PitchBook

2017 US PE & VC IPO Trends Report

Small boosts to the marketplace aren't enough to fend off stagnance

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Key takeaways

- 74 US PE & VC backed companies have completed an IPO through October 31st, raising $17.5 billion. This puts 2017 to outpace a sluggish 2016 for IPO activity, however still about 25% below the post-financial crisis average. The continued slowdown of IPOs, even when traditional factors exhibit an open opportunity, suggests more comprehensive issues with the process. These challenges have always been apparent in the IPO market, but the sheer availability and ease of access to capital has presented sponsor-backed companies with actual alternatives. Although the sentiment surrounding IPOs this year has tended to lean negative, the aggregate of companies that have priced in 2017 are faring well in the secondary market and outperforming broader market indices.

- $8 billion was raised by 42 VC-backed IPOs this year, ten of which debuted at a value over one billion dollars. This figure ties 2014 for the most unicorns to list in a year, a record that will be broken next week. The "private for longer" phenomenon remains in full effect for VC-backed companies, as they continue to choose the familiarity and independence of raising funding over an exit – contributing to decade-high levels of VC funding raised prior to an IPO.

- PE-sponsored companies have raised $9.4 billion across 32 public listings through the first ten months of this year. Activity looks to be stabilizing as 2017 is in-line with the last two years, and therefore, we expect limited deviation from current IPO levels, as other exit routes remain attractive given the record amounts of cash in the asset class.

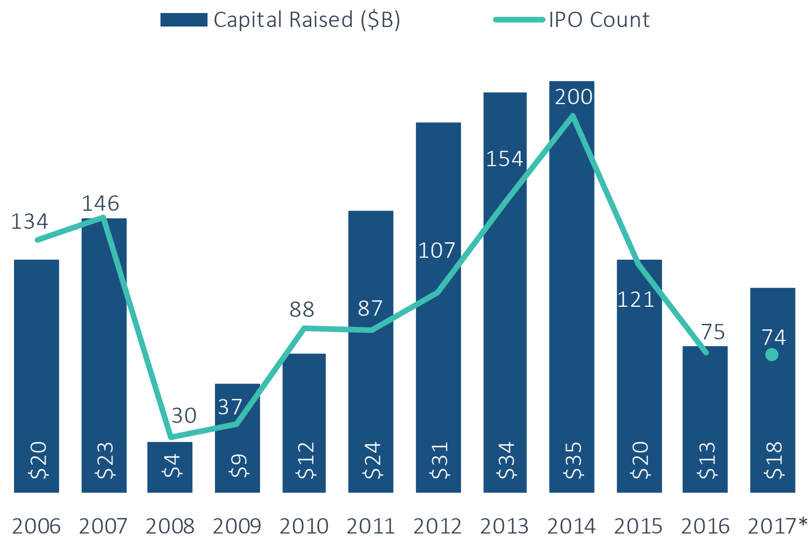
We hope this report is useful in your practice. As always, feel free to send any questions or comments to reports@pitchbook.com

