2015 Venture Capital Report

CORPORATE

WILMERHALE®

WILMER CUTLER PICKERING HALE AND DORR LLP ®

2015 Venture Capital Report – Table of Contents

REVIEW

In 2014, the venture capital market produced its strongest performance—in terms of both financing and liquidity activity—since the end of the dot-com boom. Deal flow approached its highest level since 2000, total venture capital financing proceeds soared to the second-highest level in history, the median pre-money valuation hit a record level, the number of VC-backed US issuer IPOs was the largest since 2000, and the median acquisition price for VC-backed companies was the highest since 2000. Both financing and liquidity prospects appear favorable for VC-backed companies in the coming year.

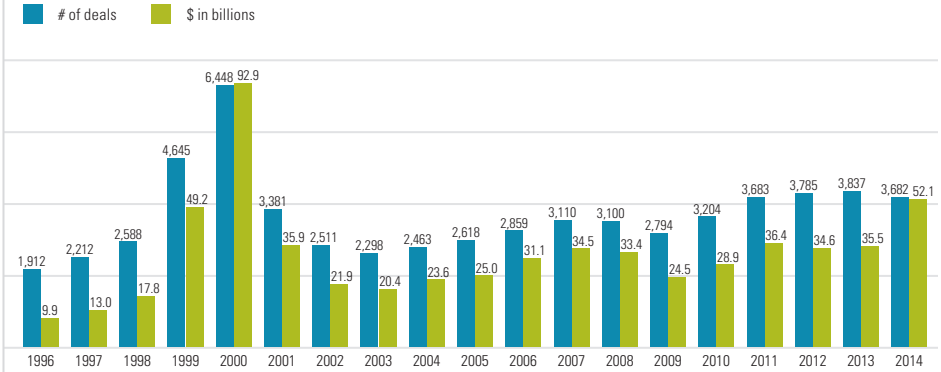
Equity Financing Activity

The number of reported venture capital financing transactions dipped 4%, from 3,837 in 2013 to 3,682 in 2014—a decline that is almost certain to be erased once all 2014 deals are accounted for. Despite the normal lag in deal reporting, the tally for 2014 was the fourth-highest annual total since the collapse of the dot-com bubble in 2000. Once all 2014 deals are reported, the year's result is likely to end up as the highest since the all-but-unapproachable total of 6,448 financings in 2000. The quarterly figures of 945, 995, 928 and 814 financings in 2014 are particularly encouraging in light of delayed reporting of some second-half transactions.

Total reported venture capital financing proceeds leapt 47%, from $35.5 billion in 2013 to $52.1 billion in 2014. The 2014 tally was the highest since 2000 and 63% higher than the average of $32.0 billion in total annual proceeds over the preceding five years. The year's total is likely to increase further after all 2014 financings have been reported. The amount of total proceeds in each of the four quarters of 2014 represented the highest quarterly total proceeds since 2000.

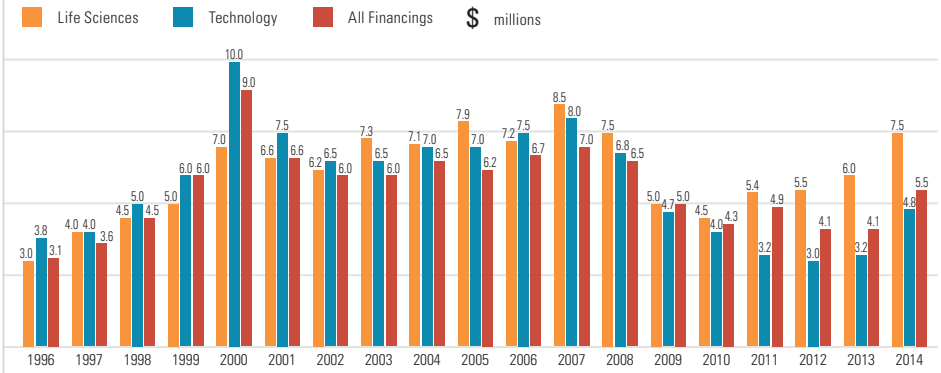
The median size of all venture capital financings increased 34%, from $4.1 million in 2013 to $5.5 million in 2014—the highest figure since 2009. After declining over the preceding five years, the median size of first-round financings increased 19%, from $2.6 million in 2013 to $3.1 million in 2014. The general decline in the median size of

US Venture Capital Financings – 1996 to 2014



Source: Dow Jones VentureSource

Median Size of US Venture Capital Financings – 1996 to 2014



Source: Dow Jones VentureSource

first-round financings in recent years has been 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, which had fluctuated between $600,000 and $800,000 since 2005, increased to $1.0 million in 2014. The median size of second-round financings increased 8%, from $6.0 million in 2013 to $6.5 million in 2014, but fell short of the $8 million-plus figures that prevailed between 2005 and 2008. The median size of later-stage financings, which had remained at the $10.0 million level for three years, increased 30%, to $13.0 million in 2014—the highest level since 2000.

The median financing size for life sciences companies increased 25%, from $6.0 million in 2013 to $7.5 million in 2014, matching the figure for 2008 and trailing only 2007's $8.5 million figure as the sector's highest median financing size since 2005. For technology companies, the median financing size increased 50%, from $3.2 million in 2013 to $4.8 million in 2014, reversing a five-year decline but remaining significantly lower than the median financing size during the ten-year period preceding 2009. The general decline in the median financing size for technology companies in recent years is at least partly attributable 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, cloud computing and open-source

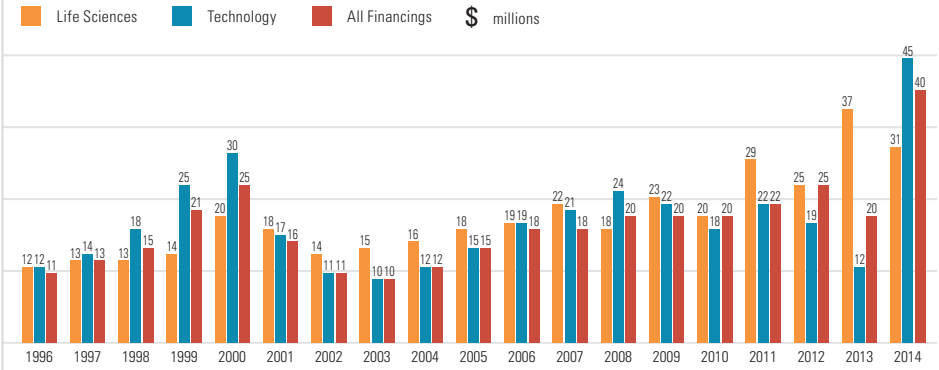
software have replaced the need to purchase expensive server racks, hire support staff and acquire costly software licenses.

For the second consecutive year, the number of very large financings increased substantially. The number of financing rounds of at least $50 million jumped 69%, from 112 in 2013 to 189 in 2014, and the number of financing rounds of at least $100 million more than doubled from 28 to 62. These increases in super-sized rounds are partly due to the growing participation of private equity, crossover and hedge funds in venture capital financing. The largest venture financings of 2014 were completed by Uber ($1.8 billion and a separate financing for $1.2 billion), Magic Leap ($542 million), Snapchat ($486 million) and Airbnb ($475 million).

The median pre-money valuation among all venture financings doubled from $20.0 million in 2013 to $40.0 million in 2014—an unprecedented year-over-year increase. The 2014 figure even exceeded the median pre-money valuations reached at the peak of the dot-com boom. This overall increase in 2014 was largely the result of a sharp increase in valuations for technology companies. The median pre-money valuation in the technology sector nearly quadrupled from $12.0 million in 2013 to $45.3 million in 2014, leapfrogging the median pre-money valuation in the life sciences sector after trailing valuations in that sector for the past five years. Among life sciences companies, the median pre-money valuation declined 18%, from $37.0 million in 2013 to $30.5 million in 2014.

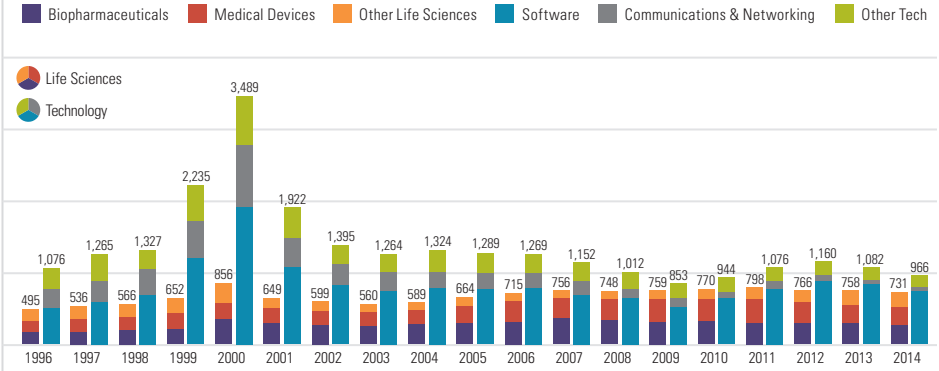
The number of reported seed and first-round venture capital equity financings declined, by 40% and 5% respectively, from 2013 to 2014. Seed and first-round financings accounted for 42% of all venture financings in 2014—down from 47% in each of the two preceding years. Proceeds from seed and first-round equity financings represented 15% of all venture capital financing proceeds in 2014, down from 20% in 2013. The average percentage of 19% represented by seed and first-round financings over the past five years is well short of the 32% average recorded during the 1996 to 2000 period. The decline in early-stage equity financings in recent years is partly attributable to the proliferation

Median Pre-Money Valuation in US Venture Capital Financings – 1996 to 2014



Source: Dow Jones VentureSource

US Venture Capital Financings by Industry – 1996 to 2014



Source: Dow Jones VentureSource

of early-stage companies receiving smaller financing amounts and surviving on lower burn rates than historical norms.

The decline in early-stage equity financings also reflects the growing influence of angel and super-angel investors and their preference for convertible debt financings, in which the company issues notes to the lenders-investors, with the notes converting into equity upon the closing of a subsequent financing, often at a discount and/or with other inducements for the lenders-investors. A variant on a convertible debt structure, called a SAFE (Simple Agreement for Future Equity) financing, has become particularly popular on the West Coast. A SAFE financing typically requires only one term to be negotiated—the cap on the conversion price—and only one legal document.

With 27% of all venture capital financing transactions in 2014, the business and financial services sector (which includes a number of tech-based companies) supplanted the technology sector for the largest market share in 2014. The technology sector accounted for 26% of the year's transactions in 2014, compared to 28% in 2013. The market share for life sciences companies was 20% in 2014, the same as in 2013, after declining in each of the preceding three years. The consumer services sector also had a 20% market share in 2014.

