FENWICK & WEST

Silicon Valley Venture Capital Survey First Quarter 2018

Full Analysis

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Cynthia Clarfield Hess, Mark Leahy and Khang Tran

Background

We analyzed the terms of 200 venture financings closed in the first quarter of 2018 by companies headquartered in Silicon Valley.

Overview of Fenwick & West Results

Valuation results were generally flat in Q1 2018 compared to the prior quarter. Overall, valuation metrics are well above historical averages[1], but have plateaued since Q3 2017.

- Up rounds exceeded down rounds 75% to 15%, with 10% flat in Q1 2018, an increase from Q4 2017 when up rounds exceeded down rounds 70% to 19%, with 11% flat.
- The Fenwick & West Venture Capital Barometer™ showed an average price increase in Q1 2018 of 74%, which was flat compared to the prior quarter. The average price increase had previously peaked in Q3 2017 after five consecutive quarters of increases before decreasing moderately in Q4 2017.
- The median price increase of financings in Q1 2018 was 41%, a slight decrease from the 42% recorded in Q4 2017, and the second consecutive quarter of declines following four quarters of increases.
- Similar to the prior quarter, the internet/digital media industry recorded the strongest valuation results in Q1 2018 compared to the other industries, with an average price increase of 101% and a median price increase of 59%. However, the valuation results for the internet/digital media industry were moderately weaker compared to the prior quarter. In contrast, the software, hardware and life sciences industries all recorded stronger valuation results in Q1 compared to the prior quarter. The hardware industry, in particular, recorded the second strongest valuation results in Q1 and the greatest improvement in valuation results compared to the prior quarter, with the average price increase increasing from 40% in Q4 2017 to 97% in Q1 2018 and the median price increase increasing from 13% in Q4 2017 to 52% in Q1 2018.

1 Since we began calculating valuation metrics in 2004.

Overview of Other Industry Data

After a strong 2017 for the U.S. venture environment, momentum in capital invested into U.S. venture-backed companies carried over into the first quarter of 2018 although deal activity continued to decline.

- Although the pace of investments decreased, the amount of capital invested increased from Q4 2017 to Q1 2018 and was the greatest amount of capital invested in a quarter since 2000.
- Later stage investment deal allocation increased to a 10-year high in Q1 while seed seed/angel investment deal allocation decreased to an eight-year low.
- The San Francisco (North Bay Area) continued to take in the largest share of investments in Q1 and increased its share compared to the prior quarter. The Los Angeles/Orange County and New England areas also recorded increases in their shares of investments in Q1 while the Silicon Valley and New York Metro areas recorded declines.
- Following a strong finish to 2017 for the initial public offerings market, there were 14 U.S. venture-backed initial public offerings in Q1, the highest number of U.S. venture-backed IPOs in the first fiscal quarter of a year since 2014.
- The number of acquisitions of U.S. venture-backed companies and the value of these deals continued to decline in Q1.
- Venture capital fundraising during Q1 is off pace in terms of both capital raised and funds closed from 2017 levels, though the anticipated closing of several large funds in the near future is expected to provide a boost to the amount of capital raised.

Venture Capital Investment

U.S. venture capital investment deal flow in Q1 2018 decreased compared to the prior quarter and the year ago period and remained significantly below the peak levels of 2015. Despite the decline in deal count, the total dollar value of financings in Q1 was substantially higher compared to the prior quarter and the year ago period and was the greatest amount of capital deployed in a quarter since 2000.

A summary of results published by three leading providers of venture data is below:

Comparison between Q1 2018 and Q4 2017:

	Q1 2018 ($Billions)	Q4 2017 ($Billions)	Difference %	Q1 2018 Deals	Q4 2017 Deals	Difference %
VentureSource[1]	$25.7	$21.7	19%	1,303	1,211	8%
PitchBook-NVCA[2]	$28.2	$21.3	33%	1,693	2,076	-18%
MoneyTree[3]	$21.1	$20.3	4%	1,206	1,233	-2%
Average	$25.0	$21.1	19%	1,401	1,507	-7%

[1] Dow Jones VentureSource ("VentureSource")

[2] PitchBook-NVCA Venture Monitor ("PitchBook-NVCA")

[3] PwC/CB Insights MoneyTree™ Report ("MoneyTree")

Comparison between Q1 2018 and Q1 2017:

	Q1 2018 ($Billions)	Q4 2017 ($Billions)	Difference %	Q1 2018 Deals	Q1 2017 Deals	Difference %
VentureSource	$25.7	$19.8	30%	1,303	1,306	-0.2%
PitchBook-NVCA	$28.2	$16.9	67%	1,693	2,271	-25%
MoneyTree	$21.1	$15.2	39%	1,206	1,371	-12%
Average	$25.0	$17.3	45%	1,401	1,649	-15%

One of the prevailing trends in venture capital in recent years has been the concentration of investment dollars into a fewer number of companies, especially later stage companies, and this trend was evident again in Q1 2018. According to VentureSource, the median amount invested per financing round by venture capitalists or venture capital-type investors (i.e., those making equity investments in early-stage companies from a fund with multiple limited partners) was $9.0 million in Q1 2018, up from $7.5 million in Q4 2017. Later rounds recorded the greatest increase, with the median amount invested increasing from $14.0 million in Q4 2017 to $18.0 million in Q1 2018. In contrast, the median amount invested in seed rounds decreased from $2.4 million in Q4 2017 to $2.1 million in Q1 2018.

Average round size continued to be inflated by a number of mega-rounds (financings that raised $100 million or more), with 34 such financings in Q1 2018 according to MoneyTree, just one less than in Q4 2017. In addition, five new VC-backed companies reached unicorn status (private companies with a valuation of at least $1 billion) in Q1.

According to Moneytree, seed/angel investment deal allocation (i.e., allocation by number of deals) decreased from 25% in Q4 2017 to an eight-year low of 21% in Q1 2018, although seed/angel invested capital allocation (i.e., allocation by amount of invested capital) was unchanged at 3%. Meanwhile, later stage (Series D and E+) investment deal allocation increased from 17%

in Q4 2017 to a 10-year high of 18% in Q2 2018. However, later stage investments recorded the greatest decline in invested capital allocation, decreasing from 40% in Q4 2017 to 36% in Q1 2018. Expansion stage (Series B) investments recorded moderate increases in both deal and invested capital allocations, while early stage (Series A) investments recorded a moderate decline in deal allocation, but also the greatest increase in invested capital allocation. Similarly, VentureSource reported a decline in seed investment deal allocation from 13% in Q4 2017 to a one-year low of 10% in Q1 2018. In addition, later stage invested capital allocation decreased from 69% in Q4 2017 to a one-year low of 62% in Q1 2018.

Investments into business and financial services recorded the largest gains in Q1 2018, comprising 28% of the total number of deals and 26% of the aggregate invested capital in Q1 2018, according to VentureSource, up from 25% and 23%, respectively, in Q4 2017. Information technology investment deal allocation was stable at 33% in Q1 2018 and the prior quarter; however, IT invested capital allocation decreased from 27% in Q4 2017 to 23% in Q1 2018. In contrast, investments into healthcare recorded a decrease in deal allocation from 24% in Q4 2017 to 22% in Q1 2018 while invested capital allocation was unchanged at 22%.

Regionally, the San Francisco (North Bay Area) continued to take in the largest share of investments at 30% of the aggregate invested capital in Q1 2018, up from 27% in the prior quarter, and 19% of the total number of deals in Q1 2018, up from 18% in the prior quarter, according to MoneyTree. The Los Angeles/Orange County and New England areas also recorded increases in both deal and invested capital allocation. In contrast, the New York Metro area recorded declines in both deal and invested capital allocation. Meanwhile, the Silicon Valley area recorded the largest decline in invested capital allocation from 18% in Q4 2017 to 14% in Q1 2018, although deal allocation for the Silicon Valley area was flat at 13%.

IPO Activity

According to VentureSource, there were 14 U.S. venture-backed initial public offerings in Q1 2018, the highest number of U.S. venture-backed IPOs in the first fiscal quarter of a year since 2014, but a decline from the 23 U.S. venture-backed IPOs in the prior quarter. The amount raised in these IPOs decreased from $2.0 billion in Q4 2017 to $1.6 billion in Q1 2018; however, the average amount raised was the second highest average amount in the last 10 quarters. Initial public offerings of healthcare companies continued to represent the largest share of IPO activity with eight IPOs in Q1, followed by IPOs of IT companies with four IPOs, including the IPOs of two tech unicorns.

There were a number IPOs of relatively less established healthcare companies in Q1 2018, contributing to the significant decrease in the median time from initial equity funding to IPO from 7.5 years in Q4 2017 to 5.6 years in Q1 2018. The median pre-IPO valuation similarly decreased from $347 million in Q4 2017 to $309 million in Q1 2018; however, the median equity amount raised prior to IPO increased moderately from $98 million in Q4 2017 to $101 million in Q1 2018.

