Wilson Sonsini Goodrich & Rosati
PROFESSIONAL CORPORATION

THE ENTREPRENEURS REPORT
Private Company Financing Trends

Q3 2012

Pre-money Valuations Since 2008, or "How Much Is My Company Worth?" Revisited

Valuations Up Substantially in Most Recent 12 Months

By Herb Fockler, Partner (Palo Alto)

Probably the most common question we are asked by start-up company entrepreneurs is, "What valuation should I put on my company when I approach investors?" We have discussed valuations a number of times previously in the *Entrepreneurs Report,* sometimes with actual data, but more often with qualitative commentary and impressions based upon our extensive representation of companies and investors in such transactions. Recently, however, we have completed a detailed, nearly five-year study of actual pre-money valuations in financings in which the firm has been involved. We collected and analyzed data from more than 700 seed and Series A financings from January 1, 2008, to the present time, and we will be presenting the results to you in this and future editions of the *Entrepreneurs Report.*

As might be expected, there have been significant fluctuations in pre-money valuations over this multiyear period, including a dramatic decline in valuations during late 2008 through early 2009 and a return to earlier levels in mid-2010, most likely correlating to the financial crisis and its aftermath. Since late 2011, however, there has been a substantial and broad-based increase in valuations, and they currently are significantly higher than at any other time in the last five years.

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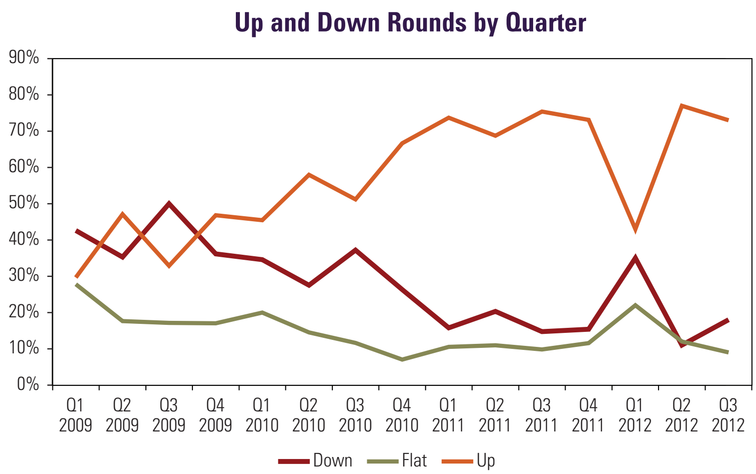
From the WSGR Database: Financing Trends for Q3 2012



Our quarterly survey of venture investment activity, like other surveys already released, shows a meaningful decline in the number of transactions and aggregate dollars invested across all sectors. Despite this decline, our survey still reflects a relatively stable, company-favorable market in key deal metrics. For instance, the percentage of venture-funding transactions representing up rounds during the third quarter of 2012 remained high, comparable to levels in the last two quarters of 2011. In addition, the median valuations for venture financings at all levels remained well above median valuations in 2010 and 2011. These results indicate that the venture-funding environment continues to be strong for entrepreneurs and early-stage companies.

Our review of the terms of venture-funding rounds closed during the first three quarters of 2012 mirrors this trend. The percentage of deals in which senior liquidation preferences were used during this period is lower compared with 2011 and 2010. Similarly, the percentage of deals with non-participating preferred stock increased during the first three quarters of 2012 compared with 2011 and 2010.

Therefore, while the level of activity appears to have declined during the third quarter, we believe that valuations and deal terms continue to indicate an overall healthy venture-funding environment.

Up and Down Rounds

The substantial majority of financings in Q3 2012 were up rounds, which comprised roughly 73% of all deals. While this percentage is lower than in Q2, when up rounds represented 77% of financings, it still represents a significant increase from the proportion in Q1 (43%) and is broadly consistent with Q2-Q4 2011, when up rounds ranged from 69% to 75% of all financings. Down rounds as a percentage of total deals rose slightly (from

For purposes of the statistics and charts in this report, our database includes venture financing transactions in which Wilson Sonsini Goodrich & Rosati represented either the company or one or more of the investors. We do not include venture debt or venture leasing transactions.

