Venture Capital Report

2024

WilmerHale

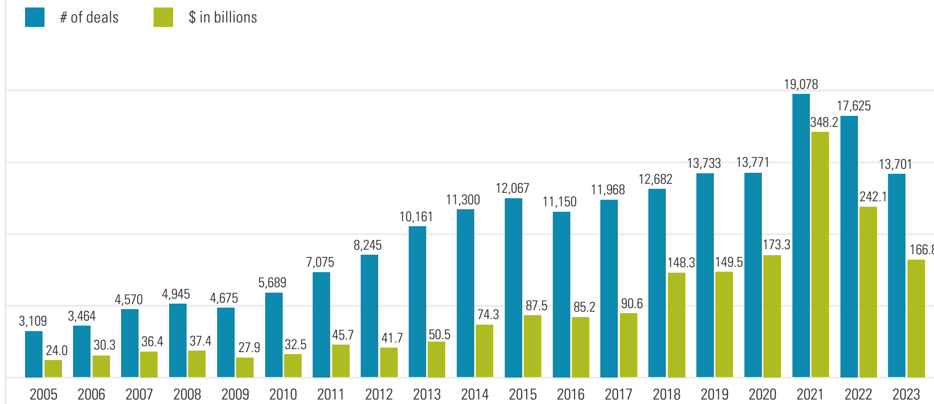
WILMER CUTLER PICKERING HALE AND DORR LLP

2024 Venture Capital Report – What's Inside

Venture capital financing activity in 2023 contracted for the second consecutive year in the face of rising interest rates, concerns regarding the trajectory of the economy and continued geopolitical tension.

VC-backed company liquidity results were more mixed in 2023. VC-backed IPOs increased from 2022 but remain well below other recent years, and the number of acquisitions of VC-backed companies declined to its lowest since 2017, although 2023 is likely to be commensurate with the average levels from 2018 to 2020 once all deals have been reported.

US Venture Capital Financings – 2005 to 2023



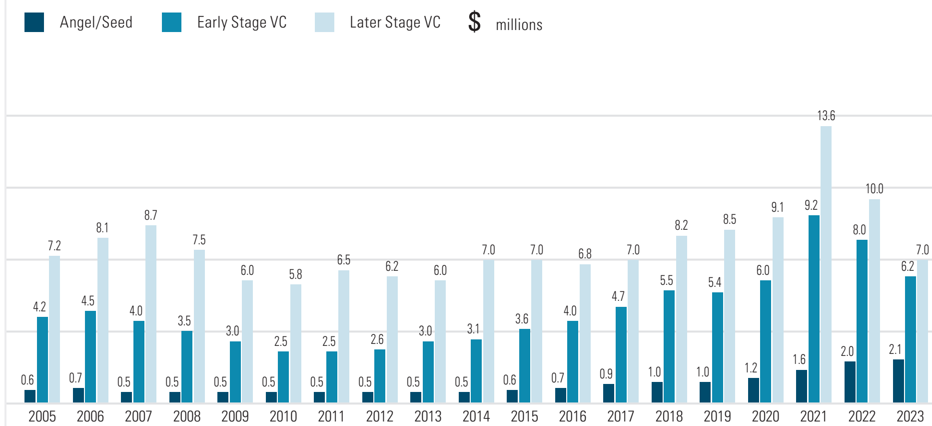
Source: PitchBook

EQUITY FINANCING ACTIVITY

The number of reported venture capital financings decreased by 22%, from 17,625 in 2022 to 13,701 in 2023. Total reported financing proceeds dropped 31% from $242.1 billion in 2022 to $166.8 billion in 2023. Despite the steep decline, the total proceeds for 2023 are the fourth-highest annual figure on record.

Overall, the median size of venture capital financings declined by 8%, from $4.0 million in 2022 to $3.7 million in 2023—the third-highest median since 2007, when angel and seed financings comprised a smaller portion of the market.

Median Size of US Venture Capital Financings – 2005 to 2023



Source: PitchBook

The median size of angel and seed financings rose by 5% year over year, from $2.0 million to $2.1 million. The median size of early-stage financings declined by 23%, from $8.0 million in 2022 to $6.2 million in 2023. The median size of later-stage financings decreased by 30%, from $10.0 million to $7.0 million.

The median financing size for life sciences companies declined from $4.9 million in 2022 to $4.5 million in 2023—the third-highest level of financing since 2008. Among technology companies, the median financing size declined from $4.3 million to $4.0 million, tied with 2021 as the second-highest level of financing since 2007.

After more than quadrupling from 2017 to 2021, the number of financing rounds of $50 million or more declined by 32%, from 1,618 in 2021 to 1,100 in 2022 and then declined a further 44% to 612 in 2023. The number of financing rounds of $100 million or more fell by 37%, from 843 in 2021 to 532 in 2022 and then by 49% to 269 in 2023. The number of financing rounds of $250 million or more dropped by 51%, from 210 in 2021 to 102 in 2022 and then declined by a further 31% to 70 in 2023, as interest in super-sized rounds from growth equity, crossover and hedge fund investors waned in the soft IPO market.

There were 10 billion-dollar venture financing rounds in 2023, compared to seven in 2022 and 20 in 2021. The largest rounds in 2023 came from OpenAI ($10.0 billion), Stripe ($6.5 billion), Anthropic (separate rounds of $4.0 billion and $2.0 billion), Metropolis ($1.7 billion) and Commure ($1.3 billion). All but three of the billion-dollar rounds for 2023 occurred in the fourth quarter of the year.

Breaking its decade-long upward trajectory, the median pre-money valuation for all venture financings fell by 3%, from $25.5 million in 2022 to $24.6 million in 2023. The median pre-money valuation in angel and seed rounds increased by 5%, from $10.0 million to $10.5 million. The median pre-money valuation in early-stage rounds fell by 20%, from $50.0 million to $40.0 million, and the median pre-money valuation in later-stage rounds declined by 17%, from $72.5 million to $60.3 million.

The median pre-money valuation in the healthcare and life sciences sector increased by 3%, from $27.2 million in 2022 to $28.0 million in 2023. Among technology companies, the median pre-money valuation declined by 15%, from $28.0 million to $23.8 million.

Angel and seed financings accounted for 36% of all venture financings in 2023 (down from 41% in 2022) and represented 9% of all venture capital financing proceeds (down from 10% in 2022). Early-stage financings accounted for 31% of all financings in 2023 (up from 29% in 2022) and 24% of all proceeds (down from 29% in 2022). Later-stage financings accounted for 33% of all financings in 2023 (up from 30% in 2022) and 67% of all proceeds (up from 61% in 2022).

The technology sector accounted for 42% of all 2023 financings, down from 44% in 2022, followed by healthcare and life sciences, which accounted for 20% of all financings in 2023, up from 19% in 2022. Artificial intelligence and machine learning companies (which encompass companies across industries) saw their collective market share of all financings increase from 17% in 2022 to 21% in 2023 (and their share of total deal value increase markedly from 19% in 2022 to 34% in 2023).

California produced 30% of all venture financings in 2023 (4,048 financings) and 48% of the year's proceeds ($79.9 billion). New York, home to companies with 1,856 financings raising $19.3 billion in 2023, finished second in the state ranking. Texas (with 847 financings raising $6.8 billion) just edged out Massachusetts (with 825 financings raising $16.2 billion) in terms of the number of financings, although proceeds trailed far behind. The next most active states in terms of the number of financings were Florida (with 602 financings raising $3.0 billion), Washington (with 424 financings raising $3.7 billion) and Colorado (with 388 financings raising $4.3 billion).

LIQUIDITY ACTIVITY

The number of US-issuer VC-backed IPOs increased to 25 in 2023 from 20 in 2022 but remains well below the median of 75 over the five-year period from 2017 to 2021. VC-backed companies accounted for 48% of all conventional IPOs (IPOs excluding SPAC IPOs and direct listings) by US issuers in 2023, up from 42% in 2022 but trailing the 58% that prevailed over the five-year period from 2017 to 2021.

Gross IPO proceeds raised by VC-backed US issuers increased to $4.6 billion in 2023 from $1.6 billion in 2022 but are a fraction of the median of $25.0 billion raised over the five-year period from 2017 to 2021. For the second consecutive year, there were no billion-dollar IPOs by VC-backed US issuers. The largest VC-backed IPO in 2023 was the $660 million offering by Instacart, followed by the IPOs of Nextracker ($638 million), Klaviyo ($576 million), ACELYRIN ($540 million) and CAVA ($318 million).

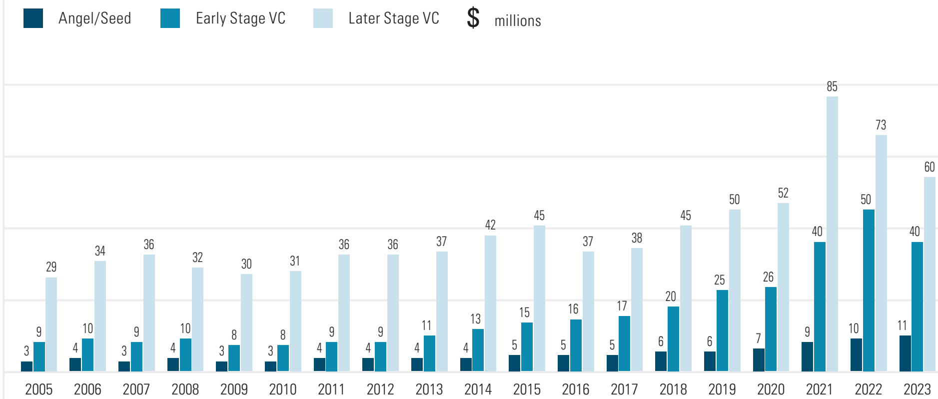
The median offering size for US VC-backed IPOs fell from $52.3 million in 2022 to $15.0 million in 2023.

In 2023, healthcare and life sciences companies accounted for 42% of all VC-backed IPOs, down from their 56% market share in 2022 and below the 60% market share that prevailed over the five-year period from 2017 to 2021. The VC-backed IPO market share for technology companies was 47% in 2023, up from 30% in 2022 and above their 35% share of the VC-backed IPO market between 2017 and 2021.

The median time from initial funding to IPO decreased from 5.2 years in 2022 to 3.8 years in 2023—the lowest figure since 2002, reflecting the influx of less-seasoned and smaller market-capitalization companies into the IPO market.

