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This is the second edition of *EEC Perspectives* to focus on “Series B” and later round financings. This issue 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 six 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 **Vinit Nijhawan**, an entrepreneur and investor, to comment on later rounds. Vinit points out, among other things, that in this investment climate you need to broaden your venture capital search to include California and New York firms. 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 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

Vinit Nijhawan, Entrepreneur and Investor

By now everyone has probably read or at least heard about the presentation from Sequoia Ventures to their portfolio companies: hunker down for a prolonged downturn by saving cash and forgoing growth for accelerated profitability. Similarly, venture firms themselves are conserving cash to invest in existing portfolio companies. As a result, the number of new investments have declined. Also there are news reports of limited partners reneging on venture fund commitments as their exposure to PE/VC has drifted above their own guidelines when the public equity markets crashed. While this appears to be affecting early stage investments more than later stage investments, especially in Massachusetts, it is bound to have a knock-on effect on later stage investments.

As the table shows, recent series B investments in Massachusetts companies do not reflect this move to conservatism. All the listed investments are up rounds. The question is will this trend continue? As money dries up companies will likely be ready to accept lower valuations. My recent experience in raising money for an acquisition is that the growth equity funds are narrowing the criteria for their investments. This is happening not just in Massachusetts but also in California. One of my companies recently had the valuation of a term sheet cut by 25% because of “market conditions.” Investors have no compelling need to invest and are using the global financial crisis to push back on valuations.

So what should you do if you need to raise a series B or C? First of all, broaden your VC pipeline to include California and New York firms. Second, if you are not exporting, especially to the BRIC countries, develop a plan to do so before you approach VCs: these countries are still growing whereas the US and Europe appear to be a prolonged recession. Third, make sure your existing investors will take their pro rata share of the new round investment: a red flag for new investors.

Read more from Vinit at his blog: entremeister.typepad.com.

Selected New England “Series B” Round Transactions

Second Quarter 2008

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
Rive Techonology Inc.	B	3.512	3,986,334	14,000,005.01	14,000,000	28.47%	35,167,994.99	49,168,000.00	Up
Medventive Inc	B	0.4631	8,134,644	3,767,153.64	28,000,000	29.05%	9,199,646.36	12,966,800.00	Up
Bradford Networks Inc.	B	1.7548	4,558,900	7,999,957.72	13,572,317	33.59%	15,816,744.15	23,816,701.87	Up
enviO networks, Inc.	B	2.73396	3,657,698	10,000,000.02	19,000,000	19.25%	41,945,239.98	51,945,240.00	Up
Avigenics, Inc.	E-1	3.0399	7,537,081	22,911,972.53	30,000,000	25.12%	68,285,027.47	91,197,000.00	Up
Innocentive, Inc.	B-2	1.5	7,500,000	11,250,000.00	45,000,000	16.67%	56,250,000.00	67,500,000.00	Up
Aspen Aerogels, Inc.	B-3	2.165511	23,915,658	51,789,620.47	72,731,089	32.88%	105,710,352.80	157,499,973.27	Up
Whaleback Systems Corporation	C	0.67	16,891,356	11,317,208.52	44,391,356	38.05%	18,425,000.00	29,742,208.52	Up
Gloucester Pharmaceuticals, Inc.	C	1.44	32,314,491	46,532,867.04	70,786,300	45.65%	55,399,404.96	101,932,272.00	Up
Casenet, Inc.	C	0.7927	14,842,549	11,765,688.59	34,000,000	43.65%	15,186,111.41	26,951,800.00	Up
Segway, Inc.	D	1.14	12,300,000	14,022,000.00	152,000,000	8.09%	159,258,000.00	173,280,000.00	Up
Bullhorn, Inc.	D	3.136	8,568,975	26,872,305.60	15,305,513	55.99%	21,125,783.17	47,998,088.77	Up
Viacor, Inc.	C	3	5,250,000	15,750,000.00	20,000,000	26.25%	44,250,000.00	60,000,000.00	Up
Optaros, Inc	C	1.4994	8,003,202	12,000,001.08	70,000,000	11.43%	92,957,998.92	104,958,000.00	Up
OmiGuide Inc.	E-1	0.97592	3,074,022	2,999,999.55	107,000,000	2.87%	101,423,440.45	104,423,440.00	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.

