# Silicon Valley Venture Survey
# Second Quarter 2012

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## Background

We analyzed the terms of venture financings for 115 companies headquartered in Silicon Valley that raised money in the second quarter of 2012.

## Overview of Fenwick & West Results

- Up rounds exceeded down rounds in 2Q12, 74% to 11%, with 15% of rounds flat. This was better than 1Q12, when up rounds exceeded down rounds 65% to 22%, and the best quarter since 2007. Series B rounds were especially strong, although we note that the percentage of Series B financings in the survey has declined for three straight quarters, perhaps indicating that companies are having difficulty securing Series B funding, but those that do are being rewarded with substantial valuation increases. This was the twelfth quarter in a row in which up rounds exceeded down rounds.
- The Fenwick & West Venture Capital Barometer™ showed an average price increase of 99% in 2Q12, an increase from 52% in 1Q12. This was the highest Barometer result since we began calculating the Barometer in 2004. That said, we note that there were two financings (one in the internet industry and one in the software industry) that were each up over 1000% (i.e. over 10x), and if they were excluded, the Barometer result would have been 70%. The median price increase in 2Q12 was 30%.
- The results by industry are set forth below. In general, internet/digital media and software continued to be the strongest industries by far, with Barometer increases of 248% and 123% respectively (which would have been 176% and 86% respectively if the two aforementioned 10x deals were excluded). The median price increase for internet/digital media and software financings were 105% and 56%, respectively. Cleantech and life science trailed significantly.

## Overview of Other Industry Data

- Venture investment was up in the software and internet/digital media industries in 2Q12 versus 1Q12, while cleantech and life science lagged. However, overall venture funding in 2012 is modestly lagging 2011 to date.
- M&A was up slightly in 2Q12 versus 1Q12, and 2012 is generally flat in dollars compared to 2011.
- The number of IPOs was down in 2Q12 compared to 1Q12, but dollars raised were up, as the Facebook IPO dominated the quarter. 2012 is ahead of 2011 year to date.
- Venture fundraising in dollars was up, but the number of funds raising money declined in 2Q12, compared to 1Q12. Fundraising in 2012 is ahead of 2011 in dollars.

  The venture environment continues to be a "tale of two cities" with software and internet/digital media thriving and life science and cleantech lagging. Additionally, we note that venture investment, M&A and IPOs have all returned to 2007 (pre financial industry meltdown) levels, but fundraising by venture capitalists continues to be significantly below those levels.

The effects of the increasing concentration of venture capital in fewer funds also bears watching. There are understandable reasons for this trend (capital moving to managers with the best results, early stage companies going global sooner and benefitting from venture capitalists with a more global reach) but this increased financial concentration could leave companies with fewer alternatives. However, the growth of super angels and micro VCs discussed below, and the commitment of some of the larger funds to continue making smaller investments, may offset this trend.

- **Venture Capital Investment.**

  Dow Jones VentureSource ("VentureSource") reported that U.S.-based companies raised $8.1 billion in 863 venture deals in 2Q12, a 31% increase in dollars and a 20% increase in deals compared to 1Q12, when $6.2 billion was raised in 717 deals (as reported in April 2012). However, investment in the first half of 2012 slightly lags the first half of 2011. Over half of all venture capital was invested in California in 2Q12, with 42% of the total in Northern California.

  Similarly, the PwC/NVCA MoneyTree™ Report based on data from Thomson Reuters (the "MoneyTree Report") reported $7.0 billion of venture investments in 898 deals in 2Q12, a 21% increase in dollars and a 18% increase in deals from the $5.8 billion invested in 758 deals in 1Q12 (as reported in April 2012). The MoneyTree reported that the software and internet industries were especially strong, while life science was weak.

- **Merger and Acquisitions Activity.**

  Dow Jones reported 110 acquisitions of venture-backed companies in 2Q12 for $13.6 billion, a 7% increase in transaction dollars, and a 12% increase in transactions, from the 98 acquisitions for $12.7 billion in 1Q12 (as reported in July 2012 – the initial April 2012 numbers were subsequently revised substantially and so are not being used). The largest acquisition in the quarter was Facebook's acquisition of Instagram for $1 billion.

  Thomson Reuters and the NVCA ("Thomson/NVCA") reported 102 transactions in 2Q12, a 19% increase from the 86 transactions reported in 1Q12 (as reported in April 2012). IT companies dominated, with 77 of the 102 deals.

- **IPO Activity.**

  VentureSource reported 11 venture-backed IPOs raising $7.7 billion in 2Q12 ($6.8 billion from Facebook), compared to 20 IPOs raising $1.4 billion in 1Q12 (as reported in April 2012). 72% of the companies going public were based in Silicon Valley, as opposed to 35% in 1Q12.

  Similarly, Thomson/NVCA reported 11 IPOs raising $17.1 billion in 2Q12 ($15.8 billion from Facebook) compared to 19 IPOs raising $1.5 billion in 1Q12. (It appears that Thomson/NVCA includes shares sold by shareholders in the IPO amount, while VentureSource does not.) Nine of the eleven IPOs were IT companies and all were U.S. based.

- **Venture Capital Fundraising.**

  Dow Jones reported that for the first half of 2012, 82 U.S. venture capital funds raised $13 billion, a 31% increase in dollars over the first half of 2011.

  Thomson/NVCA reported that 38 U.S. venture capital funds raised $5.9 billion in 2Q12, a 20% increase in dollar commitments and a 10% decrease in the number of funds compared to the $4.9 billion raised by 42 funds in 1Q12 (as reported in April 2012). The top 5 funds accounted for almost 80% of the total fundraising in the quarter. Mark Heesen, President of the NVCA, noted that this concentration of capital in fewer funds has narrowed the field of venture funds for both entrepreneurs seeking venture capital, and limited partners looking to invest in venture capital.

  Some traditional investors in venture capital are also indicating a reduction in commitment to the asset class when they cannot get into the best funds. For example, the Mercury News has reported that CalPERS will likely decrease its venture commitment from 6% of its private equity portfolio to 1%, due to poor returns on its investments. And the Kauffman Foundation has indicated similar plans (see "Kauffman Foundation Venture Capital Report" below).

  Venture fundraising by venture capital funds in 2Q12 was again less than the amount of venture capital invested in companies in the quarter.

  The SBA, after 8 years out of the market, has recently allocated $1 billion over the next five years to increase access to early stage venture capital – i.e. companies looking to raise $1 4 million. Early stage venture funds can borrow from the SBA an amount equal to what they can raise privately.

- **Secondary Trading.**

  Secondary trading was estimated to be $10 billion in 2011. The Venture Capital Journal reported that 80% of such trading occurred in negotiated one-on-one transactions (as opposed to on secondary exchanges), and that half of late stage primary financings included a secondary component, triple the amount from five years ago.

  That said, secondary exchanges had a good year in 2011, with Second Market reporting $558 million in trades and SharesPost reporting $625 million. However, with the IPOs of Zynga, LinkedIn, GroupOn and now Facebook, it seems doubtful that secondary exchange trading of other venture-backed companies will be able to take up the slack in 2012. Some exchanges are working to address this by proactively working with late stage companies to facilitate liquidity arrangements for the companies' employees and early stage investors with the exchange's investor base.

  In general, it seems that late stage companies are becoming more comfortable with secondary sales, and are leaning towards negotiated sales where information provided to investors can remain confidential, the purchasers are known and the transaction can be combined with a primary sale, if desired.

