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

Background – We analyzed the terms of venture financings for 112 technology companies headquartered in the San Francisco Bay Area that reported raising money in the second quarter of 2004.

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

Series	Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02	Q3 '02
A	17%	16%	16%	20%	20%	15%	13%	15%
B	28%	27%	27%	30%	24%	28%	20%	19%
C	25%	21%	30%	19%	29%	26%	30%	31%
D	15%	15%	15%	18%	12%	13%	22%	24%
E and higher	15%	21%	12%	13%	15%	18%	15%	11%

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

Price Change	Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02	Q3 '02
Down	21%	30%	45%	53%	56%	73%	68%	67%
Flat	12%	19%	13%	12%	4%	7%	6%	8%
Up	67%	51%	42%	35%	40%	20%	26%	25%

There was a significant increase in the percentage of up rounds, with up rounds outpacing down rounds by a 3:1 margin in the second quarter.

The percentage of down rounds by series were as follows:

Series	Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02	Q3 '02
B	16%	29%	31%	46%	26%	56%	50%	33%
C	25%	30%	34%	44%	59%	68%	67%	71%
D	18%	21%	75%	53%	64%	100%	78%	77%
E and higher	29%	38%	62%	82%	93%	87%	83%	90%

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 Q2 '04 and is provided on an aggregate basis for comparison purposes for Q1 '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.

Q2 '04

Percent Change	Series B	Series C	Series D	Series E and higher	Combined total for all Series for Q2 '04	Combined total for all Series for Q1 '04
Up rounds	+58%	+72%	+51%	+30%	+58%	+67%
Down rounds	-49%	-47%	-45%	-52%	-48%	-56%
Net result	+37%	+37%	+28%	-3%	+28%	+17%

The Fenwick & West Venture Capital Barometer™ reported a very healthy 28% average price increase for companies receiving venture capital financing in Q2 compared to such companies' previous venture financing round. This compares to an also healthy 17% average price increase for companies that received venture capital financing in Q1 compared to their previous venture capital financing round.

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

Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02	Q3 '02
56%	52%	57%	57%	55%	68%	64%	60%

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

Series	Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02	Q3 '02
B	45%	47%	38%	50%	43%	65%	51%	33%
C	50%	44%	59%	56%	59%	73%	67%	55%
D	59%	58%	62%	60%	55%	73%	78%	83%
E and higher	82%	62%	85%	73%	64%	60%	66%	70%

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

Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02	Q3 '02
25%	27%	33%	21%	44%	40%	37%	32%

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

Range of multiples	Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02	Q3 '02
>1x- 2x	84%	60%	76%	88%	78%	74%	79%	80%
>2x – 3x	8%	27%	18%	12%	11%	16%	14%	13%
> 3x	8%	13%	6%	0%	11%	10%	7%	7%

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

Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02	Q3 '02
64%	70%	74%	68%	81%	77%	74%	73%

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

Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02	Q3 '02
47%	57%	61%	66%	59%	63%	50%	51%

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

Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02	Q3 '02
6%	6%	7%	12%	4%	8%	9%	13%

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

Type of Provision	Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02	Q3 '02
Ratchet	9%	5%	9%	8%	10%	16%	18%	15%
Weighted Average	87%	93%	89%	87%	88%	83%	77%	80%
None	4%	2%	2%	5%	2%	1%	5%	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.

Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02	Q3 '02
20%	17%	20%	12%	20%	14%	25%	18%

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.

Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02	Q3 '02
77%	67%	81%	80%	84%	50%	75%	71%

- Shadow preferred stock.

Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02	Q3 '02
23%	33%	19%	20%	16%	50%	25%	29%

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

Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02	Q3 '02
28%	27%	32%	29%	40%	32%	33%	37%

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

Q2 '04	Q1 '04	Q4 '03	Q3 '03	Q2 '03	Q1 '03	Q4 '02	Q3 '02
12%	17%	11%	21%	19%	19%	21%	19%

Conclusion – The significant improvement in venture valuations that was seen in the first quarter of 2004 continued and increased in the second quarter of 2004, with up rounds outpacing down rounds by a 3:1 margin and the Fenwick & West Venture Capital Barometer™ up 28%. However, with the Nasdaq flat for Q2, and down 13% through August 11, 2004 in Q3, it remains to be seen whether, and to what extent, the improving trend in the venture environment can be maintained.

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.



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