

# Venture Capital Report

2019

WILMERHALE® 

# 2019 Venture Capital Report – What’s Inside

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## 2 US Market Review and Outlook

### REVIEW

The venture capital market hit record levels in 2018, with robust increases in deal flow and financing sizes, coupled with soaring proceeds and a record-high median pre-money valuation. The \$130.4 billion invested in the US venture capital ecosystem in 2018 represents the highest annual total in history, eclipsing the \$92.9 billion raised in 2000, and the number of 2018 venture capital financings—once all deals are accounted for—should approach the record-high annual tally from 2000.

VC-backed company liquidity activity was also strong in 2018. The IPO market produced a 56% year-over-year increase and attractive valuations, while acquisition activity reached record levels of transactions and proceeds.

### EQUITY FINANCING ACTIVITY

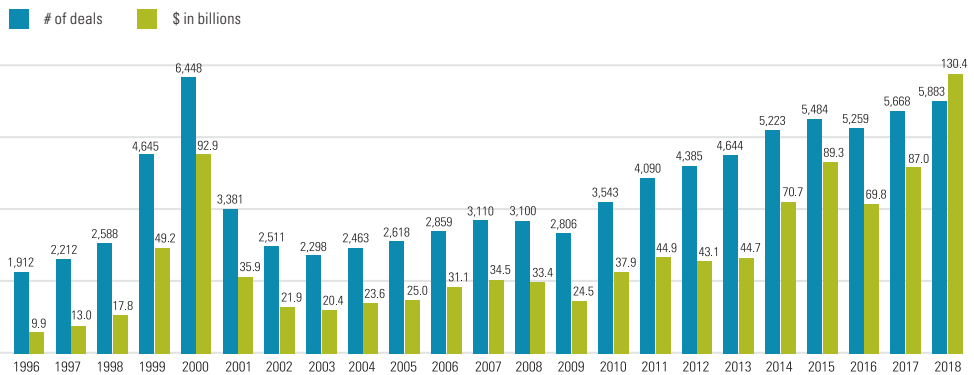
The number of reported venture capital financings increased by 4%, from 5,668 in 2017 to 5,883 in 2018. Once all financings are counted, the total for 2018 should be close to the record high of 6,448 deals in 2000.

Total reported venture capital financing proceeds increased by 50%, from \$87.0 billion in 2017 to \$130.4 billion in 2018—the highest annual level in history, with the year-over-year increase in total dollars falling just shy of the \$43.7 billion increase between 1999 and 2000.

Overall, the median size of venture capital financings increased by 20%, from \$5.0 million in 2017 to \$6.0 million in 2018—the highest level since the \$6.5 million figure for 2008. The median size of first-round financings increased by 31%, from \$4.2 million in 2017 to \$5.5 million in 2018. The median size of second-round financings increased by one-third, from \$7.5 million in 2017 to \$10.0 million in 2018. Later-stage financings saw the largest dollar increase in median financing size, growing by \$5.0 million, or 33%, from \$15.0 million in 2017 to \$20.0 million in 2018 and surpassing the previous record-high figure of \$17.1 million for 2000.

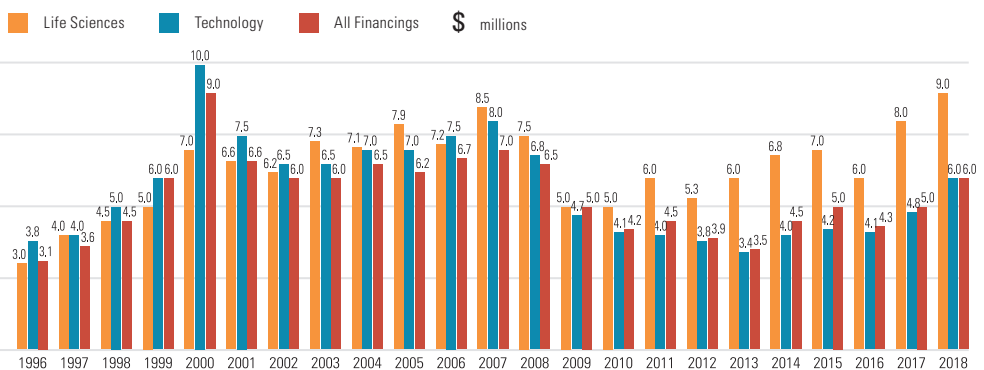
The median financing size for life sciences companies increased by 13%, from \$8.0

### US Venture Capital Financings – 1996 to 2018



Source: Dow Jones VentureSource

### Median Size of US Venture Capital Financings – 1996 to 2018



Source: Dow Jones VentureSource

million in 2017 to \$9.0 million in 2018. For technology companies, the median financing size grew by 25%, from \$4.8 million to \$6.0 million. Despite this increase, the median financing size for technology companies remains significantly below the levels seen prior to 2009. The general decline in the median financing size for technology companies in recent years is at least partly attributable to technological advances—such as cloud computing and open source software—that have enabled startups to commence and grow their operations with less funding than historically required.

Other than in 2016, the number of very large financing rounds has increased each year since 2012, as VC-backed companies increasingly rely on “IPO-sized” later-stage

rounds of financing, sometimes with the intention of eschewing the public markets.

From 2012 to 2015, the number of financing rounds of at least \$50 million grew from 82 to 283. Following a decline to 184 rounds in 2016, the number of financing rounds of at least \$50 million rebounded in 2017 to 285 and then leapt 60% to 455 in 2018.

Similarly, the number of financing rounds of at least \$100 million—which increased from 19 in 2012 to 103 in 2015 and then fell to 52 in 2016—recovered to 107 in 2017 and then jumped to 177 in 2018.

There were 15 financing rounds of at least \$500 million in 2018, up from nine in both 2016 and 2017.

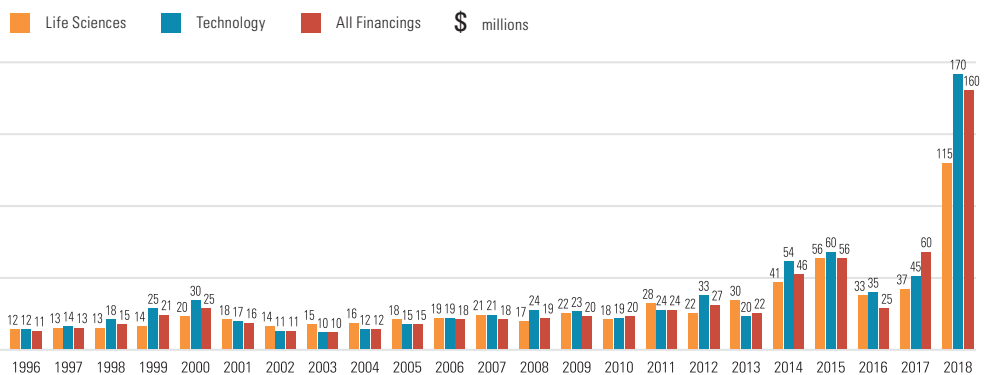
Increases in super-sized rounds are driven largely by private equity, crossover and hedge funds, which are attracted to pre-IPO companies that can offer the potential for sizeable investment returns, especially when investors are able to negotiate ratchet or other provisions guaranteeing them a minimum return at the time of an IPO, typically in the form of additional shares if the offering prices below a specified price.

The median pre-money valuation for all venture financings more than doubled from the previous record high of \$60.0 million in 2017 to \$160.0 million in 2018, primarily due to higher valuations in later-stage rounds. The median pre-money valuation in the technology sector nearly quadrupled, rising from \$45.0 million to \$170.0 million. Among life sciences companies, the median pre-money valuation jumped from \$37.3 million in 2017 to \$114.9 million in 2018—surpassing the sector’s previous record high of \$56.4 million in 2015.

Seed and first-round venture capital financings accounted for 33% of all venture financings in 2018 (equal to the figure for 2017) and represented 15% of all venture capital financing proceeds (down from 16%). Second-round financings accounted for 14% of all financings in 2018 (down from 15% in 2017) and represented 13% of all proceeds (down from 16%). Later-stage financings accounted for 30% of all financings in 2018 (up from 29% in 2017) and represented 52% of all proceeds (down from 57%). This decline in the percentage of proceeds attributable to second-round and later-stage financings is largely explained by a dramatic increase in proceeds from corporate venture capital investments, which surged from less than 3% in 2017 to 12% in 2018, primarily due to Altria’s \$12.8 billion investment in Juul Labs.

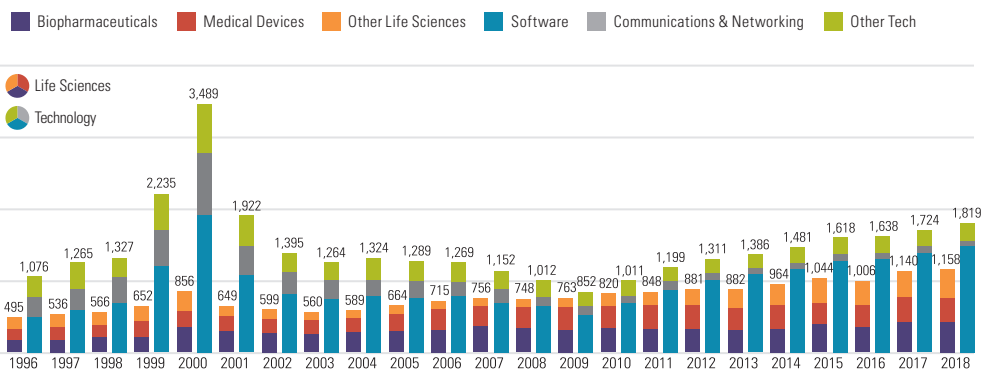
The technology sector accounted for 31% of the year’s transactions in 2018, modestly higher than its 30% market share in 2017. The business and financial services sector’s market share remained at 22% in 2018, following two consecutive annual declines. After four years of growth, the market share for life sciences companies held steady at 20% in 2018.

### Median Pre-Money Valuation in US Venture Capital Financings – 1996 to 2018



Source: Dow Jones VentureSource

### US Venture Capital Financings by Industry – 1996 to 2018



Source: Dow Jones VentureSource

California—which has led the country in financing activity in each year since 1996—produced 40% of all venture financing transactions in 2018 (2,360 financings) and 57% of the year’s proceeds (\$74.7 billion). New York, home to companies with 712 financings raising \$12.2 billion in 2018, finished second in the state rankings, followed by Massachusetts (with 463 financings raising \$11.3 billion), Texas (with 262 financings raising \$2.18 billion) and Washington (with 224 financings raising \$2.24 billion).

### LIQUIDITY ACTIVITY

The number of VC-backed US issuer IPOs increased by 52%, from 50 in 2017 to 76 in 2018. The largest was the \$756 million offering of Dropbox,

followed by the IPOs of DocuSign (\$629 million), Moderna (\$604 million) and Allogene Therapeutics (\$324 million).

In 2018, 60% of all VC-backed IPOs were by life sciences companies, up from 56% in 2017 but below the 64% that prevailed from 2014 to 2016. The VC-backed IPO market share for technology companies declined from 42% in 2017 to 36% in 2018 but compared favorably to the 33% figure that prevailed from 2014 to 2016.

The median time from initial funding to IPO decreased from 7.4 years in 2017 to 5.2 years in 2018—the lowest annual level since 2002 (3.6 years). Among life sciences companies, the median plunged from 7.1 years in 2017 to 3.5 years in 2018 (the lowest annual level since 2002), while among technology companies it

## 4 US Market Review and Outlook

jumped from 8.3 years to 11.6 years (the highest annual figure since at least 1992).

