Trends in Terms of Venture Financings in Silicon Valley—Fourth Quarter 2011

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Background

We analyzed the terms of venture financings for 117 companies headquartered in Silicon Valley that reported raising money in the fourth quarter of 2011.

Overview of Fenwick & West Results

- Up rounds exceeded down rounds in 4Q11, 70% to 16%, with 14% of rounds flat. This showed continued strong valuations in the venture environment, consistent with 3Q11, and was the tenth quarter in a row in which up rounds exceeded down rounds.

- The Fenwick & West Venture Capital Barometer™ showed an average price increase of 85% in 4Q11, an increase from 69% in 3Q11. Series B rounds were exceptionally strong, with an average increase of 164% since the last round.

  Anecdotally, we attribute the Series B results in part to the increased number of smaller, relatively low valuation, Series A financings undertaken by micro VC firms. When the investee companies in these financings make good progress, it can result in a significant percentage increase in valuation in the Series B round – and if these companies do not make good progress, and do not raise a Series B financing, they will not appear in the Barometer statistics because there is no transaction to report, as described under "Methodology" below. If Series B financings were excluded from the Barometer calculation (which we believe would be over compensating for this anomaly) the Barometer would have been 50%.

  Along these lines we note that Dow Jones VentureSource ("VentureSource") reported that the three most prolific venture investors in 4Q11 were 500 Startups, SV Angel and First Round Capital, all early stage investors, with a combined 77 investments in 4Q11.

- The results by industry are set forth below. In general, consistent with recent quarters, the internet/digital media and software (which includes many of the "big data" and "cloud" companies) industries were the valuation leaders, and cleantech and life science lagged.

Overview of Third Party Data

In 2011 we saw a generally improving venture environment, with venture investment, fundraising, valuations, M&A and IPOs all up compared to 2010. But there were some anomalies:

- Fundraising by venture funds was up in dollar terms, but the number of funds raising money declined.
- Venture capitalists invested healthy amounts at healthy valuations, and showed gains in their portfolios, but venture capitalist confidence has been down three quarters in a row.
- Some industries are concerned about a bubble (internet/digital media and software), while others are having a tough time (cleantech and life science).
- Venture capitalists again raised significantly less money than was invested in venture-backed companies.
- Although 2011 was strong, the fourth quarter showed some weakness with venture investment and M&A down in 4Q11 compared to 3Q11.
- The number of venture funds is decreasing, while the number and importance of angel investors is increasing, and secondary market activity is expanding.

- **Venture Capital Investment.**

Highlights:

- Venture investment was moderately lower in 4Q11 than 3Q11.
- Venture investment was significantly higher in 2011 than 2010.
- Average deal size increased in 2011.
- Internet and software industries lead in 2011, although both saw declines in investment in 4Q11.
- Silicon Valley received 41% of all U.S. venture investment in 2011, and 46% in 4Q11.

Data:

Venture capitalists (including corporation-affiliated venture groups) invested $7.4 billion in 803 deals in the U.S. in 4Q11, a 12% decrease in dollars from the $8.4 billion invested in 765 deals in 3Q11 (as reported in October 2011), according to VentureSource. For all of 2011 venture capitalists invested $32.6 billion in 3209 deals, a 25% increase in dollars from 2010, when $26.2 billion was invested in 2799 deals (as reported in January 2011).

The PwC/NVCA MoneyTree™ Report based on data from Thomson Reuters (the "MoneyTree Report") reported similar results. Venture investment in 4Q11 declined 6% in dollars compared to the 3Q11 results (as reported in October 2011), with investment of $6.6 billion in 844 deals in 4Q11, compared to $7.0 billion in 876 deals in 3Q11. For all of 2011 venture capitalists invested $28.4 billion in 3673 deals, a 30% increase from 2010 when $21.8 billion was invested in 3277 deals (as reported in January 2011).

The MoneyTree Report also noted that the internet and software industries saw the largest increase in investment in 2011, increasing 68% and 38% respectively over 2010, although both saw declines in investment from 3Q11 to 4Q11. Silicon Valley received 41% of all venture funding in 2011, followed by New England and New York at 11% and 9.5% respectively.

- **Merger and Acquisition Activity.**

  Highlights:

  - M&A activity declined significantly in dollar terms in 4Q11 compared to 3Q11.
  - M&A activity increased significantly in dollar terms in 2011 compared to 2010.
  - Average deal size was up significantly in 2011, as the number of deals was flat to down.

  Data:

  Acquisitions (including buyouts) of U.S. venture-backed companies in 4Q11 totaled $9.4 billion in 107 transactions, compared to $13 billion in 122 transactions in 3Q11 (as reported in October 2011), a 28% decline in dollars, according to Dow Jones. For all of 2011, 477 venture-backed companies were acquired for $47.8 billion, compared to 468 acquisitions for $35.8 billion in 2010 (as reported in January 2011), an increase of 34% in dollar terms.

  Thomson Reuters and the NVCA ("Thomson/NVCA") reported 92 acquisitions in 4Q11 compared to 101 in 3Q11 (as reported in October 2011), and 429 in all of 2011, compared to 420 in 2010 (as reported in January 2011).

- **IPO Activity.**

  Highlights:

  - IPOs increased in both 4Q11 and 2011 overall.
  - 63% of IPOs were in the IT industry.
  - Groupon and Zynga accounted for 31% of IPO money raised in 2011.

  Data:

  Dow Jones reported 10 U.S venture-backed company IPOs raising $2.4 billion in 4Q11, close to 5x higher in dollars from the 10 IPOs that raised $0.5 billion in 3Q11. In all of 2011, 45 venture-backed companies went public raising $5.4 billion, compared to 46 IPOs in 2010 raising $3.3 billion, a 64% increase in dollar terms.

  Similarly Thomson/NVCA reported a 5x increase in IPO dollars raised from 3Q11 to 4Q11, and a 41% increase in dollars raised from 2010 to 2011.

  Thomson/NVCA also reported that approximately 63% of the companies going public in both 4Q11 and 2011 overall were IT companies, and that 75% of the companies going public in 2011 were based in the U.S., with 54% of the U.S. companies based in California.

- **Venture Capital Fundraising.**

  Highlights:

  - Fundraising increased in dollar terms, but the number of funds raising money generally decreased, in both 4Q11 and 2011.
  - Venture capitalists raised less in 2011 than was raised by venture-backed companies.

  Data:

  Dow Jones reported that venture funds raised $5.2 billion in 4Q11 compared to $2.2 billion in 3Q11, and that 135 funds raised $16.2 billion in all of 2011, compared to 154 funds raising $11.6 billion in 2011. Fifteen firms accounted for $10.5 billion or 65% of the total raised in 2011.

  Dow Jones also reported that VC funds raised less than $50 billion over the past three years (2009-2011), while in the preceding three years (2006-2008), $100 billion was raised.

