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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-Q**

- Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2003**
- Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from            to            .**

**Commission File No. 0-22233**

**Endocardial Solutions, Inc.**  
(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of incorporation or organization)

**41-1724963**  
(IRS Employer Identification Number)

**1350 Energy Lane  
Suite 110  
Saint Paul, Minnesota 55108**  
(Address of principal executive offices and zip code)

**(651) 523-6900**  
(Registrant's telephone number including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) Securities Exchange Act of 1934 during the preceding twelve (12) months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.  
Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act)  
Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

**Common Stock, \$.01 par value**  
(Class)

**21,528,699**  
(Number of Shares Outstanding at November 4, 2003)

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**Endocardial Solutions, Inc.**

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**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements**

**Endocardial Solutions, Inc.**  
**Consolidated Balance Sheets**  
(000's)

	September 30, 2003 (Unaudited)	December 31, 2002 (Note)
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 9,823	\$ 1,348
Accounts Receivable, net of reserve for doubtful accounts (2003 - \$60,000; 2002 - \$60,000)	10,549	8,149
Inventories	4,260	4,635
Prepaid expenses and other current assets	1,138	872
<b>Total current assets</b>	<b>25,770</b>	<b>15,004</b>
Furniture and equipment	9,222	8,279
Less accumulated depreciation	(6,513)	(5,828)
	2,709	2,451
Deposits	51	49
Notes Receivable	206	206
Patents, net of accumulated amortization (2003 - \$124,555; 2002 - \$120,494)	7	11
<b>Total assets</b>	<b>\$ 28,743</b>	<b>\$ 17,721</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 2,491	\$ 1,705
Accrued compensation expenses	2,415	2,672
Bank line of credit	1,000	1,000
Current portion of capital lease obligations	380	514
Current portion of deferred revenue	2,416	2,217
<b>Total current liabilities</b>	<b>8,702</b>	<b>8,108</b>
Long-term Liabilities:		
Capital lease obligations	97	363
Deferred revenue	272	435
<b>Total long-term liabilities</b>	<b>369</b>	<b>798</b>
Stockholders' equity:		
Undesignated Preferred Stock, par value \$.01 per share:		
Authorized shares—10,000,000		
Issued and outstanding shares—none	—	—
Common Stock, \$.01 par value		
Authorized shares—40,000,000		
Issued and outstanding shares—September 30, 2003—21,455,208; December 31, 2002-16,567,593	215	166
Additional paid-in capital	103,917	88,987
Accumulated deficit	(84,908)	(80,448)
Accumulated other comprehensive gain/(loss)	582	309
Deferred compensation	(134)	(199)
<b>Total stockholders' equity</b>	<b>19,672</b>	<b>8,815</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 28,743</b>	<b>\$ 17,721</b>

Note: The balance sheet at December 31, 2002 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

See accompanying notes.

**Endocardial Solutions, Inc.**  
**Consolidated Statements of Operations**  
**(000's)**  
**(Unaudited)**

	<u>For the Three Months Ended</u>		<u>For the Nine Months Ended</u>	
	<u>September 30,</u> <u>2003</u>	<u>September 30,</u> <u>2002</u>	<u>September 30,</u> <u>2003</u>	<u>September 30,</u> <u>2002</u>
Revenue	\$ 9,696	\$ 5,508	\$ 26,282	\$ 20,148
Cost of goods sold	3,370	2,040	9,232	7,431
Gross profit	6,326	3,468	17,050	12,717
Operating expenses:				
Research and development	1,430	1,399	4,464	3,993
General and administrative	862	743	2,384	2,017
Sales and marketing	4,889	4,418	14,569	13,495
Operating loss	(855)	(3,092)	(4,367)	(6,788)
Other income (expense):				
Interest income	4	16	27	65
Interest expense	(25)	(40)	(87)	(100)
Other	(3)	(2)	(33)	(19)
	(24)	(26)	(93)	(54)
Net loss for the period	<u>\$ (879)</u>	<u>\$ (3,118)</u>	<u>\$ (4,460)</u>	<u>\$ (6,842)</u>
Net loss per share - basic and diluted	<u>\$ (0.04)</u>	<u>\$ (0.19)</u>	<u>\$ (0.22)</u>	<u>\$ (0.42)</u>
Weighted average shares outstanding	<u>20,476,741</u>	<u>16,616,195</u>	<u>19,916,656</u>	<u>16,239,211</u>

See accompanying notes.

**Endocardial Solutions, Inc.**  
**Consolidated Statements of Cash Flows**  
(000's)  
(Unaudited)

	For the Nine Months Ended	
	September 30, 2003	September 30, 2002
<b>Operating activities</b>		
Net loss	\$ (4,460)	\$ (6,842)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	702	1,103
Amortization of deferred compensation	65	67
Loss on disposal of equipment	8	—
Changes in operating assets and liabilities:		
Accounts Receivable	(2,148)	(1,484)
Inventory	287	(1,141)
Prepaid expenses and other assets	(209)	(429)
Accounts payable and accrued expenses	492	(1,221)
Deferred revenue	(5)	397
Net cash used in operating activities	<u>(5,268)</u>	<u>(9,550)</u>
<b>Investing activities</b>		
Purchases of furniture and equipment	(962)	(489)
Proceeds from sale of equipment	—	—
Net cash used in investing activities	<u>(962)</u>	<u>(489)</u>
<b>Financing activities</b>		
Proceeds from bank line of credit	—	250
Proceeds from capital lease obligations	—	163
Principal payments on notes payable and capital lease obligations	(400)	(578)
Proceeds from issuance of common stock	14,979	9,376
Net cash provided by (used in) financing activities	<u>14,579</u>	<u>9,211</u>
Effect of exchange rate changes on cash	126	173
Increase (decrease) in cash and cash equivalents	8,475	(655)
Cash and cash equivalents at beginning of period	1,348	4,550
Cash and cash equivalents at end of period	<u>\$ 9,823</u>	<u>\$ 3,895</u>
<b>Supplemental disclosure of non-cash investing and financing activities</b>		
Purchase of equipment and inventory through capital lease obligations	\$ —	\$ 725

See accompanying notes.

**Endocardial Solutions, Inc.****Notes to Consolidated Financial Statements**  
(Unaudited)**1. Basis of Presentation**

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the nine months ended September 30, 2003, are not necessarily indicative of the results that may be expected for the year ending December 31, 2003. These financial statements should be read in conjunction with the audited financial statements and accompanying notes for the fiscal year ended December 31, 2002, contained in the Company's Form 10-K.

**2. Inventories**

Inventories are carried at the lower of cost (first-in, first-out basis) or market. The majority of inventory consists of purchased components. To determine the technological feasibility of its software efforts, the Company utilizes the working model approach available under SFAS No. 86 and believes that the working model was achieved when the software was available for commercial use in June 1998.

Inventories consist of the following:

	September 30, 2003	December 31, 2002
Raw Materials	\$ 2,340,237	\$ 2,099,943
Work-in-progress	318,602	497,589
Finished goods	1,601,887	2,037,103
	<u>\$ 4,260,726</u>	<u>\$ 4,634,635</u>

**3. Stock-Based Compensation**

The Company accounts for stock-based compensation in accordance with the provision of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. The following table illustrates the effect on net loss and loss per share if the Company had applied the fair value recognition provisions of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-based Compensation, to stock-based employer compensation.

	For the three months ended		For the nine months ended	
	2003	2002	2003	2002
Net loss, as reported as September 30:	\$ (879,221)	\$ (3,117,673)	\$ (4,460,249)	\$ (6,842,467)
Add: Stock-based compensation, as reported	20,587	22,814	64,728	67,243
Deduct: Stock-based compensation determined under fair-value-based method for all awards	(339,031)	(426,181)	(1,070,910)	(1,310,488)
Adjusted net loss, assuming fair-value-based method for all stock-based awards	\$ (1,197,665)	\$ (3,521,040)	\$ (5,466,431)	\$ (8,085,712)
Basic and diluted loss per share, as reported	\$ (0.04)	\$ (0.19)	\$ (0.22)	\$ (0.42)
Basic and diluted loss per share, SFAS No. 123 adjusted	\$ (0.06)	\$ (0.21)	\$ (0.27)	\$ (0.50)

#### 4. Comprehensive Income

The components of comprehensive loss and income, net of related tax, were as follows:

	For the three months ended		For the nine months ended	
	September 30		September 30	
	2003	2002	2003	2002
Net (loss) income	\$ (879,221)	\$ (3,117,673)	\$ (4,460,249)	\$ (6,842,467)
Foreign currency translation adjustment	135,149	(74,884)	273,940	152,254
Comprehensive (loss) income	\$ (744,072)	\$ (3,192,557)	\$ (4,186,309)	\$ (6,690,213)

#### 5. Guarantees and Contractual Obligations

In November 2002, the Financial Accounting Standards Board issued Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (the "Interpretation"). The Interpretation requires disclosure in periodic financial statements of certain guarantee arrangements. The Interpretation also clarifies situations where a guarantor is required to recognize the fair value of certain guarantees in the financial statements. The Company does not have any guarantees that require recognition at fair value under the Interpretation.

The Company sells extended warranty contracts that include service and support, and may also include software and/or hardware upgrades. These items are required to be disclosed in periodic financial statements under the Interpretation. Revenue from the sale of extended warranty contracts are deferred and recognized ratably over the period in which the services are provided, and/or at the time the upgrades are performed. The Company does not recognize revenue from periodic upgrades to versions of previously released software upgrades. Costs associated with extended warranty contracts are recognized at the time the service is provided, and/or the upgrades performed.

Changes in the recorded deferred revenue amounts during the period are as follows:

Balance, December 31, 2002	\$ 2,652,455
Additional deferred revenue during the period	3,323,651
Deferred revenue recognized during the period	(3,288,209)
Balance, September 30, 2003	<u>\$ 2,687,897</u>

## 6. Reclassifications

Certain prior year items have been reclassified to conform to current year presentations.

## 7. Stock Offering

In January 2003, the Company received proceeds of \$8,516,750 from a private placement of 3,097,000 shares of its common stock at a price of \$2.75 per share, to accredited investors.

In August 2003, the Company received proceeds of \$7,361,123 from a private placement of 1,732,029 shares of its common stock at a price of \$4.25 per share, to accredited investors.

## 8. Segment Reporting

Sales by geographic destination as a percentage of total sales were as follows:

	For the three months ended September 30		For the nine months ended September 30	
	2003	2002	2003	2002
Domestic	78%	81%	77%	76%
International:				
Europe	18%	14%	15%	16%
Asia Pacific	4%	5%	7%	5%
Canada/Mexico	0%	0%	1%	3%

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

### General

Endocardial Solutions Inc. (the "Company"), was incorporated in May 1992. The Company develops, manufactures and markets the EnSite<sup>®</sup> clinical workstation, the EnSite Array<sup>™</sup> catheter ("EnSite Array"), and the EnSite NavX<sup>™</sup> surface electrode kit ("EnSite NavX") (collectively, the "EnSite System") for use by electrophysiologists in diagnosing and mapping abnormal heart rhythms known as tachycardias. During the second quarter of 1999, the Company received clearance from the U.S. Food and Drug Administration ("FDA") to market the EnSite workstation and the EnSite Array in the U.S. for use in the right atrium of the heart. The EnSite workstation with the EnSite Array is available to electrophysiologists in Europe for use in the right atrium and left ventricle of the heart. In April of 2003, the Company received clearance from the FDA to market EnSite NavX, a new product utilized with the EnSite clinical workstation that enables non-fluoroscopic navigation of conventional linear mapping catheters in any chamber of the heart. EnSite NavX incorporates certain three-dimensional intracardiac location technology licensed from Medtronic, Inc. The EnSite workstation with EnSite NavX also is approved for use in Europe and in all other geographies where the EnSite System is currently sold or distributed. The Company commercially released EnSite NavX worldwide during the second quarter of 2003.

### Results of Operations

**General.** Net losses were \$879,221 or \$.04 per share, for the three months ended September 30, 2003, compared to \$3.1 million or \$0.19 per share, for the same period in 2002. For the nine months ended September 30, 2003, net losses were \$4.5 million or \$0.22 per share, compared to \$6.8 million or \$0.42 per share for the same period in 2002. The Company expects losses may continue through the fourth quarter of 2003.

**Revenue and Cost of Goods Sold.** Worldwide revenue for the three months ended September 30, 2003 was approximately \$9.7 million, an increase of approximately \$4.2 million, or 76%, over the same period in 2002. For the nine months ended September 30, 2003, worldwide revenues were approximately \$26.3 million, an increase of \$6.1 million, or 30.4%, over the same period in 2002. In the U.S., revenues for the three months ended September 30, 2003 increased approximately \$3.0 million, or 67.7%, over the same three-month period in 2002. Revenue in the U.S. for the nine months ended September 30, 2003 was approximately \$20.1 million, an increase of \$4.7 million, or 30.3%, over the same period in 2002.

International revenue for the three months ended September 30, 2003 was approximately \$2.2 million, an increase of \$1.2 million, or 112.2%, compared to the same period in 2002. For the nine months ended September 30, 2003, international revenue of approximately \$6.1 million was an increase of \$1.4 million, or 30.9%, over the same period in 2002. International revenue includes direct sales to end-users in Canada and certain countries in Europe, and to distributors in other countries in Europe, the Middle East, Asia Pacific, and Mexico.

With the commercial release of EnSite NavX in the second quarter, revenue from the sale of EnSite disposable products (EnSite Array catheters and EnSite NavX surface electrode kits) for the three month period ended September 30, 2003 was approximately \$5.4 million, an increase of approximately \$2.3 million, or 75.1%, over the same period in 2002 (which included EnSite Array sales only). For the nine month period ended September 30, 2003, revenue from the sale of EnSite disposable products was approximately \$14.0 million, an increase of \$3.3 million, or 31.1%, over the same period in 2002 (which included EnSite Array sales only). Domestic sales accounted for 82.3% of total EnSite disposable product revenue for the three months ended September 30, 2003, compared to 80.1% for the same period in 2002 (which included EnSite Array sales only). For the nine months ended September 30, 2003, domestic sales accounted for 80.9% of the total EnSite disposable product revenue, as compared to 80.0% for the same period in 2002 (which included EnSite Array sales only).

Revenue from the sale of EnSite clinical workstations was approximately \$3.0 million for the three months ended September 30, 2003, compared to \$2.0 million for the same period in 2002. EnSite clinical workstation revenue for the nine month period ending September 30, 2003 was approximately \$8.7 million, as compared to \$8.2 million for the same period in 2002. Domestic sales accounted for 74.4% of EnSite clinical workstation revenue for the three months ended September 30, 2003, compared to 87.5% for the same period in 2002. Domestic sales

accounted for 73.4% of EnSite clinical workstation revenue for the nine month period ending September 30, 2003, compared to 74.3% for the same period in 2002.

Other revenue, which represents 5.4% and 7.9%, respectively, of worldwide sales for the three month periods ending September 30, 2003 and 2002, and 5.9% and 6.1% for the nine month periods ending September 30, 2002 and 2003, respectively, includes deferred revenue generated from the sale of extended warranty agreements, as well as revenue from the sale of EnSite accessories and repairs to EnSite clinical workstations.

As of September 30, 2003, the Company has upgraded more than 179 EnSite Systems globally to add EnSite NavX hardware and software. For the three months ended September 30, 2003, the Company recognized revenue of approximately \$741,000 from deferred revenue related to the installation of EnSite NavX upgrades. For the nine months ended September 30, 2003, the Company recognized revenue of approximately \$2.0 million from deferred revenue related to the installation of EnSite NavX upgrades.

Cost of goods sold was approximately \$3.4 million and \$2 million for the three month periods ended September 30, 2003 and 2002, respectively. For the nine month periods ending September 30 2003 and 2002, cost of goods sold was approximately \$9.2 million and \$7.4 million, respectively.

The Company's gross profit margin was 65.2% for the three months ended September 30, 2003, compared with 63.0% during the same period in 2002. Gross margins for the nine month periods ended September 30, 2003 and 2002 were 64.9% and 63.1%, respectively. Gross margins on approximately \$741,000 and \$2.0 million of deferred revenue recognized during the third quarter and year-to-date from the installation of EnSite NavX hardware upgrades were 11.2% and 6.7%, respectively, which has proportionately reduced the Company's overall gross margins for both the second and third quarters.

Gross margins on the sale of EnSite disposable products (EnSite Array catheters and EnSite NavX surface electrode kits) for the three month period ending September 30, 2003 were 76.2%, as compared to gross margins of 65.7% from the sale of EnSite Arrays only for the same period in 2002. For the nine month period ended September 30, 2003, gross margins from the sale of EnSite disposable products were 75.4%, as compared to gross margins of 67.4% on the sale of EnSite Arrays only for the same period in 2002.

Gross margins on the sale of EnSite clinical workstations were 58.7% in the third quarter of 2003, up from 55.1% in the third quarter of 2002. Gross margins on the sale of EnSite clinical workstations for the nine month period ending September 30, 2003 were 59.8%, as compared to 55.7% for the same period in 2002.

**Research and Development Expenses.** Research and development expenses include compensation and benefit costs in the clinical, software, hardware, catheter and applied research departments, as well as costs associated with regulatory expenses. Research and development expenses were approximately \$1.4 million for the three month period ended September 30, 2003, compared to approximately \$1.4 million during the same period in 2002. Research and development expenses for the nine month period ending September 30, 2003 were approximately \$4.5 million, as compared to \$4 million for the same period in 2002. The Company expects to make continued significant investments in research and development and clinical studies during the remainder of 2003. The Company is continuing its clinical studies using the EnSite System to assist electrophysiologists in stratifying patients with congestive heart failure ("CHF") who are candidates to receive bi-ventricular pacing devices, identifying the optimal pacing, and measuring the hemodynamic efficiency of the pacing therapy.

**General and Administrative Expenses.** General and administrative expenses were approximately \$863,000 and \$743,000 for the three month periods ended September 30, 2003 and 2002, respectively. General and administrative expenses for the nine month periods ended September 30, 2003 and 2002 were approximately \$2.4 million and \$2.0 million, respectively. The increase in expenses is primarily due to professional service expenses associated with various information technology projects, and actions undertaken by the Company to comply with certain requirements of the Sarbanes-Oxley Act of 2002. The Company also incurred fees and professional service expenses associated with filing for trademark protection in various international jurisdictions, and the execution of a new credit facility with Silicon Valley Bank. The Company expects general and administrative expenses to remain relatively constant during the fourth quarter of 2003.

**Sales and Marketing Expenses.** Sales and marketing expenses were approximately \$4.9 million during the three months ended September 30, 2003, compared to \$4.4 million during the same period in 2002. For the nine month periods ended September 30, 2003 and 2002, sales and marketing expenses were \$14.6 million and \$13.5 million, respectively. This increase in expense is primarily attributable to travel and training costs associated with the installation and upgrade of more than 179 EnSite workstations to include EnSite NavX during the second and third quarters of 2003, and an increase in commissions the Company paid for certain distributor sales in the U.S. and Europe. The Company expects sales and marketing expenses to remain relatively constant during the fourth quarter of 2003.

**Interest Income and Expense.** Interest income was approximately \$4,000 and \$16,000 for the three months ended September 30, 2003 and 2002, respectively. For the nine month periods ending September 30, 2003 and 2002, interest income was \$27,000 and \$65,000, respectively. The decrease in interest income for the three and nine month periods ended September 30, 2003 was due to lower average cash and cash equivalent balances and lower interest rates. Interest expense was approximately \$25,000 and \$40,000 for the three month periods ended September 30, 2003 and 2002, respectively. For the nine month periods ending September 30, 2003 and 2002, interest expense was \$87,000 and \$101,000, respectively.

#### **Liquidity and Capital Resources.**

The Company's operations since inception have been funded by net proceeds from the sale of common and preferred stock totaling approximately \$104.1 million. As of September 30, 2003 and December 31, 2002, the Company had cash, cash equivalents and short-term investments of approximately \$9.8 million and \$1.3 million, respectively.

For the nine months ended September 30, 2003, the Company used cash from operating activities of approximately \$5.3 million, compared to approximately \$9.5 million for the same period in 2002.

The Company's accounts receivable balance was approximately \$10.5 million as of September 30, 2003, an increase of approximately \$2.4 million from December 31, 2002. The increase in accounts receivable is, in part, attributable to the increase in revenues during the nine months ended September 30, 2003 compared to previous periods, and the Company's transition from a distributor organization to direct sales in Europe during 2002. Of the approximately \$10.5 million outstanding balance, as of September 30, 2003, approximately \$7.4 million came from sales generated in September which equated to \$6.6 million of recognized revenue for the month.

The Company's inventory balance at September 30, 2003 was approximately \$4.3 million, a decrease of approximately \$374,000, or 8.1%, over December 31, 2002. The Company believes inventories of EnSite Arrays will decrease during the fourth quarter of 2003 to historical levels. This decrease in EnSite Array inventory may be slightly offset by the inventory of EnSite NavX that was not part of the Company's inventory in 2002.

The Company has acquired the inventory components necessary to manufacture in the fourth quarter a number of "pre-NavX" EnSite v.3.2 workstations pursuant to a forecast the Company received from the its distributor in Japan. The Company may not ship these EnSite v.3.2 workstations to the Company's distributor until early 2004, which would increase the Company's EnSite workstation inventory at the end of the fourth quarter of 2003. During the fourth quarter, the Company also expects to complete its conversion of the operating software and computing platform for its EnSite workstation to a LINUX-based operating system on an Intel® Xeon® computing system, from the current UNIX-based operating system on a Silicon Graphics computing system. The Company will purchase inventory of the new Intel Xeon computer workstations in the fourth quarter for use in new EnSite System sales, in preparation for upgrading the EnSite workstations of those customers who purchase the upgrade, and for internal use in research and development, and marketing. The number of new Intel Xeon workstations purchased may increase inventory at the end of the fourth quarter.

The Company's accounts payable (including accrued expenses) balance at September 30, 2003 was approximately \$4.9 million, an increase of approximately \$529,000 from December 31, 2002. The slight increase reflects the Company's continued efforts to control its inventory and operating expenses, along with the efforts to closely match turns of both receivables and payables in order to optimize the Company's cash flow. The Company expects accounts payable and accrued expenses to remain relatively constant, or increase slightly during the fourth

quarter as a result of the operating and production expenses required to support the continued upgrade of EnSite Systems to include EnSite NavX, as well as introduction of the new computing platform.

Total deferred revenue from the sale of extended warranty agreements or standard new EnSite System warranty coverage (including service and support and hardware upgrades) was approximately \$2.7 million at September 30, 2003, as compared to approximately \$2.7 million at December 31, 2002. This balance reflects the fact that at the end of September 2003, the Company had sold extended warranties on more than 179 EnSite clinical workstations over the past nine months.

The Company had no short-term investment portfolio as of September 30, 2003 and December 31, 2002. A majority of the Company's available cash was in money market funds consistent with the Company's investment policy.

In January 2003, the Company received proceeds of \$8,516,750 from a private placement of 3,097,000 shares of its common stock to accredited investors. The placement was priced at \$2.75 per share. In August 2003, the Company received proceeds of \$7,361,123 from a private placement of 1,732,029 shares of its common stock to accredited investors. The placement was priced at \$4.25 per share.

In September 2003, the Company entered into a \$4.5 million credit facility agreement with Silicon Valley Bank ("SVB"). This new credit facility with SVB replaced a prior credit facility with SVB that the Company entered into in June 2001, and modified as of May 2002 and thereafter to extend the term of the initial agreement. The September 2003 credit facility with SVB consists of a \$3 million domestic line of credit, and a \$1.5 million international (EXIM) credit line. This credit facility operates as a revolving line of credit, with \$1.25 million reserved for use as a capital lease line. The credit facility agreement contains certain restrictive financial covenants, including an obligation to maintain a specified ratio of "current assets" to "current liabilities" ("quick ratio"), as well as a minimum "tangible net worth". As of September 30, 2003, the Company was in compliance with the tangible net worth covenant of the credit facility. As of September 30, 2003, the Company had \$477,017 outstanding related to capital leases and had an additional \$1 million outstanding on the credit line.

The Company believes that its existing cash, cash equivalents, short-term investments and bank financing will be sufficient to fund the operations of the Company through the fourth quarter of 2003. The Company's future liquidity and capital requirements will depend on numerous factors, including the timing of regulatory actions regarding the Company's products, competition, the results of clinical trials, the extent to which the Company's EnSite System and EnSite NavX products continue to gain market acceptance, the cost, timing and method of expanding sales, marketing, research and development, and manufacturing activities, and the ability of the Company to obtain additional bank or equity financing.

#### **Critical Accounting Policies**

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the U.S., which require the Company to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying consolidated financial statements and related footnotes. In preparing these financial statements, management has made its best estimates and judgments of certain amounts included in the financial statements, giving due consideration to materiality. The Company does not believe there is a great likelihood that materially different amounts would be reported related to the accounting policies described below. However, application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates.

*Revenue Recognition.* Revenue from the sale of the Company's EnSite clinical workstation is recognized at the time of shipment in instances where the Company has evidence of a contract, the purchase price is fixed and determinable, and collection is probable. Revenue from service and support contracts, and from extended warranty and hardware upgrade agreements, are deferred and recognized ratably over the period the services are provided or at the time the upgrades are performed. The Securities and Exchange Commission's Staff Accounting Bulletin (SAB) No. 101, "Revenue Recognition" provides guidance on the application of generally accepted accounting principals to selected revenue recognition issues. The Company has concluded that its revenue recognition policy is appropriate and in accordance with SAB No. 101.

*Allowance for Doubtful Accounts.* Accounts receivable are reduced by an allowance for amounts that may become uncollectible in the future. The estimated allowance is based on management's review of accounts receivable balances sales and historic write-offs.

*Inventories and Related Allowance for Excess and Obsolete Inventory.* Inventories are valued at the lower of cost or market and have been reduced by an allowance for excess and obsolete inventories. The estimated allowance is based on management's review of inventories on hand compared to estimated future usage and sales.

*New Accounting Standards.* In November 2002, the EITF published EITF Issue No. 00-21, Accounting for Revenue Arrangements with Multiple Deliverables. EITF Issue No. 00-21 addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. EITF Issue No. 00-21 establishes three principles: revenue arrangements with multiple deliverables should be divided into separate units of accounting, arrangement consideration should be allocated among the separate units of accounting based on their relative fair values, and revenue recognition criteria should be considered separately for separate units of accounting. EITF Issue No. 00-21 is effective for all revenue arrangements entered into for fiscal periods beginning after June 15, 2003, with early adoption permitted. The Company does not believe the adoption of EITF Issue No. 00-21 will have a material effect on its consolidated results of operations, financial position, or cash flows.

