HAN KUN
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Han Kun Law Offices

HAN KUN 2024 VC/PE DATA ANALYSIS

2025.08

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Part 1 Introduction

Han Kun Law Offices is a full-service law firm in China and a leader in venture capital and private equity (VC/PE) transactions. Each year, we act as legal counsel in a large number of VC/PE transactions for our clients hailing from all stripes of the VC/PE investment community. Structured either onshore or offshore, these transactions traverse the entire lifecycle of the VC/PE universe from the angel/seed stage to the pre-IPO round. The data distilled from these transactions, which form the basis of this Report, offer valuable insight into the VC/PE market in China. We publish this Report annually in the hope that participants in China's VC/PE market may find it useful to chronicle the development of the market, understand its underlying logics and gauge its trajectory.

In 2024, the global VC/PE market was subdued. A slowdown in worldwide economic growth and the growing geopolitical tensions dampened investor sentiment and translated into risk aversion among the investment community. The Chinese market, on the other hand, showed a degree of resilience. This was largely due to a series of government policies aimed to maintain economic growth and accelerate reforms and to important technological breakthroughs and their rapid deployment in the market. As an attest to the market resilience, we acted as legal counsel in nearly 250 closings of VC/PE transactions in 2024.

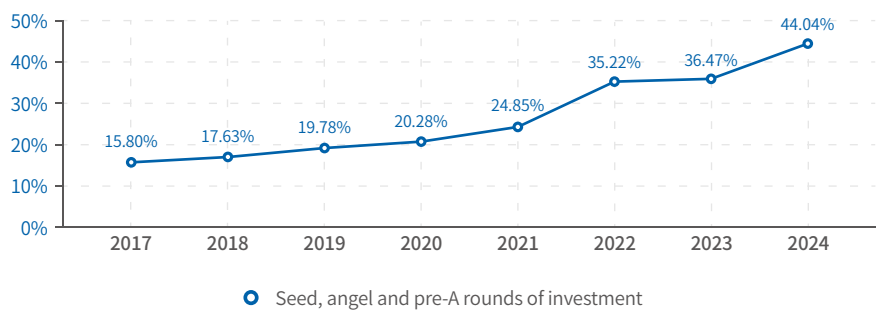
In this Report, we summarize data from the VC/PE transactions that we worked on in 2024 and analyze the investment structures and key legal terms commonly used in such transactions. Where appropriate, data from over 4,100 VC/PE transactions completed in the previous years are cited to highlight the evolving trends and changes in the investment structures and key legal terms. Unless otherwise indicated, the transactions referred to in this Report are VC/PE transactions that we have worked on as legal counsel in any given year(s).

The following trends transpired from the VC/PE transactions in 2024:

◇ **The volume of transactions continued to decline while the average deal value showed a slight increase.** In 2024, investors generally stayed cautious and observant, which suppressed investment activities and softened the VC/PE market. In the aftermath of a trend-down in 2023, the volume of VC/PE transactions in 2024 hit a new low. Correspondingly, the aggregate deal value for the year noticeably declined. Although the average individual deal value of the 2024 VC/PE transactions achieved a slight increase compared to 2023, it still trailed behind the pre-2022 average.

◇ **The percentage of early-stage investments continued to rise.** In 2024, the early-stage investments (seed, angel and Pre-A rounds) accounted for 44.04% of the total, the highest level recorded in the past eight years. By contrast, the share of Series A and later rounds of investments continued to drop for the year. This was especially true of Series C and D rounds of investments which showed the most remarkable contraction among all the VC/PE transactions in 2024.

Percentage of Early-Stage Investments — Changes Over the Past Eight Years

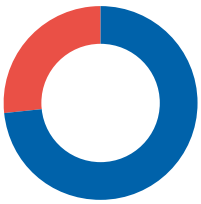


◇ **Onshore transactions continued to gain strength, while in offshore transactions the direct shareholding structure outperformed the VIE structure.** In the VC/PE parlance, an onshore transaction (or onshore structure) is where the investee company establishes an entity registered in China as financing vehicle (onshore vehicle) such that founders and investors would make investments directly into the onshore vehicle and hold their respective equity interest of the vehicle. By contrast, an offshore transaction (or offshore structure) refers to a situation where the investee company uses an entity registered outside of China (mostly in the Cayman Islands, an offshore vehicle) to receive investments while the principal business operation of the company usually remains in China. In such a transaction, founders and investors would invest in the offshore vehicle and hold their equity interest in the vehicle accordingly.

In 2024, transactions with the onshore structure accounted for 73.58% of the total, a record high in the past eight years. The onshore structure is further divided into (i) pure domestic structure where the investee company is 100% owned by domestic entities/persons with no foreign investment and (ii) the FIE structure where the company is partially owned by foreign investors and registered under PRC law as a foreign-invested enterprise. Of the onshore transactions completed in 2024, those using the pure domestic structure and those using the FIE structure accounted for 64.79% and 35.21%, respectively. As a result, the RMB denominated investments made up 67.88% of the VC/PE transactions in 2024, the highest in the past eight years.

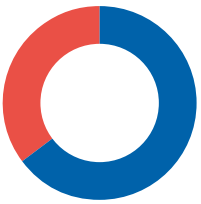
In 2024, transactions with the offshore structure accounted for 26.42% of all VC/PE transactions, the lowest level recorded in the past eight years. The offshore structure is further divided into (i) the VIE structure where the offshore vehicle controls the onshore operating company indirectly through contractual arrangements and (ii) direct shareholding structure where the offshore vehicle directly owns the equity interests in the onshore operating company without any contractual control in the group corporate structure. Among the offshore transactions in 2024, 33.33% adopted the VIE structure, a noticeable drop from 43.27% recorded in 2023. If compared to 99.32% to 70.93% of the offshore transactions that adopted the VIE structure between 2017 and 2022, the 2024 figure is even more dramatic as it represents over 50% decline in comparison. On the other hand, the direct shareholding structures accounted for 66.67% of all offshore transactions in 2024, continuing an upward trend compared to the previous years. In 2023, the use of direct shareholding structures outnumbered the VIE structures for the first time. In 2024, it continued to gain strength.

2024 VC/PE Transactions — Structures



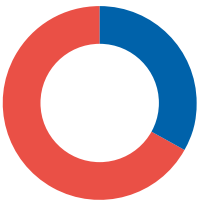
Transaction Structure

- Onshore structure 73.58%
- Offshore structure 26.42%



Onshore Structure

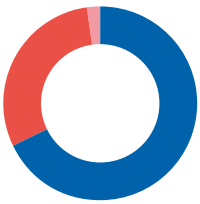
- Domestic structure 64.79%
- FIE structure 35.21%



Offshore Structure

- VIE structure 33.33%
- Direct shareholding structure 66.67%

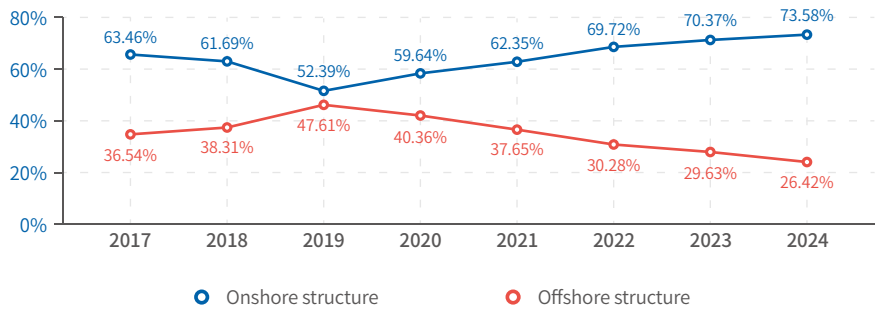
2024 VC/PE Investment Currency



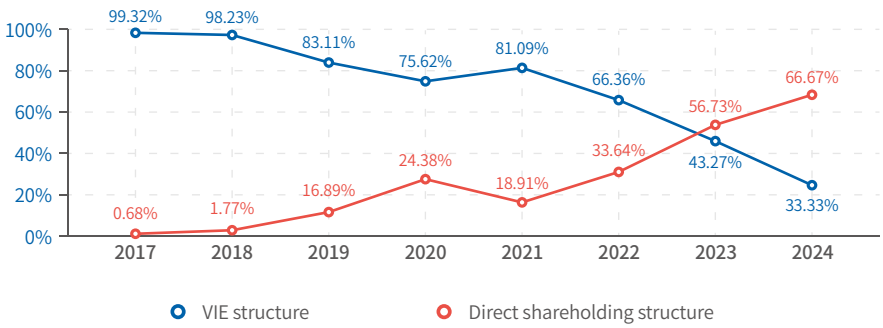
2024 VC/PE Investment Currency

- RMB 67.88%
- USD 30.05%
- HKD 2.07%

Changes in Transaction Structures over the Past Eight Years

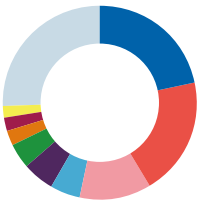


Changes in Transaction Structures over the Past Eight Years — Offshore Structure



◇ Favorite domiciles for investee companies' principal business operations: Beijing, Shanghai and Shenzhen. Our data show that the VC/PE market in Beijing, Shanghai and Shenzhen has remained ebullient over the years and the three cities have been top destinations for investments and entrepreneurial activities. As a corollary, most investee companies continued in 2024 to base their principal operations in the three cities which collectively attracted 53.37% of all VC/PE transactions for the year. It is noteworthy that the number of investments made into companies based in Hangzhou and Suzhou accounted for 5.18% each of the total, ranking them tied for the fourth most favored destinations for VC/PE investments.

2024 VC/PE Transactions — Principal Business Domiciles of Investee Companies



Beijing 21.76%	United States 4.15%
Shanghai 19.69%	Hong Kong 2.59%
Shenzhen 11.92%	Singapore 2.07%
Hangzhou 5.18%	Guangzhou 2.07%
Suzhou 5.18%	Other cities 25.39%

Note: "Other cities" includes Nanjing, Chengdu, Tianjin, Ningbo, Xi'an, Changsha, Wuhan, Hefei, Zhuhai, etc.

◇ Hot sectors for VC/PE investment: Artificial intelligence and biomedical. In 2024, artificial intelligence (AI) was the hotspot that garnered the world attention. Among the VC/PE transactions in 2024, AI software and hardware projects made up 18.65% and 7.25% respectively, aggregating to 25.90% of the total VC/PE transactions for the year. The AI sector was closely followed by biotechnology, healthcare and pharmaceuticals. Collectively, they garnered 21.24% of the VC/PE transactions in 2024. The semiconductor technology sector (e.g., integrated circuits, chips and photolithography machines) came in third with 8.29% share of the total, lower than the 11.11% recorded in 2023. Together, these three sectors attracted more than half of the VC/PE transactions in 2024.

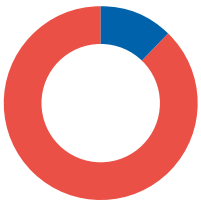
2024 VC/PE Transactions — Market Sectors

- Biotechnology, healthcare and pharmaceuticals 21.24%
- Artificial intelligenee software 18.65%
- Intelligent hardware 7.25%
- Semiconductor technology 8.29%
- New materials and new energy products 6.22%
- Automobiles and transportation 4.15%
- Food catering 4.15%
- Other Sectors 30.05%

Note: "Other Sectors" includes internet finance and financial technology, enterprise services, gaming, e-commerce and live streaming sales, etc.

◇ **Transactions initiated by strategic investors trended upward.** In 2024, the VC/PE transactions initiated by financial investors accounted for 87.56% of the total, a slight decline from the figures recorded in 2022 and 2023 respectively. Conversely, transactions driven by strategic investors increased to 12.44%, a modest rise compared to previous years. It is worth noting that in 62.50% of the strategic VC/PE transactions, the investors entered into strategic/cooperation agreements with the companies they invested in.

2024 VC/PE Investor Type



- Strategic investors 12.44%
- Financial investors 87.56%

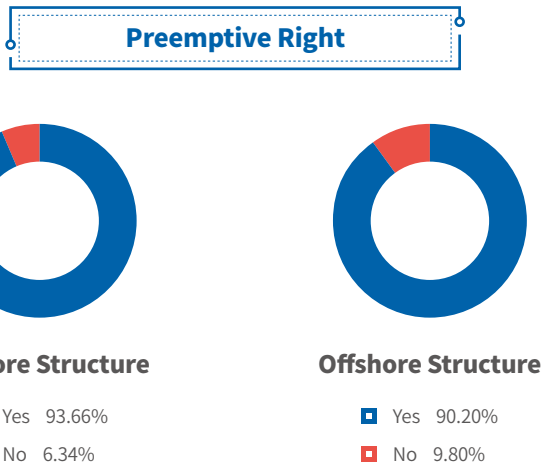
◇ **VC/PE transactions with pre-signed term sheet reached an eight-year low.** In 2024, only 32.12% of the VC/PE transactions commenced pursuant to a term sheet (or letter of intent), the lowest percentage in the past eight years. It is worth noting that transactions with pre-signed term sheet have been trending down since 2018 when they made up 66.44% of the total.

Part 2 Analysis of Key Legal Terms

Preemptive Right

The preemptive right grants certain shareholders (typically investors holding preferred shares[1]) a priority right over other shareholders and third parties to acquire newly issued share capital of the company. This right is designed to protect the shareholding of the investors from being diluted by future capital raising of the company.

According to our data, 92.75% of the VC/PE transactions in 2024 included the preemptive right, a slight drop compared to previous years. The following chart illustrates how this right was allocated in onshore and offshore transactions in 2024.



