

**Morgan Lewis**

**Q4 2018**

# **CORPORATE VENTURE CAPITAL SURVEY**



# OVERVIEW

During the fourth 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 fourth 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 fourth quarter of 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

Almost all of the transactions we reviewed (85%) involved higher valuation than previous rounds. Additionally, a few of the transactions involved the same valuations as the previous round (15%) and no down rounds were observed. These figures indicate 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, 100% of the deals had a liquidation preference of 1x.

25% 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 75% provided for a liquidation preference without participation with the common stock on any remaining amounts after the preferences are paid.

15% of the transactions included liquidation preferences that were senior to the prior round while 85% included pari passu liquidation preferences with the prior round. The liquidation preferences observed in this term continue a trend observed in the third quarter (16%) wherein fewer transactions included liquidation preferences that were senior to the prior round. In contrast, earlier in 2018 more than a third of the transactions included liquidation preferences that were senior to the prior round.

## **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, none of the transactions included cumulative dividend provisions. All of the transactions were either silent on dividends or included noncumulative 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, 15% of the transactions included some form of redemption rights, while the remaining 85% 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 the issuance of other preferred stock. An often-negotiated point is whether the new series of preferred stock 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, 50% of the transactions included voting rights only as a single class together with other series of preferred stock, while the remaining 50% included voting rights both as a single class with other preferred stockholders and 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 anti-dilution 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 three pay-to-play provision (15%) in 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 on 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 a slight decrease in the number of deals with seniority in the liquidation stack suggesting stronger leverage for companies. Finally, the lack of pay-to-play provisions suggests that for our sample investor expectations continue to be positive for future financing rounds.

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