

# MONEY & INVESTING

THE WALL STREET JOURNAL

## Tech IPOs Find Launching Pad

New Offerings Tumble Onto Market, Ahead of Google; Investors Ignore Scant Revenue and Big Losses

By PUI-WING TAM

TECHNOLOGY IPOs haven't been waiting for Google.

A few months ago, many investors were hoping that Google Inc., the popular search engine, would reignite interest in initial public offerings. The thinking went that the tech IPO market, which had waned following the dot-com bust, needed a name-brand deal such as Google's to jolt it back from the dead. Google is expected to announce plans to push forward with an IPO this week, but the tech IPO market already has surged back to life without its help.

Eleven U.S. technology companies have gone public this year, up from none in the same period a year ago, according to Thomson Financial. And the rush is just beginning. Since

March 1, 22 tech concerns have filed to go public; that is more than in the preceding four months combined. The 13 tech companies that filed for an IPO in March were the most in one month since October 2000, when there were 23 filings. Among the companies now waiting to go public: online jeweler Blue Nile Inc.; antispyware software maker Brightmail Inc.; online software maker salesforce.com Inc.; and Linux firm Linoware Inc. "Compared with a few years ago, there's clearly significant activity in tech IPOs right now, and that should stretch into a really active fall period for IPOs," says Tom Taulli, co-manager of the \$10 million Oceanus Value Fund, who closely tracks new offerings.

Driving the revival are tech companies seeking access to public capital, as well as cash-rich investors looking for new investments. IPOs provide a healthy stream of fees for investment banks. Furthermore, venture capitalists are looking to IPOs again as a way to recover long-held investments in private companies. "There's been a lot of inventory on the venture side [that needs to go public], so many of us have been waiting for the market to awaken," says Steve Domenick, a venture capitalist at Sevin Rosen Funds in Palo Alto, Calif.

With this backdrop, waiting for the Google IPO just didn't make sense, say some tech companies. Some feared Google, which is expected to be one of the hottest IPOs in a decade, would capture the attention—and cash—of investors. James Walker, chief financial officer of educational-device maker AlphaSmart Inc., which listed its stock publicly in March, said his Los Gatos, Calif., company purposely wanted to get into the market before Google did. "We're just a small-cap, and we didn't want to get lost in the shuffle," he says.

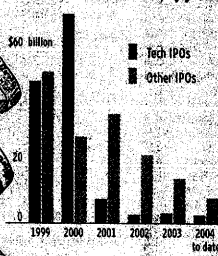
But investors beware: Many of the firms seeking IPOs have scant revenues and big losses, echoing the worst excesses of the tech-IPO boom. Linoware, which adapts the free Linux operating system for personal computers, recorded \$2 million in revenue last year but posted a loss of \$4 million. Its auditors recently questioned its ability to continue as a going concern, absent additional investments. Wire

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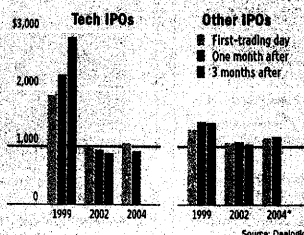
### Feeling Lucky... Again

Speculation about an expected initial public offering of Google stock has investors hoping they will be able to party like it's 1999.

Value of IPO deals, by year



Value of \$1,000 invested in the average IPO in 1999, and after the tech bubble burst, in 2002, and so far this year.



## Late-Stage Start-Ups Get More Money

By ANN GRIMES

LOOKING TO CAPITALIZE on a more-receptive investment climate, venture capitalists are pouring more dollars into later-stage start-up businesses that have weathered the technology downturn—aiming to position these companies for a public debut or sale.

New figures by the National Venture Capital Association show that venture investing for the first quarter remained steady, with \$4.6 billion being invested in 618 venture-backed companies. A rising proportion, 30% of all venture funding, went into the most-mature companies. That figure is up from 26% for all of 2003, which was the highest percentage of later-stage investing in at least 20 years.