Note: The PRC Company Law provides that when a limited liability company proposes to increase its registered capital, each shareholder has the preemptive right to subscribe for such new capital in proportion to its paid-up capital in the company's registered capital on terms and conditions that are at least as favorable as those offered to third parties. Thus, in an onshore transaction, absent any alternative agreement among all shareholders to the contrary, even if the preemptive right is not provided for in the transaction documents, all shareholders are still entitled to the preemptive right under the PRC Company Law.

[1] In VC/PE transactions, investors usually hold preferred shares in the company (also known as preferred shareholders), while founders usually hold common shares (also known as common shareholders). The preferred shares carry a series of preferred rights and privileges.

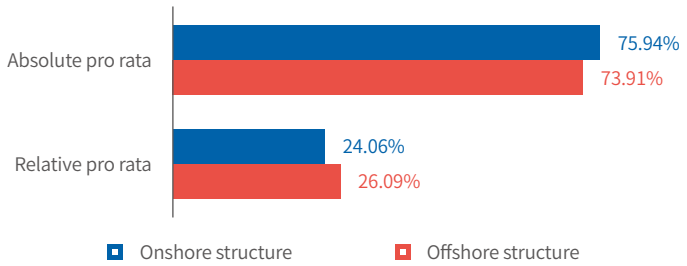
Typically, one of the following two formulas is used for calculating the number of newly issued shares that an existing investor is entitled to acquire (the "preemptive quota") under the preemptive right:

- *Absolute pro rata.* Under this formula, the preemptive quota of each existing shareholder is calculated based on its current shareholding[2] in the company. As a result, the existing investors as a group cannot collectively acquire all the newly issued shares of the company.
- *Relative pro rata.* Under this formula, the preemptive quota of each existing investor is calculated based on its shareholding relative to all existing investors. As a result, the existing investors as a group can collectively acquire all the newly issued shares of the company.

Since the primary purpose of preemptive right is to prevent dilution rather than increase the shareholding of the existing investors, the absolute pro rata is used more often than the relative pro rata formula, as is validated by our data too. In each of the past eight years, 70% to 80% of the VC/PE transactions that included the preemptive right adopted the absolute pro rata formula for calculating the preemptive quotas. In 2024, 75.42% of the transactions did the same.

The chart below shows how the two formulas were adopted in the VC/PE transactions that provided for preemptive right in 2024.

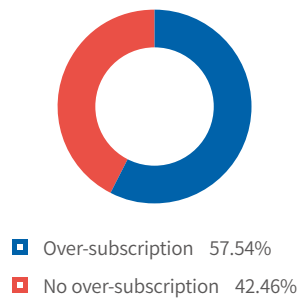
Preemptive Right — Absolute Pro Rata vs. Relative Pro Rata



[2] In offshore transactions, an investor's pro rata share (or shareholding) in a company is usually determined based on the number of common shares deliverable to it upon conversion of its preferred shares (or on an as-converted basis). Under onshore and offshore transactions, parties may further specify the formula for calculating shareholding percentage (e.g., based on the paid-up capital or fully diluted basis).

The over-subscription right often serves as a companion to the preemptive right. It allows a holder of the preemptive right who has fully exercised its preemptive right to acquire additional newly issued shares if another right holder decides not to fully utilize its preemptive quota. According to our 2024 data, about 57.54% of the VC/PE transactions that provided for the preemptive right also made available the over-subscription right.

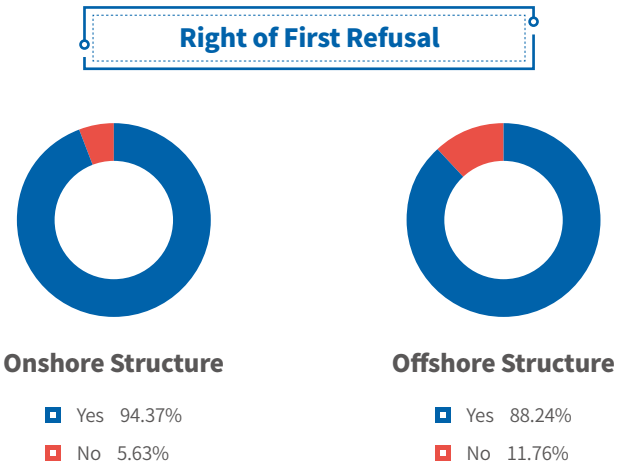
Preemptive Right — Over-subscription Right



Right of First Refusal

When a specific shareholder (the "selling shareholder") proposes to transfer its shares in the company, the right of first refusal (the "ROFR") grants certain other shareholders (the "ROFR holders") the right to acquire such shares ahead of any third party and/or other shareholders on the same terms and conditions as those offered by the third party buyer. The ROFR is designed to restrict share transfers by the selling shareholder and, when exercised, to increase the shareholding of the ROFR holders.

Based on our data, 92.75% of the VC/PE transactions in 2024 provided for the ROFR. The figure below shows how the ROFR was used in onshore and offshore transactions in 2024.



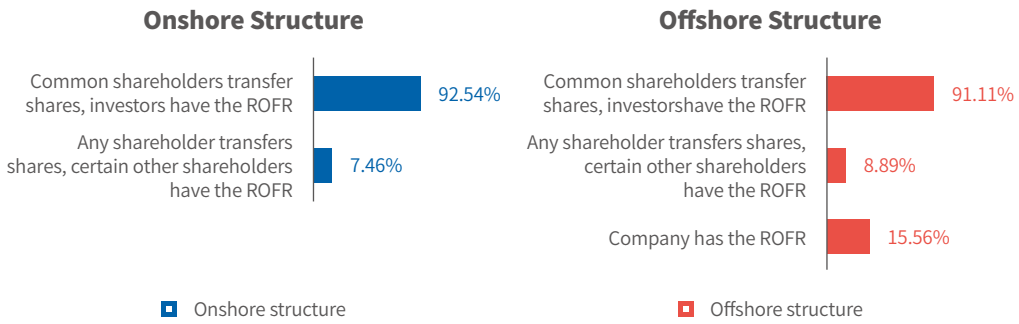
Note: the PRC Company Law contains specific provisions governing the transfer of shares in a limited liability company. Accordingly, in an onshore transaction, even if the ROFR is not expressly provided for in the transaction documents, all shareholders of a limited liability company are still entitled to the ROFR in the manner provided for in the PRC Company Law.

The common methods by which the ROFR is exercised are as follows:

- *If common shareholders transfer shares, investors will have the ROFR.* In most VC/PE transactions, common shareholders (typically the founders) are the target of ROFR. Thus, the most typical ROFR term in deal documentation provides that if a common shareholder proposes to transfer its shares, the investors will have the ROFR to acquire such shares. Our data show that in each of the past eight years this language was adopted in approximately 90% of the VC/PE transactions that provided for the ROFR. In 2024, it was 92.18%.
- *If any shareholder transfers shares, certain other shareholders will have the ROFR.* Each year, there were a small number of transactions where the parties agreed that when any shareholder proposes to sell its shares, certain other shareholders would have the ROFR to acquire such shares. Depending on the deal specifics, such "certain other shareholders" may refer to all investors or all non-selling shareholders. Accordingly, shares to be sold by any investor would similarly be subject to the ROFR.
- *The company is entitled to ROFR.* When a selling shareholder proposes to transfer its shares, the company will have the ROFR. It is commonly agreed that when a shareholder proposes to sell its shares, the company will have the ROFR first, and to the extent the company does not fully exercise its ROFR, other ROFR holders may acquire the remaining shares proposed to be transferred. Under Cayman Islands law, share repurchase by companies is relatively simple to implement. Hence, this approach is commonly adopted in offshore transactions.

The following chart shows how the different approaches were adopted in 2024 VC/PE transactions that provided for the ROFR.

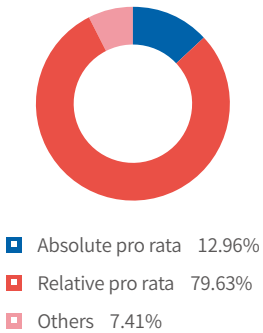
Types of Right of First Refusal



Note: The data include cases where multiple types of the right of first refusal were used simultaneously.

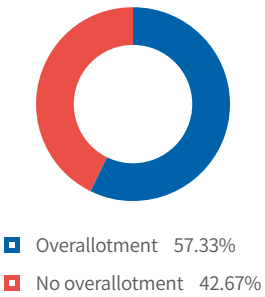
Like the preemptive right, the ROFR may also be exercised on an absolute pro rata or relative pro rata basis. Unlike the preemptive right, however, the ROFR is exercised predominantly on the relative pro rata basis. The rationale is that under the "if common shareholders transfer shares, investors will have the ROFR" scenario, the relative pro rata formula maximizes the ability of investors to acquire all the shares of the founders if they attempt to offload their shares, thereby effectively restricting the founders from selling their shares to third parties. According to our 2024 data, 79.63% of the VC/PE transactions that adopted this model used the relative pro rata approach to calculate the number of shares that an investor is entitled to acquire.

Right of First Refusal — Absolute Pro Rata vs. Relative Pro Rata



Overallotment is another important companion to the ROFR. It is designed to further restrict the selling shareholder from offloading its shares by allowing ROFR holders to acquire shares in addition to what they are otherwise entitled to acquire. Thus, if a ROFR holder does not acquire all the shares it is entitled to acquire, any other ROFR holder who has fully exercised its ROFR can further acquire the leftover shares. According to our 2024 data, the overallotment right was provided for in 57.33% of the VC/PE transactions that adopted the "if common shareholders transfer shares, investors will have the ROFR" model.

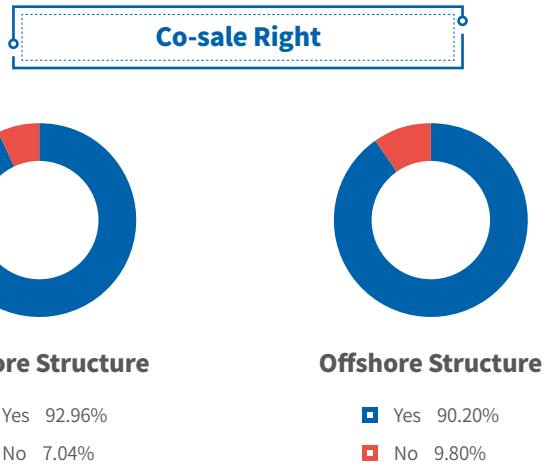
Right of First Refusal — Overallotment Right



Co-sale Right

The co-sale right is a common feature in VC/PE transactions. It allows investors to simultaneously offload their own shares with the founders and thereby further restricts the founders' freedom to transfer shares. Specifically, when a common shareholder proposes to sell its shares, each investor who has not exercised its ROFR may sell its own shares simultaneously with the selling common shareholder at a pre-agreed ratio. As a result, the number of shares planned to be sold by the selling shareholder will be correspondingly reduced. If the prospective buyer refuses to acquire the shares from the co-sale investors, the selling common shareholder cannot consummate the sale of its own shares as a result.

Based on our data, 92.23% of the VC/PE transactions provided for the co-sale right in 2024. The figure below shows how the co-sale right was adopted in onshore and offshore transactions in 2024.



The key to the co-sale right is the formula for calculating the maximum number of shares an investor can co-sell. The table below sets out the various formulas and how they were adopted to implement co-sale right in the 2024 transactions. The first formula, which maximizes the number of shares an investor can co-sell, was the most popular in both onshore and offshore transactions.

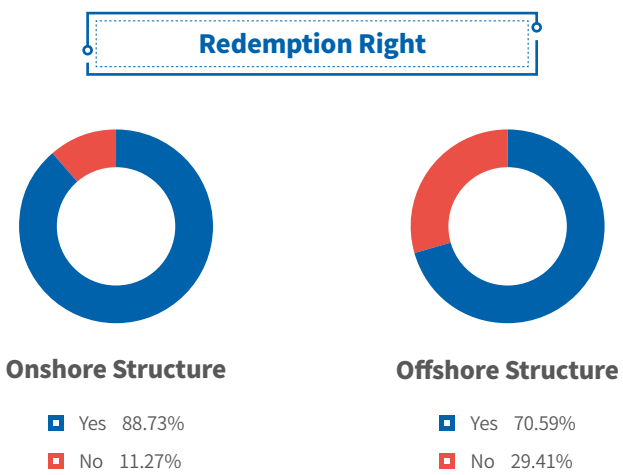
Co-sale Ratio Calculation Formula	Onshore Structure	Offshore Structure
Shares held by the investor / (shares held by all investors exercising co-sale right + shares held by the transferor)	68.94%	56.52%
Shares held by the investor / (shares held by all investors entitled to exercise co-sale right + shares held by the transferor)	15.15%	21.74%
Shares held by the investor / (shares held by all investors + shares held by the transferor)	4.55%	10.87%
Shares held by the investor / all issued and outstanding shares	1.52%	4.35%
Other formulas	9.85%	6.52%

Finally, among the 2024 VC/PE transactions that included the co-sale right, 31.46% provided for "special co-sale right under change of control" provision. Pursuant to this provision, if a share transfer by any common shareholder would lead to a change of control of the company, the investors may co-sell the whole of their shares. According to our 2024 data, the "special co-sale right under change of control" provision was more commonly used in onshore transactions than offshore ones.

Redemption Right

The redemption right (also known as the repurchase right) provides investors with a mechanism to divest their investment in the company. Specifically, it allows the investors to force the company and/or the founders to redeem their shares at a pre-agreed price upon the occurrence of one or more trigger events (the "redemption trigger events").

Based on our data over the past eight years, the redemption right was overwhelmingly adopted in both onshore and offshore transactions. However, in 2024 only 83.94% of the VC/PE transactions adopted the redemption right, the lowest level in the past eight years. Those that did not provide for the redemption right were predominantly offshore transactions. The following chart shows how the redemption right was used in onshore and offshore transactions in 2024.