The median amount raised prior to an IPO increased by 19%, from \$105.9 million in 2017 to \$126.2 million in 2018, while the median pre-IPO valuation edged up from \$360.3 million to \$371.2 million. As a result, the ratio of pre-IPO valuations to the median amount raised prior to an IPO decreased from 3.4:1 in 2017 to 2.9:1 in 2018, still the second-highest level in the last five years (a higher ratio means better returns to pre-IPO investors). The ratio was between 3.2:1 and 5.8:1 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 6.5:1 to 10.4:1 between 1996 and 2000, due to very large pre-IPO valuations by younger companies during that period.

The average VC-backed IPO in 2018 gained 7% during the year, outperforming the major stock market indices. However, only 46% of the year's VC-backed IPO class ended 2018 in positive territory—illustrating that aftermarket gains from IPOs are far from guaranteed.

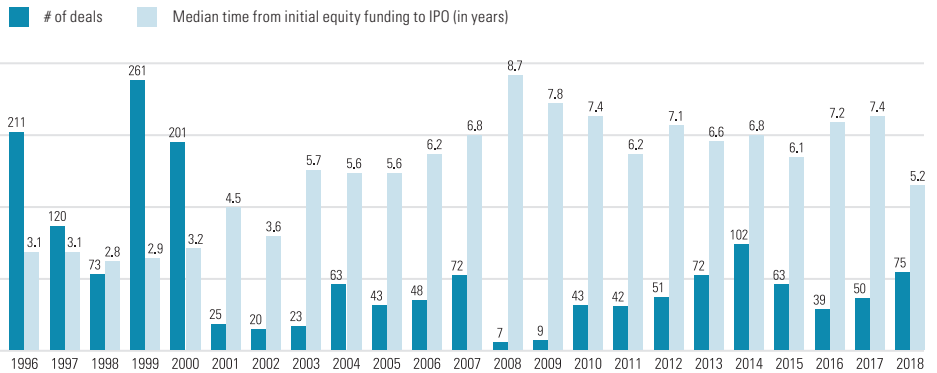
The number of reported acquisitions of VC-backed companies increased by 11%, from 707 in 2017 to a record 784 in 2018. Total reported proceeds increased by almost two-thirds, from \$89.4 billion to a record \$146.2 billion.

The median acquisition price increased by 61%, from \$80.7 million in 2017 to \$130.0 million in 2018—surpassing the previous record set in 2000.

The median time from initial funding to acquisition remained steady between 2017 and 2018 at 5.0 years, one of the shortest median figures since 2005, second only to the 4.8-year median in 2015.

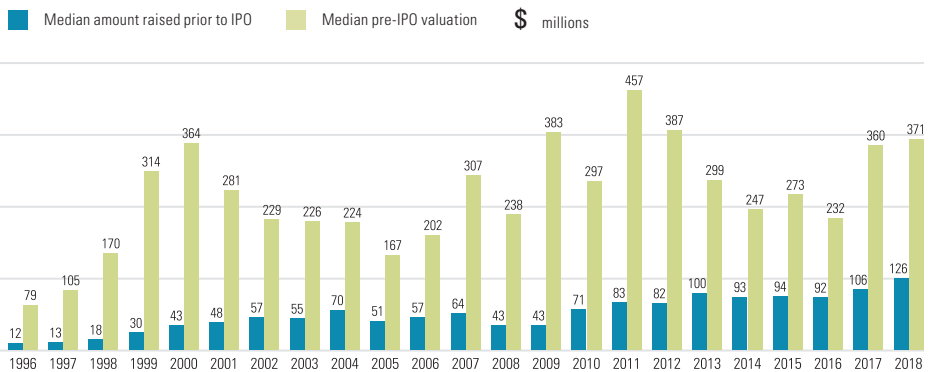
The median amount raised prior to acquisition increased by 7%, from \$12.7 million in 2017 to \$13.7 million in 2018. The ratio of median acquisition price to median amount raised prior to acquisition increased from 6.3:1 in 2017 to 9.5:1 in 2018 (a higher ratio means higher returns

### Venture Capital–Backed IPOs and Median Time to IPO – 1996 to 2018



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 2018



Source: Dow Jones VentureSource

to pre-acquisition investors). The 2018 figure was the highest recorded since the ratio of 10.0:1 in 2000, at the apex of the dot-com delirium. The increase in this ratio stemmed from significantly higher acquisition prices, coupled with low investment levels prior to acquisition.

There were 29 VC-backed company acquisitions for at least \$500 million in 2018, up from 19 in 2017 and 17 in both 2016 and 2015. The year also saw 13 billion-dollar acquisitions, up from eight in each year between 2015 and 2017. The largest deal of 2018 was SAP's \$8.0 billion acquisition of Qualtrics, just before the survey and research software company was set to go public—much like Cisco Systems's 2017 acquisition of AppDynamics on

the cusp of its IPO, which was that year's largest VC-backed acquisition.

The above comparison of the ratios of valuations to the financing amounts required to achieve liquidity events indicates that—for the sixth consecutive year—returns to venture capital investors in 2018 were higher in M&A transactions than in IPOs. Furthermore, 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 stock sales). When combined with the fact that liquidity usually arrives sooner through an M&A transaction than an IPO—as in 2018, when the median time

from initial funding to acquisition was 5.0 years, compared to a median of 5.2 years from initial funding to IPO—it is easy to see why venture capitalists often prefer a company sale to an IPO.

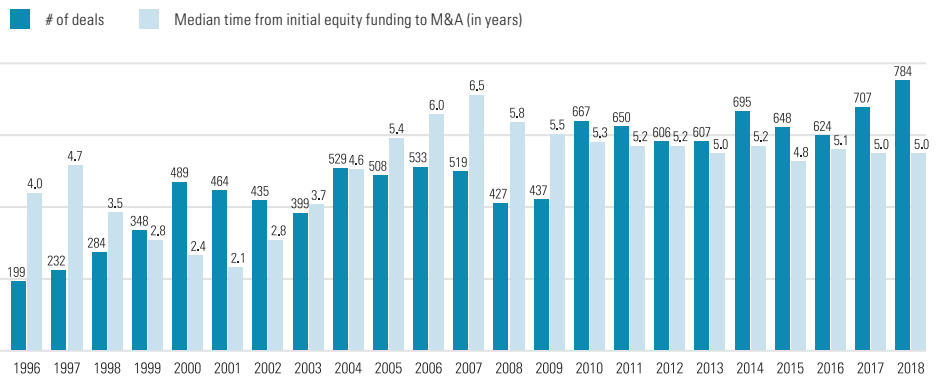
While company sales far outpace IPOs as liquidity events, the ratio of M&A transactions to IPOs for VC-backed companies declined for the second consecutive year. The ratio was 16.0:1 in 2016, 14.1:1 in 2017 and 10.3:1 in 2018.

**OUTLOOK**

Results over the coming year will depend on a variety of factors:

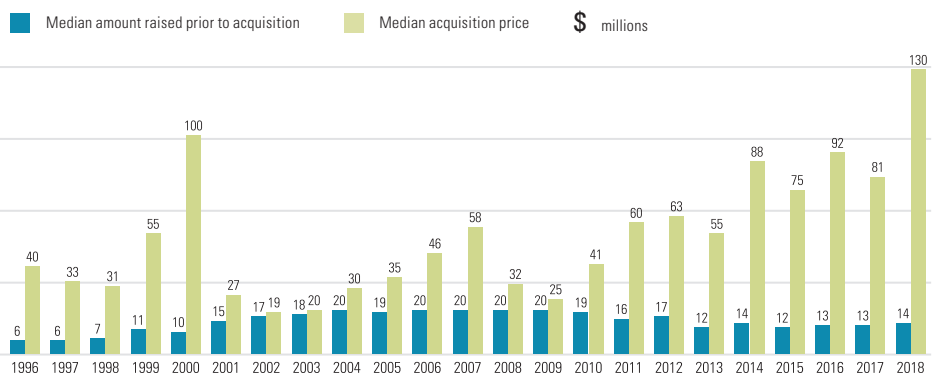
- *Financing Activity:* Deal flow should benefit from several tailwinds, including favorable macroeconomic conditions; ample amounts of venture capital fueled by the record level of fundraising in 2018; continued expansion of corporate and strategic venture investing; and the willingness of buyers to pay attractive prices in acquisitions. However, financing activity could slow if economic growth stalls, or if investors are deterred by the sharp increases in valuations across most sectors last year. Results for early 2019 are encouraging: the first quarter produced the third-highest financing proceeds on record (topped only by the previous two quarters), the third-best fundraising total of any quarter on record, and an increase in median deal size—although there was some slowdown in reported deal flow.
- *IPOs:* Although it was intended to encourage emerging growth companies (EGCs) to go public, the JOBS Act—combined with other changes in regulatory requirements and the availability of large amounts of private investment capital—has made it easier for “unicorns” and other EGCs to stay private longer. As a result, many EGCs, particularly in the technology industry, have opted to delay their public debuts, often relying on private “IPO-sized” rounds to meet their financing needs. Nonetheless, investor needs for cash returns, coupled with the attractive valuations and solid aftermarket performance of VC-backed IPOs in 2018,

**Acquisitions of US Venture-Backed Companies and Median Time to M&A – 1996 to 2018**



Source: Dow Jones VentureSource

**Median Amount Raised Prior to Acquisition and Median Acquisition Price – 1996 to 2018**



Source: Dow Jones VentureSource

should prompt additional VC-backed IPOs. Although the number of VC-backed IPOs declined from the fourth quarter of 2018 to the first quarter of 2019, some long-awaited unicorn IPOs have begun to appear, including debuts from Lyft, Pinterest, Uber and Zoom.

- *Acquisitions:* Public company balance sheets remain flush with cash, helping strategic acquirers supplement organic growth through acquisitions. With fears of rising interest rates quelled in March when the Federal Reserve indicated that it did not anticipate any rate increases for the balance of the year, debt financing should remain firmly in the acquirer’s toolkit. M&A activity in the coming year will also depend in part on valuations, which hit record levels in

2018. Preliminary data suggests that the number and value of VC-backed company acquisitions in the first quarter of 2019 was comparable to the levels seen in 2018.

- *Attractive Sectors:* Companies offering products that leverage blockchain technology, AI, machine learning and voice technology, especially in the enterprise environment, should continue to attract funding in 2019. Other industries that should receive significant investment include security, robotics, digital health, consumer e-commerce, fintech and agtech. Life sciences companies with compelling market opportunities—such as those in immunology and gene therapy—should also continue to appeal to investors. ■

## 6 Regional Market Review and Outlook

### CALIFORNIA

California companies reported 2,360 financings in 2018, up 6% from the 2,218 financings in 2017. Total proceeds reached \$74.7 billion, 75% higher than the \$42.7 billion in 2017.

The growth in proceeds was largely attributable to an increase in very large financing rounds. The number of rounds raising \$50 million or more grew by 52%, from 161 in 2017 to 244 in 2018, while the number of rounds of \$100 million or more jumped by 79%, from 58 to 104.

California-based companies accounted for 53% of all financing rounds in the country raising \$50 million or more in 2018, down from 56% in both 2016 and 2017.

California was responsible for 40% of all financing transactions in the country in 2018, compared to 41% in 2016 and 39% in 2017.

