2014 Venture Capital Report

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2014 Venture Capital Report – Table of Contents

REVIEW

In 2013, the venture capital market produced a strong performance for the third consecutive year. Financing activity approached the highest level since the end of the dot-com boom, and the number of venture-backed US issuer IPOs was the largest since 2007. Based on activity to date in 2014, both financing and liquidity conditions appear to remain favorable for VC-backed companies.

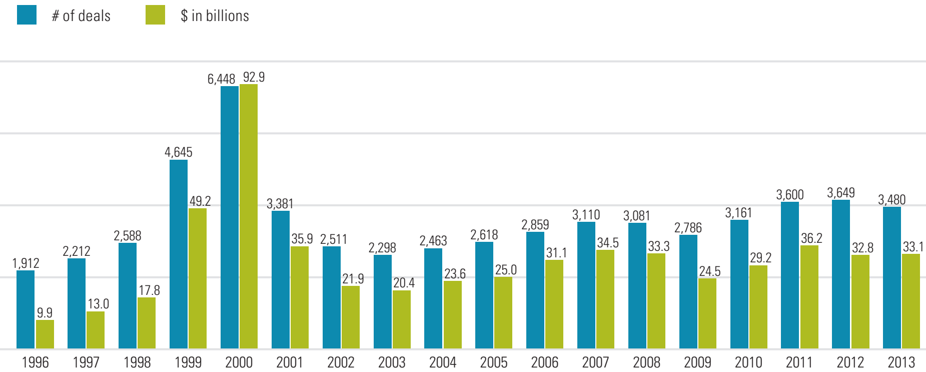
Financing Activity

The number of reported venture capital financings dipped 5%, from 3,649 in 2012 to 3,480 in 2013. Despite the normal lag in deal reporting, the tally for 2013 was the third-highest annual total since the collapse of the dot-com bubble. Once all 2013 deals are accounted for, the decline from 2012 is almost certain to be erased and the 2013 count is likely to end up as the highest since the all-but-unapproachable total of 6,448 financings in 2000. The quarterly figures of 849, 874, 856 and 901 financings in 2013 are particularly encouraging in light of delayed reporting of some second-half transactions.

Year-over-year, total venture capital financing proceeds inched up 1%, from $32.8 billion in 2012 to $33.1 billion in 2013. The 2013 tally was 14% higher than the average of $29.0 billion in annual gross proceeds over the preceding 10 years, and is likely to increase further after all 2013 financings have been reported.

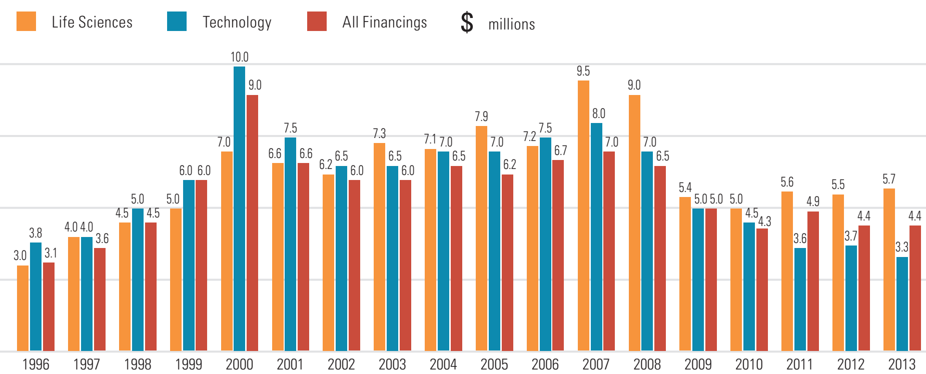
The median size of all venture capital financings in 2013 was unchanged from the prior year, remaining at $4.4 million. The median size of seed and first-round financings continued to fall in 2013, driven by reduced startup cash needs for many companies due to technological advances as well as the desire of founders to minimize dilution. The median size of seed financings declined from $700,000 in 2012 to $500,000 in 2013, while the median size of first-round financings declined from $2.7 million to $2.5 million. By comparison, in 2005, the median seed financing was $800,000 and the median first-round financing was $5.0 million—twice the amount in 2013.

US Venture Capital Financings – 1996 to 2013



Source: Dow Jones VentureSource

Median Size of US Venture Capital Financings – 1996 to 2013



Source: Dow Jones VentureSource

The median size of second-round financings increased slightly, from $5.4 million in 2012 to $5.7 million in 2013, but fell well short of the $8 million-plus figures that prevailed between 2005 and 2008. The median size of later-stage financings, which has remained steady in recent years, was $10.0 million in 2013—the same amount as in both 2012 and 2005.

The median financing size for life sciences companies ticked up from $5.5 million in 2012 to $5.7 million in 2013, but remained in line with the sector's average since 2009. For technology companies, the median financing size decreased from $3.7 million in 2012 to $3.3 million in 2013. The decline in the median financing size for technology companies in recent years is partly due to technological advances that have enabled startups to commence and grow their operations with a lower level of funding than historically required—in many cases, open-source software and cloud computing have replaced the need to purchase expensive server racks, hire support staff and acquire costly software licenses.

After declining between 2011 and 2012, the number of very large financings increased in 2013. The number of financing rounds of at least $50 million increased from 84 in 2012 to 101 in 2013, and the number of financing rounds of at least $100 million increased from 21 to 28. The largest venture financing of 2013 was completed by Uber ($361 million), followed by Spotify ($250 million) and Pinterest (separate rounds of $225 million and $200 million).

The median pre-money valuation among all venture financings decreased from $22.0 million in 2012 to $18.0 million in 2013, after increasing in each of the two prior years due to strong competition for attractive companies. The median pre-money valuation for financings by life sciences and technology companies—which was comparable in both sectors in 2012—diverged in 2013. Among life sciences companies, the median pre-money valuation increased 34%, from $22.2 million in 2012 to $29.8 million in 2013. Technology companies saw a sharp decline in median pre-money valuation, from $19.8 million in 2012 to $11.0 million, reflecting a large influx of early-stage technology companies seeking financing.

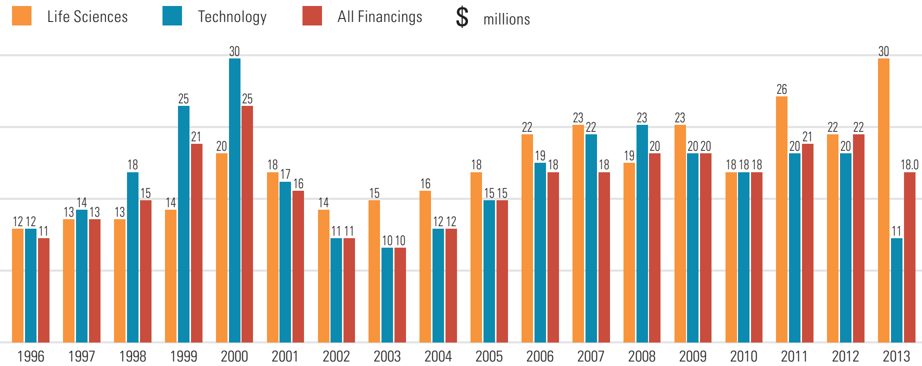
Seed and first-round venture capital financings accounted for 45% of all venture financings in 2013—shy of the 48% in 2012 but higher than any other annual percentage since the 47% figure in 2000. The annual average of 46% of all venture financings accounted for by seed and first-round transactions over the past three years now exceeds the annual average of 45% that prevailed from 1996 to 2000.

Proceeds from seed and first-round deals represented 18% of all venture capital financing proceeds in 2013, down from 21% in 2012. The percentage in both years is well short of the 32% average for the 1996 to 2000 period, reflecting the proliferation of early-stage companies receiving smaller financing amounts and surviving on lower burn rates than historical norms.

Technology companies accounted for 30% of all venture capital financings in 2013, compared to 33% in 2012. After declining for three consecutive years, the market share for life sciences companies increased from 20% in 2012 to 21% in 2013. The next-largest sectors in 2013 were business and financial services (22% market share) and consumer services (20% market share).

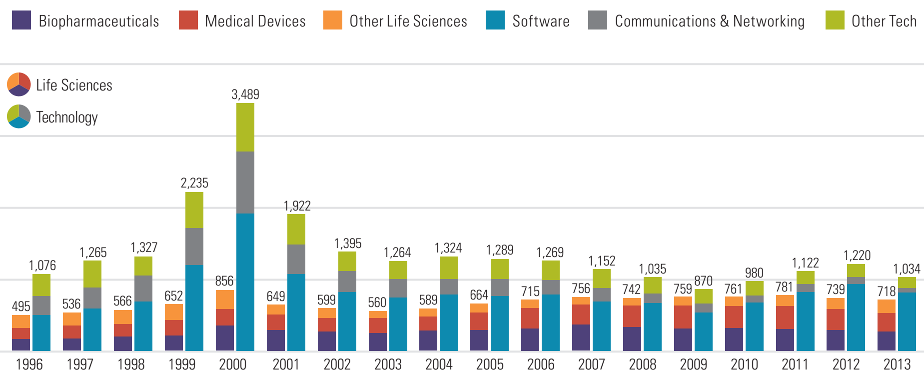
California—which has led the country in financings in each year since 1996 (the first year for which this data is available)—accounted for 40% of all venture financings in 2013 (1,389 financings).

Median Pre-Money Valuation in US Venture Capital Financings – 1996 to 2013



Source: Dow Jones VentureSource

US Venture Capital Financings by Industry – 1996 to 2013



Source: Dow Jones VentureSource

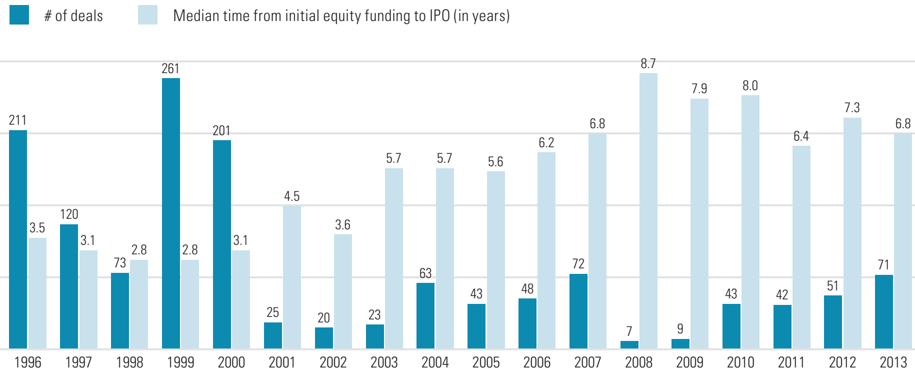
New York, home to companies with 349 financings in 2013, finished second in this category for the second year in a row, ahead of Massachusetts with 294 financings. Texas (150 financings) and Pennsylvania (95 financings) rounded out the top five positions for 2013.

Liquidity Activity

With a boost from strong capital market conditions, the number of venture-backed US issuer IPOs increased 39%, from 51 in 2012 to 71 in 2013, continuing the recovery that began in 2010 after VC-backed IPOs had all but disappeared in 2008 and 2009. The largest VC-backed IPO of 2013 was the $1.82 billion offering by Twitter, followed by the IPOs of FireEye ($304 million), Veeva Systems ($261 million), Tableau Software ($254 million) and zulily ($253 million). The median amount of time from initial funding to an IPO decreased from 7.3 years in 2012 to 6.8 years in 2013.

