Morgan Lewis

Q1 2024

CORPORATE VENTURE CAPITAL SURVEY

OVERVIEW

During the first quarter of 2024 corporate venture capital (CVC) investments by major companies continued to be active as several CVCs, including Microsoft and Nvidia, made significant investments in promising artificial intelligence (AI) startups and late-stage enterprises. Per Pitchbook, CVC investments increased 26% in the first quarter of 2024 to $15 billion. CVCs invested 47% of the capital into 33 funding rounds of more than $100 million.

In this survey, we track investment trends as the market slowed for CVC financings. We also analyze a survey of key economic terms of the largest Q1 2024 venture capital investments in which CVC programs either led the round or participated as significant or anchor investors.

KEY TERMS

Our survey focuses 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 Q1 2024, encompassing early- to late-stage financings. Of the Morgan Lewis transactions we reviewed, we noted that approximately 75% of the transactions involved higher valuations, while the other 25% were not disclosed.

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, 100% of the transactions included a 1x liquidation preference, pari passu, meaning that the new-round investors do not include a senior preference to the prior preferred round.

PARTICIPATING PREFERRED

With "nonparticipating" 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, 100% of the transactions involved "nonparticipating" preferred stock.

CUMULATIVE DIVIDEND

If dividends are cumulative, they 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, approximately 71% of the transactions excluded cumulative dividend provisions, while the remaining 29% were silent on dividends.

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, only a small minority, roughly 14%, of the transactions included some form of 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 stockholders 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, approximately 29% of the transactions included voting rights only as a single class together with other series of preferred stock, 57% included voting rights both as a single class with other preferred stockholders and a separate vote by series for certain matters, and 14% did not disclose.

"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 venture capital 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.

SPOTLIGHT ON AI AND ENERGY

AI's projected growth and energy-intensive nature leads to increased demand for energy and opportunities for CVC investments/partnerships:

- A generative AI chatbot query needs nearly 10x as much electricity to process as a search from a traditional internet search engine.
- Sources considered to power AI: renewables and nuclear.
- Traditional sources of funding such as venture capital will need to be supplemented by strategic investment by corporate partners/utilities and Inflation Reduction Act funding.

AI is also being increasingly used as a tool by energy companies:

- Utilities are relying on it to improve system reliability, grid resilience, and operations.
- There is interest in the nuclear industry to use AI to improve operational performance and mitigate risk.
- This will create opportunities for CVCs to invest and partner with the startups addressing AI and energy management tech.

Electric infrastructure build-out faces regulatory issues and other constraints:

- Regulation at the state level (transmission and generation siting, distribution system build-out and rates) and federal level (transmission planning and generator interconnection).
- Constraints: Sufficient generation and ability to transport from generation to location.

SUMMARY

While the economic terms of each investment are unique based on the facts and circumstances of the companies and investors participating, our Q1 2024 analysis indicates that the market continues to shift to more investor-favorable terms as indicated by lower valuations and the implementation of more restrictive provisions.

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