Stronger, but not by much

Overview

2017 IS EXHIBITING STRONGER ACTIVITY THAN 2016 AT THE LEAST

US PE & VC-backed IPO activity

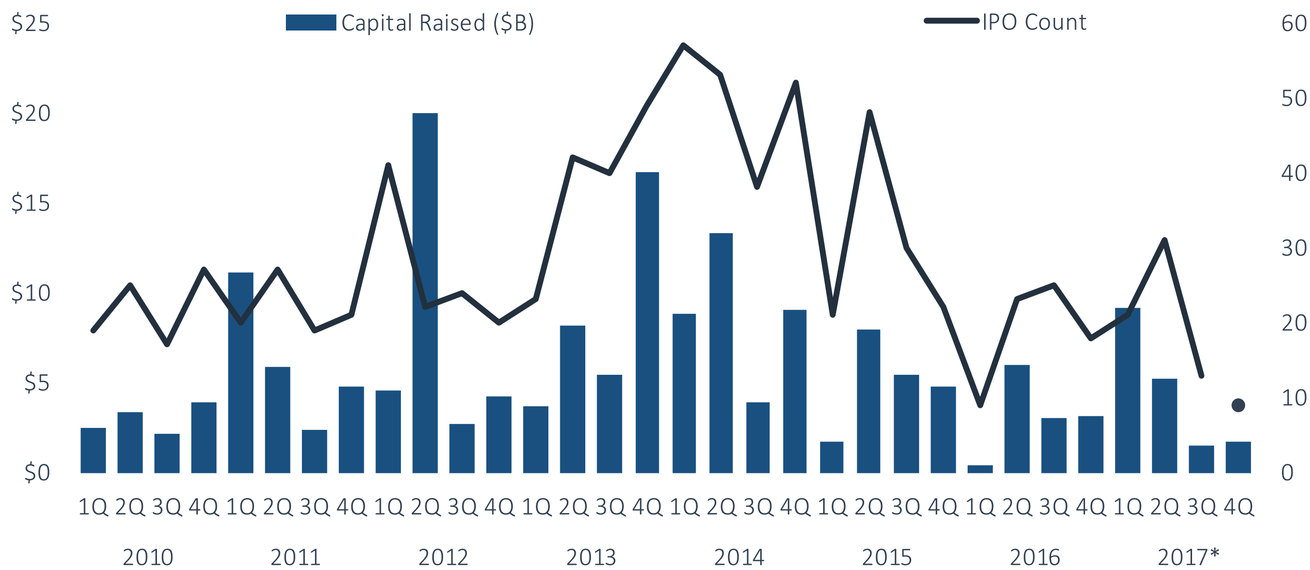


Source: PitchBook
*As of 10/31/2017

2017 has been notably lacking in newly priced IPOs despite being a year marked by frequent record highs in the public equity markets, low volatility and the expanded scope of the JOBS Act. While PE and VC IPO activity has already outstripped the tepid totals from 2016, only 74 sponsor-backed companies have debuted through the first 10 months of the year, raising just under $18 billion. This puts 2017 IPO count on track to be 25% lower than the post-financial crisis (2010-2016) average. Despite the sluggish IPO count, capital raised has been buoyed by larger deals such as VC-backed Snap's $3.4 billion offering.

4Q 2017 OFF TO A QUICK START

US PE & VC-backed IPO activity



Source: PitchBook
*As of 10/31/2017

When it comes to performance, headlines have focused heavily on the struggles of high-profile consumer-facing IPOs in the secondary markets; however, IPOs in aggregate have outperformed other equities so far this year, making the dearth of offerings more complex[1].

The prolonged slowdown of IPOs, even when traditional factors signal an open IPO window, suggests more comprehensive issues with the process and the evolving mindset of private companies. Operating as a public company seems to be one of the most oft-quoted deterrents due to a variety of real and perceived risks, including short-termism caused by the quarterly reporting cycle, the threat of activists, scrutiny of governance, increased transparency and its associated administrative costs. Many people point to these factors as discouraging the top tier of unicorns from going public, but they also pose severe obstacles for smaller companies, which must also justify the listing costs. The challenges to smaller offerings are evident in the sharp uptick in the average offering size, illustrating the skew of IPOs toward the large end of the spectrum.

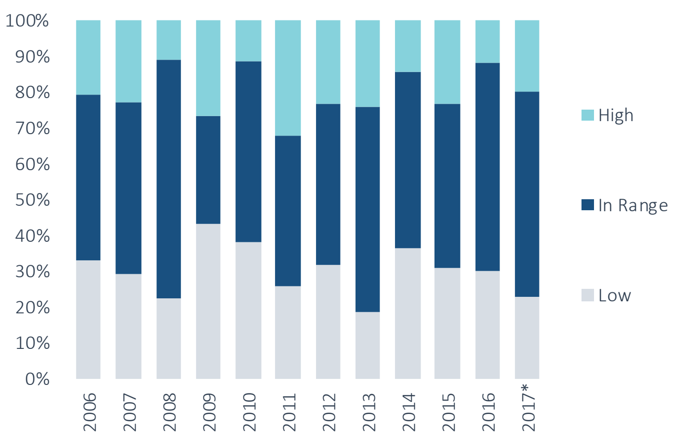
The IPO market has always had shortcomings, so the real paradigm shift in the private markets is the availability and ease of access to capital, especially for large, high-quality companies. This trend has been years in the making after extended periods of above-average fundraising, but 2017 has been truly unique with the emergence of the $93 billion SoftBank Vision Fund. This year has been dotted with billion-dollar investments from the Japanese behemoth, which drove some to hypothesize that a SoftBank round could be seen as a new stage in the private tech company lifecycle, further contributing to delays or abandonment of IPO plans.

Many of Softbank's outsized rounds also included extensive secondary purchases that allowed the exit of early investors and employees, which has traditionally been an impetus to IPO. This is exemplified by SoftBank's recent launch of a tender offer for shares of Uber at a valuation of around $50 billion, attached to a $1 billion primary investment at the most recent round's $69 billion valuation. A flourishing direct secondary market for shares of VC-backed companies is another potential drag on future IPO activity.

1: Renaissance Capital's IPO Index's return of 34.5% vs 15.2% from the S&P 500 as of October 31.

