

## Tech Stock Swoon Chills Second Quarter 2000 IPO Market

2000-07-01

Market turbulence for technology and Internet stocks chilled the IPO market for most of the second quarter of 2000. The quarter ended on a high note, however, with 18 IPOs in the last week, including three big winners that more than tripled in their first day.

The total number of IPOs declined to 103 in the second quarter from 142 in the first quarter. Total proceeds were down only slightly, to \$31.22 billion in the second quarter from \$32.15 billion in the first quarter. However, nearly 60% of the second quarter proceeds were attributable to just three huge IPOs: AT&T Wireless (\$10.62 billion), China Unicom (\$4.92 billion) and Metropolitan Life (\$2.88 billion).

| Month                      | Total      | Proceeds (millions) |
|----------------------------|------------|---------------------|
| January                    | 21         | 4,085.6             |
| February                   | 55         | 8,673.0             |
| March                      | 66         | 19,390.1            |
| <b>First Quarter 2000</b>  | <b>142</b> | <b>32,148.8</b>     |
| April                      | 37         | <b>17,655.0</b>     |
| May                        | 25         | 2,477.0             |
| June                       | 41         | 11,085.4            |
| <b>Second Quarter 2000</b> | <b>103</b> | <b>31,217.4</b>     |

|                                 |            |                 |
|---------------------------------|------------|-----------------|
| <b>Total First Half of 2000</b> | <b>245</b> | <b>63,366.2</b> |
|---------------------------------|------------|-----------------|

Technology and Internet stocks were particularly hit hard, with the number of Internet company IPOs plummeting from 86 in the first quarter of 2000 to only 47 in the second quarter.

Proceeds from Internet company IPOs decreased from \$10.15 billion in the first quarter to \$6.36 billion in the second quarter, of which 30% came from Genuity's IPO in late June.

|                                 | <b>Internet Related</b> |                                | <b>Non-Internet Related</b> |                                |
|---------------------------------|-------------------------|--------------------------------|-----------------------------|--------------------------------|
| <b>Month</b>                    | <b>Number</b>           | <b>Proceeds<br/>(millions)</b> | <b>Number</b>               | <b>Proceeds<br/>(millions)</b> |
| January                         | 8                       | 791.7                          | 13                          | 3,294.0                        |
| February                        | 38                      | 3,933.4                        | 17                          | 4,739.6                        |
| March                           | 40                      | 5,422.6                        | 26                          | 13,967.6                       |
| <b>First Quarter 2000</b>       | <b>86</b>               | <b>10,147.6</b>                | <b>56</b>                   | <b>22,001.2</b>                |
| April                           | 18                      | 2,170.2                        | 19                          | 15,484.8                       |
| May                             | 9                       | 892.7                          | 16                          | 1,584.4                        |
| June                            | 20                      | 3,299.0                        | 21                          | 7,786.4                        |
| <b>Second Quarter 2000</b>      | <b>47</b>               | <b>6,361.9</b>                 | <b>56</b>                   | <b>24,855.5</b>                |
| <b>Total First Half of 2000</b> | <b>133</b>              | <b>16,509.5</b>                | <b>122</b>                  | <b>46,856.7</b>                |
| <b>Average</b>                  |                         | <b>124.1</b>                   |                             | <b>384.1</b>                   |

The total deals and proceeds tell only part of the story. Scores of planned IPOs were cancelled, delayed or scaled back in size and/or valuation. In the second quarter, 85 IPOs were withdrawn or postponed, compared to just 20 in the first quarter. According to

CommScan LLC, 32 companies reduced their price ranges before pricing in the second quarter, compared to only eight in the first quarter.

Although there were some bright spots in the second quarter IPO market, even marquee offerings stumbled to some extent. AT&T Wireless raised \$10.62 billion in the largest IPO in U.S. history, but closed the quarter below its offering price. Genuity raised \$1.91 billion to become the largest Internet-related IPO in history, but promptly became the largest "broken" Internet IPO by declining 14% its first day.

The decline in the second quarter IPO market was caused by a number of factors, many of them related:

**Nasdaq Swoon:** In mid-April, the tech-heavy Nasdaq, host to the bulk of IPOs, fell 35% from its all-time high set in late March. The long-anticipated market correction hit Internet stocks particularly hard, as TheStreet.com Internet Sector Index dropped 46% from March 9 to April 14.