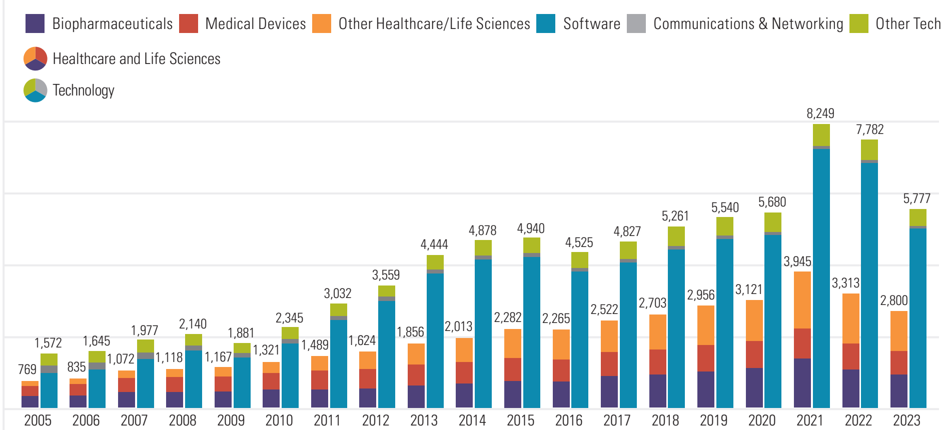
The median amount raised prior to an IPO dropped 15%, from $64.6 million in

Median Pre-Money Valuation in US Venture Capital Financings – 2005 to 2023



Source: PitchBook

US Venture Capital Financings by Industry – 2005 to 2023



Source: PitchBook

2022 to $54.9 million in 2023, while the median pre-IPO valuation fell by 48%, from $212.1 million to $110.6 million. As a result, the ratio of pre-IPO valuation to the median amount raised prior to an IPO declined from 3.3:1 in 2022 to 2.0:1 in 2023—the lowest level in more than 20 years (a higher ratio means better returns to pre-IPO investors).

VC-backed US issuer IPO companies ended 2023 down a median of 57% from their offering price, compared to a median loss of 41% in 2022 and a median loss of 11% in 2021. At the end of 2023, 33% of the year's VC-backed IPO companies were trading above their offering price, compared to 37% in 2022 and 27% in 2021.

The number of reported acquisitions of VC-backed companies decreased by 26%, from 1,286 in 2022 to 953 in 2023. Total reported acquisition proceeds fell by 15%, from $65.2 billion to $55.1 billion.

The median acquisition price increased by 18% from $45.9 million in 2022 to $54.0 million in 2023. The median time from initial funding to acquisition declined from 4.9 years in 2022 to 4.6 years—the lowest figure since 2017.

The median amount raised prior to acquisition increased by 8%, from $7.4 million in 2022 to $8.0 million in 2023.

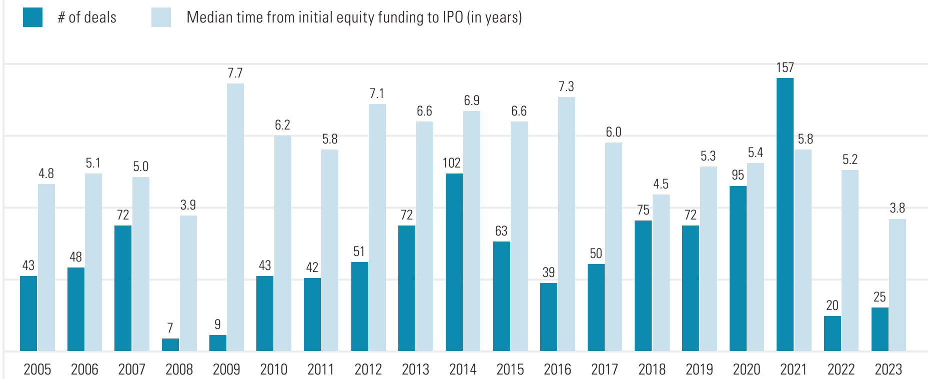
The ratio of median acquisition price to median amount raised prior to acquisition increased from 6.2:1 in 2022 to 6.8:1 in 2023 (a higher ratio means higher returns to pre-acquisition investors) —the sixth-highest ratio since 2000.

The historically high ratio in recent years is reflective of a general downward trend in pre-acquisition investments and an upward trend in acquisition prices.

There were 25 VC-backed company acquisitions of at least $500 million in 2023, comparable to 22 in 2022 but well below the 55 in 2021.

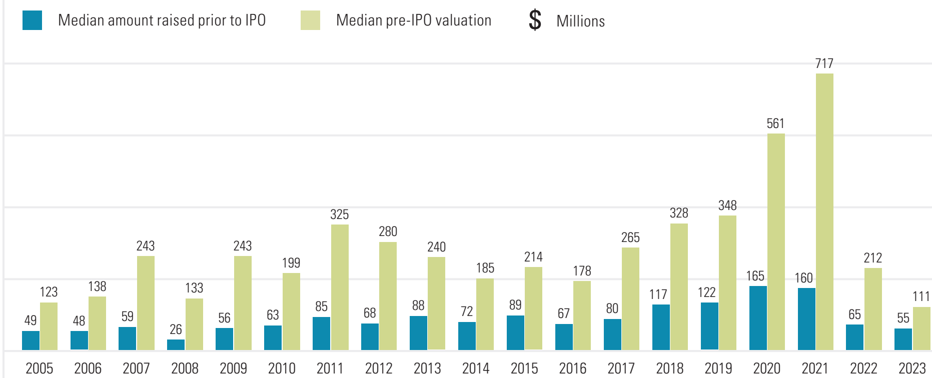
The year also produced nine billion-dollar acquisitions of VC-backed companies, up from eight in 2022 but well below the 22 in 2021. The largest deal of 2023 was the acquisition of Carmot Therapeutics by Roche for up to $3.1 billion, followed by the acquisition of Versanis Bio by Eli Lilly for up to $1.9 billion.

Venture Capital–Backed IPOs and Median Time to IPO – 2005 to 2023



Source: SEC filings and PitchBook
Based on US IPOs by VC-backed US issuers

Median Amount Raised Prior to IPO and Median Pre-IPO Valuation – 2005 to 2023



Source: PitchBook

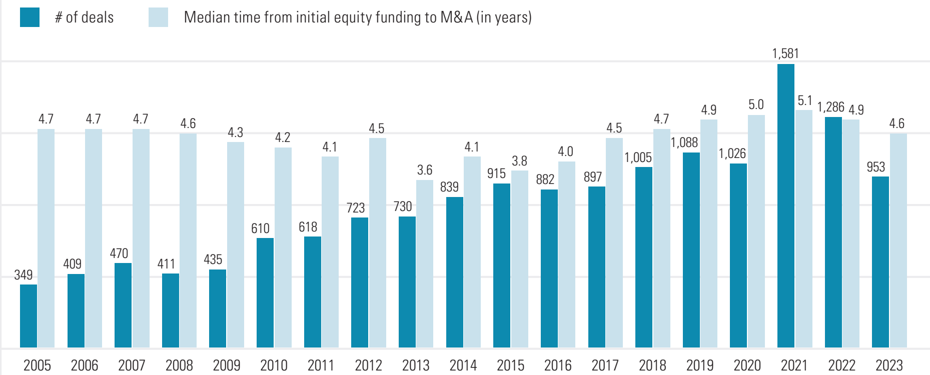
Based on the median valuations achieved in company acquisitions and IPOs compared to the median financing amounts required to achieve each type of liquidity event, 2023 marked the eleventh consecutive year in which returns to venture capital investors were higher in M&A transactions than in IPOs. Although the median time of 4.6 years from initial funding to acquisition was higher than the median time of 3.8 years from initial funding to IPO in 2023, in recent years liquidity has typically occurred more quickly from acquisitions. This pattern, combined with the tendency of M&A transactions to yield the bulk of the purchase price in cash at closing—whereas IPOs generally involve a post-IPO lockup period and market uncertainty as to the timing and prices of subsequent stock sales—underscores why investors often prefer sales of their portfolio companies instead of IPOs.

The ratio of M&A transactions to IPOs for VC-backed companies declined from 64.3:1 in 2022 to 38.1:1 in 2023, but the 2023 ratio represents the second-highest ratio since 48.2:1 in 2009 due to historically low IPO numbers.

OUTLOOK

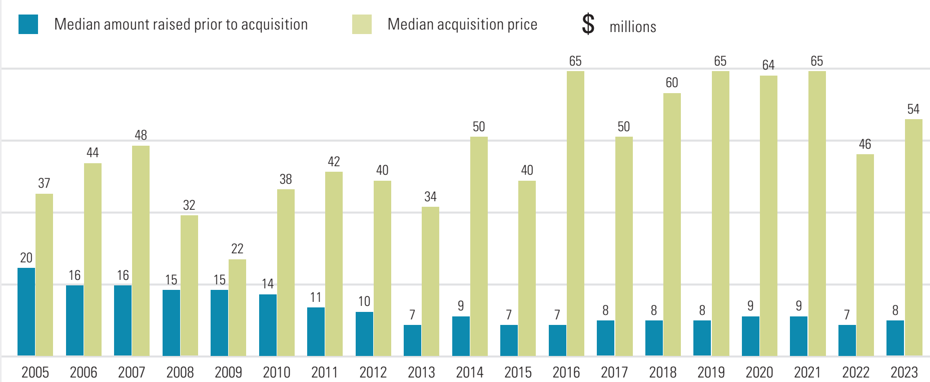
The US venture capital industry has weathered many cycles, with upturns and downturns alike proving unruly. Current market conditions will instill in founders the need to focus on profitability

Acquisitions of US Venture-Backed Companies and Median Time to M&A – 2005 to 2023



Source: PitchBook

Median Amount Raised Prior to Acquisition and Median Acquisition Price – 2005 to 2023



Source: PitchBook

instead of the growth-at-all-costs mindset that prevailed when funding was more freely available. Results over the coming year will depend on a variety of factors, including the following:

— ***Financing Activity:*** When venture capital fundraising in 2022 remarkably surpassed the previous record set in 2021, many theorized this strength was attributable to commitments made before the deterioration in economic conditions. This hypothesis appears to be borne out by the slowdown in fundraising activity in 2023. Total venture capital fundraising in 2023 was $66.9 billion, a figure 61% below the $172.8 billion reported in 2022. Macroeconomic conditions, at least in the first half of 2024, are likely to continue to pressure valuations, especially in late-stage deals, and startups that last raised money at ebullient valuations in 2020 and 2021 will need to grow into those valuations, wait for the next valuation upswing, or accept funding on less favorable terms.

— ***Attractive Sectors:*** Companies capitalizing on the broad digital transformation of business processes—including changes driven by the use of artificial intelligence—should continue to be attractive financing candidates. Persistent labor shortages and wage inflation should boost opportunities for companies that leverage robotics, automation, machine learning and voice technology. Opportunities also exist for companies transforming the broader healthcare industry. Innovative life sciences companies, including those in the fields of cell therapy, gene therapy, precision medicine and machine learning–enabled drug discovery, should continue to appeal to investors. Agtech and climate tech—particularly those companies aiding the economic transition away from fossil fuels—are among the other sectors that are likely to garner investor interest.

