

Edgar Filing: INTERNET BUSINESS INTERNATIONAL INC - Form 10-K

INTERNET BUSINESS INTERNATIONAL INC  
Form 10-K  
October 01, 2001

U.S. SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED JUNE  
30, 2001

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM  
\_\_\_\_\_ TO \_\_\_\_\_

COMMISSION FILE NUMBER: 33-43621

INTERNET BUSINESS'S INTERNATIONAL, INC.  
(Exact name of registrant as specified in its charter)

Nevada  
(State or jurisdiction of incorporation  
or organization)

33-0845463  
I.R.S. Employer  
Identification No.)

4634 South Maryland Parkway, Suite 101, Las Vegas, Nevada  
(Address of principal executive offices)

89119  
(Zip Code)

Registrant's telephone number: (702) 968-0008

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: None

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

Indicate by check mark if disclosure of delinquent  
filers pursuant to Item 405 of Regulation S-K is not contained  
herein, and will not be contained, to the best of Registrant's  
knowledge, in definitive proxy or information statements  
incorporated by reference in Part III of this Form 10-K or any  
amendment to this Form 10-K [  ]. Not Applicable.

The aggregate market value of the voting stock held by non-  
affiliates of the registrant as of September 13, 2001: Common  
Stock, par value \$0.001 per share -- \$2,827,360. As of September  
13, 2001, the registrant had 282,736,029 shares of common stock  
issued and outstanding.

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### ITEM 1. BUSINESS.

#### Introduction.

Internet Business's International, Inc. ("Registrant") is a broad based Internet company that provides goods and services over the Internet to businesses and consumers through four operating divisions: (1) ISP (Internet Service Provider); (2) On-line Lending; (3) Direct Marketing; and (4) eCommerce.

Our corporate mission is one of unification and synergy. We accomplish this mission by empowering our operating divisions with the benefits of top-notch administration and management, and enabling economies of scale by aggregating many business functions. The Registrant's vision is to build a world-class on-line enterprise that is many times the sum of its parts.

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### History of the Business.

International Food and Beverage was listed for exchange on the Over The Counter Bulletin Board in June 1988. This company operated in the food services industry until late 1997, at which time it ceased operations. This firm remained dormant until December of 1998. At that time new management was put in place, and a decision was made to move the Registrant's focus to the Internet and change the Registrant's name to Internet Business's International, Inc.

On January 1, 1999 the newly named company began to offer goods and services over the Internet, starting with the development of an on-line B2C (business to consumer) e-retail site, AuctionWinner.com, The site was launched in April 1999. In July 1999, the Registrant expanded their service offerings by acquiring an ISP (Internet Service Provider) by the name of LA Internet. The Registrant changed its domicile from Delaware to Nevada in same year.

### Current Operations.

The Registrant currently operates four reporting divisions:

- (1) ISP (which includes a national dial-up ISP; a wireless high speed ISP in Las Vegas, NV, Moreno Valley, CA and Woodland, CA; and Internet web design and hosting businesses.)
- (2) On-line Lending (which includes real estate loans and equipment leasing.)
- (3) Direct Marketing (which includes the direct marketing of long distance phone services, computers with Internet access, wireless high speed Internet access and bandwidth.)
- (4) eCommerce (which includes auction sites, B2C and B2B eCommerce, and reverse auction sites for Europe and the United States), The Registrant has 7 offices in the US and 1 in Europe and more than 60 employees.

### Operating Divisions

- (a) ISP.

The ISP division operates four businesses that serve three distinct customer groups (dial-up ISP, wireless ISP, web site design / hosting)

- (1) LA Internet ([www.lainternet.com](http://www.lainternet.com)) Los Angeles, California

LA Internet, Inc. (a wholly owned subsidiary of the Registrant) is a full service dial-up ISP and web site hosting business. LA Internet provides nationwide dial-up access for consumers and businesses. This company also provides hosting and co-location (server farm) services to individuals and businesses. LA Internet employs state of the art equipment from Sun, Dell, Cisco, and BreezeCom. T1 and T3 level bandwidth providers include major national backbones such as ELI and MCI.

Revenue is generated though monthly fess charged for dial-up Internet access and web site hosting. LA Internet currently has 10 employees.

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(2) LA Internet Design ([www.lainternetdesign.com](http://www.lainternetdesign.com)) Los Angeles, California; Sofia, Bulgaria

LA Internet Design (an operating division of LA Internet) is full service web site design and development agency. This company offers a full portfolio of offerings: strategic planning, creative design, programming, and on-line marketing plans for individuals, businesses, and government agencies.

In addition to offering professional services, LA Internet Design retails a product called Site Creator - in strategic partnership with Network Solutions. Site Creator allows individuals or businesses to create their own web sites. These sites are then hosted by LA Internet.

Revenue is generated through hourly or fixed price fees for professional services, and through the retail sale of Site Creator. LA Internet Design currently has 5 employees.

(3) BeyondDSL ([www.beyondsl.com](http://www.beyondsl.com)) Las Vegas, Nevada

BeyondDSL (an operating division of LA Internet) operates a RF (Radio Frequency) type wireless ISP in several major west coast geographies: Las Vegas, Nevada; Moreno Valley, California; and Woodland, California. BeyondDSL provides Internet access to individuals and businesses at speeds up to 3 MB (megabits) per second.

Revenue is generated through monthly fees charged for wireless Internet access. BeyondDSL currently has 10 employees.

(4) Internet 2xtreme ([www.2xtreme.net](http://www.2xtreme.net)) Woodland, California

Internet 2xtreme (an operating division of LA Internet) is a full service dial-up ISP and web site hosting business operating in Woodland, California. Internet 2xtreme re-sells LA Internet's dial-up services and BeyondDSL's wireless ISP services to consumers and business in the Woodland area. This company also provides hosting and co-location (server farm) services to individuals and businesses. Internet 2xtreme maintains its own hosting and co-location facilities in Woodland, California.

Revenue is generated through monthly fees charged for dial-up and wireless Internet access and web site hosting. Internet 2xtreme currently has 9 employees.

(b) On-line Lending Division

(1) Guarantee Capital Group ([www.net2loan.net](http://www.net2loan.net)) Irvine, California

Guarantee Capital Group\* (a wholly owned subsidiary of the Registrant) is a mortgage banking company that processes and funds loans for homes. Guarantee's customers are primarily consumers that are applying for a first mortgage on a qualifying home. Guarantee generates qualified applicants through on-line marketing campaigns and through their web site ([www.net2loan.net](http://www.net2loan.net)).

Guarantee approves and funds loans according to Freddie Mac and Fannie Mae conforming and non-conforming underwriting criteria. Institutions such as RFC, Sun Trust and Interfirst, may purchase "bulk" loans from Guarantee.

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Revenue is generated through loan fees, processing fees, and yields based upon interest earned over the life of the loan and the cost of the funds. Guarantee Capital Group currently has 23 employees.

\* In the first quarter of the current fiscal year ending June 30, 2002, management decided to expand the mortgage banking operation into states other than California. Management decided at that time to increase the company's funding line as well. These two decisions precipitated the sale of the former mortgage group - Atlas Capital and the creation of Guarantee Capital Group.

(2) Discount On-line Leasing ([www.discountonlineleasing.com](http://www.discountonlineleasing.com))  
Laguna Hills, California

Discount On-line Leasing (an operating division of the Registrant) markets equipment-leasing solutions to small businesses. This company markets solutions for a wide range of equipment assets, including agricultural, computing, communications, office, machine tool, and manufacturing equipment. Discount On-line Leasing provides equipment leases to businesses the United States and Canada. The leases are funded through a number of finance companies that specialize in capital equipment funding.

Revenue is generated through commissions paid on the successful acceptance of leases. Discount On-line Leasing currently has 1 employee.

(c) Direct Marketing Division

1st2 Market, Inc. ([www.1st2mart.com](http://www.1st2mart.com)) Las Vegas, Nevada

1st2 Market\* (a wholly owned subsidiary of the Registrant) direct markets goods and services to individuals and businesses. Types of offers that 1st2 Market represents are computers bundled with Internet access, long distance offers, and cellular telephone hardware and calling plans. 1st2 Market markets its offers through print and on-line channels with a heavy emphasis on leveraging other Internet Business' International web sites.

Revenue is generated by commissions paid on orders processed. 1st2 Market currently has 3 employees.

\* During the first quarter of the current fiscal year ending June 30, 2002, it was decided that the current corporation Allstates Communications, Inc. did not fit the Registrant's current marketing plans; therefore it was decided to close Allstates Communications and begin the new corporation 1st2 Market. The new corporation started operations in September 1, 2001. The new corporation will not market cellular phones; it will only market the Registrant's products and services.

(d) eCommerce Division

The Registrant operates a several e-retail or ecommerce web sites serving several different markets:

(1) Iauction ([www.iauction.com](http://www.iauction.com)) Hornlake, Mississippi

Iauction.com (an operating division of the Registrant) is an on-line auction site. The site is a marketplace that allows

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consumers and business to place their goods or services up for sale by auction. The registration and interface is very much like other popular Internet auction sites such as ebay.com.

The site and the programming are proprietary to iauction.com. The site features an integrated accounting program that allows iauction.com to view updated information about revenues generated by the site from outside users in real-time. Iauction.com has also implemented programs that allow the site to be continuously updated with minimum cost and administrative overhead. This company markets the auction site throughout the Internet and leverages other Registrant sites.

Revenue is generated from transaction and listing fees charged to buyers and sellers of products and services.

(2) Global Construction Buying Group ([www.globalbuyinggroup.com](http://www.globalbuyinggroup.com))  
Hornlake, Mississippi

Global Construction Buying Group (a wholly owned subsidiary of the Registrant) is a B2B (business to business) reverse auction web site. The web site uses a proprietary reverse auction platform, developed by Global Construction Buying Group. The site allows a business (purchasing party) the opportunity to place RFPs (request for pricing) on-line. Interested vendors or suppliers can bid on the RFP. The purchasing party has the opportunity to select the lowest bid from all vendors. Global Construction Buying Group has offices in Europe and the United States. The company has an agreement with IBM in Europe to market the reverse auction program.

Revenue is generated from transaction and listing fees charged to buyers and sellers of products and services.

(3) BC Lenders ([www.bclenders.net](http://www.bclenders.net)) Hornlake, Mississippi

BC Lenders (short for "bruised credit") is a reference and referral site for consumers and business that have difficulty being accepted by conventional financing groups because of a poor credit history. The borrowers fill out an application and select a lender from the list to submit the application to.

Revenue is generated through commissions paid by lenders for referring accepted applicants to their businesses.

(4) Ace Optics ([www.aceoptics.com](http://www.aceoptics.com)) Hornlake, Mississippi

Ace Optics (an operating division of the Registrant) markets and retails popular brands of visual aids and designer sunglasses over the Internet. AceOptics sells to consumers over its web site [www.aceoptics.com](http://www.aceoptics.com).

Revenue is generated by retail sales of products.

(5) Sport Stores ([www.sport-stores.com](http://www.sport-stores.com)) Hornlake, Mississippi

Sport Stores (an operating division of the Registrant), markets and retails popular brands of sports gear and sports ware over the Internet. Sport Stores sells to consumers over its web site [www.sport-stores.com](http://www.sport-stores.com). Revenue is generated by retail sales of product.

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The entire eCommerce division shares 3 employees, the also rely on technical services from LA Internet and LA Internet Design.

Corporate

Newport Beach, CA

The Registrant maintains an administration and support group in Newport Beach, California. The group supports the operating divisions and administrates the public filings and financial statements. This office has 5 employees.

Market and Competition.

The market for Internet products and services is highly competitive. Taking into consideration the advances Internet technology and the ubiquity simple web site provide, there are no substantial barriers to entry in this market, and management expects that competition will continue to intensify. Negative competitive developments could have a material adverse effect on the Registrant's business and on the trading price of its stock.

The majority of our revenues come from on-line loans. The Registrant competes with many Internet, and many non-Internet companies that provide mortgages or equipment leasing. The Registrant also competes with many other companies that offer the same type of Internet-only services we offer - such as ISP services. The Registrant competes with many eCommerce on-line vendors of products that sell similar products that are offered by its eCommerce division. The Registrant competes with its direct marketing division with many other similar direct marketing companies. As the Registrant expands the scope of its Internet services, it will compete directly with a greater number of Internet sites and other similar type of companies across a wide range of different on-line and off-line services.

The Registrant also competes in vertical markets where competitors may have advantages in expertise, brand recognition, and other factors. Many companies offer directly competitive products or services information and community services, including, among others: America On-line; Yahoo; CNET; Excite; InfoSeek Corporation; Lycos; Microsoft Corporation (msn.com); and Netscape Communications Corporation (netcenter.com). In the past several months, there have been a number of significant acquisitions and strategic plans announced among and between these companies. These include: The Walt Disney Registrant acquiring a significant interest in InfoSeek; AOL acquiring Time Warner and Netscape; @Home Networks, Inc., a provider of high speed internet access serving the cable television infrastructure and the largest shareholder of which is AT&T, acquiring Media One and Excite. There has also been a contraction in the market place due to recent failures of many dot com companies. These failures also reduced the availability of expansion capital for many Internet companies

The effect of completed and pending acquisitions on the Registrant cannot be predicted with certainty, but all of these competitors are aligned with companies that are significantly larger or better established than the Registrant. As a result, each of them will have access to significantly greater financial, marketing and, in certain cases, technical resources than the Registrant.

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These and other competitors are expected to continue to make substantial marketing expenditures to promote their on-line properties. The Registrant may be required to increase its sales and marketing expenditures significantly in response to these efforts, which may materially impair its operating results and may not be success

Management believes that the principal competitive factors in its markets are: brand recognition; ease of use; comprehensiveness; personalization; independence; quality and responsiveness of search results and other services; the availability of high-quality, targeted content and focused value-added products and services; access to end users; and with respect to advertisers and sponsors, the number of users, duration and frequency of visits, and user demographics. Competition among current and future suppliers of Internet information, communication, community and commerce services, high-traffic web sites and ISPs, as well as competition with other media for advertising placements, could result in reductions revenues. (See chart below)

The following divisions have direct competition as follows;

| Sector                        | Subsidiary                               | Competition                       |
|-------------------------------|--|-----------------------------------|
| ISP<br>Dialup                 | LA Internet                              | ixpres.com<br>earthlink.com       |
| Wireless<br>Web design        | BeyonDSL<br>LA Internet Design           | landwaves.net<br>ixpres.com       |
| On-line Lending<br>Mortgages  | Guarantee Capital                        | homeloan.com<br>dietch.com        |
| Leasing                       | Discount On-line<br>Leasing              | leaseforce.com                    |
| Direct Marketing              | 1st2 Market                              | directoneusa.com                  |
| eCommerce<br>Auctions         | iauction.com                             | bidbay.com, ubid.com,<br>ebay.com |
| Reverse Auction<br>Sunglasses | Global Construction<br>aceoptics.com sun | sorcity.com<br>sunglasshut.com    |

The Registrant also faces competition with respect to the acquisition of strategic businesses and technologies. Many of its existing competitors, as well as a number of potential new competitors, have significantly greater financial, technical, marketing and distribution resources than the Registrant does. In addition, providers of Internet tools and services may be acquired by, receive investments from, or enter into other commercial relationships with larger, well-established and well-financed companies, such as Microsoft and AOL. In addition, well-established traditional media companies may acquire, invest or otherwise establish commercial relationships with its competitors. These larger companies may use their substantial media resources to promote and enhance their own services. Greater competition resulting from such relationships could have a materially adverse effect on the Registrant's business.



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### Strategic Alliances and Agreements.

The recent alliances of the Registrant have increased the companies and its subsidiaries' ability to market its products and services; these alliances are as follows;

#### (a) Network Solutions.

The Registrant has entered into an agreement with Network Solutions to co-market "Site Creator", Network Solutions' web based Internet site development program to new clients that are obtained by the Registrant. The Registrant will receive a commission on each sale of Site Creator as well as the opportunity to host Site Creator clients with LA Internet.

#### (b) IBM.

The Registrant has entered into an alliance with IBM and IBM Solution Providers in Europe to offer the industry specific reverse auction program of the Global Construction Buying Group, Inc.

### Marketing Plans.

The Registrant competes with other on-line services, web site operators and advertising networks, as well as traditional off-line media such as television, radio and print to convey to the consumer the services and products that are offered by the Registrant. The Registrant has used Print, Radio, and Television to inform the public and consumer of these products and services. Accordingly, the Registrant may face increased pricing pressure for the purchase of advertisement space. The Registrant therefore has also developed alternative marketing plans that uses direct marketing, cross promotion and bundling of services and products to increase its client base

### Proprietary Rights.

The Registrant regards its copyrights, trademarks, trade dress, trade secrets, and similar intellectual property as critical to its success. The Registrant relies upon trademark and copyright law, trade secret protection and confidentiality or license agreements with its employees, customers, partners and others to protect its proprietary rights. Effective trademark, copyright, and trade secret protection may not be available in every country in which its products and media properties are distributed or made available through the Internet. The distinctive elements of the Registrant's web sites may not be protected under copyright law. Management cannot guarantee that the steps the Registrant has taken to protect its proprietary rights will be adequate. Many parties are actively developing communication, community, e-commerce, and other web-related technologies. Management believes that such parties will continue to take steps to protect these technologies, including seeking patent protection. As a result, management believes that disputes regarding the ownership of such technologies are likely to arise in the future. For example, management is aware that a number of patents have been issued in the areas of electronic commerce, on-line auctions, web-based information, on-line direct marketing, fantasy sports, common web graphics formats and mapping technologies. Management anticipates that additional third-party patents will be issued in the future. From time to time these parties may assert patent infringement claims against

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the Registrant. Management cannot guarantee that it would be able to license such patents on reasonable terms. The Registrant may incur expenses in defending against third-party patent claims regardless of the merit of such claims. In the event that there is a determination that the Registrant has infringed such third-party patent rights, the Registrant could incur monetary liability and be prevented from using the rights in the future.

Employees.

As of the date of this filing, the Registrant had over 60 employees. This is a reduction from the same time last year when the company had 85 employees. The reduction of the employees was due to the changes made September 1, 2001 with the mortgage lending division and the direct marketing division. The Registrant's future success is substantially dependent on the performance of its senior management and key technical personnel, and its continuing ability to attract and retain highly qualified technical and managerial personnel.

Merger Transaction.

On June 4, 2001, Return Assured Incorporated, IBUI Acquisition Corporation, a wholly owned subsidiary of Return Assured, and the Registrant entered into an Agreement and Plan of Merger and Share Exchange ("Merger Agreement"). The Merger Agreement provides, among other things, for IBUI Acquisition Corporation to be merged with and into the Registrant ("Merger") and for a share exchange between the shareholders of the Registrant and the Return Assured. Under the Merger Agreement, each of the outstanding shares of the Registrant will be converted into the right to receive 0.14 shares of the Return Assured's common stock (Return Assured will adjust the exchange ratio to reflect any reclassification, stock split, stock dividend, reorganization or other similar change with respect to Return Assured common stock or the Registrant common stock occurring before the effective time of the Merger).

In connection with the Merger transaction, Return Assured will conduct a 1:6 reverse split of its common stock. Upon the completion of the transactions contemplated in the Merger Agreement, the Registrant will become a wholly-owned subsidiary of Return Assured and the current shareholders of the Registrant will own approximately 90% of Return Assured. The Merger, a purchase transaction, will be accounted for as a reverse merger with the Registrant as the accounting acquirer.

No fractional merged Return Assured common stock will be issued. Each of the Registrant's shareholder entitled to receive a fractional share of 0.5 or greater shall receive a whole merged company share and each of the Registrant shareholder's who would otherwise be entitled to receive a fractional share of less than 0.5 shall not receive an additional whole share.

Following the adoption of the Merger Agreement and approval of the Merger by the Registrant's stockholders and the satisfaction or waiver of the other conditions to the Merger, IBUI Acquisition Corp. will merge into the Registrant. The Registrant will survive the Merger as a wholly owned subsidiary of Return Assured; the separate existence of IBUI Acquisition Corporation will cease.

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If all conditions to the Merger are satisfied or waived, the Merger will become effective at the time of the filing by the surviving corporation of a duly executed certificate of merger with the Secretary of State of the State of Delaware.

After the effective time of the Merger, Return Assured's transfer agent will mail to each record holder of the Registrant's common stock a letter of transmittal and instructions for surrendering their certificates. Only those holders who properly surrender their certificates in accordance with the instructions will receive certificates representing Return Assured common stock, cash in lieu of any fractional Return Assured common stock and any dividends or distributions to which they are entitled. The surrendered certificates representing shares of the Registrant's common stock will be cancelled. After the effective time of the Merger, each certificate representing shares of the Registrant common stock that has not been surrendered will only represent the right to receive common stock of Return Assured. Following the effective time of the Merger, the Registrant will not register any transfers of the Registrant common stock on its stock transfer books.

If any the Registrant's common stock certificate is lost, stolen or destroyed, an the Registrant stockholder must provide an appropriate affidavit of that fact. Return Assured may require an the Registrant's stockholders to deliver a bond as indemnity against any claim that may be made against Return Assured with respect to any lost, stolen or destroyed certificate.

### Risk Factors.

In addition to the other information in this Report, the following particular risk factors may be encountered in the operation of the Registrant under its current plan of business:

#### (a) Limited Operating History.

The Registrant has only begun operations as an Internet company since January 1, 1999. Therefore, the Registrant has a limited operating history, and its prospects are subject to the risks, expenses and uncertainties frequently encountered by young companies that operate exclusively in the new and rapidly evolving markets for Internet products and services. Successfully achieving its growth plan depends on, among other things, the Registrant's: ability to continue to develop and extend its brand; ability to develop new web site properties; ability to maintain and increase the levels of traffic on its internet properties; development or acquisition of services or products equal or superior to those of the Registrant's competitors; ability to effectively generate revenues through sponsored services and placements on the Registrant's internet web site properties; ability to effectively integrate the technology and operations of businesses or technologies which the company may acquire; ability to successfully develop and offer new personalized web-based services, such as e-mail services, to consumers without errors or interruptions in service; and ability to identify, attract, retain and motivate qualified personnel. Furthermore, the success of the Registrant's growth plan depends on factors outside its control including, among other things: the adoption by the market of the web as an E-Commerce medium; the successful sale of web-based services by the Registrant's sales agents; and the relative price stability for web-based services

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and products, despite competition and other factors that could reduce market prices. The Registrant may not be successful in implementing its growth plan or continuing to operate its business as anticipated.

### (b) Operating Results May Fluctuate.

The Registrant expects to derive the majority of its revenues from a variety of revenue sources, which are difficult to forecast accurately. As noted above, the Registrant expects its operating expenses to increase significantly over the near term. To the extent its expenses increase but its revenues do not, its business, operating results, and financial condition will be materially and adversely affected. Operating results may fluctuate significantly in the future as a result of a variety of factors, many of which are outside its control. These factors include: the level of usage of the Registrant's Internet sites, and the demand for the products and services that the Registrant offers over the Internet, the amount and timing of capital expenditures and other costs relating to the expansion of its operations; the introduction of new products or services by the Registrant or its competitors; pricing changes for internet-based services, the timing of initial set-up, engineering or development fees that may be paid in connection with larger area distribution arrangements; technical difficulties with respect to the online web site properties that the Registrant may develop; costs incurred with respect to acquisitions; negative general economic conditions and resulting effects on economic conditions specific to the internet and online media.

A key element of the Registrant's strategy is to generate revenues through services and products from its online media properties and its direct marketing operations. In connection with these, the Registrant will receive fees as well as a portion of transaction revenues received by business that is originated through the Registrant sites. This type of revenue generation exposes the Registrant to potentially significant financial risks, including: the risk that the Registrant fails to obtain the minimum level of revenue required to maintain the operational expenses of the Registrant.

### (c) Dependence on Continued Growth in Use of the Internet; Technological Change.

The Registrant's future success is dependent upon continued growth in the use of the Internet and the web in order to support the sale of its products and services and its online web site properties. The Companies Internet businesses are relatively new, and it is difficult to predict the extent of further growth, if any, in from these sites. The Internet may not prove to be a viable commercial marketplace for a number of reasons, including lack of acceptable security technologies, potentially inadequate development of the necessary infrastructure, or timely development and commercialization of performance improvements. To the extent that the Internet continues to experience significant growth in the number of users and level of use, the Internet infrastructure may not be able to support the demands placed upon it by such growth and the performance or reliability of the web may be adversely affected.

The market for Internet products and services is characterized by rapid technological developments, evolving

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industry standards and customer demands, and frequent new product introductions and enhancements. To the extent that higher bandwidth internet access becomes more widely available through cable modems or other technologies, the Registrant may be required to make significant changes to the design and content of its online properties in order to compete effectively. Failure to effectively adapt to these or any other technological developments may adversely affect its business, operating results, and financial condition.

The markets for the Registrant's products and services have only recently begun to develop, are rapidly evolving, and are increasingly competitive. Demand and market acceptance for recently introduced products and services are subject to a high level of uncertainty and risk. It is difficult for management to predict whether, or how fast, these markets will grow. The Registrant cannot guarantee either that the market for its products and services will continue to develop or that demand for its products and services will be sustainable. If the market develops more slowly than expected or becomes saturated with competitors, or if its products and services do not sustain market acceptance, its business, operating results, and financial condition may be materially and adversely affected.

### (d) Risks Associated with Brand Development.

The Registrant believes that establishing and maintaining its brand is a critical aspect of its efforts to attract and expand its user base. Management also believes that the importance of brand recognition will increase due to the growing number of Internet sites and the relatively low barriers to entry. Promotion and enhancement of the Registrant's brand will depend largely on its success in providing high-quality products and services. In order to attract and retain Internet users and to promote and maintain its brand, the Registrant may find it necessary to increase expenditures devoted to creating and maintaining brand loyalty. In the event of any breach or alleged breach of security or privacy involving its services, or if any third party undertakes illegal or harmful actions utilizing its community, communications or commerce services, the Registrant could suffer substantial adverse publicity and impairment of its brand and reputation. If the Registrant is unable to provide high-quality products and services or otherwise fails to promote and maintain its brand, or if it incurs excessive expenses in an attempt to improve its products and services or promote and maintain its brand, its business, operating results, and financial condition may be materially and adversely affected.

### (e) Possible Inability to Successfully Enhance or Develop Properties.

To remain competitive, the Registrant must continue to enhance and improve the functionality, features, and content of its web site properties. The Registrant may not be able to successfully maintain competitive user response times or implement new features and functions, which will involve the development of increasingly complex technologies. Personalized information services, such as its web-based email messaging services, message boards, and other community features, require significant expense. The Registrant cannot guarantee that additional revenues from these services will offset this additional expense.

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A key element of its business strategy is the development and introduction of new particular demographic characteristics, and geographic areas. The Registrant may not be successful in developing, introducing, and marketing such web site properties and such properties may not achieve market acceptance, enhance its brand name recognition, or increase user traffic. Furthermore, enhancements of or improvements to the Registrant's new properties may contain undetected errors that require significant design modifications, resulting in a loss of customer confidence and user support and a decrease in the value of its brand name. Its ability to successfully develop additional targeted media properties depends on use of the Registrant to promote such properties. If use of the Registrant's web site properties does not continue to grow, its ability to establish other targeted properties would be adversely affected. If the Registrant fails to effectively develop and introduce such new properties, or such properties fail to achieve market acceptance, its business, results of operations, and financial condition may be adversely affected.

### (f) Management of Potential Growth and Integration of Acquisitions.

The Registrant's growth may place substantial strains on its financial systems and its systems to train and manage its employee base. The process of managing large, high traffic web sites is an increasingly important and complex task. This relies on both internal and licensed third-party management and analysis systems. To the extent that the Registrant does not have the appropriate inventory or any extended failure of its management system results "make good" obligations with its customers, which, could defer revenues. Failure of its management systems to effectively scale to higher levels of use or to effectively track and provide accurate and timely E-Commerce reports and also could negatively affect its relationships with its customers. The Registrant's systems, procedures, or controls may not be adequate to support its operations, particularly with regard to support and service. Its management may not be able to achieve the rapid execution necessary to fully exploit its market opportunity. Any inability to effectively manage growth may have a materially adverse effect on its business, operating results, and financial condition.

As part of its business strategy, the Registrant may, from time to time, make acquisitions or enter into other forms of business combinations. These transactions are accompanied by a number of risks, including: the difficulty of assimilating the operations and personnel of the acquired companies; the potential disruption of its ongoing business and distraction of management; the difficulty of incorporating acquired technology or content and rights into its products and media properties; the correct assessment of the relative percentages of in-process research and development expense which can be immediately written off as compared to the amount which must be amortized over the appropriate life of the asset; the failure to successfully develop an acquired in-process technology could result in the impairment of amounts currently capitalized as intangible assets; unanticipated expenses related to technology integration; the maintenance of uniform standards, controls, procedures and policies; the impairment of relationships with employees and customers as a result of any integration of new management personnel; and the potential unknown liabilities associated with acquired businesses. The Registrant may not be successful in

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addressing these risks or any other problems encountered in connection with such acquisitions.

### (g) Risk of Capacity Constraints and Systems Failures.

The Registrant is dependent on its ability to effectively withstand a high volume of use of its online web site properties. Accordingly, the performance of its online web site properties is critical to its reputation, its ability to attract advertisers to its web sites, and to achieve market acceptance of its products and web site properties. Any system failure that causes an interruption or an increase in response time of its products and media properties could result in less traffic to its web sites and, if sustained or repeated, could reduce the attractiveness of its products and media properties to advertisers and licensees. An increase in the volume of queries conducted through its products and media properties could strain the capacity of the software or hardware the Registrant has deployed, which could lead to slower response time or system failures. In addition, as the number of web pages and users increase, its products and media properties and infrastructure may not be able to scale accordingly. Personalized information services, such as web-based email-type messaging services and other community and communication facilities, and the posting of photographs on its auction properties, involve increasingly complex technical and operational challenges that may strain its development and operational resources. The Registrant may not be able to successfully implement and scale such services to the extent required by any growth in the number of users of such services. Failure to do so may affect the goodwill of users of these services, or negatively affect its brand and reputation.

The Registrant is dependent on third parties for much of its technology and infrastructure. The Registrant's operations are susceptible to outages due to fire, floods, power loss, telecommunications failures, break-ins, and similar events. The Registrant does have multiple site capacity, which would reduce the impact in the event of any such occurrence. Despite its implementation of network security measures, its servers are vulnerable to computer viruses, break-ins, and similar disruptions from unauthorized tampering with its computer systems. The Registrant does not carry business interruption insurance to compensate for losses that may occur as a result of any of these events. Such events may have a materially adverse effect on its business, operating results, and financial condition.

### (h) Government Regulation and Legal Uncertainties.

There are currently few laws or regulations directly applicable to Internet access or to commerce on the net. Due to the increasing popularity and use of the internet, it is possible that laws and regulations may be adopted, covering issues such as user privacy, defamation, pricing, taxation, content regulation, quality of products and services, and intellectual property ownership and infringement. Such legislation could expose the Registrant to substantial liability. Such legislation could also dampen the growth in use of the web, decrease the acceptance of the web as a communications and commercial medium, or require the Registrant to incur significant expense in complying with any new regulations. In addition, several telecommunications carriers, including America's Carriers' Telecommunications Association, are seeking to have telecommunications over the web regulated by the

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Federal Communications Commission in the same manner as other telecommunications services.

Because the growing popularity and use of the web has burdened the existing telecommunications infrastructure and many areas with high web use have begun to experience interruptions in phone service, local telephone carriers, such as Pacific Bell, have petitioned the FCC to regulate ISPs and Sops and to impose access fees. Increased regulation or the imposition of access fees could substantially increase the costs of communicating on the web, potentially decreasing the demand for its products and media properties. A number of proposals have been made at the federal, state and local level that would impose additional taxes on the sale of goods and services through the Internet. Such proposals, if adopted, could substantially impair the growth of electronic commerce, and could adversely affect the Registrant's opportunity to derive financial benefit from such activities.

The Digital Millennium Copyright Act, which is intended to reduce the liability of online service providers for listing or linking to third-party web sites that include materials that infringe copyrights. Also the Children's Online Protection Act and the Children's Online Privacy Act, which will restrict the distribution of certain materials deemed harmful to children and impose additional restrictions on the ability of online services to collect user information from minors. Further, Congress recently passed (and the President has signed into law) the Protection of Children from Sexual Predators Act, which mandates that electronic communication service providers report facts or circumstances from which a violation of child pornography laws is apparent. The Registrant is currently reviewing these pieces of legislation, and cannot currently predict the effect, if any, that such legislation will have on its business. There can be no assurance that such legislation will not impose significant additional costs on its business or subject the Registrant to additional liabilities.

In addition, a number of other countries have announced or are considering additional regulation. For example, the European Commission privacy directive restricts the use of personal information without the consent of both the individual and that individual's government. Such restrictions could jeopardize the future of e-commerce in and with the European Union. In addition, the European Commission is expected in the near future to propose a directive concerning the liability of online service providers for activities that take place using their services. Such laws and regulations could fundamentally impair the Registrant's ability to provide Internet services, or substantially increase the cost of doing so. Moreover, the applicability to the Internet of existing laws governing issues such as property ownership, copyright, defamation, obscenity, and personal privacy is uncertain. The Registrant may be subject to claims that its services violate such laws. Any such new legislation or regulation in the United States or abroad or the application of existing laws and regulations to the Internet could have a material adverse effect on its business, operating results, and financial condition. Due to the global nature of the web, it is possible that the governments of other states and foreign countries might attempt to regulate its transmissions or prosecute the Registrant for violations of their laws. The Registrant might unintentionally violate such laws. Such laws may be modified, or new laws enacted, in the future. Any such



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developments may have a materially adverse effect on its business, results of operations, and financial condition.

### (i) Liability for the Registrant's Services.

The Registrant hosts a wide variety of information, community, communications and commerce services that enable individuals to exchange information, generate content, conduct business and engage in various online activities. The laws relating to the liability of providers of these online services for activities of their users are currently unsettled. Claims could be made against the Registrant for defamation, negligence, copyright or trademark infringement, personal injury or other theories based on the nature and content of information that may be posted online by its users. Such claims have been brought, and sometimes successfully pressed, against online service providers in the past. In addition, the Registrant could be exposed to liability through content and materials that may be posted by users in auctions, message boards, clubs, chat rooms, or other interactive community-building services. Such claims might include, among others, that by providing hypertext links to web sites operated by third parties, the Registrant is liable for copyright or trademark infringement or other wrongful actions by such third parties through such web sites, or that the Registrant is responsible for legal injury caused by statements made to, actions taken by or content generated by, participants in its message board services, clubs, or other community building services. It is also possible that if any information that may, in the future, be provided through its services, such as stock quotes, analyst estimates or other trading information contains errors, third parties could make claims against the Registrant for losses incurred in detrimental reliance on such information. The Registrant offers web-based e-mail type messaging services, which expose it to potential risks, such as liabilities or claims resulting from lost or misdirected messages, illegal or fraudulent use of messages, or interruptions or delays in messaging services. Investigating and defending such claims are expensive, even to the extent such claims do not result in liability.

The Registrant may also, from time to time, enter into arrangements to offer third-party products and services under the Registrant's brand or via distribution on its properties. While its agreements with these parties would provide that the Registrant would be indemnified against liabilities, such indemnification may not be adequate. The Registrant may be subject to claims concerning such services or content by virtue of its involvement in marketing, branding or providing access to such services. Any such claims may have a materially adverse effect on its business, results of operations, and financial condition.

### (j) Potential Commerce-Related Liabilities and Expenses.

As part of its business, the Registrant enters into agreements with businesses, sponsors, content providers, service providers, and merchants under which the Registrant is entitled to receive a share of revenue from the purchase of goods and services by users of its web site properties. Such arrangements may expose the Registrant to additional legal risks and uncertainties, including potential liabilities to consumers of such products and services. These activities expose the Registrant to a number of additional risks and uncertainties, including: potential liabilities for illegal activities that may

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be conducted by participating merchants; products liability or other tort claims relating to goods or services sold through hosted commerce sites; consumer fraud and false or deceptive advertising or sales practices; breach of contract claims relating to merchant transactions; claims that materials included in merchant sites or sold by merchants through these sites infringe third-party patents, copyrights, trademarks or other intellectual property rights, or are libelous, defamatory or in breach of third-party confidentiality or privacy rights; claims relating to any failure of merchants to appropriately collect and remit sales or other taxes arising from e-commerce transactions; and claims that may be brought by merchants as a result of their exclusion from its commerce services or losses resulting from any downtime or other performance failures in its hosting services.

In January of 2001, the Registrant launched IAuction.com, a service that hosts online auctions for a wide variety of goods and services. Auction services expose the Registrant to a number of significant additional risks. For example, the Registrant does not pre-screen the types of goods offered on its auctions, it is aware that certain goods, such as alcohol, tobacco, firearms, adult material and other goods that may be subject to regulation by local, state or federal authorities may be traded on the auction web site. The Registrant might not be able to prevent the unlawful exchange of goods on its service, and may be subject to civil or criminal liability for unlawful activities carried out by users through its service. In addition, while the Registrant takes no responsibility for delivery of payment or goods to any user of its auctions, the Registrant anticipates that users who did not receive the purchase price or the goods that were to have been exchanged may register complaints with the Registrant or seek to hold the Registrant liable. The Registrant also anticipates that it will receive complaints from buyers as to the quality of the goods purchased through its auctions, as well as complaints alleging that comments posted by participants of the service concerning other participants are unfair or defamatory. Any claims or litigation arising from the Registrant's auction activities could be costly. Any negative publicity generated as a result of fraudulent or deceptive conduct by users of these auctions could damage its reputation and diminish the value of its brand name. In addition, the Registrant anticipates that it will receive in the future, communications alleging that certain items sold through its auctions, or text and images posted by users in auction listings, infringe third-party copyrights, trademarks or other intellectual property rights. While its user policies prohibit the sale of goods and posting of materials, which may infringe third-party intellectual property rights, an allegation of infringement may result in costly litigation.

### ITEM 2. PROPERTIES.

The consolidated Registrant has over \$1,800,000 in equipment and furniture at a variety of co-locations for Internet wireless, and server equipment plus the following office locations;

Internet Business's International, Inc.

Corporate Headquarters

4634 S. Maryland Pky, Suite 107  
Las Vegas, Nev. 89119

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West Coast Headquarters

3900 Birch Street, Suite 103  
Newport Beach, Ca. 92660

International Headquarters  
3 Boicho Voivoda str., 1024  
Sofia, Bulgaria

Subsidiaries of Internet Business's International, Inc. (current  
as of September 10, 2001)

1 st 2 Market, Inc.  
4634 S. Maryland Pky, Suite 107  
Las Vegas, Nev. 89119

Guarantee Capital Group, a Corp.  
18004 SkyPark Ci. Suite 170,  
Irvine, Ca. 92614

Global Construction Buying Group, Inc.  
1077 Goodman Rd., Hornlake, Mississippi 38654

LA Internet, Inc.  
11500 Olympic Blvd, Suite 441, LA. Ca. 90064  
1059 Court St. Suite 123, Woodland, Ca. 95695  
4634 S. Maryland Pky, Suite 107, Las Vegas, Nev. 89119

Iauction.com Inc.  
1077 Goodman Rd., Hornlake, Mississippi 38637

### ITEM 3. LEGAL PROCEEDINGS.

Other than as set forth below, the Registrant is not a party to any material pending legal proceedings other than ordinary routine litigation incidental to the business and, to the best of its knowledge, no such action by or against the Registrant has been threatened.

The Registrant on March 2, 2001 filed an action in the United States District Court, Central District of California against Ronald Friedman, and The Ronald Friedman 1997 Grantor Retained Annuity Trust (Case Number SA CV 01-268 DOC (Eex)) for rescission of the purchase of the PMCC stock and return of the \$1,006,857. On August 16, 2001 Ronald Friedman, Robert Friedman, and The Ronald Friedman 1997 Grantor Retained Annuity Trust filed an action in the United States District Court, Southern District of New York against the company (Case Number CV 01-7637), for the balance of the contract in the amount of \$2,191,143. Each side has filed an answer to the complaints. The Registrant intends to contest this matter vigorously. Management cannot take any position at this time as to the likely outcome of the matter.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matters were submitted to a vote of the Registrant's stockholders during the fourth quarter of the fiscal year covered by this report.

PART II.

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### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

#### Market Information.

The common stock of the Registrant is traded on the Over the Counter Bulletin Board under the symbol "IBUI" and the range of closing bid prices shown below is as reported by the this market place. The quotations shown reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

For the Fiscal Year Ended June 30, Per Share Common Stock Bid Prices by Quarter

|                   | 2000 |        | 2001   |        |
|-------------------|------|--------|--------|--------|
|                   | High | Low    | High   | Low    |
| 1st Quarter 9-30  | 0.16 | 0.04   | 0.3125 | 0.1562 |
| 2nd Quarter 12-31 | 0.35 | 0.017  | 0.125  | 0.0625 |
| 3rd Quarter 3-31  | 2.00 | 0.0275 | 0.0781 | 0.0469 |
| 4th Quarter 6-30  | 0.74 | 0.20   | 0.05   | 0.03   |

#### Holder of Common Equity

As of September 10, 2001 there were 631 shareholders of record of the Registrant's Common Stock.

#### Dividends

The Registrant has not declared or paid a cash dividend to stockholders since it was organized. The Board of Directors presently intends to retain any earnings to finance Registrant operations and does not expect to authorize cash dividends in the foreseeable future. Any payment of cash dividends in the future will depend upon the Registrant's earnings, capital requirements and other factors.

#### Equity Securities Sold Without Registration.

The Registrant made the following sales of unregistered securities during the fiscal year ended December 31, 2000:

(a) During the quarter ended December 31, 2000, the Registrant issued the following shares of common stock: (a) 500,000 shares of restricted 144 stock for the acquisition of Sonic Auction.Com; and (2) 7,140,406 common stock were issued pursuant to the agreement with the conversion rights of the preferred stock issued December 15, 1998, upon the 10 day average of the closing bid price prior to the to the conversion date.

(b) During the quarter ended March 31, 2001, the Registrant issued the following shares of common stock: 18,981,080 on conversion of additional preferred stock that was originally issued December 15, 1998 (as discussed in subparagraph (a) above).

(c) During the quarter ended June 30, 2001, the Registrant issued the following shares of common stock: 19,499,430 on conversion of additional preferred stock that was originally issued December 15, 1998 (as discussed in subparagraph (a) above).

No commissions or fees were paid in connection with these sales. All of the above sales were undertaken pursuant to the

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limited offering exemption from registration under the Securities Act of 1933 as provided under Rule 506 of Regulation D by the fact that:

the sales were made to sophisticated investors as defined in Rule 502;

the information specified in paragraph (b)2(ii)(B) and paragraph (b)(2)(ii)(C) of this section was provided to each investor;

the Registrant gave each purchaser the opportunity to ask questions and receive answers concerning the terms and conditions of the offering and to obtain any additional information which the Registrant possessed or could acquire without unreasonable effort or expense that is necessary to verify the accuracy of information furnished;

at a reasonable time prior to the sale of securities, the Registrant advised the purchasers of the limitations on resale in the manner contained in paragraph Rule 502(d)2 of this section;

neither the Registrant nor any person acting on its behalf sold the securities by any form of general solicitation or general advertising; and

the company exercised reasonable care to assure that the purchasers of the securities are not underwriters within the meaning of section 2(11) of the Securities Act of 1933 in compliance with Rule 502(d).

### ITEM 6. SELECTED FINANCIAL DATA.

The selected financial data for the years ended June 30, 2001, 2000, 1999, 1998, and 1997, are derived from the audited financial statements of the Registrant and should be read in conjunction with the audited financial statements included herein.

#### Statement of Operations Data: (in thousands)

|  | Year End June 30 |          |         |          |         |
|--|------------------|----------|---------|----------|---------|
|  | 2001             | 2000     | 1999    | 1998     | 1997    |
| Revenues                               | \$49,500         | \$10,169 | \$ 141  | \$ 2,378 | \$7,358 |
| Cost of revenues                       | 42,459           | 8,849    | 23      | 2,248    | 5,847   |
| Gross profit (loss)                    | 7,041            | 1,320    | 118     | 130      | 1,511   |
| Sales & distribution exp.              | 4,090            | 375      | 43      | 525      | 1,512   |
| General and admin exp.                 | 2,702            | 2,822    | 157     | 366      | 529     |
| Net operating income (loss)            | 107              | (2,665)  | (82)    | (1,160)  | (530)   |
| Net other income and expense           | 687              | 44       | 2,250   | 0        | 0       |
| Net income (loss)                      | 794              | (2,596)  | 2,168   | (1,160)  | (530)   |
| Per common share net                   | nil              | nil      | 0.01    | nil      | nil     |
| Weighted average<br>shares outstanding | 250,907          | 189,580  | 164,550 | 158,060  | 154,763 |

#### Balance Sheet Data: (in thousands)

|                     | Year End June 30 |       |       |       |       |
|---------------------|------------------|-------|-------|-------|-------|
|                     | 2001             | 2000  | 1999  | 1998  | 1997  |
| Current assets      | 7,661            | 4,826 | 395   | 1     | 711   |
| Fixed assets        | 4,413            | 3,459 | 0     | 0     | 800   |
| Total assets        | 12,074           | 8,932 | 4,015 | 1,102 | 1,511 |
| Current liabilities | 6,902            | 3,602 | 30    | 1,819 | 1,947 |
| Long-term debt      | 1,168            | 204   | 0     | 455   | 677   |

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|                      |       |       |       |         |         |
|----------------------|-------|-------|-------|---------|---------|
| Shareholders' equity |       |       |       |         |         |
| (deficiency)         | 4,004 | 5,139 | 3,985 | (2,273) | (1,113) |

The Registrant has not paid dividends in any of the periods presented.

### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion should be read in conjunction with the financial statements of the Registrant and notes thereto contained elsewhere in this report.

#### Results of Operations.

##### (a) Comparison by Segment

The Registrant is a broadly based Internet company that supports many operating divisions. Taking into consideration the growth of many of our business in the last fiscal year, management has begun to segment the company's businesses into four operating divisions. These are as follows: (1) ISP, (2) On-line Lending, (3) Direct Marketing, (4) eCommerce. The four operating divisions are the level at which executive management reviews the results of operations in order to make decisions regarding performance assessments and resource allocations. Certain general expenses related to advertising and marketing; information systems; and finance and administrative groups are not allocated to the operating segments and are included in the "Other" section of the reconciliation of operating income reported below.

Information on reportable segments is as follows:

|                            | Twelve Months Ended |                 |
|----------------------------|---------------------|-----------------|
|                            | June 30<br>2001     | June 30<br>2000 |
| Full-service ISP           |                     |                 |
| Net sales                  | \$ 4,912,285        | \$1,577,971     |
| Operating income           | 2,037,932           | (348,367)       |
| Mortgage loan originations |                     |                 |
| Net sales                  | 43,366,519          | 8,264,071       |
| Operating income           | (83,571)            | (386,682)       |
| E-Commerce (B2BC)          |                     |                 |
| Net sales                  | 278,668             | 47,002          |
| Operating income           | (156,187)           | (164,341)       |
| Marketing (B2BC)           |                     |                 |
| Net sales                  | 495,251             | 160,380         |
| Operating income           | (825,858)           | (180,986)       |
| Other income               |                     |                 |
| Net income                 | 447,316             | 119,666         |
| Operating income           | (178,799)           | (1,584,293)     |
| Total                      |                     |                 |
| Net sales                  | 49,500,039          | 10,169,000      |
| Operating income           | 793,517             | (2,596,000)     |

##### (b) Comparison of Year to Year.

###### (1) Fiscal 2001 Compared to Fiscal 2000

Revenues for the twelve-month period ended June 30, 2001 of \$49,500,039 increased approximately 487% when compared with revenues of \$10,169,000 in the prior year. This revenue increase

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is primarily due to the company's increase in mortgage loan originations. Interest rates for mortgage loans since March of 2001 have remained in the range of 6% to 7% though the beginning of September 2001 and it is expected that rates will remain in this range throughout the end of 2001 - although it must be noted that prime interest rates are beyond the company's control. It is widely acknowledged that low rates encourage consumers to take out mortgages for the purchase of homes and this condition has impacted our business favorably. Aside from lower interest rates, several other factors contributed to the increase in mortgage loans:

(A) The on-line lending division increased their amount of Internet marketing over last year. This change contributed to a lower cost of sales and increased the total audience that viewed their ads.

(B) The online lending division incorporated new Loan Application Management software to automate loan applications.

The result was higher productivity per customer sales representative and faster loan approval / decline times.

(C) The online lending division employed a Direct Underwriting System. The division enjoyed quicker approval times due to this system.

Other factors that contributed to the increase in revenue include:

(A) Our ISP division began operations of BeyonDSL in April 2000. We began to reach a critical mass of customers in this fiscal year's reporting period.

(B) LA Internet integrated an automated billing system into their operations. This allowed us more timely and comprehensive statements.

(C) Our eCommerce division added a number of high-ticket products and sales were better than expected.

(D) Our Direct Marketing division began marketing an additional offer our long distance savings product.

The gross profit of \$7.041 million for the twelve months ended June 30, 2001 is an increase of 533% when compared to the gross profit for the prior twelve months of \$1.32 million. Profits increased as a result of revenues. Margins increased due to a number of operating efficiencies implemented in the last year and switching key suppliers. Some of the key factors include:

(A) Our On-line Lending division began marketing "bulk" loans to financial institutions. The resulted in higher margins due to a lower cost of sale per loan.

(B) Our ISP division switched backbone suppliers and reduced our bandwidth costs.

(C) Our ISP division integrated an automated billing system into their operations. This allowed us to bill more accurately.

(D) Our eCommerce division increased the number of high-ticket products they retailed. We realized higher margins on these sales.

Selling, general and administrative expenses for the 2001 fiscal year of \$5,921,184 were an increase of approximately 190% over the \$3,107,140 for the previous fiscal year 2000. The Registrant

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invested in a number of infrastructure and systems upgrades in order to automate key business functions. The upgrades came at substantial costs but were off set by the increase in revenues.

The resulting profit for the twelve-month period ended June 30, 2001 of \$793,516 was an increase of approximately 130% when compared to the loss of \$2,596,444 reported for the year ended June 30, 2000.

### (2) Fiscal 2000 Compared to Fiscal 1999

Revenues for the twelve-month period ended June 30, 2000 of \$10,169,000 increased approximately 720% when compared with revenues of \$140,641 in the prior year. This revenue increase is due to the acquisitions made by the Registrant since the end of its last fiscal year.

The gross profit margin of 13% for the twelve months ended June 30, 2000 is a significant decrease from the gross margin of 84% reported for twelve months ended June 30, 1999. Current year margins in the past twelve months reflect the reopening of the business as an Internet company after November 1998.

Selling general and administrative expenses for the 2000 fiscal year of \$3,107,140 were approximately 378% greater than those of fiscal year 1999 of \$199,753 due to the increase of operations of the Registrant.

The resulting net loss after taxes for the twelve-month period ended June 30, 2000 was \$2,596,444 versus a reported loss for the year ended June 30, 1999 of \$81,836. This loss primarily resulted from the acquisitions and investments made in the fourth quarter of this fiscal year.

### (3) Fiscal 1999 Compared To Fiscal 1998

Revenues for the twelve-month period ended June 30, 1999 of \$140,641 decreased approximately 94% when compared with revenues of \$2,378,000 in the prior year. This revenue decrease is due to the shut down of Registrant operations and closing of the business on January 18, 1998, and the reopening of the business after the acquisition of the Registrant by the current control group in November 1998.

The gross profit margin of 84% for the twelve months ended June 30, 1999 is a significant increase from the gross margin of 1.3% reported for twelve months ended June 30, 1998. Current year margins in the past twelve months reflect the reopening of the business as an Internet company after November 1998.

Selling, general and administrative expenses for the 1999 fiscal year were approximately 25% those of fiscal year 1998 due to the slowdown of operations of the Registrant approaching the close of operations as of January 1, 1998 and the subsequent reopening of the company in another industry.

The resulting loss for the twelve-month period ended June 30, 1999 was \$81,836 versus a reported loss for the year ended June 30, 1998 of \$1,160,542.

Inflation.

The moderate rate of inflation over the past few years has had an insignificant impact on the Registrant's sales and results



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of operations during the period.

### Liquidity and Capital Resources.

Net cash provided by operation of \$258,019 for twelve-month period ended June 30, 2001 was a significant reduction in cash when compared to the cash balance of \$1,661,693 for the twelve-month period ended June 30, 2000. The company is currently cash flow positive and is investing currently over \$40,000 a week with expanding its wireless Internet interstructure adding additional clients. If the U.S. economy slows down significantly the plans for the expansion of the wireless Internet will impacted and possibly stopped.

### Capital Expenditures.

There were several capital expenditures during the 2001 fiscal year, which includes purchase of additional servers and wireless Internet equipment purchased for LA Internet.

### Net Operating Loss Carry forwards.

For the fiscal year ended June 30, 2000, the Registrant had net operating loss carry forwards for federal and state purposes of approximately \$2,596,444 and \$1,340,297 respectively. These carry forwards begin to expire in 2012 and 2002, respectively.

### Forward Looking Statements.

The foregoing Management's Discussion and Analysis of Financial Condition and Results of Operations contains "forward looking statements" within the meaning of Rule 175 under the Securities Act of 1933, as amended, and Rule 3b-6 under the Securities Act of 1934, as amended, including statements regarding, among other items, the Registrant's business strategies, continued growth in the Registrant's markets, projections, and anticipated trends in the Registrant's business and the industry in which it operates. The words "believe," "expect," "anticipate," "intends," "forecast," "project," and similar expressions identify forward-looking statements. These forward-looking statements are based largely on the Registrant's expectations and are subject to a number of risks and uncertainties, certain of which are beyond the Registrant's control. The Registrant cautions that these statements are further qualified by important factors that could cause actual results to differ materially from those in the forward looking statements, including, among others, the following: reduced or lack of increase in demand for the Registrant's products, competitive pricing pressures, changes in the market price of ingredients used in the Registrant's products and the level of expenses incurred in the Registrant's operations. In light of these risks and uncertainties, there can be no assurance that the forward-looking information contained herein will in fact transpire or prove to be accurate. The Registrant disclaims any intent or obligation to update "forward looking statements."

### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Applicable.

### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

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Financial statements as of and for the fiscal years ended June 30, 2001, 2000, and 1999 are presented in a separate section of this report following Part IV.

### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

Not applicable.

### PART III.

### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

The names, ages, and respective positions of the directors and executive officers of the Registrant are set forth below. The Directors named below will serve until the next annual meeting of the Registrant's stockholders or until their successors are duly elected and have qualified. Directors are elected for a one-year term at the annual stockholders' meeting. Officers will hold their positions at the will of the board of directors, absent any employment agreement, of which none currently exist or are contemplated. There are no arrangements, agreements or understandings between non-management shareholders and management under which non-management shareholders may directly or indirectly participate in or influence the management of the Registrant's affairs. There are no legal proceedings involving the officers and directors of the Registrant.

#### Directors and Executive Officers.

(a) Louis Cherry, President/Chairman of the Board.

Mr. Cherry, age 74, was appointed Chairman of the Board, and President of the Registrant in October of 1999. From 1995 to 1998, he was self-employed as a consultant and food broker. For the period of 1993 to 1994, Mr. Cherry served as Chairman of the Board for two automobile dealerships, University Oldsmobile & Pontiac of Costa Mesa, California, and San Clemente Chrysler, Jeep & Eagle of San Clemente, California. Previously, Mr. Cherry was Chariman of the Board of a national bank and president of an investment firm. Mr. Cherry has attended the University of California at Los Angeles.

(b) Albert R. Reda, Chief Executive Officer/Secretary/Director.

Mr. Reda, age 55, was appointed a Director, Chief Executive Officer, and Secretary of the Registrant in November 1998. From 1996 to 1998, he was employed with CRT Corporation as Vice President in charge of production for manufacturing frozen food products. For the period of 1994 to 1995, Mr. Reda was self-employed in the financial lending area, buying and selling loans between individuals and institutions. Mr. Reda received his Bachelor of Science Degree from California State University, Long Beach, with a major in engineering.

(c) Wade H. Whitely, III, Director.

Mr. Whitely, age 39, has been self-employed for the past five years as a marketing and design consultant for several mortgage companies, including Marina Mortgage Corp., Ocwen Mortgage Inc., Community Mortgage Corp. and Western Thrift & Loan. For approximately 2 and one-half years prior to that, he was employed as an acting manager of Northwest Mortgage Corp. Mr.

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Whitely has also recently designed and implemented e-commerce for Sunglass Central, Optical Brigade, Net2 Loan, and Site- Creator. Mr. Whitely earned his Bachelor of Science degree in finance from Memphis State University.

Compliance with Section 16(a) of the Exchange Act.

Section 16(a) of the Securities Exchange Act of 1934 does not apply to the Registrant since it is a reporting company under Section 15(d) under that Act.

### ITEM 11. EXECUTIVE COMPENSATION.

#### Summary Compensation Table

| Name and Principal Position                           | Fiscal Year | Annual compensation |       | Other Annual compensation (1) | Awards               | Long-term compensation              |              | All other compensation |
|---|-------------|---------------------|-------|-------------------------------|----------------------|-------------------------------------|--------------|------------------------|
|   |             | Salary              | Bonus |                               | Restrict stock award | Securities under lying options SARs | LTIP payouts |                        |
|   |             | (\$)                | (\$)  | (\$)                          | (\$)                 | (#)                                 | (\$)         | (\$)                   |
| Louis Cherry,<br>President/<br>Treasurer              | 2001        | \$240,000           | 0     | \$ 9,600                      | 0                    | 0                                   | 0            | 0                      |
|   | 2000        | \$160,000           | 0     | 1,260,000                     | 0                    | 0                                   | 0            | 0                      |
|   | 1999        | 0                   | 0     | 0                             | 0                    | 0                                   | 0            | 0                      |
| Albert Reda,<br>Chief Executive Officer/<br>Secretary | 2001        | \$240,000           | 0     | \$ 9,600                      | 0                    | 0                                   | 0            | 0                      |
|   | 2000        | \$160,000           | 0     | 1,260,000                     | 0                    | 0                                   | 0            | 0                      |
|   | 1999        | 0                   | 0     | 0                             | 0                    | 0                                   | 0            | 0                      |
| Wade Whitely,<br>III,<br>Executive Vice President     | 2001        | \$ 96,000           | 0     | 0                             | 0                    | 0                                   | 0            | 0                      |
|   | 2000        | 0                   | 0     | 0                             | 0                    | 0                                   | 0            | 0                      |
|   | 1999        | 0                   | 0     | 0                             | 0                    | 0                                   | 0            | 0                      |

(1) On April 4, 2000, the Registrant issued 10,000,000 shares of restricted common stock of the Registrant each to Mr. Cherry and Mr. Reda. These shares are intended to compensate these Directors for their services to the Registrant for the period of November 1998 through October 1999, during which period neither person received any compensation from the Registrant. Pursuant to Item 402(b)(2)(iii) of Regulation S-K, these shares are valued at the fair market value at the end of each calendar month during that period when such compensation was earned.

Effective July 2000, Mr. Cherry and Mr. Reda receive car

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allowances of \$800.00 per month. On August 15, 2001, the Registrant issued 7,750,000 shares of restricted common stock of the Registrant each to Mr. Cherry and Mr. Reda (these issuances are not shown in the chart above since they occurred after the end of the 2001 fiscal year). These shares are issued as part of their employment contracts. These shares were valued at \$131,750. Pursuant to Item 402(b)(2)(iii) of Regulation SK, these shares were valued at the fair market value at the time they were issued.

There are no annuity, pension or retirement benefits proposed to be paid to officers, directors, or employees of the Registrant in the event of retirement at normal retirement date, as there is no existing plan provided for or contributed to by the Registrant.

No remuneration is proposed to be paid in the future directly or indirectly by the Registrant to any officer or director since there is no existing plan that provides for such payment, including a stock option plan.

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The following table sets forth information regarding the beneficial ownership of shares of the Registrant's common stock as of September 13, 2001, 282,736,029 shares were issued and outstanding, of which 126,027,324 are restricted by (i) all stockholders known to the Registrant to be beneficial owners of more than 5% of the outstanding Common Stock; (ii) each director; and (iii) all directors and executive officers of the Registrant individually and as a group (each person has sole voting power and sole dispositive power as to all of the shares shown as beneficially owned by them):

| Title of Class | Name and Address of Beneficial Owner   | Amount of Beneficial Ownership | Percent of Class |
|----------------|--|--------------------------------|------------------|
| Common Stock   | Reda Family Trust (1)<br>3338 Punta Alta, #1E<br>Laguna Hills, California 92653          | 29,600,000                     | 10.47%           |
| Common Stock   | Cherry Family Trust (2)<br>29245 Pompano Way<br>Laguna Niguel, California 92677          | 15,916,086                     | 5.63%            |
| Common Stock   | Romis Corp. (3)<br>P.O. Box 4321,<br>Mission Viejo, California 92690                     | 17,750,000                     | 6.27%            |
| Common Stock   | Albert Reda Corp. (4)<br>3900 Birch Street, Suite 103<br>Newport Beach, California 92660 | 17,750,000                     | 6.27%            |
| Common Stock   | Wade Whitely, III<br>3900 Birch Street, Suite 103  |                                |                  |

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|        |   |            |        |
|--------|---|------------|--------|
|        | Newport Beach, California 92660                                       | 2,000,000  | 0.71%  |
| Common |   |            |        |
| Stock  | Albert R. Reda  |            |        |
|        | 3900 Birch Street, Suite 103  |            |        |
|        | Newport Beach, California 92660                                       | 1,566,086  | 0.55%  |
| Common |   |            |        |
| Stock  | Louis Cherry  |            |        |
|        | 3900 Birch Street, Suite 103  |            |        |
|        | Newport Beach, California 92660                                       | 0          | 0.00%  |
| Common |   |            |        |
| Stock  | Shares of all directors and executive officers as a group (3 persons) | 84,582,172 | 33.45% |

(1) Reda Family Trust is a trust created by Albert Reda for shares obtained upon the change in control of the Registrant in November 1998.

(2) Cherry Family Trust is a trust created by Louis Cherry for shares obtained upon the change in control of the Registrant in November 1998.

(3) Romis Corp. is a corporation controlled by Louis Cherry, which holds shares issued as compensation for services performed by Mr. Cherry for the Registrant.

(4) Albert Reda Corp. is a corporation controlled by Albert Reda, which holds shares issued as compensation for services performed by Mr. Reda for the Registrant.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

Other than as set forth below, during the past two years, there have not been any transaction that have occurred between the Registrant and its officers, directors, and five percent or greater shareholders.

(a) On August 27, 1999 the Registrant entered into an agreement with Lifestyle Mortgage Partners for the acquisition of Mortgage Loans Home, also know as "Lifestyle Mortgage Partners", page online processing. Mr. Whitely, who became a director of the Registrant on September 27, 2000, was a general partner of Lifestyle. Under this agreement, the Registrant agreed to pay this partnership a monthly fee of \$5,000.00 as a monthly fee (this was never paid since the acquisition did not realize anticipated revenues). The Registrant did, however, issue a total of 5,000,000 shares of restricted common stock under the agreement.

(b) On November 1, 1999, the Registrant entered into an agreement with Mr. Whitely for the acquisition of the Optical Brigade.com website, and all of sunglasscentral and aces marketing URL's. Under this agreement, the Registrant agreed to pay Mr. Whitely a monthly fee of \$500.00 from the revenue generated by the website to maintain and upgrade the internet search engine activities to the sites (this fee was paid for a total of four months after the acquisition). In addition, the Registrant issued a total of 400,000 shares of restricted common stock under the agreement.

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The purchase included all inventory and shipping supplies as of the date of closing, and the following:

- (1) all the contracts with the suppliers and contact information;
- (2) the customer client base and contact information;
- (3) product ordering procedures and forms;
- (4) Virtual Cart Shopping Cart , Virtual Credit Card Processing Terminal, Authorize.Net (American Express, MasterCard, Visa, Discover/Novus and on line checks);
- (5) invoicing and shipping procedures;
- (6) procedure manual for operations; and
- (7) source codes for operations;

(c) On January 1, 2000, Mr. Reda entered into an employment agreement with the Registrant for the position of Chief Executive Officer. The following are the material terms of this agreement:

(1) A salary of \$180,000.00, payable in semi-monthly installments in accordance with the Registrant's practices, less normal payroll deductions. On the anniversary date of each year through the fourth year, the salary each be increased by \$1,000 per month.

(2) In addition to this compensation, the Registrant will periodically review Mr. Reda's performance and services rendered with a view to paying discretionary bonuses based upon above-average or outstanding performance for a prior period. Any such bonuses approved by the Registrant will be paid to Mr. Reda within 30 days of the grant thereof. The following performance milestones shall justify the particular restricted stock bonuses, to be issued by the company, as set forth below:

- (A) At \$2 million in sales, 500,000 shares of common stock.
- (B) At \$3 million in sales, 800,000 shares of common stock.
- (C) At \$5 million in sales, 1,000,000 shares of common stock.
- (D) At \$8 million in sales, 2,000,000 shares of common stock.
- (E) At \$10 million in sales, 2,500,000 shares of common stock.
- (F) At \$12 million in sales, 3,000,000 shares of restricted common stock.

To date, the Registrant has paid a total of 7,750,000 shares of common stock as a bonus under this agreement.

(3) In addition to the salary and bonuses stated above, Mr. Reda will be eligible to participate in a health insurance plan, including dependent coverage, supplied by the Registrant. Mr. Reda will also be entitled to participate in any and all group life, workers' compensation, health plan or accidental insurance plans which are adopted by the Registrant for the benefit of executive officers or employees. Mr. Reda will also be entitled to such sick leave and paid holidays and to such other perquisites of employment, as customarily are extended by the Registrant to

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executive officers or employees. In addition, Reda will also be entitled to vacation benefits.

(d) On January 1, 2000, Mr. Cherry entered into an employment agreement with the Registrant for the position of President. The following are the material terms of this agreement:

(1) A salary of \$180,000.00, payable in semi-monthly installments in accordance with the Registrant's practices, less normal payroll deductions. On the first anniversary date of the agreement, the salary will increase to \$20,000 per month, and \$25,000 per month on the second anniversary date and thereafter.

(2) In addition to this compensation, the Registrant will periodically review Mr. Cherry's performance and services rendered with a view to paying discretionary bonuses based upon above-average or outstanding performance for a prior period in the same manner as Mr. Reda. To date, the Registrant has paid a total of 7,750,000 shares of common stock as a bonus under this agreement.

(3) In addition to the salary and bonuses stated above, Mr. Cherry will be eligible to participate in other benefits as outlined above for Mr. Reda.

### PART IV.

#### ITEM 14. EXHIBITS, REPORTS ON FORM 8-K, AND INDEX TO FINANCIAL STATEMENTS.

##### Exhibits.

Exhibits included or incorporated by reference in this document are set forth in the Exhibit Index.

##### Reports on Form 8-K.

No reports on Form 8-K were filed during the last quarter of the fiscal year covered by this report.

|   |      |
|---|------|
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| Report of Independent Accountant  | 36   |
| Consolidated Balance Sheets as of<br>June 30, 2001 and June 30, 2000  | 37   |
| Consolidated Statements of Operations for the years ended<br>June 30, 2001, June 30, 2000, and June 30, 1999          | 38   |
| Consolidated Statement of Stockholders' Equity<br>for the years ended June 30, 2001, June 30, 2000, and June 30, 1999 | 39   |
| Consolidated Statements of Cash Flows for the years ended<br>June 30, 2001, June 30, 2000, and June 30, 1999          | 40   |
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#### SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned,

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thereunto duly authorized.

