

Venture Capital Report

2021

WILMERHALE® 

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REVIEW

Despite the arrival of the COVID-19 pandemic in early 2020 and the ensuing economic dislocation, venture capital financing proceeds, median amount raised, and median pre-money valuation all increased from 2019 levels, although reported deal flow dipped.

VC-backed company liquidity activity followed a similar pattern in 2020. The number of VC-backed IPOs increased, while M&A activity declined modestly, but the median pre-money valuation at the time of IPO and the median acquisition price both reached their highest levels in more than 15 years.

EQUITY FINANCING ACTIVITY

The number of venture capital financings contracted by 4%, from 12,272 in 2019 to 11,920 in 2020. Once all financings are counted, the gap between the two years is likely to close.

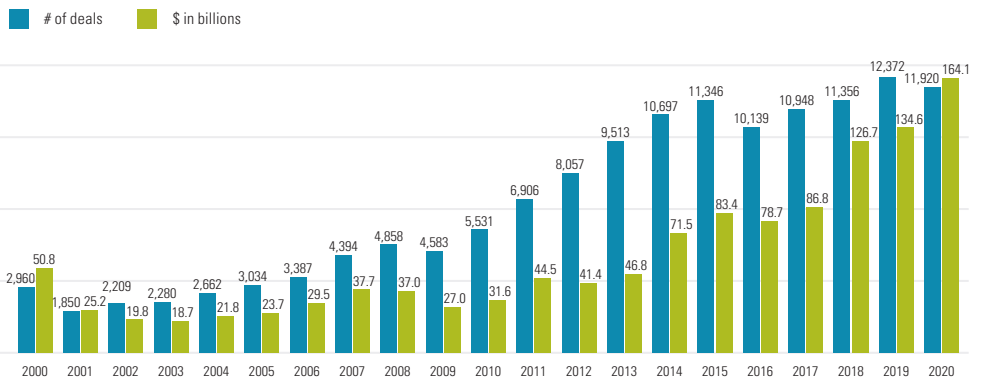
The record \$164.1 billion invested in the US venture capital ecosystem in 2020 represents an increase of 22% from the \$134.6 billion in 2019.

Overall, the median size of venture capital financings increased by 9%, from \$2.8 million in 2019 to \$3.0 million in 2020—the highest annual level since 2008, when angel and seed financings comprised a smaller portion of the market.

The median size of angel and seed financings increased by 15%, from \$1.2 million in 2019 to \$1.4 million in 2020. The median size of early-stage financings increased by 8%, from \$6.0 million to \$6.5 million. At \$10.0 million, the median size of later-stage financings in 2020 matched the prior year's figure. Median financing amounts at each financing stage have either increased or remained steady each year since 2013.

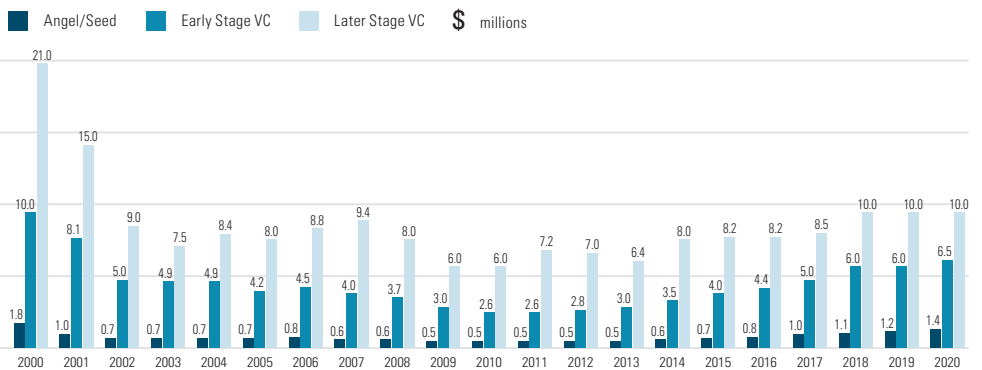
The median financing size for life sciences companies increased by one-third, from \$3.4 million in 2019 to \$4.5 million in 2020. Among technology companies, the median financing size grew by 11%, from \$3.3 million to \$3.7 million. In both

US Venture Capital Financings – 2000 to 2020



Source: PitchBook

Median Size of US Venture Capital Financings – 2000 to 2020



Source: PitchBook

sectors, median financing size reached its highest annual level since 2008.

The number of very large financings rounds continued to grow in 2020. There were 750 financing rounds of at least \$50 million in 2020, up 24% from 603 in 2019, continuing a trend that saw rounds of this size grow from 242 in 2016 to 331 in 2017, and then to 534 in 2018.

The number of financing rounds of at least \$100 million show a similar pattern, as VC-backed companies increasingly rely on “IPO-sized” later-stage rounds of financing. There were 330 financing rounds raising at least \$100 million in 2020, a 33% increase from the 248 rounds in 2019. This jump, in turn, followed the 86% surge in \$100-million financing rounds that

occurred in 2018, when the total jumped to 208, from 112 in 2017 and 77 in 2016.

Increases in super-sized rounds are driven largely by private equity, crossover and hedge funds, which are attracted to pre-IPO companies that can offer the potential for sizeable investment returns, especially when investors are able to negotiate ratchet or other provisions guaranteeing them a minimum return at the time of an IPO, typically in the form of additional shares if the offering occurs below a specified price.

There were five billion-dollar financing rounds in 2020. This elite club was led by Waymo, with its \$3.0 billion financing, followed by Rivian Automotive (\$2.5 billion), SpaceX (\$1.9 billion), Epic Games (\$1.78 billion) and Generate (\$1.0 billion).

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The median pre-money valuation for all venture financings continued its upward trajectory, increasing 17%, from \$17.1 million in 2019 to \$20.0 million in 2020. Among angel and seed rounds, the median pre-money valuation held steady at \$7.0 million in each of the last two years. The median pre-money valuation in early-stage rounds increased 12%, from \$26.9 million in 2019 to \$30.0 million in 2020, while later-stage rounds saw a 15% increase, from \$65.0 million to \$75.0 million.

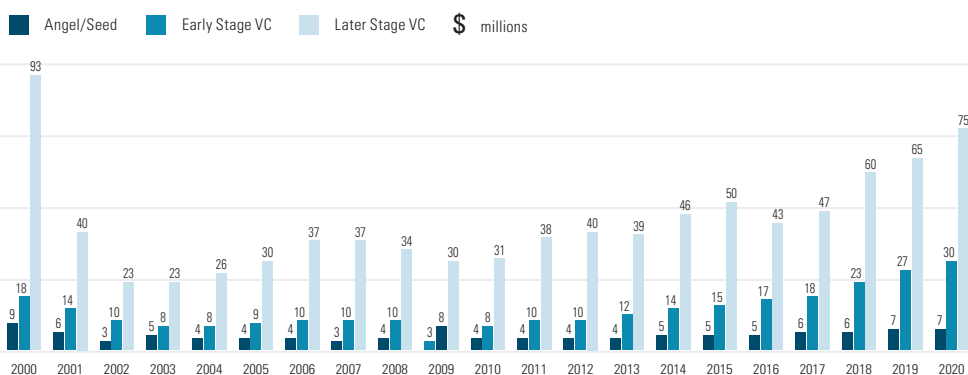
The median pre-money valuation in the technology sector increased 11%, from \$18.0 million in 2019 to \$20 million in 2020. Among life sciences companies, the median pre-money valuation jumped 49%, from \$17.5 million to \$26.0 million.

Angel and seed financings accounted for 42% of all venture financings in 2020 (down from 44% in 2019) and represented 6% of all venture capital financing proceeds (down from 8% in 2019). Early-stage financings accounted for 29% of all financings in 2020 (down from 32% in 2019) and 26% of all proceeds (down from 33% in 2019). Later-stage financings accounted for 28% of all financings in 2020 (up from 24% in 2019) and 67% of all proceeds (up from 59% in 2019).

The technology sector accounted for 37% of the year's financings in 2020, down from 38% in 2019. The life sciences sector's market share increased to 23% in 2020 from 21% in 2019. The market share for consumer goods and services companies declined from 21% in 2019 to 19% in 2020, while business services companies saw their market share increase from 13% to 14%.

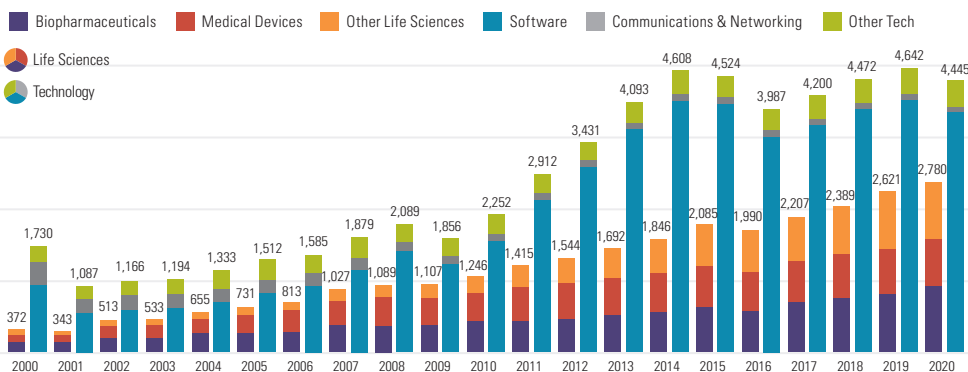
California produced 34% of all venture financings in 2020 (4,037 financings) and 51% of the year's proceeds (\$84.43 billion). New York, home to companies with 1,475 financings raising \$18.53 billion in 2020, finished second in the state rankings, followed by Massachusetts (with 860 financings raising \$17.05 billion), Texas (with 593 financings raising \$5.00 billion), Washington (with 427 financings raising \$4.88 billion) and Colorado (with 372 financings raising \$2.50 billion).

Median Pre-Money Valuation in US Venture Capital Financings – 2000 to 2020



Source: PitchBook

US Venture Capital Financings by Industry – 2000 to 2020



Source: PitchBook

LIQUIDITY ACTIVITY

The number of IPOs by VC-backed US issuers increased by 32%, from 72 in 2019 to 95 in 2020—the highest annual figure since the 102 in 2014. VC-backed companies accounted for 64% of all US-issuer IPOs in 2020, down slightly from their 65% share of the market in 2019.