In December 2002, the Financial Accounting Standards Board issued SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure. SFAS No. 148 amends SFAS No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. SFAS No. 148 also amends the disclosure requirements of SFAS No. 123 to require more disclosure in the summary of significant accounting policies, the effects of an entity's accounting policy with respect to stock-based employee compensation on reported net income and earnings per share in annual and interim financial statements. The disclosure provision is required for all companies with stock-based employee compensation, regardless of whether the company utilizes the fair value method of accounting described in SFAS No. 123 or the intrinsic value method described in APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No. 148's amendment of the transition and annual disclosure provisions of SFAS No. 123 are effective for fiscal years ending after December 15, 2002. The disclosure provisions for interim financial statements are effective for interim periods beginning after December 15, 2002. The Company currently accounts for stock-based compensation utilizing the intrinsic value method of accounting for stock-based employee compensation described by APB Opinion No. 25.

#### **Cautionary Statement**

Except for the historical information contained herein, this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements represent the Company's expectations, beliefs, intentions or strategies concerning future events, including, but not limited to, any statements regarding its current assumptions about future financial performance; the continuation of historical trends; the sufficiency of its cash balances and cash generated from operating activities for future liquidity and capital resource needs; the expected impact of changes in accounting policies on the Company's results of operations, financial condition or cash flows; anticipated problems and its plans for future operations; and the economy in general or the future of the medical device industry, all of which are subject to various risks and uncertainties. When used in this Form 10-Q and in future filings by the Company with the Securities and Exchange Commission, in the Company's press releases and in oral statements made with the approval of an authorized executive officer, the word or phrases "believes," "anticipates," "expects," "intends," "will likely result," "estimates," "projects" or similar expressions are intended to identify such forward-looking statements, but are not the exclusive means of identifying such statements. However, any statements contained in this Form 10-Q that are not statements of historical fact may be deemed to be forward-looking statements.

The Company cautions that these statements by their nature involve risks and uncertainties, certain of which are beyond its control, and actual results may differ materially depending on a variety of important factors, including, but not limited to such factors as market demand and pressures on the pricing for its products; changing market conditions, competition and growth rates within the medical device industry; changes in accounting policies; risks associated with operations outside of the U.S.; changing economic conditions such as general economic

slowdown, decreased consumer confidence and the impact of war on the economy; and other risks and uncertainties, including those described in Exhibit 99.1 to our Form 10-Q for the quarter ended September 30, 2003.

**Item 3. Qualitative and Quantitative Disclosures about Market Risk.**

The Company had approximately \$9.8 million of cash and investments as of September 30, 2003. Substantially all of the investments were U.S. government or investment grade, fixed income securities from domestic issuers. Because of the credit risk criteria of the Company's investment policies, the primary market risk associated with these investments is interest rate risk. The Company does not use derivative financial instruments to manage interest rate risk or to speculate on futures changes in interest rates. A rise in interest rates could negatively affect the fair value of the Company's investments; however, because management considers it unlikely that the Company would need or choose to substantially liquidate the Company's investments; management believes that such an increase in interest rates would not have a material impact on the Company's future earnings or cash flows. Although the Company distributes products abroad, the Company only conducts international sales in U.S. dollars and Euros. Management does believe the Company has any material foreign currency exchange rate risk.

**Item 4. Controls and Procedures.**

(a) Evaluation of disclosure controls and procedures.

Under the supervision and with the participation of our management, including the Company's Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")). Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective in timely alerting them to the material information relating to us (or our consolidated subsidiaries) required to be included in the reports we file or submit under the Exchange Act.

(b) Changes in internal controls over financial reporting.

During the quarter ended September 30, 2003, there has been no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 2. Changes in Securities and Use of Proceeds**

In August 2003, the Company completed the sale in a private placement of 1,732,029 shares of its common stock to accredited investors at a price of \$4.25 per share, for proceeds of \$7,361,123. The Company relied on the exemption from registration provided by Section 4(2) of the Securities Act of 1933. Pursuant to the terms of the stock purchase agreement, these shares were registered for resale pursuant to the Securities Act of 1933. Proceeds from the sale of these shares will be used for general working capital, including expenses associated with research and development, clinical studies and the commercial introduction of new products.

**Item 6. Exhibits and Reports on Form 8-K**

(a) Exhibits

<u>Exhibits</u>	<u>Description</u>
10.1	Form of Stock Purchase Agreement, used in transactions dated August 20, 2003 and August 25, 2003, among Endocardial Solutions, Inc. and the Investors named therein (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on August 26, 2003, as amended on Form 8-K/A filed on August 27, 2003 and Form 8-K/A filed on September 2, 2003).
10.2	Loan and Security Agreement, dated September 24, 2003, by and between Endocardial Solutions, Inc. and Silicon Valley Bank.
10.3	Loan and Security Agreement (Exim Program), dated September 24, 2003, by and between Endocardial Solutions, Inc. and Silicon Valley Bank.
10.4	Secured Promissory Note (Exim Program) dated September 24, 2003
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.1	Cautionary Statement for purposes of the "Safe Harbor" provisions of the Private Securities Litigation Reform Act of 1995.

(b) Reports on Form 8-K

A Form 8-K was filed by the Company on July 24, 2003; such report contained information disclosed pursuant to Regulation FD under Item 9 and included as an exhibit under Item 7, a copy of a press release issued by the Company announcing its second quarter 2003 earnings results.

A Form 8-K was filed by the Company on August 26, 2003, as amended on Form 8-K/A filed on August 27, 2003 and Form 8-K/A filed on September 2, 2003; such report contained information disclosed pursuant to Regulation FD under Item 5 and included as exhibits under Item 7, a copy of the press releases issued by the Company announcing the sale of approximately \$7.4 million of its common stock, as well as a copy of the Stock Purchase Agreement entered into with the Investors.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ENDOCARDIAL SOLUTIONS, INC.

Dated: November 14, 2003

By: /s/ James W. Bullock  
James W. Bullock  
*President and Chief Executive Officer*

/s/ J. Robert Paulson, Jr.  
J. Robert Paulson, Jr.  
*Chief Financial Officer*  
*(Principal Accounting Officer)*

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**Exhibit 10.2**

**Silicon Valley Bank**

**Loan and Security Agreement**

**Borrower: Endocardial Solutions, Inc.**  
**Address: 1350 Energy Lane, Suite 110**  
**St. Paul, MN 55108**

**Date: September 24, 2003**

**THIS LOAN AND SECURITY AGREEMENT** is entered into on the above date between SILICON VALLEY BANK ("Silicon"), whose address is 3003 Tasman Drive, Santa Clara, California 95054 and the borrower(s) named above (jointly and severally, the "Borrower"), whose chief executive office is located at the above address ("Borrower's Address"). The Schedule to this Agreement (the "Schedule") shall for all purposes be deemed to be a part of this Agreement, and the same is an integral part of this Agreement. (Definitions of certain terms used in this Agreement are set forth in Section 8 below.)\*

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**\*As set forth in the Amendment to Loan Documents of even date between Silicon and the Borrower, this Loan Agreement amends and restates in its entirety the Loan and Security Agreement dated June 28, 2001 (as amended from time to time) between Silicon and Borrower.**

**1. LOANS.**

**1.1 Loans.** Silicon will make loans to Borrower (the "Loans") up to the amounts (the "Credit Limit") shown on the Schedule, provided no Default or Event of Default has occurred and is continuing, and subject to deduction of Reserves for accrued interest and such other Reserves as Silicon deems proper from time to time in its good faith business judgment.

**1.2 Interest.** All Loans and all other monetary Obligations shall bear interest at the rate shown on the Schedule, except where expressly set forth to the contrary in this Agreement. Interest shall be payable monthly, on the last day of the month. Interest may, in Silicon's discretion, be charged as a Loan hereunder to Borrower's loan account, and the same shall thereafter bear interest at the same rate as the other Loans. Silicon may alternatively, in its discretion, charge interest to Borrower's Deposit Accounts maintained with Silicon. Regardless of the amount of Obligations that may be outstanding from time to time, Borrower shall pay Silicon minimum monthly interest during the term of this Agreement in the amount set forth on the Schedule (the "Minimum Monthly Interest").

**1.3 Overadvances.** If at any time or for any reason the total of all outstanding Loans and all other monetary Obligations exceeds the Credit Limit (an "Overadvance"), Borrower shall immediately pay the amount of the excess to Silicon, without notice or demand, provided that under ordinary circumstances, but without any obligation to do so, Silicon will use its best efforts to contact the Borrower regarding the payment of any such Overadvance. Without limiting Borrower's obligation to repay to Silicon the amount of any Overadvance, Borrower agrees to pay Silicon interest on the outstanding amount of any Overadvance, on demand, at the Default Rate.

**1.4 Fees.** Borrower shall pay Silicon the fees shown on the Schedule, which are in addition to all interest and other sums payable to Silicon and are not refundable.

**1.5 Loan Requests.** To obtain a Loan, Borrower shall make a request to Silicon by facsimile or telephone. Loan requests received after 12:00 Noon will not be considered by Silicon until the next Business Day. Silicon may rely on any telephone request for a Loan given by a person whom Silicon believes is an authorized representative of Borrower, and Borrower will indemnify Silicon for any loss Silicon suffers as a result of that reliance.

**1.6 Letters of Credit.** At the request of Borrower, Silicon may, in its good faith business judgment, issue or arrange for the issuance of letters of credit for the account of Borrower, in each case in form and substance satisfactory to Silicon in its sole discretion (collectively, "Letters of Credit"). The aggregate face amount of all Letters of Credit from time to time outstanding shall not exceed the amount shown on the Schedule (the "Letter of Credit Sublimit"), and shall be reserved against Loans which would otherwise be available hereunder, and in the event at any time there are insufficient Loans available to Borrower for such reserve, Borrower shall deposit and maintain with Silicon cash collateral in an amount at all times equal to such deficiency, which shall be held as Collateral for all purposes of this Agreement. Borrower shall pay all bank charges (including charges of Silicon) for the issuance of Letters of Credit, together with such additional fee as shall represent the standard charges of Silicon's letter of credit department in connection with the issuance of the Letters of Credit. Any payment by Silicon under or in connection with a Letter of Credit shall constitute a Loan hereunder on the date such payment is made. Each Letter of Credit shall have an expiry date no later than 364 days from the date of issuance. Borrower hereby agrees to indemnify and hold Silicon harmless from any loss, cost, expense, or liability, including payments made by Silicon, expenses, and reasonable attorneys' fees incurred by Silicon arising out of or in connection with any Letters of Credit. Borrower agrees to be bound by the regulations and interpretations of the issuer of any Letters of Credit guaranteed by Silicon and opened for Borrower's account or by Silicon's good faith interpretations of any Letter of Credit issued by Silicon for Borrower's account, and Borrower understands and agrees that Silicon shall not be liable for any error, negligence, or mistake, whether of omission or commission, in following Borrower's instructions or those contained in the Letters of Credit or any modifications, amendments, or supplements thereto, other than for Silicon's gross negligence or willful misconduct. Borrower understands that Letters of Credit may require Silicon to indemnify the issuing bank for certain costs or liabilities arising out of claims by Borrower against such issuing bank. Borrower hereby agrees to indemnify and hold Silicon harmless with respect to any loss, cost, expense, or liability incurred by Silicon under any Letter of Credit issued for the account of Borrower, as a result of Silicon's indemnification of any such issuing bank, unless such loss was caused by Silicon's gross negligence or willful misconduct. The provisions of this Loan Agreement, as it pertains to Letters of Credit, and any other Loan Documents relating to Letters of Credit are cumulative.

**2. SECURITY INTEREST.** To secure the payment and performance of all of the Obligations when due, Borrower hereby grants to Silicon a security interest in all of the following (collectively, the "Collateral"): all right, title and interest of Borrower in and to all of the following, whether now owned or hereafter arising or acquired and wherever located: all Accounts; all Inventory; all Equipment; all Deposit Accounts; all General Intangibles (including without limitation all Intellectual Property); all Investment Property; all Other Property; and any and all claims, rights and interests in any of the above, and all guaranties and security for any of the above, and all substitutions and replacements for, additions, accessions, attachments, accessories, and improvements to, and proceeds (including proceeds of any insurance policies, proceeds of proceeds and claims against third parties) of, any and all of the above, and all Borrower's books relating to any and all of the above. Silicon agrees to enter into subordination agreements with respect to equipment financing transactions of the Borrower entered into on or after the date hereof, with respect to equipment being purchased or acquired substantially concurrently with such financing transactions, provided that (i) the form of said agreement is acceptable to Silicon in its good faith business judgment, and (ii) the liens to which Silicon's security interest is to be subordinated are confined solely to the equipment so financed and the proceeds thereof and otherwise constitute Permitted Liens.

**3. REPRESENTATIONS, WARRANTIES AND COVENANTS OF BORROWER.**

In order to induce Silicon to enter into this Agreement and to make Loans, Borrower represents and warrants to Silicon as follows, and Borrower covenants that the following representations will continue to be true, and that Borrower will at all times comply with all of the following covenants, throughout the term of this Agreement and until all Obligations have been paid and performed in full (other than inchoate indemnity obligations of Borrower hereunder that survive any termination of this Agreement):

**3.1 Corporate Existence and Authority.** Borrower is and will continue to be, duly organized, validly existing and in good standing under the laws of the jurisdiction of its incorporation. Borrower is and will continue to be qualified and licensed to do business in all jurisdictions in which any failure to do so would result in a Material Adverse Change. The execution, delivery and performance by Borrower of this Agreement, and all other documents contemplated hereby (i) have been duly and validly authorized, (ii) are enforceable against Borrower in accordance with their terms (except as enforcement may be limited by equitable principles and by bankruptcy, insolvency, reorganization, moratorium or similar laws relating to creditors' rights generally), and (iii) do not violate Borrower's articles or certificate of incorporation, or Borrower's by-laws, or any law or any material agreement or instrument which is binding upon Borrower or its property, and (iv) do not constitute grounds for acceleration of any material indebtedness or obligation under any agreement or instrument which is binding upon Borrower or its property.

**3.2 Name; Trade Names and Styles.** The name of Borrower set forth in the heading to this Agreement is its correct name. Listed in the Representations are all prior names of Borrower and all of Borrower's present and prior trade names. Borrower shall give Silicon 30 days' prior written notice before changing its name or doing business under any other name. Borrower

has complied, and will in the future comply, in all material respects, with all laws relating to the conduct of business under a fictitious business name, except where the failure to so comply would not reasonably be expected to result in a Material Adverse Change.

**3.3 Place of Business; Location of Collateral.** The address set forth in the heading to this Agreement is Borrower's chief executive office. In addition, Borrower has places of business and Collateral is located only at the locations set forth in the Representations. Borrower will give Silicon at least 30 days prior written notice before opening any additional place of business, changing its chief executive office, or moving any of the Collateral to a location other than Borrower's Address or one of the locations set forth in the Representations, except that Borrower may maintain sales offices in the ordinary course of business at which not more than a total of \$10,000 fair market value of Equipment is located.

**3.4 Title to Collateral; Perfection; Permitted Liens.**

(a) Borrower is now, and will at all times in the future be, the sole owner of all the Collateral, except for items of Equipment which are leased to Borrower. The Collateral now is and will remain free and clear of any and all liens, charges, security interests, encumbrances and adverse claims, except for Permitted Liens. Silicon now has, and will continue to have, a first-priority perfected and enforceable security interest in all of the Collateral, subject only to the Permitted Liens, and Borrower will at all times defend Silicon and the Collateral against all claims of others (other than for rightful claims pertaining to the holders of Permitted Liens).

(b) Borrower has set forth in the Representations all of Borrower's Deposit Accounts, and Borrower will give Silicon five Business Days advance written notice before establishing any new Deposit Accounts and will cause the institution where any such new Deposit Account is maintained to execute and deliver to Silicon a control agreement in form sufficient to perfect Silicon's security interest in the Deposit Account and otherwise satisfactory to Silicon in its good faith business judgment. Nothing herein limits any requirements which may be set forth in the Schedule as to where Deposit Accounts will be maintained.

(c) In the event that Borrower shall at any time after the date hereof have any commercial tort claims against others, which it is asserting or intends to assert, and in which the potential recovery exceeds \$100,000, Borrower shall promptly notify Silicon thereof in writing and provide Silicon with such information regarding the same as Silicon shall request (unless providing such information would waive the Borrower's attorney-client privilege). Such notification to Silicon shall constitute a grant of a security interest in the commercial tort claim and all proceeds thereof to Silicon, and Borrower shall execute and deliver all such documents and take all such actions as Silicon shall reasonably request in connection therewith.

(d) None of the Collateral now is or will be affixed to any real property in such a manner, or with such intent, as to become a fixture. Borrower is not and will not become a lessee under any real property lease pursuant to which the lessor may obtain any rights in any of the Collateral and no such lease now prohibits, restrains, impairs or will prohibit, restrain or impair Borrower's right to remove any Collateral from the leased premises. Whenever any Collateral is located upon premises in which any third party has an interest, Borrower shall, whenever requested by Silicon, use its best efforts to cause such third party to execute and deliver to Silicon, in form acceptable to Silicon in its good faith business judgment, such waivers and subordinations as Silicon shall specify in its good faith business judgment, except when any such Collateral is in transit or located at any subcontractor's facility. Borrower will keep in full force and effect, and will comply with all material terms of, any lease of real property where any of the Collateral now or in the future may be located.

**3.5 Maintenance of Collateral.** Borrower will not use the Collateral for any unlawful purpose and will maintain the Collateral in good working condition (ordinary wear and tear excepted), subject, however, to any dispositions of Collateral that are otherwise specifically permitted and authorized hereunder. Borrower will immediately advise Silicon in writing of any material loss or damage in excess of \$150,000 to the Collateral.

**3.6 Books and Records.** Borrower has maintained and will maintain at Borrower's Address complete and accurate books and records, comprising an accounting system in accordance with GAAP.

**3.7 Financial Condition, Statements and Reports.** All financial statements now or in the future delivered to Silicon have been, and will be, prepared in conformity with GAAP and now and in the future will fairly present the results of operations and financial condition of Borrower, in accordance with GAAP, at the times and for the periods therein stated, provided that, interim financial statements may be subject to year end adjustments, although the lack of any such adjustments in any such interim financial statements shall not, in the reasonable judgment of the certifying officer at the time, render the interim financial statements misleading or reflect anything other than a fair presentation of such results of operations and the financial condition of Borrower. Between the last date covered by any such statement provided to Silicon and the date hereof, there has been no Material Adverse Change.

**3.8 Tax Returns and Payments; Pension Contributions.** Borrower has timely filed, and will timely file, all required tax returns and reports, and Borrower has timely paid, and will timely pay, all foreign, federal, state and local taxes, assessments,

deposits and contributions now or in the future owed by Borrower. Borrower may, however, defer payment of any contested taxes, provided that Borrower (i) in good faith contests Borrower's obligation to pay the taxes by appropriate proceedings promptly and diligently instituted and conducted, (ii) notifies Silicon in writing of the commencement of, and any material development in, any such proceedings involving more than \$100,000, and (iii) posts bonds or takes any other steps required to keep the contested taxes from becoming a lien upon any of the Collateral. Borrower is unaware of any claims or adjustments proposed for any of Borrower's prior tax years which could result in additional taxes becoming due and payable by Borrower. Borrower has paid, and shall continue to pay all amounts necessary to fund all present and future pension, profit sharing and deferred compensation plans in accordance with their terms, and Borrower has not and will not withdraw from participation in, permit partial or complete termination of, or permit the occurrence of any other event with respect to, any such plan which could reasonably be expected to result in any liability of Borrower, including any liability to the Pension Benefit Guaranty Corporation or its successors or any other governmental agency.

**3.9 Compliance with Law.** Borrower has, to the best of its knowledge, complied, and will comply, in all material respects, with all provisions of all foreign, federal, state and local laws and regulations applicable to Borrower, including, but not limited to, those relating to Borrower's ownership of real or personal property, the conduct and licensing of Borrower's business, and all environmental matters.

**3.10 Litigation.** There is no claim, suit, litigation, proceeding or investigation pending or (to best of Borrower's knowledge) threatened against or affecting Borrower in any court or before any governmental agency (or any basis therefor known to Borrower) which could reasonably be expected to result, either separately or in the aggregate, in any Material Adverse Change. Borrower will promptly inform Silicon in writing of any claim, proceeding, litigation or investigation in the future threatened or instituted against Borrower involving any single claim of \$50,000 or more, or involving \$100,000 or more in the aggregate.

**3.11 Use of Proceeds.** All proceeds of all Loans shall be used solely for lawful business purposes. Borrower is not purchasing or carrying any "margin stock" (as defined in Regulation U of the Board of Governors of the Federal Reserve System) and no part of the proceeds of any Loan will be used to purchase or carry any "margin stock" or to extend credit to others for the purpose of purchasing or carrying any "margin stock."

#### **4. ACCOUNTS.**

**4.1 Representations Relating to Accounts.** Borrower represents and warrants to Silicon as follows: Each Account with respect to which Loans are requested by Borrower shall, on the date each Loan is requested and made, (i) represent an undisputed bona fide existing unconditional obligation of the Account Debtor created by the sale, delivery, and per Borrower's contracts, the deemed acceptance of goods (which Borrower sends FOB point of shipping) or the rendition of services, or the non-exclusive licensing of Intellectual Property, in the ordinary course of Borrower's business, and (ii) meet the Minimum Eligibility Requirements set forth in Section 8 below.

**4.2 Representations Relating to Documents and Legal Compliance.** Borrower represents and warrants to Silicon as follows: To the best of Borrower's knowledge, all statements made and all unpaid balances appearing in all invoices, instruments and other documents evidencing the Accounts are and shall be true and correct and all such invoices, instruments and other documents and all of Borrower's books and records are and shall be genuine and in all respects what they purport to be. To the best of Borrower's knowledge, all sales and other transactions underlying or giving rise to each Account shall comply in all material respects with all applicable laws and governmental rules and regulations. To the best of Borrower's knowledge, all signatures and endorsements on all documents, instruments, and agreements relating to all Accounts are and shall be genuine, and all such documents, instruments and agreements are and shall be legally enforceable in accordance with their terms.

**4.3 Schedules and Documents relating to Accounts.** Borrower shall deliver to Silicon transaction reports and schedules of collections, as provided in the Schedule, on Silicon's standard forms; provided, however, that Borrower's failure to execute and deliver the same shall not affect or limit Silicon's security interest and other rights in all of Borrower's Accounts, nor shall Silicon's failure to advance or lend against a specific Account affect or limit Silicon's security interest and other rights therein. If requested by Silicon, Borrower shall furnish Silicon with copies (or, at Silicon's request, originals) of all contracts, orders, invoices, and other similar documents, and all shipping instructions, delivery receipts, bills of lading, and other evidence of delivery, for any goods the sale or disposition of which gave rise to such Accounts, and Borrower warrants the genuineness of all of the foregoing (to the best of its knowledge). Borrower shall also furnish to Silicon an aged accounts receivable trial balance as provided in the Schedule. In addition, Borrower shall deliver to Silicon, on its reasonable request, the originals of all instruments, chattel paper, security agreements, guarantees and other documents and property evidencing or securing any Accounts, in the same form as received, with all necessary indorsements, and copies of all credit memos.

**4.4 Collection of Accounts.** Borrower shall have the right to collect all Accounts, unless and until a Default or an Event of Default has occurred and is continuing. Whether or not an Event of Default has occurred and is continuing, Borrower shall

hold all payments on, and proceeds of, Accounts in trust for Silicon, and Borrower shall immediately (with term "immediately" meaning in this context within One Business Day) deliver all such payments and proceeds to Silicon in their original form, duly endorsed, by depositing the same into the lockbox or "blocked account" referred to below, to be applied to the Obligations in such order as Silicon shall determine. Silicon will require that all proceeds of Collateral be deposited by Borrower into a lockbox account, or such other "blocked account" as Silicon may specify, pursuant to a blocked account agreement in such form as Silicon may specify in its good faith business judgment.

**4.5. Remittance of Proceeds.** All proceeds arising from the disposition of any Collateral shall be delivered, in kind, by Borrower to Silicon in the original form in which received by Borrower not later than the following Business Day after receipt by Borrower, to be applied to the Obligations in such order as Silicon shall determine; provided that, if no Default or Event of Default has occurred and is continuing, Borrower shall not be obligated to remit to Silicon the proceeds of the sale of worn out or obsolete Equipment disposed of by Borrower in good faith in an arm's length transaction for an aggregate purchase price of \$25,000 or less (for all such transactions in any fiscal year). Borrower agrees that it will not commingle proceeds of Collateral with any of Borrower's other funds or property, but will hold such proceeds separate and apart from such other funds and property and in an express trust for Silicon. Nothing in this Section limits the restrictions on disposition of Collateral set forth elsewhere in this Agreement.

**4.6 Disputes.** Borrower shall notify Silicon promptly of all disputes or claims in excess of \$35,000 relating to Accounts. Borrower shall not forgive (completely or partially), compromise or settle any Account for less than payment in full, or agree to do any of the foregoing, except that Borrower may do so, provided that: (i) Borrower does so in good faith, in a commercially reasonable manner, in the ordinary course of business, and in arm's length transactions, which are reported to Silicon on the regular reports provided to Silicon; (ii) no Default or Event of Default has occurred and is continuing; and (iii) taking into account all such discounts, settlements and forgiveness, the total outstanding Loans will not exceed the Credit Limit.

**4.7 Returns.** Provided no Event of Default has occurred and is continuing, if any Account Debtor returns any Inventory to Borrower, Borrower shall promptly determine the reason for such return and if such return is customarily acceptable to Borrower under the circumstances, then Borrower shall promptly issue a credit memorandum to the Account Debtor in the appropriate amount. In the event any attempted return occurs after the occurrence and during the continuance of any Event of Default, Borrower shall hold the returned Inventory in trust for Silicon, and immediately notify Silicon of the return of the Inventory.

**4.8 Verification.** Silicon may, from time to time, verify directly with the respective Account Debtors the validity, amount and other matters relating to the Accounts, by means of mail, telephone or otherwise, either in the name of Borrower or Silicon or such other name as Silicon may choose.

**4.9 No Liability.** Silicon shall not be responsible or liable for any shortage or discrepancy in, damage to, or loss or destruction of, any goods, the sale or other disposition of which gives rise to an Account, or for any error, act, omission, or delay of any kind occurring in the settlement, failure to settle, collection or failure to collect any Account, or for settling any Account in good faith for less than the full amount thereof, nor shall Silicon be deemed to be responsible for any of Borrower's obligations under any contract or agreement giving rise to an Account. Nothing herein shall, however, relieve Silicon from liability for its own gross negligence or willful misconduct.

## **5. ADDITIONAL DUTIES OF BORROWER.**

**5.1 Financial and Other Covenants.** Borrower shall at all times comply with the financial and other covenants set forth in the Schedule.