Internet Business's International, Inc.

Dated: September 27, 2001

By: /s/ Albert R. Reda  
Albert R. Reda  
Chief Executive Officer, Secretary

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated.

| Signature                            | Title   | Date               |
|--------------------------------------|---|--------------------|
| /s/ Albert R. Reda<br>Albert R. Reda | Chief Executive Officer,<br>Secretary, and Director   | September 27, 2001 |
| /s/ Louis Cherry<br>Louis Cherry     | Chairman of the Board,<br>President, and Treasurer<br>(Principal Financial and<br>Accounting Officer) | September 27, 2001 |
| /s/ Wade Whitely<br>Wade Whitely     | Director  | September 27, 2001 |

REPORT OF INDEPENDENT ACCOUNTANT

To the Board of Directors and Stockholders of  
Internet Business's International, Inc.

We have audited the accompanying consolidated balance sheets of Internet Business's International, Inc. and Subsidiaries as of June 30, 2001 and 2000, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three fiscal years ended June 30, 2001, 2000 and 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Internet Business's International, Inc. and Subsidiaries as of June 30, 2001 and 2000 and the results of their operations and their cash flows for each of the three fiscal years ended June 30, 2001, 2000 and 1999 in conformity with generally accepted accounting principles.



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/s/ Henry Schiffer C.P.A., a P.C.  
Henry Schiffer C.P.A., a P.C.  
Beverly Hills, California  
September 10, 2001

INTERNET BUSINESS'S INTERNATIONAL, INC.  
CONSOLIDATED BALANCE SHEETS  
JUNE 30, 2001 AND 2000

|   | June 30<br>2001 | June 30<br>2000 |
|---|-----------------|-----------------|
| Assets  |                 |                 |
| Cash and cash equivalents   | \$ 258,019      | \$ 1,661,963    |
| Accounts receivable, net  | 200,968         | 128,389         |
| Inventories   | 166,307         | 0               |
| Mortgage notes held for sale  | 6,929,724       | 2,907,741       |
| Prepaid expenses and other  | 106,092         | 127,905         |
| <br>Total current assets  | <br>7,661,110   | <br>4,825,998   |
| Property and equipment, net   | 1,869,781       | 575,061         |
| Intangible assets, net  | 2,543,697       | 2,884,174       |
| Note receivable   | 0               | 654,009         |
|   | \$12,074,588    | \$ 8,939,242    |
| Liabilities and Stockholders' Equity  |                 |                 |
| Accounts payable  | \$ 559,292      | \$ 317,998      |
| Accrued liabilities   | 40,963          | 48,900          |
| Revolving line of credit  | 6,230,678       | 2,958,563       |
| Current portion of long-term debt   | 14,048          | 29,165          |
| Deferred revenues   | 56,966          | 247,090         |
| Other current liabilities   | 0               | 0               |
| <br>Total current liabilities   | <br>6,901,947   | <br>3,601,716   |
| Long-term debt  | 1,168,453       | 203,931         |
| Minority interest in subsidiaries   | 0               | (5,868)         |
| Stockholders' equity (deficit):   |                 |                 |
| Preferred stock, par value \$100.00 per share;<br>1,000,000 shares authorized; 0 and 23,900 issued<br>and outstanding at June 30, 2001 and 2000,<br>respectively.                   | 0               | 2,390,000       |
| Common stock, par value \$0.01 per share;<br>349,000,000 shares authorized; 267,236,029 and<br>221,115,113 shares issued and outstanding<br>at June 30, 2001 and 2000, respectively | 2,672,360       | 2,211,151       |
| Additional paid-in capital  | 3,669,490       | 3,669,490       |
| Accumulated deficit   | (2,337,662)     | (3,131,178)     |
| <br>Total stockholders' equity  | <br>4,004,188   | <br>5,139,463   |
| Total liabilities and stockholders' equity  | \$12,074,588    | \$ 8,939,242    |

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The accompanying notes are an integral part of these financial statements

INTERNET BUSINESS'S INTERNATIONAL, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE YEARS ENDED JUNE 30, 2001, 2000 AND 1999

|   | June 30<br>2001 | June 30<br>2000 | June 30<br>1999 |
|---|-----------------|-----------------|-----------------|
| Revenues  | \$49,500,039    | \$10,169,090    | \$ 140,641      |
| Costs and expenses:   |                 |                 |                 |
| Cost of revenues  | 42,458,697      | 8,848,582       | 22,724          |
| Interest expense  | 142,406         | 86,611          | 0               |
| Selling, general and administration                             | 5,921,184       | 3,107,140       | 199,753         |
| Depreciation and amortization                                   | 870,844         | 791,426         | 0               |
| Total costs and expenses  | 49,393,131      | 12,833,759      | 222,477         |
| Loss from operations  | 106,908         | (2,664,669)     | (81,836)        |
| Other income (expense)  | 686,608         | 44,157          | 0               |
| Income (loss) before income taxes and minority interest         | 793,517         | (2,620,512)     | (81,836)        |
| Income taxes (benefit)  | 0               | 8,800           | 0               |
| Income (loss) before extraordinary income and minority interest | 0               | (2,629,312)     | (81,836)        |
| Forgiveness of debt   | 0               | 0               | 2,249,644       |
| (Loss) income before minority interest                          | 793,517         | (2,629,312)     | 2,167,808       |
| Minority interest in loss of subsidiaries                       | 0               | (32,868)        | 0               |
| Net income (loss)   | 793,517         | (2,596,444)     | 2,167,808       |
| Net loss (income) per common share                              | nil             | nil             | 0.01            |
| Weighted average number of common shares Outstanding            | 250,907,333     | 189,571,337     | 164,550,320     |

The accompanying notes are an integral part of these financial statements

INTERNET BUSINESS'S INTERNATIONAL, INC.  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
FOR THE YEARS ENDED JUNE 30, 2001, 2000 AND 1999

|                            | June 30<br>2001 | June 30<br>2000 | June 30<br>1999 |
|----------------------------|-----------------|-----------------|-----------------|
| Preferred stock:           |                 |                 |                 |
| Balance, beginning of year | \$ 0            | \$ 2,390,000    | \$ 0            |
| Preferred stock issued     | 0               | 0               | 2,390,000       |
| Balance, end of year       | 0               | 2,390,000       | 2,390,000       |
| Common stock:              |                 |                 |                 |

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|                                |             |             |             |
|--------------------------------|-------------|-------------|-------------|
| Balance, beginning of year     | 2,211,151   | 1,773,030   | 428,000     |
| Common stock issued            | 461,209     | 438,121     | 1,345,030   |
| Balance, end of year           | 2,672,360   | 2,211,151   | 1,773,030   |
| Additional paid-in capital:    |             |             |             |
| Balance, beginning of year     | 3,669,490   | 356,930     | 1,000       |
| Common stock issued            | 0           | 3,312,560   | 355,930     |
| Balance, end of year           | 3,669,490   | 3,669,490   | 356,930     |
| Retained earnings (deficit):   |             |             |             |
| Balance, beginning of year     | (3,131,178) | (534,734)   | (2,702,542) |
| Net (loss) income for the year | 793,516     | (2,596,444) | 2,167,808   |
| Balance, end of year           | (2,337,662) | (3,131,178) | (534,734)   |
| Total stockholders' equity     | 4,004,188   | 5,139,463   | 3,985,226   |

The accompanying notes are an integral part of these financial statements

INTERNET BUSINESS'S INTERNATIONAL, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2001, 2000 AND 1999

|   | June 30<br>2001 | June 30<br>2000 | June 30<br>1999 |
|---|-----------------|-----------------|-----------------|
| Cash Flows From Operating Activities:   |                 |                 |                 |
| Net (loss) income   | \$ 793,516      | \$ (2,596,444)  | \$ 2,167,808    |
| Adjustment to reconcile net (loss) income to net cash used by operating activities: |                 |                 |                 |
| Depreciation and amortization   | 870,844         | 830,736         | 0               |
| Reserve for loss on accounts and notes Receivable                                   | 119,372         | 150,000         | 0               |
| Reserve for loss on mortgage loans Receivable                                       | 100,000         | 100,000         | 0               |
| Minority interest   | 0               | (32,868)        | 0               |
| Changes in operating assets and liabilities:  |                 |                 |                 |
| Accounts receivable   | (200,986)       | (148,813)       | (4,576)         |
| Inventories   | (166,307)       | 0               | 0               |
| Mortgage loans receivable net   | (699,046)       | 82,259          | 0               |
| Prepaid expenses and other  | 106,092         | 271,900         | (308,120)       |
| Accounts payable  | 559,292         | (278,617)       | (1,791,397)     |
| Accrued liabilities   | 40,963          | 48,900          | 0               |
| Deferred revenues   | 56,966          | 247,090         | 0               |
| Other current liabilities   | (14,048)        | (1,800)         | 0               |
| Net cash used in operating activities   | 1,566,658       | (1,327,657)     | 63,715          |
| Cash Flows From Investing Activities:   |                 |                 |                 |
| Purchases of property and equipment   | (1,713,601)     | (755,952)       | 0               |
| Businesses acquired in purchase transactions, net of cash paid                      | (26,250)        | (104,865)       | 0               |
| Purchases of intangible assets  | (85,506)        | (286,372)       | (1,120,000)     |
| Net cash used in investing activities   | (1,825,357)     | (1,147,189)     | (1,120,000)     |
| Cash Flows From Financing Activities:   |                 |                 |                 |
| Net repayments under revolving line of Credits                                      | (125,116)       | (89,437)        | 0               |

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|   |                 |               |               |
|---|-----------------|---------------|---------------|
| Repayment of short-term borrowings            | 0               | 0             | (453,200)     |
| Net issuance of long-term debt                | 964,522         | (61,887)      | 0             |
| Repayment of notes payable                    | (709,869)       | (181,832)     | 0             |
| Collection of notes receivable                | 654,009         | 1,080,991     | 0             |
| Investment by minority interest               | 0               | 27,000        | 0             |
| Preferred Stock                               | (2,390,000)     |               |               |
| Issuance of common stock                      | 461,209         | 3,279,397     | 0             |
| <br>Net cash provided by financing activities | <br>(1,145,245) | <br>4,054,232 | <br>1,137,760 |
| <br>Net increase (decrease) in cash           | <br>(1,403,944) | <br>1,579,386 | <br>81,475    |
| Cash, beginning of year                       | 1,661,693       | 82,577        | 1,102         |
| <br>Cash, end of year                         | <br>258,019     | <br>1,661,963 | <br>82,577    |
| <br>Interest paid                             | <br>142,406     | <br>86,611    | <br>0         |
| Acquisition of Businesses:                    |                 |               |               |
| Fair value of:                                |                 |               |               |
| Assets acquired                               | 31,250          | 4,640,167     |               |
| Liabilities assumed                           | 0               | (4,064,018)   |               |
| Stock issued                                  | (5,000)         | (471,284)     |               |
| <br>Net cash paid for acquisitions            | <br>26,250      | <br>104,865   |               |

The accompanying notes are an integral part of these financial statements

### INTERNET BUSINESS'S INTERNATIONAL, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 1. DESCRIPTION OF BUSINESS AND CHANGE IN CONTROL

Prior to December 31, 1997, Internet Business's International, Inc. (the "Company") was in the food product manufacturing business formerly known as "International Food and Beverage, Inc.". In November 1998, new stockholders bought majority control from the previous Chief Executive Officer through a private transaction. Immediately thereafter, the former CEO resigned and the new stockholders assumed the executive management positions. In December 31, 1998, after new management was in place, a decision was made to change the Company's principal line of business from a manufacturing business to a high technology company. In connection with the change in business, the Company changed its name from International Food & Beverage, Inc. to Internet Business's International, Inc., and reincorporated the Company on December 8, 1998 in the state of Nevada. The Company, after January 1, 1999 began plans to offer Internet based e-commerce services. In April of 1999, the Company announce it's first e-commerce site and was engaged in the development, operation and marketing of a number of commercial The Company currently has operates four reporting divisions made up of subsidiaries and or divisions of the Company. The four division are as follows: Lending on Line (which includes real estate loans and equipment leasing), Internet Service Provider (which includes a national Internet access dial-up service, wireless high speed Internet access in Las Vegas, Nevada and Woodland, California, and Internet web design and hosting), E-commerce (which includes auction sites, B2C and B2B Internet transaction, and reverse auction sites for Europe and the United States), Direct Marketing (which includes the direct marketing of long distance phone services, computers with Internet access, wireless high speed Internet access and bandwidth), and Internet web design hosting). The Company has 7 offices in the US and 1 in

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Europe and more than 60 employees.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. Significant intercompany balances and transactions are eliminated in consolidation. Affiliated companies in which the Company does not have a controlling interest are accounted for using the equity method.

#### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include allowances doubtful accounts and notes receivable and for mortgage loans receivable. Actual results could differ from those estimates.

#### Reclassifications

Certain amounts in the prior year financial statements have been reclassified to conform to the current year classification.

#### Cash and Cash Equivalents

The Company considers all short-term, highly liquid investments with an original maturity date of three months or less to be cash equivalents.

#### Mortgage Loans Held for Sale

Mortgage loans held for sale, are carried at the lower of cost or market value as determined by outstanding commitments from investors. The market value of the loans is based on the note rate and the daily loans yield spread pricing from the bank that is buying the loans. When a loan rate is locked then a corresponding price or yield is calculated.

Example: note rate of \$100,000 with a 7% locked rate from the bank paying a yield premium of 101.00%. The value of the note would then be \$101,000. A note rate at 6.875% purchased by the same bank could be valued at par and therefore the market value is \$100,000.

Mortgage loans held for sale are secured by the borrower's mortgaged property. Revenues resulting from the sale of mortgages are recognized as of the date the loans are sold to investors.

#### Property and Equipment

Property and equipment is stated at cost and depreciated or amortized on a straight-line basis over the estimated useful lives of the assets or the lease term, whichever is shorter. Estimated useful lives range from 3 to 7 years.

#### Capitalized Computer Software

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Capitalized computer software included in intangible and other assets, reflects costs related to purchased Internet websites and related software that are capitalized and amortized on a straight-line basis over periods not exceeding five years. Costs incurred to acquire or upgrade websites and other internal software is capitalized in accordance with Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. Amortization expense for fiscal 2001 and fiscal 2000 was \$ and, \$324,910 respectively.

### Intangible Assets

The Company has accounted for acquisitions of businesses under the purchase method, and the excess of the purchase price over the fair value of the net assets acquired is allocated to subscriber member bases and customer lists, existing technology, work force in place, trade names and residual goodwill, which are being amortized on the straight-line basis over 5 years.

### Long-Lived Assets

The Company periodically reviews the values assigned to long-lived assets and intangible assets, such as property and equipment, capitalized computer software, goodwill and other intangibles assets, to determine whether any impairments are other than temporary. Management reviews the undiscounted projected cash flows related to such assets and compares them to the carrying value of the assets to determine if impairment has occurred. If an asset is deemed to be impaired, the Company records the difference between the projected cash flows on a discounted basis or the fair market value (whichever is more appropriate) and the carrying value as an asset impairment charge in the period incurred. There were no such impairments in the periods presented. Management believes that the long-lived assets and intangible assets in the accompanying balance sheets are appropriately valued.

### Additional Paid In Capital

By the end of March 2000, the Registrant issued an additional 7,000,000 shares of the Registrant's common stock, in a private placement to a qualified investor which provided to the Registrant \$3,382,560.

There was no additional paid in capital during this fiscal year ending June 30, 2001.

### Revenue Recognition

Revenue is recognized for each of the division as follows:

ISP; for services provided fees paid are recognized as revenue. For design work fees are paid after the work is completed at which time it is reported as revenue. If the work is complete and has not been paid it is a receivable. For services revenue is recognized when paid for the time frame the services are contracted for. If the company hosts or provide internet access on a monthly bases then the revenue is booked as received which is paid in advance of the service actually being rendered. During fiscal 2001, the company recorded deferred revenues totaling \$56,966.

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E-commerce; for Auctions normal or reverse fees are paid upon the completion of the auction and the product is either bought or sold, revenue is reported only upon receipt of funds. For services revenue is recognized when paid for the time frame the services are contracted for. If we list the company in the directory on monthly bases then we book the revenue as received, which is paid in advance of the service actually being rendered. For products purchased we report the revenue upon receipt of it for products shipped. If the product is not shipped for any reason then the funds are returned to the buyer and there is no reporting of the funds as revenue.

Lending on line; for the real estate loans revenue is booked according to the loans funded, revenue from fees for loans not funded by the company (brokered loans) are booked upon receipt thereof. For the on line leasing, revenue is booked upon receipt of payment for advertising the web site on the net.

Direct Marketing; for products and or services sold revenue due is either reported as account receivable or as revenue upon receipt of the funds. During this fiscal year

### Advertising Expense

All advertising costs are expensed when incurred.

### Concentration of Credit Risk

The Company is subject to credit risk through trade receivables. Monthly Internet access fees and web hosting are generally billed to the customer's credit card, thus reducing the credit risk. The Company routinely assesses the financial strength of significant customers and this assessment, combined with the large number and geographic diversity of its customers, limits the Company's concentration of risk with respect to trade accounts receivable.

### Income Taxes

The Company accounts for income taxes under the asset and liability approach where deferred income tax assets and liabilities reflect the future tax consequences, based on enacted tax laws, of the temporary differences between financial and tax reporting at the balance sheet date.

### Earnings per Share

Basic earnings per share are computed by dividing net income (loss) by the weighted average of common shares outstanding for the period. Diluted earnings per share are computed by adjusting the weighted average number of shares outstanding during the period for all potentially dilutive shares outstanding during the period.

### New Accounting Pronouncement

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities. It requires that an entity recognizes all derivatives as either assets or liabilities in the statement of financial position and measures these

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instruments at fair value. SFAS No. 133 is effective for the Company in the third quarter of fiscal 2002. The Company is currently evaluating what impact, if any, SFAS No. 133 may have on its financial statements.

### 3. ACQUISITIONS AND SERVICE AGREEMENTS

The following notes refer to the Companies acquisitions and service agreements after July 1, 1999, with the exception of the listing of the LA Internet acquisition, which occurred in the prior fiscal year ending June 30, 1999.

In June 1999, the Company acquired the assets of L.A. Internet, a southern California-based Internet Service Provider, which included customer accounts, trade name, websites, etc. for \$545,000 in exchange for a reduction of the Note Receivable from Iron Horse Holdings, Inc. (see Preferred Stock Note 8).

Proforma information (unaudited) for the year ended June 30, 2000:\*

|                              | LA Internet    |
|------------------------------|----------------|
| Revenues                     | \$ 2,500,000   |
| Cost of Operations & Expense | \$ (1,920,000) |
| Net income (loss)            | \$ 580,000     |
| Income or (loss) per share   | \$ nil         |

July 1999 MBM Capital Group was acquired for \$72,000 and 112,667 shares (@ \$.01 per share valued at \$1,127) the company was sold during the fiscal year of acquisition for a \$150,000 note. After the sale MBM ceased operations and the Company considers the note valueless.

In August 1999 and November 1999, the Company purchased Net 2 Loan, an on-line loan processing website and Optical Brigade, an on-line sunglass distribution website from the same outside party, respectively. The total purchase price was 5,050,000 (@ \$.01 per share valued at is \$50,500) and 400,000 shares (@ \$.01 per share valued at \$4,000) of restricted company stock, respectively.

Proforma information (unaudited) for the year ended June 30, 2000:\*

|                              | Net 2Loan    | Optical Brigade |
|------------------------------|--------------|-----------------|
| Revenues                     | \$ 630,000   | \$ 360,000      |
| Cost of Operations & Expense | \$ (310,000) | \$ (150,000)    |
| Net income (loss)            | \$ 320,000   | \$ 210,000      |
| Income or (loss) per share   | \$ nil       | \$ nil          |

In December of 1999 the company entered into a service agreement to market the Company services on the Internet for 6,000,000 shares (@ \$.01 per share valued at \$60,000).

In February 2000, the Company acquired the assets and assumed certain liabilities of Direct Communications, Inc., a wireless communications company. In addition to assuming certain liabilities, the Company paid cash of \$80,000 and issued 30,000 shares (@\$.01 per share valued at \$300) of restricted company stock. Intangible assets purchased totaled \$265,000, consisting of customers lists, website and workforce-in-place and is being amortized over 5 years.

Proforma information (unaudited) for the year ended June 30, 2000:\*



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## Allstates Communications

|                              |              |
|------------------------------|--------------|
| Revenues                     | \$ 1,200,000 |
| Cost of Operations & Expense | \$ (900,000) |
| Net income (loss)            | \$ 300,000   |
| Income or (loss) per share   | \$ nil       |

In March 2000, the Company acquired the assets and assumed certain liabilities of Internet 2xtreme, and Internet Service Provider based in northern California. The total purchase price was \$735,000, which consisted of cash of \$17,635, restricted company stock amounting to \$186,884 (the company issued 124,589 shares based the current upon a share value of \$1.50 per share) and assumption of certain liabilities. In connection with the acquisition, the Company recorded intangible assets of approximately \$666,000, which consisted of approximately 4,800 customer accounts, website and workforce-in-place, and are being amortized over 5 years.

Proforma information (unaudited) for the year ended June 30, 2000:\*

|                              |              |
|------------------------------|--------------|
|                              | 2xtreme      |
| Revenues                     | \$ 720,000   |
| Cost of Operations & Expense | \$ (600,000) |
| Net income (loss)            | \$ 120,000   |
| Income or (loss) per share   | \$ nil       |

Also in March 2000, the Company acquired 80% of the outstanding shares of Global GPP for \$500,000. Global GPP owns a business-to-business website and has strategic agreements with IBM Hungary to market business-to-business services in Eastern Europe.

Proforma information (unaudited) for the year ended June 30, 2000:\*

|                              |                |
|------------------------------|----------------|
|                              | Global GPP     |
| Revenues                     | \$ 11,253,224  |
| Cost of Operations & Expense | \$ (5,444,994) |
| Net income (loss)            | \$ 5,808,230   |
| Income or (loss) per share   | \$ nil         |

During this quarter an additional 4,113,871 shares (@. 01 per share valued at \$41,139) for services.

In April 2000, the Company acquired all of the outstanding stock of Atlas Capital Corporation, a mortgage-banking company, for 600,000 (@ \$.01 per share equals \$6,000) shares of Company stock. In connection with the acquisition, the Company acquired assets of approximately \$3,183,000 and assuming liabilities of approximately \$3,179,000. The difference of \$260,000 was recorded as intangible assets related to acquisition of trade names, websites, workforce-in-place and is being amortized over 5 years.

Proforma information (unaudited) for the year ended June 30, 2000:\*

|                              |                |
|------------------------------|----------------|
|                              | Atlas Capital  |
| Revenues                     | \$ 37,349,000  |
| Cost of Operations & Expense | \$ (2,651,000) |
| Net loss                     | \$ (2,498,000) |

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Loss per share \$ (nil)

Other acquisitions occurred during the year ended June 30, 2000 that were not deemed to be material transactions. All acquisitions are accounted for under the purchase method of accounting and accordingly, the operations and net assets have been included in the Company's consolidated financial statements from the date of acquisition.

\*The unaudited Proforma information has been prepared assuming that material acquisitions during the year ended June 30, 2000 have taken place at the beginning of the respective period presented. The pro forma information is not necessarily indicative of the combined results that would have occurred had the acquisitions taken place at the beginning of the period, nor is it necessarily indicative of the result that may occur in the future. The pro forma for immaterial transactions are not included in the pro forma information.

In October 5, 2000 the Company acquired the auction web site Sonic Auction. for 500,000 (@\$.01 per share equals \$5,000) shares of restricted stock as per rule 144. The site primarily was a database and a functioning web auction site. Since the web site did not generate revenue at the time of acquisition but did provide an additional database that the Company could use to cross-market other Company products to, therefore a Proforma was not developed for this acquisition.

#### 4. CERTAIN FINANCIAL STATEMENT INFORMATION

|  | June 30<br>2001 | June 30<br>2000 |
|--|-----------------|-----------------|
| Accounts receivable:   |                 |                 |
| Accounts receivable  | \$ 396,977      | \$ 303,924      |
| Less: allowance for doubtful accounts                              | (196,009)       | (175,535)       |
| Accounts receivable, net   | \$ 200,968      | \$ 128,389      |
| Mortgage loans held for sale:                                      |                 |                 |
| Mortgage loans held for sale                                       | \$ 7,049,096    | \$ 3,013,203    |
| Less: allowance for loan losses                                    | (119,372)       | (105,462)       |
| Mortgage loans held for sale, net                                  | \$ 6,929,724    | \$ 2,907,741    |
| Property and equipment:  |                 |                 |
| Office furniture and equipment                                     | \$ 47,155       | \$ 74,051       |
| Machinery and computer equipment                                   | 2,239,781       | 824,234         |
| Leasehold improvements   | 1,726           | 2,182           |
| Less: accumulated depreciation                                     | (418,881)       | (325,406)       |
| Property and equipment, net  | \$ 1,869,781    | \$ 575,061      |
| Intangible assets:   |                 |                 |
| Capitalized software costs, including websites                     | \$ 1,270,156    | \$ 1,653,872    |
| Subscriber member bases  | 1,302,118       | 1,190,632       |
| Others, including customer lists, existing technology, trade names | 423,386         | 545,000         |
| Less: accumulated amortization                                     | (451,963)       | (505,330)       |
| Intangible assets, net   | \$ 2,543,697    | \$ 2,884,174    |

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### 5. Revolving Lines of Credit

The Company has a master mortgage loan warehousing agreement (credit facility) with a lender that provides a maximum of \$5,000,000 under specified conditions to fund residential mortgages to customers. The residential loans serve as collateral, and funds are advanced up to 98% of the unpaid principal amount of the qualified mortgage loan granted to the customer. The credit facility bears interest at the Prime Rate (9.5% at June 30, 2000) plus 1.0% for loans outstanding for 60 days or less. The interest rate increases to Prime Rate plus 4.0% for loans outstanding between 60 and 120 days, and increases to Prime Rate plus 6.0% for amounts outstanding over 120 days. At June 30, 2001 and 2000, amounts outstanding under the credit facility were \$0 and \$2,579,346, respectively. Subsequent to June 30, 2000, the credit facility was amended to reduce the maximum available facility to \$3,500,000, and the Company did not renew the line when it came up for renewal during the fiscal year ending June 30, 2001.

On February 1, 2000, the Company entered into a Master Repurchase Agreement that provides the Company with a warehouse facility through IMPAC Warehouse Lending Group ("IMPAC"). The IMPAC line provides the Company with an open warehouse credit line (as set forth by IMPAC) for the Company's mortgage originations only. Under the terms of the agreement, the Company must repay the funded amount within 30 days of the date the funds were disbursed with interest at the Prime Rate plus 1.0%. If the funds are not repaid within 30 days, the interest rate increases to Prime Rate plus 3.0% until repaid, and IMPAC reserves the right to sell the loan and any shortfall remains the liability of the Company. The IMPAC line is secured by the mortgage loans funded with the proceeds of such borrowings. The IMPAC line does not have a stated expiration date but is terminable by either party upon written notice. Amounts outstanding under the IMPAC line at June 30, 2001 and 2000 were \$ 6183,228 and \$ 254,217, respectively.

On March of 2001, the Company entered into a Master Repurchase Agreement that provides the Company with a warehouse facility through Imperial Warehouse Lending Group ("Imperial"). The Imperial line provides the Company with an open warehouse credit line (as set forth by Imperial) for the Company's mortgage originations only. Under the terms of the agreement, the Company must repay the funded amount within 30 days of the date the funds were disbursed with interest at the Prime Rate plus 1.0%. If the funds are not repaid within 30 days, the interest rate increases to Prime Rate plus 3.0% until repaid, and Imperial reserves the right to sell the loan and any shortfall remains the liability of the Company. The Imperial line is secured by the mortgage loans funded with the proceeds of such borrowings. The Imperial line does not have a stated expiration date but is terminable by either party upon written notice. Amounts outstanding under the IMPAC line at June 30, 2001 and 2000 were \$ 865,468 and \$ 0, respectively.

The effective interest rate for the credit lines listed above were as follows per quarter, the interest charge is deducted from the sale proceeds of the funded loans and is booked as a cost of revenue:

| Quarter       | Prime Rate | Impac | Imperial* | Number of Loans Held over 30 Days |
|---------------|------------|-------|-----------|-----------------------------------|
| Sept. 30 2000 | 9.50%      | 10.5% | N/A       | 0                                 |

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|                |       |       |       |   |
|----------------|-------|-------|-------|---|
| Dec. 31, 2000  | 9.50% | 10.5% | N/A   | 0 |
| March 31, 2001 | 8.0%  | 9.0%  | 9.0%  | 0 |
| June 30, 2001  | 6.75% | 7.75% | 7.75% | 0 |

\* Imperial line not in use prior to March 2001

In addition, the Company has a bank line of credit that provides for maximum borrowings up to \$125,000. The line of credit is personally secured by certain officers of the Company, and currently bears interest at 11.5% at June 30, 2000 and is due on August 31, 2000. The outstanding balance against the line of credit as of June 30, 2001 and 2000 were \$ 0 and \$125,000, respectively. The Company paid off the line of credit line during the fiscal year ending June 30, 2001, because it was no longer required.

All credit facilities and bank line of credit require the Company to maintain certain financial ratios and adhere to specific non-financial requirements. At June 30, 2001, the company was in compliance with the various covenants contained in the above agreements.

### 6. Long-Term Debt

Long-term debt at June 30, 2001 consists of the following:

|   | Current<br>Portion | Long-term  | Total     |
|---|--------------------|------------|-----------|
| Note payable to secured by certain Company assets, requiring monthly payments of \$6,494, including interest at 12.25%, due May 5, 2007 | \$ 40,506          | \$ 283,014 | \$323,520 |

During the fiscal year certain real estate loans defaulted. The Companies subsidiary is making payment to the lender that purchased the defaulted loans. These payments are made at the note rate for each loan. The Company has filed claims with the Companies E&O Insurance carriers. and until the claims are either denied or paid the company lists these debts as long-term debt. These notes total \$844,933. Effective September 1, 2001 the Company sold the subsidiary Atlas Capital and these liabilities are included in the sale.

### 7. Extraordinary Item

After review by legal counsel about the predecessor company's (see Note 1) unsecured prior debts, it was determined by legal counsel the Company was no longer liable for certain of the predecessor company's unsecured debt and management elected to write-off the debts during the fiscal year ended June 30, 1999 and is included as an extraordinary item as forgiveness of debt income.

### 8. Stockholders' Equity

#### Authorized Shares

During November 2000, the board of directors of the Company amended the articles of incorporation to increase the number of authorized shares of common stock to 349,000,000 shares.

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### Stock Issuance

The Company had and issued and outstanding 221,115,113 by the end of the previous fiscal year ending June 30, 2000. During this fiscal year there were 46,120,916 additional shares issued for a total of 267,236,029 issued and outstanding.

During the Quarter ending December 31, 2000; the following shares were issued 1. 500,000 shares of restricted 144 stock for the acquisition of Sonic Auction.Com and 2. 7,140,406 common stock were issued pursuant to the agreement with the conversion rights of the Preferred Stock issued December 15, 1998, upon the 10 day average of the closing bid price prior to the to the conversion date.

During the Quarter ending March 31, 2001 the following shares were issued; 18,981,080 in exchange for Preferred Stock that was originally issued December 15, 1998.

During the Quarter ending June 30, 2001 the following shares were issued: 19,499,430 additional for the conversion of the Preferred Stock (that were originally issued December 15, 1998) into common stock.

After the Quarter ending June 30, 2001, the following shares were issued: 15,500,000 as per employment contract.

After the end of the fiscal year an additional 15,500,000 shares were issued bring the total number to 282,736,029 common snares issued and outstanding of which 134,495,037 are restricted.

During March 2000, the Company issued 7,000,000 shares of common stock through a private placement transaction, resulting in net proceeds to the Company of \$3,382,560.

The Company also issued 6,422,667 and 8,000,000 shares of Company stock in connection with the acquisition of business's or net assets during the fiscal years ended June 30, 2000 and 1999, respectively. The Company also issued 30,389,449 and 11,242,790 shares of Company stock in connection with services provided or rendered during the fiscal years ended June 30, 2000 and 1999, respectively.

### Preferred Stock

On December 15, 1998, the Company entered into an agreement with Iron Horse Holdings, Inc. ("IHHI"), a privately held company that in which officers or family members of the officers of the Company have minority stock ownership, for IHHI to purchase 23,900 shares of the Company's preferred stock with a par value of \$100.00 per share, in exchange for a promissory note receivable from IHHI in the amount of \$2,500,000. The difference between the par value of the shares and the purchase price is treated as additional paid-in-capital. Shares purchased under the agreement are to be issued to IHHI or its designee. The promissory note receivable bear interest at 9% per annum, and is secured by a blanket security agreement executed by IHHI and perfected by filings as specified by law. Until such note is paid in full, IHHI shall pay the 3% coupon on such shares as are issued under the agreement directly to the shareholder(s) of record at the time such payment is due. During the fiscal year ending June 30, 2001, the company-received payment in full on the note executed by IHHI, also during this fiscal year IHHI converted the preferred into common stock. There are no preferred

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shares issued and or outstanding as of this date.

During Fiscal June 30, 2000 the Company received the following payments on the note executed by IHHI,

| Date           | Balance        | Payment         | Interest Paid |
|----------------|----------------|-----------------|---------------|
| June 30, 1999  | \$1,735,000    |                 |               |
| Sept. 30, 1999 | \$1,464,754    | \$270,246       | \$39,037      |
| Dec. 31, 2000  | \$1,194,508    | \$270,246       | \$32,957      |
| March 31, 2000 | \$ 924,262     | \$270,246       | \$26,876      |
| June 30, 2000  | \$ 654,009     | \$270,253       | \$20,796      |
| <br>Total      | <br>\$ 654,009 | <br>\$1,080,991 | <br>\$119,666 |

During Fiscal June 30, 2001 the Company received the following payments on the note executed by IHHI,

| Date           | Balance    | Payment       | Interest Paid |
|----------------|------------|---------------|---------------|
| June 30, 2000  | \$ 654,009 |               |               |
| Sept. 30, 2000 | \$ 490,509 | \$163,500     | \$14,715      |
| Dec. 31, 2000  | \$ 327,009 | \$163,500     | \$11,036      |
| March 31, 2001 | \$ 163,509 | \$163,500     | \$ 7,357      |
| June 30, 2001  | \$ 0       | \$163,509     | \$ 3,679      |
| <br>Total      | <br>\$ 0   | <br>\$654,009 | <br>\$36,787  |

### 9. Income Taxes

The provision for income taxes for the years ended June 30, 2001 and 2000 consist of the following (there were no provision for income taxes on the financials due to the net loss carry forward from the previous years operations):

|                                  | June 30<br>2001 | June 30<br>2000 |
|----------------------------------|-----------------|-----------------|
| Current income tax expense:      |                 |                 |
| Federal                          | \$ 269,795      | \$ 5,600        |
| State                            | 0               | 3,200           |
|                                  | 269,795         | 8,800           |
| <br>Deferred income tax expense: |                 |                 |
| Federal                          | 0               | 0               |
| State                            | 0               | 0               |
|                                  | 0               | 0               |
|                                  | \$ 0            | \$ 8,800        |

Amounts for deferred income tax assets and liabilities as follows:

|                                |            |            |
|--------------------------------|------------|------------|
| Assets                         | \$ 269,795 | \$ 485,500 |
| Valuation allowance            | (269,795)  | (485,500)  |
|                                | 0          | 0          |
| Liabilities                    | 0          | 0          |
| <br>Net tax asset or liability | <br>\$ 0   | <br>\$ 0   |

Deferred income tax assets consist primarily of net operating loss carry forwards. The Company has provided for a full valuation allowance on the deferred income tax assets as the

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realization of such benefits are uncertain. Such carry forwards begin to expire beginning in 2004.

For the year ended June 30, 1999, the Company excluded the forgiveness of debt income from taxable income pursuant to Internal Revenue Code Section 108(A)(1)(B) and 108(B).

### 10. Commitments

The Company leases certain of its office facilities and certain equipment under the terms of noncancellable operating leases, which expire through May 2003. Lease payments under these agreements totaled \$ 176,095 and \$138,276 for the years ended June 30, 2001 and 2000.

The future minimum rental commitments at June 30, 2001 under these leases are as follows:

Year Ending June 30,

|               |           |
|---------------|-----------|
| June 30, 2002 | 133,632   |
| June 30, 2003 | 80,503    |
|               | \$214,135 |

### 11. Segment Information

In accordance with SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information," management has determined that there are four reportable segments based on the customers served by each segment: Full service internet service provider (ISP), mortgage banking business, and business-to-business ("B2B") provider and business-to-consumer ("B2C") provider. Such determination was based on the level at which executive management reviews the results of operations in order to make decisions regarding performance assessment and resource allocation.

Full service Internet service provider serves customers requiring Internet access in the western United States through dial-up, and high-speed wireless; web hosting and web design. Mortgage banking business includes online mortgage loan origination, processing, servicing and resales. Business-to-business provider primarily provides reverse auction services to foreign companies wishing to purchase materials and supplies in the United States. Business-to-consumer provider primarily consists of cellular phone service origination fees and sales.

Certain general expenses related to advertising and marketing, information systems, finance and administrative groups are not allocated to the operating segments and are included in "other" in the reconciliation of operating income reported below. The accounting policies of the segments are the same as those described in the summary of significant accounting policies (see Note 2). Information on reportable segments is as follows:

| Fiscal Year Ended     | June 30<br>2001 | June 30<br>2000 |
|-----------------------|-----------------|-----------------|
| Full-service ISP      |                 |                 |
| Net sale              | \$ 4,912,285    | \$ 1,577,971    |
| Operating income..... | 2,037,932       | (348,367)       |

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|  |            |             |
|--|------------|-------------|
| Mortgage loan originations held for resale |            |             |
| Net sales                                  | 43,366,519 | 8,264,071   |
| Operating income                           | (83,571)   | (386,682)   |
| E Commerce (B-to-b/c)                      |            |             |
| Net sales                                  | 278,668    | 47,002      |
| Operating income                           | (156,187)  | (164,341)   |
| Marketing (B-to-b/c)                       |            |             |
| Net sales                                  | 495,251    | 160,380     |
| Operating income                           | (825,858)  | (180,986)   |
| Other                                      |            |             |
| Net income                                 | 447,316    | 119,666     |
| Unallocated expenses                       | (178,799)  | (1,584,293) |
| Total                                      |            |             |
| Net sales                                  | 49,500,039 | 10,169,090  |
| Operating income                           | 793,517    | (2,664,669) |

### 12. Other Events

#### a. PMCC

On August 2, 2000, the Company announced that it has entered into an agreement whereby the Company would purchase 2,460,000 share of PMCC Financial Corp. ("PMCC"), a full-service mortgage banking company, common stock from PMCC's former chairman of the board, Ronald Friedman, and The Ronald Friedman 1997 Grantor Retained Annuity Trust Ronald Friedman, which represents 66.36% of the 3,707,000 PMCC shares outstanding. The aggregate purchase price of \$3,198,000 is to be paid in cash to the seller by the Company as follows: \$700,000 at date of closing; \$306,857 for each of the seven installment payments to be paid on the 30th, 60th, 90th, 120th, 150th, 180th and 210th days following the close; \$175,000 on each of the 240th and 270th day after the date of the closing. Shares of PMCC, a listed AMEX company, were not trading at the time of the agreement. In the event that three months after closing, if PMCC's shares are not actively trading on the AMEX or NASDQ exchanges and the Company has not merged PMCC with the Company or any of the Company's subsidiaries, the purchase price shall be reduced by the amount of the final two \$175,000 payments.

Also on July 28, 2000, in a separate transaction, the Company entered into a stock purchase agreement with an unrelated individual whereby the Company would sell up to 370,000 of PMCC shares that the Company either owns or will eventually own, for total consideration of \$1,387,500. Shares of PMCC stock sold by the Company will be released to the buyer in proportion to payments received.

The Company on March 2, 2001 filed an action against Ronald Friedman, and The Ronald Friedman 1997 Grantor Retained Annuity Trust (Case Number SA CV 01-268 DOC (Eex)) for recession of the purchase of the PMCC stock and return of the \$1,006,857 on August 16, 2001 Ronald Friedman, Robert Friedman, and The Ronald Friedman 1997 Grantor Retained Annuity Trust filed an action against the company (Case Number 01CV 7637), for the balance of the contract in the amount of \$2,191,143. The company action was filed in Orange County; CA. and Mr. Friedman's complaint was filed in Southern District, New York. The company feels that it will prevail in both actions.



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As of December 31, 2000, the Company received payments of \$559,812 and the Company released 149,283 shares of PMCC stock that it owned. If PMCC is not actively trading within six months of the agreement, the Company will issue to the Buyer the equivalent number of shares of stock of the Company. PMCC has been actively trading as of January 19, 2001, and the gain on the sale of the PMCC stock of \$410,529 has been included in revenues for the period ending December 31,2000.

In January 2001, the PMCC was delisted from the American Stock Exchange and began trading on the Pink Sheets under the symbol of "PMCF"; this met the trading requirement as per the stock sale agreement the Company had entered into with an unrelated individual during the first quarter of this fiscal year.

### b. IBC

On August 11, 2000, the Company entered into an agreement to acquire all of the outstanding shares of International Business Co., a software developer that streamlines B2B e-commerce, in exchange for 2,000,000 shares of restricted Company shares to be held in escrow. Between the periods from September 1, 2000 through March 1, 2001, the Company can unilaterally cancel the contract if dissatisfied with the seller's performance. The Company canceled the purchase during the cancellation period agreed in the escrow.

### c. Auction-Sales.Com, Inc.

On October 19, 2000, the Registrant entered into a Stock Purchase Agreement with Auction-Sales.Com, Inc. and its majority shareholder, Zahid Rafiq (collectively, "Seller"), for the purchase by the Registrant of 96.62% of the outstanding and treasury shares of common stock of Auction-Sales.Com, Inc., a Delaware corporation (see Exhibit 10.15 of this Form 10-Q). In exchange for the shares, the Registrant will pay, under the terms of this agreement, the following:

(a) 11,000,000 shares of Registrant's restricted common stock to Seller for all of Seller's Shares, as follows:

(i) 5,500,000 restricted shares will be issued to current shareholders, identified on the list attached to the Agreement.

(ii) 2,500,000 restricted shares will be paid to certain creditors of the Registrant identified in an attachment to the Agreement. Seller represents that all of these creditors are unsecured. Seller shall procure signed consents from each creditor confirming the agreement to accept restricted shares in proportion to their claims within 60 days of closing of the transaction. Failure to procure signed consents will justify rescission of this Agreement at the option of the Registrant, such that each party shall restore to the other the consideration which each placed into the Agreement.

(iii) 3,000,000 restricted shares of the purchase price will be paid to outside consultants for work performed for facilitating the transaction.

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(b) Earn out for the "Seller": The Seller shall be paid up to an additional \$3,000,000 based upon earnings over the next 3 years through additional restricted stock. The earn out will be based on a 10% growth per year over the previous years revenue. The \$3,000,000 will be distributed equally over the subsequent 3 year i.e. \$1,000,000 per year, and can be cumulative. This earn out is further defined as follows:

(i) The initial base Year ends on September 30, 2000. The subsequent year base will be the previous revenue.

(ii) The stock will be issued per quarter upon reaching the Goal per quarter for that portion of the annualized growth of 10% over the previous year.

(c) The Registrant may invest up to \$2,000,000 in Auction-Sales.Com, Inc., at a rate not to exceed \$500,000 per quarter, based on performance on Auction-Sales.Com as a function of gross revenues and based on a budget, which is pre-approved by the Registrant.

Auction-Sales.Com is an e-commerce pricing application service provider. Auction-Sales.Com has developed a proprietary state of the art hybrid auction platform that address the combined needs of the B2C, B2B and C2C markets. This is accomplished by providing a single integrated marketplace and portal technology that empowers all parties, including manufacturers, distributors, resellers and consumers. The Auction-Sales.Com platform provides supply chain integration and economies of scale in connection with dynamic pricing application targeting businesses and /or consumers.

This acquisition was rescinded in December 2000 and the necessary documents were filed with the SEC. The site was retained until the funds invested into Auction-Sales.Com are returned which at this time management has very low expectations of occurring.

### 13. Other Agreements

#### a. Washington State Hotel and Motel Association.

The agreement, entered into in the ordinary course of business, with the Washington State Hotel and Motel Association, dated October 4, 2000, provides the use of the GGPP reverse auction site as a platform for hotel association members purchasing products needed for their different hotel properties. This method of purchasing allows the suppliers of products the chance to sell products to the buyers in competition with one another; the net effect is that the buyers would select the supplier with the lowest per unit cost. This reduces the cost of supplies and thereby should increase their potential of profit. This agreement covers the modification of the GGPP website for use by the Association, and does not involve any payment by the Registrant.

#### b. JWC Construction

The agreement, entered into in the ordinary course of business, with the JWC Construction Company of Poland, dated March 9, 2001 which will enable companies to list their purchasing requirements on projects using the reverse auction platform. This method of purchasing allows the suppliers of

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products the chance to sell products to the buyers in competition with one another; the net effect is that the buyers would select the supplier with the lowest per unit cost. This reduces the cost of supplies and thereby should increase their potential of profit. This agreement covers the modification of the Construction Buying Group website for use by the Construction industry, and does not involve any payment by the Registrant.

### EXHIBIT INDEX

| Number | Description   |
|--------|---|
| 2.1    | Agreement and Plan of Merger between the Registrant and Internet Business's International, Inc., a Delaware corporation, dated July 1, 1999 (incorporated by reference to Exhibit 2 to the Form 8-K/A filed on November 22, 1999) |
| 2.2    | Agreement and Plan of Merger and Share Exchange among the Registrant, Return Assured Incorporated, and IBUI Acquisition Corporation, dated June 4, 2001 (see below).  |
| 3.1    | Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Form 10-Q filed on December 1, 1999).  |
| 3.2    | Certificate of Amendment of Articles of Incorporation (incorporated by reference to Exhibit 3.2 to the Form 10-Q filed on December 1, 1999).  |
| 3.3    | Certificate of Amendment of Articles of Incorporation (incorporated by reference to Exhibit 3.3 of the Form 10-Q filed on May 22, 2000).  |
| 3.4    | Certificate of Amendment of Articles of Incorporation (incorporated by reference to Exhibit 3.4 of the Form 10-Q filed on May 22, 2000).  |
| 3.5    | Bylaws (incorporated by reference to Exhibit 3.3 to the Form 10-Q filed on December 1, 1999).   |
| 4.1    | Retainer Stock Plan for Non-Employee Directors and Consultants, dated October 1, 1999 (incorporated by reference to Exhibit 4.1 to Form S-8 filed on October 8, 1999)   |
| 4.2    | Consulting Agreement between the Registrant and Mark Crist, dated October 5, 1999 (incorporated by reference to Exhibit 4.2 to Form S-8 filed on October 8, 1999)   |
| 10.1   | Purchase Agreement (LA Internet) between the Registrant and Iron Horse Holdings, Incorporated, dated June 10, 1999 (incorporated by reference to Exhibit 10.2 to the Form 10-Q filed on December 1, 1999).                        |
| 10.2   | Purchase Agreement between the Registrant and the Stockholders of MBM Capital Group Inc., dated July 1, 1999 (incorporated by reference to Exhibit 10.3 to the Form 10-Q filed on December 1, 1999).                              |
| 10.3   | Acquisition Agreement (Net 2 Loan) between the Registrant and Lifestyle Mortgage Partners, dated September 15, 1999 (incorporated by reference to   |

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- Exhibit 10.4 to the Form 10-Q filed on February 22, 2000).
- 10.4 Purchase Agreement (license) between the Registrant and Stockholders of California Land & Home Sale, Inc., dated October 1, 1999 (incorporated by reference to Exhibit 10.5 to the Form 10-Q filed on February 22, 2000).
  - 10.5 Acquisition Agreement (Optical Brigade) between the Registrant and Wade Whitley, dated November 1, 1999 (incorporated by reference to Exhibit 10.6 to the Form 10-Q filed on February 22, 2000).
  - 10.6 Employment Agreement between the Registrant and Al Reda, dated January 1, 2000 (see below).
  - 10.7 Employment Agreement between the Registrant and Louis Cherry, dated January 1, 2000 (see below).
  - 10.8 Agreement for Acquisition between the Registrant and Direct Communications, Inc., dated February 25, 2000 (incorporated by reference to Exhibit 10.6 of the Form 10-Q filed on May 22, 2000).
  - 10.9 Agreement between the Registrant and Internet 2xtreme, dated March 6, 2000 (incorporated by reference to Exhibit 10.7 of the Form 10-Q filed on May 22, 2000).
  - 10.10 Agreement between the Registrant, Roanoke Technology Corp., and Global GPP Corp., dated March 21, 2000 (incorporated by reference to Exhibit 10.8 of the Form 10-Q filed on May 22, 2000).
  - 10.11 Agreement between GPP Hungary Kft and Haitec Magyarorazagi Kft, dated March 30, 2000 (incorporated by reference to Exhibit 10.9 of the Form 10-Q filed on May 22, 2000).
  - 10.12 Stock Purchase Agreement between the Registrant and Atlas Capital Corporation, dated April 1, 2000 (incorporated by reference to Exhibit 10.10 to the Form 10-K filed on September 27, 2000).
  - 10.13 Stock Purchase Agreement between the Registrant and Ronald Friedman, Robert Friedman, and The Ronald Friedman 1997 Grantor Retained Annuity Trust, dated July 28, 2000 (incorporated by reference to Exhibit 10.11 of the Form 10-Q filed on November 16, 2000).
  - 10.14 Stock Sales Agreement between the Registrant and a buyer, dated July 28, 2000 (incorporated by reference to Exhibit 10.12 of the Form 10-Q filed on November 16, 2000).
  - 10.15 Stock Purchase Agreement between the Registrant, International Business Company, Dennis B. Ginther, Clifford J. Roebuck, Jadwiga L. Ginther, and Bogumila E. Basu, dated August 19, 2000 (incorporated by reference to Exhibit 10.13 of the Form 10-Q filed on November 16, 2000).
  - 10.16 Stock Purchase Agreement between the Registrant, Sonic Auction.com, Inc., and Brian Pruett, dated October 5, 2000 (incorporated by reference to Exhibit 10.14 of the

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Form 10-Q filed on February 15, 2001).

- 10.17 Stock Purchase Agreement between the Registrant, Auction-Sales.Com, Inc., and Zahid Rafiq, dated October 19, 2000 (incorporated by reference to Exhibit 10.15 of the Form 10-Q filed on February 15, 2001).
- 21 Subsidiaries of the Registrant (see below).

### EX-2.2

#### AGREEMENT AND PLAN OF MERGER AND SHARE EXCHANGE

NOTE TO WORD PROCESSOR OPERATORS: This document does NOT use the "Heading" styles. Instead, it uses the following styles which contain the automatic numbering: Head 1, Head 2, Head 3, Head 4 and Head 5. In addition, a style called Head 2 Precursor is used for text that immediately follows Head 2 and will participate in Head 2's automatic numbering when hidden text is hidden. Whatever text is inside the Head 1 and Head 2 paragraphs when hidden text is revealed gets carried into the table of contents when its text generated.

#### AGREEMENT AND PLAN OF MERGER AND SHARE EXCHANGE

THIS AGREEMENT AND PLAN OF MERGER AND SHARE EXCHANGE is made as of June 4, 2001 by and among Return Assured Incorporated, a Delaware corporation ("RAI"), IBUI Acquisition Corp., a Nevada corporation (the "Merger Subsidiary" and together with RAI, the "RAI Parties"), and Internet Business's International, Inc., a Nevada corporation ("IBUI"). RAI, the Merger Subsidiary and IBUI are individually referred to as a "Party" and collectively referred to herein as the "Parties". Certain other terms are used herein as defined below in Article I or elsewhere in this Agreement.

#### BACKGROUND

This Agreement sets forth the terms and conditions under which (i) the Merger Subsidiary, which is a Wholly-Owned Subsidiary of RAI, will merge with and into IBUI (the "Merger and Share Exchange"). The Parties intend that upon completion of the Merger and Share Exchange, IBUI will be a Wholly-Owned Subsidiary of RAI.

The Merger Subsidiary is a Wholly-Owned Subsidiary of RAI and has been formed solely to facilitate the Merger and Share Exchange and has conducted and will conduct no business or activity other than in connection with the Merger and Share Exchange.

NOW, THEREFORE, in consideration of the respective covenants contained herein and intending to be legally bound hereby, the Parties hereto agree as follows:

#### ARTICLE 1

#### DEFINITIONS

For convenience, certain terms used in more than one part of this Agreement are listed in alphabetical order and defined or referred to below (such terms as well as any other terms defined

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elsewhere in this Agreement shall be equally applicable to both the singular and plural forms of the terms defined).

"Acquisition Proposal" is defined in Section 8.2(a).

"Affiliate" means, with respect to any Person, any other Person that directly or indirectly controls or is controlled by or under common control with such Person. For the purposes of this definition, "control" when used with respect to any Person, means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of such Person, whether through the ownership of voting securities, by contract or otherwise; and the terms of "affiliated," "controlling" and "controlled" have meanings correlative to the foregoing.

"Agreement" means this Agreement and the Exhibits and Disclosure Schedules hereto.

"Articles of Merger and Share Exchange" is defined in Section 2.2.

"Assets" means, with respect to RAI, the Merger Subsidiary or IBUI, as shown by the context in which used, all of the assets, properties, goodwill and rights of every kind and description, real and personal, tangible and intangible, wherever situated and whether or not reflected in such Party's most recent financial statements, that are owned or possessed by such Party and its Subsidiaries, taken as a whole.

"Assumed IBUI Option" is defined in Section 2.10(b).

"IBUI" means The Internet Business's International, Inc., a Nevada corporation.

"IBUI Assets" means the Assets of IBUI.

"IBUI Balance Sheet" is defined in Section 6.7.

"IBUI Balance Sheet Date" is defined in Section 6.7.

"IBUI Benefit Plan" is defined in Section 6.15.

"IBUI Business" means the Business of IBUI.

"IBUI Common Stock" means the common stock, par value \$0.001 per share, of IBUI.

"IBUI Companies" means IBUI and any IBUI subsidiaries.

"IBUI Disclosure Schedule" means the Disclosure Schedule containing information relating to IBUI pursuant to Article V and other provisions hereof that has been provided to the other Parties on the date hereof.

"IBUI Financial Statements" means the financial statements of IBUI.

"IBUI Indemnified Loss" is defined in Section 16.2.

"IBUI Indemnified Party" means IBUI and its Affiliates and each of their respective officers, directors, employees, agents and counsel; provided, however, that no Person who indemnifies IBUI

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Indemnified Parties in this Agreement in his capacity as a Stockholder will be an IBUI Indemnified Party for purposes of this Agreement, notwithstanding that the Person is an IBUI Indemnified Party for purposes of one or more of the other Agreements.

"IBUI's knowledge" or "knowledge of IBUI" with reference to any item means that which an executive officer of IBUI actually knows.

"IBUI Required Consents" is defined in Section 15.4.

"IBUI Shareholder" means a recordholder, as of the Effective Date of an outstanding certificate or certificates that immediately prior to the Effective Date represented IBUI Shares.

"IBUI Shareholder Meeting" is defined in Section 10.2.

"IBUI Subsidiary" means any Subsidiary of IBUI.

"IBUI Warrants" means any warrants to purchase IBUI Common Stock that are outstanding immediately prior to the Closing.

"IBUI Welfare Plan" is defined in Section 6.15(f).

"Benefit Plan" means all employee benefit, health, welfare, supplemental unemployment benefit, bonus, pension, profit sharing, deferred compensation, severance, incentive, stock compensation, stock purchase, retirement, hospitalization insurance, medical, dental, legal, disability, fringe benefit and similar plans, programs, arrangements or practices, including, without limitation, each "employee benefit plan" as defined in Section 3(3) of ERISA.

"Business" means with respect to RAI, or IBUI, as shown by the context in which used, the entire business and operations of such Party and its Subsidiaries, taken as a whole.

"Business Day" means any day except Saturday, Sunday and any day which shall be a legal holiday or a day on which banking institutions in the state of New York generally are authorized or required by law or other government actions to close.

"Charter Documents" means an entity's certificate or articles of incorporation, certificate defining the rights and preferences of securities, articles of organization, general or limited partnership agreement, certificate of limited partnership, joint venture agreement or similar document governing the entity.

"Closing" is defined in Section 4.1.

"Closing Date" is defined in Section 4.1.

"Code" means the Internal Revenue Code of 1986, as amended. All citations to provisions of the Code, or to the Treasury Regulations promulgated thereunder, shall include any amendments thereto and any substitute or successor provisions thereto.

"Commission" means the Securities and Exchange Commission.

"Confidentiality Agreement" is defined in Section 8.4(b).

"Contract" means any written or oral contract, agreement, letter

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of intent, agreement in principle, lease, instrument or other commitment that is binding on any Person or its property under applicable Law.

"Copyrights" means registered copyrights, copyright applications and unregistered copyrights.

"Court Order" means any judgment, decree, injunction, order or ruling of any federal, state, local or foreign court or governmental or regulatory body or authority, or any arbitrator that is binding on any Person or its property under applicable Law.

"Default" means (i) a breach, default or violation, (ii) the occurrence of an event that with or without the passage of time or the giving of notice, or both, would constitute a breach, default or violation or (iii) with respect to any Contract, the occurrence of an event that with or without the passage of time or the giving of notice, or both, would give rise to a right of termination, renegotiation or acceleration or a right to receive damages or a payment of penalties.

"DGCL" means the Delaware General Corporation Law, as amended.

"Effective Date" shall mean the time that the Articles of Merger and Share Exchange are filed with the Nevada Secretary of State.

"Effectiveness Period" shall have the meaning set forth in Section 7.2(a).

"Encumbrances" means any lien, mortgage, security interest, pledge, restriction on transferability, defect of title or other claim, charge or encumbrance of any nature whatsoever on any property or property interest.

"Environmental Condition" means any condition or circumstance, including the presence of Hazardous Substances which does or would (i) require assessment, investigation, abatement, correction, removal or remediation under any Environmental Law, (ii) give rise to any civil or criminal Liability under any Environmental Law, (iii) create or constitute a public or private nuisance or (iv) constitute a violation of or non-compliance with any Environmental Law.

"Environmental Law" means all Laws, Court Orders, principles of common law, and permits, licenses, registrations, approvals or other authorizations of any Governmental Authority relating to Hazardous Substances, pollution, protection of the environment or human health.

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended.

"Exchange Act" means the Securities Exchange Act of 1934, as amended.

"Exchange Agent" is defined in Section 2.6(a).

"Execution Date" means June [date], 2001

"Existing IBUI Option" is defined in Section 2.10(a).

"GAAP" means United States generally accepted accounting



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principles as in effect on the Issue Date, including those set forth: (a) in the opinions and pronouncements of the Accounting Principles Board of the American Institute of Certified Public Accountants, (b) in the statements and pronouncements of the Financial Accounting Standards Board, (c) in such other statements by such other entity as approved by a significant segment of the accounting profession, and (d) the rules and regulations of the Commission governing the inclusion of financial statements (including pro forma financial statements) in periodic reports required to be filed pursuant to Section 13 of the Exchange Act, including opinions and pronouncements in staff accounting bulletins and similar written statements from the accounting staff of the Commission.

"Governmental Authority" means any federal, state, local, municipal or foreign or other government or governmental agency or body.

"Governmental Permit" is defined in Section 5.12(c).

"Hazardous Substances" means any material, waste or substance (including, without limitation, any product) that may or could pose a hazard to the environment or human health or safety including, without limitation, (i) any "hazardous substances" as defined by the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. 9601 et seq. and its implementing regulations, (ii) any "extremely hazardous substance," "hazardous chemical" or "toxic chemical" as those terms are defined by the Emergency Planning and Community Right-to-Know Act, 42 U.S.C. 11001 et seq. and its implementing regulations, (iii) any "hazardous waste," as defined under the Solid Waste Disposal Act, as amended by the Resource Conservation and Recovery Act, 42 U.S.C. 6901 et seq. and its implementing regulations (iv) any "pollutant," as defined under the Water Pollution Control Act, 33 U.S.C. 1251 et seq. and its implementing regulations as any of such Laws in clauses (i) through (iv) may be amended from time to time, and (v) any material, substance or waste regulated under any Laws or Court Orders that currently exist or that may be enacted, promulgated or issued in the future by any Governmental Authority concerning protection of the environment, pollution, health or safety or the public welfare.

"Intellectual Property" means any Copyrights, Patents, Trademarks, technology, licenses, trade secrets, computer software and other intellectual property.

"Law" means any statute, law, ordinance, regulation, order, rule, common law principles or consent agreements of any Governmental Authority, including, without limitation, those covering environmental, energy, safety, health, transportation, bribery, record keeping, zoning, antidiscrimination, antitrust, wage and hour, and price and wage control matters.

"Liability" means any direct or indirect liability, indebtedness, obligation, expense, claim, loss, damage, deficiency, guaranty or endorsement of or by Person.

"Litigation" means any lawsuit, action, arbitration, administrative or other proceeding, criminal prosecution or governmental investigation or inquiry.

"Material Adverse Effect" means a fact or event which has had or

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is reasonably likely to have a material adverse effect on the Assets, Business, financial condition or results of operations of RAI, either as a corporate entity or with its Subsidiaries taken as a whole, or IBUI, as indicated by the context in which used, and when used with respect to representations, warranties, conditions, covenants or other provisions hereof means the individual effect of the situation to which it relates and also the aggregate effect of all similar situations unless the context indicates otherwise.

"Merger and Share Exchange" is defined in Section 2.1.

"Merger Subsidiary" is defined above in the Preamble.

"Nevada Law" means the Nevada Revised Statutes.

"Party Representatives" is defined in Section 8.4(b).

"Patents" means patents, patent applications, reissue patents, patents of addition, divisions, renewals, continuations, continuations-in-part, substitutions, additions and extensions of any of the foregoing.

"Person" means an individual or a corporation, partnership, trust, incorporated or unincorporated association, joint venture, limited liability company, joint stock company, government (or an agency or political subdivision thereof) or other entity of any kind.

"Post-Signing Returns" is defined in Section 9.7.

"Proceeding" means an action, claim, suit, investigation or proceeding (including, without limitation, an investigation or partial proceeding, such as a deposition), whether commenced or threatened.

"Prospectus" means the prospectus included in the Registration Statement (including, without limitation, a prospectus that includes any information previously omitted from a prospectus filed as part of an effective registration statement in reliance upon Rule 430A promulgated under the Securities Act), as amended or supplemented by any prospectus supplement, with respect to the terms of the offering of any portion of the Registrable Securities covered by the Registration Statement, and all other amendments and supplements to the Prospectus, including post-effective amendments, and all material incorporated by reference or deemed to be incorporated by reference in such Prospectus.

"Proxy Statement" is defined in Section 8.1(a).

"RAI" is defined above in the Preamble.

"RAI Assets" means the Assets of RAI.

"RAI Balance Sheet" is defined in Section 5.7.

"RAI Balance Sheet Date" is defined in Section 5.7.

"RAI Benefit Plan" is defined in Section 5.16(a).

"RAI Business" means the Business of RAI.

"RAI Common Shares" is defined in Section 2.6(a).

"RAI Companies" means RAI and any RAI Subsidiaries.

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"RAI Disclosure Schedule" means the Disclosure Schedule containing information relating to RAI pursuant to Article V and other provisions hereof that has been provided to the other Parties on the date hereof.

"RAI Holder" means a recordholder, as of the Effective Date, of an outstanding certificate or certificates that immediately prior to the Effective Date represented RAI Shares.

"RAI's knowledge" or "knowledge of RAI" with reference to any item means that which an executive officer of RAI actually knows.

"RAI Personnel" is defined in Section 5.21(a).

"RAI Required Consents" is defined in Section 14.4.

"RAI SEC Reports" is defined in Section 5.7.

"RAI Shares" is defined in Section 2.5(a).

"RAI Stockholder" means a recordholder, as of the Effective Date, or an outstanding Certificate or Certificates that immediately prior to the Effective Date represented RAI Shares.

"RAI Stockholder Indemnified Party" means (a) each Stockholder and each of that Stockholder's Affiliates (other than the Company or, following the Closing, the Surviving Corporation or IBUI or any of its Subsidiaries, if the Stockholder is an Affiliate of IBUI), and each of their respective officers, directors, employees, agents and counsel and (b) prior to the Closing, the Company and each of its officers, directors, employees, agents and counsel who are not Stockholder Indemnified Parties within the meaning of clause (a) of this definition.

"RAI Stockholder Meeting" is defined in Section 9.2.

"RAI Subsidiary" means any Subsidiary of RAI.

"RAI 10-KSB" is defined in Section 5.9.

"RAI Warrants" means any warrants to purchase Merged Company Common Stock that are outstanding immediately prior to the Closing.

"RAI Welfare Plan" is defined in Section 5.16(f).

"Registration Indemnified Party" shall have the meaning set forth in Section 7.6(c).

"Registration Indemnifying Party" shall have the meaning set forth in Section 7.6(c).

"Registration Statement" means the registration statement, contemplated by Section 7.1, including the Prospectus, amendments and supplements to such registration statement or Prospectus, including pre- and post-effective amendments, all exhibits thereto, and all material incorporated by reference or deemed to be incorporated by reference in such registration statement.

"Regulation" means any federal, state, local or foreign rule or regulation.

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"Rule 144" means Rule 144 promulgated by the Commission pursuant to the Securities Act, as such Rule may be amended from time to time, or any similar rule or regulation hereafter adopted by the Commission having substantially the same effect as such Rule.

"Rule 145" means Rule 145 promulgated by the Commission pursuant to the Securities Act, as such Rule may be amended from time to time, or any similar rule or regulation hereafter adopted by the Commission having substantially the same effect as such Rule.

"Rule 158" means Rule 158 promulgated by the Commission pursuant to the Securities Act, as such Rule may be amended from time to time, or any similar rule or regulation hereafter adopted by the Commission having substantially the same effect as such Rule.

"Rule 415" means Rule 415 promulgated by the Commission pursuant to the Securities Act, as such Rule may be amended from time to time, or any similar rule or regulation hereafter adopted by the Commission having substantially the same effect as such Rule.

"SEC" means the United States Securities and Exchange Commission.

"Securities Act" means the Securities Act of 1933, as amended.

"Subsidiary" means any corporation or other legal entity of which RAI or IBUI, as the case may be (either above or through or together with any other Subsidiary) owns, directly or indirectly, more than 50% of the stock or other equity interests the holders of which are generally entitled to vote for the election of directors or other governing body of such corporation or other entity.

"Tax Return" means any report, return, election, notice, estimate, declaration, information statement and other forms and documents (including all schedules, exhibits and other attachments thereto) relating to and filed or required to be filed with a taxing authority in connection with any Taxes (including, without limitation, estimated Taxes).

