

Venture Capital Report

2022

WILMERHALE® 

2022 Venture Capital Report—What's Inside

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2 US Market Review and Outlook

Despite the continued uncertainty and upheaval caused by the COVID-19 pandemic, the number of venture capital financings reached a record high in 2021 and proceeds nearly doubled from 2020.

VC-backed company liquidity activity also surged, with sharp increases in both the number of IPOs and the median pre-money valuation at the time of IPO, while the number of acquisitions and median acquisition price reached their highest levels in more than two decades.

EQUITY FINANCING ACTIVITY

The number of venture capital financings grew by 29%, from 12,286 in 2020 to 15,901 in 2021. The record \$332.6 billion invested in the US venture capital ecosystem in 2021 represented an increase of 98% from the \$167.8 billion in 2020.

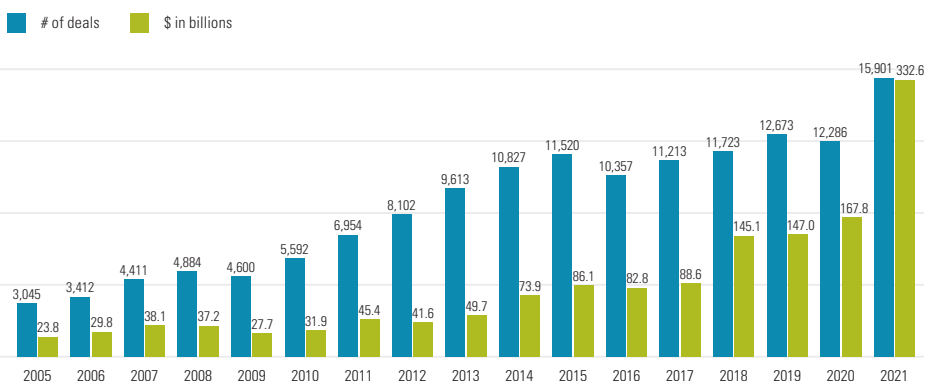
Overall, the median size of venture capital financings increased by 50%, from \$3.0 million in 2020 to \$4.5 million in 2021—the highest annual level since 2006, when angel and seed financings comprised a smaller portion of the market.

The median size of angel and seed financings rose by 49%, from \$1.34 million in 2020 to \$2.0 million in 2021. The median size of early-stage financings increased by 50%, from \$6.67 million to \$10.0 million. At \$16.0 million, the median size of later-stage financings in 2021 was 60% higher than the \$10.0 million figure in 2020. Median financing amounts at each financing stage have either increased or remained steady each year since 2013.

The median financing size for life sciences companies rose by 24%, from \$4.5 million in 2020 to \$5.6 million in 2021, the highest annual level since 2003. Among technology companies, the median financing size grew by 43%, from \$3.5 million to \$5.0 million, its highest annual level since 2007.

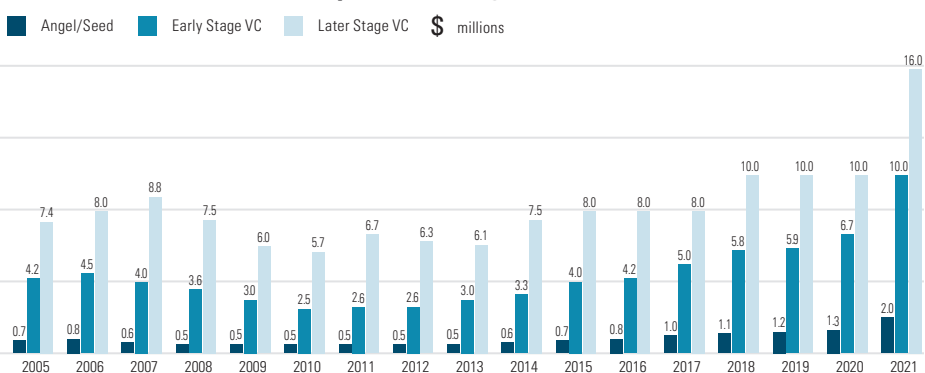
The number of large financing rounds continued to grow in 2021. There were 1,582 financing rounds of at least \$50 million in 2021, more than double the 762 in 2020, continuing a trend that saw rounds of this size grow from 334 in 2017 to 547 in 2018, and then to 622 in 2019. The number of financing rounds of at least \$100 million shows a similar

US Venture Capital Financings—2005 to 2021



Source: PitchBook

Median Size of US Venture Capital Financings—2005 to 2021



Source: PitchBook

pattern, growing by 143% from 338 to 823 in 2021, following a more modest increase between 2018 and 2019, from 217 to 259. With VC-backed companies increasingly relying on “IPO-sized” later-stage rounds of financing, the number of financing rounds of at least \$250 million jumped 156%, to 205 in 2021 from 80 in the prior year.

Increases in super-sized rounds are driven largely by growth equity, crossover and hedge funds, which are attracted to pre-IPO companies that can offer the potential for sizeable investment returns.

There were 21 billion-dollar financing rounds in 2021, one more than in the preceding three years combined. This elite club was led by Robinhood Markets, with its \$3.4 billion convertible debt financing, followed by Rivian Automotive (with rounds

of \$2.65 billion and \$2.5 billion), Waymo (\$2.5 billion) and Generate (\$2.0 billion).

The median pre-money valuation for all venture financings continued its upward trajectory, leaping 78%, from \$18.0 million in 2020 to \$32.0 million in 2021. Among angel and seed rounds, the median pre-money valuation increased 29%, from \$7.0 million to \$9.0 million. The median pre-money valuation in early-stage rounds increased 61%, from \$28.0 million to \$45.0 million, while later-stage rounds saw a 79% jump, from \$61.5 million to \$110.0 million.

The median pre-money valuation in the technology sector more than doubled the prior year’s median of \$18.0 million, reaching \$38.0 million in 2021. Among life sciences companies, the median

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pre-money valuation increased 25%, from \$24.0 million to \$30.0 million.

Angel and seed financings accounted for 39% of all venture financings in 2021 (down from 44% in 2020) and represented 6% of all venture capital financing proceeds (down from 7% in 2020). Early-stage financings accounted for 30% of all financings in 2021 (up from 27% in 2020) and 23% of all proceeds (down from 24% in 2020). Later-stage financings accounted for 31% of all financings in 2021 (up from 29% in 2020) and 72% of all proceeds (up from 69% in 2020).

The technology sector accounted for 40% of the year's financings in 2021, up from 39% in 2020. The life sciences sector's market share decreased to 21% in 2021 from 23% in 2020. The market share for consumer goods and services companies dipped from 19% in 2020 to 18% in 2021, while business services companies saw their market share hold steady at 13%.

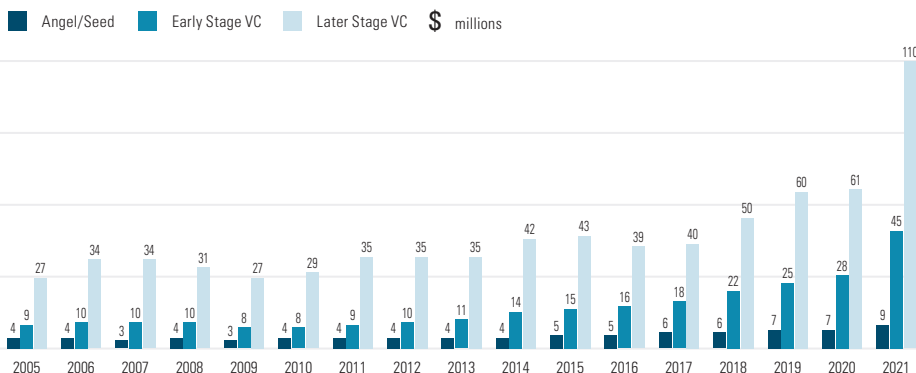
California produced 34% of all venture financings in 2021 (5,347 financings) and 47% of the year's proceeds (\$157.38 billion). New York, home to companies with 2,144 financings raising \$49.45 billion in 2021, finished second in the state rankings, followed by Massachusetts (with 1,096 financings raising \$35.51 billion), Texas (with 798 financings raising \$9.04 billion), Washington (with 553 financings raising \$8.61 billion) and Florida (with 502 financings raising \$5.98 billion).

LIQUIDITY ACTIVITY

The number of IPOs by VC-backed US issuers increased by 64%, from 95 in 2020 to 156 in 2021—the highest annual figure since the 201 in 2000. VC-backed companies accounted for 56% of all US-issuer IPOs in 2021, down from 64% in 2020, largely due to an almost three-fold increase in the number of PE-backed IPOs.

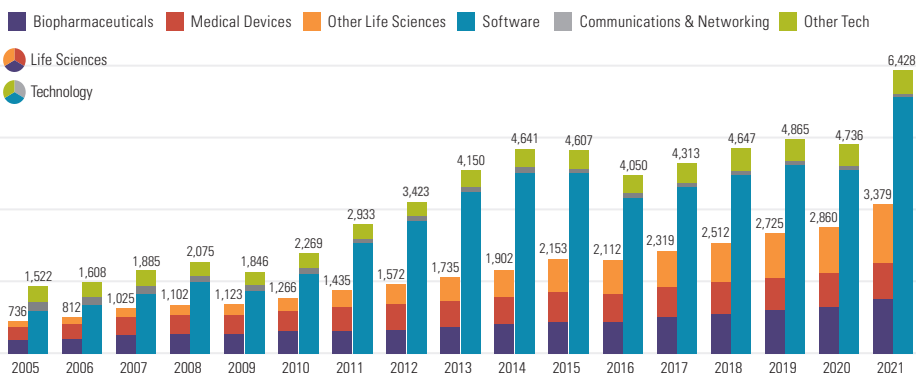
Gross IPO proceeds raised by VC-backed US issuers nearly doubled, from \$30.38 billion in 2020 to \$60.10 billion in 2021. There were 13 billion-dollar IPOs by VC-backed US issuers in 2021, up from six in both 2019 and 2020. The largest VC-backed IPO in 2021 was the \$11.93 billion offering of

Median Pre-Money Valuation in US Venture Capital Financings—2005 to 2021



Source: PitchBook

US Venture Capital Financings by Industry—2005 to 2021



Source: PitchBook

Rivian Automotive, followed by the IPOs of Bumble (\$2.15 billion), Robinhood (\$2.09 billion), Qualtrics (\$1.55 billion) and Oscar Health (\$1.44 billion).

