

## Going public not the best route for some tech companies

Kenneth Epstein

Life is not fair. Take, for example, closely held semiconductor capital equipment companies.

The boom in initial public offerings by tech companies gives the impression that any company can launch a successful IPO. If frenzied investors welcome the IPOs of Internet companies that are losing money and have no immediate prospects for earnings, then a well-managed and profitable semiconductor capital equipment maker certainly should be able to command a healthy stock value, right? Wrong. Out of the hundreds of such companies nationwide, barely a handful can expect to launch an IPO any time soon.

Here's why: The big, public semiconductor capital equipment companies are valued at 30 to 40 times earnings, and their market capitalizations (the number of shares outstanding multiplied by the stock price) exceed \$1 billion. But smaller competitors, even those with market caps of \$150 million, sell for only 10 or 15 times earnings. That's because investors are willing to pay a premium for the greater customer and product diversification of larger companies, as well as their perceived superior financial strength and management depth.

So, underwriters rarely will take a company public unless its expected market cap is at least \$100 million; often, the minimum target is \$200 million. Otherwise, the risk of not selling all the shares is too great.

Most IPOs are handled by a consortium of security firms, but sometimes a single underwriter will take a company public, usually with poor results. Such IPOs are done on a "best efforts" basis, which means the underwriter does not guarantee all the shares will be purchased but merely that it will do its best to sell the shares. If the entire offering is not sold, the value of the shares already sold almost always plummets. However, the expense of the IPO remains fixed and the net proceeds to the company could fall far short of expectations.

For its stock to be liquid, a new public company needs a breadth of sponsorship that a single underwriter simply can't provide. What's more, if other security firms were not interested in underwriting the IPO, chances are their analysts won't be interested in following the stock.

Often the lone underwriter becomes tired of creating a market for the stock. Once that happens, the stock's price spirals downward. The company won't issue more stock because the price is so low, and bitter shareholders are loath to sell their holdings for the same reason.

So what should owners of a small semiconductor capital equipment company do to convert equity to cash? Faced with an indifferent or even hostile public market, they should consider selling the company to a financial or strategic buyer.

A financial buyer is typically an institutional investor who purchases apparently undervalued companies with the intention of later selling them whole or piece-by-piece. Financial buyers rarely manage the entities they acquire and typically base their buying decision strictly on price.

A strategic buyer is a company in the same business as the seller or in a field related to it that wishes to integrate the two businesses. Strategic buyers usually will pay more for a company than will financial buyers.

Most strategic buyers want to acquire either 100 percent of a company or only 19.9 percent (the largest percentage that can be acquired in which the buyer does not have to consolidate the acquired company's financial results with its own results). But seller beware: In a "19.9 transaction" a buyer likely will impose various conditions, ranging from veto power over future financings to the right to acquire the balance of the company at a later date.

The probability of small semiconductor capital equipment companies successfully going public is low. However, an IPO is not the only way to gain liquidity. Other methods may not result in a return of 400 times earnings, but remember, life is not fair.

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