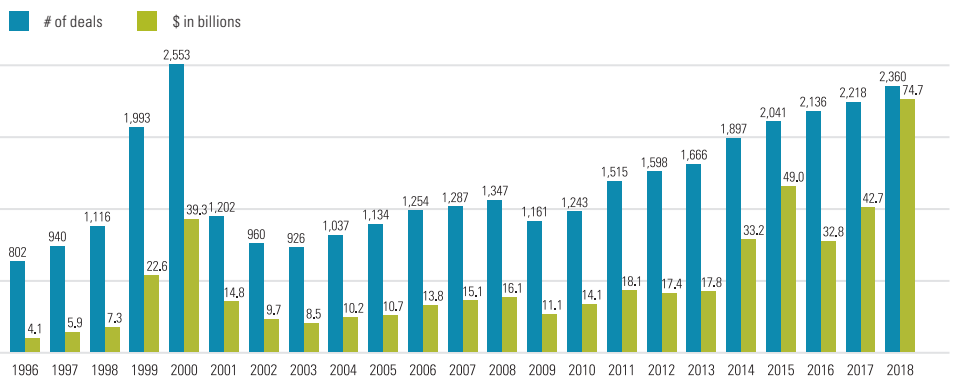
Technology was the largest sector in the state, producing 37% of all California financings in 2018, followed by consumer goods and services (24%), business and financial services (19%), and life sciences (18%).

The number of IPOs by California-based VC-backed companies increased by 83%, from 18 in 2017 to 33 in 2018. California was home to six of the eight largest VC-backed IPOs by US issuers in 2018. The largest was Dropbox's \$765 million IPO, followed by the IPO of DocuSign (\$629 million).

The number of reported acquisitions of California VC-backed companies increased by 15%, from 273 in 2017 to 314 in 2018. The state's largest deals were the \$7.5 billion acquisition of GitHub by Microsoft and the \$1.55 billion acquisition of Adaptive Insights by Workday.

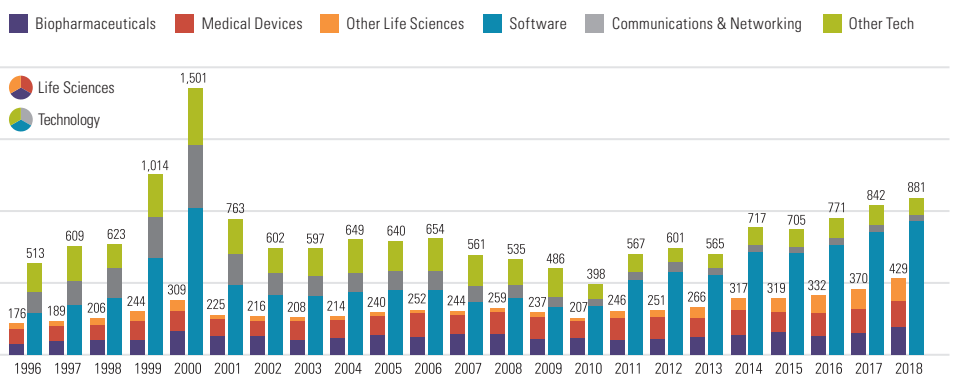
California will undoubtedly maintain its venture capital leadership in the coming year. Financing and liquidity activity in 2019 will depend on the level of venture capital fundraising, the willingness of strategic buyers to pay attractive prices, and IPO market conditions, among other factors.

### California Venture Capital Financings – 1996 to 2018



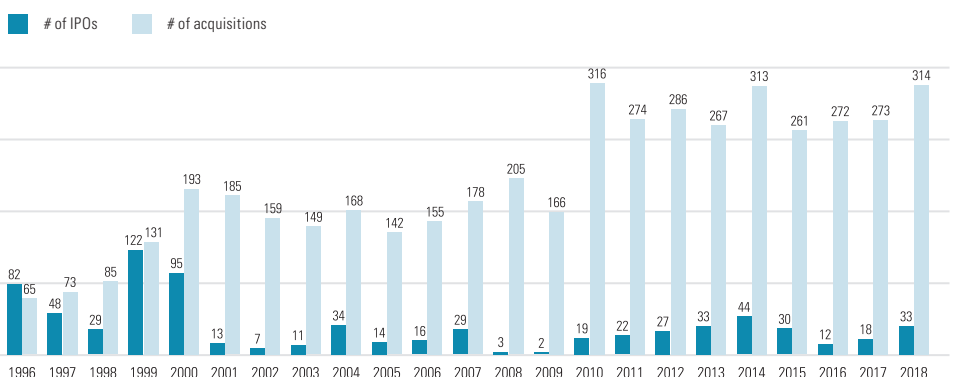
Source: Dow Jones VentureSource

### California Venture Capital Financings by Selected Industry – 1996 to 2018



Source: Dow Jones VentureSource

### California Venture-Backed IPOs and Acquisitions – 1996 to 2018



Source: Dow Jones VentureSource

**MID-ATLANTIC**

With 356 rounds, the number of reported 2018 venture capital financings in the mid-Atlantic region of Virginia, Maryland, North Carolina, Delaware and the District of Columbia represented a 15% increase from the 309 financings in 2017.

Total proceeds in the mid-Atlantic region declined by 1%, from \$3.38 billion in 2017 to \$3.33 billion in 2018, as deal sizes in the region contracted—in contrast to nationwide trends.

North Carolina led the mid-Atlantic region in deal flow for the second consecutive year, with 125 financings in 2018, while Maryland led the region in proceeds, with a total of \$1.19 billion.

The number of mid-Atlantic rounds raising \$50 million or more increased from nine in 2017 to 16 in 2018. The region’s largest financings in 2018 were by Viela Bio (\$250 million), CuriosityStream (\$115 million) and Precision BioSciences (\$110 million).

Technology companies accounted for 35% of all mid-Atlantic financings in 2018—extending the sector’s longstanding leadership in the region—followed by business and financial services companies (27%) and life sciences companies (24%).

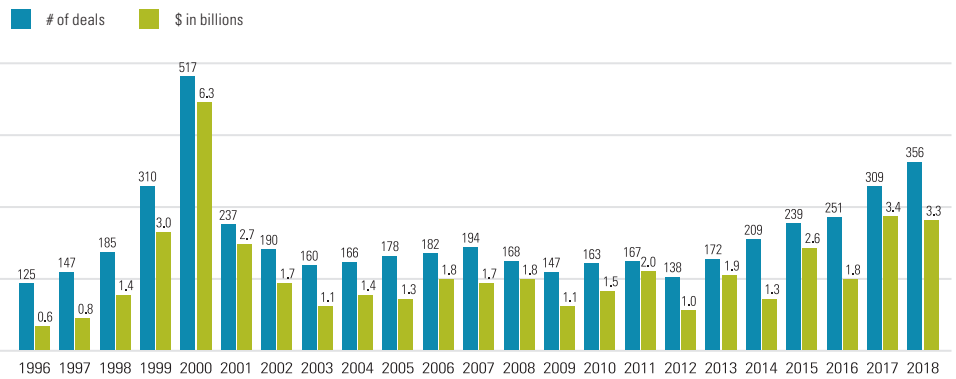
After generating four VC-backed IPOs in 2017, the region produced only two in 2018—Maryland-based Tenable Holdings (\$251 million) and North Carolina-based Liquidia Technologies (\$50 million).

The number of reported acquisitions of mid-Atlantic VC-backed companies increased by 38%, from 34 in 2017 to 47 in 2018. North Carolina generated 15 deals, followed by Virginia (14) and Maryland (nine).

The region’s largest M&A transaction of the year was the \$775 million acquisition of ECS Federal by On Assignment.

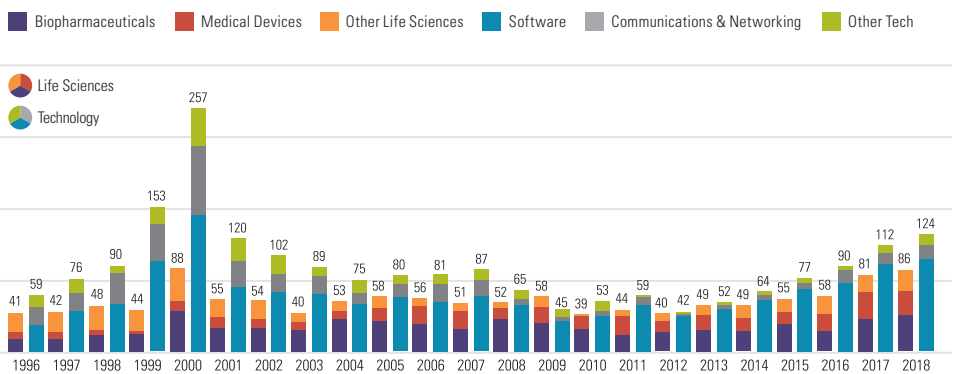
Assuming market conditions are conducive, the mid-Atlantic region is likely to see growth in financing and liquidity activity in the coming year.

**Mid-Atlantic Venture Capital Financings – 1996 to 2018**



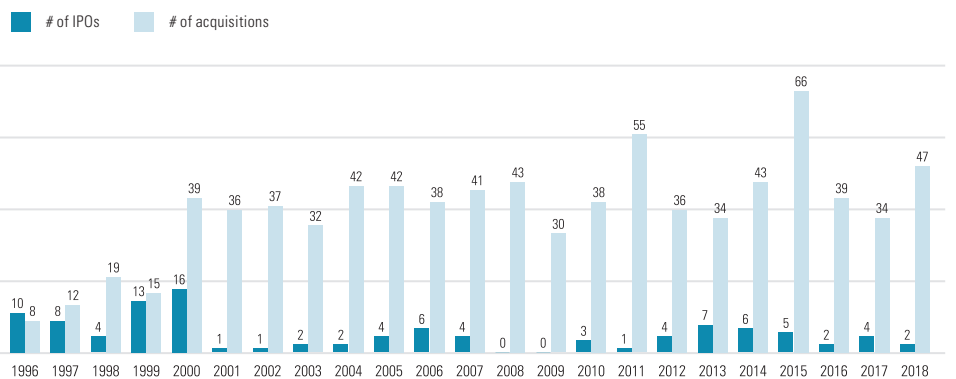
Source: Dow Jones VentureSource

**Mid-Atlantic Venture Capital Financings by Selected Industry – 1996 to 2018**



Source: Dow Jones VentureSource

**Mid-Atlantic Venture-Backed IPOs and Acquisitions – 1996 to 2018**



Source: Dow Jones VentureSource



## 8 Regional Market Review and Outlook

### NEW ENGLAND

New England companies reported 565 venture capital financings in 2018—the highest annual figure for the region since the dot-com boom years—up 26% from 449 financings in 2017. Total proceeds increased by 61%, from \$7.45 billion in 2017 to \$12.02 billion in 2018—just shy of the region’s record tally of \$12.03 billion in 2000.

Massachusetts, the perennial leader in New England and the nation’s third-largest source of VC financings, led the region in 2018 with 463 financings and \$11.34 billion in proceeds.

The number of rounds raising \$50 million or more increased from 39 in 2017 to 70 in 2018, with the largest coming from Cambridge Mobile Telematics (\$500 million) and Moderna (\$500 million).

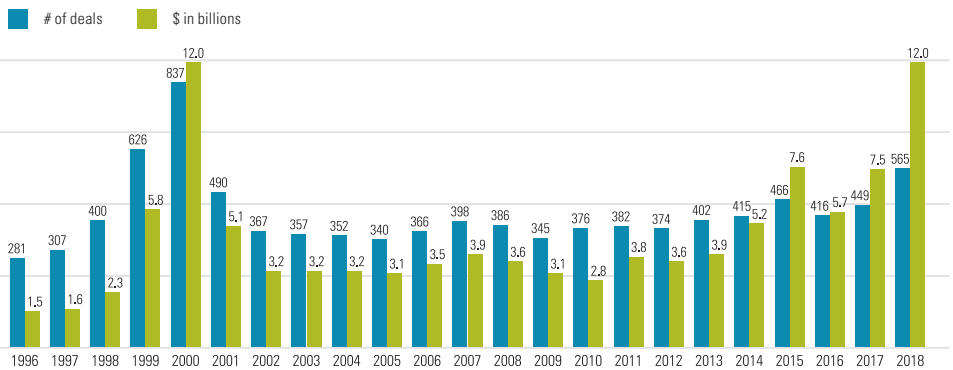
The life sciences sector represented 40% of New England’s venture capital financings in 2018, followed by technology (27%) and consumer goods and services (16%).