The median offering size for US VC-backed IPOs edged down by 4%, from \$182.7 million in 2020 to \$176.0 million.

In 2021, life sciences companies accounted for 56% of all VC-backed IPOs, down from their 70% market share in 2020 and the average of 61% that prevailed over the five-year period from 2015 to 2019. Among technology companies, the VC-backed IPO market share increased to 38% in 2021, from 27% in 2020, surpassing the 37% share of the VC-backed IPO market claimed by technology companies between 2015 and 2019.

The median time from initial funding to IPO increased from 5.3 years in 2020 to 6.0 years in 2021, but still represented the third-lowest figure in the last ten years.

The median amount raised prior to an IPO rose modestly, from \$167.4 million in 2020 to \$173.8 million in 2021, while the median pre-IPO valuation climbed by 48%, from \$543.2 million to \$802.0 million. As a result, the ratio of pre-IPO valuation to the median amount raised prior to an IPO increased from 3.2:1 in 2020 to 4.6:1 in 2021—the highest level since 2012 (a higher ratio means better returns to pre-IPO investors).

The median 2021 VC-backed US issuer IPO ended the year down 11% from its offering price, in contrast to the median gain of 67% in 2020. At the end of 2021, only 27% of the year's VC-backed IPO class

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were trading above their offering price, compared to 80% in 2020 and 57% in 2019.

The number of reported acquisitions of VC-backed companies increased by 40%, from 979 in 2020 to a record 1,373 in 2021. Total reported acquisition proceeds increased by 8%, from \$90.8 billion to a record \$98.0 billion. Once all 2021 acquisitions are accounted for, the year's totals for deals and proceeds will exceed those of 2020 by even wider margins.

The median acquisition price increased by 5%, from \$70.0 million in 2020 to \$73.5 million—the highest figure since 2000. The median time from initial funding to acquisition grew from 5.2 years in 2020 to a new annual high of 5.3 years in 2021.

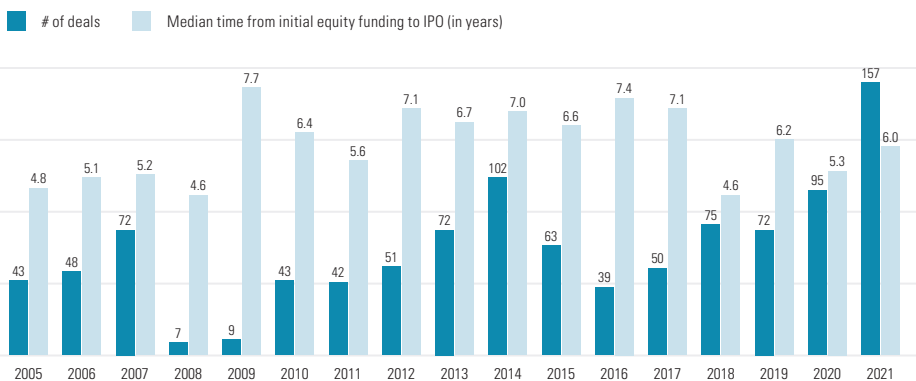
The median amount raised prior to acquisition decreased by 5%, from \$10.5 million in 2020 to \$10.0 million in 2021.

The ratio of median acquisition price to median amount raised prior to acquisition increased from 6.7:1 in 2020 to 7.4:1 in 2021 (a higher ratio means higher returns to pre-acquisition investors). The 2021 figure was the third-highest ratio since the 12.7:1 recorded in 2000, behind only the 8.3:1 recorded in 2016 and 8.2:1 in 2019. The increase in this ratio reflects the combination of significantly higher acquisition prices and lower levels of pre-acquisition investments.

There were 51 VC-backed company acquisitions of at least \$500 million in 2021, representing a 28% increase over the 40 in 2020 and an 89% increase over the annual average of 27 that prevailed during the five-year period from 2015 to 2019.

The year also produced 23 billion-dollar acquisitions, equal to the number in 2020 and up from the 18 in 2019. The largest deal of 2021 was the \$8.0 billion acquisition of GRAIL by Illumina, followed by the \$6.5 billion acquisition of Auth0 by Okta, the \$3.9 billion acquisition of Ginger by Headspace, the \$2.5 billion acquisition of Divvy by Bill.com and the \$2.15 billion acquisition of Thrive Earlier Detection by Exact Sciences.

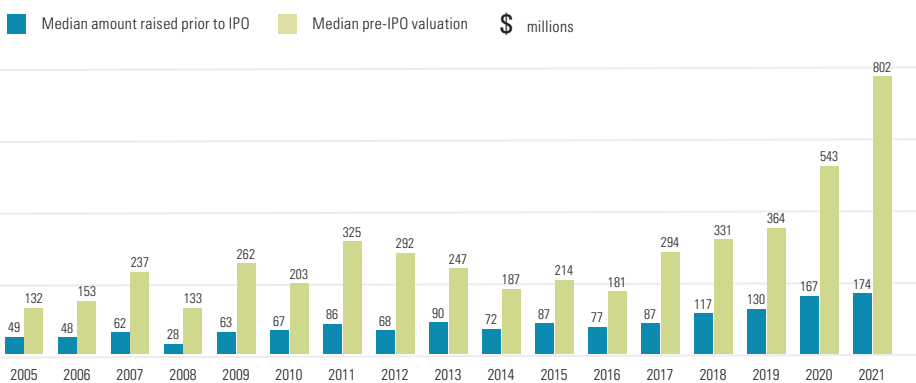
Venture Capital–Backed IPOs and Median Time to IPO—2005 to 2021



Source: SEC filings and PitchBook

The chart above is based on US IPOs by VC-backed US issuers.

Median Amount Raised Prior to IPO and Median Pre-IPO Valuation—2005 to 2021



Source: PitchBook

Based on the valuations achieved in company sales and IPOs compared to the financing amounts required to achieve each type of liquidity event, 2021 marked the ninth consecutive year in which returns to venture capital investors were higher in M&A transactions than in IPOs. Liquidity also arrived sooner through M&A transactions than through IPOs in 2021, with a median time of 5.3 years from initial funding to acquisition, compared to a median of 6.0 years from initial funding to IPO. This fact, combined with the tendency of M&A transactions to yield the bulk of the purchase price in cash at closing—whereas IPOs generally involve a post-IPO

lockup period and market uncertainty as to the timing and prices of subsequent stock sales—makes it easy to see why investors often prefer a company sale to an IPO.

While company sales continue to far outpace IPOs as liquidity events, the ratio of M&A transactions to IPOs for VC-backed companies declined to 8.1:1 in 2021 from 10.3:1 in 2020 and 14.2:1 in 2019.

OUTLOOK

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

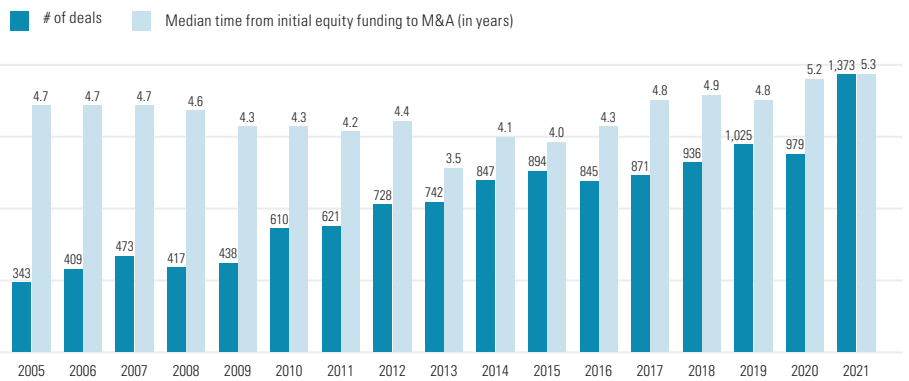
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— **Financing Activity:** Venture capital fundraising reached a record \$128.3 billion in 2021, up 48% from the \$86.9 billion in 2020. This surge in venture capital, combined with the increasing presence of non-traditional investors such as hedge funds, PE firms and sovereign wealth funds, has produced vast pools of capital available to emerging companies. Although the pandemic has not yet run its course and the economy is facing the twin headwinds of inflation and rising interest rates—and, more recently, the specter of rising oil prices following Russia’s invasion of Ukraine—the environment for venture capital financing activity should remain favorable in the coming year.

— **Attractive Sectors:** The pandemic has created numerous opportunities for companies that leverage blockchain technology, AI, machine learning and voice technology to enable and accelerate the digital transformation of business processes. Companies offering products or services that ease the demands of remote work, improve work-life balance, or address the continuing health and safety concerns arising from the pandemic should also remain attractive financing candidates in the coming year, while those operating in industries hard-hit by the pandemic will likely continue to struggle to adjust to the “new normal.” Other sectors that should receive significant investment include digital health, cybersecurity, robotics, fintech, cleantech and agtech. Innovative life sciences companies, and those with compelling market opportunities—such as in rare diseases, immunology and gene therapy—should also continue to appeal to investors.

