



Is SOX to blame for IPO decline? What's next?

By Matthew Sheahan, Senior Editor
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Normally, the number of venture-backed IPOs jumping almost 100% in one quarter would be a cause for celebration. But the rise between the second and third quarters still leaves a VC-backed IPO market that is a shadow of its 2004 self.

A total of 19 venture capital-backed companies launched IPOs in the third quarter for a total of about \$1.5 billion, according to Thomson Venture Economics (publisher of VCJ) and the National Venture Capital Association. That is a significant jump from the second quarter, when 10 VC-backed companies began trading on public markets in offerings worth approximately \$714 million. But the total is far off the mark set in the third quarter of 2004, when 24 venture-backed companies held IPOs for a total of more than \$3.2 billion.

There is little hope that this year's VC-backed IPO total will match last year's. In 2004, a total of 93 venture-backed companies held IPOs for more than \$11 billion. For 2005 to match that mark, 54 venture-backed companies would have to go public in Q4.

"You're going from very, very poor to very poor," says NVCA President Mark Heesen. "This isn't a time for excessive jubilation. It is good to see the uptick, but that's what it is, an uptick."

Heesen points out that while the M&A market was very healthy in the third quarter—with 74 venture-backed companies getting acquired—the industry also needs a healthy IPO market. "You need to have your stars, and your stars are the companies that go public," he says. "For entrepreneurs to have goals they need to be able to look at the Googles of the world and want to emulate them."

Many in the venture capital industry blame Sarbanes-Oxley regulations for the reduced number of IPOs. "Sarbanes-Oxley has been very bad for IPOs," Tim Draper, managing director of Draper Fisher Jurvetson, told VCJ in response to an email query. "It costs a minimum of \$1 million per year to comply with Sarbanes-Oxley, a real deterrent for small companies to go public. So they are waiting longer."

David Reuter, a vice president with Philadelphia-based private equity firm LLR Partners, agrees that Sarbanes-Oxley has had a profound impact on private companies. "The financial costs and what I'll call emotion cost over the last couple of years are very substantial," he says. "You have a direct hit to your profitability. A lot of private companies are examining that closely

and not going public to remain a more profitable business." He adds that the financial terms of Sarbanes-Oxley have also increased premiums on directors and forced substantial infrastructure investment in order for companies to meet internal reporting requirements.

In spite of Sarbanes-Oxley, the VC-backed IPO market is "healthy," says Reuter. He notes that the lean period between 2001 and 2003 caused demand to spike in 2004. "To the extent that [VC-backed IPO activity] dramatically increases, people will begin to develop skepticism of companies that are coming out," Reuter says. "I prefer to avoid that."

John Fitzgibbon, an analyst with IPO reporting firm IPO Desktop, has a positive outlook for the IPO market as a whole. "The traffic in the IPO market has been picking up since the Nasdaq hit its low at the end of April," he says.

Fitzgibbon expects to see a continual increase in IPOs in the fourth quarter. He says that the market is still solidly a bull market despite a host of adverse economic events. "Interest rate changes, oil up to \$70 a barrel, natural disasters, exploding debt and there's no end in sight for the deficit: These are not exactly the ground work for a bull market, but this market hasn't sold off on us," he says. "People have had every reason in the world to bail out of the market and they haven't."

There are plenty of VC-backed companies waiting in the IPO queue. Thirty such companies were in registration with the SEC at the close of Q3 (compared to 38 at the end of the second quarter).