

Dear Clients and Friends,

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

We are pleased to present the results of our survey for the first 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, the 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 2004, 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 2004, we examined the terms of 50 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 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).

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 a turning point in the relative number of up-rounds; the trend identified in our previous survey, of an increasing number of up-rounds, continued, with up-rounds now constituting a majority (55%) of the surveyed transactions, and down-rounds accounting for only 42%. The number of up-rounds during the covered period was five and a half times that of the second half of 2003. Furthermore, a comparison of the results for each of the first and second quarters of 2004 shows this trend on a quarter to quarter basis – in the second quarter of 2004 there were two and a half times as many up-rounds as down-rounds - although as the absolute number of transactions reviewed in the second quarter of 2004 may be too small to serve as a solid foundation for any final conclusion on this point.

It should nonetheless be noted, however, that as anyone closely involved in the hi-tech industry is well aware, a relatively large number of companies (42% in the first quarter of 2004, and about 27% in the second quarter) are still struggling to survive, at the cost of rising capital through down-round transactions.

One should note also that the period covered by this survey ended on June 30, 2004, prior to the recent 10% decline in the Nasdaq index; it will be interesting to see, given the delays seen in the past in the venture capital market's adjustment of company valuations in accordance with events in the financial markets, whether this decline will be expressed in the results for the coming months.

The results of the Silicon Valley survey, which had indicated a similar turning-point in the trend of up-rounds already in the period covered by the previous survey, now also indicate a clear strengthening of that trend in the second quarter of 2004, with up-rounds outnumbering down-rounds by a ration of 3:1.

This change in the market's trend is also clearly recognizable in other terms characteristic of venture capital transactions; generally speaking, there appears to be a continuing trend of a 'softening-up' of investor protection provisions. For instance, there has been an increase in the use of 'weighted average' anti-dilution protection as opposed to 'full ratchet' mechanisms, and a decrease in the use of multiple-based liquidation preferences.

It is also quite interesting to note the extensive use made in the Israeli market, as opposed to that of the Silicon Valley, of liquidation preferences senior to those of previous investors (78% of Israeli transactions vs. 54% of Silicon Valley transactions), of participation rights for preferred shares (90% of Israeli transactions vs. 67% of Silicon Valley transactions), and of cumulative dividends / interest accruals (62% of Israeli transactions vs. 6% of Silicon Valley transactions). This extensive use has been evident throughout all of the periods covered in our surveys.

We hope that you find this survey useful and interesting. We plan to continue surveying the common legal terms of future VC transactions in Israel, and perhaps even to deepen and broaden the scope of our future surveys.

To be placed on an email list for future editions of this survey, please go to 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.

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 2004)**

- **Background** – We have analyzed the terms of venture financings for 50 Israeli and Israeli-related technology companies that reported raising money in the first 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 first 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	H1/04	Q4/03+Q1/04	H2/03
A	20%	19%	22%
B	36%	23%	30%
C	26%	29%	22%
D	8%	15%	19%
E and higher	10%	14%	7%

- **Price Change** – The financings closed in the first 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 the each company's respective previous round, as follows:

Price Change	H1/04	Q4/03+Q1/04	H2/03
Down	42%	44%	62%
Flat	3%	18%	28%
Up	55%	38%	10%

The results for the first half of 2004 indicate a reversal in the ratio of up-rounds to down-rounds, with up-rounds outnumbering down-rounds.

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

Series	H1/04	Q4/03+Q1/04	H2/03
B	24%	27%	73%
C	62%	64%	55%
D	0%	29%	56%
E and higher	80%	57%	50%

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

H1/04	Q4/03+Q1/04	H2/03
78%	76%	82%

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

Series	H1/04	Q4/03+Q1/04	H2/03
B	61%	58%	82%
C	92%	87%	75%
D	75%	63%	82%
E and higher	100%	100%	100%

- **Multiple-Based Liquidation Preferences** - The percentage of financing transactions with senior liquidation preferences based on multiples was as follows:

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

H1/04	Q4/03+Q1/04	H2/03
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:

H1/04	Q4/03+Q1/04	H2/03
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 under the terms of the following percentages of financings:

H1/04	Q4/03+Q1/04	H2/03
62%	58%	54%

Note: Of the above – in each of H2/03 and in H1/04 - one third are based on cumulative dividends and two thirds are based on accrued interest.

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

Type of Provision	H1/04	Q4/03+Q1/04	H2/03
Full Ratchet	28%	29%	38%
Weighted Average	66%	65%	55%
None	6%	6%	7%

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

H1/04	Q4/03+Q1/04	H2/03
14%	15%	9%

- **Redemption** – The percentage of transactions in each of the first 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:

H1/04	Q4/03+Q1/04	H2/03
26%	33%	27%

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

H1/04	Q4/03+Q1/04	H2/03
10%	12%	14%

Conclusion – There was a significant increase in the ratio of up-rounds to down-rounds during the first half of 2004 compared to the periods covered by our previous surveys, with up-rounds outnumbering down-rounds! Improvements in other financing terms were also noted, except for the increase in the use of pay-to-play provisions.

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 2004)

- **Background** – We have analyzed the terms of venture financings for 50 Israeli based/related technology companies that reported raising at least \$500,000 in the first half of 2004, and compared those terms to the terms of venture financings for 238 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 – 20% (compared to 16% in the SF Bay Area)
 - Series B – 36% (compared to 27% in the SF Bay Area)
 - Series C – 26% (compared to 23% in the SF Bay Area)
 - Series D – 8% (compared to 15% in the SF Bay Area)
 - Series E and higher – 10% (compared to 18% in the SF Bay Area)
- **Price Change** – The financings during the first 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	42%	26%
Flat	3%	16%
Up	55%	58%

Both in Israel and in the Silicon Valley, up-rounds outpaced down-rounds!

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

Series	Israel	Silicon Valley
B	24%	23%
C	62%	27%
D	0%	19%
E and higher	80%	35%

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

Israel	Silicon Valley
78%	54%

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

Series	Israel	Silicon Valley
B	61%	46%
C	92%	47%
D	75%	58%
E and higher	100%	70%

- **Multiple-Based Liquidation Preference** –The percentages of financing transactions with senior liquidation preferences based on multiples was as follows:

Israel	Silicon Valley
23%	26%

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	100%	76%
>2x - 3x	0%	15%
>3x	0%	9%

- **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
90%	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
67%	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
62%	6%

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

Type of Provision	Israel	Silicon Valley
Full Ratchet	28%	7%
Weighted Average	66%	90%
None	6%	3%

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

Israel	Silicon Valley
14%	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
26%	27%

- **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
10%	15%

- **Conclusion** – **The gap between the terms of Israeli venture financings and those of Silicon Valley venture financings has continued to narrow. The most significant change is in the number of up-rounds, as in both Israeli and Silicon Valley venture financings, up-rounds outpaced down-rounds!**

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.

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