

# 2016 Venture Capital Report

CORPORATE



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### REVIEW

In 2015, the venture capital market produced strong results overall. Financing activity remained consistent with the high level of 2014, while deal proceeds increased by almost one-quarter, as the median pre-money valuation hit a record for the second year in a row. The number of VC-backed US issuer IPOs fell below the yield for 2013 and 2014, but still represented the fourth-highest annual figure since the dot-com boom era, and the median acquisition price for VC-backed companies was the highest since 2000. Prospects for VC-backed companies generally appear favorable heading into 2016, although both financing and liquidity activity may face headwinds in the coming year.

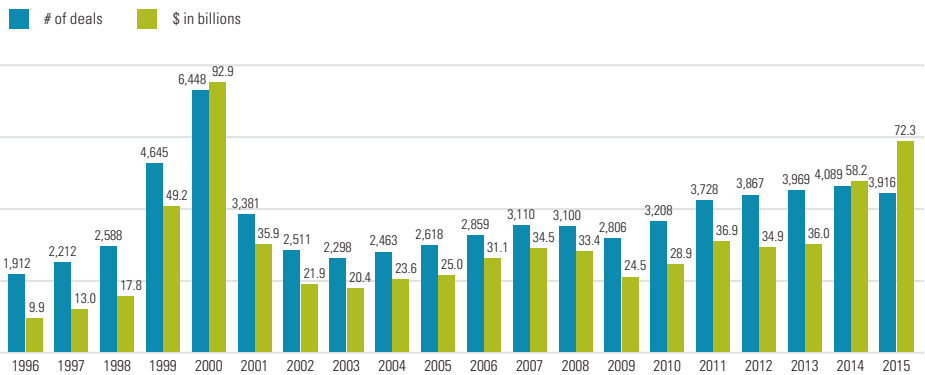
#### Equity Financing Activity

The number of reported venture capital financings dipped 4%, from 4,089 in 2014 to 3,916 in 2015—a decline that is almost certain to be erased once all 2015 deals are accounted for. Even adjusting for the normal lag in deal reporting, deal flow appears to have slowed, at least modestly, over the second half of 2015. The first six months of the year produced 2,074 deals, compared to 1,842 over the last six months of the year.

Total reported venture capital financing proceeds jumped 24%, from \$58.2 billion in 2014 to \$72.3 billion in 2015. The 2015 tally was the highest since the \$92.9 billion in 2000 and more than double the average of \$36.0 billion in total annual proceeds that prevailed for the five-year period preceding 2014. Total financing proceeds increased in each successive quarter of 2015, before declining in the fourth quarter to the lowest quarterly level since the third quarter of 2014.

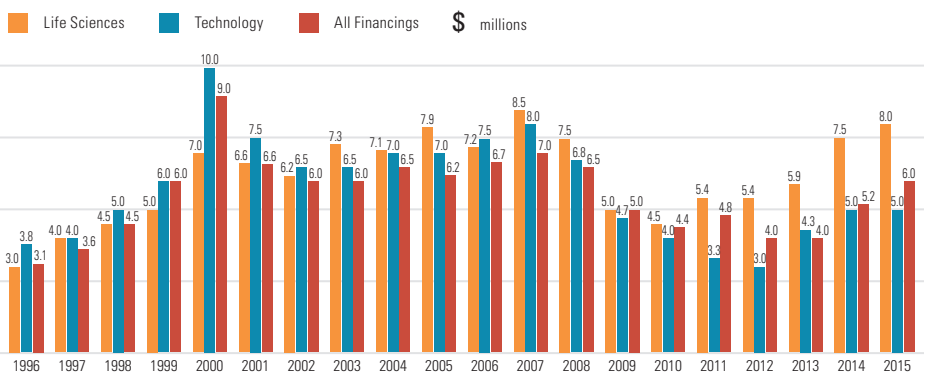
The median size of all venture capital financings increased 15%, from \$5.2 million in 2014 to \$6.0 million in 2015—the highest level since 2008. The median size of first-round financings increased for the second year in a row, from \$3.1 million in 2014 to \$3.2 million in 2015. The median size of second-round financings increased by a wider margin, up 13%, from \$6.6 million in 2014 to \$7.5 million in 2015, but the 2015 figure still fell short of the \$8 million-plus second-round sizes that prevailed between

### US Venture Capital Financings – 1996 to 2015



Source: Dow Jones VentureSource

### Median Size of US Venture Capital Financings – 1996 to 2015



Source: Dow Jones VentureSource

2005 and 2008. The median size of later-stage financings, which had remained steady at \$10 million between 2011 and 2013, increased from \$14 million in 2014 to \$15 million in 2015—the highest tally since the \$20 million figure in 2000.

The median financing size for life sciences companies increased for the fifth consecutive year, up 6%, from \$7.5 million in 2014 to \$8.0 million in 2015, trailing only 2007's \$8.5 million figure as the sector's highest median financing size. For technology companies, the median financing size remained steady at \$5.0 million, but is significantly lower than the typical median financing size during the ten-year period preceding 2009. The general decline in the median financing size for technology companies in recent

years is at least partly attributable to technological advances that have enabled startups to commence and grow their operations with a lower level of funding than historically required—in many cases, cloud computing and open-source software have replaced the need to purchase expensive server racks, hire support staff and acquire costly software licenses.

As venture-backed companies increasingly have relied on IPO-sized later-stage rounds of financing—sometimes with the intention to eschew the public markets entirely—the volume of very large financings has increased dramatically. The number of financing rounds of at least \$50 million increased from 83 in 2012 to 112 in 2013, almost doubled to 209 in 2014, and then increased a further 32% to 275 in 2015.

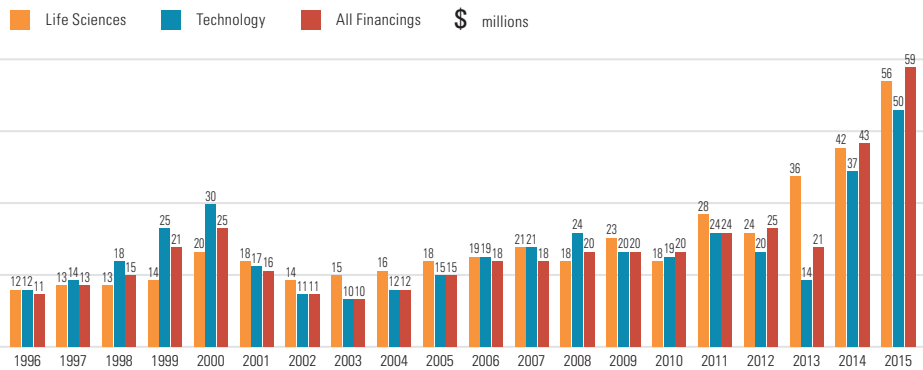
The number of financing rounds of at least \$100 million increased from 19 in 2012 to 28 in 2013, more than doubled to 63 in 2014, and then leapt another 60% to 101 in 2015. These increases in super-sized rounds continue to be driven largely by private equity, crossover and hedge funds, which historically had avoided investments in private companies but are now attracted to pre-IPO companies that offer the potential for sizeable valuation increases and investment returns, especially when investors are able to negotiate ratchet provisions guaranteeing them a minimum return at the time of an IPO, typically in the form of additional shares if the offering prices below a set price.

There were six billion-dollar financing rounds in 2015. This elite club was led—for the second year in a row—by Uber (with a \$2.1 billion financing and a separate financing for \$1.0 billion), followed by Airbnb (\$1.5 billion) and Lyft, Social Finance and SpaceX (each \$1.0 billion).

The median pre-money valuation among all venture financings increased 35%, from \$43.3 million in 2014 to \$59.1 million in 2015—the highest level since 1996 (the first year for which this data is available). Both life sciences and technology companies enjoyed sharp increases in valuations. The median pre-money valuation in the technology sector increased 36%, from \$36.8 million in 2014 to \$50.0 million in 2015. Among life sciences companies, the median pre-money valuation increased 34%, from \$42.0 million to \$56.4 million, the fifth year in a row that the median pre-money valuation in the sector has been higher than that of tech companies.

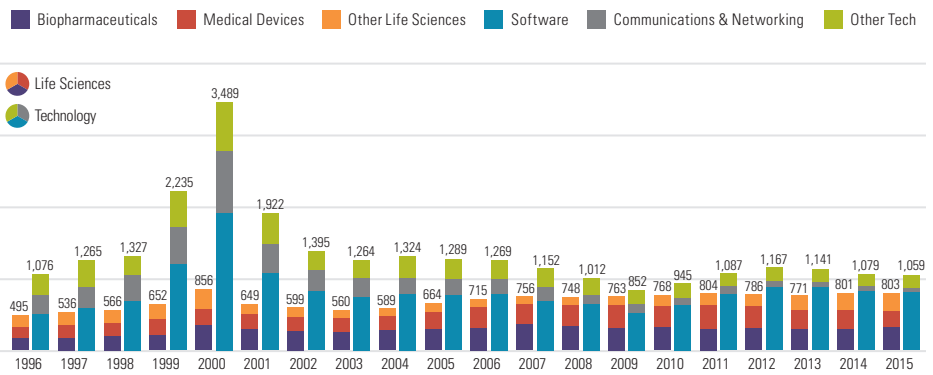
While the 2015 figures are likely understated, the number of reported seed and first-round venture capital equity financings declined by 39% and 5%, respectively, from 2014 to 2015. Seed and first-round financings accounted for 40% of all venture financings in 2015—down from 44% in 2014 and 48% in 2013. Proceeds from seed and first-round equity financings represented 13% of all venture capital financing proceeds in 2015, down from 16% in 2014 and 20% in 2013. The number of second and later-stage round financings increased by 8%

### Median Pre-Money Valuation in US Venture Capital Financings – 1996 to 2015



Source: Dow Jones VentureSource

### US Venture Capital Financings by Industry – 1996 to 2015



Source: Dow Jones VentureSource

and 4%, respectively, between 2014 and 2015. Proceeds from later-stage equity financings represented 64% of all venture capital financing proceeds in 2015.

The technology sector accounted for 27% of the year's transactions in 2015, up slightly from 26% in 2014. The business and financial services sector (which had supplanted the technology sector for the largest market share for the first time in 2014) saw its market share decline from 27% to 26%. After posting four consecutive declines between 2009 and 2013, the market share for life sciences companies increased for the second year in a row, from 20% in 2014 to 21% in 2015.

California—which has led the country in financing activity in each year since 1996—

accounted for 42% of all venture financing transactions in 2015 (1,644 financings) and 56% of all proceeds (\$40.6 billion). New York, home to companies with 429 financings raising \$7.26 billion in 2015, finished second in deal flow for the fourth year in a row, just ahead of Massachusetts, which logged 332 financings raising \$6.67 billion. Texas (with 147 financings raising \$1.71 billion) and Washington (with 132 financings raising \$1.86 billion) rounded out the top five positions for 2015.

#### Liquidity Activity

The number of venture-backed US issuer IPOs declined by 38%, from 102 in 2014 to 63 in 2015. While the 2015 figure also fell short of the 72 VC-backed US issuer IPOs in 2013, it represented the fourth-highest annual figure since 2000. The largest VC-

backed IPO of 2015 was the \$732 million offering of Fitbit, followed by the IPOs of Atlassian (\$462 million), Pure Storage (\$425 million), Etsy (\$267 million) and Sunrun (\$251 million). The median amount of time from initial funding to an IPO inched down from 6.9 years in 2014 to 6.7 years in 2015—the second-lowest annual figure since 2007.

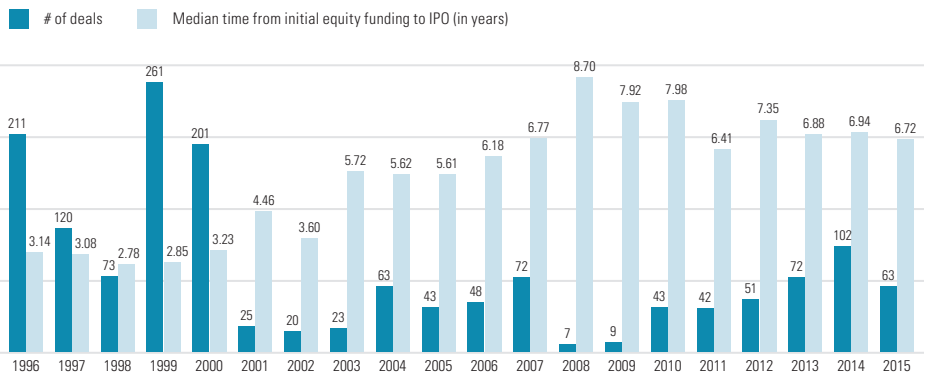
In 2015, 68% of all VC-backed IPOs were by life sciences companies, up from 63% in 2014 and 51% in 2013, while the VC-backed IPO market share for technology companies decreased from 49% in 2013 to 34% in 2014 and 30% in 2015.

The median amount raised prior to an IPO increased 6%, from \$88.4 million in 2014 to \$93.9 million in 2015, and the median pre-IPO valuation increased 22%, from \$216.7 million to \$265.0 million. As a result, the ratio of pre-IPO valuations to the median amount raised prior to an IPO by venture-backed companies going public increased to 2.8:1, up from 2.5:1 in 2014 (a higher ratio means better returns to pre-IPO investors). Despite the increase, the ratio is at its second-lowest level in the last 20 years. The ratio was between 3.2:1 and 5.5:1 for each year from 2001 to 2012, other than a spike to 9.0:1 in 2009 based on a very small sample size of VC-backed IPOs that year. In contrast, this ratio ranged from 7.5:1 to 10.0:1 from 1997 to 2000, due to very large pre-IPO valuations by younger companies.