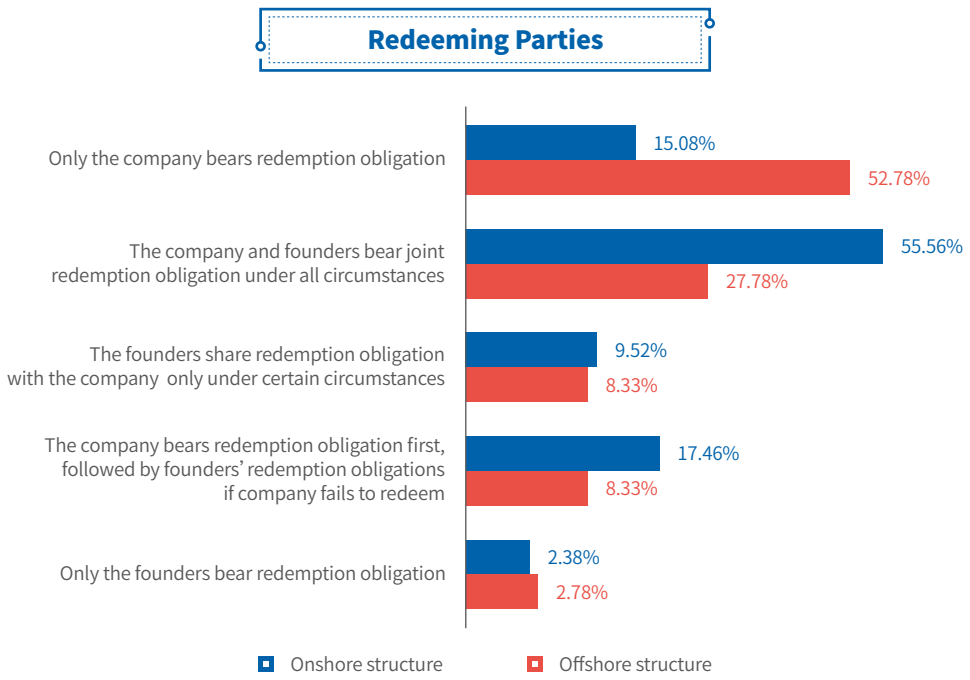
Onshore and offshore transactions differ substantially in terms of which party to bear the redemption obligation. In most offshore transactions, the obligation falls solely on the company. In onshore transactions by contrast, founders and the company are usually jointly liable for the redemption obligation. This divergence primarily stems from the differences in law and judicial practice of the jurisdictions where the financing vehicles are established. In some foreign jurisdictions (typically, the Cayman Islands), procedures for share redemption are straightforward. However, the procedures for share repurchase by limited liability companies under the PRC law are relatively complex. Thus, investors in onshore transactions usually require that founders and companies be jointly responsible for the redemption to ensure successful redemption. In this context, it is noteworthy that the offshore VC/PE transactions where the redemption obligation rests solely with the company have steadily declined in recent years. In 2024, only 52.78% of the offshore transactions with the redemption right required that the company be the sole party responsible for the redemption obligation, while those requiring founders to jointly bear the redemption obligation increased slightly. This reflects that in recent years investors in offshore transactions demanded a higher certainty to exit their investment.

When required to be jointly responsible for the redemption obligation, founders often seek to limit their personal risk exposure through various workarounds, such that their obligation will only be triggered (i) under certain pre-agreed circumstances or (ii) if the company is unable to carry out the redemption due to legal obstacles or the lack of funds.

The following is a summary of the common variations as to which parties to bear the redemption obligation:

- the company alone bears the redemption obligation;
- the company and founders jointly bear the redemption obligation under all circumstances;
- the founders share the redemption obligation with the company only under limited circumstances;
- the company bears the obligation first and the founders would be required to share the redemption obligation if the company fails to fulfill its redemption obligation; or
- the founders alone bear the redemption obligation.

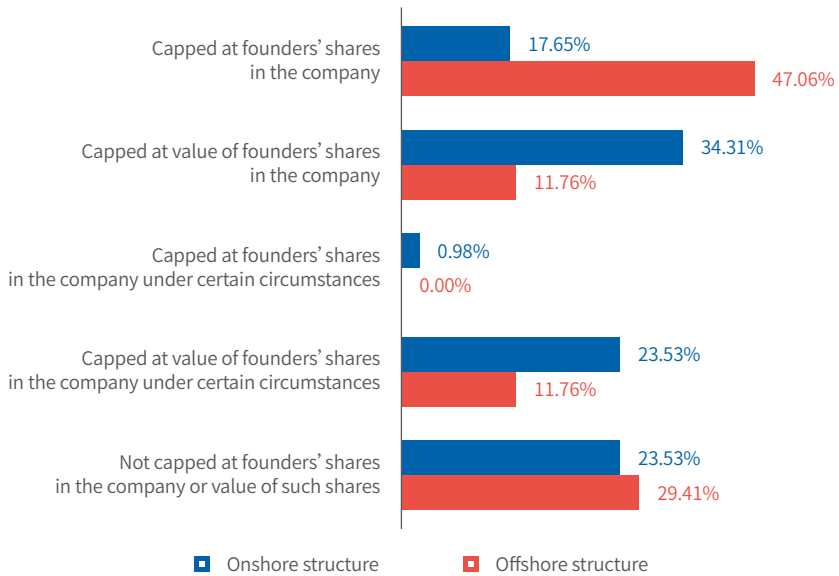
The chart below presents a breakdown of how the redemption obligations were allocated in onshore and offshore transactions in 2024.



Where founders are responsible for the redemption, they often seek to cap their obligation to protect their personal and family assets. Typically, the cap is structured such that, under all or specific circumstances, the redemption obligation is limited to the founders' shares in the company or the value of such shares.

The chart below shows the various caps that founders used to limit their redemption obligation in 2024 transactions where they assumed the redemption obligation.

Redeeming Parties — When Founders Assume the Redemption Obligation, the Capped Amount

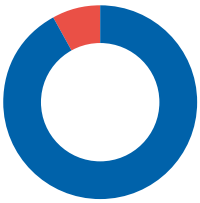


Investors may demand the company and/or the founders to redeem their shares if and only if a trigger event occurs. In this context, three trigger events are most common, as follows:

(1) Material breach by the company and/or founders of the transaction documents

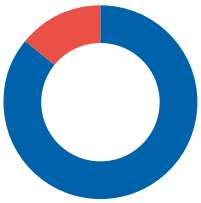
In 2024, this was the top trigger event for investors to demand redemption. It was adopted in 90.74% of the VC/PE transactions with the redemption right.

Redemption Trigger Event — Material Breach of Transaction Documents by Company and/or Founders



Onshore Structure

- Yes 92.06%
- No 7.94%

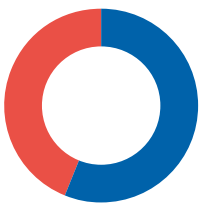


Offshore Structure

- Yes 86.11%
- No 13.89%

Since the benchmark for materiality is often elusive, it is often difficult to ascertain whether a breach constitutes a material breach. To resolve this uncertainty, companies and founders often request a grace period to cure the breach such that investors may only demand redemption if the breach remains uncured after expiration of the grace period. Like in 2023, about 56.16% of the transactions with this trigger event set out a grace period in 2024.

Redemption Trigger Event — Material Breach of Transaction Documents by Company and/or Founders Use of Grace Period

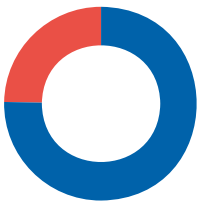


- With grace period 56.16%
- Without grace period 43.84%

(2) Failure to consummate a qualified IPO within requisite time limit

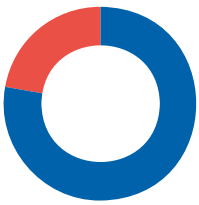
As shown in our data, where the redemption right was accorded to investors, 75.93% of the transactions in 2024 provided that if the company failed to complete a qualified IPO within a requisite time limit, the investors could demand redemption of their shares. In previous years, an overwhelming majority of transactions (over 82%) made the IPO time limit a condition to trigger the redemption obligation. As is shown below, this percentage dropped noticeably in 2024.

Redemption Trigger Event — Company's Failure to Complete Qualified IPO within Required Time Limit after Closing



Onshore Structure

Yes 75.40%
No 24.60%



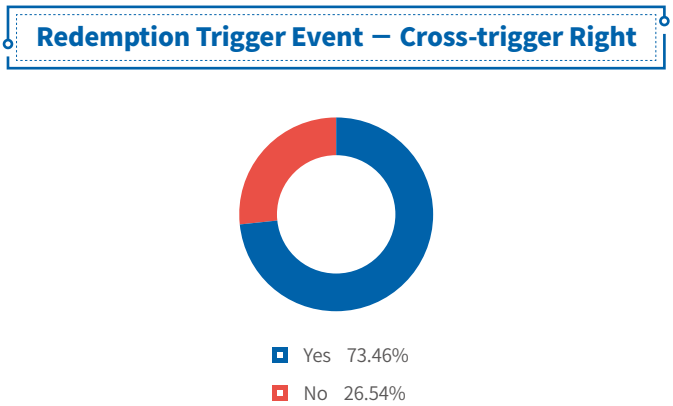
Offshore Structure

Yes 77.78%
No 22.22%

A three-to-five-year time limit is typical for investors to require a company to complete the qualified IPO (the "IPO time limit"). However, in about 70% of angel, seed or Pre-A round VC/PE transactions, the IPO time limit often exceeds five years. As shown in our 2024 data, among the VC/PE transactions that used the IPO time limit, 48.78% of them had a time limit longer than five years, a noticeable increase compared to the previous year. Conversely, only 39.02% set an IPO time limit within the three-to-five-year range in 2024. We believe that this had a lot to do with the steady increase of early-stage investments over the past few years and with the persisting uncertainties in domestic and overseas listing environments.

(3) Demand for redemption by other investors

In 2024, among the VC/PE transactions providing for the redemption right, 73.46% provided that if an investor demanded redemption, any other investor could also demand redemption (the "cross-trigger right"). This 73.46% was the highest percentage in recent years.



The rationale for the cross-trigger right is to prevent an investor being disadvantaged when the redemption enforced by another investor may bleed the company dry of cash and suppress the company's valuation. Since each round of financing would have an IPO time limit running from the financial close, the IPO time limit of a subsequent financing would expire later in time than that set in the previous round of financings. Thus, the redemption right of the earlier round investors would be triggered sooner than that for the subsequent investors. For this reason, investors in subsequent rounds of financing sometimes require the earlier investors to extend their IPO deadline. Companies may also request an extension as it would ease the time pressure on the company to accomplish the IPO. In 2024, in about one-third of the subsequent-round VC/PE transactions, investors in earlier rounds all agreed to extend the existing IPO deadlines. If, on the other hand, the earlier investors insist on sticking to their original IPO time limit, subsequent investors often request a cross-trigger right so that they could enforce redemption simultaneously with the earlier investors.

In addition to the three redemption trigger events discussed above, other common triggering events include (i) failure of founders or the company management to meet an integrity test, (ii) criminal liabilities of the founders, (iii) failure of the company to obtain or retain key licenses or intellectual properties, (iv) illegality of the company's business operation due to change of the PRC legal environment.

The redemption price is typically calculated based on the following formulas:

(a) multiples of the investment principal amount;

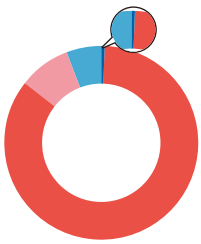
(b) investment principal amount (or certain multiples thereof) + simple or compound interest accrued thereon; or

(c) the higher of (i) the amount as per (a) or (b) and (ii) certain other benchmarks such as the fair market value or audited net assets value.

As shown in our data over the past eight years, formula (b) was the most popular for the calculation of the redemption price, regardless of whether the underlying transactions were structured onshore or offshore. According to our 2024 data, formula (b) was used in 84.57% of the transactions that adopted the redemption right. This seems to suggest that investors and companies preferred a formula that could adjust the price by factoring in the timing of the exit.

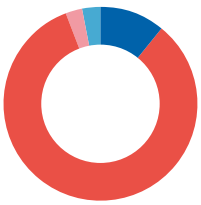
The chart below shows how the various formulas were used in the 2024 transactions that included the redemption right.

Formulas for Calculation of Redemption Price



Onshore Structure

- Multiples of investment principal 0.79%
- Investment principal (including multiples thereof) + simple/compound interest 84.92%
- Higher of two or three models 8.73%
- Others 5.56%



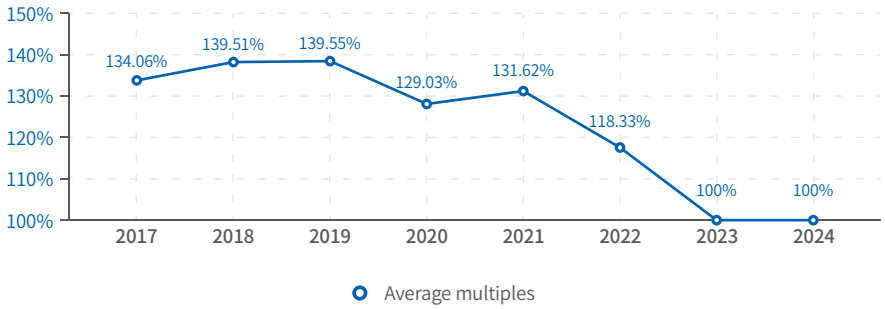
Offshore Structure

- Multiples of investment principal 11.11%
- Investment principal (including multiples thereof) + simple/compound interest 83.33%
- Higher of two or three models 2.78%
- Others 2.78%

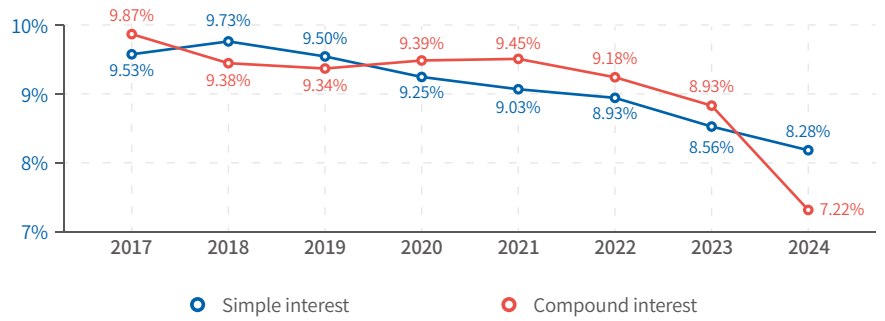
Based on our 2024 data, where the redemption price was calculated based on formula (a) (multiples of the investment principal), the average multiple was 100%, same as in 2023, the lowest in the past eight years. Where the redemption price was calculated based on formula (b) (investment principal or certain multiples thereof + simple or compound interest accrued thereon), the average interest rate was 8.28% annualized simple interest or 7.22% annualized compound interest, representing a trend-down as compared to the previous years.