California—which has led the country in financing activity in each year since 1996 (the first year for which this data is available)—accounted for 44% of all venture financing transactions in 2014 (1,615 financings) and 55% of all proceeds

($28.84 billion). New York, home to companies with 368 financings raising $4.64 billion in 2014, finished second in deal flow for the third year in a row, ahead of Massachusetts, which logged 283 financings raising $4.17 billion. Texas (with 138 financings raising $1.77 billion) and Washington (with 95 financings raising $1.09 billion) rounded out the top five positions for 2014.

Liquidity Activity

With a boost from strong capital market conditions, the number of venture-backed US issuer IPOs increased 42%, from 72 in 2013 to 102 in 2014, continuing the recovery that began in 2010 after VC-backed IPOs had all but disappeared in 2008 and 2009. The year's tally represented the highest number of VC-backed IPOs since 2000. The largest VC-backed IPO of 2014 was the $1.78 billion offering of JD.com, followed by the IPOs of Mobileye ($890 million), LendingClub ($870 million), King Digital Entertainment ($500 million) and GoPro ($427 million). After decreasing from 7.3 years in 2012 to 6.8 years in 2013, the median amount of time from initial funding to an IPO inched up to 6.9 years in 2014.

In 2014, 63% of all VC-backed IPOs were by life sciences companies, up from 51% in 2013, while the VC-backed IPO market share for technology companies decreased from 49% to 34%.

The median amount raised prior to an IPO declined 11%, from $100.9 million in 2013 to $89.6 million in 2014, and the median pre-IPO valuation decreased 25%, from $289.3 million to $216.7 million. 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 third consecutive year, reaching 2.4:1 in 2014, compared 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. 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.

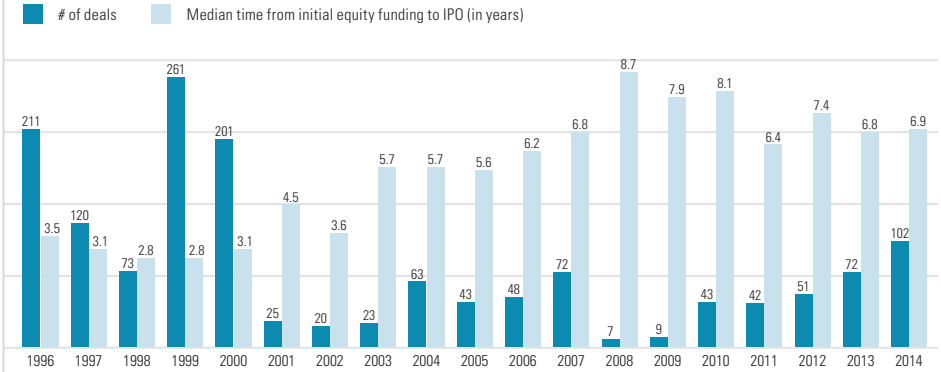
Reversing a three-year decline, the M&A market for venture-backed companies expanded in 2014. The number of reported acquisitions of VC-backed companies increased 8%, from 449 in 2013 to 483 in 2014, while total proceeds nearly doubled, increasing from $41.3 billion to $79.8 billion. Once all 2014 acquisitions are accounted for, the improvement in 2014 deal activity should be even greater.

The median acquisition price for venture-backed companies increased 25%, from $50.0 million in 2013 to $75.0 million in 2014—the highest figure since 2000. After posting consecutive annual increases from 2001 to 2007, followed by consecutive annual declines through 2013, the median amount of time from initial funding to acquisition reversed course again, inching up from 5.0 years in 2013 to 5.1 years in 2014.

The median amount raised prior to acquisition increased 28%, from $11.3 million in 2013 to $14.5 million in 2014. The ratio of median acquisition price to median amount raised prior to acquisition increased from 4.4:1 in 2013 to 5.2:1 in 2014 (a higher ratio means higher returns to pre-acquisition investors). This ratio in 2014 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 significantly higher acquisition prices, coupled with only modest increases in investment levels prior to acquisition.

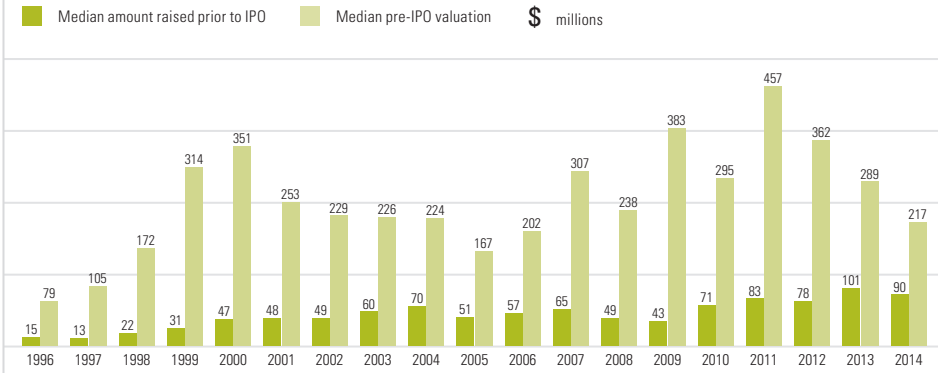
The largest VC-backed company acquisition of 2014 was Facebook's acquisition of WhatsApp for a stunning $19 billion. There were a total of 23 VC-backed company acquisitions for

Venture Capital–Backed IPOs and Median Time to IPO – 1996 to 2014



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 2014



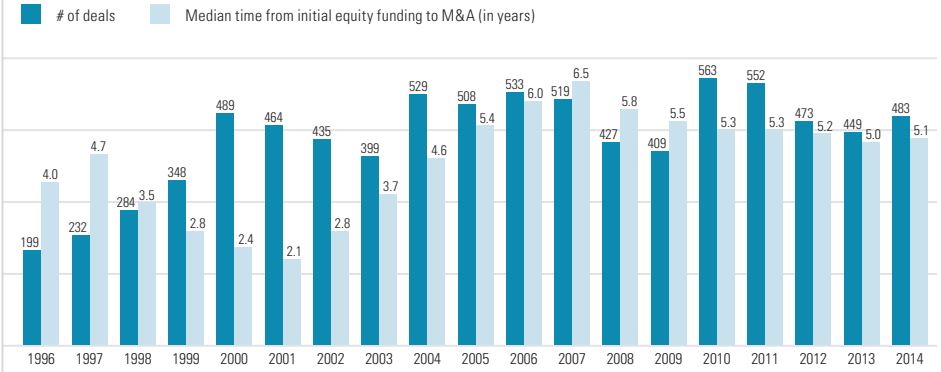
Source: Dow Jones VentureSource

at least $500 million in 2014, up from nine in 2013. Billion-dollar acquisitions of VC-backed companies increased to nine in 2014, up from seven in 2013.

The above comparison of the ratios of valuations to the financing amounts required to achieve liquidity events indicates that for only the second time since 2000—but for the second consecutive year—returns to venture capital investors were higher in M&A transactions than in IPOs in 2014. 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 2014 for M&A transactions (5.1 years) than IPOs (6.9 years), these data points underscore why venture capitalists often prefer a company sale to an IPO.

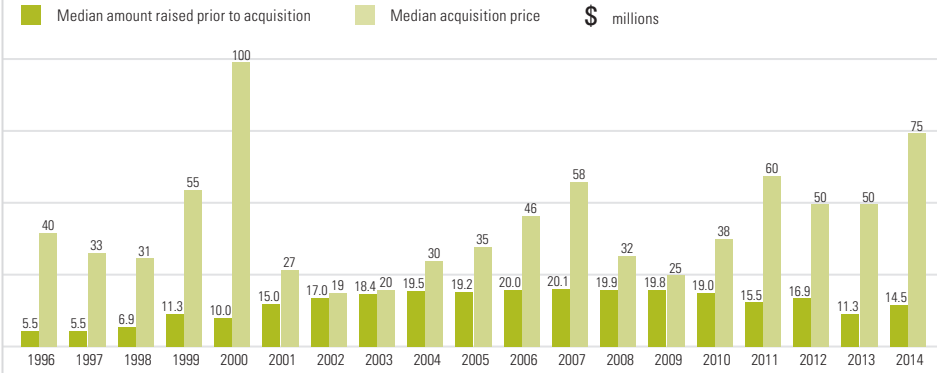
The ratio of M&A transactions to IPOs for venture-backed companies declined for the third consecutive year, reaching 4.7:1 in 2014 compared to 6:2.1 in 2013. The 2014 ratio was the lowest annual ratio since the 2.4:1 in 2000.

Acquisitions of US Venture-Backed Companies and Median Time to M&A – 1996 to 2014



Source: Dow Jones VentureSource

Median Amount Raised Prior to Acquisition and Median Acquisition Price – 1996 to 2014



Source: Dow Jones VentureSource

OUTLOOK

The overall performance of the venture capital market in the coming year will depend on a number of factors, including general economic and capital markets conditions and the amount of fundraising by venture capital funds. Subject to these uncertainties, we offer the following insights:

- *Financing Activity*: Venture capital financing activity should continue to be brisk in 2015. Valuations, however, seem ripe for some contraction in light of the lofty levels achieved in 2014. Early results in 2015 show a modest decline in deal flow compared to 2014, although a number of recent large financings demonstrate the market's continued capacity for outsized rounds when warranted.
- *IPOs*: On the heels of a very good IPO market for venture-backed companies over the past five years, including an exceptionally strong year in 2014, expectations remain high for the IPO market in 2015. However, a number of attractive IPO candidates—including a growing number of "unicorns" valued in excess of $1 billion—appear to be biding their time before going public. The VC-backed company IPO market has begun 2015 at a more measured pace than in 2014, but various VC-backed companies are positioned to pursue large IPOs later this year if they so choose.
- *Acquisitions*: Prospects for the M&A market for venture-backed companies appear promising. 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 2015 has already seen several large acquisitions of VC-backed companies.
- *Attractive Sectors*: Technology companies leveraging the massive adoption of smartphones and mobile applications and the ever-increasing level of broadband connectivity, as well as companies deploying SaaS models or focused on major business challenges such as cybersecurity, should continue to be prime targets for VC funding. Healthcare IT and life sciences companies with compelling market opportunities should also continue to attract funding, particularly as the high level of life sciences IPOs in 2014 produces investment returns that should help venture capital fundraising. ■

CALIFORNIA

California companies reported 1,615 financings in 2014, up 3% from the 1,570 financings in 2013 and the highest annual total since the peak of the dot-com boom in 2000. Driven by a number of very large transactions, total proceeds surged 63%, from $17.67 billion to $28.84 billion. The financing and proceeds totals for 2014 are likely to be even more impressive after all deals have been reported.

