IPO Market Completes Slow 2001 with Modest Upturn (Full Text)

2002-01-01

The IPO market was sluggish throughout 2001 in the face of unreceptive capital markets, cautious investors and an economic recession. In the fourth quarter, however, the IPO market did show some signs of recovery.

In 2001, there were only 91 IPOs with gross proceeds of $41.25 billion, compared to 446 IPOs raising $108.15 billion in 2000 and 537 IPOs raising $95.33 billion in 1999. Average deal size jumped to $453.3 million in 2001 from $242.5 million in 2000 and from $177.5 million in 1999, as offerings by more mature companies supplanted start-up company IPOs.

The 91 IPOs in 2001 were the lowest annual total since the 62 IPOs in 1979. With no IPOs between August 13 and October 3, September 2001 became the first month since 1975 without a single new offering, capping the lowest quarterly total (13 IPOs) in more than two decades.

IPOs by U.S. companies declined 77%, from 339 in 2000 to 77 in 2001, and gross proceeds from U.S. issuer IPOs declined 42%, from $55.46 billion in 2000 to $32.19 billion in 2001. With investors turning to offerings by more seasoned companies, gross proceeds were boosted by a number of multi-billion dollar IPOs, led by Kraft Foods ($8.68 billion), Agere Systems ($3.6 billion), Prudential Financial ($3.03 billion) and KPMG Consulting ($2.02 billion).

Overall, the year produced seven billion-dollar IPOs by U.S. companies compared to six billion-dollar IPOs in 2000 – a year with more than four times as many offerings. As a result, average U.S. deal size increased from $163.6 million in 2000 to $418.1 million in 2001. In 1999, with numerous start-up companies going public, average U.S. deal size was only $128.4 million.

Monthly and Quarterly Totals

The monthly and quarterly totals show the docile pace of the IPO market throughout the year:

Month	Total	Proceeds ($ millions)
January	3	212.4
February	9	3,767.9
March	8	4,232.8
First Quarter 2001	**20**	**8,213.1**
April	5	2,291.2
May	9	1,452.1
June	15	14,115.0
Second Quarter 2001	**29**	**17,858.3**
July	9	2,393.4
August	4	620.6
September	0	0.0
Third Quarter 2001	**13**	**3,014.0**
October	7	3,979.3
November	10	1,253.2
December	12	6,931.8
Fourth Quarter 2001	**29**	**12,164.2**
2001 Total	**91**	**41,249.7**

Fourth Quarter Highlights

The IPO market showed some signs of a recovery in the fourth quarter of 2001, with the average fourth quarter IPO increasing 33% from its offer price by year-end. The average IPO from the first three quarters gained 35% during the fourth quarter, outperforming both the

Nasdaq (30%) and NYSE (13%) during the fourth quarter.

Only four of the quarter's 29 offerings ended the year below their offer price and seven had gains of over 50%. The two most successful offerings of the quarter, based on year-end gains, were semiconductor companies Magma Design Automation (up 133%) and Nassda Corporation (up 104%). The fourth quarter also saw a large number of offerings by health care and medical related companies – 13 offerings with an average quarter end gain of 38%.

2001 IPO Market Performance

Aftermarket performance for the average IPO in 2001 bucked the unfavorable market conditions that prevailed throughout the year. Nearly two-thirds of all 2001 IPOs ended the year above their initial offering price, and the average IPO in 2001 was trading 16% above its offering price at year-end. The biggest first-day gainer of the year – Simplex Solutions – increased 77% on its debut, compared to 85 offerings that more than doubled on their opening day in 2000 and 29 offerings that more than tripled in 2000. By year-end, the biggest winner was Verisity, trading 171% above its IPO price. The top performing IPOs of the year were:

Company	IPO Date	IPO Price ($)	12/31/01 Price ($)	Change
Verisity Ltd.	3/20/01	7.00	18.95	171%
Magma Design Automation, Inc.	11/19/01	13.00	30.28	133%
Monolithic System Technology, Inc.	6/28/01	10.00	20.60	106%
Nassda Corporation	12/12/01	11.00	22.49	104%
Williams Energy Partners L.P.	2/5/01	21.50	41.80	94%
Dr. Reddy's Laboratories Limited	4/11/01	10.04	18.95	89%
Accenture Ltd.	7/18/01	14.50	26.92	86%
PDF Solutions, Inc.	7/26/01	12.00	21.00	75%

Willis-Group Holdings Limited	6/11/01	13.50	23.55	74%
Odyssey Healthcare, Inc.	10/30/01	15.00	25.94	73%

Although the aftermarket performance of IPOs in 2001 improved significantly from 2000, in which the average IPO ended the year 19% below its offer price, the comparison to the ebullient market of 1999 is stark. In 1999, 16 IPOs increased more than 1,000% by year-end and the *average* 1999 IPO gained 181% during 1999. Of course, these run-ups proved short-lived for investors who held these stocks, as the top-ten IPOs of 1999 declined an average of 79% during 2000 and a further 55% during 2001.

Offerings by health care and medical related companies accounted for 24% of 2001's IPOs followed by energy related companies with 19% of the year’s offerings, as investors soured on the technology company IPOs that drove the market in 1999 and 2000. Several semiconductor-related and computer-security companies had successful IPOs in 2001 but, overall, technology-related IPOs declined to roughly 45% of all IPOs in 2001 from 89% in 2000 and 81% in 1999. Proceeds from technology company IPOs declined to 28% of total IPO proceeds in 2001 from 79% in 2000 and 59% in 1999. Internet companies have nearly disappeared from the IPO landscape, accounting for only one IPO (Loudcloud) in 2001.