- **Seed Investment.**

Although concern continues that the valuations of seed stage companies are getting frothy, the expansion of the accelerator/incubator model continues. Accelerators focused on Swiss, Danish, Israeli and German entrepreneurs have each been started in the past year, or are in the process of being started, in Silicon Valley. And General Catalyst Partners has joined Yuri Milner, SV Angel and Andreesen Horowitz in the Start Fund which commits to loan $150,000 to each Y Combinator company (foregoing information from Venture Wire).

Additionally, the two most active venture capitalists in 2Q12 were 500 Startups and First Round Capital (tied for second with NEA), both of whom are seed investors. (VentureSource)

And perhaps most interestingly, a significant number of super angels/micro VCs are seeking to raise larger funds or taking on LPs, which if successful could act as a counterweight to the decreasing number of venture capital funds (Venture Capital Journal).

- **The Kauffman Foundation Venture Capital Report.**

In May 2012 the respected Kauffman Foundation issued a report that concluded, based on their 20 year history of venture investing experience in nearly 100 funds, that "the Limited Partner investment model is broken." The report based its conclusion on, among other things, poor returns from most venture funds, incentives for managers to create larger funds to increase management fees, the increasing length of life of venture funds and the relatively small amounts invested personally by many fund managers. It recommended that limited partners require a better alignment of interests between LPs and GPs, more transparency and better governance provisions.

The Kauffman Foundation has indicated that it intends to focus its future venture investment in funds of less than $400 million, with historical performance above what could be achieved in equivalent public market funds (which it believes are better performance measures than IRR, top quartile, vintage year and gross return measurements), and in which GPs commit at least 5% of the capital. They also plan to increase their direct investing and to move a portion of their capital allocated to venture capital into the public markets, as they do not believe that there are enough strong venture capitalists to absorb the available capital.

Other suggestions from the Kauffman report include (i) that management fees should be based on a budget, not a percentage of funds under management, (ii) that investors should receive their funds back plus a preferred return before venture capitalists share in profits, and (iii) that there should be more transparency in how the venture capital management company is structured to understand how the individual venture capitalists are incented.

- **Venture Capital Return.**

Cambridge Associates reported that the value of its venture capital index increased by 4.7% in 1Q12 (2Q12 information has not been publicly released) compared to 18.7% for Nasdaq, although for the 12 month period ended March 31, 2012, the venture capital index was up 12.8%, which slightly beat Nasdaq which was up 11.2%. The Cambridge venture index is net of fees, expenses and carried interest.

For the ten years ended March 31, 2012 the Cambridge venture capital index was up 4.4% per year, while Nasdaq was up 5.30%.

- **Venture Capital Sentiment.**

  The Silicon Valley Venture Capitalist Confidence Index® produced by Professor Mark Cannice at the University of San Francisco reported that the confidence level of Silicon Valley venture capitalists was 3.47 on a 5-point scale in 2Q12, a decrease from the 3.79 reported in 1Q12. Reasons given for the decrease in confidence were primarily macro oriented (global economy, life science regulation), as there was general agreement that the entrepreneurial environment viewed in isolation was strong.

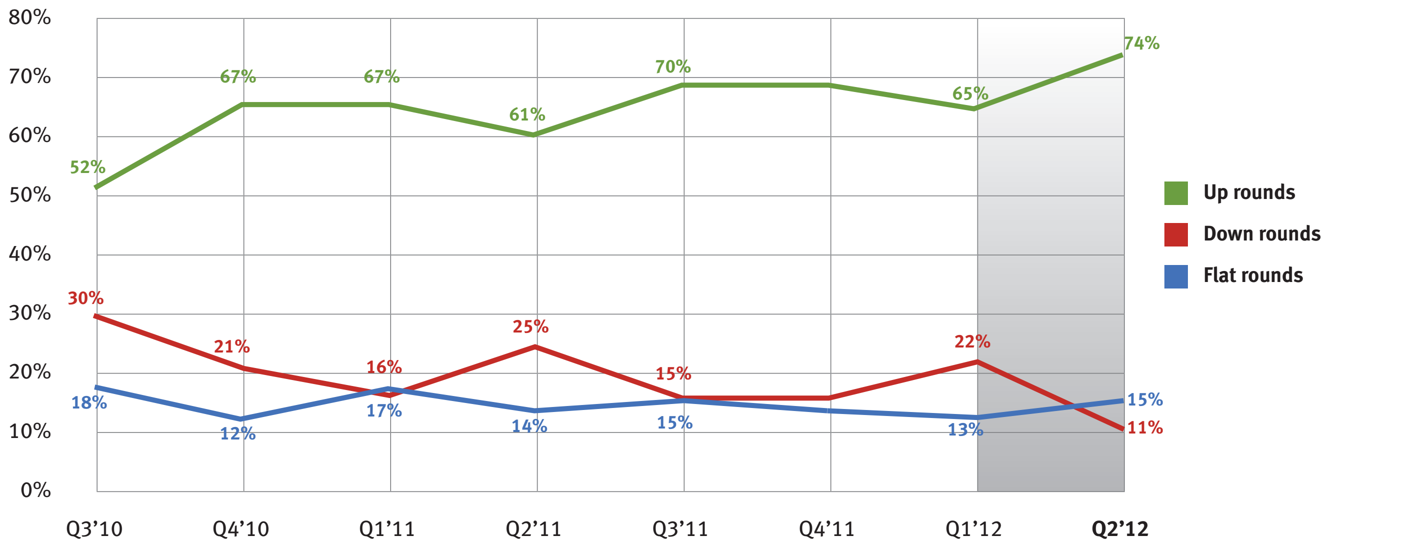
  The Deloitte/NVCA Global Confidence Survey reported that global venture capitalists were most confident about the prospects of the cloud computing, software, new media, healthcare IT and consumer businesses (in order of higher confidence to lower) and were least confident about the medical device, financial services, biopharmaceuticals, cleantech, telecom and semiconductor industries (in order of higher confidence to lower).