"Taxes" means any and all federal, state, local and foreign taxes, assessments and other governmental charges, duties, impositions, levies and liabilities, including, without limitation, taxes based upon or measured by gross receipts, income, profits, sales, use and occupation, and value added, ad valorem, transfer, gains, franchise, withholding, payroll, recapture, employment, excise, unemployment, insurance, social security, business license, occupation, business organization, stamp, environmental and property taxes, together with all interest, penalties and additions imposed with respect to such amounts. For purposes of this Agreement, "Taxes" also includes any obligations under any agreements or arrangements with any Person with respect to the liability for, or sharing of, Taxes (including pursuant to Treas. Reg. Section 1.1502-6 or comparable provisions of state, local or foreign Tax Law) and including any liability for Taxes as a transferee or successor, by Contract or otherwise.

"Termination Date" means September 30, 2001

"Trademarks" means registered trademarks, registered service marks, trademark and service mark applications and unregistered trademarks and service marks.

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"Transaction Documents" means this Agreement and the Employment Agreements.

"Transactions" means the Merger and Share Exchange, the exchange of the IBUI Shares for RAI Shares, the assumption by RAI of the Existing IBUI Options, the exchange of the IBUI Warrants for RAI Warrants, and the other transactions contemplated by the Transaction Documents.

"Wholly-Owned Subsidiary" of any Person means any Subsidiary in which all of the stock or other equity interests is owned, directly or indirectly, by such Person.

### ARTICLE 2

#### PLAN OF MERGER AND SHARE EXCHANGE

##### 2.1 THE MERGER AND SHARE EXCHANGE

Upon the terms and subject to the conditions hereof, and in accordance with the relevant provisions of the DGCL and Nevada Law, the Merger Subsidiary shall be merged with and into IBUI (the "Merger and Share Exchange"). Following the Merger and Share Exchange, IBUI shall continue as the surviving corporation (the "Surviving Corporation") and shall continue its existence under Nevada Law, and the separate corporate existence of the Merger Subsidiary shall cease.

##### 2.2 EFFECTIVE DATE

As soon as practicable, but in any event within one business day after the satisfaction or waiver of all conditions to the Merger and Share Exchange, the Parties shall file with the Secretary of State of Nevada the Articles of Merger and Share Exchange (the "Articles of Merger and Share Exchange") in such form as is required by Nevada Law. The Merger and Share Exchange shall become effective at the Effective Date.

##### 2.3 CERTIFICATE OF INCORPORATION AND BYLAWS

The Certificate of Incorporation of IBUI as in effect immediately prior to the Effective Date shall be the initial Certificate of Incorporation of the Surviving Corporation. The bylaws of IBUI as in effect immediately prior to the Effective Date shall be the initial bylaws of the Surviving Corporation.

##### 2.4 DIRECTORS

The initial directors of the Surviving Corporation shall be [Names]. Such persons shall hold such positions until their successors are elected or appointed in accordance with the Certificate of Incorporation and the bylaws of the Surviving Corporation.

##### 2.5 EXCHANGE OF SHARES

On the Effective Date the shares of the IBUI Common Stock shall be converted and exchanged into shares of RAI common stock, par value \$0.001 per share, (the "Merged Company Common Stock") and warrants exercisable with respect to shares of RAI Common Stock shall become exercisable with respect to shares of Merged Company Common Stock in the following manner:

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(a) Each issued and outstanding share of the IBUI Common Stock shall, by virtue of the Merger and Share Exchange and without any action on the part of the holder thereof, be converted and exchanged into 0.14 shares of Merged Company Common Stock, provided however, that to the extent any holder of the IBUI Common Stock shall be entitled, as a result of the foregoing conversion and exchange, to receive less than a whole share of Merged Company Common Stock, then and in any such event:

(i) no fractional share and/or fractional interest in a whole share shall be issued; and

(ii) the fractional interest of such holder shall be liquidated for cash equivalent calculated on the basis of the closing sales price of Merged Company Common Stock on the Effective Date or on the first day thereafter that such price is available.

(b) Anything in this Section 4 to the contrary notwithstanding, any and all issued shares of the IBUI Common Stock owned by IBUI and held as treasury stock shall be cancelled and retired and no shares of RAI Common Stock shall be issued with respect thereto.

### 2.6 APPOINTMENT OF EXCHANGE AGENT

Prior to the Effective Date RAI shall, subject to the provisions of Paragraph 8 hereof:

(a) Designate Continental Stock Transfer and Trust (the "Exchange Agent") to implement the exchange (subsequent to the Effective Date) of certificates representing shares of the IBUI Common Stock (the "Old Certificates") for certificates representing shares of RAI Common Stock (the "New Certificates");

(b) engage the Exchange Agent for a period of the lesser of (i) 12 consecutive months following the Effective Date and (ii) the date on which all of the Old Certificates held by the IBUI Stockholders have been surrendered for the New Certificates; and

(c) provide to the Exchange Agent sufficient supplies of New Certificates so as to enable a holder of an Old Certificate(s) to surrender such Certificate(s) and receive New Certificate(s).

### 2.7 CERTIFICATE EXCHANGE

Subsequent to the Effective Date the issuance and distribution of New Certificates in exchange for Old Certificates shall be implemented as follows:

(a) As promptly after the Effective Date as shall be reasonably possible, the Exchange Agent shall be directed to, and shall, notify (the "Notification") each holder of an Old Certificate of the consummation of the Merger and Share Exchange, the availability of New Certificates and a description of the procedure to be followed (and documents to be executed and submitted) in connection with the surrender of the Old Certificate and the issuance of the New

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Certificate. Upon compliance by a holder thereof with the requirements for the certificate surrender and issuance specified in the Notification, the Exchange Agent shall be directed to, and shall, issue and transmit to such holder New Certificates (representing that number of shares of RAI Common Stock to which such holder shall be entitled as herein provided). Until surrendered and replaced as aforesaid:

(i) each Old Certificate shall, and be deemed to, represent and evidence (for all corporate purposes other than the payment of dividends and other distributions) that number of shares of RAI Common Stock into which the shares of the IBUI Common Stock therein referred to are convertible and exchangeable as herein provided and

(ii) each Old Certificate shall not be transferable on the books and records of IBUI and/or RAI.

(b) From and after the Effective Date any and all dividends and/or distributions of every kind, nature or description declared and payable by RAI on, or with respect to, RAI Common Stock to any holder of an Old Certificate (collectively "Distributions") shall be paid, retained, invested and paid over as follows:

(i) Until such time as the Old Certificate is surrendered for replacement by a New Certificate(s) as herein provided, no Distribution shall be paid over by RAI and/or the Exchange Agent to such holder on, or with respect to, the shares of RAI Common Stock evidenced by such Old Certificate;

(ii) All Distributions payable on, or with respect to, shares of RAI Common Stock represented by Old Certificates shall be paid over by RAI to the Exchange Agent and dealt in and with by the Exchange Agent as follows:

(A) All Distributions in cash shall be deposited by the Exchange Agent in an interest bearing account (the "Distribution Account") and retained and disposed of as hereinbelow provided;

(B) Upon surrender by, or on behalf of, a holder of an Old Certificate for surrender and replacement as hereinabove provided (or satisfactory proof of loss and an indemnity in favor of, and acceptable to, RAI and the Exchange Agent), the Exchange Agent shall pay over and/or deliver to such holder (in addition to the New Certificate(s) to which such holder shall be entitled) (y) the principal amount of any cash dividends and any property (other than shares of RAI Common Stock) previously received by the Exchange Agent with respect to the shares of RAI Common Stock evidenced by such Old Certificate and (z) a certificate representing any shares of RAI Common Stock forming part of any Distribution made prior to the date of any such surrender; and

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(C) Any and all interest earned and/or credited on, or with respect to, Distributions shall be applied by the Exchange Agent to the payment of its fees and disbursements and the remainder, if any, paid over to RAI upon the termination of the engagement of the Exchange Agent.

(c) From and after the Effective Date the sole rights of the holders of Old Certificates (except as otherwise provided by law) shall be those to which they are entitled as owners of RAI Common Stock into which the shares of the IBUI Common Stock evidenced by such Old Certificates shall have been converted as herein provided.

### 2.8 TRANSFERS

If the holder of any Old Certificate desires that the New Certificate to be issued in replacement therefore (as hereinabove provided) is to be issued in a name other than that on the Old Certificate which it replaces, any such issuance shall be subject to and conditioned upon:

(a) Delivery to the Exchange Agent of the Old Certificate duly endorsed in blank or accompanied by a duly executed stock assignment power and otherwise in form for transfer acceptable to the Exchange Agent; and

(b) Payment to RAI or the Exchange Agent of any and all transfer and/or other taxes payable, in the opinion of the Exchange Agent, by reason of the issuance and/or transfer of such New Certificate and/or the shares of RAI Common Stock evidenced thereby.

### 2.9 TERMINATION OF EXCHANGE AGENT

Upon the termination of the Exchange Agent's engagement as hereinabove provided, the Exchange Agent shall deliver to RAI the then balance of the Distribution Account and, upon such delivery, the Exchange Agent shall have no further duties or obligations as exchange agent to RAI, The Merger Subsidiary, IBUI or their respective stockholders. Thereafter, the duties to be performed by the Exchange Agent as described in Sections 6 and 7 hereof shall be performed by RAI in lieu of, and instead of, the Exchange Agent. All blank stock certificates evidencing RAI Common Stock shall be retained by the Exchange Agent for utilization by it in the performance of its duties as transfer agent for, and with respect to, RAI Common Stock.

### 2.10 OPTIONS AND WARRANTS

(a) At the Effective Date, RAI shall assume IBUI's rights and obligations under each of the outstanding stock options previously granted by IBUI to certain of its employees, directors and consultants that are outstanding immediately prior to the Effective Date (each such stock option existing immediately prior to the Effective Date is referred to herein as an "Existing IBUI Option" and each such assumed stock option existing immediately after the Effective Date is referred to herein as an "Assumed IBUI Option"). Under each Assumed IBUI Option, the optionee shall have the right to receive from RAI, in accordance with the



terms and subject to the conditions of the Existing IBUI Option, the Merger Consideration that such optionee would have been entitled to receive had the optionee exercised his or her Existing IBUI Option immediately prior to the Effective Date, but only in accordance with the terms and conditions of the Existing IBUI Option (including payment of the aggregate exercise price thereof). Except as provided in this Section 2.10(a), the Assumed IBUI Option shall not give the optionee any additional benefits that the holder thereof did not have under the Existing IBUI Option; provided, however, that the terms of such Existing IBUI Options shall govern the vesting thereof, including, if applicable, any vesting of Existing IBUI Options as a result of the Merger and Share Exchange. Each Assumed IBUI Option shall constitute a continuation of the Existing IBUI Option, substituting RAI for IBUI.

(b) Each IBUI Warrant that is outstanding immediately prior to the Effective Date and that does not expire at the Effective Date by the terms thereof shall, by virtue of the Merger and Share Exchange and pursuant to the terms of the IBUI Warrant or with the consent of the majority of the holders thereof, be converted into and exchanged for a Merged Company Warrant exercisable for the [Conversion Number] of Merged Company Shares for each share of Merged Company Common Stock for which the IBUI Warrant is exercisable immediately prior to the Effective Date, at an exercise price per Merged Company Share that has been adjusted in accordance with the terms of the IBUI Warrant converted hereunder as a result of the Merger and Share Exchange. The IBUI Warrants shall have the terms and conditions of the IBUI Warrants converted hereunder. At the Effective Date, RAI shall make available to any holders of IBUI Warrants converted hereunder a new warrant evidencing RAI Warrant.

2.11 [Intentionally Omitted]

#### 2.12 MERGER SUBSIDIARY CAPITAL STOCK

Each share of capital stock of the Merger Subsidiary issued and outstanding immediately prior to the Effective Date shall be converted, by virtue of the Merger and Share Exchange, into one share of common stock of the Surviving Corporation.

#### 2.13 NO FURTHER TRANSFER OF SHARES

After the Effective Date, there shall be no transfers of IBUI Shares that were outstanding immediately prior to the Effective Date on the stock transfer books of the Surviving Corporation. If, after the Effective Date, Certificates are presented to the Surviving Corporation for transfer, they shall be canceled and exchanged for the Merger Consideration as provided in this Article II.

### ARTICLE 3

#### RESCISSION RIGHTS

##### 3.1 GENERAL

Each of the RAI Parties and IBUI acknowledge and agree that

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the obligations of the RAI Parties and IBUI are unique and personal to the RAI Parties and IBUI, respectively, and may be discharged only by the RAI Parties and IBUI, respectively. The RAI Parties and IBUI further acknowledge and agree that if the RAI Parties or IBUI were to fail to observe or to perform any of certain provisions of this Agreement, including in particular those set forth in this Article III, the award of damages arising from such breach would be difficult, and perhaps impossible, to ascertain in money or money's worth, and therefore, damages would not be an adequate remedy. Therefore the Parties agree that each of the RAI Parties and IBUI shall have rescission rights as set forth in this Article III.

### 3.2 RESCISSION RIGHTS OF RAI STOCKHOLDERS

If any representation or warranty of IBUI contained in this Agreement or any covenant of IBUI contained in this Agreement shall be materially breached, then, at any time for twelve (12) months after the Effective Date, the majority in interest of the RAI Stockholders may rescind the Merger and Share Exchange by signing RAI notice of the right to rescind the Merger and Share Exchange. RAI shall then promptly give notice of the RAI Stockholders notice of rescission to the IBUI Shareholders and the IBUI Shareholders shall have thirty (30) days from the date of the RAI Stockholders notice to cure such breach if such breach is capable of being cured. If the breach is not cured within the applicable period or not capable of being cured, then all of the shares of the Surviving Corporation shall be put back to the RAI Stockholders in accordance with Section 3.4.

### 3.3 RESCISSION RIGHTS OF IBUI SHAREHOLDERS

If any representation or warranty of the RAI Parties contained in this Agreement or any covenant of IBUI contained in this Agreement shall be materially breached then, at any time twelve (12) months after the Effective Date, then the majority in interest of the IBUI Shareholders may rescind the Merger and Share Exchange by signing RAI notice of the right to rescind the Merger and Share Exchange. RAI shall then promptly give notice of the IBUI Shareholders notice of rescission to the RAI Stockholders and the RAI Stockholders shall have thirty (30) days from the date of the IBUI Shareholders notice to cure such breach if each breach is capable of being cured. If the breach is not cured within the applicable period or not capable of being cured, then all of the shares of the Surviving Corporation shall be put back to the IBUI Shareholders in accordance with Section 3.4.

### 3.4 APPLICABLE PROVISIONS TO ARTICLE III

In the event of rescission under Sections 3.2 or 3.3, the following shall apply:

(a) All assets held by IBUI at the Effective Date shall be held by IBUI when returned to the IBUI Shareholders, upon the closing of the rescission; and

(b) New assets acquired by the Surviving Corporation after the Effective Date and held by IBUI on the closing of the rescission, to the extent not offset by new liabilities of IBUI on the closing of the rescission shall be equitably divided between RAI and IBUI, and, to the extent that the Parties can not agree upon an equitable

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division, such new assets shall be sold and the net proceeds of sale shall be evenly divided between RAI and IBUI.

### 3.5 MODIFICATION

Any provision under this Article III may be modified or waived only by the written consents of the majority in interest or the IBUI Shareholders and the RAI Stockholders.

## ARTICLE 4

### THE CLOSING

#### 4.1 THE CLOSING

The closing of the transactions contemplated by this Agreement shall take place on such date, at such place and at such time within five business days after the satisfaction or waiver of the last of the conditions set forth in Article XII, XIII, XIV and XV hereof. The closing of such transactions shall be referred to herein as the "Closing;" the date of the Closing shall be referred to herein as the "Closing Date".

#### 4.2 DELIVERIES

At the Closing,

(a) IBUI, the Merger Subsidiary and RAI shall deliver or cause to be delivered to the Secretary of State of the State of Nevada a duly executed Articles of Merger and Share Exchange as required under Nevada Law and the Parties shall take all such other and further actions as may be required by Nevada Law and any other applicable Law to make the Merger and Share Exchange effective upon the terms and subject to the conditions hereof; and

(b) The Parties shall also deliver to each other the respective agreements and other documents and instruments specified with respect to them in Articles XII, XIII, XIV and XV.

## ARTICLE 5

### REPRESENTATIONS AND WARRANTIES OF RAI

RAI hereby represents and warrants to IBUI as follows, except as otherwise set forth in the RAI Disclosure Schedule (items disclosed in one Section of such Schedule shall apply to all other Sections unless specified otherwise):

#### 5.1 CORPORATE

Each RAI Company is a corporation duly organized, validly existing and in good standing under the Laws under which it was incorporated. Each RAI Company is qualified to do business as a foreign corporation in any jurisdiction where it is required to be so qualified, except where the failure to so qualify would not have a Material Adverse Effect. The Charter Documents and bylaws of each RAI Company (all of which have been delivered or made available to IBUI) have been duly adopted and are current, correct and complete. Each RAI Company has all necessary corporate power and authority to own, lease and operate its part

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of the RAI Assets and to carry on its part of the RAI Business as it is now being conducted.

### 5.2 AUTHORIZATION

Each RAI Company has the requisite corporate power and authority to execute and deliver the Transaction Documents to which it is a party and to perform the Transactions to be performed by it. Such execution, delivery and performance by each RAI Company has been duly authorized by all necessary corporate action, other than the approval of this Agreement and consummation of the Merger and Share Exchange, which is subject to the approval of the holders of a majority of the outstanding RAI Common Shares, and are the only consents or approvals of holders of RAI capital stock required for the consummation of the Transactions. Each Transaction Document executed and delivered by each RAI Company as of the date hereof has been duly executed and delivered by such RAI Company and constitutes a valid and binding obligation of such RAI Company enforceable against such RAI Company in accordance with its terms. Any Transaction Document executed and delivered by each RAI Company after the date hereof will be duly executed and delivered by such RAI Company and will constitute a valid and binding obligation of such RAI Company, enforceable against such RAI Company in accordance with its terms, except as otherwise limited by bankruptcy, insolvency, reorganization and other laws affecting creditors rights generally, and except that the remedy of specific performance or other equitable relief is available only at the discretion of the court before which enforcement is sought.

### 5.3 VALIDITY OF CONTEMPLATED TRANSACTIONS

Except for compliance with (i) the Securities Act and the Exchange Act and (ii) the filing of the Articles of Merger and Share Exchange with the Secretary of State of the State of Nevada, neither the execution and delivery by each RAI Company of the respective Transaction Documents to which it is or will be a party, nor the performance of the Transactions to be performed by it, will require any filing, consent or approval under or constitute a Default, or result in a loss of material benefit under, (a) any Law or Court Order to which any RAI Company is subject, (b) the Charter Documents or bylaws of any RAI Company, or (c) any Contracts to which any RAI Company is a party or by which any of the RAI Assets may be subject, except for Defaults which would not have a Material Adverse Effect.

### 5.4 CAPITALIZATION AND STOCK OWNERSHIP

The total authorized capital stock of RAI consists of (a) 50,000,000 shares of Merged Company Common Stock, and (b) 1,000,000 shares of Series A Preferred Stock, par value \$0.001 per share (the "Preferred Stock"). Of such authorized capital stock, the only issued and outstanding shares on the date hereof are [ ] RAI Common Shares. Except as set forth in the RAI Disclosure Schedule, there are no existing options, warrants, calls, commitments or other rights of any character (including conversion or preemptive rights) relating to the acquisition of any issued or unissued capital stock or other securities of RAI. The RAI Disclosure Schedule sets forth, as of the date hereof, as to each option or warrant, the holder, date of grant, exercise price and number of shares subject thereto. All of the issued and outstanding RAI Common Shares are validly issued fully paid and

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non-assessable. Following the Effective Date, no options, warrants, calls, commitments or other rights of any character (including conversion or preemptive rights) will entitle any Person to acquire any securities of the Surviving Corporation or any subsidiary thereof.

### 5.5 LISTING

RAI Common Stock is listed for quotation on the NASDAQ Small Cap Market under the symbol "RTRN". RAI has received a letter from NASDAQ indicating that it has not met the ongoing listing requirements in that RAI's common stock has traded below \$1.00 for more than 30 trading days. The Company's shares now must close above \$1.00 for 10 consecutive trading days by June 4, 2001. After June 4, 2001, RAI may request a meeting with NASDAQ to address this issue.

### 5.6 REGISTRATION STATEMENT; CONSENT SOLICITATION STATEMENT; PROSPECTUS

None of the information supplied or to be supplied by or on behalf of any RAI Company specifically for inclusion in the Registration Statement (as defined in Section 7.1) will (except to the extent revised or superseded by amendments or supplements contemplated hereby), at the time of distribution to the IBUI Shareholders, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading. None of the information supplied or to be supplied by or on behalf of any RAI Company specifically for inclusion or incorporation by reference in the Consent Solicitation Statement/Prospectus (as defined in Section 7.1) will (except to the extent revised or superseded by amendments or supplements contemplated hereby), at the date it (or any such amendment or supplement) is mailed to the stockholders of RAI and at the time of the RAI Stockholder Meeting, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they are made, not misleading. The Registration Statement and the Consent Solicitation Statement/Prospectus (except for information relating solely to IBUI) will comply in all material respects with the requirements of the Securities Act and the Exchange Act and the Regulations promulgated thereunder.

### 5.7 RAI SEC REPORTS; FINANCIAL STATEMENTS

RAI has filed all required forms, reports, statements, schedules and other documents with the SEC since January 1, 1997, including its (a) Annual Reports on Form 10-KSB for the fiscal years ended August 30, 2000, 1999 and 1998, (b) all proxy statements relating to RAI's meetings of stockholders (whether annual or special) held since January 1, 1997, and (c) all other reports or registration statements filed by RAI with the SEC since January 1, 1997 (collectively, the "RAI SEC Reports"). Each of such RAI SEC Reports, at the time it was filed, complied in all material respects with all applicable requirements of the Securities Act and the Exchange Act, and with the forms and Regulations of the SEC promulgated thereunder, and did not contain at the time filed any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of

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the circumstances under which they are made, not misleading. The financial statements, including all related notes and schedules, contained in the RAI SEC Reports (or incorporated by reference therein) fairly present the consolidated financial position of RAI as at the respective dates thereof and the consolidated results of operations and cash flows of RAI for the periods indicated in accordance with GAAP applied on a consistent basis throughout the periods involved (except for changes in accounting principles disclosed in the notes thereto) and subject in the case of interim financial statements to normal year-end adjustments and the absence of notes. For purposes of this Agreement, the balance sheet of RAI as of August 30, 2000 is referred to as the "RAI Balance Sheet" and the date thereof is referred to as the "RAI Balance Sheet Date."

### 5.8 TAXES

(a) Each RAI Company has (i) filed (or, in the case of Tax Returns not yet due, will file) with the appropriate governmental agencies all material Tax Returns required to be filed on or before the Effective Date and all such Tax Returns filed were true, correct and complete in all material respects, and (ii) paid (or, in the case of Taxes not yet due, will pay), all Taxes shown on such Tax Returns.

(b) Each RAI Company has (i) duly paid or caused to be paid all material Taxes and all Taxes shown on Tax Returns that are or were due, except to the extent that a sufficient reserve for Taxes has been reflected on the RAI Balance Sheet and (ii) provided a sufficient reserve on the RAI Balance Sheet for the payment of all Taxes not yet due and payable.

(c) No deficiency in respect of any Taxes which has been assessed against an RAI Company remains unpaid, except for Taxes being contested in good faith, and RAI has no knowledge of any unassessed Tax deficiencies or of any audits or investigations pending or threatened against an RAI Company with respect to any Taxes.

(d) No RAI Company has extended or waived the application of any applicable statute of limitations of any jurisdiction regarding the assessment or collection of any Tax or any Tax Return.

(e) There are no liens for Taxes upon any assets of any RAI Company except for liens for current Taxes not yet due.

(f) Each RAI Company has to its knowledge (i) complied with all material provisions of the Code relating to the withholding and payment of Taxes and (ii) has made all deposits required by applicable Law to be made with respect to employees' withholding and other payroll, employment or other withholding or related Taxes.

(g) No RAI Company is a party to any contract, agreement, plan or arrangement that, individually or in the aggregate, or when taken together with any payment that may be made under this Agreement or any agreements contemplated hereby, could give rise to the payment of any "excess parachute payment" within the meaning of Section 280G of the Code.

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(h) No RAI Company is a party to any agreement relating to the allocating or sharing of the payment of, or liability for, Taxes for any period (or portion thereof).

(i) To RAI's knowledge, except for the group of which RAI is presently the ultimate parent, no RAI Company has ever been a member of an affiliated group of corporations (within the meaning of Section 1504 of the Code).

### 5.9 TITLE TO ASSETS AND RELATED MATTERS

Each RAI Company has good and marketable title to its part of the RAI Assets, free from any Encumbrances except (a) any Encumbrance in favor of any RAI Company, (b) items described in any notes to the consolidated financial statements of RAI contained in RAI's Annual Report on Form 10-KSB for the fiscal year ended August 31, 2000 (the "RAI 10-KSB") included in the RAI SEC Reports, (c) minor matters that would not have a Material Adverse Effect, (d) constitutional and statutory liens arising from the obligation to pay for the provision of materials or services not yet in Default and Taxes not yet due and (e) RAI Assets transferred among the RAI Companies.

### 5.10 REAL PROPERTY

All material real estate leased by any RAI Company as of the date hereof and used in the operation of the RAI Business are disclosed in the RAI SEC Reports. As of the date hereof, none of the RAI Companies owns any real property.

### 5.11 SUBSIDIARIES

As of the date hereof none of the RAI Companies owns, directly or indirectly, any interest or investment (whether equity or debt) in any corporation, partnership, limited liability company, business trust, joint venture or other legal entity. RAI (or another RAI Company) owns all of the issued and outstanding shares of capital stock of each RAI Subsidiary. There are no existing options, warrants, calls, commitments or other rights of any character (including conversion or preemptive rights) relating to the acquisition or voting of any issued or unissued capital stock or other securities of any RAI Subsidiary. All of the shares of capital stock of each RAI Subsidiary are duly and validly authorized and issued, fully paid and non-assessable.

### 5.12 LEGAL PROCEEDINGS; COMPLIANCE WITH LAW; GOVERNMENTAL PERMITS

(a) There is no Litigation that is pending or, to RAI's knowledge, threatened against any RAI Company that would have a Material Adverse Effect. RAI is and has been in compliance with all applicable Laws, including Environmental Law, except where the failure to be in compliance would not have a Material Adverse Effect. There has been no Default under any Laws applicable to any RAI Company, including Environmental Laws, except for any Defaults that would not have a Material Adverse Effect. There has been no Default with respect to any Court Order applicable to any RAI Company. No RAI Company has received any written notice and, to the knowledge of RAI, no other communication has been received to the effect that it is not in compliance with any applicable Laws, and RAI has no reason to believe that any presently existing circumstances are likely to result in

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violations of any applicable Laws, except to the extent that such failures to comply or violations would not have a Material Adverse Effect.

(b) To RAI's knowledge, there is no Environmental Condition at any property presently or formerly owned or leased by an RAI Company which is reasonably likely to have a Material Adverse Effect.

(c) The RAI Companies have all material consents, permits, franchises, licenses, concessions, registrations, certificates of occupancy, approvals and other authorizations of Governmental Authorities (collectively, the "Governmental Permits") required in connection with the operation of their respective businesses as now being conducted, all of which are in full force and effect, except where the failure to obtain any such Governmental Permit or of any such Governmental Permit to be in full force and effect, would not have a Material Adverse Effect. Each RAI Company has complied, in all material respects, with all of its Governmental Permits, except where the failure to so comply would not have a Material Adverse Effect.

### 5.13 CONTRACTS AND COMMITMENTS

The RAI Disclosure Schedule describes:

(a) Contracts (excluding letters of intent and agreements in principle) involving any RAI Company in amounts in excess of \$100,000.

(b) All employment, consulting, management, severance or agency Contracts providing for annual payments of at least \$100,000 (y) with any executive officers or directors of RAI, or (z) allowing the other party to terminate and receive payment based on the execution of this Agreement and consummation of the Transactions.

(c) Any employment agreements with any Person to whom any RAI Company makes annual salary payments in excess of \$100,000.

(d) All Contracts limiting the freedom of any RAI Company to compete in any line of business, or with any Person, or in any geographic area or market.

Each Contract providing for payments in excess of \$100,000 to which any RAI Company is a party (i) is legal, valid, binding and enforceable against RAI or the applicable Subsidiary except as otherwise limited by bankruptcy, insolvency, reorganization and other laws affecting creditors' rights generally, and except that the remedy of specific performance or other equitable relief is available only at the discretion of the court before which enforcement is sought, and (ii) neither RAI nor the applicable Subsidiary, nor to RAI's knowledge, any other party, is in Default under any such Contract, other than in the case of (i) and (ii) above where the failure to be so would not have a Material Adverse Effect.

### 5.14 EMPLOYEE RELATIONS

No RAI Company is (a) a party to, involved in or, to RAI's knowledge, threatened by, any labor dispute or unfair labor



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practice charge, or (b) currently negotiating any collective bargaining agreement, and no RAI Company has experienced any work stoppage during the last three years.

### 5.15 ERISA

(a) The RAI Disclosure Schedule contains a complete list of all Benefit Plans sponsored or maintained by any RAI Company or under which any RAI Company may be obligated for its employees, directors or independent contractors ("RAI Benefit Plans"). RAI has delivered or made available to IBUI (i) accurate and complete copies of all RAI Benefit Plan documents and of any summary plan descriptions, summary annual reports and insurance contracts relating thereto, (ii) accurate and complete detailed summaries of all unwritten RAI Benefit Plans, (iii) accurate and complete copies of the most recent financial statements and actuarial reports with respect to all RAI Benefit Plans for which financial statements or actuarial reports are required or have been prepared and (iv) accurate and complete copies of all annual reports for all RAI Benefit Plans (for which annual reports are required) prepared within the last two years.

(b) All RAI Benefit Plans conform in all material respects to, and are being administered and operated in material compliance with, the requirements of ERISA, the Code and all other applicable Laws, including applicable Laws of foreign jurisdictions. There have not been any "prohibited transactions," as such term is defined in Section 4975 of the Code or Section 406 of ERISA involving any of the RAI Benefit Plans, that could subject any RAI Company to any material penalty or tax imposed under the Code or ERISA.

(c) Any RAI Benefit Plan that is intended to be qualified under Section 401(a) of the Code and exempt from tax under Section 501(a) of the Code has been determined by the Internal Revenue Service to be so qualified, and such determination remains in effect and has not been revoked.

Nothing has occurred since the date of any such determination that is reasonably likely to affect adversely such qualification or exemption, or result in the imposition of excise taxes or income taxes on unrelated business income under the Code or ERISA with respect to any RAI Benefit Plan.

(d) No RAI Company has a current or contingent obligation to contribute to any multiemployer plan (as defined in Section 3(37) of ERISA) and (ii) no RAI Company, nor any entity that has been treated as a single employer with any RAI Company under Sections 414(b), (c), (m) or (o) of the Code, has any liability, contingent or otherwise, under Title IV of ERISA or Section 412 of the Code.

(e) There are no pending or, to the knowledge of RAI, threatened claims by or on behalf of any RAI Benefit Plans, or by or on behalf of any individual participants or beneficiaries of any RAI Benefit Plans, alleging any breach of fiduciary duty on the part of any RAI Company or any of the officers, directors or employees of any RAI Company under ERISA or any other applicable Regulations, or claiming

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benefit payments other than those made in the ordinary operation of such plans, or alleging any violation of any other applicable Laws. To RAI's knowledge, the RAI Benefit Plans are not the subject of any investigation, audit or action by the Internal Revenue Service, the Department of Labor or the Pension Benefit Guaranty Corporation ("PBGC"). Each RAI Company has made all required contributions under the RAI Benefit Plans including the payment of any premiums payable to the PBGC and other insurance premiums.

(f) With respect to any RAI Benefit Plan that is an employee welfare benefit plan (within the meaning of Section 3(1) of ERISA) (an "RAI Welfare Plan"), (i) each RAI Welfare Plan for which contributions are claimed as deductions under any provision of the Code is in material compliance with all applicable requirements pertaining to such deduction, (ii) with respect to any welfare benefit fund (within the meaning of Section 419 of the Code) related to an RAI Welfare Plan, there is no disqualified benefit (within the meaning of Section 4976(b) of the Code) that would result in the imposition of a tax under Section 4976(a) of the Code, and (iii) any RAI Benefit Plan that is a group health plan (within the meaning of Section 4980B(g)(2) of the Code) complies, and in each and every case has complied, with all of the material requirements of Section 4980B of the Code, ERISA, Title XXII of the Public Health Service Act and the applicable provisions of the Social Security Act.

(g) The execution of this Agreement and the performance of the Transactions will not (either alone or in combination with the occurrence of any additional or subsequent events) constitute an event under any RAI Benefit Plan that will or may result in any payment (whether of severance pay or otherwise), acceleration, forgiveness of indebtedness, vesting, distribution, increase in benefits or obligation to fund benefits with respect to any current or former employee, director or consultant of any RAI Company.

### 5.16 PATENTS, TRADEMARKS, ETC.

To RAI's knowledge, no RAI Company infringes upon or unlawfully or wrongfully uses any Intellectual Property owned or claimed by another Person and no Person infringes on or wrongfully uses any Intellectual Property owned or claimed by RAI, except for those situations that would not have a Material Adverse Effect. To RAI's knowledge, the RAI Companies own or have valid rights to use all Intellectual Property used in the conduct of their business except where the failure to have valid rights to use such Intellectual Property will not have a Material Adverse Effect, free and clear of all Encumbrances, other than Encumbrances which would not have a Material Adverse Effect.

### 5.17 ABSENCE OF CERTAIN CHANGES

Since the RAI Balance Sheet Date, the RAI Companies have conducted the RAI Business in the ordinary course, as of the date hereof, there has not been:

(a) any Material Adverse Effect on the RAI Business or, in the aggregate, Liabilities of the RAI Companies;

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- (b) any distribution or payment declared or made in respect of RAI's capital stock by way of dividends, purchase or redemption of shares or otherwise;
- (c) any increase in the compensation payable or to become payable to any current director or officer of any RAI Company, except for merit and seniority increases for employees made in the ordinary course of business, nor any material change in any existing employment, severance, consulting arrangements or any RAI Benefit Plan;
- (d) any sale, assignment or transfer of any RAI Assets, or any additions to or transactions involving any RAI Assets, other than those made in the ordinary course of business or those solely involving the RAI Companies;
- (e) other than in the ordinary course of business, any waiver or release of any material claim or right or cancellation of any material debt held by any RAI Company;
- (f) any change in practice with respect to Taxes, or any election, change of any election, or revocation of any election with respect to Taxes, or any settlement or compromise of any dispute involving a Tax liability;
- (g) (i) any creation, assumption or maintenance of any long-term debt or any short-term debt for borrowed money other than under existing notes payable, lines of credit or other credit facility or in the ordinary course of business or with respect to its Wholly-Owned Subsidiaries; (ii) any assumption, granting of guarantees, endorsements or otherwise becoming liable or responsible (whether directly, contingently or otherwise) for the obligations of any other Person except its Wholly-Owned Subsidiaries; or (iii) any loans, advances or capital contributions to, or investments in, any other Person except its Wholly-Owned Subsidiaries;
- (h) any material agreement, commitment or contract, except agreements, commitments or contracts for the purchase, sale or lease of goods or services in the ordinary course of business;
- (i) other than in the ordinary course of business, any authorization, recommendation, proposal or announcement of an intention to authorize, recommend or propose, or enter into any Contract with respect to, any (i) plan of liquidation or dissolution, (ii) acquisition of a material amount of assets or securities, (iii) disposition or Encumbrance of a material amount of assets or securities, (iv) merger or consolidation or (v) material change in its capitalization; or
- (j) any change in accounting or Tax procedure or practice.

### 5.18 CORPORATE RECORDS

The minute books of each RAI Company contain accurate, complete and current copies of all Charter Documents and of all minutes of meetings, resolutions and other proceedings of its Board of Directors and stockholders.

### 5.19 FINDER'S FEES

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No Person is or will be entitled to any commission, finder's fee or other payment in connection with the Transactions based on arrangements made by or on behalf of RAI.

### 5.20 REORGANIZATION

No RAI Company has or, as of the Closing Date, will have taken any action or failed to take any action which action or failure would result in the failure of the Merger and Share Exchange to qualify as a reorganization within the meaning of Code Section 368(a). RAI has no knowledge of any fact or circumstance that is reasonably likely to prevent the Merger and Share Exchange from qualifying as a reorganization within the meaning of Code Section 368(a).

### 5.21 OWNERSHIP OF MERGER SUBSIDIARY; NO PRIOR ACTIVITIES

The Merger Subsidiary is a Wholly-Owned Subsidiary of RAI created solely for the purpose of effecting the Merger and Share Exchange. As of the date hereof and the Effective Date, except for Liabilities incurred in connection with its incorporation or organization and the Transactions and except for this Agreement and the other Transaction Documents, neither RAI or the Merger Subsidiary has, nor will have, directly or indirectly, through any Subsidiary or Affiliate of RAI, any material Liabilities, engaged in any material business activities of any type or kind whatsoever or entered into any agreements or arrangements with any Person.

## ARTICLE 6

### REPRESENTATIONS AND WARRANTIES OF IBUI

IBUI hereby represents and warrants to RAI as follows, except as otherwise set forth in the IBUI Disclosure Schedule (items disclosed in one Section of such Schedule shall apply to all other Sections unless specified otherwise):

#### 6.1 CORPORATE

Each IBUI Company is a corporation duly organized, validly existing and in good standing under the Laws under which it was incorporated. Each IBUI Company is qualified to do business as a foreign corporation in any jurisdiction where it is required to be so qualified, except where the failure to so qualify would not have a Material Adverse Effect. The Charter Documents and bylaws of each IBUI Company (all of which have been delivered or made available to RAI) have been duly adopted and are current, correct and complete. Each IBUI Company has all necessary corporate power and authority to own, lease and operate its part of the IBUI Assets and to carry on its part of the IBUI Business as it is now being conducted.

#### 6.2 AUTHORIZATION

Each IBUI Company has the requisite corporate power and authority to execute and deliver the Transaction Documents to which it is a party and to perform the Transactions to be performed by it. Such execution, delivery and performance by each IBUI Company has been duly authorized by all necessary corporate action, other than the approval of this Agreement and consummation of the Merger and Share Exchange, which is subject

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to the approval of the holders of a majority of the outstanding IBUI Common Stock, and are the only consents or approvals of holders of IBUI capital stock required for the consummation of the Transactions. Each Transaction Document executed and delivered by each IBUI Company as of the date hereof has been duly executed and delivered by such IBUI Company and constitutes a valid and binding obligation of such IBUI Company, enforceable against such IBUI Company in accordance with its terms. Any Transaction Document executed and delivered by each IBUI Company after the date hereof will be duly executed and delivered by such IBUI Company and will constitute a valid and binding obligation of such IBUI Company, enforceable against such IBUI Company in accordance with its terms, except as otherwise limited by bankruptcy, insolvency reorganization and other laws affecting creditors rights generally, and except that the remedy of specified performance or other equitable relief is available only at the discretion of the court before which enforcement is sought.

### 6.3 VALIDITY OF CONTEMPLATED TRANSACTIONS

Except for compliance with (i) the Securities Act and the Exchange Act and (ii) the filing of the Articles of Merger and Share Exchange with the Secretary of State of the State of Nevada, neither the execution and delivery by each IBUI Company of the respective Transaction Documents to which it is or will be a party, nor the performance of the Transactions to be performed by it, will require any filing, consent or approval under or constitute a Default, or result in a loss of material benefit under, (a) any Law or Court Order to which any IBUI Company is subject, (b) the Charter Documents or bylaws of any IBUI Company, (c) any other Contracts to which any IBUI Company is a party or by which any of the IBUI Assets may be subject, except for Defaults which would not have a Material Adverse Effect.

### 6.4 CAPITALIZATION AND STOCK OWNERSHIP

The total authorized capital stock of IBUI consists of 349,000,000 shares of IBUI Common Stock, par value \$0.001 per share and 1,000,000 shares of preferred stock, par value \$100.00 per share. Of such authorized capital stock, the only issued and outstanding shares on the date hereof are 267,236,029 shares of IBUI Common Stock and 10,000 shares of preferred stock. There are no existing options, warrants, calls, commitments or other rights of any character (including conversion or preemptive rights) relating to the acquisition of any issued or unissued capital stock or other securities of IBUI. The IBUI Disclosure Schedule sets forth, as of the date hereof, as to each option or warrant, the holder, date of grant, exercise price and number of shares subject thereto. All of the shares of issued and outstanding shares of IBUI Common Stock are validly issued, fully paid and non-assessable.

### 6.5 [Intentionally Omitted]

### 6.6 REGISTRATION STATEMENT; CONSENT SOLICITATION STATEMENT; PROSPECTUS

None of the information supplied or to be supplied by or on behalf of any IBUI Company specifically for inclusion in the Registration Statement will (except to the extent revised or superseded by amendments or supplements contemplated hereby), at the time of distribution to the IBUI Shareholders, contain any untrue statement of a material fact or omit to state any material

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fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading. None of the information supplied or to be supplied by or on behalf of any IBUI Company specifically for inclusion or incorporation by reference in the Consent Solicitation Statement/Prospectus (as defined in Section 7.1) will (except to the extent revised or superseded by amendments or supplements contemplated hereby), at the date it (or any such amendment or supplement) is mailed to the stockholders of RAI and at the time of the RAI Stockholder Statement Meeting, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they are made, not misleading.

### 6.7 IBUI SEC REPORTS; FINANCIAL STATEMENTS

IBUI has filed all required forms, reports, statements, schedules and other documents with the SEC since March 31, 1998, including its (a) Annual Reports on Form 10-KSB for the fiscal years ended June 30, 2000, 1999 and 1998, (b) all proxy statements relating to IBUI's meetings of stockholders (whether annual or special) held since July 1999, and (c) all other reports or registration statements filed by IBUI with the SEC since March 31, 1998 (collectively, the "IBUI SEC Reports"). Each of such IBUI SEC Reports, at the time it was filed, complied in all material respects with all applicable requirements of the Securities Act and the Exchange Act, and with the forms and Regulations of the SEC promulgated thereunder, and did not contain at the time filed any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they are made, not misleading. The financial statements, including all related notes and schedules, contained in the IBUI SEC Reports (or incorporated by reference therein) fairly present the consolidated financial position of IBUI as at the respective dates thereof and the consolidated results of operations and cash flows of IBUI for the periods indicated in accordance with GAAP applied on a consistent basis throughout the periods involved (except for changes in accounting principles disclosed in the notes thereto) and subject in the case of interim financial statements to normal year-end adjustments and the absence of notes. For purposes of this Agreement, the balance sheet of IBUI as of June 30, 2000 is referred to as the "IBUI Balance Sheet" and the date thereof is referred to as the "IBUI Balance Sheet Date."

### 6.8 TAXES

(a) Each IBUI Company (i) has filed (or, in the case of Tax Returns not yet due, will file) with the appropriate governmental agencies all material Tax Returns required to be filed on or before the Effective Date and all such Tax Returns filed were true, correct and complete in all material respects, and (ii) has paid (or, in the case of Taxes not yet due, will pay), all Taxes shown on such Tax Returns.

(b) Each IBUI Company has (i) duly paid or caused to be paid all material Taxes and all Taxes shown on Tax Returns that are or were due, except to the extent that a sufficient reserve for Taxes has been reflected on the IBUI Balance Sheet and (ii) provided a sufficient reserve on the

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IBUI Balance Sheet for the payment of all Taxes not yet due and payable.

(c) No deficiency in respect of any Taxes which has been assessed against any IBUI Company remains unpaid, except for Taxes being contested in good faith, and IBUI has no knowledge of any unassessed Tax deficiencies or of any audits or investigations pending or threatened against IBUI with respect to any Taxes.

(d) No IBUI Company has extended or waived the application of any applicable statute of limitations of any jurisdiction regarding the assessment or collection of any Tax or any Tax Return.

(e) There are no liens for Taxes upon any assets of any IBUI Company except for liens for current Taxes not yet due.

(f) Each IBUI Company has to its knowledge (i) complied with all material provisions of the Code relating to the withholding and payment of Taxes and (ii) has made all deposits required by applicable Law to be made with respect to employees' withholding and other payroll, employment or other withholding or related Taxes.

(g) No IBUI Company is a party to any contract, agreement, plan or arrangement that, individually or in the aggregate, or when taken together with any payment that may be made under this Agreement or any agreements contemplated hereby, could give rise to the payment of any "excess parachute payment" within the meaning of Section 280G of the Code.

(h) No IBUI Company is a party to any agreement relating to the allocating or sharing of the payment of, or liability for, Taxes for any period (or portion thereof).

(i) To IBUI's knowledge, no IBUI Company has ever been a member of an affiliated group of corporations (within the meaning of Section 1504 of the Code).

### 6.9 TITLE TO ASSETS AND RELATED MATTERS

Each IBUI Company has good and marketable title to its part of the IBUI Assets, free from any Encumbrances except (a) any Encumbrance in favor of IBUI, (b) items described in any notes to the consolidated financial statements of IBUI contained in IBUI's Annual Report on Form 10-KSB included in the IBUI SEC Reports, (c) minor matters that would not have a Material Adverse Effect, (d) constitutional and statutory liens arising from the obligation to pay for the provision of materials or services not yet in Default and Taxes not yet due and (e) IBUI Assets transferred among the IBUI Companies.

### 6.10 REAL PROPERTY

All material real estate leased by any IBUI Company as of the date hereof and used in the operation of the IBUI Business are disclosed in the IBUI Financial Statements. As of the date hereof, none of the IBUI Companies owns any real property.

### 6.11 SUBSIDIARIES

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As of the date hereof none of the IBUI Companies owns, directly or indirectly, any interest or investment (whether equity or debt) in any corporation, partnership, limited liability company, business trust, joint venture or other legal entity. IBUI (or another IBUI Company) owns all of the issued and outstanding shares of capital stock of each IBUI Subsidiary, except that Global GPP Corp. is eighty percent (80%) owned by IBUI. There are no existing options, warrants, calls, commitments or other rights of any character (including conversion or preemptive rights) relating to the acquisition or voting of any issued or unissued capital stock or other securities of any IBUI Subsidiary. All of the shares of capital stock of each IBUI Subsidiary are duly and validly authorized and issued, fully paid and non-assessable.

### 6.12 LEGAL PROCEEDINGS; COMPLIANCE WITH LAW; GOVERNMENTAL PERMITS

(a) There is no Litigation that is pending or, to IBUI's knowledge, threatened against any IBUI Company that would have a Material Adverse Effect. Each IBUI Company is and has been in compliance with all applicable Laws, including Environmental Laws, except where the failure to be in compliance would not have a Material Adverse Effect. There has been no Default under any Laws applicable to any IBUI Company, including Environmental Laws, except for any Defaults that would not have a Material Adverse Effect. There has been no Default with respect to any Court Order applicable to any IBUI Company. No IBUI Company has received any written notice and, to the knowledge of IBUI, no other communication has been received to the effect that it is not in compliance with any applicable Laws, and IBUI has no reason to believe that any presently existing circumstances are likely to result in violations of any applicable Laws, except to the extent that such failures to comply or violations would not have a Material Adverse Effect.

(b) To IBUI's knowledge, there is no Environmental Condition at any property presently or formerly owned or leased by an IBUI Company which is reasonably likely to have a Material Adverse Effect.

(c) The IBUI Companies have all Governmental Permits required in connection with the operation of their respective businesses as now being conducted, all of which are in full force and effect, except where the failure to obtain any such Governmental Permit or of any such Governmental Permit to be in full force and effect, would not have a Material Adverse Effect. Each IBUI Company has complied, in all material respects, with all of its Governmental Permits, except where the failure to so comply would not have a Material Adverse Effect.

### 6.13 CONTRACTS AND COMMITMENTS

The IBUI Disclosure Schedule describes:

(a) Contracts (excluding letters of intent and agreements in principle) involving IBUI in amounts in excess of \$100,000.

(b) All employment, consulting, management, severance or agency Contracts providing for annual payments of at least \$100,000 (y) with any executive officers or directors



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of IBUI, or (z) allowing the other party to terminate and receive payment based on the execution of this Agreement and consummation of the Transactions, and (ii) any employment agreements with any Person to whom IBUI makes annual salary payments in excess of \$100,000.

(c) All Contracts limiting the freedom of IBUI to compete in any line of business, or with any Person, or in any geographic area or market.

Each Contract providing for payments in excess of \$100,000 to which IBUI is a party (i) is legal, valid, binding and enforceable against IBUI except as otherwise limited by bankruptcy, insolvency, reorganization and other laws affecting creditors' rights generally, and except that the remedy of specific performance or other equitable relief is available only at the discretion of the court before which enforcement is sought, and (ii) IBUI, and to IBUI's knowledge, any other party, is not in Default under any such Contract, other than in the case of (i) and (ii) above where the failure to be so would not have a Material Adverse Effect.

### 6.14 INITIAL LISTING REQUIREMENT

IBUI exceeds the Initial Listing Requirements for the NASDAQ Small Cap Market, as defined in the listing requirements for the NASDAQ SmallCap Market, except for the minimum required bid price for its common stock.

### 6.15 EMPLOYEE RELATIONS

No IBUI Company is (a) a party to, involved in or, to IBUI's knowledge, threatened by, any labor dispute or unfair labor practice charge, or (b) currently negotiating any collective bargaining agreement, and IBUI has not experienced any work stoppage during the last three years.

### 6.16 ERISA

(a) The IBUI Disclosure Schedule contains a complete list of all Benefit Plans sponsored or maintained by any IBUI Company or under which any IBUI Company may be obligated for its employees, directors or independent contractors ("IBUI Benefit Plans"). IBUI has delivered or made available to RAI (i) accurate and complete copies of all IBUI Benefit Plan documents and of any summary plan descriptions, summary annual reports and insurance contracts relating thereto, (ii) accurate and complete detailed summaries of all unwritten IBUI Benefit Plans, (iii) accurate and complete copies of the most recent financial statements and actuarial reports with respect to all IBUI Benefit Plans for which financial statements or actuarial reports are required or have been prepared and (iv) accurate and complete copies of all annual reports for all IBUI Benefit Plans (for which annual reports are required) prepared within the last two years.

(b) All IBUI Benefit Plans conform in all material respects to, and are being administered and operated in material compliance with, the requirements of ERISA, the Code and all other applicable Laws, including applicable Laws of foreign jurisdictions. There have not

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been any "prohibited transactions," as such term is defined in Section 4975 of the Code or Section 406 of ERISA involving any of the IBUI Benefit Plans, that could subject IBUI to any material penalty or tax imposed under the Code or ERISA.

(c) Any IBUI Benefit Plan that is intended to be qualified under Section 401(a) of the Code and exempt from tax under Section 501(a) of the Code has been determined by the Internal Revenue Service to be so qualified, and such determination remains in effect and has not been revoked.

Nothing has occurred since the date of any such determination that is reasonably likely to affect adversely such qualification or exemption, or result in the imposition of excise taxes or income taxes on unrelated business income under the Code or ERISA with respect to any IBUI Benefit Plan.

(d) (i) No IBUI Company has current or contingent obligation to contribute to any multiemployer plan (as defined in Section 3(37) of ERISA) and (ii) no IBUI Company nor any entity that has been treated as a single employer with any IBUI Company under Sections 414(b), (c), (m) or (o) of the Code, has any liability, contingent or otherwise, under Title IV of ERISA or Section 412 of the Code.

(e) There are no pending or, to the knowledge of IBUI, threatened claims by or on behalf of any IBUI Benefit Plans, or by or on behalf of any individual participants or beneficiaries of any IBUI Benefit Plans, alleging any breach of fiduciary duty on the part of any IBUI Company or any of the officers, directors or employees of any IBUI Company under ERISA or any other applicable Regulations, or claiming benefit payments other than those made in the ordinary operation of such plans, or alleging any violation of any other applicable Laws. To IBUI's knowledge, the IBUI Benefit Plans are not the subject of any investigation, audit or action by the Internal Revenue Service, the Department of Labor or the Pension Benefit Guaranty Corporation ("PBGC"). Each IBUI Company has made all required contributions under the IBUI Benefit Plans including the payment of any premiums payable to the PBGC and other insurance premiums.

(f) With respect to any IBUI Benefit Plan that is an employee welfare benefit plan (within the meaning of Section 3(1) of ERISA) (an "IBUI Welfare Plan"), (i) each IBUI Welfare Plan for which contributions are claimed as deductions under any provision of the Code is in material compliance with all applicable requirements pertaining to such deduction, (ii) with respect to any welfare benefit fund (within the meaning of Section 419 of the Code) related to an IBUI Welfare Plan, there is no disqualified benefit (within the meaning of Section 4976(b) of the Code) that would result in the imposition of a tax under Section 4976(a) of the Code, and (iii) any IBUI Benefit Plan that is a group health plan (within the meaning of Section 4980B(g)(2) of the Code) complies, and in each and every case has complied, with all of the material requirements of Section 4980B of the Code, ERISA, Title XXII of the Public Health Service Act and the applicable provisions of the Social Security Act.

(g) The execution of this Agreement and the

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performance of the Transactions will not (either alone or in combination with the occurrence of any additional or subsequent events) constitute an event under any IBUI Benefit Plan that will or may result in any payment (whether of severance pay or otherwise), acceleration, forgiveness of indebtedness, vesting, distribution, increase in benefits or obligation to fund benefits with respect to any current or former employee, director or consultant of any IBUI Company.

### 6.17 PATENTS, TRADEMARKS, ETC.

To IBUI's knowledge, no IBUI Company infringes upon or unlawfully or wrongfully use any Intellectual Property owned or claimed by another Person and no Person infringes on or wrongfully uses any Intellectual Property owned or claimed by any IBUI Company, except for those situations that would not have a Material Adverse Effect. The IBUI Companies own or have valid rights to use all Intellectual Property used in the conduct of their business except where the failure to have valid rights to use such Intellectual Property will not have a Material Adverse Effect, free and clear of all Encumbrances, other than Encumbrances which would not have a Material Adverse Effect.

### 6.18 ABSENCE OF CERTAIN CHANGES

Since the IBUI Balance Sheet Date, the IBUI Companies have conducted the IBUI Business in the ordinary course, as of the date hereof, there has not been:

- (a) any Material Adverse Effect on the IBUI Business or, in the aggregate, Liabilities of the IBUI Companies;
- (b) any distribution or payment declared or made in respect of IBUI's capital stock by way of dividends, purchase or redemption of shares or otherwise;
- (c) any increase in the compensation payable or to become payable to any current director or officer of any IBUI Company, except for merit and seniority increases for employees made in the ordinary course of business, nor any material change in any existing employment, severance, consulting arrangements or any IBUI Benefit Plan;
- (d) any sale, assignment or transfer of any IBUI Assets, or any additions to or transactions involving any IBUI Assets, other than those made in the ordinary course of business or those solely involving the IBUI Companies;
- (e) other than in the ordinary course of business, any waiver or release of any material claim or right or cancellation of any material debt held by any IBUI Company;
- (f) any change in practice with respect to Taxes, or any election, change of any election, or revocation of any election with respect to Taxes, or any settlement or compromise of any dispute involving a Tax liability;
- (g) (i) any creation, assumption or maintenance of any long-term debt or any short-term debt for borrowed money other than under existing notes payable, lines of credit or other credit facility or in the ordinary course of business (ii) any assumption, granting of guarantees,

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endorsements or otherwise becoming liable or responsible (whether directly, contingently or otherwise) for the obligations of any other Person or (iii) any loans, advances or capital contributions to, or investments in, any other Person except its Wholly-Owned Subsidiaries;

(h) any material agreement, commitment or contract, except agreements, commitments or contracts for the purchase, sale or lease of goods or services in the ordinary course of business;

(i) other than in the ordinary course of business, any authorization, recommendation, proposal or announcement of an intention to authorize, recommend or propose, or enter into any Contract with respect to, any (i) plan of liquidation or dissolution, (ii) acquisition of a material amount of assets or securities, (iii) disposition or Encumbrance of a material amount of assets or securities, (iv) merger or consolidation or (v) material change in its capitalization; or

(j) any change in accounting or Tax procedure or practice.

### 6.19 CORPORATE RECORDS

The minute books of each IBUI Company contain accurate, complete and current copies of all Charter Documents and of all minutes of meetings, resolutions and other proceedings of its Board of Directors and stockholders.

### 6.20 FINDER'S FEES

No Person is or will be entitled to any commission, finder's fee or other payment in connection with the Transactions based on arrangements made by or on behalf of IBUI.

### 6.21 REORGANIZATION

No IBUI Company has not or, as of the Closing Date, will have not taken any action or failed to take any action which action or failure would result in the failure of the Merger and Share Exchange to qualify as a reorganization within the meaning of Code Section 368(a). IBUI has no knowledge of any fact or circumstance that is reasonably likely to prevent the Merger and Share Exchange from qualifying as a reorganization within the meaning of Code Section 368(a).

## ARTICLE 7

### REGISTRATION STATEMENT AND CONSENT SOLICITATION STATEMENT

#### 7.1 REGISTRATION STATEMENT AND CONSENT SOLICITATION STATEMENT

In connection with the subject Merger and Share Exchange and the solicitation of stockholder consents thereto and pursuant to Rule 145, RAI shall file a Registration Statement on Form S-4 (the "Registration Statement"), with the Securities and Exchange Commission (the "SEC") pursuant to the Securities Act of 1933, as amended (the "Securities Act"), the Registration Statement to include as Part I thereof the prospectus and consent solicitation statement to be transmitted to the IBUI Stockholders (such prospectus and consent solicitation statement, as from time to

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time amended and/or supplemented, hereinafter referred to as the "Consent Solicitation Statement/Prospectus") (a) with respect to the solicitation of consents from the IBUI Stockholders to the subject merger and share exchange pursuant to Section 92A.120 of the Nevada Law and Section 14(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and (b) with respect to the distribution of the shares of RAI Common Stock to the IBUI Stockholders in exchange for their shares of the IBUI Common Stock pursuant to the terms of this Agreement, the subject Merger and Share Exchange, the Securities Act and the rules and regulations promulgated thereunder. In connection with the preparation, utilization and/or distribution of the Consent Solicitation Statement/Prospectus to be issued and distributed to the IBUI Stockholders in connection with the Merger and Share Exchange and the preparation and utilization of the Registration Statement of which the Consent Solicitation Statement/Prospectus constitutes Part I thereof, the parties shall follow the procedures as provided in this Section 7.

(a) The parties hereto shall cooperate in the preparation thereof consistent with the applicable requirements of Nevada Law, the Securities Act and the Exchange Act and the rules and regulations promulgated under the Securities Act and the Exchange Act by the SEC; and, without limiting the generality of the foregoing, each of RAI and IBUI shall promptly supply to the other any and all information and material (relating to itself and/or the subject transaction) as may be requested or required in connection with the preparation and filing of the Registration Statement, including, without limitation, all information concerning their respective officers, directors and principal stockholders that is reasonably requested for inclusion in the Consent Solicitation Statement/Prospectus; and each shall take and perform such other and further acts and actions as shall be necessary or appropriate to cause the prompt preparation, completion, filing, review, finalization and clearance of the Registration Statement.

(b) Subject to the Registration Statement being declared effective by the SEC, the Consent Solicitation Statement/Prospectus, and any other communication required by the Exchange Act or the rules and regulations promulgated thereunder or reasonably requested by RAI, shall be mailed by IBUI or its transfer agent to the IBUI Stockholders as soon after such effective date as is reasonably possible. Subsequent thereto, IBUI shall transmit to the IBUI Stockholders such amended and/or supplemental consent solicitation materials as may be necessary, in light of subsequent developments or otherwise, to render the Consent Solicitation Statement/Prospectus, as so amended or supplemented, not false or misleading with respect to any material fact and so as not to omit to state any information necessary to make the statements made, within the context made, not misleading. Prior to the Effective Date (or earlier termination of this Agreement) neither party hereto shall distribute any material (other than the Consent Solicitation Statement/Prospectus as herein provided) which might constitute, or be deemed to constitute, a "prospectus" relating to the Merger and Share Exchange within the meaning of the Securities Act without the prior written consent of all of the parties hereto in each instance.

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(c) IBUI hereby authorizes the utilization by RAI in the Registration Statement, or in any filing with a state securities administrator, of all information concerning IBUI either provided to RAI by IBUI in connection with or contained in the Consent Solicitation Statement/Prospectus and/or contained in any filings heretofore made by IBUI pursuant to the Securities Act and/or the Exchange Act. IBUI shall promptly advise RAI if at any time any of such information or material is or becomes incorrect, inaccurate or incomplete in any material respect and, in connection therewith, IBUI shall provide RAI with such information and material as shall be needed to correct any such inaccuracy or omission. RAI shall promptly advise IBUI if at any time any of the information or material contained in the Registration Statement and supplied by RAI is or becomes incorrect, inaccurate or incomplete in any material respect. RAI shall cause the preparation, review, clearance, approval and distribution of such amended or supplemented material as shall be necessary to correct or eliminate any such inaccuracies and/or omissions as provided in this Section 12.

(d) Each of RAI and IBUI covenants and warrants to the other that any and all information and/or material supplied by it to the other and/or in connection with the Registration Statement and/or the within transactions (i) will, at the time made and at each Relevant Date (as hereinafter defined), be true and correct in all material respects; (ii) will comply in all material respects with the requirements of the Securities Act and the Exchange Act and the rules and regulations promulgated thereunder by the SEC; and (iii) will not contain any statement which, at the time, and at each Relevant Date and in light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein made not false or misleading. For the purposes of this Agreement, the term "Relevant Date" shall be and mean each of (x) the effective date of the Registration Statement, (y) the mailing date of the Consent Solicitation Statement/Prospectus and (z) the Effective Date. Each of RAI and IBUI specifically agrees to indemnify and hold harmless the other (and their respective officers, directors, employees, agents and representatives) from and against any and all costs, expenses, losses, demands, claims and liabilities of every kind, nature and description (including reasonable attorneys' fees) arising out of, or relating to any breach or anticipatory breach by it of its duties and obligations pursuant to this Section 12(d) hereof.

### 7.2 REGISTRATION EXPENSES

(a) All fees and expenses incident to the performance of or compliance with this Agreement by RAI shall be borne by RAI whether or not the Registration Statement is filed or becomes effective and whether or not any Registrable Securities are sold pursuant to the Registration Statement. The fees and expenses referred to in the foregoing sentence shall include, without limitation, (i) all registration and filing fees (including, without limitation, fees and expenses (A) with respect to filings required to be made with the Nasdaq Stock Market and (B) in compliance with state securities or Blue Sky laws (ii)

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printing expenses (including, without limitation, expenses of printing certificates for Registrable Securities and of printing prospectuses if the printing of prospectuses is requested by the Majority Holders) (iii) messenger, telephone and delivery expenses, (iv) fees and disbursements of counsel for RAI and, (v) fees and disbursements of all independent certified public accountants, (vi) Securities Act liability insurance, if RAI so desires such insurance, and (vii) fees and expenses of all other Persons retained by RAI in connection with the consummation of the transactions contemplated by this Article VII. In addition, RAI shall be responsible for all of its internal expenses incurred in connection with the consummation of the transactions contemplated by this Agreement (including, without limitation, all salaries and expenses of its officers and employees performing legal or accounting duties), the expense of any annual audit and, the fees and expenses incurred in connection with the listing of the Registrable Securities on any securities exchange or market on which similar securities issued by RAI are then listed.

(b) Notwithstanding anything to the contrary herein, IBUI shall be responsible for the cost of the fees and expenses of its attorneys and accountants.

### 7.3 INDEMNIFICATION

(a) RAI shall, notwithstanding termination of this Agreement and without limitation as to time, indemnify and hold harmless IBUI and each of its officers and directors and employees, each Person who controls IBUI (within the meaning of Section 15 of the Securities Act or Section 20 of the Exchange Act) and the officers, directors, agents and employees of each such controlling Person, to the fullest extent permitted by applicable law, from and against any and all losses, claims, damages, liabilities, costs (including, without limitation, costs of preparation and attorneys' and expert fees) and expenses (collectively, "Losses"), as incurred, arising out of or relating to any breach of any warranty or representation contained herein, any untrue or alleged untrue statement of a material fact contained in the Registration Statement or the Consent Solicitation Statement/Prospectus or arising out of or relating to any omission or alleged omission of a material fact required to be stated therein or necessary to make the statements therein (in the case of any Prospectus or form of prospectus or supplement thereto, in light of the circumstances under which they were made) not misleading, except solely to the extent that (i) such untrue statements or omissions are based solely upon information regarding IBUI furnished in writing to RAI by or on behalf of IBUI expressly for use therein, which information was relied on by RAI for use therein or (ii) such information relates to IBUI or IBUI's proposed method of distribution of Registrable Securities and was furnished in writing to RAI by or on behalf of IBUI expressly for use therein. RAI shall notify the IBUI promptly of the institution, threat or assertion of any Proceeding of which RAI is aware in connection with the transactions contemplated by this Agreement.

(b) In connection with the Registration Statement, IBUI shall furnish to RAI in writing such

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information as RAI reasonably requests for use in connection with the Registration Statement or any Prospectus and agrees to indemnify and hold harmless RAI, their directors, officers, agents and employees, each Person who controls RAI (within the meaning of Section 15 of the Securities Act and Section 20 of the Exchange Act), and the directors, officers, agents or employees of such controlling Persons, to the fullest extent permitted by applicable law, from and against all Losses (as determined by a court of competent jurisdiction in a final judgment not subject to appeal or review) arising solely out of or based solely upon any untrue statement of a material fact contained in the information provided to RAI as provided for hereinabove, and only to the extent, that (i) such untrue statement or omission is contained in any information furnished in writing by IBUI to RAI specifically for inclusion in the Registration Statement or such Prospectus and such information was relied upon by RAI for use in the Registration Statement, such Prospectus or such form of prospectus or (ii) such information relates to IBUI or IBUI's proposed method of distribution of Registrable Securities and was furnished in writing by or on behalf of IBUI to RAI specifically for inclusion in the Registration Statement or such Prospectus and such information was relied upon by RAI for use in the Registration Statement, such Prospectus or such form of prospectus.

(c) If any Proceeding shall be brought or asserted against any Person entitled to indemnity hereunder (a "Registration Indemnified Party"), such Registration Indemnified Party promptly shall notify the Person from whom indemnity is sought (the "Registration Indemnifying Party") in writing, and the Registration Indemnifying Party shall assume the defense thereof, including the employment of counsel reasonably satisfactory to the Registration Indemnified Party and the payment of all fees and expenses incurred in connection with defense thereof; provided, that the failure of any Registration Indemnified Party to give such notice shall not relieve the Registration Indemnifying Party of its obligations or liabilities pursuant to this Article VII, except (and only) to the extent that it shall be finally determined by a court of competent jurisdiction (which determination is not subject to appeal or further review) that such failure shall have proximately and materially adversely prejudiced the Registration Indemnifying Party.

