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Silicon Valley Venture Capital Survey Second Quarter 2018

Full Analysis

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Cynthia Clarfield Hess, Mark Leahy and Khang Tran

Background

We analyzed the terms of 225 venture financings closed in the second quarter of 2018 by companies headquartered in Silicon Valley.

Overview of Fenwick & West Results

Valuation results continued to be strong in Q2 2018, but declined moderately compared to the prior quarter.

- Up rounds exceeded down rounds 78% to 12%, with 10% flat in Q2 2018, an increase from Q1 when up rounds exceeded down rounds 75% to 15%, with 10% flat.
- The Fenwick & West Venture Capital Barometer™ showed an average price increase in Q2 2018 of 70%, a moderate decrease from the 74% recorded in the prior quarter, and the first quarter in which the average price increase had declined compared to the prior quarter since Q4 2016.
- The median price increase of financings in Q2 2018 was 37%, a decrease from the 41% recorded in Q1.
- Series B financings recorded the strongest valuation results in Q2 2018, with an average price increase of 117%, an increase from 92% in Q1, and a median price increase of 66%, an increase from 49% in Q1. Series C financings recorded the weakest valuation results in the quarter and the greatest declines, with the average price increase declining from 81% in Q1 to 36% in Q2 and the median price increase declining from 53% in Q1 to 22% in Q2.
- The software industry recorded the strongest valuation results in Q2 2018, with an average price increase of 85% and a median price increase of 46%, both moderately higher compared to the prior quarter. The valuation results for the internet/digital media industry, while still strong in comparison to the other industries, recorded the greatest declines in the quarter, with the average price increase declining from 101% in Q1 to 61% in Q2 and the median price increase declining from 59% in Q1 to 25% in Q2.

Overview of Other Industry Data

The U.S. venture environment remained strong in the second quarter of 2018 with the amount of capital invested in the quarter down only moderately from the over 10 year high recorded in the prior quarter. Deal activity in the quarter continued the downward trend observed over the past several years.

- Both the pace of investments and the amount of capital invested decreased moderately from Q1 2018 to Q2 2018.
- U.S. venture deals continued to grow in size, especially in later rounds where the median amount invested increased significantly in Q2 compared to the prior quarter.
- The Internet sector continued to receive the greatest share of investments, followed by the healthcare sector and the mobile and telecommunications sector.
- San Francisco (North Bay Area) again took in the largest share of investments in Q2, although the area's share declined moderately compared to the prior quarter.
- The number of U.S. venture-backed IPOs in Q2 was up significantly from the prior quarter and was the most in a quarter since Q1 2014, and the aggregate amount raised in these IPOs was the highest amount in a quarter in over 10 years.
- The number of acquisitions of U.S. venture-backed companies and the value of these deals increased significantly in Q2 to the highest levels in over 10 years.
- After a relatively slow start to the year, venture capital fundraising in terms of both fund count and capital raised are now on pace to surpass 2017 levels.

Venture Capital Investment

U.S. venture capital investment deal flow in Q2 2018 decreased moderately compared to both the prior quarter and the year ago period and remained significantly below the peak levels of 2015. The total dollar value of financings in Q2 was also moderately lower than in Q1, during which the greatest amount of capital was deployed in a quarter since 2000, but substantially higher compared to the year ago period.

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

Comparison between Q2 2018 and Q1 2018:

	Q2 2018	Q1 2018 ($Billions)	Difference %	Q2 2018 Deals	Q1 2018 Deals	Difference %
VentureSource[1]	$27.1	$26.1	4%	1,426	1,422	0%
PitchBook-NVCA[2]	$27.3	$30.2	-10%	1,859	2,138	-13%
MoneyTree[3]	$23.0	$22.4	2%	1,416	1,297	9%
Average	$25.8	$26.3	-2%	1,567	1,619	-3%

[1] Dow Jones VentureSource ("VentureSource")

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

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

Comparison between Q2 2018 and Q2 2017:

	Q2 2018	Q2 2017 ($Billions)	Difference %	Q2 2018 Deals	Q2 2017 Deals	Difference %
VentureSource	$27.1	$21.3	27%	1,426	1,395	2.2%
PitchBook-NVCA	$27.3	$20.9	31%	1,859	2,256	-18%
MoneyTree	$23.0	$19.2	20%	1,416	1,336	6%
Average	$25.8	$20.5	26%	1,567	1,662	-6%

U.S. venture deals continued to grow in size, with an increasing concentration of investment dollars into a fewer number of companies. 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 $10.0 million in Q2 2018, up from $8.0 million in Q1 2018. While this trend was evident across all rounds, later rounds again recorded the greatest increase, with the median amount invested having increased from $16.8 million in Q1 to $24.0 million in Q2. Meanwhile, seed and first rounds recorded only moderate increases in median deal size in Q2 compared to Q1.

According to MoneyTree, there were 45 mega-rounds (financings that raised $100 million or more), breaking the prior record of 36 mega-rounds set in Q3 2015. However, mega-rounds represented only 34% of the quarterly funding amount in Q2 2018, the second consecutive quarter of decline and the lowest percentage since Q1 2017. In addition, six new VC-backed companies reached unicorn status (private companies with a valuation of at least $1 billion) during Q2.

According to MoneyTree, seed/angel, expansion stage (Series B) and later stage (Series D and E+) investment deal allocations (i.e., allocation by number of deals) were unchanged in Q2 2018 compared to Q1 2018, while early stage (Series A) investment deal allocation declined slightly from 25% in Q1 to 24% in Q2. Continuing the trend of the past several years, later stage investments represented the lowest deal share at 11% in Q2, but the highest share of the invested capital at 38% in Q2, which was unchanged from Q1. Meanwhile, seed stage investments recorded a slight decline in invested capital allocation from 4% in Q1 to 3% in Q2, while expansion stage investments recorded a slight increase in invested capital allocation from 32% in Q1 to 33% in Q2.

The Internet sector continued to receive the greatest share of investments in Q2 2018 according to MoneyTree, comprising 43% of the total number of deals, down moderately from 46% in Q1 2018, and 39% of the aggregate invested capital, up from 36% in Q1. The healthcare sector saw the second highest level of investment activity in the quarter at 15% of the total deal count and 23% of the total invested capital, followed by the mobile and telecommunications sector at 12% of the total deal count and 15% of the invested capital.

Regionally, San Francisco (North Bay Area) continued to take in the largest share of investments in Q2 2018 at 25% of the aggregate invested capital, down from 29% in the prior quarter, and 19% of the total number of deals, down slightly from 20% in the prior quarter, according to MoneyTree. Investments into New York Metro area-based companies in Q2 represented the second highest deal share at 14%, but only the fourth highest share of the invested capital at 12%. Investments into companies based in the Silicon Valley (South Bay Area) in Q2 represented the third highest deal share at 12%, down slightly from 13% in Q1, and the second highest share of the invested capital at 17%, unchanged from Q1. The New England area recorded a slight decline in deal share in Q2; however, the invested capital allocation increased from 12% in Q1, which was the fourth highest share of the invested capital in Q1, to 13% in Q2, which was the third highest share of the invested capital in Q2.

IPO Activity

Initial public offerings continued to be a bright spot in the exit market. According to VentureSource, there were 31 U.S. venture-backed IPOs in Q2 2018, up significantly from the 15 IPOs in Q1 2018 and the highest number of U.S. venture-backed IPOs in a quarter since Q1 2014. The aggregate amount raised in the IPOs in the quarter was $4.8 billion, the highest amount in a quarter in over 10 years. The healthcare industry again made up a majority of the IPO count with 20 IPOs in Q2, up from nine in Q1, while the aggregate amount raised in these IPOs increased from $823.9 million in Q1 to $2.1 billion in Q2. Meanwhile, the IT industry saw a decline in IPO activity, with the number of IPOs of IT companies declining from four in Q1 to three in Q2 and the aggregate amount raised declining from $778.4 million in Q1 to $469.2 million in Q2.

