European technology deal terms:

From founder's rights to bigger deals, *Shawn Atkinson* and *Jamie Moore* chart the ways the global pandemic affected investments in technology

When the global pandemic ushered in a new virtual era, the European tech ecosystem played a key role in supporting the massive shift to online activity. That led to stiff competition for investments in fintech, marketplaces and other sectors.

We reviewed nearly 500 European tech deals we helped close in 2021 to find out how those changes affected deal terms – and to discern what that might tell investors about 2022.

About 53% of the venture financing deals we reviewed were on the company side compared with 47% on the investor side.

Here are five things we learned:

1. Founders gained more say in who sits on the board

About 90% of European tech venture financing deals we helped close last year gave founders the right to appoint someone to the board of directors, a 12.5% increase from the year before. That helped founders protect their positions and bargaining power for future rounds.

By way of comparison, 84% of deals we closed in 2021 gave lead investors a say in naming someone to the board.

That shift unfolded alongside increases in valuation and the size of funding rounds, more unicorns and a robust crop of startups accelerating toward an IPO or liquidation event faster than ever before.

2. Some changes in anti-dilution protection also favoured founders

Among the deals we closed last year, fewer early stage deals included anti-dilution protection for investors.

We also saw companies increasingly move away from anti-dilution protection at Series C rather than Series D.

3. Liquidation preferences remained the norm, especially in later rounds

Roughly 95% of European tech venture-financing deals we handled last year included terms addressing liquidation preferences. Deals without liquidation preferences declined by about 5% but remained the exception rather than the rule.

About 80% of deals we helped close included a 1X non-participating liquidation preference, compared with 15% that included a 1X participating preference.

More than 90% of Series C and 100% of Series D funding rounds and beyond had 1X non-participating liquidation preferences as standard.

4. Founder veto/consent terms varied by deal stage

Most of the deals we closed included founder veto/consent prevalent in earlier stages and dropping off in later stages.

About 40% of deals involving seed funding included founder veto/consent rights. That proportion declined steadily as the size of the funding rounds increased, from 37 percent at Series A to 10 percent at Series D and beyond.

5. The number of deals went up – and so did their size

We closed deals with an aggregate value of more than $20bn last year, about a fifth of the record $100bn-plus investors poured into European tech last year.

The number of deals we closed increased

Lloyds of London wraps up risk-mitigation

David Rose

After more than two decades of rapid capital markets evolution, we have arrived at a place where – outside of retail, startup, SME and corporate banking services – mainstream banks do not have much else to do. Financing for growth, expansion and development now comes from the private capital market in the form of private equity and, more recently, debt.

Growth and returns

The vast $20tn lake of "dry powder" (Source: PFX and industry associations) now managed by private capital funds of all descriptions overwhelms mainstream banking capacity. But, despite this huge resource, for private equity funds the challenge has always been to deliver the consistent growth and returns that ultra and high net worth individuals (U/HNWI) and other private investors demand. In truth, they want to see the same risk-mitigation and long-term returns as they have with the mainstream equity markets.

For private equity investors there is a well-established menu of financing structures. M&A, VC, real estate et al, all have their own unique characteristics and risk versus reward dynamic. But investment is rarely predicated entirely on the investee's assets or balance sheet, but instead with a heavy reliance on forecasts in business plans and prospectuses. Each transaction needs its own individual structure based on its own unique circumstances. Each deal puts the investor's reputation and resources on the line. The necessary extensive due diligence brings added upfront cost, not always resulting in a closed deal.

But, in all this, there is actually a stable and predictable PE investment with a structure common to all transactions. This structure is "project finance". What separates this from all others is that investment is predicated on the financial stability and track record of whoever is contracted to buy the output from the built project, and not those of the investee. Their assets and balance sheet become all but irrelevant.

Wikipedia will still have us believe that project finance is the exclusive domain of mega-$ infrastructure projects funded by top-tier global institutions. When in fact, and increasingly so over two decades, it has been deployed across many sectors with deal values from as low as sub-$10m to $10bn-plus, all funded by private capital investors. Renewables, hospitality, healthcare, transport,

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> David Rose, Project Finance Exchange

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five things we learned in 2021

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> Shawn Atkinson and Jamie Moore, Orrick

35% in 2021 – and the aggregate deal value went up a whopping 210% compared with the year before. Our deal term review showed that later-stage deals – Series C and D – attracted the most substantial levels of investment, with a 99% increase in average deal size in those rounds.

We also saw a record year for mega rounds. Nearly 20% of our European venture financing deals had a value of more than $100m, and almost half of those had a value of $250m or more.

About one in four deals involved investment in fintech, with robust growth in sectors that include marketplaces and energy.

We go into greater depth about our findings from a review of deal terms in European tech in Orrick's new *Deal Flow 2.0 report*. No other venture capital deal review provides the same level of insight into deal terms across all stages against the backdrop of key market trends.

Our review paints the portrait of an ecosystem that hummed with activity in a dynamic market last year – and most signs we see this year point to robust future investment as well.

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insurance for private equity investors

logistics, infrastructure and countless other sectors are all now benefiting from the unique project finance structure.

Insurance wrap

Of specific interest to private equity investors is the recent introduction of insurance wraps. These are constructed of interlinked Lloyds of London-backed policies covering every conceivable aspect of the project. They are underwritten against the financial stability and track record of not only the buyer of the output from the built project, but whoever is going to build it. Indeed, the underwriting drills down to architects, key personnel, specialist contractors (hotel fit-out, specialist construction etc) and much else besides.

The insurance markets are engaged at the same time as the investor commences their due diligence (after signing of conditional terms sheet) with the financial and insurance DD run concurrently to achieve a simultaneous close. When the Wrap is set-up, the Lloyds-of-London A+ rating is endowed upon the project.

In practical terms, for a waste-to-energy (W2E) plant the "contracted off-taker" would usually be a national or regional electricity grid which would have a Power Purchase Agreement (PPA) with the plant signed, or ready to sign, before construction commences. Or, for a hospitality deal the investee could be a hotel operator with a successful track record, or with an operations and management agreement (OMA) with a quality hotel brand. The list is endless, but all with the fundamental 'contracted off-taker' requirement, with the same track record and financial stability criteria applying to whoever is going to build the project.

The underwriting is against the contracts and agreements with landowners or vendors, off-take agreement or PPA, contractor performance agreements and other fixed elements of the project. This means that only the debt financing can be Wrapped but, critically, with the comfort of the Wrap passing onto the private equity component.

Project financings have been predominantly debt, but always with an equity kicker, depending on the risk profile. Now, private equity investors can lead project finance transactions by calling upon debt from elsewhere within their firms, or working with an outsourced private debt provider, to secure the Wrap. A significant added benefit is that the Wrap underwriters contribute significantly to the due diligence process. They charge the client a fixed fee, usually between £5,000 and £10,000 to set up the interlinked policies, with the premiums added to debt repayments.

Project finance evolution

The first recorded project financing was in 1299 when an Italian merchant bank, the House of Frescobaldi, funded a silver mine in Devon, England with the loan repaid with the output from the mine. In itself, the very essence of project finance.

It has taken more than 700 years, but project finance is now a nascent, maturing and potentially deeply liquid global capital market in its own right, witnessed by the opening in 2021 of the Project Finance Exchange (PFX). PFX has the capacity for thousands of investors to seamlessly identify, connect and engage with thousands of projects at any one time. It is a private capital market with no investor or project identifying information available to the public domain. The PFX site also provides direct access to the leading provider of insurance wraps

David Rose is chair of Project Finance Exchange (PFX).