Morgan Lewis

Q1 2020

CORPORATE VENTURE CAPITAL SURVEY

OVERVIEW

During the first quarter of 2020, corporate venture capital (CVC) programs at major companies continued to make significant investments in promising startups and late-stage enterprises. In this survey, we track investment trends as the market slowed for CVC financings at the end of the quarter as we entered the coronavirus (COVID-19) environment. We also analyze a survey of key economic terms of the largest venture capital investments during the first quarter of 2020 in which CVC programs either led the round or participated as significant or anchor investors.

KEY TERMS

We focused our survey on the following deal terms typically negotiated between companies and investors:

- **Valuation**
- **Liquidation Preference**
- **Participating Preferred**
- **Dividends**
- **Redemption Rights**
- **Protective Provisions**
- **"Pay-to-Play" Provisions**

VALUATION

The survey covers a wide range of financing transactions during 2020 — from early to late stage financings. Of the transactions we reviewed, we noted that all involved higher valuation than previous, other than one down round completed in March. This indicates that the market may be slowing and this is starting to impact valuations.

LIQUIDATION PREFERENCE

While preferred stockholders receive preferential treatment on distribution over common stockholders in the event of liquidation, the liquidation preference among different series of preferred stock is often a negotiated term. The later-round preferred stockholders may request a senior ranking over prior-round preferred stockholders, while earlier investors may insist on equal (or pari passu) treatment with new investors.

Based on our review, 94% of the transactions included a 1x liquidation preference, and only 6% of the transactions had a liquidation preference greater than 1x.

Based on our review, 19% of the transactions included a senior preference while the remaining 81% included pari passu liquidation preference with the other preferred stockholders. This reflects an increase from the 2019 surveys suggesting that investors are becoming more aggressive in negotiating senior right to the prior preferred rounds.

PARTICIPATING PREFERRED

With “non-participating” preferred stock, the preferred stockholders are entitled to receive only the amount of their preference (typically the amount paid for the stock) plus any accrued and unpaid dividends upon a sale or liquidation of the company. With “participating” preferred stock, preferred stockholders are entitled to receive their preference amount first in a liquidation event (plus accrued and unpaid dividends), with any remaining proceeds being divided among holders of common stock and preferred stock on an as-converted basis.

Based on our review, only 24% of the transactions included participation rights, while the remaining 76% involved “non-participating” preferred stock.

CUMULATIVE DIVIDEND

If dividends are cumulative, dividends accrue and accumulate at a specified rate whether or not declared by the board. Upon conversion of the preferred stock, cumulative dividends would convert into additional common stock, which would increase the investors’ percentage ownership interest in the company above their original investment. Based on our review, 5% of the transactions included cumulative dividend provisions, while the remaining 95% either were silent on dividends or included non-cumulative dividend provisions..

REDEMPTION RIGHTS

Redemption rights allow investors to force the company, in specified circumstances, to redeem their shares at cost, and in some cases, cost plus a small guaranteed rate of return. Based on our review, 13% of the transactions included some form of redemption rights, while the remaining 87% did not provide redemption rights.

PROTECTIVE PROVISIONS

Protective provisions provide preferred stockholders with special approval rights with respect to certain matters of particular significance to their investment in addition to class or series voting rights that may exist under relevant state corporate laws. These matters may include liquidation and sale of the company, amendment of charter or bylaws, changes in board size, and authorization of issuance of other preferred stock. An often-negotiated point is whether a specific series of preferred stockholder should have the right to vote together as a single class with other series of preferred stock, and/or separately without the participation from other preferred stockholders.

Based on our review, 29% of the transactions included voting rights only as a single class together with other series of preferred stock, while the remaining 71% included voting rights both as a single class with other preferred stockholders and a separate vote by series for certain matters.

“PAY-TO-PLAY” PROVISIONS

A “pay-to-play” provision requires that investors participate in a later financing in order to retain their antidilution or other special rights. A pay-to-play is not a standard term in most VC financings and typically will come into play only in down-rounds. We did not observe any pay-to- play provisions in the transactions we reviewed.

SUMMARY

While the economic terms of each investment are unique based on the facts and circumstances of the companies and investors participating, the Q1 2020 survey indicates that the market may be shifting to more investor-favorable terms, as indicated by the increase in more restrictive provisions including redemption rights, series votes under the protective provisions, seniority in the liquidation stack vs. prior preferred rounds, and cumulative dividends.

We will continue to track these trends in the Q2 2020 survey to see if the market is shifting to more conservatism as companies confront down rounds and reduced valuations in the COVID-19 environment.

Morgan Lewis

Strategic Investments & Corporate Venture Capital

CONTACTS

Karen A. Abesamis
karen.abesamis@morganlewis.com
+1.650.843.7277

Jeffrey P. Bodle
jeffrey.bodle@morganlewis.com
+1.215.963.5417

Eric Hwang
eric.hwang@morganlewis.com
+1.650.843.7588

E. John Park
john.park@morganlewis.com
+1.650.843.7595

Christopher Rose
chris.rose@morganlewis.com
+1.310.907.1036

Nancy Yamaguchi
nancy.yamaguchi@morganlewis.com
+1.415.442.1242

Connect with us

www.morganlewis.com

06052020_201468