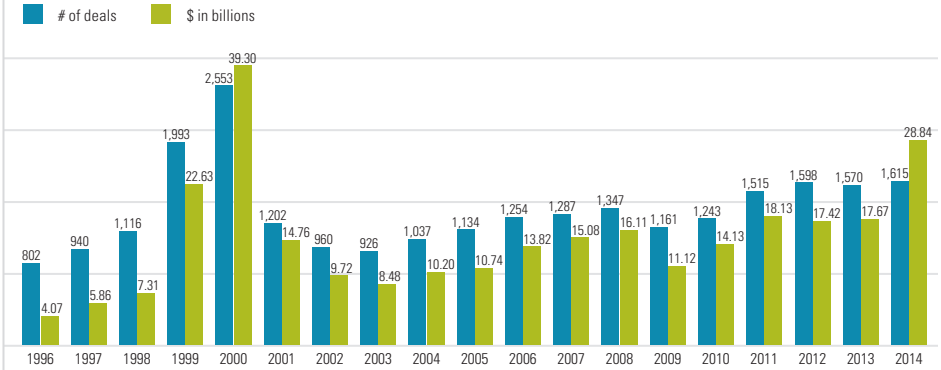
Roughly four times the size of the next-largest venture capital market in the United States, California was responsible for 44% of the nation's financing transactions in 2014. Accounting for 29% of all California financings in 2014, technology was the largest sector in the state, followed by business and financial services (27%), consumer services (23%) and life sciences (15%). California companies generated the two largest financing rounds in the country in 2014 ($1.8 billion and $1.2 billion, both by Uber), and eight of the ten largest rounds.

The number of IPOs by California-based VC-backed companies increased by one-third, from 33 in 2013 to 44 in 2014—representing 33% of all VC-backed IPOs in the nation. California was home to the two largest VC-backed IPOs by US-based issuers in 2014: LendingClub ($870 million) and GoPro ($427 million).

The number of reported acquisitions of California VC-backed companies increased 20%, from 213 in 2013 to 255 in 2014. California produced four of the five largest VC-backed company acquisitions of 2014, led by Facebook's acquisition of WhatsApp for $19 billion—the most ever paid for a VC-backed company—followed by Google's acquisition of Nest Labs for $3.2 billion and Apple's acquisition of Beats Electronics for $2.5 billion.

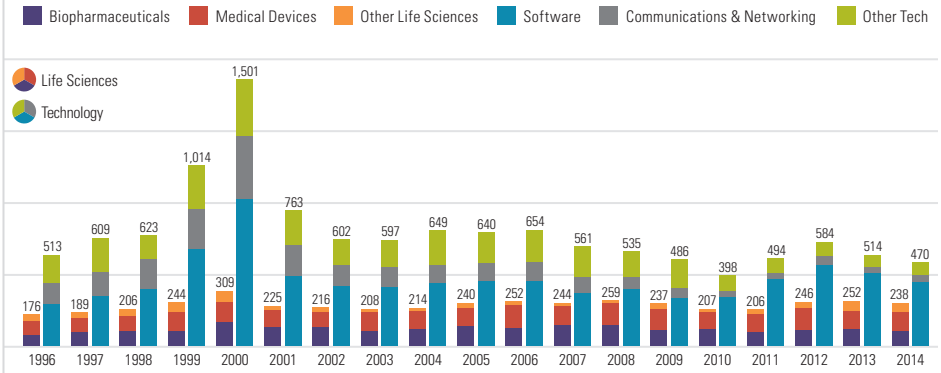
California will undoubtedly maintain its venture capital leadership in the coming year. Future levels of venture capital financing and liquidity activity will depend, in part, on venture capital fundraising, the continued willingness of strategic buyers to pay attractive premiums, and the overall health of the capital markets.

California Venture Capital Financings – 1996 to 2014



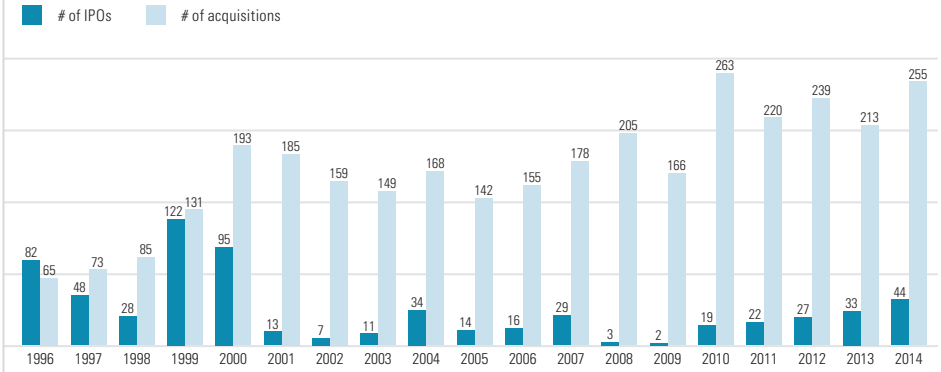
Source: Dow Jones VentureSource

California Venture Capital Financings by Selected Industry – 1996 to 2014



Source: Dow Jones VentureSource

California Venture-Backed IPOs and Acquisitions – 1996 to 2014



Source: Dow Jones VentureSource

MID-ATLANTIC

After experiencing strong growth in 2013, venture capital financing activity in the mid-Atlantic region of Virginia, Maryland, North Carolina, Delaware and the District of Columbia contracted slightly in 2014.

The number of reported venture capital financings in the region edged down 3%, from 172 in 2013 to 166 in 2014, although this decline should be erased after all transactions are reported. Total proceeds declined 37%, from $1.88 billion to $1.19 billion, as deal sizes in the region shrank. The region's largest financings in 2014 were by Viamet Pharmaceuticals ($60 million) and Optoro ($50 million).

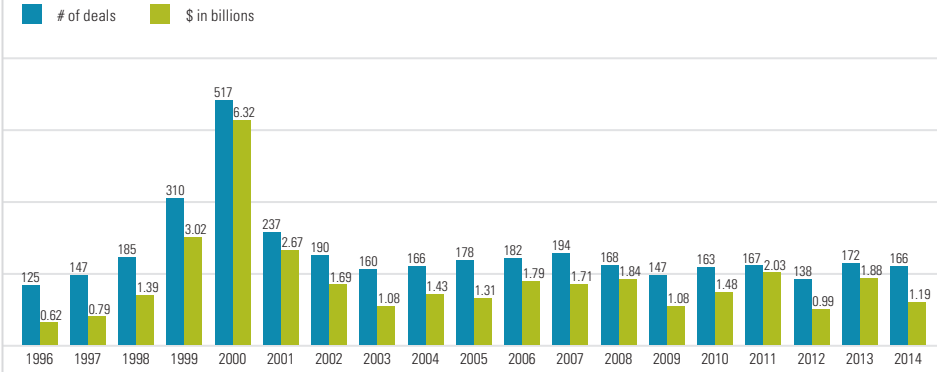
Accounting for 32% of all mid-Atlantic financings in 2014, business and financial services was the region's largest sector, followed closely by technology (29%) and life sciences (26%).

After two consecutive annual increases, the number of VC-backed IPOs in the mid-Atlantic region dipped from seven in 2013 to six in 2014, the largest of which were by 2U ($119 million) and Opower ($116 million). Four of the region's IPOs were in the life sciences sector, and the other two were by cloud-based software companies. North Carolina produced three IPOs, all by biopharmaceutical companies. Of the mid-Atlantic region's remaining 2014 IPOs, two were from Maryland and one was from Virginia.

The number of reported acquisitions of mid-Atlantic VC-backed companies increased from 20 in 2013 to 22 in 2014—marking the second consecutive annual increase, but falling well short of the average of 37 over the 10-year period preceding 2012. The region's largest M&A transaction of the year was the $200 million acquisition of Physical Graph by Samsung, followed by Good Technology's acquisition of BoxTone ($164 million) and TiVo's acquisition of Digitalsmiths ($135 million).

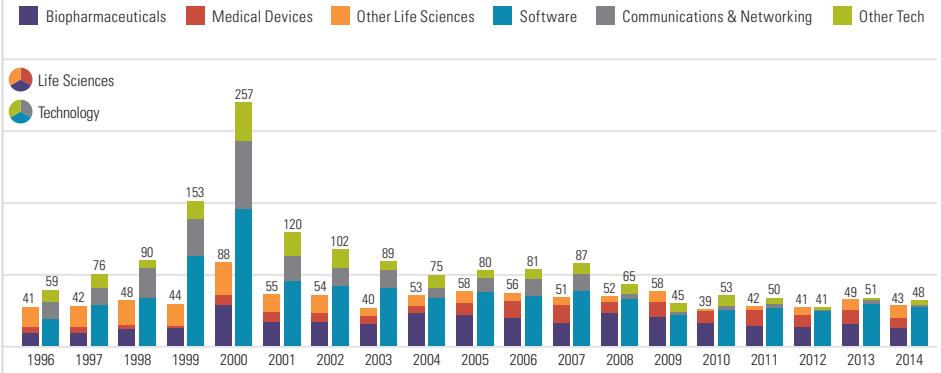
Coming off a relatively flat year, the mid-Atlantic region can be expected to see an increase in financing activity in 2015, led by life sciences companies, and some improvement in liquidity events.

Mid-Atlantic Venture Capital Financings – 1996 to 2014



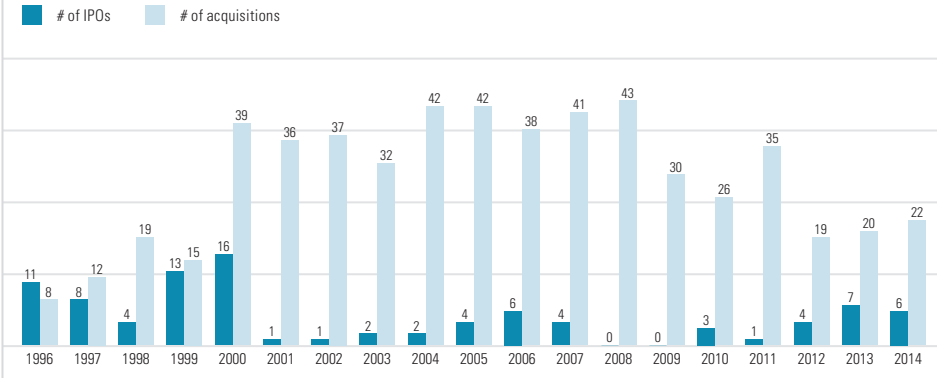
Source: Dow Jones VentureSource

Mid-Atlantic Venture Capital Financings by Selected Industry – 1996 to 2014



Source: Dow Jones VentureSource

Mid-Atlantic Venture-Backed IPOs and Acquisitions – 1996 to 2014



Source: Dow Jones VentureSource

NEW ENGLAND

New England companies reported 351 venture capital financings in 2014, down 13% from the 402 financings in 2013. Once all deal activity has been reported, the 2014 tally is likely to approach last year's total, which was the state's highest level of financing activity since 2001. As a result of larger transaction sizes, total proceeds increased 24%, from $3.93 billion to $4.87 billion—New England's highest total since 2001. The region's largest financings in 2014 came from Boston-Power ($250 million) and Intarcia Therapeutics ($200 million).