**5.2 Insurance.** Borrower shall, at all times insure all of the tangible personal property Collateral and carry such other business insurance, with insurers reasonably acceptable to Silicon, in such form and amounts as Silicon may reasonably require and that are customary and in accordance with standard practices for Borrower's industry and locations, and Borrower shall provide evidence of such insurance to Silicon. All such property insurance policies shall name Silicon as an additional loss payee, and shall contain a lenders loss payee endorsement in form reasonably acceptable to Silicon. Upon receipt of the proceeds of any such insurance, Silicon shall promptly apply such proceeds in reduction of the Obligations in accordance with Silicon's standard procedures, except that, provided no Default or Event of Default has occurred and is continuing, Silicon shall release to Borrower insurance proceeds with respect to Equipment totaling less than \$100,000, which shall be utilized by Borrower for the replacement of the Equipment assets with respect to which the insurance proceeds were paid. Silicon may require reasonable assurance that the insurance proceeds so released will be so used. If Borrower fails to provide or pay for any insurance as described in this Section 5.2 or as may be otherwise required under the Loan Documents, Silicon may, but is not obligated to, obtain the same at Borrower's expense. Borrower shall promptly deliver to Silicon copies of all material reports made to insurance companies. Silicon hereby acknowledges that existing insurance policies are acceptable and comport with Section 5.2.

**5.3 Reports.** Borrower, at its expense, shall provide Silicon with the written reports set forth in the Schedule, and such other written reports with respect to Borrower (including budgets, sales projections, operating plans and other financial documentation), as Silicon shall from time to time specify in its good faith business judgment.

**5.4 Access to Collateral, Books and Records.** At reasonable times, and on one Business Day's prior notice, Silicon, or its agents, shall have the right to inspect the Collateral, and the right to audit and copy Borrower's books and records. The parties contemplate that such audits will be performed no more frequently than quarterly, but nothing herein restricts Silicon's right to conduct such audits more frequently if (i) Silicon believes that it is advisable to do so in Silicon's good faith business judgment, or (ii) Silicon believes in good faith that an event of default or an event which, with notice or passage of time or both would constitute an event of default, has occurred and is continuing. Silicon shall take reasonable steps to keep confidential all information obtained in any such inspection or audit, but Silicon shall have the right to disclose any such information to its auditors, regulatory agencies, and attorneys, and pursuant to any subpoena or other legal process. The foregoing inspections and audits shall be at Borrower's expense and the charge therefor shall be \$750 per person per day (or such higher amount as shall represent Silicon's then current standard charge for the same), plus reasonable out-of-pocket expenses. In the event Borrower and Silicon schedule an audit more than 10 days in advance, and Borrower seeks to reschedule the audit with less than five days' written notice to Silicon, then (without limiting any of Silicon's rights or remedies), Borrower shall pay Silicon a cancellation fee of \$1,000 plus any out-of-pocket expenses incurred by Silicon, to compensate Silicon for the anticipated costs and expenses of the cancellation.

**5.5 Negative Covenants.** Except as may be permitted in the Schedule, Borrower shall not, without Silicon's prior written consent (which shall be a matter of its good faith business judgment), do any of the following: (i) merge or consolidate with another corporation or entity; (ii) acquire any assets, except in the ordinary course of business; (iii) enter into any other transaction outside the ordinary course of business; (iv) sell or transfer any Collateral, except for the sale of finished Inventory in the ordinary course of Borrower's business, and except for the sale of obsolete or unneeded Equipment in the ordinary course of business and non-exclusive licenses and similar non-exclusive arrangements for the use of Intellectual Property; (v) store any Inventory or other Collateral with any warehouseman or other third party which has not executed and delivered to Silicon a bailee agreement or other similar agreement acceptable to Silicon in its good faith business judgment with respect to finished goods inventory, except when any such Collateral or Inventory is in transit or located at a subcontractor's facility; (vi) sell any Inventory on a sale-or-return, guaranteed sale, consignment, or other contingent basis other than for such customary and ordinary course return transactions arising from Borrower's product warranties; (vii) make any loans of any money or other assets, other than (a) travel advances to Borrower's employees in the ordinary course of business consistent with past business practices (including without limitation, for travel entertainment and relocation expenses) and in aggregate amounts consistent with past ordinary course business practices of Borrower; (b) extension of trade credit in the ordinary course of business to non-affiliated entities; (c) other loans and advances to employees, officers and directors, in the ordinary course of business in an aggregate principal amount not to exceed \$25,000, at any time outstanding for all such loans to all employees, officers and directors, provided, no new such loans and advances shall be made while any Default or Event of Default is then occurring; (viii) incur any debts, outside the ordinary course of business, which results in a Material Adverse Change; (ix) guarantee or otherwise become liable with respect to the obligations of another party or entity; (x) pay or declare any dividends on Borrower's stock (except for dividends payable solely in stock of Borrower); (xi) redeem, retire, purchase or otherwise acquire, directly or indirectly, any of Borrower's stock, except that Borrower may repurchase its stock in accordance with Borrower's employee stock option plan, provided that the aggregate amount of consideration paid by Borrower for such repurchases shall not exceed \$100,000 in the aggregate in any fiscal year, and before and after giving effect to any such repurchase no Default or Event of Default has occurred and is continuing; (xii) make any change in Borrower's capital structure which would result in a Material Adverse Change; or (xiii) engage, directly or indirectly, in any business other than the businesses currently engaged in by Borrower or reasonably related thereto; or (xiv) dissolve or elect to dissolve. Transactions permitted by the foregoing provisions of this Section are only permitted if no Default or Event of Default would occur as a result of such transaction.

**5.6 Litigation Cooperation.** Should any third-party suit or proceeding be instituted by or against Silicon with respect to any Collateral or relating to Borrower, Borrower shall, upon reasonable notice, without expense to Silicon, make available Borrower and its officers, employees and agents and Borrower's books and records, to the extent that Silicon may deem them reasonably necessary in order to prosecute or defend any such suit or proceeding.

**5.7 Further Assurances.** Borrower agrees, at its expense, on request by Silicon, to execute all documents and take all actions, as Silicon, may, in its good faith business judgment, deem reasonably necessary or useful in order to perfect and maintain Silicon's perfected first-priority security interest in the Collateral (subject to Permitted Liens), and in order to fully consummate the transactions contemplated by this Agreement.

## 6. TERM.

**6.1 Maturity Date.** This Agreement shall continue in effect until the maturity date set forth on the Schedule (the "Maturity Date"), subject to Section 6.3 below.

**6.2 Early Termination.** This Agreement may be terminated prior to the Maturity Date as follows: (i) by Borrower, effective three Business Days after written notice of termination is given to Silicon; or (ii) by Silicon at any time after the occurrence and during the continuance of an Event of Default, without notice, effective immediately. If this Agreement is terminated by Borrower or by Silicon under this Section 6.2, Borrower shall pay to Silicon a termination fee in an amount equal to \$40,000 plus one percent (1.0%) of the aggregate outstanding principal balance of the Term Loans, provided that no termination fee shall be charged if the credit facility hereunder is replaced with a new facility from another division of Silicon Valley Bank. The termination fee shall be due and payable on the effective date of termination and thereafter shall bear interest at a rate equal to the highest rate applicable to any of the Obligations.

**6.3 Payment of Obligations.** On the Maturity Date or on any earlier effective date of termination, Borrower shall pay and perform in full all Obligations (other than for any inchoate indemnity obligations of Borrower hereunder that survive termination of this Agreement), whether evidenced by installment notes or otherwise, and whether or not all or any part of such Obligations are otherwise then due and payable. Without limiting the generality of the foregoing, if on the Maturity Date, or on any earlier effective date of termination, there are any outstanding Letters of Credit issued by Silicon or issued by another institution based upon an application, guarantee, indemnity or similar agreement on the part of Silicon, then on such date Borrower shall provide to Silicon cash collateral in an amount equal to 105% of the face amount of all such Letters of Credit plus all interest, fees and cost due or to become due in connection therewith (as estimated by Silicon in its good faith business judgment, taking into account the excess of cash collateral over 100% of the face amount of such Letters of Credit), to secure all of the Obligations relating to said Letters of Credit, pursuant to Silicon's then standard form cash pledge agreement. Notwithstanding any termination of this Agreement, all of Silicon's security interests in all of the Collateral and all of the terms and provisions of this Agreement shall continue in full force and effect until all Obligations have been paid and performed in full; provided that Silicon may, in its sole discretion, refuse to make any further Loans after termination. No termination shall in any way affect or impair any right or remedy of Silicon, nor shall any such termination relieve Borrower of any Obligation to Silicon, until all of the Obligations (other than for any inchoate indemnity obligations of Borrower hereunder that survive termination of this Agreement) have been paid and performed in full. Upon payment and performance in full of all the Obligations and termination of this Agreement, Silicon shall promptly terminate its financing statements with respect to the Borrower and deliver to Borrower such other documents as may be required to fully terminate Silicon's security interests and Silicon shall further reassign and redeliver (or cause to be reassigned or redelivered) to Borrower, or to such person as Borrower shall designate, against receipt, such of the Borrower's assets delivered to Silicon as shall have not been sold or otherwise applied by Silicon pursuant to the terms of the Loan Documents that are still then held by Silicon.

## 7. EVENTS OF DEFAULT AND REMEDIES.

**7.1 Events of Default.** The occurrence of any of the following events shall constitute an "Event of Default" under this Agreement, and Borrower shall give Silicon immediate written notice thereof: (a) Any warranty, representation, statement, report or certificate made or delivered to Silicon by Borrower or any of Borrower's officers, employees or agents, now or in the future, shall be untrue or misleading in a material respect when made or deemed to be made; or (b) Borrower shall fail to pay when due any Loan or any interest thereon or any other monetary Obligation; or (c) the total Loans and other Obligations outstanding at any time shall exceed the Credit Limit provided, however, if an Overadvance results directly from a change by Silicon of either the amount of Reserves or of the "Minimum Eligibility Requirements", then if Borrower fails to pay such Overadvance within three Business Days of the occurrence of the Overadvance; or (d) Borrower shall fail to comply with any of the financial covenants set forth in the Schedule, or shall fail to perform any other non-monetary Obligation which by its nature cannot be cured, or shall fail to permit Silicon to conduct an inspection or audit as specified in Section 5.4 hereof; or (e) Borrower shall fail to perform any other non-monetary Obligation, which failure is not cured within five Business Days after the date due; or (f) any levy, assessment, attachment, seizure, lien or encumbrance (other than a Permitted Lien) is made on all or any part of the Collateral which is not cured within 10 days after the occurrence of the same; or (g) any default or event of default occurs under any obligation in excess of \$100,000, secured by a Permitted Lien, which is not cured within any applicable cure period or waived in writing by the holder of the Permitted Lien; or (h) Borrower breaches any material contract or obligation, which has resulted or may reasonably be expected to result in a Material Adverse Change; or (i) Dissolution, termination of existence, insolvency or business failure of Borrower; or appointment of a receiver, trustee or custodian, for all or any part of the property of, assignment for the benefit of creditors by, or the commencement of any proceeding by Borrower under any reorganization, bankruptcy, insolvency, arrangement, readjustment of debt, dissolution or liquidation law or statute of any jurisdiction, now or in the future in effect, which is not dismissed within 45 days after the date commenced; or (j) the commencement of any proceeding against Borrower or any guarantor of any of the Obligations under any reorganization, bankruptcy, insolvency, arrangement, readjustment of debt, dissolution or liquidation law or statute of any jurisdiction, now or in the future in effect, which is not cured by the dismissal thereof within 45 days after the date

commenced; or (k) revocation or termination of, or limitation or denial of liability upon, any guaranty of the Obligations or any attempt to do any of the foregoing, or commencement of proceedings by any guarantor of any of the Obligations under any bankruptcy or insolvency law; or (l) revocation or termination of, or limitation or denial of liability upon, any pledge of any certificate of deposit, securities or other property or asset of any kind pledged by any third party to secure any or all of the Obligations, or any attempt to do any of the foregoing, or commencement of proceedings by or against any such third party under any bankruptcy or insolvency law; or (m) Borrower makes any payment on account of any indebtedness or obligation which has been subordinated to the Obligations other than as permitted in the applicable subordination agreement, or if any Person who has subordinated such indebtedness or obligations terminates or in any way limits his subordination agreement; or (n) if a Person or group of affiliated Persons shall acquire, beneficially or of record, more than 30% of the outstanding shares of stock of Borrower, in one or more transactions, and such Person or group of affiliated Persons has "control" of the Borrower (which shall mean the effective ability to elect a majority of the Board of Directors of Borrower) (such acquisition and control referred to herein as a "Change in Control"), then Borrower shall notify Silicon of the Change in Control within five Business Days after Borrower has actual knowledge of the Change in Control, and if Silicon shall give written notice to Borrower that, in the exercise of its good faith business judgment it does not consent to the Change in Control then the same shall constitute an Event of Default; or (o) Borrower shall generally not pay its debts as they become due, or Borrower shall conceal, remove or transfer any part of its property, with intent to hinder, delay or defraud its creditors, or make or suffer any transfer of any of its property which may be fraudulent under any bankruptcy, fraudulent conveyance or similar law; or (p) a Material Adverse Change shall occur. Silicon may cease making any Loans hereunder during any of the above cure periods, and thereafter if an Event of Default has occurred and is continuing.

**7.2 Remedies.** Upon the occurrence and during the continuance of any Event of Default, and at any time thereafter, Silicon, at its option, and without notice or demand of any kind (all of which are hereby expressly waived by Borrower, to the extent permitted by law), may do any one or more of the following: (a) Cease making Loans or otherwise extending credit to Borrower under this Agreement or any other Loan Document; (b) Accelerate and declare all or any part of the Obligations to be immediately due, payable, and performable, notwithstanding any deferred or installment payments allowed by any instrument evidencing or relating to any Obligation; (c) Take possession of any or all of the Collateral wherever it may be found, and for that purpose Borrower hereby authorizes Silicon without judicial process (subject to the rights of any landlord regarding any of Borrower's leased premises) to enter onto any of Borrower's premises without interference to search for, take possession of, keep, store, or remove any of the Collateral, and remain on the premises or cause a custodian to remain on the premises in exclusive control thereof, without charge for so long as Silicon deems it necessary, in its good faith business judgment, in order to complete the enforcement of its rights under this Agreement or any other agreement; provided, however, that should Silicon seek to take possession of any of the Collateral by court process, Borrower hereby irrevocably waives: (i) any bond and any surety or security relating thereto required by any statute, court rule or otherwise as an incident to such possession; (ii) any demand for possession prior to the commencement of any suit or action to recover possession thereof; and (iii) any requirement that Silicon retain possession of, and not dispose of, any such Collateral until after trial or final judgment; (d) Require Borrower to assemble any or all of the Collateral and make it available to Silicon at places designated by Silicon which are reasonably convenient to Silicon and Borrower, and to remove the Collateral to such locations as Silicon may deem advisable; (e) Complete the processing, manufacturing or repair of any Collateral prior to a disposition thereof and, for such purpose and for the purpose of removal, Silicon shall have the right to use Borrower's premises, vehicles, hoists, lifts, cranes, and other Equipment and all other property without charge; (f) Sell, lease or otherwise dispose of any of the Collateral, in its condition at the time Silicon obtains possession of it or after further manufacturing, processing or repair, at one or more public and/or private sales, in lots or in bulk, for cash, exchange or other property, or on credit, and to adjourn any such sale from time to time without notice other than oral announcement at the time scheduled for sale. Silicon shall have the right to conduct such disposition on Borrower's premises (subject to the rights of any landlord regarding any of Borrower's leased premises) without charge, for such time or times as Silicon deems reasonable, or on Silicon's premises, or elsewhere and the Collateral need not be located at the place of disposition. Silicon may directly or through any affiliated company purchase or lease any Collateral at any such public disposition, and if permissible under applicable law, at any private disposition. Any sale or other disposition of Collateral shall not relieve Borrower of any liability Borrower may have if any Collateral is defective as to title or physical condition or otherwise at the time of sale; (g) Demand payment of, and collect any Accounts and General Intangibles comprising Collateral and, in connection therewith, Borrower irrevocably authorizes Silicon to endorse or sign Borrower's name on all collections, receipts, instruments and other documents, to take possession of and open mail addressed to Borrower and remove therefrom payments made with respect to any item of the Collateral or proceeds thereof, and, in Silicon's good faith business judgment, to grant extensions of time to pay, compromise claims and settle Accounts and the like for less than face value; (h) Offset against any sums in any of Borrower's general, special or other Deposit Accounts with Silicon against any or all of the Obligations; and (i) Demand and receive possession of any of Borrower's federal and state income tax returns and the books and records utilized in the preparation thereof or referring thereto. All reasonable attorneys' fees, expenses, costs, liabilities and obligations incurred by Silicon with respect to the foregoing shall be added to and become part of the Obligations, shall be due on demand, and shall bear interest at a rate equal to the highest interest rate applicable to any of the Obligations. Without limiting any of Silicon's rights and remedies,

from and after the occurrence and during the continuance of any Event of Default, the interest rate applicable to the Obligations shall be increased by an additional four percent per annum (the "Default Rate").

**7.3 Standards for Determining Commercial Reasonableness.** Borrower and Silicon agree that a sale or other disposition (collectively, "sale") of any Collateral which complies with the following standards will conclusively be deemed to be commercially reasonable: (i) Notice of the sale is given to Borrower at least ten days prior to the sale, and, in the case of a public sale, notice of the sale is published at least five days before the sale in a newspaper of general circulation in the county where the sale is to be conducted; (ii) Notice of the sale describes the collateral in general, non-specific terms; (iii) The sale is conducted at a place designated by Silicon, with or without the Collateral being present; (iv) The sale commences at any time between 8:00 a.m. and 6:00 p.m. (in the time zone where collateral is located); (v) Payment of the purchase price in cash or by cashier's check or wire transfer is required; (vi) With respect to any sale of any of the Collateral, Silicon may (but is not obligated to) direct any prospective purchaser to ascertain directly from Borrower any and all information concerning the same. Silicon shall be free to employ other methods of noticing and selling the Collateral, in its discretion, if they are commercially reasonable.

**7.4 Power of Attorney.** Upon the occurrence and during the continuance of any Event of Default, without limiting Silicon's other rights and remedies, Borrower grants to Silicon an irrevocable power of attorney coupled with an interest, authorizing and permitting Silicon (acting through any of its employees, attorneys or agents) at any time, at its option, but without obligation, with or without notice to Borrower, and at Borrower's expense, to do any or all of the following, in Borrower's name or otherwise, but Silicon agrees that if it exercises any right hereunder, it will do so in good faith and in a commercially reasonable manner: (a) Execute on behalf of Borrower any documents that Silicon may, in its good faith business judgment, deem advisable in order to perfect and maintain Silicon's security interest in the Collateral, or in order to exercise a right of Borrower or Silicon, or in order to fully consummate all the transactions contemplated under this Agreement, and all other Loan Documents; (b) Execute on behalf of Borrower, any invoices relating to any Account, any draft against any Account Debtor and any notice to any Account Debtor, any proof of claim in bankruptcy, any Notice of Lien, claim of mechanic's, materialman's or other lien, or assignment or satisfaction of mechanic's, materialman's or other lien; (c) Take control in any manner of any cash or non-cash items of payment or proceeds of Collateral; endorse the name of Borrower upon any instruments, or documents, evidence of payment or Collateral that may come into Silicon's possession; (d) Endorse all checks and other forms of remittances received by Silicon; (e) Pay, contest or settle any lien, charge, encumbrance, security interest and adverse claim in or to any of the Collateral, or any judgment based thereon, or otherwise take any action to terminate or discharge the same; (f) Grant extensions of time to pay, compromise claims and settle Accounts and General Intangibles for less than face value and execute all releases and other documents in connection therewith; (g) Pay any sums required on account of Borrower's taxes or to secure the release of any liens therefor, or both; (h) Settle and adjust, and give releases of, any insurance claim that relates to any of the Collateral and obtain payment therefor; (i) Instruct any third party having custody or control of any books or records belonging to, or relating to, Borrower to give Silicon the same rights of access and other rights with respect thereto as Silicon has under this Agreement; and (j) Take any action or pay any sum required of Borrower pursuant to this Agreement and any other Loan Documents. Any and all reasonable sums paid and any and all reasonable costs, expenses, liabilities, obligations and attorneys' fees incurred by Silicon with respect to the foregoing shall be added to and become part of the Obligations, shall be payable on demand, and shall bear interest at a rate equal to the highest interest rate applicable to any of the Obligations. In no event shall Silicon's rights under the foregoing power of attorney or any of Silicon's other rights under this Agreement be deemed to indicate that Silicon is in control of the business, management or properties of Borrower. The foregoing power of attorney shall expire upon payment in full of the Obligations (other than for inchoate indemnity obligations which survive the termination of this Agreement) and the termination of this Agreement.

**7.5 Application of Proceeds.** All proceeds realized as the result of any sale of the Collateral shall be applied by Silicon first to the reasonable costs, expenses, liabilities, obligations and attorneys' fees incurred by Silicon in the exercise of its rights under this Agreement, second to the interest due upon any of the Obligations, and third to the principal of the Obligations, in such order as Silicon shall determine in its sole discretion. Any surplus shall be paid to Borrower or other persons legally entitled thereto; Borrower shall remain liable to Silicon for any deficiency. If, Silicon, in its good faith business judgment, directly or indirectly enters into a deferred payment or other credit transaction with any purchaser at any sale of Collateral, Silicon shall have the option, exercisable at any time, in its good faith business judgment, of either reducing the Obligations by the principal amount of purchase price or deferring the reduction of the Obligations until the actual receipt by Silicon of the cash therefor.

**7.6 Remedies Cumulative.** In addition to the rights and remedies set forth in this Agreement, Silicon shall have all the other rights and remedies accorded a secured party under the California Uniform Commercial Code and under all other applicable laws, and under any other instrument or agreement now or in the future entered into between Silicon and Borrower, and all of such rights and remedies are cumulative and none is exclusive. Exercise or partial exercise by Silicon of one or more of its rights or remedies shall not be deemed an election, nor bar Silicon from subsequent exercise or partial exercise of

any other rights or remedies. The failure or delay of Silicon to exercise any rights or remedies shall not operate as a waiver thereof, but all rights and remedies shall continue in full force and effect until all of the Obligations have been fully paid and performed.

8. **DEFINITIONS.** As used in this Agreement, the following terms have the following meanings:

“Account Debtor” means the obligor on an Account.

“Accounts” means all present and future “accounts” as defined in the California Uniform Commercial Code in effect on the date hereof with such additions to such term as may hereafter be made, and includes without limitation all accounts receivable and other sums owing to Borrower.

“Affiliate” means, with respect to any Person, a relative, partner, shareholder, director, officer, or employee of such Person, or any parent or subsidiary of such Person, or any Person controlling, controlled by or under common control with such Person.

“Business Day” means a day on which Silicon is open for business.

“Code” means the Uniform Commercial Code as adopted and in effect in the State of California from time to time.

“Collateral” has the meaning set forth in Section 2 above.

“continuing” and “during the continuance of” when used with reference to a Default or Event of Default means that the Default or Event of Default has occurred and has not been either waived in writing by Silicon or cured within any applicable cure period.

“Default” means any event which with notice or passage of time or both, would constitute an Event of Default.

“Default Rate” has the meaning set forth in Section 7.2 above.

“Deposit Accounts” means all present and future “deposit accounts” as defined in the California Uniform Commercial Code in effect on the date hereof with such additions to such term as may hereafter be made, and includes without limitation all general and special bank accounts, demand accounts, checking accounts, savings accounts and certificates of deposit.

“Eligible Inventory” [Not Applicable]

“Eligible Accounts” means Accounts and General Intangibles arising in the ordinary course of Borrower’s business from the sale of goods or the rendition of services, or the non-exclusive licensing of Intellectual Property, which Silicon, in its good faith business judgment, shall deem eligible for borrowing. Without limiting the fact that the determination of which Accounts are eligible for borrowing is a matter of Silicon’s good faith business judgment, the following (the “Minimum Eligibility Requirements”) are the minimum requirements for an Account to be an Eligible Account: (i) the Account must not be outstanding for more than 90 days from its invoice date (the “Eligibility Period”), (ii) the Account must not represent progress billings, or be due under a fulfillment or requirements contract with the Account Debtor, (iii) the Account must not be subject to any contingencies (including Accounts arising from sales on consignment, guaranteed sale or other terms pursuant to which payment by the Account Debtor may be conditional) other than for potential customary and ordinary course returns arising from Borrower’s product warranties, (iv) the Account must not be owing from an Account Debtor with whom Borrower has any dispute (whether or not relating to the particular Account), (v) the Account must not be owing from an Affiliate of Borrower, (vi) the Account must not be owing from an Account Debtor which is subject to any insolvency or bankruptcy proceeding, or whose financial condition is not acceptable to Silicon, or which, fails or goes out of a material portion of its business, (vii) the Account must not be owing from the United States or any department, agency or instrumentality thereof (unless there has been compliance, to Silicon’s satisfaction, with the United States Assignment of Claims Act), (viii) the Account must not be owing from an Account Debtor located outside the United States or Canada (unless pre-approved by Silicon in its discretion in writing, or backed by a letter of credit satisfactory to Silicon, or FCIA insured satisfactory to Silicon), (ix) the Account must not be owing from an Account Debtor to whom Borrower is or may be liable for goods purchased from such Account Debtor or otherwise (but, in such case, the Account will be deemed not eligible only to the extent of any amounts owed by Borrower to such Account Debtor). Accounts owing from one Account Debtor will not be deemed Eligible Accounts to the extent they exceed 25% of the total Accounts outstanding. In addition, if more than 50% of the Accounts owing from an Account Debtor are outstanding for a period longer than their Eligibility Period (without regard to unapplied credits) or are otherwise not eligible Accounts, then all Accounts owing from that Account Debtor will be deemed ineligible for borrowing. Silicon may, from time to time, in its good faith business judgment, revise the Minimum Eligibility Requirements, upon written notice to Borrower.

“Equipment” means all present and future “equipment” as defined in the California Uniform Commercial Code in effect on the date hereof with such additions to such term as may hereafter be made, and includes without limitation all machinery, fixtures, goods, vehicles (including motor vehicles and trailers), and any interest in any of the foregoing.

“Event of Default” means any of the events set forth in Section 7.1 of this Agreement.

“GAAP” means generally accepted accounting principles consistently applied.

“General Intangibles” means all present and future “general intangibles” as defined in the California Uniform Commercial Code in effect on the date hereof with such additions to such term as may hereafter be made, and includes without limitation all Intellectual Property, payment intangibles, royalties, contract rights, goodwill, franchise agreements, purchase orders, customer lists, route lists, telephone numbers, domain names, claims, income tax refunds, security and other deposits, options to purchase or sell real or personal property, rights in all litigation presently or hereafter pending (whether in contract, tort or otherwise), insurance policies (including without limitation key man, property damage, and business interruption insurance), payments of insurance and rights to payment of any kind.

“good faith business judgment” means honesty in fact and good faith (as defined in Section 1201 of the Code) in the exercise of Silicon’s business judgment.

“including” means including (but not limited to).

“Intellectual Property” means all present and future (a) copyrights, copyright rights, copyright applications, copyright registrations and like protections in each work of authorship and derivative work thereof, whether published or unpublished, (b) trade secret rights, including all rights to unpatented inventions and know-how, and confidential information; (c) mask work or similar rights available for the protection of semiconductor chips; (d) patents, patent applications and like protections including without limitation improvements, divisions, continuations, renewals, reissues, extensions and continuations-in-part of the same; (e) trademarks, servicemarks, trade styles, and trade names, whether or not any of the foregoing are registered, and all applications to register and registrations of the same and like protections, and the entire goodwill of the business of Borrower connected with and symbolized by any such trademarks; (f) computer software and computer software products; (g) designs and design rights; (h) technology; (i) all claims for damages by way of past, present and future infringement of any of the rights included above; (j) all licenses or other rights to use any property or rights of a type described above.

