FENWICK & WEST

Silicon Valley Venture Capital Survey Third Quarter 2018

Full Analysis

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Background

We analyzed the terms of 215 venture financings closed in the third quarter of 2018 by companies headquartered in Silicon Valley.

Overview of Fenwick & West Results

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

- Up rounds exceeded down rounds 78% to 9%, with 13% flat in Q3 2018, a moderate improvement from Q2, when up rounds exceeded down rounds 78% to 12%, with 10% flat.
- The Fenwick & West Venture Capital Barometer™ showed an average price increase in Q3 2018 of 71%, a slight increase from the 70% recorded in the prior quarter.
- The median price increase of financings in Q3 2018 was 42%, a moderate hike from the 37% recorded in Q2.
- Series B financings recorded the strongest valuation results in Q3 2018, although the average price increase declined from 117% in Q2 to 92% in Q3, while the median price increase was up moderately from 66% in Q2 to 68% in Q3. Series C and D financings both recorded strong gains in valuation results in Q3, while Series E financings recorded the weakest valuation results in the quarter.
- The life sciences industry recorded the strongest valuation results in Q3 2018 and the greatest gain from the prior quarter, with an average price increase of 110%, up from 63% in Q2, and a median price increase of 44%, up from 19% in Q2. The internet/digital media industry also recorded strong valuation results in the quarter, with an average price increase of 78%, up from 61% in Q2, and a median price increase of 47%, up from 25% in Q2. The software industry recorded the greatest decline in valuation results in Q3, while the hardware industry had the weakest valuation results in the quarter.

Overview of Other Industry Data

The U.S. venture environment remained strong in the third quarter of 2018 with the greatest amount of capital deployed in a quarter since 2000 despite declining deal volume.

[1] Since we began calculating valuation metrics in 2004.

- Both the pace of investments and the amount of capital invested increased from Q2 2018 and Q3 2017 to Q3 2018.
- Later-stage investments continued to represent the lowest deal share, but the highest share of the invested capital in Q3. Meanwhile, seed-stage investment deal allocation declined in Q3 to the lowest percentage since Q4 2009.
- 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 Q3, followed by the New York Metro area. The New England area moved ahead of the Silicon Valley (South Bay Area) for the first time into third place in Q3 in terms of deal share, but the region's invested capital allocation declined moderately in Q3 and placed the region fourth behind the Silicon Valley (South Bay Area) by that measure.
- U.S. venture-backed IPO activity in Q3 was down from the prior quarter, but the number of IPOs and the amount raised in the quarter were still the highest in the third quarter of a calendar year since 2014 and 2013, respectively.
- The number of acquisitions of U.S. venture-backed companies in the quarter was the highest since Q4 2010 and the aggregate value of these deals was the second highest in over 10 years.
- Venture capital fundraising in terms of both fund count and capital raised remain on pace to surpass 2017 levels. With the rise in larger investment vehicles, average and median fund sizes are at eight- and 10-year highs, respectively.

Venture Capital Investment

Although U.S. venture capital investment deal flow in Q3 2018 declined compared to both the prior quarter and the year ago period, the total dollar value of the financings in Q3 increased compared to both 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 Q3 2018 and Q2 2018:

	Q3 2018 ($Billions)	**Q2 2018 ($Billions)**	**Difference %**	**Q3 2018 Deals**	**Q2 2018 Deals**	**Difference %**
VentureSource[1]	$31.5	$27.6	14%	1,377	1,498	-8%
PitchBook-NVCA[2]	$27.9	$27.6	1%	1,937	2,349	-18%
MoneyTree[3]	$27.5	$23.6	17%	1,229	1,501	-18%
Average	$29.0	$26.3	10%	1,514	1,783	-15%

[1] Dow Jones VentureSource ("VentureSource")

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

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

Comparison between Q3 2018 and Q3 2017:

	Q3 2018 ($Billions)	Q3 2017 ($Billions)	Difference %	Q3 2018 Deals	Q3 2017 Deals	Difference %
VentureSource	$31.5	$23.6	34%	1,377	1,376	0.1%
PitchBook-NVCA	$27.9	$24.2	15%	1,937	2,240	-14%
MoneyTree	$27.5	$20.6	34%	1,229	1,480	-17%
Average	$29.0	$22.8	27%	1,514	1,699	-11%

The trend over the last several years of increasing concentration of investment dollars into a fewer number of companies was again evident this quarter. 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 $8.0 million in Q3 2018, down slightly from $8.1 million in Q2 2018. However, the $8.0 million median amount during the first three quarters of 2018 remained significantly higher than the $6.5 million median amount in the first three quarters of 2017. Later-stage rounds recorded the greatest decline in the median amount in Q3 compared to the prior quarter, declining from $22.5 million in Q2 to $16.1 million in Q3. Meanwhile, first rounds recorded the greatest increase in the median amount in Q3 compared to the prior quarter, increasing from $5.1 million in Q2 to $5.5 million in Q3.

According to MoneyTree, there were 55 mega-rounds (financings that raised $100 million or more) in Q3 2018, breaking the previous record of 46 mega-rounds set just in the prior quarter. With an aggregate of $14.1 billion raised, representing 51% of the total funding amount in the quarter, mega-rounds were also at record levels in terms of dollar amount and percentage of all funding. In addition, the quarter saw 16 new U.S. VC-backed companies reach unicorn status (private companies with a valuation of at least $1 billion), substantially higher than the seven new U.S. unicorns in the prior quarter and a new quarterly record for unicorn creation.

According to MoneyTree, early-stage (Series A), expansion-stage (Series B and C) and later-stage (Series D and E+) investment deal allocations (i.e., allocation by number of deals) were all up moderately in Q3 2018 compared to the prior quarter, while seed-stage investment deal allocation declined from 26% in Q2 to 18% in Q3, the lowest percentage since Q4 2009. Later-stage investments continued to represent the highest share of the invested capital at 32% in Q3, although this was a decline from 38% in Q2 and the lowest percentage since Q4 2016. Meanwhile, investments not associated with any stage in a company's funding history, including corporate minority rounds, recorded a substantial rise in invested capital allocation from 9% in Q2 to 19% in Q3, the highest percentage in over 10 years.

The internet sector again received the greatest share of investments in Q3 2018 according to MoneyTree, comprising 43% of the total number of deals and 39% of the aggregate invested capital, both unchanged from the prior quarter. The healthcare sector saw the second-highest level of investment activity in the quarter at 17% of the total deal count, up moderately from 15% in the prior quarter, and 20% of the total invested capital, down moderately from 23% in the prior quarter, followed by the mobile and telecommunications sector at 12% of the total deal count and 15% of the invested capital, both unchanged from the prior quarter.

Regionally, San Francisco (North Bay Area) continued to take in the largest share of investments in Q3 2018 at 29% of the aggregate invested capital, up from 25% in the prior quarter, and 19% of the total number of deals, unchanged from the prior quarter, according to MoneyTree. Investments into New York Metro area-based companies in Q3 saw the second highest level of investment activity at 21% of the aggregate invested capital, up substantially from 12% in the prior quarter, and 13% of the deal share, unchanged from the prior quarter. The New England area moved ahead of the Silicon Valley (South Bay Area) for the first time into third place in Q3 in terms of deal share at 10%, up slightly from 9% in Q2, but the region's invested capital allocation declined moderately from 13% in Q2 to 9% in Q3. Meanwhile, although the deal share of the Silicon Valley (South Bay Area) declined moderately from 12% in Q2 to 10% in Q3, the region's invested capital allocation increased slightly from 17% in Q2 to 18% in Q3.