The number of reported acquisitions of VC-backed companies declined 7%, from 562 in 2014 to 522 in 2015, while total proceeds fell by one-third, decreasing from \$87.4 billion to \$58.3 billion. Once all 2015 acquisitions are accounted for, 2015 deal activity should be in line with 2014, although the shortfall in proceeds is likely to remain, due to a decline in the number of acquisitions with purchase prices of at least \$500 million.

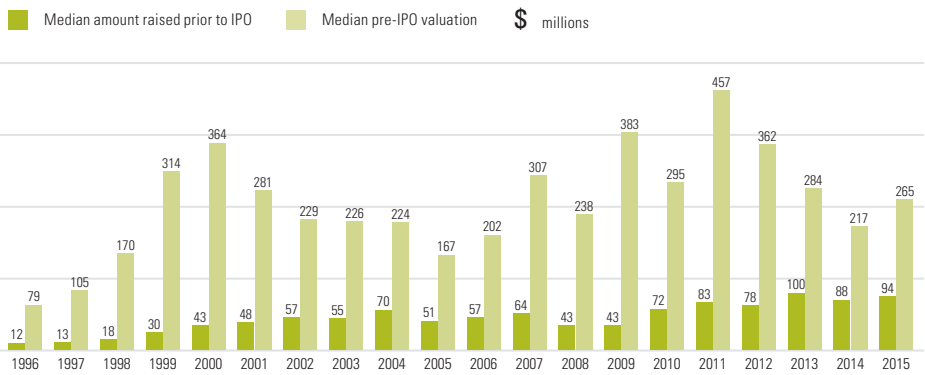
The median acquisition price for venture-backed companies increased 31%, from \$65.0 million in 2014 to \$85.0 million in 2015—the highest annual figure since the \$100.0 million in 2000. Aside from a tiny uptick in 2012, the median amount of time from initial funding to acquisition has declined for eight years in a row, from 6.5 years in 2007 to 4.6 years in 2015.

## Venture Capital–Backed IPOs and Median Time to IPO – 1996 to 2015



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

## Median Amount Raised Prior to IPO and Median Pre-IPO Valuation – 1996 to 2015



Source: Dow Jones VentureSource

The median amount raised prior to acquisition decreased 11%, from \$14.1 million in 2014 to \$12.5 million in 2015. The ratio of median acquisition price to median amount raised prior to acquisition increased from 4.6:1 in 2014 to 6.8:1 in 2015 (a higher ratio means higher returns to pre-acquisition investors). This ratio in 2015 was the highest annual figure since the ratio of 10.0:1 in 2000 at the apex of the dot-com delirium. The increase in this ratio largely stems from significantly higher acquisition prices, coupled with historically low investment levels prior to acquisition.

There were a total of 19 VC-backed company acquisitions for at least \$500 million in 2015, down from the 23 in 2014 but well above the nine in 2013. The eight

billion-dollar acquisitions of VC-backed companies in 2015 fell one shy of the prior year's tally, but topped 2013's total by one.

The above comparison of the ratios of valuations to the financing amounts required to achieve liquidity events indicates that—for only the third time since 2000, and for the third consecutive year—returns to venture capital investors in 2015 were higher in M&A transactions than in IPOs. Furthermore, venture investors generally achieve liquidity more rapidly in an M&A transaction (which frequently yields the bulk of the purchase price in cash at closing) than in an IPO (which generally involves a post-IPO lockup period of 180 days and market uncertainty on the timing and prices of subsequent sales). Highlighting

the uncertainty of an IPO as the path to liquidity, the average 2015 VC-backed IPO eked out a gain of less than 2% during the year, with 59% of IPO companies trading below their offering price at year-end.

When combined with 2015's shorter timeline from initial funding to liquidity for M&A transactions (4.6 years) than IPOs (6.7 years), these data points underscore why venture capitalists often prefer a company sale to an IPO.

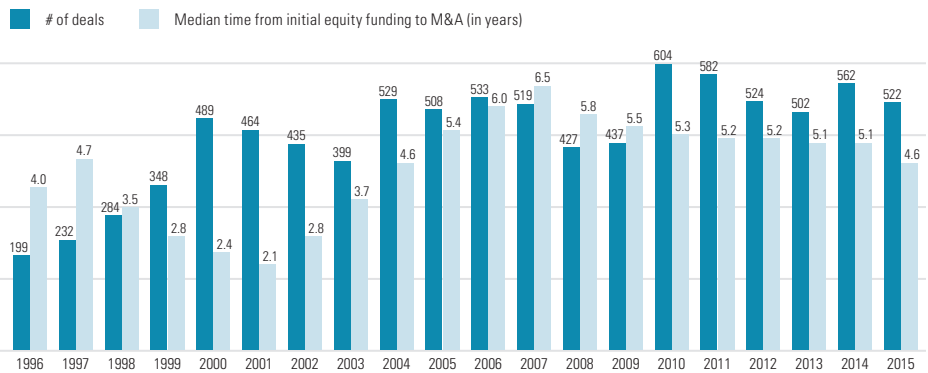
Following six years of consecutive declines, the ratio of M&A transactions to IPOs for venture-backed companies increased from 5.5:1 in 2014 to 8.3:1 in 2015. Despite the increase, the 2015 ratio was at its fourth-lowest level since 2000.

**OUTLOOK**

Financing and liquidity activity in the venture capital market over the coming year will depend on a number of factors. On the heels of a strong 2015, the headwinds of a stalled IPO market, a slowdown in M&A activity and a pullback by crossover investors has created significant uncertainty and begun to depress deal flow and valuations heading into 2016. At the same time, the near-record amount of capital raised by venture capital funds last year, and the resurgence in corporate venture investing, should mean that good companies—especially those whose founders have successful track records—continue to get funded.

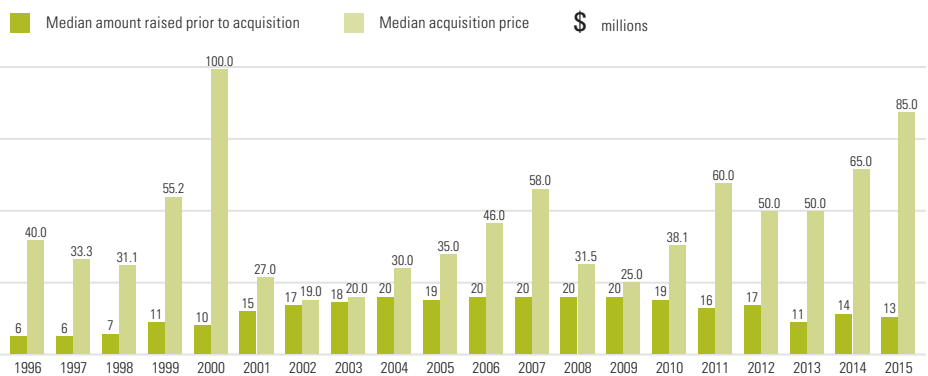
- **Financing Activity:** Venture capital fundraising in 2015 was at its highest since 2007. However, the surge in valuations over the past two years, especially in later-stage rounds, has led to concerns that valuations have become detached from intrinsic values. Recent months have seen crossover investors reassess and write-down the value of many of their investments in “unicorns” (startup companies whose valuations exceed \$1 billion). Financing activity in the early months of 2016 suggests the likelihood of a contraction in deal flow compared to 2015.
- **IPOs:** At the start of 2016, there are almost 150 unicorns, along with other companies that are qualified to pursue

**Acquisitions of US Venture-Backed Companies and Median Time to M&A – 1996 to 2015**



Source: Dow Jones VentureSource

**Median Amount Raised Prior to Acquisition and Median Acquisition Price – 1996 to 2015**



Source: Dow Jones VentureSource

an IPO. Many of these companies have opted for the relative ease of private fundraising and chosen to remain private. Others are likely waiting for more favorable market conditions. The first few months of 2016 have seen the lowest number of IPOs since 2009. With improvements in capital market conditions, deal flow can be expected to resume, although the timing is uncertain.

- **Acquisitions:** Public companies' balance sheets remain strong, and favorable interest rates can help strategic acquirers supplement organic growth through acquisitions. Nonetheless, the level of M&A activity in the coming year will depend in part on the extent of the correction in private company valuations, a process which appears to be underway.

- **Attractive Sectors:** Technology companies leveraging big data to bring new insights to industry should continue to find funding, as should artificial intelligence and cybersecurity companies. Life sciences companies with compelling market opportunities—such as in immuno-oncology and gene therapy—should also continue to attract funding. In addition, SAAS (software-as-a-service) companies and on-demand, “asset-light” businesses should remain popular with investors, and companies deploying novel applications for robotics are attracting investment. Although they have drawn media attention, companies based on the “Internet of Things” or wearable technology may have a harder time getting funded without significant differentiation. ■

## 6 Regional Market Review and Outlook

### CALIFORNIA

California companies reported 1,644 financings in 2015, down 10% from the 1,819 financings in 2014, although the 2015 count is likely understated due to delayed reporting. Driven by a number of very large rounds, total proceeds increased by 23%, from \$32.9 billion in 2014 to \$40.6 billion in 2015, edging out the \$39.3 billion in 2000 as the highest annual gross proceeds figure on record.

In 2015, California-based companies accounted for 49% of all financing rounds in the country raising \$50 million or more, 69% of the nation's \$100 million-plus rounds and all rounds in excess of \$500 million. Overall, California was responsible for 42% of all financing transactions in the country in 2015, down from 44% in 2014.

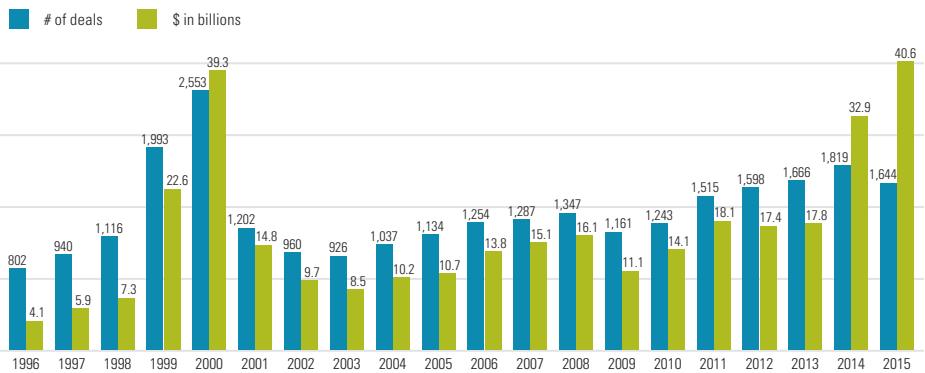
Technology was the largest sector in the state, with 29% of all California financings in 2015, followed by business and financial services (27%), consumer goods and services (25%) and life sciences (14%).

The number of IPOs by California-based VC-backed companies declined by almost one-third, from 44 in 2014 to 30 in 2015—but California offerings still accounted for 48% of all VC-backed IPOs in the nation. California was home to four of the five-largest VC-backed IPOs by US issuers in 2015, led by Fitbit (\$732 million) and Pure Storage (\$425 million).

The number of reported acquisitions of California VC-backed companies declined 18%, from 265 in 2014 to 216 in 2015. The year's largest deals in the state were the \$1.5 billion acquisition of Lynda.com by LinkedIn and the \$1.25 billion acquisition of Flexus Biosciences by Bristol-Myers Squibb.

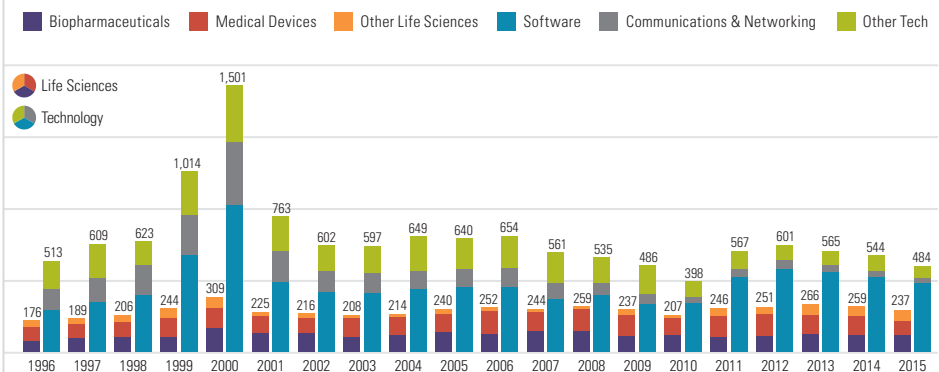
California will undoubtedly maintain its venture capital leadership in the coming year. Financing and liquidity activity in 2016 will largely depend on the level of venture capital fundraising, the degree to which strategic buyers scale back the premiums they are willing to pay, and the timing and extent of improvement in IPO market conditions.