The drop of redemption price correlated with the global economic slowdown in 2024 which lowered the expectations of certain institutional investors about the internal rate of return of the companies they would invest in. Likewise, some companies and founders became increasingly vigilant and protective about the redemption price as the economic uncertainties increased the likelihood of triggering their redemption obligations.

Redemption Price — Multiples of Investment Principal
Average Multiples Trend over the Past Eight Years



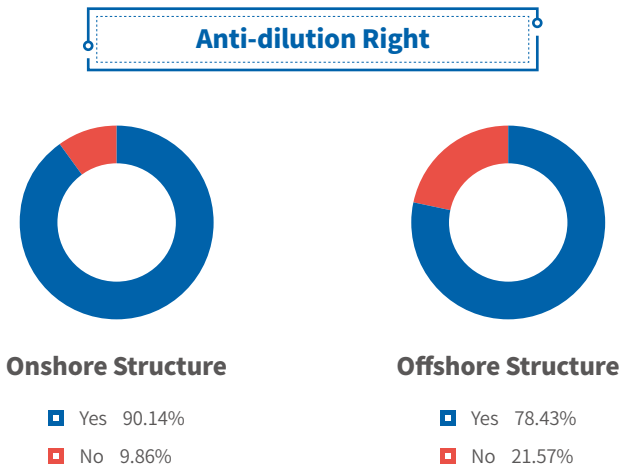
Redemption Price — Investment Principal (or certain multiples thereof) + Simple/Compound Interest
Average Interest Trend over the Past Eight Years



Anti-dilution Right

When a company raises a new round of financing at a price lower than the previous round (a down round), the anti-dilution right allows the existing investors to adjust the price per share they paid in the previous round in accordance with a pre-agreed formula such that they would be entitled to obtain additional shares to compensate for the higher price they paid before. In offshore transactions, the anti-dilution right is often actualized by adjusting the conversion price between the preferred shares and common shares such that each preferred share can be converted into additional common shares. In onshore transactions where share conversion is not explicitly permissible by law, the adjustment is often effected in one of the following ways: (i) the company issues additional shares to the affected investors at a nominal price, (ii) the founders transfer part of their shares to the affected investors at a nominal price or (iii) the company and/or founders provide cash compensation to the affected investors.

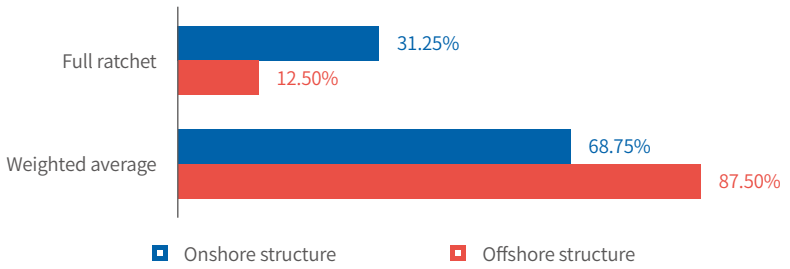
According to our data, in each of the past eight years, over 90% of the VC/PE transactions included the anti-dilution right. In 2024, this percentage dropped to 87.05%. The chart below illustrates how the anti-dilution right was adopted in onshore and offshore transactions in 2024.



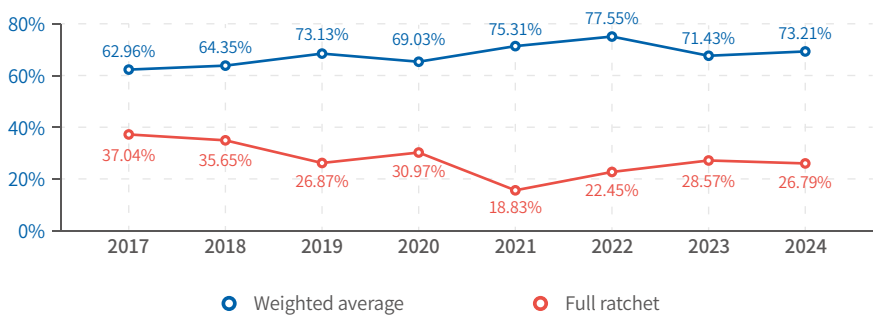
For the share price adjustment, there are two main methodologies-the “full-ratchet” and the “weighted average”. Although the weighted average formula offers less robust protection to investors than the full-ratchet formula, it is more agreeable to companies and more widely used in VC/PE transactions.

The chart below shows how these two formulas were used in the 2024 transactions that provided for the anti-dilution right. As is shown in the chart, the overwhelming majority used the weighted average formula to adjust the share price in both onshore and offshore transactions.

Anti-dilution Right — Full Ratchet vs. Weighted Average



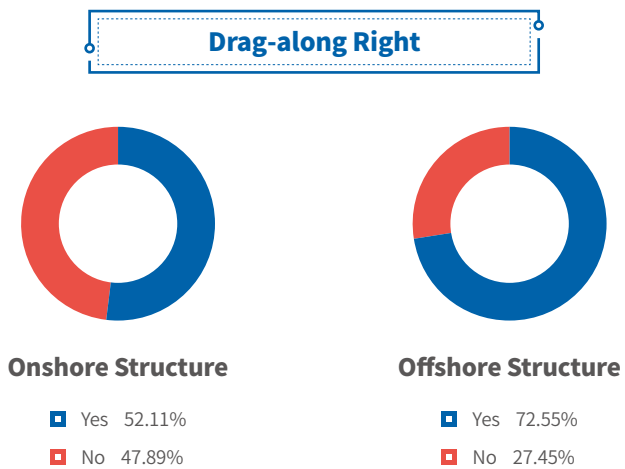
Formulas for Calculation of Anti-dilution Right over the Past Eight Years



Drag-along Right

The drag-along right grants certain investors the right to force all other shareholders of the company to participate in the trade sale of the company when certain pre-agreed conditions materialize. A trade sale involves the sale of all or substantially all the company's equity and/or assets to a third party. When a prospective trade sale offers good price and/or conditions, investors may be motivated to exit investment with a desirable return on their investment. However, since investors are usually minority shareholders with no control over the company, they cannot proceed with the trade sale without the consent and cooperation of other shareholders. The drag-along right is therefore important to the investors as it empowers them to force all other shareholders to consent to and follow through with the trade sale.

As our data show, 57.51% of the VC/PE transactions in 2024 provided for the drag-along right which was more common in offshore transactions than in onshore ones. The chart below illustrates how the drag-along right was used in onshore and offshore transactions in 2024.



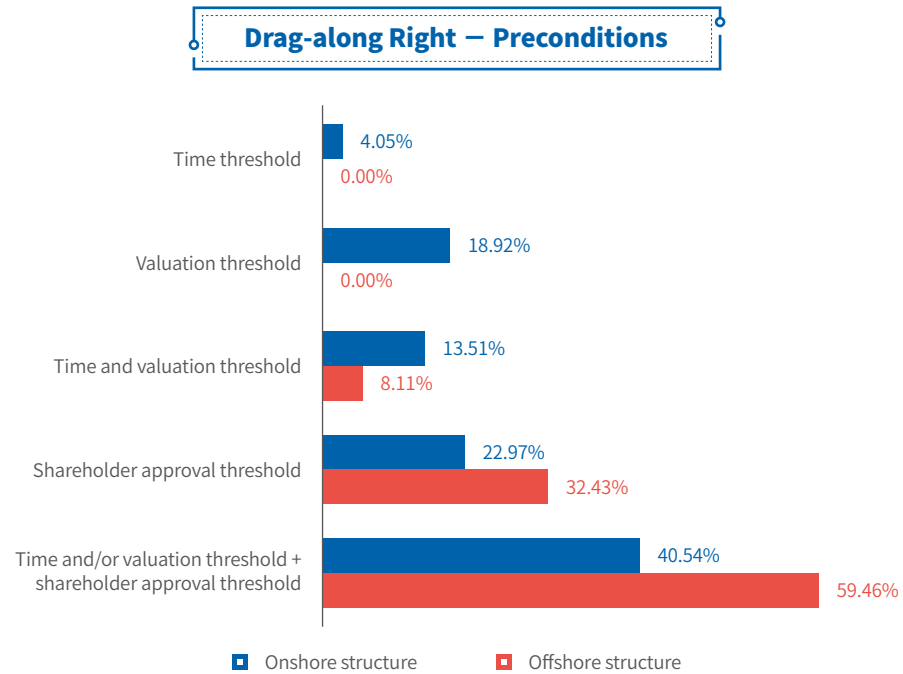
Parties entitled to the drag-along right are usually investors, including any specific investor(s) or the investor(s) holding a requisite percentage of shares. In some VC/PE transactions, however, founders may also insist that the trade sale of the company be subject to their approval or approval of their appointed directors. Among the 2024 transactions that provided for the drag-along right, around one-third required only the consent of the investors to effectuate the drag-along right. Transactions where the consent of the founders or their appointed directors was required accounted for 43.34% of the total.

Since the drag-along right may cause drastic changes to the equity and/or asset composition of the company, it is often agreed that investors may not exercise the drag-along right unless certain preconditions materialize, which typically include the following:

- A period of time has elapsed after the investment close (the "time threshold");
- Valuation of the company in the trade sale has reached a set target (the "valuation threshold");
- Both the time threshold and valuation threshold must have been met (the "time and valuation threshold");
- The trade sale and its terms have been approved by the shareholders holding a requisite percentage of the company's shares (the "shareholder approval threshold"); or
- Satisfaction of both time threshold and/or valuation threshold and shareholder approval threshold (the "time and/or valuation threshold + shareholder approval threshold").

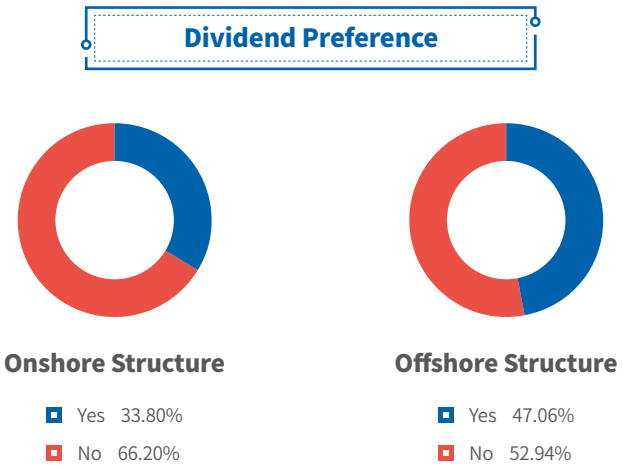
As is shown in our data, shareholder approval is a prerequisite in most VC/PE transactions for investors to enforce the drag-along right. This remained true in 2024 where the "time and/or valuation threshold + shareholder approval threshold" and the "shareholder approval threshold" were almost ubiquitous as preconditions for the drag-along right accounting for 46.85% and 26.13%, respectively, of the VC/PE transactions providing for the drag-along right. The lone use of the "time threshold" was the rarest, accounting for only 2.70%. It is worth noting that in 2024 the lone use of the "time threshold" and the "valuation threshold" as the drag-along precondition occurred only in onshore transactions.

The chart below shows a breakdown of the preconditions in the 2024 transactions that provided for the drag-along right.

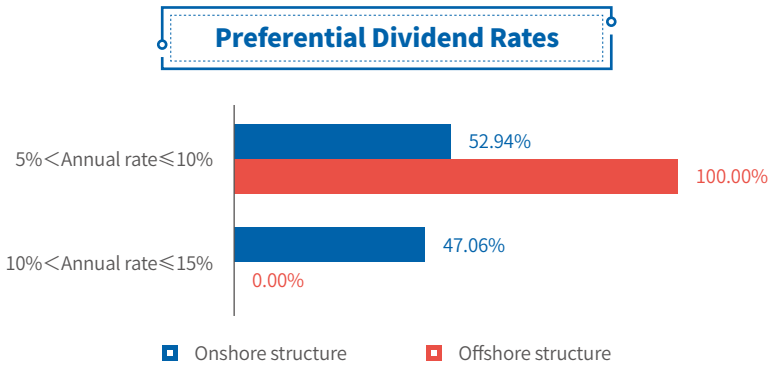


Dividend Preference

The dividend preference grants investors the right to receive dividends ahead of common shareholders. In practice, many investors do not demand a dividend preference because dividend income is not their primary motivation for investment in the first place, especially for start-up companies that are not expected to become profitable in short order. Our data seem to support this observation. In 2024, 62.69% of the VC/PE transactions did not include the dividend preference, and this was particularly true in onshore transactions than offshore ones.

