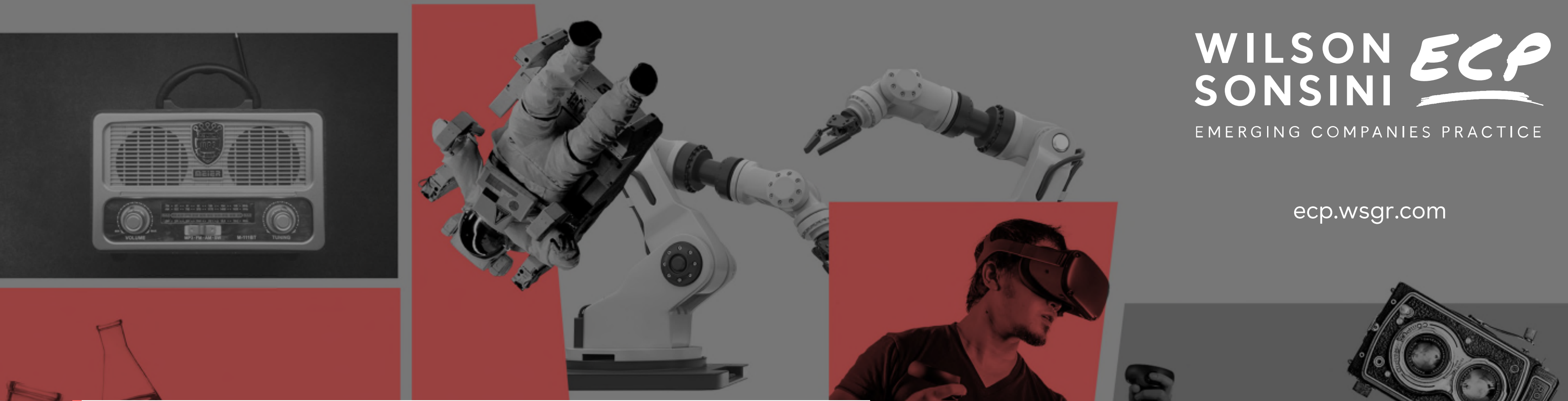

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EMERGING COMPANIES PRACTICE

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THE ENTREPRENEURS REPORT

PRIVATE COMPANY FINANCING TRENDS

From the Wilson Sonsini Database:

FINANCING TRENDS FOR Q1 2023

Key Developments in This Report

Seed valuations rise as others fall

Even as down-round financings increase, Q1 2023 saw median pre-money valuations rebound for Seed stage companies, while valuations for Series A, B, and C and later companies fell compared to 2022. These trends suggest that sluggish public markets may be driving investors to be more conservative in valuing mature companies, but that the effect is less pronounced for early-stage start-ups.

See p. 4

Fundraise amounts decline across the board

The median amount of cash raised in preferred stock financings in Q1 2023 declined for all stages from Seed through Series C and later. Both pre-seed and post-seed convertible bridge notes also posted declines in the median amounts raised, indicating that investors at all stages of the company lifecycle are becoming more frugal when it comes to writing checks.

See p. 6

Down rounds are prevalent

Down and flat rounds made up nearly 40% of all private company equity financing rounds in the first quarter of 2023. While the prevalence of down and flat rounds was exceptionally low during the pandemic funding boom of 2021 and early 2022, the current trend is well above even pre-pandemic figures, signaling a significant shift in the start-up and investment landscape of 2023.

See p. 9

Convertible notes serve as investor-friendly stopgaps

In response to the current turbulent equity funding environment, companies and investors continue to utilize convertible notes to bridge financial needs. Companies may prefer to raise funds using notes in order to push out re-valuation in the hopes of delaying a down round, but note investors are increasingly asking for (and receiving) higher interest rates and shorter maturity periods.

See p. 11

Market Perspective with Wilson Sonsini's Becki DeGraw

Becki DeGraw is co-chair of Wilson Sonsini's emerging companies practice and practices corporate and securities law in the firm's SOMA office. She serves as outside general counsel and advises technology and growth companies, working closely with entrepreneurs to guide them through initial company formation issues, day-to-day corporate governance matters, financing transactions, and liquidity events.

Becki also has extensive experience and spends much of her time counseling investors of all sizes, ranging from accelerators, family offices, and traditional venture funds to private equity and corporate strategic investment arms.

Looking back at Q1 2023, what stands out to you?

After last year's slowdown, I think many people expected this quarter to bring an even more significant downturn. However, I have been pleasantly surprised with the number and quality of deals that I have seen over the past few months. It's true that both valuations and the amount of capital that start-ups have been able to raise continue to drop (especially compared to the boom that we saw in 2021), but in many ways, it feels like we are slowly returning to the pre-pandemic period of 2017-2019.

What are your clients most concerned with right now?

Extending cash runway is on everyone's mind. The days of being able to raise money every 12 months (or less) are over for the foreseeable future, even for those rockstar companies that continue to do well in the current economy. My most successful clients are learning to strike a balance between cost-cutting and strategically deploying their capital in creative ways that further their core mission and drive metrics, which will be critical when they need to raise again.

Given the recent surge in down-round financings, how can start-ups maintain their value proposition and attract investors?

