FENWICK & WEST LLP

Trends in Terms of Venture Financings
In the San Francisco Bay Area
(Fourth Quarter 2008)

- **Background** – We analyzed the terms of venture financings for 128 companies headquartered in the San Francisco Bay Area that reported raising money in the fourth quarter of 2008.

- **Overview**

  - Up rounds exceeded down rounds 54% up vs. 33% down with 13% flat. This was the lowest amount by which up rounds exceeded down rounds since 3Q04. Perhaps more ominously, down rounds increased each month through the quarter, and for December 2008, 45% of all financings were down rounds, compared to 48% up and 7% flat.

  - A breakdown of 4Q08 financings by industry shows that Web 2.0/digital media was by far the strongest industry. When Web 2.0/digital media companies are excluded from the results, up rounds decreased to 46%, down rounds increased to 39%, with 15% of rounds flat.

  - The Fenwick & West Venture Capital Barometer™ showed an average price increase of 25% for companies receiving venture capital in 4Q08 compared to such companies' prior financing round, a significant decline from the 55% reported in 3Q08, and the lowest quarterly total since 1Q05. If Web 2.0/digital media financings are factored out the Venture Capital Barometer would have been flat (0%).

  - Anecdotal evidence indicates that there is a flight to quality, with venture capitalists focusing on funding their most promising companies, and perhaps even pulling forward financings for those companies, to make sure they have sufficient funds should the poor financing environment continue for a prolonged period, or worsen. If true, this evidence, combined with the significant reduction in U.S. venture investment in 4Q08 described below, could indicate that less promising companies are not being funded (as opposed to being funded at lower valuations) which could cause results to be skewed in a positive direction.

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

- The amount invested by venture capitalists in the U.S. in 4Q08 was approximately $5.5 billion, a significant decline from the $7.6 billion invested in 3Q08 and the $7.9 billion invested in 4Q07. The total amount invested in all of 2008 was $28.8 billion, compared to $31.4 billion in 2007. [1]

- Fundraising by U.S. venture capitalists was $24.7 billion in 2008, which amount was the lowest amount raised in a year since 2004. [1]

- There were 65 acquisitions of venture-backed companies in the U.S. in 4Q08, for a total of $3.8 billion, a significant decline from 75 transactions totaling $4.8 billion in 3Q08 and 123 transactions totaling $16.4 billion in 4Q07. There were 325 acquisitions of venture-backed companies in the U.S. in all of 2008, totaling $23.5 billion, the lowest dollar amount for acquisitions since 2003, and the lowest number of deals since 1999. Additionally, the age of acquired companies increased for the seventh straight year, with the median time from initial equity funding to acquisition reaching 6.5 years in 2008. [1]

- There were no IPOs of venture-backed companies in the U.S. in 4Q08, and only 7 in all of 2008 (of which 6 were in 1Q08). This was the lowest annual total for venture-backed IPOs since 1992.[1]

- Venture investment in IT in 2008 was down 15% from 2007, with the software segment being especially hard hit, while investment in the Web 2.0/digital media segment was up 17% from 2007. [1]

- Healthcare investments fell 22% in 2008 compared to 2007, while energy investments increased from $1.7 billion in 2007 to $3.6 billion in 2008. [1]

- The Silicon Valley Venture Capitalists Confidence Index™ produced by the University of San Francisco reports the confidence level of Silicon Valley venture capitalists at 2.77 on a 5 point scale, a decline from 2.89 in 3Q08 and the lowest confidence level since the index began in 1Q04.

- Nasdaq was down 24% in 4Q08 (and down 40.5% for all of 2008), and is down 9% in 1Q09 through February 25, 2009.

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

Series	Q4'08	Q3'08	Q2'08	Q1'08	Q4'07	Q3'07	Q2'07	Q1'07
A	16%	16%	15%	17%	16%	13%	14%	18%
B	26%	26%	31%	29%	26%	38%	34%	38%
C	29%	28%	20%	22%	27%	28%	25%	20%
D	14%	17%	19%	13%	16%	12%	18%	12%
E and higher	15%	13%	15%	19%	15%	9%	9%	12%

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

Price Change	Q4'08	Q3'08	Q2'08	Q1'08	Q4'07	Q3'07	Q2'07	Q1'07
Down	33%	12%	13%	19%	22%	14%	11%	9%
Flat	13%	15%	19%	9%	9%	7%	8%	12%
Up	54%	73%	68%	72%	69%	79%	81%	79%

The percentage of down rounds by series were as follows:

Series	Q4'08	Q3'08	Q2'08	Q1'08	Q4'07	Q3'07	Q2'07	Q1'07
B	21%	7%	3%	16%	11%	13%	5%	7%
C	43%	14%	23%	25%	11%	14%	10%	4%
D	22%	12%	14%	29%	47%	8%	17%	0%
E and higher	45%	15%	19%	10%	33%	33%	27%	36%

- **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 Q4'08 and is provided on an aggregate basis for comparison purposes for the prior four 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 the results are not weighted for the amount raised in a financing.