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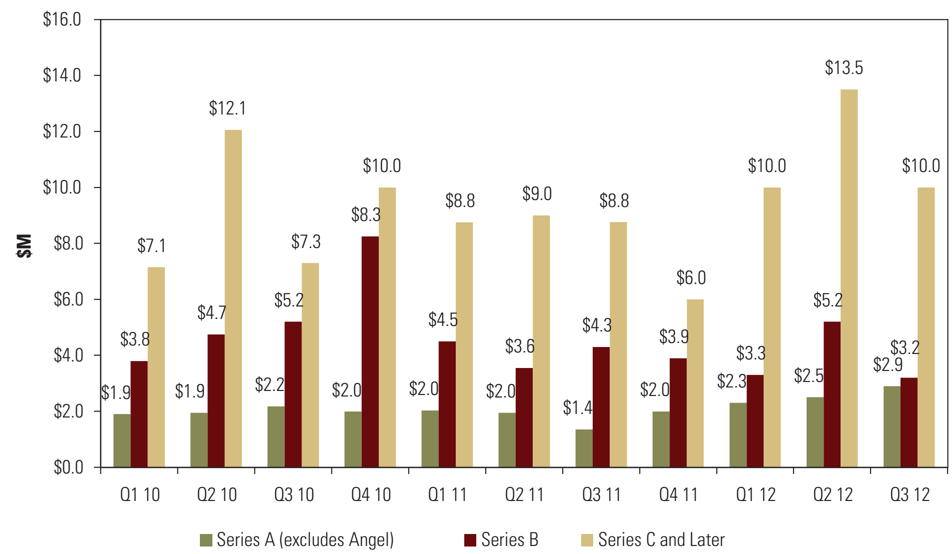
11% in Q2 2012 to 18% in Q3), but were similarly much lower than in Q1 (35%) and generally consistent with the percentages in Q2-Q4 2011 (15%-20%). Flat rounds decreased modestly to 9% of all Q3 2012 deals, down from 12% of Q2 deals and generally similar to the 10%-12% figures in Q1-Q4 2011.

Valuations

Companies that received their first round of venture financing in Q3 2012 did so at valuations slightly lower than those in the prior two quarters. The median pre-money valuation for Q3 2012 Series A rounds (other than angel deals) was $8.0 million, compared with $8.2 million in Q1 and $8.3 million in Q2.

While Q3 2012 valuations for more established companies also declined slightly from Q2 levels, they remained significantly higher than those in the prior two quarters. The median pre-money valuation for Q3 2012 Series B deals was $20.0 million, down from $24.0 million in Q2 but well up from $15.0 million in Q1 2012 and $12.3 million in Q4 2011. The change for companies raising funds in Series C and later rounds was quite similar, where the median pre-money valuation declined slightly to $118.5 million in Q3 2012 from $120.0 million in Q2 but remained far above the $80.0 million and $75.8 million median pre-money valuations in Q1 2012 and Q4 2011, respectively.

