

2008 Venture Capital Report



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2 US Venture Capital Market Review and Outlook

2007 Review

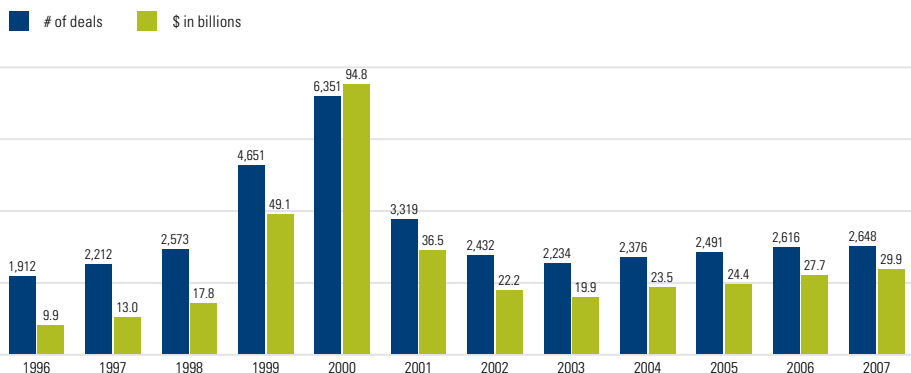
The gradual but steady increase in venture investing activity that has characterized the venture capital market over the past several years continued in 2007. Of greater significance was the more pronounced improvement in the IPO and M&A markets for venture-backed companies over the past year.

In 2007, 2,648 reported venture capital financings raised total proceeds of \$29.9 billion. This compares to 2,616 financings, raising \$27.7 billion, in 2006. Figures captured in the first quarter typically understate the prior year's total level of venture financing activity by 5 to 10 percent, due to the delayed reporting of many venture capital transactions, so the increase in investing activity in 2007 was greater than current figures would indicate. 2007 is the fourth consecutive year in which the number of financings has increased. 2007 financing activity remains significantly lower, however, than the levels reached during the 1999–2001 Internet bubble.

The median size of venture capital financings increased to \$7.6 million in 2007, from \$7.0 million in 2006. The 2007 figure is the highest figure in any year other than 2000. The median financing size for life sciences companies (\$10.0 million) increased significantly from 2006 (\$7.5 million), while the figure for information technology companies (\$7.0 million) remained unchanged.

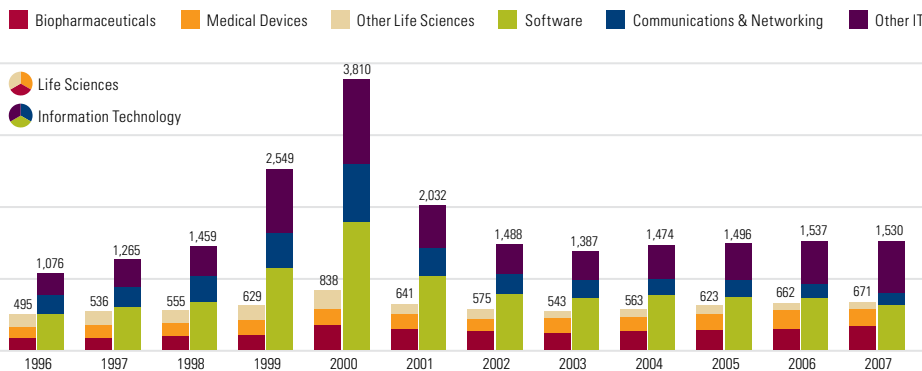
Valuations of venture-backed companies decreased significantly from 2006 to 2007. The median pre-money valuation for venture financings was \$16.0 million in 2007, compared to \$20.0 million in 2006. This drop contrasts with the large increase in pre-money valuations from 2005 (\$15.0 million) to 2006, and also marks the first time since 2002–2003 that company valuations decreased. Last year, pre-money valuations were down for both life sciences (\$20.3 million) and IT companies (\$13.8 million). This downswing is somewhat surprising in light of the success venture-backed companies enjoyed in the IPO and M&A arenas in 2007, though the overall trend looks less dramatic if the 2006 figure is instead regarded as an anomaly.

US Venture Capital Financings – 1996 to 2007



Source: Dow Jones VentureOne

US Venture Capital Financings by Industry – 1996 to 2007



Source: Dow Jones VentureOne

In 2007, seed and first-round venture capital financings represented 38% of the total number of venture financings and 23% of the amount of venture money raised. Seed and first-round financings have constituted between 31% and 37% of all venture financings in each year since 2001. The proportion of new investing activity during the last seven years is significantly lower than not only the 1999–2000 level (54%), but also the 1996–1998 level (49%). This relative decline in new investing activity is due in part to the fact that more rigorous investment criteria are being applied by investors than during

the Internet bubble, and in part to the longer average time from initial funding to a liquidity event, which increases the relative amount of money needed for investment in later-stage companies.

The breakdown of venture capital financings by industry sector in 2007 was similar to that of prior years. In 2007, IT companies represented 58%, and life sciences companies constituted 23%, of all venture capital financings. This split is generally consistent with the breakdowns over the last 12 years, other than during the 1999–2001 Internet

bubble, when life sciences financings dipped below 20%. As has been the case in recent years, the amount invested in life sciences companies in 2007 as a percentage of total venture investments (34%) was higher than the percentage of life sciences financings, due to the greater capital needs of life sciences companies.

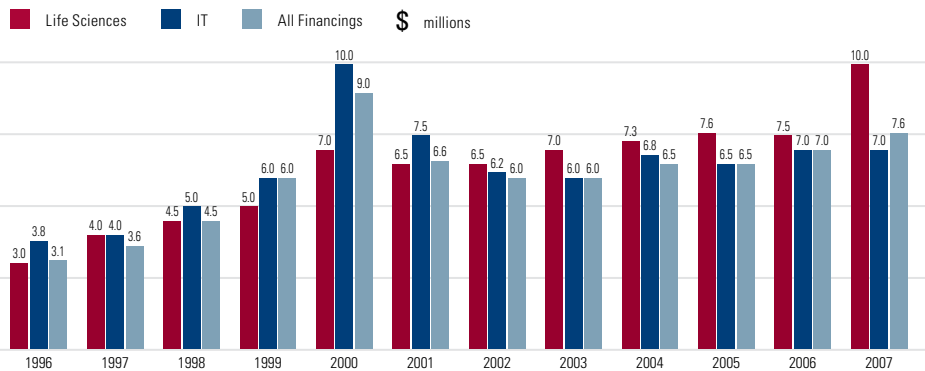
The geographic breakdown for venture capital investing has remained fairly constant since 1996. California-based companies accounted for 42% of all venture financings in 2007, and have led the country in this regard in each year since 1996 (the first year for which this data is available). Massachusetts, home to 12% of the companies receiving venture financing in 2007, again finished second in this category, as it has in each year since 1996. New York and Texas—both of which have been in the top five each year since 2004—held third and fourth position in 2007, with Washington coming in fifth.

In 2007, the IPO market for venture-backed companies continued to exhibit the same momentum it has shown over the last few years. Seventy-five venture-backed companies went public last year, compared to 56 in 2006. The total of 75 venture-backed IPOs in 2007 is the highest since the 201 IPOs in 2000. The IPO market fell off the cliff after 2000, dropping to 22 IPOs in 2001, but has been gradually getting stronger over the last several years. It is worth noting that the level of IPO activity in 2007 was not only dwarfed by the activity during 1999–2000, which boasted an average of 226 per year, but was also significantly lower than the number of IPOs completed in the period 1996–1997, which saw an average of 168.

For the first time in several years, the number of IPOs by IT companies (34) outpaced that of life sciences companies (31). In contrast, the IT/life sciences split was 20/28 in 2006 and 11/20 in 2005.

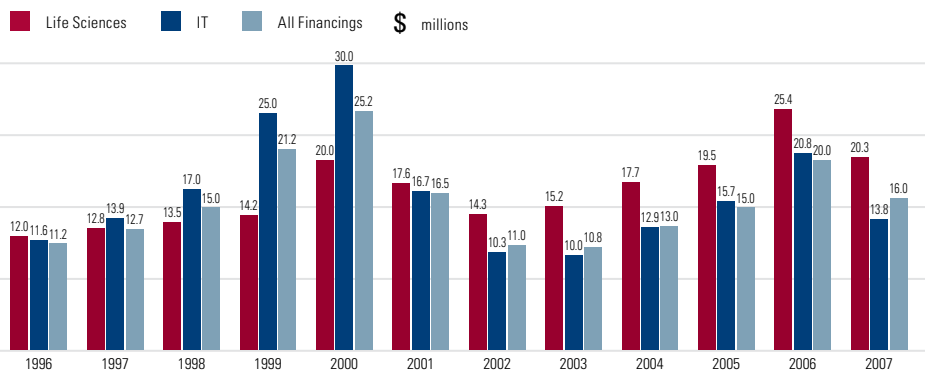
The strength of the IPO market in 2007 is also evidenced by the sharp increase in valuations of IPO companies. The median pre-IPO valuation of venture-backed IPO companies was \$309 million in 2007, compared to \$202 million in 2006. The 2007 valuation figure is the highest since 2000 (\$362 million) and is

Median Size of US Venture Capital Financings – 1996 to 2007



Source: Dow Jones VentureOne

Median Pre-Money Valuation in US Venture Capital Financings – 1996 to 2007



Source: Dow Jones VentureOne

also dramatically higher than the median valuations in the “pre-bubble” 1996–1998 period (an average of \$119 million).

It is illuminating (and perhaps sobering) to compare pre-IPO valuations to the median amount raised prior to IPO by venture-backed companies going public. In 2007, the ratio of median pre-IPO valuation to median amount raised prior to IPO was 4.7:1. This ratio was between 3.0:1 and 4.0:1 for each year from 2003 to 2006. In contrast, this ratio ranged from 7.7:1 to 10.0:1 from 1997 through 2000. The decrease as compared to 1997–1998

is attributable to the significantly lower amount invested in companies prior to their IPOs a decade ago, while the decrease as compared to 1999–2000 is attributable to the significantly higher IPO valuations in 1999–2000. Thus, not only have there been fewer venture-backed IPOs in the last several years than during the latter half of the 1990s, but the venture-backed companies that are going public are producing lower returns for their investors.

As was the case with the IPO market, the M&A market for venture-backed companies was stronger in 2007 than

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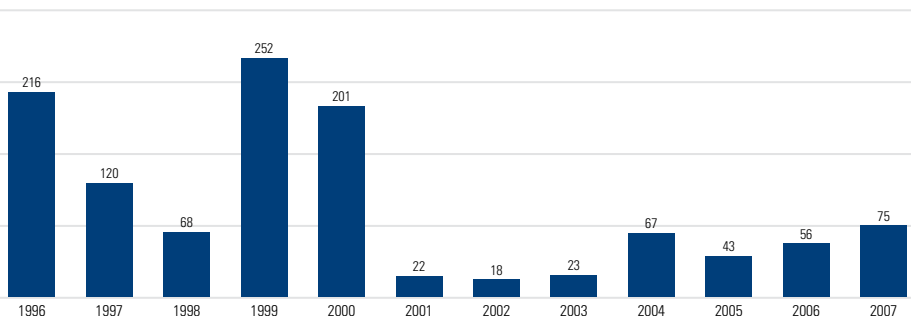
in 2006. There were 398 reported acquisitions of venture-backed companies in 2007, compared to 420 in 2006, but the data will likely show a small increase from 2006 to 2007 once all 2007 transactions are reported. While the number of acquisitions did not change significantly in 2007, the purchase prices did. The median acquisition price for venture-backed companies jumped from \$53 million in 2006 to \$97 million in 2007. This represents both the fifth consecutive annual increase in the median acquisition price and, by a wide margin, the highest figure of any year other than 2000 (when the median acquisition price was \$100 million).

