

Dear Clients and Friends,

Re: **Survey On Legal Terms In Capital Venture Transactions – First Half of 2005**

We are pleased to present the results of our survey for the first half of 2005, analyzing the legal terms commonly used in venture capital financings in Israeli and “Israeli related” hi-tech companies and comparing these terms to those used in the Silicon Valley.

As was the practice in our previous surveys, this new survey relates to a six-month period, rolling one quarter forward in comparison to our previous survey, and provides an analysis of the legal terms of venture capital transactions closed during the first half of 2005, as compared with those of similar transactions closed during the periods covered by our earlier surveys.

In preparing our survey for the first half of 2005, we examined the terms of 46 venture capital financings of Israeli and Israeli-related hi-tech companies, each for an investment amount of no less than US \$500,000. The survey included only equity transactions in which venture capital funds participated, and not bridge loan transactions or investments made solely by “angels”.

The number of surveyed Israeli transactions constitutes approximately 50% of the relevant Israeli venture financings that closed during the covered period and met our qualifying criteria, constituting a majority of the most significant transactions in terms of funds invested.

As always, this survey was produced in coordination with Fenwick & West LLP., a leading Silicon Valley law firm. Our cooperation with Fenwick & West in producing this survey has enabled us also to present to you their corresponding survey covering Silicon Valley venture financings during the covered period, and thus to draw an interesting comparison between the terms commonly practiced in Israel and those used in the Silicon Valley.

For the first time since we began publication of this survey, the number of up-rounds has outnumbered the number of down-rounds by more than three times! The number of down-rounds decreased constituting less than fifth of the total surveyed investment rounds, while the number of up-rounds continued to increase, constituting a substantial majority of 65% of all of the follow-on investment rounds. This gap between the number of up-rounds and the number of down-rounds is even higher than that reflected in the Silicon Valley survey for the covered period – there the number of up-rounds is only two times the number of down-rounds.

Particularly noticeable is the conclusion that newer investment rounds barely had to raise follow-on rounds at lower price terms, and hence there are hardly any down-rounds in the Series B rounds.

In parallel to the positive trend in the price terms of investment rounds, the Israeli survey results indicated some toughening with respect to certain investors’ protective provisions as compared to the previous survey. Interestingly, said trend was evidenced in the Silicon Valley previous quarter survey results and such trend was restrained in the results of the last quarter results.

For example, there was an increase in the use of interest provisions or cumulative dividends calculated as a rate of the investment amount, which allows investors to receive a return on their investment which exceeds their investment amount (usually ranging between 6% to 8% of the investment amount per annum). The percentage of use of said provision which in this survey stands at 78% is the highest of all the periods surveyed. In contrast, in the Silicon Valley, where the use of said provision has in any event been lower compared to the use thereof in Israel, a decrease in the use of such provision was demonstrated - 7% in the Silicon Valley versus 78% in Israel. This gap has been strictly maintained throughout the periods covered by our surveys and more than anything else it seems that this is a result of the differences of the common practices in the industry.

In addition, the use of participation rights for preferred shares in liquidation has increased once again to levels which were witnessed in previous surveys – 91% (after a drop to a rate of 79% in the last two surveys).

In contrast, for the first time since we began publication of the survey, there was no use whatsoever of the “pay to play” provision.

We estimate that the toughening in the aforesaid terms may not entail much significance, especially in light of the increase in up-rounds, but rather a specific deviation. In any event, it will indeed be interesting to see the development of this trend in the upcoming surveys.

We hope that you find this survey useful and interesting. **To be placed on an email list for future editions of this survey, please go to www.shibolet.com.**

To review the Q1/'05 edition of the Fenwick & West Venture Capital Survey summarizing venture capital terms in the Silicon Valley, please go to www.fenwick.com/vctrends.htm.

For additional information about this report, please contact Mr. Lior Aviram at L.Aviram@shibolet.com or Ms. Limor Peled at L.Peled@shibolet.com, Shibolet, Yisraeli, Roberts, Zisman & Co., Advocates and Notaries, Tel: +972 (3) 710-3311.



SHIBOLETH, YISRAELI, ROBERTS, ZISMAN & CO.
in cooperation with
FENWICK & WEST LLP

**Trends in Legal Terms in Venture Financings
 in Israel
 (First Half of 2005)**

- **Background** – We have analyzed the terms of venture financings for 46 Israeli and Israeli-related technology companies that reported raising money in the first half of 2005. Our survey does not include financing rounds of less than US \$500,000. The tables below also show, for purposes of comparison, the results of our previously released surveys.
- **Financing Round** – The financings closed in the first half of 2005 and in the periods covered by our previous surveys may be broken down by types of round, or series, as follows:

Series	H1'05	Q4'04+ Q1'05	H2'04	Q2'04+ Q3'04	H1'04	Q4'03+ Q1'04	H2'03
A	28%	32%	35%	22%	20%	19%	22%
B	22%	30%	21%	24%	36%	23%	30%
C	26%	21%	25%	29%	26%	29%	22%
D	9%	10%	11%	16%	8%	15%	19%
E and higher	15%	7%	8%	9%	10%	14%	7%

- **Price Change** – The financings closed in the first half of 2005 and in the periods covered by our previous surveys may be broken down by the directions of the change in price as compared to each company's respective previous round, as follows:

Price Change	H1'05	Q4'04+ Q1'05	H2'04	Q2'04+ Q3'04	H1'04	Q4'03+ Q1'04	H2'03
Down	19%	28%	43%	46%	42%	44%	62%
Flat	16%	13%	12%	14%	3%	18%	28%
Up	65%	59%	45%	40%	55%	38%	10%

Up-rounds outpaced down-rounds with a solid majority for the second time in a row and by the highest margin since we started the Israeli survey in the second half of 2003.

