

## PRIVATE EQUITY PARTNERS | MARKET UPDATE

May 2005

In this month's commentary, we discuss the perceived symbiotic relationship between the IPO market and venture capital liquidity.

### IPOs as an Historical Liquidity Option

The infusion of venture capital coupled with the onslaught of initial public offerings in 1999-2000 has in the public's mind linked the two financing strategies with one another. Many believed (and continue to believe) that venture liquidity strongly depends on a robust IPO market. Certainly venture capitalists benefit from the markets' ready acceptance of new issues, but public offerings are by no means the only available exit strategy. In fact, as the data below shows, IPOs have never even been the primary source of liquidity for venture-backed companies.

Venture-backed Liquidity Events (\$ in millions)					
Year	IPOs (Total)	Total Offer Amount	M&A Deals (Total)	M&A Deals (Disclosed)	Total Disclosed Value
2000	264	\$25,499.4	316	202	\$68,353.1
2001	41	\$3,489.9	350	165	\$17,660.7
2002	24	\$2,473.5	315	150	\$7,830.9
2003	29	\$2,022.7	291	123	\$7,726.1
2004	93	\$11,014.9	333	181	\$15,111.9

Source: Thomson Venture Economics & National Venture Capital Association

Even during 2000 (the hottest year for IPOs) venture-backed M&A deals exceeded the total number of IPOs, 316 to 264. What's more, total M&A liquidity events in the next four years eclipsed public offerings by nearly 7-to-1. When the bubble burst in 2001 and the IPO window closed, venture capitalists continued to seek liquidity by selling their portfolio companies to both financial and strategic acquirers. This trend continues today. Although public offering activity picked up considerably in 2004, venture capitalists still tap the M&A market as a primary means of exiting their investments. Notwithstanding the changing nature of venture-backed liquidity over the past five years, we believe Mark Hessen, President of the National Venture Capital Association, put it best when saying, "The public tends to focus on the IPO market as the more visible liquidity event, but acquisitions are truly the bread and butter of venture capital exits." Indeed, M&A has been and still remains the more prevalent liquidity option for venture-backed companies.

### A Note on the Current IPO Market

Despite the increased number of public offerings in 2004, today's IPO market remains highly selective. A large registration backlog (~100) currently exists but it is unknown whether or when these deals will actually get done due to recent market volatility. That said, the more important question facing investors making allocations to venture capital today is what the M&A and IPO markets will look like 4-5 years from now when the majority of their portfolio companies are mature enough to be exited. Regardless of IPO market conditions, LPs must assume that liquidity alternatives will exist for venture-backed companies of enduring value, be it an IPO, sale to a strategic suitor or recapitalization with another private equity firm.

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