The ratio of median acquisition price to median amount raised prior to acquisition was 4.5:1 in 2007. To put that in perspective, this ratio was between 1.2:1 and 2.5:1 in each year from 2001 to 2006, while it ranged from 4.5:1 to 9.7:1 between 1996 and 2000. These figures illustrate that, like the IPO market, the M&A market for venture-backed companies has improved over the last five years, but is still producing much lower returns for venture capital investors than it did in the 1996–2000 time period. Not surprisingly, the overall returns are somewhat higher on IPOs than on M&A transactions, since few underperforming companies are able to go public. The higher valuations ascribed to IPO companies is offset in part, however, by the fact that the median amount raised prior to liquidity event for M&A companies is generally less than half the amount for IPO companies.

In 2007, the ratio of M&A transactions to IPOs for venture-backed companies was 5.3:1. This ratio was at least 6:1 in every year from 2001 to 2006. In contrast, over the five-year period from 1996 to 2001, the ratio of M&A transactions to IPOs for venture-backed companies was less than 2:1. A review of this data along industry lines shows that, while there was not a significant difference in the number of IT and life sciences company IPOs in 2007, the ratio of IT company acquisitions to life sciences company acquisitions was more than 4:1, which is consistent with the data for the last several years.

US Venture-Backed IPOs – 1996 to 2007

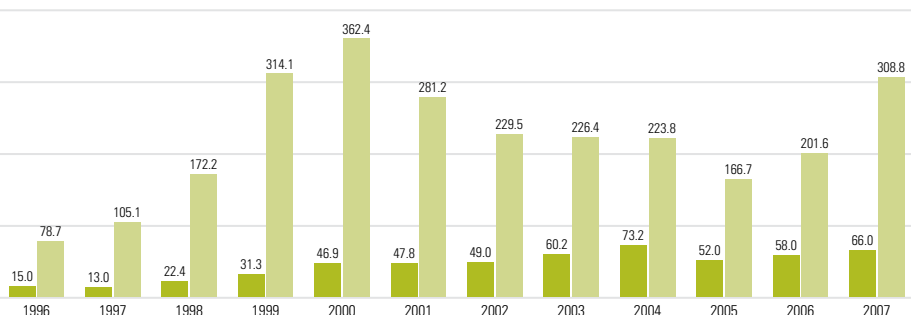
■ # of deals



Source: Dow Jones VentureOne

Median Amount Raised Prior to IPO and Median Pre-IPO Valuation – 1996 to 2007

■ Median amount raised prior to IPO ■ Median pre-IPO valuation \$ millions



Source: Dow Jones VentureOne

2008 Outlook

We believe that the level of venture capital financing activity will increase moderately in 2008 as compared to 2007, continuing the trend that has characterized the last several years. The likelihood of this increase is also supported by market factors such as the significant amount of venture capital available for investment and the enticement of the strong IPO and M&A markets seen in 2007.

What will happen with venture capital valuations in 2008 is more difficult to predict, as there are a number of

countervailing factors at play. The favorable valuations for liquidity events in 2007 are offset by concerns about the health of the economy and the capital markets in 2008. The abundance of venture dollars looking for investments is likely to be balanced by concerns that too much invested in a particular company or sector will prevent a suitable rate of return on the money invested. The steep decrease in valuations in 2007 may be viewed as an ominous sign (at least from a company's perspective), but leaves room for some improvement in 2008.

We expect that the level of investments in IT companies as compared to life sciences companies will increase somewhat in 2008. The improved IPO market in 2007 was fueled largely by IT companies, and acquisitions of IT companies again significantly outnumbered acquisitions of life sciences companies, a trend that should contribute to a larger appetite for IT investments. In addition, the telecom and other segments of the IT industry continue their slow rebound from the doldrums of the early part of the decade.

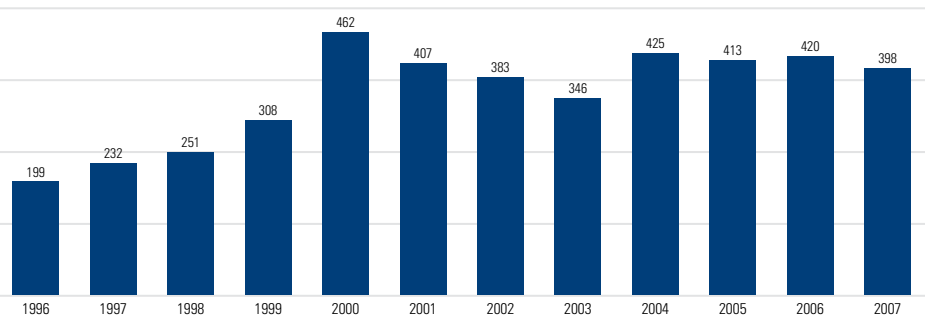
There has been a lot of industry buzz about investments in “clean technology” and renewable energy sources. It is likely that economic factors such as the price of oil, as well as social and political trends, will result in increased investment in this area. However, these same factors are driving up valuations to the point where they may cause many investors to steer clear of this market.

It is probably stating the obvious to note that globalization trends in venture investing will continue in 2008. International markets such as China, India and other parts of Southeast Asia are not only spawning increased entrepreneurial activity and innovation, but the regulatory environments in those countries are also becoming more hospitable to foreign investment. However, these factors are tempered by concerns about the political and economic environments and the somewhat undeveloped “ecosystems” in which these companies will have to develop. As a result, while investments in international-based companies should continue to increase, we believe they will do so at a measured pace.

Despite the strong venture-backed IPO market in 2007, current market trends do not bode well for the IPO market in 2008. Following declines in the last two months of 2007, the Dow Jones Industrial Average dropped 7.5% in the first quarter of 2008 and the NASDAQ Composite plummeted 14.1% in the same period. In addition to the overall market decline, the significant market volatility experienced recently makes it even more difficult for IPO candidates to properly time their offerings. Moreover, other

Acquisitions of US Venture-Backed Companies – 1996 to 2007

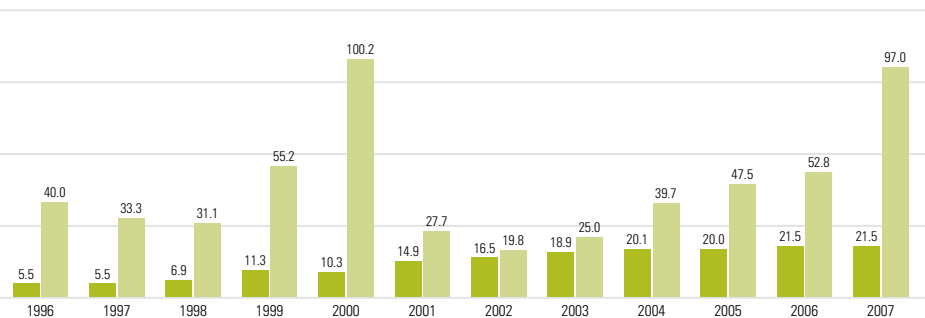
■ # of deals



Source: Dow Jones VentureOne

Median Amount Raised Prior to Acquisition and Median Acquisition Price – 1996 to 2007

■ Median amount raised prior to acquisition ■ Median acquisition price \$ millions



Source: Dow Jones VentureOne

macroeconomic trends and predictions of a recession will likely weigh down the IPO market for much of 2008.

A downturn in the venture-backed IPO market is likely to also have a negative impact on the M&A market, for several reasons. First, any issues relating to the economy in general that dampen the IPO market should also adversely affect the valuations of companies being acquired. Second, limitations on the IPO market as a credible alternative for venture-backed companies would diminish the leverage of those companies in negotiating

acquisition prices. There may well be more acquisitions of venture-backed companies in 2008 than in 2007, but we expect that the acquisition prices will decrease, particularly given the lofty valuation levels seen in 2007. One market development that we do not believe will have a significant impact on the M&A market for venture-backed companies is the debt crunch that is limiting private equity buyouts, as most venture-backed companies are not large enough to be attractive buyout targets for typical private equity firms. ■

California

California companies reported 925 financings in 2007—down from 1,046 in 2006—while reported proceeds were essentially unchanged at \$11.30 billion, compared to \$11.40 billion the prior year. Final 2007 data—after all transactions have been reported—are likely to close the gap in deal volume and show modest growth in proceeds.

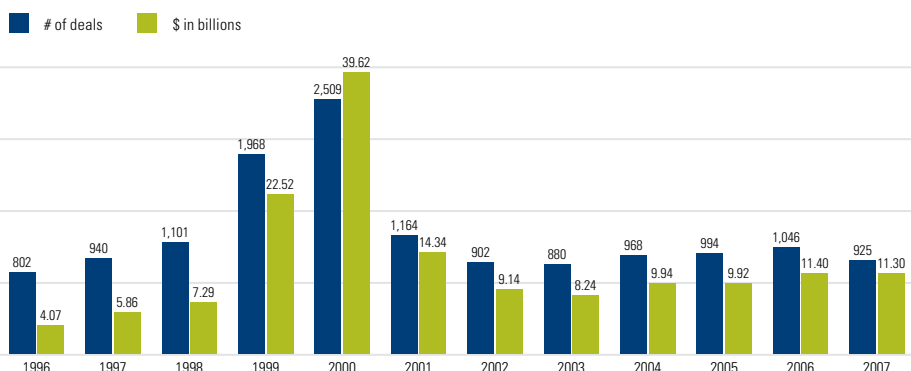
Roughly three times the size of the next largest venture capital market in the United States, California was responsible for 42% of all deals and 46% of all proceeds in the country in 2007. Although California's venture capital activity remains well below the peak year of 2000—when it produced a staggering 2,509 financings with \$39.62 billion in proceeds—deal volume continues to exceed pre-bubble levels by a modest amount, while annual proceeds are substantially higher.

California's venture capital market spans all industry sectors, with particular strengths in technology, life sciences, consumer retail and media/entertainment. IT companies dominated the market again in 2007, accounting for 65% of all financings in the state, down from 67% in 2006. Life sciences companies made up 21% of California's deals in 2007, up slightly from 20% in the prior year.

California spawned 29 IPOs by venture-backed companies in 2007, a 38% increase from the 21 in 2006. The number of acquisitions of VC-backed companies was unchanged, totalling 151 in both 2006 and 2007. The state produced five of the 11 company sales nationwide that fetched at least \$500 million in 2007.

