

## Internet IPOs Show Impressive Strength in Third Quarter of 1999

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Initial public offerings by Internet-related companies ("iPOs") showed impressive strength in the third quarter of 1999, despite overall market choppiness, a mid-summer lull and substantial declines in market valuations of large-cap Internet stocks.

Overall market conditions appeared to be hurt during the third quarter by:

- hikes in interest rates in late June and again in August
- concerns about Y2K-related market turbulence as year-end approaches
- Microsoft President's Steve Ballmer's widely reported statements in September that technology stocks are absurdly overvalued

All major indexes except the Nasdaq Composite declined in the third quarter. The Nasdaq Composite, which is dominated by large technology stocks such as Microsoft, Intel and Cisco, inched up 2.2% in the third quarter. At September 30, the average stock had fallen more than 20% from its 52-week high. TheStreet.com's Internet index of 20 large-cap Web stocks is down more than 30% from April. In this "stealth bear" market, the strength of all IPOs, and iPOs in particular, was somewhat surprising.

### The Big Picture

In the third quarter of 1999, there were 101 iPOs raising \$7.412 billion, compared to 10 iPOs raising \$562 million in the third quarter of 1998. Year to date, 215 iPOs have raised \$17.159 billion. iPOs represented 67% of the total number of IPOs and 41% of the total dollar volume of all IPOs in the third quarter of 1999. Year to date, iPOs represent 57% of the total number of IPOs and 36% of the total dollar volume of all IPOs.

The number and proceeds of iPOs for each month and quarter of 1999 were:

Month	Number of iPOs	Proceeds (millions)
January	4	289.7



February	10	614.5
March	12	1,164.2
<b>First Quarter Total</b>	<b>26</b>	<b>2,068.4</b>
April	19	1,385.2
May	30	2,953.0
June	39	3,340.2
<b>Second Quarter Total</b>	<b>88</b>	<b>7,678.4</b>
July	37	3,307.9
August	30	1,971.6
September	34	2,132.9
<b>Third Quarter Total</b>	<b>101</b>	<b>7,412.4</b>
<b>Year to Date Total</b>	<b>215</b>	<b>17,159.2</b>

#### **A See-Saw Quarter**

The strength of the overall statistics for the *i*PO market in the third quarter masks some significant fluctuations. The July *i*PO market matched the record levels of June as Net-phoria continued. In August, the Federal Reserve Board boosted interest rates for the second time in two months and the *i*PO market cooled. With a few notable exceptions, such as Internet Capital Group and Red Hat, August's *i*POs had lackluster receptions, and many *i*POs were priced below their filing ranges and/or traded down upon their market debuts. More than a half-dozen prominent *i*POs were cancelled or postponed in August, including Garden.com, Medscape, DSL.net, FTD.com and Women.com. The *i*PO market returned with a vengeance in September, led by the spectacular performances of Foundry Networks and Alteon WebSystems, and a total of 30 *i*POs were launched in the last two weeks of September alone.

#### **The New Metrics**



iPO valuations continued to perplex pundits in the third quarter. Profitability was as elusive as ever for most Internet companies, but perhaps the market's punishment of Amazon.com for its July announcement of widening losses is a harbinger that losses will not be tolerated indefinitely. The most successful themes for iPOs in the third quarter were Internet network equipment (the "plumbers"), e-commerce software, Internet telephony and business-to-business (or "B2B"). Companies perceived to be early movers or to enjoy high growth prospects also continued to be well-received in the iPO market.

### Winners and Losers

Once again, the third quarter provided some spectacular opening days for iPOs. Foundry Networks soared 525% on its first trading day, trailing only theglobe.com (up 606% on its opening day of November 13, 1998) for the largest first-day gain by an iPO stock. Other third-quarter iPOs that were fast out of the blocks included Alteon WebSystems (294% increase on first trading day), Red Hat (272%), Efficient Networks (241%), Quest Software (236%) and China.com (236%). The average first day gain was 69% for iPOs in the third quarter, compared to 73% for iPOs in the second quarter and 154% for iPOs in the first quarter.

As measured by increases from the iPO price through September 30, 1999, the biggest winners of the third quarter were:

Company	iPO Date	iPO Price (\$)	9/30/99 Price (\$)	% Change
Internet Capital Group, Inc.	8/4/99	12.00	87.88	632%
Red Hat, Inc.	8/11/99	14.00	96.00	586%
Foundry Networks, Inc.	9/27/99	25.00	126.00	404%
Alteon WebSystems, Inc.	9/23/99	18.00	94.00	395%
Commerce One, Inc.	7/1/99	21.00	97.72	365%



Net2Phone, Inc.	7/29/99	15.00	52.13	248%
Clarent Corporation	7/1/99	15.00	50.94	240%
Kana Communications, Inc.	9/21/99	15.00	49.88	233%
Quest Software, Inc.	8/13/99	14.00	46.50	232%
China.com Corporation	7/12/99	20.00	65.00	225%

The third quarter also produced some *i*PO flops. First-day losers were led by Cobalt Group (down 24% from its *i*PO price), BigStar Entertainment (18%) and Webstakes.com (18%). Through September 30, nine third-quarter *i*POs were trading down more than 30%, led by JFAX.COM (down 48% from its *i*PO price) and Quokka Sports (42%).

