

Dear Clients and Friends,

Re: **Survey On Legal Terms In Capital Venture Transactions - May 2004**

We are pleased to present the results of our second survey 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.

Given the rapid changes currently taking place in the hi-tech industry, we have worked to produce an additional survey only one quarter after our first survey was released, in order to allow its readers to follow developments as closely as possible. This survey relates to a six-month period, rolling one quarter forward in comparison to our previous survey. We have included the data for two quarters primarily in order to counter the effect that a small number of exceptional deals might have on statistics garnered from the relatively small absolute number of deals in Israel.

The survey reviews and analyzes the legal terms of financing transactions closed in the fourth quarter of 2003 and in the first quarter of 2004, and compares these data with those presented in our first survey covering the second half of 2003.

In preparing the survey, we examined the terms of 52 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 constituted approximately 56% 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).

The survey was produced in coordination with Fenwick & West LLP., a leading Silicon Valley law firm that has produced a well respected survey tracking the terms of various financings in the Silicon Valley for the past two years, and the Israeli survey was developed using the same format and methodology.

Our cooperation with Fenwick & West in producing this survey has enabled us to present to you as well 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 the comparison survey indicate that the trend of the fourth quarter of 2003 identified in our previous survey, of an increasing number of up-rounds, **grew more pronounced in the first quarter of 2004**. The results show a significant rise in the number of up-rounds during the covered period compared to the second half of 2003 – in fact, nearly four times as many! However, the number of down-rounds in Israel for the reviewed period is still higher than that of up-rounds (44% down-rounds, 38% up-rounds), while in the Silicon Valley the ratio for deals reviewed for the parallel period was opposite (47% up-rounds, 37% down-rounds).

With respect to the other terms of the investment rounds, the trend was mixed. Together with a certain increase in the use of 'pay-to-play' and redemption provisions, which generally reflect investors' concerns for protection under pessimistic scenarios, there is a distinct increase in the use of 'weighted average' anti-dilution provisions, coupled with a decrease in the use of multiple-based liquidation preference provisions, both of which generally reflect a more optimistic approach.

One explanation for this mixed trend in the terms of investment transactions may lie in the fact that a significant portion of the deals in the last quarter are still 'difficult' rounds, in companies which have undergone some reorganization and heavy devaluation, thus leading investors continuing on with such companies to adopt a cautious approach, protecting themselves with the legal techniques used in recent years which were rougher on the industry (such as pay-to-play provisions).

In comparison with the terms found in the Silicon Valley, it appears that the gaps with respect to some provisions is narrowing, while it remains wide with respect to others; all in all, the terms in use in Israel still seem in general to be stricter than those prevalent in the Silicon Valley. The results from the Silicon Valley reflect in their terms a broader optimism, and one may discern in them almost across the board an improvement in the mood of the venture capital industry. It will indeed be interesting to see whether the results of the Israeli survey of the next quarter will show Israel following in the steps of the Silicon Valley trends, as it has in the last quarter.

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

**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 Q1/04 edition of the Fenwick & West Venture Capital Survey summarizing venture capital terms in the Silicon Valley, please go to [www.fenwick.com/vctrends.htm](http://www.fenwick.com/vctrends.htm).**



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

**Trends in Legal Terms in Venture Financings**  
**In Israel**  
**(Fourth Quarter of 2003 & First Quarter of 2004)**

- **Background** – We analyzed the terms of venture financings for 52 Israeli and Israeli related technology companies that reported raising money in the fourth quarter of 2003 and in the first quarter of 2004. Our survey does not include financing rounds that were below US \$500,000. The tables below also show, for purposes of comparison, the results of our previous survey for the second half of 2003.

- **Financing Round** – The financings may be broken down by type of round, as follows:

Series	Q4/03+Q1/04	2H/03
A	19%	22%
B	23%	30%
C	29%	22%
D	15%	19%
E and higher	14%	7%

- **Price Change** – The directions of price changes for companies receiving financing, compared to their previous round, were as follows:

Price Change	Q4/03+Q1/04	2H/03
Down	44%	62%
Flat	18%	28%
Up	38%	10%

The results for the periods of Q4/03 and Q1/04 indicate a significant improvement in the ratio of up-rounds to down-rounds.

The percentages of down-rounds by series were as follows:

Series	Q4/03+Q1/04	2H/03
B	27%	73%
C	64%	55%
D	29%	56%
E and higher	57%	50%

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

Q4/03+Q1/04	2H03
76%	82%

The percentages of senior liquidation preference by series were as follows:

Series	Q4/03+Q1/04	2H/03
B	58%	82%
C	87%	75%
D	63%	82%
E and higher	100%	100%

- **Multiple Liquidation Preferences** - The percentage of senior liquidation preferences that were based on multiples were as follows:

Q4/03+Q1/04	2H/03
31%	44%

Of the senior liquidation preferences that were based on multiples, the ranges of the multiples broke down as follows:

Range of multiples	Q4/03+Q1/04	2H/03
>1x- 2x	80%	88%
>2x - 3x	10%	6%
> 3x	10%	6%

- **Participation in Liquidation** - The percentages of financings that provided for participation were as follows:

Q4/03+Q1/04	2H/03
90%	91%

Of those financings that had participation, the percentages that were not capped were as follows:

Q4/03+Q1/04	2H/03
60%	59%

- **Cumulative Dividends and/or accrued interest as part of the liquidation preference** – Cumulative dividends and/or accrued interest as part of the liquidation preference were provided for in the following percentages of financings:

Q4/03+Q1/04	2H/03
58%	54%

Note: Of the above – both in Q4/03+Q1/04 and in 2H/03, one third are based on cumulative dividends and two thirds are based on accrued interest.

