



Trends in Terms of Venture Financings In Silicon Valley (First Quarter 2011)

Background – We analyzed the terms of venture financings for 122 companies headquartered in Silicon Valley that reported raising money in the first quarter of 2011.

Overview of Fenwick & West Results

- Up rounds exceeded down rounds in 1Q11 67% to 16%, with 17% of rounds flat. This is very similar to 4Q10, when up rounds exceeded down rounds 67% to 21%, with 12% flat. This was the seventh quarter in a row in which up rounds exceeded down rounds. It was also the largest amount by which up rounds exceeded down rounds in 3.5 years.
- The Fenwick & West Venture Capital Barometer showed an average price increase of 52% in 1Q11, less than the 61% increase registered in 4Q10, but still a very healthy increase. This was also the seventh quarter in a row in which the Barometer was positive.
- Interpretive Comment regarding the Barometer. When interpreting the Barometer results please bear in mind that the results reflect the average price increase of companies raising money this quarter compared to their prior round of financing, which was in general 12-18 months prior. Given that venture capitalists (and their investors) generally look for at least a 20% IRR to justify the risk that they are taking, and that by definition we are not taking into account those companies that were unable to raise a new financing (and that likely resulted in a loss to investors), a Barometer increase in the 30-40% range should be considered normal in a healthy venture environment.
- The results by industry are set forth below. In general, the software and internet/digital media industries had the best valuation-related results in 1Q11, followed by the hardware industry, while the life science industry continued to lag.
- We also note anecdotally that we are seeing an increasing number of early stage companies being funded in a more substantive way by angels, and accordingly delaying their first venture capital round, especially in the internet/digital media space. For a copy of our initial angel/seed financing survey, please go [here](#).

Overview of Other Industry Data

There was a significant increase in commitments to venture capital funds in 1Q11 – a welcome result given that venture capitalists had invested \$68.3 billion, while raising only \$55 billion, over the past three years. That said, the funds raised were concentrated in a few large funds such as Bessemer, Sequoia and JP Morgan, which together accounted for over 55% of the total amount raised.

Liquidity results for venture-backed companies in 1Q11 were solid but not extraordinary. There are however signals that the IPO market will continue to improve.

Detailed results from third-party publications are as follows:

- Venture Capital Investment. Venture capitalists invested \$6.4 billion in 661 deals in the U.S. in 1Q11, compared to \$7.6 billion in 735 deals reported in January 2011 for 4Q10, according to Dow Jones VentureSource (“VentureSource”). Although this represents a 16% decline in dollars and a 10% decline in deal volume from 4Q10, the 1Q11 results were generally flat with the average of \$6.6 billion raised per quarter in 2010.

The PwC/NVCA MoneyTree™ Report based on data from Thomson Reuters (the “MoneyTree Report”) reported venture investment of \$5.9 billion in 736 deals in 1Q11, a 5% increase in dollars and an 11% decrease in deal volume from 4Q10.

Unlike results in recent quarters, the cleantech and life science industries saw the largest percentage increases in investment compared to 4Q10, and the internet sector lagged.

- Merger and Acquisition Activity. Acquisitions of U.S. venture-backed companies in 1Q11 totaled \$9.8 billion in 104 transactions, compared to \$10.5 billion in 109 transactions in 4Q10, according to VentureSource. Although this represents a 7% decrease in dollars and a 5% decrease in deal volume, it is approximately 10% above the average of \$9 billion of acquisitions per quarter in 2010.

The MoneyTree Report reported an increase in M&A transactions from 97 in 4Q10 to 109 in 1Q11, and a slight decrease in average deal size.

- Initial Public Offerings. VentureSource reported that 11 venture backed companies went public in 1Q11, raising \$768 million, a decrease from 14 IPOs raising \$1.1 billion in 4Q10, but flat with the quarterly average of 11.5 IPOs in 2010. Close to half of the 1Q11 IPOs were healthcare related.

The MoneyTree Report reported that 14 venture-backed companies went public in 1Q11, raising \$1.4 billion. The quarter marked the strongest Q1 for IPOs since 2007, and unlike 4Q10, was dominated by U.S.-based companies who comprised 10 of the 14 deals.

With 45 companies in registration at the end of 1Q11, there is reason to believe that 2Q11 will show improvement in IPO activity.