IPO Activity

According to VentureSource, there were 21 U.S. venture-backed IPOs in Q3 2018, down from the 31 IPOs in Q2, but the highest number of IPOs in the third quarter of a calendar year since 2014. The aggregate amount raised in these IPOs in the quarter was $2.3 billion, down from $4.8 billion in Q2, which was the greatest amount in a quarter in over 10 years. Nevertheless, the amount was the greatest raised in the third quarter of a calendar year since 2013. The healthcare industry again made up a majority of the IPO count with 16 IPOs in Q3, down from 20 in Q2. The business and financial services industry saw the greatest decline in IPO activity with no IPOs this quarter after a quarter in which six companies in the industry had IPOs. Meanwhile, the IT industry still has yet to see any significant increase in IPO activity this year with only three IPOs in the quarter and 10 total in the first three quarters of the year.

The median time from initial equity funding to IPO increased from 4.5 years in Q2 2018 to 5.9 years in Q3 2018. Healthcare companies in particular saw a significant rise in the median time from initial equity funding to IPO from 2.9 years in Q2 to 5.9 years in Q3. In contrast, the median pre-IPO valuation and the median equity amount raised prior to IPO declined in Q3 when compared to the prior quarter, but have generally trended upwards over the past several years.

Merger and Acquisition Activity

There were 202 acquisitions of U.S. venture-backed companies in Q3 2018, according to VentureSource, up moderately from 190 M&A deals in Q2 and the highest deal volume since Q4 2010. While the aggregate value of these deals fell from $37.5 billion in Q2 to $33.0 billion in Q3, it was nevertheless the second highest aggregate deal value in over 10 years.

The IT industry saw the greatest amount of M&A deal activity with 78 deals in Q3 2018 for an aggregate of $12.1 billion, up from 70 deals for an aggregate of $7.8 billion in the prior quarter. The business and financial services industry was next with 54 deals for an aggregate of $9.1 billion in Q3, down from 56 deals for an aggregate of $13.5 billion in the prior quarter, followed by the healthcare industry with 36 deals for an aggregate of $8.1 billion in the Q3, up significantly from 23 deals for an aggregate of $3.2 billion in the prior quarter. Meanwhile, the consumer services industry recorded a substantial decline in M&A deal activity from 33 deals for an aggregate of $12.0 billion in Q2 to 26 deals for an aggregate of $2.5 billion in Q3.

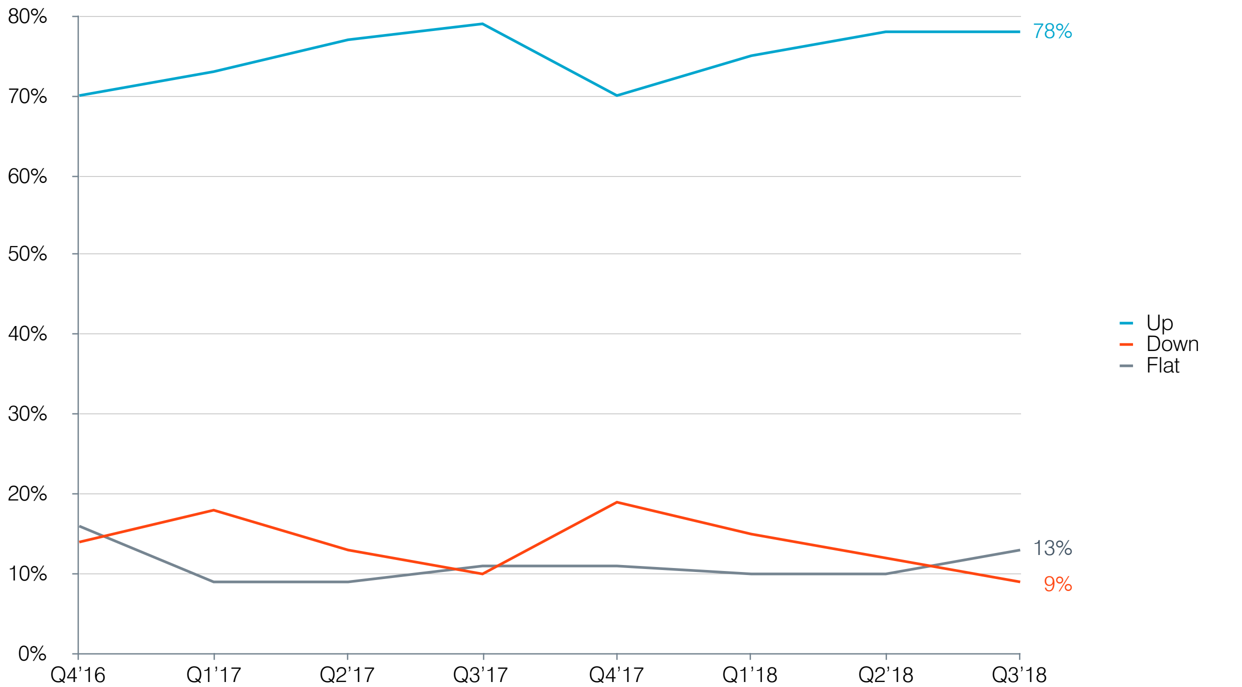
The median time from initial equity funding to acquisition declined from 5.2 years in Q2 2018 to 4.5 years in Q3 2018. Much of the decline can be attributed to the healthcare companies acquired in the quarter where, in contrast to the healthcare IPOs in the quarter, the median time from initial equity funding to exit declined substantially from 8.3 years in Q2 to 4.6 years in Q3. Similarly, the median equity amount raised prior to acquisition declined from $16.1 billion in Q2 to $10.4 billion in Q3.

Venture Capital Fundraising

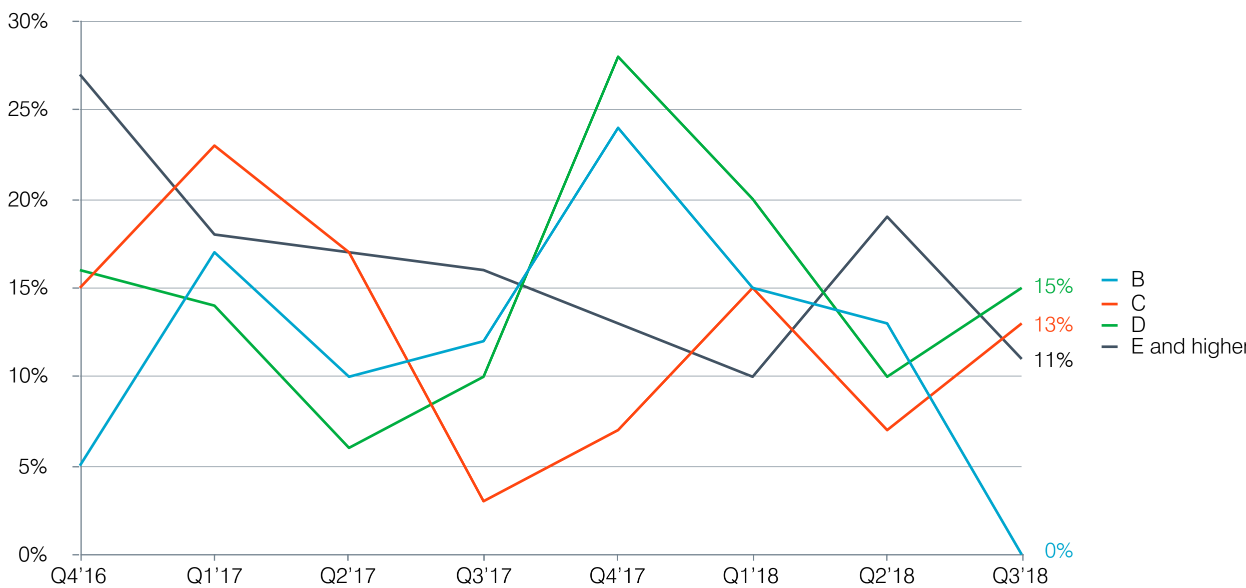
According to PitchBook-NVCA, venture capital fundraising in terms of both fund count and capital raised remain on pace to surpass 2017 levels with $32.4 billion raised across 230 funds through the first three quarters of the year after $35.3 billion was raised across 288 funds during 2017. Venture capitalists have favored larger funds in recent years to keep pace with growing VC deal sizes. Average and median fund sizes are at eight- and 10-year highs of $151.3 million and $68.0 million, respectively, in 2018, up from $132.2 million and $50.0 million, respectively, in 2017. This increase from 2017 in fund size has been primarily driven by the increase in funds of $250+ million, with the number of funds in the $250 million to $500 million range and mega-funds (fund size of more than $1 billion) closed so far in 2018 (27 and five, respectively) already surpassing the counts in all of 2017 (25 and three, respectively). In contrast, after a strong start to the year, fundraising for microfunds (fund size of less than $50 million) has declined in 2018.