  Similarly, Thomson/NVCA reported that 38 U.S. venture funds raised $5.6 billion in 4Q11, a 162% increase in dollars but a 41% decline in number of funds compared to the $2.1 billion raised by 64 funds in 3Q11. For all of 2011, 169 funds raised $18.2 billion, a 32% increase in dollars compared to 2010, when 169 funds raised $13.8 billion.

- **Secondary Markets**

  Highlights:

  - Secondary trading markets for shares in venture-backed companies are developing and growing, but are currently very focused on the major internet/digital companies.
  - Secondary funds continue to see significant activity.

  Data:

  Until recently, the liquidity formula for venture investors and entrepreneurs was essentially: Liquidity = IPOs plus M&A. However, in recent years, with liquidity for venture-backed companies being difficult, and liquidity becoming increasingly important due to global financial turmoil, a third path for liquidity has grown – secondary purchases of equity in venture-backed companies (i.e., direct secondary purchases).

  One of the more recent developments is the founding of secondary markets such as SecondMarket and SharesPost, which enable stockholders in venture-backed companies to sell their shares in an auction or market type environment to accredited investors. Some statistics on these markets are:

  - SecondMarket completed $558 million in transactions in 2011, a 55% increase over 2010.
  - 61% of those transactions were in the consumer web and social media space.
  - 73% of the buyers were institutions, 27% were individuals (by dollars).
  - 79% of the sellers were ex-employees (by transactions).

SharesPost handled over 1000 transactions for 40-50 venture-backed companies in 2011. They have created an index of their most frequently traded shares. The index was up 54% in 2011.

Another development is the growth of more traditional secondary funds that typically purchase shares in large blocks in negotiated transactions from shareholders in venture-backed companies. Industry Ventures estimates that they saw $7 billion of such opportunities in 2011, and Millenium Technology Ventures indicated in early 2011 that they expected the direct secondary market in private technology companies to be $10 billion annually by the end of 2013. These are not insubstantial numbers when compared to the approximately $53 billion of combined IPO and M&A provided liquidity in 2011.

- **Venture Capital Sentiment.**

Highlights:

- The Silicon Valley Venture Capitalist Confidence Index declined for the third straight quarter.
- A plurality of U.S. venture capitalists believe venture investment and fundraising will decline in 2012.
- However, U.S. venture capitalists also believe that IPOs, M&A and secondary market activity will increase.

Data:

The Silicon Valley Venture Capitalist Confidence Index® produced by Professor Mark Cannice at the University of San Francisco reported that the confidence level of Silicon Valley venture capitalists was 3.27 on a 5 point scale in 4Q11, a decrease from the 3.41 reported for 3Q11, and the third quarter of decrease in a row.

According to the Venture View survey of venture capitalists conducted by the NVCA and Dow Jones VentureSource in December 2011, venture capitalists predictions for 2012 (compared to 2011) were:

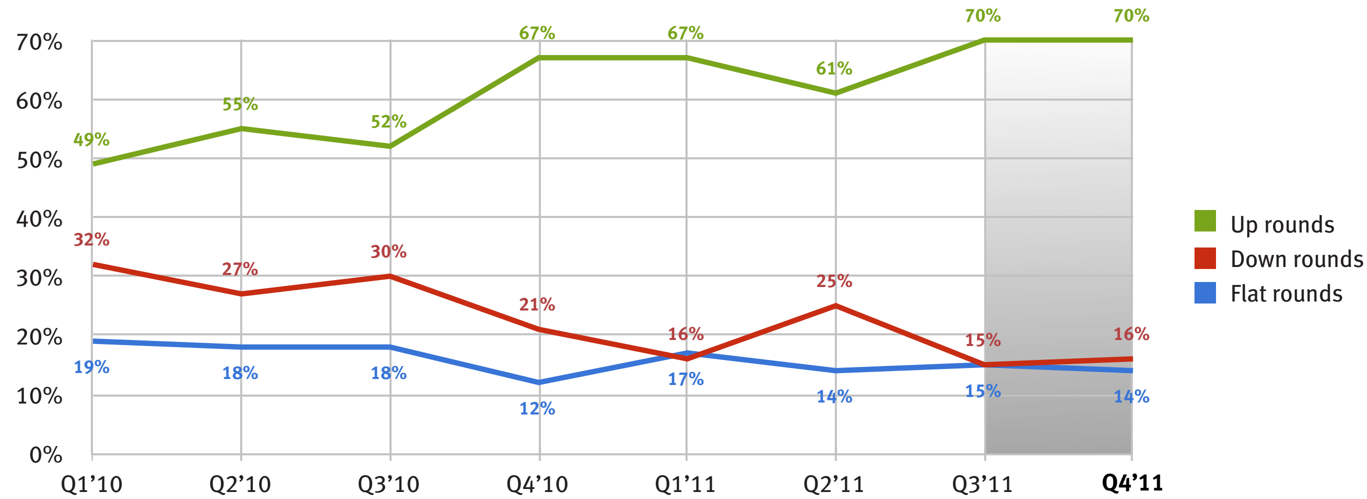
Venture capital investment:	36% decrease	33% flat	32% increase
Venture capital fundraising:	42% decrease	31% flat	27% increase
Number of IPOs:	48% increase	34% same/unsure	18% less
Mergers and acquisitions:	69% increase	27% same/unsure	4% decrease
Secondary market activity:	49% increase	29% less	22% same

- **Additional Observations and Information.**
  - There are currently over 30 internet/digital media companies with valuations over $1 billion, and another 30 companies that require valuations over $1 billion to provide their most recent investors with a 1.5x return (Hans Swildens of Industry Ventures).
  - Will the recent IPOs of Zynga, LinkedIn and Groupon, and the expected Facebook IPO, result in increased internet/social media M&A as these newly public companies have additional cash and liquid stock with which to acquire companies? Note that Google had 79 acquisitions in 2011.
  - CalPers has reduced its target allocation for venture capital from 7% to 1%, in part to improve liquidity of its portfolio (VentureWire).
  - The 100% tax exclusion for Qualifying Small Business Stock purchased and held for five years expired at the end of 2011. However, President Obama has proposed legislation to reinstate the exclusion.
  - 54% of U.S. 18-34 year olds want to start a business per a recent Kauffman Foundation/Young Invincibles survey. A new "Venture for America" organization has been formed to place recent college grads at small businesses in American cities. InterMatch reports that 93% of early stage Silicon Valley companies plan to hire interns. (Venture Wire reports). If young people are committed to being entrepreneurs, the future might be brighter than it otherwise looks.
- **Nasdaq.**