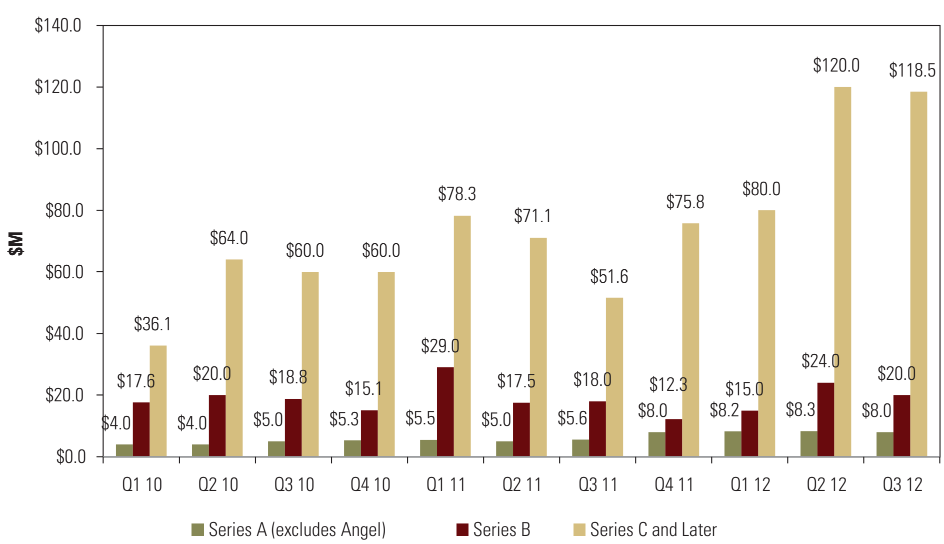
Median Amount Raised



Amounts Raised

Median amounts raised in Q3 2012 as compared with the prior quarter were slightly higher for Series A rounds but notably lower for Series B and later rounds. For non-angel Series A rounds, the median amount raised in Q3 2012 rose to $2.9 million from $2.5 million in Q2 and remained well above the $2.3 million figure in Q1 2012. For Series B rounds, the median amount raised was $3.2 million, well below the $5.2 million figure in Q2 and also lower than the comparable figures for all quarters in 2011. Similarly, the median amount raised for Series C and later rounds dropped to $10 million in Q3 2012 from $13.5 million in Q2, but remained above all comparable 2011 quarterly figures.

Median Pre-money Valuations



Deal Terms

Liquidation preferences. Senior liquidation preferences were used in 39% of all Series B and later deals in the first three quarters of 2012, down from 47% of deals in 2011 and 50% in 2010. The use of such preferences decreased in both up rounds, from 34% of deals in 2011 to 28% in the first three quarters of 2012, and down rounds, from 79% of deals in 2011 to 63% in Q1-3 2012. Conversely, the use of *pari passu* liquidation preferences increased to 58% of Q1-Q3 2012 financings from 51% of 2011 financings and 48% of 2010 financings. The percentage increased both for up rounds (69% in Q1-Q3 2012 versus 64% in 2011) and down rounds (34% in Q1-Q3 2012 versus 18% in 2011). These trends likely reflect the increasing valuations in later-stage rounds in 2012 as compared with 2011 and, thus, the corresponding greater negotiating power of earlier investors.

Participation rights. The proportion of deals with non-participating preferred stock continued to increase in the first three quarters of 2012 as compared with prior years,

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to 66% in Q1-Q3 2012 from 58% in 2011 and 49% in 2010. The proportion increased both in up rounds, from 59% in 2011 to 68% in Q1-Q3 2012, and in down rounds, from 32% in 2011 to 38% in Q1-Q3 2012. The percentage of deals with capped participating preferred stock remained at 16% in Q1-Q3 2012, the same level as for 2011, while the percentage with fully participating preferred stock decreased from 26% in 2011 to 18% in Q1-Q3 2012. Again, these trends likely reflect the increasing valuations in later-stage rounds in 2012 as compared with 2011 and, thus, the corresponding greater negotiating power of companies and earlier investors.

Anti-dilution provisions. Broad-based weighted-average anti-dilution protection provisions continued to be overwhelmingly prevalent, being used in 91% of Q1-Q3 2012 deals, the same percentage as in each of 2010 and 2011. Broad-based weighted-average was used in 93% of Q1-Q3 2012 up rounds, as compared with 91% of such rounds in 2011, and in 80% of Q1-Q3 2012 down rounds, unchanged from 2011. The use of full-ratchet anti-dilution stayed level at 3% of financings in Q1-Q3 2012, the same proportion as in 2011.

Pay-to-play provisions. The use of pay-to-play provisions decreased slightly, from 12% of 2011 deals to 11% of those in Q1-Q3 2012. Pay-to-play usage decreased slightly in both up rounds, from 5% of 2012 financings to 4% of Q1-Q3 2012 deals, and down rounds, from 31% of 2011 financings to 29% of Q1-Q3 2012 deals.