A Registration Indemnified Party shall have the right to employ separate counsel in any such Proceeding and to participate in the defense thereof, but the fees and expenses of such counsel shall be at the expense of such Registration Indemnified Party or Parties unless: (1) the Registration Indemnifying Party has agreed to pay such fees and expenses; or (2) the Registration Indemnifying Party shall have failed promptly to assume the defense of such Proceeding and to employ counsel reasonably satisfactory to such Registration Indemnified Party in any such Proceeding; or (3) the named parties to any such Proceeding (including any impleaded parties) include both such Registration Indemnified Party and the Registration Indemnifying Party, and such Registration Indemnified Party shall have been advised by counsel that a conflict of interest is likely to exist if the same counsel were to represent such



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Registration Indemnified Party and the Registration Indemnifying Party (in which case, if such Registration Indemnified Party notifies the Registration Indemnifying Party in writing that it elects to employ separate counsel at the expense of the Registration Indemnifying Party, the Registration Indemnifying Party shall not have the right to assume the defense thereof and such counsel shall be at the expense of the Registration Indemnifying Party). The Registration Indemnifying Party shall not be liable for any settlement of any such Proceeding effected without its written consent, which consent shall not be unreasonably withheld. No Registration Indemnifying Party shall, without the prior written consent of the Registration Indemnified Party, effect any settlement of any pending Proceeding in respect of which any Registration Indemnified Party is a party, unless such settlement includes an unconditional release of such Registration Indemnified Party from all liability on claims that are the subject matter of such Proceeding.

All fees and expenses of the Registration Indemnified Party to which the Registration Indemnified Party is entitled hereunder (including reasonable fees and expenses to the extent incurred in connection with investigating or preparing to defend such Proceeding in a manner not inconsistent with this Section) shall be paid to the Registration Indemnified Party, as incurred, within ten (10) Business Days of written notice thereof to the Registration Indemnifying Party.

(d) If a claim for indemnification under Section 7.3(a) or 7.3(b) is unavailable to a Registration Indemnified Party or is insufficient to hold such Registration Indemnified Party harmless for any Losses in respect of which this would apply by its terms (other than by reason of exceptions provided in this Section 7.3(d), then each Registration Indemnifying Party, in lieu of indemnifying such Registration Indemnified Party, shall contribute to the amount paid or payable by such Registration Indemnified Party as a result of such Losses, (i) in such proportion as is appropriate to reflect the relative benefits received by the Registration Indemnifying Party on the one hand and the Registration Indemnified Party on the other from the distribution of the Registrable Securities or (ii) if the allocation provided by clause (i) above is not permitted by applicable law, in such proportion as is appropriate to reflect not only the relative benefits referred to in clause (i) above but also the relative fault of the Registration Indemnifying Party and Registration Indemnified Party in connection with the actions, statements or omissions that resulted in such Losses as well as any other relevant equitable considerations. The relative fault of such Registration Indemnifying Party and Registration Indemnified Party shall be determined by reference to, among other things, whether any action in question, including any untrue or alleged untrue statement of a material fact or omission or alleged omission of a material fact, has been taken or made by, or relates to information supplied by, such Registration Indemnifying Party or Registration Indemnified Party, and the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such action, statement or omission. The amount paid or payable by a party as a result of any Losses shall

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be deemed to include, subject to the limitations set forth in Section 7.3(c), any attorneys' or other fees or expenses incurred by such party in connection with any Proceeding to the extent such party would have been indemnified for such fees or expenses if the indemnification provided for in this Section was available to such party.

The parties hereto agree that it would not be just and equitable if contribution pursuant to this Section 7.3(d) were determined by pro rata allocation or by any other method of allocation that does not take into account the equitable considerations referred to in the immediately preceding paragraph. No Person guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the Securities Act) shall be entitled to contribution from any Person who was not guilty of such fraudulent misrepresentation.

(e) No Holder shall be required to contribute, in the aggregate, any amount in excess of the amount by which the proceeds actually received by such Holder from the sale of the Registrable Securities subject to the Proceeding exceeds the amount of any damages that any person has otherwise been required to pay by reason of such Holder's untrue or alleged untrue statement or omission or alleged omission.

(f) The indemnity and contribution agreements contained in this Section are in addition to any liability that the Indemnifying Parties may have to the Indemnified Parties.

### 7.4 RULE 144

RAI shall file the reports required to be filed by it under the Securities Act and the Exchange Act in a timely manner and, if at any time RAI is not required to file such reports, they will, upon the request of any Holder, make publicly available other information so long as necessary to permit sales of its securities pursuant to Rule 144. RAI further covenants that it will take such further action as any Holder may reasonably request, all to the extent required from time to time to enable such Holder to sell Registrable Securities without registration under the Securities Act within the limitation of the exemptions provided by Rule 144. Upon the request of any Holder, RAI shall deliver to such Holder a written certification of a duly authorized officer as to whether it has complied with such requirements.

## ARTICLE 8

### COVENANTS OF THE PARTIES

#### 8.1 PROXY STATEMENT

RAI and IBUI will each prepare and file with the SEC as soon as reasonably practicable after the date hereof a proxy statement to be filed under the Exchange Act by such Party and to be distributed by such Party in connection with such Party's Stockholder Meeting (each, a "Proxy Statement, and together, the "Proxy Statements"). Each Party shall allow the other Party the opportunity to review and comment on the Proxy Statement prior to filing with the SEC. Each Party will furnish to the other Party all information concerning itself and its Subsidiaries as the other Party or its counsel may reasonably request and that is required or customary for inclusion in the such Proxy Statement.

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Notwithstanding anything to the contrary contained in this Agreement, IBUI shall bear all expenses incurred by RAI in the preparation, filing and distribution of the Proxy Statement.

### 8.2 NO SOLICITATION

(a) From and after the date hereof, RAI, without the prior written consent of IBUI, will not, and will not authorize or permit any of its Subsidiaries or its Party Representatives to, directly or indirectly, solicit, initiate or encourage (including by way of furnishing information) or take any other action to facilitate knowingly any inquiries or the making of any proposal which constitutes or may reasonably be expected to lead to an Acquisition Proposal (as defined below) from any Person, or engage in any discussion or negotiations relating thereto or accept any Acquisition Proposal; provided, however, that notwithstanding any other provision hereof, RAI may at any time prior to the time RAI's stockholders shall have voted to approve this Agreement, engage in discussions or negotiations with a third party who (without any solicitation, initiation, encouragement, discussion or negotiation, directly or indirectly, by or with any RAI Company or its Party Representatives after the date hereof) seeks to initiate such discussions or negotiations and may furnish such third party information concerning RAI and its Business and Assets if, and only to the extent that, (i) (x) the third party has first made an Acquisition Proposal that is (as determined in good faith by the RAI Board of Directors after consultation with its legal and financial advisor) financially superior to the Transactions and has demonstrated that the funds necessary for the Acquisition Proposal are reasonably likely to be available and the Acquisition Proposal is reasonably capable of consummation in accordance with its terms (as determined in good faith in each case by RAI's Board of Directors after consultation with its legal and financial advisors) and (y) RAI's Board of Directors shall conclude in good faith, after considering applicable provisions of applicable Law, on the basis of advice of its counsel, that such action is necessary for the Board of Directors to act in a manner consistent with its fiduciary duties under applicable Law and (ii) prior to furnishing such information to or entering into discussions or negotiations with such Person, RAI (x) provides prompt notice to IBUI to the effect that it is furnishing information to or entering into discussions or negotiations with such Person and (y) receives from such Person an executed confidentiality agreement in reasonably customary form. RAI shall immediately cease and terminate any existing solicitation, initiation, encouragement, activity, discussion or negotiation with any Persons conducted heretofore by RAI or its Party Representatives with respect to the foregoing. RAI shall not release any third party from, or waive any provision of, any standstill agreement to which it is a party or any confidentiality agreement between it and another Person who has made an Acquisition Proposal, unless such Person has made an Acquisition Proposal meeting the criteria set forth in clause (a) (i) (x) above and RAI's Board of Directors shall conclude in good faith, after considering applicable provisions of applicable Law, on the basis of advice of its counsel, that such action is necessary for the Board of Directors to act in a manner

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consistent with its fiduciary duties under applicable Law. RAI shall immediately notify IBUI orally (with a prompt written confirmation) of any such inquiries, offers or proposals (including the terms and conditions of any such proposal and the identity of the Person making it and shall provide copies of any such written inquiries, offers or proposals), shall keep IBUI informed of the status and details of any such inquiry, offer or proposal (and agrees that any material modification of the terms of an inquiry or proposal shall constitute a new inquiry or proposal), and shall give IBUI two (2) business days' advance notice of any agreement to be entered into with, or any information to be supplied to, any Person making such inquiry, offer or proposal (no such agreement, other than a confidentiality agreement as set forth in this Section, to be executed or agreed prior to the termination of this Agreement in accordance with its terms). As used herein, "Acquisition Proposal" shall mean a bona fide proposal or offer (other than by IBUI) for a tender or exchange offer, merger, consolidation or other business combination involving RAI or any Subsidiary thereof, of any proposal to acquire in any manner a substantial equity interest in, or a substantial amount of the assets of, RAI or any such Subsidiary.

(b) From and after the date hereof, IBUI, without the prior written consent of RAI, will not, and will not authorize or permit any of its Subsidiaries or its Party Representatives to, directly or indirectly, solicit, initiate or encourage (including by way of furnishing information) or take any other action to facilitate knowingly any inquiries or the making of any proposal which constitutes or may reasonably be expected to lead to an Acquisition Proposal (as defined above) from any Person, or engage in any discussion or negotiations relating thereto or accept any Acquisition Proposal; provided, however, that notwithstanding any other provision hereof, IBUI may at any time prior to the time the Shareholders shall have voted to approve this Agreement, engage in discussions or negotiations with a third party who (without any solicitation, initiation, encouragement, discussion or negotiation, directly or indirectly, by or with IBUI or its Party Representatives after the date hereof) seeks to initiate such discussions or negotiations and may furnish such third party information concerning IBUI and its Business and Assets if, and only to the extent that, (i) (x) the third party has first made an Acquisition Proposal that is (as determined in good faith by the IBUI Board of Directors after consultation with its legal and financial advisor) financially superior to the Transactions and has demonstrated that the funds necessary for the Acquisition Proposal are reasonably likely to be available and the Acquisition Proposal is reasonably capable of consummation in accordance with its terms (as determined in good faith in each case by IBUI's Board of Directors after consultation with its legal and financial advisors) and (y) IBUI's Board of Directors shall conclude in good faith, after considering applicable provisions of applicable Law, on the basis of advice of its counsel, that such action is necessary for the Board of Directors to act in a manner consistent with its fiduciary duties under applicable Law and (ii) prior to furnishing such information to or entering into discussions or negotiations with such Person, IBUI (x) provides prompt

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notice to RAI to the effect that it is furnishing information to or entering into discussions or negotiations with such Person and (y) receives from such Person an executed confidentiality agreement in reasonably customary form. IBUI shall immediately cease and terminate any existing solicitation, initiation, encouragement, activity, discussion or negotiation with any Persons conducted heretofore by IBUI or its Party Representatives with respect to the foregoing. IBUI shall not release any third party from, or waive any provision of, any standstill agreement to which it is a party or any confidentiality agreement between it and another Person who has made an Acquisition Proposal, unless such Person has made an Acquisition Proposal meeting the criteria set forth in clause (a)(i)(x) above and IBUI's Board of Directors shall conclude in good faith, after considering applicable provisions of applicable Law, on the basis of advice of its counsel, that such action is necessary for the Board of Directors to act in a manner consistent with its fiduciary duties under applicable Law. IBUI shall immediately notify RAI orally (with a prompt written confirmation) of any such inquiries, offers or proposals (including the terms and conditions of any such proposal and the identity of the Person making it and shall provide copies of any such written inquiries, offers or proposals), shall keep RAI informed of the status and details of any such inquiry, offer or proposal (and agrees that any material modification of the terms of an inquiry or proposal shall constitute a new inquiry or proposal) , and shall give RAI two (2) business days' advance notice of any agreement to be entered into with, or any information to be supplied to, any Person making such inquiry, offer or proposal (no such agreement, other than a confidentiality agreement as set forth in this Section, to be executed or agreed prior to the termination of this Agreement in accordance with its terms).

### 8.3 NOTIFICATION OF CERTAIN MATTERS

Each of RAI and IBUI shall give prompt notice to each other of the following:

- (a) the occurrence or nonoccurrence of any event whose occurrence or nonoccurrence would be likely to cause either (i) any representation or warranty contained in this Agreement to be untrue or inaccurate in any material respect at any time from the date hereof to the Effective Date, or (ii) directly or indirectly, any Material Adverse Effect;
- (b) any material failure of such Party, or any officer, director, employee or agent of any thereof, to comply with or satisfy any covenant, condition or agreement to be complied with or satisfied by it hereunder; and
- (c) any facts relating to such Party which would make it necessary or advisable to amend the Proxy Statement in order to make the statements therein not misleading or to comply with applicable Law; provided, however, that the delivery of any notice pursuant to this Section 8.3 shall not limit or otherwise affect the remedies available hereunder to the Party receiving such notice.

### 8.4 ACCESS TO INFORMATION

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(a) From the date hereof to the Effective Date, RAI and IBUI shall, and shall cause its respective Subsidiaries, and its officers, directors, employees, auditors, counsel and agents to afford the officers, employees, auditors, counsel, financial advisors and agents of the other Party complete access at all reasonable times to such Party's and its Subsidiaries' officers, employees, auditors, counsel, agents, properties, offices and other facilities and to all of their respective books and records, and shall furnish the other with all financial, operating and other data and information as such other Party may reasonably request.

(b) All information so received from the other Party shall be deemed received pursuant to the confidentiality agreement provisions in the Letter of Intent dated May 10, 2001 heretofore executed and delivered by IBUI and RAI (the "Confidentiality Agreement"), and each such Party shall, and shall cause its Subsidiaries and each of its and their respective officers, directors, employees, auditors, counsel, financial advisors and agents ("Party Representatives"), to comply with the provisions of the Confidentiality Agreement with respect to such information. The provisions of the Confidentiality Agreement are hereby incorporated herein by reference with the same effect as if fully set forth herein.

### 8.5 PUBLIC ANNOUNCEMENTS

RAI and IBUI (a) shall use all reasonable efforts to develop a joint communications plan and each Party shall use all reasonable efforts to ensure that all press releases and other public statements with respect to the Transactions shall be consistent with such joint communications plan or, to the extent inconsistent therewith, shall have received the prior written approval of the other and (b) before issuing any press release or otherwise making any public statements with respect to the Transactions, will consult with each other as to its form and substance and shall not issue any such press release or make any such public statement prior to such consultation, except for each of (a) and (b) above as may be required by Law (it being agreed that the Parties hereto are entitled to disclose all requisite information concerning the Transactions in any filings required with the SEC) or the rules and regulations of the Nasdaq Stock Market, Inc.

### 8.6 COOPERATION

Upon the terms and subject to the conditions hereof, each of the Parties shall use its commercially reasonable efforts to take or cause to be taken all actions and to do or cause to be done all things necessary, proper or advisable to consummate as promptly as practicable the Transactions and shall use its commercially reasonable efforts to obtain all RAI Required Consents and IBUI Required Consents, and to effect all necessary filings under the Securities Act and the Exchange Act. Without limiting the generality of the foregoing, each Party shall use all commercially reasonable efforts to take, or cause to be taken, all other actions and to do, or cause to be done, all other things necessary, proper or advisable to fulfill the conditions herein to the extent that the fulfillment thereof is

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within a Party's control.

### 8.7 REORGANIZATION

From and after the date hereof and until the Effective Date, neither RAI or IBUI, nor any of their respective Subsidiaries shall knowingly take any action, or knowingly fail to take any action, that would jeopardize qualification of the Merger and Share Exchange as a reorganization within the meaning of Section 368(a) of the Code. Notwithstanding that there is no guaranty of qualification, the Parties agree that the Merger and Share Exchange is intended to be a tax-free reorganization under Section 368 of the Code, and this Agreement is intended to be a "plan of reorganization" within the meaning of the regulations promulgated under such section of the Code.

## ARTICLE 9

### COVENANTS OF RAI

#### 9.1 OPERATION OF THE BUSINESS

Except as contemplated by this Agreement or as expressly agreed to in writing by IBUI, during the period from the date of this Agreement to the Effective Date, RAI and its Subsidiaries will conduct their operations only in the ordinary course of business consistent with sound financial, operational and regulatory practice, and will take no action which would materially adversely affect their ability to consummate the Transactions. Without limiting the generality of the foregoing, except as otherwise expressly provided in this Agreement or except as disclosed in the RAI Disclosure Schedule, prior to the Effective Date, neither RAI nor any of its Subsidiaries will, without the prior written consent of IBUI:

(a) amend its Charter Documents or bylaws (or similar organizational documents);

(b) authorize for issuance, issue, sell, deliver, grant any options for, or otherwise agree or commit to issue, sell or deliver any shares of its capital stock or any other securities, other than pursuant to and in accordance with the terms of any existing RAI options or warrants listed on the RAI Disclosure Schedule;

(c) recapitalize, split, combine or reclassify any shares of its capital stock; declare, set aside or pay any dividend or other distribution (whether in cash, stock or property or any combination thereof) in respect of its capital stock; or purchase, redeem or otherwise acquire any of its or its Subsidiaries' securities or modify any of the terms of any such securities, except for the Reverse Stock Split as defined in Section 9.8 hereof.

(d) (i) create, incur, assume or permit to exist any long-term debt or any short-term debt for borrowed money other than under existing notes payable, lines of credit or other credit facilities or in the ordinary course of business, or with respect to its Wholly-Owned Subsidiaries in the ordinary course of business, or with respect to its Wholly-Owned Subsidiaries; (ii) assume, guarantee, endorse or otherwise become liable or responsible (whether directly,

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contingently or otherwise) for the obligations of any other Person except its Wholly-Owned Subsidiaries in the ordinary course of business or as otherwise may be contractually required and disclosed in the RAI Disclosure Schedule; or (iii) make any loans, advances or capital contributions to, or investments in, any other Person except its Wholly-Owned Subsidiaries;

(e) (i) amend any RAI Benefit Plan or (ii) except in the ordinary course of business consistent with usual practice or established policy (a) increase in any manner the rate of compensation of any of its directors, officers or other employees everywhere, except for increases in the ordinary course of business; (b) pay or agree to pay any bonus, pension, retirement allowance, severance or other employee benefit except as required under currently existing RAI Benefit Plans disclosed in the RAI Disclosure Schedule or in the ordinary course of business; or (c) amend, terminate or enter into any employment, consulting, severance, change in control or similar agreements or arrangements with any of its directors, officers or other employees;

(f) enter into any material agreement, commitment or contract, except agreements, commitments or contracts for the purchase, sale or lease of goods or services in the ordinary course of business;

(g) other than in the ordinary course of business, authorize, recommend, propose or announce an intention to authorize, recommend or propose, or enter into any Contract with respect to, any (i) plan of liquidation or dissolution, (ii) acquisition of a material amount of assets or securities, (iii) disposition or Encumbrance of a material amount of assets or securities, (iv) merger or consolidation or (v) material change in its capitalization;

(h) change any material accounting or Tax procedure or practice;

(i) take any action the taking of which, or knowingly omit to take any action the omission of which, would cause any of the representations and warranties herein to fail to be true and correct in all material respects as of the date of such action or omission as though made at and as of the date of such action or omission;

(j) compromise, settle or otherwise modify any material claim or litigation not identified in the RAI Disclosure Schedule; or

(k) commit or agree to do any of the foregoing.

### 9.2 RAI STOCKHOLDER MEETING

RAI shall cause a meeting of its stockholders (the "RAI Stockholder Meeting") to be duly called and held as soon as reasonably practicable for the purpose of voting on the adoption of this Agreement and the Merger and Share Exchange as required by the DGCL and the Nasdaq Stock Market. Subject to their fiduciary duties, the directors of RAI shall recommend such adoption of this Agreement and the Merger and Share Exchange by RAI's stockholders and the other matters to be voted upon. In connection with such meeting, RAI (a) will mail to its



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stockholders as promptly as practicable the Proxy Statement and all other proxy materials for such meeting, (b) will use all reasonable efforts to obtain the necessary approvals by its stockholders of this Agreement and the Transactions, and (c) will otherwise comply with all legal requirements applicable to such meeting.

### 9.3 MAINTENANCE OF THE ASSETS

RAI shall, and shall cause each other RAI Company to, use its reasonable best efforts to continue to maintain and service the RAI Assets consistent with past practice. RAI shall not, and shall cause each other RAI Company not to, directly or indirectly, sell or encumber all or any part of the RAI Assets, other than sales in the ordinary course of business or sales to or Encumbrances in favor of any other RAI Company, or initiate or participate in any discussions or negotiations or enter into any agreement to do any of the foregoing.

### 9.4 EMPLOYEES AND BUSINESS RELATIONS

RAI shall, and shall cause each other RAI Company to, use commercially reasonable efforts to keep available the services of its current employees and agents and to maintain its relations and goodwill with its suppliers, customers, distributors and any others having business relations with it.

### 9.5 CERTAIN TAX MATTERS

From the date hereof until the Effective Date, (a) RAI and each of its Subsidiaries will prepare and file, in the manner required by applicable Law, all Tax Returns (the "Post-Signing Returns") required to be filed under applicable Law; (b) RAI and each of its Subsidiaries will timely pay all Taxes shown as due and payable on such Post-Signing Returns that are so filed; (c) RAI and each of its Subsidiaries will make provision for all Taxes payable by RAI and/or any such Subsidiary under applicable Law for which no Post-Signing Return is due prior to the Effective Date; and (d) RAI will promptly notify IBUI in writing of any action, suit, proceeding, claim or audit pending against or with respect to RAI or any of its Subsidiaries in respect of any Tax that is not disclosed on the RAI Disclosure Schedule.

### 9.6 MAINTENANCE OF LISTING

RAI will use its best efforts to maintain the listing of Merged Company Common Stock on the Nasdaq Small Cap Market and to keep current its filings with the SEC as required under Section 13 of the Exchange Act. RAI shall immediately notify IBUI of, and provide IBUI a copy of, any notice or correspondence from the Nasdaq Stock Market Inc.

### 9.7 STATE ANTI-TAKEOVER LAW

If any "business combination," "moratorium," "control share," "fair price," "interested shareholder," "affiliated transaction" or other anti-takeover statute or regulation under the DGCL or Nevada Law (i) prohibits or restricts RAI's ability to perform its obligations under this Agreement or any party's ability to consummate the Merger and Share Exchange or the other transactions contemplated hereby or thereby, or (ii) would have the effect of invalidating or voiding this Agreement or any provision hereof, then RAI shall use its best efforts to obtain

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any necessary consents or approvals so that the foregoing shall not apply.

### 9.8 REVERSE STOCK SPLIT

Prior to the Closing Date, RAI shall have conducted a reverse split of its Common Stock on a 1:6 basis (the "Reverse Stock Split").

## ARTICLE 10

### COVENANTS OF IBUI

#### 10.1 OPERATION OF THE BUSINESS

Except as contemplated by this Agreement or as expressly agreed to in writing by RAI, during the period from the date of this Agreement to the Effective Date, IBUI and its subsidiaries will conduct its operations only in the ordinary course of business consistent with sound financial, operational and regulatory practice, and will take no action which would materially adversely affect its ability to consummate the Transactions. Without limiting the generality of the foregoing, except as otherwise expressly provided in this Agreement or except as disclosed in the IBUI Disclosure Schedule, prior to the Effective Date, IBUI will not, without the prior written consent of RAI:

(a) amend its Charter Documents or bylaws (or similar organizational documents);

(b) authorize for issuance, issue, sell, deliver, grant any options for, or otherwise agree or commit to issue, sell or deliver any shares of its capital stock or any other securities, other than pursuant to and in accordance with the terms of any Existing Options or IBUI Warrants listed on the IBUI Disclosure Schedule;

(c) recapitalize, split, combine or reclassify any shares of its capital stock; declare, set aside or pay any dividend or other distribution (whether in cash, stock or property or any combination thereof) in respect of its capital stock; or purchase, redeem or otherwise acquire any of its securities or modify any of the terms of any such securities;

(d) (i) create, incur, assume or permit to exist any long-term debt or any short-term debt for borrowed money other than under existing notes payable, lines of credit or other credit facilities or in the ordinary course of business, or with respect to its Wholly-Owned Subsidiaries ; (ii) assume, guarantee, endorse or otherwise become liable or responsible (whether directly, contingently or otherwise) for the obligations of any other Person except its Wholly-Owned Subsidiaries in the ordinary course of business or as otherwise may be contractually required and disclosed in the IBUI Disclosure Schedule; or (iii) make any loans, advances or capital contributions to, or investments in, any other Person;

(e) (i) amend any IBUI Benefit Plan or (ii) except in the ordinary course of business consistent with usual practice or established policy (a) increase in any manner the rate of compensation of any of its directors, officers or other employees everywhere, except for increases in the ordinary course of business; (b) pay or agree to pay

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any bonus, pension, retirement allowance, severance or other employee benefit except as required under currently existing IBUI Benefit Plans disclosed in the IBUI Disclosure Schedule or in the ordinary course of business; or (c) amend, terminate or enter into any employment, consulting, severance, change in control or similar agreements or arrangements with any of its directors, officers or other employees;

(f) enter into any material agreement, commitment or contract, except agreements, commitments or contracts for the purchase, sale or lease of goods or services in the ordinary course of business;

(g) other than in the ordinary course of business, authorize, recommend, propose or announce an intention to authorize, recommend or propose, or enter into any Contract with respect to, any (i) plan of liquidation or dissolution, (ii) acquisition of a material amount of assets or securities, (iii) disposition or Encumbrance of a material amount of assets or securities, (iv) merger or consolidation or (v) material change in its capitalization;

(h) change any material accounting or Tax procedure or practice;

(i) take any action the taking of which, or knowingly omit to take any action the omission of which, would cause any of the representations and warranties herein to fail to be true and correct in all material respects as of the date of such action or omission as though made at and as of the date of such action or omission;

(j) compromise, settle or otherwise modify any material claim or litigation not identified in the IBUI Disclosure Schedule; or

(k) commit or agree to do any of the foregoing.

### 10.2 IBUI SHAREHOLDER MEETING

IBUI shall cause a meeting of the IBUI Shareholders (the "IBUI Shareholder Meeting") to be duly called and held as soon as reasonably practicable for the purpose of voting on the adoption of this Agreement and the Merger and Share Exchange as required by Nevada Law. Subject to their fiduciary duties, the directors of IBUI shall recommend such adoption of this Agreement and the Merger and Share Exchange by IBUI's stockholders. In connection with such meeting, IBUI (a) will mail to its stockholders as promptly as practicable all required materials for such meeting, (b) will use all reasonable efforts to obtain the necessary approvals by its stockholders of this Agreement and the Transactions, and (c) will otherwise comply with all legal requirements applicable to such meeting.

### 10.3 MAINTENANCE OF THE ASSETS

IBUI shall, and shall cause each other IBUI Company to, use its reasonable best efforts to continue to maintain and service the IBUI Assets consistent with past practice. IBUI shall not, and shall cause each other RAI Company not to, use its indirectly, sell or encumber all or any part of the IBUI Assets, other than sales in the ordinary course of business or initiate or participate in any discussions or negotiations or enter into

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any agreement to do any of the foregoing.

### 10.4 EMPLOYEES AND BUSINESS RELATIONS

IBUI shall, and shall cause each other IBUI Company to use commercially reasonable efforts to keep available the services of its current employees and agents and to maintain its relations and goodwill with its suppliers, customers, distributors and any others having business relations with it.

### 10.5 ASSUMPTION OF LIABILITIES

IBUI shall assume 100% of RAI's current liabilities, as listed on Schedule 10.5 hereto, not to exceed \$900,000.

### 10.6 EXPENSES

IBUI shall pay all of the legal, accounting and other expenses incurred by each RAI Company and IBUI in connection with the Transactions.

### 10.7 CERTAIN TAX MATTERS

From the date hereof until the Effective Date, (a) IBUI will prepare and file, in the manner required by applicable Law, all Post-Signing Returns required to be filed under applicable Law; (b) IBUI and each of its Subsidiaries will timely pay all Taxes shown as due and payable on such Post-Signing Returns that are so filed; (c) IBUI and each of its Subsidiaries will make provision for all Taxes payable by IBUI under applicable Law for which no Post-Signing Return is due prior to the Effective Date; and (d) IBUI will promptly notify RAI in writing of any action, suit, proceeding, claim or audit pending against or with respect to IBUI or any of Subsidiaries in respect of any Tax that is not disclosed on the IBUI Disclosure Schedule.

### 10.8 STATE ANTI-TAKEOVER LAW

If any "business combination," "moratorium," "control share," "fair price," "interested shareholder," "affiliated transaction" or other anti-takeover statute or regulation under Nevada Law (i) prohibits or restricts IBUI's ability to perform its obligations under this Agreement or any party's ability to consummate the IBUI Merger and Share Exchange or the other transactions contemplated hereby or thereby, or (ii) would have the effect of invalidating or voiding this Agreement or any provision hereof or thereof, then IBUI shall use its best efforts to obtain any necessary consents or approvals so that the foregoing shall not apply.

## ARTICLE 11

### POST-CLOSING COVENANTS

#### 11.1 APPOINTMENT TO THE BOARD OF DIRECTORS OF RAI

At the Effective Date, the size of RAI Board of Directors shall be seven (7) and RAI Board of Directors shall be as set forth on Exhibit 11.1.

#### 11.2 EMPLOYMENT AGREEMENTS

RAI shall execute and deliver employment agreements to [names] and [names] shall execute and deliver said employment agreements

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in the form annexed hereto as Exhibit 11.2.

### 11.3 INDEMNIFICATION, DIRECTORS' AND OFFICERS' INSURANCE

For a period of two (2) years after the Effective Date, RAI shall (a) maintain in effect the current provisions regarding indemnification of officers and directors contained in the Charter Documents and bylaws of RAI, and (b) indemnify the directors and officers of RAI to the fullest extent to which RAI is permitted to indemnify such officers and directors under its Charter Documents and bylaws and applicable Law as in effect immediately prior to the Effective Date. For a period of two (2) years after the Effective Date, RAI shall maintain in effect the current policies of directors' and officers' liability insurance and fiduciary liability insurance maintained by RAI (provided that RAI may substitute therefor policies of at least the same coverage and amounts containing terms and conditions which are, in the aggregate, no less advantageous to the insured in any material respect) with respect to claims arising from facts or events which occurred on or before the Effective Date.

## ARTICLE 12

### CONDITIONS PRECEDENT TO OBLIGATIONS OF ALL PARTIES

The respective obligations of each Party to consummate the Merger and Share Exchange and the other Transactions shall be subject to the fulfillment at or prior to the Effective Date of the following conditions:

#### 12.1 LEGALITY

All required governmental approvals shall have been obtained and any applicable waiting periods, shall have expired. No Law or Court Order shall have been enacted, entered, promulgated or enforced by any court or governmental entity that is in effect and that has the effect of making the Merger and Share Exchange illegal or otherwise prohibiting the consummation of the Merger and Share Exchange and no legal action shall be pending or threatened which is reasonably likely to have a Material Adverse Effect on Party.

#### 12.2 FAIRNESS OPINION

An investment banking firm reasonably acceptable to the Parties will have delivered to RAI's Board of Directors and IBUI's Board of Directors its opinion to the effect that on the date of the opinion the (i) the Merger and Share Exchange and the other Transactions contemplated herein, as a whole, is fair from a financial point of view to the RAI Stockholders, (ii) the Merger and Share Exchange and the other Transactions contemplated herein, as a whole, is fair from a financial point of view to the IBUI Shareholders, and (iii) the Merger Consideration is fair to the IBUI Shareholders from a financial point of view.

#### 12.3 APPROVAL BY IBUI SHAREHOLDERS AND RAI STOCKHOLDERS

This Agreement shall have been approved and adopted by the stockholders of RAI in accordance with the DGCL and its Charter Documents, and by the stockholders of IBUI in accordance with Nevada Law and its Charter Documents. No shareholder of IBUI will have exercised any appraisal rights such shareholder may

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have under applicable Law.

### ARTICLE 13

#### CONDITIONS CONCURRENT TO OBLIGATIONS OF ALL PARTIES

The respective obligations of each Party to consummate the Merger and Share Exchange and the Transactions shall be subject to the fulfillment, concurrent with the Closing, of each of the following conditions:

13.1 [Intentionally Omitted]

### ARTICLE 14

#### CONDITIONS PRECEDENT TO OBLIGATIONS OF IBUI

The obligations of IBUI to consummate the Merger and Share Exchange and the Transactions shall be subject to the satisfaction or waiver, on or before the Effective Date, of each of the following conditions:

##### 14.1 REPRESENTATIONS AND WARRANTIES

The representations and warranties of the RAI Parties contained in this Agreement shall be true and correct on the date hereof and (except to the extent such representations and warranties speak as of an earlier date) shall also be true and correct on and as of the Closing Date, except for changes contemplated by this Agreement, with the same force and effect as if made on and as of the Closing Date.

##### 14.2 AGREEMENTS, CONDITIONS AND COVENANTS

The RAI Parties shall have performed or complied in all material respects with all agreements, conditions and covenants required by this Agreement to be performed or complied with by them on or before the Effective Date.

##### 14.3 CERTIFICATES

IBUI shall have received a certificate of an executive officer of RAI to the effect set forth in Sections 14.1, 14.2 , 14.4 and 14.5.

##### 14.4 REQUIRED CONSENTS

RAI sure shall have obtained all consents ("RAI Required Consents") from third parties the absence of which would result in a Material Adverse Effect on the RAI Companies.

##### 14.5 MATERIAL ADVERSE EFFECT

There shall have been no Material Adverse Effect on the RAI Companies taken as a whole or the RAI Companies taken as a whole.

##### 14.6 ANCILLARY DOCUMENTS

Each RAI Party shall have tendered executed copies of the respective Transaction Documents to which it is intended to be a party.

##### 14.7 BOARD RECOMMENDATION

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The Board of Directors of IBUI will have (a) approved and adopted this Agreement, including the Merger and Share Exchange and the other Transactions, and determined that the Merger and Share Exchange is fair to the stockholders of IBUI, and (b) subject to fiduciary obligations of the IBUI Board of Directors, resolved to recommend approval and adoption of this Agreement, including the Merger and Share Exchange and the other Transactions, by the IBUI Shareholders.

### 14.8 LEGAL OPINION

IBUI shall have received an opinion of counsel, reasonably acceptable to IBUI, it being understood that Kaplan Gottbetter & Levenson, LLP is acceptable to IBUI, that:

(a) Each of the RAI Companies is a corporation, duly chartered, validly existing and in good standing under the laws of its state of incorporation, with the requisite corporate power and authority to own and use its properties and assets and to carry on its business as currently conducted. Each of the RAI Companies is duly qualified to do business and is in good standing as a foreign corporation in each jurisdiction in which the nature of the business conducted or property owned by it makes such qualification necessary, except where the failure to be so qualified or in good standing, as the case may be, would not individually or in the aggregate have a Material Adverse Effect.

(b) Each of the RAI Companies has the requisite corporate power and authority to enter into and to consummate the transactions contemplated by the Merger and Share Exchange Agreement and to otherwise carry out their respective obligations thereunder. The execution and delivery of the Merger and Share Exchange Agreement by the RAI Companies and the consummation by them of the transactions contemplated thereby, including the issuance of the shares thereunder have been duly authorized by all necessary action on the part of each of the RAI Companies, including without limitation approval by the shareholders of each of the RAI Companies if required by applicable Law. The Merger and Share Exchange Agreement has been duly executed and delivered by the RAI Companies and constitutes the valid and binding obligation of the RAI Companies enforceable against the RAI Companies in accordance with its terms.

(c) The shares of RAI to be issued to the shareholders of IBUI pursuant to the Merger and Share Exchange, have been duly authorized, and assuming without independent investigation that the shares of capital stock of IBUI outstanding on the date of effectiveness of the Merger and Share Exchange are duly authorized, validly issued, fully paid and nonassessable, when (a) the Merger and Share Exchange has become effective and (b) the shares of capital stock of IBUI have been duly delivered pursuant to the terms of the Merger and Share Exchange Agreement, such shares of RAI will be validly issued, fully paid and non-assessable.

(d) No shares of the capital stock of RAI are entitled to preemptive or similar rights. There are no outstanding options, warrants, script rights to subscribe to, registration rights, calls or commitments of any

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character whatsoever relating to, or, securities, rights or obligations convertible into or exchangeable for, or giving any person any right to subscribe for or acquire, any shares of capital stock, or contracts, commitments, understandings, or arrangements by which RAI is or may become bound to issue additional shares of capital stock, or securities or rights convertible or exchangeable into shares of capital stock.

### ARTICLE 15

#### CONDITIONS PRECEDENT TO OBLIGATIONS OF THE RAI PARTIES

The obligations of the RAI Parties to consummate the Merger and Share Exchange and the Transactions and the obligations of the RAI Parties to consummate the IBUI Merger and Share Exchange and the Transactions shall be subject to the satisfaction or waiver, on or before the Effective Date, of each of the following conditions:

##### 15.1 REPRESENTATIONS AND WARRANTIES

The representations and warranties of IBUI contained in this Agreement shall be true and correct on the date hereof and (except to the extent such representations and warranties speak as of an earlier date) shall also be true and correct on and as of the Closing Date, except for changes contemplated by this Agreement, with the same force and effect as if made on and as of the Closing Date.

##### 15.2 AGREEMENTS, CONDITIONS AND COVENANTS

IBUI shall have performed or complied in all material respects with all agreements, conditions and covenants required by this Agreement to be performed or complied with by it on or before the Effective Date.

##### 15.3 CERTIFICATES

RAI shall have received a certificate of an executive officer of IBUI to the effect set forth in Sections 15.1, 15.2, 15.4 and 15.5, respectively.

##### 15.4 REQUIRED CONSENTS

IBUI shall have obtained all consents ("IBUI Required Consents") from third parties the absence of which would result in a Material Adverse Effect on IBUI.

##### 15.5 MATERIAL ADVERSE EFFECT

There shall have been no Material Adverse Effect on IBUI taken as a whole.

##### 15.6 ANCILLARY DOCUMENTS

IBUI shall have tendered executed copies of the Transaction Documents to which it is intended to be a party.

##### 15.7 BOARD RECOMMENDATION

The Board of Directors of RAI will have approved and adopted this Agreement, including the RAI Merger and Share Exchange, the IBUI Merger and Share Exchange and the other Transactions, and



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determined that each of the RAI Merger and Share Exchange and IBUI Merger and Share Exchange is fair to RAI.

### 15.8 LEGAL OPINION

RAI shall have received an opinion of counsel, reasonably acceptable to RAI, it being understood that Brian F. Faulkner, Esq. is acceptable to RAI, that:

(a) Each of the IBUI companies is a corporation, duly chartered, validly existing and in good standing under the laws of its state of incorporation, with the requisite corporate power and authority to own and use its properties and assets and to carry on its business as currently conducted. Each of the IBUI Companies is duly qualified to do business and is in good standing as a foreign corporation in each jurisdiction in which the nature of the business conducted or property owned by it makes such qualification necessary, except where the failure to be so qualified or in good standing, as the case may be, would not individually or in the aggregate have a Material Adverse Effect.

(b) Each of the IBUI Companies has the requisite corporate power and authority to enter into and to consummate the transactions contemplated by the Merger and Share Exchange Agreement and to otherwise carry out their respective obligations thereunder. The execution and delivery of the Merger and Share Exchange Agreement by the IBUI Companies and the consummation by them of the transactions contemplated thereby, including the issuance of the shares thereunder have been duly authorized by all necessary action on the part of each IBUI Company, including without limitation approval by the shareholders of each of the IBUI Companies, if required by applicable Law. The Merger and Share Exchange Agreement has been duly executed and delivered by the IBUI Companies, and constitutes the valid and binding obligation of the IBUI Companies, enforceable against the IBUI Companies in accordance with its terms.

(c) No shares of the capital stock of IBUI are entitled to preemptive or similar rights. There are no outstanding options, warrants, subscription rights to subscribe to, registration rights, calls or commitments of any character whatsoever relating to, or, securities, rights or obligations convertible into or exchangeable for, or giving any person any right to subscribe for or acquire, any shares of capital stock, or contracts, commitments, understandings, or arrangements by which IBUI is or may become bound to issue additional shares of capital stock, or securities or rights convertible or exchangeable into shares of capital stock.

### 15.9 LINE OF CREDIT

IBUI Shall have obtained a line of credit which is substantially similar in all material respects with the Form of Equity Line Agreement attached hereto as Exhibit 15.9.

## ARTICLE 16

### INDEMNIFICATION

#### 16.1 SURVIVAL OF REPRESENTATIONS AND WARRANTIES

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All of the representations and warranties set forth in Articles V and VI in this Agreement, notwithstanding any investigation at any time made by or on behalf of any party hereto, and in any certificate delivered in connection herewith with respect to any of those representations and warranties, will terminate on the Effective Date.

### 16.2 INDEMNIFICATION OF IBUI INDEMNIFIED PARTIES

RAI covenants and agrees that it will indemnify each IBUI Indemnified Party against, and hold each IBUI Indemnified Party harmless from and in respect of, all claims that arise from, are based on, arise out of, or are attributable to (i) any breach of the representations and warranties of the RAI Companies or in certificates delivered in connection herewith; (ii) the nonfulfillment of any covenant or agreement on the part of the RAI Companies under this Agreement to be performed prior to the Closing or (iii) any liability under the Securities Act, the Exchange Act or other applicable Law which arises out of or is based on (A) any untrue statement or alleged untrue statement of a material fact relating to RAI and its Subsidiaries, or any of them, which is provided to IBUI or its counsel in writing by the RAI or (B) any omission or alleged omission to state therein a material fact relating to RAI and its Subsidiaries, or any of them, required to be stated therein or necessary to make the statements therein not misleading, and not provided to IBUI or its counsel by RAI after a written request therefor (each damage claim described in Section 16.2 being an "IBUI Indemnified Loss"). Once the occurrence of a breach of any representations or warranties has been established, damages shall be calculated without regard to whether such breach caused a Material Adverse Effect.

### 16.3 INDEMNIFICATION OF RAI INDEMNIFIED PARTIES

IBUI covenants and agrees that it will indemnify each RAI Indemnified Party against, and hold each RAI Indemnified Party harmless from and in respect of, all claims that arise from, are based on, arise out of, or are attributable to (i) any breach of the representations and warranties of the IBUI Companies or in certificates delivered in connection herewith; (ii) the nonfulfillment of any covenant or agreement on the part of the IBUI Companies under this Agreement to be performed prior to the Closing or (iii) any liability under the Securities Act, the Exchange Act or other applicable Law which arises out of or is based on (A) any untrue statement or alleged untrue statement of a material fact relating to IBUI and its Subsidiaries, or any of them, which is provided to RAI or its counsel in writing by the IBUI Companies or (B) any omission or alleged omission to state therein a material fact relating to IBUI and its Subsidiaries, or any of them, required to be stated therein or necessary to make the statements therein not misleading, and not provided to RAI or its counsel by IBUI after a written request therefor (each damage claim described in Section 16.3 being a "RAI Indemnified Loss"). Once the occurrence of a breach of any representations or warranties has been established, damages shall be calculated without regard to whether such breach caused a Material Adverse Effect.

### 16.4 CONDITIONS OF INDEMNIFICATION

(a) All claims for indemnification under this Agreement (except Article VII) shall be asserted and

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resolved as follows in this Section 16.4. The provisions of Article XVI shall be the sole manner by which the Indemnified Party shall assert any claim against the Indemnifying Party that does not involve a Third Party Claim, including without limitation any claim for breach of this Agreement.

(b) A party claiming indemnification under this Agreement (an "Indemnified Party") shall promptly (i) notify the party from whom indemnification is sought (the "Indemnifying Party") of any third-party claim or claims asserted against the Indemnified Party ("Third Party Claim") that could give rise to a right of indemnification under this Agreement and (ii) transmit to the Indemnifying Party a written notice ("Claim Notice") describing in reasonable detail the nature of the Third Party Claim, a copy of all papers served with respect to that claim (if any), an estimate of the amount of damages attributable to the Third Party Claim to the extent feasible (which estimate shall not be conclusive of the final amount of such claim) and the basis for the Indemnified Party's request for indemnification under this Agreement. Except as set forth in Section 16.1, the failure to promptly deliver a Claim Notice shall not relieve the Indemnifying Party of its obligations to the Indemnified Party with respect to the related Third Party Claim except to the extent that the resulting delay is materially prejudicial to the defense of that claim. Within 15 days after receipt of any Claim Notice (the "Election Period"), the Indemnifying Party shall notify the Indemnified Party (i) whether the Indemnifying Party disputes its potential liability to the Indemnified Party under this Article XVI with respect to that Third Party Claim and (ii) if the Indemnifying Party does not dispute its potential liability to the Indemnified Party with respect to that Third Party Claim, whether the Indemnifying Party desires, at the sole cost and expense of the Indemnifying Party, to defend the Indemnified Party against that Third Party Claim.

(c) If the Indemnifying Party does not dispute its potential liability to the Indemnified Party and notifies the Indemnified Party within the Election Period that the Indemnifying Party elects to assume the defense of the Third Party Claim, then the Indemnifying Party shall have the right to defend, at its sole cost and expense, that Third Party Claim by all appropriate proceedings, which proceedings shall be prosecuted diligently by the Indemnifying Party to a final conclusion or settled at the discretion of the Indemnifying Party in accordance with this Section 16.4(c) and the Indemnified Party will furnish the Indemnifying Party with all information in its possession, subject to a confidentiality agreement, with respect to that Third Party Claim and otherwise cooperate with the Indemnifying Party in the defense of that Third Party Claim; provided, however, that the Indemnifying Party shall not enter into any settlement with respect to any Third Party Claim that (i) purports to limit the activities of, or otherwise restrict in any way, any Indemnified Party or any Affiliate of any Indemnified Party, (ii) involves a guilty plea to any crime or (iii) involves a fine or penalty, whether or not paid by the Indemnifying Party, without the prior consent of that Indemnified Party (which consent may

be withheld in the sole discretion of that Indemnified Party). The Indemnified Party is hereby authorized, at the sole cost and expense of the Indemnifying Party, to file, during the Election Period, any motion, answer or other pleadings that the Indemnified Party shall deem necessary or appropriate to protect its interests or those of the Indemnifying Party. The Indemnified Party may participate in, but not control, any defense or settlement of any Third Party Claim controlled by the Indemnifying Party pursuant to this Section 16.4(c) and will bear its own costs and expenses with respect to that participation; provided, however, that if the named parties to any such action (including any impleaded parties) include both the Indemnifying Party and the Indemnified Party, and the Indemnified Party has been advised by counsel that there may be one or more legal defenses available to it which are different from or additional to those available to the Indemnifying Party, then the Indemnified Party may employ separate counsel at the expense of the Indemnifying Party (provided that such expenses are reasonable), and, on its written notification of that employment, the Indemnifying Party shall not have the right to assume or continue the defense of such action on behalf of the Indemnified Party.

(d) If the Indemnifying Party (i) within the Election Period (A) disputes its potential liability to the Indemnified Party under this Article XVI, (B) elects not to defend the Indemnified Party pursuant to Section 16.4(c) or (C) fails to notify the Indemnified Party that the Indemnifying Party elects to defend the Indemnified Party pursuant to Section 16.4(c) or (ii) elects to defend the Indemnified Party pursuant to Section 16.4(c) but fails diligently and promptly to prosecute or settle the Third Party Claim, then the Indemnified Party shall have the right to defend, at the sole cost and expense of the Indemnifying Party (provided that such expenses are reasonable) (if the Indemnified Party is entitled to indemnification hereunder), the Third Party Claim by all appropriate proceedings, which proceedings shall be promptly and vigorously prosecuted by the Indemnified Party to a final conclusion or settled. The Indemnified Party shall have full control of such defense and proceedings. Notwithstanding the foregoing, if the Indemnifying Party has delivered a written notice to the Indemnified Party to the effect that the Indemnifying Party disputes its potential liability to the Indemnified Party under this Article XVI and if such dispute is resolved in favor of the Indemnifying Party, the Indemnifying Party shall not be required to bear the costs and expenses of the Indemnified Party's defense pursuant to this Section 16.4 or of the Indemnifying Party's participation therein at the Indemnified Party's request, and the Indemnified Party shall reimburse the Indemnifying Party in full for all reasonable costs and expenses of such litigation. The Indemnifying Party may participate in, but not control, any defense or settlement controlled by the Indemnified Party pursuant to this Section 16.4(d), and the Indemnifying Party shall bear its own costs and expenses with respect to such participation.

(e) In the event any Indemnified Party should have a claim against any Indemnifying Party hereunder that does not involve a Third Party Claim, the Indemnified Party shall transmit to the Indemnifying Party a written notice

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(the "Indemnity Notice") describing in reasonable detail the nature of the claim, an estimate of the amount of damages attributable to that claim to the extent feasible (which estimate shall not be conclusive of the final amount of such claim) and the basis of the Indemnified Party's request for indemnification under this Agreement. If the Indemnifying Party does not notify the Indemnified Party within 15 days from its receipt of the Indemnity Notice that the Indemnifying Party disputes such claim, the claim specified by the Indemnified Party in the Indemnity Notice shall be deemed a liability of the Indemnifying Party hereunder. If the Indemnifying Party has timely disputed such claim, as provided above, such dispute shall be resolved by proceedings in an appropriate court of competent jurisdiction if the parties do not reach a settlement of such dispute within 30 days after notice of a dispute is given.

(f) Payments of all amounts owing by an Indemnifying Party pursuant to this Article XVI relating to a Third Party Claim shall be made within 30 days after the latest of (i) the settlement of that Third Party Claim, (ii) the expiration of the period for appeal of a final adjudication of that Third Party Claim or (iii) the expiration of the period for appeal of a final adjudication of the Indemnifying Party's liability to the Indemnified Party under this Agreement. Payments of all amounts owing by an Indemnifying Party pursuant to Section 16.4(e) shall be made within 30 days after the later of (i) the expiration of the 30-day Indemnity Notice period or (ii) the expiration of the period for appeal of a final adjudication of the Indemnifying Party's liability to the Indemnified Party under this Agreement.

### 16.5 REMEDIES NOT EXCLUSIVE

The remedies provided in this Agreement shall not be exclusive of any other rights or remedies available to one party against the other, either at law or in equity.

## ARTICLE 17

### TERMINATION

#### 17.1 GROUNDS FOR TERMINATION

This Agreement may be terminated at any time before the Effective Date, in each case as authorized by the respective Boards of Directors of the Parties:

- (a) By mutual written consent of each of RAI and IBUI;
- (b) By RAI or IBUI if the Merger and Share Exchange shall not have been consummated on or before the Termination Date; provided, however, that the right to terminate this Agreement under this Section 17.1(b) shall not be available to any Party whose failure to fulfill any obligation under this Agreement has been the cause of, or resulted in, the failure of the Effective Date to occur on or before the Termination Date;
- (c) By RAI or IBUI if a court of competent jurisdiction or governmental, regulatory or administrative

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agency or commission shall have issued a Court Order (which Court Order the Parties shall use commercially reasonable efforts to lift) that permanently restrains, enjoins or otherwise prohibits the Transactions, and such Court Order shall have become final and nonappealable;

(d) By IBUI if RAI shall have breached, or failed to comply with, in any material respect, any of its obligations under this Agreement or any representation or warranty made by RAI shall have been incorrect in any material respect when made, and such breach, failure or misrepresentation is not cured within 20 days after notice thereof, and in either case, any such breaches, failures or misrepresentations, individually or in the aggregate, results or would reasonably be expected to result in a failure to satisfy a condition to RAI's obligations to consummate the transactions contemplated hereby;

(e) By RAI if IBUI shall have breached, or failed to comply with, in any material respect, any of its obligations under this Agreement or any representation or warranty made by it shall have been incorrect in any material respect when made, and such breach, failure or misrepresentation is not cured within 20 days after notice thereof, and in either case, any such breaches, failures or misrepresentations, individually or in the aggregate, results or would reasonably be expected to result in a failure to satisfy a condition to IBUI's obligations to consummate the transactions contemplated hereby;

(f) By RAI if at the RAI Stockholder Meeting (including any adjournment thereof) this Agreement and the Merger and Share Exchange shall fail to be approved and adopted by the affirmative vote of the stockholders of RAI as required under the DGCL;

(g) By IBUI if at the IBUI Shareholder Meeting (including any adjournment thereof) this Agreement and the Merger and Share Exchange shall fail to be approved and adopted by the affirmative vote of the stockholders of IBUI as required under Nevada law;

(h) By RAI, prior to the approval of this Agreement by the stockholders of RAI, upon five days notice to IBUI, if, as a result of an Acquisition Proposal received by RAI from a Person other than a Party to this Agreement or any of its Affiliates, the Board of Directors of RAI determines in good faith that its fiduciary obligations under applicable Law require that such Acquisition Proposal be accepted; provided, however, that (i) immediately following such termination RAI executes with such third party a definitive agreement to implement such Acquisition Proposal, (ii) the Board of Directors of RAI shall have concluded in good faith, after considering applicable provisions of applicable Law and after giving effect to all concessions which may be offered by IBUI pursuant to clause (iii) below, on the basis of advice of counsel, that such action is necessary for the Board of Directors to act in a manner consistent with its fiduciary duties under applicable Law, and (iii) prior to any such termination, (x) RAI shall have provided IBUI with five days' notice of the terms of the proposal and otherwise complied with Section 8.2(a)

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hereof (including making the finding contemplated by Section 8.2(a)(x) hereof) and (y) RAI shall, and shall cause its financial and legal advisors to, negotiate with IBUI to make such adjustments in the terms and conditions of this Agreement as would enable RAI to proceed with the Transactions;

(i) By IBUI, prior to the approval of this Agreement by the stockholders of IBUI, upon five days notice to RAI, if, as a result of an Acquisition Proposal received by IBUI from a Person other than a Party to this Agreement or any of its Affiliates, the Board of Directors of IBUI determines in good faith that its fiduciary obligations under applicable Law require that such Acquisition Proposal be accepted; provided, however, that (i) immediately following such termination IBUI executes with such third party a definitive agreement to implement such Acquisition Proposal, (ii) the Board of Directors of IBUI shall have concluded in good faith, after considering applicable provisions of applicable Law and after giving effect to all concessions which may be offered by RAI pursuant to clause (iii) below, on the basis of advice of counsel, that such action is necessary for the Board of Directors to act in a manner consistent with its fiduciary duties under applicable Law, and (iii) prior to any such termination, (x) IBUI shall have provided RAI with five days' notice of the terms of the proposal and otherwise complied with Section 8.2(b) hereof (including making the finding contemplated by Section 8.2(b)(i)(x) hereof) and (y) IBUI shall, and shall cause its financial and legal advisors to, negotiate with RAI to make such adjustments in the terms and conditions of this Agreement as would enable IBUI to proceed with the Transactions.

(j) By RAI if the Board of Directors of IBUI shall withdraw, modify or change its recommendation of this Agreement or the Merger and Share Exchange or shall have failed to reaffirm its recommendation within five business days of RAI's request that it do so or shall have recommended or issued a neutral recommendation (or taken no position) with respect to any Acquisition Proposal.

(k) By IBUI if the Board of Directors of RAI shall withdraw, modify or change its recommendation of this Agreement or the Merger and Share Exchange or shall have failed to reaffirm its recommendation within five business days of IBUI's request that it do so or shall have recommended or issued a neutral recommendation (or taken no position) with respect to any Acquisition Proposal.

(l) By IBUI if RAI is not listed for trading on the NASDAQ Smallcap Market on the Effective Date.

### 17.2 EFFECT OF TERMINATION

(a) If this Agreement is terminated pursuant to Section 17.1(a), (b), or (l), this Agreement shall be terminated and there shall be no liability on the part of any of the Parties; notwithstanding the foregoing, nothing herein shall relieve any Party from liability for any willful breach hereof; provided that the provisions of Sections 8.3, 8.4(b), 9.6, 10.6, 11.2 and this Section 17.2 shall survive the termination hereof.

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(b) If this Agreement is terminated by IBUI pursuant to Section 17.1(d) or (k) or by RAI pursuant to Section 17.1(f) or (h), then RAI shall pay IBUI liquidated damages in the amount of US\$500,000.

(c) If this Agreement is terminated by RAI pursuant to Section 17.1(e) or (j) or by IBUI pursuant to Section 17.1(g) or (i), then IBUI shall pay RAI liquidated damages in the amount of US\$500,000.

### ARTICLE 18

#### GENERAL MATTERS

18.1 [Intentionally Omitted]

18.2 CONTENTS OF AGREEMENT

This Agreement, together with the other Transaction Documents, set forth the entire understanding of the Parties hereto with respect to the Transactions and supersede all prior agreements or understandings among the Parties regarding those matters.

18.3 AMENDMENT, PARTIES IN INTEREST, ASSIGNMENT, ETC.

This Agreement may be amended, modified or supplemented only by a written instrument duly executed by each of the Parties hereto. If any provision of this Agreement shall for any reason be held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provision hereof, and this Agreement shall be construed as if such invalid, illegal or unenforceable provision had never been contained herein. This Agreement shall be binding upon and inure to the benefit of and be enforceable by the respective heirs, legal representatives, successors and permitted assigns of the Parties hereto. No Party hereto shall assign this Agreement or any right, benefit or obligation hereunder. Any term or provision of this Agreement may be waived at any time by the Party entitled to the benefit thereof by a written instrument duly executed by such Party. The Parties hereto shall execute and deliver any and all documents and take any and all other actions that may be deemed reasonably necessary by their respective counsel to complete the Transactions. Nothing in this Agreement is intended or will be construed to confer on any Person other than the Parties hereto any rights or benefits hereunder.

18.4 INTERPRETATION

Unless the context of this Agreement clearly requires otherwise, (a) references to the plural include the singular, the singular the plural, the part the whole, (b) references to any gender include all genders, (c) "or" has the inclusive meaning frequently identified with the phrase "and/or," (d) "including," "includes" or similar words has the inclusive meaning frequently identified with the phrase "but not limited to" and (e) references to "hereunder" or "herein" relate to this Agreement. The section and other headings contained in this Agreement are for reference purposes only and shall not control or affect the construction of this Agreement or the interpretation thereof in any respect. Section, subsection, Disclosure Schedule and Exhibit references are to this Agreement unless otherwise specified. The Exhibits and Schedules referred to in this Agreement will be



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deemed to be a part of this Agreement. Each accounting term used herein that is not specifically defined herein shall have the meaning given to it under GAAP.

### 18.5 NOTICES

All notices that are required or permitted hereunder shall be in writing and shall be sufficient if personally delivered or sent by a nationally recognized overnight courier upon proof of delivery. Any notices shall be deemed given upon receipt at the address set forth below, unless such address is changed by notice to the other Party hereto:

If to RAI:

Return Assured Incorporated  
885 West Georgia, Suite 2240  
Vancouver, BC V6C 3E8  
Attn: Matthew Sebal

with a required copy to:

Kaplan Gottbetter & Levenson, LLP  
630 Third Avenue  
New York, New York 10017  
Attn: Adam S. Gottbetter, Esq.

If to IBUI:

Internet Business's International, Inc.  
3900 Birch Street  
Suite 103  
New Port Beach, CA 32826  
Attn: Albert R. Reda

with a required copy to:

Brian F. Faulkner, Esq.  
3900 Birch Street  
Suite 113  
Newport Beach, CA 32826

### 18.6 GOVERNING LAW AND VENUE

This Agreement shall be construed and interpreted in accordance with the Laws of the State of New York without regard to its provisions concerning conflict of laws. Any dispute or controversy concerning or relating to this Agreement shall be exclusively resolved in the federal or state courts located in the State of New York, New York County.

### 18.7 COUNTERPARTS

This Agreement may be executed in two or more counterparts, each of which shall be binding as of the date first written above, and all of which shall constitute one and the same instrument. Each such copy shall be deemed an original, and it shall not be necessary in making proof of this Agreement to produce or account for more than one such counterpart.

### 18.8 WAIVERS

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Compliance with the provisions of this Agreement may be waived only by a written instrument specifically referring to this Agreement and signed by the Party waiving compliance. No course of dealing, nor any failure or delay in exercising any right, will be construed as a waiver, and no single or partial exercise of a right will preclude any other or further exercise of that or any other right.

### 18.9 MODIFICATION

No supplement, modification or amendment of this Agreement will be binding unless made in a written instrument that is signed by all of the Parties hereto and that specifically refers to this Agreement.

### 18.10 ENFORCEMENT OF AGREEMENT

The parties hereto agree that irreparable damage would occur in the event that any of the provisions of this Agreement was not performed in accordance with its specific terms or was otherwise breached. It is accordingly agreed that the parties shall be entitled to an injunction to prevent breaches of this Agreement and to enforce specifically the terms and provisions hereof in any court of competent jurisdiction, this being in addition to any other remedy to which they are entitled at law or equity.

### 18.11 WAIVER OF JURY TRIAL

Each party acknowledges and agrees that any controversy which may arise under this Agreement is likely to involve complicated and difficult issues, and therefore each such party hereby irrevocably and unconditionally waives any right such party may have to a trial by jury in respect of any litigation directly or indirectly arising out of or relating to this Agreement, or the Transactions contemplated by this Agreement. Each party certifies and acknowledges that (i) no representative, agent or attorney of any other party has represented, expressly or otherwise, that such other party would not, in the event of litigation, seek to enforce the foregoing waiver, (ii) each party understands and has considered the implications of this waiver, (iii) each party makes this waiver voluntarily, and (iv) each party has been induced to enter into this Agreement by, among other things, the mutual waivers and certifications in this Section 18.11.

### 18.12 SEVERABILITY

If any term or other provision of this Agreement is invalid, illegal or incapable of being enforced by any rule of law or public policy, all other conditions and provisions of this Agreement shall nevertheless remain in full force and effect. Upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the parties hereto shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible to the fullest extent permitted by applicable Law in an acceptable manner to the end that the Transactions are fulfilled to the extent possible.

IN WITNESS WHEREOF, this Agreement has been executed by the Parties hereto as of the day and year first written above.

INTERNET BUSINESS'S INTERNATIONAL, INC.

By:/s/ Albert Reda  
Albert Reda  
Chief Executive Officer

RETURN ASSURED INCORPORATED

By:/s/ Matthew J. Sebal  
Matthew J. Sebal  
President

IBUI ACQUISITION CORPORATION

By:/s/ Matthew J. Sebal  
Matthew J. Sebal  
President

EX-10.6

EMPLOYMENT AGREEMENT

This EMPLOYMENT AGREEMENT ("Agreement") is made, entered into, and effective as of January 1, 2000 ("Effective Date"), by and between Internet Business' International, a Nevada corporation (the "Company") and Al Reda ("Reda").

RECITALS

WHEREAS, COMPANY desires to benefit from Reda's expertise and employ Reda as Chief Executive Officer ("C.E.O.") and Reda is willing to accept such employment.

NOW, THEREFORE, in consideration of the mutual covenants and conditions contained herein, the parties hereto hereby agree as follows:

AGREEMENT

ARTICLE I

Term and Duties

The Company hereby employs Reda as C.E.O. as of the Effective Date and Reda agrees to enter into and remain in the employ of the Company until five years from the date of this Agreement unless (i) this Agreement is terminated as provided hereinbelow; or (ii) this Agreement is extended by mutual agreement of the parties. Reda shall faithfully and diligently perform all professional duties and acts as C.E.O. as may be reasonably requested of Reda by the Company or its officers consistent with the function of a C.E.O. of a comparable business holding company.

ARTICLE II

Duties

2.1 Reda agrees to perform Reda's services to the best of his ability. Reda agrees throughout the term of this Agreement to

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devote sufficient time, energy and skill to the business of the Company and to the promotion of the best interests of the Company. The Company understands and agrees that Reda may from time to time undertake business opportunities so long as they do not conflict with his duties to the Company and hereby waives any claim it may have with respect to Reda's undertaking such opportunities.

### ARTICLE III

#### Compensation

3.1 Subject to the termination of this Agreement as provided herein, the Company shall compensate Reda for his services hereunder at an annual salary ("Salary") of One Hundred Eighty Thousand Dollars (\$180,000.00) payable in semi-monthly installments in accordance with the Company's practices, less normal payroll deductions.

3.2 In addition to the Salary as defined above, the Company agrees to the following schedule:

a. On the first year's anniversary of this Agreement, Reda's salary shall be \$16,000 per month

b. On the second year's anniversary of this Agreement, Reda's salary shall be \$17,000 per month.

c. On the third year's anniversary of this Agreement, Reda's salary shall be \$18,000 per month.

d. On the fourth year's anniversary of this Agreement, Reda's salary shall be \$19,000 per month.

3.3 In addition to the compensation set forth above, the Company shall periodically review Reda's performance and services rendered with a view to paying discretionary bonuses based upon above-average or outstanding performance for a prior period. Any such bonuses approved by the Company shall be paid to Reda within 30 days of the grant thereof. The following performance milestones shall justify the particular stock bonuses, to be issued by the company, as set forth below:

a. At \$ 2 million in sales, 500,000 shares of IBI stock.

b. At \$ 3 million in sales, 800,000 shares of IBI stock.

c. At \$ 5 million in sales, 1,000,000 shares of IBI stock.

d. At \$ 8 million in sales, 2,000,000 shares of IBI stock.

e. At \$ 10 million in sales, 2,500,000 shares of IBI stock.

f. At \$ 12 million in sales, 3,000,000 shares of IBI stock.

3.4 In addition to the Salary and bonuses stated above, commencing with the Effective Date, Reda shall be eligible to participate in a health insurance plan, including dependent coverage, supplied by the Company. Reda shall be entitled to participate in any and all group life, workers' compensation, health plan or accidental insurance plans which are adopted by the Company for the benefit of executive officers or employees. Reda shall be entitled to such sick leave and paid holidays and to such

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other prerequisites of employment, as customarily are extended by the Company to executive officers or employees. In addition, Reda shall be entitled to such other benefits as the Company may elect to provide generally, from time to time, to executive officers or employees. Reda shall be entitled to the following vacation benefits:

- i. 4 weeks on first year anniversary
- ii. 5 weeks on second year anniversary
- iii. 6 weeks on third year anniversary and thereafter.

3.5 If for any reason, including malfeasance, misfeasance, and/or nonfeasance, the Company decides to terminate Reda, then Reda shall still be entitled to all benefits under this Agreement.

### ARTICLE IV

#### Expenses

The Company shall reimburse Reda for all reasonable business related expenses incurred by Reda in the course of his normal duties on behalf of the company. In reimbursing Reda for expenses, the ordinary and usual business guidelines and documentation requirements shall be adhered to by the Company and Reda.

### ARTICLE V

#### Binding Effect

This Agreement shall be binding upon and inure to the benefit of the parties hereto their respective devisees, legatees, heirs, legal representatives, successors, and permitted assigns. The preceding sentence shall not affect any restriction on assignment set forth elsewhere in this Agreement.

### ARTICLE VI

#### Arbitration

If a dispute or claim shall arise between the parties with respect to any of the terms or provisions of this Agreement, or with respect to the performance by any of the parties under this Agreement, then the parties agree that the dispute shall be arbitrated in Orange County, California before a single arbitrator, in accordance with the rules of Judicial Arbitration and Mediation Services, Inc./Endispute ("JAMS/Endispute").

### ARTICLE VII

#### Notices

Any notice, request, demand, or other communication given pursuant to the terms of this Agreement shall be deemed given upon delivery, if hand delivered or delivered via facsimile, or Forty-Eight (48) hours after deposit in the United States mail, postage prepaid, and sent certified or registered mail, return receipt requested, correctly addressed to the addresses of the parties indicated below or at such other address as such party shall in writing have advised the other party.

If to the Company:

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3900 Birch Street, #113  
Newport Beach, CA 92660

If to Reda:

2557 Oxford Lane  
Costa Mesa, CA 92626

ARTICLE VIII

Assignment

Subject to all other provisions of this Agreement, any attempt to assign or transfer this Agreement or any of the rights conferred hereby, by judicial process or otherwise, to any person, firm, company, or corporation without the prior written consent of the party, shall be invalid, and may, at the option of such other party, result in an incurable event of default resulting in termination of this Agreement and all rights hereby conferred.