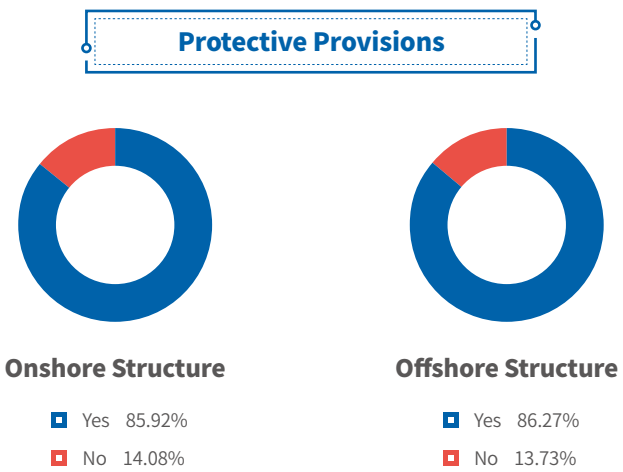


In transactions where the dividend preference is provided for, some investors also require that the dividend amount be calculated pursuant to an annual rate of interest (the "investor dividend rate") accrued on the principal of their investment. Among the 2024 VC/PE transactions that provided for the dividend preference, 31.94% specified that investors' dividend amounts be calculated pursuant to the investor dividend rate. Typically, the investor dividend rates were between 5% and 10% per annum. However, in 2024 only 65.22% of the investor dividend rates were between 5% and 10%, while 34.78% of the rates (all in onshore transactions) fell in the 10%—15% range. The following chart shows how the different investor dividend rates are spread in the 2024 transactions.



Protective Provisions

Protective provisions grant certain shareholders or their appointed directors the right to veto specific matters of the company. Matters subject to the veto right, known as "reserved matters", often relate to issues vital to the company such as the company's share structure, business operations, disposal of assets, incurrence of debt, corporate restructuring and liquidation. According to our data, 86.01% of the VC/PE transactions in 2024 included the protective provisions.



Since the protective provisions are designed to protect the interests of investors, the veto right is generally granted to the investors (including specific investors or investors holding a certain percentage of voting rights) and/or their appointed directors. The veto right may be exercised at the shareholder level, the board level, or both. Reserved matters subject to the veto right at the shareholder level generally concern the share structure, shareholder rights, amendments to the articles of association, mergers, splits, liquidation and dissolution of the company. Reserved matters subject to the veto right at the board level usually pertain to important business operations of the company.

At the shareholder level, the veto right is generally enforced by:

- only one series of preferred shareholders (including any specific preferred shareholder(s)), which usually occurs in early-stage financing;
- holders of certain percentage of voting rights in each series of the preferred shares, exercising separately; or

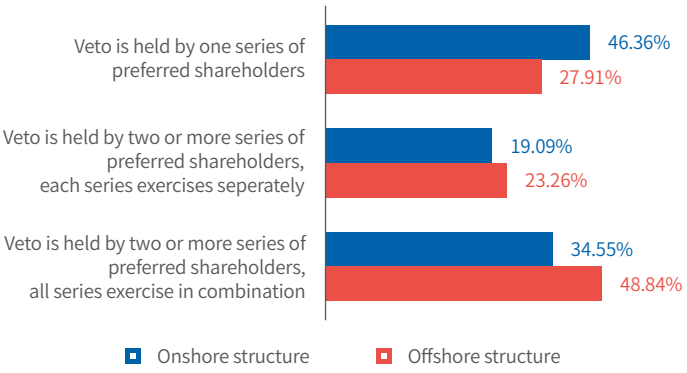
- holders of certain percentage of voting rights across all series of the preferred shares, calculated in the aggregate.

At the board level, the veto right is generally exercised by requiring the reserved matters to be approved by

- each investor-appointed director; or
- a certain percentage of all investor-appointed directors.

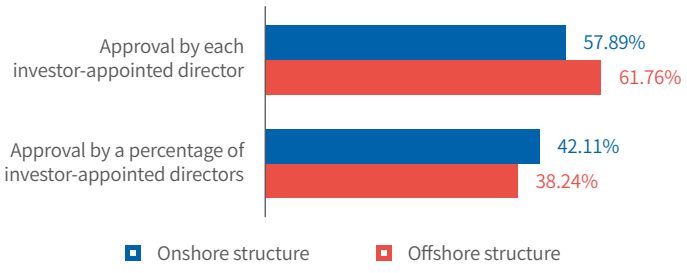
The chart below presents a breakdown of the veto right mechanisms at the shareholder level in the 2024 transactions.

Protective Provisions — Veto Right Mechanisms at Shareholder Level



The chart below presents a breakdown of the veto right mechanisms at the board level in the 2024 transactions.

Protective Provisions — Veto Right Mechanisms at Board Level

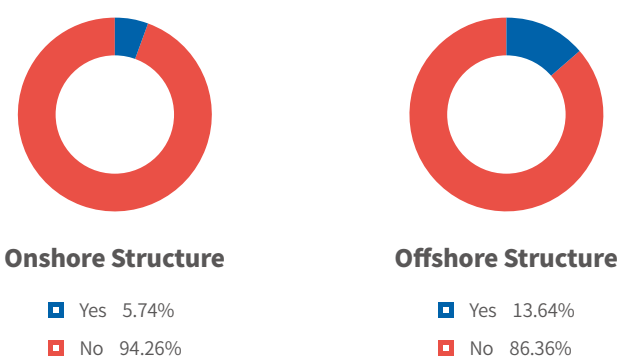


In some VC/PE transactions, the company set a threshold to restrict the investors' veto right. For instance, an investor (or its appointed director) would be entitled to the veto right only if it holds at least a certain number or percentage of shares of the company. The veto right would be relinquished should the number or percentage of the shares fall below the threshold either resulting from a share transfer or share dilution. In the 2024 transactions where the protective provisions were provided for, 27.71% (mostly offshore transactions) established such a threshold to restrict the veto right.

Finally, after multiple rounds of financing, the ownership of the founders may be diluted up to a point where they lose control of the company. For example, in 2024, in about 9% of the VC/PE transactions, the founders' shareholding in the company fell below 30% after the capital raising. Given this situation, founders would likewise seek a special veto right relating to matters vital to the company. As shown in our data, in each of the past eight years about 4% to 10% of the VC/PE transactions granted a special veto right to the founders (or their appointed directors). In 2024, this percentage was 7.83%.

The following chart shows whether the founders (or their appointed directors) enjoyed a special veto right in 2024.

Protective Provisions — Whether Founders (or their appointed directors) Have Veto Right for Certain Reserved Matters



Note: The data include cases where investors were given the veto right simultaneously.

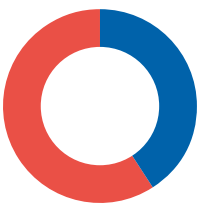
Board Composition

In most VC/PE transactions, directors appointed by founders tend to dominate the company board. For example, in each of the past eight years, there were only 2—5% of VC/PE transactions where the votes controlled by founder-appointed directors were less than or equal to those controlled by investor-appointed directors. To counter the dominance of founder-appointed directors and to participate in vital decisions for the company, investors usually demand the right to appoint directors to the board. In 72.02% of the VC/PE transactions in 2024, investors secured the right to appoint directors.

From the company's perspective, however, as the number of investors increases, the company may want to limit the number of investor-appointed directors. One option is to set a threshold for investors to appoint directors. Specifically, the company may require investors to hold a minimum number or percentage of the company shares as a condition for appointing directors. This is akin to restricting investors' veto right discussed above. If the number or percentage of shares held by an investor fell below the minimum, such investor would lose the right to appoint directors. Our record shows that in the past eight years this type of restriction has trended upwards. In the 2024 VC/PE transactions that included investors' right to appoint directors, 46.04% of the companies established a threshold to limit such rights, more often in offshore transactions than in onshore ones.

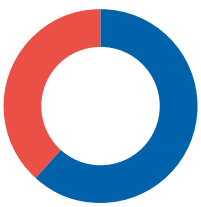
The chart below shows the use of the threshold for investors' right to appoint directors in the 2024 transactions.

Investors Must Hold a Certain Percentage or Number of Shares to Appoint Directors



Onshore Structure

- Yes 40.95%
- No 59.05%



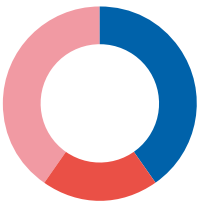
Offshore Structure

- Yes 61.76%
- No 38.24%

Employee Equity Incentive Plans

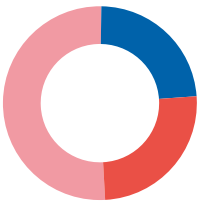
Employee equity incentive plans, customarily known as "ESOPs", are a standard feature in most start-up companies. They are designed to motivate senior officers and key employees to serve and create value for the companies on a continuous basis. Our data show that in the 2024 VC/PE transactions, 35.75% of the companies adopted specific ESOP programs at or before the investment close, while 43.01% reserved shares for ESOPs at the investment close and agreed to establish specific ESOP programs afterwards. The chart below illustrates the breakdown of the investee companies that established or plan to establish ESOPs at the investment close in onshore and offshore transactions in 2024.

ESOPs at the Closing



Onshore Structure

- Have complete ESOP 40.14%
- No ESOP 19.72%
- Reserved shares and will establish ESOP after closing 40.14%

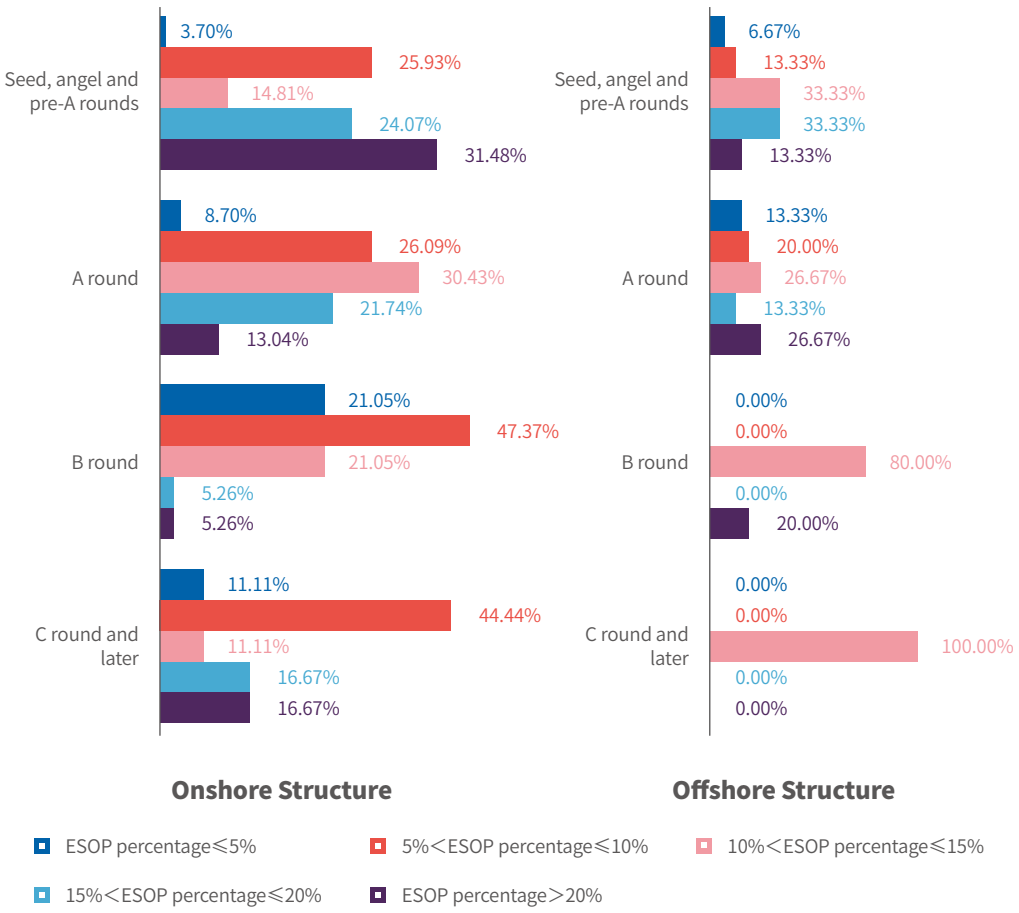


Offshore Structure

- Have complete ESOP 23.53%
- No ESOP 25.49%
- Reserved shares and will establish ESOP after closing 50.98%

The proportion of share capital allocated to ESOPs may be adjusted by the company based on its business needs and to accommodate multiple rounds of capital raising. As shown in our 2024 data, in onshore transactions, most companies allocated 5% to 10% of their share capital to support ESOP programs, while in offshore transactions, this percentage typically ranged between 10% and 15%. The chart below shows the percentage of shares reserved for ESOPs in each financing round.