Merger and Acquisition Activity

U.S. M&A deal volume decreased in Q1 2018, with VentureSource reporting a decline in the number of acquisitions of U.S. venture-backed companies from 156 in Q4 2017 to 120 in Q1 2018, which was the lowest number of acquisitions since Q2 2015. The overall value of these deals also decreased from $18.4 billion in Q4 2017 to $17.3 billion in Q1 2018, which was also the lowest aggregate deal value since Q2 2015. On the other hand, the median deal value increased from $110.0 million in Q4 2017 to $117.5 million in Q1 2018, the highest median deal value in the last eight quarters.

While the number of acquisitions of IT companies in Q1 2018 was relatively flat compared to the prior quarter, the aggregate value of these acquisitions decreased considerably from $7.4 billion in Q4 2017 to $2.7 billion in Q1 2018. In contrast, the number of acquisitions of healthcare companies decreased in Q1 2018 compared to the prior quarter, but the aggregate value of these acquisitions increased from $2.4 billion in Q4 2017 to $4.4 billion in Q1 2018.

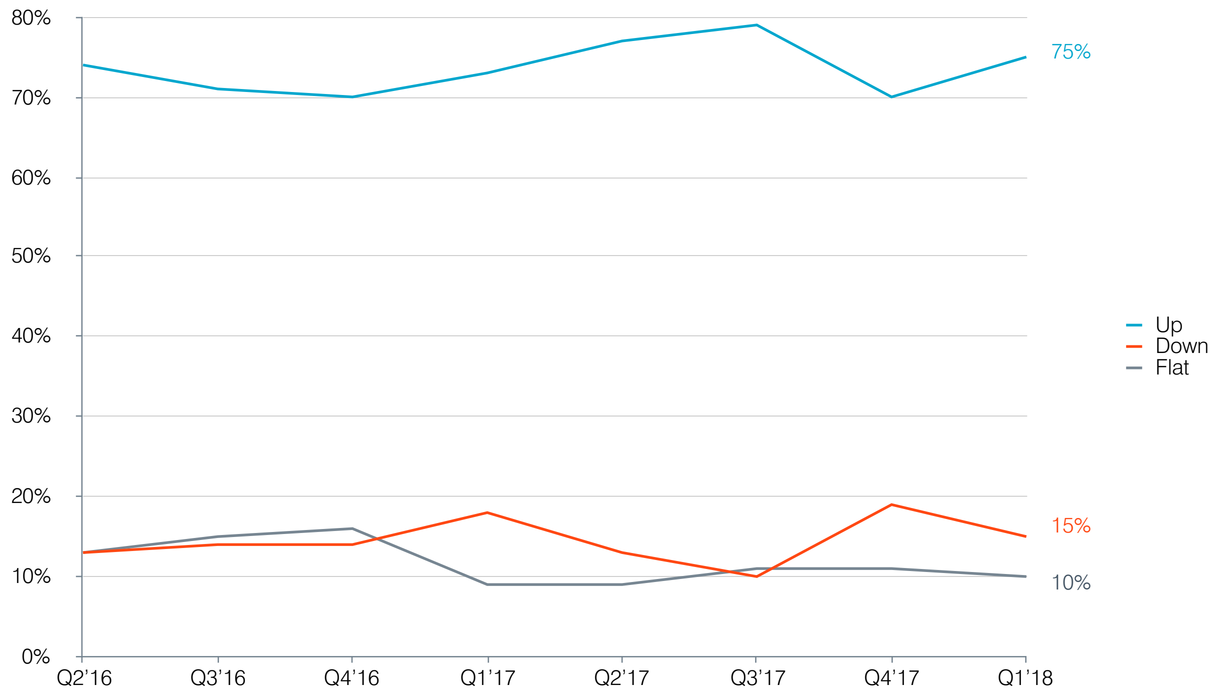
According to VentureSource, the median time from initial equity funding to acquisition in Q1 2018 was unchanged from the prior quarter at 5.1 years; however, the median equity amount raised prior to acquisition decreased from $15.5 million in Q4 2017 to $13.7 million in Q1 2018.

Venture Capital Fundraising

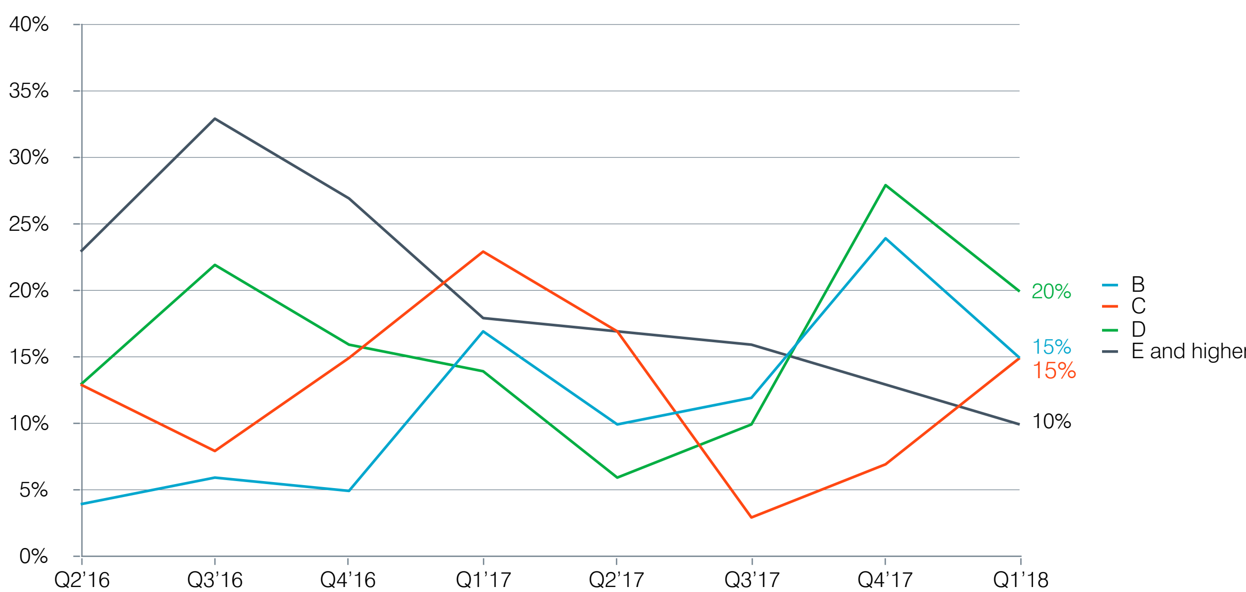
According to PitchBook-NVCA, venture capitalist firms raised $7.9 billion across 54 funds in Q1 2018, which is moderately below the pace of both capital raised and funds closed in 2017. Fundraising for microfunds (fund size of less than $50 million) was particular strong in the quarter, representing the highest percentage of the total fund count since 2015 and contributing to a decline in the median fund size. In addition, two mega-funds (fund size of more than $1 billion) closed in Q1 2018 with four other mega-funds expected to close in the near future.

Fenwick & West Data on Valuation

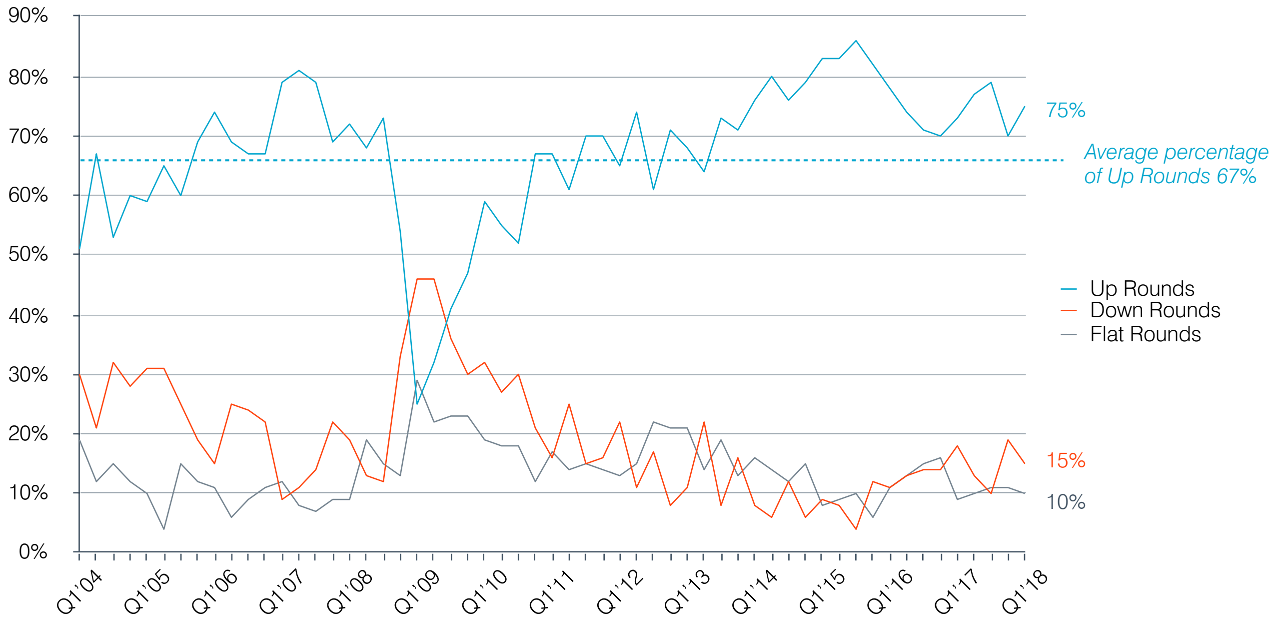
PRICE CHANGE—The direction of price changes for companies receiving financing in a quarter, compared to their prior round of financing.