The median time from initial equity funding to IPO decreased from 5.1 years in Q1 2018 to 4.5 years in Q2 2018, primarily as a result of the increase in the number of IPOs of relatively less established healthcare companies over the past several years. In contrast, the median time to IPO for IT companies has increased over the past several years from 7.9 years in 2013 to 12.5 years in 2018, with highly-valued VC-backed IT companies continuing to raise further rounds and grow in the private market. Consistent with this trend, the median pre-IPO valuation increased from $319 million in Q1 to $473 million in Q2 and the median equity amount raised prior to IPO increased from $102 million in Q1 to $150 million in Q2.

Merger and Acquisition Activity

U.S. M&A activity was robust in Q2 2018, with 173 deals valued at an aggregate of $36.7 billion, according to VentureSource, the highest deal volume and aggregate deal value in over 10 years. The median deal value, on the other hand, decreased from $125.0 million in Q1 to $119.0 million in Q2.

The IT industry again led in terms of M&A deal count with 64 deals in Q2 2018, up slightly from 63 deals in Q1 2018, followed by the business and financial services industry, which recorded the greatest increase from 40 deals in Q1 to 49 deals in Q2. Meanwhile, the consumer services industry recorded only a moderate increase in deal count, but the aggregate value of these deals increased substantially from $2.2 billion in Q1 to $11.2 billion in Q2, which was second only to the business and financial services industry's $12.9 billion in aggregate M&A deal value in Q2.

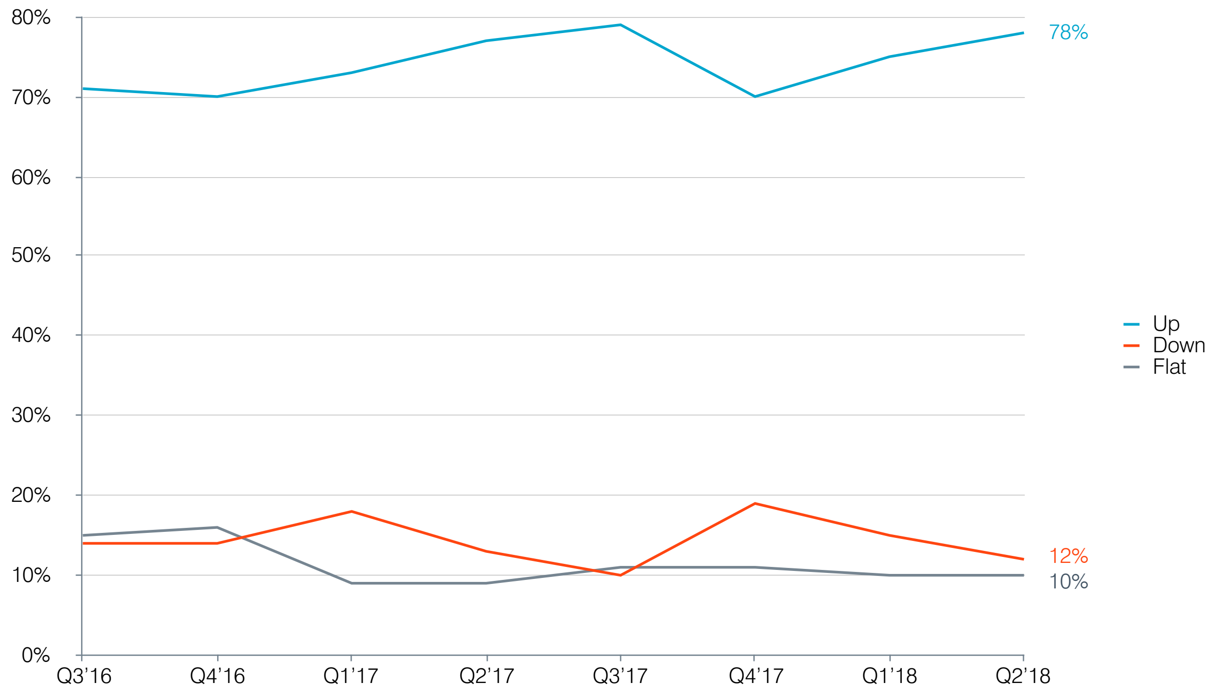
In contrast to the decline in median deal value, VentureSource reported a slight increase in the median time from initial equity funding to acquisition from 5.2 years in Q1 2018 to 5.4 years in Q2 2018. Similarly, the median equity amount raised prior to acquisition increased from $15.2 million in Q1 to $16.3 million in Q2.

Venture Capital Fundraising

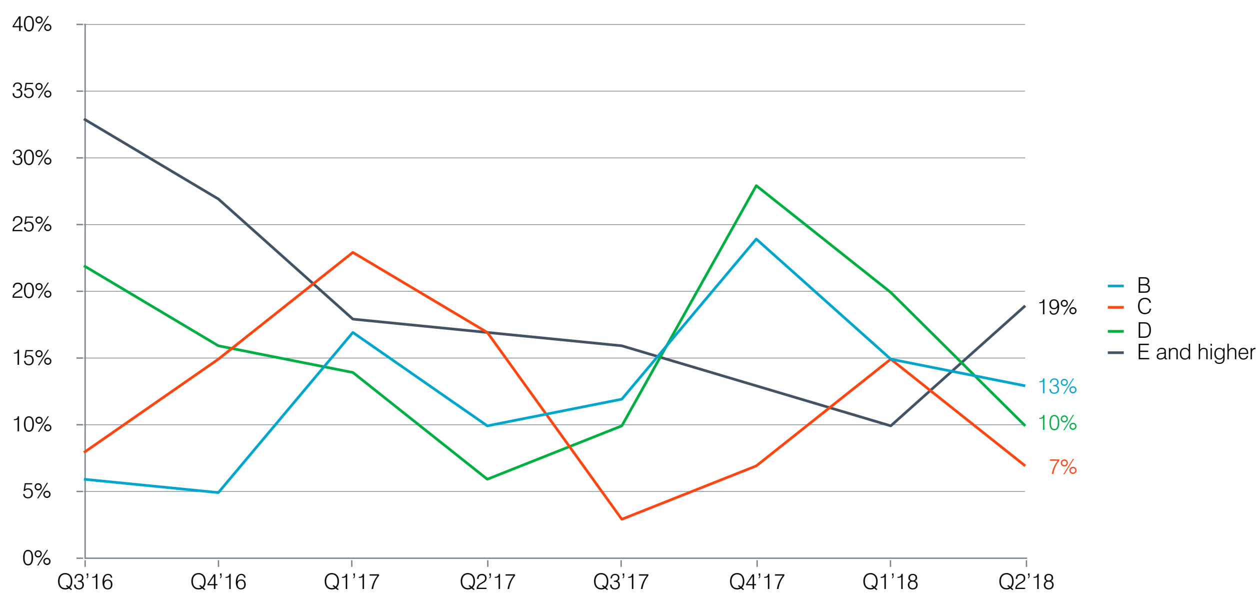
According to PitchBook-NVCA, venture capitalist firms raised $10.8 billion across 72 funds in Q2 2018, an uptick in activity from Q1 2018. Both fund count and capital raised are now on pace to surpass 2017 levels. Median fund size has been increasing over the past few years to $65.0 million in the first half of 2018, which is a 10-year high. This increase in fund size has been primarily driven by the increase in funds in the $100 million to $500 million range. In contrast, after a strong start to the year, fundraising for microfunds (fund size of less than $50 million) has declined in 2018. Another trend is the continuing decrease in mega-funds (fund size of more than $1 billion) raised, though there is optimism that this trend will reverse in the second half of the year with the potential closings of seven open mega-funds.