THE MAJORITY OF PRIVATELY BACKED DEBUTS ARE PRICING IN OR ABOVE RANGE

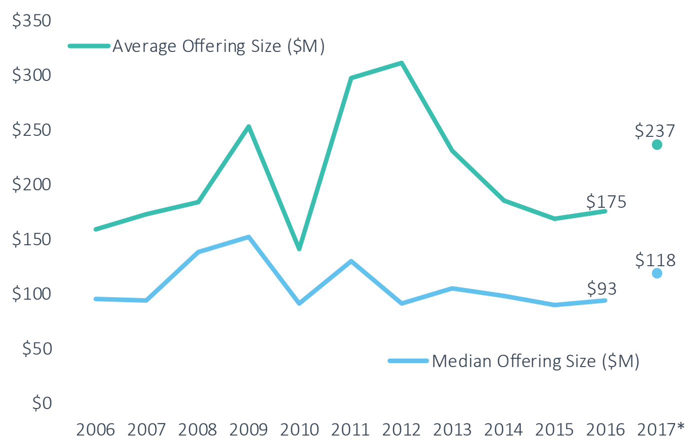
US PE & VC-backed IPOs hitting range



Source: PitchBook
*As of 10/31/2017

THE RISE IN AVERAGE OFFERING SIZE SPEAKS TO THE CHALLENGES OF SMALL LISTINGS

Median US PE & VC-backed IPO size



Source: PitchBook
*As of 10/31/2017

ALTERNATIVES ABOUND

As companies have eschewed IPOs, special purpose acquisition companies (SPACs) and direct listings were floated during the year as other alternatives to traditional offerings for large VC-backed companies. The VC firms Social Capital and Hedosophia combined to raise $600 million in a SPAC, which they intend to use to acquire a tech-focused unicorn, effectively taking the company public without going through the hassle of registration and a roadshow. Separately, Spotify announced in spring 2017 that it would go forward with a direct listing of its shares on the NYSE, forgoing raising additional capital to take an easier but riskier path to public markets.

It is too early to make many judgments since Social Capital Hedosophia hasn't announced a merger for the SPAC and Spotify's plan has yet to come to fruition, but we are skeptical that either method will upend the traditional IPO model. Both methods mainly seek to reduce the inefficiency and underwriting costs of the traditional IPO—concerns that are already being addressed with expansions of the JOBS Act. The updates to the legislation in 2017 allowed for companies over the $1 billion revenue threshold to file confidentially to avoid some upfront costs and time commitments. And while these alternative listing options can expedite the process of listing, they cannot do anything to mitigate the inherent difficulties of operating in the public markets.

PE-BACKED IPOS

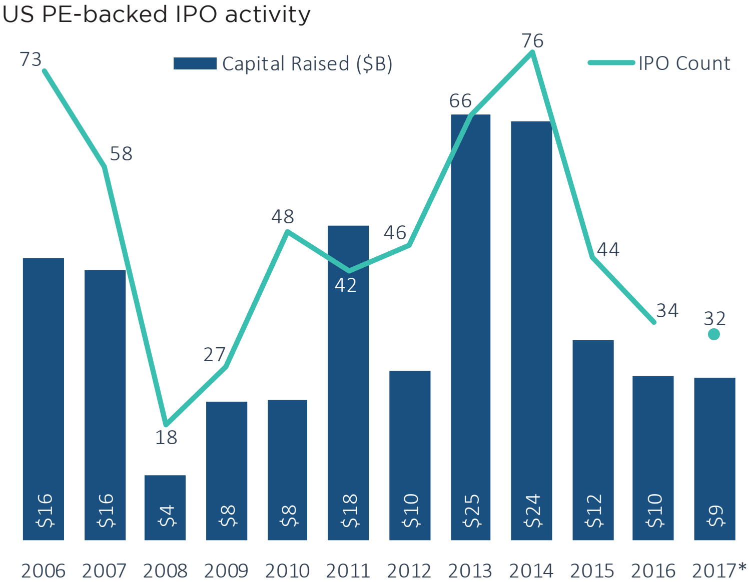
PE-sponsored companies have raised $9.4 billion across 32 public listings through the first 10 months of the year. Although 2017 activity is on pace for more PE-backed companies to go public and raise more capital than in all of 2016, it is likely to remain well below the numbers experienced between 2011 through 2014. Experts have cited a variety of reasons for the widespread cooling of IPO market in the last few years, but from a PE standpoint the relative complexity and cost of bringing a company public compared to an M&A exit is likely the biggest factor. Selling a company is quicker and cheaper than an IPO, plus sellers of private companies are currently able to fetch high valuations—comparable to public valuations—which makes foregoing an IPO a more enticing option.

Despite a slow IPO market, the median offering size for PE-sponsored IPOs rose to $209.3 million—the second highest level ever. The largest PE-sponsored public offering of the year remains the $1.8 billion offering of Invitation Homes, the company that Blackstone created in 2012 as a new platform to lease single-family homes. The second largest PE exit via IPO was $1 billion less, with a public offering by Gardner Denver for $826 million following a $3.9 billion buyout by KKR and AlpInvest Partners four years ago.

After dropping sharply in 2015, PE IPO activity looks to be stabilizing as 2017 is in line with the last two years, which may be the new normal in the current market environment. We expect limited deviation from current IPO levels, as other exit routes should remain attractive given the buildup of dry powder in PE funds and cash reserves on strategics' balance sheets.