— ***IPOs:*** While the number of IPOs by VC-backed companies increased in 2023, the overall IPO market remained in the doldrums and the profile of the median IPO company in 2023 is far from what it was two years ago. With private financing terms less favorable than a few years ago and public market scrutiny of valuations less forgiving, VC-backed companies may try to extend their runway and remain private as long as possible, hoping a more receptive IPO market emerges.

— ***Acquisitions:*** M&A activity was weighed down by the continued rise in interest rates and the uncertain trajectory of the economy in 2023. The higher cost of capital is likely to continue to temper acquisition activity by financial buyers, but the forecast of slower economic growth may also spur companies to consider augmenting organic growth through acquisitions or seeking new technologies that improve efficiency and reduce costs. The heightened scrutiny of proposed acquisitions by US and international regulatory bodies has recently delayed or outright scuttled deals and is likely to weigh on the market.

— ***Impact of SPAC IPOs, Reverse Mergers:*** Despite retrenchment of the SPAC IPO market in 2023, the year ended with 127 SPACs seeking business combinations, many of which face deadlines to complete a business combination or return funds to investors. In these circumstances, some VC-backed companies may find a business combination with a SPAC a tempting alternative to a traditional IPO. Alternatively, VC-backed life sciences companies may elect to pursue reverse mergers with publicly traded companies whose clinical research programs have suffered serious setbacks or failures. ■

CALIFORNIA

California-based companies reported 4,048 venture capital financings in 2023, 27% below the 2022 tally of 5,561. California was responsible for 30% of all US financing transactions in 2023, down from 32% in 2022.

Total reported proceeds raised by California-based companies declined 20%, from $100.0 billion in 2022 to $79.9 billion in 2023.

The number of rounds in which California-based companies raised $100 million or more fell by 52%, from 237 in 2022 to 113 in 2023, and the number of rounds in which California-based companies raised $250 million or more declined by 22%, from 45 to 35. The largest rounds raised by California-based companies in 2023 came from OpenAI ($10.0 billion), Stripe ($6.5 billion) and Anthropic (separate rounds of $4.0 billion and $2.0 billion, respectively).

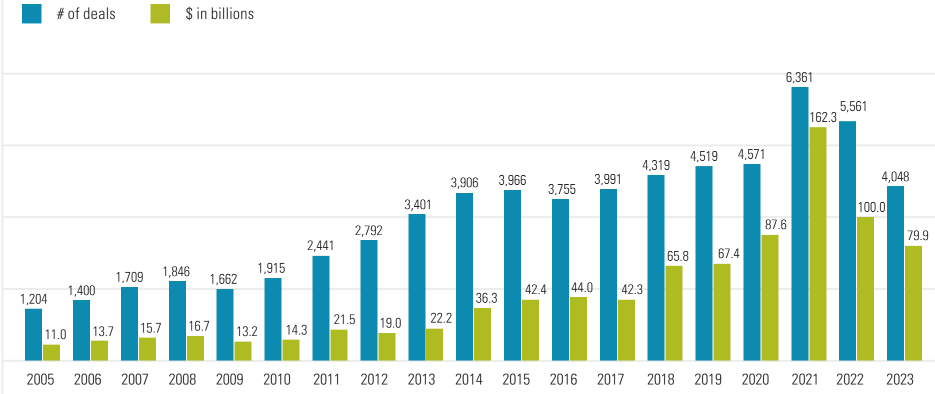
Technology was the largest sector in the state, producing 49% of all California financings in 2023, followed by healthcare and life sciences (17%), consumer goods and services (15%); and business services (13%).

The number of IPOs by California-based VC-backed companies increased from six in 2022 to 10 in 2023 but remained well below the median of 36 over the five-year period from 2017 to 2021. The state produced the two largest VC-backed IPOs of 2023, by Instacart ($660 million) and Nextracker ($638 million), and the largest VC-backed life sciences company IPO by ACELYRIN ($540 million).

The number of reported acquisitions of California VC-backed companies decreased by 22%, from 418 in 2022 to 328 in 2023. The state's largest deals involving VC-backed companies were the acquisition of Carmot Therapeutics by Roche for up to $3.1 billion and the acquisition of Versanis Bio by Eli Lilly for up to $1.9 billion.

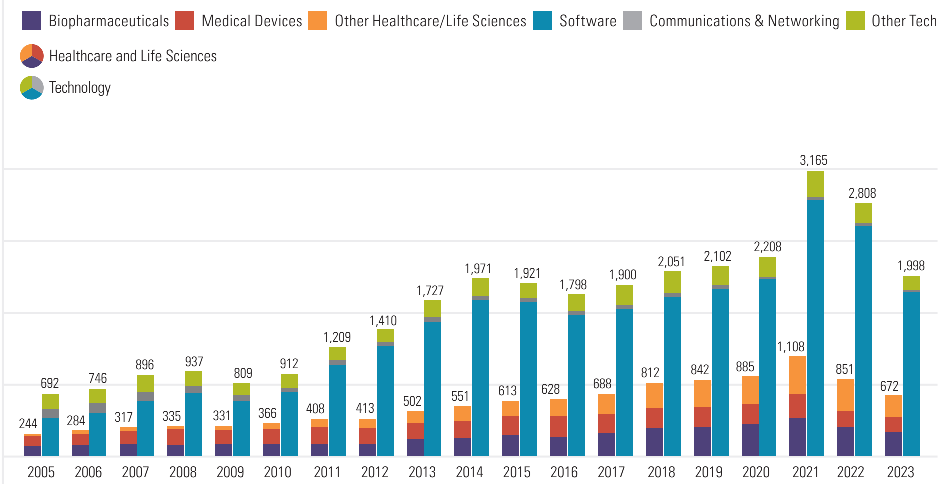
California continues to maintain its venture capital leadership and will undoubtedly do so in the coming year. The extent to which financing and liquidity activity rebounds will continue to depend on macroeconomic and IPO market conditions and the willingness of strategic buyers to pay attractive prices, among other factors.

California Venture Capital Financings – 2005 to 2023



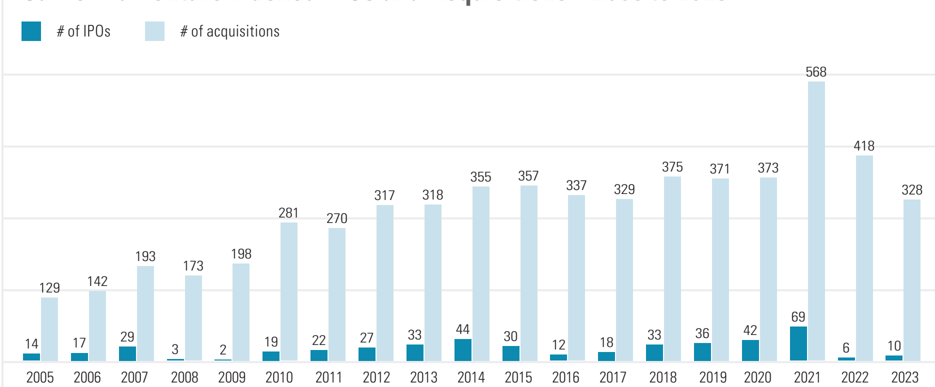
Source: PitchBook

California Venture Capital Financings by Selected Industry – 2005 to 2023



Source: PitchBook

California Venture-Backed IPOs and Acquisitions – 2005 to 2023



Source: SEC filings and PitchBook

MID-ATLANTIC

The number of reported venture capital financings by companies based in the mid-Atlantic region of Virginia, Maryland, North Carolina, Delaware and the District of Columbia declined by 14%, from 1,384 in 2022 to 1,185 in 2023.

Total reported proceeds raised by companies based in the mid-Atlantic region decreased by 31%, from $13.5 billion to $9.3 billion. The number of rounds in which mid-Atlantic companies raised $100 million or more fell from 23 in 2022 to 11 in 2023.

The largest rounds raised by mid-Atlantic companies in 2023 came from JUUL ($1.3 billion), Mapbox ($280 million), Aledade ($260 million) and X-energy ($235 million).

Technology companies accounted for 45% of all mid-Atlantic financings in 2023—extending the sector's long-standing leadership in the region—followed by healthcare and life sciences (22%), and consumer goods and services and business services (each with 13%).

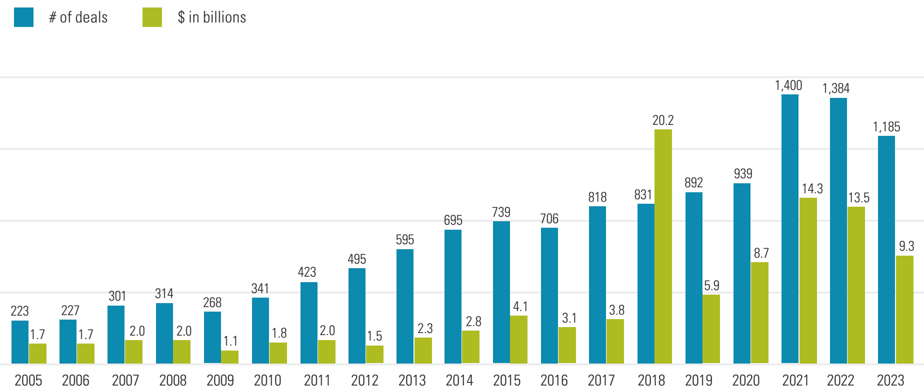
The mid-Atlantic region generated a pair of VC-backed IPOs in 2023, compared to one in 2022 and a median of four over the five-year period from 2017 to 2021. Washington DC–based CAVA Group's $318 million IPO was the fifth-largest VC-backed IPO of the year.

The number of reported acquisitions of mid-Atlantic VC-backed companies in 2023 was comparable to the number from 2022, decreasing slightly from 81 to 79. Virginia generated 26 deals, followed by Maryland with 15 deals and Delaware and North Carolina, each with 14 deals.

The region's largest M&A transactions involving VC-backed companies in 2023 were the $450 million acquisition of Haystack Oncology by Quest Diagnostics and the $250 million acquisition of Payzer by WEX.

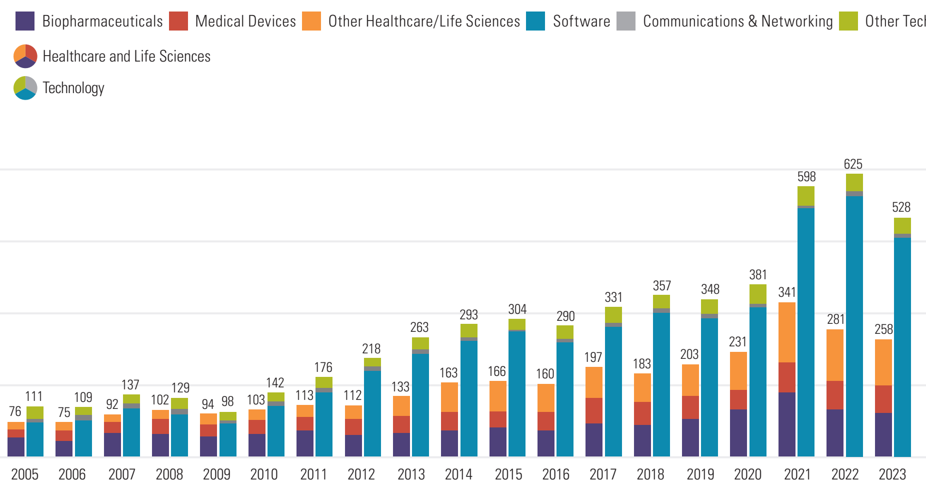
With a strong venture capital ecosystem, the mid-Atlantic region should continue to generate promising startups in the coming year, although financing and liquidity activity in the region will continue to depend on market conditions and other factors.