“Inventory” means all present and future “inventory” as defined in the California Uniform Commercial Code in effect on the date hereof with such additions to such term as may hereafter be made, and includes without limitation all merchandise, raw materials, parts, supplies, packing and shipping materials, work in process and finished products, including without limitation such inventory as is temporarily out of Borrower’s custody or possession or in transit and including any returned goods and any documents of title representing any of the above.

“Investment Property” means all present and future investment property, securities, stocks, bonds, debentures, debt securities, partnership interests, limited liability company interests, options, security entitlements, securities accounts, commodity contracts, commodity accounts, and all financial assets held in any securities account or otherwise, and all options and warrants to purchase any of the foregoing, wherever located, and all other securities of every kind, whether certificated or uncertificated.

“Loan Documents” means, collectively, this Agreement, the Representations, and all other present and future documents, instruments and agreements between Silicon and Borrower, including, but not limited to those relating to this Agreement, and all amendments and modifications thereto and replacements therefor.

“Material Adverse Change” means any of the following: (i) a material adverse change in the business, operations, or financial or other condition of the Borrower, or (ii) a material impairment of the prospect of repayment of any portion of the Obligations; or (iii) a material impairment of the value or priority of Silicon’s security interests in the Collateral.

“Obligations” means all present and future Loans, advances, debts, liabilities, obligations, guaranties, covenants, duties and indebtedness at any time owing by Borrower to Silicon, whether evidenced by this Agreement or any note or other instrument or document, or otherwise, whether arising from an extension of credit, opening of a letter of credit, banker’s acceptance, loan, guaranty, indemnification or otherwise, whether direct or indirect (including, without limitation, those acquired by assignment and any participation by Silicon in Borrower’s debts owing to others), absolute or contingent, due or to become due, including, without limitation, all interest, charges, expenses, fees, attorney’s fees, expert witness fees, audit fees, letter of credit fees, collateral monitoring fees, closing fees, facility fees, termination fees, minimum interest charges and any other sums chargeable to Borrower under this Agreement or under any other Loan Documents.

“Other Property” means the following as defined in the California Uniform Commercial Code in effect on the date hereof with such additions to such term as may hereafter be made, and all rights relating thereto: all present and future “commercial tort claims” (including without limitation any commercial tort claims identified in the Representations), “documents”, “instruments”, “promissory notes”, “chattel paper”, “letters of credit”, “letter-of-credit rights”, “fixtures”, “farm products” and “money”; and all other goods and personal property of every kind, tangible and intangible, whether or not governed by the California Uniform Commercial Code.

“Permitted Liens” means the following: (i) purchase money security interests in specific items of Equipment; (ii) leases of specific items of Equipment; (iii) liens for taxes not yet payable; (iv) additional security interests and liens consented to in writing by Silicon, which consent may be withheld in its good faith business judgment; (v) security interests being terminated substantially concurrently with this Agreement; (vi) liens of materialmen, mechanics, warehousemen, carriers, or other similar liens arising in the ordinary course of business and securing obligations which are not delinquent; (vii) liens incurred in connection with the extension, renewal or refinancing of the indebtedness secured by liens of the type described above in clauses (i) or (ii) above, provided that any extension, renewal or replacement lien is limited to the property encumbered by the existing lien and the principal amount of the indebtedness being extended, renewed or refinanced does not increase; (viii) Liens in favor of customs and revenue authorities which secure payment of customs duties in connection with the importation of goods. Silicon will have the right to require, as a condition to its consent under subparagraph (iv) above, that the holder of the additional security interest or lien sign an intercreditor agreement on Silicon’s then standard form, acknowledge that the security interest is subordinate to the security interest in favor of Silicon, and agree not to take any action to enforce its subordinate security interest so long as any Obligations remain outstanding, and that Borrower agree that any uncured default in any obligation secured by the subordinate security interest shall also constitute an Event of Default under this Agreement.

“Person” means any individual, sole proprietorship, partnership, joint venture, trust, unincorporated organization, association, corporation, government, or any agency or political division thereof, or any other entity.

“Representations” means the written Representations and Warranties provided by Borrower to Silicon referred to in the Schedule.

“Reserves” means, as of any date of determination, such amounts as Silicon may from time to time establish and revise in its good faith business judgment, reducing the amount of Loans, Letters of Credit and other financial accommodations which would otherwise be available to Borrower under the lending formula(s) provided in the Schedule: (a) to reflect events, conditions, contingencies or risks which, as determined by Silicon in its good faith business judgment, do or may adversely affect (i) the Collateral or any other property which is security for the Obligations or its value (including without limitation any increase in delinquencies of Accounts), (ii) the assets, business or prospects of Borrower or any Guarantor, or (iii) the security interests and other rights of Silicon in the Collateral (including the enforceability, perfection and priority thereof); or (b) to reflect Silicon’s good faith belief that any collateral report or financial information furnished by or on behalf of Borrower or any Guarantor to Silicon is or may have been incomplete, inaccurate or misleading in any material respect; or (c) in respect of any state of facts which Silicon determines in good faith constitutes an Event of Default or may, with notice or passage of time or both, constitute an Event of Default.

Other Terms. All accounting terms used in this Agreement, unless otherwise indicated, shall have the meanings given to such terms in accordance with GAAP, consistently applied. All other terms contained in this Agreement, unless otherwise indicated, shall have the meanings provided by the Code, to the extent such terms are defined therein.

## **9. GENERAL PROVISIONS.**

**9.1 Interest Computation.** In computing interest on the Obligations, all checks, wire transfers and other items of payment received by Silicon (including proceeds of Accounts and payment of the Obligations in full) shall be deemed applied by Silicon on account of the Obligations two Business Days after receipt by Silicon of immediately available funds, and, for purposes of the foregoing, any such funds received after 12:00 Noon on any day shall be deemed received on the next Business Day. Silicon shall not, however, be required to credit Borrower’s account for the amount of any item of payment which is unsatisfactory to Silicon in its good faith business judgment, and Silicon may charge Borrower’s loan account for the amount of any item of payment which is returned to Silicon unpaid.

**9.2 Application of Payments.** All payments with respect to the Obligations shall be promptly applied in accordance with this Agreement and Silicon’s standard procedures may be applied, and in Silicon’s good faith business judgment may be reversed and re-applied, to the Obligations, in such order and manner as Silicon shall determine in its good faith business judgment.

**9.3 Charges to Accounts.** Silicon may, in its discretion, require that Borrower pay monetary Obligations in cash to Silicon, or charge them to Borrower’s Loan account, in which event they will bear interest at the same rate applicable to the Loans. Silicon may also, in its discretion, charge any monetary Obligations to Borrower’s Deposit Accounts maintained with Silicon.

**9.4 Monthly Accountings.** Silicon shall provide Borrower monthly with an account of advances, charges, expenses and payments made pursuant to this Agreement. Such account shall be deemed correct, accurate and binding on Borrower and an account stated (except for reverses and reapplications of payments made and corrections of errors discovered by Silicon), unless Borrower notifies Silicon in writing to the contrary within 90 days after such account is rendered, describing the nature of any alleged errors or omissions.

**9.5 Notices.** All notices to be given under this Agreement shall be in writing and shall be given either personally or by reputable private delivery service or by regular first-class mail, or certified mail return receipt requested, addressed to Silicon or Borrower at the addresses shown in the heading to this Agreement, or at any other address designated in writing by one party to the other party. Notices to Silicon shall be directed to the Commercial Finance Division, to the attention of the Division Manager or the Division Credit Manager. All notices shall be deemed to have been given upon delivery in the case of notices personally delivered, or at the expiration of one Business Day following delivery to the private delivery service, or two Business Days following the deposit thereof in the United States mail, with postage prepaid.

**9.6 Severability.** Should any provision of this Agreement be held by any court of competent jurisdiction to be void or unenforceable, such defect shall not affect the remainder of this Agreement, which shall continue in full force and effect.

**9.7 Integration.** This Agreement and such other written agreements, documents and instruments as may be executed in connection herewith are the final, entire and complete agreement between Borrower and Silicon and supersede all prior and contemporaneous negotiations and oral representations and agreements, all of which are merged and integrated in this Agreement. There are no oral understandings, representations or agreements between the parties which are not set forth in this Agreement or in other written agreements signed by the parties in connection herewith.

**9.8 Waivers; Indemnity.** The failure of Silicon at any time or times to require Borrower to strictly comply with any of the provisions of this Agreement or any other Loan Document shall not waive or diminish any right of Silicon later to demand and receive strict compliance therewith. Any waiver of any default shall not waive or affect any other default, whether prior or subsequent, and whether or not similar. None of the provisions of this Agreement or any other Loan Document shall be deemed to have been waived by any act or knowledge of Silicon or its agents or employees, but only by a specific written waiver signed by an authorized officer of Silicon and delivered to Borrower. Borrower waives the benefit of all statutes of limitations relating to any of the Obligations or this Agreement or any other Loan Document, and Borrower waives demand, protest, notice of protest and notice of default or dishonor, notice of payment and nonpayment, release, compromise, settlement, extension or renewal of any commercial paper, instrument, account, General Intangible, document or guaranty at any time held by Silicon on which Borrower is or may in any way be liable, and notice of any action taken by Silicon, unless expressly required by this Agreement. Borrower hereby agrees to indemnify Silicon and its affiliates, subsidiaries, parent, directors, officers, employees, agents, and attorneys, and to hold them harmless from and against any and all claims, debts, liabilities, demands, obligations, actions, causes of action, penalties, costs and expenses (including reasonable attorneys' fees), of every kind, which they may sustain or incur based upon or arising out of any of the Obligations, or any relationship or agreement between Silicon and Borrower, or any other matter, relating to Borrower or the Obligations; provided that this indemnity shall not extend to damages proximately caused by the indemnitee's own gross negligence or willful misconduct. A Person seeking to be indemnified under this Section 9.8 shall make commercially reasonable efforts to notify Borrower of any event requiring indemnification within a reasonable time following such Person's receipt of notice of commencement of any action or proceeding giving rise to a claim for indemnification hereunder, provided that (i) there shall be no obligation to so notify Borrower if an Event of Default has occurred and is continuing, (ii) neither Silicon nor any such Person shall have any liability or obligation for any inadvertent failure to provide such notice, (iii) no failure to provide such notice shall affect Borrower's obligation to provide indemnity hereunder and (iv) in any event, nothing herein shall impose on Silicon any duty or obligation to impair the confidentiality or sanctity of its attorney client relationship. In such proceeding, such Person shall use commercially reasonable efforts to keep Borrower reasonably informed of its defense and any settlement of any such action or proceeding and negotiations to settle or otherwise resolve any claim, provided that (i) such Person shall have the exclusive right to decide to accept or reject any settlement offer, (ii) there shall be no obligation to keep Borrower so informed if an Event of Default has occurred and is continuing, (iii) neither Silicon nor any such Person shall have any liability or obligation for any inadvertent failure to keep Borrower so informed, (iv) no failure to keep Borrower so informed shall affect Borrower's obligation to provide indemnity hereunder and (v) in any event, nothing herein shall impose on Silicon any duty or obligation to impair the confidentiality or sanctity of its attorney client relationship. Notwithstanding any provision in this Agreement to the contrary, the indemnity agreement set forth in this Section shall survive any termination of this Agreement and shall for all purposes continue in full force and effect.

**9.9 No Liability for Ordinary Negligence.** Neither Silicon, nor any of its directors, officers, employees, agents, attorneys or any other Person affiliated with or representing Silicon shall be liable for any claims, demands, losses or damages, of any kind whatsoever, made, claimed, incurred or suffered by Borrower or any other party through the ordinary negligence of Silicon, or any of its directors, officers, employees, agents, attorneys or any other Person affiliated with or representing Silicon, but nothing herein shall relieve Silicon from liability for its own gross negligence or willful misconduct.

**9.10 Amendment.** The terms and provisions of this Agreement may not be waived or amended, except in a writing executed by Borrower and a duly authorized officer of Silicon.

**9.11 Time of Essence.** Time is of the essence in the performance by Borrower of each and every obligation under this Agreement.

**9.12 Attorneys Fees and Costs.** Borrower shall reimburse Silicon for all reasonable attorneys' fees and all filing, recording, search, title insurance, appraisal, audit, and other reasonable costs incurred by Silicon, pursuant to, or in connection with, or relating to this Agreement (whether or not a lawsuit is filed), including, but not limited to, any reasonable attorneys' fees and costs Silicon incurs in order to do the following: prepare and negotiate this Agreement and all present and future documents relating to this Agreement; obtain legal advice in connection with this Agreement or Borrower; enforce, or seek to enforce, any of its rights; prosecute actions against, or defend actions by, Account Debtors; commence, intervene in, or defend any action or proceeding; initiate any complaint to be relieved of the automatic stay in bankruptcy; file or prosecute any probate claim, bankruptcy claim, third-party claim, or other claim; examine, audit, copy, and inspect any of the Collateral or any of Borrower's books and records; protect, obtain possession of, lease, dispose of, or otherwise enforce Silicon's security interest in, the Collateral; and otherwise represent Silicon in any litigation relating to Borrower. In satisfying Borrower's obligation hereunder to reimburse Silicon for attorneys fees, Borrower may, for convenience, issue checks directly to Silicon's attorneys, Levy, Small & Lallas, but Borrower acknowledges and agrees that Levy, Small & Lallas is representing only Silicon and not Borrower in connection with this Agreement. If either Silicon or Borrower files any lawsuit against the other predicated on a breach of this Agreement, the prevailing party in such action shall be entitled to recover its reasonable costs and attorneys' fees, including (but not limited to) reasonable attorneys' fees and costs incurred in the enforcement of, execution upon or defense of any order, decree, award or judgment. All attorneys' fees and costs to which Silicon may be entitled pursuant to this Paragraph shall immediately become part of Borrower's Obligations, shall be due on demand, and shall bear interest at a rate equal to the highest interest rate applicable to any of the Obligations.

**9.13 Benefit of Agreement.** The provisions of this Agreement shall be binding upon and inure to the benefit of the respective successors, assigns, heirs, beneficiaries and representatives of Borrower and Silicon; provided, however, that Borrower may not assign or transfer any of its rights under this Agreement without the prior written consent of Silicon, and any prohibited assignment shall be void. No consent by Silicon to any assignment shall release Borrower from its liability for the Obligations.

**9.14 Joint and Several Liability.** If Borrower consists of more than one Person, their liability shall be joint and several, and the compromise of any claim with, or the release of, any Borrower shall not constitute a compromise with, or a release of, any other Borrower.

**9.15 Limitation of Actions.** Any claim or cause of action by Borrower against Silicon, its directors, officers, employees, agents, accountants or attorneys, based upon, arising from, or relating to this Loan Agreement, or any other Loan Document, or any other transaction contemplated hereby or thereby or relating hereto or thereto, or any other matter, cause or thing whatsoever, occurred, done, omitted or suffered to be done by Silicon, its directors, officers, employees, agents, accountants or attorneys, shall be barred unless asserted by Borrower by the commencement of an action or proceeding in a court of competent jurisdiction by the filing of a complaint within one year after the first act, occurrence or omission upon which such claim or cause of action, or any part thereof, is based, and the service of a summons and complaint on an officer of Silicon, or on any other person authorized to accept service on behalf of Silicon, within thirty (30) days thereafter. Borrower agrees that such one-year period is a reasonable and sufficient time for Borrower to investigate and act upon any such claim or cause of action. The one-year period provided herein shall not be waived, tolled, or extended except by the written consent of Silicon in its sole discretion. This provision shall survive any termination of this Loan Agreement or any other Loan Document.

**9.16 Paragraph Headings; Construction.** Paragraph headings are only used in this Agreement for convenience. Borrower and Silicon acknowledge that the headings may not describe completely the subject matter of the applicable paragraph, and the headings shall not be used in any manner to construe, limit, define or interpret any term or provision of this Agreement. This Agreement has been fully reviewed and negotiated between the parties and no uncertainty or ambiguity in any term or provision of this Agreement shall be construed strictly against Silicon or Borrower under any rule of construction or otherwise.

**9.17 Governing Law; Jurisdiction; Venue.** This Agreement and all acts and transactions hereunder and all rights and obligations of Silicon and Borrower shall be governed by the laws of the State of California. As a material part of the consideration to Silicon to enter into this Agreement, Borrower (i) agrees that all actions and proceedings relating directly or indirectly to this Agreement shall, at Silicon's option, be litigated in courts located within California, and that the exclusive venue therefor shall be Santa Clara County; (ii) consents to the jurisdiction and venue of any such court and consents to service of process in any such action or proceeding by personal delivery or any other method permitted by law; and (iii) waives any and all rights Borrower may have to object to the jurisdiction of any such court, or to transfer or change the venue of any such action or proceeding.

**9.18 Mutual Waiver of Jury Trial. BORROWER AND SILICON EACH HEREBY WAIVE THE RIGHT TO TRIAL BY JURY IN ANY ACTION OR PROCEEDING BASED UPON, ARISING OUT OF, OR IN ANY WAY RELATING TO, THIS AGREEMENT OR ANY OTHER PRESENT OR FUTURE INSTRUMENT OR AGREEMENT BETWEEN SILICON AND BORROWER, OR ANY CONDUCT, ACTS OR OMISSIONS OF**

**SILICON OR BORROWER OR ANY OF THEIR DIRECTORS, OFFICERS, EMPLOYEES, AGENTS, ATTORNEYS OR ANY OTHER PERSONS AFFILIATED WITH SILICON OR BORROWER, IN ALL OF THE FOREGOING CASES, WHETHER SOUNDING IN CONTRACT OR TORT OR OTHERWISE.**

**Borrower:**

**ENDOCARDIAL SOLUTIONS, INC.**

**By /s/ J. Robert Paulson, Jr.  
Vice President, CFO**

**By /s/ J. Robert Paulson, Jr.  
Secretary or Ass't Secretary**

**Silicon:**

**SILICON VALLEY BANK**

**By /s/ J. Anthony Clarkson  
Title Vice President Market Manager**

**Silicon Valley Bank**

**Schedule to  
Loan and Security Agreement**

**Borrower:** Endocardial Solutions, Inc.  
**Address:** 1350 Energy Lane, Suite 110  
St. Paul, MN 55108

**Date:** September 24, 2003

This Schedule forms an integral part of the Loan and Security Agreement between Silicon Valley Bank and the above-borrower of even date.

**1. CREDIT LIMIT**  
(Section 1.1):

An amount not to exceed the sum of 1, 2 and 3 below:

1. Revolving Loans. An amount equal to: (A) the lesser of: (i) **\$3,000,000** at any one time outstanding (the "Maximum Credit Limit"), or (ii) **75%** (an "Advance Rate") of the amount of Borrower's Eligible Accounts (as defined in Section 8 above) minus (B) the Term Loans (as defined below).

Silicon may, from time to time, modify the Advance Rate, in its good faith business judgment, upon notice to the Borrower, based on changes in collection experience with respect to Accounts or other issues or factors relating to the Accounts or other Collateral.

plus

2. Existing Term Loans. An amount equal to the aggregate unpaid principal balance from time to time outstanding of the Existing Term Loans (the "Existing Term Loans"). The outstanding principal amount of Existing Term Loan #1 as of the date hereof is **\$114,000**. The outstanding principal balance amount of Existing Term Loan #2 as of the date hereof is **\$426,400**. No additional Existing Term Loans will be made. The Existing Term Loans shall continue to be repaid as provided for herein.

plus

3. 2003 Term Loans. An amount equal to the aggregate unpaid principal balance from time to time outstanding of the Loans ("2003 Term Loans") made from time to time by Silicon to

Borrower in a total amount not to exceed **\$1,000,000** for the purchase by Borrower of new or used Equipment acceptable to Silicon in its sole discretion, including computer equipment, office equipment, lab equipment, test equipment and furnishings. To evidence each of the 2003 Term Loans, Borrower shall deliver to Silicon, at the time of each 2003 Term Loan request, an invoice for the Equipment (a) to be purchased or (b) which was previously purchased by the Borrower. The Loan request with respect to any particular Equipment must be made within 90 days of the date such Equipment was purchased. The 2003 Term Loans shall be used only to (a) purchase Equipment or (b) reimburse the Borrower for previously purchased Equipment and shall not exceed **100%** of the invoice amount of such Equipment approved from time to time by Silicon; provided that the aggregate amount of the Equipment Loans for (i) the purchase or license of software, (ii) leasehold improvements and (iii) other soft costs, including sales tax, freight and installation expenses shall not exceed **35%** of each 2003 Term Loan. Subject to and upon the terms and conditions of this Agreement, 2003 Term Loans shall be available through the following periods: (i) from the date of this Agreement through November 30, 2003 ("Draw Period #1"); (ii) from December 1, 2003 through February 29, 2004 ("Draw Period #2"); (iii) from March 1, 2004 through May 30, 2004 ("Draw Period #3) and (iv) from June 1, 2004 through August 31, 2004 ("Draw Period #4). The 2003 Term Loans outstanding as of the end of each Draw Period shall be repaid as provided for herein. Interest shall accrue from the date of each 2003 Term Loan at the rate provided for herein and is payable monthly as provided for herein. 2003 Term Loans shall be made in disbursements of not less than \$100,000.

The Term Loans, once repaid, cannot be reborrowed.

Notwithstanding the foregoing, all Obligations relating to the Term Loans shall be reserved against the Revolving Loans which would otherwise be available to Borrower as set forth above.

As used in this Agreement, the term "Term Loans" includes the Existing Term Loans and the 2003 Term Loans, and the term "Loans" includes the Revolving Loans and the Term Loans.

**Letter of Credit Sublimit**  
(Section 1.6):

**\$750,000.**

**Exim Agreement;  
Cross-Collateralization;  
Cross-Default:**

Silicon and the Borrower are parties to that certain Loan and Security Agreement (Exim Program) of even date (the "Exim Agreement"). Both this Agreement and the Exim Agreement shall continue in full force and effect, and all rights and remedies under this Agreement and

the Exim Agreement are cumulative. The term "Obligations" as used in this Agreement and in the Exim Agreement shall include without limitation the obligation to pay when due all Loans made pursuant to this Agreement (the "Non-Exim Loans") and all interest thereon and the obligation to pay when due all Loans made pursuant to the Exim Agreement (the "Exim Loans") and all interest thereon. Without limiting the generality of the foregoing, all "Collateral" as defined in this Agreement and as defined in the Exim Agreement shall secure all Exim Loans and all Non-Exim Loans and all interest thereon, and all other Obligations. Any Event of Default under this Agreement shall also constitute an Event of Default under the Exim Agreement, and any Event of Default under the Exim Agreement shall also constitute an Event of Default under this Agreement. In the event Silicon assigns its rights under the Exim Agreement and/or under any Note evidencing Exim Loans and/or its rights under this Agreement and/or under any Note evidencing Non-Exim Loans, to any third party, including without limitation the Export-Import Bank of the United States ("Exim Bank"), whether before or after the occurrence of any Event of Default, Silicon shall have the right (but not any obligation), in its sole discretion, to allocate and apportion Collateral to the Agreement and/or Note assigned and to specify the priorities of the respective security interests in such Collateral between itself and the assignee, all without notice to or consent of the Borrower.

**2. INTEREST.**

**Interest Rate** (Section 1.2):

With respect to all Loans:

A rate equal to the "Prime Rate" in effect from time to time, plus **1.50%** per annum, provided that the interest rate in effect on any day shall not be less than **5.75%** per annum. Interest shall be calculated on the basis of a 360-day year for the actual number of days elapsed. As used in this Agreement, "Prime Rate" means the interest rate announced from time to time by Silicon as its "prime rate" (which is a base rate upon which other rates charged by Silicon are based, and it is not necessarily the best rate available at Silicon). The interest rate applicable to the Obligations shall change on each date there is a change in the Prime Rate.

**Minimum Monthly Interest** (Section 1.2):

\$5,000 per month in the aggregate as between this Agreement and the Exim Agreement.

**3. FEES (Section 1.4):**

Loan Fee: With respect to the Revolving Loans and Exim Loans:

\$25,000, payable concurrently herewith.

With respect to the 2003 Term Loans:

\$5,000, payable concurrently herewith.

Collateral Monitoring Fee:

\$1,250, per month in the aggregate as between this Agreement and the Exim Agreement, payable in arrears (prorated for any partial month at the beginning and at termination of this Agreement).

**4. MATURITY DATE**  
(Section 6.1):

The first anniversary of the date of this Agreement.

Notwithstanding the foregoing, with respect to Existing Term Loan #1: The outstanding principal balance of Existing Term Loan #1 shall continue to be repaid by Borrower to Silicon as provided for in the Existing Term Loan Documentation in equal monthly payments of principal, on the 30th day of each month and continuing until the earlier of the following dates: (i) June 30, 2004, or (ii) the date Existing Term Loan #1 has been indefeasibly paid in full, or (iii) the date the Revolving Loans are terminated, or (iv) the date this Agreement terminates by its terms or is terminated by either party in accordance with its terms. On the earlier to occur of the foregoing dates, the entire unpaid principal balance of Existing Term Loan #1, plus all accrued and unpaid interest thereon, shall be due and payable. Interest on Existing Term Loan #1 shall be payable monthly as provided in Section 1.2 of this Agreement.

Notwithstanding the foregoing, with respect to Existing Term Loan #2: The outstanding principal balance of Existing Term Loan #2 shall continue to be repaid by Borrower to Silicon as provided for in the Existing Term Loan Documentation in equal monthly payments of principal, on the 30th day of each month and continuing until the earlier of the following dates: (i) March 30, 2005, or (ii) the date Existing Term Loan #2 has been indefeasibly paid in full, or (iii) the date the Revolving Loans are terminated, or (iv) the date this Agreement terminates by its terms or is terminated by either party in accordance with its terms. On the earlier to occur of the foregoing dates, the entire unpaid principal balance of Existing Term Loan #2, plus all accrued and unpaid interest thereon, shall be due and payable.

Interest on Existing Term Loan #2 shall be payable monthly as provided in Section 1.2 of this Agreement.

Notwithstanding the foregoing, with respect to the 2003 Term Loans: The outstanding principal balance of the 2003 Term Loans as of the end of each applicable Draw Period shall be repaid by Borrower to Silicon in thirty-three (33) equal monthly payments of principal, commencing on the last day of the calendar month in which the applicable Draw Period ends and continuing on the same day of each subsequent month until the earlier of the following dates: (i) the date such 2003 Term Loan has been indefeasibly paid in full, or (ii) the date the Revolving Loans are terminated, or (iii) the date this Agreement terminates by its terms or is terminated by either party in accordance with its terms. On the earlier to occur of the foregoing dates, the entire unpaid principal balance of the 2003 Term Loans, plus all accrued and unpaid interest thereon, shall be due and payable. Interest on each 2003 Term Loan shall be payable monthly as provided in Section 1.2 of this Agreement.