Redemption. The use of redemption provisions dropped slightly, from 24% of deals in 2011 to 23% in Q1-Q3 2012. Investor-option redemption (used in 22% of deals) continued to be far more popular than mandatory redemption (1%).

To see how the terms tracked in the table on the page 4 can be used in the context of a financing, we encourage you to draft a term sheet using our automated Term Sheet Generator. You'll find a link in the Entrepreneurial Services section of wsgr.com, along with information about the wide variety of services Wilson Sonsini Goodrich & Rosati offers to entrepreneurs and early-stage companies.

Bridge Loan Terms

For the first time, we include data on bridge loans in the *Entrepreneurs Report*. Venture-stage companies frequently raise funds through such financings, almost always through convertible notes, either before their first true equity financing round (termed "Pre Series A" in the table below) or to bridge the companies between later-stage equity rounds ("Post Series A"). These financings increasingly are favored because they typically can be negotiated and closed far more quickly and cheaply than priced equity financings, as there are fewer terms and, as a result, much shorter documentation. Clients frequently ask WSGR attorneys for benchmark data on the terms of such bridge loans, including interest rates, maturities, subordination, and conversion prices and discounts, so we are pleased to present the data below as a service to both companies and investors.

The data in the chart is aggregated from 2012 debt financings through September 30, 2012, in which Wilson Sonsini Goodrich & Rosati represented either the company or an investor.

Bridge Loans January through September 2012	**Pre Series A**	**Post Series A**
Interest rate less than 8%	63%	36%
Interest rate at 8%	31%	49%
Interest rate greater than 8%	6%	15%
Maturity less than 12 months	6%	39%
Maturity 12 months	29%	34%
Maturity more than 12 months	65%	28%
Debt is subordinated to other debt	6%	38%
Loan includes warrants[1]	8%	36%
• Warrant coverage less than 25%	33%	39%
• Warrant coverage at 25%	33%	30%
• Warrant coverage greater than 25%	0%	15%
• Warrant coverage described as variable or "other"	33%	15%
Principal is convertible into equity	98%	97%
• Conversion to equity at discounted price[2]	78%	45%
◦ Discount on conversion less than 20%	16%	14%
◦ Discount on conversion at 20%	53%	32%
◦ Discount on conversion greater than 20%	32%	55%
• Conversion to equity at same price as other investors	14%	44%
Repayment at multiple of loan on acquisition	6%	20%

[1]Of the Pre Series A bridges that have warrants, 50% also have a discount on conversion into equity. For Post Series A bridges with warrants, 22% also have a discount on conversion into equity.
[2]Of the Pre Series A bridges that have a discount on conversion into equity, 7% have warrants. For Post Series A bridges that have a discount on conversion into equity, 20% have warrants.

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Private Company Financing Trends (WSGR Deals)[1]

	2010 All Rounds[2]	2011 All Rounds[2]	Q1-Q3 2012 All Rounds[2]	2010 Up Rounds[3]	2011 Up Rounds[3]	Q1-Q3 2012 Up Rounds[3]	2010 Down Rounds[3]	2011 Down Rounds[3]	Q1-Q3 2012 Down Rounds[3]
Liquidation Preferences - Series B and Later									
Senior	50%	47%	39%	38%	34%	28%	63%	79%	63%
Pari Passu with Other Preferred	48%	51%	58%	59%	64%	69%	34%	18%	34%
Complex	2%	1%	2%	3%	1%	2%	3%	3%	0%
Not Applicable	0%	1%	1%	0%	1%	1%	0%	0%	3%
Participating vs. Non-participating									
Participating - Cap	23%	16%	16%	26%	17%	13%	22%	22%	19%
Participating - No Cap	27%	26%	18%	21%	24%	19%	34%	46%	44%
Non-participating	49%	58%	66%	53%	59%	68%	45%	32%	38%
Anti-dilution Provisions									
Weighted Average - Broad	91%	91%	91%	95%	91%	93%	89%	80%	80%
Weighted Average - Narrow	3%	4%	2%	4%	7%	2%	3%	6%	7%
Ratchet	3%	3%	3%	1%	2%	2%	2%	6%	10%
Other (Including Blend)	3%	3%	3%	1%	1%	3%	6%	9%	3%
Pay to Play - Series B and Later									
Applicable to This Financing	9%	6%	7%	3%	1%	0%	17%	20%	26%
Applicable to Future Financings	4%	6%	4%	2%	4%	4%	3%	11%	3%
None	87%	88%	90%	95%	94%	96%	80%	69%	71%
Redemption									
Investor Option	24%	22%	22%	23%	25%	21%	29%	32%	29%
Mandatory	1%	2%	1%	0%	2%	1%	3%	3%	3%
None	74%	76%	77%	77%	73%	78%	68%	65%	68%