Gross IPO proceeds raised by VC-backed US issuers increased by 21%, from \$25.04 billion in 2019 to \$30.38 billion in 2020. There were five billion-dollar IPOs by VC-backed US issuers in 2020, a tally equal to 2019. The largest 2020 IPO was the \$3.49 billion offering of Airbnb, followed by the IPOs of DoorDash (\$3.37 billion), Snowflake (\$3.36 billion), Unity Software (\$1.30 billion) and Wish (\$1.10 billion).

The median offering size for US VC-backed IPOs increased by 65%, from \$110.5 million in 2019 to \$182.7 million in 2020.

In 2020, life sciences companies accounted for 70% of all VC-backed IPOs, up from their 59% market share in 2019 and the 62% that prevailed over the five-year period from 2014 to 2018. The VC-backed IPO market share for technology companies declined to 27% in 2020 from 40% in 2019, compared to the 36% market share over the five-year period from 2014 to 2018.

The median time from initial funding to IPO declined from 6.6 years in 2019 to 5.3 years in 2020, the second-lowest figure since 2009.

The median amount raised prior to an IPO increased by 27%, from \$131.8 million in

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2019 to \$167.1 million in 2020, while the median pre-IPO valuation climbed by 60%, from \$360.5 million to \$577.5 million. As a result, the ratio of pre-IPO valuation to the median amount raised prior to an IPO increased from 2.8:1 in 2019 to 3.5:1 in 2020—equal to the 3.5:1 in 2017 and the highest level since 2012 (a higher ratio means better returns to pre-IPO investors).

The average 2020 VC-backed US issuer IPO gained 104% from its offering price through year-end. At the end of 2020, 80% of the year's VC-backed IPO class were trading above their offering price, up from 57% in 2019.

The number of reported acquisitions of VC-backed companies declined by 9%, from 1,018 in 2019 to 930 in 2020. Total reported proceeds decreased by 5%, from \$92.7 billion to \$87.9 billion. Once all 2020 acquisitions are accounted for, however, the year's totals for deals and proceeds should approach or exceed those of 2019.

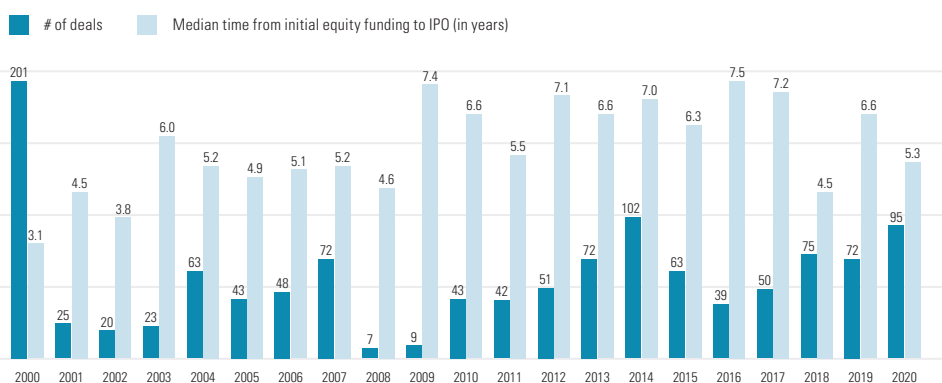
The median acquisition price increased by 16%, from \$75.0 million in 2019 to \$87.1 million in 2020. The median time from initial funding to acquisition increased from 4.9 years in 2019 to a record annual high of 5.0 years in 2020.

The median amount raised prior to acquisition increased by 16%, from \$9.4 million in 2019 to \$10.9 million in 2020—the highest annual figure since the \$11.3 million in 2011.

After three consecutive annual increases, the ratio of median acquisition price to median amount raised prior to acquisition remained steady at 8.0:1 in 2020 (a higher ratio means higher returns to pre-acquisition investors). The 2020 figure was the second-highest ratio since the 12.5:1 recorded in 2000, at the apex of the dot-com delirium, behind only the 8.8:1 recorded in 2016. The increase in this ratio reflects the combination of significantly higher acquisition prices and lower levels of pre-acquisition investments.

There were 38 VC-backed company acquisitions of at least \$500 million in 2020, a total that represented a 15% increase over the 33 in 2019 and a 52% increase over the annual average

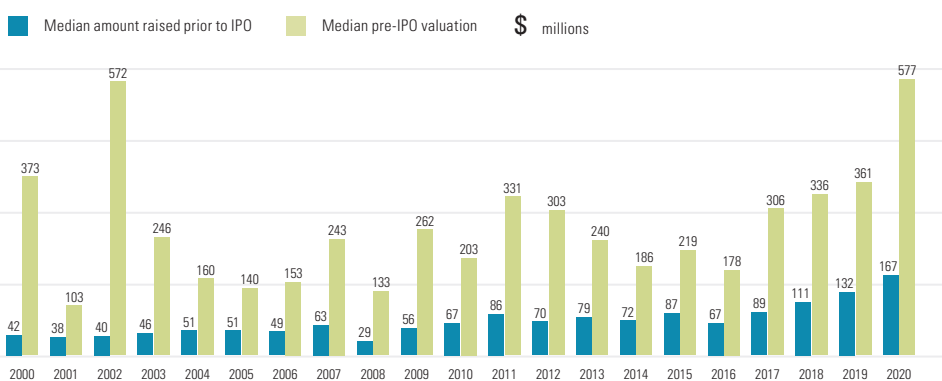
Venture Capital–Backed IPOs and Median Time to IPO – 2000 to 2020



Source: SEC filings and PitchBook

The above chart is based on US IPOs by VC-backed US issuers.

Median Amount Raised Prior to IPO and Median Pre-IPO Valuation – 2000 to 2020



Source: PitchBook

of 25 that prevailed during the five-year period from 2014 to 2018.

The year also saw 23 billion-dollar acquisitions, up from 19 in 2019. The largest deal of 2020 was the \$7.1 billion acquisition of Credit Karma by Intuit, followed by the \$4.9 billion acquisition of Forty Seven by Gilead Sciences, the \$4.0 billion acquisition of AskBio by Bayer and the \$4.0 billion acquisition of Uber Advanced Technologies Group by Aurora.

Based on the valuations achieved in company sales and IPOs compared to the financing amounts required to achieve each type of liquidity event, 2020 marked the ninth consecutive year in which returns to venture capital investors were higher in M&A transactions than in IPOs. Liquidity also arrived sooner

through M&A transactions than through IPOs in 2020, with a median time of 5.0 years from initial funding to acquisition, compared to a median of 5.3 years from initial funding to IPO. This fact, combined with the tendency of M&A transactions to yield the bulk of the purchase price in cash at closing—whereas IPOs generally involve a post-IPO lockup period of 180 days and market uncertainty as to the timing and prices of subsequent stock sales—makes it easy to see why investors often prefer a company sale to an IPO.

While company sales continue to far outpace IPOs as liquidity events, the ratio of M&A transactions to IPOs for VC-backed companies declined from 14.1:1 in 2019 to 9.8:1 in 2020.

OUTLOOK

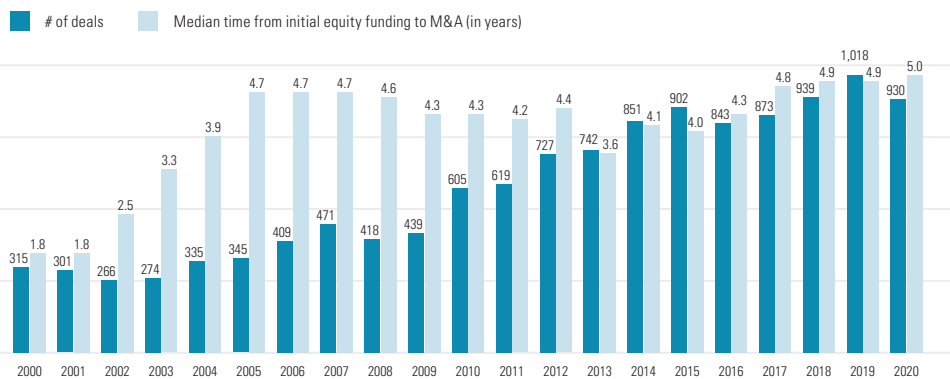
Results over the coming year will depend on a variety of factors, including the following:

— **Financing Activity:** Predictions that the COVID-19 pandemic would lead to a sharp contraction in venture capital activity, reductions in pre-money valuations, and a potential private capital crunch in 2020 proved incorrect. While the pandemic has not yet run its course and the timing and extent of economic recovery remains uncertain, the combination of ample funds for investment (venture capital fundraising reached a record of \$73.6 billion in 2020) and the prospect of gradual economic recovery suggest a favorable environment for venture capital financing activity in the coming year.

— **Attractive Sectors:** Companies offering products or services to meet the demands of remote work or address health and safety consequences of the COVID-19 pandemic should remain attractive financing candidates, while those operating in industries hard-hit by the pandemic will likely continue to struggle to adjust to the “new normal.” In addition, companies that leverage blockchain technology, AI, machine learning and voice technology to continue the digital transformation of business processes should attract funding in 2021. Other sectors that should receive significant investment include digital health, security, consumer e-commerce, robotics, fintech and agtech. Innovative life sciences companies, and those with compelling market opportunities—such as in immunology and gene therapy—should also continue to appeal to investors.

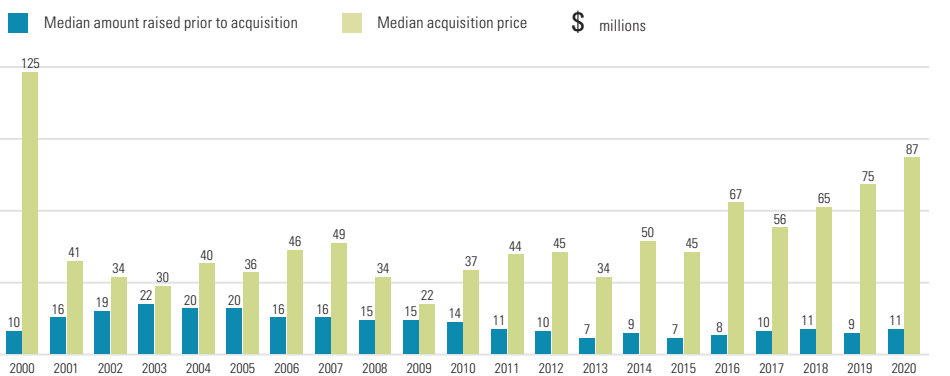
— **IPOs:** Although it was intended to encourage emerging growth companies (EGCs) to go public, the JOBS Act—combined with other changes in regulatory requirements and the availability of large amounts of private investment capital—has made it easier for VC-backed companies to stay private longer. As a result, many VC-backed companies, particularly in the

Acquisitions of US Venture-Backed Companies and Median Time to M&A – 2000 to 2020



Source: PitchBook

Median Amount Raised Prior to Acquisition and Median Acquisition Price – 2000 to 2020



Source: PitchBook

technology industry, have opted to delay their public debuts, often relying on private “IPO-sized” crossover rounds to meet their financing needs and to scale up before going public. The solid aftermarket performance of prominent VC-backed IPOs in 2020 should, however, spur more VC-backed companies to pursue IPOs in the coming year.