Fenwick & West Data on Valuation

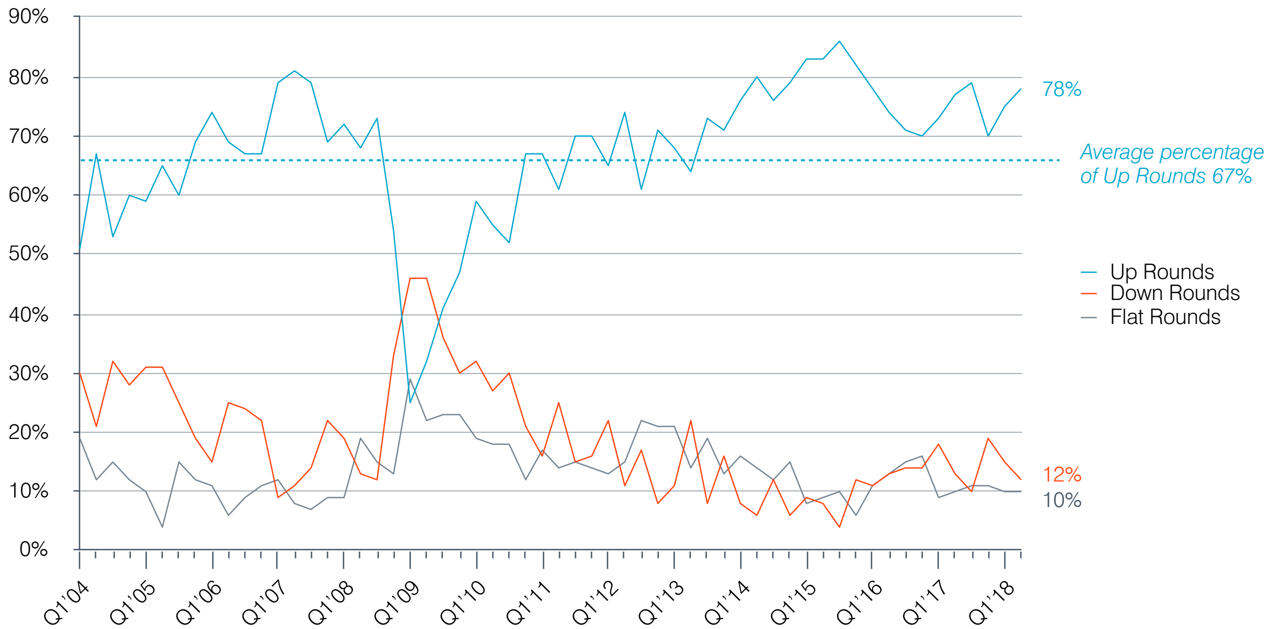
PRICE CHANGE—The direction of price changes for companies receiving financing in a quarter, compared to their prior round of financing.



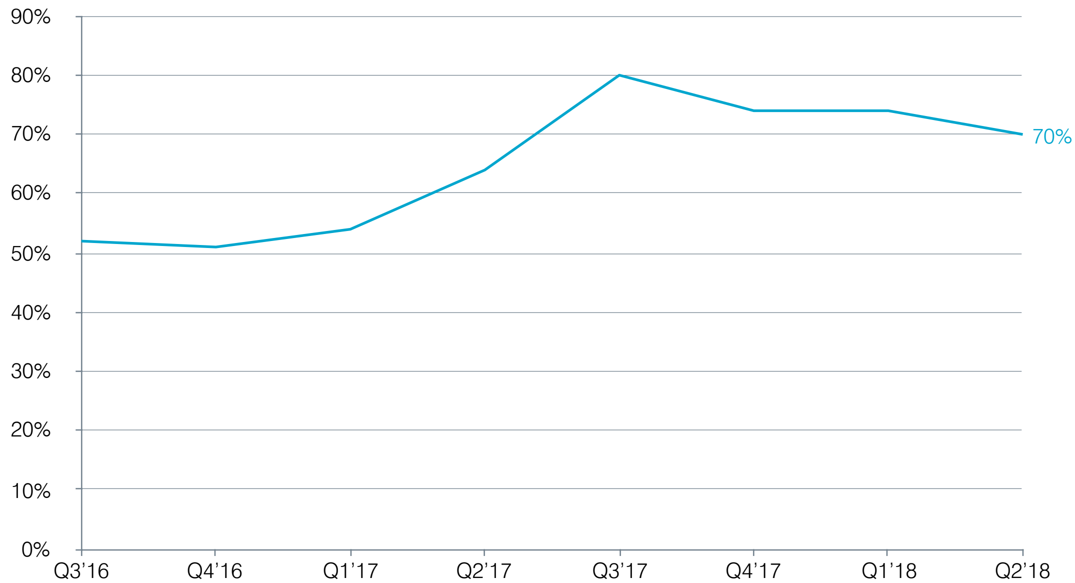
The percentage of **DOWN ROUNDS** by series were as follows:



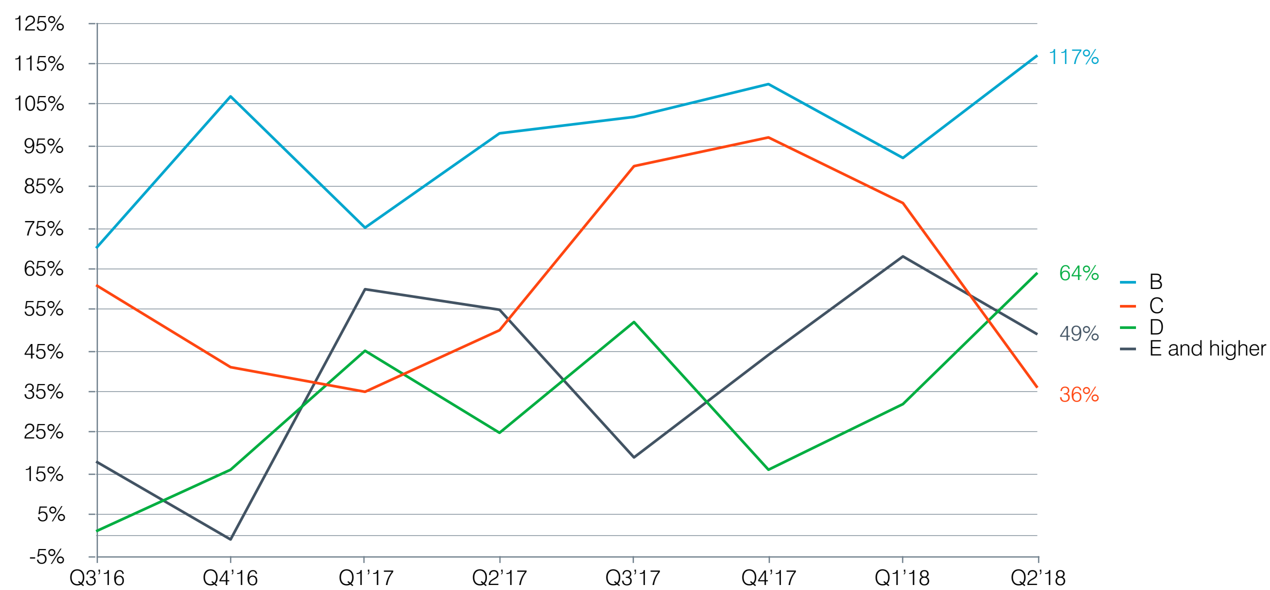
EXPANDED PRICE CHANGE GRAPH—Set forth below is the direction of price changes for each quarter since 2004.



THE FENWICK & WEST VENTURE CAPITAL BAROMETER™ (magnitude of price change)—Set forth below is the *average* 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.