**5. FINANCIAL COVENANTS**  
(Section 5.1):

Borrower shall comply with each of the following covenants. Compliance shall be determined as of the end of each month, except as otherwise specifically provided below:

**Minimum Tangible  
Net Worth:**

Borrower shall maintain a Tangible Net Worth of not less than **\$9,000,000**.

**Definitions.**

For purposes of the foregoing financial covenants, the following term shall have the following meaning:

“Current assets”, “current liabilities” and “liabilities” shall have the meaning ascribed thereto by GAAP.

“Tangible Net Worth” shall mean the excess of total assets over total liabilities, determined in accordance with GAAP, with the following adjustments:

(A) there shall be excluded from assets: (i) notes, accounts receivable and other obligations owing to Borrower from its officers or other Affiliates, and (ii) all assets which would be classified as intangible assets under GAAP, including without limitation goodwill, licenses, patents, trademarks, trade names, copyrights, capitalized software and organizational costs, licenses and franchises

(B) there shall be excluded from liabilities: all indebtedness which is subordinated to the Obligations under a subordination agreement

in form specified by Silicon or by language in the instrument evidencing the indebtedness which Silicon agrees in writing is acceptable to Silicon in its good faith business judgment.

**6. REPORTING.**  
(Section 5.3):

Borrower shall provide Silicon with the following:

1. Transaction reports and schedules of collections, each week and at the time of each Loan request, on Silicon's standard form
2. Monthly accounts receivable agings, aged by invoice date, within twenty days after the end of each month.
3. Monthly accounts payable agings, aged by invoice date, and outstanding or held check registers, if any, within twenty days after the end of each month.
4. Monthly reconciliations of accounts receivable agings (aged by invoice date), transaction reports, and general ledger, within twenty days after the end of each month.
5. A copy of the Board of Director's Report each time a Board of Director's meeting is held and, in any event, within thirty days of the date of such meeting.
6. Monthly unaudited financial statements, as soon as available, and in any event within thirty days after the end of each month.
7. Monthly Compliance Certificates, within thirty days after the end of each month, in such form as Silicon shall reasonably specify, signed by the Chief Financial Officer of Borrower, certifying that as of the end of such month Borrower was in full compliance with all of the terms and conditions of this Agreement, and setting forth calculations showing compliance with the financial covenants set forth in this Agreement and such other information as Silicon shall reasonably request, including, without limitation, a statement that at the end of such month there were no held checks.
8. Quarterly unaudited financial statements, as soon as available, and in any event within forty-five days after the end of each fiscal quarter of Borrower.
9. Annual operating budgets (including income statements, balance sheets and cash flow statements, by month) for the upcoming fiscal year of Borrower within thirty days prior to the end of each fiscal year of Borrower.
10. Annual financial statements, as soon as available, and in any event within 120 days following the end of Borrower's fiscal year,

certified by, and with an unqualified opinion of, independent certified public accountants acceptable to Silicon.

**7. BORROWER INFORMATION:**

Borrower represents and warrants that the information set forth in the Representations and Warranties of the Borrower dated July 27, 2003, previously submitted to Silicon (the "Representations") is true and correct as of the date hereof.

**8. ADDITIONAL PROVISIONS**

- (1) **Banking Relationship.** Borrower shall at all times maintain its primary banking relationship, including without limitation its primary operating account, with Silicon. Without limiting the generality of the foregoing, Borrower shall, at all times, maintain not less than 100% of its total cash and investments on deposit with Silicon.
- (2) **Subordination of Inside Debt.** All present and future indebtedness of Borrower to its officers, directors and shareholders ("Inside Debt") shall, at all times, be subordinated to the Obligations pursuant to a subordination agreement on Silicon's standard form. Borrower represents and warrants that there is no Inside Debt presently outstanding, except for the following: None. Prior to incurring any Inside Debt in the future, Borrower shall cause the person to whom such Inside Debt will be owed to execute and deliver to Silicon a subordination agreement on Silicon's standard form.

Borrower:

Silicon:

ENDOCARDIAL SOLUTIONS, INC.

SILICON VALLEY BANK

By /s/ J. Robert Paulson, Jr.  
Vice President, CFO

By /s/ J. Anthony Clarkson  
Title Vice President Market Manager

By /s/ J. Robert Paulson, Jr.  
Ass't Secretary

Form: -3 (3/7/02)  
Version -4

DOC 3 : Header

**Exhibit 10.3**

**Silicon Valley Bank**

**Loan and Security Agreement  
(Exim Program)**

**Borrower: Endocardial Solutions, Inc.  
Address: 1350 Energy Lane, Suite 110  
St. Paul, MN 55108**

**Date: September 24, 2003**

**THIS LOAN AND SECURITY AGREEMENT** is entered into on the above date between SILICON VALLEY BANK ("Silicon"), whose address is 3003 Tasman Drive, Santa Clara, California 95054 and the borrower(s) named above (jointly and severally, the "Borrower"), whose chief executive office is located at the above address ("Borrower's Address"). The Schedule to this Agreement (the "Schedule") shall for all purposes be deemed to be a part of this Agreement, and the same is an integral part of this Agreement. (Definitions of certain terms used in this Agreement are set forth in Section 8 below.)

**1. LOANS.**

**1.1 Loans.** Silicon will make loans to Borrower (the "Loans") up to the amounts (the "Credit Limit") shown on the Schedule, provided no Default or Event of Default has occurred and is continuing, and subject to deduction of Reserves for accrued interest and such other Reserves as Silicon deems proper from time to time in its good faith business judgment.

**1.2 Interest.** All Loans and all other monetary Obligations shall bear interest at the rate shown on the Schedule, except where expressly set forth to the contrary in this Agreement. Interest shall be payable monthly, on the last day of the month. Interest may, in Silicon's discretion, be charged as a Loan hereunder to Borrower's loan account, and the same shall thereafter bear interest at the same rate as the other Loans. Silicon may alternatively, in its discretion, charge interest to Borrower's Deposit Accounts maintained with Silicon. Regardless of the amount of Obligations that may be outstanding from time to time, Borrower shall pay Silicon minimum monthly interest during the term of this Agreement in the amount set forth on the Schedule (the "Minimum Monthly Interest").

**1.3 Overadvances.** If at any time or for any reason the total of all outstanding Loans and all other monetary Obligations exceeds the Credit Limit (an "Overadvance"), Borrower shall immediately pay the amount of the excess to Silicon, without notice or demand, provided that under ordinary circumstances, but without any obligation to do so, Silicon will use its best efforts to contact the Borrower regarding the payment of any such Overadvance. Without limiting Borrower's obligation to repay to Silicon the amount of any Overadvance, Borrower agrees to pay Silicon interest on the outstanding amount of any Overadvance, on demand, at the Default Rate.

**1.4 Fees.** Borrower shall pay Silicon the fees shown on the Schedule, which are in addition to all interest and other sums payable to Silicon and are not refundable.

**1.5 Loan Requests.** To obtain a Loan, Borrower shall make a request to Silicon by facsimile or telephone. Loan requests received after 12:00 Noon will not be considered by Silicon until the next Business Day. Silicon may rely on any telephone request for a Loan given by a person whom Silicon believes is an authorized representative of Borrower, and Borrower will indemnify Silicon for any loss Silicon suffers as a result of that reliance.

**1.6 Letters of Credit.** [Not Applicable.]

**2. SECURITY INTEREST.** To secure the payment and performance of all of the Obligations when due, Borrower hereby grants to Silicon a security interest in all of the following (collectively, the "Collateral"): all right, title and interest of Borrower in and to all of the following, whether now owned or hereafter arising or acquired and wherever located: all Accounts; all Inventory; all Equipment; all Deposit Accounts; all General Intangibles (including without limitation all Intellectual Property); all Investment Property; all Other Property; and any and all claims, rights and interests in any of the above, and all guaranties and security for any of the above, and all substitutions and replacements for, additions, accessions, attachments, accessories, and improvements to, and proceeds (including proceeds of any insurance policies, proceeds of proceeds and claims against third parties) of, any and all of the above, and all Borrower's books relating to any and all of the above. Silicon agrees to enter into subordination agreements with respect to equipment financing transactions of the Borrower entered into on or after the date hereof, with respect to equipment being purchased or acquired substantially concurrently with such financing transactions, provided that (i) the form of said agreement is acceptable to Silicon in its good faith business judgment, and (ii) the liens to which Silicon's security interest is to be subordinated are confined solely to the equipment so financed and the proceeds thereof and otherwise constitute Permitted Liens.

**3. REPRESENTATIONS, WARRANTIES AND COVENANTS OF BORROWER.**

In order to induce Silicon to enter into this Agreement and to make Loans, Borrower represents and warrants to Silicon as follows, and Borrower covenants that the following representations will continue to be true, and that Borrower will at all times comply with all of the following covenants, throughout the term of this Agreement and until all Obligations have been paid and performed in full (other than inchoate indemnity obligations of Borrower hereunder that survive any termination of this Agreement):

**3.1 Corporate Existence and Authority.** Borrower is and will continue to be, duly organized, validly existing and in good standing under the laws of the jurisdiction of its incorporation. Borrower is and will continue to be qualified and licensed to do business in all jurisdictions in which any failure to do so would result in a Material Adverse Change. The execution, delivery and performance by Borrower of this Agreement, and all other documents contemplated hereby (i) have been duly and validly authorized, (ii) are enforceable against Borrower in accordance with their terms (except as enforcement may be limited by equitable principles and by bankruptcy, insolvency, reorganization, moratorium or similar laws relating to creditors' rights generally), and (iii) do not violate Borrower's articles or certificate of incorporation, or Borrower's by-laws, or any law or any material agreement or instrument which is binding upon Borrower or its property, and (iv) do not constitute grounds for acceleration of any material indebtedness or obligation under any agreement or instrument which is binding upon Borrower or its property.

**3.2 Name; Trade Names and Styles.** The name of Borrower set forth in the heading to this Agreement is its correct name. Listed in the Representations are all prior names of Borrower and all of Borrower's present and prior trade names. Borrower shall give Silicon 30 days' prior written notice before changing its name or doing business under any other name. Borrower has complied, and will in the future comply, in all material respects, with all laws relating to the conduct of business under a fictitious business name, except where the failure to so comply would not reasonably be expected to result in a Material Adverse Change.

**3.3 Place of Business; Location of Collateral.** The address set forth in the heading to this Agreement is Borrower's chief executive office. In addition, Borrower has places of business and Collateral is located only at the locations set forth in the Representations. Borrower will give Silicon at least 30 days prior written notice before opening any additional place of business, changing its chief executive office, or moving any of the Collateral to a location other than Borrower's Address or one of the locations set forth in the Representations, except that Borrower may maintain sales offices in the ordinary course of business at which not more than a total of \$10,000 fair market value of Equipment is located.

**3.4 Title to Collateral; Perfection; Permitted Liens.**

(a) Borrower is now, and will at all times in the future be, the sole owner of all the Collateral, except for items of Equipment which are leased to Borrower. The Collateral now is and will remain free and clear of any and all liens, charges, security interests, encumbrances and adverse claims, except for Permitted Liens. Silicon now has, and will continue to have, a first-priority perfected and enforceable security interest in all of the Collateral, subject only to the Permitted Liens, and Borrower will at all times defend Silicon and the Collateral against all claims of others (other than for rightful claims pertaining to the holders of Permitted Liens).

(b) Borrower has set forth in the Representations all of Borrower's Deposit Accounts, and Borrower will give Silicon five Business Days advance written notice before establishing any new Deposit Accounts and will cause the institution where any such new Deposit Account is maintained to execute and deliver to Silicon a control agreement in form sufficient to perfect Silicon's security interest in the Deposit Account and otherwise satisfactory to Silicon in its good faith business

judgment. Nothing herein limits any requirements which may be set forth in the Schedule as to where Deposit Accounts will be maintained.

(c) In the event that Borrower shall at any time after the date hereof have any commercial tort claims against others, which it is asserting or intends to assert, and in which the potential recovery exceeds \$100,000, Borrower shall promptly notify Silicon thereof in writing and provide Silicon with such information regarding the same as Silicon shall request (unless providing such information would waive the Borrower's attorney-client privilege). Such notification to Silicon shall constitute a grant of a security interest in the commercial tort claim and all proceeds thereof to Silicon, and Borrower shall execute and deliver all such documents and take all such actions as Silicon shall reasonably request in connection therewith.

(d) None of the Collateral now is or will be affixed to any real property in such a manner, or with such intent, as to become a fixture. Borrower is not and will not become a lessee under any real property lease pursuant to which the lessor may obtain any rights in any of the Collateral and no such lease now prohibits, restrains, impairs or will prohibit, restrain or impair Borrower's right to remove any Collateral from the leased premises. Whenever any Collateral is located upon premises in which any third party has an interest, Borrower shall, whenever requested by Silicon, use its best efforts to cause such third party to execute and deliver to Silicon, in form acceptable to Silicon in its good faith business judgment, such waivers and subordinations as Silicon shall specify in its good faith business judgment, except when any such Collateral is in transit or located at any subcontractor's facility. Borrower will keep in full force and effect, and will comply with all material terms of, any lease of real property where any of the Collateral now or in the future may be located.

**3.5 Maintenance of Collateral.** Borrower will not use the Collateral for any unlawful purpose and will maintain the Collateral in good working condition (ordinary wear and tear excepted), subject, however, to any dispositions of Collateral that are otherwise specifically permitted and authorized hereunder. Borrower will immediately advise Silicon in writing of any material loss or damage in excess of \$150,000 to the Collateral.

**3.6 Books and Records.** Borrower has maintained and will maintain at Borrower's Address complete and accurate books and records, comprising an accounting system in accordance with GAAP.

**3.7 Financial Condition, Statements and Reports.** All financial statements now or in the future delivered to Silicon have been, and will be, prepared in conformity with GAAP and now and in the future will fairly present the results of operations and financial condition of Borrower, in accordance with GAAP, at the times and for the periods therein stated, provided that, interim financial statements may be subject to year end adjustments, although the lack of any such adjustments in any such interim financial statements shall not, in the reasonable judgment of the certifying officer at the time, render the interim financial statements misleading or reflect anything other than a fair presentation of such results of operations and the financial condition of Borrower. Between the last date covered by any such statement provided to Silicon and the date hereof, there has been no Material Adverse Change.

**3.8 Tax Returns and Payments; Pension Contributions.** Borrower has timely filed, and will timely file, all required tax returns and reports, and Borrower has timely paid, and will timely pay, all foreign, federal, state and local taxes, assessments, deposits and contributions now or in the future owed by Borrower. Borrower may, however, defer payment of any contested taxes, provided that Borrower (i) in good faith contests Borrower's obligation to pay the taxes by appropriate proceedings promptly and diligently instituted and conducted, (ii) notifies Silicon in writing of the commencement of, and any material development in, any such proceedings involving more than \$100,000, and (iii) posts bonds or takes any other steps required to keep the contested taxes from becoming a lien upon any of the Collateral. Borrower is unaware of any claims or adjustments proposed for any of Borrower's prior tax years which could result in additional taxes becoming due and payable by Borrower. Borrower has paid, and shall continue to pay all amounts necessary to fund all present and future pension, profit sharing and deferred compensation plans in accordance with their terms, and Borrower has not and will not withdraw from participation in, permit partial or complete termination of, or permit the occurrence of any other event with respect to, any such plan which could reasonably be expected to result in any liability of Borrower, including any liability to the Pension Benefit Guaranty Corporation or its successors or any other governmental agency.

**3.9 Compliance with Law.** Borrower has, to the best of its knowledge, complied, and will comply, in all material respects, with all provisions of all foreign, federal, state and local laws and regulations applicable to Borrower, including, but not limited to, those relating to Borrower's ownership of real or personal property, the conduct and licensing of Borrower's business, and all environmental matters.

**3.10 Litigation.** There is no claim, suit, litigation, proceeding or investigation pending or (to best of Borrower's knowledge) threatened against or affecting Borrower in any court or before any governmental agency (or any basis therefor known to Borrower) which could reasonably be expected to result, either separately or in the aggregate, in any Material Adverse Change. Borrower will promptly inform Silicon in writing of any claim, proceeding, litigation or investigation in the future threatened or instituted against Borrower involving any single claim of \$50,000 or more, or involving \$100,000 or more in the aggregate.

**3.11 Use of Proceeds.** All proceeds of all Loans shall be used solely for lawful business purposes. Borrower is not purchasing or carrying any "margin stock" (as defined in Regulation U of the Board of Governors of the Federal Reserve System) and no part of the proceeds of any Loan will be used to purchase or carry any "margin stock" or to extend credit to others for the purpose of purchasing or carrying any "margin stock."

#### **4. ACCOUNTS.**

**4.1 Representations Relating to Accounts.** Borrower represents and warrants to Silicon as follows: Each Account with respect to which Loans are requested by Borrower shall, on the date each Loan is requested and made, (i) represent an undisputed bona fide existing unconditional obligation of the Account Debtor created by the sale, delivery, and per Borrower's contracts, the deemed acceptance of goods (which Borrower sends FOB point of shipping) or the rendition of services, or the non-exclusive licensing of Intellectual Property, in the ordinary course of Borrower's business, and (ii) meet the Minimum Eligibility Requirements set forth in Section 8 below.

**4.2 Representations Relating to Documents and Legal Compliance.** Borrower represents and warrants to Silicon as follows: To the best of Borrower's knowledge, all statements made and all unpaid balances appearing in all invoices, instruments and other documents evidencing the Accounts are and shall be true and correct and all such invoices, instruments and other documents and all of Borrower's books and records are and shall be genuine and in all respects what they purport to be. To the best of Borrower's knowledge, all sales and other transactions underlying or giving rise to each Account shall comply in all material respects with all applicable laws and governmental rules and regulations. To the best of Borrower's knowledge, all signatures and endorsements on all documents, instruments, and agreements relating to all Accounts are and shall be genuine, and all such documents, instruments and agreements are and shall be legally enforceable in accordance with their terms.

**4.3 Schedules and Documents relating to Accounts.** Borrower shall deliver to Silicon transaction reports and schedules of collections, as provided in the Schedule, on Silicon's standard forms; provided, however, that Borrower's failure to execute and deliver the same shall not affect or limit Silicon's security interest and other rights in all of Borrower's Accounts, nor shall Silicon's failure to advance or lend against a specific Account affect or limit Silicon's security interest and other rights therein. If requested by Silicon, Borrower shall furnish Silicon with copies (or, at Silicon's request, originals) of all contracts, orders, invoices, and other similar documents, and all shipping instructions, delivery receipts, bills of lading, and other evidence of delivery, for any goods the sale or disposition of which gave rise to such Accounts, and Borrower warrants the genuineness of all of the foregoing (to the best of its knowledge). Borrower shall also furnish to Silicon an aged accounts receivable trial balance as provided in the Schedule. In addition, Borrower shall deliver to Silicon, on its reasonable request, the originals of all instruments, chattel paper, security agreements, guarantees and other documents and property evidencing or securing any Accounts, in the same form as received, with all necessary indorsements, and copies of all credit memos.

**4.4 Collection of Accounts.** Borrower shall have the right to collect all Accounts, unless and until a Default or an Event of Default has occurred and is continuing. Whether or not an Event of Default has occurred and is continuing, Borrower shall hold all payments on, and proceeds of, Accounts in trust for Silicon, and Borrower shall immediately (with term "immediately" meaning in this context within One Business Day) deliver all such payments and proceeds to Silicon in their original form, duly endorsed, by depositing the same into the lockbox or "blocked account" referred to below, to be applied to the Obligations in such order as Silicon shall determine. Silicon will require that all proceeds of Collateral be deposited by Borrower into a lockbox account, or such other "blocked account" as Silicon may specify, pursuant to a blocked account agreement in such form as Silicon may specify in its good faith business judgment.

**4.5 Remittance of Proceeds.** All proceeds arising from the disposition of any Collateral shall be delivered, in kind, by Borrower to Silicon in the original form in which received by Borrower not later than the following Business Day after receipt by Borrower, to be applied to the Obligations in such order as Silicon shall determine; provided that, if no Default or Event of Default has occurred and is continuing, Borrower shall not be obligated to remit to Silicon the proceeds of the sale of worn out or obsolete Equipment disposed of by Borrower in good faith in an arm's length transaction for an aggregate purchase price of \$25,000 or less (for all such transactions in any fiscal year). Borrower agrees that it will not commingle proceeds of Collateral with any of Borrower's other funds or property, but will hold such proceeds separate and apart from such other funds and property and in an express trust for Silicon. Nothing in this Section limits the restrictions on disposition of Collateral set forth elsewhere in this Agreement.

**4.6 Disputes.** Borrower shall notify Silicon promptly of all disputes or claims in excess of \$35,000 relating to Accounts. Borrower shall not forgive (completely or partially), compromise or settle any Account for less than payment in full, or agree to do any of the foregoing, except that Borrower may do so, provided that: (i) Borrower does so in good faith, in a commercially reasonable manner, in the ordinary course of business, and in arm's length transactions, which are reported to Silicon on the regular reports provided to Silicon; (ii) no Default or Event of Default has occurred and is continuing; and (iii) taking into account all such discounts, settlements and forgiveness, the total outstanding Loans will not exceed the Credit Limit.

**4.7 Returns.** Provided no Event of Default has occurred and is continuing, if any Account Debtor returns any Inventory to Borrower, Borrower shall promptly determine the reason for such return and if such return is customarily acceptable to Borrower under the circumstances, then Borrower shall promptly issue a credit memorandum to the Account Debtor in the appropriate amount. In the event any attempted return occurs after the occurrence and during the continuance of any Event of Default, Borrower shall hold the returned Inventory in trust for Silicon, and immediately notify Silicon of the return of the Inventory.

**4.8 Verification.** Silicon may, from time to time, verify directly with the respective Account Debtors the validity, amount and other matters relating to the Accounts, by means of mail, telephone or otherwise, either in the name of Borrower or Silicon or such other name as Silicon may choose.

**4.9 No Liability.** Silicon shall not be responsible or liable for any shortage or discrepancy in, damage to, or loss or destruction of, any goods, the sale or other disposition of which gives rise to an Account, or for any error, act, omission, or delay of any kind occurring in the settlement, failure to settle, collection or failure to collect any Account, or for settling any Account in good faith for less than the full amount thereof, nor shall Silicon be deemed to be responsible for any of Borrower's obligations under any contract or agreement giving rise to an Account. Nothing herein shall, however, relieve Silicon from liability for its own gross negligence or willful misconduct.

## **5. ADDITIONAL DUTIES OF BORROWER.**

**5.1 Financial and Other Covenants.** Borrower shall at all times comply with the financial and other covenants set forth in the Schedule.

**5.2 Insurance.** Borrower shall, at all times insure all of the tangible personal property Collateral and carry such other business insurance, with insurers reasonably acceptable to Silicon, in such form and amounts as Silicon may reasonably require and that are customary and in accordance with standard practices for Borrower's industry and locations, and Borrower shall provide evidence of such insurance to Silicon. All such property insurance policies shall name Silicon as an additional loss payee, and shall contain a lenders loss payee endorsement in form reasonably acceptable to Silicon. Upon receipt of the proceeds of any such insurance, Silicon shall promptly apply such proceeds in reduction of the Obligations in accordance with Silicon's standard procedures, except that, provided no Default or Event of Default has occurred and is continuing, Silicon shall release to Borrower insurance proceeds with respect to Equipment totaling less than \$100,000, which shall be utilized by Borrower for the replacement of the Equipment assets with respect to which the insurance proceeds were paid. Silicon may require reasonable assurance that the insurance proceeds so released will be so used. If Borrower fails to provide or pay for any insurance as described in this Section 5.2 or as may be otherwise required under the Loan Documents, Silicon may, but is not obligated to, obtain the same at Borrower's expense. Borrower shall promptly deliver to Silicon copies of all material reports made to insurance companies. Silicon hereby acknowledges that existing insurance policies are acceptable and comport with Section 5.2.

**5.3 Reports.** Borrower, at its expense, shall provide Silicon with the written reports set forth in the Schedule, and such other written reports with respect to Borrower (including budgets, sales projections, operating plans and other financial documentation), as Silicon shall from time to time specify in its good faith business judgment.

**5.4 Access to Collateral, Books and Records.** At reasonable times, and on one Business Day's prior notice, Silicon, or its agents, shall have the right to inspect the Collateral, and the right to audit and copy Borrower's books and records. The parties contemplate that such audits will be performed no more frequently than quarterly, but nothing herein restricts Silicon's right to conduct such audits more frequently if (i) Silicon believes that it is advisable to do so in Silicon's good faith business judgment, or (ii) Silicon believes in good faith that an event of default or an event which, with notice or passage of time or both would constitute an event of default, has occurred and is continuing. Silicon shall take reasonable steps to keep confidential all information obtained in any such inspection or audit, but Silicon shall have the right to disclose any such information to its auditors, regulatory agencies, and attorneys, and pursuant to any subpoena or other legal process. The foregoing inspections and audits shall be at Borrower's expense and the charge therefor shall be \$750 per person per day (or such higher amount as shall represent Silicon's then current standard charge for the same), plus reasonable out-of-pocket expenses. In the event Borrower and Silicon schedule an audit more than 10 days in advance, and Borrower seeks to reschedule the audit with less than five days' written notice to Silicon, then (without limiting any of Silicon's rights or remedies), Borrower shall pay Silicon a cancellation fee of \$1,000 plus any out-of-pocket expenses incurred by Silicon, to compensate Silicon for the anticipated costs and expenses of the cancellation.

**5.5 Negative Covenants.** Except as may be permitted in the Schedule, Borrower shall not, without Silicon's prior written consent (which shall be a matter of its good faith business judgment), do any of the following: (i) merge or consolidate with another corporation or entity; (ii) acquire any assets, except in the ordinary course of business; (iii) enter into any other transaction outside the ordinary course of business; (iv) sell or transfer any Collateral, except for the sale of finished Inventory in the ordinary course of Borrower's business, and except for the sale of obsolete or unneeded Equipment in the ordinary

course of business and non-exclusive licenses and similar non-exclusive arrangements for the use of Intellectual Property; (v) store any Inventory or other Collateral with any warehouseman or other third party which has not executed and delivered to Silicon a bailee agreement or other similar agreement acceptable to Silicon in its good faith business judgment with respect to finished goods inventory, except when any such Collateral or Inventory is in transit or located at a subcontractor's facility; (vi) sell any Inventory on a sale-or-return, guaranteed sale, consignment, or other contingent basis other than for such customary and ordinary course return transactions arising from Borrower's product warranties; (vii) make any loans of any money or other assets, other than (a) travel advances to Borrower's employees in the ordinary course of business consistent with past business practices (including without limitation, for travel entertainment and relocation expenses) and in aggregate amounts consistent with past ordinary course business practices of Borrower; (b) extension of trade credit in the ordinary course of business to non-affiliated entities; (c) other loans and advances to employees, officers and directors, in the ordinary course of business in an aggregate principal amount not to exceed \$25,000, at any time outstanding for all such loans to all employees, officers and directors, provided, no new such loans and advances shall be made while any Default or Event of Default is then occurring; (viii) incur any debts, outside the ordinary course of business, which results in a Material Adverse Change; (ix) guarantee or otherwise become liable with respect to the obligations of another party or entity; (x) pay or declare any dividends on Borrower's stock (except for dividends payable solely in stock of Borrower); (xi) redeem, retire, purchase or otherwise acquire, directly or indirectly, any of Borrower's stock, except that Borrower may repurchase its stock in accordance with Borrower's employee stock option plan, provided that the aggregate amount of consideration paid by Borrower for such repurchases shall not exceed \$100,000 in the aggregate in any fiscal year, and before and after giving effect to any such repurchase no Default or Event of Default has occurred and is continuing; (xii) make any change in Borrower's capital structure which would result in a Material Adverse Change; or (xiii) engage, directly or indirectly, in any business other than the businesses currently engaged in by Borrower or reasonably related thereto; or (xiv) dissolve or elect to dissolve. Transactions permitted by the foregoing provisions of this Section are only permitted if no Default or Event of Default would occur as a result of such transaction.