— **Acquisitions:** M&A activity in the coming year should be bolstered by several factors. The historically low interest rate environment should encourage strategic acquirers to supplement organic growth with debt-financed acquisitions. Some companies will likely pursue acquisitions to respond to the acceleration of changes in business practices resulting from the pandemic. The large and growing number of special

purpose acquisition companies (SPACs) seeking acquisitions provides all private companies with a new pool of potential acquirers. Acquisition prices cannot increase indefinitely, but companies with differentiated market positions and strong growth potential are likely to continue to attract premium acquisition prices.

Venture capital financing and liquidity activity in 2021 is off to a promising start. The number of financings in the first quarter increased 3% from the fourth quarter of 2020, while total proceeds jumped 65%. The first quarter produced 54 VC-backed IPOs, up from 40 in the prior quarter (representing the highest quarterly tally since the third quarter of 2000). With 297 VC-backed company acquisitions, M&A deal flow also reached a record level in the first quarter of 2021. ■

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CALIFORNIA

California companies reported 4,037 financings in 2020, a decline of 5% from the 4,256 in 2019. California was responsible for 34% of all US financing transactions in 2020, matching its market share in the prior year.

Total proceeds grew 28%, from \$66.20 billion in 2019 to \$84.43 billion in 2020, partly due to an increase in large financings.

The number of rounds raising \$50 million or more rose by 24%, from 307 to 381, while the number of rounds of \$100 million or more increased by 35%, from 133 to 180. California-based companies accounted for 51% of all financing rounds in the country raising \$50 million or more in 2020, equal to the percentage in 2019.

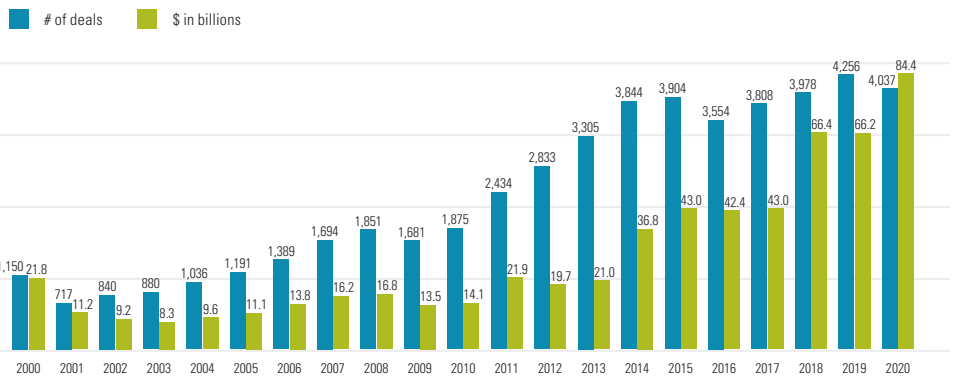
Technology was the largest sector in the state, producing 43% of all California financings in 2020, followed by life sciences (20%), consumer goods and services (18%), and business services (13%).

The number of IPOs by California-based VC-backed companies increased for the fourth consecutive year, growing 17%, from 36 in 2019 to 42 in 2020. California was home to just over half of the 20 largest VC-backed IPOs by US issuers in 2020, compared to three-quarters in 2019. The largest was Airbnb's \$3.49 billion IPO, followed by the IPOs of DoorDash (\$3.37 billion) and Snowflake (\$3.36 billion).

The number of reported acquisitions of California VC-backed companies declined by 6%, from 377 in 2019 to 355 in 2020. The state's largest deals were the \$7.1 billion acquisition of Credit Karma by Intuit, the \$4.9 billion acquisition of Forty Seven by Gilead Sciences, the \$3.2 billion acquisition of Segment by Twilio, and the \$2.75 billion acquisition of VelosBio by Merck.

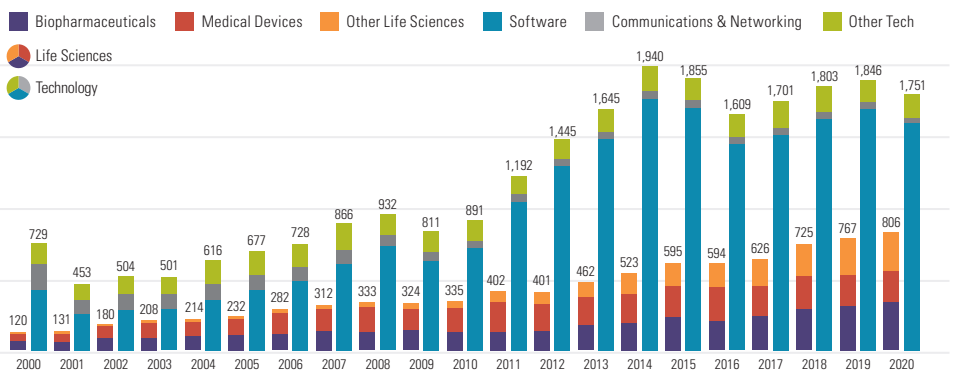
California will undoubtedly maintain its venture capital leadership in the coming year. Financing and liquidity activity in 2021 will depend on the level of venture capital fundraising, macroeconomic conditions, the willingness of strategic buyers to pay attractive prices, and IPO market conditions, among other factors.

California Venture Capital Financings – 2000 to 2020



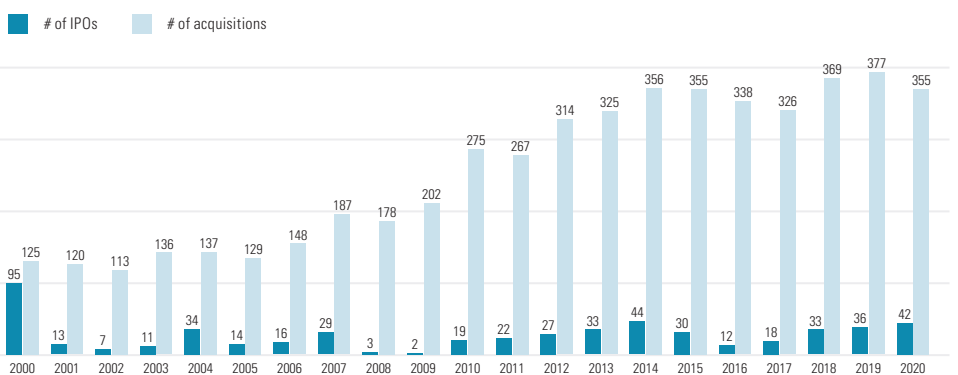
Source: PitchBook

California Venture Capital Financings by Selected Industry – 2000 to 2020



Source: PitchBook

California Venture-Backed IPOs and Acquisitions – 2000 to 2020



Source: SEC filings and PitchBook

7 Regional Market Review and Outlook

MID-ATLANTIC

With 772 rounds, the number of reported 2020 venture capital financings in the mid-Atlantic region of Virginia, Maryland, North Carolina, Delaware and the District of Columbia represented a decline of 2% from the 787 financings in 2019.

Buoyed by an increase in the number of large financings, total proceeds in the mid-Atlantic region increased by 66%, from \$4.25 billion in 2019 to \$7.04 billion in 2020. The number of mid-Atlantic rounds raising \$50 million or more increased by 47%, from 17 in 2019 to 25 in 2020, while the number of rounds raising \$100 million or more increased from three to eight.

North Carolina led the mid-Atlantic region in both deal volume and proceeds in 2020, with 228 financings raising \$3.60 billion, followed by Virginia with 176 financings (\$1.16 billion) and Maryland with 148 financings (\$1.20 billion).

Technology companies accounted for 37% of all mid-Atlantic financings in 2020—extending the sector’s longstanding leadership in the region—followed by life sciences (25%), consumer goods and services (17%), and business services (14%).

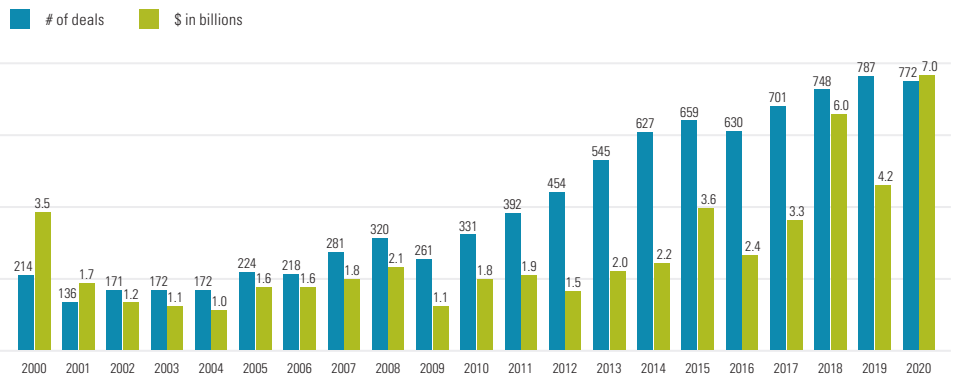
The region generated three VC-backed IPOs in 2020, equal to the count for 2019, led by a pair of Delaware-based companies—nCino (\$250 million) and Prelude Therapeutics (\$158 million).

The number of reported acquisitions of mid-Atlantic VC-backed companies dipped from 58 in 2020 to 57 in 2019. Virginia generated 22 deals, followed by Maryland with 15 deals and North Carolina with 11 deals.

The region’s largest M&A transaction of the year was the \$4.0 billion acquisition of AskBio by Bayer, followed by the \$2.75 billion acquisition of EdgeConnex by EQT Infrastructure, and the \$425 million acquisition of OncoImmune by Merck.