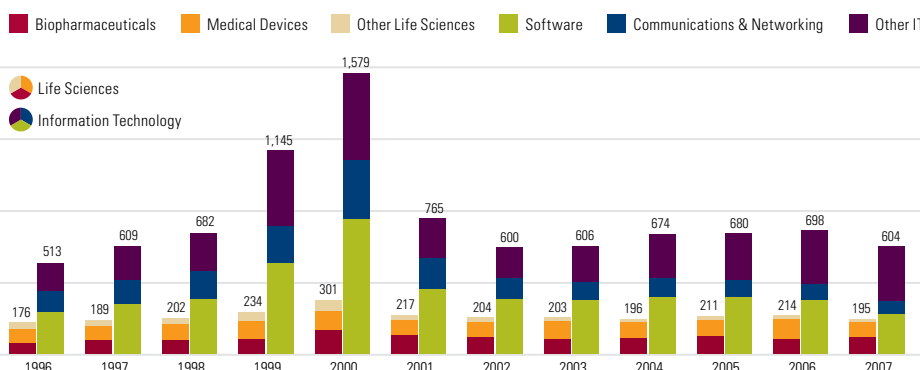
We expect California to maintain its venture capital leadership in 2008, particularly in technology and life sciences. With a heavy concentration of industry leaders, venture capitalists, scientific talent, entrepreneurs, service providers and other startup infrastructure in California, conditions appear ripe for growth.

California Venture Capital Financings – 1996 to 2007



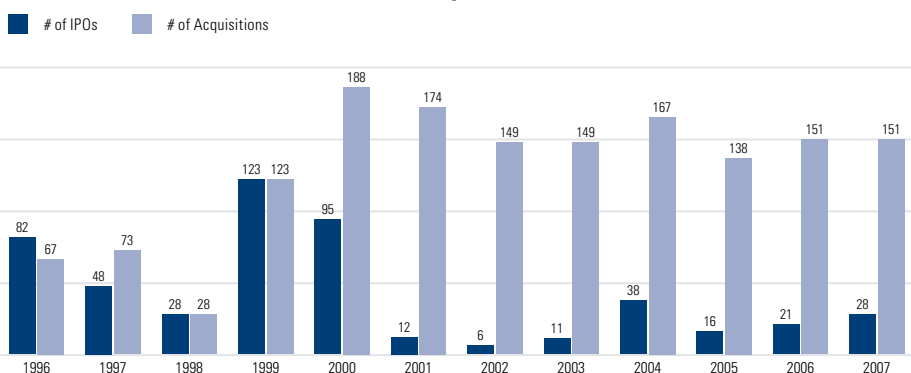
Source: Dow Jones VentureOne

California Venture Capital Financings by Industry – 1996 to 2007



Source: Dow Jones VentureOne

California Venture-Backed IPOs and Acquisitions – 1996 to 2007



Source: Dow Jones VentureOne

Mid-Atlantic

The number of reported venture capital financings in the mid-Atlantic region of Virginia, Maryland, North Carolina, Delaware and the District of Columbia edged down from 144 in 2006 to 139 in 2007, but proceeds grew from \$1.45 billion to \$1.53 billion. Once all 2007 transactions have been reported, we expect deal volume in the region will top 2006's total.

With an average of 157 venture capital financings over the past six years, deal volume in the mid-Atlantic region continues to top the levels seen in the pre-bubble years of 1996–1998 (an average of 149 deals per year), while average annual proceeds have increased even more (from \$0.91 billion to \$1.35 billion).

The percentage of all financings in the region completed by IT companies edged up from 57% in 2006 to 58% in 2007, while the portion attributable to life sciences companies declined from 31% to 29%.

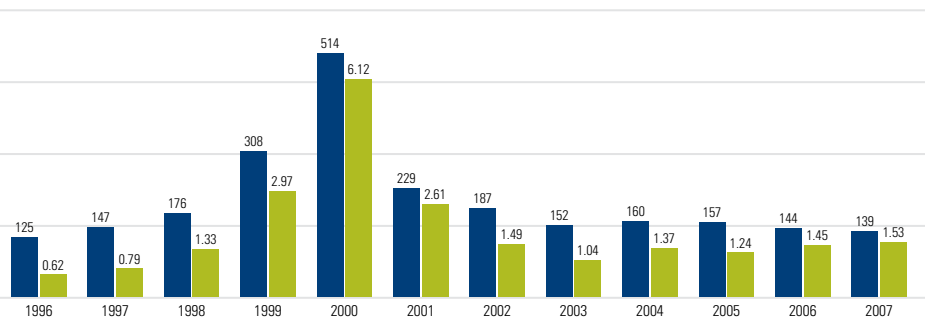
There were four IPOs by mid-Atlantic VC-backed companies in 2007—down from six in 2006 but equaling the second highest total of the post-bubble era. After a four-year drought, Virginia produced two IPOs to lead the region, and Maryland and North Carolina each contributed one. Aftermarket performance ran the gamut, with one company (comScore) up 98% by year-end and another (Sourcefire) down 44%. Three of the four mid-Atlantic IPOs in 2007 were tech-related.

The number of acquisitions of venture-backed companies in the region dipped to 27 in 2007 from 28 the prior year. Virginia continued to lead the region in VC-backed M&A transactions by a healthy margin, contributing 15 of the 2007 deals.

For 2008, we expect that the information technology, government-related IT services and defense industries will produce a steady stream of attractive emerging companies in the region. We also expect that the region—and particularly the Research Triangle area—will remain a leading center of life sciences-related investment.

Mid-Atlantic Venture Capital Financings – 1996 to 2007

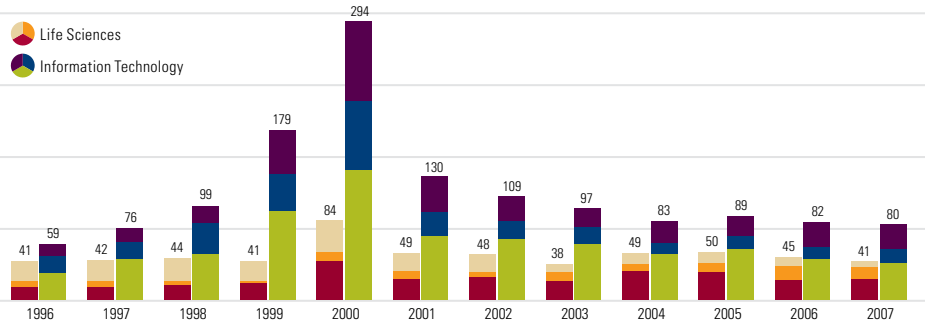
■ # of deals ■ \$ in billions



Source: Dow Jones VentureOne

Mid-Atlantic Venture Capital Financings by Industry – 1996 to 2007

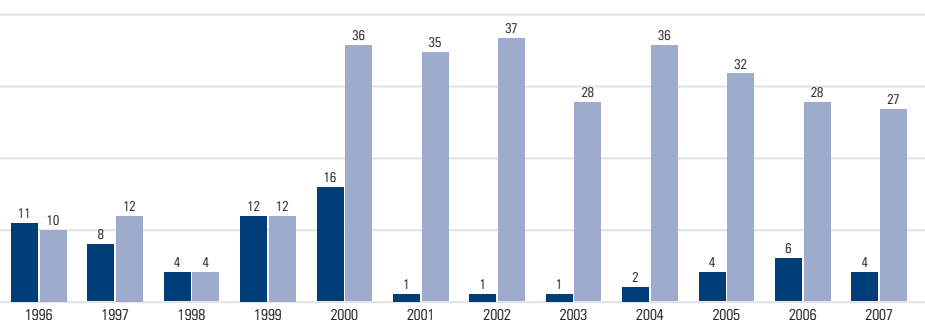
■ Biopharmaceuticals ■ Medical Devices ■ Other Life Sciences ■ Software ■ Communications & Networking ■ Other IT



Source: Dow Jones VentureOne

Mid-Atlantic Venture-Backed IPOs and Acquisitions – 1996 to 2007

■ # of IPOs ■ # of acquisitions



Source: Dow Jones VentureOne

New England

New England companies reported 305 financings in 2007, up modestly from 295 in 2006, while proceeds jumped 21% to reach \$3.33 billion compared to \$2.75 billion in the prior year. Once all 2007 transactions have been reported, we expect that the year will show even stronger growth.

While venture capital investment in the region remains well below the bubble years of 1999–2001, the average number of New England financings over the last six years (317 deals) closely parallels that of the 1996–1998 period (327 deals), and average annual proceeds have increased by two-thirds between these periods.

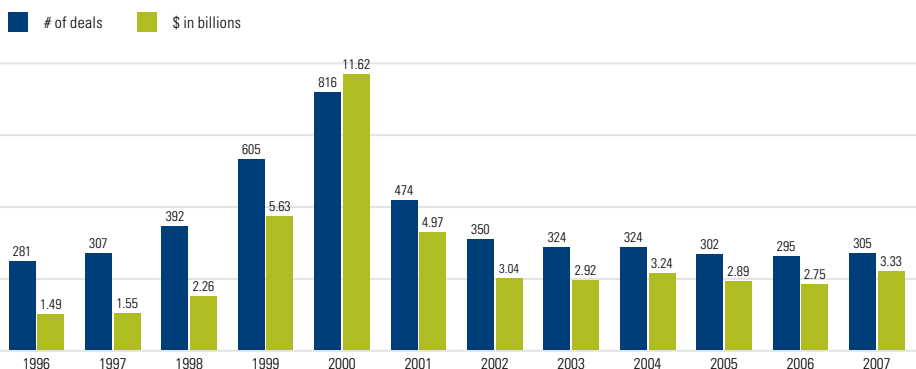
New England continues to be a leading center of activity for technology and life sciences companies. In 2007, information technology companies accounted for 58% of the region's venture capital financings, down slightly from 59% in 2006, while life sciences companies increased their market share again, from 29% to 32%—the largest percentage since at least 1996.

New England is the only region to report increases in IPOs by VC-backed companies in each of the past three years. With 18 venture-backed IPOs in 2007, New England doubled its total of nine IPOs in 2006. For the second consecutive year, Massachusetts produced all but one IPO coming out of the region, including the largest—Starent Networks (\$136.2 million). All but two of the region's IPOs in 2007 were tech-related.

Acquisitions of venture-backed companies in New England declined from 75 in 2006 to 55 in 2007. In late 2007, however, the region produced the then-largest all-cash purchase price in history for a private VC-backed company—the blockbuster sale of EqualLogic to Dell for \$1.4 billion, which closed in early 2008.

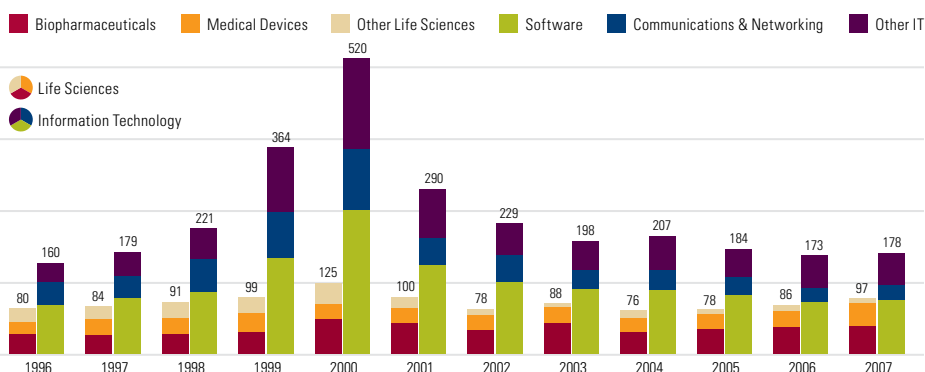
For 2008, we expect New England—and Massachusetts in particular—to remain one of the country's most appealing environments for emerging companies and a hub of venture capital activity.