[1] We based this analysis on deals having an initial closing in the period to ensure that the data clearly reflects current trends. Please note that the numbers do not always add up to 100% due to rounding.
[2] Includes flat rounds and, unless otherwise indicated, Series A rounds.
[3] Note that the All Rounds metrics include flat rounds and, in certain cases, Series A financings as well. Consequently, metrics in the All Rounds column may be outside the ranges bounded by the Up Rounds and Down Rounds columns, which will not include such transactions.

Pre-money Valuations Since 2008 . . .

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Methodology

Our attorneys submit transaction summaries for most of the financings the firm does. During the study period, summaries were submitted for 708 deals labeled either "seed" or "Series A." We culled that list down to approximately 500 deals that we believe are representative of a typical first-round financing, excluding deals that appeared to be preceded by another equity (though not a debt) financing and deals for which the amount invested was less than $500,000 or more than $20 million, or the pre-money valuation was less than $1 million or more than $50 million.

A significant number of the remaining deals were small, most likely reflecting the increase in angel and super-angel investments in recent years, as well as the increasing ability to start a new venture in the Internet, media, and even software spaces without having to raise many millions of capital up front. Given that the economics of these smaller deals could be different from those of larger traditional VC financings, we separated the deals into two groups by the amount invested—one for investments of more than $500,000 but less than $2 million and the other for investments of $2 million and up. The first group consisted of approximately 200 deals, and the second group approximately 300. We believe this roughly divides the deals into angel/seed-type deals and traditional VC-type deals, notwithstanding that there are no specific definitions for "angel," "seed," or "traditional VC."[1] This article discusses certain aspects relating to the traditional VC deal group; future articles will discuss the angel/seed group and other aspects of the study.[2]

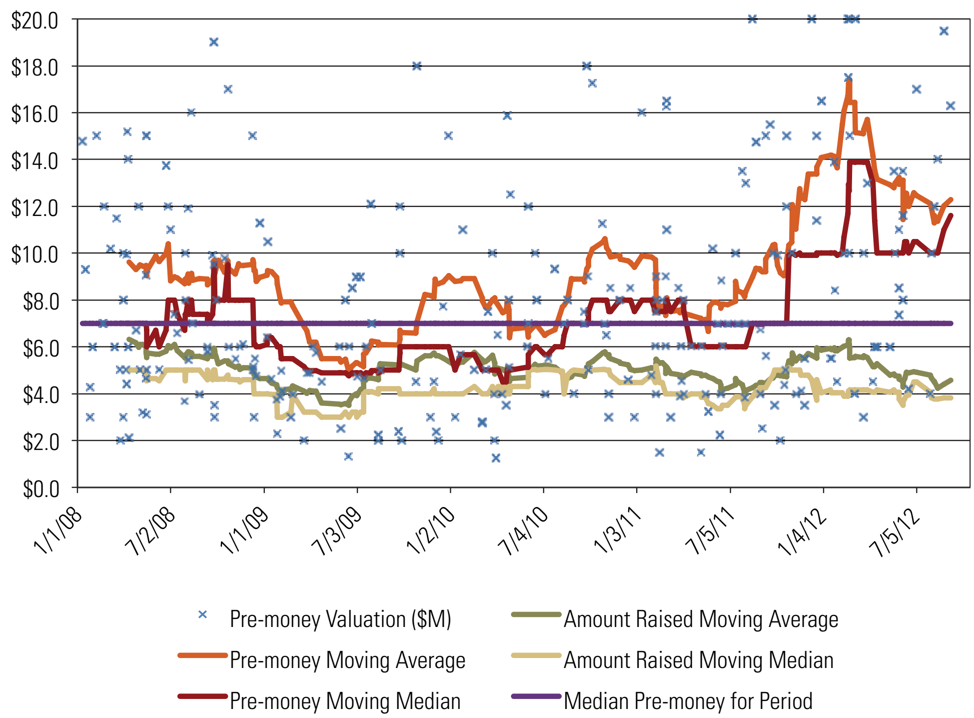
For each deal in the traditional VC group, we reviewed the dollar amount invested and the pre-money valuation ascribed to the company. The results are shown on the chart below as X's in a scatter plot over time. Given that there was great variation among the individual deals (and the fact that not all of the deals fit within the axis limits of the chart), we then calculated 25-deal rolling averages for both amounts invested and pre-money valuations, in order to aggregate and smooth out the results so that trends could be discerned. We also looked at the median for the 25 preceding deals in order to reveal any distortion caused by a few particularly large or small deals.