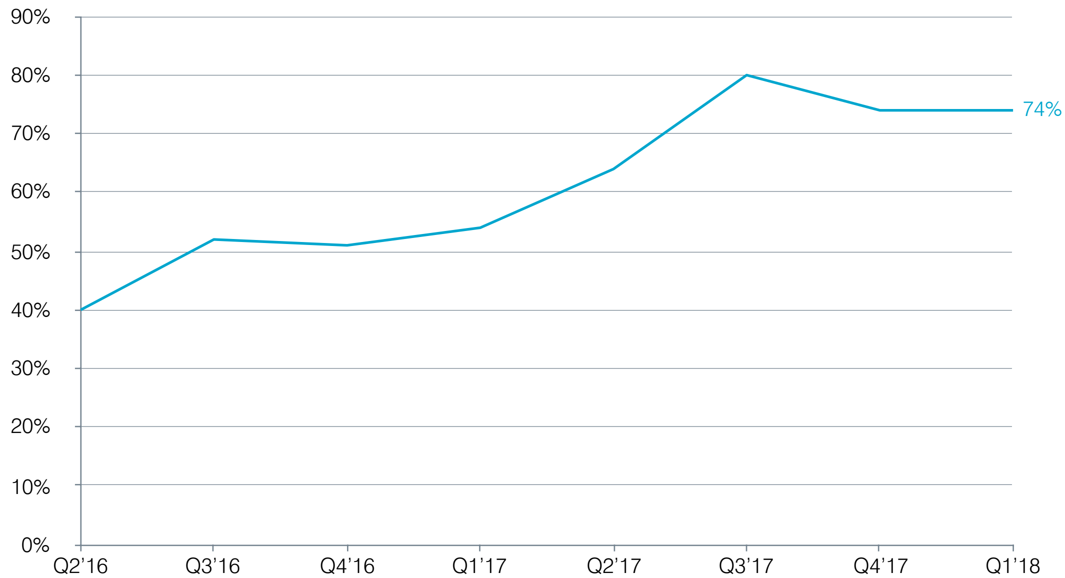
The percentage of **DOWN ROUNDS** by series were as follows:



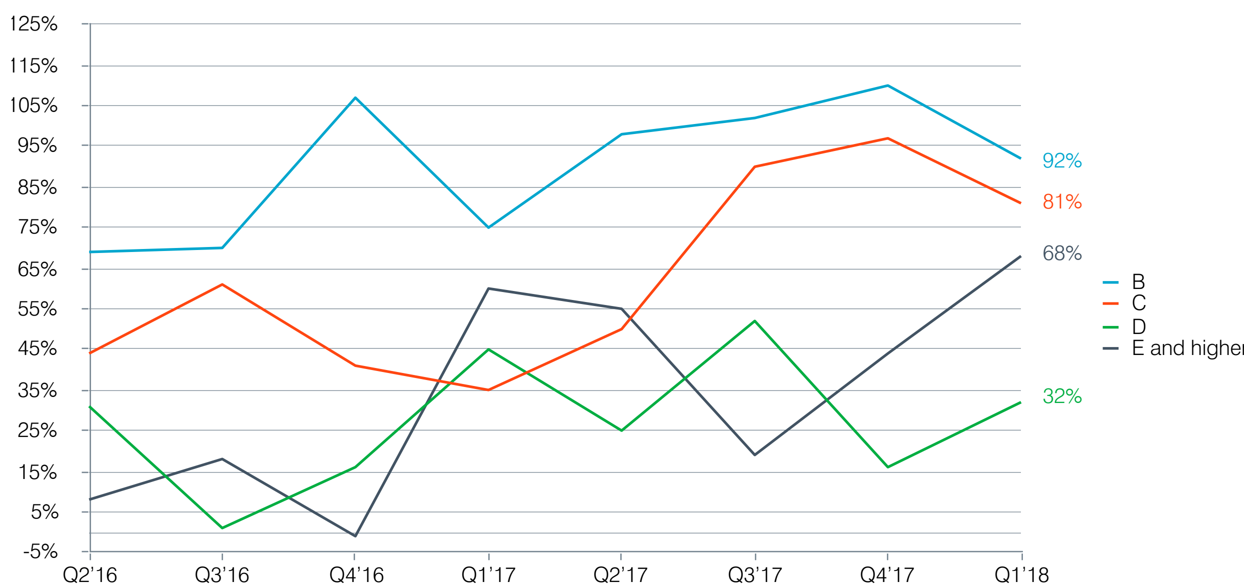
EXPANDED PRICE CHANGE GRAPH—Set forth below is the direction of price changes for each quarter since 2004.



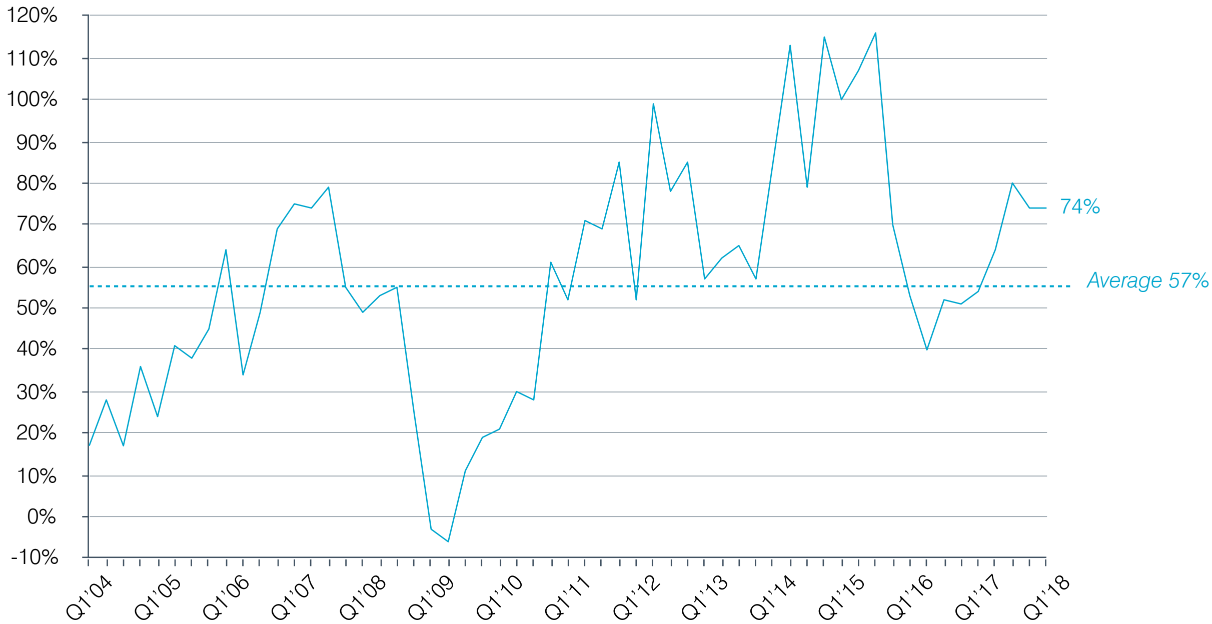
THE FENWICK & WEST VENTURE CAPITAL BAROMETER™ (magnitude of price change) — Set forth below is the <u>average</u> percentage change between the price per share at which companies raised funds in a quarter, compared to the price per share at which such companies raised funds in their prior round of financing. In calculating the average, all rounds (up, down and flat) are included, and results are not weighted for the amount raised in a financing.



