BACKGROUND

During the first quarter of 2015, corporate venture capital (CVC) groups at major companies continued to make significant investments in promising startups and late-stage enterprises. In this survey, we briefly review relevant statistical data that demonstrates a clear trend of robust activity by CVCs in recent years. We also analyze the key terms of the largest venture capital investments during the first quarter of 2015 in which CVC programs either led the round or participated as significant or anchor investors, including the later stage unicorn financings. Of these financings, CVCs were the lead investor in 60% of the financings reviewed. The objective of the survey is to identify significant trends and factors that may distinguish CVC-sponsored investments from traditional VC financing transactions.

We believe it is critical to understand CVCs given their increasingly prominent role in the venture capital landscape (as highlighted by the data on the following pages).
CVCS PARTICIPATED IN 178 DEALS TOTALING $3.6B IN Q1 2015

As venture capital (VC) funding rose to highs not seen since the “dot-com” days, CVC investors are participating in an increasingly larger share of the overall venture ecosystem.

In 2014, CVCs participated in 727 deals totaling $12.6 billion in overall funding. On a year-over-year basis, 2014 total CVC deals rose 25% and the CVC dollars invested rose 77%, and that momentum is carrying into 2015. In Q1 2015, CVCs participated in 178 deals totaling $3.6 billion over the three month period—the highest Q1 deal total in any of the last four years and 11% higher than Q1 2014’s CVC deal activity.

QUARTERLY CVC INVESTMENT AND DEAL VOLUME TREND
US-based Q1’11 – Q1’15

NUMBER OF CVCS DOING DEALS HITS THREE-DIGIT MARK, CONTINUES TO RISE TO NEW HIGHS

CVC participation hit another multi-year high as 100 unique CVCs completed an investment in Q1’15, a 9% rise from the same quarter last year and a 43% jump from the same quarter two years ago.

ACTIVE CORPORATE VENTURE FIRMS BY QUARTER
US-based Investments, Q1’11 – Q1’15
CVCS PARTICIPATING IN LARGER SHARE OF VENTURE PIE

In 2010, CVCs participated in 12% of all US VC deals. In 2014, CVC participation in US VC deals ticked up to 14%. And 2015 looks like it will show a further increase in the CVC share of venture deal activity. Year-to-date for 2015, the percentage of US VC deals with CVC participation has hit 16%.

PERCENT OF US-BASED VC DEALS WITH CVC PARTICIPATION
Annual Trend, 2010 – 2015 YTD
KEY ECONOMIC TERMS OF CVC DEALS

We focused our survey on the following deal terms typically negotiated between companies and investors:

- Valuation
- Liquidation preference
- Participation rights
- Dividend
- Redemption rights
- Protective provisions
- “Pay-to-play” provisions

The following is a summary of the key terms for the largest venture capital investments in Q1 in which CVCs led the round or participated as a significant investor.

VALUATION

The survey covers a wide range of financing transactions during the first quarter—from Series B to Series E preferred stock issuances. All of the transactions we reviewed involved higher valuation than previous rounds and the average per share price increase from the prior round was over 150%. Valuation is, of course, impacted by various factors, including the overall strength of the venture capital funding over the period. However, the fact that no down-round was observed indicates strong interest by CVC programs to invest in many of these later stage unicorn-type deals.

LIQUIDATION PREFERENCE

While preferred stockholders receive preferential treatment over common stockholders on distributions that occur in the event of liquidation, the liquidation preference among different series of preferred stock is often a negotiated term. The later-round preferred stockholders may request a senior ranking over prior-round preferred stockholders, while earlier investors may insist on equal (or pari passu) treatment with new investors. Based on our review, 30% of CVC transactions in Q1 included senior preference while the remaining 70% included pari passu liquidation preference. In addition, 10% of the deals had a liquidation preference greater than 1X the original purchase price.

PARTICIPATION RIGHTS

With “non-participating” preferred stock, the preferred stockholders are entitled to receive only the amount of their preference (typically the amount paid for the stock) plus any accrued and unpaid dividends upon a sale or liquidation of the company. With “participating” preferred stock, preferred stockholders are entitled to receive their preference amount first in a liquidation event (plus accrued and unpaid dividends), with any remaining proceeds being divided among holders of common stock and preferred stock on an as-converted basis. Based on our review, only 17% of the transactions reviewed included participation rights, while the remaining 83% involved “non-participating” preferred stock.

CUMULATIVE DIVIDEND

If dividends are cumulative, dividends accrue and accumulate at a specified rate whether or not declared by the board. Upon a liquidation event, cumulative dividends would be added to the preference amount. Based on our review, only 13% of the transactions surveyed included cumulative dividend provisions, while the remaining 87% 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, 30% of the transactions included some form of redemption rights, while the remaining 70% 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 a specific series of preferred stock should have the right to vote as a separate class with other series of preferred stock, which would give such preferred stockholder more control over the affairs of the company. Based on our review, only 26% of the CVC transactions surveyed in Q1 2015 included voting rights as a separate class, while the remaining 73% included voting rights together as a single class with other preferred stockholders.

“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 did not observe any pay-to-play provisions for any of the transactions we reviewed.
CONCLUSION

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

For one thing, it appears that CVC programs are offering terms that are substantially similar to traditional VC financing, which seems contrary to the conventional wisdom that CVC investors tend to focus on control provisions and governance restrictions due to their strategic intent. For example, the lack of participating preferred stock, cumulative dividend and redemption rights is fairly common in a typical up-round VC financing.

In addition, it appears that CVC investors are more willing to accept a liquidation preference on an equal basis with prior investors, suggesting that they are less likely to insist on preferential treatment. Moreover, the lack of separate voting right by series indicates that CVC investors are placing less emphasis on exerting additional control, which is noteworthy given the market perception that strategic investors are more likely to focus on protective and control provisions.

In summary, the trend we observed in Q1 2015 may reflect a more competitive market for CVC investors, particularly for companies that have a compelling story and a strong track record.

Below we provide a “Company Friendly Barometer” for each of the seven key economic terms to illustrate—one to five (one representing least favorable and five most favorable)—how each term impacts the company.

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