Pre-money Valuations and Amounts Raised

The chart below shows an average pre-money valuation for the entire period of almost $10 million, significantly higher than a more expected range of $5 million to $7 million. The median of $7 million for the entire period, on the other hand, is more consistent with the expected range, indicating that most deals were below the average with occasional deals at much higher valuations.

Within the period, valuations varied substantially, with the average falling by half in early 2009. Such a dramatic decline is not

Initial Equity Financings ($2M and up) Pre-money and Amounts Raised 25-Deal Moving Averages and Medians



[1] Despite the use of these terms, we did not actually try to separate the deals by type of investors. Thus, investments by angel investors of $2M or more are included within the traditional VC group discussed in this article. On the other hand, we did look at some subgroups divided by industries, such as IT and biotech. But since no particular subgroup stood out from the rest, we continued to analyze each of the larger groups as a whole.

[2] The pre-money valuation and amount invested figures shown on the chart above and discussed in this article are not strictly comparable to those shown and discussed on page 2 of this report. The figures on page 2 include data for smaller financings excluded for the figures discussed here and are based on a different methodology for treating financings with multiple closings.

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Pre-money Valuations Since 2008 . . .

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surprising, given the severity of uncertainty arising from the fiscal crisis and its aftermath.[3] The median also declined during this time, though not by as much, reflecting that it started at a lower level than the average and indicating that there were almost no particularly high valuation deals during the period, as is confirmed by looking at the scatter-plot data. Our conclusion is that investors generally were reluctant to fund companies at pre-crisis valuations and *very* reluctant to commit to particularly high valuations for any companies, no matter how attractive.

Average valuations recovered to earlier levels in early 2010, dipped again mid-year, rose slightly at the end of 2010, and dipped once again (though not as much) in early 2011, likely reflecting the recession and general choppiness in the U.S. and global economies during these periods. The variations during this time, however, generally stayed with the range of $7 million to $10 million for average valuations and $5 million to $8 million for median valuations. The difference between average and median increased significantly at times during this period, indicating the return of occasional particularly high-valuation deals at those times.

Surprisingly, valuations broke out of this range and increased substantially in late 2011, progressing to levels not seen during the entire period studied and topping out at an average pre-money valuation of $17.5 million in spring 2012 notwithstanding the economic challenges and uncertainty that continued through 2011 and to the present. The general nature of this increase is demonstrated by the fact that median valuations also increased substantially, at times to double the median of nine months earlier. Medians increased above the $7 million median for the entire period studied, first to $10 million about four months starting in late 2011, and then to almost $14 million by spring 2012. The increase was not just a case of occasional particularly large deals; throughout the last 12 months, half of the 25 most recently completed first-round financings had pre-money valuations of at least $10 million and sometimes of at least $14 million. This seems fairly remarkable.

More recently, valuations continue to remain significantly higher than at any other point during the entire period, with a recent average valuation of above $12 million and a median above $10 million. Clearly, this is an unusual and founder-favorable time.