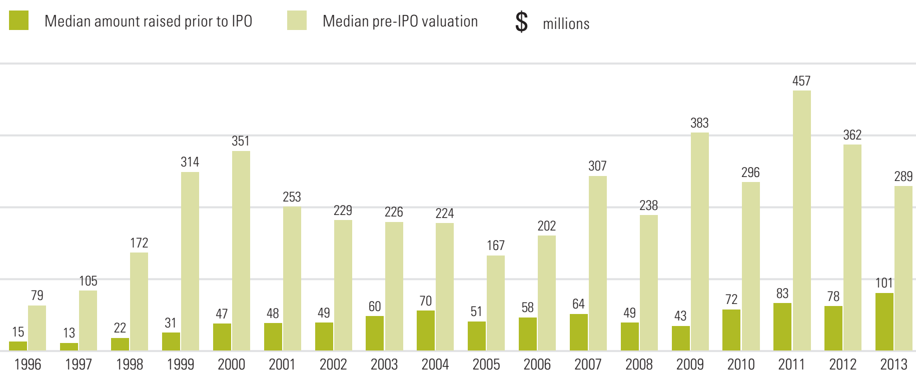
The median amount raised prior to an IPO increased 29%, from $78.4 million in 2012 to $100.9 million in 2013. The median pre-IPO valuation decreased 20%, from $362.2 million in 2012 to $289.3 million in 2013. As a result, the ratio of pre-IPO valuations to the median amount raised prior to an IPO by venture-backed companies going public fell for the second consecutive year, from 4.6:1 in 2012 to 2.9:1 in 2013 (a lower ratio means lower returns to pre-IPO investors). This ratio was between 3.2:1 and 5.5:1 for each year from 2001 to 2012, other than a spike to 9.0:1 in 2009 based on a very small sample size of VC-backed IPOs that year.

Venture Capital–Backed IPOs and Median Time to IPO – 1996 to 2013



Source: Dow Jones VentureSource and SEC filings
The above chart is based on US IPOs by VC-backed US issuers.

Median Amount Raised Prior to IPO and Median Pre-IPO Valuation – 1996 to 2013



Source: Dow Jones VentureSource

In contrast, this ratio ranged from 7.5:1 to 10.0:1 from 1997 to 2000, due to very large pre-IPO valuations by younger companies.

Unlike the ebullient market for VC-backed IPOs, the M&A market for venture-backed companies contracted for the third consecutive year in 2013. The number of reported acquisitions of VC-backed companies declined by 9%, from 456 in 2012 to 413 in 2013. Total proceeds fell 14%, from $43.0 billion in 2012 to $36.9 billion in 2013.

The median acquisition price for venture-backed companies declined by only 4%, from $60.0 million in 2012 to $57.5 million in 2013—the fourth-highest figure since 2000. The median amount of time from initial funding to acquisition has declined or remained steady each year since 2007—reversing a pattern of consecutive annual increases from 2001 to 2007. The 2013 figure inched down to 5.0 years from 5.2 years in 2012.

The median amount raised prior to acquisition decreased 32%, from $16.8 million in 2012 to $11.4 million in 2013—the lowest annual median since the $10.0 million figure in 2000. The ratio of median acquisition price to median amount raised prior to acquisition increased from 3.6:1 in 2012 to 5.0:1 in 2013 (a higher ratio means higher returns to pre-acquisition investors). This ratio in 2013 was the highest annual figure since the ratio of 10.0:1 in 2000 at the apex of the dot-com delirium. The increase in this ratio largely stems from lower investment levels prior to acquisition.

The largest VC-backed company acquisition of 2013 was the $1.3 billion acquisition of Waze by Google. There were a total of nine VC-backed company acquisitions for at least $500 million in 2013, up one from 2012 but down from the 14 in 2011. Billion-dollar acquisitions of VC-backed companies increased to seven in 2013, up from four in 2012 and none in 2011.

The above comparison of the ratios of valuations to the financing amounts required to achieve liquidity events indicates that returns to venture capital investors were higher in M&A transactions than in IPOs in 2013—for the first time since 2000. Furthermore, venture investors generally achieve liquidity more rapidly in an M&A transaction (which frequently yields the bulk of the purchase price in cash at closing) than in an IPO (which generally involves a post-IPO lockup period of 180 days and market uncertainty on the timing and prices of subsequent sales). When combined with the shorter timeline from initial funding to liquidity in 2013 for M&A transactions (5.0 years) than IPOs (6.8 years), these data points underscore why venture capitalists often prefer a company sale to an IPO.

The ratio of M&A transactions to IPOs for venture-backed companies was 5.8:1 in 2013, compared to 8.9:1 in 2012 and 12.9:1 in 2011. The 2013 ratio was the lowest annual ratio since the 2.4:1 in 2000.

OUTLOOK

The overall health of the venture capital market in the coming year will depend on a number of factors, including the following:

- *Financing Activity*: We expect venture capital financing activity to show a moderate increase in 2014, although the health of the overall market remains heavily dependent on broader economic conditions. There were 862 reported venture capital financings in the first quarter of 2014—only 29 below the number of reported financings in the first quarter of 2013—and the tally for the first quarter of 2014 is almost certain to top the corresponding figure for 2013 once all financings have been reported. Gross proceeds soared 44%, from $7.48 billion in the first quarter of 2013 to $10.74 billion in the first quarter of 2014, representing the highest quarterly total since the first quarter of 2001. The largest venture capital financings in the first quarter of 2014 were completed by Lyft ($250 million), Jawbone (also $250 million), Intarcia Therapeutics ($200 million) and Cloudera ($160 million, plus an additional $740 million investment from Intel). The first quarter of 2014 produced 13 financings in excess of $100 million, compared to a total of 28 such financings in all of 2013.

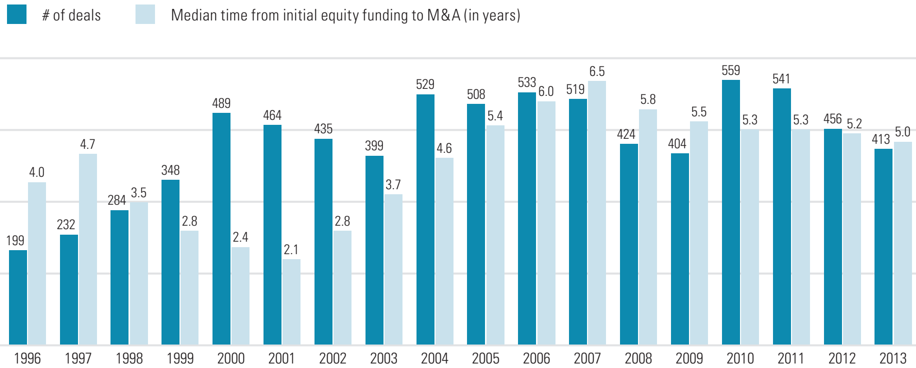
- *IPOs*: On the heels of a very good IPO market for venture-backed companies over the past four years, including an exceptionally strong year in 2013, expectations remain high for the IPO market in 2014. Although the extent to which the JOBS Act has prompted eligible companies to go public over the past two years is unclear—and some provisions of the act actually make it easier for a company to stay private for a longer period of time—the act has undoubtedly enhanced the flexibility companies have in planning and timing their IPOs. The first quarter of 2014 had 36 venture-backed US issuer IPOs, compared to nine in the first quarter of 2013—the highest quarterly tally since the third quarter of 2000. The largest venture-backed US issuer IPO in the first quarter of 2014 came from A10 Networks ($187.5 million), followed by Castlight Health ($177.6 million) and Coupons.com ($168.0 million).

- *Acquisitions*: Prospects for the M&A market for venture-backed companies also appear promising, despite the decline in acquisition activity and prices in 2013. Strategic acquirers have excess cash to deploy, and the existence of a credible IPO alternative enhances the leverage of venture-backed companies in negotiating acquisition prices. The start of 2014 has already seen six VC-backed company acquisitions for more than $1 billion, led by Facebook's proposed acquisition of WhatsApp for a stunning $19 billion and Google's $3.2 billion acquisition of Nest, compared to a total of seven billion-dollar-plus acquisitions in all of 2013.

- *Attractive Sectors*: Technology companies leveraging the massive adoption of smartphones and mobile applications and the ever-increasing level of broadband connectivity—including companies focused on data analytics, SAAS (software-as-a-service) models and cybersecurity—should continue to be prime targets for VC funding. Healthcare IT and life sciences companies with compelling market opportunities (especially those whose founders have successful track records) should also continue to attract funding, particularly as the high level of life sciences IPOs in 2013 produces investment returns that should help venture capital fundraising.

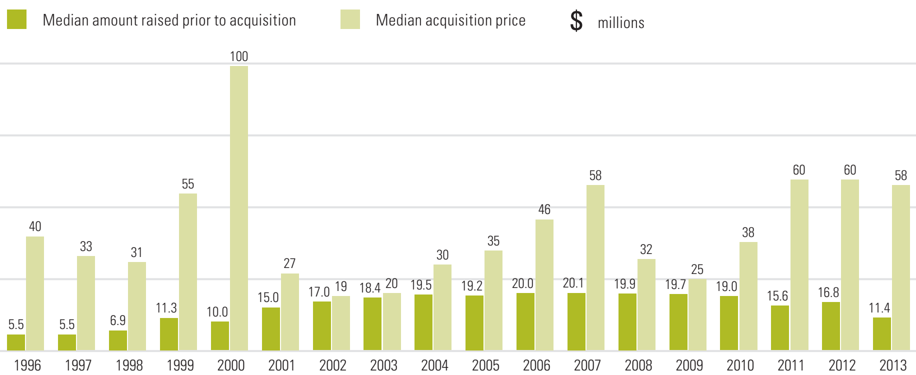
- *Looming "Series B Crunch?"*: Past concerns about a "Series A funding cliff" (in which the high level of seed and early-stage financing makes it difficult for startups to compete for VC financing) appear to have been replaced by worries about a "Series B crunch" (in which post-Series A companies cannot attract a second round of VC financing). While talk of a Series B crunch is probably overblown—because some VC-backed companies will become viable without additional funding, many will be acquired, and others will fail—it is true that the growth rate of Series A financings in 2013 far outstripped that of Series B financings. The coming 18 months is likely to see increased competition for Series B financings. ■

Acquisitions of US Venture-Backed Companies and Median Time to M&A – 1996 to 2013



Source: Dow Jones VentureSource

Median Amount Raised Prior to Acquisition and Median Acquisition Price – 1996 to 2013



Source: Dow Jones VentureSource

CALIFORNIA

California companies reported 1,389 financings in 2013, down from the 1,472 financings in 2012 but still the third-highest annual total since the peak of the dot-com boom in 2000, while gross proceeds dipped from $16.73 billion to $16.47 billion. The financing and proceeds totals for 2013 are likely to top 2012's figures after all deals have been reported.