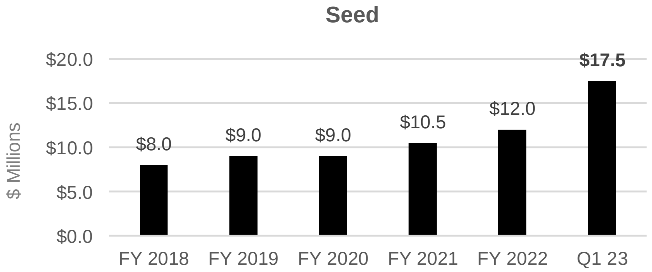
The fundamentals of fundraising remain the same, regardless of economic conditions. Start-ups should focus on demonstrating a strong and defensible business model, emphasizing their competitive advantages, and showcasing traction and growth potential. Strategically, founders can also consider bridge notes and SAFEs as a way to raise capital now while foregoing the need to agree on some of the more tenuous deal terms that go into an equity financing.

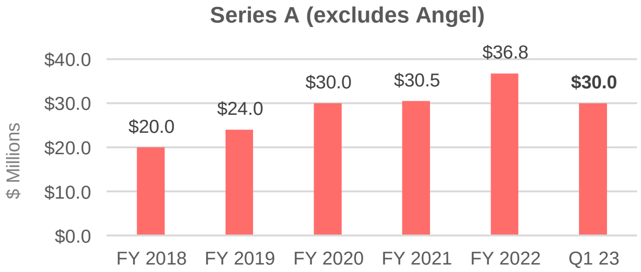
What are you hoping to see in your practice and the industry moving into Q2 and the rest of the year?

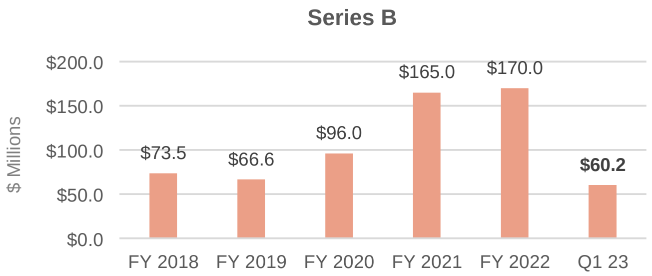
I would love to see market conditions and interest rates stabilize in a way that results in more companies being able to enter the public markets. This might relieve some of the downward valuation pressure on the more mature companies that are struggling to make it past the Series C and D stages, but I think it will continue to be a tough year to fundraise for these companies.

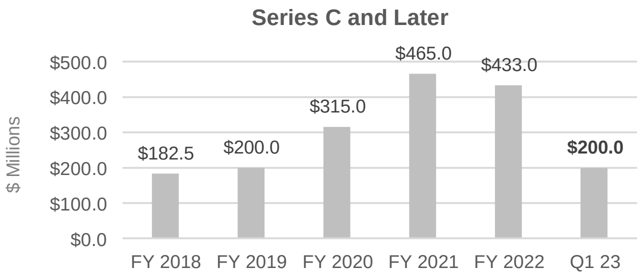
PRE-MONEY MEDIAN VALUATIONS

Later Stages Hit Five-Year Low









Seed valuations continue to climb and are now close to doubling pre-pandemic medians.

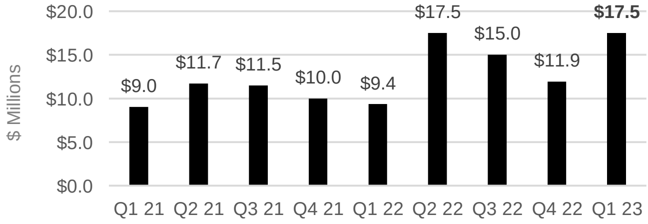
To a lesser extent, Series A median valuations also remain elevated over 2018-2019 figures.

Likely driven by lackluster public markets, the retreat to pre-COVID median valuations is complete for companies raising Series B or later rounds.

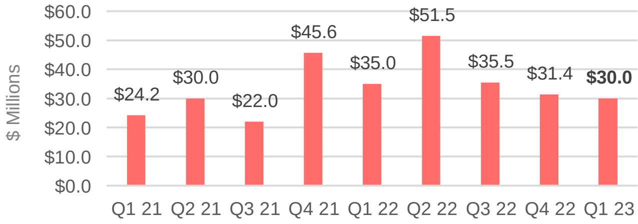
PRE-MONEY MEDIAN VALUATIONS

Quarterly Comparisons Show a Seed-Stage Comeback

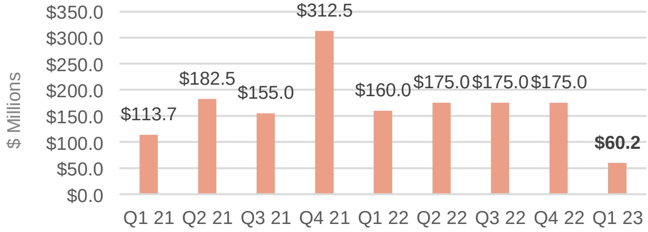
Seed



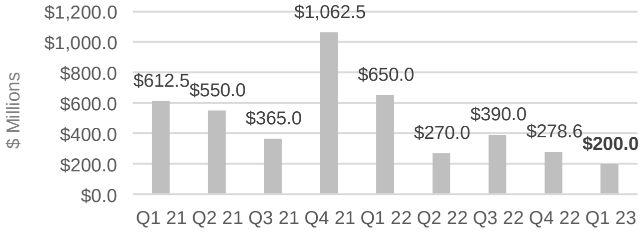
Series A (excludes Angel)



Series B



Series C and Later



Median Seed valuations in Q1 2023 reversed their downward trend in recent quarters and matched the all-time high of $17.5M set in Q2 2022.

Later-stage valuations, on the other hand, continue to decline, with Series A, B, and C or later valuations sliding significantly from the highs of late 2021 and early 2022.