Possible Reasons for Recent Higher Valuations

What is the cause of this recent period of substantially higher pre-money valuations? It simply could be the result of higher-quality ideas for new ventures coming forward, but we have nothing else to indicate why this period would be different from others, and the increase appears not to be coming just from companies in any particular industry. Another reason could be that there is too much investment money chasing too few deals, but if that were the case, we would expect to see the amounts raised also to increase, which they did not. In addition, the number of first-round financings our firm worked on in the second quarter of 2012 was higher than for any other quarter in the entire period.[4] So while either of these factors may contribute to higher valuations at certain times, we believe that the current higher valuations are the result of a number of other factors, which fall into two, slightly overlapping categories: (i) founders currently are in a stronger position negotiating with first-round investors, and (ii) companies obtaining their first equity investment are doing so later in their development than in the past. In effect, Series A is the new Series B.

We believe the stronger founder negotiating position is the result of a confluence of current circumstances. First, the buzz in the start-up environment has become more founder-favorable in recent years, with a number of prominent investors (many of whom were successful founders themselves) strongly espousing founders' rights and interests, both for the companies in which they invest and across the start-up community generally. Not all founders benefit from this attitude, but some, especially those who have founded successful companies before, can.

This leads to a second set of favorable circumstances: recent highly publicized acquisitions of very early-stage ventures at very high prices, such as Facebook's acquisition of Instagram, and anticipated and actual high-valuation IPOs by Facebook and others over the past year. The extreme success of a few high-profile ventures, whether in the form of acquisitions or IPOs, generally will pull up valuations for other similarly situated companies, and we believe

[3] We plotted our 25-deal rolling averages at the closing date of the 25th deal. We believe this is appropriate, as investors pricing a deal can only look backward to previous deals and have very limited ability to anticipate prices in future transactions. This, however, causes a lag between the occurrence of events that may affect valuations and when the effects show up in our data. We estimate this lag to be about six months based on the following: Valuations in term sheets pending at the time of an event generally won't be renegotiated, and may take up to two or three months to close. Since our 25-deal aggregation roughly equates to four to five months in time, it can be six months before the effects of an event are reflected in most deals in the aggregation and thus in the average. The lag may be even longer for the median, in that the addition of a new deal to the group is likely to affect the average immediately in some way, while it will affect the median only if the new deal falls on the other side of the existing median from the deal that drops off.

[4] The number of deals in the third quarter of 2012, on the other hand, appears to be one of the lowest for the period.

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Pre-money Valuations Since 2008 . . .

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the current situation is no different. In addition, founders and other high-level employees of these companies who leave to start new ventures are likely to have significantly greater clout in negotiating with investors in those ventures, given their previous experience and successful track records. This clout may be bolstered by the strong desire of some of these founders to maintain control of their ventures and avoid real or perceived over-dilution of their founders' interests in a way they were unable to do in their previous ventures. Moreover, the enormous—and now liquid—wealth created for founders and early employees by recent high-profile IPOs has provided them not only with more clout, but also with substantial resources with which to self-fund their next ventures.

This latter factor is part of a larger trend we are seeing, in which companies increasingly have become able to develop their technology, products, and entire businesses further before having to seek the substantial invested capital that can be obtained only through an equity financing. It has become standard for new ventures to seek the initial funding they need to get up and running and start development not through a full-blown equity investment, but rather through quick and simple convertible note (and more recently, convertible equity) financings. Such financings are generally seen as less time-consuming and much more cost-effective than even "lite" preferred stock financings for raising the capital new companies need for early operations.[5] At the same time, the amount of capital needed in some spaces, such as the Internet, media, and even software sectors, has become more modest. Tools, resources, and services that can assist companies to develop their technology and products to prototype, beta, or even commercial launch increasingly have become available, enabling new ventures to get by on smaller amounts of initial capital than ever before and to delay seeking a larger first-round equity financing until value-enhancing milestones have been achieved. A final factor we see that combines many of the foregoing is the larger number of companies working with incubators and accelerators, which provide infrastructure, education, connections, and even financial support to new ventures, so that founders can concentrate on developing their ventures rather than on raising funds immediately.