The number of VC-backed IPOs by New England-based companies increased from 14 in 2017 to 21 in 2018—all but two by life sciences companies. Massachusetts led the region with 19 IPOs, while Connecticut and New Hampshire each added one. The region’s largest VC-backed IPOs were by Moderna (\$604 million) and Rubius Therapeutics (\$241 million).

The number of reported acquisitions of VC-backed companies in New England declined from 75 in 2017 to 51 in 2018, of which Massachusetts contributed 43. The region’s largest M&A transaction of the year was the \$1.0 billion acquisition of PillPack by Amazon, followed by the \$550 million acquisition of Kensho Technologies by S&P Global.

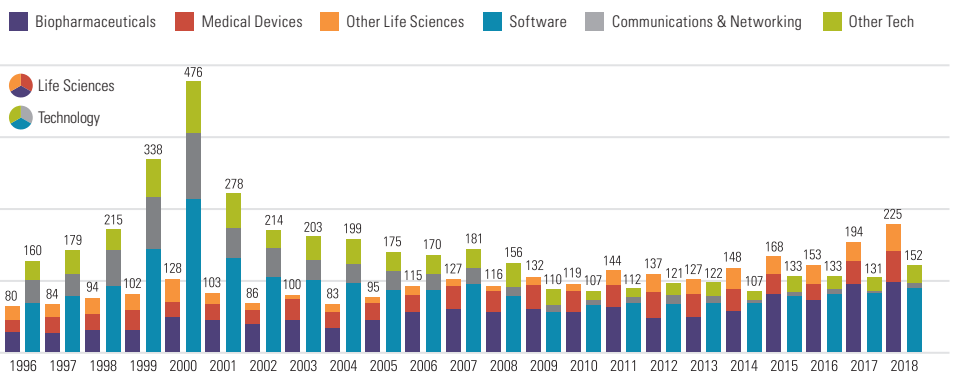
With its concentration of world-renowned universities and research institutions, New England—and Massachusetts in particular—should remain a hub of venture capital and IPO activity during the coming year, particularly in the life sciences and technology sectors.

### New England Venture Capital Financings – 1996 to 2018



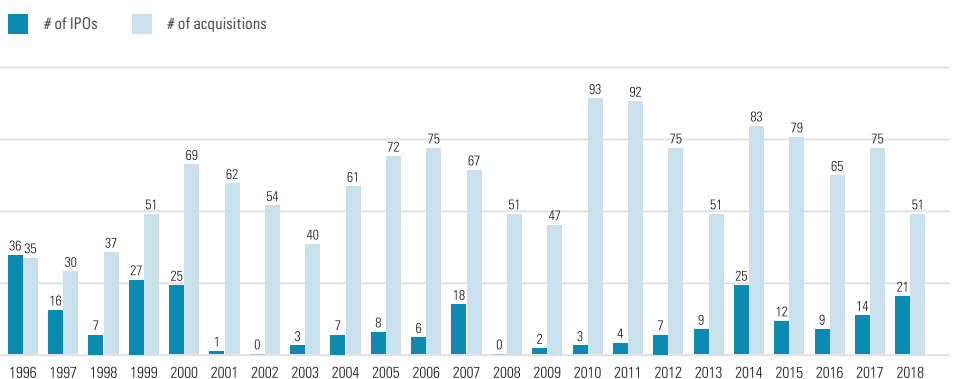
Source: Dow Jones VentureSource

### New England Venture Capital Financings by Selected Industry – 1996 to 2018



Source: Dow Jones VentureSource

### New England Venture-Backed IPOs and Acquisitions – 1996 to 2018



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 increased by 10%, from 844 in 2017 to 930 in 2018. Total proceeds in the region increased 9%, from \$12.73 billion in 2017 to \$13.93 billion in 2018.

New York, the nation’s second-largest source of VC financings, led the tri-state region in 2018 with 712 financings and \$12.19 billion in proceeds.

The number of rounds raising \$50 million or more increased from 39 in 2017 to 68 in 2018. The region’s largest financings came from Peloton Interactive (\$550 million) and Ambatana (\$500 million).

Technology companies accounted for 27% of the tri-state region’s VC financings in 2018, followed by consumer goods and services companies with 27% and life sciences companies with 17%.

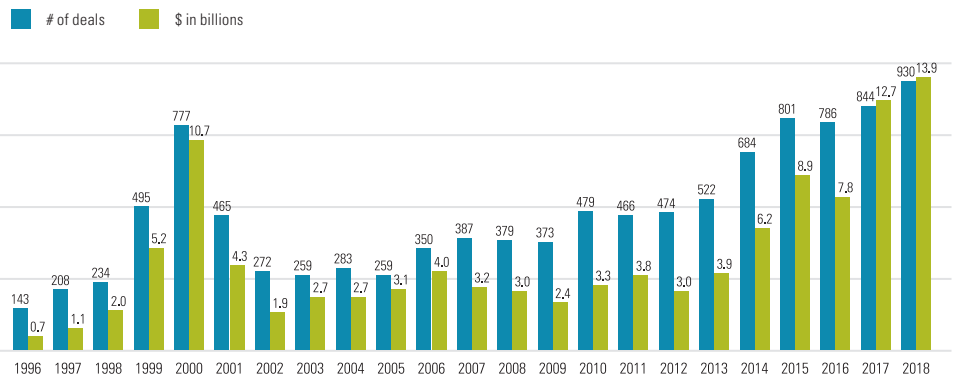
There were eight VC-backed IPOs in the tri-state region in 2018—all from life sciences companies—equaling the tally for 2017. New York and New Jersey each produced three of the region’s VC-backed IPOs in 2018, with Pennsylvania contributing two. The region’s largest VC-backed IPOs came from New York-based Y-mAbs Therapeutics (\$96 million) and Pennsylvania-based Neuronetics (\$94 million).

The number of reported acquisitions of VC-backed companies in the tri-state region in 2018 was 107, the same as the prior year. New York generated a record-high 85 deals in 2018, followed by Pennsylvania with 12 and New Jersey with 10.

The region’s largest deal of 2018 was the \$1.9 billion acquisition of Flatiron Health by Roche, followed by the \$1.6 billion acquisition of AppNexus by AT&T and the \$800 million acquisition of Datorama by salesforce.

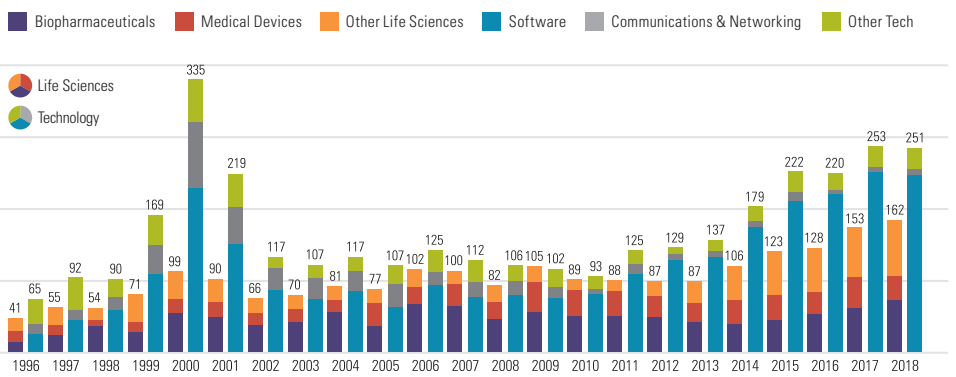
With strength across a broad array of industry sectors, including consumer, technology and life sciences, the tri-state region is likely to see financing activity continue to flourish in the coming year. If market conditions are conducive, the region should also see a pickup in liquidity events. ■