- **Nasdaq.**

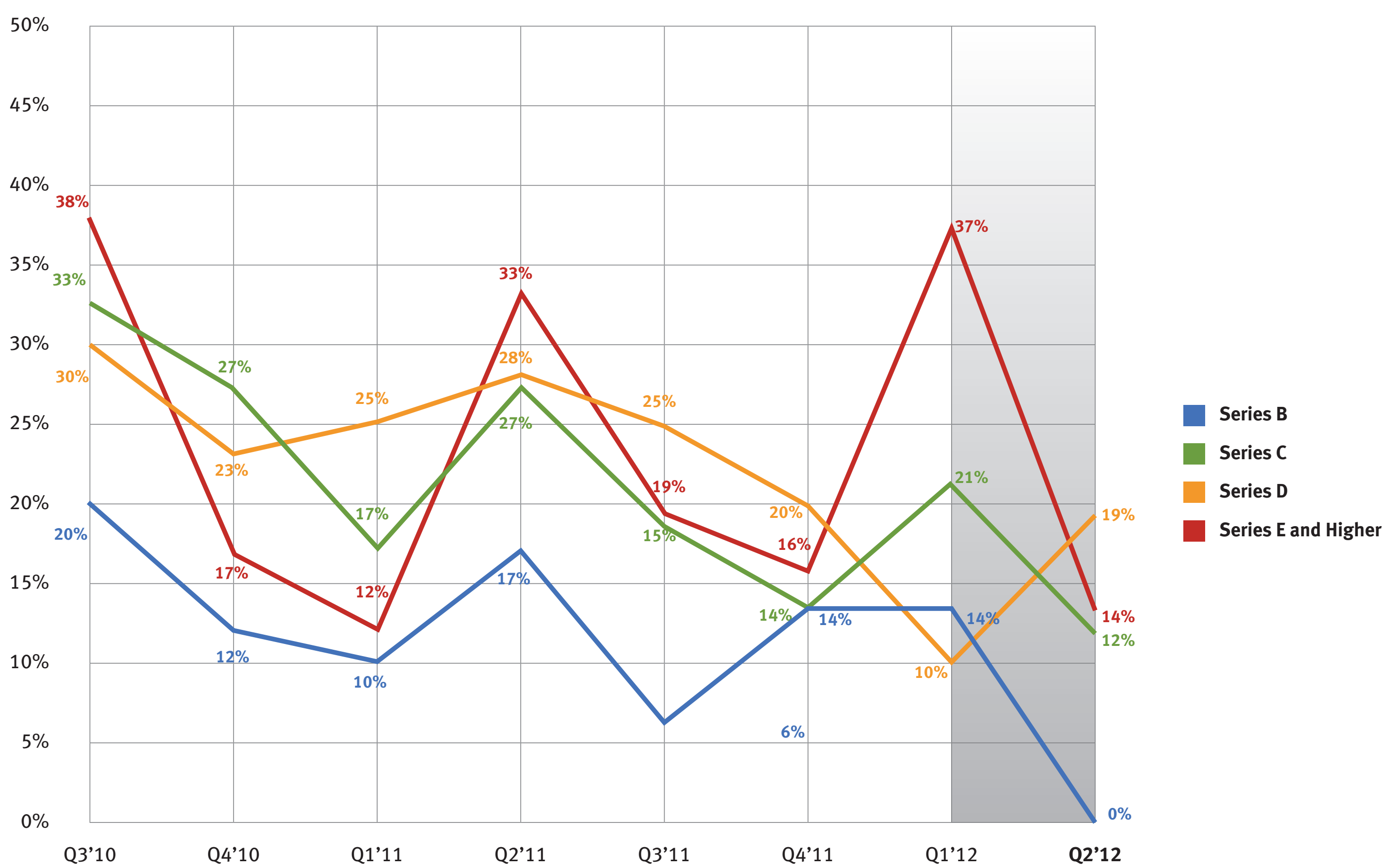
  Nasdaq decreased 4.9% in 2Q12, but has increased 2.8% in 3Q12 through August 10, 2012.

## Fenwick & West Data on Valuation

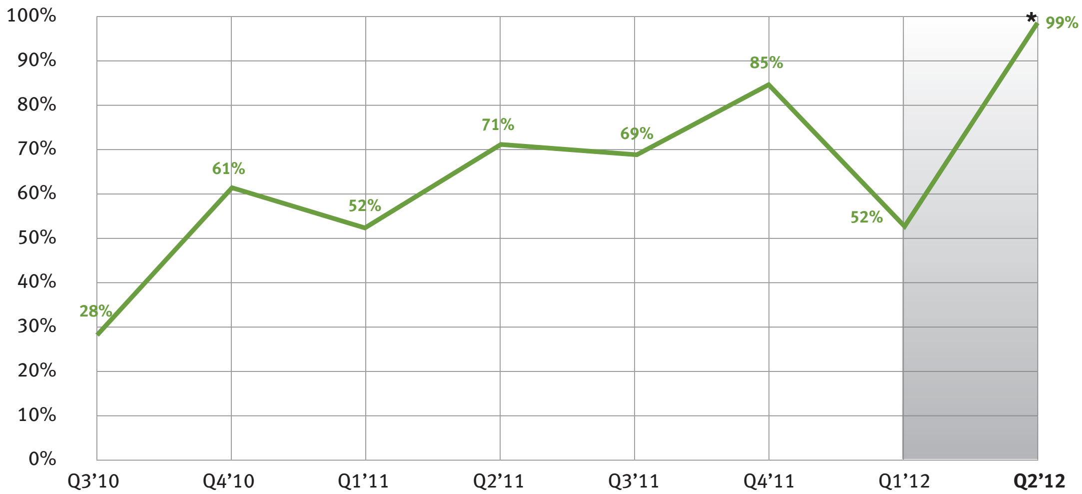
**PRICE CHANGE** — The direction of price changes for companies receiving financing in a quarter, compared to their prior round of financing.




The percentage of down rounds by series were as follows:

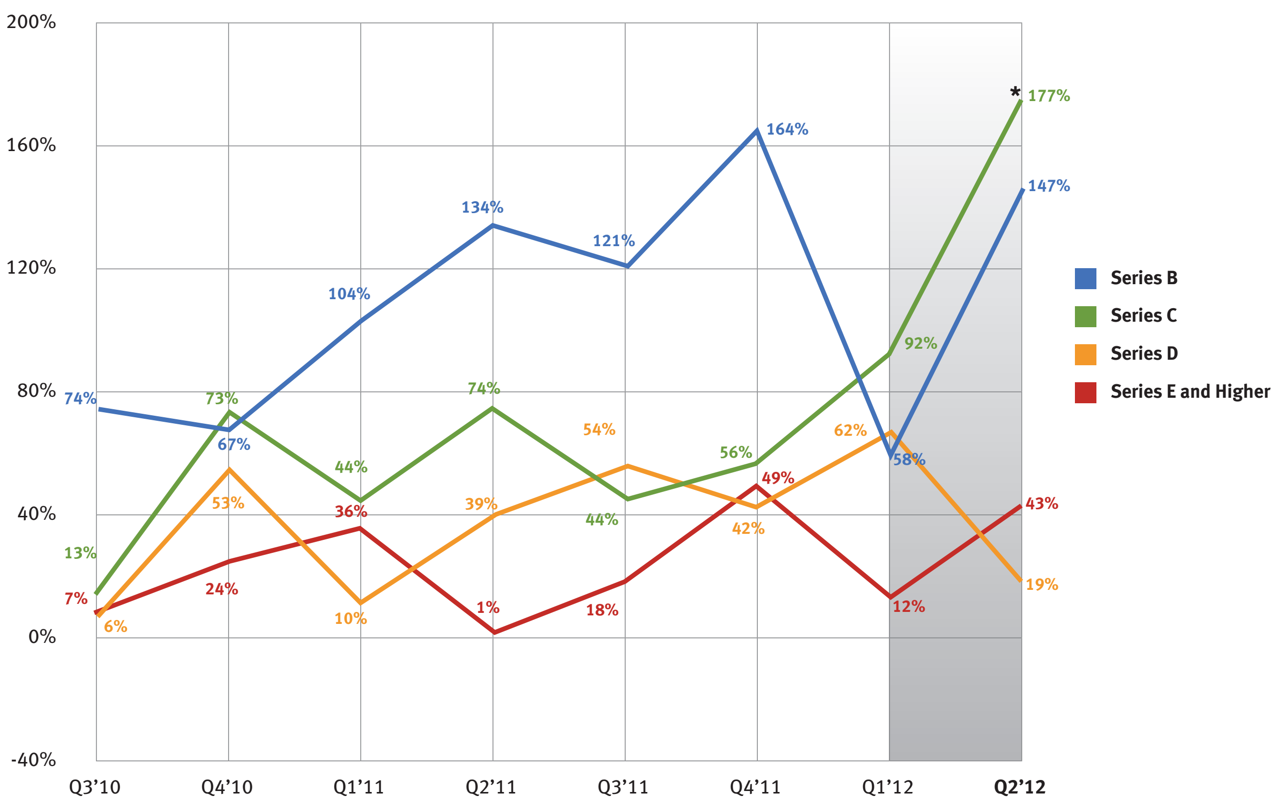


**THE FENWICK & WEST VENTURE CAPITAL BAROMETER™ (MAGNITUDE OF PRICE CHANGE)—** Set forth below is the average percentage change between the price per share at which companies raised funds in a quarter, compared to the price per share at which such companies raised funds in their prior round of financing. In calculating the average, all rounds (up, down and flat) are included, and results are not weighted for the amount raised in a financing.




