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Trends in Terms of Venture Financings In the San Francisco Bay Area (Second Quarter 2006)

- **Background** – We analyzed the terms of venture financings for 90 technology companies headquartered in the San Francisco Bay Area that reported raising money in the second quarter of 2006.
- **Overview** – The results of the 2Q06 survey showed a continuation of the strong positive trend in Silicon Valley venture valuations, although the amount of increase in valuations was less than some recent quarters. The highlights of the quarter were as follows:
 - Up rounds exceeded down rounds in 2Q06 for the tenth quarter in a row (69% up vs. 25% down, with 6% flat), although by less than 1Q06 (which was 74% up vs. 15% down, with 11% flat).
 - The Fenwick & West Venture Capital Barometer™ showed a 34% average price increase for Silicon Valley companies receiving venture capital in 2Q06 compared to such companies' previous financing round. Although this was a significant increase, it was less of an increase than in the prior four quarters.

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

- The amount invested by venture capitalists in the U.S. in 2Q06 was approximately \$6.7 billion, an increase over \$6.4 billion in 2Q05 and \$6.2 billion in 1Q06. The combined total of \$12.9 billion for the first half of 2006 puts the industry on pace for its largest investing year since 2001.¹
- Acquisitions of venture backed companies in the U.S. in 2Q06 was approximately \$7.1 billion in 92 transactions. This was a decline from \$8.5 billion/97 transactions and \$8.4 billion/103 transactions in 2Q05 and 1Q06, respectively, although the combined total of \$15.5 billion/195 transactions for the first half of 2006 puts the industry on pace for its best acquisitions year since 2000.¹
- There were 16 IPOs of venture backed companies in the U.S. in 2Q06, of which 10 were health care companies. These IPOs raised \$1.3 billion. This was an improvement over 13 IPOs raising \$.6 billion in 1Q06 and the combined total of 29 IPOs raising \$1.9

billion in the first half of 2006 puts the industry on pace to have its best IPO year since 2000, other than 2004 when 67 IPOs raised \$5 billion.¹

- Nasdaq was down 7% in 2Q06 and is down less than 1% in 3Q06 to date.

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

Series	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05	Q4 '04	Q3 '04
A	14%	11%	22%	18%	15%	24%	18%	14%
B	34%	40%	35%	31%	26%	29%	24%	29%
C	28%	17%	17%	23%	27%	16%	28%	20%
D	16%	15%	11%	15%	21%	22%	18%	20%
E and higher	8%	17%	15%	13%	11%	9%	12%	17%

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

Price Change	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05	Q4 '04	Q3 '04
Down	25%	15%	19%	25%	31%	31%	28%	32%
Flat	6%	11%	12%	15%	4%	10%	12%	15%
Up	69%	74%	69%	60%	65%	59%	60%	53%

The percentage of down rounds by series were as follows:

Series	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05	Q4 '04	Q3 '04
B	16%	12%	10%	16%	12%	19%	24%	12%
C	32%	12%	5%	35%	32%	36%	25%	32%
D	14%	27%	46%	33%	37%	30%	28%	52%
E and higher	57%	12%	35%	23%	60%	62%	42%	42%

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 Q2'06 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.

Q2'06

Percent Change	Series B	Series C	Series D	Series E and higher	Combined total for all Series for Q2'06	Combined total for all Series for Q1'06	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
Up rounds	+89%	+59%	+30%	+100%	+69%	+95%	+81%	+88%	+83%	+66%
Down rounds	-55%	-50%	-86%	-58%	-57%	-49%	-56%	-60%	-43%	-49%
Net result	+66%	+17%	+12%	-5%	+34%	+64%	+45%	+38%	+41%	+24%

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

Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05	Q4 '04	Q3 '04
50%	40%	41%	57%	46%	50%	46%	54%

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

Series	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05	Q4 '04	Q3 '04
B	35%	29%	22%	42%	25%	38%	32%	33%
C	76%	47%	40%	48%	40%	57%	39%	59%
D	36%	60%	69%	87%	68%	55%	72%	61%
E and higher	57%	41%	65%	77%	70%	62%	50%	74%

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

Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05	Q4 '04	Q3 '04
16%	14%	24%	30%	22%	12%	24%	31%

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

Range of multiples	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05	Q4 '04	Q3 '04
>1x- 2x	83%	80%	67%	93%	88%	100%	89%	75%
>2x – 3x	0%	20%	33%	7%	0%	0%	0%	6%
> 3x	17%	0%	0%	0%	12%	0%	11%	19%

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

Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05	Q4 '04	Q3 '04
71%	65%	64%	70%	71%	73%	60%	74%

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

Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05	Q4 '04	Q3 '04
64%	55	50%	54%	60%	51%	60%	63%

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

Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05	Q4 '04	Q3 '04
8%	3%	4%	3%	4%	9%	9%	9%

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

Type of Provision	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05	Q4 '04	Q3 '04
Ratchet	2%	4%	9%	7%	8%	9%	9%	14%
Weighted Average	97%	92%	85%	92%	88%	87%	85%	85%
None	1%	4%	6%	1%	4%	4%	6%	1%

- **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.

Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05	Q4 '04	Q3 '04
16%	11%	16%	8%	16%	17%	12%	16%

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.

Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05	Q4 '04	Q3 '04
86%	73%	89%	88%	87%	93%	75%	72%

- Shadow Preferred Stock.

Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05	Q4 '04	Q3 '04
14%	27%	11%	12%	13%	7%	25%	28%

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

Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05	Q4 '04	Q3 '04
33%	27%	31%	32%	29%	30%	28%	30%

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

Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05	Q4 '04	Q3 '04
12%	9%	11%	17%	15%	13%	8%	20%

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.