- Venture Capital Fundraising. VentureSource reported that U.S. funds raised \$7.7 billion in 1Q11, in 25 funds. This was the highest amount raised in a first quarter since 2001, but the lowest number of individual funds raising money in a first quarter since 2003.

Similarly, VentureSource reported that U.S. venture funds raised \$7.1 billion in 1Q11, in 36 funds.

- Sentiment. The Silicon Valley Venture Capital Confidence Index produced by Professor Mark Cannice at the University of San Francisco reported that the confidence level of Silicon Valley venture capitalists was 3.91 on a 5 point scale, an increase from the prior quarter’s reading of 3.75 and the highest reading since 3Q07.
- Nasdaq. Nasdaq increased 5% in 1Q11, but has decreased by 4% in 2Q11 through May 27, 2011.

Detailed Fenwick & West Results

Financing Round – The financings broke down according to the following rounds:

Series	Q1'11	Q4'10	Q3'10	Q2'10	Q1'10	Q4'09	Q3'09	Q2'09
A	18%	13%	20%	18%	24%	23%	17%	8%
B	24%	26%	23%	22%	21%	22%	31%	27%
C	24%	35%	28%	28%	30%	21%	19%	35%
D	20%	14%	9%	20%	11%	17%	16%	13%
E and higher	14%	12%	20%	12%	14%	17%	17%	17%

Price Change – The direction of price changes for companies receiving financing this quarter, compared to their previous round, were as follows:

Price Change	Q1'11	Q4'10	Q3'10	Q2'10	Q1'10	Q4'09	Q3'09	Q2'09
Down	16%	21%	30%	27%	32%	30%	36%	46%
Flat	17%	12%	18%	18%	19%	23%	23%	22%
Up	67%	67%	52%	55%	49%	47%	41%	32%

The percentage of down rounds by series were as follows:

Series	Q1'11	Q4'10	Q3'10	Q2'10	Q1'10	Q4'09	Q3'09	Q2'09
B	10%	12%	20%	14%	23%	24%	19%	16%
C	17%	27%	33%	29%	45%	25%	45%	51%
D	25%	23%	30%	36%	18%	47%	56%	67%
E and higher	12%	17%	38%	33%	27%	26%	39%	67%

The Fenwick & West Venture Capital Barometer™ (Magnitude of Price Change) –Set forth below is (i) for up rounds, the average per share percentage increase over the previous round, (ii) for down rounds, the average per share percentage decrease over the previous round, and (iii) the overall average per share percentage change from the previous round for all rounds taken together. Such information is broken down by series for 1Q11 and is provided on an aggregate basis for comparison purposes for the prior four quarters. In calculating the “net result” for all rounds, “flat rounds” are included. For purposes of these calculations, all financings are considered equal, and accordingly the results are not weighted for the amount raised in a financing.

Percent Change	Series B	Series C	Series D	Series E and higher	Combined total for all Series for Q1'11	Combined total for all Series for Q4'10	Combined total for all Series for Q3'10	Combined total for all Series for Q2'10	Combined total for all Series for Q1'10
Up rounds	+145%	+72%	+51%	+66%	+91%	+104%	+81%	+86%	+78%
Down rounds	-60%	-38%	-79%	-27%	-56%	-45%	-47%	-65%	-54%
Net result	+104%	+44%	+10%	+36%	+52%	+61%	+28%	+30%	+21%

Results by Industry for Price Changes and Fenwick & West Venture Capital Barometer™ – The table below sets forth the direction of price changes and Barometer results for companies receiving financing in 1Q11, compared to their previous round, by industry group. Companies receiving Series A financings are excluded as they have no previous rounds to compare.

Industry	Number of Financings	Up Rounds	Down Rounds	Flat Rounds	Barometer
Software	38	72%	14%	14%	+75%
Hardware	22	80%	15%	5%	+43%
Lifescience	20	44%	31%	25%	-8%
Internet/Digital Media	33	70%	11%	19%	+77%
Cleantech	5	60%	0%	40%	+54%
Other	4	50%	25%	25%	+5%
Total - All Industries	122	67%	16%	17%	+52%

Please note that some industries have small sample sizes that reduce the statistical validity of the results.

