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TECHNOLOGY IPOs DECLINE SINCE FACEBOOK, AMID DEARTH OF NEW TECH BREAKTHROUGHS

by Dan Lonkevich

U.S. technology initial public offerings have fallen in number and volume since **Facebook**'s **(FB)** $16 billion IPO in May 2012, as technology companies and institutional investors slept off the hangover from the social media network's mess of a coming-out party.

Now, four months into 2013, the tech sector seems thirsty for some new magical elixir, or perhaps a nip of hair of the dog from last year, except that nothing at the bar will do.

Year-to-date, six technology IPOs have raised $965.6 million, according to data from Dealogic. Of those, one tech IPO raised $96.6 million in the second quarter and five tech deals raised $869 million in the first quarter. In the first quarter of 2012, 12 tech IPOs raised $1.28 billion.

The biggest tech IPO of the year so far was phone conference services provider **West Corp.**'s **(WSTC)** $425.5 million deal on March 21, followed by ad-tracking company **Marin Software**'s **(MRIN)** $120.8 million deal March 21, enterprise software developer **Model N Inc.**'s **(MODN)** $120.1 million deal March 19 and enterprise software developer **Rally Software Development**'s **(RALY)** $96.7 million deal April 11.

Tech IPOs represented a paltry 10% of the total volume of IPOs in the first quarter and only 14% of the number of deals. That compared with 22% of the volume and 31% of the number of deals in the first quarter of 2012.

The share of tech IPOs also was lower than in the fourth quarter when tech IPOs accounted for 14% of the volume and 16% of the deals. The shares were the lowest since the third quarter of 2011 when tech deals accounted for only 5% of volume and 14% of deals.

"It's not a reflection of a lack of appetite from institutional investors," said Charles Mather, the head of equity

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IROQUOIS URGES GALE FORCE CEO, BOARD TO STEP DOWN OVER 'SEVERE MISMANAGEMENT'

Iroquois Capital, one of the most active investors in private placements by microcap companies, is calling for Canadian oil and gas producer **Gale Force Petroleum (GFPMF)** to replace its management and board because of "severe mismanagement of Gale Force's otherwise valuable assets."

In a letter dated April 25, Joshua Silverman, the managing partner of New York-based Iroquois Capital and the Iroquois Master Fund, and Scot Cohen, who manages the Iroquois Capital Opportunity Fund, say Gale Force "is deeply undervalued largely as a result of the lack of effective oversight by the board of directors of the company, which has lost its legitimacy and the confidence of its shareholders."

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capital markets at investment bank **Janney Capital Markets** in New York. "In the second half of March, a lot of deals actually got done. It's more a reluctance of issuers, because of a hangover from the Facebook IPO."

The Shadow Pipeline

Mather said he is optimistic that IPOs in general and tech IPOs in particular will make a comeback in the rest of 2013 because "the performance of the deals that have been done has been strong."

Many technology companies have opted to declare themselves as emerging growth companies under the Jumpstart Our Business Startups Act and have filed for IPOs through the confidential channel offered by the JOBS Act, he said.

"The shadow pipeline of deals is more heavily populated by technology deals than the activity to date would suggest," he said.

Even though Facebook was in every important way sui generis, the poor performance of its stock in the wake of the IPO has made many technology company chief executives skeptical of the IPO market and more willing to look for capital from private placements.

"So much of the tech world's focus has been on Facebook," Mather said. "We heard that from people all over the market in large caps, mid caps, and even microcaps."

Janney is seeing more activity since the latter half of March and there's been lots of enthusiasm for enterprise software as a service, or SAS.

Institutional investors have been attracted to enterprise SAS because of its subscription based revenue model which is steady and predictable.

"It's a prescription for enthusiasm in the institutional universe," Mather said.

Even though "2008 is clearly receding in the rearview mirror, experienced practitioners in the institutional investor community still have memories of the volatility in the market during and after the financial crisis," he said.

"The 'tweet retreat' is only the latest example of investor fears," Mather said, citing a hacked tweet of an *Associated Press* story on April 23 about a supposed bombing at the White House. It erased $136 billion of value from the S&P 500 before it could be corrected.

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>
> *—Christopher Marlett*
> *MDB Capital Group*

"We'll see a lot more tech IPOs this year," Mather said. "Whether they represent as large a share as other sectors is another matter."

IPOs by real estate investment trusts and energy master limited partnerships have become fixtures in the IPO market, and tech IPOs may not been able to overtake their position, he said.

Most likely, tech IPOs will continue to underperform these emerging sectors "because we don't have another Facebook"-type IPO waiting in the wings.

In the meantime, some tech CEOs have eschewed IPOs in the current anti-Facebook climate and sought to raise significant amounts of capital from private placements.

Eventbrite Inc., a privately held online event ticketing company, raised $60 million from **T. Rowe Price Group** and **Tiger Global Management**, allowing it to put off an IPO.

Kevin Hartz, co-founder and CEO of San Francisco-based Eventbrite, couldn't be reached for comment.

He told *The Wall Street Journal* that money invested by T. Rowe Price and Tiger gave Eventbrite "flexibility in setting the timeline for a later IPO, on our schedule."