ARTICLE IX

Choice of Law

This Agreement and the rights of the parties hereunder shall be governed by and constructed in accordance with the laws of the State of California including all matters of construction, validity, performance, and enforcement and without giving effect to the principles of conflict of laws.

ARTICLE X

Jurisdiction

The parties submit to the jurisdiction of the Courts of the State of California or a Federal Court empaneled in the State of California for the resolution of all legal disputes arising under the terms of this Agreement, including, but not limited to, enforcement of arbitration award.

ARTICLE XI

Entire Agreement

Except as provided herein, this Agreement contains the entire agreement of the parties, and supersedes all existing negotiations, representations, or agreements and all other oral, written, or other communications between them concerning the subject matter of this Agreement. There are no representations, agreements, arrangements, or understandings, oral or written, between and among the parties hereto relating to the subject matter of this Agreement that are not fully expressed herein.

ARTICLE XII

Severability

If any provision of this Agreement is unenforceable, invalid, or violates applicable law, such provision, or unenforceable portion of such provision, shall be deemed stricken and shall not affect the enforceability of any other provisions of this Agreement.

ARTICLE XIII

Captions

The captions in this Agreement are inserted only as a matter of convenience and for reference and shall not be deemed to define, limit, enlarge, or describe the scope of this Agreement or the relationship of the parties, and shall not affect this Agreement or the construction of any provisions herein.

ARTICLE XIV

Counterparts

This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which shall together constitute one and the same instrument.

ARTICLE XV

Modification

No change, modification, addition, or amendment to this Agreement shall be valid unless in writing and signed by all parties hereto.

ARTICLE XVI

Waiver

No waiver of any breach, covenant, representation, warranty, or default of this Agreement by any party shall be considered to be a waiver of any other breach, covenant representation warranty or default of this Agreement.

ARTICLE XVII

Interpretation

The terms and conditions of this Agreement shall be deemed to have been prepared jointly by all of the Parties hereto. Any ambiguity or uncertainty existing hereunder shall not be construed against any one of the drafting parties, but shall be resolved by reference to the other rules of interpretation of contracts as they apply in the State of California.

ARTICLE XVIII

Attorneys' Fees

Except as otherwise provided herein, if a dispute should arise between the parties including, but not limited to arbitration, the prevailing party shall be reimbursed by the non-prevailing party for all reasonable expenses incurred in resolving such dispute, including reasonable attorneys' fees.

ARTICLE XIX

Taxes

Any income taxes required to be paid in connection with the payments due hereunder, shall be borne by the party required to

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make such payment. Any withholding taxes in the nature of a tax on income shall be deducted from payments due, and the party required to withhold such tax shall furnish to the party receiving such payment all documentation necessary to prove the proper amount to withhold of such taxes and to prove payment to the tax authority of such required withholding.

### ARTICLE XX

#### Not for the Benefit of Creditors of Third Parties

The provisions of this Agreement are intended only for the regulation of relations among the parties. This Agreement is not intended for the benefit of creditors of the parties or other third parties and no rights are granted to creditors of the parties or other third parties under this Agreement.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed as of the Effective Date.

"Company"

"Reda"

Internet Business's International

By:/s/ Louis Cherry  
Louis Cherry, President

By:/s/ Albert Reda  
Albert Reda

EX-10.7

### EMPLOYMENT AGREEMENT

This EMPLOYMENT AGREEMENT ("Agreement") is made, entered into, and effective as of January 1, 2000 ("Effective Date"), by and between Internet Business' International, a Nevada corporation (the "Company") and Louis Cherry ("Cherry").

#### RECITALS

WHEREAS, COMPANY desires to benefit from Cherry's expertise and employ Cherry as President and Cherry is willing to accept such employment.

NOW, THEREFORE, in consideration of the mutual covenants and conditions contained herein, the parties hereto hereby agree as follows:

#### AGREEMENT

#### ARTICLE I

##### Term and Duties

The Company hereby employs Cherry as President as of the Effective Date and Cherry agrees to enter into and remain in the employ of the Company until five years from the date of this Agreement unless (i) this Agreement is terminated as provided hereinbelow; or (ii) this Agreement is extended by mutual agreement of the parties. Cherry shall faithfully and diligently perform all professional duties and acts as President as may be reasonably requested of Cherry by the Company or its officers consistent with the function of a President of a comparable business holding company.



ARTICLE II

Duties

2.1 Cherry agrees to perform Cherry's services to the best of his ability. Cherry agrees throughout the term of this Agreement to devote sufficient time, energy and skill to the business of the Company and to the promotion of the best interests of the Company. The Company understands and agrees that Cherry may from time to time undertake business opportunities so long as they do not conflict with his duties to the Company and hereby waives any claim it may have with respect to Cherry's undertaking such opportunities.

ARTICLE III

Compensation

3.1 Subject to the termination of this Agreement as provided herein, the Company shall compensate Cherry for his services hereunder at an annual salary ("Salary") of One Hundred Eighty Thousand Dollars (\$180,000.00) payable in semi-monthly installments in accordance with the Company's practices, less normal payroll deductions.

3.2 In addition to the Salary as defined above, the Company agrees to the following schedule:

- a. On the first year's anniversary of this Agreement, Cherry's salary shall be \$20,000 per month
- b. On the second year's anniversary of this Agreement, Cherry's salary shall be \$25,000 per month and continue on thereafter.

3.3 In addition to the compensation set forth above, the Company shall periodically review Cherry's performance and services rendered with a view to paying discretionary bonuses based upon above-average or outstanding performance for a prior period. Any such bonuses approved by the Company shall be paid to Cherry within 30 days of the grant thereof. The following performance milestones shall justify the particular stock bonuses, in unrestricted stock, which are cumulative, to be issued by the Company, as below:

- a. At \$ 2 million in sales, 500,000 shares of IBI stock.
- b. At \$ 3 million in sales, 800,000 shares of IBI stock.
- c. At \$ 5 million in sales, 1,000,000 shares of IBI stock.
- d. At \$ 8 million in sales, 2,000,000 shares of IBI stock.
- e. At \$ 10 million in sales, 2,500,000 shares of IBI stock.
- f. At \$ 12 million in sales, 3,000,000 shares of IBI stock.

3.4 In addition to the Salary and bonuses stated above, commencing with the Effective Date, Cherry shall be eligible to participate in a health insurance plan, including dependent coverage, supplied by the Company. Cherry shall be entitled to participate in any and all group life, workers' compensation,

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health plan or accidental insurance plans which are adopted by the Company for the benefit of executive officers or employees. Cherry shall be entitled to such sick leave and paid holidays and to such other perquisites of employment, as customarily are extended by the Company to executive officers or employees. In addition, Cherry shall be entitled to such other benefits as the Company may elect to provide generally, from time to time, to executive officers or employees. Cherry shall be entitled to the following vacation benefits:

- i. 4 weeks on first year anniversary
- ii. 5 weeks on second year anniversary
- iii. 6 weeks on third year anniversary and thereafter.

3.5 If for any reason, including but not limited to malfeasance, misfeasance, and/or nonfeasance, or layoff, the Company decides to terminate Cherry, then the Company shall immediately pay, meaning within five (5) calendar days, the following: The sum of \$500,000 plus all of the stock set forth in paragraph 3.3, above.

3.7 If for any reason Reda wishes to retire, becomes incapacitated, or is otherwise unable to continue employment with the Company, he shall continue receiving compensation at the current rate for the next three years.

### ARTICLE IV

#### Expenses

The Company shall reimburse Cherry for all reasonable business related expenses incurred by Cherry in the course of his normal duties on behalf of the company. In reimbursing Cherry for expenses, the ordinary and usual business guidelines and documentation requirements shall be adhered to by the Company and Cherry. Cherry shall receive a car allowance of \$400 per month.

### ARTICLE V

#### Binding Effect

This Agreement shall be binding upon and inure to the benefit of the parties hereto their respective devisees, legatees, heirs, legal representatives, successors, and permitted assigns. The preceding sentence shall not affect any restriction on assignment set forth elsewhere in this Agreement.

### ARTICLE VI

#### Arbitration

If a dispute or claim shall arise between the parties with respect to any of the terms or provisions of this Agreement, or with respect to the performance by any of the parties under this Agreement, then the parties agree that the dispute shall be arbitrated in Orange County, California before a single arbitrator, in accordance with the rules of Judicial Arbitration and Mediation Services, Inc./Endispute ("JAMS/Endispute").

### ARTICLE VII

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## Notices

Any notice, request, demand, or other communication given pursuant to the terms of this Agreement shall be deemed given upon delivery, if hand delivered or delivered via facsimile, or Forty-Eight (48) hours after deposit in the United States mail, postage prepaid, and sent certified or registered mail, return receipt requested, correctly addressed to the addresses of the parties indicated below or at such other address as such party shall in writing have advised the other party.

If to the Company:

3900 Birch Street, #113  
Newport Beach, CA 92660

If to Cherry:

27786 Hidden Trail Road  
Laguna Hills, CA 92660

## ARTICLE VIII

### Assignment

Subject to all other provisions of this Agreement, any attempt to assign or transfer this Agreement or any of the rights conferred hereby, by judicial process or otherwise, to any person, firm, company, or corporation without the prior written consent of the party, shall be invalid, and may, at the option of such other party, result in an incurable event of default resulting in termination of this Agreement and all rights hereby conferred.

## ARTICLE IX

### Choice of Law

This Agreement and the rights of the parties hereunder shall be governed by and constructed in accordance with the laws of the State of California including all matters of construction, validity, performance, and enforcement and without giving effect to the principles of conflict of laws.

## ARTICLE X

### Jurisdiction

The parties submit to the jurisdiction of the Courts of the State of California or a Federal Court empaneled in the State of California for the resolution of all legal disputes arising under the terms of this Agreement, including, but not limited to, enforcement of arbitration award.

## ARTICLE XI

### Entire Agreement

Except as provided herein, this Agreement contains the entire agreement of the parties, and supersedes all existing negotiations, representations, or agreements and all other oral, written, or other communications between them concerning the

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subject matter of this Agreement. There are no representations, agreements, arrangements, or understandings, oral or written, between and among the parties hereto relating to the subject matter of this Agreement that are not fully expressed herein.

### ARTICLE XII

#### Severability

If any provision of this Agreement is unenforceable, invalid, or violates applicable law, such provision, or unenforceable portion of such provision, shall be deemed stricken and shall not affect the enforceability of any other provisions of this Agreement.

### ARTICLE XIII

#### Captions

The captions in this Agreement are inserted only as a matter of convenience and for reference and shall not be deemed to define, limit, enlarge, or describe the scope of this Agreement or the relationship of the parties, and shall not affect this Agreement or the construction of any provisions herein.

### ARTICLE XIV

#### Counterparts

This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which shall together constitute one and the same instrument.

### ARTICLE XV

#### Modification

No change, modification, addition, or amendment to this Agreement shall be valid unless in writing and signed by all parties hereto.

### ARTICLE XVI

#### Waiver

No waiver of any breach, covenant, representation, warranty, or default of this Agreement by any party shall be considered to be a waiver of any other breach, covenant representation warranty or default of this Agreement.

### ARTICLE XVII

#### Interpretation

The terms and conditions of this Agreement shall be deemed to have been prepared jointly by all of the Parties hereto. Any ambiguity or uncertainty existing hereunder shall not be construed against any one of the drafting parties, but shall be resolved by reference to the other rules of interpretation of contracts as they apply in the State of California.

### ARTICLE XVIII

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Attorneys' Fees

Except as otherwise provided herein, if a dispute should arise between the parties including, but not limited to arbitration, the prevailing party shall be reimbursed by the non-prevailing party for all reasonable expenses incurred in resolving such dispute, including reasonable attorneys' fees.

ARTICLE XIX

Taxes

Any income taxes required to be paid in connection with the payments due hereunder, shall be borne by the party required to make such payment. Any withholding taxes in the nature of a tax on income shall be deducted from payments due, and the party required to withhold such tax shall furnish to the party receiving such payment all documentation necessary to prove the proper amount to withhold of such taxes and to prove payment to the tax authority of such required withholding.

ARTICLE XX

Not for the Benefit of Creditors of Third Parties

The provisions of this Agreement are intended only for the regulation of relations among the parties. This Agreement is not intended for the benefit of creditors of the parties or other third parties and no rights are granted to creditors of the parties or other third parties under this Agreement.

ARTICLE XXI

Defense and Indemnity

Should Cherry be sued and/or prosecuted with respect to any act performed as part of his duties of office or any failure to act, then the Company shall defend, indemnify, retain legal counsel and otherwise hold him harmless for costs of defense, settlements, sanctions or awards.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed as of the Effective Date.

"Company"

"Cherry"

Internet Business's International

By: /s/ Al Reda  
Al Reda, CEO

/s/ Louis Cherry  
Louis Cherry

EX-21

SUBSIDIARIES OF THE REGISTRANT

LA Internet, Inc., a California corporation

MBM Capital Group, Inc., a Nevada corporation

Allstates Communication, Inc., a Nevada corporation

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Global GPP Corp. (80%), a North Carolina corporation (100% owned subsidiary: GPP Hungary Kft, a Hungary corporation)

Guarantee Capital Group, a California corporation

1st2Market, Inc., a Nevada corporation

Global Construction Buying Group, a Nevada corporation

#000000; border-bottom:double 2.5pt #000000;white-space:nowrap;">

\$

1,058,032

### Total Level Three Debt Investments

(a) The significant unobservable inputs used in the fair value measurement of the Company's debt securities are hypothetical market yields and premiums/(discounts). The hypothetical market yield is defined as the exit price of an investment in a hypothetical market to hypothetical market participants where buyers and sellers are willing participants. The premiums (discounts) relate to company specific characteristics such as underlying investment performance, security liens, and other characteristics of the investment. Significant increases (decreases) in the inputs in isolation would result in a significantly lower (higher) fair value measurement, depending on the materiality of the investment. Debt investments in the industries noted in the Company's Consolidated Schedule of Investments are included in the industries note above as follows:

- Pharmaceuticals, above, is comprised of debt investments in the Specialty Pharmaceuticals, Drug Discovery and Development, Drug Delivery, Diagnostic and Biotechnology Tools industries in the Consolidated Schedule of Investments.
  - Technology, above, is comprised of debt investments in the Software, Semiconductors, Internet Consumer and Business Services, Consumer and Business Products, Information Services, and Communications and Networking industries in the Consolidated Schedule of Investments.
  - Medical Devices, above, is comprised of debt investments in the Surgical Devices, Medical Devices and Equipment and Biotechnology Tools industries in the Consolidated Schedule of Investments.
  - Energy Technology, above, aligns with the Energy Technology Industry in the Consolidated Schedule of Investments.
  - Lower Middle Market, above, is comprised of debt investments in the Communications and Networking, Electronics and Computer Hardware, Healthcare Services - Other, Information Services, Internet Consumer and Business Services, Media/Content/Info, and Specialty Pharmaceuticals industries in the Consolidated Schedule of Investments.
- (b) The weighted averages are calculated based on the fair market value of each investment.

- (c) The significant unobservable inputs used in the fair value measurement of impaired debt securities is the probability weighting of alternative outcomes.
- (d) Imminent payoffs represent debt investments that the Company expects to be fully repaid within the next three months, prior to their scheduled maturity date.

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|  | Fair Value at     |   |   |                 |                        |
|--|-------------------|---|---|-----------------|------------------------|
|  | December 31, 2014 |   |   |                 | Weighted               |
| Investment Type - Level (in thousands) | Valuation         | Techniques/Methodologies                            | Unobservable Input <sup>(a)</sup>             | Range           | Average <sup>(b)</sup> |
| Pharmaceuticals                        | \$ 117,229        | Originated Within 6 Months                          | Origination Yield                             | 10.34% - 16.52% | 11.76%                 |
|  | 237,595           | Market Comparable Companies                         | Hypothetical Market Yield                     | 9.75% - 17.73%  | 10.62%                 |
|  |                   |   | Premium/(Discount)                            | (0.50%) - 1.00% |                        |
| Medical Devices                        | 60,332            | Originated Within 6 Months                          | Origination Yield                             | 12.14% - 16.56% | 13.69%                 |
|  | 60,658            | Market Comparable Companies                         | Hypothetical Market Yield                     | 11.64% - 22.22% | 12.19%                 |
|  |                   |   | Premium/(Discount)                            | 0.00% - 1.00%   |                        |
|  | 12,970            | Liquidation <sup>(c)</sup>                          | Probability weighting of alternative outcomes | 50.00%          |                        |
| Technology                             | 152,645           | Originated Within 6 Months                          | Origination Yield                             | 10.54% - 20.02% | 14.08%                 |
|  | 80,835            | Market Comparable Companies                         | Hypothetical Market Yield                     | 6.95% - 15.50%  | 13.01%                 |
|  |                   |   | Premium/(Discount)                            | 0.00% - 0.50%   |                        |
|  | 27,159            | Liquidation <sup>(c)</sup>                          | Probability weighting of alternative outcomes | 10.00% - 90.00% |                        |
| Energy Technology                      | 4,437             | Originated Within 6 Months                          | Origination Yield                             | 13.85% - 21.57% | 19.00%                 |
|  | 52,949            | Market Comparable Companies                         | Hypothetical Market Yield                     | 13.20% - 16.62% | 15.41%                 |
|  |                   |   | Premium/(Discount)                            | 0.00% - 1.50%   |                        |
|  | 1,600             | Liquidation <sup>(c)</sup>                          | Probability weighting of alternative outcomes | 100.00%         |                        |
| Lower Middle Market                    | 2,962             | Originated Within 6 Months                          | Origination Yield                             | 14.04%          | 14.04%                 |
|  | 59,254            | Market Comparable Companies                         | Hypothetical Market Yield                     | 11.91% - 15.33% | 13.98%                 |
|  |                   |   | Premium/(Discount)                            | 0.00% - 0.50%   |                        |
|  | 4,096             | Liquidation <sup>(c)</sup>                          | Probability weighting of alternative outcomes | 45.00% - 55.00% |                        |
|  |                   | Debt Investments Where Fair Value Approximates Cost |   |                 |                        |
|  | 9,318             | Imminent Payoffs <sup>(d)</sup>                     |   |                 |                        |
|  | 39,867            | Debt Investments Maturing in Less than One Year     |   |                 |                        |
|  | \$923,906         | Total Level Three Debt Investments                  |   |                 |                        |



- (a) The significant unobservable inputs used in the fair value measurement of the Company's securities are hypothetical market yields and premiums/(discounts). The hypothetical market yield is defined as the exit price of an investment in a hypothetical market to hypothetical market participants where buyers and sellers are willing participants. The premiums (discounts) relate to company specific characteristics such as underlying investment performance, security liens, and other characteristics of the investment. Significant increases (decreases) in the inputs in isolation would result in a significantly lower (higher) fair value measurement, depending on the materiality of the investment. Debt investments in the industries noted in the Company's Consolidated Schedule of Investments are included in the industries note above as follows:
- Pharmaceuticals, above, is comprised of debt investments in the Specialty Pharmaceuticals, Drug Discovery and Development, Drug Delivery, Diagnostic and Biotechnology Tools industries in the Consolidated Schedule of Investments.
  - Medical Devices, above, is comprised of debt investments in the Surgical Devices, Medical Devices and Equipment and Biotechnology Tools industries in the Consolidated Schedule of Investments.
  - Technology, above, is comprised of debt investments in the Software, Semiconductors, Internet Consumer and Business Services, Consumer and Business Products, Information Services, and Communications and Networking industries in the Consolidated Schedule of Investments.
  - Energy Technology, above, aligns with the Energy Technology Industry in the Consolidated Schedule of Investments.
  - Lower Middle Market, above, is comprised of debt investments in the Communications and Networking, Electronics and Computer Hardware, Healthcare Services - Other, Information Services, Internet Consumer and Business Services, Media/Content/Info, and Specialty Pharmaceuticals industries in the Consolidated Schedule of Investments.
- (b) The weighted averages are calculated based on the fair market value of each investment.
- (c) The significant unobservable inputs used in the fair value measurement of impaired debt securities is the probability weighting of alternative outcomes.
- (d) Imminent payoffs represent debt investments that the Company expects to be fully repaid within the next three months, prior to their scheduled maturity date.

| Investment Type - Level Three                    | Fair Value at March 31, 2015 | Valuation Techniques/         | Unobservable Input (a)                 | Range            | Weighted Average (e) |
|--|------------------------------|-------------------------------|--|------------------|----------------------|
| Equity and Warrant Investments                   | (in thousands)               | Methodologies                 | EBITDA Multiple (b)                    | 4.5x - 21.6x     | 8.8x                 |
| Equity Investments                               | \$ 12,500                    | Market Comparable Companies   | Revenue Multiple (b)                   | 0.8x - 3.8x      | 2.6x                 |
|  |                              |                               | Discount for Lack of Marketability (c) | 6.11% - 30.04%   | 15.93%               |
|  |                              |                               | Average Industry Volatility (d)        | 32.52% - 94.47%  | 66.80%               |
|  |                              |                               | Risk-Free Interest Rate                | 0.17% - 0.85%    | 0.24%                |
|  |                              |                               | Estimated Time to Exit (in months)     | 8 - 35           | 11                   |
|  | 18,956                       | Market Adjusted OPM Backsolve | Average Industry Volatility (d)        | 29.95% - 87.97%  | 66.97%               |
|  |                              |                               | Risk-Free Interest Rate                | 0.23% - 1.32%    | 0.61%                |
|  |                              |                               | Estimated Time to Exit (in months)     | 11 - 41          | 20                   |
| Warrant Investments                              | 10,760                       | Market Comparable Companies   | EBITDA Multiple (b)                    | 5.7x - 81.9x     | 20.6x                |
|  |                              |                               | Revenue Multiple (b)                   | 0.3x - 14.2x     | 4.0x                 |
|  |                              |                               | Discount for Lack of Marketability (c) | 12.85% - 36.52%  | 22.77%               |
|  |                              |                               | Average Industry Volatility (d)        | 43.78% - 75.78%  | 57.20%               |
|  |                              |                               | Risk-Free Interest Rate                | 0.17% - 1.10%    | 0.49%                |
|  |                              |                               | Estimated Time to Exit (in months)     | 8 - 47           | 21                   |
|  | 13,975                       | Market Adjusted OPM Backsolve | Average Industry Volatility (d)        | 29.95% - 105.34% | 68.29%               |
|  |                              |                               | Risk-Free Interest Rate                | 0.17% - 2.95%    | 0.78%                |
|  |                              |                               | Estimated Time to Exit (in months)     | 8 - 50           | 26                   |
| Total Level Three Warrant and Equity Investments | \$ 56,191                    |                               |  |                  |                      |

(a) The significant unobservable inputs used in the fair value measurement of the Company's warrant and equity-related securities are revenue and/or EBITDA multiples and discounts for lack of marketability. Additional inputs used in the Black Scholes Option Pricing Model ("OPM") include industry volatility, risk free interest rate and

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estimated time to exit. Significant increases (decreases) in the inputs in isolation would result in a significantly higher (lower) fair value measurement, depending on the materiality of the investment. For some investments, additional consideration may be given to data from the last round of financing or merger/acquisition events near the measurement date.

- (b) Represents amounts used when the Company has determined that market participants would use such multiples when pricing the investments.  
(c) Represents amounts used when the Company has determined market participants would take into account these discounts when pricing the investments.  
(d) Represents the range of industry volatility used by market participants when pricing the investment.  
(e) Weighted averages are calculated based on the fair market value of each investment.

| Investment Type - Level        | Fair Value at     |      | Valuation Techniques/         | Range                                  | Weighted Average (e) |
|--------------------------------|-------------------|------|-------------------------------|--|----------------------|
|                                | December 31, 2014 | 2014 |                               |  |                      |
| Equity and Warrant Investments | (in thousands)    |      | Methodologies                 | Unobservable Input (a)                 |                      |
| Equity Investments             | \$ 12,249         |      | Market Comparable Companies   | EBITDA Multiple (b)                    | 5.2x - 23.4x         |
|                                |                   |      |                               | Revenue Multiple (b)                   | 0.9x - 3.6x          |
|                                |                   |      |                               | Discount for Lack of Marketability (c) | 5.67% - 35.45%       |
|                                |                   |      |                               | Average Industry Volatility (d)        | 48.10% - 95.18%      |
|                                |                   |      |                               | Risk-Free Interest Rate                | 0.22% - 0.83%        |
|                                |                   |      |                               | Estimated Time to Exit (in months)     | 10 - 28              |
|                                | 46,686            |      | Market Adjusted OPM Backsolve | Average Industry Volatility (d)        | 38.95% - 84.30%      |
|                                |                   |      |                               | Risk-Free Interest Rate                | 0.10% - 1.32%        |
|                                |                   |      |                               | Estimated Time to Exit (in months)     | 6 - 43               |
| Warrant Investments            | 9,725             |      | Market Comparable Companies   | EBITDA Multiple (b)                    | 0.0x - 98.9x         |
|                                |                   |      |                               | Revenue Multiple (b)                   | 0.3x - 15.7x         |
|                                |                   |      |                               | Discount for Lack of Marketability (c) | 12.12% - 35.50%      |
|                                |                   |      |                               | Average Industry Volatility (d)        | 37.70% - 108.86%     |
|                                |                   |      |                               | Risk-Free Interest Rate                | 0.22% - 1.34%        |
|                                |                   |      |                               | Estimated Time to Exit (in months)     | 10 - 47              |
|                                | 12,198            |      | Market Adjusted OPM           | Average Industry Volatility (d)        | 32.85% - 99.81%      |

## Backsolve

|                                    |         |      |
|------------------------------------|---------|------|
|                                    | 0.21% - | 0.9% |
| Risk-Free Interest Rate            | 2.95%   |      |
| Estimated Time to Exit (in months) | 10 - 48 | 28   |

Total Level Three  
Warrant  
and Equity Investments

\$ 80,858

- (a) The significant unobservable inputs used in the fair value measurement of the Company's warrant and equity-related securities are revenue and/or EBITDA multiples and discounts for lack of marketability. Additional inputs used in the Black Scholes Option Pricing Model ("OPM") include industry volatility, risk free interest rate and estimated time to exit. Significant increases (decreases) in the inputs in isolation would result in a significantly higher (lower) fair value measurement, depending on the materiality of the investment. For some investments, additional consideration may be given to data from the last round of financing or merger/acquisition events near the measurement date.
- (b) Represents amounts used when the Company has determined that market participants would use such multiples when pricing the investments.
- (c) Represents amounts used when the Company has determined market participants would take into account these discounts when pricing the investments.
- (d) Represents the range of industry volatility used by market participants when pricing the investment.
- (e) Weighted averages are calculated based on the fair market value of each investment.

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## Debt Investments

The Company follows the guidance set forth in ASC 820 which establishes a framework for measuring the fair value of assets and liabilities and outlines a fair value hierarchy which prioritizes the inputs used to measure fair value and the effect of fair value measures on earnings. The Company's debt securities are primarily invested in venture capital-backed companies in technology-related industries, including technology, biotechnology, life science and energy and renewables technology. Given the nature of lending to these types of businesses, the Company's investments in these portfolio companies are considered Level 3 assets under ASC 820 because there is no known or accessible market or market indexes for debt instruments for these investment securities to be traded or exchanged.

In making a good faith determination of the value of the Company's investments, the Company generally starts with the cost basis of the investment, which includes the value attributed to the Original Issue Discount ("OID"), if any, and payment-in-kind ("PIK") interest or other receivables which have been accrued to principal as earned. The Company then applies the valuation methods as set forth below.

The Company applies a procedure for debt investments that assumes the sale of each investment in a hypothetical market to a hypothetical market participant where buyers and sellers are willing participants. The hypothetical market does not include scenarios where the underlying security was simply repaid or extinguished, but includes an exit concept. The Company determines the yield at inception for each debt investment. The Company then uses senior secured, leveraged loan yields provided by third party providers to determine the change in market yields between inception of the debt security and the measurement date. Industry specific indices are used to benchmark/assess market based movements.

Under this process, the Company also evaluates the collateral for recoverability of the debt investment. The Company considers each portfolio company's credit rating, security liens and other characteristics of the investment to adjust the baseline yield to derive a credit adjusted hypothetical yield for each investment as of the measurement date. The anticipated future cash flows from each investment are then discounted at the hypothetical yield to estimate each investment's fair value as of the measurement date.

The Company's process includes, among other things, the underlying investment performance, the current portfolio company's financial condition and market changing events that impact valuation, estimated remaining life, current market yield and interest rate spreads of similar securities as of the measurement date. The Company values its syndicated loans using broker quotes and bond indices amongst other factors. If there is a significant deterioration of the credit quality of a debt investment, the Company may consider other factors to estimate fair value, including the proceeds that would be received in a liquidation analysis.

The Company records unrealized depreciation on investments when it believes that an investment has decreased in value, including where collection of a loan is doubtful or, if under the in-exchange premise, when the value of a debt security is less than amortized cost of the investment. Conversely, where appropriate, the Company records unrealized appreciation if it believes that the underlying portfolio company has appreciated in value and, therefore, that its investment has also appreciated in value or, if under the in-exchange premise, the value of a debt security is greater than amortized cost.

When originating a debt instrument, the Company generally receives warrants or other equity-related securities from the borrower. The Company determines the cost basis of the warrants or other equity-related securities received based upon their respective fair values on the date of receipt in proportion to the total fair value of the debt and warrants or other equity-related securities received. Any resulting discount on the debt investments from recordation of the warrant or other equity instruments is accreted into interest income over the life of the debt investment.

#### Equity-Related Securities and Warrants

Securities that are traded in the over-the-counter markets or on a stock exchange will be valued at the prevailing bid price at period end. The Company has a limited number of equity securities in public companies. In accordance with the 1940 Act, unrestricted publicly traded securities for which market quotations are readily available are valued at the closing market quote on the measurement date.

The Company estimates the fair value of warrants using a Black Scholes Option Pricing Model (“OPM”). At each reporting date, privately held warrant and equity-related securities are valued based on an analysis of various factors including, but not limited to, the portfolio company’s operating performance and financial condition and general market conditions, price to enterprise value or price to equity ratios, discounted cash flow, valuation comparisons to comparable public companies or other industry benchmarks. When an external event occurs, such as a purchase transaction, public offering, or subsequent equity sale, the pricing indicated by that external event is utilized to corroborate the Company’s valuation of the warrant and equity-related securities. The Company periodically

reviews the valuation of its portfolio companies that have not been involved in a qualifying external event to determine if the enterprise value of the portfolio company may have increased or decreased since the last valuation measurement date.

Investments measured at fair value on a recurring basis are categorized in the tables below based upon the lowest level of significant input to the valuations as of March 31, 2015 (unaudited) and as of December 31, 2014. The Company transfers investments in and out of Level 1, 2 and 3 securities as of the beginning balance sheet date, based on changes in the use of observable and unobservable inputs utilized to perform the valuation for the period. During the three months ended March 31, 2015, there were no transfers between Levels 1 or 2.

|                     | Balance            | Quoted Prices In                              |   |   |
|---------------------|--------------------|---|---|---|
|                     |                    | Active Markets For Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| (in thousands)      | March 31, 2015     |   |   |   |
| Description         |                    |   |   |   |
| Senior secured debt | \$1,058,032        | \$—   | \$ —  | \$ 1,058,032                              |
| Preferred stock     | \$29,217           | —   | —   | 29,217                                    |
| Common stock        | \$43,234           | 40,995  | —   | 2,239                                     |
| Warrants            | \$30,938           | —   | 6,203   | 24,735                                    |
| <b>Total</b>        | <b>\$1,161,421</b> | <b>\$40,995</b>                               | <b>\$ 6,203</b>                               | <b>\$ 1,114,223</b>                       |

|                     | Balance            | Quoted Prices In                              |   |   |
|---------------------|--------------------|---|---|---|
|                     |                    | Active Markets For Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| (in thousands)      | December 31, 2014  |   |   |   |
| Description         |                    |   |   |   |
| Senior secured debt | \$923,906          | \$—   | \$ —  | \$ 923,906                                |
| Preferred stock     | \$57,548           | —   | —   | 57,548                                    |
| Common stock        | \$14,185           | 12,798  | —   | 1,387                                     |
| Warrants            | \$25,098           | —   | 3,175   | 21,923                                    |
| <b>Total</b>        | <b>\$1,020,737</b> | <b>\$12,798</b>                               | <b>\$ 3,175</b>                               | <b>\$ 1,004,764</b>                       |

The table below presents a reconciliation for all financial assets and liabilities measured at fair value on a recurring basis, excluding accrued interest components, using significant unobservable inputs (Level 3) for the three months ended March 31, 2015 (unaudited) and the year ended December 31, 2014.

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| (in thousands)  | Balance, January 1, 2015 | Net Realized (Losses) <sup>(1)</sup> | Net Change in   |                  |             | Repayments Sales <sup>(6)</sup> | Gross Transfers into Level 3 <sup>(3)</sup> | Gross Transfers out of Level 3 <sup>(3)</sup> | Balance, March 31, 2015 |
|-----------------|--------------------------|--------------------------------------|---|------------------|-------------|---------------------------------|---|---|-------------------------|
|                 |                          |                                      | Unrealized Appreciation (Depreciation) <sup>(2)</sup> | Purchases        |             |                                 |   |   |                         |
| Senior Debt     | \$923,906                | \$ —                                 | \$ 1,123  | \$207,819        | \$ —        | \$(74,816 )                     | \$ —  | \$ —  | \$1,058,032             |
| Preferred Stock | 57,548                   | —                                    | 2,328   | 355              | —           | —                               | 41  | (31,055 )                                     | 29,217                  |
| Common Stock    | 1,387                    | —                                    | 852   | —                | —           | —                               | —   | —   | 2,239                   |
| Warrants        | 21,923                   | (576 )                               | 1,456   | 2,152            | —           | —                               | —   | (220 )  | 24,735                  |
| <b>Total</b>    | <b>\$1,004,764</b>       | <b>\$ (576 )</b>                     | <b>\$ 5,759</b>                                       | <b>\$210,326</b> | <b>\$ —</b> | <b>\$(74,816 )</b>              | <b>\$ 41</b>                                | <b>\$ (31,275 )</b>                           | <b>\$1,114,223</b>      |

| (in thousands)  | Balance, January 1, 2014 | Net Realized (Losses) <sup>(1)</sup> | Net Change in   |                  |                  | Repayments Sales <sup>(6)</sup> | Gross Transfers into Level 3 <sup>(4)</sup> | Gross Transfers out of Level 3 <sup>(4)</sup> | Balance, December 31, 2014 |
|-----------------|--------------------------|--------------------------------------|---|------------------|------------------|---------------------------------|---|---|----------------------------|
|                 |                          |                                      | Unrealized Appreciation (Depreciation) <sup>(2)</sup> | Purchases        |                  |                                 |   |   |                            |
| Senior Debt     | \$821,988                | \$ —                                 | \$ (14,182 )  | \$615,596        | \$ —             | \$(497,258 )                    | \$ —  | \$(2,238 )                                    | \$923,906                  |
| Preferred Stock | 35,554                   | (750 )                               | 15,779  | 7,097            | (503 )           | —                               | 2,007                                       | (1,636 )                                      | 57,548                     |
| Common Stock    | 2,107                    | (130 )                               | 601   | —                | (1,189)          | —                               | —   | (2 )  | 1,387                      |
| Warrants        | 28,707                   | (48 )                                | (10,553 )   | 8,596            | (2,503)          | —                               | —   | (2,276 )                                      | 21,923                     |
| <b>Total</b>    | <b>\$888,356</b>         | <b>\$ (928 )</b>                     | <b>\$ (8,355 )</b>                                    | <b>\$631,289</b> | <b>\$(4,195)</b> | <b>\$(497,258 )</b>             | <b>\$ 2,007</b>                             | <b>\$ (6,152 )</b>                            | <b>\$1,004,764</b>         |

(1) Includes net realized gains (losses) recorded as realized gains or losses in the accompanying Consolidated Statement of Operations.

(2) Included in change in net unrealized appreciation (depreciation) in the accompanying Consolidated Statement of Operations.

(3) Transfers in/out of Level 3 during the three months ended March 31, 2015 relate to the exercise of warrants in Forescout, Inc. to equity and the initial public offerings of Box, Inc. and Zosano Pharma, Inc.

(4) Transfers in/out of Level 3 during the year ended December 31, 2014 relate to the conversion of Paratek Pharmaceuticals, Inc., SCI Energy, Inc., Oraya Therapeutics, Inc., and Neuralstem, Inc. debt to equity, the exercise of warrants in Box, Inc and WildTangent, Inc. to equity, the conversion of warrants in Glori Energy, Inc. to equity in the company's reverse public merger, the public merger of Paratek Pharmaceuticals, Inc. with Transcept Pharmaceuticals, Inc. and the initial public offerings of Concert Pharmaceuticals, Inc., Dicerna Pharmaceuticals, Inc., Everyday Health, Inc., Neothetics, Inc., Revance Therapeutics, Inc., and UniQure BV.



- (5) Amounts listed above are inclusive of loan origination fees received at the inception of the loan which are deferred and amortized into fee income as well as the accretion of existing loan discounts and fees during the period.
- (6) Amounts listed above include the acceleration and payment of loan discounts and loan fees due to early payoffs or restructures.

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For the three months ended March 31, 2015, approximately \$2.3 million and \$852,000 in net unrealized appreciation was recorded for preferred stock and common stock Level 3 investments, respectively, relating to assets still held at the reporting date. For the same period, approximately \$704,000 and \$924,000 in net unrealized appreciation was recorded for debt and warrant Level 3 investments, respectively, relating to assets still held at the reporting date.

For the year ended December 31, 2014, approximately \$15.0 million and \$555,000 in net unrealized appreciation was recorded for preferred stock and common stock Level 3 investments, respectively, relating to assets still held at the reporting date. For the same period, approximately \$14.2 million and \$2.8 million in net unrealized depreciation was recorded for debt and warrant Level 3 investments, respectively, relating to assets still held at the reporting date.

As required by the 1940 Act, the Company classifies its investments by level of control. "Control investments" are defined in the 1940 Act as investments in those companies that the Company is deemed to "control". Generally, under the 1940 Act, the Company is deemed to "control" a company in which it has invested if it owns 25% or more of the voting securities of such company or has greater than 50% representation on its board. "Affiliate investments" are investments in those companies that are "affiliated companies" of the Company, as defined in the 1940 Act, which are not control investments. The Company is deemed to be an "affiliate" of a company in which it has invested if it owns 5% or more but less than 25% of the voting securities of such company. "Non-control/non-affiliate investments" are investments that are neither control investments nor affiliate investments.

The following table summarizes the Company's realized and unrealized gain and loss and changes in our unrealized appreciation and depreciation on affiliate investments for the three months ended March 31, 2015 and 2014 (unaudited). The Company did not hold any Control investments at either March 31, 2015 or 2014.

| (in thousands)             |           | For the Three Months Ended March 31, 2015 |                            |              |                 |  |             |
|----------------------------|-----------|---|----------------------------|--------------|-----------------|--|-------------|
|                            |           | Fair Value at                             | Unrealized                 |              | Reversal of     |  | Realized    |
|                            |           | March 31,                                 | Investment (Depreciation)/ |              | (Depreciation)/ |  | Gain/(Loss) |
| Portfolio Company          | Type      | 2015                                      | Income                     | Appreciation | Appreciation    |  |             |
| Gelesis, Inc.              | Affiliate | \$ 2,414                                  | \$ —                       | \$ 2,087     | \$ —            |  | \$ —        |
| Optiscan BioMedical, Corp. | Affiliate | 6,768                                     | —                          | 695          | —               |  | —           |
| Stion Corporation          | Affiliate | 1,600                                     | 101                        | (469)        | —               |  | —           |
| Total                      |           | \$ 10,782                                 | \$ 101                     | \$ 2,313     | \$ —            |  | \$ —        |

| (in thousands)    |      | For the Three Months Ended March 31, 2014 |                            |              |                 |  |             |
|-------------------|------|---|----------------------------|--------------|-----------------|--|-------------|
|                   |      | Fair Value at                             | Unrealized                 |              | Reversal of     |  | Realized    |
|                   |      | March 31,                                 | Investment (Depreciation)/ |              | (Depreciation)/ |  | Gain/(Loss) |
| Portfolio Company | Type | 2014                                      | Income                     | Appreciation | Appreciation    |  |             |

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|                            |           |           |         |        |    |   |    |   |
|----------------------------|-----------|-----------|---------|--------|----|---|----|---|
| Gelesis, Inc.              | Affiliate | \$ 497    | \$—     | \$ 24  | \$ | — | \$ | — |
| Optiscan BioMedical, Corp. | Affiliate | 5,032     | —       | 247    |    | — |    | — |
| Stion Corporation          | Affiliate | 5,664     | 1,475   | (224 ) |    | — |    | — |
| Total                      |           | \$ 11,193 | \$1,475 | \$ 47  | \$ | — | \$ | — |

A summary of the composition of the Company's investment portfolio as of March 31, 2015 (unaudited) and December 31, 2014 at fair value is shown as follows:

|                                   | March 31, 2015    |                     | December 31, 2014 |                     |   |
|-----------------------------------|-------------------|---------------------|-------------------|---------------------|---|
|                                   | Investments<br>at | Percentage of Total | Investments<br>at | Percentage of Total |   |
| (in thousands)                    | Fair Value        | Portfolio           | Fair Value        | Portfolio           |   |
| Senior secured debt with warrants | \$878,830         | 75.7                | % \$740,659       | 72.6                | % |
| Senior secured debt               | 210,140           | 18.1                | % 208,345         | 20.4                | % |
| Preferred stock                   | 29,217            | 2.5                 | % 57,548          | 5.6                 | % |
| Common stock                      | 43,234            | 3.7                 | % 14,185          | 1.4                 | % |
| Total                             | \$1,161,421       | 100.0               | % \$1,020,737     | 100.0               | % |

The increase in common stock and the decrease in preferred stock is primarily due to the initial public offering of Box, Inc. on January 23, 2015 in which all of our preferred shares were converted to common stock in the public portfolio company. The shares held by the Company in Box, Inc. are subject to a customary IPO lockup period and the Company is restricted from selling these shares of common stock for approximately six months from the date of the initial public offering. The Company's potential gain is subject to the price of the shares when the Company exits the investment.

A summary of the Company's investment portfolio, at value, by geographic location as of March 31, 2015 (unaudited) and December 31, 2014 is shown as follows:

|                | March 31, 2015     |                     | December 31, 2014  |                     |  |
|----------------|--------------------|---------------------|--------------------|---------------------|--|
|                | Investments at     | Percentage of Total | Investments at     | Percentage of Total |  |
| (in thousands) | Fair Value         | Portfolio           | Fair Value         | Portfolio           |  |
| United States  | \$1,100,701        | 94.8 %              | \$967,803          | 94.8 %              |  |
| India          | 29,645             | 2.5 %               | 24,175             | 2.4 %               |  |
| Netherlands    | 20,629             | 1.8 %               | 19,913             | 2.0 %               |  |
| Israel         | 8,032              | 0.7 %               | 6,498              | 0.6 %               |  |
| Canada         | 2,343              | 0.2 %               | 2,314              | 0.2 %               |  |
| England        | 71                 | —                   | 34                 | —                   |  |
| <b>Total</b>   | <b>\$1,161,421</b> | <b>100.0 %</b>      | <b>\$1,020,737</b> | <b>100.0 %</b>      |  |

The following table shows the fair value of the Company's portfolio by industry sector at March 31, 2015 (unaudited) and December 31, 2014:

|                                       | March 31, 2015 |                     | December 31, 2014 |                     |  |
|---------------------------------------|----------------|---------------------|-------------------|---------------------|--|
|                                       | Investments at | Percentage of Total | Investments at    | Percentage of Total |  |
| (in thousands)                        | Fair Value     | Portfolio           | Fair Value        | Portfolio           |  |
| Drug Discovery & Development          | \$299,133      | 25.8 %              | \$267,618         | 26.2 %              |  |
| Software                              | 156,179        | 13.4 %              | 125,412           | 12.3 %              |  |
| Drug Delivery                         | 140,725        | 12.1 %              | 88,491            | 8.7 %               |  |
| Medical Devices & Equipment           | 135,285        | 11.6 %              | 138,046           | 13.5 %              |  |
| Energy Technology                     | 107,283        | 9.2 %               | 68,280            | 6.7 %               |  |
| Internet Consumer & Business Services | 87,374         | 7.5 %               | 69,655            | 6.8 %               |  |
| Consumer & Business Products          | 63,737         | 5.5 %               | 63,225            | 6.2 %               |  |
| Specialty Pharmaceuticals             | 50,583         | 4.4 %               | 51,536            | 5.0 %               |  |
| Communications & Networking           | 37,362         | 3.2 %               | 61,433            | 6.0 %               |  |
| Information Services                  | 32,244         | 2.8 %               | 27,016            | 2.6 %               |  |
| Media/Content/Info                    | 27,412         | 2.4 %               | 29,219            | 2.9 %               |  |
| Surgical Devices                      | 9,674          | 0.8 %               | 9,915             | 1.0 %               |  |

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|                                 |              |       |   |              |       |   |
|---------------------------------|--------------|-------|---|--------------|-------|---|
| Healthcare Services, Other      | 7,657        | 0.7   | % | 10,527       | 1.0   | % |
| Semiconductors                  | 5,076        | 0.4   | % | 5,126        | 0.5   | % |
| Biotechnology Tools             | 960          | 0.1   | % | 3,721        | 0.4   | % |
| Diagnostic                      | 671          | 0.1   | % | 825          | 0.1   | % |
| Electronics & Computer Hardware | 66           | 0.0   | % | 692          | 0.1   | % |
| Total                           | \$ 1,161,421 | 100.0 | % | \$ 1,020,737 | 100.0 | % |

During the three months ended March 31, 2015, the Company funded and or restructured investments in debt securities totaling approximately \$207.0 million. During the three months ended March 31, 2015, the Company funded equity investments totaling approximately \$2.4 million.

During the three-months ended March 31, 2014, the Company funded investments in debt securities and equity investments totaling approximately \$110.4 million and \$1.5 million, respectively. The Company converted approximately \$2.0 million of warrants to equity in three portfolio companies during the three-months ended March 31, 2014.

No single portfolio investment represents more than 10% of the fair value of the investments as of March 31, 2015 and December 31, 2014.

During the three months ended March 31, 2015, the Company recognized net realized gains of approximately \$3.3 million. During the three months ended March 31, 2015, the Company recorded gross realized gains of approximately \$4.3 million primarily from the sale of investments in four portfolio companies, including Cempra, Inc. (\$2.0 million), Celladon Corporation (\$1.4 million), Everyday Health, Inc. (\$387,000) and Identiv, Inc. (\$304,000). These gains were partially offset by gross realized losses of approximately \$1.0 million from the liquidation of the Company's investments in three portfolio companies.

During the three-month period ended March 31, 2014, the Company recognized gross realized gains of approximately \$5.4 million primarily from the sale of investments in five portfolio companies, including CTI BioPharma Corp. (\$1.3 million), Neuralstem, Inc. (\$1.2 million), Portola Pharmaceuticals, Inc. (\$700,000), AcclRx Pharmaceuticals, Inc. (\$485,000) and Dicerna Pharmaceuticals, Inc. (\$200,000). These gains were partially offset by gross realized losses of approximately \$500,000 from the liquidation of the Company's warrant and equity investments in five portfolio companies.

Loan origination and commitment fees received in full at the inception of a loan are deferred and amortized into fee income as an enhancement to the related loan's yield over the contractual life of the loan. Loan exit fees to be paid at the termination of the loan are accreted into interest income over the contractual life of the loan. The Company had approximately \$5.5 million and \$4.5 million of unamortized fees at March 31, 2015 and December 31, 2014, respectively, and approximately \$17.8 million and \$19.3 million in exit fees receivable at March 31, 2015 and December 31, 2014, respectively.

The Company has debt investments in its portfolio that contain a PIK provision. The PIK interest, computed at the contractual rate specified in each loan agreement, is added to the principal balance of the loan and recorded as interest income. To maintain the Company's status as a RIC, this non-cash source of income must be paid out to stockholders in the form of dividends even though the Company has not yet collected the cash. Amounts necessary to pay these dividends may come from available cash or the liquidation of certain investments. The Company recorded approximately \$907,000 and \$852,000 in PIK income during the three months ended March 31, 2015 and 2014, respectively.

In certain investment transactions, the Company may provide advisory services. For services that are separately identifiable and external evidence exists to substantiate fair value, income is recognized as earned, which is generally when the investment transaction closes. The Company had no income from advisory services in either the three months ended March 31, 2015 or 2014.

In the majority of cases, the Company collateralizes its investments by obtaining a first priority security interest in a portfolio company's assets, which may include its intellectual property. In other cases, the Company may obtain a negative pledge covering a company's intellectual property. At March 31, 2015, approximately 48.1% of the Company's portfolio company debt investments were secured by a first priority security in all of the assets of the portfolio company, including their intellectual property, and 51.9% of the Company's portfolio company debt investments were to portfolio companies that were prohibited from pledging or encumbering their intellectual property, or subject to a negative pledge. At March 31, 2015 the Company had no equipment only liens on any of our portfolio companies.

### 3. Fair Value of Financial Instruments

Fair value estimates are made at discrete points in time based on relevant information. These estimates may be subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined

with precision. The Company believes that the carrying amounts of its financial instruments, consisting of cash and cash equivalents, receivables, accounts payable and accrued liabilities, approximate the fair values of such items due to the short maturity of such instruments. The Convertible Senior Notes, the April 2019 Notes, the September 2019 Notes (together with the April 2019 Notes, the “2019 Notes”), the 2024 Notes, the 2017 Asset-Backed Notes, the 2021 Asset-Backed Notes and the SBA debentures, as each term is defined herein, as sources of liquidity remain a strategic advantage due to their flexible structure, long-term duration, and low fixed interest rates. At March 31, 2015, the April 2019 Notes were trading on the New York Stock Exchange for 25.45 per dollar at par value, the September 2019 Notes were trading on the New York Stock Exchange for 25.51 per dollar at par value and the 2024 Notes were trading on the New York Stock Exchange for 25.15 per dollar at par value. Based on market quotations on or around March 31, 2015, the Convertible Senior Notes were trading for 1.2150 per dollar at par value, the 2017 Asset-Backed Notes were trading for 1.0000 per dollar at par value and the 2021 Asset-Backed Notes were trading for 0.9997 per dollar at par value. Calculated based on the net present value of payments over the term of the notes using estimated market rates for similar notes and remaining terms, the fair value of the SBA debentures would be approximately \$196.7 million, compared to the carrying amount of \$190.2 million as of March 31, 2015.

See the accompanying Consolidated Schedule of Investments for the fair value of the Company’s investments. The methodology for the determination of the fair value of the Company’s investments is discussed in Note 2.

The liabilities of the Company below are recorded at amortized cost and not at fair value on the Consolidated Statement of Assets and Liabilities. The following table provides additional information about the level in the fair value hierarchy of the Company's liabilities at March 31, 2015 (unaudited) and December 31, 2014:

| (in thousands)           | March     | Unobservable               |                             |                  |
|--------------------------|-----------|----------------------------|-----------------------------|------------------|
|                          |           | Identical Assets (Level 1) | Observable Inputs (Level 2) | Inputs (Level 3) |
| Description              | 31, 2015  |                            |                             |                  |
| Convertible Senior Notes | \$21,435  | \$ —                       | \$ 21,435                   | \$ —             |
| 2017 Asset-Backed Notes  | 4,203     | —                          | 4,203                       | —                |
| 2021 Asset-Backed Notes  | 129,260   | —                          | 129,260                     | —                |
| April 2019 Notes         | 86,011    | —                          | 86,011                      | —                |
| September 2019 Notes     | 87,626    | —                          | 87,626                      | —                |
| 2024 Notes               | 103,618   | —                          | 103,618                     | —                |
| SBA Debentures           | 196,681   | —                          | —                           | 196,681          |
| Total                    | \$628,834 | \$ —                       | \$ 432,153                  | \$ 196,681       |

| (in thousands)           | December  | Unobservable               |                             |                  |
|--------------------------|-----------|----------------------------|-----------------------------|------------------|
|                          |           | Identical Assets (Level 1) | Observable Inputs (Level 2) | Inputs (Level 3) |
| Description              | 31, 2014  |                            |                             |                  |
| Convertible Senior Notes | \$22,799  | \$ —                       | \$ 22,799                   | \$ —             |
| 2017 Asset-Backed Notes  | 22,068    | —                          | —                           | 22,068           |
| 2021 Asset-Backed Notes  | 129,300   | —                          | 129,300                     | —                |
| April 2019 Notes         | 86,450    | —                          | 86,450                      | —                |
| September 2019 Notes     | 88,073    | —                          | 88,073                      | —                |
| 2024 Notes               | 104,071   | —                          | 104,071                     | —                |
| SBA Debentures           | 191,779   | —                          | —                           | 191,779          |
| Total                    | \$644,540 | \$ —                       | \$ 430,693                  | \$ 213,847       |

The 2017 Asset-Backed Notes transferred from Level 3 to Level 2 as of March 31, 2015 due to the rapid amortization event triggered in February 2015, as the assets are now expected to be repaid at par within one year. See "Subsequent Events."

#### 4. Borrowings Long Term

##### Outstanding Borrowings

At March 31, 2015 (unaudited) and December 31, 2014, the Company had the following available borrowings and outstanding borrowings:



| (in thousands)                          | March 31, 2015   |                               | December 31, 2014 |                               |
|---|------------------|-------------------------------|-------------------|-------------------------------|
|   | Total Available  | Carrying Value <sup>(1)</sup> | Total Available   | Carrying Value <sup>(1)</sup> |
| SBA Debentures <sup>(2)</sup>           | \$190,200        | \$190,200                     | \$190,200         | \$190,200                     |
| 2019 Notes                              | 170,364          | 170,364                       | 170,364           | 170,364                       |
| 2024 Notes                              | 103,000          | 103,000                       | 103,000           | 103,000                       |
| 2017 Asset-Backed Notes                 | 4,203            | 4,203                         | 16,049            | 16,049                        |
| 2021 Asset-Backed Notes                 | 129,300          | 129,300                       | 129,300           | 129,300                       |
| Convertible Senior Notes <sup>(3)</sup> | 17,642           | 17,375                        | 17,674            | 17,345                        |
| Wells Facility <sup>(4)</sup>           | 75,000           | —                             | 75,000            | —                             |
| Union Bank Facility <sup>(4)</sup>      | 75,000           | —                             | 75,000            | —                             |
| <b>Total</b>                            | <b>\$764,709</b> | <b>\$614,442</b>              | <b>\$776,587</b>  | <b>\$626,258</b>              |

- (1) Except for the Convertible Senior Notes, all carrying values are the same as the principal amount outstanding.
- (2) At both March 31, 2015 and December 31, 2014, the total available borrowings under the SBA debentures were \$190.2 million, of which \$41.2 million was available in HT II and \$149.0 million was available in HT III.
- (3) During the three months ended March 31, 2015, holders of approximately \$32,000 of the Company's Convertible Senior Notes have exercised their conversion rights. The balance at March 31, 2015 represents the remaining aggregate principal amount outstanding of the Convertible Senior Notes less the unaccreted discount initially recorded upon issuance of the Convertible Senior Notes. The total unaccreted discount for the Convertible Senior Notes was approximately \$267,000 at March 31, 2015 and \$329,000 at December 31, 2014.
- (4) Availability subject to the Company meeting the borrowing base requirements.

### Long-Term SBA Debentures

On September 27, 2006, HT II received a license to operate as a SBIC under the SBIC program and is able to borrow funds from the SBA against eligible investments and regulatory capital. Under the Small Business Investment Company Act and current SBA policy applicable to SBICs, a SBIC can have outstanding at any time SBA guaranteed debentures up to twice the amount of its regulatory capital. With the Company's net investment of \$38.0 million in HT II as of March 31, 2015, HT II has the capacity to issue a total of \$41.2 million of SBA guaranteed debentures, subject to SBA approval, of which \$41.2 million was available at March 31, 2015. As of March 31, 2015, HT II has paid the SBA commitment fees and facility fees of approximately \$1.5 million and \$3.6 million, respectively. As of March 31, 2015 the Company held investments in HT II in 37 companies with a fair value of approximately \$111.2 million, accounting for approximately 9.6% of the Company's total portfolio at March 31, 2015.

On May 26, 2010, HT III received a license to operate as a SBIC under the SBIC program and is able to borrow funds from the SBA against eligible investments and additional contributions to regulatory capital. With the Company's net investment of \$74.5 million in HT III as of March 31, 2015, HT III has the capacity to issue a total of \$149.0 million of SBA guaranteed debentures, of which \$149.0 million was outstanding as of March 31, 2015. As of March 31, 2015, HT III has paid commitment fees and facility fees of approximately \$1.5 million and \$3.6 million, respectively. As of March 31, 2015, the Company held investments in HT III in 42 companies with a fair value of approximately \$288.4 million, accounting for approximately 24.8% of the Company's total portfolio at March 31, 2015.

SBICs are designed to stimulate the flow of private equity capital to eligible small businesses. Under present SBA regulations, eligible small businesses include businesses that have a tangible net worth not exceeding \$19.5 million and have average annual fully taxed net income not exceeding \$6.5 million for the two most recent fiscal years. In addition, SBICs must devote 25.0% of its investment activity to "smaller" enterprises as defined by the SBA. A smaller enterprise is one that has a tangible net worth not exceeding \$6.0 million and has average annual fully taxed net income not exceeding \$2.0 million for the two most recent fiscal years. SBA regulations also provide alternative size standard criteria to determine eligibility, which depend on the industry in which the business is engaged and are based on such factors as the number of employees and gross sales. According to SBA regulations, SBICs may make long-term loans to small businesses, invest in the equity securities of such businesses and provide them with consulting and advisory services. Through the Company's wholly-owned subsidiaries HT II and HT III, the Company plans to provide long-term loans to qualifying small businesses, and in connection therewith, make equity investments.

HT II and HT III are periodically examined and audited by the SBA's staff to determine their compliance with SBA regulations. If HT II or HT III fails to comply with applicable SBA regulations, the SBA could, depending on the severity of the violation, limit or prohibit HT II's or HT III's use of debentures, declare outstanding debentures immediately due and payable, and/or limit HT II or HT III from making new investments. In addition, HT II or HT III may also be limited in their ability to make distributions to the Company if they do not have sufficient capital in accordance with SBA regulations. Such actions by the SBA would, in turn, negatively affect the Company because HT II and HT III are the Company's wholly owned subsidiaries. HT II and HT III were in compliance with the terms of the SBIC's leverage as of March 31, 2015 as a result of having sufficient capital as defined under the SBA regulations.

The rates of borrowings under various draws from the SBA beginning in March 2009 are set semiannually in March and September and range from 2.25% to 4.62%. Interest payments on SBA debentures are payable semiannually. There are no principal payments required on these issues prior to maturity and no prepayment penalties. Debentures under the SBA generally mature ten years after being borrowed. Based on the initial draw down date of March 2009, the initial maturity of SBA debentures will occur in March 2019. In addition, the SBA charges a fee that is set annually, depending on the Federal fiscal year the leverage commitment was delegated by the SBA, regardless of the

date that the leverage was drawn by the SBIC. The annual fees related to HT II debentures that pooled on September 22, 2010 were 0.406% and 0.285%, depending upon the year in which the underlying commitment was closed. The annual fees on other debentures have been set at 0.906%. The annual fees related to HT III debentures that pooled on March 27, 2013 were 0.804%. The annual fees on other debentures have been set at 0.515%. The rates of borrowings on the Company's SBA debentures range from 3.05% to 5.53% when including these annual fees.

The average amount of debentures outstanding for the three months ended March 31, 2015 for HT II was approximately \$41.2 million with an average interest rate of approximately 4.46%. The average amount of debentures outstanding for the three months ended March 31, 2015 for HT III was approximately \$149.0 million with an average interest rate of approximately 3.38%.

As of March 31, 2015, the maximum statutory limit on the dollar amount of combined outstanding SBA guaranteed debentures is \$225.0 million, subject to periodic adjustments by the SBA. In aggregate, at March 31, 2015, with the Company's net investment of \$112.5 million, HT II and HT III have the capacity to issue a total of \$190.2 million of SBA-guaranteed debentures, subject to SBA approval. At March 31, 2015, the Company has issued \$190.2 million in SBA-guaranteed debentures in the Company's SBIC subsidiaries.

The Company reported the following SBA debentures outstanding as of March 31, 2015 (unaudited) and December 31, 2014:

(in thousands)

| Issuance/Pooling Date | Maturity Date     | Interest Rate <sup>(1)</sup> | March 31, 2015 | December 31, 2014 |
|-----------------------|-------------------|------------------------------|----------------|-------------------|
|                       |                   |                              |                |                   |
| SBA Debentures:       |                   |                              |                |                   |
| March 25, 2009        | March 1, 2019     | 5.53%                        | \$ 18,400      | \$ 18,400         |
| September 23, 2009    | September 1, 2019 | 4.64%                        | 3,400          | 3,400             |
| September 22, 2010    | September 1, 2020 | 3.62%                        | 6,500          | 6,500             |
| September 22, 2010    | September 1, 2020 | 3.50%                        | 22,900         | 22,900            |
| March 29, 2011        | March 1, 2021     | 4.37%                        | 28,750         | 28,750            |
| September 21, 2011    | September 1, 2021 | 3.16%                        | 25,000         | 25,000            |
| March 21, 2012        | March 1, 2022     | 3.28%                        | 25,000         | 25,000            |
| March 21, 2012        | March 1, 2022     | 3.05%                        | 11,250         | 11,250            |
| September 19, 2012    | September 1, 2022 | 3.05%                        | 24,250         | 24,250            |
| March 27, 2013        | March 1, 2023     | 3.16%                        | 24,750         | 24,750            |
| Total SBA Debentures  |                   |                              | \$ 190,200     | \$ 190,200        |

(1) Interest rate includes annual charge  
2019 Notes

On March 6, 2012, the Company and U.S. Bank National Association (the “2019 Trustee”) entered into an indenture (the “Base Indenture”). On April 17, 2012, the Company and the 2019 Trustee entered into the First Supplemental Indenture to the Base Indenture (the “First Supplemental Indenture”), dated April 17, 2012, relating to the Company’s issuance, offer and sale of \$43.0 million aggregate principal amount of 7.00% senior notes due 2019 (the “April 2019 Notes”). The sale of the April 2019 Notes generated net proceeds, before expenses, of approximately \$41.7 million.

In July 2012, the Company reopened the Company’s April 2019 Notes and issued an additional \$41.5 million in aggregate principal amount of April 2019 Notes, which included the exercise of an over-allotment option, bringing the total amount of the April 2019 Notes issued to approximately \$84.5 million in aggregate principal amount.

On September 24, 2012, the Company and the 2019 Trustee, entered into the Second Supplemental Indenture to the Base Indenture (the “Second Supplemental Indenture”), dated as of September 24, 2012, relating to the Company’s issuance, offer and sale of \$75.0 million aggregate principal amount of 7.00% senior notes due 2019 (the “September 2019 Notes” and, together with the April 2019 Notes, the “2019 Notes”). The sale of the September 2019 Notes generated net proceeds, before expenses, of approximately \$72.75 million.

In October 2012, the underwriters exercised their over-allotment option for an additional \$10.9 million of the September 2019 Notes, bringing the total amount of the September 2019 Notes issued to approximately \$85.9 million in aggregate principal outstanding.

As of March 31, 2015 (unaudited) and December 31, 2014, the 2019 Notes payable is comprised of:

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| (in thousands)               | March 31, 2015 | December 31, 2014 |
|------------------------------|----------------|-------------------|
| April 2019 Notes             | \$ 84,490      | \$ 84,490         |
| September 2019 Notes         | 85,874         | 85,874            |
| Carrying Value of 2019 Notes | \$ 170,364     | \$ 170,364        |

April 2019 Notes

The April 2019 Notes will mature on April 30, 2019 and may be redeemed in whole or in part at the Company's option at any time or from time to time on or after April 30, 2015, upon not less than 30 days nor more than 60 days written notice by mail prior to the date fixed for redemption thereof, at a redemption price of 100% of the outstanding principal amount thereof plus accrued and unpaid interest payments otherwise payable for the then-current quarterly interest period accrued to but not including the date fixed for redemption. The April 2019 Notes bear interest at a rate of 7.00% per year payable quarterly on January 30, April 30, July 30 and October 30 of each year, commencing on July 30, 2012, and trade on the New York Stock Exchange under the trading symbol "HTGZ."

The April 2019 Notes are the Company's direct unsecured obligations and rank: (i) pari passu with the Company's other outstanding and future senior unsecured indebtedness; (ii) senior to any of the Company's future indebtedness that expressly provides it is subordinated to the April 2019 Notes; (iii) effectively subordinated to all the Company's existing and future secured indebtedness (including indebtedness that is initially unsecured to which the Company subsequently grant security), to the extent of the value of the assets securing such indebtedness; (iv) structurally subordinated to all existing and future indebtedness and other obligations of any of the Company's subsidiaries.

The Base Indenture, as supplemented by the First Supplemental Indenture, contains certain covenants including covenants requiring the Company's compliance with (regardless of whether it is subject to) the asset coverage requirements set forth in Section 18(a)(1)(A) as modified by Section 61(a)(1) of the 1940 Act to comply with the restrictions on dividends, distributions and purchase of capital stock set forth in Section 18(a)(1)(B) as modified by Section 61(a)(1) of the 1940 Act and to provide financial information to the holders of the April 2019 Notes and the 2019 Trustee if the Company should no longer be subject to the reporting requirements under the Securities Exchange Act of 1934. These covenants are subject to important limitations and exceptions that are described in the Base Indenture, as supplemented by the First Supplemental Indenture. The Base Indenture provides for customary events of default and further provides that the 2019 Trustee or the holders of 25% in aggregate principal amount of the outstanding April 2019 Notes in a series may declare such April 2019 Notes immediately due and payable upon the occurrence of any event of default after expiration of any applicable grace period.

The April 2019 Notes were sold pursuant to an underwriting agreement dated April 11, 2012 among the Company and Stifel, Nicolaus & Company, Incorporated, as representative of the several underwriters named in the underwriting agreement.

#### September 2019 Notes

The September 2019 Notes will mature on September 30, 2019 and may be redeemed in whole or in part at the Company's option at any time or from time to time on or after September 30, 2015, upon not less than 30 days nor more than 60 days written notice by mail prior to the date fixed for redemption thereof, at a redemption price of 100% of the outstanding principal amount thereof plus accrued and unpaid interest payments otherwise payable for the then-current quarterly interest period accrued to but not including the date fixed for redemption. The September 2019 Notes bear interest at a rate of 7.00% per year payable quarterly on March 30, June 30, September 30 and December 30 of each year, commencing on December 30, 2012, and trade on the New York Stock Exchange under the trading symbol "HTGY."

The September 2019 Notes are the Company's direct unsecured obligations and rank: (i) pari passu with the Company's other outstanding and future senior unsecured indebtedness; (ii) senior to any of the Company's future indebtedness that expressly provides it is subordinated to the September 2019 Notes; (iii) effectively subordinated to all the Company's existing and future secured indebtedness (including indebtedness that is initially unsecured to which the Company subsequently grants security), to the extent of the value of the assets securing such indebtedness; (iv) structurally subordinated to all existing and future indebtedness and other obligations of any of the Company's subsidiaries.