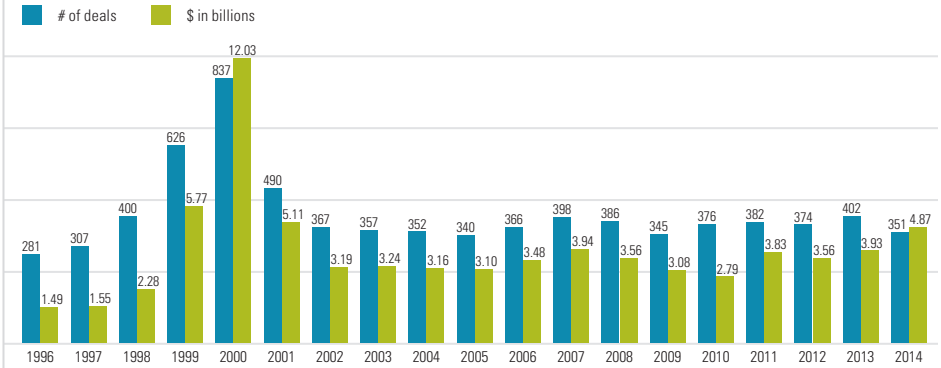
For the sixth consecutive year, the number of financings by life sciences companies in 2014 outpaced the number of financings by technology companies. The life sciences sector accounted for 37% of New England's venture capital financings, followed by technology (27%), business and financial services (25%) and consumer services (14%).

New England generated 25 venture-backed IPOs in 2014, a nearly three-fold increase from 2013 and the region's highest annual count since 2000. Massachusetts accounted for 22 of the region's IPOs—a whopping 77% of them by life sciences companies—and Connecticut contributed the remaining three. However, the region's largest VC-backed IPOs were by a pair of technology companies, Wayfair ($319 million) and HubSpot ($125 million).

The number of reported acquisitions of VC-backed companies in New England soared from 38 in 2013 to 60 in 2014, exactly reversing the prior year's decline. The region's largest M&A transaction of the year was the $1 billion acquisition of Dealer.com by Dealertrack, followed by WEX's acquisition of Evolution1 ($533 million).

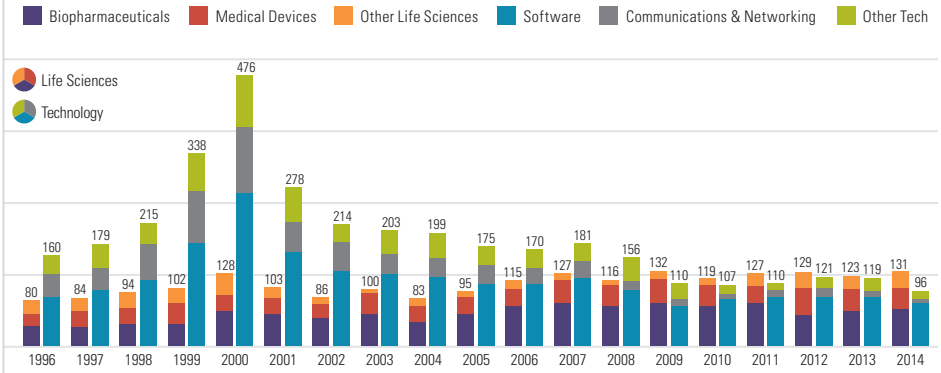
With its concentration of world-renowned universities and research institutions, New England—and Massachusetts in particular—should remain one of the country's most appealing environments for emerging companies and a hub of venture capital and IPO activity during 2015, particularly in the life sciences and technology sectors.

New England Venture Capital Financings – 1996 to 2014



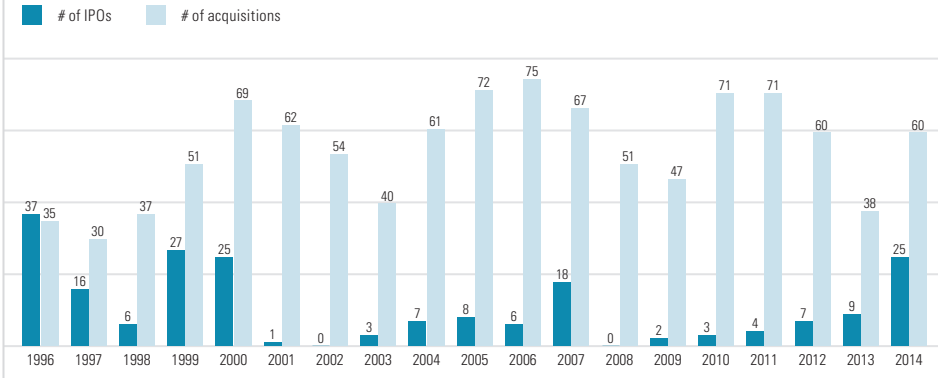
Source: Dow Jones VentureSource

New England Venture Capital Financings by Selected Industry – 1996 to 2014



Source: Dow Jones VentureSource

New England Venture-Backed IPOs and Acquisitions – 1996 to 2014



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 declined 10%, from 522 in 2013 to 472 in 2014, although the gap should narrow once all transactions are reported. Total proceeds in the region jumped 49%, from $3.89 billion to $5.80 billion—the region's highest tally since 2000.

New York led the tri-state region with 368 financings in 2014, down modestly from 390 in 2013, but topped Massachusetts for the third consecutive year as the nation's second-largest source of VC financings. Total proceeds in New York, which have increased 127% over the past two years, surpassed Massachusetts for the first time in 2014.

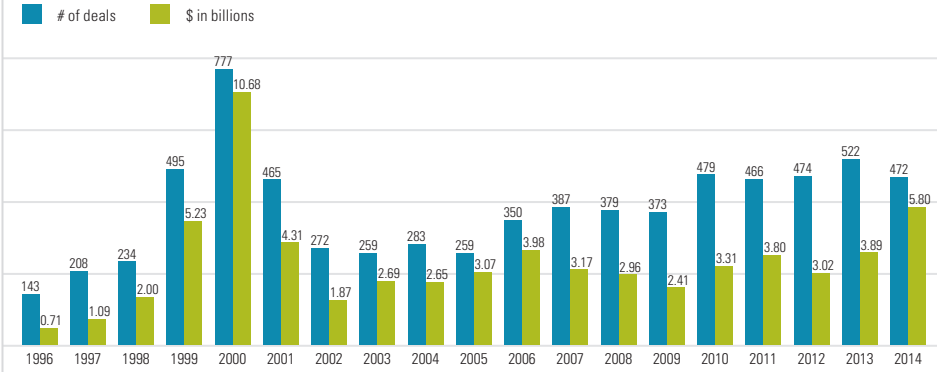
Consumer services companies accounted for the largest share of the tri-state region's VC financing activity in 2014, with 33% of all financings, followed by technology companies with 23%. Life sciences companies contributed 17% of the region's financings.

The number of VC-backed IPOs in the tri-state region increased from nine in 2013 to 12 in 2014, representing the region's highest annual total since 2000. New York, New Jersey and Pennsylvania each produced four IPOs. The region's largest VC-backed IPOs were by On Deck Capital ($200 million), Varonis Systems ($106 million) and Everyday Health ($100 million).

Reported acquisitions of venture-backed companies in the tri-state region declined 31%, from 81 in 2013 to 56 in 2014—the lowest level since 2010. The region's largest deal of 2014 was the $420 million acquisition of Tri-Northern Security Distribution by Anixter International, followed by M/A-COM Technology's acquisition of BinOptics ($230 million) and Rocket Fuel's acquisition of XPlusOne (also $230 million).

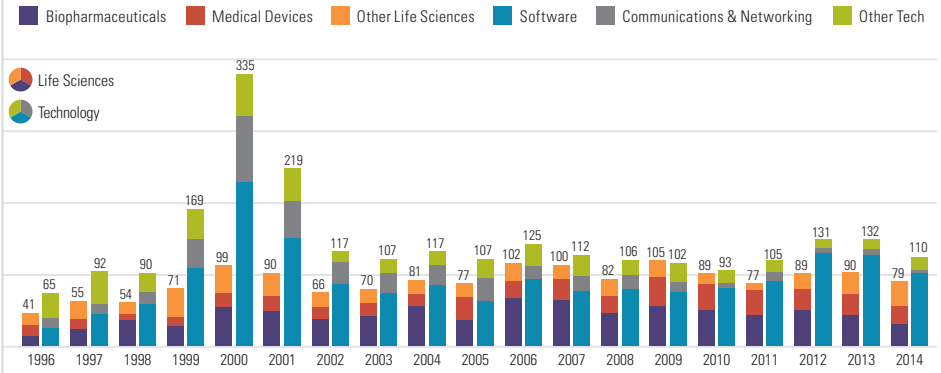
With strength across a broad array of industry sectors, the tri-state region can be expected to experience an increase in financing activity over the coming year. The region may have difficulty matching its 2014 level of IPO activity in 2015, but M&A deal flow can be expected to return to more normal levels. ■

Tri-State Venture Capital Financings – 1996 to 2014



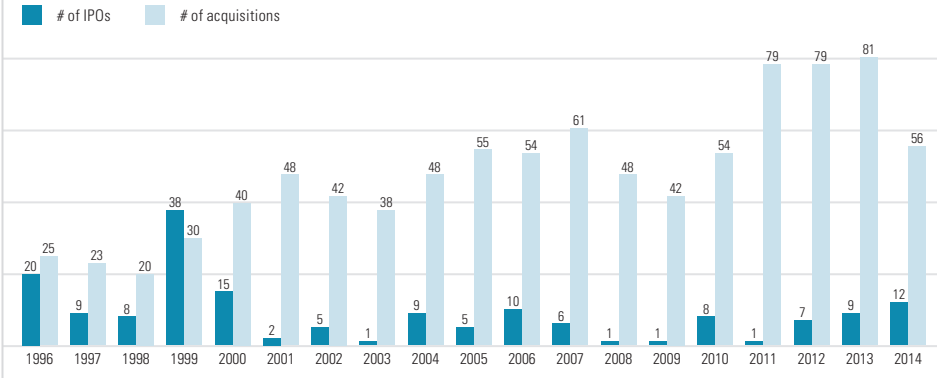
Source: Dow Jones VentureSource

Tri-State Venture Capital Financings by Selected Industry – 1996 to 2014



Source: Dow Jones VentureSource

Tri-State Venture-Backed IPOs and Acquisitions – 1996 to 2014



Source: Dow Jones VentureSource

Counsel of Choice for Venture Capital Financings

SERVING INDUSTRY LEADERS IN TECHNOLOGY, LIFE SCIENCES, ENERGY AND CLEANTECH, FINANCIAL SERVICES, COMMUNICATIONS AND BEYOND