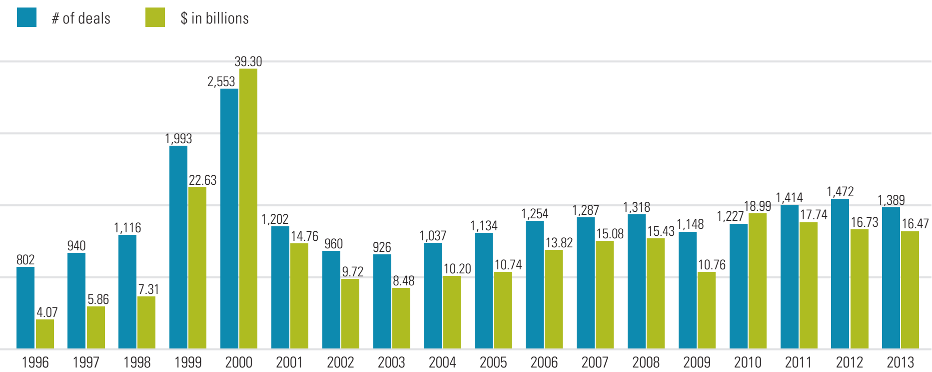
Roughly four times the size of the next-largest venture capital market in the United States, California was responsible for 40% of the nation's financing transactions in 2013. Accounting for 35% of all California financings in 2013, technology was the largest sector in the state, followed by business and financial services (23%) and consumer services (22%). Life sciences companies accounted for 17% of the state's total in 2013.

The number of IPOs by California-based VC-backed companies increased from 27 in 2012 to 32 in 2013. California was home to the three largest VC-backed IPOs of 2013: Twitter ($1.82 billion), FireEye ($304 million) and Veeva Systems ($261 million).

The number of reported acquisitions of California VC-backed companies declined from 231 in 2012 to 203 in 2013. California produced four of the ten largest VC-backed company acquisitions of 2013, led by the $1.15 billion acquisition (including milestone payments) of Pearl Therapeutics by AstraZeneca, Monsanto's acquisition of The Climate Corporation ($1.1 billion) and Johnson & Johnson's acquisition of Aragon Pharmaceuticals ($1 billion, including milestone payments).

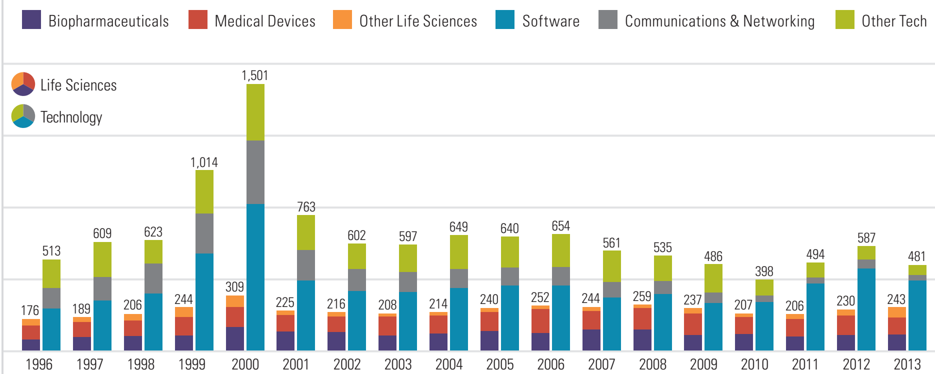
We expect California to maintain its venture capital leadership in the coming year. Future levels of venture capital financing and liquidity activity will depend, in part, on venture capital fundraising, the willingness of strategic buyers to pay attractive premiums, and the overall health of the capital markets. The year has begun on a strong note, with the first quarter of 2014 producing 12 VC-backed IPOs and 70 acquisitions of VC-backed companies, led by Facebook's proposed acquisition of WhatsApp for $19 billion—the most ever paid for a VC-backed company.

California Venture Capital Financings – 1996 to 2013



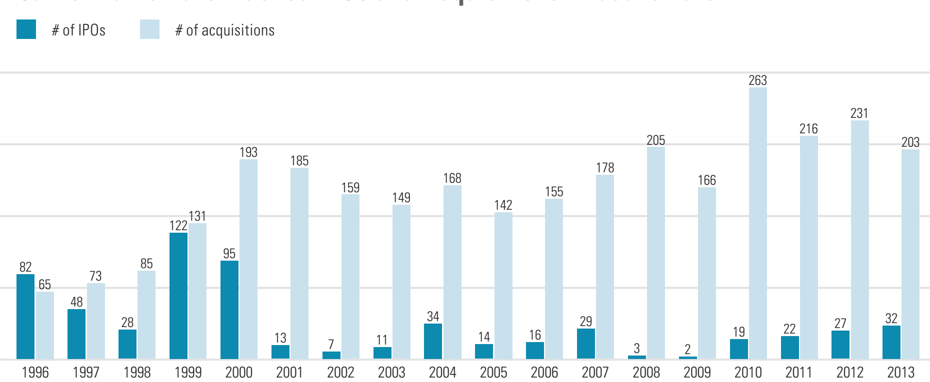
Source: Dow Jones VentureSource

California Venture Capital Financings by Industry – 1996 to 2013



Source: Dow Jones VentureSource

California Venture-Backed IPOs and Acquisitions – 1996 to 2013



Source: Dow Jones VentureSource

MID-ATLANTIC

Venture capital financing activity in the mid-Atlantic region of Virginia, Maryland, North Carolina, Delaware and the District of Columbia rebounded in 2013 after declining the prior year. The number of reported venture capital financings in the mid-Atlantic region increased 14%, from 138 in 2012 to 157 in 2013, while proceeds jumped 77%, from $992 million to $1.75 billion.

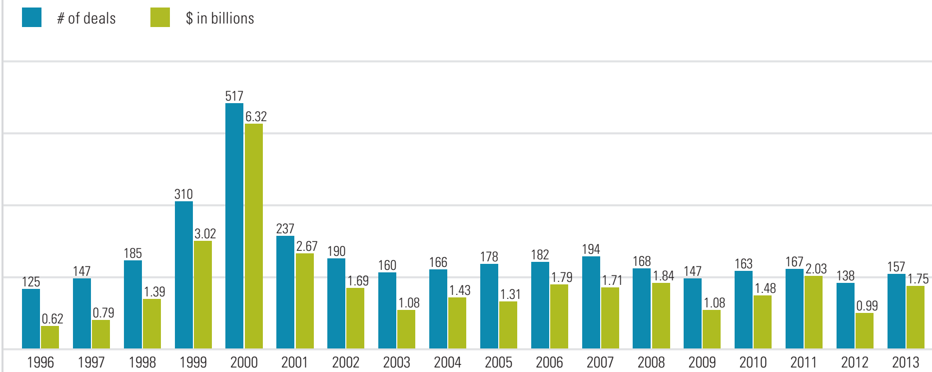
Accounting for 31% of all mid-Atlantic financings in 2013, technology was the region's largest sector, followed closely by life sciences (29%) and business and financial services (28%).

The number of VC-backed IPOs in the mid-Atlantic region increased from four in 2012 to seven in 2013—the second consecutive annual increase and the highest annual count since the 16 in 2000. Five of the region's IPOs were by life sciences companies, led by Intrexon's $160 million offering (the third-largest life sciences IPO in the country in 2013). North Carolina produced four IPOs in 2013, representing that state's highest annual tally since 2000. Of the mid-Atlantic region's remaining IPOs in 2013, two were from Maryland and one was from Virginia.

The number of reported acquisitions of mid-Atlantic VC-backed companies declined from 18 in 2012 to 17 in 2013—less than half the average of 37 over the 10-year period preceding 2012. The region's largest M&A transaction of the year was the $1 billion acquisition of Mandiant by FireEye.

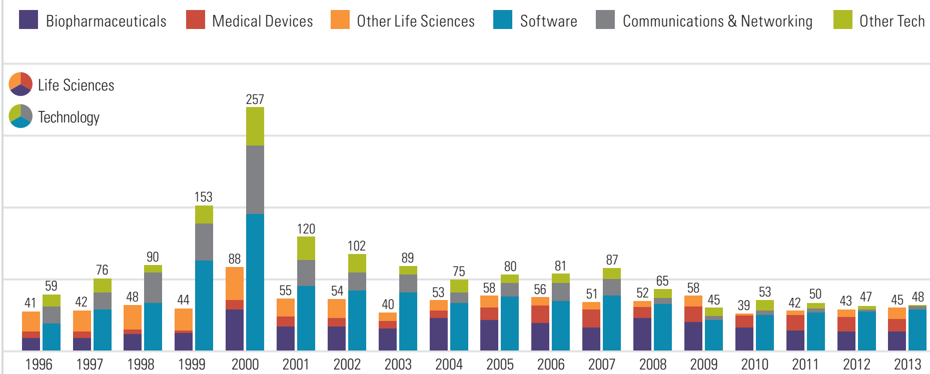
We expect a moderate increase in financing activity for the mid-Atlantic region in the coming year, led by life sciences and defense-related technology companies, and further improvement in liquidity events. The first quarter of 2014 has already produced four VC-backed IPOs, including 2U's $119 million offering, and eight reported acquisitions of VC-backed companies, led by Open Text's $1.2 billion acquisition of cloud-based B2B integration service provider GXS.

Mid-Atlantic Venture Capital Financings – 1996 to 2013



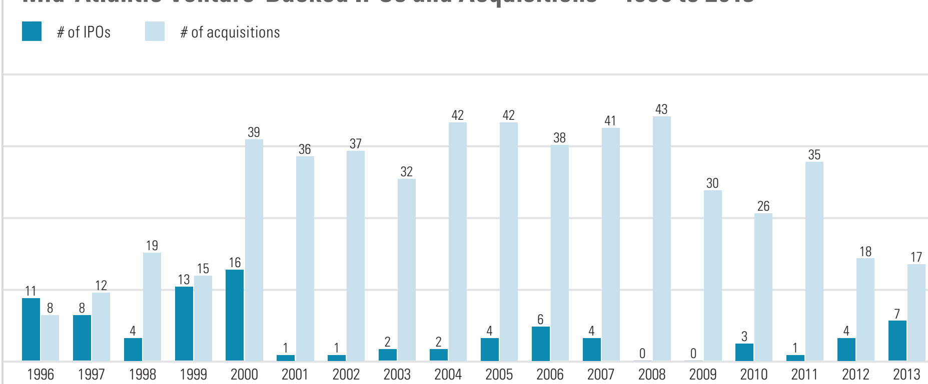
Source: Dow Jones VentureSource

Mid-Atlantic Venture Capital Financings by Industry – 1996 to 2013



Source: Dow Jones VentureSource

Mid-Atlantic Venture-Backed IPOs and Acquisitions – 1996 to 2013



Source: Dow Jones VentureSource

NEW ENGLAND

New England companies reported 378 venture capital financings in 2013, up from 374 financings in 2012. Once all deal activity has been accounted for, the 2013 tally is likely to exceed the 398 deals in 2007 as the state's high point in financing activity since 2001. Gross proceeds in the region increased from $3.56 billion in 2012 to $3.77 billion in 2013.

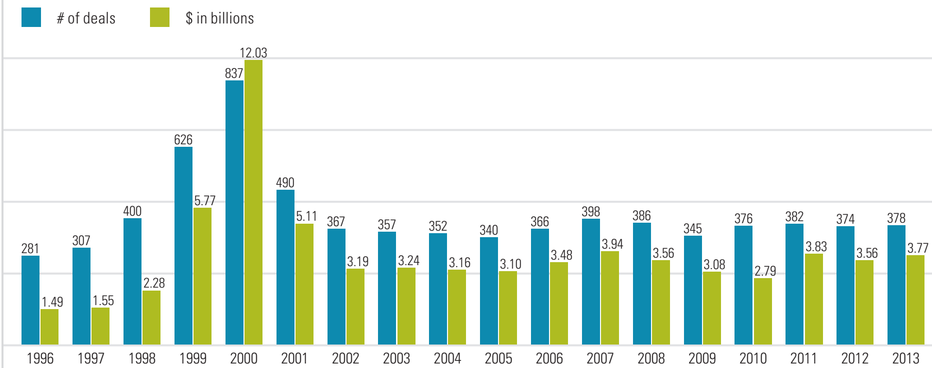
For the fourth time in the last five years, the number of financings by life sciences companies in 2013 outpaced the number of financings by technology companies. The life sciences sector accounted for 31% of New England's venture capital financings in 2013, followed by technology (30%), business and financial services (21%) and consumer services (13%).