**Tri-State Venture Capital Financings – 1996 to 2018**



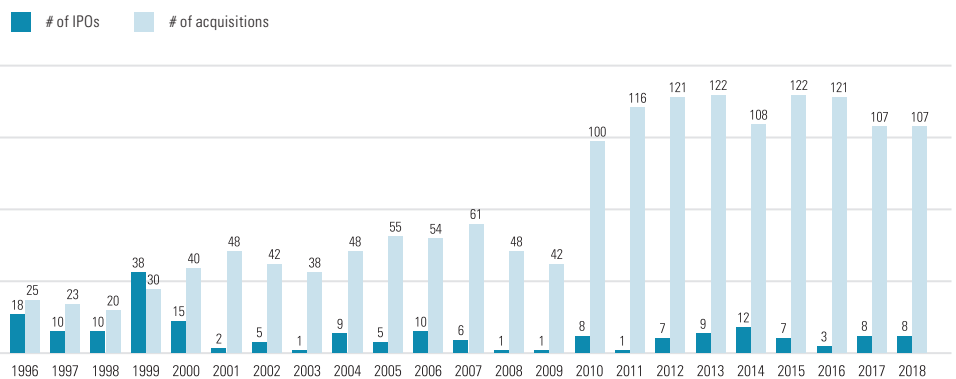
Source: Dow Jones VentureSource

**Tri-State Venture Capital Financings by Selected Industry – 1996 to 2018**



Source: Dow Jones VentureSource



































**Tri-State Venture-Backed IPOs and Acquisitions – 1996 to 2018**



Source: Dow Jones VentureSource

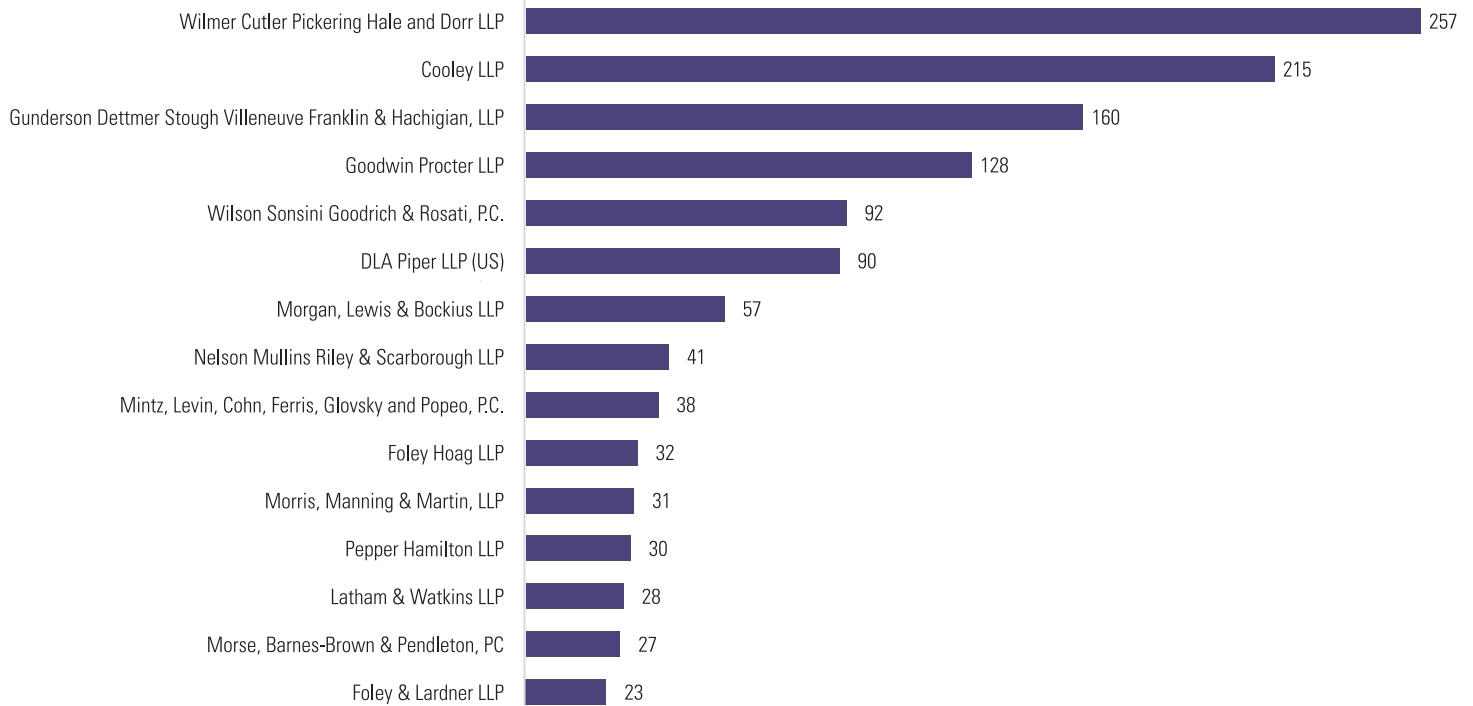
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|  |  |  |  |   |  |   |  |   |
|--|--|--|--|---|--|---|--|---|
|  <p>\$100,000,000<br/>Second Round<br/>February 2018</p>  |  <p>\$85,000,000<br/>Late Stage<br/>November 2018</p>     |  <p>\$53,000,000<br/>First Round<br/>June 2018</p>       |  <p>\$60,000,000<br/>Third Round<br/>October 2018</p>     |  <p>\$58,000,000<br/>First Round<br/>January 2018</p>      |  <p>\$9,000,000<br/>First Round<br/>June 2018</p>       |  <p>\$36,000,000<br/>Second Round<br/>June 2018</p>    |  <p>\$100,000,000<br/>Late Stage<br/>March 2018</p>       |   |
|  <p>\$32,000,000<br/>Late Stage<br/>January 2018</p>      |  <p>\$30,000,000<br/>First Round<br/>November 2018</p>    |  <p>\$20,000,000<br/>Second Round<br/>June 2018</p>      |  <p>\$18,000,000<br/>Third Round<br/>September 2018</p>   |  <p>\$55,000,000<br/>Third Round<br/>May 2018</p>          |  <p>\$65,000,000<br/>Second Round<br/>December 2018</p> |  <p>\$12,900,000<br/>Second Round<br/>March 2019</p>   |  <p>\$65,000,000<br/>First Round<br/>August 2018</p>      |  <p>\$12,000,000<br/>Second Round<br/>March 2019</p> |
|  <p>\$30,000,000<br/>Second Round<br/>March 2018</p>    |  <p>\$50,000,000<br/>Late Stage<br/>March 2019</p>      |  <p>\$38,000,000<br/>Late Stage<br/>February 2019</p> |  <p>\$19,000,000<br/>Second Round<br/>August 2018</p>   |  <p>\$67,000,000<br/>Late Stage<br/>February 2019</p>    |  <p>\$17,000,000<br/>Second Round<br/>June 2018</p>   |  <p>\$9,000,000<br/>First Round<br/>August 2018</p>  |  <p>\$80,000,000<br/>Second Round<br/>August 2018</p>   |   |
|  <p>\$23,000,000<br/>Second Round<br/>December 2018</p> |  <p>\$67,000,000<br/>Second Round<br/>November 2018</p> |  <p>\$25,000,000<br/>Third Round<br/>June 2018</p>     |  <p>\$16,000,000<br/>Third Round<br/>September 2018</p> |  <p>\$20,000,000<br/>Second Round<br/>September 2018</p> |  <p>\$60,000,000<br/>Late Stage<br/>May 2018</p>      |  <p>\$30,000,000<br/>Second Round<br/>March 2018</p> |  <p>\$10,700,000<br/>Second Round<br/>February 2018</p> |  <p>\$29,700,000<br/>Late Stage<br/>April 2018</p> |

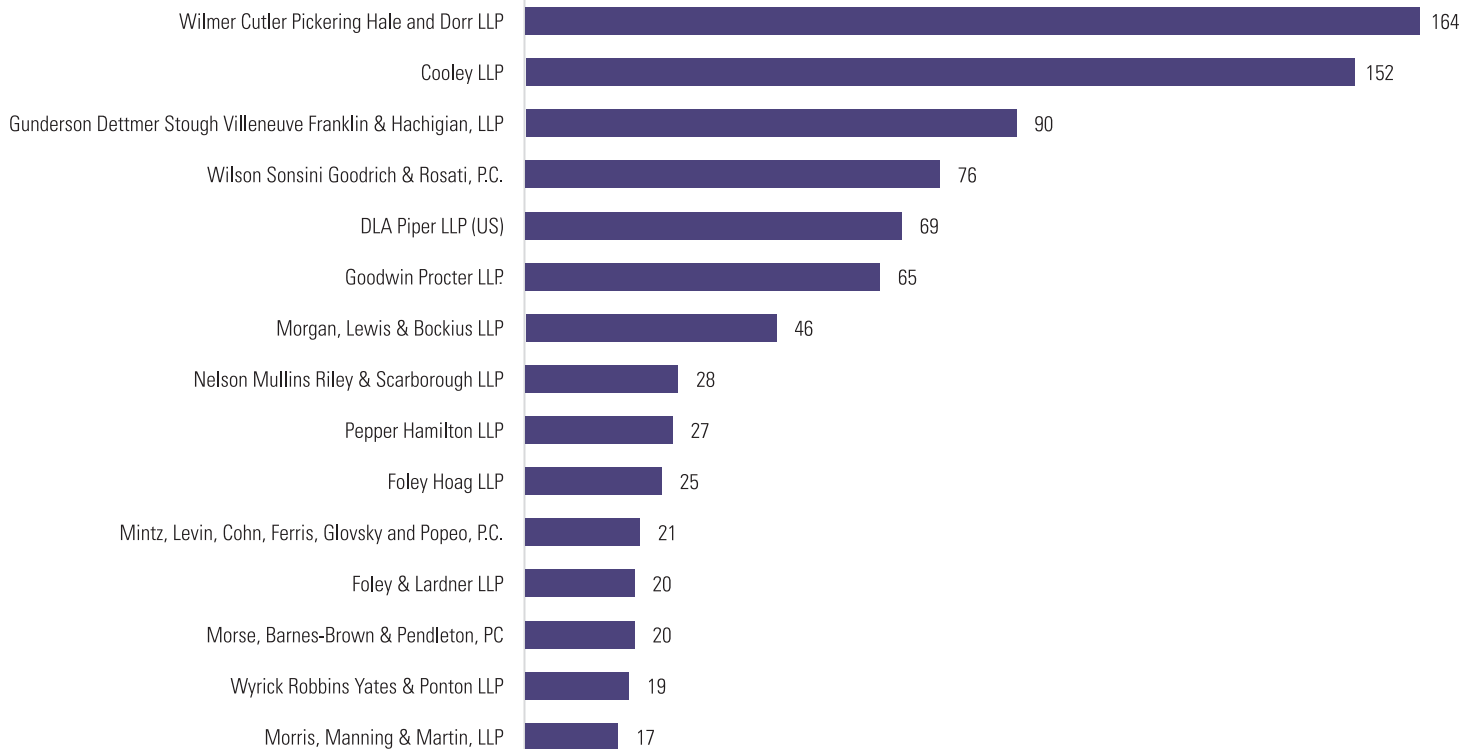
## 12 Law Firm Rankings – Eastern US

### Counsel to Eastern US Technology and Life Sciences Companies Receiving VC Financing – 2008 to 2018



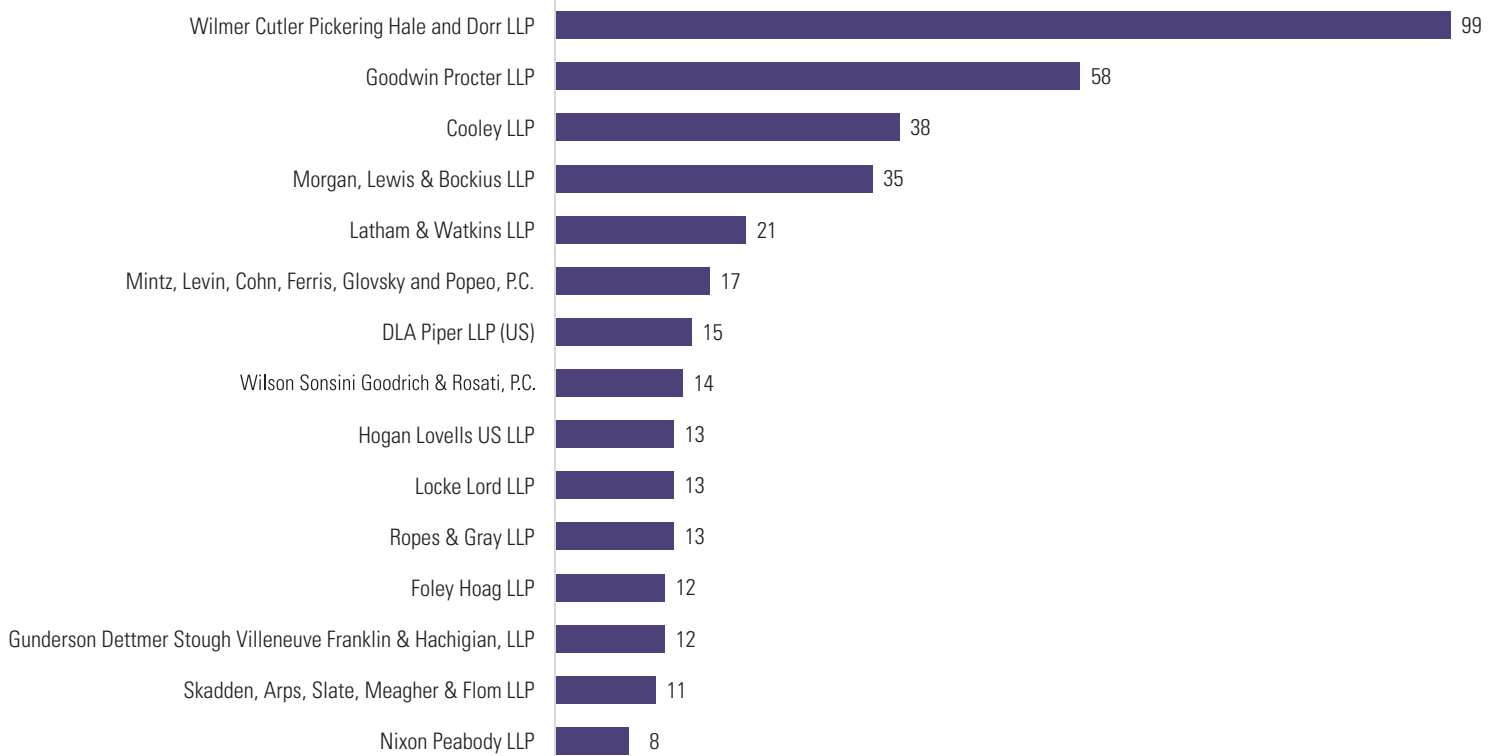
The above chart is based on information technology and life sciences companies located east of the Mississippi River that completed a seed, first, second, later-stage or restart round of venture capital financing between 2008 and 2018.  
Source: Dow Jones VentureSource