**Interest Rates:** The cumulative effect of six interest rate hikes since June 1999, topped off by the half-point increase in mid-May, was finally felt. Growth stocks, especially Internet companies swapping rapid growth for earnings, were especially hurt.

**Dot-Com Retrenchment:** The reality set in that a clever domain name and swanky backers could not mask the shallow business models of many business-to-consumer web sites. Layoffs, scalebacks and outright business failures appeared in the online toy, entertainment, apparel, pet supply, gift, advice and other e-commerce sectors. Even Internet titan Amazon.com's viability was questioned by a bond analyst in late June.

## **Winners and Losers**

First-day gains were off sharply in the second quarter compared to the first quarter. The average IPO in the second quarter increased only 36% on its first trading day, compared to an average first-day gain of 93% for first quarter IPOs. The first quarter saw 21 IPOs triple on their first day and 52 IPOs double, compared to only five "triples" and 11 "doubles" in the second quarter.

The top opening-day performers of the second quarter were Marvell Technology (278%), StorageNetworks (234%), ONI Systems (230%), Accelerated Networks (219%) and Bookham Technology (202%). However, none of these deals cracked the all-time top-thirty list for first-day gains.

The second quarter also experienced a larger percentage of IPOs ending their first day of trading below their offering price - 18% of second quarter IPOs compared to 11% of first quarter IPOs.

The biggest winners of the quarter, based on June 30 closing prices compared to offering prices, were:

| Company                        | IPO Date | IPO Price (\$) | 6/30/00<br>Price (\$) | Change |
|--------------------------------|----------|----------------|-----------------------|--------|
| Sonus Networks, Inc.           | 5/25/00  | 23.00          | 157.88                | 586%   |
| Nuance Communications, Inc.    | 4/12/00  | 17.00          | 83.31                 | 390%   |
| Orchid BioSciences, Inc.       | 5/4/00   | 8.00           | 37.97                 | 375%   |
| ONI Systems Corp.              | 5/31/00  | 25.00          | 117.20                | 369%   |
| New Focus, Inc.                | 5/17/00  | 20.00          | 82.13                 | 311%   |
| Marvell Technology Group Ltd.  | 6/26/00  | 15.00          | 57.00                 | 280%   |
| Bookham Technology plc         | 4/11/00  | 15.83          | 59.25                 | 274%   |
| Centillum Communications, Inc. | 5/23/00  | 19.00          | 69.00                 | 263%   |
| Stanford Microdevices, Inc.    | 5/24/00  | 12.00          | 43.44                 | 262%   |

|                              |        |       |       |      |
|------------------------------|--------|-------|-------|------|
| Krispy Kreme Doughnuts, Inc. | 4/4/00 | 21.00 | 73.50 | 250% |
|------------------------------|--------|-------|-------|------|

The average second quarter IPO ended the quarter 73% above its offering price, compared to first quarter-end gains of 57% for first quarter IPOs. Despite the fall from favor of Internet stocks, Internet-related IPOs fared better than other IPOs, ending the second quarter with an average gain of 79% compared to 68% for all other IPOs. The improved performance of second quarter IPOs, as measured by quarter-end prices, may reflect the fact that the IPO market was much more selective in the second quarter.

The average first quarter IPO ended the second quarter only 6% above its offering price. First quarter Internet-related IPOs ended the second quarter with an average loss of 4%, while other first quarter IPOs ended the second quarter up 22% on average.

### Foreign Offerings Continue to Surge

Of the 245 IPOs in the first half of 2000, 88 IPOs (36% of the total) were by companies based in the Eastern U.S. (east of the Mississippi River), 102 IPOs (42%) were by companies based in the Western U.S. and the remaining 55 IPOs (22%) were by foreign companies. Eastern U.S. IPOs raised \$15.54 billion (25% of the total), Western U.S. IPOs raised \$22.87 billion (36%) and foreign IPOs raised \$24.96 billion (39%).

