



# **EEC Perspectives**

JANUARY 2009 Quarterly Review of "Series A" and First Round Financings

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This is the third edition of *EEC Perspectives* to focus on "Series A" and first round financings. This *EEC Perspectives* presents data and analysis on the number and size of transactions in the New England region and, with respect to numbers of transactions, nationally for the first nine months of 2008. It also reports and provides analysis on certain key terms of the New England transactions.

For this issue of *EEC Perspectives*, we have asked **Carl Stjernfeldt** of **Castile Ventures**, to comment on first round financings in 2008. Carl points out that despite negative global economic news, there was positive regional news – on average every week in '08 a New England technology company raised its first round of venture capital. We plan to bring you other points of view in future issues of *EEC Perspectives*.

We hope you will find this information useful in your financing efforts. In addition, we would like to hear from you if you have transactions or comments that might be interesting to others. Do not hesitate to send one of us at the EEC an email at info@foleyhoag.com. Also, please visit our Web site emergingenterprisecenter.com and plan on attending some of the many networking and educational events we hold at the EEC. We hope you will find the EEC a valuable resource as you start and grow your company.

David A. Broadwin

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## **A Market Perspective**

Carl Stjernfeldt, General Partner, Castile Ventures

Entrepreneurs thrive in every economy... and '08 was no different. With all the focus on the negative global economic news, you could have easily missed the positive regional news – on average every week in '08, a New England technology company raised its first round of venture capital. While the pace slowed versus recent years, the funding size remained consistent versus '07, with half the companies reporting they raised more than \$5M during their initial funding.

During a down economy, the pace of new investments slows for a few reasons. First, companies lack exit opportunities which increases the time and capital VCs must spend on their existing portfolio. Second, venture-backed companies try to run longer on existing capital by extending the funding runway to avoid raising new money at lower multiples. But even in a down economy, determined entrepreneurs remain passionate about funding their idea.

Given this supply and demand problem, below are a few "must do's" for fundraising:

#### **Show Results**

Outline a plan that in 18 – 24 months accomplishes milestones that create real value.

#### **Remain Capital Efficient**

Detail how little cash you will need to get to break even – the point at which even without an exit you are self-sustainable.

#### It's a Slow Ride

Plan that it will take at least six months to raise capital – both your first round and follow-ons.

#### **Keep it Real**

Be realistic about valuations and terms given the supply and demand issue discussed above.

#### **People Matter**

Build an outstanding team that includes veterans who have weathered a variety of economic cycles.

#### **Money Talks**

Build a strong syndicate or ask for help doing so. Chances are good you'll need more money than you think and the right partners help.

As a reminder, during the most recent IPO window, the majority of successful companies were started during 2000 – 2003... another challenging cycle. Heed their lessons learned, seek the advice of other veterans of these times, and best of luck in '09 claiming your week to raise that first round.

View Carl Stjernfeldt's bio at http://www.castileventures.com/team/carl\_stjernfeldt.html.



## **Selected New England "Series A" Round Transactions**

### Third Quarter 2008

#### 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
Lucid Imagination, Inc.	\$4.33	1,750,000	\$7,577,500	3,500,000	50%	\$7,577,500	\$15,155,000
Punchbowl Software, Inc.	\$1.566465	1,647,020	\$2,579,999.18	5,000,000	32.94%	\$5,252,325.82	\$7,832,325
Tipjoy Inc.	\$0.13125	3,110,000	\$408,187.50	11,200,000	27.76%	\$1,061,812.50	\$1,470,000

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.

#### **COMMENTARY:**

## John Hancock, Foley Hoag Partner

to support existing portfolio companies rather than invest in new ventures at a time of increased lengthening negotiations and delaying the closing. Start-ups always face challenges when

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 2008<sup>1</sup>

	Q1		Q	2	(	)3	Q4
Based on NVCA Form <sup>2</sup>	Yes 5	No 3	Yes 5	No 0	Yes 2	No 1	
Dividends						'	
Cumulative accruing <sup>3</sup>	Yes 5	No 3	Yes 3	No 2	Yes 1	No 2	
1x Liquidation Preference <sup>4</sup>							
With full participation	2		2		0		
With capped participation	C		1			2	
Non-participating	6		2		1		
Greater than 1x Liquidation Preference							
With full participation	0		0		0		
With capped participation	0		0		0		
Non-participating	C		0		0		
Redemption	8		3		1		
Antidilution <sup>5</sup>							
Fully broad-based	0		0		0		
Broad-based	6		5		3		
Narrow-based	1		0		0		
Full ratchet	1		0		0		
Pay to Play Provision	1		1		0		

- <sup>1</sup> Determined from a review of publicly available Certificate of Incorporation filings.
- <sup>2</sup> Certificate of Incorporation appears to have been based substantially on the NVCA form.
- <sup>3</sup> Dividend rates ranged from 7% to 10% during the first three quarters of 2008.
- 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.





# COMMENTARY: Alex Aber, Foley Hoag Lawyer

Given the declining economy between Q2 2008 and Q3 2008, it should be no surprise that there were fewer total deals in Q3 and that the deal terms for the Series A rounds that closed in Q3 were generally more favorable to investors than in prior quarters. Interestingly, investors seemed to apply their leverage by focusing on terms that serve to increase their upside potential in an exit rather than on the terms that operate to limit their downside in future rounds. For example, the preferred stock liquidation preference in two-thirds of the deals in Q3 had some sort of participation feature (as compared to only 60% of deals in Q2 and only 25% of deals in Q1). By contrast, we did not see a shift away from weighted average anti-dilution protection towards a full-ratchet formulation as one might have expected given the potential for down-rounds in the coming quarters. Moreover, only one third of the deals in Q3 included redemption rights (as compared to 60% of deals in Q2 and 100% of deals in Q1), which may suggest a growing skepticism among investors of the practical value of redemption rights.

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\*

Industry		20	07		2008					
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	9 Months ended September 30, 2007	9 Months ended September 30, 2008
Biopharma	7	8	2	3	2	3	3		17	8
Medical Device	5	3	2	0	5	0	1		10	6
Alternative Energy	0	0	2	0	1	2	0		2	3
Software	8	6	5	2	2	1	4		19	7
Communications	1	1	0	0	0	0	0		2	0
Other	2	5	7	7	3	12	6		14	21
Total	21	23	18	9	13	18	13		62	44

<sup>\*</sup> Source: Dow Jones VentureOne

## National "Series A" and First Round Transactions By Industry\*

		20	07		2008					
Industry	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	9 Months ended September 30, 2007	9 Months ended September 30, 2008
Biopharma	28	26	14	19	24	23	12		68	59
Medical Device	20	15	11	9	24	13	12		46	49
Alternative Energy	12	7	13	9	8	13	12		32	33
Software	52	47	39	33	32	33	35		138	100
Communications	11	13	10	7	3	0	8		34	11
Other	77	92	93	92	89	106	80		262	275
Total	200	200	180	169	180	188	159		580	527

<sup>\*</sup> Source: Dow Jones VentureOne





## Size of New England 2008 Year to Date "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	2	2	0	1	4
Medical Device	3	1	2	0	0
Alternative Energy	0	1	0	0	0
Software	4	4	1	0	0
Communications	0	0	0	0	0
Other	15	3	1	1	1
Total	24	11	4	2	5

<sup>\*</sup> Source: Dow Jones VentureOne

The tables above summarize publicly available information about the number and size of first 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 below is based on information made publicly available by participants in the relevant transactions and therefore is not comprehensive.

COMMENTARY:

Dave Broadwin, Foley Hoag Partner





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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