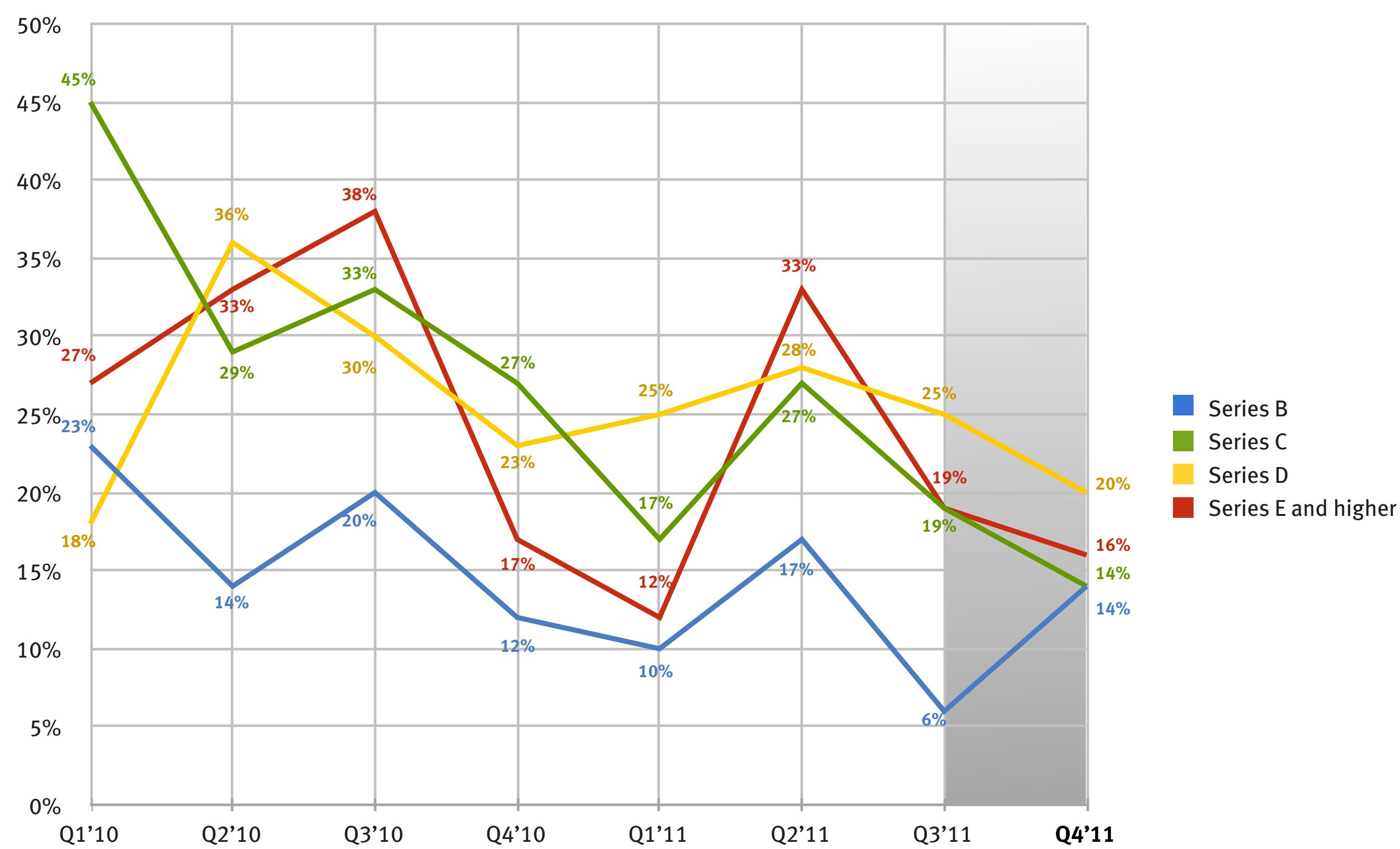
  Nasdaq increased 6.5% in 4Q11, and has increased an additional 11.4% in 1Q12 through February 16, 2012.

Fenwick & West Data on Valuation

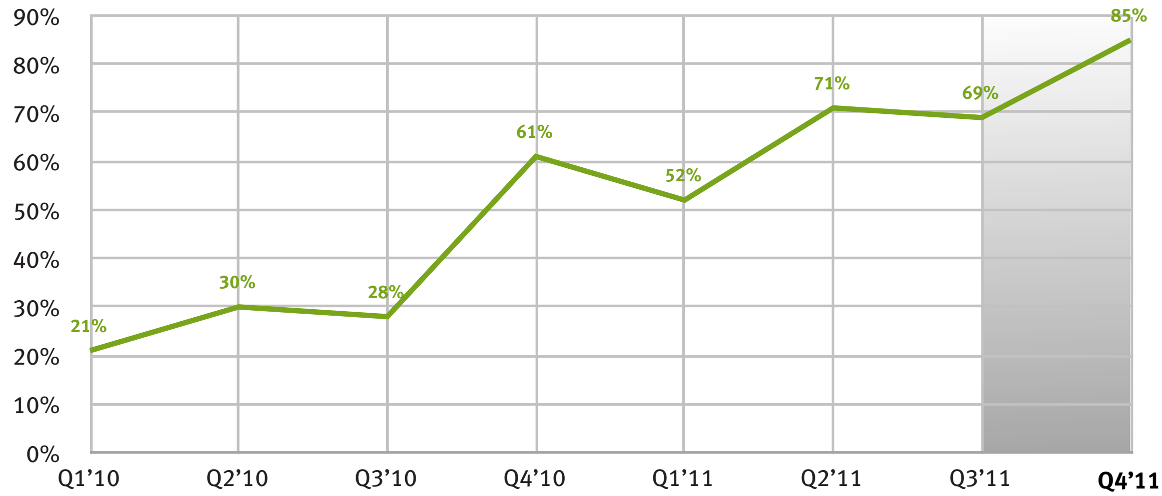
PRICE CHANGE—The direction of price changes for companies receiving financing in a quarter, compared to their prior round of financing.