New England generated nine venture-backed IPOs in 2013, compared to seven in 2012—the second-highest annual count since 2000. All Massachusetts-based IPOs in 2013 were by life sciences companies. The largest VC-backed IPOs came from Karyopharm Therapeutics ($109 million) and Agios Pharmaceuticals ($106 million).

The number of reported acquisitions of VC-backed companies in New England declined for the second year in a row, dropping from 57 in 2012 to 37 in 2013. The region's largest M&A transaction of the year was the $1 billion acquisition of security company Trusteer by IBM, followed by EMC's acquisition of security/identity management software provider Aveksa ($225 million) and Millennial Media's acquisition of mobile ad company JumpTap (also $225 million).

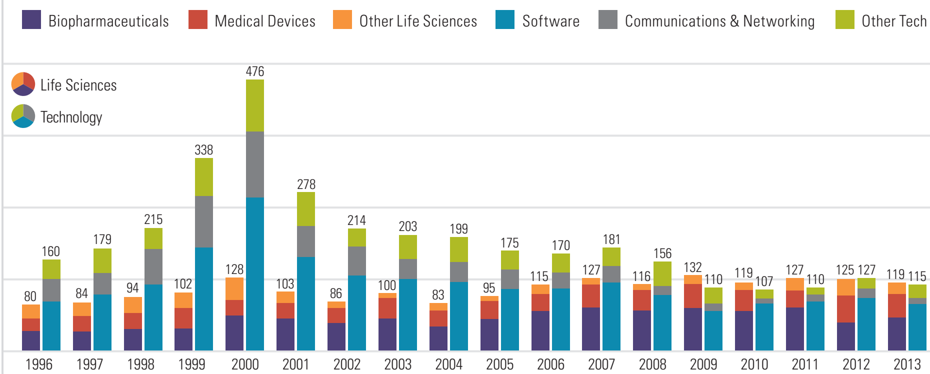
With its concentration of world-renowned universities and research institutions, New England—and Massachusetts in particular—should remain one of the country's most appealing environments for emerging companies and a hub of venture capital and IPO activity during 2014. The first quarter of 2014 has already produced eight venture-backed IPOs, of which seven were by life sciences companies, and 14 reported acquisitions of venture-backed companies, the largest being the $1 billion acquisition of Dealer.com by DealerTrack.

New England Venture Capital Financings – 1996 to 2013



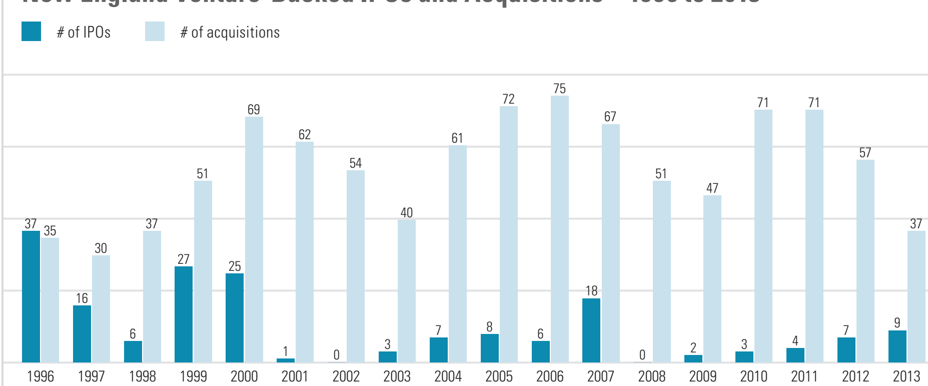
Source: Dow Jones VentureSource

New England Venture Capital Financings by Industry – 1996 to 2013



Source: Dow Jones VentureSource

New England Venture-Backed IPOs and Acquisitions – 1996 to 2013



Source: Dow Jones VentureSource

TRI-STATE

The number of reported venture capital financings in the tri-state region of New York, New Jersey and Pennsylvania edged up from 474 in 2012 to 477 in 2013. New York led the region with 349 financings—its highest annual tally since 2000—topping Massachusetts for the second consecutive year. Gross proceeds in the region increased 19%, from $3.02 billion in 2012 to $3.61 billion in 2013.

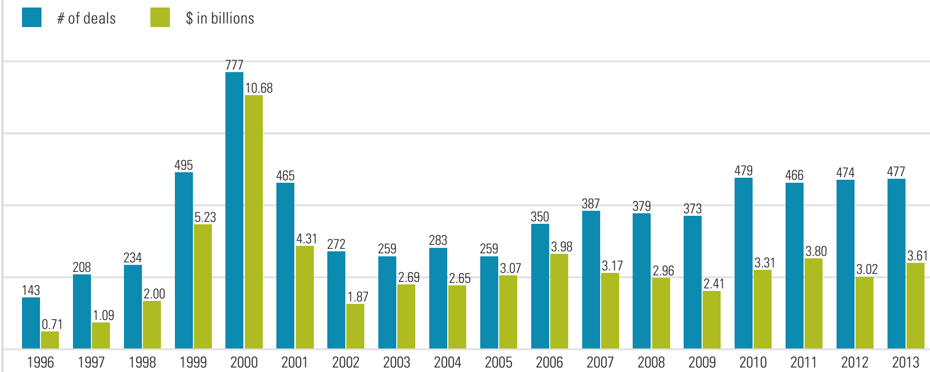
Consumer services companies accounted for the largest share of the tri-state region's VC financing activity in 2013, with 29% of all financings, followed by technology companies with 28%. Life sciences companies accounted for 17% of the region's financings in 2013.

The tri-state region generated nine VC-backed IPOs in 2013, compared to seven in 2012, representing the region's highest annual total since 2006. New Jersey led the tri-state region's IPO count in 2013, with four IPOs, followed by New York with three and Pennsylvania with two. The region's largest VC-backed IPOs were by Ophthotech ($167.0 million) and PTC Therapeutics ($126 million)—the second- and fourth-largest life sciences company IPOs in the country in 2013.

Reported acquisitions of venture-backed companies in the tri-state region edged down from 77 in 2012 to 75 in 2013. The region's largest deal of 2013 was the $1.1 billion acquisition of microblogging service Tumblr by Yahoo, followed by WhipTail Technologies' $415 million acquisition by Cisco Systems and the $400 million acquisition of CyOptics by Avago Technologies.

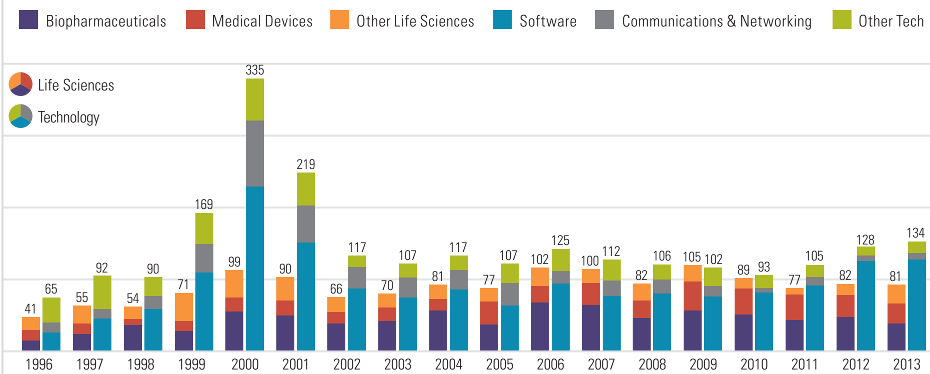
With strength across a broad array of industry sectors, the tri-state region should experience an increase in financing and liquidity activity over the coming year. The year is off to a strong start, with the first quarter of 2014 producing eight VC-backed IPOs, led by Varonis Systems' $106 million offering, and 13 reported acquisitions of VC-backed companies, the largest of which was the $160 million acquisition of medical device startup TyRx by Medtronic. ■

Tri-State Venture Capital Financings – 1996 to 2013



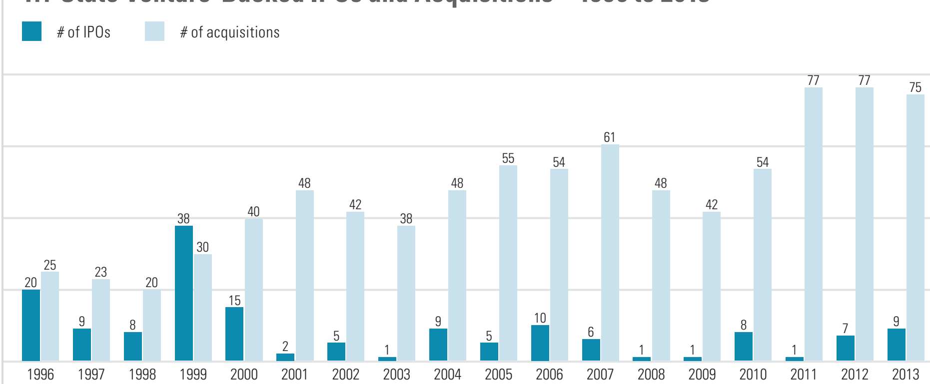
Source: Dow Jones VentureSource

Tri-State Venture Capital Financings by Industry – 1996 to 2013



Source: Dow Jones VentureSource

Tri-State Venture-Backed IPOs and Acquisitions – 1996 to 2013



Source: Dow Jones VentureSource

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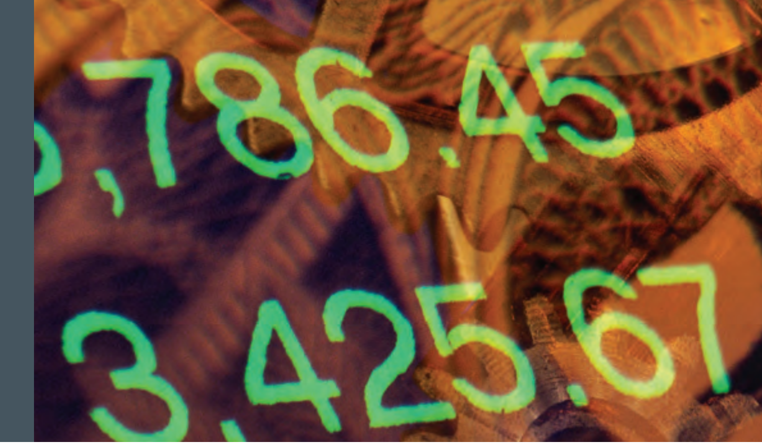