Percentage of Shares Reserved for ESOPs in Each Financing Round



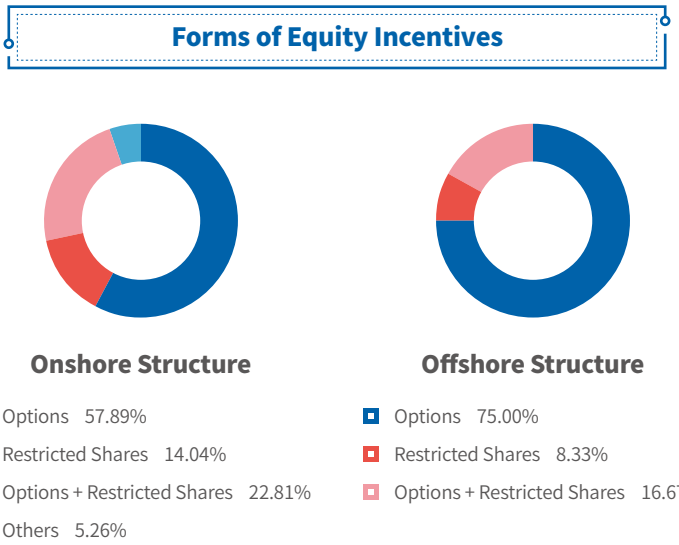
Equity incentives under ESOPs may take different forms with the following being the most common:

- *Stock options.* The company grants employees stock options to acquire a specified number of shares at a predetermined price within a definitive time subject to certain conditions. The options typically would vest over time with the employees according to a schedule set forth in the relevant agreement between the company and the employees. When employees exercise their vested options, the company will issue shares to them accordingly.
- *Restricted shares.* The company directly issues shares to the employees subject to certain restrictions for a definitive time. The restrictions typically involve a schedule that governs the release of the shares. Before release, the shares are subject to certain restrictions or conditions, such as transfer, voting and the company's right to redeem the shares.

Other forms of equity incentives may include restricted share units and stock appreciation rights.

According to our data for 2024, among the VC/PE transactions that established specific ESOP programs, 91.67% offshore companies and 80.70% onshore companies adopted stock options, while 25% offshore companies and 36.84% onshore companies adopted restricted shares[3]. As is clearly shown in our data, stock options were the most popular form of incentive under ESOPs both for onshore and offshore transactions.

[3] For stock options, the percentages include case where only stock options were granted and case where multiple forms of incentives (which include stock options) were granted concurrently. Similarly, for restricted shares, the percentages include case where only restricted shares were granted and case where multiple forms of incentives (which include restricted shares) were granted concurrently.



Equity incentives may be issued to employees through various channels with the following being the most common:

(a) *Direct issue method.* The company directly issues equity incentives to employees.

(b) *Platform issue method.* The company has the founders or senior officers set up one or more platforms, either directly or indirectly, to hold the incentive shares of the company for the benefit of employees. Eligible employees would hold equity incentives at the platform level in an amount corresponding to their entitlement in the company under the ESOP programs.

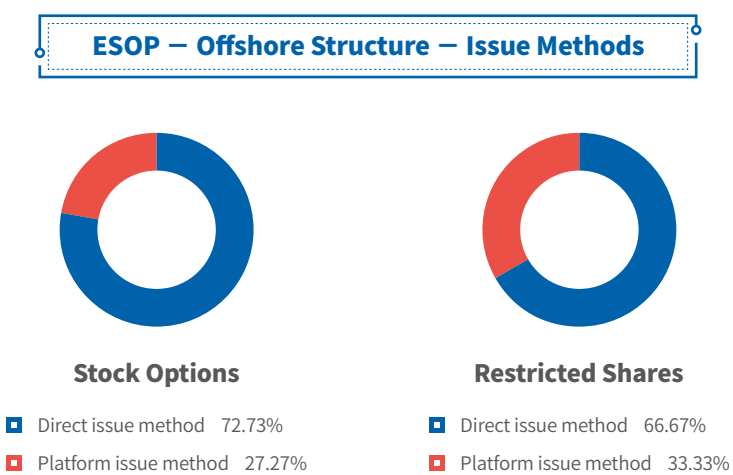
(c) *Trust method.* The founders hold equity incentives in trust for the benefit of the employees with the arrangement formalized by contract between the founders and the employees.

Due to differences in laws and regulations, offshore and onshore transactions employ different methods to issue equity incentives.

(1) Offshore Transactions

For both stock options and restricted shares, offshore companies often implement ESOP programs through the direct issue method. This approach is favored because in some foreign jurisdictions (typically, the Cayman Islands) the procedures for directly issuing options or shares are straightforward and it is not necessary for the company to register the stock options or update the shareholder registrar when the options are issued. A Cayman Islands company may reserve certain number of shares from its share capital for the ESOP program, known as the "ESOP pool", and then grant stock options to the employees against the shares in the ESOP pool. When an employee exercises his stock options, the company will issue corresponding shares from the ESOP pool to the employee. Prior to exercising, the employee does not legally own the shares. The direct issue method is easy to effectuate and is commonly used for stock options. It is noteworthy that if the employees are Chinese nationals, extra care is called for if the offshore company intends to directly issue the incentive shares to the employees. Under the PRC foreign exchange regulations, Chinese employees are required to register their holdings of shares in an offshore company.

Based on our 2024 data, in offshore transactions where specific ESOP programs were established, over 70% of the companies chose the direct issue method, while fewer than 30% opted for the platform issue method.



Note: The data are based on cases in which multiple issue methods are adopted simultaneously.

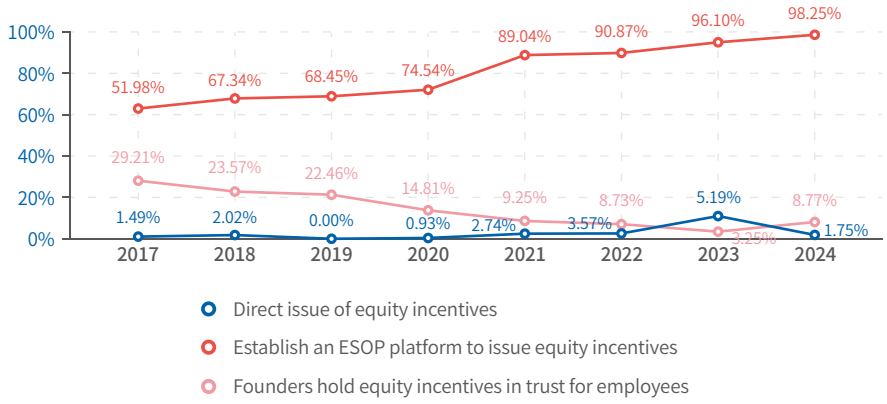
(2)Onshore Transactions

Under the PRC Company Law, the concept of reserved shares is not recognized and the number of shareholders in a limited liability company may not exceed 50. As a result, in onshore VC/PE transactions few companies implement ESOP programs through the direct issue method. Instead, onshore companies typically use a platform to issue equity incentives. At the platform level, employees may own the shares or units of interest either (i) directly or (ii) by virtue of contractual arrangement between them and the company without having the employees registered as owners of the shares.

According to our 2024 data, 98.25% of the onshore companies that established ESOP programs chose the platform method to issue equity incentives. Meanwhile, a small number of onshore companies used the trust method either singly or in conjunction with other methods. It is important to note that Chinese listing rules require that any prospective A-share company must have a clear and transparent ownership structure. To comply with this requirement, companies aiming to list on the A-share market need to register all the employees holding stock options or incentive shares and carefully manage any unexercised options and shares held in trust before listing.

Where the platform structures are adopted, the majority of onshore companies opt for limited partnerships as their ESOP platforms to achieve tax efficiency, with only a small minority using limited liability companies as platforms. This was certainly true in 2024 when all the platforms used by onshore companies for their ESOP programs were structured as limited partnerships. ESOP platforms typically obtain the incentive shares of the company (i) by acquiring the newly issued shares of the company or (ii) by acquiring shares transferred to the platform by founders. According to our 2024 data, over 60% of the ESOP platforms obtained incentive shares by subscribing for newly issued shares of the companies.

ESOP — Onshore Structure — Issue Methods over the Past Eight Years



Note: The data are based on cases in which multiple issue methods are adopted simultaneously.

Liquidation Preference

The liquidation preference grants investors the right to receive asset distributions ahead of other shareholders (particularly common shareholders) when a "liquidation event" occurs. It is designed to ensure that investors will have the priority right to receive their investment principal and the agreed return on their investment upon the occurrence of the liquidation event.

The "liquidation event" is often defined to include the liquidation, dissolution or trade sale of the company. The liquidation preference allows investors to receive distribution of the company's assets in one of the two ways, as follows:

- *Participating.* Investors are entitled to receive their liquidation preference amounts based on a pre-agreed formula ahead of other shareholders. Subsequently, they may participate in the distribution of the remaining assets of the company, if any, with other shareholders on a pro-rata basis.

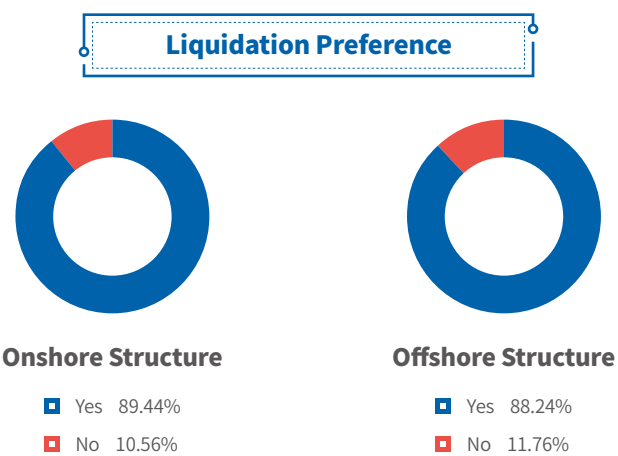
Under this arrangement, the amount distributable to investors is sometimes capped by an agreement among parties to the transaction. For example, if the amount distributable to an investor pursuant to the participating liquidation preference exceeds the cap (usually certain multiples of its investment principal), the investor will not participate in any further distribution. Alternatively, if the company's valuation in the liquidation event exceeds the pre-agreed threshold or the amount distributable to an investor based on its shareholding in the company exceeds a pre-agreed amount, the participating liquidation preference will cease to apply to the investor.

- *Non-participating.* Investors will only receive distributions in an amount calculated pursuant to a pre-agreed formula and will not, thereafter, participate in the distribution of any remaining assets of the company with other shareholders.

Despite these liquidation preference arrangements, if an investor would receive more distribution based on its shareholding in the company than pursuant to any of the liquidation preference arrangements, the investor could simply elect to directly share the company's assets with all other shareholders on the pro-rata basis.

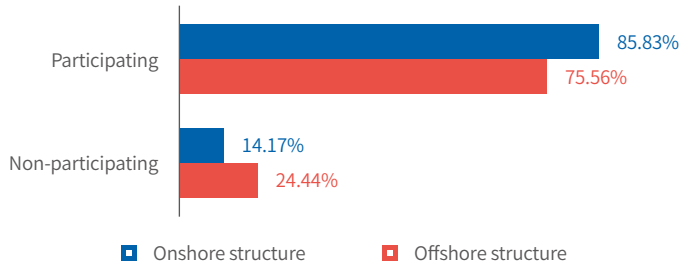
In each of the past eight years, over 90% of the VC/PE transactions provided for the liquidation preference and most of them chose the participating approach. In 2024, 89.12% of the transactions provided for liquidation preference, and 83.14% of them adopted the participating liquidation preference, the lowest level in the past eight years. Among the VC/PE transactions that provided for participating liquidation preference in 2024, 4.20% capped the amount distributable to investors.

The chart below shows the use of liquidation preference in onshore and offshore transactions in 2024.



The following chart shows the use of participating and non-participating approaches in the 2024 transactions that provided liquidation preference. Our data show that the participating liquidation preference was more popular in both onshore and offshore transactions.

Liquidation Preference — Participating vs. Non-participating



The liquidation preference amounts are typically calculated pursuant to one of the following formulas:

(a) multiples of the investment principal amount;

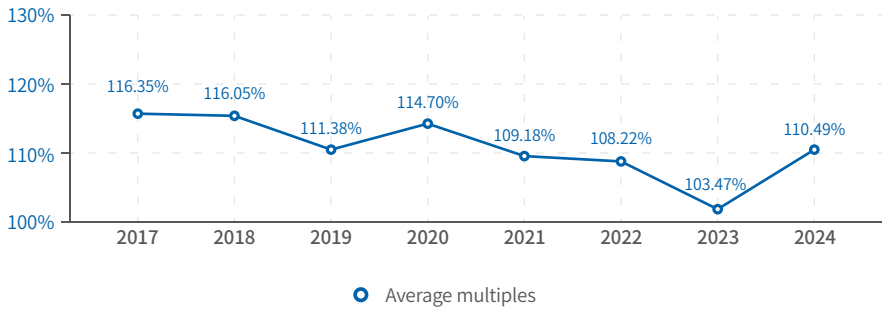
(b) investment principal amount (or certain multiples thereof) + simple or compound interest accrued thereon; or

(c) the higher of (i) the amount calculated as per (a) or (b) and (ii) certain other benchmarks such as the fair market value or the audited net assets value.

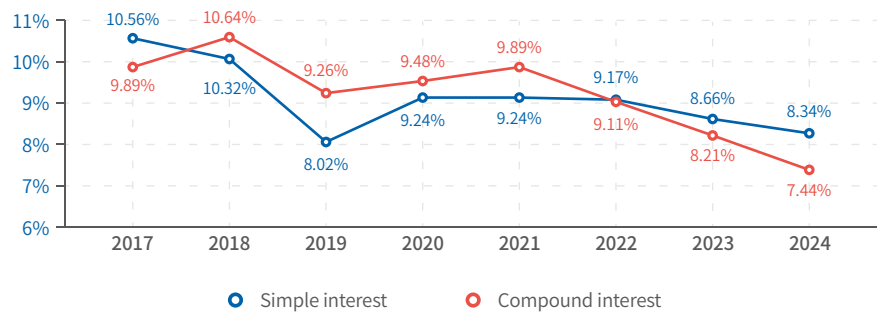
According to our data, formula (b) has become more popular in recent years. Among the 2024 VC/PE transactions that provided for liquidation preference, the use of formula (b) accounted for 72.44% in onshore transactions and 55.56% in offshore transactions, an increase in both instances compared to previous years. The use of formula (a) accounted for 19.69% in onshore transactions and 35.56% in offshore transactions, showing a decline compared to previous years. Formula (c) was used in 6.98% of the transactions that provided for liquidation preference, consistent with past years.