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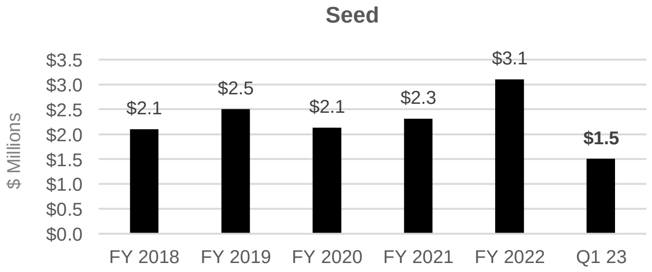
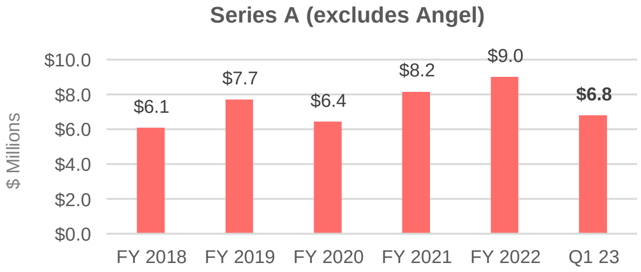
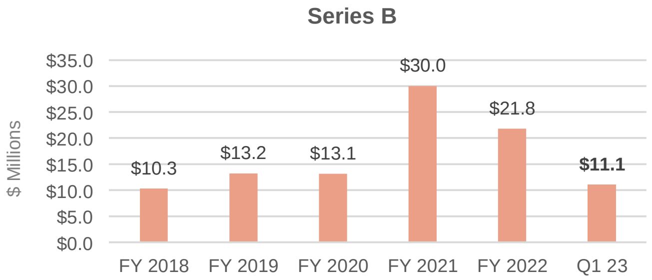
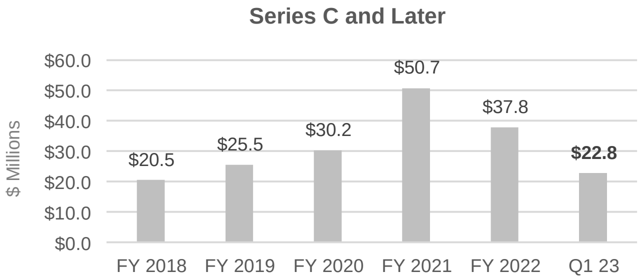
EQUITY FUNDRAISE MEDIAN AMOUNTS

Cash Raised Is Down to Pre-pandemic Figures







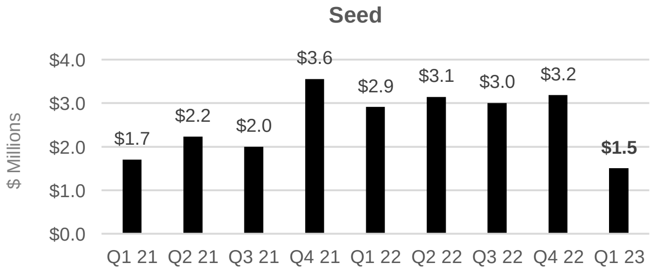


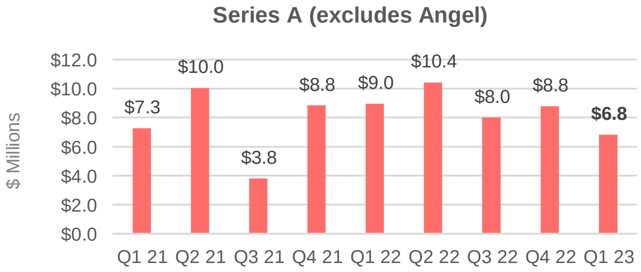
While Seed valuations remain high, median Seed raise amounts plummeted to $1.5M, a figure not seen since early 2018.

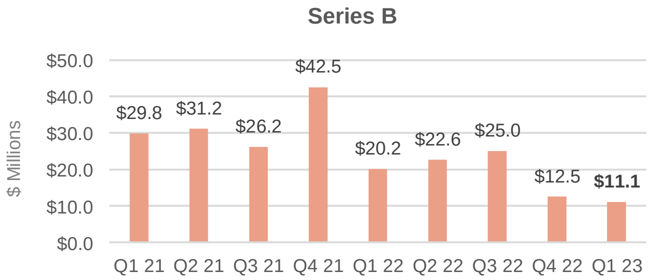
Later-stage start-ups are not faring much better, with the median Series B and Series C and later companies managing to raise less than half as much cash compared to 2021.

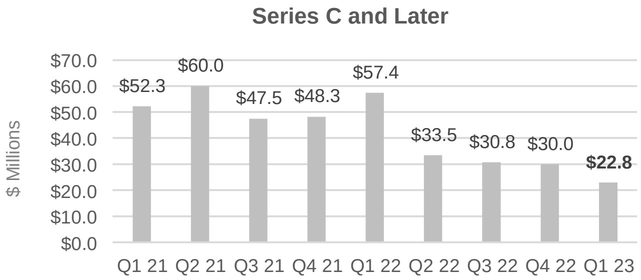
EQUITY FUNDRAISE MEDIAN AMOUNTS

Quarterly Declines Continue at Later Stages









Quarterly trends show a similar, if more gradual, overall decline in fundraising amounts.