### California Venture Capital Financings – 1996 to 2015



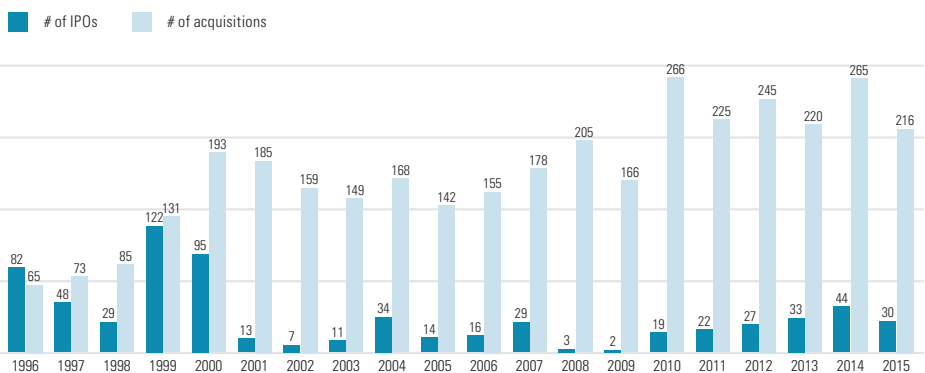
Source: Dow Jones VentureSource

### California Venture Capital Financings by Selected Industry – 1996 to 2015



Source: Dow Jones VentureSource

### California Venture-Backed IPOs and Acquisitions – 1996 to 2015



Source: Dow Jones VentureSource

**MID-ATLANTIC**

With 176 rounds, the number of reported 2015 venture capital financings in the mid-Atlantic region of Virginia, Maryland, North Carolina, Delaware and the District of Columbia matched the 2014 total. After all deals are reported, the region is likely to show a modest increase for the year.

Total gross proceeds in the region doubled from \$1.26 billion in 2014 to \$2.52 billion in 2015—the highest annual gross proceeds figure for the region since the \$2.67 billion in 2001. The number of financing rounds raising \$50 million or more leapt from two in 2014 to nine in 2015.

The region’s largest financings in 2015 were by Tenable Network Security (\$250 million), AvidXchange (\$225 million) and Vox Media (\$200 million). These financings mark the first time in the last four years that the region has produced a deal in excess of \$150 million.

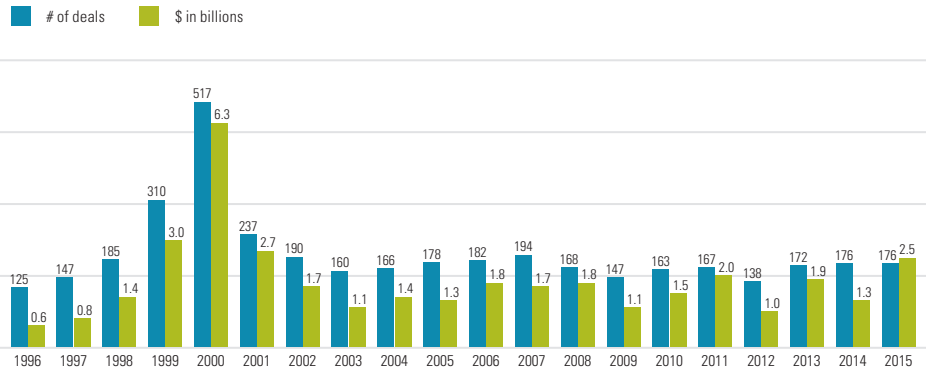
Technology companies accounted for 31% of all mid-Atlantic financings in 2015, followed closely by business and financial services companies (30%) and life sciences companies (25%).

The number of VC-backed IPOs declined from six in 2014 to five in 2015, the largest of which were by Evolent Health (\$196 million) and REGENXBIO (\$139 million). Maryland contributed three IPOs, all by biopharmaceutical companies, while North Carolina and Virginia each produced one technology company IPO.

The number of reported acquisitions of mid-Atlantic VC-backed companies soared by 59%, from 22 in 2015 to 35 in 2015. North Carolina generated 14 deals, followed by Virginia (10), Maryland (9) and the District of Columbia (2). The region’s largest M&A transaction of the year was the \$1.2 billion acquisition of Virtustream by EMC Corporation.

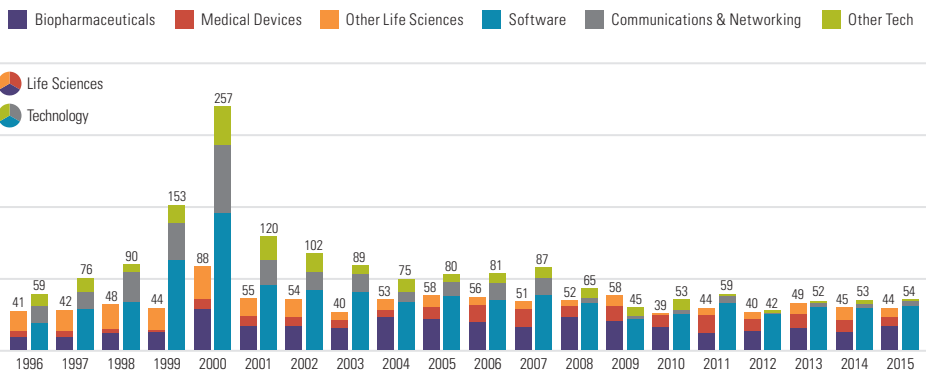
Assuming market conditions are conducive, the mid-Atlantic region appears poised to enjoy continued strength in deal activity in 2016, led by life sciences companies.

**Mid-Atlantic Venture Capital Financings – 1996 to 2015**



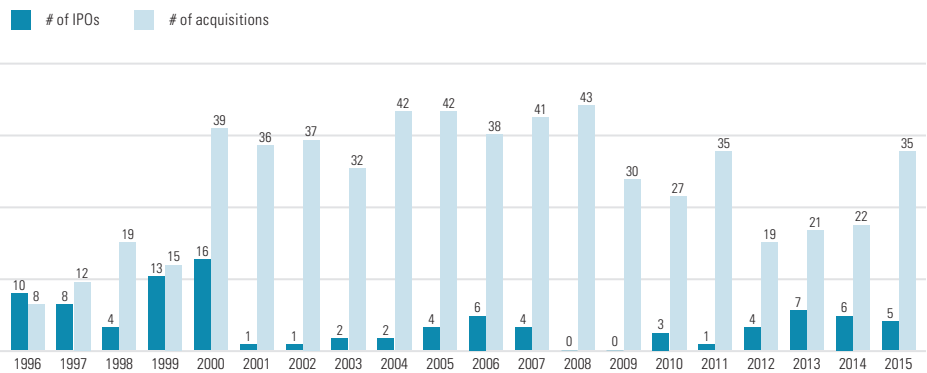
Source: Dow Jones VentureSource

**Mid-Atlantic Venture Capital Financings by Selected Industry – 1996 to 2015**



Source: Dow Jones VentureSource

**Mid-Atlantic Venture-Backed IPOs and Acquisitions – 1996 to 2015**



Source: Dow Jones VentureSource



## NEW ENGLAND

New England companies reported 389 venture capital financings in 2015, up from 381 financings in 2014. Once all deals are accounted for, the 2015 figure is likely to surpass the 402 deals in 2013—the highest annual tally since the 490 in 2001.

Boosted by a spike in the number of large financings—as the number of rounds raising \$50 million or more jumped from 21 in 2014 to 35 in 2015—total gross proceeds for the region increased 34%, from \$5.19 billion to \$6.92 billion. The region's largest financings in 2015 came from Moderna Therapeutics (\$450 million), DraftKings (\$300 million) and Intarcia Therapeutics (also \$300 million).

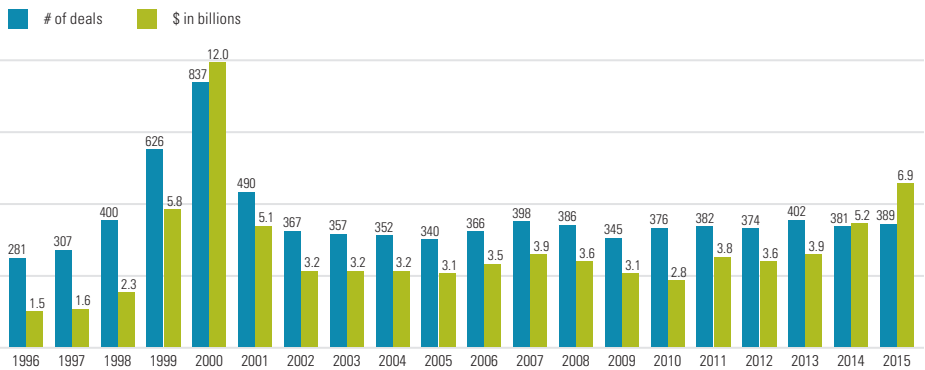
For the seventh consecutive year, the number of financings by life sciences companies outpaced the number of financings by technology companies. The life sciences sector represented 35% of New England's venture capital financings, followed by technology (29%), and business and financial services (22%).

The number of venture-backed IPOs by New England-based companies declined from 25 in 2014 to 12 in 2015. All hailed from Massachusetts, with life sciences companies accounting for all but one. The largest VC-backed IPOs were by Blueprint Medicines (\$147 million) and ConforMIS (\$135 million).

The number of reported acquisitions of VC-backed companies in New England declined 14%, from 63 in 2014 to 54 in 2015, of which Massachusetts contributed 45. The region's largest M&A transaction of the year was the \$400 million acquisition of Cervalis by CyrusOne, followed by the \$312 million acquisition of TEI Biosciences by Integra LifeSciences, and the \$280 million acquisition of Paydiant by PayPal.

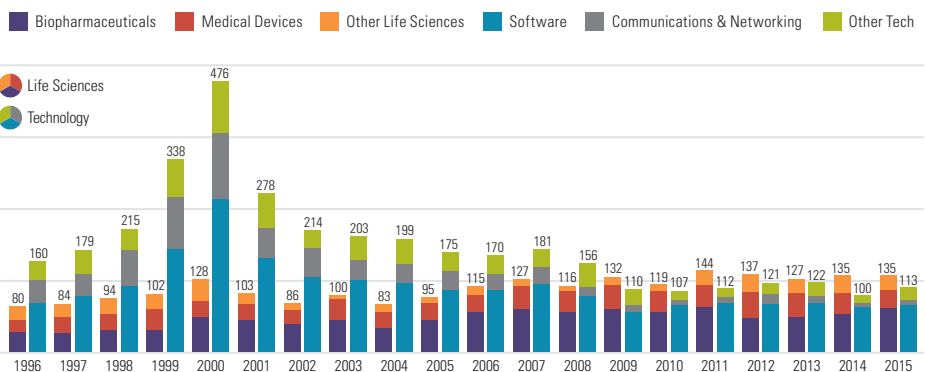
With its concentration of world-renowned universities and research institutions, New England—and Massachusetts in particular—should remain one of the country's most appealing environments for emerging companies and a hub of venture capital and IPO activity during 2016, particularly in the life sciences and technology sectors.

### New England Venture Capital Financings – 1996 to 2015



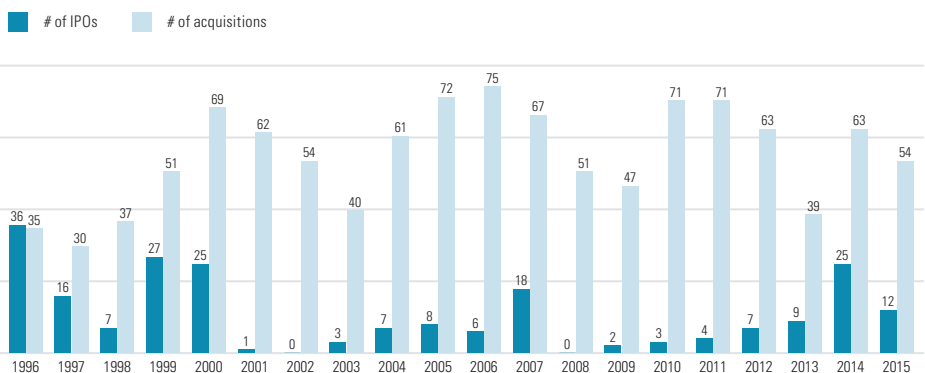
Source: Dow Jones VentureSource

### New England Venture Capital Financings by Selected Industry – 1996 to 2015



Source: Dow Jones VentureSource

### New England Venture-Backed IPOs and Acquisitions – 1996 to 2015



Source: Dow Jones VentureSource

**TRI-STATE**

The number of reported venture capital financings in the tri-state region of New York, New Jersey and Pennsylvania increased 8%, from 520 in 2014 to 561 in 2015. New York led the region with 429 financings in 2015, up from 406 in the prior year, topping Massachusetts for the fourth consecutive year as the nation's second-largest source of VC financings.

Total proceeds in the region increased for the third consecutive year, jumping 40%, from \$6.16 billion in 2014 to \$8.64 billion in 2015—the region's highest tally since 2000. Financing proceeds from New York-based companies, which represented 84% of the region's total, increased 48%, from \$4.89 billion to \$7.26 billion, and surpassed Massachusetts for the second year in a row.

The region's largest financings in 2015 came from WeWork (\$434 million), Jet.com (\$350 million), Oscar Insurance (\$328 million) and FanDuel (\$275 million).