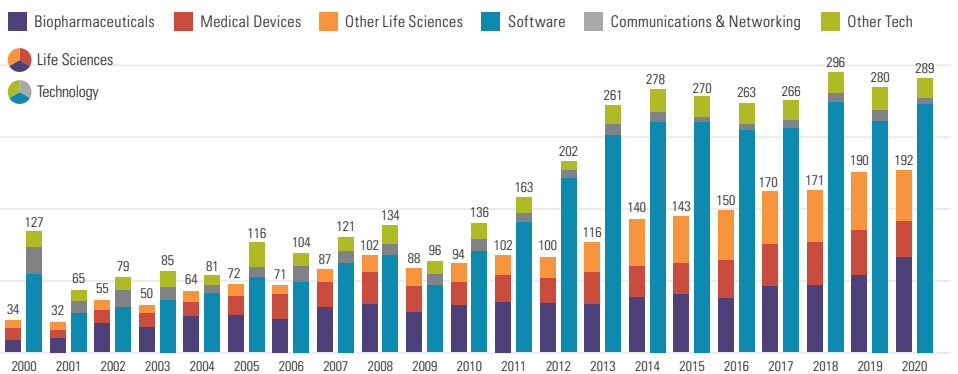
With a strong venture capital ecosystem, the mid-Atlantic region should be poised for growth in financing and liquidity activity in the coming year if market conditions are conducive.

Mid-Atlantic Venture Capital Financings – 2000 to 2020



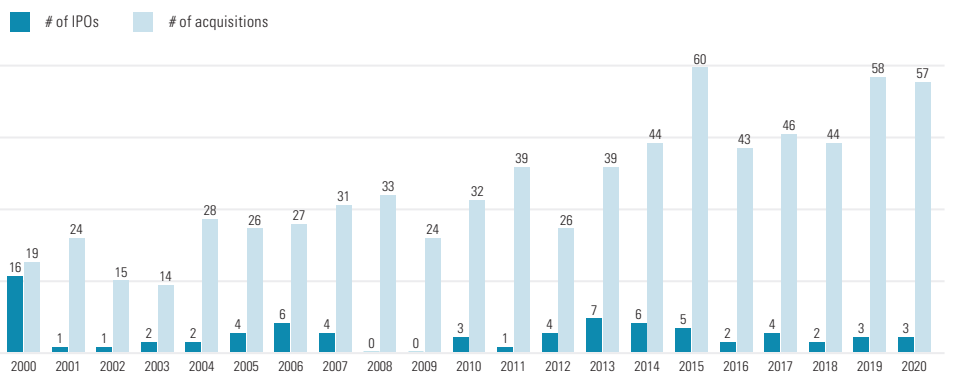
Source: PitchBook

Mid-Atlantic Venture Capital Financings by Selected Industry – 2000 to 2020



Source: PitchBook

Mid-Atlantic Venture-Backed IPOs and Acquisitions – 2000 to 2020



Source: SEC filings and PitchBook

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NEW ENGLAND

New England companies reported 1,130 venture capital financings in 2020, an increase of 9% from the 1,037 financings in 2019. Total proceeds were \$18.61 billion, an increase of 45% from the \$12.82 billion in the prior year.

Massachusetts, the perennial leader in New England and the nation's third-largest source of VC financings, led the region in 2020, with 860 financings and \$17.05 billion in proceeds.

The number of rounds raising \$50 million or more increased by 32%, from 87 in 2019 to 115 in 2020, while the number of rounds raising \$100 million or more increased by 82%, from 26 to 47. The largest rounds in 2020 came from Indigo Agriculture (\$535 million), XtalPi (\$319 million) and Tessera Therapeutics (\$230 million).

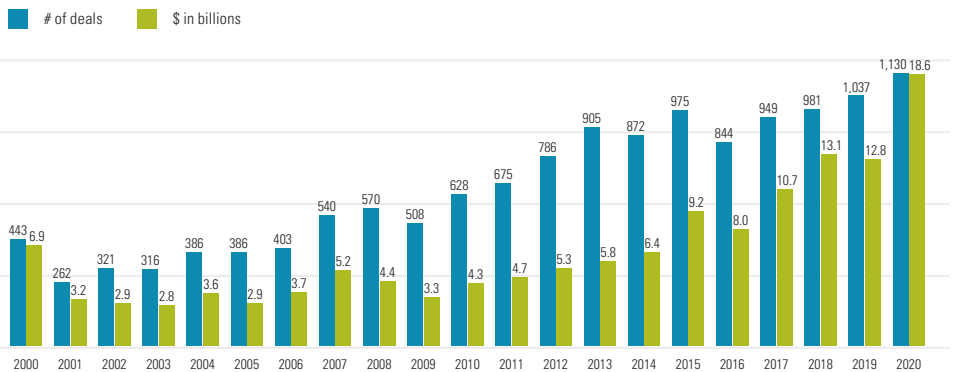
The life sciences sector increased its share of New England venture capital financings for the sixth consecutive year, representing 40% of the region's total in 2020 (up from 34% in 2019), followed by technology (27%), consumer goods and services (14%), and business services (12%).

The number of VC-backed IPOs by New England-based companies increased by 86%, from 14 in 2019 to 26 in 2020, to become the highest annual tally since 2000. All the region's VC-backed IPOs were by Massachusetts-based companies, and all but one were by life sciences companies—the remaining IPO, the largest of 2020, was by telehealth company American Well.

The number of reported acquisitions of VC-backed companies in New England decreased by 16%, from 96 in 2019 to 81 in 2020, of which Massachusetts contributed 65. The region's largest M&A transaction was the \$2.1 billion acquisition of Corvidia by Novo Nordisk, followed by the \$539 million acquisition of Censa Pharmaceuticals by PTC Therapeutics.

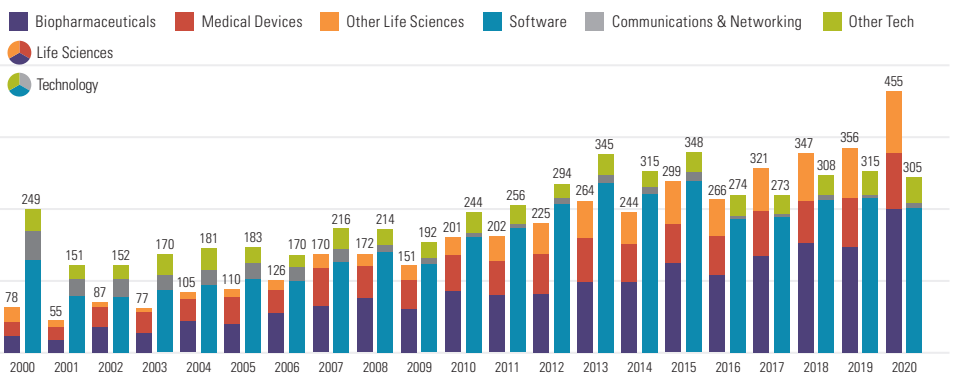
With its concentration of world-renowned universities and research institutions, New England—and Massachusetts in particular—should remain a hub of venture capital and IPO activity during the coming year, particularly in the life sciences and technology sectors.

New England Venture Capital Financings – 2000 to 2020



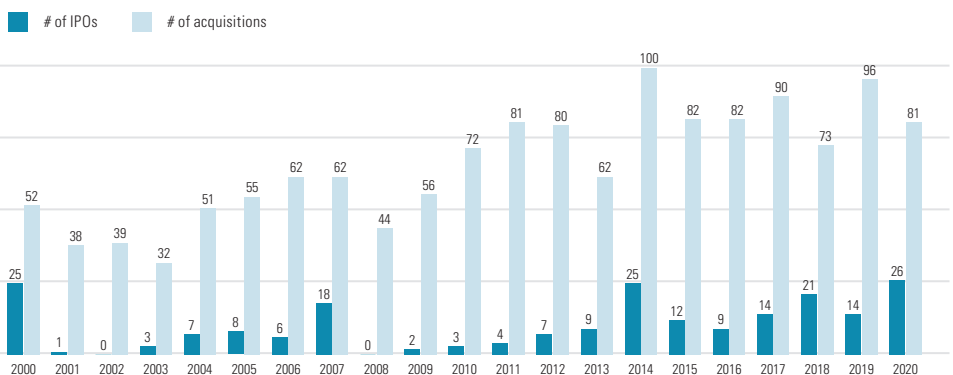
Source: PitchBook

New England Venture Capital Financings by Selected Industry – 2000 to 2020



Source: PitchBook

New England Venture-Backed IPOs and Acquisitions – 2000 to 2020



Source: SEC filings and PitchBook

9 Regional Market Review and Outlook

TRI-STATE

The number of reported venture capital financings in the tri-state region of New York, New Jersey and Pennsylvania declined by 4%, from 2,046 in 2019 to 1,960 in 2020, while total proceeds inched up, from \$21.79 billion to \$21.85 billion.

New York, the nation's second-largest source of VC financings, led the tri-state region in 2020, with 1,475 financings and \$18.53 billion in proceeds.

The number of rounds raising \$50 million or more increased by 23%, from 90 in 2019 to 111 in 2020, while the number of rounds of \$100 million or more increased by 18%, from 40 to 47. The region's largest financing came from goPuff (\$380 million), Everest Medicines (\$310 million) and You & Mr Jones (\$260 million).

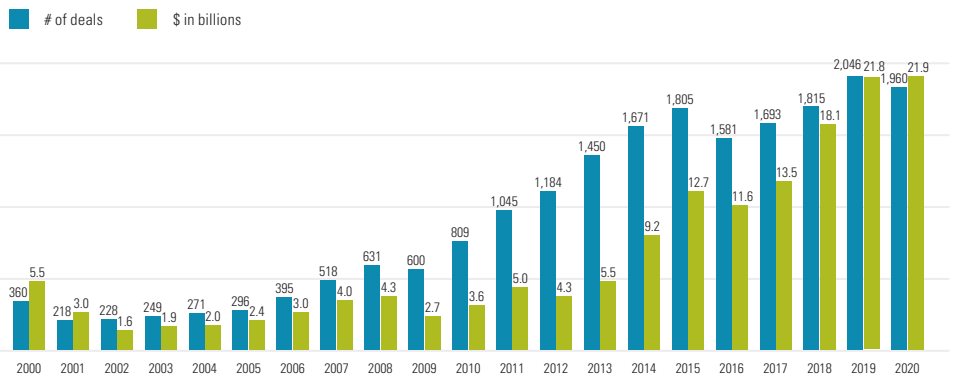
Technology companies accounted for 36% of the tri-state region's VC financings in 2020, followed by consumer goods and services (24%), life sciences (20%), and business services (14%).

There were twelve VC-backed IPOs in the tri-state region in 2020, up from eleven in 2019—equaling the region's highest annual figure since 2000. New York produced six VC-backed IPOs, with Pennsylvania contributing four and New Jersey accounting for the remaining two. The largest venture-backed IPOs were from Vroom (\$468 million), Legend Biotech (\$424 million) and Lemonade (\$319 million).