According to our 2024 data, where formula (a) was used to calculate the liquidation preference amounts, the multiples ranged from 100% to 200%, with 110.49% being the average. Where formula (b) was used, the average interest rate was 8.34% annualized simple interest or 7.44% annualized compound interest.

Liquidation Preference Amounts — Multiples of Investment Principal
Average Multiples Trend over the Past Eight Years



Liquidation Preference Amounts — Investment Principal (or certain multiples thereof) + Simple/Compound Interest
Average Interest Trend over the Past Eight Years



Restrictions on Founders

It is critical for both investors and the company to ensure stability of the founding team. Hence, in addition to the right of first refusal and co-sale right discussed above, investors often require additional restrictions in VC/PE documents to deter founders from transferring their shares. These restrictions typically include:

- *Share transfer restriction.* Prohibit founders from selling or otherwise disposing of their shares within a specific time. For example, the prohibition would last until the IPO or trade sale of the company or until the divestment of a specific investor.

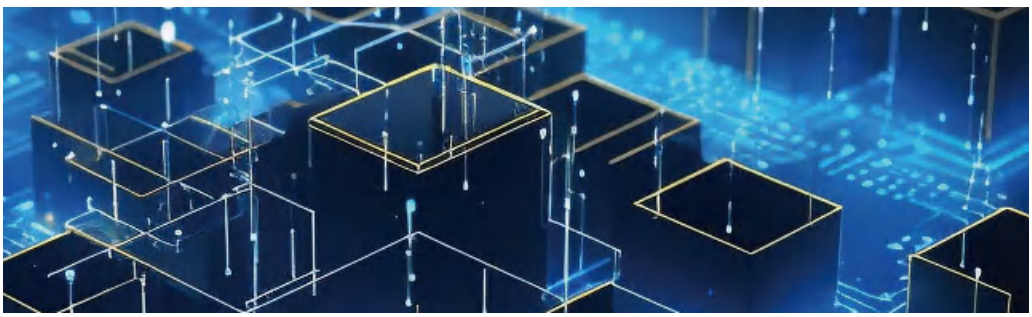
- *Restricted shares.* Make shares held by founders classified as restricted shares, such that if a founder is no longer employed by the company or a certain pre-defined event occurs, the company and/or investors (or any other designated shareholders) will have the right to acquire such restricted shares.

In addition to share transfer restrictions, investors often require founders to (a) devote all their work time to the company and (b) assume non-compete and non-solicitation obligations in favor of the company for as long as they remain employed by, or hold shares in, the company plus a defined period of time post their departure from the company or ownership of the company shares.

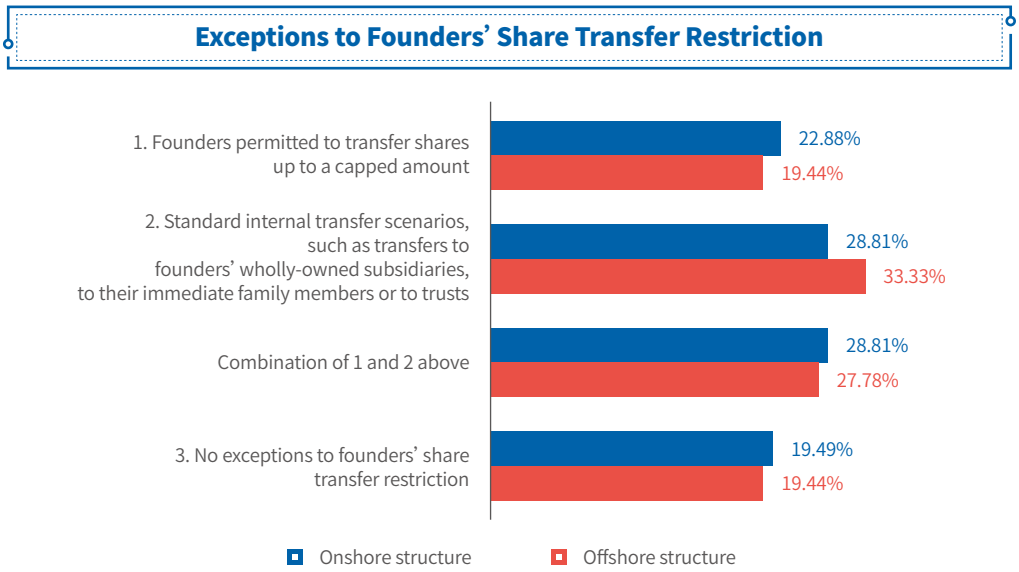
Share Transfer Restrictions

In each of the past eight years, about 88% to 93% of the VC/PE transactions contained share transfer restrictions applicable to founders. Over 90% of these transactions prohibited founders from selling or otherwise disposing of their shares within a specific time unless otherwise consented to by the investors. The remaining minority included other types of restrictions.

Founders, on the other hand, often seek to retain flexibility to transfer their shares by requesting exceptions to the transfer restrictions. The exceptions typically include the following: (i) founders may transfer their shares up to a capped amount; and/or (ii) standard internal share transfers are permitted, such as transfers to founders' wholly-owned subsidiaries or, for financial planning purposes, to their immediate family members or to a trust in which they or their immediate family members are beneficiaries. Based on our data of the past eight years, a growing number of share transfer restrictions had one or more such exceptions. According to our 2024 data, only 19.48% of VC/PE transactions adopted absolute share transfer restrictions with no exception permitted.



The chart provides a breakdown of how such exceptions were adopted in 2024 share transfer restrictions.



Restricted Shares

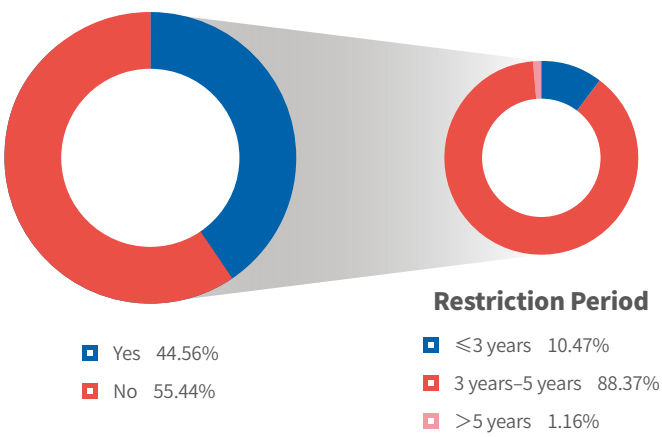
In some VC/PE transactions, investors require that founders' shares be classified as restricted shares. Once so classified, the founders' shares are generally subject to a restriction period (known as the release period), during which (i) a founder may not sell or otherwise dispose of the shares, and (ii) upon termination of the founder's employment with the company or the occurrence of a pre-defined event, such shares will be subject to mandatory repurchase by the company and/or purchase by the investors or other designated shareholders. The restricted share arrangement usually occurs in early rounds of financing. Based on our 2024 data, 60.47% of the restricted share arrangements occurred in angel, seed and Pre-A round financings. The restriction period typically ranged from three to five years.

Shares subject to mandatory repurchase or purchase may include either the shares still locked in the release period or all the shares held by the founder. The price may be the fair market value, the cost price or the lowest price permitted by law. The scope and price of the shares subject to the mandatory repurchase or purchase are usually determined by considering (i) why the founder's employment with the company is terminated (i.e., voluntary resignation, dismissal for cause or no-fault departure) and (ii) the nature of another trigger event.

It should be noted that the restricted shares held by any founder, regardless of whether released or not, are officially registered shares of the company. Generally, the restriction and release mechanism only affect the disposal of the shares, and the scope and price related to the mandatory repurchase or purchase of the shares. They do not affect the ownership and voting power of the shares for as long as the founder remains employed with the company and no other trigger event has occurred.

According to our data, about 50%—60% of the VC/PE transactions each year prior to 2023 required the founders' shares to be classified as restricted shares. In both 2023 and 2024, this percentage dropped to around 44%.

Whether Founders' Shares are Classified as Restricted Shares and the Restriction Period



Share Transfer by Founders

According to our 2024 data, 11.40% of the VC/PE transactions involved founders selling their original shares during the company's capital raising. These instances occurred more often in onshore transactions than offshore ones. Founders are usually driven by business objectives to offload their original shares during capital raising, such as (i) founders wishing to cash out, (ii) optimizing the company's ownership structure and (iii) investors wishing to acquire such original shares at a lower price than the new shares to be issued by the company in a capital raising. Where the original shares change hands, the most common method is either for a founder to directly transfer such shares to the new investor(s) or for the company to repurchase the founder's shares and then issue new shares to the investor(s).

Share transfers raise taxation issues. According to our 2024 data, among the VC/PE transactions that involved founders selling their original shares, 86.36% provided that the tax arising from the sale should be borne by the selling founders, 4.55% provided that the tax should be borne by both the seller and purchaser, while around 9% did not address the tax issue at all.

Information Right and Inspection Right

The information right allows investors to obtain operational and financial information of the company. Our data over the past eight years show that each year around 90% of the VC/PE transactions set out the information right. In 2024, this percentage was 92.78%. Among the VC/PE transactions that included the information right in 2024, 34.88% of the offshore transactions established a threshold to restrict the right, such that investors were required to hold a minimum number or percentage of the company shares as a condition to have the information right, while only one onshore transaction set out such a condition to restrict the information right.

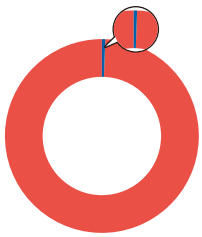
The inspection right allows investors to inspect the finance and operation of the company, including examining the books and records and inquiring directors and officers of the business operations of the company. In 2024, 76.67% of the VC/PE transactions included the inspection right, among which 37.50% of the offshore transactions established a threshold to restrict the right, while only 8.16% of the onshore transactions did the same.

The information right and inspection right together give the non-controlling investors an opportunity to monitor the operational and financial conditions of the company. As a general matter, what type of information to request and at what time and frequency to deliver the information will be decided by investors to satisfy their post-investment management needs. The company, on the other hand, will assess the extent to which the investors enjoy the information and inspection rights pursuant to its ability to prepare the information and its confidentiality obligations.

Survival Period of Representations and Warranties

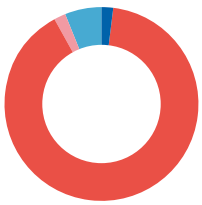
In VC/PE transactions, investors often require corporate warrantors (typically, the company, its corporate group and the founders) to make representations and warranties regarding such matters as the ownership structure, business operation, tax, assets, labor and litigation of the corporate group, as of the signing or closing date. Our data over the past eight years show that most transaction documents did not specify the survival period of the representations and warranties. This means that if any of the representations and warranties is found to be untrue, the investors would be able to claim for breach of contract against the corporate warrantors at any time within the applicable statute of limitations. In 2024, 96.89% of the VC/PE transactions did not include a specific survival period for corporate warrantors' representations and warranties. There were a few exceptions where the transaction documents imposed a time limit for investors to raise claims for breach of the representations and warranties (or only selected representations and warranties). Under this scenario, investors' right to raise such claims would be relinquished if the claims were not made within the set survival period. The length of the survival period may be consistent for all representations and warranties or may vary according to their significance. The chart below shows the use of the survival period for representations and warranties in onshore and offshore transactions in 2024.

Survival Period of Representations and Warranties



Onshore Structure

- Survival period for selected reps and warranties 0.70%
- No survival period 99.30%



Offshore Structure

- Survival period for selected reps and warranties 1.96%
- No survival period 90.20%
- Uniform survival period for all reps and warranties 1.96%
- Different survival periods for all reps and warranties 5.88%

Based on our 2024 data, among the VC/PE transactions that set out the survival period for representations and warranties, such survival period generally ranged from one to three years.

Indemnification and Founders' Personal Liability

In VC/PE transaction documents, investors often require corporate warrantors to provide indemnification if one or more of the following occurs: (i) any representation and warranty made by the corporate warrantors is found to be untrue, inaccurate, incomplete or misleading as of the signing date or the closing date, (ii) any corporate warrantor fails to comply with its obligations or covenants or (iii) any non-compliance event specified by investors occurs.

Corporate warrantors, on the other hand, often seek to limit their indemnification liabilities by establishing (i) a cap which would limit the maximum amount of damages that investors are entitled to claim, and/or (ii) a threshold which requires that investors can only claim damages if the losses resulting from the breach exceeded a certain amount.

According to our data, 75.65% of the VC/PE transactions in 2024 expressly imposed indemnification obligations upon the corporate warrantors. Among these transactions, (i) 19.18% established a cap, (ii) 5.48% set a threshold, and (iii) 17.12% set out both a cap and threshold to limit the corporate warrantors' indemnification obligations. The use of such a cap and/or threshold was more prevalent in offshore transactions. Conversely, in 72.48% of the onshore transactions in 2024, the corporate warrantors did not request either the cap or threshold.

In many instances, the company and founders are required to jointly indemnify the investors so that the investors would get the maximal amount of compensation. When required to bear joint indemnification obligations, the founders usually seek to limit their personal exposure to liabilities by (i) not agreeing to bear joint obligation with the company, (ii) agreeing to assume joint liabilities only under limited circumstances, such as when the founders themselves have caused the breach, or (iii) requiring claims to be made against the company first, with the founders' obligation being triggered only if the company is unable to satisfy the indemnification due to legal obstacles or lack of funds.

