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EEC Perspectives

MAY 2009
Quarterly Review of Series A and First Round Financings and Series B and Later Round Financings

Included in this Issue

Quarterly Review of Series A and First Round Financings and Series B and Later Round Financings

Get Your Pole Vaults Out

Mark Haddad

The bar has been raised. That's what VCs have been telling everyone since September. And it had started to show in the numbers in Q4 of 2008, but it really showed in the first quarter of 2009. As has been widely reported by various surveys, nationally, Q1 was the lowest investment level in more than a decade. While there are not good numbers available, it is reasonable to infer that angel investing has had a similar decline, if not worse. The good news is that the decline in New England has not been nearly as bad as elsewhere. Truly innovative companies are still getting funded, and this may be one way in which the science and tech-heavy New England area is distinguishing itself while softer tech plays that are more prevalent on the West Coast seem to have suffered more.

There has been a lot of talk about a shakeup in the VC community. Prominent VCs have been able to raise new funds, although often at lower levels than their initial targets. Less prominent firms have been having difficulty raising new funds, and some of them will inevitably quietly go away. This would suggest a shortage of investment capital and a chance for VCs to be more picky about where they put their funds.

From smart grid to cloud computing, there are some very hot spaces out there right now, that many VCs are looking at. But they have definitely broadened their focus to look at all sorts of things. I've seen recent announcements about a men's custom shirts retailer and a cupcake company getting funding. Granted, these companies were outside of New England, but these are still not your typical venture play. That suggests to me that some of this shift is less about a shortage of VC money than a shock to the system that causes VCs to look longer and closer, and focus more on profitable, revenue-generating, business plans than trendy companies that have not yet figured out exactly how they will make money. The larger shortage, if you believe the VCs, is that, even though they are seeing more deal flow than ever, there is a limited number of good investment opportunities that fit the criteria for a successful VC investment. If there was a shortage of money, VCs would not be looking far and wide for deals outside of their sweet spots. In the IT space, a lot of this is caused by the fact that cloud computing, outsourcing, and other innovations have made it cheaper and cheaper to build a company—you don't necessarily need VC money anymore, certainly not at historic levels. At the same time, very capital intensive companies in energy and biotech are a lot riskier now that the necessary later stage capital that would be found in the debt and public markets is harder to come by.

The numbers are a little misleading in some other ways as well. Ever since the stock market started dropping, VCs, like many angel investors, have been distracted by low public valuations to the point that there have been several PIPEs (private investments in public equities) being done by traditional VCs. I worked on one over the summer that involved a very prominent VC firm. At the time I found it somewhat surprising. By the winter, this started to become commonplace. Imagine you invested in a company and brought it to a successful IPO a couple years ago at $9 a share. Within a year, the stock prices almost doubles, but since then has had a rapid decline, along with the stock markets generally. You know the company well, believe in its story, and still see a promising future for it, despite what the public markets are telling you. And now its trading below $0.50. In that case, when choosing between a company at fire sale prices you know and believe in, versus a promising but unproven startup asking for a similar valuation, where do you think you would put your money? These deals are not showing up in the numbers, so they understate the amount of money VCs are putting to work over all (although they don't understate how much money is going to early stage startups.)

Another source of the downward numbers may be that companies (and their investors) are distracted by looking at ways government stimulus funds may be available to them. I know a number of entrepreneurs who are looking for non-dilutive government funding first, before ever approaching VCs. Whether much of this stimulus money will ever makes its way down to very early stage companies, however, remains to be seen.

As we enter spring hoping the sparse winter was an anomaly and not a sign of things to come, there have been some hopeful signs recently. First, VC exits may start to recover soon. There were actually a couple of IPOs recently, and I'm happy to report that, at least from our experiences at Foley Hoag, there has been a noticeable uptick in M&A activity. These all should eventually have trickle down effects for early stage financings, as VCs free up time and resources that can be diverted to new ventures. Second, being that it is spring, its also been business plan contest season. As in year's past I've seen a number of interesting plans. This year however, I had the chance to be a mock judge for TiE Boston's TYE program, which is for high school students (there was even a team of 8th and 9th graders). I can tell you that I was blown away by the ideas and business plans coming out of these high school students. As one of the VCs judging the panel with me said, if these kids are the future and there are similar kids across the country, I'm not worried at all about the long term future of the country and its economy.