New England Venture Capital Financings – 1996 to 2007



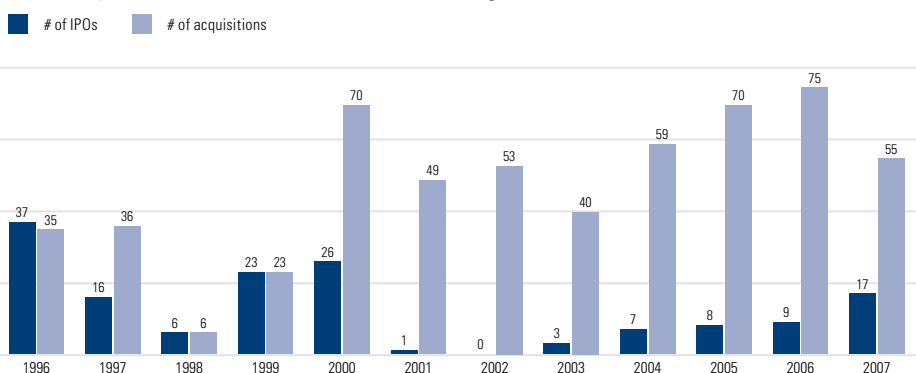
Source: Dow Jones VentureOne

New England Venture Capital Financings by Industry – 1996 to 2007



Source: Dow Jones VentureOne

New England Venture-Backed IPOs and Acquisitions – 1996 to 2007



Source: Dow Jones VentureOne

Tri-State

The number of reported venture capital financings in the tri-state region of New York, New Jersey and Pennsylvania declined from 277 in 2006 to 230 in 2007, while proceeds decreased from \$2.75 billion to \$2.07 billion. We expect the region to report larger numbers once all 2007 transactions have been reported, but to remain below the corresponding data for 2006.

Despite the drop in the region's 2007 deal flow, activity was close to the levels of the post-bubble period (an annual average of 245 deals and \$2.23 billion in proceeds). Venture capital activity in the region significantly exceeds the pre-boom years of 1996–1998, which produced an annual average of 191 financings raising \$1.26 billion.

IT companies garnered the largest share of the tri-state region's VC financing market in 2007, at 46%, compared to 49% in 2006. Life sciences companies logged 27% of the region's financings in 2007, down slightly from 28% in the prior year.

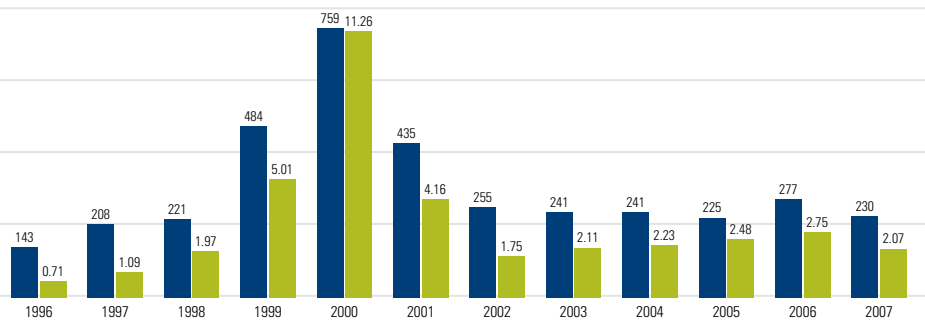
The number of venture-backed IPOs in the region decreased from nine in 2006 to six in 2007. New Jersey led the region again in 2007, producing four, with New York and Pennsylvania each contributing one.

In contrast to the region's slump in IPO activity, the number of acquisitions of venture-backed companies increased from 51 in 2006 to 57 in 2007—the highest total in more than a decade. In 2007, the tri-state region accounted for four of the country's 11 acquisitions of VC-backed companies for more than \$500 million, including the largest sale of the year (Reliant Pharmaceuticals' acquisition by GlaxoSmithKline for \$1.65 billion).

We believe that the tri-state region's strengths in the pharmaceuticals, life sciences, financial services and information technology sectors—combined with its large number of Fortune 500 companies—will continue to provide a favorable environment for VC-backed startup companies in 2008. ■

Tri-State Venture Capital Financings – 1996 to 2007

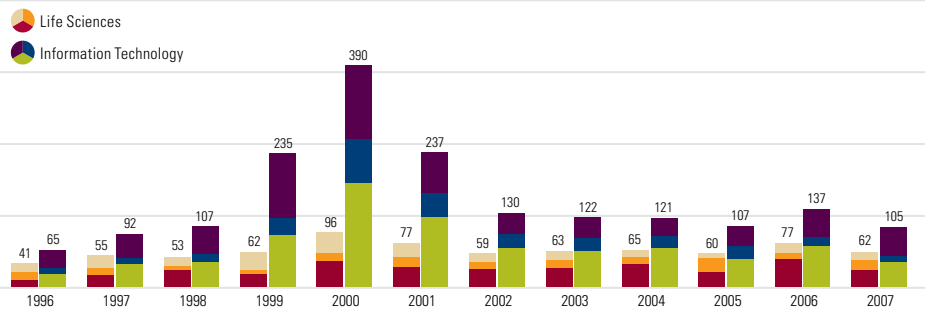
■ # of deals ■ \$ in billions



Source: Dow Jones VentureOne

Tri-State Venture Capital Financings by Industry – 1996 to 2007

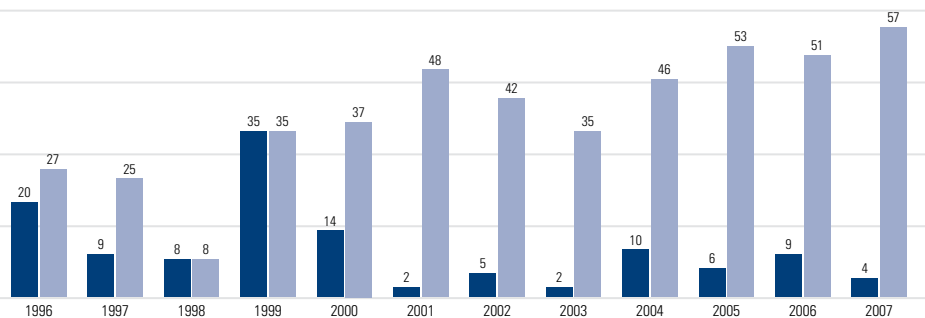
■ Biopharmaceuticals ■ Medical Devices ■ Other Life Sciences ■ Software ■ Communications & Networking ■ Other IT



Source: Dow Jones VentureOne

Tri-State Venture-Backed IPOs and Acquisitions – 1996 to 2007

■ # of IPOs ■ # of acquisitions



Source: Dow Jones VentureOne

Counsel of Choice to Venture Capital–Backed Companies

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

Financings

							
\$70,000,000 <i>Fourth Round</i> January 2007	\$25,000,000 <i>First Round</i> April 2007	\$32,000,000 <i>Second Round</i> August 2007	\$53,000,000 <i>Third Round</i> March 2007	\$25,000,000 <i>Second Round</i> July 2007	\$35,000,000 <i>Late Stage</i> June 2007	\$36,000,000 <i>First Round</i> August 2007	\$14,000,000 <i>First Round</i> April 2007

Initial Public Offerings

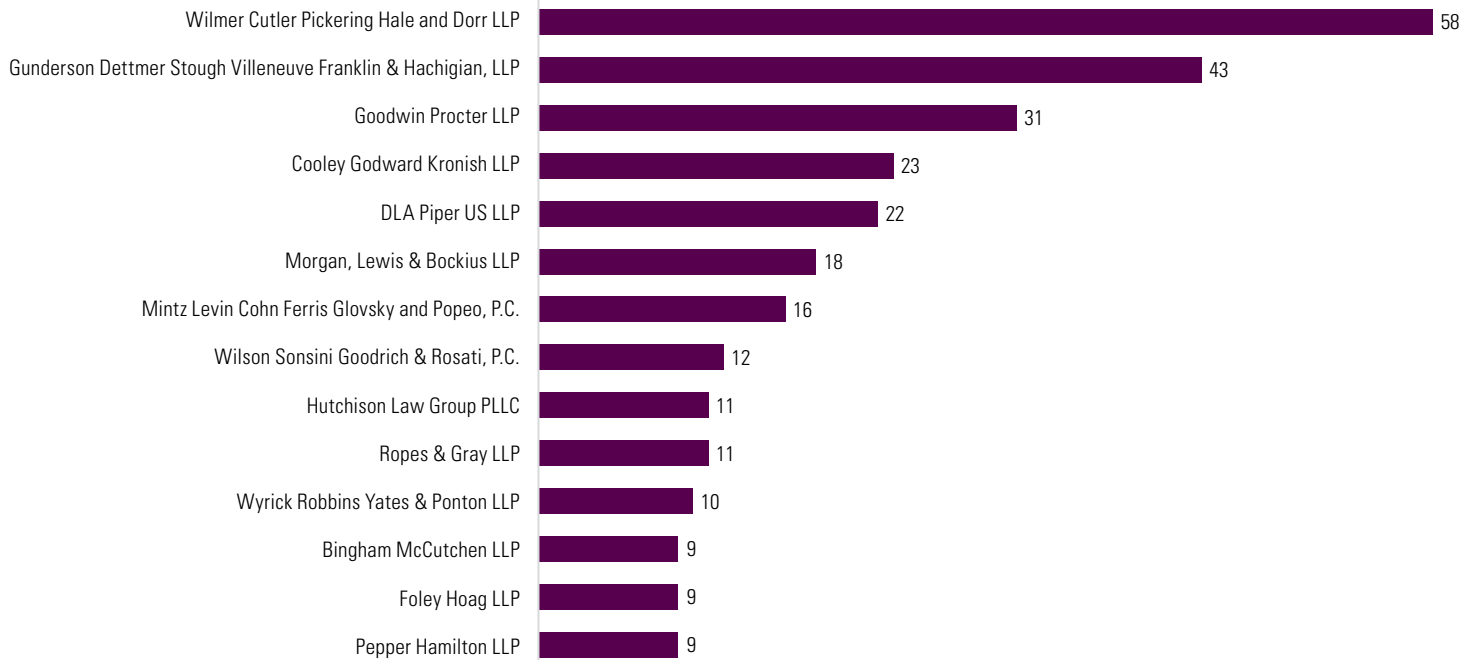
								
<i>Initial Public Offering of Common Stock</i> \$135,204,000 Counsel to Issuer June 2007	<i>Initial Public Offering of Common Stock</i> \$124,200,000 Counsel to Issuer July 2007	<i>Initial Public Offering of Common Stock</i> \$115,115,000 Counsel to Underwriters May 2007	<i>Initial Public Offering of Common Stock</i> \$107,200,000 Counsel to Issuer October 2007	<i>Initial Public Offering of Common Stock</i> \$100,000,000 Counsel to Issuer April 2007	<i>Initial Public Offering of Common Stock</i> \$86,250,000 Counsel to Underwriters May 2007	<i>Initial Public Offering of Common Stock</i> \$41,616,000 Counsel to Issuer November 2007	<i>Initial Public Offering of Common Stock</i> \$58,100,000 Counsel to Issuer July 2007	<i>Public Offering of Common Stock</i> \$96,153,000 Counsel to Underwriters April 2007