GOING PUBLIC OVERSHADOWED BY M&A EXITS FOR PE SPONSORS

US PE-backed IPO activity



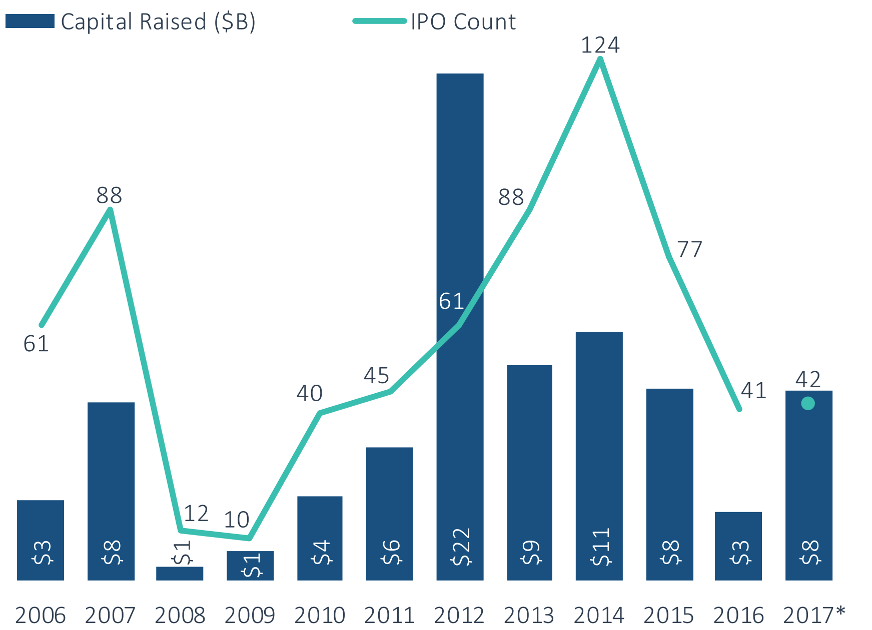
Source: PitchBook
*As of 10/31/2017

VC-BACKED IPOS

VC offerings thus far in 2017 have reversed the downtrend of the last two years, albeit with a steep jump in value assisted by a handful of outsized deals. Of the $8 billion raised by 42 VC-backed IPOs this year, 10 debuted at a value exceeding $1 billion. This ties 2014 for the most unicorns to list in a year, but the median post-money valuation is 70% higher in 2017 than in 2014. This surge in valuations was mainly driven by small companies' willingness to go public back in 2014, which saw a decade-high number of IPOs. 4Q 2017 is off to a quick start, tallying eight VC-backed IPOs through the end of October (and as of November 27, 19) and surpassing every quarter of the year, possibly signaling some momentum for the push to the end of the year and into next.

WILL THERE BE MOMENTUM HEADING INTO 2018?

US VC-backed IPO activity



Source: PitchBook
*As of 10/31/2017

Staying private makes its mark

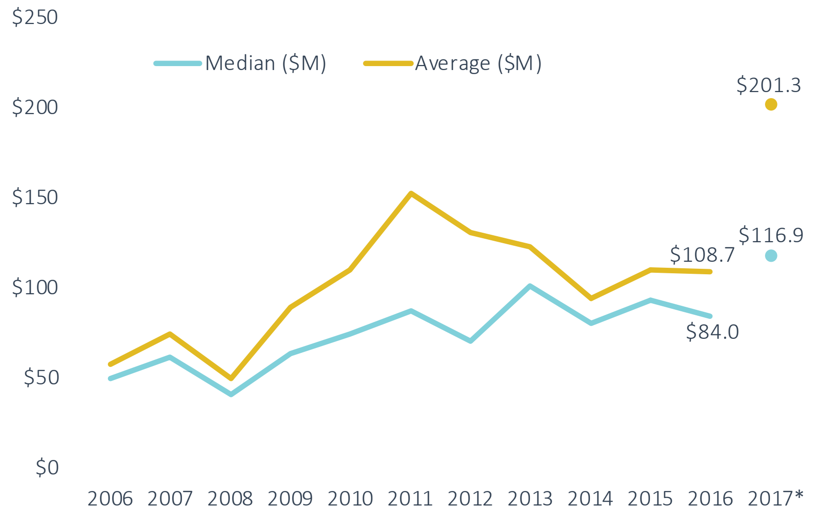
Trends in VC prior to IPO

2017 has shown both a continuation and even extension of the "private for longer" phenomenon of recent years, as VC-backed companies continue to choose the familiarity and independence of raising venture funding over an exit. Long-term trends corroborate this, but the uptick in 2017 across VC raised prior to IPO points toward more structural changes. Larger VC deal sizes across stages have helped to drive both the average and median capital raised prior to IPO to decade highs, but this is also a function of the increased age of companies entering each stage. Factoring in the large proportion of unicorns that listed this year, the 39% growth in the median amount raised by newly listed companies—while muted compared to the 85% jump of the average—is still significant and shows a clearer picture of the environment.

Another significant move caused by larger rounds—especially at the late stage—was the expansion of median time between last VC financing and IPO to 1.4 years. This is the highest level for that metric since 2012 and represents growth of almost 150% in just two years, exemplifying how deal sizes have extended cash runways. This can help assessment of the possible IPO pipeline when looking back on large deals in the past 18 months.

