
2003 Venture Capital Market Review—Hale and Dorr Announces Release of 2003 Venture Capital Report

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Entering 2003, many industry observers believed that the U.S. venture capital financing market would begin to improve as compared to 2002. This optimism was based on both empirical data and the notion that the 2002 venture capital market was so depressed that there was no where to go but up. As it turned out, however, 2003 extended rather than reversed the market downturn that began in the latter part of 2000.

The number of venture capital financings declined for the third straight year. The 1,884 venture financings in 2003 represented a decrease of 15% as compared to 2002, and a decline of 70% as compared to the 2000 peak. The amount of venture capital invested also decreased, from \$21.0 billion in 2002 to \$16.9 billion in 2003. The amount invested in venture capital financings has declined more steeply than the number of deals, reflecting smaller financings.

While venture capital deal flow decreased in 2003, valuations of venture-backed companies showed signs of bottoming out and beginning to improve. For 2003 deals, the median pre-money valuation was \$9.9 million, essentially flat as compared to 2002. However, the trend within the year was positive, as the median pre-money valuation was just under \$9 million for the first half of 2003 and approximately \$11 million for the second half of 2003.

Seed and first-round venture capital financings once again declined in 2003 as a percentage of total venture capital financings. During each year from 1995 to 2000, seed and first-round financings were between 48% and 55% of total venture financings. Since then, however, there has been a significant decline, as seed and first-round financings dropped as a percentage of total venture financings to 38% in 2001, 30% in 2002 and 29% in 2003.

One market metric that has not changed significantly in recent years is investments by industry sector. Financings of information technology companies as a percentage of total venture capital financings ranged from 54% to 59% in each year between 1996 and 2003. The life sciences sector has exhibited a little more volatility over this time period, with a high of 26% of all venture financings in 1996 and a low of 13% in both 1999 and 2000. In 2003, life sciences investments accounted for 24% of the number of venture financings but 32% of the venture funds invested, as the financing sizes have increased slightly in the life sciences sector but decreased in the information technology

sector.

Although the number of IPOs by venture capital-financed companies in 2003 was dramatically lower than the IPO numbers during the boom years of the late 1990s, the trend line during 2003 was more positive, as the breakdown from the first to the fourth quarter was zero, two, six and 13 IPOs. In addition, the median pre-money valuation of the venture-backed companies engaging in IPOs in 2003 was \$233 million. This figure represents a slight increase over 2002 (\$229 million) and, while somewhat lower than 1999–2000 (\$336 million), represents a significant increase over 1996–1998 (\$102 million).

The M&A market was also not an especially fruitful path to liquidity for venture-backed companies in 2003. The number of acquisitions of venture-backed companies continued to decline, dropping to 304 in 2003 from 372 in 2002.

The prices paid to acquire venture-backed companies in 2003 (\$25 million median) were higher than in 2002 (\$19 million median), but were well below the prices paid not only in 1999–2000, but also in 1996–1998. More disturbingly, the median amount of venture capital money raised by acquired companies has increased as the acquisition prices have decreased, further reducing the return to venture capital investors.

The outlook for 2004 can probably best be characterized as one of guarded optimism. We believe that the number of venture capital financings will be greater in 2004 than in 2003, for several reasons, although we expect that the average financing size will decrease in 2004. We also believe that the market for liquidity events—both IPOs and acquisitions—will improve somewhat in 2004.

Our newly published *2003 Venture Capital Report* contains additional information and analysis about the venture capital market, including:

- a detailed analysis of the 2003 venture capital market, including industry breakdowns;
- trends in acquisitions of, and IPOs by, venture-backed companies;
- the outlook for the 2004 venture capital market;
- regional breakdowns (New England, Tri-State, Mid-Atlantic and Europe);
- trends in venture capital deal terms;
- preparing for an IPO following sweeping changes in the regulatory landscape; and
- venture capital counsel rankings.

To request a copy of the *2003 Venture Capital Report*, please click [here](#) or call +1-617-526-5600.

Our companion publication, the *2003 IPO Report*, includes:

- detailed analysis of the 2003 IPO market;
- the outlook for the 2004 IPO market;
- regional breakdowns (New England, Tri-State, Mid-Atlantic and Non-U.S. Issuer);
- a review of the 2003 PIPEs and Rule 144A markets;
- an overview of the impact of the investment banking global settlement;
- discussion of the key attributes of outstanding corporate directors; and

- IPO counsel and underwriter rankings.

To request a copy of the *2003 IPO Report*, please click [here](#) or call +1-617-526-5600.

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