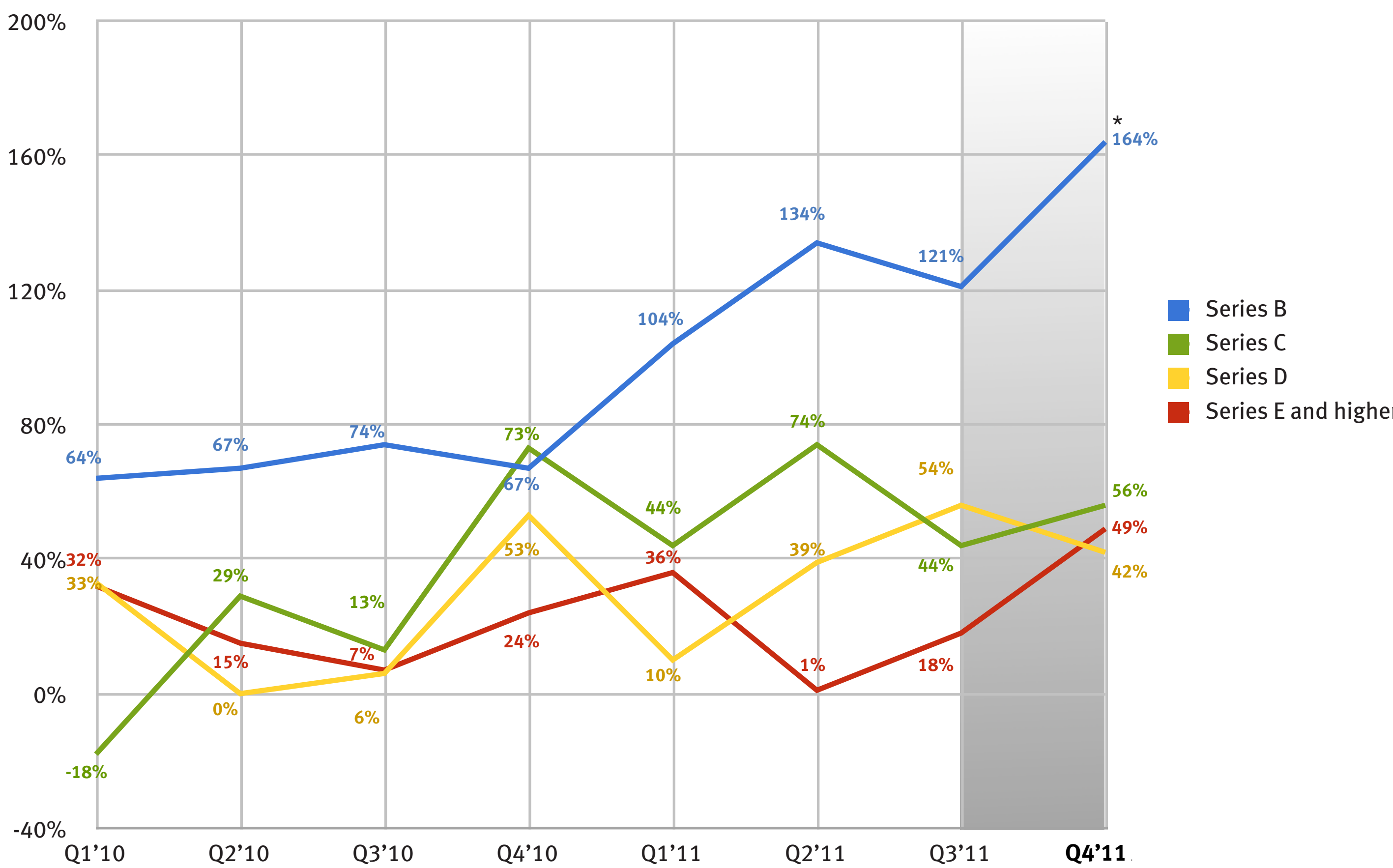
The percentage of down rounds by series were as follows:



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:



*See explanatory note on first page.

RESULTS BY INDUSTRY FOR CURRENT QUARTER — The table below sets forth the direction of price changes, Barometer results and number of financings for companies receiving financing in 4Q11, 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	Barometer	Number of Financings
Software	80%	11%	9%	+105%	44
Hardware	78%	0%	22%	+58%	9
Lifescience	42%	33%	25%	+36%	12
Internet/Digital Media	75%	12%	13%	+122%	16
Cleantech	29%	43%	28%	-3%	7
Other	100%	0%	0%	+50%	1
Total All Industries	**70%**	**16%**	**14%**	**+85%**	**89**

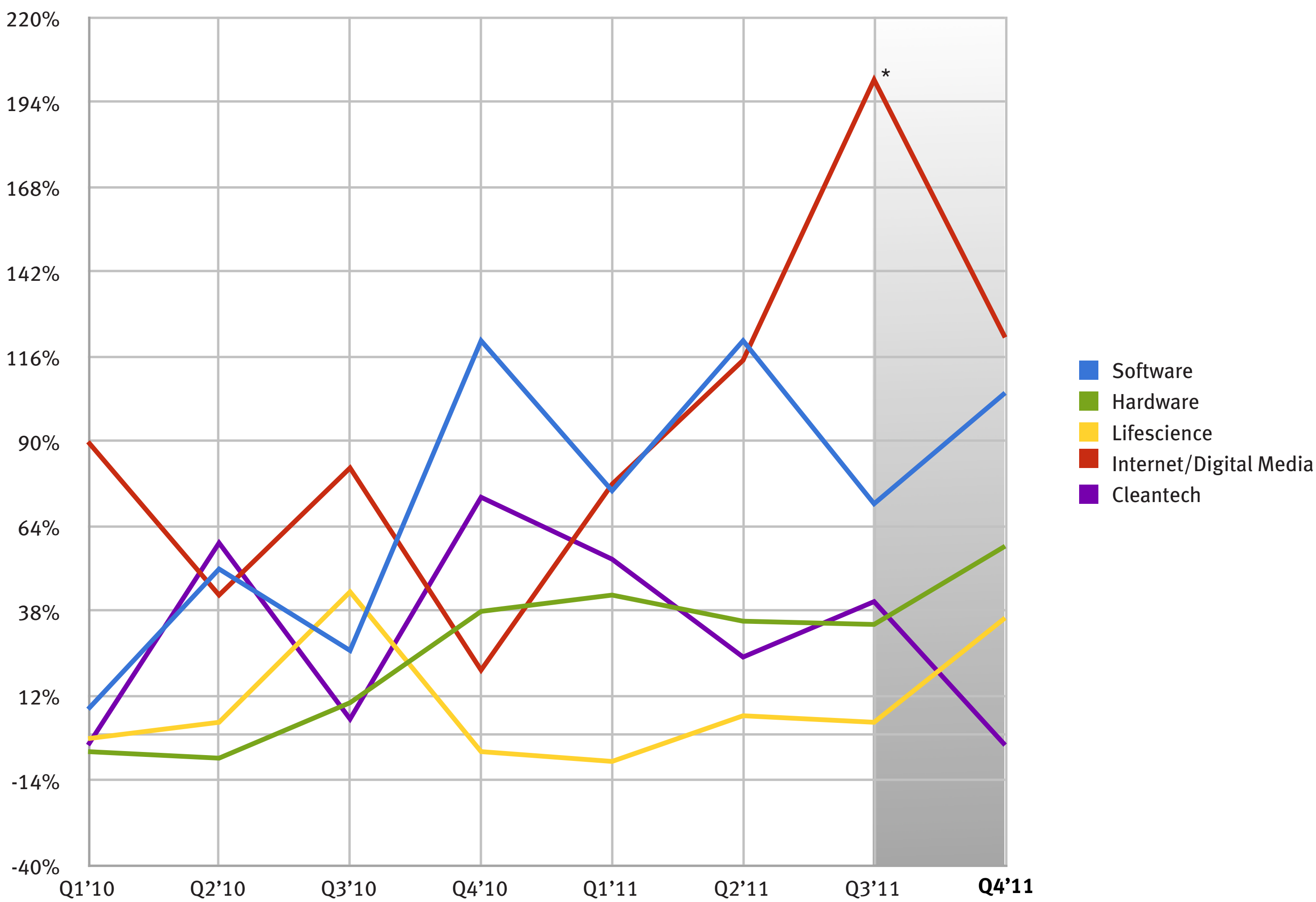
DOWN ROUND RESULTS BY INDUSTRY — The table below sets forth the percentage of "down rounds," by industry groups, for each of the past eight quarters.

