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

- **Background** – We analyzed the terms of venture financings for 92 technology companies headquartered in the San Francisco Bay Area that reported raising money in the second quarter of 2005.
- **Overview**

The results of the 2Q05 survey showed a continuation of the positive trend in the venture environment. The highlights of the quarter were as follows:

- Up rounds outpaced down rounds for the sixth quarter in a row, and by the second highest margin since we started the survey in 2002.
- The Fenwick & West Venture Capital Barometer™ showed a 41% average price increase for companies receiving venture capital financing in 2Q05 compared to such companies' previous financing round. This was the largest increase to date.
- The amount invested by venture capitalists in the U.S. in 2Q05 increased by approximately 15% in dollar terms over 1Q05, as reported by industry publications. Close to half of the increase was generated by the life science sector.

Although these are important positive indications, there is reason for some caution as 2Q05 venture capital liquidity indicators were more mixed. These included the following:

- There were only five venture backed IPOs in the U.S. in 2Q05, only one of which was from the IT industry. However, with the Nasdaq up 3.6% in 2Q05, there is reason to believe the IPO market may improve.
- Both the aggregate dollar volume of acquisitions of U.S. venture backed companies, and the total number of transactions, declined from 1Q05, as reported by industry publications. Although the aggregate dollar volume remained historically high at \$6.8 billion, the number of transactions, at 77, was the lowest in two years.

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

Series	Q2'05	Q1'05	Q4 '04	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03
A	15%	24%	18%	14%	17%	16%	16%	20%
B	26%	29%	24%	29%	28%	27%	27%	30%
C	27%	16%	28%	20%	25%	21%	30%	19%
D	21%	22%	18%	20%	15%	15%	15%	18%
E and higher	11%	9%	12%	17%	15%	21%	12%	13%

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

Price Change	Q2'05	Q1'05	Q4 '04	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03
Down	31%	31%	28%	32%	21%	30%	45%	53%
Flat	4%	10%	12%	15%	12%	19%	13%	12%
Up	65%	59%	60%	53%	67%	51%	42%	35%

The percentage of down rounds by series were as follows:

Series	Q2'05	Q1'05	Q4 '04	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03
B	12%	19%	24%	12%	16%	29%	31%	46%
C	32%	36%	25%	32%	25%	30%	34%	44%
D	37%	30%	28%	52%	18%	21%	75%	53%
E and higher	60%	62%	42%	42%	29%	38%	62%	82%

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 Q2'05 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.

Q2'05

Percent Change	Series B	Series C	Series D	Series E and higher	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	Combined total for all Series for Q2 '04	Combined total for all Series for Q1 '04
Up rounds	+117%	+67%	+57%	+49%	+83%	+66%	84%	+66%	+58%	+67%
Down rounds	-38%	-48%	-35%	-47%	-43%	-49%	-54%	-59%	-48%	-56%
Net result	+93%	+28%	+20%	-9%	+41%	+24%	+36%	+17%	+28%	+17%

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

Q2'05	Q1'05	Q4 '04	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03
46%	50%	46%	54%	56%	52%	57%	57%

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

Series	Q2'05	Q1'05	Q4 '04	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03
B	25%	38%	32%	33%	45%	47%	38%	50%
C	40%	57%	39%	59%	50%	44%	59%	56%
D	68%	55%	72%	61%	59%	58%	62%	60%
E and higher	70%	62%	50%	74%	82%	62%	85%	73%

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

Q2'05	Q1'05	Q4 '04	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03
22%	12%	24%	31%	25%	27%	33%	21%

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

Range of multiples	Q2'05	Q1'05	Q4 '04	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03
>1x- 2x	88%	100%	89%	75%	84%	60%	76%	88%
>2x – 3x	0%	0%	0%	6%	8%	27%	18%	12%
> 3x	12%	0%	11%	19%	8%	13%	6%	0%

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

Q2'05	Q1'05	Q4 '04	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03
71%	73%	60%	74%	64%	70%	74%	68%

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

Q2'05	Q1'05	Q4 '04	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03
60%	51%	60%	63%	47%	57%	61%	66%

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

Q2'05	Q1'05	Q4 '04	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03
4%	9%	9%	9%	6%	6%	7%	12%

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

Type of Provision	Q2'05	Q1'05	Q4 '04	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03
Ratchet	8%	9%	9%	14%	9%	5%	9%	8%
Weighted Average	88%	87%	85%	85%	87%	93%	89%	87%
None	4%	4%	6%	1%	4%	2%	2%	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.

Q2'05	Q1'05	Q4 '04	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03
16%	17%	12%	16%	20%	17%	20%	12%

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.

Q2'05	Q1'05	Q4 '04	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03
87%	93%	75%	72%	77%	67%	81%	80%

- Shadow Preferred Stock.

Q2'05	Q1'05	Q4 '04	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03
13%	7%	25%	28%	23%	33%	19%	20%

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

Q2'05	Q1'05	Q4 '04	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03
29%	30%	28%	30%	28%	27%	32%	29%

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

Q2'05	Q1'05	Q4 '04	Q3 '04	Q2 '04	Q1 '04	Q4 '03	Q3 '03
15%	13%	8%	20%	12%	17%	11%	21%

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. Information on aggregate dollar venture investment and M&A activity was obtained from publications by the Dow Jones VentureSource Survey and/or the Pricewaterhouse Coopers/Thomson Venture Economics/National Venture Capital Association Moneytree™ Survey.