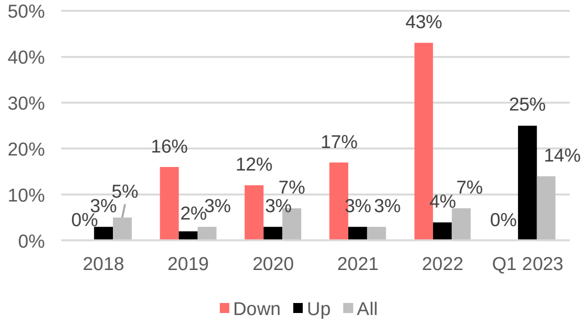
Series C and later companies are now raising less cash than what Series B companies managed to collect in each quarter of 2021.

Median raise amounts for Series C and later companies declined for the fourth consecutive quarter.

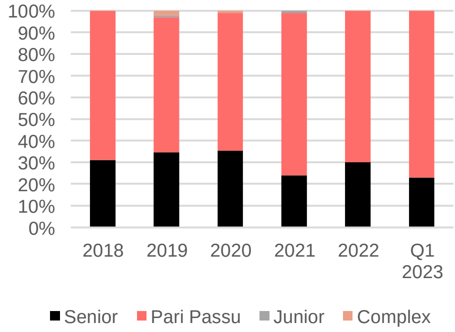
EQUITY FINANCING DEAL TERMS*

Economic Terms More Favorable to New Investors

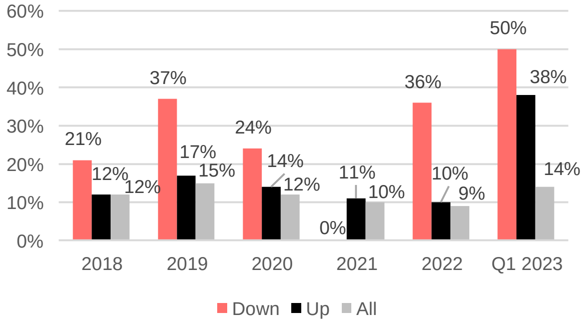
Deals with Pay to Play
(Series B and Later Financings)



Liquidation Preferences
(Series B and Later Financings)



Participating Liquidation Preference
(All Preferred Stock Financings)



In Q1 2023, VCs continued to demand the investor-favorable deal terms that became more common in 2022. *Pari Passu* liquidation preferences remain the most prevalent liquidation structure for new preferred stock, but the number of companies issuing *participating* preferred stock has also risen to levels not seen since 2019. Furthermore, financings with a pay-to-play element have more than quadrupled since 2021, now comprising 14% of all Series B financings.

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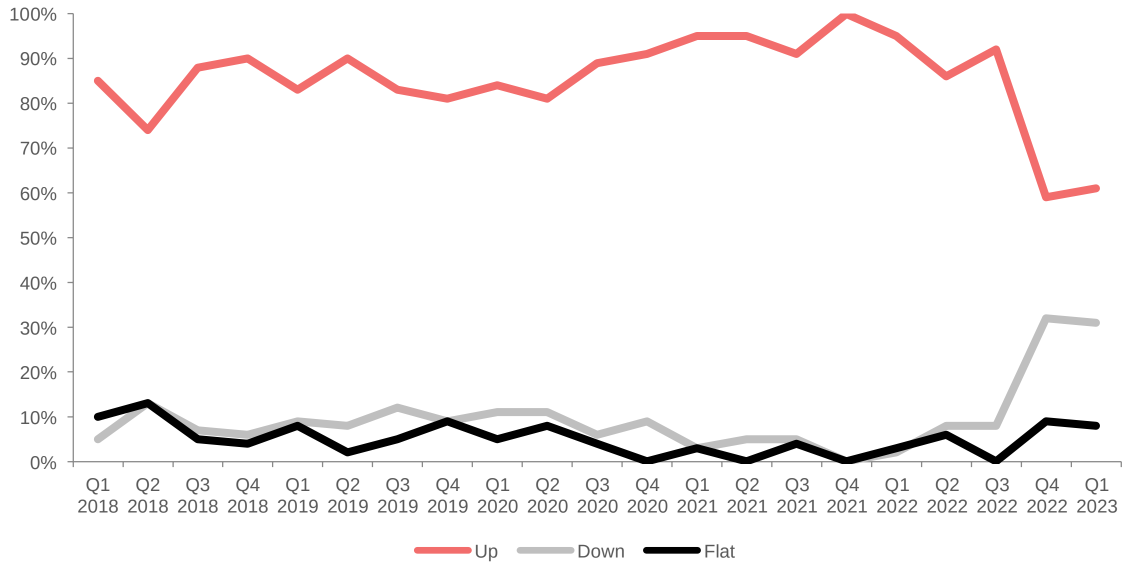
* For a more detailed summary of private company financing deal terms, see the Appendix on page 16.

Up and Down Rounds by Quarter

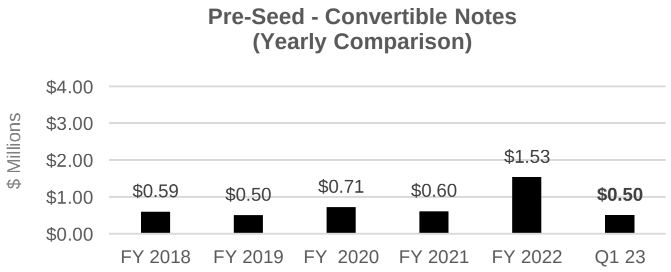


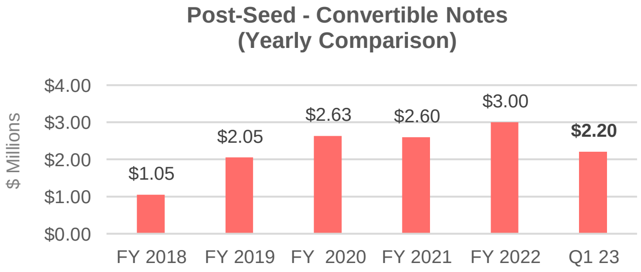
The overall percentages of down and flat rounds remain at near-historic highs, with 39% of companies failing to raise an up round in the first quarter of 2023.

