



FENWICK & WEST LLP



Trends in Terms of Venture Financings in the San Francisco Bay Area

Fourth Quarter 2005

FENWICK & WEST LLP

Trends in Terms of Venture Financings in the San Francisco Bay Area (Fourth Quarter 2005)

Background

We analyzed the terms of venture financings for 115 technology companies headquartered in the San Francisco Bay Area that reported raising money in the fourth quarter of 2005.

Overview

The results of the 4Q05 survey showed a continuation of the strong positive trend in venture valuations. The highlights of the quarter were as follows:

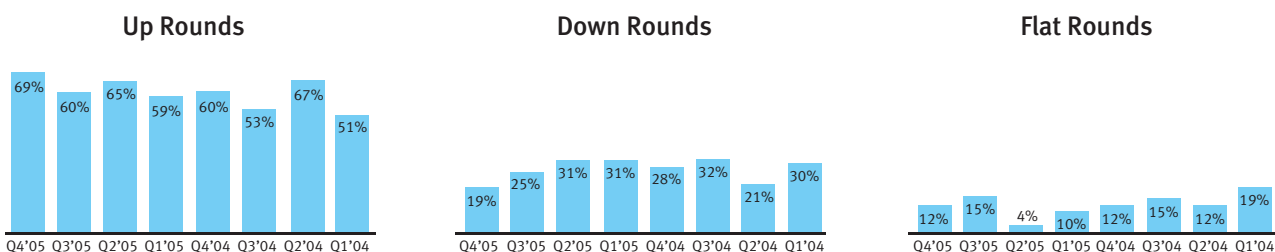
- Up rounds exceeded down rounds for the eighth quarter in a row, and by the largest margin since our survey began (69% up vs. 19% down, with 12% flat).
- The Fenwick & West Venture Capital Barometer showed a 45% average price increase for companies receiving venture capital in 4Q05 compared to such companies' previous financing round. This was also the largest increase since the survey began.

Other U.S. venture industry related results for the quarter and the year included the following:

- The amount invested by venture capitalists in the U.S. in 4Q05 was approximately \$5.3 billion. Although this amount was approximately 10% less than the amounts invested in 3Q05 and 2Q05, it fell solidly within the \$5–6 billion quarterly range seen since the end of 2003. Overall the amount invested by venture capitalists in the U.S. in 2005 was up approximately 2% over 2004.¹
- Acquisitions of venture backed companies in the U.S. fell significantly in 4Q05 with 77 transactions totaling \$4.2 billion, compared to 98 transactions totaling \$7.6 billion in 3Q05. However 2005 in general was the best acquisition year for venture backed companies since 2000, both in terms of aggregate amount paid (\$27.3 billion) as well as median amount paid per transaction (\$48 million).¹
- IPOs of venture backed companies continued to lag, with only 12 IPOs in 4Q05. Although 2005 was the second best IPO year since 2000, the 41 venture backed IPOs in 2005 was a significant drop off from the 67 IPOs in 2004.¹
- Healthcare companies continued to be strong contributors in all categories, accounting for 30% of funding, 34% of acquisition proceeds and 45% of IPO proceeds of all venture backed U.S. companies in 2005.¹
- Nasdaq was up 2.3% in 4Q05 and is up over 3% in 1Q06 to date. As Nasdaq was up only 1% for 2005 on the whole, this recent improvement could provide a foundation for strengthened acquisition and IPO activity in 2006.

Price Change

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



The percentage of down rounds by series were as follows:

Series	Q4'05	Q3'05	Q2'05	Q1'05	Q4'04	Q3'04	Q2'04	Q1'04
B	10%	16%	12%	19%	24%	12%	16%	29%
C	5%	35%	32%	36%	25%	32%	25%	30%
D	46%	33%	37%	30%	28%	52%	18%	21%
E and higher	35%	23%	60%	62%	42%	42%	29%	38%

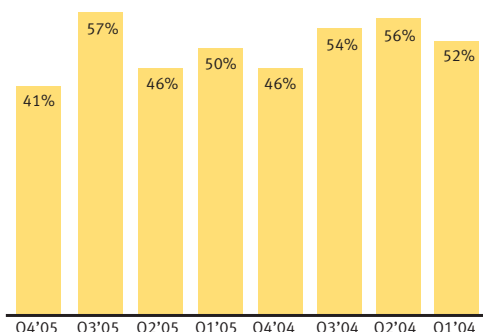
The Fenwick & West Venture Capital Barometer™ (Magnitude of Price Change)—Set forth below is (i) for up rounds, the average per share percentage increase over the previous round, (ii) for down rounds, the average per share percentage decrease over the previous round, and (iii) the overall average per share percentage change from the previous round for all rounds taken together. Such information is broken down by series for Q4'05 and is provided on an aggregate basis for comparison purposes for the prior five quarters. 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.

