displays to further enhance the experience and drive sales.
- Track record and vision – the Company brings the vision and strategy for success with years of experience working with large retailers, content providers, device manufacturers, and digital media solutions.

MOD Systems' consumer kiosk, "POD," is a unique hardware component, providing exceptional in-store experiences, enabling consumers to sample, listen, and purchase content via download to portable device or burn to CD/DVD.

MOD Systems targets traditional media retailers, big box retailers, and other nontraditional retailers, including supermarkets and convenience stores. The Company primarily focuses on large-scale, multiple-location retailers selling entertainment devices. Several Fortune 500 retail customers currently deploy the Company's platform. MOD System provides technology for Starbucks' in-store music system and Circuit City. The Company also has partnerships with Toshiba and Accenture.

MOD Systems' core revenue comes from software and hardware licensing revenue and application service provider (ASP) services revenue from the retailer. The Company does not participate in the content owner/retailer/consumer transaction other than distribution, royalty reporting, and sales tracking.

2.3 Stage of Development

The AICPA's Audit and Accounting Practice Guide defines six stages of development for start-up enterprises. In this hierarchy, SVB Analytics categorizes MOD Systems as a Stage 3 company.[9]

> Stage 3 companies have met key product development milestones, but development is still in progress and the companies have no project revenue. Stage 3 companies typically have raised several rounds of venture capital with those venture capital investors holding preferred stock.

SVBA classifies MOD Systems as a Stage 3 company because the Company has a near developed and pilot developed media-on-demand platform, has been internally funded, and has been generating modest revenue since 2006 ($719,019 in 2006, $163,945 in 2007, and $175,840 through June, 2008).

2.4 Facilities

MOD Systems leases an 8,800 square foot facility in Seattle, Washington.

2.5 Intellectual Property

MOD Systems has not filed for any patents. However, the Company has acquired substantial IP from Mark Phillips through the Anythingbox Incorporated acquisition.

MOD Systems currently holds registered trademarks for "MOD Systems."

The Company may also be in the process of developing other IP. The eventual value of MOD Systems' IP and in-process research and development will depend upon the growth and maturation of the overall market for MOD Systems' products. The value of the IP also depends upon any competing technologies that have been developed or are in development that may be superior to the solutions provided by MOD Systems. Any value of the Company's intellectual property is included in the final determined enterprise value. Consequently, no specific independent value was assigned to the Company's intellectual property.

[9] American Institute of Certified Public Accountants 2004, Valuation of Privately-Held-Company Equity Securities Issued as Compensation, pp. 13–14.

2.6 Management Team and Workforce

As of the valuation date, the Company had 35 employees and 8 part-time contractors/consultants. Some of the key members of the management team include:

Anthony Bay, Executive Chairman and Co-Founder

Mr. Bay brings more than 25 years of experience as a technology executive and private venture investor. He is the former executive chairman of Loudeye Corporation (formerly NASDAQ: LOUD), which was acquired in 2006 by Nokia and now powers Nokia's global music service; OVI. Loudeye was a leading provider of business-to-business systems and services for the digital media industry.

Before joining Loudeye, Mr. Bay spent six years with Microsoft, last serving as corporate vice president and general manager of the Digital Media Division, and as a member of Microsoft's executive staff. He was responsible for multimedia and digital rights management (DRM) technologies, overseeing a team of 700 and a research and development budget of more than $125 million. Mr. Bay's team was responsible for the creation and development of Windows Media technologies, including Media Player, Media Server, codecs, DRM, and the windowsmedia.com portal.

Previously, Mr. Bay served as general manager of Microsoft's Commercial Systems Division. He was responsible for core components of the Internet services platform including ISP and carrier infrastructure, website development, content management, and e-commerce. Mr. Bay joined Microsoft in 1994 as part of the MSN management team and was responsible initially for Internet strategy and engineering. He was appointed general manager of all MSN development and systems. Mr. Bay managed the development organization that shipped the original version of MSN with Windows 95. He spent eight years at Apple Computer, including three years at Apple's European headquarters in Paris. He served as general manager of Apple's Online Services in Europe, general manager for Enterprise Systems Europe, and product line manager for Apple's Workgroup Systems.

Mr. Bay sits on the board of CMGI (NASDAQ: CMGI) and chairs the technology committee, which governs its @Ventures VC subsidiary. He is also a principal in 21st Century Music, an independent music company. Mr. Bay served for five years on the board of European Capital Ventures (ECV), a small private equity investment firm in London, and he also served as chairman and vice chairman for four years at Active24 (OSLO: ACTIVE), an ECV portfolio company and one of the largest pan-European small and medium business web hosting providers.

Mr. Bay has a bachelor's degree from the University of California Los Angeles and an MBA from California State University San Jose. He also has studied at INSEAD in Paris, France, and at Goerg-August Universitaet in Goettingen, Germany.

Mark Phillips, Chief Executive Officer, Chief Technology Officer, and Co-Founder

Mr. Phillips holds nine years of senior management and engineering experience developing and successfully bringing to market mobile and digital media enterprise software solutions. He co-founded the company in 2005 with the vision to create a complete ecosystem for retailers to profitably manage, merchandise, and deliver digital media to customers.

Prior to MOD Systems, Mr. Phillips served as CTO and Senior Vice President of Research and Development for Fullplay Media Systems, Inc., where he directed the company's technical vision and engineering initiatives, developed intellectual properties, and structured strategic customer relationships. Mr. Phillips has participated in the development of more than 35 products.

Mr. Phillips earned his B.A. in Comparative History of Ideas, with a minor in Architecture Design, from the University of Washington. He studied Computer Science his senior year while working at the University of Washington Human Interface Technologies Lab, where he also served as a Developer. After school, he founded Oo-moja Software, and worked for MetaBridge, Inc., a software company. He later served as a Senior Software Engineer and Developer for software company Saltmine Creative, Inc. Mr. Phillips has been an entrepreneur since grade school.

He is an active member of the University of Washington's Advisory Board for Embedded Systems. Mr. Phillips is also a member of the American Electronics Association, Alliance of Angels, and is an active angel investor in the Keiretsu Forum.

Kenn A. Gordon, VP, Chief Information Officer

Mr. Gordon has been with MOD Systems since its founding in 2005. He brings more than a decade of experience managing corporate finances, operations, and investments. In his role as vice president of finance and operations, Mr. Gordon has conducted extensive market analysis and research generating business plans and forecasts within the digital media space.

Most recently, Mr. Gordon served as chief operating officer and chief financial officer of A DOT Corporation, where he was fundamental to the rapid growth of the company. He also served as hardware program manager and manufacturing manager, and he oversaw shipment of the Subcarrier Signal Monitor and other product development and prototyping projects.
Prior to joining A DOT, Mr. Gordon was a senior program manager at Fullplay Media, where he led several product development projects including shipping the Iomega HipZip and the Digital Audio Jukebox beta, and developing the Interactive Merchandising System beta with Best Buy.

Before FullPlay Media, Mr. Gordon gained financial management and operations experience as the business manager in charge of finance and operations for Shaman Drum Bookshop, a large independent trade and textbook retailer with annual revenues in excess of $3 million. Mr. Gordon studied philosophy at Michigan State University in East Lansing, Michigan.

David M. Douglass, VP, Chief Financial Officer

David's career spans more than 25 years and includes senior management positions in finance, general management, and operations for both international and domestic companies.

Douglass is a partner of Tatum, LLP, an executive services firm that provides strategic and operating leadership in finance and information technology. In recent years as a Tatum Partner, David has served as CFO of a publicly-traded online photo services company, a private equity backed multi-state group of heavy duty truck dealerships, a subsidiary of a publicly-traded provider of mobile data communications solutions and a tax-exempt, multi-location air ambulance service providing emergency medical transport.

Prior to joining Tatum, David was involved in technology startups. He served as CFO of The Cobalt Group (NASDAQ: CBLT) during its final venture capital stages and IPO process. The Cobalt Group is a leading provider of internet products and services to the automotive industry. Prior to Cobalt, David climbed the corporate ladder at PACCAR Inc (NASDAQ: PCAR), a worldwide manufacturer of transportation equipment where he held the positions of Director of Internal Audit and Managing Director of Foden Trucks, based in England.

David earned a B.A. summa cum laude from the University of Puget Sound and a M.B.A. from the University of Washington. He also attended Duke University's Advanced Management Program at the Fuqua School of Business. Douglass is a certified public accountant (inactive).

2.7 Capital Structure and Financing History

In August 2008, MOD Systems anticipates receiving $35 million in funding from an investor group led by Toshiba and NCR. This equity financing will be the Company's first round of professional venture funding. The following table illustrates the Company's financing rounds:

Round	Date	Pre-Money	Amount Raised
A Round	8/2008	$87.8 M	$35.0M

Please see Exhibit G for details on the capitalization table.

2.8 Future Financing

MOD Systems is currently looking to raise $35 million in a Series A round equity financing in August of 2008, consisting of approximately $30.0 million in cash and the conversion of $5.0 million of existing convertible notes into preferred Series A shares. Strategic investor, Toshiba, will invest $20.0 million of the $30.0 million and convert a $4.0 million note. NCR will invest $10 million. The anticipated purchase price will be $2.7448 per share on a pre-money of $87.8 million. The proceeds will be used to repay a $0.5 million note and grow the business.

Concurrent with the Series A funding, the company will be acquiring a significant amount of IP from Mark Phillips in exchange for $45 M in common stock and $5M in promissory notes to be paid as a bullet payment due within five years with interest adjusted quarterly at Prime + 1%.

2.9 Risks

Based on its analysis and discussions with the management team, SVB Analytics recognizes that MOD Systems faces the following risks, all of which it incorporates into this analysis through discount factors to future performance:

- **Market Outlook** – The target market of the Company may not continue to develop at the level at which the Company's Management and independent research groups project. Any delay in market opportunity or penetration may adversely impact the Company's ability to meet its operational plans.
- **Competition** – The Company competes against large multi-national corporations with significant resources. These multinational corporations may leverage existing distribution channels or development efforts to render the Company's offering obsolete.
- **Product Acceptance –** Consumers and/or businesses may adopt different technology and/or industry standards (which are out of the influential control of the Company) may change towards solutions the Company does not support. This may negatively impact the Company's ability to operate as a going concern.
- **Customer Concentration**s – The Company has significant customer concentration, which are not under long-term contract. Any contraction in this customer base would have a material impact on the results of the Company and may require un-anticipated funding needs.
- **High Insurance Costs** – The Company could face large liabilities for future potential errors in its products and services.
- **Beta** – The Company is currently in or recently emerging from BETA testing of its product/service. It anticipates additional testing and scalability development before it is ready for general availability. The Company is not certain it will be successful in mitigating the technological hurdles associated with these needs.
- **Security** – The Company operates in a highly regulated industry specific to data privacy, any breach, or data or inability to mitigate data vulnerability may negatively impact the Company's ability to execute on its business plan or attract or retain customers.
- **Market Penetration** – The target market may not readily adopt the new technology, and/or the sales cycle may extend beyond the expectations of the Company requiring additional investment to support carrying costs.
- **Scalability –** The Company has limited supply / supplier resources, and may compete for the same against larger companies with significant resources and credit. Should the Company be unable to meet its demand, it may suffer irreparable reputational harm and/or experience delays in executing its business model and internally financing its operations. Hitherto, the Company has only pilots. For the Company to scale up its business operation, it needs to gain traction in the market.
- **Execution – Partnerships** – The Company is looking forward to closing a few partnership deals with major studios. Any set back on this front will have a negative impact on the Company's business.

2.10 Financial Analysis

SVB Analytics received copies of the following documents as of the valuation date:

- The Company's internally prepared financial statements from 2006 through June 2008
- Company prepared financial projections through 2013
- Management presentations regarding the Company's products and services
- Amended and Restated Articles/Certificate of Incorporation

SVB Analytics has also engaged in discussions with Management regarding its business plan, future prospects, and historical and projected financial performance.

The Company has generated operating and net losses since inception, including net losses of $5.67 million in 2007 and $3.97 million through June, 2008. See Exhibit B for the Company's financial statements. Based on the Company's projections, the forecast included revenue and major expense categories along with selected balance sheet and cash flow information.

Historical Income Statement and Balance Sheet Highlights

Income Statement	2006	2007	12/31/2007 to 06/30/2008
Revenues	$719,019	$163,945	$175,840
Cost of Sales	$142,821	$20,000	$103,111
Gross Profit	$576,198	$143,945	$72,729
Gross Margin - %	80.14%	87.80%	41.36%
Operating Expenses	$2,339,365	$5,978,628	$4,063,463
Operating Income	($1,763,167)	($5,834,683)	($3,990,734)
Operating Margin - %	-245%	-3559%	-2270%
EBIT	($1,761,796)	($5,745,041)	($3,862,551)
Net Income	($1,753,472)	($5,672,115)	($3,973,791)

Balance Sheet	2006	2007	6/30/2008
Total Current Assets	$505,866	$1,836,030	$31,191,738
Net Fixed Assets	$67,156	$248,756	$385,946
Total Other Assets	$46,327	$119,577	$176,306
Total Assets	$619,348	$2,204,363	$31,753,990
Total Liabilities	$269,565	$6,026,653	$4,663,986
Total Shareholder's Equity	$349,783	($3,822,290)	$27,090,004
Total Liabilities & Shareholder's	$619,348	$2,204,363	$31,753,989

3.0 Industry Overview

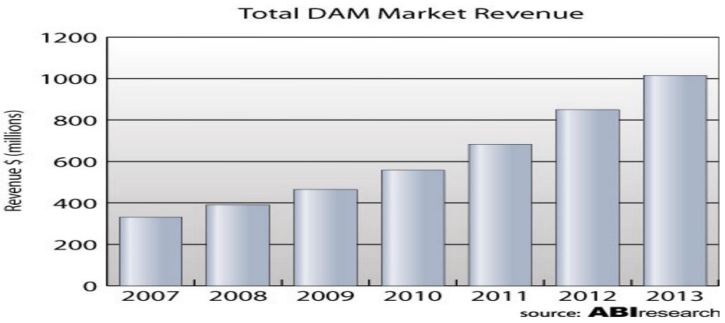
The condition of and outlook for the industry significantly influence the Company's operations, financial performance, and enterprise value. The following is a brief overview of the digital asset management (DAM) industry.

3.1 Market Overview

The arrival of digital media results from the convergence of telecoms, media, and IT. Digital media refers to electronic media that work on digital codes. Digital media like digital audio, digital video, and other digital "content" can be created, referred to, and distributed via digital information processing machines. As the digital age is transforming day-to-day life, increasingly digital media applications are being found in different verticals bringing along with them the need to manage these digital assets.[10]

DAM consists of tasks and decisions surrounding ingesting, annotating, cataloguing, storage, and retrieval of digital assets, such as digital photographs, animations, videos, and music. It may consist of the conversion of huge amount of information into manageable files that are stored and controlled using software systems, as well as the preservation of valuable data by conversion into digital media that is stored, usually on CDs and DVDs. Effective implementation of a DAM system helps in reducing time and cost of content production, maximizing the return on investment (ROI) from media assets, bringing new products and services to market faster, and streamlining compliance.

The global market for DAM solutions – the use of software and hardware to store, organize, retrieve and distribute the world's exploding volume of digital media files – exceeded $330 million in 2007.[11] The figure represents the total DAM market revenue for 2007–2013.[12]



3.2 Competitive Environment

MOD Systems faces competition from companies operating in the digital asset management industry space. Competitors include RedDot, Mix&Burn, Mediaport Entertainment, PolarFrog, TitleMatch, MoovyPlay, NCR, and PortoMedia.

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[10] Report, August 31, 2005, "Value proposition of digital asset management (DAM) solutions drives market growth," – Frost & Sullivan Research Service http://www.frost.com/prod/servlet/report-brochure.pag?id=F449-01-00-00-00

[11] Abstract, May 13, 2008, "Demand for Collaboration Driving $330 Million Digital Asset Management Markets," – ABI research http://www.abiresearch.com/eblasts/archives/analystinsider_template.jsp?id=115

[12] Abstract, May 13, 2008, "Demand for Collaboration Driving $330 Million Digital Asset Management Markets," – ABI research http://www.abiresearch.com/eblasts/archives/analystinsider_template.jsp?id=115

4.0 Economic Overview

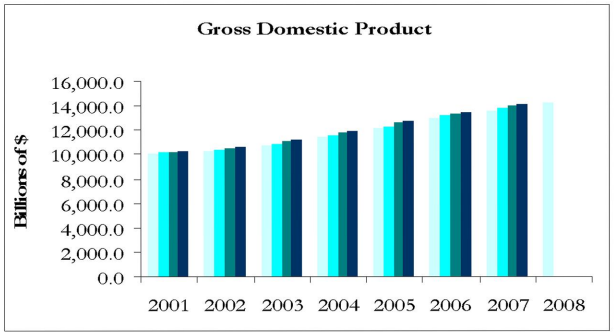
In valuing a business, it is important to consider the condition and outlook for the economy or economies of the particular geographic regions in which the enterprise operates or sells its products or services. This review of economic conditions and outlook is required because the performance of a business is affected to varying degrees by overall trends in the economic environment in which the business operates and the value of a business or its assets cannot be determined in isolation from these factors. The following section provides a brief discussion of the economic condition and outlook for the United States' economy as of the end of the first quarter of 2008.

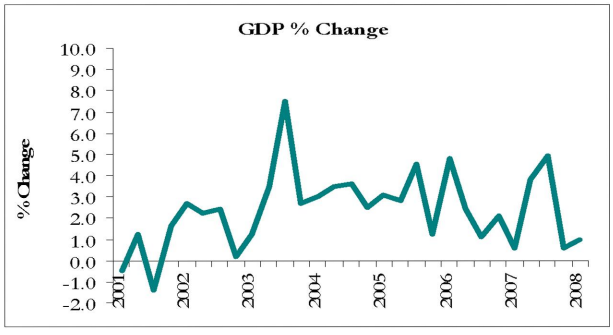
4.1 U.S. Economic Conditions and Outlook

The U.S. economy continued to weaken during the first quarter of 2008 as home values declined, lending activity froze, energy prices soared and job losses accelerated.[13] The Federal Reserve lowered its key interest rate, the Fed Funds rate by 2.00% to 2.25% during the first quarter of 2008 from 4.25% in the fourth quarter of 2007. The economic forecast for 2008 is expected to be bleak. A lagging economy is likely to have wide ramifications. In the heat of a presidential election year, unemployment would start to rise, making the economy a major issue for the candidates. An anemic economy would also present a challenge to the Federal Reserve Board, which might opt to keep cutting interest rates.[14]

4.2 Gross Domestic Product

Real gross domestic product (GDP) increased at an annual rate of 1.0% in the first quarter of 2008. In the fourth quarter of 2007, real GDP increased 0.6%. The increase in real GDP in the first quarter primarily reflected positive contributions from personal consumption expenditures (PCE) for services, exports of goods and services, and federal government spending that were partly offset by negative contributions from residential fixed investment and PCE for durable goods.[15]





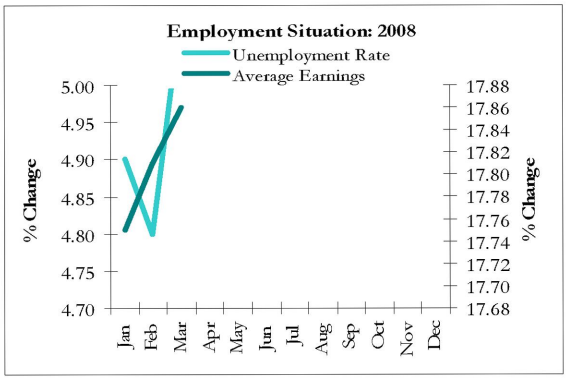
[13] Lynch, J. K., April 4, 2008, "Market Outlook," p. 2, Evergreen Investments, http://www1.evergreeninvestments.com/content/public/news/marketcmt_040408.pdf

[14] Ron Scherer December 28, 2007, "U.S. Economic Forecast for 2008:Bleak," http://www.csmonitor.com/2007/1228/p01s07-usec.html

[15] Bureau of Economic Analysis, U.S. Department of Commerce June 27, 2008, "Gross Domestic Product: First Quarter 2008 (Final)," News Release, p.1, http://bea.gov/newsreleases/national/gdp/2008/gdp108f.htm

4.3 Employment[16]

The US national unemployment rate rose to 4.9% during the first quarter of 2008 compared with 4.8% in the fourth quarter of 2007. The number of unemployed persons during the first quarter of 2008 was at 7.591 million compared with a 7.375 million in the fourth quarter of 2007. During the first quarter of 2008, the education and health services, leisure and hospitality, and government sectors continued to add jobs, while employment in manufacturing, construction, retail trade, and professional and business services showed a downward trend.

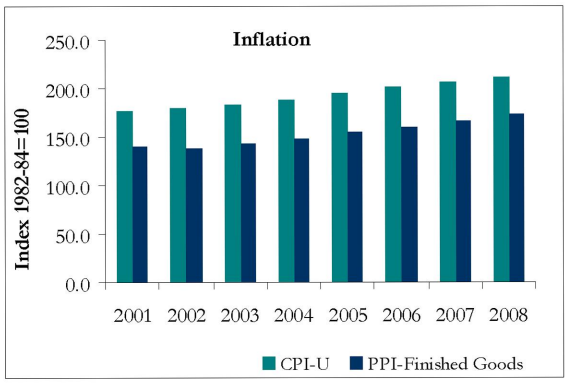


Average hourly earnings increased to $17.81 during the first quarter of 2008 from $17.64 in the fourth quarter of 2007. Average weekly earnings also increased to $600.68 during the first quarter of 2008 from $596.34 in the fourth quarter of 2007.

4.4 Inflation

On a seasonally adjusted basis, consumer prices rose 0.4% in March 2008. The Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) increased 0.9% in March 2008 and is 4.3% higher than one year ago.[17]

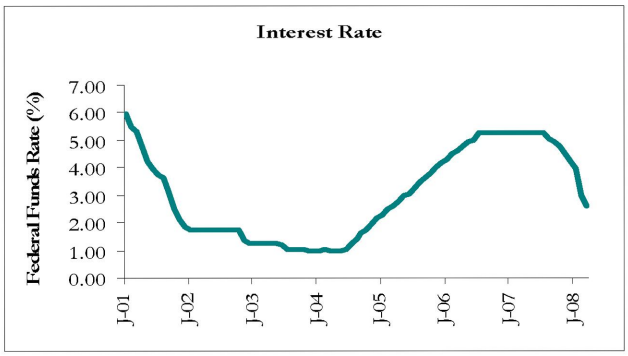
The Producer Price Index (PPI) for finished goods increased 1.1% in March 2008. This advance followed a 0.3% rise in February 2008.[18]



[16] Bureau of Labor Statistics, U.S. Department of Labor April 4, 2008, "The Employment Situation: March 2008," p. 1, http://www.bls.gov/news.release/empsit.nr0.htm
[17] Bureau of Labor Statistics, United States Department of Labor, April 16, 2008, "Consumer Price Index: March 2008," pp. 1–2, http://www.bls.gov/news.release/cpi.nr0.htm
[18] Bureau of Labor Statistics, United States Department of Labor, April 15, 2008, "Producer Price Index: March 2008," p. 1, http://www.bls.gov/news.release/ppi.nr0.htm

4.5 Interest Rates[19]

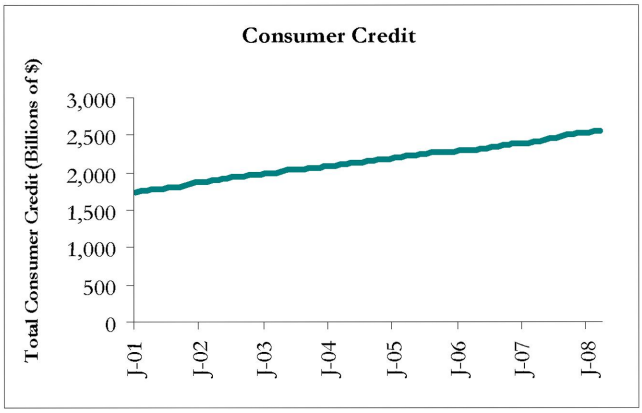
The Federal Reserve lowered the federal funds rate to 2.25% during the first quarter of 2008 from 4.25% in the fourth quarter of 2007. The Committee met four times during the reporting period (two of which were unscheduled) on January 29–30, 2008 and March 18, 2008. Uncertainties in the outlook for economic activity and deteriorating financial market conditions warranted a sharp cut in the interest rates during the reporting period.

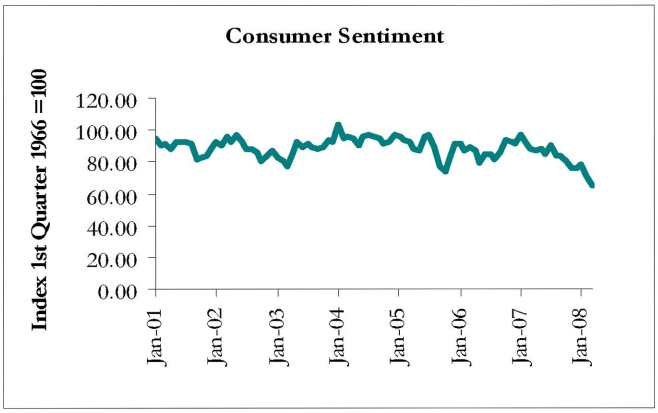


4.6 Consumer Confidence

Consumer credit increased at an annual rate of 5.5% in the first quarter of 2008. Total outstanding consumer credit for the first quarter of 2008 was at $2,558.4 billion.[20] Consumer spending increased 0.4% in March 2008.[21]

The Consumer Sentiment Index fell to 64.5 in March 2008 from 76.4 in February 2008.[22] A growing number of surveys have shown that US consumer confidence is falling sharply because of recession fears.





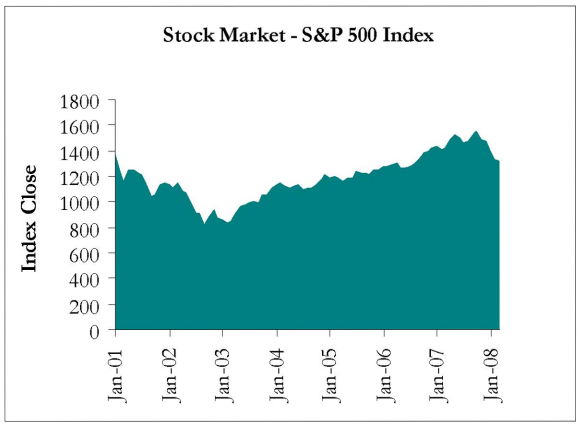
[19] Statement by the Federal Open Market Committee, March 18, 2008, http://www.federalreserve.gov/monetarypolicy/files/fomcminutes20080318.pdf
[20] "Federal Reserve Statistical Release: March 2008," May 7, 2008, p.1, http://www.federalreserve.gov/releases/g19/Current/
[21] Rex Nutting, May 1, 2008, "Income gains eroded by inflation in March," http://www.marketwatch.com/news/story/income-gains-eroded-inflation-march/story.aspx?guid=%7B2A365B33-49FD-42DD-88EC-C18349BC09FB%7D
[22] News release March 25, 2008 "Consumer confidence hits record low," http://www.reuters.com/article/businessNews/idUSN2535036520080325

4.7 International Trade

Exported goods and services averaged $148.5 billion in the month of March 2008, while imports of goods and services averaged $206.7 billion resulting in a deficit of $58.2 billion, down from $61.7 billion in February 2008. The deficit on goods and services increased to $174.9 billion in the first quarter of 2008 from $173.8 billion in the fourth quarter of 2007.[23]

4.8 The Stock and Bond Markets[24]

The financial markets remained volatile in the first quarter of 2008, as investors had to contend with news of falling profits, weaker housing, job losses, higher inflation and the ongoing credit crisis. The bond market grew more concerned about growth, rather than inflation, as the quarter progressed, driving the yield on the 10-year Treasury down below 3.5%.



The Standard & Poor's 500 Index lost 9.4% during the first quarter of 2008, 10-year Treasury note ended with return of 5.8%, and the Lehman Brothers Aggregate Bond Index gained 2.2% during the quarter ended March 2008.

4.9 Venture Capital Funding Markets

In the first quarter of 2008, a mere 56 venture-backed M&A deals were completed, one of the lowest quarterly level in the past decade. While deal volume was at a nine-year low, average disclosed quarterly dollar volume reached $290.2 million, the highest level seen since the year 2000.[25]

In the first quarter of 2008, only five venture-backed companies raised $282.7 million in public offerings. This is the lowest quarterly number of IPO's since the second quarter of 2003.[26] The Life Sciences sector saw the majority of venture-backed companies come to the public market with four IPO's raising $221 million during the first quarter of 2008.

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[23] Bureau of Economic Analysis, May 9, 2008, "U.S. International Trade in Goods and Services: March 2008," p.1, http://www.bea.gov/newsreleases/international/trade/2008/trad0308.htm and Bureau of Economic Analysis, June 17, 2008, "U.S. International Transactions: First Quarter 2008," p.1, http://bea.gov/newsreleases/international/transactions/2008/trans108.htm

[24] Lynch, J. K., April 4, 2008, "Market Outlook," p. 1, Evergreen Investments, http://www1.evergreeninvestments.com/content/public/news/marketcmt_040408.pdf

[25] National Venture Capital Association, April 1, 2008, "Venture-Backed Exits Decline Significantly in First Quarter 2008," http://www.nvca.org/

[26] Ibid.

Venture-Backed IPOs - Q1 2008

Industry	# of IPO's	Size ($M)
Computer Software & Services	1	61.80
Medical/Health	3	215.20
Biotechnology	1	5.80
Total	**5**	**282.80**

Source: National Venture Capital Association and Thomson Financial

Venture-Backed M&A Deals with disclosed value - Q1 2008

Industry	# of M&As	Size ($M)
Communications and Media	6	90.00
Internet Specific	12	1,678.70
Computer Software & Services	16	43.00
Semiconductor/Other Elect.	4	184.80
Computer Hardware	3	-
Biotechnology	1	12.00
Medical/Health	4	217.30
Other Products	4	247.00
Consumer Related	3	19.20
Industrial Energy	3	-
Total	**56**	**2,492.00**

Source: National Venture Capital Association and Thomson Financial

Investments in the Cleantech sector continued to increase in quantity and size in Q407, continuing growth trends that show no signs of abating. In North America, seventy-two Cleantech deals were completed in the fourth quarter of 2007. In the fourth quarter of 2007, 76 of the 106 Cleantech deals involved energy-related companies.[27]

4.10 Summary of U.S. Economic Outlook

The U.S. economic output continued to dwindle during the first three months of the year as home values declined, lending activity froze, energy prices soared, and job losses accelerated. Notwithstanding the fiscal and monetary stimuli, the scourge of recession looms large and will come sooner than later, possibly by the first half of 2008. Market interest rates suggest the federal funds rate is going lower, possibly as low as 1.5%, in coming months. On the positive side, significant and unprecedented fiscal and monetary steps like interest rates cut, expanded lending facility, tax incentives, and government spending may serve to generate output in the second half of 2008, albeit at the expense of inflation.[28]

[27] "Cleantech Investment Monitor," Q4 2007, p. 7, Cleantech Venture Network LLC., http://cleantechnetwork.com/documents/2007_Q4_InvestmentMonitor_v.3-ExecutiveSummary.pdf
[28] Lynch, J. K., April 4, 2008, "Market Outlook," p. 1, Evergreen Investments, http://www1.evergreeninvestments.com/content/public/news/marketcmt_040408.pdf

5.0 Valuation Theory

In order to arrive at the fair market value of a Company's Common Stock, one must first value the enterprise and then allocate that value through the capital structure. As such, SVB Analytics has considered the three generally accepted approaches to valuation described in the following sections.

5.1 Approaches to Valuation of Enterprise

The AICPA Guidelines for the Valuation of Privately-Held-Company Equity Securities outline three basic approaches of determining value:

1. Market Approach
2. Income Approach
3. Asset-based or Cost Approach

5.1.1 Market Approach – Guideline Company and Recent Transaction

The guideline (or comparable) company approach relies on an analysis of publicly traded companies similar in industry and/or business model to the Company. This approach uses these guideline companies to develop relevant market multiples and ratios such as revenue, earnings before interest, taxes, depreciation and amortization (EBIT and EBITDA), net income and/or tangible book value. These multiples and values are then applied to the Company's results. Since no two companies are perfectly comparable, premiums or discounts may be applied to the subject company if its position in its industry is significantly different from the position of the guideline companies, or if its intangible attributes are significantly different.

The recent transaction approach uses actual prices paid for companies similar to the Company. Exit multiples of total purchase price paid to revenues, EBIT, EBITDA, net income and/or book value may be developed for each comparable transaction, if the data is available. These multiples are then applied to the Company's latest twelve month and projected performance.

5.1.2 Income Approach – Discounted Cash Flow ("DCF")

A DCF analysis rests on the following assumptions:

- A business is worth today what it can generate in future cash to its owners;
- Cash received today is worth more than an equal amount of cash received in the future; and
- Future cash flows can be reasonably estimated.

The DCF analysis is based on the present value of two components; projected cash flows and a residual value. Cash flows are estimated for a future period based on historical data and projections provided by Management and, if necessary, expanded by SVB Analytics with Management's review and input. These cash flows are then discounted back to their present value equivalents at a calculated discount rate or weighted average cost of capital ("WACC") and summed. A residual value based on an exit or steady state terminal multiple, which represents the future cash flows of the company beyond the discrete projection period, is then discounted to its present value and added to the first amount. In applying the DCF analysis, it is essential that the cash flows to be discounted are clearly defined and that a discount rate appropriate for the degree of risk inherent in that return stream is established.

5.1.3 Cost Approach – Adjusted Book Value

This approach involves identifying the Company's more important tangible assets and estimating the individual current market values of each and then totaling them to derive the value of the business as a whole. The price at which a business entity changes hands can be influenced by the values of the assets employed in the business, net of its liabilities. In a favorable economic and industry environment, "net asset value" is less important to overall value than the earnings generated from those assets. Aggregate tangible assets may be perceived as providing a valuation "floor" in the absence of earnings. For this analysis, the cost approach method is utilized under an assumption or probability of dissolution or orderly liquidation.

6.0 Enterprise Value Determination

In reviewing valuation approaches for MOD Systems, SVB Analytics considered the Market Approach. Based on the stage of the Company, SVB Analytics did not use the Income Approach. For the Market Approach, we reviewed comparable companies, both in the public market and in 100% control transactions.

6.1 Market Approach – Publicly Traded Comparables

Based on research and discussion with Management, SVB Analytics identified eight publicly traded companies in the digital asset management space. Because MOD Systems generated net losses at the valuation date, SVB Analytics chose to utilize a multiple of enterprise value to revenue as the valuation metric for this approach. To generate a valuation of MOD Systems given the significant revenue growth the Company anticipates in the next several years, SVB Analytics applied the comparable companies' respective multiples to the Company's forward revenue estimates for 2008, 2009, and 2010.

SVB Analytics searched for public companies listed on the US exchanges in the digital asset management industry. In addition, SVB Analytics performed searches based on the following keyword terms:

- Media on Demand
- Digital Media Platform
- Distribution of Digital Media

SVB Analytics also discussed potential comparable public companies with the Company's Management and selected the following comparables based on size, business model, industry, and business descriptions:

- Apple Inc.
- LodgeNet Interactive Corporation
- RealNetworks Inc.
- Avid Technology Inc.
- DivX, Inc.
- Sonic Solutions
- Napster Inc.
- Concurrent Computer Corp.

Based on a review of the comparable companies' operating metrics, size, and business descriptions and discussions with management, we chose to calculate revenue multiples at the narrow average.

We then applied our concluded multiples to MOD Systems' adjusted projected revenues to determine the enterprise value of the Company. The calculated value results in the marketable, non-controlling value of MOD Systems. Exhibit C details more information about this analysis, including descriptive information about the companies.

SVB Analytics utilized the trading information from these companies in its calculation of volatility when arriving at its assumptions for the Option Pricing Method, described below (see Exhibit J-3). SVB Analytics also used these companies to calculate Beta (see Exhibit E-3) in determining the WACC.

6.2 Market Approach – M&A Transaction Comparables

SVB Analytics reviewed merger and acquisition data regarding transactions in which the target company is similar to the company being valued in industry, size, and/or developmental stage. SVB Analytics searched public and proprietary databases for transactions in the digital asset management industry. In addition, SVB Analytics performed searches based on the following keyword terms:

- Media on Demand
- Digital Media Platform
- Distribution of Digital Media

As a result of this analysis, SVB Analytics identified ten transactions where the target company competed in an industry or supplied a service that was similar to that of MOD Systems, four of which had enough information to calculate exit multiples.

SVB Analytics calculated the multiple of transaction value at the time the transaction closed to the trailing twelve-month revenue of the target company (when such information was available). SVB Analytics then applied that multiple to the twelve-month revenue of the Company, resulting in a controlling, marketable level of enterprise value. SVB Analytics utilized 2008, 2009, and 2010 revenue for this analysis and adjusted the revenue projection for each year by the discount factor for that year (as outlined in Exhibit E and based on the calculated WACC discussed below). Exhibit D provides additional information about the resulting transaction analysis, including descriptive information about the target companies.

6.3 Income Approach – Discounted Cash Flow Analysis

The forecast we used for the discounted cash flow (DCF) analysis was provided by the Company and is detailed in Exhibit B. The projections detail significant revenue growth from 2008 to 2013. Revenue is expected to grow from $5.8 million in 2008 to $235.9 million in 2013. Operating margin is expected to grow to about 45.9% over the forecast period.

6.3.1 Weighted Average Cost of Capital (WACC)

The WACC is calculated by identifying and inputting the following five data points: the Company's cost of equity, its cost of debt, the percentage of equity (in the capital structure), the percentage of debt (in the capital structure), and the tax rate into the WACC formula. Among the five data points, the cost of equity is derived by applying the widely accepted Capital Asset Pricing Model ("CAPM") while the remaining four data points are readily observable. The CAPM formula is defined as follows:

$$Re = Rf + \beta\,(Rm) + Rc + CSRP$$

Where:

Re = Return on equity
Rf = Risk-free rate
β = Beta
Rm = Market risk premium
Rc = Size premium
CSRP = Company Specific Risk Premium

Exhibit E-2 details the data sources and calculation of the CAPM.

The size premium (Rc) is also known as Small Stock Risk Premium ("SSRP"). SVB Analytics adds the SSRP into the calculation of the cost of capital since the CAPM does not fully account for the higher returns of small and/or early stage company stocks. Based on Ibbotson Associates' study of historical return data from 1926 to 2005,[29] smaller companies have had higher returns that are not fully explainable by the CAPM. Excess returns increase as the size of the companies decrease from the largest companies in decile 1 to the smallest decile 10. These findings are consistent with those detailed in the Grabowski & King study published by Duff & Phelps in 2007.

In addition to the SSRP, SVB Analytics also adds a Company Specific Risk Premium ("CSRP") to the total cost of capital to reflect the additional risk associated with the fact that the Company is at an earlier stage (and hence, of higher risk) than companies in the smallest segment in the SSRP. Because venture-backed companies of similar size and stage typically have a cost of capital in the 40% to 60% range (per the AICPA Guide), we derived an implied CSRP for MOD Systems such that the WACC is at the low point of that range.

Exhibit E-3 shows the detail SSRP and CSRP data.

[29] Ibbotson Associates 2006, Stocks, Bonds, Bills and Inflation 2006 Yearbook, pp. 141–143.

6.5 Weighting

In determining the value of the enterprise and subsequently an individual share of Common Stock, SVB Analytics weights the various valuation methodologies based on many factors. These factors include discussions with Management regarding their expected exit outcomes, as well as the quality of the information specific to each valuation approach. For the Market Approach, weights are based not only on the number of appropriate trading and related-transaction comparables, but also on the similarities between the Company and the comparables in such areas as lines of business, overall business model, level of revenue, market share, maturity of business and other metrics.

Exhibit F details the value distribution of the approaches described above and weighting SVB Analytics employed in arriving MOD Systems' weighted equity value as of the valuation date. In general, when considering weightings of these methods, two fundamental considerations must be made: first, the weighting of the overarching approaches (Market), and second, the weighting of the sub-approaches (e.g. M&A comparables vs. public comparables). The weightings that follow incorporate SVB Analytics' viewpoint for MOD Systems with regard to those considerations.

- SVB Analytics weighted the *Market Approach – Publicly Traded Comparables* at **25%** due primarily to the number of public company comparables and how closely they relate to MOD Systems
- SVB Analytics weighted the *Market Approach – M&A Comparables* at **25%** due primarily to the universe of M&A comparables, and the nature of MOD Systems' business model relative to selected comparables
- SVB Analytics weighted the *Market Approach – Post-Money Valuation* at **50%** due primarily to the pending Series A investment based upon the term sheet provided to MOD Systems.

6.6 Discount for Lack of Control

We did not incorporate a discount for lack of control given the SEC's recent stance on minority vs. control discounts. The SEC's comments focus on the difficulty in demonstrating a differential return to control investors vs. minority investors, and, as a result, has discouraged valuation professionals from including these discounts in their analyses.

6.7 Discount for Lack of Marketability

The last step in calculating the value of MOD Systems' common stock is to apply a per share discount for the lack of marketability. The discount for lack of marketability reflects the lower value placed on securities that are not freely transferable as compared to those that trade frequently in an established market.

SVB Analytics applied a 20% discount to the value of the Common Shares. This DLOM was based on a reduction of a 26.9% discount of an at-the-money put option analysis. This analysis determines the value of a put option (as a percentage of the underlying stock value) using the Black–Scholes option pricing framework with inputs that are determined in Section 9.0 of this report (volatility, expected term, risk-free rate).

Basic Put Option Analysis - DLOM		
Term		3.5 years
Current Price		$2.745
Dividend Yield		0.0%
Strike Price	$	2.74
Maturity (in years)		3.5
Risk-free Rate		3.3%
Annualized Volatility		47%
d1		0.57
d2		(0.31)
Intrinsic Value of Call	$	-
Call Price	$	1.04
Put Price	$	0.74
Indicated Black-Scholes Put Value	$	0.74
Implied Marketability Discount		**26.9%**

6.8 Methods of Allocating Value of the Enterprise to the Equity Holders

AICPA guidelines for Valuation of Privately-Held-Company Equity Securities outline three basic methods of allocating value:

1. Probability Weighted Expected Return Method (PWERM)
2. Current Value Method (CVM)
3. Option Pricing Method (OPM)

7.0 Probability Weighted Expected Return Method (PWERM)

As outlined in the AICPA Guidelines pertaining to the PWERM allocation method,[30] SVB Analytics considers various potential liquidity outcomes and assigned probabilities to each, based on empirical research[31] and discussions with Management, to arrive at the weighted per share value, when applicable.

7.1 PWERM Events

Under the PWERM, the value of an enterprise's Common Stock is estimated based upon an analysis of values for the Company assuming various possible future events:

- Initial public offering (IPO)
- Strategic merger or sale
- Dissolution / No value to common
- Private company

The per share value of the Common Stock is based upon the probability-weighted present value of expected future equity values, under each of the possible future event scenarios, as well as the rights and preferences of each share class.

7.2 PWERM Steps

The steps in applying the PWERM method to the Company are as follows:

1. For each of the possible events, a range of future equity values is estimated, based on the Market, Income and/or Cost Approaches discussed above and over a range of possible event dates, all plus or minus a standard deviation for value and timing. We selected the timing of these events based on discussions with Management and significant investors and reviewed these assumptions with Management prior to finalizing our analysis (see Exhibit H-1).
2. Specifically, for each future Business Equity Value, the rights and preferences of each shareholder class are considered in order to determine the appropriate allocation of value to Common Shares (see Exhibit H-2).
3. The value of each Common Share is then multiplied by a discount factor derived from the calculated discount rate and the expected timing of the event (plus or minus a standard deviation of time).

[30] American Institute of Certified Public Accountants 2004, Valuation of Privately-Held-Company Equity Securities Issued as Compensation, pp. 59–61.
[31] Das, S., Jagannathan, M., and Sarin, A. January 2002, The Private Equity Discount: An Empirical Examination of the Exit of Venture Backed Companies.

4. The value of Common Share, taking into account sensitivities to the timing of the event, is then multiplied by an estimated probability for each of the possible events based on discussions with Management and external research.
5. The calculated value of the Common Share under the Private Company scenario is then discounted for a lack of marketability and a lack of control where appropriate.
6. A probability-weighted per-share value of Common Stock is then determined.

Exhibit H details the expected values and timing of the four possible events outlined above based upon Management's representations, as well as an analysis of both Management's income forecast and the multiples of comparable public companies and transactions.

7.3 IPO

SVB Analytics believes that, as of the valuation date, the undertaking an Initial Public Offering (IPO) of MOD Systems' securities would be a distant, yet possible future event. We therefore estimated an IPO exit scenario for our analysis. Based on discussions with Management, SVB Analytics selected 12/31/2012 for the timing of the event. Revenue multiple has been selected at the narrow average to reflect an IPO exit value at the given time and valuation level. Exhibit H details additional information on the PWERM analysis for this possible future event.

7.4 Merger or Sale

In discussions with SVB Analytics, MOD Systems Management represented that a sale or merger of the Company would be a possible future event. We therefore estimated both an early and late Merger or Sale exit scenario for our analysis. Based on discussions with Management, SVB Analytics selected 12/31/2010 and 12/31/2011 for the respective timing of the events. Revenue multiple has been selected at the narrow average to reflect a Merger or Sale exit value at the given time and valuation level. Exhibit H details additional information on the PWERM analysis for this possible future event.

7.5 Dissolution / No Value to Common

SVB Analytics believes that failure and dissolution of the Company or an exit, which results in no value to common, also remained a possible future event. SVB Analytics selected 12/31/2010 for the timing of that event based on the current cash levels of the Company and its burn rate. Exhibit H details additional information on the PWERM analysis for this possible future event.

7.6 Private Company

In discussions with SVB Analytics, Management represented that the continued, long-term operation of MOD Systems as a private company was also a possible future event given the nature of MOD Systems' operations and the availability of both reliable historical and forecast financial information. Exhibit H details additional information on the PWERM analysis for this possible future event.

7.7 PWERM Probability Weighting

As a starting point for determining the probabilities associated with the possible future events for MOD Systems, SVB Analytics utilized empirical research that researched historical probabilities for an IPO and Merger, by stage of development and industry similar to that of the Company.[32] The final refinement of these probabilities was based on discussions with Management and significant investors and the facts surrounding both the nature of the business model and the anticipated exit strategies. The results, used to arrive at the weighted per share value, are as follows:

- SVB Analytics weighted an Initial Public Offering (IPO) –event at **10**% based on empirical research and discussions with Management, including their plans for the Company and whether or not it would be an attractive candidate for the public markets at this time and valuation level
- SVB Analytics weighted a Strategic Merger or Sale – Early event at **30**% based on empirical research and discussions with Management, including their plans for the Company and the number and type of potential acquirers at the time and valuation level
- SVB Analytics weighted a Strategic Merger or Sale – Late event at **30**% based on empirical research and discussions with Management, including their plans for the Company and the number and type of potential acquirers at the time and valuation level
- SVB Analytics weighted Dissolution / No Value to Common at **10**% based on research and discussions with Management
- SVB Analytics weighted the Private Company (no liquidity) event at **20**% based on discussions with Management

7.8 PWERM Result

After weighting the individual per share values, SVB Analytics arrived at the Fair Market Value of the Common Stock. Exhibit H details the overall analysis and conclusions.

[32] Das, S., Jagannathan, M. and Sarin, A. January 2002, The Private Equity Discount: An Empirical Examination of the Exit of Venture Backed Companies.

8.0 Current Value Method (CVM)

The current value method (CVM) allocates the enterprise value derived from one or more of the approaches described above to the various series of preferred stock based on their liquidation preferences or conversion values, in accordance with the terms of the prevailing Articles/Certificate of Incorporation, assuming that each class of stock takes the course of action that maximizes their return.

The fundamental assumption of this method is that the manner in which each class of preferred stockholders will exercise its rights and achieve its return is determined based on the enterprise value as of the valuation date and not at some future date. Accordingly, depending upon the equity value and the nature and amount of the various liquidation preferences, preferred stockholders will participate in equity value allocation either as preferred stockholders or, if conversion would provide them with better economic results, as Common Stock holders. Convertible preferred stock that is "out of the money" as of the valuation date is assigned a value that takes into consideration any liquidation preference. Convertible preferred stock that is "in the money" is treated as if it had converted to Common Stock. Common Shares are assigned a value equal to their pro rata share of the residual amount (if any) that remains after consideration of the liquidation preference of "out-of-the-money" preferred stock.

The method assumes that the value of the convertible preferred stock is represented by the most favorable claim the preferred stockholders have on the equity value as of the valuation date.

CVM is useful in two types of circumstances. The first occurs when a liquidity event in the form of an acquisition or dissolution of the enterprise is imminent, and expectations about the future of the enterprise as a going concern are virtually irrelevant. The second occurs when an enterprise is at such an early stage of its development that:

- No material progress has been made on the enterprise's business plan.
- No significant common equity value has been created in the business above the liquidation preference of the preferred shares.
- There is no reasonable basis for estimating the amount and timing of any such common equity value above the liquidation preference that might be created in the future.

SVB Analytics employs the CVM under the assumption that a hypothetical transaction takes place.

8.1 Allocation of Value to Share Classes

As of the valuation date, MOD Systems had one series of Preferred Stock and one series of Common Stock outstanding, as follows:

(1) Series A Preferred (including shares from a convertible debt instrument) Stock.
(2) Common Stock.

See Exhibit G for the detailed Capitalization Table as of the valuation date. Shares represented by warrants for common and stock options that would exercise given their strike price have been included in the share count on a net of exercise basis utilizing the Treasury Method (cash generated by option or warrant exercises are used to buy back stock) in order to appropriately allocate the equity value to each class. SVB Analytics reviewed MOD Systems' prevailing Articles/Certificate of Incorporation to determine the rights of each class of stock.

After determining a weighted equity value, or value that is "distributable" to equity holders, SVB Analytics removes liquidation preferences to arrive at the value attributable to the Common Shares (and converted preferred, if applicable).

In the case of preferred holders without participation rights, SVB Analytics considers the price of the Common Stock (prior to any discounts for lack of marketability) at which the Preferred shareholders would maximize their return by declining their liquidation rights and converting their Preferred shares to Common Stock. At that point, no liquidation deduction was made for any preferences associated with the Preferred Stock ownership. Utilizing this method of allocation and the weighted equity value outlined above, the following was determined:

- The Series A preferred stock did not have to make a decision (they have liquidation and participation rights). The Series A would convert to Common at an enterprise value of $239 million (at a per share value of Common of $5.48).

SVB Analytics then divided the remaining value by the number of fully diluted Common Shares to arrive at a common per share value.

The allocation of value through the use of the Current Value Method to the Common Stock is outlined in Exhibit I.

9.0 Option Pricing Method (OPM)

SVB Analytics estimated the fair value of the common equity of the Company using the Option Pricing Method ("OPM"). OPM treats the rights of the preferred and common shareholders as equivalent to that of call options on any value of the enterprise above certain break points of value based upon the preferred shareholders' liquidation preferences, rights to participation and conversion. Thus, the value of the Common Stock can be determined by estimating the value of its portion of each of these call option rights.

9.1 Summary of Option Pricing Method

As outlined in the AICPA guidelines:

> The option pricing method treats common stock and preferred stock as call options on the enterprise's value, with exercise prices based on the liquidation preference of the preferred stock. Under this method, the common stock has value only if the funds available for distribution to shareholders exceed the value of the liquidation preference at the time of a liquidity event (for example, merger, or sale), assuming the enterprise has funds available to make a liquidation preference meaningful and collectible by the shareholders. The common stock is modeled as a call option that gives its owner the right but not the obligation to buy the underlying enterprise value at a predetermined or exercise price. In the model, the exercise price is based on a comparison with the enterprise value rather than, as in the case of a "regular" call option, a comparison with a per-share stock price. Thus, common stock is considered to be a call option with a claim on the enterprise at an exercise price equal to the remaining value immediately after the preferred stock is liquidated. The option pricing method has commonly used the Black–Scholes model to price the call option.
>
> The option pricing method considers the various terms of the stockholder agreements, including the level of seniority among the securities, dividend policy, conversion ratios, and cash allocations, upon liquidation of the enterprise. In addition, the method implicitly considers the effect of the liquidation preference as of the future liquidation date, not as of the valuation date.[33]

[33] American Institute of Certified Public Accountants 2004, Valuation of Privately-Held-Company Equity Securities Issued as Compensation, p. 61.

9.2 Option Pricing Method – Steps and Conclusions

The following general steps comprise the dynamic option analysis:

1) Determine the weighted equity value of the Company distributable to equity holders as a whole. See Exhibit F.
2) Determine the minimum and maximum ranges of values at which debt, preferred and common equity holders receive value. These points ("Break Points") are based on liquidation preferences (as a whole) and points at which the preferred security holders would receive the same amount in conversion as in liquidation for each convertible security. These Break Points, at the minimum of each range, are the strike prices of the various options.
3) Apply the Black–Scholes option model with option strike prices equal to the Break Points and the current stock price equal to the weighted equity value of the business enterprise as determined above. The "Term" of the option is defined as the average expected holding period of the investors in the security (based on discussions with management). The volatility is the expected volatility of the business enterprise (typically defined through analysis of public guideline company equity market data). For additional information, see Exhibit J.
4) The value of the total rights related to each range is equal to the difference in the option values at each Break Point. The differences in the option values are defined as the "Preference Values."
5) Based on the capital structure and specifics of the prevailing Articles/Certificate of Incorporation at the valuation date, calculate the percentage of each gross preference value attributable to each security based on each security's relative right to the proceeds.
6) Multiply each gross preference value by the percentage attributable to each security to determine the amount of value attributable to each security.
7) Sum the total of the gross preference values apportioned to each security to identify the total value of each security.
8) Divide the total value of each security by the number of fully diluted shares to identify per share value of each security.
9) Apply a discount for lack of marketability to the value of the Common Shares.

The tables at Exhibit J describe the five variables and break point analysis relevant to the allocation of the Enterprise Value of the Company and the calculations of the per share value of each security through the use of the Option Pricing Method along with the particular metrics used in our analysis.

10.0 Conclusion

Exhibit A shows a summary of inputs and results of the three allocation methodologies employed by SVB Analytics in this Opinion.

SVB Analytics utilized the Option Pricing Method (OPM) as its primary allocation method. Though presented here, SVB Analytics did not use the Current Value Method (CVM) or Probability Weighted Expected Return Method (PWERM) as bases for conclusions.

> The result of the analysis and allocation of equity value is that the Common Stock of MOD Systems Incorporatedhas a value of **$1.27 per share as of June 30, 2008** on a minority, non-marketable basis.

SVB Analytics

MOD Systems, Inc.

Valuation Summary

Valuation as of 06/30/08

Exhibit A

Draft for Discussion Purposes Only

	Probability Weighted Expected Return Method					Current Value Method			Option Pricing Method
	PWERM					CVM			OPM
Exhibit	Exhibit H					Exhibit I			Exhibit J
Report Section	Section 7.0					Section 8.0			Section 9.0
Approach						Market Approach			
Scenario	Initial Public Offering	Merger or Sale (Early)	Merger or Sale (Late)	Dissolution / No Value to Common	Private Company Scenario	Publicly Traded Comparables Revenue Multiple	M&A Comparables Revenue Multiple	Post-Money Valuation	
Exhibit	Exhibit H					Exhibit C	Exhibit D	Exhibit G	Exhibit J
Report Section	Section 7.3	Section 7.4	Section 7.4	Section 7.5	Section 7.6	Section 6.1	Section 6.2	Section 6.4	Section 9.0
Applicable Multiple - Based on Comparable Analysis	1.0x	2.7x	2.7x	1.0x		1.0x	2.7x	NA	
Timing of Event	12/31/2012	12/31/2010	12/31/2011	12/31/2010	6/30/2008	06/30/08	06/30/08	06/30/08	12/29/2011
Business Enterprise Value	$215,785,930	$122,471,349	$268,064,100	$36,250,004	$92,500,000	$52,874,428	$68,747,208	$124,250,029	$92,500,000
Weighting	10.0%	30.0%	30.0%	10.0%	20.0%	25.0%	25.0%	50.0%	100%
Weighted Enterprise Value	$79,632,635					$92,500,000			$92,500,000
Method Fair Market Value per Common Share	$1.21					$1.10			$1.27
Usage	Not Applicable					Confirming			Primary
Final Fair Market Value per Common Share	$1.27								

SVB Analytics

MOD Systems, Inc.

Model Forecast

Valuation as of 06/30/08

Exhibit B - 1a

Draft for Discussion Purposes Only

		Actual	Actual	Co Prep. Actual
		2006	2007	12/31/2007 to 06/30/2008
Income Statement				
Revenues		$719,019	$163,945	$175,840
Cost of Sales		$142,821	$20,000	$103,111
Gross Profit		$576,198	$143,945	$72,729
Gross Margin - %		80.14%	87.80%	41.36%
Operating Expenses				
G&A		$1,899,949	$4,756,948	$3,341,736
Sales & Marketing		$66,233	$166,709	$126,286
R&D		$271,597	$903,226	$382,150
Amortization		$59	$1,907	$1,167
Other		$41,962	$60,196	$9,061
Interest Expense		$1,371	$89,642	$128,183
Depreciation		$58,194	$0	$74,880
Total		$2,339,365	$5,978,628	$4,063,463
Operating Income		($1,763,167)	($5,834,683)	($3,990,734)
Operating Margin - %		-245.22%	-3558.92%	-2269.52%
EBITDA		($1,703,543)	($5,743,134)	($3,786,504)
EBIT		($1,761,796)	($5,745,041)	($3,862,551)
Other Income		$11,465	$203,645	$18,446
Other Expense		$1,770	$41,078	$1,503
Pretax Income		($1,753,472)	($5,672,115)	($3,973,791)
Taxes		$0	$0	$0
Net Income		**($1,753,472)**	**($5,672,115)**	**($3,973,791)**
Assumed NOLS	$303,075	($1,450,397)	($7,122,512)	($11,096,303)
Effective Tax Rate		0.00%	0.00%	0.00%

Source: MOD Systems, Inc.

SVB Analytics

MOD Systems, Inc.

Model Forecast

Valuation as of 06/30/08

Exhibit B - 1b

Draft for Discussion Purposes Only

		Co Prep. Forecast	Co Prep. Forecast	Co Prep. Forecast	Co Prep. Forecast	Co Prep. Forecast	Co Prep. Forecast	Co Prep. Forecast
		06/30/2008 to 12/31/2008	2008	2009	2010	2011	2012	2013
Income Statement								
Revenues		$5,650,399	$5,826,239	$19,298,041	$45,512,254	$99,616,781	$222,191,099	$235,934,650
Cost of Sales		$139,361	$242,472	$1,771,212	$5,898,492	$15,973,296	$36,568,968	$25,714,680
Gross Profit		$5,511,038	$5,583,767	$17,526,829	$39,613,762	$83,643,485	$185,622,131	$210,219,970
Gross Margin - %		97.53%	95.84%	90.82%	87.04%	83.97%	83.54%	89.10%
Operating Expenses								
G&A		$6,289,372	$9,631,109	$16,159,528	$20,036,496	$29,155,326	$47,812,695	$61,936,841
Sales & Marketing		$675,149	$801,435	$2,818,812	$4,360,409	$6,829,911	$10,615,719	$13,348,450
R&D		$3,087,285	$3,469,435	$8,009,797	$11,201,533	$17,807,664	$18,964,292	$20,243,226
Amortization		$875,833	$877,000	$977,000	$1,077,000	$1,177,000	$1,276,000	$1,375,000
Other		$956,920	$965,981	$1,888,759	$2,240,666	$2,597,722	$3,551,608	$4,112,968
Interest Expense		$63,818	$192,001	$92,510	$92,510	$59,834	$25,696	$0
Depreciation		$585,444	$660,323	$1,427,563	$1,699,008	$1,434,150	$1,000,278	$1,000,213
Total		$12,533,822	$16,597,284	$31,373,969	$40,707,623	$59,061,607	$83,246,287	$102,016,698
Operating Income		($7,022,784)	($11,013,518)	($13,847,140)	($1,093,860)	$24,581,878	$102,375,844	$108,203,272
Operating Margin - %		-124.29%	-189.03%	-71.75%	-2.40%	24.68%	46.08%	45.86%
EBITDA		($5,497,689)	($9,284,193)	($11,350,067)	$1,774,658	$27,252,862	$104,677,818	$110,578,485
EBIT		($6,958,966)	($10,821,517)	($13,754,630)	($1,001,350)	$24,641,712	$102,401,540	$108,203,272
Other Income		($18,446)	$0	$0	$0	$0	$0	$0
Other Expense		($1,503)	$0	$0	$0	$0	$0	$0
Pretax Income		($7,039,727)	($11,013,518)	($13,847,140)	($1,093,860)	$24,581,878	$102,375,844	$108,203,272
Taxes		$0	$0	$0	$0	$0	$35,840,539	$37,871,145
Net Income		**($7,039,727)**	**($11,013,518)**	**($13,847,140)**	**($1,093,860)**	**$24,581,878**	**$66,535,305**	**$70,332,127**
Assumed NOLS	$303,075	($18,136,030)	($18,136,030)	($31,983,170)	($33,077,030)	($8,495,152)	$58,040,154	$128,372,280
Effective Tax Rate		0.00%	0.00%	0.00%	0.00%	0.00%	35.01%	35.00%

Source: MOD Systems, Inc.

SVB Analytics

Exhibit B - 2

MOD Systems, Inc.

Draft for Discussion Purposes Only

Model Forecast

Valuation as of 06/30/08

	Actual 2006	Actual 2007	Co Prep. Actual 12/31/2007 to 06/30/2008
Balance Sheet			
Assets			
Current Assets			
Cash	$381,892	$1,403,118	$30,771,976
Non Operating Cash	$0	$0	$0
Accounts Receivable	$26,458	$215,322	$17,051
Inventory	$0	$0	$0
Other Current Assets	$97,516	$217,590	$402,710
Total Current Assets	$505,866	$1,836,030	$31,191,738
Fixed Assets			
Cumulative PP&E	$212,766	$393,024	$605,339
Less: Cumulative Depreciation	($145,610)	($144,268)	($219,392)
Net Fixed Assets	$67,156	$248,756	$385,946
Other Assets			
Other Long Term Assets	$0	$110,340	$168,236
Other Long Term Assets 2	$0	$0	$5,000,000
Other Long Term Assets 3	$0	$0	$0
Intangible Assets and patent and trademark	$46,327	$9,237	$8,070
Total Other Assets	$46,327	$119,577	$5,176,306
Total Assets	**$619,348**	**$2,204,363**	**$36,753,990**
Liabilities & Shareholders' Equity			
Current Liabilities			
Accounts Payable	$252,239	$1,261,833	$1,186,387
Accrued Expenses	$0	$49,446	$397,146
Line of Credit	$0	$0	$0
Current Portion of LTD	$0	$0	$0
Deferred Revenue	$0	$76,167	$3,040,000
Other Current Liabilities"credit cards"	$17,326	$102,473	$37,423
Other Current Liabilities 2	$0	$206,842	$3,030
Other Current Liabilities - ABX promissory notes	$0	$0	$5,000,000
Total Current Liabilities	$269,565	$1,696,760	$9,663,986
Long-Term Liabilities			
Long-Term Debt	$0	$0	$0
Convertible LTD	$0	$4,329,893	$0
Other Long-Term Liabilities	$0	$0	$0
Total Liabilities	$269,565	$6,026,653	$9,663,986
Shareholders' Equity			
Investors Capital	$180	$222	$222
Preferred Stock	$0	$0	$35,000,000
Common Stock	$1,750,000	$3,250,000	$3,250,000
APIC	$50,000	$50,000	$28,667
Prior Period Adjustment to Ret. Earn. - Difference	$0	$0	$20,201
+/- Retained Earnings	($1,450,397)	($7,122,512)	($11,096,303)
Total Shareholder's Equity	$349,783	($3,822,290)	$27,202,787
Total Liabilities & Shareholder's Equity	**$619,348**	**$2,204,363**	**$36,866,773**

Source: MOD Systems, Inc.

SVB Analytics

Exhibit B - 3

MOD Systems, Inc.

Draft for Discussion Purposes Only

Model Forecast

Valuation as of 06/30/08

Statement of Cash Flows

	Actual 2007	Co Prep. Actual 12/31/2007 to 06/30/2008
Cash from Operating Activities		
Net Income	($5,672,115)	($3,973,791)
+ Depreciation	$0	$74,880
Change in A/R	($188,863)	$198,271
Change in Inventory	$0	$0
Change in Other Current Assets	($120,075)	($185,120)
Change in Other Assets	($110,340)	($5,057,895)
Change in A/P	$1,009,594	($75,446)
Change in Accrued Expenses	$49,446	$347,700
Change in Deferred Revenue	$76,167	$2,963,833
Change in Other Current Liabiliti	$291,989	$4,731,138
Change in Other Liabilities	$0	$0
Other - Change in Depreciation	$0	$245
Cash from Operating Activities	($4,664,198)	($976,186)
Cash from Investing Activities		
Change in Gross Fixed Assets	($180,258)	($212,315)
Change in Intangible Assets	$37,089	$1,167
Other	($1,342)	$0
Cash from Investing Activities	($144,511)	($211,148)
Cash from Financing Activities		
Change in Line of Credit	$0	$0
Change in Long Term Debt (inc. CP)	$0	$0
Change in Convertible Debt	$4,329,893	($4,329,893)
Change in Investors Capital	$42	$0
Change in Preferred Stock	$0	$35,000,000
Change in Common Stock	$1,500,000	$0
Change in APIC	$0	($21,333)
Other - Change in Prior Period Adjustme	$0	$20,201
Cash from Financing Activities	$5,829,935	$30,668,975
Change in Cash	$1,021,226	$29,481,642
Beginning Cash	$381,892	$1,403,118
Cash at the end of Period	**$1,403,118**	**$30,884,759**

Source: MOD Systems, Inc.

SVB Analytics

MOD Systems, Inc.

Public Company Comparables - Revenue Multiple Analysis

Valuation as of 06/30/08

Exhibit C - 1

Draft for Discussion Purposes Only

($ mm, except per share price)		Trading Performance					Trading Statistics - Multiples (b)							
							Revenue				Revenue			
	Ticker Symbol (a)	Stock Price On 6/30/08	Market Cap	Debt	Cash	Enterprise Value (C)	LTM	CY 08E	CY 09E	CY 10E	LTM	CY 08E	CY 09E	CY 10E
Apple Inc.	NasdaqGS:AAPL	$167.44	$147,619	$0	$9,070	$138,549	$28,747	$33,808	$42,699	$51,706	4.8x	4.1x	3.2x	2.7x
LodgeNet Interactive Corporation	NasdaqGS:LNET	$4.91	$109	$621	$19	$711	$550	$571	$599	$614	1.3x	1.2x	1.2x	1.2x
RealNetworks Inc.	NasdaqGS:RNWK	$6.60	$942	$0	$479	$463	$586	$636	$700	$741	0.8x	0.7x	0.7x	0.6x
Avid Technology Inc.	NasdaqGS:AVID	$16.99	$629	$0	$129	$500	$909	$882	$934	$946	0.6x	0.6x	0.5x	0.5x
DivX, Inc.	NasdaqGM:DIVX	$7.34	$238	$0	$23	$215	$90	$98	$117	$137	2.4x	2.2x	1.8x	1.6x
Sonic Solutions	NasdaqGS:SNIC	$5.96	$157	$0	$62	$95	$133	$136	$149	NA	0.7x	0.7x	0.6x	NM
Napster Inc.	NasdaqGM:NAPS	$1.42	$68	$0	$33	$35	$127	$126	$138	$188	0.3x	0.3x	0.3x	0.2x
Concurrent Computer Corp.	NasdaqGM:CCUR	$6.80	$56	$1	$25	$33	$74	$82	$132	NA	0.4x	0.4x	0.2x	NM
										Median	0.8x	0.7x	0.7x	0.9x
										Mean	1.4x	1.3x	1.1x	1.1x
										High	4.8x	4.1x	3.2x	2.7x
										Low	0.3x	0.3x	0.2x	0.2x
										1st Quartile	0.5x	0.5x	0.5x	0.6x
										3rd Quartile	1.6x	1.5x	1.3x	1.5x
										Avg. Less High and Low	1.0x	1.0x	0.9x	1.0x

Notes:

(a) Financial data provided by Capital IQ, a division of Standard & Poor's.

(b) Estimates data provided by ReutersEstimates.

(c) Enterprise value is market capitalization plus debt and less cash

(d) Revenue multiples selected based on review of comparables and discussions with management.

(e) Adjustments to revenue based on forecast optimism.

Market Approach - Publicly Traded Comparables

	2008	2009	2010
MOD Systems, Inc. Revenue	$5.8	$19.3	$45.5
Selected Multiple (Narrow Average) (d)	1.0x	0.9x	1.0x
Enterprise Value	$5.7	$16.5	$44.2
Adjustment (e)	0.0%	0.0%	0.0%
Adjusted Enterprise Value	$5.7	$16.5	$44.2
Concluded Enterprise Value	$22.1		

SVB Analytics

MOD Systems, Inc.

Public Company Comparables - EBITDA Multiple Analysis

Valuation as of 06/30/08

Exhibit C - 2

Draft for Discussion Purposes Only

($ mm, except per share price)		Trading Performance									Trading Statistics - Multiples (b)			
							EBITDA				EBITDA			
	Ticker Symbol (a)	Stock Price On 6/30/08	Market Cap	Debt	Cash	Enterprise Value (C)	LTM	CY 08E	CY 09E	CY 10E	LTM	CY 08E	CY 09E	CY 10E
Apple Inc.	NasdaqGS:AAPL	$167.44	$147,619	$0	$9,070	$138,549	$5,938	$7,004	$8,222	$9,301	23.3x	19.8x	16.9x	14.9x
LodgeNet Interactive Corporation	NasdaqGS:LNET	$4.91	$109	$621	$19	$711	$139	$149	$163	$157	5.1x	4.8x	4.4x	4.5x
RealNetworks Inc.	NasdaqGS:RNWK	$6.60	$942	$0	$479	$463	($5)	$68	$85	$82	NM	6.8x	5.5x	5.6x
Avid Technology Inc.	NasdaqGS:AVID	$16.99	$629	$0	$129	$500	$36	$26	$53	NA	13.7x	18.9x	9.4x	NM
DivX, Inc.	NasdaqGM:DIVX	$7.34	$238	$0	$23	$215	$5	$28	$36	$44	43.7x	7.5x	5.9x	4.8x
Sonic Solutions	NasdaqGS:SNIC	$5.96	$157	$0	$62	$95	($1)	$9	$26	NA	NM	10.6x	3.6x	NM
Napster Inc.	NasdaqGM:NAPS	$1.42	$68	$0	$33	$35	($12)	($7)	($6)	($6)	NM	NM	NM	NM
Concurrent Computer Corp.	NasdaqGM:CCUR	$6.80	$56	$1	$25	$33	$2	$5	NA	NA	13.7x	7.2x	NM	NM
										Median	13.7x	7.5x	5.7x	5.2x
										Mean	19.9x	10.8x	7.6x	7.5x
										High	43.7x	19.8x	16.9x	14.9x
										Low	5.1x	4.8x	3.6x	4.5x
										1st Quartile	13.7x	7.0x	4.6x	4.8x
										3rd Quartile	23.3x	14.8x	8.5x	8.0x
										Avg. Less High and Low	16.9x	10.2x	6.3x	5.2x

Notes:

(a) Financial data provided by Capital IQ, a division of Standard & Poor's.

(b) Estimates data provided by ReutersEstimates.

(c) Enterprise value is market capitalization plus debt and less cash

(d) EBITDA multiples selected based on review of comparables and discussions with management.

(e) Adjustments to revenue based on forecast optimism.

Market Approach - Publicly Traded Comparables

	2008	2009	2010
MOD Systems, Inc. EBITDA	($9.3)	($11.4)	$1.8
Selected Multiple (Narrow Average) (d)	10.2x	6.3x	5.2x
Adjusted EBITDA	($94.7)	($71.3)	$9.3
Adjustment (e)	0.0%	0.0%	0.0%
Enterprise Value	NM	NM	$9.3
Concluded Enterprise Value	NM		

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Exhibit C - 3

MOD Systems, Inc.

Draft for Discussion Purposes Only

Public Company Comparables

Valuation as of 06/30/08

($ mm, except per share price)	No of Shares Outstanding	LTM CAPEX	LTM CAPEX % of Rev	LTM Non-Cash Working Capital	LTM-1 Non-Cash Working Capital	Change in Non-Cash Working Capital	LTM Revenue	LTM-1 Revenue	Avg Non-Cash WC / Avg Revenue	LTM Operating Statistics GP % Rev	Oper Inc % Rev	SG&A % Rev	R&D % Rev	LTM LTM-1 Revenue Y/Y	2007E LTM Revenue Y/Y	2008E 20087E Revenue Y/Y	2009E 2008E Revenue Y/Y
Apple Inc.	885.9	($872)	3.0%	($1,994)	($2,346)	$352	$28,747	$26,499	(7.9%)	34.4%	19.3%	11.9%	3.2%	NM	17.6%	64.0%	52.9%
LodgeNet Interactive Corporation	22.7	($82)	14.9%	($15)	($9)	($6)	$550	$486	(2.4%)	36.0%	1.3%	10.6%	0.0%	NM	3.8%	23.3%	7.5%
RealNetworks Inc.	142.7	($30)	5.1%	($172)	($190)	$18	$586	$568	(31.4%)	61.9%	-9.1%	53.3%	17.8%	NM	8.5%	23.6%	16.5%
Avid Technology Inc.	37.0	($23)	2.5%	$68	$56	$12	$909	$930	6.7%	50.2%	-1.7%	32.0%	16.7%	NM	(3.0%)	1.6%	7.3%
DivX, Inc.	32.4	($3)	3.8%	($1)	($3)	$1	$90	$85	(2.2%)	94.9%	2.2%	70.4%	22.3%	NM	9.5%	40.7%	39.1%
Sonic Solutions	26.4	($2)	1.6%	($26)	($29)	$3	$133	$136	(20.5%)	75.1%	-6.2%	47.8%	33.5%	NM	2.5%	7.7%	NM
Napster Inc.	47.9	($1)	1.1%	($35)	($32)	($2)	$127	$126	(26.5%)	28.5%	-14.7%	32.4%	7.6%	NM	(1.1%)	11.2%	49.1%
Concurrent Computer Corp.	8.3	($2)	2.6%	$2	$2	$0	$74	$71	2.9%	52.7%	-2.6%	33.1%	22.2%	NM	10.7%	80.1%	NM
MOD Systems, Inc. (a)	42.0	$0.30	117%	($10.0)	($0.7)	($9.29)	$0.26	$0.44	(1524.9%)	56.2%	-2681.0%	2301.3%	323.8%	(41.7%)	2155.9%	231.2%	135.8%
Median		**($13)**	**2.8%**	**($21)**	**($19)**	**$2**	**$341**	**$311**	**(5.1%)**	**51.4%**	**-2.2%**	**32.7%**	**17.2%**	**NM**	**6.2%**	**23.5%**	**27.8%**
Mean		**($127)**	**4.3%**	**($272)**	**($319)**	**$47**	**$3,902**	**$3,612**	**(10.1%)**	**54.2%**	**-1.5%**	**36.4%**	**15.4%**	**NM**	**6.0%**	**31.5%**	**28.8%**
High		**($1)**	**14.9%**	**$68**	**$56**	**$352**	**$28,747**	**$26,499**	**6.7%**	**94.9%**	**19.3%**	**70.4%**	**33.5%**	**0.0%**	**17.6%**	**80.1%**	**52.9%**
Low		**($872)**	**1.1%**	**($1,994)**	**($2,346)**	**($6)**	**$74**	**$71**	**(31.4%)**	**28.5%**	**-14.7%**	**10.6%**	**0.0%**	**0.0%**	**(3.0%)**	**1.6%**	**7.3%**
1st Quartile		**($43)**	**2.3%**	**($69)**	**($72)**	**($1)**	**$118**	**$116**	**(22.0%)**	**35.6%**	**-7.0%**	**27.0%**	**6.5%**	**NM**	**1.6%**	**10.4%**	**9.8%**
3rd Quartile		**($2)**	**4.1%**	**($0)**	**($1)**	**$13**	**$667**	**$658**	**(0.9%)**	**65.2%**	**1.5%**	**49.2%**	**22.3%**	**NM**	**9.8%**	**46.5%**	**46.6%**
Avg. Less High and Low		**($24)**	**3.1%**	**($41)**	**($44)**	**$5**	**$399**	**$388**	**(9.4%)**	**51.7%**	**-2.7%**	**35.1%**	**15.0%**	**0.0%**	**5.6%**	**28.4%**	**28.1%**

Notes:

Financial data provided by Capital IQ, a division of Standard & Poor's.

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Exhibit C - 4

MOD Systems, Inc.

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Public Company Comparables
Valuation as of 06/30/08

Company	
Apple Inc.	Apple, Inc. designs, manufactures, and sells personal computers, portable digital music players, and mobile communication devices, as well as related software, services, peripherals, and networking solutions worldwide. The company's products include desktop and notebook computers, server and storage products, and related devices and peripherals; Mac OS X operating system; and iLife, a suite of software for creation and management of digital photography, music, movies, DVDs, and Web site. In addition, it provides music products and services comprising iPod, portable digital music players and related accessories; online music services, third-party music, audio books, music videos, short films, television shows, movies, podcasts, and iPod games through its iTunes stores; and portable and desktop speaker systems, headphones, car radio solutions, voice recorders, cables and docks, power supplies and chargers, and carrying cases and armbands.
LodgeNet Interactive Corporation	LodgeNet Interactive Corporation and its subsidiaries provide interactive media and connectivity solutions to the hospitality industry in the United States, Canada, and Mexico. The company also offers interactive television services, including on-demand movies, music, and games, as well as subscription sports and television on-demand programming services. It also offers satellite-delivered television programming and Internet access customer support services; broadband Internet systems; and video, Internet, and technical support services, as well as offers professional, technical, and installation services. In addition, the company provides on-demand and television entertainment content, patient education content, software maintenance, and technical support services to the healthcare industry.
RealNetworks Inc.	RealNetworks, Inc. provides network-delivered digital media products and services primarily in the United States, Asia, and Europe. The company also develops and markets software products and services that enable the creation, distribution, and consumption of digital media, including audio and video. It provides various music services that include Rhapsody digital music service; Rhapsody To Go, a service that enables subscribers to transfer their music to portable devices; RadioPass, an Internet radio subscription service; RealPlayer Music Store, which enables consumers to purchase and download individual digital music tracks; and RealMusic, which provides music downloads, music news, and other music content. The company also offers media software and services, which comprise RealPlayer that enable consumers to discover, play, and manage audio and video programming on the Internet; and SuperPass, which offers video, digital music, and games content.
Avid Technology Inc.	Avid Technology, Inc. develops, markets, sells, and supports software and hardware products for the production, management, and distribution of digital media content. It operates in three segments: Professional Video, Audio, and Consumer Video. The Professional Video segment offers solutions, including video and film editing systems, integrated storage, workflow and asset management tools, 3D and special-effects software, as well as a range of services from product support and training to consultancy and managed services. This segment markets these solutions to professional users, broadcast and cable companies, corporations, governmental entities, and educational institutions under the Avid Video, Softimage, and Sundance Digital names. The Audio segment produces digital audio systems for audio recording, editing, signal processing, mixing, post production, collaborating, distributing, and scoring to professional music studios, project studios, film and television production and post production facilities, television and radio broadcasters, production studios, performance venues, corporations, governmental entities, and educational institutions under the Digidesign, M-Audio, and Sibelius names.
DivX, Inc.	DivX, Inc., a digital media company, creates, distributes, and licenses digital video technologies. The company's digital media ecosystem enables users to compress, secure, and distribute digital video and participate in its digital media ecosystem. Its technologies are incorporated into various software product bundles, as well as software development kits that are licensed to hardware and software companies. DivX also offers certification services to software and hardware companies, and operates a digital media distribution system in which, it acts as an application service provider to third party content owners. In addition, the company offers a mobile media platform service, which enables users to discover video content from various sources using compatible handheld Internet-connected devices and provides access to manage accounts and favorites from a computer's browser.
Sonic Solutions	Sonic Solutions engages in the development and marketing of computer software related to digital media for consumer and professional end users. Its software and services enable the creation, design, management, and delivery of data, photographs, audio, interactive features, and video in digital formats in various playback platforms, including Internet, broadcast, mobile, and optical disc formats, such as compact audio discs, digital video discs, and Blu-ray discs. The company operates in two segments: Consumer and Professional. The Consumer segment includes the Roxio Division, which offer consumer digital media software products under the Roxio brand name; and Advanced Technology Group, which develops software components for its operating units, as well as for licensing to PC and CE application developers under Roxio, AuthorScript, CinePlayer, and Qflix brand names.
Napster Inc.	Napster, Inc. offers interactive music services that enable fans to sample, listen to, subscribe to, and purchase from online music catalogs utilizing secure and legal platforms. The company focuses on its online music distribution business under the Napster brand. It enables its subscribers to access radio, Billboard charts, pre-programmed playlists, personalization features, message boards, and community features, as well as to enjoy their music on various media, including personal computers, CDs, MP3 players, music-enabled cellular phones, and digital media devices for the living room. The company delivers online music to its customers as individual downloads and through subscriptions accessible through the Internet and wireless devices; Napster and Napster To Go, the Web-based music subscription services, which provide consumers in the United States with access to approximately 6 million tracks, as well as in Canada, Germany, the United Kingdom, and Japan.
Concurrent Computer Corp.	Concurrent Computer Corporation provides computer systems, software, and services for the video-on-demand and real-time markets. Its on-demand products include MediaHawk On-Demand Platform, which combines commercial-off-the-shelf hardware sourced from original equipment manufacturers suppliers with its proprietary software; and Everstream Data Suite, a solution for collecting data from disparate interactive TV systems and platforms, scrubbing, and transforming that data into standardized information, as well as storing that data within a standard data warehouse model. The company's real-time products consist of SUSE Linux Enterprise-Real Time, an operating system for various applications, such as financial trading, telecommunications, modeling, simulation, data acquisition, industrial control, and medical imaging systems; RedHawk Linux, an open source Linux operating system for the real-time applications in simulation, data acquisition, and industrial systems control; iHawk servers; ImaGen, an imaging platform for simulation and modeling applications; Power Hawk, a family of UNIX-based advanced VersModular Eurocard systems capable of supporting data acquisition, simulation, and industrial p

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MOD Systems, Inc.