Fenwick & West Data on Valuation

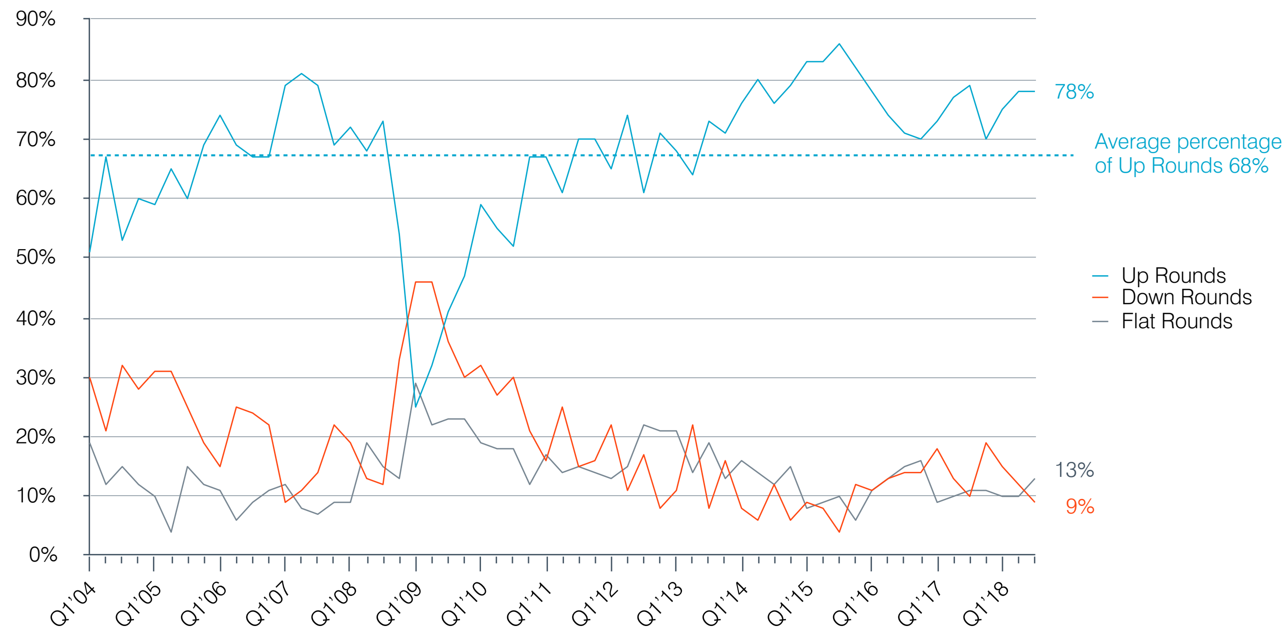
PRICE CHANGE—The direction of price changes for companies receiving financing in a quarter, compared to their prior round of financing.



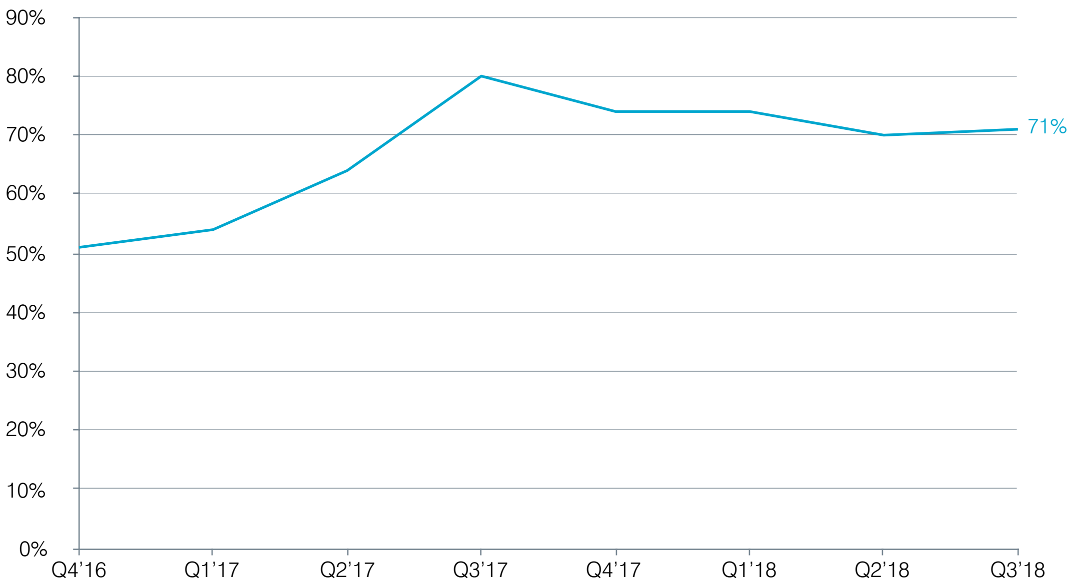
The percentage of **DOWN ROUNDS** by series were as follows:



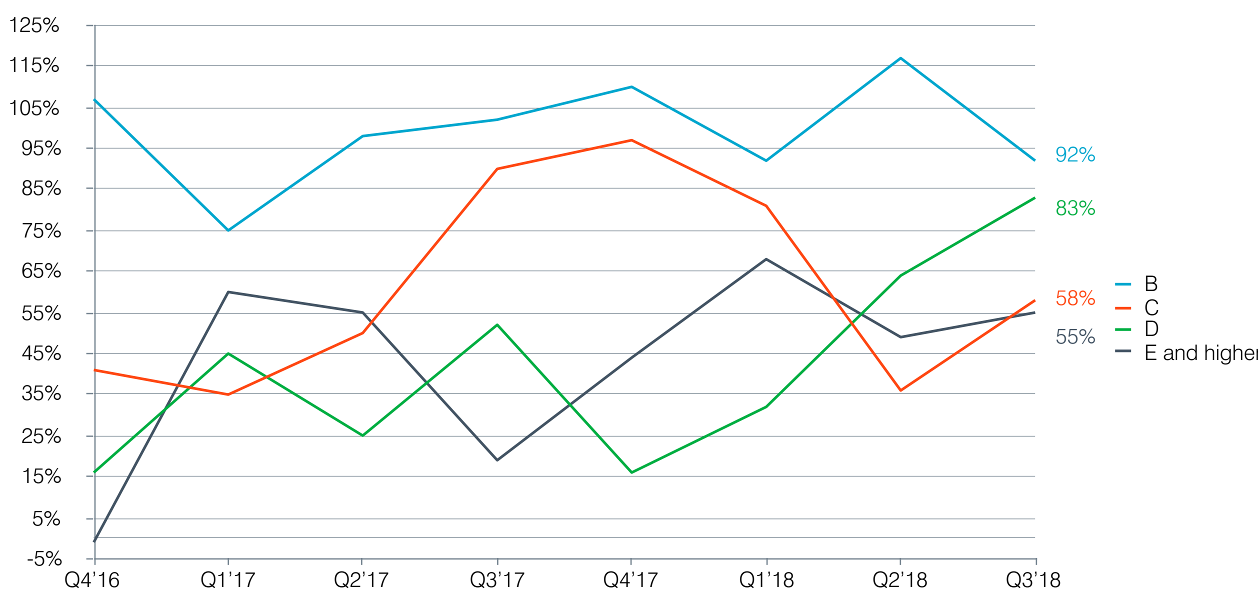
EXPANDED PRICE CHANGE GRAPH — Below is the direction of price changes for each quarter since 2004.



