CIRM Loan Program
RFI Response

PROPOSED UNDERWRITING AND PORTFOLIO MANAGEMENT PROCESSES

SUBMITTED BY:

ORIX VENTURE FINANCE, LLC
Michael David, Managing Director
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Overview:
The objective of this memorandum is to provide the California Institute for Regenerative Medicine ("CIRM") with the proposed underwriting and portfolio management processes that ORIX Venture Finance ("OVF"), if engaged by CIRM, would implement in connection with CIRM's loan program. This process is modeled after the underwriting and management procedures that OVF has successfully employed and refined in its deployment of over $700 million in more than 70 venture debt transactions since 2001. OVF currently manages a $350 million debt portfolio and a portfolio of warrant and equity investments in more than 50 companies.

Seasoned OVF professionals would be assigned to the CIRM contract, with each professional having an average of 10 plus years experience in underwriting, structuring, and managing venture debt transactions. These OVF professionals currently serve out of OVF's Northern and Southern California offices, providing the geographical coverage necessary to respond quickly to opportunities that meet CIRM's funding criteria.

The proposed underwriting process is outlined in ten distinct steps. For each step, a description is provided regarding purpose, responsibilities by party, sequence, and time to completion. A visual timeline is included to supplement the description for each underwriting step ("Exhibit A"). Portfolio management capabilities and possible fee structures are briefly discussed following the underwriting process section. OVF can provide additional background on the portfolio management process and compensation models after further discussion and feedback from CIRM.

I. Scientific Peer Review Completed

Per CIRM's stated requirements, the financial due diligence process would not commence until after completion of the CIRM scientific peer review, but before CIRM's Governing Board reviews the application. Upon completion of the scientific peer review, an authorized CIRM delegate would be required to provide written notification to OVF to initiate the due diligence process, formally introduce the selected OVF project manager to one or more contacts at the prospective borrower ("PB"), and wire a retainer for services to be provided by OVF. Estimated time to perform the action items is 1 day from the completion of the scientific review.

II. Information Request

Once OVF receives an information package and notification from CIRM to begin the underwriting process, OVF would distribute an initial financial/due diligence information request to PB. Information received would be quickly analyzed by OVF to identify the risk profile and growth prospects of the PB for purposes of drafting an "indicative proposal." In an effort to expedite the information request, OVF recommends that the CIRM scientific board include OVF as a covered party in its executed confidentiality agreement with PB. Information requested will include, but not necessarily limited to the following: i.) historical and forecast financial information, ii.) detailed product information, iii.) description of on and off balance sheet liabilities and commitments, iv.)

industry white papers, v.) industry research on market size and competition, vi.) strategic plans and resource requirements, and vii.) clinical roadmap and discussion of risks.

The information request may occur in two phases depending on the availability of information and PB's willingness to share information prior to receipt of a termsheet. Generally, a more detailed second information request will follow after an indicative termsheet has been executed. Estimated time to receive the initial information requested is highly dependent on quality and extent of previously compiled PB information and PB resources. The time from request to information receipt generally varies from 3 to 10 days.

III. Indicative Termsheet Discussion and Negotiation

OVF highly recommends that it prepare an indicative termsheet, with input from CIRM, before proceeding with detailed due diligence. The purpose of the indicative termsheet is to assess whether there is a general agreement between CIRM and PB on the pricing and structure of the loan before parties expend significant time and effort on due diligence. The indicative termsheet would be developed after OVF performs a cursory review of the initial due diligence material (Step II). OVF would also seek input and written approval from CIRM regarding targeted terms and milestones prior to distributing the indicative termsheet to PB.

The indicative termsheet is a non-binding agreement and would be used for discussion purposes only. Final loan terms would be subject to change, hopefully not materially, based on any new or unexpected findings from the due diligence process and/or feedback from the CIRM Governing Board during its approval process (steps VI-VIII). The time to complete the indicative termsheet phase is highly dependent on receiving timely feedback from PB and its board, but typically varies from 14-21 days (or more) from start to finish.

IV. Indicative Termsheet Executed

Execution of the indicative termsheet and receipt of deposit from PB are milestones that mark the start of the financial/collateral audit and formal ORIX due diligence processes. Prior to embarking on these processes, PB would be required to wire a deposit to cover ancillary costs, such as travel and third-party audit expenses, and to ensure PB is committed to closing the loan. The deposit would be non-refundable should PB elect, for whatever reason, to terminate discussions with CIRM/ORIX prior to loan closing. This is a milestone event that takes 1 day to complete.