After losing billions of dollars for investors since the technology bubble burst, the share of companies receiving funding at each stage of development during the past two years "has steadily drifted toward later-stage companies," according to the NVCA, which conducts the quarterly MoneyTree survey with Thomson Venture Economics and PricewaterhouseCoopers.

Late-stage companies—such as Google Inc.—typically have a proven product or service, several quarters of revenue and, often, are cash-flow positive.

Meanwhile, funding for the youngest start-up businesses remains essentially flat, "despite anecdotal buzz of a resurgence," the survey said.

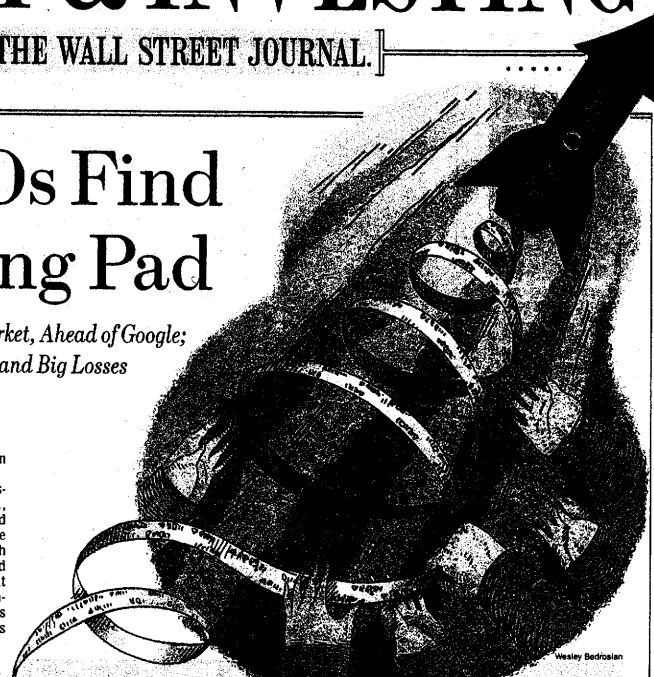
Historically, bets placed on those newest start-up companies pay venture capitalists and their investors the highest returns, but at the greatest risk.

The more-conservative, late-stage strategy is starting to pay off, at least in the short run, as venture firms deploy "larger amounts of capital in operating companies closer to exit events," said Jesse Reyes, a Thomson vice president.

Late-stage investors posted one-year returns of 25.4% for 2003, compared with a negative 7.1% for those who made early-stage investments, NVCA data show. Those positive results, most of which started to occur in the fourth quarter of 2003, helped the venture industry crawl into the black and post a return of 8.1% for 2003, the first positive return since the downturn began in the second quarter of 2000.

Despite the anticipation surrounding the coming initial public offering of Internet search-engine concern Google, venture capitalists

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Wesley Bedrosian

## Tech IPOs Pour Into Market, Ahead of Google

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less-software maker Seven Networks Inc., which filed to go public in late March, lost \$12.9 million in 2003, on revenue of \$6.9 million. And nanotechnology concern Nanosys Inc., which filed to go public last week, had revenue of \$3 million and a loss of \$9.2 million last year.

Officials at Lindows, Seven Networks and Nanosys declined to comment, citing the quiet period before their IPO.

### HEARD ON THE STREET

These companies are still more solid than some of

the dot-coms that went public with little more than a business plan in the late 1990s, says David Liu, senior vice president of investment bank Broadview International, a division of Jefferies Group. But he says that companies in "hot" sectors—such as specialty semiconductors, online advertising and Chinese Internet companies—are trying to capitalize on investor interest to go public despite poor financials.

As a result, Mr. Liu believes many of the tech companies that are waiting to go public now won't succeed. "I'm just not sure how many of those will get done," he says.

Chad Keck, co-head of corporate finance at investment bank Needham &

Co., says he has told clients they need to be profitable and have quarterly revenue of \$20 million to go public. But as investor appetite for IPOs has increased this year, that is changing. "More people seem to be accepting the speculative and early stage IPO, which is troubling," he says.