The changing IPO market was also reflected in the percentage of companies listing on Nasdaq and the NYSE. In both 1999 and 2000, 88% of companies going public debuted on Nasdaq. The NYSE had only 9% of new listings in 1999 and 11% in 2000. In contrast, in 2001, 57% of all IPOs were listed on Nasdaq and 41% were listed on the NYSE.

By historical standards, the high-flying IPO market of 1999 and early 2000 was as anomalous as the slumbering IPO market of 2001. Many factors will determine whether 2002 marks a return to more normal IPO conditions.

2002 IPO Market Outlook

We believe that technology will remain a driver of long-term economic growth and that the long-term prospects for many innovative companies in the telecommunications, wireless, electronics, instrumentation, software, life sciences, medical devices and health care industries are bright. Although we do not anticipate a return to the IPO market conditions of 1999 and 2000 any time soon, we do expect the IPO market to improve in 2002 from last year's performance. Companies with experienced management, solid business plans, superior products or market positions and strong growth and earnings prospects will be first in line.

The 2002 IPO market is likely to continue to reflect a higher proportion of more-established companies than in recent years. According to VentureOne, U.S. venture capitalists eschewed most early-stage investing in 2001, allocating approximately 80% of their overall funding to companies in their second or later rounds of financing even as they raised more money to sustain their portfolios. According to VentureWire, venture capital firms raised $55 billion nationally in 2001, down 21% from $70 billion in 2000, but start-up investing dropped 43%. Venture fundraising in 2001 also showed significant shifts between two of the largest regional sources of IPOs, with New England increasing from $8.2 billion in 2000 to $10.0 billion in 2001 while Silicon Valley plummeted from $31.5 billion to $11.2 billion.

The extent of the revival of the IPO market in 2002 will depend on many factors, including the following:

Capital Market Conditions: Capital market conditions have long been a leading indicator for the IPO market. Despite rebounding from a low of 1,387 shortly after the terrorist attacks in September, the Nasdaq ended the year at 1,950 – about where it was trading at the end of 1998 and 21% below where it began 2001 (2,470). The Dow ended the year at 10,022 – 7% below the 10,788 level where it began the year. Earnings warnings, announcements of weak earnings, gloomy economic news and geopolitical concerns depressed the market for most of the year until fourth quarter rallies boosted the major indices. The year-end up-ticks were good news for the IPO market although stock prices remain at the high end of historical price-earnings ratios.

Revived Economic Growth: Fueled by the technology sector, the U.S. economy enjoyed a remarkable ten-year period of growth and wealth creation that finally sputtered to an end in the first quarter of 2001. The Federal Reserve Bank cut the federal funds rate 11 times during 2001, from 6.5% at the start of the year to 1.75% in late December, but lower interest rates do not necessarily address the underlying causes of market weakness in general and of technology stocks in particular. Historically high levels of IT spending driven by Y2K concerns and the build-out of technology networks in the 1998-2000 period produced excess capacity which, coupled with weakening economic conditions, led to a steep drop in technology spending in 2001. Although some signs of increased consumer confidence and business investment had emerged by year-end, the nascent recovery could fail to materialize in 2002.

Earnings and Revenue Growth: With a continued emphasis on profits, especially for technology companies whose valuations often depend on high rates of expected earnings growth, the 2002 IPO market may take a cue from the upcoming fourth quarter earnings announcements. In recent quarters, companies in some technology sectors – notably telecom – have reported declining revenues as well as large losses. A return to revenue growth and profitability would help jump-start the IPO market.

Supply and Demand: For the first time in several years, this factor may bode well in the near-term for the IPO market. At the end of 2001, only 31 active IPOs were in registration according to Dealogic CommScan. With two dozen IPOs in the last two months of the year, including a technology venture-backed company (NetScreen Technologies) with big losses that nonetheless priced 60% above the mid-point of its filing range and jumped another 48% on its first day, the IPO market may finally be showing some signs of momentum. Of course, with more than 80% of U.S. stock mutual funds losing money in 2001 and, according to Lipper, the average tech fund losing 38 percent, institutional appetite for IPOs in 2002 is uncertain.

Emerging Technologies: Much of the impetus for the strong IPO market throughout most of the 1990s can be traced to new technologies in telecommunications, life sciences and other fields. These technologies had – and many still have – great commercial promise but large capital needs, sending scores of young companies to the IPO market. Although innovation never stops, incremental advances do not catch the fancy of consumers or the market as dramatically as revolutionary technologies, such as the PC, biopharmaceuticals and the Internet. How the market reacts to the next “killer app” remains to be seen.

Liquidity Needs: Venture-backed companies depend on a healthy IPO market for liquidity. The huge volume of venture capital investment plowed into start-ups in 1999 and 2000 failed to germinate into IPO market activity in 2001. With capital markets unreceptive to companies without a proven track record or profitable business model, venture capital investors are left with a crop of portfolio companies in later rounds of financing that continue to require funding.

With a larger number of later-stage portfolio companies, venture capital firms will be eager to bring their survivors to market, even at valuations that would have been unthinkable just a year or two ago.

David A. Westenberg

Senior Partner

David.Westenberg@haledorr.com

Tim Gallagher

Financial Analyst

Timothy.Gallagher@haledorr.com

Notes on Data: Hale and Dorr LLP compiled all data in this review unless otherwise noted. Offerings by REITs, bank conversions and closed-end investment trusts are excluded. Offering proceeds exclude proceeds from exercise of underwriters' over-allotment options, if applicable. The data is collected from various sources, including IPO.com, IPOCentral.com, SEC filings and the Washington Service Bureau.

January 18, 2002