

Internet Services San Francisco

• Venture-Backed IPOs On The Rise In 2Q, Study Says

By Lisa Lacy 7/1/2004

A report on second quarter venture-backed initial public offerings shows significant improvement from the same period a year earlier, indicating that the exit window is more open than it has been in some time. In addition, a number of VC-backed companies are in registration for public offerings, a sign that the uptick may be more than just a short-lived phenomenon.

The report, from VentureOne, also looked at merger and acquisition activity, finding it held fairly steady with what VentureOne calls the "robust level" reported in the first quarter. In the second quarter, 88 VC-backed companies were merged or acquired for a total of \$5.5 billion.

According to the report, the number of initial public offerings completed in the second quarter of 2004 rose to 24 from only two a year earlier. These companies raised \$1.3 billion, up from \$164 million a year earlier, signaling an increased appetite for IPOs and an improvement in liquidity activity.

"The window is definitely more open for companies for the first time since 2000," said John Gabbert, vice president of worldwide research at VentureOne. Gabbert said that 24, while not an off-the-charts number, is nevertheless quite an improvement from the dearth of IPOs in recent years.

"Twenty-four is a pretty good number, but not really that stellar. But relative to the last three years, it's a large number," he said.

Healthcare companies dominated IPOs, according to VentureOne data, while information technology companies led in the M&A category. More than two-thirds of the IPOs were in healthcare and more than half - 13 - were in the biopharmaceutical sector. Two-thirds of mergers fell into the IT category.

Gabbert said the rise in healthcare IPOs is a direct result of increased investment in biopharmaceutical companies for over a year.

"There is a backlog of companies with good, quality VC backing that have finally achieved traction and this is more so in the biopharmaceutical arena," Gabbert said. "These companies are able to make it to the public market after finally reaching benchmarks such as profitability or proof in business models."

"The public market has an appetite for biopharmaceutical companies. There are opportunistic acquisitions in the IT space .. but very few healthcare companies are acquired," Gabbert said. He added, "If the company can raise money in a more favorable public market than a trade sale, it will do so."

But life sciences companies have not all had an easy road to the public market this quarter, with a number of them - Acadia Pharmaceuticals Inc., Critical Therapeutics Inc. and Alnylam Pharmaceuticals Inc., for example - forced to cut prices to get to market.

Morgenthaler Ventures partner Robin Bellas attributed increased IPO activity among biotech companies to a market that is excited about second generation cancer drugs.

He said continued product development at start-ups has led to more drug approvals at these companies than at the larger pharmaceutical companies. This has caused the IPO window to open over the past six months, even though biotech companies have struggled to achieve high market caps.

Bellas believes there will be a continued stream of moderately valued IPOs as well as increased deals between pharmaceutical companies and biotech firms as a result of increased collaborations. Larger companies will turn to acquisitions after monitoring company progress quarter to quarter. When products near approval, big pharma will buy either the product or the biotech company, he said.

The median amount raised in second quarter IPOs fell to \$50 million from the \$58 million median last quarter. The companies that did reach the public markets are still requiring a high level of investment from venture capitalists prior to their public offerings. The median amount raised prior to liquidity for the current crop of IPO companies was \$74 million, compared to \$91 million in the first quarter.

Gabbert said the level of VC investment is high in part because companies raised so much during the bubble, and in part because they had to invest in product development to a significant extent in the challenging market that followed.

Bellas commented that "By doing a last private round, the company signals it is attractive enough to generate capital and has enough fire power to continue growth."

Forty-eight companies are currently registered to go public, which Gabbert said indicates that the increased pace of public offerings may continue throughout the year. Only five VC-backed companies were registered in the second quarter of 2003. About 10 of the current 48 companies are re-registering for IPOs after withdrawing previous registrations due to poor market conditions, Gabbert said.

Despite the underrepresentation of IT companies in the IPO sector, the largest public offering came from a technology firm: salesforce.com raised \$110 million in its June 23 public offering. Shares of salesforce.com, a customer relationship management software firm based in San Francisco, are currently trading at around \$16, well above the \$11 offering price. The current market capitalization for the company is roughly \$1.62 billion, given 101.3 million shares outstanding.

In the M&A sector, the total amount paid for IT companies in the second quarter reached \$3.4 billion. Software companies were most active in this area, followed by semiconductor firms. Seventeen healthcare companies of the 88 total completed M&As this quarter, for \$1.3 billion.

Gabbert said the number of true acquisitions has stayed constant while the amount paid for companies is on the rise.

Some companies are opting for a dual track in which they register to go public and instead are then acquired. Anti-spam company Brightmail, for example, was on the cusp of an IPO when it opted instead for a \$300 million acquisition by Symantec in May. "The best time to sell is when the company has filed an IPO," said Morgenthaler partner Gary Little. "An S1 is a great cleansing process," he said - because the company is clean as a result of Sarbanes-Oxley requirements and the S1 provides as much disclosure as an acquirer will ever get.

The median amount paid for companies merged or acquired was \$49 million in the second quarter, nearly identical to the median amount paid in the first quarter and up from \$24.75 million in the year-ago quarter, according to Gabbert. The median amount these companies raised prior to the acquisition was \$25 million, giving many investors a solid return.

There were several blockbuster deals in the quarter, including the \$486.7 million acquisition of integrated broadband access developer Catena Networks by Ciena on May 3, the largest deal of the quarter. In another notable deal, Advertising.com was bought by America Online for \$435 million. Both these deals easily surpass the largest M&A deal of 2003, when publicly traded enterprise storage giant Network Appliance acquired Spinnaker Networks, a developer of network attached storage technology, in an all-stock deal worth \$300 million, nearly \$250 million more than the company had received in venture funding.

Little expects more M&A on the IT side, driven by macro issues such as how well the largest acquirers are doing.

Bellas expects an increase in both M&A and IPO activity in the medical device sector as the stent market, "the largest market in the history of man," develops. It has been so long since the successful medical device IPO window - what Bellas calls the "class of '96" - that the time is right for more mature companies to start going public, he said.

VentureOne is a unit of Dow Jones & Co., also the publisher of this newsletter.