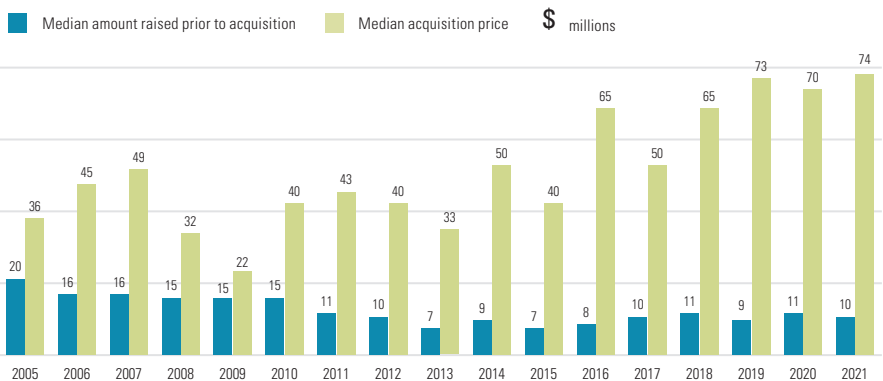
— **IPOs:** The JOBS Act, combined with other regulatory changes and the availability of large amounts of private capital, has made it easier for VC-backed companies to stay private longer. As a result, many VC-backed companies, particularly in the technology industry, have opted to delay their public debuts, often relying on private “IPO-sized” crossover rounds to meet their financing needs and to scale up before going public. The tepid aftermarket performance of many VC-backed IPOs in 2021 is likely to heighten

Acquisitions of US Venture-Backed Companies and Median Time to M&A—2005 to 2021



Source: PitchBook

Median Amount Raised Prior to Acquisition and Median Acquisition Price—2005 to 2021



Source: PitchBook

concerns regarding the IPO valuations of VC-backed companies in the coming year.

— **Acquisitions:** M&A activity in the coming year should get a boost from several factors. Despite the expectation that the Federal Reserve will raise interest rates in 2022 to help contain inflationary pressures, interest rates remain at a historically low level, which should encourage strategic acquirers to supplement organic growth with debt-financed acquisitions. Other companies will likely pursue acquisitions to respond to the acceleration of changes in business practices resulting from the pandemic. While acquisition prices cannot increase indefinitely, companies with differentiated market positions

and strong growth potential are likely to continue to fetch favorable prices.

— **Impact of SPACs:** In the coming year, special purpose acquisition companies (SPACs) should play a prominent role in the M&A market and produce additional liquidity opportunities (and an alternative pathway to public ownership) for VC-backed companies. Over the past two years, there have been more than 850 IPOs by SPACs, with aggregate proceeds of more than \$225 billion. At year-end 2021, there were 574 SPACs (with aggregate IPO proceeds of approximately \$155 billion) seeking acquisition targets, each facing a deadline (typically 12–24 months after IPO) by which it must complete a business combination or return funds to investors.

6 Regional Market Review and Outlook

CALIFORNIA

California companies reported 5,347 venture capital financings in 2021, an increase of 28% from the 4,173 in 2020. California was responsible for 34% of all US financing transactions in 2021, matching its market share in the prior two years.

Total proceeds grew 79%, from \$88.07 billion in 2020 to \$157.38 billion in 2021, partly due to an increase in very large financings. California's share of all financing proceeds nationwide dipped from 52% to 47%.

The number of rounds raising \$100 million or more rose by 117%, from 183 to 398 (48% of the US total in 2021), while the number of rounds of \$250 million or more increased by 111%, from 53 to 112 (55% of the US total in 2021).

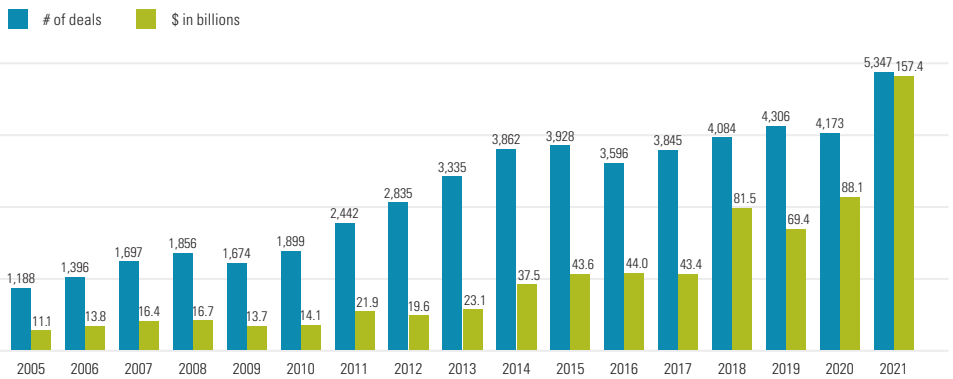
Technology was the largest sector in the state, producing 47% of all California financings in 2021, followed by life sciences (18%), consumer goods and services (17%), and business services (12%).

The number of IPOs by California-based VC-backed companies increased for the fifth consecutive year, growing 64%, from 42 in 2020 to 69 in 2021. California was home to 12 of the 20 largest VC-backed IPOs by US issuers in 2021. The largest were by Rivian Automotive (\$11.93 billion), Robinhood (\$2.09 billion) and TuSimple (\$1.35 billion).

The number of reported acquisitions of California VC-backed companies increased by 37%, from 366 in 2020 to 502 in 2021. The state's largest deals were the \$8.0 billion acquisition of GRAIL by Illumina, the \$3.9 billion acquisition of Ginger by Headspace, and the \$1.4 billion acquisition of Nuvia by Qualcomm.

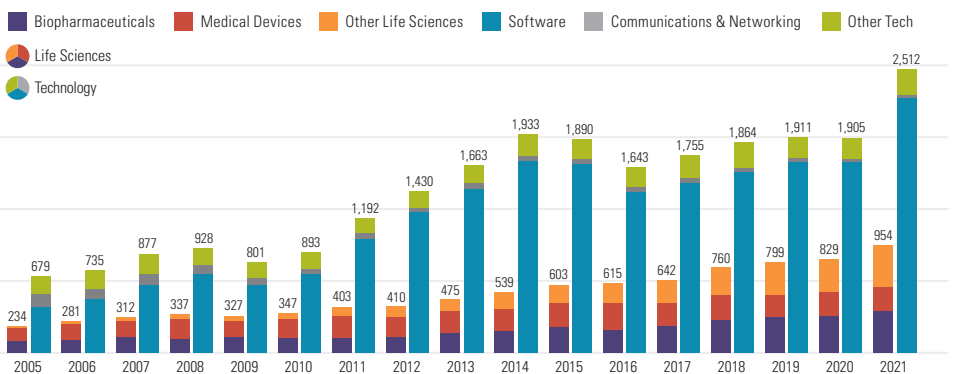
California will undoubtedly maintain its venture capital leadership in the coming year. The extent to which financing and liquidity activity can top the lofty totals of 2021 will depend on the level of venture capital fundraising, macroeconomic conditions, the continued willingness of strategic buyers to pay attractive prices, and IPO market conditions, among other factors.

California Venture Capital Financings—2005 to 2021



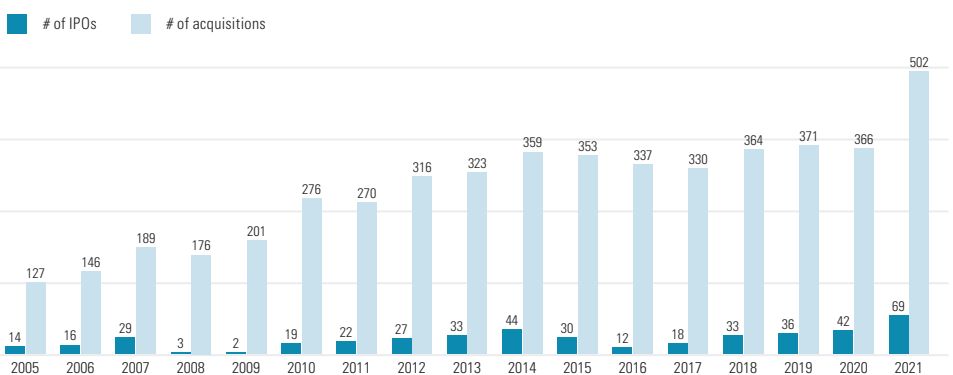
Source: PitchBook

California Venture Capital Financings by Selected Industry—2005 to 2021



Source: PitchBook

California Venture-Backed IPOs and Acquisitions—2005 to 2021



Source: SEC filings and PitchBook

7 Regional Market Review and Outlook

MID-ATLANTIC

With 1,160 rounds, the number of reported 2021 venture capital financings in the mid-Atlantic region of Virginia, Maryland, North Carolina, Delaware and the District of Columbia represented an increase of 40% from the 830 financings in 2020.

Buoyed by an uptick in the number of large financings, total proceeds in the mid-Atlantic region grew by 56%, from \$7.63 billion in 2020 to \$11.93 billion in 2021. The number of mid-Atlantic rounds raising \$100 million or more jumped from ten in 2020 to 28 in 2021.

North Carolina led the mid-Atlantic region for the second consecutive year, with 330 financings raising \$3.50 billion.

Technology companies accounted for 42% of all mid-Atlantic financings in 2021—extending the sector’s longstanding leadership in the region—followed by life sciences (24%), consumer goods and services (16%), and business services (13%).

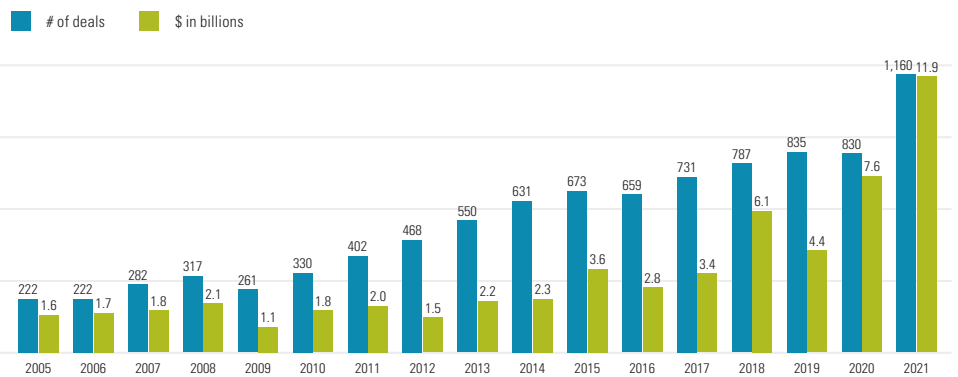
The region generated eight VC-backed IPOs in 2021, up from three in both 2019 and 2020. The largest was by accounts payable automation software provider AvidXchange (\$600 million), followed by Xometry (\$303 million) and Acumen Pharmaceuticals (\$160 million).