Allied Minds	$100,000,000	*Second Round*	May 2013
affirmed	$51,000,000	*Third Round*	May 2013
Spark	$50,000,000 (total committed amount)	*First Round*	October 2013
1366 technologies	$15,000,000	*Third Round*	September 2013
KENSHO	$10,000,000	*Seed Round*	December 2013
StackRiver	$10,000,000	*Second Round*	July 2013
editas medicine	$43,000,000	*First Round*	November 2013
Cydan	$26,000,000	*First Round*	March 2013
Visterra	$34,200,000	*First Round*	December 2013
catabasis	$32,400,000	*Second Round*	October 2013
Blue Danube Labs	$7,700,000	*First Round*	June 2013
green biologics	£15,400,000	*Second Round*	November 2013
Knome	$13,000,000	*Third Round*	December 2013
Isabella Products	$9,200,000	*First Round*	May 2013
cloudscaling	$10,000,000	*Second Round*	May 2013
Lolly Wolly Doodle	$20,000,000	*First Round*	June 2013
mitokyne	$45,000,000	*First Round*	October 2013
Cloudant	$12,000,000	*Second Round*	April 2013
Kala Pharmaceuticals	$11,500,000	*First Round*	February 2013
CounterTack	$12,000,000	*Second Round*	October 2013
Aileron	$30,000,000	*Fifth Round*	November 2013
MyOptiqueGroup	£8,000,000	*Late Stage*	November 2013
Karyopharm Therapeutics	$67,200,000	*Second Round*	July 2013
Ataxion	$17,000,000	*First Round*	February 2014
Fractyl	$14,300,000	*Second Round*	March 2013
tōkai pharmaceuticals	$35,500,000	*Fifth Round*	May 2013
Calorics Pharmaceuticals	$10,200,000	*First Round*	September 2013
Jumio	$35,000,000	*Late Stage*	August 2013
Altiostar Networks	$50,000,000	*Third Round*	August 2013
mc10	$19,800,000	*Fourth Round*	December 2013
Syros Pharmaceuticals	$30,000,000	*First Round*	April 2013
Reflexis	$28,350,000	*Second Round*	December 2013

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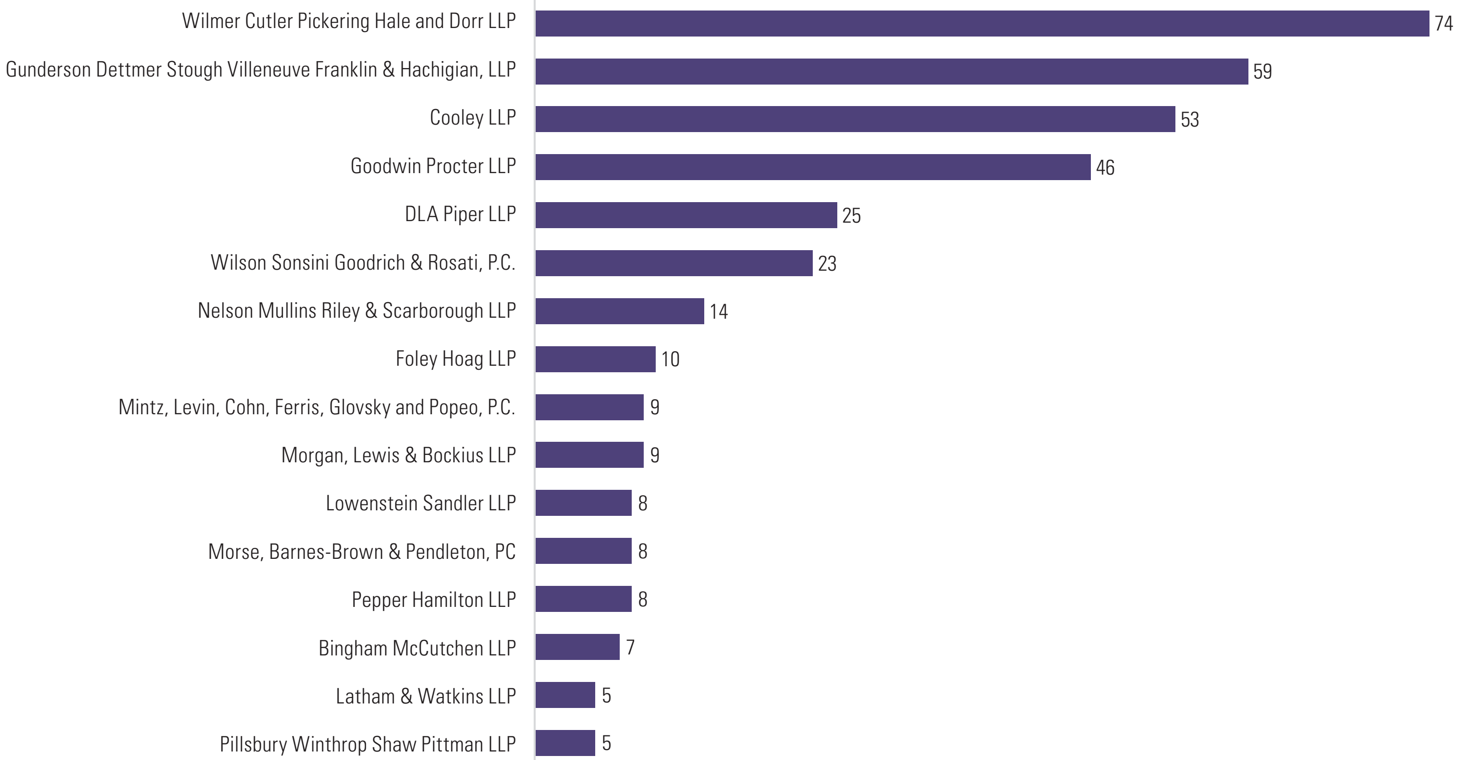
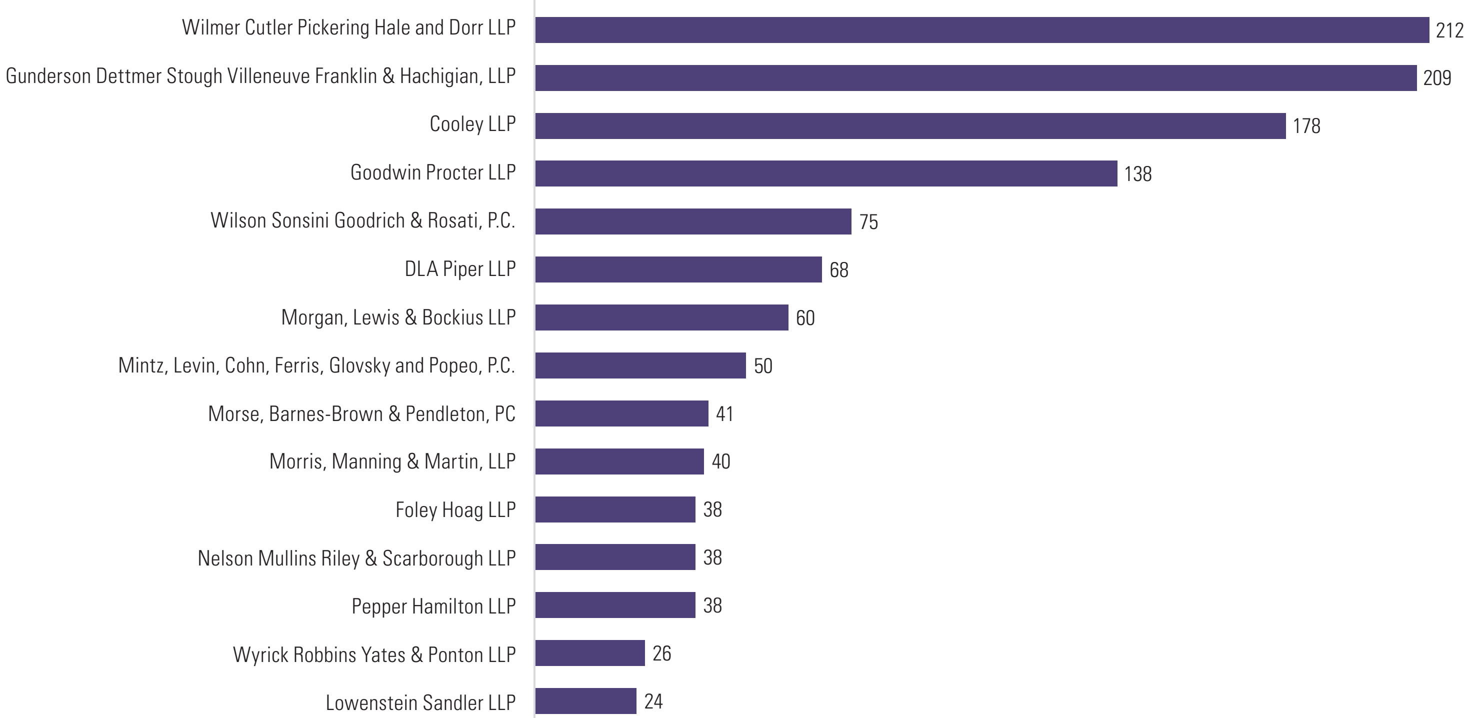
Counsel to Eastern US Companies Receiving VC Financing – 2013



The above chart is based on companies located east of the Mississippi River that completed a seed, first, second, later-stage or restart round of venture capital financing in 2013.

Source: Dow Jones VentureSource

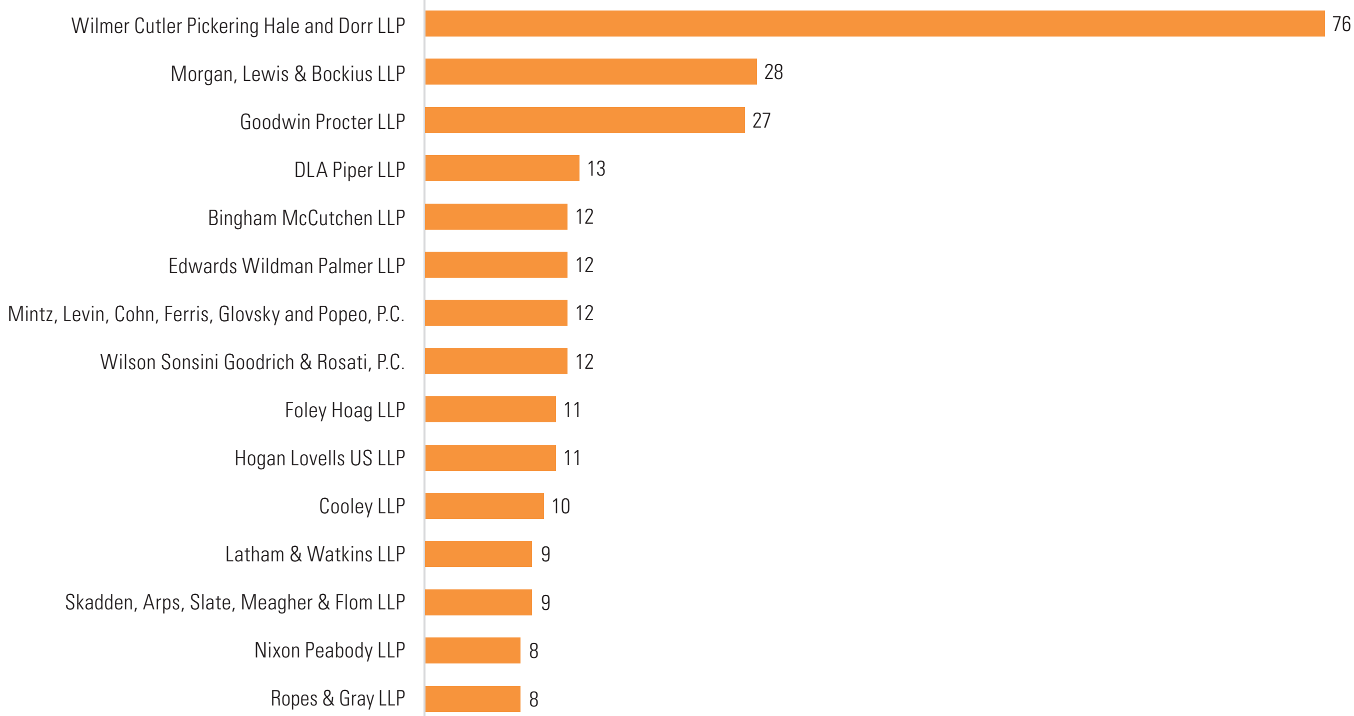
Counsel to Eastern US VC-Backed Companies at Year-End 2013



The above chart is based on VC-backed companies located east of the Mississippi River that were private and independent as of the end of 2013.