**5.6 Litigation Cooperation.** Should any third-party suit or proceeding be instituted by or against Silicon with respect to any Collateral or relating to Borrower, Borrower shall, upon reasonable notice, without expense to Silicon, make available Borrower and its officers, employees and agents and Borrower's books and records, to the extent that Silicon may deem them reasonably necessary in order to prosecute or defend any such suit or proceeding.

**5.7 Further Assurances.** Borrower agrees, at its expense, on request by Silicon, to execute all documents and take all actions, as Silicon, may, in its good faith business judgment, deem reasonably necessary or useful in order to perfect and maintain Silicon's perfected first-priority security interest in the Collateral (subject to Permitted Liens), and in order to fully consummate the transactions contemplated by this Agreement.

## **6. TERM.**

**6.1 Maturity Date.** This Agreement shall continue in effect until the maturity date set forth on the Schedule (the "Maturity Date"), subject to Section 6.3 below.

**6.2 Early Termination.** This Agreement may be terminated prior to the Maturity Date as follows: (i) by Borrower, effective three Business Days after written notice of termination is given to Silicon; or (ii) by Silicon at any time after the occurrence and during the continuance of an Event of Default, without notice, effective immediately. If this Agreement is terminated by Borrower or by Silicon under this Section 6.2, Borrower shall pay to Silicon a termination fee as set forth in the Non-Exim Agreement (as defined in the Schedule) of approximate even date herewith, provided that no termination fee shall be charged if the credit facility hereunder is replaced with a new facility from another division of Silicon Valley Bank. The termination fee shall be due and payable on the effective date of termination and thereafter shall bear interest at a rate equal to the highest rate applicable to any of the Obligations.

**6.3 Payment of Obligations.** On the Maturity Date or on any earlier effective date of termination, Borrower shall pay and perform in full all Obligations (other than for any inchoate indemnity obligations of Borrower hereunder that survive termination of this Agreement), whether evidenced by installment notes or otherwise, and whether or not all or any part of such Obligations are otherwise then due and payable. Without limiting the generality of the foregoing, if on the Maturity Date, or on any earlier effective date of termination, there are any outstanding Letters of Credit issued by Silicon or issued by another institution based upon an application, guarantee, indemnity or similar agreement on the part of Silicon, then on such date Borrower shall provide to Silicon cash collateral in an amount equal to 105% of the face amount of all such Letters of Credit plus all interest, fees and cost due or to become due in connection therewith (as estimated by Silicon in its good faith business judgment, taking into account the excess of cash collateral over 100% of the face amount of such Letters of Credit), to secure all of the Obligations relating to said Letters of Credit, pursuant to Silicon's then standard form cash pledge agreement. Notwithstanding any termination of this Agreement, all of Silicon's security interests in all of the Collateral and all of the terms and provisions of this Agreement shall continue in full force and effect until all Obligations have been paid and performed in full; provided that Silicon may, in its sole discretion, refuse to make any further Loans after termination. No

termination shall in any way affect or impair any right or remedy of Silicon, nor shall any such termination relieve Borrower of any Obligation to Silicon, until all of the Obligations (other than for any inchoate indemnity obligations of Borrower hereunder that survive termination of this Agreement) have been paid and performed in full. Upon payment and performance in full of all the Obligations and termination of this Agreement, Silicon shall promptly terminate its financing statements with respect to the Borrower and deliver to Borrower such other documents as may be required to fully terminate Silicon's security interests and Silicon shall further reassign and redeliver (or cause to be reassigned or redelivered) to Borrower, or to such person as Borrower shall designate, against receipt, such of the Borrower's assets delivered to Silicon as shall have not been sold or otherwise applied by Silicon pursuant to the terms of the Loan Documents that are still then held by Silicon.

**7. EVENTS OF DEFAULT AND REMEDIES.**

**7.1 Events of Default.** The occurrence of any of the following events shall constitute an "Event of Default" under this Agreement, and Borrower shall give Silicon immediate written notice thereof: (a) Any warranty, representation, statement, report or certificate made or delivered to Silicon by Borrower or any of Borrower's officers, employees or agents, now or in the future, shall be untrue or misleading in a material respect when made or deemed to be made; or (b) Borrower shall fail to pay when due any Loan or any interest thereon or any other monetary Obligation; or (c) the total Loans and other Obligations outstanding at any time shall exceed the Credit Limit provided, however, if an Overadvance results directly from a change by Silicon of either the amount of Reserves or of the "Minimum Eligibility Requirements", then if Borrower fails to pay such Overadvance within three Business Days of the occurrence of the Overadvance; or (d) Borrower shall fail to comply with any of the financial covenants set forth in the Schedule, or shall fail to perform any other non-monetary Obligation which by its nature cannot be cured, or shall fail to permit Silicon to conduct an inspection or audit as specified in Section 5.4 hereof; or (e) Borrower shall fail to perform any other non-monetary Obligation, which failure is not cured within five Business Days after the date due; or (f) any levy, assessment, attachment, seizure, lien or encumbrance (other than a Permitted Lien) is made on all or any part of the Collateral which is not cured within 10 days after the occurrence of the same; or (g) any default or event of default occurs under any obligation in excess of \$100,000, secured by a Permitted Lien, which is not cured within any applicable cure period or waived in writing by the holder of the Permitted Lien; or (h) Borrower breaches any material contract or obligation, which has resulted or may reasonably be expected to result in a Material Adverse Change; or (i) Dissolution, termination of existence, insolvency or business failure of Borrower; or appointment of a receiver, trustee or custodian, for all or any part of the property of, assignment for the benefit of creditors by, or the commencement of any proceeding by Borrower under any reorganization, bankruptcy, insolvency, arrangement, readjustment of debt, dissolution or liquidation law or statute of any jurisdiction, now or in the future in effect, which is not dismissed within 45 days after the date commenced; or (j) the commencement of any proceeding against Borrower or any guarantor of any of the Obligations under any reorganization, bankruptcy, insolvency, arrangement, readjustment of debt, dissolution or liquidation law or statute of any jurisdiction, now or in the future in effect, which is not cured by the dismissal thereof within 45 days after the date commenced; or (k) revocation or termination of, or limitation or denial of liability upon, any guaranty of the Obligations or any attempt to do any of the foregoing, or commencement of proceedings by any guarantor of any of the Obligations under any bankruptcy or insolvency law; or (l) revocation or termination of, or limitation or denial of liability upon, any pledge of any certificate of deposit, securities or other property or asset of any kind pledged by any third party to secure any or all of the Obligations, or any attempt to do any of the foregoing, or commencement of proceedings by or against any such third party under any bankruptcy or insolvency law; or (m) Borrower makes any payment on account of any indebtedness or obligation which has been subordinated to the Obligations other than as permitted in the applicable subordination agreement, or if any Person who has subordinated such indebtedness or obligations terminates or in any way limits his subordination agreement; or (n) if a Person or group of affiliated Persons shall acquire, beneficially or of record, more than 30% of the outstanding shares of stock of Borrower, in one or more transactions, and such Person or group of affiliated Persons has "control" of the Borrower (which shall mean the effective ability to elect a majority of the Board of Directors of Borrower) (such acquisition and control referred to herein as a "Change in Control"), then Borrower shall notify Silicon of the Change in Control within five Business Days after Borrower has actual knowledge of the Change in Control, and if Silicon shall give written notice to Borrower that, in the exercise of its good faith business judgment it does not consent to the Change in Control then the same shall constitute an Event of Default; or (o) Borrower shall generally not pay its debts as they become due, or Borrower shall conceal, remove or transfer any part of its property, with intent to hinder, delay or defraud its creditors, or make or suffer any transfer of any of its property which may be fraudulent under any bankruptcy, fraudulent conveyance or similar law; or (p) a Material Adverse Change shall occur. Silicon may cease making any Loans hereunder during any of the above cure periods, and thereafter if an Event of Default has occurred and is continuing.

**7.2 Remedies.** Upon the occurrence and during the continuance of any Event of Default, and at any time thereafter, Silicon, at its option, and without notice or demand of any kind (all of which are hereby expressly waived by Borrower, to the extent permitted by law), may do any one or more of the following: (a) Cease making Loans or otherwise extending credit to Borrower under this Agreement or any other Loan Document; (b) Accelerate and declare all or any part of the Obligations to be immediately due, payable, and performable, notwithstanding any deferred or installment payments allowed by any instrument evidencing or relating to any Obligation; (c) Take possession of any or all of the Collateral wherever it may be

found, and for that purpose Borrower hereby authorizes Silicon without judicial process (subject to the rights of any landlord regarding any of Borrower's leased premises) to enter onto any of Borrower's premises without interference to search for, take possession of, keep, store, or remove any of the Collateral, and remain on the premises or cause a custodian to remain on the premises in exclusive control thereof, without charge for so long as Silicon deems it necessary, in its good faith business judgment, in order to complete the enforcement of its rights under this Agreement or any other agreement; provided, however, that should Silicon seek to take possession of any of the Collateral by court process, Borrower hereby irrevocably waives: (i) any bond and any surety or security relating thereto required by any statute, court rule or otherwise as an incident to such possession; (ii) any demand for possession prior to the commencement of any suit or action to recover possession thereof; and (iii) any requirement that Silicon retain possession of, and not dispose of, any such Collateral until after trial or final judgment; (d) Require Borrower to assemble any or all of the Collateral and make it available to Silicon at places designated by Silicon which are reasonably convenient to Silicon and Borrower, and to remove the Collateral to such locations as Silicon may deem advisable; (e) Complete the processing, manufacturing or repair of any Collateral prior to a disposition thereof and, for such purpose and for the purpose of removal, Silicon shall have the right to use Borrower's premises, vehicles, hoists, lifts, cranes, and other Equipment and all other property without charge; (f) Sell, lease or otherwise dispose of any of the Collateral, in its condition at the time Silicon obtains possession of it or after further manufacturing, processing or repair, at one or more public and/or private sales, in lots or in bulk, for cash, exchange or other property, or on credit, and to adjourn any such sale from time to time without notice other than oral announcement at the time scheduled for sale. Silicon shall have the right to conduct such disposition on Borrower's premises (subject to the rights of any landlord regarding any of Borrower's leased premises) without charge, for such time or times as Silicon deems reasonable, or on Silicon's premises, or elsewhere and the Collateral need not be located at the place of disposition. Silicon may directly or through any affiliated company purchase or lease any Collateral at any such public disposition, and if permissible under applicable law, at any private disposition. Any sale or other disposition of Collateral shall not relieve Borrower of any liability Borrower may have if any Collateral is defective as to title or physical condition or otherwise at the time of sale; (g) Demand payment of, and collect any Accounts and General Intangibles comprising Collateral and, in connection therewith, Borrower irrevocably authorizes Silicon to endorse or sign Borrower's name on all collections, receipts, instruments and other documents, to take possession of and open mail addressed to Borrower and remove therefrom payments made with respect to any item of the Collateral or proceeds thereof, and, in Silicon's good faith business judgment, to grant extensions of time to pay, compromise claims and settle Accounts and the like for less than face value; (h) Offset against any sums in any of Borrower's general, special or other Deposit Accounts with Silicon against any or all of the Obligations; and (i) Demand and receive possession of any of Borrower's federal and state income tax returns and the books and records utilized in the preparation thereof or referring thereto. All reasonable attorneys' fees, expenses, costs, liabilities and obligations incurred by Silicon with respect to the foregoing shall be added to and become part of the Obligations, shall be due on demand, and shall bear interest at a rate equal to the highest interest rate applicable to any of the Obligations. Without limiting any of Silicon's rights and remedies, from and after the occurrence and during the continuance of any Event of Default, the interest rate applicable to the Obligations shall be increased by an additional four percent per annum (the "Default Rate").

**7.3 Standards for Determining Commercial Reasonableness.** Borrower and Silicon agree that a sale or other disposition (collectively, "sale") of any Collateral which complies with the following standards will conclusively be deemed to be commercially reasonable: (i) Notice of the sale is given to Borrower at least ten days prior to the sale, and, in the case of a public sale, notice of the sale is published at least five days before the sale in a newspaper of general circulation in the county where the sale is to be conducted; (ii) Notice of the sale describes the collateral in general, non-specific terms; (iii) The sale is conducted at a place designated by Silicon, with or without the Collateral being present; (iv) The sale commences at any time between 8:00 a.m. and 6:00 p.m. (in the time zone where collateral is located); (v) Payment of the purchase price in cash or by cashier's check or wire transfer is required; (vi) With respect to any sale of any of the Collateral, Silicon may (but is not obligated to) direct any prospective purchaser to ascertain directly from Borrower any and all information concerning the same. Silicon shall be free to employ other methods of noticing and selling the Collateral, in its discretion, if they are commercially reasonable.

**7.4 Power of Attorney.** Upon the occurrence and during the continuance of any Event of Default, without limiting Silicon's other rights and remedies, Borrower grants to Silicon an irrevocable power of attorney coupled with an interest, authorizing and permitting Silicon (acting through any of its employees, attorneys or agents) at any time, at its option, but without obligation, with or without notice to Borrower, and at Borrower's expense, to do any or all of the following, in Borrower's name or otherwise, but Silicon agrees that if it exercises any right hereunder, it will do so in good faith and in a commercially reasonable manner: (a) Execute on behalf of Borrower any documents that Silicon may, in its good faith business judgment, deem advisable in order to perfect and maintain Silicon's security interest in the Collateral, or in order to exercise a right of Borrower or Silicon, or in order to fully consummate all the transactions contemplated under this Agreement, and all other Loan Documents; (b) Execute on behalf of Borrower, any invoices relating to any Account, any draft against any Account Debtor and any notice to any Account Debtor, any proof of claim in bankruptcy, any Notice of Lien, claim of mechanic's, materialman's or other lien, or assignment or satisfaction of mechanic's, materialman's or other lien; (c)

Take control in any manner of any cash or non-cash items of payment or proceeds of Collateral; endorse the name of Borrower upon any instruments, or documents, evidence of payment or Collateral that may come into Silicon's possession; (d) Endorse all checks and other forms of remittances received by Silicon; (e) Pay, contest or settle any lien, charge, encumbrance, security interest and adverse claim in or to any of the Collateral, or any judgment based thereon, or otherwise take any action to terminate or discharge the same; (f) Grant extensions of time to pay, compromise claims and settle Accounts and General Intangibles for less than face value and execute all releases and other documents in connection therewith; (g) Pay any sums required on account of Borrower's taxes or to secure the release of any liens therefor, or both; (h) Settle and adjust, and give releases of, any insurance claim that relates to any of the Collateral and obtain payment therefor; (i) Instruct any third party having custody or control of any books or records belonging to, or relating to, Borrower to give Silicon the same rights of access and other rights with respect thereto as Silicon has under this Agreement; and (j) Take any action or pay any sum required of Borrower pursuant to this Agreement and any other Loan Documents. Any and all reasonable sums paid and any and all reasonable costs, expenses, liabilities, obligations and attorneys' fees incurred by Silicon with respect to the foregoing shall be added to and become part of the Obligations, shall be payable on demand, and shall bear interest at a rate equal to the highest interest rate applicable to any of the Obligations. In no event shall Silicon's rights under the foregoing power of attorney or any of Silicon's other rights under this Agreement be deemed to indicate that Silicon is in control of the business, management or properties of Borrower. The foregoing power of attorney shall expire upon payment in full of the Obligations (other than for inchoate indemnity obligations which survive the termination of this Agreement) and the termination of this Agreement.

**7.5 Application of Proceeds.** All proceeds realized as the result of any sale of the Collateral shall be applied by Silicon first to the reasonable costs, expenses, liabilities, obligations and attorneys' fees incurred by Silicon in the exercise of its rights under this Agreement, second to the interest due upon any of the Obligations, and third to the principal of the Obligations, in such order as Silicon shall determine in its sole discretion. Any surplus shall be paid to Borrower or other persons legally entitled thereto; Borrower shall remain liable to Silicon for any deficiency. If, Silicon, in its good faith business judgment, directly or indirectly enters into a deferred payment or other credit transaction with any purchaser at any sale of Collateral, Silicon shall have the option, exercisable at any time, in its good faith business judgment, of either reducing the Obligations by the principal amount of purchase price or deferring the reduction of the Obligations until the actual receipt by Silicon of the cash therefor.

**7.6 Remedies Cumulative.** In addition to the rights and remedies set forth in this Agreement, Silicon shall have all the other rights and remedies accorded a secured party under the California Uniform Commercial Code and under all other applicable laws, and under any other instrument or agreement now or in the future entered into between Silicon and Borrower, and all of such rights and remedies are cumulative and none is exclusive. Exercise or partial exercise by Silicon of one or more of its rights or remedies shall not be deemed an election, nor bar Silicon from subsequent exercise or partial exercise of any other rights or remedies. The failure or delay of Silicon to exercise any rights or remedies shall not operate as a waiver thereof, but all rights and remedies shall continue in full force and effect until all of the Obligations have been fully paid and performed.

**8. DEFINITIONS.** As used in this Agreement, the following terms have the following meanings:

"Account Debtor" means the obligor on an Account.

"Accounts" means all present and future "accounts" as defined in the California Uniform Commercial Code in effect on the date hereof with such additions to such term as may hereafter be made, and includes without limitation all accounts receivable and other sums owing to Borrower.

"Affiliate" means, with respect to any Person, a relative, partner, shareholder, director, officer, or employee of such Person, or any parent or subsidiary of such Person, or any Person controlling, controlled by or under common control with such Person.

"Business Day" means a day on which Silicon is open for business.

"Code" means the Uniform Commercial Code as adopted and in effect in the State of California from time to time.

"Collateral" has the meaning set forth in Section 2 above.

"continuing" and "during the continuance of" when used with reference to a Default or Event of Default means that the Default or Event of Default has occurred and has not been either waived in writing by Silicon or cured within any applicable cure period.

"Default" means any event which with notice or passage of time or both, would constitute an Event of Default.

"Default Rate" has the meaning set forth in Section 7.2 above.

“Deposit Accounts” means all present and future “deposit accounts” as defined in the California Uniform Commercial Code in effect on the date hereof with such additions to such term as may hereafter be made, and includes without limitation all general and special bank accounts, demand accounts, checking accounts, savings accounts and certificates of deposit.

“Eligible Accounts” means Accounts and General Intangibles arising in the ordinary course of Borrower’s business from the sale of goods or the rendition of services, or the non-exclusive licensing of Intellectual Property, which Silicon, in its good faith business judgment, shall deem eligible for borrowing and which constitutes “Eligible Export-Related Accounts Receivable” (as defined in the Exim Borrower Agreement referred to in the Schedule). Without limiting the fact that the determination of which Accounts are eligible for borrowing is a matter of Silicon’s good faith business judgment, the following (the “Minimum Eligibility Requirements”) are the minimum requirements for a Account to be an Eligible Account: (i) the Account must not be on terms of more than net 90 days from its invoice date and must not be outstanding for more than 60 days past its due date as set forth in the applicable invoice (the “Eligibility Period”), (ii) the Account must not represent progress billings, or be due under a fulfillment or requirements contract with the Account Debtor, (iii) the Account must not be subject to any contingencies (including Accounts arising from sales on consignment, guaranteed sale or other terms pursuant to which payment by the Account Debtor may be conditional) other than for potential customary and ordinary course returns arising from Borrower’s product warranties, (iv) the Account must not be owing from an Account Debtor with whom Borrower has any dispute (whether or not relating to the particular Account), (v) the Account must not be owing from an Affiliate of Borrower, (vi) the Account must not be owing from an Account Debtor which is subject to any insolvency or bankruptcy proceeding, or whose financial condition is not acceptable to Silicon, or which, fails or goes out of a material portion of its business, (vii) the Account must not be owing from the United States or any department, agency or instrumentality thereof (unless there has been compliance, to Silicon’s satisfaction, with the United States Assignment of Claims Act), (viii) [intentionally omitted], (ix) the Account must not be owing from an Account Debtor to whom Borrower is or may be liable for goods purchased from such Account Debtor or otherwise (but, in such case, the Account will be deemed not eligible only to the extent of any amounts owed by Borrower to such Account Debtor). Accounts owing from one Account Debtor will not be deemed Eligible Accounts to the extent they exceed 25% of the total Accounts outstanding (except that, in the case of Nihon Kohden, said percentage shall be 75%). In addition, if more than 50% of the Accounts owing from an Account Debtor are outstanding for a period longer than their Eligibility Period (without regard to unapplied credits) or are otherwise not eligible Accounts, then all Accounts owing from that Account Debtor will be deemed ineligible for borrowing. Silicon may, from time to time, in its good faith business judgment, revise the Minimum Eligibility Requirements, upon written notice to Borrower.

“Equipment” means all present and future “equipment” as defined in the California Uniform Commercial Code in effect on the date hereof with such additions to such term as may hereafter be made, and includes without limitation all machinery, fixtures, goods, vehicles (including motor vehicles and trailers), and any interest in any of the foregoing.

“Event of Default” means any of the events set forth in Section 7.1 of this Agreement.

“GAAP” means generally accepted accounting principles consistently applied.

“General Intangibles” means all present and future “general intangibles” as defined in the California Uniform Commercial Code in effect on the date hereof with such additions to such term as may hereafter be made, and includes without limitation all Intellectual Property, payment intangibles, royalties, contract rights, goodwill, franchise agreements, purchase orders, customer lists, route lists, telephone numbers, domain names, claims, income tax refunds, security and other deposits, options to purchase or sell real or personal property, rights in all litigation presently or hereafter pending (whether in contract, tort or otherwise), insurance policies (including without limitation key man, property damage, and business interruption insurance), payments of insurance and rights to payment of any kind.

“good faith business judgment” means honesty in fact and good faith (as defined in Section 1201 of the Code) in the exercise of Silicon’s business judgment.

“including” means including (but not limited to).

“Intellectual Property” means all present and future (a) copyrights, copyright rights, copyright applications, copyright registrations and like protections in each work of authorship and derivative work thereof, whether published or unpublished, (b) trade secret rights, including all rights to unpatented inventions and know-how, and confidential information; (c) mask work or similar rights available for the protection of semiconductor chips; (d) patents, patent applications and like protections including without limitation improvements, divisions, continuations, renewals, reissues, extensions and continuations-in-part of the same; (e) trademarks, servicemarks, trade styles, and trade names, whether or not any of the foregoing are registered, and all applications to register and registrations of the same and like protections, and the entire goodwill of the business of Borrower connected with and symbolized by any such trademarks; (f) computer software and computer software products; (g) designs and design rights; (h) technology; (i) all claims for damages by way of past, present and future infringement of any of the rights included above; (j) all licenses or other rights to use any property or rights of a type described above.

“Inventory” means all present and future “inventory” as defined in the California Uniform Commercial Code in effect on the date hereof with such additions to such term as may hereafter be made, and includes without limitation all merchandise, raw materials, parts, supplies, packing and shipping materials, work in process and finished products, including without limitation such inventory as is temporarily out of Borrower’s custody or possession or in transit and including any returned goods and any documents of title representing any of the above.

“Investment Property” means all present and future investment property, securities, stocks, bonds, debentures, debt securities, partnership interests, limited liability company interests, options, security entitlements, securities accounts, commodity contracts, commodity accounts, and all financial assets held in any securities account or otherwise, and all options and warrants to purchase any of the foregoing, wherever located, and all other securities of every kind, whether certificated or uncertificated.

“Loan Documents” means, collectively, this Agreement, the Representations, and all other present and future documents, instruments and agreements between Silicon and Borrower, including, but not limited to those relating to this Agreement, and all amendments and modifications thereto and replacements therefor.

“Material Adverse Change” means any of the following: (i) a material adverse change in the business, operations, or financial or other condition of the Borrower, or (ii) a material impairment of the prospect of repayment of any portion of the Obligations; or (iii) a material impairment of the value or priority of Silicon’s security interests in the Collateral.

“Obligations” means all present and future Loans, advances, debts, liabilities, obligations, guaranties, covenants, duties and indebtedness at any time owing by Borrower to Silicon, whether evidenced by this Agreement or any note or other instrument or document, or otherwise, whether arising from an extension of credit, opening of a letter of credit, banker’s acceptance, loan, guaranty, indemnification or otherwise, whether direct or indirect (including, without limitation, those acquired by assignment and any participation by Silicon in Borrower’s debts owing to others), absolute or contingent, due or to become due, including, without limitation, all interest, charges, expenses, fees, attorney’s fees, expert witness fees, audit fees, letter of credit fees, collateral monitoring fees, closing fees, facility fees, termination fees, minimum interest charges and any other sums chargeable to Borrower under this Agreement or under any other Loan Documents.

“Other Property” means the following as defined in the California Uniform Commercial Code in effect on the date hereof with such additions to such term as may hereafter be made, and all rights relating thereto: all present and future “commercial tort claims” (including without limitation any commercial tort claims identified in the Representations), “documents”, “instruments”, “promissory notes”, “chattel paper”, “letters of credit”, “letter-of-credit rights”, “fixtures”, “farm products” and “money”; and all other goods and personal property of every kind, tangible and intangible, whether or not governed by the California Uniform Commercial Code.

“Permitted Liens” means the following: (i) purchase money security interests in specific items of Equipment; (ii) leases of specific items of Equipment; (iii) liens for taxes not yet payable; (iv) additional security interests and liens consented to in writing by Silicon, which consent may be withheld in its good faith business judgment; (v) security interests being terminated substantially concurrently with this Agreement; (vi) liens of materialmen, mechanics, warehousemen, carriers, or other similar liens arising in the ordinary course of business and securing obligations which are not delinquent; (vii) liens incurred in connection with the extension, renewal or refinancing of the indebtedness secured by liens of the type described above in clauses (i) or (ii) above, provided that any extension, renewal or replacement lien is limited to the property encumbered by the existing lien and the principal amount of the indebtedness being extended, renewed or refinanced does not increase; (viii) Liens in favor of customs and revenue authorities which secure payment of customs duties in connection with the importation of goods. Silicon will have the right to require, as a condition to its consent under subparagraph (iv) above, that the holder of the additional security interest or lien sign an intercreditor agreement on Silicon’s then standard form, acknowledge that the security interest is subordinate to the security interest in favor of Silicon, and agree not to take any action to enforce its subordinate security interest so long as any Obligations remain outstanding, and that Borrower agree that any uncured default in any obligation secured by the subordinate security interest shall also constitute an Event of Default under this Agreement.