The number of reported acquisitions of mid-Atlantic VC-backed companies increased by 21%, from 61 in 2020 to 74 to 2021. North Carolina generated 26 deals, while Virginia produced 19 deals and Maryland 11 deals.

The region’s largest M&A transaction of the year was the \$1.1 billion acquisition of Clarabridge by Qualtrics, followed by the \$400 million acquisition of ACell by Integra LifeSciences, and the \$350 million acquisition of Vigene Biosciences by Charles River Laboratories.

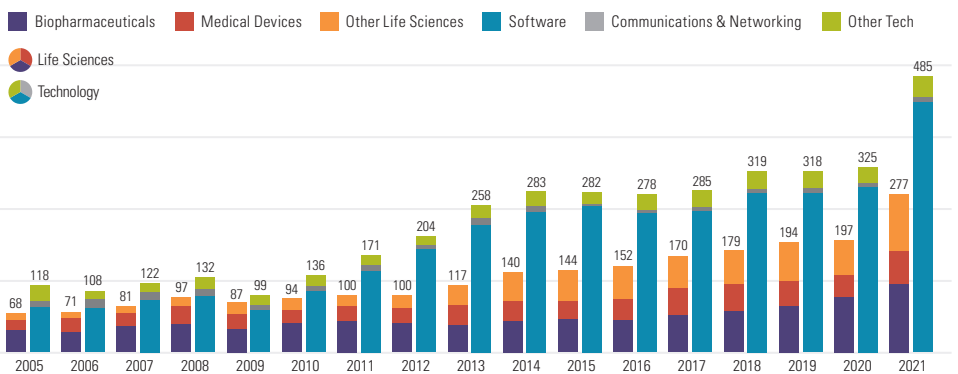
With a strong venture capital ecosystem, the mid-Atlantic region should continue to generate substantial levels of financing and liquidity activity in the coming year, although the region’s ability to exceed the tallies of 2021 will depend on market conditions and other factors.

Mid-Atlantic Venture Capital Financings—2005 to 2021



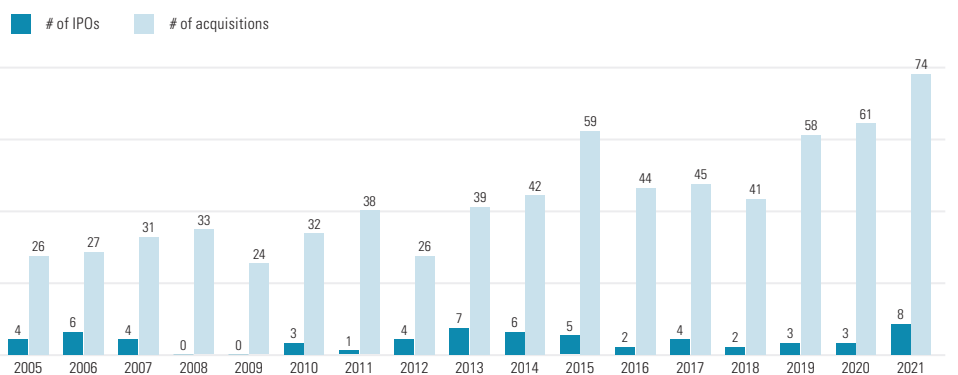
Source: PitchBook

Mid-Atlantic Venture Capital Financings by Selected Industry—2005 to 2021



Source: PitchBook

Mid-Atlantic Venture-Backed IPOs and Acquisitions—2005 to 2021



Source: SEC filings and PitchBook

8 Regional Market Review and Outlook

NEW ENGLAND

New England companies reported 1,404 venture capital financings in 2021, an increase of 25% from the 1,123 financings in 2020. Total proceeds were \$38.10 billion, almost double the \$19.22 billion in the prior year.

Massachusetts, the perennial leader in New England and the nation's third-largest source of VC financings, led the region in 2021, with 1,096 financings and \$35.51 billion in proceeds.

The number of rounds raising \$100 million or more leapt by 109%, from 47 in 2020 to 98 in 2021, while the number of rounds raising \$250 million or more almost tripled, growing from nine to 25. The largest rounds in 2021 came from Commonwealth Fusion Systems (\$1.8 billion), Devoted Health (\$1.15 billion) and Thrasio (\$1.0 billion).

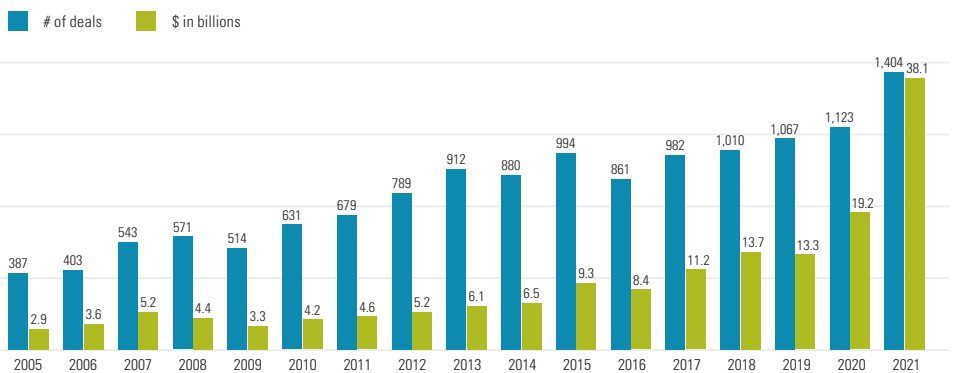
The life sciences sector accounted for 38% of New England venture capital financings in 2021, followed by technology (30%), consumer goods and services (14%), and business services (11%).

The number of VC-backed IPOs by New England-based companies increased from 26 in 2020 to 30 in 2021—the highest annual tally since 1996. All but two of the region's VC-backed IPOs were by Massachusetts-based companies, and all but three were by life sciences companies. The largest of 2021 were by Toast (\$870 million), Adagio Therapeutics (\$309 million) and Verve Therapeutics (\$267 million).

The number of reported acquisitions of VC-backed companies in New England grew by 51%, from 88 in 2020 to 133 in 2021—the highest annual figure on record—of which Massachusetts contributed 111. The region's largest M&A transactions were the \$2.15 billion acquisition of Thrive Earlier Detection Corp. by Exact Sciences and the \$1.83 billion acquisition of Turbonomic by IBM.

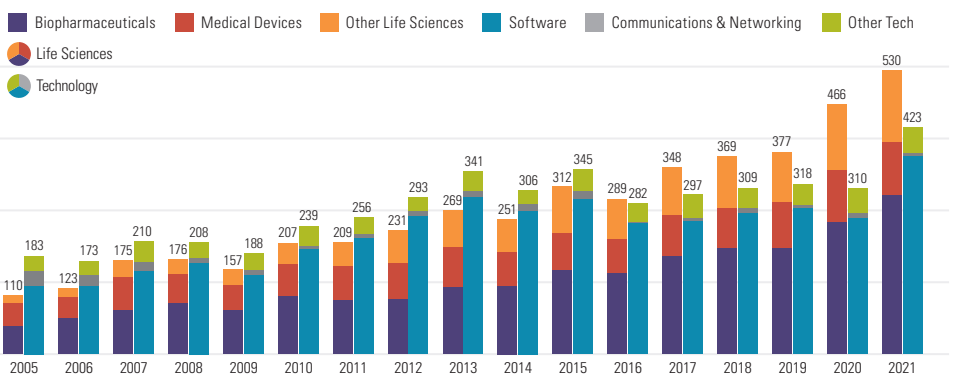
With its concentration of world-renowned universities and research institutions, New England—and Massachusetts in particular—should remain a hub of financing and liquidity activity during the coming year.

New England Venture Capital Financings—2005 to 2021



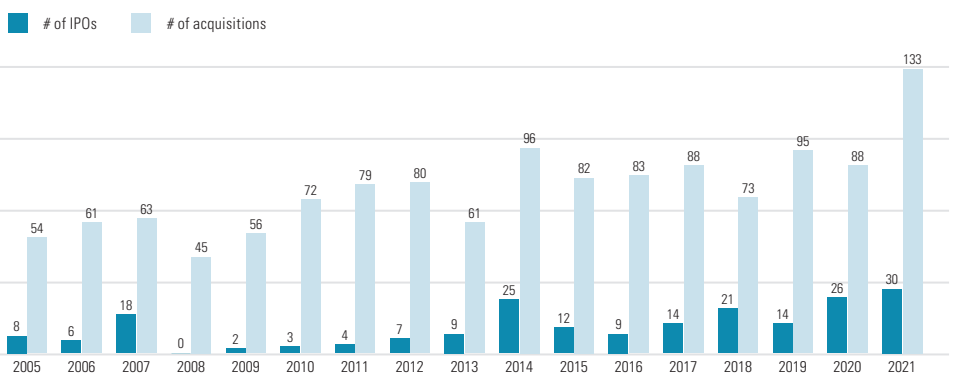
Source: PitchBook

New England Venture Capital Financings by Selected Industry—2005 to 2021



Source: PitchBook

New England Venture-Backed IPOs and Acquisitions—2005 to 2021



Source: SEC filings and PitchBook

9 Regional Market Review and Outlook

TRI-STATE

The number of reported venture capital financings in the tri-state region of New York, New Jersey and Pennsylvania increased by 38%, from 1,994 in 2020 to 2,759 in 2021, while total proceeds jumped 183%, from \$21.80 billion to \$61.77 billion.

