

Included in this Issue

- A Market Perspective:
Axel Bichara on
the State of the
Technology Industry
- New England First
Round Transactions

This edition of *EEC Perspectives* is devoted to first round financing and focuses on “Series A” financings. We plan two sister publications: one devoted to seed financings and one devoted to second and later round financings. Each of these publications is intended to provide data and analysis of the types of financing in which entrepreneurs often engage, and each will be published quarterly. These publications will present data and analysis on the number and size of transactions in the New England region and, with respect to numbers of transactions, nationally. They will also report and provide analysis on certain key terms of the New England transactions.

For this inaugural issue of *EEC Perspectives*, we have asked **Axel Bichara** of **Atlas Venture** to comment on the state of the technology industry. Axel points out that some of the most successful companies got started during an economic downturn. In addition to being among the most visible and active supporters of entrepreneurial activity in New England, Axel Bichara is a Partner with Atlas Venture where he focuses on software and services technology and was the lead investor in SolidWorks, a mechanical design automation software company, and a lead investor in SpeechWorks. We plan to bring you other points of view in future issues of *EEC Perspectives*.

We hope you will find the data and analysis useful to you in your financing efforts. 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 at emergingenterprise.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](#)

A Market Perspective

Axel Bichara, Partner, Atlas Venture

Technology innovation has been accelerating during the last centuries and will continue to do so. Innovation helps drive entrepreneurship and new business opportunities. That's good news for entrepreneurs and early-stage investors in the US where the state of innovation and entrepreneurship continues to be exceptional. There are plenty of excellent start-up opportunities. The funding environment for start-ups will remain strong, with an abundance of capital from both VC and private investors.

Globalization provides a wealth of new opportunities for these start-ups and can be leveraged more than ever. Beyond early-stage research and development, entrepreneurs need to be thinking globally. The challenge is adapting to the world's new order in which technology is conceived and developed in one region, manufactured in a different region by companies owned in another, with R&D possibly in another, and finally distributed and sold in yet other regions or worldwide. Your customers, partners and employees can be located in any part of the world, according to what best suits the business. In a global market there are more opportunities in every dimension and the time is now to start addressing the realities of this new order.

A world view changes everything.

In times of slow economic growth, as we are now experiencing in the US, people sometimes over-react needlessly. Historically, some of the most successful companies got started during an economic downturn and, with globalization, emerging companies here are successfully leveraging the world market to compensate. There are some concerns about the exit market in the present environment, but this is primarily in the near term. The management teams of strong companies, financed by supportive investors, may need to adjust operations in the short term, but are not losing sight of the big vision and long-term upside. We know that our investments are long-term partnerships with entrepreneurs.

New England is strong in its foundation of traditional technology expertise, has become a leader in life sciences, and is seeing healthy growth in the clean tech sector. With its leadership in research, and outstanding colleges and universities, this region is a great place to build a business. VCs and entrepreneurs play well together here, and the ecosystem is broad and deep. Great ideas and entrepreneurs will always get funded here.

New England First Round Transactions

First Quarter 2008

Implied Pre-Money and Post-Money Valuation for Selected Companies

Company	Original issue price of most recent round of preferred stock	Number of authorized shares of most recent round of preferred stock	Value of authorized preferred stock sold 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
Allegro Diagnostics Corp.	\$0.74	5,718,027	\$4,231,3390	16,858,391	34%	\$8,243,869	\$12,475,209
AutoVirt, Inc.	\$1.00	4,000,000	\$4,000,000	11,000,000	36%	\$7,000,000	\$11,000,000
Avedro, Inc.	\$0.65818	12,154,730	\$8,000,000	25,000,000	49%	\$8,454,499	\$16,454,500
StyleFeeder Inc.	\$1.40366	1,424,845	\$1,999,997	4,669,104	30%	\$4,553,836	6,553,834.50
Tributes, Inc.	\$0.10	41,946,600	\$4,194,660	88,640,130	47%	\$4,669,353	\$8,864,013
Cambria Pharmaceuticals, Inc.	\$1.1852216	5,906,063	\$6,999,99	16,240,836	36%	\$12,248,996	\$19,248,989
Vortex Medical, Inc.	\$1.00	3,000,000	\$3,000,000	9,000,000	33%	\$6,000,000	\$9,000,000
Unidesk Corporation	\$1.00	8,185,000	\$8,185,000	17,000,000	48%	\$8,815,000	\$17,000,000

COMMENTARY: Mark Haddad, Foley Hoag Lawyer

“Series A valuations in the first quarter were consistent with the general rule that your Series A investors will get one-third to one-half of the company for their investment, with 5 of the reported deals hovering around one-third and 3 of the deals hovering around one-half. As most VCs will readily admit, Series A valuations are an inexact science. Something less than one-third is generally too small a stake for the VCs to invest the time and energy they expect to contribute to a portfolio company. On the other hand, anything more than half the company does not leave enough equity and incentive for the founding team and employees, after factoring the previous dilution from any seed investments, the expected dilution from later rounds and the impact of the unallocated option pool. Working backwards, since the amount of dilution generally needs to fit within this range, it is really driven in many ways by the size of the investment. From that standpoint, it is often better for entrepreneurs to focus first on justifying a larger investment round, rather than focusing on the exact pre-money valuation at the outset.”

The table above sets forth for each company named, the number of shares of preferred stock authorized, the original issue price of the most recently issued series of preferred stock (or equivalent number) as set forth in such company's Certificate of Incorporation, the value of the most recently issued authorized preferred stock (calculated by multiplying the original issue price of the preferred stock by the number of authorized shares of preferred stock), the number of shares of common stock authorized in such company's Certificate of Incorporation, and the implied pre-money and post-money valuation of the company assuming all authorized shares of common stock were issued and each such share had a value equal to the original issue price of the most recently issued series of preferred stock.