The Numbers

Amanda Vendig

Set forth below are analysis and commentary regarding the information reported in the various tables throughout this issue of *EEC Perspectives*.

Implied Pre-Money and Post-Money Valuations -- New England Q1 2009

It is difficult to read too much into these numbers given the small data size (particularly for the Series A rounds) but it is interesting to note that all but two of the reported Series B/later rounds raised less than $10 million and approximately half of the Series B/later rounds raised less than $5.5 million yet all were up rounds.

Terms

There are a couple of interesting points to note in the matrices of terms for selected New England Series A rounds and Series B/later rounds for Q1 2009: (i) with respect to liquidation preferences most of the deals had full participation preferences, this continues a trend away from non-participating preferences towards full participation preferences that began in the second half of 2008 and (ii) despite market circumstances in Q1 2009 there were no full ratchet antidilution provisions.

Activity Level

New England Series A round activity in Q1 2009 was down significantly compared to Q1 2008 and Q4 2008. New England Series B/later round activity in Q1 2009 was down compared to Q1 2008 but remained flat compared to Q4 2008. Nationally the Q1 2009 activity level was down both for Series A rounds and for Series B/later rounds compared to Q1 2008 and Q4 2008.

New England Series A round activity was down 40% in Q1 2009 compared to both Q1 2008 and Q4 2008. New England Series B/later round activity was flat compared to Q1 2008 but was down 16% compared to Q4 2008. Nationally, Series A round activity was down 54% in Q1 2009 compared to Q1 2008, and down 40% compared to Q4 2008. Series B/later round activity was down 21% in Q1 2009 compared to Q1 2008, and down 13% compared to Q4 2008.

In 2008, both in New England and nationally, we saw significant declines in software and communications financings transactions. In comparison, biopharma, medical device and alternative energy financing transactions saw much smaller declines or remained relatively flat. Interestingly, in Q1 2009 this trend did not continue - biopharma, medical device and alternative energy transactions saw significant declines in Series A transactions in New England and nationally compared to Q1 2008 and Q4 2008. The Series B/later round financing transactions in these industries also saw declines (with a couple of exceptions) although not as dramatic as the Series A financing numbers. In contrast, software and communications financing transactions saw smaller declines or were flat compared to Q1 2008 and Q4 2008 and nationally Series A communications financing transactions were up 86% compared to Q4 2008 and up 57% compared to Q1 2008.

The information in the size of transaction table for New England Series A rounds in Q1 2009 is about what one would normally expect. All transactions raised $10 million or less, with the majority raising less than $5 million. The information in the size of transaction table for New England Series B/later rounds in Q1 2009 continues a trend that we saw in late 2008 with 60% or more of the deals raising less than $10 million and approximately 35% raising less than $5 million.

Conclusion

The reported information suggests that we are not out of the woods yet as the number of deals, both regionally and nationally, has continued to decline since Q4 2008. In particular, Series A rounds were down dramatically (40%) from Q4 2008. This suggest that in Q1 2009 it was harder than ever to get an initial round of financing done. This is consistent with our own experience here at Foley Hoag that most of deals getting done are inside/ Series B/later round financings. The data also suggests that there is a trend toward some more investor friendly deal terms (i.e. the trend towards cumulative accruing dividends and full participation preferences). However, it is also important to point out that we continue to see a lot of entrepreneurial activity which suggests entrepreneurs are not getting scared off by the market conditions but are hunkering down, trying to do more with less and waiting for the time when things will turn around.

