IPOs Ready to Launch

June 2019

OVERVIEW

- **Private Equity is playing an increasingly large role in the global economy and impacting portfolio construction**
- **Muted mark-to-market volatility and less short-term scrutiny in private equity appeals to investors and companies alike**
- **One method by which a company ultimately exits private ownership is by going public through an Initial Public Offering (IPO)**

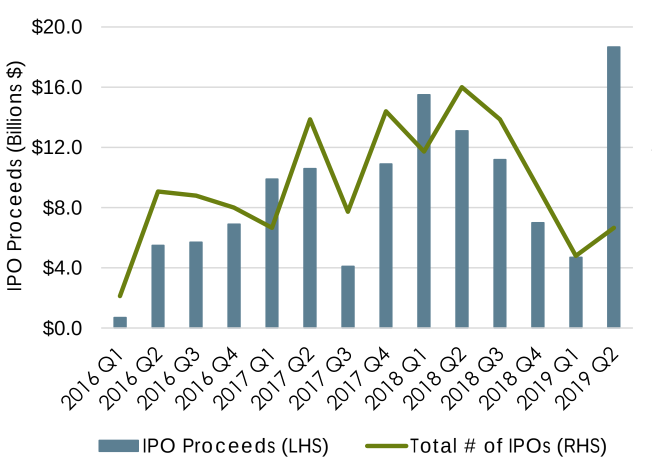
Background

Private equity investing generally involves committing capital to an investment manager, who then invests in privately owned companies in various stages of development or evolution. These companies are seeking cash for a variety of purposes, but are not yet able to access public markets. Most companies begin life small and take on private investors as a means of enhancing growth through capital buildout or expanding marketing efforts. If successful, founders of the company or newer investors may decide to monetize the value they have created, or realize that access to more diversified funding is required. At that point, options for exit include selling to other private investors, selling to strategic corporations that are already publically traded, or expanding ownership through an Initial Public Offering (IPO).

IPO Basics

An IPO is not a simple exercise, with significant disclosures and heightened regulatory requirements arising both before and after the event. The decision to take a company public via an IPO also depends on the market's appetite for risk. Many companies seeking to go public are technology or biotech oriented, with high cash burn rates, currently operating at a loss. With value ultimately tied to the expectation of future profitability, a risk-off atmosphere in public markets can have a meaningful impact on the level of IPO activity. Although IPO volume can be sporadic, the chart below illustrates a steady increase in both count and proceeds between 2016-2018. It is not uncommon for IPO activity to accelerate late in an economic or market cycle, and 2019 has already witnessed the launch of several high-profile companies such as Lyft ($2.3 billion in late-March), Pinterest ($1.6 billion in April), and most recently Uber ($8.1 billion in early May). IPOs are far from the only exit option for investors, but remain key for the select group of "unicorns" that have become so large.

US Initial Public Offerings by Quarter

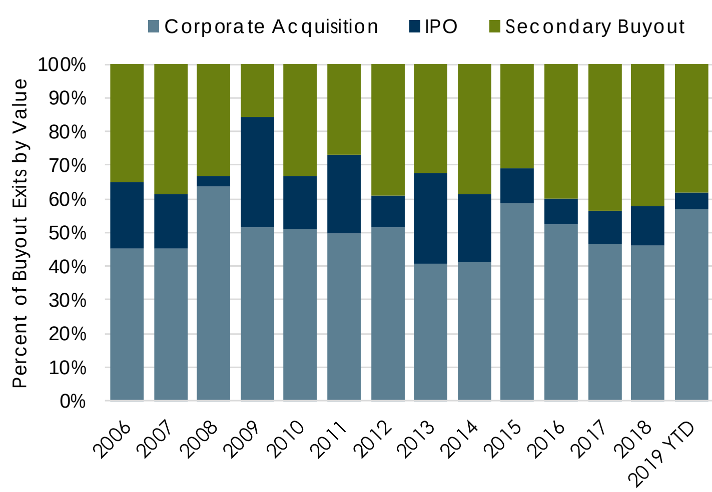


Source: Renaissance Capital, Bloomberg, ACG Research (as of 5/31/19)

How does the IPO Market Impact Private Equity Investments?

Basic fundamentals of supply and demand ultimately drive market performance. When IPOs are attractive to public investors, more private companies may see it as a signal to exit the private markets or to attain additional funding at a premium price. In contrast, if the public markets are not as attracted to IPOs, there will be fewer outside dollars moving toward the privately held companies, and private equity sponsors will evaluate alternative options to obtain additional capital or monetize their investment. As illustrated in the chart below, IPOs have historically represented a relatively small percentage of total private equity exits. Peaking at ~30%, IPOs are largely related to the venture capital sub-set within the private equity complex. While the degree of success for venture capital funds may depend somewhat on the hardiness of the IPO market, purchase price discipline, the appropriate use of leverage, and the overall health of the economy are ultimately expected to drive vintage year returns.

Private Equity Buyout Exit Types



Source: Pitchbook, ACG Research (as of 3/31/19)

ACG's Position

Despite bouts of public market volatility, IPOs appear to be on an uptick this year, and the pipeline remains strong with the likes of WeWork, Airbnb, and Palantir Technologies progressing toward a public debut. An active IPO market is one reflection of the opportunity for enhanced private equity returns. As has been seen, though, the market's appetite for IPOs can vary significantly from month-to-month and from year-to-year. As private equity investors know, there is a long tail to investing, with the first hurdle being able to put the money to work and the second hurdle finding the right timing and method to generate distributions. Helping clients manage sector and vintage year diversification is an important part of what we do in this space, and our team can assist with finding the right implementation and setting proper expectations going forward.

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231 South Bemiston Avenue ♦ 14th Floor ♦ Saint Louis, Missouri 63105
www.acgnet.com
314.862.4848