V. Financial Processes and Collateral Audit

Upon execution of the indicative termsheet, OVF would work with PB and a third party auditor to perform a financial processes and collateral audit on PB. A California based auditor would be selected by OVF, subject to CIRM's approval. The purpose of this audit is different from a GAAP audit in that the former is specifically designed to assess weaknesses in financial controls that could lead to inaccurate reporting and/or make PB vulnerable to fraudulent activity. The auditor performs tests on cash management, invoicing, and collections, among other items, to ensure that PB has implemented the appropriate financial systems and controls to achieve its operating and financial plans. This audit also provides support for the quality and value of current assets – accounts receivable and inventory specifically -- that may serve as collateral for the underlying loan. Cost of the independent financial process and collateral audit generally varies from $20,000 to $30,000, depending on scope of analysis and stage of borrower.

OVF works closely with the auditor during this process and has long-standing relationships with several reputable firms that it may consider engaging. The time to completion is highly dependent on the stage of PB, particularly whether it is pre or post revenue. Estimated time to conduct the audit and to prepare the necessary reports varies from 18 to 24 days from start to finish.

VI. ORIX Due Diligence

ORIX's due diligence process would start after execution of the indicative termsheet and in parallel with step V, the financial processes and collateral audit. For ORIX, the due diligence process is the most time consuming of the ten steps and consists of the following action items:

(i) **Initial interviews with PB management and CIRM scientific panel**: Financial due diligence is all encompassing as it requires an understanding of the risks inherent to future operations, market maturity, product development, clinical/regulatory approval, among myriad other considerations. Initially, OVF would meet with PB management to learn about PB's strategic and operating plans, business model, competition, addressable market, management team depth and qualifications, forecasts, and other financial and non-financial diligence topics. Subsequent to the management meeting, OVF would meet with the CIRM scientific team to review findings from their clinical analysis and to collectively gauge the likelihood that PB can execute according to its stated plan. Both PB and CIRM discussions are critical in determining the range of financial scenarios that PB may encounter and the probability that PB will remain financially viable.

(ii) **Analyze information and follow on questions**:
After the initial interviews, additional information requests will be made by OVF pertaining to key risk issues and/or growth drivers of PB. All requested information will be reviewed and analyzed. Additional questions and requests will arise, requiring further communication between OVF and PB.

(iii) **Management background checks:**
Key management team members will be required to submit a background authorization and information form to OVF. Background checks will be conducted by a third party and include results on education, court records, NASD investigations, credit reports, driving violations, UCC filings, and Internet searches. A background check summary would be provided in OVF's

investment memorandum/application, with the full background report made available to CIRM upon request.

(iv) **Financial scenarios and valuation:**
PB's financial plan will be analyzed and modified to reflect possible scenarios in which PB deviates from its stated management plans and milestones. Assumptions are documented and supported by findings from the due diligence process. Financing and exit strategies are considered under each financial scenario. OVF will research databases (e.g., VentureSource) to identify private and public comparables to establish the basis for a current market based valuation. Depending on the stage of the PB, this information may not be readily available or relevant.

From start to finish, the estimated time to complete the due diligence process is 21 to 27 days in duration.

VII. Investment Memorandum/Application Preparation

The investment memorandum and/or application preparation step will commence prior to completion of due diligence. OVF generally compiles an 8-10 page report summarizing the business and key findings that are critical to making an investment decision. Financial schedules including management case and multiple scenarios are provided as exhibits to the textual report.

While OVF has its own standard report, OVF recommends that it work closely with CIRM to develop a deliverable that is most useful for its own decision making purposes. OVF can collaborate with the CIRM scientific panel if a consolidated application is required. From start to finish, OVF estimates that memorandum and schedule drafting will take between 10 to 16 days to complete.

VIII. CIRM Application Approved

Per CIRM memorandum, OVF understands that it may take the CIRM Governing Board one month before it considers an application. In the market for venture backed debt, time to close is a critical criteria used by borrowers in selecting a lender. OVF notes that it is important to be able to provide visibility to PB's with respect to time to close, particularly given that many PB's will be cash constrained. OVF will work with CIRM to streamline any processes that OVF controls in an effort expedite time to close.