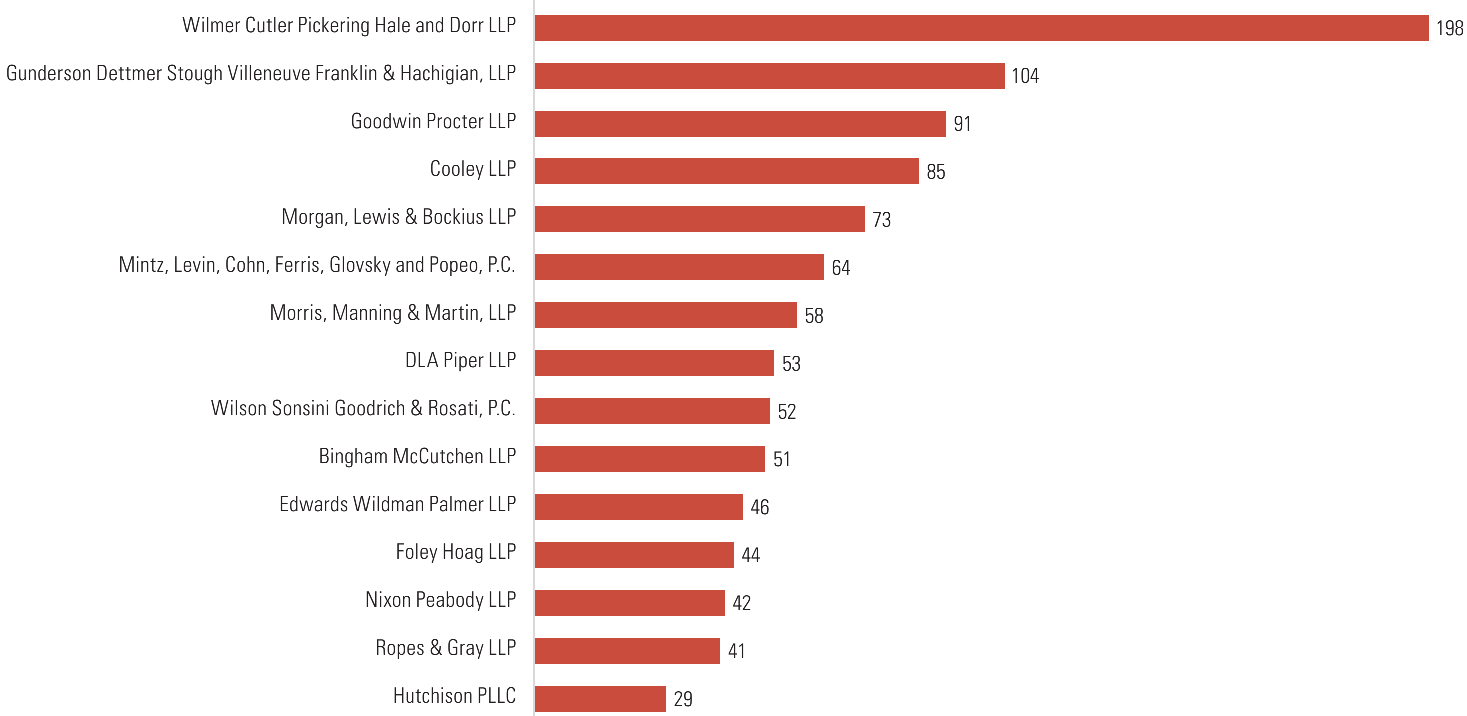
Source: Dow Jones VentureSource

Counsel in IPOs of Eastern US VC-Backed Companies – 1996 to 2013



The above chart is based on VC-backed companies located east of the Mississippi River.
Source: Dow Jones VentureSource and SEC filings

Counsel in Sales of Eastern US VC-Backed Companies – 1996 to 2013



The above chart is based on VC-backed companies located east of the Mississippi River.
Source: Dow Jones VentureSource

REVIEW

With the economic recovery slowly gaining ground, the number of reported venture capital financings in Europe increased 6%, from 1,320 in 2012 to 1,395 in 2013, and gross proceeds increased 15%, from €4.85 billion to €5.59 billion. Once all 2013 transactions have been reported, the year's tallies for both financings and proceeds should be the highest since 2007.

Consumer information services companies accounted for the largest portion of the European venture capital market in 2013, representing 18% of all financings and 15% of gross proceeds, followed by business support services companies (17% of financings and 12% of proceeds) and software companies (16% of financings and 8% of proceeds). With a larger median financing size, companies in the life sciences sector produced 24% of the year's proceeds, while accounting for only 15% of all financings.

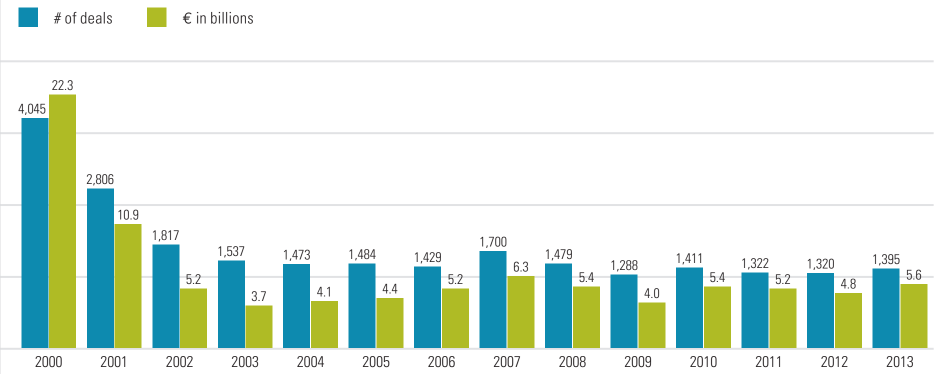
Once again, the United Kingdom was the largest venture capital market in Europe in 2013, generating 30% of both the year's financings and gross proceeds, followed by Germany (21% of financings and 20% of proceeds) and France (17% of financings and 10% of proceeds).

The number of IPOs by European venture-backed companies inched down from 16 in 2012 to 15 in 2013, but average company proceeds increased from €22 million to €32 million. Acquisitions of European VC-backed companies increased slightly, from 143 in 2012 to 145 in 2013, but activity remains almost 30% below the level that prevailed between 2008 and 2011, and is at half the level of the period 2004 to 2007.

OUTLOOK

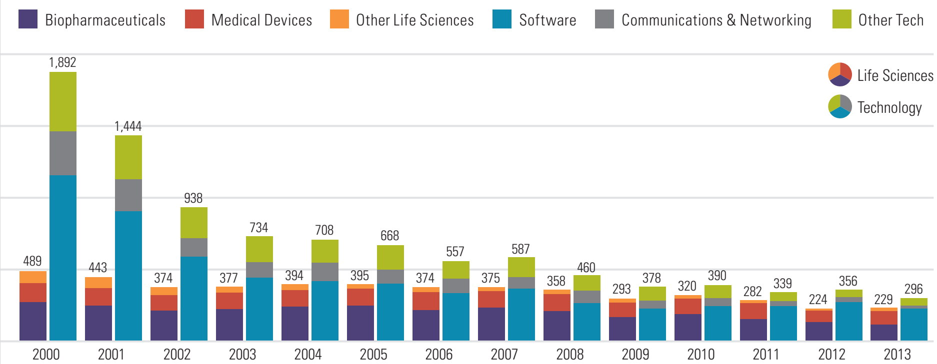
With an increasingly globalized Internet and the cost of starting new companies at historically low levels, conditions are ripe for the level of European venture capital activity to increase in 2014. Increased IPO activity should improve investment returns and make it easier for venture capital firms to raise new funds in what otherwise remains a challenging macroeconomic environment. ■