THE FENWICK & WEST VENTURE CAPITAL BAROMETER™ (magnitude of price change) — 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.

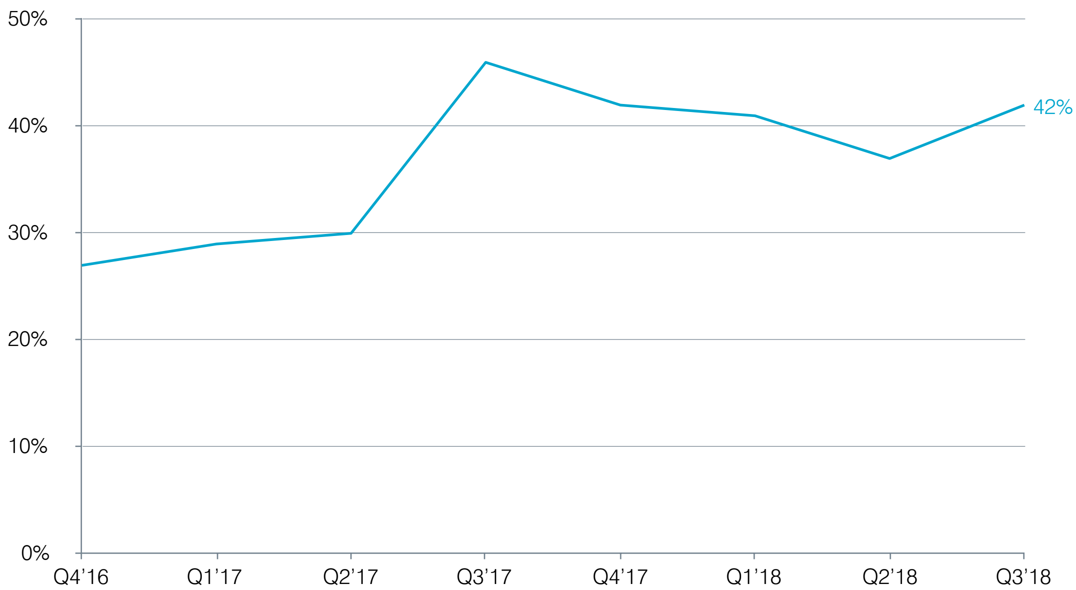


The Barometer results by series are as follows:

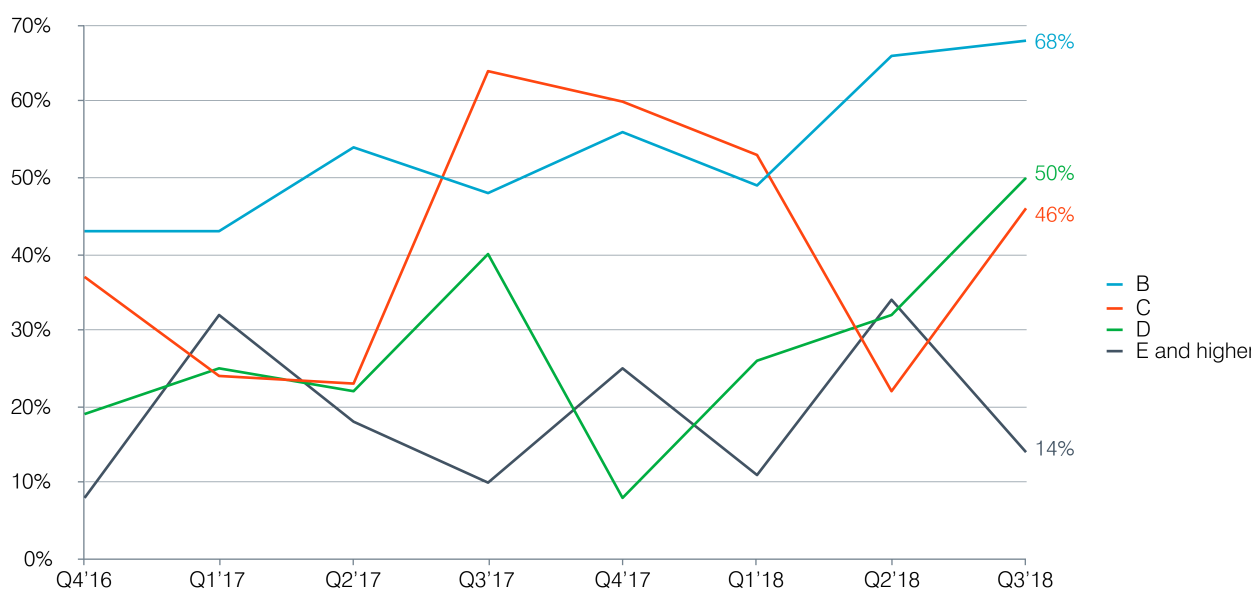


EXPANDED BAROMETER GRAPH — Below is the average percentage price change for each quarter since we began calculating this metric in 2004.

MEDIAN PERCENTAGE PRICE CHANGE—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 different than the Barometer, which is based on average percentage price change.



MEDIAN PERCENTAGE PRICE CHANGE BY SERIES.



EXPANDED MEDIAN PRICE CHANGE GRAPH—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 illustrates 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	77%	11%	11%	61%	45%	71
Hardware	71%	14%	14%	58%	30%	21
Life Sciences	82%	5%	14%	110%	44%	22
Internet/Digital Media	82%	5%	14%	78%	47%	22
Other	75%	5%	20%	70%	37%	20
Total all Industries	**78%**	**9%**	**13%**	**71%**	**42%**	**156**