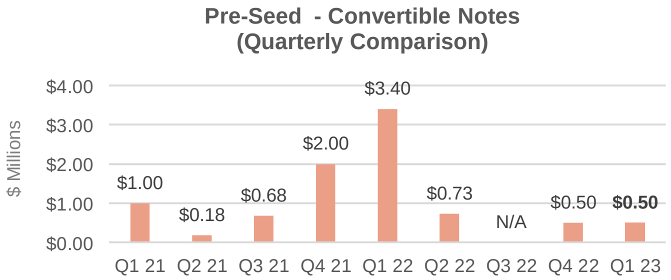
However, after a dramatic rise in down rounds in the second half of 2022, the trend appears to be leveling off. In Q1 2023, the prevalence of down and flat rounds decreased by 2%, while the number of up rounds increased from 59% to 61% quarter-over-quarter.

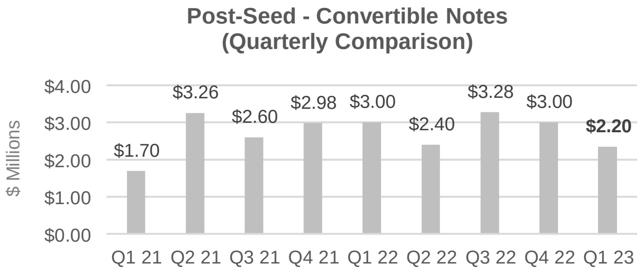
CONVERTIBLE NOTE MEDIAN RAISE AMOUNTS

Investors Tighten the Purse Strings





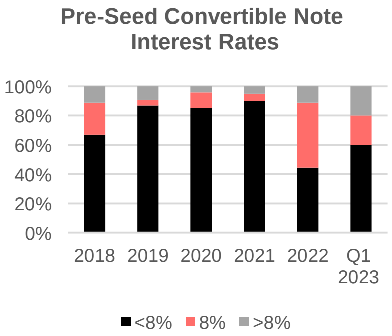


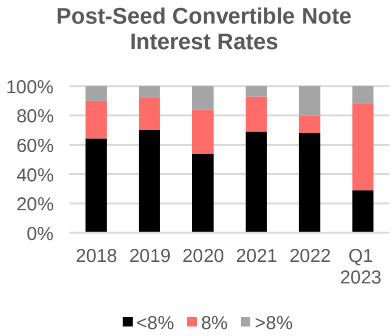


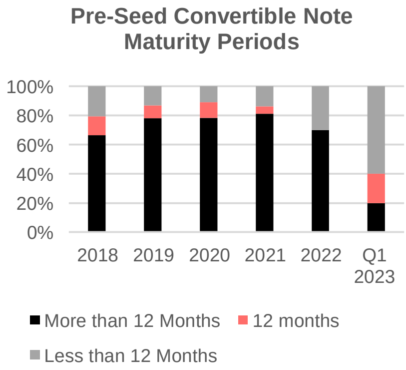
Mirroring the decline in cash raised through Seed-stage equity financings, the median amounts raised in pre- and post-Seed convertible note financings both declined on a year-over-year basis.

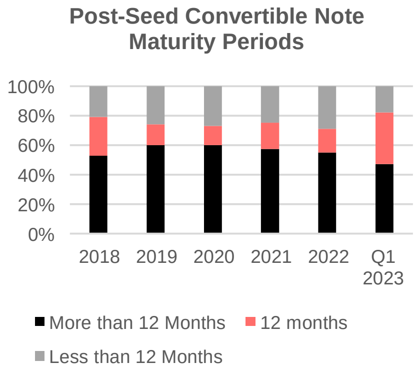
CONVERTIBLE NOTE DEAL TERMS*

Interest Rates Are Up, Maturity Periods Are Down









Not surprisingly, given the Federal Reserve's steady schedule of interest rate increases, convertible note interest rates continue to rise, with 40% of pre-Seed and 71% of post-Seed convertible notes having interest rates of 8% or higher.

Investors are also negotiating for shorter maturity periods, with 80% of pre-Seed and 53% of post-Seed maturing in 12 months or less. Although convertible notes are rarely called for repayment at maturity, a looming maturity date can provide investors with additional negotiating leverage when a company later needs additional capital.