New York, the nation's second-largest source of VC financings, led the region with 2,144 financings and \$49.45 billion in proceeds.

The number of rounds raising \$100 million or more soared by 249%, from 45 in 2020 to 157 in 2021, while the number of rounds of \$250 million or more soared from six to 42. The region's largest financings came from online software and training provider Articulate Global (\$1.5 billion) and instant grocery delivery platform company Gopuff (three separate billion-dollar rounds).

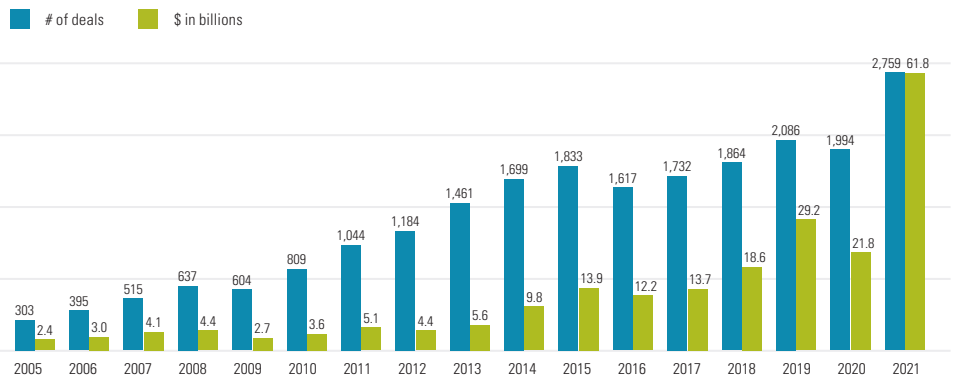
Technology companies accounted for 39% of the tri-state region's VC financings in 2021, followed by consumer goods and services (23%), life sciences (20%), and business services (12%).

There were 20 VC-backed IPOs in the tri-state region in 2021, up from 12 in 2020—the region's highest annual figure since 1999. New York produced 17 VC-backed IPOs, with Pennsylvania contributing two and New Jersey accounting for the other one. The largest venture-backed IPOs were from Vroom (\$468 million), Legend Biotech (\$424 million) and Lemonade (\$319 million).

The number of reported acquisitions of VC-backed companies in the tri-state region increased by 36%, from 153 in 2020 to 238 in 2021. New York generated 192 deals in 2021, followed by Pennsylvania with 26 and New Jersey with 20. The largest deals were the \$1.8 billion acquisition of Stack Exchange by Prosus and the \$1.28 billion acquisition of Frame.io by Adobe.

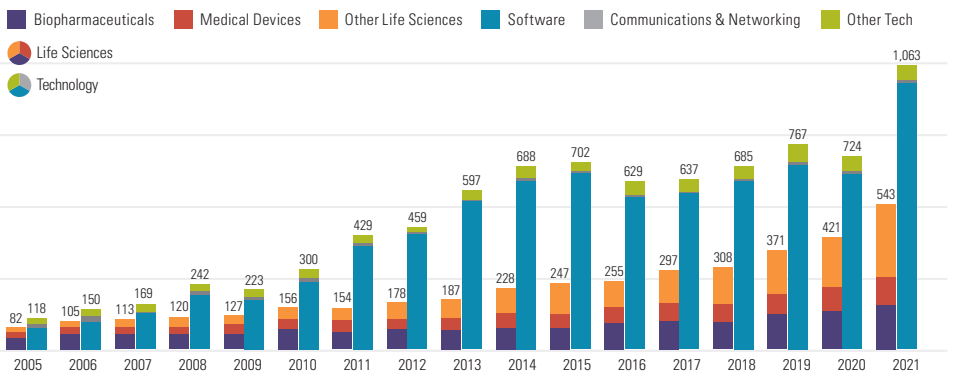
Due to its strength across a broad array of industry sectors, the tri-state region should continue to produce large numbers of financings and liquidity events, with growth beyond 2021's lofty tallies dependent on market conditions and other factors.

Tri-State Venture Capital Financings—2005 to 2021



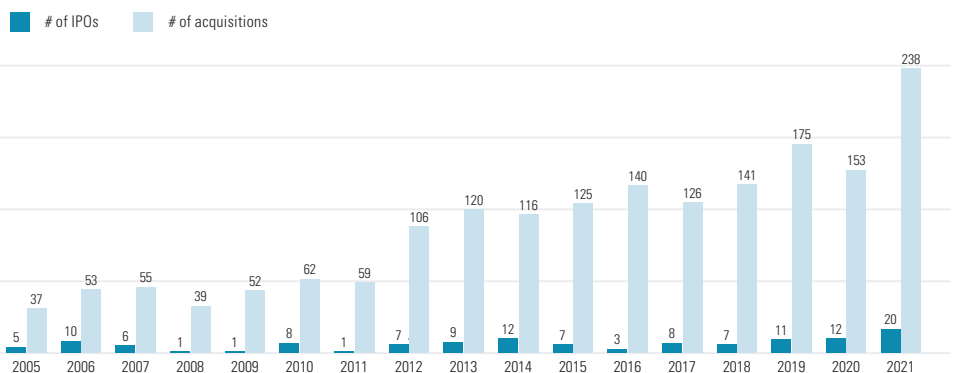
Source: PitchBook

Tri-State Venture Capital Financings by Selected Industry—2005 to 2021



Source: PitchBook



































Tri-State Venture-Backed IPOs and Acquisitions—2005 to 2021



Source: SEC filings and PitchBook

Counsel of Choice for Venture Capital Financings

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

 \$30,500,000 <i>Third Round</i> December 2021	 \$8,000,000 <i>First Round</i> April 2021	 \$60,000,000 <i>Second Round</i> December 2021	 \$157,000,000 <i>First Round</i> August 2021	 \$53,000,000 <i>Second Round</i> December 2021	 \$82,000,000 <i>First Round</i> April 2021	 \$74,000,000 <i>Second Round</i> June 2021	 \$13,500,000 <i>First Round</i> July 2021	 \$75,000,000 <i>Second Round</i> July 2021
 \$32,000,000 <i>First Round</i> June 2021	 \$20,000,000 <i>Second Round</i> March 2021	 \$30,000,000 <i>First Round</i> November 2021	 \$15,000,000 <i>First Round</i> October 2021	 \$25,000,000 <i>Second Round</i> May 2021	 \$75,000,000 <i>First Round</i> January 2021	 \$100,000,000 <i>First Round</i> August 2021	 \$90,000,000 <i>Late Stage</i> March 2021	
 \$8,000,000 <i>Seed Round</i> August 2021	 \$450,000,000 <i>Fourth Round</i> September 2021	 \$300,000,000 <i>Late Stage</i> February 2021	 \$55,000,000 <i>Third Round</i> August 2021	 \$65,000,000 <i>Third Round</i> June 2021	 \$100,000,000 <i>Third Round</i> June 2021	 \$14,000,000 <i>First Round</i> February 2021	 \$69,000,000 <i>Second Round</i> September 2021	 \$118,000,000 <i>Third Round</i> September 2021
 \$78,000,000 <i>Second Round</i> October 2021	 \$28,000,000 <i>Second Round</i> March 2021	 \$42,000,000 <i>Third Round</i> July 2021	 \$125,000,000 <i>Late Stage</i> January 2021	 \$61,000,000 <i>Second Round</i> June 2021	 \$44,000,000 <i>Seed Round</i> March 2021	 \$25,000,000 <i>Third Round</i> March 2021	 \$145,000,000 <i>Fourth Round</i> October 2021	

From Main Street to Wall Street

12 Planning From the Outset for an Eventual IPO or Company Sale

You've got the vision, the core team, and even a little money. You're prepared to devote enormous time and energy to your new startup. You're unsure what lies ahead but want to preserve the possibility of going public or being acquired someday. A full slate of IPO or company sale preparations is daunting and unnecessary for a newly founded company, but here are 10 things a startup should do to groom itself for a future liquidity event.

- **Protect Your IP:** In some sectors, intellectual property is the heart of the company, but even low-tech or no-tech startups routinely rely on confidential information, trademarks, domain names and copyrights. You should fashion an IP protection program that matches your needs and budget. Basic IP protection includes trademark searches; non-disclosure and invention assignment agreements with employees; confidentiality and IP ownership agreements with consultants and third parties; proper use of confidentiality legends, trademark symbols and copyright notices; and domain name registration. Advanced IP protection includes US and foreign patent applications. When acquiring IP rights from third parties, negotiate for broad rights covering both research and commercial purposes.
- **Respect Former Employers and Uncle Sam:** You've got a great idea and maybe a promising technology or discovery, but be certain it isn't owned by a former employer, since a lawsuit can stop your new company in its tracks. Similarly, make sure you retain the rights in any inventions or discoveries involving federal funding or government contracts. Also, be mindful of any non-competition or non-solicitation agreements you or your employees may have—these obligations can affect how you conduct business and your ability to recruit talent from former employers.
- **Bootstrap to Minimize Dilution:** A founder's sweat equity is a crucial part of the startup package, and by granting equity incentives a startup can pay less cash compensation to employees (although minimum wage laws still apply). "Bootstrapping" can help delay

substantial outside investment until significant milestones justify a higher valuation—and protect that equity from dilution. Bootstrapping might include founder resources, loans from friends and family, or cash flow from operations. Friends-and-family investments present both benefits (it is money) and disadvantages (it can be awkward to ask Mom for a loan), but may be the best funding alternative at inception.