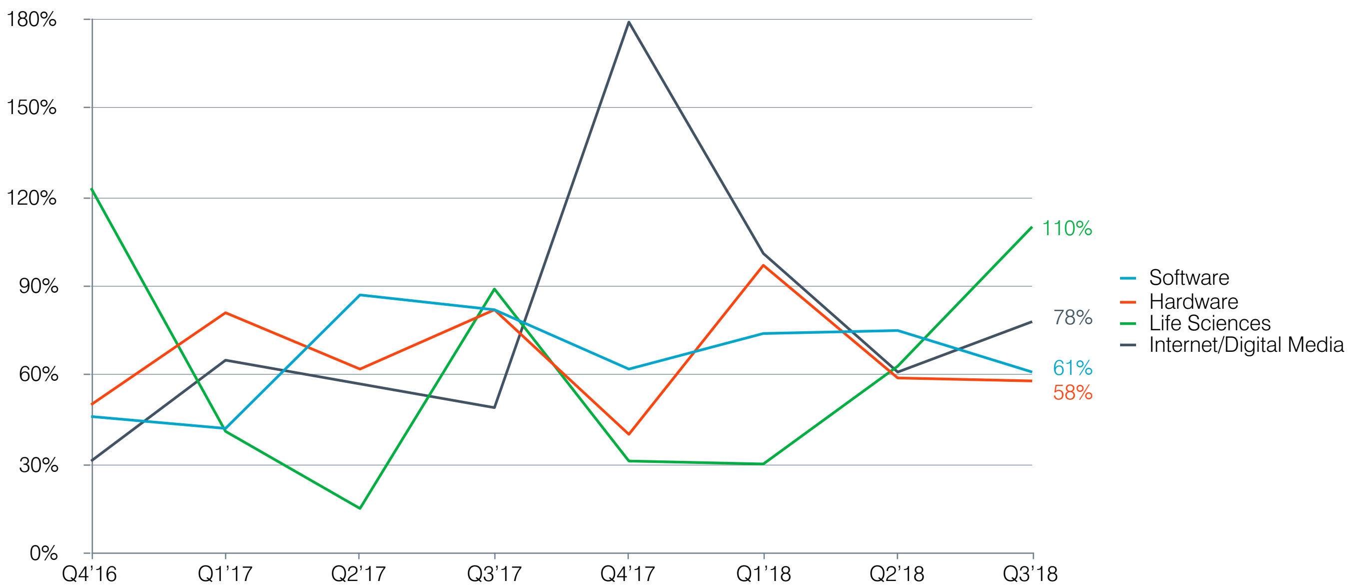
DOWN ROUND RESULTS BY INDUSTRY—The table below illustrates the percentage of "down rounds," by industry groups, for each of the past eight quarters.

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

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

Industry	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17	Q1'18	Q2'18	Q3'18
Software	46%	42%	87%	82%	62%	74%	75%	61%
Hardware	50%	81%	62%	82%	40%	97%	59%	58%
Life Sciences	123%	41%	15%	89%	31%	30%	63%	110%
Internet/Digital Media	31%	65%	57%	49%	179%	101%	61%	78%
Other	-5%	69%	43%	107%	73%	72%	81%	70%
Total all Industries	**51%**	**54%**	**64%**	**80%**	**74%**	**74%**	**70%**	**71%**

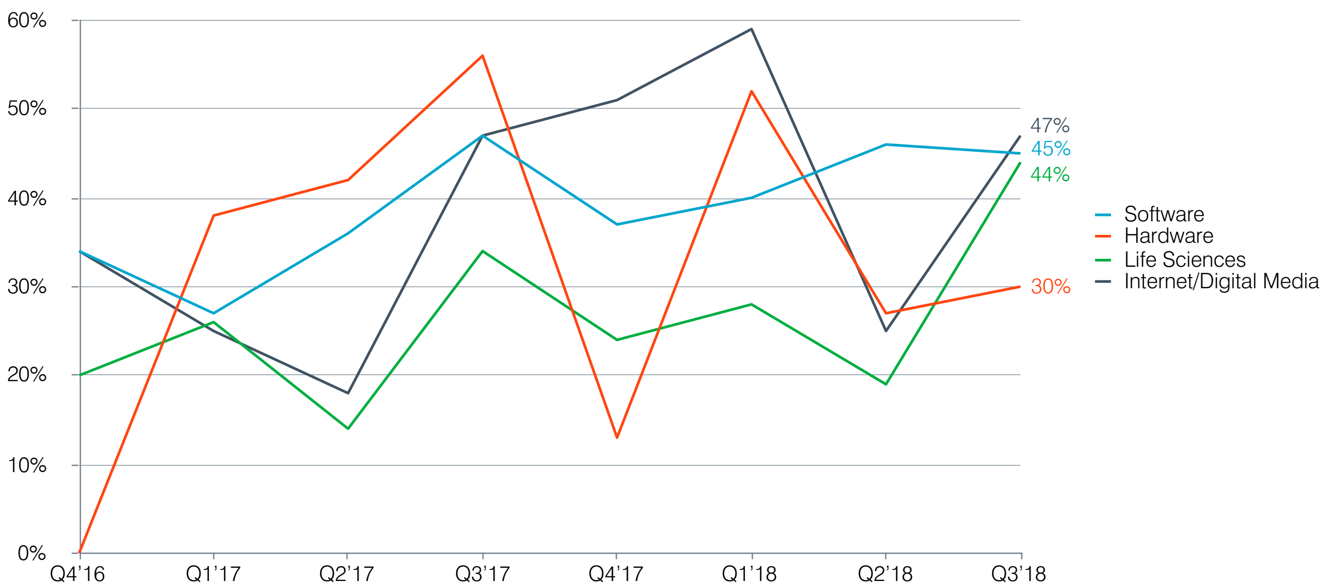
A graphical representation of the above data is below.



MEDIAN PERCENTAGE PRICE CHANGE RESULTS BY INDUSTRY—The table below illustrates 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 the average percentage price change.

Median % Price Change	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17	Q1'18	Q2'18	Q3'18
Software	34%	27%	36%	47%	37%	40%	46%	45%
Hardware	0%	38%	42%	56%	13%	52%	27%	30%
Life Sciences	20%	26%	14%	34%	24%	28%	19%	44%
Internet/Digital Media	34%	25%	18%	47%	51%	59%	25%	47%
Other	0%	59%	44%	18%	63%	35%	53%	37%
Total all Industries	**27%**	**29%**	**30%**	**46%**	**42%**	**41%**	**37%**	**42%**

A graphical representation of the above data is below.

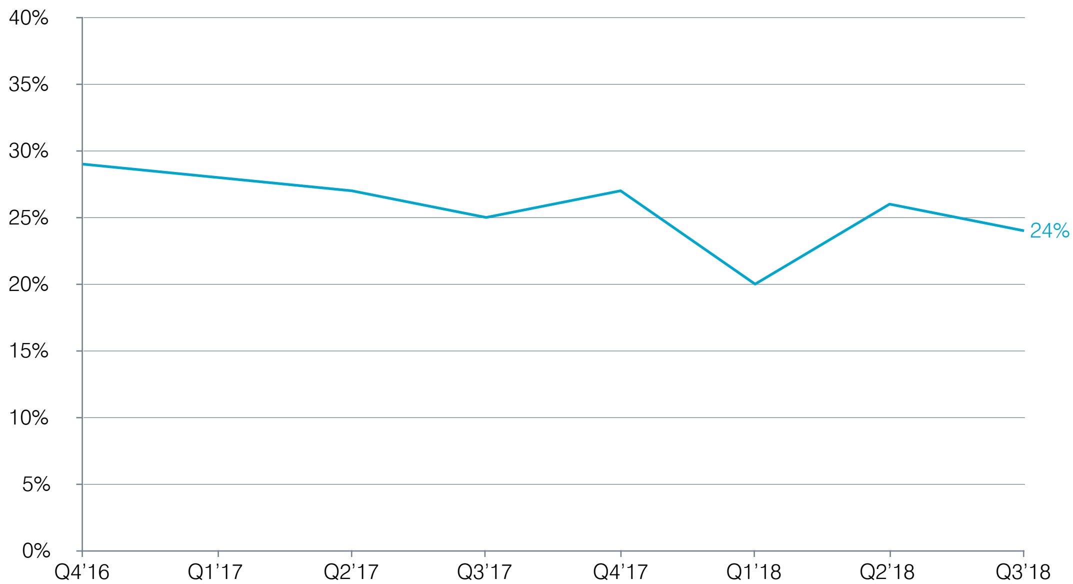


FINANCING ROUND—This quarter's financings broke down by series according to the chart below.

