

Morgan Lewis

**CORPORATE VENTURE CAPITAL
SURVEY: Q1 2018**



Overview

- During the first quarter of 2018, corporate venture capital (CVC) firms and groups continued to make significant investments in promising startups and late-stage enterprises. In this survey, we analyze the key economic terms of the largest venture capital investments during the first quarter of 2018 in which CVC programs either led the round or participated as significant or anchor investors based upon publicly available filings. The survey covers a wide range of financing transactions during the first quarter 2018 — from Series A to Series H preferred stock issuances.

Key Terms

- We focused our survey on the following deal terms typically negotiated between companies and investors:
 - Valuation
 - Liquidation preference
 - Dividends
 - Redemption rights
 - Protective provisions
 - “Pay-to-play” provisions

Valuation

- All of the transactions we reviewed involved higher valuations than the prior round. The fact that no down-round was observed indicates that valuations continue to be healthy for the larger venture financings with CVC lead investors or with CVC investor participation across a range of industries and technologies.

Liquidation Preference

- Based on our sample, 94% of the deals had a liquidation preference of 1x and only 6% had a liquidation preference greater than 1x.
- 19% of the transactions provided for a liquidation preference with participation rights with the common holders on any remaining amounts after the preferences are paid, while 81% provided for a liquidation preference without participation with the common stock on an remaining amounts after the preferences are paid.
- 44% of the transactions included liquidation preferences that were senior to the prior round while 56% included pari passu liquidation preferences with the prior round. Compared to our 2017 CVC survey results where 81% of the transactions included pari passu liquidation preference, fewer CVC investors are willing to accept a liquidation preference on an equal basis with prior investors, suggesting that more investors are likely to insist on preferential treatment. While valuations continue to be healthy, investors from our sample are being more aggressive in negotiating the liquidation preference term.

Cumulative Dividend

- If dividends are cumulative, dividends accrue and accumulate at a specified rate whether or not declared by the board. Upon conversion of the preferred stock, cumulative dividends would convert into additional common stock, which would increase the investors' percentage ownership interest in the company above their original investment. Based on our review, 25% of the transactions included cumulative dividend provisions, while the remaining 75% either were silent on dividends or included non-cumulative dividend provisions.

Redemption Rights

- Redemption rights allow investors to force the company, in specified circumstances, to redeem their shares at cost, and in some cases, cost plus a small guaranteed rate of return. Based on our review, 38% of the transactions included some form of redemption rights, while the remaining 62% did not provide redemption rights.

Protective Provisions

- Protective provisions provide preferred stockholders with special approval rights with respect to certain matters of particular significance to their investment in addition to class or series voting rights that may exist under relevant state corporate laws. These matters may include liquidation and sale of the company, amendment of charter or bylaws, changes in board size, and authorization of issuance of other preferred stock. An often-negotiated point is whether the new series of preferred stockholder in the new round of financing should have the right to vote separately as a series of preferred stock, versus together as a single class of preferred stock with the other holders of preferred stock. Separate series voting rights provide greater voting power to the new series of preferred stock.
- Based on our review, 19% of the transactions included voting rights only as a single preferred class together, while the remaining 81% included voting rights with a single preferred class as well as a separate vote by series for certain matters.

“Pay-to-Play” Provisions

- A “pay-to-play” provision requires that investors participate in a later financing in order to retain their antidilution or other special rights. A pay-to-play is not a standard term in most VC financings and typically will come into play only in down-rounds. We only observed one pay-to-play provisions of the transactions we reviewed.

Summary

While the economic terms of each investment are unique based on the facts and circumstances of the companies and investors participating, one can nevertheless glean a pattern from the survey with respect to CVC investments.

Based upon our sample, the market for deals led by CVCs continues to be strong, as up rounds and significant valuation increases were noted across a range of sectors. In addition, although many perceive CVCs as being more focused on control and governance related terms, the deals we reviewed did not include protective provisions that vary significantly from your typical venture capital financing protective provisions. The economic terms such as liquidation preference and dividends also continue to be in line with the general trends we see in venture financings generally, with some investors negotiating more aggressively for seniority in the liquidation stack than in our prior surveys. Finally, the lack of pay to play provisions suggests that for our sample investor expectations continue to be positive for future financing rounds.