M&A Transactions

						
<i>acquisition by Dell</i> \$1,400,000,000 January 2008	<i>acquisition by Amgen</i> \$300,000,000 July 2007	<i>acquisition by NXP Semiconductors</i> \$110,000,000 (including earnout) January 2008	<i>acquisition by Hitachi Data Systems</i> \$120,000,000 February 2007	<i>acquisition by Biogen Idec</i> \$120,000,000 (including earnout) January 2007	<i>acquisition by GSK</i> £230,000,000 January 2007	<i>acquisition by Bristol-Myers Squibb</i> \$430,000,000 October 2007

12 Law Firm Rankings – Eastern US

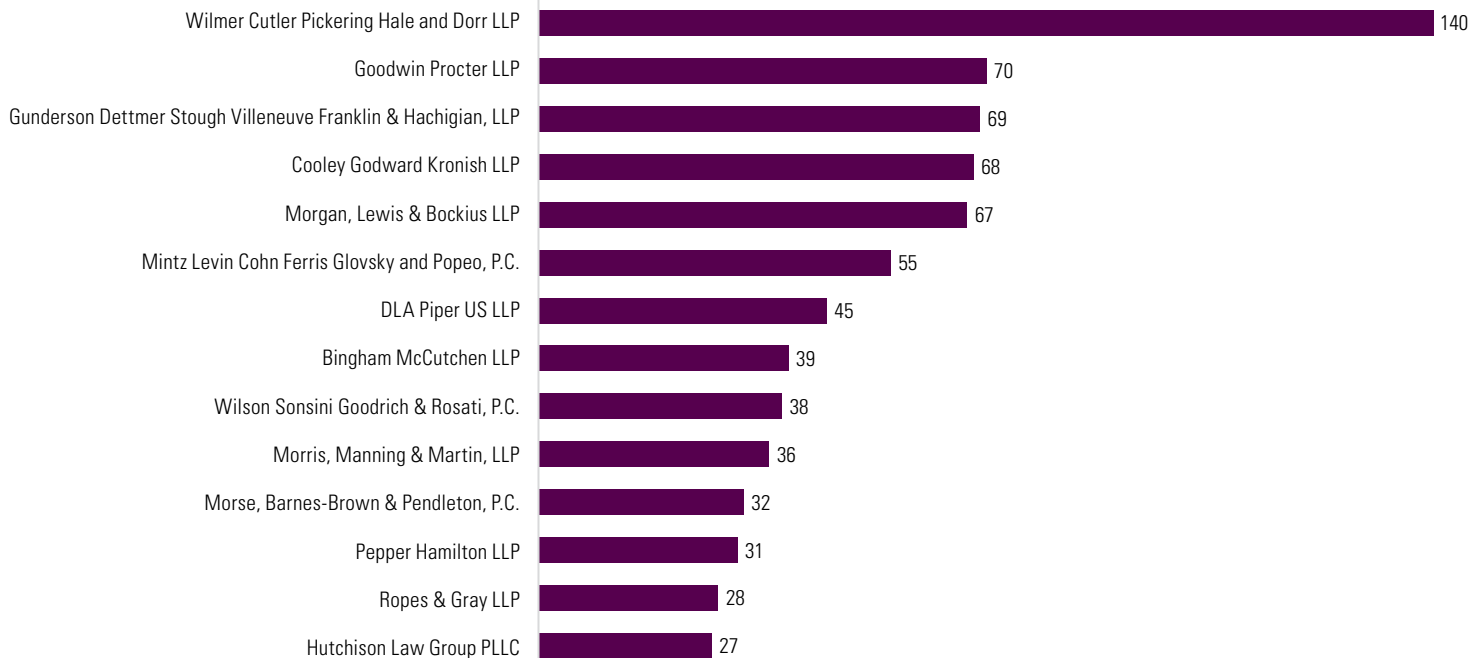
Counsel to Companies Receiving VC Financing in 2007 – Eastern US



The above chart is based on companies located east of the Mississippi River that completed a seed, first, second, later-stage or restart round of venture capital financing in 2007.

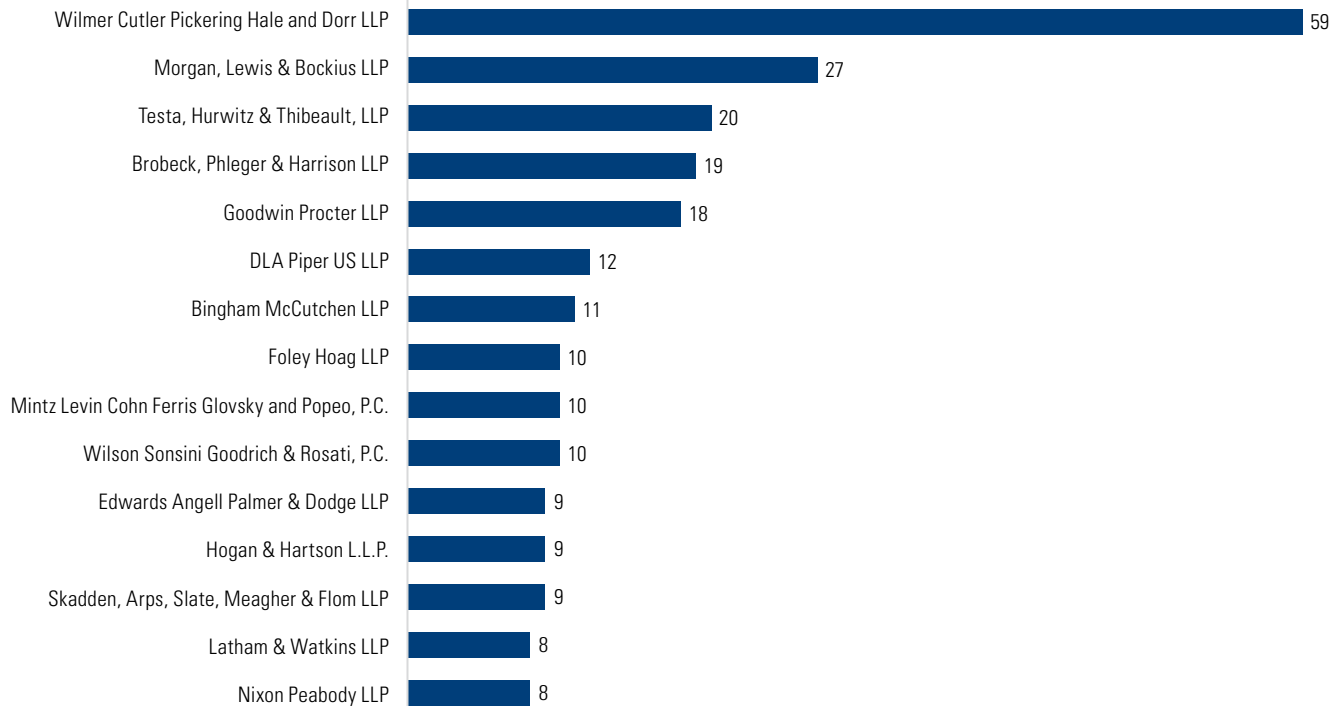
Source: Dow Jones VentureOne

Counsel to VC-Backed Companies at Year-End 2007 – Eastern US

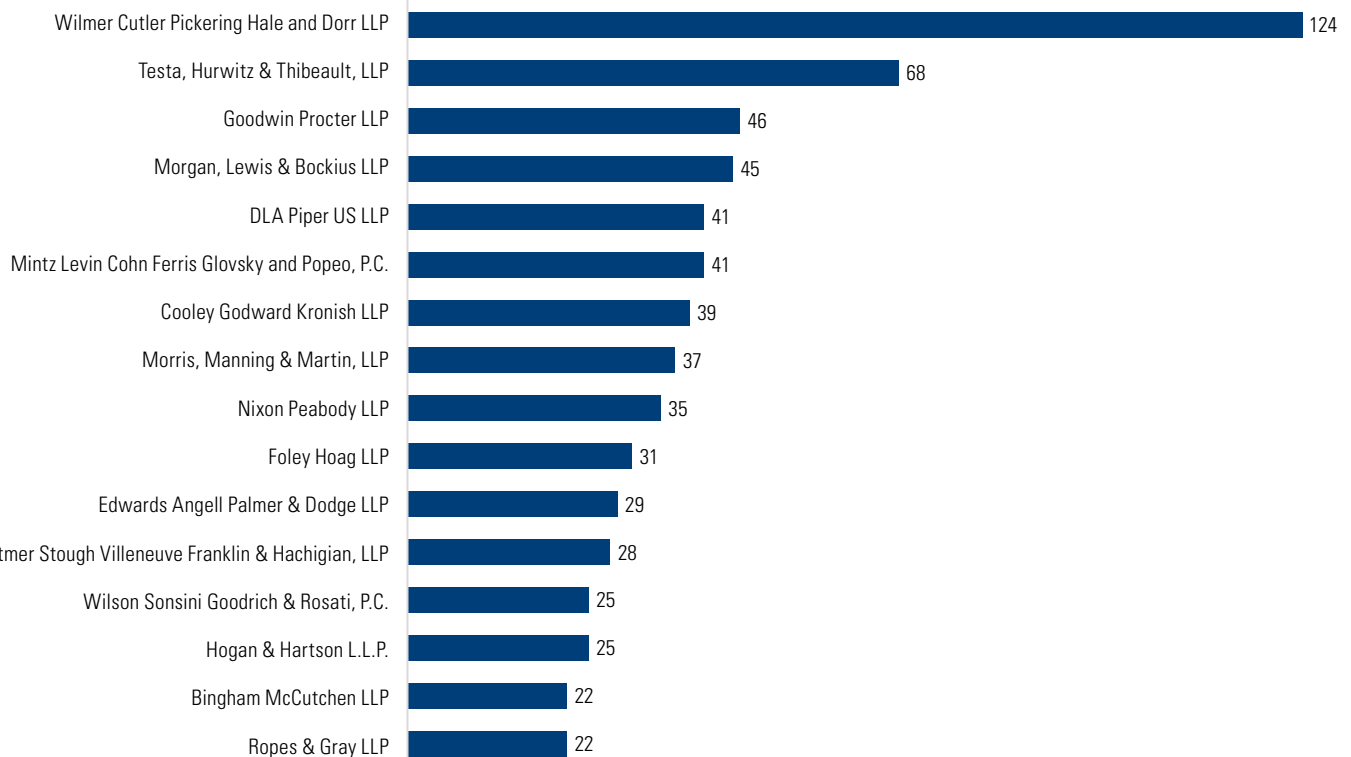


The above chart is based on VC-backed companies located east of the Mississippi River that were private and independent as of the end of 2007.

Source: Dow Jones VentureOne

Company Counsel in IPOs of Eastern US VC-Backed Companies – 1996 to 2007

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

Company Counsel in Sales of Eastern US VC-Backed Companies – 1996 to 2007

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

2007 Review

In 2007, the European venture capital market saw fewer deals than in 2006, but produced the largest investment amount in five years. Liquidity events were mixed; both the number of IPOs and acquisitions declined, but exit valuations reached their highest levels since the boom years.

Venture capital financing proceeds in Europe increased for the fourth consecutive year, reaching €4.56 billion in 2007, while the number of reported venture capital financings fell from 998 in 2006 to 897 in 2007, the seventh consecutive annual decline. Once all 2007 transactions have been reported, we expect the year's deal total to narrow this gap.

The median financing size in Europe increased again to €2.8 million in 2007—the sixth consecutive annual increase and the highest level since at least 1999—in spite of only a modest increase in early-stage rounds. Seed and first-round deals edged up from 44% of all rounds in 2006 to 45% in 2007—the highest level since 2001—while later-stage financings were unchanged at 35%.

