

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

- **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 fourth quarter of 2006.
- **Overview**

The results of the 4Q06 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 twelfth quarter in a row (67% up vs. 22% down, with 11% flat).
- The Fenwick & West Venture Capital Barometer showed a 69% average price increase for companies receiving venture capital in 4Q06 compared to such companies' previous financing round. This was the largest increase since the survey began. This increase was driven in significant part by nine 4Q06 financings in which the purchase price of the stock sold in the financing was at least three times higher than the prior round. Of these nine financings, most were Web 2.0 and related fields.

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 4Q06 was approximately \$5.8 billion. Although this amount was approximately 15% less than the amounts invested in 3Q06 and 2Q06, it fell solidly within the \$5-7 billion quarterly range seen since the end of 2003. Overall the amount invested by venture capitalists in the U.S. in 2006 was up approximately 8% over 2005.¹
- Acquisitions of venture backed companies in the U.S. fell in 4Q06 with 75 transactions totaling \$7.3 billion, compared to 112 transactions totaling \$7.7 billion in 3Q06. However 2006 in general was the best acquisition year for venture backed companies since 2000, both in terms of aggregate amount paid (\$31.2 billion) as well as median amount paid per transaction (\$52 million).¹
- IPOs of venture backed companies improved noticeably in 4Q06, with 18 IPOs raising \$1.2 billion in 4Q06. 2006 was the second best IPO year since 2000, with 56 venture backed IPOs raising \$3.7 billion.¹
- Healthcare companies had another good year, with venture investment increasing to \$8.25 billion, up 12% over 2005, and the industry accounting for 28 of the 56 IPOs. Information services (which includes Web 2.0 companies) also had a good year with investment

increasing to \$2.4 billion, up 27% from 2005. Alternative energy had a substantial increase in activity with investment at \$537 million being close to three times higher than 2005.¹

- Nasdaq was up 2.0% in 4Q06, was up 9.5% for 2006, and is up 3% in 1Q07 to date.

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

Series	Q4'06	Q3'06	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05
A	22%	23%	14%	11%	22%	18%	15%	24%
B	31%	31%	34%	40%	35%	31%	26%	29%
C	23%	24%	28%	17%	17%	23%	27%	16%
D	11%	17%	16%	15%	11%	15%	21%	22%
E and higher	13%	5%	8%	17%	15%	13%	11%	9%

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

Price Change	Q4'06	Q3'06	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05
Down	22%	24%	25%	15%	19%	25%	31%	31%
Flat	11%	9%	6%	11%	12%	15%	4%	10%
Up	67%	67%	69%	74%	69%	60%	65%	59%

The percentage of down rounds by series were as follows:

Series	Q4'06	Q3'06	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05
B	6%	13%	16%	12%	10%	16%	12%	19%
C	15%	24%	32%	12%	5%	35%	32%	36%
D	42%	38%	14%	27%	46%	33%	37%	30%
E and higher	53%	33%	57%	12%	35%	23%	60%	62%

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 Q4'06 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.

Q4'06

Percent Change	Series B	Series C	Series D	Series E and higher	Combined total for all Series for Q4'06	Combined total for all Series for Q3'06	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
Up rounds	+152%	+113%	+46%	+32%	+119%	+86%	+69%	+95%	+81%	+88%
Down rounds	-42%	-33%	-59%	-53%	-49%	-35%	-57%	-49%	-56%	-60%
Net result	+124%	+82%	+9%	-15%	+69%	+49%	+34%	+64%	+45%	+38%

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

Q4'06	Q3'06	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05
40%	42%	50%	40%	41%	57%	46%	50%

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

Series	Q4'06	Q3'06	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05
B	23%	30%	35%	29%	22%	42%	25%	38%
C	38%	41%	76%	47%	40%	48%	40%	57%
D	58%	57%	36%	60%	69%	87%	68%	55%
E and higher	67%	67%	57%	41%	65%	77%	70%	62%

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

Q4'06	Q3'06	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05
14%	26%	16%	14%	24%	30%	22%	12%

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

Range of multiples	Q4'06	Q3'06	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05
>1x- 2x	40%	90%	83%	80%	67%	93%	88%	100%
>2x – 3x	60%	10%	0%	20%	33%	7%	0%	0%
> 3x	0%	0%	17%	0%	0%	0%	12%	0%

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

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

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

Q4'06	Q3'06	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05
64%	58%	64%	55	50%	54%	60%	51%

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

Q4'06	Q3'06	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05
4%	7%	8%	3%	4%	3%	4%	9%

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

Type of Provision	Q4'06	Q3'06	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05
Ratchet	4%	4%	2%	4%	9%	7%	8%	9%
Weighted Average	95%	95%	97%	92%	85%	92%	88%	87%
None	1%	1%	1%	4%	6%	1%	4%	4%

- **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.

Q4'06	Q3'06	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05
10%	10%	16%	11%	16%	8%	16%	17%

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.

Q4'06	Q3'06	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05
73%	50%	86%	73%	89%	88%	87%	93%

- Shadow Preferred Stock.

Q4'06	Q3'06	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05
27%	50%	14%	27%	11%	12%	13%	7%

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

Q4'06	Q3'06	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05
22%	29%	33%	27%	31%	32%	29%	30%

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

Q4'06	Q3'06	Q2'06	Q1'06	Q4'05	Q3'05	Q2'05	Q1'05
6%	5%	12%	9%	11%	17%	15%	13%

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.