Percent Change	Series B	Series C	Series D	Series E and higher	Combined total for all Series for Q4'08	Combined total for all Series for Q3'08	Combined total for all Series for Q2'08	Combined total for all Series for Q1'08	Combined total for all Series for Q4'07
Up rounds	+105%	+76%	+63%	+31%	+80%	+83%	+91%	+78%	+91%
Down rounds	-53%	-57%	-58%	-49%	-54%	-49%	-56%	-36%	-36%
Net result	+59%	+14%	+26%	-13%	+25%	+55%	+53%	+49%	+55%

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

Q4'08	Q3'08	Q2'08	Q1'08	Q4'07	Q3'07	Q2'07	Q1'07
41%	45%	38%	47%	39%	42%	51%	36%

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

Series	Q4'08	Q3'08	Q2'08	Q1'08	Q4'07	Q3'07	Q2'07	Q1'07
B	30%	35%	21%	38%	26%	23%	47%	30%
C	35%	48%	32%	46%	43%	48%	39%	25%
D	61%	59%	62%	36%	53%	69%	65%	50%
E and higher	50%	38%	50%	70%	40%	67%	74%	64%

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

Q4'08	Q3'08	Q2'08	Q1'08	Q4'07	Q3'07	Q2'07	Q1'07
23%	16%	11%	17%	15%	21%	15%	14%

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

Range of multiples	Q4'08	Q3'08	Q2'08	Q1'08	Q4'07	Q3'07	Q2'07	Q1'07
>1x- 2x	70%	50%	75%	100%	80%	100%	75%	100%
>2x – 3x	20%	50%	25%	0%	20%	0%	25%	0%
> 3x	10%	0%	0%	0%	0%	0%	0%	0%

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

Q4'08	Q3'08	Q2'08	Q1'08	Q4'07	Q3'07	Q2'07	Q1'07
57%	62%	57%	60%	59%	54%	48%	59%

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

Q4'08	Q3'08	Q2'08	Q1'08	Q4'07	Q3'07	Q2'07	Q1'07
51%	51%	55%	56%	41%	39%	54%	52%

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

Q4'08	Q3'08	Q2'08	Q1'08	Q4'07	Q3'07	Q2'07	Q1'07
4%	4%	6%	5%	4%	4%	6%	8%

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

Type of Provision	Q4'08	Q3'08	Q2'08	Q1'08	Q4'07	Q3'07	Q2'07	Q1'07
Ratchet	2%	7%	1%	2%	3%	6%	5%	5%
Weighted Average	98%	93%	99%	98%	97%	94%	93%	94%
None	0%	0%	0%	0%	0%	0%	2%	0%

- **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.

Q4'08	Q3'08	Q2'08	Q1'08	Q4'07	Q3'07	Q2'07	Q1'07
15%	12%	7%	6%	9%	13%	10%	8%

Note that anecdotal evidence indicates that companies are increasingly using contractual "pull up" provisions instead of charter based "pay to play" provisions. These two types of provisions have similar economic effect but are implemented differently. The above information includes some, but likely not all, pull up provisions, and accordingly may understate the use of these provisions.

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.

Q4'08	Q3'08	Q2'08	Q1'08	Q4'07	Q3'07	Q2'07	Q1'07
85%	60%	87%	67%	89%	57%	77%	89%

- Shadow Preferred Stock.

Q4'08	Q3'08	Q2'08	Q1'08	Q4'07	Q3'07	Q2'07	Q1'07
15%	40%	13%	33%	11%	43%	23%	11%

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

Q4'08	Q3'08	Q2'08	Q1'08	Q4'07	Q3'07	Q2'07	Q1'07
20%	23%	29%	20%	21%	26%	22%	26%

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

Q4'08	Q3'08	Q2'08	Q1'08	Q4'07	Q3'07	Q2'07	Q1'07
13%	4%	4%	5%	5%	9%	3%	9%

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. The contents of this report are not intended, and should not be considered, as legal advice or opinion.

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[1] Information in this paragraph obtained from Dow Jones VentureSource.