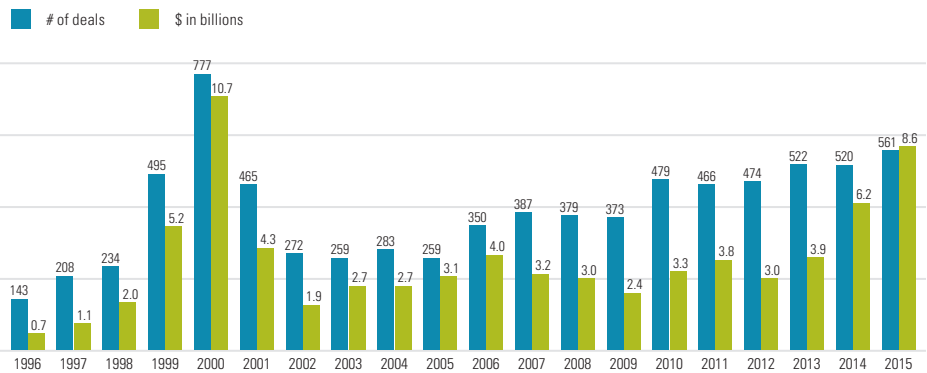
Consumer services companies accounted for the largest share of the tri-state region's VC financing activity in 2015, with 33% of all financings, followed by technology companies with 23% and life sciences companies with 17%—the same proportions as in 2014.

The number of VC-backed IPOs in the tri-state region declined from 12 in 2014 to seven in 2015. Pennsylvania produced three IPOs, with New Jersey and New York each adding a pair. The region's largest VC-backed IPOs were by Etsy (\$267 million) and Spark Therapeutics (\$161 million).

Reported acquisitions of venture-backed companies in the tri-state region increased by one-quarter, from 56 in 2014 to 70 in 2015, but remained below the average of 81 that prevailed over the three-year period preceding 2014. The region's largest deal of 2015 was the \$2.3 billion acquisition of Ikarria by Mallinckrodt, followed by the \$442 million acquisition of Business Insider by Axel Springer.

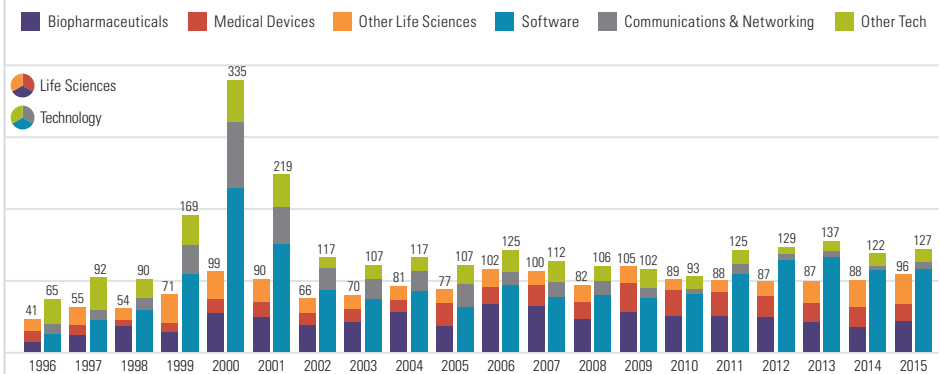
With strength across a broad array of industry sectors, including consumer, technology and life sciences, financing activity in the tri-state region is likely to continue its overall upward trajectory. ■

**Tri-State Venture Capital Financings – 1996 to 2015**



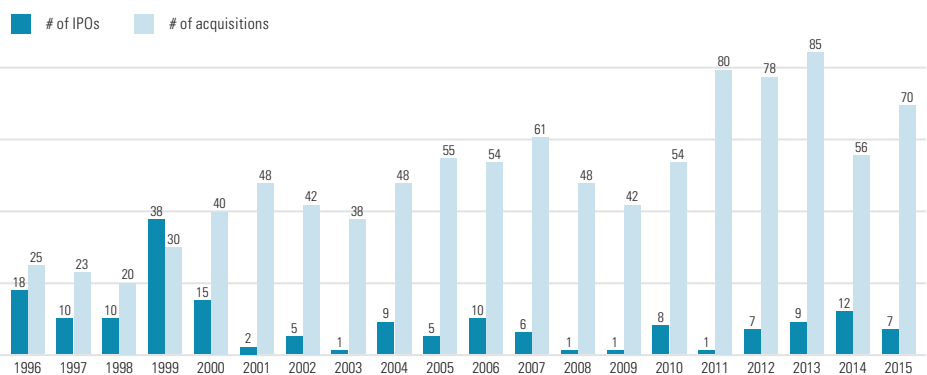
Source: Dow Jones VentureSource

**Tri-State Venture Capital Financings by Selected Industry – 1996 to 2015**




Source: Dow Jones VentureSource

**Tri-State Venture-Backed IPOs and Acquisitions – 1996 to 2015**



Source: Dow Jones VentureSource

## 10 Five Common Mistakes Every Entrepreneur Should Avoid

 Making mistakes is part of the learning curve of launching a startup. Most errors can be fixed without any major impact on your business, but some that seem like no big deal can have serious implications.

Seemingly innocent gaffes can be a red flag to potential investors. In the worst-case scenario, they can cost you so much time and money to fix that they can drag your whole company under. Starting a company is hard, so don't make it even harder on yourself.

Are you at risk of making any of these mistakes?

### **BLOWING OFF PAYROLL**

Before you bring employees on board, you need a payroll system that can handle required employer withholdings and employment taxes as well as make quarterly payments and contributions for Medicare and Social Security. You need signed I-9 forms on file affirming that all workers are cleared to work in the United States. And you need to comply with state and local laws, too. Keep in mind that the company's failure to pay taxes could lead to personal liability for responsible officers of the company.

Startups in New York should note that the state is particularly aggressive when it comes to workers' compensation insurance and has been known to levy fines and penalties in the five figures for failing to purchase mandated coverage.

Consult a CPA or accounting advisor sooner rather than later to avoid payroll problems and an unwelcome letter from the IRS or a state or local tax or regulatory authority.

### **USING UNPAID INTERNS**

Wouldn't it be great if eager college students provided free labor in exchange for the amazing experience of seeing your dynamic startup in action? It's tempting, but don't go there.

Qualifying college students as unpaid interns can be difficult to do. The default rule is that people working for you are

in fact employees. To be an intern, the student must meet several criteria based on applicable law, like working in an educational environment, receiving college credit for working in the startup and not displacing a regular employee. Even if students sign a document affirming that they agree to work without pay and are not claiming to be employees, you're not off the hook.

Wage claims cannot be waived, so unpaid interns can later sue you for back pay if the intern criteria are not met. If they pursue unemployment benefits or a workers' compensation claim, your business's employment records and tax payments can be scrutinized by state and federal agents. The IRS can hit you up for unpaid taxes and impose penalties steep enough to shutter a cash-poor business. Again, responsible officers can be personally liable for unpaid taxes.

Pay your interns minimum wage and treat them as temporary employees. Then you'll have a clean conscience when you send them on a latte run.

### **SELLING UNREGISTERED SECURITIES**

Before you can sell securities (such as stock, SAFEs or convertible notes) to anyone, you must do one of two things: file a registration statement with the US Securities and Exchange Commission with the mandatory disclosures that protect investors, or find an exemption from those requirements. And that's just at the federal level. You must also comply with laws governing the sale of securities in every state where your investors are based, not just where your startup is located. The truth is that startups usually can rely on exemptions at the federal and state level, but finding an exemption requires advance planning.

Fail to qualify for an exemption from registration and investors can legally demand a refund of their investment—money you might have already spent. You could also face fraud charges for failing to disclose adequate information about the sale of unregistered securities. Potential investors will want to understand

to whom the company has sold securities and the exemption on which you relied, so before you offer to sell your securities to your business school buddies, consult a trusted legal advisor to be sure you're complying with applicable securities laws.

### **PAYING EMPLOYEES "LATER"**

Founders sometimes tell us they have a handful of employees who will be "paid" with stock options or who will receive a salary when some funding comes through. Whoa. All workers by law must receive at least minimum wage, or a minimum salary if they are exempt employees.


If at all possible, bring on these early workers as consultants or contractors—and treat them as such by not defining their workday or how they do their job. It's fine to "pay" consultants with stock, but keep in mind just calling a worker a consultant doesn't make the worker a consultant—the worker really needs to meet the legal requirements of a consultant. Remember, the default rule is that workers are employees unless proven otherwise.

### **"BORROWING" MATERIAL**

You need a privacy policy and terms of use for your website. Instead of paying a lawyer to draft these documents, founders sometimes just lift the boilerplate text from their competitor's website. The founders think this saves time and money: since the competitor is engaged in the same line of business as the founders' company, they figure if they just copy the competitor's website they'll be covering everything that needs to be covered on their own website.

We know an entrepreneur who tried this. He came to see us after he received a nasty letter from his competitor's attorney threatening legal action if he didn't immediately take down the pirated text. He learned that copyright law protects even dull legal jargon when it's published in most media, and that copying the content created by someone else without that person's permission violates copyright law.

Bite the bullet and pay for legal advice before you get into trouble. Or prepare to pay more to dig yourself out later. ■

 Since the 1849 gold rush, California has had a reputation as a great place to seek—and find—your fortune. The Golden State is home to the Golden Gate Bridge, the Golden State Warriors and, in Silicon Valley, golden opportunities. But, as you might suspect from a state with a pioneering mentality and history, California sometimes operates like its own country, with laws that aren't like anyone else's.

Here are four areas where California law puts a unique twist on business. If you're running a startup here, or if you're thinking of doing so, you'll need to pay close attention to these quirks.

## IT'S ALL ABOUT THE EQUITY

Out-of-state startups eager to enter the California marketplace are often surprised by the perks that Silicon Valley workers want. Employees have little interest in old-school employee benefits. But stock options? Bring 'em on. (You can earn bonus points by providing a gourmet cafeteria and well-equipped fitness center.)

It's common in Silicon Valley to grant options or shares to advisors, early employees and key contributors. Many want to cash out and use the proceeds to help buy a home or just pay the rent in the country's most costly real estate market.

California is one of the few states that regulate filing requirements for stock plans. The state can levy fines on companies that fail to comply with its onerous regulations. Founders must also abide by federal regulations, including arcane tax rules requiring that deferred compensation be paid by March 15 of the following calendar year, although stock options granted at fair market value are exempt. This clearly isn't something you want to puzzle out on your own. Consult legal and valuation experts to be sure you're not running afoul of either California or federal law. Or both.

## GOODBYE COLLEAGUE, HELLO COMPETITION

So many potentially brilliant ideas are erupting in Silicon Valley that it's no wonder this area is prone to earthquakes. Smart and ambitious people think big, and sometimes those big thoughts happen while they're working for someone else—like you.

Unlike many other states, California law generally bars post-employment non-compete agreements. The state considers non-competes to be against public policy and ultimately unenforceable, except in narrow circumstances, so there's really nothing you can do to prevent your employees from jumping ship and signing on with your biggest competitor.

You also can't stop employees from leaving to launch their own businesses, even in the same space as yours, provided they haven't hijacked your intellectual property or trade secrets to do so. Of course, on their first day of work, you did have employees sign over to the company all rights to anything developed on the job, right?

One strategy that offers some defense against competitors who rise from your ranks is to insist that employees sign a non-compete agreement that is enforceable in states that permit it. This could deter a subset of your team from setting up shop in Austin or Boston, because Texas and Massachusetts are less restrictive with respect to non-competes.

## FREE LABOR, COSTLY PROBLEMS

California has always spawned exciting innovations, from surfboards to computers. Tech companies large and small are deluged with requests from college students who want to breathe that heady startup air. They're so eager for the experience that they're willing to "intern" for free. It's tempting to take advantage of that kind of enthusiastic workforce, especially in costly California. The state's minimum wage rose from \$9 to \$10 an hour on January 1, and the minimum wage in San Francisco increases from \$12.15 to \$13 on July 1.

College students and new grads may insist they're thrilled to work as unpaid interns, but you must proceed with caution. If interns are doing routine office tasks, you must pay them the mandated minimum wage. If they're getting college credit for skilled work—think beta-testing software or developing a marketing campaign—you should have them acknowledge that they know they are not employees and won't claim to be. Unfortunately, even this precaution is no guarantee against being sued later for back pay.

Protect your company's interests by requiring all interns to sign an agreement affirming that everything they invent or develop during their time with you belongs to your company alone.

## SELLING OUT

To top it off, the California Corporations Code, through its so-called "quasi-California" corporation statute, purports to impose various California corporate law requirements on corporations incorporated in other states, including Delaware, if specified tests are met. This can make a difference when it comes time to sell your company.

California law is more liberal than Delaware law in the timing of stockholder written consents to approve a company sale. However, California requires that all shares of the same class or series be "treated equally with respect to any distribution of cash, rights, securities, or other property" unless all holders of the class or series consent otherwise. This requirement is stricter than the comparable rules in Delaware, which have been interpreted—at least in some cases—to allow different forms of payment to be made to different holders of the same class of stock.




















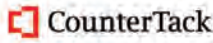












California law also requires that the principal terms of a merger be approved by the holders of a majority of each class of outstanding shares. Therefore, the holders of any class of outstanding shares—including common stock, which generally is controlled by founders and employees—can block a merger even if they hold less than a majority of the outstanding shares of the target. In contrast, Delaware law does not mandate any such class voting.

