

שבולת, ישראלי, רוברטס, זיסמן ושות'

SHIBOLETH

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

Dear Clients and Friends,

Re: **Survey On Legal Terms In Capital Venture Transactions – Fourth Quarter of 2004/First Quarter of 2005**

We are pleased to present the results of our survey for the fourth quarter of 2004/first quarter 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 fourth quarter of 2004 and the first quarter of 2005, as compared with those of similar transactions closed during the periods covered by our earlier surveys.

In preparing our survey for the fourth quarter of 2004/first quarter of 2005, we examined the terms of 57 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 more than 50% 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 continuation of the positive trend in capital venture transactions and a further correlation between the terms commonly practiced in Israel and those used in the Silicon Valley.

The numerical majority of up-rounds over down-rounds reported in the second half of 2004 has grown more pronounced whereby **the number of down-rounds have significantly decreased and the number of up-rounds have significantly increased**, constituting a substantial majority of 59% of all of the follow-on investment rounds!

For the first time since we began publication of this survey, the results of the Israeli survey and those of the Silicon Valley survey for the covered period are almost identical with respect to this issue – 28% down-rounds in Israel versus 29% in the Silicon Valley and 59% up-rounds in Israel versus 60% in the Silicon Valley.

The “softening” trend regarding investors’ protective provisions which was witnessed in the second half of 2004 has also been maintained. Particularly noticeable this time was the drop in the use of multiple liquidation preference provisions from 24% in the previous survey to 11% in this survey. An additional decrease in the use of senior liquidation preference provisions has also been demonstrated.

Interestingly, in parallel to the decrease in the use of multiple liquidation preference provisions, a rise in the use of interest provisions or cumulative dividends calculated as a rate of the investment amount was witnessed. This allows investors to still receive a certain additional amount as a return on their investment, in preference to the rest of the shareholders (which amount usually ranges between 6% to 8% of the investment amount per annum). Note that use of such terms in the Silicon Valley are significantly lower than their use in Israel – 9% in the Silicon Valley versus 63% 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.

It should also be noted that if one examines the Silicon Valley on a quarterly basis, although there is a continuation of the positive trend there as well, there is an indication that several of the investors’ protective provisions have been somewhat “tightened” as compared to the previous quarter. In contrast, in Israel, the last quarter demonstrated a strong tendency towards continuation of the positive trend and “softening” of the investment terms.

The aforesaid difference between Israel and the Silicon Valley may lie in the fact, as was reported in recent industry reports in the US, that there has been an approximately 15% decrease in the aggregate amount of venture capital financings during the first quarter of 2005 compared to the last quarter of 2004; whereas, in Israel, a maintained stability has been reported. In both markets, the forecasts are positive and it will indeed be interesting to see the development of the trends 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
 (Fourth Quarter of 2004 & First Quarter of 2005)**

- **Background** – We have analyzed the terms of venture financings for 57 Israeli and Israeli-related technology companies that reported raising money in the fourth quarter of 2004 and in the first quarter 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 fourth quarter of 2004/the first quarter of 2005 and in the periods covered by our previous surveys may be broken down by types of round, or series, as follows:

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

- **Price Change** – The financings closed in the fourth quarter of 2004/the first quarter 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	Q4'04+Q1'05	H2'04	Q2'04+Q3'04	H1'04	Q4'03+Q1'04	H2'03
Down	28%	43%	46%	42%	44%	62%
Flat	13%	12%	14%	3%	18%	28%
Up	59%	45%	40%	55%	38%	10%

Up-rounds continue to outnumber down-rounds and have significantly increased to constitute a solid majority in the fourth quarter of 2004/the first quarter of 2005.

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

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

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

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

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

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

Q4'04+Q1'05	H2'04	Q2'04+Q3'04	H1'04	Q4'03+Q1'04	H2'03
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	Q4'04+Q1'05	H2'04	Q2'04+Q3'04	H1'04	Q4'03+Q1'04	H2'03
>1x- 2x	67%	88%	92%	100%	80%	88%
>2x - 3x	33%	0%	0%	0%	10%	6%
> 3x	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:

Q4'04+Q1'05	H2'04	Q2'04+Q3'04	H1'04	Q4'03+Q1'04	H2'03
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:

Q4'04+Q1'05	H2'04	Q2'04+Q3'04	H1'04	Q4'03+Q1'04	H2'03
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:

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

- **Anti-dilution Provisions** - The use of anti-dilution provisions in the financings which took place in the fourth quarter of 2004/the first quarter of 2005 and in the periods covered by our previous surveys may be broken down as follows:

Type of Provision	Q2'04+ Q3'04	H2'04	Q2'04+ Q3'04	H1'04	Q4'03+ Q1'04	H2'03
Full Ratchet	30%	30%	34%	28%	29%	38%
Weighted Average	65%	64%	64%	66%	65%	55%
None	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 fourth quarter of 2004/the first quarter 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-

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

- **Redemption** – The percentage of transactions in the fourth quarter of 2004/the first quarter 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:

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

- **Corporate Reorganizations** – The percentage of post-Series A financing transactions in the fourth quarter of 2004/the first quarter 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:

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

Conclusion – The results in the fourth quarter of 2004/the first quarter of 2005 reflect a continued improvement in venture terms, with a significant increase in the number of up-rounds.

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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עורכי דין ונוטריונים ADVOCATES & NOTARIES

**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
(Fourth Quarter of 2004 & First Quarter of 2005)**

- **Background** – We have analyzed the terms of venture financings for 57 Israeli based/related technology companies that reported raising at least \$500,000 in in the fourth quarter of 2004 and in the first quarter of 2005, and compared those terms to the terms of venture financings for 190 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 – 32% (compared to 21% in the Silicon Valley)
 Series B – 30% (compared to 27% in the Silicon Valley)
 Series C – 21% (compared to 22% in the Silicon Valley)
 Series D – 10% (compared to 20% in the Silicon Valley)
 Series E and higher – 7% (compared to 10% in the Silicon Valley)
- **Price Change** – The financings during the fourth quarter of 2004 / the first quarter 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	28%	29%
Flat	13%	11%
Up	59%	60%

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

Series	Israel	Silicon Valley
B	12%	22%
C	50%	29%
D	33%	29%
E and higher	25%	50%

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

Israel	Silicon Valley
72%	48%

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

Series	Israel	Silicon Valley
B	82%	35%
C	58%	45%
D	67%	63%
E and higher	75%	55%

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

Israel	Silicon Valley
11%	18%

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	67%	92%
>2x - 3x	33%	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
79%	66%

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
51%	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
63%	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%	9%
Weighted Average	65%	86%
None	5%	5%

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

Israel	Silicon Valley
9%	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
16%	29%

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

Israel	Silicon Valley
0%	11%

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.