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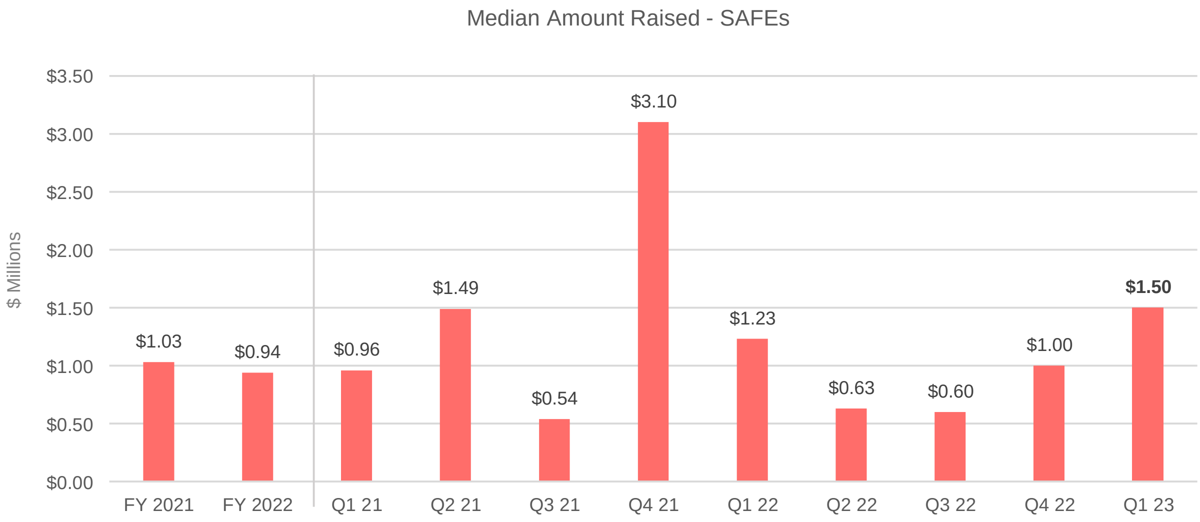
* For a more detailed summary of convertible note deal terms, see the Appendix on page 17.

SAFEs

Median Raise Amounts Bounce Back from 2022’s Low-Water Mark

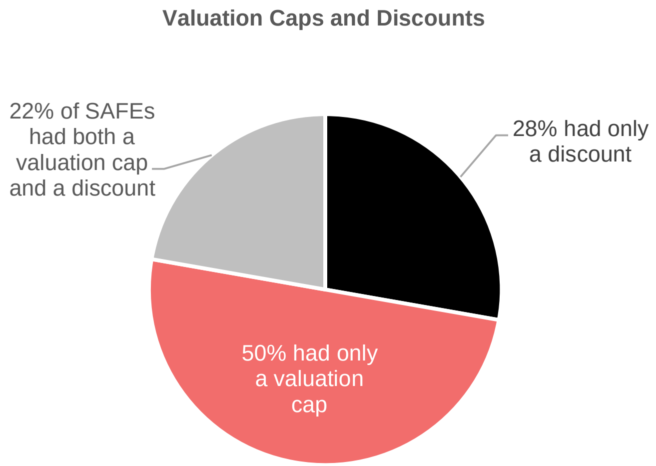


The median amount raised in SAFE financings continues to rise, with Q1 2023’s median of $1.5M reaching a level not seen since 2021.

This increase is likely due to a combination of (1) early-stage companies opting to raise cash via SAFEs while postponing initial Seed rounds and (2) start-ups increasingly using SAFEs over convertible notes to bridge the gaps between equity rounds.

SAFEs

Investors Stick to Standard Terms



SAFEs continue to be popular among emerging companies due to their simple and standard terms. With some slight variations, SAFE terms in Q1 2023 remained largely consistent with 2022. In Q1 2023, 50% of SAFEs included a discount, up from 38% in 2022. Valuation caps were included in 72% of SAFEs, down from 90% in 2022.

In Case You Missed It: Wilson Sonsini Alert on the Dos and Don'ts for Developing, Extending, and Using Generative AI Models

Generative AI (GenAI) refers to a category of artificial intelligence (AI) models capable of generating text, images, music, or other content in response to a user's input prompts and based on training data embodied in the AI model.

While GenAI models show great promise, companies should consider the legal, commercial, and ethical risks posed by this technology. All companies that intend to use GenAI tools for day-to-day business tasks or to develop their own GenAI applications should evaluate the risk/reward tradeoffs and develop an AI policy that provides guidance to employees about the acceptable use of GenAI tools and the risks that could result from unauthorized use.

Wilson Sonsini recently issued an alert on the topic of GenAI that includes the following:

- A discussion about the relationship among training data, input prompts, and output content by treating the GenAI model as a "black box" in order to identify key legal and commercial risks;
- An analysis of the dos and don'ts for typical AI use cases, ranging from developing GenAI models from scratch and extending foundational models for specific applications to simply using GenAI tools for day-to-day business tasks; and
- A summary of key provisions that should form part of an organization's AI usage policy.

The full alert is available here.

Firm Launches Start-Up Financing Module for Neuron

neuron

Following the successful launch of Neuron's incorporation module in 2021 and corporate governance module in 2022, Wilson Sonsini continues to streamline, automate, and digitize the routine legal processes along a start-up's journey with another major addition to Neuron's capabilities: **a start-up financing module**, announced in March 2023. The financing module pairs the personalized service of the firm's leading emerging companies attorneys with the innovative technology of the Neuron platform to complete a financing round at record pace.

Neuron's first financing module is focused on SAFE financings, the predominant type of financing mechanism for early-stage start-ups in the United States. With an average Net Promoter Score of 96, the platform generates SAFEs and collects signatures in a frictionless, yet highly personalized process that frees founders and investors to focus on business growth and allows attorneys to focus on providing high-value advice and customizations.

For more information, visit ecp.wsgr.com/neuron.

Wilson Sonsini Wins *Legalweek's* "Enabling Start-Up Success" Award

In March 2023, Wilson Sonsini was named the winner of the "Enabling Start-Up Success" award as part of *Legalweek's* 2023 Leaders in Tech Law Awards for its creation of Neuron, the firm's proprietary, cloud-based software platform. The firm was also a finalist in the "Tech-Enabled Corporate Department of the Year" category. The winners were announced at the 2023 *Legalweek* Conference in New York.

