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IPOs Stage a Measured Comeback

By Josh Friedman
Times Staff Writer

When Ray W. McKewon, executive vice president of Accredited Home Lenders Holding Co., looked at the company's stock price last Valentine's Day, he didn't see a lot of love.

The San Diego-based mortgage company, which McKewon co-founded in 1990, had just gone public at $8 a share, and in its first day of trading on the Nasdaq Stock Market it "rocketed" to $7.25, he recalled recently with a sarcastic chuckle. For two weeks after its initial public offering, the stock languished under its offering price.

"I got a lot of calls asking me for apologies — especially from alleged friends and family," McKewon said. "One investor asked me if I felt like I had rabies."

No one is asking that anymore. After closing Wednesday at $30.60, up almost 283% from its offering price, Accredited Home Lenders is no dog these days — and neither, analysts say, is the overall market for IPOs, which is showing signs of revival after a three-year drought.

If the stock's run-up sounds like a return to the IPO mania of 1999 and early 2000, don't be deceived: Accredited Home Lenders, last year's best-performing new stock, is an exception, analysts say. As more firms line up to go public, they contend, today's IPO market is healthy but not overheated.

That bodes well for firms looking to raise capital by selling stakes to the public this year and for the investors considering investing in them. Unlike the bubble years, young companies generally won't be able to go public too soon. When that happened during the boom years, companies set themselves — and their investors — up for spectacular falls when they couldn't meet the expectations priced into their shares.

Analysts say investors who do their homework can find deals at reasonable valuations, both at the offering price and in subsequent "after-market" trading on the major exchanges.

Robert Lachman / Los Angeles Times

SITTING PRETTY: Executive Vice President Ray McKewon, left, and CEO James Konrath took Accredited Home Lenders Holding public at $8 in February. It closed Wednesday at $30.60.

The main risks to the IPO sector are the same as those hovering over all of Wall Street these days, experts say: another devastating terrorist attack, a setback to the U.S. economy's recent record of growth or an Enron-scale corporate scandal that sends investors fleeing to the sidelines.

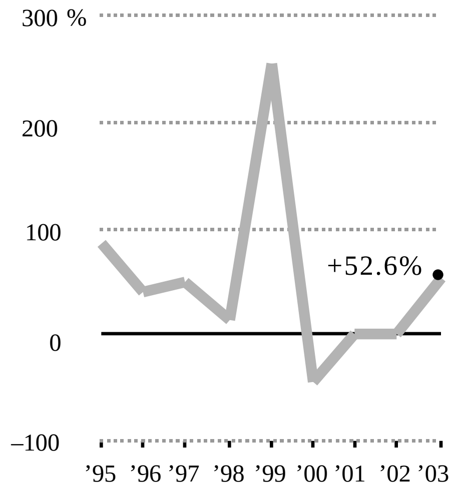
In total, 2003 was one of the slowest years on record for first-time stock offerings as the 69 IPOs trailed even the bear market years of 2001 and 2002, according to Renaissance Capital's IPOHome.com in Greenwich, Conn. But the IPO market gained steam along with the stock market as the year went on, with 63 of the 69 deals coming out in the second half.

The pace is still subdued compared with the manic years of the last bull market, when the annual outpouring of first-time offerings peaked at 486 in 1999.

Better days

After three down years, the performance of first-time stock offerings rebounded in 2003.

Bloomberg IPO index, annual percentage change*



*The index measures the performance of initial public stock offerings during their first year as publicly traded companies.

Source: Boomberg News

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Performance in 2003 was strong but still well short of 1999's blowout gains. A Bloomberg News index that measures IPO performance jumped 52.6% last year, handily beating the blue-chip Standard & Poor's 500 index, which rose 26%. It was the best year for IPOs since 1999, when the Bloomberg index rose 256.2%.

"The exuberance is a lot more rational now," said portfolio manager Kathy Smith of Renaissance Capital's IPO Plus Fund, which returned 52% last year.