M&A Comparable Transactions

Valuation as of 06/30/08

($ mm, except per share price)

Exhibit D - 1

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	Announced Date (a)	Closed/ Effective Date	Name of Target	Name of Buyer	% Sought	Transaction Value	Enterprise Value	Target LTM Revenue	Target LTM EBITDA	Revenue Multiple	EBITDA Multiple
1	6/30/2007	6/30/2007	SyncCast Communications	Technicolor, Inc.	100	$24	$24	NA	NA	NA	NA
2	4/24/2007	6/4/2007	Pathfire, Inc.	DG FastChannel, Inc. (NasdaqGM:DGIT)	100	$30	$30	$16	NA	1.9x	NA
3	3/7/2007	3/12/2007	Princeton Server Group, Inc.	TelVue Corp. (OTCBB:TEVE)	100	$7	$6	$2	($1)	3.5x	NA
4	10/12/2006	2/20/2007	VitalStream Holdings Inc.	Internap Network Services Corp. (NasdaqGS:INAP)	100	$226	$210	$23	($2)	8.9x	NA
5	2/19/2007	2/19/2007	Cauldron Solutions, LLC	AnyStream, Inc.	100	NA	NA	NA	NA	NA	NA
6	1/1/2007	1/1/2007	Mediabolic, Inc.	Macrovision Solutions Corp. (NasdaqGS:MVSN)	100	43.5	43.5	NA	NA	NA	NA
7	8/7/2006	10/16/2006	Loudeye Corp.	Nokia Corp. (HLSE:NOK1V)	100	$60	$37	$29	($22)	1.3x	NA
8	6/28/2006	6/28/2006	thePlatform, Inc.	Comcast Corp. (NasdaqGS:CMCS.A)	100	$100	NA	NA	NA	NA	NA
9	2/25/2006	3/14/2006	Kontiki, Inc.	VeriSign Inc. (NasdaqGS:VRSN)	100	$58	$58	NA	NA	NA	NA
10	4/15/2005	4/15/2005	Media DVX	DG FastChannel, Inc. (NasdaqGM:DGIT)	100	$10	$10	NA	NA	NA	NA
				Median		**$44**	**$34**	**$20**	**($2)**	**2.7x**	**NM**
				Mean		**$62**	**$52**	**$18**	**($8)**	**3.9x**	**NM**
				High		**$226**	**$210**	**$29**	**($1)**	**8.9x**	**0.0x**
				Low		**$7**	**$6**	**$2**	**($22)**	**1.3x**	**0.0x**
				1st Quartile		**$24**	**$20**	**$13**	**($12)**	**1.7x**	**NM**
				3rd Quartile		**$60**	**$47**	**$25**	**($2)**	**4.9x**	**NM**
				Narrow Ave.		**$46**	**$34**	**$20**	**($2)**	**2.7x**	**0.0x**

Market Approach - M&A Comparables

	Revenue			EBITDA		
	2008	2009	2010	2008	2009	2010
MOD Systems, Inc. Financial Input	$5.8	$19.3	$45.5	($9.3)	($11.4)	$1.8
Selected Multiple (Narrow Average) (b)	2.7x	2.7x	2.7x	0.0x	0.0x	0.0x
Enterprise Value	$15.7	$51.9	$122.5	$0.0	$0.0	$0.0
Discount Factor (from WACC)	0.88	0.68	0.53	0.88	0.68	0.53
Adjusted Enterprise Value	$13.8	$35.4	$64.7	NM	NM	$0.0
Concluded Enterprise Value	$38.0			NM		

Notes:

(a) Transaction data provided by Capital IQ and Mergerstat

(b) Multiples selected based on review of comparables and discussions with management.

SVB Analytics

Exhibit D - 2

MOD Systems, Inc.

Draft for Discussion Purposes Only

M&A Comparable Transactions
Valuation as of 06/30/08

Company	
SyncCast Communications	SyncCast Communications develops solutions for delivering digital content and related data via the Internet and other media. It offers streaming media solutions, such as digital rights management applications, DVD protection systems, logging and reporting tools, and digital asset management applications. The company also offers various XML/SQL based tools for managing, ingesting, integrating, and delivering content to the systems of various enterprises. In addition, SyncCast provides secure distribution solutions for delivering media over traditional mediums, such as CD-ROM and DVD. Further, the company offers solutions ranging from application development, Web hosting, and Internet connectivity to deployment and systems integration. It serves broadcasters, Internet portals, mobile carriers, retail companies, communications firms, technology houses, and content companies in the United States and internationally. The company was founded in 2000 and is based in Anaheim, California. As of June 30, 2007, SyncCast Communications is a subsidiary of Technicolor, Inc.
Pathfire, Inc.	Pathfire, Inc. provides digital media distribution and management solutions to the television, media, and entertainment industries. The company offers Digital Media Gateway, a digital IP store-and-forward platform, delivering news stories, syndicated programming, advertising spots, and video news releases to broadcasters. It provides solutions for content providers and broadcasters, as well as station solutions. The company was founded in 1996 as Video Networks, Inc. and changed its name to Pathfire, Inc. in 2001. Pathfire, Inc. is based in Roswell, Georgia. As of June 4, 2007, Pathfire, Inc. is a subsidiary of DG FastChannel, Inc.
Princeton Server Group, Inc.	Princeton Server Group, Inc. develops digital video systems, appliances, and software that support capture, storage, manipulation, and play-out of digital media in multiple formats. Its products include PEG broadcast servers, MPEG encoders, storage servers, HD broadcast servers, VOD servers, and Sat/DTV edge servers. The company's server solutions include file-based broadcasting, PEG digital video suit, and classroom VOD. It also provides professional services. It serves clients in various areas, including public, educational, and government broadcast; university broadcasting; professional satellite and digital TV broadcast; educational video-on-demand; federal government systems; and contract development services. The company was founded in 2003 and is based in Princeton, New Jersey. As of March 12, 2007, Princeton Server Group, Inc. is a subsidiary of TelVue Corp.
VitalStream Holdings Inc.	As of February 20, 2007, VitalStream Holdings Inc. was acquired by Internap Network Services Corp. VitalStream Holdings, Inc. provides products and services for storing and delivering digital media to worldwide audiences over the Internet. It offers a range of Internet products and services, including audio and video streaming, live event streaming, live web casting, media asset management, integrated hosting services, advertising solutions, subscription services, content delivery, and professional services. The company's products and services enable its customers to create and market their content, while outsourcing the encoding, data storage, broadcasting, hosting, and related functions. It serves media and entertainment, advertising, SMB/SOHO, corporate communications, and educational institutions. The company markets and sells its products and services through multiple channels, reseller and original equipment manufacturer partners, service providers, and its Web site. VitalStream Holdings was incorporated in 1986 and is based in Irvine, California.
Cauldron Solutions, LLC	Cauldron Solutions, LLC provides technology solutions that manage production, planning, and distribution of on demand digital media content. Its solutions help content providers to package, schedule assets, and deliver content. The company offers Entitlement Platform, which helps to turn broadcast video network into network that supports customized service offerings to individual customers over multiple consumer networks; and On-Demand Workflow Manager that allows programming networks and distributors to automate the processes for packaging, distribution, and scheduling of on-demand digital content. Cauldron Solutions also provides cost/benefit analysis of hardware and software configurations, as well as installation, customization, hosting, training, system documentation, and on-call support services. It serves cable multi-system operators, telecommunication operators, and media networks, as well as consumer electronics and advertising companies. The company was founded in 2001 and is based in New York, New York. Cauldron Solutions, LLC operates as a subsidiary of AnyStream, Inc.
Mediabolic, Inc.	Mediabolic, Inc. develops entertainment networking software that enables manufacturers to create digital entertainment products. The company's software allows connected entertainment devices and computers to interoperate together, as well as enables users to browse and play back their personal content in the home. It offers Network Media Player, a turnkey reference design that unleashes the power of the PC to the TV through rich applications; Nexperia Network Media Player Reference Design, which delivers standard digital media adapter capabilities, as well as the ability to access PC and Internet applications on TVs in the home; Source Code SDK to create products using the digital media software; Player Software that delivers an intuitive user interface to various standalone and embedded media devices in standard and high definition; and Media Server, which makes music, photo, and video files available over a network for streamed playback on connected entertainment products. The company also provides professional support and certification, and value add technology services. It serves consumer electronics and PC manufacturers. The company was founded in 1999 and is headquartered in S
Loudeye Corp.	Loudeye Corp. provides business-to-business digital media services that facilitate the distribution, promotion, and sale of digital media content for media and entertainment, mobile communications, consumer products, consumer electronics retail, and ISP customers worldwide. Its services include turn-key, outsourced digital media distribution and promotional services, such as private-labeled digital media store services, including mobile music services; and digital media content services, such as encoding, music samples services, hosting, and Web casting, as well as Internet radio services. The company's digital media store services include hosting, publishing, and managing digital media content, and delivering such content to end-consumers on behalf of its customers; and digital rights management and licensing, usage reporting, digital content royalty settlement, customer support, and publishing-related services. Loudeye was founded in 1997 and is headquartered in Seattle, Washington. As of October 16, 2006, Loudeye Corp. is a subsidiary of Nokia Corp.

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Exhibit D - 2

MOD Systems, Inc.

Draft for Discussion Purposes Only

M&A Comparable Transactions
Valuation as of 06/30/08

Company	
thePlatform, Inc.	thePlatform, Inc. provides digital media publishing solutions for the content providers, broadband media sites, and mobile businesses in the United States. Its product 'Media Publishing System' allows customers to publish digital media anywhere, over any network, and to any device. The company offers solutions for news outlets, print media, television producers, film studios, and music labels to get content online, media management, creating revenue, and distribution through syndication; solutions for broadband media sites for automating content collection, supporting partner relationships, managing end users, and providing content presentation and ad integration; and solutions for carriers, mobile virtual network operators, and mobile content aggregators to collect, manage, and distribute content through various platforms to support business objectives. It also offers services, including transcoding target media formats; and a suite of tools to create content and user policies, protect media, process transactions, and insert ads. thePlatform, Inc. was founded in 2000 as Reliacast, Inc. and changed its name to thePlatform, Inc. in July 2002. The company is headquartered in Seattle, Washington. As of June 28, 200
Kontiki, Inc.	As of March 14, 2006, Kontiki, Inc. was acquired by VeriSign, Inc. Kontiki, Inc. offers digital media delivery solutions. The company's grid delivery technology taps the unused resources of networked PCs and servers, allowing enterprises to deliver corporate video, corporate training, and digital media content, as well as allows receiving content in the background without degradation of system performance. The company also offers a software delivery solution for corporate video communications. In addition, its Delivery Management System enables companies to publish, protect, deliver, and measure video communications. The company was founded as Zodiac Networks in 2000 and changed its name to Kontiki, Inc. in 2001. The company is headquartered in Sunnyvale, California.
Media DVX	Questex Media Group, Inc. operates as a business-to-business integrated media and information provider. It offers print and digital media publications, conferences, tradeshows, events, interactive media, research, information, and integrated marketing services. The company provides print, online, and face-to-face platforms for conducting business with suppliers, clients, and prospects. Questex Media serves various markets, including entertainment, travel, spa, leisure, natural resources, landscape and building services, info and document management, design and engineering, communications technology, beauty and wellness, small business, hotel and hospitality, marketing, and abilities. The company was founded in 2005 and is headquartered in Newton, Massachusetts with additional offices in North America, South America, Asia, and Europe.

SVB Analytics

MOD Systems, Inc.

Net Present Value Using Free Cash Flows & WACC

Valuation as of 06/30/08

Exhibit E - 1

Draft for Discussion Purposes Only

		Actual		Projected - Company and SVBA					
		2007	12/31/2007 to 06/30/2008	06/30/2008 to 12/31/2008	2009	2010	2011	2012	2013
Free Cash Flow									
NOPLAT									
EBIT		($5,745)	($3,863)	($6,959)	($13,755)	($1,001)	$24,642	$102,402	$108,203
Less Cash Taxes		$0	$0	$0	$0	$0	$0	$35,850	$37,871
NOPLAT		($5,745)	($3,863)	($6,959)	($13,755)	($1,001)	$24,642	$66,552	$70,332
Net Investment									
Net Capital Expenditures	2.8%	($180)	($212)	($898)	($2,302)	($1,000)	($1,000)	($1,000)	($1,000)
Depreciation		$0	$75	$585	$1,428	$1,699	$1,434	$1,000	$1,000
Incr. in Working Capital	5.0%	$1,118	$8,093	($9,648)	($674)	($1,311)	($2,705)	($6,129)	($687)
Net Investment		$938	$7,956	($9,960)	($1,548)	($612)	($2,272)	($6,129)	($687)
Unlevered Free Cash Flow		**($4,807)**	**$4,093**	**($16,919)**	**($15,302)**	**($1,613)**	**$22,370**	**$60,423**	**$69,645**
Discounting									
Discount Rate (k)	29.0%								
Period (in Years)				0.50	1.00	1.00	1.00	1.00	1.00
Discount Factor (end-year)				0.88	0.68	0.53	0.41	0.32	0.25
Mid-year Adjustment (in Years)				0.25	1.00	2.00	3.00	4.00	5.00
Discount Factor (mid-year)				0.94	0.77	0.60	0.47	0.36	0.28
Discounted Unlevered Free Cash Flow				($15,868)	($11,850)	($968)	$10,410	$21,797	$19,475
PV Annual Cash Flows	**$22,996**								

Partial Period Calculation

End of Period	12/31/2008
Valuation Date	6/30/2008
Days in Period	184

Note:
Excess working capital release occurs in first forecast period of DCF

Income Approach	Public Comparables Terminal Revenue	M&A Comparables Terminal Revenue	Public Comparables Terminal EBITDA		
Terminal Cash Flow Valuation Year	2013	2013	2013		
Performance Metric	Revenue	Revenue	EBITDA		
Performance Value	$235,935	$235,935	$110,578		
Adjusted Comparable Multiple	**0.97x**	**2.69x**	**10.21x**		
Exit Value	$229,133	$634,889	$1,128,494		
Discount Factor in Terminal Year (end of year)	0.25	0.25	0.25		
Terminal Value	**$56,414**	**$156,315**	**$277,844**		
Enterprise Value - Forecast	$0	$0	$0		
PV Annual Cash Flows	$22,996	$22,996	$22,996		
PV NOL Estimate	$0	$0	$0		
Terminal Value	$56,414	$156,315	$277,844		
Total Enterprise Value	**$79,411**	**$179,311**	**$300,840**		

SVB Analytics
MOD Systems, Inc.

Cost of Capital - WACC

Valuation as of 06/30/08

Exhibit E - 2

Draft for Discussion Purposes Only

Cost of Equity (K_e)	WACC Using Primary Industry Beta	
Risk Free Rate (R_f)	3.33%	1
Equity Risk Premium ($R_m - R_f$)	6.30%	2
Beta, Relevered (based on Industry)	2.06	3
Small Stock Risk Premium (SSRP)	6.27%	4
Company Specific Risk Premium (CSRP)	7.00%	5
Calculated Cost of Equity	29.57%	
Cost of Equity (CAPM) = $Rf_1+B^*(Rm-Rf_2)$ + SSRP +CSRP		
Cost of Debt (K_d)		
Pre-Tax Cost of Debt	10.47%	6
Cost of Debt (K_d)		
Pre-Tax Cost of Debt	10.47%	6
Combined Effective Tax Rate	40.0%	7
Calculated After-Tax Cost of Debt (Rounded)	6.28%	
Cost of Debt = Pre-Tax Cost of Debt * (1-Tax Rate)		

Weighted Average Cost of Capital (WACC)	Estimated Cost of Capital	Capital Structure / Weight	Weighted Cost of Capital
Equity	29.57%	96.00%	28.39%
Debt	6.28%	4.00%	0.25%
Weighted Average Cost of Capital			**28.64%**
WACC = (K_e x Equity Weight) + (K_d x Debt Weight)		(rounded)	**29.00%**

1) The risk-free rate utilized was the yield on the 5 Year treasury constant maturity as of 06/30/08 Source: Capital IQ.
2) The expected equity risk premium as indicated by Ibbotson Associates 2007.
3) The beta utilized was the relevered median beta of the guideline companies.
4) The 10th decile premium as indicated by Ibbotson Associates 2007
5) Company specific risk was based upon our view of the additional risks associated with an investment in the Company.
6) The pre-tax cost of debt was the average yield of SVB's commercial loans as of Q4 2007.
7) The effective tax rate utilized is the estimated tax rate used in the projections.

SVB Analytics

MOD Systems, Inc.

Cost of Capital - SSRP, CRSP, and Beta

Valuation as of 06/30/08

Exhibit E - 3

Draft for Discussion Purposes Only

Small Stock Risk Premium (SSRP): Ibbotson Associates

Decile		Market Capitalization	Size Premium
1	Largest	371,187.37	-0.36%
2		16,820.57	0.65%
3		7,777.18	0.81%
4		4,085.18	1.03%
5		2,848.77	1.45%
6		1,946.59	1.67%
7		1,378.48	1.62%
8		976.62	2.28%
9		626.96	2.70%
10	Smallest	314.43	6.27%
Breakdown of the 10th Decile	Mid-cap, 3-5		
10a decile	Low-cap, 6-8	314.43	4.35%
10b decile (smallest)	Micro-cap, 9-10	173.44	9.68%
SELECTED:	10th decile (smallest)	314.43	6.27%

Source: Ibbotson Associates 2007

Small Stock Risk Premium (SSRP): Duff & Phelps

Portfolio Rank by Size		Average Sales ($Mils)	Smoothed Premium over CAPM
1	Largest	71,497.00	1.35%
2		23,797.00	2.08%
3		14,895.00	2.39%
4		10,851.00	2.60%
5		8,568.00	2.76%
6		6,554.00	2.94%
7		5,199.00	3.09%
8		4,552.00	3.18%
9		3,593.00	3.33%
10		3,117.00	3.43%
11		2,461.00	3.58%
12		2,154.00	3.67%
13		1,851.00	3.77%
14		1,641.00	3.85%
15		1,462.00	3.93%
16		1,228.00	4.05%
17		1,040.00	4.16%
18		919.00	4.24%
19		767.00	4.36%
20		685.00	4.43%
21		550.00	4.58%
22		434.00	4.74%
23		326.00	4.93%
24		224.00	5.18%
25	Smallest	91.00	5.77%
SELECTED:			Not Used

Source: Duff & Phelps, 2007

Beta

Company Name	Ticker	Levered Beta	Equity Market Value (MM)	Interest Bearing Debt	Preferred Stock	Minority Interest	Total Capital	Tax Rate	Unlevered Beta	Equity to Capital
Apple Inc.	NasdaqGS:AAPL	2.37	$147,618.96	$0.00	$0.00	$0.00	$147,618.96	40.0%	2.37	100.0%
LodgeNet Interactive Corporation	NasdaqGS:LNET	2.20	$109.41	$620.80	$0.00	$0.00	$730.21	40.0%	0.50	15.0%
RealNetworks Inc.	NasdaqGS:RNWK	1.34	$941.66	$0.00	$0.00	$14.68	$956.34	40.0%	1.33	98.5%
Avid Technology Inc.	NasdaqGS:AVID	0.60	$628.77	$0.00	$0.00	$0.00	$628.77	40.0%	0.60	100.0%
DivX, Inc.	NasdaqGM:DIVX	NA	$237.69	$0.03	$0.00	$0.00	$237.72	40.0%	NA	100.0%
Sonic Solutions	NasdaqGS:SNIC	2.46	$157.24	$0.00	$0.00	$0.00	$157.24	40.0%	2.46	100.0%
Napster Inc.	NasdaqGM:NAPS	2.06	$67.88	$0.00	$0.00	$0.00	$67.88	40.0%	2.06	100.0%
Concurrent Computer Corp.	NasdaqGM:CCUR	2.28	$56.48	$0.95	$0.00	$0.00	$57.43	40.0%	2.25	98.3%
	Mean	1.90	18,727.26	77.72	0.00	1.83	18,806.82	40.0%	1.65	89.0%
	Median	2.20	197.47	0.00	0.00	0.00	433.24	40.0%	2.06	100.0%

Source: CapitalIQ

Beta - Application to MOD Systems, Inc.

	Unlevered Beta	Target Equity Market Value	Target Interest Bearing Debt	Preferred Stock	Minority Interest	Tax Rate	Relevered Beta
Guideline Companies Mean	1.65	89.0%	11.0%	0.0%	0.0%	40.0%	1.77
Guideline Companies Median	2.06	100.0%	0.0%	0.0%	0.0%	40.0%	2.06

SVB Analytics
MOD Systems, Inc.
Enterprise Value
Valuation as of 06/30/08

Exhibit F

Draft for Discussion Purposes Only

Valuation Approach	Market Approach	Market Approach	Market Approach	Income Approach	Income Approach
	Publicly Traded Comparables Revenue Multiple	M&A Comparables Revenue Multiple	Post-Money Valuation	Public Comparables Terminal Revenue	M&A Comparables Terminal Revenue
Location	**Exhibit C - 1**	**Exhibit D - 1**	**Exhibit G**	**Exhibit E**	**Exhibit E**
Applied WACC, where applicable	NA	NA	NA	29.00%	29.00%
Enterprise Value	$22,102,451	$37,975,232	$124,250,029	$79,410,650	$179,310,969
Less: Debt	**$0**	$0	NA	$0	$0
Plus: Cash	**$30,771,976**	$30,771,976	NA	NA	NA
Equity Value	$52,874,428	$68,747,208	$124,250,029	$79,410,650	$179,310,969
Less: Discount for Lack of Control (a) 0.0%	NA	$0	$0	NA	$0
Equity Value	$52,874,428	$68,747,208	$124,250,029	$79,410,650	$179,310,969
Weighting	**25%**	**25%**	**50%**	**0%**	**0%**
Weighted Equity Value	$13,218,607	$17,186,802	$62,125,014	$0	$0

	Real Number	**Rounded**
Weighted Equity Value	$92,530,423	**$92,500,000**

Note:

(a) Discount for lack of control is the inverse of the control premium.
From MergerStat 2007 - Q2 data for the 'Technology - SW & Services' industry classification.

SVB Analytics
MOD Systems, Inc.

Capitalization Table

Valuation as of 06/30/08

Exhibit G - 1

Draft for Discussion Purposes Only

Shareholder	Common	Common Warrants	Series A	Series A Warrants	Options	Converted to Common	%
Mark Phillips	22,839,787	71,545				22,911,332	51%
Anthony Bay	2,500,000					2,500,000	6%
Warren Lieberfarb	71,429	18,215				89,644	0%
Robert Arnold	857,142	120,000				977,142	2%
Series A US Investors			3,643,293			3,643,293	8%
Toshiba Corporation			9,108,233			9,108,233	20%
Deluxe Corporation			455,411	72,865		528,276	1%
Others		510,000				510,000	1%
Options Available					3,262,910	3,262,910	7%
Options Granted					1,737,090	1,737,090	4%
Total	26,268,358	719,760	13,206,937	72,865	5,000,000	45,267,920	100%
% of Shareholding	58%	2%	29%	0%	11%	100%	

Source: MOD Systems, Inc.

Post-Money Valuation		
Series A Capital Raise	$	36,250,004
Ownership %		29%
Implied Post-Money Value	$	**124,250,029**
Shares Outstanding		45,267,920
Series A Pricing (per share)	$	2.74
Implied Post-Money Value	$	**124,250,029**

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MOD Systems, Inc.

Capitalization Rights Summary

Valuation as of 06/30/08

Exhibit G - 2

Draft for Discussion Purposes Only

	Class	Preferred Series A Warrants	Preferred Series A	Common Warrants	Common	Options
	Date of Issue	06/30/08	06/30/08			
	Shares Authorized	-	-	NA	-	5,000,000
	Shares Issued	72,865	13,206,937	719,760	26,268,358	1,737,090
	Par	$ -	$ -	$ -	$ -	$ -
	Cap (x)					
	Cap ($)					
LIQUIDATION	**Seniority**	0	1	2	2	2
LIQUIDATION	**Per Share Preference**	$ -	$ 2.744770			
LIQUIDATION	**Participating**	$ -	Yes			
LIQUIDATION	**Dividend Rate**	8%	8%			
LIQUIDATION	**Dividend Inclusion**	Cumulative	Cumulative			
LIQUIDATION	**Anti-dilution Rights**	0	Partial-ratchet			
CONVERSION	**Convertibility: Upon Certain Events**	0	Yes			
CONVERSION	**Convertibility: Upon Majority Election**	0	Yes			
CONVERSION	**Redeemable**	0	Yes			

***Anti-Dilution Rights:**

Full Ratchet is where the conversion price adjusts automatically to the most recent round of issued preferred stock, regardless of the dilution effect on the new issuance

Partial Ratchet adjusts the conversion price on a weighted-average and ranges from a narrow (closer to a full-ratchet approach) to a broad-based approach (sensitive to dilution of other issuances)

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Exhibit H - 1

MOD Systems, Inc.

Draft for Discussion Purposes Only

Enterprise Value - Probability Weighted Expected Return Method (PWERM)

Valuation as of 06/30/08

Valuation Method	Initial Public Offering	Merger or Sale (Early)	Merger or Sale (Late)	Dissolution / No Value to Common	Private Company Scenario
Expected Pre-Money Valuation:					
Applicable Performance Metric - Description	2012 Revenue	2010 Revenue	2011 Revenue	Invested Capital	Various Approaches
Applicable Performance Metric - Value	$222,191,099	$45,512,254	$99,616,781	$36,250,004	
Applicable Multiple - Based on Comparable Analysis	**1.0x**	**2.7x**	**2.7x**	**1.0x**	
Expected Value at Time of Transaction	$215,785,930	$122,471,349	$268,064,100	$36,250,004	$92,500,000
Exit Multiple Metric - Description	2012 Net Income	2010 Net Income	2011 Net Income	NA	
Exit Multiple - Value	3.2x	NA	10.9x	NA	
Business Enterprise Value	$215,785,930	$122,471,349	$268,064,100	$36,250,004	$92,500,000
Standard Deviation (%)	20%	20%	20%	20%	0%
Standard Deviation ($)	$43,157,186	$24,494,270	$53,612,820	$7,250,001	$0
Discounted Expected Value					
Timing of Event	12/31/2012	12/31/2010	12/31/2011	12/31/2010	6/30/2008
Valuation Date	6/30/2008	6/30/2008	6/30/2008	6/30/2008	6/30/2008
Years Until Event	4.51	2.50	3.50	2.50	0.00
Days Until Event	1,645	914	1,279	914	0
Standard deviation (days)	180	180	180	180	0
Calculated WACC	29.00%	29.00%	29.00%	29.00%	29.00%
Calculated Discount Factor	0.32	0.53	0.41	0.53	1.00
Calculated Discount Factor - High	0.36	0.60	0.46	0.60	1.00
Calculated Discount Factor - Low	0.28	0.47	0.36	0.47	1.00

SVB Analytics *Exhibit H - 2*

MOD Systems, Inc. **Draft for Discussion Purposes Only**

Allocation of Value - Probability Weighted Expected Return Method (PWERM)

Valuation as of 06/30/08

Valuation Method		Initial Public Offering	Merger or Sale (Early)	Merger or Sale (Late)	Dissolution / No Value to Common	Private Company Scenario
Weighted Equity Value		$215,785,930	$122,471,349	$268,064,100	$36,250,004	$92,500,000
Value of Preferred Stock						
Available for distribution to Preferred Series A		$215,785,930	$122,471,349	$268,064,100	$36,250,004	$92,500,000
Preferred Series A Financing (Preferences)						
Dividend value (at date of event)		$ -	$ -	$ -	$ -	$ -
Shares - Preferred Series A		-	13,206,937	-	13,206,937	13,206,937
Liquidation Preference (per share)		**$2.745**	**$2.745**	**$2.745**	**$2.745**	**$2.745**
Liquidation preference value		$0	$36,250,004	$0	$36,250,004	$36,250,004
Value of Preferred Series A Round Preferred		$0	$36,250,004	$0	$36,250,004	$36,250,004
Available for distribution to Common Stock and Equivalents		$215,785,930	$86,221,345	$268,064,100	$0	$56,249,996
Common Stock and Equivalents						
Preferred Series A Warrants Shares - Converted to common		72,865	72,865	72,865	72,865	72,865
Preferred Series A Shares - Converted to common		13,206,937	13,206,937	13,206,937	13,206,937	13,206,937
Common Warrants Shares - Converted to common		719,760	719,760	719,760	719,760	719,760
Common Shares		26,268,358	26,268,358	26,268,358	26,268,358	26,268,358
Options Shares		3,251,103	1,610,234	3,581,487	0	518,446
Number of Common and Converted Shares and Outstanding Options		43,519,023	41,878,154	43,849,407	40,267,920	40,786,366
Value per Common Share		**$4.96**	**$2.06**	**$6.11**	**$0.00**	**$1.38**
Calculated Discount Factor		0.32	0.53	0.41	0.53	1.00
Discounted Expected Value		$1.57	$1.09	$2.50	$0.00	$1.38
Probability of Outcome (a)		**10.0%**	**30.0%**	**30.0%**	**10.0%**	**20.0%**
Probability Weighted Value per Common Share (Individual Methods)		**$0.16**	**$0.33**	**$0.75**	**$0.00**	**$0.28**
Less: DLOC (Shareholder level) (b)	**0.0%**					$0.00
Less: DLOM (Shareholder level) (c)	**20.0%**	$0.03	$0.07	$0.15	$0.00	$0.06
		$0.13	**$0.26**	**$0.60**	**$0.00**	**$0.22**
Adjusted Value per Common Share		**$1.21**				

Notes:

(a) Based on discussions with Management and a review of empirical studies

(b) See footnote on Exhibit F

(c) Discount for lack of marketability applied to all scenarios. While liquidity is implied in certain of the scenarios, there is an implicit required hold until liquidity can be achieved, similar to other investments like Rule 144 restricted stock. The implicit required hold warrants a marketability discount. SVB Analytics based on a reduction of a put-option calculation of 27%

SVB Analytics

MOD Systems, Inc.

Implied Value of Each Share Class

Valuation as of 06/30/08

Exhibit H - 3

Draft for Discussion Purposes Only

Discounted Weighted Enterprise Value:	$79,632,635

Event Date Value	Initial Public Offering	Merger or Sale (Early)	Merger or Sale (Late)	Dissolution / No Value to Common	Private Company Scenario
Preferred Series A Warrants	$361,296	$150,019	$445,445	$0	$100,491
Preferred Series A	$65,485,642	$63,441,267	$80,737,823	$36,250,004	$54,464,183

Discount Factor	0.32	0.53	0.41	0.53	1.00
Probability	10%	30%	30%	10%	20%

Note: Discount factor based on WACC.

Valuation Date Value	Initial Public Offering	Merger or Sale (Early)	Merger or Sale (Late)	Dissolution / No Value to Common	Private Company Scenario
Preferred Series A Warrants	$11,467	$23,787	$54,752	$0	$20,098
Preferred Series A	$2,078,428	$10,059,221	$9,923,842	$1,915,929	$10,892,837

Weighted Value per Class	
Preferred Series A Warrants	$110,104
Preferred Series A	$34,870,255

Number of Shares per Class	
Preferred Series A Warrants	72,865
Preferred Series A	13,206,937

Weighted Value per Share per Class	
Preferred Series A Warrants	$1.51
Preferred Series A	$2.64

SVB Analytics

Exhibit I

MOD Systems, Inc.

Draft for Discussion Purposes Only

Allocation of Value - Current Value Method (CVM)

Valuation as of 06/30/08

Weighted Equity Value (controlling, marketable)		**$92,500,000**
Value of Preferred Stock		
	Available for distribution to Preferred Series A	**$92,500,000**
Preferred Series A Financing (Preferences)		
Dividend value	$	-
Shares - Preferred Series A		13,206,937
Liquidation Preference (per share)		**$2.745**
Liquidation preference value		$36,250,004
Value of Preferred Series A Round Preferred		$36,250,004
	Available for distribution to Common Stock and Equivalents	**$56,249,996**
Common Stock and Equivalents		
Preferred Series A Warrants Shares - Converted to common		72,865
Preferred Series A Shares - Converted to common		13,206,937
Common Warrants Shares - Converted to common		719,760
Common Shares		26,268,358
Options Shares		518,446
Number of Common and Converted Shares and Outstanding Options		40,786,366
Value per Common Share (controlling, marketable)		$1.38
Less: Discount for Lack of Control (Shareholder level) (a)	**0.0%**	$0.00
Less: Discount for Lack of Marketability (Shareholder level) (b)	**20.0%**	$0.28
Adjusted Value per Common Share (minority, non-marketable)		**$1.10**

Note:

(a) Discount calculated from Mergerstat. See footnote on Exhibit F

(b) SVB Analytics based on a reduction of a put-option calculation of 27%

SVB Analytics

MOD Systems, Inc.

Allocation of Value - Option Pricing Method (OPM)

Valuation as of 06/30/08

Exhibit J - 1

Draft for Discussion Purposes Only

STEP ONE	Option Pricing Method Inputs	
	Weighted Equity Value	$92,500,000
	Plus: Debt	$0
	Enterprise Value	**$92,500,000**
	Years Until Event (a)	3.50
	Date of Event	12/29/2011
	Risk Free Rate (b)	3.33%
	Volatility (c)	47.00%
	Dividend Yield	0.0%

(a) Based on a weighted average of the PWERM exits
(b) US Treasury matching the expected term identified in (a)
(c) Based on the average of the comparables identified on Exhibit J-3.

Break Point Analysis	
$0	Before this break point, debt is repaid
$0	After this break point, only the Series A receives value.
$36,250,004	After this break point, the Series A and the Common receive value.
$36,290,272	After this break point, the $0.001 options exercise.
$46,805,134	After this break point, the $0.26 options exercise.
$152,505,000	After this break point, the Series A reaches its cap (Common at $2.74).
$175,660,650	After this break point, the $3.50 options exercise.
$239,396,424	After this break point, the Series A converts to Common (Common at $5.48)
$0	
$0	
$0	
$0	
$0	

Black Scholes Option Model Valuation

Scenario	First	Second	Third	Fourth	Fifth	Sixth	Seventh	Eighth	Ninth	Tenth
Form of Option	Before this break point, debt is repaid	After this break point, only the Series A receives value.	After this break point, the Series A and the Common receive value.	After this break point, the $0.001 options exercise.	After this break point, the $0.26 options exercise.	After this break point, the Series A reaches its cap (Common at $2.74).	After this break point, the $3.50 options exercise.	After this break point, the Series A converts to Common (Common at $5.48)		
TWO **Black-Scholes Inputs**										
Firm Value @ Valuation Date	$92,500,000	$92,500,000	$92,500,000	$92,500,000	$92,500,000	$92,500,000	$92,500,000	$92,500,000	$92,500,000	$92,500,000
Entity Value Range Minimum	**$0**	**$0**	**$36,250,004**	**$36,290,272**	**$46,805,134**	**$152,505,000**	**$175,660,650**	**$239,396,424**	**$0**	**$0**
Entity Value Range Maximum	$0	$36,250,004	$36,290,272	$46,805,134	$152,505,000	$175,660,650	$239,396,424	NA	NA	NA
Dividend Yield	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Years to Maturity	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5
Risk free Rate (Rf)	3.33%	3.33%	3.33%	3.33%	3.33%	3.33%	3.33%	3.33%	3.33%	3.33%
Volatility Data										
Volatility	47.0%	47.0%	47.0%	47.0%	47.0%	47.0%	47.0%	47.0%	47.0%	47.0%
Variance	0.22	0.22	0.22	0.22	0.22	0.22	0.22	0.22	0.22	0.22
Black-Scholes Functions and Normal Distributions										
D1	26.67	26.67	1.64	1.64	1.35	0.00	-0.16	-0.51	0.00	0.00
D2	25.79	25.79	0.76	0.76	0.47	-0.88	-1.04	-1.39	0.00	0.00
N(D1)	1.00	1.00	0.95	0.95	0.91	0.50	0.44	0.31	0.00	0.00
N(D2)	1.00	1.00	0.78	0.78	0.68	0.19	0.15	0.08	0.00	0.00
THREE **Value of Call Option**	$92,500,000	$92,500,000	$62,777,869	$62,750,073	$55,946,197	$20,516,932	$17,027,795	$10,667,143	$0	$0

FOUR	Calculation of Gross Preference Value									
	Call Option At Min. Entity Value Range	$92,500,000	$92,500,000	$62,777,869	$62,750,073	$55,946,197	$20,516,932	$17,027,795	$10,667,143	$0	$0
	Call Option At Max. Entity Value Range	$92,500,000	$62,777,869	$62,750,073	$55,946,197	$20,516,932	$17,027,795	$10,667,143	$0	$0	$0
	Incremental Option Value for Range	$0	$29,722,131	$27,796	$6,803,876	$35,429,265	$3,489,137	$6,360,651	$10,667,143	$0	$0
	Total for All Securities	**$92,500,000**									

Exhibit J - 2

SVB Analytics

MOD Systems, Inc.

Draft for Discussion Purposes Only

Allocation of Value - Option Pricing Method (OPM)

Valuation as of 06/30/08

Scenario	First	Second	Third	Fourth	Fifth	Sixth	Seventh	Eighth	Ninth	Tenth
Form of Option	Before this break point, debt is repaid	After this break point, only the Series A receives value.	After this break point, the Series A and the Common receive value.	After this break point, the $0.001 options exercise.	After this break point, the $0.26 options exercise.	After this break point, the Series A reaches its cap (Common at $2.74).	After this break point, the $3.50 options exercise.	After this break point, the Series A converts to Common (Common at $5.48)		

FIVE Capitalization

Scenario	First	Second	Third	Fourth	Fifth	Sixth	Seventh	Eighth	Ninth	Tenth
Share Category		Capital	Shares	Shares	Shares	Shares	Shares	Shares	Shares	Shares
Preferred Series A Warrants	$0	$0	72,865	72,865	72,865	0	0	72,865	72,865	72,865
Preferred Series A	$0	$36,250,004	13,206,937	13,206,937	13,206,937	0	0	13,206,937	13,206,937	13,206,937
Common Warrants	$0	$0	719,760	719,760	719,760	719,760	719,760	719,760	719,760	719,760
Common	$0	$0	26,268,358	26,268,358	26,268,358	26,268,358	26,268,358	26,268,358	26,268,358	26,268,358
Options	$0	$0	0	330,000	562,521	3,825,431	5,000,000	5,000,000	5,000,000	5,000,000
Total	$0	$36,250,004	40,267,920	40,597,920	40,830,441	30,813,549	31,988,118	45,267,920	45,267,920	45,267,920

SIX Identification of the Relative Rights to Distributions

Rights to Distributions (%)										
Debt	100.00%									
Preferred Series A Warrants	0.00%	0.00%	0.18%	0.18%	0.18%	0.00%	0.00%	0.16%	0.16%	0.16%
Preferred Series A	0.00%	100.00%	32.80%	32.53%	32.35%	0.00%	0.00%	29.18%	29.18%	29.18%
Common Warrants	0.00%	0.00%	1.79%	1.77%	1.76%	2.34%	2.25%	1.59%	1.59%	1.59%
Common	0.00%	0.00%	65.23%	64.70%	64.34%	85.25%	82.12%	58.03%	58.03%	58.03%
Options	0.00%	0.00%	0.00%	0.81%	1.38%	12.41%	15.63%	11.05%	11.05%	11.05%
Total Shares (%)	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

SEVEN Calculation of the Value of the Distribution Rights

Debt	$0									
Preferred Series A Warrants	$0	$0	$50	$12,212	$63,226	$0	$0	$17,170	$0	$0
Preferred Series A	$0	$29,722,131	$9,116	$2,213,374	$11,459,883	$0	$0	$3,112,144	$0	$0
Common Warrants	$0	$0	$497	$120,626	$624,548	$81,501	$143,120	$169,608	$0	$0
Common	$0	$0	$18,133	$4,402,360	$22,793,499	$2,974,468	$5,223,310	$6,189,998	$0	$0
Options	$0	$0	$0	$55,305	$488,109	$433,168	$994,221	$1,178,223	$0	$0
Total Incremental Option Value	$0	$29,722,131	$27,796	$6,803,876	$35,429,265	$3,489,137	$6,360,651	$10,667,143	$0	$0
Total for All Securities	$92,500,000									

EIGHT Calculation of the Per Share Value of each Security

Security	Total Value in $000s	Number of Shares (not converted)	Per Share Value
Debt	$0		
Preferred Series A Warrants	$92,658	72,865	$0.00
Preferred Series A	$46,516,648	13,206,937	$3.52
Common Warrants	$1,139,899	719,760	$1.58
Common	$41,601,767	26,268,358	$1.58
Options	$3,149,027	1,737,090	$1.81
Total	$92,500,000		

NINE Summary of Analysis of Common Stock of MOD Systems, Inc.

Value per Common Share		$1.58
Less: DLOM (a)	20.0%	$0.32
Adjusted Value per Common Share		**$1.27**

Note:

(a) SVB Analytics based on a reduction of a put-option calculation of 27%

(b) Premium based on preferred rights. Preferred investors have other rights including anti-dilution rights, redemption rights, drag along rights, etc.

(c) A preferred investment typically has illiquidity built in to its share price. Consequently, we have incorporated a discount for this illiquidity.

SVB Analytics

MOD Systems, Inc.

Volatility - Option Pricing Method (OPM)

Valuation as of 06/30/08

Exhibit J - 3

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Ticker	Company Name	1 Year	2 Year	3 Year	4 Year	5 Year
Volatilities Calculated on 03/31/08						
NasdaqGS:AAPL	Apple Inc.	44.9%	38.9%	38.8%	39.7%	39.2%
NasdaqGS:LNET	LodgeNet Interactive Corporation	65.8%	54.2%	48.1%	44.0%	42.5%
NasdaqGS:RNWK	RealNetworks Inc.	44.5%	40.4%	43.7%	46.0%	49.1%
NasdaqGS:AVID	Avid Technology Inc.	47.6%	42.4%	44.4%	42.0%	42.7%
NasdaqGM:DIVX	DivX, Inc.	70.4%	66.3%	NA	NA	NA
NasdaqGS:SNIC	Sonic Solutions	64.0%	52.1%	49.3%	50.9%	53.8%
NasdaqGM:NAPS	Napster Inc.	53.6%	48.1%	52.5%	57.0%	NA
NasdaqGM:CCUR	Concurrent Computer Corp.	56.8%	58.4%	54.6%	58.0%	63.2%
	First Quartile	**46.9%**	**41.9%**	**44.0%**	**43.0%**	**42.5%**
	Median	**55.2%**	**50.1%**	**48.1%**	**46.0%**	**45.9%**
	Average	**56.0%**	**50.1%**	**47.3%**	**48.2%**	**48.4%**
	Third Quartile	**64.5%**	**55.2%**	**50.9%**	**54.0%**	**52.6%**

Note: Volatilities calculated on a daily basis.

Exhibit K – Appraisers' Bios and Credentials

Brendan Kennedy

Brendan Kennedy is a Managing Director with SVB Analytics, responsible for executing client valuation assignments and issuing valuation opinions for private companies. Mr. Kennedy brings a strong background in entrepreneurship, with an emphasis on technology companies, to his role at SVB Analytics.

Prior to joining SVB Analytics, Mr. Kennedy founded Mindability Inc., an online usability and experience measurement company. As CEO, he grew the company to thirty employees before its acquisition by an international customer satisfaction and loyalty-marketing firm. Prior to Mindability, Mr. Kennedy founded Torsionsoft Inc., a custom software development firm that created project management and voice-integrated applications for the Boeing Commercial Aircraft Group.

For entrepreneurs, Mr. Kennedy has created business plans, shaped business strategy, and pitched companies to potential investors. For investors, he has performed venture capital due diligence, competitive analyses, and startup valuations. In 2005, Kennedy won the Yale University Entrepreneurship Society Y50K competition with a business plan based on the design of a health care information management system.

At Sellen Construction Company, Mr. Kennedy designed project management and communication software systems in Microsoft VB, SQL Server, Crystal Reports, and Exchange.

Mr. Kennedy earned an MBA from the Yale School of Management, a master's degree in engineering from the University of Washington, and a bachelor's degree from the University of California, Berkeley. He is a three-time Ironman triathlete and a native of San Francisco.

Steve Allan

Steve Allan is an associate with SVB Analytics, responsible for executing client valuation assignments and issuing valuation opinions for private companies. Allan brings a strong financial background and passion for entrepreneurship to his role at SVB Analytics.

Prior to joining SVB Analytics in 2008, Mr. Allan worked with J.P. Morgan Chase in New York for the firm's fixed income trading business. While at J.P. Morgan, Mr. Allan worked with both the proprietary and client-focused U.S. Dollar Fixed Income Derivatives desks.

Before J.P. Morgan, Mr. Allan worked with AT&T. Joining AT&T in 2000, Mr. Allan completed the two-year rotational training Financial Leadership Program. After graduating from the program, Mr. Allan joined AT&T Consumer Services in a marketing and sales role developing models for customer acquisition and retention partnerships and strategies.

In 2006, Mr. Allan co-authored the winning business plan and best presentation award winner for the IrishAngels-sponsored University of Notre Dame McCloskey Social Business Plan Competition with a plan for a socially-focused, hybrid for-benefit organization, PEPY Tours. Mr. Allan then served as a board member and Chief Financial Officer for the organization.

Mr. Allan earned a master's in business administration from Duke University's Fuqua School of Business and a bachelor's degree in finance from the University of Notre Dame.

SVB Analytics
A Member of SVB Financial Group

Assumptions Limiting Opinion Exhibit L

Purpose and Distribution of Report. The report prepared by SVB Analytics is prepared solely for the purpose stated in the Engagement Letter and should not be used for any other purpose. Except as specifically stated in the report prepared by SVB Analytics, the SVB Analytics report and its contents may not be quoted or referred to, in whole or in part, in any registration statement, prospectus, public filing, loan agreement, or other agreement or document without the prior written approval of SVB Analytics. Except as set forth in SVB Analytics' report, the SVB Analytics report is prepared for Client use only and may not be reproduced or distributed to any third parties without SVB Analytics' prior written consent.

Scope of Analysis. The appraisal of any financial instrument or business is a matter of informed judgment. The accompanying appraisal has been prepared on the basis of information and assumptions set forth in the attached report, its appendices, our underlying work papers, and these limiting conditions and assumptions.

Nature of Opinion. Neither the opinion nor the report provided or prepared by SVB Analytics are to be construed as a fairness opinion as to the fairness of an actual or proposed transaction, a solvency opinion, or an investment recommendation, but, instead, are the expression of SVB Analytics' determination of the fair market value of assets between a hypothetical willing buyer and a hypothetical willing seller in an assumed transaction on an assumed valuation date. For various reasons, the price at which the assets might be sold in a specific transaction between specific parties on a specific date might be significantly different from the fair market value as expressed in our report.

Going Concern Assumption, No Undisclosed Contingencies. SVB Analytics' analysis:
(a) is based on the past and present financial condition of the Client and its assets as of the valuation date; (b) assumes that as of the valuation date the Client and its assets will continue to operate as configured as a going concern; (c) assumes that the current level of management expertise and effectiveness would continue to be maintained and that the character and integrity of the enterprise through any sale, reorganization, exchange, or diminution of the owners' participation would not be materially or significantly changed; and (d) assumes that the Company had no undisclosed real or contingent assets or liabilities, no unusual obligations or substantial commitments, other than in the ordinary course of business, nor had any litigation pending or threatened that would have a material effect on our analysis.

Lack of Verification of Information Provided. With the exception of any audited financial statements provided to SVB Analytics, SVB Analytics has relied on information supplied by the Client without audit or verification. SVB Analytics has assumed that all information furnished is complete, accurate and reflects Client's management's good faith efforts to describe the status and prospects of the Client at the valuation date from an operating and a financial point of view. As part of this engagement, SVB Analytics has relied upon publicly available data from recognized sources of financial, industry, or statistical information, which have not been verified.

Reliance on Forecasted Data. SVB Analytics' use of Client's management's projections or forecasts in any analysis does not constitute an examination or compilation of prospective financial statements in accordance with standards established by the American Institute of Certified Public Accountants ("AICPA"). SVB Analytics does not express an opinion or any other form of assurance on the reasonableness of the underlying assumptions or whether any of the prospective financial statements, if used, are presented in conformity with AICPA presentation guidelines. Further, there will usually be differences between prospective and actual results because events and circumstances frequently do not occur as expected and these differences may be material. Achievement of the forecasted results is dependent on action, plans, and assumptions of management.

Subsequent Events. The terms of SVB Analytics' engagement are such that SVB Analytics has no obligation to update this report or to revise the valuation because of events and transactions occurring subsequent to the date of the valuation unless SVB Analytics is engaged to provide valuations in the future.

Legal Matters. SVB Analytics assumes no responsibility for legal matters including interpretations of either the law or contracts. SVB Analytics has made no investigation of legal title and has assumed that all owners' claims to property are valid. SVB Analytics has given no consideration to liens or encumbrances except as specifically stated in financial statements provided to SVB Analytics. SVB Analytics has assumed that all required licenses, permits, etc. are in full force and effect. SVB Analytics assumes that all applicable federal, state, local zoning, environmental and similar laws and regulations have and continue to be complied with by Client. SVB Analytics assumes no responsibility for the acceptability of the valuation approaches used in our report as legal evidence in any particular court or jurisdiction. The suitability of SVB Analytics' report and opinion for any legal forum is a matter for Client and Client's legal advisor to determine. SVB Analytics assumes that any Employee Agreement provided by Client's management is legally enforceable and is the most recent document available.

Testimony. SVB Analytics and its employees, consultants and agents shall not provide any testimony or appear in any legal proceeding unless SVB Analytics coordinates such testimony.

Verification of Hazardous Conditions. SVB Analytics will not investigate the extent of any hazardous substances or environmental conditions that may exist and takes no responsibility for investigating or having knowledge of them. The presence of hazardous substances, such as asbestos or environmental conditions may affect the value of Client's property. SVB Analytics' valuation report will be based on the assumption that there are no hazardous substances or environmental conditions on, in or near the Client's property. Any person entitled to rely on this report wishing to know whether such liabilities exist, or their scope, and the effect on the value of the property is encouraged to obtain a professional environmental assessment. SVB Analytics does not conduct or provide environmental assessments and has not performed one for the subject property. SVB Analytics has not determined independently whether the Company is subject to any present or future liability relating to environmental matters (including but not limited to CERCLA/Superfund liability), nor the scope of any such liabilities. SVB Analytics' valuation takes no such liabilities into account except as they have been reported expressly to SVB Analytics by the Company, or by an environmental consultant working for the Company, and then only to the extent that the liability was reported to us in an actual or estimated dollar amount. Such matters are noted in the report. To the extent such information has been reported to us, SVB Analytics has relied on it without verification and offers no warranty or representation as to its accuracy or completeness.

Condition, Zoning and Other Regulatory Compliance of Client's Property or Locations. SVB Analytics assumes no knowledge or liability whatsoever with respect to the condition of the Client's property or locations at which Client and its employees and operations are located, or for hidden or unapparent conditions, if any, of the subject property, subsoil or structures, and further assume no liability or responsibility whatsoever with respect to the correction of any defects which may now exist or which may develop in the future. Equipment components considered, if any, were assumed to be adequate for the needs of the property's improvements, and in good working condition, unless otherwise reported. SVB Analytics assumes that Client has complied with all public and private zoning and use restrictions and regulations, unless non-conformity was stated, defined and considered in SVB Analytics' report. SVB Analytics will not make a specific compliance survey or analysis of this property to determine whether or not it is in conformity with the various detailed requirements of the Americans with Disabilities Act ("ADA"). Any failure of compliance with the ADA of Client's properties and could have a negative effect upon the value of the property. SVB Analytics has no direct evidence relating to compliance or non-compliance with the ADA and will not consider possible non-

compliance with the requirements of the ADA in preparing its valuation report.

Circular 230 Disclaimer. As set forth in the Engagement Letter, SVB Analytic's report is limited to issues concerning compliance with IRC §409(a). Additional issues may exist that could affect the Federal tax treatment of the interests that are the subject of SVB Analytics' report, and the report does not consider or provide a conclusion with respect to any additional issues. SVB Analytics' report is not intended or written to be used, and cannot be used, by Client or any other person or entity, for the purpose of avoiding any penalties that may be imposed on any taxpayer.

EXHIBIT “G”

APPRAISAL REPORT OF

BANANA CORPORATION

Seattle, Washington
Valued as of June 16, 2006

PREPARED BY

Kevin R. Yeanoplos, CPA/ABV/CFF, ASA
Valuation Analyst

John M. Martin
Valuation Analyst

Brueggeman and Johnson Yeanoplos, P.C.

ISSUANCE DATE
July 24, 2009

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BRUEGGEMAN AND JOHNSON YEANOPLOS, P.C.

July 24, 2009

Mr. Mark Phillips, CEO
Banana Corporation
2801 1st Avenue, Suite 1104
Seattle, Washington 98121

PRELIMINARY DRAFT

Re: Valuation of Banana Corporation

Dear Mr. Phillips:

We have prepared and enclosed herewith, our preliminary appraisal report of Banana Corporation, ("BC" or "the Company") dated July 24, 2009. The purpose of this valuation is to establish the fair market value as of June 16, 2006 of a 100% ownership interest in the Company. Our preliminary opinion of value is based on an analysis of the information provided to us by management prior to the date of this report and is subject to change based on additional information we may receive in the future. We understand that the results of our analysis will be used for internal purposes.

The standard of value is "fair market value." Fair market value is defined by the Uniform Business Corporation Act by the International Glossary of Business Valuation Terms as "the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts." We assume that the Company will continue as a going concern and that the character of its present business will remain intact.

This report is based on historical and prospective financial and economic information provided to us by management and other parties. Had we audited or reviewed the underlying financial data, matters may have come to our attention that would have resulted in our using amounts that differ from those provided. Accordingly, we take no responsibility for the underlying data, financial or otherwise, presented in this report.

Users of this valuation report should be aware that business valuations are based on future earnings potential and/or asset values that may or may not materialize. Therefore, the actual results achieved and/or asset values obtained during the forecast period will vary from the forecasts used in this report, and the variations may be material.

In our opinion, based on our study and analysis, and the assumptions and limiting conditions as described in this report, we have concluded that the fair market value of a 100% equity interest in the common shares of Banana Corporation, as a going concern as of June 16, 2006, is:

Fair Market Value of
BANANA CORPORATION
As of June 16, 2006

Interest Valued	Value
100% Equity Interest in Banana Corporation	**$ 58,967,000**

We have no present or contemplated financial interest in Banana Corporation. Our fees for this valuation are based upon normal hourly billing rates, and are in no way contingent upon the results of our findings. We have no responsibility to update this report for events and circumstances occurring subsequent to the date of this report, although we will be pleased to perform an update valuation should you require one.

This letter and report are to be distributed only in their entirety, and are intended and restricted for use by the management of Banana Corporation and their representatives relative to the aforementioned purpose. This report is not to be copied or made available to any persons without the express written consent of Brueggeman and Johnson Yeanoplos, P.C.

Brueggeman and Johnson Yeanoplos, P.C.

Kevin R. Yeanoplos, CPA/ABV/CFF, ASA

Tucson, Arizona
July 24, 2009

INTRODUCTION

PURPOSE OF VALUATION

Brueggeman and Johnson Yeanoplos, P.C. has been retained by Banana Corporation and has prepared this report for the purpose of expressing its opinion as to the fair market value of a 100% equity interest in the Company as of June 16, 2006. This report is intended to present an objective, unbiased opinion of value for the exclusive purpose mentioned previously.

This report is not designed or intended to be a document suitable for use in selling this business to outside individuals or other entities which may be uninformed about the entity being valued. Because this report is to be used for management purposes, it may not contain sufficient descriptive information to satisfy an uninformed prospective buyer of the subject Company. It is also not designed to adequately portray all of the desirable qualities of the business, which should be addressed in an offering document designed for a potential buyer of the business.

APPROACH TO VALUATION

Our approach has been to determine an indication of value that would provide a fair and reasonable return on investment to an investor or owner, in view of the facts that would have been reasonably available to them at the time. We based our opinion on, among other things, our assessment of the risks facing the Company and the return on investment that would be required on alternative investments with similar levels of risk.

In our determination of value, we have considered certain factors set forth by the Internal Revenue Service in Revenue Ruling 59-60 for the valuation of security interests in closely held businesses. These factors include:

- The nature of the business and the history of the enterprise from its inception;
- The general economic outlook and the condition and outlook of the specific industry in particular;
- The book value of the stock and the financial condition of the business;
- The earnings capacity of the company;
- Whether or not the enterprise has goodwill or other intangible value;
- Sales of the stock and the size of the block of stock to be valued;
- The market price of the stock of corporations engaged in the same or similar line of business, having their stock actively traded in a free and open market, either in an exchange or over-the-counter.

We studied, analyzed, and interpreted both internal and external factors that could influence the value of BC.

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Internal factors included the Company's financial position, results of operations, and management, as well as the size and marketability of the interest being valued.

External factors included, among other things, the status of the industry and the position of the Company relative to the industry.

In performing our work, we were provided with and/or relied upon various sources of information, including but not limited to:

- Banana Corporation, forecast of revenues and expenses for the years ending December 31, 2007 through 2011;
- United States Patent Application Publication - Number 11/725,181 filed March 16, 2007;
- MetaWallet Software License Agreement by and between MetaWallet Inc. and Millicom International Cellular, S.A.;
- Banana Corporation internally prepared company and product description document titled "MetaWallet: Mobile Banking for Emerging Markets" and dated June 15, 2009;
- Banana Corporation internally prepared Power Point presentation titled "The mCommerce Platform: Mobile Payment and Payment Software" and dated February 2007;
- "Banking on Mobiles: Why, How, for Whom?" published by Consultative Group to Assist the Poor (CGAP) and written by Ignacio Mas and Kabir Kumar, dated June 2008;
- "Mobile Banking in Latin America" published in the Financial Services Intelligence Series by Business News Americas, dated May 2008;
- Unaudited supplemental information, including, but not limited to:
  - History of the Company;
  - Information on certain past transactions in the shares;
  - Sales and operating profitability statements;
  - Officer compensation;
  - Ownership breakdown of the shares;
  - General information on the Company's marketing, competitors, suppliers, customers, and other information from an interview with the Company's management;
- Surveys of industry peer financial results contained in *RMA Annual Statement Studies*, 2005/2006 Edition, published by the Risk Management Association (formerly Robert Morris Associates), a banking industry association. This study provides detailed financial ratio information on a variety of industry groupings, separated by company size;

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- Analysis of information on possible publicly traded and privately held comparable companies and industry information including the following:
  - Search of the Electronic Data Gathering and Retrieval ("EDGAR") database of public company filings with the Securities and Exchange Commission;
  - Analysis of possible public company and industry information via computer database;
  - Specific company annual reports, 10-K's and 10-Q's;
  - Database searches and reviews of articles, forecasts and abstracts via the Internet;
  - Analysis of possible privately held comparable companies obtained from *Pratt's Stats*, *Mid-Market Comps* (*Done Deals*), *BizComps*, and the *Institute of Business Appraiser's Transaction Database*;

- Information regarding the economic outlook for emerging markets as reported in the *Bank of International Settlements 75th Annual Report*;

- Information regarding the present conditions and outlook for the industry in which the Company operates as contained in *IBIS World Industry Reports*.

- Resources regarding business valuation issues including, but not limited to the following:
  - *Business Valuation Review*, a publication of the Business Valuation Committee of the American Society of Appraisers;
  - *ASA Business Valuation Standards* of the American Society of Appraisers, the *Uniform Standards of Professional Appraisal Practice*, published by the Appraisal Foundation, and the *Statement on Standards for Valuation Services 1*, issued by the AICPA Consulting Services Executive Committee;
  - *Valuing A Business: The Analysis and Appraisal of Closely Held Companies*, Fifth Edition, by Shannon P. Pratt, FASA;
  - *Cost of Capital, 2006 Yearbook*, a publication of Morningstar, Chicago – updated annually;
  - *Duff & Phelps, LLC Risk Premium Report 2006*, a publication of Standard & Poor's Corporate Value Consulting, a division of The McGraw-Hill Companies, distributed by Morningstar, updated annually;
  - *Stocks, Bonds, Bills & Inflation, 2006 Yearbook*, a publication of Morningstar, Chicago – updated annually; and,

- Other various relevant information.

The procedures employed in valuing the subject interest in the Company included such steps as we considered necessary, including but not limited to:

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- Discussions with management regarding valuation related issues including the following items (not all inclusive):
  - past and future operations of the business;
  - discretionary expenses;
  - capital structure; and,
  - operational strengths and weaknesses.
- An analysis of the historical and estimated future financial condition of the Company;
- An analysis of the industry in which the Company operates;
- An analysis of the general economic environment as of the valuation date;
- A comparative analysis where possible of guideline companies; and,
- An analysis of the other pertinent facts and data resulting in our conclusion of value.

The approaches and methodologies used in our work did not comprise an examination in accordance with generally accepted auditing standards (GAAS). The objective of a GAAS examination is to express an opinion regarding the fair presentation of historical or prospective financial statements or other financial information presented in accordance with generally accepted accounting principles (GAAP). Since we did not perform an examination in accordance with GAAS, we express no opinion and accept no responsibility for the accuracy and completeness of the financial information or other data provided to us by others. We assume that the financial and other information provided to us is accurate and complete, and we have relied upon this information in performing our valuation.

Importance of Limiting Conditions

We urge readers to study the *Statement of Assumptions and Limiting Conditions* contained in Appendix 5 of this report for important conditions, restrictions, and assumptions. Additionally, numerous assumptions are included throughout this report. Therefore, readers should study the entire report in order to obtain an understanding of the value estimate contained herein.

Definitions

A summary of definitions as adopted by the American Society of Appraisers, Institute of Business Appraisers, American Institute of Certified Public Accountants, Canadian Institute of Chartered Business Valuators, and National Association of Certified Valuation Analysts is included in Appendix 3.

Valuator Independence

This report was prepared in full by Brueggeman and Johnson Yeanoplos, P.C., Kevin R. Yeanoplos, CPA/ABV/CFF, ASA and John M. Martin. Brueggeman and Johnson Yeanoplos, P.C. acted as an independent valuation firm and has not acted as an advocate for the Company or any other party. This report was prepared in accordance with the *Statement on Standards for Valuation Services 1* of the American Institute of Certified Public Accountants ("AICPA") the *Code of Ethics* of the American

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Society of Appraisers and the *Uniform Standards of Professional Appraisal Practice* ("USPAP"). Brueggeman and Johnson Yeanoplos, P.C.'s fee for this engagement was in no way determined by the fair market value estimate provided.

SUMMARY OF KEY VALUATION FACTORS

Listed below is a summary of some of the positive and negative factors that we considered in this valuation (not all-inclusive):

Positives:

- The Company has substantially completed its development process as of the date of valuation;
- A lack of a well developed formal banking sector in emerging markets combined with high cell phone penetration and low Internet and ATM penetration provide an attractive opportunity for the widespread implementation of mobile banking;
- Mobile banking provides carriers and banks with attractive opportunities for new sources of revenue and cost reduction; and,
- Successful mobile banking initiatives in countries such as South Africa and the Philippines suggest that the use of mobile phones to provide financial services can be effective and profitable for both mobile telephone operators and financial institutions.

Negatives:

- The Company is in the start-up stage of its development and has not yet negotiated any licensing agreements with carriers or financial institutions or generated revenues;
- Challenges remain to obtaining widespread acceptance of mobile banking technology in emerging markets including the need to overcome a large customer adoption barrier; and,
- Several hurdles remain for the implementation mobile banking in emerging markets, such as the ability to provide liquidity through a cash conversion platform and gaining merchant acceptance of mobile payments;

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FUNDAMENTAL INFORMATION ON THE SUBJECT COMPANY

BACKGROUND AND OPERATIONS

Banana Corporation was incorporated in the State of Washington on June 16, 2006. BC's only product offering is its proprietary MetaWallet mCommerce software platform.

MetaWallet is a software platform designed to provide mCommerce business solutions addressing untapped markets with a low-margin, high-volume model of mobility services. MetaWallet combines banking and cellular technology to enable consumers to conduct financial transactions on their cell phones. The technology specifically targets emerging markets in Latin America, Africa, and Asia, where there is little infrastructure for landlines or readily accessible financial institutions, but where phones are ubiquitous. MetaWallet aims to leverage the developed cellular infrastructure in emerging markets to substitute for the absence of a developed financial infrastructure.

COMPANY OWNERSHIP

The Company is closely held and ownership on June 16, 2006 was as follows:

Ownership
As of June 16, 2006

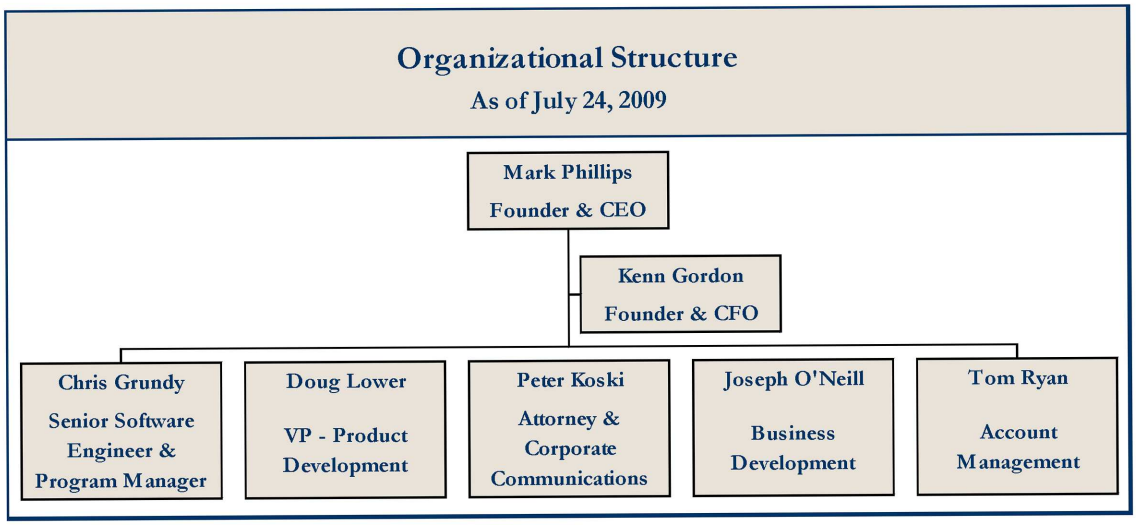
	Percentage
Mark Phillips	84.60%
Robert Arnold	15.40%
Total	**100.00%**

The Company was funded with a cash contribution of $5.5 million by Robert Arnold. In exchange for his contribution, Mr. Arnold received a 15.4% ownership interest in the Company. The intellectual property for the MetaWallet mCommerce platform was contributed by Mark Phillips. Mr. Phillips holds an 84.6% ownership interest in the Company.

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ORGANIZATIONAL STRUCTURE

The Company's organizational structure, as of the date of this report, is as follows:



BOARD OF DIRECTORS AND MANAGEMENT

The Company's executive officers are as outlined in the following table:

Top Executives
As of July 24, 2009

Name	Position
Mark Phillips	CEO & Co-Founder
Kenn Gordon	CFO & Co-Founder

Management Depth

BC was founded by Mark Phillips and Kenn Gordon. Mr. Phillips and Mr. Gordon serve as the Company's Chief Executive Officer and Chief Financial Officer, respectively. Mr. Phillips and Mr. Gordon are Managing Partners of Phillips Holdings, LLC. Mr. Phillips is co-founder and CEO of MOD Systems, a digital media company. Mr. Phillips has also been CEO of A DOT Corporation, an engineering consulting firm, and CTO and Senior Vice President of Research and Development at Fullplay. Mr. Gordon is the CFO of MOD Systems. Mr. Gordon has also been CFO of A DOT Corporation, and Program Manager and Manufacturing Manager at Fullplay. Between the two of them, they have over thirteen years bringing to market digital media, enterprise software solutions, embed-

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ded hardware, and wireless solutions. Doug Lower, Vice President of Program Development, has nine years in Product and Software Development.

The MetaWallet team also includes David Clemmer, Systems Architect and Senior Software Engineer, Chris Gundy, Senior Software Engineer and Program Manager. After an initial period of incubation, the team will recruit high level Board of Advisors, Directors and core management team. It is anticipated that the Seattle based team will consist of the core management and 15-20 product support, business development, finance, legal, and accounting personnel.

PRODUCTS AND SERVICES

MetaWallet is a flexible mobile banking platform, designed to address the unique needs of emerging markets. MetaWallet develops, integrates, and deploys commerce and financial system software that enables stored value transactions for mobile phone users.

The product provides interoperability across various mobile operators and banks and offers turnkey implementation, complete administrative and support services, secure real-time payments, and inexpensive transaction costs for customers. The technology is proven, robust, and scaleable to very high transaction volumes.

MetaWallet also supplies a platform and means for pervasive adoption by the customer pipeline of mobile banking, mobile payments, and peer-to-peer virtual transactions.

MetaWallet's software solution enables:

- Mobile airtime purchasing;
- Mobile account inquiry;
- Mobile account management;
- Stored value transactions;
- Mobile person-to-person exchange of value;
- Mobile account transfer;
- Mobile bill payment;
- Mobile remittances;
- Mobile coupon management;
- Mobile loan management; and,
- Banking integration.

According to management, in most emerging markets pre-paid service accounts for well over 90% of the market. MetaWallet's solution is unique in that it easily and conveniently allows consumers to top up their pre-paid accounts. This simple feature is anticipated by management to be the most widely used and most profitable element of MetaWallet's solution. In addition to pre-pay top up, MetaWallet enables account inquiry, peer-to-peer exchange of value, account transfer, overseas remittance cap-

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ture, and others services. The MetaWallet solution can be implemented on either pure SMS basis or SMS with a MetaWallet client-based interface.

MetaWallet provides a high level of security including features such as a user assigned personal identification number, encrypted communications, and the ability to incorporate any security system into the MetaWallet platform.

MARKET OPPORTUNITY

According to management, emerging markets are plagued with a scarcity of personal computers and a dearth of readily accessible financial institutions, yet they are populated with an increasingly active consumer base. This paradox creates a need for the efficient and secure management of financial transactions and presents an opportunity to provide a vehicle for facilitating the consumer-based economies in emerging markets. ATMs are absent, electronic banking is inaccessible, and depositors must sometimes wait hours in line to access their funds. Moreover, even simple functions, such as prepay top up for calling cards, are inconvenient and prepay card distribution is expensive and inefficient. Carrier customer acquisition cost and churn are exceedingly high and the predominance of the cash economy created by the absence of a mature financial infrastructure limits the services offered and the revenue earned by banks.

While PC and ATM penetration is low in emerging markets, cell phone penetration is high. Furthermore, partially due to low PC penetration and Internet usage, consumers use a high volume of cell phone based text messages for communication. According to management, the market inefficiency created by the absence of a stable financial infrastructure provides a fertile market opportunity for cell phone based mobile banking.

Management believes MetaWallet's mobile banking solution provides an efficient and secure vehicle for consumers' financial transactions and increases revenue and customer loyalty for carriers and banks.

According to management, MetaWallet will allow consumers to more easily and conveniently pay bills, add prepay minutes to their mobile accounts, and conduct person-to-person transactions and transfers, including remittances. Moreover, MetaWallet's software greatly reduces crime vulnerability by creating cashless consumers and obviating ATM withdrawals. Consumers can safely conduct financial transactions with stored value that can only be accessed and transferred through a secure PIN. And with the availability of mobile airtime purchasing, MetaWallet protects consumers from counterfeit prepaid cards.

Carriers benefit financially from increased SMS traffic, increased minutes of use for prepaid users, lower prepay distribution costs, new revenue sources, reduced churn, and enhanced customer satisfaction. Carriers can increase usage of prepaid minutes by making it more convenient to top up prepay minutes and can significantly increase high profit text messaging revenue. MetaWallet's software

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offers new services to mobile subscribers that present carriers with an immediate competitive edge and increase differentiation among competing carriers. MetaWallet enables carriers to enroll new subscribers and increase the average revenue for existing subscribers. MetaWallet's software will increase the average revenue per user through new subscribers, higher traffic, transactional fees, and the increase sale of new handsets. While increasing revenue, MetaWallet's software also reduces carriers' costs, particularly those related to prepaid airtime distribution and customer acquisition. MetaWallet's technology is developed specifically for the needs of carriers in emerging markets.

Banks earn increased fees and enhanced customer loyalty as consumers use mobile banking services. Banks can also earn greater profit margins through increased reserves for investing and lending as more consumers open accounts to take advantage of mobile banking. Moreover, banking relationships can be enhanced and infrastructure costs can be reduced using mobile technology. By extending branch functionality to mobile phones, banks can offer value-added services, such as bill payment, money transfer, and secure person-to-person transactions. Such services increase their reach and profitability by attracting new customers, creating new revenue streams, securing revenue assurance, and increasing differentiation among competitors. Banks can also decrease new customer acquisition costs and help eliminate fraud.

STAGE OF DEVELOPMENT

As of the date of this report, the Company has completed the software and SMS and UI client interface development process, has filed a patent for the MetaWallet product, has engaged with a major global carrier group, is working with a Latin American carrier to implement services, and has received sponsorship by major investors. To date, BC has obtained a commitment to conduct a trial in Ghana and a commitment to implement the MetaWallet service in Bolivia.

Intellectual Property Protection

As of the date of valuation, the Company had plans to file for patent and trademark protection for its MetaWallet mCommerce software platform. As of the date of this report, the MetaWallet software is protected by United States Patent Application number 11/725,181, filed on March 16, 2007. According to the US Patent and Trademark Office, trademark protection for the MetaWallet software was filed on August 2, 2006 and on January 16, 2007 and both efforts to obtain trademark protection were abandoned on January 17, 2007 and June 22, 2009, respectively. As of the date of this report, we were not made aware of any trademark protection for the MetaWallet software.

BUSINESS MODEL

The Company has implemented a flexible business model to bring the MetaWallet product to market which includes the following features:

- Upfront licensing fee, revenue share, or a combination of both;

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- International based developers;
- License software directly to carriers and carrier groups;
- Licensees handle customer support in country; and,
- Carriers or banks control service perpetually without MetaWallet control.

BC has positioned the MetaWallet product to provide a carrier-centric mobile banking solution which is specifically designed for carriers in high-growth developing markets. Such a solution relies on deep carrier group relationships and a fully integrated carrier-bank-retailer-consumer system.

Marketing and Distribution

Management indicated that MetaWallet will leverage cell phone penetration to target carriers' existing customer base. MetaWallet is a software provider and will not manage overseas marketing. Instead, MetaWallet will leverage the financial benefit to carriers and banks by enabling them to market to existing subscribers and account holders, and attract new subscribers and account holders.

Geographic Markets

BC intends to offer its MetaWallet service in emerging markets where banking services are underdeveloped. According to management, the Company has focused its initial efforts to introduce the MetaWallet service in Latin America and Africa. The Latin American/Caribbean market includes approximately 175 million cell phone users while Sub-Saharan Africa includes approximately 62 million cell phone users. In its World Development Indicators 2006 Regional Fact Sheet, the World Bank has observed that "mobile phone service is booming, but internet access remains low."

In Latin America, approximately 32% of the population has mobile phones while only 10% have Internet access. In Sub-Saharan Africa, approximately 8.6% of the population has mobile phones while only 1.9% have Internet Access. Such low rates of Internet access inhibit the growth of Internet banking in these regions, while relatively high rates of mobile phone penetration provide the Company with an attractive opportunity to bring banking services to underserved communities via the mobile banking platform. MetaWallet specifically targets countries where cell phone penetration is at least four times the Internet penetration.

Customer Base

MetaWallet targets three categories of customers: carriers, banks, and non-profits. According to management, mobile carriers can employ MetaWallet's software to attract new subscribers and increase usage and sale of minutes, resulting in a combination of increased subscribers and greater minutes of usage per subscriber. Carriers can attract new subscribers with profile-driven value added services, such as coupons, promotions, and instantaneous sale of minutes. Carriers can also increase the average revenue per user through greater minutes of usage per subscriber, increased sale of handsets, and use of mobile phones for bill payments, person-to-person transactions, foreign remittances, and

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cross-selling with banks and merchants. Carriers' can further increase revenues through the collection of an increased number of subscription and transaction fees.

Banks can employ MetaWallet's software to connect account holders' cellular service to their bank accounts, extending branch functionality and enabling carriers to operate a bank system internally. MetaWallet's software enables increased accessibility of bank accounts, thereby increasing the number of account holders and springing new revenue streams for financial institutions. MetaWallet's software can reduce fraud and ease bill payment, money transfer, and person-to-person payments. By attracting new account holders, MetaWallet's software can also decrease new customer acquisition costs.

Non-profit organizations can leverage MetaWallet's software to increase the efficiency of their operations. Micro-lending organizations can distribute loans with fewer transaction costs, increased transparency, and enhanced accountability. Non-profit organizations can accept donations through mobile technology and can inexpensively solicit funds through targeted text messages.

Competition

The Company's competitors include companies involved in efforts to enable mobile banking, mobile payments, remittance systems and micro-lending software infrastructures. According to management, the Company has five broad categories of competitors including:

- Carriers whom can joint venture with a bank to implement a mCommerce system;
- Banks whom can joint venture with a carrier to implement a mCommerce system;
- Payment solutions providers such as Visa, MasterCard, and American Express;
- Financial remittance systems such as Western Union; and,
- Mobile Payment/Mobile Banking Software companies.