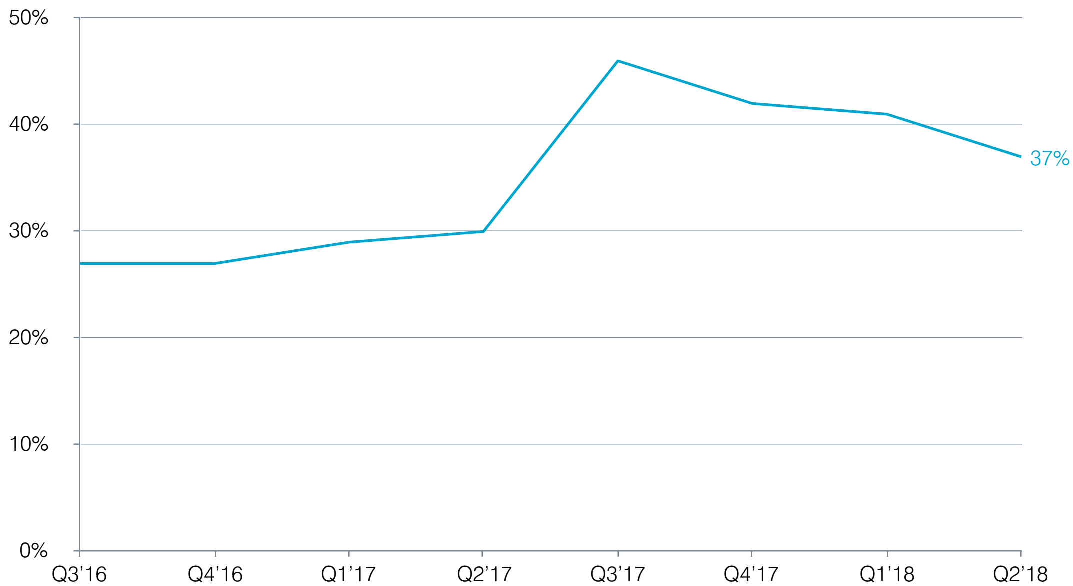


The Barometer results by series are as follows:

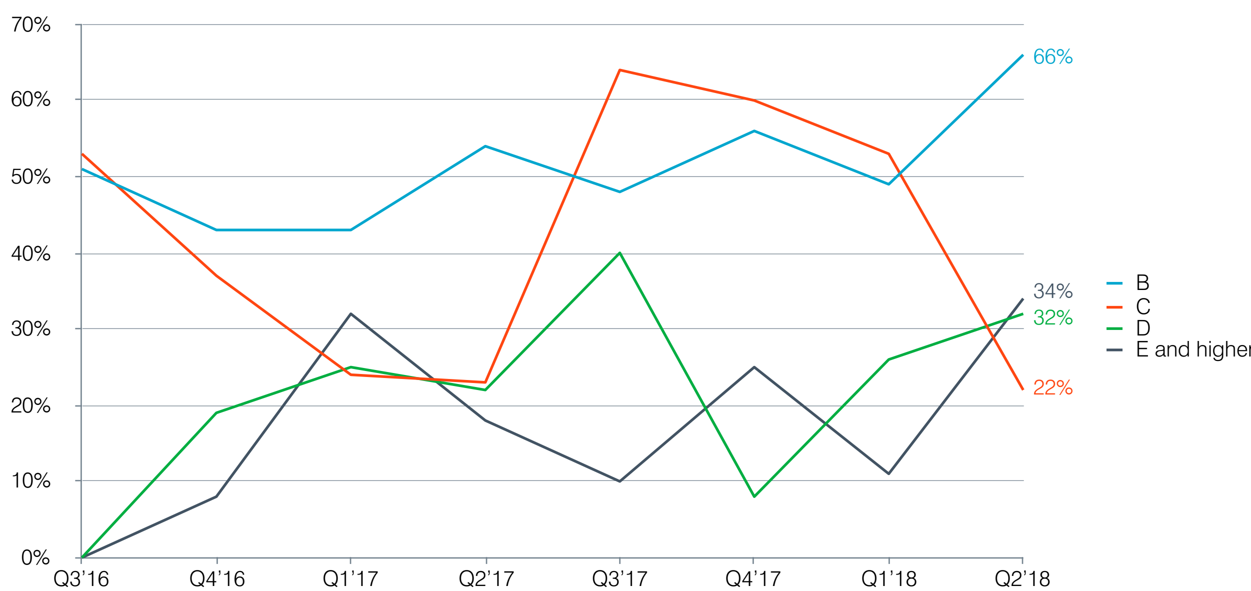


EXPANDED BAROMETER GRAPH — Set forth below is the average percentage price change for each quarter since we began calculating this metric in 2004.

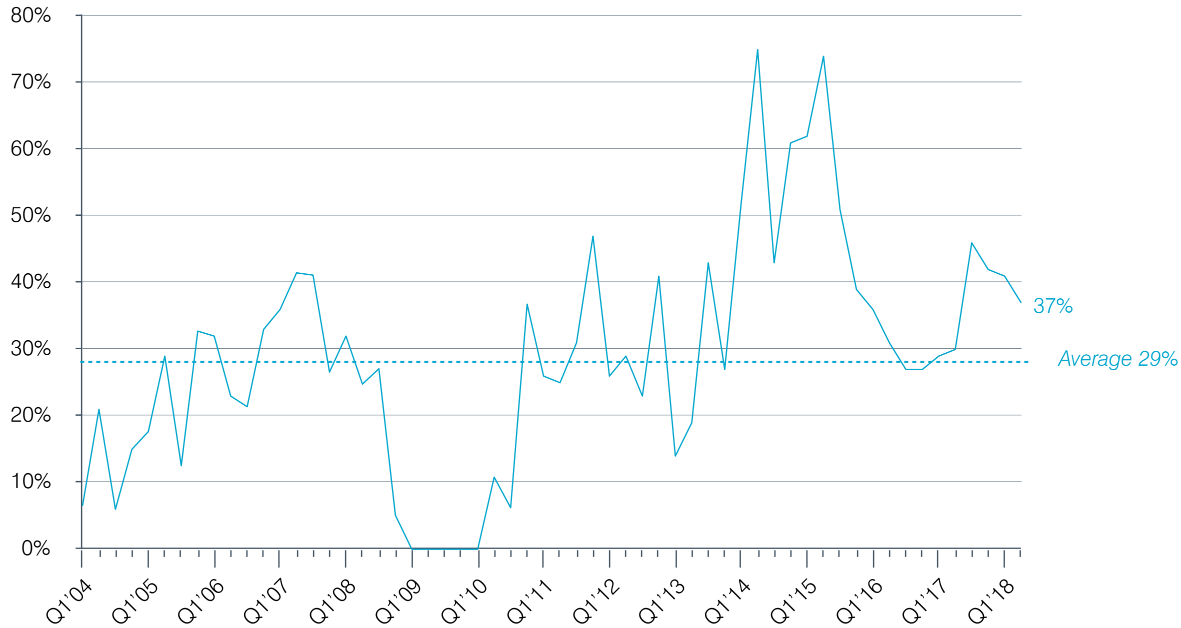
MEDIAN PERCENTAGE PRICE CHANGE—Set forth below is the median percentage change between the price per share at which companies raised funds in a quarter, compared to the price per share at which such companies raised funds in their prior round of financing. In calculating the median, all rounds (up, down 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	78%	14%	9%	75%	46%	81
Hardware	81%	5%	14%	59%	27%	21
Life Science	73%	10%	17%	63%	19%	30
Internet/Digital Media	74%	16%	11%	61%	25%	19
Other	84%	16%	0%	81%	53%	19
Total all Industries	**78%**	**12%**	**10%**	**70%**	**37%**	**170**