The number of reported acquisitions of VC-backed companies in the tri-state region declined by 17%, from 169 in 2019 to 140 in 2020. New York generated 106 deals in 2020 (down from 121 in 2019), followed by Pennsylvania with 19 and New Jersey with 15. The largest deals were the \$4.0 billion acquisition of Uber Advanced Technologies Group by Aurora and the \$500 million acquisition of Mirror by Lululemon Athletica.

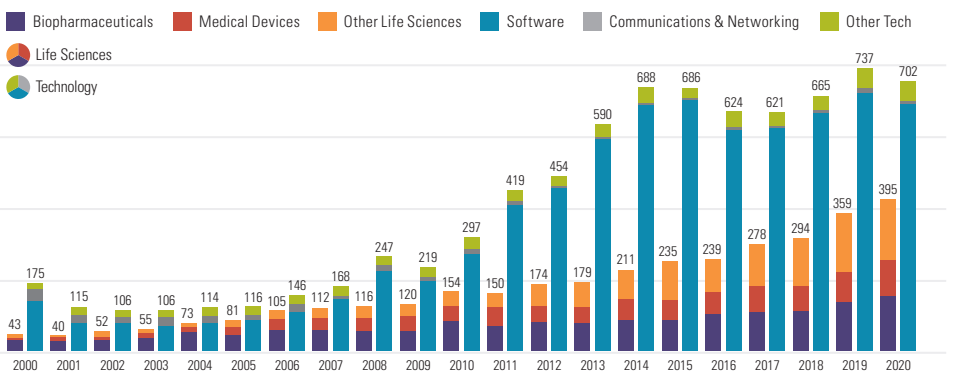
With strength across a broad array of industry sectors, the tri-state region should continue to produce attractive financing candidates and, assuming conducive market conditions, further growth in liquidity events. ■

Tri-State Venture Capital Financings – 2000 to 2020



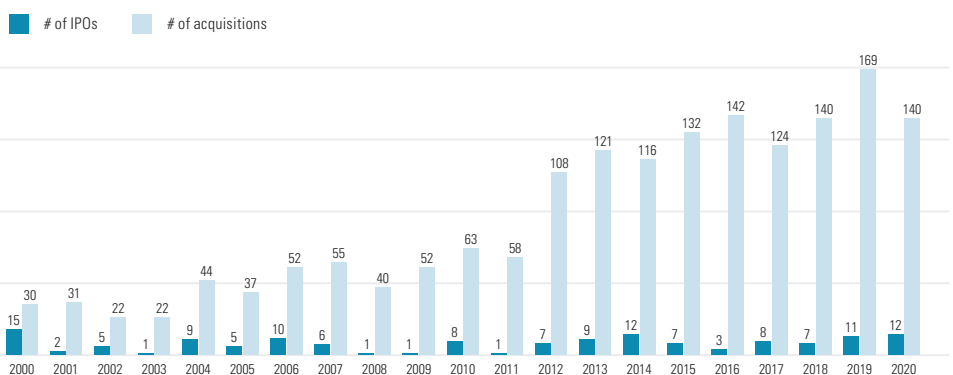
Source: PitchBook

Tri-State Venture Capital Financings by Selected Industry – 2000 to 2020



Source: PitchBook



































Tri-State Venture-Backed IPOs and Acquisitions – 2000 to 2020



Source: SEC filings and PitchBook

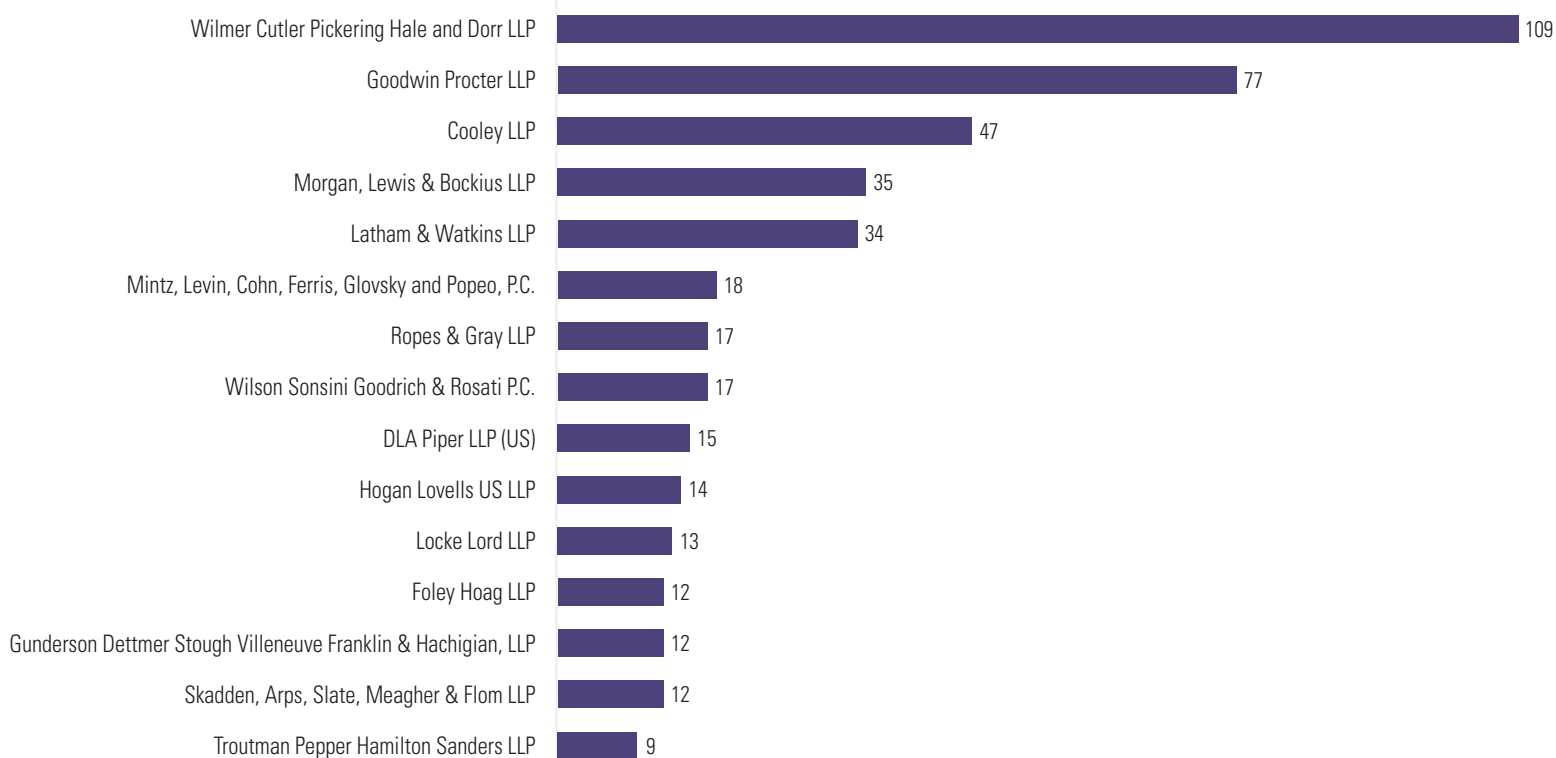
WilmerHale has helped thousands of startups go from formation to funding to business expansion, with many going on to market leadership and successful IPOs or acquisitions.

We have handled more than 250 venture financings raising in excess of \$14 billion since the beginning of 2020, adding to a record that, over the past decade, has included more than 2,500 venture financings with total proceeds in excess of \$50 billion.

 \$110,000,000 Third Round January 2020	 \$15,000,000 First Round December 2020	 \$125,000,000 Late Stage January 2021	 \$10,500,000 First Round October 2020	 \$57,600,000 Second Round September 2020	 \$65,000,000 Third Round October 2020	 \$33,700,000 Second Round June 2020	 \$150,000,000 First Round December 2020	
 \$25,000,000 First Round December 2020	 \$12,750,000 First Round December 2020	 \$12,000,000 Second Round October 2020	 \$50,000,000 First Round November 2020	 \$13,700,000 Third Round April 2020	 \$21,000,000 Third Round December 2020	 \$17,000,000 Second Round December 2020	 \$15,000,000 First Round November 2020	 \$56,700,000 Third Round July 2020
 \$50,000,000 Late Stage September 2020	 \$80,000,000 Second Round March 2020	 \$82,000,000 Fourth Round November 2020	 \$47,000,000 Second Round December 2020	 \$40,000,000 Fourth Round May 2020	 \$94,000,000 Second Round January 2021	 \$22,500,000 First Round January 2021	 \$91,500,000 Second Round June 2020	
 \$115,000,000 Second Round August 2020	 \$30,000,000 Second Round May 2020	 \$100,000,000 Third Round June 2020	 \$13,000,000 First Round May 2020	 \$145,000,000 Late Stage March 2020	 \$80,000,000 First Round January 2021	 \$72,000,000 Second Round December 2020	 \$7,500,000 First Round December 2020	 \$95,000,000 Third Round February 2021

