Morgan Lewis

Q3 2024

CORPORATE VENTURE CAPITAL SURVEY

OVERVIEW

Corporate venture capital (CVC) continued at a slow rate in the third quarter of 2024. Only 23.2% of deals that were completed include a CVC investor in Q3, according to Pitchbook data. In this survey, we track investment trends as the market slowed for CVC financings. We also analyze a survey of key economic terms of the largest Q3 2024 venture capital investments in which CVC programs either led the round or participated as significant or anchor investors.

KEY TERMS

We focused our survey on the following deal terms typically negotiated between companies and investors:

- Valuation
- Liquidation Preference
- Participating Preferred
- Cumulative Dividend
- Redemption Rights
- Protective Provisions
- "Pay-to-Play" Provisions

VALUATION

The survey covers a wide range of financing transactions during Q3 2024, from early to late stage. Of our transactions we reviewed that disclosed prior valuations, we noted that virtually all of the transactions involved higher valuations than in the prior round. Compared to Q2, this represented an overall increase in the number of deals with higher valuations.

LIQUIDATION PREFERENCE

While preferred stockholders receive preferential treatment on distribution over common stockholders in the event of liquidation, the liquidation preference among different series of preferred stock is often a negotiated term. The later-round preferred stockholders may request a senior ranking over prior-round preferred stockholders, while earlier investors may insist on equal (or pari passu) treatment with new investors.

Based on our review, 100% of the transactions included a 1x liquidation preference which was pari passu with the prior preferred round, meaning that the new round investors do not include a senior preference to the prior preferred round. These results were the same as from the Q1 survey, indicating that in terms of liquidation preference, companies have been able to continue to hold the line on providing seniority to new investors in the liquidation stack.

PARTICIPATING PREFERRED

With non-participating preferred stock, the preferred stockholders are entitled to receive only the amount of their preference (typically the amount paid for the stock). With participating preferred stock, preferred stockholders are entitled to receive their preference amount first in a liquidation event (plus accrued and unpaid dividends), with any remaining proceeds divided among holders of common stock and preferred stock on an as-converted basis. Based on our review, 66% of the transactions involved non-participating preferred stock. This proportion was lower than in Q2.

CUMULATIVE DIVIDEND

If dividends are cumulative, dividends accrue and accumulate at a specified rate whether or not declared by the board. Upon conversion of the preferred stock, cumulative dividends would convert into additional common stock, which would increase the investors' percentage ownership interest in the company above their original investment. Based on our review, none of the transactions included cumulative dividends. Compared to Q2, this represents a decrease.

REDEMPTION RIGHTS

Redemption rights allow investors to force the company, in specified circumstances, to redeem their shares at cost, and in some cases, cost plus a small guaranteed rate of return.

Based on our review, none of the transactions included any form of redemption rights, the same as in Q2. Redemption rights are fairly rare in venture financings versus private equity deals generally.

PROTECTIVE PROVISIONS

Protective provisions provide preferred stockholders with special approval rights with respect to certain matters of particular significance to their investment in addition to class or series voting rights that may exist under relevant state corporate laws. These matters may include liquidation and sale of the company, amendment of charter or bylaws, changes in board size, and authorization of issuance of other preferred stock. An often-negotiated point is whether the new series of preferred stock should vote together as a single class with the prior series of preferred stock or have a separate approval right specific to the new series.

Based on our review, virtually all of the transactions included voting rights only as a single class together with other series of preferred stock. Compared to Q2, this represented an increase in voting rights only as a preferred single class.

'PAY-TO-PLAY' PROVISIONS

A "pay-to-play" provision requires that investors participate in a later financing in order to retain their antidilution or other special rights. A pay-to-play is not a standard term in most VC financings and typically will come into play only in down rounds. We did not observe any pay-to-play provisions in the transactions we reviewed.

SUMMARY

While the economic terms of each investment are unique based on the facts and circumstances of the companies and investors participating, our Q3 2024 analysis indicates that the environment for venture financing transactions improved from Q2 as valuations increased. However, the deal terms have not shifted significantly for those companies that were able to close financings during Q3. Based on our review, none of the transactions included cumulative dividends. Compared to Q2, this represents a decrease.

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