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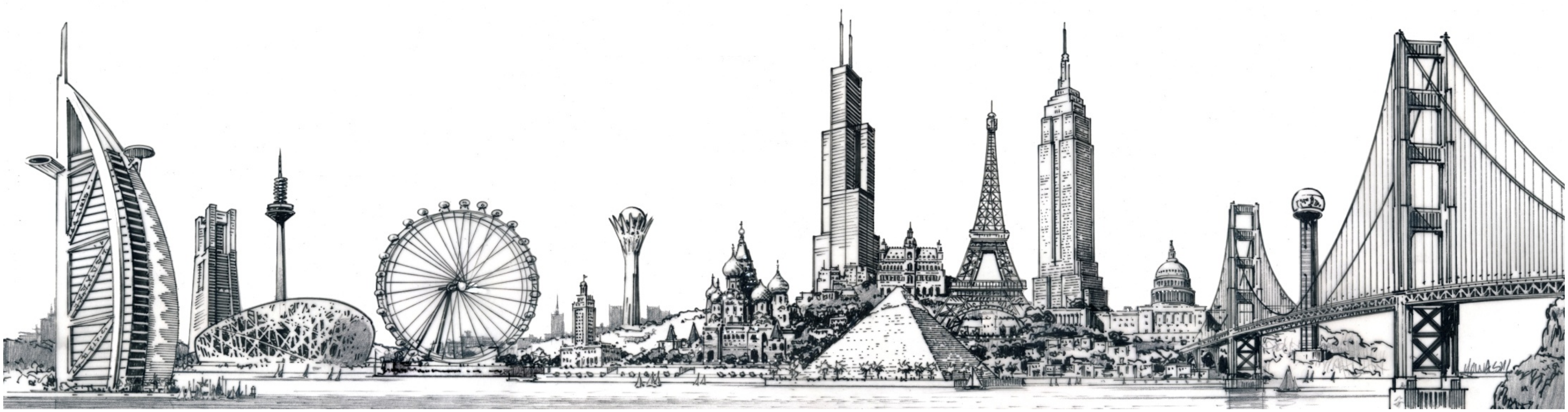
CORPORATE VENTURE CAPITAL SURVEY: Q1 2017



- During the first quarter of 2017, corporate venture capital (CVC) programs at major companies continued to make significant investments in promising startups and late-stage enterprises. In this survey, we briefly review relevant statistical data that demonstrates a clear trend of robust participation by CVCs in recent years. We also analyze a survey of key economic terms of the largest venture capital investments during the first quarter of 2017 in which CVC programs either led the round or participated as significant or anchor investors. The objective of the survey is to identify significant trends and factors that may distinguish CVC-sponsored investments from traditional VC financing transactions.
- We believe it is critical to understand CVCs given their increasingly prominent role in the venture capital landscape (as the data below highlights).

Key Economic Terms of CVC Deals

- We focused our survey on the following deal terms typically negotiated between companies and investors:
  - Valuation
  - Liquidation preference
  - Participation rights
  - Dividend
  - Redemption rights
  - Protective provisions
  - "Pay-to-play" provisions
- Below is our discussion of what we observed in CVC deals with respect to these deal terms.

Valuation

- The survey covers a wide range of financing transactions during 2017—from Series B to Series G preferred stock issuances. All most all of the transactions we reviewed involved higher valuation than previous rounds. The fact that only one down-round was observed may indicate the strong desire of CVC programs to invest in companies with a clear growth trajectory.

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, 19% of the transactions included senior preference while the remaining 81% included pari passu liquidation preference.

Participation Rights

- 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, only 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, 19% of the transactions included some form of redemption rights, while the remaining 81% 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 only observed two pay-to-play provisions of 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, one can nevertheless glean a pattern from the survey with respect to CVC-sponsored investments. For one thing, it appears that CVC programs are offering terms that are substantially similar to traditional VC financing, which seems contrary to the conventional wisdom that CVC investors tend to “drive a hard bargain” for more investor-friendly terms due to their strategic interest in the company. For example, the lack of participating preferred stock, cumulative dividend and redemption rights is fairly common in a typical up-round VC financing. In addition, it appears that the CVC investors are more willing to accept a liquidation preference on an equal basis with prior investors, suggesting that they are less likely to insist on preferential treatment. Moreover, the request for a separate voting right by series is also typical in a later-round VC financing. This result of our survey is noteworthy since the market perception is that strategic investors are more likely to focus on protective and control provisions. This may reflect a more competitive market for CVC investors, particularly for companies that have a compelling story and a strong track record.

We have provided the following “Company Friendly Barometer” for each of the seven key economic terms to illustrate—on a scale of one to five (one representing least favorable and five most favorable)—how each term impacts the company.