ATAXION	Spark Therapeutics	trevi Therapeutics	AILERON Therapeutics	Vtesse	dc devices	mineraltree	coolplanet
$17,000,000 *First Round* February 2014	$72,800,000 *Second Round* May 2014	$26,000,000 *Second Round* May 2014	$33,000,000 *Late Stage* October 2014	$25,000,000 *First Round* December 2014	$34,000,000 *Fourth Round* June 2014	$11,100,000 *Second Round* January 2015	$100,000,000 *Fourth Round* March 2014

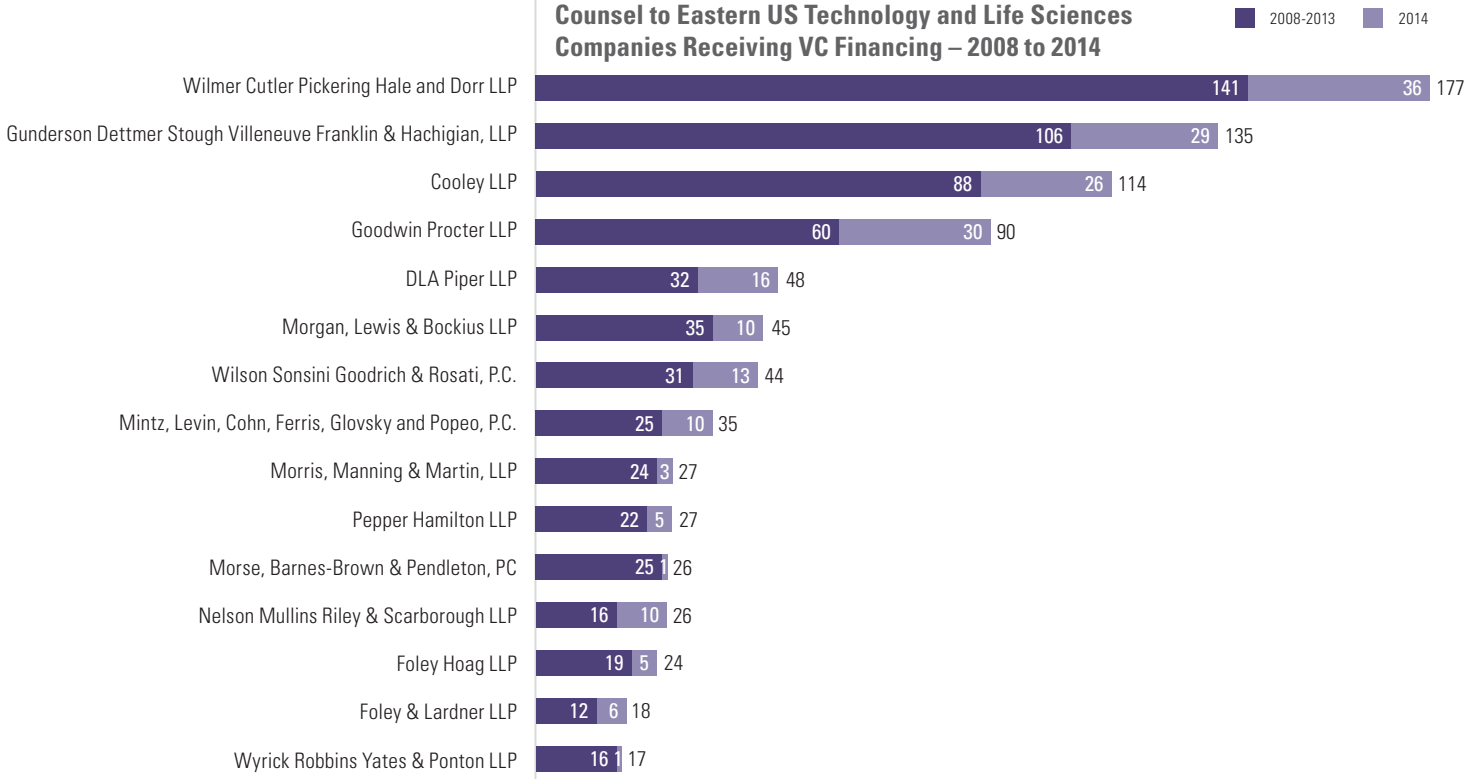
VIAMET	ALTIOSTAR	OXITEC	SYNTIMMUNE	BLUE DANUBE	GreenBiologics	ConsumerPhysics
$60,000,000 *Fourth Round* October 2014	$70,000,000 *Fourth Round* January 2015	£6,100,000 *Late Stage* June 2014	$28,000,000 *First Round* September 2014	$10,000,000 *Second Round* December 2014	$42,000,000 *Third Round* December 2014	$13,500,000 *Second Round* July 2014

KEW GROUP	Allena Pharmaceuticals	Daktari	CounterTack	BarkBox	Zopa	Visterra	avogy
$16,800,000 *Second Round* December 2014	$25,000,000 *Third Round* October 2014	$15,500,000 *Fourth Round* March 2015	$20,000,000 *Second Round* June 2014	$10,000,000 *Second Round* July 2014	£15,000,000 *Late Stage* January 2014	$30,000,000 *Second Round* May 2014	$40,000,000 *Second Round* June 2014

EXECONLINE	kolltan Pharmaceuticals Inc	peerTransfer	QD VISION	rethink robotics	Syros Pharmaceuticals	benu
$5,000,000 *First Round* September 2014	$60,000,000 *Fourth Round* March 2014	$22,000,000 *Third Round* January 2015	$29,000,000 *Late Stage* December 2014	$26,600,000 *Fourth Round* December 2014	$53,000,000 *Second Round* October 2014	$27,700,000 *Fourth Round* October 2014

WILMERHALE®

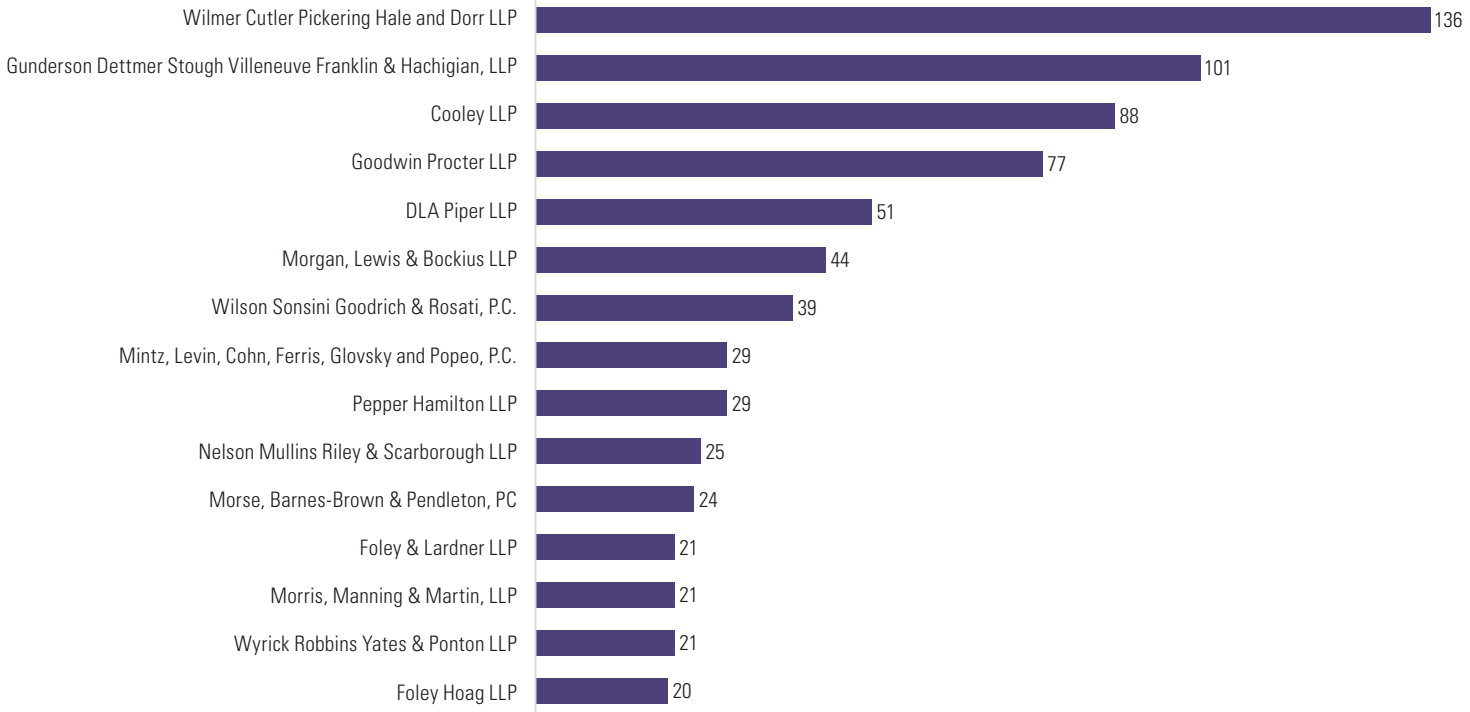
Counsel to Eastern US Technology and Life Sciences Companies Receiving VC Financing – 2008 to 2014



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 between 2008 and 2014.

Source: Dow Jones VentureSource

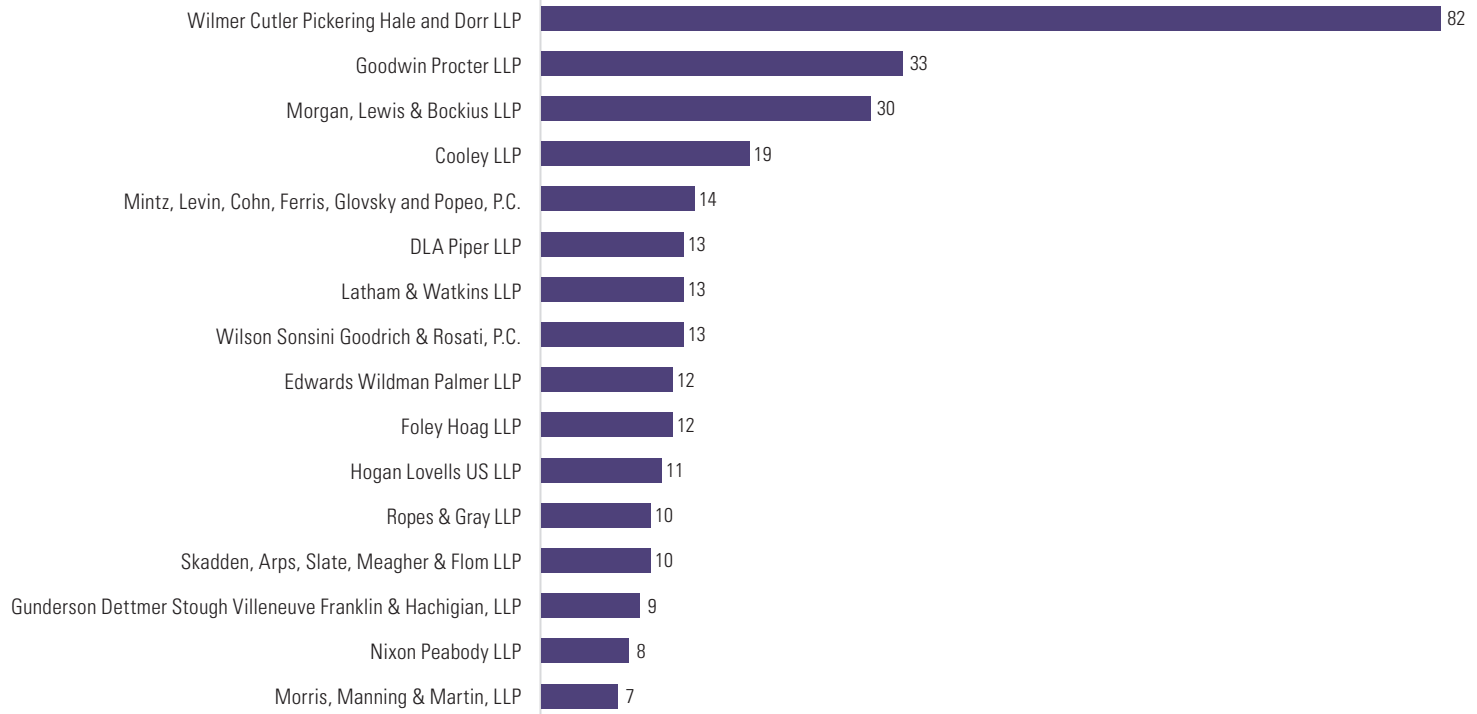
Counsel to Eastern US VC-Backed Technology and Life Sciences Companies at Year-End 2014



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 2014.