The six-month totals for foreign IPOs now stand just shy of the 1999 full year figures. In 1999, 57 foreign IPOs generated gross proceeds of \$33.70 billion. As noted in our last quarterly IPO report, the trend of foreign offerings in the U.S. is likely to continue because many overseas markets are still developing and trail the U.S. in technological advances and liquidity.

California continues to lead the IPO state rankings with 66 IPOs in the first half of 2000. Next were Massachusetts (21 IPOs), New York (10 IPOs), Texas (10 IPOs) and Washington (9 IPOs).

### Leading Underwriters

In the first half of 2000, the underwriters lead-managing the most IPOs were:

| Lead Underwriter             | Number of IPOs | 1999 Rank (full year) |
|------------------------------|----------------|-----------------------|
| Goldman, Sachs & Co.         | 35             | 2 <sup>nd</sup>       |
| Credit Suisse First Boston   | 31             | 1 <sup>st</sup>       |
| Morgan Stanley Dean Whittier | 26             | 3 <sup>rd</sup>       |

|   |    |                  |
|---|----|------------------|
| Merrill Lynch & Co.                           | 19 | 6 <sup>th</sup>  |
| Robertson Stephens                            | 18 | 4 <sup>th</sup>  |
| Deutsche Banc Alex. Brown                     | 14 | 8 <sup>th</sup>  |
| Chase H&Q                                     | 13 | 10 <sup>th</sup> |
| Lehman Brothers                               | 13 | 7 <sup>th</sup>  |
| Donaldson, Lufkin & Jenrette Securities Corp. | 11 | 5 <sup>th</sup>  |
| Salomon Smith Barney                          | 10 | 11 <sup>th</sup> |

#### Top East Coast Law Firms

The law firms participating in the most Eastern U.S. IPOs in the first half of the year were:

| Law Firm                   | Counsel to Issuer | Counsel to Underwriters | Total | 1999 Rank (full year) |
|----------------------------|-------------------|-------------------------|-------|-----------------------|
| Hale and Dorr              | 8                 | 6                       | 14    | 1 <sup>st</sup>       |
| Ropes & Gray               | 3                 | 6                       | 9     | 9 <sup>th</sup>       |
| Skadden Arps               | 2                 | 5                       | 7     | 4 <sup>th</sup>       |
| Testa, Hurewitz & Thibault | 1                 | 6                       | 7     | 2 <sup>nd</sup>       |
| Davis Polk & Wardwell      | 0                 | 7                       | 7     | 6 <sup>th</sup>       |
| Goodwin, Proctor           | 4                 | 1                       | 5     | 19 <sup>th</sup>      |

|                               |   |   |   |                  |
|-------------------------------|---|---|---|------------------|
| & Hoar                        |   |   |   |                  |
| Morgan, Lewis & Bockius       | 4 | 1 | 5 | 7 <sup>th</sup>  |
| Piper Marbury Rudnick & Wolfe | 4 | 1 | 5 | 19 <sup>th</sup> |
| Cravath, Swaine & Moore       | 0 | 5 | 5 | 5 <sup>th</sup>  |
| Shearman & Sterling           | 0 | 5 | 5 | 19 <sup>th</sup> |

### Valuation Shifts

In our year-end 1999 review of the IPO market, we discussed the economy-wide shift of valuation from brick-and-mortar businesses to their online counterparts. We compared the market valuations at December 31, 1997 and 1999 of selected long-established, traditional companies with newer, Internet-based counterparts. The following table updates this analysis to June 30, 2000:

|                                 | Valuation at<br>12/31/97 | Valuation at<br>12/31/99 | % Change 12/31/97<br>to 12/31/99 | Valuation at<br>6/30/00 |
|---------------------------------|--------------------------|--------------------------|----------------------------------|-------------------------|
| <b>Book Sales</b>               |                          |                          |                                  |                         |
| Barnes and Noble <sup>2</sup>   | 2.27                     | 1.43                     | (37%)                            | 1.43                    |
| barnesandnoble.com <sup>1</sup> | 2.52                     | 2.05                     | (19%)                            | 0.95                    |
| Amazon.com                      | 1.44                     | 25.94                    | 1,699%                           | 12.77                   |
| <b>Auction Services</b>         |                          |                          |                                  |                         |