“Person” means any individual, sole proprietorship, partnership, joint venture, trust, unincorporated organization, association, corporation, government, or any agency or political division thereof, or any other entity.

“Representations” means the written Representations and Warranties provided by Borrower to Silicon referred to in the Schedule.

“Reserves” means, as of any date of determination, such amounts as Silicon may from time to time establish and revise in its good faith business judgment, reducing the amount of Loans, Letters of Credit and other financial accommodations which would otherwise be available to Borrower under the lending formula(s) provided in the Schedule: (a) to reflect events, conditions, contingencies or risks which, as determined by Silicon in its good faith business judgment, do or may adversely affect (i) the Collateral or any other property which is security for the Obligations or its value (including without limitation any increase in delinquencies of Accounts), (ii) the assets, business or prospects of Borrower or any Guarantor, or (iii) the

security interests and other rights of Silicon in the Collateral (including the enforceability, perfection and priority thereof); or (b) to reflect Silicon's good faith belief that any collateral report or financial information furnished by or on behalf of Borrower or any Guarantor to Silicon is or may have been incomplete, inaccurate or misleading in any material respect; or (c) in respect of any state of facts which Silicon determines in good faith constitutes an Event of Default or may, with notice or passage of time or both, constitute an Event of Default.

**Other Terms.** All accounting terms used in this Agreement, unless otherwise indicated, shall have the meanings given to such terms in accordance with GAAP, consistently applied. All other terms contained in this Agreement, unless otherwise indicated, shall have the meanings provided by the Code, to the extent such terms are defined therein.

**9. GENERAL PROVISIONS.**

**9.1 Interest Computation.** In computing interest on the Obligations, all checks, wire transfers and other items of payment received by Silicon (including proceeds of Accounts and payment of the Obligations in full) shall be deemed applied by Silicon on account of the Obligations two Business Days after receipt by Silicon of immediately available funds, and, for purposes of the foregoing, any such funds received after 12:00 Noon on any day shall be deemed received on the next Business Day. Silicon shall not, however, be required to credit Borrower's account for the amount of any item of payment which is unsatisfactory to Silicon in its good faith business judgment, and Silicon may charge Borrower's loan account for the amount of any item of payment which is returned to Silicon unpaid.

**9.2 Application of Payments.** All payments with respect to the Obligations shall be promptly applied in accordance with this Agreement and Silicon's standard procedures may be applied, and in Silicon's good faith business judgment may be reversed and re-applied, to the Obligations, in such order and manner as Silicon shall determine in its good faith business judgment.

**9.3 Charges to Accounts.** Silicon may, in its discretion, require that Borrower pay monetary Obligations in cash to Silicon, or charge them to Borrower's Loan account, in which event they will bear interest at the same rate applicable to the Loans. Silicon may also, in its discretion, charge any monetary Obligations to Borrower's Deposit Accounts maintained with Silicon.

**9.4 Monthly Accountings.** Silicon shall provide Borrower monthly with an account of advances, charges, expenses and payments made pursuant to this Agreement. Such account shall be deemed correct, accurate and binding on Borrower and an account stated (except for reverses and reapplications of payments made and corrections of errors discovered by Silicon), unless Borrower notifies Silicon in writing to the contrary within 90 days after such account is rendered, describing the nature of any alleged errors or omissions.

**9.5 Notices.** All notices to be given under this Agreement shall be in writing and shall be given either personally or by reputable private delivery service or by regular first-class mail, or certified mail return receipt requested, addressed to Silicon or Borrower at the addresses shown in the heading to this Agreement, or at any other address designated in writing by one party to the other party. Notices to Silicon shall be directed to the Commercial Finance Division, to the attention of the Division Manager or the Division Credit Manager. All notices shall be deemed to have been given upon delivery in the case of notices personally delivered, or at the expiration of one Business Day following delivery to the private delivery service, or two Business Days following the deposit thereof in the United States mail, with postage prepaid.

**9.6 Severability.** Should any provision of this Agreement be held by any court of competent jurisdiction to be void or unenforceable, such defect shall not affect the remainder of this Agreement, which shall continue in full force and effect.

**9.7 Integration.** This Agreement and such other written agreements, documents and instruments as may be executed in connection herewith are the final, entire and complete agreement between Borrower and Silicon and supersede all prior and contemporaneous negotiations and oral representations and agreements, all of which are merged and integrated in this Agreement. There are no oral understandings, representations or agreements between the parties which are not set forth in this Agreement or in other written agreements signed by the parties in connection herewith.

**9.8 Waivers; Indemnity.** The failure of Silicon at any time or times to require Borrower to strictly comply with any of the provisions of this Agreement or any other Loan Document shall not waive or diminish any right of Silicon later to demand and receive strict compliance therewith. Any waiver of any default shall not waive or affect any other default, whether prior or subsequent, and whether or not similar. None of the provisions of this Agreement or any other Loan Document shall be deemed to have been waived by any act or knowledge of Silicon or its agents or employees, but only by a specific written waiver signed by an authorized officer of Silicon and delivered to Borrower. Borrower waives the benefit of all statutes of limitations relating to any of the Obligations or this Agreement or any other Loan Document, and Borrower waives demand, protest, notice of protest and notice of default or dishonor, notice of payment and nonpayment, release, compromise, settlement, extension or renewal of any commercial paper, instrument, account, General Intangible, document or guaranty at any time held by Silicon on which Borrower is or may in any way be liable, and notice of any action taken by Silicon, unless

expressly required by this Agreement. Borrower hereby agrees to indemnify Silicon and its affiliates, subsidiaries, parent, directors, officers, employees, agents, and attorneys, and to hold them harmless from and against any and all claims, debts, liabilities, demands, obligations, actions, causes of action, penalties, costs and expenses (including reasonable attorneys' fees), of every kind, which they may sustain or incur based upon or arising out of any of the Obligations, or any relationship or agreement between Silicon and Borrower, or any other matter, relating to Borrower or the Obligations; provided that this indemnity shall not extend to damages proximately caused by the indemnitee's own gross negligence or willful misconduct. A Person seeking to be indemnified under this Section 9.8 shall make commercially reasonable efforts to notify Borrower of any event requiring indemnification within a reasonable time following such Person's receipt of notice of commencement of any action or proceeding giving rise to a claim for indemnification hereunder, provided that (i) there shall be no obligation to so notify Borrower if an Event of Default has occurred and is continuing, (ii) neither Silicon nor any such Person shall have any liability or obligation for any inadvertent failure to provide such notice, (iii) no failure to provide such notice shall affect Borrower's obligation to provide indemnity hereunder and (iv) in any event, nothing herein shall impose on Silicon any duty or obligation to impair the confidentiality or sanctity of its attorney client relationship. In such proceeding, such Person shall use commercially reasonable efforts to keep Borrower reasonably informed of its defense and any settlement of any such action or proceeding and negotiations to settle or otherwise resolve any claim, provided that (i) such Person shall have the exclusive right to decide to accept or reject any settlement offer, (ii) there shall be no obligation to keep Borrower so informed if an Event of Default has occurred and is continuing, (iii) neither Silicon nor any such Person shall have any liability or obligation for any inadvertent failure to keep Borrower so informed, (iv) no failure to keep Borrower so informed shall affect Borrower's obligation to provide indemnity hereunder and (v) in any event, nothing herein shall impose on Silicon any duty or obligation to impair the confidentiality or sanctity of its attorney client relationship. Notwithstanding any provision in this Agreement to the contrary, the indemnity agreement set forth in this Section shall survive any termination of this Agreement and shall for all purposes continue in full force and effect.

**9.9 No Liability for Ordinary Negligence.** Neither Silicon, nor any of its directors, officers, employees, agents, attorneys or any other Person affiliated with or representing Silicon shall be liable for any claims, demands, losses or damages, of any kind whatsoever, made, claimed, incurred or suffered by Borrower or any other party through the ordinary negligence of Silicon, or any of its directors, officers, employees, agents, attorneys or any other Person affiliated with or representing Silicon, but nothing herein shall relieve Silicon from liability for its own gross negligence or willful misconduct.

**9.10 Amendment.** The terms and provisions of this Agreement may not be waived or amended, except in a writing executed by Borrower and a duly authorized officer of Silicon.

**9.11 Time of Essence.** Time is of the essence in the performance by Borrower of each and every obligation under this Agreement.

**9.12 Attorneys Fees and Costs.** Borrower shall reimburse Silicon for all reasonable attorneys' fees and all filing, recording, search, title insurance, appraisal, audit, and other reasonable costs incurred by Silicon, pursuant to, or in connection with, or relating to this Agreement (whether or not a lawsuit is filed), including, but not limited to, any reasonable attorneys' fees and costs Silicon incurs in order to do the following: prepare and negotiate this Agreement and all present and future documents relating to this Agreement; obtain legal advice in connection with this Agreement or Borrower; enforce, or seek to enforce, any of its rights; prosecute actions against, or defend actions by, Account Debtors; commence, intervene in, or defend any action or proceeding; initiate any complaint to be relieved of the automatic stay in bankruptcy; file or prosecute any probate claim, bankruptcy claim, third-party claim, or other claim; examine, audit, copy, and inspect any of the Collateral or any of Borrower's books and records; protect, obtain possession of, lease, dispose of, or otherwise enforce Silicon's security interest in, the Collateral; and otherwise represent Silicon in any litigation relating to Borrower. In satisfying Borrower's obligation hereunder to reimburse Silicon for attorneys fees, Borrower may, for convenience, issue checks directly to Silicon's attorneys, Levy, Small & Lallas, but Borrower acknowledges and agrees that Levy, Small & Lallas is representing only Silicon and not Borrower in connection with this Agreement. If either Silicon or Borrower files any lawsuit against the other predicated on a breach of this Agreement, the prevailing party in such action shall be entitled to recover its reasonable costs and attorneys' fees, including (but not limited to) reasonable attorneys' fees and costs incurred in the enforcement of, execution upon or defense of any order, decree, award or judgment. All attorneys' fees and costs to which Silicon may be entitled pursuant to this Paragraph shall immediately become part of Borrower's Obligations, shall be due on demand, and shall bear interest at a rate equal to the highest interest rate applicable to any of the Obligations.

**9.13 Benefit of Agreement.** The provisions of this Agreement shall be binding upon and inure to the benefit of the respective successors, assigns, heirs, beneficiaries and representatives of Borrower and Silicon; provided, however, that Borrower may not assign or transfer any of its rights under this Agreement without the prior written consent of Silicon, and any prohibited assignment shall be void. No consent by Silicon to any assignment shall release Borrower from its liability for the Obligations.

**9.14 Joint and Several Liability.** If Borrower consists of more than one Person, their liability shall be joint and several, and the compromise of any claim with, or the release of, any Borrower shall not constitute a compromise with, or a release of, any other Borrower.

**9.15 Limitation of Actions.** Any claim or cause of action by Borrower against Silicon, its directors, officers, employees, agents, accountants or attorneys, based upon, arising from, or relating to this Loan Agreement, or any other Loan Document, or any other transaction contemplated hereby or thereby or relating hereto or thereto, or any other matter, cause or thing whatsoever, occurred, done, omitted or suffered to be done by Silicon, its directors, officers, employees, agents, accountants or attorneys, shall be barred unless asserted by Borrower by the commencement of an action or proceeding in a court of competent jurisdiction by the filing of a complaint within one year after the first act, occurrence or omission upon which such claim or cause of action, or any part thereof, is based, and the service of a summons and complaint on an officer of Silicon, or on any other person authorized to accept service on behalf of Silicon, within thirty (30) days thereafter. Borrower agrees that such one-year period is a reasonable and sufficient time for Borrower to investigate and act upon any such claim or cause of action. The one-year period provided herein shall not be waived, tolled, or extended except by the written consent of Silicon in its sole discretion. This provision shall survive any termination of this Loan Agreement or any other Loan Document.

**9.16 Paragraph Headings; Construction.** Paragraph headings are only used in this Agreement for convenience. Borrower and Silicon acknowledge that the headings may not describe completely the subject matter of the applicable paragraph, and the headings shall not be used in any manner to construe, limit, define or interpret any term or provision of this Agreement. This Agreement has been fully reviewed and negotiated between the parties and no uncertainty or ambiguity in any term or provision of this Agreement shall be construed strictly against Silicon or Borrower under any rule of construction or otherwise.

**9.17 Governing Law; Jurisdiction; Venue.** This Agreement and all acts and transactions hereunder and all rights and obligations of Silicon and Borrower shall be governed by the laws of the State of California. As a material part of the consideration to Silicon to enter into this Agreement, Borrower (i) agrees that all actions and proceedings relating directly or indirectly to this Agreement shall, at Silicon's option, be litigated in courts located within California, and that the exclusive venue therefor shall be Santa Clara County; (ii) consents to the jurisdiction and venue of any such court and consents to service of process in any such action or proceeding by personal delivery or any other method permitted by law; and (iii) waives any and all rights Borrower may have to object to the jurisdiction of any such court, or to transfer or change the venue of any such action or proceeding.

**9.18 Mutual Waiver of Jury Trial.** **BORROWER AND SILICON EACH HEREBY WAIVE THE RIGHT TO TRIAL BY JURY IN ANY ACTION OR PROCEEDING BASED UPON, ARISING OUT OF, OR IN ANY WAY RELATING TO, THIS AGREEMENT OR ANY OTHER PRESENT OR FUTURE INSTRUMENT OR AGREEMENT BETWEEN SILICON AND BORROWER, OR ANY CONDUCT, ACTS OR OMISSIONS OF SILICON OR BORROWER OR ANY OF THEIR DIRECTORS, OFFICERS, EMPLOYEES, AGENTS, ATTORNEYS OR ANY OTHER PERSONS AFFILIATED WITH SILICON OR BORROWER, IN ALL OF THE FOREGOING CASES, WHETHER SOUNDING IN CONTRACT OR TORT OR OTHERWISE.**

**Borrower:**

**Silicon:**

**ENDOCARDIAL SOLUTIONS, INC.**

**SILICON VALLEY BANK**

By /s/ J. Robert Paulson, Jr.  
Vice President, CFO

By /s/ J. Anthony Clarkson  
Title Vice President Market Manager

By /s/ J. Robert Paulson, Jr.  
Ass't Secretary

**Silicon Valley Bank**

**Schedule to  
Loan and Security Agreement  
(Exim Program)**

**Borrower: Endocardial Solutions, Inc.**  
**Address: 1350 Energy Lane, Suite 110**  
**St. Paul, MN 55108**

**Date: September 24, 2003**

This Schedule forms an integral part of the Loan and Security Agreement between Silicon Valley Bank and the above-borrower of even date.

**1. CREDIT LIMIT**

(Section 1.1):

An amount not to exceed the lesser of (i) **\$1,500,000** at any one time outstanding (the "Maximum Credit Limit"), or (ii) **80%** of the amount of Borrower's Eligible Receivables (as defined in Section 8 above).

**2. INTEREST.**

**Interest Rate** (Section 1.2):

A rate equal to the "Prime Rate" in effect from time to time, plus **1.50%** per annum, provided that the interest rate in effect on any day shall not be less than **5.75%** per annum. Interest shall be calculated on the basis of a 360-day year for the actual number of days elapsed. As used in this Agreement, "Prime Rate" means the interest rate announced from time to time by Silicon as its "prime rate" (which is a base rate upon which other rates charged by Silicon are based, and it is not necessarily the best rate available at Silicon). The interest rate applicable to the Obligations shall change on each date there is a change in the Prime Rate.

**Minimum Monthly Interest** (Section 1.2):

\$5,000 per month in the aggregate as between this Agreement and the Non-Exim Agreement.

**3. FEES (Section 1.4):**

Loan Fee: See Non-Exim Agreement (as defined below) of approximate even date herewith.

Collateral Monitoring Fee: \$1,250, per month in the aggregate as between this Agreement and the Non-Exim Agreement, payable in arrears (prorated for any partial month at the beginning and at termination of this Agreement).

**4. MATURITY DATE**  
(Section 6.1):

The first anniversary of the date of this Agreement.

**5. FINANCIAL COVENANTS**  
(Section 5.1):

Borrower shall comply with each of the financial covenants set forth in the Non-Exim Agreement (defined below).

**6. REPORTING.**  
(Section 5.3):

Borrower shall provide Silicon with the following:

1. Transaction reports and schedules of collections, each week and at the time of each Loan request, on Silicon's standard form
2. Monthly accounts receivable agings, aged by invoice date, within twenty days after the end of each month.
3. Monthly accounts payable agings, aged by invoice date, and outstanding or held check registers, if any, within twenty days after the end of each month.
4. Monthly reconciliations of accounts receivable agings (aged by invoice date), transaction reports, and general ledger, within twenty days after the end of each month.
5. A copy of the Board of Director's Report each time a Board of Director's meeting is held and, in any event, within thirty days of the date of such meeting.
6. Monthly unaudited financial statements, as soon as available, and in any event within thirty days after the end of each month.
7. Monthly Compliance Certificates, within thirty days after the end of each month, in such form as Silicon shall reasonably specify, signed by the Chief Financial Officer of Borrower, certifying that as of the end of such month Borrower was in full compliance with

all of the terms and conditions of this Agreement, and setting forth calculations showing compliance with the financial covenants set forth in this Agreement and such other information as Silicon shall reasonably request, including, without limitation, a statement that at the end of such month there were no held checks.

8. Quarterly unaudited financial statements, as soon as available, and in any event within forty-five days after the end of each fiscal quarter of Borrower.
9. Annual operating budgets (including income statements, balance sheets and cash flow statements, by month) for the upcoming fiscal year of Borrower within thirty days prior to the end of each fiscal year of Borrower.
10. Annual financial statements, as soon as available, and in any event within 120 days following the end of Borrower's fiscal year, certified by, and with an unqualified opinion of, independent certified public accountants acceptable to Silicon.

#### 7. BORROWER INFORMATION:

Borrower represents and warrants that the information set forth in the Representations and Warranties of the Borrower dated July 27, 2003, previously submitted to Silicon (the "Representations") is true and correct as of the date hereof.

#### 8. ADDITIONAL PROVISIONS

- (1) **Banking Relationship.** Borrower shall at all times maintain its primary banking relationship, including without limitation its primary operating account, with Silicon. Without limiting the generality of the foregoing, Borrower shall, at all times, maintain not less than 100% of its total cash and investments on deposit with Silicon.
- (2) **Subordination of Inside Debt.** All present and future indebtedness of Borrower to its officers, directors and shareholders ("Inside Debt") shall, at all times, be subordinated to the Obligations pursuant to a subordination agreement on Silicon's standard form. Borrower represents and warrants that there is no Inside Debt presently outstanding, except for the following: None. Prior to incurring any Inside Debt in the future, Borrower shall cause the person to whom such Inside Debt will be owed to execute and deliver to Silicon a subordination agreement on Silicon's standard form.

**9. EXIM PROVISIONS:**

- (1) **Exim Guaranty.** Prior to the first disbursement of any Loans hereunder, Borrower shall cause the Export Import Bank of the United States (the "Exim Bank") to guarantee the Loans made under this Agreement, pursuant to a Master Guarantee Agreement, Loan Authorization Agreement and (to the extent applicable) Delegated Authority Letter Agreement (collectively, the "Exim Guaranty"), and Borrower shall cause the Exim Guaranty to be in full force and effect throughout the term of this Agreement and so long as any Loans hereunder are outstanding. If, for any reason, the Exim Guaranty shall cease to be in full force and effect, or if the Exim Bank declares the Exim Guaranty void or revokes any obligations thereunder or denies liability thereunder, any such event shall constitute an Event of Default under this Agreement. Nothing in any confidentiality agreement in this Agreement or in any other agreement shall restrict Silicon's right to make disclosures and provide information to the Exim Bank in connection with the Exim Guaranty.
- (2) **Exim Borrower Agreement; Costs.** Borrower shall, concurrently execute and deliver a Borrower Agreement, in the form specified by the Exim Bank, in favor of Silicon and the Exim Bank (the "Exim Borrower Agreement"). This Agreement is subject to all of the terms and conditions of the Exim Borrower Agreement, all of which are hereby incorporated herein by this reference. Borrower expressly agrees to perform all of the obligations and comply with all of the affirmative and negative covenants and all other terms and conditions set forth in the Exim Borrower Agreement as though the same were expressly set forth herein. In the event of any conflict between the terms of the Exim Borrower Agreement and the other terms of this Agreement, whichever terms are more restrictive shall apply. Borrower acknowledges and agrees that it has received a copy of the Loan Authorization Agreement which is referred to in the Exim Borrower Agreement. Borrower agrees to be bound by the terms of the Loan Authorization Agreement, including, without limitation, by any additions or revisions made prior to its execution on behalf of Exim Bank. Upon the execution of the Loan Authorization Agreement by Exim Bank and Silicon, it shall become an attachment to the Exim Borrower Agreement. Borrower shall reimburse Silicon for all fees and all out of pocket costs and expenses incurred by Silicon with respect to the Exim Guaranty and the Exim Borrower Agreement, including without limitation all facility fees and usage fees, and Silicon is

authorized to debit Borrower's account with Silicon for such fees, costs and expenses when paid by Silicon.

**(3) Non-Exim Agreement; Cross-Collateralization; Cross-Default.** Silicon and the Borrower are parties to that certain Loan and Security Agreement of approximate even date herewith (as amended from time to time, the "Non-Exim Agreement"). Both this Agreement and the Non-Exim Agreement shall continue in full force and effect, and all rights and remedies under this Agreement and the Non-Exim Agreement are cumulative. The term "Obligations" as used in this Agreement and in the Non-Exim Agreement shall include without limitation the obligation to pay when due all Loans made pursuant to this Agreement (the "Exim Loans") and all interest thereon and the obligation to pay when due all Loans made pursuant to the Non-Exim Agreement (the "Non-Exim Loans") and all interest thereon. Without limiting the generality of the foregoing, all "Collateral" as defined in this Agreement and as defined in the Non-Exim Agreement shall secure all Exim Loans and all Non-Exim Loans and all interest thereon, and all other Obligations. Any Event of Default under this Agreement shall also constitute an Event of Default under the Non-Exim Agreement, and any Event of Default under the Non-Exim Agreement shall also constitute an Event of Default under this Agreement. In the event Silicon assigns its rights under this Agreement and/or under any Note evidencing Exim Loans and/or its rights under the Non-Exim Agreement and/or under any Note evidencing Non-Exim Loans, to any third party, including without limitation the Exim Bank, whether before or after the occurrence of any Event of Default, Silicon shall have the right (but not any obligation), in its sole discretion, to allocate and apportion Collateral to the Agreement and/or Note assigned and to specify the priorities of the respective security interests in such Collateral between itself and the assignee, all without notice to or consent of the Borrower.

Borrower:  
  
ENDOCARDIAL SOLUTIONS, INC.

Silicon:  
  
SILICON VALLEY BANK

By /s/ J. Robert Paulson, Jr.  
Vice President, CFO

By /s/ J. Anthony Clarkson  
Title Vice President Market Manager

By /s/ J. Robert Paulson, Jr.  
Ass't Secretary

DOC 4 : Header

**Exhibit 10.4**

**Silicon Valley Bank**

**SECURED PROMISSORY NOTE**  
(Exim Program)

**\$1,500,000**

**SEPTEMBER 24, 2003**

**FOR VALUE RECEIVED**, the undersigned (jointly and severally, the "Borrower") promises to pay to the order of **SILICON VALLEY BANK** ("Silicon"), at 3003 Tasman Drive, Santa Clara, California 95054, or at such other address as the holder of this Note shall direct, the principal sum of **ONE MILLION FIVE HUNDRED THOUSAND DOLLARS** (\$1,500,000), or such lesser or greater amount as shall be equal to the unpaid balance of the "Exim Loans" as defined in the Loan and Security Agreement (Exim Program) between Borrower and Silicon of even date herewith (the "Loan Agreement").

The principal amount of this Note shall be payable as set forth in the Loan Agreement.

This Note shall bear interest on the unpaid principal balance hereof from time to time outstanding at a rate equal to the interest rate set forth in the Loan Agreement.

Accrued interest on this Note shall be payable monthly in accordance with the terms of the Loan Agreement. Any accrued interest not paid when due shall bear interest at the same rate as the principal hereof.

Principal of and interest on this Note shall be payable in lawful money of the United States of America. If a payment hereunder becomes due and payable on a Saturday, Sunday or legal holiday, the due date thereof shall be extended to the next succeeding business day, and interest shall be payable thereon during such extension.

In the event any payment of principal or interest on this Note is not paid in full when due, or if any other Event of Default occurs hereunder, under the Loan Agreement or under any other present or future instrument, document, or agreement between the Borrower and Silicon (collectively, "Events of Default"), Silicon may, at its option, at any time thereafter, declare the entire unpaid principal balance of this Note plus all accrued interest to be immediately due and payable, without notice or demand. The acceptance of any installment of principal or interest by Silicon after the time when it becomes due, as herein specified, shall not be held to establish a custom, or to waive any rights of Silicon to enforce payment when due of any further installments or any other rights, nor shall any failure or delay to exercise any rights be held to waive the same.

All payments hereunder are to be applied first to reasonable costs and fees referred to hereunder, second to the payment of accrued interest and the remaining balance to the payment of principal. Silicon shall have the continuing and exclusive right to apply or reverse and reapply any and all payments hereunder.

The Borrower agrees to pay all reasonable costs and expenses (including without limitation reasonable attorney's fees) incurred by Silicon in connection with or related to this Note, or its enforcement, whether or not suit be brought. The Borrower hereby waives presentment, demand for payment, notice of dishonor, notice of nonpayment, protest, notice of protest, and any and all other notices and demands in connection with the delivery, acceptance, performance, default, or enforcement of this Note, and the Borrower hereby waives the benefits of any statute of limitations with respect to any action to enforce, or otherwise related to, this Note.

This Note is secured by the Loan Agreement and all other present and future security agreements between the Borrower and Silicon. Nothing herein shall be deemed to limit any of the terms or provisions of the Loan Agreement or any other present or future document, instrument or agreement, between the Borrower and Silicon, and all of Silicon's rights and remedies hereunder and thereunder are cumulative.

In the event any one or more of the provisions of this Note shall for any reason be held to be invalid, illegal or unenforceable, the same shall not affect any other provision of this Note and the remaining provisions of this Note shall remain in full force and effect.

No waiver or modification of any of the terms or provisions of this Note shall be valid or binding unless set forth in a writing signed by a duly authorized officer of Silicon, and then only to the extent therein specifically set forth. If more than one person executes this Note, their obligations hereunder shall be joint and several.