STAGGERING JUMP IN AVERAGE CAPITAL RAISED IN 2017 YTD

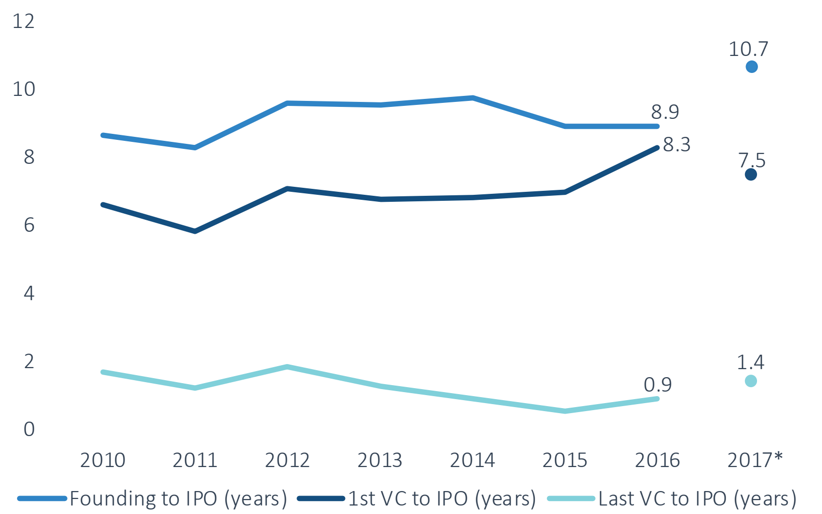
VC raised prior to IPO by US-based companies



Source: PitchBook
*As of 10/31/2017

TIME FROM LAST ROUND TO IPO NEARLY TRIPLES IN JUST TWO YEARS

Median time between venture rounds & IPO by US VC-backed companies

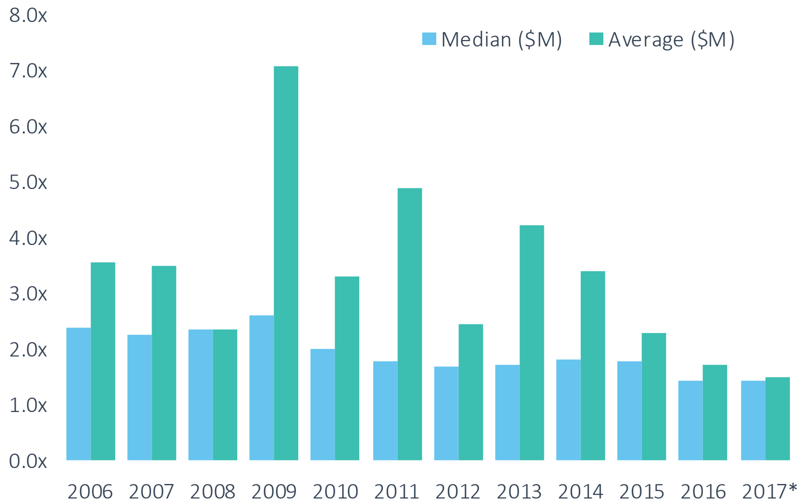


Source: PitchBook
*As of 10/31/2017

Trends in VC, continued

THE AVERAGE HITS A NEW LOW

US VC-backed company IPO postvaluation/most recent VC round postvaluation



Source: PitchBook
*As of 10/31/2017

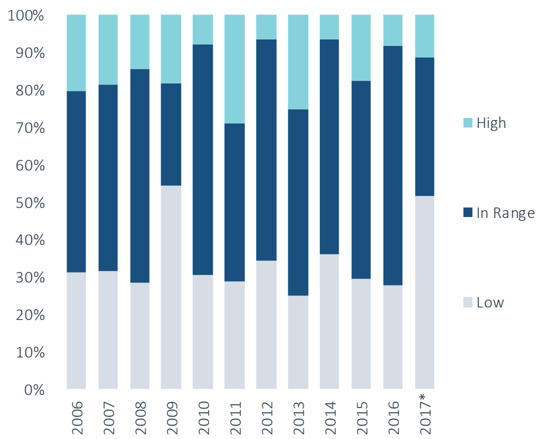
The confluence of these factors has also contributed to the run-up in VC valuations in recent years. 2017 continued the trend toward a historically low level of valuation step-up between last financing and IPO. We mostly attribute this to inflated private market valuations, particularly in the late stages, where the median valuation has spiked 75% just since 2016. VC initial pricing performance has been strong this year but this could have been assisted by some conservatism, as 97% of VC-backed companies hit or exceeded their target price ranges. This metric can't track companies that lowered their range after initial conversations with investors, which could lead to some upward bias as long as the investment bankers and management team can successfully manage expectations.