A successful Google IPO could generate a lot of copycat deals from companies that aren't as profitable as Google, says Rich Peterson, chief market strategist at Thomson Financial. "Things like profitability and revenue become secondary in whatever is the hot industry," he says.

Indeed, some unprofitable tech concerns with few prospects for immediate revenue growth have recently managed to go public. In early February, for example, solar-technology firm DayStar Technologies Inc. listed its shares on the Nasdaq Stock Market, raising \$10.5 million. The Grass Valley, Calif., company, which has eight employees, was able to go public even though it had revenue of just \$72,000 in the nine months ended Sept. 30, 2003, and a loss of about \$810,000 during the same period. DayStar's main product, a thin film solar cell, won't be out until mid-2005.

Kelly McCarthy, DayStar's vice president of investor relations, says many investors had asked the company if it was

jumping the gun by going public. But Ms. McCarthy says its listing was "perfect timing," because it was offering investors the chance to "invest in an early stage technology company at the forefront of the renewable-energy industry."

DayStar shares began trading on the Nasdaq Small-Cap Market in late March at around \$2.40. In 4 p.m. trading yesterday on the Nasdaq Stock Market, DayStar shares fell 4.5% to \$3.40 each. The rising share price puts DayStar in the minority among recent IPOs. Six of the 10 tech firms that went public in the first quarter are now trading below their offering price, says Thomson Financial's Mr. Peterson.

Some of the newly listed companies are profitable, including AlphaSmart. In its first quarterly financial results as a public company earlier this month, AlphaSmart posted net income of \$63,000, with revenue of \$8.8 million, up from \$8.3 million in the same period a year ago. AlphaSmart sold shares in February at \$6. In 4 p.m. trading yesterday on the Nasdaq, AlphaSmart shares fell 2.8% to \$5.20.

Meanwhile, SIRF Technology Holdings Inc., a maker of location-based technology, reported first-quarter net income of \$4.1 million, on revenue of \$28.4 million. SIRF started trading Thursday at \$12. By the end of its first day of trading, its shares had jumped 28%.

# Late-Stage Start-Ups End Up With the Money

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ists are hardly out of the woods. Three-year returns of negative 18.9% indicate many continue to struggle with the excesses of the boom. The annual returns also trail the Nasdaq—they typically track the index—by 42 percentage points.

Yesterday, on a conference call with reporters, Ted Schlein, a general partner with Kleiner Perkins Caufield & Byers, one of the two Silicon Valley venture firms that backed Google, tried to temper that anticipation. "I don't actually think it causes some big gold rush," he said. "I don't think it breaks some log jam. It's a good example of a company that has done well..."

Nevertheless, improved market conditions that began in the fourth quarter of 2003, are contributing to a turnaround. So, too, is the current, slower investment pace, reflecting "a disciplined deployment of capital," says NVCA President Mark Heesen.

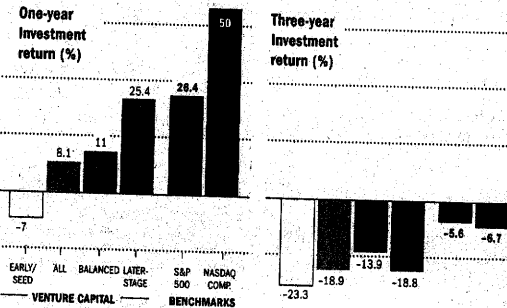
With the number of venture-backed companies that have registered for IPOs on the rise, analysts are hopeful that the upswing will continue. Already this year, \$2.1 billion has been raised for investors of 16 venture-backed technology and biotechnology IPOs, exceeding last year's total of \$1.7 billion for 23 venture-backed public offerings in those sectors, according to VentureEconomics. The \$907 million raised from 13 venture-backed IPOs in the life-sciences sector is nearly double the \$501 million raised by eight venture-backed biotechnology IPOs for all of 2003. (The life-sciences sector includes biotechnology and medical-device companies.)