This analysis is based upon the assumption that the number of authorized shares of common stock is approximately equal to the fully diluted number of shares assuming conversion of all convertible securities (including preferred stock) and the grant and exercise of all options contemplated at the time of the most recent preferred stock financing and the exercise of all other rights to acquire common stock (such as warrants granted to equipment lessors and the like). The analysis assumes that there is no “cushion” of extra shares of common stock and does not account for any value derived from the payment of the exercise price of options and warrants. For these and other reasons, the analysis is inherently imprecise. However, in a typical situation 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 New England Series A Rounds 2008¹

	Q1	
	Yes	No
Based on NVCA Form	5	3
Dividends		
Cumulative accruing ²	5	3
1x Liquidation Preference		
With full participation	2	
With capped participation	0	
Non-participating	6	
Greater than 1x Liquidation Preference		
With full participation	0	
With capped participation	0	
Non-participating	0	
Redemption	8	
Antidilution ³		
Fully broad based	0	
Broad based	6	
Narrow based	1	
Full ratchet	1	
Pay to Play Provision	1	

COMMENTARY:

Jerry O'Connor, Foley Hoag Partner

“The data pretty much confirms what we have been telling founders to expect by way of the ‘standard’ first round term sheet, i.e., investors may or may not use the NVCA forms, and a simple 1X liquidation preference, with no participation, usually prevails. I am always surprised to see even one deal with full-ratchet anti-dilution protection.

The overall drop in the number of first round deals, with only one in the alternative energy space, is certainly noteworthy. At the EEC we work with a lot of early-stage clean energy companies, and I can tell you that there has been no downturn in the number of entrepreneurs seeking seed and first-round funding, nor any slowdown in the funds being raised by VCs to invest in cleantech. What I think we are seeing, at least in cleantech deals locally, is investors taking their time to assess first-round investing opportunities. Nonetheless, I think that we will see an increase in these deals during 2008, as cleantech start-ups use grants and seed money to achieve the developmental milestones that establish their eligibility for venture investment.”

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

² Dividend rates ranged from 8% to 10% during the first quarter of 2008.

³ “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” 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 First Round Transactions by Industry*

Industry	2007				2008	Total 2007	Total 2008
	Q1	Q2	Q3	Q4	Q1		
Biopharma	7	8	2	3	1	20	1
Medical Device	5	3	2	0	5	10	5
Alternative Energy	0	0	2	0	1	2	1
Software	8	6	5	2	1	21	1
Communications	1	1	0	0	0	2	0
Other	2	5	7	7	5	21	5
Total	21	23	18	9	13	71	13

* Source: Dow Jones VentureOne

National First Round Transactions by Industry*

Industry	2007				2008	Total 2007	Total 2008
	Q1	Q2	Q3	Q4	Q1		
Biopharma	28	26	14	19	20	87	20
Medical Device	20	15	11	9	20	55	20
Alternative Energy	12	7	13	9	7	41	7
Software	52	47	39	33	24	171	24
Communications	11	13	10	7	2	41	2
Other	77	92	93	92	84	354	84
Total	200	200	180	169	157	749	157

* Source: Dow Jones VentureOne

Size of New England Q1 2008 First Round Transactions by Industry*

	\$5 million or less	Above \$5 million up to \$10 million	Above \$10 million up to \$15 million	Above \$15 million
Biopharma	1	0	0	0
Medical Devices	2	1	2	0
Alternative Energy	1	0	1	0
Software	1	0	0	0
Communications	0	0	0	0
Other	3	1	0	0
Total	8	2	3	0

* Source: Dow Jones VentureOne

COMMENTARY: David Pierson, Foley Hoag Partner

"The tables show a number of interesting trends in first round financing activity:

- Both locally and nationally, first round closings were down rather significantly, both generally and across most sectors, in Q1 2008 compared to Q1 2007.
- Locally, activity during Q1 2008 was roughly in line with Q3 and Q4 2007, while nationally Q1 2008 saw a continued erosion in the number of first round closings.
- Both locally and nationally, Q1 2008 saw a resurgence of medical device deals and significant declines in software and communications deals.
- Locally, biopharma deals declined sharply in Q1 2008, a trend not evident nationally.

It is dangerous, of course, to draw too many conclusions, even tentative ones, from one quarter's worth of data. But the reported information does support the general impression evident in the popular press that deals have become somewhat harder to do, and are taking somewhat longer to close. From our own practice and experience here at the EEC, we can attest that there is still plenty of first round activity afoot. Early stage deals are still getting done and, in my view, will continue to get done at least at Q1 2008 levels during the remainder of 2008."

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 VentureOne. 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 "first round" category 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 quarterly review 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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The Emerging Enterprise Center at Foley Hoag (EEC), located in the heart of the Route 128 technology corridor, serves the wide-ranging needs of Greater Boston's entrepreneur and venture communities by providing timely and efficient delivery of a full complement of legal services and widening access to business management expertise and professional networks. The EEC focuses on key priorities for any emerging technology company: patent protection and strategy, corporate organization and governance, financing and deals. It also serves as a state-of-the-art venue offering seminars, programs and events to facilitate learning, collaboration and networking among industry organizations, providing a forum where entrepreneurs and industry thought leaders convene to exchange ideas and accelerate the progress of emerging enterprises. Visit the EEC at emergingenterprisecenter.com.

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