With a total of 237 deals, software companies again accounted for the largest sector of the European venture capital market, representing 26% of all financings, up from 25% in 2006. Financings by software companies produced €790 million in proceeds in 2007, compared to €771 million the year before.

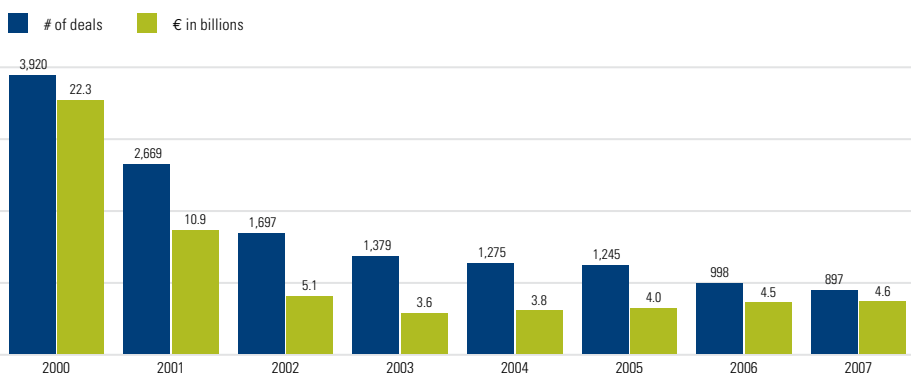
The number of financings by information technology companies surged to 155 in 2007, or 17% of the total, from 106, or 11% of the total, in the prior year. Proceeds jumped from €398 million to €574 million.

Biopharmaceutical companies produced 115 financings in 2006, or 13% of all deals—compared to 15% in 2006. Proceeds in this sector declined from €1.26 billion to €995 million.

Rounding out the largest sectors in 2007 was medical devices, with 58 deals and €381 million in proceeds.

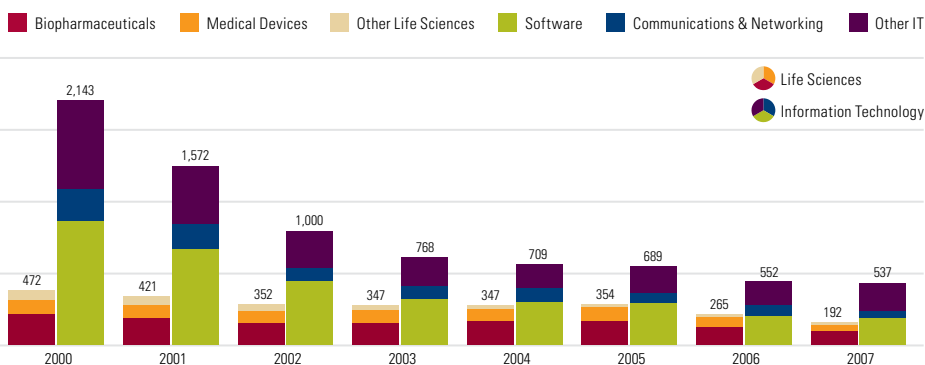
The United Kingdom remains the largest venture capital market in Europe, having produced 35% of all deals

European Venture Capital Financings – 2000 to 2007



Source: Dow Jones VentureOne

European Venture Capital Financing by Industry – 2000 to 2007



Source: Dow Jones VentureOne

in 2007 (unchanged from 2006), followed closely by France with 31% (up from 23%), Germany with 15% (unchanged) and Sweden with 6% (down from 11%).

The number of IPOs by European venture-backed companies retreated to 38 in 2007 from 89 in 2006—but was still higher than any annual total from 2001 to 2004. Proceeds declined from €1.74 billion to €894 million. After topping the number of IPOs by US VC-backed companies for two consecutive years, European VC-backed companies produced only half as many IPOs as their US counterparts in 2007.

On a more positive note, the median pre-IPO valuation reached €59.2 million in 2007, the largest valuation since 2000, and the median amount raised was €15.8 million, a six-year high.

The continued increase in pre-IPO valuations reflects, in part, a more mature base of IPO companies. The median time from initial equity funding to IPO was a record 6.9 years in 2007, up from 5.9 years in 2006, but less than the 7.1-year median for US VC-backed companies completing IPOs in 2007. The median amount invested in European

VC-backed companies prior to IPO increased to €7.8 million in 2007 from €7.5 million in 2006. In 2005, the median amount invested was €10.3 million.

Technology companies again dominated the European VC-backed company IPO market in 2007. For the first time, life sciences companies led the market, with 18 IPOs in 2007, followed by information technology companies with 14. France produced 12 IPOs in 2007, followed by Sweden with five, while Germany—the 2006 leader—produced only four. UK companies, again favoring M&A exits, also generated four IPOs in 2007.

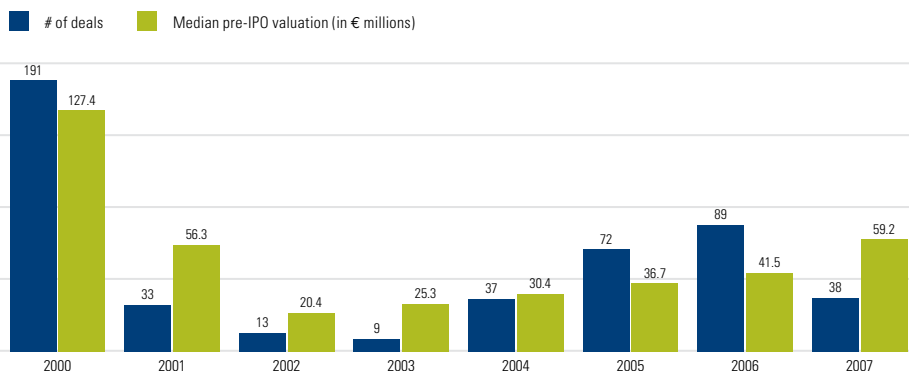
The lack of a European public market where high-growth companies can raise substantial sums of money and provide sufficient liquidity to investors remains a concern for European VC-backed companies seeking exits. In 2007, one AIM-listed company, Ocean Power Technologies, turned to a US Nasdaq offering to bankroll \$100 million in proceeds.

The number of reported acquisitions of European venture-backed companies dropped from 218 in 2006 to 136 in 2007, the lowest level since 2002, although the year's tally should increase once all transactions have been reported.

A staggering 74% of the year's reported deals involved information technology companies. In a reversal of the geographical source of IPOs in 2007, UK-based companies accounted for 32 deals, followed by France with 26, and Finland, Germany and Sweden with 12 each. The UK's deals included the £230 million sale of Domantis to GSK, one of the largest cash purchases of a private biotech company in history, as well as the largest sale of 2007—the £241 acquisition of IXEurope by Equinix.

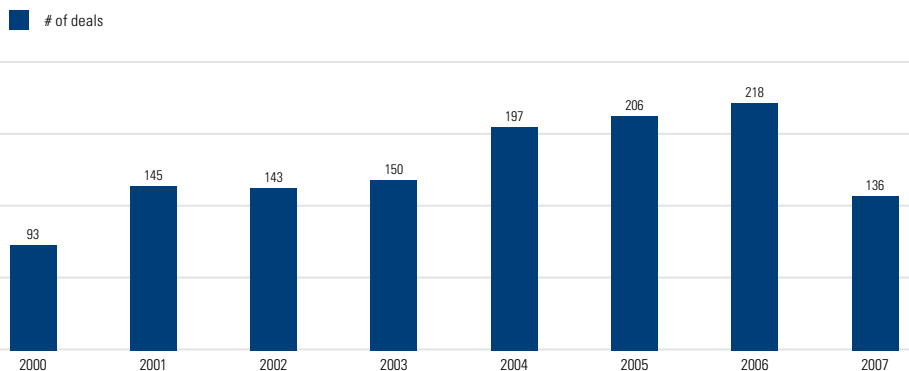
The median acquisition price reached €23 million in 2007, up 31% from €17.6 million in the prior year. The median amount raised prior to acquisition was a record €6.7 million. Technology companies fetched even higher prices, with a median of nearly €30 million. The higher acquisition prices probably reflect the greater maturity of the acquired

European Venture-Backed IPOs – 2000 to 2007



Source: Dow Jones VentureOne

Acquisitions of European Venture-Backed Companies – 2000 to 2007



Source: Dow Jones VentureOne

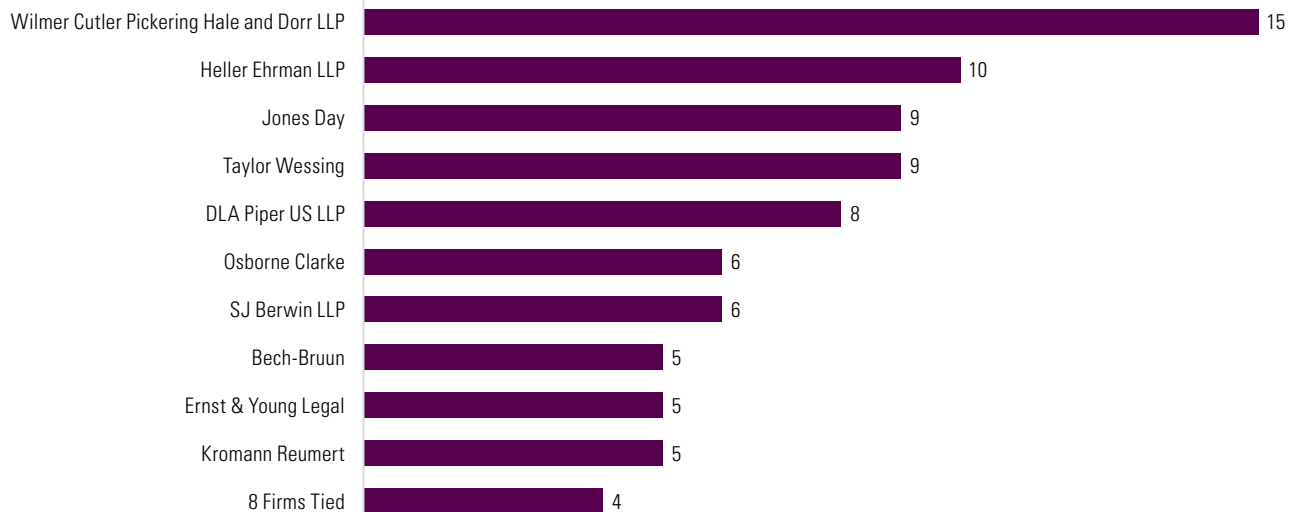
companies, whose median time from initial equity funding to acquisition increased to a record 6.6 years in 2007—just shy of the 6.7 year median for acquired VC-backed companies in the United States.

2008 Outlook

For 2008, we expect European venture capital investment to remain steady or increase modestly. We also anticipate that the median financing size of VC deals in Europe will continue to increase as more later-stage rounds—particularly deals led by private equity firms—are completed.