Summary of Forecasted Revenues and Expenses

Summarized below is management's forecast of revenues and expenses for the years ending December 31, 2007 through 2011:

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Summary of Forecasted
Revenues and Expenses (in Millions)

	For the Years Ending December 31,				
	2007	2008	2009	2010	2011
Revenues	$ 805	$ 28,201	$ 168,146	$ 237,901	$ 333,518
Total Operating Expenses	3,328	5,697	8,534	9,581	10,082
Pre-Tax Earnings	(2,523)	22,505	159,612	228,320	323,436
Provision for Income Taxes	(817)	7,967	55,892	79,902	113,121
Net Income	**$ (1,706)**	**$ 14,538**	**$ 103,720**	**$ 148,419**	**$ 210,315**

Source: Summarized from internally prepared forecast of revenues and expenses.

SUMMARY

MetaWallet leverages cell phone penetration in emerging markets to provide a mobile banking platform for communities with underdeveloped financial infrastructures. MetaWallet's software integrates and deploys commerce and financial system software that enables stored value transactions for mobile phone users. MetaWallet's mobile banking software is specially designed for emerging markets that enjoy high cell phone penetration, but suffer from low PC and ATM penetration.

As of the date of valuation, the Company is in the start-up stage of its life cycle. Although the Company has substantially completed the product development process, risks remain to bringing the MetaWallet product to market such as those presented by the process of obtaining agreements with mobile phone carriers and financial institutions and securing additional funding to support growth. In addition, several hurdles remain to the widespread implementation of mCommerce platforms in emerging markets such as the need to establish a means to provide liquidity to mobile banking customers through networks of cash-in/cash-out agents and the need to overcome a large customer adoption barrier.

We believe an investor in BC would assess some additional risk to an investment in the Company based internal factors related to its stage of development as well as external factors such as challenges to widespread acceptance of mCommerce in emerging markets. We will reflect this additional risk in our determination of an appropriate rate of return later in this report.

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ECONOMIC CONDITIONS

INTRODUCTION

No individual company operates in isolation. Any company's performance depends on external variables over which it can exercise only limited influence. Macroeconomic variables such as the state of the international economy, decisions made by the Federal Reserve Board, and the relative cost of capital can affect a company's access to raw materials, governmental and agency rules, and the regulations and structure of the competitive environment in which the company operates. The Gross Domestic Product (GDP) level, a measure of overall supply and demand, is ultimately determined by changing demographics, customer attitudes and consumer spending patterns.

THE EMERGING MARKETS ECONOMY

The following excerpts are from the Bank of International Settlements 75th Annual Report: Issues in Emerging Market Economies, dated June 2006, have been included in order to provide an overview of emerging market economies around the time of the valuation.

Highlights

The expansion which has been under way in emerging market economies since 2002 consolidated further in the period under review. Strong growth in many countries was accompanied by increasing export values and large current account surpluses. This permitted a sizeable reduction in external debt burdens and a further significant build-up of foreign currency reserves. Fiscal positions also improved, and balance sheet positions strengthened. Partly reflecting these factors, consumer and investor confidence remained buoyant. In contrast with previous experience, domestic demand proved remarkably resilient to higher oil prices even in oil-importing countries.

External conditions have been unusually favorable to emerging market economies in the current cycle. These include strong global demand, large terms-of-trade improvements for many countries and much easier external financing. One major question is whether the authorities in emerging markets have adequately exploited these favorable circumstances to secure lasting improvements in fiscal positions. A second question concerns imbalances that might raise inflation risks or lead to unsustainable increases in asset prices. While inflation has, so far, remained well contained in many countries, prospects are uncertain in the light of volatile commodity prices and very low or negative real short-term interest rates. A bout of turbulence in financial markets in May 2006 has added to this uncertainty. A major challenge for the monetary authorities in many countries is how to avoid policy mistakes that might put macroeconomic and financial stability at risk.

Macroeconomic Overview

Growth was robust in all regions last year (Table III.1). Moreover, in China revised GDP figures reveal that previous growth rates had been significantly underestimated. Growth accelerated in India; Korea successfully emerged from the 2003 credit card debacle; and much of Southeast Asia continued to grow at a strong rate. In Latin America, notwithstanding some slowdown, the expansion remained intact, and industrial output rebounded in Brazil and Mexico in early 2006. Argentina, Chile, Colombia and Peru all continued to see above trend growth. The expansion also remained strong in central and eastern Europe, although Hungary and Turkey had to deal with increased market volatility following the financial turbulence which began in Iceland in the early

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part of 2006. Growth was robust in much of the Middle East and Africa under the influence of higher commodity prices, especially oil.

Output growth and current account balance

	Real GDP[1]				Current account balance[2]		
	Average 2002–04	2005	2006		Average 2002–04	2005	2006
			First quarter	Full-year forecast			
Asia	7.6	8.0	8.7	7.7	158	252	220
China	9.7	9.9	10.3	9.6	50	161	137
Hong Kong SAR	4.5	7.3	8.2	5.3	14	22	23
India[3]	6.6	8.3	9.3	7.5	2	–16	–19
Korea	4.9	4.0	6.2	5.2	15	17	7
Other Asia[4]	5.1	5.0	5.6	4.8	76	70	73
Latin America[5]	2.5	4.3	5.5	4.6	9	39	31
Argentina	1.9	9.2	9.7	7.7	7	5	4
Brazil	2.5	2.2	3.4	3.5	3	14	9
Mexico	2.1	3.0	5.5	4.0	–10	–6	–7
Central Europe[6]	3.5	4.0	5.4	4.8	–19	–16	–17
Russia	6.4	6.4	6.3	6.2	41	84	90
Turkey	7.5	7.4	2.6	5.3	–8	–23	–28
Africa[7]	4.6	5.2	…	5.7	–3	15	24
Middle East[7]	5.4	5.9	…	5.7	64	196	241
Total[8]	6.1	6.7	7.6	6.7	242	549	560
Memo: G7	*2.1*	*2.6*	*2.8*	*2.8*	*–376*	*–614*	*–710*

Note: 2006 data are based on May consensus forecasts, JPMorgan Chase and IMF.

[1] Annual changes, in per cent. Regional figures are weighted averages based on 2000 GDP and PPP exchange rates. [2] In billions of US dollars. Regional figures are the sum of the economies included. [3] Annual data are fiscal years beginning in April. [4] Indonesia, Malaysia, the Philippines, Singapore, Taiwan (China) and Thailand. [5] The economies listed plus Chile, Colombia, Peru and Venezuela. [6] The Czech Republic, Hungary and Poland. [7] Country coverage according to IMF definition. [8] Comprises the economies above. For quarterly GDP growth, excluding Africa and the Middle East.

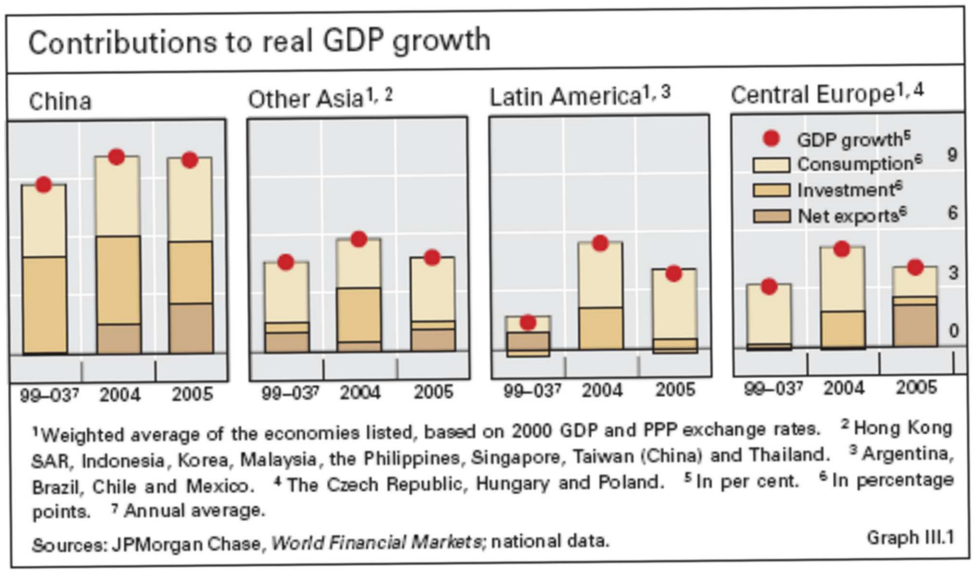
Sources: IMF; © Consensus Economics; JPMorgan Chase; national data. Table III.1

Pattern of Demand

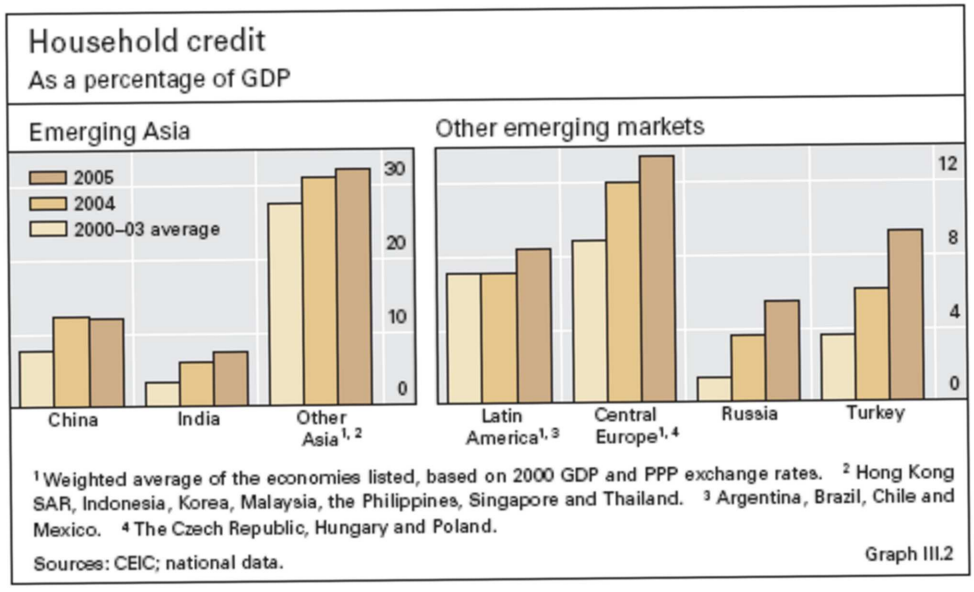
External demand continued to play an important role in a number of countries (Graph III.1). In general, demand for emerging market exports remained very strong while improved terms of trade played a special role in commodity exporting countries. Moreover, the export performance of Asian economies was helped in particular by an end to the inventory-led slowdown in the electronics sector which had begun in 2004. Compared to earlier downturns, firms have been relatively quick this time in reducing their excess inventories. In addition, the slowdown in the global demand for high-tech products proved to be only temporary. The combined effects of these developments were reflected in strong exports and large current account surpluses in many countries.

Nevertheless, the contribution of external demand to growth varied across countries. The contribution rose particularly sharply in China last year and remained substantial in Hong Kong SAR, Korea and Singapore. This was also true in several central European economies, notably the Czech Republic and Poland, which saw a significant improvement in their trade balances. By contrast, the contribution of net external demand declined in several oil importing Asian economies and Latin America.

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In all regions, growth was supported by strong household spending. Robust private consumption was supplemented, in many countries, by increased spending on residential construction. Two factors played an important role. First, household spending and consumer confidence were boosted by rising incomes, falling unemployment and high asset prices. In China, for instance, household spending was underpinned by robust growth in both urban and rural incomes (of 91/2% and 6%, respectively, in real per capita terms in 2005). A rebound in agricultural income and improved household balance sheets, respectively, played a similar role in India and Korea. In Hong Kong, the recovery was associated with a rebound in asset prices. In Latin America, similar income and wealth effects were supported by large improvements in the terms of trade (see the next section). In Argentina and Chile, private consumption was driven last year by strong increases in real wages, which also played a role in several central and eastern European economies. In the Czech Republic, the demand for consumer durables picked up on the back of strong household income. In Turkey, household spending on consumer durables continued to rise against a background of declining inflation and interest rates.



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Second, a rapid expansion in bank lending provided a further boost to household spending. This has been reflected in a sharply rising ratio of outstanding household credit to GDP in many countries over the past few years (Graph III.2). A major factor boosting such credit has been the low borrowing costs associated with continuing easy monetary policies (see the section on monetary policy). Other contributing factors have been a decline in inflation, a progressive deregulation of credit markets, tax rebates to home buyers and far-reaching financial innovations attracting an increasing number of households to mortgage markets.

In Brazil, lending to households surged last year (by 37%) following the introduction of a payroll guarantee scheme that effectively protects banks against default risk. In Saudi Arabia, a rapidly growing young population, and the fact that banks can now recover their debts by attaching wage payments, contributed to a similar rate of credit expansion.

In contrast to robust household spending, non-residential investment – particularly capital spending by the corporate sector – remained relatively weak (Table III.2) in most regions. This was especially true in Asia, where nonresidential investment as a percentage of GDP either continued to fall or remained far below the levels seen prior to the 1997–98 Asian financial crises. China has been a major exception to this trend. In India, strong profits and rising equity prices have also been associated with a revival of investment more generally.

Fixed investment

As a percentage of GDP

	Residential investment[1]			Non-residential investment			Total investment		
	1996[2]	2000	2005[3]	1996[2]	2000	2005[3]	1996[2]	2000	2005[3]
Asia									
China	2.9	3.3	5.9	29.9	29.5	39.3	32.8	32.9	45.2
Hong Kong SAR	15.1	11.8	7.6	15.7	14.6	13.2	30.8	26.4	20.8
India[4]	4.5	6.1	6.9	20.2	16.8	17.8	24.7	22.9	26.0
Korea	7.0	4.3	5.9	30.5	26.8	23.2	37.5	31.1	29.1
Other Asia[5, 6]	10.3	6.0	5.1	25.5	17.3	17.4	35.7	23.3	22.6
Latin America									
Argentina	5.0	4.7	4.5	13.1	11.5	17.0	18.1	16.2	21.5
Brazil	9.0	8.7	7.0	10.2	10.6	13.0	19.3	19.3	20.0
Chile	9.3	7.1	7.5	17.1	13.7	14.9	26.4	20.7	22.4
Mexico	3.8	4.7	4.8	14.1	16.7	14.5	17.8	21.4	19.3
Central and eastern Europe[5, 7]	7.2	6.3	4.4	16.4	17.4	15.9	23.6	23.7	20.4
South Africa	1.7	1.4	2.0	14.6	13.7	14.9	16.3	15.1	16.8

[1] Including all construction where a breakdown is not available. [2] For South Africa, 1998. [3] Or latest available. [4] Fiscal years beginning in April. [5] Weighted average of the economies listed, based on 2000 GDP and PPP exchange rates. [6] Malaysia, the Philippines, Singapore and Thailand. [7] The Czech Republic, Hungary, Poland and Turkey.

Sources: CEIC; Datastream; Eurostat; national data. Table III.2

The fact that non-residential investment in several parts of Asia has been weak despite strong profits and improved balance sheets has surprised many observers. Nevertheless, various indicators suggest that some of the previous constraints on corporate spending have eased over the past several years. For example, firms have substantially lowered their leverage ratios since the 1997–98 crises. In Korea, the debt/equity ratio was cut by about two thirds to 111% between 1998 and 2005. Moreover, excess capacity has been substantially reduced or eliminated, and the flow of bank credit to the corporate sector has improved. Korea, Indonesia and Malaysia, for instance, saw substantial increases in non-residential investment last year.

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In Latin America, the picture was more mixed, with investment being particularly volatile in Brazil. After recording an annual rate of over 10% in 2004, real investment growth in Brazil fell to 2% in 2005. In Mexico, the recent weakness in non-residential investment has been associated with a loss in the competitiveness of the export sector. For instance, Mexico's share in US imports declined by about 11/2 percentage points between 2001 and 2005. By contrast, non-residential capital spending has rebounded in Argentina over the past two years. In central and eastern Europe, investment ratios have fallen over the past five years, partly reflecting weak non-residential investment.

Rising Inflation Pressures

Strong growth and rising commodity prices put upward pressure on prices in all regions. Nevertheless, despite these pressures inflation remained well contained in most countries last year (Table III. 3). In China, output growth was particularly strong but was associated with very low measured inflation. In India and Korea, headline inflation softened towards the end of last year, after rising significantly in 2004. In several countries in Asia, inflation movements were affected by the timing of the withdrawal of oil subsidies. As for Latin America, inflation was on a downward path in Brazil and Mexico in much of the second half of 2005. In Chile, underlying inflation remained subdued, although headline inflation did rise towards the end of 2005. In contrast, Argentina and Venezuela continued to experience relatively high rates of inflation. In central Europe, inflation declined in most countries last year, reflecting not only exchange rate appreciation but also increased competition at the retail level. Turkey's inflation fell again last year, continuing a longer-term trend.

Outlook and Risks

Forecasts for 2006 are for continued strong growth or even an acceleration in most emerging market economies. Nevertheless, most countries are expected to remain in current account surplus, and inflation is forecast to remain moderate. Such forecasts are evidently not without some risks.

First, the continued dependence of a large number of countries on export driven growth means that they are exposed to volatility in major industrial economies, as well as in China. Countries that have received a substantial degree of external financing might also be subject to changes in investor sentiment. Second, there are some risks from credit-financed household spending. A too rapid expansion in housing demand might lead to overheating in the property market, particularly in Asia. Property prices have been rising in Asia over the past two years, although in several cases (e.g. Hong Kong, Singapore and Thailand) they are recovering from a previous downturn. Korea faced a major challenge in the real estate market last year as property prices rose sharply in some cities in the first half of 2005. In response, the authorities introduced a package of stabilization measures (including higher taxation, restrictions on mortgage lending for speculative purposes, and additional land allocation for construction) to cool the real estate market. South Africa has seen a major upturn in the property market, with residential property prices increasing by 50% in the past two years.

A third source of vulnerability is that banks in many countries, particularly in central Europe, have shifted a large part of their risks to the household sector through lending at variable interest rates or in foreign currency. It is difficult to assess whether households would be able to withstand unexpected shocks that could quickly increase their debt burdens. Furthermore, the experience of Korea in 2003 has demonstrated that the rapid expansion of household debt, even when denominated in local currency, can generate significant volatility in consumption and adversely affect future growth.

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Consumer prices[1]

Annual changes, in per cent

	Headline				Core[2]		
	2004	2005	2006		2004	2005	2006
			April[3]	Full-year forecast[4]			April[3]
Asia[5]	4.4	3.4	3.1	3.8	2.1	2.0	1.2
China	3.9	1.9	1.2	2.2	–0.6	0.2	–1.0
India	6.6	4.8	3.6	4.9	7.0	3.9	2.5
Indonesia	6.1	10.5	15.4	13.5	6.0	7.5	9.4
Korea	3.6	2.8	2.0	2.8	2.4	2.3	2.2
Thailand	2.8	4.5	6.0	4.5	0.4	1.6	2.9
Other Asia[5, 6]	2.3	3.4	3.3	3.3	1.6	2.4	2.4
Latin America[5]	6.1	5.7	5.1	5.2	5.8	5.7	5.2
Argentina	6.1	12.3	11.6	12.3	6.4	14.2	11.6
Brazil	7.6	5.7	4.6	4.4	7.9	5.6	5.0
Mexico	5.2	3.3	3.2	3.4	3.8	3.1	3.2
Other Latin America[5, 7]	4.2	3.7	3.7	3.7	3.8	3.0	3.7
Central Europe[5]	4.0	2.3	1.6	1.6	2.9	1.8	1.2
Czech Republic	2.8	1.9	2.8	2.7	2.4	1.8	2.3
Hungary	6.8	3.6	2.7	2.3	5.8	2.1	0.7
Poland	3.6	2.1	0.7	1.0	2.1	1.8	0.9
Russia	10.9	12.7	9.8	9.9	7.9	6.7	6.0
South Africa	1.4	3.4	2.8	4.1	4.7	4.1	2.3
Turkey	8.6	8.2	8.8	7.6	12.3	11.0	11.6

[1] For India, wholesale prices. Average of period; for Latin America, end of period. [2] Headline excluding food and energy or national definition. [3] Or latest available. [4] Consensus forecast published in May. [5] Weighted average of the economies listed, based on 2000 GDP and PPP exchange rates. [6] Hong Kong SAR, Malaysia, the Philippines, Singapore and Taiwan (China). [7] Chile, Colombia and Peru.

Sources: IMF; OECD; CEIC; © Consensus Economics; national data; BIS estimates. Table III.3

Two Major External Challenges

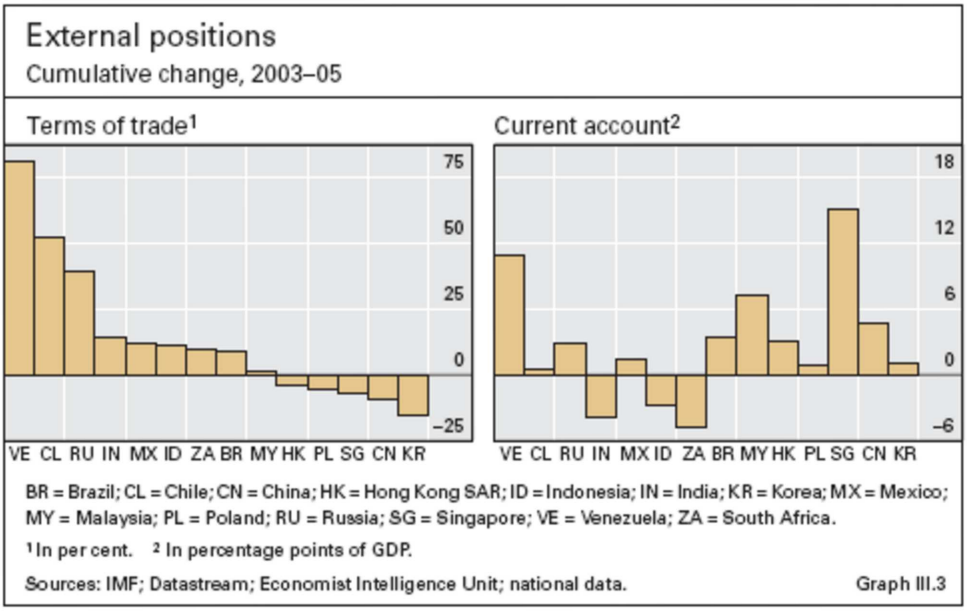
Two important developments over recent years have been large shifts in the terms of trade of emerging market economies and continued strong demand for emerging market assets. Such developments have major implications, not only for growth, but also for the conduct of fiscal and monetary policies.

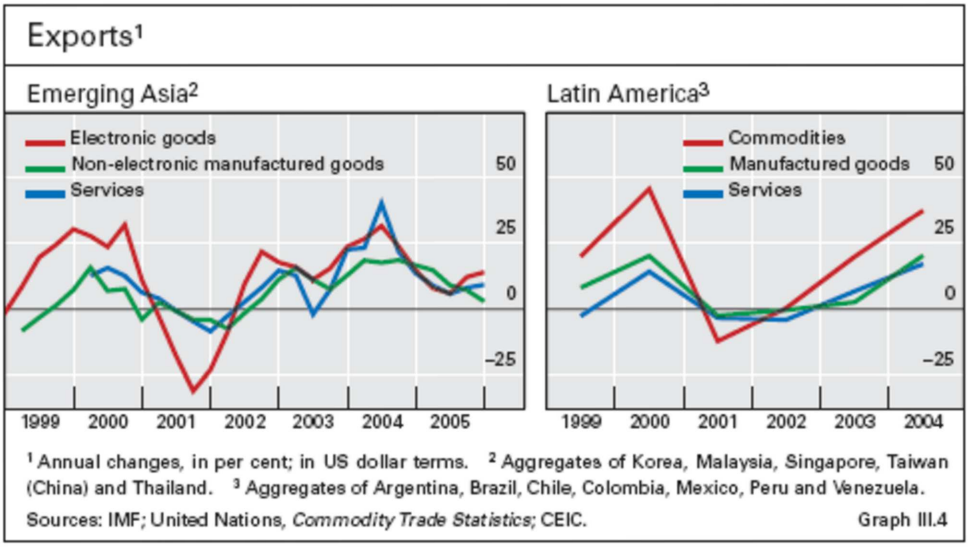
Shifts in the Terms of Trade

Swings in relative prices since 2002 have been associated with large terms of trade movements in emerging market economies. For example, oil prices in dollar terms almost doubled between 2001 and early 2006, after falling sharply in the 1990s. Prices of industrial metals and certain agricultural raw materials also increased rapidly during the same period. At the same time, world manufacturing prices have strengthened only modestly. As a result, commodity-exporting countries have seen some of the largest improvements to their terms of trade in recent years (Graph III.3, left-hand panel). By contrast, countries with a significant concentration of exports in manufactures or services, and large oil import requirements, have suffered substantial terms of- trade losses.

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The impact of terms-of-trade changes has also varied across commodity exporting countries. Strong terms-of-trade improvements have been associated with higher current account surpluses in several Latin American countries (Graph III.3, right-hand panel). Brazil, Chile, Colombia, Peru and Venezuela have all benefited from large increases in the prices of their main commodity exports. Gains from higher export prices have also been substantial in other regions, particularly oil-exporting economies like Russia and Saudi Arabia.





At the same time, many countries with improved terms of trade have also benefited from a large increase in export volumes. This has applied not only to commodity exports, but also to a broad spectrum of manufactures and services. For example, while the export prices of Argentina's primary commodities fell by 9% last year, this was more than offset by a 27% rise in export volumes. Nevertheless, in some other commodity-exporting countries, increased imports and other payments far exceeded export growth, resulting in a net deterioration of the current account. This was the case in South Africa, which saw a record current account deficit of over 4% of GDP last year.

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There is some evidence to suggest that the adverse impact of terms-of-trade losses on commodity-importing countries has been more limited than expected, notably in Asia, where dependence on oil tends to be rather high. Despite a major deceleration last year, export growth remained strong in most of Asia (Graph III.4), helping to offset terms-of-trade losses. In effect, part of the additional revenues of oil-exporting countries was recycled back to the Asian region through the trade sector. Indeed, the exports of Asia (excluding Japan) to oil-exporting countries rose by 27% during the first half of 2005. The net result was that many Asian economies continued to enjoy large current account surpluses.

One question concerns the sustainability of the recent shift in the terms of trade, against the historical background of the high volatility of commodity prices. On the one hand, it is possible that strong global growth will lead to yet further increases in the demand for commodities. The continued buoyancy of the Chinese economy points in this direction. Last year, China accounted for over 57% of the incremental demand for aluminium, 60% of that for copper and over 30% of that for oil. Such a trend could be reinforced in the future by a major expansion of Indian demand for oil and other commodities. On the other hand, past experience suggests that the prices of non-oil commodities have been more volatile and have a stronger tendency to revert to the mean than does the price of oil. This may be partly due to differences in market structure, given that the cartelised structure of the oil market facilitates control of supply. In contrast, in other markets (especially those for agricultural commodities), supply conditions are more responsive to price levels. Higher real prices of commodities could still dampen future demand, especially when technological innovation leads to more efficient use of commodity inputs.

Strong Demand for Emerging Market Assets

The demand for emerging market assets strengthened during the period under review. Net private capital flows reached about $254 billion in 2005, distinctly up from 2004 (Table III.4), and well above the levels prevailing in 1998–2002. Sizeable flows appear to have continued in the first quarter of 2006, although there has been some recent volatility. Net capital flows to central Europe and Latin America increased significantly in 2005, although net private flows to Asia halved. Portfolio investment and other private flows explain most of the changes in private capital flows by region. In Asia, net portfolio investment reversed direction, resulting in outflows in 2005 (at least partly reflecting substantial gross outflows) while other private flows (which include cross-border bank lending) also fell.

Net foreign direct investment (FDI) is still the most important component of net capital flows and reached $212 billion in 2005, a moderate increase from 2004. Its regional distribution in 2005 was also similar to that a year earlier: $72 billion to Asia, $51 billion to Latin America and $41 billion to central and eastern Europe, with the remainder distributed evenly between Africa and the Middle East. In some cases, gross inflows were larger than net inflows, reflecting growing FDI outflows from emerging economies. Several multinational firms based in emerging economies now have large positions abroad. For example, in 2004 the FDI stock abroad exceeded $100 billion for both Singapore (104% of GDP) and Russia (18%), and amounted to $69 billion for Brazil (11.5%) and $32–38 billion for China (2.4%), South Africa (18%) and Korea (4.7%).

Net inflows differ considerably across regions and economies. In central and eastern Europe, where economic integration with the rest of Europe continued to advance, net inflows exceeded 6% of GDP. By contrast, they were much lower in Latin America. Only a small group of countries had relatively large current account deficits and a corresponding need for large capital inflows: Hungary, South Africa and Turkey stood out in this regard. Other countries with current account deficits are India, Mexico and Poland.

Under current conditions, it remains unclear how far increased capital flows to emerging market economies reflect easy conditions in developed financial markets (so-called “push” factors), due to developments in policy or market sentiment. Earlier fears that monetary policy tightening in the United States would lead to shifts out of emerging market assets proved unfounded, at least prior

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to May 2006, when equity prices in many countries fell sharply. Indeed, sovereign bond spreads continued to fall even as US policy rates were steadily increased during 2004 and 2005 (Graph III.5, panel A). Sovereign spreads for several Latin American borrowers have narrowed. Central and eastern Europe has also registered sustained improvements. The sovereign spreads of crisis-hit Asian countries, which rose to an average of 830 basis points in the wake of the crisis, have now fallen, but are still above those of mid-1997 (Graph III.5, panel B). Nevertheless, it remains to be seen what the effects of concerted monetary tightening in the major industrial countries might be.

Still with regard to "push" factors, a number of explanations could be offered for declining sovereign spreads. One is the growing diversification of portfolios to include emerging market securities. Another is that conditions in developed bond markets remain highly liquid. This held down yields on long-term US bonds during 2005, encouraging a search for yield. While this effect has diminished in 2006 with the rise in US long-term rates, it is noteworthy that the spread on US high-yield bonds stabilized towards the end of the period under review while that for emerging market bonds continued to fall (Graph III.5, panel A). Such a development cannot then be attributed solely to global financial conditions but must also reflect investors' assessment that the underlying risks in holding emerging market debt have changed for the better (for additional perspective, see Chapter VI).

Turning to the "pull" factors driving capital inflows, economic fundamentals have improved in four key ways in this decade. The first is that economic reforms and deeper integration with the world economy have lifted growth rates in most countries relative to those in the major developed market economies (Graph III.5, panel C). The effects of EU accession by countries in central and eastern Europe, an increased trade orientation in Latin America and the growing integration of China and India into the global economy have stimulated growth in the countries concerned and have also boosted demand for goods produced by other emerging market economies.

The second improvement is that current account surpluses have enabled several countries to reduce their net external indebtedness. Foreign reserves have increased and external debt has been repaid, with a particular focus on official or restructured debt. In some cases, external debt has been reduced by drawing on foreign reserves. For example, Russia cleared its debt to the IMF and paid $15 billion to the Paris Club of official creditor countries last year. In December 2005, Brazil paid off $15.5 billion owed to the IMF and Paris Club debt of $2.6 billion; in April 2006, it paid off its Brady bond debt (albeit partly funded by new external debt). Argentina has also repaid its outstanding debt to the international financial institutions (Graph III.5, panel D). In April 2006, Nigeria became the first African country to eliminate its Paris Club debt, totalling $30 billion; $12.4 billion was repaid and the remaining debt was forgiven. An important domestic counterpart of growing current account surpluses and external debt repayment has been significant increases in national saving rates. One notable example is that the saving rate in Latin America as a whole rose to 22% of GDP in 2005, compared with around 17% of GDP in the early 2000s.

A third improvement is that currency mismatches have been reduced (Graph III.5, panel E). The currency of denomination of international bank lending has progressively shifted towards the use of local currencies. Governments and other borrowers in capital markets have reduced their reliance on foreign currency debt as they have issued more domestic paper. According to BIS statistics, the total amount outstanding of domestic bonds and notes issued by borrowers in Latin America rose from $228 billion in 2000 to $379 billion in 2005; external debt securities fell by $17 billion over the same period. The proportion of exchange rate-indexed debt in domestic debt markets has declined in a number of important cases. For example, in Brazil the share of such indexed debt in total public debt fell from 37% in 2002 to 2.3% by the first quarter of 2006. Domestic debt markets have also deepened, with international trading of domestic debt instruments rising sharply. Significantly, there also appears to have been a gradual extension of the maturity structure of domestic government debt in some countries. The greater depth of local currency debt markets offers global investors new means of considerably improving returns. Because domestic bond yields in emerging markets appear to respond more to domestic factors, and have comparatively

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low correlations with yields in developed markets or in other emerging markets, such paper also offers diversification opportunities.

A fourth change is that the financial positions both of the non-financial corporate sector and of banks have strengthened in recent years. Corporate leverage ratios have fallen, and there has been a significant and broad-based improvement in banking systems. Banks' returns on assets have grown, and a number of indicators suggest that the quality of banks' balance sheets has risen. Another simple indicator is that the ratio of bank stock price indices to overall stock indices – which fell sharply during the crises of the late 1990s – has recovered (Graph III.5, panel F).

In short, current account surpluses and reduced net external indebtedness, combined with substantial improvements in growth, national balance sheet positions and banking systems, have supported a strong revival of foreign demand for emerging market assets. At the same time, it must be recognized that new conditions pose certain risks. While domestic bond market development can impose discipline on fiscal authorities by signalling market concerns about inappropriate policies, it could in some cases increase the temptation to resort to inflationary financing. Moreover, the changing exposures of domestic investors could influence financial stability. On the one hand, the increase in local institutional investors is beneficial for market development and the diversification of risks. On the other hand, there is evidence that holdings of domestic government bonds in some countries are concentrated in the portfolios of banks, exposing them to significant interest rate risk.

Issues Raised By Commodity Price Increases

Since 2003, sharp increases in commodity prices have posed two major fiscal challenges. First, a number of oil-importing countries, particularly in Asia, have had to decide what to do about subsidies designed to reduce the cost of energy. Rising oil prices have increased the cost of such subsidies and have exacerbated the distortions that arise from shielding consumers (and sometimes firms) from price changes. In some cases, subsidy costs have largely been shifted to public oil companies which are not allowed to raise retail prices. Such artificially low prices have led to shortages, tempted local oil companies to sell abroad and encouraged smuggling. Countries have responded by lifting these subsidies. For example, Thailand ended fuel subsidies in 2005, while India and Indonesia reduced them significantly, causing a jump in fuel prices. As discussed below, the rising costs of fiscal subsidies and efforts to reduce them have complicated the conduct of monetary policy by sharply increasing headline inflation.

Second, producers should respond with prudence to the fiscal impact of commodity price windfalls that cannot be sustained. Because high prices are likely to be temporary, efforts have to be made to limit expenditure increases in response since these are more likely to be of a permanent nature. This would also mitigate undesirable procyclicality in government spending. Moreover, in the case of oil and other non-renewable commodities, the non-commodity primary deficit should be set so that part of the earnings from commodities can be invested in financial assets. The return on these assets can then fund spending once the commodity has been exhausted. Stabilization funds taking in the revenue from commodity price windfalls operate in a number of countries, including Chile and Russia. In 2005, Mexico also enacted legislation that would use oil price windfalls to fund investment spending by state-owned enterprises, particularly the oil company, Pemex, and to enlarge substantially an oil stabilization fund. However, efforts to establish or operate such funds have posed challenges in a number of countries. For example, in Venezuela a macroeconomic stabilization fund was significantly depleted after a major oil production strike in 2002. While oil revenue windfalls have partly been used to accumulate reserves and pay down debt, the fund has not been recently replenished. Instead, significant amounts of resources are being allocated to finance current spending.

The fiscal issues raised by such windfalls are illustrated by the recent experience of Russia, which has dramatically improved its net financial asset position. Russia's gross public debt has fallen sharply, from 96% of GDP in 1999 to a projected 14% in 2005. In part, this reflected prepayment of debt, notably to the IMF and the Paris Club last year. In addition, an oil stabilization fund, estab-

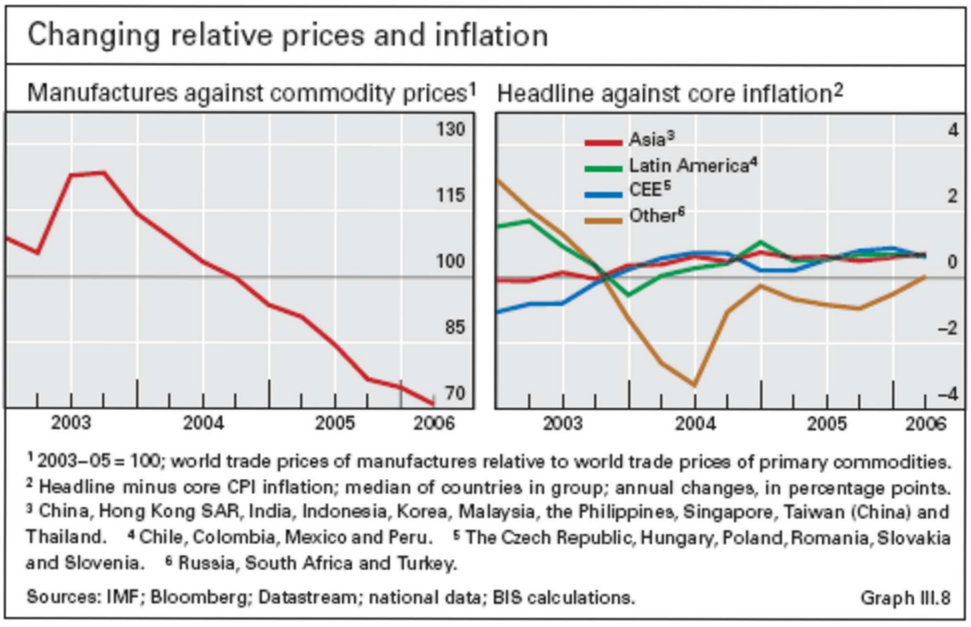
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lished in 2004, had accumulated $43 billion by the end of 2005. Primary surpluses have also risen, from 2.7% of GDP in 2002 to close to 8.7% in 2005. While large primary surpluses have alleviated pressures on aggregate demand arising from the windfall, fiscal policy has recently eased considerably. Proposals for spending a higher proportion of the oil windfall, including through public sector wage and pension increases, and more infrastructure spending, raise concerns about exacerbating inflationary pressures. High oil prices could also weaken the drive for microeconomic reforms, including improvements to tax administration.

Implications Of Relative Price Shocks

The first issue complicating the conduct of monetary policy is the assessment of relative price shocks. Commodity prices have risen at the same time that international prices of manufactures have strengthened only modestly (Graph III.8, left-hand panel). If the commodity shock was expected to reverse, it would not generally be seen as a major threat to underlying inflation. But longer lasting relative price changes are more of a problem, as is well illustrated by recent experience. The rise in commodity prices has created a gap between core and headline inflation that has persisted over an extended period (Graph III.8, right-hand panel). This raises the question of whether monetary authorities should assign greater weight to movements in core or headline inflation in assessing inflation risks and formulating policy.

Two contrasting points need to be considered. First, higher commodity prices are proving to be remarkably durable (apparently reflecting a continued strengthening in demand), have already raised headline inflation and could at some point affect inflation expectations. Second, in spite of this, there are still no clear signs of higher inflation expectations and associated wage pressures in a significant number of emerging market economies. There appear to be structural changes in pricing behavior in emerging market economies similar to those observed in developed economies (see Chapter II). In effect, the prices of goods and services (including wages) seem to have become less prone to disturbances from specific price shocks, or even swings in capacity utilisation.



These considerations have conflicting implications for policy. On the one hand, persistent commodity price increases would seem to argue for leaning against expectations by focusing on headline inflation. On the other hand, if behavior has changed significantly, this argues for a more restrained policy response based on the presumption that headline inflation will in fact fall back

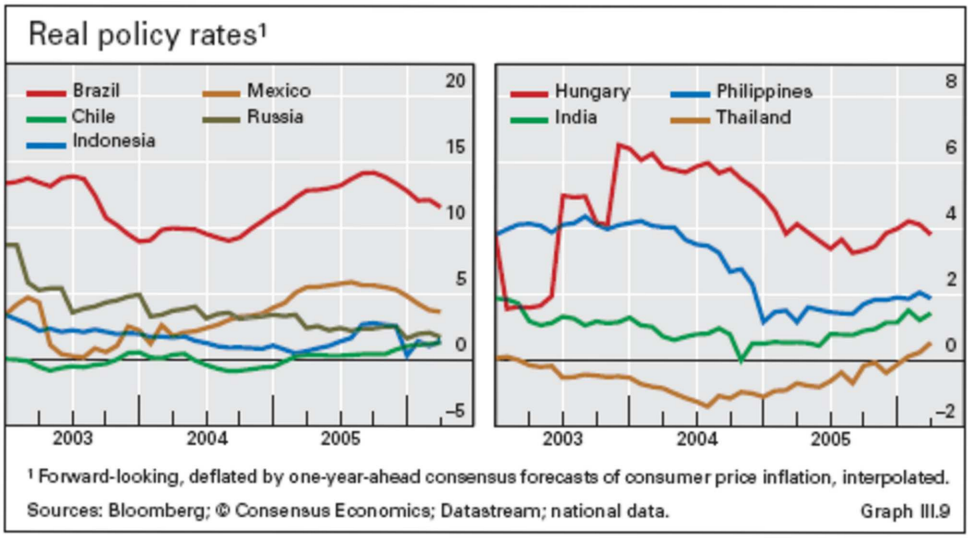
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to core levels.

Assessing whether core inflation will rise to headline or headline will fall to core is complicated. A judgment must be made about the permanent nature of the commodity price shock, as well as of the changes in the pricing process that seem to have anchored core prices to date. Concerning this second issue, China is key, as its inflation is very low even though growth is high enough to put pressure on global commodity prices. One explanation could be substantial productivity growth in the manufacturing sector. This could well be a longer lasting phenomenon that will have persistent effects on wages and prices both in China and elsewhere.

However, China has in the past experienced bouts of inflation after long periods of rapid growth. Moreover, it may be that inflation in China is actually rising already but this is masked because the measured price index takes insufficient account of inflation in services. Finally, inflation pressures already appear to be significant in a number of emerging market economies.

Against this background of uncertainty, relative price shocks over the past few years have elicited different policy responses, with a broad tendency towards tightening. Some commodity producers have focused on headline rather than core inflation. Policy interest rates in Brazil, Chile and Mexico were increased comparatively early in the process, preventing erosion in (ex ante) real interest rates as inflation forecasts edged up (Graph III.9). In contrast, the real interest rate in Russia has drifted downwards.



Policy Responses And Regimes

The resolution of the policy dilemma cited above has varied considerably across countries and to some extent has depended on how each country's monetary policy regime has influenced responses to nominal exchange rate movements. Some countries, typically those with inflation targeting regimes, have opted for greater exchange rate flexibility. For example, among commodity exporters where appreciation pressures would be anticipated due to terms-of-trade gains, Brazil and Chile experienced significant nominal exchange rate appreciation between the beginning of 2005 and early 2006. This has been reflected in significant real effective exchange rate appreciation (Graph III.10). In contrast, other countries have opted for greater stability in nominal exchange rates, including Argentina and Russia, which maintain what might be described as hybrid monetary regimes, and Saudi Arabia and Venezuela, which have pegged exchange rates. However, except for Saudi Arabia, real exchange rates have still appreciated in these countries because of

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higher inflation. In Russia, the authorities have acknowledged the need to allow further nominal exchange rate appreciation in order to counter growing liquidity and to dampen excess demand.

The authorities in China, and in much of the rest of Asia, have intervened on a massive scale for several years to moderate appreciation. Continued heavy intervention took China's reserves to $875 billion by the end of April 2006. Oil exporters have added substantially to the stock of foreign financial assets held as official reserves (Table III.5). Elsewhere, the rate of accumulation of international reserves appears to have slowed from the heady pace recorded in 2003 and 2004. The extent of sterilization has varied, but one way of gauging its potential impact on local financial markets is to measure reserves against outstanding public debt securities. Where this ratio is large, as in Asia, the possible distorting effects on domestic financial intermediation deserve close examination.

Foreign exchange reserves

	Outstanding position[1]				In relation to public debt securities[2]		
	2000	2004	2005	Apr 2006[3]	2000	2004	2005
Total emerging markets	973	2,094	2,487	2,679	39	59	64
Oil exporters[4]	110	282	386	443	26	61	78
China	166	610	819	875	–7	104	152
Other Asia[5]	529	962	1,003	1,060	103	100	93
Latin America[6]	88	111	121	124	12	13	10
Other emerging markets[7]	80	129	159	177	28	15	19

[1] At end of period; in billions of US dollars. [2] In per cent. Calculated as the ratio of foreign exchange reserves net of currency in circulation to outstanding government international and domestic debt securities. For Algeria, Egypt, Nigeria, Oman, Qatar and Venezuela, includes only international securities; for India, only domestic securities. [3] Or latest available. [4] Algeria, Egypt, Mexico, Nigeria, Oman, Qatar, Russia and Venezuela. [5] India, Indonesia, Korea, Malaysia, the Philippines, Singapore, Taiwan (China) and Thailand. [6] Argentina, Brazil, Chile, Colombia and Peru. [7] The Czech Republic, Hungary, Poland, South Africa and Turkey.

Sources: IMF; BIS. Table III.5

A number of countries have begun to use other instruments to help resolve the policy dilemma cited above. In the Baltic and southeastern European states, the authorities have resorted to direct instruments, such as increased reserve requirements and tighter prudential limits. In order to meet the Maastricht criteria and adhere to ERM II protocols, these countries are attempting to control inflation and maintain exchange rate stability. However, the use of direct instruments in these countries raises questions about possible inefficiencies and costs to the financial system.

While the foregoing has focused on responses to appreciation pressures, some countries experienced episodes of significant pressures for depreciation in 2005 or the first quarter of 2006. For example, the Indonesian rupiah depreciated by 11% against the US dollar in August 2005 due to uncertainty about the fiscal burden of energy subsidies in the light of higher oil prices; the rupiah subsequently recovered. The Hungarian forint depreciated between February and early April 2006, also due to concerns about the fiscal and current account positions.

Consequences Of Policy Responses

One question of interest is whether differences in monetary policy regimes, and in the attention paid to the exchange rate, can be shown to matter in terms of inflationary outcomes. As summarized in Table III.6, the answer is mixed. Inflation targeting regimes, in which the exchange rate has been allowed to float relatively freely, have typically delivered a moderate rate of inflation. Within

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this group, Korea shows few signs of consumer price inflation, while previously high inflation rates in Brazil and Turkey have successfully been lowered towards target.

Policy indicators under different policy regimes

Median of country data for 2004–05, except where indicated

	Countries with:		
	Inflation targets[1]	Hybrid regimes[2]	Exchange rate targets[3]
Headline consumer price index[4]	3.9	7.0	2.9
Inflation relative to target/partner[5]	0.2	.	1.0
Real interest rate[6]	2.4	0.7	1.1
Nominal effective exchange rate[4]	3.8	0.2	–2.3
Foreign exchange reserves[4]	12.5	16.4	18.5
Private sector credit[4]	15.2	24.8	29.4

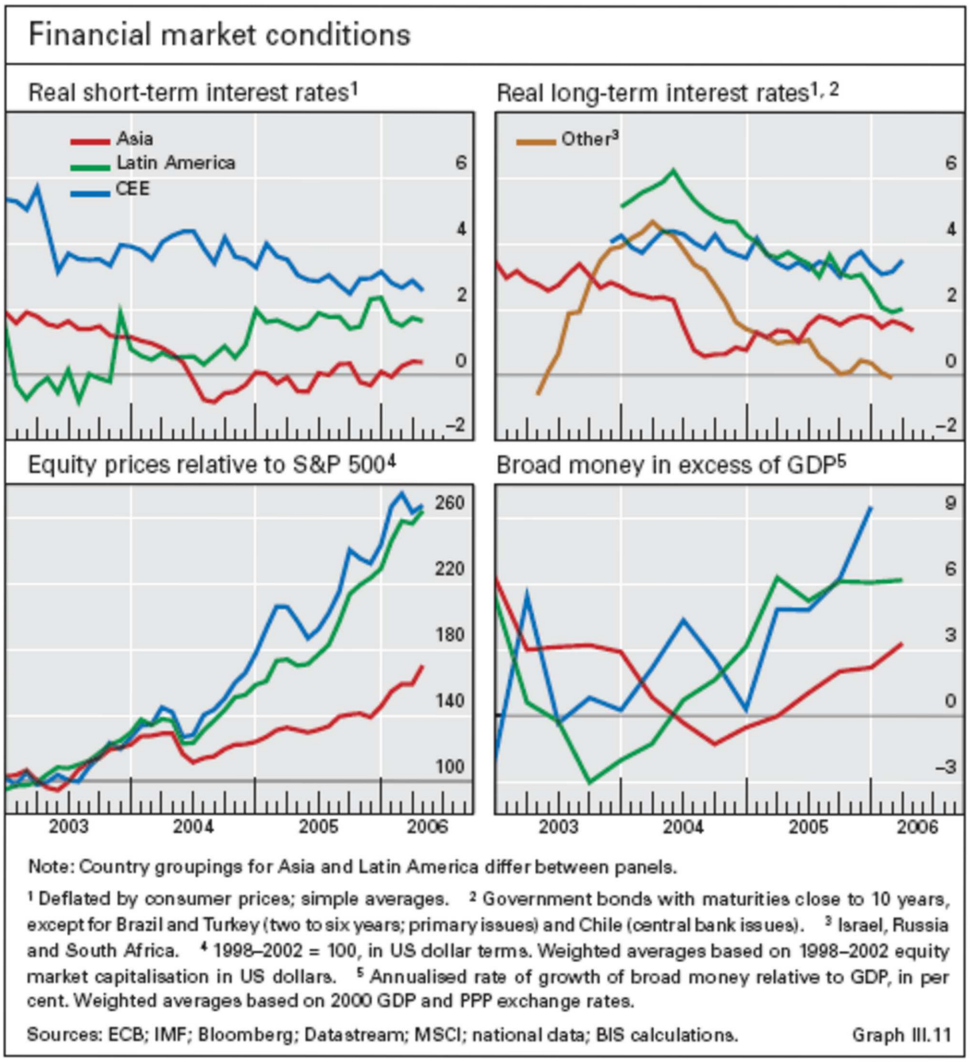
[1] Brazil, Chile, Colombia, the Czech Republic, Hungary, Korea, Mexico, Peru, the Philippines, Poland, South Africa, Thailand and Turkey. [2] Argentina, India, Indonesia, Romania, Russia, Singapore and Taiwan (China). [3] China, Estonia, Hong Kong SAR, Latvia, Lithuania, Malaysia, Saudi Arabia, Slovakia, Slovenia and Venezuela. [4] Annual changes, in per cent. [5] Divergence from the centre of inflation target ranges or from main partner's implicit target (1.8 for the euro area, 2.0 for the United States), in percentage points. [6] Central bank rate or short-term money market rate, deflated by one-year-ahead CPI inflation consensus forecasts, interpolated.

Sources: IMF; Bloomberg; © Consensus Economics; Datastream; national data; BIS calculations.

Table III.6

Inflation has fallen to within the target range for the first time since it was introduced in Mexico, and is in the target range in Chile. Both countries allowed the exchange rate to adjust and increased policy rates early. Similar outcomes have been observed in Colombia and Peru, which are also inflation targeting commodity producers.

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However, median inflation for countries with fixed exchange rate regimes was even lower than for inflation targeting regimes. Both China and Saudi Arabia present interesting puzzles because consumer price inflation in both economies has remained very low in spite of rapid growth and signs of ample liquidity. Nevertheless, pegging does not always guarantee low inflation; a case in point is Venezuela, which maintains a fixed exchange rate and has experienced double digit inflation.

Inflation was highest in countries with hybrid regimes which have not fully adopted inflation targeting or have no explicit nominal anchor. Some of these countries appear to attach a high weight to exchange rate stability, judging by the small change in the median nominal exchange rate. Compared to inflation targeters, countries with hybrid regimes have also experienced greater liquidity.

Among the countries in the hybrid group, inflation was in double digits in Argentina and Russia, where the nominal exchange rate was relatively stable. Their experience suggests that there are indeed risks associated with resisting appreciation in response to external shocks. In these countries, producer price inflation measures also show significant inflation rates in the pipeline. Administrative price agreements or controls mask a potentially more serious inflation problem.

In spite of the steps towards tightening taken lately in some countries, recent external shocks and policy responses have been associated with generally easy financial conditions in emerging market economies. This can be seen in continued low real interest rates notwithstanding robust eco-

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nomic activity and significant increases in broad money (Graph III.11). But equity prices, which had risen sharply, fell steeply in May 2006 in several countries.

The main conclusion is that inflation risks in the emerging markets, while hard to read at present, have increased. Recent experience has also underlined how monetary policy can have implications for the financial system. Prolonged large-scale intervention or monetary easing to hold the exchange rate down can affect the structure of balance sheets in the private sector (especially banks), lower real interest rates, raise credit growth and encourage debt accumulation. The effects of the resulting imbalances, whether on inflation or growth, will take time to unfold fully but will become more significant the longer monetary stimulus is allowed to continue.

SUMMARY

The expansion which has been under way in emerging market economies since 2002 consolidated further in the period under review. External conditions including strong global demand, large terms of trade improvements and much easier external financing have been favorable to emerging market economies in the current cycle. In all regions, growth was supported by strong household spending. Household spending and consumer confidence were boosted by rising incomes, falling unemployment and high asset prices. Inflation has remained well contained in many countries, but prospects are uncertain in the light of volatile commodity prices and very low or negative real short-term interest rates.

We believe an investor in BC would assess some additional risk to an investment in the Company based on current economic conditions and the economic outlook for emerging economies. We will reflect this risk in our determination of an appropriate rate of return later in this report.

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INDUSTRY CONDITIONS

In addition to giving consideration to the economy, we also consider the state of the industry in which the Company operates. The industrial climate can have significant effects on the value of a company. The factors influencing the industry can include technological change, fluctuations in supply and demand, price increases or decreases, and the competitive landscape. We analyzed information regarding the industry in which the Company operates. Excerpts from the materials we analyzed are included below:

The following excerpts are from *IBIS World Industry Reports*, for "Computer Systems Design and Related Services in the US", dated May 4, 2006:

INDUSTRY DEFINITION

This industry comprises establishments primarily engaged in providing expertise in the field of information technologies through one or more of the following activities: (1) writing, modifying, testing, and supporting software to meet the needs of a particular customer; (2) planning and designing computer systems that integrate computer hardware, software, and communication technologies, even though such establishments may provide custom software as an integral part of their services; (3) on-site management and operation of clients computer systems and/or data processing facilities; and (4) other professional and technical computer-related advice and services. Also included with 54151, Computer Systems Design and Related Services, is 541511 Custom Computer Programming Services. This industry comprises establishments primarily engaged in writing, modifying, testing, and supporting software to meet the needs of a particular customer.

Key Statistics

Key Statistics
Computer Systems Design and Related Services in the US

	2006
Revenue	$175,426
Number of Enterprises	344,082
Forecasted Revenue Growth to 2010	$ 201,129
Recent Employment Growth	-1.00%
Average Revenue Per Employee	$ 130,000
Imports Share of Domestic Demand	0.78%
Exports Share of Revenue	3.30%

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- For 2005, the estimated industry revenue was $175,426 million, and it was estimated that there were 360,881 establishments/locations that had a total of 1,347,686 employees. The estimated wages paid totaled $74,490 million and industry value added was $90,739 million. Exports in that year were estimated at $5,789 million and imports at $1340 million and, therefore, the total domestic demand was estimated at $170,977 million.

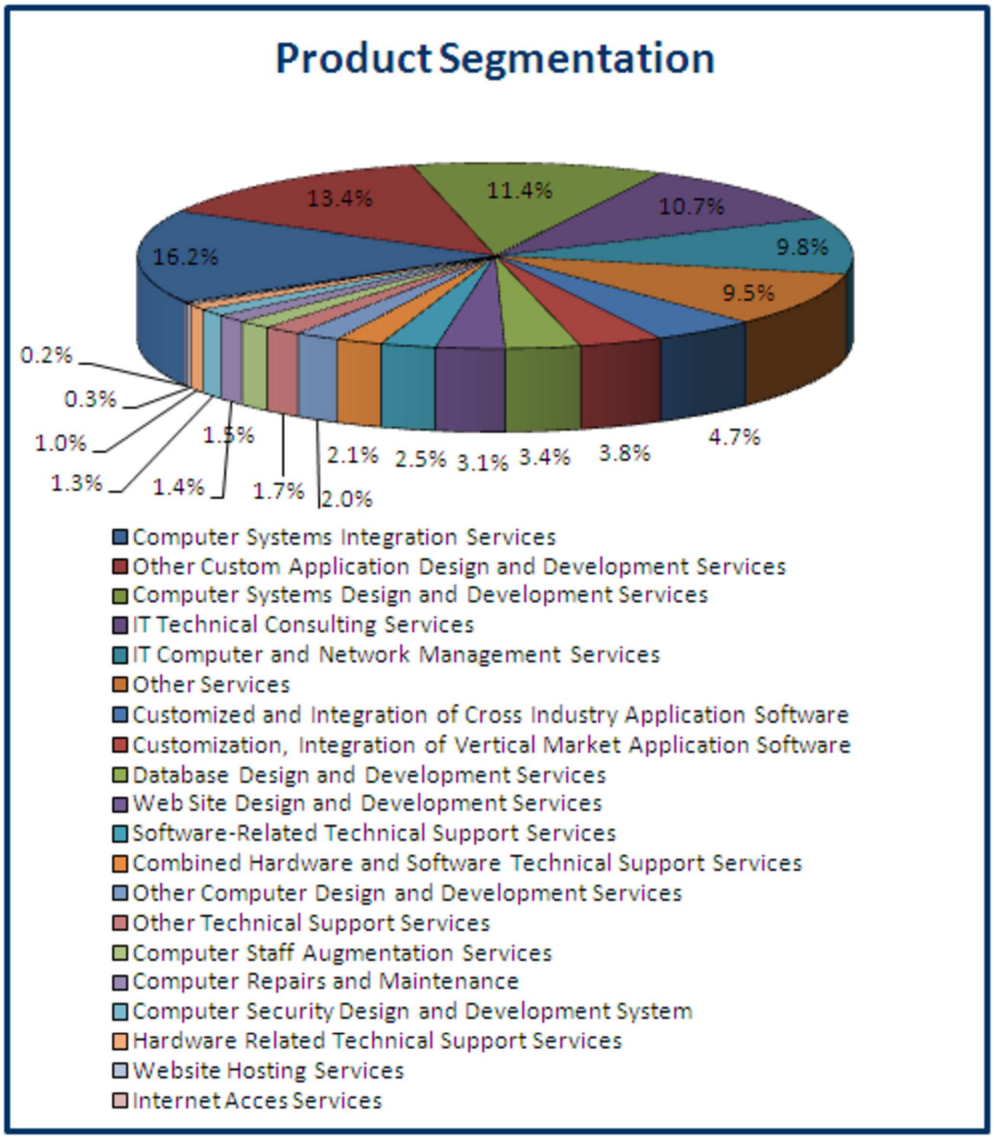
- Software begins as an intangible idea which may be expressed in a flowchart which sets out the basic logic of the program. The diagrammatic representation is then converted to source code which is written in one of the many high-level programming languages. However, since a computer cannot understand source code, it is converted into machine or object code using software programs known as compilers, interpreters or assemblers.

- Software development involves a large up-front investment in research and development and is currently very labor intensive. The investment involved varies according to the complexity of the program and is proportional to the labor input required.

- Software products have, over time, become increasingly complex and has not, in general, involved any significant degree of automation in development. This, however, may change with the increased use of the Java language, possibly being able to be used by people to compile their own software by linking ready made, off the shelf packages or modules, as required.

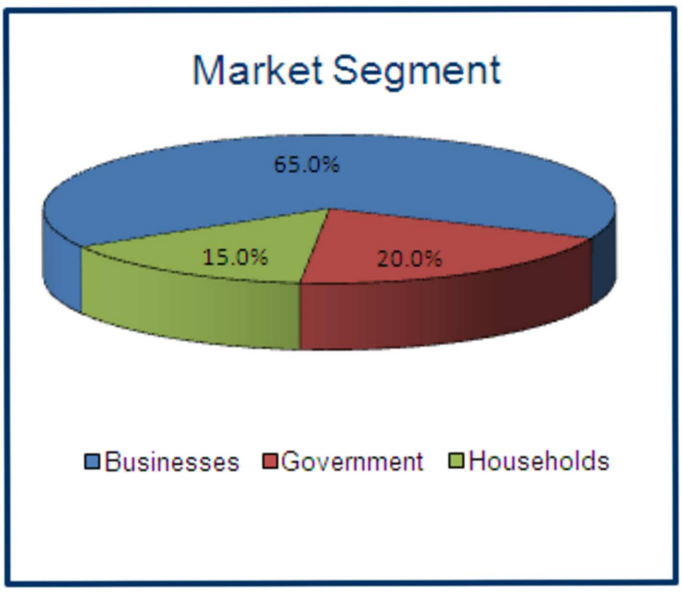
- A current industry issue relates to the actual and potential level of export of jobs from this industry to mainly India and China by major operators, as clients seek out further reductions in their IT costs from their existing and new outsourced contracts.

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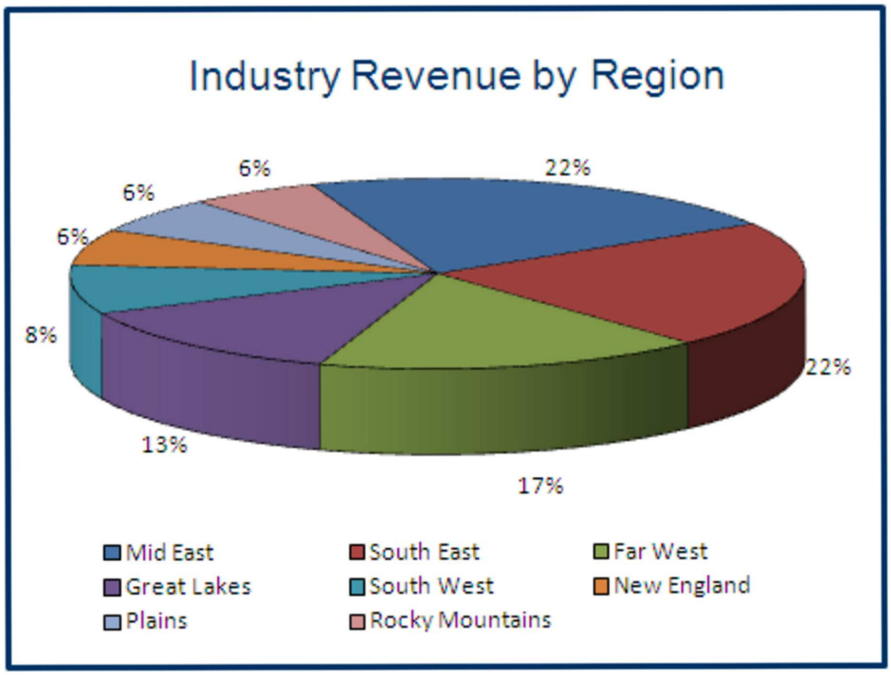


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Major Market Segments



Geographic Spread



Historical Performance

Indications of the past performance of this industry are available from the Bureau of Census information for 1992 and 1997. It was evident that the industry at least doubled in size over these five years, depending on which measure is used. Between 1992 and 1997, the proportion of companies in the computer software industry of total US companies increased from 0.9 per cent to 1.7 per cent. Total employment increased by 75 per cent from 832,800 in 1992 to 1,475,405 in 1997.

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Finally, industry sales revenue increased from $95 billion to $231 billion (or 143 per cent in nominal terms) over this period.

It was also estimated that between 1990 and 1997, employment in the computer programming services area increased from 151,000 to 322,000 (by 113 per cent), prepackaged software employment grew from 113,000 to 230,000 (or 104 per cent), computer integrated systems design grew from 98,000 to 163,000 (or 66 per cent), computer processing and data preparation grew from 197,000 to 249,000 (or 26 per cent) and information storage and retrieval from 48,000 to 81,000 (or 69 per cent).

The average wages and earnings paid per person also increased significantly between 1990 and 1997 by between 43 per cent and 70 per cent, in nominal terms, depending on the nature of work performed.

Overall, the demand for computing services was estimated to have grown very strongly from the mid to late 1980s, due to strong economic growth and the increased use of computer consultancy services by the insurance and banking and finance sectors, as well as by governments. The main growth area in the computer services area was the software and systems integration areas, followed by packaged software sales.

It was also estimated that during the economic recession of the early 1990s, the industry suffered a major decrease in demand for its services. This resulted from a combination of slower growth during the recession and in the immediate period following it, the restructuring of industry, particularly among its major client industries of banking, finance and insurance and the cancellation and review of existing contracts and any proposed new projects.

This industry then grew strongly again from the end of 1992, mainly due to the trend to outsource IT and the computer services functions from governments and companies across nearly all industries.

Since 1994 significant industry growth has occurred. This resulted from the outsourcing of IT (including data processing), the Y2K bug, which led to significant software and hardware changes by businesses, governments and households and from the increased ownership of computers at homes and schools. There also was increased use and demand for the internet and services, related to this increased use of e-commerce (including business to business and business to consumer links), demand for web pages during the late-1990s and early 2000s and the demand for more on-line services and information by the finance/banking and other industries. The internet also dramatically lowered the cost of data storage and computer networking. By August 2000, 51 per cent of US households had a computer and 41.5 per cent had access to the internet.

In 2000 it was estimated that the IT industry's share of the economy (in terms of revenue) had increased to 8.3 per cent. Also since 1995, it contributed about 30 per cent of the overall growth in the economy, which included from increased research and development expenditure. Part of the industry's growth could be attributed to the declining cost of computers, which between 1995 and 1999 decreased by around 26 per cent per year, and led to increased business, government and household investment in IT equipment, software and services.

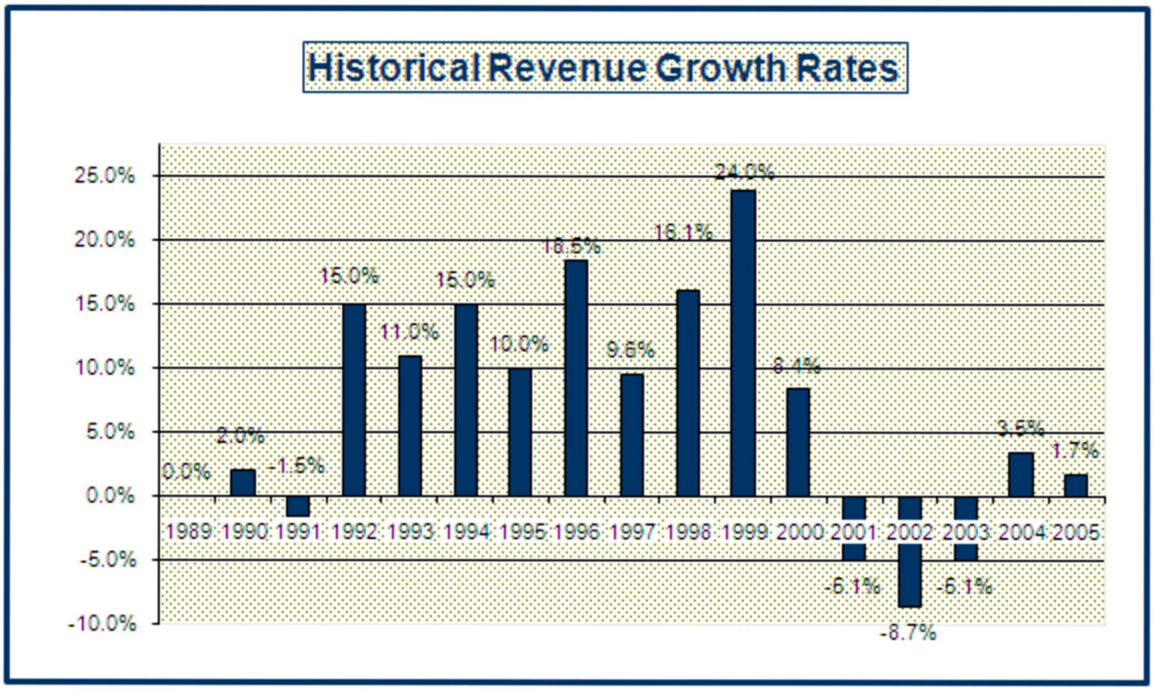
Between 1997 and mid-2000, it was estimated that the number of employees in the computer programming services component increased from 321,800 to 453,600 (or 41 per cent), in prepackaged software component from 224,500 to 326,100 (or 45 per cent) and in computer integrated systems design from 161,300 to 213,800 (or 33 per cent).

From the 1990s to the early 2000s, pre-packaged software employment and revenue grew strongly (at around 12 per cent per annum) and was directly linked to the shipment of new PCs. Domestically, it was estimated that around 80 per cent of pre-packaged software was designed for business use and the remainder for households and educational use. Some software companies

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began re-evaluation of their future direction, with the expected strong growth in software rental and the use of the internet and open-standards programs. The other areas which were expected to have an impact on this industry was computer networking, this included the use of wireless technology to transmit and access data via palm tops and cell phones, and the increased use of broadband technology in all forms.

A US Census Bureau survey of the computer services industry indicated that between 1999 and 2000 revenues increased by around 13 per cent, custom computer programming services revenue by around 12 per cent, computer systems design services by 14 per cent, computer facilities management services by 8 per cent and other computer related services by 27 per cent.



OUTLOOK

Sensitivities

This industry is sensitive to the growth of IT solutions in general and especially to the trends in outsourcing of IT by the government and private sector. The industry is now increasingly more sensitive to clients seeking actual cost reductions and productivity improvements from any IT solution. Clients have also become more budget and cost conscious, when it comes to approving new IT projects.

Over the outlook period, the prospects for this industry has changed from what was achieved in the past, due to the significant decrease in the value of high technology stocks and the increased questioning within some elements of the business and government sectors as to the actual benefits of undertaking some planned IT projects or to outsource their computer services.

In 2006, the forecast for continuing slow domestic and international economic growth is estimated to lead to further slow industry revenue growth. Clients are expected to continue to evaluate the options associated with transferring some application tasks to highly skilled and lower labor cost countries. While strong growth in contracts is expected to occur from the Department of Homeland

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Security, this will be offset by the lagged effects on business confidence and economic activity from the increases in interest rates during 2005 and early 2006, and affect investment decisions, in areas such as IT.

From 2007 to 2010 the industry's real value added growth is expected to remain relatively slow, compared to the 1990s, and due to the forecast continuing slow domestic economic growth. Over the period to 2010 the industry is estimated to achieve a real annual average growth in value added of around 3.4 per cent, compared with forecast real growth in GDP of 3 per cent per annum over the same period.

One of the most critical factors is the development of strategic alliances and partnerships between companies in the software, hardware and computer consultancy services areas to be able to offer clients a comprehensive and a one-stop solution. This area is expected to be of increasing importance in the future.

Within this, some of the current growth areas include network management, security including developing firewall security systems for clients, spam controls, networks, internet site development, e-commerce and in the new area of installation of "thin servers" for clients to replace existing servers and possibly ISPs.

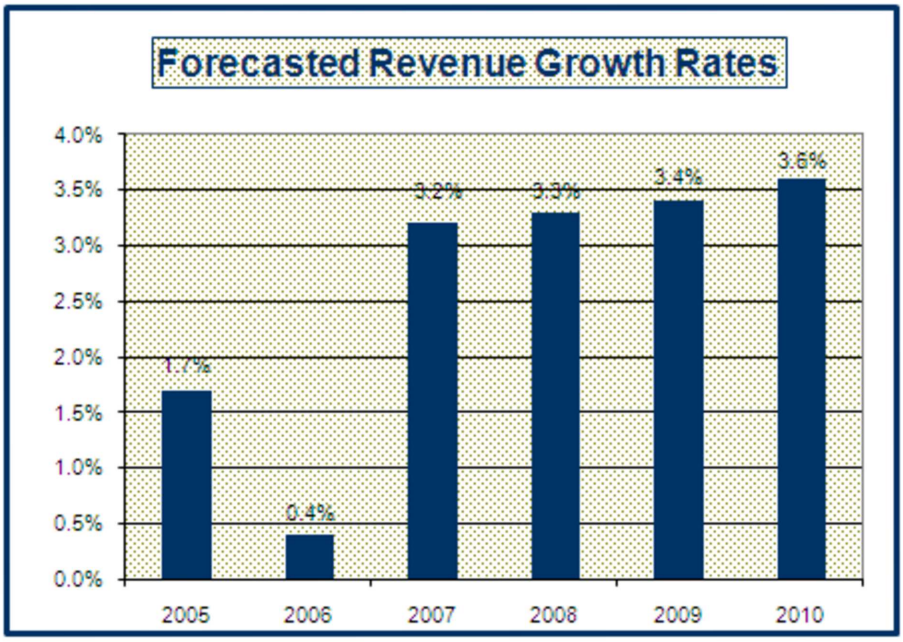
Areas of change which may affect this industry over time may also include:
-Networking and continuing moves towards more internet based servers and related software;
-Increasing security including from viruses, spyware, pop-ups, spam mail etc.;
-Renting of software over the internet (Applications Service Providers) saving software licenses and some hardware and installation costs;
-Selling of software services on the internet on a subscriptions, use or transaction basis;
-Continuing growth in entertainment software - video games and for music, movies etc.;
-Increasing business to business e-commerce;
-Data services via wireless (mobile) technology;
-Increasing broadband networks using cable modems, Digital Subscriber Lines (using existing copper wires, satellites, fiber optics);
-VoIP systems;
-increasing middleware linkages; and
-In home networking of appliances and computers.

With the cost structure of the industry being high, partly due to the need for a significant and recurring research and development budget, the forecast initial slowing in demand for IT services will have to be watched carefully by all operators.

Mergers between and acquisitions of companies within the industry is expected to continue in the short term.

It is expected that exports will become increasingly more important over the outlook period as US companies seek further growth opportunities elsewhere. Globalization of this industry will also increase at a significant pace over the next 3 to 5 years. Increasingly major operators may relocate some of their operations to places like India, where there is a large number of highly skilled, but lower cost IT professionals, as well as call center/customer service centers.

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The following excerpts are from "Banking on Mobiles: Why, How, for Whom?" published by Consultative Group to Assist the Poor (CGAP) and written by Ignacio Mas and Kabir Kumar, dated June 2008.

> If you are a small bank thinking about doing mobile banking,[1] then you are where Abbas Ali Sikander, the group executive director of Tameer Microfinance Bank in Pakistan, was a year ago. He wondered then: "How does Tameer get to market rapidly without the burden of physical infrastructure investments, especially in rural areas?"[2]
>
> Branchless banking looked attractive, and mobile phones could help. With subscription numbers at over 50 million, mobile phones were already reaching rural Pakistanis who have no formal banking access. But which rural mobile phone users should he target? And how can he use mobile phones as a channel and as a service? Abbas knew that, without a clear strategic direction, he easily could get swept away by mobile phone operators who were already well known retail brands. An even larger issue confronting him was developing an agent network, especially in rural areas, for customers to get access to cash in their accounts.
>
> With a few exceptions, the road to implementing mobile banking is littered with discontinued mobile banking projects, failed new technology vendors, and shelved deployment plans. For customers, mobile banking presents a delicate balance between a conceptually powerful opportunity (being able to transact any time, anywhere) and practical challenges (finicky menu sequences on a small screen and tiny buttons). Many banks launched into mobile banking without a well-articulated idea of what customers' problems were and how to address those problems.
>
> Ivatury and Mas (2008) predicted that poor people are more likely than rich people to use mobile phones to undertake financial transactions. People in developing countries have less options (if any) for transferring money and accessing banking services, because there is less deployed formal banking infrastructure— fewer branches, automated teller machines (ATMs) generally co-located to relieve branches, and low Internet penetration. So a branchless banking channel using

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mobile phones could be far more preferable to poor people than the available options: traveling to and queuing at distant branches or saving in cash or physical assets.

This paper examines how banks can translate the potential of mobile phones into greater financial access for poor people. Although mobile phone operators have been able to use the mobile phone for mobile remittance and bill payment services in several countries, banks have had little success in using mobile phones as part of a growth or outreach strategy.

This paper focuses on smaller banks or microfinance institutions (MFIs) that face a much higher cost-of-service delivery because of the smaller transaction values they handle and the likely more remote and dispersed location of at least some of their customers. The opportunity seems particularly great for them, but implementation challenges also loom larger because of their small scale. This discussion assumes these banks and MFIs have adequate back office and transaction switching capability and sufficient internal controls, whether managed in-house or outsourced. Without that, mobile banking is not possible because it is fundamentally a front end to a financial institution's information technology system.

We do not offer a single, generally applicable solution because there are many mobile banking solutions. The journey to success starts with identifying the fit of mobile banking within the bank's overall customer strategy. Beyond that, we offer some "lessons for the road" for banks.

First, financial institutions need to bring operators to the negotiating table if they want a customer-friendly, fast, and secure mobile banking experience—it's a lot harder to construct the service without the active involvement of the operator. Operators control a key element of the security infrastructure, which is embedded within the phone. The service needs to work under precarious conditions (people using low-end handsets in areas with unreliable wireless connectivity), making the correct technology choices critical. In fact, customer experience is determined directly by the technology platform used. So finding the right technology partner and optimizing the operator's resources is critical. This gives mobile phone operators substantial leverage when negotiating with banks.

Second, customers are more likely to take up the service if they can easily get their hands on cash. Banks need to find a way to provide liquidity through a network of cash-in/cash-out agents. Here again mobile phone operators have an advantage: their network of mass-market prepaid card retailers, which can do double duty as cash agents.

Third, if mobile phones are used to drive customer outreach and mass-market growth rather than to enrich the service experience for existing customers, banks need to develop a highly efficient channel to drive awareness of the service and strong branding to overcome natural customer resistance to new technologies and the associated security fears. Many banks—and not only the smaller ones—choose to rely on mobile phone operators to promote and even brand the mobile banking service given the operators' credibility with and understanding of mass-market marketing techniques.

Once a small bank or MFI considers all of this, the biggest uncertainty remains how to take its customers from their early experimentation with the service to a point where they truly can understand the value it can bring them and they can feel comfortable operating it. There is a large customer adoption barrier—and it's upfront.

1 Throughout this paper we use the term "bank" to refer to any type of authorized deposit-taking institution and, hence, would generally include some forms of nonbanks, NGOs, cooperatives, and MFIs. We also use the term "mobile banking" broadly to refer to any kind of payment or transaction undertaken using a mobile phone against a bank account that is accessible directly from the user's mobile phone.

2 CGAP is supporting Tameer Microfinance Bank in its implementation of branchless banking.

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Abbas discovered that pinpointing the precise role mobile banking can play within a bank's strategy is not straightforward. The issues are not complex, but they are highly interrelated. Therefore, in our discussion, we first identify what it is about a mobile phone—the device itself—that can make it a potentially useful tool for banks as an access device compared to other electronic banking interfaces. Is it because we can carry it with us? Is it because its architecture offers special security or usability benefits? Or is it simply because it is a widely available Internet or point-of-sale (POS) terminal where there are few alternatives?

Second, we map "inherent" benefits of the mobile phone to four typical strategic drivers for banks: increase penetration, sell more services, retain the most valuable customers, and reduce the cost of providing services.

Third, we build on the first two to develop a set of mobile banking cases or prototypical strategies banks may use.

The second part of this paper leads banks and MFIs through the implementation choices available. In the markets we are primarily concerned with, where most people are using basic handsets,[3] wireless connectivity coverage is limited (see Table 1), the mobile market is less competitive because it has fewer players (e.g., Safaricom has 70 percent market share in Kenya), and there are simply less technological options, the wrong technology choice can easily jeopardize the success of the banking service.

Table 1. Wireless Penetration Rates for Developing Regions

	Wireless Penetration Rates (%)		
	2003 (Q1)	2008 (Q1)	2012 (Q1)
Africa	4.75	30.60	50.13
Asia Pacific	13.06	39.08	60.81
Eastern Europe	20.50	102.79	134.72
Latin America/Caribbean	19.74	70.40	90.84
Middle East	17.84	61.91	98.26

Source: Wireless Intelligence at www.wirelessintelligence.com.

