Equity capital markets update – signs of life in the IPO market

June 3, 2020
While market volatility has dramatically slowed IPO activity in 2020, there have been some key developments in the last few weeks that are encouraging for public company aspirants and the markets in general.

First ... the bad news. Not surprisingly, IPO activity is down considerably this year. Through May the number of IPOs (ex-business development companies (BDCs) and special purpose acquisition companies (SPACs)) has been cut in half compared with last year, and gross IPO proceeds are down about 65%. These year-over-year comparisons would look even worse if 2019 IPO activity had not been negatively impacted by the government shutdown early in the year.

On a brighter note, a narrow portion of the IPO market has continued to function well throughout this period of market volatility. Of note seven biotech companies have gone public since mid-March, many of which upsized their deals and priced at the top (or above) their marketed price range. This group is currently trading up nearly 90% from their IPO price, a positive indicator highly correlated with future interest in the IPO product.

Importantly, we are beginning to observe several positive indicators for the broader IPO market, as well as a few notable trends that we highlight below.

**The broader IPO market is beginning to re-emerge**

- Stock prices and valuations have recovered despite economic and fundamental business headwinds. The S&P 500 is now off only 5% YTD, with a number of sectors back to pre-crisis levels. While some degree of re-tracing is expected, the velocity of the rebound reflects improved investor sentiment and risk appetite.

- The Chicago Board Options Exchange Volatility Index (VIX) is currently trading in a range between 25 and 30, receding considerably from its high of 83 in March. The current level remains elevated on a historical basis, but significantly closer to normalized and constructive levels (the 10-year VIX average through February 15 (pre-crisis) was 17). For context, market environments with a VIX below 20 are generally the most conducive/receptive for IPO issuance.

- The IPO asset class has generally performed well for investors this year. Aftermarket performance, often a leading indicator for IPO investor appetite generally, is up over 65% YTD.*

- Several tech companies that navigated the market over the last month have priced and traded well, including:
  - *SelectQuote* ($656m insurance-tech IPO, mid-May) – after an accelerated three-day roadshow, the deal was upsized and priced above the range. The stock increased 35% on its first day of trading.
  - *Inari Medical* ($156m medical device IPO, mid-May) – priced well above the initially marketed price range and rose nearly 125% on its first day of trading, despite the fact that the market for its products is currently constrained by the ongoing crisis.

- Last week, Warner Music Group launched its mega-IPO and ZoomInfo Technologies launched the first software IPO of the year. On June 3rd Warner priced an upsized deal raising $1.9b, making it the largest US IPO in 2020. ZoomInfo Technologies has already increased its marketing range and is scheduled to price this week.

- Additionally, several large high-growth companies have elected to file publicly and enter the IPO pipeline recently including Dada Nexus, Vroom and Shift4payments.

**Emerging IPO trends: are we “seeing the future” of IPOs?**

- Shorter, virtual roadshows. Since the onset of the crisis, most IPO roadshows have been reduced to 3-4 days from the traditional 7-8 day marketing period. The shorter roadshows have been driven by the desire to limit market risk and have been enabled by the ability to cover more ground through video conferencing.

- Extensive premarketing and pre-funding. Shorter roadshows have also been enabled by extensive pre-marketing activities, as well as additional funding rounds shortly before IPO launches. Companies are pursuing capital raises ahead of IPOs for a few reasons including: (i) to mitigate some of the uncertainty
and imbedded deal risk in the IPO market, and (ii) to have flexibility to reduce IPO deal sizes and increase cash, improving pricing leverage with investors.

- **The rise of SPACs.** Despite the market crisis, SPAC issuance is on pace to meet or exceed 2019’s record of 59 SPAC IPOs raising more than $12b. The deals are larger and the sponsors are more “mainstream” than ever before. The combination of record SPAC acquisition capacity, constrained IPO markets, strong ongoing SPAC merger activity, and higher profile sponsors should continue to enhance the viability of the SPAC path to the public markets for a broader swath of issuers than in the past.

Looking ahead – potential inflection points on the horizon

- **Impact of the presidential election.** Although IPO activity in election years has historically tended to skew toward the first half of the year and away from the election, recent market volatility and the “postponement” of a portion of the IPO pipeline could lead to more deals around the election than in years past. Prospective issuers are preparing for potential IPOs over the next few quarters, perhaps with less focus on the election than there might have been in a more normalized environment.

- **Prospective impact of the pandemic:**
  - **Financials.** In general companies will need to educate Wall Street on the impact of the pandemic on their business and forward projections. For companies that experienced a dip in performance, it will be critical to demonstrate the one-time nature of the impact and the signs of a return to "normal." For those that experienced a surge during the pandemic, the Street will seek comfort on the portion of the bump that will "stick" as conditions moderate.
  - **Business models.** For business models that have been adjusted during the pandemic, investors will focus on how well the revised model has been “battle-tested” before giving valuation credit for the changes.
  - **Valuations.** IPO investors look at projected results to determine valuation and pricing. For example a late 2020 or early 2021 IPO will typically reference calendar year 2021 as the primary valuation driver. However, depending on the shape of the recovery, the question for companies might be whether investors are willing to look out further for more “normalized” results.

Overall, we are still in the early innings of an IPO market recovery despite the sharp recent rebound in stock prices and market sentiment. If investors continue to see outsized IPO returns, we expect the pipeline to reload fairly quickly. However, there is limited precedent for the intensity of this recovery, so some retracing in the coming weeks or months could be possible, and a corresponding pullback in risk appetite for IPOs would then also be expected. Even so, companies that prepare to go public ahead of time and are able to move quickly when markets are conducive will have a clear advantage. Advanced IPO preparation could be the difference between gaining access to the public markets and getting shut out.

Please feel free to reach out to the EY Equity Capital Markets team if a conversation about the IPO markets or process would be helpful for your clients.

Source: Dealogic, S&P Capital IQ.

* Data excludes SPACs and IPOs from China.
About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. For more information about our organization, please visit ey.com.

Ernst & Young Capital Advisors, LLC (EYCA) is a registered broker-dealer and member of FINRA (www.finra.org) providing sector-specific advice on M&A, debt capital markets, equity capital markets and capital restructuring transactions. It is an affiliate of Ernst & Young LLP, a member firm of Ernst & Young Global Limited, serving clients in the US.

© 2020 Ernst & Young LLP.
All Rights Reserved.

SCORE No. 09495-201US
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax or other professional advice. Please refer to your advisors for specific advice.

Some of the materials contained herein are copyright © 2019, S&P Capital IQ (S&P). Reproduction and distribution of referenced S&P data in any form is prohibited except with the prior written permission of S&P. Use of S&P information is intended for the recipient's internal use purposes only. None of S&P, its affiliates or their suppliers (together, S&P parties) guarantee the accuracy, adequacy, completeness or availability of any information nor are responsible for any errors or omission, regardless of the cause or for the results obtained from the use of such information. In no event shall any S&P party be liable for any damages, costs, expenses, legal fees or losses (including lost income or profit or opportunity costs) in connection with any use of S&P information.

ey.com
eyinvestmentbanking.com