A year marked by caution

IPO metrics

PE SEES SOME MISFIRES

US PE-backed IPOs (#) hitting range



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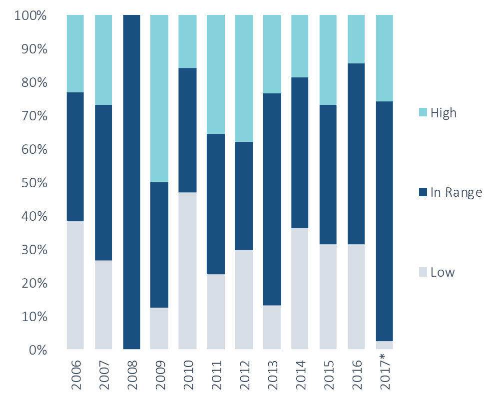
VC-BACKED COMPANIES ARE PRICING MORE SHREWDLY

US VC-backed IPOs (#) hitting range



Source: PitchBook
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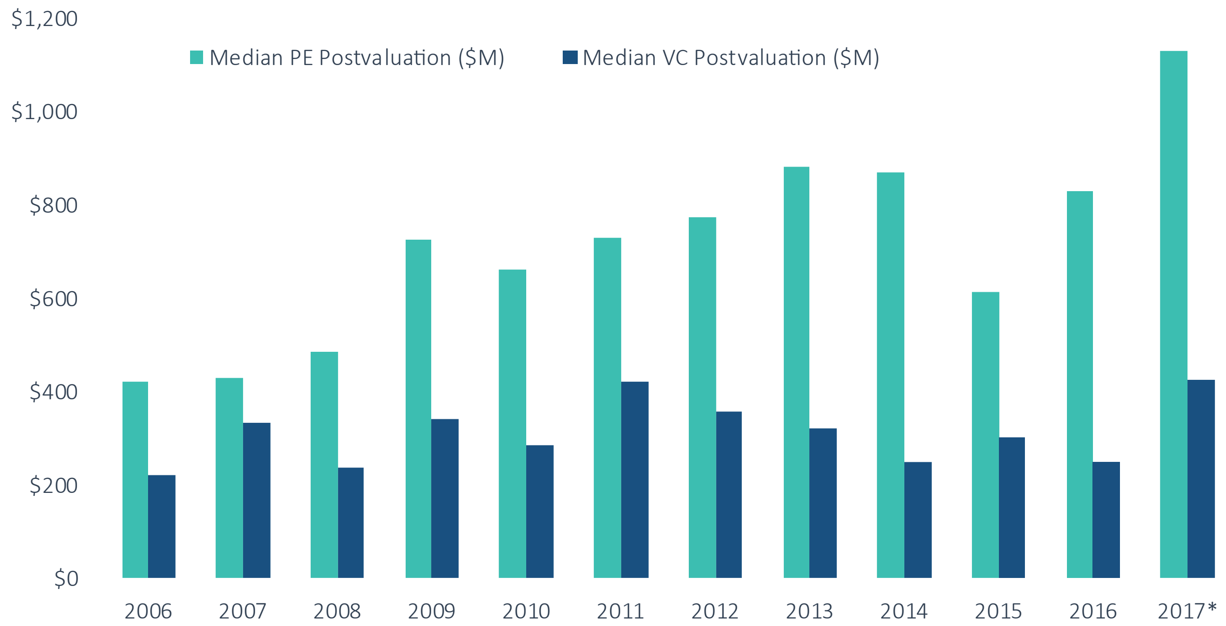
MEDIAN POSTVALUATIONS AT IPO RISE TO HIGHEST LEVELS SINCE FINANCIAL CRISIS

Average & median US PE & VC-backed IPO postvaluations ($M)



Source: PitchBook
*As of 10/31/2017

Spotlight: Changes for Exchanges?

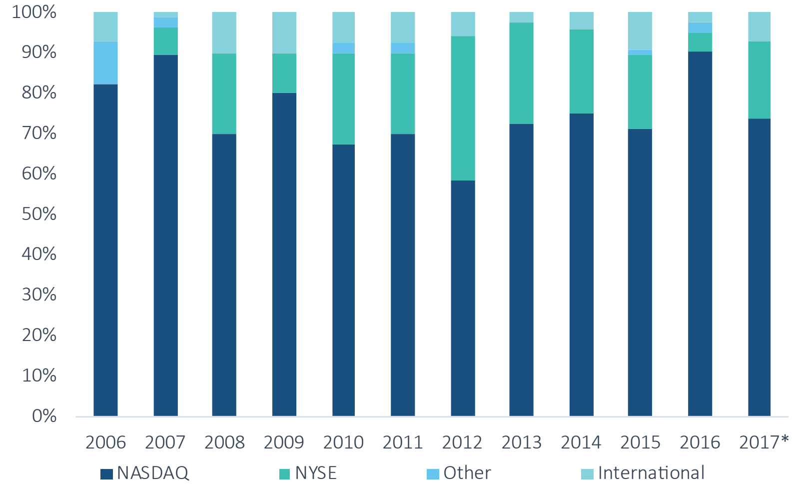
While financial metrics understandably garner the most attention from investors when a company is going public, the exchange the company chooses to list on has importance as well. The New York Stock Exchange (NYSE) and the NASDAQ have engaged in a lengthy battle for supremacy in the US, with the NYSE functioning as an auction market while the NASDAQ acts as a market maker in a dealer's market. These differences are reflected in a variety of ways, including perception, with the NYSE being viewed as the more traditional option while the NASDAQ is depicted as a technology-focused upstart. However, the more pertinent difference is cost, with companies paying a significant premium to list on the NYSE.