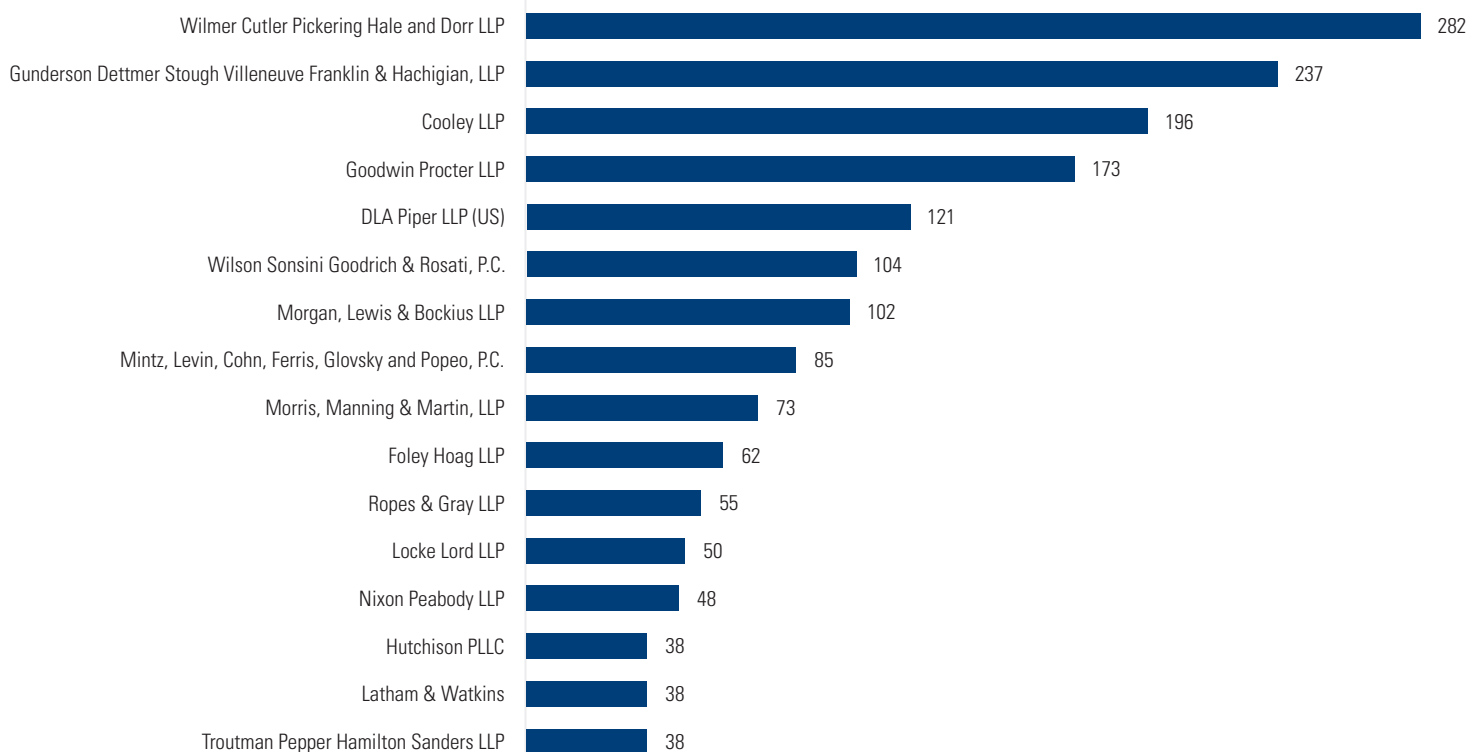
12 Law Firm Rankings

Company Counsel in Eastern US VC-Backed IPOs – 1996 to 2020



Source: SEC filings

Counsel in Sales of Eastern US VC-Backed Companies – 1996 to 2020



Source: Dow Jones VentureSource for 1996-2019 transactions and PitchBook for 2020 transactions
The above charts are based on VC-backed companies located east of the Mississippi River.

Management Carve-Out Plans in Sales of Private Companies

When a company is acquired, the purchase price typically is allocated among stockholders in the manner specified in the company’s corporate charter. In the sale of a venture capital-backed company, holders of preferred stock are entitled to receive liquidation preferences before any proceeds are available for holders of common stock and options. As a result, the allocation of sale proceeds in accordance with the corporate charter may result in little or no proceeds being paid to the company’s management and other employees, with respect to their equity holdings. In this event, management may have little incentive to remain with the company through the negotiation of the deal, let alone during the period between the signing and closing of an acquisition agreement.

A so-called “management carve-out plan” can address this situation by providing for a portion of the acquisition price to be paid directly to management and other plan participants, instead of being allocated strictly in accordance with the corporate charter. Management carve-out plans are sometimes implemented long before a company begins a sale process and at other times are put in place at the time and in the context of a specific transaction. In recent years, management carve-out plans have become less common in sales of private companies—likely due to a substantial increase in valuations and acquisition prices—but, when they have been used, their size (as a percentage of the acquisition price) has increased.

BASIC TERMS

A company that wishes to implement a management carve-out plan must address a number of often-complicated issues.

The first set of issues relates to participation in the plan:

- Who will participate—all employees, certain designated employees, or only management?
- Are participants selected and economic interests in the plan allocated at the time the plan is implemented or only later, at the time the company is being sold? The former approach should be a

more effective retention and recruiting tool, since employees can be assured of some type of payoff upon a sale of the company, while the latter approach provides more flexibility to the board of directors to reward those employees who contribute the most to the company through the time of sale, and can avoid some legal and tax complexities.

- Do plan participants’ interests vest over time?
- If participants in the plan are designated at the time of implementation, do they lose their participation rights if they leave the company prior to a sale? If so, what happens to the forfeited interests? Do they automatically accrue pro rata to the benefit of the other participants, or is the total payoff to plan participants instead reduced?

The second group of issues involves the determination of the amount to be paid to plan participants:

- Is the payment a fixed amount or based on the sale price? Is there a cap on the amount paid under the plan?
- If the payment is based on the sale price, how is the sale price determined for this purpose? Is it the gross sale price or the net price after transaction expenses and other offsets to the purchase price (such as debt)? How are earnouts and escrows accounted for? What about assumed or retained liabilities (including company taxes), or company wind-down expenses?
- Does the payment accrue from the first dollar, or apply only above a minimum sale price (to avoid rewarding employees for a sale at an unattractive price) and/or below a maximum sale price (because

at a higher sale price employee equity interests become valuable again and a carve-out plan is either unnecessary or the amount of compensation due creates a barrier to the buyer’s retention efforts)?

- What is the payment timing? In an asset sale, what if the company needs to retain a portion of the sale proceeds for a period of time to satisfy contingent obligations?
- Is the payment made in cash, or in the form of the consideration (including stock) paid by the buyer? Does the buyer have flexibility to determine the form in which payment is made—for example, in order to comply with securities laws?
- Is the amount payable to participants reduced by the value received for their equity interests in the acquisition of the company?

POSSIBLE STRUCTURES

Management carve-out plans often involve difficult choices with respect to the terms and structure of the plan and challenging legal issues. Described below are four possible structures, and the principal advantages and disadvantages of each.

Alternative One

Enter into retention agreements with individual employees or establish a bonus plan with individual employees that provides for cash payments upon an acquisition.

Primary advantages:

- Simple to implement—stockholder approval is typically not required, and no new securities are issued

COMPARISON OF ALTERNATIVE STRUCTURES

	ALTERNATIVE ONE	ALTERNATIVE TWO	ALTERNATIVE THREE	ALTERNATIVE FOUR
Ease of implementation	Simple	Complicated (if charter amendment involved)	Complicated (charter amendment required)	Very complicated (charter amendment required)
Plan participation	Flexible	Flexible	Inflexible	Flexible
Acquiring company forced to pay some cash	Yes	No	No	No
Tax-deferred treatment possible	No	No	Yes	Yes
Capital gains possible	No	No	Yes	Yes

Management Carve-Out Plans in Sales of Private Companies

14 TECHNIQUE PROVIDES RETENTION INCENTIVE WHEN COMMON STOCK HAS LITTLE VALUE

- Participation can be limited to specific persons (such as key employees) and subject to conditions (such as remaining employed through closing)

Primary disadvantages:

- Forces the buyer to pay a portion of the acquisition price in cash (to fund payments under the plan), even if the buyer wishes to use stock for the acquisition
- Payments to plan participants are taxable as ordinary income, not capital gains

Alternative Two

Establish a plan providing for the payment of a portion of the acquisition price to plan participants, often in the form of the consideration paid by the buyer.

Primary advantages:

- Participation can be limited to specific persons (such as key employees) and subject to conditions (such as remaining employed through closing)
- Does not force the buyer to pay a portion of the acquisition price in cash

Primary disadvantages:

- Harder to implement than the first alternative if a charter amendment is required to avoid contravention of preferred stock liquidation preferences
- Payments to plan participants are taxable at the time of receipt, even in a tax-free acquisition and even if payments are in the form of stock that cannot be immediately sold
- Payments to plan participants are taxed as ordinary income, not capital gains

Alternative Three

Amend the terms of the company's charter to provide that a specified percentage of the acquisition proceeds is paid to the holders of common stock (and, possibly, option holders) on a *pari passu* basis with the liquidation preference payments to the holders of preferred stock.

Primary advantages:

- Does not force the buyer to pay a portion of the acquisition price in cash

- If acquisition is structured as tax-free, plan participants share in that benefit
- In a taxable acquisition, payments to plan participants would typically be treated as capital gains (rather than ordinary income), which would be long-term if the common stock has been held for more than one year

Primary disadvantages:

- Payments are shared on a pro-rata basis by all holders (including non-employees) of common stock and options, and cannot be directed solely or disproportionately to contributing employees
- Charter amendment required

Alternative Four

Create and issue a new class of stock, the terms of which provide for the payment of a specified portion of the acquisition proceeds to the holders of that class of stock.

Primary advantages:

- Participation can be limited to specific persons (such as key employees) and subject to conditions (such as remaining employed through closing)
- Does not force the buyer to pay a portion of the acquisition price in cash
- If acquisition is structured as tax-free, plan participants share in that benefit
- In taxable acquisition, payments to plan participants would typically be treated as capital gains (not ordinary income), which would be long-term if the new stock has been held for more than one year

Primary disadvantages:

- Complex to structure and implement

- Plan participants must either pay for the new stock or incur taxable income upon receiving the stock if issued without consideration
- Because the terms of the new class of stock include a liquidation preference that effectively guarantees some payment upon an acquisition, the fair market value of the new stock (either paid by plan participants or recognized as taxable income) is generally not as low as the fair market value of ordinary common stock

OTHER CONSIDERATIONS

Depending on how it is structured, a management carve-out plan can raise a number of other legal and tax issues, such as:

- Possible issues under Section 280G (parachute payment provisions) or Section 409A (deferred compensation provisions), or ERISA concerns
- Whether the implementation of the plan is consistent with the fiduciary duties of the board of directors
- What consents or waivers are required to implement the plan, such as stockholder approval of a charter amendment, the waiver of anti-dilution provisions and the waiver of preemptive rights

CONCLUSION

Management carve-out plans often involve difficult choices with respect to the terms and structure of the plan and challenging legal issues. However, when properly structured and implemented, a management carve-out plan can go a long way toward addressing a fundamental problem many venture-backed companies face. ■

FREQUENCY AND SIZE OF MANAGEMENT CARVE-OUT PLANS IN SALES OF PRIVATE COMPANIES

	2016	2017	2018	2019	2020	SINCE 2007
Frequency	15%	9%	8%	10%	6%	14%
Median size (as percentage of acquisition price)	8%	9%	10%	11%	13%	10%

Source: SRS Acquiom's MarketStandard database (based on more than 2,400 private company acquisitions in which it served as shareholder representative)

Cross-Border Operations? Transfer Pricing Required

Early-stage companies are expanding internationally faster than ever. Thanks to the Internet, nascent companies, be they SAAS/cloud computing companies, sellers of goods or services, marketplace platforms, biotech enterprises or any other kind of business, are peddling their wares across borders earlier and earlier after their launch. With business growth and cross-border expansion come tax and financial obligations, including multi-jurisdictional compliance with US and foreign transfer pricing rules.