Selected New England Series A Round Transactions

First Quarter 2009

Implied Pre-Money and Post-Money Valuation

Company	Original issue price of Series A preferred stock	Number of authorized shares of Series A preferred stock	Value of Series A preferred stock authorized	Number of authorized shares of common stock	Series A preferred stock as a percentage of authorized common stock	Implied pre-money valuation	Implied post-money valuation
Extreme Reach, Inc.	$0.1657	15,691,197	$2,600,031.34	34,000,000	46.15%	$3,033,768.66	$5,633,800.00
Claros Diagnostics, Inc.	$1.2383000	9,528,753	$11,799,454.84	18,500,000	51.51%	$11,109,095.16	$22,908,550.00

This analysis is inherently imprecise and is based on a number of general assumptions which may or may not be accurate. However, in a typical situation we believe it will yield an approximation of the valuation placed on the company at the time of financing, and therefore may be of interest to our readers.

Selected New England Series B and Later Round Transactions

First Quarter 2009

Implied Pre-Money and Post-Money Valuation

Company	Most recent round of preferred stock	Original issue price of most recent round of preferred stock	Number of authorized shares of preferred stock in most recent round	Value of preferred stock authorized in most recent round	Number of authorized shares of common stock	Most recent round of preferred stock as a percentage of authorized common stock	Implied pre-money valuation	Implied post-money valuation	Up or Down Round
A123 Systems, Inc.	Series F	9.195740	7,531,763	$69,260,134.29	110,000,000	6.85%	$942,271,265.71	$1,011,531,400.00	UP
Aegis Lightwave, Inc.	Series E	0.690666	4,343,634	$3,000,000.32	35,000,000	12.41%	$21,173,309.68	$24,173,310.00	UP
Aveksa, Inc.	Series C	0.444400	22,500,000	$9,999,000.00	75,000,000	30.00%	$23,331,000.00	$33,330,000.00	UP
Cartiza, Inc.	Series A-3	0.220400	19,283,119	$4,249,999.43	85,000,000	22.69%	$14,484,000.57	$18,734,000.00	UP
Everyzing, Inc.	Series B+	0.921680	11,000,000	$10,138,480.00	65,000,000	16.92%	$49,770,720.00	$59,909,200.00	UP
Fanzter, Inc.	Series B	0.500000	4,000,000	$2,000,000.00	17,500,000	22.86%	$6,750,000.00	$8,750,000.00	UP
Firstbest Systems, Inc.	Series B	1.320000	5,350,355	$7,062,468.60	22,500,000	23.78%	$22,637,531.40	$29,700,000.00	UP
Intelligent Bio-systems, Inc.	Series B	0.921420	4,000,000	$3,685,680.00	20,000,000	20.00%	$14,742,720.00	$18,428,400.00	UP
Quantia Communications, Inc.	Series D	1.000000	7,135,000	$7,135,000.00	50,814,083	14.04%	$43,679,083.00	$50,814,083.00	UP
Quattro Wireless	Series C	2.904300	4,476,122	$13,000,001.12	22,500,000	19.89%	$52,346,748.88	$65,346,750.00	UP
Reva Systems Corporation	New Series A (reverse stock split	1.000000	5,647,000	$5,647,000.00	9,000,000	62.74%	$3,353,000.00	$9,000,000.00	UP

This analysis is inherently imprecise and is based on a number of general assumptions which may or may not be accurate. However, in a typical situation we believe it will yield an approximation of the valuation placed on the company at the time of financing, and therefore may be of interest to our readers.

We can prepare a similar analysis across any group of transactions that our clients are interested in. For example, we could prepare analysis for a group of competitive companies so you can see what the implied valuations of your competitors are. If you would like additional information on this service, please contact your lawyer at Foley Hoag or one of our Emerging Enterprise Center lawyers listed at the end of this publication.

Terms of Selected New England Series A Rounds 2009[1]

	Q1		Q2		Q3		Q4	
Based on NVCA Form[2]	Yes 2	No 0	Yes	No	Yes	No	Yes	No
Dividends								
Cumulative accruing[3]	Yes 2	No 0	Yes	No	Yes	No	Yes	No
1x Liquidation Preference								
With full participation	2							
With capped participation	0							
Non-participating	0							
Greater than 1x Liquidation Preference								
With full participation								
With capped participation								
Non-participating								
Redemption	1							
Antidilution[4]	0							
Fully broad-based	0							
Broad-based	2							
Narrow-based	0							
Full ratchet	0							
Pay to Play Provision	0							