Imagining the Customer Experience

Before getting into the why and how of mobile banking, let's look at what the customer may experience with mobile banking. To open a bank account, the customer goes to a bank branch or an agent accredited by the bank where she is properly identified as required by law. She fills out a form, where she supplies her name, address, and mobile phone number, and she presents an acceptable form of identification. Or, if she already has a bank account, she can register for mobile banking through a mobile phone by sending a text message to a particular number.

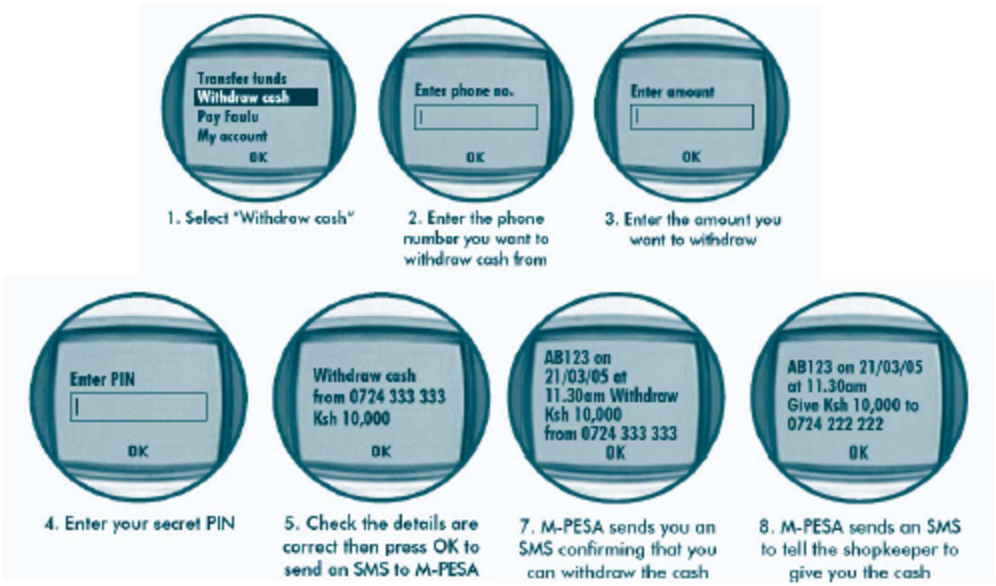
3 A large share of low-income customers in many Asian markets use Nokia 1100 series phones. See http://en.wikipedia.org/wiki/Nokia_1101.

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Once the account is opened, the bank transmits the mobile banking application wirelessly to the customer's phone. Now the customer registers her phone number and selects her personal identification number (PIN). She finds the mobile banking application, which will appear on the main menu of her phone. Let's say it is under Tools as My Banking.

Once she launches the application, she will be asked to pick and type in a PIN. She can now begin transacting. She will be able to receive her salary, remittances, and other transfers into this account, and she will be able to make payments (e.g., pay utility bills). See Figure 1.

Figure 1. Example of what a customer sees on her phone in a cash withdrawal: The case of M-PESA in Kenya



The customer will need to add or take cash out of her account in person from time to time. Let's say she wants to withdraw cash at a corner store that is acting as an agent for her bank. The customer launches the application from the phone's menu, puts in her PIN, and selects Withdraw from the menu. She will be prompted to select the account from which she wants to withdraw, enter the amount, and then enter the phone number of the store clerk.

The next screen will prompt the customer to confirm the transaction by selecting OK or retyping her PIN. Both the customer and the store owner will get a message confirming that the customer's account is debited and the amount is transferred to the store owner's account. At this point, the store owner hands over the cash.

The first time customers use this service, the process may seem confusing and even protracted. But customers become familiar with the process quickly and appreciate the convenience of not having to carry a separate bank card, and especially being able to transact from anywhere to anyone with a mobile phone—not just to get cash at the store.

Back to Basics: What is the "it" in Mobile Banking?

What contribution can mobile phones make to banking? We examine this by formulating hypotheses on how mobile phones can change the relationship between a bank and its customers.

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1. Mobile phone = a ubiquitously deployed base of technology?

Under this hypothesis, the potential of the mobile phone, the "clever trick" we might seek to exploit, lies not so much in its inherent capabilities or how customers relate to it, but in the fact that it is (practically) everywhere. This is why we claim that mobile banking offers more opportunity to poor people—who have less alternatives—than rich people. Its power is in transforming the economics of service delivery and less in the nature of the service proposition itself. Consider four specific devices mobile phones could replace:

1a. Mobile phone = a virtual bank card. A bank card is essentially a memory device in the client's possession that serves two purposes: it identifies the user, and it identifies the account (and institution) where the user's financial balances are held. The mobile phone could be used to securely store this information, thereby avoiding the costly exercise of having to distribute cards to the entire banked population. In fact, the subscriber identity module (SIM) card inside GSM phones is in itself a smartcard (i.e., a card with a chip, similar to the more modern bank cards), although it is not encased in the usual plastic form factor. The bank customer's PIN and account number can be recorded on this SIM card or on the phone's memory acting as a virtual card.

1b. Mobile phone = a POS terminal. A mobile phone can be used to initiate transaction requests and communicate with the appropriate bank to solicit transaction authorization. This is the function of a POS terminal at a retail store: it has a screen and data entry keyboard to capture the user's transaction details, a card reader to capture stored client information (to confirm his identity and locate his account), and a secure communications link with a bank. A mobile phone can replicate this functionality. If the client is using a virtual card on his phone, the mobile phone-as-POS will be able to read it directly; otherwise, a card reader will need to be attached to the mobile phone.

1c. Mobile phone = a human ATM. A POS is used to pay for goods at the store. If we consider cash and access to your savings as "the good" that customers fetch at the store, then that POS (plus the store's till) serves the cash collection and distribution function of an automatic teller machine (ATM). Mobile phones can provide that POS-as-ATM functionality.

1d. Mobile phone = an Internet banking terminal. Internet banking is based on two fundamental customer value drivers: control (instant access to any account detail I need) and convenience (ability to make payments and transfers remotely). It has demonstrated its usefulness, to such an extent that it is now in the channel arsenal of practically all major banks. But its use is limited in many countries by the poor reach of the Internet itself. The mobile phone device and wireless connectivity bring the Internet terminal into the hands of customers.

Leveraging the deployed base of mobile phones has to translate into some cost savings, but how much? Excluding costs associated with connection to the payment system and to switch transactions that they need to incur whether they use branches or mobile phones, we expect to see in at least one case the costs decline from approximately US$70,000 for a branch to US$1,140 for agents using cell phones.

2. Mobile phone = a new way for customers to interact with technology?

The technology elements embodied in a phone may not be new, but what is new may be the way customers relate to the technology. Mobile phones are personal devices. The value of the device is so high for some of us that we even decorate and personalize it like we do our cars or homes. One study indicated that mobile phone users were not without their phones for more than 30 minutes. The device gives us a sense of immediacy. It's not so much about anytime/anywhere, it's about here and now. It gives us a feeling of possibility, convenience, and control.

Beyond the cost saving of using an existing deployed base of terminals, how can banks exploit this sense of immediacy to develop a deeper and more meaningful relationship with a customer who

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happens to have a mobile phone? How can these attributes of the relationship between customers and their mobile phone be used to create new banking services or service models?

At the very least, mobile phones provide banks the opportunity to send personalized messages to all their customers—messages that serve to market a new product, introduce a new feature to a service, or alert on specific account activity. Customers could immediately verify account balances and recent account activity when needed. Moreover, because it allows for two-way interaction, the phone also makes it possible for customers to take immediate action from wherever they are, for instance when they are reaching a low-balance threshold or when there is unusual activity on their account so customers themselves can be part of fraud prevention.

This enhances customers' sense of control. Interactivity can go further into tailoring services as the relationship between banks and their customers matures. For instance, customers could request a higher credit ceiling on the fly, when needed, with verification happening over the phone. In any case, it is probably fair to say that we have only begun to imagine the possibilities of exploiting the mobile phone in creating new service experiences.

3. Mobile phone = a useful new functionality?

Is there an inherent capability "inside" the mobile phone that really is new, that allows customers to do something that they simply couldn't easily do before?

A mobile phone can be used to enter, display, process, store, and transmit information—but so can computers, ATMs, and POS devices, which are the electronic network end-points banks use today to service customers. In fact, mobile phones are more limited than these devices, for instance in terms of processing power. There is really not much that is functionally new in a mobile phone as a terminal device: after all, no one was thinking of banking applications when mobile phone standards were being defined.

However there is a characteristic of the mobile phone's architecture that sets it apart from most other computing devices that could be used for banking purposes. This is the existence of a device within a device, or a SIM card inside the mobile phone.[4] Neither of the two devices is functionally new: the SIM card is a smartcard (a card with a chip) and the mobile phone is a limited computer. But having one inside the other enables interesting security features.

The SIM's memory contains two essential elements: the phone's user menu and the security keys that are used to encrypt all information the phone sends to and receives from the network. The memory in the SIM is tightly controlled by the mobile operator; no other party, not even the customer, can access it or store applications without the explicit authorization of the mobile operator. Therefore, the contents of the SIM are much more tamper proof than the rest of the phone or any standard computer. The downside is that the closed architecture of the SIM limits service innovation by third parties. Combining the tight security of the SIM with the more open architecture of the phone itself allows mobile phones to attain the best of two worlds: a secure kernel within a flexible, service innovation-friendly shell.

The mobile phone is also a connected device with a particularity: it can attach itself anywhere on the network, automatically. There is one intrinsic feature of a mobile phone that has so far not been used much in mobile banking applications: location awareness. The mobile phone can be spotted in most mobile networks within a couple dozen kilometers or tens of meters (i.e., either single-cell or with more sophisticated multi-cell triangulation technologies). One interesting idea tested by Bankinter in Spain is using the location of the credit card at point of transaction relative to the cardholder's mobile phone (which is presumed to be on or near the cardholder). If they are far apart, there can be more reason to question the authenticity of the requested transaction.

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Summary: The Power of Economics vs. Customer Experience

A mobile phone is, and always will be, more limited in its capabilities than either a connected personal computer or a specialized POS. But it has economics on its side. For instance, the high cost of the required dedicated broadband infrastructure and the devices themselves will hinder the spread of Internet banking in developing countries. In rural areas it is further hindered by a vicious circle: low device penetration does not warrant roll-out of appropriate broadband communications infrastructure, and while the infrastructure is not in place few customers will invest in personal computers.

But, if we exploit the built-in data-handling capabilities of mobile phones, it turns out that the job of deploying "Internet machines" in developing countries and rural areas is substantially done or under way. By "free riding" on the strong economics of the mobile voice service, business cases have been closed and vicious circles have been broken.

But make no mistake: the mobile phone offers a substandard user experience, at least for users unaccustomed to the service. It's great to be able to use devices that people already own, and it's great that mobile phones give people an opportunity to feel more in control over their financial services. But driving customer adoption will not be straightforward if they are intimidated when they first hear about it and scared off the first time they experience it. This presents a key trade-off: mobile banking reduces the cost of service delivery but may create a larger adoption hurdle.

What About Cash?

Mobile phones are ingenious devices, but one thing they cannot do by themselves is convert cash into electronic value or dispense cash. They can be used only to transfer or transform value electronically. A mobile banking platform therefore needs to be supported with a cash conversion platform—whether full-blown bank branches, ATM terminals, or third party banking agents. Remember, the whole mobile proposition is based on choice and control: if I don't have a choice of cashing in or out of my electronic wallet, I am not likely to think mobile banking is doing much for me.

A bank that wants to cover a new geography with a mobile banking strategy will need a cash-in/cashout network in that same geography. The mobile platform will not "liberate it" from having to figure out a physical cash delivery channel: it's clicks and mortar. But it can be "clicks and mortar lite," because the mobile banking platform itself can help in deploying that network cost-effectively by letting, for instance, an agents' mobile phone act as a POS for handling agent transactions.[5]

To what extent will mobile payments replace the need for cash? To answer that question we need to understand the relationship between electronic money that may be accessible through mobile phones and cash. There are two key roles of money: as store of value and as means of payment or exchange.[6] In a totally cash-based economy, cash fulfills the two roles at the same time. It may be inconvenient for people to store and move so much cash around, but at least there is no risk of lack of liquidity: if you have enough value stored in cash, then you have enough cash to make a payment.

4 Throughout this paper the case of mobile phones is considered using the more prevalent GSM standard. Some networks use other standards(CDMA, iDEN) that may not use a SIM card.

5 For a general description of banking agents, see Mas and Siedek (2008). Note that agents may also play a valuable role in getting customers acclimated to the mobile proposition with on-the-spot training that customers may need to pick up a new service.

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It is only when the two roles are separated that liquidity may become a problem. For instance, as people move into savings in real goods (bricks, chicken, real estate) in search of convenience and higher returns in the store-of-value function, the total amount of savings far exceeds the amount of cash easily available. Liquidity might be a problem if you are not able to convert your physical savings into cash readily enough. In that case, you might need to resort to bartering your physical assets—so you tend to choose physical stores of value that are tradable and movable (e.g., livestock). When people need to resort to barter, cash has lost both functions—as store of value and as means of exchange.

Similarly, once there is electronic money, the demand for cash depends strictly on the extent to which this new electronic form of store of value can also be a means of exchange. Can we use electronic money to directly pay for all that we need? In the language of payments, is there a wide acceptance network?

To the extent that electronic money is convenient for us to use and widely accepted, we return to a world where the same "asset" is performing both functions. Now, there is no liquidity issue with electronic money and cash loses its role. But if electronic money is not widely accepted, and we know of only a handful of places where it is accepted as a form of payment, storing my value in electronic form exposes me to liquidity risk: I cannot ensure that I can convert electronic value into cash quickly enough if and when I need to spend the value.

People have heralded the end of cash before but the claims of a cashless society are more emboldened today by the growth in cell phone use globally.[7] In fact, the relationship between electronic money accessible via mobile phones and cash is likely to vary over time.

In the early stages of introduction of this electronic money, it will be essential to ensure that people have ready cash-in/cash-out options to support the mobile proposition. Customers will want to test the liquidity of electronic money. Typically they will want to convert all electronic money inflows into cash immediately and in full. In places where cards have been used with microfinance clients or low-income customers, people who live in all-cash economies, most cash out their loans, government benefits, and so forth, on the spot immediately after they receive them.

As electronic money gains acceptance as a store of value, people might restrict getting their cash out to meet their daily liquidity needs for very small value transactions only. In fact, in this stage, we expect there to be substantial net cash into the mobile banking system as it absorbs cash that had previously been performing the store-of-value function (under the mattress). Over time, because goods, services, and salaries will be paid increasingly through electronic transfers, cash conversion will become unnecessary. Direct electronic transfer will skip the electronic value-to-cash conversion on the paying side and the corresponding cash-to-electronic value on the receiving side. Now, finally, total cash substitution is happening, both as store of value and as means of exchange. Ultimately, cash-in/cash-out points may not be necessary at all.[8] But you would do well not to plan for that world as yet.

6 The other function of money is the "unit of account." We don't cover the issue of alternate currencies—money used in virtual online worlds, for instance. For information on forms of alternate currencies and their economic significance, see David Birch's Digital Money Forum blog at http://www.digitalmoneyforum.com/blog.

7 For instance, see The Economist (2007).

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The above discussion highlighted the key potential benefits of using mobile phones to deliver banking services: lower cost of deployment for the bank, and choice and control by the user. The potential benefits of mobile banking need to be related to banks' own strategic drivers. There are some basic core strategies banks may follow to promote and protect growth. We illustrate how mobile phones may support each strategy, with reference to the potential benefits of mobile phones discussed above. Table 2 provides a summary of the arguments. These are reinforcing, but banks may need to prioritize among these to be able to develop a coherent, focused strategy.

Increase market penetration. Go for underserved population segments, and grow the total revenue pie. Mobile banking can serve primarily to reduce the cost of deploying customer touch points into lower income or more remotely located population segments (the "deployed base" view). Mobile-as-ATMs can enable merchants to become cash-in/cash-out points; mobileas- POS can serve to substitute cash and electronically capture transactions at the store. Mobile-as-Internet-machines can allow customers to transact remotely (sending remittances, paying bills) without having to physically access a service point.

Sell more services to existing customers. Develop new products that target unmet needs of existing customers. These new services could exploit the new functionality available through a mobile phone (e.g., location awareness, under the "new functionality" view) or its value as a personal technology (the "new way to interact" view). In the latter case, the mobile phone would act as a service "presentation" and delivery channel, its main utility no different than an Internet machine.

Retention of most valuable customers. Protect the roughly 20 percent of customers who bring roughly 80 percent of the value, offering them a quality and breadth of service that will make them less vulnerable to churn. Individual services are rarely unique to a bank, because they are easily replicable. Rather, the important thing is to embed the nonunique services within a unique customer experience. Having an informational and transactional capability in customers' pockets (the mobile-as-Internet-machine), banks may be able to propose new services to their customers in a much more targeted way. Banks also can fully exploit the immediacy of the mobile environment to extend the benefits of control and choice, and hence convenience, across their entire product range (the "new way to interact" view).

Reduce cost of service provision. Put primary emphasis on bottom-line over top-line growth. Cutting costs is not only about margin: seeking low(est) cost position in the market also should deter competitors from engaging in value-destroying price wars, thereby protecting the revenue base. This is fundamentally about replacing more expensive channels and devices with the cheaper mobile solution (the "deployed base" view).

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Table 2. Mapping the Main Benefits Derived From Using Mobile Phones to Banks' Strategic Drivers

Use of Mobile Phone	Strategic Drivers For Banks: Increase Market Penetration	Sell More Services to Strategic Customers	Retention of Most Valuable Customers	Reduce Cost of Service Provision
Deployed Internet Terminal	Remote transactions for underserved populations	Alternate channel for customers	Unique Customer Experience	Use in place of PC and broadband Internet connection
Deployed POS/ Virtual Card	Reach underserved populations with agents			Use in place of card and POS device
Personal Device		Unique customer experience	Immediate action and sense of control experience	
New Inherent Functionality	Use SIM functionality for "virtual" card	Use location awareness for real-time products		

Putting it all together: Three mobile banking scenarios

Having looked at the building blocks—the special features of mobile phones and how they might support a bank's various strategic objectives—we now construct three different deployment scenarios, shown in Table 3. These are based on the degree to which the mobile channel is geared toward retaining existing or acquiring new customers, and in the latter case whether these new customers are obtained by expanding the market or winning them over from competitors. We offer these as archetypes to illustrate three extreme cases that, in combination, span the range of strategies a bank might pursue.

Cool value add

In this scenario, a bank seeks to exploit the personal nature of the mobile handset to build a stronger relationship with its customers. The mobile proposition is used to expand the choice of channel and services to the customer. The business case is based on customer retention; the mobile service is used to create a specific point of differentiation from other banks.

ABSA was one of the first banks in South Africa to introduce mobile banking in 2002. The fact that its customers use the mobile phone as a complementary channel is illustrated by the fact that

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usage volumes increase significantly during holiday seasons (like Christmas): customers on vacation choose to do banking transactions via mobile phone when they can't access the Internet or ATMs. The bank has in fact sought to integrate the Mobile and Internet channels: it has introduced SMS alerts to customers every time there is a successful log-in into the customer's Internet banking application, as a security precaution.

Easy bank

In this scenario, the bank uses the mobile phone to broaden the range of channels through which it interacts with its customers. The mobile phone offers full service capabilities: it is used not just for sending out information or messaging with customers, but also to transact. It does not seek to displace established channels for existing customers, but the breadth of channels allows the bank to address more diverse segments. Low-value transactions undertaken by poorer segments of the population are conducted via mobile phone. For them, the branch may eventually become merely a sales channel, while mobile and ATM serve as their primary transactional channels.

Recently, Equity Bank created two new channels to complement its branch, ATM, and mobile van channels: a closed-loop POS network, where customers can do basic banking transactions, and a mobile phone channel, where customers can check balances, remit funds, and do other transactions. The mobile channel is likely to be used by younger customers and migrants who send frequent small amounts of money home. Customers can cash in or out at agents, branches, ATMs, or mobile vans and can use both the mobile phone and card linked to the same basic transactional account.

Virtual bank

In this scenario, a bank seeks significant outreach and growth of customers, because of new market entry or geographic expansion or a run for scale. By using mobile banking as the main customer touch point, the bank seeks growth without investing in as much physical infrastructure. Indeed, mobile banking can be a way of limiting the risk in a growth strategy. The customer experience is likely to be less-than-perfect but customers are likely to be more tolerant because they simply do not have many alternatives. Customer experience just needs to be good enough to have broad appeal and deliver scale.

Tameer Bank in Pakistan may decide that it wants to reach rural Pakistanis mainly via cell phones and agents. It may decide that it won't open any more branches outside the two major cities and that it will partner with companies with retail presence, including the mobile operator, to create its cash-conversion platform. Tens of millions of subscribers of one of the top three mobile operators will, within a short time, become account holders at Tameer. Those customers may rarely visit a Tameer branch, if at all, but they will still come to recognize and trust the brand of the service.

Lessons for the Road

Banking via a mobile channel is an idea that most bankers (and many bank clients) find intuitively logical, albeit daunting and confusing, to implement. In today's world of electronic-based accounts, money is "information" passing through communications networks. The customer experience at the ATM— punching in a PIN, selecting among various options, being instantly gratified—evokes our mobile phone experience. We place our mobile phones in a very exclusive location—our pocket—alongside our money and our home keys, which suggests the high value we attach and even the level of dependence we have to the phone. Why can't my mobile phone be my wallet?

But first an update on Ali Abbas Sikander and Tameer Bank: Abbas decided that the mobile banking channel was probably going to be the only channel for his rural customers, and hence it was going to be a key element of an aggressive growth strategy. Abbas and his colleagues determined the level of strategic engagement with the operator and the type of solution after navigating through their technology choices (which were explained in the second part of this paper). He

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decided to use an STK solution, which offers the highest level of end-to-end security but also requires a more integrated partnership with the mobile operator.

He decided to use the operator's prepaid card distribution network, one of the largest retail networks in Pakistan, to distribute new SIMs and serve as cash-in/cash-out points. Although the new service is most likely to be co-branded by the operator and Tameer, the operator's brand will be more prominent, which will help market the service to millions who use cell phones but have no formal banking relationships and already know the operator's brand well.

As banks follow Abbas's lead and begin implementing their mobile banking strategy, here are some "lessons for the road."

The mobile banking opportunity will be largest for growth-oriented banks. Banks that are aiming to grow rapidly should benefit more from strategic alliances with mobile operators, leveraging several of the operator's key assets. Banks can take advantage of the mobile operator's widespread wireless coverage and extensive use of wireless devices as part of a branchless expansion program (using, for instance, manned POS devices at stores serving as banking agents). Branch economics, with heavy capital and labor costs, favor an environment for branches that is densely populated and where the customer transacts at higher values. Banks can also take advantage of mobile operator's large and tiered distribution networks to roll out their banking agents.

Telecommunications companies have substantial leverage in mobile banking, and banks need to sit down and negotiate with them. Banks need to work with mobile operators if they want to create mobile banking services that are highly customer friendly, fast, and secure. Mobile operators' control of the SIM, plus the attraction of leveraging their distribution networks, puts them in a strong negotiating position. This might create a challenge for smaller banks, who might find it more difficult to strike the right deal with mightier operators, or who might simply struggle to get them at the negotiating table. It also may create a tension with the principle of interoperability across networks, because tighter relationships might not be achievable with all networks.

Liquidity (conversion to/from cash) remains the anchor of the value proposition for mobile banking customers. To derive the most value from remote transactions—using the cell phone just like an Internet terminal—begins with getting people to leave more cash in their accounts. This might happen when people see that there are many ways in which they can cash out. In the language of payments, there needs to be a wide acceptance network. Once that cash-in/cash-out network is established, the value of transacting remotely may become more apparent. There may be cash substitution, but it will be only a very gradual process.

Banks who want to use mobile banking to reach out to unbanked customers need to develop strong partnerships for mass-market promotion of the service. Most banks do not have the capacity to aggressively market mobile banking on their own. Banks that want to use mobile banking to reach unbanked customers need access to marketing channels to and brand credibility with precisely those customers who have been excluded from banking. Unlike most banks, mobile operators traditionally use a mass market approach and aim to get into the pocket of every citizen.

Banks can learn from the mass-marketing approaches of mobile operators, or better still, can partner with them—and that's on the marketing and branding side, not just on the technical service delivery side. Also, there may be other types of service providers or retailers that banks could seek out as marketing partners.

Mobile banking does not raise any inherently new security issues; still, ensuring adequate security through a combination of technology and operating processes is paramount. Any bank with an Internet banking channel can offer mobile banking today: all the bank would need to do is "reformat" its Internet banking content from HTML to WAP, to make it accessible to devices with smaller screens and a mobile-specific browser.

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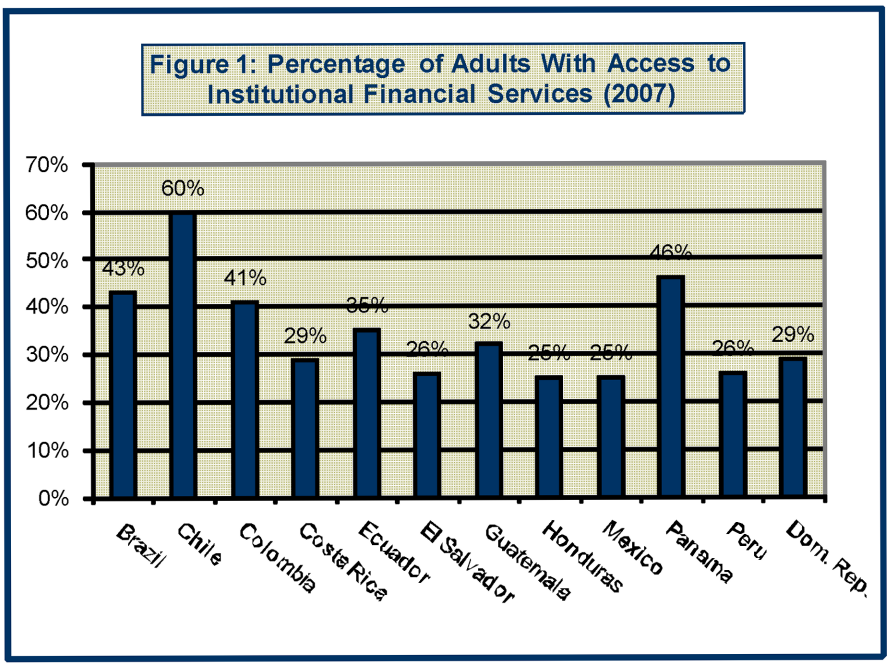
The security solutions to the problem of Internet banking (fundamentally, communicating through a customer device and over a network that cannot be assumed to be totally secure) apply equally to mobile banking. Moreover, mobile banking introduces the opportunity of using SIM-based security, which is more analogous to the ATM banking model in its use of cards (physical bank cards or embedded in the SIM card). Whatever the security of the technical solution, operators will need to ensure that operating procedures around it do not open up vulnerabilities.

The following excerpts are from "Mobile Banking in Latin America" published in the Financial Services Intelligence Series by Business News Americas, dated May 2008.

INTRODUCTION

Spanish telecommunications giant Telefónica announced in May it will start rolling out the development of mobile banking services in Latin America, in partnership with the Inter- American Development Bank (IDB). The initiative is due to take shape in July, and is aimed at the 175 million Latin Americans that have mobile phones but do not have bank accounts. That figure, along with statistics claiming 70% of Latin America's population does not have access to financial services and that 65% of the population has a mobile phone, indicate the potential reach of mobile banking in the region.

The Telefónica/IDB project - and others being carried out in the region - seeks to use Latin America's exponential growth of mobile services as a bridge to bringing large numbers of potential clients into the financial system by allowing them to perform services over their mobile phone.



Experience in other parts of the world, such as South Africa and the Philippines, has shown that the use of mobile phones to provide financial services to the portion of the public without banking services is effective and - importantly - profitable for both mobile telephone operators and financial institutions. It is a growing business. Consultancy Juniper Research pointed to a recent study showing that the number of people using mobile financial services will reach 816 million by 2011.

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For banks, mobile banking's primary benefit is cost reduction. Costs could be 60% less than operations carried out in branches. According to a report by the Consultative Group to Assist the Poor (CGAP) - a consortium of development agencies - the cost of a bank transaction in the Philippines costs US$2.50 at a branch, but only US$0.50 via mobile banking. For mobile operators, mobile banking is a way of boosting profits per user in a segment of the market with high volumes but low profitability.

But however much banks and telephone companies wish to expand the market, they have to negotiate some obstacles. The cost of transactions, although less than that of traditional banking, can still be high for low-income populations and the strict guidelines that regulate banks in Latin America make it difficult to implement these projects. These two details go some way to explaining the relatively slow development of mobile banking in Latin America compared to other parts of the world.

The actual growth potential for mobile banking in the region is thus open to interpretation, and the extent to which it becomes an effective method for channeling the potential offered by microfinancing and remittances, and for increasing banking service penetration, depends on a number of market, technological and regulatory factors that this report addresses.

Mobile Telephony and Banking Services

South Africa and the Philippines are two successful cases of mobile banking. While poor and rural populations in those areas had almost no access to banks before, the situation is starting to turn around thanks to the high mobile telephony penetration. Under this model, banks were able to overcome the costly option of opening branches in different parts of the country to attract clients.

But face-to-face contact has not been replaced entirely: banking kiosks that serve as a type of branch have been installed in rural areas. They are operated by bank employees or even by community members with the bank's prior approval. "The secret to this service lies in its accessibility and availability," says Brian Richardson, executive director of Wizzit, the mobile banking unit of South Africa's Bank of Athens. Wizzit hopes to have 500,000 accounts by 2010 and is already expanding services to rural zones of the country.

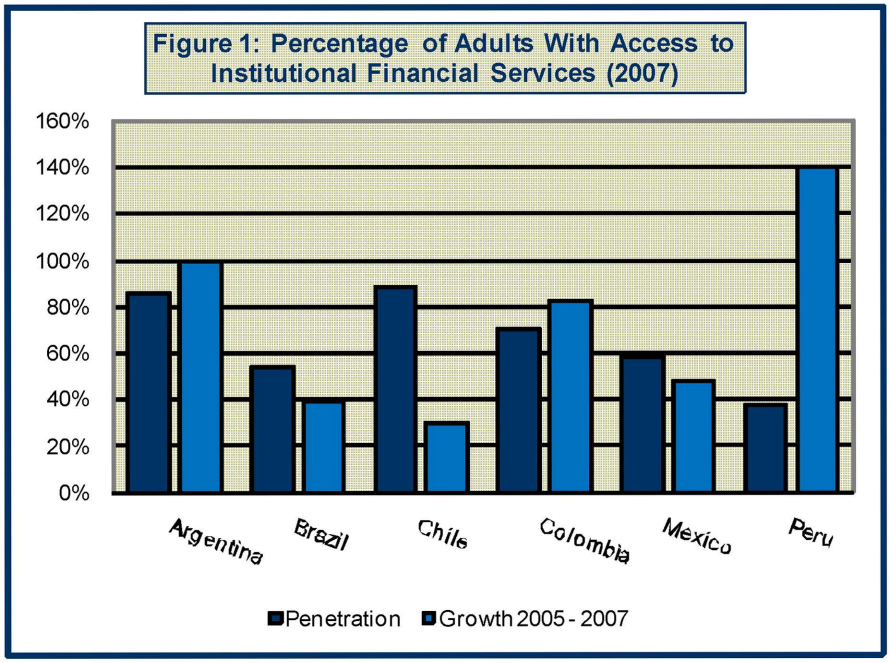
The strong growth in mobile telephony penetration is global. In Latin America, penetration in the six largest economies stands at some 65%, as shown in Figure 2. A large part of that growth has built on favorable macroeconomic conditions throughout the region, which in recent years has seen slow and steady economic growth and controlled inflation, leading to the likelihood that the mobile banking market will develop further.

Mobile banking in Latin America started in 2006 and since then has grown strongly and silently, expanding at the same rate as Europe did earlier this decade when mobile banking rocketed thanks to improvements in connectivity, better devices and more affordable services for text messaging (SMS), the most popular technology for mobile banking.

According to Pedro José Garcia, senior financial services executive at the Latin American unit of Accenture, the region performs 420 million mobile transactions each month with users making an estimated average of three transactions per month to pay microloans and utility services, and to transfer cash.

One of the financial services on which mobile banking projects in Latin America are focusing most attention is remittances. In 2006, Latin America received over US$68 billion from 650 million money transfers. At an average cost of US$10 per transaction, this represents a total of US$6.5 billion every year, a cost that could fall significantly through mobile banking, according to Garcia. Gavin Krugel, strategy director for mobile operators association GSMA, said that if transfers were performed via mobile phones, the cost of remittances would drop to 4% of the amount sent, which is considerably lower than the 10-24% levels that fees currently stand at.

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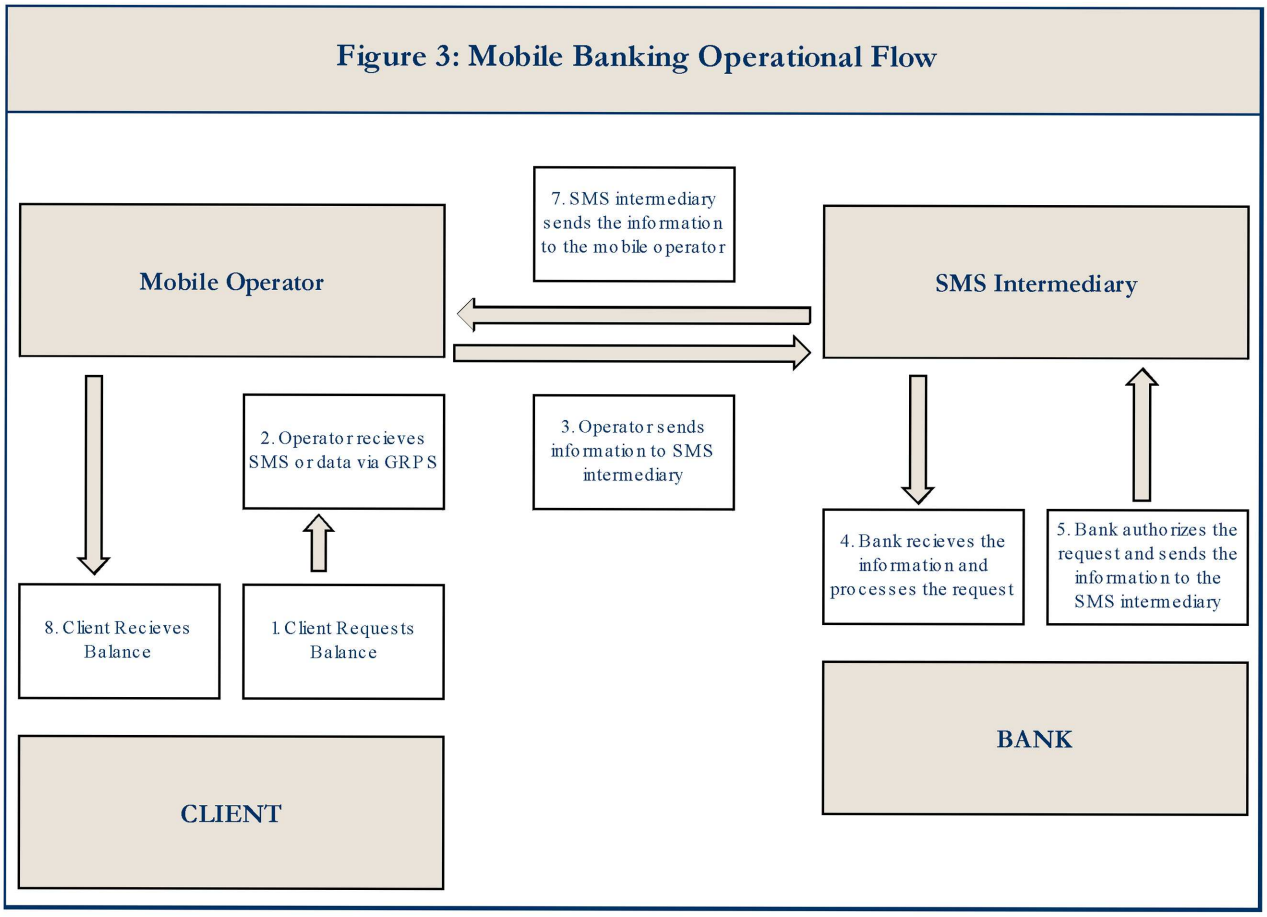
Microfinance is also a focal point. Some 600 financial entities currently provide credit to over 8 million clients, according to a recent IDB study showing information gathered from 25 countries in the region. The region's entire microfinance portfolio at end-2007 was estimated at US$8.6 billion. Although rates of growth differ between countries, figures show a significant increase from the US$1bn in volume and the two million clients in 2001.

Perhaps the most relevant detail about mobile banking projects is that nearly 70% of the entire portfolio and over half of microfinance clients in Latin America are served by regulated institutions. This stands as a guarantee that processes will be rigorous and overseen by a competent regulator.

So far, the use of mobile banking has been largely dictated by client demand. Banks have been more reactive than proactive, and according to ebanking.cl's Claudio Wipe, this may be due to that for now at least, banks prefer to approach sectors they know well with new products, before offering already-proven products to new sectors.

There are other reasons to explain the relatively slow growth of mobile banking in Latin America: small screens and buttons on a majority of the apparatuses, concerns about information staying secure during the entire transaction process, regulatory doubts, the availability and reliability offered by the telecommunications network; and the use of service providers which adds another element of risk to a process that is expected to be as confidential as possible.

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Two elements of this mobile option distinguish it from other remote banking channels such as internet banking or PoS terminals for credit and debit cards: the mobile handset and the mobile network, which involve an entire infrastructure that is necessary for relaying the information contained in a message from a handset to a financial institution and back again.

These two elements create an even more complicated environment that market players like financial institutions, carriers and regulators need to better understand. Complexity is moreover increasing, with ever-more sophisticated apparatuses meaning that in the high-end segment of the mobile financial services market is growing increasingly similar to internet banking.

There are several business models for mobile banking. According to AFI, a Spanish consortium for financial and information consultancy which promotes the development of mobile banking, there are three models: those driven by telecommunications operators, those driven by financial entities, and joint ventures between telecommunications operators and financial entities.

Depending on the relationship between financial distribution channels, there are two main models: additive, where mobile banking is an additional and complementary channel; and transformational, where financial services become available on a market that did not previously offer access to other channels of banking distribution

Furthermore, AFI has identified five models based on applied technology: short message service (SMS), data transmission, applications installed in a user ID module, access via WAP and JAVA applications.

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According to a report published last year by Spanish messaging platform supplier Latinia, nearly 38% of the 100 largest banks in Latin America already offer services that clients can access via mobile phones. SMS is the preferred method in mobile banking. 76% of Latin American banks that offer mobile banking use this method. It is most popular in Brazil, Argentina, Chile, Mexico and Venezuela.

According to Latinia, alerts or notifications constitute the most basic service while it is also in highest demand on the most mature markets. The principal findings of Latinia's study are:

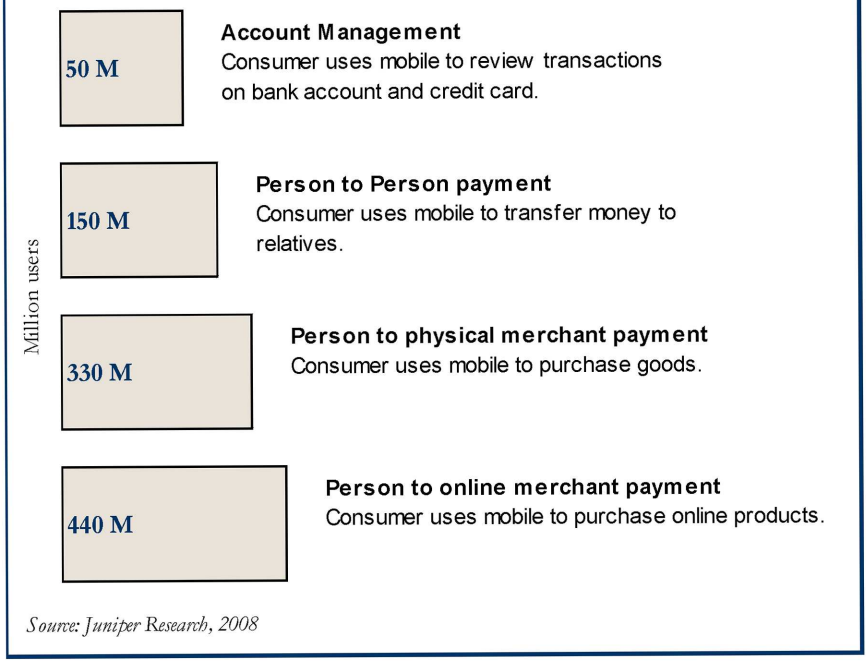
- 44% of banks with mobile banking services that Latinia analyzed offer alerts and notifications, which the Spanish firm found to be a basic service in the highest demand on the most mature markets.

- 33% of entities allow clients to view balances, movements or transactions.

- 55% of the banks included in the study offer financial services at portals via WAP technology.

- 31% of the entities offer micro applications that can be downloaded onto the mobile terminal. These services, however, require the mobile handset to have more sophisticated functions.

Figure 5: Potential of Mobile Payments. Global Estimate, 2012



Source: Juniper Research, 2008

Fernando Lezama, CEO of the Mexican unit of Sybase - one of the world's largest providers of software for managing data, mobility and services - indicated that part of the success of SMS is due to the fact that it creates a sense of urgency when the message is received as opposed to phone calls or email.

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Through text messaging, account holders can perform bank transactions that range from basic consultations - like viewing account balance or making a transfer from one account to another - to making more complex transactions such as drawing up investment portfolios, receiving alerts if suspicious movements are detected on an account or even updating passwords on security devices via mobile messaging, Lezama said.

"It is very interesting for banks to open this channel because, on one hand, it creates a whole new pool of potential account holders that probably have limited internet access but also so that executives and people who move around a lot can have access to their bank accounts," he adds. Another attractive feature is SMS's popularity with youth who represent potential clients since they are already familiar with the means of communication.

When any mobile telephone carrier sends data to a bank via SMS, a mobile server captures the transaction, sends the information to bank systems, performs the transaction through banks' own security systems and send the result back to the account holder in the form of another SMS.

But how secure is an SMS? Passwords are 16 bits, the same level of security as the internet. All of the information is encrypted at all times and no relevant information is stored on the mobile, Lezama explains. "As opposed to a telephone call or an email, SMS creates a sense of urgency when you receive it and that explains part of its success," he said.

But ebanking.cl's Wipe believes that SMS is easy to intercept and is therefore corruptible, besides costing an average of US$0.10/message. According to Wipe, banks, carriers and regulators need to make a larger effort to help turn the development of mobile banking into a reality in the region. "It's necessary to create incentives in the right places," he says.

Ludwig Schulze, global manager for corporate business development at Finnish mobile phone manufacturer Nokia, says that the private and public sectors both have a lot of work ahead of them. The private sector still needs to face the challenge of adopting lower cost banking models with services and devices that are more accessible and innovative while, on the public side, governments need to design a regulatory framework that makes it easier to develop the lower-cost banking models and they need to encourage experimentation and commercial innovation and even consider dropping taxes on services and networks in order to speed up the implementation process.

Regulation is one of the most complex issues. "As a regulator, I am concerned about several points," Felipe Tam, the head of Peru's banking, insurance and pension regulator, said at a conference on the topic in Miami. Tam is uneasy about several issues, including the growth of non-regulated entities on the market, the new opportunities for money laundering that these types of services open and the possibility of serious crime as the mobile phone is transformed into a virtual mobile wallet.

The largest challenge for regulators is to find a balance that allows the new channel to develop in an effective way with manageable fees - especially when we consider that crux of the issue is for the lowest-income segment to begin using bank services - while simultaneously maintaining a secure system and ensuring the security of those who use it.

"Regulations are the largest challenge for mobile banking in Latin America," says GSMA's Gavin Krugel, adding "Requirements should be applied proportionately and based on risk while also working to the benefit of competition by increasing competition."

Nokia's Schulze believes the first barriers to growth in mobile banking are the issues of security and encryption - where sporadic improvements have been made - along with accessibility.

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In all likelihood, within a few years SMS will be seen as an almost primitive instrument for making mobile transactions. The multimedia options offered by WAP technology and the implementation of 3G networks in the region, which will multiply the speed and capacity of data transmissions, indicate that mobile services offered by banks will constantly improve.

Some banks in the United States, for example, are working on pilot projects that will enable them to send their clients investment options when accounts are detected to have surplus funds. The client will quickly receive a message and be able to decide how to use funds that are not generally put to use but can now generate new interest for the customer.

With mobile notices, banks will also be able to offer new and more sophisticated investment portfolios to middle-income clients that have not had access to such services thus far. "One interesting niche for banks is to create secondary markets for generating investment portfolios during periods of improved liquidity with an interest rate that is higher than the passive rate offered by banks," Sybase's Lezama says.

But the main idea in Latin America is to use mobile banking as a way of increasing banking services to middle and low income segments of the market. In a move to promote use of this model, the IDB recently announced it would finance five mobile banking pilot projects in the region this year. "The added value lent by the IDB is intended precisely for triggering these areas of coordination," says Mario Marcel, the multilateral entity's manager of institutional capacity and financial markets.

The IDB has also kicked off a program with GSMA to stimulate the use of mobile banking in Latin America. In addition, BBVA has teamed up with Telefónica and Visa to seal a deal for pilot projects in different countries around the region in coming months. "As banks, we need to put ourselves out there and seek channels that are an alternative to the typical branch," says Vicente Rodero, BBVA director for South America. "We have to bring the bank to those who do not have access, rather than the other way around," says Wizzit's Richardson.

Experts are already sizing up the trend. Sybase's Lezama estimates that 80% of the banks operating in Latin America will offer clients some type of mobile banking service within 12-18 months. "This trend is irreversible and unavoidable," he considers. According to Lezama, banks that are not offering these services will have to do so sooner or later, since they run the risk of losing part of their client base to other banks that may be moving faster. Based on a Sybase pilot project in Mexico, banks expect to increase their client bases 20% if they manage to offer their service before competitors, especially to young people.

All of the pieces are in place for mobile banking to take off. When that would happen is not clear, although some industry players - like Gustavo Jiménez, business development VP at the Latin American and Caribbean branch of US electronic payments company VeriFone - believe that launch on a massive scale will take as much as five years, when the interests of markets players finally converge. But as Accenture's Garcia stated, the necessary technology and functionality - including broadband, the number of mobile phones and even the macro conditions for sustaining the model - are already in place, as is the potential market. As Telefónica Empresas Latinoamérica president Claudio Muñoz puts it, "We have built the bridge. Now we must cross it."

SUMMARY

According to IBIS, in 2006 a major growth area in computer services was in software and systems integration as well as eCommerce and online services by the finance/banking industry. Over the period 2006 to 2010, growth in the computer services industry is expected to be approximately 3.4%

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compared with forecasted real growth in GDP of approximately 3% per annum over the same period.

Mobile banking presents opportunities for growth in developing nations as a result of a lack of a well developed formal banking infrastructure, particularly in rural areas, and low Internet penetration but relatively high mobile phone penetration. For example, approximately 70% of Latin America's population does not have access to financial services while approximately 65% of the population has a mobile phone, presenting attractive opportunities for financial institutions to expand their services to underserved communities in the region. Successful mobile banking initiatives in other parts of the world, such as South Africa and the Philippines suggest that the use of mobile phones to provide financial services can be effective and profitable for both mobile telephone operators and financial institutions. Recent studies indicate the number of people using mobile financial services will reach 816 million by 2011.

Although the opportunities for mobile banking in emerging markets are promising, several hurdles to the widespread implementation of mCommerce platforms remain. Such hurdles include coordination between mobile telephone operators and financial institutions, the need to provide liquidity through a network of cash-in/cash-out agents, and the need to overcome the large customer adoption barrier.

We believe an investor in BC would assess some additional risk to an investment in the Company based on the outlook for mobile banking services in emerging markets. We will reflect this additional risk in our determination of an appropriate rate of return later in this report.

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VALUATION METHODS

OVERVIEW

The appropriate application of a particular method of valuation in a given case is dependent upon the facts and circumstances surrounding the case. The factors applicable to a particular case that will impact the selection of the most appropriate method of valuation may include, but are not limited to the following:

- The purpose of the valuation;
- The existence or lack of adequate publicly traded comparable companies;
- The relative stability or irregularity of the historical earnings of the subject company;
- The premise of the valuation engagement (i.e., liquidation versus going concern).

In this valuation, we considered the use of the income, cost, and market approaches and corresponding methods in determining fair market value. Following is a general overview of the income, cost and market methods that we considered and the ones that we used. A detailed description of the application of the methods used to value the Company appears later in the report. While we considered various methods to value BC, we specifically used the discounted cash flows method.

INCOME APPROACH

The income approach is based upon the economic principle of "anticipation" (sometimes called the principle of "expectation"). In this approach, the value of the subject investment (i.e., the subject business interest) is the present value of the economic income expected to be generated by the investment. As the name of this economic principle implies, the investor "anticipates" the "expected" economic income to be earned from the investment. This expectation of prospective economic income is converted to a present worth – that is, the indicated value of the subject business interest.

There are numerous methods that make up the income approach, including capitalization of earnings, capitalization of dividends, capitalization of excess earnings, discounted future earnings, and discounted free cash flow. We used the discounted cash flows method for reasons that we will explain in the following section. A brief explanation of the various methods available within the income approach and how they are used to value a business follows.

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All capitalization methods estimate value by converting a company's estimated future income stream into value. This is accomplished through the application of an appropriate capitalization rate, which incorporates an investor's required rate of return based on perceived investment risk and a factor for expected growth in earnings. The result is that value is ultimately based on the present worth, today, of anticipated future benefits that the buyer will receive (in the form of earnings, cash flow, or dividends). Capitalization methods are most useful when economic income is stable and growing at an even rate. An offshoot of the Gordon-Shapiro dividend discount valuation model, the capitalization of an income stream is a "single period" valuation method that employs the following formula:

Formula For Use of

The Capitalized Future Income Method

$$PV = \sum_{i=1}^{n} \frac{E_i}{(k+1)^i}$$

Where:

PV = Present Value.

n = The last period for which economic income is expected.

E_i = Expected amount of economic income in the period immediately ahead.

k = Discount rate (required yield rate or total rate of return.)

i = The future periods over which economic income is expected to be received.

We did not use this method in our calculations because the Company's short-term growth is expected to be significantly different from its long-term sustainable growth.

Excess Earnings Method

The excess earnings ("formula method") method, as originally described in IRS Appeals and Review Memorandum 34 and updated by Revenue Ruling 68-609, is essentially a hybrid of the cost and income approaches. It involves the determination of earnings that are separately attributable to the tangible and intangible assets of a Company.

This method involves the following steps:

1. Multiplying the net tangible assets of the company by the rate of return such assets might reasonably be required to earn.

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2. Deducting this estimate of "tangible earnings" from total earnings, to derive the portion of earnings attributable to the intangible assets.

3. Dividing the earnings attributable to intangible assets by a capitalization rate appropriate for intangibles, to estimate the total value attributable to the intangibles.

4. Summing the value attributable to intangible assets and the value of the net tangible assets of the company to estimate an overall value.

This method is a way of estimating the intangible value of a business. The Internal Revenue Service has stated that this method should only be used when other better methods are not available. We did not use this method in our valuation of the Company, as more appropriate methods were available.

Discounted Future Income Methods

Discounted projected future income methods involve projecting possible future income streams (e.g., earnings, cash flow) on a year-by-year basis, usually for five or more years. Future income streams are then discounted at an appropriate discount rate (required rate of return on investment based on perceived investment risk) to a present value today. At the final projection year a "terminal value" is determined, representing an estimated value for all income streams occurring after the terminal period. The terminal value is then discounted (at the discount rate) to its present value today. The summation of the present value of the projected income streams and the terminal value yields a value estimate of the company.

When a "debt free" approach is employed, the income streams are discounted to present value at a "weighted average cost of capital," a measure incorporating the costs of debt and equity. The resulting value represents the value of the total capitalization of the company, including debt and equity. The total present value of debt is subtracted from this value in order to obtain the fair market value of equity in the company.

Shown below is the generalized formula for the discounted future income method. The formula shows the indicated value to be the sum of the present values of the annual income streams and the terminal value of the company:

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Formula for Use of
the Discounted Future Income Method

$$PV = \frac{E_1}{(1+k)} + \frac{E_2}{(1+k)^2} + ... + \frac{E_n}{(1+k)^n} + \frac{\frac{E_n(1+g)}{k-g}}{(1+k)^n}$$

Where:

$E_1 \ldots E_n$ = Expected amounts of economic income in each period E_1 through E_n

k = Discount Rate

n = Number of periods in the discrete projection period

g = Annually compounded growth rate in perpetuity for the prospective economic income, beyond the discrete projection period

If a company's earnings or cash flows are growing at a constant rate into perpetuity, the above method does not need to be used, as the formula is then mathematically equivalent to the results achieved by using the capitalization method discussed earlier. However, when a company is experiencing a normal near-term rate of growth that is above a sustainable long-term trend, or where there are cyclical or unusual near-term factors that are influencing results (which can be reasonably predicted), this method can more reliably capture the valuation impacts of the fluctuations than a capitalization method. Because management expects BC's short-term growth in cash flows to be significantly different than its long-term growth, we have used this method.

Indication of Value Using the Discounted Cash Flows Method

We used the discounted cash flows method to arrive at an opinion of value. The following sections detail how we used this method to value the Company including the expected future cash flows and the development of the discount rate used.

Estimated Future Cash Flows

Management provided forecasted revenues and expenses based on their future expectations. We calculated expected cash flows to invested capital based on management's projections and industry ratios. The expected cash flows to invested capital are as follows:

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Computation of Estimated Future Cash Flows to Invested Capital

	Future Periods Ending December 31,				
	2007	2008	2009	2010	2011
Earnings Before Interest, Taxes, Depreciation, and Amortization[1]	$(2,523,000)	$22,505,000	$159,612,000	$228,320,000	$323,436,000
Less Income Taxes[1]	817,000	(7,967,000)	(55,892,000)	(79,902,000)	(113,121,000)
After Tax Earnings to Invested Capital	(1,706,000)	14,538,000	103,720,000	148,418,000	210,315,000
Less Incremental Change in Working Capital[2]	(103,000)	(3,512,000)	(17,942,000)	(8,943,000)	(12,259,000)
Cash Flows to Invested Capital	**$(1,809,000)**	**$ 11,026,000**	**$ 85,778,000**	**$ 139,475,000**	**$ 198,056,000**

[1] *From management prepared forecast for the years ending December 31, 2007 through 2011.*

[2] *Based on the RMA industry average revenue to working capital ratio for SIC code 7371 and forecasted revenues.*

Derivation of Rate of Return

We used the "build-up" derivation of the "Capital Asset Pricing Model" (CAPM) in determining an appropriate discount and capitalization rates. Under the build-up method, the rate of return required by an investor for investing in a particular company is the sum of the "riskless" rate, a risk premium required by the market in general, an industry risk premium, a risk premium for small companies, and a risk premium for any additional risks inherent to the specific company. Rates for U.S. Treasury Bills, Notes, and Bonds are often used as proxies for the riskless rate. The greater the risk for a specific company, the greater the rate of return required to compensate an investor for incurring the risk. The result is a "discount rate" representing the annual investor-required rate of return, a measure of the cost of equity. The build-up method can be summarized by the following formula:

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Build-up Pricing Model	
	Riskless Rate
+	Equity Risk Premium for Investing in Large Public Company Stocks
+	Size Premium
+/-	Combined Industry and Specific Company Risk
=	**Discount Rate** (i.e., Cost of Equity)

This discount rate can then be used in several ways for valuation purposes:

ESTIMATING THE WEIGHTED AVERAGE COST OF CAPITAL – By weighting a company's relative cost of equity capital (using the fair market value of equity) and its relative after-tax cost of debt (using the fair market value of interest bearing debt), an overall "weighted average cost of capital" (WACC) can be determined. The WACC can then be used as the rate of return at which to discount projected future "debt free cash flows" (or earnings, if appropriate) to obtain a value for the total capitalization of the Company. This value includes debt and equity and is called "enterprise value."

DETERMINING CAPITALIZATION RATE TO BE APPLIED TO EARNINGS OR OTHER INCOME OR CASH FLOW MEASURES - Subtracting the long-term expected growth rate in earnings from the discount rate (cost of equity), yields and estimate of the rate at which to capitalize earnings. When the earnings are divided by the capitalization rate this results in an estimate of value.

Riskless Rate

Rates for U.S. Treasury Bills, Notes, and Bonds are often used as proxies for the riskless rate. According to the Federal Reserve Statistical Release dated June 19, 2006, the yield on actively traded long-term (20-year) U.S. Government Treasury Securities on June 16, 2006 was 5.31%.

Combined General Equity Risk Premium and Size Premium

According to the *Stocks, Bonds, Bills and Inflation 2006 Yearbook* ("SBBI"), published by Ibbotson Associates, over the 1926-2005 time frame, small company stocks (smallest 20% of NYSE, AMEX, and NASDAQ companies) returned an average annual amount of 24.87% (dividends and capital appreciation), or 19.65% above the annual income returns on long-term U.S. Treasury Coupon Bonds over the same period. This 19.65% consists of both the general equity risk premium of 7.10% (Ibbotson's Equity Risk Premium for the NYSE, AMEX, and NASDAQ top 20% of companies) and the size

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premium of 12.55%. Investors expect an additional return on investments in smaller companies, as discussed earlier in this report.

Specific Company Risk Premium

In some cases, it may be appropriate to add or subtract an additional risk premium for company specific risk, representing the positive or negative risk other than the general equity risk premium, and size premium. In this instance we added a company-specific risk premium. We based the additional adjustment, in part, on the factors summarized in the "summary of key valuation factors" section of this report and other factors discussed throughout this report. We also considered the annual rates of return required by venture capital investors in start-up stage companies as a reasonableness check on our resulting discount rate.

The purpose of the specific company risk premium analysis is to quantify the risk associated with achieving management's forecast. When an established company has a history of producing forecasts, we are able to compare management's historical forecasts to actual results achieved to assess management's forecasting prowess. However, because BC is a start-up company with no history of operations and is participating in the pioneering stage of the mCommerce industry, we are unable to make such a comparison. In addition, because the mCommerce industry is not yet fully developed, there is uncertainty as to the industry's ultimate future growth. As such, we believe the risk of BC's projected cash flows not materializing as expected is high. Accordingly, we added a company specific risk premium of 70%.

Final Summarizing to Reach a Discount Rate

The riskless rate and various premia are now summed to develop a discount rate, as shown below:

Development of Equity Discount Rate
As of June 16, 2006

Riskless Rate	5.31%
Plus General Equity Risk Premium	7.10%
Plus Small Stock Premium	12.55%
Plus Combined Industry and Company Specific Risk Premium	65.00%
Equals the Cost of Equity	**89.96%**

The greater the risk for a specific asset the greater the rate of return required to compensate an investor for incurring the risk. The result is a "discount rate" representing the annual investor required rate of return, a measure of the cost of equity. We considered the characteristics of BC (dis-

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cussed previously), and where a hypothetical buyer would most likely assess the Company in terms of risk relative to other investment vehicles. The following table summarizes the spectrum of the rates of return of various types of investments.

Investment Spectrum Annual Rates of Return
Development of Contract Discount Rate

Investment Type	Annual Return
Long-Term (20-year Maturity) Treasury Coupon Yield[1]	5.3%
Long-Term Corporate Bonds Arithmetic Mean Return[2]	6.2%
Largest Decile Arithmetic Mean Return[3]	11.3%
Real Estate Investment Trusts (REITs)[4]	13.8%
Smallest Decile Arithmetic Mean Return[5]	21.6%
Venture Capital - Second Stage / Expansion[6]	20% - 40%
Venture Capital - First Stage / Early Development[6]	40% - 60%
Venture Capital - Start-Up[6]	50% - 100%

[1] *Federal Reserve Statistical Release dated June 19, 2006.*

[2] *Reflects the mean return for long-term corporate bonds from 1926 through 2005 reported by Stocks, Bonds, Bills & Inflation, 2006 Yearbook, published by Ibbotson Associates.*

[3] *Reflects the mean return for the largest decile portfolio from 1926 through 2005 reported by Stocks, Bonds, Bills & Inflation, 2006 Yearbook, published by Ibbotson Associates.*

[4] *Reflects the compound annual return for REITs from 1975 to 2005 reported by National Association of Real Estate Investment Trusts.*

[5] *Reflects the mean return for the smallest decile portfolio (market capitalization less than $265 million) from 1926 through 2005 reported by Stocks, Bonds, Bills & Inflation, 2006 Yearbook, published by Ibbotson Associates.*

[6] *Timmons, Jeffrey A., New Venture Creation, 5th Edition, (Chicago: Irwin, 1999).*

As of the date of valuation, BC appears to be in the start-up stage of its development. In the start-up stage, the feasibility of the idea has been proven and capital has been raised from private investors (angels) who specialize in preliminary investments and/or from entities who invest in companies in their early phases. At this stage, the money is applied toward recruiting a broader management team and employees, completing the business plan, and finalizing the prototype for production or launch of version 1.0.

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As indicated in the table above, expected annual returns for companies in the start up stage of development ranges from 50% to 100%. After consideration of all relevant factors, we believe a cost of equity of 91.44% is reasonable for BC.

The above discount rate represents the cost of the Company's equity. We weighted the cost of equity with the cost of debt in order to determine the weighted average cost of the Company's invested capital. The following table demonstrates the computation of the weighted average cost of capital:

Development of the Weighted Average Cost of Capital
As of June 16, 2006

Cost of Debt - Tax Effected	0.00%	Multiply by Weight	0%	Equals	0.00%
Cost of Equity	89.96% [2]	Multiply by Weight	100% [1]	Equals	89.96%
Weighted Average Cost of Capital Discount Rate			**100%**		**89.96%**

[1] *Weighting based on actual capital structure as of June 16, 2006.*
[2] *From the "Development of Equity Discount Rate" table.*

Terminal Value Capitalization Rate

The capitalization rate is based on the previously determined discount rate, less a long-term sustainable annual growth rate of 3%. The long-term growth rate of the industry is closely tied to the overall macro-economic growth rate of the economy. In the near term, growth in earnings may continue to be enhanced at a faster rate. When the long-term growth rate is subtracted from the discount rate, a capitalization rate results as follows:

Development of the Capitalization Rate
As of June 16, 2006

Discount Rate	89.96%
Less the Long-Term Sustainable Annual Growth Rate	-3.00%
Equals the Capitalization Rate Applicable to Future Cash Flow	**86.96%**
Rounded	**87.00%**

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Using BC's estimated future cash flows as computed previously and the discount rate of 91.44%, we calculated the preliminary value of an equity interest in BC as follows:

Discounted Cash Flows Method
As of June 16, 2006

Future Period Ending	Future Cash Flows	Discount Factor[1] at 90%	Present Value
2007	$ (1,809,000)	0.7255	$ (1,312,387)
2008	11,026,000	0.3818	4,210,053
2009	85,778,000	0.2010	17,238,200
2010	139,475,000	0.1058	14,752,267
2011	198,056,000	0.0557	11,025,462
Terminal Value	234,480,092	0.0557	13,053,133
Indication of Enterprise Value			58,966,728
Less Interest Bearing Debt[2]			-
Indication of the Value of Operating Equity			**$ 58,966,728**
Rounded			**$ 58,967,000**

[1] *Discount factor based on a half-year convention, which assumes cash flows are received throughout the year rather than at the end of the year.*

[2] *From internally prepared financial statements as of June 16, 2006.*

Derivation of Terminal Value

It is impractical to estimate future cash flows into perpetuity and the longer the time period of the estimates the more difficult it becomes to estimate cash flows accurately. For these reasons the DCF method estimates cash flows for a finite number of years and then capitalizes the subsequent period cash flow. The capitalization of the subsequent period cash flow is called the terminal value. We computed the terminal value as follows:

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Terminal Value
As of June 16, 2006

Cash Flow, 2011	**$ 198,056,000**
Multiply by Long-Term Growth Factor	1.03
Expected Cash Flow, 2012	$ 203,997,680
Divide by Terminal Value Capitalization Rate	87%
Terminal Value	**$ 234,480,092**

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The market approach is based on the economic principle of efficient markets. The market approach estimates a value by comparing the subject business interest to comparative business interest that have been sold in an established market place.

There are numerous methods within the market approach, including the identification and analysis of comparable publicly-traded companies whose securities sell on a free and open market, definitive and verifiable transaction data available on actual sales of similar privately held concerns, actual or potential markets for a security such as buy/sell or shareholder agreements, and past transactions in the shares of the Company itself.

Search for Private Company ("Guideline") Comparables

We searched private transaction databases to find comparable closely held companies that have sold in the private market. These databases included:

Bizcomps - This database provides information on over 10,000 small business sales over the past ten years. A "small business" is defined as one that was sold for less than five million dollars. Additionally, more than half of the transactions involve entities with less than $500,000 in annual gross revenue. The study includes data provided by business brokers with direct knowledge of the transactions.

Mid Market Comps - Published by ValuSource, this database provides information on over 7,100 mid-level companies sold over the past ten years. The sales prices for these transactions range from one million dollars to $250 million with more than one-half of the transactions occurring below ten million dollars. The information is compiled from data provided by business brokers with knowledge of the transactions.

Pratt's Stats - Published by Business Valuation Resources, LLC, this database includes transaction information on more than 8,600 private and closely held companies from 1990 to the present. The sales prices for these transactions range from less than one million dollars to more than one billion dollars.

IBA - Published by the Institute of Business Appraisers ("IBA"), this database includes information on more than 33,000 closely held business transactions, gathered from IBA members.

The following chart shows the selection criteria for sales of privately held companies:

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Private Company Comparable Selection Criteria
- Revenues not greater than 25 times the size of the subject company; - Sales occurring within five years of the valuation date; - Same or similar line of business; and, - Not in financial distress.

The transactions in the various databases generally involve privately held businesses where a controlling interest (usually 100%) has been transferred. One difficulty with using the information is that we do not know the motivations of either the buyer or the seller. We do not know if the buyer had synergies or economies of scale to gain from the transaction, nor do we know if the seller was in distress or in a "fire" sale situation. In addition, the transactions in the databases may be somewhat dated.

Based on the lack of insight into the specific assets and operations of the companies included in the private company transaction databases, as well as the uncertainty of future revenues and earnings of the subject company, we believe that the private company comparable method does not result in a meaningful value conclusion. Consequently, we did not utilize the private company transaction method.

Search for Public Company ("Guideline") Comparables

When valuing the shares of a closely held company, since no market exists, an alternative is to seek guidance from the prices investors are willing to pay for securities of similar companies that are publicly traded. Revenue Ruling 59-60 suggests that the valuation of an investment interest in a closely held security should be based on, or at least considered to be based on, trading prices of public traded securities of "comparable" companies that are engaged in the same or similar lines of business.

There is an inherent difference between closely held companies and publicly traded companies. Closely held companies are often managed directly by their shareholders whereas publicly traded companies are usually not. A primary goal of management of a public company is to maximize the wealth of the company's shareholders through the payment of dividends or through capital appreciation. Earnings per share is a commonly used standard by which to evaluate the success of a public company's management. The owner/operators of private companies, however, can often maximize their benefits through salaries and other perquisites without regard to earnings, although earnings are still important to bankers, outside shareholders, and other third parties.

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While RR 59-60 suggests the consideration of comparable companies, it does not clearly define "comparable." However, over the years, the valuation profession has defined several aspects of a publicly traded security that must exist before the security can be reasonably considered to be comparable to the closely held security. These factors include:

- companies are in the same or similar line of business.
- companies have similar competitive positions within the industry.
- companies have similar historical rates of growth.
- companies have similar historical and current levels of profitability.
- companies have similar capital structures.
- companies have similar product lines.
- companies are of similar size, relative to sales volume and total assets.

During the course of this engagement we analyzed the EDGAR database from the Securities and Exchange Commission, and other sources in order to attempt to locate guideline companies. These sources provide information related to publicly traded companies, including but not limited to:

- Standard Industrial Classification Code (SIC)
- Name of the enterprise
- Exchange in which the security is traded
- Historical beta
- Total market capitalization
- Common equity
- Preferred equity
- Amount of deferred tax and credits
- Amount of other liabilities
- Amount of long-term debt
- Amount of current liabilities
- Amount of total assets
- Amount of total net sales
- Earnings growth
- Return on equity (ROE)

We searched for possible comparable public companies in the same or similar line of business as the Company. The purpose of this analysis was to determine their validity as possible comparables along the following criteria:

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Public Company Comparable Selection Criteria
- Freely and actively traded shares on the over-the-counter or national exchanges; - Reasonably comparable capital structure; - Same or similar line of business; and, - Not in financial distress.

Resources used to identify guideline companies included SIC and NAICS codes, the Directory of Companies Required To File With The Securities & Exchange Commission, Hoover's On-Line survey and other on-line searches via the Internet and the SEC EDGAR database. We reviewed a number of companies to determine if any of them were reasonably similar and met initial selection criteria. Based on the aforementioned criteria, we identified potential guideline companies that are classified under one of the following SIC codes:

Peer Industry	
SIC Code	Description
7371	Computer programming services, computer programs or systems software development, custom
6794	Patent owners and lessors, copyright buying and licensing, patent buying and licensing

After a closer analysis, we determined that the differences between the potential public companies and the subject company were too significant to use them as guideline companies under the market approach. The public companies are more diverse in their product offerings, and have considerable differences with BC in terms of size, access to capital markets, management depth, name recognition, and established customers and markets.

Additionally, the potential guideline companies we found have products with proven technology and have achieved commercialization with some if not all of their products. BC is considered a "start-up" company, and as of the date of valuation, did not have any reported revenues nor was there a licensing agreement in place, and had not yet achieved commercialization of its technology. Therefore, the potential guideline companies did not provide a meaningful comparison for valuation purposes.

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We also looked at acquisition data reported in the Control Premium Study published by FactSet MergerStat, LLC for target companies that were categorized under either of the above indicated SIC codes. The acquisitions we found are as follows:

Control Premium Study

SIC	Target Name	Acquisition Date	Price ($ Millions)	Price to Revenue	Price to Earnings	Target Invested Capital/EBIT	Target Invested Capital/EBITDA
7371	Segue Software, Inc.	4/20/2006	$ 89.80	2.60	29.20	32.00	27.90
7371	PinkRoccade NV	3/23/2005	$ 445.50	0.50	41.10	31.60	11.10
7371	Corio, Inc.	3/16/2005	$ 183.60	2.60	(12.30)	(13.30)	(42.60)
7371	Delta Singular SA	4/8/2005	$ 277.70	12.80	(38.00)	(37.10)	(58.70)
7371	Datamat SpA	10/5/2005	$ 173.70	521.90	(1,022.00)	(2,528.00)	(5,294.30)
7371	HTE Inc	3/17/2003	$ 111.30	1.60	16.80	11.00	7.70
7371	PSB AG	3/25/2003	$ 14.80	0.20	16.80	12.40	6.50
7371	Rolfe & Nolan PLC	3/7/2003	$ 24.20	0.60	(2.90)	(4.20)	(6.90)
7371	Proval	4/14/2003	$ 6.80	0.70	11.80	9.20	NA
7371	Eyretel Plc	4/23/2003	$ 60.20	0.80	53.90	57.20	18.10
7371	Virage	9/3/2003	$ 23.40	1.80	(1.30)	(1.30)	(1.50)
7371	TDS Informationstechnologie AG	8/14/2003	$ 19.00	1.10	1,791.00	45.30	9.30
7371	MIS AG	12/23/2003	$ 37.30	0.70	(2.80)	(2.90)	(4.10)
7371	Data Return Corp	1/9/2002	$ 66.10	1.20	(1.20)	(1.90)	(2.90)
7371	SoftQuad Software Ltd	3/19/2002	$ 11.60	2.10	(0.80)	(0.80)	(0.90)
7371	Poet Holdings, Inc.	3/26/2004	$ 28.80	432.00	(6.00)	(6.00)	(6.90)
7371	American Management Systems, Inc.	4/30/2004	$ 826.90	0.90	48.10	352.50	19.00
7371	Ubizen NV	5/24/2004	$ 70.90	1.00	(1.30)	(1.40)	NA
7371	Basis 100 Inc	9/9/2004	$ 30.20	1.50	(6.30)	(38.50)	18.20
7371	SciQuest, Inc.	7/28/2004	$ 24.00	3.60	(1.40)	(1.60)	(2.40)
7371	Netegrity Inc	11/24/2004	$ 431.90	4.80	68.00	61.80	37.00
7371	SNetSolve Inc	11/19/2004	$ 128.50	3.00	(160.40)	(111.70)	67.60
7371	Diamond Computer Service Co ltd	12/22/2004	$ 255.00	0.80	22.40	14.90	8.80
7371	Optims SA	11/22/2004	$ 13.90	1.20	32.00	97.40	18.00
			Median:	**1.35**	**(1.00)**	**(1.05)**	**7.10**

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Control Premium Study

SIC	Target Name	Acquisition Date	Price ($ Millions)	Price to Revenue	Price to Earnings	Target Invested Capital/EBIT	Target Invested Capital/EBITDA
6794	InterTrust Technologies Corp	1/3/2003	$ 417.70	35.60	(23.60)	NMF	NMF
6794	Refac Inc.	2/28/2003	$ 13.70	1.20	(3.00)	NMF	NMF
6794	Dwyer Group	10/30/2003	$ 48.60	1.90	16.50	NMF	NMF
6794	Blimpie International	1/24/2002	$ 25.70	0.90	76.80	NMF	NMF
			Median:	**1.55**	**6.75**	**NMF**	**NMF**

NMF - No Material Figure

We were not able to use the above acquisition data for valuation purposes for the same reasons we did not use the publicly traded guideline company method. Therefore, we did not utilize the market approach for the valuation of BC.

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COST APPROACH

The cost approach (or asset-based approach) is based on the economic principle of substitution. When properly applied, cost approach methods are some of the more complex and rigorous valuation analyses.

However, the theoretical underpinning of this approach is simple: the value of the business enterprise is the value of all of the subject business assets (both tangible and intangible) less the value of all of the subject business liabilities (both recorded and contingent). Basically, this approach recognizes that all of the economic value of a business comes from, and can be identified with, the productive assets of the business.

The cost approach involves adjusting the Company's individual assets and liabilities up or down to reflect their fair market value, taking into account tangible and intangible assets and any contingent liabilities. Tangible assets can be easily appraised and their actual balance sheet values adjusted to reflect the results accordingly. However, it can be difficult to individually quantify the fair market value of intangible assets such as the name, reputation, trained workforce, and other factors. As such, the cost approach generally is less preferred when valuing a start-up company with an asset base composed primarily of intangible assets.

Cost Method Considered

Adjusted Net Assets – The adjusted net assets method is an asset-based method. It is used to value a business based on the fair market value of the underlying assets and liabilities. Using this method, the valuator adjusts the book value of the company's assets and liabilities to their fair market values. Both tangible and intangible assets and liabilities are adjusted as needed. Appropriate valuation adjustments are applied to the "net assets" to arrive at final indication of value.

This method of valuation is most appropriately applied in situations where the subject company is an investment company, a holding company, or a company that is marginally profitable. In addition, this method can be used when a significant portion of the company's assets is composed of liquid assets or other investments (such as real estate investments).

We were not made aware of any current or future plans to pursue a course of liquidation.

CONCLUSION

Based on our consideration of all relevant factors, the fair market value of a 100% equity interest in Banana Corporation as of June 16, 2006 is $58,967,000.

We have no present or contemplated financial interest in Banana Corporation. Our fees for this valuation are based upon hourly billing rates, and are in no way contingent upon the results of our find-

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ings. We have no responsibility to update this report for events and circumstances occurring subsequent to the date of this report, although we will be pleased to perform an update valuation should you require one.

This valuation was performed to determine the fair market value of the Company and is intended for no other purpose. This letter and report are to be distributed only in their entirety, and are intended and restricted for use by the management of Banana Corporation and their representatives. This report is not to be copied or made available to any persons without the express written consent of Brueggeman and Johnson Yeanoplos, P.C.

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APPENDIX 1

CERTIFICATION

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We certify that, to the best of our knowledge and belief:

1. The statements of fact contained in this appraisal report are true and correct.

2. The reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and is our personal, impartial, and unbiased professional analyses, opinions, and conclusions.

3. We have no present or prospective interest in the property that is the subject of this report, and we have no personal interest with respect to the parties involved.

4. We have no bias with respect to the property that is the subject of this report or to the parties involved with this assignment.

5. Our engagement in this assignment was not contingent upon developing or reporting predetermined results.

6. Our compensation for completing this assignment is not contingent upon the development or reporting of a predetermined value or direction in value that favors the cause of the client, the amount of the value opinion, the attainment of a stipulated result, or the occurrence of a subsequent event directly related to the intended use of this appraisal.

7. The economic and industry data included in the valuation report have been obtained from various printed or electronic reference sources that the valuation analyst believes to be reliable. The valuation analyst has not performed any corroborating procedures to substantiate that data.

8. Our analyses, opinions, conclusions (valuation engagement) and this report has been prepared in conformity with the American Institute of Certified Public Accountants Statement on Standards for Valuation Services No. 1 and the 2008-2009 Uniform Standards of Professional Appraisal Practice standards for conducting and reporting on business valuations.

9. The parties for which the information and use of the valuation report is restricted are identified; the valuation report is not intended to be and should not be used by anyone other than such parties.

10. The valuation analyst has no obligation to update the report or the opinion of value for information that comes to our attention after the date of the report.

11. This report and analysis were prepared under the direction of Kevin R. Yeanoplos, CPA/ABV/CFF, ASA with significant professional assistance from John M. Martin. Kevin R. Yeanoplos, CPA/ABV/CFF, ASA is a Certified Public Accountant licensed in the state of Arizona and is

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accredited in business valuation by the American Institute of Certified Public Accountants. He is also an accredited senior appraiser with the American Society of Appraisers, a certified business appraiser with The Institute of Business Appraisers and a certified valuation analyst with the National Association of Certified Valuation Analysts.

12. The American Society of Appraisers has a mandatory recertification program for its Senior Members. Appraisers are in compliance with that program.

13. No one provided significant professional assistance to the persons signing this report.

Kevin R. Yeanoplos, CPA/ABV/CFF, ASA

John M. Martin
July 24, 2009

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APPENDIX 2

CURRICULA VITAE

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CURRICULUM VITAE

KEVIN R. YEANOPLOS, CPA/ABV/CFF, ASA

Certified Public Accountant
Accredited in Business Valuation
Certified in Financial Forensics
Accredited Senior Appraiser

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PROFESSIONAL HISTORY

Prior

Yeanoplos Drysdale Group, PLLC
Valuation Advisors
Tucson, Arizona
Managing Member

Beacon Valuation Group, Ltd
Valuation Advisors
Tucson, Arizona
President

Moran, Quick & Yeanoplos, PLLC
Certified Public Accountants and Consultants
Tucson, Arizona
Managing Partner

Black, Green, Yeanoplos & Co., P.C.
Certified Public Accountants and Consultants
Salt Lake City, Utah
President & Director of Consulting Services

YES Financial Consultants
Certified Public Accountants & Consultants
Salt Lake City, Utah
President & Director of Consulting Services

Intermountain Power Agency
Public Utility
Murray, Utah
Internal Auditor

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RECENT PROFESSIONAL HISTORY (CONTINUED)

Huber, Erickson & Bowman
Certified Public Accountants
Salt Lake City, Utah
Manager of Accounting Services

Peat, Marwick, Mitchell & Co.
Certified Public Accountants
Salt Lake City, Utah
Senior Auditor

AREAS OF SPECIAL COMPETENCE

Valuation of over 900 closely held businesses across the U.S. and internationally, including construction companies, automobile dealers, professional practices and other
Litigation support services, business valuations, economic damages and analysis, reasonable compensation
Provided expert testimony in Utah, Arizona, Colorado, Pennsylvania, Florida, Illinois, Washington, Tennessee
Court appointed expert on business valuation
Economic, financial, operational and management consulting for small to medium sized businesses
Excess compensation analysis
Healthcare consulting
General business consulting

MAJOR PROJECTS

Business valuation engagements including financial analyses and management evaluation.
Development of franchise valuation model, utilizing franchise specific factor matrix.
Analysis of medical practice acquisitions relative to private inurement and anti-kickback issues.
Preparation of capital and operating budgets, cash flow analyses and return on investment computations for ongoing businesses as well as proposed, ongoing and/or distressed businesses.
Strategic short- and long-term business and financial planning for various business organizations.