The percentages of financing transactions that were down-rounds, broken down by series, were as follows:

Series	H1'05	Q4'04+ Q1'05	H2'04	Q2'04+ Q3'04	H1'04	Q4'03+ Q1'04	H2'03
B	0%	12%	25%	23%	24%	27%	73%
C	33%	50%	56%	59%	62%	64%	55%
D	25%	33%	43%	62%	0%	29%	56%
E and higher	14%	25%	40%	40%	80%	57%	50%

- **Liquidation Preference** – Senior liquidation preferences were used in the following percentages of financings:

H1'05	Q4'04+ Q1'05	H2'04	Q2'04+ Q3'04	H1'04	Q4'03+ Q1'04	H2'03
76%	72%	80%	91%	78%	76%	82%

The percentages of financing transactions with senior liquidation preference, broken down by series, were as follows:

Series	H1'05	Q4'04+ Q1'05	H2'04	Q2'04+ Q3'04	H1'04	Q4'03+ Q1'04	H2'03
B	80%	82%	85%	79%	61%	58%	82%
C	75%	58%	75%	100%	92%	87%	75%
D	75%	67%	71%	89%	75%	63%	82%
E and higher	71%	75%	100%	100%	100%	100%	100%

- **Multiple-Based Liquidation Preferences** - The percentage of financing transactions with senior liquidation preferences that included multiple preferences was as follows:

H1'05	Q4'04+ Q1'05	H2'04	Q2'04+ Q3'04	H1'04	Q4'03+ Q1'04	H2'03
16%	11%	24%	29%	23%	31%	44%

Of the financings in which there were senior liquidation preferences based on multiples, the range of the multiples may be broken down as follows:

Range of multiples	H1'05	Q4'04+ Q1'05	H2'04	Q2'04+ Q3'04	H1'04	Q4'03+ Q1'04	H2'03
>1x- 2x	25%	67%	88%	92%	100%	80%	88%
>2x - 3x	75%	33%	0%	0%	0%	10%	6%
> 3x	0%	0%	12%	8%	0%	10%	6%

- **Participation in Liquidation** - The percentage of transactions, out of the total number of financing transactions, which included participation rights in liquidation were as follows:

H1'05	Q4'04+ Q1'05	H2'04	Q2'04+ Q3'04	H1'04	Q4'03+ Q1'04	H2'03
91%	79%	79%	93%	90%	90%	91%

Out of those financing transactions the terms of which provided for participation, the percentages of those in which no cap was placed on the investors right to participation were as follows:

H1'05	Q4'04+ Q1'05	H2'04	Q2'04+ Q3'04	H1'04	Q4'03+ Q1'04	H2'03
69%	51%	60%	69%	67%	60%	59%

- **Cumulative Dividends and/or Accrued Interest as Part of the Liquidation Preference** – Cumulative dividends and/or accrued interest constituted part of the liquidation preferences in the following percentages of financings:

H1'05	Q4'04+ Q1'05	H2'04	Q2'04+ Q3'04	H1'04	Q4'03+ Q1'04	H2'03
78%	63%	52%	57%	62%	58%	54%

- **Anti-dilution Provisions** - The use of anti-dilution provisions in the financings which took place in the first half of 2005 and in the periods covered by our previous surveys may be broken down as follows:

Type of Provision	H1'05	Q2'04+ Q3'04	H2'04	Q2'04+ Q3'04	H1'04	Q4'03+ Q1'04	H2'03
Full Ratchet	31%	30%	30%	34%	28%	29%	38%
Weighted Average	65%	65%	64%	64%	66%	65%	55%
None	4%	5%	6%	2%	6%	6%	7%

- **Pay-to-Play Provisions** - The use of pay-to-play provisions in the financings which took place in the first half of 2005 and in the periods covered by our previous surveys may be broken down as follows:

Percentages (out of total number of financings in the relevant period) having pay-to-play provisions-

H1'05	Q4'04+ Q1'05	H2'04	Q2'04+ Q3'04	H1'04	Q4'03+ Q1'04	H2'03
0%	9%	13%	10%	14%	15%	9%

- **Redemption** – The percentage of transactions in the first half of 2005 and the periods covered by our previous surveys, out of the total number of financings in each respective period, in which the terms provided for mandatory redemption or redemption at the option of the venture capitalist was as follows:

H1'05	Q4'04+ Q1'05	H2'04	Q2'04+ Q3'04	H1'04	Q4'03+ Q1'04	H2'03
17%	16%	21%	22%	26%	33%	27%

- **Corporate Reorganizations** – The percentage of post-Series A financing transactions in the first half of 2005 and the periods covered by our previous surveys, out of the total number of financings in each respective period, which involved the conversion of senior securities into more junior securities was as follows:

H1'05	Q4'04+ Q1'05	H2'04	Q2'04+ Q3'04	H1'04	Q4'03+ Q1'04	H2'03
7%	0%	2%	16%	10%	12%	14%

Conclusion – The results in the first half of 2005 reflect a significant improvement in the price change terms, with up-rounds outnumbering down-rounds by more than three times constituting the highest margin since we started the Israeli survey. In the other terms of venture financings, the results indicate either some toughening or no substantial change.