Mid-Atlantic Venture Capital Financings – 2005 to 2023



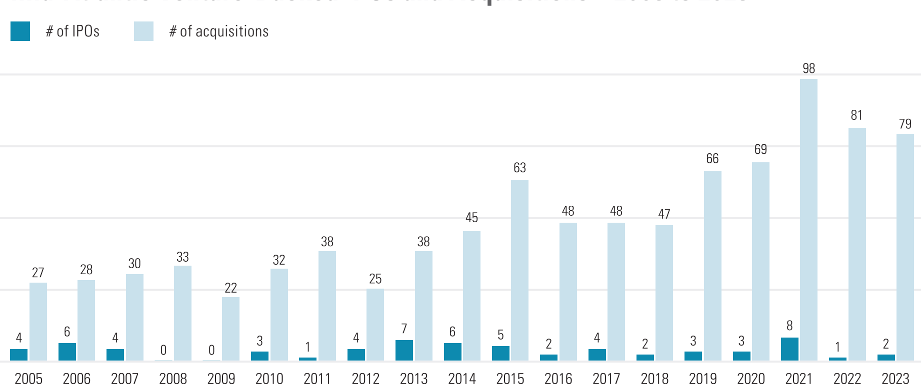
Source: PitchBook

Mid-Atlantic Venture Capital Financings by Selected Industry – 2005 to 2023



Source: PitchBook

Mid-Atlantic Venture-Backed IPOs and Acquisitions – 2005 to 2023



Source: SEC filings and PitchBook

NEW ENGLAND

New England companies reported 1,092 venture capital financings in 2023, a decrease of 23% from the 1,413 financings in 2022. Total reported proceeds raised by New England companies were $17.6 billion, down 32% from the $25.8 billion raised in the prior year.

Massachusetts, the perennial leader in New England, produced 825 financings and $16.2 billion in proceeds.

The number of rounds in which New England companies raised $100 million or more declined by 30%, from 69 in 2022 to 48 in 2023, and the number of rounds in which New England companies raised $250 million or more decreased slightly from 13 to 11. The largest rounds in 2023 came from Ascend Elements ($542 million), Curie.Bio ($520 million), ElevateBio ($401 million) and Nexamp ($400 million).

The healthcare and life sciences sector accounted for 39% of New England venture capital financings in 2023, followed by technology (28%), business services (14%), and consumer goods and services (11%).

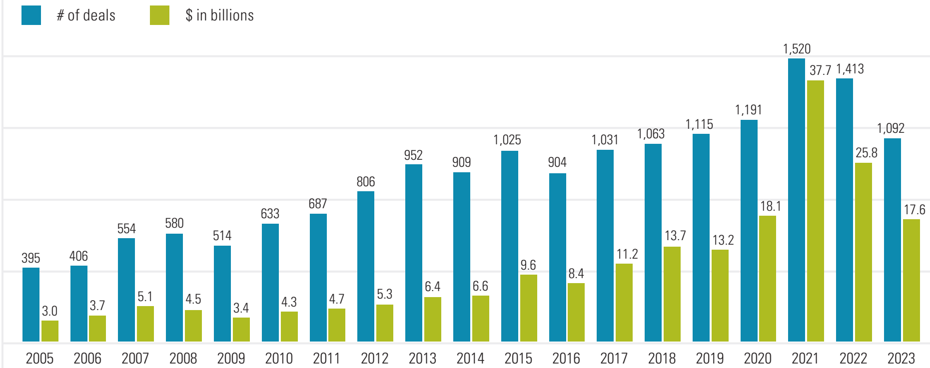
The number of VC-backed IPOs by New England–based companies declined from eight in 2022 to five in 2023. The region's largest IPO was by Klaviyo, the third-largest VC-backed IPO of the year at $576 million. The remaining New England IPOs came from life sciences companies, led by Apogee Therapeutics ($300 million) and Neumora Therapeutics ($250 million).

The number of reported acquisitions of VC-backed companies in New England dropped by 47%, from 123 in 2022 to 65 in 2023.

The region's largest M&A transaction involving a VC-backed company was the acquisition of Massachusetts-based Magenta Therapeutics by Dianthus Therapeutics through a reverse merger for $380 million.

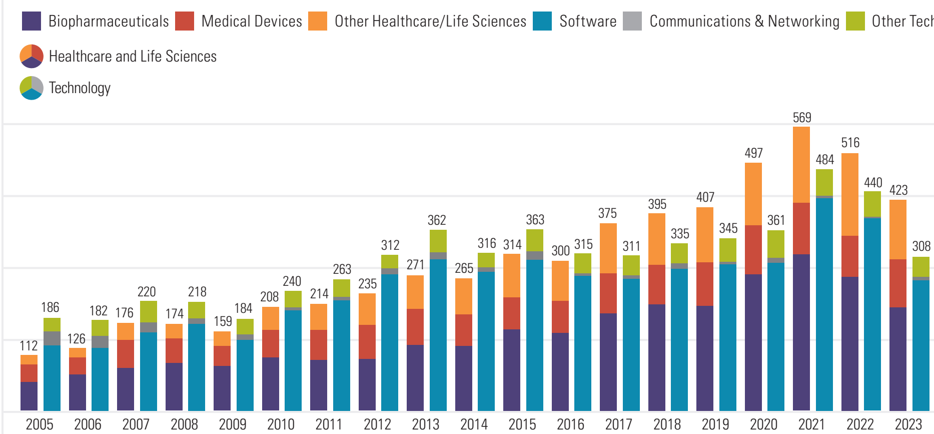
With its concentration of world-renowned universities and research institutions and consistent strength in the healthcare and life sciences sector, New England—and Massachusetts in particular—should remain a hub of financing and liquidity activity during the coming year.

New England Venture Capital Financings – 2005 to 2023



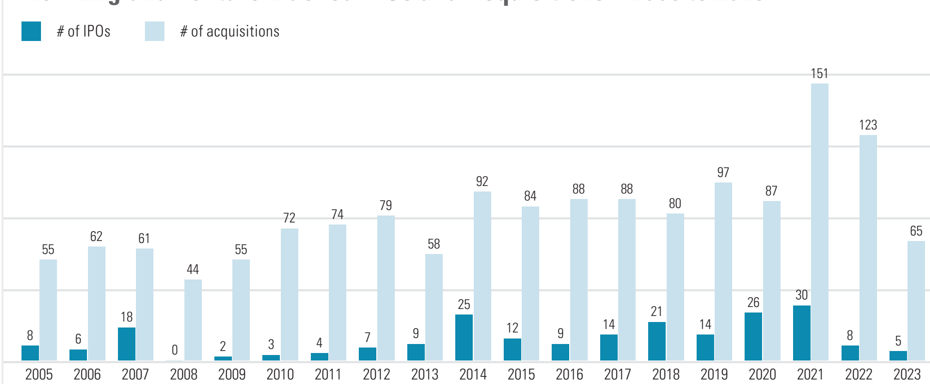
Source: PitchBook

New England Venture Capital Financings by Selected Industry – 2005 to 2023



Source: PitchBook

New England Venture-Backed IPOs and Acquisitions – 2005 to 2023



Source: SEC filings and PitchBook

TRI-STATE

The number of reported venture capital financings in the tri-state region of New York, New Jersey and Pennsylvania decreased by 22%, from 3,077 in 2022 to 2,393 in 2023, while total reported proceeds declined 37%, from $37.2 billion to $23.5 billion.

New York, the nation's second-largest source of VC financings, led the region with 1,856 financings and $19.3 billion in proceeds, accounting for 14% of all US financing transactions and 12% of US total reported proceeds in 2023, respectively.

The number of rounds in which tri-state companies raised $100 million or more fell by 48%, from 83 in 2022 to 43 in 2023, and the number of rounds in which tri-state companies raised $250 million or more contracted from 13 to nine. The region's largest financings came from Metropolis ($1.7 billion), Clear Street ($435 million) and CoreWeave ($421 million).

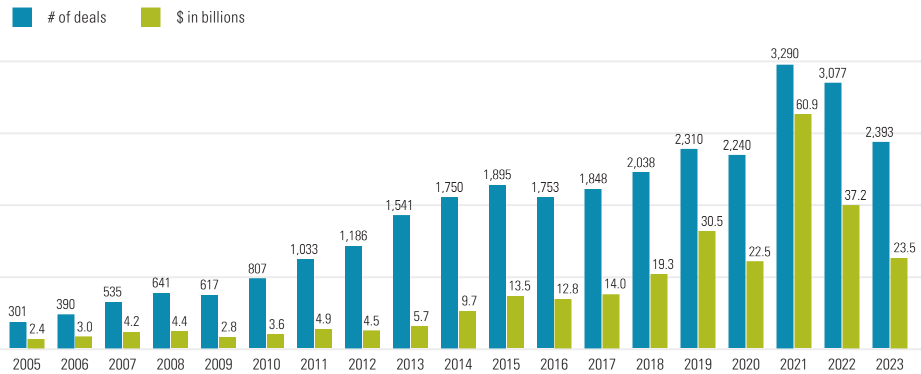
Technology companies accounted for 44% of the tri-state region's VC financings in 2023, followed by healthcare and life sciences (19%), consumer goods and services (17%), and business services (13%).

Consistent with 2022, there were two VC-backed IPOs in the tri-state region in 2023, compared to a median of 11 over the five-year period from 2017 to 2021. The region's pair of IPOs came from Pennsylvania-based Mineralys Therapeutics ($192 million) and New York–based Lexeo Therapeutics ($100 million).

The number of reported acquisitions of VC-backed companies in the tri-state region decreased by 33%, from 219 in 2022 to 147 in 2023. New York generated 114 of the region's deals in 2023. The largest 2023 deal was the acquisition of Tmunity by Gilead Sciences–owned Kite Pharma for approximately $300 million (plus up to approximately $1.0 billion in potential future payments).