Down Rounds	Q1'10	Q2'10	Q3'10	Q4'10	Q1'11	Q2'11	Q3'11	Q4'11
Software	30%	21%	32%	7%	14%	14%	14%	11%
Hardware	40%	36%	35%	36%	15%	15%	12%	0%
Lifescience	20%	22%	27%	36%	31%	31%	22%	33%
Internet/Digital Media	17%	35%	0%	25%	11%	11%	18%	12%
Cleantech	67%	29%	60%	14%	0%	0%	11%	43%
Other	50%	50%	33%	0%	25%	25%	0%	0%
Total all Industries	**32%**	**27%**	**30%**	**21%**	**16%**	**16%**	**15%**	**16%**

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

Barometer	Q1'10	Q2'10	Q3'10	Q4'10	Q1'11	Q2'11	Q3'11	Q4'11
Software	8%	51%	26%	121%	75%	121%	71%	105%
Hardware	-5%	-7%	10%	38%	43%	35%	34%	58%
Lifescience	-1%	4%	44%	-5%	-8%	6%	4%	36%
Internet/Digital Media	90%	43%	82%	20%	77%	115%	201%*	122%
Cleantech	-3%	59%	5%	73%	54%	24%	41%	-3%
Total all industries	**21%**	**30%**	**28%**	**61%**	**52%**	**71%**	**69%**	**+85%**

A graphical representation of the above is below.



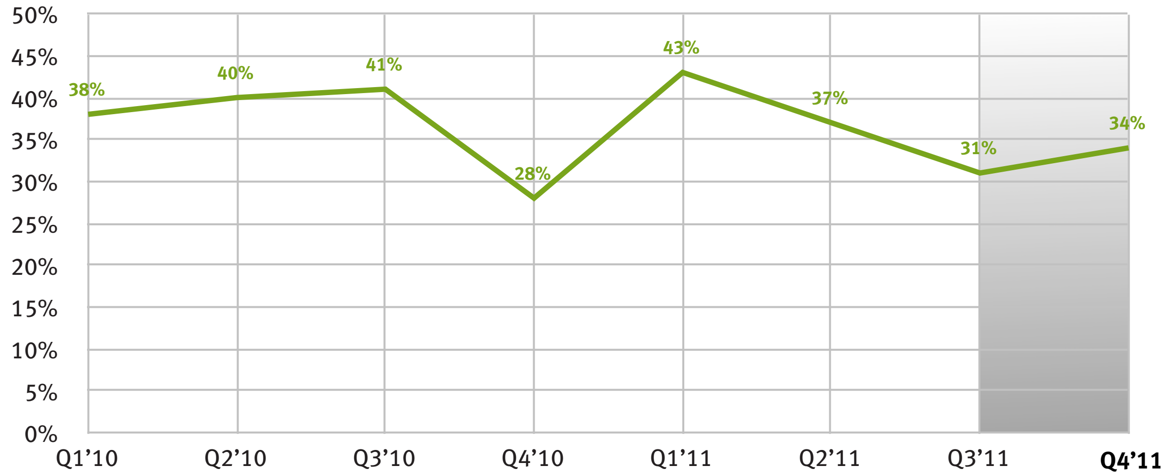
*Please note that one internet/digital media company had a 1,500% up round. If this were excluded the Barometer result for the internet/digital media industry would have been 73%.

FINANCING ROUND — Financings broke down by series according to the chart below.

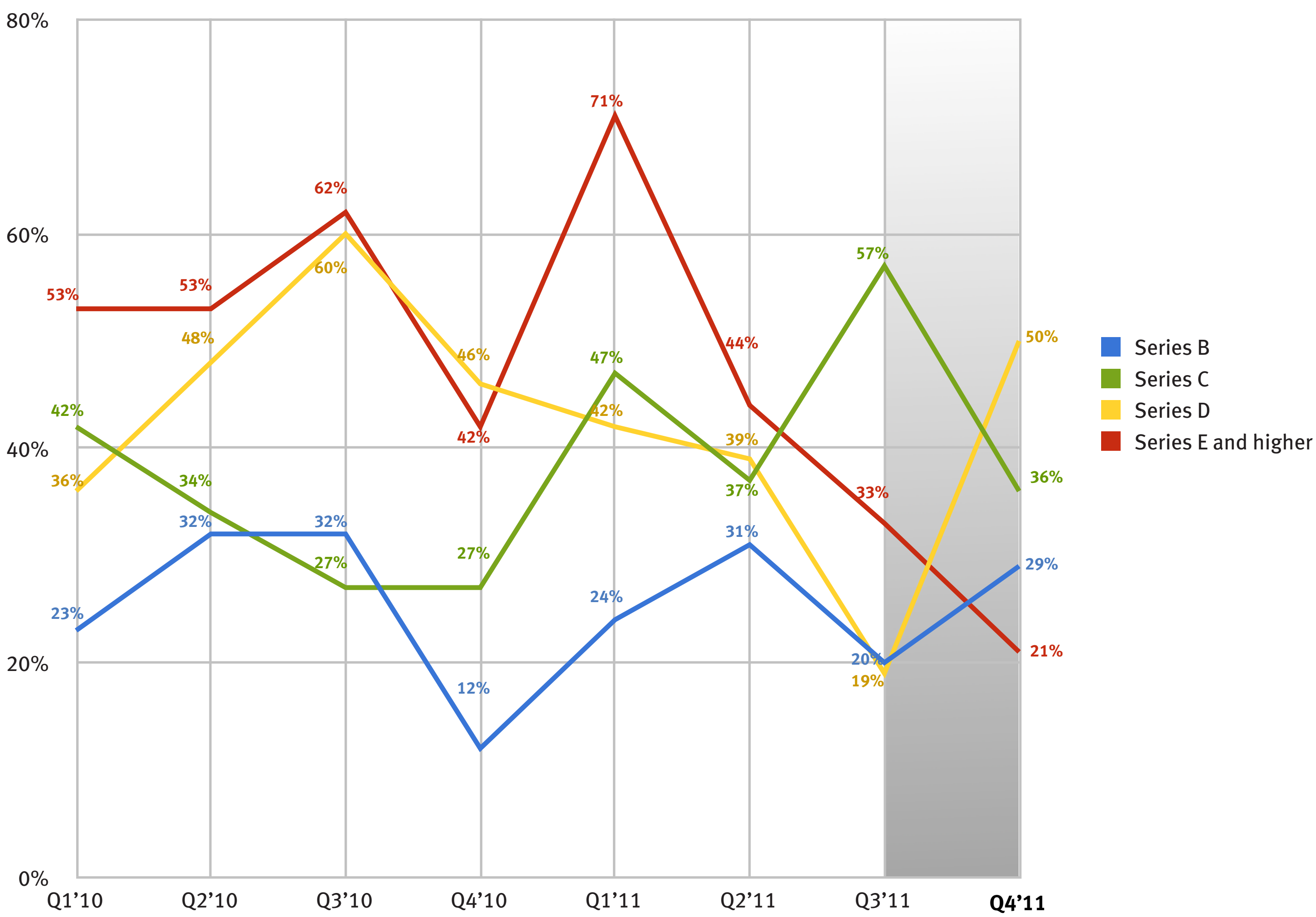
Series	Q1'10	Q2'10	Q3'10	Q4'10	Q1'11	Q2'11	Q3'11	Q4'11
Series A	24%	18%	20%	13%	18%	19%	18%	24%
Series B	21%	22%	23%	26%	24%	25%	31%	24%
Series C	30%	28%	28%	35%	24%	26%	19%	19%
Series D	11%	20%	9%	14%	20%	15%	14%	17%
Series E and higher	14%	12%	20%	12%	14%	15%	18%	16%