The Base Indenture, as supplemented by the Second Supplemental Indenture, contains certain covenants including covenants requiring the Company to comply with (regardless of whether it is subject to) the asset coverage requirements set forth in Section 18 (a)(1)(A) as modified by Section 61(a)(1) of the 1940 Act to comply with the restrictions on dividends, distributions and purchase of capital stock set forth in Section 18(a)(1)(B) as modified by Section 61(a)(1) of the 1940 Act and to provide financial information to the holders of the September 2019 Notes and the 2019 Trustee if the Company should no longer be subject to the reporting requirements under the Securities Exchange Act of 1934. These covenants are subject to important limitations and exceptions that are described in the

Base Indenture, as supplemented by the Second Supplemental Indenture. The Base Indenture provides for customary events of default and further provides that the Trustee or the holders of 25% in aggregate principal amount of the outstanding September 2019 Notes in a series may declare such September 2019 Notes immediately due and payable upon the occurrence of any event of default after expiration of any applicable grace period.

The September 2019 Notes were sold pursuant to an underwriting agreement dated September 19, 2012 among the Company and Stifel, Nicolaus & Company, Incorporated, as representative of the several underwriters named in the underwriting agreement.

For the three months ended March 31, 2015 and 2014 (unaudited), the components of interest expense and related fees and cash paid for interest expense for the April 2019 Notes and September 2019 Notes are as follows:

| (in thousands)                          | Three Months<br>Ended March<br>31, |         |
|---|------------------------------------|---------|
|   | 2015                               | 2014    |
| Stated interest expense                 | \$2,981                            | \$2,981 |
| Amortization of debt issuance cost      | 240                                | 240     |
| Total interest expense and fees         | \$3,221                            | \$3,221 |
| Cash paid for interest expense and fees | \$2,981                            | \$2,981 |

As of March 31, 2015, the Company was in compliance with the terms of the Base Indenture, and respective supplemental indentures thereto, governing the April 2019 Notes and September 2019 Notes. See “Subsequent Events.”

#### 2024 Notes

On July 14, 2014, the Company and U.S. Bank, N.A. (the “2024 Trustee”), entered into the Third Supplemental Indenture (the “Third Supplemental Indenture”) to the Base Indenture between the Company and the 2024 Trustee, dated July 14, 2014, relating to the Company’s issuance, offer and sale of \$100.0 million aggregate principal amount of 2024 Notes. On August 6, 2014, the underwriters issued notification to exercise their over-allotment option for an additional \$3.0 million in aggregate principal amount of the 2024 Notes. The sale of the 2024 Notes generated net proceeds of approximately \$99.9 million.

The 2024 Notes will mature on July 30, 2024 and may be redeemed in whole or in part at the Company’s option at any time or from time to time on or after July 30, 2017, upon not less than 30 days nor more than 60 days written notice by mail prior to the date fixed for redemption thereof, at a redemption price of 100% of the outstanding principal amount thereof plus accrued and unpaid interest payments otherwise payable for the then-current quarterly interest period accrued to but not including the date fixed for redemption. The 2024 Notes bear interest at a rate of 6.25% per year payable quarterly on January 30, April 30, July 30 and October 30 of each year, commencing on July 30, 2014, and trade on the New York Stock Exchange under the trading symbol “HTGX.”

The 2024 Notes will be the Company’s direct unsecured obligations and will rank: (i) pari passu with the Company’s other outstanding and future senior unsecured indebtedness; (ii) senior to any of the Company’s future indebtedness that expressly provides it is subordinated to the 2024 Notes; (iii) effectively subordinated to all the Company’s existing and future secured indebtedness (including indebtedness that is initially unsecured to which the Company subsequently grants security), to the extent of the value of the assets securing such indebtedness; (iv) structurally subordinated to all existing and future indebtedness and other obligations of any of the Company’s subsidiaries.

The Base Indenture, as supplemented by the Third Supplemental Indenture, contains certain covenants including covenants requiring the Company to comply with (regardless of whether it is subject to) the asset coverage requirements set forth in Section 18(a)(1)(A) as modified by Section 61(a)(1) of the 1940 Act and to comply with the restrictions on dividends, distributions and purchase of capital stock set forth in Section 18(a)(1)(B) as modified by Section 61(a)(1) of the 1940 Act. These covenants are subject to important limitations and exceptions that are described in the Base Indenture, as supplemented by the Third Supplemental Indenture. The Base Indenture, as supplemented by the Third Supplemental Indenture, also contains certain reporting requirements, including a



requirement that the Company provide financial information to the holders of the 2024 Notes and the 2024 Trustee if the Company should no longer be subject to the reporting requirements under the Securities Exchange Act of 1934. The Base Indenture provides for customary events of default and further provides that the 2024 Trustee or the holders of 25% in aggregate principal amount of the outstanding 2024 Notes in a series may declare such 2024 Notes immediately due and payable upon the occurrence of any event of default after expiration of any applicable grace period. As of March 31, 2015, the Company was in compliance with the terms of the Base Indenture as supplemented by the Third Supplemental Indenture.

At both March 31, 2015 and December 31, 2014, the 2024 Notes had an outstanding principal balance of \$103.0 million.

For the three months ended March 31, 2015 and 2014, (unaudited), the components of interest expense and related fees and cash paid for interest expense for the 2024 Notes are as follows:

| (in thousands)                          | Three Months<br>Ended March<br>31, |      |
|---|------------------------------------|------|
|   | 2015                               | 2014 |
| Stated interest expense                 | \$1,609                            | \$ — |
| Amortization of debt issuance cost      | 83                                 | —    |
| Total interest expense and fees         | \$1,692                            | \$ — |
| Cash paid for interest expense and fees | \$1,609                            | \$ — |

## 2017 Asset-Backed Notes

On December 19, 2012, the Company completed a \$230.7 million term debt securitization in connection with which an affiliate of the Company made an offer of \$129.3 million in aggregate principal amount of fixed-rate asset-backed notes (the “2017 Asset-Backed Notes”), which 2017 Asset-Backed Notes were rated A2(sf) by Moody’s Investors Service, Inc. The 2017 Asset-Backed Notes were sold by Hercules Capital Funding Trust 2012-1 pursuant to a note purchase agreement, dated as of December 12, 2012, by and among the Company, Hercules Capital Funding 2012-1, LLC as trust depositor (the “2012 Trust Depositor”), Hercules Capital Funding Trust 2012-1 as issuer (the “2012 Securitization Issuer”), and Guggenheim Securities, LLC, as initial purchaser, and are backed by a pool of senior loans made to certain of the Company’s portfolio companies and secured by certain assets of those portfolio companies and are to be serviced by the Company. Interest on the 2017 Asset- Backed Notes will be paid, to the extent of funds available, at a fixed rate of 3.32% per annum. The 2017 Asset-Backed Notes have a stated maturity of December 16, 2017.

As part of this transaction, the Company entered into a sale and contribution agreement with the 2012 Trust Depositor under which the Company has agreed to sell or have contributed to the 2012 Trust Depositor certain senior loans made to certain of the Company’s portfolio companies (the “2012 Loans”). The Company has made customary representations, warranties and covenants in the sale and contribution agreement with respect to the 2012 Loans as of the date of their transfer to the 2012 Trust Depositor.

In connection with the sale of the 2017 Asset-Backed Notes, the Company has made customary representations, warranties and covenants in the note purchase agreement. The 2017 Asset-Backed Notes are secured obligations of the 2012 Securitization Issuer and are non-recourse to the Company. The 2012 Securitization Issuer also entered into an indenture governing the 2017Asset-Backed Notes, which includes customary representations, warranties and covenants. The 2017 Asset-Backed Notes were sold without being registered under the Securities Act (A) in the United States to “qualified institutional buyers” as defined in Rule 144A under the Securities Act and to institutional “accredited investors” (as defined in Rule 501(a)(1), (2), (3) or (7) under the Securities Act) who in each case, are “qualified purchasers” as defined in Sec. 2(A)(51) of the 1940 Act and pursuant to an exemption under the Securities Act and (B) to non-U.S. purchasers acquiring interest in the 2017 Asset-Backed Notes outside the United States in accordance with Regulation S of the Securities Act. The 2012 Securitization Issuer will not be registered under the 1940 Act in reliance on an exemption provided by Section 3(c) (7) thereof. In addition, the 2012 Trust Depositor entered into an amended and restated trust agreement in respect of the 2012 Securitization Issuer, which includes customary representations, warranties and covenants.

The 2012 Loans are serviced by the Company pursuant to a sale and servicing agreement, which contains customary representations, warranties and covenants. The Company performs certain servicing and administrative functions with respect to the 2012 Loans. The Company is entitled to receive a monthly fee from the 2012 Securitization Issuer for servicing the 2012 Loans. This servicing fee is equal to the product of one-twelfth (or in the case of the first payment date, a fraction equal to the number of days from and including December 5, 2012 through and including January 15, 2013 over 360) of 2.00% and the aggregate outstanding principal balance of the 2012 Loans plus the amount of collections on deposit in the 2012 Securitization Issuer’s collection account, as of the first day of the related collection period (the period from the 5th day of the immediately preceding calendar month through the 4th day of the calendar month in which a payment date occurs, and for the first payment date, the period from and including December 5, 2012, to the close of business on January 4, 2013).

The Company also serves as administrator to the 2012 Securitization Issuer under an administration agreement, which includes customary representations, warranties and covenants.

At March 31, 2015 and December 31, 2014, the 2017 Asset-Backed Notes had an outstanding principal balance of \$4.2 million and \$16.0 million, respectively. See “Subsequent Events.”

Under the terms of the 2017 Asset Backed Notes, the Company is required to maintain a reserve cash balance, funded through interest and principal collections from the underlying securitized debt portfolio, which may be used to pay monthly interest and principal payments on the 2017 Asset-Backed Notes. The Company has segregated these funds and classified them as restricted cash. There was approximately \$2.7 million and \$1.2 million of restricted cash as of March 31, 2015 and December 31, 2014, respectively, funded through interest collections.

#### 2021 Asset-Backed Notes

On November 13, 2014, the Company completed a \$237.4 million term debt securitization in connection with which an affiliate of the Company made an offer of \$129.3 million in aggregate principal amount of fixed-rate asset-backed notes (the “2021 Asset-Backed Notes”), which 2021 Asset-Backed Notes were rated A(sf) by Kroll Bond Rating Agency, Inc. (“KBRA”). The 2021 Asset-Backed Notes were sold by Hercules Capital Funding Trust 2014-1 pursuant to a note purchase agreement, dated as of November 13, 2014, by and among the Company, Hercules Capital Funding Trust 2014-1, LLC as trust depositor (the “2014 Trust Depositor”), Hercules Capital Funding Trust 2014-1 as issuer (the “2014 Securitization Issuer”), and Guggenheim Securities, LLC, as initial purchaser, and are backed by a pool of senior loans made to certain of the Company’s portfolio companies and secured by certain assets of those

portfolio companies and are to be serviced by the Company. The securitization has an 18-month reinvestment period during which time principal collections may be reinvested into additional eligible loans. Interest on the 2021 Asset-Backed Notes will be paid, to the extent of funds available, at a fixed rate of 3.524% per annum. The 2021 Asset-Backed Notes have a stated maturity of April 16, 2021.

As part of this transaction, the Company entered into a sale and contribution agreement with the 2014 Trust Depositor under which the Company has agreed to sell or have contributed to the 2014 Trust Depositor certain senior loans made to certain of the Company's portfolio companies (the "2014 Loans"). The Company has made customary representations, warranties and covenants in the sale and contribution agreement with respect to the 2014 Loans as of the date of their transfer to the 2014 Trust Depositor.

In connection with the issuance and sale of the 2021 Asset-Backed Notes, the Company has made customary representations, warranties and covenants in the note purchase agreement. The 2021 Asset-Backed Notes are secured obligations of the 2014 Securitization Issuer and are non-recourse to the Company. The 2014 Securitization Issuer also entered into an indenture governing the 2021 Asset-Backed Notes, which includes customary representations, warranties and covenants. The 2021 Asset-Backed Notes were sold without being registered under the Securities Act (A) in the United States to "qualified institutional buyers" as defined in Rule 144A under the Securities Act and to institutional "accredited investors" (as defined in Rule 501(a)(1), (2), (3) or (7) under the Securities Act) who in each case, are "qualified purchasers" as defined in Sec. 2 (A)(51) of the 1940 Act and pursuant to an exemption under the Securities Act and (B) to non-U.S. purchasers acquiring interest in the 2021 Asset-Backed Notes outside the United States in accordance with Regulation S of the Securities Act. The 2014 Securitization Issuer will not be registered under the 1940 Act in reliance on an exemption provide by Section 3(c) (7) thereof and Rule 3A-7 thereunder. In addition, the 2014 Trust Depositor entered into an amended and restated trust agreement in respect of the 2014 Securitization Issuer, which includes customary representation, warranties and covenants.

The 2014 Loans are serviced by the Company pursuant to a sale and servicing agreement, which contains customary representations, warranties and covenants. The Company performs certain servicing and administrative functions with respect to the 2014 Loans. The Company is entitled to receive a monthly fee from the 2014 Securitization Issuer for servicing the 2014 Loans. This servicing fee is equal to the product of one-twelfth (or in the case of the first payment date, a fraction equal to the number of days from and including October 5, 2014 through and including December 5, 2014 over 360) of 2.00% and the aggregate outstanding principal balance of the 2014 Loans plus collections on deposit in the 2014 Securitization Issuer's collections account, as of the first day of the related collection period (the period from the 5th day of the immediately preceding calendar month through the 4th day of the calendar month in which a payment date occurs, and for the first payment date, the period from and including October 5, 2014, to the close of business on December 5, 2014).

The Company also serves as administrator to the 2014 Securitization Issuer under an administration agreement, which includes customary representations, warranties and covenants.

At both March 31, 2015 and December 31, 2014, the 2021 Asset-Backed Notes had an outstanding principal balance of \$129.3 million.

Under the terms of the 2021 Asset-Backed Notes, the Company is required to maintain a reserve cash balance, funded through interest and principal collections from the underlying securitized debt portfolio, which may be used to pay monthly interest and principal payments on the 2021 Asset-Backed Notes. The Company has segregated these funds and classified them as restricted cash. There was approximately \$19.2 million and \$11.5 million of restricted cash as of March 31, 2015 and December 31, 2014, respectively, funded through interest collections.

Convertible Senior Notes

In April 2011, the Company issued \$75.0 million in aggregate principal amount of 6.00% convertible senior notes due 2016 (the "Convertible Senior Notes"). During the three months ended March 31, 2015, holders of approximately \$32,000 of the Company's Convertible Senior Notes have exercised their conversion rights. As of March 31, 2015, the carrying value of the Convertible Senior Notes, comprised of the aggregate principal amount outstanding less the unaccreted discount initially recorded upon issuance of the Convertible Senior Notes, is approximately \$17.4 million.

The Convertible Senior Notes mature on April 15, 2016 (the "Maturity Date"), unless previously converted or repurchased in accordance with their terms. The Convertible Senior Notes bear interest at a rate of 6.00% per year payable semiannually in arrears on April 15 and October 15 of each year, commencing on October 15, 2011. The Convertible Senior Notes are the Company's senior unsecured obligations and rank senior in right of payment to the Company's existing and future indebtedness that is expressly subordinated in right of payment to the Convertible Senior Notes; equal in right of payment to the Company's existing and future unsecured indebtedness that is not so subordinated; effectively junior in right of payment to any of the Company's secured indebtedness (including unsecured indebtedness that the Company later secures) to the extent of the value of the assets securing such

indebtedness; and structurally junior to all existing and future indebtedness (including trade payables) incurred by the Company's subsidiaries, financing vehicles or similar facilities.

Prior to the close of business on the business day immediately preceding October 15, 2015, holders may convert their Convertible Senior Notes only under certain circumstances set forth in the indenture. On or after October 15, 2015 until the close of business on the scheduled trading day immediately preceding the Maturity Date, holders may convert their Convertible Senior Notes at any time. Upon conversion, the Company will pay or deliver, as the case may be, at the Company's election, cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock. The conversion rate will initially be 84.0972 shares of common stock per \$1,000 principal amount of Convertible Senior Notes (equivalent to an initial conversion price of approximately \$11.89 per share of common stock). The conversion rate will be subject to adjustment in some events but will not be adjusted for any accrued and unpaid interest. In addition, if certain corporate events occur prior to the Maturity Date, the conversion rate will be increased for converting holders. As of March 31, 2015, the conversion rate was 88.6189 shares of common stock per \$1,000 principal amount of Convertible Senior Notes (equivalent to an adjusted conversion price of approximately \$11.28 per share of common stock).

The Company may not redeem the Convertible Senior Notes prior to maturity. No sinking fund is provided for the Convertible Senior Notes. In addition, if certain corporate events occur, holders of the Convertible Senior Notes may require the Company to repurchase for cash all or part of their Convertible Senior Notes at a repurchase price equal to 100% of the principal amount of the Convertible Senior Notes to be repurchased, plus accrued and unpaid interest through, but excluding, the required repurchase date.

The Convertible Senior Notes are accounted for in accordance with ASC 470-20 (previously FASB Staff Position No. APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)"). In accounting for the Convertible Senior Notes, the Company estimated at the time of issuance that the values of the debt and the embedded conversion feature of the Convertible Senior Notes were approximately 92.8% and 7.2%, respectively. The original issue discount of 7.2% attributable to the conversion feature of the Convertible Senior Notes was recorded in "capital in excess of par value" in the Consolidated Statement of Assets and Liabilities. As a result, the Company recorded interest expense comprised of both stated interest expense as well as accretion of the original issue discount resulting in an estimated effective interest rate of approximately 8.1%.

Upon meeting the stock trading price conversion requirement as set forth in the Indenture, dated April 15, 2011, between the Company and U.S. Bank National Association, during the three months ended June 30, 2014, September 30, 2014 and December 31, 2014, the Convertible Senior Notes became convertible on July 1, 2014 and continued to be convertible during each of the three months ended September 30, 2014, December 31, 2014 and March 31, 2015, respectively. During this period and as of March 31, 2015, approximately \$57.4 million of the Convertible Senior Notes had been converted and were settled with a combination of cash equal to the outstanding principal amount of the converted notes and approximately 1.5 million shares of the Company's common stock, or \$24.3 million. By not meeting the stock trading price conversion requirement during the three months ended March 31, 2015, the Convertible Senior Notes are currently not convertible for the three months ending June 30, 2015. See "Subsequent Events."

The Company recorded a loss on extinguishment of debt for the proportionate amount of unamortized debt issuance costs and original issue discount on Notes converted during the period. The loss was partially offset by a gain in the amount of the difference between the outstanding principal balance of the converted notes and the fair value of the debt instrument. The net loss on extinguishment of debt the Company recorded for the three months ended March 31, 2015 and the year ended December 31, 2014 was approximately \$1,000 and \$1.6 million, respectively, and was classified as a component of net investment income in the Company's Consolidated Statement of Operations.

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As of March 31, 2015 (unaudited) and December 31, 2014, the components of the carrying value of the Convertible Senior Notes were as follows:

| (in thousands)                             | March 31, 2015 | December 31, 2014 |
|--|----------------|-------------------|
| Principal amount of debt                   | \$ 17,642      | \$ 17,674         |
| Original issue discount, net of accretion  | (267 )         | (329 )            |
| Carrying value of Convertible Senior Notes | \$ 17,375      | \$ 17,345         |

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For the three months ended March 31, 2015 and 2014 (unaudited), the components of interest expense, fees and cash paid for interest expense for the Convertible Senior Notes were as follows:

| (in thousands)                       | Three Months<br>Ended March<br>31, |         |
|--------------------------------------|------------------------------------|---------|
|                                      | 2015                               | 2014    |
| Stated interest expense              | \$215                              | \$1,125 |
| Accretion of original issue discount | 62                                 | 271     |
| Amortization of debt issuance cost   | 33                                 | 144     |
| Total interest expense               | \$310                              | \$1,540 |
| Cash paid for interest expense       | \$—                                | \$—     |

The estimated effective interest rate of the debt component of the Convertible Senior Notes, equal to the stated interest of 6.0% plus the accretion of the original issue discount, was approximately 8.1% for the three months ended March 31, 2015 and 2014. Interest expense decreased by approximately \$910,000 during the three months ended March 31, 2015 from the three months ended March 31, 2014, due to Convertible Senior Notes settled between periods. As of March 31, 2015, the Company is in compliance with the terms of the indentures governing the Convertible Senior Notes.

#### Wells Facility

In August 2008, the Company entered into a \$50.0 million two-year revolving senior secured credit facility with Wells Fargo Capital Finance (the “Wells Facility”). On June 20, 2011, the Company renewed the Wells Facility, and the Wells Facility was further amended on August 1, 2012, December 17, 2012 and August 8, 2014. Under this senior secured facility, Wells Fargo Capital Finance has made commitments of \$75.0 million. The facility contains an accordion feature, in which the Company can increase the credit line up to an aggregate of \$300.0 million, funded by additional lenders and with the agreement of Wells Fargo Capital Finance and subject to other customary conditions. The Company expects to continue discussions with various other potential lenders to join the new facility; however, there can be no assurances that additional lenders will join the Wells Facility.

On August 1, 2012, the Company entered into an amendment to the Wells Facility that reduced the interest rate floor by 75 basis points to 4.25% and extended the maturity date by one year to August 2015. Additionally, the August 2012 amendment added an amortization period that commences on the day immediately following the end of the revolving credit availability period and ends one year thereafter on the maturity date. The August 2012 amendment also reduced the unused line fee, as further discussed below. On August 8, 2014, the Company entered into a further amendment to the Wells Facility to set the interest rate floor at 4.00% and to extend the revolving credit availability period to August 2017.

As amended, borrowings under the Wells Facility will generally bear interest at a rate per annum equal to LIBOR plus 3.50%, with a floor of 4.00% and an advance rate of 50% against eligible debt investments. The Wells Facility is secured by debt investments in the borrowing base. The Wells Facility requires payment of a non-use fee on a scale of 0.0% to 0.50% of the average monthly outstanding balance. The monthly payment of a non-use fee thereafter shall depend on the average balance that was outstanding on a scale between 0.0% and 0.50%. For the three months ended



March 31, 2015 and 2014, this non-use fee was approximately \$94,000 and \$110,000, respectively. On June 20, 2011 the Company paid an additional \$1.1 million in structuring fees in connection with the Wells Facility which are being amortized through the end of the term of the Wells Facility. In connection with the August 2014 amendments, the Company paid an additional \$750,000 in structuring fees in connection with the Wells Facility which are being amortized through the end of the term of the Wells Facility.

The Wells Facility includes various financial and operating covenants applicable to the Company and the Company's subsidiaries, in addition to those applicable to Hercules Funding II, LLC. As amended, these covenants require the Company to maintain certain financial ratios and a minimum tangible net worth in an amount, when added to outstanding subordinated indebtedness, that is in excess of \$500.0 million plus 90% of the cumulative amount of equity raised after June 30, 2014. As of March 31, 2015, the minimum tangible net worth covenant has increased to \$590.4 million as a result of the March 2015 follow-on public offering of 7.6 million shares of common stock for total net proceeds of approximately \$100.1 million. The Wells Facility provides for customary events of default, including, but not limited to, payment defaults, breach of representations or covenants, including certain key man provisions and lien limitations, bankruptcy events and change of control. The Company was in compliance with all covenants at March 31, 2015.

At March 31, 2015 there were no borrowings outstanding on this facility. See "Subsequent Events."

### Union Bank Facility

The Company has a \$75.0 million revolving senior secured credit facility (the “Union Bank Facility”) with MUFG Union Bank, N.A. (“MUFG Union Bank”). The Company originally entered into the Union Bank Facility on February 10, 2010 but, following several amendments, amended and restated the Union Bank Facility on August 14, 2014. The amendment and restatement extends the maturity date of the Union Bank Facility to August 1, 2017, increases the size of the Union Bank Facility to \$75.0 million from \$30.0 million, and adjusts the interest rate for LIBOR borrowings under the Union Bank Facility. LIBOR-based borrowings by the Company under the Union Bank Facility will bear interest at a rate per annum equal to LIBOR plus 2.25% with no floor, whereas previously the Company paid a per annum interest rate on such borrowings equal to LIBOR plus 2.50% with a floor of 4.00%. Other borrowings by the Company under the Union Bank Facility, which are based on a reference rate instead of LIBOR, will continue to bear interest at a rate per annum equal to the reference rate (which is the greater of the federal funds rate plus 1.00% and a periodically announced MUFG Union Bank index rate) plus the greater of (i) 4.00% minus the reference rate and (ii) 1.00%. The Company continues to have the option of determining which type of borrowing to request under the Union Bank Facility. Subject to certain conditions, the amendment also removes a previous ceiling on the amount of certain unsecured indebtedness that the Company may incur.

The Union Bank Facility contains an accordion feature, pursuant to which the Company may increase the size of the Union Bank Facility to an aggregate principal amount of \$300.0 million by bringing in additional lenders, subject to the approval of MUFG Union Bank and other customary conditions. There can be no assurances that additional lenders will join the Union Bank Facility to increase available borrowings.

The Union Bank Facility requires the payment of a non-use fee of 0.50% annually. For the three months ended March 31, 2015 and 2014, this non-use fee was approximately \$94,000 and \$37,500, respectively. The amount that the Company may borrow under the Union Bank Facility is determined by applying an advance rate to eligible loans. The Union Bank Facility generally requires payment of monthly interest on loans based on a reference rate and at the end of a one, two, or three-month period, as applicable, for loans based on LIBOR. All outstanding principal is due upon maturity.

The Union Bank Facility is collateralized by debt investments in the Company’s portfolio companies, and includes an advance rate equal to 50.0% of eligible debt investments placed in the collateral pool.

The Company has various financial and operating covenants required by the Union Bank Facility. These covenants require, among other things, that the Company maintain certain financial ratios, including liquidity, asset coverage, and debt service coverage, and a minimum tangible net worth in an amount, when added to outstanding subordinated indebtedness, that is in excess of \$550.0 million plus 90% of the amount of net cash proceeds received from the sale of common stock after June 30, 2014. As of March 31, 2015, the minimum tangible net worth covenant has increased to \$640.1 million as a result of the March 2015 follow-on public offering of 7.6 million shares of common stock for total net proceeds of approximately \$100.1 million. The Union Bank Facility provides for customary events of default, including, but not limited to, payment defaults, breach of representations or covenants, bankruptcy events and change of control. The Company was in compliance with all covenants at March 31, 2015.

At March 31, 2015 there were no borrowings outstanding on this facility.

### Citibank Credit Facility

The Company, through Hercules Funding Trust I, an affiliated statutory trust, had a securitized credit facility (the “Citibank Credit Facility”) with Citigroup Global Markets Realty Corp. (“Citigroup”), which expired under normal terms. During the first quarter of 2009, the Company paid off all principal and interest owed under the Citibank Credit

Facility. Citigroup has an equity participation right through a warrant participation agreement on the pool of debt investments and warrants collateralized under the Citibank Credit Facility. Pursuant to the warrant participation agreement, the Company granted to Citigroup a 10% participation in all warrants held as collateral. However, no additional warrants were included in collateral subsequent to the facility amendment on May 2, 2007. As a result, Citigroup is entitled to 10% of the realized gains on the warrants until the realized gains paid to Citigroup pursuant to the agreement equal \$3,750,000 (the "Maximum Participation Limit"). The obligations under the warrant participation agreement continue even after the Citibank Credit Facility is terminated until the Maximum Participation Limit has been reached.

During the three months ended March 31, 2015, the Company recorded an increase in participation liability and a decrease in unrealized appreciation by a net amount of approximately \$41,000 primarily due to appreciation of fair value on the pool of warrants collateralized under the warrant participation. The remaining value of their participation right on unrealized gains in the related equity investments is approximately \$142,000 as of March 31, 2015 and is included in accrued liabilities. There can be no assurances that the unrealized appreciation of the warrants will not be higher or lower in future periods due to fluctuations in the value of the warrants, thereby increasing or reducing the effect on the cost of borrowing. Since inception of the agreement, the Company has paid Citigroup approximately \$2.1 million under the warrant participation agreement thereby reducing realized gains by this amount. The Company will continue to pay Citigroup under the warrant participation agreement until the Maximum Participation Limit is reached or the warrants expire. Warrants subject to the Citigroup participation agreement are set to expire between February 2016 and January 2017.

## 5. Income taxes

The Company intends to continue to operate so as to qualify to be taxed as a RIC under Subchapter M of the Code and, as such, will not be subject to federal income tax on the portion of taxable income and gains distributed to stockholders.

To qualify as a RIC, the Company is required to meet certain income and asset diversification tests in addition to distributing at least 90% of its investment company taxable income, as defined by the Code. The amount to be paid out as a dividend is determined by the Board of Directors each quarter and is based upon the annual earnings estimated by the management of the Company. To the extent that the Company's earnings fall below the amount of dividends declared, however, a portion of the total amount of the Company's dividends for the fiscal year may be deemed a return of capital for tax purposes to the Company's stockholders.

Taxable income includes the Company's taxable interest, dividend and fee income, as well as taxable net capital gains. Taxable income generally differs from net income for financial reporting purposes due to temporary and permanent differences in the recognition of income and expenses, and generally excludes net unrealized appreciation or depreciation, as gains or losses are not included in taxable income until they are realized.

Taxable income includes non-cash income, such as changes in accrued and reinvested interest and dividends, which includes contractual payment-in-kind interest, and the amortization of discounts and fees. Cash collections of income resulting from contractual PIK interest arrangements or the amortization of discounts and fees generally occur upon the repayment of the loans or debt securities that include such items. Non-cash taxable income is reduced by non-cash expenses, such as realized losses and depreciation and amortization expense.

During the three months ended March 31, 2015, the Company declared a distribution of \$0.31 per share. The determination of the tax attributes of the Company's distributions is made annually as of the end of the Company's fiscal year based upon its taxable income for the full year and distributions paid for the full year. As a result, a determination made on a quarterly basis may not be representative of the actual tax attributes of the Company's distributions for a full year. If the Company had determined the tax attributes of our distributions year-to-date as of March 31, 2015, approximately 100% would be from ordinary income and spillover earnings from 2014. However there can be no certainty to shareholders that this determination is representative of what the tax attributes of its 2015 distributions to shareholders will actually be.

As a RIC, the Company will be subject to a 4% nondeductible federal excise tax on certain undistributed income unless the Company distributes in a timely manner an amount at least equal to the sum of (1) 98% of its ordinary

income for each calendar year, (2) 98.2% of its capital gain net income for the 1-year period ending October 31 in that calendar year and (3) any income realized, but not distributed, in the preceding year (the “Excise Tax Avoidance Requirements”). The Company will not be subject to excise taxes on amounts on which the Company is required to pay corporate income tax (such as retained net capital gains). Depending on the level of taxable income earned in a tax year, the Company may choose to carry over taxable income in excess of current year distributions from such taxable income into the next tax year and pay a 4% excise tax on such income, as required. The maximum amount of excess taxable income that may be carried over for distribution in the next year under the Code is the total amount of dividends paid in the following year, subject to certain declaration and payment guidelines. To the extent the Company chooses to carry over taxable income into the next tax year, dividends declared and paid by the Company in a year may differ from taxable income for that year as such dividends may include the distribution of current year taxable income, the distribution of prior year taxable income carried over into and distributed in the current year, or returns of capital.

Taxable income for the three-months ended March 31, 2015 was approximately \$16.3 million or \$0.26 per share. Taxable net realized loss for the same period were \$2.6 million or approximately \$0.04 per share. Taxable income for the three-months ended March 31, 2014 was approximately \$12.3 million or \$0.20 per share. Taxable net realized gains for the same period were \$3.5 million or approximately \$0.06 per share.

The Company intends to distribute approximately \$16.7 million of spillover from long term earnings from the year ended December 31, 2014 to the Company’s shareholders in 2015.

## 6. Shareholders' Equity

On August 16, 2013, the Company entered into an "At-The-Market" ("ATM") equity distribution agreement with JMP Securities LLC ("JMP"). The equity distribution agreement provides that the Company may offer and sell up to 8.0 million shares of its common stock from time to time through JMP, as its sales agent. Sales of the Company's common stock, if any, may be made in negotiated transactions or transactions that are deemed to be "at the market," as defined in Rule 415 under the Securities Act, including sales made directly on the NYSE or similar securities exchange or sales made to or through a market maker other than on an exchange, at prices related to the prevailing market prices or at negotiated prices.

During the year ended December 31, 2014, the Company sold 650,000 shares of common stock for total accumulated net proceeds of approximately \$9.5 million, all of which is accretive to net asset value. The Company generally uses net proceeds from these offerings to make investments, to repurchase or pay down liabilities and for general corporate purposes. As of March 31, 2015, approximately 7.35 million shares remain available for issuance and sale under the equity distribution agreement.

On February 24, 2015, the Company's Board of Directors authorized a stock repurchase plan permitting the Company to repurchase up to \$50.0 million of its common stock. The Company may repurchase shares of its common stock in the open market, including block purchases, at prices that may be above or below the net asset value as reported in the most recently published financial statements. During the three month period ended March 31, 2015, the Company did not repurchase any common stock.

The Company anticipates that the manner, timing, and amount of any share purchases will be determined by management based upon the evaluation of market conditions, stock price, and additional factors in accordance with regulatory requirements. Pursuant to the 1940 Act, the Company is required to notify shareholders when such a program is initiated or implemented. The repurchase program does not require the Company to acquire any specific number of shares and may be extended, modified, or discontinued at any time.

On March 27, 2015, the Company raised approximately \$100.1 million, after deducting offering expenses, in a public offering of 7,590,000 shares of its common stock.

The Company has issued stock options for common stock subject to future issuance, of which 585,729 and 695,672 were outstanding at March 31, 2015 and December 31, 2014, respectively.

## 7. Equity Incentive Plan

The Company and its stockholders have authorized and adopted the 2004 Equity Incentive Plan (the “2004 Plan”) for purposes of attracting and retaining the services of its executive officers and key employees. Under the 2004 Plan, the Company is authorized to issue 7.0 million shares of common stock. On June 1, 2011, stockholders approved an amended and restated plan and provided an increase of 1.0 million shares, authorizing the Company to issue 8.0 million shares of common stock under the 2004 Plan.

The Company and its stockholders have authorized and adopted the 2006 Non-Employee Director Plan (the “2006 Plan” and, together with the 2004 Plan, the “Plans”) for purposes of attracting and retaining the services of its Board of Directors. Under the 2006 Plan, the Company is authorized to issue 1.0 million shares of common stock. The Company filed an exemptive relief request with the Securities and Exchange Commission (“SEC”) to allow options to be issued under the 2006 Plan which was approved on October 10, 2007.

On June 21, 2007, the stockholders approved amendments to the 2004 Plan and the 2006 Plan allowing for the grant of restricted stock. The amended Plans limit the combined maximum amount of restricted stock that may be issued under both Plans to 10% of the outstanding shares of the Company’s stock on the effective date of the Plans plus 10% of the number of shares of stock issued or delivered by the Company during the terms of the Plans. The amendments further specify that no one person shall be granted awards of restricted stock relating to more than 25% of the shares available for issuance under the 2004 Plan. Further, the amount of voting securities that would result from the exercise of all of the Company’s outstanding warrants, options and rights, together with any restricted stock issued pursuant to the Plans, at the time of issuance shall not exceed 25% of its outstanding voting securities, except that if the amount of voting securities that would result from such exercise of all of the Company’s outstanding warrants, options and rights issued to the Company’s directors, officers and employees, together with any restricted stock issued pursuant to the Plans, would exceed 15% of the Company’s outstanding voting securities, then the total amount of voting securities that would result from the exercise of all outstanding warrants, options and rights, together with any restricted stock issued pursuant to the Plans, at the time of issuance shall not exceed 20% of our outstanding voting securities.

The following table summarizes the common stock options activities for the three months ended March 31, 2015 and 2014 (unaudited):

|                                      | Three Months Ended March 31,<br>2015 |  | 2014                       |  |
|--------------------------------------|--------------------------------------|--|----------------------------|--|
|                                      | Common<br>Stock<br>Options           | Weighted<br>Average<br>Exercise<br>Price | Common<br>Stock<br>Options | Weighted<br>Average<br>Exercise<br>Price |
| Outstanding at December 31,          | 695,672                              | \$ 14.58                                 | 833,923                    | \$ 12.53                                 |
| Granted                              | 68,500                               | \$ 14.10                                 | —                          | \$ —                                     |
| Exercised                            | (34,664 )                            | \$ 10.69                                 | (61,755 )                  | \$ 11.77                                 |
| Forfeited                            | (141,280)                            | \$ 14.71                                 | (1,751 )                   | \$ 11.39                                 |
| Expired                              | (2,499 )                             | \$ 11.01                                 | —                          | \$ —                                     |
| Outstanding at March 31,             | 585,729                              | \$ 14.74                                 | 770,417                    | \$ 12.59                                 |
| Shares Expected to Vest at March 31, | 438,472                              | \$ 14.74                                 | 518,046                    | \$ 12.59                                 |

The following table summarizes common stock options outstanding and exercisable at March 31, 2015 (unaudited):

(Dollars in thousands,

| except exercise price)   | Options outstanding    |   |                                 | Options exercisable |   |                                 | Weighted<br>average<br>exercise<br>price |
|--------------------------|------------------------|---|---------------------------------|---------------------|---|---------------------------------|--|
|                          | Number<br>of<br>shares | Weighted<br>average<br>remaining<br>contractual<br>life | Aggregate<br>intrinsic<br>value | Number<br>of shares | Weighted<br>average<br>remaining<br>contractual<br>life | Aggregate<br>intrinsic<br>value |  |
| Range of exercise prices |                        |   |                                 |                     |   |                                 |  |
| \$9.25 - \$14.02         | 133,645                | 5.60  | \$ 165,079                      | 47,361              | 4.11  | \$ 113,493                      | \$ 11.11                                 |
| \$14.60 - \$16.34        | 452,084                | 6.27  | —                               | 99,896              | 5.52  | —                               | \$ 15.14                                 |
| \$9.25 - \$16.34         | 585,729                | 6.12  | \$ 165,079                      | 147,257             | 5.07  | \$ 113,493                      | \$ 13.85                                 |

Options generally vest 33% one year after the date of grant and ratably over the succeeding 24 months.

All options may be exercised for a period ending seven years after the date of grant. At March 31, 2015, options for 147,257 shares were exercisable at a weighted average exercise price of approximately \$13.85 per share with a weighted average remaining contractual term of 5.07 years.

The Company determined that the fair value of options granted under the 2006 and 2004 Plans during the three months ended March 31, 2015 was approximately \$27,000. No options were granted during the three months ended March 31, 2014. During the three months ended March 31, 2015 and 2014, approximately \$67,000 and \$140,000 of



share-based cost due to stock option grants was expensed, respectively. As of March 31, 2015, there was approximately \$436,000 of total unrecognized compensation costs related to stock options. These costs are expected to be recognized over a weighted average remaining vesting period of 1.74 years.

The fair value of options granted is based upon a Black Scholes option pricing model using the assumptions in the following table for the three months ended March 31, 2015:

|                          |  |
|--------------------------|--|
|                          | Three<br>Months<br>Ended<br>March<br>31,<br>2015 |
| Expected Volatility      | 18.94%   |
| Expected Dividends       | 10%  |
| Expected term (in years) | 4.5  |
|                          | 1.08% -  |
| Risk-free rate           | 1.57%  |

During the three months ended March 31, 2015 the Company granted 579,833 shares of restricted stock pursuant to the Plans. During the three months ended March 31, 2014 the Company did not grant any restricted stock pursuant to the Plans. The Company determined that the fair value of restricted stock granted under the 2006 and 2004 Plans during the three months ended March 31, 2015 was approximately \$8.1 million. During the three months ended March 31, 2015 and 2014, the Company expensed approximately \$2.7 million and \$1.4 million of compensation expense related to restricted stock, respectively. As of March 31, 2015, there was approximately \$17.9 million of total unrecognized compensation costs related to restricted stock. These costs are expected to be recognized over a weighted average remaining vesting period of 2.00 years.

The following table summarizes the activities for the Company's unvested restricted stock for the three months ended March 31, 2015 and 2014 (unaudited):

|                          | Three Months Ended March 31,<br>2015 |                                       | 2014                         |                                       |
|--------------------------|--------------------------------------|---------------------------------------|------------------------------|---------------------------------------|
|                          | Restricted<br>Stock<br>Units         | Weighted<br>Average<br>Exercise Price | Restricted<br>Stock<br>Units | Weighted<br>Average<br>Exercise Price |
| Unvested at December 31, | 1,302,780                            | \$ 13.23                              | 1,035,897                    | \$ 11.94                              |
| Granted                  | 579,833                              | \$ 14.02                              | —                            | \$ —                                  |
| Vested                   | (102,042 )                           | \$ 12.01                              | (284,490 )                   | \$ 12.21                              |
| Forfeited                | (1,438 )                             | \$ 12.88                              | —                            | \$ —                                  |
| Unvested at March 31,    | 1,779,133                            | \$ 13.56                              | 751,407                      | \$ 11.84                              |

The SEC, through an exemptive order granted on June 22, 2010, approved amendments to the Plans which allow participants to elect to have the Company withhold shares of the Company's common stock to pay for the exercise price and applicable taxes with respect to an option exercise ("net issuance exercise"). The exemptive order also permits the holders of restricted stock to elect to have the Company withhold shares of Hercules stock to pay the applicable taxes due on restricted stock at the time of vesting. Each individual can make a cash payment at the time of option exercise or to pay taxes on restricted stock.

## 8. Earnings Per Share

Shares used in the computation of the Company's basic and diluted earnings per share are as follows (unaudited):

| (in thousands, except per share data)                                 | Three Months<br>Ended March 31, |          |
|---|---------------------------------|----------|
|   | 2015                            | 2014     |
| <b>Numerator</b>  |                                 |          |
| Net increase in net assets resulting from operations                  | \$21,919                        | \$22,185 |
| Less: Dividends declared-common and restricted shares                 | (20,266)                        | (19,165) |
| Undistributed earnings  | 1,653                           | 3,020    |
| Undistributed earnings-common shares                                  | 1,653                           | 3,020    |
| Add: Dividend declared-common shares                                  | 19,712                          | 18,928   |
| Numerator for basic and diluted change in net assets per common share | 21,365                          | 21,948   |
| <b>Denominator</b>  |                                 |          |
| Basic weighted average common shares outstanding                      | 63,783                          | 60,870   |
| Common shares issuable  | 380                             | 1,825    |
| Weighted average common shares outstanding assuming dilution          | 64,163                          | 62,695   |
| <b>Change in net assets per common share</b>                          |                                 |          |
| Basic   | \$0.33                          | \$0.36   |
| Diluted   | \$0.33                          | \$0.35   |

In the table above, unvested share-based payment awards that have non-forfeitable rights to dividends or dividend equivalents are treated as participating securities for calculating earnings per share.

For the purpose of calculating diluted earnings per share for three months ended March 31, 2015 and 2014, the dilutive effect of the Convertible Senior Notes under the treasury stock method is included in this calculation because the Company's share price was greater than the conversion price in effect (\$11.28 as of March 31, 2015 and \$11.56 as of March 31, 2014) for the Convertible Senior Notes for such periods.

The calculation of change in net assets resulting from operations per common share—assuming dilution, excludes all anti-dilutive shares. For the three months ended March 31, 2015 and 2014, the number of anti-dilutive shares, as calculated based on the weighted average closing price of the Company's common stock for the periods, was approximately 652,102 and 797,489 shares, respectively.

At March 31, 2015, the Company was authorized to issue 100,000,000 shares of common stock with a par value of \$0.001. Each share of common stock entitles the holder to one vote.

## 9. Financial Highlights

Following is a schedule of financial highlights for the three months ended March 31, 2015 and 2014:

|  | Three Months Ended<br>March 31, |           |
|--|---------------------------------|-----------|
|  | 2015                            | 2014      |
| Per share data <sup>(1)</sup> :  |                                 |           |
| Net asset value at beginning of period   | \$10.18                         | \$10.51   |
| Net investment income  | 0.20                            | 0.30      |
| Net realized gain on investments   | 0.05                            | 0.08      |
| Net unrealized appreciation (depreciation) on investments  | 0.09                            | (0.02 )   |
| Total from investment operations   | 0.34                            | 0.36      |
| Net increase (decrease) in net assets from capital share transactions                                  | 0.23                            | (0.01 )   |
| Distributions of net investment income   | (0.32 )                         | (0.31 )   |
| Stock-based compensation expense included in investment income <sup>(2)</sup>                          | 0.04                            | 0.03      |
| Net asset value at end of period   | \$10.47                         | \$10.58   |
| Ratios and supplemental data:  |                                 |           |
| Per share market value at end of period  | \$13.48                         | \$14.07   |
| Total return <sup>(3)</sup>  | -7.35 %                         | -12.42 %  |
| Shares outstanding at end of period  | 72,891                          | 61,760    |
| Weighted average number of common shares outstanding   | 63,783                          | 60,870    |
| Net assets at end of period  | \$763,326                       | \$653,302 |
| Ratio of operating expense to average net assets <sup>(4)(5)</sup>                                     | 11.73 %                         | 10.74 %   |
| Ratio of net investment income before investment gains and losses to average net assets <sup>(4)</sup> | 7.82 %                          | 11.26 %   |
| Average debt outstanding   | \$624,132                       | \$536,110 |
| Weighted average debt per common share   | \$9.79                          | \$8.81    |

(1) All per share activity is calculated based on the weighted average shares outstanding for the relevant period.

(2) Stock option expense is a non-cash expense that has no effect on net asset value. Pursuant to ASC 718, net investment income includes the expense associated with the granting of stock options which is offset by a corresponding increase in paid-in capital.

(3) The total return for the three months ended March 31, 2015 and 2014 equals the change in the ending market value over the beginning of the period price per share plus dividends paid per share during the period, divided by the beginning price assuming the dividend is reinvested on the date of the distribution. As such, the total return is not annualized.

(4) All ratios are calculated based on weighted average net assets for the relevant period and are annualized.

(5) Operating expense as used in the ratio of operating expense to average net assets does not include loss on debt extinguishment (long-term liabilities - convertible senior notes). If loss on debt extinguishment (long-term liabilities - convertible senior notes) were included in total expense, the ratio for the three months ended March 31, 2015 would be 11.73%. There was no loss on debt extinguishment (long-term liabilities - convertible senior notes) in the three months ended March 31, 2014 so the ratio for that period would not change.



## 10. Commitments and Contingencies

The Company's commitments and contingencies consist primarily of unused commitments to extend credit in the form of loans to the Company's portfolio companies. The balance of unfunded contractual commitments to extend credit at March 31, 2015 totaled approximately \$377.6 million. Approximately \$243.5 million of these unfunded contractual commitments as of March 31, 2015 are dependent upon the portfolio company reaching certain milestones before the debt commitment becomes available. Since a portion of these commitments may expire without being drawn, unfunded contractual commitments do not necessarily represent future cash requirements. In addition, the Company had approximately \$141.0 million of non-binding term sheets outstanding at March 31, 2015. Non-binding outstanding term sheets are subject to completion of the Company's due diligence and final investment committee approval process, as well as the negotiation of definitive documentation with the prospective portfolio companies. These non-binding term sheets generally convert to contractual commitments in approximately 90 days from signing. Not all non-binding term sheets are expected to close and do not necessarily represent the Company's future cash requirements.

Certain premises are leased under agreements which expire at various dates through March 2020. Total rent expense amounted to approximately \$408,000 and \$388,000 during the three months ended March 31, 2015 and 2014, respectively. Future commitments under the credit facility and operating leases were as follows at March 31, 2015:

|  | Payments due by period (in thousands) |                        |                |                |                  |
|--|---------------------------------------|------------------------|----------------|----------------|------------------|
|  | Total                                 | Less<br>than 1<br>year | 1 - 3<br>years | 3 - 5<br>years | After 5<br>years |
| Contractual Obligations <sup>(1)(2)</sup>  |                                       |                        |                |                |                  |
| Borrowings <sup>(3)(4)</sup>               | \$614,442                             | \$4,240                | \$17,338       | \$321,464      | \$271,400        |
| Operating Lease Obligations <sup>(5)</sup> | 5,867                                 | 1,539                  | 3,071          | 1,257          | —                |
| Total                                      | \$620,309                             | \$5,779                | \$20,409       | \$322,721      | \$271,400        |

(1) Excludes commitments to extend credit to our portfolio companies.

(2) The Company also has a warrant participation agreement with Citigroup. See Note 4 to the Company's consolidated financial statements.

(3) Includes \$190.2 million in borrowings under the SBA debentures, \$170.4 million of the 2019 Notes, \$103.0 million of the 2024 Notes, \$4.2 million in aggregate principal amount of the 2017 Asset-Backed Notes, \$129.3 million in aggregate principal amount of the 2021 Asset-Backed Notes and \$17.4 million of the Convertible Senior Notes.

(4) Except for the Convertible Senior Notes, all carrying values are the same as the principal amount outstanding. The aggregate principal amount outstanding of the Convertible Senior Notes is \$17.6 million less the unaccreted discount initially recorded upon issuance of the Convertible Senior Notes. The total unaccreted discount for the Convertible Senior Notes was \$267,000 at March 31, 2015.

(5) Long-term facility leases.

The Company may, from time to time, be involved in litigation arising out of its operations in the normal course of business or otherwise. Furthermore, third parties may try to seek to impose liability on the Company in connection

with the activities of its portfolio companies. While the outcome of any current legal proceedings cannot at this time be predicted with certainty, the Company does not expect any current matters will materially affect the Company's financial condition or results of operations; however, there can be no assurance whether any pending legal proceedings will have a material adverse effect on the Company's financial condition or results of operations in any future reporting period.

#### 11. Recent Accounting Pronouncements

In February 2015, the FASB issued ASU 2015-02, "Consolidation (Topic 810) – Amendments to the Consolidation Analysis". The new guidance applies to entities in all industries and provides a new scope exception to registered money market funds and similar unregistered money market funds. It makes targeted amendments to the current consolidation guidance and ends the deferral granted to investment companies from applying the VIE guidance. The Company is currently assessing the additional disclosure requirements. ASU 2015-02 is effective for public business entities for annual reporting periods beginning after December 15, 2016.

In April 2015, the FASB issued ASU 2015-03, "Simplifying the Presentation of Debt Issuance Costs", which requires debt issuance costs to be presented in the balance sheet as a direct deduction from the associated debt liability. The Company is currently assessing the additional disclosure requirements. ASU 2015-03 is effective for interim and annual reporting periods in fiscal years that begin after December 15, 2015.

## 12. Subsequent Events

### Dividend Declaration

On May 4, 2015 the Board of Directors declared a cash dividend of \$0.31 per share to be paid on May 25, 2015 to shareholders of record as of May 18, 2015. This dividend represents the Company's thirty-ninth consecutive dividend declaration since the Company's initial public offering, bringing the total cumulative dividend declared to date to \$10.61 per share.

### 2017 Asset-Backed Notes Repayment

In February 2015, changes in the payment schedule of obligors in the 2017 Asset-Backed Notes collateral pool triggered a rapid amortization event in accordance with the sale and servicing agreement for the 2017 Asset-Backed Notes. Due to this Event, the 2017 Asset-Backed Notes were fully repaid as of April 16, 2015.

### April 2019 Notes – Redemption

In April 2015, the company redeemed \$20.0 million of the \$84.5 million in issued and outstanding aggregate principal amount of April 2019 Notes, as previously approved by the Board of Directors. The Company currently intends to make additional redemptions on the April 2019 Notes throughout the 2015 calendar year, depending on our anticipated cash needs. The Company will provide notice for and complete all redemptions in compliance with the terms of the Base Indenture, as supplemented by the First Supplemental Indenture.

### Convertible Senior Notes

The Convertible Senior Notes are convertible into shares of the Company's common stock beginning October 15, 2015, or, under certain circumstances, earlier. Upon conversion of the Convertible Senior Notes, the Company has the choice to pay or deliver, as the case may be, at the Company's election, cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock. The current conversion price of the Convertible Senior Notes is approximately \$11.28 per share of common stock, in each case subject to adjustment in certain circumstances. By not meeting the stock trading price conversion requirement during the three months ended March 31, 2015, the Convertible Senior Notes are currently not convertible for the three months ending June 30, 2015.

At March 31, 2015 approximately \$38,000 of the Convertible Senior Notes were converting pursuant to the conversion procedures as set forth in the Indenture, and were settled in April 2015 with a combination of cash equal to the outstanding principal amount of the converted notes and approximately 614 shares of the Company's common stock. No additional notes are converting as of May 4, 2015 and no further settlements will be made prior to July 1, 2015.

### Amendment to Wells Facility

In May 2015, the Company entered into a further amendment to the Wells Facility to remove the interest rate floor and to reduce the LIBOR rate margin by 25 basis points to 3.25%.

### Amendment to Charter

Effective as of April 6, 2015, the Company amended its charter to increase the number of shares of common stock it is authorized to issue from 100,000,000 to 200,000,000. The Company effected the increase in authorized shares by filing Articles of Amendment with the State Department of Assessments and Taxation of Maryland.



Portfolio Company Developments

As of May 4, 2015, the Company held warrants or equity positions in five companies that have filed registration statements on Form S-1 with the SEC in contemplation of potential initial public offerings, including Gelesis, Inc., Good Technology, Inc. and three companies which filed confidentially under the JOBS Act. There can be no assurance that these companies will complete their initial public offerings in a timely matter or at all. In April 2015, the Company's portfolio company ViewRay, Inc. formally withdrew its Form S-1 with the SEC, which had been on file as of March 31, 2015.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Forward-Looking Statements

The matters discussed in this report, as well as in future oral and written statements by management of Hercules Technology Growth Capital, Inc., that are forward-looking statements are based on current management expectations that involve substantial risks and uncertainties which could cause actual results to differ materially from the results expressed in, or implied by, these forward-looking statements. Forward-looking statements relate to future events or our future financial performance. We generally identify forward-looking statements by terminology such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “could,” “intends,” “target,” “projects,” “contemplates,” “believes,” “estimates,” “potential” or “continue” or the negative of these terms or other similar expressions. Important assumptions include our ability to originate new investments, achieve certain margins and levels of profitability, the availability of additional capital, and the ability to maintain certain debt to asset ratios. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this report should not be regarded as a representation by us that our plans or objectives will be achieved. The forward-looking statements contained in this report include statements as to:

- our future operating results;
- our business prospects and the prospects of our prospective portfolio companies;
- the impact of investments that we expect to make;
- our informal relationships with third parties including in the venture capital industry;
- the expected market for venture capital investments and our addressable market;
- the dependence of our future success on the general economy and its impact on the industries in which we invest;
- our ability to access debt markets and equity markets;
- the ability of our portfolio companies to achieve their objectives;
- our expected financings and investments;
- our regulatory structure and tax status;
- our ability to operate as a BDC, a SBIC and a RIC;
- the adequacy of our cash resources and working capital;
- the timing of cash flows, if any, from the operations of our portfolio companies;
- the timing, form and amount of any dividend distributions;
- the impact of fluctuations in interest rates on our business;
- the valuation of any investments in portfolio companies, particularly those having no liquid trading market; and
- our ability to recover unrealized losses.

The following discussion should be read in conjunction with our consolidated financial statements and related notes and other financial information appearing elsewhere in this report. In addition to historical information, the following discussion and other parts of this report contain forward-looking information that involves risks and uncertainties. Our actual results could differ materially from those anticipated by such forward-looking information due to the factors discussed under Item 1A—“Risk Factors” of Part II of this quarterly report on Form 10-Q, Item 1A—“Risk Factors” of our annual report on Form 10-K filed with the SEC on March 2, 2015 and under “Forward-Looking Statements” of this Item 2.

### Overview

We are a specialty finance company focused on providing senior secured loans to venture capital-backed companies in technology-related industries, including technology, biotechnology, life science, and energy and renewables technology at all stages of development. We source our investments through our principal office located in Palo Alto, CA, as well as through our additional offices in Boston, MA, New York, NY, McLean, VA and Radnor, PA.

Our goal is to be the leading structured debt financing provider for venture capital-backed companies in technology-related industries requiring sophisticated and customized financing solutions. Our strategy is to evaluate and invest in a broad range of

technology-related industries including technology, biotechnology, life science, and energy and renewables technology and to offer a full suite of growth capital products. We invest primarily in structured debt with warrants and, to a lesser extent, in senior debt and equity investments. We invest primarily in private companies but also have investments in public companies.

We use the term “structured debt with warrants” to refer to any debt investment, such as a senior or subordinated secured loan, that is coupled with an equity component, including warrants, options or rights to purchase common or preferred stock. Our structured debt with warrants investments typically are secured by some or all of the assets of the portfolio company.

Our investment objective is to maximize our portfolio total return by generating current income from our debt investments and capital appreciation from our equity-related investments. Our primary business objectives are to increase our net income, net operating income and net asset value by investing in structured debt with warrants and equity of venture capital-backed companies in technology-related industries with attractive current yields and the potential for equity appreciation and realized gains. Our equity ownership in our portfolio companies may exceed 25% of the voting securities of such companies, which represents a controlling interest under the 1940 Act. In some cases, we receive the right to make additional equity investments in our portfolio companies in connection with future equity financing rounds. Capital that we provide directly to venture capital-backed companies in technology-related industries is generally used for growth and general working capital purposes as well as in select cases for acquisitions or recapitalizations.

We also make investments in qualifying small businesses through our two wholly-owned SBICs. Our SBIC subsidiaries, HT II and HT III, hold approximately \$154.9 million and \$319.2 million in assets, respectively, and accounted for approximately 8.9% and 18.4% of our total assets, respectively, prior to consolidation at March 31, 2015. As of March 31, 2015, the maximum statutory limit on the dollar amount of combined outstanding SBA guaranteed debentures is \$225.0 million, subject to periodic adjustments by the SBA. In aggregate, at March 31, 2015, with our net investment of \$112.5 million, HT II and HT III have the capacity to issue a total of \$190.2 million of SBA-guaranteed debentures, subject to SBA approval. At March 31, 2015, we have issued \$190.2 million in SBA-guaranteed debentures in our SBIC subsidiaries.

We have qualified as and have elected to be treated for tax purposes as a RIC under the Code. Pursuant to this election, we generally will not have to pay corporate-level taxes on any income that we distribute to our stockholders. However, our qualification and election to be treated as a RIC requires that we comply with provisions contained in the Code. For example, as a RIC we must receive 90% or more of our income from qualified earnings, typically referred to as “good income,” as well as satisfy asset diversification and income distribution requirements.

We are an internally managed, non-diversified, closed-end investment company that has elected to be regulated as a business development company under the 1940 Act. As a business development company, we are required to comply with certain regulatory requirements. For instance, we generally have to invest at least 70% of our total assets in

“qualifying assets,” which includes securities of private U.S. companies, cash, cash equivalents and high-quality debt investments that mature in one year or less.

Our portfolio is comprised of, and we anticipate that our portfolio will continue to be comprised of, investments primarily in technology related companies at various stages of their development. Consistent with requirements under the 1940 Act, we invest primarily in United-States based companies and to a lesser extent in foreign companies.

We regularly engage in discussions with third parties with respect to various potential transactions. We may acquire an investment or a portfolio of investments or an entire company or sell a portion of our portfolio on an opportunistic basis. We, our subsidiaries or our affiliates may also agree to manage certain other funds that invest in debt, equity or provide other financing or services to companies in a variety of industries for which we may earn management or other fees for our services. We may also invest in the equity of these funds, along with other third parties, from which we would seek to earn a return and/or future incentive allocations. Some of these transactions could be material to our business. Consummation of any such transaction will be subject to completion of due diligence, finalization of key business and financial terms (including price) and negotiation of final definitive documentation as well as a number of other factors and conditions including, without limitation, the approval of our board of directors and required regulatory or third party consents and, in certain cases, the approval of our stockholders. Accordingly, there can be no assurance that any such transaction would be consummated. Any of these transactions or funds may require significant management resources either during the transaction phase or on an ongoing basis depending on the terms of the transaction.

## Portfolio and Investment Activity

The total fair value of our investment portfolio was \$1.2 billion at March 31, 2015, as compared to \$1.0 billion at December 31, 2014.

The fair value of our debt investment portfolio at March 31, 2015 was approximately \$1.1 billion, compared to a fair value of approximately \$923.9 million at December 31, 2014. The fair value of the equity portfolio at March 31, 2015 was approximately \$72.5 million, compared to a fair value of approximately \$71.7 million at December 31, 2014. The fair value of the warrant portfolio at March 31, 2015 was approximately \$30.9 million, compared to a fair value of approximately \$25.1 million at December 31, 2014.

## Portfolio Activity

Our investments in portfolio companies take a variety of forms, including unfunded contractual commitments and funded investments. From time to time, unfunded contractual commitments depend upon a portfolio company reaching certain milestones before the debt commitment is available to the portfolio company, which is expected to affect our funding levels. These commitments will be subject to the same underwriting and ongoing portfolio maintenance as the on-balance sheet financial instruments that we hold. Debt commitments generally fund over the two succeeding quarters from close. Not all debt commitments represent our future cash requirements. Similarly, unfunded contractual commitments may expire without being drawn and do not represent our future cash requirements. We intend to have our unfunded commitments covered by either liquid assets or borrowings to the extent required by the 1940 Act.

Prior to entering into a contractual commitment, we generally issue a non-binding term sheet to a prospective portfolio company. Non-binding term sheets are subject to completion of our due diligence and final investment committee approval process, as well as the negotiation of definitive documentation with the prospective portfolio companies. These non-binding term sheets generally convert to contractual commitments in approximately 90 days from signing. Not all non-binding term sheets are expected to close and do not necessarily represent future cash requirements.

Our portfolio activity for the three months ended March 31, 2015 (unaudited) and the year ended December 31, 2014 was comprised of the following:

| (in millions)  | March 31, 2015 | December 31, 2014 |
|--|----------------|-------------------|
| <b>Debt Commitments <sup>(1)</sup></b>                 |                |                   |
| New portfolio company                                  | \$ 201.5       | \$ 776.9          |
| Existing portfolio company                             | 68.1           | 118.0             |
| Total  | \$ 269.6       | \$ 894.9          |
| <b>Funded and Restructured Debt Investments</b>        |                |                   |
| New portfolio company                                  | \$ 139.1       | \$ 434.0          |
| Existing portfolio company                             | 67.9           | 177.0             |
| Total  | \$ 207.0       | \$ 611.0          |
| <b>Funded Equity Investments</b>                       |                |                   |
| New portfolio company                                  | \$ 1.4         | \$ 7.2            |
| Existing portfolio company                             | 1.0            | 3.1               |
| Total  | \$ 2.4         | \$ 10.3           |
| <b>Unfunded Contractual Commitments <sup>(2)</sup></b> |                |                   |

|                            |          |          |
|----------------------------|----------|----------|
| Total                      | \$ 377.6 | \$ 339.0 |
| Non-Binding Term Sheets    |          |          |
| New portfolio company      | \$ 136.0 | \$ 104.0 |
| Existing portfolio company | 5.0      | 4.2      |
| Total                      | \$ 141.0 | \$ 108.2 |

(1) Includes restructured loans and renewals in addition to new commitments.

(2) The amount for March 31, 2015 includes unfunded contractual commitments in 41 new and existing portfolio companies. Approximately \$243.5 million of these unfunded contractual commitments as of March 31, 2015 are dependent upon the portfolio company reaching certain milestones before the debt commitment becomes available.

We receive payments in our debt investment portfolio based on scheduled amortization of the outstanding balances. In addition, we receive principal repayments for some of our loans prior to their scheduled maturity date. The frequency or volume of these early principal repayments may fluctuate significantly from period to period. During the three months ended March 31, 2015, we received approximately \$74.0 million in aggregate principal repayments. Of the approximately \$74.0 million of aggregate principal repayments, approximately \$27.5 million were scheduled principal payments, and approximately \$46.5 million were early principal repayments

related to 11 portfolio companies. Of the approximately \$46.5 million early principal repayments, approximately \$2.9 million was an early repayment due to a M&A transaction related to one portfolio company. Although we have experienced significant principal repayments during the previous year, we believe that future early repayments will not be significant based on our current portfolio; however, the yield on our loan portfolio may be lower.

Total portfolio investment activity (inclusive of unearned income) for the three months ended March 31, 2015 (unaudited) and for the year ended December 31, 2014 was as follows:

| (in millions)   | March 31, 2015 | December 31, 2014 |
|---|----------------|-------------------|
| Beginning portfolio   | \$ 1,020.7     | \$ 910.3          |
| New fundings and restructures   | 209.4          | 621.3             |
| Warrants not related to current period fundings                                     | 0.5            | 0.8               |
| Principal payments received on investments  | (27.5 )        | (135.8 )          |
| Early payoffs   | (46.5 )        | (358.3 )          |
| Accretion of loan discounts and paid-in-kind principal                              | 7.0            | 24.5              |
| Net acceleration of loan discounts and loan fees due to early payoff or restructure | (0.8 )         | (3.3 )            |
| New loan fees   | (2.9 )         | (9.2 )            |
| Warrants converted to equity  | —              | 2.0               |
| Sale of investments   | (2.7 )         | (9.1 )            |
| Loss on investments due to write offs   | (1.0 )         | (3.9 )            |
| Net change in unrealized appreciation (depreciation)                                | 5.2            | (18.6 )           |
| Ending portfolio  | \$ 1,161.4     | \$ 1,020.7        |

The following table shows the fair value of our portfolio of investments by asset class as of March 31, 2015 (unaudited) and December 31, 2014.

| (in thousands)                    | March 31, 2015 |                     | December 31, 2014 |                     |   |
|-----------------------------------|----------------|---------------------|-------------------|---------------------|---|
|                                   | Investments at | Percentage of Total | Investments at    | Percentage of Total |   |
|                                   | Fair Value     | Portfolio           | Fair Value        | Portfolio           |   |
| Senior secured debt with warrants | \$878,830      | 75.7                | % \$740,659       | 72.6                | % |
| Senior secured debt               | 210,140        | 18.1                | % 208,345         | 20.4                | % |
| Preferred stock                   | 29,217         | 2.5                 | % 57,548          | 5.6                 | % |
| Common stock                      | 43,234         | 3.7                 | % 14,185          | 1.4                 | % |
| Total                             | \$1,161,421    | 100.0               | % \$1,020,737     | 100.0               | % |

The increase in common stock and the decrease in preferred stock is primarily due to the initial public offering of Box, Inc. on January 23, 2015 in which all of our preferred shares were converted to common stock in the public portfolio company. The shares held by us in Box, Inc. are subject to a customary IPO lockup period and we are restricted from selling our shares of common stock for approximately six months from the date of the initial public offering. Our



potential gain is subject to the price of the shares when we exit the investment.

