

שבולת, ישראל, רוברטס, זיסמן ושות'



SHIBOLETH YISRAELI ROBERTS ZISMAN & Co.
עורכי דין ונוטריונים ADVOCATES & NOTARIES

Dear Clients and Friends,

Re: **Survey On Legal Terms In Capital Venture Transactions – Second Half of 2004**

We are pleased to present the results of our survey for the second half of 2004, 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 second half of 2004, as compared with those of similar transactions closed during the periods covered by our earlier surveys.

In preparing our survey for the second half of 2004, we examined the terms of 63 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 60% of the Israeli venture financings that closed during the covered period and met our qualifying criteria, constituting a majority both of the investment rounds in general and 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.

The results of this survey indicate a positive change of trend that matches the generally optimistic atmosphere of the Israeli venture capital industry at the close of 2004.

The numerical majority of up-rounds over down-rounds reported in the first half of 2004, which temporarily disappeared in our survey for the second and third quarters of 2004, returned in the second half of 2004.

The mild toughening of investors’ protective provisions witnessed in the second and third quarters of 2004 was also reversed in the second half of 2004, and the use of full ratchet anti-dilution provisions, senior liquidation preference provisions and multiple liquidation preference provisions decreased.

Moreover, for the first time since we began publication of this survey approximately a year and a half ago, there was a significant drop in the use of participation rights for preferred shares in liquidation – from over 90% to 79%!

Another positive development indicated by the results of our survey for the second half of 2004 is a substantial rise in the percentage of Series A rounds – from approximately 20% to 35% – which would in turn indicate that the industry is once again investing in early stage companies.

Interestingly, the “softening” discussed above of investors’ protective provisions commonly used in Israeli VC transactions, as demonstrated most strikingly by the decrease in the use of participation rights, appears to somewhat narrow the gap between the venture capital terms commonly used in Israel and those prevalent in the Silicon Valley.

When we began surveying the prevalent legal terms in Israel and comparing them to those commonly used in the Silicon Valley, we expressed our hope that these surveys would increase the degree of transparency of the Israeli hi-tech industry, both internally and for international funds interested in Israel, thus eventually contributing to a better understanding of the industry and further facilitating the negotiation of future transactions. It appears that the results for the second half of 2004 indicate such a trend, and we hope that these surveys will continue to contribute in this direction.

On a closing note, as we have seen in previous surveys, the results continue to reflect an interesting correlation between the venture capital market and events in the financial markets. In our last survey, we noted the rise in the Nasdaq indexes following the end of Q3 ‘04 and our expectation that this rise would be reflected in the next survey; this indeed appears to have been the case, as one may see in the results of this survey.

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 Q4/‘04 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
(Second Half of 2004)**

- **Background** – We have analyzed the terms of venture financings for 63 Israeli and Israeli-related technology companies that reported raising money in the second half of 2004. 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 second half of 2004 and in the periods covered by our previous surveys may be broken down by types of round, or series, as follows:

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

- **Price Change** – The financings closed in the second half of 2004 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	H2'04	Q2'04+Q3'04	H1'04	Q4'03+Q1'04	H2'03
Down	43%	46%	42%	44%	62%
Flat	12%	14%	3%	18%	28%
Up	45%	40%	55%	38%	10%

Up-rounds returned to outnumber down-rounds in the second half of 2004 .

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

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

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

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

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

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

H2'04	Q2'04+Q3'04	H1'04	Q4'03+Q1'04	H2'03
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	H2'04	Q2'04+Q3'04	H1'04	Q4'03+Q1'04	H2'03
>1x- 2x	88%	92%	100%	80%	88%
>2x - 3x	0%	0%	0%	10%	6%
> 3x	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:

H2'04	Q2'04+Q3'04	H1'04	Q4'03+Q1'04	H2'03
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:

H2'04	Q2'04+Q3'04	H1'04	Q4'03+Q1'04	H2'03
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:

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

Note: In each of the above periods, rounds using accrued interest outnumbered those using cumulative dividends by a ratio of two to one.

- **Anti-dilution Provisions** - The use of anti-dilution provisions in the financings which took place in the second half of 2004 and in the periods covered by our previous surveys may be broken down as follows:

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

- **Pay-to-Play Provisions** - The use of pay-to-play provisions in the financings which took place in the second half of 2004 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-

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

- **Redemption** – The percentage of transactions in the second half of 2004 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:

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

- **Corporate Reorganizations** – The percentage of post-Series A financing transactions in the second half of 2004 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:

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

Conclusion – The results for the second half of 2004 reflect some improvement in venture terms, with the percentage of up-rounds exceeding that of down-rounds, and a decrease in the use of full ratchet anti-dilution protection, senior liquidation preference and multiple liquidation preference. There was also, for the first time in the periods covered by our surveys, a significant decrease in the use of participation rights in liquidation.

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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**FENWICK & WEST LLP
SHIBOLETH, YISRAELI, ROBERTS, ZISMAN & CO.**

**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
(Second Half of 2004)**

- **Background** – We have analyzed the terms of venture financings for 63 Israeli based/related technology companies that reported raising at least \$500,000 in the second half of 2004, and compared those terms to the terms of venture financings for 214 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 – 35% (compared to 16% in the Silicon Valley)
 Series B – 21% (compared to 27% in the Silicon Valley)
 Series C – 25% (compared to 23% in the Silicon Valley)
 Series D – 11% (compared to 19% in the Silicon Valley)
 Series E and higher – 8% (compared to 15% in the Silicon Valley)
- **Price Change** – The financings during the second half of 2004 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	43%	30%
Flat	12%	14%
Up	45%	56%

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

Series	Israel	Silicon Valley
B	25%	17%
C	56%	28%
D	43%	41%
E and higher	40%	42%

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

Israel	Silicon Valley
80%	50%

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

Series	Israel	Silicon Valley
B	85%	33%
C	75%	48%
D	71%	66%
E and higher	100%	65%

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

Israel	Silicon Valley
24%	28%

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	88%	80%
>2x - 3x	0%	4%
>3x	12%	16%

- **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
79%	68%

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
60%	61%

- **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
52%	9%

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

Type of Provision	Israel	Silicon Valley
Full Ratchet	30%	12%
Weighted Average	64%	85%
None	6%	3%

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

Israel	Silicon Valley
13%	14%

- **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
21%	29%

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

Israel	Silicon Valley
2%	14%

Conclusion – The results for the second half of 2004 reflect improvement in venture terms both in the Silicon Valley and in Israel, although the terms in the Silicon Valley are still more favorable than those in Israel.

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 – l.aviram@shibolet.com or Limor Peled – l.peled@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.