SILICON, BY ITS ACCEPTANCE HEREOF, AND BORROWER EACH HEREBY WAIVE THE RIGHT TO TRIAL BY JURY IN ANY ACTION OR PROCEEDING BASED UPON, ARISING OUT OF, OR IN ANY WAY RELATING TO: (I) THIS NOTE; OR (II) ANY OTHER PRESENT OR FUTURE INSTRUMENT OR AGREEMENT BETWEEN SILICON AND BORROWER; OR (iii) ANY CONDUCT, ACTS OR OMISSIONS OF SILICON OR BORROWER OR ANY OF THEIR DIRECTORS, OFFICERS, EMPLOYEES, AGENTS, ATTORNEYS OR ANY OTHER PERSONS AFFILIATED WITH SILICON OR BORROWER; IN EACH OF THE FOREGOING CASES, WHETHER SOUNDING IN CONTRACT OR TORT OR OTHERWISE.

This Note is payable in, and shall be governed by the laws of, the State of California.

Endocardial Solutions, Inc.,  
a Delaware corporation

By /s/ J. Robert Paulson, Jr.  
Title V.P., CFO

DOC 5 : Header

**Exhibit 31.1**

**Certification of Chief Executive Officer  
pursuant to Section 302 of the  
Sarbanes-Oxley Act of 2002**

I, James W. Bullock, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Endocardial Solutions, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 14, 2003

/s/ James W. Bullock

Signature

Name: James W. Bullock

Title: Chief Executive Officer

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DOC 6 : Header

**Exhibit 31.2**

**Certification of Chief Financial Officer  
pursuant to Section 302 of the  
Sarbanes-Oxley Act of 2002**

I, J. Robert Paulson, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Endocardial Solutions, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 14, 2003

/s/ J. Robert Paulson, Jr.

Signature

Name: J. Robert Paulson, Jr.

Title: Chief Financial Officer

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DOC 7 : Header

**Exhibit 32.1**

**CERTIFICATION PURSUANT TO  
18 U.S.C. §1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Endocardial Solutions, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James W. Bullock, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ James W. Bullock  
James W. Bullock  
Chief Executive Officer  
November 14, 2003

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DOC 8 : Header

**Exhibit 32.2**

**CERTIFICATION PURSUANT TO  
18 U.S.C. §1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Endocardial Solutions, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, J. Robert Paulson, Jr., Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ J. Robert Paulson, Jr.  
J. Robert Paulson, Jr.  
Chief Financial Officer  
November 14, 2003

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DOC 9 : Header

**EXHIBIT 99.1**

**CAUTIONARY STATEMENT**

Forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the "PSLRA") are included in our Form 10-Q. The words or phrases "believes," "may," "will," "expects," "should," "continue," "anticipates," "intends," "will likely result," "estimates," "projects" or similar expressions identify forward-looking statements in our Form 10-Q and in our future filings with the Securities and Exchange Commission, in our press releases, in our presentations to securities analysts or investors, and in oral statements made by or approved by an executive officer of Endocardial Solutions, Inc. Forward-looking statements involve risks and uncertainties that may materially and adversely affect our business, results of operation, financial condition or prospects, and may cause our actual results to differ materially from historical results or the results discussed in the forward-looking statements.

You should consider carefully the following cautionary statements if you own our common stock or are planning to buy our common stock. We intend to take advantage of the "safe harbor" provisions of the PSLRA by providing this discussion. We are not undertaking to address or update each factor in future filings or communications regarding our business or results except to the extent required by law.

**Our success depends on the commercialization and market acceptance of the EnSite System**

The EnSite System is currently our only potential product, and our success depends entirely on the successful commercialization and market acceptance of the EnSite System. Problems in the following areas could materially impact the commercialization of the EnSite System:

- research and development,
- clinical testing,
- regulatory submissions and approval,
- product manufacturing and continued commercial growth,
- marketing, or
- product distribution.

We began to generate revenue from the EnSite Array in the second quarter of 1998. We began to generate revenue from EnSite NavX in 2003. We cannot assure you that we will continue to derive revenues from the sale of the EnSite System sufficient to generate a substantial return on investment for our stockholders.

**Our products are subject to regulatory approval before they may be marketed in the U.S. and abroad, and we may not obtain regulatory approval for use of the EnSite Array for all chambers of the heart**

The manufacture and sale of medical devices, including the EnSite System, are subject to extensive regulation in the United States, principally by the U.S. Food and Drug Administration and corresponding state agencies, and in other countries. In the United States, human diagnostic devices are regulated under the federal Food, Drug and Cosmetic Act, and are subject to clinical testing mandated by the FDA before they will give clearance for marketing. The Food, Drug and Cosmetic Act provides two basic review procedures, including a shortened submission procedure under Section 510(k) whereby the manufacturer notifies the FDA of its intent to market the product and attempts to establish that the product to be marketed is substantially equivalent to another FDA-cleared product. If a device fails to qualify for the 510(k) procedure, the manufacturer must file a pre-market approval application, which typically involves more clinical testing and a significantly longer FDA review process. During the third and fourth quarters of 1998, we submitted to the FDA two pre-market notification applications under Section 510(k) containing the results of our left ventricular and right atrium multi-center clinical trials. The FDA cleared the marketing of the EnSite Array for use in the right atrium of the heart in April 1999. Following discussions with the FDA, in March 1999, we announced that our FDA application for left ventricular use of the EnSite Array would be submitted as a pre-market approval application because the FDA did not find, based on initial clinical data, substantial equivalence with other devices used in the ventricles of the heart. We have submitted portions of our pre-market approval application that have been approved by the FDA. However, we may

not be able to file a complete pre-market approval application with the FDA until we complete more clinical trials, but we have not yet undertaken another clinical study for use of the EnSite Array in the left ventricle. We are still in discussions with the FDA regarding the extent of additional clinical trials that may be required and the best approach to obtain market approval for use of the EnSite Array in the left ventricle. In the meantime, we received FDA approval in January 2001 to conduct a left atrium multi-center clinical trial for the EnSite Array that we began in the second quarter of 2001. We received clearance from the FDA under Section 510(k) in April of 2003 to market the use of EnSite NavX in all chambers of the heart, and have received similar regulatory approvals to market EnSite NavX in Europe, as well as all other geographies in which the EnSite Array is currently sold and distributed.

Sales of medical devices outside of the United States are subject to international regulatory requirements that vary from country to country, and approval for sale internationally may take more or less time than that required for FDA approval. Prior to clearance for marketing in Europe, the EnSite System was required to meet regulatory standards outlined in several directives administered by the European Union. In order to affix a CE Mark to the EnSite System, allowing it to be marketed in Europe, we followed the conformity assessment procedures applicable to our product classification and submitted a declaration of conformity. We have obtained CE Mark certification for the EnSite Array for use in the right atrium and left ventricle of the heart, allowing us to sell the EnSite Array in member countries of the European Union. We also have obtained CE Mark certification for EnSite NavX for use in all chambers of the heart. We may encounter significant costs and requests for additional information in our continuing efforts to obtain regulatory approvals for other clinical applications of the EnSite Array in Europe, and in other countries, which could substantially delay or preclude us from marketing our products for those clinical applications internationally. We have obtained regulatory approval to market and sell EnSite NavX in all other international geographies in which we have approval to market and sell the EnSite Array.

Marketing approvals, if granted for some but not all chambers of the heart, require us to limit the indicated use of our EnSite Array. FDA enforcement policy strictly prohibits the marketing of approved medical devices for unapproved uses. Product approvals could be withdrawn for failure to comply with regulatory standards or the occurrence of unforeseen problems following the initial marketing. We will be required to follow FDA regulations regarding Good Manufacturing Practices and similar regulations in other countries, which include testing, control, and documentation requirements. Ongoing compliance with Good Manufacturing Practices and other applicable regulatory requirements will be monitored through periodic inspections by federal and state agencies, including the FDA, and by comparable agencies in other countries. If we fail to comply with applicable regulatory requirements, we could be subjected to warning letters, fines, injunctions, civil penalties, recall or seizure of products, total or partial suspension of production, refusal of the government to grant pre-market approval, withdrawal of approvals and criminal prosecution.

We cannot assure you that we will be able to obtain the necessary regulatory approvals on a timely basis or at all for future applications of the EnSite System. Delays in receipt of or failure to receive the approvals, the loss of previously obtained approvals, or failure to comply with existing or future regulatory requirements could materially limit our ability to market the EnSite System and generate substantial revenue from additional sales of EnSite Array catheters and EnSite NavX surface electrode kits.

**Clinical testing of our EnSite Array may not be completed in a timely manner or prove to be safe and effective in all chambers of the heart**

We have conducted clinical trials in the use of the EnSite Array in patients for ventricular tachycardia and supraventricular tachycardia in the United States and in Europe. In 1999, we received clearance from the FDA to market the EnSite Array in the U.S. for use in the right atrium of the heart, but we believe we will be required to conduct more clinical testing in the United States in order to support a pre-market approval application to the FDA for marketing approval for use of the EnSite Array in the left ventricle of the heart. In January 2001, we received FDA approval to also conduct a left atrium multi-center clinical trial that we began in the second quarter of 2001. Patients selected for clinical trials must meet stringent guidelines to undergo testing, and we cannot assure you that patients can be enrolled in clinical trials on a timely basis. Further, we cannot assure you that use of our EnSite Array will prove to be safe and effective in clinical trials under United States or international regulatory guidelines for all chambers of the heart. As to be expected when performing delicate and invasive procedures involving the heart, we have at times experienced complications in our clinical trials. The clinical procedures employing the EnSite Array for diagnosis are often combined with other diagnostic catheters and procedures to treat the

arrhythmia, and complications arising from such procedures are often pooled together because of the difficulty of determining which device or procedure is the true cause of any adverse event. Major complications, as defined by the FDA, that we have experienced during clinical trials of the EnSite Array requiring surgical repair and/or blood transfusion include: cardiac perforation (a puncture of the heart wall); myocardial infarction (heart attack); and hematoma (localized swelling resulting from a broken blood vessel). Additional clinical trials of the EnSite Array may identify significant technical or other obstacles to be overcome prior to obtaining approvals. We believe further clinical studies will be required in order to obtain clearance from the FDA to market the use of the EnSite Array in other chambers of the heart. If the EnSite Array does not prove to be safe and effective in clinical trials involving other chambers of the heart, our ability to market the EnSite Array, and generate substantial revenue from additional sales of EnSite Array catheters, EnSite NavX upgrades to the EnSite System, or EnSite NavX surface electrode kits, may be materially limited.

**Our EnSite System assists electrophysiologists in the diagnosis and treatment of cardiac arrhythmias, and enables the non-fluoroscopic navigation and positioning of conventional linear electrophysiology catheters, but we depend on other companies to develop products to treat cardiac arrhythmias that will increase the usefulness of our EnSite System**

Current treatments for cardiac arrhythmias include therapeutic drugs, implantable defibrillators, implantable pacemakers or bi-ventricular stimulation devices, surgery and catheter ablation. We believe the EnSite System enables increased use of catheter ablation for treating both complex and "less complex" arrhythmias which, in turn, could increase the volume of use of our EnSite System. Catheter ablation is a procedure in which a physician inserts a catheter through a vein in the groin or neck and advances it into one or more chambers of the heart. While in contact with the internal wall of a heart chamber, a high radio frequency energy is applied through the tip of the catheter to deaden the heart tissue at the site causing the arrhythmia. Our EnSite System enables electrophysiologists to pinpoint the location within a heart chamber to be ablated and visualize and navigate the catheter to that spot. Because ablation treatment is relatively new, the long-term effects of ablation on patients are unknown. As a result, the long term success of ablation therapy in treating arrhythmias may not be known for several years. Catheter ablation devices require approval by the FDA, and we cannot assure you that a catheter ablation market will continue to develop. Moreover, we cannot assure you of the extent to which the EnSite Array is useful in diagnosing arrhythmias for treatment by catheter ablation products, and the extent to which EnSite NavX is useful in guiding and navigating conventional linear diagnostic and ablation catheters. We are not in the process of developing a catheter for ablation treatment and are entirely dependent upon other medical device companies to develop those devices. If a market for treating cardiac arrhythmias by catheter ablation does not continue to develop, our ability to market the EnSite System and generate substantial revenue from additional sales of EnSite Array catheters and EnSite NavX surface electrode kits may be limited.

**Our products may be unable to diagnose or assist in the treatment of atrial fibrillation**

In addition to assisting the diagnosis and treatment of complex arrhythmias such as atrial tachycardia and ventricular tachycardia, we intend to apply the EnSite System to the diagnosis of atrial fibrillation. Atrial fibrillation is the most common type of sustained arrhythmia, and the ability to diagnose atrial fibrillation, and to navigate linear catheters during the diagnosis and treatment of atrial fibrillation, could lead to a significant market opportunity for us. However, we have conducted only limited clinical studies of our technology on patients suffering from atrial fibrillation. Although it is possible for atrial fibrillation to originate in the right atrium, medical research has shown that atrial fibrillation most often originates in the left atrium. In January 2001, we received clearance from the FDA to market the use of the EnSite Array in the left atrium in a multi-center clinical study for mapping and diagnosing arrhythmias including atrial fibrillation. We may, however, be unable to successfully extend our EnSite Array technology to the mapping of atrial fibrillation or obtain regulatory approval to market any products developed using the technology to map atrial fibrillation. In April of 2003 we received clearance from the FDA to market the use of EnSite NavX in all chambers of the heart, including the left atrium. We have made, and expect to continue to make, research and development expenditures to extend the application of the EnSite System technology to the diagnosis of atrial fibrillation. We cannot assure you that we will realize any benefit from these expenditures.

Atrial fibrillation is a complex disease and the subject of continuing research. The device therapies and techniques for diagnosing and treating atrial fibrillation presently available continue to develop and evolve, and the long-term effectiveness of such treatments are still unknown. Even if we are successful in extending our EnSite

technology to map, diagnose, and navigate catheters used in the treatment of atrial fibrillation, we cannot assure you that these treatments for atrial fibrillation will prove effective over the long-term, or that the diagnostic and navigation capabilities of any of our EnSite products will continue to be utilized or prove to be effective for atrial fibrillation. As a result, the commercial market for the diagnosis and treatment of atrial fibrillation may not continue to develop for any of our current or future EnSite products. We have no present intention to develop any medical devices on our own for the treatment of atrial fibrillation.

**Our products may not succeed in the market**

The commercial success of the EnSite System ultimately depends upon the number of diagnostic and therapeutic ablation procedures performed by electrophysiologists using the EnSite System. Our EnSite System may not gain any significant increased market acceptance among electrophysiologists, patients, health care insurers and managed care providers. Electrophysiologists and other physicians may elect not to recommend diagnostic or therapeutic procedures for any number of reasons, including safety and efficacy, the availability of alternative procedures and treatment options, or inadequate levels of reimbursement. Broad use of the EnSite System also requires time-consuming training of electrophysiologists and electrophysiology lab staff, which also could adversely affect market acceptance.

**We face significant industry competition**

The cardiac medical device market is highly competitive, and the EnSite System must compete with more established devices. Certain of our competitors are developing new approaches and new products for diagnosing and treating arrhythmias, including mapping systems that use single or multiple-point catheters that physically must come in contact with the heart wall in order to record electrical activity. Certain of our competitors have integrated product lines that include products for both diagnosis and ablation treatment of cardiac arrhythmias, which may afford them opportunities for product bundling and other marketing advantages. Many of our competitors have an established presence in the field of electrophysiology and established relationships with electrophysiology labs. Many of our competitors have substantially greater financial and other resources than we do, including larger research and development staffs and more experience and capabilities in conducting research and development activities, testing products in clinical trials, obtaining regulatory approvals, and manufacturing, marketing and distributing products. Some of our competitors may achieve patent protection, regulatory approval or product commercialization more quickly than us, which may decrease our ability to compete.

**Our products may become obsolete if we are unable to anticipate and adapt to rapidly changing technology**

The medical device industry is subject to rapid technological innovation and, consequently, the life cycle of any particular product is short. Alternative diagnostic systems or other discoveries and developments with respect to mapping cardiac arrhythmias, and navigating and positioning catheters used to diagnose and treat cardiac arrhythmias, may render our products obsolete. Furthermore, the greater financial and other resources of many of our competitors may permit them to respond more rapidly than us to technological advances. If we fail to demonstrate the safety, benefit, efficacy, and cost-effectiveness of our products as compared to those of our competitors, or if we fail to develop new technologies and products or upgrade our existing products before our competitors, our ability to market our products and generate substantial revenues may be limited.

**We depend on our patents and proprietary technology, which we may not be able to protect**

Our success will depend in part on our ability to obtain and maintain patent protection for our products and processes, to preserve our trade secrets and to operate without infringing the intellectual property rights of others. The patent positions of medical device companies are uncertain and involve complex and evolving legal and factual questions. We cannot assure you that any of our pending or future patent applications will result in issued patents, that any current or future patents will not be challenged, invalidated or circumvented, that the scope of any of our patents will exclude competitors or that the patent rights granted to us will provide us any competitive advantage. We may discover that our technology infringes patents or other rights owned by others, and we cannot be certain that we were the first to make the inventions covered by each of our issued patents and our pending patent applications, or that we were the first to file patent applications for such inventions. In addition, we cannot assure you that our competitors will not seek to apply for and obtain patents that will prevent, limit or interfere with our

ability to make, use or sell our products either in the United States or in international markets. Further, the laws of certain foreign countries may not protect our intellectual property rights to the same extent as do the laws of the United States.

In addition to patents, we rely on trade secrets and proprietary knowledge that we seek to protect, in part, through confidentiality agreements with employees, consultants and others. We cannot assure you that our proprietary information or confidentiality agreements will not be breached, that we will have adequate remedies for any breach, or that our trade secrets will not otherwise become known to or independently developed by competitors.

**We may face intellectual property infringement claims which would be costly to resolve**

There has been substantial litigation regarding patent and other intellectual property rights in the medical device industry and our competitors may resort to intellectual property litigation as a means of competition. Intellectual property litigation is complex and expensive and the outcome is difficult to predict. We cannot assure you that we will not become subject to patent infringement claims or litigation, or interference proceedings declared by the United States Patent and Trademark Office, or the patent regulatory agencies of foreign jurisdictions, to determine the priority of inventions. Litigation or regulatory proceedings may also be necessary to enforce our patent or other intellectual property rights. We may not always have the financial resources to assert patent infringement suits or to defend ourselves from claims. An adverse result in any litigation could subject us to liabilities to, or require us to seek licenses from or pay royalties to, others that may be substantial. Furthermore, we cannot assure you that the necessary licenses would be available to us on satisfactory terms, if at all.

**We have limited manufacturing experience necessary for high-volume manufacturing capacity**

We have limited experience manufacturing our products in the volumes that may be necessary for us to achieve significant growth in the commercial sales of our products. We may need to expend significant capital resources and develop the necessary expertise to establish large-scale manufacturing capabilities. We may encounter the following difficulties in scaling up production of our products:

- problems involving production yields,
- quality control and assurance,
- component supply shortages,
- shortages of qualified personnel,
- compliance with U.S. and foreign regulations, or
- the need for further U.S. or foreign regulatory approval of new manufacturing processes.

Our manufacturing facilities will be periodically inspected by United States and foreign regulatory authorities. In order to manufacture products for sale in the United States, our operations must undergo "Good Manufacturing Practices" compliance inspections conducted by the FDA. We passed inspection of our facility and manufacturing processes by the FDA in the fourth quarter of 2001. We will also be required to comply with ISO 9001 Quality System requirements and CE Mark regulations in order to continue to sell our products in Europe. We received ISO 9001 Quality System Certification in August 1997. We began placing the CE Mark on the EnSite Array catheter and the EnSite clinical workstation in the second quarter of 1998. We began using the CE Mark on the EnSite NavX surface electrode kits in second quarter of 2003. If we fail to comply with Good Manufacturing Practices or ISO 9001 and CE Mark regulations in future audits, we may be required to modify our manufacturing policies and procedures. In addition, we may be required to stop all or part of our operations until we can demonstrate that appropriate steps have been taken to comply with the regulations.

**We depend on a few suppliers for key components of our products**

We purchase components for the EnSite System from a variety of vendors. While it is our goal to be able to have multiple sources to procure these components, in some cases it is not economically practical to do so. While we do have some components that we currently obtain from a single source, such as the EnSite System computer from Silicon Graphics and EnSite NavX surface electrode kits from a division of Tyco, Inc., we are aware of

alternate supply sources that could provide such components or products with minimal modification to the current versions of the EnSite System or EnSite NavX surface electrode kits. Additionally, we practice supply chain management and maintain safety stocks of critical components and products, and have put agreements in place with our key vendors to manage the availability of critical components and products. Despite our efforts to mitigate this risk, if our vendors are unable to provide an adequate supply of components or products in a timely manner, or if we are unable to locate qualified alternate vendors for components or products at a reasonable cost, the availability of some or all of our EnSite System products to our customers and our ability to generate substantial revenues could be materially limited.

**Our sales and marketing efforts may not be successful**

We continue to gain experience in marketing and selling the EnSite System through a direct sales organization in the U.S., but we have limited experience in marketing and selling the EnSite System through a direct sales organization in parts of Europe, and through third-party distributors in other geographies in which the EnSite System is sold and distributed. We cannot assure you that we will be able to maintain a suitable sales force in the U.S. or abroad or enter into or maintain satisfactory marketing and distribution arrangements with others. Our sales and marketing efforts may not be successful.

**We will need to carefully manage our expanding operations in order to achieve sustainable growth**

In order to achieve increased sales levels, complete clinical trials, prepare additional products for clinical trials, and develop future products, we believe that we will be required to periodically expand our operations, particularly in the areas of research and development, manufacturing, quality assurance, and sales and marketing. As we expand our operations in these areas, the expansion likely will result in new and increased responsibilities for management. To accommodate any growth and compete effectively, we must implement and improve our information systems, procedures and controls, and expand, train, motivate and manage our work force. Our future success will depend significantly on the ability of our current and future management to operate effectively. We cannot assure you that our personnel, systems, procedures and controls will be adequate to support our future operations.

**International operations will expose us to additional risks**

We are marketing and will continue to market and sell the EnSite System either through a direct sales force or through distributors in international markets, subject to our receipt of the requisite foreign regulatory approvals. We have distribution arrangements with approximately seventeen distributors in international markets, and currently retain all distribution rights in the United States and several countries in Europe. We cannot assure you that international distributors for our products will devote adequate resources to selling and servicing our products.

Changes in overseas economic conditions, currency exchange rates, foreign tax laws or tariffs or other trade regulations could materially and adversely affect on our ability to market our products internationally. Our business is also expected to subject us and our representatives, agents and distributors to laws and regulations of the foreign jurisdictions in which we operate or our products are sold. We may depend on foreign distributors and agents for compliance and adherence to foreign laws and regulations.

**Our success may depend on the ability of health care providers to achieve adequate levels of third-party reimbursement**

Sales of our products will continue to depend largely on the availability of adequate reimbursement for diagnostic and therapeutic procedures for cardiac arrhythmias from third-party payors, such as government and private insurance plans, health maintenance organizations and preferred provider organizations. In the United States, our products are purchased primarily by health care providers such as doctors and hospitals who then seek reimbursement for the health care services provided to their patients. Specific to Medicare, the use of the EnSite Array or EnSite NavX is currently reimbursable under both inpatient and outpatient procedure scenarios. For inpatient procedures, the EnSite Array and EnSite NavX will most typically be reimbursed under Diagnosis Related Group 518. For outpatient procedures, both the EnSite Array and EnSite NavX is eligible for separate

reimbursement in addition to the hospital's Ambulatory Payment Classification for cardiac three-dimensional mapping. Third-party payors are increasingly challenging the pricing of medical products and procedures they consider unnecessary, inappropriate, not cost-effective, experimental or used for a non-approved indication. Even if a procedure is eligible for reimbursement, the level of reimbursement may not be adequate to enable us to achieve or maintain market acceptance of our products or maintain price levels that exceed our costs of developing and manufacturing our products.

The EnSite Array catheter and EnSite NavX surface electrode kits are being sold at a premium price compared to other single point catheters used in diagnostic, mapping, or catheter navigation procedures. In addition, an initial capital outlay is required for acquiring an EnSite clinical workstation (unless such workstation is leased or rented pursuant to a third-party financing transaction). Assuming no increase in the level of reimbursement for electrophysiology procedures utilizing our products, we will continue to be required to justify the relative increased cost to the health care providers and payors of using the EnSite System. We will continue to be required to demonstrate the enhanced benefits of the EnSite System to health care providers and payors in terms of such factors as enhanced patient procedural efficiencies, reduced radiation exposure, reduced procedure times, and improved patient outcomes. The demonstration of these benefits may require us to conduct post-marketing clinical studies, which may be costly, lengthy, and may not provide the cost or clinical justification results we are seeking. Without adequate support from third-party payors, the market for our products may be severely limited.

We are unable to predict what additional legislation or regulation, if any, relating to the health care industry or third-party coverage and reimbursement may be enacted in the future, or what effect such legislation or regulation would have on us. Reforms may include mandated basic health care benefits, limitations on the growth of private health insurance premiums and Medicare and Medicaid spending, greater reliance on prospective payment systems, the creation of large insurance purchasing groups and fundamental changes to the health care delivery system. We anticipate that Congress and state legislatures will continue to review and assess alternative health care delivery systems and payment methodologies. We cannot predict whether any reform proposals will be adopted or what impact they may have on us.

Reimbursement systems in international markets vary significantly by country and by region within some countries. Many international markets have government managed health care systems that control reimbursement for new devices and procedures. In most international markets, there are private insurance systems as well as government managed systems. We cannot assure you that reimbursement for our products will be available in international markets under either government or private reimbursement systems.

**Our products may expose us to costly litigation**

We may be exposed to product liability claims if a patient is adversely affected by our products. We currently carry product liability insurance covering our clinical trial operations with an aggregate limit of \$5 million. We cannot assure you that our existing insurance coverage limits are adequate to cover any liabilities we might incur in connection with the distribution of our products. Although we obtained product liability insurance coverage in connection with the commercialization of the EnSite System, insurance may not continue to be available on commercially reasonable terms. In addition, insurance might not adequately cover any product liability claim.

**We have a history of operating losses and expect future losses**

We have generated increasing revenue, but have sustained significant operating losses each year since our inception. We expect our losses to continue at least through the third quarter of 2003. We may never generate substantial operating revenues or achieve profitability. Our ability to generate revenues from operations and make a profit depends upon successful development, regulatory approval, manufacturing and commercialization of the EnSite System and our successful transition from a research and development company to a manufacturing and sales company.

**We may be unable to meet our future capital requirements**

We may require substantial funds to meet our working capital requirements for expansion of sales and marketing, research and development, clinical trials, regulatory approval and manufacturing activities. In order to meet our funding needs, we may be required to raise additional funds through public or private financings, including the sale of equity or debt. Any additional equity financings may dilute current stockholders, and debt financing, if available, may involve restrictive covenants. Adequate funds for our operations, whether from financial markets or from other sources, may not be available when needed on attractive terms, if at all. Insufficient funds may require us to delay, scale back or eliminate some or all of our plans for growth.