- **Stay Out of the Woodwork:** An IPO or company sale can be "out of the woodwork" time. Former employees and other people you've long since forgotten might show up on the cusp of the deal looking for a piece of the company. Preempt these surprises by making sure your IP rights are properly documented and all equity commitments have been honored.
- **Employ At Will and Take Vacations:** Your employment policies will evolve with the growth of your business. An essential one is an employment-at-will policy—stating that the employment of any employee can be terminated at any time and for any reason, or for no reason. The policy's purpose is to negate any inference that an employee is entitled to continued employment or severance upon termination. Limits on vacation carryover should also be adopted early on, to avoid the buildup of accrued vacation on your books. Besides, periodic vacations will keep key employees fresh and productive.
- **Pre-Wire the Company:** Set up your capital structure in anticipation of an IPO or company sale. Preferred stock should automatically convert into common stock in an IPO, and "tag-along" rights can expedite stockholder approval of a sale. Investor rights agreements should terminate in either type of transaction. Place IPO lockup provisions in your stock plans and financing documents. Include persons on your board of directors (including female and diverse members) who could form the nucleus of a public company board. These kinds of steps can ease aspects of a future IPO or sale process.

- **Observe Securities and Tax Requirements:** Issuances of stock and options must comply with the securities laws. Violations can result in liability to the company, make it difficult to attract investors, and even jeopardize a potential IPO or company sale. Equity grants can have adverse tax and accounting consequences if not structured properly. Attending to these matters is usually not particularly burdensome, but should not be overlooked.
- **Remember the Regulators:** Various regulations may apply to your new company depending on its size, location, industry and other factors. Keep on top of applicable regulatory requirements—future IPO underwriters and buyers will scrutinize your business and may hold you accountable for serious deficiencies.
- **Discover Delaware:** If you hope to go public, incorporate in Delaware—more than 90% of all IPO companies do. Delaware offers nationwide familiarity; a permissive and flexible corporation statute; a well-developed body of case law; and an experienced judiciary. Reincorporation in Delaware prior to an IPO is possible, but starting off in Delaware will facilitate your financings and other corporate transactions from the beginning.
- **Keep Good House:** IPO or sale preparations will proceed more smoothly if you attend to "corporate housekeeping" on a regular basis. This includes minute books, stock and option records, employee agreements, IP documentation, contracts and other corporate records and formalities, as well as legal compliance. Many defects can be fixed as a transaction draws nearer, but the process will be helped if you start with a solid foundation of good housekeeping.

Finally, don't despair if the IPO market is not ready when you are. In recent years, far more startups have been acquired than gone public. Both possibilities can even be combined in a "dual track" strategy, in which you simultaneously pursue an IPO while entertaining acquisition offers. The above preparations will serve both paths well, and help build a stronger company even if you pursue neither. ■

Basic Intellectual Property Protection for Startup Companies

13 Seven Simple Steps That Won't Sap a Startup's Stash

Every startup company has or will have intellectual property, often derived from a variety of sources. Intellectual property may be developed internally; may be in-licensed from commercial enterprises, universities or other third parties; or may result from joint development, collaboration or similar arrangements.

In some sectors, intellectual property is at the core of a company's success, while in other industries intellectual property rights play a less important role. Even low-tech businesses, however, rely on intellectual property rights to some extent. What successful company does not have confidential information about its business, customers, suppliers and business partners (trade secrets); a name under which it sells products or services (a trademark or service mark); a website for customers and prospective employees to visit (a domain name); or written product literature, advertisements or other materials (copyrights)? The answer is none.

DEVELOPING AN IP PROTECTION PROGRAM

In a startup company, intellectual property protection is a matter of business strategy, priorities and tradeoffs. Protection of every item of intellectual property created, developed, conceived or reduced to practice—even if possible—would be prohibitively expensive and consume an unacceptable amount of time from management and key employees.

A company should develop an intellectual property protection program and review and update the program periodically to reflect the company's evolving business, financial resources and needs, and changes in the prevailing legal environment. That program should be shaped by, among other factors:

- the company's business goals;
- the technology and intellectual property rights the company owns or expects to develop or acquire;
- the geographic scope of the company's present and anticipated operations;

- the locations of the company's present and anticipated key competitors;
- the type of intellectual property protection then available for the particular items sought to be protected;
- the availability of legal protections in foreign jurisdictions;
- the likelihood that the company could or would enforce its intellectual property rights through litigation;
- the company's financial resources;
- the scope of protection obtained by key competitors; and
- an assessment of the importance of intellectual property rights to effective competition in the marketplace.

BASIC IP PROTECTION

At a minimum, and regardless of a company's resources or the nature of its business, every startup company should provide for basic intellectual property protection. The steps outlined below cost relatively little and can be readily incorporated into standard business practices. There is, of course, much more a company can do to enhance and protect its intellectual property rights—such as filing US and foreign patent applications—and investors often ascribe value to intellectual property rights. However, if the company does nothing more than take the following steps, it should have a decent shot at owning its inventions, preserving its trademark rights, protecting its trade secrets, enforcing its copyrights and retaining its domain name.

- **Name Searches:** Check the availability of the corporate name in the state of incorporation and other jurisdictions where operations are anticipated. Undertake trademark searches on the company name and principal product and/or service names or designations at the same time.
- **Ownership of Rights:** Make sure the company's intellectual property isn't owned by a former employer of a company employee and that the company retains the rights in any inventions

or discoveries involving federal funding or government contracts. Vet possible conflicting intellectual property ownership obligations that company consultants might have, such as those of surgeons and clinicians to hospitals or research institutions.

- **Employee and Consulting Agreements:** Require all employees to sign non-disclosure agreements. Employees (at least those in managerial, professional, scientific or technical positions) should also sign invention assignment agreements. Consulting agreements should include confidentiality obligations and provisions that assign ownership of work product to the company—otherwise an independent contractor may retain rights in inventions, discoveries or other materials arising under the agreement.
- **Additional Confidentiality Precautions:** Require every third party to sign a non-disclosure agreement before receiving confidential information from the company. Limit internal access to the company's confidential information to those with a need to know. Consider seeking intellectual property protection prior to third-party or government disclosures, including FDA 510(k) submissions for medical devices or clinical trial submissions.
- **Legends and Notices:** Affix confidentiality legends on materials containing confidential or proprietary information; use proper trademark symbols with company trademarks and service marks; and include copyright notices on all significant written materials created by company employees or otherwise owned by the company.
- **Domain Name:** Register a domain name in order to operate a website at that address.
- **Employee Awareness:** Instruct employees about the importance of intellectual property rights. Encourage employees to bring significant developments or discoveries to management's attention. Consider offering financial incentives to employees who create patentable inventions. ■

Re-Mapping State Tax Compliance for a Remote Workforce

One of the enduring changes ushered in by the COVID-19 pandemic is a dramatic increase in remote work. Jobs that were by default in-office have shifted to hybrid models; jobs that previously offered flex-time are often fully remote. Across industries and company sizes—from startups to mature public companies—employers are navigating generational differences in expectations around work flexibility, unprecedented turnover brought on by the pandemic, and regulatory requirements implicated by remote work.

State tax compliance is among the most significant of those regulatory requirements. With remote work increasingly taking place across state lines, there are implications for income tax withholding requirements, state employment/unemployment taxes, and the employer's own corporate and sales tax filing footprints. While many states provided relief during 2020 and 2021 from particular state tax consequences of remote work associated with the pandemic, that relief has now expired in almost all cases.

For employers who have not yet done so, 2022 is the right time to align their state tax compliance with their “new normal” work patterns. The following are top priority areas to consider.

EMPLOYEE INCOME TAX WITHHOLDING

Employers historically have registered for payroll withholding in jurisdictions in which they had offices, and perhaps also jurisdictions in which fully remote employees resided. Employers often report 100% of an employee's wages to the jurisdiction where the employee is based (the office jurisdiction), even when the employee may work from multiple locations, such as in a flexible work arrangement. Employers now need to review and, in some cases, adapt these past practices to address the greater prevalence of remote work.

How to think about registration responsibilities

Almost every state that has an income tax considers the presence of a single employee working in the jurisdiction to be sufficient to require payroll

withholding registration. A few states have *de minimis* grace periods of 15, 20 or 30 days, during which an employee can work in-state without triggering registration. Contemporary remote work arrangements routinely exceed those thresholds. Before the pandemic, states often ignored remote work because it was less widespread, more irregular, and the province of smaller employers. That level of tolerance is rapidly diminishing as remote work becomes mainstream.

At a minimum, employers now need to consider registering in each jurisdiction in which a material amount of remote work is conducted (more than one or two remote workers, or one or two higher-profile employees). Registration may have tax withholding implications that go beyond the particular remote workers whose presence triggers the registration. Employers should consider the impact on (and their own withholding tax exposure relating to) employees who are residents of the new registration state, as well as employees working there.

How to make withholding determinations

Tax withholding requirements vary from state to state, but there are broad patterns.

— **Withhold using work location and employee residence:** Most states require withholding primarily based on work location and secondarily based on the employee's residence. If the state in which the work is located imposes an income tax, the employer is required to withhold that state's tax. If no income tax is imposed in that state, the employer must withhold for the tax of the state where the employee resides. There may also be a “top-up” withholding requirement in the residence state if the work state imposes a tax that is exceeded by the residence state tax.

- **Regular rule for determining work location:** Most states determine work location based on where work is performed, so hybrid or full-time remote work arrangements may change the jurisdiction entitled to collect withholding tax. To comply with withholding rules for these states, employers will need some ability

to keep track of employees' remote work locations and the amount of time worked from the office and from the remote location. For example, a Nevada resident working in California would be subject to California tax withholding, but the same employee would not be subject to withholding when working from home in Nevada, which has no personal income tax. (Temporary relief allowing employers to continue withholding tax based on the pre-pandemic work location generally expired at or before the end of 2021.)

