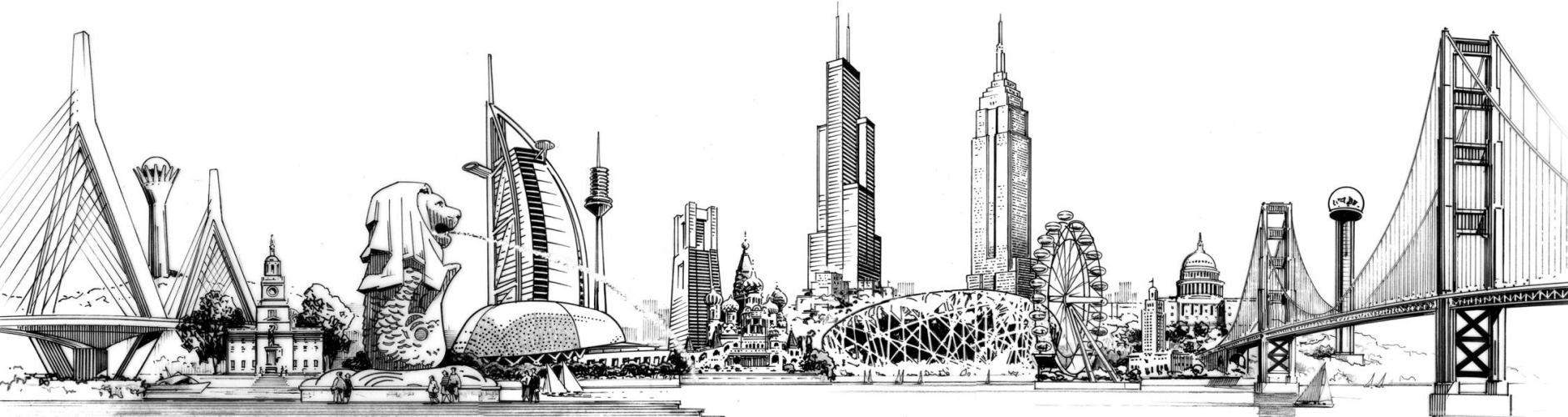


Morgan Lewis

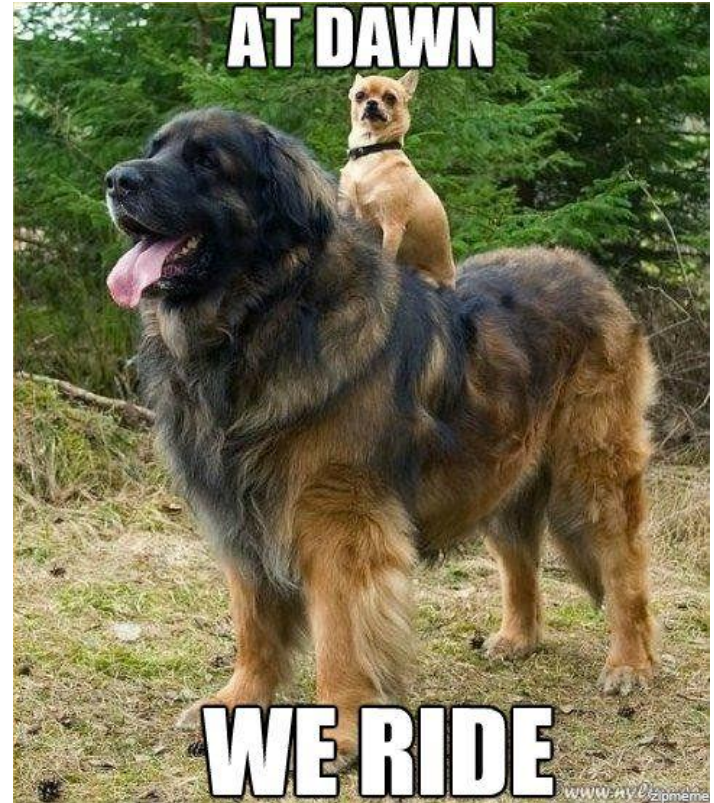
CORPORATE VENTURE INVESTMENTS



Overview

What is corporate
venture investment and
why has its time come?

Morgan Lewis



Overview

- More than 20% of venture deals
- Approximately \$20 billion in 2016
- Number of cvcs doubled since 2012
- Larger average deal size
- Almost two-thirds in mobile and internet sectors

Overview

- Why the “corporate” investor distinction?
 - Investor motivations
 - Issuer motivations
 - Misperceptions and cross-purposes



Overview

- How and when does a strategic investor typically enter an investment?
 - Strategic investor as lead
 - VC as lead
 - True start-up
 - Established VC-backed issuer
 - Up rounds/down rounds

Deal Stage 1: The NDA

- Is it only about confidentiality?
- Strategic investors may now or in the future be actively competing with the issuer
- Most NDAs do not survive for the length of the investment relationship
- Will the NDA be superseded by subsequent investment documentation?

