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IPOS

As High-Tech IPOs Dwindle, Start-Ups Look to Private Money for More Backing

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An IPO drought in Silicon Valley is intensifying, prompting big changes in how high-tech companies backed by venture capitalists raise money.

In the second quarter, no companies backed by venture capitalists went public via an initial public offering in the U.S., the first time that has happened since 1978, according to the National Venture Capital Association. There were just five venture-capital-backed stock offerings in the first quarter, compared with 31 in the fourth quarter of 2007.

NOTHING VENTURED?

• **The Trend:** Fewer companies backed by venture capitalists are going public -- zero in the second quarter.
• **The Fallout:** New investment banks specializing in late-stage, private-placement deals, including Advanced Equities and Revolution Partners, are capitalizing on the IPO lockout to do more private deals.
• **The Future:** Venture capitalists want legislative help for small companies trying to go public. But other, structural changes on Wall Street may be to blame for

dashed IPO hopes.

(For more on the quarter in IPOs, see related article[1].)

With stock offerings not an option for many small, venture-backed companies -- at least in the near term -- these start-ups are being forced to raise more money privately to stay afloat. They are turning to new investment banks that have stepped in to fill the void, including Advanced Equities Financial Corp. of Chicago; Revolution Partners of Boston; and **GCA Savvian** and Bandon Partners of San Francisco.

"Our business has never been better," says Dwight Badger, the co-founder and chief executive of Advanced Equities, which specializes in doing late-stage private placements for venture-backed companies. The company had about $300 million in revenue last year, up from $3 million in 2002, according to Mr. Badger's business partner, Keith Daubenspeck.

Advanced Equities has been a big backer of long-private firms like **Alien Technology** Corp., a company that makes radio-frequency identification tags and has raised $290 million in private money from venture capitalists and others since it was founded in the mid-1990s. Alien, based in Morgan Hill, Calif., filed to go public in 2006 but scuttled the deal because it didn't think investors would value the company highly enough.

"Now probably isn't the best environment for an IPO" either, says Alien's chief executive, George W. Everhart, adding that the company expects to announce another "financing event" soon. As the company grows privately, "there's a need for working capital," which means more business for firms like Advanced Equities, he says.

Revolution Partners, meanwhile, did four big private placements last year and will do at least eight such deals this year, says Peter Falvey, formerly of tech investment bank Robertson Stephens, who co-founded the firm in 2001. Revolution also has seen an uptick in its mergers-and-acquisitions business, he says, since more start-ups are willing to entertain buyout offers now that the IPO markets are effectively closed.

The flurry of late-stage financing, of course, is delaying profits for venture capitalists, who see their biggest paydays when the companies they back go public. And though some venture-backed start-ups are considering acquisition offers -- a good thing for venture capitalists, since they also make money when their companies are bought -- the IPO slowdown is denting the value of M&A deals.

In the second quarter, the total disclosed value of venture-backed M&A in the U.S. came in just shy of $2.4 billion, down nearly 40% from $3.97 billion in last year's second quarter.

The languid economy is a big factor limiting deal activity. But if IPOs are down also, "all of a sudden, you don't have pressure on a buyer to buy a company before they go public," which can reduce the price a buyer is willing to pay, or scuttle deals altogether, says Jim Fulton, a partner with law firm Cooley Godward Kronish LP in Palo Alto, Calif. Cooley lawyers advised companies on eight IPOs in 2007, but have done only one so far this year. "We're clearly off the pace," Mr. Fulton says.

Other beneficiaries of the IPO doldrums include investment firms that traffic in the low-profile secondary market for venture-capital deals. These firms buy positions in private, venture-backed companies from venture-capital firms, or venture arms of corporations; investors in venture-capital firms, such as pension funds or hedge funds; and sometimes from the cash-strapped executives of start-ups themselves.

Many of these executives have lately been frustrated that they can't liquidate their stakes and finally see a payday from their years of work. Right now, the average venture-backed company in the U.S. takes 8.6 years from inception to go public, up from less than 4½ years in 1999.

"The secondary market gets busier when the primary market needs liquidity," says Hans Swildens, the founder of Industry Ventures, a San Francisco secondary-venture-capital firm. "The downturn's created a large opportunity" for secondary firms. Mr. Swildens says Industry Ventures has bought 36 venture positions in the last 12 months, compared with 27 in the previous year.

The National Venture Capital Association this week called the current lack of IPOs a "capital markets crisis" and urged government action to simplify some regulations for start-ups.

Some venture capitalists and bankers say that recent structural changes on Wall Street have done more to hurt small companies' IPO chances, including a dearth of research analysts who cover smaller stocks. Without research, big, institutional buyers won't buy those stocks.

"The economics have been destroyed for small-cap IPOs," says Revolution Partners' Mr. Falvey.

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