1 Determined from a review of publicly available Certificate of Incorporation filings.

2 Certificate of Incorporation appears to have been based substantially on the NVCA form.

3 Dividend rates ranged from 7% to 8% for 2009.

4 "Fully broad-based", "broad-based" and "narrow-based" all refer to a weighted average conversion rate adjustment formula. "Narrow-based" means that the formula includes outstanding equity on an as-converted basis, but not options or warrants. "Broad-based" adds to the narrow-based formula outstanding options and warrants on an as-exercised basis, but does not include ungranted options. "Fully broad-based" adds to the broad-based formula options that may be issued in the future pursuant to a plan approved by the Board of Directors. "Full ratchet" means that the conversion rate adjusts to the lowest price at which the issuer sells or is deemed to sell (as in the case of a sale of convertible securities) any shares of common stock.

The table above summarizes publicly available information about various terms included in the Certificates of Incorporation for "Series A" financings for companies headquartered in New England. For the purposes of this table we have focused solely on transactions that appeared to us, from the public filings, to be identifiable as "Series A" financings. We have excluded transactions that appeared to us to involve considerations and concerns different from those applicable in a typical "Series A ", such as might occur, for example in the case of a recapitalization. For this reason, the set of transactions described above is somewhat different from the set of transactions described in the later tables. We have selected terms to report on that we believe will be of particular interest to entrepreneurs. Each of these terms is linked to a description of that term in our Web site. Information included in the table above is based on information made publicly available by participants in the relevant transactions and therefore is not comprehensive.

Terms of Selected New England Series B and Later Rounds[5]

	Q1		Q2		Q3		Q4	
Based on NVCA Form[6]	Yes 7	No 9	Yes	No	Yes	No	Yes	No
Dividends								
Cumulative accruing[7]	Yes 3	No 13	Yes	No	Yes	No	Yes	No
1x Liquidation Preference[8]								
With full participation	9							
With capped participation	3							
Non-participating	4							
Greater than 1x Liquidation Preference								
With full participation								
With capped participation								
Non-participating								
Redemption	13							
Antidilution[9]								
Fully broad-based	3							
Broad-based	13							
Narrow-based	0							
Full ratchet	0							
Pay to Play Provision	4							

[5] Determined from a review of publicly available Certificate of Incorporation filings.
[6] Certificate of Incorporation appears to have been based substantially on the NVCA form.
[7] Dividend rates were 8% for the first quarter of 2009.
[8] "Fully broad-based", "broad-based" and "narrow-based" all refer to a weighted average conversion rate adjustment formula. "Narrow-based" means that the formula includes outstanding equity on an as-converted basis, but not options or warrants. "Broad-based" adds to the narrow-based formula outstanding options and warrants on an as-exercised basis, but does not include ungranted options. "Fully broad-based" adds to the broad-based formula options that may be issued in the future pursuant to a plan approved by the Board of Directors. "Full ratchet" means that the conversion rate adjusts to the lowest price at which the issuer sells or is deemed to sell (as in the case of a sale of convertible securities) any shares of common stock.

The table above summarizes publicly available information about various terms included in the Certificates of Incorporation for "Series B" and later round financings for companies headquartered in New England. For the purposes of this table we have focused solely on transactions that appeared to us, from the public filings, to be identifiable as "Series B" and later round financings. We have excluded transactions that appeared to us to involve considerations and concerns different from those applicable in a typical "Series B "or later round, such as might occur, for example in the case of a recapitalization. For this reason, the set of transactions described above is somewhat different from the set of transactions described in the later tables. We have selected terms to report on that we believe will be of particular interest to entrepreneurs. Each of these terms is linked to a description of that term in our Web site. Information included in the table above is based on information made publicly available by participants in the relevant transactions and therefore is not comprehensive.

We can prepare a similar analysis across any group of transactions that our clients are interested in. For example we could prepare analysis by industry so you can see what terms are prevalent in your industry. If you would like additional information on this service, please contact your lawyer at Foley Hoag or one of our Emerging Enterprise Center lawyers listed at the end of this publication.