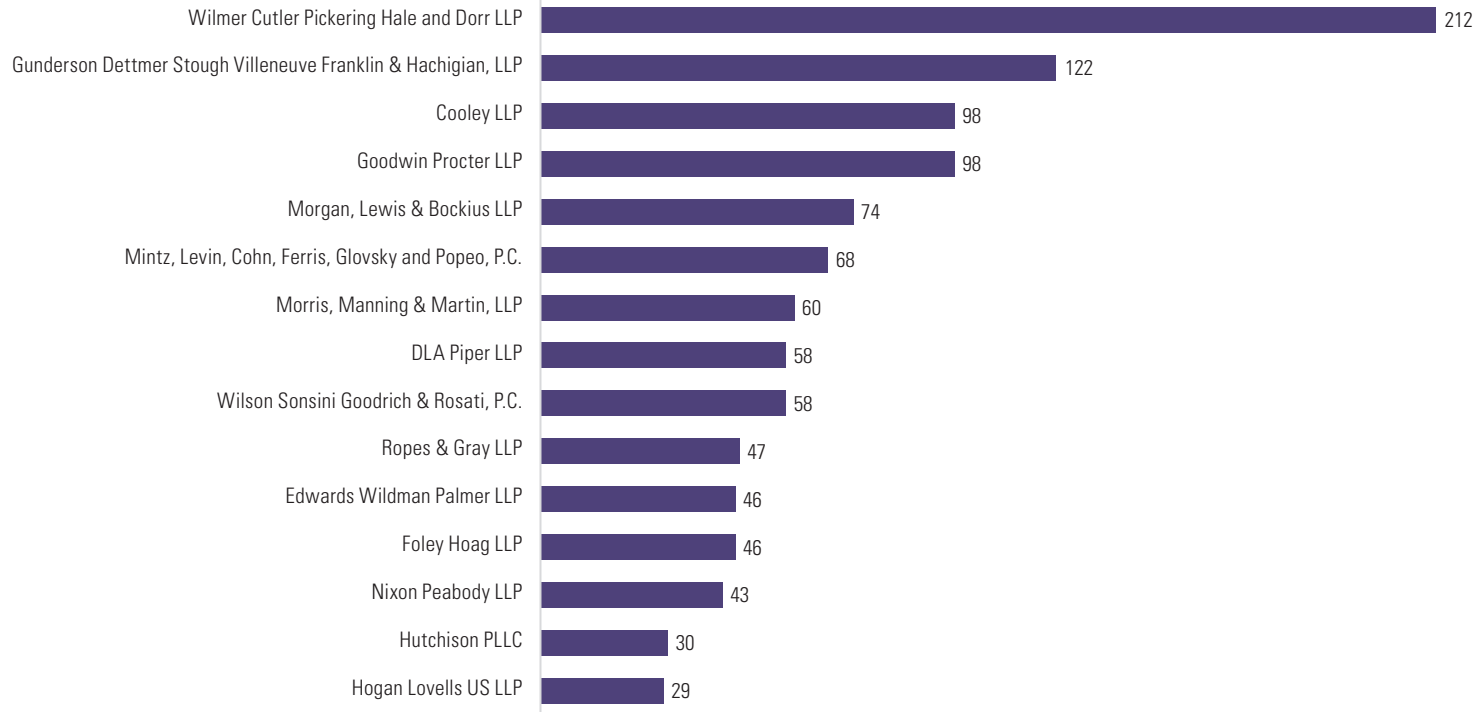
Source: Dow Jones VentureSource

Company Counsel in Eastern US VC-Backed IPOs – 1996 to 2014



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 2014



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

REVIEW

The European venture capital market produced strong results in 2014, particularly as measured by financing proceeds and liquidity events.

The number of reported venture capital financings in Europe declined 11%, from 1,636 in 2013 to 1,460 in 2014, but this decline is likely to be erased once all transactions have been reported. Gross proceeds increased 25%, from €6.29 billion to €7.89 billion—the highest annual gross proceeds since the €10.88 billion in 2001.

In 2014, consumer information services companies represented 30% of all European venture capital financings and 29% of gross proceeds, followed by business support services companies (28% of financings and 31% of proceeds) and technology companies (18% of financings and 12% of proceeds). With a larger median financing size, companies in the life sciences sector produced 22% of the year's proceeds, while accounting for only 15% of all financings.

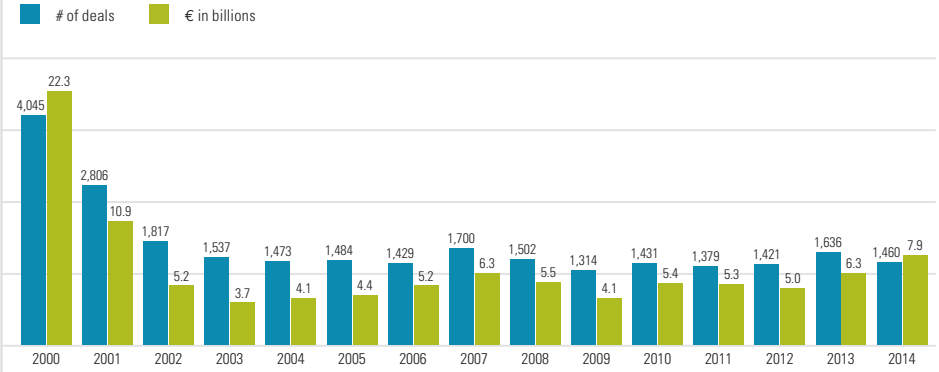
The United Kingdom generated 25% of Europe's venture capital financings and 26% of all gross proceeds in 2014, while Germany produced 16% of the financings and 27% of the proceeds. France followed with 17% of the year's financings and 12% of all proceeds.

The number of IPOs by European venture-backed companies more than tripled, from 18 in 2013 to 55 in 2014—the highest annual tally since the 97 in 2006. Acquisitions of European VC-backed companies increased 21%, from 166 to 201, but M&A activity remained 30% below the level that prevailed from 2004 to 2008.

OUTLOOK

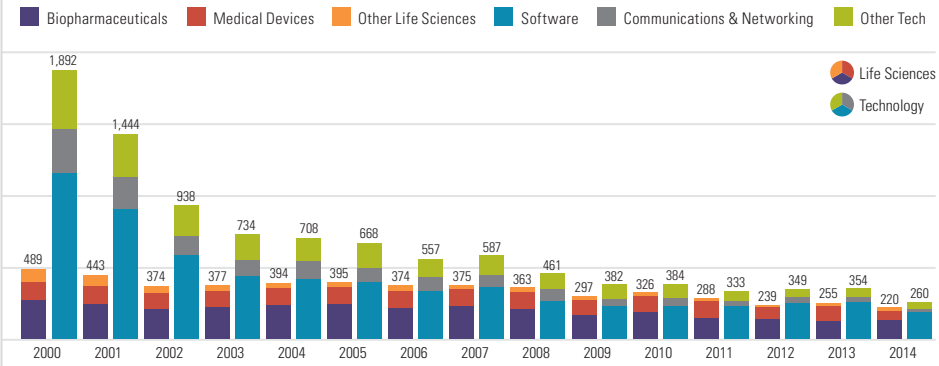
With an increasingly globalized Internet and the cost of starting new companies at historically low levels, new business formation remains brisk. The sharp increase in VC-backed IPOs in 2014 should improve investment returns and make it easier for venture capital firms to raise new funds. Together, these factors bode well for an increase in European venture capital activity in 2015, despite continuing economic challenges. ■