Liquidation Preference – Senior liquidation preferences were used in the following percentages of financings:

Q1'11	Q4'10	Q3'10	Q2'10	Q1'10	Q4'09	Q3'09	Q2'09
43%	28%	41%	40%	38%	41%	49%	41%

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

Series	Q1'11	Q4'10	Q3'10	Q2'10	Q1'10	Q4'09	Q3'09	Q2'09
B	24%	12%	32%	32%	23%	24%	38%	17%
C	47%	27%	27%	34%	42%	50%	40%	52%
D	42%	46%	60%	48%	36%	58%	63%	50%
E and higher	71%	42%	62%	53%	53%	37%	67%	53%

Multiple Liquidation Preferences - The percentage of senior liquidation preferences that were multiple preferences were as follows:

Q1'11	Q4'10	Q3'10	Q2'10	Q1'10	Q4'09	Q3'09	Q2'09
14%	13%	20%	17%	23%	19%	21%	24%

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

Range of multiples	Q1'11	Q4'10	Q3'10	Q2'10	Q1'10	Q4'09	Q3'09	Q2'09
>1x – 2x	83%	100%	85%	71%	86%	57%	89%	75%
>2x – 3x	0%	0%	0%	29%	14%	43%	11%	25%
>3x	17%	0%	15%	0%	0%	0%	0%	0%

Participation in Liquidation – The percentages of financings that provided for participation were as follows:

Q1'11	Q4'10	Q3'10	Q2'10	Q1'10	Q4'09	Q3'09	Q2'09
43%	45%	53%	35%	48%	51%	53%	49%

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

Q1'11	Q4'10	Q3'10	Q2'10	Q1'10	Q4'09	Q3'09	Q2'09
60%	40%	58%	61%	54%	54%	60%	67%

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

Q1'11	Q4'10	Q3'10	Q2'10	Q1'10	Q4'09	Q3'09	Q2'09
8%	5%	7%	7%	7%	4%	7%	2%

Antidilution Provisions – The uses of antidilution provisions in the financings were as follows:

Type of Provision	Q1'11	Q4'10	Q3'10	Q2'10	Q1'10	Q4'09	Q3'09	Q2'09
Ratchet	5%	3%	4%	4%	5%	6%	3%	3%
Weighted Average	92%	95%	93%	94%	94%	94%	96%	97%
None	3%	2%	3%	2%	1%	0%	1%	0%

Pay-to-Play Provisions – The use of pay-to-play provisions in the financings was as follows:

Percentages of financings having pay-to-play provisions.

Q1'11	Q4'10	Q3'10	Q2'10	Q1'10	Q4'09	Q3'09	Q2'09
5%	7%	15%	16%	7%	10%	15%	15%

Note that anecdotal evidence indicates that companies are increasingly using contractual “pull up” provisions instead of charter based “pay to play” provisions. These two types of provisions have similar economic effect but are implemented differently. The above information includes some, but likely not all, pull up provisions, and accordingly may understate the use of these provisions.

The pay-to-play provisions provided for conversion of non-participating investors’ preferred stock into common stock or shadow preferred stock, in the percentages set forth below:

- Common Stock.

Q1'11	Q4'10	Q3'10	Q2'10	Q1'10	Q4'09	Q3'09	Q2'09
83%	100%	81%	100%	86%	80%	93%	100%

- Shadow Preferred Stock.

Q1'11	Q4'10	Q3'10	Q2'10	Q1'10	Q4'09	Q3'09	Q2'09
17%	0%	19%	0%	14%	20%	7%	0%

Redemption – The percentages of financings providing for mandatory redemption or redemption at the option of the venture capitalist were as follows:

Q1'11	Q4'10	Q3'10	Q2'10	Q1'10	Q4'09	Q3'09	Q2'09
20%	19%	22%	23%	24%	21%	19%	20%

Corporate Reorganizations – The percentages of post-Series A financings involving a corporate reorganization were as follows:

Q1'11	Q4'10	Q3'10	Q2'10	Q1'10	Q4'09	Q3'09	Q2'09
7%	4%	9%	8%	14%	5%	8%	10%

For additional information about this report please contact Barry Kramer at 650-335-7278; bkramer@fenwick.com or Michael Patrick at 650-335-7273; mpatrick@fenwick.com at Fenwick & West. The contents of this report are not intended, and should not be considered, as legal advice or opinion.

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