- **Antidilution Provisions** - The uses of anti-dilution provisions in the financings were as follows:

Type of Provision	Q4/03+Q1/04	2H/03
Full Ratchet	29%	38%
Weighted Average	65%	55%
None	6%	7%

The results for the periods of Q4/03 and Q1/04 indicate an increase in the use of weighted average anti-dilution formulas.

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

Q4/03+Q1/04	2H/03
15%	9%

The results for the periods of Q4/03 and Q1/04 indicate an increase in the use of pay-to-play provisions.

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

Q4/03+Q1/04	2H/03
33%	27%

The results for the periods of Q4/03 and Q1/04 indicate an increase in the use of redemption provisions.

- **Corporate Reorganizations** – The percentages of post-Series A financings involving the conversion of senior securities into more junior securities were as follows:

Q4/03+Q1/04	2H/03
12%	14%

**Conclusion** – There was a significant increase in up-rounds during Q4/03 and Q1/04 compared to 2H/03. In the other terms of venture financings there was mixed trend; while there was an improvement in certain terms, we noted a certain increase in the use of pay-to-play and redemption provisions and the in the range of multiples.

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**Analysis of Legal Terms of Venture Financings  
Of Israeli Companies  
and Comparison of such Terms with the Terms of Venture Financings in  
Silicon Valley  
(Q4 2003 and Q1 2004)**

- **Background** – We analyzed the terms of venture financings for 52 Israeli based/related technology companies that reported raising at least \$500,000 in Q4 2003 and Q1 2004, and compared such terms to the terms of venture financings for 233 technology companies headquartered in 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 – 19% (compared to 16% in the SF Bay Area)
  - Series B – 23% (compared to 27% in the SF Bay Area)
  - Series C – 29% (compared to 25% in the SF Bay Area)
  - Series D – 15% (compared to 15% in the SF Bay Area)
  - Series E and higher – 14% (compared to 17% in the SF Bay Area)
- **Price Change** – The directions of price changes for companies receiving financing in Q4 2003 and Q1 2004 were as follows:

Price Change	Israel	Silicon Valley
Down	44%	37%
Flat	18%	16%
Up	38%	47%

The percentages of down rounds by series were as follows:

Series	Israel	Silicon Valley
B	27%	30%
C	64%	32%
D	29%	46%
E and higher	57%	46%

As shown in our attached survey comparing the result of venture funding in Israel during Q4/03+Q1/04 to 2H/03, the Israeli environment has significantly improved, in the sense that there has

been significant increase in up-rounds, although down-rounds still outpace up-rounds in Israel, whereas in the Silicon Valley up-rounds outpaced down-rounds.

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

Israel	Silicon Valley
76%	54%

The percentages of senior liquidation preference by series were as follows:

Series	Israel	Silicon Valley
B	58%	43%
C	87%	53%
D	63%	60%
E and higher	100%	69%

- **Multiple Liquidation Preference** – The percentages of senior liquidation preferences that were based on multiples were as follows:

Israel	Silicon Valley
31%	29%

Of the senior liquidation preferences, the range of multiples broke down as follows:

Range of Multiples	Israel	Silicon Valley
>1x - 2x	80%	68%
>2x - 3x	10%	22%
>3x	10%	10%

- **Participation in Liquidation** – The percentages of financings that provided for participation were as follows:

Israel	Silicon Valley
90%	72%

Of those financings that had participation, the percentages that were not capped were as follows:

Israel	Silicon Valley
60%	59%

- **Cumulative Dividends/Interest Accrual** – Cumulative dividends or interest accruals (which is an Israeli concept similar to cumulative dividends) were provided for in the following percentages of financings:

Israel	Silicon Valley
58%	6%

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

Type of Provision	Israel	Silicon Valley
Full Ratchet	29%	7%
Weighted Average	65%	91%
None	6%	2%

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

Israel	Silicon Valley
15%	18%

- **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
33%	29%

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

Israel	Silicon Valley
12%	14%

- **Conclusion** – The gap between the terms of Israeli venture financings and those of Silicon Valley venture financings has somewhat narrowed, although the terms of Israeli venture financings remained tougher. The most significant change is in the number of up-rounds noted in Israeli venture financings, which indicates that the venture financing environment in Israel, as that of the Silicon Valley, has improved.

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