European Venture Capital Financings – 2000 to 2014



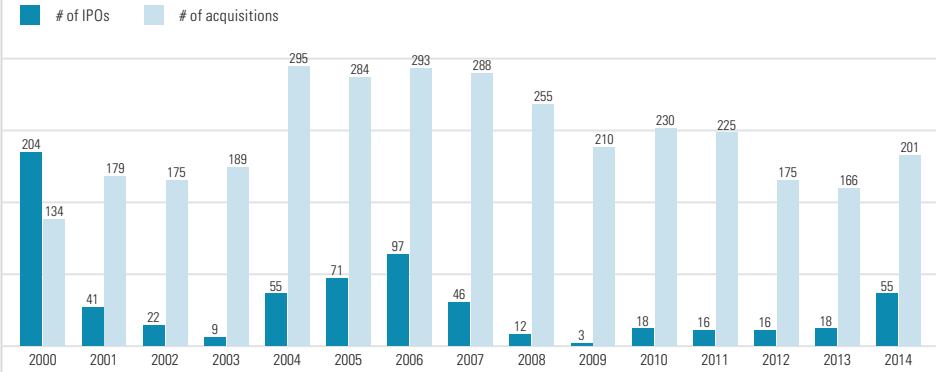
Source: Dow Jones VentureSource

European Venture Capital Financings by Selected Industry – 2000 to 2014



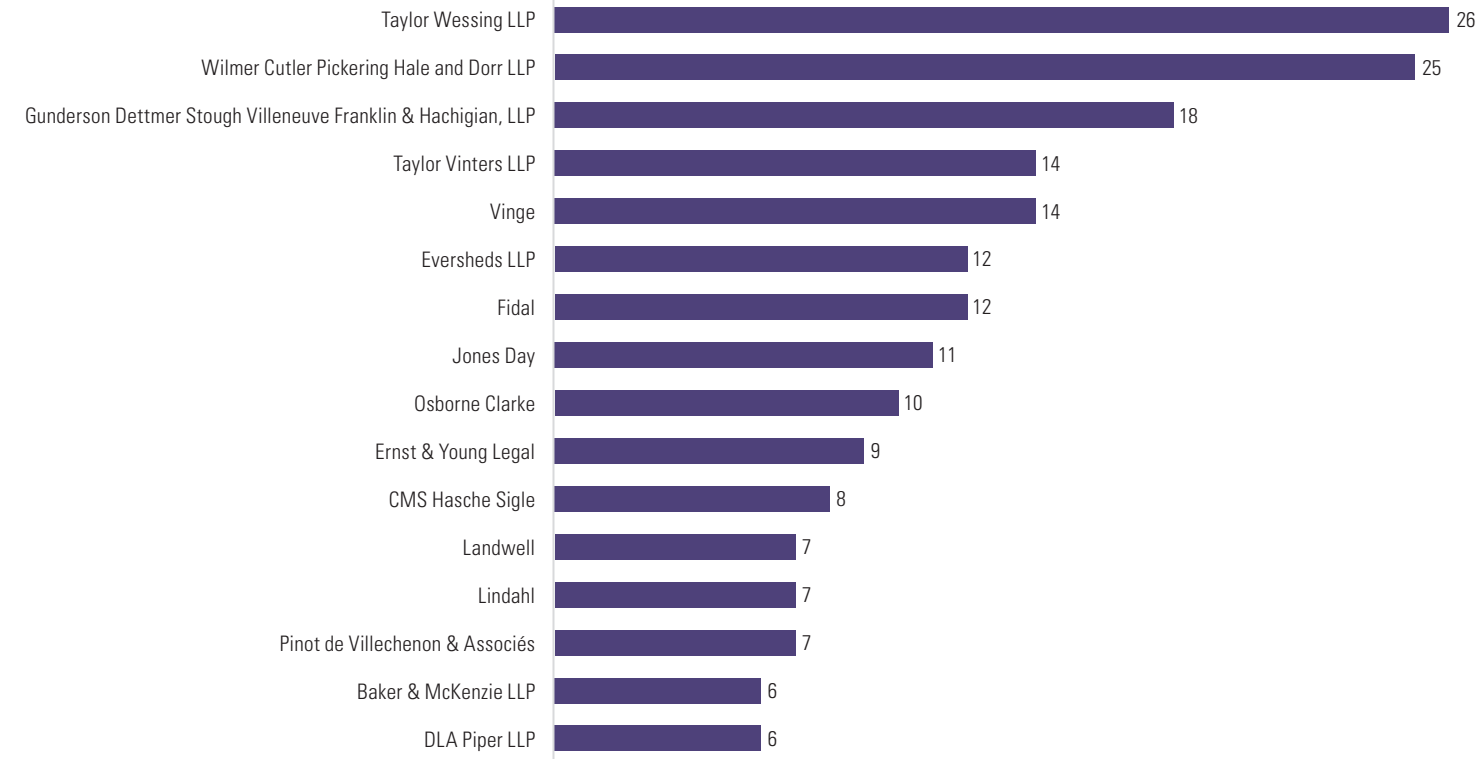
Source: Dow Jones VentureSource

European Venture-Backed IPOs and Acquisitions – 2000 to 2014



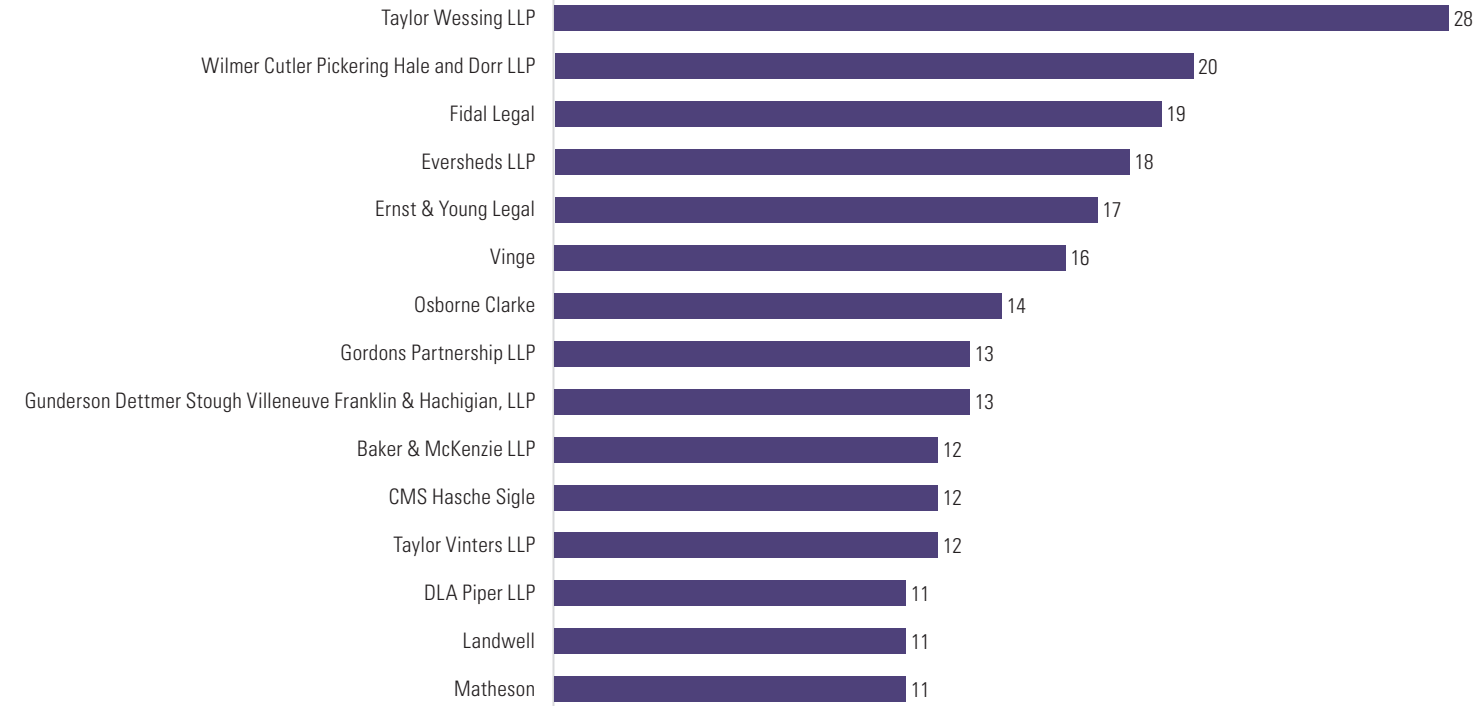
Source: Dow Jones VentureSource

Counsel to European Technology and Life Sciences Companies Receiving VC Financing – 2008 to 2014



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 2014.
Source: Dow Jones VentureSource

Counsel to European VC-Backed Technology and Life Sciences Companies at Year-End 2014



The above chart is based on European VC-backed companies that were private and independent as of the end of 2014.
Source: Dow Jones VentureSource

16 When Should I Incorporate My Startup?

If you are reading this, odds are you think of yourself as the founder of a startup. And if you are the founder of a startup, odds are it is time for you to incorporate your company.

WHY SHOULD I INCORPORATE MY STARTUP?

The most important benefit of incorporation is limitation of liability. If a third party sues your business, that third party can only reach the assets of the entity that you've incorporated. Assuming you've complied with corporate laws related to the corporate entity, the third party cannot successfully recover from your personal assets, such as your house, your bank account or your dog. The protection of limited liability is particularly useful if your company is actually working with third parties—hiring employees, leasing space or contracting with suppliers.

There are other benefits of incorporating a company. First, when you incorporate your company, you issue stock to the founders and possibly others who have a relationship with the company, such as early-stage employees. This exercise legally determines the company's owners. If it's just you, easy. If it's you and a few friends or colleagues who've been helping you out, the process of incorporating and issuing stock will make it very clear who owns what, and any back-of-the-napkin or late-night discussions regarding allocation of ownership should be resolved at the time of incorporation.

Having a clear and tidy capitalization structure is beneficial, both because it can save heartache and avert acrimony between founders who were not on the same page, and because investors may be discouraged from investing in a company that has a complicated cap table or a dispute about stock ownership. Also, it often makes sense to incorporate your business and issue shares to the founders sooner rather than later, when the value is low and shares can be issued to founders at a low price and without incurring hefty tax if the founders accept stock as compensation without paying for it.

Becoming a corporation also allows you to compensate your service providers with something other than cash (which, for many startups, is in short supply): stock options! Grants of stock options are a valuable tool to attract and incent employees and advisors.

Because a corporation has a legal identity distinct from its founders and stockholders, incorporation also creates a place to "store" the company's intellectual property (IP), even if the IP was developed collectively by multiple people. Once your company is incorporated, all IP related to the business of the company should be owned by the corporation, not by the individual founders or others who developed the IP. Each founder and any consultant should assign all rights to any IP created for the company to the corporation. That way, if a member of the founding team or a consultant walks away, your company's inventions do not legally travel with the departing person. Potential investors and acquirers will lose interest in the company if they are not comfortable that the intellectual property is legally owned by the entity.

WHAT ARE THE DOWNSIDES OF INCORPORATING MY STARTUP?

Now, you may be thinking: "Yes. I have an idea; I might even have co-founders; there is valuable IP involved. We are serious about this business and we want to move forward. Why wouldn't we incorporate?"

Here are two reasons: It may be that you need to continue to develop your initial science or technology, or refine your business plan, before jumping in full-time. Or you may still be hammering out exactly what the respective roles of the co-founders will be going forward. If this sounds like you, take the time you need.

You also should consider the expense of incorporating your company, including the costs associated with preparing and filing your company's certificate of incorporation, qualifying your company to do business in the state in which it is located (if different than the state of incorporation) and annual franchise taxes (which generally vary based on your company's outstanding stock and assets).

SHOULD I TALK TO MY EMPLOYER BEFORE INCORPORATING?

If you are currently employed, or you were employed when you developed the IP that is going to serve as the foundation of your company, you should consider the rights the employer may have in the IP. Most employers have a policy that says inventions or discoveries that you make while you are their employee belong to them and not to you, although these policies often except inventions you created on your own time and without use of your employer's facilities or resources. If this is not the situation, and if you want the IP to belong to your company, you will need to ask your employer.

In the case of a life sciences startup based on inventions from your lab at a university, you will need the cooperation of the university to legally transfer the applicable patent to your company. Sometimes, the university may not be eager to transfer or license the patent to your company, and your best option may be to team up with the university to commercialize the patent, rather than trying to extract it from the university. Alternatively, the university may see little to no commercial value in a patent and decide that it no longer wants to bear the cost of maintaining that patent; in that case, you may have the opportunity to assume the obligation to pay the cost of maintaining the patent in exchange for the right to develop and commercialize the patent. Of course, there are many potential outcomes in between these two poles.