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MAJOR PROJECTS - CONT.

Numerous operational reviews of professional practices and businesses, including evaluation of organizational structure, financial controls and both formal and informal management information systems.

PROFESSIONAL ACTIVITIES

Lecturer and instructor for professional organizations (AICPA, ASA, NACVA, UACPA, ISCPA, etc.) throughout the United States on the topic of Business Valuations.

Former Associate Editor of the quarterly *Valuation Examiner*, National Association of Certified Valuation Analysts

Editorial Advisory Board for the *Journal of Accountancy*

Guest panelist for the H.N. and Frances C. Berger Entrepreneurship Program, Eller College of Business and Public Administration, The University of Arizona

Guest lecturer for Thunderbird American Graduate School of Management, Glendale AZ.

AICPA Business Valuation Volunteer of the Year 2006

ASCPA Special Award for Dedication to the BV Section 2007

SPECIALIZED TRAINING

American Society of Appraisers, Principles of Valuation

American Institute of Certified Public Accountants, Business Valuation Certificate of Educational Achievement

American Institute of Certified Public Accountants, Annual National Business Valuation Conferences

Illinois CPA Society, Annual Business Valuation Symposium

Various other relevant training and readings in the area of business valuation

American Arbitration Association, Commercial Arbitrator Training Workshop I and II

Collaborative Divorce Team Training

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COMMUNITY INVOLVEMENT

Sertoma Club, Charter Member Midvale, Utah Chapter
Former President, United Cerebral Palsy of Utah Housing Corporation
Former Member Finance Committee, Make-A-Wish Foundation of Utah
Former National Treasurer, The Bridge Foundation
Former Member Finance Committee, Ronald McDonald House
Former Chairman, Treasurer, Fort Lowell Shootout
Former Advisor, Women's Sports Foundation - Tucson Chapter
Former Board Member, Desert Dove Farm, Inc.

PROFESSIONAL & BUSINESS ASSOCIATIONS

Licensed to practice in Utah, Arizona, Washington.

- American Institute of Certified Public Accountants
  - Member of Consulting Services Division
  - Member Virtual Grassroots Panel
  - Past Member CS Member Development and Communications Subcommittee
  - Past Member CS Business Valuations and Appraisals Committee
  - Past Member ABV Exam Writing Subcommittee
  - Chair, ABV Credential Committee
  - Chair, 2000 National Bus. Val. Conference
- American Association of Franchises and Dealers
  - Past Chairman, FinancialLine Steering Committee
  - Past Secretary, Trade Association Council
  - Past Member Fair Franchising Standards Committee
  - Past Member National Franchisee Training Initiative
- Past Member Institute of Valuation Advisors
- Past Member The ESOP Association
- The National Center For Employee Ownership
- Past Member Salt Lake Estate Planning Council
- Past Member Southern Arizona Estate Planning Council
- Past Member Institute of Business Appraisers
- American Society of Appraisers
  - Past Secretary/Treasurer, Salt Lake Chapter
  - Past Secretary/Treasurer, Tucson Chapter
  - Past President, Tucson Chapter
  - International Board of Examiners
  - Education Task Force
- National Association of Certified Valuation Analysts
  - Past Member Standards Committee
  - Past Member CVA Grading Team
  - Past Vice-President and Executive Board member
  - Past Advisory Board member
  - Past Member Business Valuation Research Institute

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PROFESSIONAL & BUSINESS ASSOCIATIONS – CONT.

- Utah Association of Certified Public Accountants
  - Past Secretary, Litigation Support Committee
  - Founding Chairman, Business Valuation Committee
- Arizona Society of Certified Public Accountants
  - Past Member Litigation Support Committee
  - Two-time Chairman, Business Valuation Committee
  - Past Secretary, Treasurer, Southern Chapter
- Illinois Society of Certified Public Accountants
  - Past Member Litigation Support Committee
- Salt Lake Area Chamber of Commerce
  - Past Member Business Education Partnership Committee
  - Past Member Business to Business Roundtable
- Tucson Metropolitan Chamber of Commerce
  - Past Member, Business Development Committee
- Financial Consulting Group
  - Past Team Leader, Franchise Industry
  - Member Advisory Board
- Past Member Utah Restaurant Association
- International Who's Who of Professionals
- Graduate of Greater Tucson Leadership '99
- American Arbitration Association Commercial Panel
- The Best Lawyers of America Directory of Expert Witnesses
- Past Member Arizona Association of Business Brokers
- Medical Group Management Association
- Arizona Medical Group Management Association

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SELECTED INVOLVEMENT IN PROFESSIONAL PUBLICATIONS AND PRESENTATIONS

1) Using Valuation Master 4.0, text for Certified Professional Education (CPE) Seminars; Black Green, Yeanoplos & Co., P.C., 1994.
2) Business Valuations: Fundamentals and Techniques, text for CPE Seminars, primary author, Black, Green, Yeanoplos & Co., P.C., 1994.
3) Business Valuations: Case Analysis, text for CPE Seminars, co-author, Black, Green, Yeanoplos & Co., P.C., 1994.
4) Fundamentals of Finance and Accounting, text for CPE Seminars, Black, Green, Yeanoplos & Co., P.C., 1994.
5) So You Need and Expert Witness?, article for Viewpoint on Value, Practice Development Institute, 1995.
6) What Does Federal Rule # 26 Mean For You?, Presentation given at National Association of Certified Valuation Analysts Spring 1995 Semi-Annual Conference.
7) Business Valuation: Opportunities for Success, Presentation given at the Utah Association of CPA's Update '95 Conference.
8) Business Valuation: An Advanced Case Study, Presentation given at the Utah Association of CPA's Update '95 Conference.
9) Estate Valuation: Voo Doo Economics?, Presentation given for Lorman Education Services, Inc., 1996.
10) Working Without a Net: The Case for Engagement Letters, Presentation given at American Institute of Certified Public Accountants 1996 National Business Valuations Conference.
11) What is Value?, Presentation given for Security Financial Group, 1996.
12) The Basics of Business Valuation., Presentation given at Westminster College's 20th Annual Tax Practitioners' Institute, 1996.
13) Information Sources for Litigation Support: The Where's and Why's, Presentation given at the Utah Association of CPA's 1996 Summer Update.
14) Selecting the Best Equity Structure, Presentation given at American Association of Franchises and Dealers 1996 Annual Meeting and Convention.
15) Show Me the Money! How to Manage a Competitive Franchise Without Exhausting Your Profits, Presentation given at the Association of Meineke Dealers 1997 Annual Conference.
16) Practical Tips to Maximize Your Profits, Presentation given at American Association of Franchises and Dealers 1997 Annual Meeting and Convention.
17) Overview of the AICPA Business Valuation CEA Program, Article written for *The Journal Entry*, monthly newsletter of the Utah Association of CPA's.
18) Accredited Business Valuator Examination Review Course; First Edition, CPE Seminar, co-author, written for the Utah Association of CPA's, 1997.
19) *Upstart Guide to Evaluating, Buying, and Growing a Franchise*, co-author, written for the Association of Small Business Development Centers, 1997.
20) Selected Tax Aspects of Estate Planning, Presentation given for Lorman Education Services, Inc., 1997.

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SELECTED INVOLVEMENT IN PROFESSIONAL PUBLICATIONS AND PRESENTATIONS (CONTINUED)

21) What are the Costs of Being a Franchise?, Presentation given for the Association of Small Business Development Centers, 1997.
22) Valuation Discounts and Family Limited Partnerships: FliP's or Flops?, Presentation given for the Utah Association of CPA's, 1997.
23) Valuation Discounts and Family Limited Partnerships: FliP's or Flops?, Presentation given for the CPA/Law Forum, Tucson, Arizona, 1997.
24) Considerations for the Appraisal of Donated Property, Presentation given for the American Society of Appraisers, Tucson Chapter, 1997.
25) The Basics of Business Valuation, Presentation given for the Arizona's Women's Society of Certified Public Accountants, 1998.
26) Breaking Up is Hard to Do! The Taxing Financial Aspects of Marital Dissolutions, Presentation given to the Utah State Bar Association Family Law Section, 1998.
27) Valuation Adjustments and Family Limited Partnerships, Presentation given at Bank of America, Phoenix, Arizona, 1998.
28) Seeing Litigation Through Rose-Colored Eyeshades – Effective Utilization of the CPA, Presentation given at State Bar of Arizona, Family Law Section, Tucson, Arizona, 1998.
29) Preparing for the 1998 Accredited Business Valuator Examination Review Course, CPE seminar, co-author, written for the American Institute of CPA's, 1998.
30) Cases, Places, Faces and All That Jazz! Presentation given to the Utah Association of CPA's Annual Business Valuation Symposium, 1998
31) "The Price is Right" – Developing Valuation Opportunities, Presentation given to Utah Association of CPA's Annual Tax Symposium, 1998.
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33) International Business Valuations: Overview and Methodologies, AICPA Co-Author, 1998.
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100) Feelin' Hot, Hot, Hot - Exploring Hot Button Issues, Presentation given at the Washington Society of CPAs Business Valuation and Litigation Support Seminar, October 2006.
101) The Qualified Appraiser, Presentation given at the Tax Study Group, Tucson, Arizona, January 19, 2007.
102) The Qualified Appraiser, Presentation given at to the Tucson Chapter of the ASA, March 19, 2007.
103) Where There's Smoke....., Presentation given to the AWSCPA Tucson Chapter, May 23, 2007.
104) Valuing Auto Dealerships, Teleconference presented for BV Resources, LLC., October 2007.
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Selected Courses Instructed

1) Business Valuations: Fundamental, Techniques & Theory, National Association of Certified Valuation Analysts.
2) Business Valuations: Case Analysis Series #1 and Report Writing, National Association of Certified Valuation Analysts.
3) Using Valuation Master 4.0, National Association of Certified Valuation Analysts.
4) Introduction to the Valuation of Businesses & Professional Practices, American Institute of CPA's.
5) An Engagement Approach to Researching, Evaluating & Understanding the Company, American Institute of CPA's.
6) Data Research & the Market Approach to Valuation, American Institute of CPA's.
7) The Income Approach & Asset Based Approach to Valuation, American Institute of CPA's.
8) Special Issues in Business Valuation, American Institute of CPA's.
9) Valuations and Transfers: A Case Study, American Institute of CPA's.
10) The CPA-Valuator-Expert Witness, American Institute of CPA's.
11) A Practical Approach to Valuation Report Writing, American Institute of CPA's.
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24) Advanced Computing the Cost of Capital, American Institute of CPA's.
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30) Valuation Introduction, Research and Analysis, and the Asset Approach, American Institute of CPA's.
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37) Valuing Goodwill and Intangible Assets, American Institute of CPA's.

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Selected Courses Instructed (continued)

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40) Fundamentals of Business Valuation: Business Valuation School, American Institute of CPA's.

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Option One Mortgage Company
Critical Assets
Irvine, California
Senior Securitization Portfolio Manager

ACC Capital Holdings Corporation
Treasury Analysis
Orange, California
Senior Financial Modeling Analyst

Countrywide Financial Corporation
Valuations and Analysis
Calabasas, California
Portfolio Analyst

AREAS OF SPECIAL COMPETENCE

Business valuation engagements for:

> Financial Reporting (FAS 141 and 142)
> Employee Stock Ownership Plans
> Mergers & Acquisitions
> Gift and Estate Tax
> Patent and Other Intangible Asset Valuations
> Litigation

Businesses valued include:

> Medical/Veterinary Practices
> Professional Practices
> Automotive Dealerships
> Manufacturing Companies
> Construction Companies
> Retail Establishments

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> Valuation of Mortgage Servicing Rights and other financial assets related to the mortgage banking industry.

MAJOR PROJECTS

Design and implementation of various financial models, data management systems, and analysis methodologies for financial asset valuations in the mortgage banking industry including:

- Sensitivity analyses to portfolio composition changes, assumption changes, collateral performance, and market factors.
- Prepayment and delinquency/foreclosure analysis and tracking methodology.
- Methodology for conducting research of market factors for assumption validation and refinement.
- Methodology for conducting research of internal servicing economics for assumption validation and refinement.

Implementation of Mortgage Industry Advisory Corporation valuation software for the valuation of a mortgage servicing rights portfolio in excess of 400,000 loans.

Provide monthly production and quarterly portfolio market valuations for financial reporting purposes. Conduct economic valuations to determine portfolio profitability.

Provide quarterly reporting and analysis package to senior management including portfolio structure and strategy recommendations.

EDUCATION

Master of Science in Management with a concentration in Finance
The University of Arizona, Tucson, Arizona

Bachelor of Science in Business Administration (Finance Major)
The University of Arizona, Tucson, Arizona

Working towards Chartered Financial Analyst (CFA) designation.
Passed Level I exam in December 2006.
Passed Level II exam in June 2008.

2008 AICPA National Business Valuation School
Phoenix, Arizona (July 14 - 18, 2008)

PROFESSIONAL & BUSINESS ASSOCIATIONS

- CFA Society of Tucson
- Financial Consulting Group

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APPENDIX 3

DEFINITIONS

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INTERNATIONAL GLOSSARY OF BUSINESS VALUATION TERMS

To enhance and sustain the quality of business valuations for the benefit of the profession and its clientele, the below identified societies and organizations have adopted the definitions for the terms included in this glossary.

The performance of business valuation services requires a high degree of skill and imposes upon the valuation professional a duty to communicate the valuation process and conclusion, in a manner that is clear and not misleading. This duty is advanced through the use of terms whose meanings are clearly established and consistently applied throughout the profession.

If, in the opinion of the business valuation professional, one or more of these terms needs to be used in a manner that materially departs from the enclosed definitions, it is recommended that the term be defined as used within that valuation engagement.

This glossary has been developed to provide guidance to business valuation practitioners by further memorializing the body of knowledge that constitutes the competent and careful determination of value and, more particularly, the communication of how that value was determined.

Departure from this glossary is not intended to provide a basis for civil liability and should not be presumed to create evidence that any duty has been breached.

American Institute of Certified Public Accountants
American Society of Appraisers
Canadian Institute of Chartered Business Valuators
National Association of Certified Valuation Analysts
The Institute of Business Appraisers

Adjusted Book Value Method – a method within the asset approach whereby all assets and liabilities (including off-balance sheet, intangible, and contingent) are adjusted to their fair market values (NOTE: In Canada on a going concern basis).

Adjusted Net Asset Method – see **Adjusted Book Value Method**.

Appraisal - see **Valuation**.

Appraisal Approach - see **Valuation Approach**.

Appraisal Date - see **Valuation Date**.

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Appraisal Method - see **Valuation Method**.

Appraisal Procedure - see **Valuation Procedure**.

Arbitrage Pricing Theory – a multivariate model for estimating the cost of equity capital, which incorporates several systematic risk factors.

Asset (Asset-Based) Approach - a general way of determining a value indication of a business, business ownership interest, or security using one or more methods based on the value of the assets net of liabilities.

Beta - a measure of systematic risk of a stock; the tendency of a stock's price to correlate with changes in a specific index.

Blockage Discount - an amount or percentage deducted from the current market price of a publicly traded stock to reflect the decrease in the per share value of a block of stock that is of a size that could not be sold in a reasonable period of time given normal trading volume.

Book Value – see **Net Book Value**.

Business - see **Business Enterprise**.

Business Enterprise - a commercial, industrial, service, or investment entity (or a combination thereof) pursuing an economic activity.

Business Risk – the degree of uncertainty of realizing expected future returns of the business resulting from factors other than financial leverage. See **Financial Risk**.

Business Valuation - the act or process of determining the value of a business enterprise or ownership interest therein.

Capital Asset Pricing Model (CAPM) - a model in which the cost of capital for any stock or portfolio of stocks equals a risk-free rate plus a risk premium that is proportionate to the systematic risk of the stock or portfolio.

Capitalization - a conversion of a single period of economic benefits into value.

Capitalization Factor - any multiple or divisor used to convert anticipated economic benefits of a single period into value.

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Capitalization of Earnings Method – a method within the income approach whereby economic benefits for a representative single period are converted to value through division by a capitalization rate.

Capitalization Rate - any divisor (usually expressed as a percentage) used to convert anticipated economic benefits of a single period into value.

Capital Structure - the composition of the invested capital of a business enterprise, the mix of debt and equity financing.

Cash Flow - cash that is generated over a period of time by an asset, group of assets, or business enterprise. It may be used in a general sense to encompass various levels of specifically defined cash flows. When the term is used, it should be supplemented by a qualifier (for example, "discretionary" or "operating") and a specific definition in the given valuation context.

Common Size Statements – financial statements in which each line is expressed as a percentage of the total. On the balance sheet, each line item is shown as a percentage of total assets, and on the income statement, each item is expressed as a percentage of sales.

Control - the power to direct the management and policies of a business enterprise.

Control Premium - an amount or a percentage by which the pro rata value of a controlling interest exceeds the pro rata value of a non-controlling interest in a business enterprise, to reflect the power of control.

Cost Approach - a general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capability of that asset.

Cost of Capital - the expected rate of return that the market requires in order to attract funds to a particular investment.

Debt-Free - ***we discourage the use of this term.*** See **Invested Capital**.

Discount for Lack of Control - an amount or percentage deducted from the pro rata share of value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control.

Discount for Lack of Marketability - an amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability.

Discount for Lack of Voting Rights – an amount or percentage deducted from the per share value of a minority interest voting share to reflect the absence of voting rights.

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Discount Rate - a rate of return used to convert a future monetary sum into present value.

Discounted Cash Flow Method – a method within the income approach whereby the present value of future expected net cash flows is calculated using a discount rate.

Discounted Future Earnings Method – a method within the income approach whereby the present value of future expected economic benefits is calculated using a discount rate.

Economic Benefits - inflows such as revenues, net income, net cash flows, etc.

Economic Life - the period of time over which property may generate economic benefits.

Effective Date - see **Valuation Date**.

Enterprise - see **Business Enterprise**.

Equity – the owner's interest in property after deduction of all liabilities.

Equity Net Cash Flows - those cash flows available to pay out to equity holders (in the form of dividends) after funding operations of the business enterprise, making necessary capital investments, and increasing or decreasing debt financing.

Equity Risk Premium - a rate of return added to a risk-free rate to reflect the additional risk of equity instruments over risk free instruments (a component of the cost of equity capital or equity discount rate).

Excess Earnings - that amount of anticipated economic benefits that exceeds an appropriate rate of return on the value of a selected asset base (often net tangible assets) used to generate those anticipated economic benefits.

Excess Earnings Method - a specific way of determining a value indication of a business, business ownership interest, or security determined as the sum of a) the value of the assets derived by capitalizing excess earnings and b) the value of the selected asset base. Also frequently used to value intangible assets. See **Excess Earnings**.

Fair Market Value - the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts. {NOTE: In Canada, the term "price" should be replaced with the term "highest price"}

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Fairness Opinion – an opinion as to whether or not the consideration in a transaction is fair from a financial point of view.

Financial Risk – the degree of uncertainty of realizing expected future returns of the business resulting from financial leverage. See **Business Risk**.

Forced Liquidation Value - liquidation value, at which the asset or assets are sold as quickly as possible, such as at an auction.

Free Cash Flow – ***we discourage the use of this term.*** See **Net Cash Flow**.

Going Concern - an ongoing operating business enterprise.

Going Concern Value - the value of a business enterprise that is expected to continue to operate into the future. The intangible elements of Going Concern Value result from factors such as having a trained work force, an operational plant, and the necessary licenses, systems, and procedures in place.

Goodwill - that intangible asset arising as a result of name, reputation, customer loyalty, location, products, and similar factors not separately identified.

Goodwill Value - the value attributable to goodwill.

Guideline Public Company Method – a method within the market approach whereby market multiples are derived from market prices of stocks of companies that are engaged in the same or similar lines of business, and that are actively traded on a free and open market.

Income (Income-Based) Approach - a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that convert anticipated economic benefits into a present single amount.

Intangible Assets - non-physical assets such as franchises, trademarks, patents, copyrights, goodwill, equities, mineral rights, securities and contracts (as distinguished from physical assets) that grant rights and privileges, and have value for the owner.

Internal Rate of Return – a discount rate at which the present value of the future cash flows of the investment equals the cost of the investment.

Intrinsic Value – the value that an investor considers, on the basis of an evaluation or available facts, to be the "true" or "real" value that will become the market value when other investors reach the same conclusion. When the term applies to options, it is the difference between the exercise price or strike price of an option and the market value of the underlying security.

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Invested Capital - the sum of equity and debt in a business enterprise. Debt is typically a) all interest bearing debt or b) long-term interest-bearing debt. When the term is used, it should be supplemented by a specific definition in the given valuation context.

Invested Capital Net Cash Flows - those cash flows available to pay out to equity holders (in the form of dividends) and debt investors (in the form of principal and interest) after funding operations of the business enterprise and making necessary capital investments.

Investment Risk - the degree of uncertainty as to the realization of expected returns.

Investment Value - the value to a particular investor based on individual investment requirements and expectations. {NOTE: in Canada, the term used is "Value to the Owner"}.

Key Person Discount - an amount or percentage deducted from the value of an ownership interest to reflect the reduction in value resulting from the actual or potential loss of a key person in a business enterprise.

Levered Beta - the beta reflecting a capital structure that includes debt.

Limited Appraisal – the act or process of determining the value of a business, business ownership interest, security, or intangible asset with limitations in analyses, procedures, or scope.

Liquidity - the ability to quickly convert property to cash or pay a liability.

Liquidation Value - the net amount that would be realized if the business is terminated and the assets are sold piecemeal. Liquidation can be either "orderly" or "forced."

Majority Control - the degree of control provided by a majority position.

Majority Interest - an ownership interest greater than 50% of the voting interest in a business enterprise.

Market (Market-Based) Approach - a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.

Market Capitalization of Equity – the share price of a publicly traded stock multiplied by the number of shares outstanding.

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Market Capitalization of Invested Capital – the market capitalization of equity plus the market value of the debt component of invested capital.

Market Multiple – the market value of a company's stock or invested capital divided by a company measure (such as economic benefits, number of customers).

Marketability - the ability to quickly convert property to cash at minimal cost.

Marketability Discount - see **Discount for Lack of Marketability**.

Merger and Acquisition Method – a method within the market approach whereby pricing multiples are derived from transactions of significant interests in companies engaged in the same or similar lines of business.

Mid-Year Discounting – a convention used in the Discounted Future Earnings Method that reflects economic benefits being generated at midyear, approximating the effect of economic benefits being generated evenly throughout the year.

Minority Discount - a discount for lack of control applicable to a minority interest.

Minority Interest - an ownership interest less than 50% of the voting interest in a business enterprise.

Multiple - the inverse of the capitalization rate.

Net Book Value - with respect to a business enterprise, the difference between total assets (net of accumulated depreciation, depletion, and amortization) and total liabilities as they appear on the balance sheet (synonymous with Shareholder's Equity). With respect to a specific asset, the capitalized cost less accumulated amortization or depreciation as it appears on the books of account of the business enterprise.

Net Cash Flows – when the term is used, it should be supplemented by a qualifier. See **Equity Net Cash Flows** and **Invested Capital Net Cash Flows**.

Net Present Value – the value, as of a specified date, of future cash inflows less all cash outflows (including the cost of investment) calculated using an appropriate discount rate.

Net Tangible Asset Value - the value of the business enterprise's tangible assets (excluding excess assets and non-operating assets) minus the value of its liabilities.

Non-Operating Assets - assets not necessary to ongoing operations of the business enterprise. {NOTE: in Canada, the term used is "Redundant Assets"}.

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Normalized Earnings – economic benefits adjusted for nonrecurring, noneconomic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

Normalized Financial Statements – financial statements adjusted for nonoperating assets and liabilities and/or for nonrecurring, noneconomic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

Orderly Liquidation Value - liquidation value at which the asset or assets are sold over a reasonable period of time to maximize proceeds received.

Premise of Value - an assumption regarding the most likely set of transactional circumstances that may be applicable to the subject valuation; e.g. going concern, liquidation.

Present Value – the value, as of a specified date, of future economic benefits and/or proceeds from sale, calculated using an appropriate discount rate.

Portfolio Discount - an amount or percentage deducted from the value of a business enterprise to reflect the fact that it owns dissimilar operations or assets that do not fit well together.

Price/Earnings Multiple – the price of a share of stock divided by its earnings per share.

Rate of Return – an amount of income (loss) and/or change in value realized or anticipated on an investment, expressed as a percentage of that investment.

Redundant Assets – see **Non-Operating Assets**.

Report Date – the date conclusions are transmitted to the client.

Replacement Cost New – the current cost of a similar new property having the nearest equivalent utility to the property being valued.

Reproduction Cost New – the current cost of an identical new property.

Required Rate of Return – the minimum rate of return acceptable by investors before they will commit money to an investment at a given level of risk.

Residual Value – the value as of the end of the discrete projection period in a discounted future earnings model.

Return on Equity – the amount, expressed as a percentage, earned on a company's common equity for a given period.

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Return on Investment – see **Return on Invested Capital** and **Return on Equity**.

Return on Invested Capital – the amount, expressed as a percentage, earned on a company's total capital for a given period.

Risk-Free Rate – the rate of return available in the market on an investment free of default risk.

Risk Premium – a rate of return added to a risk-free rate to reflect risk.

Rule of Thumb – a mathematical formula developed from the relationship between price and certain variables based on experience, observation, hearsay, or a combination of these; usually industry specific.

Special Interest Purchasers – acquirers who believe they can enjoy post-acquisition economies of scale, synergies, or strategic advantages by combining the acquired business interest with their own.

Standard of Value – the identification of the type of value being used in a specific engagement; e.g. fair market value, fair value, investment value.

Sustaining Capital Reinvestment – the periodic capital outlay required to maintain operations at existing levels, net of the tax shield available from such outlays.

Systematic Risk – the risk that is common to all risky securities and cannot be eliminated through diversification. The measure of systematic risk in stocks is the beta coefficient.

Tangible Assets – physical assets (such as cash, accounts receivable, inventory, property, plant and equipment, etc.).

Terminal Value - see **Residual Value**.

Transaction Method - see **Merger and Acquisition Method.**

Unlevered Beta – the beta reflecting a capital structure without debt.

Unsystematic Risk – the risk specific to an individual security that can be avoided through diversification.

Valuation – the act or process of determining the value of a business, business ownership interest, security, or intangible asset.

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Valuation Approach – a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more valuation methods.

Valuation Date – the specific point in time as of which the valuator's opinion of value applies (also referred to as "Effective Date" or "Appraisal Date").

Valuation Method – within approaches, a specific way to determine value.

Valuation Procedure – the act, manner, and technique of performing the steps of an appraisal method.

Valuation Ratio – a fraction in which a value or price serves as the numerator and financial, operating, or physical data serves as the denominator.

Value to the Owner – see **Investment Value**.

Voting Control – *de jure* control of a business enterprise.

Weighted Average Cost of Capital (WACC) – the cost of capital (discount rate) determined by the weighted average, at market value, of the cost of all financing sources in the business enterprise's capital structure.

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APPENDIX 4

STATEMENT OF ASSUMPTIONS & LIMITING CONDITIONS

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STATEMENT OF ASSUMPTIONS & LIMITING CONDITIONS

The conclusion of value arrived at herein is valid only for the stated purpose as of the date of the valuation.

We have accepted financial statements and other related information provided by Banana Corporation or its representatives, in the course of this engagement, without any verification as fully and correctly reflecting the enterprise's business conditions and operating results for the respective periods, except as specifically noted herein. Brueggeman and Johnson Yeanoplos, P.C. ("BJY") has not audited, reviewed, or compiled the financial information provided to us and, accordingly, we express no audit opinion or any other form of assurance on this information.

We assume that the intellectual property necessary for Banana Corporation to function under its current business model is owned by the Company.

We have obtained public information and industry and statistical information from sources we believe to be reliable. However, we make no representation as to the accuracy or completeness of such information and have performed no procedures to corroborate the information.

We do not provide assurance on the achievability of the results forecasted by Banana Corporation because events and circumstances frequently do not occur as expected; differences between actual and expected results may be material; and achievement of the forecasted results is dependent on actions, plans, and assumptions of management.

The conclusion of value arrived at herein is based on the assumption that the current level of management expertise and effectiveness would continue to be maintained and that the character and integrity of the enterprise through any sale, reorganization, exchange, or diminution of the owners' participation would not be materially or significantly changed.

This report and the conclusion of value arrived at herein are for the exclusive use of our client for the sole and specific purposes as noted herein. They may not be used for any other purpose or by any other party for any purpose. Furthermore the report and conclusion of value are not intended by the author and should not be construed by the reader to be investment advice in any manner whatsoever. The conclusion of value represents the opinion of BJY based on information furnished to them by Banana Corporation and other sources.

Neither all nor any part of the contents of this report (especially the conclusion of value, the identity of any valuation specialist(s), or the firm with which such valuation specialists are connected or any reference to any of their professional designations) should be disseminated to the public through advertising media, public relations, news media, sales media, mail, direct transmittal, or any other means of communication, including but not limited to the Securities and Exchange Commission or

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other governmental agency or regulatory body, without the prior written consent and approval of BJY.

Future services regarding the subject matter of this report, including, but not limited to testimony or attendance in court, shall not be required of BJY unless previous arrangements have been made in writing.

BJY is not an environmental consultant or auditor, and it takes no responsibility for any actual or potential environmental liabilities. Any person entitled to rely on this report, wishing to know whether such liabilities exist, or the scope and their effect on the value of the property, is encouraged to obtain a professional environmental assessment. BJY does not conduct or provide environmental assessments and has not performed one for the subject property.

BJY has not determined independently whether Banana Corporation is subject to any present or future liability relating to environmental matters (including, but not limited to CERCLA/Superfund liability) nor the scope of any such liabilities. BJY's valuation takes no such liabilities into account, except as they have been reported to BJY by Banana Corporation or by an environmental consultant working for Banana Corporation, and then only to the extent that the liability was reported to is in an actual or estimated dollar amount. Such matters, if any, are noted in the report. To the extent such information has been reported to us, BJY has relied on it without verification and offers no warranty or representation as to its accuracy or completeness.

BJY has not made a specific compliance survey or analysis of the subject property to determine whether it is subject to, or in compliance with, the American Disabilities Act of 1990, and this valuation does not consider the effect, if any, of noncompliance.

No change of any item in this report shall be made by anyone other than BJY and we shall have no responsibility for any such unauthorized change.

Unless otherwise stated, no effort has been made to determine the possible effect, if any, on the subject business due to future Federal, state, or local legislation, including any environmental or ecological matters or interpretations thereof.

If prospective financial information approved by management has been used in our work, we have not examined or compiled the prospective financial information and therefore, do not express an audit opinion or any other form of assurance on the prospective financial information or the related assumptions. Events and circumstances frequently do not occur as expected, and there will usually be differences between prospective financial information and actual results, and those differences may be material.

We have conducted interviews with the current management of Banana Corporation concerning the past, present, and prospective operating results of the company.

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Except as noted, we have relied on the representations of the owners, management, and other third parties concerning the value and useful condition of all equipment, real estate, investments used in the business, and any other assets or liabilities, except as specifically stated to the contrary in this report. We have not attempted to confirm whether or not all assets of the business are free and clear of liens and encumbrances or that the entity has good title to all assets.

The approaches and methodologies used in our work did not comprise an examination in accordance with generally accepted accounting principles, the objective of which is an expression of an opinion regarding the fair presentation of financial statements or other financial information, whether historical or prospective, presented in accordance with generally accepted accounting principles. We express no opinion and accept no responsibility for the accuracy and completeness of the financial information or other data provided to us by others. We assume that the financial and other information provided to is accurate and complete, and we have relied upon this information in performing our valuation.

The valuation may not be used in conjunction with any other appraisal or study. The value conclusion(s) stated in this appraisal is based on the program of utilization described in this report, and may not be separated into parts. The appraisal was prepared solely for the purpose, function and party so identified in the report. The report may not be reproduced, in whole or in part, and the findings of the report may not be utilized by a third party for any purpose, without the express written consent of BJY.

Unless otherwise stated in the appraisal, the valuation of the business has not considered or incorporated the potential economic gain or loss resulting from contingent assets, liabilities or events existing as of the valuation date.

The working papers for this engagement are being retained in our files and are available for your reference. We would be available to support our calculated value should this be required. Those services would be performed for an additional fee.

Any decision to purchase, sell or transfer any interest in the subject company or its subsidiaries shall be your sole responsibility, as well as the structure to be utilized and the price to be accepted.

The selection of the price to be accepted requires consideration of factors beyond the information we will provide or have provided. An actual transaction involving the subject business might be concluded at a higher value or at a lower value, depending upon the circumstances of the transaction and the business, and the knowledge and motivational influences which may affect the sale of a business interest, the appraiser assumes no responsibility for the actual price of any subject business interest if sold or transferred.

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All facts and data set forth in our letter report are true and accurate to the best of the Appraiser's knowledge and belief.

During the course of the valuation, we considered information provided by management and other third parties. We believe these sources to be reliable, but no further responsibility is assumed for their accuracy.

Any projections of future events described in this report represent the general expectancy concerning such events as of the valuation date(s). These future events may or may not occur as anticipated, and actual operating results may vary from those described in our report.

If applicable, we have used financial projections approved by management. We have not examined the forecast data or the underlying assumptions in accordance with the standards prescribed by the American Institute of Certified Public Accountants and do not express an opinion or any other form of assurance on the forecast data and related assumptions. The future may not occur as anticipated, and actual operating results may vary from those described in our report. In the case that the forecast data differ from the actual future events, our recommendations as to the indication of value may be materially affected.

We have no responsibility or obligation to update this report for events or circumstances occurring subsequent to the date of this report.

In all matters that may be potentially challenged by a Court or other party we do not take responsibility for the degree of reasonableness of contrary positions that others may choose to take, nor for the costs or fees that may be incurred in the defense of our recommendations against challenge(s). We will, however, retain our supporting workpapers for your matter(s), and will be available to assist in defending our professional positions taken, at our then current rates, plus direct expenses at actual, and according to our then current Standard Professional Agreement.

No third parties are intended to be benefited. An engagement for a different purpose, or under a different standard or basis of value, or for a different date of value, could result in a materially different opinion of value.

BJY retains all exclusive rights to copyrights to the report and to control the issuance of copies by others, and the client has no right of diffusion, reproduction, distribution or sale. The client may reproduce copies of the report solely for its internal use. Otherwise, the client may not reproduce without the prior written consent of BJY.

Our report will not be used for financing, or included in a private placement or other public documents and may not be relied upon by any third parties.

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The report assumes all required licenses, certificates of occupancy, consents, or legislative or administrative authority from any local, state or national government, or private entity or organization have been or can be obtained or reviewed for any use on which the opinion contained in the report are based.

BJY does not consent to be "expertised" with respect to matters involving the Securities and Exchange Commission. For purposes of this report, the foregoing sentence means that BJY shall not be referred to by name or anonymously in any filing or document. Should you breach this stipulation and refer to BJY by name or anonymously, you will amend such filing or document upon written consent of BJY.

We express no opinion for matters that require legal or other specialized expertise, investigation, or knowledge beyond that customarily employed by business appraisers.

Unless stated otherwise in this report, we express no opinion as to: 1) the tax consequences of any transaction which may result, 2) the effect of the tax consequences of any net value received or to be received as a result of a transaction, and 3) the possible impact on the market value resulting from any need to effect a transaction to pay taxes.

The dollar amount of any value reported is based on the purchasing power of the U.S. dollar as of the valuation date. The appraiser assumes no responsibility for economic or physical factors occurring subsequent to the date that may affect the opinions reported.

The estimate of fair market value assumes that the Company is a "going concern," based on an all cash purchase, or equivalent terms thereof. The Company would have a materially different value in liquidation. No estimate of the value that could be achieved in liquidation is included in this report.

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EXHIBIT “H”

DRAFT

October 29, 2007

Mr. Mark Phillips
Mod Systems, Inc.
720 Third Avenue, Suite 1100
Seattle, WA 98104

Re: Valuation of Patents

Dear Mr. Phillips:

We have prepared and enclosed herewith, our report of the appraisal of certain patents pending, ("the Patents") owned by Mr. Mark Phillips dated October 29, 2007. The purpose of this valuation is to establish the fair market value as of October 26, 2007 of the Patents under their current pending status, and additionally, to establish the fair market value as of October 26, 2007 of the Patents under the assumption that they have been approved and issued. We understand that the results of our analysis will be used in connection with internal planning purposes to determine a price at which to potentially sell the Patents.

The standard of value is "fair market value." Fair market value is defined by IRS Revenue Ruling 59-60, 1959-1, C.B. 237 as "the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts." RR59-60 also states that "in addition that the hypothetical buyer and seller are assumed to be able, as well as willing, to trade and to be well informed about the property and the market for such property."

This report is based on historical and prospective financial and economic information provided to us by management and other parties. Had we audited or reviewed the underlying financial data, matters may have come to our attention that would have resulted in our using amounts that differ from those provided. Accordingly, we take no responsibility for the underlying data, financial or otherwise, presented in this report.

Users of this valuation report should be aware that asset valuations are based on future earnings potential and/or asset values that may or may not materialize. Therefore, the actual results achieved and/or asset values obtained during the forecast period will vary from the forecasts used in this report, and the variations may be material.

In our opinion, based on our study and analysis, and the assumptions and limiting conditions as described in this report, we have concluded that the fair market value of the Patents as of October 26, 2007, is:

CPA ABV Accredited In Business Valuation

FCG Financial Consulting Group, L.C.

Fair Market Value of
MARK PHILLIPS PATENTS
As of October 26, 2007

	Pending	Issued
Fair Market Value of the Patents as of October 26, 2007 (royalty rate of $8.00 per unit shipped for data transfer optimization and $.80 per unit shipped for playlist selection)	**$ 393,000,000**	**$ 494,000,000**
Fair Market Value of the Patents as of October 26, 2007 (royalty rate of $4.00 per unit shipped for data transfer optimization and $.40 per unit shipped for playlist selection)	**$ 197,000,000**	**$ 247,000,000**

We have no present or contemplated financial interest in the Patents or Mod Systems, Inc. Our fees for this valuation are based upon normal hourly billing rates, and are in no way contingent upon the results of our findings. We have no responsibility to update this report for events and circumstances occurring subsequent to the date of this report, although we will be pleased to perform an update valuation should you require one.

This letter and report are to be distributed only in their entirety, and are intended and restricted for use by Mark Phillips and his representatives relative to the aforementioned purpose. This report is not to be copied or made available to any persons without the express written consent of Brueggeman and Johnson Yeanoplos, P.C.

Brueggeman and Johnson Yeanoplos, P.C.

Kevin R. Yeanoplos, CPA/ABV, ASA

Tucson, Arizona
October 29, 2007

INTRODUCTION

PURPOSE OF VALUATION

Brueggeman and Johnson Yeanoplos, P.C. has been retained by Mark Phillips, and has prepared this report for the purpose of expressing its opinion as to the fair market value of the Patents as of October 26, 2007. This report is intended to present an objective, unbiased opinion of value for the exclusive purpose mentioned previously.

This report is not designed or intended to be a document suitable for use in selling the Patents to outside individuals or other entities which may be uninformed about the Patents being valued. Because this report is to be used for internal planning purposes, it may not contain sufficient descriptive information to satisfy an uninformed prospective buyer of the subject Patents. It is also not designed to adequately portray all of the desirable qualities of the Patents, which should be addressed in an offering document designed for a potential buyer.

APPROACH TO VALUATION

Our approach has been to determine an indication of value that would provide a fair and reasonable return on investment to an investor or owner, in view of the facts that would have been reasonably available to them at the time. We based our opinion on, among other things, our assessment of the risks of investing in the Patents and the return on investment that would be required on alternative investments with similar levels of risk.

In performing our work, we were provided with and/or relied upon various sources of information, including but not limited to:

- TOFU Business Model including projected revenues and expenses for years 2008 through 2015, prepared internally;
- United States Patent Application - Number 09/975,736 filed October 10, 2001;
- United States Patent Application - Number 09/975,748 filed October 10, 2001;
- United States Patent Application - Number 09/975,749 filed October 10, 2001;
- United States Patent Application - Number 10/039,906 filed January 2, 2002;
- Unaudited supplemental information, including, but not limited to:
  - History of the Patents;
  - Information on certain past transactions; and,
  - Ownership breakdown of the Patents.

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- Information regarding the economic outlook for the overall U.S. economy;

- Information regarding the present conditions and outlook for the compressed audio player and the embedded audio device industry as reported by IDC;

- Resources regarding business valuation issues including the following:

  - *ASA Business Valuation Standards* of the American Society of Appraisers, and the *Uniform Standards of Professional Appraisal Practice*, published by the Appraisal Foundation;
  - *Royalty Rates for Licensing Intellectual Property*, by Russell Parr, CFA, ASA, published by John Wiley & Sons, Inc.;
  - *Valuing Intangible Assets*, by Robert F. Reilly, CFA, ASA, CPA and Robert P. Schweihs, ASA;

- Other various relevant information.

The procedures employed in valuing the subject interest in the Patents included such steps as we considered necessary, including but not limited to:

- Read and analyzed the documents provided, as listed above;
- Discussions with Mark Phillips and Robert Bergstrom, Esq. regarding past and future activities and expectations for the Patents;
- An analysis of the general economic environment as of the valuation date;
- An analysis of current conditions and the outlook for the portable audio device industry;
- A comparative analysis where possible of guideline assets; and,
- An analysis of the other pertinent facts and data resulting in our conclusion of value.

The approaches and methodologies used in our work did not comprise an examination in accordance with generally accepted auditing standards (GAAS). The objective of a GAAS examination is to express an opinion regarding the fair presentation of historical or prospective financial statements or other financial information presented in accordance with generally accepted accounting principles (GAAP). Since we did not perform an examination in accordance with GAAS, we express no opinion and accept no responsibility for the accuracy and completeness of the financial information or other data provided to us by others. We assume that the financial and other information provided to us is accurate and complete, and we have relied upon this information in performing our valuation.

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IMPORTANCE OF LIMITING CONDITIONS

We urge readers to study the *Statement of Assumptions and Limiting Conditions* contained in Appendix 4 of this report for important conditions, restrictions, and assumptions. Additionally, numerous assumptions are included throughout this report. Therefore, readers should study the entire report in order to obtain an understanding of the value estimate contained herein.

DEFINITIONS

A summary of definitions as adopted by the American Society of Appraisers, Institute of Business Appraisers, American Institute of Certified Public Accountants, Canadian Institute of Chartered Business Valuators, and National Association of Certified Valuation Analysts is included in Appendix 3.

VALUATOR INDEPENDENCE

This report was prepared in full by Brueggeman and Johnson Yeanoplos, P.C., Kevin R. Yeanoplos, CPA/ABV, ASA, Clay S. Danielson, ASA, and John M. Martin. Brueggeman and Johnson Yeanoplos, P.C. acted as an independent valuation firm and has not acted as an advocate for the Patents, Mod Systems, Inc., or any other party. This report was prepared in accordance with the *Code of Ethics* of the American Society of Appraisers and the *Uniform Standards of Professional Appraisal Practice* ("USPAP"). Brueggeman and Johnson Yeanoplos, P.C.'s fee for this engagement was in no way determined by the fair market value estimate provided.

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FUNDAMENTAL INFORMATION ON THE PATENTS

BACKGROUND AND NATURE OF PATENTS

The Patents that are the subject of this report are utility patents and relate to the design of a portable audio device. All four Patents are owned by Mark Phillips and were pending as of the date of valuation. A description of each patent including the filing date, application number with the United States Patent and Trademark Office, name(s) of the inventors, and the status of the Patent as of the date of valuation follows:

System and Method for Mapping Interface Functionality in a Portable Audio Device

A portable digital audio device is capable of playing a number of different data file types, such as music data files, speech data files, video data files, and the like. Different CODECs are generally used for different data types. The system determines the data file type and selects the appropriate CODEC based on the reported data file type. In addition, the reported data file type is used to select the appropriate media interface manager and appropriate user interface. The user interface, or "skin" is selected for compatibility with the media interface manager and selected CODEC. The appropriate controls are enabled and displayed for user operation. As new CODECs are added to the system, appropriate media interface managers and skins are also added to provide the necessary user interface compatibility.

Application Filing Date: October 10, 2001
Application Number: 09/975,736
Inventors: Mark E. Phillips and Edward C. Miller
Status: Appeal brief filed October 10, 2007

System and Method for Musical Playlist Selection in a Portable Audio Device

A portable audio playing device implements a jukebox manager function to permit the simple generation of musical playlists and the alteration or editing of existing playlists. Data, such as MPEG-3 data or other conventional audio format data, may be readily downloaded into the system for storage in a solid state memory or in a spinning media device. The audio tracks are associated with one or more metatags that are used to describe the content of each track. The metatags and associated audio tracks are stored in a data structure that may be implemented as a database or other convenient data structure that readily permits searching by user-specified search terms. The user generates a new playlist by selecting one or more metatags corresponding to the desired musical tracks. The system queries the data structure using the user-specified metatags and automatically generates a playlist containing one or more audio tracks whose metatags correspond to the user-specified metatags. Alternatively, the system may perform the same query and simply generate a results list that will allow the user to manually specify which of the audio tracks identified by the search process will be added to the newly created playlist. The system also permits the simple editing of existing playlists. New audio tracks may be added in the manner described above using metatags for searching or maybe manually added from the list of stored audio tracks. The system readily supports different audio formats and different playlist types.

Application Filing Date: October 10, 2001
Application Number: 09/975,748
Inventors: Mark E. Phillips and Eric P. Gibbs
Status: Appeal brief filed October 16, 2007

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System and Method for Data Transfer Optimization in a Portable Audio Device

A system and method are disclosed wherein a battery powered portable audio device utilizes a spinning media device for data storage. To conserve batter power, the motor in the media storage device is not powered unless an actual data transfer is required. A processor calculates the amount of data remaining in a data buffer and considers a number of factors, such as the type of spinning media storage device, amount of available buffer space, the type of CODEC used to implement the system, and the type of data to determine when it will be necessary to power up the spinning media storage device and transfer data to assure that a continuous stream of data is provided to the CODEC.

Application Filing Date: October 10, 2001
Application Number: 09/975,749
Inventors: Mark E. Phillips and Eric P. Gibbs
Status: Reply brief filed September 27, 2007

System and Method for Playlist Completion in a Portable Audio Device

A portable audio playing device automatically searches and makes available for acquisition additional data files that will complete the content of data files already present in the portable device. In one example, the portable playing device stores musical tracks, which may comprise selections from a particular album, artist, musical genre, or the like. The portable audio device communicates with a computer network to provide a list of additional musical titles that correspond with user-selected criteria, such as album. The device includes a display that lists presently stored content and additional available content that may be acquired by the user. Alternatively, the system may automatically display additional content based on categories of already stored content, such as albums, artists, genre, or the like, without user selection of search criteria.

Application Filing Date: January 2, 2002
Application Number: 10/039,906
Inventors: Mark E. Phillips and Eric P. Gibbs
Status: Waiting for examination

PATENT VALUE CONSIDERATIONS

The value of a patent can vary significantly based on its characteristics and other factors. We have listed some of the key factors that influence the value of a patent and how they relate to the Patents as follows:

Economic Life - The economic life of a patent is limited by its legal term. In the United States, the legal life of a utility patent applied for after June 7, 1995, ends 20 years after its earliest effective filing date. However, while the legal term provides an upper bound, it is important to consider the patent's economic, technological, and regulatory context in determining the economic life of the patent. Based on the original filing dates, the subject Patents have a legal term that extends to approximately the year 2021.

Market Potential - The value of a patent is impacted by the condition of the market for the end product(s) to which the patent pertains. For example, whether the market is expanding, contracting

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or stagnant. We believe that the Patents pertain to expanding product markets, which has a positive impact on their value.

Availability of Substitutes - The possibility of a competitor designing around the protected process, or the development of a superior process that would render the patent obsolete can diminish a patent's potential value. Given the rapid pace of technological change and fierce competition in the market for audio devices, we believe the threat posed by competitive pressures would diminish the value of the Patents.

Blocking Patents - Owning a patent does not guarantee the right to "practice the invention" if doing so infringes on someone else's underlying patent. If a new invention infringes on a prior patent, the earlier one is said to "block" it, diminishing its potential value. A portfolio of related patents can be worth more to a single owner than the same patents would be individually to multiple parties because it can eliminate blocking patents. We were not made aware of any blocking patents pertaining to the subject Patents.

Foreign Patent Protection - Because patents are only enforceable in the jurisdictions issuing them, patents registered in multiple national jurisdictions will have a larger market and will be worth more. The Patents are only registered in the United States and do not enjoy foreign protection.

Prior Royalties Paid for the Patent - Prior royalties paid for the patent, with appropriate adjustments for differences in context from the previous to the current time, can be a good indication of value. We were not made aware of any prior royalties paid for the Patents.

Litigation Concerns - Actual or threatened litigation involving a patent can provide an indication of the relative value of the patent. A successfully litigated patent is evidence of the patent's value and signals to competitors to stay out of the market. Conversely, a failed attempt to enforce a patent can adversely affect its value. We were not made aware of any actual or threatened litigation involving the Patents.

The following chart summarizes the key characteristics listed above as they relate to the Patents:

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Key Characteristics
MARK PHILLIPS PATENTS
Value Impact Analysis

	Very Negative	Negative	Neutral	Positive	Very Positive
Economic Life				✓	
Market Potential					✓
Availability of Substitutes		✓			
Blocking Patents			✓		
Foreign Patent Protection			✓		
Royalties Paid for the Patents			✓		
Litigation Concerns		✓			

SUMMARY

The Patents have approximately fourteen years remaining in their legal term. We believe that the market for the products for which the Patents apply is expanding and is likely to continue expanding through the remaining legal term of the Patents. However, we also believe that fierce competitive pressures and rapidly evolving technology pose a significant risk to the value of the Patents. Based on the nature of the Patents and the considerations discussed above, we believe an investor in the Patents would assess additional risk to an investment in the Patents. We will reflect this additional risk in our determination of an appropriate rate of return later in this report.

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ECONOMIC CONDITIONS

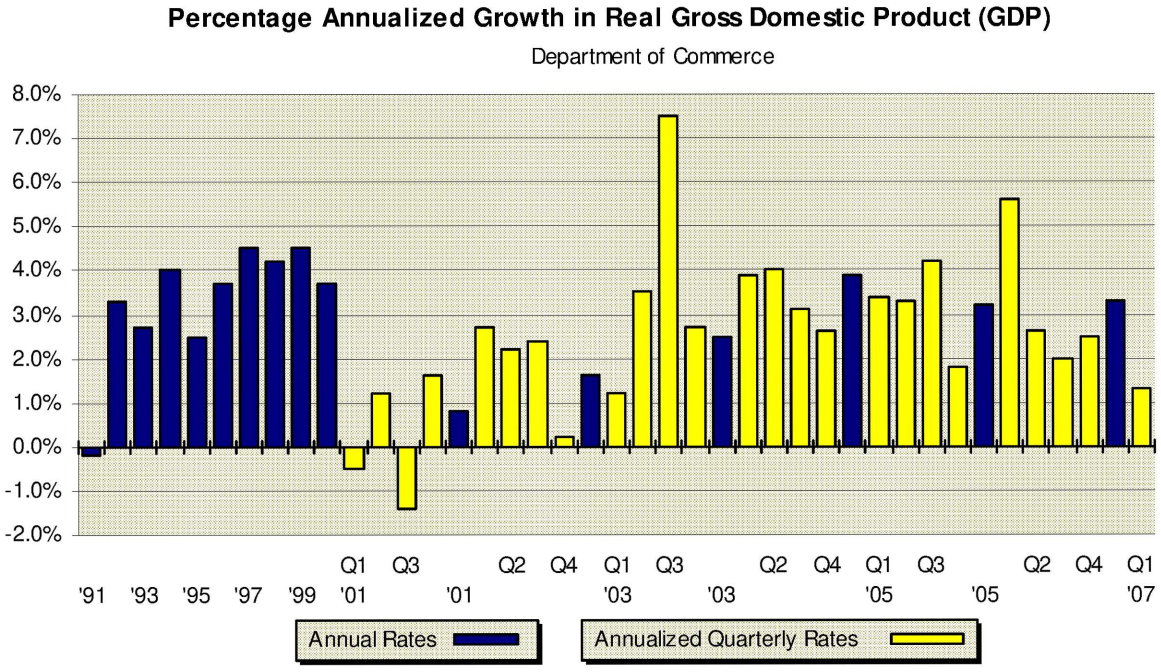
INTRODUCTION

The value of many intangible assets, such as the Patents, can be indirectly impacted by many external variables. Macroeconomic variables such as the state of the international economy, decisions made by the Federal Reserve Board, and the relative cost of capital can affect the value of an intangible asset, in addition to governmental and agency rules, and the regulations and structure of the relative competitive environment. The Gross Domestic Product (GDP) level, a measure of overall supply and demand, is ultimately determined by changing demographics, customer attitudes and consumer spending patterns.

The U.S. Economy

The following excerpts from *The National Economic Review 1st Quarter 2007* (the most recent available) prepared by Mercer Capital and published by John Wiley & Sons, Inc. have been included in order to provide an overview of the national economy around the time of the valuation.

General Economic Overview



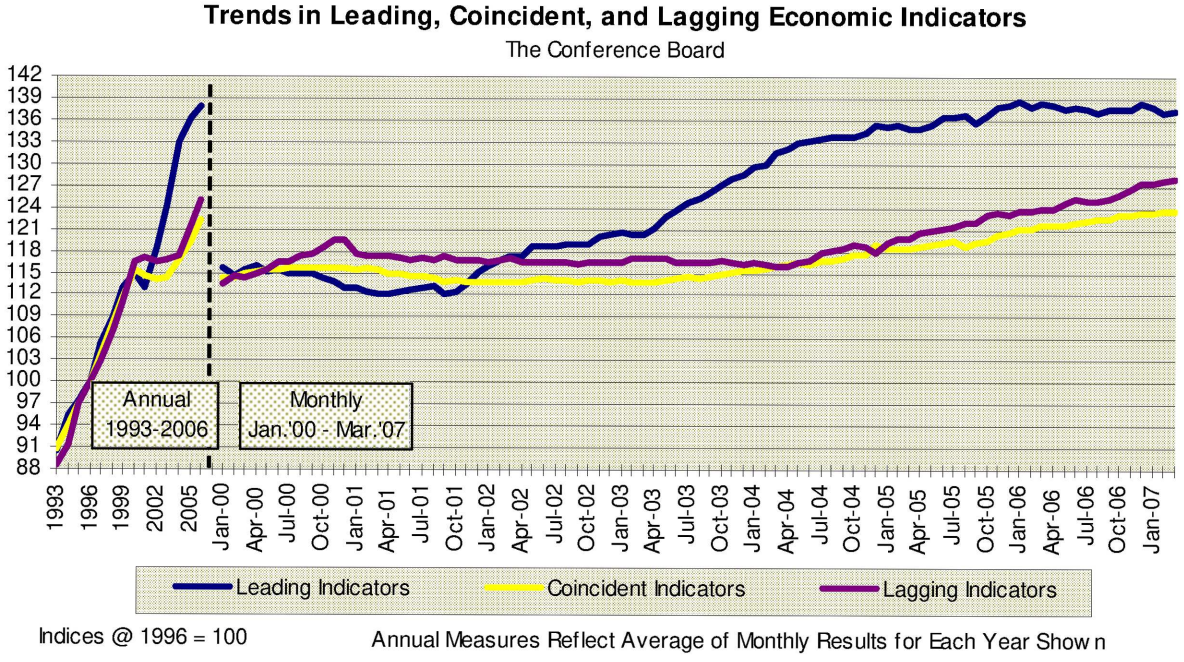
According to advance estimates released by the Department of Commerce's Bureau of Economic Analysis, Real Gross Domestic Product ("GDP"), the output of goods and services produced by labor and property located in the United States, increased at an annualized rate of 1.3% during the first quarter of 2007. This is the twenty-second consecutive quarterly rise in GDP subsequent to the 2001 recession, and compares to a revised increase of 2.5% in the fourth quarter of 2006. However, the 1.3% increase during the quarter was the lowest increase since a 1.2% increase in

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the first quarter of 2003 and was lower than expected by most economists. The deceleration of growth during the first quarter is attributed to higher fuel prices, continuing malaise in the housing market, and weakening of business investment. Strong consumer spending served to partially offset a decline in business capital investment. Consumer spending was buoyed in the first quarter by a favorable employment environment.

The growth in real GDP in the first quarter reflected increases in personal consumption expenditures ("PCE") and state and local government spending. These factors were partially offset by negative contributions from residential fixed investment, private inventory investment, federal government spending, and imports. Economists note that GDP for all of 2006 grew 3.3%, up slightly from the 3.2% in 2005. First quarter GDP growth was less than economist expectations of approximately 2.5%. Economists predict GDP growth on the order of 2.2% for the second quarter of 2007. After the second quarter, growth is expected to accelerate modestly to approximately 2.6% to 2.9%, representing better growth than evidenced in the first quarter but lower than the longer-term trend.

At its March meeting, the Federal Reserve held the federal funds rate and the discount rate steady at 5.25% and 6.25%, respectively, after a similar move at its January meeting. Following a deliberate period of rate increases, the Fed has elected to encourage steady interest rates over the past three quarters, given a pronounced cooling in economic growth and modestly increased uncertainty concerning inflation. However, possible increases in resource utilization could potentially trigger an increase in inflation which could prompt the Federal Reserve to tighten monetary policy. The March statement indicated that core inflation has increased in recent months and high levels of resource utilization could potentially elevate inflation pressures. Future policy adjustments will depend on contemporaneous developments and future expectations for both inflation and economic growth.



The Conference Board ("TCB") reported that the Composite Index of Leading Economic Indicators ("LEI"), the government's primary forecasting gauge, increased 0.1% in March to 137.4 after decreases of 0.3% and 0.6% in January and February, respectively (all figures recently revised). The index attempts to gauge economic activity six to nine months in advance. Multiple consecutive moves in the same direction are said to be indicative of the general direction of the economy.

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Six of the ten leading economic indicators rose during March. Positive contributors to the LEI (largest to smallest) included average weekly initial claims for unemployment insurance, average weekly manufacturing hours, real money supply, vendor performance, building permits, and manufacturers' new orders for consumer goods and materials. Collectively, these positive contributions to the LEI modestly eclipsed the negative contributions which included stock prices, index of consumer expectations, interest rate spread, and manufacturers' new orders for nondefense capital goods. In December, the Coincident Index and the Lagging Index also increased 0.1%. The LEI suggests that economic growth should continue at a modest rate.

Although economic growth in 2006 was generally positive, it represented a slowdown relative to 2004 and 2005 levels. First quarter 2007 economic results represented a continuation of the weakness evidenced in 2006. According to a monthly survey of over 50 forecasters polled by The Wall Street Journal, annualized quarterly GDP is projected to grow 2.2%, 2.5% and 2.9%, respectively, for the balance of 2007. These modest growth figures are expected to be at least partially due to a continuing, albeit less severe, decline in the housing sector which began in 2006. Decreasing real estate values have the potential to dampen home-equity financed consumer spending, reduce construction activity, and lead to job losses in the construction industry. However, most economists feel the economy will be buoyed in the back half of 2007 as housing market weakness abates, the Federal Reserve possibly lowers interest rates toward the end of the year, and manufacturing rebounds. Just under half of the economists indicated an expectation for the economy to improve over the next twelve months, while 27% expect it to get worse and 22% expect it to stay the same. This contrasts with the more pessimistic views of the American public of which 49% expect the economy to stay the same and 31% expect the situation to worsen.

Consumer Spending and Inflation

The seasonally adjusted annual rate ("SAAR") of inflation for the first quarter of 2007 was 4.7%, compared to changes of 5.7%, 0.6%, and 0.2% respectively, for the last three quarters of 2006. The index for energy increased 5.9% in March, following a decrease of 1.5% in January and an increase of 0.9% in February. Core inflation rose 2.3% (SAAR) during the first quarter of 2007 following increases of 3.4%, 2.7%, and 1.6% for the last three quarters of 2006, respectively. The PPI rose 6.9% (SAAR) for the first quarter after rising 3.5% in the fourth quarter.

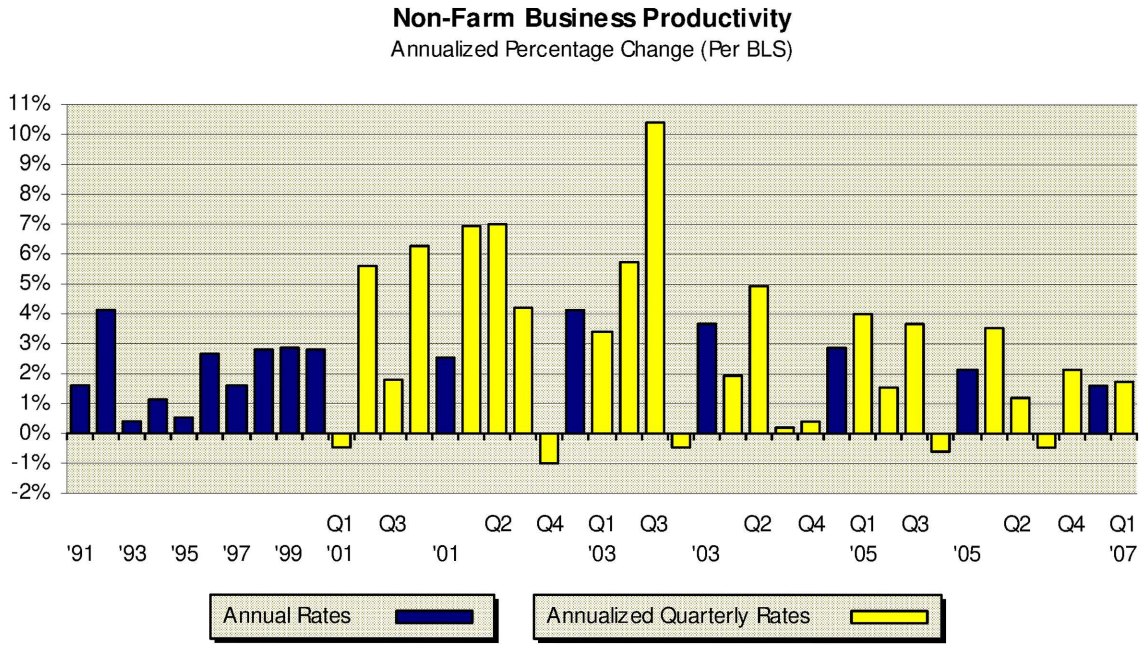
The advance estimates in percentage change in retail and food service sales for March 2007 were up 0.7% from the previous month and up 3.8% from March 2006. Real personal consumption spending increased 3.8% in the first quarter of 2007 compared to increases of 2.8% and 4.2% (revised), respectively, in the third and fourth quarters of 2006.

Interest Rates

The Federal Reserve's Open Market Committee ("FOMC") kept its target for the federal funds rate unchanged at 5.25% during the fourth quarter. The Committee kept target rates unchanged during the third and fourth quarters of 2006, marking the first quarters since the latter part of 2003 that the Committee has not raised interest rates. The staff forecast prepared for the December meeting indicated that growth in economic activity had slowed to a pace below that of the economy's long-run potential in the second half of 2006.

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Business and Manufacturing Productivity



The seasonally adjusted annual rate of non-farm business productivity increased 1.7% in the first quarter following a revised 2.1% increase during the fourth quarter of 2006. Productivity rose 1.3% the entire business sector. Manufacturing productivity increased 2.7% during the quarter as output increased 1.5% and hours decreased 1.1%.

Industrial Production and Capacity Utilization

First quarter 2007 production increased at an annual rate of 1.4% following a revised 1.5% decrease during the fourth quarter. Manufacturing production rose 0.7% in March after increasing 0.1% in February. Manufacturing production is currently 2.6% higher than measured at March 2006. Capacity utilization declined 0.2 percentage points in March to 81.4%, and was equal to prior year levels. For the fourth quarter, capacity utilization measured a revised 81.5%.

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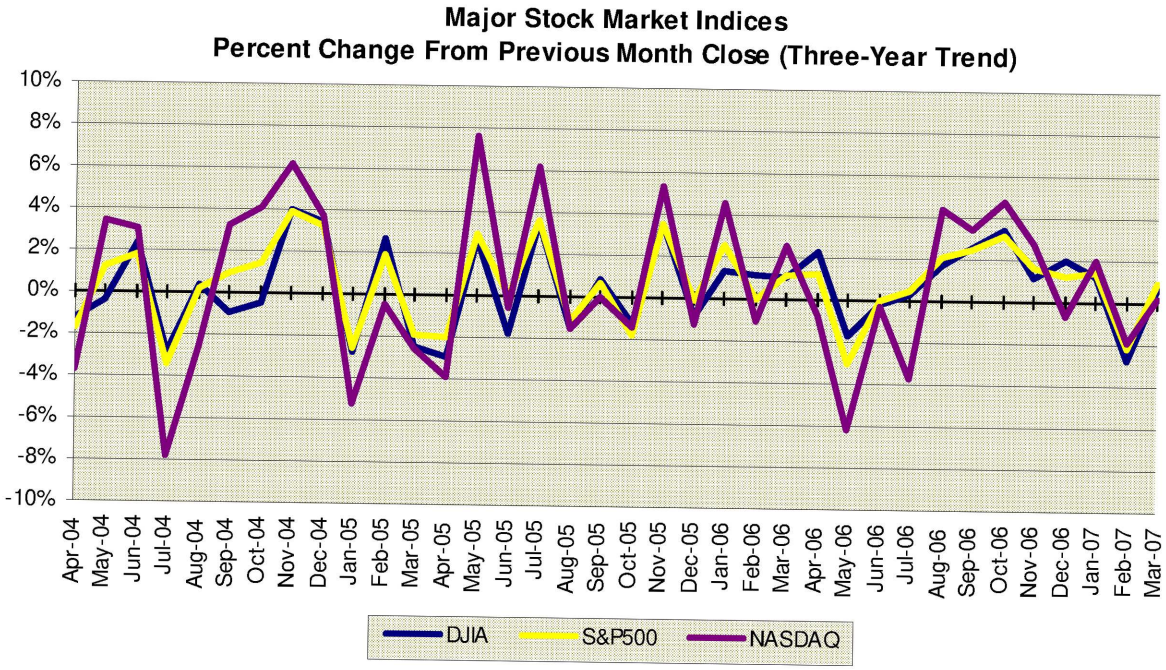
Unemployment



The unemployment rate was 4.4% in March, down only slightly from fourth quarter levels of 4.5% and slightly below forecasts. Unemployment figures of 4.4% to 4.5% during the fourth quarter of 2006 and the first quarter of 2007 represented the lowest levels in over five years. March payrolls increased by 180,000 jobs, following a revised gain of 113,000 jobs in February.

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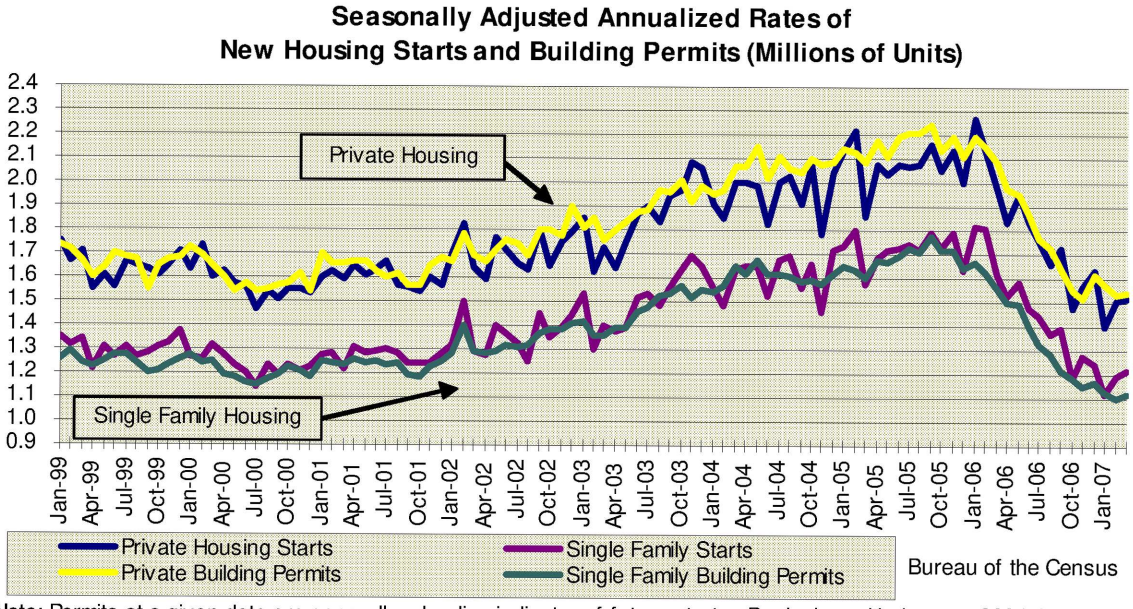
The Financial Markets



The Dow closed the first quarter at 12354.35, down 0.9% for the quarter. The S&P 500 index rose 0.2% during the quarter to close at 1420.86 following a 6.2% increase in the fourth quarter. The S&P 500 was up 13.6% in 2006. The NASDAQ Composite Index rose 0.3% during the first quarter to close at 2421.64, following a 6.9% increase in the fourth quarter. The Wilshire 5000 index closed at 14409.30, up 1.1% for the quarter. The monthly average yields-to-maturity on the 20 year Treasury bond during the first quarter of 2007 were 4.95%, 4.93%, and 4.81%, respectively, for January, February, and March.

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Housing Starts and Building Permits



Note: Permits at a given date are generally a leading indicator of future starts. Beginning with January 2004, building permit data reflects the change to the 20,000 place series.

New privately owned housing starts were at a seasonally adjusted annualized rate of 1.518 million units in March, 0.8% above the revised February estimate, but 23.0% below the March 2006 level. Single-family housing starts were 1.218 million which is 2.0% above the February figure. Private housing units authorized by building permits measured 1.544 million units in March, 0.8% above the revised February rate of 1.532 million units.

Summary and Outlook

Economic results related to the first quarter of 2007 were generally mixed. GDP measures were weaker than anticipated, while labor the labor market and consumer spending rallied. GDP growth expectations from private economists surveyed by The Wall Street Journal are on the order of 2.2% for the second quarter and 2.5% and 2.9% for the last two quarters of 2007, respectively. This compares to GDP growth of 3.9%, 3.2%, and 3.3% for 2004, 2005, and 2006, respectively. Despite reduced growth rates, the majority of economists do not foresee the likelihood of a recession in the near future. This deceleration in growth is expected to be at least partially due to the continuing decline in the housing sector which began in 2006. However, experts note that what consumers are not spending on construction improvements, they are instead spending on personal consumption. This somewhat mitigates the downward effect on GDP. However, rising fuel prices and the likelihood that the job market may weaken slightly would likely reduce consumer spending. The Federal Reserve's outlook concurs with that of the private economists by suggesting growth at a moderate pace for the remainder of 2007. Inflation readings were elevated during the fourth quarter causing some concern for economists. While inflation is not expected to be a major problem for 2007, should actual inflation exceed expected inflation, the costs to growth could be significant. Economists are moderately bullish on the stock market through 2007 and decidedly optimistic long-term. The Fed is expected to reduce interest rates once during late 2007. The goal is for interest rates to be low enough to spur expansion, while keeping inflation fears low.

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Economic results related to the first quarter of 2007 were generally mixed. GDP measures were weaker than anticipated, while the labor market and consumer spending rallied. Despite reduced GDP growth rates, the majority of economists do not foresee the likelihood of a recession in the near future. This deceleration in growth is expected to be at least partially due to the continuing decline in the housing sector which began in 2006. The Federal Reserve's outlook concurs with that of the private economists by suggesting growth at a moderate pace for the remainder of 2007. Inflation readings were elevated during the fourth quarter causing some concern for economists. While inflation is not expected to be a major problem for 2007, should actual inflation exceed expected inflation, the costs to growth could be significant. Economists are moderately bullish on the stock market through 2007 and decidedly optimistic long-term. The Fed is expected to reduce interest rates once during late 2007.

We believe an investor in the Patents would not assess additional risk to an investment in the Patents based on current economic conditions or the economic outlook.

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INDUSTRY CONDITIONS

In addition to giving consideration to the economy, we also consider the state of the industry that can impact the value of the Patents. The industrial climate can have significant effects on the value of an intangible asset. The factors influencing the industry can include technological change, fluctuations in supply and demand, price increases or decreases, and the competitive landscape. We analyzed information regarding the industry with which the Patents are associated. Excerpts from the materials we analyzed are included below:

OVERVIEW

The following excerpt is from the IDC Market Analysis, *"Worldwide and U.S. Compressed Audio Player 2005 - 2009 Forecast and Analysis"* prepared by Susan Kevorkian:

> Portable compressed audio players led the home and automotive device categories worldwide in volume in 2004, and are expected to do the same in 2005. Key market changes for the portable compressed audio player market in general in 2004 and 2005 to date include:
>
> - Apple Computer introduced the iPod shuffle portable flash player - its first in the portable flash category - in January 2005. In September 2005, Apple discontinued the iPod mini portable jukebox and introduced the iPod nano, a portable flash player.
>
> - In late 2004, Creative Technology announced plans to spend $100 million on marketing in 2005 to compete with Apple in the MP3 player market. The announcement coincided with the release of Creative's Zen Micro.
>
> - In July 2005, D&M Holdings sold strategic Rio Audio assets to SigmaTel and in August, announced its plans to exit the portable compressed audio player market entirely by the end of September. } In mid-2005, HP discontinued its relationship with Apple to offer HP-branded iPods. When Apple iPod from HP became available in the fall of 2004 (after being announced in January 2004), it was HP's reentry into the market: The company had discontinued the Compaq iPaq portable MP3 player line following the Compaq-HP merger. The deal with Apple gave HP a way to get back into the portable MP3 player market with a high-profile player that complemented its Windows-based PCs, and Apple gained access to HP's retail channels. But the results were disappointing. HP sold fewer units than expected, and Apple only allowed HP to sell new iPod models (including the mini, photo, and shuffle) months after Apple itself introduced the players. Now, HP is in a position to develop its own branded Windows Media Audio (WMA)œcompatible devices, and Apple is free to develop more fruitful distribution relationships, if it chooses to at all.
>
> - In March 2005, Samsung Electronics announced its intentions to leverage its handset and chip-making expertise to compete against Apple and other companies in the portable MP3 player market in 2005. The company plans to focus on the portable flash player market, and has announced that it will launch twelve new portable MP3 player models in 2005.
>
> - In late 2004 and early 2005, Sony began to shift away from the primary support of its proprietary audio codec and storage technologies, and introduced portable flash players and portable jukeboxes that support MP3 natively.

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Portable Flash Players

In 2004, portable flash player shipments more than doubled worldwide from the previous year to 26.36 million units. A primary driver of demand was the falling cost per megabyte of flash memory. Demand was strong worldwide, given competitive retail price points in comparison to portable jukeboxes. In the United States and Western Europe, higher capacity (256MB+) was popular, while in Asia/Pacific, and in particular in China, lower capacities (less than 256MB) were in demand.

Falling flash prices enabled vendors to offer sub-$200 1GB densities, which began shipping at the end of 2004 from Samsung and SanDisk. In early 2005, Apple entered the portable flash player market for the first time with the iPod shuffle. Initially, the shuffle was priced at $99 for 512MB and $149 for 1GB. In late June, Apple cut the price of the 1GB shuffle to $129.

In September 2005, Apple introduced the iPod nano portable flash player in 2GB and 4GB capacities, priced at $199 and $249, respectively. The 4GB iPod nano is the highest-capacity portable flash player on the market today.

Key players in the market worldwide in 2004 and 2005 include Apple, Creative Technology, Lenovo, Rio Audio, Samsung, and Thomson/RCA. The Rio Audio device line (including portable flash and jukebox devices) was discontinued by parent company D&M Holdings effective September 2005. Sony began to make a comeback in portable audio with a new line of flash players that, for the first time, offers native MP3 support. Strong regional players include Digitalway in Asia/Pacific and SanDisk in the United States.

Portable Jukeboxes

In 2004, Apple Computer continued to dominate the worldwide and U.S. portable jukebox markets, commanding more than a 65% market share worldwide.

In September 2005, Apple discontinued its popular iPod mini, which was based on a 1in. HDD, and launched the iPod nano portable flash player.

Color screens and digital photo support became more common, with models from Apple, Gateway, and iRiver.

Key players in the market worldwide include Apple, Archos, Creative Technology, iRiver, Rio Audio, and Samsung.

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Table 1 shows 2004 worldwide and U.S. market share for the portable flash compressed audio player category.

Table 1
Worldwide and U.S Portable Flash Player Unit Shipment Share by Vendor

Vendor	Share (%)
Worldwide	
iRiver/Reigncom	10.4
Creative Technology	9.3
Samsung	5.8
Lenovo	4.6
Thomson/RCA	2.7
Other	67.2
United States	
Creative Technology	13.7
iRiver/Reigncom	8.0
Rio Audio	4.4
Thomson/RCA	4.0
Samsung	1.1
Other	68.9

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Table 2 shows 2004 worldwide and U.S. market share for the portable jukebox compressed audio player category.

Table 2
Worldwide and U.S Portable Jukebox Unit Shipment Share by Vendor

Vendor	Share (%)
Worldwide	
Apple	66.1
Creative Technology	16.0
iRiver/Reigncom	4.6
Rio Audio	4.0
Samsung	1.4
Other	8.0
United States	
Apple	69.9
Creative Technology	13.2
iRiver/Reigncom	4.3
Rio Audio	3.8
Samsung	1.4
Other	7.3

Portable MP3 CD/MD Players

The major consumer electronics (CE) companies that dominate the portable CD player category, such as Panasonic, Philips, Samsung, Sony, and Thomson/RCA, are also the key players in the MP3 CD player market. These vendors include MP3 support as a feature in a growing percentage of their products. This trend has been the primary driver of unit shipments in the MP3 CD player category.

Compressed audio enabled MiniDisc (MD)œbased devices, such as the Net MD and Hi-MD Walkman players, are currently available only from Sony. This will likely be the case for the foreseeable future.

Portable - Home and Car

Portable devices, which can be connected to home and car systems with device docks or adapters, have emerged as potential substitute products for compressed audioœenabled home and car systems as well as sources of music for consumers on the go.

This trend is being driven by several factors. First, 1GB+ device capacities (now for portable flash players as well as for portable jukeboxes) allow users to store hundreds or thousands of songs, and turn portable MP3 players into repositories for substantial music collections. For this reason, it

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is efficient to bring the portable device to stationary home and car systems, instead of replicating the same collection of music files on those systems. Second, it allows consumers to maximize their investment in the player by making it adaptable to multiple situations. Third, device manufacturers looking to ride the coattails of Apple's success with the iPod have, with Apple's approval and licensing, given rise to an unprecedented accessory market that enables consumers to showcase the iPod's cool factor in situations outside of their pockets and in addition to the iPod's white earphone cords. Accessories have also become available for MP3 players offered by Apple's competitors, but to a lesser extent. Accessories offered include adapters, docks, and related devices such as powered speakers with built-in iPod connectors from Altec Lansing, Belkin, Bose, and Logitech, among others. Apple has partnered with car manufacturers, including Alfa Romeo, BMW, Daihatsu, Ferrari, Honda/Acura, Mazda, Mercedes-Benz, Mini, Nissan, Smart, Volkswagen/Audi, and Volvo to offer built-in iPod device connectors and displays in new cars. IDC believes that home and car MP3 player connectors may be "good enough" solutions for consumers who are not interested in spending more money on home and car compressed audio players. However, we also believe that there will continue to be room in the market for home and automotive compressed audio player form factors and also multimedia player home and car devices that support video as well as compressed audio and other media formats.