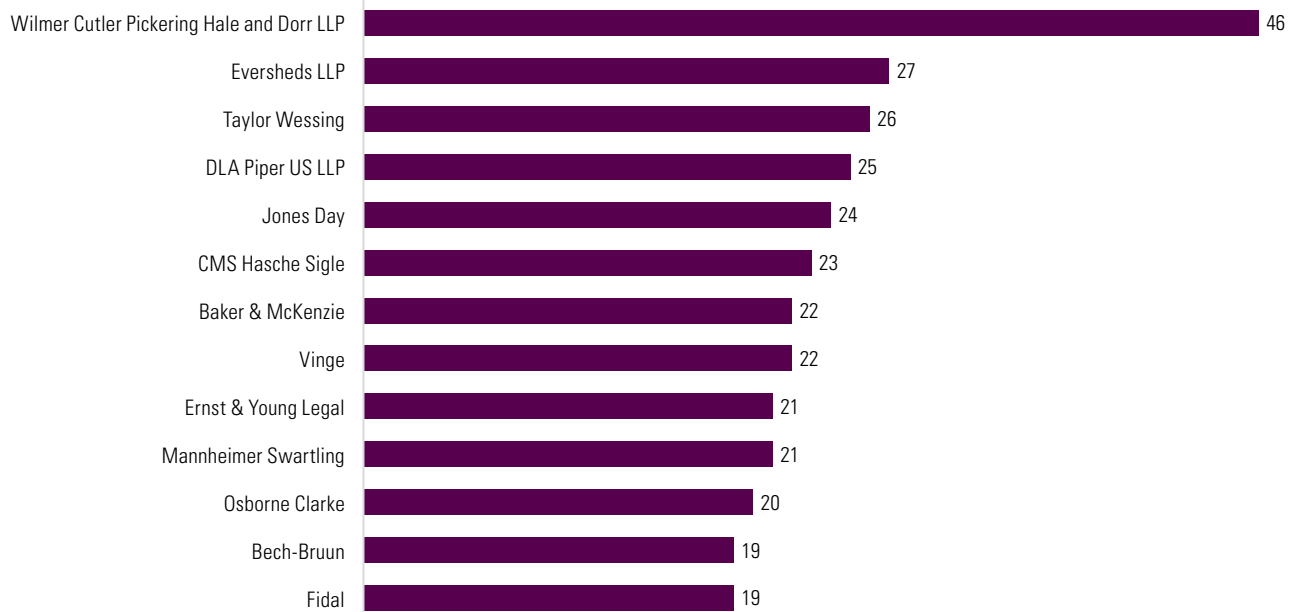
The liquidity outlook for European VC-backed companies appears clouded. Weakening capital market conditions do not bode well for IPO flow in 2008, although the success of the Ocean Power Technologies IPO may herald an increasing receptiveness to AIM companies in the US public market. On the M&A front, the large valuation gains of recent years seem unlikely to be repeated in 2008, but the large Domantis and IXEurope acquisitions suggest strong demand for strategically important tech companies. ■

Counsel to Companies Receiving VC Financing in 2007 – Europe



*The above chart is based on European companies that completed a seed, first, second, later-stage or restart round of venture capital financing in 2007.
Source: Dow Jones VentureOne*

Counsel to VC-Backed Companies at Year-End 2007 – Europe



*The above chart is based on European VC-backed companies that were private and independent as of the end of 2007.
Source: Dow Jones VentureOne*

Fundraising

US venture capital fund formation activity continued at a healthy pace throughout 2007. With a strong fourth quarter, a total of 148 funds raised \$32.2 billion in 2007, an increase over the \$30.0 billion raised by 105 funds in the prior year. We expect the 2007 total to show even stronger growth over 2006 once all fundraising transactions have been reported.

Fund sizes in 2007 continued to be relatively moderate, as general partners made reasonably conservative assumptions about investment pace.

We expect that venture capital fundraising will continue at about the same pace in 2008. Institutional investors may be looking to place money previously allocated to buyout funds in venture funds, in the fear that the status of the credit markets may restrict buyout transactional activity. Many venture funds are currently in the market and planning closings in the first half of the year. Fund sizes are likely to remain moderate, to provide flexibility to fund managers.

Pressure on Terms

In 2008, investors are likely to continue to put pressure on several deal terms, including management fees and successor fund provisions.

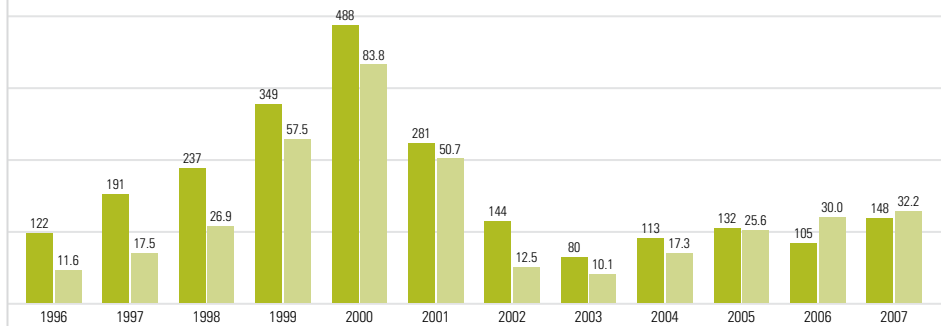
Management Fees. Venture fund management fees typically range from between 2% and 2.5% of investor capital commitments. Generally, the percentage ratchets down after the end of the fund's investment period. Investors are increasingly focusing on earlier rampdowns, which may occur in response to certain events, and on downward adjustment of both the base on which the fee is calculated, and the percentage itself. Possible fee reduction events include:

- a temporary or permanent suspension of the fund's investment period (for example, upon a key person event); or
- the formation of a successor fund by the sponsors.

Investors argue that under these circumstances the general partner is no

Commitments to US Venture Capital Funds – 1996 to 2007

\$ billions



Source: Dow Jones VentureOne

longer devoting the same time or energy to fund activities and therefore its fee compensation should be reduced. While this seems reasonable at first blush, it is often the case that the same personnel and resources are required to manage the fund even after a successor vehicle is formed, and to nurture and harvest existing investments after the early termination or suspension of an investment period.

Investors are also focusing on the calculation of fee amounts during the rampdown period. While it is customary to reduce the fee percentage during the rampdown period by 10% per year, it is often the case that the base to which the percentage is applied—the capital commitments—is unchanged. Investors are in many cases seeking to reduce both the percentage and the base. Alternatives include a base equal to:

- fair market value of the fund's remaining investments;
- capital commitments less the cost of investments that have been liquidated or written off; or
- assets under management plus a reserve for follow-on investments.

Fund sponsors typically insist that at least some portion of the base represents amounts that they expect to invest after the beginning of the rampdown period, as those are assets that will be under management prior to the expiration of the fund term.

Successor Funds. After the end of its investment period, a fund is typically not

permitted to make investments, other than follow-on investments in existing portfolio companies. Accordingly, if a venture firm identifies an investment in a new company, it wants to have an investing entity available to make that investment.

Typically, a fund sponsor is permitted to form a successor fund after the earlier of the following events:

- the end of the investment period; and
- the first date on which a certain percentage of fund capital commitments have been invested, committed for investment, spent on expenses, and reserved for expenses and/or follow-on investments.

Investors often negotiate the percentage of capital that must be committed—which usually ends up in a range between 66 2/3% and 80%—and whether amounts reserved for follow-on investments and expenses can be included, as the fund sponsor has a fair bit of discretion in determining these amounts. In some cases, investors request that the advisory board approve the reserve amounts, or caps on the total amount of commitments that may be reserved for follow-on investments.

These provisions, and many other important fund terms—including key person events, distribution waterfalls, general partner removal rights and early fund termination events—are likely to be the subject of much discussion. Thus, while fund sponsors should be encouraged by a high level of investor interest, they should expect a fair amount of negotiation over investment terms. ■

18 Trends in Venture Capital Financing Terms



Based on hundreds of venture capital financing transactions we handled from 2003 to 2007 for companies and venture capitalists in the United States and Europe, we have compiled the following deal data:

Deals with Multiple Liquidation Preferences		2003	2003 Range	2004	2004 Range	2005	2005 Range	2006	2006 Range	2007	2007 Range
A “multiple liquidation preference” is a provision that provides that the holders of preferred stock are entitled to receive more than 1x their money back before the proceeds of the liquidation or sale are distributed to holders of common stock.	Series A	0%	N/A	22%	1.25x – 5x	3%	1.5x	5%	2x	4%	1.5x – 2x
	Post-Series A	24%	1.5x – 5x	11%	1.5x – 3x	10%	1.5x – 2x	9%	1.25x – 3x	7%	1.5x – 2x
Deals with Participating Preferred		2003	2003 Range	2004	2004 Range	2005	2005 Range	2006	2006 Range	2007	2007 Range
“Participating preferred” stock entitles the holder not only to receive its stated liquidation preference, but also to receive a pro rata share (assuming conversion of the preferred stock into common stock) of any remaining proceeds available for distribution to holders of common stock.	Series A Total Capped	61%	N/A	56%	N/A	58%	48%	59%	22%	57%	42%
	Post-Series A Total Capped	76%	2x – 4x	54%	2x – 5x	71%	2x – 5x	62%	2x – 5x	62%	2x – 6x
Deals with an Accruing Dividend		2003		2004		2005		2006		2007	
“Accruing dividends” are generally payable upon liquidation or redemption of the preferred stock. Because the sale of the company is generally deemed to be a “liquidation,” the accrued dividend effectively increases the liquidation preference of the preferred stock.	Series A	30%		47%		78%		53%		43%	
	Post-Series A	52%		48%		87%		55%		38%	
Anti-Dilution Provisions		2003		2004		2005		2006		2007	
A “full ratchet” anti-dilution formula is more favorable to the investors because it provides that the conversion price of the preferred stock will be reduced to the price paid in the dilutive issuance, regardless of how many shares are involved in the dilutive issuance. In contrast, a “weighted average” anti-dilution formula takes into account the dilutive impact of the dilutive issuance based upon factors such as the number of shares and the price involved in the dilutive issuance and the number of shares outstanding before and after the dilutive issuance.	Series A										
	Full Ratchet	3%		3%		0%		7%		9%	
	Weighted Average	97%		97%		100%		93%		91%	
	Post-Series A										
	Full Ratchet	30%		7%		16%		7%		5%	
	Weighted Average	70%		93%		84%		93%		95%	
Deals with Pay-to-Play Provisions		2003		2004		2005		2006		2007	
“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	31%		26%		25%		22%		28%	
	% of Total That Convert to Common Stock	50%		67%		55%		65%		79%	
	% of Total That Convert to Shadow Preferred Stock	50%		33%		45%		35%		21%	



We reviewed all merger transactions between 2004 and 2007 involving venture-backed targets (as reported in Dow Jones VentureOne) where 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	2004	2005	2006	2007
Sample Size	54	39	53	33
Cash	43%	69%	68%	48%
Stock	41%	10%	8%	0%
Cash and Stock	17%	21%	24%	52%
Deals with Earn-Out	2004	2005	2006	2007
With Earn-Out	24%	15%	17%	39%
Without Earn-Out	76%	85%	83%	61%
Deals with Indemnification	2004	2005	2006	2007
With Indemnification	89%	100%	94%	100%
By Target's Shareholders	37%	46%	38%	48%
By Buyer ¹				
Survival of Representations and Warranties ²	2004	2005	2006	2007
Shortest	6 Months	9 Months	12 Months	6 Months ³
Longest	36 Months	24 Months	36 Months	36 Months
Most Frequent	12 Months	12 Months	12 Months	12 and 18 Months (tie)
Caps on Indemnification Obligations	2004	2005	2006	2007
With Cap	85%	100%	100%	97%
Limited to Escrow	72%	79%	84%	78%
Limited to Purchase Price	7%	5%	2%	9%
Exceptions to Limits ⁴	74%	73%	84%	97%
Without Cap	15%	0%	0%	3%
Escrows	2004	2005	2006	2007
With Escrow	83%	97%	94%	94%
% of Deal Value				
Lowest	4%	2%	3%	3%
Highest	23%	20%	20%	43%
Most Frequent	10%–20%	10%	10%	10%
Length of Time				
Shortest	6 Months	6 Months	12 Months	6 Months
Longest	36 Months	24 Months	36 Months	60 Months
Most Frequent	12 Months	12 Months	12 Months	12 and 18 Months (tie)
Exclusive Remedy	64%	84%	89%	73%
Exceptions to Escrow Limit Where Escrow Was Exclusive Remedy ⁵	72%	66%	86%	100%
Baskets for Indemnification	2004	2005	2006	2007
Deductible	39%	38%	48%	48% ⁶
Threshold	51%	62%	52%	39% ⁶
MAE Closing Condition	2004	2005	2006	2007
Condition in Favor of Buyer	81%	82%	98%	97%
Condition in Favor of Target ⁷	30%	13%	23%	44%
Exceptions to MAE	2004	2005	2006	2007
With Exception ⁸	78%	79%	85%	91%

¹ The buyer provided indemnification in 48% of the 2004 transactions, 25% of the 2005 transactions, 41% of the 2006 transactions and 53% of the 2007 transactions where buyer stock was used as consideration. In 65% of the 2004 transactions, 17% of the 2005 transactions, 35% of the 2006 transactions and 56% of the 2007 transactions where the buyer provided indemnification, buyer stock was used as consideration.