Some of these differences can impede quick and easy exits. On the other hand, California also offers something not available in Delaware or most other states, if the buyer is issuing shares to the target's shareholders: a "fairness hearing," which can provide a relatively efficient and inexpensive alternative to SEC registration that still results in essentially freely tradable stock. This avenue usually makes more sense for publicly held buyers than for privately held buyers, who may want to create a trading market for their shares. ■

# Counsel of Choice for Venture Capital Financings

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

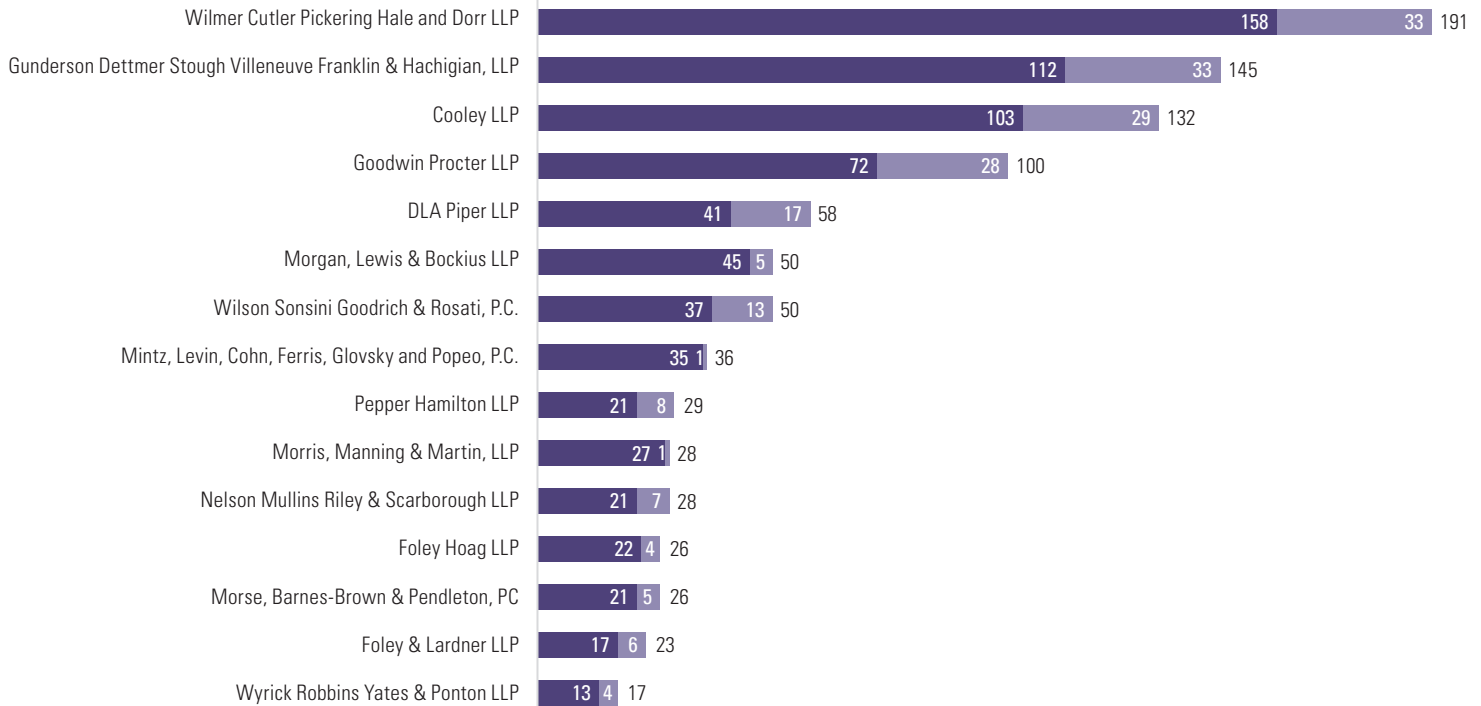


 \$135,000,000 <i>Fourth Round</i> May 2015	 \$5,000,000 <i>First Round</i> December 2015	 \$47,000,000 <i>Fourth Round</i> December 2015	 \$48,000,000 <i>First Round</i> July 2015	 \$90,000,000 <i>Second Round</i> December 2015	 \$10,000,000 <i>First Round</i> July 2015	 \$20,000,000 <i>Fourth Round</i> January 2015	 \$217,000,000 <i>First Round</i> May 2015	
 \$22,000,000 <i>Third Round</i> January 2015	 \$55,000,000 <i>Late Stage</i> December 2015	 \$40,000,000 <i>Fourth Round</i> June 2015	 €42,100,000 <i>Third Round</i> April 2015	 \$10,500,000 <i>Second Round</i> November 2015	 \$28,000,000 <i>Fourth Round</i> April 2015	 \$25,000,000 <i>Third Round</i> October 2015	 \$40,000,000 <i>Late Stage</i> January 2016	 \$50,000,000 <i>Late Stage</i> February 2015
 \$16,000,000 <i>Second Round</i> May 2015	 \$5,000,000 <i>First Round</i> April 2015	 \$15,000,000 <i>Third Round</i> June 2015	 \$120,000,000 <i>Second Round</i> August 2015	 \$7,200,000 <i>Second Round</i> December 2015	 \$5,000,000 <i>First Round</i> December 2015	 \$24,000,000 <i>Second Round</i> March 2015	 \$15,000,000 <i>Fourth Round</i> August 2015	
 \$31,500,000 <i>Late Stage</i> June 2015	 \$70,000,000 <i>Fourth Round</i> January 2015	 \$22,000,000 <i>Late Stage</i> October 2015	 \$12,000,000 <i>First Round</i> October 2015	 \$28,000,000 <i>Fourth Round</i> June 2015	 \$34,000,000 <i>Fourth Round</i> August 2015	 \$20,000,000 <i>Late Stage</i> May 2015		

# 14 Law Firm Rankings – Eastern US

## Counsel to Eastern US Technology and Life Sciences Companies Receiving VC Financing – 2008 to 2015

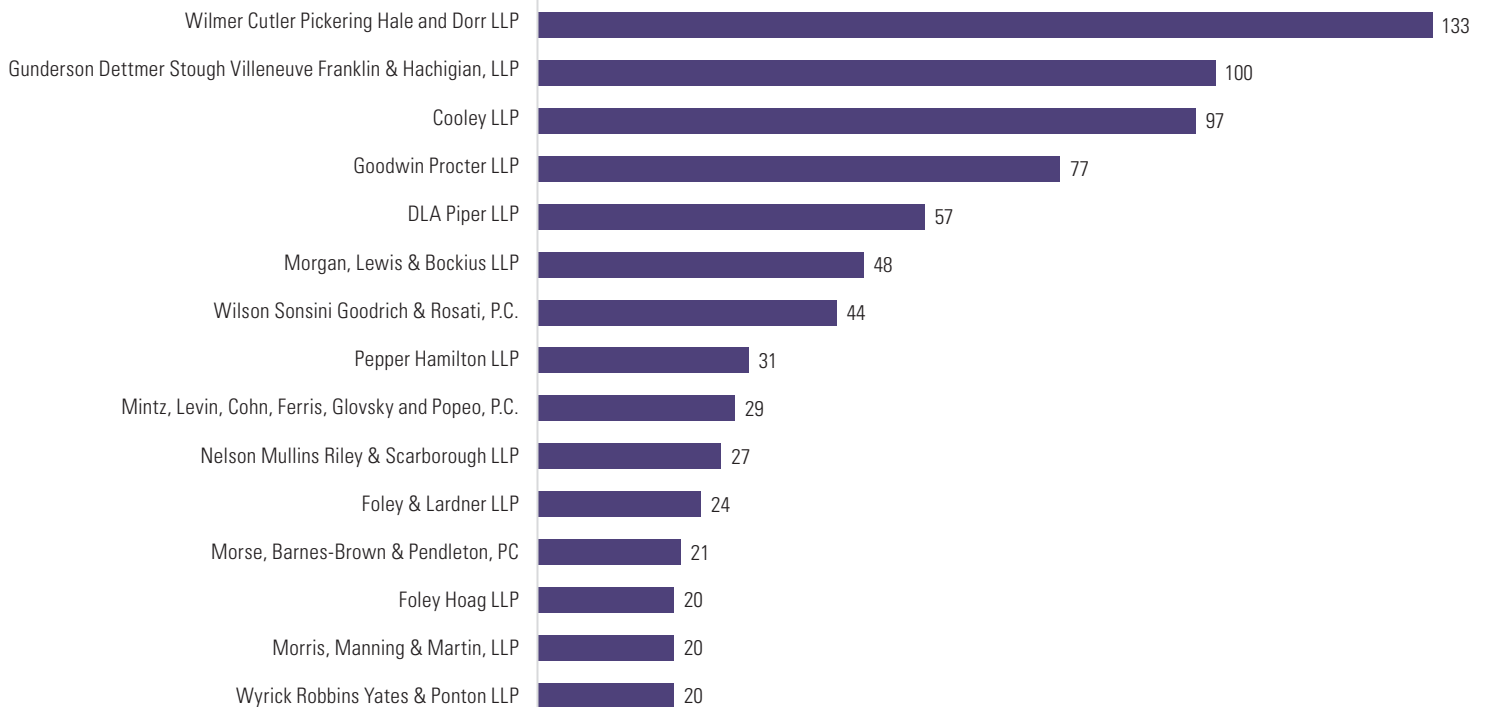
2008–2015 2015



The above chart is based on companies located east of the Mississippi River that completed a seed, first, second, later-stage or restart round of venture capital financing between 2008 and 2015.

Source: Dow Jones VentureSource

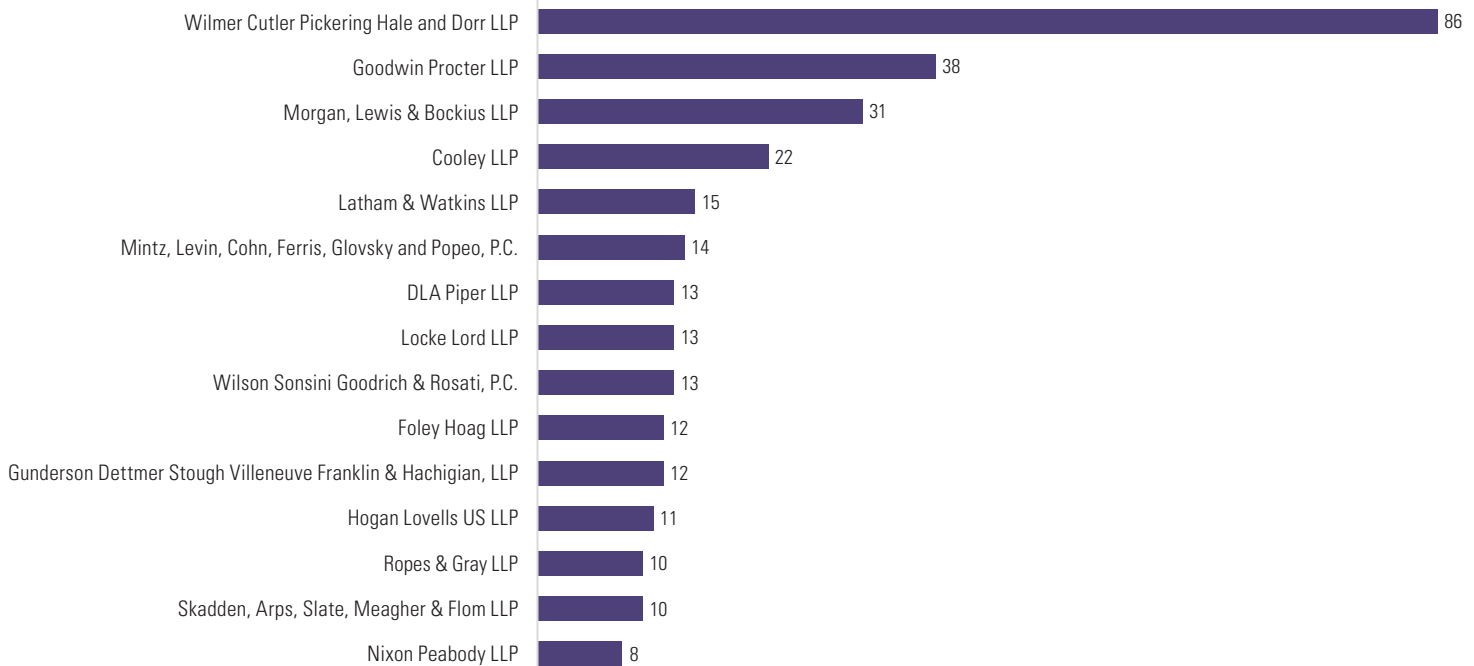
## Counsel to Eastern US VC-Backed Technology and Life Sciences Companies at Year-End 2015



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 2015.