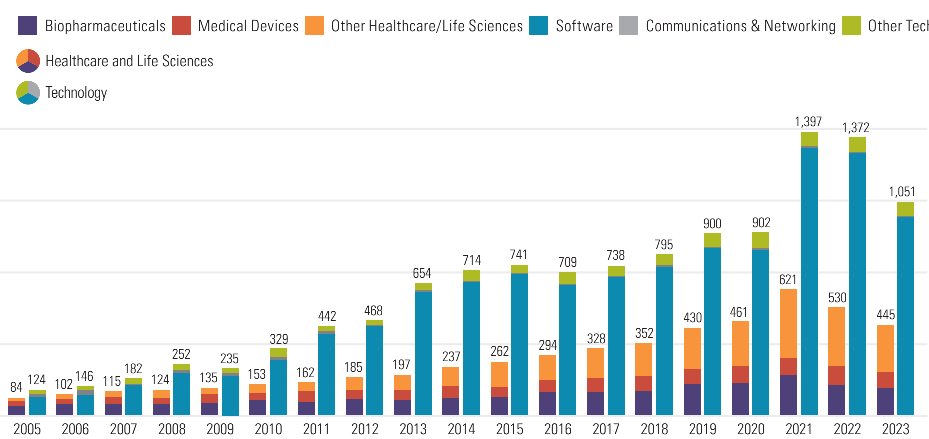
Due to its strength across a broad array of industry sectors, the tri-state region should continue to produce large numbers of financings and liquidity events. The level of deal activity in the coming year will continue to depend on macroeconomic and market conditions, among other factors. ■

Tri-State Venture Capital Financings – 2005 to 2023



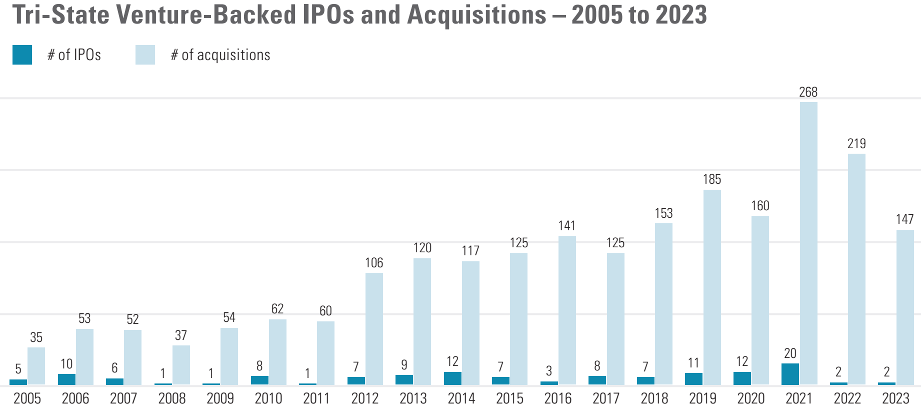
Source: PitchBook

Tri-State Venture Capital Financings by Selected Industry – 2005 to 2023



Source: PitchBook

Tri-State Venture-Backed IPOs and Acquisitions – 2005 to 2023



Source: SEC filings and PitchBook

Counsel of Choice for Venture Capital Financings

Serving market leaders in technology, life sciences, financial services and a wide variety of other industries

Aleph	$11,500,000	*First Round*	September 2023
ampcontrol	$10,000,000	*First Round*	June 2023
BusRight	$10,600,000	*Seed*	May 2023
conta simples	$41,500,000	*Second Round*	December 2023
gaia	$3,000,000	*Seed*	November 2022
Georgiamune	$75,000,000	*First Round*	August 2023
HawkEye 360	$68,000,000	*Late Stage*	October 2023
JUMBA	$4,535,000	*Seed*	February 2023
Magnet Biomedicine	$19,200,000	*Seed*	August 2023
GLASS HEALTH	$5,000,000	*Seed*	September 2023
SIERRA SPACE	$290,000,000	*Second Round*	September 2023
Smile ID	$19,800,000	*Second Round*	February 2023
LIND AI	$5,500,000	*Seed*	December 2023
UPLAND PLAY. EARN. CONNECT.	$7,000,000	*First Round*	October 2023
volastra	$60,000,000	*First Round*	March 2023
ZERO EMISSION INDUSTRIES	$10,000,000	*First Round*	August 2022
EQUII	$6,000,000	*Seed*	September 2022
PHANTOM NEURO	$6,000,000	*Seed*	September 2022
respira	$25,900,000	*First Round*	November 2022
thirdweb	$24,000,000	*First Round*	July 2022
butlr	$20,000,000	*First Round*	May 2022
ALETHEA	$17,250,000	*Second Round*	November 2023
GIVECAMPUS	$50,000,000	*First Round*	July 2022
ORNA	$221,000,000	*Second Round*	August 2022
FLARE THERAPEUTICS	$123,350,000	*Second Round*	February 2023
AURON THERAPEUTICS	$48,250,000	*First Round*	July 2022
SONDE	$19,250,000	*Second Round*	May 2022
X-BOW	$27,000,000	*First Round*	April 2022
FERVO ENERGY	$138,000,000	*Third Round*	August 2022
Dedrone	$30,000,000	*Third Round*	July 2022
PREVEIL	$20,350,000	*Third Round*	June 2022
OWL LABS	$25,000,000	*Fourth Round*	May 2022
IMMUTA	$100,000,000	*Late Stage*	June 2022
ASI AIR SPACE INTELLIGENCE	$34,000,000	*Second Round*	December 2023

Over time, there have been huge shifts in the amount of financing required to start and scale businesses. Advances such as cloud computing and open-source software have enabled technology startups to commence and grow their operations with less funding than historically required, while launching life sciences companies and AI-driven companies can remain a capital-intensive process.

2015 was the first year to see 100 rounds in which companies raised $100 million or more in venture financing. Increased participation by growth equity, crossover and hedge funds attracted by the lure of pre-IPO companies offering the potential for outsized returns contributed to the number of rounds in which companies raised so-called “mega-rounds” of $100 million or more jumping from 113 in 2015 to 843 in 2021.

The slowdown in the venture market since the frothy apex of valuations in 2021 has resulted in the number of rounds in which companies raised $100 million or more falling to 269 in 2023. While this tally is approximately one-third of the 2021 total, it still remains slightly ahead of 2019. What remains unknown is whether 2023’s results are a return to historical trends or there will be continued reduction in mega-rounds in 2024.

2023 was the first year in recent history to see a greater number of financing rounds of $100 million or more for healthcare and life sciences companies than technology companies. In 2023, healthcare and life sciences companies accounted for 34% of financing rounds of $100 million or more, compared to 29% for technology companies. By comparison, healthcare and life sciences companies accounted for only 21% of such rounds in 2019.

Artificial intelligence and machine learning companies (which encompass companies across industries) accounted for 21% of financing rounds of $100 million or more in both 2021 and 2022, and 25% of financing rounds of $100 million or more in 2023.

With the number of mega-rounds unlikely to see a sizable increase in the coming year, deliberation of alternative exit strategies is likely to become more pressing for many companies. ■

Number of Large Rounds by Venture Financing Threshold

YEAR	$50 MILLION	$100 MILLION	$200 MILLION	$250 MILLION	$500 MILLION	$1 BILLION
2019	623	262	91	68	20	6
2020	787	340	118	80	25	5
2021	1,618	843	325	210	66	20
2022	1,100	532	169	102	27	7
2023	612	269	94	70	19	10
2019 to 2023	4,740	2,246	797	530	157	48

Number of Companies Raising Venture Financing Rounds of $100 Million or More by State of Company Headquarters

YEAR	CALIFORNIA	NEW YORK	MASS-ACHUSETTS	TEXAS	WASHINGTON	COLORADO	FLORIDA	US TOTAL
2019	136	34	25	7	7	3	4	262
2020	180	39	37	14	10	5	2	340
2021	393	133	92	27	25	21	15	843
2022	237	71	64	19	16	15	16	532
2023	113	37	47	9	5	13	1	269
2019 to 2023	1,059	314	265	76	63	57	38	2,246

Number of Companies Raising Venture Financing Rounds of $100 Million or More by Industry Group and in Artificial Intelligence & Machine Learning

YEAR	B2B	B2C	FINANCIAL SERVICES	HEALTHCARE	TECHNOLOGY	OTHER	US TOTAL	AI & MACHINE LEARNING
2019	31	55	19	56	95	6	262	51
2020	26	46	26	111	123	8	340	57
2021	80	91	66	217	363	26	843	174
2022	47	47	45	129	233	31	532	111
2023	38	19	20	92	85	15	269	68
2019 to 2023	222	258	176	605	899	86	2,246	461

Say Goodbye to Noncompetes?

It is an employer's worst nightmare: to learn not only that the employee who quit yesterday is joining a direct competitor but also that there is nothing the employer may legally do to stop it. Recent developments in the law have increasingly made this nightmare a reality.

BACKGROUND

A post-employment noncompete is a contractual term between an employer and an employee that prohibits the employee, for a specified time after the employee's cessation of employment, from competing with the employer.

According to the Federal Trade Commission (FTC), about one in five American workers is bound by a noncompete. And, historically, the vast majority of states (notably excluding California) have enforced these restrictions as long as they were reasonably limited in geographic scope and duration. In recent years, many states have cracked down on employee noncompetes, even beyond limiting their permitted geographic scope and duration. Now the federal government is looking to prohibit their use too.

STATE RESTRICTIONS

Noncompete Bans

A small but growing minority of states —currently California, Oklahoma, North Dakota and Minnesota—have banned noncompetes for employees and independent contractors, with only limited exceptions (such as in the sale-of-business context). These bans prohibit these restrictions and render them void and unenforceable, regardless of an individual's level of compensation, access to sensitive confidential information, and/or willingness to agree to the restriction.

The New York State Assembly also passed a bill in June 2023 that would have banned noncompetes without exception, but it was ultimately vetoed by the governor after a great amount of press attention and employer outcry. It is expected that revised noncompete legislation will be introduced.

Salary Thresholds

Several states, including Colorado, the District of Columbia, Illinois, Maryland, Maine, New Hampshire, Oregon, Rhode Island, Virginia and Washington, have adopted laws that ban noncompetes for any employee who earns less than a salary threshold set by the state. These laws make no exception for startups, which often will not have the resources to pay employees (including founders) the required threshold amount.

Notice Requirements

Some of the salary threshold states as well as others (including the District of Columbia, Oregon, Colorado, Virginia, Illinois, Washington, Maine, New Hampshire and Massachusetts) require that employers seeking to enter into noncompetes adhere to certain strict notice obligations, and hold void and unenforceable noncompetes entered into without the required notice. For example, Massachusetts requires that an employee receive a copy of the noncompete at least 10 business days before an employee's start date.

The complexity and variation among these laws means that employers are at risk that small timing errors made at an employee's commencement of employment may result in an otherwise permissible noncompete being found void and unenforceable.

Position-Based Restrictions

Finally, certain states have opted, sometimes in addition to the above restrictions, to limit the types of employees who may be bound by a noncompete. For example, Massachusetts only permits noncompetes with exempt employees over the age of 18 who are not engaged as interns.