- **Special rule—“Convenience of the employer”:** A few states apply another rule to determine work location. Under the so-called “convenience of the employer rule” applied by Arkansas, Connecticut (sometimes), Delaware, Nebraska, Pennsylvania and, most notoriously, New York, the work location is deemed to be the employer's office where the employee is based, unless there is a business necessity for the employee to work remotely. The business necessity exception is interpreted narrowly (especially by New York), so states applying this rule generally disregard remote work and require withholding based solely on office location. Employers with offices in a “convenience of the employer” state should consider the impact on their post-pandemic withholding models, as there may be conflicts between office and remote work jurisdictions.
- **Employee residence only:** In some circumstances, withholding is based solely on the employee's residence, without regard to work location. Withholding is based on residence when the residence state and the work state are parties to a “reciprocal arrangement”; these are fairly common in the mid-Atlantic and Midwest. So, for instance, under Maryland's reciprocal arrangements with Pennsylvania and the District of Columbia, a Maryland resident is subject to Maryland tax withholding whether working at the employer's DC office, from home in Maryland, or from a vacation house in the Poconos. DC only imposes income tax on its residents, so its withholding is never imposed based on work location.

Re-Mapping State Tax Compliance for a Remote Workforce

15 The State of Play Now That Pandemic Relief Has Expired

STATE EMPLOYMENT AND UNEMPLOYMENT TAXES

States impose a variety of payroll taxes apart from income tax withholding to fund unemployment programs, workers' compensation insurance, disability insurance and paid family and medical leave (collectively, "SUTA").

SUTA taxes are generally imposed based on the employee's work location. For example, an employer contributes to Maine unemployment insurance for an employee who works in Maine, even if the employee lives in New Hampshire and the employer has an office there. During the pandemic, employers typically relied on a rule that disregards temporary relocations and did not change the SUTA location for employees who were working temporarily from home.

For permanent remote work arrangements, however, employers will need to reassess employee location. Fully remote employees will generally be subject to SUTA in the remote jurisdiction. The circumstances of hybrid employees will need to be analyzed under a five-tier hierarchy that may, depending on the situation, assign their SUTA responsibility to their office location, the office location of their supervisor, or their residence.

CORPORATE TAX FILING RESPONSIBILITY

States historically imposed corporate taxes only on companies with some physical connection to the state. There were some exceptions for particular industries (such as financial institutions) or where a related company had the necessary physical connection but, for the most part, corporations determined their filing responsibility based on where they had employees, physical locations, or other property, such as inventory.

Market-Based Corporate Tax Filing Now More Prevalent

That paradigm has shifted over the past five to seven years, as some states have begun to require companies with a significant market in the state to file returns and pay corporate taxes. Because these states

define the significance of a company's market in the state based on "economic nexus" thresholds that are relatively high (such as \$500,000 or \$1,000,000 of in-state sales per year), these rules have had the greatest impact on large companies.

Tax Filing Footprints Grow for Large and Small Companies

Remote work is now intersecting with economic nexus thresholds to significantly broaden corporate tax filing footprints for both larger and smaller companies. Once a company has an employee working remotely in a state, the company becomes subject to corporate tax in that state and is required to file returns. Employee location is also one of the factors states consider in "apportioning" a company's income for state tax purposes, so remote work arrangements can affect not only the liability for tax, but also the portion of a company's income that is subject to tax in the remote work jurisdiction.

For parts of the past two years, many states provided relief from the application of corporate taxes (and in some cases from the impact on state tax apportionment) resulting from temporary work-from-home arrangements necessitated by the pandemic. That relief has now ended, and employers need to take account of their new remote work patterns in determining corporate filing footprints and tax liabilities. As in the case of withholding tax compliance, this will require visibility as to where employees are performing remote work, as well as how much time they are working in-office and remotely.

SALES AND USE TAX COLLECTION RESPONSIBILITY

Most sales and use taxes in the United States are collected by vendors from their customers. Vendors are required to register with state tax authorities, determine which of their transactions are subject to sales and use taxes, collect the taxes, and remit them to the appropriate jurisdiction. A vendor that fails to collect sales and use taxes when required to do so becomes liable for the tax that otherwise would have been paid by its customers.

State Sales Tax Collection Responsibility Shifts to Economic Nexus for Larger Vendors

Even more than for corporate taxes, the responsibility for sales tax collection historically depended on a vendor's physical presence in the taxing jurisdiction. Prior to 2018, based on two US Supreme Court decisions, a vendor without a physical presence in a taxing jurisdiction could not be required to register there or collect the tax. In 2018, however, in *South Dakota v. Wayfair, Inc.*, the Supreme Court overruled these prior decisions and allowed states to impose sales tax collection responsibility based on an economic nexus threshold. States rapidly adopted threshold nexus statutes, some with thresholds as low as \$10,000 of sales per year (the most common threshold is \$100,000).

As a result of these statutes, larger vendors need to collect sales taxes in most or all of the 45 states (plus DC) that impose them. For smaller vendors, however, physical presence is still a relevant factor in determining the states for which they need to collect sales taxes. And, as in the case of withholding and corporate taxes, any temporary pandemic relief rules that states had put in place to alleviate the impact of remote work arrangements have now expired.

Remote Work Expands Sales and Use Tax Filing Footprint for Smaller Vendors

As the expansion of remote work broadens the sales tax filing footprint for smaller vendors, more attention is also being paid to sales taxes (both from the standpoint of state enforcement and M&A diligence) because of the *Wayfair* decision. A vendor that has a remote worker in a state is required to register and collect that state's sales and use taxes. Small employers may find that this issue is more sensitive than the corporate tax issue, both because of exposure (the potential liability for undercollected sales tax is based on gross receipts, not net income) and complexity (the scope of state sales taxes varies considerably more than that of income taxes, particularly in the software and service sectors, requiring a state-by-state exposure analysis). ■

Seeking Talent Overseas

Driven by competitive pressures and a global economy, companies regularly recruit employees from foreign countries. The trend is even more pronounced among technology and life sciences companies, reflecting both a perceived shortage of highly educated and highly skilled workers in those industries and the large number of foreign nationals attending US colleges and universities. For startup and other companies, the hiring of foreign nationals necessitates advance planning and introduces unfamiliar requirements and incremental expense.

Set forth below is an overview of the current requirements for permanent and temporary work authorizations in the United States. Immigration law is fluid and heavily politicized. For example, the Biden administration has lifted a number of immigration restrictions implemented by the prior administration and has pledged additional changes, such as clearing the green card backlog. It remains to be seen whether there will be further significant changes to the availability of work authorizations for foreign nationals.

BASIC REQUIREMENTS

Only US citizens and US permanent residents may lawfully work in the United States without specific work authorization from the US Citizenship and Immigration Services (USCIS). In general, work authorizations have a temporary duration and require employer sponsorship; most do not authorize the spouse or dependent children of the foreign national to work in the United States. Some work authorizations are subject to annual quotas, while others are not. In almost all cases, the employer must apply for work authorization for the foreign national and wait until it is approved before hiring the worker. Regular processing time typically ranges from two to six months, depending on the classification. For an additional fee, USCIS will process applications in some categories within 15 days.

Permanent employment authorization requires permanent residency (commonly known as a “green card”). Most green card applicants are sponsored by family

members or employers, although self-sponsorship is also possible for limited categories of individuals. Green cards are subject to annual quotas; the wait can range from several years in some categories to more than a decade in others.

After five years (three years if the applicant is married to a US citizen), a green card holder can apply for US citizenship. The applicant must demonstrate good moral character, a basic understanding of the English language and knowledge of the US government and institutions, and must satisfy physical residency and other requirements.

TYPES OF WORK AUTHORIZATIONS

Work authorizations are issued in different classifications, depending on the attributes and activities of the foreign national. The most common work authorizations used by early-stage companies are summarized below.

— *Professional Employees (H-1B)*: The H-1B authorization is available for degreed professionals (or those with equivalent work experience) who will work in specialty occupations and is issued in three-year increments for a total duration of up to six years. Absent an extension, which is available only in very limited circumstances, the foreign national must then leave the United States for at least one year. H-1B authorizations are portable to new employers if the worker holds a bachelor’s degree or higher and works in a specialty occupation; the new employer also must file an H-1B petition. H-1B authorizations are currently capped at 65,000 per year. An additional 20,000 H-1B authorizations annually are reserved for holders of US master’s degrees or higher from US educational institutions.

— *Canadian and Mexican Professionals Under USMCA (TN)*: The TN authorization is available to Canadian and Mexican nationals who possess the educational or experience requirements for specific occupations—including, among others, biologists, chemists, computer systems analysts, engineers and scientific technicians—covered by the United States-Mexico-Canada

Agreement (USCMA), which replaced the North American Free Trade Agreement (NAFTA) effective July 1, 2020. TN authorizations are issued in up to three-year increments and may be renewed indefinitely, as long as the holder’s role in the United States is temporary. In order to apply for a green card, holders of TN authorizations generally must switch to H-1B status or another non-immigrant visa status, or leave the United States.

— *Persons of Extraordinary Ability (O-1)*: Persons of “extraordinary ability” in the sciences, arts, education, business or athletics may obtain an O-1 authorization. Although applicable rules specifically mention that eligibility requires receipt of a major internationally recognized award (such as the Nobel Prize), in practice individuals with significant accomplishments or other evidence of major achievement—such as publications, awards or patents—may be granted this status.

— *Intra-Company Transferees (L-1)*: The L-1 authorization permits employers with foreign affiliates to transfer their foreign national employees holding executive, managerial or specialized knowledge positions to the United States. To qualify, the transferee must be employed abroad by the affiliate for one continuous year within the preceding three years. Executive and managerial transferees can remain in the United States for up to seven years; transferees with specialized knowledge can stay for up to five years.