*Please note that one software company had a 1460% up round and one internet/digital media company had a 1190% up round. If these were excluded the Barometer result for 2Q12 would have been 70%.

The Barometer results by series are as follows:




*Please note that the two above mentioned software and internet/digital media companies with greater than 10x up rounds were both Series C rounds. If these were excluded the Barometer result for Series C rounds in 2Q12 would have been 72%.

**RESULTS BY INDUSTRY FOR CURRENT QUARTER** — The table below sets forth the direction of price changes, Barometer results and number of financings for companies receiving financing in 2Q12, compared to their previous round, by industry group. Companies receiving Series A financings are excluded as they have no previous rounds to compare.

| Industry | Up Rounds | Down Rounds | Flat Rounds | Barometer | Number of Financings |
|---|---|---|---|---|---|
| Software | 86% | 8% | 5% | +123%* | 37 |
| Hardware | 71% | 15% | 14% | +46% | 14 |
| Lifescience | 53% | 6% | 41% | +11% | 17 |
| Internet/Digital Media | 93% | 0% | 7% | +248%* | 14 |
| Cleantech | 25% | 75% | 0% | -34% | 4 |
| Other | 0% | 50% | 50% | -33% | 2 |
| Total all Industries | **74%** | **11%** | **15%** | **99%** | **88** |

*These include the two previously mentioned companies with greater than 10x up rounds in 2Q12. Excluding those two companies, the Software Barometer would have been 86% and the Internet/Digital Media Barometer would have been 176%.

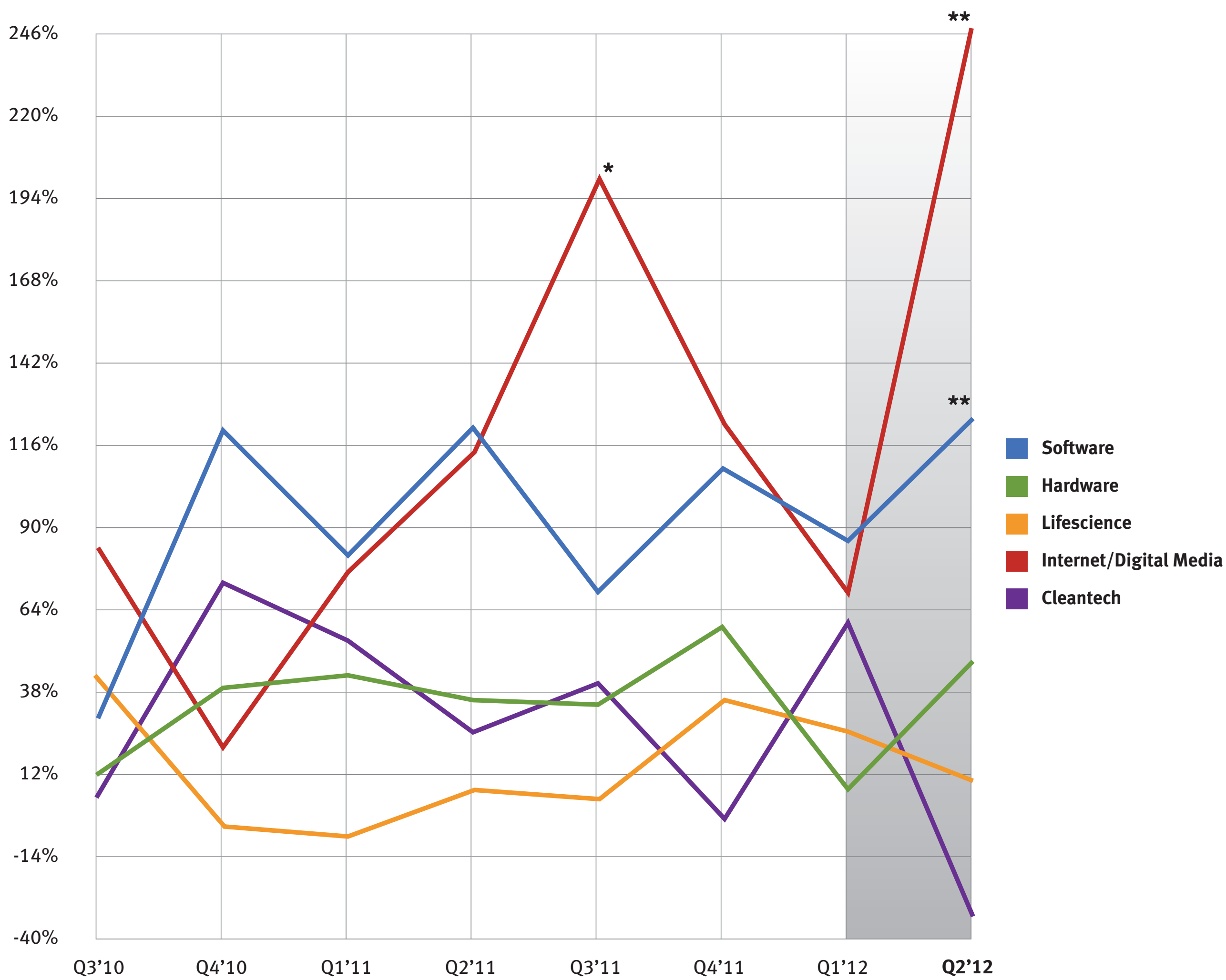
**DOWN ROUND RESULTS BY INDUSTRY** — The table below sets forth the percentage of "down rounds," by industry groups, for each of the past eight quarters.

| Down Rounds | Q3'10 | Q4'10 | Q1'11 | Q2'11 | Q3'11 | Q4'11 | Q1'12 | Q2'12 |
|---|---|---|---|---|---|---|---|---|
| Software | 32% | 7% | 14% | 14% | 14% | 11% | 14% | 8% |
| Hardware | 35% | 36% | 15% | 15% | 12% | 0% | 42% | 15% |
| Lifescience | 27% | 36% | 31% | 31% | 22% | 33% | 24% | 6% |
| Internet/Digital Media | 0% | 25% | 11% | 11% | 18% | 12% | 20% | 0% |
| Cleantech | 60% | 14% | 0% | 0% | 11% | 43% | 0% | 75% |
| Other | 33% | 0% | 25% | 25% | 0% | 0% | 0% | 50% |
| Total all Industries | **30%** | **21%** | **16%** | **16%** | **15%** | **16%** | **22%** | **11%** |

**BAROMETER RESULTS BY INDUSTRY** — The table below sets forth Barometer results by industry group for each of the last eight quarters.

| Barometer | Q3'10 | Q4'10 | Q1'11 | Q2'11 | Q3'11 | Q4'11 | Q1'12 | Q2'12 |
|---|---|---|---|---|---|---|---|---|
| Software | 23% | 121% | 75% | 121% | 71% | 105% | 85% | 123%** |
| Hardware | 10% | 38% | 43% | 35% | 34% | 58% | 5% | 46% |
| Lifescience | 44% | -5% | -8% | 6% | 4% | 36% | 26% | 11% |
| Internet/Digital Media | 82% | 20% | 77% | 115% | 201%* | 122% | 72% | 248%** |
| Cleantech | 5% | 73% | 54% | 24% | 41% | -3% | 61% | -33% |
| Total all Industries | **28%** | **61%** | **52%** | **71%** | **69%** | **85%** | **52%** | **99%** |

A graphical representation of the above is below.