European Venture Capital Financings – 2000 to 2013



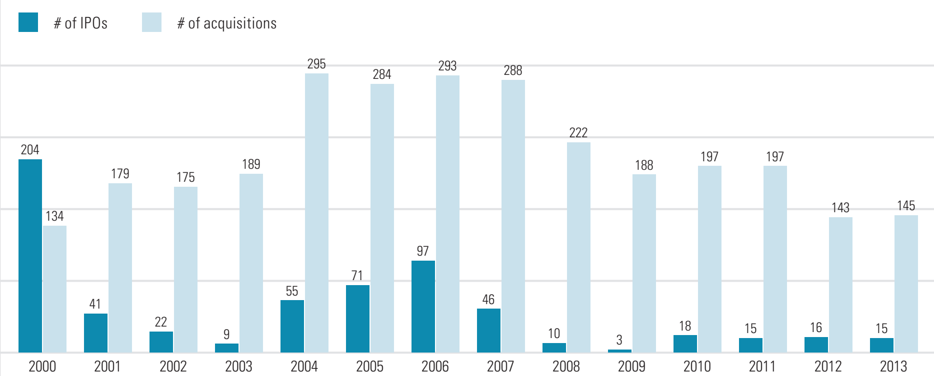
Source: Dow Jones VentureSource

European Venture Capital Financings by Industry – 2000 to 2013



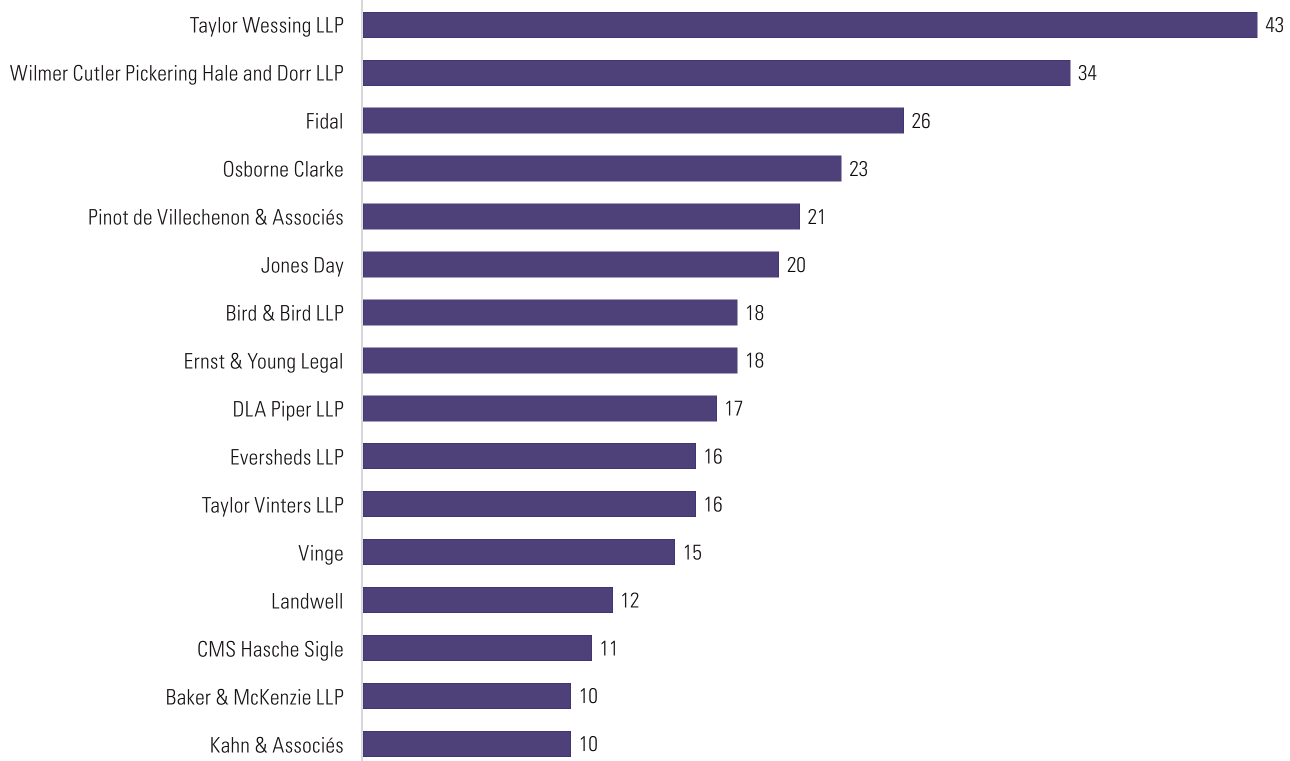
Source: Dow Jones VentureSource

European Venture-Backed IPOs and Acquisitions – 2000 to 2013



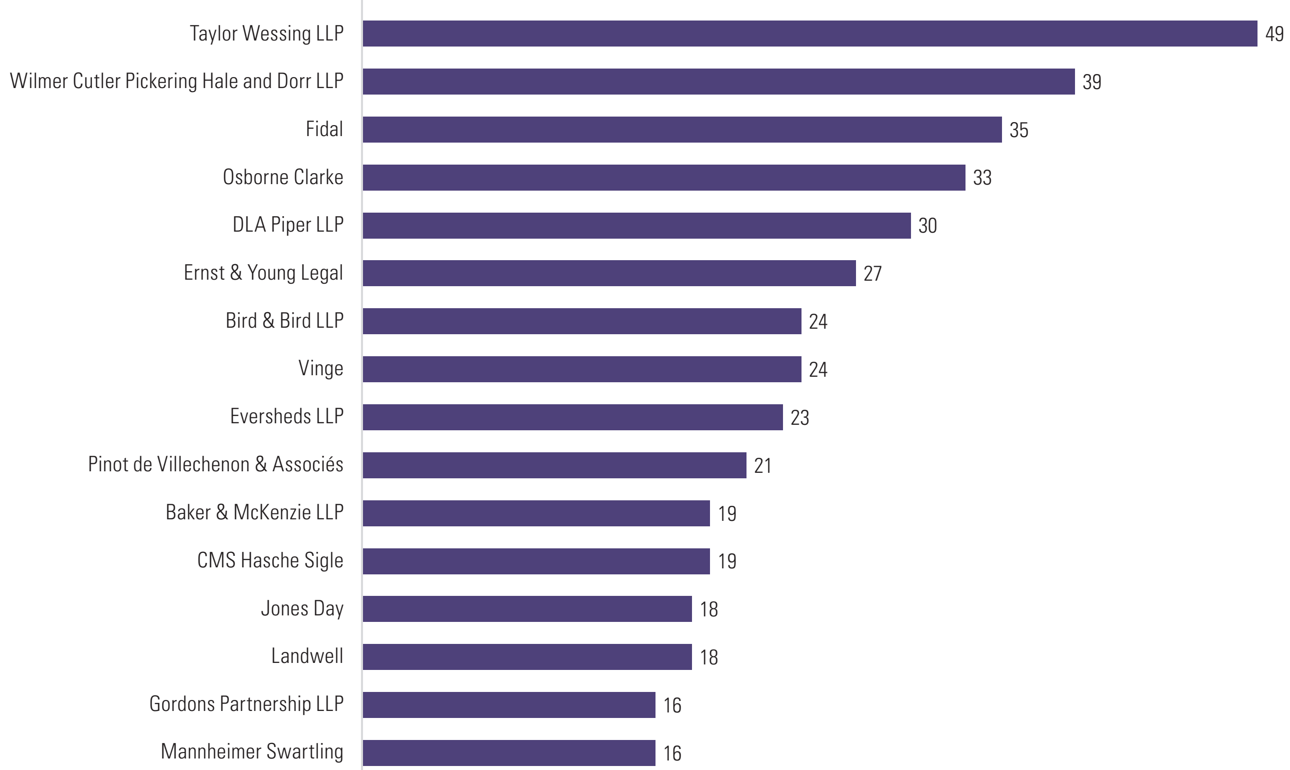
Source: Dow Jones VentureSource

Counsel to European Companies Receiving VC Financing – 2008 to 2013



The above chart is based on European companies that completed a seed, first, second, later-stage or restart round of venture capital financing between 2008 and 2013.
Source: Dow Jones VentureSource

Counsel to European VC-Backed Companies at Year-End 2013



The above chart is based on European VC-backed companies that were private and independent as of the end of 2013.
Source: Dow Jones VentureSource

In addition to other benefits for startup companies, the JOBS Act contains provisions that permit general solicitation in private fundraising and authorize crowdfunding, subject to SEC rulemaking. Below is an update on the implementation of these provisions.

ELIMINATION OF BAN ON GENERAL SOLICITATION

Prior SEC rules prohibited general solicitation and general advertising to attract investors in private placements conducted under Regulation D. The JOBS Act required the SEC to amend its rules to permit such activities in placements conducted pursuant to Rule 506, provided that all purchasers qualify as "accredited investors" (high-income and high-net-worth individuals and qualifying institutions) and the company takes reasonable steps to verify that the purchasers in such placement are accredited investors.

In July 2013, the SEC adopted rule amendments to implement these requirements. Under new paragraph (c) to Rule 506, general solicitation and general advertising are permitted in private placements conducted pursuant to Rule 506 if the company takes reasonable steps to verify that all purchasers are accredited investors; each purchaser is (or the company reasonably believes that each purchaser is) an accredited investor; and all other applicable terms and conditions of Regulation D are satisfied. Companies that conduct Rule 506 offerings without engaging in general solicitation or general advertising are not subject to the new verification requirement. The amended rule became effective on September 23, 2013.

In adopting the amended rule, the SEC stated that the determination of whether a company has taken reasonable steps to verify that purchasers are accredited investors will be assessed objectively, based on the particular facts and circumstances of each purchaser and transaction. The SEC indicated that companies should consider the following factors in determining whether their process of verification is reasonable in connection with any given transaction:

- the nature of the purchasers and the type of accredited investor that the purchaser claims to be;
- the amount and type of information that the company has about the purchaser; and
- the nature of the offering, such as the manner in which the purchaser was solicited to participate.

To supplement the above principles-based framework, the SEC specified four non-exclusive, non-mandatory methods by which a company may verify accredited investor status of natural persons and indicated that these methods, if used, are deemed to satisfy the verification requirement (provided that the company does not otherwise have knowledge that the purchaser is not an accredited investor):

- reviewing any IRS form that reports the purchaser's income for the two most recent years and obtaining a written representation from the purchaser that he or she has a reasonable expectation of reaching the income level necessary to qualify as an accredited investor during the current year;
- reviewing specified types of documentation dated within the prior three months and obtaining a written representation from the purchaser that all liabilities necessary to make a determination of net worth have been disclosed;
- obtaining a written confirmation from a registered broker-dealer or investment adviser, a licensed attorney in good standing, or a certified public accountant who is duly registered and in good standing, that such person or entity has taken reasonable steps to verify the purchaser's accredited investor status within the prior three months and determined that the purchaser is an accredited investor; and
- with regard to a purchaser that previously participated in an offering made by the company pursuant to Rule 506, where that purchaser continues to hold the company's securities, obtaining a certification from the prior purchaser that he or she qualifies as an accredited investor.

Concurrently, the SEC amended Form D—the form that must be filed with the SEC to report private placements conducted pursuant to Regulation D and that contains basic information about the company and the placement—to add a separate box for companies to check if they are relying on the new Rule 506(c) exemption.

At the same time that it adopted the above rule amendments, the SEC also proposed to:

- require legends in any written general solicitation or general advertising materials used in a Rule 506(c) offering;
- require, as a temporary rule that would expire after two years, that companies engaging in general solicitation or general advertising in a Rule 506(c) offering submit soliciting materials to the SEC no later than the date of first use of such materials;
- require companies that intend to engage in general solicitation or general advertising in a Rule 506(c) offering to file a Form D no later than 15 calendar days in advance of the first use of general solicitation or general advertising for such offering;
- expand the information required to be provided on Form D for Rule 506(c) offerings to include the types of general solicitation and general advertising used and the methods used to verify that purchasers are accredited investors;
- require all companies relying on Rule 506 (whether or not they engage in general solicitation or general advertising) to file a Form D no later than 30 calendar days after the termination of an offering to report the final offering outcome; and
- disqualify companies that did not comply with the Form D filing requirements within the preceding five years from using Rule 506 until one year after the required Form D filing(s) are made.

The proposals remain pending as of March 31, 2014.

CROWDFUNDING EXEMPTION

The JOBS Act required the SEC to adopt rules to permit private US companies, without registration, to engage in "crowdfunding" transactions, subject to specified restrictions. Crowdfunding is not available to foreign companies.

In October 2013, the SEC proposed crowdfunding rules that provide:

- *Maximum Offering Size*: Within any 12-month period, the maximum offering size for crowdfunding transactions is $1 million.
- *Investor Limits*: The amount any individual investor may invest in a 12-month period must not exceed (1) the greater of $2,000 or 5% of the annual income or net worth of the investor, if both the annual income and net worth of the investor are less than $100,000, and (2) 10% of the annual income or net worth of the investor, not to exceed a maximum aggregate investment of $100,000 by the investor, if either the annual income or net worth of the investor is equal to or more than $100,000. To determine the investment limit for a natural person, the person's annual income and net worth may be calculated jointly with the annual income and net worth of the person's spouse.
- *Intermediary*: One (and only one) intermediary, either a broker or a new type of entity called a "funding portal," must be used in the transaction. The intermediary must effect transactions exclusively through an Internet website or other similar electronic medium. The intermediary must register with the SEC and any applicable self-regulatory organization; ensure that investors understand the risks of the investment and can bear the burden of possibly losing the investment; conduct a background check on each officer, director and 20% stockholder of the company; and make sure that no investment limits are exceeded. An intermediary is prohibited from having a financial interest in a company that is offering or selling securities through the intermediary's platform.
- *Disclosure Requirements*: Before offering securities in a crowdfunding transaction, a company must file with the SEC and provide to investors, the intermediary and potential investors an offering statement on Form C that discloses: specified information about the company, its management and related-person transactions; a description of the company's business and anticipated business plan; risk factors; the target offering amount and the deadline to reach the target offering amount; a description of the purpose and intended use of the offering proceeds; a description of the process to complete the transaction or cancel an investment commitment; a description of the ownership and capital structure of the company, including the price and terms of the securities being offered and the name and ownership level of each 20% stockholder; the amount of compensation paid to the intermediary; a description of the company's exempt offerings conducted within the past three years; and the financial information described below. The Form C must be amended to disclose any material changes, additions or updates that occur prior to the completion or termination of the offering.
- *Financial Information*: The Form C must contain a description of the company's financial condition, including a description of the material terms of the company's indebtedness and a discussion of the company's historical results of operations, liquidity and capital resources, and (1) for offerings of $100,000 or less, financial statements for the company's two most recently completed fiscal years certified by the CEO to be true and complete in all material respects plus the company's income tax returns for its most recently completed year, (2) for offerings of more than $100,000 but not more than $500,000, financial statements reviewed by an independent public accountant, and (3) for offerings of more than $500,000, audited financial statements.
- *Progress Reports*: The company must file with the SEC and provide updates (on Form C: Progress Update) to investors, the intermediary and potential investors to disclose its progress in meeting the target offering amount no later than five business days after reaching 50% and 100% of the target offering amount.
- *Ongoing Reporting Obligations*: Following completion of a crowdfunding transaction, the company must, within 120 days after the end of each fiscal year, post on its website and file with the SEC an annual report (on Form C: Annual Report) containing the description of the company's financial condition and results of operations and the financial statements described above and specified other information. This reporting obligation lasts until the company registers as a reporting company under the Exchange Act, repurchases all securities issued by it in crowdfunding transactions, or liquidates or dissolves its business in accordance with state law.
- *Rescission Claims*: Under the proposed rules, investors would have an unconditional right to annul an investment commitment until 48 hours prior to the deadline specified in the company's offering materials. Under the JOBS Act, investors can bring rescission claims (claims for refunds of amounts invested) for material misstatements and omissions in connection with the sale of a security in a crowdfunding transaction. These claims may be brought against the company; the company's directors, principal executive officers, principal financial officer, controller or principal accounting officer; and any person who offers or sells the security in the offering.
- *Advertising Restrictions*: Companies may not advertise the offering, except for notices that direct investors to the intermediary. Companies may not, directly or indirectly, compensate anyone for promoting the offering through the intermediary's communication channel without taking reasonable steps to ensure that the person clearly discloses the receipt (both past and prospective) of compensation each time the person makes a promotional communication.
- *Resale Limitations*: Investors may not resell securities purchased in crowdfunding transactions for one year, beginning on the date of purchase, except to the company; to an accredited investor, as part of an SEC-registered offering; to family members; or in connection with death or divorce.