THE FTC'S POSITION

On January 5, 2023, the FTC jumped into the fray, proposing a new rule that would not only ban new noncompetes but also void existing ones, superseding any state statute, regulation, order or interpretation to the extent it is inconsistent with the rule. The FTC's theory is that noncompetes reduce workers' wages (even for those not subject to noncompetes) and restrain innovation and economic liberty. The Commission has concluded that, by preventing the formation of competing businesses and the creation of innovative ideas, consumers are ultimately harmed.

After having invited public comment, the FTC is scheduled to announce its decision on the proposed rule in April 2024.

THE NLRB'S POSITION

Last but not least, the National Labor Relations Board (NLRB) has also been paying close attention to noncompetes. In May 2023, the NLRB's General Counsel published a memorandum announcing her opinion that most noncompetes violate the National Labor Relations Act (NLRA). Then, in September 2023, in a first-of-its-kind action, the Regional Director of NLRB Region 9 (Cincinnati) filed a complaint against Juvly Aesthetics, alleging that the company violated the NLRA by requiring that its employees sign restrictive covenant agreements containing post-employment noncompetes. We are awaiting the decision in this case.

WHAT CAN EMPLOYERS DO?

Without a crystal ball, the future for employee noncompetes remains unknown. Employee noncompetes are under attack and are expected to continue being under attack for the foreseeable future. Employers are advised to review their existing employee arrangements and do the following:

- Re-evaluate existing noncompetes and tailor them for the employee being hired.
- Ensure that every employee signs a confidentiality and assignment of inventions agreement, which are forms enforced by courts in all states.
- Consider a non-solicitation of customers provision, which are enforced in most states.
- Consider imposing employee non-solicitation provisions, which are enforced in most states (but not always in California).
- Revisit compensation packages to ensure that employees stay loyal.

While there is no one-size-fits-all solution, employers should consult with their counsel who can guide them through the various rules to ensure that their businesses are as protected as possible. ■

Stock options are a critical component of any venture-backed company's ability to recruit, incentivize and retain key talent. However, when options have exercise prices that are higher than the fair market value of the underlying stock (i.e., when the options are "underwater"), they lose most, if not all, of their incentive and retentive value. To avoid the loss of key employees who are instrumental in the company's future success, a company may determine that a repricing of underwater options is necessary.

For most private companies, a repricing is often as simple as reducing the exercise price of all outstanding underwater options held by current service providers to the current fair market value of the underlying stock. Generally, other than reducing the exercise price, all other terms of the repriced options—including their vesting and acceleration provisions and their original expiration dates—are left unchanged. Even in such a straightforward structure, however, there are a number of business and legal considerations that a private company must balance as it evaluates whether and how to implement a repricing, including the (often surprising) consideration that the consent of the option holders may be required.

KEY CONSIDERATIONS

Tax Considerations

Under US federal tax law, in order to get the benefit of preferential incentive stock option (ISO) tax treatment, an option holder must sell stock received upon exercise of an ISO on a date that is more than two years after the ISO was granted and more than one year after it was exercised. Because the amendment of an ISO to reduce its exercise price is treated as the grant of a new option for US tax purposes, the two-year waiting period will start over when the repricing occurs. In addition, the aggregate fair market value of all ISOs granted to an employee that become "first exercisable" in any calendar year cannot exceed $100,000 (with fair market value for this purpose being the fair market value of the company's stock on the date of grant of the options). If an option is repriced, the $100,000 rule requires that both (i) any portion of the original option that is or would become first exercisable in the year of the repricing and (ii) any portion of the repriced option that is or becomes first exercisable in the year of the repricing, be applied against the $100,000 limit for that year. The effect of this recalculation of the $100,000 limitation can cause all or a portion of an option that previously qualified as an ISO to become a nonstatutory stock option (NSO) and, as a result, lose the potential to receive preferential tax treatment.

For most private companies, a repricing is often as simple as reducing the exercise price of all outstanding underwater options held by current service providers to the current fair market value of the underlying stock.

As long as the exercise price of the repriced option is set at or above the fair market value of the underlying stock on the effective date of repricing, the repricing should not cause any issues under Section 409A of the Internal Revenue Code. However, the company should have a recent Section 409A valuation prepared by an independent valuation firm to assist in determining the exercise price for the repriced options, and as with any determination of fair market value, the company's board must take all additional relevant factors into account as well. Further, to avoid an option being characterized as having a "floating" exercise price (and thus violating Section 409A), a company should not effect multiple or serial repricings. Therefore, before embarking on any repricing, a company should carefully consider whether it has already effected an option repricing or whether it expects the fair market value of the underlying stock to fall further, such that another repricing may become necessary in the near future.

Securities Law Compliance

A private company must ensure that the grant of the repriced options, which is treated as the grant of new options for securities law purposes, in an option repricing is exempt from registration under the Securities Act of 1933. This is typically achieved pursuant to the exemption provided by Rule 701 (and sometimes supplemented by exemptions under Section 4(a)(2), Regulation D and/or Regulation S). The company's Rule 701 analysis should be revisited prior to completing the repricing, as Rule 701 sets specified dollar-value and share number limitations on the amount of equity awards that can be granted in any 12-month period. Large-scale repricings can sometimes result in proposed repriced options exceeding the relevant limitations imposed by Rule 701. In these situations, companies may need to consider either cutting back the scope of the repricing or finding alternative exemptions that would cover some of the newly repriced options.

Accounting Treatment

A repricing may result in significant new compensation charges, in addition to the ongoing compensation charges associated with the canceled options (which are not eliminated upon the repricing), and thus the company's accountants should be consulted before proceeding with a repricing.

Consent Considerations

Subject to review of the company's stock incentive plans and any applicable investor agreements, stockholder consent is typically not required for a private company to reprice stock options. Whether an option holder's consent to a repricing is required will generally be dictated by the terms of the company's stock incentive plans and forms of award agreement under those plans. Some plans or award agreements prohibit any amendment to options without the consent of the option holder. Other plans and agreements may permit amendment without the consent of the option holder, but only to the extent that the company's board of directors determines that the amendment will not have a material adverse effect on the option holder.

In virtually all cases where the company proposes to change the vesting schedule, the number of shares subject to the option or the plan under which the repriced option is granted, the consent of the option holder will be required. By contrast, where the only change to an outstanding NSO is that the option exercise price is to be reduced, the consent of the participant is rarely required. In most circumstances where the repricing will cause some or all of a participant's ISOs to cease to be ISOs by application of the $100,000 ISO rule (described above), the consent of the participant will be required. A more nuanced question is whether the repricing's restarting of the ISO waiting period (described above) is an adverse consequence that would require the consent of the participant, because preferential ISO treatment may be more difficult to attain as a result of the repricing. Making this determination requires a careful reading of the plan and award agreements to confirm exactly what types of amendments would require the consent of the option holders, as well as an assessment by the board of directors as to the timeline to a potential liquidity event, the type of liquidity event, the likelihood of participants exercising options in advance of a liquidity event and other relevant factors. The determination of what consent, if any, will be required from eligible participants is critical to determining how the repricing will be completed.

THE REPRICING PROCESS

Preliminary Matters

Prior to obtaining board approval of any option repricing, the company should consult with its human resources team, legal counsel, accountants and third-party valuation specialists to assess the scope of any repricing and any practical impediments that could limit the company's ability to complete a repricing. A valuation can take several weeks to complete, and an updated Rule 701 analysis can also require some lead time and iteration if the facts surrounding the repricing are complicated. Appropriate involvement from human resources or equity plan administrators can help evaluate whether any changes to awards will create appropriate incentives and retention structures for the company's employees.

Board Approval

The company's board, or a duly authorized committee of the board, must approve the terms of any option repricing program. Any such approval must be made after the board (or the committee of the board) carefully considers the need for, and the costs of, the repricing. In connection with that approval, the board will need to determine the company's fair market value in compliance with Section 409A as of the date it approves entry into the repricing to ensure that the proposed exercise price of the repriced options is at least equal to the then-current fair market value. If the repricing is structured as a tender offer, the board will also need to determine the fair market value in compliance with Section 409A again upon the close of the tender offer period.

Documenting the Repricing

The documents necessary to effect the repricing depend in large part on the extent to which participant consent is required:

— If consent from more than a limited number of option holders is required, the company will have to comply with the SEC's tender offer rules for the repricing. The company must provide adequate disclosure to eligible participants regarding the nature of the repricing and provide an offering period that is open for at least 20 business days (but, to comply with the ISO regulations, less than 30 calendar days) to elect whether to participate in the repricing. The company also cannot change certain terms of the repricing, such as the scope of the repricing or the terms of the repriced options, during the pendency of the tender offer, and the repricing itself is subject to the anti-fraud provisions of the SEC's tender offer rules. The repricing will be effective on the date of board approval of the then-current fair market value of the underlying stock following the expiration of the tender offer period.

— If consent is required from only a limited number of option holders, the company will need to provide adequate disclosure to eligible option holders, similar to the disclosure that would be required for a tender offer. Some period of time in which to consent to the repricing must be provided, but that period of time should be short enough that the fair market value is unlikely to change before its expiration. Generally, three to five business days is an appropriate window in which to allow option holders to decide whether to participate in the repricing. The repricing will be effective on the date on which the eligible participant consents to the repricing.

— If consent from an eligible participant is not required, the board may unilaterally approve the repricing of options. In such case, the company will typically provide a letter to eligible participants notifying them that their options have been repriced and the rationale for and key terms of the repricing. Some companies also choose to include additional information (such as a set of frequently asked questions) to anticipate participant questions. The repricing will be effective on the date on which the board approves the repricing or such other date as may be specified in the board approval.

> The determination of what consent, if any, will be required from eligible participants is critical to determining how the repricing will be implemented.

Post-Repricing Recordkeeping

The repricing documents described above may, for those participants whose options were unilaterally repriced or who elected to consent to the repricing, serve as amendments to outstanding option award agreements. With that in mind, the company's stock option records and ledgers (whether maintained by the company or by a third party on an electronic platform) should be updated to reflect the repricing and care should be taken to ensure that any new ISO/NSO splits are properly reflected.

CONCLUSION

Unlike option repricings in the public company context, undertaking a private company repricing can be a fairly straightforward endeavor. However, care must be taken to ensure that the repricing is effected at a time when the company believes the stock has "bottomed out," that the terms of the repricing will appropriately incentivize and retain the company's key service providers, and, most critically of all, that the extent of any required participant consent is identified and obtained in accordance with the governing plan documents and applicable law. ■

Choose Your Investor Wisely—Financing Considerations for Defense Tech Startups

Navigating the booming defense technology subsector of the emerging company ecosystem requires careful planning and execution. Beyond putting together a trusted team and developing a uniquely marketable product, defense tech startups should carefully consider how to choose potential investors, who may also become their commercial partners.

SIGNIFICANT CAPITAL INFLOWS INTO THE DEFENSE TECH SECTOR

By the numbers, the growth of defense tech within the venture capital landscape stands out.

