Doors Opening for Venture-backed Exits, M&As Set Record

National Venture Capital Association NEW YORK – It may be too soon to "declare a recovery," but doors are opening for venture-backed exits, according to Thompson Reuters and the National Venture Capital Association's first quarter 2010 report. The quarter's 111 merger and acquisition deals were the most on record, the report says. Nine venture-backed firms went public in the quarter, a number of IPOs unmatched since the fourth quarter of 2007.

The number of IPOs in the quarter exceeded the entire total of IPOs in 2009. Several have done quite well. The report notes that 43 firms are now registered to launch IPOS.

For the first quarter, 31 disclosed venture-backed M&A exits averaged $180.2 million, which was 21 percent higher than the total average disclosed transaction value for all of 2009.

There were nine venture-backed IPOs valued at $936.2 million in the first quarter of 2010 quarter of 2009, more than double the amount raised during the fourth quarter of 2009. During the first quarter of 2009, no venture-backed companies came to market with initial public offerings.

The information technology sector led the venture-backed M&A landscape, with 81 deals and a disclosed total dollar value of $2.3 billion.

Three of IPOs were in biotech

Three of the eight IPO exits for the quarter were in the Biotechnology sector, accounting for a total of $310.5 million. Within this sector, Cambridge, Massachusetts-based biopharmaceutical company, Ironwood Pharmaceuticals, raised $187.5 million in the largest venture-backed IPO of the quarter.

"The exit activity in first quarter of 2010 has engendered a cautious optimism within the venture capital industry," said Mark Heesen, president of the NVCA.

"The IPO volume, while not nearly enough to declare a recovery, has shown the most improvement since the financial crisis began and the pipeline of companies in registration continues to build.

"The record breaking number of venture-backed acquisitions is also encouraging as the quality of these transactions appears to have held strong. It is premature to suggest we have permanently turned the corner, but that corner is in sight and within reach as long as we can continue this positive upwards trajectory over the next consecutive quarters."

DowJones Venture Source offered slightly different totals but similar conclusions.

"After two difficult, nearly dormant years for IPOs, venture-backed companies started 2010 with a strong showing in the public market," added Jessica Canning, the global research director for Dow Jones VentureSource.

Canning said 2010 is shaping up to see an active IPO market, music to the ears of entrepreneurs and venture capitalists alike after the last year of a nearly shuttered IPO window. Last year the first quarter saw no IPOs, for instance.

VC Ranks Thinning Overall While New Firms Entering the Fray

Sizing Up Promising Young Firms

The technology bubble popped a decade ago, but the venture-capital industry that helped finance the boom stayed largely intact. Now venture-capital firms are going through their own brutal culling.

Venture firms are struggling to raise new cash, hampered by poor investment returns and a difficult economy. Last year, 125 venture funds in the U.S. collected $13.6 billion, down from 203 funds that raised $28.7 billion in 2008 and down from 217 funds that raised $40.8 billion in 2007, according to data tracker VentureSource.

Pacific Biosciences, which makes DNA-sequencing instruments, came out No. 1 in a ranking of the 50 venture-backed companies in the U.S. with the greatest potential. **Read more.**

"There are a lot of firms that have dropped off," says Rebecca Lynn, a principal at venture capital firm Morgenthaler Ventures in Menlo Park, Calif. "We'll see a continued shakeout as a lot of firms that aren't the top firms won't be around."

There were 794 active venture-capital firms in the U.S. at the end of 2009, meaning they have raised money in the last eight years, down from a peak of 1,023 in 2005, according to Thomson Reuters and the National Venture Capital Association.

Amid all the gloom, some start-ups are still managing to find backers. Pacific Bioscienses Inc., which makes DNA sequencing instruments, has raised more than $260 million and tops a list of 50 venture-funded companies compiled by research firm VentureSource, a unit of Wall Street Journal owner News Corp. (See the complete list.)

Many venture firms—which put money into young companies with the aim of profiting later when those firms are sold or go public—profited handsomely in the boom years in the late 1990s and early 2000, when the industry fueled the dot-com bubble and spawned hits such as eBay Inc. and Yahoo Inc. Even when the boom went bust, venture firms kept going because their funds typically are set up as long-term, 10-year investment vehicles that don't quickly close down like a hedge fund might.

Pacific Biosciences is working on a DNA sequencing process that it says will allow a person's genome to be sequenced in under an hour for less than $100 making a future of personally tailored genetic medicine more feasible.