Fenwick & West Data on Legal Terms

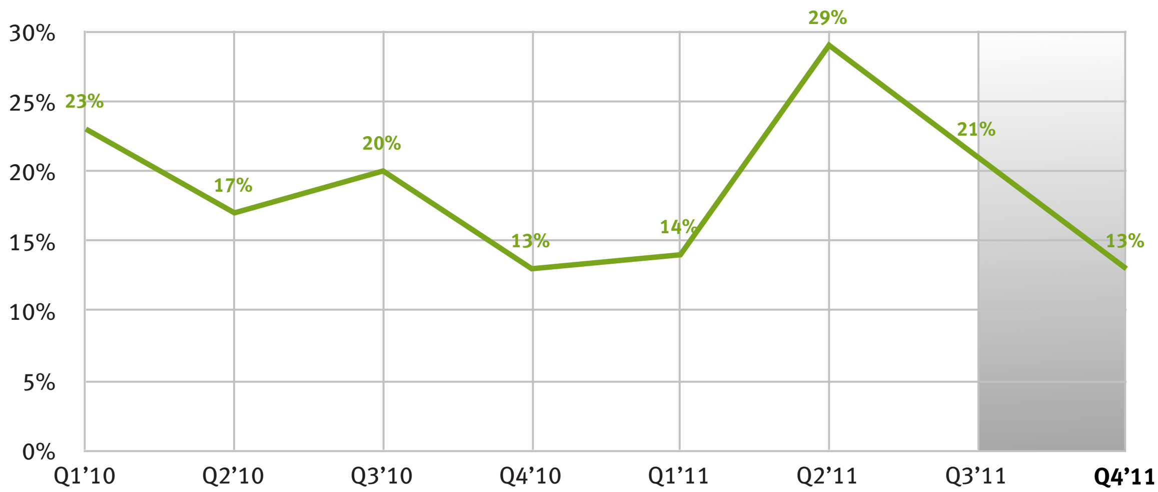
LIQUIDATION PREFERENCE — Senior liquidation preferences were used in the following percentages of financings.



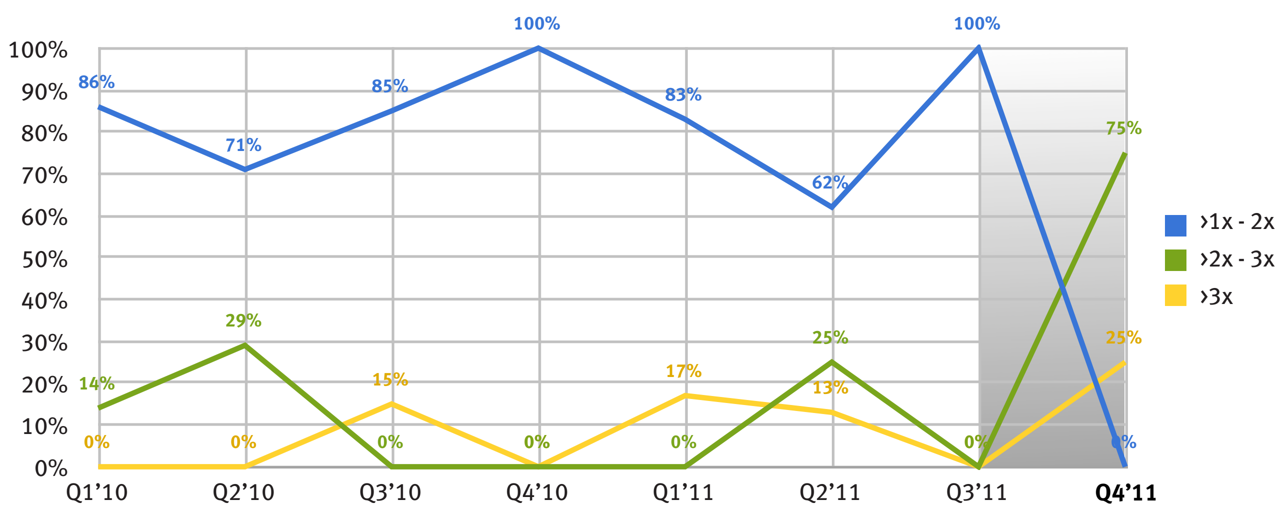
The percentage of senior liquidation preference by series was as follows:



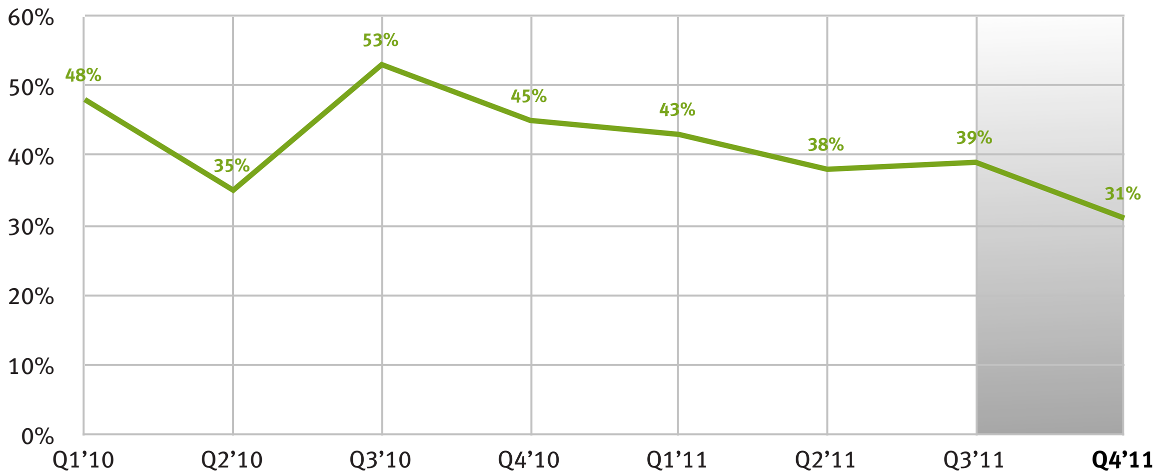
MULTIPLE LIQUIDATION PREFERENCES — The percentage of senior liquidation preferences that were multiple liquidation preferences were as follows:



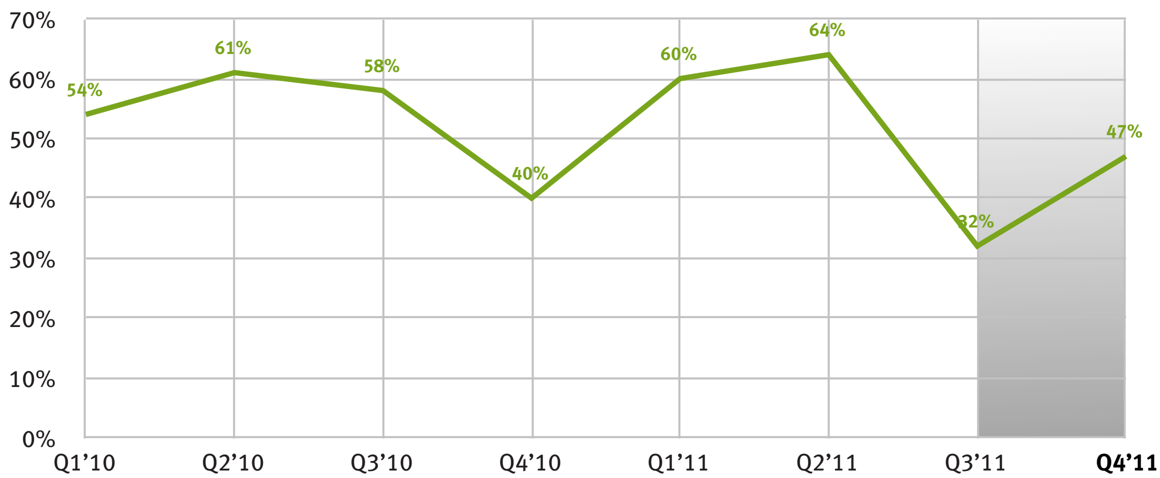
Of the senior liquidation preferences that were a multiple preference, the ranges of the multiples broke down as follows:



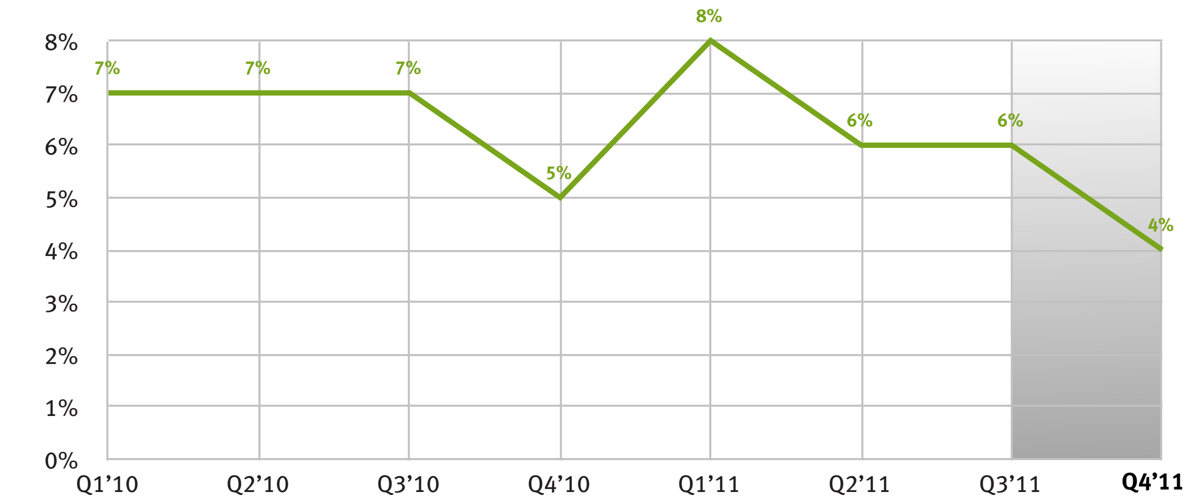
PARTICIPATION IN LIQUIDATION — The percentages of financings that provided for participation were as follows:



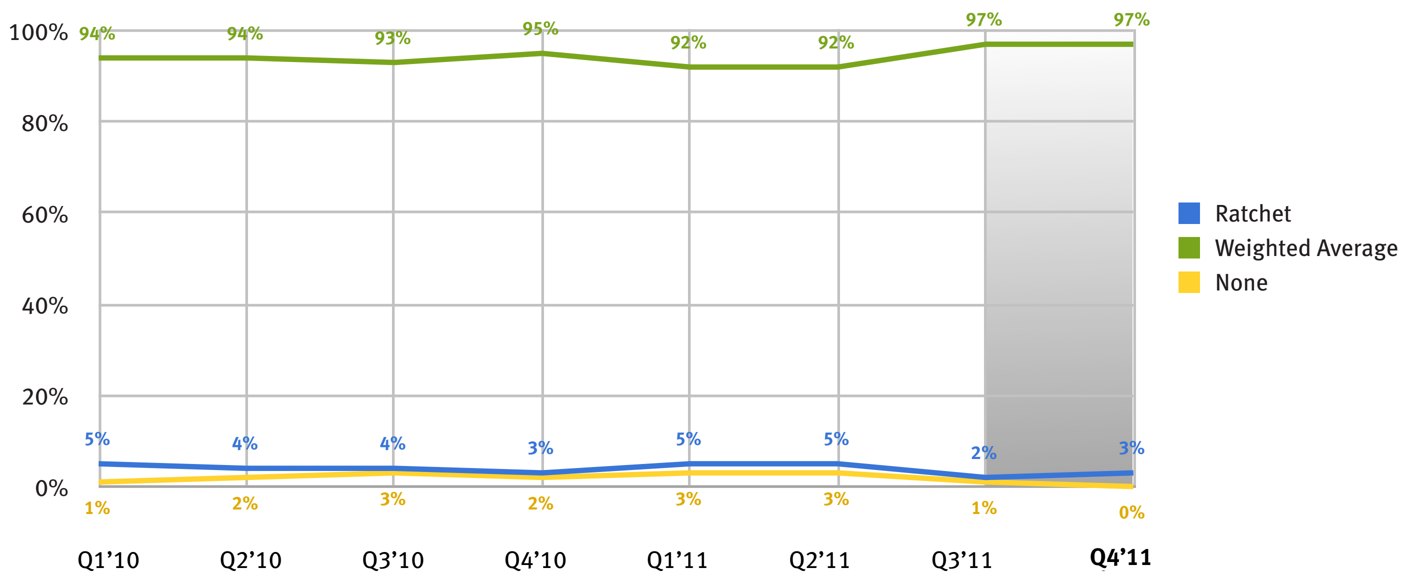
Of the financings that had participation, the percentages that were not capped were as follows:



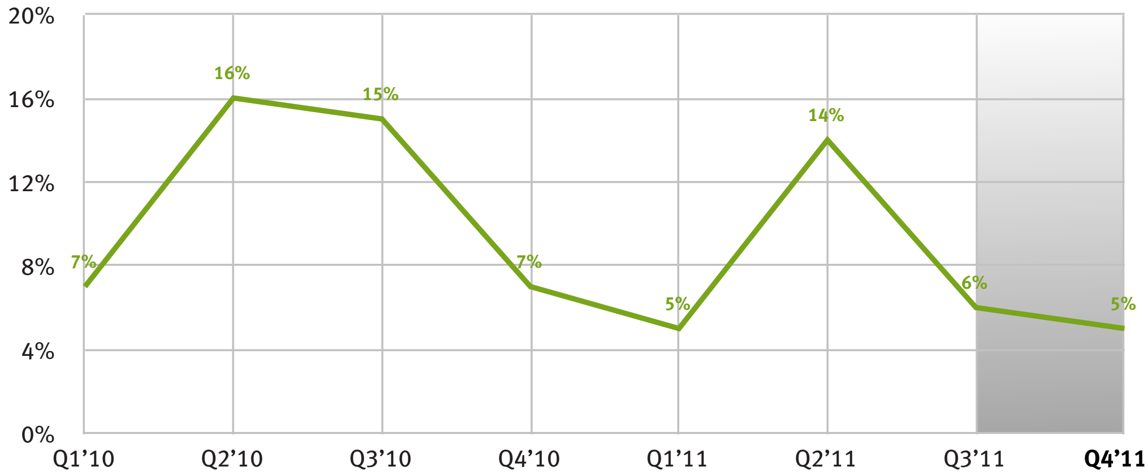
CUMULATIVE DIVIDENDS – Cumulative dividends were provided for in the following percentages of financings:



ANTIDILUTION PROVISIONS –The uses of antidilution provisions in the financings were as follows:

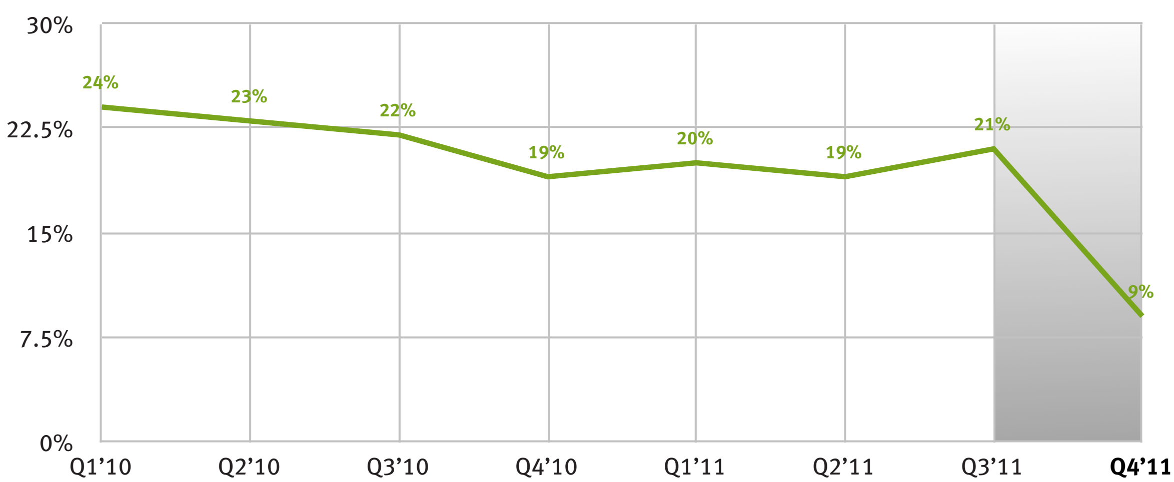


PAY-TO-PLAY PROVISIONS – The percentages of financings having pay-to-play provisions were as follows:

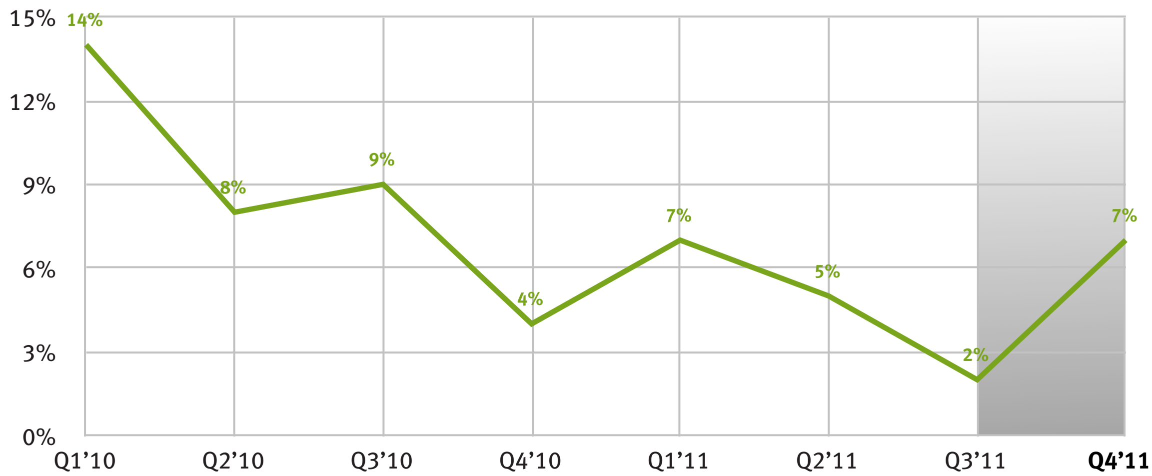


Note that anecdotal evidence indicates that companies are increasingly using contractual "pull up" provisions instead of charter based "pay to play" provisions. These two types of provisions have similar economic effect but are implemented differently. The above information includes some, but likely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

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:



- **Notes 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 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 40% range should be considered normal.

  When comparing current period results to prior period results based on third party data (e.g., amounts invested by venture capitalists, amount of M&A proceeds, etc.), we use the prior period results initially published by the third party for the period, not the results that have been updated with additional information over time, to provide better comparability with the current period results. For example, when comparing fourth quarter results to third quarter results, we use the initially published third quarter results, typically provided in October, not the updated results that are typically provided in January. Such situations are set forth in our report with a parenthetical as to the date the information was initially reported.

- **Disclaimer.**

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