Deal Stage 1

- Lockdown
- Term sheet
- Diligence
- Capitalization table
 - Current and pro forma



Deal Stage 1: Investment Term Sheet

- Preferred stock
- *Pari passu* vs. senior liquidation preference
- Participation rights
- Cumulative dividends
- Redemption rights
- Protective provisions

Deal Stage 2: Due Diligence and Negotiation

- Who is doing diligence?
 - Has there been diligence by a non-angel investor before?
 - New VC investors will shoulder much of the diligence burden
 - Existing VC investors will likely do none...and they have very different motivations and economics
 - Other strategic investors will have different motivations



Stage 2: Due Diligence and Negotiation

- Common approach: Targeted and piggyback diligence
 - Review disclosure schedules against representations
 - “Passive” diligence via conference call
 - Review only what are key drivers of investment (e.g., key commercial contract, IP, etc.)

Stage 2: Due Diligence and Negotiation

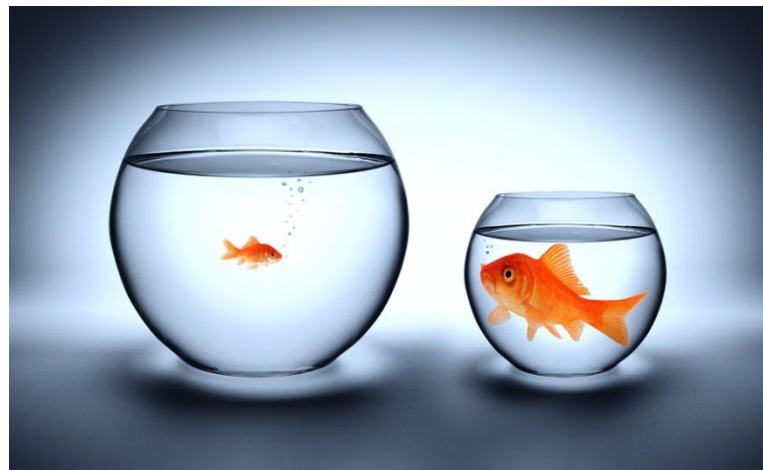
- Level of negotiation will vary based on relative size of investment and what strategic investor brings to financing
- Typical changes to the investment documents
 - Changes to enable unrestricted transferability within corporate family
 - “Major Investor” thresholds
 - Preemptive rights
 - Information rights
 - Are earlier-stage investors special?
 - The celebrity investor
- Corporate governance concerns

Deal Stage 2: Board Seat vs. Observation Rights

- Board seat
 - Fiduciary duties
 - No meaningful ability to influence
 - Can effectively get trapped on the board

VS.

- Observation rights
 - Same access to information to allow monitoring of investment
 - No fiduciary duties
 - Caution should be taken to avoid being a quasi-director



Deal Stage 3: Typical Closing Documentation

- Stock purchase agreement
 - Blackline against prior rounds
- Issuer charter
 - Sets the terms, rights, and preferences of the shares (the economics)
 - Contains the protective provisions: contractual vs. organic
- Investor rights agreement
 - Grants investors registration rights
 - Preemptive rights (a/k/a right of first offer)
- Voting agreement
 - Composition of board of directors

Deal Stage 3: Typical Closing Documentation (Continued)

- Co-sale and right of first refusal agreement
 - Imposes transfer restrictions on founders (maybe investors)
 - Drags and tags
- Strategic agreements
 - IP licenses
 - Distribution
 - Production
 - Consulting



Deal Stage 3: Closing Side Letters

- Importance of a side letter
- Observation rights
- Notice of sale of issuer: COMMON
 - A right of notice of potential sale of issuer (incoming offers and solicitations)
 - Allows for a chance to put a competing offer on table
 - A window to get into a sole process
- More aggressive strategic rights?
 - Right of first offer/negotiation – LESS COMMON
 - Right of first refusal – EVEN LESS COMMON
 - Full option to acquire – EVEN LESS COMMON

Deal Stage 4: Managing the Investment

What Information Is Helpful?

- Financial statements?
- Quarterly capitalization table?
- Copies of 409A valuations?
- Post-board meeting consultation?
- Execution copies of new investment docs?

Deal Stage 5: Exit Sale of Stake to a Third Party

- Secondary sales becoming more typical
- Challenging without issuer support and cooperation
- Rights of first refusal and co-sale rights of other investors implicated



Deal Stage 5: Exit Sale of Issuer to a Third Party

- Typically by merger
- Strategic and investment rights implicated
 - Notice of transaction if a side letter is in place
 - Right to vote in favor (or not); right to dissent/seek appraisal rights
 - Being “drag[ged]-along” is a possibility
- Drag-along rights
 - Strategics usually not permitted to block
 - Consider conditions on the drag-along right (e.g., no drag unless return is greater than 2x)

Conclusion: Key Takeaways

- Strategic venture investing continues to grow in importance
- Strategic venture investing offers significant benefits to both investors and issuers distinguishing it from traditional venture investments
- Terms are complex and deal-specific but certain market norms have evolved