Compressed Audio-Enabled Mobile Phones

Another trend that has begun to emerge is compressed audio integration in a greater number of mobile phones and the availability of wireless music services worldwide. Wireless music services enhance the value proposition of music-enabled handsets by allowing consumers to download or stream music directly to a handset without using a PC as an intermediary. IDC believes that MP3-enabled handsets will compete with standalone portable MP3 players as a substitute product, but their availability does not signal the demise of the portable compressed audio player category. Mobile phone vendors have a ways to go before their devices will be on par with standalone portable MP3 players.

As we have seen with other "converged" devices, it is not sufficient to only add a feature to a device to drive consumer usage of the feature. To draw users to this feature and ensure that they continue to use it, handsets will also need to have better-optimized software and hardware interfaces to facilitate accessing locally stored music files or wireless music services. In addition, power management will need to be improved to consistently support multimedia features as well as voice calls. Also, handset usage may be restricted in some situations, such as on airplanes (ostensibly due to concerns about interference with airplane navigation and communications equipment), in gyms (due to camera-enabled cell phones and privacy issues), and other public places due to noise concerns (e.g., ring-tone and conversation noise).

IDC expects that there will be a wide spectrum of user behavior around MP3-enabled mobile phones and portable MP3 players. On one end will be those who favor individual standalone devices, including portable MP3 players and digital cameras, and on the other end will be those who like multifunctional devices such as handsets with compressed audio and digital camera functionality. In between, there will be a large middle category, which will include consumers who own both types of devices, using both for playing music depending on lifestyle and occasion. As time goes on and MP3-enabled handsets become easier to use for audio playback, it is likely that more consumers will shift from favoring standalone devices to using portable MP3 players and MP3-enabled phones, and MP3-enabled phones exclusively. This topic is also discussed in the Future Outlook section.

Home Players

The audio-focused home compressed audio player category is challenged by many substitutes, including MP3-enabled DVD players, DVRs, media centers, home networked receivers, and other

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networked devices. These devices compete with home compressed audio players by offering support for multiple media formats - including compressed audio - in single-component solutions. Note that MP3-enabled DVD players and DVRs are counted in the "other" device category.

Home MP3 CD/MD Players

This category includes CD and MiniDisc-based shelf systems that support compressed audio playback. It also includes standalone stereo component CD players and rack systems that support compressed audio functionality.

As mentioned in the portable MP3 CD/MD player category, it is the major consumer electronics companies, such as Panasonic, Philips, Samsung, Sony, and Thomson RCA, that dominate the home compressed audio-enabled CD and MD player market because they include MP3 support as a feature in a growing percentage of their products. This trend has been the primary driver of unit shipments in the MP3 CD player category. However, it should be noted that the home CD player category overall is shrinking rapidly as consumers shift to home DVD players which also support CD and compressed audio playback.

Home Jukeboxes

This category includes hard driveœbased devices that support compressed and uncompressed audio. Note that this category includes only home jukeboxes that support audio formats exclusively. Hard driveœbased devices that support multiple media formats such as digital images, video, and audio are not included.

This category has grown slowly, because of relatively high price points and audio-only support. In the United States, the largest market, home jukeboxes, has been positioned as a premium product, and vendors typically target the high-end aftermarket and custom installation markets that are driven by quality and convenience.

In Japan, a coalition of vendors including Kenwood, Pioneer, Sharp, and Sony supporting the Any Music service began shipping HDD-based broadband-connected devices in 2004. Some of those devices also support video and are not counted in this forecast. Key players in the worldwide home jukebox market are Escient, Kenwood, Pioneer, Sharp, and Sony.

Home Networked Audio Receivers

These devices are thin clients that play back audio files stored on another device such as a PC. Home networked audio receivers do not include native storage. Music may be streamed over Ethernet, phone line, power line, and/or wireless-based home networks. Home networked receivers allow music to be streamed from the storage source to another location (i.e., another area in a room or another room in a house). Note that this category includes only devices that support audio formats exclusively. Networked receivers that support multiple media formats such as digital images, video, and audio are not included.

2004 and 2005 brought new players to the market, including Linksys, Roku, and Sonos. As of 2005, Voyetra Turtle Beach, which previously offered the Audiotron, one of the first devices available in this category, had exited the market. Motorola had also discontinued its SimpleFi device.

Key players in the worldwide home networked audio receiver category include Creative Technology, Linksys, Roku, and Sonos.

Automotive MP3 CD/MD Players

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This category includes automotive MP3 CD players and automotive MiniDisc players that support compressed audio formats and are sold through the aftermarket, dealer, and automotive OEM channels. MP3- and DVD-Video-enabled automotive devices are counted as part of the "other" compressed audio players category.

As with the portable and home MP3 CD/MD player categories, it is the major automotive electronics companies that dominate the automotive compressed audio-enabled CD and MD player market because they include MP3 support as a feature in a growing percentage of their CD players. This trend has been the primary driver of unit shipments in the MP3 CD player category. The automotive device market is transitioning from CD to DVD more slowly than the home

The following excerpt is from the IDC Market Analysis, *"U.S. Consumer Network - Embedded Audio Device 2005 - 2009 Forecast and Analysis"* prepared by Jonathan Gaw and Susan Kevorkian:

Multimedia networking is the next major horizon in the consumer digital technology space, and virtually every segment of the consumer technology sector stands to benefit from networked multimedia. Broadband service providers view home networking as a way of reducing subscriber churn while creating new revenue streams. PC and consumer electronics manufacturers view networked multimedia as an application to drive new sales. Content providers view networked multimedia as another means by which consumers can access their services or content, thereby making those services and content that much more valuable.

Widely accepted technology standards, such as the 802.11 wireless networking protocol, have already received wide consumer acceptance, with even the traditionally conservative industries such as residential telecommunications embracing the technology with brio.

Home networking has already gotten a strong foothold in the United States, and a growing number of households are using their networks for multimedia purposes, such as streaming audio from a PC to a stereo or home theater system.

Broadband subscribers have a strong interest in using their PCs and digital devices for listening to audio files. More than 1 in 8 respondents to IDC's 2005 Home Networking Panel Survey said they "used a stereo or home theater system that was connected to a home network to listen to audio files stored on a PC or network storage device."

Also, those who own portable compressed audio players, such as iPods, are more likely to own a home network. Similarly, the survey found that one-quarter of home network owners own a portable music player, while only 1 in 10 broadband subscribers who do not own a home network own a portable music player.

Market Drivers

Various technology and market elements have come together to create an environment ripe for consumers to finally start crossing the bridge between the PC and the consumer electronics worlds. All of the technological elements are either currently in place or on the near horizon. For example:

- Broadband adoption. Already, more than 30 million U.S. households subscribe to broadband Internet access. Broadband penetration is both an indicator of technological readiness by consumers and an enabler of both home networking and digital audio content and applications.

- Home networking adoption. More than 14 million U.S. households have a home network, a key component to networked multimedia. The large majority of those households use their networks

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for PC-related applications, such as sharing a broadband connection or peripherals among PCs. However, IDC surveys have shown a strong interest among home networkers to use their equipment for entertainment purposes. Broadband service providers view home networking as a customer retention tool and have recently begun to more aggressively market residential gateways, which combine a router with a modem.

- Digital audio device adoption. In 2004, nearly 23 million portable compressed audio players were shipped in the United States, indicating the strength of the interest in having music in a digital format. Having the music in a digital format is a critical step toward home-networked audio multimedia. Once people have their music in digital form, it opens the door for them to share their music across their various music players.

- Paid music service adoption. In 2004, 9.3 million U.S. users paid to subscribe to an online music service. The willingness to pay for online music, not just rip music from CDs or download music from free peer-to-peer systems, indicates a growing interest in acquiring music via the Internet.

- Wireless networking technologies. Improved wireless Ethernet technologies have made networked multimedia much more feasible by enabling home entertainment systems to access music residing on a PC or a storage device in another room without having to string wires. The emergence of 802.11g brought more than enough bandwidth to the home network to accommodate audio networking, while the pending 802.11n standard promises to increase the range of the networks as well as throughput. Furthermore, improvements in quality of service of wireless Ethernet have already started to be put in place, promising smooth transmission of data.

As digital audio content and services proliferate, consumers are looking to free the digital music from their PC confines and play the music through their stereos and home theater systems, and home networks will allow them to do that.

Market Inhibitors

As in most consumer technology markets, technology adoption occurs in fits and starts, with perception, accessibility, price points, and a myriad of other nontechnology factors coming into play. In the PC world, simplicity in implementation and operation plays a greater role in the consumer market than in the enterprise. Similarly, simplicity in the consumer electronics world is even more important than in the PC world. The TV is the standard for simplicity, not the PC.

Furthermore, the notion of home networking to many consumers today is as foreign to them as the notion of the Internet was 10 years ago. It took years for many mainstream consumers who logged on to the Internet to go beyond sending email, and even then this oftentimes happened only after they had been exposed to PCs in the workplace, where technical training and support were available. If they did venture to the Web, oftentimes they did not understand that the content of the site they were visiting did not actually reside on their computer. In addition, unlike PC and Internet usage, there are few analogies to the home network and devices in the enterprise outside of networked PCs and printers; many consumers are first introduced to technologies at work that they eventually adopt for personal use. Similarly, consumers have a hard time conceptualizing both the operation and the value of a network in their home. What does it do and why would they want to do that? For example:

- Inertia. Changing consumers' behavior when there already exists a substantively satisfactory incumbent requires more than a better product with more features at a reasonable price. Rather, when it comes to entertainment, mainstream users will only gradually upgrade their equipment unless changing lifestyles demand new features or a new technology comes along that is perceived to be radically better than the incumbent.

- Consumer mindset. Educating consumers on the difference between the analog and digital worlds has historically been a challenge since the early days of consumer computing, and it is

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unlikely that will change for multimedia networking. This problem has been compounded by evolving methods of digital media delivery, including those based on physical media, such as the CD and DVD, and delivering audio and video files via stream and/or download to a PC. Consumers may have difficulty adopting a different conceptual framework of music based on bits instead of atoms. The availability of attractive and affordable portable compressed audio players and IP-based music services has moved that process along significantly, but multimedia networking will require a further evolution on the part of the mainstream consumer, and therefore marketing and education by the vendors in the home networking market.

- Home networking interfaces. The complexity of home networking - indeed, the very language of "networking" - tends to turn off consumers. Installing, maintaining, and operating a home network can be confusing and complex for the mainstream user, particularly in an environment with PCs that have different operating systems and security setups. Home networking vendors have made significant strides in making their devices more accessible, such as push-button systems to create secure wireless networks, but they need to continue to improve, and the market messaging needs to evolve if this market is going to take off.

- Security. Mainstream home networking users grudgingly sacrifice security for simplicity, and multimedia networking only exacerbates the issue. One-third of home networking users use the encryption option on their wireless networks, while two-thirds rely on firewalls.

FUTURE OUTLOOK

Recent years have seen the introduction of a growing number of devices designed for wirelessly connecting a stereo or home entertainment system to a home network to access online music and/or music files locally stored on a PC or other network storage device. Some of the devices, such as Linksys' Wireless-B Media Link for Music, come from the networking industry, while others come from the consumer electronics world. While these third-party devices are adequate interim solutions that bridge the PC network and the home's multimedia devices, IDC believes that the endgame has networking as a built-in feature of AV and DVD receivers, which serve as the center of the home theater experience, and secondarily in devices such as DVD players. Ultimately, we expect that consumer electronics players (those who are key players today, but also those who are likely to enter this market given the opportunities available) will take the lion's share of the networking-embedded home stereo market.

The following excerpt is from an online article titled, *"Portable Music, Video Players Set to Double"* prepared by Bryan Gardiner:

Analyst firm iSuppli released new figures for the portable media player (PMP) industry yesterday, saying that it expects the market to double—in terms of units shipped—from 2005 to 2011.

This year alone, unit shipments are expected to reach 217 million, up 22 percent from 2006's 178 million, according to the research firm. iSuppli also said that PMP/MP3 players now represent one of the fastest growing segments in the consumer electronics industry and that shipments are expected to rise to 269 million units, globally, by 2011.

Revenue is expected to follow suit, increasing from $20.6 billion this year to $21.5 billion in 2011, according to Chris Crotty, senior analyst for consumer electronics at iSuppli.

"A major driving factor behind this growth is the fact that PMP/MP3 players take advantage of the Internet more than other consumer electronics devices, giving users the ability to quickly and easily sample, acquire, and share media," he said in a statement Wednesday.

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PMP shipments, in particular, are forecasted to grow faster than those of music-only MP3 players in the coming years due to increased consumer use of the Internet for video. That trend will continue as broadband connectivity and Internet usage rises during the next five years, iSuppli said.

By 2011, PMPs are expected to account for more than 66 percent of the combined PMP/MP3 unit shipments. In particular, Flash-based PMPs are expected to reach the 135 million unit mark by 2011, up from 47 million this year.

Crotty also attributed the rapid market expansion to the growing catalog of available content and component cost reductions that are now making players more affordable.

SUMMARY

Based on the above analysis we do not believe that an investor in the Patents would assess additional risk to an investment in the Patents due to the current conditions or industry outlook. We will reflect this in our development of an applicable discount rate later in this report.

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VALUATION METHODS

OVERVIEW

The appropriate application of a particular method of valuation in a given case is dependent upon the facts and circumstances surrounding the case. The factors applicable to a particular case that will impact the selection of the most appropriate method of valuation may include, but are not limited to the following:

- The purpose of the valuation;
- The existence or lack of adequate publicly traded comparable assets;
- The relative stability or irregularity of the historical earnings of the subject asset;
- The premise of the valuation engagement (i.e., liquidation versus going concern).

In this valuation, we considered the use of the income, cost, and market approaches and corresponding methods in determining fair market value. Following is a general overview of the income, cost and market methods that we considered and the ones that we used. A detailed description of the application of the methods we applied to value the Patents appears later in the report. While we considered various methods to value the Patents, we specifically used the discounted royalty method.

INCOME APPROACH

The income approach is based upon the economic principle of "anticipation" (sometimes called the principle of "expectation"). In this approach, the value of the subject investment (i.e., the Patents) is the present value of the economic income expected to be generated by the investment. As the name of this economic principle implies, the investor "anticipates" the "expected" economic income to be earned from the investment. This expectation of prospective economic income is converted to a present worth – that is, the indicated value of the subject business interest.

There are numerous methods that make up the income approach, including capitalization of earnings, capitalization of dividends, capitalization of excess earnings, discounted future earnings, and discounted free cash flow. We used the discounted royalty method for reasons that we will explain in the following section.

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Discounted projected future income methods involve projecting possible future income streams (e.g., earnings, cash flow) on a year-by-year basis, usually for five or more years. Future income streams are then discounted at an appropriate discount rate (required rate of return on investment based on perceived investment risk) to a present value today. At the final projection year a "terminal value" is determined, representing an estimated value for all income streams occurring after the terminal period. The terminal value is then discounted (at the discount rate) to its present value today. The summation of the present value of the projected income streams and the terminal value yields a value estimate of the asset.

Shown below is the generalized formula for the discounted future income method. The formula shows the indicated value to be the sum of the present values of the annual income streams and the terminal value of the asset:

Formula for Use of

the Discounted Future Income Method

$$PV = \frac{E_1}{(1+k)} + \frac{E_2}{(1+k)^2} + ... + \frac{E_n}{(1+k)^n} + \frac{\frac{E_n(1+g)}{k-g}}{(1+k)^n}$$

Where:

$E_1 \ldots E_n$ = Expected amounts of economic income in each period E_1 through E_n

k = Discount Rate

n = Number of periods in the discrete projection period

g = Annually compounded growth rate in perpetuity for the prospective economic income, beyond the discrete projection period

If an asset's earnings or cash flows are growing at a constant rate into perpetuity, the above method does not need to be used, as the formula is then mathematically equivalent to the results achieved by using a capitalization method. When cash flows are expected to terminate at a known future date, this method is appropriate. Since the legal term of the Patents is based on a 20 year period, we utilized the discounted cash flow method. However, we did not include a terminal value in our calculations as the Patents are assumed to not have material value at the end of their legal term.

The following sections detail how we used the discounted cash flow method to value the Patents including the expected future royalty income and the development of the discount rates used.

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A patent gives the owner an exclusive right to prevent others from practicing the patented technology in the country issuing the patent for the term of the patent. The right may be enforced in a lawsuit for monetary damages or to prohibit use of the patent. In a patent license, royalties are paid to the patent owner in exchange for a license to practice one or more of the four basic patent rights: to manufacture, use, sale, or advertise for sale, a patented technology.

Patent rights may be divided and licensed out in various ways, on an exclusive or nonexclusive basis. The license may be subject to limitations as to time or territory. A license may encompass an entire technology or it may involve a mere component or improvement on a technology. In the United States, "reasonable" royalties may be imposed, both after-the-fact and prospectively, by a court as a remedy for infringement.

Determination of an Appropriate Royalty Rate Under the Income Approach

The income approach focuses on the licensor estimating the profits generated by the licensee and obtaining an appropriate share of the generated profit. It is unrelated to costs of technology development or the costs of competing technologies.

The approach requires the licensee (or licensor): (a) to generate a cash-flow projection of incomes and expenses over the life-span of the license under an agreed scenario of incomes and costs (b) determining the Net Present Value, ("NPV") of the profit stream, based on a selected discount factor, and c) negotiating the division of such profit between the licensor and the licensee.

The actual discount factor used depends on the risk assumed by the principal gainer in the transaction. For instance, a mature technology worked in different geographies, will carry a lower risk of non-performance (thus, a lower discount rate) than a technology being applied for the first time. A similar situation arises when there is the option of working the technology in one of two different regions; the risk elements in each region would be different.

Three aspects to the profit of the enterprise must be noted:

(a) The profit that accrues to the licensee may not arise solely through the engine of the technology. There are returns from the mix of assets it employs such as fixed and working capital and the returns from intangible assets such as distribution systems, trained workforce, etc. Allowances need to be made for them.

(b) Profits are also generated by thrusts in the general economy, gains from infrastructure, and the basket of licensed rights - patents, trademark, know-how. A lower royalty rate may apply in an

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advanced country where large market volumes can be commanded, or where protection to the technology is more secure than in an emerging economy (or perhaps, for other reasons, the inverse).

(c) The royalty rate is only one aspect of the negotiation. Contractual provisions such as an exclusive license, rights to sub-license, warranties on the performance of technology may enhance the advantages to the licensee.

The basic advantage of this approach, which is perhaps the most widely applied, is that the royalty rate can be negotiated without comparative data on how other agreements have been transacted. In fact, it is almost ideal for a case where precedent does not exist.

Determination of an Appropriate Royalty Rate Under the Market Approach

We used the market approach in the determination of an appropriate royalty rate for the Patents. Under the market approach the royalty rate is determined from comparing competing or similar technologies in an industry, modified by considerations of useful remaining life of the technology in that industry and contracting elements such as exclusivity provisions, front-end royalties, field of use restrictions, geographic limitations and the "technology bundle" (i.e. the mix of patents, know-how, trade-mark rights, etc.) accompanying it. The following table depicts the range of royalty rates by industry and is based on compiled royalty information from *"Use of the 25 Per Cent Rule in Valuing IP"* and *"Valuing Your Intellectual Property for Strategic Alliances and Financing"*.

Royalty Distribution Analysis by Industry

Industry	Licenses	Min. Royalty %	Max. Royalty %	Avg. Royalty %	Med. Royalty %
Automotive	35	1.00%	15.00%	4.70%	4.00%
Computers	68	0.20%	15.00%	5.20%	4.00%
Consumer Goods	90	0.00%	17.00%	5.50%	5.00%
Electronics	132	0.50%	15.00%	4.30%	4.00%
Healthcare	280	0.10%	77.00%	5.80%	4.80%
Internet	47	0.30%	40.00%	11.70%	7.50%
Machine Tools	84	0.50%	26.00%	5.20%	4.60%
Pharma/Bio	328	0.10%	40.00%	7.00%	5.10%
Software	119	0.00%	70.00%	10.50%	6.80%

We concentrated on the electronics licensing data as it is the most relevant sector with regard to comparable royalty rates for the subject Patents. As indicated in the previous table, the average royalty rate for the 132 transactions under the electronics category was 4.30% and the median was 4.00%. The royalty rates on each of these transactions were based on a fixed percentage of revenues,

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with revenues being synonymous with the terms net sales, invoice price, wholesale price, wholesale costs and similar descriptions.

The distribution of the royalty rates in various technology sectors is illustrated in the following table:

Royalty Rate Segmentation in Technology Sectors

Industry	0-2%	2-5%	5-10%	10-15%	15-20%
Aerospace	50.0%	50.0%			
Chemical	16.5%	58.2%	24.3%	0.8%	0.4%
Computers	62.5%	31.3%	6.3%		
Electronics		50.0%	25.0%	25.0%	
Healthcare	3.3%	51.7%	45.0%		
Pharma/Bio	23.6%	32.1%	29.3%	12.5%	
Telecom	40.0%	37.3%	23.6%		1.1%

Source: Dan McGavock of IPC Group

As illustrated in the previous table, 50% of the royalty rates from the electronics sector fell within the 2% to 5% range, 25% fell within the 5% to 10% range, and 25% fell within the 10% to 15% range.

In the case of the subject Patents, we were provided with projected annual unit shipments, which were based on relevant industry statistics. We were also provided with Mr. Phillips' estimated royalty amounts of $8.00 per unit shipped related to data transfer optimization and $.80 per unit shipped related to the playlist selection, which translates to an approximate royalty rate of 5.2% and 1.6%, respectively. We also included another discounted royalty calculation based on a royalty rate of $4.00 per unit shipped related to data transfer optimization and $.40 per unit shipped related to the playlist selection, which translates to an approximate royalty rate of 2.6% and 0.8%, respectively. Based on the previous industry analysis and royalty analysis, we believe that the projected annual unit shipments and the indicated royalty rates are reasonable.

Indication of Value Using the Discounted Royalty Method

Estimated Future Royalty Income

As previously indicated, we were provided with the projected annual unit shipments related to the Patents based on relevant industry statistics. We calculated the estimated future after-tax royalty income for the years ending December 31, 2008 through 2021 based on projected annual unit shipments and the following scenarios of royalty fee per unit shipped:

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In the first scenario, we used a royalty rate of $8.00 per unit shipped for the Patents related to data transfer optimization and $.80 per unit shipped for the Patents related to playlist selection.

In the second scenario, we used a royalty rate of $4.00 per unit shipped for the Patents related to data transfer optimization and $.40 per unit shipped for the Patents related to playlist selection. We estimated potential royalty income under these scenarios as follows:

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Estimated Future Royalty Income (Millions)

As of October 26, 2007

Future Periods	Unit Shipments [1]		Royalty Rate per Unit [2]		Pre-Tax Royalty Income		Total Pre-Tax Royalty Income	Less Income Taxes [3]	Annual After-Tax Royalty Income
	Data Transfer Optimization	Playlist Selection	Data Transfer Optimization	Playlist Selection	Data Transfer Optimization	Playlist Selection			
2008	24.12	56.97	$8.00	$0.80	$192.96	$45.58	$238.54	$95.41	$143.12
2009	23.20	59.14	$8.00	$0.80	$185.60	$47.31	$232.91	$93.16	$139.75
2010	22.28	61.31	$8.00	$0.80	$178.24	$49.05	$227.29	$90.92	$136.37
2011	21.36	63.48	$8.00	$0.80	$170.88	$50.78	$221.66	$88.67	$133.00
2012	15.76	60.97	$8.00	$0.80	$126.08	$48.78	$174.86	$69.94	$104.91
2013	16.71	65.01	$8.00	$0.80	$133.68	$52.01	$185.69	$74.28	$111.41
2014	17.66	69.05	$8.00	$0.80	$141.28	$55.24	$196.52	$78.61	$117.91
2015	18.61	73.09	$8.00	$0.80	$148.88	$58.47	$207.35	$82.94	$124.41
2016	19.56	77.13	$8.00	$0.80	$156.48	$61.70	$218.18	$87.27	$130.91
2017	20.51	81.17	$8.00	$0.80	$164.08	$64.94	$229.02	$91.61	$137.41
2018	21.46	85.21	$8.00	$0.80	$171.68	$68.17	$239.85	$95.94	$143.91
2019	22.41	89.25	$8.00	$0.80	$179.28	$71.40	$250.68	$100.27	$150.41
2020	23.36	93.29	$8.00	$0.80	$186.88	$74.63	$261.51	$104.60	$156.91
2021	24.31	97.33	$8.00	$0.80	$194.48	$77.86	$272.34	$108.94	$163.41
Subtotal							**$3,156.40**	**$1,262.56**	**$1,893.84**

[1] *Royalty units based on IDC #33932 "Worldwide and U.S. Compressed Audio Player 2005-2009 Forecast and Analysis" and management estimates.*

[2] *Provided by management.*

[3] *Combined federal and state tax rate of 40%.*

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Estimated Future Royalty Income (Millions)

As of October 26, 2007

Future Periods	Unit Shipments [1]		Royalty Rate per Unit [2]		Pre-Tax Royalty Income		Total Pre-Tax Royalty Income	Less Income Taxes [3]	Annual After-Tax Royalty Income
	Data Transfer Optimization	Playlist Selection	Data Transfer Optimization	Playlist Selection	Data Transfer Optimization	Playlist Selection			
2008	24.12	56.97	$4.00	$0.40	$96.48	$22.79	$119.27	$47.71	$71.56
2009	23.20	59.14	$4.00	$0.40	$92.80	$23.66	$116.46	$46.58	$69.87
2010	22.28	61.31	$4.00	$0.40	$89.12	$24.52	$113.64	$45.46	$68.19
2011	21.36	63.48	$4.00	$0.40	$85.44	$25.39	$110.83	$44.33	$66.50
2012	15.76	60.97	$4.00	$0.40	$63.04	$24.39	$87.43	$34.97	$52.46
2013	16.71	65.01	$4.00	$0.40	$66.84	$26.00	$92.84	$37.14	$55.71
2014	17.66	69.05	$4.00	$0.40	$70.64	$27.62	$98.26	$39.30	$58.96
2015	18.61	73.09	$4.00	$0.40	$74.44	$29.24	$103.68	$41.47	$62.21
2016	19.56	77.13	$4.00	$0.40	$78.24	$30.85	$109.09	$43.64	$65.46
2017	20.51	81.17	$4.00	$0.40	$82.04	$32.47	$114.51	$45.80	$68.70
2018	21.46	85.21	$4.00	$0.40	$85.84	$34.08	$119.92	$47.97	$71.95
2019	22.41	89.25	$4.00	$0.40	$89.64	$35.70	$125.34	$50.14	$75.20
2020	23.36	93.29	$4.00	$0.40	$93.44	$37.32	$130.76	$52.30	$78.45
2021	24.31	97.33	$4.00	$0.40	$97.24	$38.93	$136.17	$54.47	$81.70
Subtotal							**$1,578.20**	**$631.28**	**$946.92**

[1] *Royalty units based on IDC #33932 "Worldwide and U.S. Compressed Audio Player 2005-2009 Forecast and Analysis" and management estimates.*

[2] *Provided by management.*

[3] *Combined federal and state tax rate of 40%.*

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The following excerpt is from an online article titled, *"Making Money From Your Invention"* authored by Robert M. Hunter, Ph.D., Registered Patent Agent:

> The most difficult factor to come up with is the discount factor. It is the way that both the cost of money and risk are factored into the analysis. It is not unusual for discount factors in the 25-35 percent per year range (compounded annually) to be used. This may sound disgustingly high, but when one realizes that angels and venture capitalists use discount factors of 50-100 percent for startups, numbers used in industry sound like "free money." In setting the discount rate, one should consider such factors as how "proven" the concept is, how close it is to a product, how solid are the patents, how broad the patent claims are, how acceptable the product is to "lead customers," etc.

The greater the risk for a specific asset the greater the rate of return required to compensate an investor for incurring the risk. The result is a "discount rate" representing the annual investor required rate of return, a measure of the cost of equity. We considered the terms and investment characteristics of the subject Patents (discussed previously) and where a hypothetical buyer would most likely assess the Patents in terms of risk relative to other investment vehicles. The following table summarizes the spectrum of the rates of return for various types of investments:

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Investment Spectrum Annual Rates of Return
Development of Contract Discount Rate

Investment Type	Annual Return
Long-Term (20-year Maturity) Treasury Coupon Yield[1]	4.7%
Long-Term Corporate Bonds Arithmetic Mean Return[2]	6.2%
Largest Decile Arithmetic Mean Return[3]	11.4%
Real Estate Investment Trusts (REITs)[4]	13.8%
Smallest Decile Arithmetic Mean Return[5]	21.6%
Venture Capital - Second Stage / Expansion[6]	20% - 40%
Venture Capital - First Stage / Early Development[6]	40% - 60%
Venture Capital - Start-Up[6]	50% - 100%

[1] *Federal Reserve Statistical Release Date October 29, 2007.*

[2] *Reflects the mean return for long-term corporate bonds from 1926 through 2006 reported by Stocks, Bonds, Bills & Inflation, 2007 Yearbook, published by Ibbotson Associates.*

[3] *Reflects the mean return for the largest decile portfolio (market capitalization of $16.8 billion and higher) from 1926 through 2006 reported by Stocks, Bonds, Bills & Inflation, 2007 Yearbook, published by Ibbotson Associates.*

[4] *Reflects the compound annual return for REITs from 1975 to 2005 reported by National Association of Real Estate Investment Trusts.*

[5] *Reflects the mean return for the smallest decile portfolio (market capitalization between $2.2 million and $314.9 million) from 1926 through 2006 reported by Stocks, Bonds, Bills & Inflation, 2007 Yearbook, published by Ibbotson Associates.*

[6] *Timmons, Jeffrey A., New Venture Creation, 5th Edition, (Chicago: Irwin, 1999).*

Given the current pending status, the limited economic life of the Patents, and the estimated royalty income generated from the Patents we believe that the appropriate required rate of return would be approximately 40%. Under the assumption that the Patents are approved and issued, we believe that the appropriate required rate of return would be approximately 30%.

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Specific Asset Risk Premium

In some cases, it may be appropriate to add or subtract an additional risk premium for asset specific risk, representing the positive or negative risk relative to an investment in small, publicly traded companies. In this specific instance we added an additional risk premium. The additional adjustment was primarily based on the intangible nature of the Patents, which typically warrants a higher required rate of return compared to a company as a whole (i.e. tangible and intangible assets). Additionally, we have increased the asset-specific risk premium under the assumption that the Patents are pending, versus the assumption that the Patents have been issued.

We also considered the state of the market for which the Patents apply, the competitive landscape, and the availability of substitutes for the Patents as stated previously in this report. To recapitulate, we believe that the market for the products for which the Patents apply is expanding and is likely to continue expanding through the remaining legal term of the Patents. However, we also believe that fierce competitive pressures and rapidly evolving technology pose a significant risk to the value of the Patents. Based on the nature of the Patents and these considerations, we believe an investor in the Patents would assess significant additional risk to an investment in the Patents.

Discounted Royalty Income

Using estimated after-tax royalty income derived from the Patents as computed previously for a royalty rate of $8.00 per unit shipped for the Patents related to data transfer optimization and $.80 per unit shipped for the Patents related to playlist selection, and the previously determined discount rates of 40% under the assumption that the Patents are pending and 30% under the assumption that the Patents are issued, we calculated the preliminary value of an interest in the Patents as follows:

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Discounted Royalty Method (Millions)
As of October 26, 2007

Future Period Ending	Total Future Royalty Income [1]	Discount Factor at 40% [2]	Present Value (Patents Pending)	Discount Factor at 30% [3]	Present Value (Patents Issued)
2008	$143.12	0.8452	$120.96	0.8771	$125.53
2009	$139.75	0.6037	$84.36	0.6747	$94.28
2010	$136.37	0.4312	$58.80	0.5190	$70.77
2011	$133.00	0.3080	$40.96	0.3992	$53.09
2012	$104.91	0.2200	$23.08	0.3071	$32.22
2013	$111.41	0.1571	$17.51	0.2362	$26.32
2014	$117.91	0.1122	$13.24	0.1817	$21.43
2015	$124.41	0.0802	$9.97	0.1398	$17.39
2016	$130.91	0.0573	$7.50	0.1075	$14.08
2017	$137.41	0.0409	$5.62	0.0827	$11.36
2018	$143.91	0.0292	$4.20	0.0636	$9.16
2019	$150.41	0.0209	$3.14	0.0489	$7.36
2020	$156.91	0.0149	$2.34	0.0376	$5.91
2021	$163.41	0.0106	$1.74	0.0290	$4.73
Indication of the Value of the Patents			**$393.43**		**$493.62**
Rounded			**$393.00**		**$494.00**

[1] *From the "Estimated Future Royalty Income" table.*
[2] *We used a 40% discount rate assuming the patents are pending.*
[3] *We used a 30% discount rate assuming the patents are issued.*

Using estimated after-tax royalty income derived from the Patents as computed previously for a royalty rate of $4.00 per unit shipped for the Patents related to data transfer optimization and $.40 per unit shipped for the Patents related to playlist selection, and the previously determined discount rates of 40% under the assumption that the Patents are pending and 30% under the assumption that the Patents are issued, we calculated the preliminary value of an interest in the Patents as follows:

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Discounted Royalty Method (Millions)
As of October 26, 2007

Future Period Ending	Total Future Royalty Income [1]	Discount Factor at 40% [2]	Present Value (Patents Pending)	Discount Factor at 30% [3]	Present Value (Patents Issued)
2008	$71.56	0.8452	$60.48	0.8771	$62.76
2009	$69.87	0.6037	$42.18	0.6747	$47.14
2010	$68.19	0.4312	$29.40	0.5190	$35.39
2011	$66.50	0.3080	$20.48	0.3992	$26.55
2012	$52.46	0.2200	$11.54	0.3071	$16.11
2013	$55.71	0.1571	$8.75	0.2362	$13.16
2014	$58.96	0.1122	$6.62	0.1817	$10.71
2015	$62.21	0.0802	$4.99	0.1398	$8.69
2016	$65.46	0.0573	$3.75	0.1075	$7.04
2017	$68.70	0.0409	$2.81	0.0827	$5.68
2018	$71.95	0.0292	$2.10	0.0636	$4.58
2019	$75.20	0.0209	$1.57	0.0489	$3.68
2020	$78.45	0.0149	$1.17	0.0376	$2.95
2021	$81.70	0.0106	$0.87	0.0290	$2.37
Indication of the Value of the Patents			**$196.71**		**$246.81**
Rounded			**$197.00**		**$247.00**

[1] *From the "Estimated Future Royalty Income" table.*
[2] *We used a 40% discount rate assuming the patents are pending.*
[3] *We used a 30% discount rate assuming the patents are issued.*

Conclusion

Based on our consideration of all relevant factors, the fair market value of the Patents for a royalty rate of $8.00 per unit shipped for the Patents related to data transfer optimization and $.80 per unit shipped for the Patents related to playlist selection, as of October 26, 2007 is $393,000,000 under pending status and $494,000,000 under issued status. The fair market value of the Patents for a royalty rate of $4.00 per unit shipped for the Patents related to data transfer optimization and $.40 per unit shipped for the Patents related to playlist selection, as of October 26, 2007 is $197,000,000 under pending status and $247,000,000 under issued status.

We have no present or contemplated financial interest in Mark Phillips Patents or the Patents. Our fees for this valuation are based upon hourly billing rates, and are in no way contingent upon the results of our findings. We have no responsibility to update this report for events and circumstances

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occurring subsequent to the date of this report, although we will be pleased to perform an update valuation should you require one.

This valuation was performed to determine the fair market value of the Patents and is intended for no other purpose. This letter and report are to be distributed only in their entirety, and are intended and restricted for use by Mark Phillips and his representatives. This report is not to be copied or made available to any persons without the express written consent of Brueggeman and Johnson Yeanoplos, P.C.

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EXHIBIT “I”

NON-EXCLUSIVE LICENSE AGREEMENT

This Non-Exclusive License Agreement ("Agreement") is made and entered into as of June 20th, 2006 ("Effective Date") by and between Mark E. Phillips, an individual citizen of the State of Washington with a mailing address of 720 3rd Ave #1100, Seattle, Washington 98104 ("Phillips"), and Banana Corporation, a Washington corporation with a principal place of business at 720 Third Avenue, Suite 1100, Seattle, Washington 98104 ("BANANA").

WHEREAS, Phillips and BANANA wish to enter an agreement authorizing certain use by BANANA of Licensed Materials, as more particularly set forth herein;

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties intending to be bound hereby agree as follows:

1. DEFINITIONS.

As used in this Agreement, the following terms shall have the following meanings:

1.1. "After-developed Property" shall mean any and all intellectual property developed by either party, before or after the Effective Date, that is an idea, invention, or improvement, or a derivative work, or Confidential Information of, relating to, and/or resulting from access to the Licensed Materials.

1.2. "Field of Use" shall mean phone transactions for use in connection with BANANA product, service and software offerings.

1.3. "Licensed Materials" shall mean all intellectual property rights of Phillips as may exist in relation the items identified in Exhibit A, all After-developed Property, and all Confidential Information disclosed by Phillips hereunder. Licensed Materials shall include computer programming code identified in Exhibit A.

1.4. "Licensed Product" shall mean any product or service that was created by exploitation of or that in its operation or use exploits any intellectual property right within the Licensed Materials.

1.5. "Net Sales Price" shall mean the gross sales price or license or other fee charged by BANANA to any party for and/or in connection with a unit of Licensed Product, less any amount actually returned by BANANA to a party in connection with the return of a defective Licensed Product.

CONFIDENTIAL

2. LICENSE GRANT

2.1. License. Subject to all the terms and conditions of this Agreement, Phillips hereby grants to BANANA a worldwide, non-exclusive, non-transferable, non-sublicensable, revocable, royalty-bearing license during the Term to exploit the Licensed Materials for the sole purpose of creating, offering, and selling Licensed Products within the Field of Use.

2.2. Implied Licenses. The only license granted in this Agreement is the license expressly set forth in paragraph 2.1. There are no implied licenses under this Agreement.

3. ROYALTIES AND OTHER PAYMENTS

3.1. Signing Fee. BANANA shall pay a one-time signing fee to Phillips in the amount of $ 2,500,000 upon execution of this Agreement by Phillips. If BANANA fails to pay such fee upon execution by Phillips, any unpaid portion shall accrue interest at the rate of 5% per year, compounded annually.

3.2. Payments and Reports. All payments due pursuant to paragraph 3.2 shall be paid by BANANA to Phillips annually. Each payment shall be accompanied by a report that includes all information necessary to determine the royalty due, including without limitation the unit sales of each type of Licensed Product, the Net Sales Price of each type of Licensed Product, and the calculation of the royalty based on such sales. Payments and reports provided pursuant to this paragraph shall be provided by BANANA to Phillips within one month of the end of each calendar year.

3.3. Affiliate Businesses. Phillips may, but is not required to, include Mr. Arnold in future businesses related to Phillips intellectual property or development of Banana after developed product.

4. RECORDS

4.1. Retaining Records. BANANA shall keep for at least three (3) years after each annual payment required to be made hereunder sufficient books and records to enable Phillips conveniently to verify the proper payment of all amounts due hereunder. Such books and records shall be kept at BANANA's primary place of business.

4.2. Right to Review Records. Phillips shall have the right, not more than once per calendar year, to examine and audit the books and records kept by BANANA pursuant to paragraph 4.1. Phillips shall exercise this right only during customary business hours of BANANA and shall provide reasonable notice of his intention to conduct such examination or audit. Phillips may conduct any such examination or audit with the assistance of a certified public accountant or other professional. Phillips shall procure from any such accountant or other professional an undertaking to hold all information derived from the examination or audit confidential, provided that Phillips

and the accountant or other professional may use any information derived from the audit for the purpose of enforcing Phillips' rights hereunder. BANANA shall make available to Phillips all facilities reasonably necessary to enable the examination or audit. If any examination or audit shows an underpayment by BANANA, BANANA shall immediately pay to Phillips the full amount of the underpayment and interest on the underpayment at the rate set forth in paragraph 3.2. If any examination or audit shows an underpayment by BANANA of two point five percent (2.5%) or more, BANANA shall immediately pay to Phillips the full amount of the underpayment, interest on the underpayment at the rate set forth in paragraph 3.2, and all expenses incurred by Phillips in connection with the examination or audit.

5. COOPERATION

5.1. New Developments. Any After-developed Property shall be owned by Phillips. BANANA shall assign and hereby does assign to Phillips, on its own behalf and on behalf of any of its employees and agents, any and all rights as it may have in any After-developed Property. BANANA shall, for itself and its employees and agents, execute any document and take any action reasonably required to effect the foregoing assignment. BANANA shall promptly inform Phillips of any After-developed Property in a manner that will enable Phillips to seek patent, copyright, and/or other legal protection of such After-developed Property. All costs associated with obtaining such protection shall be borne in the first instance by Phillips and promptly reimbursed by BANANA, upon the presentation by Phillips of invoices and/or receipts reflecting payment of such costs; this reimbursement by BANANA shall be further consideration for the license granted in this Agreement.

5.2. Notice of Infringement. BANANA shall promptly notify Phillips in writing if BANANA learns or suspects that any third-party may be infringing any right within the Licensed Materials.

5.3. Enforcement. Phillips shall have the sole right, but no obligation, to pursue any infringement of the Licensed Materials, to defend any challenge to the validity or enforceability of the Licensed Materials, and to enter any settlements, judgments or other arrangements in respect of the Licensed Materials.

5.4. Assistance. BANANA shall cooperate fully with Phillips in Phillips' efforts to procure, perfect, and enforce any rights within the Licensed Materials.

6. TERM AND TERMINATION

6.1. Term. The term of this Agreement ("Term") will commence upon the Effective Date and continue for a period of three (3) years unless earlier terminated as provided in this Agreement.

6.2. Notice of Material Breach or Default. If a party commits a material breach or default in the performance of any of its obligations under this Agreement, the

other party may give the defaulting party written notice of the material breach or default and its intention to terminate the Agreement if the material breach or default is not cured within fifteen (15) days (or such later date as may be specified in writing by the other party). If the defaulting party fails to cure the breach or default in such time, this Agreement shall be deemed terminated without any further action by any party. Any failure by a party to pay timely to the other party any amounts owing under this Agreement will constitute a material breach of this Agreement.

6.3. Accelerated Notice and Termination. If a party commits a material breach or default in the performance of any of its obligations under this Agreement and such material breach or default is not susceptible of cure, the other party may terminate this Agreement effectively immediately upon written notice to the defaulting party.

6.4. Insolvency or Bankruptcy. Phillips may terminate this Agreement by written notice to BANANA in the event that BANANA shall become insolvent or bankrupt, or shall have made an assignment for the benefit of its creditors, or there shall have been appointed a trustee or receiver of BANANA or for all or a substantial part of BANANA's property, or shall any case or proceeding have been commenced or other action taken by or against BANANA in bankruptcy or seeking reorganization, liquidation, dissolution, or adjustment of its debts. In addition, Phillips may terminate this Agreement by written notice to BANANA if the annualized revenue of BANANA falls below $3,000,000 for any one (1) year period.

6.5. Post-Termination Obligations. Upon termination of this Agreement for any reason, all licenses granted herein shall immediately terminate, and BANANA shall deliver to Phillips all Licensed Materials and Confidential and all documents and other records that contain Licensed Materials or Confidential Information. Within fifteen (15) days of termination, BANANA shall verify in writing to Phillips that it has complied with the requirements of this paragraph.

6.6. Survival. The following provisions shall survive termination of this Agreement: Section 1, Section 3 (as to any payment or reports due), Section 4 (to the extent set forth therein), Sections 5-7, Section 8 (to the extent set forth therein), and Section 9.

7. WARRANTIES AND DISCLAIMERS

7.1. Mutual Warranties. Each party represents and warrants to the other that (a) this Agreement has been duly executed and delivered and constitutes a valid and binding agreement enforceable against such party in accordance with its terms; (b) no authorization or approval from any third party is required in connection with such party's execution, delivery, or performance of this Agreement; and (c) the execution, delivery, and performance of this Agreement does not violate the laws of any jurisdiction or the terms or conditions of any other agreement to which it is a party or by which it is otherwise bound.

7.2. Indemnification by BANANA. BANANA shall indemnify, defend, and hold Phillips harmless from and against any claim arising out of the exploitation by BANANA of the Licensed Materials, the sale or licensing or other offering of Licensed Products, and the conduct generally of BANANA's business.

7.3. Disclaimer. EXCEPT FOR THE EXPRESS REPRESENTATIONS AND WARRANTIES STATED IN THIS SECTION 7, NEITHER PARTY MAKES ANY REPRESENTATION OR WARRANTY OF ANY KIND WHETHER EXPRESS, IMPLIED (EITHER IN FACT OR BY OPERATION OF LAW), OR STATUTORY, AS TO ANY MATTER WHATSOEVER. EACH PARTY EXPRESSLY DISCLAIMS ALL IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR ANY PARTICULAR PURPOSE, QUALITY, ACCURACY, TITLE, AND NON-INFRINGEMENT. THE LICENSED MATERIALS ARE PROVIDED AS-IS. NEITHER PARTY WARRANTS AGAINST INTERFERENCE WITH THE ENJOYMENT OF ANY MATERIALS OR INFORMATION PROVIDED IN CONNECTION WITH THIS AGREEMENT. NEITHER PARTY WARRANTS THAT ANY MATERIAL OR INFORMATION PROVIDED IN CONNECTION WITH THIS AGREEMENT IS ERROR-FREE OR THAT OPERATION OR USE OF SUCH MATERIALS OR INFORMATION WILL BE SECURE OR UNINTERRUPTED. NEITHER PARTY HAS THE RIGHT TO MAKE OR PASS ON ANY REPRESENTATION OR WARRANTY ON BEHALF OF THE OTHER PARTY TO ANY THIRD PARTY.

7.4. Disclaimer of Consequential Damages. NOTWITHSTANDING ANYTHING TO THE CONTRARY IN THIS AGREEMENT, NEITHER PARTY WILL, UNDER ANY CIRCUMSTANCES, BE LIABLE TO THE OTHER PARTY OR ANY THIRD PARTY FOR CONSEQUENTIAL, INCIDENTAL, SPECIAL, OR EXEMPLARY DAMAGES ARISING OUT OF OR RELATED TO THE LICENSED MATERIALS, LICENSED PRODUCTS, OR WORK CONTEMPLATED UNDER THIS AGREEMENT, INCLUDING BUT NOT LIMITED TO LOST PROFITS OR LOSS OF BUSINESS, EVEN IF A PARTY IS APPRISED OF THE LIKELIHOOD OF SUCH DAMAGES. THIS PARAGRAPH SHALL NOT EFFECT ANY OBLIGATION TO INDEMNIFY UNDER PARAGRAPH 7.2.

7.5. Independent Allocations of Risk. EACH PROVISION OF THIS AGREEMENT THAT PROVIDES FOR A LIMITATION OF LIABILITY, DISCLAIMER OF WARRANTIES, OR EXCLUSION OF DAMAGES IS TO ALLOCATE THE RISKS OF THIS AGREEMENT BETWEEN THE PARTIES. THIS ALLOCATION IS REFLECTED IN THE TERMS OFFERED BY THE PARTIES AND IS AN ESSENTIAL ELEMENT OF THE BASIS OF THE BARGAIN BETWEEN THE PARTIES. EACH OF THESE PROVISIONS IS SEVERABLE AND INDEPENDENT OF ALL OTHER PROVISIONS OF THIS AGREEMENT, AND EACH OF THESE PROVISIONS WILL APPLY EVEN IF THE WARRANTIES IN THIS AGREEMENT HAVE FAILED OF THEIR ESSENTIAL PURPOSE.

such information from Phillips or his Affiliates, licensees, employees or agents; or (ii) was developed by employees or agents of Phillips independently of, and without reference to, any Confidential Information and not in the course of Phillips' employment with MOD.

1.4 "Contributed Assets" has the meaning set forth in the Contribution Agreement.

1.5 "Effective Date" has the meaning set forth in the introductory paragraph of this Agreement.

1.6 "Field of Use" shall mean (a) the business of MOD as conducted or contemplated to be conducted as of the Effective Date, including the development, commercialization, manufacture, use, marketing, sale, licensing, distribution, installation, support and maintenance of (i) software, hardware, systems, and services for the delivery of digital products and services at physical retail points of sale or via any network; (ii) portable media devices (including smart devices) that are compatible with such software, hardware, systems, or services for use in connection with the storage and use by consumers of digital products and services; and (iii) "digital set-top boxes," home media servers, and similar products that are compatible with such software, hardware, systems, or services for use in connection with the storage and use by consumers of digital products and services, and (b) other activities that MOD may conduct from time to time following the Effective Date. For the avoidance of doubt, it is understood that the Field of Use will expand in scope to cover any activities MOD conducts, which were not conducted or contemplated to be conducted as of the Effective Date.

1.7 "Intellectual Property" means any and all (a) patents and patent applications ("Patents"); (b) copyrights and similar rights in works of authorship (including, without limitation, software) ("Copyrights"); (c) trademarks, service marks, trade names, trade dress and domain names, and all goodwill associated therewith ("Trademarks"); (d) trade secrets and other rights in proprietary and confidential information ("Trade Secrets"); and all other intellectual and industrial property and related rights, whether statutory or common law, and whether protected, created or arising under the laws of the United States or any other jurisdiction, together with all national, foreign, and state registrations, applications for registration and renewals and extensions thereof.

1.8 "Licensed Materials" means the Intellectual Property and Technology set forth on Schedule 1 and any other Intellectual Property and Technology that Phillips owns or otherwise has the right to license as of the Effective Date or at any time thereafter within the Field of Use.

1.9 "Net Revenues" means the gross revenues earned by Phillips and his Affiliates and licensees from Royalty-Bearing Products, less separately stated charges for (a) sales and use taxes, excise taxes, customs duties and other similar taxes; (b) shipping and insurance charges; and (c) the amount of any bad debts, refunds and credits, but only to the extent that such bad debts, refunds and credits are actually recognized against such gross revenues and provided that such bad debts, refunds and credits do not exceed ten (10%) of gross revenues per year.

1.10 "Payments" has the meaning set forth in Section 2.4.

1.11 "Person" means a natural individual, partnership, limited liability company, corporation or other entity.

1.12 "Phillips Patents" means the Patents included in the Licensed Materials.

1.13 "Royalty-Bearing Product" means any product or service now or hereafter developed, manufactured, sold, licensed or otherwise distributed or disposed of by or on behalf of Phillips or any of his Affiliates or licensees that incorporates, practices or otherwise uses any After-developed Property, or that would in the absence of the licenses granted hereunder infringe or misappropriate any Intellectual Property included in the After-developed Property.

1.14 "Technology" means all software, hardware, documentation and other works, inventions, know-how, technology, information and materials

1.15 "Terminated Licenses" has the meaning set forth in the Termination Agreement.

1.16 "Transaction Agreements" means this Agreement, the Subscription and Constribution Agreement between MOD and Phillips or even date herewith (the "Contribution Agreement"), and the Termination Agreement between MOD and Phillips or even date herewith (the "Termination Agreement").

2. License Grant

2.1 License to Licensed Materials. Phillips hereby grants to MOD and its Affiliates an exclusive, perpetual, irrevocable, fully paid-up, royalty-free, sublicensable (through multiple levels), transferable, right and license throughout the universe to use, reproduce, distribute, display and perform (whether publicly or otherwise), prepare derivative works of and otherwise modify, make, sell, offer to sell, import and otherwise practice, exercise, use and exploit all or any portion of the Licensed Materials in the Field of Use.

2.2 Moral Rights. Phillips irrevocably waives any "moral rights" or other rights with respect to attribution of authorship or integrity of any Licensed Materials that Phillips may have or acquire under any applicable law under any legal theory, and, in the event such waiver is held to be ineffective, unenforceable, void or voidable under applicable law, Phillips irrevocably covenants not to assert any such rights against MOD or any of its Affiliates.

2.3 Delivery. Phillips shall promptly after the Effective Date deliver to MOD all software (including all source code with comments, libraries, tools, utilities and other related materials), hardware, documentation, media and other tangible property (collectively, "Tangible Property") included in the Licensed Materials, to the extent that such Tangible Property was not already in MOD's possession prior to the Effective Date. Phillips shall further deliver to MOD any additional Tangible Property included in or related to the Licensed Materials promptly upon MOD's request from time to time.

2.4 Payments. In consideration for the rights and licenses granted herein, MOD shall pay Phillips the royalties set forth on Schedule 2 (the "Payments"). In the event that any of the Phillips Patents or any claim thereof is abandoned, or finally rejected or held invalid or unenforceable by a decision of a patent granting authority beyond right of review or appeal (including a decision which was appealable but which was not appealed within the allotted time), MOD and Phillips shall negotiate in good faith and agree upon an appropriate reduction in the Payments.

2.5 No Implied Licenses. Phillips reserves all rights to the Licensed Materials not otherwise expressly granted herein, including the right to use the Licensed Materials outside the Field of Use. The only licenses granted by Phillips in this Agreement are the licenses expressly set forth in Section 2.1. There are no implied licenses under this Agreement.

3. Grantback License.

3.1 Grant of License. Subject to the terms and conditions of this Agreement, MOD hereby grants to Phillips a nonexclusive, irrevocable (except as set forth in Section 7.2), worldwide, sublicensable right and license to use, copy, modify and distribute any of the After-developed Property solely outside the Field of Use.

3.2 Limitations. Except in connection with his employment with MOD, Phillips shall not (and shall have no right to) use, copy, modify or distribute any After-developed Property for any purposes (including, without limitation, in connection with any product or service) within the Field of Use. Notwithstanding the license granted in Section 3.1 and except in connection with his employment with MOD, Phillips shall not (and shall have no right to), distribute, sublicense or otherwise provide or disclose any Confidential Information (including, without limitation, any source code) to any third Person without MOD's prior written consent, except to his Affiliates and licensees as necessary to exercise the rights granted under Section 3.1, and then only subject to an appropriate written confidentiality agreement sufficient to prevent any unauthorized use, disclosure, publication or dissemination. Phillips shall hold all Confidential Information in strict confidence and shall protect such information and materials from unauthorized use, disclosure, publication or dissemination using the same degree of care that he uses to protect his own confidential and proprietary information and materials of similar nature and importance (but in no event less than reasonable care). Phillips shall ensure that his Affiliates and licensees comply with the limitations and other applicable terms and conditions set forth herein, and shall be responsible for any Affiliate's or licensee's failure to so comply. Promptly after the Effective Date, MOD and Phillips shall discuss in good faith and mutually agree upon written procedures to govern Phillips' access to, and storage, copying and use of, After-developed Property. Phillips shall comply with all such procedures.

3.3 No Implied Licenses. MOD reserves all rights in and to the After-developed Propery not otherwise expressly granted herein, including the right to use the Licensed Materials inside and outside the Field of Use. The only licenses granted by MOD in this Agreement are the licenses expressly set forth in Section 3.1. There are no implied licenses under this Agreement.

4. Royalties and Payments for Royalty-Bearing Products.

4.1 Royalties. Phillips shall pay MOD a royalty of five percent (5%) of Net Revenues.

4.2 Reports and Payments. Phillips and his Affiliates shall (a) keep true, accurate and detailed accounts and records of all royalties and other sums due under this Agreement; (b) within thirty (30) days after the close of each calendar quarter, deliver to MOD a statement of all royalties due, if any, for Royalty-Bearing Products sold, licensed or otherwise distributed or disposed of during such calendar quarter (showing the gross revenue and Net

Revenue for each Royalty-Bearing Product and the calculations used to determine Net Revenue); and (iii) within thirty (30) days after the close of each calendar quarter, pay to MOD the royalties payable for such calendar quarter.

4.3 Wire Transfer; Currency Conversion. All royalties due hereunder shall be paid in U.S. Dollars by wire transfer to such financial institution and account number as MOD may designate in writing to Phillips. With respect to Net Revenues generated in foreign currency, the exchange rate used to determine royalties shall be the average exchange rate for such calendar quarter as calculated using the daily closing exchange rate set forth in the final edition of The Wall Street Journal (version distributed in Washington State).

4.4 Audits. Phillips shall maintain and make available to MOD or its representatives for inspection, audit, and/or copying all books and records to enable MOD to determine that it has received all royalties and proper payments due from Phillips for the Royalty-Bearing Products. Such books and records shall contain, without limitation, all domestic and international gross revenues and all deductions therefrom used to calculate Net Revenues, all itemized for the Royalty-Bearing Products, by quarter and also summarized by year. Such inspections, audits, and copying shall be no more than twice a year, at MOD's expense, unless the audit shows that Phillips has reported less than ninety-five percent (95%) of the sums payable to MOD during the period under review, in which event Phillips shall, in addition to paying all such underpayments and interest thereon, reimburse MOD for the expenses of such inspections, audits and copying. MOD's rights under this provision shall continue for a period of one (1) year after the termination of this Agreement.

5. Obligations of Phillips

5.1 Prosecution and Maintenance. Phillips shall diligently prosecute the Intellectual Property included in the Licensed Materials to issuance, and shall pay all registration, renewal, maintenance and other necessary fees, and take all other necessary actions, to prosecute, renew and maintain such Intellectual Property. MOD shall have the right to review, comment on, and approve (such approval not to be unreasonably withheld) any patent applications or other applications for registration of such Licensed Materials prepared by or for Phillips and any responses to office actions, correspondence with governmental authorities or other parties, pleadings, and other submissions, and to receive copies of any office actions, correspondence with governmental authorities or other parties, pleadings, and other submissions, in connection with any such prosecution, renewal and maintenance of such Intellectual Property.

5.2 Abandonment. If Phillips ceases or intends to cease prosecution or maintenance of any of the Intellectual Property included in the Licensed Materials or fails to pay or intends not to pay any applicable fees necessary to prosecute, renew or maintain any of such Intellectual Property (and does not promptly remedy such failure), then Phillips shall so notify MOD and shall promptly assign all of his remaining right, title and interest in and to such Intellectual Property to MOD. Phillips shall give MOD such notice at least sixty (60) days prior to the applicable filing or payment deadline in the event that he intends to cease such prosecution, maintenance or payment. In such event, Phillips shall execute such written instruments and perform such other acts as MOD may reasonably request to effectuate such assignment and otherwise establish, maintain and enforce MOD's rights in the Licensed Materials.

6. Ownership; Enforcement; Cooperation

6.1 Ownership. Except for the licenses granted herein (and subject to Section 5.2), all right, title and interest in and to the Licensed Materials shall be retained by and remain the sole property of Phillips. Except for the grantback licenses granted herein, all right, title and interest in and to the After-developed Property shall be retained by and remain the sole property of MOD.

6.2 Enforcement.

(a) Enforcement Within the Field of Use. MOD shall have the exclusive right (but not the obligation) to institute and prosecute any action or proceeding to enforce the Intellectual Property included in the Licensed Materials against any infringement, misappropriation or other violation by any third Person within the Field of Use, including any settlement discussions relating to, and any declaratory judgment action arising from, such infringement, misappropriation or other violation by competent counsel of MOD's choice. MOD shall have the exclusive right to control such action or proceeding.

(b) Enforcement Outside the Field of Use. Subject to Sections 6.2(c) and 6.2(d), Phillips shall have the exclusive right (but not the obligation) to institute and prosecute any action or proceeding to enforce the Intellectual Property included in the Licensed Materials against any infringement, misappropriation or other violation by any third Person outside the Field of Use, including any settlement discussions relating to, and any declaratory judgment action arising from, such infringement, misappropriation or other violation by competent counsel of Phillips' choice. Subject to Sections 5.2, 6.2(c) and 6.2(d), Phillips shall have the exclusive right to control such action or proceeding.

(c) Defensive Enforcement. Notwithstanding anything to the contrary in Section 6.2(b) or elsewhere in this Agreement, in the event that MOD or any of its Affiliates receives any notice or other communication from any third Person ("Claimant") claiming that the operation of MOD's or such Affiliate's business or any product or service of MOD or such Affiliate infringes, misappropriates or otherwise violates any Intellectual Property or other rights of such third Person, or that invites MOD or such Affiliate to take a license, authorization, covenant not to sue or the like under any Intellectual Property or other rights of such third Person, or that otherwise gives MOD or such Affiliate a reasonable apprehension that it may be sued by such third Person with respect to any Intellectual Property or other claim (collectively, a "Claim"), then, if MOD so requests in connection with its or its Affiliate's defense of or response to such Claim, Phillips shall exercise his enforcement rights set forth in Section 6.2(b) against such Claimant as follows: At MOD's direction and expense, and using competent counsel of MOD's choice, Phillips shall institute and prosecute any action or proceeding to enforce the Intellectual Property included in the Licensed Materials against any infringement, misappropriation or other violation by such Claimant outside the Field of Use, and, if so directed by MOD, shall enter into settlement discussions with and grant licenses to such Claimant outside the Field of Use. MOD shall have the exclusive right to control such action or proceeding and any related settlement discussions and licensing arrangements. Without limitation of the foregoing, Phillips shall not interfere with MOD's or its Affiliates' defense of any Claim, including by granting any Claimant a license under the applicable Intellectual Property except at MOD's direction.

(d) MOD Review. Notwithstanding anything to the contrary in Section 6.2(b) or elsewhere in this Agreement, Phillips shall notify MOD prior to taking any steps to assert (including issuing any demand letter), or instituting any action or proceeding to enforce, the Intellectual Property included in the Licensed Materials against third Persons. MOD shall have the right to review, comment on, and approve any such steps, actions or proceedings and any correspondence, pleadings and other submissions related thereto, such approval not to be unreasonably withheld. MOD shall not be deemed to have unreasonably withheld its approval if it believes in good faith that the enforcement activity proposed by Phillips is likely to materially adversely affect the Intellectual Property included in the Licensed Materials or the business of MOD or its Affiliates.

6.3 Cooperation. In the event that either Phillips on the one hand, or MOD or any of its Affiliates on the other hand (in either case, the "Enforcing Party"), institutes or prosecutes any action or proceeding to enforce the Intellectual Property included in the Licensed Materials against any infringement, misappropriation or other violation by a third Person as contemplated by Section 6.2(a) or 6.2(b), the other party (the "Non-Enforcing Party") shall, at the request and expense of the Enforcing Party, cooperate fully with the Enforcing Party in connection with such action or proceeding, including by executing such documents as the Enforcing Party may reasonably request and making available all relevant and non-privileged personnel, records, information and other materials in Non-Enforcing Party's possession or control (subject to appropriate confidentiality obligations, if applicable). If the Enforcing Party reasonably determines that the Non-Enforcing Party should be joined to any action or proceeding contemplated by Section 6.2(a) or 6.2(b) (as applicable), the Non-Enforcing Party shall (and hereby consents to) join and remain as a plaintiff, and shall require its other licensees to join and remain as plaintiffs, for the purpose of procuring standing to bring the action or proceeding. The Enforcing Party shall be entitled to retain all damages and other amounts recovered in connection with such action or proceeding.

7. Term; Termination.

7.1 Term. This Agreement shall commence upon the Effective Date and shall continue thereafter unless and until terminated as set forth in this Section 7.

7.2 No Termination by Phillips. The licenses granted to MOD hereunder are perpetual and irrevocable and cannot be terminated by Phillips for any reason. In the event of any breach or alleged breach of this Agreement by MOD, Phillips' sole and exclusive remedy shall be to seek damages, and Phillips shall not (and shall have no right to) terminate this Agreement or the licenses granted herein, or to enjoin MOD or its Affiliates or licensees from exercising such licenses.

7.3 Termination by MOD. In the event of any material breach of Section 3.2 of this Agreement by Phillips, MOD may, in addition to any other remedies available to it, terminate this Agreement and the licenses granted to Phillips herein by not less than thirty (30) days written notice specifying such breach, unless within the period of such notice Phillips has cured the breach specified therein. Upon any termination of this Agreement, Phillips shall cease all use of the After-developed Property, all sublicenses granted by Phillips with respect to the After-developed Property shall automatically terminate, and Phillips shall return to MOD or destroy (and shall

cause his Affiliates and licensees to return to MOD or destroy) at MOD's direction any and all Confidential Information of MOD. For avoidance of doubt, in the event of any such termination, the licenses granted to MOD hereunder and the other provisions set forth in Section 7.4 shall survive.

7.4 Survival. Sections 1, 2, 3.3, 4 (with respect to royalties owed as of termination), 5.2, 6, 7.2, 7.4, 8, 9, 10, 11 and 13 shall survive any termination of this Agreement.

8. Representations and Warranties of Phillips. Phillips represents and warrants to MOD, as of the Effective Date and thereafter, as follows:

8.1 Authorization. Phillips has all requisite power and legal authority to execute and deliver each Transaction Agreement to which he is a party and any other agreements or documents contemplated thereby, and to carry out and perform his obligations thereunder. Each Transaction Agreement to which Phillips is a party is a valid and binding obligation of his, enforceable against him in accordance with its terms.

8.2 Litigation. There is no claim, action, suit, investigation or proceeding pending or to the knowledge of the Phillips, threatened against him and to the knowledge of the Phillips no event has occurred or circumstance exists that may give rise to or serve as the basis for the commencement of any proceeding in connection with the subject matter of the Transaction Agreements.

8.3 Intellectual Property.

(a) Phillips has taken all reasonable steps to maintain the confidentiality of all Trade Secrets included in the Licensed Materials, and to Phillips' best knowledge there is no misappropriation or unauthorized disclosure or use of any such Trade Secrets. Phillips has required each person or entity that has received or had access to any such Trade Secret, or that has contributed to the creation or development of any Licensed Materials, to execute sufficient non-disclosure and assignment agreements that (i) assign to Phillips all right, title and interest in such Licensed Materials, and (ii) provide reasonable protection for such Trade Secrets. To the best knowledge of Phillips, no such person or entity is in breach of any such non-disclosure agreement.

(b) To Phillips' best knowledge, there are no facts or circumstances that could impair the validity or enforceability of any Intellectual Property included in the Licensed Materials, the Intellectual Property included in the Licensed Materials is valid, enforceable, subsisting and in full force and effect, and no Licensed Materials have passed into the public domain. Phillips is the sole and exclusive owner of the Licensed Materials and none of the Licensed Materials is jointly owned by any third Person. Upon the Effective Date, MOD will have a valid and enforceable exclusive license with respect to all Licensed Materials within the Field of Use on the terms set forth in the License Agreement. In each case in which Phillips has acquired ownership (or purported to acquire ownership) of any Licensed Materials from any other person or entity, Phillips has obtained a valid and enforceable assignment sufficient to unconditionally and irrevocably transfer all rights therefor to Phillips. Phillips has not granted any exclusive license with respect to any Licensed Materials to any third Person, except for the Terminated Licenses which shall be terminated as of the Effective Date in accordance with the Termination Agreement.

(c) Schedule 8.3(c) lists all Patents, registered Copyrights and applications therefor, and registered Trademarks and applications therefor included in the Licensed Materials (collectively, "Registered Licensed Materials"), together with the name of the applicant or registrant of record, the applicable jurisdiction, and the applicable application or registration number. All necessary registration, maintenance, and renewal fees in connection with all of the Registered Licensed Materials have been paid, and all necessary applications, affidavits, certificates and other documents have been filed with the applicable authorities in the United States and foreign jurisdictions for the purposes of securing and maintaining such Registered Licensed Materials.

(d) MOD's use, practice and exercise of its exclusive rights to the Licensed Materials within the Field of Use (including, without limitation, the design, development, manufacture, sale, licensing, marketing, distribution and provision of any current or now contemplated product or service of MOD) does not and shall not infringe, misappropriate, disclose or use without authorization, or otherwise violate any Intellectual Property of any third Person. Phillips has not received, nor is he aware of, any claim, demand, invitation to license, or other communication alleging any such infringement, misappropriation, unauthorized use or disclosure, or other violation. To Phillips' best knowledge, no third Person has infringed, misappropriated, disclosed or used without authorization, or otherwise violated any Licensed Materials, and Phillips has not issued any oral or written claim, demand, invitation to license or other communication alleging such infringement, misappropriation, unauthorized use or disclosure, or other violation. Notwithstanding anything contained in the foregoing, Phillips' representations and warranties under the first sentence of this Section 8.3(d) shall not apply with respect to any infringement to the extent resulting from: (i) alterations, changes or modifications of or to the Licensed Materials by MOD or for MOD by a third Person, if such infringement would not have occurred without such alterations, changes or modifications; (ii) MOD's combination of the Licensed Materials with other products or services not provided by Phillips or for Phillips by any third Person, if such infringement would not have occurred without such combination; or (iii) MOD's use of the Licensed Materials outside the Field of Use.

(e) Phillips is the sole and exclusive owner of the software (including source code) that is included in the Licensed Materials ("Phillips Software"). Phillips has not exclusively licensed any Phillips Software to any third Person, except in connection with the Terminated Licenses which shall be terminated as of the Effective Date in accordance with the Termination Agreement. To Phillips' best knowledge, all Phillips Software is free of any material defects, bugs and errors, and does not contain or make available any disabling codes or instructions, spyware, Trojan horses, worms, viruses or other software routines that permit or cause unauthorized access to, or disruption, impairment, disablement, or destruction of, software, data or other materials.

(f) Phillips has not granted or agreed to grant, nor has he caused any other Person to grant or agree to grant, any license (except for the Terminated Licenses), covenant, release, immunity or other right with respect to any Licensed Materials to any third Person, and no third Person has granted or agreed to grant any license, covenant, release, immunity or other right with respect to any Licensed Materials to Phillips.

(g) Neither the Transaction Agreements nor the consummation of the transactions contemplated thereby, nor any contract, agreement or other arrangement to which Phillips is a party, will cause or require (or purport to cause or require) MOD to grant to any third Person any license, covenant, release, immunity or other right with respect to any Intellectual Property or be subject to any non-competition provision or similar restriction.

(h) Schedule 8.3(h) lists all software that is distributed as "open source software" or under any licensing or distribution model that purports to require the distribution of or access to source code or purports to restrict the ability to charge for distribution of or to use software for commercial purposes (including, without limitation, the GNU General Public License and GNU Lesser General Public License) ("Open Source") that is included in the Licensed Materials, or is used in or necessary to the conduct of MOD's business, as now conducted and as contemplated to be conducted as of the Effective Date, including, without limitation, any Open Source that is incorporated into or otherwise used in connection with any Phillips Software or any of MOD's products or services or the development thereof, together with a description of the manner in which such Open Source is incorporated into or otherwise used in connection with such Phillips Software or product or service or the development thereof. Phillips has enforced an Open Source policy to identify and regulate the use and distribution of Open Source in connection with its business, and to avoid the release of the source code of any Phillips Software. To Phillips' best knowledge, there has been no material deviation from or violation of its policies with respect to Open Source. Phillips has not breached any Open Source license.

(i) Phillips has complied with all applicable laws, regulations and generally accepted industry standards, and all requirements under any contracts to which he is a party relating to privacy and data security, in each case with respect to the Licensed Materials, including, without limitation, with respect to the collection, use, and disclosure of any personally identifiable information collected, used, or held for use by or for Phillips and included in the Licensed Materials. Phillips has taken commercially reasonable measures (and all measures required by law) to ensure that such personally identifiable information is protected against unauthorized access, disclosure, use, modification, or other misuse or misappropriation. Phillips has not received any claims, complaints or other communications from third parties (including, without limitation, any governmental authorities) relating to privacy or data security, including, without limitation, with respect to the unauthorized access, disclosure, use, modification, or other misuse or misappropriation or personally identifiable information.

(j) Phillips is in compliance with all applicable ISO (International Standards Organization) standards, ANSI (American National Standards Institute) standards, and other similar standards relevant to the Licensed Materials, and has obtained all required licenses applicable to the implementation of such standards with respect to the Licensed Materials, including, without limitation, licenses under the DVD 3C, DVD 6C and MPEG LA patent pools.

(k) Each item of the Licensed Materials is solely and exclusively owned by Phillips, and Phillips has good and marketable title thereto, free and clear of any liens, security interests, claims or encumbrances, and, upon the Effective Date, will be licensed to MOD pursuant to a valid and enforceable license as contained in this Agreement. MOD's rights under this Agreement will be freely assignable and sublicensable without the need for any licenses, releases, consents, approvals or immunities not yet granted or obtained. Upon the Effective Date, all

Licensed Materials will be immediately available for use and practice by MOD, free and clear of any liens, security interests, claims or encumbrances, and without payment of any royalties (except the Payments), fees, or other amounts. There is no Technology or Intellectual Property that Phillips owns or has the right to license that is related to MOD's business, as now conducted and as contemplated to be conducted as of the Effective Date, that is not included in either the Licensed Materials or the Contributed Assets assigned to MOD pursuant to the Contribution Agreement.

(l) No later than thirty (30) days after the Effective Date, Phillips shall take all actions necessary or as required by MOD, including, without limitation, the execution of all documents required by MOD to evidence the License Agreement as contemplated by this Agreement.

8.4 Noncontravention. Neither the execution and delivery by Phillips of the Transaction Agreements, nor the consummation by Phillips of the transactions contemplated thereby, will (a) conflict with or violate any agreement to which Phillips is a party, (b) require on the part of Phillips any filing list, or any permit, authorization, consent or approval of, any court, arbitrational tribunal, administrative agency or commission or other governmental or regulatory authority, or agency, (c) conflict with, result in a breach of, constitute (with or without due notice or lapse of time or both) a default under, result in the acceleration of obligations under, create in any person or entity the right to terminate, modify or cancel, or require any notice, consent or waiver under, any contract or, agreement, note, lease or license to which Phillips is a party or by which Phillips is bound, (d) result in the imposition or any lien, security interest, charge or other encumbrance upon any assets of Phillips, or (e) violate any order, writ, injunction or decree or any statute, rule or regulation applicable to Phillips or any of his properties or assets.

8.5 Disclosure. No representations, warranties, assurances or statements by Phillips in any Transaction Agreement and no statement contained in any document (including the Exhibits and Schedules attached hereto), certificates or other writings furnished or to be furnished by Phillips to MOD pursuant to the provisions hereof contains or will contain any untrue statement of material fact, or omits or will omit to state any fact necessary, in light of the circumstances under which it was made, in order to make the statements herein or therein not misleading. Phillips has disclosed to MOD all material information relating to the Assigned Assets (whether tangible or intangible).

9. Indemnification. Phillips agrees to indemnify, defend and hold harmless MOD, its officers, directors, employees, shareholders, agents and representatives from and against any costs, expenses, obligations, damages, liabilities or losses (including, without limitation, reasonable attorneys' fees and expenses, amounts paid in settlement, interest, and court costs) (collectively, "Losses") incurred or suffered by MOD arising out of, relating to or based upon (a) any inaccuracy in, or breach of, any of the representations or warranties of Phillips contained in any Transaction Agreement; or (b) any breach of any covenant or other agreement of Phillips contained in any Transaction Agreement; provided, however, that Phillips' total indemnification liability under the Transaction Agreements shall not exceed in the aggregate, the actual proceeds received by Phillips in connection with a sale of fifty percent (50%) of the Equity Consideration Shares (as defined in the Contribution Agreement) PLUS fifty percent (50%) of the Payments actually received by Phillips. In the event Phillips incurs any obligation to indemnify, defend or hold harmless hereunder, Phillips shall promptly sell up to fifty percent (50%) of his Equity Consideration Shares

to the extent required to satisfy such obligation. Notwithstanding the foregoing, in no event shall Phillips be deemed to have (a) breached or made an inaccurate representation or warranty contained in any Transaction Agreement, or (b) breached any covenant or other agreement of Phillips contained in any Transaction Agreement as a result of his having entered into that certain Freedom of Operation Agreement, dated as of the Effective Date, by and among Phillips, MOD and Toshiba Corporation.

10. Reliance on Representations and Warranties. The representations and warranties of Phillips contained in any Transaction Agreement shall not be affected or deemed waived by reason of any investigation made by or on behalf of MOD (including, but not limited to, by any of MOD's representatives), or by reason of the fact that MOD or any of MOD's representatives knew or should have known that any such representation or warranty is or might be inaccurate. Further, the parties acknowledge that Phillips is also an officer, director and shareholder of MOD. In no event shall any knowledge of Phillips be imputed or otherwise deemed to be knowledge of MOD by reason of Phillips being an officer, director or shareholder of MOD.

11. Confidentiality. The parties will treat the terms of the Transaction Agreements as the confidential information of both parties and neither party will disclose the terms of the Transaction Agreements to any third Person without the prior written consent of the other party. Notwithstanding the foregoing, either party may disclose the terms of the Transaction Agreement: (i) pursuant to the order or requirement of a court, administrative agency, or other governmental body, provided that the party required to make such a disclosure gives reasonable notice to the other party to contest such an order or requirement; (ii) on a confidential basis to its legal or financial advisors; (iii) as required under applicable securities regulations; and (iv) subject to execution of reasonable and customary written confidentiality agreements, to present or future providers of venture capital and/or potential private investors in or acquirers of such party.

12. Payment of Professional Fees. MOD will cause all of Phillips' professional fees incurred by Phillips in connection with the transactions contemplated by the Transaction Agreements, including all fees owed to accountants, attorneys or tax advisors, to be paid in full upon the Effective Date.

13. Miscellaneous.

13.1 Notices. All notices and other communications required or permitted hereunder shall be given in writing as set forth below and shall be deemed effective (a) upon delivery, when delivered personally or sent by overnight courier, (b) if sent by mail, at the earlier of its receipt or seventy-two (72) hours after deposit in a regularly maintained receptacle for the deposit of the U.S. mail, addressed and mailed as set forth below, or (c) upon acknowledgement of receipt, when sent by facsimile or electronic mail.

If to Phillips:

Mark Phillips
c/o MOD Systems Incorporated
720 Third Avenue, Suite 1100
Seattle, Washington 98104

With a copy to:

Foster Pepper PLLC
1111 Third Avenue, Suite 3400
Seattle, Washington 98101
Attention: Derek de Bakker

If to MOD:

MOD Systems Incorporated
720 Third Avenue, Suite 1100
Seattle, Washington 98104
Attention: Kenneth Gordon

With a copy to:

Lane Powell PC
1420 Fifth Ave, Suite 4100
Seattle, Washington 98101
Attention: Thomas Grohman/Steven Winters

or to such other address as any of them shall give to the others by notice made pursuant to this Section 13.1.

13.2 Assignment. This Agreement, including the licenses granted herein, and all representations and warranties, indemnification obligations, and other terms and conditions incorporated by reference herein, shall be freely assignable and transferable by MOD.

13.3 Successors and Assigns. Except as otherwise provided herein, the provisions hereof shall inure to the benefit of, and be binding upon, the successors, assigns, heirs, executors and administrators of the parties hereto. Phillips' obligations set forth in this Agreement are intended to and shall run with the applicable Licensed Materials, and shall be binding on any successors, assignees, licensees or other transferees of any Licensed Materials. Phillips shall require, as an express condition to any sale, license or other transfer to a third Person of any Licensed Materials, that such third Person expressly assumes all such obligations. Nothing in this Agreement is intended to confer upon any Person other than the parties hereto or their respective successors or assigns any rights, remedies, obligations or liabilities under or by reason of this Agreement, except as expressly provided by this Agreement.

13.4 Nature of Rights. The rights licensed to each party hereunder are rights in "intellectual property" within the scope of Section 101 (or its successors) of the United States Bankruptcy Code (the "Code"). Each party shall have and may fully exercise all rights available to it under the Code, including under Section 365(n) or its successors.

13.5 Innovations Assignment Agreement. (a) Phillips' obligations and responsibilities under this Agreement and the other Transaction Agreements, including with respect to MOD's confidential and proprietary information, Intellectual Property and Technology, are in addition to and without limitation of Phillips' obligations and responsibilities under that certain Employee Innovations and Proprietary Rights Assignment Agreement between the parties dated as of May 19, 2005 (the "Innovations Assignment Agreement"); and (b) any Technology or Intellectual Property that Phillips develops or creates in the course of his employment with MOD shall be solely and exclusively owned by MOD as set forth in the Innovations Assignment Agreement.

13.6 Entire Agreement; Amendment. This Agreement and the other Transaction Agreements, the Schedules attached hereto, and the other documents delivered pursuant hereto, constitute the full and entire understanding and agreement between the parties with regard to the subjects hereof and thereof. Except as expressly provided herein, neither this Agreement nor any term hereof may be amended, waived, discharged or terminated other than by a written instrument signed by the party against whom enforcement of any such amendment, waiver, discharge or termination is sought.