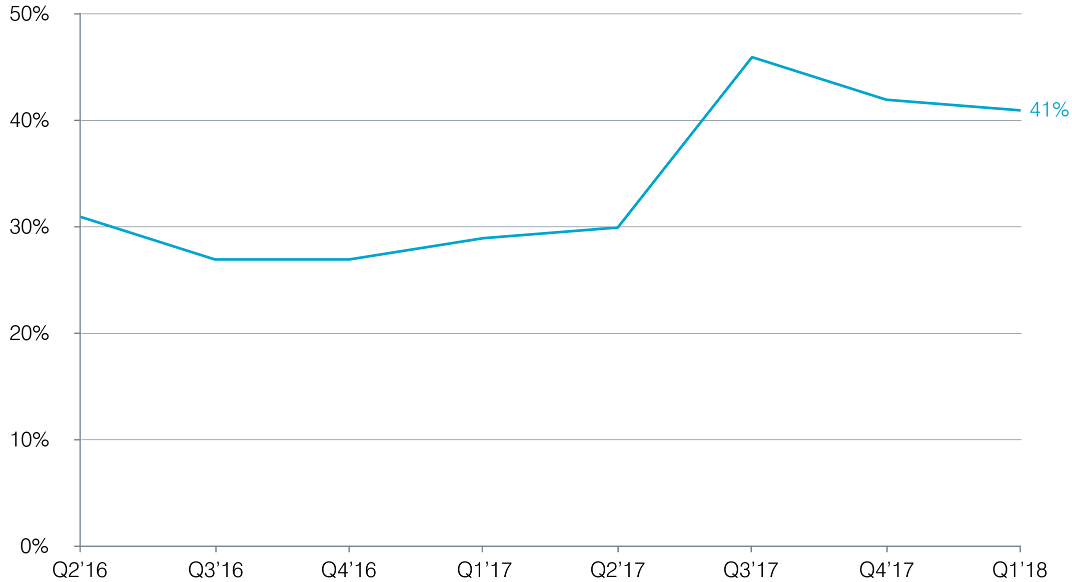
The Barometer results by series are as follows:



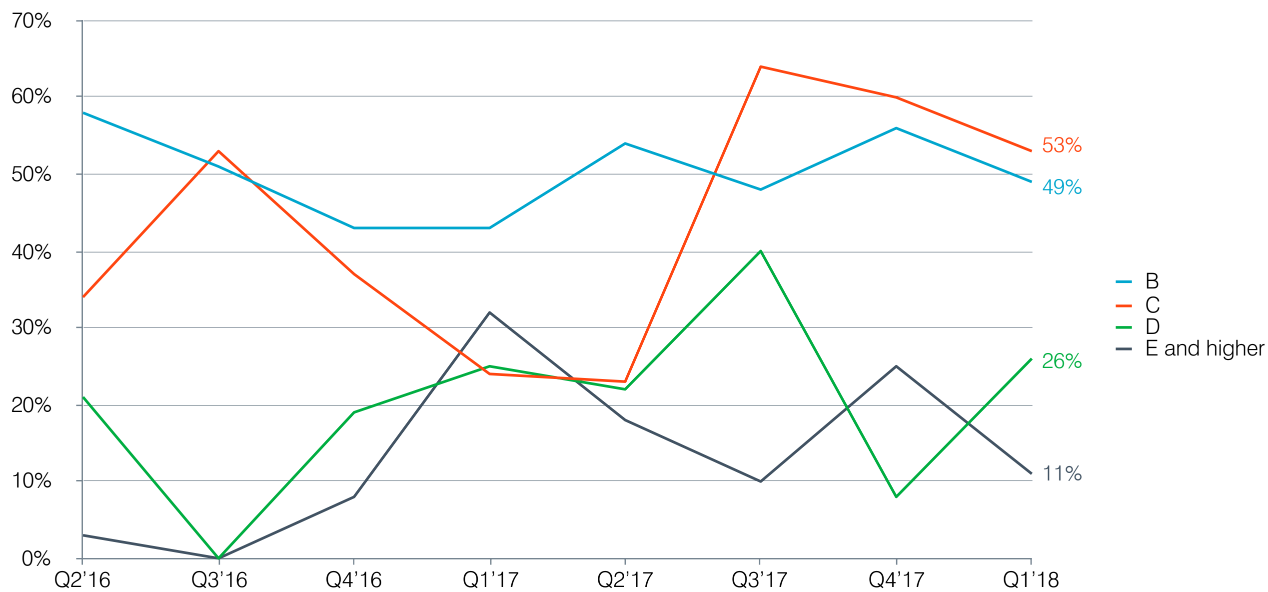
EXPANDED BAROMETER GRAPH — Set forth below is the average percentage price change for each quarter since we began calculating this metric in 2004.



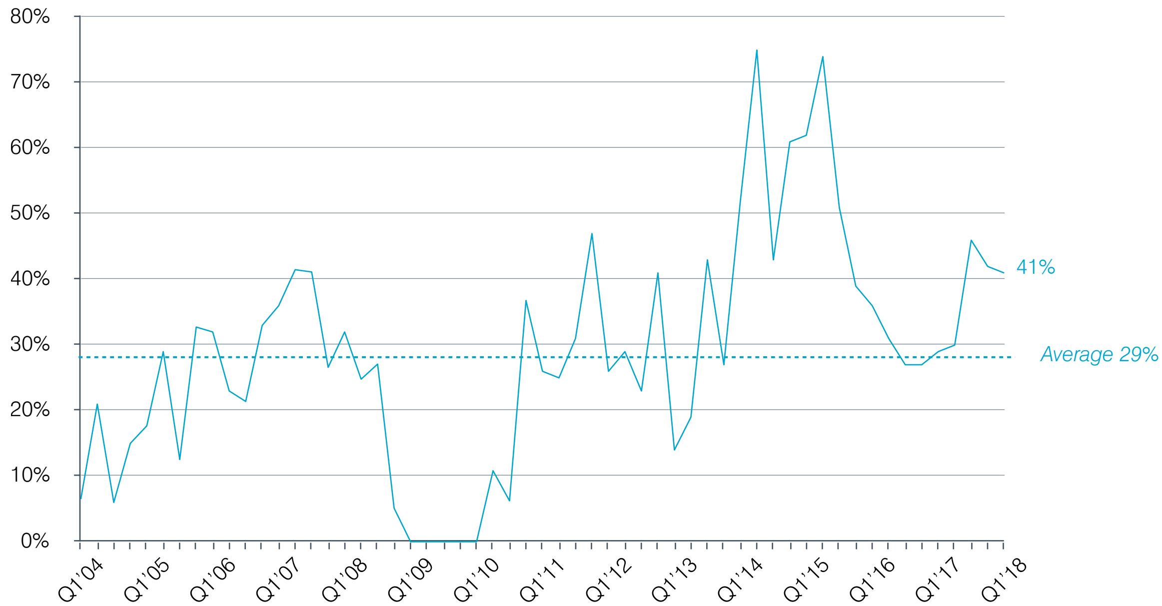
MEDIAN PERCENTAGE PRICE CHANGE—Set forth below is the median percentage change between the price per share at which companies raised funds in a quarter, compared to the price per share at which such companies raised funds in their prior round of financing. In calculating the median, all rounds (up, down and flat) are included, and results are not weighted for the amount raised in the financing. Please note that this is different than the Barometer, which is based on average percentage price change.



MEDIAN PERCENTAGE PRICE CHANGE BY SERIES.



EXPANDED MEDIAN PRICE CHANGE GRAPH—Set forth below is the median percentage price change for each quarter since we began calculating this metric in 2004.



RESULTS BY INDUSTRY FOR DIRECTION OF PRICE CHANGES AND AVERAGE AND MEDIAN PRICE CHANGES — The table below sets forth the direction of price changes, and average and median price change results for companies receiving financing in this quarter, compared to their previous round, by industry group. Companies receiving Series A financings are excluded as they have no previous rounds to compare.