Due to its lower cost, the NASDAQ historically attracted smaller cap, tech-focused startups; however, the NYSE has landed a handful of high-profile tech IPOs in recent years, including Snap and Twitter, which has translated into a higher share of venture-backed capital raised on the NYSE. While these splashy IPOs have swayed the media narrative somewhat, both exchanges appear to be primarily attracting offerings in their core areas.

Since 2015, 77% of IPOs from VC-backed companies—which tend to be younger and focused on innovative industries such as healthcare and tech—have occurred on the NASDAQ. Despite hosting such a high proportion of VC-backed listings, the NASDAQ has only accounted for 40% of IPOs from PE-backed companies, which are typically more mature and operate in stodgier industries such as commercial services, consumer goods and energy. Conversely, the NYSE has accounted for 55% of PE IPOs during that period, but only 16% of VC-backed listings.

THE NASDAQ STILL DOMINATES VC

IPOs of US VC-backed companies (#) by exchange



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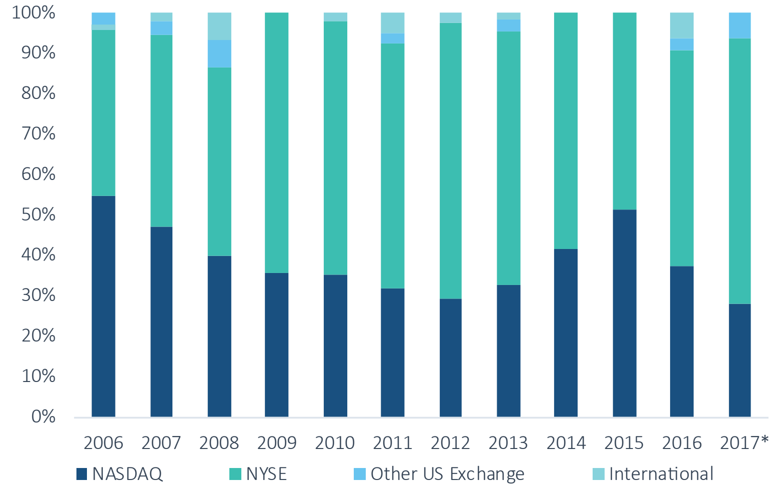
IPOs of US PE-backed companies (#) by exchange



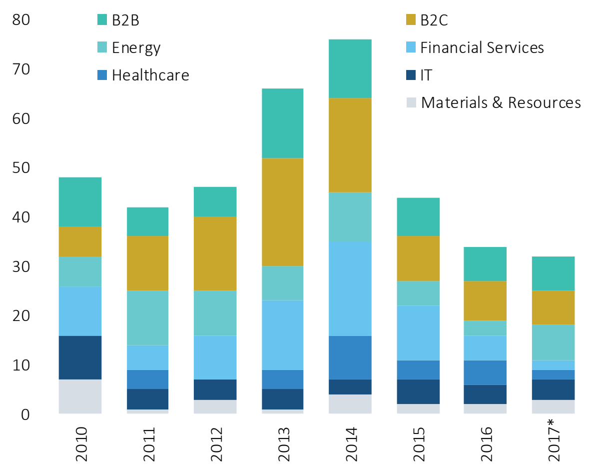
Source: PitchBook. *As of 10/31/2017

PE & VC backers hold steady

IPOs by sector

MORE OF THE SAME

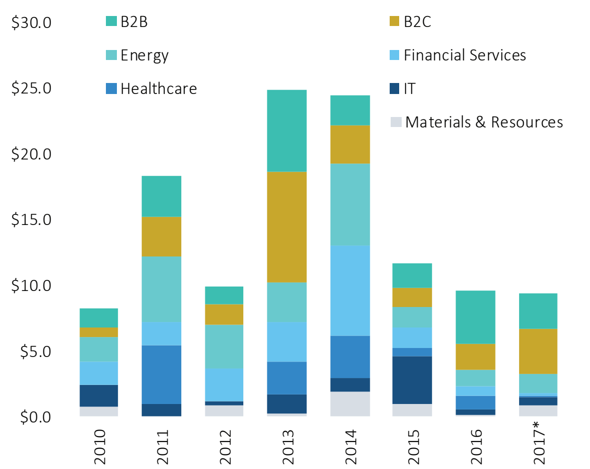
US PE-backed IPOs (#) by sector



Source: PitchBook
*As of 10/31/2017

CONSUMER GOODS COMPANIES SEE A POP

US PE-backed IPOs ($B) by sector



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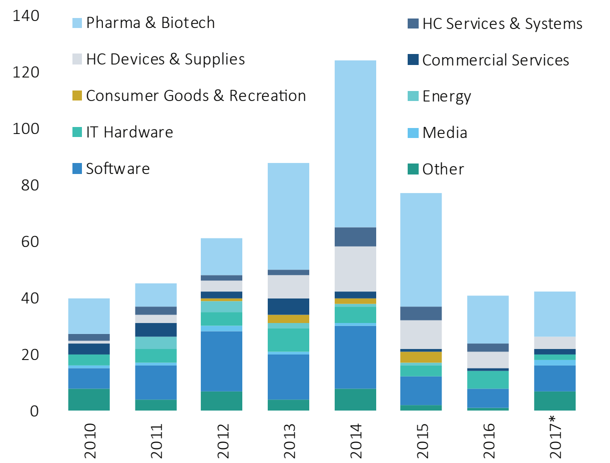
BIOTECHS BOLSTER OVERALL IPO VOLUME