13.7 Further Assurances. The parties shall cooperate in supplying such information as may be reasonably requested by another party to complete and file any forms, documents or instruments presently or hereafter required and shall execute and deliver to each other such other documents and do such other acts and things, all as the other party may reasonably request for the purpose of carrying out the intent of this Agreement, the other Transaction Agreement and the transactions contemplated thereby.

13.8 Severability. In the event that any provision of this Agreement becomes or is declared by a court of competent jurisdiction to be illegal, unenforceable or void, this Agreement shall continue in full force and effect to the extent than enforceable, provided that no such severability shall be effective if it materially changes the economic benefit of this Agreement to any party.

13.9 Governing Law. This Agreement shall be governed in all respects by the laws of the State of Washington, without reference to its conflicts of laws rules. Any proceeding related to this Agreement shall be commenced or maintained only in the courts in State of Washington, and the parties hereto hereby irrevocably submit to the jurisdiction of any state or federal court sitting in State of Washington, in any action or proceeding brought to enforce or otherwise arising out of or relating to this Agreement, and hereby waive any objection to venue in any such court and any claim that such forum is an inconvenient forum. If litigation or any other legal proceeding is commenced by any of the parties hereto to enforce or interpret any of the provisions of this Agreement, the substantially prevailing party shall be entitled to recover reasonable costs and attorneys' fees at mediation, arbitration, trial, on appeal, and on any petition for review.

13.10 Offset. In addition to all other remedies available to MOD under applicable law, MOD shall have right to offset any Losses for which it is entitled to indemnification under Section 9 against the Payments.

13.11 Headings. The headings used in this Agreement are used for convenience only and shall not be considered in construing or interpreting this Agreement.

13.12 Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be deemed an original and all of which together shall constitute one and the same instrument. Facsimile transmission of any signed original documents, and the retransmission of any signed facsimile transmission, shall be the same as delivery of the original signed documents. At the request of either party, the other party shall confirm documents with a facsimile transmitted signature by signing an original document.

13.13 Interpretation. This Agreement has been negotiated by the parties and their respective counsel. This Agreement shall be interpreted fairly in accordance with its terms and without any construction in favor of or against either Party. In addition, for purposes of interpreting this Agreement, (a) unless the context otherwise requires, the singular includes the plural, and the plural includes the singular; (b) unless otherwise specifically stated, the words "herein," "hereof," and "hereunder" and other words of similar import refer to this Agreement as a whole and not to any particular section or paragraph; and (c) the words "include" and "including"

shall not be construed as terms of limitation, and shall therefore mean "including but not limited to" and "including without limitation."

[*Signatures appear on the following page*]

IN WITNESS WHEREOF, authorized signers of the parties hereto have caused this Agreement to be duly executed as of the date first written above.

PHILLIPS:

MARK PHILLIPS

MARK PHILLIPS

MOD:

MOD SYSTEMS INCORPORATED,
a Washington corporation

By: D M Douglass

Name: David M. Douglass

Its: Vice President and Chief Financial Officer

SCHEDULE 1

Certain Licensed Materials

	Name		Registration/Application Number (if applicable)		Description
1.	System and Method for Musical Playlist Selection in a Portable Audio Device		35073.001, 09/975,748		U.S. Patent Application
2.	Fullplay 'Dharma' source code SDK ARM7		N/A		Fullplay 'Dharma' reference design system source code represents a generic ARM7 audio media player. Including flash and HDD file systems, network stacks, digital audio encoding and decoding, DAC output, USB device class drivers and simple media player application with "skinning", audio metadata database, playlists, and settings menu.
3.	Telechips TCC82X		N/A		ARM9 Audio Media SDK Reference Design
4.	Fullplay "DJ" CD-R HDD mp3 jukebox		N/A		CD-R jukebox embedded application with idle encoding
5.	Custom acoustical compression fingerprint tool		N/A		In encode – compress function 12-24 feature fingerprint tool for acoustical similarity matching.
6.	System and Method For Data Transfer Optimization In A Portable Audio Device		35073.002, 09/975,749		U.S. Patent Application
7.	System and Method for Mapping Interface Functionality to Codec Functionality in a Portable Audio Device		35073.003, 09/975,736		U.S. Patent Application
8.	System and Method For Playlist Completion In A Portable Audio Device		35073.004, 10/039,906		U.S. Patent Application
9.	Network communication stack, boot loader updater, SOAP and UPnP communications system.		N/A		Reduced TCP/IP network stack for low SRAM, flash and processing overhead. Network advertisement protocol for secure transfer of boot loaders and firmware for network updates. Web services communication stack for embedded devices for operations with Windows and general XML, SOAP and device profile specifications.
10.	FullPlay UPNP media library		N/A		Desktop Application which enumerates audio content on Windows XP for purpose of transferring or streaming metadata or files to an embedded player client.
11.	Gameboy ROM emulator		N/A		ARM, fixed point implementation of a Gameboy
12.	MPEG1 Layer 3 codec, lossless audio codec		N/A		MPEG 1 Layer 3 decoder and encoder with machine optimization for SH3, MIPS, ARM7 and Intel. Encode function is symmetrical to decode.
13.	Peer to peer - sensor emulator and network library communication		N/A		Time division multi-plex simulator, frequency hopping and pico-net, scatter-net profiles. Variable payload and broadcast frame packets calculated by frequency and channels.

	Name		Registration/Application Number (if applicable)		Description
	systems				
14.	Cell tower/FM tower triangulation, neighbor list and location service client and server decoder system		N/A		Cell-phone and 802.11b radio location service based on cell tower map, signal strength and neighbor list calculators. SMS data encoding packet system with self ordering.
15.	MetaWallet source code, build tools, database, website, and patent applications.		N/A		Virtual wallet account management, payment processing and remittance software, with demonstration application. Web implementation, WAP, and SMS. Personal finance account application for cell phones. Patent Application, SQL, Web Services, and trademark for "MetaWallet"
16.	1999, 2000,2001,2002 Automotive CE platform with SH3 to ARM9 media player		N/A		Windows CE Media Player – Audio only, voice processor command interface
17.	Ogg Vorbis		N/A		Fixed point Ogg decoder.
18.	PC, Linux and Windows GCC compiler		N/A		Compiler instances for ARM7, Sigma Designs, Cirrus Logic 9800
19.	C# code generator		N/A		.Net code generation tools using function based metadata for BLL and DAL
20.	Code counting, source control, and source comparison tools..		N/A		Various quick line counters, code analyzers and export systems to excel for high-level project and information sharing with code bases.
21.	Zigbee peer-to-peer sample application		N/A		Zigbee prototype interface to .net Micro framework
22.	SPOT Applications, Swatch MSN watch applications		N/A		Peer to peer, games, applications and data feeds for the Microsoft Smart Personal Objects MSN Direct watch. Poker, Pong, chat. 4 button text input scheme.
23.	Fossil MSN watch faces		N/A		Fossil MSN Direct calendar and holiday watch faces.
24.	.NET micro framework applications		N/A		Robotic hexapod walker, Zigbee switch simulator, and various .Net micro framework applications and Visual Studio tools
25.	IP database and content online tool		N/A		Custom, patent, materials and document tracking site
26.	Boomerang / getmystuffback.com		N/A		Web Application which links people with those that have borrowed something from them to Amazon recommendations on replacements
27.	Method and system for value transfer between mobile-phone users		App: 11/725,181 Pub: 20080125080		U.S. Patent Application
28.	Transactional services associated with mobile devices		App: 11/679,338 Pub: 20080208739		U.S. Patent Application

SCHEDULE 2

Royalties

Total Payments in the amount of $5,000,000 payable as follows (subject to Sec. 4 of the Agreement):

- $500,000 on September 30, 2009
- $1,000,000 on September 30, 2010
- $1,500,000 on September 30, 2011
- $2,000,000 on September 30, 2012

SCHEDULE 8.3(c)

REGISTERED LICENSED MATERIALS

	Name		Registration/Application Number (if applicable)		Description
1.	System and Method for Musical Playlist Selection in a Portable Audio Device		35073.001, 09/975,748		U.S. Patent Application
2.	System and Method For Data Transfer Optimization In A Portable Audio Device		35073.002, 09/975,749		U.S. Patent Application
3.	System and Method for Mapping Interface Functionality to Codec Functionality in a Portable Audio Device		35073.003, 09/975,736		U.S. Patent Application
4.	System and Method For Playlist Completion In A Portable Audio Device		35073.004, 10/039,906		U.S. Patent Application
5.	Method and system for value transfer between mobile-phone users		App: 11/725,181 Pub: 20080125080		U.S. Patent Application
6.	Transactional services associated with mobile devices		App: 11/679,338 Pub: 20080208739		U.S. Patent Application

SCHEDULE 8.3(h)

OPEN SOURCE SOFTWARE

None

EXHIBIT “L”

EXECUTIVE EMPLOYMENT AGREEMENT

THIS EXECUTIVE EMPLOYMENT AGREEMENT (this "Agreement") is dated the 17th day of October, 2008 (the "Effective Date"), by and between MOD SYSTEMS INCORPORATED, a Washington corporation (the "Company"), and MARK E. PHILLIPS, an individual ("Employee").

RECITALS

WHEREAS, the Company has entered into the Series A Preferred Stock Purchase Agreement dated as of September 24, 2008 (the "SPA") with the Purchasers identified in the SPA.

WHEREAS, as an inducement for the parties to the SPA to enter into the SPA, and as a condition precedent to the Closing thereunder, and for other consideration and covenants, the parties hereto have agreed to the terms set forth in this Agreement.

WHEREAS, pursuant to this Agreement, Employee is receiving new consideration from the Company in the form of compensation and benefits increases, including separation benefits and other benefits to which he was not previously entitled, all of which the parties agree constitute new, sufficient and adequate consideration for his assumption of new and modified restrictions related to competition and solicitation.

NOW, THEREFORE, for good and valuable consideration, the receipt of which is hereby acknowledged, the parties hereby agree as follows:

AGREEMENT

1. Innovations Assignment Agreement. The Company and Employee are parties to that certain Employee Innovations and Proprietary Rights Assignment Agreement dated as of May 19, 2005, which is attached hereto as Exhibit A and the provisions of which (as amended pursuant to this Section 1) are incorporated and reaffirmed herein (as so amended, the "Innovations Assignment Agreement") . To the extent any of the terms of this Agreement conflict with the terms of the Innovations Assignment Agreement, the terms of this Agreement shall prevail. Specifically, the parties hereby amend the Innovations Assignment Agreement as follows:

a. Employment at Will. Section 7 (Employment at Will) of the Innovations Assignment Agreement is deleted in its entirety.

b. Non-Competition. Section 9 (Non-Competition) of the Innovations Assignment Agreement is hereby deleted in its entirety and replaced with the following:

"Non-Competition. While Employee is employed by the Company and for a period of two (2) years after the termination of Employee's employment with the Company, Employee will not directly or indirectly, separately or in association with others, whether as an owner, director, officer, manager, consultant, agent, employee or otherwise, accept employment or engage in activities that compete with the Company, or with the reasonably anticipated

planned product developments of the Company as of Employee's termination date, in the United States, Canada, Japan and People's Republic of China. Employee acknowledges that the geographical scope of these limitations is reasonable and necessary for the protection of the Company's trade secrets and other proprietary information. Employee further acknowledges that if a court of competent jurisdiction finds this non-competition provision invalid or unenforceable due to unreasonableness in time, geographic scope or scope of the Company's business, then such court will interpret and enforce this provision to the maximum extent that such court deems reasonable. Notwithstanding the foregoing, nothing contained herein shall preclude Employee from (i) beneficially owning, as an investment, up to five percent (5%) of the publicly held securities of an entity (regardless of whether such entity competes with the Company), so long as the investment does not give Employee the right to control such entity, or (ii) engaging in consulting activities for Toshiba Corporation, a Japanese corporation ("Toshiba") (as may be agreed by Employee and Toshiba) that are not competitive with the Company."

c. Non-solicitation of Customers or Prospects. Section 10.1 (Non-solicitation of Customers or Prospects) of the Innovations Assignment Agreement is hereby deleted in its entirety and replaced with the following:

"Non-solicitation of Customers or Prospects. Employee acknowledges that information about the Company's customers is confidential and constitutes trade secrets. Accordingly, Employee agrees that during the period commencing on the date hereof and ending two (2) years after the termination of Employee's employment with the Company, Employee will not either directly or indirectly, separately or in association with others, solicit or encourage others to solicit any of the Company's customers or customer prospects, for the purpose of diverting or taking away business from the Company. For purposes of Employee's obligations under this Section 10.1 following the Termination Date, "customers or customer prospects" shall be limited to (i) those customers of the Company existing as of the Termination Date, and (ii) those customer prospects of the Company, of which Employee has knowledge, existing as of the Termination Date."

d. Non-solicitation of Company's Employees. Section 10.2 (Non-solicitation of Company's Employees) of the Innovations Assignment Agreement is hereby deleted in its entirety and replaced with the following:

"Non-solicitation of the Company's Employees. Employee agrees that during the period commencing on the date hereof and ending two (2) years after the termination of Employee's employment with the Company, Employee will not either directly or indirectly, separately or in association with others, interfere with, impair, disrupt or damage the Company's business by soliciting, encouraging or attempting to hire any of Company's employees or causing others to solicit or encourage any of the Company's employees to discontinue their employment with the Company. For purposes of Employee's obligations under this Section 10.2 following the Termination Date, Employee's obligation not to solicit any employee of the Company or encourage any employee to discontinue its employment with the Company shall be limited to those employees employed by the Company as of the Termination Date."

e. Non-hiring of Company's Employees. Employee further agrees that during the term of this Agreement and for a period of two (2) years after the effective date of Employee's termination of employment, Employee shall not, directly or indirectly, hire or attempt to hire any employee of the Company or assist in such hiring by any other person or entity.

f. Notification to Subsequent Employers. Employee hereby authorizes the Company at its discretion to contact Employee's prospective or subsequent employers and inform them of this Agreement or any other policy or agreement between Employee and the Company that may be in effect at the time that Executive's employment with the Company ends.

2. Employment. The Company employs Employee and Employee accepts employment on the terms and conditions in this Agreement.

3. Duties. Employee is employed in the capacity of "Chief Executive Officer" and "Chief Technology Officer". In this capacity Employee shall have responsibility for those duties which would reasonably be expected of a chief executive officer and chief technology officer in similar situations. Employee shall report directly to, and take direction from, the Company's board of directors (the "Board"). Subject to the provisions of this Agreement, Employee's precise duties may be changed, extended or curtailed, from time to time, at the Board's direction, and Employee shall assume and perform the further reasonable responsibilities and duties that the Board may assign from time to time.

4. Intensity of Effort; Other Business. Employee shall devote such time, attention and efforts to the Company's business and affairs as may be reasonably necessary for the performance of Employee's duties and responsibilities hereunder, and shall faithfully and diligently serve the Company's interests. Notwithstanding anything contained herein to the contrary, Employee may embark on the part-time pursuit of a masters of business administration degree or a doctorate degree in computer science, provided that such endeavor does not interfere with Employee's obligations hereunder. In the event that employee embarks on pursuit of such graduate education, the Company may, in the Board's discretion, reimburse Employee, or pay on Employee's behalf, the actual tuition and fees incurred by Employee relating to the pursuit of such degree during the term of his employment.

5. Term. The initial term of this Agreement shall commence on the Effective Date and shall expire on the fifth (5th) anniversary of the Effective Date (the "Term"). This Agreement may terminate before the expiration of the Term as provided below. The initial term of this Agreement shall automatically renew for successive one (1) year terms ending on the anniversary of the Effective Date, unless either party delivers written notice to the other party of nonrenewal at least ninety (90) days prior to the end of the initial Term. Notwithstanding the initial Term or any renewals thereof, the Term or any renewal may be terminated prior to the date on which it would otherwise expire or be renewed as set forth herein. In the event of a notice of nonrenewal delivered to Employee by the Company, the nonrenewal shall be treated as a Termination without Cause pursuant to Section 8.a.

6. Compensation. Employee's compensation shall be as follows:

a. Salary. Employee's salary during the Term shall be Forty-One Thousand Six Hundred Sixty-Six and 67/100 Dollars ($41,666.67) per month, which is Five Hundred Thousand Dollars ($500,000.00) per year on an annualized basis, and which shall be computed and paid in equal installments consistent with the Company's normal payroll procedures.

b. Bonus. Employee shall receive a bonus in an amount consistent with the Company's executive bonus compensation plan as approved and implemented by the Board at its sole discretion ("Bonus Payment"). The bonus shall be paid in full to Employee no later than the 15th day of the third month following the last day of the period for which the bonus is earned.

c. Stock Option Plan. During the Term, Employee shall be entitled to participate in the Company's stock option plan, if any, in the discretion of the Board.

7. Benefits.

a. Benefit Plans. Employee shall be eligible to participate in all benefit plans (including health care coverage) that are provided generally to the Company's executive employees, in accordance with the benefit plans established by the Company and as may be amended from time to time in the Company's sole discretion.

b. Personal Time-Off. During the Term, the Company will provide Employee twenty (20) business days of personal time-off ("PTO") per year, which amount may increase from time to time, consistent with the Company's policy regarding PTO for senior executives. PTO not taken during any applicable fiscal year shall be carried over to the next following fiscal year consistent with the Company's policy regarding PTO carryover for senior executives and the Company's policy regarding caps on PTO carryover for senior executives as now in force or as such policy may be adopted or revised from time to time in the future in the Company's sole discretion. Upon termination of employment for any reason Employee shall be paid for any accrued but unused PTO consistent with the Company's policy applied to senior executives, as now in force or as such policy may be adopted or revised from time to time in the future.

c. Business Expenses. Employee is authorized to incur reasonable expenses to carry out the Company's business. The Company shall reimburse Employee for those expenses timely submitted to the Company. Employee shall provide to the Company, prior to any reimbursement, the itemized expense account information as required by the Company's policy regarding expense reimbursement. Timely submission of expense account information, as required by Company policy, also applies to use of Company credit card(s).

d. D&O Insurance. Employee will be entitled to receive director and officer indemnity insurance (including "tail" coverage for a reasonable term following termination of Employee's positions as such officer or director) in coverage type and amounts as made available by the Company to other directors and officers of the Company.

e. Sabbatical. For so long as Employee is employed by the Company, every seven (7) years (subject to the provisions set forth herein) Employee shall be eligible for a ninety (90) calendar day sabbatical ("Sabbatical"), the time of which shall be reasonably agreed to by the Board and Employee, with the Board having final authority to approve or deny specific dates. Employee shall receive credit for such Sabbatical days at a rate of one (1) day per month, except that accrued unused Sabbatical time shall not be paid out at termination regardless of the reason. For purposes hereof, Employee shall be deemed to have been employed by the Company for thirty-eight (38) months and shall be credited thirty-eight (38) days towards the Sabbatical.

8. Termination. Employee's employment may be terminated before the expiration of this Agreement as follows, in which event Employee's compensation and benefits shall terminate, except as otherwise provided below:

a. By the Company Without Cause. The Company may terminate Employee's employment at any time without Cause (as defined below) or advance notice. If the Company terminates Employee's employment when neither Cause nor Permanent Disability (as defined below) exists, the Company shall pay to Employee: (i) a termination payment equal to two (2) years' of Employee's salary, less all lawful deductions, as of the effective date of termination, which payment shall be made in equal monthly installments pursuant to the normal payroll practices of the Company over the one (1) year period following the last day of the month in which the Employee's termination without Cause occurs; and (ii) one hundred percent (100%) of COBRA health insurance premiums for the benefit of Employee and any eligible dependents, per the Company's health insurance plan(s) in effect at the time of Employee's termination, for a period of eighteen (18) months following termination. Employee's rights under COBRA shall be the same as for any other terminating employee. All of the benefits provided for herein shall collectively be referred to as "Separation Benefits."

Notwithstanding anything in this Agreement to the contrary, if the Employee's employment is terminated in connection with the Company's insolvency, the Employee's right to receive any unpaid Severance Benefits shall be subordinate to the rights of the holders of the Company's Series A Preferred Stock then outstanding to receive distributions or other payments on or with respect to such stock. The "Company's insolvency" means the Company commences a voluntary case or other proceeding seeking liquidation, reorganization, or other relief with respect to itself or its debts under any bankruptcy, insolvency or other similar law now or hereafter in effect, or seeking the appointment of a trustee, receiver, liquidator, custodian or other similar official for the Company or any substantial part of its property, or taking possession by any such official in any involuntary case or other proceeding commenced against the Company, or makes a general assignment for the benefit of creditors, or fails generally to pay its debts as they become due, or takes any corporate action to authorize any of the foregoing.

Notwithstanding anything else to the contrary in this Agreement, the Company shall not be required to provide Employee with any Separation Benefits unless and until Employee signs and delivers to the Company a comprehensive release of claims in a form reasonably satisfactory to the Company (which release shall be executed and delivered by Employee promptly after the effective date of the termination) and the period, if any, during which such release can be revoked by the Employee expires without revocation.

b. By the Company for Cause. The Company may terminate Employee's employment for Cause upon delivery of written notice to Employee indicating that such termination is for Cause and the effective date of such termination, which may be immediate upon delivery of such notice. In the event Employee is terminated pursuant to this Section 8(b), Employee shall receive no further compensation in accordance with Section 6, other than base salary accrued through such termination.

For purposes of this Agreement "Cause" means and is limited to: (i) theft, dishonesty, conversion, embezzlement, fraud, or misappropriation by Employee of funds or other assets of the Company, or any other act of fraud or dishonesty with respect to the Company or Employee's duties; (ii) conviction of a felony or of any crime involving moral turpitude; (iii) violation of any law, Company Code of Conduct or Company policy against discrimination or workplace harassment that has a material adverse impact on the Company or its business; (iv) failure to follow the reasonable directives of the Board after written notice of such failure and reasonable opportunity to correct or discontinue such failure, which shall not exceed 30 days; (v) unauthorized dissemination by Employee of Proprietary Information (as defined in the Innovations Assignment Agreement); (vi) Employee's failure to perform substantially his responsibilities under this Agreement, after demand for substantial performance has been given by the Company that specifically identifies how Employee has not substantially performed his responsibilities, which period to perform shall not exceed 30 days; (vii) misconduct by Employee in the performance of Employee's duties that results in financial or reputational detriment to the Company; and (viii) Employee's attempt to obstruct or failure to cooperate with any investigation authorized by the Company or any governmental or self-regulatory entity.

c. By Employee Without Good Reason. Employee may terminate Employee's employment at any time without Good Reason (as defined below), by giving thirty (30) calendar days' advance written notice of termination. In the event Employee terminates his or her employment pursuant to this Section 8(c), Employee shall receive no further salary payments in accordance with Section 6, other than salary accrued through such termination date. Upon receipt of Employee's written notice of termination, the Company shall have the right, in its sole discretion, to accelerate the date of termination to any date prior to the termination date specified in such notice and such termination shall remain a termination by Employee hereunder.

d. By Employee for Good Reason. Employee may terminate Employee's employment for Good Reason, in which event Employee shall be entitled to the same Separation Benefits under this Agreement as if the Company had terminated Employee's employment without Cause. If Employee wishes to terminate employment for Good Reason Employee shall first give the Company ninety (90) days' written notice of the circumstances constituting Good Reason and an opportunity to cure, unless the circumstances are not subject to being cured. Following the notice and opportunity to cure (if cure is not made), or immediately if notice and opportunity to cure are not required, Employee may terminate employment for Good Reason by giving written notice of termination. The termination shall take effect immediately upon such notice.

For purposes of this Agreement, "Good Reason" means and is limited to: (i) the occurrence without Cause and without Employee's consent of a material reduction in the character of Employee's duties or level of work responsibility that substantially changes the character of Employee's duties; (ii) a reduction in Employee's salary below the level initially established pursuant to Section 6(a); (iii) the Company's failure to provide compensation or benefits owed to Employee following written demand for such compensation or benefits; (iv) or any material breach by the Company of its duties or obligations to Employee.

e. Death. In the event of Employee's death, this Agreement, Employee's employment hereunder, and the Company's obligations hereunder shall terminate forthwith and the Company shall have no further obligation to pay compensation to Employee or Employee's estate, successors or beneficiaries, other than to pay Employee's base salary through the date of death.

f. Permanent Disability. The Company may terminate Employee's employment immediately if Employee becomes Permanently Disabled (as defined below). In the event Employee's employment is terminated pursuant to this Section 8(f), Employee shall be entitled to the same Separation Benefits under this Agreement as if the Company had terminated Employee's employment without Cause.

For purposes of this Agreement, Employee will be considered "Permanently Disabled" or to have suffered a "Permanently Disability" if, for a continuous period of ninety (90) consecutive days or one hundred twenty (120) cumulative days in any one hundred eighty (180) day period, Employee has been unable to perform the essential functions of the job (with or without reasonable accommodation) because of one or more mental or physical illnesses and/or disabilities.

9. Parachute Payments. If any severance, accelerated vesting or other payment or benefit Employee would receive pursuant to a Change in Control from the Company or otherwise ("Payment") would (i) constitute a "parachute payment" within the meaning of Section 280G of the Internal Revenue Code of 1986, as amended (the "Code"), and (ii) but for this sentence, be subject to the excise tax imposed by Section 4999 of the Code (the "Excise Tax"), then such Payment shall be reduced to the Reduced Amount. The "Reduced Amount" shall be either (x) the largest portion of the Payment that would result in no portion of the Payment being subject to the Excise Tax or (y) the largest portion, up to and including the total, of the Payment, whichever amount, after taking into account all applicable federal, state and local employment taxes, income taxes, and the Excise Tax (all computed at the highest applicable marginal rate), results in Employee's receipt, on an after-tax basis, of the greater amount of the Payment. "Change in Control" means (i) the closing of the sale, transfer or other disposition of all or substantially all of the Company's assets, (ii) the consummation of a merger or consolidation of the Company with or into another entity, or (iii) the closing of the transfer (whether by merger, consolidation or otherwise), in one transaction or a series of related transactions, to a person or group of affiliated persons of the Company's securities if, after such closing, such person or group of affiliated persons would hold 50% or more of the outstanding voting stock of the Company (or the surviving or acquiring entity).

The accounting firm engaged by the Company for general audit purposes as of the day prior to the effective date of the Change in Control shall perform the foregoing calculations. If the accounting firm so engaged by the Company is serving as accountant or auditor for the individual, entity or group effecting the Change in Control, the Company shall appoint a nationally recognized accounting firm to make the determinations required hereunder. The Company shall bear all expenses with respect to the determinations by such accounting firm required to be made hereunder.

The accounting firm engaged to make the determinations hereunder shall provide its calculations, together with detailed supporting documentation, to the Company and Employee within fifteen (15) calendar days before the closing date of the Change in Control (if requested at that time by the Company or Employee) or such other time as requested by the Company or Employee. If the accounting firm determines that no Excise Tax is payable with respect to a Payment, either before or after the application of the Reduced Amount, it shall furnish the Company and Employee with an opinion reasonably acceptable to Employee that no Excise Tax will be imposed with respect to such Payment. Any good faith determinations of the accounting firm made hereunder shall be final, binding and conclusive upon the Company and Employee.

10. Indemnification.

The Company shall defend and indemnify Employee from and against any and all claims that may be asserted against Employee by third parties (including derivative claims asserted by third parties on behalf of the Company) that are connected with Employee's employment by the Company, to the extent permitted by applicable law. The foregoing notwithstanding, the Company shall not be required to defend or indemnify Employee (i) in criminal proceedings, (ii) in civil proceedings where Employee is the plaintiff, or (iii) to the extent it is finally adjudicated that Employee did not act in good faith and in the reasonable belief that Employee's actions were appropriate in the discharge of Employee's duties for the Company. The Company may fulfill its duty of defense by providing competent legal counsel of the Company's choosing.

The foregoing rights are in addition to any other rights to which Employee may be entitled under any other agreement, policy, bylaw, insurance policy, ordinance, statute or other provision.

11. Life Insurance.

a. The Company. The Company shall purchase one or more term life and disability insurance policies on the life of Employee, with the Company named as beneficiary, with an aggregate death benefit of up to Thirty Million Dollars ($30,000,000.00). Any benefit received by the Company shall be used to satisfy any redemption obligation of the Company to purchase preferred stock shares and any remaining proceeds may be retained by the Company.

b. Employee. The Company shall provide an insurance benefit to Employee equal to four (4) times Employee's annual salary, with a beneficiary(ies) as designated by Employee.

c. Further Cooperation. The Company and Employee shall fully cooperate with each other by taking all actions reasonably necessary to carry out the intentions of this section. Each party hereto shall cooperate in purchasing any insurance policies, including taking into consideration the wishes of the other party hereto with respect to the type of policy purchased and the quality of the insurance provider, and Employee shall submit to any reasonable application process, including medical testing, requested by the Company or any applicable insurance provider.

12. Dispute Resolution; Attorneys Fees. Any disputes arising under or related to this Agreement shall be governed by the dispute resolution procedure set forth in the Innovations Assignment Agreement. The substantially prevailing party in any proceeding to construe or enforce this Agreement or the Innovations Assignment Agreement, including any appeals, shall be entitled to recover its costs, including reasonable attorneys fees.

13. Governing Law. This Agreement shall be governed by the internal laws of the State of Washington without giving effect to provisions thereof related to choice of laws or conflict of laws.

14. Waiver. No waiver of any provision of this Agreement shall be valid unless in writing, signed by the party against whom the waiver is sought to be enforced. The waiver of any breach of this Agreement or failure to enforce any provision of this Agreement shall not waive any later breach.

15. Assignment; Successors. The Company may assign its rights and delegate its duties under this Agreement. Employee may not assign Employee's rights or delegate Employee's duties under this Agreement, without the written consent of the Company.

16. Binding Effect. This Agreement is binding upon the parties and their personal representatives, heirs, successors and permitted assigns.

17. Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be an original and all of which, taken together, shall constitute a single agreement.

18. Complete Agreement. This Agreement and the Innovations Assignment Agreement, which is incorporated herein by this reference, are the final and complete expression of the parties' agreement relating to Employee's employment. This Agreement may be amended only by a writing signed by both parties; it may not be amended orally or by course of dealing. The parties are not entering into this Agreement relying on anything not set out in this Agreement. This Agreement shall control over any inconsistent policies or procedures of the Company, whether in effect now or adopted later, but the Company's policies and procedures that are consistent with this Agreement, whether in effect now or adopted later, shall apply to Employee according to their terms.

19. Savings Clause. If any provision of this Agreement, is held to be invalid or unenforceable to any extent in any context, it shall nevertheless be enforced to the fullest extent allowed by law in that and other contexts, and the validity and force of the remainder of this Agreement shall not be affected thereby.

20. Survival of Obligations. Employee's obligations under the Innovations Assignment Agreement, as modified by Section 1 of this Agreement, shall survive the termination or expiration of this Agreement regardless of the reason for such termination or expiration.

21. Cooperation. During the Term of this Agreement and thereafter, the Employee shall, upon reasonable notice and reimbursement to the Employee of reasonable out of pocket costs incurred, furnish such information and proper assistance to the Company as may be reasonably required by the Company in connection with any dispute or litigation in which the Company is or may become involved. Such cooperation shall include, but not be limited to, Employee's provision of truthful evidence in any proceeding at the Company's request by means of affidavit, deposition or trial testimony.

22. Notices. Unless otherwise provided, any notice required or permitted by this Agreement shall be in writing and shall be deemed sufficient upon delivery, when delivered personally or by overnight courier or when sent by confirmed electronic mail or facsimile if sent during normal business hours of the recipient; if not, then on the next Business Day, or 48 hours after being deposited in the mail, as certified or registered mail, with postage prepaid, and addressed to the party to be notified at such party's address or facsimile number as set forth on Exhibit A hereto or as subsequently modified by written notice.

[*Signatures appear on the following page*]

DATED as of the date first written above.

EMPLOYEE:

MARK E. PHILLIPS

Notice Address:
720 Third Avenue, Suite 1100
Seattle, WA 98104

EMPLOYER:

MOD SYSTEMS INCORPORATED,
a Washington corporation

By:_____
Name: David M. Douglass
Title: Vice President and Chief Financial Officer

Notice Address:
720 Third Avenue, Suite 1100
Seattle, WA 98104

DATED as of the date first written above.

EMPLOYEE:

MARK E. PHILLIPS

Notice Address:

EMPLOYER:

MOD SYSTEMS INCORPORATED,
a Washington corporation

By: D M Douglas
Name: DAVID M. DOUGLAS
Title: VP + CFO

Notice Address:
720 Third Ave, #1100
Seattle, WA 98104

EXHIBIT A

PARTIES

If to the Company:

MOD Systems Incorporated
720 Third Avenue, Suite 1100
Seattle, WA 98104
Attention: David Douglass
Telephone: +1-206-973-1036
Facsimile: +1-206-374-2718

If to Employee:

Mark Phillips
c/o MOD Systems Incorporated
720 Third Avenue, Suite 1100
Seattle, WA 98104
Telephone: +1-206-973-1036
Facsimile: +1-206-374-2718

EXHIBIT B

INNOVATIONS ASSIGNMENT AGREEMENT

[See attached]

EMPLOYEE INNOVATIONS AND PROPRIETARY RIGHTS ASSIGNMENT AGREEMENT

In consideration of my employment by MOD Systems, Inc. (the "***Company***") and other good and valuable consideration, the receipt and sufficiency of which I hereby acknowledge, I acknowledge and agree that:

1. Duties. As an employee of the Company, and in consideration of the compensation to be paid to me, I will perform such duties for the Company as may be designated by the Company from time to time. During my period of employment, I will devote my best efforts to the interests of the Company and will not engage in employment or other activities determined by the Company to be detrimental to the best interests of the Company and the Company's business. The Company's business means the business of the Company conducted from time to time or that is completed by the Company during by employment with the Company (the "***Business***").

2. Proprietary Information. At all times during my employment and thereafter I will not disclose to anyone outside the Company or use for any purpose other than work for the Company any of the following types of information: (a) any confidential or proprietary technical, financial, marketing, manufacturing, distribution or other technical or business information or trade secrets of the Company, including, without limitation, information related to concepts, techniques, processes, methods, systems, designs, circuits, cost data, computer programs, source documentation, trade secrets, formulae, development or experimental work, work in progress, forecasts, proposed and future products, marketing plans and information, customers and suppliers, or any other nonpublic information which has commercial value; (b) any information that the Company has received from others which the Company is obligated to treat as confidential or proprietary; or (c) any confidential or proprietary information which is circulated within the Company via its internal electronic mail system or otherwise. All information described above in this section shall be considered "***Proprietary Information***", and shall be the sole property of the Company, the Company's assigns, and the Company's customers. I will not disclose any Proprietary Information to anyone inside the Company except on a "need-to-know" basis. If I have any questions as to what constitutes Proprietary Information, or to whom, if anyone, inside the Company, it may be disclosed, I will consult with my manager at the Company.

3. Proprietary Information of Third Parties. During my employment at the Company, I will not use improperly or disclose any confidential or proprietary information or trade secrets of my former or current employers, principals, partners, co-venturers, clients, customers, or suppliers of the vendors or customers of such persons or entities. I will not bring onto the premises of the Company any unpublished document or any property belonging to any such persons or entities or their vendors or customers unless such persons or entities have given prior consent. I will not violate any non-disclosure or proprietary rights agreement I might have signed in connection with any such person or entity.

4. Assignment of Innovations. I will make prompt and full disclosure to the Company, will hold in trust for the sole benefit of Company, and will assign exclusively to the Company all my right, title and interest in and to any and all innovations, discoveries, designs, developments, improvements, copyrightable material and trade secrets (collectively "***Innovations***") that I, solely or jointly, may conceive, develop or reduce to practice during the period of time I am employed by the Company (a "***Company Innovation***"). To the extent any of the rights, title and interest in any Company Innovation cannot be assigned by me to the Company, I hereby grant to the Company an exclusive, royalty-free, transferable, irrevocable, worldwide license (with rights to sublicense through multiple tiers of sublicensees) to practice such rights, title and interest. Finally, to the extent any of the rights, title and interest can be neither assigned nor licensed, I hereby irrevocably waive and agree never to assert such

rights, title and interest against the Company or any of the Company's successors in interest to such rights.

I understand that my obligation to assign, license, or waive a claim with respect to any Innovation must comply with the requirements of RCW 49.44.140. Pursuant to this Washington statute, this Section 4 (Assignment of Innovations) does not apply to and I do not assign my rights to any Innovation (whether a Company Innovation or otherwise) when I can prove that: (a) I developed the Innovation entirely on my own time; (b) I did not use the Company equipment, supplies, facilities , or trade secret information in its development; (c) the Innovation does not relate (i) directly to the business of the Company, or (ii) to the actual or demonstrably anticipated research or development of the Company; and (d) the Innovation does not result from any work performed by me for the Company.

This Section 4 (Assignment of Innovations) shall be construed to apply to all Company Innovations with which I am involved from this date forward, as well as all Company Innovations with which I have been involved since my employment with the Company began.

5. Disclosure of Prior Innovations. Exhibit A ("***Prior Innovations***"), which is attached hereto and incorporated by this reference, is a list describing all Innovations belonging to me and made by me prior to my employment with the Company that I wish to have excluded from this Agreement ("***Prior Innovations***"). If there is no list on Exhibit A, I represent that there are no Prior Innovations. If in the course of my employment at the Company, I use or incorporate into a Company product, process, or machine an Innovation owned by me or in which I have an interest, the Company is hereby granted and shall have an exclusive, royalty-free, irrevocable, worldwide license to make, have made, use, and sell that Innovation without restriction as to the extent of my ownership or interest. Notwithstanding the foregoing, I agree that I will not incorporate, or permit to be incorporated, any Innovation owned by me into any Company Innovation without the Company's prior written consent.

6. Cooperation. I will execute any proper oath or verify any proper document in connection with carrying out the terms of this Agreement. If, because of my mental or physical incapacity or for any other reason whatsoever, the Company is unable to secure my signature to apply for or to pursue any application process concerning Innovations assigned to the Company as stated above, I hereby irrevocably designate and appoint the Company and its duly authorized officers and agents as my agent and attorney-in-fact, to act for me and on my behalf to execute and file any such applications and to do all other lawfully permitted acts to further the prosecution and issuance of all appropriate procedures thereon with the same legal force and effect as if executed by me. I will testify at the Company's request and expense in any interference, litigation, or other legal proceeding that may arise during or after my employment.

7. Employment at Will. I acknowledge that my employment will be of indefinite duration and that either the Company or I will be free to terminate my employment at any time with or without cause. I also acknowledge that any representations to the contrary are unauthorized and void, unless contained in a formal written employment contract signed by an officer of the Company. I further acknowledge that the terms and conditions of this Agreement shall survive termination of my employment.

8. Return of Materials. Upon termination of my employment, or at any time at the Company's request before termination, I will promptly (but no later than five (5) days after the earlier of my employment's termination or the Company's request) return to the Company all papers, drawings, notes, memoranda, manuals, specifications, designs, devices, documents, diskettes and tapes, and any other material on any media containing or disclosing any confidential or proprietary, technical or business information, as well as any keys, pass cards, identification cards or other property belonging to the

Company. I will submit a written certification of my compliance with my obligations under this Section 8 (Return of Materials) at the same time.

9. Non-Competition. For a period of one (1) year after termination of my employment, I will not directly or indirectly, whether as an owner, director, officer, manager, consultant, agent or employee, accept employment or engage in activities that compete with the Business, or with the reasonably anticipated planned product developments of the Company as of my termination date, in any geographical location in the United States in which the Company or any of its subsidiaries, licensees or affiliates is then operating or preparing to operate. I acknowledge that the geographical scope of these limitations is reasonable and necessary for the protection of the Company's trade secrets and other Proprietary Information. I further acknowledge that if a court of competent jurisdiction finds this non-competition provision invalid or unenforceable due to unreasonableness in time, geographic scope, or scope of the Business, then such court will interpret and enforce this provision to the maximum extent that such court deems reasonable.

10. Non-solicitation.

10.1 Non-solicitation of Customers or Prospects. I acknowledge that information about the Company's customers is confidential and constitutes trade secrets. Accordingly, I agree that during the term of this Agreement and for a period of one (1) year after the termination of my employment, I will not, either directly or indirectly, separately or in association with others, interfere with, impair, disrupt or damage the Company's relationship with any of its customers or customer prospects by soliciting or encouraging others to solicit any of them for the purpose of diverting or taking away business from the Company.

10.2 Non-solicitation of Company's Employees. I agree that during the term of this Agreement and for a period of one (1) year after the termination of my employment, I will not, either directly or indirectly, separately or in association with others, interfere with, impair, disrupt or damage the Company's business by soliciting, encouraging or attempting to hire any of the Company's employees or causing others to solicit or encourage any of the Company's employees to discontinue their employment with the Company.

11. No Violation of Rights of Third Parties. I warrant that my performance of all the terms of this Agreement and my employment with the Company does not and will not breach any agreement to keep in confidence proprietary information, knowledge or data acquired by me prior to my employment with the Company. I agree not to disclose to the Company, or induce the Company to use, any confidential or proprietary information or material belonging to any previous employers or others. I warrant that I am not a party to any other agreement that will interfere with my full compliance with this Agreement. I further agree not to enter into any agreement, whether written or oral, that conflicts with the provisions of this Agreement.

12. Restrictions on the Use of Public Software. Unless otherwise agreed in writing, I will not incorporate any Public Software in whole or in part into any Company Innovations. "***Public Software***" means any software that contains, or is derived (in whole or in part) from any software that is distributed as free software, open source software (e.g., Linux) or similar licensing or distribution models, including but not limited to, software licensed or distributed under any of the following licenses or distribution models or licenses or distribution models similar to any of the following: (i) GNU's General Public License (GPL) or Lesser/Library GPL (LGPL); (ii) the Artistic License (e.g. PERL); (iii) the Mozilla Public License; (iv) the Netscape Public License; (v) the Sun Community Source License (SCSL); (vi) the Sun Industry Standards License (SISL); (vii) the BSD License; and (viii) the Apache License.

13. Injunctive Relief. I acknowledge that any violation of this Agreement by me will cause irreparable injury to the Company, and the Company shall be entitled to extraordinary relief in court, including, but not limited to, temporary restraining orders, preliminary injunctions and permanent injunctions, without the necessity of posting bond or security, in addition to all other equitable and legal remedies.

14. Arbitration. In the event of any dispute or claim solely related to or arising out of the termination of my employment with the Company for any reason (including, but not limited to, any claims for breach of contract, wrongful termination, or age, sex, race, national origin, disability or other discrimination or harassment), I agree that all such disputes will be fully, finally and exclusively resolved by binding arbitration conducted by the American Arbitration Association in King County, Washington. I hereby waive my right to have such disputes or claims tried by a judge or jury and acknowledge and agree that I have had an opportunity to consult with my attorney with respect to the waiver of this right. I acknowledge and agree that this arbitration provision will not apply to any claims by the Company and me arising out of or related to Proprietary Information, Innovations and other intellectual property rights.

15. General Provisions. This Agreement shall be governed by and construed in accordance with the laws of the State of Washington without giving effect to any conflict of laws principles to the contrary. Venue for any disputes arising under this Agreement will lie exclusively in the state or federal courts located in King County, Washington. The parties irrevocably waive any right to raise *forum non conveniens* or any other argument that King County, Washington is not the proper venue, and irrevocably consent to personal jurisdiction in the state and federal courts of Washington. If a court of competent jurisdiction declares any provision of this Agreement to be void or unenforceable, then (a) such provision will be interpreted, construed or reformed to the extent reasonably required to render it valid, enforceable and consistent with the original intent underlying such provision, and (b) such invalidity or enforceability will not affect any other provision of this Agreement or any other agreement between the Company and me. Any waiver of any term or provision of this Agreement shall be effected only by written agreement between the Company and myself. No such waiver or consent by the Company of a breach by me will constitute waiver or consent of any subsequent breach unless that is explicitly stated. Any notice required or permitted by this agreement shall be made in writing, and shall be delivered either personally, by certified or registered mail, or shall be left at the recipient's usual place of abode with a person of suitable age and discretion who resides there. This Agreement, together with Exhibit A attached hereto, my offer letter from the Company, and stock option agreement, if any, sets forth the entire understanding between the parties with respect to their subject matter and supersedes all prior and contemporaneous agreements, negotiations and understandings between the parties, whether oral or written.

HAVING READ AND FULLY UNDERSTOOD THIS AGREEMENT, I have signed my name this 14 day of May, 2005.

Signature

Mark Phillips
Name (Print)

Innovations listed on attached:
✓ Yes ___ No

Exhibit A

PRIOR INNOVATIONS

AVAILABLE ELECTRONICALLY FROM COMPANY
Exhibit is 1,248 pages

Please see attached documentation of prior innovations.

EXHIBIT “M”

SUBSCRIPTION AND CONTRIBUTION AGREEMENT

THIS SUBSCRIPTION AND CONTRIBUTION AGREEMENT (this "Agreement") is made as of October 17, 2008 (the "Effective Date"), by and between MOD SYSTEMS INCORPORATED, a Washington corporation ("MOD"), and MARK E. PHILLIPS, an individual ("Phillips").

RECITALS

WHEREAS, Phillips is the exclusive owner of, or otherwise has the right to assign, certain Intellectual Property and Technology, as further defined and described in this Agreement;

WHEREAS, concurrently with this Agreement, Phillips, MOD, Toshiba Corporation, Deluxe Entertainment Services Group Inc. and NCR Corporation are entering into that certain Series A Preferred Stock Purchase Agreement dated as of the Effective Date (the "Series A Transaction"); and

WHEREAS, effective upon the closing of the Series A Transaction, and in combination therewith, Phillips desires to contribute and irrevocably assign such Intellectual Property and Technology in exchange for consideration in the form of common shares of MOD, all as set forth below, which shall constitute a transfer pursuant to Internal Revenue Code Section 351.

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties agree as follows:

AGREEMENT

1. Definitions.

1.1 "Affiliate" means with respect to any specified Person, any Person that directly or through one or more intermediaries controls or is controlled by or is under common control with the specified Person. As used in this definition, the term "control" means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a Person, whether through ownership of voting securities, by contract or otherwise. Notwithstanding the foregoing, MOD shall not be deemed to be an Affiliate of Phillips for purposes of this Agreement.

1.2 "Contributed Assets" means any and all Intellectual Property and Technology that Phillips owns or otherwise has the right to assign and that is used in or otherwise related to the business of MOD as conducted or contemplated to be conducted as of the Effective Date, including the Intellectual Property and Technology set forth on Schedule 1, but not including the Excluded Assets (which Excluded Assets shall be licensed to MOD pursuant to the License Agreement).

1.3 "Effective Date" has the meaning set forth in the introductory paragraph of this Agreement.

1.4 "Excluded Assets" means the Intellectual Property and Technology set

forth on Schedule 2.

1.5 "Intellectual Property" means any and all (a) patents and patent applications ("Patents"); (b)copyrights and similar rights in works of authorship (including, without limitation, software) ("Copyrights"); (c) trademarks, service marks, trade names, trade dress and domain names, and all goodwill associated therewith ("Trademarks"); (d) trade secrets and other rights in proprietary and confidential information ("Trade Secrets"); and all other intellectual and industrial property and related rights, whether statutory or common law, and whether protected, created or arising under the laws of the United States or any other jurisdiction, together with all national, foreign, and state registrations, applications for registration and renewals and extensions thereof.

1.6 "License Agreement" means that certain License Agreement between Phillips and MOD, of even date herewith.

1.7 "Licensed Materials" has the meaning set forth in the License Agreement.

1.8 "Payments" has the meaning set forth in the License Agreement.

1.9 "Person" means a natural individual, partnership, limited liability company, corporation or other entity.

1.10 "Technology" means all software, hardware, documentation and other works, inventions, know-how, technology, information and materials.

1.11 "Termination Agreement" has the meaning set forth in Section 2.6.

1.12 "Transaction Agreements" means this Agreement, the License Agreement and the Termination Agreement.

2. The Transaction Generally.

2.1 Contribution and Assignment. Phillips hereby irrevocably contributes, assigns, transfers and conveys, and otherwise grants in perpetuity, to MOD, its successors and assigns all right, title and interest throughout the universe in and to the Contributed Assets, together with all benefits, privileges, causes of action and remedies relating to any of the Contributed Assets, whether before or hereafter accrued (including, without limitation, the sole and exclusive rights to apply for and maintain all registrations, renewals and/or extensions with respect to the Contributed Assets; to sue for all past, present or future infringements or other violations of any rights in the Contributed Assets; and to settle and retain proceeds from any such actions).

2.2 Moral Rights. Phillips irrevocably waives any "moral rights" or other rights with respect to attribution of authorship or integrity of any Contributed Assets that Phillips may have or acquire under any applicable law under any legal theory, and, in the event such waiver is held to be ineffective, unenforceable, void or voidable under applicable law, Phillips irrevocably covenants not to assert any such rights against MOD or any of its Affiliates.

2.3 After-acquired Rights. In the event that Phillips acquires after the Effective Date, by agreement, operation of law or otherwise, ownership or other additional or greater interest in any Contributed Assets than that assigned hereunder, such later-acquired rights shall automatically be subject to this Agreement such that such rights are assigned to MOD hereunder as if Phillips had possessed them on the Effective Date.

2.4 Delivery. Phillips shall promptly after the Effective Date deliver to MOD all software (including all source code with comments, libraries, tools, utilities and other related materials), hardware, documentation, media and other tangible property (collectively, "Tangible Property") included in or related to the Contributed Assets, to the extent that such Tangible Property was not already in MOD's possession prior to the Effective Date. Phillips shall further deliver to MOD any additional Tangible Property included in or related to the Contributed Assets promptly upon MOD's request from time to time.

2.5 Cooperation. Phillips shall cooperate in supplying such information as may be reasonably requested by MOD to complete and file any forms, documents or instruments presently or hereafter required, and shall execute and deliver to MOD such other documents and do such other acts and things, all as MOD may reasonably request for the purpose of vesting, securing, perfecting, protecting and enforcing MOD's right, title and interest in and to the Contributed Assets or otherwise carrying out the intent of this Agreement and the transactions contemplated hereby all at MOD's sole cost and expense.

2.6 Termination of Existing License Agreement. On the Effective Date, MOD and Phillips shall, and Phillips shall cause AnythingBox Incorporated ("ABX") to, enter into that certain Termination Agreement dated as of the date hereof, the form of which is attached hereto as Exhibit B (the "Termination Agreement"). The Termination Agreement shall terminate (a) that certain License Agreement dated as of April 25, 2008 between Phillips and ABX, and (b) that certain License Agreement dated as of April 23, 2007 between Phillips and MOD (together, the "Terminated Licenses"), and the Terminated Licenses shall cease to have any further force or effect.

3. Equity Consideration Shares. In consideration for the contribution and assignment of the Contributed Assets, MOD shall issue to Phillips on the Effective Date, and Phillips hereby acknowledges receipt of as of the Effective Date, eleven million four hundred one thousand one hundred ninety-six (11,401,196) shares of MOD's common stock (the "Equity Consideration Shares"), having an agreed value equal to Thirty-Eight Million Nine Hundred Thousand Dollars and No Cents ($38,900,000.00).

4. Representations and Warranties of Phillips. Phillips represents and warrants to MOD, as of the Effective Date and thereafter, as follows:

4.1 Authorization. Phillips has all requisite power and legal authority to execute and deliver each Transaction Agreement to which he is a party and any other agreements or documents contemplated thereby, and to carry out and perform his obligations thereunder. Each Transaction Agreement to which Phillips is a party is a valid and binding obligation of his, enforceable against him in accordance with its terms.

4.2 Litigation. There is no claim, action, suit, investigation or proceeding pending or to the knowledge of the Phillips, threatened against him and to the knowledge of the Phillips no event has occurred or circumstance exists that may give rise to or serve as the basis for the commencement of any proceeding in connection with the subject matter of the Transaction Agreements.

4.3 Intellectual Property.

(a) Phillips has taken all reasonable steps to maintain the confidentiality of all Trade Secrets included in the Contributed Assets, and to Phillips' best knowledge there is no misappropriation or unauthorized disclosure or use of any such Trade Secrets. Phillips has required each person or entity that has received or had access to any such Trade Secret, or that has contributed to the creation or development of any Contributed Assets, to execute sufficient non-disclosure and assignment agreements that (i) assign to Phillips all right, title and interest in such Contributed Assets, and (ii) provide reasonable protection for such Trade Secrets. To the best knowledge of Phillips, no such person or entity is in breach of any such non-disclosure agreement.

(b) To Phillips' best knowledge, there are no facts or circumstances that could impair the validity or enforceability of any Intellectual Property included in the Contributed Assets, the Intellectual Property included in the Contributed Assets is valid, enforceable, subsisting and in full force and effect, and no Contributed Assets have passed into the public domain. Phillips is, and on the Effective Date MOD will be, the sole and exclusive owner of all Contributed Assets and none of the Contributed Assets is jointly owned by any third Person. In each case in which Phillips has acquired ownership (or purported to acquire ownership) of any Contributed Assets from any other person or entity, Phillips has obtained a valid and enforceable assignment sufficient to unconditionally and irrevocably transfer all rights in such Contributed Assets to Phillips. Phillips has not granted any exclusive license with respect to any Contributed Assets to any third Person, except for the Terminated Licenses which shall be terminated as of the Effective Date in accordance with the Termination Agreement.

(c) Schedule 4.3(c) lists all Patents, registered Copyrights and applications therefor, and registered Trademarks and applications therefor included in the Contributed Assets (collectively, "Registered Contributed Assets"), together with the name of the applicant or registrant of record, the applicable jurisdiction, and the applicable application or registration number. All necessary registration, maintenance, and renewal fees in connection with all the Registered Contributed Assets have been paid, and all necessary applications, affidavits, certificates and other documents have been filed with the applicable authorities in the United States or foreign jurisdictions for the purposes of securing and maintaining such Registered Contributed Assets.

(d) MOD's use, practice and commercialization of the Contributed Assets in MOD's business, as now conducted and as contemplated to be conducted as of the Effective Date (including, without limitation, the design, development, manufacture, sale, licensing, marketing, distribution and provision of any current or now contemplated product or service of MOD) does not and shall not infringe, misappropriate, disclose or use without authorization, or otherwise violate any Intellectual Property of any third Person. Phillips has not received, nor is he aware of, any claim, demand, invitation to license, or other communication

alleging any such infringement, misappropriation, unauthorized use or disclosure, or other violation. To Phillips' best knowledge, no third Person has infringed, misappropriated, disclosed or used without authorization, or otherwise violated any Contributed Assets, and Phillips has not issued any oral or written claim, demand, invitation to license or other communication alleging such infringement, misappropriation, unauthorized use or disclosure, or other violation. Notwithstanding anything contained in the foregoing, Phillips' representations and warranties under the first sentence of this Section 4.3(d) shall not apply with respect to any infringement to the extent resulting from: (i) alterations, changes or modifications of or to the Contributed Assets by MOD or for MOD by a third Person, if such infringement would not have occurred without such alterations, changes or modifications; or (ii) MOD's combination of the Contributed Assets with other products or services not provided by Phillips or for Phillips by any third Person, if such infringement would not have occurred without such combination.

(e) Phillips is the sole and exclusive owner of the software (including source code) that is included in the Contributed Assets ("Phillips Software"). Phillips has not exclusively licensed any Phillips Software to any third Person, except in connection with the Terminated Licenses. To Phillips' knowledge, all Phillips Software is free of any material defects, bugs and errors, and does not contain or make available any disabling codes or instructions, spyware, Trojan horses, worms, viruses or other software routines that permit or cause unauthorized access to, or disruption, impairment, disablement, or destruction of, software, data or other materials.

(f) Phillips has not granted or agreed to grant, nor has he caused any third Person to grant or agree to grant, any license (except for the Terminated Licenses), covenant, release, immunity or other right with respect to Contributed Assets to any third Person, and no third Person has granted or agreed to grant any license, covenant, release, immunity or other right with respect to Contributed Assets to Phillips.

(g) Neither the Transaction Agreements nor the consummation of the transactions contemplated thereby, nor any contract, agreement or other arrangement to which Phillips is a party, will cause or require (or purport to cause or require) MOD to grant to any third Person any license, covenant, release, immunity or other right with respect to any Intellectual Property or be subject to any non-competition provision or similar restriction.

(h) Schedule 4.3(h) lists all software that is distributed as "open source software" or under any licensing or distribution model that purports to require the distribution of or access to source code or purports to restrict the ability to charge for distribution of or to use software for commercial purposes (including, without limitation, the GNU General Public License and GNU Lesser General Public License) ("Open Source") that is included in the Contributed Assets or is used in or necessary to the conduct of MOD's business, as now conducted and as contemplated to be conducted as of the Effective Date, including, without limitation, any Open Source that is incorporated into or otherwise used in connection with any Phillips Software or any of MOD's products or services or the development thereof, together with a description of the manner in which such Open Source is incorporated into or otherwise used in connection with such Phillips Software or product or service or the development thereof. Phillips has enforced an Open Source policy to identify and regulate the use and distribution of Open Source in connection with its business, and to avoid the release of the source code of any Phillips Software. To Phillips' best

knowledge, there has been no material deviation from or violation of its policies with respect to Open Source. Phillips has not breached any Open Source license.

(i) Phillips has complied with all applicable laws, regulations and generally accepted industry standards, and all requirements under any contracts to which he is a party relating to privacy and data security, in each case with respect to the Contributed Assets, including, without limitation, with respect to the collection, use, and disclosure of any personally identifiable information collected, used, or held for use by or for Phillips and included in the Contributed Assets. Phillips has taken commercially reasonable measures (and all measures required by law) to ensure that such personally identifiable information is protected against unauthorized access, disclosure, use, modification, or other misuse or misappropriation. Phillips has not received any claims, complaints or other communications from third parties (including, without limitation, any governmental authorities) relating to privacy or data security, including, without limitation, with respect to the unauthorized access, disclosure, use, modification, or other misuse or misappropriation or personally identifiable information.

(j) Phillips is in compliance with all applicable ISO (International Standards Organization) standards, ANSI (American National Standards Institute) standards, and other similar standards relevant to the Contributed Assets, and has obtained all required licenses applicable to the implementation of such standards with respect to the Contributed Assets, including, without limitation, licenses under the DVD 3C, DVD 6C and MPEG LA patent pools.

(k) Each item of the Contributed Assets is solely and exclusively owned by Phillips and Phillips has good and marketable title thereto, and, upon the Effective Date, the Contributed Assets will be solely and exclusively owned by MOD pursuant to the terms of this Agreement, free and clear of any liens, security interests, claims or encumbrances. Upon the Effective Date, all Contributed Assets will be freely assignable and fully sublicensable by MOD, and immediately available for use, practice and commercialization by MOD, free and clear of any liens, security interests, claims or encumbrances, and without payment of any royalties, fees, or other amounts. There is no Technology or Intellectual Property that Phillips owns or has the right to license that is related to MOD's business, as now conducted and as contemplated to be conducted as of the Effective Date, that is not included in either the Contributed Assets or the Licensed Materials.

(l) No later than thirty (30) days after the Effectve Date, Phillips shall take all actions necessary or as required by MOD, including, without limitation, the execution of all documents required by MOD to record the assignments and transfers of the Contributed Assets as contemplated by this Agreement.

4.4 Noncontravention. Neither the execution and delivery by Phillips of the Transaction Agreements, nor the consummation by Phillips of the transactions contemplated thereby, will (i) conflict with or violate any agreement to which Phillips is a party, (ii) require on the part of Phillips any filing list, or any permit, authorization, consent or approval of, any court, arbitrational tribunal, administrative agency or commission or other governmental or regulatory authority, or agency, (iii) conflict with, result in a breach of, constitute (with or without due notice or lapse of time or both) a default under, result in the acceleration of obligations under, create in any person or entity the right to terminate, modify or cancel, or require any notice, consent or

waiver under, any contract or, agreement, note, lease or license to which Phillips is a party or by which Phillips is bound, (iv) result in the imposition or any lien, security interest, charge or other encumbrance upon any assets of Phillips, or (v) violate any order, writ, injunction or decree or any statute, rule or regulation applicable to Phillips or any of his properties or assets.

4.5 Disclosure. No representations, warranties, assurances or statements by Phillips in the Transaction Agreements and no statement contained in any document (including the Exhibits and Schedules attached hereto), certificates or other writings furnished or to be furnished by Phillips to MOD pursuant to the provisions hereof contains or will contain any untrue statement of material fact, or omits or will omit to state any fact necessary, in light of the circumstances under which it was made, in order to make the statements herein or therein not misleading. Phillips has disclosed to MOD all material information relating to the Contributed Assets (whether tangible or intangible).

5. Additional Representations and Warranties of Phillips. Phillips hereby represents and warrants to MOD with respect to the shares of MOD's common stock comprising the Equity Consideration Shares, as follows:

5.1 Investor Qualifications. Phillips, by reason of his business or financial experience, is capable of evaluating the merits and risks of an investment in MOD.

5.2 Investment Intent. Phillips understands that the shares of MOD have not been and will not be registered under the Securities Act of 1933, as amended (the "Securities Act") by reason of a specific exemption from the registration provisions of the Securities Act that depends upon, among other things, the bona fide nature of the investment intent and the accuracy of the representations as expressed herein.

5.3 Rule 144. Phillips agrees and acknowledges that the shares of MOD must be held indefinitely unless subsequently registered under the Securities Act or an exemption from such registration is available in connection with a proposed transfer. Phillips is aware of the provisions of Rule 144 promulgated under the Securities Act, which permit limited resale of shares purchased in a private placement subject to the satisfaction of certain conditions as provided in Rule 144.

5.4 No Public Market. Phillips understands that no public market now exists for any of the securities issued by MOD, that MOD has made no assurances that a public market will ever exist for such shares and that, even if such a public market exists at some future time, MOD may not then be satisfying the current public information requirements of Rule 144.

6. Indemnification. Phillips agrees to indemnify, defend and hold harmless MOD, its officers, directors, employees, shareholders, agents and representatives from and against any costs, expenses, obligations, damages, liabilities or losses (including, without limitation, reasonable attorneys' fees and expenses, amounts paid in settlement, interest, and court costs) (collectively, "Losses") incurred or suffered by MOD arising out of, relating to or based upon (a) any inaccuracy in, or breach of, any of the representations or warranties of Phillips contained in any Transaction Agreement; or (b) any breach of any covenant or other agreement of Phillips contained in any Transaction Agreement; provided, however, that Phillips' total indemnification liability under the

Transaction Agreements shall not exceed in the aggregate, the actual proceeds received by Phillips in connection with a sale of fifty percent (50%) of the Equity Consideration Shares PLUS fifty percent (50%) of the Payments actually received by Phillips under the License Agreement. In the event Phillips incurs any obligation to indemnify, defend or hold harmless hereunder, Phillips shall promptly sell up to fifty percent (50%) of his Equity Consideration Shares to the extent required to satisfy such obligation. Notwithstanding the foregoing, in no event shall Phillips be deemed to have (a) breached or made an inaccurate representation or warranty contained in any Transaction Agreement, or (b) breached any covenant or other agreement of Phillips contained in any Transaction Agreement as a result of his having entered into that certain Freedom of Operation Agreement, dated as of the Effective Date, by and among Phillips, MOD and Toshiba Corporation.

7. Survival. All of the representations, warranties, covenants and agreements of Phillips and MOD contained in this Agreement shall survive the Effective Date and shall continue to survive at all times thereafter.

8. Reliance on Representations and Warranties. The representations and warranties of Phillips contained in any Transaction Agreement shall not be affected or deemed waived by reason of any investigation made by or on behalf of MOD (including, but not limited to, by any of MOD's representatives), or by reason of the fact that MOD or any of MOD's representatives knew or should have known that any such representation or warranty is or might be inaccurate. Further, the parties acknowledge that Phillips is also an officer, director and shareholder of MOD. In no event shall any knowledge of Phillips be imputed or otherwise deemed to be knowledge of MOD by reason of Phillips being an officer, director or shareholder of MOD.

9. Payment of Professional Fees. MOD will cause all of Phillips' professional fees incurred by Phillips in connection with the transactions contemplated by the Transaction Agreements, including all fees owed to accountants, attorneys or tax advisors, to be paid in full on the Effective Date.

10. Miscellaneous.

10.1 Notices. All notices and other communications required or permitted hereunder shall be given in writing as set forth below and shall be deemed effective (i) upon delivery, when delivered personally or sent by overnight courier, (ii) if sent by mail, at the earlier of its receipt or seventy-two (72) hours after deposit in a regularly maintained receptacle for the deposit of the U.S. mail, addressed and mailed as set forth below, or (iii) upon acknowledgement of receipt, when sent by facsimile or electronic mail.

If to Phillips:	With a copy to:
Mark Phillips c/o MOD Systems Incorporated 720 Third Avenue, Suite 1100 Seattle, Washington 98104	Foster Pepper PLLC 1111 Third Avenue, Suite 3400 Seattle, Washington 98101 Attention: Derek de Bakker
If to MOD:	With a copy to:
MOD Systems Incorporated	Lane Powell PC

720 Third Avenue, Suite 1100
Seattle, Washington 98104
Attention: Kenneth Gordon

1420 Fifth Ave, Suite 4100
Seattle, Washington 98101
Attention: Thomas Grohman/Steven Winters

or to such other address as any of them shall give to the others by notice made pursuant to this Section 10.1.

10.2 Assignment. This Agreement, including all representations and warranties, indemnification obligations, and other terms and conditions herein, shall be freely assignable and transferable in whole or in part by MOD. Phillips may assign or transfer this Agreement in whole or in part only with the prior written consent of MOD, which MOD may withhold or grant in its sole discretion.

10.3 Successors and Assigns. Except as otherwise provided herein, the provisions hereof shall inure to the benefit of, and be binding upon, the successors, permitted assigns, heirs, executors and administrators of the parties hereto. Nothing in this Agreement is intended to confer upon any party other than the parties hereto or their respective successors or assigns any rights, remedies, obligations or liabilities under or by reason of this Agreement, except as expressly provided by this Agreement.

10.4 Entire Agreement; Amendment. This Agreement and the other Transaction Agreements, the Schedules attached hereto, and the other documents delivered pursuant hereto, constitute the full and entire understanding and agreement between the parties with regard to the subjects hereof and thereof. Except as expressly provided herein, neither this Agreement nor any term hereof may be amended, waived, discharged or terminated other than by a written instrument signed by the party against whom enforcement of any such amendment, waiver, discharge or termination is sought.

10.5 Further Assurances. The parties shall cooperate in supplying such information as may be reasonably requested by another party to complete and file any forms, documents or instruments presently or hereafter required and shall execute and deliver to each other such other documents and do such other acts and things, all as the other party may reasonably request for the purpose of carrying out the intent of the Transaction Agreements and the transactions contemplated hereby.

10.6 Innovations Assignment Agreement. (a) Phillips' obligations and responsibilities under this Agreement and the other Transaction Agreements, including with respect to MOD's confidential and proprietary information, Intellectual Property and Technology, are in addition to and without limitation of Phillips' obligations and responsibilities under that certain Employee Innovations and Proprietary Rights Assignment Agreement between the parties dated as of May 19, 2005 (the "Innovations Assignment Agreement"); and (b) any Technology or Intellectual Property that Phillips develops or creates in the course of his employment with MOD shall be solely and exclusively owned by MOD as set forth in the Innovations Assignment Agreement.

10.7 Severability. In the event that any provision of this Agreement becomes or is declared by a court of competent jurisdiction to be illegal, unenforceable or void, this Agreement

shall continue in full force and effect to the extent than enforceable, provided that no such severability shall be effective if it materially changes the economic benefit of this Agreement to any party.

10.8 Governing Law. This Agreement shall be governed in all respects by the laws of the State of Washington, without reference to its conflicts of laws rules. Any proceeding related to this Agreement shall be commenced or maintained only in the courts in State of Washington, and the parties hereto hereby irrevocably submit to the jurisdiction of any state or federal court sitting in State of Washington, in any action or proceeding brought to enforce or otherwise arising out of or relating to this Agreement, and hereby waive any objection to venue in any such court and any claim that such forum is an inconvenient forum. If litigation or any other legal proceeding is commenced by any of the parties hereto to enforce or interpret any of the provisions of this Agreement, the substantially prevailing party shall be entitled to recover reasonable costs and attorneys' fees at mediation, arbitration, trial, on appeal, and on any petition for review.

10.9 Offset. In addition to all other remedies available to MOD under applicable law, MOD shall have right to offset any Losses for which it is entitled to indemnification under Section 6 against the Payments.

10.10 Headings. The headings used in this Agreement are used for convenience only and shall not be considered in construing or interpreting this Agreement.

10.11 Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be deemed an original and all of which together shall constitute one and the same instrument. Facsimile transmission of any signed original documents, and the retransmission of any signed facsimile transmission, shall be the same as delivery of the original signed documents. At the request of either party, the other party shall confirm documents with a facsimile transmitted signature by signing an original document.

10.12 Interpretation. This Agreement has been negotiated by the parties and their respective counsel. This Agreement shall be interpreted fairly in accordance with its terms and without any construction in favor of or against either party. In addition, for purposes of interpreting this Agreement, (a) unless the context otherwise requires, the singular includes the plural, and the plural includes the singular; (b) unless otherwise specifically stated, the words "herein," "hereof," and "hereunder" and other words of similar import refer to this Agreement as a whole and not to any particular section or paragraph; and (c) the words "include" and "including" shall not be construed as terms of limitation, and shall therefore mean "including but not limited to" and "including without limitation".

[*Signatures appear on the following page*]

IN WITNESS WHEREOF, authorized signers of the parties hereto have caused this Agreement to be duly executed as of the date first written above.

PHILLIPS:

MARK PHILLIPS

MOD:

MOD SYSTEMS INCORPORATED,
a Washington corporation

By: _____

Name: David M. Douglass

Its: Vice President and Chief Financial Officer

SCHEDULE 1

Certain Contributed Assets

	Name		Registration/Application Number (if applicable)		Description/File Name
	"A DOT" Sigma Designs POD hardware and software materials.		N/A		Implementation of the "Point of Decision" hardware for retail kiosk functions such as physical CD and DVD sampling, searching and downloading.
	"A DOT" Sigma Designs set-top box hardware and software.		N/A		Implementation of the retail digital signage set-top box, consumer set-top box, and retail overhead and sampling server.
	Fullplay Portable Devices based on "Dharma" reference board.		N/A		Various prototyped audio media players configured for Dharma before final hardware was provided.
	Iomega Hipzip Portable Media Player		N/A		Portable player using Iomega Clik! Drive as storage.
	Pogo! HDD recorder and player		N/A		Portable mp3 recorder and player based on a 2.5 laptop hard drive.
	IJAM dual MMC mp3 player		N/A		Fixed LCD display with dual MMC slots, USB implemented in multi-LUN
	Dataplay media player		N/A		Prototype Dataplay mp3 player
	IBM CF Microdrive Player		N/A		Micro-drive HDD portable audio player
	Mp3 CD-R Portable Player		N/A		CD-R ATA and error correction mp3 player portable application
	Fullplay MUZE DVD player platform.		N/A		DVD MIPs support for network media center operations. DVD MIPs core processor port of Fullplay SDK, with MPEG2 decoder and overlay support
	Windows CE Portable Media Player		N/A		Winamp skinned mp3 player for Windows CE
	CPLD control for ATA via Cirrus Logic 7312		N/A		Fixed GPIO access to IDE chains with ATA through a CPLD for aggregation of address bus, chip select, and address lines.
	eCos framework and device drivers for ARM7, ARM9, memory manager, caching, network ARM7, ARM9, MIPs		N/A		Core eCos OS board support package with ARM7, MIPs, and peripheral set including redboot, GCC specific to each platform and BSP
	Cirrus Logic 7312 Reference design – hardware		N/A		Dharma hardware schematics and manufacturing materials
	Cirrus Logic DVD MIPS 9800 design – hardware		N/A		DVD MIPS Cirrus 9800 hardware and software home media server concept implemented on a DVD processor. UX on application processor and trick view. Trick view blurred application processor UX rendering and background MPEG2 decodes.
	LVS – Listening viewing station / IMS		N/A		Fullplay's LVS product
	LVS PC content server		N/A		Fullplay's sampling service
	MTP host and client reference library		N/A		Media Transport Protocol materials for digital media device Windows compliances

	Name		Registration/Application Number (if applicable)		Description/File Name
	802.11b Photo TV viewer		N/A		Concept device which links 802.11b, mapped/shared online folder with TV NSTC optimized processor photo output
	Generic embedded media framework, common library and reference materials		N/A		Embedded device toolkits for content metadata windows, database, message pumps, and player state control. Message format, metadata, asset tags, file handlers.
	Encryption libraries		N/A		MD5, XML parser&builder, audio header parsers, ANSI RSA, AES, base64
	"Embedded store" FullAudio prototype		N/A		Embedded device, Windows CE, media player sampling and purchasing application.
	Method and apparatus for partial publication and inventory maintenance of media objects in a region		App: 11/683,765 Pub: 20080222155		
	Method and system for efficient and dynamically adaptable digitally-encoded-information distribution		App: 11/974,918 Pub: 20080133546		
	MsS technology data analysis and reporting software for structural health monitoring / MOD Corporate (store/kiosk system)		TXu001302005		U.S. Copyright Registration

SCHEDULE 2

The Excluded Assets

	Name		Registration/Application Number (if applicable)		Description
1.	System and Method for Musical Playlist Selection in a Portable Audio Device		35073.001, 09/975,748		U.S. Patent Application
2.	Fullplay 'Dharma' source code SDK ARM7		N/A		Fullplay 'Dharma' reference design system source code represents a generic ARM7 audio media player. Including flash and HDD file systems, network stacks, digital audio encoding and decoding, DAC output, USB device class drivers and simple media player application with "skinning", audio metadata database, playlists, and settings menu.
3.	Telechips TCC82X		N/A		ARM9 Audio Media SDK Reference Design
4.	Fullplay "DJ" CD-R HDD mp3 jukebox		N/A		CD-R jukebox embedded application with idle encoding
5.	Custom acoustical compression fingerprint tool		N/A		In encode – compress function 12-24 feature fingerprint tool for acoustical similarity matching.
6.	System and Method For Data Transfer Optimization In A Portable Audio Device		35073.002, 09/975,749		U.S. Patent Application
7.	System and Method		35073.003, 09/975,736		U.S. Patent Application

	Name		Registration/Application Number (if applicable)		Description
	for Mapping Interface Functionality to Codec Functionality in a Portable Audio Device				
8.	System and Method For Playlist Completion In A Portable Audio Device		35073.004, 10/039,906		U.S. Patent Application
9.	Network communication stack, boot loader updater, SOAP and UPnP communications system.		N/A		Reduced TCP/IP network stack for low SRAM, flash and processing overhead. Network advertisement protocol for secure transfer of boot loaders and firmware for network updates. Web services communication stack for embedded devices for operations with Windows and general XML, SOAP and device profile specifications.
10.	FullPlay UPNP media library		N/A		Desktop Application which enumerates audio content on Windows XP for purpose of transferring or streaming metadata or files to an embedded player client.
11.	Gameboy ROM emulator		N/A		ARM, fixed point implementation of a Gameboy
12.	MPEG1 Layer 3 codec, lossless audio codec		N/A		MPEG 1 Layer 3 decoder and encoder with machine optimization for SH3, MIPS, ARM7 and Intel. Encode function is symmetrical to decode.
13.	Peer to peer - sensor emulator and network library communication systems		N/A		Time division multi-plex simulator, frequency hopping and pico-net, scatter-net profiles. Variable payload and broadcast frame packets calculated by frequency and channels.
14.	Cell tower/FM tower triangulation, neighbor list and location service client and server decoder system		N/A		Cell-phone and 802.11b radio location service based on cell tower map, signal strength and neighbor list calculators. SMS data encoding packet system with self ordering.
15.	MetaWallet source code, build tools, database, website, and patent applications.		N/A		Virtual wallet account management, payment processing and remittance software, with demonstration application. Web implementation, WAP, and SMS. Personal finance account application for cell phones. Patent Application, SQL, Web Services, and trademark for "MetaWallet"
16.	1999, 2000,2001,2002 Automotive CE platform with SH3 to ARM9 media player		N/A		Windows CE Media Player – Audio only, voice processor command interface
17.	Ogg Vorbis		N/A		Fixed point Ogg decoder.
18.	PC, Linux and Windows GCC compiler		N/A		Compiler instances for ARM7, Sigma Designs, Cirrus Logic 9800
19.	C# code generator		N/A		.Net code generation tools using function based metadata for BLL and DAL
20.	Code counting, source control, and source comparison		N/A		Various quick line counters, code analyzers and export systems to excel for high-level project and information sharing with code bases.

	Name		Registration/Application Number (if applicable)		Description
	tools..				
21.	Zigbee peer-to-peer sample application		N/A		Zigbee prototype interface to .net Micro framework
22.	SPOT Applications, Swatch MSN watch applications		N/A		Peer to peer, games, applications and data feeds for the Microsoft Smart Personal Objects MSN Direct watch. Poker, Pong, chat. 4 button text input scheme.
23.	Fossil MSN watch faces		N/A		Fossil MSN Direct calendar and holiday watch faces.
24.	.NET micro framework applications		N/A		Robotic hexapod walker, Zigbee switch simulator, and various .Net micro framework applications and Visual Studio tools
25.	IP database and content online tool		N/A		Custom, patent, materials and document tracking site
26.	Boomerang / getmystuffback.com		N/A		Web Application which links people with those that have borrowed something from them to Amazon recommendations on replacements
27.	Method and system for value transfer between mobile-phone users		App: 11/725,181 Pub: 20080125080		U.S. Patent Application
28.	Transactional services associated with mobile devices		App: 11/679,338 Pub: 20080208739		U.S. Patent Application

EXHIBIT B

TERMINATION AGREEMENT

AGREEMENT TO TERMINATE PRIOR LICENSE AGREEMENTS BETWEEN MARK E. PHILLIPS AND MOD SYSTEMS INCORPORATED AND BETWEEN MARK E. PHILLIPS AND ANYTHINGBOX INCORPORATED

This Agreement to Terminate Prior License Agreements Between Mark E. Phillips and MOD Systems Incorporated and Mark E. Phillips and AnythingBox Incorporated (the "**Agreement**") is made as of September __, 2008 (the "**Effective Date**"), by and among AnythingBox Incorporated, a Washington corporation ("**ABX**"); MOD Systems Incorporated, a Washington corporation ("**MOD**"); and Mark Phillips, an individual ("**Phillips**"), as follows:

WHEREAS, concurrently with this Agreement, Phillips, MOD, Toshiba Corporation, Deluxe Entertainment Services Group Inc. and NCR Corporation are entering into the Series A Preferred Stock Purchase Agreement dated as of the Effective Date (the "**Stock Purchase Agreement**");

WHEREAS, prior to the Effective Date, Phillips had licensed certain intellectual property and technology to ABX under that certain License Agreement by and between Phillips and ABX, dated April 25, 2008 (the "Phillips-ABX License Agreement"); and he had licensed certain other intellectual property and technology to MOD under that certain License Agreement by and between Phillips and MOD, dated April 23, 2007 (the "Phillips-MOD License Agreement"); and

WHEREAS, as a condition to closing the Stock Purchase Agreement, Phillips and ABX (a corporation wholly-owned by Phillips) must terminate the Phillips-ABX License Agreement, and Phillips and MOD must terminate the Phillips-MOD License Agreement;

NOW, THEREFORE, in consideration of the mutual covenants contained herein and in the Stock Purchase Agreement, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereby agree as follows:

1. Termination of Phillips-ABX License Agreement. Phillips and ABX agree that the Phillips-ABX License Agreement is hereby terminated and shall be of no further force or effect. For purposes of clarification, Phillips and MOD affirm and agree that Section 6.7 of the Phillips-ABX License Agreement regarding the survival of certain provision after termination is hereby cancelled and terminated, shall have no further force or effect, and any provisions that Phillips and ABX had agreed would survive shall not survive. To the extent such termination is void or voidable under applicable law, each of Phillips, ABX and MOD covenants not to assert any claims against the other in connection therewith.

