Internet IPOs Conclude a Sensational Year in 1999

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The Internet is probably the most profound cultural, economic and financial development since the Industrial Revolution. The countless examples during 1999 of the pervasive impact of the Internet included:

- Merrill Lynch, the largest full-service stock brokerage in the world, introduced discount online trading
- IBM announced that it would stop selling PCs through retailers in the U.S. and would sell PCs only over the web
- Encyclopedia Britannica placed its encyclopedia for free on the Internet, swapping two centuries of book sales for an online advertising strategy
- Microsoft and Intel became the first "new economy" companies, and the first Nasdaq issuers, to be included in the Dow Jones Industrial Average

Against this backdrop, it is hardly surprising that initial public offerings by Internet-related companies ("*i*POs") dominated the new-issues market in 1999. Still, the extent of the domination was remarkable:

- 289 *i*POs raised $24.66 billion in 1999, compared to 42 *i*POs raising $1.96 billion in 1998
- *i*POs represented 60% of the total number of IPOs in 1999, compared to 14% of IPOs in 1998
- the average *i*PO ended the year 266% above its offering price, compared to an average appreciation during 1999 for non-Internet related IPOs of only 59%; the Nasdaq Composite was up 86% in 1999 and the Dow increased 25% for the year
- the average *i*PO closed 90% above its offering price on its opening day
- of the 30 largest first-day gains in IPO history, 29 occurred during 1999, and nearly all were *i*POs

The only IPO statistic not dominated during 1999 by *i*POs was total proceeds. *i* POs represented 60% of all IPOs in 1999 but accounted for 40% of total proceeds, reflecting smaller deal sizes, on average, for *i*POs than other IPOs. This was primarily due to seven IPOs over $1 billion each during 1999 by non-Internet related companies, led by UPS ($5.47 billion), Goldman Sachs ($3.66 billion) and Charter Communications ($3.23 billion). Interestingly, even UPS could not resist Internet positioning entirely, noting in its prospectus that during the 1998 holiday season it shipped 55% of the goods purchased over the Internet.

Trends and Observations

Confounding Valuations. *i*PO valuations confounded observers throughout the year. Profitability was elusive for most Internet companies, and valuations were driven much more by growth potential than traditional financial measures. In some respects, valuations appeared to reflect a portfolio approach, akin to a venture capitalist who trades the certainty of many losers for the hope of a few big winners. Over time, investor patience with delayed profitability may grow thin, as shown by the market's punishment of Amazon.com for its July and October announcements of widening losses.

Hot Sectors. Even within the Internet industry, some sectors were hotter than others. Early in the year, *i*POs by "e-tailers" engaged in business-to-consumer e-commerce dominated. As the year progressed and the supply of e-tailer *i*POs swelled, enthusiasm cooled and a number of these deals were cancelled or postponed, or had lackluster performance in the aftermarket. By the second half of 1999, the most successful *i*POs were from providers of Internet network equipment and e-commerce software -- the so-called "plumbers" who support the Internet infrastructure -- as well as companies in the business-to-business (B2B) and Internet telephony spaces.

Unseasoned Issuers. The trend toward younger and smaller companies pursuing IPOs continued in 1999, with 81% having less than $100 million in revenue and 57% being less than five years old. This trend has become extreme among *i*POs, with numerous examples of Internet-related companies going public less than two years after formation. The speed and extent of wealth creation as a result of the most successful *i*POs in 1999 was without precedent.

Brand Strength. With the surge in Internet companies and *i*POs in 1999, brand strength proved as powerful in the online world as on Madison Avenue. The market positions of early Internet titans such as Amazon.com, Yahoo! and eBay were solidified due in part to their name recognition, while scores of newcomers struggled to build up brand awareness. Despite an ad blitz from newer competitors, Media Metrix reported in early January that the 50 most-visited Web sites in the 1999 holiday season were dominated by a handful of well-established Internet companies and the new online initiatives of traditional retailers transitioning their brand strength to the web. None of the e-tailers devoted to health and beauty products, luxury gifts or gift certificates made the top 50 list. It remains to be seen whether the multi-million dollar Super Bowl ads of various dot-com startups will catapult them ahead of the pack.

High Volatility. Beginning with startling jumps on their first day of trading, *i*POs in 1999 showed a high degree of volatility. Subsequent price performance of many Internet-related companies, even those with the most successful *i*POs, was often dizzying.

Valuation Shifts

Regardless of the ebb and flow of individual Internet stocks, there has been an economy-wide shift of valuation from brick-and-mortar businesses to their online counterparts. The following table compares the market valuations at December 31, 1997 and 1999 of selected long-established, traditional companies (most of which have now introduced online components) and newer, Internet-based counterparts.

Click and Mortar

Internet companies are beginning to use their highly valued stock to acquire old-line institutions and create "click and mortar" companies. For example:

- In May 1999, eBay, founded in 1995, acquired Butterfield & Butterfield, founded in 1865 and now the third largest auctioneer of fine and decorative art and collectibles in the U.S., for $235 million in eBay stock.
- Wit Capital, an Internet investment banking and brokerage firm established in 1996, acquired SoundView Technology Group, an investment banking firm founded in 1979, for $310 million (paid mostly in Wit stock) in January 2000.
- In January 2000, Charles Schwab, the largest discount online brokerage, agreed to acquire U.S. Trust, a money management firm founded in 1853, for $2.9 billion in stock in order to create a full-service brokerage and wealth management company.
- In the biggest M&A transaction in history, America Online agreed in January 2000 to acquire Time Warner, the largest media and entertainment company in the world with roots dating to the 1920s, in a stock merger valued at $350 billion.

Monthly Data

Winners and Losers

Throughout 1999, and especially in the fourth quarter, *i*POs provided some spectacular opening days for IPOs. VA Linux Systems closed 698% above its offering price on its first trading day, the largest first-day gain by an IPO stock in history. Other *i*POs that were fast out of the blocks included Foundry Networks (525%), FreeMarkets (483%), Cobalt Networks (482%), MarketWatch.com (474%), Akamai Technologies (458%), Cacheflow (427%), Sycamore Networks (386%), Ask Jeeves (364%) and priceline.com (331%). The average first day gain for *i*POs was 90% for all of 1999 and 107% in the fourth quarter of 1999.

Overall, there were far more winners than losers in 1999, with 82% of the *i*POs closing on December 31 at a higher price than their *i*PO prices. The average *i*PO in 1999 closed 266% over its offering price on December 31, including 16 that increased by more than 1,000% and 46 that increased by more than 500%. The average non-Internet related IPO in 1999 closed 59% over its offering price on December 31.

West Coast Tops East Coast

The West Coast generated more *i*POs than the East Coast in 1999, primarily due to a flood of California-based *i*POs. Overall, of the 289 *i*POs in 1999, 162 were by Internet companies based in the Western U.S. (west of the Mississippi River) and 127 were based in the Eastern U.S. California led all states with 115 *i*POs in 1999, followed by New York (40), Massachusetts (23), Texas (18), Washington (11) and Virginia (8). Another 20 *i*POs were by companies based outside of the U.S.

David A. Westenberg
david.westenberg@haledorr.com

Authors

David A. Westenberg

RETIRED PARTNER

david.westenberg@wilmerhale.com

+1 617 526 6000