Now in its third year, the annual *Legalweek* Leaders in Tech Law Awards honor individuals and organizations for their innovation advancement efforts. Click here for the full list of finalists and winners.

Appendix – Private Company Financing Deal Terms (Wilson Sonsini Deals)

	2018 All Rounds[2]	2019 All Rounds[2]	2020 All Rounds[2]	2021 All Rounds[2]	2022 All Rounds[2]	Q1 2023 All Rounds[2]	2018 Up Rounds[3]	2019 Up Rounds[3]	2020 Up Rounds[3]	2021 Up Rounds[3]	2022 Up Rounds[3]	Q1 2023 Up Rounds[3]	2018 Down Rounds[3]	2019 Down Rounds[3]	2020 Down Rounds[3]	2021 Down Rounds[3]	2022 Down Rounds[3]	Q1 2023 Down Rounds[3]
Liquidation Preferences - Series B and Later																		
Senior	31%	35%	35%	24%	30%	23%	28%	30%	32%	23%	26%	25%	36%	63%	56%	50%	64%	25%
Pari Passu with Other Preferred	69%	63%	63%	75%	70%	77%	72%	68%	67%	76%	74%	75%	64%	37%	44%	50%	36%	75%
Junior	0%	1%	0%	1%	0%	0%	0%	1%	0%	1%	0%	0%	0%	0%	0%	0%	0%	0%
Complex	0%	2%	1%	0%	0%	0%	0%	2%	1%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Participating vs. Non-participating																		
Participating - Cap	5%	5%	4%	4%	3%	5%	5%	5%	6%	4%	3%	13%	7%	5%	0%	0%	0%	25%
Participating - No Cap	7%	10%	8%	6%	6%	9%	7%	12%	8%	7%	7%	25%	14%	32%	24%	0%	36%	25%
Non-participating	88%	85%	88%	90%	91%	86%	88%	83%	86%	89%	90%	63%	79%	63%	76%	100%	64%	50%
Dividends																		
Yes, Cumulative	7%	5%	10%[4]	5%	6%	9%	9%	6%	10%[4]	6%	8%	13%	23%	11%	25%[4]	0%	8%	0%
Yes, Non-Cumulative	61%	56%	79%[4]	56%	51%	43%	62%	67%	83%[4]	65%	57%	50%	69%	79%	69%[4]	57%	58%	75%
None	32%	39%	10%[4]	39%	43%	48%	29%	28%	7%[4]	29%	35%	38%	8%	11%	6%[4]	43%	33%	25%
Anti-dilution Provisions																		
Weighted Average - Broad	94%	94%	95%	97%	98%	93%	94%	99%	98%	98%	99%	100%	100%	89%	76%	100%	100%	75%
Weighted Average - Narrow	2%	0%	1%	1%	0%	2%	3%	0%	2%	1%	0%	0%	0%	5%	6%	0%	0%	25%
Ratchet	0%	0%	1%	1%	1%	0%	0%	0%	0%	1%	1%	0%	0%	5%	6%	0%	0%	0%
Other (Including Blend)	1%	1%	1%	0%	0%	0%	1%	0%	1%	1%	0%	0%	0%	0%	0%	0%	0%	0%
None	3%	4%	2%	1%	1%	5%	2%	1%	0%	0%	0%	0%	0%	0%	12%	0%	0%	0%
Pay to Play - Series B and Later																		
Yes, Pay to Play	5%	3%	7%	3%	7%	14%	3%	2%	3%	3%	4%	25%	0%	16%	12%	17%	43%	0%
None	95%	97%	93%	97%	93%	86%	97%	98%	97%	97%	96%	75%	100%	84%	88%	83%	57%	100%
Redemption																		
Yes, Redemption	9%	14%	13%	10%	8%	9%	13%	17%	10%	15%	12%	0%	14%	26%	25%	17%	7%	50%
None	91%	86%	88%	90%	92%	91%	87%	82%	90%	86%	89%	100%	86%	74%	75%	83%	93%	50%

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[1] We based this analysis on deals having an initial closing in the period to ensure that the data clearly reflects current trends. Please note the numbers do not always add up to 100% due to rounding.
[2] Includes flat rounds and, unless otherwise indicated, Series A rounds.
[3] Note that the All Rounds metrics include flat rounds and, in certain cases Series A financings as well. Consequently, metrics in the All Rounds column may be outside the ranges bounded by the Up Rounds and Down Rounds columns, which will not include such transactions.
[4] The 2020 increase in the number of transactions reported as including dividends resulted in part from a change to our reporting methodology.

Appendix – Convertible Notes – Deal Terms (Wilson Sonsini Deals)