Q4'05 Percent Change	Series B	Series C	Series D	Series E and higher	Combined total for all Series for Q4'05	Combined total for all Series for Q3'05	Combined total for all Series for Q2'05	Combined total for all Series for Q1'05	Combined total for all Series for Q4'04	Combined total for all Series for Q3'04
Up Rounds	+99%	+57%	+55%	+78%	+81%	+88%	+83%	+66%	+84%	+66%
Down Rounds	-61%	-80%	-61%	-43%	-56%	-60%	-43%	-49%	-54%	-59%
Net Result	+73%	+47%	-11%	+22%	+45%	+38%	+41%	+24%	+36%	+17%

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

Series	Q4'05	Q3'05	Q2'05	Q1'05	Q4'04	Q3'04	Q2'04	Q1'04
A	22%	18%	15%	24%	18%	14%	17%	16%
B	35%	31%	26%	29%	24%	29%	28%	27%
C	17%	23%	27%	16%	28%	20%	25%	21%
D	11%	15%	21%	22%	18%	20%	15%	15%
E and higher	15%	13%	11%	9%	12%	17%	15%	21%

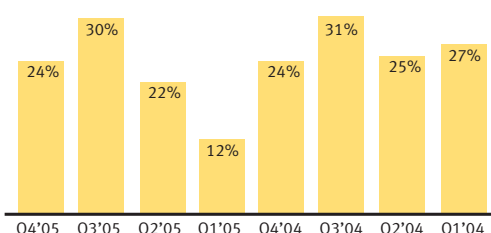
Liquidation Preference—Senior liquidation preferences were used in the following percentages of financings:



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

Series	Q4'05	Q3'05	Q2'05	Q1'05	Q4'04	Q3'04	Q2'04	Q1'04
B	22%	42%	25%	38%	32%	33%	45%	47%
C	40%	48%	40%	57%	39%	59%	50%	44%
D	69%	87%	68%	55%	72%	61%	59%	58%
E and higher	65%	77%	70%	62%	50%	74%	82%	62%

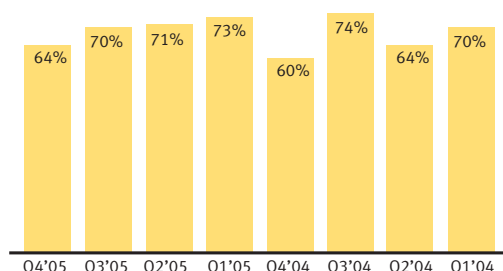
Multiple Liquidation Preferences—The percentage of senior liquidation preferences that were multiple preferences were as follows:



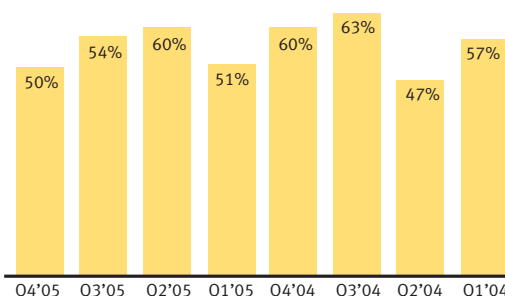
Of the senior liquidation preferences, the ranges of the multiples broke down as follows:

Range of multiples	Q4'05	Q3'05	Q2'05	Q1'05	Q4'04	Q3'04	Q2'04	Q1'04
>1x - 2x	67%	93%	88%	100%	89%	75%	84%	60%
>2x - 3x	33%	7%	0%	0%	0%	6%	8%	27%
> 3x	0%	0%	12%	0%	11%	19%	8%	13%

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



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



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

Q4'05	Q3'05	Q2'05	Q1'05	Q4'04	Q3'04	Q2'04	Q1'04
4%	3%	4%	9%	9%	9%	6%	6%

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

Type of Provision	Q4'05	Q3'05	Q2'05	Q1'05	Q4'04	Q3'04	Q2'04	Q1'04
Ratchet	9%	7%	8%	9%	9%	14%	9%	5%
Weighted Average	85%	92%	88%	87%	85%	85%	87%	93%
None	6%	1%	4%	4%	6%	1%	4%	2%

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.

Q4'05	Q3'05	Q2'05	Q1'05	Q4'04	Q3'04	Q2'04	Q1'04
16%	8%	16%	17%	12%	16%	20%	17%

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

Q4'05	Q3'05	Q2'05	Q1'05	Q4'04	Q3'04	Q2'04	Q1'04
31%	32%	29%	30%	28%	30%	28%	27%

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

Q4'05	Q3'05	Q2'05	Q1'05	Q4'04	Q3'04	Q2'04	Q1'04
11%	17%	15%	13%	8%	20%	12%	17%

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. To be placed on an email list for future editions of this survey please go to www.fenwick.com/vctrends.htm. The contents of this report are not intended, and should not be considered, as legal advice or opinion.

¹ Information in this paragraph obtained from Dow Jones VentureSource.