Along with Accredited Home Lenders, other top-performing IPOs included foreign companies such as China Life Insurance Co., whose New York-traded shares jumped almost 77% from the offering price. Among Southern California IPOs, big gainers included Digital Theater Systems Inc. of Agoura Hills, up 45%, and San Diego-based Web hosting firm Kintera Inc., up 77%.

Demand for new issues is still coming primarily from institutional investors such as insurance companies and pension funds rather than individuals, she said. Small investors who were left holding the ashes after being burned by the market crash of 2000 remain wary, but pros are being tempted by acceptable valuations.

During 1999 and 2000, only about 1 in 4 companies that went public had turned a profit, whereas three-fourths of IPOs were profitable in 2003, Smith noted.

"Better-quality companies are coming public, and investors are pickier," she said. "You have to come public at an attractive price."

Here is a closer look at the key trends:

■ Stoked partly by a mortgage boom, the biggest and hottest IPO sector in 2003 was financial services.

The sector accounted for 20% of the new issues last year, with an average gain of 45% in the after-market, according to IPOHome.com. In addition to Accredited Home Lenders, the 10 best performers included three insurers.

Smith said the sector's momentum can continue this year, but she advised being wary of lofty valuations, especially if the Federal Reserve raises interest rates, which could harm the sector. "I'd put up a yellow flag on financials but not a red one," she said.

■ It's a global IPO market, and China has become a major player.

Foreign companies generated 40% of last year's IPO proceeds, paced by China Life's $3-billion deal.

Tom Taulli, corporate finance instructor at USC's Marshall School of Business, noted that travel website operator Ctrip.com (which some dub "the Expedia of China") zoomed 89% in its first day of trading Dec. 9, putting an exclamation point on the IPO market's comeback.

Notable IPOs this year may include Bank of China and three of its major rivals, along with Chinese technology firms such as Joyo.com and Shanghai Shanda Networking.

As Smith put it, "The Chinese economy is going public."

■ Biotech was a bust as investors shunned promising but risky and expensive investments.

The average biotech IPO last year lost 15% from its offering price, according to IPOHome.com, as conservative investors favored companies already in the black. Many biotech firms, by contrast, offer upside potential but have heavy losses on the books.

Still, as investors continue warming up to new offerings, the biotech chill could thaw, said Don Williams, head of Ernst & Young's Southern California venture capital advisory group.

The IPO calendar includes San Diego-based Santarus Inc., for example, which has filed to raise as much as $85 million in a deal led by SG Cowen and UBS Investment Bank. Santarus is seeking FDA approval for a fast-acting acid-reflux drug, Rapinex, which would allow it to tap into a lucrative market fueled by America's junk food obsession, Williams said.

"We get worse and worse about what we're willing to eat and how late we're willing to eat it," he said.

■ As usual, tech firms are sparking interest among IPO investors.

Salesforce.com, which hopes to raise as much as $150 million in a deal managed by lead underwriter Morgan Stanley, probably is getting the most buzz of any name on the official calendar. Founded in 1999 by a former Oracle Corp. executive, the firm says it has been profitable for two quarters, though it has provided no financial details.

Businesses rent Salesforce.com's software and services to manage customer relationships online, a model that has generated growing revenue.

In another closely watched deal, Motorola Inc. plans to raise $2 billion by spinning off its semiconductor unit, SPS Spinco. Goldman Sachs & Co. is the lead underwriter.

■ Folks are gaga for Google — but the market isn't hinging on it.

The Silicon Valley sensation, which generated about $1 billion in sales and $200 million in profit last year, is mulling over an IPO that could easily top $2 billion.

Still, Google is no cinch to go public. The firm might sell out to an established tech giant rather than go it alone, Taulli said.

The IPO market seems to be recovering with or without Google.

Smith said the resurgent economy and the upturn in capital spending by businesses were helping cyclical and traditional companies such as Richfield, Ohio-based International Steel Group Inc., which went public at $28 on Dec. 11 and closed Wednesday at $38.95, up 39% from its offer price.

"This pickup isn't just about search engines," Smith said.

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HOME LENDERS

Contact:
Rick Howe
Director of Corporate Communications
858.676.2148, rhowe@accredhome.com
www.accredhome.com