Industry	Up Rounds	Down Rounds	Flat Rounds	Average Price Change	Median Price Change	Number of Financings
Software	73%	16%	11%	74%	40%	85
Hardware	90%	10%	0%	97%	52%	10
Life Science	63%	16%	21%	30%	28%	19
Internet/Digital Media	83%	17%	0%	101%	59%	24
Other	85%	0%	15%	72%	35%	13
Total all Industries	**75%**	**15%**	**10%**	**74%**	**41%**	**151**

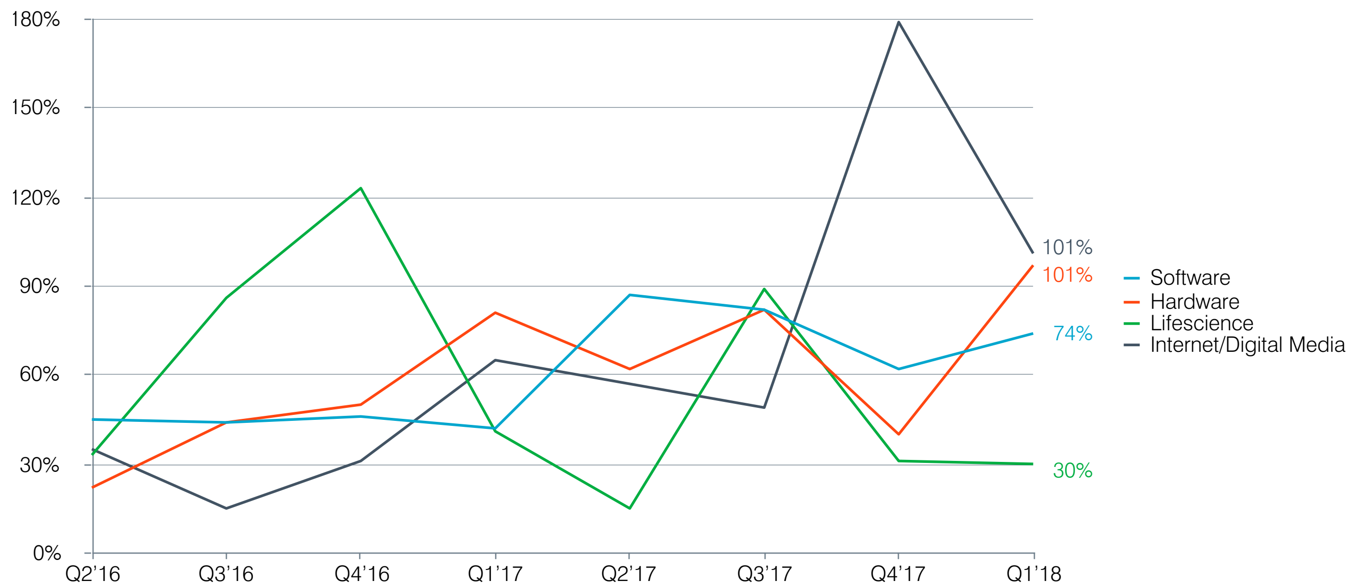
DOWN ROUND RESULTS BY INDUSTRY — The table below sets forth the percentage of "down rounds," by industry groups, for each of the past eight quarters.

Down Rounds	Q2'16	Q3'16	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17	Q1'18
Software	13%	14%	13%	20%	14%	10%	18%	16%
Hardware	15%	8%	18%	18%	17%	8%	28%	10%
Life Science	13%	18%	13%	17%	16%	9%	21%	16%
Internet/Digital Media	13%	20%	15%	24%	11%	8%	14%	17%
Other	8%	0%	17%	0%	8%	15%	13%	0%
Total all Industries	**13%**	**14%**	**14%**	**18%**	**13%**	**10%**	**19%**	**15%**

BAROMETER RESULTS BY INDUSTRY—The table below sets forth Barometer results by industry group for each of the last eight quarters.

Industry	Q2'16	Q3'16	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17	Q1'18
Software	45%	44%	46%	42%	87%	82%	62%	74%
Hardware	22%	44%	50%	81%	62%	82%	40%	97%
Life Science	33%	86%	123%	41%	15%	89%	31%	30%
Internet/Digital Media	35%	15%	31%	65%	57%	49%	179%	101%
Other	56%	78%	-5%	69%	43%	107%	73%	72%
Total all Industries	**40%**	**52%**	**51%**	**54%**	**64%**	**80%**	**74%**	**74%**

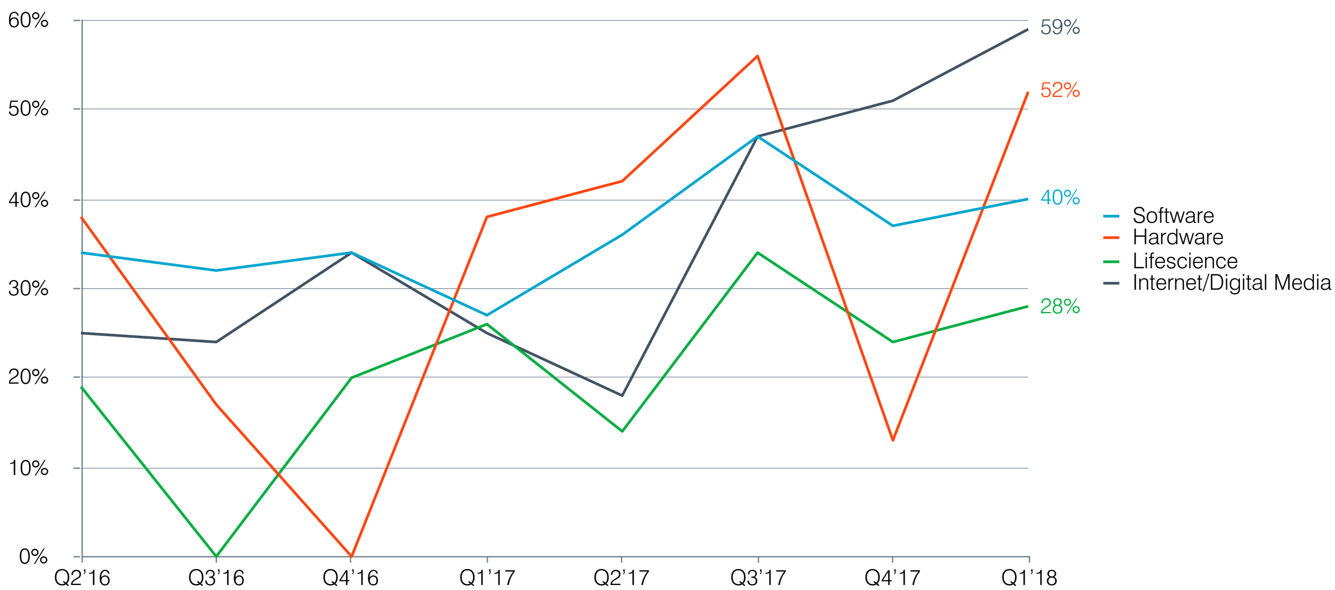
A graphical representation of the above is below.



MEDIAN PERCENTAGE PRICE CHANGE RESULTS BY INDUSTRY —The table below sets forth the median percentage price change results by industry group for each of the last eight quarters. Please note that this is different than the Barometer, which is based on average percentage price change.

Median % Price Change	Q2'16	Q3'16	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17	Q1'18
Software	34%	32%	34%	27%	36%	47%	37%	40%
Hardware	38%	17%	0%	38%	42%	56%	13%	52%
Life Science	19%	0%	20%	26%	14%	34%	24%	28%
Internet/Digital Media	25%	24%	34%	25%	18%	47%	51%	59%
Other	39%	53%	0%	59%	44%	18%	63%	35%
Total all Industries	**31%**	**27%**	**27%**	**29%**	**30%**	**46%**	**42%**	**41%**

A graphical representation of the above is below.

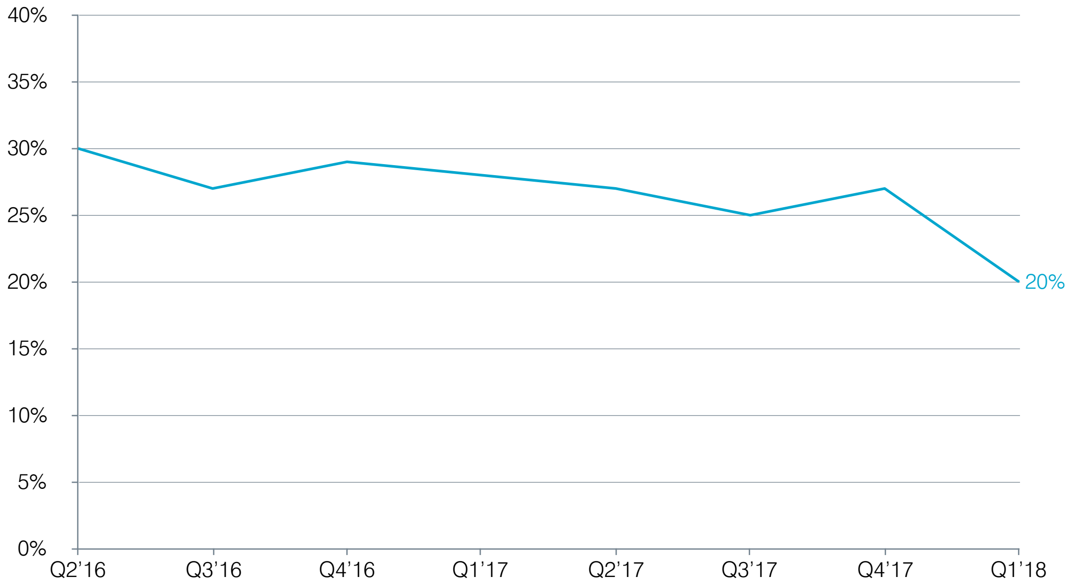


FINANCING ROUND—This quarter's financings broke down by series according to the chart below.