Crowdfunding will not become available until the SEC's implementing rules are adopted. The proposals remain pending as of March 31, 2014. ■

Based on hundreds of venture capital financing transactions we handled from 2009 to 2013 for companies and venture capitalists in the United States and Europe, we have compiled the following deal data:

Deals with Multiple Liquidation Preferences		2009	2009 Range	2010	2010 Range	2011	2011 Range	2012	2012 Range	2013	2013 Range
A "multiple liquidation preference" is a provision that provides that the holders of preferred stock are entitled to receive more than 1x their money back before the proceeds of the liquidation or sale are distributed to holders of common stock.	Series A	0%	N/A	4%	2x	7%	1.2x– 3x	0%	N/A	5%	2x – 3x
	Post–Series A	19%	1.5x – 5x	10%	1.5x – 2x	4%	1.3x –1.5x	7%	2x –2.4x	9%	1.5x – 2.17x

Deals with Participating Preferred Stock		2009	2009 Range	2010	2010 Range	2011	2011 Range	2012	2012 Range	2013	2013 Range
"Participating preferred" stock entitles the holder not only to receive its stated liquidation preference, but also to receive a pro-rata share (assuming conversion of the preferred stock into common stock) of any remaining proceeds available for distribution to holders of common stock.	Series A										
	Total	30%		33%		24%		15%		8%	
	Capped	25%	2x – 3x	18%	2x – 3x	45%	2x – 3x	43%	2x – 10x	50%	2x – 3x
	Post–Series A										
	Total	57%		44%		34%		27%		24%	
	Capped	35%	2x – 6x	45%	1.6x – 5.5x	30%	1.75x – 8x	44%	2x – 3x	41%	2x – 5x

Deals with an Accruing Dividend		2009	2010	2011	2012	2013
"Accruing dividends" are generally payable upon liquidation or redemption of the preferred stock. Because the sale of the company is generally deemed to be a "liquidation," the accrued dividend effectively increases the liquidation preference of the preferred stock.	Series A	41%	23%	18%	29%	9%
	Post–Series A	41%	30%	43%	28%	11%

Anti-Dilution Provisions		2009	2010	2011	2012	2013
A "full ratchet" anti-dilution formula is more favorable to the investors because it 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 of the dilutive issuance based upon factors such as the number of shares and the price involved in the dilutive issuance and the number of shares outstanding before and after the dilutive issuance.	Series A					
	Full Ratchet	0%	0%	2%	0%	0%
	Weighted Average	100%	100%	98%	100%	100%
	Post–Series A					
	Full Ratchet	9%	4%	3%	3%	1%
	Weighted Average	91%	96%	97%	97%	99%

Deals with Pay-to-Play Provisions		2009	2010	2011	2012	2013
"Pay-to-play" provisions provide an incentive to investors to invest in future down rounds of financing. Investors that do not purchase their full pro-rata share in a future down round lose certain rights (e.g., their anti-dilution rights are taken away or their shares of preferred stock may be converted into common stock).	Total	35%	20%	19%	7%	7%
	% of Total that Convert to Common Stock	87%	100%	82%	100%	100%
	% of Total that Convert to Shadow Preferred Stock	13%	0%	18%	0%	0%

We reviewed all merger transactions between 2007 and 2013 involving venture-backed targets (as reported in Dow Jones VentureSource) 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:

Characteristics of Deals Reviewed	2007	2008	2009	2010	2011	2012	2013
Sample Size	33	25	15	17	51	26	27
Cash	48%	76%	60%	71%	73%	73%	59%
Stock	0%	4%	0%	6%	4%	8%	8%
Cash and Stock	52%	20%	40%	23%	23%	19%	33%
Deals with Earnout	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
With Earnout	39%	12%	27%	29%	29%	31%	33%
Without Earnout	61%	88%	73%	71%	71%	69%	67%
Deals with Indemnification	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
With Indemnification							
By Target's Shareholders	100%	96%	100%	100%	98%	100%	100%
By Buyer[1]	48%	48%	36%	17%	43%	62%	44%
Survival of Representations and Warranties[2]	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Shortest	6 Months[3]	12 Months	6 Months	9 Months	12 Months[4]	10 Months	12 Months
Longest	36 Months	24 Months	18 Months	21 Months	24 Months	24 Months	30 Months
Most Frequent	12 and 18 Months (tie)	12 Months	18 Months	18 Months	18 Months	18 Months	18 Months
Caps on Indemnification Obligations	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
With Cap	97%	95%	100%	100%	100%	100%	100%
Limited to Escrow	78%	81%	71%	71%	77%	81%	88%
Limited to Purchase Price	9%	14%	0%	6%	2%	0%	0%
Exceptions to Limits[5]	97%	62%	71%	94%	96%	96%	100%
Without Cap	3%	5%	0%	0%	0%	0%	0%
Escrows	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
With Escrow	94%	96%	93%	100%	94%	100%	93%[6]
% of Deal Value							
Lowest	3%	3%	10%	2%	5%	5%	5%
Highest	43%	15%	15%	25%	31%	16%	20%
Most Frequent	10%	10%	10%	10%	10%	10%	10%
Length of Time							
Shortest	6 Months	12 Months	12 Months	9 Months	12 Months	10 Months	12 Months
Longest	60 Months	36 Months	18 Months	36 Months	36 Months	48 Months	30 Months
Most Frequent	12 and 18 Months (tie)	12 Months	12 and 18 Months (tie)	18 Months	18 Months	12 Months	18 Months
Exclusive Remedy	73%	83%	46%	53%	78%	73%	60%
Exceptions to Escrow Limit Where Escrow Was Exclusive Remedy[7]	100%	85%	83%	80%	97%	100%	100%
Baskets for Indemnification	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Deductible[8]	48%	43%[9]	43%	56%	38%	27%	50%
Threshold[8]	39%	48%[9]	57%	44%	60%	65%	42%
MAE Closing Condition	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Condition in Favor of Buyer	97%	88%	100%	100%	98%	95%	100%
Condition in Favor of Target[10]	44%	21%	20%	19%	15%	9%	17%
Exceptions to MAE	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
With Exception[11]	91%	92%	93%	94%	94%[12]	84%[13]	96%[14]

1 The buyer provided indemnification in 53% of the 2007 transactions, 50% of the 2008 transactions, 40% of the 2009 transactions, 80% of the 2010 transactions, 29% of the 2011 transactions, 57% of the 2012 transactions, and 55% of the 2013 transactions where buyer stock was used as consideration. In 56% of the 2007 transactions, 25% of the 2008 transactions, 40% of the 2009 transactions, 33% of the 2010 transactions, 23% of the 2011 transactions, 25% of the 2012 transactions, and 50% of the 2013 transactions where the buyer provided indemnification, buyer stock was used as consideration.

2 Measured for representations and warranties generally; specified representations and warranties may survive longer.

3 In two cases representations and warranties did not survive, but in one such case there was indemnity for specified litigation, tax matters and appraisal claims.

4 In one case representations and warranties did not survive.

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.

6 One of two transactions not including an escrow at closing did require funding of escrow with proceeds of earnout payments.

7 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.

8 A "hybrid" approach with both a deductible and a threshold was used in another 13% of these transactions in 2007, 4% of these transactions in 2008, 2% of these transactions in 2011, 8% of these transactions in 2012, and 8% of these transactions in 2013.

9 Another 4% of these transactions had no deductible or threshold.

10 In 86% of these transactions in 2007, 60% of these transactions in 2008, 100% of these transactions in 2009, 67% of these transactions in 2010, 86% of these transactions in 2011, 100% of these transactions in 2012, and 100% of these transactions in 2013, buyer stock was used as consideration.

11 Generally, exceptions were for general economic and industry conditions.

12 Excludes one transaction where the specified exceptions do not apply for purposes of a standalone "material adverse effect" closing condition.

13 Includes one transaction where the specified exceptions apply for purposes of a standalone "material adverse effect" closing condition and certain representations, but do not apply for purposes of other representations.

14 The only transaction not including such exceptions provided for a closing on the same day the definitive agreement was signed.

Want to know more about the IPO and M&A markets?

Our *2014 IPO Report* offers a detailed analysis of, and outlook for, the IPO market. The report features regional breakdowns; useful IPO market metrics; an update on the pros, cons and recent rates of adoption of various elements of JOBS Act relief available to emerging growth companies; and a look at the expanded role CEOs now must play in the IPO process. We review important considerations around the inclusion of "flash results" in IPO prospectuses; present a primer on the characteristics of venture capital–backed and private equity–backed IPOs and their current market outlook; and provide an overview of "cross-border" IPOs by foreign companies in the United States.

See our *2014 M&A Report* for a detailed review of, and outlook for, the global M&A market. Other highlights include a comparison of deal terms in public and private acquisitions, an update on takeover defenses, and insights into CFIUS and FCPA considerations in M&A transactions. We also look at financial statement requirements in mergers and acquisitions, and survey key terms in sales of VC-backed companies.

To request a copy of any of the reports described above, or to obtain additional copies of the *2014 VC Report*, please contact the WilmerHale Marketing Department at marketing@wilmerhale.com or call +1 617 526 5600. An electronic copy of this report can be found at www.wilmerhale.com/2014VCreport.

Data Sources: WilmerHale compiled all data in this report from Dow Jones VentureSource, except as otherwise indicated. For law firm rankings, IPOs by VC-backed companies and sales of VC-backed companies are included under the current name of each law firm.

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 upward over time as additional deals are reported. Based on historical experience, the adjustments in US data are likely to be in the range of 5–10% in the first year following the initial release of data and in smaller amounts in succeeding years, and the adjustments in European data are likely to be more pronounced.

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