# Zynga's IPO flop could hurt some Silicon Valley startups

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Zynga's unexpected IPO flop this month could be bad news for other Silicon Valley startups.

With buzzed-about social media companies having failed so far to make a lasting impression on Wall Street, the bar for going public is likely to remain high. That could dampen the wealth-generating effect a raft of initial public offerings can have on Bay Area employment, housing prices and luxury auto dealerships.

And if venture capitalists can't take their portfolio companies public, they'll have to find buyers for them or consider less attractive alternatives: Feed them more cash, pull the plug or let them die a slow death.

"There are going to be a lot of 'walking dead' startups that can't close that third or fourth funding round," said Tim Young, founder of San Francisco social networking startup Socialcast. The company, which sells Facebook-style collaboration software to corporate clients, was acquired earlier this year by VMware.

Not everyone agrees a zombie invasion is around the corner. After all, they note that venture capital firms still have cash to invest.

"I haven't been this busy in a decade," said Curtis Mo, a securities lawyer at DLA Piper's Silicon Valley offices.

Still, even the optimists concede that the valley's mojo could weaken in the new year absent improvements in the broader economy. That could hurt startups that have garnered a few million venture dollars but can't find a willing buyer and are still far from IPO-ready.

"I think it's a real possibility," said Mike Smerklo, chief executive of San Francisco-based Service Source, which went public in March before the stock market went sideways. Smerklo, a former investment banker, hearkens back to the dot-com bust and notes: "As soon as the public market investor starts to pull back, it has that ripple effect on the whole funding cycle."

Smerklo said it may be more appropriate for many companies to stay private in such an environment - provided they can carefully husband their cash. "I'd be looking for alternative sources of funds, and I'd be realistic about valuations," he said.

One such alternative is Industry Ventures, a San Francisco firm that invests in venture-backed companies whose original backers are getting antsy for a return. "We have seen an uptick this quarter," said founder Hans Swildens, "and we also see an uptick for next quarter. It's natural that our market sees more deals in times like this."

Swildens said his firm is getting more calls from venture capital firms that raised funds over the past decade and are running out of time to show returns to their outside investors.

Nationwide, Swildens said, "There are 65 tech companies on file to go public, and it's pretty clear all these guys are not gonna be able to go out." Those that can't find a buyer or aren't profitable enough to stay private may be forced into deeply discounted takeovers by buyout firms.

In addition, he noted, "All these seed and 'angel' funds backed thousands of small companies, and now they all need series B rounds, and there's not enough capital to fund them. A lot of those companies are probably not going to make it."

Although Zynga's tepid reception on Wall Street was surprising, given the buzz around the company and its $1 billion in yearly revenue, it was also in keeping with recent history.

Birinyi Associates, a money management and research firm in Greenwich, Conn., notes that of the 31 Internet and social media companies that have gone public since the beginning of last year, 19 are trading below their IPO prices. Zynga, which opened at $10 a share on Dec. 16, closed at $9.39 on Friday.

And many of the ones that have managed to stay above that line, including LinkedIn and Groupon, finished Friday well below their first-day closing prices.

It's little wonder that the National Venture Capital Association recently reported that VC optimism about the IPO market was on the wane.

A recent forecast from PricewaterhouseCoopers was more bullish, predicting that the $1 billion Zynga raked in through its stock sale despite a lackluster reception from retail investors would encourage more companies to go public in 2012.

But the report also noted that a number of companies shelved IPO plans in the fourth quarter of this year. And the $6.4 billion raised via U.S. initial public offerings during the quarter was just a fraction of what companies raised by going public in the same period a year ago.

Ken DeLeon, a broker with Keller Williams Realty in Palo Alto, expects that many startup employees planning to buy new homes on IPO riches will have to think again in the wake of Zynga's flop. That could lead to fallout for nontechies as well.

"I think it will dampen" the housing market in most parts of the valley, he said.

That said, the biggest IPO looming on the local radar - Facebook's - should keep demand robust in Palo Alto, Mountain View and Menlo Park, where DeLeon said he's sold a whopping $270 million worth of homes this year.

Many employees of the social networking giant have money to burn, thanks to secondary markets for private stock that have enabled them to offload some of their holdings. And, said DeLeon, "Normal people are buying in fear of the Facebook IPO and trying to get out in front of it.

"This little microclimate of Palo Alto and Menlo Park will fare better than others," he said. "But even Los Altos and other nearby markets are starting to soften."



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