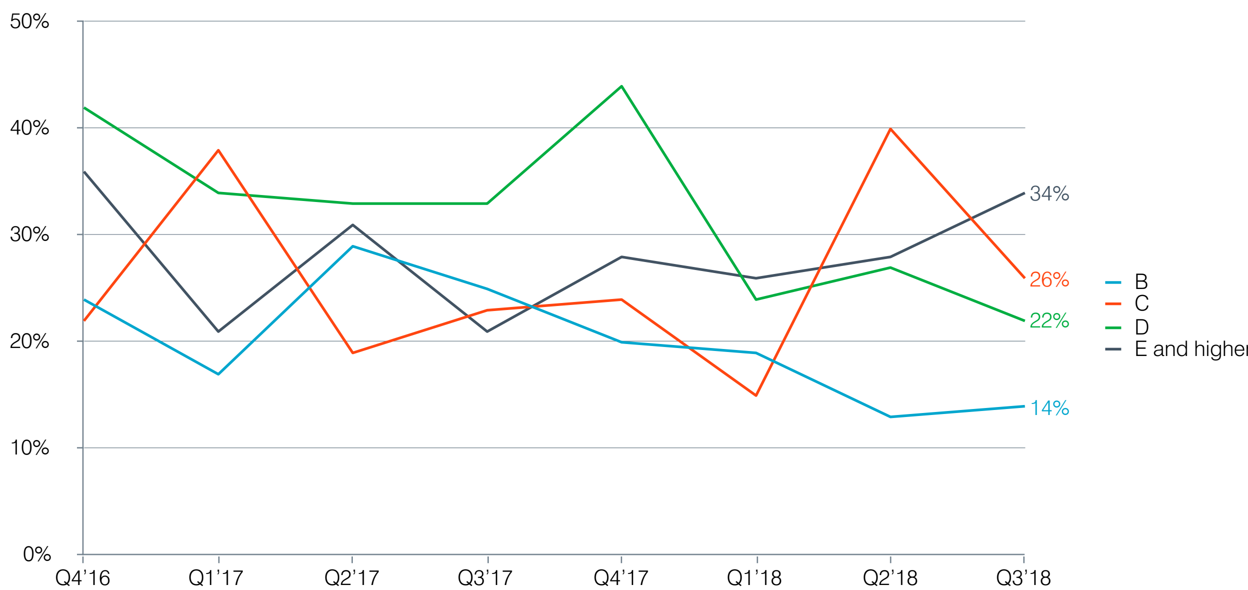
Series	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17	Q1'18	Q2'18	Q3'18
Series A	22%	29%	28%	27%	29%	25%	24%	27%
Series B	28%	18%	23%	32%	26%	27%	24%	20%
Series C	20%	20%	23%	19%	15%	21%	19%	18%
Series D	14%	15%	9%	11%	13%	13%	13%	13%
Series E and Higher	16%	17%	17%	10%	17%	16%	19%	22%

Fenwick & West Data on Legal Terms

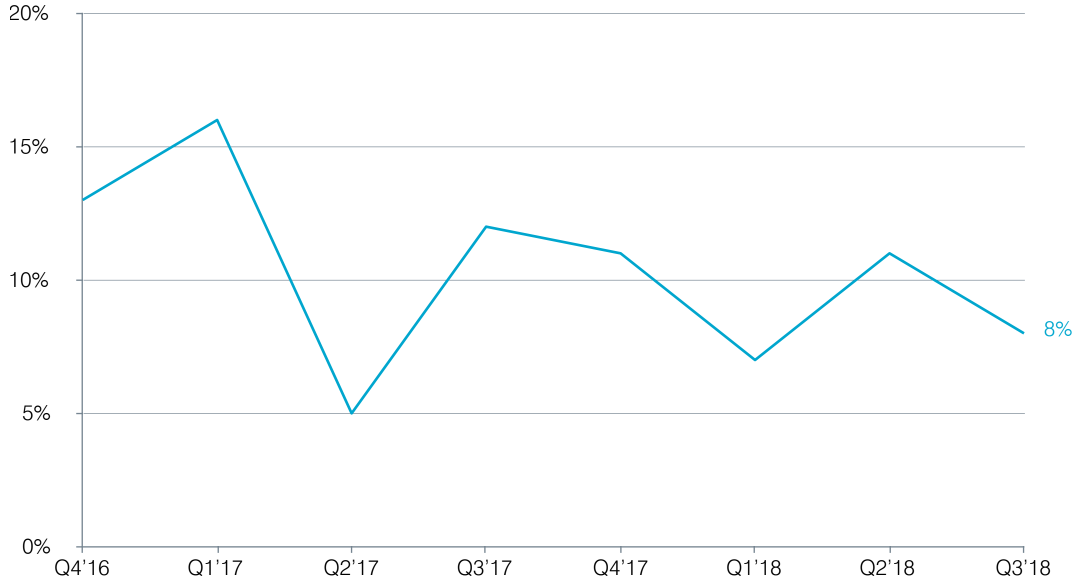
LIQUIDATION PREFERENCE—Senior liquidation preferences were used in the following percentages of financings.



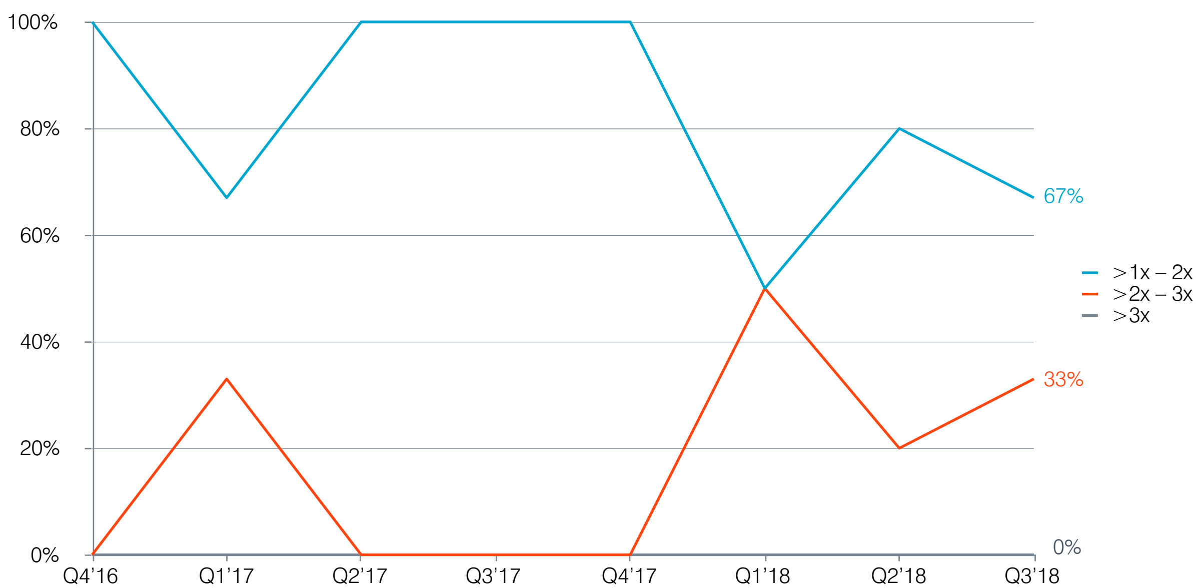
The percentage of senior liquidation preference by series was as follows:



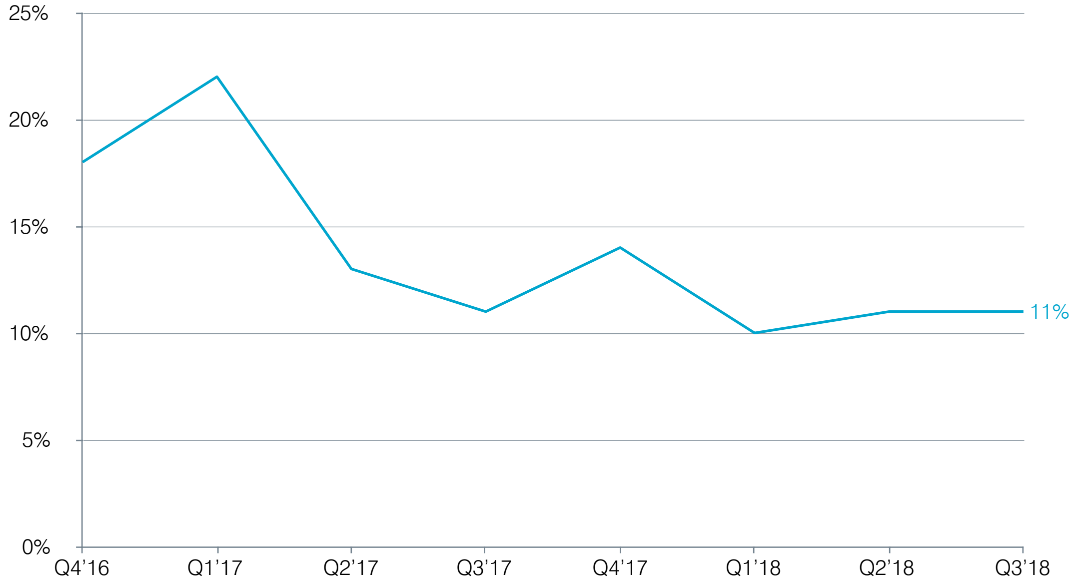
MULTIPLE LIQUIDATION PREFERENCES—The percentage of senior liquidation preferences that were multiple liquidation preferences was as follows:



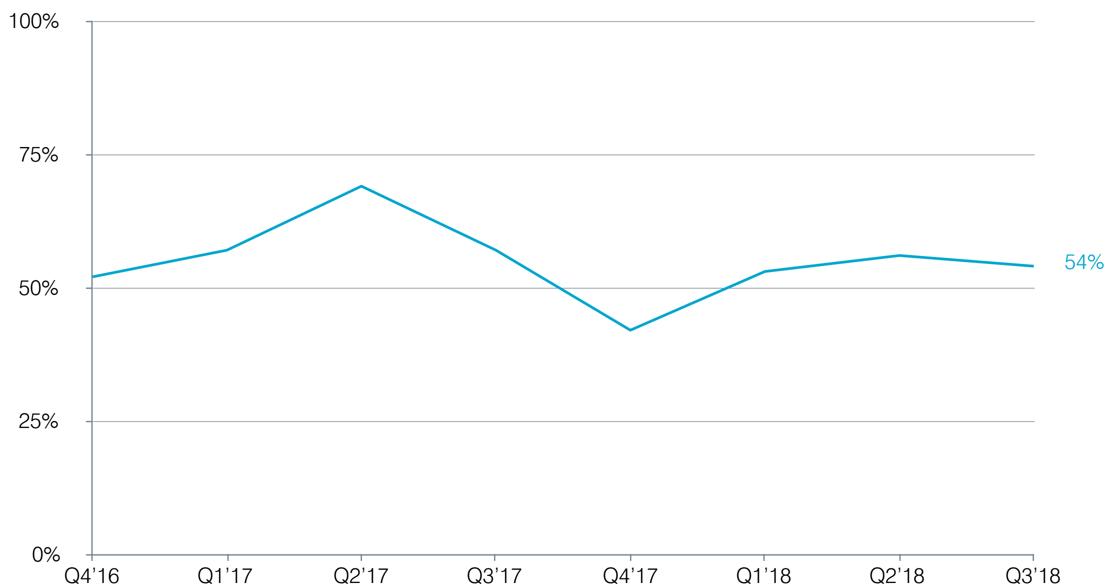
Of the senior liquidation preferences that were a multiple preference, the ranges of the multiples broke down as follows:



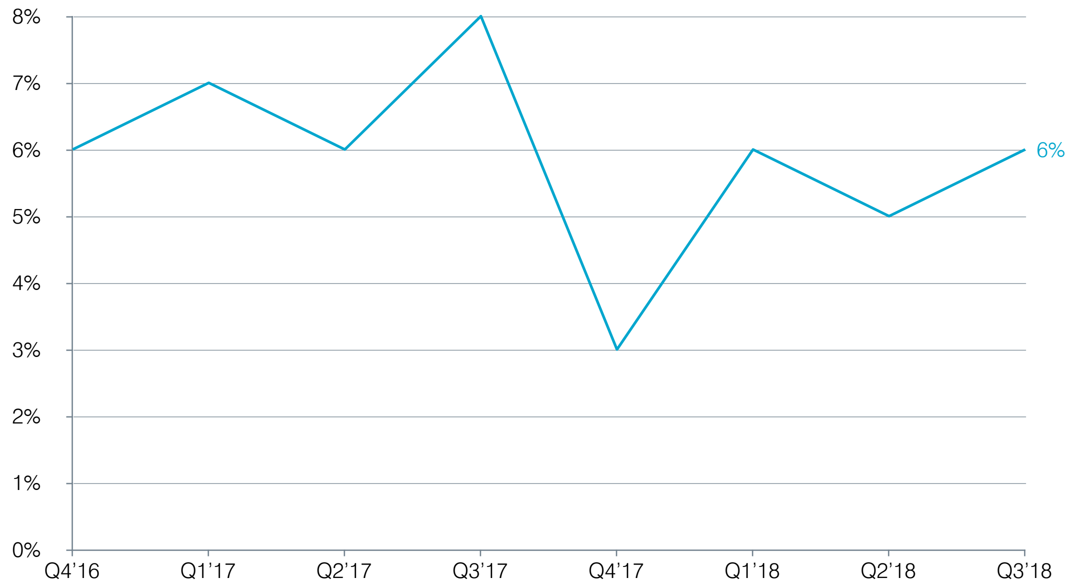
PARTICIPATION IN LIQUIDATION — The percentages of financings that provided for participation were as follows:



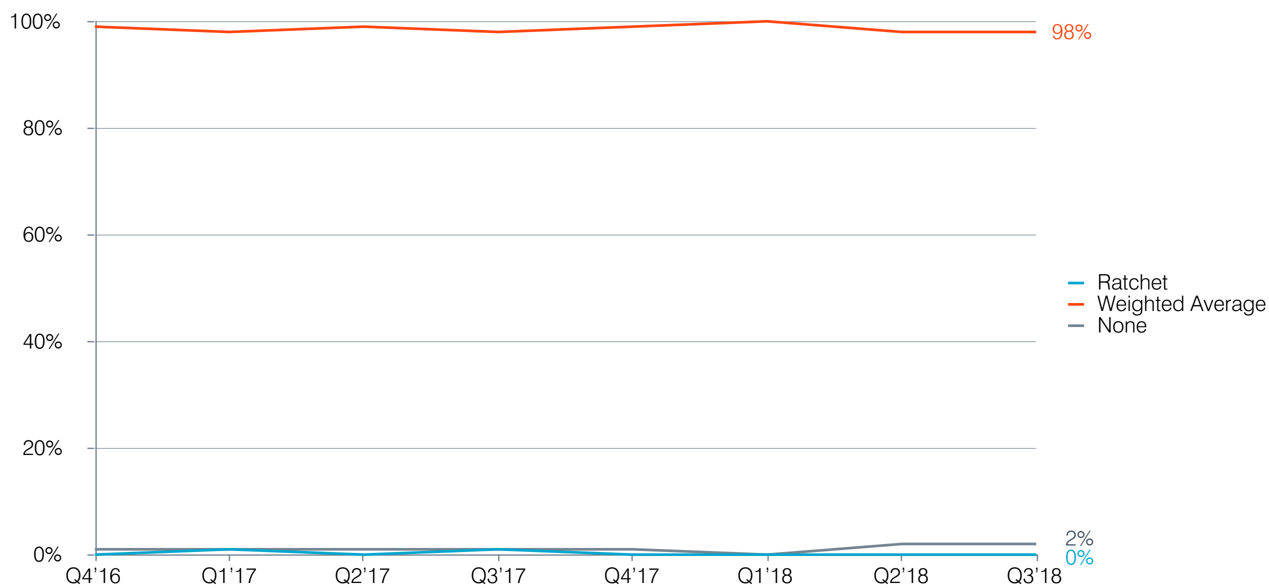
Of the financings that had participation, the percentages that were not capped were as follows:



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

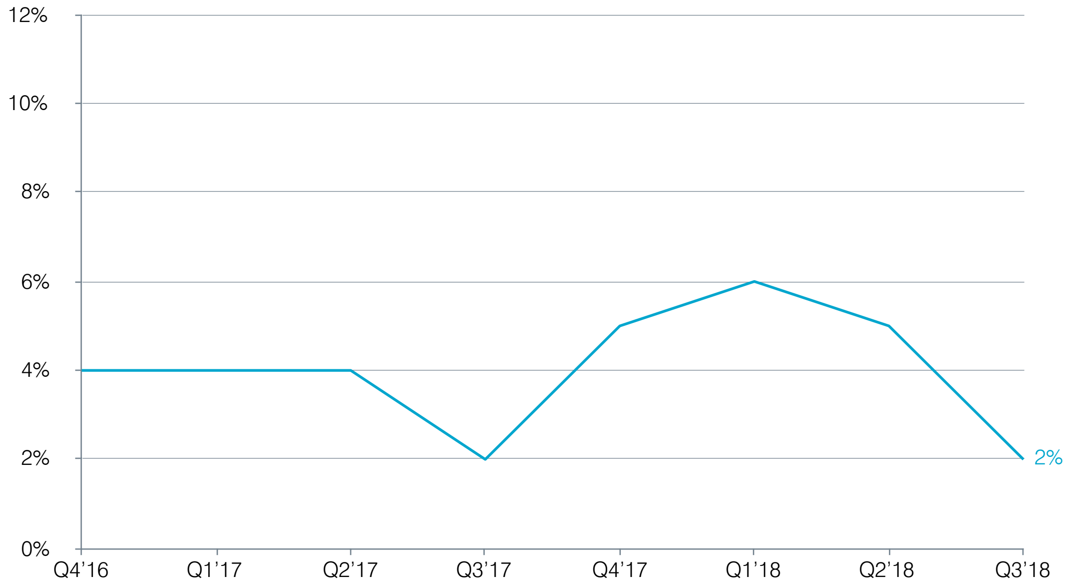


ANTIDILUTION PROVISIONS—The uses of (non-IPO) antidilution provisions in the financings were as follows:

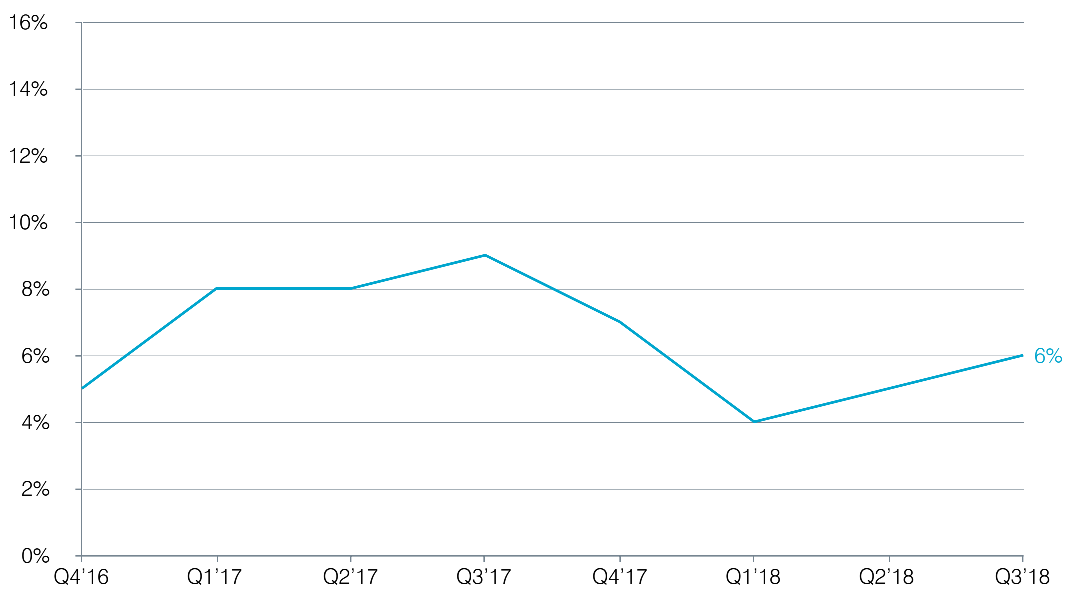


Please note that the chart above only applies to non-IPO anti-dilution provisions. In other words, the chart refers to anti-dilution provisions that protect the investor against a future venture financing at a price below what the investor paid. The chart does not include anti-dilution provisions designed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

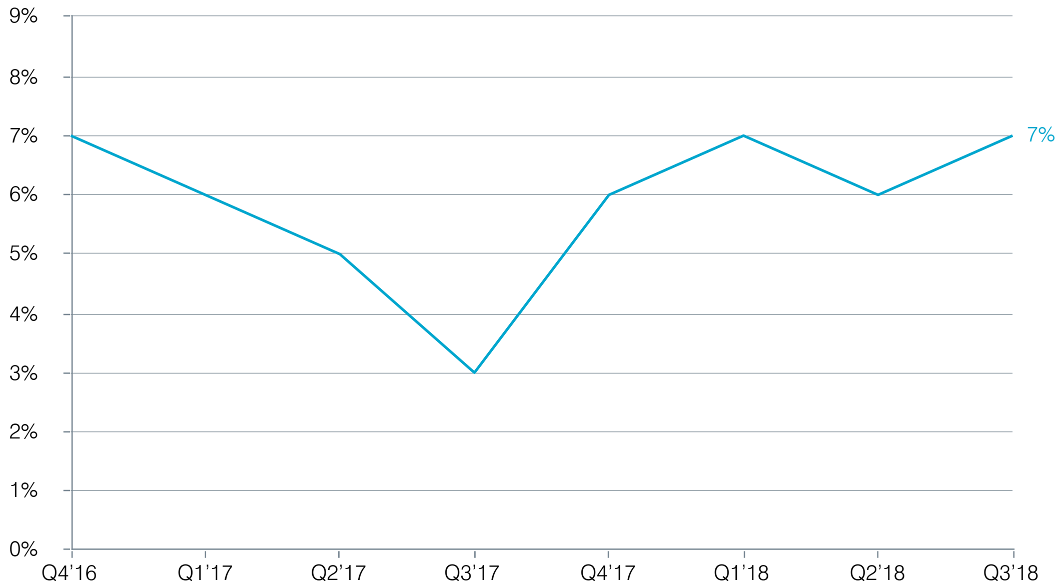
PAY-TO-PLAY PROVISIONS—The percentages of financings having pay-to-play provisions were as follows:



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 has been published quarterly since the first quarter of 2002. 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 toward 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

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