The Activity Level Summary

New England Series A and First Round Transactions by Industry*

	2008				2009					
Industry	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Quarter ended March 31, 2008**	**Quarter ended March 31, 2009**
Biopharma	2	3	3	6	**1**				2	**1**
Medical Device	5	0	1	1	**0**				5	**0**
Alternative Energy	1	2	0	1	**0**				1	**0**
Software	2	1	4	2	**2**				2	**2**
Communications	0	0	0	0	**0**				0	**0**
Other	3	12	5	3	**5**				3	**5**
Total	13	18	13	13	**8**				13	**8**

* Source: Dow Jones VentureOne

New England Series B and Later Round Transactions by Industry*

	2008				2009					
Industry	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Quarter ended March 31, 2008**	**Quarter ended March 31, 2009**
Biopharma	5	6	11	6	**10**				5	**10**
Medical Device	5	5	6	6	**4**				5	**4**
Alternative Energy	1	3	0	2	**1**				1	**1**
Software	14	13	10	19	**13**				14	**13**
Communications	1	2	2	3	**3**				1	**3**
Other	13	11	14	10	**8**				13	**8**
Total	39	40	43	46	**39**				39	**39**

* Source: Dow Jones VentureOne

The Activity Level Summary

National Series A and First Round Transactions by Industry*

	2008				2009					
Industry	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Quarter ended March 31, 2008**	**Quarter ended March 31, 2009**
Biopharma	24	23	12	17	**9**				24	**9**
Medical Device	24	13	12	10	**4**				24	**4**
Alternative Energy	8	13	12	8	**3**				8	**3**
Software	32	33	35	22	**15**				32	**15**
Communications	3	0	8	1	**7**				3	**7**
Other	89	106	80	80	**45**				89	**45**
Total	180	188	159	138	**83**				180	**83**

* Source: Dow Jones VentureOne

National Series B and Later Round Transactions by Industry*

	2008				2009					
Industry	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Quarter ended March 31, 2008**	**Quarter ended March 31, 2009**
Biopharma	33	41	44	43	**39**				33	**39**
Medical Device	44	44	42	35	**31**				44	**31**
Alternative Energy	10	16	18	20	**11**				10	**11**
Software	111	117	89	93	**85**				111	**85**
Communications	28	25	29	28	**22**				28	**22**
Other	154	128	129	126	**112**				154	**112**
Total	380	371	351	345	**300**				380	**300**

* Source: Dow Jones VentureOne

Size of New England 2009 Series A and First Round Transactions by Industry*

Industry	$5 million or less	Above $5 million up to $10 million	Above $10 million up to $15 million	Above $15 million up to $20 million	Above $20 million
Biopharma	1	0	0	0	0
Medical Device	0	0	0	0	0
Alternative Energy	0	0	0	0	0
Software	1	2	0	0	0
Communications	0	0	0	0	0
Other	3	1	0	0	0
Total	5	3	0	0	0

* Source: Dow Jones VentureOne

Size of New England 2009 Series B and Later Round Transactions by Industry*

Industry	$5 million or less	Above $5 million up to $10 million	Above $10 million up to $15 million	Above $15 million up to $20 million	Above $20 million
Biopharma	2	1	1	1	5
Medical Device	3	0	0	0	1
Alternative Energy	0	0	0	0	0
Software	6	4	3	0	0
Communications	2	1	0	0	0
Other	1	4	2	0	0
Total	14	10	6	1	6

* Source: Dow Jones VentureOne

The tables above summarize publicly available information about the number and size of first round financings and second round financings for companies headquartered in New England and nationally by industry. The data included in the tables is derived from Venture Source, a publication of Dow Jones Venture One. Venture Source categorizes transactions as "seed round" "first round," "second round" and so on. Upon examination of each transaction, it is not always clear why a particular transaction was put in a particular category, however, for the purposes of these tables we have used the categories as defined by VentureSource. Information included in the tables above is based on information made publicly available by participants in the relevant transactions and therefore is not comprehensive.

If you have any questions about this publication or about the EEC and how we can help your entrepreneurial venture, please feel free to contact any of the following lawyers:

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