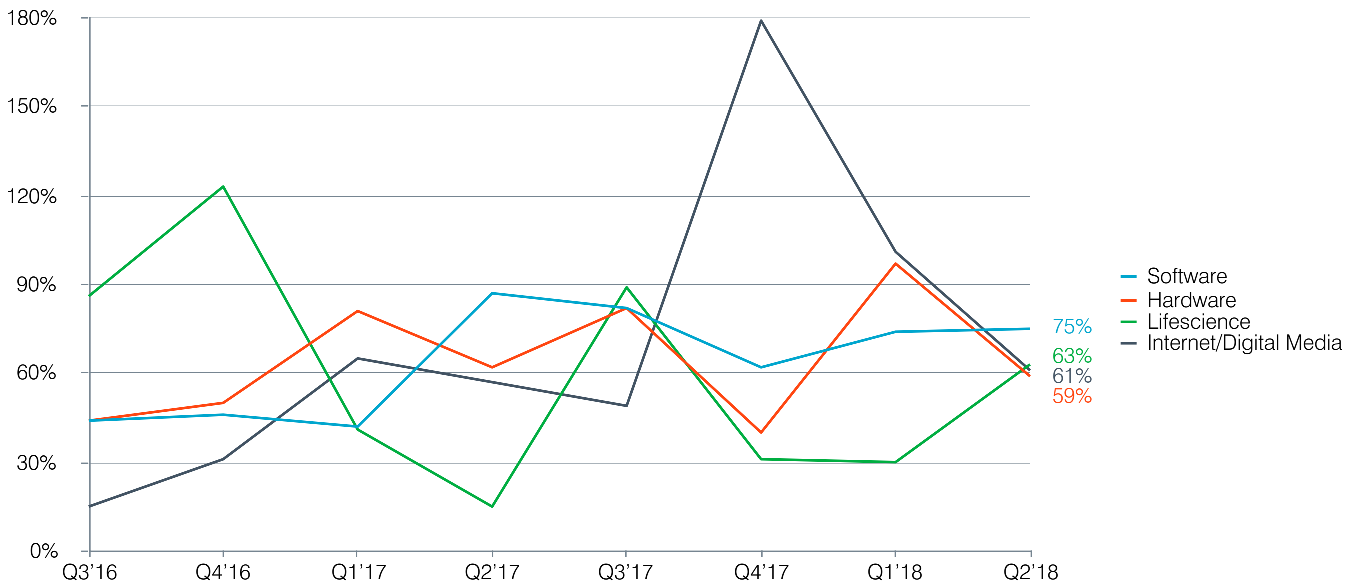
DOWN ROUND RESULTS BY INDUSTRY — The table below sets forth the percentage of "down rounds," by industry groups, for each of the past eight quarters.

Down Rounds	Q3'16	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17	Q1'18	Q2'18
Software	14%	13%	20%	14%	10%	18%	16%	14%
Hardware	8%	18%	18%	17%	8%	28%	10%	5%
Life Science	18%	13%	17%	16%	9%	21%	16%	10%
Internet/Digital Media	20%	15%	24%	11%	8%	14%	17%	16%
Other	0%	17%	0%	8%	15%	13%	0%	16%
Total all Industries	**14%**	**14%**	**18%**	**13%**	**10%**	**19%**	**15%**	**12%**

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

Industry	Q3'16	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17	Q1'18	Q2'18
Software	44%	46%	42%	87%	82%	62%	74%	75%
Hardware	44%	50%	81%	62%	82%	40%	97%	59%
Life Science	86%	123%	41%	15%	89%	31%	30%	63%
Internet/Digital Media	15%	31%	65%	57%	49%	179%	101%	61%
Other	78%	-5%	69%	43%	107%	73%	72%	81%
Total all Industries	**52%**	**51%**	**54%**	**64%**	**80%**	**74%**	**74%**	**70%**

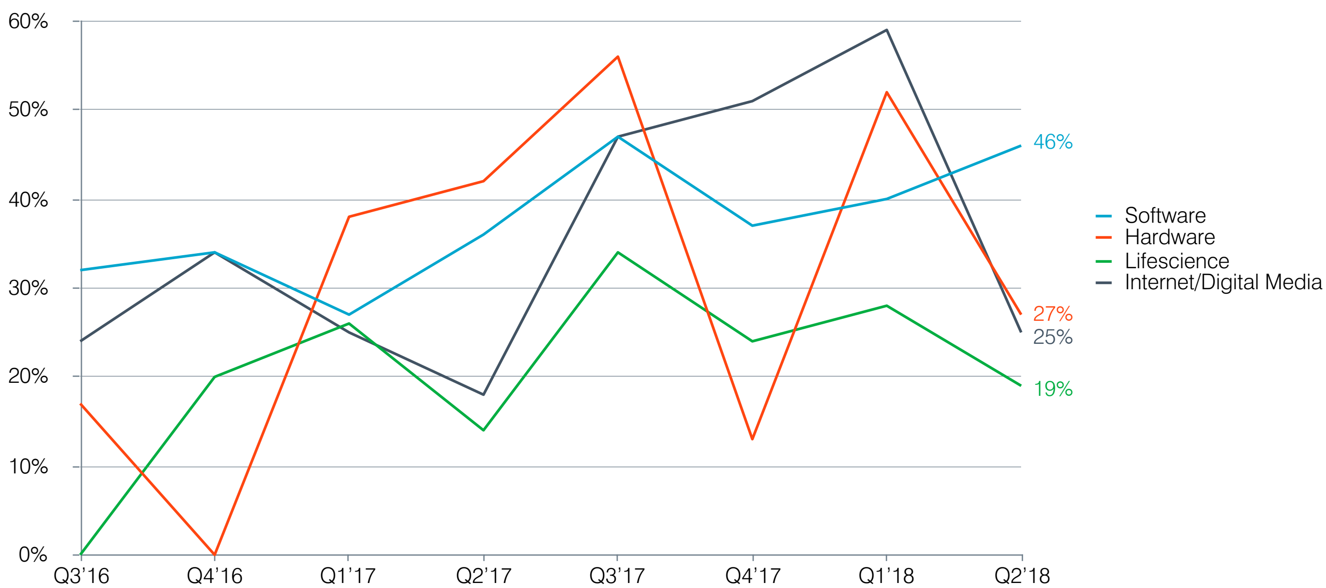
A graphical representation of the above is below.



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

A graphical representation of the above is below.

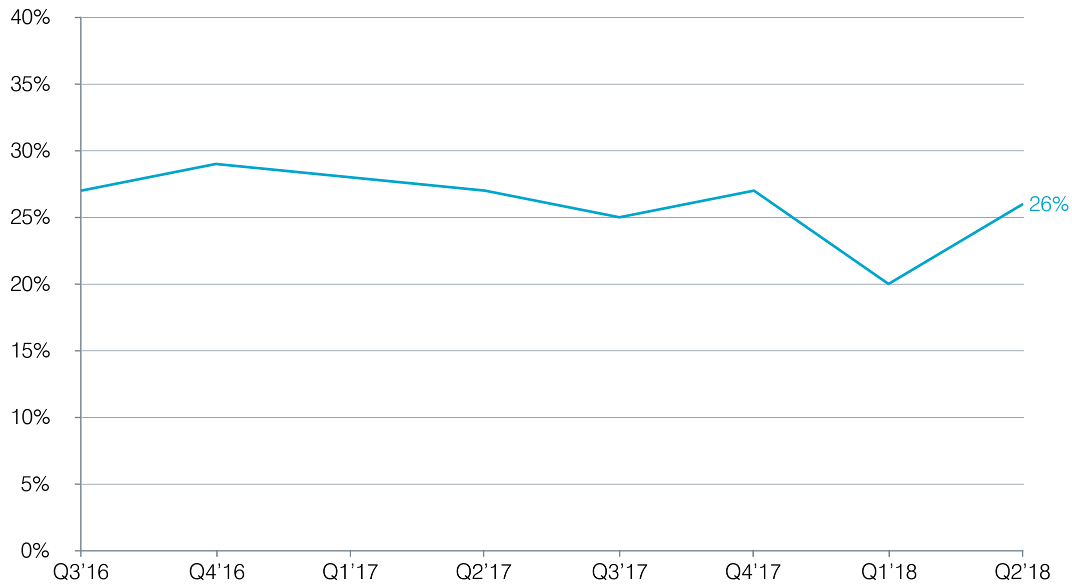


FINANCING ROUND—This quarter's financings broke down by series according to the chart below.