Convertible Notes[1]	2018 Pre-Seed	2019 Pre-Seed	2020 Pre-Seed	2021 Pre-Seed	2022 Pre-Seed	Q1 2023 Pre-Seed	2018 Post-Seed	2019 Post-Seed	2020 Post-Seed	2021 Post-Seed	2022 Post-Seed	Q1 2023 Post-Seed
Interest rate less than 8%	67%	87%	85%	90%	44%	60%	65%	70%	54%	69%	68%	29%
Interest rate at 8%	22%	4%	11%	5%	44%	20%	25%	22%	30%	24%	12%	59%
Interest rate greater than 8%	11%	9%	4%	5%	11%	20%	10%	8%	16%	7%	20%	12%
Maturity less than 12 months	21%	13%	11%	14%	30%	60%	21%	26%	27%	25%	29%	18%
Maturity 12 months	13%	9%	11%	5%	0%	20%	26%	14%	13%	18%	16%	35%
Maturity more than 12 months	67%	78%	79%	81%	70%	20%	53%	60%	60%	58%	55%	47%
Debt is subordinated to other debt	23%	27%	13%	14%	40%	20%	47%	49%	46%	48%	41%	29%
Loan includes warrants[2]	4%	2%	4%	0%	0%	0%	18%	8%	12%	6%	20%	6%
Warrant coverage less than 25%	0%	100%	100%	N/A	N/A	N/A	33%	80%	67%	0%	11%	0%
Warrant coverage at 25%	0%	0%	0%	N/A	N/A	N/A	11%	0%	0%	0%	0%	0%
Warrant coverage greater than 25%	100%	0%	0%	N/A	N/A	N/A	56%	20%	33%	100%	89%	100%
Automatic conversion into equity on qualified financing[3]	98%	100%	100%	100%	100%	100%	96%	96%	92%	96%	93%	88%
Voluntary conversion into equity on qualified financing[3]	2%	0%	0%	0%	0%	0%	4%	4%	8%	4%	7%	13%
Conversion rate subject to price cap[4]	69%	69%	68%	71%	56%	40%	25%	51%	36%	52%	32%	38%
Conversion to equity at discounted price[5]	83%	68%	78%	75%	50%	100%	85%	81%	79%	70%	78%	69%
Conversion to equity at same price as other investors	14%	12%	13%	15%	30%	0%	6%	11%	17%	25%	20%	25%
Discount on conversion less than 20%	23%	18%	11%	20%	40%	20%	20%	27%	25%	21%	29%	9%
Discount on conversion at 20%	60%	63%	69%	60%	20%	40%	48%	57%	46%	63%	39%	55%
Discount on conversion greater than 20%	17%	18%	20%	20%	40%	40%	33%	16%	29%	16%	32%	36%

[1] We based this analysis on deals having an initial closing in the period to ensure that the data clearly reflects current trends. Please note the numbers do not always add up to 100% due to rounding. Pre-Seed refers to convertible notes issued prior to the first preferred stock financing. Post-Seed refers to convertible notes issued after the first preferred stock financing.

Of the 2018 post-Seed convertible notes with warrants, 45% also had a discount on conversion into equity. Of the 2019 post-Seed convertible notes with warrants, 71% also had a discount on conversion into equity. Of the 2020 post-Seed convertible notes with warrants, 44% also had a discount on conversion into equity. Of the 2021 post-Seed convertible notes with warrants, 100% also had a discount on conversion into equity. Of the 2022 post-Seed convertible notes with warrants, 59% also had a discount on conversion into equity. There were not enough post-Seed convertible notes with warrants to provide a trend in Q1 2023.

[3] The 2018 median dollar threshold for a qualified financing in pre- and post-Seed convertible notes was $3M and $5M, respectively. The 2019 median dollar threshold for a qualified financing in pre- and post-Seed convertible notes was $4M and $8M, respectively. The 2020 median dollar threshold for a qualified financing in pre- and post-Seed convertible notes was $3M and $10M, respectively. The 2021 median dollar threshold for a qualified financing in pre- and post-Seed convertible notes was $4M and $10M, respectively. The 2022 median dollar threshold for a qualified financing in pre- and post-Seed convertible notes was $7M and $10M, respectively. The Q1 2023 median dollar threshold for a qualified financing in pre- and post-Seed convertible notes was $5M and $10M, respectively.

[4] The 2018 median price cap in pre- and post-Seed convertible notes was $8M and $40M, respectively. The 2019 median price cap in pre- and post-Seed convertible notes was $9M and $35M, respectively. The 2020 median price cap in pre- and post-Seed convertible notes was $8M and $47M, respectively. The 2021 median price cap in pre- and post-Seed convertible notes was $12M and $47M, respectively. The 2022 median price cap in pre- and post-Seed convertible notes was $35M and $50M, respectively. The Q1 2023 median price cap in pre- and post-Seed convertible notes was $23M and $35M, respectively.

[5] Of the 2018 post-Seed convertible notes that had a discount on conversion into equity, 11% also had warrants. Of the 2019 post-Seed convertible notes that had a discount on conversion into equity, 7% had warrants. Of the 2020 post-Seed convertible notes that had a discount on conversion into equity, 7% had warrants. Of the 2021 post-Seed convertible notes that had a discount on conversion into equity, 3% had warrants. Of the 2022 post-Seed convertible notes that had a discount on conversion into equity, 17% had warrants. Of the Q1 2023 post-Seed convertible notes that had a discount on conversion into equity, 9% had warrants.

Wilson Sonsini Methodology

- The Up/Down/Flat analysis is based on Wilson Sonsini deals having an initial closing in the period reported to ensure that the data clearly reflects current trends.
- The median pre-money valuation is calculated based on the pre-money valuation given at the time of the initial closing of the financing round. If the issuer has a closing in a subsequent quarter, the original pre-money valuation is used in the calculation of the median for that quarter as well.
- A substantial percentage of deals have multiple closings that span fiscal quarters. The median amount raised is calculated based on the aggregate amount raised in the reported quarter.

This report is based on detailed deal data provided by the firm’s corporate and securities attorneys and analyzed by the firm’s Knowledge Management department.

For purposes of the statistics and charts in this report, our database includes venture financing transactions in which Wilson Sonsini Goodrich & Rosati represented either the company or one or more of the investors.

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WILSON SONSINI ECP
EMERGING COMPANIES PRACTICE

650 Page Mill Road, Palo Alto, California 94304-1050 | Phone 650-493-9300 | Fax 650-493-6811 | www.wsgr.com

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