### Counsel to Eastern US VC-Backed Technology and Life Sciences Companies at Year-End 2018



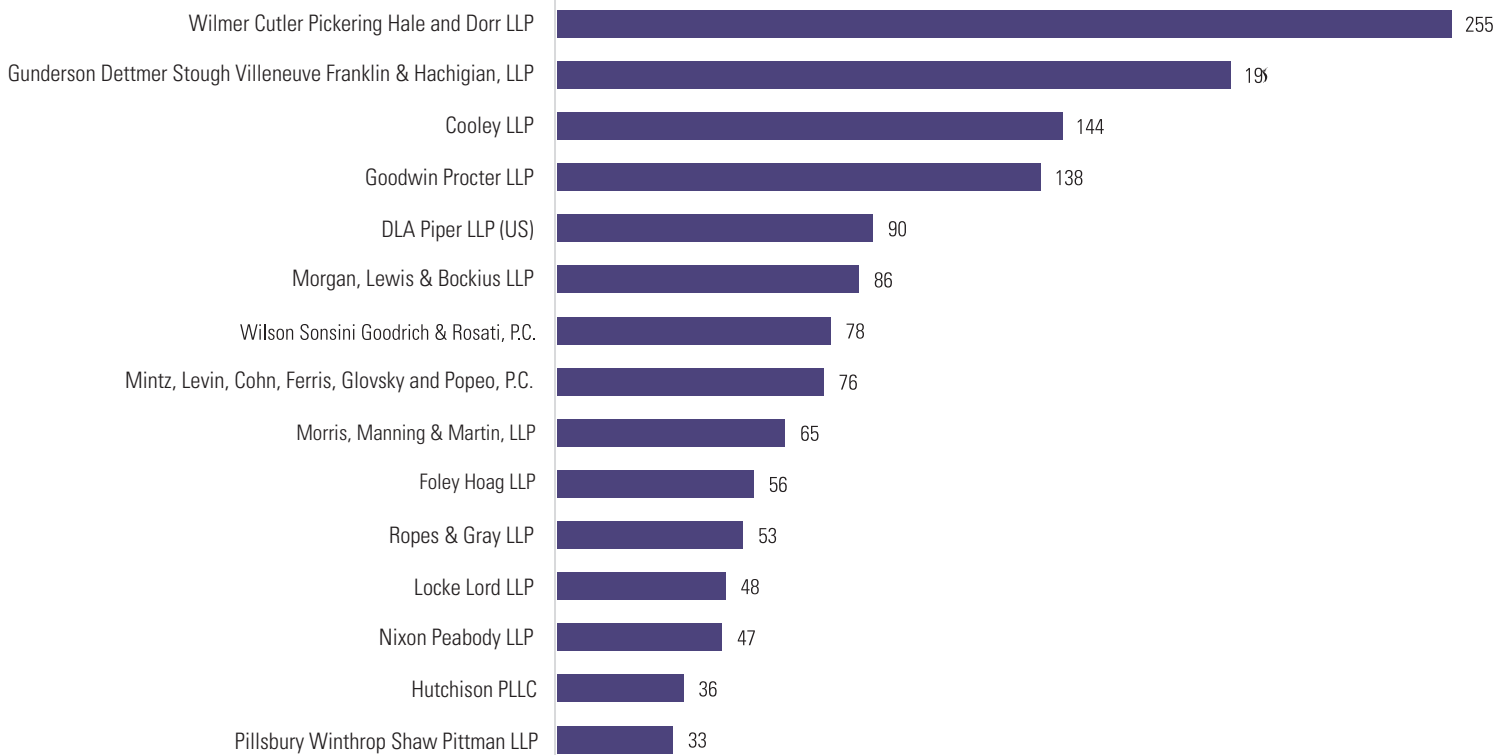
The above chart is based on VC-backed companies located east of the Mississippi River that were private and independent as of the end of 2018.  
Source: Dow Jones VentureSource

**Company Counsel in Eastern US VC-Backed IPOs – 1996 to 2018**



*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 2018**



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

## 14 Section 83(i): The Devil's in the Details

Section 83(i) of the Internal Revenue Code, which was enacted as part of 2017's sweeping tax reform legislation, gives certain private company employees the ability to elect to defer, solely for income tax purposes and for a period of up to five years, the income that would otherwise arise upon the exercise of compensatory stock options or the issuance of shares in the settlement of restricted stock units (RSUs).

While at first blush the new provision appears to be a boon for private company employees and an easy benefit for privately held businesses to provide, Section 83(i) imposes a number of technical and administratively burdensome requirements and limitations that generally render the election either unavailable or unattractive, and creates risks for both the company and the employee. Companies may therefore wish to take advantage of initial guidance issued by the Treasury Department and the Internal Revenue Service (IRS) to structure equity awards so as to disqualify them from satisfying the requirements of Section 83(i) altogether, thereby avoiding the associated burdens and risks.

### REQUIREMENTS AND LIMITATIONS

Only “qualified employees” may make a Section 83(i) election with respect to “qualified stock” and an election that is properly made (within the 30-day window beginning after the date on which the option is exercised or the RSU is settled) is effective for a period of up to five years. Unpacking these concepts highlights the limited scope and utility of Section 83(i).

- Employees who are “excluded employees” are not “qualified employees” and may not make a Section 83(i) election. “Excluded employees” include a corporation’s 1% owners, chief executive officer, chief financial officer and four highest-compensated officers. As a result, key company stockholders and executives are not eligible to make a Section 83(i) election.
- Among other things, in order to be “qualified stock,” stock must be issued pursuant to the exercise of an option or

settlement of an RSU that was granted under a written plan in a calendar year during which at least 80% of all of the corporation’s US-based employees were granted stock options or were granted RSUs, with the “same rights and privileges” to receive qualified stock (referred to as the “80% test”). In applying these requirements:

- IRS guidance makes clear that awards made in prior calendar years may not be treated as having been granted in the year being tested for purposes of the 80% test.
- In determining whether the 80% test has been satisfied, the corporation must count all individuals employed at any time during the year in question—regardless of whether the employees were employed by the corporation at the beginning of the year or the end of the year—but must exclude “excluded employees” and persons customarily employed for fewer than 30 hours a week.
- The meaning of the “same rights and privileges” remains unclear—although the statute does provide that the phrase does not require equal-sized grants to all employees (provided that employees receive more than a de minimis amount).
- Once made, a Section 83(i) election is effective for income tax purposes (but not payroll tax purposes—provision must still be made for payroll taxes upon exercise of the option or settlement of the RSU) for a period of up to five years. The deferral period ends before the end of five years, however, if:
  - the stock with respect to which the election is made becomes transferable (including, for this purpose, to the corporation itself);
  - the employee becomes an “excluded employee”;
  - any of the corporation’s stock becomes publicly traded; or
  - the employee revokes the election.

In addition, a Section 83(i) election may not be made if:

- the qualified employee has made an election under Internal Revenue Code Section 83(b) with respect to the qualified stock;
- any stock of the corporation that issued the qualified stock is publicly traded at any time before the election is made; or
- the corporation purchases any of its outstanding stock in the calendar year preceding the calendar year that includes the first date the rights of the employee in the qualified stock are transferable or are not subject to a substantial risk of forfeiture, except as described below.

A corporation’s stock repurchases will not disqualify a qualified employee from making a Section 83(i) election if at least 25% of the total value of the stock repurchased in the preceding calendar year was stock with respect to which an election under Section 83(i) was in effect and the corporation determined the individuals from whom such stock is purchased on a reasonable basis.

In light of these requirements and limitations, determining whether a particular award will result in the issuance of qualified stock upon exercise of an option or settlement of an RSU will require private companies to establish robust administrative and tracking procedures to ensure that all applicable conditions have been satisfied.

### RISKS

Even if a qualified employee can make a Section 83(i) election, doing so is not without risk.

- From a qualified employee’s perspective, by far the most significant risk is that the amount deferred is fixed when the Section 83(i) election is made and does not take into account any changes in the value of the underlying stock during the deferral period. If the stock’s value decreases during the deferral period—an all-too-real possibility for a privately held emerging company—

neither the amount deferred nor the employee's ultimate tax bill is reduced to reflect that decrease in value.

- Section 83(i) was enacted, in part, to provide private-company employees with a way to receive stock (via the exercise of an option or in settlement of an RSU) without having to pay income tax on the resulting income at a time when there is no market for the shares received. However, there is no guarantee that a Section 83(i) deferral period will end (and income taxes will be due) at a time when there is a market for the shares of qualified stock. For example, in the context of going public, the deferral period ends when the stock becomes publicly traded on an established securities market, without regard to the lockup provisions that ordinarily apply. Thus, except in the context of the sale of the company, it is unlikely that the deferral period will end when the shares are liquid.
- When the deferral period ends, the amount deferred is treated as ordinary compensation income for the purposes of income tax withholding and reporting. As a result, in accordance with applicable tax rules, the corporation must ensure that it can satisfy the withholding tax obligation then due. This may be difficult enough if the stock has declined in value and/or the stock is illiquid but will be even more difficult if the deferral period ends at a time when the employee is no longer employed by the corporation.
- Failure by the corporation to certify to a qualified employee that stock being issued upon exercise of an option or settlement of an RSU is qualified stock and to notify the employee that a Section 83(i) election may be available with respect to that stock (and what the consequences of making the Section 83(i) election are) may expose the corporation to a \$100 per-failure penalty (subject to a maximum penalty of \$50,000 for all failures during any calendar year).
- Nothing on the face of Section 83(i) requires a corporation to affirmatively choose to permit its employees to make Section 83(i) elections. And, because

the election is available with respect to options exercised or RSUs settled on or after January 1, 2018, a significant concern since enactment of Section 83(i) has been that a corporation that happens to have equity grant patterns and practices that satisfied the requirements of Section 83(i) would find itself required to satisfy the notice requirements for employees exercising options (or being issued stock in settlement of RSUs) or be subject to penalties. This risk is heightened by the fact that the “same rights and privileges” requirement of the 80% test does not need to be met for awards granted before 2018.

Given the complex requirements and limitations and the questionable benefit of making a Section 83(i) election, it is little wonder that many companies have asked whether they are required to provide employees with the ability to do so.

#### IRS GUIDANCE

The initial guidance provided by the Treasury Department and IRS addresses concerns about a company's ability to ensure that withholding tax obligations at the end of the applicable deferral period are satisfied, and concerns about the possibility of inadvertently creating the conditions that would allow an employee to make a Section 83(i) election in the first place.

The guidance provides that, in order to be a qualified employee, an employee making a Section 83(i) election must agree in the election that all qualified stock subject to the deferral election will be held in an escrow account established by the company. The escrow arrangement must provide that the deferral stock be deposited into escrow before the end of the calendar year in which the election is made and remain in escrow until the applicable income tax withholding tax obligation in the year in which the deferral period ends has been satisfied (either as a result of the corporation retaining a number of the deferral shares with a fair market value equal to the income tax withholding obligation or as a result of the employee satisfying the income tax withholding obligation by other means).

Any remaining shares must be delivered to the employee as soon as practicable after the withholding obligation has been satisfied.

Importantly, a company is not required to establish such an escrow arrangement. By declining to establish the required escrow, a company can effectively preclude its employees from making Section 83(i) elections with respect to both new awards and awards that were outstanding at the time the new law went into effect.

Going forward, companies that do not intend to establish escrow arrangements of the kind described above or otherwise create the conditions that would allow their employees to make Section 83(i) elections may also explicitly provide in their forms of option or RSU award agreements that no Section 83(i) election will be available with respect to the stock received under the award even if it would otherwise be qualified stock for purposes of Section 83(i). ■

#### OTHER TAX REFORM PROVISIONS OF NOTE

The federal tax act enacted in late 2017 contains a variety of other provisions of potential interest to private companies. For example, as a result of tax reform:

- *Tax Rates*: The maximum corporate tax rate was reduced from 35% to 21%.
- *AMT*: The alternative minimum tax for corporations was repealed.
- *Net Operating Losses*: For losses arising in taxable years beginning after December 31, 2017, the amount of net operating loss (NOL) a company may deduct in a taxable year is limited to 80% of the company's taxable income for such year (computed without regard to the NOL deduction). Any such NOLs are no longer permitted to be carried back but may be carried forward indefinitely.
- *Interest Deductions*: The amount of business interest a company may deduct in any taxable year after December 31, 2017, is generally limited to the amount of business interest income of the company for such taxable year plus 30% of the adjusted taxable income of the company for such taxable year.

