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Bay Area IPOs reap less in 2006

Many startups turning to London stock market to avoid high fees for complying with U.S. regulations

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The financial lifeline for the Bay Area's innovation economy may need a shot in the arm.

Fledgling companies based in the nine-county region are not raising as much money through first-time sales of their stock to the public as they did a year ago, according to a Times survey.

Through the first 11 months of 2006, the dollar value of initial public offerings for Bay Area companies had slumped 22 percent compared with the same period in 2005.

The setback for initial public offerings in the Bay Area marks the second-straight year of declines following a robust 2004 whose signature event was the IPO for Google Inc. And nationwide, IPO activity is up in 2006 compared with 2005.

The sluggish trends for Bay Area IPOs is the second indicator in about a month that suggests startups in this region may be having a tougher time raising capital than they did the year before.

The MoneyTree survey, released in October, determined that venture funding for privately held companies in the third quarter of this year had fallen 10 percent below the 2005 levels.

Why is this happening? A number of financing professionals believe regulatory red tape caused by the Sarbanes Oxley corporate governance legislation has prompted new companies to avoid going public. In some cases, they have been forced to go overseas to harvest financing in the public markets.

"We expect many more liquidity exits for our privately held companies through mergers and acquisitions than through IPOs," said Randy Hawks, managing director with Oakland-based Claremont Creek Ventures.

Bay Area companies raised about $1.85 billion through an IPO during the first 11 months of 2006, the Times analysis shows. That compares with $2.36 billion raised via IPOs over the same period in 2005.

The IPO market did display some hopeful signs, though. While 2006 will likely mark a second-straight year of funding erosion, the totals for this year are well above the dismal year of 2003, when Bay Area firms raised only $932 million.

Plus, in the first 11 months of this year, 17 Bay Area companies went public, slightly above the 15 that staged IPOs from January through November of 2005.

Through Wednesday, two East Bay companies had gone public in 2006. Fremont-based Smart Modular Technologies Inc. raised $163.8 million in its IPO. Hayward-based Thermage Inc. raised $42 million in its offering a few weeks ago. In 2005, one East Bay company, Ikanos Communications Inc. of Fremont, went public, raising $76.8 million.

A growing number of companies are going to the United Kingdom to float their IPOs on exchanges in London.

"It's not that it is less expensive to go public on the London exchange, but that the ongoing costs of complying with regulations is less expensive in England," said Donald Reinke, a partner with the Oakland office of Reed Smith.

Reinke said ongoing costs of complying with U.S. regulations can be three or four times as much than for companies that trade in London. Reinke helped arrange public stock sales for two California companies in the U.K., including South San Francisco biotech firm Napo Pharmaceuticals. Napo raised $22 million.

Hawks pointed out that in 1999, 45 percent of U.S. privately held companies that were backed by venture money wound up going public, and 55 percent wound up in a merger or acquisition.

In 2006, 10 percent of the private companies with venture funding went public, and 90 percent ended with a merger or acquisition, Hawk said, citing venture industry data.

Still, venture professionals say they still see plenty of activity for new Bay Area companies. But it is primarily in the private venture market.

"Innovation is even more buoyant in the Bay Area than it has been," said Randy Williams, founder and chief executive of the Lafayette-based Keiretsu Forum, which provides early stage financing for private companies. "We are having explosive growth in activity. We see a lot of interesting opportunities in software, telecommunications, biotech."

Despite the new obstacles for raising public money, analysts believe the Bay Area will remain a vital center for startups.

"Innovation is the fundamental element that makes the Bay Area economy different from any other region in the United States," said Bruce Kern, executive director with the East Bay's Economic Development Alliance for Business.

He said he believes this will continue in the Bay Area and the East Bay. "The seed corn of innovation is being supplied by the area's universities and laboratories," he added.

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