But in the past decade, many start-ups have flopped or have struggled to go public amid an unwelcoming market for inital public offerings. The tough environment has been exacerbated by the credit crunch, which makes it difficult for many start-ups to obtain bank lines of credit, say venture capitalists.

While failed start-ups aren't new, some of the busts have been particularly big recently, with the investments selling their assets for just a tiny fraction of the amount they raised.

Take, for example, Copan Systems Inc. The data-storage company, based in Longmont, Colo., raised more than $107 million in venture capital over the past eight years, according to VentureSource. Despite all the cash, the start-up fizzled: Late last month, Copan's assets were sold in a private foreclosure sale to Silicon Graphics International Corp. for $2 million.

"The company had some traction but it just required too much money to get there," says Phil Siegel, a partner at venture-capital firm Austin Ventures, which invested in Copan. Silicon Graphics acknowledges that it got a good deal.

By PUI-WING TAM

The market has been lukewarm towards venture-backed initial public offerings since the dot-com bust in 2000 and 2001. And while some venture capitalists have profited in recent years by selling start-ups for big sums—think of Google Inc.'s $1.7 billion purchase of video site YouTube in 2006—the returns from such deals typically aren't as lucrative as those generated by IPOs.

Overall, venture-backed companies generated $17.1 billion in IPOs and mergers and acquisitions in 2009, down 34% from $26.1 billion produced in 2008, according to VentureSource.

Many venture capitalists—especially those working at lesser-known firms that don't have the same access to the best deals as high-profile firms such as Sequoia Capital and Accel Partners—don't have much of a track record to show investors as they try and garner new cash. As a result, some venture firms are winding down.

Frazier Technology Ventures late last year said it didn't plan to raise a new fund. Len Jordan, a partner at the Seattle venture fund, says the firm "concluded it wouldn't be successful in raising a new fund after we had spent some time trying."

Frazier Technology is continuing to support the start-ups it has invested in out of its current $104 million fund, says Mr. Jordan.

Other venture firms are lowering their fund fees or are raising smaller funds than in the past. Late last year, venture-capital firm Highland Capital closed a $400 million fund, half the size of its previous fund, which was raised in 2006.

And Draper Fisher Jurvetson, Battery Ventures and Opus Capital have all offered lower fees to investors in recent months as they have pursued new funds.

In response to the tough environment, some venture firms are searching for better returns in new areas. While Steamboat Ventures, an affiliate of Walt Disney Co., has continued to have exits in the U.S., it has also focused overseas in the past four years, particularly in markets like China, says John Ball, a Steamboat managing director.

The venture firm today has a third of its capital allocated to Asia, with two thirds in the U.S., he says. "It's a useful way to diversify across markets," says Mr. Ball.

Meanwhile, Austin Ventures has de-emphasized its investments in young companies and is instead focused on larger private-equity deals that take $15 million to $25 million of capital, says Mr. Siegel.

That arena is less crowded, he says, which means there's more opportunity. "We're moving to where the puck is going," says Mr. Siegel.

VC Returns Up in Short Term, Down Over 5 & 10 Years

National Venture Capital Association WASHINGTON, DC – Venture capital performance improved slightly in the shortest and longest time horizons ending September 30, 2009 but continued to deteriorate in the 5 and 10-year periods ending in the quarter, according to the Cambridge Associates U.S. Venture Capital Index, the performance benchmark of the National Venture Capital Association.

The 10-year return fell to 8.4 percent from 14.3 percent in the previous quarter – and from 40.2 percent one year earlier.

The decline was not unexpected as the lucrative 1999 exits are no longer included in the 10-year calculation. The 5-year returns also declined to 4.9 percent from 5.7 percent in the previous quarter and from10.7 percent one year ago.

Impact of Net bubble took a decade

"It has taken a full decade after the technology bubble burst for the venture industry to fully realize the impact of that era and its aftermath," said Mark Heesen, president of the NVCA.

"The significant returns created by the robust exit markets of the late1990s have carried the industry for a long period of time. The new reality is much more somber for many venture firms. There are still healthy returns to be made in venture capital, but until the venture community seesa more vibrant exit market we do not expect marked improvement overall."

Peter D. Mooradian at Cambridge Associates, said, "The exit markets have displayed some welcome signs of life in recent months, and we have noted a more upbeat outlook among a number of GPs with respect to potential exits. That said, exits have not recovered to a level that can support healthy venture capital returns, and it remains to be seen if recent activity will evolve into more sustainable momentum in 2010."