*Please note that one internet/digital media company had a 1500% up round in 3Q11. If this were excluded the Barometer result for the internet/digital media industry in 3Q11 would have been 73%.

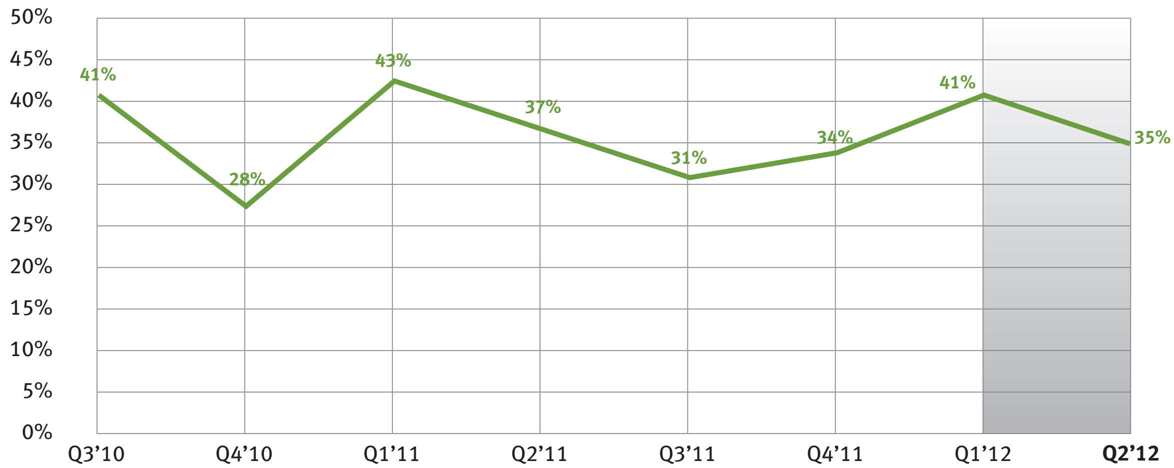
**These include the two previously mentioned companies with greater than 10x up rounds in 2Q12. Excluding those two companies, the Software Barometer would have been 86% and the Internet/Digital Media Barometer would have been 176%.

**FINANCING ROUND** — This quarter's financings broke down by series according to the chart below.

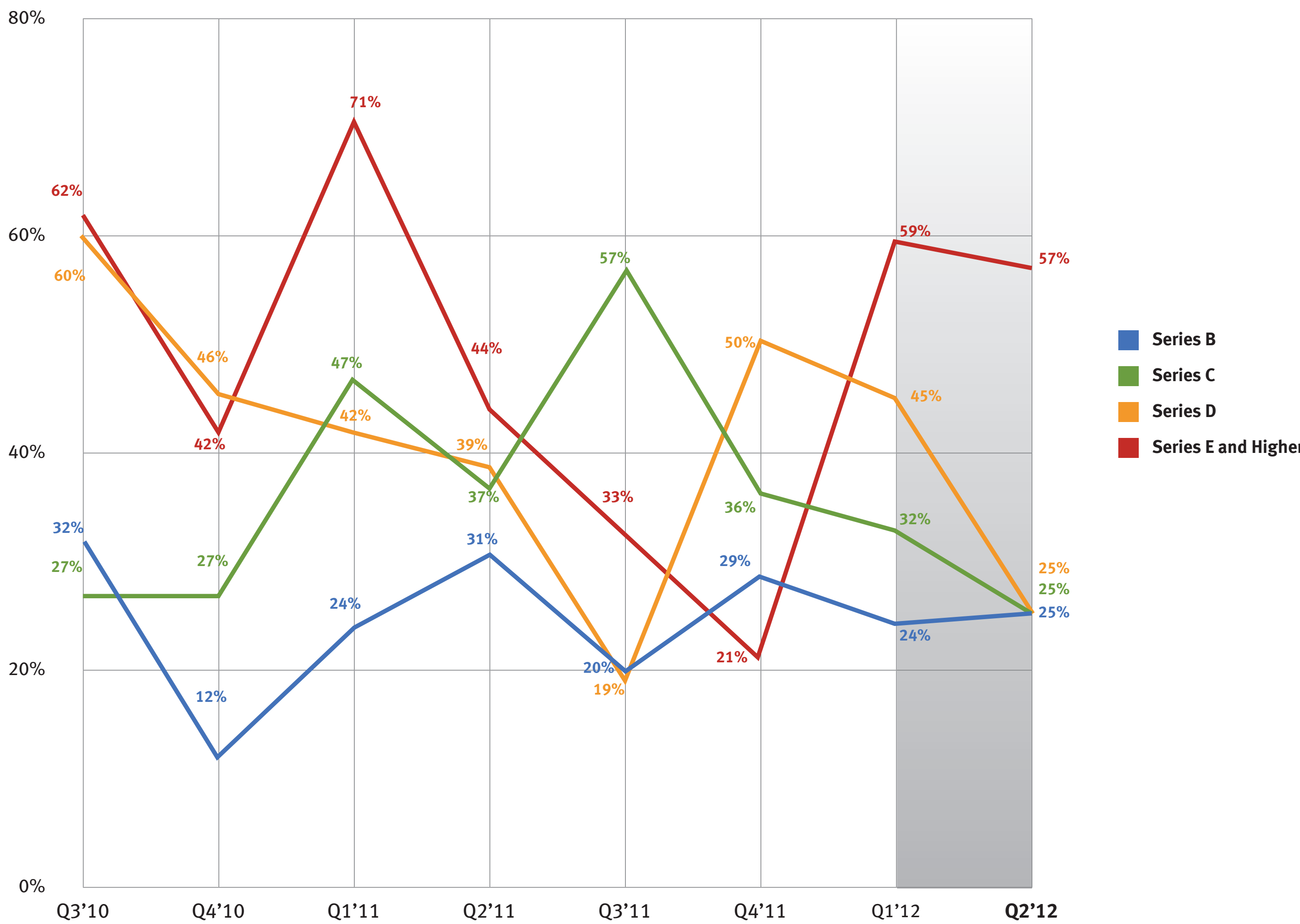
| Series | Q3'10 | Q4'10 | Q1'11 | Q2'11 | Q3'11 | Q4'11 | Q1'12 | Q2'12 |
|---|---|---|---|---|---|---|---|---|
| Series A | 20% | 13% | 18% | 19% | 18% | 24% | 24% | 24% |
| Series B | 23% | 26% | 24% | 25% | 31% | 24% | 18% | 17% |
| Series C | 28% | 35% | 24% | 26% | 19% | 19% | 17% | 21% |
| Series D | 9% | 14% | 20% | 15% | 14% | 17% | 17% | 14% |
| Series E and Higher | 20% | 12% | 14% | 15% | 18% | 16% | 24% | 24% |