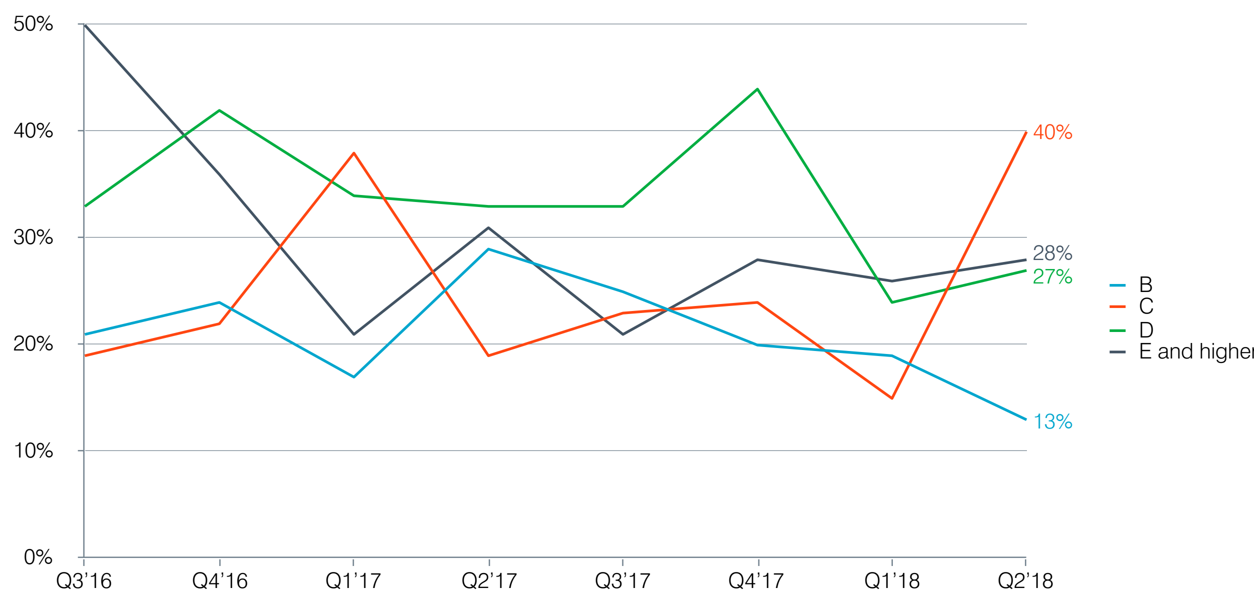
Series	Q3'16	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17	Q1'18	Q2'18
Series A	26%	22%	29%	28%	27%	29%	25%	24%
Series B	32%	28%	18%	23%	32%	26%	27%	24%
Series C	17%	20%	20%	23%	19%	15%	21%	19%
Series D	12%	14%	15%	9%	11%	13%	13%	13%
Series E and Higher	12%	16%	17%	17%	10%	17%	16%	19%

Fenwick & West Data on Legal Terms

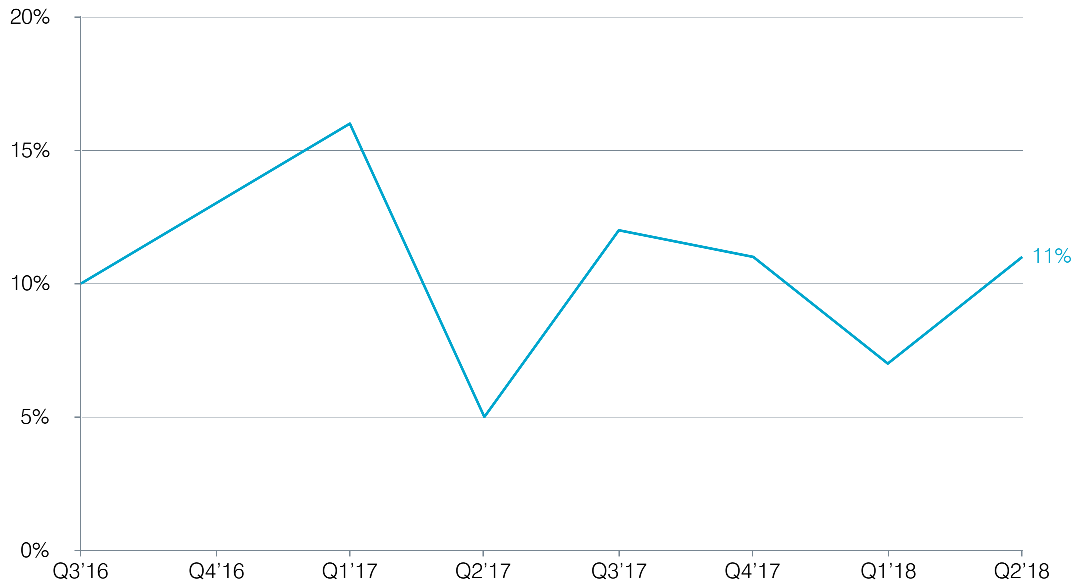
LIQUIDATION PREFERENCE—Senior liquidation preferences were used in the following percentages of financings.



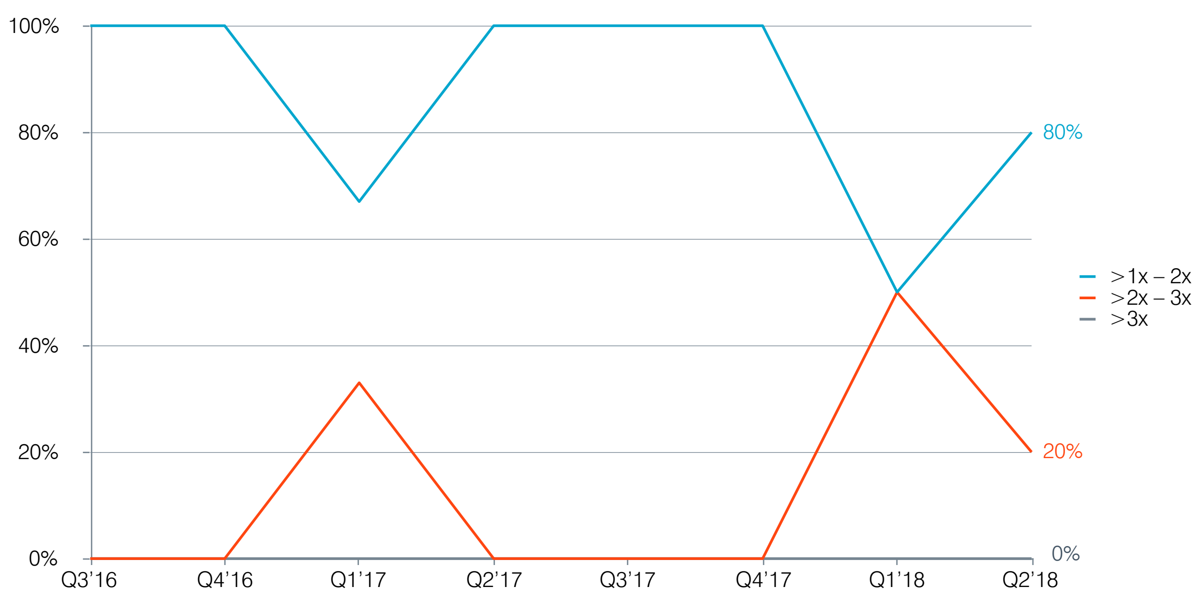
The percentage of senior liquidation preference by series was as follows:



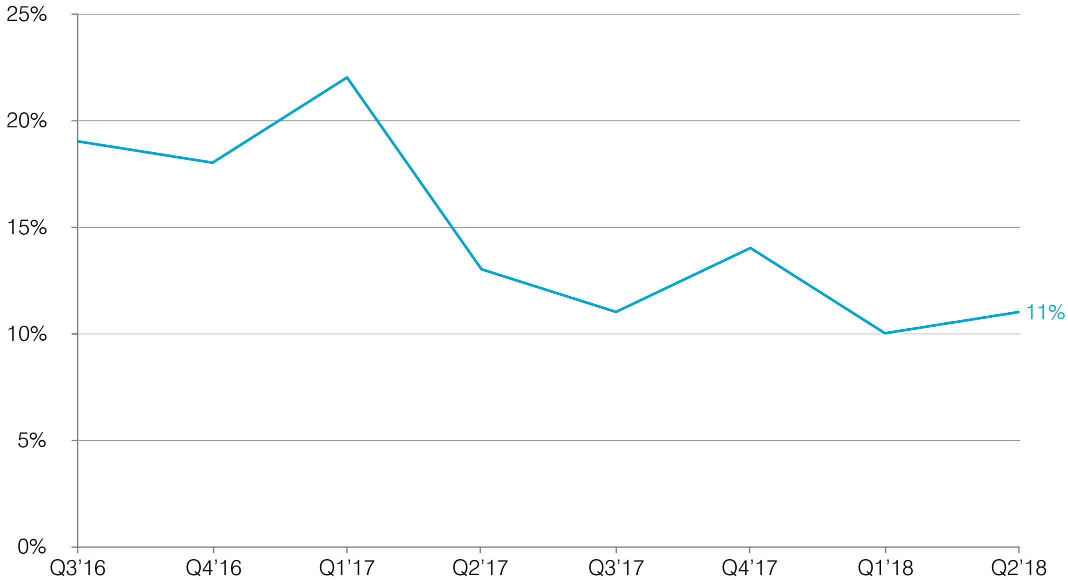
MULTIPLE LIQUIDATION PREFERENCES — The percentage of senior liquidation preferences that were multiple liquidation preferences were as follows:



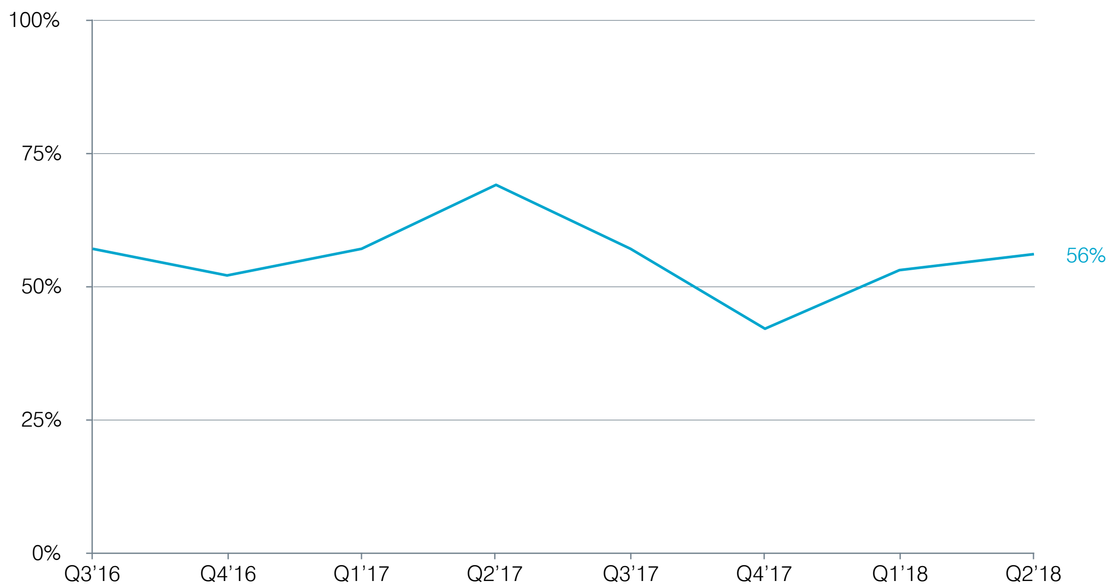
Of the senior liquidation preferences that were a multiple preference, the ranges of the multiples broke down as follows:



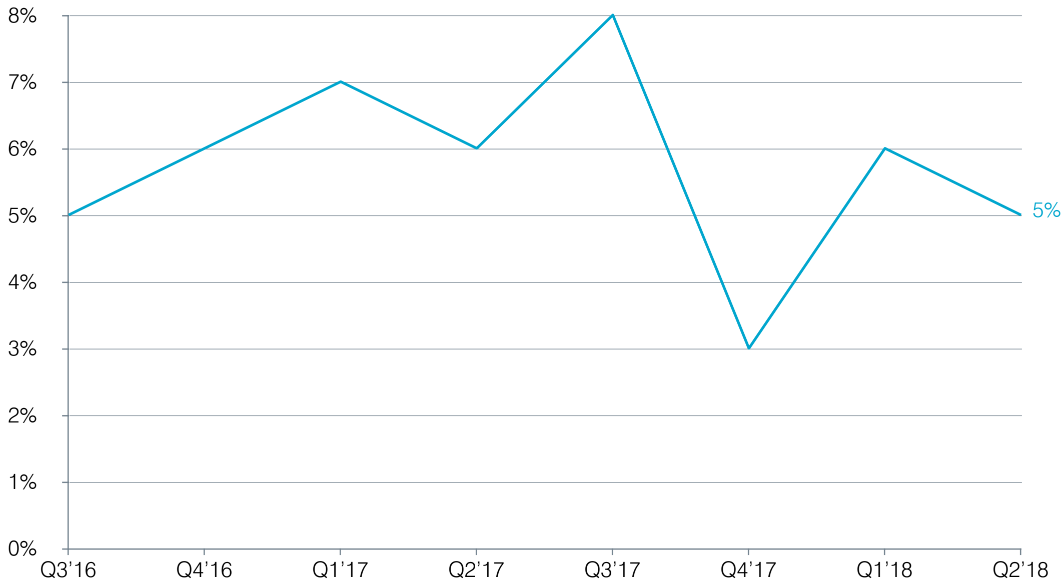
PARTICIPATION IN LIQUIDATION —The percentages of financings that provided for participation were as follows:



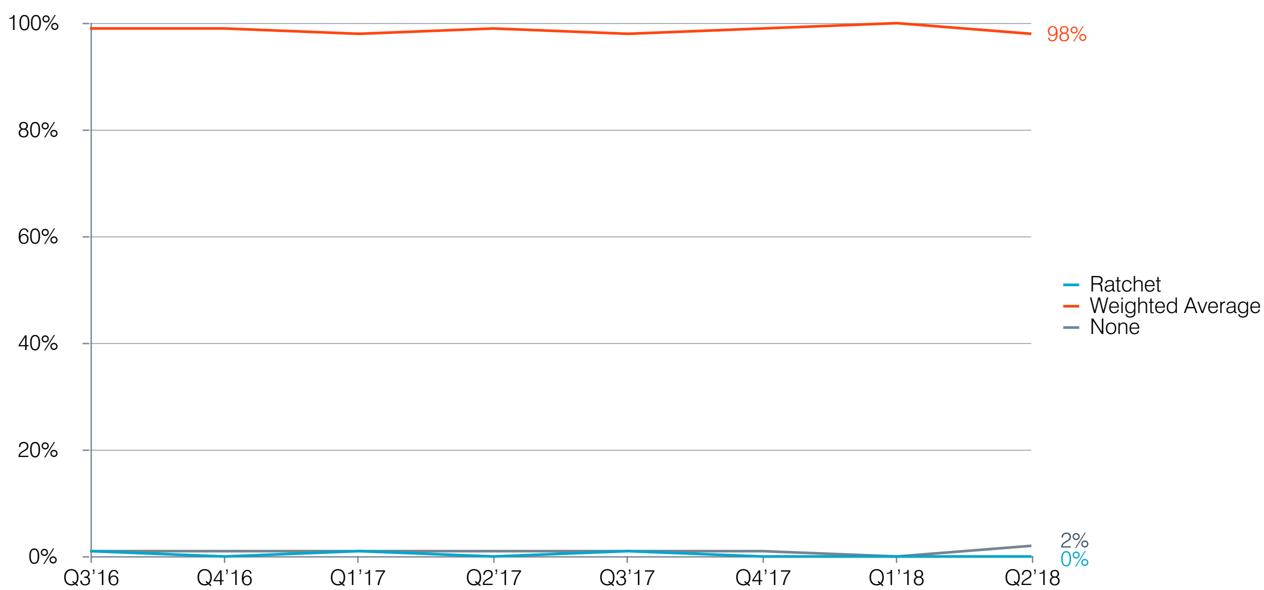
Of the financings that had participation, the percentages that were not capped were as follows:



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

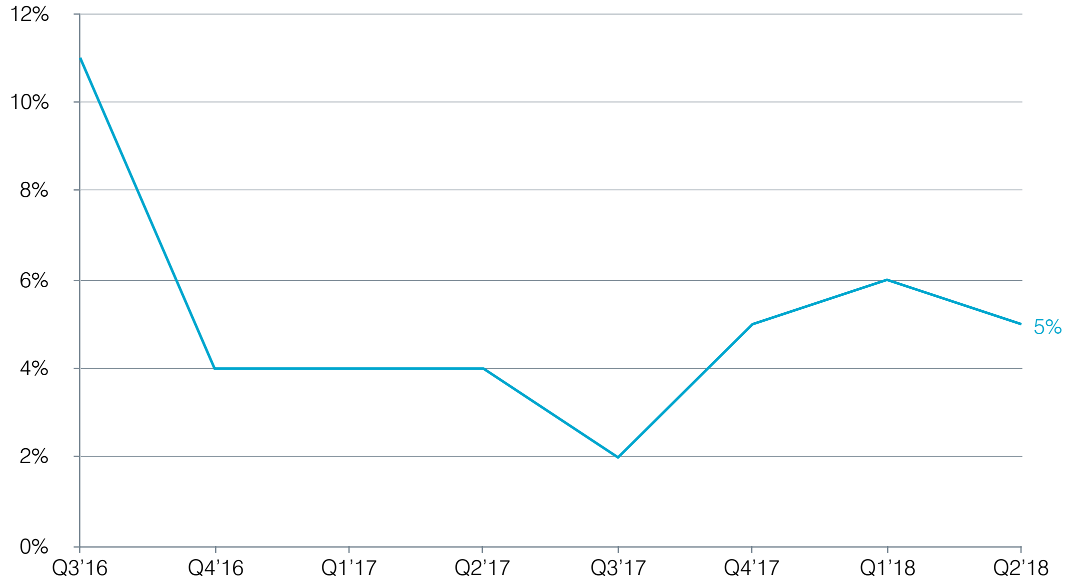


ANTIDILUTION PROVISIONS –The uses of (non-IPO) antidilution provisions in the financings were as follows:

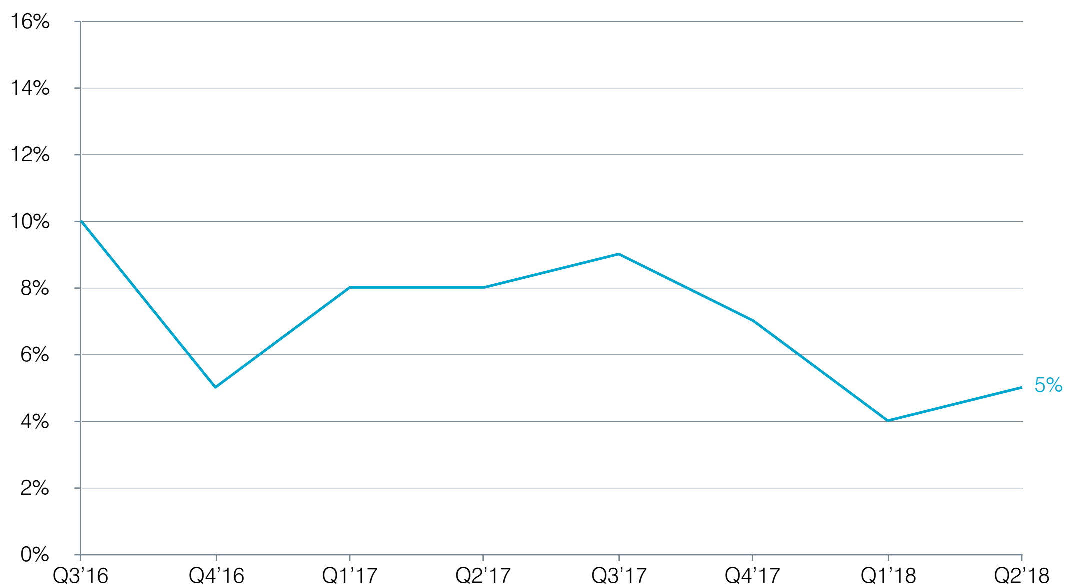


Please note that the chart above only applies to non-IPO anti-dilution provisions. In other words, the chart refers to anti-dilution provisions that protect the investor against a future venture financing at a price below what the investor paid. The chart does not include anti-dilution provisions designed 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.

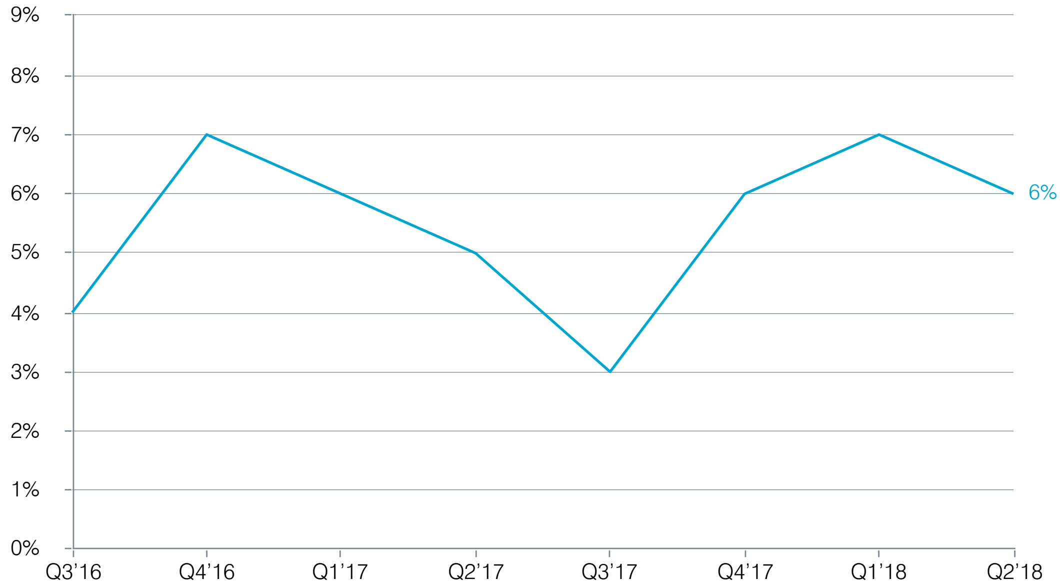
PAY-TO-PLAY PROVISIONS – The percentages of financings having pay-to-play provisions were as follows:



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.