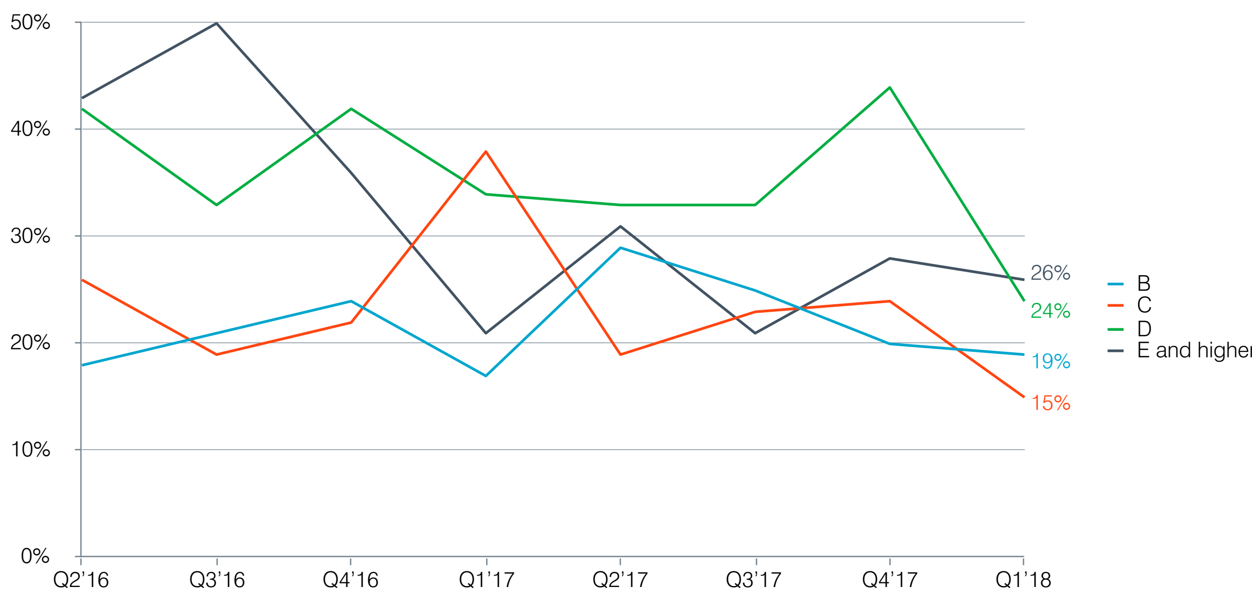
Series	Q2'16	Q3'16	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17	Q1'18
Series A	21%	26%	22%	29%	28%	27%	29%	25%
Series B	23%	32%	28%	18%	23%	32%	26%	27%
Series C	24%	17%	20%	20%	23%	19%	15%	21%
Series D	12%	12%	14%	15%	9%	11%	13%	13%
Series E and Higher	21%	12%	16%	17%	17%	10%	17%	16%

Fenwick & West Data on Legal Terms

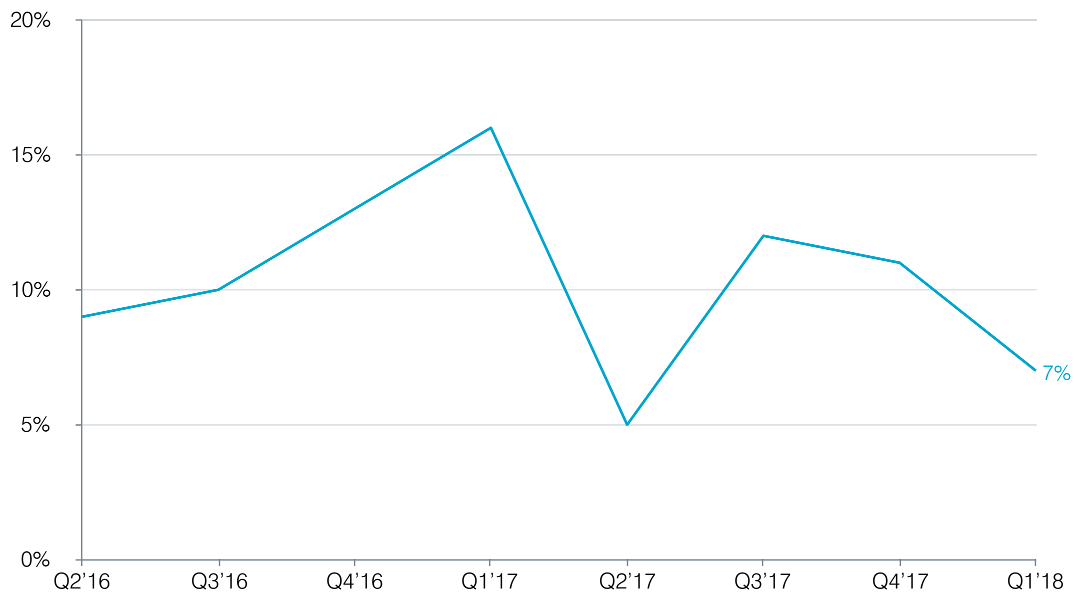
LIQUIDATION PREFERENCE—Senior liquidation preferences were used in the following percentages of financings.



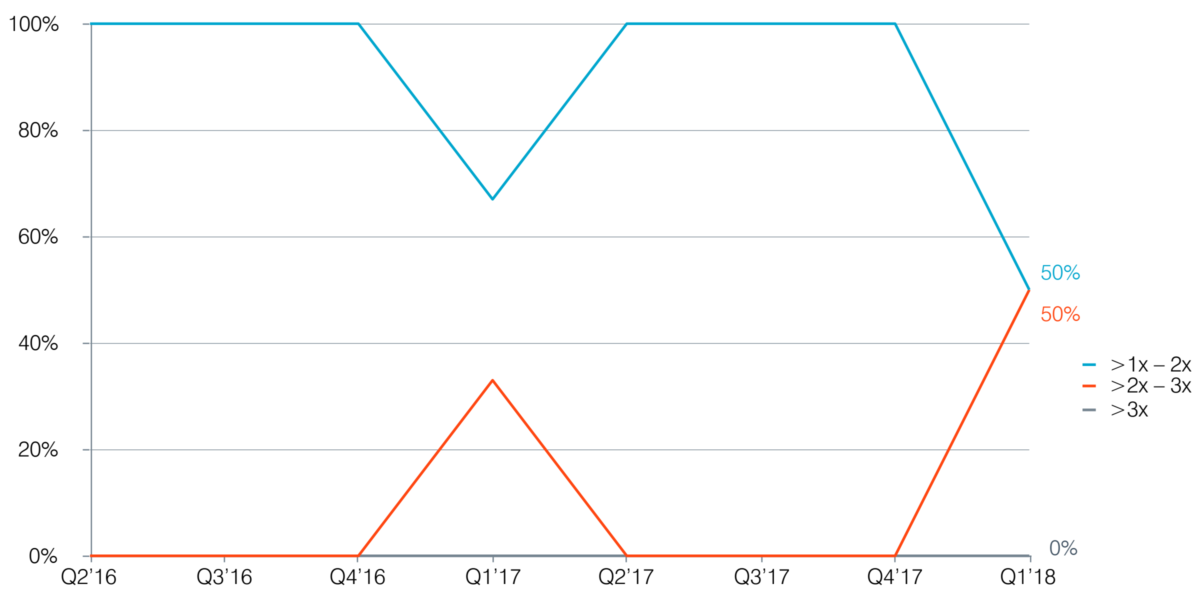
The percentage of senior liquidation preference by series was as follows:



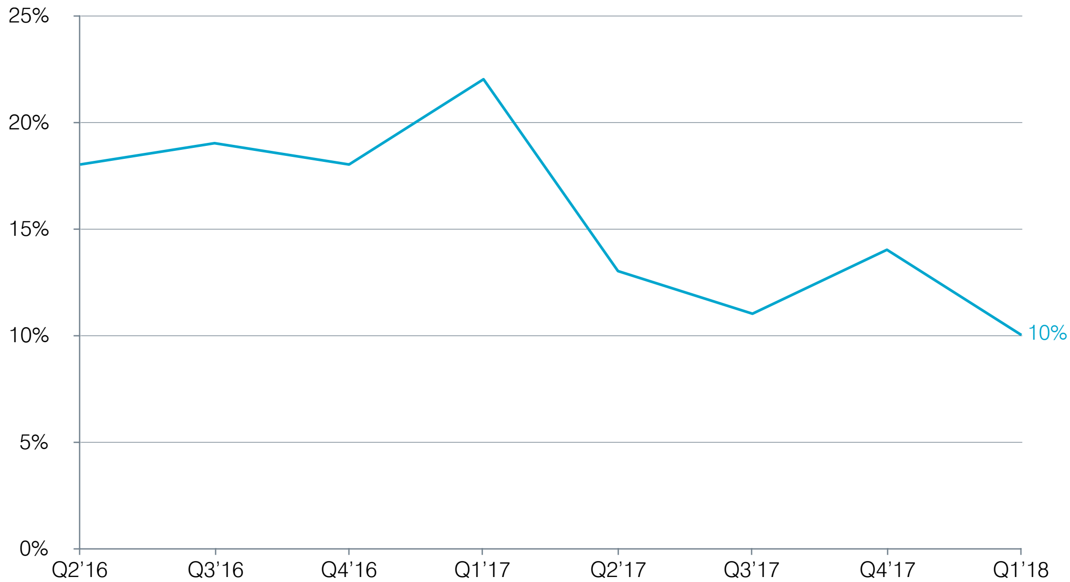
MULTIPLE LIQUIDATION PREFERENCES — The percentage of senior liquidation preferences that were multiple liquidation preferences were as follows:



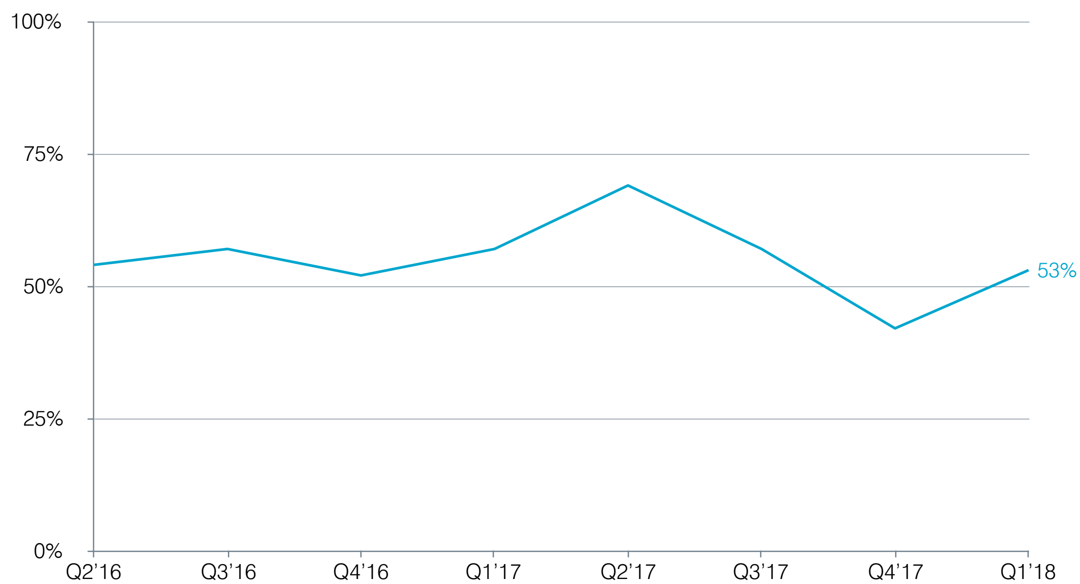
Of the senior liquidation preferences that were a multiple preference, the ranges of the multiples broke down as follows:



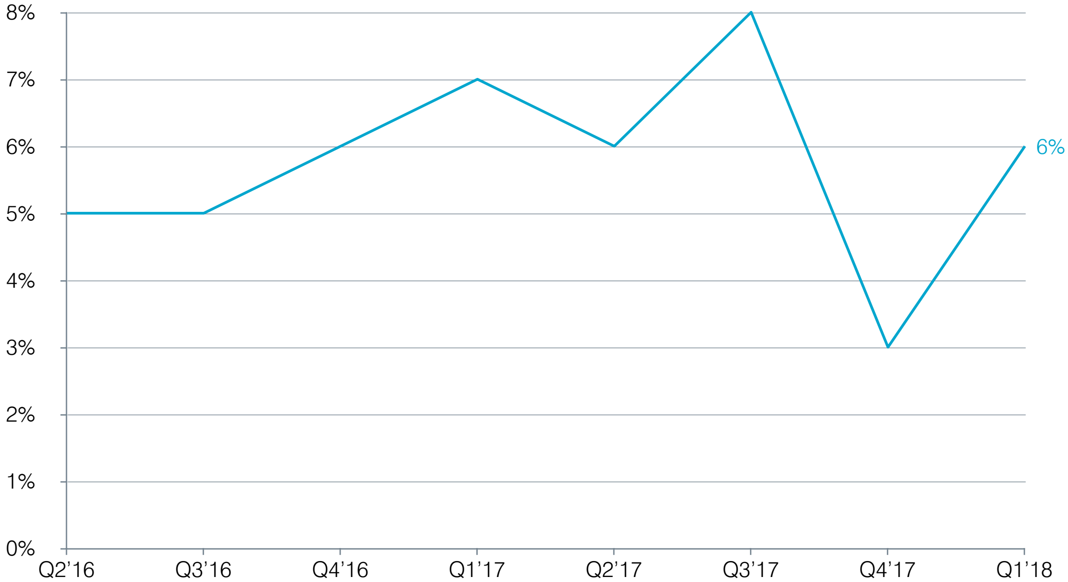
PARTICIPATION IN LIQUIDATION — The percentages of financings that provided for participation were as follows:



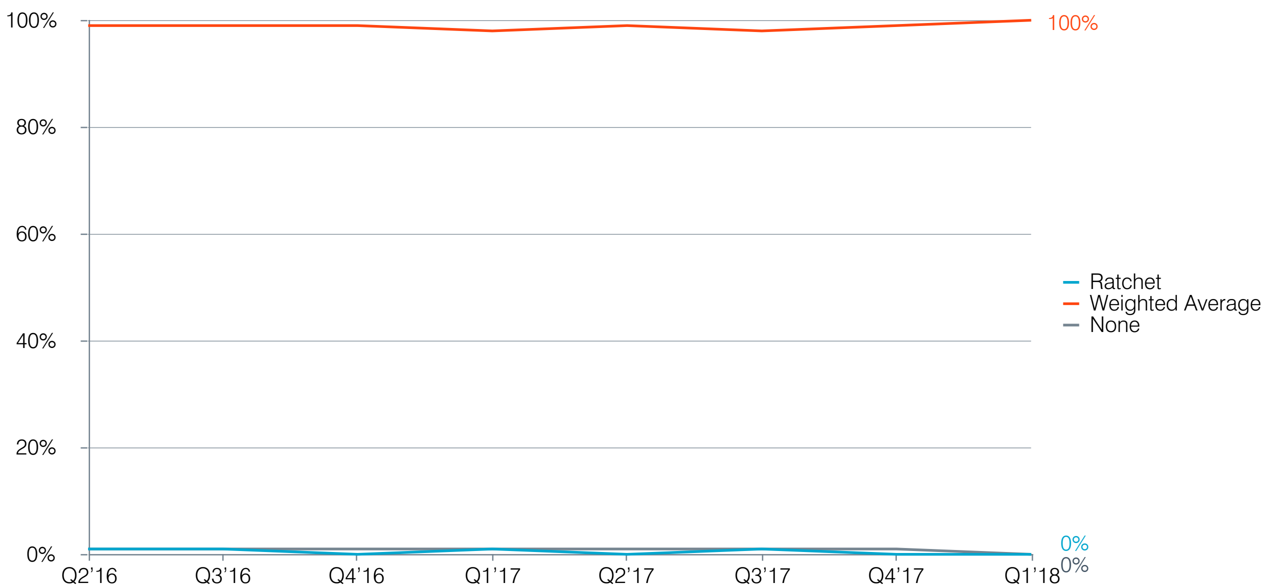
Of the financings that had participation, the percentages that were not capped were as follows:



CUMULATIVE DIVIDENDS – Cumulative dividends were provided for in the following percentages of financings:

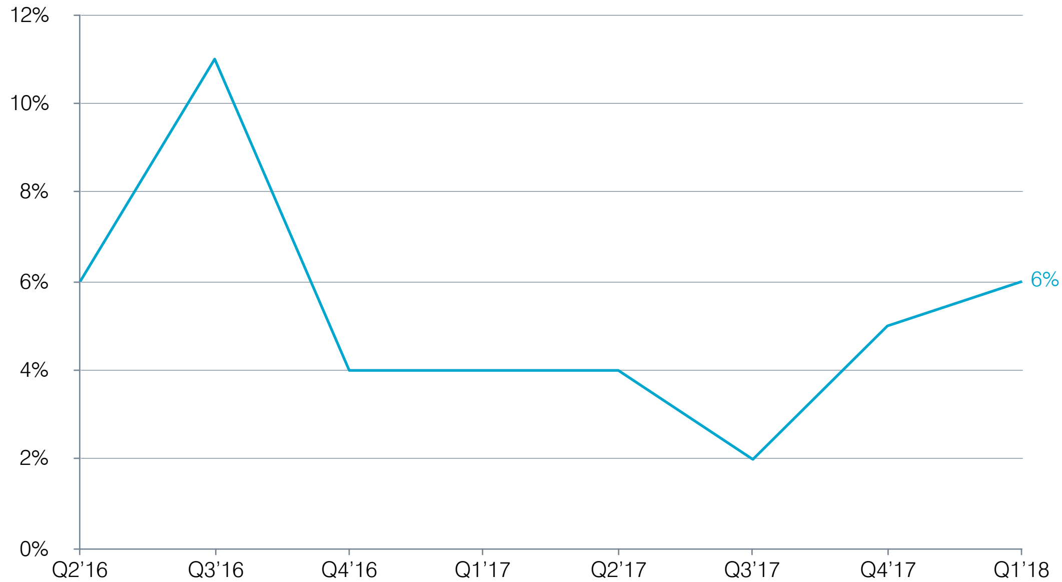


ANTIDILUTION PROVISIONS –The uses of (non-IPO) antidilution provisions in the financings were as follows:

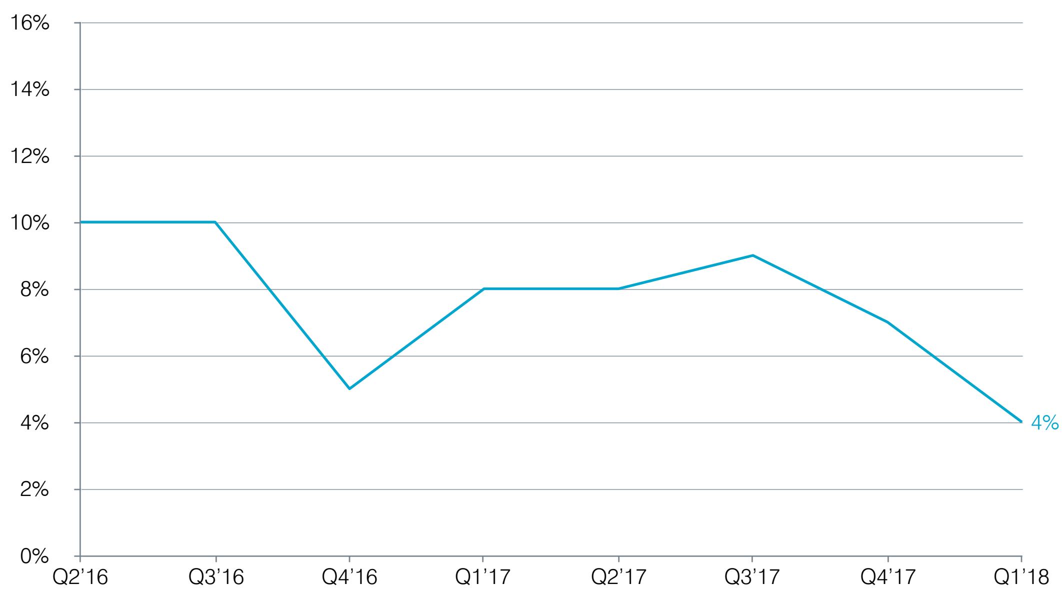


Please note that the chart above only applies to non-IPO anti-dilution provisions. In other words, the chart refers to anti-dilution provisions that protect the investor against a future venture financing at a price below what the investor paid. The chart does not include anti-dilution provisions designed to protect against an IPO at a price below the price paid by the venture investor (e.g., an IPO ratchet), because those provisions are generally only negotiated/included in very late stage, high value deals. We believe it would not be useful to provide a percentage of all financings that have IPO anti-dilution provisions, because it will provide a result that is artificially low. An analysis of IPO anti-dilution provisions is included in our Unicorn Survey, which by its nature is focused on late stage, high value deals.

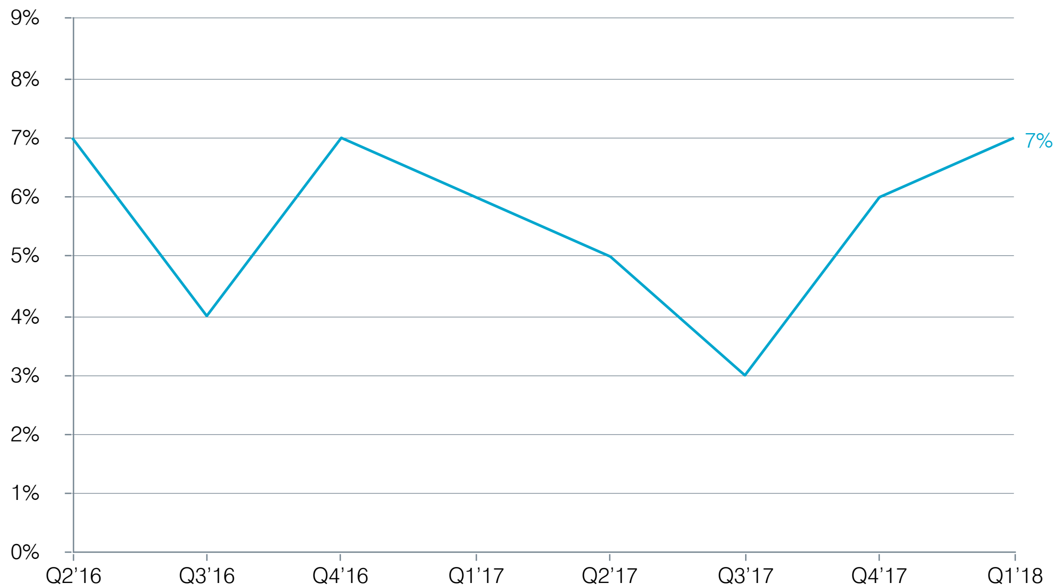
PAY-TO-PLAY PROVISIONS – The percentages of financings having pay-to-play provisions were as follows:



REDEMPTION – The percentages of financings providing for mandatory redemption or redemption at the option of the investor were as follows:



CORPORATE REORGANIZATIONS – The percentages of post-Series A financings involving a corporate reorganization (i.e. reverse splits or conversion of shares into another series or classes of shares) were as follows:



About our Survey

The Fenwick & West Venture Capital Survey was first published in the first quarter of 2002 and has been published every quarter since then. Its goal is to provide information to the global entrepreneurial and venture community on the terms of venture financings in Silicon Valley.

The survey is available to all, without charge, by signing up at www.fenwick.com/vcsurvey/sign-up. We are pleased to be a source of information to entrepreneurs, investors, educators, students, journalists and government officials.

Our analysis of Silicon Valley financings is based on independent data collection performed by our lawyers and paralegals, and is not skewed towards or overly representative of financings in which our firm is involved. We believe that this approach, compared to only reporting on deals handled by a specific firm, provides a more statistically valid and larger dataset.

For purposes of determining whether a company is based in “Silicon Valley” we use the area code of the corporate headquarters. The area codes included are 650, 408, 415, 510, 925, 916, 707, 831 and 209.

Note on Methodology

When interpreting the Barometer results please bear in mind that the results reflect the average price increase of companies raising money in a given quarter compared to their prior round of financing, which was on average about 18 months prior. By definition the Barometer does not include companies that do not do follow-on financings (which may be because they went out of business, were acquired or went public). Accordingly we believe that our results are most valuable for identifying trends in the venture environment, as opposed to calculating absolute venture returns. Please also note that our calculations are not “dollar weighted,” i.e. all venture rounds are treated equally, regardless of size.

About the Authors

Cynthia Clarfield Hess is Co-Chair of Fenwick's Startup and Venture Capital Group. In her 25 plus years as a corporate attorney, Cindy has counseled technology companies on a broad range of corporate transactional matters, from formation matters and venture capital financings to mergers and acquisitions and public offerings, representing both companies and underwriters. She has worked with a wide range of high-technology clients – from established technology stalwarts to emerging companies developing disruptive technologies, which include some of the hottest and most innovative companies in the mobile, SaaS and social media spaces.

Mark Leahy, Co-Chair of Fenwick's Startup and Venture Capital Group and a seasoned advisor to technology companies on a broad range of corporate transactional matters, focuses on providing legal solutions that advance his clients' business objectives. His practice focuses on venture capital financings, corporate governance, mergers and acquisitions, and public offerings. His expertise spans a wide range of technologies, including software, semiconductor, internet/e-commerce, and data management and storage.

Khang Tran supports the firm's knowledge management efforts by collecting and sharing knowledge and expertise across the firm, which in turn, is leveraged to improve the quality of legal services to the firm's clients.

Contact/Sign Up Information

For additional information about this report please contact Cynthia Hess at 650.335.7238; chess@fenwick.com or Mark Leahy at 650.335.7682; mleahy@fenwick.com at Fenwick & West.

To view the most recent survey please visit fenwick.com/vcsurvey. To be placed on an email list for future editions of this survey please visit fenwick.com/vcsurvey/sign-up.

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