## 16 Investments in Competing Companies: When is it an Antitrust Issue?

Imagine the airline industry in its nascent stage: a few airlines have launched, but it is not clear which are likely to survive. A savvy investor might decide to spread its investments across multiple companies—say, the new Pan Am and the new TWA—to increase the likelihood that it has a stake in a future winner. That investor should be aware that even partial ownership of competing companies can be subject to antitrust scrutiny.

### WHY MIGHT THIS BE AN ISSUE?

Cross-shareholding could harm competition through the direct or indirect action of the investor, or as a result of changed incentives.

- *Direct Investor Influence:* First, cross-shareholding may decrease competition by giving the investor the ability to influence how each company behaves competitively. In our hypothetical, investors that have a voting interest in both Pan Am and TWA, or governance rights such as the right to appoint members to the board of directors, might be able to influence TWA to compete less aggressively or to coordinate its conduct with Pan Am (or vice versa).
- *Information Sharing:* Second, cross-shareholding could lessen competition by giving the investor access to nonpublic, competitively sensitive information of competitors. In our hypothetical, the investor could then direct Pan Am or TWA to take certain actions, or suggest courses of action, that decrease competition between them. The investor might also share nonpublic, competitively sensitive information between the airlines, which may make it easier for them to coordinate their behavior.
- *Reduced Incentive to Compete:* The third theory of harm is more recent and controversial: some have argued that cross-shareholdings could lessen competition by reducing the incentive of the companies to compete. In our hypothetical, when Pan Am and TWA are independent, they try to maximize their own returns at the expense of their competitors. But our investor might prefer that the airlines compete less vigorously and instead maximize *industry* returns because the investor has a stake in multiple players in the segment. And, the theory goes, Pan Am and TWA might

even incorporate these preferences into their behavior without direct or indirect influence from their shared investor.

### IS THERE ECONOMIC SUPPORT FOR THESE THEORIES?

The first and second concerns about cross-shareholdings are well understood and relatively straightforward: the competing companies are either directly influenced by their shared investor or obtain competitively sensitive information from the investor in ways that they otherwise would (and should) not. Evidence of such influence or information sharing can provide a basis for an antitrust claim. If influence over the competing investments results from board membership, the prohibition against “interlocking” directorates of Section 8 of the Clayton Act also may apply.

The third concern is newer and not nearly as well understood, and it has been a focus of recent debate—specifically on how to measure potential anticompetitive impacts from changed incentives. In 2016, for example, three economists published a study concluding that US banking fees were strongly correlated with cross-shareholding by their investors. A year later, the same authors argued that cross-shareholdings in US airlines were correlated with increased prices. These papers and similar scholarship have argued for policy changes that would increase antitrust scrutiny of cross-shareholding.

Other authors have sought to rebut these concerns or have urged caution by antitrust enforcers. For example, a July 2017 paper modeled the effects of common ownership on airline prices and found no evidence that it raised prices.

There are also practical issues with this third theory of harm. In our hypothetical, for example, if Pan Am’s managers are paid based on Pan Am’s performance (as opposed to industry performance), it is unclear why they would be willing to sacrifice that compensation to try to boost TWA’s (and the broader industry’s) returns.

### WHERE DO THE US ANTITRUST AGENCIES STAND ON THIS ISSUE?

If our investor nonetheless decided to invest in both Pan Am and TWA, US antitrust authorities could scrutinize their

cross-shareholdings under Section 7 of the Clayton Act, which generally prohibits acquisitions of voting securities or assets that substantially lessen competition. Post-acquisition, US antitrust authorities also could investigate restraints of trade arising from cross-shareholdings under Sections 1 and 2 of the Sherman Act, and Section 5 of the Federal Trade Commission Act. And if the investor has board seats in both companies, Section 8 of the Clayton Act might apply, as noted above.

In practice, however, the US antitrust agencies remain cautious about over-enforcement against cross-shareholdings. In a 2017 OECD submission, the agencies noted that “across-the-board limitations on common ownership without sufficient evidence of anticompetitive effects could impose unintended real-world costs on businesses and consumers by making it more difficult to diversify risk,” and therefore concluded that they would not change their enforcement practices until the economic debate matures. To date, the US antitrust agencies have taken enforcement action against shareholdings in competitors on the basis of direct influence but have not litigated a case involving changed incentives. The area nevertheless remains a hot topic of antitrust law and an important issue for investors.

### IF THERE IS A PROBLEM, HOW CAN IT BE FIXED?

The most extreme remedy for anticompetitive harm arising from cross-shareholdings is for the antitrust agencies to block the acquisition or require the divestiture of shares of the competing companies. As an alternative, the antitrust authorities could impose restrictions on the flow of confidential information to and from the investor, or otherwise limit the ability of the investor to influence the decisions of the competing companies.

In other enforcement actions involving minority ownership positions in competitors—but not specifically cross-shareholdings—the agencies occasionally also have imposed remedies that converted active shareholder rights into passive investments. ■



## Trends in VC-Backed Company M&A Deal Terms 17

We reviewed all merger transactions between 2011 and 2018 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   | 2011              | 2012              | 2013              | 2014             | 2015             | 2016              | 2017             | 2018              |
|---|-------------------|-------------------|-------------------|------------------|------------------|-------------------|------------------|-------------------|
| <b>Sample Size</b>  | 51                | 26                | 27                | 37               | 27               | 19                | 18               | 37                |
| <b>Cash</b>   | 73%               | 73%               | 59%               | 59%              | 67%              | 47%               | 56%              | 84%               |
| <b>Stock</b>  | 4%                | 8%                | 8%                | 3%               | 4%               | 0%                | 0%               | 3%                |
| <b>Cash and Stock</b>   | 23%               | 19%               | 33%               | 38%              | 29%              | 53%               | 44%              | 13%               |
| <b>Deals with Earnout</b>   | <b>2011</b>       | <b>2012</b>       | <b>2013</b>       | <b>2014</b>      | <b>2015</b>      | <b>2016</b>       | <b>2017</b>      | <b>2018</b>       |
| With Earnout  | 29%               | 31%               | 33%               | 30%              | 26%              | 37%               | 22%              | 32%               |
| Without Earnout   | 71%               | 69%               | 67%               | 70%              | 74%              | 63%               | 78%              | 68%               |
| <b>Deals with Indemnification</b>   | <b>2011</b>       | <b>2012</b>       | <b>2013</b>       | <b>2014</b>      | <b>2015</b>      | <b>2016</b>       | <b>2017</b>      | <b>2018</b>       |
| With Indemnification  |                   |                   |                   |                  |                  |                   |                  |                   |
| By Target's Shareholders  | 98%               | 100%              | 100%              | 97%              | 100%             | 100% <sup>1</sup> | 94% <sup>2</sup> | 84%               |
| By Buyer  | 43%               | 62%               | 44%               | 49%              | 69%              | 37%               | 61%              | 39%               |
| <b>Survival of Representations and Warranties<sup>3</sup></b>             | <b>2011</b>       | <b>2012</b>       | <b>2013</b>       | <b>2014</b>      | <b>2015</b>      | <b>2016</b>       | <b>2017</b>      | <b>2018</b>       |
| Shortest  | 12 Mos.           | 10 Mos.           | 12 Mos.           | 12 Mos.          | 12 Mos.          | 12 Mos.           | 9 Mos.           | 12 Mos.           |
| Longest   | 24 Mos.           | 24 Mos.           | 30 Mos.           | 24 Mos.          | 24 Mos.          | 18 Mos.           | 24 Mos.          | 24 Mos.           |
| Most Frequent   | 18 Mos.           | 18 Mos.           | 18 Mos.           | 12&18 Mos. (tie) | 18 Mos.          | 18 Mos.           | 12 Mos.          | 18 Mos.           |
| <b>Caps on Indemnification Obligations</b>                                | <b>2011</b>       | <b>2012</b>       | <b>2013</b>       | <b>2014</b>      | <b>2015</b>      | <b>2016</b>       | <b>2017</b>      | <b>2018</b>       |
| With Cap  | 100%              | 100%              | 100%              | 100%             | 100%             | 100%              | 100%             | 100%              |
| Limited to Escrow   | 77%               | 81%               | 88%               | 89%              | 79%              | 83%               | 94% <sup>5</sup> | 79%               |
| Limited to Purchase Price   | 2%                | 0%                | 0%                | 0%               | 0%               | 0%                | 0%               | 0%                |
| Exceptions to Limits <sup>4</sup>   | 96%               | 96%               | 100%              | 100%             | 100%             | 95%               | 94%              | 100%              |
| Without Cap   | 0%                | 0%                | 0%                | 0%               | 0%               | 0%                | 0%               | 0%                |
| <b>Escrows</b>  | <b>2011</b>       | <b>2012</b>       | <b>2013</b>       | <b>2014</b>      | <b>2015</b>      | <b>2016</b>       | <b>2017</b>      | <b>2018</b>       |
| With Escrow   | 96%               | 100%              | 93% <sup>6</sup>  | 100%             | 93%              | 89%               | 100%             | 90% <sup>6</sup>  |
| % of Deal Value   |                   |                   |                   |                  |                  |                   |                  |                   |
| Lowest <sup>7</sup>   | 5%                | 5%                | 5%                | 2%               | 4%               | 5%                | 4%               | 3%                |
| Highest   | 31%               | 16%               | 20%               | 16%              | 16%              | 15%               | 13%              | 15%               |
| Most Frequent   | 10%               | 10%               | 10%               | 10%              | 10%              | 10%               | 5%               | 10%               |
| Length of Time  |                   |                   |                   |                  |                  |                   |                  |                   |
| Shortest  | 12 Mos.           | 10 Mos.           | 12 Mos.           | 12 Mos.          | 12 Mos.          | 12 Mos.           | 9 Mos.           | 12 Mos.           |
| Longest   | 36 Mos.           | 48 Mos.           | 30 Mos.           | 24 Mos.          | 36 Mos.          | 24 Mos.           | 24 Mos.          | 36 Mos.           |
| Most Frequent   | 18 Mos.           | 12 Mos.           | 18 Mos.           | 12 Mos.          | 12&18 Mos. (tie) | 18 Mos.           | 12&18 Mos. (tie) | 18 Mos.           |
| Exclusive Remedy  | 78%               | 73%               | 60%               | 86%              | 63%              | 88%               | 71%              | 72%               |
| Exceptions to Escrow Limit Where Escrow Was Exclusive Remedy <sup>4</sup> | 97%               | 100%              | 100%              | 100%             | 100%             | 93%               | 92%              | 100%              |
| <b>Baskets for Indemnification</b>  | <b>2011</b>       | <b>2012</b>       | <b>2013</b>       | <b>2014</b>      | <b>2015</b>      | <b>2016</b>       | <b>2017</b>      | <b>2018</b>       |
| Deductible <sup>8</sup>   | 38%               | 27%               | 50%               | 44%              | 31%              | 47%               | 63%              | 47%               |
| Threshold <sup>8</sup>  | 60%               | 65%               | 42%               | 56%              | 61%              | 53%               | 37%              | 53%               |
| <b>MAE Closing Condition</b>  | <b>2011</b>       | <b>2012</b>       | <b>2013</b>       | <b>2014</b>      | <b>2015</b>      | <b>2016</b>       | <b>2017</b>      | <b>2018</b>       |
| Condition in Favor of Buyer   | 98%               | 95%               | 100%              | 97%              | 100%             | 100%              | 94%              | 100%              |
| Condition in Favor of Target  | 15%               | 9%                | 17%               | 19%              | 12%              | 39%               | 22%              | 12%               |
| <b>Exceptions to MAE</b>  | <b>2011</b>       | <b>2012</b>       | <b>2013</b>       | <b>2014</b>      | <b>2015</b>      | <b>2016</b>       | <b>2017</b>      | <b>2018</b>       |
| With Exception <sup>9</sup>   | 94% <sup>10</sup> | 84% <sup>11</sup> | 96% <sup>12</sup> | 100%             | 100%             | 100%              | 100%             | 97% <sup>12</sup> |

<sup>1</sup> Includes one transaction where the only representations that survive for purposes of indemnification are certain "fundamental" representations and representations concerning material contracts and intellectual property.