"I would agree that Facebook has spooked a lot of people," said Mitchell Littman, a partner at the law firm of **Littman & Krooks** in New York. "The analogy I'd make is people have been on the beach and now they're beginning to dip their toes in the water."

The volume of technology IPOs also may be down because technology entrepreneurs as a group "are more savvy about mergers and acquisitions as an exit strategy alternative to an IPO," Littman said.

"That kind of mentality has shifted, especially with the younger generation of technology entrepreneurs," he said. "They've seen people make money from selling their startups and move on to do other interesting things. These entrepreneurs are not going to be married to their jobs and their startups forever."

Lack of Tech Innovation

Some market players are skeptical that tech IPOs will make much of a comeback this year or even in the next few years.

"There isn't much new out there," said Christopher Marlett, CEO of boutique investment bank **MDB Capital Group** in Santa Monica, Calif. "There isn't a social-networking-hype wave. There are a lot of deals but nothing that's capturing the imagination of institutional investors. There just isn't a tech boom right now."

MDB Capital Group is one of the few firms out doing microcap tech deals, Marlett said.

"We're keeping busy because we have a proprietary business model," he said.

The major banks, however, are sitting on the sidelines because there's nothing big to do.

"When you think about technology, so much of the developments have

been around computing power," Marlett said. "People don't buy computers any more. You're seeing people do things on the cloud. Personal computers and software are dead. And social media maybe isn't what we thought it was cracked up to be."

Littman said Marlett makes a fair point about the lack of any new technologies.

"If you look at recent reviews of new devices like the iPhone, they complain that none of the devices feature any new break-through technology," he said. "It's all just improvements on existing technology."

Another factor Marlett points out is that the venture capital market just doesn't have the war chest to fund new exciting ventures after a 10-year period in which many funds lost money.

After funding venture capital funds for years with little to show for it, pension funds are shying away from venture capital, he said. The result has been venture capital funds that are surviving on fumes and struggling to produce enough returns to justify their fees.

"Financial bubbles are good because lots of new things get funded," he said.

"IPO volume is not going to be very high until we see another boom in technology," Marlett said. "I don't see it coming back in any big way for a long time. That's why we're more focused on physical sciences and life sciences. The dynamics in tech are totally changed right now."

'Political Belly Wash'

For some IPO market observers, the problem with tech IPOs is really just a microcosm of the problems with the broader IPO market.

"The market structure just doesn't support small cap companies and startups," said David Weild, the chairman and chief executive officer of **Weild & Co.**, a New York-based boutique investment bank. "We should be having 900 IPOs a year and instead we've been having about 96 a year. When you're dealing with such small numbers, you're going to have a lot of noise."

The current market structure doesn't provide visibility and support to small cap companies, Weild said. Stock prices quoted in decimal increments and regulations mandating the separation of research and underwriting have reduced trading and underwriting revenue.

"If you pull all the incentives out, then you have the collapse of the small cap IPO market," he said.

Weild has advocated for allowing companies to experiment with wider tick sizes, which would allow underwriters to earn larger profits from trading. Those trading fees used to enable them to provide research and other market-making support to small cap companies.

The Securities and Exchange Commission is currently considering its options with regard to experimentation with tick size. Earlier this month, the SEC's Advisory Committee on Small and Emerging Companies recommended that the SEC adopt a rule that would allow smaller companies to let their stocks trade in larger tick sizes.

The advisory committee said that economic incentives were needed to convince investment banks and other market participants to provide services such as market making and equity research. Allowing companies to choose their tick sizes could help the banks to generate enough revenue that they would be willing to add market makers and provide analyst coverage of smaller companies. That, in turn, could generate more interest among investors.

The committee also recommended against a temporary or pilot program for determining tick sizes and instead urged the SEC to commit to a permanent change in rules regarding tick sizes.

"In my humble opinion, we've finally gotten to the perfectly regulated market," said Chris Andersen, the founder of boutique investment banking and advisory firm **G.C. Andersen Partners** in New York.

"We are so regulated that no individual investor has enough intelligible information to form a fundamental opinion on value," he said. "In a funny way, we so reduced the flow of information we no longer have to worry about insider trading because most of our trading is being done without information!"

Anderson said that even company insiders today prefer to get liquidity for their holdings in the private market because it's so much easier and less expensive than going public.

"Trying to comply with regulations has become so onerous and cumbersome, people are jumping through hoops to avoid the public markets," he said. "We've forced the research analysts out of the market who used to provide so much support to startup companies and IPO's aftermarkets."

Investors are investing without making fundamental decisions about a company's business, he said.

"Instead of buying stocks, they're using algorithmic models to trade or else they buy ETF and sector funds," he said. "It's starving the market. Individual investors no longer bother with having fundamental convictions about a company's merit."

Entrepreneurs "are asking, 'Why should I do an IPO when I can sell my securities in the private market?'" he said. "The public market has become less viable and attractive."

Asked whether the JOBS Act wasn't supposed to solve some of these issues, Andersen said "can't you recognize political belly wash when you see it?"

With the current regulatory climate, Andersen said "we have the illusion of volume that evaporates anytime something bad happens. That is not a market."

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