Based on Data Provided by Pitchbook:

(i) from 2022 to 2027, the U.S. defense tech market is projected to grow to nearly $185 billion at a compound annual growth rate of 15.9%;

(ii) from 2016 to 2022, the defense tech sector saw $135 billion invested across 4,744 deals, with acquisitions accounting for 71% of defense tech VC exits; and

(iii) US venture investment in defense startups surged from less than $16 billion in 2019 to $33 billion in 2022, with an additional $14.5 billion in Q1 2023.

The sector's expansion is partially explained by its versatility, since defense tech is often dual-use, meaning it can serve both defense and commercial purposes. Dual-use technology can broaden the financing options available to a defense tech startup, allowing for government funding options otherwise unavailable to purely commercial endeavors. Escalation of multiple global conflicts in recent years prioritized the US military's interest in funding defense-applicable technology, with a special focus on emerging dual-use technologies such as artificial intelligence, software, semiconductors, and renewable energy generation and storage.

CHOOSING YOUR FUNDING SOURCE

Founders of defense tech startups should consider including experienced advisors from the time of incorporation forward to help identify risks specific to the evolving landscape. With government funding options and institutional venture capital as potential alternatives, startups must remember that the source of financing can be mission-critical. Beyond determining the financing instruments for raising capital, startups should seek investors experienced with government customers.

Protect Your Capitalization Table

The defense tech startup should consider how inclusion of certain investors on its capitalization table may negatively impact or prevent altogether opportunities necessary for success. For instance, startups must pay attention to regulatory issues related to foreign investment, especially considering bipartisan sensitivity around foreign investment in companies with a nexus to the defense sector. The presence of foreign investors on a company's capitalization table might negatively impact future business with government customers. Additionally, the Committee on Foreign Investment in the United States (CFIUS) has significant power to review certain types of foreign investment in US companies before or after closing, which may introduce delays or regulatory obstacles. Because CFIUS jurisdiction can be so far-reaching, it is important to consider in advance whether a particular prospective investment may generate regulatory obstacles with regard to the investment or future obstacles with regard to the US company's operations.

Further, consider whether an investor seeks purely financial returns or has strategic interests as well. While most venture capital investors will have purely financial motivations, strategic investors or investors with comparable portfolio companies may have complicated intentions. For example, if a strategic investor is contemplating a commercial arrangement as well, a company should consider the consequences of the prospective commercial arrangement going sideways, since the strategic investor would likely remain on the capitalization table, may maintain a board seat, and may even hold a right of first offer in an exit scenario. This can decrease the company's negotiating leverage or even wholly preclude interest from future strategic investors, commercial partners or potential acquirers.

Consider an Investor's Experience and Reputation

Whether considering funding from equity investors or venture lenders, companies should review an investor's experience and reputation with government customers and the defense industry and within the greater venture capital landscape. When a defense tech startup has alternatives, it should focus on investors with experience working with government customers and knowledge of the regulatory hurdles. It is desirable that the investor understand the federal acquisition process, the challenges associated with it, and the patience required to grow, including overcoming the proverbial "Valley of Death."

CERTAIN FUNDING PROGRAMS AVAILABLE TO DEFENSE TECH STARTUPS

Small Business Innovation Research (SBIR): An R&D program that facilitates opportunities for US-owned and controlled businesses with 500 or fewer employees to propose new concepts to federal agencies.

Small Business Technology Transfer (STTR): A federal program that partially funds cooperative R&D between small businesses and research institutions, built on a three-phase structure similar to SBIR's program.

Other Transaction Agreements (OTAs): Research and prototype development arrangements designed to invite the participation of nontraditional government contractors.

Defense Innovation Unit (DIU): The lone DoD organization focused exclusively on fielding and scaling commercial technology across the U.S. military at commercial speeds.

In-Q-Tel: A not-for-profit venture capital firm partnered with the CIA.

Defense Innovation Accelerator for the North Atlantic (DIANA): An accelerator program under NATO that provides companies with access to grants to support technology development and demonstration.

Investors with a solid reputation with government customers, lenders, other investors and their portfolio companies bring benefits. Those investors can attract government contractors who have worked with their other portfolio companies. Similarly, strategic investors can create immediate credibility with the government customer and the investment community, along with access to the strategic investor's knowledge, technology and assets.

Funding From Government Programs—Pros and Cons

When receiving funding directly from the government, defense tech startups should consider what they want in return. Derived from taxpayers, government funds are subject to specific guidelines to ensure deployment in accordance with legal and budgetary guidelines. Further, where startups receive research and development funding from the government, they should consider how that may impact their ownership and use of intellectual property generated from those efforts. There are multiple government funding programs to consider.

Debt Options – Classic Venture Debt and Defense-Specific Lending

As with other startups, debt financing can be a viable option in the defense tech space. Loans are non-dilutive, though venture loans will typically come with a warrant exercisable for shares of common or preferred stock of the company. Further, loans may be a helpful way to extend the runway prior to a preferred stock financing. For startups that have already raised an equity financing, there may be adequate collateral to secure a loan at favorable rates. However, most startups in the early stages lack the necessary assets or revenues to favorably secure or afford the costs related to servicing such loans, making equity investments more attractive.

In recent years, industry-specific lending models have emerged, including government invoice factoring and government contract financing. Government invoice factoring is a type of financing option that allows government contractors to sell their unpaid invoices to a third party at a discount. Essentially, the factoring company advances the company a portion of the invoice amount and then collects payment from the government agency on the company's behalf. Government contract financing, unlike invoice factoring, is not based on the value of the unpaid invoices but instead based on the estimated revenue of the company's current and upcoming approved government contracts. ■

REGULATORY FOCUS ON FOREIGN INVESTMENT IS GROWING

There is greater scrutiny today on inbound and outbound foreign investment than at any time in the past several decades. CFIUS has more authorities than it enjoyed in the past and is using those authorities to scrutinize current and past investments across a range of economic sectors. At the same time, the Biden Administration has announced plans to develop an "outbound CFIUS" regime. Last summer the Biden Administration issued an Executive Order on Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern, which will create a new set of rules around "outbound investments" in certain high-technology industries focused on the People's Republic of China (PRC).

The outbound CFIUS executive order, which is the first step in the creation of an outbound investment review regime, asserts that there is a "national emergency" posed by "countries of concern" pursuing "sensitive technologies and products critical for the military, intelligence, surveillance, or cyber-enabled capabilities." It identifies China and its Special Administrative Regions of Macau and Hong Kong as the only countries of concern.

There's every reason to believe that scrutiny around foreign investment (inbound and outbound) will continue to be heightened for the foreseeable future. Indeed, there is generally bipartisan agreement that foreign investment needs to be more regulated and that Chinese investment is particularly fraught.

Other regulators are likewise taking action. The Select Committee on China recently entitled released a long-awaited report "How American Venture Capital Fuels the PRC Military and Human Rights Abuses." The report focuses on the ways in which US venture capital investments into the Chinese artificial and semiconductor sectors purportedly enhance China's People's Liberation Army, embolden "digital authoritarianism" and "undermine American technological leadership."

The reach of attention goes beyond traditional defense technologies. In addition to its report on VC activity, the Select Committee on China is pursuing "field hearings" in the life science technology corridor around Boston to examine United States-China competition in biotech, purported US dependency on China for pharmaceuticals, and China's ambitions to dominate the advanced biotech and life science sectors. The Committee's trip to Boston underscores widespread sentiment in Washington that America's advanced life science companies need special protection from Chinese encroachment.

The Defense Department is pursuing a "name and shame" approach to highlight Chinese investment activity in the United States. For example, the Department of Defense (DoD) recently released an updated list of alleged Chinese military companies (CMC) operating in the United States. The list is part of an effort that DoD describes as critical to countering efforts by China to enhance the PLA's military capacity:

> Updating the Section 1260H list of "Chinese military companies" is an important continuing effort in highlighting and countering the PRC's Military-Civil Fusion strategy. The PRC's Military-Civil Fusion strategy supports the modernization goals of the People's Liberation Army (PLA) by ensuring it can acquire advanced technologies and expertise developed by PRC companies, universities and research programs that appear to be civilian entities. Section 1260H directs the Department to begin identifying, among other things, Military-Civil Fusion contributors operating directly or indirectly in the United States.

Together, all these developments highlight an ongoing, bipartisan push in Washington to aggressively counter Chinese investment in the United States, as well as American investment in critical Chinese sectors.

Trends in Convertible Note and SAFE Terms

Based on hundreds of convertible note and SAFE (simple agreements for future equity) financing transactions we handled from 2019 to 2023 for companies and investors, we have compiled the following deal data:

		2019	2020	2021	2022	2023
Deals With Purchase Agreement		**2019**	**2020**	**2021**	**2022**	**2023**
If included, a purchase agreement typically contains representations and warranties from the company (and possibly the founders).	% of deals	63%	36%	50%	38%	53%
Term*		**2019**	**2020**	**2021**	**2022**	**2023**
The term of the convertible note before it matures.	Median Range	17 mos. 12–36 mos.	24 mos. 5–48 mos.	12 mos. 4–36 mos.	12 mos. 10–60 mos.	24 mos. 3–32 mos.
Interest Rate*		**2019**	**2020**	**2021**	**2022**	**2023**
The rate at which interest accrues during the term of the convertible note.	Median Range	6% 3%–15%	5% 0.2%–8.5%	5% 0.2%–8%	6% 1.3%–8%	8% 5%–15%
Deals With Security Interest*		**2019**	**2020**	**2021**	**2022**	**2023**
Convertible note investors sometimes require the company to provide a security interest in company assets.	% secured % unsecured	18% 82%	11% 89%	0% 100%	0% 100%	3% 97%
Deals With Conversion Discount		**2019**	**2020**	**2021**	**2022**	**2023**
Convertible note and SAFE investors often require that conversion in connection with an equity financing be at a discount from the price paid by new investors in the financing. A conversion discount is often coupled with a cap on the valuation at which conversion occurs.	% of deals Range of discounts % with ≤ 20% discount % with > 20% discount % with valuation cap	70% 10%–25% 95% 5% 42%	89% 15%–40% 92% 8% 40%	85% 10%–35% 94% 6% 35%	63% 10%–30% 87% 13% 47%	66% 10%–50% 71% 29% 57%
Deals With Conversion Upon Maturity*		**2019**	**2020**	**2021**	**2022**	**2023**
If a convertible note is outstanding at the time of maturity and is not otherwise paid upon maturity, it often converts into shares of the company's common stock or preferred stock. This conversion is most often at the election of the investor but may be mandatory.	% of deals % with optional conversion % with mandatory conversion % that convert into: common stock preferred stock	55% 92% 8% 33% 67%	53% 90% 10% 11% 89%	59% 80% 20% 10% 90%	46% 50% 50% 33% 67%	77% 88% 12% 12% 88%
Deals With Conversion Upon Company Sale		**2019**	**2020**	**2021**	**2022**	**2023**
If a convertible note or SAFE is outstanding at the time of a sale of the company, it often converts into shares of the company's common stock or preferred stock. This conversion is most often at the election of the investor but may be mandatory.	% of deals† % with optional conversion % with mandatory conversion % that convert into: common stock preferred stock	56% 73% 27% 67% 33%	32% 78% 22% 50% 50%	50% 90% 10% 80% 20%	21% 80% 20% 60% 40%	50% 94% 6% 31% 69%
Deals With Repayment Premium Upon Company Sale		**2019**	**2020**	**2021**	**2022**	**2023**
Convertible note and SAFE investors may require that they receive a multiple of the outstanding investment amount in connection with a sale of the company.	% of deals† Median premium Range of premiums	37% 2x 1.5x–3x	43% 2x 1.5x–3x	50% 2x 1.25x–2.5x	29% 1.5x 1.25x–2.0x	53% 2x 1.5x–4.0x
Deals With Warrant Coverage		**2019**	**2020**	**2021**	**2022**	**2023**
Investors sometimes receive a warrant in addition to their note or SAFE. The amount of company stock covered by the warrant is usually proportional to the investment amount, referred to as the warrant coverage.	% of deals Coverage range % that cover common % that cover preferred % that cover common or preferred (depending on the circumstances)	15% 10%–35% 50% 25% 25%	0% N/A N/A N/A N/A	5% 25% (one deal) 100% 0% 0%	0% N/A N/A N/A N/A	16% 50%–100% 60% 40% 0%

* Excludes SAFEs, which by their nature do not have maturity dates, interest rates or security interests.