IX. Loan Documentation

The proposed timeline contemplates that loan documentation will not commence until after the CIRM application and loan funding are approved by the CIRM Governing Board. CIRM could consider starting the loan documentation process prior to the Governing Board rendering its decision, recognizing that either CIRM or the PB would need to bear the legal expenses if the Governing Board does not approve the loan.

OVF would engage one of its preferred, California based law firms, subject to approval by CIRM, to document loan and warrant agreements. These law firms have substantial experience documenting venture stage transactions. OVF would work closely with counsel to ensure that the loan documents reflect the formal approval provided by the Governing Board. Loan documentation is typically an iterative process (unless CIRM has a standard agreement that it decides will not be modified) that involves negotiation of both business and legal points, including security interests, collateral types, events of default, affirmative and negative covenants, and legal organization. The OVF team selected for this contract is experienced in working with lender and borrower counsel to negotiate terms.

OVF will seek approval from and provide recommendations to CIRM on any material deviation from the Governing Board approval or the standard loan agreement. The standard OVF loan and warrant agreements will be shared with CIRM counsel for review and sign off prior to OVF underwriting its first loan.

Loan documentation timing varies widely depending on PB's immediate need for capital, PB counsel's experience in negotiating loan documents, and willingness for CIRM to negotiate the standard agreements. From start to finish, the loan documentation process generally takes from 9 to 23 days. Legal cost associated with loan documentation generally varies from $30,000 to $40,000.

X. Loan Execution & Funding

This is a milestone event that occurs upon the completion of loan documentation. PB and CIRM will be required signatories to the loan agreement. OVF will not be a party to the loan agreement nor serve as a source of funding. The loan will be funded according to wiring instructions provided by PB at closing with the funds coming from one or more CIRM accounts.

Portfolio Management:
Portfolio management is an ongoing function from loan closing through final maturity/payoff of the loan. Portfolio management is accountable for the following activities: i.) collection and review of borrower financial statements, ii.) receiving and reconciling borrower interest, fees, and principal payments, iii.) funding activities and logistics (i.e., loan could be multiple draws), iv.) amending loan agreement, v.) monitoring borrower compliance to all loan documentation, including achievement of milestones and financial benchmarks, vi.) resolving events of default, vii) reporting borrower performance and condition to lender, and viii) tracking and executing warrant positions.

OVF has developed and implemented the necessary financial systems and procedures to manage a loan portfolio for the benefit of CIRM. A more thorough description of the portfolio management process and OVF's role in that process can be developed after further discussion with CIRM.

Estimated Costs – Underwriting, Portfolio Management, and Ancillary:
OVF is willing to consider an hourly, fee-for-service model for underwriting services rendered. The hourly rates, to be mutually agreed upon by OVF and CIRM, would vary based on the experience levels of the OVF professionals engaged in underwriting. Portfolio management services fees would be based on an annual percentage of committed loan capital. We propose an annual fee of 1.0%-2.0% of committed assets and 25% of the warrants issued as compensation for providing ongoing portfolio management, including tracking and execution of the CIRM warrant portfolio. The annual percentage fee for portfolio management will vary based on the size (capital committed or number of transactions) of the CIRM loan portfolio managed by OVF. The proposed portfolio management and underwriting compensation models are consistent with those widely adopted in the management of venture related assets. The hourly underwriting rates will be determined after further discussions between OVF and CIRM.

Third party and ancillary costs would be incurred during the underwriting process and ongoing portfolio management. These costs are separate from and in addition to the fees paid to OVF. Costs associated with travel, collateral audit fees, and legal fees incurred in loan documentation typically vary from $35,000 to $70,000 per transaction.

Conclusion:
OVF recognizes that the scope of the proposed underwriting and portfolio management services will change given CIRM's unique needs and internal requirements. Based on the proposed 10 underwriting steps, OVF estimates from the start of the underwriting process to funding will take approximately 63 calendar days[1]. Upon loan closing, OVF can offer all the necessary portfolio management functions, on an ongoing basis through loan maturity or payoff, to closely monitor CIRM's loan and warrant positions. We propose a compensation model that combines fee for service for underwriting services rendered and percentage of committed loan capital and warrants for portfolio management.

We welcome the opportunity to modify these processes and our scope of services to meet CIRM's needs. Please contact Michael David at 650-352-5000 should you have any questions or would like to discuss in detail.

Attachment
Exhibit A: Underwriting Processes and Timeline to Funding

[1] Note this timeframe excludes the amount of time that the Governing Board will require to review and approve the application.