For additional information about this report please contact Lior Aviram – l.aviram@shibolet.com or Limor Peled – l.peled@shibolet.com, at Shibolet, Yisraeli, Roberts, Zisman & Co., 972-3-7103311; or Barry Kramer at 650-335-7278; bkramer@fenwick.com or Michael Patrick at 650-335-7273; mpatrick@fenwick.com at Fenwick & West. To be placed on an email list for future editions of this survey please go to www.shibolet.com or to www.fenwick.com/vctrends.htm.



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**Analysis of Legal Terms of Venture Financings
of Israeli Companies
and a Comparison of Those Terms with the Terms of Venture Financings
in the Silicon Valley
(First Half of 2005)**

- **Background** – We have analyzed the terms of venture financings for 46 Israeli based/related technology companies that reported raising at least \$500,000 in the first half of 2005, and compared those terms to the terms of venture financings for 181 technology companies headquartered in the Silicon Valley (the San Francisco Bay Area) that reported raising money in the same period.
- **Financing Round** – The Israeli financings may be broken down according to type of round as follows:
 Series A – 28% (compared to 19% in the Silicon Valley)
 Series B – 22% (compared to 28% in the Silicon Valley)
 Series C – 26% (compared to 22% in the Silicon Valley)
 Series D – 9% (compared to 21% in the Silicon Valley)
 Series E and higher – 15% (compared to 10% in the Silicon Valley)
- **Price Change** – The financings during the first half of 2005 may be broken down by the directions of the change in price as compared to the each company's respective previous round, as follows:

Price Change	Israel	Silicon Valley
Down	19%	31%
Flat	16%	7%
Up	65%	62%

The percentages of financing transactions that were down-rounds, broken down by series, were as follows:

Series	Israel	Silicon Valley
B	0%	16%
C	33%	33%
D	25%	33%
E and higher	14%	61%

- **Liquidation Preference** – Senior liquidation preferences were used in the following percentages of post-Series A financings:

Israel	Silicon Valley
76%	48%

The percentages of financing transactions senior liquidation preference, broken down by series, were as follows:

Series	Israel	Silicon Valley
B	80%	32%
C	75%	46%
D	75%	62%
E and higher	71%	67%

- **Multiple-Based Liquidation Preference** –The percentages of financing transactions with senior liquidation preferences that included multiple preferences was as follows:

Israel	Silicon Valley
16%	17%

Of the financings in which there were senior liquidation preferences based on multiples, the range of the multiples may be broken down as follows:

Range of Multiples	Israel	Silicon Valley
>1x - 2x	25%	92%
>2x - 3x	75%	0%
>3x	0%	8%

- **Participation in Liquidation** –The percentage of transactions, out of the total number of financing transactions, that provided for participation rights in liquidation were as follows:

Israel	Silicon Valley
91%	72%

Out of those financing transactions the terms of which provided for participation, the percentages of those in which no cap was placed on the investors right to participation were as follows:

Israel	Silicon Valley
69%	55%

- **Cumulative Dividends/Interest Accrual** – Cumulative dividends or interest accruals (which is an Israeli concept similar to cumulative dividends) constituted part of the liquidation preferences under the terms of the following percentages of financings:

Israel	Silicon Valley
78%	7%

- **Anti-dilution Provisions** – The use of anti-dilution provisions in the financings were as follows:

Type of Provision	Israel	Silicon Valley
Full Ratchet	31%	8%
Weighted Average	65%	87%
None	4%	5%

- **Pay-to-Play Provisions** – The use of pay-to-play provisions in the financings was as follows:

Israel	Silicon Valley
0%	17%

- **Redemption** – The percentages of financings providing for either mandatory redemption or redemption at the option of the venture capitalist were as follows:

Israel	Silicon Valley
17%	30%

- **Corporate Reorganizations** – The percentages of post-Series A financings involving a corporate reorganization (conversion of senior securities) were as follows:

Israel	Silicon Valley
7%	14%

For additional information about this report please contact Barry Kramer at 650-335-7278; bkramer@fenwick.com or Michael Patrick at 650-335-7273; mpatrick@fenwick.com at Fenwick & West; or Lior Aviram – laviram@shibolet.com or Limor Peled – lpeled@shibolet.com, at Shibolet, Yisraeli, Roberts, Zisman & Co., 972-3-7103311. To be placed on an email list for future editions of this survey please go to www.fenwick.com/vctrends.htm or to www.shibolet.com.