† Excluding SAFEs, 50%, 42%, 53%, 38% and 73% of convertible note transactions included conversion upon company sale and 45%, 63%, 53%, 54% and 77% of convertible note transactions included a repayment premium upon company sale for each of the years 2019 through 2023, respectively.

Trends in Venture Capital Financing Terms

Based on hundreds of venture capital financing transactions we handled from 2019 to 2023 for companies and investors, we have compiled the following deal data:

Deals With Multiple Liquidation Preferences

A "multiple liquidation preference" entitles holders of preferred stock to receive more than 1x their money back before sale or liquidation proceeds are distributed to holders of common stock.

	2019	2019 Range	2020	2020 Range	2021	2021 Range	2022	2022 Range	2023	2023 Range
First round	2%	1.5x (one deal)	0%	N/A	0%	N/A	0%	N/A	0%	N/A
Post–first round	4%	1.5x–2x	3%	1.5x–2.25x	0%	N/A	2%	2x–3x	8%	1.5x–2x

Deals With Participating Preferred Stock

"Participating preferred" stock entitles holders to receive a stated liquidation preference plus a pro rata share (on an as-converted basis) of any remaining proceeds available for distribution to holders of common stock.

	2019	2019 Range	2020	2020 Range	2021	2021 Range	2022	2022 Range	2023	2023 Range
First round										
Total	14%		9%		9%		4%		5%	
Capped	38%	1x–3x	80%	2x–3x	20%	3x (one deal)	0%	N/A	100%	3x (one deal)
Post–first round										
Total	11%		10%		6%		10%		16%	
Capped	17%	1.6x–3.5x	22%	1.25x–2x	29%	2x–2.5x	30%	1.5x–3.5x	10%	3x (one deal)

Deals With an Accruing Dividend

"Accruing dividends" are generally payable upon liquidation or redemption of the preferred stock, effectively increasing the liquidation preference of the preferred stock.

	2019	2020	2021	2022	2023
First round	10%	9%	5%	2%	14%
Post–first round	15%	8%	11%	10%	18%

Anti-Dilution Provisions

A "full ratchet" anti-dilution formula provides that the conversion price of the preferred stock will be reduced to the price paid in the dilutive issuance, regardless of how many shares are involved in the dilutive issuance. In contrast, a "weighted average" anti-dilution formula takes into account the dilutive impact based upon the number of shares and the price involved in the dilutive issuance and the number of shares outstanding before and after the dilutive issuance.

	2019	2020	2021	2022	2023
First round					
Full ratchet	0%	2%	0%	2%	0%
Weighted average	100%	98%	100%	98%	100%
Post–first round					
Full ratchet	2%	0%	0%	3%	2%
Weighted average	98%	100%	100%	97%	98%

Deals With Pay-to-Play Provisions

"Pay-to-play" provisions provide an incentive to investors to invest in future rounds of financing. Investors that do not purchase their full pro rata share in a future round lose certain rights (e.g., their shares of preferred stock may be converted into common stock at the then-applicable conversion rate or a more punitive rate, and they may lose director designation, registration or other rights).

	2019	2020	2021	2022	2023
Total	8%	3%	3%	2%	12%
% of total that convert into common stock	92%	100%	83%	100%	100%
% of total that convert into another series of preferred stock	8%	0%	17%	0%	0%

Explanatory Note: "First round" refers to a company's first-priced preferred stock financing regardless of round designation.

Trends in VC-Backed Company M&A Deal Terms

We reviewed all merger transactions between 2019 and 2023 involving VC-backed targets (as reported in PitchBook after 2019 and in Dow Jones VentureSource or PitchBook for 2019) in which the merger documentation was publicly available and the deal value was $25 million or more. Based on this review, we have compiled the following deal data:[1]

Characteristics of Deals Reviewed		2019	2020	2021	2022	2023
The number of deals we reviewed and the type of consideration paid in each	Sample Size	20	25	45	22	15
	Cash	60%	60%	24%	41%	40%
	Stock	0%	8%	18%	5%	20%
	Cash and Stock	40%	32%	58%	54%	40%
Deals With Earnout		**2019**	**2020**	**2021**	**2022**	**2023**
Deals that provided contingent consideration based upon post-closing performance of the target, achievement of milestones by the target or other contingencies concerning the value of target (other than balance sheet adjustments)	With Earnout	40%	28%	42%	41%	27%
	Without Earnout	60%	72%	58%	59%	73%
Deals With Indemnification		**2019**	**2020**	**2021**	**2022**	**2023**
Deals where the target's shareholders or the buyer indemnified the other post-closing for breaches of representations, warranties and covenants	With Indemnification					
	By Target's Shareholders	80%	88%	76%[2]	86%	67%
	By Buyer	45%	32%	29%	68%	47%
Deals With Representation and Warranty Insurance		**2019**	**2020**	**2021**	**2022**	**2023**
Deals that expressly contemplate representation and warranty insurance	With Representation and Warranty Insurance	25%	68%	47%	50%	33%
Survival of Representations and Warranties		**2019**	**2020**	**2021**	**2022**	**2023**
Length of time that representations and warranties survived the closing for indemnification purposes (subset: deals where representations and warranties survived the closing for indemnification purposes)[3]	Shortest	12 Mos.	12 Mos.	12 Mos.	12 Mos.	12 Mos.
	Longest	24 Mos.	18 Mos.	24 Mos.	24 Mos.	24 Mos.
	Most Frequent	18 Mos.	12 Mos.	12 Mos.	12 Mos.	12 & 18 Mos. (tie)
Caps on Indemnification Obligations		**2019**	**2020**	**2021**	**2022**	**2023**
Upper limits on indemnification obligations where representations and warranties survived the closing for indemnification purposes	With Cap	100%	100%	100%	100%	100%
	Limited to Escrow[4]	86%	81%	90%	78%	80%
	Limited to Purchase Price	0%	0%	0%	0%	0%
	Exceptions to Limits[5]	100%	95%	100%	89%	100%
	Without Cap	0%	0%	0%	0%	0%

[1] For certain transactions, certain deal terms have been redacted from the publicly available documentation and are not reflected in the data compiled in this table.

[2] Excludes two transactions that do not provide for indemnification but permit setoff against contingent consideration.

[3] Measured for representations and warranties generally; specified representations and warranties may survive longer.

[4] Includes two transactions in 2021 and one transaction in 2023 where the limit was below the escrow amount.

[5] Generally, exceptions were for fraud, willful misrepresentation and certain "fundamental" representations commonly including capitalization, authority and validity. In a limited number of transactions, exceptions also included intellectual property representations.

Escrows		2019	2020	2021	2022	2023
Deals having escrows securing indemnification obligations of the target's shareholders (subset: deals with indemnification obligations of the target shareholders)	With Escrow	94%	90%	91%	89%	90%
	% of Deal Value					
	Lowest[6]	10%	8%	5%	7%	5%
	Highest	13%	15%	18%	15%	10%
	Most Frequent	12%	15%	10%	8%	6%
	Length of Time[7]					
	Shortest	12 Mos.	12 Mos.	12 Mos.	12 Mos.	12 Mos.
	Longest	36 Mos.	24 Mos.	36 Mos.	30 Mos.	24 Mos.
	Most Frequent	12 Mos.	12 Mos.	12 Mos.	12 Mos.	12 & 18 Mos. (tie)
	Exclusive Remedy	64%	68%	53%	73%	56%
	Exceptions to Escrow Limit Where Escrow Was Exclusive Remedy[5]	100%	92%	100%	91%	100%

Baskets for Indemnification		2019	2020	2021	2022	2023
Deals with indemnification only for amounts above a specified "deductible" or only after a specified "threshold" amount is reached	Deductible	56%	52%[8]	71%[9]	53%[8]	80%
	Threshold	44%	29%[8]	26%[9]	32%[8]	10%

MAE Closing Condition		2019	2020	2021	2022	2023
Deals with closing condition for the absence of a "material adverse effect" with respect to the other party, either explicitly or through representation brought down to closing	Condition in Favor of Buyer	100%	100%	97%	100%	91%
	Condition in Favor of Target	35%	24%	37%	29%	18%

Exceptions to MAE		2019	2020	2021	2022	2023
Deals where the definition of "material adverse effect" for the target contained specified exceptions	With Exception[10]	100%	100%	95%[11]	100%	100%

[6] Excludes transactions that also specifically referred to representation and warranty insurance as recourse for the buyer.
[7] Length of time does not include transactions where such time period cannot be ascertained from publicly available documentation.
[8] A "hybrid" approach with both a deductible and a threshold was used in another 10% of these transactions in 2020 and 11% of these transactions in 2022.
[9] A 50/50 cost sharing approach was used in another 3% of these transactions in 2021.
[10] Generally, exceptions were for general economic and industry conditions.
[11] The only transaction(s) not including such exceptions provided for a closing on the same day the definitive agreement was signed.

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Data Sources: WilmerHale compiled all data in this report from PitchBook, except as otherwise indicated.

Special note on data: Due to delayed reporting of some transactions, the venture capital financing and M&A data discussed in this report is likely to be adjusted over time as additional deals are reported. Based on historical experience, the number of reported venture capital financing and M&A transactions is likely to increase by approximately 5%–10% in the first year following the initial release of data and by smaller amounts in succeeding years, and other venture capital financing and M&A data is likely to be adjusted to reflect the inclusion of additional deals.

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