A summary of our investment portfolio at value by geographic location is as follows:

|                | March 31, 2015     |                               | December 31, 2014  |                               |  |
|----------------|--------------------|-------------------------------|--------------------|-------------------------------|--|
|                | Investments at     | Percentage of Total Portfolio | Investments at     | Percentage of Total Portfolio |  |
| (in thousands) | Fair Value         |                               | Fair Value         |                               |  |
| United States  | \$1,100,701        | 94.8 %                        | \$967,803          | 94.8 %                        |  |
| India          | 29,645             | 2.5 %                         | 24,175             | 2.4 %                         |  |
| Netherlands    | 20,629             | 1.8 %                         | 19,913             | 2.0 %                         |  |
| Israel         | 8,032              | 0.7 %                         | 6,498              | 0.6 %                         |  |
| Canada         | 2,343              | 0.2 %                         | 2,314              | 0.2 %                         |  |
| England        | 71                 | —                             | 34                 | —                             |  |
| <b>Total</b>   | <b>\$1,161,421</b> | <b>100.0 %</b>                | <b>\$1,020,737</b> | <b>100.0 %</b>                |  |

As of March 31, 2015, the Company held warrants or equity positions in six companies that have filed registration statements on Form S-1 with the SEC in contemplation of potential initial public offerings, including Good Technology, Inc., ViewRay, Inc. and four companies which filed confidentially under the JOBS Act. There can be no assurance that these companies will complete their initial public offerings in a timely manner or at all.

#### Changes in Portfolio

We generate revenue in the form of interest income, primarily from our investments in debt securities, and commitment and facility fees. Fees generated in connection with our debt investments are recognized over the life of the loan or, in some cases, recognized as earned. In addition, we generate revenue in the form of capital gains, if any, on warrants or other equity-related securities that we acquire from our portfolio companies. Our investments generally range from \$1.0 million to \$40.0 million. As of March 31, 2015, our debt investments have a term of between two and seven years and typically bear interest at a rate ranging from the prevailing U.S. prime rate, or Prime, or the London Interbank Offered Rate, or LIBOR, to approximately 14%. In addition to the cash yields received on our debt investments, in some instances, our debt investments may also include any of the following: end-of-term payments, exit fees, balloon payment fees, commitment fees, success fees, payment-in-kind (“PIK”) provisions or prepayment fees which may be required to be included in income prior to receipt.

Loan origination and commitment fees received in full at the inception of a loan are deferred and amortized into fee income as an enhancement to the related loan’s yield over the contractual life of the loan. We recognize nonrecurring fees amortized over the remaining term of the loan commencing in the quarter relating to specific loan modifications. Loan exit fees to be paid at the termination of the loan are accreted into interest income over the contractual life of the loan. We had approximately \$5.5 million and \$4.5 million of unamortized fees at March 31, 2015 and December 31, 2014, respectively, and approximately \$17.8 million and \$19.3 million in exit fees receivable at March 31, 2015 and December 31, 2014, respectively.

We have debt investments in our portfolio that contain a PIK provision. The PIK interest, computed at the contractual rate specified in each loan agreement, is added to the principal balance of the loan and recorded as interest income. To maintain our status as a RIC, this non-cash source of income must be paid out to stockholders in the form of dividends even though we have not yet collected the cash. Amounts necessary to pay these dividends may come from available cash or the liquidation of certain investments. We recorded approximately \$907,000 and \$852,000 in PIK income during the three months ended March 31, 2015 and 2014, respectively.

In the majority of cases, we collateralize our investments by obtaining a first priority security interest in a portfolio company’s assets, which may include its intellectual property. In other cases, we obtain a negative pledge covering a company’s intellectual property. At March 31, 2015, approximately 48.1% of our portfolio company debt investments were secured by a first priority security in all of the assets of the portfolio company, including their intellectual property, and 51.9% of our portfolio company debt investments were to portfolio companies that were prohibited from pledging or encumbering their intellectual property, or subject to a negative pledge. At March 31, 2015 we had no equipment only liens on any of our portfolio companies.

Interest on debt securities is generally payable monthly, with amortization of principal typically occurring over the term of the investment. In addition, certain of our loans may include an interest-only period ranging from three to eighteen months or longer. In limited instances in which we choose to defer amortization of the loan for a period of time from the date of the initial investment, the principal amount of the debt securities and any accrued but unpaid interest become due at the maturity date.

The core yield on our debt investments, which excludes any benefits from the accretion of fees and income related to early loan repayments attributed to the acceleration of unamortized fees and income as well as prepayment of fees,

was 12.8% and 14.0%, during the three months ended March 31, 2015 and 2014, respectively. The effective yield on our debt investments, which includes the effects of fee and income accelerations attributed to early payoffs, restructuring, loan modifications and other one-time event fees, was 12.9% and 17.9% for the three months ended March 31, 2015 and 2014, respectively. This decrease in effective yield between periods is primarily due to decreased one-time fee accelerations and payoffs during the three months ended March 31, 2015 as compared to the three months ended March 31, 2014. The effective yield is derived by dividing total investment income by the weighted average earning investment portfolio assets outstanding during the quarter, excluding non-interest earning assets such as warrants and equity investments.

## Portfolio Composition

Our portfolio companies are primarily privately held companies and public companies which are active in the drug discovery and development, software, drug delivery, medical device and equipment, energy technology, internet consumer and business services, consumer and business products, specialty pharmaceuticals, communications and networking, information services, media/content/info, surgical devices, healthcare services, semiconductors, biotechnology tools, diagnostic and electronics and computer hardware industry sectors. These sectors are characterized by high margins, high growth rates, consolidation and product and market extension opportunities. Value for companies in these sectors is often vested in intangible assets and intellectual property.

As of March 31, 2015, approximately 62.9% of the fair value of our portfolio was composed of investments in four industries: 25.8% was composed of investments in the drug discovery and development industry, 13.4% was composed of investments in the software industry, 12.1% was composed of investments in the drug delivery industry and 11.6% was composed of investments in the medical devices and equipment industry.

The following table shows the fair value of our portfolio by industry sector at March 31, 2015 (unaudited) and December 31, 2014:

|                                       | March 31, 2015    |                     | December 31, 2014 |                     |   |
|---------------------------------------|-------------------|---------------------|-------------------|---------------------|---|
|                                       | Investments<br>at | Percentage of Total | Investments<br>at | Percentage of Total |   |
| (in thousands)                        | Fair Value        | Portfolio           | Fair Value        | Portfolio           |   |
| Drug Discovery & Development          | \$299,133         | 25.8                | % \$267,618       | 26.2                | % |
| Software                              | 156,179           | 13.4                | % 125,412         | 12.3                | % |
| Drug Delivery                         | 140,725           | 12.1                | % 88,491          | 8.7                 | % |
| Medical Devices & Equipment           | 135,285           | 11.6                | % 138,046         | 13.5                | % |
| Energy Technology                     | 107,283           | 9.2                 | % 68,280          | 6.7                 | % |
| Internet Consumer & Business Services | 87,374            | 7.5                 | % 69,655          | 6.8                 | % |
| Consumer & Business Products          | 63,737            | 5.5                 | % 63,225          | 6.2                 | % |
| Specialty Pharmaceuticals             | 50,583            | 4.4                 | % 51,536          | 5.0                 | % |
| Communications & Networking           | 37,362            | 3.2                 | % 61,433          | 6.0                 | % |
| Information Services                  | 32,244            | 2.8                 | % 27,016          | 2.6                 | % |
| Media/Content/Info                    | 27,412            | 2.4                 | % 29,219          | 2.9                 | % |
| Surgical Devices                      | 9,674             | 0.8                 | % 9,915           | 1.0                 | % |
| Healthcare Services, Other            | 7,657             | 0.7                 | % 10,527          | 1.0                 | % |
| Semiconductors                        | 5,076             | 0.4                 | % 5,126           | 0.5                 | % |
| Biotechnology Tools                   | 960               | 0.1                 | % 3,721           | 0.4                 | % |
| Diagnostic                            | 671               | 0.1                 | % 825             | 0.1                 | % |
| Electronics & Computer Hardware       | 66                | 0.0                 | % 692             | 0.1                 | % |
| Total                                 | \$1,161,421       | 100.0               | % \$1,020,737     | 100.0               | % |

Industry and sector concentrations vary as new loans are recorded and loans pay off. Loan revenue, consisting of interest, fees, and recognition of gains on equity and equity-related interests, can fluctuate materially when a loan is paid off or a related warrant or equity interest is sold. Revenue recognition in any given year can be highly concentrated among several portfolio companies.

For the three months ended March 31, 2015 and the year ended December 31, 2014, our ten largest portfolio companies represented approximately 27.3% and 28.6% of the total fair value of our investments in portfolio companies, respectively. At March 31, 2015, we had two investments that represent 5% or more of our net assets and at December 31, 2014, we had three investments that represented 5% or more of our net assets. At March 31, 2015, we had three equity investments representing approximately 57.5% of the total fair value of our equity investments, and each represented 5% or more of the total fair value of our equity investments. At December 31, 2014, we had three equity investments which represented approximately 61.5% of the total fair value of our equity investments, and each represented 5% or more of the total fair value of our equity investments.

As of March 31, 2015, 100.0% of our debt investments were in a senior secured first lien position, and approximately 97.3% of the debt investment portfolio was priced at floating interest rates or floating interest rates with a Prime or LIBOR-based interest rate floor. As a result, we believe we are well positioned to benefit should market interest rates rise in the near future.

Our investments in senior secured debt with warrants have equity enhancement features, typically in the form of warrants or other equity-related securities designed to provide us with an opportunity for capital appreciation. Our warrant coverage generally ranges from 3% to 20% of the principal amount invested in a portfolio company, with a strike price generally equal to the most recent equity financing round. As of March 31, 2015, we held warrants in 129 portfolio companies, with a fair value of approximately \$30.9 million. The fair value of our warrant portfolio increased by approximately \$5.8 million, as compared to a fair value of \$25.1 million at December 31, 2014 primarily related to the addition of warrants in nine new and eight existing portfolio companies during the period.

Our existing warrant holdings would require us to invest approximately \$94.4 million to exercise such warrants as of March 31, 2015. Warrants may appreciate or depreciate in value depending largely upon the underlying portfolio company's performance and overall market conditions. Of the warrants which we have monetized since inception, we have realized warrant gain multiples in the range of approximately 1.02x to 14.93x based on the historical rate of return on our investments. However, our warrants may not appreciate in value and, in fact, may decline in value. Accordingly, we may not be able to realize gains from our warrant portfolio.

As required by the 1940 Act, we classify our investments by level of control. "Control investments" are defined in the 1940 Act as investments in those companies that we are deemed to "control", which, in general, includes a company in which we own 25% or more of the voting securities of such company or have greater than 50% representation on its board. "Affiliate investments" are investments in those companies that are "affiliated companies" of ours, as defined in the 1940 Act, which are not control investments. We are deemed to be an "affiliate" of a company in which we have invested if we own 5% or more, but less than 25%, of the voting securities of such company. "Non-control/non-affiliate investments" are investments that are neither control investments nor affiliate investments.

The following table summarizes our realized and unrealized gain and loss and changes in our unrealized appreciation and depreciation on affiliate investments for the three months ended March 31, 2015 and 2014 (unaudited). We did not hold any Control investments at either March 31, 2015 or 2014.

| (in thousands)             |           | For the Three Months Ended March 31, 2015 |                      |                                 |   |          |             |
|----------------------------|-----------|---|----------------------|---------------------------------|---|----------|-------------|
| Portfolio Company          | Type      | Fair Value at<br>March 31,<br>2015        | Unrealized           |                                 | Reversal of                                   | Realized |             |
|                            |           |   | Investment<br>Income | (Depreciation)/<br>Appreciation | Unrealized<br>(Depreciation)/<br>Appreciation |          | Gain/(Loss) |
| Gelesis, Inc.              | Affiliate | \$ 2,414                                  | \$—                  | \$ 2,087                        | \$ —  | \$ —     |             |
| Optiscan BioMedical, Corp. | Affiliate | 6,768                                     | —                    | 695                             | —   | —        |             |
| Stion Corporation          | Affiliate | 1,600                                     | 101                  | (469)                           | —   | —        |             |
| Total                      |           | \$ 10,782                                 | \$ 101               | \$ 2,313                        | \$ —  | \$ —     |             |

| (in thousands)    |      | For the Three Months Ended March 31, 2014 |                      |                                 |   |          |
|-------------------|------|---|----------------------|---------------------------------|---|----------|
| Portfolio Company | Type | Fair Value at<br>March 31,<br>2014        | Unrealized           |                                 | Reversal of                                   | Realized |
|                   |      |   | Investment<br>Income | (Depreciation)/<br>Appreciation | Unrealized<br>(Depreciation)/<br>Appreciation |          |

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|                            |           |           |         |        | Appreciation |   |      |
|----------------------------|-----------|-----------|---------|--------|--------------|---|------|
| Gelesis, Inc.              | Affiliate | \$ 497    | \$—     | \$ 24  | \$           | — | \$ — |
| Optiscan BioMedical, Corp. | Affiliate | 5,032     | —       | 247    |              | — | —    |
| Stion Corporation          | Affiliate | 5,664     | 1,475   | (224 ) |              | — | —    |
| Total                      |           | \$ 11,193 | \$1,475 | \$ 47  | \$           | — | \$ — |

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## Portfolio Grading

We use an investment grading system, which grades each debt investment on a scale of 1 to 5 to characterize and monitor our expected level of risk on the debt investments in our portfolio with 1 being the highest quality. The following table shows the distribution of our outstanding debt investments on the 1 to 5 investment grading scale at fair value as of March 31, 2015 (unaudited) and December 31, 2014, respectively:

| Investment Grading | March 31, 2015      |                             |                               | December 31, 2014   |                             |                               |
|--------------------|---------------------|-----------------------------|-------------------------------|---------------------|-----------------------------|-------------------------------|
|                    | Number of Companies | Debt Investments Fair Value | Percentage of Total Portfolio | Number of Companies | Debt Investments Fair Value | Percentage of Total Portfolio |
| 1                  | 16                  | \$ 188,399                  | 17.8 %                        | 19                  | \$ 195,819                  | 21.2 %                        |
| 2                  | 45                  | 590,876                     | 55.9 %                        | 45                  | 479,037                     | 51.8 %                        |
| 3                  | 14                  | 174,911                     | 16.5 %                        | 16                  | 183,522                     | 19.9 %                        |
| 4                  | 11                  | 90,233                      | 8.5 %                         | 6                   | 39,852                      | 4.3 %                         |
| 5                  | 5                   | 13,613                      | 1.3 %                         | 8                   | 25,676                      | 2.8 %                         |
|                    |                     | \$ 1,058,032                | 100.0 %                       |                     | \$ 923,906                  | 100.0 %                       |

As of March 31, 2015, our debt investments had a weighted average investment grading of 2.26, as compared to 2.24 at December 31, 2014. Our policy is to lower the grading on our portfolio companies as they approach the point in time when they will require additional equity capital. Additionally, we may downgrade our portfolio companies if they are not meeting our financing criteria or are underperforming relative to their respective business plans. Various companies in our portfolio will require additional funding in the near term or have not met their business plans and therefore have been downgraded until their funding is complete or their operations improve.

The 97% increase in percentage of total portfolio rated 4 at March 31, 2015 from December 31, 2014 is due to the downgrade of four portfolio companies from a 3 to a 4 during the three months ended March 31, 2015. The increase in weighted average investment grading at March 31, 2015 is partially offset by the 53% decrease in percentage of total portfolio rated 5 at March 31, 2015 from December 31, 2014 due to the upgrade of three portfolio companies from a 5 during the three months ended March 31, 2015.

At March 31, 2015, we had four debt investments on non-accrual with a cumulative cost and fair value of approximately \$34.0 million and \$12.0 million, respectively. At December 31, 2014 we had four debt investments on non-accrual with a cumulative cost and fair value of approximately \$28.9 million and \$10.6 million, respectively.

## Results of Operations

Comparison of the three month periods ended March 31, 2015 and 2014

## Investment Income



Total investment income for the three months ended March 31, 2015 was approximately \$32.5 million as compared to approximately \$35.8 million for the three months ended March 31, 2014.

Interest income for the three months ended March 31, 2015 totaled approximately \$30.6 million as compared to approximately \$30.8 million for the three months ended March 31, 2014. Income from commitment, facility and loan related fees for the three months ended March 31, 2015 totaled approximately \$1.9 million as compared to approximately \$4.9 million for the three months ended March 31, 2014. The decrease in both interest income and income from commitment, facility and loan related fees for the three months ended March 31, 2015 as compared to the three months ended March 31, 2014 is primarily attributable to interest and fees that were accelerated related to early pay-offs and restructurings during the three months ended March 31, 2014 that did not occur during the three months ended March 31, 2015.

The following table shows the PIK-related activity for the three months ended March 31, 2015 and 2014, at cost (unaudited):

| (in thousands)                             | Three Months<br>Ended March 31, |         |
|--|---------------------------------|---------|
|  | 2015                            | 2014    |
| Beginning PIK loan balance                 | \$6,250                         | \$5,603 |
| PIK interest capitalized during the period | 907                             | 852     |
| Payments received from PIK loans           | (1,356)                         | (1,207) |
| Ending PIK loan balance                    | \$5,801                         | \$5,248 |

The increase in payments received from PIK loans and PIK interest capitalized during the three months ended March 31, 2015 as compared to the three months ended March 31, 2014 is due to the relative principal balances outstanding on PIK loans and timing of payment and funding activities between the comparable periods.

In certain investment transactions, we may earn income from advisory services; however, we had no income from advisory services in either the three months ended March 31, 2015 or 2014.

#### Operating Expenses

Our operating expenses are comprised of interest and fees on our borrowings, general and administrative expenses and employee compensation and benefits. Our operating expenses totaled approximately \$19.5 million and \$17.5 million during the three months ended March 31, 2015 and 2014, respectively.

#### Interest and Fees on our Borrowings

Interest and fees on our borrowings totaled approximately \$9.4 million and \$9.2 million for the three months ended March 31, 2015 and 2014, respectively. The increase in the three month period ended March 31, 2015 was primarily attributable to the higher weighted average balances outstanding on our 2019 Notes and Asset Backed Notes, partially offset by a reduction in outstanding Convertible Senior Notes.

We had a weighted average cost of debt, comprised of interest and fees and loss on debt extinguishment (long-term liabilities – convertible senior notes), of approximately 6.1% and 6.9% for the three months ended March 31, 2015 and 2014, respectively. The decrease between comparative periods was primarily driven by the issuance or substitution of lower cost debt positions between periods.

#### General and Administrative Expenses

General and administrative expenses include legal fees, consulting fees, accounting fees, printer fees, insurance premiums, rent, expenses associated with the workout of underperforming investments and various other expenses. Our general and administrative expenses increased to \$3.6 million from \$2.5 million for the three months ended March 31, 2015 and 2014, respectively. The increase is primarily due to recruiting costs associated with strategic board recruitment and operational hiring objectives as well as an increase in corporate legal expenses and outside consulting services.

#### Employee Compensation

Employee compensation and benefits totaled approximately \$3.8 million for the three months ended March 31, 2015 as compared to approximately \$4.2 million for the three months ended March 31, 2014. The decrease between these periods was primarily due to changes in variable compensation expense.

Stock-based compensation totaled approximately \$2.7 million for the three months ended March 31, 2015 as compared to approximately \$1.6 million for the three months ended March 31, 2014. The increase was primarily attributable to additional stock based compensation awards granted in March of 2015 and April of 2014.

#### Loss on Extinguishment of Convertible Senior Notes

Upon meeting the stock trading price conversion requirement during the three months ended June 30, 2014, September 30, 2014 and December 31, 2014, the Convertible Senior Notes became convertible on July 1, 2014 and continued to be convertible during each of the three months ended September 30, 2014, December 31, 2014 and March 31, 2015, respectively. During this period and as of March 31, 2015, holders of approximately \$57.4 million of our Convertible Senior Notes have exercised their conversion rights and these Convertible Senior Notes were settled with a combination of cash equal to the outstanding principal amount of the converted notes and approximately 1.5 million shares of the Company's common stock, or \$24.3 million. See "Subsequent Events."

We recorded a loss on extinguishment of debt for the proportionate amount of unamortized debt issuance costs and original issue discount on Notes converted during the period. The loss was partially offset by a gain in the amount of the difference between the outstanding principal balance of the converted notes and the fair value of the debt instrument. The net loss on extinguishment of debt we recorded for the three months ended March 31, 2015 was approximately \$1,000 and was classified as a component of net investment income in our Consolidated Statement of Operations.

## Net Investment Realized Gains and Losses and Net Unrealized Appreciation and Depreciation

Realized gains or losses are measured by the difference between the net proceeds from the repayment or sale and the cost basis of an investment without regard to unrealized appreciation or depreciation previously recognized, and includes investments written off during the period, net of recoveries. Net change in unrealized appreciation or depreciation primarily reflects the change in portfolio investment values during the reporting period, including the reversal of previously recorded unrealized appreciation or depreciation when gains or losses are realized.

A summary of realized gains and losses for the three months ended March 31, 2015 and 2014 is as follows:

| (in thousands)     | Three Months<br>Ended March 31, |         |
|--------------------|---------------------------------|---------|
|                    | 2015                            | 2014    |
| Realized gains     | \$4,330                         | \$5,382 |
| Realized losses    | (1,018)                         | (510)   |
| Net realized gains | \$3,312                         | \$4,872 |

During the three months ended March 31, 2015 and 2014, we recognized net realized gains of approximately \$3.3 million and \$4.9 million, respectively.

During the three months ended March 31, 2015, we recorded gross realized gains of approximately \$4.3 million primarily from the sale of investments in four portfolio companies, including Cembra, Inc. (\$2.0 million), Celladon Corporation (\$1.4 million), Everyday Health, Inc. (\$387,000) and Identiv, Inc. (\$304,000). These gains were partially offset by gross realized losses of approximately \$1.0 million from the liquidation of our warrant and equity investments in three portfolio companies.

During the three-month period ended March 31, 2014, we recognized gross realized gains of approximately \$5.4 million primarily from the sale of investments in five portfolio companies, including CTI BioPharma Corp. (\$1.3 million), Neuralstem, Inc. (\$1.2 million), Portola Pharmaceuticals, Inc. (\$700,000), AcelRx Pharmaceuticals, Inc. (\$485,000) and Dicerna Pharmaceuticals, Inc. (\$200,000). These gains were partially offset by gross realized losses of approximately \$500,000 from the liquidation of our warrant and equity investments in five portfolio companies.

The net unrealized appreciation and depreciation of our investments is based on the fair value of each investment determined in good faith by our Board of Directors. The following table summarizes the change in net unrealized appreciation/depreciation of investments for the three months ended March 31, 2015 and 2014:

| (in thousands)  | Three<br>Months Ended March 31, |           |
|---|---------------------------------|-----------|
|   | 2015                            | 2014      |
| Gross unrealized appreciation on portfolio investments                        | \$ 21,155                       | \$ 25,249 |
| Gross unrealized depreciation on portfolio investments                        | (13,239 )                       | (25,296 ) |
| Reversal of prior period net unrealized appreciation upon a realization event | (3,708 )                        | (1,656 )  |
| Reversal of prior period net unrealized depreciation upon a realization event | 1,005                           | 739       |
| Net unrealized appreciation (depreciation) on taxes payable                   | 442                             | (72 )     |

|   |          |           |
|---|----------|-----------|
| Citigroup warrant participation                                     | (41 )    | 45        |
| Net unrealized appreciation (depreciation) on portfolio investments | \$ 5,614 | \$ (991 ) |

During the three months ended March 31, 2015, we recorded approximately \$5.6 million of net unrealized appreciation, of which \$5.2 million is net unrealized appreciation from our debt, equity and warrant investments. Approximately \$704,000 million is attributed to net unrealized appreciation on our debt investments which primarily related to the reversal of \$2.4 million unrealized depreciation for prior period collateral based impairments on two portfolio companies offset by \$1.8 million unrealized depreciation for collateral based impairments on six portfolio companies. Approximately \$1.0 million is attributed to net unrealized appreciation on our equity investments which primarily related to approximately \$3.0 million unrealized appreciation on three private portfolio companies and \$1.5 million unrealized appreciation on our public equity portfolio related to portfolio company performance offset by the reversal of \$3.7 million of prior period net unrealized appreciation upon being realized as a gain for our sale of shares of Cempra, Inc. Celladon Corporation, Everyday Health, and Identiv, Inc. as discussed above. Finally, approximately \$3.1 million is attributed to net unrealized appreciation on our warrant investments which primarily related to \$1.2 million of unrealized appreciation on our public portfolio company investments and the reversal of \$1.0 million of unrealized depreciation upon being realized as a loss due to the liquidation of our warrant investments in three portfolio companies.

Net unrealized appreciation increased by approximately \$442,000 as a result of decreased estimated taxes payable for the three months ended March 31, 2015.

During the three months ended March 31, 2015, net unrealized appreciation was offset by approximately \$41,000 of net appreciation of fair value on the pool of warrants collateralized under the warrant participation.

During the three-months ended March 31, 2014, we recorded approximately \$1.0 million of net unrealized depreciation from our debt, equity and warrant investments. Approximately \$12.0 million is attributed to net unrealized appreciation on equity. This unrealized appreciation was offset by approximately \$10.3 million attributed to net unrealized depreciation on our warrant investments, including approximately \$1.5 million of net unrealized depreciation due to the reversal of prior period net unrealized appreciation upon being realized as a gain. Additionally, this unrealized appreciation was offset by approximately \$2.7 million of net unrealized depreciation on our debt investments, which primarily related to \$7.2 million of unrealized depreciation for collateral based impairments and the reversal of approximately \$300,000 of prior period net unrealized appreciation upon being realized as a loss due to the write-off or early payoff of debt investments.

Net unrealized appreciation decreased by approximately \$72,000 as a result of estimated taxes payable for the three-months ended March 31, 2014.

During the three-months ended March 31, 2014, net unrealized appreciation increased by approximately \$45,000 as a result of net depreciation of fair value on the pool of warrants collateralized under the warrant participation agreement.

The following table summarizes the change in net unrealized appreciation/(depreciation) in the investment portfolio by category, excluding net unrealized appreciation (depreciation) on taxes payable and Citigroup warrant participation, for the three months ended March 31, 2015 and 2014 (unaudited).

|  | Three Months Ended March 31,<br>2015 |        |          |         |
|--|--------------------------------------|--------|----------|---------|
| (in millions)  | Debt                                 | Equity | Warrants | Total   |
| Collateral Based Impairments                           | \$(1.8)                              | \$—    | \$—      | \$(1.8) |
| Reversals of Prior Period Collateral based impairments | 2.4                                  | —      | 0.2      | 2.6     |
| Reversals due to Debt Payoffs & Warrant/Equity sales   | 0.4                                  | (3.7)  | 1.0      | (2.3)   |
| Fair Value Market/Yield Adjustments*                   |                                      |        |          |         |
| Level 1 & 2 Assets                                     | —                                    | 1.5    | 1.2      | 2.7     |
| Level 3 Assets   | 0.1                                  | 3.2    | 0.7      | 4.0     |
| Total Fair Value Market/Yield Adjustments              | 0.1                                  | 4.7    | 1.9      | 6.7     |
| Total Unrealized Appreciation/(Depreciation)           | \$1.1                                | \$1.0  | \$3.1    | \$5.2   |
|  | Three Months Ended March 31,<br>2014 |        |          |         |
| (in millions)  | Debt                                 | Equity | Warrants | Total   |
| Collateral Based Impairments                           | \$(7.2)                              | \$—    | \$(0.2)  | \$(7.4) |
| Reversals due to Debt Payoffs & Warrant/Equity sales   | (0.3)                                | 0.2    | (9.6)    | (9.7)   |
| Fair Value Market/Yield Adjustments*                   |                                      |        |          |         |
| Level 1 & 2 Assets                                     | —                                    | 3.5    | 0.1      | 3.6     |
| Level 3 Assets   | 4.8                                  | 8.3    | (0.6)    | 12.5    |
| Total Fair Value Market/Yield Adjustments              | 4.8                                  | 11.8   | (0.5)    | 16.1    |

|  |          |         |            |           |
|--|----------|---------|------------|-----------|
| Total Unrealized Appreciation/(Depreciation) | \$ (2.7) | \$ 12.0 | \$ (10.3 ) | \$ (1.0 ) |
|--|----------|---------|------------|-----------|

\*Level 1 assets are generally equities listed in active markets and level 2 assets are generally warrants held in a public company. Observable market prices are typically the primary input in valuing level 1 and 2 assets. Level 3 asset valuations require inputs that are both significant and unobservable. Generally, level 3 assets are debt investments and warrants and equities held in a private company. See Note 2 to the financial statements discussing ASC 820.

#### Income and Excise Taxes

We account for income taxes in accordance with the provisions of ASC 740, Income Taxes, which requires that deferred income taxes be determined based upon the estimated future tax effects of differences between the financial statement and tax basis of assets and liabilities given the provisions of the enacted tax law. Valuation allowances are used to reduce deferred tax assets to the amount likely to be realized. We intend to distribute approximately \$16.7 million of spillover from long term earnings from the year ended December 31, 2014 to our shareholders in 2015.

### Net Increase in Net Assets Resulting from Operations and Earnings Per Share

For the three months ended March 31, 2015 and 2014, the net increase in net assets resulting from operations totaled approximately \$21.9 million and approximately \$22.2 million, respectively. These changes are made up of the items previously described.

The basic and fully diluted net change in net assets per common share were \$0.33 and \$0.33, respectively, for the three months ended March 31, 2015, whereas the basic and fully diluted net change in net assets per common share for the three months ended March 31, 2014 was \$0.36 and \$0.35, respectively.

For the purpose of calculating diluted earnings per share for three months ended March 31, 2015 and 2014, the dilutive effect of the Convertible Senior Notes under the treasury stock method is included in this calculation as our share price was greater than the conversion price in effect (\$11.28 as of March 31, 2015 and \$11.56 as of March 31, 2014) for the Convertible Senior Notes for such periods.

### Financial Condition, Liquidity, and Capital Resources

Our liquidity and capital resources are derived from our Wells Facility, Union Bank Facility (together the “Credit Facilities”), SBA debentures, Convertible Senior Notes, 2019 Notes, 2024 Notes, 2017 Asset-Backed Notes, 2021 Asset-Backed Notes (as each is defined herein) and cash flows from operations, including investment sales and repayments, and income earned. Our primary use of funds from operations includes investments in portfolio companies and payments of fees and other operating expenses we incur. We have used, and expect to continue to use, our borrowings and the proceeds from the turnover of our portfolio and from public and private offerings of securities to finance our investment objectives. We may raise additional equity or debt capital through both registered offerings off a shelf registration, “At-The-Market”, or ATM, and private offerings of securities, by securitizing a portion of our investments or borrowing, including from the SBA through our SBIC subsidiaries.

On August 16, 2013, we entered into an ATM equity distribution agreement with JMP Securities LLC, or JMP. The equity distribution agreement provides that we may offer and sell up to 8.0 million shares of our common stock from time to time through JMP, as our sales agent. Sales of our common stock, if any, may be made in negotiated transactions or transactions that are deemed to be “at the market,” as defined in Rule 415 under the Securities Act of 1933, as amended, including sales made directly on the NYSE or similar securities exchange or sales made to or through a market maker other than on an exchange, at prices related to the prevailing market prices or at negotiated prices.

During the year ended December 31, 2014, we sold 650,000 shares of common stock for total accumulated net proceeds of approximately \$9.5 million, all of which is accretive to net asset value. We generally use the net proceeds from these offerings to make investments, to repurchase or pay down liabilities and for general corporate purposes. As of March 31, 2015, approximately 7.35 million shares remained available for issuance and sale under the equity distribution agreement.

As of March 31, 2015, approximately \$57.4 million of our Convertible Senior Notes had been converted and were settled with a combination of cash equal to the outstanding principal amount of the converted notes and approximately 1.5 million shares of our common stock, or \$24.3 million. By not meeting the stock trading price conversion requirement during the three months ended March 31, 2015, the Convertible Senior Notes will not be convertible during the three-month period ending June 30, 2015. See “Subsequent Events”.

At March 31, 2015, we had \$17.6 million of Convertible Senior Notes, \$170.4 million of 2019 Notes, \$103.0 million of 2024 Notes, \$4.2 million of 2017 Asset-Backed Notes, \$129.3 million of 2021 Asset-Backed Notes and \$190.2



million of SBA debentures payable. We had no borrowings outstanding under either the Wells Facility or the Union Bank Facility. See “-Subsequent Events.”

At March 31, 2015, we had \$321.8 million in available liquidity, including \$171.8 million in cash and cash equivalents. We had available borrowing capacity of approximately \$75.0 million under the Wells Facility and \$75.0 million under the Union Bank Facility, subject to existing terms and advance rates and regulatory and covenant requirements. We primarily invest cash on hand in interest bearing deposit accounts.

At March 31, 2015, we had \$112.5 million of cash in restricted accounts related to our SBIC that we may use to fund new investments in the SBIC. With our net investments of \$38.0 million and \$74.5 million in HT II and HT III, respectively, we have the combined capacity to issue a total of \$190.2 million of SBA guaranteed debentures, subject to SBA approval. At March 31, 2015, we have issued \$190.2 million in SBA guaranteed debentures in our SBIC subsidiaries.

At March 31, 2015, we had approximately \$21.9 million of restricted cash, which consists of collections of interest and principal payments on assets that are securitized. In accordance with the terms of the related securitized 2017 Asset-Backed Notes and 2021 Asset-Backed Notes, based on current characteristics of the securitized debt investment portfolios, the restricted funds may be used to pay monthly interest and principal on the securitized debt and are not distributed to us or available for our general operations. During

the three months ended March 31, 2015, we principally funded our operations from (i) cash receipts from interest, dividend and fee income from our investment portfolio and (ii) cash proceeds from the realization of portfolio investments through the repayments of debt investments and the sale of debt and equity investments.

During the three months ended March 31, 2015, our operating activities used \$114.1 million of cash and cash equivalents, compared to \$35.8 million provided during the three months ended March 31, 2014. This \$149.9 million decrease in cash provided by operating activities resulted primarily from the increase in investment purchases of approximately \$95.5 million and the decrease of proceeds received from investment payoffs of approximately \$59.6 million.

During the three months ended March 31, 2015, our investing activities used \$9.3 million of cash, compared to approximately \$1.5 million provided during the three months ended March 31, 2014. This \$10.8 million decrease in cash provided by investing activities was primarily due to an increase of approximately \$9.3 million in cash, classified as restricted cash, on assets that are securitized.

During the three months ended March 31, 2015, our financing activities provided \$68.0 million of cash, compared to \$81.2 million used during the three months ended March 31, 2014. This \$149.2 million increase in cash provided by financing activities was primarily due to proceeds from issuance of common stock of \$101.4 million as a result of a public offering of 7,590,000 shares on March 27, 2015 and decreases in repayments of 2017 Asset-Backed Notes and SBA debentures of \$13.9 million and \$34.8 million, respectively.

As of March 31, 2015, net assets totaled \$763.3 million, with a net asset value per share of \$10.47. We intend to generate additional cash primarily from cash flows from operations, including income earned from investments in our portfolio companies. Our primary use of funds will be investments in portfolio companies and cash distributions to holders of our common stock.

As required by the 1940 Act, our asset coverage must be at least 200% after each issuance of senior securities. As of March 31, 2015 our asset coverage ratio under our regulatory requirements as a business development company was 279.7% excluding our SBA debentures as a result of our exemptive order from the SEC which allows us to exclude all SBA leverage from our asset coverage ratio. As a result of the SEC exemptive order, our ratio of total assets on a consolidated basis to outstanding indebtedness may be less than 200%, which while providing increased investment flexibility, also may increase our exposure to risks associated with leverage. Total leverage when including our SBA debentures was 224.1% at March 31, 2015.

#### Outstanding Borrowings

At March 31, 2015 (unaudited) and December 31, 2014, we had the following available borrowings and outstanding amounts:

| (in thousands)                | March 31, 2015  |                               | December 31, 2014 |                               |
|-------------------------------|-----------------|-------------------------------|-------------------|-------------------------------|
|                               | Total Available | Carrying Value <sup>(1)</sup> | Total Available   | Carrying Value <sup>(1)</sup> |
| SBA Debentures <sup>(2)</sup> | \$190,200       | \$190,200                     | \$190,200         | \$190,200                     |
| 2019 Notes                    | 170,364         | 170,364                       | 170,364           | 170,364                       |
| 2024 Notes                    | 103,000         | 103,000                       | 103,000           | 103,000                       |
| 2017 Asset-Backed Notes       | 4,203           | 4,203                         | 16,049            | 16,049                        |
| 2021 Asset-Backed Notes       | 129,300         | 129,300                       | 129,300           | 129,300                       |

|   |           |           |           |           |
|---|-----------|-----------|-----------|-----------|
| Convertible Senior Notes <sup>(3)</sup> | 17,642    | 17,375    | 17,674    | 17,345    |
| Wells Facility <sup>(4)</sup>           | 75,000    | —         | 75,000    | —         |
| Union Bank Facility <sup>(4)</sup>      | 75,000    | —         | 75,000    | —         |
| Total                                   | \$764,709 | \$614,442 | \$776,587 | \$626,258 |

- (1) Except for the Convertible Senior Notes, all carrying values are the same as the principal amount outstanding.
- (2) At both March 31, 2015 and December 31, 2014, the total available borrowings under the SBA debentures were \$190.2 million, of which \$41.2 million was available in HT II and \$149.0 million was available in HT III.
- (3) During the three months ended March 31, 2015, holders of approximately \$32,000 of our Convertible Senior Notes have exercised their conversion rights. The balance at March 31, 2015 represents the remaining aggregate principal amount outstanding of the Convertible Senior Notes less the unaccreted discount initially recorded upon issuance of the Convertible Senior Notes. The total unaccreted discount for the Convertible Senior Notes was approximately \$267,000 at March 31, 2015 and \$329,000 at December 31, 2014.
- (4) Availability subject to us meeting the borrowing base requirements.

Our net asset value may decline as a result of economic conditions in the United States. Our continued compliance with the covenants under our Credit Facilities, Convertible Senior Notes, 2019 Notes, 2024 Notes, 2017 Asset-Backed Notes, 2021 Asset-Backed Notes and SBA debentures depend on many factors, some of which are beyond our control. Material net asset devaluation could have a material adverse effect on our operations and could require us to reduce our borrowings in order to comply with certain covenants, including the ratio of total assets to total indebtedness. We believe that our current cash and cash equivalents, cash

generated from operations, and funds available from our Credit Facilities will be sufficient to meet our working capital and capital expenditure commitments for at least the next 12 months.

Debt financing costs are fees and other direct incremental costs we incur in obtaining debt financing and are recognized as prepaid expenses and amortized into the Consolidated Statement of Operations as loan fees over the term of the related debt instrument. Prepaid financing costs, net of accumulated amortization, as of March 31, 2015 (unaudited) and December 31, 2014 were as follows:

|                          | March    |                   |
|--------------------------|----------|-------------------|
| (in thousands)           | 31, 2015 | December 31, 2014 |
| SBA Debentures           | \$3,872  | \$ 4,038          |
| 2019 Notes               | 4,112    | 4,352             |
| 2024 Notes               | 3,121    | 3,205             |
| 2017 Asset-Backed Notes  | 63       | 506               |
| 2021 Asset-Backed Notes  | 2,985    | 3,207             |
| Convertible Senior Notes | 143      | 175               |
| Wells Facility           | 708      | 794               |
| Union Bank Facility      | 141      | 156               |
| Total                    | \$15,145 | \$ 16,433         |

#### Commitments

In the normal course of business, we are party to financial instruments with off-balance sheet risk. These consist primarily of unfunded contractual commitments to extend credit, in the form of loans, to our portfolio companies. Unfunded contractual commitments to provide funds to portfolio companies are not reflected on our balance sheet. Our unfunded contractual commitments may be significant from time to time. As of March 31, 2015, we had unfunded contractual commitments of approximately \$377.6 million. Approximately \$243.5 million of these unfunded contractual commitments are dependent upon the portfolio company reaching certain milestones before the contractual commitment becomes available. These commitments will be subject to the same underwriting and ongoing portfolio maintenance as are the on-balance sheet financial instruments that we hold. Since these commitments may expire without being drawn upon, the total commitment amount does not necessarily represent our future cash requirements. We intend to use cash flow from normal and early principal repayments, and proceeds from borrowings and notes to fund these commitments. We intend to have our unfunded commitments covered by either liquid assets or borrowings to the extent required by the 1940 Act.

In addition, we had approximately \$141.0 million of non-binding term sheets outstanding to five new and existing companies, which generally convert to contractual commitments within approximately 90 days of signing. Non-binding outstanding term sheets are subject to completion of our due diligence and final investment committee approval process, as well as the negotiation of definitive documentation with the prospective portfolio companies. Not all non-binding term sheets are expected to close and do not necessarily represent future cash requirements.

#### Contractual Obligations

The following table shows our contractual obligations as of March 31, 2015 (unaudited):

| Contractual Obligations <sup>(1)(2)</sup>  | Payments due by period (in thousands) |                        |                 |                  |                  |
|--|---------------------------------------|------------------------|-----------------|------------------|------------------|
|  | Total                                 | Less<br>than 1<br>year | 1 - 3<br>years  | 3 - 5<br>years   | After 5<br>years |
| Borrowings <sup>(3) (4)</sup>              | \$614,442                             | \$4,240                | \$17,338        | \$321,464        | \$271,400        |
| Operating Lease Obligations <sup>(5)</sup> | 5,867                                 | 1,539                  | 3,071           | 1,257            | —                |
| <b>Total</b>                               | <b>\$620,309</b>                      | <b>\$5,779</b>         | <b>\$20,409</b> | <b>\$322,721</b> | <b>\$271,400</b> |

(1) Excludes commitments to extend credit to our portfolio companies.

(2) We also have a warrant participation agreement with Citigroup. See Note 4 to our consolidated financial statements.

(3) Includes \$190.2 million in borrowings under the SBA debentures, \$170.4 million of the 2019 Notes, \$103.0 million of the 2024 Notes, \$4.2 million in aggregate principal amount of the 2017 Asset-Backed Notes, \$129.3 million in aggregate principal amount of the 2021 Asset-Backed Notes and \$17.4 million of the Convertible Senior Notes.

(4) Except for the Convertible Senior Notes, all carrying values are the same as the principal amount outstanding. The aggregate principal amount outstanding of the Convertible Senior Notes is \$17.6 million less the unaccreted discount initially recorded upon issuance of the Convertible Senior Notes. The total unaccreted discount for the Convertible Senior Notes was \$267,000 at March 31, 2015.

(5) Long-term facility leases.

Certain premises are leased under agreements which expire at various dates through March 2020. Total rent expense amounted to approximately \$408,000 and \$388,000 during the three months ended March 31, 2015 and 2014, respectively.

We and our executives and directors are covered by Directors and Officers Insurance, with the directors and officers being indemnified by us to the maximum extent permitted by Maryland law subject to the restrictions in the 1940 Act.

## Borrowings

### Long-term SBA Debentures

On September 27, 2006, HT II received a license to operate as a SBIC under the SBIC program and is able to borrow funds from the SBA against eligible investments and regulatory capital. Under the Small Business Investment Company Act and current SBA policy applicable to SBICs, a SBIC can have outstanding at any time SBA guaranteed debentures up to twice the amount of its regulatory capital. With our net investment of \$38.0 million in HT II as of March 31, 2015, HT II has the capacity to issue a total of \$41.2 million of SBA guaranteed debentures, subject to SBA approval, of which \$41.2 million was available at March 31, 2015. As of March 31, 2015, HT II has paid the SBA commitment fees and facility fees of approximately \$1.5 million and \$3.6 million, respectively. As of March 31, 2015 we held investments in HT II in 37 companies with a fair value of approximately \$111.2 million, accounting for approximately 9.6% of our total portfolio at March 31, 2015.

On May 26, 2010, HT III received a license to operate as a SBIC under the SBIC program and is able to borrow funds from the SBA against eligible investments and additional contributions to regulatory capital. With our net investment of \$74.5 million in HT III as of March 31, 2015, HT III has the capacity to issue a total of \$149.0 million of SBA guaranteed debentures, of which \$149.0 million was outstanding as of March 31, 2015. As of March 31, 2015, HT III has paid commitment fees and facility fees of approximately \$1.5 million and \$3.6 million, respectively. As of March 31, 2015, we held investments in HT III in 42 companies with a fair value of approximately \$288.4 million accounting for approximately 24.8% of our total portfolio at March 31, 2015.

SBICs are designed to stimulate the flow of private equity capital to eligible small businesses. Under present SBA regulations, eligible small businesses include businesses that have a tangible net worth not exceeding \$19.5 million and have average annual fully taxed net income not exceeding \$6.5 million for the two most recent fiscal years. In addition, SBICs must devote 25.0% of its investment activity to “smaller” enterprises as defined by the SBA. A smaller enterprise is one that has a tangible net worth not exceeding \$6.0 million and has average annual fully taxed net income not exceeding \$2.0 million for the two most recent fiscal years. SBA regulations also provide alternative size standard criteria to determine eligibility, which depend on the industry in which the business is engaged and are based on such factors as the number of employees and gross sales. According to SBA regulations, SBICs may make long-term loans to small businesses, invest in the equity securities of such businesses and provide them with consulting and advisory services. Through its wholly-owned subsidiaries HT II and HT III, we plan to provide long-term loans to qualifying small businesses, and in connection therewith, make equity investments.

HT II and HT III are periodically examined and audited by the SBA’s staff to determine their compliance with SBA regulations. If HT II or HT III fails to comply with applicable SBA regulations, the SBA could, depending on the severity of the violation, limit or prohibit HT II’s or HT III’s use of debentures, declare outstanding debentures immediately due and payable, and/or limit HT II or HT III from making new investments. In addition, HT II or HT III may also be limited in their ability to make distributions to us if they do not have sufficient capital in accordance with SBA regulations. Such actions by the SBA would, in turn, negatively affect us because HT II and HT III are our

wholly owned subsidiaries. HT II and HT III were in compliance with the terms of the SBIC's leverage as of March 31, 2015 as a result of having sufficient capital as defined under the SBA regulations.

The rates of borrowings under various draws from the SBA beginning in March 2009 are set semiannually in March and September and range from 2.25% to 4.62%. Interest payments on SBA debentures are payable semiannually. There are no principal payments required on these issues prior to maturity and no prepayment penalties. Debentures under the SBA generally mature ten years after being borrowed. Based on the initial draw down date of March 2009, the initial maturity of SBA debentures will occur in March 2019. In addition, the SBA charges a fee that is set annually, depending on the Federal fiscal year the leverage commitment was delegated by the SBA, regardless of the date that the leverage was drawn by the SBIC. The annual fees related to HT II debentures that pooled on September 22, 2010 were 0.406% and 0.285%, depending upon the year in which the underlying commitment was closed. The annual fees on other debentures have been set at 0.906%. The annual fees related to HT III debentures that pooled on March 27, 2013 were 0.804%. The annual fees on other debentures have been set at 0.515%. The rates of borrowings on our SBA debentures range from 3.05% to 5.53% when including these annual fees.

The average amount of debentures outstanding for the three months ended March 31, 2015 for HT II was approximately \$41.2 million with an average interest rate of approximately 4.46%. The average amount of debentures outstanding for the three months ended March 31, 2015 for HT III was approximately \$149.0 million with an average interest rate of approximately 3.38%.

As of March 31, 2015, the maximum statutory limit on the dollar amount of combined outstanding SBA guaranteed debentures is \$225.0 million, subject to periodic adjustments by the SBA. In aggregate, at March 31, 2015, with our net investment of \$112.5 million, HT II and HT III have the capacity to issue a total of \$190.2 million of SBA-guaranteed debentures, subject to SBA approval. At March 31, 2015, we have issued \$190.2 million in SBA-guaranteed debentures in our SBIC subsidiaries.

We reported the following SBA debentures outstanding as of March 31, 2015 (unaudited) and December 31, 2014:

(in thousands)

| Issuance/Pooling Date | Maturity Date     | Interest Rate <sup>(1)</sup> | Interest       |                   |
|-----------------------|-------------------|------------------------------|----------------|-------------------|
|                       |                   |                              | March 31, 2015 | December 31, 2014 |
| SBA Debentures:       |                   |                              |                |                   |
| March 25, 2009        | March 1, 2019     | 5.53%                        | \$ 18,400      | \$ 18,400         |
| September 23, 2009    | September 1, 2019 | 4.64%                        | 3,400          | 3,400             |
| September 22, 2010    | September 1, 2020 | 3.62%                        | 6,500          | 6,500             |
| September 22, 2010    | September 1, 2020 | 3.50%                        | 22,900         | 22,900            |
| March 29, 2011        | March 1, 2021     | 4.37%                        | 28,750         | 28,750            |
| September 21, 2011    | September 1, 2021 | 3.16%                        | 25,000         | 25,000            |
| March 21, 2012        | March 1, 2022     | 3.28%                        | 25,000         | 25,000            |
| March 21, 2012        | March 1, 2022     | 3.05%                        | 11,250         | 11,250            |
| September 19, 2012    | September 1, 2022 | 3.05%                        | 24,250         | 24,250            |
| March 27, 2013        | March 1, 2023     | 3.16%                        | 24,750         | 24,750            |
| Total SBA Debentures  |                   |                              | \$ 190,200     | \$ 190,200        |

(1) Interest rate includes annual charge  
2019 Notes

On March 6, 2012, we and U.S. Bank National Association (the “2019 Trustee”) entered into an indenture (the “Base Indenture”). On April 17, 2012, we and the 2019 Trustee entered into the First Supplemental Indenture to the Base Indenture (the “First Supplemental Indenture”), dated April 17, 2012, relating to our issuance, offer and sale of \$43.0 million aggregate principal amount of 7.00% senior notes due 2019 (the “April 2019 Notes”). The sale of the April 2019 Notes generated net proceeds, before expenses, of approximately \$41.7 million.

In July 2012, we reopened our April 2019 Notes and issued an additional \$41.5 million in aggregate principal amount of April 2019 Notes, which included the exercise of an over-allotment option, bringing the total amount of the April 2019 Notes issued to approximately \$84.5 million in aggregate principal amount.

On September 24, 2012, we and the 2019 Trustee, entered into the Second Supplemental Indenture to the Base Indenture (the “Second Supplemental Indenture”), dated as of September 24, 2012, relating to our issuance, offer and sale of \$75.0 million aggregate principal amount of 7.00% senior notes due 2019 (the “September 2019 Notes” and, together with the April 2019 Notes, the “2019 Notes”). The sale of the September 2019 Notes generated net proceeds, before expenses, of approximately \$72.75 million.

In October 2012, the underwriters exercised their over-allotment option for an additional \$10.9 million of the September 2019 Notes, bringing the total amount of the September 2019 Notes issued to approximately \$85.9 million in aggregate principal outstanding.



As of March 31, 2015 (unaudited) and December 31, 2014, the 2019 Notes payable is comprised of:

| (in thousands)               | March 31, 2015 | December 31, 2014 |
|------------------------------|----------------|-------------------|
| April 2019 Notes             | \$ 84,490      | \$ 84,490         |
| September 2019 Notes         | 85,874         | 85,874            |
| Carrying Value of 2019 Notes | \$ 170,364     | \$ 170,364        |

#### April 2019 Notes

The April 2019 Notes will mature on April 30, 2019 and may be redeemed in whole or in part at our option at any time or from time to time on or after April 30, 2015, upon not less than 30 days nor more than 60 days written notice by mail prior to the date fixed for redemption thereof, at a redemption price of 100% of the outstanding principal amount thereof plus accrued and unpaid interest payments otherwise payable for the then-current quarterly interest period accrued to but not including the date fixed for redemption. The April 2019 Notes bear interest at a rate of 7.00% per year payable quarterly on January 30, April 30, July 30 and October 30 of each year, commencing on July 30, 2012, and trade on the New York Stock Exchange under the trading symbol "HTGZ."

The April 2019 Notes are our direct unsecured obligations and rank: (i) pari passu with our other outstanding and future senior unsecured indebtedness; (ii) senior to any of our future indebtedness that expressly provides it is subordinated to the April 2019 Notes; (iii) effectively subordinated to all our existing and future secured indebtedness (including indebtedness that is initially unsecured to which the Company subsequently grant security), to the extent of the value of the assets securing such indebtedness; (iv) structurally subordinated to all existing and future indebtedness and other obligations of any of our subsidiaries.

The Base Indenture, as supplemented by the First Supplemental Indenture, contains certain covenants including covenants requiring our compliance with (regardless of whether it is subject to) the asset coverage requirements set forth in Section 18(a)(1)(A) as modified by Section 61(a)(1) of the 1940 Act to comply with the restrictions on dividends, distributions and purchase of capital stock set forth in Section 18(a)(1)(B) as modified by Section 61(a)(1) of the 1940 Act and to provide financial information to the holders of the April 2019 Notes and the 2019 Trustee if we should no longer be subject to the reporting requirements under the Securities Exchange Act of 1934. These covenants are subject to important limitations and exceptions that are described in the Base Indenture, as supplemented by the First Supplemental Indenture. The Base Indenture provides for customary events of default and further provides that the 2019 Trustee or the holders of 25% in aggregate principal amount of the outstanding April 2019 Notes in a series may declare such April 2019 Notes immediately due and payable upon the occurrence of any event of default after expiration of any applicable grace period.

The April 2019 Notes were sold pursuant to an underwriting agreement dated April 11, 2012 among us and Stifel, Nicolaus & Company, Incorporated, as representative of the several underwriters named in the underwriting agreement.

#### September 2019 Notes

The September 2019 Notes will mature on September 30, 2019 and may be redeemed in whole or in part at our option at any time or from time to time on or after September 30, 2015, upon not less than 30 days nor more than 60 days written notice by mail prior to the date fixed for redemption thereof, at a redemption price of 100% of the outstanding principal amount thereof plus accrued and unpaid interest payments otherwise payable for the then-current quarterly interest period accrued to but not including the date fixed for redemption. The September 2019 Notes bear interest at a rate of 7.00% per year payable quarterly on March 30, June 30, September 30 and December 30 of each year, commencing on December 30, 2012, and trade on the New York Stock Exchange under the trading symbol "HTGY."

The September 2019 Notes are our direct unsecured obligations and rank: (i) pari passu with our other outstanding and future senior unsecured indebtedness; (ii) senior to any of our future indebtedness that expressly provides it is subordinated to the September 2019 Notes; (iii) effectively subordinated to all our existing and future secured indebtedness (including indebtedness that is initially unsecured to which we subsequently grant security), to the extent of the value of the assets securing such indebtedness; (iv) structurally subordinated to all existing and future indebtedness and other obligations of any of our subsidiaries.

The Base Indenture, as supplemented by the Second Supplemental Indenture, contains certain covenants including covenants requiring us to comply with (regardless of whether it is subject to) the asset coverage requirements set forth in Section 18 (a)(1)(A) as modified by Section 61(a)(1) of the 1940 Act to comply with the restrictions on dividends, distributions and purchase of capital stock set forth in Section 18(a)(1)(B) as modified by Section 61(a)(1) of the 1940 Act and to provide financial information to the holders of the September 2019 Notes and the 2019 Trustee if we should no longer be subject to the reporting requirements under the Securities Exchange Act of 1934. These covenants are subject to important limitations and exceptions that are described in the Base Indenture, as supplemented by the Second Supplemental Indenture. The Base Indenture provides for customary events of default and further provides that the 2019 Trustee or the holders of 25% in aggregate principal amount of the outstanding September 2019 Notes in

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a series may declare such September 2019 Notes immediately due and payable upon the occurrence of any event of default after expiration of any applicable grace period.

The September 2019 Notes were sold pursuant to an underwriting agreement dated September 19, 2012 among us and Stifel, Nicolaus & Company, Incorporated, as representative of the several underwriters named in the underwriting agreement.

For the three months ended March 31, 2015 and 2014 (unaudited), the components of interest expense and related fees and cash paid for interest expense for the April 2019 Notes and September 2019 Notes are as follows:

| (in thousands)                          | Three Months<br>Ended March<br>31, |         |
|---|------------------------------------|---------|
|   | 2015                               | 2014    |
| Stated interest expense                 | \$2,981                            | \$2,981 |
| Amortization of debt issuance cost      | 240                                | 240     |
| Total interest expense and fees         | \$3,221                            | \$3,221 |
| Cash paid for interest expense and fees | \$2,981                            | \$2,981 |

As of March 31, 2015, we are in compliance with the terms of the Base Indenture, and respective supplemental indentures thereto, governing the April 2019 Notes and September 2019 Notes. See Note 4 to our consolidated financial statements for more detail on the 2019 Notes. Also, see “Subsequent Events.”

#### 2024 Notes

On July 14, 2014, we and U.S. Bank, N.A. (the “2024 Trustee”), entered into the Third Supplemental Indenture (the “Third Supplemental Indenture”) to the Base Indenture between us and the 2024 Trustee, dated July 14, 2014, relating to our issuance, offer and sale of \$100.0 million aggregate principal amount of 2024 Notes. On August 6, 2014, the underwriters issued notification to exercise their over-allotment option for an additional \$3.0 million in aggregate principal amount of the 2024 Notes. The sale of the 2024 Notes generated net proceeds of approximately \$99.9 million.

The 2024 Notes will mature on July 30, 2024 and may be redeemed in whole or in part at our option at any time or from time to time on or after July 30, 2017, upon not less than 30 days nor more than 60 days written notice by mail prior to the date fixed for redemption thereof, at a redemption price of 100% of the outstanding principal amount thereof plus accrued and unpaid interest payments otherwise payable for the then-current quarterly interest period accrued to but not including the date fixed for redemption. The 2024 Notes bear interest at a rate of 6.25% per year payable quarterly on January 30, April 30, July 30 and October 30 of each year, commencing on July 30, 2014, and trade on the New York Stock Exchange under the trading symbol “HTGX.”

The 2024 Notes will be our direct unsecured obligations and will rank: (i) pari passu with our other outstanding and future senior unsecured indebtedness; (ii) senior to any of our future indebtedness that expressly provides it is subordinated to the 2024 Notes; (iii) effectively subordinated to all of our existing and future secured indebtedness (including indebtedness that is initially unsecured to which we subsequently grant security), to the extent of the value of the assets securing such indebtedness; (iv) structurally subordinated to all existing and future indebtedness and other obligations of any of our subsidiaries.

The Base Indenture, as supplemented by the Third Supplemental Indenture, contains certain covenants including covenants requiring us to comply with (regardless of whether it is subject to) the asset coverage requirements set forth in Section 18(a)(1)(A) as modified by Section 61(a)(1) of the 1940 Act and to comply with the restrictions on dividends, distributions and purchase of capital stock set forth in Section 18(a)(1)(B) as modified by Section 61(a)(1) of the 1940 Act. These covenants are subject to important limitations and exceptions that are described in the Base Indenture, as supplemented by the Third Supplemental Indenture. The Base Indenture, as supplemented by the Third Supplemental Indenture, also contains certain reporting requirements, including a requirement that we provide financial information to the holders of the 2024 Notes and the 2024 Trustee if we should no longer be subject to the reporting requirements under the Securities Exchange Act of 1934. The Base Indenture provides for customary events of default and further provides that the 2024 Trustee or the holders of 25% in aggregate principal amount of the outstanding 2024 Notes in a series may declare such 2024 Notes immediately due and payable upon the occurrence of any event of default after expiration of any applicable grace period. As of March 31, 2015, we were in compliance with the terms of the Base Indenture, as supplemented by the Third Supplemental Indenture.

At both March 31, 2015 and December 31, 2014, the 2024 Notes had an outstanding principal balance of \$103.0 million.

For the three months ended March 31, 2015 and 2014 (unaudited), the components of interest expense and related fees and cash paid for interest expense for the 2024 Notes are as follows:

| (in thousands)                          | Three Months<br>Ended March<br>31, |      |
|---|------------------------------------|------|
|   | 2015                               | 2014 |
| Stated interest expense                 | \$1,609                            | \$ — |
| Amortization of debt issuance cost      | 83                                 | —    |
| Total interest expense and fees         | \$1,692                            | \$ — |
| Cash paid for interest expense and fees | \$1,609                            | \$ — |

#### 2017 Asset-Backed Notes

On December 19, 2012, we completed a \$230.7 million term debt securitization in connection with which an affiliate of ours made an offer of \$129.3 million in aggregate principal amount of fixed-rate asset-backed notes (the “2017 Asset-Backed Notes”), which 2017 Asset-Backed Notes were rated A2(sf) by Moody’s Investors Service, Inc. The 2017 Asset-Backed Notes were sold by Hercules Capital Funding Trust 2012-1 pursuant to a note purchase agreement, dated as of December 12, 2012, by and among us, Hercules Capital Funding 2012-1, LLC as trust depositor (the “2012 Trust Depositor”), Hercules Capital Funding Trust 2012-1 as issuer (the “2012 Securitization Issuer”), and Guggenheim Securities, LLC, as initial purchaser, and are backed by a pool of senior loans made to certain of our portfolio companies and secured by certain assets of those portfolio companies and are to be serviced by

us. Interest on the 2017 Asset- Backed Notes will be paid, to the extent of funds available, at a fixed rate of 3.32% per annum. The 2017 Asset-Backed Notes have a stated maturity of December 16, 2017.

As part of this transaction, we entered into a sale and contribution agreement with the 2012 Trust Depositor under which we have agreed to sell or have contributed to the 2012 Trust Depositor certain senior loans made to certain of our portfolio companies (the “2012 Loans”). We have made customary representations, warranties and covenants in the sale and contribution agreement with respect to the 2012 Loans as of the date of their transfer to the 2012 Trust Depositor.

In connection with the sale of the 2017 Asset-Backed Notes, we have made customary representations, warranties and covenants in the note purchase agreement. The 2017 Asset-Backed Notes are secured obligations of the 2012 Securitization Issuer and are non-recourse to us. The 2012 Securitization Issuer also entered into an indenture governing the 2017 Asset-Backed Notes, which includes customary representations, warranties and covenants. The 2017 Asset-Backed Notes were sold without being registered under the Securities Act (A) in the United States to “qualified institutional buyers” as defined in Rule 144A under the Securities Act and to institutional “accredited investors” (as defined in Rule 501(a)(1), (2), (3) or (7) under the Securities Act) who in each case, are “qualified purchasers” as defined in Sec. 2(A)(51) of the 1940 Act and pursuant to an exemption under the Securities Act and (B) to non-U.S. purchasers acquiring interest in the 2017 Asset-Backed Notes outside the United States in accordance with Regulation S of the Securities Act. The 2012 Securitization Issuer will not be registered under the 1940 Act in reliance on an exemption provided by Section 3(c) (7) thereof. In addition, the 2012 Trust Depositor entered into an amended and restated trust agreement in respect of the 2012 Securitization Issuer, which includes customary representations, warranties and covenants.

The 2012 Loans are serviced by us pursuant to a sale and servicing agreement, which contains customary representations, warranties and covenants. We perform certain servicing and administrative functions with respect to the 2012 Loans. We are entitled to receive a monthly fee from the 2012 Securitization Issuer for servicing the 2012 Loans. This servicing fee is equal to the product of one-twelfth (or in the case of the first payment date, a fraction equal to the number of days from and including December 5, 2012 through and including January 15, 2013 over 360) of 2.00% and the aggregate outstanding principal balance of the 2012 Loans plus the amount of collections on deposit in the 2012 Securitization Issuer’s collection account, as of the first day of the related collection period (the period from the 5th day of the immediately preceding calendar month through the 4th day of the calendar month in which a payment date occurs, and for the first payment date, the period from and including December 5, 2012, to the close of business on January 4, 2013).

We also serve as administrator to the 2012 Securitization Issuer under an administration agreement, which includes customary representations, warranties and covenants.

At March 31, 2015 and December 31, 2014, the 2017 Asset-Backed Notes had an outstanding principal balance of \$4.2 million and \$16.0 million, respectively. See “Subsequent Events.”

Under the terms of the 2017 Asset Backed Notes, we are required to maintain a reserve cash balance, funded through interest and principal collections from the underlying securitized debt portfolio, which may be used to pay monthly interest and principal payments on the 2017 Asset-Backed Notes. We have segregated these funds and classified them as restricted cash. There was approximately \$2.7 million and \$1.2 million of restricted cash as of March 31, 2015 and December 31, 2014, respectively, funded through interest collections.

2021 Asset-Backed Notes

On November 13, 2014, we completed a \$237.4 million term debt securitization in connection with which an affiliate of ours made an offer of \$129.3 million in aggregate principal amount of fixed-rate asset-backed notes (the “2021 Asset-Backed Notes”), which 2021 Asset-Backed Notes were rated A(sf) by Kroll Bond Rating Agency, Inc. (“KBRA”). The 2021 Asset-Backed Notes were sold by Hercules Capital Funding Trust 2014-1 pursuant to a note purchase agreement, dated as of November 13, 2014, by and among us, Hercules Capital Funding 2014-1, LLC as trust depositor (the “2014 Trust Depositor”), Hercules Capital Funding Trust 2014-1 as issuer (the “2014 Securitization Issuer”), and Guggenheim Securities, LLC, as initial purchaser, and are backed by a pool of senior loans made to certain of our portfolio companies and secured by certain assets of those portfolio companies and are to be serviced by us. The securitization has an 18-month reinvestment period during which time principal collections may be reinvested into additional eligible loans. Interest on the 2021 Asset-Backed Notes will be paid, to the extent of funds available, at a fixed rate of 3.524% per annum. The 2021 Asset-Backed Notes have a stated maturity of April 16, 2021.

As part of this transaction, we entered into a sale and contribution agreement with the 2014 Trust Depositor under which we have agreed to sell or have contributed to the 2014 Trust Depositor certain senior loans made to certain of our portfolio companies (the “2014 Loans”). We have made customary representations, warranties and covenants in the sale and contribution agreement with respect to the 2014 Loans as of the date of their transfer to the 2014 Trust Depositor.

In connection with the issuance and sale of the 2021 Asset-Backed Notes, we have made customary representations, warranties and covenants in the note purchase agreement. The 2021 Asset-Backed Notes are secured obligations of the 2014 Securitization Issuer and are non-recourse to us. The 2014 Securitization Issuer also entered into an indenture governing the 2021 Asset-Backed Notes, which includes customary representations, warranties and covenants. The 2021 Asset-Backed Notes were sold without being registered under the Securities Act (A) in the United States to “qualified institutional buyers” as defined in Rule 144A under the Securities Act and to institutional “accredited investors” (as defined in Rule 501(a)(1), (2), (3) or (7) under the Securities Act) who in each case, are “qualified purchasers” as defined in Sec. 2 (A)(51) of the 1940 Act and pursuant to an exemption under the Securities Act and (B) to non-U.S. purchasers acquiring interest in the 2021 Asset-Backed Notes outside the United States in accordance with Regulation S of the Securities Act. The 2014 Securitization Issuer will not be registered under the 1940 Act in reliance on an exemption provide by Section 3(c) (7) thereof and Rule 3A-7 thereunder. In addition, the 2014 Trust Depositor entered into an amended and restated trust agreement in respect of the 2014 Securitization Issuer, which includes customary representation, warranties and covenants.

The 2014 Loans are serviced by us pursuant to a sale and servicing agreement, which contains customary representations, warranties and covenants. We perform certain servicing and administrative functions with respect to the 2014 Loans. We are entitled to receive a monthly fee from the 2014 Securitization Issuer for servicing the 2014 Loans. This servicing fee is equal to the product of one-twelfth (or in the case of the first payment date, a fraction equal to the number of days from and including October 5, 2014 through and including December 5, 2014 over 360) of 2.00% and the aggregate outstanding principal balance of the 2014 Loans plus collections on deposit in the 2014 Securitization Issuer’s collections account, as of the first day of the related collection period (the period from the 5th day of the immediately preceding calendar month through the 4th day of the calendar month in which a payment date occurs, and for the first payment date, the period from and including October 5, 2014, to the close of business on December 5, 2014).

We also serve as administrator to the 2014 Securitization Issuer under an administration agreement, which includes customary representations, warranties and covenants.