The following is a summary of the common variations as to which parties are liable for the indemnification:

(1) the company alone is liable for the indemnification;

(2) the company and founders are jointly liable under all circumstances;

(3) the company and founders are jointly liable under limited circumstances;

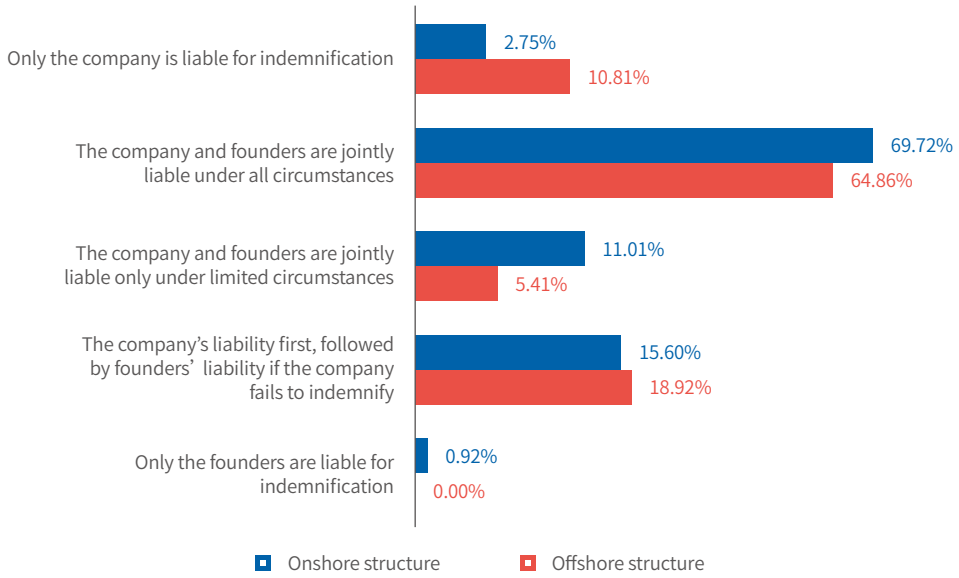
(4) the company is liable first with the founders' obligations being triggered if the company fails to satisfy the indemnification; or

(5) the founders alone are liable for indemnification.

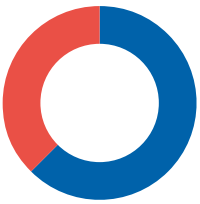
Among the 2024 VC/PE transactions that included indemnification by the corporate warrantors, 94.52% required the company and founders to be jointly responsible for the indemnification (instances (2)—(4) above). Among these transactions, "the company and founders are jointly liable under all circumstances" was the most prevalent.

Where the indemnification obligation is imposed on the founders, they often seek to cap their exposure to protect their personal and family assets. Typically, the cap is structured such that under all or limited circumstances, the founders' indemnification liabilities would be limited to their shares in the company or the value of such shares. In 2024 VC/PE transactions where founders were required to assume indemnification liabilities (instances (2)—(5) above), 66.91% capped the founders' liabilities to the extent of their shares in the company or the value of such shares. The cap arrangements were more popular in offshore transactions than in onshore ones.

Parties Liable for Indemnification

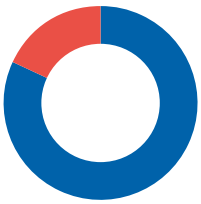


Caps to Founders' Indemnification Liabilities



Onshore Structure

- Capped at founders' shares in the company or value of such shares 62.26%
- Not capped at founders' shares in the company or value of such shares 37.74%



Offshore Structure

- Capped at founders' shares in the company or value of such shares 81.82%
- Not capped at founders' shares in the company or value of such shares 18.18%

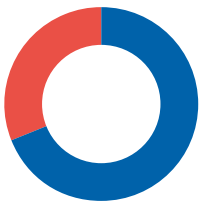
Restrictions on Investors

In VC/PE transactions, restrictions imposed on investors typically include (i) restrictions on share transfer to specific entities and (ii) restrictions on investment in or cooperation with specific entities.

Share Transfer Restrictions

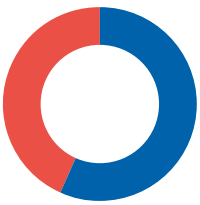
For most financial investors, the sale of their shares in the company is a key component of their exit strategy and as a corollary they would oppose any restriction on their ability to offload their shares. On the other hand, an increasing number of companies in recent years have sought to impose such restrictions on the investors. In 65.80% of the VC/PE transactions in 2024, companies placed restrictions on investors' share transfers, the highest percentage in recent years. These restrictions typically included (i) prohibition of share transfer to a competitor of the company and/or (ii) prohibition of share transfer to a competitor of certain shareholders of the company (such as industry or strategic investors). The following chart presents an overview of share transfer restrictions on investors in the 2024 VC/PE transactions.

Investor Share Transfer Restrictions



Onshore Structure

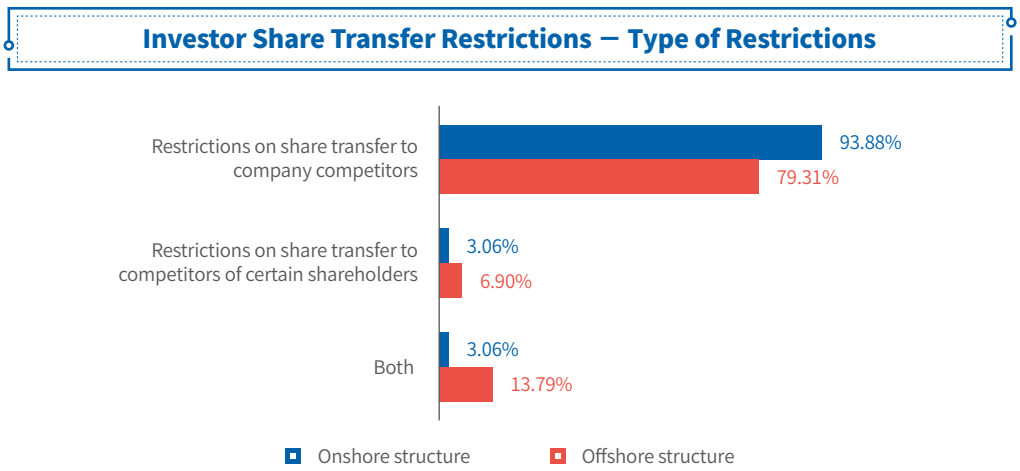
- Yes 69.01%
- No 30.99%



Offshore Structure

- Yes 56.86%
- No 43.14%

Our data also show that in both onshore and offshore transactions, most share transfer restrictions prohibited investors from transferring shares to the company's competitors.



Such share transfer restrictions are usually implemented through the following mechanisms:

(a) *Share transfer is subject to consent.* If the transfer is to a competitor of the company, the consent of the company and/or the founders is required. If the transfer is to a competitor of another shareholder, the consent from the affected shareholder is required. This restriction practically grants the consenting party veto power to block the share transfer.

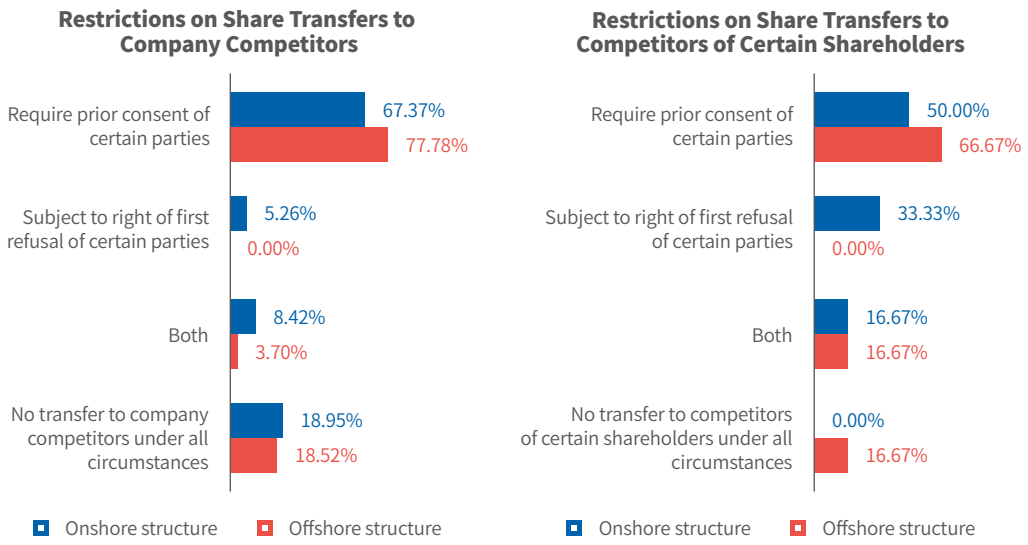
(b) *Share transfer is subject to the right of first refusal.* If the transfer is to a competitor of the company, founders usually have the right of first refusal. If the transfer is to a competitor of another shareholder, the affected shareholder will have the right of first refusal. While the party holding the right of first refusal does not have veto power to deny the share transfer, the complex procedures associated with the right of first refusal may practically frustrate the investors' share transfer.

(c) *Share transfer is subject to both mechanisms described in (a) and (b) above.*

(d) *Share transfer is prohibited under all circumstances.* This is obviously the most draconian restriction. Considering the sale of shares is a critical part of an investor's exit strategy, investors usually resist such an absolute restriction. They are usually willing to accept a compromise of limited restrictions such as those described in (a) or (b) above.

The following chart illustrates the use of various restriction mechanisms in the 2024 transactions that included investors' share transfer restrictions.

Investor Share Transfer Restrictions – Restriction Mechanisms



Investment Restrictions

In addition to share transfer restrictions, each year a small number of VC/PE transactions seek to restrict investors from investing in or cooperating with other entities, typically the company's competitors. If an investor violates the prohibitions, it will be deprived of its preference rights or certain other shareholder rights such as the right to appoint directors, the information right or voting right. Based on our data, 4.15% of the VC/PE transactions in 2024 imposed such restrictions on investors, the lowest of the recent years.

Most-favored Nation Clause

If the company accords certain investors (including the existing shareholders, investors of the same round and/or future investors) better terms and conditions for their investment than a particular investor (the "subject investor"), the "most-favored nation" ("MFN") clause would automatically grant the same terms and conditions to the subject investor.

The MFN clause can be applied to the existing shareholders, investors of the same round or investors of subsequent rounds. The rationale for the MFN clause is as follows:

- In a capital raising, the subject investor may lack the opportunity to conduct a thorough investigation of the company and therefore may not be aware of all the terms and conditions that the company has already given to the existing shareholders. As the price for the current round of capital raising is often higher than previous rounds, the subject investor can invoke the MFN clause to be treated no less favorably than the existing shareholders.
- Although the rights and obligations of all investors and shareholders are generally set out in the same transaction documents, there still may exist other documents (such as side agreements) between the company (and/or founders) and certain other investors or shareholders unbeknown to the subject investor. For this reason, the subject investor may invoke the MFN clause to ensure that it is treated the same as the existing shareholders and other investors of the same round.
- When a company raises subsequent rounds of financing, it is widely accepted that the new investors should be entitled to more favorable terms and conditions as they pay a higher price than did the investors in the previous arounds. However, they should not as a matter of course enjoy the benefit of certain non-economic clauses (such as the right of first refusal, the preemptive right, the drag-along right and the voting right) on a more favorable basis than the subject investor. Hence, the subject investor may want to seek the protection of the MFN treatment in respect of such non-economic terms while allowing the future investors to have the more favorable economic terms that they would conventionally enjoy. As sometimes is the case, parties to a VC/PE transaction may agree to restrict the application of the MFN clause such that it would be invoked only if the valuation of the company in a future financing is less than a certain threshold.

Our record shows that in 2024, 60% of the VC/PE transactions used the MFN clause to align the treatment of the existing shareholders and/or investors of the same round, while 45% used the MFN clause in respect of investors in the future rounds of capital raising.

Valuation Adjustment Mechanism

Valuation adjustment mechanism ("VAM"), which is distinct from the redemption right discussed above, is not commonly used in VC/PE transactions. Based on our 2024 data, only 4.66% of the VC/PE transactions adopted the VAM.

A VAM clause typically includes the following components:

- Benchmarks;
- Parties obligated to compensate investors if the benchmarks are not met; and
- Mechanisms for compensation.

Among the VC/PE transactions that included VAM in 2024, most of the benchmarks focused on the company's ability to achieve certain performance goals.

When a benchmark is not met, either the founders and company on a separate or joint basis will be obligated to compensate the investors. Among the VC/PE transactions that included the VAM in 2024, the obligation was borne one third each by the founders, the company on a separate basis and by the founders and company on a joint basis. This represents a noticeable change from 2023 when 65% of the transactions required the founders alone to bear the compensation obligation.

If the company is responsible for the compensation, it typically will do one of the following to meet its obligations: (i) adjust the conversion price of the investors' preferred shares into common shares (this method is used only in offshore transactions), (ii) issue additional shares to the investors at a nominal price, (iii) make cash payments to the investors or (iv) a combination of the above methods. If the founders are responsible for the compensation, they would usually do one of the following to meet their obligations: (i) transfer their shares to the investors at a nominal price, (ii) make cash payments to the investors, (iii) a combination of the above. According to our data over the past eight years, the most common form of VAM compensation is for the company to issue new shares or for the founders to transfer their shares to the investors at a nominal price.

Governing Law and Dispute Resolution

Among the 2024 VC/PE transactions, all onshore transactions were governed by the PRC law. In contrast, around 70% of the offshore transactions chose Hong Kong law as the governing law, a noticeable decline compared to previous years, while 15.69% selected Delaware state law and 5.88% used Singapore law as the governing law.

According to our data over the past eight years, arbitration was chosen as the means of dispute resolution in over 90% of the VC/PE transactions each year. This percentage was 93.78% in 2024.

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