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Tech Company Goes Public but Its Shares Dive 20%

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Rackspace Hosting, a San Antonio company that provides Web hosting to corporate clients, went public Friday, ending a six-month market drought in initial public offerings of shares in technology companies.

But Rackspace's shares sank 20 percent in their first day of trading, and analysts cautioned that the company's debut, which raised $187.5 million, did not signal a turnaround in the dim prospects for tech start-ups hoping to cash out by selling stock to the public.

"There has been far too much importance placed on this I.P.O. as the pied piper for the tech sector and for the health of the I.P.O. market," said David Menlow, president of IPOfinancial.com. "Rackspace is not the I.P.O. market savior."

Rackspace priced 15 million shares at $12.50, the low end of their expected range, Thursday evening. The shares began trading on the New York Stock Exchange Friday at $10, rising as high as $11.58 before closing at $10.01.

The company offered its shares through a Dutch auction, which aims to balance supply and demand by taking bids from individual and institutional investors, then pricing the shares at the highest price at which they can all be sold. That hurt the stock by pushing its initial price too high, Mr. Menlow said.

"The Dutch auction system has been faring very poorly after many different auctions over the years, and I believe the traditional form of bringing I.P.O.'s to the marketplace is a truer indication to investors of where after-market demand is," he said.

Paul Bard of Renaissance Capital, a research firm specializing in I.P.O.'s, said Rackspace was priced fairly. Shares offered through Dutch auctions typically result in small first-day gains, averaging 4 percent. But companies that price shares within their proposed ranges, as Rackspace did, tend to have strong long-term returns, Mr. Bard said.

"The problem is that in the current state of the markets, as soon as people heard it priced lower than expected, psychologically they're thinking there is not a lot of demand and it's not a good deal," he said.

Rackspace is the second venture-backed tech company to go public this year. ArcSight had its public offering on Feb. 14. In 2007, 48 venture-backed tech companies went public, according to the National Venture Capital Association.

The association recently declared the start-up community in crisis after no venture-backed companies went public in the second quarter — the first such dry spell since 1978.

At the end of the second quarter, 20 of the 42 venture-backed companies that were in the pipeline to go public were tech companies, including Rackspace, according to Thomson Reuters.

But Mark Heesen, president of the association, worried that many of those companies registered for public offerings not to go public but to capture the attention of acquirers.

"They're saying to potential acquirers, 'I'm Sarbanes-Oxley compliant, please buy me,' " he said. This year, 59 companies have withdrawn or postponed their filings to go public, compared with 14 at this point last year, according to Renaissance Capital.

Rackspace was founded in 1998 and backed by Silicon Valley venture capital firms Norwest Venture Partners and Sequoia Capital.

It had revenue of $362 million in 2007, up 62 percent from the previous year, and posted net income of $17.8 million.