At both March 31, 2015 and December 31, 2014, the 2021 Asset-Backed Notes had an outstanding principal balance of \$129.3 million.

Under the terms of the 2021 Asset-Backed Notes, we are required to maintain a reserve cash balance, funded through interest and principal collections from the underlying securitized debt portfolio, which may be used to pay monthly interest and principal payments on the 2021 Asset-Backed Notes. We have segregated these funds and classified them as restricted cash. There was approximately \$19.2 million and \$11.5 million of restricted cash as of March 31, 2015 and December 31, 2014, respectively, funded through interest collections.

#### Convertible Senior Notes

In April 2011, we issued \$75.0 million in aggregate principal amount of 6.00% convertible senior notes (the “Convertible Senior Notes”) due 2016. During the three months ended March 31, 2015, holders of approximately \$32,000 of our Convertible Senior Notes have exercised their conversion rights. As of March 31, 2015, the carrying value of the Convertible Senior Notes, comprised of the aggregate principal amount outstanding less the unaccreted discount initially recorded upon issuance of the Convertible Senior Notes, is approximately \$17.4 million

The Convertible Senior Notes mature on April 15, 2016 (the “Maturity Date”), unless previously converted or repurchased in accordance with their terms. The Convertible Senior Notes bear interest at a rate of 6.00% per year payable semiannually in arrears on April 15 and October 15 of each year, commencing on October 15, 2011. The Convertible Senior Notes are our senior unsecured obligations and rank senior in right of payment to our existing and



future indebtedness that is expressly subordinated in right of payment to the Convertible Senior Notes; equal in right of payment to our existing and future unsecured indebtedness that is not so subordinated; effectively junior in right of payment to any of our secured indebtedness (including unsecured indebtedness that we later secure) to the extent of the value of the assets securing such indebtedness; and structurally junior to all existing and future indebtedness (including trade payables) incurred by our subsidiaries, financing vehicles or similar facilities.

Prior to the close of business on the business day immediately preceding October 15, 2015, holders may convert their Convertible Senior Notes only under certain circumstances set forth in the indenture. On or after October 15, 2015 until the close of business on the scheduled trading day immediately preceding the Maturity Date, holders may convert their Convertible Senior Notes at any time. Upon conversion, we will pay or deliver, as the case may be, at our election, cash, shares of our common stock or a combination of cash and shares of our common stock. The conversion rate will initially be 84.0972 shares of common stock per \$1,000 principal amount of Convertible Senior Notes (equivalent to an initial conversion price of approximately \$11.89 per share of common stock). The conversion rate will be subject to adjustment in some events but will not be adjusted for any accrued and unpaid interest. In addition, if certain corporate events occur prior to the Maturity Date, the conversion rate will be increased for converting

holders. As of March 31, 2015, the conversion rate was 88.6189 shares of common stock per \$1,000 principal amount of Convertible Senior Notes (equivalent to an adjusted conversion price of approximately \$11.28 per share of common stock).

We may not redeem the Convertible Senior Notes prior to maturity. No sinking fund is provided for the Convertible Senior Notes. In addition, if certain corporate events occur, holders of the Convertible Senior Notes may require us to repurchase for cash all or part of their Convertible Senior Notes at a repurchase price equal to 100% of the principal amount of the Convertible Senior Notes to be repurchased, plus accrued and unpaid interest through, but excluding, the required repurchase date.

The Convertible Senior Notes are accounted for in accordance with ASC 470-20 (previously FASB Staff Position No. APB 14- 1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)"). In accounting for the Convertible Senior Notes, we estimated at the time of issuance that the values of the debt and the embedded conversion feature of the Convertible Senior Notes were approximately 92.8% and 7.2%, respectively. The original issue discount of 7.2% attributable to the conversion feature of the Convertible Senior Notes was recorded in "capital in excess of par value" in the Consolidated Statement of Assets and Liabilities. As a result, we record interest expense comprised of both stated interest expense as well as accretion of the original issue discount resulting in an estimated effective interest rate of approximately 8.1%.

Upon meeting the stock trading price conversion requirement during the three months ended June 30, 2014, September 30, 2014 and December 31, 2014, the Convertible Senior Notes became convertible on July 1, 2014 and continued to be convertible during each of the three months ended September 30, 2014, December 31, 2014 and March 31, 2015, respectively. During this period and as of March 31, 2015, approximately \$57.4 million of the Convertible Senior Notes had been converted and were settled with a combination of cash equal to the outstanding principal amount of the converted notes and approximately 1.5 million shares of our common stock, or \$24.3 million. By not meeting the stock trading price conversion requirement during the three months ended March 31, 2015, the Convertible Senior Notes are currently not convertible for the three months ending June 30, 2015. See "Subsequent Events."

We recorded a loss on extinguishment of debt for the proportionate amount of unamortized debt issuance costs and original issue discount on Notes converted during the period. The loss was partially offset by a gain in the amount of the difference between the outstanding principal balance of the converted notes and the fair value of the debt instrument. The net loss on extinguishment of debt we recorded for the three months ended March 31, 2015 and the year ended December 31, 2014 was approximately \$1,000 and \$1.6 million, and was classified as a component of net investment income in our Consolidated Statement of Operations.

As of March 31, 2015 (unaudited) and December 31, 2014, the components of the carrying value of the Convertible Senior Notes were as follows:

| (in thousands)                             | March 31, 2015 | December 31, 2014 |
|--|----------------|-------------------|
| Principal amount of debt                   | \$ 17,642      | \$ 17,674         |
| Original issue discount, net of accretion  | (267 )         | (329 )            |
| Carrying value of Convertible Senior Notes | \$ 17,375      | \$ 17,345         |

For the three months ended March 31, 2015 and 2014 (unaudited), the components of interest expense, fees and cash paid for interest expense for the Convertible Senior Notes were as follows:

| (in thousands)                       | Three Months<br>Ended March<br>31, |         |
|--------------------------------------|------------------------------------|---------|
|                                      | 2015                               | 2014    |
| Stated interest expense              | \$215                              | \$1,125 |
| Accretion of original issue discount | 62                                 | 271     |
| Amortization of debt issuance cost   | 33                                 | 144     |
| Total interest expense               | \$310                              | \$1,540 |
| Cash paid for interest expense       | \$—                                | \$—     |

The estimated effective interest rate of the debt component of the Convertible Senior Notes, equal to the stated interest of 6.0% plus the accretion of the original issue discount, was approximately 8.1% for the three months ended March 31, 2015 and 2014. Interest expense decreased by approximately \$910,000 during the three months ended March 31, 2015 from the three months ended March 31, 2014, due to Convertible Senior Notes settled between periods. As of March 31, 2015, we were in compliance with the terms of the indentures governing the Convertible Senior Notes.

### Wells Facility

In August 2008, we entered into a \$50.0 million two-year revolving senior secured credit facility with Wells Fargo Capital Finance (the “Wells Facility”). On June 20, 2011, we renewed the Wells Facility, and the Wells Facility was further amended on August 1, 2012, December 17, 2012 and August 8, 2014. Under this senior secured facility, Wells Fargo Capital Finance has made commitments of \$75.0 million. The facility contains an accordion feature, in which we can increase the credit line up to an aggregate of \$300.0 million, funded by additional lenders and with the agreement of Wells Fargo Capital Finance and subject to other customary conditions. We expect to continue discussions with various other potential lenders to join the new facility; however, there can be no assurances that additional lenders will join the Wells Facility.

On August 1, 2012, we entered into an amendment to the Wells Facility that reduced the interest rate floor by 75 basis points to 4.25% and extended the maturity date by one year to August 2015. Additionally, the August 2012 amendment added an amortization period that commences on the day immediately following the end of the revolving credit availability period and ends one year thereafter on the maturity date. The August 2012 amendment also reduced the unused line fee, as further discussed below. On August 8, 2014, we entered into a further amendment to the Wells Facility to set the interest rate floor at 4.00% and to extend the revolving credit availability period to August 2017.

As amended, borrowings under the Wells Facility will generally bear interest at a rate per annum equal to LIBOR plus 3.50%, with a floor of 4.00% and an advance rate of 50% against eligible debt investments. The Wells Facility is secured by debt investments in the borrowing base. The Wells Facility requires payment of a non-use fee on a scale of 0.0% to 0.50% of the average monthly outstanding balance. The monthly payment of a non-use fee thereafter shall depend on the average balance that was outstanding on a scale between 0.0% and 0.50%. For the three months ended March 31, 2015 and 2014, this non-use fee was approximately \$94,000 and \$101,000, respectively. On June 20, 2011 we paid an additional \$1.1 million in structuring fees in connection with the Wells Facility which are being amortized through the end of the term of the Wells Facility. In connection with the August 2014 amendments, we paid an additional \$750,000 in structuring fees in connection with the Wells Facility which are being amortized through the end of the term of the Wells Facility.

The Wells Facility includes various financial and operating covenants applicable to us and our subsidiaries, in addition to those applicable to Hercules Funding II, LLC. As amended, these covenants require us to maintain certain financial ratios and a minimum tangible net worth in an amount, when added to outstanding subordinated indebtedness, that is in excess of \$500.0 million plus 90% of the cumulative amount of equity raised after June 30, 2014. As of March 31, 2015, the minimum tangible net worth covenant has increased to \$590.4 million as a result of the March 2015 follow-on public offering of 7.6 million shares of common stock for total net proceeds of approximately \$100.1 million. The Wells Facility provides for customary events of default, including, but not limited to, payment defaults, breach of representations or covenants, including certain key man provisions and lien limitations, bankruptcy events and change of control. We were in compliance with all covenants at March 31, 2015.

At March 31, 2015 there were no borrowings outstanding on this facility. See Note 4 to our consolidated financial statements for more detail on the Wells Facility. Also, see “Subsequent Events.”

### Union Bank Facility

We have a \$75.0 million revolving senior secured credit facility (the “Union Bank Facility”) with MUFG Union Bank, N.A. (“MUFG Union Bank”). We originally entered into the Union Bank Facility on February 10, 2010 but, following several amendments, amended and restated the Union Bank Facility on August 14, 2014. The amendment and restatement extends the maturity date of the Union Bank Facility to August 1, 2017, increases the size of the Union Bank Facility to \$75.0 million from \$30.0 million, and adjusts the interest rate for LIBOR borrowings under the Union

Bank Facility. LIBOR-based borrowings by us under the Union Bank Facility will bear interest at a rate per annum equal to LIBOR plus 2.25% with no floor, whereas previously we paid a per annum interest rate on such borrowings equal to LIBOR plus 2.50% with a floor of 4.00%. Other borrowings by us under the Union Bank Facility, which are based on a reference rate instead of LIBOR, will continue to bear interest at a rate per annum equal to the reference rate (which is the greater of the federal funds rate plus 1.00% and a periodically announced MUFG Union Bank index rate) plus the greater of (i) 4.00% minus the reference rate and (ii) 1.00%. We continue to have the option of determining which type of borrowing to request under the Union Bank Facility. Subject to certain conditions, the amendment also removes a previous ceiling on the amount of certain unsecured indebtedness that we may incur.

The Union Bank Facility contains an accordion feature, pursuant to which we may increase the size of the Union Bank Facility to an aggregate principal amount of \$300.0 million by bringing in additional lenders, subject to the approval of MUFG Union Bank and other customary conditions. There can be no assurances that additional lenders will join the Union Bank Facility to increase available borrowings.

The Union Bank Facility requires the payment of a non-use fee of 0.50% annually. For the three months ended March 31, 2015 and 2014, this non-use fee was approximately \$94,000 and \$37,500, respectively. The amount that we may borrow under the Union Bank Facility is determined by applying an advance rate to eligible loans. The Union Bank Facility generally requires payment of monthly interest on loans based on a reference rate and at the end of a one, two, or three-month period, as applicable, for loans based on LIBOR. All outstanding principal is due upon maturity.

The Union Bank Facility is collateralized by debt investments in our portfolio companies, and includes an advance rate equal to 50.0% of eligible debt investments placed in the collateral pool.

We have various financial and operating covenants required by the Union Bank Facility. These covenants require, among other things, that we maintain certain financial ratios, including liquidity, asset coverage, and debt service coverage, and a minimum tangible net worth in an amount, when added to outstanding subordinated indebtedness, that is in excess of \$550.0 million plus 90% of the amount of net cash proceeds received from the sale of common stock after June 30, 2014. As of March 31, 2015, the minimum tangible net worth covenant has increased to \$640.1 million as a result of the March 2015 follow-on public offering of 7.6 million shares of common stock for total net proceeds of approximately \$100.1 million. The Union Bank Facility provides for customary events of default, including, but not limited to, payment defaults, breach of representations or covenants, bankruptcy events and change of control. We were in compliance with all covenants at March 31, 2015.

At March 31, 2015 there were no borrowings outstanding on this facility. See Note 4 to our consolidated financial statements for more detail on the Union Bank Facility.

#### Citibank Credit Facility

We, through Hercules Funding Trust I, an affiliated statutory trust, had a securitized credit facility (the "Citibank Credit Facility") with Citigroup Global Markets Realty Corp. ("Citigroup"), which expired under normal terms. During the first quarter of 2009, we paid off all principal and interest owed under the Citibank Credit Facility. Citigroup has an equity participation right through a warrant participation agreement on the pool of debt investments and warrants collateralized under the Citibank Credit Facility. Pursuant to the warrant participation agreement, we granted to Citigroup a 10% participation in all warrants held as collateral. However, no additional warrants were included in collateral subsequent to the facility amendment on May 2, 2007. As a result, Citigroup is entitled to 10% of the realized gains on the warrants until the realized gains paid to Citigroup pursuant to the agreement equal \$3,750,000 (the "Maximum Participation Limit"). The obligations under the warrant participation agreement continue even after the Citibank Credit Facility is terminated until the Maximum Participation Limit has been reached.

During the three months ended March 31, 2015, we recorded an increase in participation liability and a decrease in unrealized appreciation by a net amount of approximately \$41,000 primarily due to appreciation of fair value on the pool of warrants collateralized under the warrant participation. The remaining value of their participation right on unrealized gains in the related equity investments was approximately \$142,000 as of March 31, 2015 and is included in accrued liabilities. There can be no assurances that the unrealized appreciation of the warrants will not be higher or lower in future periods due to fluctuations in the value of the warrants, thereby increasing or reducing the effect on the cost of borrowing. Since inception of the agreement, we have paid Citigroup approximately \$2.1 million under the warrant participation agreement thereby reducing our realized gains by this amount. We will continue to pay Citigroup under the warrant participation agreement until the Maximum Participation Limit is reached or the warrants expire. Warrants subject to the Citigroup participation agreement are set to expire between February 2016 and January 2017.



## Dividends

The following table summarizes our dividends declared and paid, to be paid, or reinvested on all shares, including restricted stock, to date:

| Date Declared     | Record Date       | Payment Date       | Amount<br>Per<br>Share |
|-------------------|-------------------|--------------------|------------------------|
| October 27, 2005  | November 1, 2005  | November 17, 2005  | \$ 0.03                |
| December 9, 2005  | January 6, 2006   | January 27, 2006   | 0.30                   |
| April 3, 2006     | April 10, 2006    | May 5, 2006        | 0.30                   |
| July 19, 2006     | July 31, 2006     | August 28, 2006    | 0.30                   |
| October 16, 2006  | November 6, 2006  | December 1, 2006   | 0.30                   |
| February 7, 2007  | February 19, 2007 | March 19, 2007     | 0.30                   |
| May 3, 2007       | May 16, 2007      | June 18, 2007      | 0.30                   |
| August 2, 2007    | August 16, 2007   | September 17, 2007 | 0.30                   |
| November 1, 2007  | November 16, 2007 | December 17, 2007  | 0.30                   |
| February 7, 2008  | February 15, 2008 | March 17, 2008     | 0.30                   |
| May 8, 2008       | May 16, 2008      | June 16, 2008      | 0.34                   |
| August 7, 2008    | August 15, 2008   | September 19, 2008 | 0.34                   |
| November 6, 2008  | November 14, 2008 | December 15, 2008  | 0.34                   |
| February 12, 2009 | February 23, 2009 | March 30, 2009     | 0.32 *                 |
| May 7, 2009       | May 15, 2009      | June 15, 2009      | 0.30                   |
| August 6, 2009    | August 14, 2009   | September 14, 2009 | 0.30                   |
| October 15, 2009  | October 20, 2009  | November 23, 2009  | 0.30                   |
| December 16, 2009 | December 24, 2009 | December 30, 2009  | 0.04                   |
| February 11, 2010 | February 19, 2010 | March 19, 2010     | 0.20                   |
| May 3, 2010       | May 12, 2010      | June 18, 2010      | 0.20                   |
| August 2, 2010    | August 12, 2010   | September 17, 2010 | 0.20                   |
| November 4, 2010  | November 10, 2010 | December 17, 2010  | 0.20                   |
| March 1, 2011     | March 10, 2011    | March 24, 2011     | 0.22                   |
| May 5, 2011       | May 11, 2011      | June 23, 2011      | 0.22                   |
| August 4, 2011    | August 15, 2011   | September 15, 2011 | 0.22                   |
| November 3, 2011  | November 14, 2011 | November 29, 2011  | 0.22                   |
| February 27, 2012 | March 12, 2012    | March 15, 2012     | 0.23                   |
| April 30, 2012    | May 18, 2012      | May 25, 2012       | 0.24                   |
| July 30, 2012     | August 17, 2012   | August 24, 2012    | 0.24                   |
| October 26, 2012  | November 14, 2012 | November 21, 2012  | 0.24                   |
| February 26, 2013 | March 11, 2013    | March 19, 2013     | 0.25                   |
| April 29, 2013    | May 14, 2013      | May 21, 2013       | 0.27                   |
| July 29, 2013     | August 13, 2013   | August 20, 2013    | 0.28                   |
| November 4, 2013  | November 18, 2013 | November 25, 2013  | 0.31                   |
| February 24, 2014 | March 10, 2014    | March 17, 2014     | 0.31                   |
| April 28, 2014    | May 12, 2014      | May 19, 2014       | 0.31                   |
| July 28, 2014     | August 18, 2014   | August 25, 2014    | 0.31                   |
| October 29, 2014  | November 17, 2014 | November 24, 2014  | 0.31                   |
| February 24, 2015 | March 12, 2015    | March 19, 2015     | 0.31                   |



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|             |              |              |          |
|-------------|--------------|--------------|----------|
| May 4, 2015 | May 18, 2015 | May 25, 2015 | 0.31     |
|             |              |              | \$ 10.61 |

\*Dividend paid in cash and stock.

On May 4, 2015 the Board of Directors declared a cash dividend of \$0.31 per share to be paid on May 25, 2015 to shareholders of record as of May 18, 2015. This dividend represents our thirty-ninth consecutive dividend declaration since our initial public offering, bringing the total cumulative dividend declared to date \$10.61 per share.

Our Board of Directors maintains a variable dividend policy with the objective of distributing four quarterly distributions in an amount that approximates 90 - 100% of our taxable quarterly income or potential annual income for a particular year. In addition, at the end of the year, our Board of Directors may choose to pay an additional special dividend, or fifth dividend, so that we may

distribute approximately all of our annual taxable income in the year it was earned, or may elect to maintain the option to spill over our excess taxable income into the coming year for future dividend payments.

Distributions in excess of our current and accumulated earnings and profits would generally be treated first as a return of capital to the extent of the stockholder's tax basis, and any remaining distributions would be treated as a capital gain. The determination of the tax attributes of our distributions is made annually as of the end of our fiscal year based upon our taxable income for the full year and distributions paid for the full year. Of the dividends declared during the years ended December 31, 2014 and 2013, 100% were distributions of ordinary income. There can be no certainty to stockholders that this determination is representative of what the tax attributes of our 2015 distributions to stockholders will actually be.

Each year a statement on Form 1099-DIV identifying the source of the distribution (i.e., paid from ordinary income, paid from net capital gains on the sale of securities, and/or a return of paid-in-capital surplus which is a nontaxable distribution) is mailed to our stockholders. To the extent our taxable earnings fall below the total amount of our distributions for that fiscal year, a portion of those distributions may be deemed a tax return of capital to our stockholders.

We operate to qualify to be taxed as a RIC under the Code. Generally, a RIC is entitled to deduct dividends it pays to its shareholders from its income to determine "taxable income." Taxable income includes our taxable interest, dividend and fee income, as well as taxable net capital gains. Taxable income generally differs from net income for financial reporting purposes due to temporary and permanent differences in the recognition of income and expenses, and generally excludes net unrealized appreciation or depreciation, as gains or losses are not included in taxable income until they are realized. In addition, gains realized for financial reporting purposes may differ from gains included in taxable income as a result of our election to recognize gains using installment sale treatment, which generally results in the deferment of gains for tax purposes until notes or other amounts, including amounts held in escrow, received as consideration from the sale of investments are collected in cash. Taxable income includes non-cash income, such as changes in accrued and reinvested interest and dividends, which includes contractual payment-in-kind interest, and the amortization of discounts and fees. Cash collections of income resulting from contractual PIK interest arrangements or the amortization of discounts and fees generally occur upon the repayment of the loans or debt securities that include such items. Non-cash taxable income is reduced by non-cash expenses, such as realized losses and depreciation and amortization expense.

As a RIC, we will be subject to a 4% nondeductible federal excise tax on certain undistributed income unless we distribute in a timely manner an amount at least equal to the sum of (1) 98% of our ordinary income for each calendar year, (2) 98.2% of our capital gain net income for the 1-year period ending October 31 in that calendar year and (3) any income realized, but not distributed, in the preceding year (the "Excise Tax Avoidance Requirements"). We will not be subject to excise taxes on amounts on which we are required to pay corporate income tax (such as retained net capital gains). Depending on the level of taxable income earned in a tax year, we may choose to carry over taxable income in excess of current year distributions from such taxable income into the next tax year and pay a 4% excise tax on such income, as required. The maximum amount of excess taxable income that may be carried over for distribution in the next year under the Code is the total amount of dividends paid in the following year, subject to certain declaration and payment guidelines. To the extent we choose to carry over taxable income into the next tax year, dividends declared and paid by us in a year may differ from taxable income for that year as such dividends may include the distribution of current year taxable income, the distribution of prior year taxable income carried over into and distributed in the current year, or returns of capital.

We can offer no assurance that we will achieve results that will permit the payment of any cash distributions and, if we issue senior securities, we will be prohibited from making distributions if doing so causes us to fail to maintain the asset coverage ratios stipulated by the 1940 Act or if distributions are limited by the terms of any of our borrowings.

Our ability to make distributions will be limited by the asset coverage requirements under the 1940 Act.

We intend to distribute approximately \$16.7 million of spillover from long term earnings from the year ended December 31, 2014 to our shareholders in 2015.

We maintain an “opt-out” dividend reinvestment plan for our common stockholders. As a result, if we declare a dividend, cash dividends will be automatically reinvested in additional shares of our common stock unless the stockholder specifically “opts out” of the dividend reinvestment plan and chooses to receive cash dividends.

### Critical Accounting Policies

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and revenues and expenses during the period reported. On an ongoing basis, our management evaluates its estimates and assumptions, which are based on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ from those estimates. Changes in our estimates and assumptions could materially impact our results of operations and financial condition.

### Reclassification

Certain balances from prior years have been reclassified in order to conform to the current year presentation.

### Valuation of Portfolio Investments

The most significant estimate inherent in the preparation of our consolidated financial statements is the valuation of investments and the related amounts of unrealized appreciation and depreciation of investments recorded.

At March 31, 2015, approximately 83.7% of our total assets represented investments in portfolio companies that are valued at fair value by the Board of Directors. Value, as defined in Section 2(a)(41) of the 1940 Act, is (i) the market price for those securities for which a market quotation is readily available and (ii) for all other securities and assets, fair value is as determined in good faith by the Board of Directors. Our investments are carried at fair value in accordance with the 1940 Act and Accounting Standards Codification topic 820 Fair Value Measurements and Disclosures (“ASC 820”). Our debt securities are primarily invested in venture capital-backed companies in technology-related industries, including technology, biotechnology, life science and energy and renewables technology at all stages of development. Given the nature of lending to these types of businesses, our investments in these portfolio companies are generally considered Level 3 assets under ASC 820 because there is no known or accessible market or market indexes for these investment securities to be traded or exchanged. As such, we value substantially all of our investments at fair value as determined in good faith pursuant to a consistent valuation policy by our Board of Directors in accordance with the provisions of ASC 820 and the 1940 Act. Due to the inherent uncertainty in determining the fair value of investments that do not have a readily available market value, the fair value of our investments determined in good faith by our Board of Directors may differ significantly from the value that would have been used had a readily available market existed for such investments, and the differences could be material.

We may from time to time engage an independent valuation firm to provide us with valuation assistance with respect to certain of our portfolio investments on a quarterly basis. We intend to continue to engage an independent valuation firm to provide us with assistance regarding our determination of the fair value of selected portfolio investments each quarter unless directed by the Board of Directors to cancel such valuation services. The scope of the services rendered by an independent valuation firm is at the discretion of the Board of Directors. Our Board of Directors is ultimately and solely responsible for determining the fair value of our investments in good faith.

With respect to investments for which market quotations are not readily available or when such market quotations are deemed not to represent fair value, our Board of Directors has approved a multi-step valuation process each quarter, as described below:

(1) our quarterly valuation process begins with each portfolio company being initially valued by the investment professionals responsible for the portfolio investment;

(2) preliminary valuation conclusions are then documented and business based assumptions are discussed with our investment committee;

(3) the Audit Committee of the Board of Directors reviews the preliminary valuation of the investments in the portfolio company as provided by the investment committee, which incorporates the results of the independent valuation firm as appropriate; and

(4) the Board of Directors, upon the recommendation of the Audit Committee, discusses valuations and determines the fair value of each investment in our portfolio in good faith based on the input of, where applicable, the respective independent valuation firm and the investment committee.

ASC 820 establishes a framework for measuring the fair value of assets and liabilities and outlines a fair value hierarchy which prioritizes the inputs used to measure fair value and the effect of fair value measures on earnings. ASC 820 also requires disclosure for fair value measurements based on the level within the hierarchy of the information used in the valuation. ASC 820 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

We have categorized all investments recorded at fair value in accordance with ASC 820 based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels, defined by ASC 820 and directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets and liabilities, are as follows:

Level 1—Inputs are unadjusted, quoted prices in active markets for identical assets at the measurement date. The types of assets carried at Level 1 fair value generally are equities listed in active markets.

Level 2—Inputs (other than quoted prices included in Level 1) are either directly or indirectly observable for the asset in connection with market data at the measurement date and for the extent of the instrument's anticipated life. Fair valued assets that are generally included in this category are warrants held in a public company.

Level 3—Inputs reflect management's best estimate of what market participants would use in pricing the asset at the measurement date. It includes prices or valuations that require inputs that are both significant to the fair value measurement and unobservable. Generally, assets carried at fair value and included in this category are the debt investments and warrants and equities held in a private company.

In accordance with ASU 2011-04, the following table provides quantitative information about our Level 3 fair value measurements of our investments as of March 31, 2015. In addition to the techniques and inputs noted in the table below, according to our valuation policy, we may also use other valuation techniques and methodologies when determining our fair value measurements. The table below is not intended to be all-inclusive, but rather provides information on the significant Level 3 inputs as they relate to our fair value measurements.

| Investment Type - Level (in<br>Thousands) | Fair Value<br>at            | Techniques/Methodologies       | Unobservable Input <sup>(a)</sup>               | Range                                     | Weighted<br>Average<br><sup>(b)</sup> |
|---|-----------------------------|--------------------------------|---|---|---------------------------------------|
|   | March 31, 2015<br>Valuation |                                |   |   |                                       |
| Pharmaceuticals                           | \$113,110                   | Originated Within 6<br>Months  | Origination Yield                               | 10.34% -<br>15.43%                        | 12.69%                                |
|   | 290,713                     | Market Comparable<br>Companies | Hypothetical Market Yield<br>Premium/(Discount) | 9.83% -<br>16.70% -<br>(0.50%) -<br>1.00% | 12.76%                                |
| Technology                                | 113,378                     | Originated Within 6<br>Months  | Origination Yield                               | 6.15% -<br>16.82%                         | 14.38%                                |
|   | 168,727                     | Market Comparable<br>Companies | Hypothetical Market Yield<br>Premium/(Discount) | 6.77% -<br>18.01% -<br>0.00% -<br>1.00%   | 13.90%                                |
|   | 24,398                      | Liquidation <sup>(c)</sup>     | Probability weighting of alternative outcomes   | 10.00% -<br>100.00%                       |                                       |
| Medical Devices                           | 28,140                      | Originated Within 6<br>Months  | Origination Yield                               | 12.14% -<br>21.03%                        | 14.00%                                |
|   | 102,363                     |                                | Hypothetical Market Yield                       |   | 14.34%                                |

|                     |             |   |   |                 |        |
|---------------------|-------------|---|---|-----------------|--------|
|                     |             | Market Comparable Companies                         |   | 11.29% - 21.87% |        |
|                     |             |   | Premium/(Discount)                            | 0.00% - 0.50%   |        |
| Energy Technology   | 42,884      | Originated Within 6 Months                          | Origination Yield                             | 7.16% - 15.05%  | 12.04% |
|                     | 51,881      | Market Comparable Companies                         | Hypothetical Market Yield                     | 13.33% - 23.41% | 15.93% |
|                     |             |   | Premium/(Discount)                            | 0.00 - 1.50%    |        |
|                     | 1,600       | Liquidation <sup>(c)</sup>                          | Probability weighting of alternative outcomes | 100.00%         |        |
| Lower Middle Market | 19,699      | Market Comparable Companies                         | Hypothetical Market Yield                     | 13.59%          | 13.59% |
|                     |             |   | Premium/(Discount)                            | 1.00%           |        |
|                     |             | Liquidation <sup>(c)</sup>                          | Probability weighting of alternative outcomes | 45.00% - 55.00% |        |
|                     | 5,390       |   |   |                 |        |
|                     |             | Debt Investments Where Fair Value Approximates Cost |   |                 |        |
|                     | —           | Imminent Payoffs <sup>(d)</sup>                     |   |                 |        |
|                     | 95,749      | Debt Investments Maturing in Less than One Year     |   |                 |        |
|                     | \$1,058,032 | Total Level Three Debt Investments                  |   |                 |        |

(a) The significant unobservable inputs used in the fair value measurement of the Company's debt securities are hypothetical market yields and premiums/(discounts). The hypothetical market yield is defined as the exit price of an investment in a hypothetical market to hypothetical market participants where buyers and sellers are willing participants. The premiums (discounts) relate to company specific characteristics such as underlying investment performance, security liens, and other characteristics of the investment. Significant increases (decreases) in the inputs in isolation would result in a significantly lower (higher) fair value measurement, depending on the materiality of the investment. Debt investments in the industries noted in the Company's Consolidated Schedule of Investments are included in the industries note above as follows:

- Pharmaceuticals, above, is comprised of debt investments in the Specialty Pharmaceuticals, Drug Discovery and Development, Drug Delivery, Diagnostic and Biotechnology Tools industries in the Consolidated Schedule of Investments.
- Technology, above, is comprised of debt investments in the Software, Semiconductors, Internet Consumer and Business Services, Consumer and Business Products, Information Services, and Communications and Networking industries in the Consolidated Schedule of Investments.
- Medical Devices, above, is comprised of debt investments in the Surgical Devices, Medical Devices and Equipment and Biotechnology Tools industries in the Consolidated Schedule of Investments.
- Energy Technology, above, aligns with the Energy Technology Industry in the Consolidated Schedule of Investments.
- Lower Middle Market, above, is comprised of debt investments in the Communications and Networking, Electronics and Computer Hardware, Healthcare Services - Other, Information Services, Internet Consumer and Business Services, Media/Content/Info, and Specialty Pharmaceuticals industries in the Consolidated Schedule of Investments.

(b) The weighted averages are calculated based on the fair market value of each investment.

(c) The significant unobservable inputs used in the fair value measurement of impaired debt securities is the probability weighting of alternative outcomes.

(d) Imminent payoffs represent debt investments that we expect to be fully repaid within the next three months, prior to their scheduled maturity date.





| Fair Value at                          |                          | December 31, 2014                                   |   |                                   | Weighted |
|--|--------------------------|---|---|-----------------------------------|----------|
| Investment Type - Level (in thousands) | Techniques/Methodologies | Unobservable Input <sup>(a)</sup>                   | Range   | Average <sup>(b)</sup>            |          |
| Pharmaceuticals                        | \$117,229                | Originated Within 6 Months                          | Origination Yield                             | 10.34% - 16.52%                   | 11.76%   |
|  | 237,595                  | Market Comparable Companies                         | Hypothetical Market Yield Premium/(Discount)  | 9.75% - 17.73%<br>(0.50%) - 1.00% | 10.62%   |
| Medical Devices                        | 60,332                   | Originated Within 6 Months                          | Origination Yield                             | 12.14% - 16.56%                   | 13.69%   |
|  | 60,658                   | Market Comparable Companies                         | Hypothetical Market Yield Premium/(Discount)  | 11.64% - 22.22%<br>0.00% - 1.00%  | 12.19%   |
| Technology                             | 12,970                   | Liquidation <sup>(c)</sup>                          | Probability weighting of alternative outcomes | 50.00%                            |          |
|  | 152,645                  | Originated Within 6 Months                          | Origination Yield                             | 10.54% - 20.02%                   | 14.08%   |
|  | 80,835                   | Market Comparable Companies                         | Hypothetical Market Yield Premium/(Discount)  | 6.95% - 15.50%<br>0.00% - 0.50%   | 13.01%   |
|  | 27,159                   | Liquidation <sup>(c)</sup>                          | Probability weighting of alternative outcomes | 10.00% - 90.00%                   |          |
| Energy Technology                      | 4,437                    | Originated Within 6 Months                          | Origination Yield                             | 13.85% - 21.57%                   | 19.00%   |
|  | 52,949                   | Market Comparable Companies                         | Hypothetical Market Yield Premium/(Discount)  | 13.20% - 16.62%<br>0.00% - 1.50%  | 15.41%   |
| Lower Middle Market                    | 1,600                    | Liquidation <sup>(c)</sup>                          | Probability weighting of alternative outcomes | 100.00%                           |          |
|  | 2,962                    | Originated Within 6 Months                          | Origination Yield                             | 14.04%                            | 14.04%   |
|  | 59,254                   | Market Comparable Companies                         | Hypothetical Market Yield Premium/(Discount)  | 11.91% - 15.33%<br>0.00% - 0.50%  | 13.98%   |
|  | 4,096                    | Liquidation <sup>(c)</sup>                          | Probability weighting of alternative outcomes | 45.00% - 55.00%                   |          |
|  |                          | Debt Investments Where Fair Value Approximates Cost |   |                                   |          |
|  | 9,318                    | Imminent Payoffs <sup>(d)</sup>                     |   |                                   |          |
|  | 39,867                   | Debt Investments Maturing in Less than One Year     |   |                                   |          |
|  | \$923,906                | Total Level Three Debt Investments                  |   |                                   |          |

- (a) The significant unobservable inputs used in the fair value measurement of the Company's securities are hypothetical market yields and premiums/(discounts). The hypothetical market yield is defined as the exit price of an investment in a hypothetical market to hypothetical market participants where buyers and sellers are willing participants. The premiums (discounts) relate to company specific characteristics such as underlying investment performance, security liens, and other characteristics of the investment. Significant increases (decreases) in the inputs in isolation would result in a significantly lower (higher) fair value measurement, depending on the materiality of the investment. Debt investments in the industries noted in the Company's Consolidated Schedule of Investments are included in the industries note above as follows:
- Pharmaceuticals, above, is comprised of debt investments in the Specialty Pharmaceuticals, Drug Discovery and Development, Drug Delivery, Diagnostic and Biotechnology Tools industries in the Consolidated Schedule of Investments.
  - Medical Devices, above, is comprised of debt investments in the Surgical Devices, Medical Devices and Equipment and Biotechnology Tools industries in the Consolidated Schedule of Investments.
  - Technology, above, is comprised of debt investments in the Software, Semiconductors, Internet Consumer and Business Services, Consumer and Business Products, Information Services, and Communications and Networking industries in the Consolidated Schedule of Investments.
  - Energy Technology, above, aligns with the Energy Technology Industry in the Consolidated Schedule of Investments.
  - Lower Middle Market, above, is comprised of debt investments in the Communications and Networking, Electronics and Computer Hardware, Healthcare Services - Other, Information Services, Internet Consumer and Business Services, Media/Content/Info, and Specialty Pharmaceuticals industries in the Consolidated Schedule of Investments.
- (b) The weighted averages are calculated based on the fair market value of each investment.
- (c) The significant unobservable input s used in the fair value measurement of impaired debt securities is the probability weighting of alternative outcomes.
- (d) Imminent payoffs represent debt investments that we expect to be fully repaid within the next three months, prior to their scheduled maturity date.

| Investment Type - Level Three                    | Fair Value at March 31, 2015 | Valuation Techniques/         | Unobservable Input (a)                 | Range            | Weighted Average (e) |
|--|------------------------------|-------------------------------|--|------------------|----------------------|
| Equity and Warrant Investments                   | (in thousands)               | Methodologies                 | EBITDA Multiple (b)                    | 4.5x - 21.6x     | 8.8x                 |
| Equity Investments                               | \$ 12,500                    | Market Comparable Companies   | Revenue Multiple (b)                   | 0.8x - 3.8x      | 2.6x                 |
|  |                              |                               | Discount for Lack of Marketability (c) | 6.11% - 30.04%   | 15.93%               |
|  |                              |                               | Average Industry Volatility (d)        | 32.52% - 94.47%  | 66.80%               |
|  |                              |                               | Risk-Free Interest Rate                | 0.17% - 0.85%    | 0.24%                |
|  |                              |                               | Estimated Time to Exit (in months)     | 8 - 35           | 11                   |
|  | 18,956                       | Market Adjusted OPM Backsolve | Average Industry Volatility (d)        | 29.95% - 87.97%  | 66.97%               |
|  |                              |                               | Risk-Free Interest Rate                | 0.23% - 1.32%    | 0.61%                |
|  |                              |                               | Estimated Time to Exit (in months)     | 11 - 41          | 20                   |
| Warrant Investments                              | 10,760                       | Market Comparable Companies   | EBITDA Multiple (b)                    | 5.7x - 81.9x     | 20.6x                |
|  |                              |                               | Revenue Multiple (b)                   | 0.3x - 14.2x     | 4.0x                 |
|  |                              |                               | Discount for Lack of Marketability (c) | 12.85% - 36.52%  | 22.77%               |
|  |                              |                               | Average Industry Volatility (d)        | 43.78% - 75.78%  | 57.20%               |
|  |                              |                               | Risk-Free Interest Rate                | 0.17% - 1.10%    | 0.49%                |
|  |                              |                               | Estimated Time to Exit (in months)     | 8 - 47           | 21                   |
|  | 13,975                       | Market Adjusted OPM Backsolve | Average Industry Volatility (d)        | 29.95% - 105.34% | 68.29%               |
|  |                              |                               | Risk-Free Interest Rate                | 0.17% - 2.95%    | 0.78%                |
|  |                              |                               | Estimated Time to Exit (in months)     | 8 - 50           | 26                   |
| Total Level Three Warrant and Equity Investments | \$ 56,191                    |                               |  |                  |                      |

(a) The significant unobservable inputs used in the fair value measurement of the Company's warrant and equity-related securities are revenue and/or EBITDA multiples and discounts for lack of marketability. Additional inputs used in the Black Scholes Option Pricing Model ("OPM") include industry volatility, risk free interest rate

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and estimated time to exit. Significant increases (decreases) in the inputs in isolation would result in a significantly higher (lower) fair value measurement, depending on the materiality of the investment. For some investments, additional consideration may be given to data from the last round of financing or merger/acquisition events near the measurement date.

- (b) Represents amounts used when the Company has determined that market participants would use such multiples when pricing the investments.  
(c) Represents amounts used when the Company has determined market participants would take into account these discounts when pricing the investments.  
(d) Represents the range of industry volatility used by market participants when pricing the investment.  
(e) Weighted averages are calculated based on the fair market value of each investment.

| Investment Type - Level Three  | Fair Value at     | Validation Techniques/        | Unobservable Input (a)                 | Range            | Weighted Average (e) |
|--------------------------------|-------------------|-------------------------------|--|------------------|----------------------|
|                                | December 31, 2014 |                               |  |                  |                      |
| Equity and Warrant Investments | (in thousands)    | Methodologies                 | EBITDA Multiple (b)                    | 5.2x - 23.4x     | 8.5x                 |
| Equity Investments             | \$ 12,249         | Market Comparable Companies   | Revenue Multiple (b)                   | 0.9x - 3.6x      | 2.6x                 |
|                                |                   |                               | Discount for Lack of Marketability (c) | 5.67% - 35.45%   | 15.95%               |
|                                |                   |                               | Average Industry Volatility (d)        | 48.10% - 95.18%  | 62.78%               |
|                                |                   |                               | Risk-Free Interest Rate                | 0.22% - 0.83%    | 0.24%                |
|                                |                   |                               | Estimated Time to Exit (in months)     | 10 - 28          | 11                   |
|                                | 46,686            | Market Adjusted OPM Backsolve | Average Industry Volatility (d)        | 38.95% - 84.30%  | 55.0%                |
|                                |                   |                               | Risk-Free Interest Rate                | 0.10% - 1.32%    | 0.2%                 |
|                                |                   |                               | Estimated Time to Exit (in months)     | 6 - 43           | 10                   |
| Warrant Investments            | 9,725             | Market Comparable Companies   | EBITDA Multiple (b)                    | 0.0x - 98.9x     | 16.6x                |
|                                |                   |                               | Revenue Multiple (b)                   | 0.3x - 15.7x     | 4.3x                 |
|                                |                   |                               | Discount for Lack of Marketability (c) | 12.12% - 35.50%  | 22.1%                |
|                                |                   |                               | Average Industry Volatility (d)        | 37.70% - 108.86% | 67.2%                |
|                                |                   |                               | Risk-Free Interest Rate                | 0.22% - 1.34%    | 0.8%                 |
|                                |                   |                               | Estimated Time to Exit (in months)     | 10 - 47          | 27                   |
|                                | 12,198            | Market Adjusted OPM           | Average Industry Volatility (d)        | 32.85% - 99.81%  | 67.6%                |

## Backsolve

|                                    |         |      |
|------------------------------------|---------|------|
|                                    | 0.21% - | 0.9% |
| Risk-Free Interest Rate            | 2.95%   |      |
| Estimated Time to Exit (in months) | 10 - 48 | 28   |

|  |           |
|--|-----------|
| Total Level Three<br>Warrant and Equity<br>Investments | \$ 80,858 |
|--|-----------|

- (a) The significant unobservable inputs used in the fair value measurement of the Company's warrant and equity-related securities are revenue and/or EBITDA multiples and discounts for lack of marketability. Additional inputs used in the Black Scholes Option Pricing Model ("OPM") include industry volatility, risk free interest rate and estimated time to exit. Significant increases (decreases) in the inputs in isolation would result in a significantly higher (lower) fair value measurement, depending on the materiality of the investment. For some investments, additional consideration may be given to data from the last round of financing or merger/acquisition events near the measurement date.
- (b) Represents amounts used when the Company has determined that market participants would use such multiples when pricing the investments.
- (c) Represents amounts used when the Company has determined market participants would take into account these discounts when pricing the investments.
- (d) Represents the range of industry volatility used by market participants when pricing the investment.
- (e) Weighted averages are calculated based on the fair market value of each investment.

## Debt Investments

We follow the guidance set forth in ASC 820 which establishes a framework for measuring the fair value of assets and liabilities and outlines a fair value hierarchy which prioritizes the inputs used to measure fair value and the effect of fair value measures on earnings. Our debt securities are primarily invested in venture capital-backed companies in technology-related markets, including technology, biotechnology, life science and energy and renewables technology industries at all stages of development. Given the nature of lending to these types of businesses, our investments in these portfolio companies are considered Level 3 assets under ASC 820 because there is no known or accessible market or market indexes for debt instruments for these investment securities to be traded or exchanged.

In making a good faith determination of the value of our investments, we generally start with the cost basis of the investment, which includes the value attributed to the Original Issue Discount (“OID”), if any, and PIK interest or other receivables which have been accrued to principal as earned. We then apply the valuation methods as set forth below.

We apply a procedure for debt investments that assumes the sale of each investment in a hypothetical market to a hypothetical market participant where buyers and sellers are willing participants. The hypothetical market does not include scenarios where the underlying security was simply repaid or extinguished, but includes an exit concept. We determine the yield at inception for each debt investment. We then use senior secured, leveraged loan yields provided by third party providers to determine the change in market yields between inception of the debt security and the measurement date. Industry specific indices are used to benchmark/assess market based movements.

Under this process, we also evaluate the collateral for recoverability of the debt investments. We consider each portfolio company’s credit rating, security liens and other characteristics of the investment to adjust the baseline yield to derive a credit adjusted hypothetical yield for each investment as of the measurement date. The anticipated future cash flows from each investment are then discounted at the hypothetical yield to estimate each investment’s fair value as of the measurement date.

Our process includes, among other things, the underlying investment performance, the current portfolio company’s financial condition and market changing events that impact valuation, estimated remaining life, current market yields and interest rate spreads of similar securities as of the measurement date. We value our syndicated debt investments using broker quotes and bond indices amongst other factors. If there is a significant deterioration of the credit quality of a debt investment, we may consider other factors than those a hypothetical market participant would use to estimate fair value, including the proceeds that would be received in a liquidation analysis.

We record unrealized depreciation on investments when we believe that an investment has decreased in value, including where collection of a debt investment is doubtful or, if under the in-exchange premise, when the value of a debt security is less than the amortized cost of the investment. Conversely, where appropriate, we record unrealized appreciation if we believe that the underlying portfolio company has appreciated in value and, therefore, that our investment has also appreciated in value or, if under the in-exchange premise, the value of a debt security is greater than amortized cost.

When originating a debt instrument, we generally receive warrants or other equity-related securities from the borrower. We determine the cost basis of the warrants or other equity-related securities received based upon their respective fair values on the date of receipt in proportion to the total fair value of the debt and warrants or other equity-related securities received. Any resulting discount on the debt investment from recordation of the warrant or other equity instruments is accreted into interest income over the life of the loan.

## Equity-Related Securities and Warrants

Securities that are traded in the over-the-counter markets or on a stock exchange will be valued at the prevailing bid price at period end. We have a limited number of equity securities in public companies. In accordance with the 1940 Act, unrestricted publicly traded securities for which market quotations are readily available are valued at the closing market quote on the measurement date.

We estimate the fair value of warrants using a Black Scholes Option Pricing Model (“OPM”). At each reporting date, privately held warrant and equity related securities are valued based on an analysis of various factors including, but not limited to, the portfolio company’s operating performance and financial condition and general market conditions, price to enterprise value or price to equity ratios, discounted cash flow, valuation comparisons to comparable public companies or other industry benchmarks. When an external event occurs, such as a purchase transaction, public offering, or subsequent equity sale, the pricing indicated by that external event is utilized to corroborate our valuation of the warrant and equity related securities. We periodically review the valuation of our portfolio companies that have not been involved in a qualifying external event to determine if the enterprise value of the portfolio company may have increased or decreased since the last valuation measurement date.

### Income Recognition

We record interest income on the accrual basis and we recognize it as earned in accordance with the contractual terms of the loan agreement to the extent that such amounts are expected to be collected. OID initially represents the value of detachable equity warrants obtained in conjunction with the acquisition of debt securities and is accreted into interest income over the term of the loan as a yield enhancement. When a loan becomes 90 days or more past due, or if management otherwise does not expect the portfolio company to be able to service its debt and other obligations, we will generally place the loan on non-accrual status and cease recognizing interest income on that loan until all principal has been paid. Any uncollected interest related to prior periods is reversed from income in the period that collection of the interest receivable is determined to be doubtful. However, we may make exceptions to this policy if the investment has sufficient collateral value and is in the process of collection. At March 31, 2015, we had four debt investments on non-accrual with a cumulative cost and approximate fair value of \$34.0 million and \$12.0 million, respectively, compared to four debt investments on non-accrual at December 31, 2014 a cumulative cost and approximate fair market value of \$28.9 million and \$10.6 million, respectively.

### Paid-In-Kind and End of Term Income

Contractual PIK interest, which represents contractually deferred interest added to the loan balance that is generally due at the end of the loan term, is generally recorded on the accrual basis to the extent such amounts are expected to be collected. We will generally cease accruing PIK interest if there is insufficient value to support the accrual or we do not expect the portfolio company to be able to pay all principal and interest due. In addition, we may also be entitled to an end-of-term payment that we amortize into income over the life of the loan. To maintain our status as a RIC, PIK and end-of-term income must be paid out to stockholders in the form of dividends even though we have not yet collected the cash. Amounts necessary to pay these dividends may come from available cash or the liquidation of certain investments. We recorded approximately \$907,000 and \$852,000 in PIK income during the three months ended March 31, 2015 and 2014, respectively.

### Fee Income

Fee income, generally collected in advance, includes loan commitment and facility fees for due diligence and structuring, as well as fees for transaction services and management services rendered by us to portfolio companies and other third parties. Loan and commitment fees are amortized into income over the contractual life of the loan. Management fees are generally recognized as income when the services are rendered. Loan origination fees are capitalized and then amortized into interest income using the effective interest rate method. In certain loan arrangements, warrants or other equity interests are received from the borrower as additional origination fees.

We recognize nonrecurring fees amortized over the remaining term of the loan commencing in the quarter relating to specific loan modifications. Certain fees may still be recognized as one-time fees, including prepayment penalties, fees related to select covenant default waiver fees and acceleration of previously deferred loan fees and OID related to early loan pay-off or material modification of the specific debt outstanding.

### Equity Offering Expenses

Our offering costs are charged against the proceeds from equity offerings when received.

### Debt Issuance Costs

Debt issuance costs are fees and other direct incremental costs incurred by us in obtaining debt financing. Debt issuance costs are recognized as prepaid expenses and amortized over the life of the related debt instrument using the



straight line method, which closely approximates the effective yield method.

#### Stock-Based Compensation

We have issued and may, from time to time, issue additional stock options and restricted stock to employees under our 2004 Equity Incentive Plan and Board members under our 2006 Equity Incentive Plan. We follow ASC 718, formally known as FAS 123R “Share-Based Payments” to account for stock options granted. Under ASC 718, compensation expense associated with stock-based compensation is measured at the grant date based on the fair value of the award and is recognized over the vesting period. Determining the appropriate fair value model and calculating the fair value of stock-based awards at the grant date requires judgment, including estimating stock price volatility, forfeiture rate and expected option life.

## Income Taxes

We operate to qualify to be taxed as a RIC under the Code. Generally, a RIC is entitled to deduct dividends it pays to its shareholders from its income to determine “taxable income.” Taxable income includes our taxable interest, dividend and fee income, as well as taxable net capital gains. Taxable income generally differs from net income for financial reporting purposes due to temporary and permanent differences in the recognition of income and expenses, and generally excludes net unrealized appreciation or depreciation, as gains or losses are not included in taxable income until they are realized. In addition, gains realized for financial reporting purposes may differ from gains included in taxable income as a result of our election to recognize gains using installment sale treatment, which generally results in the deferment of gains for tax purposes until notes or other amounts, including amounts held in escrow, received as consideration from the sale of investments are collected in cash.

Taxable income includes non-cash income, such as changes in accrued and reinvested interest and dividends, which includes contractual PIK interest arrangements, and the amortization of discounts and fees. Cash collections of income resulting from contractual PIK interest arrangements or the amortization of discounts and fees generally occur upon the repayment of the loans or debt securities that include such items. Non-cash taxable income is reduced by non-cash expenses, such as realized losses and depreciation and amortization expense.

As a RIC, we will be subject to a 4% nondeductible federal excise tax on certain undistributed income unless the we distribute in a timely manner an amount at least equal to the sum of (1) 98% of our ordinary income for each calendar year, (2) 98.2% of our capital gain net income for the 1-year period ending October 31 in that calendar year and (3) any income realized, but not distributed, in the preceding year (the “Excise Tax Avoidance Requirements”). We will not be subject to excise taxes on amounts on which we are required to pay corporate income tax (such as retained net capital gains).

Depending on the level of taxable income earned in a tax year, we may choose to carry over taxable income in excess of current year distributions from such taxable income into the next tax year and pay a 4% excise tax on such income, as required. The maximum amount of excess taxable income that may be carried over for distribution in the next year under the Code is the total amount of dividends paid in the following year, subject to certain declaration and payment guidelines. To the extent we choose to carry over taxable income into the next tax year, dividends declared and paid by us in a year may differ from taxable income for that year as such dividends may include the distribution of current year taxable income, the distribution of prior year taxable income carried over into and distributed in the current year, or returns of capital.

We intend to distribute approximately \$16.7 million of spillover from long term earnings from the year ended December 31, 2014 to our shareholders in 2015.

Because federal income tax regulations differ from accounting principles generally accepted in the United States, distributions in accordance with tax regulations may differ from net investment income and realized gains recognized for financial reporting purposes. Differences may be permanent or temporary. Permanent differences are reclassified among capital accounts in the financial statement to reflect their tax character. Temporary differences arise when certain items of income, expense, gain or loss are recognized at some time in the future. Differences in classification may also result from the treatment of short-term gains as ordinary income for tax purposes.

## Recent Accounting Pronouncements

In February 2015, the FASB issued ASU 2015-02, “Consolidation (Topic 810) – Amendments to the Consolidation Analysis”. The new guidance applies to entities in all industries and provides a new scope exception to registered money market funds and similar unregistered money market funds. It makes targeted amendments to the current

consolidation guidance and ends the deferral granted to investment companies from applying the VIE guidance. We are currently assessing the additional disclosure requirements. ASU 2015-02 is effective for public business entities for annual reporting periods beginning after December 15, 2016.

In April 2015, the FASB issued ASU 2015-03, "Simplifying the Presentation of Debt Issuance Costs", which requires debt issuance costs to be presented in the balance sheet as a direct deduction from the associated debt liability. The Company is currently assessing the additional disclosure requirements. ASU 2015-03 is effective for interim and annual reporting periods in fiscal years that begin after December 15, 2015.

#### Subsequent Events

##### Dividend Declaration

On May 4, 2015 the Board of Directors declared a cash dividend of \$0.31 per share to be paid on May 25, 2015 to shareholders of record as of May 18, 2015. This dividend represents our thirty-ninth consecutive dividend declaration since our initial public offering, bringing the total cumulative dividend declared to date to \$10.61 per share.

##### 2017 Asset-Backed Notes Repayment

In February 2015, changes in the payment schedule of obligors in the 2017 Asset-Backed Notes collateral pool triggered a rapid amortization event in accordance with the sale and servicing agreement for the 2017 Asset-Backed Notes. Due to this Event, the 2017 Asset-Backed Notes were fully repaid as of April 16, 2015.

##### April 2019 Notes – Redemption

In April 2015 we redeemed \$20.0 million of the \$84.5 million in issued and outstanding aggregate principal amount of April 2019 Notes, as previously approved by the Board of Directors. We currently intend to make additional redemptions on the April 2019 Notes throughout the 2015 calendar year, depending on our anticipated cash needs. We will provide notice for and complete all redemptions in compliance with the terms of the Base Indenture, as supplemented by the First Supplemental Indenture.

##### Convertible Senior Notes

The Convertible Senior Notes are convertible into shares of our common stock beginning October 15, 2015, or, under certain circumstances, earlier. Upon conversion of the Convertible Senior Notes, we have the choice to pay or deliver, as the case may be, at our election, cash, shares of our common stock or a combination of cash and shares of our common stock. The current conversion price of the Convertible Senior Notes is approximately \$11.28 per share of common stock, in each case subject to adjustment in certain circumstances. By not meeting the stock trading price conversion requirement during the three months ended March 31, 2015, the Convertible Senior Notes are currently not convertible for the three months ending June 30, 2015.

At March 31, 2015 approximately \$38,000 of the Convertible Senior Notes were converting pursuant to the conversion procedures as set forth in the Indenture, and were settled in April 2015 with a combination of cash equal to the outstanding principal amount of the converted notes and approximately 614 shares of our common stock. No additional notes are converting as of May 4, 2015 and no further settlements will be made prior to July 1, 2015.

##### Amendment to Wells Facility

In May 2015, we entered into a further amendment to the Wells Facility to remove the interest rate floor and to reduce the LIBOR rate margin by 25 basis points to 3.25%.

##### Amendment to Charter

Effective as of April 6, 2015, we amended our charter to increase the number of shares of common stock we are authorized to issue from 100,000,000 to 200,000,000. We effected the increase in authorized shares by filing Articles of Amendment with the State Department of Assessments and Taxation of Maryland.

##### Amendment to 2004 Equity Incentive Plan

At our 2015 Annual Meeting of stockholders, our stockholders will vote on whether to approve an amendment to the 2004 Equity Incentive Plan to increase the number of shares of common stock authorized for issuance thereunder by 4.0 million shares.

Closed and Pending Commitments

As of May 4, 2015, Hercules has:

- a. Closed debt and equity commitments of approximately \$31.4 million to new and existing portfolio companies.
- b. Pending commitments (signed non-binding term sheets) of approximately \$162.4 million. The table below summarizes our year-to-date closed and pending commitments as follows:

| Closed Commitments and Pending Commitments (in millions)  |         |
|---|---------|
| January 1 - March 31, 2015 Closed Commitments             | \$271.9 |
| Q2-15 Closed Commitments (as of May 4, 2015)              | \$31.4  |
| Total Year-to-date 2015 Closed Commitments <sup>(a)</sup> | \$303.3 |
| Pending Commitments (as of May 4, 2015) <sup>(b)</sup>    | \$162.4 |
| Year to date 2015 Closed and Pending Commitments          | \$465.7 |

Notes:

- a. Closed Commitments may include renewals of existing credit facilities. Not all Closed Commitments result in future cash requirements. Commitments generally fund over the two succeeding quarters from close.
- b. Not all pending commitments (signed non-binding term sheets) are expected to close and do not necessarily represent any future cash requirements.

Portfolio Company Developments

As of May 4, 2015, we held warrants or equity positions in five companies that have filed registration statements on Form S-1 with the SEC in contemplation of potential initial public offerings, including Gelesis, Inc., Good Technology, Inc. and three companies which filed confidentially under the JOBS Act. There can be no assurance that these companies will complete their initial public offerings in a timely manner or at all. In April 2015, our portfolio company ViewRay, Inc. formally withdrew its Form S-1 with the SEC, which had been on file as of March 31, 2015.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to financial market risks, including changes in interest rates. Interest rate risk is defined as the sensitivity of our current and future earnings to interest rate volatility, variability of spread relationships, the difference in re-pricing intervals between our assets and liabilities and the effect that interest rates may have on our cash flows. Changes in interest rates may affect both our cost of funding and our interest income from portfolio investments, cash and cash equivalents and idle funds investments. Our investment income will be affected by changes in various interest rates, including LIBOR and Prime rates, to the extent our debt investments include variable interest rates. As of March 31, 2015, approximately 97.3% of the loans in our portfolio had variable rates based on floating Prime or LIBOR rates with a floor. Changes in interest rates can also affect, among other things, our ability to acquire and originate loans and securities and the value of our investment portfolio.

Based on our Consolidated Statement of Assets and Liabilities as of March 31, 2015, the following table shows the approximate annualized increase (decrease) in components of net assets resulting from operations of hypothetical base rate changes in interest rates, assuming no changes in our investments and borrowings.

| (in thousands)                      | Interest | Interest | Net       |
|-------------------------------------|----------|----------|-----------|
| Basis Point Increase <sup>(1)</sup> | Income   | Expense  | Income    |
| 100                                 | \$7,471  | \$       | —\$7,471  |
| 200                                 | \$13,525 | \$       | —\$13,525 |
| 300                                 | \$25,333 | \$       | —\$25,333 |
| 400                                 | \$35,155 | \$       | —\$35,155 |
| 500                                 | \$44,143 | \$       | —\$44,143 |

(1) A decline in interest rates would not have a material impact on our Consolidated Financial Statements.

We do not currently engage in any hedging activities. However, we may, in the future, hedge against interest rate fluctuations by using standard hedging instruments such as futures, options, and forward contracts. While hedging activities may insulate us against changes in interest rates, they may also limit our ability to participate in the benefits of lower interest rates with respect to our borrowed funds and higher interest rates with respect to our portfolio of investments. During the three months ended March 31, 2015 we did not engage in interest rate hedging activities.

Although we believe that the foregoing analysis is indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in the credit market, credit quality, size and composition of the assets in our portfolio. It does not adjust for other business developments, including borrowings under our Credit Facilities, SBA debentures, Convertible Senior Notes, 2019 Notes, 2024 Notes, 2017 Asset-Backed Notes and 2021 Asset-Backed Notes that could affect the net increase in net assets resulting from operations, or net income. It also does not assume any repayments from borrowers. Accordingly, no assurances can be given that actual results would not differ materially from the statement above.

Because we currently borrow, and plan to borrow in the future, money to make investments, our net investment income is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest the funds borrowed. Accordingly, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income. In periods of rising interest rates, our cost of funds would increase, which could reduce our net investment income if there is not a corresponding increase in interest income generated by variable rate assets in our investment portfolio.

For additional information regarding the interest rate associated with each of our Credit Facilities, SBA debentures, Convertible Senior Notes, 2019 Notes, 2024 Notes, 2017 Asset-Backed Notes and 2021 Asset-Backed Notes, please refer to “Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations - Financial Condition, Liquidity and Capital Resources - Outstanding Borrowings” in this quarterly report on Form 10-Q.



#### ITEM 4. CONTROLS AND PROCEDURES

##### Disclosure Controls and Procedures

Our chief executive and chief financial officers, under the supervision and with the participation of our management, conducted an evaluation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. As of the end of the period covered by this quarterly report on Form 10-Q, our chief executive and chief financial officers have concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our chief executive and chief financial officers, as appropriate to allow timely decisions regarding required disclosure.

##### Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financing reporting, as defined in Rules 13a-15(f) and 15d-15(f) of the Securities Exchange Act of 1934, as amended, that occurred during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II: OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

We may, from time to time, be involved in litigation arising out of our operations in the normal course of business or otherwise. Furthermore, third parties may try to seek to impose liability on us in connection with the activities of our portfolio companies. While the outcome of any current legal proceedings cannot at this time be predicted with certainty, we do not expect any current matters will materially affect our financial condition or results of operations; however, there can be no assurance whether any pending legal proceedings will have a material adverse effect on our financial condition or results of operations in any future reporting period.

## ITEM 1A. RISK FACTORS

In addition to the risks discussed below, important risk factors that could cause results or events to differ from current expectations are described in Part I, Item 1A “Risk Factors” of the Company’s Annual Report on Form 10-K for the year ended December 31, 2014 filed with the Securities and Exchange Commission on March 2, 2015.

Our financial results could be negatively affected if a significant portfolio investment fails to perform as expected.

Our total investment in companies may be significant individually or in the aggregate. As a result, if a significant investment in one or more companies fails to perform as expected, our financial results could be more negatively affected and the magnitude of the loss could be more significant than if we had made smaller investments in more companies. The following table shows the fair value of the totals of investments held in portfolio companies at March 31, 2015 that represent greater than 5% of our net assets:

| (in thousands)                  | March 31, 2015 |                          |   |
|---------------------------------|----------------|--------------------------|---|
|                                 | Fair Value     | Percentage of Net Assets |   |
| Sungevity Development, LLC.     | \$40,883       | 5.4                      | % |
| Merrimack Pharmaceuticals, Inc. | \$40,515       | 5.3                      | % |

Sungevity Development, LLC. is a global residential solar energy provider focused on making it easy and affordable for homeowners to benefit from solar power.

Merrimack Pharmaceuticals, Inc. is a biopharmaceutical company discovering, developing and preparing to commercialize innovative medicines paired with companion diagnostics for the treatment of serious diseases, with an initial focus on cancer.

Our financial results could be materially adversely affected if these portfolio companies or any of our other significant portfolio companies encounter financial difficulty and fail to repay their obligations or to perform as expected.



## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the three month period ended March 31, 2015, we issued approximately 40,084 shares of common stock to shareholders in connection with the dividend reinvestment plan. These issuances were not subject to the registration requirements of the Securities Act of 1933, as amended. The aggregate value of the shares of our common stock issued under our dividend reinvestment plan was approximately \$562,000.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable

## ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable

## ITEM 5. OTHER INFORMATION

On May 6, 2015, Hercules Technology Growth Capital, Inc. (the "Company"), through a special purpose wholly-owned subsidiary of the Company, Hercules Funding II LLC, amended its credit facility with Wells Fargo Capital Finance, LLC ("WFCF") under which WFCF has committed \$75.0 million in initial credit capacity. The facility contains an accordion feature, in which the Company can increase the credit line up to an aggregate of \$300.0 million. The amendment reduces the interest rate per annum on LIBOR rate borrowings from LIBOR plus 3.50 % to LIBOR plus 3.25% and eliminates the interest rate floors on borrowings. The amendment is effective as of May 6, 2015.

Under the credit facility, as amended, LIBOR rate borrowings will bear interest at a rate per annum equal to LIBOR plus 3.25%, with no interest rate floor. The advance rate for eligible debt investments under the credit facility is 50%. The credit facility requires payment of a monthly non-use fee of the average monthly outstanding balance to a scale of 0.0% to 0.50% of the average monthly outstanding balance. The monthly payment of a non-use fee thereafter shall depend on the average balance that was outstanding on a scale between 0.0% and 0.50%. The credit facility generally requires payment of interest on a monthly basis. All outstanding principal is due upon maturity.

The credit facility also contains an accordion feature which allows the Company to increase the credit line up to an aggregate amount of \$300.0 million funded by additional lenders who may join the facility and with the agreement of WFCF and subject to other customary conditions. There can be no assurances that additional lenders will join the new credit facility.

The credit facility provides for customary events of default, including, but not limited to, payment defaults, breach of representations or covenants, including certain key-man provisions and lien limitations, bankruptcy events and change of control. The credit facility also includes various financial and operating covenants applicable to the Company and its subsidiaries. The covenants require, among other things, that the Company maintain certain financial ratios and a minimum tangible net worth in an amount, when added to outstanding subordinated indebtedness that is in excess of

\$500.0 million plus 90% of the cumulative amount of equity raised after June 30, 2014.

The foregoing description of the credit facility does not purport to be complete and is qualified in its entirety by reference to the full text of the loan and security agreement, as amended, attached hereto as Exhibit 10.1.

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ITEM 6. EXHIBITS

Exhibit

Number Description

- |      |  |
|------|--|
| 10.1 | Seventh Amendment to Loan and Security Agreement by and among Hercules Funding II, LLC and Wells Fargo Capital Finance, LLC (f/k/a Wells Fargo Foothill, LLC), dated as of May 6, 2015.* |
| 31.1 | Chief Executive Officer Certification Pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*                                     |
| 31.2 | Chief Financial Officer Certification Pursuant to Exchange Act Rule 13a-14 (a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*                                    |
| 32.1 | Chief Executive Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*  |
| 32.2 | Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*  |

\*Filed herewith.

SIGNATURES

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

HERCULES TECHNOLOGY GROWTH CAPITAL, INC. (Registrant)

Dated: May 7, 2015 /S/ MANUEL A. HENRIQUEZ  
Manuel A. Henriquez  
Chairman, President, and Chief Executive Officer

Dated: May 7, 2015 /S/ JESSICA BARON  
Jessica Baron  
Vice President of Finance and Chief Financial Officer

EXHIBIT INDEX

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\* Filed herewith.