Overall, there were far more winners than losers in the third quarter, with 78% of the *i*POs closing on September 30 at a higher price than their *i*PO prices. The average third-quarter *i*PO closed 89% over its offering price on September 30. In comparison, the average second-quarter *i*PO closed 91% over its offering price on September 30 and the average first-quarter closed 113% over its offering price on September 30.

Life at the top can be brief, however. Of all *i*POs in the first half of 1999, 63% saw their market prices decline from June 30 to September 30. Six of the ten best performing *i*POs through June 30, 1999 declined in the third quarter, including Healtheon (down 52% from June 30 to September 30), priceline.com (down 44%) and StarMedia (down 43%). The lockups for five of these six companies expired in the third quarter, suggesting that insider selling (actual or potential) can contribute to price declines. The hottest first-day *i*PO in history, theglobe.com, closed at \$13.69 on September 30, down 57% from its first-day close but still more than triple its *i*PO price (as adjusted for an intervening stock split).

Through September 30, 1999, the ten best performing *i*POs of 1999 are:

Company	<i>i</i> PO Date	<i>i</i> PO Price (\$)	9/30/99 Price (\$)	% Change
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Phone.com, Inc.	6/10/99	16.00	151.50	847%
Redback Networks, Inc.	5/17/99	11.50 <sup>1</sup>	108.00	839%
Internet Capital Group, Inc.	8/4/99	12.00	87.88	632%
Red Hat, Inc.	8/11/99	14.00	96.00	586%
F5 Networks, Inc.	6/4/99	10.00	68.00	580%
Ariba, Inc.	6/23/99	23.00	144.50	528%
Juniper Networks, Inc.	6/24/99	34.00	182.06	435%
Foundry Networks, Inc.	9/27/99	25.00	126.00	404%
CyberSource Corporation	6/23/99	11.00	55.38	403%
Alteon WebSystems, Inc.	9/23/99	19.00	94.00	395%

<sup>1</sup>adjusted for 2:1 split on August 20

### West Coast Tops East Coast

California led the pack again in the third quarter and has now spawned 76 iPOs in 1999. Following California year to date are New York (30), Texas (15), Massachusetts (13) and Washington (10). Although the East Coast edged the West Coast in iPOs in the first half of 1999, the West Coast



topped the East Coast in the third quarter primarily due to a flood of California-based *i*POs. Overall, of the 215 *i*POs in the first nine months of 1999, 110 were by Internet companies based in the Western U.S. (west of the Mississippi River), 94 were based in the Eastern U.S. and eleven were based outside of the U.S.

### Leading Underwriters

In the first nine months of 1999, the underwriters lead-managing the most *i*POs were:

Lead Underwriter	Number of <i>i</i> POs
Goldman, Sachs & Co.	26
Robertson Stephens	24
Credit Suisse First Boston	22
Morgan Stanley Dean Witter	17
Deutsche Banc Alex. Brown	16
Donaldson, Lufkin & Jenrette	14
Bear, Stearns & Co. Inc.	13

### Top Law Firms

The law firms participating in the most Eastern U.S. *i*POs in the first nine months of the year were:

Law Firm	<u>Counsel to Issuer</u>	<u>Counsel to Underwriters</u>	<u>Total <i>i</i>POs</u>	<u>Percentage of Total</u>
Hale and Dorr LLP	8	11	19	20.2%
Brobeck, Phleger & Harrison	6	8	14	14.9%
Testa, Hurwitz & Thibeauct	4	9	13	13.8%



Cravath, Swaine & Moore	0	8	8	8.5%
Davis, Polk & Wardwell	1	4	5	5.3%
Skadden, Arps, Slate, Meagher & Flom	2	3	5	5.3%
Wilson, Sonsini, Goodrich & Rosati	3	2	5	5.3%
Foley, Hoag & Eliot	1	3	4	4.3%
Morgan, Lewis & Bockius	3	1	4	4.3%
Orrick, Herrington & Sutcliffe	2	2	4	4.3%

## Outlook

The *i*PO market demonstrated impressive strength in the third quarter of 1999, despite market choppiness. Key factors that will influence the *i*PO market in the fourth quarter include:

**Holiday E-commerce:** Online spending in the upcoming holiday season is expected to surge, which should boost e-tailers and related e-commerce companies.

**Interest Rates:** The Fed's decision in early October not to raise interest rates is good news for all investors, but the Fed's indication that it is leaning toward higher rates could dampen enthusiasm for Internet growth stocks and *i*POs. The Fed also disclosed in its August 24 deliberations that future interest-rate increases will depend "importantly" on continued "flattening of equity prices" in order to quell inflationary pressures. Since August 24, the Dow Jones Industrial Average has declined by about 10%. The Fed's disclosure suggests that a broad market surge could foretell another rate hike.

**Y2K Concerns:** As the new millennium approaches, concern over possible market turbulence in general, and e-commerce activity in particular, may increase.

**Supply and Demand:** Supply and demand still matter, and there were approximately 125 *i*POs pending at September 30.

On balance, conditions seem favorable for a strong fourth quarter in *i*POs, but it is not a slam dunk. Internet investors are notoriously fickle, and any of the factors noted above could chill the market for new Internet issues. In the longer-term, the *i*PO market should remain vibrant as the shift to a Web-



based economy continues.

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*Note on Data:* All data in this review was compiled by Hale and Dorr LLP. Offering proceeds exclude proceeds from exercise of underwriters' over-allotment options, if applicable. The data came from a number of sources, including IPO Central, IPO Data Systems, SEC filings, Thomson Financial Securities Data and the Washington Service Bureau.

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