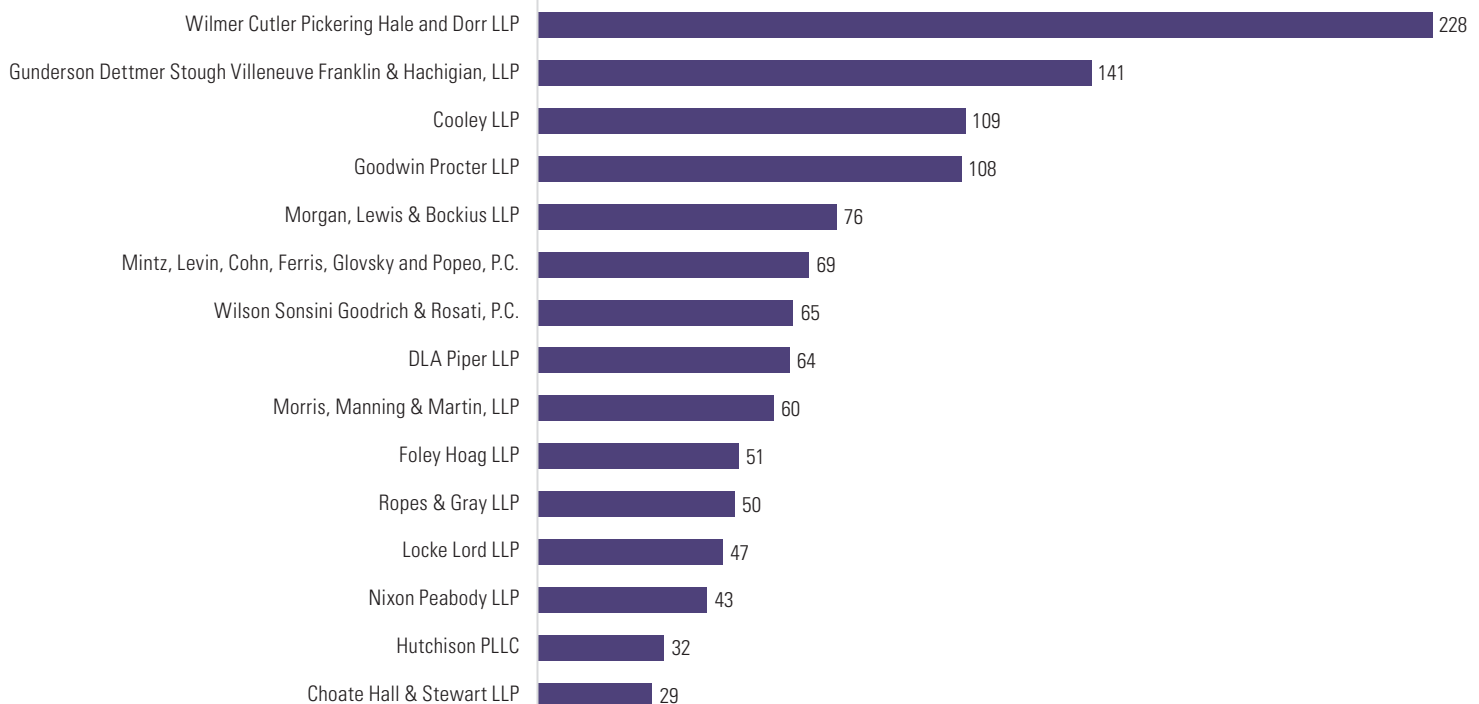
Source: Dow Jones VentureSource

**Company Counsel in Eastern US VC-Backed IPOs – 1996 to 2015**



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

**Counsel in Sales of Eastern US VC-Backed Companies – 1996 to 2015**



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

## REVIEW

The European venture capital market produced strong results in 2015, particularly as measured by financing proceeds.

The number of reported venture capital financings declined 2%, from 1,634 in 2014 to 1,598 in 2015. Once all transactions have been reported, however, the 2015 tally should approach or pass the 1,734 financings recorded in 2013—the high-water mark since the 2,806 in 2001. Gross proceeds soared 54%, from €8.43 billion in 2014 to €12.96 billion in 2015—the highest annual gross proceeds since the €22.26 billion in 2000.

The median size of all European venture capital financings increased 22%, from €1.8 million in 2014 to €2.2 million in 2015. The median size of first-round financings increased by 41%, from €1.2 million to €1.7 million, while the median second-round financing size remained steady at €3.0 million. The median size of later-stage financings jumped from €6.0 million in 2014 to €10.0 million in 2015.

In 2015, consumer information services companies represented 28% of all European venture capital financings and 35% of gross proceeds. With a larger median financing size, companies in the life sciences sector produced 25% of the year's proceeds, while accounting for only 16% of all financings.

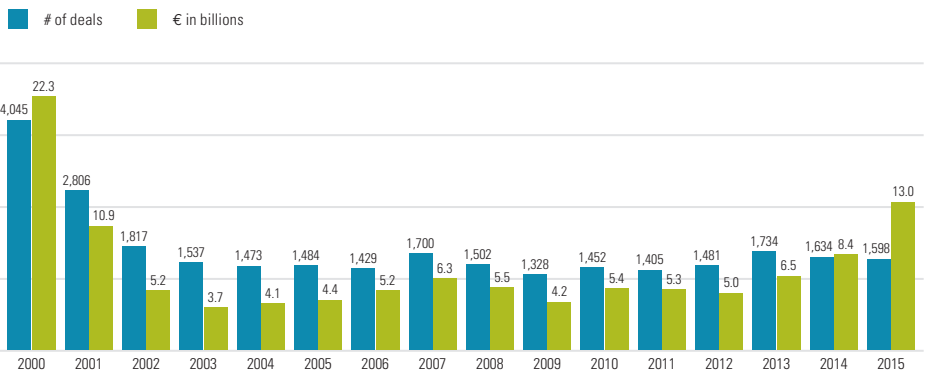
The United Kingdom generated 25% of Europe's venture capital financings and 33% of all gross proceeds in 2015, well ahead of Germany (21% of financings and 20% of proceeds) and France (17% of financings and 13% of proceeds).

The number of IPOs by European venture-backed companies declined by 13%, from 55 in 2013 to 48 in 2015, but still represented the second-highest annual figure since 2006. Acquisitions of European VC-backed companies slipped 3%, from 220 to 213.

## OUTLOOK

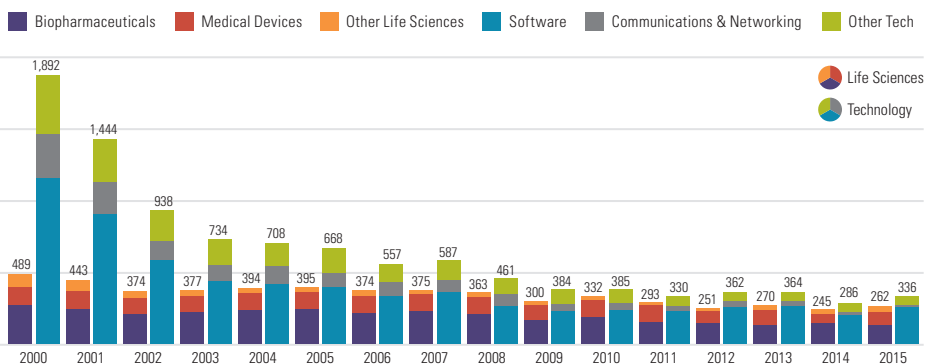
European venture-backed companies enjoyed favorable levels of financing and liquidity activity in 2015. The outlook for the coming year appears promising, unless the market is slowed by continuing macroeconomic challenges. ■

## European Venture Capital Financings – 2000 to 2015



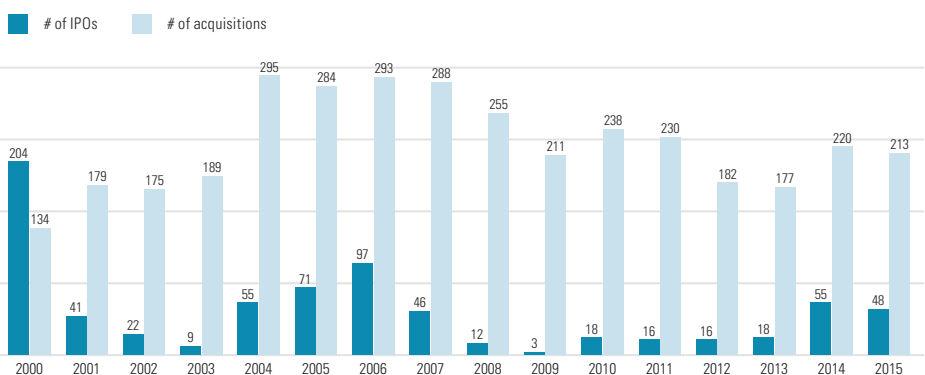
Source: Dow Jones VentureSource

## European Venture Capital Financings by Selected Industry – 2000 to 2015



Source: Dow Jones VentureSource

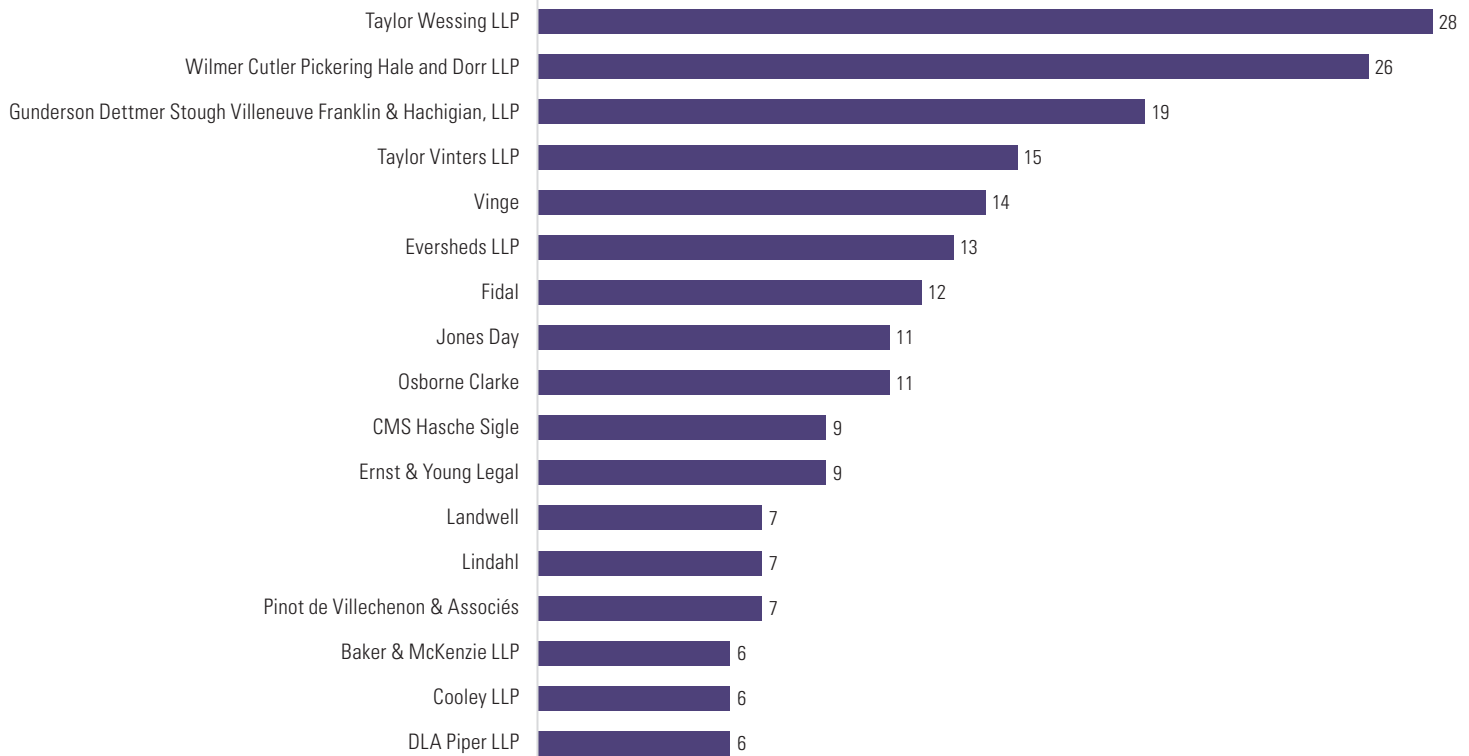
## European Venture-Backed IPOs and Acquisitions – 2000 to 2015



