



FENWICK & WEST LLP  
A LIMITED LIABILITY PARTNERSHIP

## FENWICK & WEST LLP

### Trends in Legal Terms in Venture Financings In the San Francisco Bay Area (Third Quarter 2004)

**Background** – We analyzed the terms of venture financings for 113 technology companies headquartered in the San Francisco Bay Area that reported raising money in the third quarter of 2004.

**Financing Round** – The financings broke down according to the following rounds:

Series	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02
A	14%	17%	16%	16%	20%	20%	15%	13%
B	29%	28%	27%	27%	30%	24%	28%	20%
C	20%	25%	21%	30%	19%	29%	26%	30%
D	20%	15%	15%	15%	18%	12%	13%	22%
E and higher	17%	15%	21%	12%	13%	15%	18%	15%

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

Price Change	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02
Down	32%	21%	30%	45%	53%	56%	73%	68%
Flat	15%	12%	19%	13%	12%	4%	7%	6%
Up	53%	67%	51%	42%	35%	40%	20%	26%

The percentage of down rounds by series were as follows:

Series	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02
B	12%	16%	29%	31%	46%	26%	56%	50%
C	32%	25%	30%	34%	44%	59%	68%	67%
D	52%	18%	21%	75%	53%	64%	100%	78%
E and higher	42%	29%	38%	62%	82%	93%	87%	83%

**Overall, a majority of financing rounds continued to be up rounds, but the percentage of down rounds has increased, especially in later rounds.**

**The Fenwick & West Venture Capital Barometer™ (Magnitude of Price Change)** –Set forth below is (i) for up rounds, the average per share percentage increase over the previous round, (ii) for down rounds, the average per share percentage decrease over the previous round, and (iii) the overall average per share percentage change from the previous round for all rounds taken together. Such information is broken down by series for Q3 '04 and is provided on an aggregate basis for comparison purposes for Q1 '04 and Q2 '04. In calculating the “net result” for all rounds, “flat rounds” are included. For purposes of these calculations, all financings are considered equal, and accordingly we have not weighted the results for the amount raised in a financing.

**Q3 '04**

<b>Percent Change</b>	<b>Series B</b>	<b>Series C</b>	<b>Series D</b>	<b>Series E and higher</b>	<b>Combined total for all Series for Q3 '04</b>	<b>Combined total for all Series for Q2 '04</b>	<b>Combined total for all Series for Q1 '04</b>
Up rounds	+92%	+51%	+19%	+40%	+66%	+58%	+67%
Down rounds	-67%	-42%	-65%	-62%	-59%	-48%	-56%
Net result	+61%	+14%	-26%	-16%	+17%	+28%	+17%

The Fenwick & West Venture Capital Barometer™ reported a healthy 17% average price increase for companies receiving venture capital financing in Q3 '04 compared to such companies' previous financing round. However, this is a reduction from the 28% increase for companies that received venture capital funding in Q2 compared to their previous venture capital financing round.

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

<b>Q3 '04</b>	<b>Q2 '04</b>	<b>Q1 '04</b>	<b>Q4 '03</b>	<b>Q3 '03</b>	<b>Q2 '03</b>	<b>Q1 '03</b>	<b>Q4 '02</b>
54%	56%	52%	57%	57%	55%	68%	64%

The percentage of senior liquidation preference by series was as follows:

<b>Series</b>	<b>Q3 '04</b>	<b>Q2 '04</b>	<b>Q1 '04</b>	<b>Q4 '03</b>	<b>Q3 '03</b>	<b>Q2 '03</b>	<b>Q1 '03</b>	<b>Q4 '02</b>
B	33%	45%	47%	38%	50%	43%	65%	51%
C	59%	50%	44%	59%	56%	59%	73%	67%
D	61%	59%	58%	62%	60%	55%	73%	78%
E and higher	74%	82%	62%	85%	73%	64%	60%	66%

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

<b>Q3 '04</b>	<b>Q2 '04</b>	<b>Q1 '04</b>	<b>Q4 '03</b>	<b>Q3 '03</b>	<b>Q2 '03</b>	<b>Q1 '03</b>	<b>Q4 '02</b>
31%	25%	27%	33%	21%	44%	40%	37%

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

Range of multiples	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02
>1x- 2x	75%	84%	60%	76%	88%	78%	74%	79%
>2x – 3x	6%	8%	27%	18%	12%	11%	16%	14%
> 3x	19%	8%	13%	6%	0%	11%	10%	7%

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

Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02
74%	64%	70%	74%	68%	81%	77%	74%

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

Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02
63%	47%	57%	61%	66%	59%	63%	50%

**Cumulative Dividends** – Cumulative dividends were provided for in the following percentages of financings:

Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02
9%	6%	6%	7%	12%	4%	8%	9%

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

Type of Provision	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02
Ratchet	14%	9%	5%	9%	8%	10%	16%	18%
Weighted Average	85%	87%	93%	89%	87%	88%	83%	77%
None	1%	4%	2%	2%	5%	2%	1%	5%

**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.

Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02
16%	20%	17%	20%	12%	20%	14%	25%

The pay-to-play provisions provided for conversion of non-participating investors' preferred stock into common stock or shadow preferred stock, in the percentages set forth below:

- Common Stock.

Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02
72%	77%	67%	81%	80%	84%	50%	75%

- Shadow Preferred Stock.

Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02
28%	23%	33%	19%	20%	16%	50%	25%

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

<b>Q3 '04</b>	<b>Q2 '04</b>	<b>Q1 '04</b>	<b>Q4 '03</b>	<b>Q3 '03</b>	<b>Q2 '03</b>	<b>Q1 '03</b>	<b>Q4 '02</b>
30%	28%	27%	32%	29%	40%	32%	33%

**Corporate Reorganizations** - The percentages of post-Series A financings involving a corporate reorganization were as follows:

<b>Q3 '04</b>	<b>Q2 '04</b>	<b>Q1 '04</b>	<b>Q4 '03</b>	<b>Q3 '03</b>	<b>Q2 '03</b>	<b>Q1 '03</b>	<b>Q4 '02</b>
20%	12%	17%	11%	21%	19%	19%	21%

**Conclusion** – The results of Q3 '04 were mixed as up rounds outpaced down rounds and valuations increased compared to prior financing rounds, but by less than in Q2 '04. There was also a general toughening of the other financing terms in Q3 '04.

These results are probably not surprising given the reduction in aggregate venture investment in the US in Q3 '04 noted in various industry publications and the 7% decrease in the Nasdaq in Q3 '04. Additionally, the significant improvements in valuations and terms that we saw in Q1 '04 and Q2 '04 was a difficult trend to maintain.

That said, we note that the overall results of Q3 '04 were favorable, and the Nasdaq is up 9% so far this quarter, so the general trend continues to be favorable.

For additional information about this report please contact Barry Kramer at 650-335-7278; [bkramer@fenwick.com](mailto:bkramer@fenwick.com) or Michael Patrick at 650-335-7273; [mpatrick@fenwick.com](mailto:mpatrick@fenwick.com) at Fenwick & West. To be placed on an email list for future editions of this survey please go to [www.fenwick.com/vctrends.htm](http://www.fenwick.com/vctrends.htm). The contents of this report are not intended, and should not be considered, as legal advice or opinion.