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The $1 Billion Club Gets Crowded

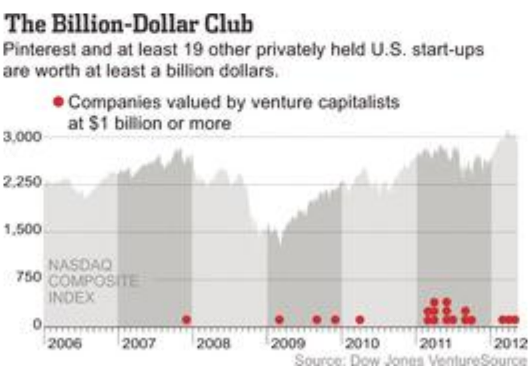
Pinterest Is Latest Start-Up Hitting Rich Valuation; Venture Activity Rivals Dot-Com Boom Days

By PUI-WING TAM

The coveted club of Silicon Valley start-ups worth a billion dollars is quickly losing its exclusivity.

At least 20 closely held U.S. companies backed by venture capital are now valued at $1 billion or more, including the latest inductee, Pinterest. The online scrapbooking start-up, which launched in 2009, this week raised $100 million in capital at a $1.5 billion valuation despite having little revenue and no profits.

Today's membership exceeds even that during the frothy days of the late 1990s dot-com bubble, when 18 such start-ups scored a $1 billion-or-higher price tag, according to an analysis by Dow Jones VentureSource.



Most of the valuation frenzy has unfolded only recently. Since the beginning of last year, 15 start-ups have landed 10-figure valuations. Only two weeks ago, note-taking app maker Evernote Corp. hit the milestone. "We weren't chasing valuation but we had offers for significantly above $1 billion," said Phil Libin, Evernote's chief executive.

The billion-dollar list now excludes Facebook Inc., FB +0.03%which on Friday is set to become a publicly traded company, valued at north of $100 billion. But it does include a large share of high-flying Web players such as file-sharing company Dropbox Inc. and room-rental provider Airbnb Inc., as well as a few lesser-known start-ups such as e-commerce platform company Rearden Commerce Inc. and business software maker Workday Inc.

"Everyone thinks they're in Lake Wobegon," said Venky Ganesan, a venture capitalist at Globespan Capital Partners, referring to the Garrison Keillor novel about the fictional town "where all the women are strong, all the men are good-looking, and all the children are above average." In Silicon Valley these days, "everyone thinks they're smarter than the average" in making some of these big start-up bets, he said.

Betting Big in the Boom Era

Of the private U.S. companies valued by venture capitalists at $1 billion or more from 1999 to 2000, only a handful still exist.

Akamai Technologies – Publicly traded

@Home – Merged with Excite in 1999, then went bankrupt in 2001

Cereva Networks -- Closed in 2002

Chorum Technologies – Went out of business

Corvis – Bought by Broadwing for $91 million in 2003

CoSine Communications – Trades on the Pink Sheets

eToys – Went bankrupt in 2001

Foundries Holdings – Went out of business

Internet Brands Inc. – Taken private in a $640 million buyout in 2010

IPG Photonics – Publicly traded

ONI Systems -- Acquired by Ciena in 2002 for $900 million in stock.

Procket Networks – Sold assets to Cisco Systems for $89 million in 2004

StorageNetworks -- Liquidated in 2003

Tellium -- Acquired by Zhone Technologies in 2003

Tellme Networks -- Bought by Microsoft for $800 million in 2007

TradeOut.com – Went out of business

Webvan – Went out of business

Zhone Technologies – Publicly traded

The valuation frenzy is being driven by investors' desires to find the next big hit a la Facebook, and a belief that this time it's different with the new generation of Web companies. Many of the start-ups are experiencing strong growth—generally with users and sometimes also with their revenue—and are benefiting from a confluence of tech trends such as social media and mobile technologies that give these companies huge audiences.

In his own venture firm's analysis of the billion-dollar club, Mr. Ganesan said the pipeline of 20 or so closely held companies is almost equal to the number of publicly traded Internet companies with market capitalizations of more than $1 billion, which he counts at 23.

"Can we really double the number of Internet companies that have over a $1 billion market cap?" Mr. Ganesan asks. "That feels statistically hard."

The swelling number of billion-dollar club start-ups shows how frothy and murky private-company valuations have become. While public market valuations are typically a function of a consensus between many buyers, in private-company financings it takes only one deep-pocketed investor who is willing to pay up to set the price.

In Pinterest's case, investors had virtually no revenue to base their valuation on, but they were enamored with the site's surging user-growth rates. Pinterest reached 20 million unique visitors to its site last month, up from around 1 million in July 2011, according to comScore Inc., which has called it one of the fastest-growing standalone sites it has tracked.

Last month, mobile photo-sharing app maker Instagram was acquired by Facebook for $1 billion. Instagram has no revenue but only 18 months since its launch its user base grew to about 30 million people.

Many of today's billion-dollar club members do differ from their dot-com brethren in that they generate revenue, and spend far less cash than Web companies a decade ago. Dropbox CEO Drew Houston, for example, has said the San Francisco company is profitable even though a minority of its users pay fees to store large amounts of files.

How many of these billion-dollar companies will ultimately lead to big profits, however, is unclear. In the dot-com bubble, many billion-dollar companies —such as online grocer Webvan and online toy seller eToys—famously flamed out.

More recently, social games maker Zynga Inc. ZNGA -15.60%was valued at around $14 billion in private-market transactions before it went public last December at around a $9 billion valuation. It now has a market capitalization of about $6 billion.

But if any of these start-ups turn out to be the next Facebook, which is set to produce some of the biggest-ever returns for venture capitalists, any losses on other start-up bets will be quickly papered over. Venture capital firm Accel Partners, which took a chance on Facebook in 2005 with a $12.7 million bet, now holds a stake valued at $7.7 billion.

One effect of so many billion-dollar club members is that it drives up start-up prices everywhere. Earlier this week, Quora Inc., a question-and-answer site started by two of Facebook's earliest employees, raised a new financing valuing it at $400 million, up from around $86 million two years ago, said people familiar with the matter.

The problem is, everyone looks at a $1 billion financing "and says that's the price for their company," said Gary Little, a venture capitalist at Morgenthaler Ventures, which invested $8 million in Evernote in 2009. "In heady times, it does raise valuations across the board."

"We all worry about this," added David York, CEO of Top Tier Capital Partners, a San Francisco firm that invests in venture-capital funds. "Some of [these bets] are working so it's hard to completely throw the baby out with the bath water. It's on the one hand, on the other hand."

Entrepreneurs say taking a $1 billion valuation is just good business because it builds up a war chest of cash.

Evernote's Mr. Libin, who has presided over the company as its user base has jumped to more than 30 million from six million in January 2011, said his start-up's financing round earlier this month was the start of the firm's IPO planning.

"As CEO of Evernote, I don't care whether there's a bubble or not," he said. "What we want is to make sure we're isolated from market forces and bubble dynamics and that we've got the resources to get through it."

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