Source: Dow Jones VentureSource

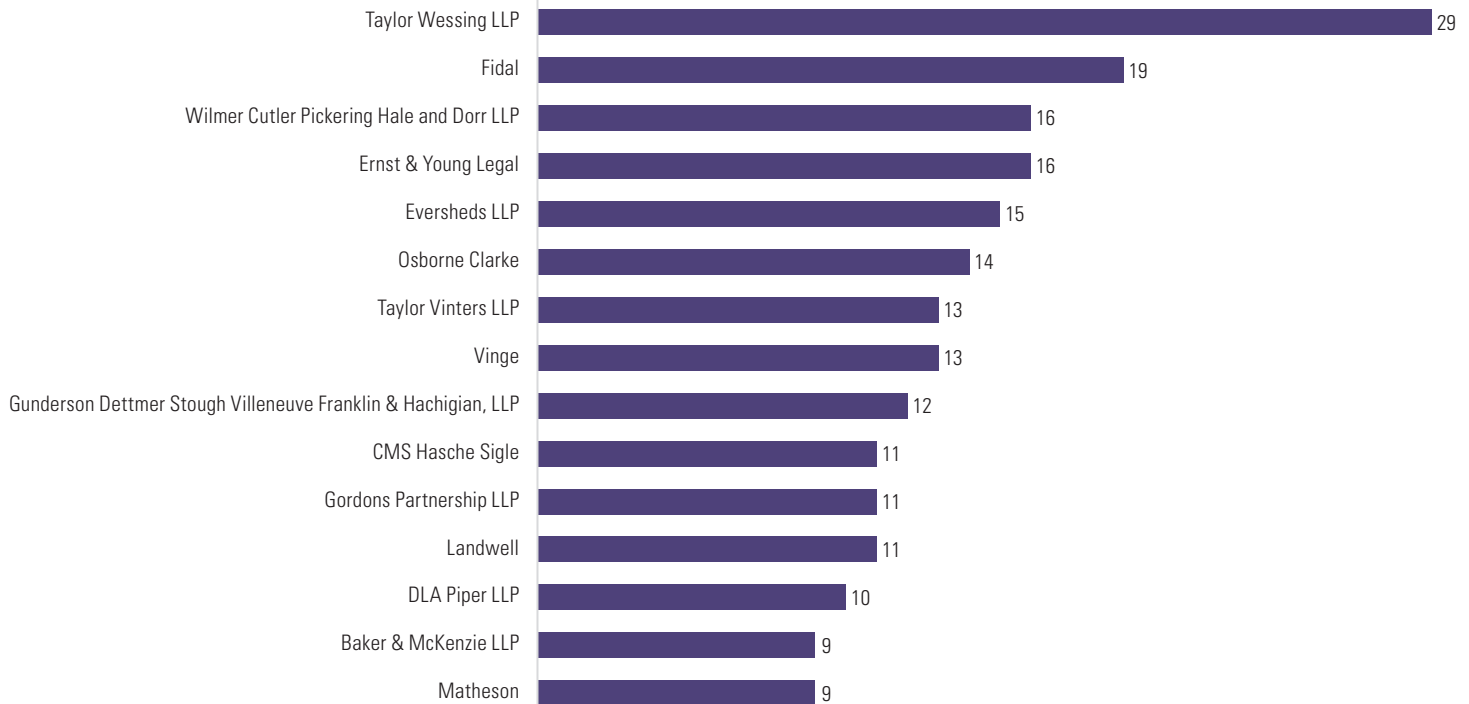


**Counsel to European Technology and Life Sciences Companies Receiving VC Financing – 2008 to 2015**



*The above chart is based on European companies that completed a seed, first, second, later-stage or restart round of venture capital financing between 2008 and 2015. Source: Dow Jones VentureSource*

**Counsel to European VC-Backed Technology and Life Sciences Companies at Year-End 2015**



*The above chart is based on European VC-backed companies that were private and independent as of the end of 2015. Source: Dow Jones VentureSource*

## 18 Pre-IPO Financing Toolkit Expands

 Startup companies routinely rely on exemptions from the registration requirements of the Securities Act to complete private placements of securities. As a result of the JOBS Act, the principal exemption historically relied upon (Regulation D) was amended to permit general solicitation and advertising in selected offerings. In addition, two new alternatives—one primarily directed to early-stage companies (crowdfunding) and one of greater appeal to later-stage companies (an expanded Regulation A)—were recently added to the pre-IPO financing toolkit. Although adopted pursuant to the JOBS Act, the new rules are not limited to offerings by emerging growth companies. None of the exemptions are available to companies disqualified under the SEC’s “bad actor” rules or specified types of non-operating companies.

### REGULATION D

Regulation D, which has existed for more than 30 years, is available to both US and foreign companies, whether privately or publicly held. Regulation D consists of three separate rules (Rules 504, 505 and 506). Rule 506 is generally considered the most flexible and useful because offerings pursuant to it are not subject to limits on size, investment amounts or the number of accredited investors, or specific disclosure requirements (unless the offering includes unaccredited investors). “Accredited investors” are high-income or high-net-worth individuals, entities satisfying specified standards, and certain other investors.

Since its adoption, Regulation D prohibited general solicitation and advertising in connection with private placements conducted pursuant to Regulation D. The JOBS Act required the SEC to eliminate this prohibition in private placements under Rule 506 (but not placements under Rule 504 or Rule 505), provided that all purchasers are accredited investors.

Effective September 23, 2013, the SEC adopted new paragraph (c) to Rule 506 to permit general solicitation and general advertising in private placements conducted pursuant to Rule 506 if the company takes reasonable steps to verify that all purchasers are accredited investors; each purchaser is (or the company reasonably believes that each purchaser is) an accredited

investor; and all other applicable terms and conditions of Regulation D are satisfied. Pre-existing Rule 506(b) remains available for offerings conducted without general solicitation or advertising. Although, to date, Rule 506(c) has been used far less frequently than Rule 506(b), the popularity of offerings involving general solicitation or advertising under Rule 506(c) is likely to grow as companies become more familiar and comfortable with Rule 506(c).

### REGULATION CROWDFUNDING

In a “crowdfunding” financing, a company uses the Internet to seek small investments from a large number of investors. Prior to the enactment of the JOBS Act, securities could not be sold in crowdfunding transactions except pursuant to registration or an existing exemption from registration. Subject to SEC rulemaking, the JOBS Act created a new exemption that permits private US companies, without Securities Act registration, to publicly offer and sell securities in crowdfunding transactions raising up to \$1 million within any 12-month period.

In October 2015, the SEC adopted rules to implement the crowdfunding provisions of the JOBS Act. The rules (referred to as “Regulation Crowdfunding”) will become effective on May 16, 2016. Crowdfunding is subject to the following requirements:

- **Eligibility:** Crowdfunding is available to US companies that are not Exchange Act reporting companies.
- **Maximum Offering Size:** Within any 12-month period, the maximum offering size for crowdfunding transactions is \$1 million.
- **Investor Limits:** The maximum amount an investor may invest in any crowdfunded offerings in a 12-month period is equal to:
  - the greater of \$2,000 or 5% of the annual income or net worth of the investor, if both the annual income and net worth of the investor are less than \$100,000; or
  - 10% of the annual income or net worth of the investor, not to exceed a maximum aggregate investment of \$100,000 by the investor, if either the annual income or net

worth of the investor is equal to or more than \$100,000.

To determine the investment limit for a natural person, the person’s annual income and net worth may be calculated jointly with the annual income and net worth of the person’s spouse.

- **Mandatory Use of Intermediary:** An intermediary—either a registered broker-dealer or a “funding portal”—must be used to effect crowdfunding transactions through an Internet website. The intermediary must register with the SEC; ensure that investors understand the risks of the investment; conduct a background check on each officer, director and 20% stockholder of the company; and make sure that no investment limits are exceeded.
- **Disclosure Requirements:** The company must prepare and file with the SEC, and provide to investors and the intermediary, an offering statement on Form C that includes specified information regarding:
  - the company, including its business, management, related-person transactions, ownership, capital structure, indebtedness, financial condition, risk factors and exempt offerings conducted within the past three years;
  - the offering, including the target offering amount and deadline, the intended use of the proceeds, the price and terms of the securities being offered, and offering and cancellation procedures; and
  - the intermediary’s financial interests in the company and the offering, including the amount of compensation to be paid to the intermediary.
- **Financial Statements:** The Form C must also include, for the company’s two most recent fiscal years, financial statements that have been:
  - certified by the company’s CEO, for offerings of \$100,000 or less;
  - reviewed (but not audited) by an independent public accountant, for offerings of more than \$100,000 but not more than \$500,000; and

### Comparison of Private Offering Exemptions

Below is a high-level comparison of selected aspects of the exemptions from registration under Regulation D, Regulation Crowdfunding and Regulation A+.

	REGULATION D		REGULATION CROWDFUNDING	REGULATION A+	
	RULE 506(b)	RULE 506(c)		TIER 1	TIER 2
Eligibility	Any company not otherwise disqualified	Any company not otherwise disqualified	Non-reporting US companies not otherwise disqualified	Non-reporting US and Canadian companies not otherwise disqualified	Non-reporting US and Canadian companies not otherwise disqualified
Maximum offering size	Unlimited	Unlimited	\$1 million in any 12-month period	\$20 million in any 12-month period	\$50 million in any 12-month period
Maximum per-investor dollar amount	Unlimited	Unlimited	Up to \$100,000, depending on investor's annual income and net worth	Unlimited	Accredited investors: unlimited Unaccredited investors: 10% of annual income or net worth Entities: 10% of annual revenue or net assets
Maximum number of investors	Accredited investors: unlimited Unaccredited investors: 35	Unlimited	Unlimited	Unlimited	Unlimited
Nature of investors	No restrictions, except unaccredited investors must be financially sophisticated	Accredited investors only	No restrictions	No restrictions	No restrictions
Intermediary	Not required	Not required	Required	Not required	Not required
Investor solicitation	General solicitation and advertising not permitted	General solicitation and advertising permitted	Permitted through intermediary's portal and limited other advertising	"Testing-the- waters" permitted	"Testing-the- waters" permitted
Disclosure requirements	If unaccredited investors participate, specified information and financial statements must be provided Otherwise, no specific requirements	No specific requirements	Offering statement required	Offering statement required	Offering statement required
Financial statements			Must be certified by CEO or reviewed or audited by independent public accountant (depending on offering size and other factors)	Need not be audited	Must be audited
SEC filings (public disclosure)	Form D (publicly discloses offering size but not valuation or disclosure materials)	Form D (publicly discloses offering size but not valuation or disclosure materials)	Form C (publicly discloses offering statement, financial statements and offering terms)	Form 1-A (publicly discloses offering statement, financial statements and offering terms)	Form 1-A (publicly discloses offering statement, financial statements and offering terms)
Ongoing reporting obligations	None	None	Annual updates to offering statement and financial statements	None	Annual reports, semi-annual reports and current event reports
Resales of securities	Restricted for one year	Restricted for one year	Restricted for one year	Unrestricted, except by company affiliates	Unrestricted, except by company affiliates
State registration	Exempt	Exempt	Exempt	Not exempt	Exempt

## 20 Pre-IPO Financing Toolkit Expands

- reviewed (but not audited) by an independent public accountant, for offerings of more than \$500,000 (except the financial statements must be audited if not the company's first crowdfunded offering).
- **Updates and Progress Reports:** The company must update its Form C to disclose material changes. The company must also disclose (either through SEC filings or on the intermediary's platform) its progress in meeting the target offering amount. Within five business days after the offering, the company must file a Form C-U with the SEC to report the total offering proceeds.
- **Offering Timeline:** Offerings must be held open for at least 21 days and potential investors can cancel an investment commitment until 48 hours prior to the offering deadline.
- **Investor Solicitation:** The company may communicate with investors about itself and the offering through the intermediary's platform. Advertisements must be limited to a statement that the company is conducting an offering, the name of the intermediary through which the offering is being conducted and a link to its platform, the terms of the offering, contact information for the company, and a brief description of the company's business. Any promoter must disclose the receipt of compensation in each promotional communication.
- **Reporting Obligations:** Following completion of a crowdfunding transaction, the company must, within 120 days after the end of each fiscal year, post on its website and file with the SEC an annual report updating most of the information contained in its original Form C. This reporting obligation generally lasts until the company registers as a reporting company under the Exchange Act.
- **Resale Limitations:** Investors may not resell securities purchased in crowdfunding transactions for one year except to the company, to an accredited investor, to family members, in connection with death or divorce, or as part of an SEC registered offering.

### REGULATION A+

Unlike the creation of the crowdfunding exemption, which was entirely new, the JOBS Act sought to revitalize Regulation A, which has existed since the dawn of federal securities regulation. Regulation A provides an exemption from registration for small public offerings but had been seldom used in recent years, partly due to the \$5 million maximum offering size. The JOBS Act sought to address the perceived limitations in Regulation A, effectively creating a new exemption dubbed "Regulation A+."

In March 2015, the SEC adopted rules creating two tiers of Regulation A+ offerings, with different offering caps, disclosure requirements and ongoing reporting obligations:

- Tier 1 offerings may raise up to \$20 million, including no more than \$6 million offered by selling stockholders, in a 12-month period; and
- Tier 2 offerings may raise up to \$50 million, including no more than \$15 million offered by selling stockholders, in a 12-month period.

For offerings up to \$20 million, the company may elect whether to proceed under Tier 1 or Tier 2.

#### Provisions Applicable to Both Tier 1 and Tier 2 Offerings

- **Eligibility:** Regulation A+ is available to US and Canadian companies that are not Exchange Act reporting companies.
- **Disclosure Requirements:** Offerings under Regulation A+ are made pursuant to an offering statement that includes basic information about the company, including its business, management, compensation, related-person transactions, ownership, capital structure, MD&A and risk factors, and about the offering, including use of proceeds, selling stockholders, the securities being offered and the plan of distribution.
- **Financial Statements:** The offering statement must include balance sheets as of the company's two most recent fiscal year-ends and other financial statements not older than nine months.
- **SEC Filing and Review:** Offering statements must be filed with the

SEC (on Form 1-A) and are subject to SEC review. Companies may submit draft offering statements for non-public SEC review prior to filing.

- **Resales:** Securities sold pursuant to Regulation A+ are freely transferable, except by affiliates of the company.
- **Investor Solicitation:** The company may solicit investor interest using written "testing-the-waters" materials filed with the SEC.

#### Provisions Applicable Only to Tier 2 Offerings

- **Investor Limits:** Investors that do not qualify as accredited investors are limited to purchasing no more than 10% of the greater of the investor's annual income or net worth (for an entity, the limit is 10% of the greater of the entity's annual revenue or net assets at fiscal year-end).
- **Financial Statements:** The financial statements included in the offering statement and annual reports must be audited.
- **Periodic Reporting Requirements:** The company is required to file annual reports, semi-annual reports and current event reports with the SEC that are similar to the requirements for public company reporting under the Exchange Act.