Work authorizations are also available in various other categories, such as E-1 for “treaty traders”; E-2 for “treaty investors”; E-3 for Australian nationals; F-1 for foreign national students graduating from US educational institutions; H-3 for holders of temporary trainee work authorization; and J-1 for participants in approved education or training programs. There is also a B-1 authorization for temporary business visitors that does not permit work in the United States, but does allow such visitors to participate in business activities such as attending meetings and conferences, consulting with business associates, and participating in short-term training programs. ■

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

We reviewed all merger transactions between 2017 and 2021 involving VC-backed targets (as reported in PitchBook after 2019, in Dow Jones VentureSource or Pitchbook for 2019, and in Dow Jones VentureSource prior to 2019) in which the merger documentation was publicly available and the deal value was \$25 million or more. Based on this review, we have compiled the following deal data:¹

Characteristics of Deals Reviewed	2017	2018	2019	2020	2021
Sample Size	18	37	20	25	45
Cash	56%	84%	60%	60%	24%
Stock	0%	3%	0%	8%	18%
Cash and Stock	44%	13%	40%	32%	58%
Deals With Earnout	2017	2018	2019	2020	2021
With Earnout	22%	32%	40%	28%	42%
Without Earnout	78%	68%	60%	72%	58%
Deals With Indemnification	2017	2018	2019	2020	2021
With Indemnification					
By Target's Shareholders	94% ²	84%	80%	88%	76% ³
By Buyer	61%	39%	45%	32%	29%
Deals With Representation and Warranty Insurance	2017	2018	2019	2020	2021
With Representation and Warranty Insurance	Not Tracked	41%	25%	68%	47%
Survival of Representations and Warranties⁴	2017	2018	2019	2020	2021
Shortest	9 Mos.	12 Mos.	12 Mos.	12 Mos.	12 Mos.
Longest	24 Mos.	24 Mos.	24 Mos.	18 Mos.	24 Mos.
Most Frequent	12 Mos.	18 Mos.	18 Mos.	12 Mos.	12 Mos.
Caps on Indemnification Obligations	2017	2018	2019	2020	2021
With Cap	100%	100%	100%	100%	100%
Limited to Escrow	94% ⁶	79%	86%	81%	90% ⁵
Limited to Purchase Price	0%	0%	0%	0%	0%
Exceptions to Limits ⁵	94%	100%	100%	95%	100%
Without Cap	0%	0%	0%	0%	0%
Escrows	2017	2018	2019	2020	2021
With Escrow	100%	90% ⁷	94%	90%	91%
% of Deal Value					
Lowest ⁸	4%	3%	10%	8%	5%
Highest	13%	15%	13%	15%	18%
Most Frequent	5%	10%	12%	15%	10%
Length of Time ⁹					
Shortest	9 Mos.	12 Mos.	12 Mos.	12 Mos.	12 Mos.
Longest	24 Mos.	36 Mos.	36 Mos.	24 Mos.	36 Mos.
Most Frequent	12 & 18 Mos. (tie)	18 Mos.	12 Mos.	12 Mos.	12 Mos.
Exclusive Remedy	71%	72%	64%	68%	53%
Exceptions to Escrow Limit Where Escrow Was Exclusive Remedy ⁵	92%	100%	100%	92%	100%
Baskets for Indemnification	2017	2018	2019	2020	2021
Deductible	63%	47%	56%	52% ¹⁰	71% ¹¹
Threshold	37%	53%	44%	29% ¹⁰	26% ¹¹
MAE Closing Condition	2017	2018	2019	2020	2021
Condition in Favor of Buyer	94%	100%	100%	100%	97%
Condition in Favor of Target	22%	12%	35%	24%	37%
Exceptions to MAE	2017	2018	2019	2020	2021
With Exception ¹²	100%	97% ¹³	100%	100%	95% ¹³

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

² 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.

³ Excludes two transactions that do not provide for indemnification but permit setoff against contingent consideration.

⁴ Measured for representations and warranties generally; specified representations and warranties may survive longer.

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 Includes two transactions where the limit was below the escrow amount.

⁷ One transaction not including an escrow at closing did require funding of escrow with proceeds of earnout payments.

⁸ Excludes transactions which also specifically referred to representation and warranty insurance as recourse for the buyer.

⁹ Length of time does not include transactions where such time period cannot be ascertained from publicly available documentation.

¹⁰ A "hybrid" approach with both a deductible and a threshold was used in another 10% of these transactions in 2020.

¹¹ A 50/50 cost sharing approach was used in another 3% of these transactions in 2021.

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

¹³ The only transaction(s) 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 2017 to 2021 for companies and investors, we have compiled the following deal data:

Deals With Purchase Agreement		2017	2018	2019	2020	2021
If included, a purchase agreement typically contains representations and warranties from the company (and possibly the founders).	% of deals	57%	40%	63%	36%	50%
Term		2017	2018	2019	2020	2021
The term of the convertible note before it matures.	Median Range	18 mos. 1–60 mos.	12 mos. 3–24 mos.	17 mos. 12–36 mos.	24 mos. 5–48 mos.	12 mos. 4–36 mos.
Interest Rate		2017	2018	2019	2020	2021
The rate at which interest accrues during the term of the convertible note.	Median Range	6% 2%–10%	5% 2%–8%	6% 3%–15%	5% 0.2%–8.5%	5% 0.2%–8%
Deals With Security Interest		2017	2018	2019	2020	2021
Convertible note investors sometimes require the company to provide a security interest in company assets.	% secured	16%	10%	15%	7%	0%
	% unsecured	84%	90%	85%	93%	100%
Deals With Conversion Discount		2017	2018	2019	2020	2021
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	72%	77%	70%	89%	85%
	Range of discounts	8%–30%	10%–25%	10%–25%	15%–40%	10%–35%
	% with ≤ 20% discount	98%	91%	95%	92%	94%
	% with > 20% discount	2%	9%	5%	8%	6%
	% with valuation cap	82%	57%	42%	40%	35%
Deals With Conversion Upon Maturity		2017	2018	2019	2020	2021
If a convertible note is outstanding at the time of maturity and is not otherwise paid upon maturity, it often converts into shares of the company's common stock or preferred stock. This conversion is most often at the election of the investor but may be mandatory.	% of deals	39%	27%	44%	36%	50%
	% with optional conversion	91%	75%	92%	90%	80%
	% with mandatory conversion	9%	25%	8%	10%	20%
	% that convert into: common stock	42%	38%	33%	11%	10%
	preferred stock	58%	62%	67%	89%	90%
Deals With Conversion Upon Company Sale		2017	2018	2019	2020	2021
If a convertible note or SAFE is outstanding at the time of a sale of the company, it often converts into shares of the company's common stock or preferred stock. This conversion is most often at the election of the investor but may be mandatory.	% of deals	61%	57%	56%	32%	50%
	% with optional conversion	93%	88%	73%	78%	90%
	% with mandatory conversion	7%	12%	27%	22%	10%
	% that convert into: common stock	71%	82%	67%	50%	80%
	preferred stock	29%	18%	33%	50%	20%
Deals With Repayment Premium Upon Company Sale		2017	2018	2019	2020	2021
Investors may require that they receive a multiple of the outstanding investment amount in connection with a sale of the company.	% of deals	59%	57%	37%	43%	50%
	Median premium	2x	2x	2x	2x	2x
	Range of premiums	1.5x–4.1x	1.2x–2x	1.5x–3x	1.5x–3x	1.25x–2.5x
Deals With Warrant Coverage		2017	2018	2019	2020	2021
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	8%	10%	15%	0%	5%
	Coverage range	5%–100%	25%–65%	10%–35%	N/A	25% (one deal)
	% that cover common	20%	33%	50%	N/A	100%
	% that cover preferred	80%	67%	25%	N/A	0%
	% that cover common or preferred (depending on the circumstances)	0%	0%	25%		0%

* Excludes one deal in which the note is convertible into either common stock or preferred stock, depending on the circumstances.

Explanatory Note: By their nature, SAFEs do not have maturity dates, interest rates or security interests.

19 Trends in Venture Capital Financing Terms

Based on hundreds of venture capital financing transactions we handled from 2017 to 2021 for companies and investors, we have compiled the following deal data:

Deals With Multiple Liquidation Preferences		2017	2017 Range	2018	2018 Range	2019	2019 Range	2020	2020 Range	2021	2021 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	3%	1.08x–2x	3%	1.5x	2%	1.5x (one deal)	0%	N/A	0%	N/A
	Post-first round	8%	1.32x–3x	3%	1.5x–2.5x	4%	1.5x–2x	3%	1.5x–2.25x	0%	N/A
Deals With Participating Preferred Stock		2017	2017 Range	2018	2018 Range	2019	2019 Range	2020	2020 Range	2021	2021 Range
“Participating preferred” stock entitles holders to receive a stated liquidation preference plus a pro-rata share (on an as-converted basis) of any remaining proceeds available for distribution to holders of common stock.	First round	10%		13%		14%		9%		9%	
	Total Capped	14%	2x (one deal)	0%	N/A	38%	1x–3x	80%	2x–3x	20%	3x (one deal)
	Post-first round	16%		31%		11%		10%		6%	
	Total Capped	56%	2x–2.5x	41%	2x–5x	17%	1.6x–3.5x	22%	1.25x–2x	29%	2x–2.5x
Deals With an Accruing Dividend		2017		2018		2019		2020		2021	
“Accruing dividends” are generally payable upon liquidation or redemption of the preferred stock, effectively increasing the liquidation preference of the preferred stock.	First round	8%		7%		10%		9%		5%	
	Post-first round	26%		24%		15%		8%		11%	
Anti-Dilution Provisions		2017		2018		2019		2020		2021	
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%		2%		0%	
	Weighted average	100%		100%		100%		98%		100%	
	Post-first round										
Full ratchet	0%		1%		2%		0%		0%		
Weighted average	100%		99%		98%		100%		100%		
Deals With Pay-to-Play Provisions		2017		2018		2019		2020		2021	
“Pay-to-play” provisions provide an incentive to investors to invest in future rounds of financing. Investors that do not purchase their full pro-rata share in a future round lose certain rights (e.g., their shares of preferred stock may be converted into common stock at the then applicable conversion rate or a more punitive rate, and they may lose director designation, registration or other rights).	Total	7%		7%		8%		3%		3%	
	% of total that convert into common stock	83%		100%		92%		100%		83%	
	% of total that convert into another series of preferred stock	17%		0%		8%		0%		17%	

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

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

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

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