"If the pace continues, given the fact that it is only April, it could be the best year for venture-backed IPOs since 2000," said Richard Peterson, a Thomson spokesman. Analysts consider 100 public offerings a quarter to be healthy, he said. Eighty-seven more venture-backed companies are in registration, according to the NVCA.

Even hotter is the activity occurring in the mergers-and-acquisitions area as private, venture-backed companies, especially in information technology, consolidate and find eager strategic buyers. The dollar value of mergers and acquisitions in the first quarter rose to \$5.3 billion, a level unseen since the second quarter of 2001, according to VentureOne/Alterna-

## Venturing Into the Black

In 2003, most venture-capital funds were back in the black (left chart), but those who invested in these funds in 2001 (right chart) are still in the red.



Source: Thomson Venture Economics/National Venture Capital Association

ive Investor, a Dow Jones & Co. service.

Steve Baloff, a general partner at Advanced Technology Ventures in Palo Alto, Calif., attributes the uptick to pent-up demand after a three-year "liquidity drought." He also says corporations that cut research and development from their bottom line are eager to snap up promising technology for next-generation products. Buoyed by the rising stock market, "they've gone through consolidation and now are focusing on top-line growth," he says.

Venture capitalist Promod Haque, managing director at Norwest Venture Partners in Palo Alto, Calif., says he is "starting to see quite a bit of this money going into later-stage deals." One driver behind the trend: Companies that survived the bust are in pretty good shape and valued higher. Many venture firms, which made hasty bets during the technology boom, expect to raise new funds this year. "Their tendency is to invest more in later-stage deals with the idea that they could get some near-term liquidity through IPOs and M&A. ... This is sort of what you hear," Mr. Haque says.

Jim Tullis, a managing partner of life-sciences venture firm Tullis Dickerson, of Greenwich, Conn., agrees. "When you have three years of adverse performance," he says, "you are looking for something to help you in a hurry."

If the IPO window remains steady and venture capitalists continue to get relief, he said, he expects to see more interest in taking more risk with brand-new start-ups—"by the end of the year," he predicts.

Another factor, many venture capitalists still have excess capital on their hands—the industry is bogged down by a \$50 billion to \$55 billion overhang in promised but yet-to-be invested capital—and so is looking to put big chunks of capital to work.

Much of that explains the activity in life-sciences investing, which the MoneyTree survey shows continued to attract the bulk of venture dollars in the first quarter.

Biotechnology and medical-device companies pulled in \$1.3 billion, or 27% of all dollars for the quarter, close to last year's 12-year high. Even more, large pharmaceutical companies increasingly are relying on start-up businesses for drug discovery and development. In the first quarter, nine out of the 10 largest IPOs were by biopharmaceutical companies.

In line with historical norms, software regained attention from venture capitalists in the first quarter, pulling nearly one-third of first-time financing dollars.

Meanwhile, the number of dollars and deals in telecommunications rose quarter over quarter, with 65 companies attracting \$547 million. Other areas of interest: personalized medicine and alternative energy.

In other corners, some venture capitalists are hedging their bets by changing strategies. Recently, longtime Silicon Valley investor Roger McNamee announced plans to launch a private-equity fund that will focus on large technology, media and entertainment deals.

Others are starting new funds. Among them: Terence Garnett and David Helfrich, who recently departed two established venture firms to launch what they are calling a \$250 million "venture buyout fund." Their idea is to cherry-pick revenue-producing companies that were bought up during the boom, only to languish within a parent corporation, they say. Harvard University is their biggest backer, the two say. "Investors are hunting for new opportunities," Mr. Garnett says.

The question, of course, is whether venture capitalists will abandon their new discipline should Google ever take hold.

When it comes to technology IPOs, for instance, the bar is falling quickly.

"In speaking with several bankers, the minimums for IPO consideration during the summer of 2003 were \$60 million to \$80 million in revenues, profitability and a projected post-IPO market cap of \$200 million or more," says Jocelyn M. Arad, a partner with Testa Hurwitz & Thibault, LLP, a Boston law firm. "Current criteria is \$40 million in revenue, profitability not required in all cases, and a \$125 million market cap."