### PRACTICAL TAKEAWAYS

Due to the disclosure, financial statement and ongoing reporting requirements of the crowdfunding exemption, its practical utility may be limited, particularly for pre-IPO companies whose capital needs significantly exceed the \$1 million maximum. Although the maximum size of a Regulation A+ offering has been substantially increased, an offering under Tier 2 imposes limits on the amount of securities that may be sold to unaccredited investors and requires audited financial statements and ongoing public reporting. As a result, pre-IPO companies may find that the use of Regulation D—either under new Rule 506(c) permitting general solicitation but limited to accredited investors, or under good old Rule 506(b) prohibiting general solicitation but not limited to accredited investors—has more appeal than the new exemptions. ■

# Trends in VC-Backed Company M&A Deal Terms 21

 We reviewed all merger transactions between 2008 and 2015 involving venture-backed targets (as reported in Dow Jones VentureSource) in which the merger documentation was publicly available and the deal value was \$25 million or more.

Based on this review, we have compiled the following deal data:

Characteristics of Deals Reviewed	2008	2009	2010	2011	2012	2013	2014	2015
<b>Sample Size</b>	25	15	17	51	26	27	37	27
<b>Cash</b>	76%	60%	71%	73%	73%	59%	59%	67%
<b>Stock</b>	4%	0%	6%	4%	8%	8%	3%	4%
<b>Cash and Stock</b>	20%	40%	23%	23%	19%	33%	38%	29%
<b>Deals with Earnout</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
<b>With Earnout</b>	12%	27%	29%	29%	31%	33%	30%	26%
<b>Without Earnout</b>	88%	73%	71%	71%	69%	67%	70%	74%
<b>Deals with Indemnification</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
<b>With Indemnification</b>								
By Target's Shareholders	96%	100%	100%	98%	100%	100%	97%	100%
By Buyer	48%	36%	17%	43%	62%	44%	49%	69%
<b>Survival of Representations and Warranties<sup>1</sup></b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2014</b>
<b>Shortest</b>	12 Mos.	6 Mos.	9 Mos.	12 Mos.	10 Mos.	12 Mos.	12 Mos.	12 Mos.
<b>Longest</b>	24 Mos.	18 Mos.	21 Mos.	24 Mos.	24 Mos.	30 Mos.	24 Mos.	24 Mos.
<b>Most Frequent</b>	12 Mos.	18 Mos.	18 Mos.	18 Mos.	18 Mos.	18 Mos.	12 & 18 Mos. (tie)	18 Mos.
<b>Caps on Indemnification Obligations</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2014</b>
<b>With Cap</b>	95%	100%	100%	100%	100%	100%	100%	100%
Limited to Escrow	81%	71%	71%	77%	81%	88%	89%	79%
Limited to Purchase Price	14%	0%	6%	2%	0%	0%	0%	0%
Exceptions to Limits <sup>2</sup>	62%	71%	94%	96%	96%	100%	100%	100%
<b>Without Cap</b>	5%	0%	0%	0%	0%	0%	0%	0%
<b>Escrows</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
<b>With Escrow</b>	96%	93%	100%	94%	100%	93% <sup>3</sup>	97%	93%
<b>% of Deal Value</b>								
Lowest <sup>4</sup>	3%	10%	2%	5%	5%	5%	2%	4%
Highest	15%	15%	25%	31%	16%	20%	16%	16%
Most Frequent	10%	10%	10%	10%	10%	10%	10%	10%
<b>Length of Time</b>								
Shortest	12 Mos.	12 Mos.	9 Mos.	12 Mos.	10 Mos.	12 Mos.	12 Mos.	12 Mos.
Longest	36 Mos.	18 Mos.	36 Mos.	36 Mos.	48 Mos.	30 Mos.	24 Mos.	36 Mos.
Most Frequent	12 Mos.	12 & 18 Mos. (tie)	18 Mos.	18 Mos.	12 Mos.	18 Mos.	12 Mos.	12 & 18 Mos. (tie)
<b>Exclusive Remedy</b>	83%	46%	53%	78%	73%	60%	86%	63%
<b>Exceptions to Escrow Limit Where Escrow Was Exclusive Remedy<sup>8</sup></b>	85%	83%	80%	97%	100%	100%	100%	100%
<b>Baskets for Indemnification</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
<b>Deductible<sup>5</sup></b>	43% <sup>6</sup>	43%	56%	38%	27%	50%	44%	31%
<b>Threshold<sup>5</sup></b>	48% <sup>6</sup>	57%	44%	60%	65%	42%	56%	61%
<b>MAE Closing Condition</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
<b>Condition in Favor of Buyer</b>	88%	100%	100%	98%	95%	100%	97%	100%
<b>Condition in Favor of Target</b>	21%	20%	19%	15%	9%	17%	19%	12%
<b>Exceptions to MAE</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2014</b>
<b>With Exception<sup>7</sup></b>	92%	93%	94%	94% <sup>8</sup>	84% <sup>9</sup>	96% <sup>10</sup>	100%	100%

<sup>1</sup> Measured for representations and warranties generally; specified representations and warranties may survive longer. Excludes one transaction in each of 2011 and 2014 where general representations and warranties did not survive.

<sup>2</sup> Generally, exceptions were for fraud, willful misrepresentation and certain "fundamental" representations commonly including capitalization, authority and validity. In a limited number of transactions, exceptions also included intellectual property representations.

<sup>3</sup> One of two transactions not including an escrow at closing did require funding of escrow with proceeds of earnout payments.

<sup>4</sup> Excludes transactions which also specifically referred to representation and warranty insurance as recourse for the buyer.

<sup>5</sup> A "hybrid" approach with both a deductible and a threshold was used in another 4% of these transactions in 2008, 2% of these transactions in 2011, 8% of these transactions in 2012, 8% of these transactions in 2013, and 8% of these transactions in 2015.

<sup>6</sup> Another 4% of these transactions had no deductible or threshold.

<sup>7</sup> Generally, exceptions were for general economic and industry conditions.

<sup>8</sup> Excludes one transaction where the specified exceptions do not apply for purposes of a standalone "material adverse effect" closing condition.

<sup>9</sup> Includes one transaction where the specified exceptions apply for purposes of a standalone "material adverse effect" closing condition and certain representations, but do not apply for purposes of other representations.

<sup>10</sup> The only transaction not including such exceptions provided for a closing on the same day the definitive agreement was signed.

## 22 Trends in Convertible Debt Terms

Based on more than 100 convertible debt financing transactions we handled from 2013 to 2015 for companies and investors throughout the United States, we have compiled the following deal data:

Deals with Note Purchase Agreement		2013	2014	2015	
Convertible note investors often require the company to enter into a note purchase agreement containing representations and warranties from the company (and possibly the founders).	% of Deals	65%	64%	74%	
Term		2013	2014	2015	
The term of the convertible note before it becomes due and payable.	Median Range	15 mos. 1–48 mos.	18 mos. 1–72 mos.	18 mos. 4–60 mos.	
Interest Rate		2013	2014	2015	
The rate at which interest accrues during the term of the convertible note.	Median Range	6% 0.25%–20%	6% 0.33%–15%	5% 2%–14%	
Deals with Security Interest		2013	2014	2015	
Convertible note investors sometimes require the company to provide a security interest in some or all of the company's assets. If the note is not repaid or converted into capital stock, the pledged assets would become available to satisfy the note.	% Secured	25%	20%	15%	
	% Unsecured	75%	80%	85%	
Deals with Conversion Discount		2013	2014	2015	
Convertible note investors often require that the notes convert in connection with a financing at a discount from the price paid by new investors in the financing to reward the convertible note investors for the risk of investing before the new investors. A conversion discount is often coupled with a cap on the valuation at which the notes convert.	% of Deals	66%	72%	89%	
	Range of Discounts	10%–50%	10%–50%	10%–50%	
	% with 20% or Less Discount	71%	76%	74%	
	% with Greater Than 20% Discount	29%	24%	26%	
	% with Valuation Cap	67%	74%	55%	
Deals with Conversion upon Maturity		2013	2014	2015	
If a convertible note is not converted or otherwise paid upon maturity, it often converts into shares of the company's capital stock (common or preferred stock). This conversion is most often at the election of the investor but may be mandatory.	% of Deals	59%	57%	60%	
	% with Optional Conversion	80%	90%	89%	
	% with Mandatory Conversion	20%	10%	11%	
	% that Convert into:	Common	31%	54%	32%
		Preferred	69%	46%	68%
Deals with Conversion upon Company Sale		2013	2014	2015	
If a convertible note is not converted or otherwise paid at the time of a sale of the company, it often converts into shares of the company's capital stock (common or preferred stock). This conversion is most often at the election of the investor but may be mandatory.	% of Deals	66%	66%	74%	
	% with Optional Conversion	95%	86%	91%	
	% with Mandatory Conversion	5%	14%	9%	
	% that Convert into:	Common	55%	60%	49%
		Preferred	45%	40%	51%
Deals with Conversion Premium upon Company Sale		2013	2014	2015	
Convertible note investors may require that they receive a multiple of the outstanding principal of the convertible note upon a sale of the company.	% of Deals	51%	52%	53%	
	Median Premium	2x	2x	2x	
	Range of Premiums	2x–4x	1.5x–3x	1.5x–4x	
Deals with Warrant Coverage		2013	2014	2015	
Convertible note investors sometimes receive a warrant in addition to a note. The amount of company stock covered by the warrant is usually proportional to the principal amount of the note, referred to as the warrant coverage. For example, if the investor is funding \$100,000 and the warrant coverage is 10%, then the number of shares of stock for which the warrant is exercisable would equal \$10,000 divided by the warrant exercise price.	% of Deals	5%	11%	4%	
	Coverage Range	4%–25%	1%–50%	Insufficient data	
	% that Cover Common	0%	20%	50%	
	% that Cover Preferred	100%	80%	50%	

Based on hundreds of venture capital financing transactions we handled from 2010 to 2015 for companies and venture capitalists in the United States and Europe, we have compiled the following deal data:

Deals with Multiple Liquidation Preferences		2010	2010 Range	2011	2011 Range	2012	2012 Range	2013	2013 Range	2014	2014 Range	2015	2015 Range
A “multiple liquidation preference” is a provision that provides that the holders of preferred stock are entitled to receive more than 1x their money back before the proceeds of the liquidation or sale are distributed to holders of common stock.	Series A	4%	2x	7%	1.2x–3x	0%	N/A	5%	2x–3x	0%	N/A	2%	1.5x (all)
	Post-Series A	10%	1.5x–2x	4%	1.3x–1.5x	7%	2x–2.4x	9%	1.5x–2.17x	3%	1.5x (all)	4%	1.5x–2x
Deals with Participating Preferred Stock		2010	2010 Range	2011	2011 Range	2012	2012 Range	2013	2013 Range	2014	2014 Range	2015	2015 Range
“Participating preferred” stock entitles the holder not only to receive its stated liquidation preference, but also to receive a pro-rata share (assuming conversion of the preferred stock into common stock) of any remaining proceeds available for distribution to holders of common stock.	Series A Total	33%		24%		15%		8%		12%		6%	
	Capped	18%	2x–3x	45%	2x–3x	43%	2x–10x	50%	2x–3x	40%	3x–5x	100%	2x–3x
	Post-Series A Total	44%		34%		27%		24%		19%		19%	
	Capped	45%	1.6x–5.5x	30%	1.75x–8x	44%	2x–3x	41%	2x–5x	45%	2x–5x	50%	2x–5x
Deals with an Accruing Dividend		2010		2011		2012		2013		2014		2015	
“Accruing dividends” are generally payable upon liquidation or redemption of the preferred stock. Because the sale of the company is generally deemed to be a “liquidation,” the accrued dividend effectively increases the liquidation preference of the preferred stock.	Series A	23%		18%		29%		9%		11%		12%	
	Post-Series A	30%		43%		28%		11%		22%		25%	
Anti-Dilution Provisions		2010		2011		2012		2013		2014		2015	
A “full ratchet” anti-dilution formula is more favorable to the investors because it provides that the conversion price of the preferred stock will be reduced to the price paid in the dilutive issuance, regardless of how many shares are involved in the dilutive issuance. In contrast, a “weighted average” anti-dilution formula takes into account the dilutive impact of the dilutive issuance based upon factors such as the number of shares and the price involved in the dilutive issuance and the number of shares outstanding before and after the dilutive issuance.	Series A												
	Full Ratchet	0%		2%		0%		0%		0%		0%	
	Weighted Average	100%		98%		100%		100%		100%		100%	
	Post-Series A												
Full Ratchet	4%		3%		3%		1%		1%		0%		
Weighted Average	96%		97%		97%		99%		99%		100%		
Deals with Pay-to-Play Provisions		2010		2011		2012		2013		2014		2015	
“Pay-to-play” provisions provide an incentive to investors to invest in future down rounds of financing. Investors that do not purchase their full pro-rata share in a future down round lose certain rights (e.g., their anti-dilution rights are taken away or their shares of preferred stock may be converted into common stock).	Total	20%		19%		7%		7%		8%		5%	
	% of Total that Convert into Common Stock	100%		82%		100%		100%		53%		71%	
	% of Total that Convert into Shadow Preferred Stock	0%		18%		0%		0%		47%		29%	

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

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



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