2. Termination of Phillips-MOD License Agreement. Phillips and MOD agree that the Phillips-MOD License Agreement is hereby terminated and shall be of no further force or effect. For purposes of clarification, Phillips and MOD affirm and agree that Section 6.6 of the Phillips-MOD License Agreement regarding the survival of certain provisions after termination is hereby cancelled and terminated, shall have no further force or effect, and any provisions that

Phillips and MOD had agreed would survive shall not survive, including without limitation any royalty payment obligations of MOD to Phillips thereunder. To the extent such termination is void or voidable under applicable law, each of Phillips, ABX and MOD covenants not to assert any claims against the other in connection therewith.

3. Severability. The provisions of this Agreement shall be severable and the invalidity or unenforceability of any one or more of the provisions hereof shall not affect the validity or enforceability of the other provisions. If the term or the scope of any covenant contained herein exceeds that permitted by law or public policy, the term or scope of the covenant shall be construed as enforceable for the longest terms and largest scope permitted by law and public policy, and any court or other decision-making body is hereby authorized and requested to reform such covenant accordingly.

4. Construction. The parties agree and acknowledge that they have had an opportunity to consult with their respective counsel and with such other experts or advisors as they have deemed necessary in connection with the negotiation, execution and delivery of this Agreement. This Agreement shall be construed without any presumption or rule requiring that it might be construed against the party causing this Agreement, or any part of it to be drafted.

5. Governing Law. This Agreement shall be governed by, construed and enforced in accordance with the internal laws of the State of Washington, without giving effect to principles and provisions thereof relating to conflict or choice of laws, irrespective of the fact that any one of the parties is now or may become a resident of a different state. Venue for any action under this Agreement shall lie only in King County, Washington. The parties hereby consent to personal jurisdiction over them by the courts within King County, Washington. The parties waive all objection and challenge to such venue and personal jurisdiction.

6. Entire Agreement**.** This Agreement constitutes the entire agreement of the parties hereto with respect to the subject matter hereof. Except for that certain Employee Innovations and Proprietary Rights Assignment Agreement, dated May 19, 2005, between Phillips and MOD, this Agreement supersedes all previous, contemporaneous and inconsistent agreements, negotiations, representations and promises between the parties, written or oral, regarding the subject matter hereof, including without limitation those agreements referenced in Sections 1 and 2 of this Agreement.

[intentionally left blank]

IN WITNESS WHEREOF, the undersigned are authorized to execute, and have executed this Agreement as of the date set forth below their respective names.

ANYTHINGBOX INCORPORATED. By: _____ Name: _____ Its: _____ Date: _____ MARK E. PHILLIPS: By: _____ Mark E. Phillips, individually Date: _____	MOD SYSTEMS INCORPORATED. By: _____ Name: _____ Its: _____ Date: _____

SCHEDULE 4.3(c)

REGISTERED CONTRIBUTED ASSETS

Copyright	Jurisdiction	Owner	Reg. No.	Status
MsS technology data analysis and reporting software for structural health monitoring / MOD Corporate (store/kiosk system)	United States	Mark Phillips	TXu001302005	Registered 4/17/06

SCHEDULE 4.3(h)

OPEN SOURCE SOFTWARE

None

EXHIBIT “N”

MOD SYSTEMS INCORPORATED

SHAREHOLDERS AGREEMENT

This Shareholders Agreement (this "Agreement") is made as of October 17, 2008, by and among (i) MOD Systems Incorporated, a Washington corporation (the "Company"), (ii) Mark Phillips ("Phillips"), and Anthony Bay ("Bay", and collectively with Phillips, the "Founders"), and (iii) Toshiba Corporation, a Japanese corporation ("Toshiba"), NCR Corporation, a Maryland corporation ("NCR"), and Deluxe Entertainment Services Group Inc., a Delaware corporation ("Deluxe", and collectively with Toshiba and NCR, the "Investors").

RECITALS

A. The Investors are acquiring shares of the Company's Series A Preferred Stock ("Series A Preferred Stock") pursuant to the Series A Preferred Stock Purchase Agreement dated as of September 24, 2008 among the Company and the Investors (the "Stock Purchase Agreement").

B. The parties hereto desire to enter into this Agreement in order to set forth certain matters concerning the ownership and operation of the Company and certain rights and obligations of the parties hereto, on the terms and conditions contained herein.

AGREEMENT

The parties hereby agree as follows:

1. **Registration Rights**. The Company, the Founders and the Investors covenant and agree as follows:

1.1 **Definitions**. For purposes of this Agreement:

(a) The term "Exchange Act" means the Securities Exchange Act of 1934, as amended (and any successor thereto) and the rules and regulations promulgated thereunder;

(b) The term "Form S-3" means such form under the Securities Act as in effect on the date hereof or any successor form under the Securities Act that permits significant incorporation by reference of the Company's subsequent public filings under the Exchange Act;

(c) The term "Founders' Stock" means the shares of Common Stock now or hereafter held by the Founders;

(d) The term "Holder" means any person or entity ("Person") owning or having the right to acquire Registrable Securities or any assignee thereof in accordance with Section 1.12 of this Agreement;

(e) The term "Qualified IPO" means a firm commitment underwritten public offering by the Company of shares of its Common Stock pursuant to a registration statement under the Securities Act, the public offering price of which is not less than $15.6509 per share, which results in aggregate cash proceeds to the Company of at least $50,000,000 (net of underwriting discounts and commissions);

(f) The terms "register," "registered," and "registration" refer to a registration effected by preparing and filing a registration statement or similar document in compliance with the Securities Act, and the declaration or ordering of effectiveness of such registration statement or document by the SEC;

(g) The term "Registrable Securities" means (i) the shares of Common Stock issuable or issued upon conversion of the Series A Preferred Stock now or hereafter outstanding, other than shares for which registration rights have terminated pursuant to Section 1.15 hereof, and (ii) the shares of Founders' Stock, and (iii) any other shares of Common Stock of the Company issued as (or issuable upon the conversion or exercise of any warrant, right or other security which is issued as) a dividend or other distribution with respect to, or in exchange for or in replacement of, the shares listed in (i) and (ii); provided, however, that (x) for the purposes of Sections 1.1(h), 1.2, 1.4, 1.13 and 2 the Founders' Stock and any shares issued in respect of Founders' Stock under (iii) shall not be deemed Registrable Securities, and (y) the foregoing definition shall exclude in all cases any Registrable Securities sold by a Person in a transaction in which such Person's rights under this Agreement are not assigned. Notwithstanding the foregoing, shares of Common Stock or other securities shall only be treated as Registrable Securities if and so long as (A) they have not been sold to or through a broker or dealer or underwriter in a public distribution or a public securities transaction, (B) they have not been sold in a transaction exempt from the registration and prospectus delivery requirements of the Securities Act under Section 4(1) thereof so that all transfer restrictions, and restrictive legends with respect thereto, if any, are removed upon the consummation of such sale, or (C) the Holder thereof is entitled to exercise any right provided in Section 1 in accordance with Section 1.15 below;

(h) The number of shares of "Registrable Securities then outstanding" shall be determined by the number of shares of Common Stock outstanding which are, and the number of shares of Common Stock issuable pursuant to then exercisable or convertible securities which are, Registrable Securities;

(i) The term "SEC" means the Securities and Exchange Commission; and

(j) The term "Securities Act" means the Securities Act of 1933, as amended, (and any successor thereto) and the rules and regulations promulgated thereunder;

1.2 **Request for Registration.**

(a) If the Company shall receive at any time after six (6) months after the effective date of the first registration statement for a public offering of securities of the Company (other than a registration statement relating either to the sale of securities to employees

of the Company pursuant to a stock option, stock purchase or similar plan or an SEC Rule 145 transaction), a written request from the Holders of a majority of the Registrable Securities then outstanding that the Company file a registration statement under the Securities Act covering the registration of all or part of the Registrable Securities then outstanding (providedthat each registration statement have an anticipated aggregate offering price, net of underwriting discounts and commissions, of at least $10,000,000), then the Company shall, within ten (10) days of the receipt thereof, give written notice of such request to all Holders and shall, subject to the limitations of subsection 1.2(b), use its commercially reasonable efforts to file as soon as practicable, and in any event within 60 days of the receipt of such request, a registration statement under the Securities Act covering all Registrable Securities, and shall use its commercially reasonable efforts to cause such registration statement to become effective within 180 days of the filing of such registration statement as would permit or facilitate that sale and distribution of all or such portion of such Registrable Securities, which the Holders request to be registered within 20 days of the mailing of such notice by the Company.

(b) If the Holders initiating the registration request hereunder ("Initiating Holders") intend to distribute the Registrable Securities covered by their request by means of an underwriting, they shall so advise the Company as a part of their request made pursuant to this Section 1.2 and the Company shall include such information in the written notice referred to in subsection 1.3. The underwriter will be selected by a majority in interest of the Initiating Holders and shall be reasonably acceptable to the Company. In such event, the right of any Holder to include its Registrable Securities in such registration shall be conditioned upon such Holder's participation in such underwriting and the inclusion of such Holder's Registrable Securities in the underwriting (unless otherwise mutually agreed by a majority in interest of the Initiating Holders and such Holder) to the extent provided herein. All Holders proposing to distribute their securities through such underwriting shall (together with the Company as provided in subsection 1.5(e)) enter into an underwriting agreement in customary form with the underwriter or underwriters selected for such underwriting. Notwithstanding any other provision of this Section 1.2, if the underwriter advises the Initiating Holders in writing that marketing factors require a limitation of the number of shares to be underwritten, then the Initiating Holders shall so advise all Holders of Registrable Securities which would otherwise be underwritten pursuant hereto, and the number of shares of Registrable Securities that may be included in the underwriting shall be allocated among all participating Holders thereof, including the Initiating Holders, in proportion (as nearly as practicable) to the amount of Registrable Securities of the Company owned by each participating Holder; provided, however, that the number of shares of Registrable Securities to be included in such underwriting shall not be reduced unless all other securities are first entirely excluded from the underwriting. Any Registrable Securities excluded or withdrawn from such underwriting shall be withdrawn from the registration.

(c) Notwithstanding the foregoing, if the Company shall furnish to Holders requesting a registration statement pursuant to this Section 1.2, a certificate signed by the President of the Company stating that in the good faith judgment of the Board of Directors of the Company (the "Board"), it would be seriously detrimental to the Company and its shareholders for such registration statement to be filed and it is therefore essential to defer the filing of such registration statement, the Company shall have the right to defer such filing for a period of not more than 120 days after receipt of the request of the Initiating Holders; provided

however, that the Company may not utilize this right more than once in any twelve-month period.

(d) In addition, the Company shall not be obligated to effect, or to take any action to effect, any registration pursuant to this Section 1.2:

(i) After the Company has effected two (2) registrations pursuant to this Section 1.2 and such registrations have been declared or ordered effective;

(ii) During the period starting with the date 90 days prior to the Company's good faith estimate of the date of filing of, and ending on a date 90 days after the effective date of, a registration subject to Section 1.3 hereof unless such offering is the initial public offering of the Company's securities, in which case, ending on a date 180 days after the effective date of such registration subject to Section 1.3 hereof; provided that the Company is actively employing in good faith all reasonable efforts to cause such registration statement to become effective; or

(iii) If the Initiating Holders propose to dispose of shares of Registrable Securities that may be immediately registered on Form S-3 pursuant to a request made pursuant to Section 1.4 below.

1.3 **Company Registration**. If (but without any obligation to do so) the Company proposes to register (including for this purpose a registration effected by the Company for shareholders other than the Holders) any of its stock under the Securities Act in connection with the public offering of such securities solely for cash (other than a registration relating solely to the sale of securities to participants in a Company stock plan or a transaction covered by Rule 145 under the Securities Act, a registration in which the only stock being registered is Common Stock issuable upon conversion of debt securities which are also being registered, or any registration on any form which does not include substantially the same information as would be required to be included in a registration statement covering the sale of the Registrable Securities), the Company shall, at least 5 days prior to the filing of such registration statement, give each Holder written notice of such registration. Upon the written request of each Holder given within 20 days after mailing of such notice by the Company in accordance with Section 4.6, the Company shall, subject to the provisions of Section 1.8, cause to be registered under the Securities Act all of the Registrable Securities that each such Holder has requested to be registered.

1.4 **Form S-3 Registration**. In case the Company shall receive from any Holder or Holders of not less than twenty-five percent (25%) of the Registrable Securities then outstanding a written request or requests that the Company effect a registration on Form S-3 and any related qualification or compliance with respect to all or a part of the Registrable Securities owned by such Holder or Holders, the Company will:

(a) promptly give written notice of the proposed registration, and any related qualification or compliance, to all other Holders; and

(b) as soon as practicable, effect such registration and all such qualifications and compliances as may be so requested and as would permit or facilitate the sale

and distribution of all or such portion of such Holder's or Holders' Registrable Securities as are specified in such request, together with all or such portion of the Registrable Securities of any other Holder or Holders joining in such request as are specified in a written request given within 20 days after receipt of such written notice from the Company; provided however, that the Company shall not be obligated to effect any such registration, qualification or compliance, pursuant to this Section 1.4: (i) if Form S-3 is not available for such offering by the Holders; (ii) if the Holders, together with the holders of any other securities of the Company entitled to inclusion in such registration, propose to sell Registrable Securities and such other securities (if any) at an aggregate price to the public (net of any underwriters' discounts or commissions) of less than $1,000,000; (iii) if the Company shall furnish to the Holders a certificate signed by the President of the Company stating that in the good faith judgment of the Board, it would be seriously detrimental to the Company and its shareholders for such registration on Form S-3 to be effected at such time, in which event the Company shall have the right to defer the filing of the Form S-3 registration statement for a period of not more than 120 days after receipt of the request of the Holder or Holders under this Section 1.4; provided, however, that the Company shall not utilize this right more than once in any 12-month period; (iv) if the Company has, within the 12-month period preceding the date of such request, already effected two registrations on Form S-3 for the Holders pursuant to this Section 1.4; (v) in any particular jurisdiction in which the Company would be required to qualify to do business or to execute a general consent to service of process in effecting such registration, qualification or compliance; or (vi) during the period ending 180 days after the effective date of a registration statement subject to Section 1.3.

(c) Subject to the foregoing, the Company shall file a registration statement covering the Registrable Securities and other securities so requested to be registered as soon as practicable after receipt of the request or requests of the Holders. Registrations effected pursuant to this Section 1.4 shall not be counted as demands for registration or registrations effected pursuant to Sections 1.2 or 1.3, respectively.

1.5 **Obligations of the Company**. Whenever required under this Section 1 to effect the registration of any Registrable Securities, the Company shall, as expeditiously as reasonably possible:

(a) Prepare and file with the SEC a registration statement with respect to such Registrable Securities and use its best efforts to cause such registration statement to become effective, and, upon the request of the Holders of a majority of the Registrable Securities registered thereunder, keep such registration statement effective for up to 180 days, or until the distribution described in such registration statement is completed, if earlier. The Company shall not be required to file, cause to become effective or maintain the effectiveness of any registration statement that contemplates a distribution of securities on a delayed or continuous basis pursuant to Rule 415 under the Securities Act.

(b) Prepare and file with the SEC such amendments and supplements to such registration statement and the prospectus used in connection with such registration statement as may be necessary to comply with the provisions of the Securities Act with respect to the disposition of all securities covered by such registration statement for up to 180 days, or until the distribution described in such registration statement is completed, if earlier.

(c) Furnish to the Holders such numbers of copies of a prospectus, including a preliminary prospectus, in conformity with the requirements of the Securities Act, and such other documents as they may reasonably request in order to facilitate the disposition of Registrable Securities owned by them.

(d) Use its commercially reasonable efforts to register and qualify the securities covered by such registration statement under such other securities or Blue Sky laws of such jurisdictions as shall be reasonably requested by the Holders, provided that the Company shall not be required in connection therewith or as a condition thereto to qualify to do business or to file a general consent to service of process in any such states or jurisdictions.

(e) In the event of any underwritten public offering, enter into and perform its obligations under an underwriting agreement, in usual and customary form, with the managing underwriter of such offering. Each Holder participating in such underwriting shall also enter into and perform its obligations under such an agreement.

(f) Notify each Holder of Registrable Securities covered by such registration statement at any time when a prospectus relating thereto is required to be delivered under the Securities Act of the happening of any event as a result of which the prospectus included in such registration statement, as then in effect, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading in the light of the circumstances then existing. The Company will amend or supplement such prospectus in order to cause such prospectus not to include any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein not misleading in the light of the circumstances then existing.

(g) Cause all such Registrable Securities registered pursuant hereunder to be listed on each securities exchange on which similar securities issued by the Company are then listed.

(h) Provide a transfer agent and registrar for all Registrable Securities registered pursuant hereunder and a CUSIP number for all such Registrable Securities, in each case not later than the effective date of such registration.

(i) Use its commercially reasonable efforts to furnish, at the request of any Holder requesting registration of Registrable Securities pursuant to this Section 1, on the date that such Registrable Securities are delivered to the underwriters for sale in connection with a registration pursuant to this Section 1, if such securities are being sold through underwriters, (i) an opinion, dated such date, of the counsel representing the Company for the purposes of such registration, in form and substance as is customarily given to underwriters in an underwritten public offering, addressed to the underwriters and (ii) a "comfort" letter dated such date, from the independent certified public accountants of the Company, in form and substance as is customarily given by independent certified public accountants to underwriters in an underwritten public offering, addressed to the underwriters.

1.6 **Furnish Information**. It shall be a condition precedent to the obligations of the Company to take any action pursuant to this Section 1 with respect to the Registrable Securities of any selling Holder that such Holder shall furnish to the Company such information regarding itself, the Registrable Securities held by it, and the intended method of disposition of such securities as shall be required to effect the registration of such Holder's Registrable Securities. The Company shall have no obligation with respect to any registration requested pursuant to Sections 1.2 or 1.4 of this Agreement if, as a result of the application of the preceding sentence, the number of shares or the anticipated aggregate offering price of the Registrable Securities to be included in the registration does not equal or exceed the number of shares or the anticipated aggregate offering price required to originally trigger the Company's obligation to initiate such registration as specified in subsection 1.2(a) or subsection 1.4(b), whichever is applicable.

1.7 **Expenses of Registration**. All expenses other than underwriting discounts and commissions incurred in connection with registrations, filings or qualifications pursuant to Section 1.2, including all registration, filing and qualification fees, printers' and accounting fees, fees and disbursements of counsel for the Company, and the reasonable fees and disbursements, not to exceed $30,000, of one counsel for the selling Holders selected by them with the approval of the Company, which approval shall not be unreasonably withheld, shall be borne by the Company; provided, however, that the Company shall not be required to pay for any expenses of any registration proceeding begun pursuant to Section 1.2 if the registration request is subsequently withdrawn at the request of the Holders of a majority of the Registrable Securities to be registered (in which case all participating Holders shall bear such expenses), unless the Holders of a majority of the Registrable Securities agree to forfeit their right to one demand registration pursuant to Section 1.2; provided further, however, that if at the time of such withdrawal, the Holders (i) have learned of a material adverse change in the condition, business, or prospects of the Company that was not known to the Holders at the time of their request and (ii) have withdrawn the request with reasonable promptness following disclosure by the Company of such material adverse change, then the Holders shall not be required to pay any of such expenses and shall not forfeit their rights pursuant to Section 1.2.

(a) **Company Registration**. All expenses other than underwriting discounts and commissions incurred in connection with registrations, filings or qualifications of Registrable Securities pursuant to Section 1.3 for each Holder (which right may be assigned as provided in Section 1.12), including all registration, filing, and qualification fees, printers' and accounting fees, fees and disbursements of counsel for the Company and the reasonable fees and disbursements, not to exceed $30,000, of one counsel for the selling Holder or Holders selected by them with the approval of the Company, which approval shall not be unreasonably withheld, shall be borne by the Company.

(b) **Registration on Form S-3**. All expenses other than underwriting discounts and commissions incurred in connection with a registration requested pursuant to Section 1.4, including all registration, filing, qualification, printers' and accounting fees and the reasonable fees and disbursements, not to exceed $30,000, of one counsel for the selling Holder or Holders selected by them with the approval of the Company, which approval shall not be unreasonably withheld, and counsel for the Company, shall be borne by the Company.

1.8 **Underwriting Requirements**. In connection with any offering involving an underwriting of shares of the Company's capital stock, the Company shall not be required under Section 1.3 to include any of the Holders' securities in such underwriting unless they accept the terms of the underwriting as agreed upon between the Company and the underwriters selected by it (or by other Persons entitled to select the underwriters), and then only in such quantity as the underwriters determine in their sole discretion will not jeopardize the success of the offering by the Company. If the total amount of securities, including Registrable Securities, requested by shareholders to be included in such offering exceeds the amount of securities sold other than by the Company that the underwriters determine in their sole discretion is compatible with the success of the offering, then the Company shall be required to include in the offering only that number of such securities, including Registrable Securities, which the underwriters determine in their sole discretion will not jeopardize the success of the offering (the securities so included to be apportioned pro rata among the selling shareholders according to the total amount of securities entitled to be included therein owned by each selling shareholder or in such other proportions as shall mutually be agreed to by such selling shareholders), provided that (i) in no event shall the amount of securities of the selling Holders included in the offering be reduced below 30% of the total amount of securities included in such offering, unless such offering is the initial public offering of the Company's securities, in which case, the selling shareholders may be excluded if the underwriters make the determination described above and no other shareholder's securities are included, and (ii) the securities of each of the Founders, any Person then beneficially holding at least one percent (1%) of the Company's outstanding capital stock, and the Company's chief executive officer, chief technology officer and chief financial officer otherwise includable in the applicable offering must be reduced ratably with the Registrable Securities in order for the provisions of this sentence to apply to the Registrable Securities. For purposes of the preceding parenthetical concerning apportionment, for any selling shareholder which is a holder of Registrable Securities and which is a partnership or corporation, the partners, retired partners and shareholders of such holder, or the estates and family members of any such partners and retired partners and any trusts for the benefit of any of the foregoing Persons shall be deemed to be a single "selling shareholder," and any pro-rata reduction with respect to such "selling shareholder" shall be based upon the aggregate amount of shares carrying registration rights owned by all entities and individuals included in such "selling shareholder," as defined in this sentence.

1.9 **Delay of Registration**. No Holder shall have any right to obtain or seek an injunction restraining or otherwise delaying any such registration as the result of any controversy that might arise with respect to the interpretation or implementation of this Section 1.

1.10 **Indemnification**. In the event any Registrable Securities are included in a registration statement under this Section 1:

(a) To the extent permitted by law, the Company will indemnify and hold harmless each Holder, the partners, members, officers, directors and representatives of each Holder, any underwriter (as defined in the Securities Act) for such Holder and each Person, if any, who controls such Holder or underwriter within the meaning of the Securities Act or the Exchange Act, against any losses, claims, damages, or liabilities (joint or several) to which they may become subject under the Securities Act, the Exchange Act or other federal or state law,

insofar as such losses, claims, damages, or liabilities (or actions in respect thereof) arise out of or are based upon any of the following statements, omissions or violations (collectively a "Violation"): (i) any untrue statement or alleged untrue statement of a material fact contained in such registration statement or incorporated by reference therein, including any preliminary prospectus or final prospectus contained therein or any amendments or supplements thereto, (ii) the omission or alleged omission to state therein a material fact required to be stated therein, or necessary to make the statements therein not misleading, or (iii) any Violation or alleged Violation by the Company of the Securities Act, the Exchange Act, any federal or state securities law or any rule or regulation promulgated under the Securities Act, the Exchange Act or any federal or state securities law; and the Company will pay to each such Holder, partner, member, officer, director, representative, underwriter or controlling Person, as incurred, any legal or other expenses reasonably incurred by them in connection with investigating or defending any such loss, claim, damage, liability, or action; provided, however, that the indemnity agreement contained in this subsection 1.10(a) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability, or action if such settlement is effected without the consent of the Company (which consent shall not be unreasonably withheld), nor shall the Company be liable to any Holder, partner, member, officer, director, underwriter or controlling Person for any such loss, claim, damage, liability, or action to the extent that it arises out of or is based upon a Violation which occurs in reliance upon and in conformity with written information furnished expressly for use in connection with such registration by any such Holder, partner, member, officer, director, underwriter or controlling Person.

(b) To the extent permitted by law, each selling Holder will indemnify and hold harmless the Company, each of its directors, each of its officers who has signed the registration statement, each Person, if any, who controls the Company within the meaning of the Securities Act, any underwriter, any other Holder selling securities in such registration statement and any controlling Person of any such underwriter or other Holder's partners, directors, officers or any Person who controls such Holder, against any losses, claims, damages, or liabilities (joint or several) to which any of the foregoing Persons may become subject, under the Securities Act, the Exchange Act or other federal or state law, insofar as such losses, claims, damages, or liabilities (or actions in respect thereto) arise out of or are based upon any Violation, in each case to the extent (and only to the extent) that such Violation occurs as a result of and in reliance upon and in conformity with written information furnished by such Holder expressly for use in connection with such registration; and each such Holder will pay, as incurred, any legal or other expenses reasonably incurred by any Person intended to be indemnified pursuant to this subsection 1.10(b), in connection with investigating or defending any such loss, claim, damage, liability, or action if it is judicially determined that there was such a Violation; provided, however, that the indemnity agreement contained in this subsection 1.10(b) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability or action if such settlement is effected without the consent of the Holder, which consent shall not be unreasonably withheld; provided that in no event shall any indemnity under this subsection 1.10(b) exceed the net proceeds from the offering received by such Holder, except in the case of willful fraud by such Holder.

(c) Promptly after receipt by an indemnified party under this Section 1.10 of notice of the commencement of any action (including any governmental action), such indemnified party will, if a claim in respect thereof is to be made against any indemnifying

party under this Section 1.10, deliver to the indemnifying party a written notice of the commencement thereof and the indemnifying party shall have the right to participate in, and, to the extent the indemnifying party so desires, jointly with any other indemnifying party similarly noticed, to assume the defense thereof with counsel mutually satisfactory to the parties; provided, however, that an indemnified party (together with all other indemnified parties which may be represented without conflict by one counsel) shall have the right to retain one separate counsel, with the reasonable fees and expenses to be paid by the indemnifying party, if representation of such indemnified party by the counsel retained by the indemnifying party would be inappropriate due to actual or potential differing interests between such indemnified party and any other party represented by such counsel in such proceeding. The failure to deliver written notice to the indemnifying party within a reasonable time of the commencement of any such action, if prejudicial to its ability to defend such action, shall relieve such indemnifying party of any liability to the indemnified party under this Section 1.10, but the omission so to deliver written notice to the indemnifying party will not relieve it of any liability that it may have to any indemnified party otherwise than under this Section 1.10.

(d) If the indemnification provided for in this Section 1.10 is held by a court of competent jurisdiction to be unavailable to an indemnified party with respect to any loss, liability, claim, damage or expense referred to therein, then the indemnifying party, in lieu of indemnifying such indemnified party hereunder, shall contribute to the amount paid or payable by such indemnified party as a result of such loss, liability, claim, damage, or expense in such proportion as is appropriate to reflect the relative fault of the indemnifying party on the one hand and of the indemnified party on the other in connection with the statements or omissions that resulted in such loss, liability, claim, damage or expense as well as any other relevant equitable considerations; provided that in no event shall any contribution by a Holder under this subsection 1.10(d) exceed the net proceeds from the offering received by such Holder, except in the case of willful fraud by such Holder. The relative fault of the indemnifying party and of the indemnified party shall be determined by reference to, among other things, whether the untrue or alleged untrue statement of a material fact or the omission to state a material fact relates to information supplied by the indemnifying party or by the indemnified party and the parties' relative intent, knowledge, access to information, and opportunity to correct or prevent such statement or omission.

(e) Notwithstanding the foregoing, to the extent that the provisions on indemnification and contribution contained in the underwriting agreement entered into in connection with the underwritten public offering are in conflict with the foregoing provisions, the provisions in the underwriting agreement shall control.

(f) The obligations of the Company and Holders under this Section 1.10 shall survive the completion of any offering of Registrable Securities in a registration statement under this Section 1, and, with respect to liability arising from an offering to which this Section 1.10 would apply that is covered by a registration filed before termination of this Agreement, shall survive such termination. No indemnifying party, in the defense of any such claim or litigation, shall, except with the consent of each indemnified party, consent to entry of any judgment or enter into any settlement which does not include as an unconditional term thereof the giving by the claimant or plaintiff to such indemnified party of a release from all liability in respect to such claim or litigation.

1.11 **Reports Under the Exchange Act**. With a view to making available to the Holders the benefits of Rule 144 promulgated under the Securities Act and any other rule or regulation of the SEC that may at any time permit a Holder to sell securities of the Company to the public without registration or pursuant to a registration on Form S-3, the Company agrees to:

(a) make and keep public information available, as those terms are understood and defined in SEC Rule 144, at all times after 90 days after the effective date of the first registration statement filed by the Company for the offering of its securities to the general public so long as the Company remains subject to the periodic reporting requirements under Sections 13 or 15(d) of the Exchange Act;

(b) take such action, including the voluntary registration of its Common Stock under Section 12 of the Exchange Act, as is necessary to enable the Holders to utilize Form S-3 for the sale of their Registrable Securities, such action to be taken as soon as practicable after the end of the fiscal year in which the first registration statement filed by the Company for the offering of its securities to the general public is declared effective;

(c) file with the SEC in a timely manner all reports and other documents required of the Company under the Securities Act and the Exchange Act; and

(d) furnish to any Holder, so long as the Holder owns any Registrable Securities, forthwith upon request (i) a written statement by the Company that it has complied with the reporting requirements of SEC Rule 144 (at any time after 90 days after the effective date of the first registration statement filed by the Company), the Securities Act and the Exchange Act (at any time after it has become subject to such reporting requirements), or that it qualifies as a registrant whose securities may be resold pursuant to Form S-3 (at any time after it so qualifies), (ii) a copy of the most recent annual or quarterly report of the Company and such other reports and documents so filed by the Company, and (iii) such other information as may be reasonably requested in availing any Holder of any rule or regulation of the SEC which permits the selling of any such securities without registration or pursuant to such form.

1.12 **Assignment of Registration Rights**. The rights to cause the Company to register Registrable Securities pursuant to this Section 1 may be assigned (but only with all related obligations) by a Holder to a transferee or assignee (so long as the shares remain Registrable Securities) (i) in case of an assignment by a an Investor of Series A Preferred Stock purchased at Closing under the Stock Purchase Agreement, (x) so long as the Series A Preferred Stock being assigned constitutes at least fifty percent (50%) of the shares of such stock purchased by the assigning Investor at the Closing (subject to adjustment for stock splits, stock dividends, reclassification or the like), or (y) if the Series A Preferred Stock being assigned constitutes less than fifty percent (50%) of the shares of such stock purchased by the assigning Investor at the Closing (subject to adjustment for stock splits, stock dividends, reclassification or the like), so long as the stock being assigned constitutes all of the Series A Preferred Stock then held by such Investor, (ii) that is a subsidiary, parent, partner, limited partner, retired partner, member, retired member or shareholder of a Holder, (iii) that is an affiliated fund or entity of the Holder, which means with respect to a limited liability company or a limited liability partnership, a fund or entity managed by the same manager or managing member or general partner or management company or by an entity controlling, controlled by, or under common control with

such manager or managing member or general partner or management company (such a fund or entity, an "Affiliated Fund"), (iv) who is a Holder's child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law (such a relation, a Holder's "Immediate Family Member", which term shall include adoptive relationships), or (v) that is a trust for the benefit of an individual Holder or such Holder's Immediate Family Member, provided the Company is, within a reasonable time after such transfer, furnished with written notice of the name and address of such transferee or assignee and the securities with respect to which such registration rights are being assigned; and provided, further, that such assignment shall be effective only if the transferee agrees to be bound by this Agreement and immediately following such transfer the further disposition of such securities by the transferee or assignee is restricted under the Securities Act. For the purposes of determining the number of shares of Registrable Securities held by a transferee or assignee, the holdings of transferees and assignees of (x) a partnership who are partners or retired partners of such partnership or (y) a limited liability company who are members or retired members of such limited liability company (including Immediate Family Members of such partners or members who acquire Registrable Securities by gift, will or intestate succession) shall be aggregated together and with the partnership or limited liability company; provided that all assignees and transferees who would not qualify individually for assignment of registration rights shall have a single attorney-in-fact for the purpose of exercising any rights, receiving notices or taking any action under Section 1.

1.13 **Limitations on Subsequent Registration Rights**. After the date of this Agreement, the Company shall not without the prior written consent of the Holders of at least a majority of the Registrable Securities then outstanding and each Major Holder, enter into any agreement with any holder or prospective holder of any securities of the Company which would allow such holder or prospective holder to (i) include such securities in any registration filed under Sections 1.2, 1.3 or 1.4 hereof, unless under the terms of such agreement, such holder or prospective holder may include such securities in any such registration only to the extent that the inclusion of its securities will not reduce the amount of the Registrable Securities of the Holders which is included or (ii) make a demand registration.

1.14 **Lock-Up Agreement**. In connection with a Qualified IPO and upon request of the underwriters managing such offering of the Company's securities, each Holder agrees not to sell, make any short sale of, loan, grant any option for the purchase of, or otherwise dispose of, or enter into any hedging or similar transaction with the same economic effect as a sale, any securities of the Company, however or whenever acquired (other than those included in the registration) without the prior written consent of such underwriters, for such period of time, not to exceed 180 days from the effective date of such registration as may be requested by such managing underwriters and to execute an agreement reflecting the foregoing as may be requested by the underwriters at the time of the Company's initial public offering.

(a) **Limitations**. The obligations described in Section 1.14 shall apply only if each of the Founders, any Person then beneficially holding at least one percent (1%) of the Company's outstanding capital stock, and the Company's chief executive officer, chief technology officer and chief financial officer enter and remain bound by similar agreements, and shall not apply to a registration relating solely to employee benefit plans, or to a registration relating solely to a transaction pursuant to Rule 145 under the Securities Act. If either Founder,

any Person then beneficially holding at least one percent (1%) of the Company's outstanding capital stock, or any of the Company's chief executive officer, chief technology officer and chief financial officer is released from the lock-up, all Holders will be released from the lock-up.

(b) **Stop-Transfer Instructions** In order to enforce the foregoing covenants, the Company may impose stop-transfer instructions with respect to the securities of each Holder (and the securities of every other Person subject to the restrictions in Section 1.14).

(c) **Transferees Bound**. Each Holder agrees that prior to a Qualified IPO it will not transfer securities of the Company unless each transferee agrees in writing to be bound by all of the provisions of this Section 1.14.

(d) **Legend**. Each Holder understands that each certificate represents shares of capital stock of the Company held by it shall bear substantially the following legend:

> THE SECURITIES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO RESTRICTIONS ON TRANSFERABILITY AND RESALE, INCLUDING A LOCK-UP PERIOD FOLLOWING THE EFFECTIVE DATE OF THE ISSUER'S REGISTRATION STATEMENT FILED UNDER THE ACT, AS AMENDED, AS SET FORTH IN AN AGREEMENT BETWEEN THE COMPANY AND THE ORIGINAL HOLDER OF THESE SECURITIES, A COPY OF WHICH MAY BE OBTAINED AT THE ISSUER'S PRINCIPAL OFFICE. SUCH LOCK-UP PERIOD IS BINDING ON TRANSFEREES OF THESE SHARES.

1.15 **Termination of Registration Rights**. No Holder shall be entitled to exercise any right provided for in this Section 1 after the earlier of (i) five (5) years following the consummation of a Qualified IPO, or (ii) at such time as Rule 144 or another similar exemption under the Securities Act is available for the sale of all of such Holder's shares during a three-month period without registration.

2. **Covenants of the Company**.

2.1 **Delivery of Financial Statements, Reports and Information**.

(a) The Company shall deliver to each Person that holds at least 1,600,000 shares of Preferred Stock ("Major Holder") the following financial statements of the Company on a consolidated basis in accordance with this Section 2.1, each of which statements may be unaudited:

(i) As soon as practicable, but in any event within ninety (90) days after the end of each fiscal year of the Company, an income statement and a statement of cash flows for such fiscal year, and a balance sheet and a statement of shareholder's equity as of the end of such fiscal year, such financial statements to be in reasonable detail, prepared in accordance with U.S. generally accepted accounting principles consistently applied ("GAAP"); and

(ii) As soon as practicable, but in any event within forty-five (45) days after the end of each of the first three quarters of each fiscal year of the Company, an income statement and a statement of cash flows for such fiscal quarter and for the current fiscal year to date, and an unaudited balance sheet as of the end of such fiscal quarter, and a comparison of such quarter's results with the results projected by the Company's annual budget; and

(iii) Reasonably in advance of any material transaction of the Company, a written summary of the proposed transaction and its material terms.

(b) The Company shall deliver to each of Toshiba and NCR (so long as the recipient is a Major Holder) the following reports and information:

(i) As soon as practicable, but in any event within thirty (30) days after the end of each month, an unaudited management report of the Company's financial condition as of the end of such month and the Company's operational and financial performance for such month, such report to be in reasonable detail, and to include a comparison of such month's performance with the performance projected by the Company's annual budget; and

(ii) As soon as practicable, but in any event within thirty (30) days prior to the beginning of each fiscal year of the Company, an annual budget and business plan for the Company and its subsidiaries for such fiscal year, which specifies the expected revenues, expenses, investments, capital expenditures, operational targets and other matters relating to the Company and its subsidiaries ("Annual Budget").

2.2 **Inspection**. The Company shall permit each Major Holder, at such Major Holder's expense, to visit and inspect the Company's properties, to examine its books of account and records and to discuss the Company's affairs, finances and accounts with its officers, all at such reasonable times as may be requested by the Major Holder and upon notice submitted to the Company within a reasonable time; provided, however, that the Company shall not be obligated pursuant to this Section 2.2 to provide access to any information which it reasonably considers to be a trade secret or similar confidential information.

2.3 **Right of First Offer**.

(a) Subject to the terms and conditions specified in this Section 2.3, the Company hereby grants to each Major Holder a right of first offer with respect to future sales by the Company of its Shares (as hereinafter defined). A Major Holder who chooses to exercise the right of first offer may designate as purchasers under such right itself or its Affiliates, in such proportions as it deems appropriate. "Affiliate" means with respect to any Person, any Person that directly or through one or more intermediaries controls or is controlled by or is under common control with the specified Person. As used in this definition, the term "control" means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a Person, whether through ownership of voting securities, by contract or otherwise.

(b) Each time the Company proposes to offer any shares of, or securities convertible into or exercisable for any shares of, any class of its capital stock

("Shares"), the Company shall first make an offering of such Shares to each Major Holder in accordance with the following provisions:

(i) The Company shall deliver a notice (the "RFO Notice") to the Major Holders stating (x) its bona fide intention to offer such Shares, (y) the number of such Shares to be offered, and (z) the price and terms, if any, upon which it proposes to offer such Shares.

(ii) Within fifteen (15) Business Days after its receipt of the RFO Notice, the Major Holder may elect to purchase or obtain, at the price and on the terms specified in the RFO Notice (provided that if the Company changes the terms of the offering after the RFO Notice is delivered, then a new fifteen (15) Business Day period will commence from the time such change is made), up to that portion of such Shares which equals the proportion that the number of shares of Common Stock issued and held (assuming the exercise and conversion of all Series A Preferred Stock, stock options, warrants, convertible notes and other similar convertible securities) by such Major Holder bears to the total number of shares of Common Stock then outstanding (assuming the exercise and conversion of Series A Preferred Stock, stock options, warrants, convertible notes and other similar convertible securities). Such purchase shall be completed at the same closing as that of any third party purchasers or at an additional closing thereunder. The Company shall promptly, in writing, inform each Major Holder that purchases all the shares available to it (each, a "Fully-Exercising Investor") of any other Major Holder's failure to do likewise. For a period of five (5) days thereafter, each Fully-Exercising Investor shall have a right of over-allotment to purchase up to that portion of the non-purchasing Major Investor's portion of the Shares which equals the proportion that the number of shares of Common Stock issued and held (assuming the exercise and conversion of all Series A Preferred Stock, stock options, warrants, convertible notes and other similar convertible securities) by such Fully-Exercising Investor bears to the total number of shares of Common Stock then held by all Fully-Exercising Investors (assuming the exercise and conversion of all Series A Preferred Stock, stock options, warrants, convertible notes and other similar convertible securities). "Business Day" means a day other than a Saturday, Sunday or other day on which commercial banks in Japan or the United States are authorized or required to close.

(iii) The Company may, during the 45-day period following the expiration of the periods provided in subsection 2.3(b)(ii) hereof, offer the remaining unsubscribed portion of the Shares to any Person or Persons at a price not less than, and upon terms no more favorable to the offeree than those specified in the RFO Notice. If the Company does not enter into an agreement for the sale of the Shares within such period, or if such agreement is not consummated within 60 days of the execution thereof, the right provided hereunder shall be deemed to be revived and such Shares shall not be offered unless first reoffered to the Major Holders in accordance herewith.

(c) The right of first offer in this Section 2.3 shall not be applicable to any of the following issuances ("Permitted Dilution"): (i) the issuance of up to 3,281,688 shares of Common Stock to employees, consultants, officers or directors of the Company pursuant to stock purchase or stock option plans or agreements approved by the Board, (ii) the issuance of capital stock in connection with bona fide acquisition transactions approved by the Board and Toshiba and NCR as contemplated under Section 2.7, (iii) shares issued upon conversion of the

Series A Preferred Stock, (iv) the issuance of capital stock in a Qualified IPO, (v) the issuance of up to 376,948 shares of Common Stock or rights to acquire Common Stock issued in connection with strategic collaborations, development agreements or licensing transactions, the terms of which are approved by the Board and (as applicable) Toshiba and NCR as contemplated under Section 2.7, (vi) issuance of Series A Preferred Stock upon exercise of outstanding warrants to acquire 63,894 shares of Series A Preferred Stock, (vii) issuance of Common Stock upon exercise of outstanding warrants to acquire 342,812 shares of Common Stock, or (viii) stock splits, stock dividends or like transactions. In addition to the foregoing, the right of first offer in this Section 2.3 shall not be applicable with respect to any Major Holder and any subsequent securities issuance, if (A) at the time of such subsequent securities issuance, the Major Holder is not an "accredited investor," as that term is then defined in Rule 501(a) under the Securities Act, and (B) such subsequent securities issuance is otherwise being offered only to accredited investors.

(d) Deluxe shall be deemed to be a Major Holder solely for purposes of this Section 2.3.

2.4 **Board Meetings and Committees** The Board shall hold a regular meeting no less frequent than once every six (6) weeks during the term of this Agreement, unless otherwise approved by a majority of the directors.

2.5 **Key-Man Life Insurance**. The Company shall maintain in full force and effect "key person" life insurance coverage on the life of Phillips, on terms and conditions reasonably acceptable to the Company and the Holders of a majority of the Registrable Securities then outstanding (provided that the coverage amount thereof shall not be required to exceed $30,000,000), with proceeds payable to the Company. The Company shall use such proceeds first for the purpose of redeeming the Series A Preferred shares upon exercise of the redemption right under Section 3.1, and the remaining proceeds (if any) will be retained by the Company.

2.6 **Directors' and Officers' Liability Insurance**. The Company shall use its commercially reasonable efforts to maintain in full force and effect directors and officers liability insurance on terms and conditions reasonably acceptable to the Company and the Holders of a majority of the Registrable Securities then outstanding.

2.7 **Toshiba and NCR Approval Rights**.

(a) So long as Toshiba beneficially owns at least 4,385,000 shares of Series A Preferred Stock, the Company will not take or agree to take any of the following actions (each, a "Preferred Approval Action") without the prior written approval of Toshiba, and so long as NCR beneficially owns at least 1,250,000 shares of Series A Preferred Stock, the Company will not take or agree to take any Preferred Approval Action without the prior written approval of NCR:

(i) Enter any new line of business which is not related to, complimentary with or an extension of the business conducted at any time by the Company, or cease to be engaged in any line of business conducted by the Company which represents a material portion of the Company's revenue.

(ii) Incur any capital commitment or any expenditure for marketing, rights to video or other content, in excess of $1,000,000 in any single transaction or series of related transactions, or in excess of $2,000,000 in the aggregate with respect to the Company and its subsidiaries taken as a whole in any fiscal year, other than as set forth in the Annual Budget approved by Toshiba and NCR for such year.

(iii) Incur, create, assume, guarantee or otherwise become liable with respect to indebtedness in excess of $1,000,000 in any single transaction or series of related transactions, or in excess of $3,000,000 in the aggregate with respect to the Company and its subsidiaries taken as a whole, other than as set forth in the Annual Budget approved by Toshiba and NCR for such year.

(iv) Institute, dismiss, withdraw or settle any litigation, arbitration or similar proceeding (i) involving claims for exceeding or anticipated to exceed $1,000,000 or (ii) otherwise material to the Company and/or any subsidiary.

(v) Acquire or dispose of any interest in any other company, partnership or business, where the fair market value of such interest in the reasonable estimation of the Board exceeds $1,000,000.

(vi) Sell, transfer, lease, pledge or otherwise dispose of assets in any transaction or series of related transactions with a fair market value in excess of $1,000,000 in the reasonable estimation of the Board, or otherwise outside of the ordinary course of business.

(vii) Issue any equity securities or any options, warrants, conversion rights or other rights to acquire equity securities of the Company or any of its subsidiaries, except for equity securities and related rights issued in accordance with Permitted Dilution.

(viii) Approve or implement any stock based employee compensation plan or any other profit sharing plan or program (or any change thereto) with respect to the employees of the Company and/or its subsidiaries, except for stock purchase and stock option plans or agreements allowed as Permitted Dilution.

(ix) Approve, enter into, modify or exercise rights with respect to any transaction, contract or commitment between the Company or any of its subsidiaries, on the one hand, and any officer of the Company or any of its Affiliates or Associates, on the other hand. "~~Associates~~" means, with respect to a Founder or Holder, each parent, spouse, sibling, and child (including those adopted) of such Founder or Holder. For the avoidance of doubt, neither Toshiba nor NCR shall be deemed to be an Affiliate of the Company for purposes of this Section 2.7(a)(ix).

(x) Approve the Annual Budget or any other long-term, mid-term or annual business plan of the Company and its subsidiaries, or any modifications or amendments thereto.

(xi) Appoint or dismiss the chief executive officer, chief technology officer or chief financial officer.

(xii) Determine or amend the compensation (including bonuses) and other benefits for the chief executive officer, chief technology officer or chief financial officer for any year, in each case if the total value of the compensation and other benefits of the officer for the applicable year (as determined in the reasonable estimation of the Board) would exceed 130% of the total value of such officer's compensation and other benefits for the prior year.

(xiii) Approve any amalgamation, consolidation, merger, reorganization, sale of all or substantially all assets, recapitalization or similar transaction involving the Company or any of its subsidiaries ("Corporate Event").

(xiv) File any petition or commence any proceedings with respect to bankruptcy, receivership, reorganization or insolvency.

(xv) Dissolve, liquidate or wind-up the Company or any of its subsidiaries.

(b) In the event the Company desires to take any Preferred Approval Action, the Company shall provide Toshiba and NCR with written notice, to include a reasonably detailed written description of the proposed action, in accordance with Section 2.1(a)(iii). Toshiba and NCR shall each notify the Company of its approval or disapproval of each applicable matter not later than ten (10) Business Days after receipt of such notice. If Toshiba or NCR does not deliver to the Company a written notice of disapproval of the applicable Preferred Approval Action within ten (10) Business Days after Toshiba's and NCR's respective receipt of the Company's written notice with respect to such action, such partywill be deemed to have waived its right to approve such Preferred Approval Action. For the avoidance of doubt, this Section 2.7 is in addition to, and does not limit or otherwise affect in any way, any authorizations, approvals or other requirements that apply to any matter under applicable law, the organizational documents of the Company or otherwise.

2.8 **Corporate Event Discussion Right.** If the Company receives a bona fide third-party proposal with respect to a Corporate Event (a "Qualified Corporate Event Proposal"), then the Company shall provide each of NCR and Toshiba with written notice of such Qualified Corporate Event Proposal in accordance with the first sentence of Section 2.7(b), including (i) a description of the proposed Corporate Event, (ii) the identity of the party making the proposal, and (iii) the consideration and other material terms and conditions of the Qualified Corporate Event Proposal. At Toshiba's or NCR's request, respectively, the Company and such party shall have good faith discussions for a period of not to exceed thirty (30) days with respect to a potential acquisition of the Company by such party, or other strategic transaction between the parties. For the avoidance of doubt, (x) neither Toshiba, NCR nor the Company will be obligated to enter into or consummate any such acquisition or other transaction unless and until the parties enter into legally binding, definitive agreements for the applicable transaction, and (y) this Section 2.8 shall not affect Toshiba's or NCR's rights to approve Corporate Events under Section 2.7(a)(xiii).

2.9 **Confidential Information and Invention Assignment Agreements** The Company shall cause each employee, consultant and advisor of the Company hired at any time after the date hereof to enter into the Company's standard form Confidential Information and Invention Assignment Agreement, in substantially the form provided to counsel for Toshiba.

2.10 **Observer Rights.**

(a) Subject to Section 2.10(b), so long as Toshiba beneficially owns at least 4,385,000 shares of Series A Preferred Stock, Toshiba shall have the right to designate one Board observer (an "Observer"), and so long as NCR owns at least 1,250,000 shares of Series A Preferred Stock, NCR shall have the right to designate one Observer. Each Observer shall have the right to attend Board meetings in a non-voting capacity and receive all materials, documents and notices given to directors in connection therewith (the "Materials"). The Company shall invite each Observer to attend all Board meetings in such capacity, and the Company shall provide Materials (i) to the Observer designated by NCR, contemporaneously with the delivery of such Materials to the Board members, and (ii) to the Observer designated by Toshiba, at the request of such Observer.

(b) Notwithstanding anything to the contrary in the foregoing, each Observer may be excluded from (i) access to any Board meeting or portion thereof, or (ii) receipt of any Materials, if such access or receipt would (x) adversely affect the attorney-client privilege between the Company and its counsel, or (y) adversely affect the Company's proprietary interest in the trade secrets and other intellectual property embodied by the Materials.

2.11 **Termination of Covenants.**

(a) Sections 2.3 through 2.10 shall terminate as to each Holder and be of no further force or effect (i) immediately prior to the consummation of a Qualified IPO, or (ii) upon termination of the Agreement, as provided in Section 4.1.

(b) Sections 2.1 and 2.2 shall terminate as to each Holder and be of no further force or effect when the Company first becomes subject to the periodic reporting requirements of Sections 13 or 15(d) of the Exchange Act, if this occurs earlier than the events described in Section 2.11(a).

3. **Additional Agreements.**

3.1 **Redemption Rights.**

(a) Subject to any legal restrictions on the Company's redemption of shares, if Holders of a least a majority of the shares of Series A Preferred Stock then outstanding deliver a written redemption exercise notice ("Redemption Notice") to the Company following the occurrence of any Redemption Trigger, the Company shall so notify each other Holder of Series A Preferred Stock, who shall each be entitled to participate in the redemption by delivering a Redemption Notice to the Company within fifteen days following receipt of the Redemption Notice. Upon the Company's receipt of the Redemption Notice(s), the Company shall be obligated to purchase from such Holders all of the shares of Series A Preferred Stock designated for redemption in the Redemption Notices ("Redemption Shares"), for a price (the

"Redemption Price") equal to the aggregate Original Issuance Price (as defined in the Articles) of the Redemption Shares, plus any declared but unpaid dividends on such shares.

(b) Each of the following shall constitute a "Redemption Trigger":

(i) If at any time prior to October 17, 2010, Phillips ceases to devote substantially all of his professional time and efforts on behalf of the Company in a senior capacity for any reason other than (x) because Phillips becomes Permanently Disabled, (y) the termination of Phillips's employment by the Company without Cause, or (z) Phillips's termination of his employment with the Company for Good Reason. For purposes hereof, "Permanently Disabled", "Cause" and "Good Reason" each have the meanings set forth for such terms in the Employment Agreement dated as of the date hereof between Phillips and the Company (as the same may be amended from time to time, the "Employment Agreement").

(ii) If Phillips materially breaches any non-competition or non-solicitation obligation to the Company (including without limitation under Section 3.3 of this Agreement or Section 1(a) of the Employment Agreement) and fails to cure such breach within fifteen (15) days after receipt of written notice of the breach from the Company, NCR or Toshiba.

(c) The closing of the Company's redemption of Redemption Shares pursuant to this Section 3.1 shall take place within fifteen (15) days following the Company's receipt of the Redemption Notice for such redemption. At such closing, the Company shall pay the Redemption Price to each applicable Holder for its Redemption Shares by wire transfer of immediately available funds to an account designated by such Holder.

3.2 **Put Rights**.

(a) If the Company fails for any reason (including without limitation due to applicable legal restrictions) to redeem any Redemption Shares in accordance with Section 3.1 (any such shares not so redeemed, the "Put Shares"), then if Holders of a least a majority of the shares of Series A Preferred Stock then outstanding deliver a written notice ("Put Notice") to Phillips and all of the Holders within thirty (30) days following such failure of the Company, each Holder of Put Shares shall have the right at its election to cause Phillips to purchase, and in such case Phillips shall purchase, all or any portion of such Holder's Put Shares for a purchase price (the "Put Price") equal to the cash Redemption Price of such Shares; provided that the aggregate number of Put Shares that Phillips may be required to purchase under this Section 3.2 shall not exceed 5,790,406 shares. If as a result of the foregoing limitation on Phillips' obligation to purchase Put Shares, the aggregate number of Put Shares that Phillips must purchase in any put exercise under this Section 3.2 is less than the total number of Put Shares otherwise to be sold in such exercise, the Put Shares to be sold shall be allocated ratably among the selling Holders in proportion to the total number of Put Shares that such Holders would otherwise sell in the put exercise but for the foregoing limitation.

(b) Each Holder of Put Shares may exercise its put rights under this Section 3.2 by delivering written notice of exercise to Phillips within thirty (30) days following the Holder's receipt of the Put Notice in accordance with Section 3.2(a). Phillips shall pay the

aggregate Put Price for a Holder's Put Shares in eight (8) equal quarterly cash installments, the first such installment to be due and payable on the last day of the Company's first full fiscal quarter following the Holder's delivery of its exercise notice to Phillips. On each payment date, Phillips shall pay the installment to the Holder by wire transfer of immediately available funds to an account designated by such Holder, and the Holder shall deliver share certificates to Phillips representing the pro rata portion of the Put Shares to which such installment payment corresponds.

3.3 **Non-Competition; Non-Solicitation.**

(a) During the period commencing on the date hereof and ending two (2) years after the termination of Phillips' employment with the Company (the "Restricted Period"), Phillips will not either directly or indirectly, separately or in association with others, whether as an owner, director, officer, manager, consultant, agent, employee or otherwise, accept employment or engage in activities that compete with the business of the Company, or with the reasonably anticipated planned product developments of the Company as of the termination date of Phillips' employment with the Company ("Termination Date"), in the United States, Canada, Japan or the People's Republic of China. Phillips acknowledges that the geographical scope of these limitations is reasonable and necessary for the protection of the Company's trade secrets and other proprietary information. Phillips further acknowledges that if a court of competent jurisdiction finds these non-competition provisions invalid or unenforceable due to unreasonableness in time, geographic scope or scope of the Company's business, then such court will interpret and enforce these provisions to the maximum extent that such court deems reasonable. Notwithstanding the foregoing, nothing contained herein shall preclude Phillips from (i) beneficially owning, as an investment, up to five percent (5%) of the publicly held securities of an entity (regardless of whether such entity competes with the Company), so long as the investment does not give Phillips the right to control such entity, or (ii) engaging in consulting activities for Toshiba (as may be agreed by Phillips and Toshiba) that are not competitive with the Company.

(b) Phillips acknowledges that information about the Company's customers is confidential and constitutes trade secrets. Accordingly, Phillips agrees that during the Restricted Period, Phillips will not either directly or indirectly, separately or in association with others, solicit or encourage others to solicit any of the Company's customers or customer prospects, for the purpose of diverting or taking away business from the Company. For purposes of Phillips' obligations under this Section 3.3(b) following the Termination Date, "customers or customer prospects" shall be limited to (i) those customers of the Company existing as of the Termination Date, and (ii) those customer prospects of the Company, of which Phillips has knowledge, existing as of the Termination Date.

(c) Phillips agrees that during the Restricted Period, Phillips will not either directly or indirectly, separately or in association with others, solicit, encourage or attempt to hire any of the Company's employees, or cause or attempt to cause others to solicit or encourage any of the Company's employees to discontinue their employment with the Company. For purposes of Phillips' obligations under this Section 3.3(c) following the Termination Date, Phillips' obligation not to solicit any employee of the Company or encourage any employee to

discontinue its employment with the Company shall be limited to those employees employed by the Company as of the Termination Date.

3.4 **Confidentiality.** Each Investor agrees that for a period of three (3) years following its receipt thereof, such Investor will keep confidential and will not disclose, divulge, or use for any purpose (other than to monitor its investment in the Company, or otherwise in connection with the Transaction Agreements or the matters contemplated thereby ("Permitted Use")) any information obtained from the Company pursuant to the terms of or in connection with this Agreement (including in the case of Toshiba and NCR, Materials provided to its respective Observer in accordance with Section 2.10) that is marked or described as, identified in writing as, or provided under circumstances reasonably indicating that it is, confidential or proprietary ("Confidential Information"), unless such Confidential Information (a) is known or becomes known to the public in general (other than as a result of a breach of this Section 3.4 by such Investor), (b) is or has been independently developed or conceived by the Investor without use of the Company's Confidential Information, or (c) is or has been made known or disclosed to the Investor by a third party without a breach of any obligation of confidentiality such third party may have to the Company. Notwithstanding the foregoing, an Investor may disclose Confidential Information (i) to its attorneys, accountants, consultants, and other professionals to the extent necessary to obtain their services in connection with any Permitted Use, (ii) to any prospective purchaser of any Registrable Securities from such Investor, if such prospective purchaser agrees in writing to maintain the confidentiality of such information and not to use such information other than in evaluating the purchase of the Registrable Securities, or (iii) as may otherwise be required by law, provided that the Investor promptly notifies the Company of such disclosure and takes reasonable steps to minimize the extent of any such required disclosure. Toshiba and NCR shall cause their respective Observers to comply with this Section 3.4 with respect to Materials constituting Confidential Information and received by the Observer in accordance with Section 2.10. Notwithstanding the foregoing, all budget, strategic planning, customer and pricing information shall be deemed to be Confidential Information for purposes hereof.

3.5 **Publicity.** The Company shall not make any press release or other public announcement (whether written or oral) ("Announcement") which mentions or references an Investor, or its investment in or relationship or agreements with the Company, without the prior written approval of such Investor. Subject to its legal obligations (including requirements of stock exchanges and other similar bodies), each Investor shall (a) consult in advance with the Company and each of NCR and Toshiba regarding the timing and content of all Announcements by such Investor regarding the Company, and use reasonable efforts to agree with the Company and each of NCR and Toshiba upon the content of any such Announcement prior to the release of the Announcement, and (b) not make reference to any other Investor in any such Announcement without the prior written consent of such Investor.

4. **Miscellaneous**.

4.1 **Termination**. This Agreement shall terminate and be of no further force or effect upon the consummation of (without duplication) a Liquidation Event (as defined in the Articles) or any transaction or series of related transactions which are deemed to be a liquidation, dissolution or winding up of the Company pursuant to the Company's Amended and

Restated Articles of Incorporation, as such Amended and Restated Articles of Incorporation may be amended from time to time (the "Articles").

4.2 **Certain Matters With Respect to Toshiba and NCR.**

(a) In recognition and anticipation that (i) each of NCR and Toshiba will remain, for some period of time, a shareholder of the Company, (ii) the Company, NCR and Toshiba may engage in the same or similar activities or lines of business and may have an interest in the same or similar areas of corporate opportunities, (iii) the Company may engage in material business transactions with Toshiba and NCR, and (iv) there will or may be benefits to be derived by the Company through its continued or potential contractual, corporate and business relations with Toshiba and NCR, this Section confirms certain matters with respect to the Company, NCR and Toshiba, and the powers, rights, duties and liabilities of the Company and its officers, directors, employees and shareholders in connection therewith. As used in this Section 4.2 (except as used in the references to the Freedom of Operation Agreement and the Non-Assertion Agreement below), the "Company" means the Company and/or any of its subsidiaries, and "Toshiba" means Toshiba and/or any of its subsidiaries, and NCR means NCR and/or any of its subsidiaries.

(b) The Company, the Founders and the Investors each acknowledge and agree as follows:

(i) Concurrently herewith, (x) Toshiba, the Company and Phillips are entering into the Freedom of Operation Agreement dated as of the date hereof (the "Freedom of Operation Agreement"), and (y) Toshiba and the Company are entering into the Non-Assertion Agreement dated as of the date hereof (the "Non-Assertion Agreement"). Such Person has received and reviewed each such agreement, and hereby approves each such agreement and the terms thereof.

(ii) Each of NCR and Toshiba will have the right to, and will have no duty not to, (x) engage in the same or similar business activities or lines of business as the Company, (y) compete against the Company, and (z) do business with any potential or actual competitor, customer or supplier of the Company. Neither NCR nor Toshiba will be liable to the Company or its shareholders, regardless of the impact any activities may have on the Company, for breach of any fiduciary duty as a shareholder of the Company by reason of any activities of Toshiba or NCR, and the Company will have no interest or expectancy that Toshiba or NCR will not engage in any of the foregoing activities, any interest or expectancy being hereby renounced by the Company. With respect to any potential transaction or matter that may be a corporate opportunity or otherwise of interest to Toshiba, NCR or the Company, neither Toshiba nor NCR will have a duty to communicate or present the corporate opportunity to the Company, the Company will have no interest or expectancy in any such transaction or matter, and Toshiba or NCR may take action with respect to such transaction or matter in its discretion.

(iii) No contract, agreement, arrangement or transaction (or any amendment, modification or termination thereof) between the Company and NCR or Toshiba (including without limitation the Freedom of Operation Agreement and the Non-Assertion Agreement) shall be void or voidable or otherwise be considered to be unfair to the corporation

solely for the reason that Toshiba or NCR is a party thereto, or because any representatives of Toshiba or NCR are present at or participate in any meeting of the Board or committee thereof which authorizes the contract, agreement, arrangement, or transaction (or the amendment, modification or termination thereof).

(c) Nothing in this Section is intended to, and will not be construed to, (i) serve as evidence of, give rise to or expand any party's fiduciary duties under applicable law, (ii) affect in any manner the Freedom of Operations Agreement, the Non-Assertion Agreement or the respective rights and obligations under such agreements of the parties thereto, or (iii) affect in any manner any party's rights and obligations under Section 3.4 or any other confidentiality or non-disclosure obligations agreed to in a written instrument by such party with or for the benefit of any other party.

4.3 **Entire Agreement**. This Agreement and the documents referred to herein constitute the entire agreement among the parties with respect to the subject matter hereof and no party shall be liable or bound to any other party in any manner by any warranties, representations or covenants except as specifically set forth herein or therein.

4.4 **Successors and Assigns**. Except as otherwise provided in this Agreement, the terms and conditions of this Agreement shall inure to the benefit of and be binding upon the respective permitted successors and assigns of the parties (including transferees of Series A Preferred Stock, or any Common Stock issued upon conversion thereof). Nothing in this Agreement, express or implied, is intended to confer upon any party other than the parties hereto or their respective successors and assigns any rights, remedies, obligations, or liabilities under or by reason of this Agreement, except as expressly provided in this Agreement.

4.5 **Amendments and Waivers**. Any term of this Agreement may be amended or waived only with the written consent of the Company, each Major Holder and the Holders of a majority of the Registrable Securities then outstanding, not including the Founders' Stock; provided, however, that (a) if such amendment or waiver has the effect of affecting the Founders' Stock (i) in a manner different than Registrable Securities held by other Holders and (ii) in a manner adverse to the interests of the holders of the Founders' Stock, then such amendment or waiver shall require the consent of the holder or holders of a majority of the Founders' Stock; (b) if such amendment or waiver adversely affects the rights of any Holder in a discriminatory manner as compared to other Holders (other than as reflected by the number or type of Registrable Security held by such adversely affected Holder), then such amendment or waiver shall require the consent of such Holder; (c) the provisions of Sections 2.7, 2.8, 2.10 and 4.2 may not be amended or waived without the written consent of Toshiba and NCR; and (d) the provisions of Section 2.3(d) may not be amended or waived without the written consent of Deluxe. Notwithstanding the foregoing, this Agreement may be amended with only the written consent of the Company for the sole purpose of including a transferee or assignee who acquires Registrable Securities in compliance with Section 1.12. Any amendment or waiver effected in accordance with this paragraph shall be binding upon each party to the Agreement, whether or not such party has signed such amendment or waiver, each future holder of all such Registrable Securities, and the Company.

4.6 **Notices**. Unless otherwise provided, any notice required or permitted by this Agreement shall be in writing and shall be deemed sufficient upon delivery, when delivered personally or by overnight courier or when sent by confirmed electronic mail or facsimile if sent during normal business hours of the recipient; if not, then on the next Business Day, or 48 hours after being deposited in the mail, as certified or registered mail, with postage prepaid, and addressed to the party to be notified at such party's address or facsimile number as set forth on Exhibit A hereto or as subsequently modified by written notice.

4.7 **Severability**. If any provisions of this Agreement shall be held to be illegal, invalid or unenforceable, the parties agree that such provisions will be enforced to the maximum extent permissible so as to effect the intent of the parties, and the validity, legality and enforceability of the remaining provisions of this Agreement shall not in any way be affected or impaired thereby. If necessary to effect the intent of the parties, the parties will negotiate in good faith to amend this Agreement to replace the unenforceable provision with an enforceable provision which as closely as possible reflects and gives effect to such intent.

4.8 **Delays or Omissions**. It is agreed that no delay or omission to exercise any right, power, or remedy accruing to any party, upon any breach, default or noncompliance by another party under this Agreement shall impair any such right, power, or remedy, nor shall it be construed to be a waiver of any such breach, default or noncompliance, or any acquiescence therein, or of any similar breach, default or noncompliance thereafter occurring. It is further agreed that any waiver, permit, consent, or approval of any kind or character on any party's part of any breach, default or noncompliance under the Agreement or any waiver on such party's part of any provisions or conditions of this Agreement must be in writing and shall be effective only to the extent specifically set forth in such writing. All remedies, either under this Agreement, by law, or otherwise afforded to any party, shall be cumulative and not alternative.

4.9 **Attorneys' Fees**. In the event that any suit or action is instituted under or in relation to this Agreement, including without limitation to enforce any provision in this Agreement, the substantially prevailing party in such dispute shall be entitled to recover from the losing party all fees, costs and expenses of enforcing any right of such substantially prevailing party under or with respect to this Agreement, including without limitation, such reasonable fees and expenses of attorneys and accountants, which shall include, without limitation, all fees, costs and expenses of appeals.

4.10 **Governing Law**. This Agreement shall be governed by and construed in accordance with the laws of the State of Washington, without regard to conflicts of law principles thereof.

4.11 **Counterparts**. This Agreement may be executed in counterparts, each of which shall be binding as of the date first written above, and all of which shall constitute one and the same instrument. Each such counterpart shall be deemed an original, and it shall not be necessary in making proof of this Agreement to produce or account for more than one such counterpart. The exchange of copies of this Agreement and of signature pages by facsimile transmission, portable document format (.pdf) or other electronic format shall be deemed to be their original signatures for all purposes.

4.12 **Interpretation and Construction of this Agreement**. Unless the context shall otherwise require, any pronoun shall include the corresponding masculine, feminine and neuter forms, and words using the singular or plural number shall also include the plural or singular number, respectively. The words "include," "includes" and "including" shall be deemed to be followed by the phrase "without limitation". All references herein to Articles, Sections, Annexes, Exhibits and Schedules shall be deemed to be references to Articles and Sections of, and Annexes, Exhibits and Schedules to, this Agreement unless the context shall otherwise require. The headings of the Articles and Sections are inserted for convenience of reference only and are not intended to be a part of or to affect the meaning or interpretations of this Agreement. Unless the context shall otherwise require, any reference to any agreement or other instrument or statute or regulation is to such agreement, instrument, statute or regulation as amended and supplemented from time to time (and, in the case of a statute or regulation, to any successor provision). Any reference in this Agreement to a "day" or a number of "days" (without the explicit qualification of "Business") shall be interpreted as a reference to a calendar day or number of calendar days. If any action or notice is to be taken or given on or by a particular calendar day, and such calendar day is not a Business Day, then such action or notice shall be deferred until, or may be taken or given, on the next Business Day.

4.13 **Effect of Change in Company's Capital Structure**. If, from time to time during the term of this Agreement, there is any change in the character or amount of any of the outstanding Registrable Securities or other applicable equity securities of the Company (including as a result of a stock dividend, stock split, reverse stock split, combination, reclassification or like change in the capital structure of the Company), then, in such event, any and all new, substituted or additional securities resulting from such change shall be immediately subject to the provisions of this Agreement with the same force and effect as the securities presently subject to this Agreement. Additionally, appropriate adjustments shall be made in the number and class of shares and price per share, as applicable to any provisions of this Agreement in the event of a stock dividend, stock split, reverse stock split, combination, reclassification or like change in the capital structure of the Company.

4.14 **Aggregation of Stock**. All shares of the Preferred Stock held or acquired by affiliated Persons shall be aggregated together for the purpose of determining the availability of any rights under this Agreement.

[Signature Page Follows]

The Parties have executed and delivered this Shareholders Agreement as of the date first written above.

COMPANY:

MOD SYSTEMS INCORPORATED

By: _____
Name: Mark Phillips
Title: Chief Executive Officer

FOUNDERS:

MARK PHILLIPS

_____

ANTHONY BAY

_____

INVESTORS:

TOSHIBA CORPORATION

By: 
Name: Y. Fujii
Title: Corporate Senior Vice President

NCR CORPORATION

By: _____
Name:
Title:

DELUXE ENTERTAINMENT SERVICES GROUP INC.

By: _____
Name:
Title:

INVESTORS:

TOSHIBA CORPORATION

By: _____
Name: Y. Fujii
Title: Corporate Senior Vice President

NCR CORPORATION

By: _____
Name: ANTHONY MASSETTI
Title: SVP & CFO

DELUXE ENTERTAINMENT SERVICES GROUP INC.

By: _____
Name:
Title:

INVESTORS:

TOSHIBA CORPORATION

By: _____
Name: Y. Fujii
Title: Corporate Senior Vice President

NCR CORPORATION

By: _____
Name:
Title:

DELUXE ENTERTAINMENT SERVICES GROUP INC.

By: _____
Name:
Title:

EXHIBIT A

INVESTORS

If to the Company:

MOD Systems Incorporated
720 Third Avenue, Suite 1100
Seattle, WA 98104
Attention: David Douglass
Telephone: +1-206-973-1036
Facsimile: +1-206-374-2718

If to Mark Phillips:

c/o MOD Systems Incorporated
720 Third Avenue, Suite 1100
Seattle, WA 98104
Telephone: +1-206-973-1036
Facsimile: +1-206-374-2718

If to Anthony Bay:

16224 NE 130th Street
Redmond, WA 98052
Facsimile: +1-425-885-2318
Email: abay@labay.org

If to Toshiba:

Toshiba Corporation
1-1-1 Shibaura, Minato-ku
Tokyo 105-8001, Japan
Attention: Tetsuya Kato
Telephone: +81-3-3457-8322
Facsimile: +81-3-5444-9439

If to NCR:

NCR Corporation
1700 S. Patterson Blvd.
Dayton, Ohio 45479
Attention: General Counsel
Telephone: +1-937-445-5000
Facsimile: +1-937-445-7214

If to Deluxe:

Deluxe Entertainment Services Group Inc.
1377 North Serrano Avenue
Hollywood, CA 90027

Attention:	Scott R. Ehrlich
Telephone:	+1-323-960-1817
Facsimile:	+1-323-389-0506
Email:	scott.ehrlich@bydeluxe.com

EXHIBIT “O”

Jeff Smyth Interview
January 18, 2011

DEPARTMENT OF THE TREASURY
Internal Revenue Service
Criminal Investigation

Memorandum of Interview

Investigation #:	1000233040	**Location:**	Telephone Interview
Investigation Name:	Mark Edward Phillips		
Date:	January 18, 2011		
Time:	Approximately 12:00 PM – 12:14 PM		
Participant(s):	Jeff Smyth, Witness Benjamin George, Special Agent Spencer Walker, Special Agent, FBI		

As per the information above Jeff Smyth [Smyth] participated in a witness preparation interview.

Smyth was shown a one page email during the interview, a copy of which email is appended to this memorandum and incorporated herein by reference.

Smyth provided the following information:

1. Jeff98104@gmail.com is Smyth's email and was so in December 2009.

2. Smyth first met Jan Wallace [Wallace] sometime in December 2009. Smyth went to Arizona and gathered documents, which he maintained on a thumb drive. Smyth is unsure about the true owner of the account jardin.m.wallace@gmail.com. Smyth received emails from Wallace using the email addresses of janwallace@att.net and jardin.wallace@gmail.com, but he does not recall seeing any from the account jardin.m.wallace@gmail.com.

3. Smyth does not recognize the email document appended to this memorandum. Smyth did have an I-phone during the time this email was sent. Smyth would have been in Sun Valley, Idaho at this time and would not have had access to his computer. Smyth does not recognize the documents attached to the email appended to this memorandum.

4. Smyth believes that he was told that MARK PHILLIPS [PHILLIPS] was using a fake email address at one point.

5. Smyth has no idea where he would have received the email address jardin.m.wallace@gmail.com.

6. Smyth does not keep email on either his I-phone or Gmail account as he would be overrun with email if he did so.

7. During the conversation Smyth checked his computer and I-phone for copies of the email appended to this memorandum of related emails. Smyth's earliest email related to this matter was from April 21, 2009.

I made final revisions to this memorandum on January 18, 2011 after refreshing my memory from notes made during and immediately after the interview with Jeff Smyth.

Memorandum Author
Benjamin George
Special Agent

Gmail

Jan Wallace <jardin.m.wallace@gmail.com>

Kyleen Cane Securities Fraud Information

Jeff <jeff98104@gmail.com> **Tue, Dec 29, 2009 at 9:33 AM**
To: Jan Wallace <jardin.m.wallace@gmail.com>

Ok. Got it.

Sent from Jeff's i-Phone
[Quoted text hidden]

<Tarapasky v Wallace (and Cane) Judgement Breach of Trust.zip>

<20070514 WALLACE LAHKA DAVI HEPBURN.pdf>

<20070630 DAVI 10KSB (0001144204070452).pdf>

<WALLACE COMPLAINTS (Dynamic Associates, MW Medical, Parrish Medley).pdf>

<SCHEME PRESENTATION HIGHLY CONFIDENTIAL.pdf>

<20060315 WALLACE PAYMENT TO LOM SUNSHINE ARCH.pdf>

Swaminathan, Aravind (USAWAW)

From: Jeff Smyth [jeff@smythlaw.com]
Sent: Wednesday, May 26, 2010 2:30 PM
To: Diggs, Matthew (USAWAW); Swaminathan, Aravind (USAWAW)
Cc: 'Shaunta Knibb'; 'Linda Petorak'
Subject: Phillips

Matt and Aravind:

From my notes, it appears that I have interviewed the following persons. There may be others whom I cannot currently recall.

Claire Ambrosio
Anthony Bay
John Cook
Nancy Devlin
Scott Ehrlick
John Fluke
Rachel Huffman
Kyleen Cane
Scott Lipsky
Doug and Maureen Lower
Dierdre McSweeney
Mark Phillips
Tom Ryan
Alyssa Royce
Jan Wallace

If I remember others, I will let you know.

Best regards,

Jeff Smyth

Jeff Smyth

Smyth & Mason PLLC
71st Floor Columbia Center
Seattle, WA 98104
(206) 621-7100

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Swaminathan, Aravind (USAWAW)

From: Jeff Smyth [jeff@smythlaw.com]
Sent: Wednesday, May 26, 2010 4:11 PM
To: Diggs, Matthew (USAWAW); Swaminathan, Aravind (USAWAW)
Cc: 'Shaunta Knibb'
Subject: FW: Phillips

Here is some additional interview information:

From: Shaunta Knibb [mailto:shaunta@smythlaw.com]
Sent: Wednesday, May 26, 2010 4:07 PM
To: 'Jeff Smyth'
Subject: RE: Phillips

I **think** either you or Tom Stone also spoke with:

Jan Hendrickson
Cole Younger
Yoshihide Fuiji
JJ McKay
Jody Sorenson
David Douglas
John Butler

And, of course, the firm has spoken with:

Cyndi Hertzog (employee of de Haan PLLC)
Julia de Haan
Christy Wise
Robert Arnold

Shaunta Knibb

SMYTH & MASON, PLLC
Attorneys at Law
701 Fifth Avenue, Suite 7100
Seattle, WA 98104
(206) 621-7100

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From: Jeff Smyth [mailto:jeff@smythlaw.com]
Sent: Wednesday, May 26, 2010 2:30 PM
To: 'Diggs, Matthew (USAWAW)'; 'Swaminathan, Aravind (USAWAW)'
Cc: 'Shaunta Knibb'; 'Linda Petorak'
Subject: Phillips

Matt and Aravind:

From my notes, it appears that I have interviewed the following persons. There may be others whom I cannot currently recall.

Claire Ambrosio
Anthony Bay
John Cook
Nancy Devlin
Scott Ehrlick
John Fluke
Rachel Huffman
Kyleen Cane
Scott Lipsky
Doug and Maureen Lower
Dierdre McSweeney
Mark Phillips
Tom Ryan
Alyssa Royce
Jan Wallace

If I remember others, I will let you know.

Best regards,

Jeff Smyth



Smyth & Mason PLLC
71st Floor Columbia Center
Seattle, WA 98104
(206) 621-7100

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EXHIBIT “P”

DEPARTMENT OF THE TREASURY
Internal Revenue Service
Criminal Investigation

Memorandum of Interview

Investigation #:	1000233040	**Location:**	U.S. Courthouse 700 Stewart St. Seattle, WA 98101
Investigation Name:	Mark Edward Phillips		
Date:	February 16, 2011		
Time:	Approximately 9:15 AM – 9:20 AM		
Participant(s):	Julia De Haan, Witness Spencer Walker, Special Agent, FBI Benjamin George, Special Agent		

As per the information above Julia De Haan [De Haan] participated in an interview.

De Haan provided the following information:

1. MARK PHILLIPS [PHILLIPS] never put any of his own money into Mod when the company started. The only people that contributed money to Mod were Anthony Bay [Bay] and Robert Arnold [Arnold].

2. The FullPlay IP was purchased out of bankruptcy by PHILLIPS using a Mod Systems check during the time that PHILLIPS was running Mod Systems. This may have later been reimbursed to Mod Systems.

3. Concerning the representation that PHILLIPS had made $3 million at ADot, De Haan wondered why this money was not paid to Mod Systems. During a prior interview between PHILLIPS and De Haan when De Haan asked how many customers that ADot had PHILLIPS could not recall the number and could not recall that Microsoft was ADot's largest customer.

4. Other than loans before the Series A financing which were repaid, PHILLIPS did not put his own money into Mod Systems after the Starbucks deal fell apart.

5. To De Haan's knowledge PHILLIPS did not put money into Mod, he only took it out.

6. De Haan questions whether the GreenPlay product was operational at the time of PHILLIPS' transition from Mod Systems. De Haan believes that this product was finished afterwards and that at the time of PHILLIPS departure it was an "empty box" the "guts" of which "didn't work" as of March 2009.

7. De Haan is not certain that Arnold signed a document that has been represented as giving PHILLIPS and Bay "carte blanche" authorization to run Mod Systems as they saw fit.

8. Jan Wallace [Wallace] never met Arnold to "blow the whistle" on PHILLIPS, but rather Wallace went to Jeff Smyth to report PHILLIPS' conduct. De Haan "smelled a rat" at Mod as early as the Series A financing and she hired Smyth months before Wallace met with Smyth.

I made final revisions to this memorandum on February 16, 2011 after refreshing my memory from notes made during and immediately after the interview with Julia De Haan.

Memorandum Author
Benjamin George
Special Agent