COMMENTARY:

David Pierson, Foley Hoag Partner

The information in the table above presents a mixed picture. On the one hand, there was a decent level of activity for later stage deals in Q2 2008, and all of the reported deals were up rounds. On the other hand, the size of the deals varied widely, as did the percentage of the financed companies sold and the implied pre- and post-money valuations. Some of these differences can be accounted for by industry sector and some by the stage of the financing round in question, but other factors from which it is hard to generalize are also undoubtedly at work. One thing that seems clear, however, is that at least as a general proposition, the companies that raised cash in the second quarter of 2008 are now probably quite pleased that they did so. With the recent meltdown of the credit and capital markets, fundraising has become more difficult, particularly for later stage deals. Belt-tightening and surviving on less have become the flavors of the day. At least for the near future, the deals that get done will likely involve more internally led rounds and less favorable deal terms, including decreased valuations and down rounds.

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.

Terms of New England Series B and Later Rounds¹

	Q1		Q2		Q3	Q4
Based on NVCA Form ²	Yes 6	No 4	Yes 10	No 5		
Dividends						
Cumulative accruing ³	Yes 5	No 5	Yes 7	No 8		
1x Liquidation Preference⁴						
With full participation	1		2			
With capped participation	3		3			
Non-participating	4		8			
Greater than 1x Liquidation Preference						
With full participation	0		0			
With capped participation	0		2			
Non-participating	0		0			
Redemption	9		11			
Antidilution⁵						
Fully broad based	1		3			
Broad based	6		10			
Narrow based	0		1			
Full ratchet	3		1			
Pay to Play Provision	3		3			

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 6% to 8% during the second quarter of 2008.

⁴ Two of the transactions involved liquidation preferences which are not typical in these type of transactions and therefore were not included in the above chart.

⁵ "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.

COMMENTARY:

Amanda Vendig, Foley Hoag Lawyer

Overall there does not seem to be any real change in deal terms from Q1 2008 to Q2 2008. In both Q1 2008 and Q2 2008, the deals were pretty much evenly split between cumulative accruing dividends and non-cumulative accruing dividends. In addition almost all of the deals done contained redemption rights for the preferred stock and the vast majority of deals contained broad based anti-dilution protection. It is interesting to note that in Q2 2008 there were two deals which contained a greater than 1X liquidation preference. These days a 1x liquidation preference is pretty standard, however after the stock market bubble burst in 2000 multiple liquidation preferences became much more common during the 2001-2003 period. The liquidation preference is the amount of money that an investor will get back prior to any distributions to the holders of common stock. Aggressive liquidation preferences mean that a company must be sold at a higher price in order for common holders to receive a return.

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 B and Later Round Transactions by Industry*

Industry	2007				2008				6 Months ended June 30, 2007	6 Months ended June 30, 2008
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4		
Biopharma	4	7	9	13	5	6			11	11
Medical Device	3	10	3	4	5	5			13	10
Alternative Energy	1	0	3	1	1	3			1	4
Software	12	24	12	23	14	13			36	27
Communications	5	5	5	2	1	2			10	3
Other	9	7	14	9	13	11			16	24
Total	34	53	43	52	39	40			87	79

* Source: Dow Jones VentureOne

National Series B and Later Round Transactions By Industry*

Industry	2007				2008				6 Months ended June 30, 2007	6 Months ended June 30, 2008
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4		
Biopharma	46	50	37	61	33	41			96	74
Medical Device	41	49	32	39	44	44			90	88
Alternative Energy	5	18	14	8	10	16			23	26
Software	91	132	102	111	111	117			223	228
Communications	36	28	41	28	28	25			64	53
Other	98	132	127	140	154	128			230	282
Total	317	409	353	387	380	371			726	751

* Source: Dow Jones VentureOne

Size of New England 2008 Year to Date 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	6
Medical Device	5	4	0	0	1
Alternative Energy	1	1	0	0	2
Software	10	7	6	0	4
Communications	0	2	0	0	1
Other	11	6	5	0	2
Total	29	21	12	1	16

* Source: Dow Jones VentureOne

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

COMMENTARY:

Jerry O'Connor, Foley Hoag Partner

Probably the most interesting thing about the June 30 activity level numbers is how out of date they might already seem, what with the infamous Sequoia memo and other calls to early-stage companies to gird themselves against the market downswing. Looking forward, and based on what we are seeing here at the EEC, I would expect software and life science deals to decline from the numbers above, and clean energy deals to grow in number and percentage as both seed and B rounds continue to close in that space. Even in clean tech, though, we are seeing some bridge note rounds intended to stretch the company to the next round, where a year ago or earlier in 2008 we might have expected to go straight to a B round. This is particularly true for companies that are at, or close to, market entry with a product, and thus at revenue risk.

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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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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