WHAT IS TRANSFER PRICING?

The phrase “transfer pricing” refers to the pricing of intercompany transactions. Section 482 of the Internal Revenue Code requires that the documentation and pricing of cross-border intercompany relationships and transactions be in accordance with the “arm’s-length” standard, to clearly reflect income for US federal income tax purposes. The “arm’s-length” standard has been the hallmark for establishing intercompany pricing in the United States for decades and has also become the international standard and accepted norm for establishing intercompany pricing.

WHEN DO TRANSFER PRICING REQUIREMENTS APPLY?

Transfer pricing obligations arise when *parties owned or controlled directly or indirectly by the same interests* (such as parent/subsidiary, brother/sister, parent/branch or other controlled participant relationships) *engage in cross-border transactions with each other* (including management services, G&A support services, distributors, manufacturers, R&D, financing, technical support services and similar relationships).

Early-stage companies are often unaware of their transfer pricing obligations. Even if they are aware, they often believe that the rules don’t apply to them because they have no revenue or operate at a loss, or because of other misconceptions. The reality is that if there is a cross-border transaction between commonly controlled companies (or branches), then US and foreign transfer pricing rules apply (and there is no materiality threshold under Section 482).

WHY SHOULD ONE CARE?

The practical answer is that transfer pricing-related obligations are an easy compliance item to address when expanding into cross-border business, but they can raise problematic issues if they are not addressed, and this omission can, in itself, result in significant issues with US and foreign tax authorities.

For example, if investors or acquirors discover during diligence that a company’s compliance with easy items is lacking, these parties may wonder “what else hasn’t been done right?” and become concerned about the related exposure the company faces. Such discoveries can create trust issues when young companies can least afford them.

WHAT IS REQUIRED?

Compliance is typically addressed through a combination of intercompany agreements and contemporaneous transfer pricing documentation.

Ideally, all cross-border transactions between controlled parties should be identified and documented with an intercompany agreement that proactively defines, where applicable:

- the sales model for intercompany transactions (such as a limited risk distributor or sales representative, which have real differences in taxation); and/or
- the services provided, which are highly dependent on the organization’s legal structure and fall into different categories—for example, G&A services are typically parent-to-subsubsidiary, while R&D and manufacturing services are typically subsidiary-to-parent.

Intercompany agreements serve as company policies and procedures relating to cost allocation, invoicing and payment, and similar terms. In particular, intercompany agreements state the compensation to the service provider, which is the focus of both the arm’s-length standard for transfer pricing and a required element of the Section 482 documentation requirement. This documentation and the other regulatory requirements

of Section 482 must be substantially completed before the company’s tax return for that taxable year is filed.

Contemporaneous transfer pricing documentation, which is based on a functional analysis and comparable transactions or industries (with similar functions identified), establishes a range of compensation that the service provider can earn (or that the service recipient should pay). Generally speaking, so long as the compensation equals or exceeds the lower quartile of applicable properly computed compensation, then a tax authority should not impose penalties, although this is not a hard-and-fast rule.

Companies should devote proper attention to determining the compensation range for the service provider because valuation is amorphous, with inherent room for error or negotiation. Relying on what someone “did at their last company” usually isn’t a reliable indicator of allowable pricing. As a practical matter, if a US parent company has a foreign subsidiary (which is not an entrepreneur or owner of intellectual property rights) with operating losses, this is a red flag that may draw scrutiny, audit and adjustments in many jurisdictions.

WHAT SHOULD ONE DO?

Although strict compliance with US transfer pricing rules may be challenging in some circumstances, companies should at the very least achieve material compliance. At a minimum, companies should put in place intercompany agreements that include a benchmark profit margin or pricing methodology that is developed in conjunction with an economist or transfer pricing service provider and falls within an acceptable range of pricing (with internal documentation showing the cost allocation and pricing used). Material compliance that shows results inside this range and reflects thoughtful consideration of intercompany relationships often carries the day with tax authorities, investors, buyers, auditors and the like.

Bottom line, companies should be thoughtful about their compliance obligations rather than ignore them. ■

SEC Rule Amendments Expand the Pre-IPO Financing Toolkit

Startup companies routinely rely on exemptions from the registration requirements of the Securities Act of 1933 to complete private placements of securities. Over the past decade, the JOBS Act and subsequent SEC rule amendments have created new exemptions and expanded others. Recent SEC rule changes have further expanded the pre-IPO financing toolkit.

REGULATION D

Regulation D prescribes general requirements and exempts financings under two separate rules. Under Rule 506, placements may be of any size, an unlimited number of “accredited investors” and up to 35 investors who do not qualify as accredited may participate, specified information must be supplied to unaccredited investors, and unaccredited investors must be financially sophisticated. In addition, Rule 506(c) permits general solicitation and advertising, while Rule 506(b) does not. By contrast, Rule 504 placements may include an unlimited number of investors (accredited or unaccredited) and are not subject to any specific disclosure requirements, but are limited in offering size and may not include general solicitation and advertising.

Private companies generally find that Regulation D provides the most useful and practical exemptions from registration. Two recent rule changes should make Regulation D even more helpful:

- Effective in December 2020, the SEC amended the definition of accredited investor to add new categories of natural persons based on professional credentials or financial sophistication and to add new categories of entities, including a “catch-all” category for any entity owning in excess of \$5 million in investments.
- Effective in March 2021, the SEC increased the maximum offering size under Rule 504 from \$5 million to \$10 million.

REGULATION A

Regulation A provides an exemption from registration for small public

offerings. Offerings under both Tier 1 and Tier 2 of Regulation A are subject to basic disclosure and financial statement requirements, require SEC filing and review, and permit investor interest to be solicited through the use of written “test-the-waters” materials filed with the SEC. In addition, Tier 2 offerings are subject to limits on the amount of securities that may be sold to unaccredited investors and require audited financial statements and ongoing public reporting.

Tier 1 offerings may raise up to \$20 million, including no more than \$6 million offered by selling stockholders, in a 12-month period. Effective in March 2021, the SEC increased the maximum offering amounts in any 12-month period for Tier 2 offerings from \$50 million to \$75 million for company issuances and from \$15 million to \$22.5 million for secondary sales. These changes may expand the universe of companies who find Regulation A appealing—particularly those that wish to become publicly traded without undertaking a conventional IPO or merging with a SPAC.

REGULATION CROWDFUNDING

Regulation Crowdfunding permits private companies to use the Internet to seek small investments from a large number of investors without registration. The exemption limits the amount an investor may invest in crowd-funded offerings within a 12-month period, requires all sales to be made through a registered broker-dealer or a “funding portal,” imposes disclosure and financial statement requirements, and requires annual SEC reporting.

To date, Regulation Crowdfunding has not been widely used. Effective in March 2021, the SEC increased the maximum amount of securities that a company may publicly offer and sell within any 12-month period from \$1.07 million to \$5 million, eliminated investment limits for accredited investors and loosened investment limits for unaccredited investors. These amendments should make Regulation Crowdfunding attractive to more companies.

INVESTOR COMMUNICATIONS

Effective in March 2021, the SEC adopted two rules that allow companies to engage in certain investor communications.

Rule 148 permits specified communications in connection with “demo day” meetings. A demo day meeting is a meeting in which more than one company participates and that is sponsored by an institution of higher education, state/local government, nonprofit organization, angel investor group, incubator or accelerator. Permitted information is limited to a notification that the company is offering or planning to offer securities, the type and amount of securities being offered, the intended use of proceeds, and the unsubscribed amount of the offering. Sponsors are not permitted to provide investment advice to attendees, engage in investment negotiations, charge attendance fees (other than reasonable administrative fees) or receive finder’s fees or similar compensation.

Under Rule 241, companies (and their authorized representatives) may engage in specified written or oral “test-the-waters” communications with prospective investors to determine interest in a contemplated offering of securities exempt from registration, provided that the company has not determined the exemption on which it intends to rely, no money or other consideration is solicited or accepted, and no offering commitment is made. ■

PREVALENCE OF EXEMPTIONS

According to the SEC, during the period July 1, 2019, through June 30, 2020:

- **Regulation D:** \$1.4 trillion was raised with a median offering size of \$1.8 million under Rule 506(b), \$69 billion was raised with a median offering size of \$900,000 under Rule 506(c), and \$171 million was raised with a median offering size of \$100,000 under Rule 504.
- **Regulation A:** \$1.3 billion was raised with a median offering size of \$2.1 million.
- **Regulation Crowdfunding:** \$88 million was raised with a median offering size of \$100,000.

17 Trends in VC-Backed Company M&A Deal Terms

We reviewed all merger transactions between 2016 and 2020 involving VC-backed targets (as reported in PitchBook for 2020, in Dow Jones VentureSource or Pitchbook for 2019, and in Dow Jones VentureSource prior to 2019) in which the merger documentation was publicly available and the deal value was \$25 million or more. Based on this review, we have compiled the following deal data:¹