## Fenwick & West Data on Legal Terms

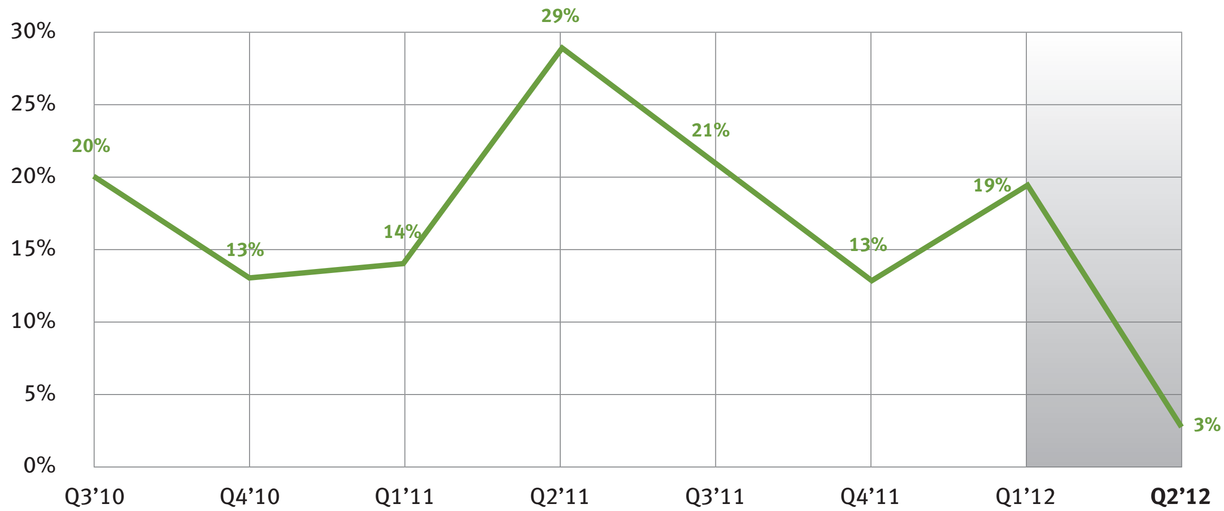
**LIQUIDATION PREFERENCE**—Senior liquidation preferences were used in the following percentages of financings.



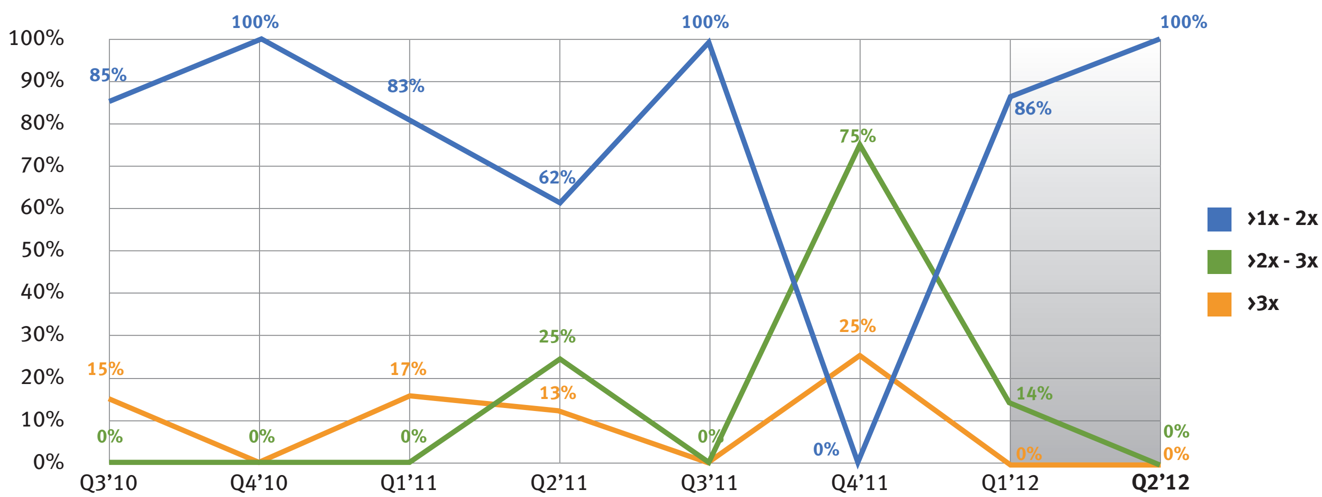

The percentage of senior liquidation preference by series was as follows:



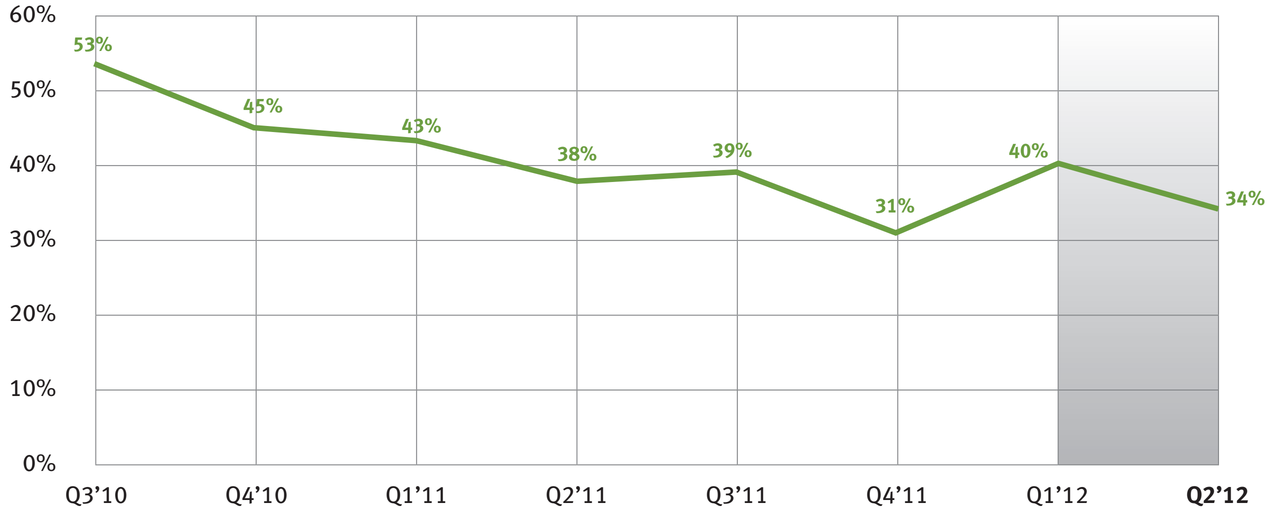
**MULTIPLE LIQUIDATION PREFERENCES** — The percentage of senior liquidation preferences that were multiple liquidation preferences were as follows:



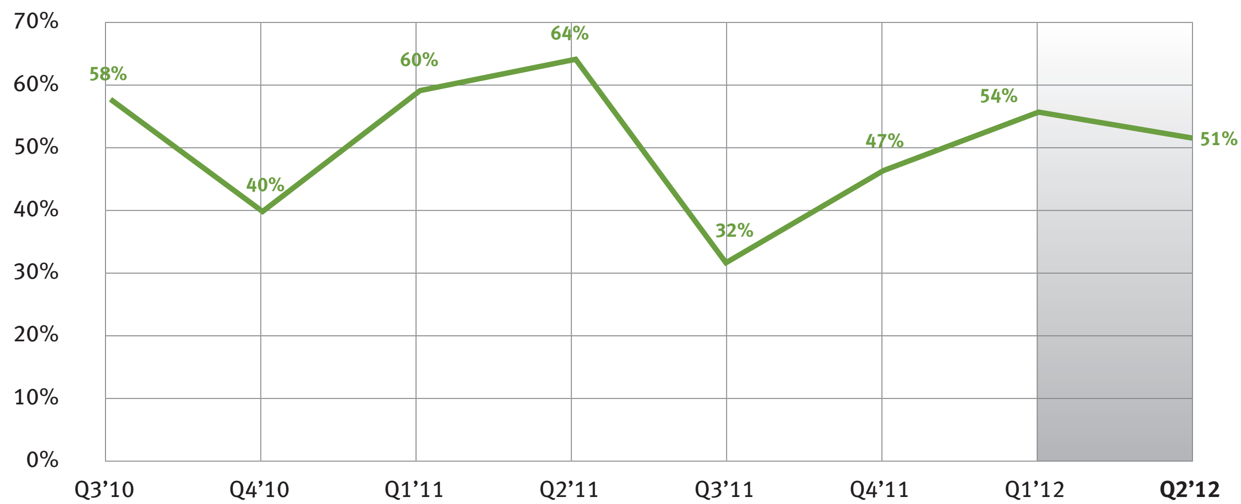

Of the senior liquidation preferences that were a multiple preference, the ranges of the multiples broke down as follows:



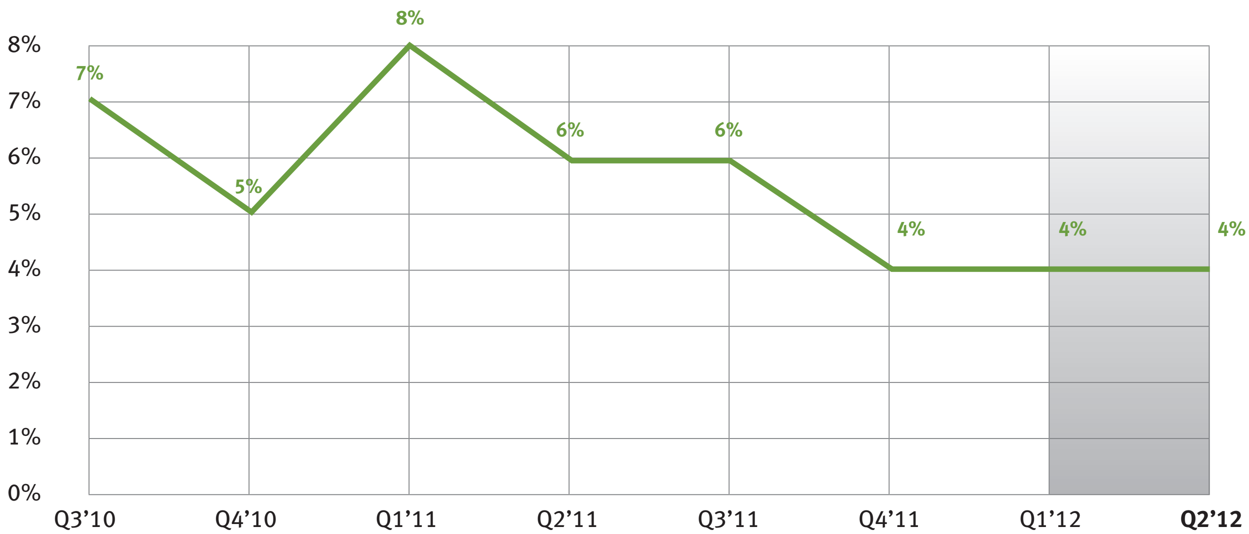
**PARTICIPATION IN LIQUIDATION** — The percentages of financings that provided for participation were as follows:



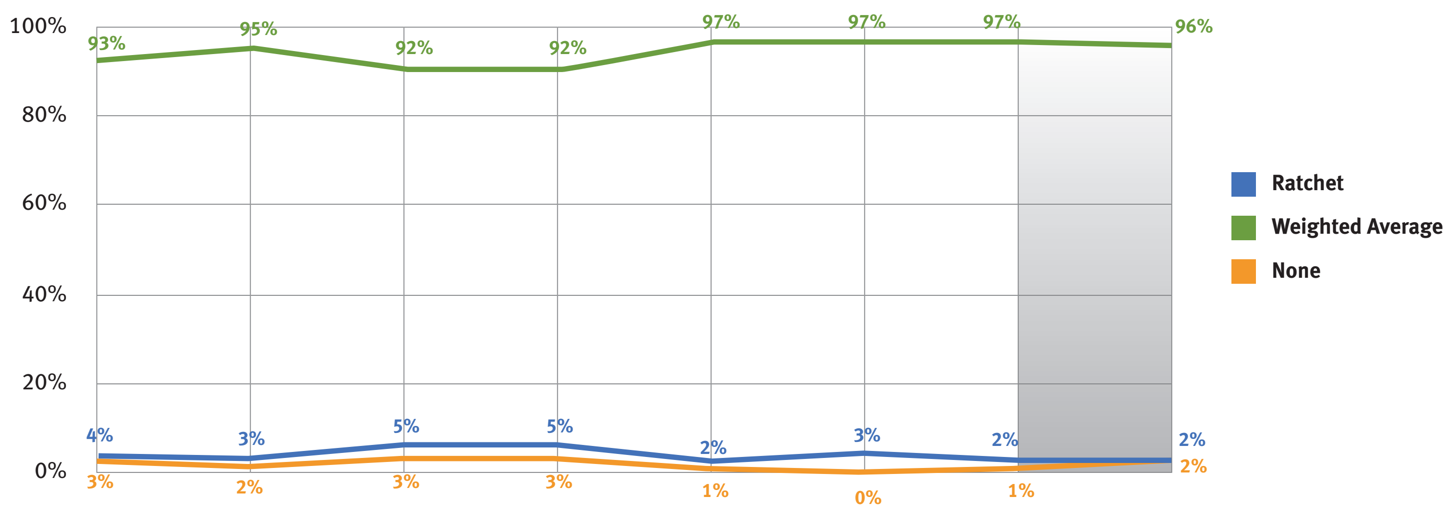

Of the financings that had participation, the percentages that were not capped were as follows:



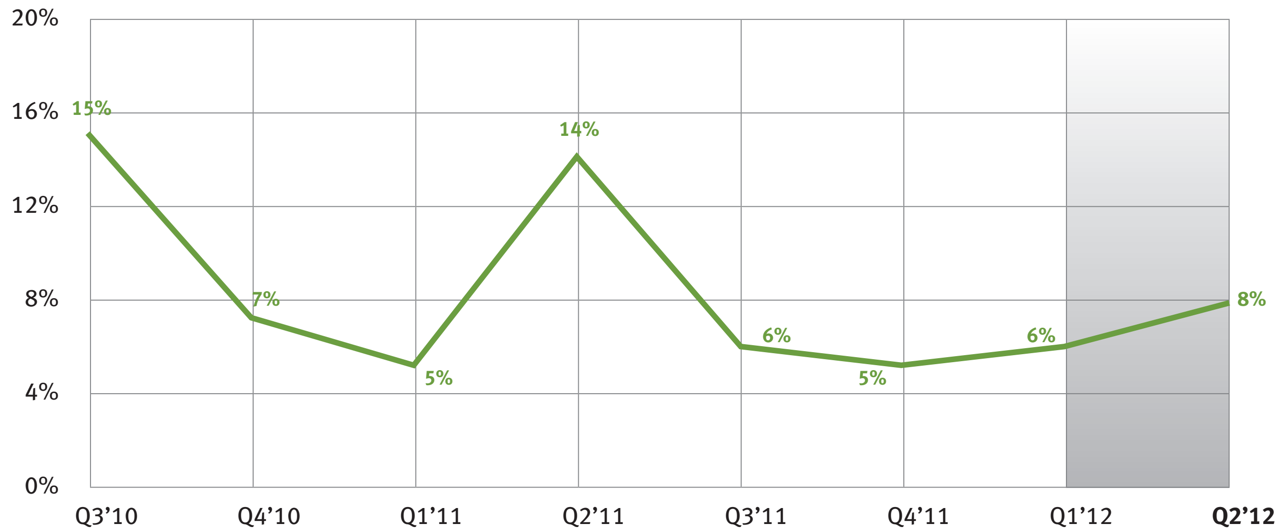
**CUMULATIVE DIVIDENDS** – Cumulative dividends were provided for in the following percentages of financings:




**ANTIDILUTION PROVISIONS** –The uses of antidilution provisions in the financings were as follows:

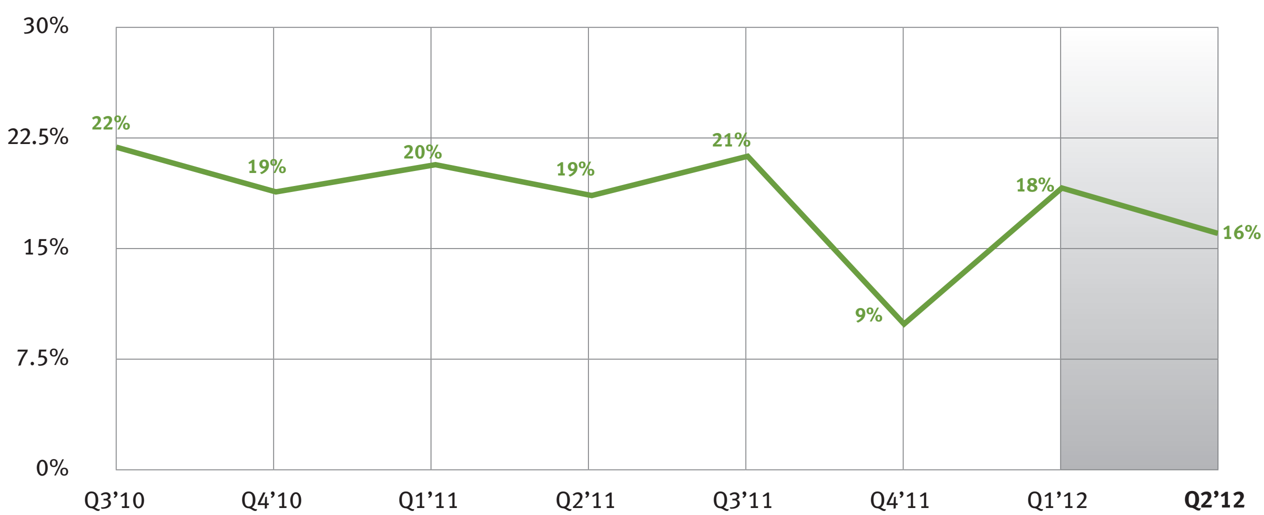


**PAY-TO-PLAY PROVISIONS** – The percentages of financings having pay-to-play provisions were as follows:

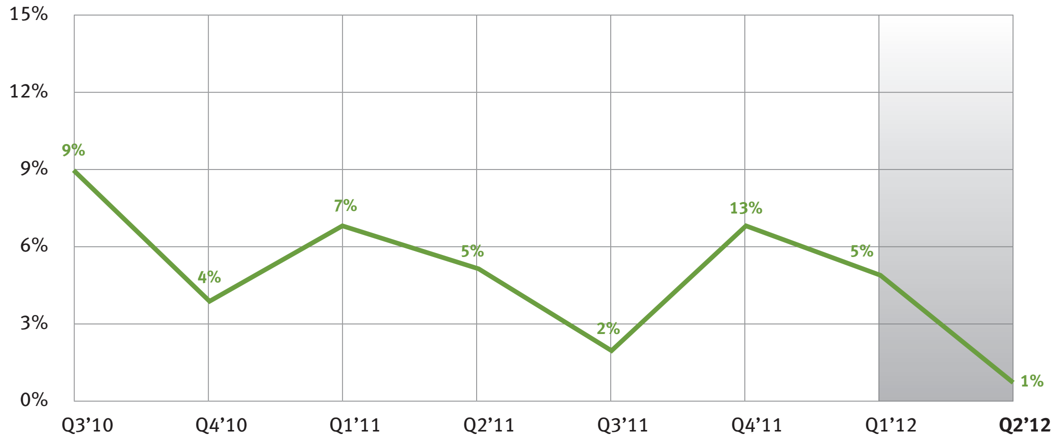



Note that anecdotal evidence indicates that companies are increasingly using contractual "pull up" provisions instead of charter based "pay to play" provisions. These two types of provisions have similar economic effect but are implemented differently. The above information includes some, but likely not all, pull up provisions, and accordingly may understate the use of these provisions.

**REDEMPTION** – The percentages of financings providing for mandatory redemption or redemption at the option of the investor were as follows:



**CORPORATE REORGANIZATIONS** – The percentages of post-Series A financings involving a corporate reorganization (i.e. reverse splits or conversion of shares into another series or classes of shares) were as follows:




- **Notes on Methodology.**

  When interpreting the Barometer results please bear in mind that the results reflect the average price increase of companies raising money in a given quarter compared to their prior round of financing, which was in general 12 to 18 months prior. Given that venture capitalists (and their investors) generally look for at least a 20% IRR to justify the risk that they are taking, and that by definition we are not taking into account those companies that were unable to raise a new financing (and that likely resulted in a loss to investors), a Barometer increase in the 40% range should be considered normal.

  When comparing current period results to prior period results based on third party data (e.g., amounts invested by venture capitalists, amount of M&A proceeds, etc.), we use the prior period results initially published by the third party for the period, not the results that have been updated with additional information over time, to provide better comparability with the current period published results. For example, when comparing fourth quarter results to third quarter results, we use the initially published third quarter results, typically provided in October, not the updated results that are typically provided in January. Such situations are set forth in our report with a parenthetical as to the date the information was initially reported.

- **Disclaimer.**

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- **Contact/Sign Up Information**

  For additional information about this report please contact Barry Kramer at 650-335-7278; bkramer@fenwick.com or Michael Patrick at 650-335-7273; mpatrick@fenwick.com at Fenwick & West.

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