Other Observations

Turning to amounts invested, both average and median amounts were fairly constant throughout the entire period, with averages of $5 million to $6 million and medians of $4 million to $5 million, with a modest decline in early 2009, possibly reflecting liquidity issues among investors and a reluctance to commit capital during and after the fiscal crisis. As with valuations above, the difference between average and median reflects the presence of occasional deals with particularly large amounts invested.

The relative constancy of amounts raised throughout the entire period studied does present a possible counterargument to our view above that companies are now further along in their development when they seek their first equity funding. It would not be surprising to see a more mature company raising a larger amount of capital than a raw start-up would to fund their respective next stages of development. Yet we do not see this in the data; amounts invested have not increased significantly in the past 12 months, despite the notable increase in valuations. A possible explanation is that these companies are, in fact, more mature, but the factors enabling them to develop further before their first equity financing—e.g., founders' wherewithal to self-fund and desire to maintain control, the availability of tools and resources to develop products and services—continue to play a role after the financing and thus reduce the amount of capital the company believes it needs to achieve the milestones necessary for it to raise a second round of equity funding.

Finally, putting together both the pre-money valuation data and the amount-invested data, we can get a view of the relative ownership split between founders and investors in start-up companies immediately after their first equity financing. Throughout the almost five-year period studied, both average and median pre-money valuations have always exceeded average and median amounts invested, frequently by 100% and recently by 200%. While there obviously were significant variations among particular deals, on average, founders were able to maintain majority ownership of their new ventures on an outstanding share basis through the closing of the first equity financing, in some cases by a fairly large margin. And even on a fully diluted basis, founders often still ended up with 50% of their companies, notwithstanding allocation of 15% to 20% of the capitalization to an option plan reserve (which almost always comes out of the founders' shares). We will be discussing this aspect of our study more in the next edition of the *Entrepreneurs Report.* Nonetheless, it appears that, despite the financial crisis, recession, and other turmoil, recent years have been good times to be a founder of a company—and the past year, even better.

Those are our thoughts about the factors affecting pre-money valuations in first-round equity financings over the past five years, based on the deals in which we've been involved. But if you've seen other deals and have different thoughts, we'd like to hear about them. Please feel free to email me at hfockler@wsgr.com with your comments. If we get enough interesting opinions, we'll publish a view from the entrepreneurial community on first-round valuations and the factors affecting them.

[5] We excluded from our study any deal in which it appeared that the company had engaged in a previous *equity* financing. We did not, however, exclude previous non-equity or convertible equity financings. While we believe that such financings are one of the factors enabling companies to delay and develop further before seeking their first equity financing, the presence or absence of such a financing by itself does not appear to be closely correlated with a higher pre-money valuation. We are analyzing this further, and expect to discuss the results of that analysis in a future edition of the *Entrepreneurs Report.*

Dow Jones VentureSource Ranks Firm No. 1 in Q1-Q3 2012 Issuer-Side Venture Financing

Dow Jones VentureSource's legal rankings for issuer-side venture financing deals in the first three quarters of 2012 placed Wilson Sonsini Goodrich & Rosati ahead of all other firms by the total number of rounds of equity financing raised on behalf of clients. The firm is credited as legal advisor in 244 rounds of equity financing, while its nearest competitor advised on 150 rounds of equity financing.[1]

According to VentureSource, WSGR ranked first nationally in Q1-Q3 2012 issuer-side deals in the following industries: information technology,[2] healthcare,[3] clean technology, communications and networking, energy and utilities, consumer goods, industrial goods and materials, business and financial services, semiconductors, electronics and computer hardware, software, and medical devices and equipment.

[1] As VentureSource continues to collect data and update its database, newly reported deals from a given time period may alter previously reported results.
[2] Information technology includes the following subsets: semiconductors, communications/networking, electronics/computer hardware, and software.
[3] Healthcare consists of the biopharmaceutical and medical devices/equipment subsets.

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