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

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

⁴ Generally, exceptions were for fraud and willful misrepresentation.

⁵ Generally, exceptions were for fraud, intentional misrepresentation and criminal activity.

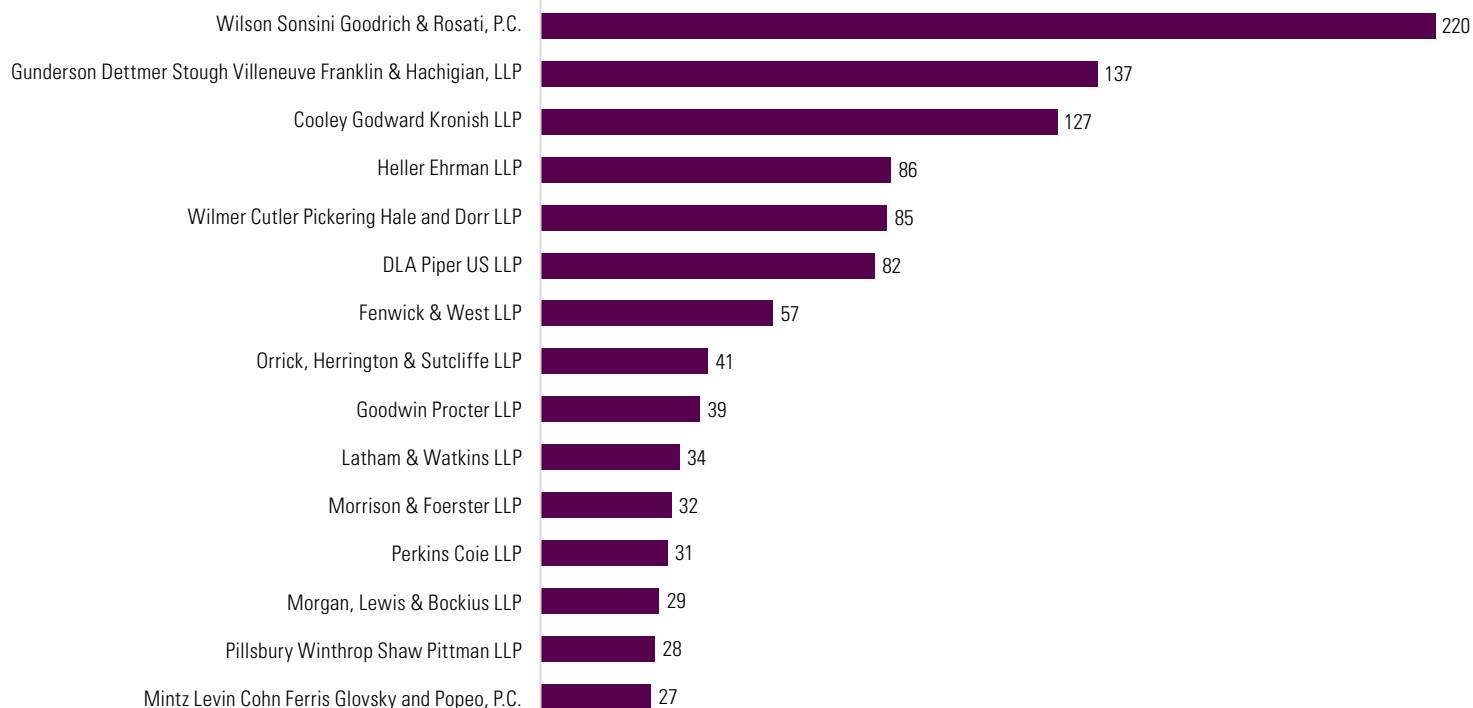
⁶ Another 13% of these transactions used a "hybrid" approach with both a deductible and a threshold.

⁷ In 50% of these transactions in 2004, in 80% of these transactions in 2005, in 83% of these transactions in 2006 and in 86% of these transactions in 2007, buyer stock was used as consideration.

⁸ Generally, exceptions were for general economic and industry conditions.

20 Law Firm Rankings – Worldwide

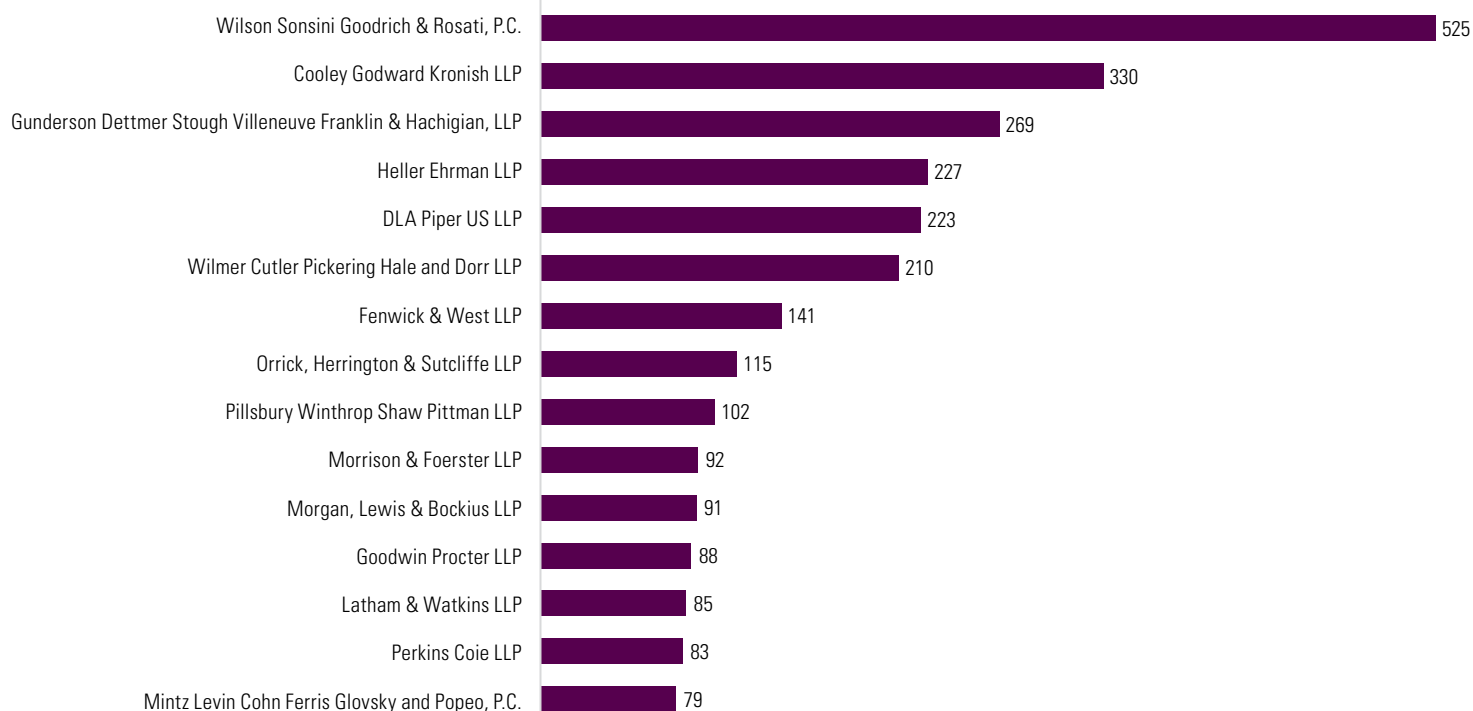
Counsel to Companies Receiving VC Financing in 2007 – Worldwide



The above chart is based on all companies contained in the VentureSource database that completed a seed, first, second, later-stage or restart round of venture capital financing in 2007.

Source: Dow Jones VentureOne

Counsel to VC-Backed Companies at Year-End 2007 – Worldwide



The above chart is based on all VC-backed companies contained in the VentureSource database that were private and independent as of the end of 2007.

Source: Dow Jones VentureOne

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

Our *2008 IPO Report* offers a detailed analysis of the 2007 IPO market and the outlook for the year ahead. The report features regional IPO market breakdowns, a review of the PIPEs and Rule 144A markets, and an analysis of the benefits and challenges of pursuing a “dual track” IPO. We also discuss the recent surge in IPOs by special purpose acquisition companies, examine the latest developments in the proxy environment, and take a look back at the evolution of the IPO process over the last decade.

See our *2008 M&A Report* for a detailed review of the global M&A market and the outlook for the coming year. In other highlights, we revisit recent trends in takeover defenses, review the impact of CFIUS on foreign acquisitions of US companies, present a survey of key terms in sales of VC-backed companies, examine the ramifications of recent SEC changes to Rules 144 and 145, and discuss the impact of FASB’s adoption of new accounting rules for M&A transactions.

For summaries and analysis of compensation data from the past year, collected from hundreds of executives and private companies located throughout the country, see our *2007 Compensation and Entrepreneurship Report in Information Technology* and our *2007 Compensation and Entrepreneurship Report in Life Sciences* at www.wilmerhale.com/compreports.

To request a copy of any of the reports described above, or to obtain additional copies of the *2008 Venture Capital Report*, please contact the WilmerHale Marketing and Business Development Department at marketing@wilmerhale.com or call +1 617 526 5600. An electronic copy of this report can be found at www.wilmerhale.com/2008VCreport.

Data Sources

All data in this report was compiled from the VentureSource database from Dow Jones VentureOne, except as otherwise described.

Special note on data: All venture capital financing and M&A data discussed in this report is based on currently available information. Due to delayed reporting of some transactions, the 2007 data that is presently available is likely to be adjusted upward over time as additional deals are reported. Based on historical experience, the adjustments in US data are likely to be in the range of 5–10% in the first year following the initial release of data and in smaller amounts in succeeding years, and the adjustments in European data are likely to be more pronounced.

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