Characteristics of Deals Reviewed	2016	2017	2018	2019	2020
Sample Size	19	18	37	20	25
Cash	53%	56%	84%	60%	60%
Stock	0%	0%	3%	0%	8%
Cash and Stock	47%	44%	13%	40%	32%
Deals with Earnout	2016	2017	2018	2019	2020
With Earnout	37%	22%	32%	40%	28%
Without Earnout	63%	78%	68%	60%	72%
Deals with Indemnification	2016	2017	2018	2019	2020
With Indemnification					
By Target's Shareholders	100% ²	94% ³	84%	80%	88%
By Buyer	37%	61%	39%	45%	32%
Deals with Representation and Warranty Insurance	2016	2017	2018	2019	2020
With Representation and Warranty Insurance	Not Tracked	Not Tracked	41%	25%	68%
Survival of Representations and Warranties⁴	2016	2017	2018	2019	2020
Shortest	12 Mos.	9 Mos.	12 Mos.	12 Mos.	12 Mos.
Longest	18 Mos.	24 Mos.	24 Mos.	24 Mos.	18 Mos.
Most Frequent	18 Mos.	12 Mos.	18 Mos.	18 Mos.	12 Mos.
Caps on Indemnification Obligations	2016	2017	2018	2019	2020
With Cap	100%	100%	100%	100%	100%
Limited to Escrow	83%	94% ⁶	79%	86%	81%
Limited to Purchase Price	0%	0%	0%	0%	0%
Exceptions to Limits ⁵	95%	94%	100%	100%	95%
Without Cap	0%	0%	0%	0%	0%
Escrows	2016	2017	2018	2019	2020
With Escrow	89%	100%	90% ⁷	94%	90%
% of Deal Value					
Lowest ⁸	5%	4%	3%	10%	8%
Highest	15%	13%	15%	13%	15%
Most Frequent	10%	5%	10%	12%	15%
Length of Time ⁹					
Shortest	12 Mos.	9 Mos.	12 Mos.	12 Mos.	12 Mos.
Longest	24 Mos.	24 Mos.	36 Mos.	36 Mos.	24 Mos.
Most Frequent	18 Mos.	12 & 18 Mos. (tie)	18 Mos.	12 Mos.	12 Mos.
Exclusive Remedy	88%	71%	72%	64%	68%
Exceptions to Escrow Limit Where Escrow Was Exclusive Remedy ⁵	93%	92%	100%	100%	92%
Baskets for Indemnification	2016	2017	2018	2019	2020
Deductible ¹⁰	47%	63%	47%	56%	52%
Threshold ¹⁰	53%	37%	53%	44%	29%
MAE Closing Condition	2016	2017	2018	2019	2020
Condition in Favor of Buyer	100%	94%	100%	100%	100%
Condition in Favor of Target	39%	22%	12%	35%	24%
Exceptions to MAE	2016	2017	2018	2019	2020
With Exception ¹¹	100%	100%	97% ¹²	100%	100%

¹ For certain transactions, certain deal terms have been redacted from the publicly available documentation and are not reflected in the data compiled below.

² Includes one transaction where the only representations that survive for purposes of indemnification are certain "fundamental" representations and representations concerning material contracts and intellectual property.

³ Includes one transaction where the only representations that survive for purposes of indemnification are those concerning capitalization, financial statements and undisclosed liabilities, but excludes one transaction where indemnification was provided for breaches of covenants prior to the closing but representations did not survive for purposes of indemnification.

⁴ Measured for representations and warranties generally; specified representations and warranties may survive longer.

⁵ Generally, exceptions were for fraud, willful misrepresentation and certain "fundamental" representations commonly including capitalization, authority and validity. In a limited number of transactions, exceptions also included intellectual property representations.

⁶ Includes two transactions where the limit was below the escrow amount.

⁷ One transaction not including an escrow at closing did require funding of escrow with proceeds of earnout payments.

⁸ Excludes transactions which also specifically referred to representation and warranty insurance as recourse for the buyer.

⁹ Length of time does not include transactions where such time period cannot be ascertained from publicly available documentation.

¹⁰ A "hybrid" approach with both a deductible and a threshold was used in another 10% of these transactions in 2020.

¹¹ Generally, exceptions were for general economic and industry conditions.

¹² The only transaction not including such exceptions provided for a closing on the same day the definitive agreement was signed.

18 Trends in Convertible Note and SAFE Terms

Based on hundreds of convertible note and SAFE (simple agreements for future equity) financing transactions we handled from 2016 to 2020 for companies and investors, we have compiled the following deal data:

Deals with Purchase Agreement		2016	2017	2018	2019	2020
If included, a purchase agreement typically contains representations and warranties from the company (and possibly the founders).	% of deals	67%	57%	40%	63%	36%
Term		2016	2017	2018	2019	2020
The term of the convertible note before it matures.	Median Range	18 mos. 2–60 mos.	18 mos. 1–60 mos.	12 mos. 3–24 mos.	17 mos. 12–36 mos.	24 mos. 5–48 mos.
Interest Rate		2016	2017	2018	2019	2020
The rate at which interest accrues during the term of the convertible note.	Median Range	5% 0.64%–10%	6% 2%–10%	5% 2%–8%	6% 3%–15%	5% 0.2%–8.5%
Deals with Security Interest		2016	2017	2018	2019	2020
Convertible note investors sometimes require the company to provide a security interest in company assets.	% secured	13%	16%	10%	15%	7%
	% unsecured	87%	84%	90%	85%	93%
Deals with Conversion Discount		2016	2017	2018	2019	2020
Convertible note and SAFE investors often require that conversion in connection with an equity financing be at a discount from the price paid by new investors in the financing. A conversion discount is often coupled with a cap on the valuation at which conversion occurs.	% of deals	72%	72%	77%	70%	89%
	Range of discounts	10%–50%	8%–30%	10%–25%	10%–25%	15%–40%
	% with ≤ 20% discount	69%	98%	91%	95%	92%
	% with > 20% discount	31%	2%	9%	5%	8%
	% with valuation cap	64%	82%	57%	42%	40%
Deals with Conversion upon Maturity		2016	2017	2018	2019	2020
If a convertible note is not converted or otherwise paid upon maturity, it often converts into shares of the company's common stock or preferred stock. This conversion is most often at the election of the investor but may be mandatory.	% of deals	50%	39%	27%	44%	36%
	% with optional conversion	89%	91%	75%	92%	90%
	% with mandatory conversion	11%	9%	25%	8%	10%
	% that convert into: common stock	41%	42%	38%	33%	11%
	preferred stock	59%	58%	62%	67%	89%
Deals with Conversion upon Company Sale		2016	2017	2018	2019	2020
If a convertible note or SAFE is outstanding at the time of a sale of the company, it often converts into shares of the company's common stock or preferred stock. This conversion is most often at the election of the investor but may be mandatory.	% of deals	46%	61%	57%	56%	32%
	% with optional conversion	92%	93%	88%	73%	78%
	% with mandatory conversion	8%	7%	12%	27%	22%
	% that convert into: common stock	56%	71%	82%	67%	50%
	preferred stock	44%	29%	18%	33%	50%
Deals with Repayment Premium upon Company Sale		2016	2017	2018	2019	2020
Investors may require that they receive a multiple of the outstanding investment amount in connection with a sale of the company.	% of deals	57%	59%	57%	37%	43%
	Median premium	2x	2x	2x	2x	2x
	Range of premiums	0.5x–3x	1.5x–4.1x	1.2x–2x	1.5x–3x	1.5x–3x
Deals with Warrant Coverage		2016	2017	2018	2019	2020
Investors sometimes receive a warrant in addition to their note or SAFE. The amount of company stock covered by the warrant is usually proportional to the investment amount, referred to as the warrant coverage.	% of deals	17%	8%	10%	15%	0%
	Coverage range	5%–50%	5%–100%	25%–65%	10%–35%	N/A
	% that cover common	0%	20%	33%	50%	N/A
	% that cover preferred	100%	80%	67%	25%	N/A
	% that cover common or preferred (depending on the circumstances)	–	0%	0%	25%	

* Excludes one deal in which the note is convertible into either common stock or preferred stock, depending on the circumstances.

Explanatory Note: By their nature, SAFEs do not have maturity dates, interest rates or security interests.

19 Trends in Venture Capital Financing Terms

Based on hundreds of venture capital financing transactions we handled from 2016 to 2020 for companies and investors, we have compiled the following deal data:

Deals with Multiple Liquidation Preferences		2016	2016 Range	2017	2017 Range	2018	2018 Range	2019	2019 Range	2020	2020 Range
A “multiple liquidation preference” entitles holders of preferred stock to receive more than 1x their money back before sale or liquidation proceeds are distributed to holders of common stock.	First round	0%	N/A	3%	1.08x–2x	3%	1.5x	2%	1.5x (one deal)	0%	N/A
	Post-first round	4%	1.12x–1.25x	8%	1.32x–3x	3%	1.5x–2.5x	4%	1.5x–2x	3%	1.5x–2.25x
Deals with Participating Preferred Stock		2016	2016 Range	2017	2017 Range	2018	2018 Range	2019	2019 Range	2020	2020 Range
“Participating preferred” stock entitles holders to receive a stated liquidation preference plus a pro-rata share (on an as-converted basis) of any remaining proceeds available for distribution to holders of common stock.	First round Total Capped	13%	Insufficient data	10%	14% 2x (one deal)	13%	0% N/A	14%	38% 1x–3x	9%	80% 2x–3x
	Post-first round Total Capped	28%	34% 2x–5x	16%	56% 2x–2.5x	31%	41% 2x–5x	11%	17% 1.6x–3.5x	10%	22% 1.25x–2x
Deals with an Accruing Dividend		2016	2017	2018	2019	2020					
“Accruing dividends” are generally payable upon liquidation or redemption of the preferred stock, effectively increasing the liquidation preference of the preferred stock.	First round	23%	8%	7%	10%	9%					
	Post-first round	30%	26%	24%	15%	8%					
Anti-Dilution Provisions		2016	2017	2018	2019	2020					
A “full ratchet” anti-dilution formula provides that the conversion price of the preferred stock will be reduced to the price paid in the dilutive issuance, regardless of how many shares are involved in the dilutive issuance. In contrast, a “weighted average” anti-dilution formula takes into account the dilutive impact based upon the number of shares and the price involved in the dilutive issuance and the number of shares outstanding before and after the dilutive issuance.	First round										
	Full ratchet	0%	0%	0%	0%	2%					
	Weighted average	100%	100%	100%	100%	98%					
	Post-first round										
Full ratchet	1%	0%	1%	2%	0%						
Weighted average	99%	100%	99%	98%	100%						
Deals with Pay-to-Play Provisions		2016	2017	2018	2019	2020					
“Pay-to-play” provisions provide an incentive to investors to invest in future rounds of financing. Investors that do not purchase their full pro-rata share in a future round lose certain rights (e.g., their anti-dilution rights are taken away or their shares of preferred stock may be converted into common stock).	Total	10%	7%	7%	8%	3%					
	% of total that convert into common stock	94%	83%	100%	92%	100%					
	% of total that convert into shadow preferred stock	6%	17%	0%	8%	0%					

Explanatory Note: “First round” refers to a company’s first priced preferred stock financing regardless of round designation.

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Data Sources: WilmerHale compiled all data in this report from PitchBook, except as otherwise indicated. For law firm rankings, IPOs by VC-backed companies and sales of VC-backed companies are included under the current name of each law firm.

Special note on data: Due to delayed reporting of some transactions, the venture capital financing and M&A data discussed in this report is likely to be adjusted over time as additional deals are reported. Based on historical experience, the number of reported venture capital financing and M&A transactions is likely to increase by approximately 5–10% in the first year following the initial release of data and by smaller amounts in succeeding years, and other venture capital financing and M&A data is likely to be adjusted to reflect the inclusion of additional deals.

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