<sup>2</sup> Includes one transaction where the only representations that survive for purposes of indemnification are those concerning capitalization, financial statements and undisclosed liabilities, but excludes one transaction where indemnification was provided for breaches of covenants prior to the closing but representations did not survive for purposes of indemnification.

<sup>3</sup> Measured for representations and warranties generally; specified representations and warranties may survive longer.

<sup>4</sup> 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.

<sup>5</sup> Includes two transactions where the limit was below the escrow amount.

<sup>6</sup> One transaction not including an escrow at closing did require funding of escrow with proceeds of earnout payments.

<sup>7</sup> Excludes transactions which also specifically referred to representation and warranty insurance as recourse for the buyer.

<sup>8</sup> A "hybrid" approach with both a deductible and a threshold was used in another 2% of these transactions in 2011, 8% of these transactions in 2012, 8% of these transactions in 2013, and 8% of these transactions in 2015.

<sup>9</sup> Generally, exceptions were for general economic and industry conditions.

<sup>10</sup> Excludes one transaction where the specified exceptions do not apply for purposes of a standalone "material adverse effect" closing condition.

<sup>11</sup> 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.

<sup>12</sup> The only transaction not including such exceptions provided for a closing on the same day the definitive agreement was signed.

## 18 Trends in Convertible Note and SAFE Terms

Based on hundreds of convertible note and SAFE (simple agreements for future equity) financing transactions we handled from 2015 to 2018 for companies and investors, we have compiled the following deal data:

| Deals with Purchase Agreement   |                                  | 2015                 | 2016                 | 2017                 | 2018                 |
|---|----------------------------------|----------------------|----------------------|----------------------|----------------------|
| If included, a purchase agreement typically contains representations and warranties from the company (and possibly the founders).   | % of Deals                       | 74%                  | 67%                  | 57%                  | 40%                  |
| Term  |                                  | 2015                 | 2016                 | 2017                 | 2018                 |
| The term of the convertible note before it matures.   | Median Range                     | 18 mos.<br>4–60 mos. | 18 mos.<br>2–60 mos. | 18 mos.<br>1–60 mos. | 12 mos.<br>3–24 mos. |
| Interest Rate   |                                  | 2015                 | 2016                 | 2017                 | 2018                 |
| The rate at which interest accrues during the term of the convertible note.   | Median Range                     | 5%<br>2%–14%         | 5%<br>0.64%–10%      | 6%<br>2%–10%         | 5%<br>2%–8%          |
| Deals with Security Interest  |                                  | 2015                 | 2016                 | 2017                 | 2018                 |
| Convertible note investors sometimes require the company to provide a security interest in company assets.  | % Secured                        | 15%                  | 13%                  | 16%                  | 10%                  |
|   | % Unsecured                      | 85%                  | 87%                  | 84%                  | 90%                  |
| Deals with Conversion Discount  |                                  | 2015                 | 2016                 | 2017                 | 2018                 |
| Convertible note and SAFE investors often require that conversion in connection with an equity financing be at a discount from the price paid by new investors in the financing. A conversion discount is often coupled with a cap on the valuation at which conversion occurs. | % of Deals                       | 89%                  | 72%                  | 72%                  | 77%                  |
|   | Range of Discounts               | 10%–50%              | 10%–50%              | 8%–30%               | 10%–25%              |
|   | % with 20% or Less Discount      | 74%                  | 69%                  | 98%                  | 91%                  |
|   | % with Greater Than 20% Discount | 26%                  | 31%                  | 2%                   | 9%                   |
|   | % with Valuation Cap             | 55%                  | 64%                  | 82%                  | 57%                  |
| Deals with Conversion upon Maturity   |                                  | 2015                 | 2016                 | 2017                 | 2018                 |
| If a convertible note is not converted or otherwise paid upon maturity, it often converts into shares of the company's capital stock. This conversion is most often at the election of the investor but may be mandatory.   | % of Deals                       | 60%                  | 50%                  | 39%                  | 27%                  |
|   | % with Optional Conversion       | 89%                  | 89%                  | 91%                  | 75%                  |
|   | % with Mandatory Conversion      | 11%                  | 11%                  | 9%                   | 25%                  |
|   | % that Convert into:             |                      |                      |                      |                      |
|   | Common                           | 32%                  | 41%                  | 42%                  | 38%                  |
|   | Preferred                        | 68%                  | 59%                  | 58%                  | 62%                  |
| Deals with Conversion upon Company Sale   |                                  | 2015                 | 2016                 | 2017                 | 2018                 |
| If a convertible note or SAFE is outstanding at the time of a sale of the company, it often converts into shares of the company's capital stock. This conversion is most often at the election of the investor but may be mandatory.  | % of Deals                       | 74%                  | 46%                  | 61%                  | 57%                  |
|   | % with Optional Conversion       | 91%                  | 92%                  | 93%                  | 88%                  |
|   | % with Mandatory Conversion      | 9%                   | 8%                   | 7%                   | 12%                  |
|   | % that Convert into:             |                      |                      |                      |                      |
|   | Common                           | 49%                  | 56%                  | 71%                  | 82%                  |
|   | Preferred                        | 51%                  | 44%                  | 29%                  | 18%                  |
| Deals with Conversion Premium upon Company Sale   |                                  | 2015                 | 2016                 | 2017                 | 2018                 |
| Investors may require that they receive a multiple of the outstanding investment amount in connection with a sale of the company.   | % of Deals                       | 53%                  | 57%                  | 59%                  | 57%                  |
|   | Median Premium                   | 2x                   | 2x                   | 2x                   | 2x                   |
|   | Range of Premiums                | 1.5x–4x              | 0.5x–3x              | 1.5x–4.1x            | 1.2x–2x              |
| Deals with Warrant Coverage   |                                  | 2015                 | 2016                 | 2017                 | 2018                 |
| Investors sometimes receive a warrant in addition to their note or SAFE. The amount of company stock covered by the warrant is usually proportional to the investment amount, referred to as the warrant coverage.  | % of Deals                       | 4%                   | 17%                  | 8%                   | 10%                  |
|   | Coverage Range                   | Insufficient data    | 5%–50%               | 5%–100%              | 25%–65%              |
|   | % that Cover Common              | 50%                  | 0%                   | 20%                  | 33%                  |
|   | % that Cover Preferred           | 50%                  | 100%                 | 80%                  | 67%                  |

*Explanatory Note:* By their nature, SAFEs do not have maturity dates, interest rates or security interests. As a result, the metrics reported above that relate to maturity dates, interest rates and security interests are based solely on convertible note financings.

## Trends in Venture Capital Financing Terms 19

Based on hundreds of venture capital financing transactions we handled from 2013 to 2018 for companies and investors, we have compiled the following deal data:

| Deals with Multiple Liquidation Preferences   |   | 2013 | 2013 Range | 2014 | 2014 Range | 2015 | 2015 Range | 2016              | 2016 Range  | 2017 | 2017 Range    | 2018 | 2018 Range              |
|---|---|------|------------|------|------------|------|------------|-------------------|-------------|------|---------------|------|-------------------------|
| A “multiple liquidation preference” entitles holders of preferred stock to receive more than 1x their money back before sale or liquidation proceeds are distributed to holders of common stock.  | First Round   | 5%   | 2x–3x      | 0%   | N/A        | 2%   | 1.5x (all) | 0%                | N/A         | 3%   | 1.08x–2x      | 3%   | 1.5x (two deals)        |
|   | Post-First Round                                    | 9%   | 1.5x–2.17x | 3%   | 1.5x (all) | 4%   | 1.5x–2x    | 4%                | 1.12x–1.25x | 8%   | 1.32x–3x      | 3%   | 1.5x–2.5x (three deals) |
| Deals with Participating Preferred Stock  |   | 2013 | 2013 Range | 2014 | 2014 Range | 2015 | 2015 Range | 2016              | 2016 Range  | 2017 | 2017 Range    | 2018 | 2018 Range              |
| “Participating preferred” stock entitles holders to receive a stated liquidation preference plus 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.   | First Round   | 8%   |            | 12%  |            | 6%   |            | 13%               |             | 10%  |               | 13%  |                         |
|   | Total Capped  | 50%  | 2x–3x      | 40%  | 3x–5x      | 100% | 2x–3x      | Insufficient data |             | 14%  | 2x (one deal) | 0%   | N/A                     |
|   | Post-First Round                                    | 24%  |            | 19%  |            | 19%  |            | 28%               |             | 16%  |               | 31%  |                         |
|   | Total Capped  | 41%  | 2x–5x      | 45%  | 2x–5x      | 50%  | 2x–5x      | 34%               | 2x–5x       | 56%  | 2x–2.5x       | 41%  | 2x–5x                   |
| Deals with an Accruing Dividend   |   | 2013 |            | 2014 |            | 2015 |            | 2016              |             | 2017 |               | 2018 |                         |
| “Accruing dividends” are generally payable upon liquidation or redemption of the preferred stock, effectively increasing the liquidation preference of the preferred stock.   | First Round   | 9%   |            | 11%  |            | 12%  |            | 23%               |             | 8%   |               | 7%   |                         |
|   | Post-First Round                                    | 11%  |            | 22%  |            | 25%  |            | 30%               |             | 26%  |               | 24%  |                         |
| Anti-Dilution Provisions  |   | 2013 |            | 2014 |            | 2015 |            | 2016              |             | 2017 |               | 2018 |                         |
| A “full ratchet” anti-dilution formula provides that the conversion price of the preferred stock will be reduced to the price paid in the dilutive issuance, regardless of how many shares are involved in the dilutive issuance. In contrast, a “weighted average” anti-dilution formula takes into account the dilutive impact based upon the number of shares and the price involved in the dilutive issuance and the number of shares outstanding before and after the dilutive issuance. | First Round   |      |            |      |            |      |            |                   |             |      |               |      |                         |
|   | Full Ratchet  | 0%   |            | 0%   |            | 0%   |            | 0%                |             | 0%   |               | 0%   |                         |
|   | Weighted Average                                    | 100% |            | 100% |            | 100% |            | 100%              |             | 100% |               | 100% |                         |
|   | Post-First Round                                    |      |            |      |            |      |            |                   |             |      |               |      |                         |
| Full Ratchet  | 1%  |      | 1%         |      | 0%         |      | 1%         |                   | 0%          |      | 1%            |      |                         |
| Weighted Average  | 99%   |      | 99%        |      | 100%       |      | 99%        |                   | 100%        |      | 99%           |      |                         |
| Deals with Pay-to-Play Provisions   |   | 2013 |            | 2014 |            | 2015 |            | 2016              |             | 2017 |               | 2018 |                         |
| “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   | 7%   |            | 8%   |            | 5%   |            | 10%               |             | 7%   |               | 7%   |                         |
|   | % of Total that Convert into Common Stock           | 100% |            | 53%  |            | 71%  |            | 94%               |             | 83%  |               | 100% |                         |
|   | % of Total that Convert into Shadow Preferred Stock | 0%   |            | 47%  |            | 29%  |            | 6%                |             | 17%  |               | 0%   |                         |

*Explanatory Note:* “First round” refers to a company’s first priced preferred stock financing regardless of round designation.

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