

Dear Clients and Friends,

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

We are pleased to present the results of our survey for the second 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 this is the last survey for 2005, and in light of the quantity of data which has accumulated since we first began publication of this survey in the second half of 2003, we chose to present this survey in a slightly different format and compare results on a six-month period basis for the periods surveyed, without rolling one quarter forward as was done in our previous surveys.

In preparing our survey for the second half of 2005, we examined the terms of 41 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 55% 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.

The survey results show that the number of up-rounds in the second half of 2005 continue to outnumber the number of down-rounds. **Thus, we can conclude that the survey results for 2005 are characterized by an increase in the number of up-rounds which constitute a majority of approximately two thirds of all of the investment rounds surveyed in 2005 – a substantial improvement from the investment rounds surveyed in 2004.**

**In parallel to the trend of maintaining the increase in the number of up-rounds, this survey indicates an increase in the number of down-rounds – from 19% in the first half of 2005 to 30% in the second half of 2005.** This increase in the number of down-rounds was on account of the decrease in the number of flat rounds – 4% flat rounds in the second half of 2005 in comparison to 16% flat rounds in the first half of 2005. The main increase in down-rounds was in the investment rounds of Series B and Series E and higher.

Perhaps the increase in the number of down-rounds indicates a certain stability in the business environment of the hi-tech industry and a “normalization” of the evaluations. The number of down-rounds in the second half of 2005 is similar to the percentages reflected in the Silicon Valley survey for the first half of 2005, consistent with the trend in the Israeli market to “follow” the tendency in the Silicon Valley.

The increase in the number of down-rounds can also account for the increase in the use of the “full ratchet” anti-dilution protection which was reflected in the survey results for the second half of 2005 – 39% in comparison to 31% in the first half of 2005. Nonetheless, it should be noted that approximately 56% of the full ratchet provisions are limited to a specific period or apply until the next round of investment, and thereafter a “weighted average” formula applies.

The Israeli survey results also indicate that the toughening with respect to certain investors' protective provisions reflected in the survey results for the first half of 2005 has been restrained. For example, the use of interest provisions or cumulative dividends calculated as a rate of the investment amount, allowing investors to receive a return on their investment that exceeds their investment amount, which reached its highest percentage of 78% in the previous survey – dropped back to 68%. In addition, the use of participation rights for preferred shares in liquidation which increased in the previous survey as compared to earlier surveys, dropped from 91% to 85%.

Moreover, the survey results reflect that in 2005, the use of the multiple liquidation provisions by investors has decreased while the use of interest provisions or cumulative dividends calculated as a rate of the investment amount has increased. This trend is of course consistent with the increase in the number of up-rounds.

In general, the Israeli investments continue to be characterized with a higher use of the following provisions as compared to investments in the Silicon Valley: participation rights provisions, interest provisions or cumulative dividends calculated as a rate of the investment amount and full ratchet anti-dilution protection.

**A special one-time review:** As this survey is the last survey for 2005, we decided to examine with respect to the **entire** year, an element which is not surveyed by us on a regular basis - the composition of the board of directors in the various rounds of investment. It was perhaps expected that the more rounds of investment that a company undergoes and/or is a more “mature” company, the board composition would consist of a higher number of members, in order to accommodate both the increase in the number of investors and the tasks involved which may be more complex. **However, that is not the case!** The conclusion reached from examination of the data is that **there is not necessarily a difference in the number of board members in the earlier rounds (i.e. Series A and Series B), compared to the number of board members in later rounds (i.e. Series D and Series E and higher).** We found that quite often in earlier rounds (37% of the earlier rounds surveyed for 2005), the board compositions consisted of 7 members and more, and in comparison, in later rounds, there were board compositions which consisted of 4 and 5 members (16% of the later rounds surveyed for 2005).