The bottom line: If your employer has rights in the IP that will serve as the foundation of your company's efforts, there is no need to form a corporation until you and your employer come to an understanding with respect to the IP. Incorporation can wait.

CONCLUSION

Incorporation offers important advantages and is necessary if you are going to accept funding and grow your startup for eventual sale or IPO. Once your technology and team are in place, incorporation is the next logical step for your startup. It's time to launch your company! ■

We reviewed all merger transactions between 2008 and 2014 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	2008	2009	2010	2011	2012	2013	2014
Sample Size	25	15	17	51	26	27	37
Cash	76%	60%	71%	73%	73%	59%	59%
Stock	4%	0%	6%	4%	8%	8%	3%
Cash and Stock	20%	40%	23%	23%	19%	33%	38%
Deals with Earnout	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
With Earnout	12%	27%	29%	29%	31%	33%	30%
Without Earnout	88%	73%	71%	71%	69%	67%	70%
Deals with Indemnification	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
With Indemnification							
By Target's Shareholders	96%	100%	100%	98%	100%	100%	97%
By Buyer[1]	48%	36%	17%	43%	62%	44%	49%
Survival of Representations and Warranties[2]	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Shortest	12 Months	6 Months	9 Months	12 Months[3]	10 Months	12 Months	12 Months[4]
Longest	24 Months	18 Months	21 Months	24 Months	24 Months	30 Months	24 Months
Most Frequent	12 Months	18 Months	18 Months	18 Months	18 Months	18 Months	12 and 18 Months (tie)
Caps on Indemnification Obligations	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
With Cap	95%	100%	100%	100%	100%	100%	100%
Limited to Escrow	81%	71%	71%	77%	81%	88%	89%
Limited to Purchase Price	14%	0%	6%	2%	0%	0%	0%
Exceptions to Limits[5]	62%	71%	94%	96%	96%	100%	100%
Without Cap	5%	0%	0%	0%	0%	0%	0%
Escrows	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
With Escrow	96%	93%	100%	94%	100%	93%[6]	97%
% of Deal Value							
Lowest	3%	10%	2%	5%	5%	5%	2%[7]
Highest	15%	15%	25%	31%	16%	20%	16%
Most Frequent	10%	10%	10%	10%	10%	10%	10%
Length of Time							
Shortest	12 Months	12 Months	9 Months	12 Months	10 Months	12 Months	12 Months
Longest	36 Months	18 Months	36 Months	36 Months	48 Months	30 Months	24 Months
Most Frequent	12 Months	12 and 18 Months (tie)	18 Months	18 Months	12 Months	18 Months	12 Months
Exclusive Remedy	83%	46%	53%	78%	73%	60%	86%
Exceptions to Escrow Limit Where Escrow Was Exclusive Remedy[8]	85%	83%	80%	97%	100%	100%	100%
Baskets for Indemnification	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Deductible[9]	43%[10]	43%	56%	38%	27%	50%	44%
Threshold[9]	48%[10]	57%	44%	60%	65%	42%	56%
MAE Closing Condition	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Condition in Favor of Buyer	88%	100%	100%	98%	95%	100%	97%
Condition in Favor of Target[11]	21%	20%	19%	15%	9%	17%	19%
Exceptions to MAE	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
With Exception[12]	92%	93%	94%	94%[13]	84%[14]	96%[15]	100%

[1] The buyer provided indemnification in 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, 55% of the 2013 transactions, and 53% of the 2014 transactions where buyer stock was used as consideration. In 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, 50% of the 2013 transactions, and 44% of the 2014 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 one case, representations and warranties did not survive.

[4] In one case, general representations and warranties did not survive, but certain "fundamental" representations and warranties did 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] Excludes one transaction with an escrow of 0.75% which also specifically referred to representation and warranty insurance as recourse for the buyer.

[8] 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.

[9] A "hybrid" approach with both a deductible and a threshold was used in another 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.

[10] Another 4% of these transactions had no deductible or threshold.

[11] In 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, 100% of these transactions in 2013, and 86% of these transactions in 2014, buyer stock was used as consideration.

[12] Generally, exceptions were for general economic and industry conditions.

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

[14] 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.

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

Based on more than 100 convertible debt financing transactions we handled in 2013 and 2014 for companies and investors throughout the United States, we have compiled the following deal data:

Deals with Note Purchase Agreement		2013	2014
Convertible note investors often require the company to enter into a note purchase agreement containing representations and warranties from the company (and possibly the founders).	% of Deals	65%	64%
Term		**2013**	**2014**
The term of the convertible note before it becomes due and payable.	Median Range	15 months 1 month–48 months	18 months 1 month–72 months
Interest Rate		**2013**	**2014**
The rate at which interest accrues during the term of the convertible note.	Median Range	6% 0.25%–20%	6% 0.33%–15%
Deals with Security Interest		**2013**	**2014**
Convertible note investors sometimes require the company to provide a security interest in some or all of the company's assets. If the note is not repaid or converted into capital stock, the pledged assets would become available to satisfy the note.	% Secured % Unsecured	25% 75%	20% 80%
Deals with Conversion Discount		**2013**	**2014**
Convertible note investors often require that the notes convert in connection with a financing at a discount from the price paid by new investors in the financing to reward the convertible note investors for the risk of investing before the new investors. A conversion discount is often coupled with a cap on the valuation at which the notes convert.	% of Deals Range of Discounts % with 20% or Less Discount % with Greater Than 20% Discount % with Valuation Cap	66% 10%–50% 71% 29% 67%	72% 10%–50% 76% 24% 74%
Deals with Conversion upon Maturity		**2013**	**2014**
If a convertible note is not converted or otherwise paid upon maturity, it often converts into shares of the company's capital stock (common 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 Preferred	59% 80% 20% 31% 69%	57% 90% 10% 54% 46%
Deals with Conversion upon Company Sale		**2013**	**2014**
If a convertible note is not converted or otherwise paid at the time of a sale of the company, it often converts into shares of the company's capital stock (common 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 Preferred	66% 95% 5% 55% 45%	66% 86% 14% 60% 40%
Deals with Conversion Premium upon Company Sale		**2013**	**2014**
Convertible note investors may require that they receive a multiple of the outstanding principal of the convertible note upon a sale of the company.	% of Deals Median Premium Range of Premiums	51% 2x 2x–4x	52% 2x 1.5x–3x
Deals with Warrant Coverage		**2013**	**2014**
Convertible note investors sometimes receive a warrant in addition to a note. The amount of company stock covered by the warrant is usually proportional to the principal amount of the note, referred to as the warrant coverage. For example, if the investor is funding $100,000 and the warrant coverage is 10%, then the number of shares of stock for which the warrant is exercisable would equal $10,000 divided by the warrant exercise price.	% of Deals Coverage Range % that Cover Common % that Cover Preferred	5% 4%–25% 0% 100%	11% 1%–50% 20% 80%

Based on hundreds of venture capital financing transactions we handled from 2010 to 2014 for companies and venture capitalists in the United States and Europe, we have compiled the following deal data:

Deals with Multiple Liquidation Preferences		2010	2010 Range	2011	2011 Range	2012	2012 Range	2013	2013 Range	2014	2014 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	4%	2x	7%	1.2x–3x	0%	N/A	5%	2x–3x	0%	N/A
	Post–Series A	10%	1.5x–2x	4%	1.3x–1.5x	7%	2x–2.4x	9%	1.5x–2.17x	3%	1.5x (all)

Deals with Participating Preferred Stock		2010	2010 Range	2011	2011 Range	2012	2012 Range	2013	2013 Range	2014	2014 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	33%		24%		15%		8%		12%	
	Capped	18%	2x–3x	45%	2x–3x	43%	2x–10x	50%	2x–3x	40%	3x–5x
	Post–Series A										
	Total	44%		34%		27%		24%		19%	
	Capped	45%	1.6x–5.5x	30%	1.75x–8x	44%	2x–3x	41%	2x–5x	45%	2x–5x

Deals with an Accruing Dividend		2010	2011	2012	2013	2014
"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	23%	18%	29%	9%	11%
	Post–Series A	30%	43%	28%	11%	22%

Anti-Dilution Provisions		2010	2011	2012	2013	2014
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%	2%	0%	0%	0%
	Weighted Average	100%	98%	100%	100%	100%
	Post–Series A					
	Full Ratchet	4%	3%	3%	1%	1%
	Weighted Average	96%	97%	97%	99%	99%

Deals with Pay-to-Play Provisions		2010	2011	2012	2013	2014
"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	20%	19%	7%	7%	8%
	% of Total that Convert into Common Stock	100%	82%	100%	100%	53%
	% of Total that Convert into Shadow Preferred Stock	0%	18%	0%	0%	47%

Follow us **@WHLaunch** on

POSITION YOUR STARTUP FOR SUCCESS

WILMERHALE LAUNCH℠

Founders and other entrepreneurs are faced with many questions during their journey to launch a successful business. WilmerHale Launch has the answers you need to get your company off the ground—and keep it there.

We've helped thousands of startups successfully launch their companies; raise billions in angel, venture and strategic financing; and take their companies to sale, IPO and beyond.

READY TO GET STARTED? Visit **WilmerHaleLaunch.com**

- Expand your lexicon with our **Startup Dictionary**
- View a list of common startup-related questions on our **Q&A Forum**
- Discover answers specific to your business with our **Knowledge Navigator**
- Find out what's going on in the industry with our **Event Listings**
- Create important legal documents for free with our **Document Generator**
- Read about trends in the startup community on our **Blog**
- Make decisions on how to divide equity with access to an **Equity Calculator**
- Learn about topics pertaining to your business by watching our nearly 100 **Videos**

Powered by WILMERHALE®

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

Our *2015 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 rates of adoption of various elements of JOBS Act relief available to emerging growth companies, and helpful tips on how to keep your directed share program company-friendly. We examine the pros and cons of employee stock purchase plans; review various SEC, stock exchange and other considerations around director independence; address key areas of regulatory diligence for companies going public; and offer a helpful walk-through of the process of SEC review of Form S-1 registration statements in the lead-up to an IPO.

See our *2015 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, updates on takeover defenses and the current climate around proxy access, and a look at the use of social media by public companies and activist shareholders in contested situations. We also examine recent trends in merger control, discuss lessons from *Cigna v. Audax* for sales of VC-backed companies structured as mergers, address the challenges posed by pre-IPO 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 *2015 VC Report*, please contact the WilmerHale Client Development Department at ClientDevelopment@wilmerhale.com or call +1 617 526 5600. An electronic copy of this report can be found at www.wilmerhale.com/2015VCreport.

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.

Mixed Sources
Product group from well-managed forests, controlled sources and recycled wood or fiber
www.fsc.org Cert no. BV-COC-070904
© 1996 Forest Stewardship Council

15_0134 KW 4/15 6,000

WilmerHale recognizes its corporate responsibility to environmental stewardship.

wilmerhale.com