|                              |       |       |        |       |
|------------------------------|-------|-------|--------|-------|
| Sotheby's                    | 1.05  | 1.76  | 69%    | 1.03  |
| eBay <sup>1</sup>            | 0.72  | 15.21 | 2,026% | 14.26 |
| <b>Toy Sales</b>             |       |       |        |       |
| Toys "R" Us                  | 8.77  | 3.43  | (61%)  | 3.15  |
| eToys <sup>1</sup>           | 2.04  | 3.14  | 54%    | 0.77  |
| <b>Air Travel</b>            |       |       |        |       |
| Delta Airlines <sup>3</sup>  | 10.28 | 6.62  | (36%)  | 6.19  |
| UAL Corp. (United Air Lines) | 5.67  | 4.15  | (27%)  | 2.91  |
| priceline.com <sup>1</sup>   | 2.28  | 6.94  | 205%   | 6.49  |
| <b>Advertising Services</b>  |       |       |        |       |
| Young & Rubicam <sup>1</sup> | 1.66  | 4.92  | 196%   | 4.13  |
| DoubleClick <sup>1</sup>     | 0.27  | 11.39 | 4,124% | 4.67  |
| <b>Stock Trading</b>         |       |       |        |       |
| Merrill Lynch                | 24.44 | 30.55 | 25%    | 44.30 |
| Charles Schwab               | 11.23 | 36.00 | 221%   | 42.45 |
| E TRADE <sup>1</sup>         | 0.31  | 6.39  | 1,969% | 4.81  |
| <b>Communications</b>        |       |       |        |       |



|                |       |        |        |        |
|----------------|-------|--------|--------|--------|
| AT&T           | 99.58 | 162.32 | 63%    | 100.08 |
| America Online | 9.43  | 169.58 | 1,698% | 121.51 |

<sup>1</sup> Company was not public on December 31, 1997. The market valuation for these companies has been calculated by multiplying the company's IPO price by the number of shares outstanding immediately after its IPO.

<sup>2</sup> Barnes & Noble owns approximately 40% of barnesandnoble.com.<sup>3</sup> Delta is an investor in priceline.com.

## Outlook

Although the quarter-end strength has given the IPO market some momentum entering the third quarter, it probably does not signal a return to the Internet-mania that fueled the IPO market for most of 1999 and early 2000. It does, however, demonstrate that quality sells even in a selective market. The breadth of any rebound in the IPO market in the coming months will depend on many factors, including the following:

**Interest Rates:** All eyes are on the Fed as it seeks to engineer a soft landing to the longest-running economic expansion in U.S. history. The Fed did not raise interest rates at its June meeting, but it's anybody's guess whether rates have stabilized. Many analysts believe the Fed will act again, noting that its most recent report indicated a "bias" toward further increases.

**Market Recovery:** General market conditions must remain on their recently favorable course if IPOs are to return in force. By the end of the second quarter, the Nasdaq Composite Index had recovered 19% from its 2000 low, although it was still 21% below its record high. TheStreet.com Internet Sector Index was up 18% from its April low but still trailed its high by 37%.

**Supply and Demand:** The ongoing shift to a technology-based economy, coupled with a significant volume of venture capital investment, should continue to supply the IPO pipeline. The supply of "IPO shares" also increases when pre-IPO stock floods the market as IPO lockup periods expire. Demand is the trickiest part of this equation.

**Focus on Earnings:** The increasing selectivity among Internet and technology-based companies has placed a renewed emphasis on profitability. Although few Internet companies have ever turned a profit, they are now expected to show narrowing losses and a plausible model to achieve profitability. Upcoming second quarter earnings announcements should help

set the tone for the IPO market.

**E-commerce Prospects:** Many Internet and technology stocks relate, directly or indirectly, to electronic commerce. The increasing importance of e-commerce remains inevitable, but the pace and scope of its proliferation continue to be hindered by the twin challenges of privacy and security.

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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.

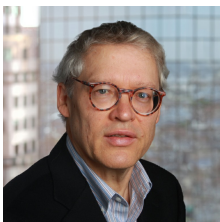
The data came from a number of sources, including IPO.com, IPOCentral.com, SEC filings and the Washington Service Bureau.

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