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](http://www.shibolet.com).**

**To review the Q4/'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](http://www.fenwick.com/vctrends.htm).**

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

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

- **Background** – We have analyzed the terms of venture financings for 41 Israeli and Israeli-related technology companies that reported raising money in the second 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 second 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	H2'05	H1'05	H2'04	H1'04	H2'03
A	34%	28%	35%	20%	22%
B	27%	22%	21%	36%	30%
C	12%	26%	25%	26%	22%
D	17%	9%	11%	8%	19%
E and higher	10%	15%	8%	10%	7%

- **Price Change** – The financings closed in the second 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	H2'05	H1'05	H2'04	H1'04	H2'03
Down	30%	19%	43%	42%	62%
Flat	4%	16%	12%	3%	28%
Up	66%	65%	45%	55%	10%

**Up-rounds continued to outpace down-rounds in H2'05, constituting two thirds of the surveyed rounds in both H1'05 and H2'05. Nevertheless, there was an increase in the number of down-rounds in comparison to H1'05 on account of the decrease in the number of flat rounds.**

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

Series	H2'05	H1'05	H2'04	H1'04	H2'03
B	36%	0%	25%	24%	73%
C	20%	33%	56%	62%	55%
D	29%	25%	43%	0%	56%
E and higher	25%	14%	40%	80%	50%

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

H2'05	H1'05	H2'04	H1'04	H2'03
81%	76%	80%	78%	82%

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

Series	H2'05	H1'05	H2'04	H1'04	H2'03
B	73%	80%	85%	61%	82%
C	100%	75%	75%	92%	75%
D	71%	75%	71%	75%	82%
E and higher	100%	71%	100%	100%	100%

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

H2'05	H1'05	H2'04	H1'04	H2'03
18%	16%	24%	23%	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	H2'05	H1'05	H2'04	H1'04	H2'03
>1x- 2x	75%	25%	88%	100%	88%
>2x - 3x	0%	75%	0%	0%	6%
> 3x	25%	0%	12%	0%	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:

H2'05	H1'05	H2'04	H1'04	H2'03
85%	91%	79%	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:

H2'05	H1'05	H2'04	H1'04	H2'03
57%	69%	60%	67%	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:

H2'05	H1'05	H2'04	H1'04	H2'03
68%	78%	52%	62%	54%

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

Type of Provision	H2'05	H1'05	H2'04	H1'04	H2'03
Full Ratchet	39%	31%	30%	28%	38%
Weighted Average	61%	65%	64%	66%	55%
None	0%	4%	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 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-

H2'05	H1'05	H2'04	H1'04	H2'03
15%	0%	13%	14%	9%

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

H2'05	H1'05	H2'04	H1'04	H2'03
20%	17%	21%	26%	27%

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

H2'05	H1'05	H2'04	H1'04	H2'03
2%	7%	2%	10%	14%

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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 2005)**

- **Background** – We have analyzed the terms of venture financings for 41 Israeli based/related technology companies that reported raising at least \$500,000 in the second half of 2005, and compared those terms to the terms of venture financings for 215 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 –34% (compared to 20% in the Silicon Valley)  
 Series B – 27% (compared to 33% in the Silicon Valley)  
 Series C – 12% (compared to 20% in the Silicon Valley)  
 Series D – 17% (compared to 13% in the Silicon Valley)  
 Series E and higher – 10% (compared to 14% 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:

<b>Price Change</b>	<b>Israel</b>	<b>Silicon Valley</b>
Down	30%	22%
Flat	4%	13%
Up	66%	65%

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

<b>Series</b>	<b>Israel</b>	<b>Silicon Valley</b>
B	36%	13%
C	20%	21%
D	29%	39%
E and higher	25%	30%

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

Israel	Silicon Valley
81%	48%

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

Series	Israel	Silicon Valley
B	73%	31%
C	100%	42%
D	71%	79%
E and higher	100%	67%

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

Israel	Silicon Valley
18%	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	75%	83%
>2x - 3x	0%	17%
>3x	25%	0%

- **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
85%	67%

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
57%	52%

- **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
68%	4%

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

<b>Type of Provision</b>	<b>Israel</b>	<b>Silicon Valley</b>
Full Ratchet	39%	8%
Weighted Average	61%	88%
None	0%	4%

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

<b>Israel</b>	<b>Silicon Valley</b>
15%	12%

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

<b>Israel</b>	<b>Silicon Valley</b>
20%	32%

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

<b>Israel</b>	<b>Silicon Valley</b>
2%	14%

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