US VC-backed IPOs (#) by sector



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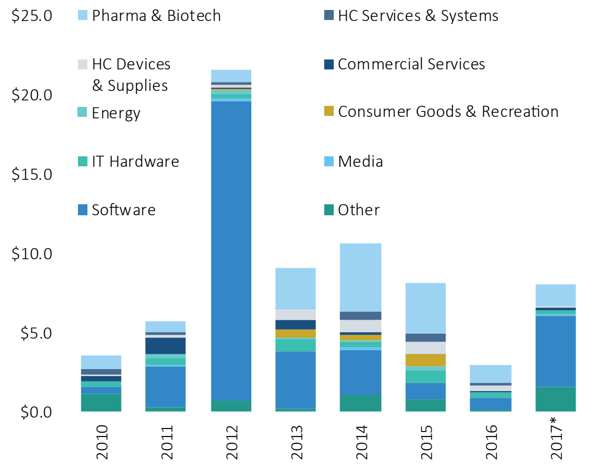
SOFTWARE IS DOMINANT IN 2017

US VC-backed IPOs ($B) by sector



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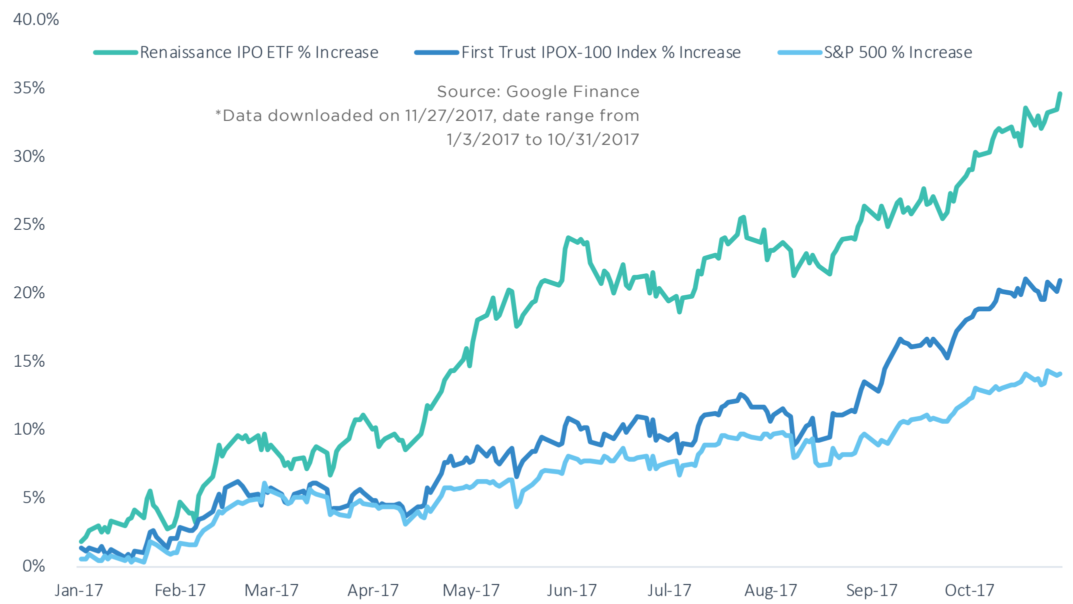
Spotlight: Unheralded successes drowned out by plunges

PE & VC-backed IPO performance

2017 IPO activity has not only rebounded from the sluggish environment in 2016, but those companies that have priced are also faring well in the secondary market[2]. This may come as a bit of a surprise to those who don't follow the public equity markets full-time, as media sentiment around IPOs has tended to lean negative. The disconnect can be partially explained by the underperformance of large, high-profile, consumer-facing businesses including Blue Apron—the worst performing IPO of the year, down 70% from initial pricing as of this writing. Others that fit this description include Snap, J. Jill and Yogaworks, all of which have lost around half of their equity value since debuting on the public markets.

On the other end of the continuum, there are success stories of sponsor-backed IPOs that have flown under the radar but have contributed heavily to the strong aggregate secondary market performance. For example, Roku, the streaming platform and set-top box manufacturer, has returned 166% from its IPO price with the help of one of the largest "IPO pops" of the year. With less consumer buzz, AnaptysBio is a clinical-stage biotech company that focuses on antibody products treating inflammation that has now returned 428% from its IPO price following a gap-up after positive results on a Phase II proof-of-concept study on an eczema drug. On the PE-backed side, Smart Global Holdings, a specialty memory solutions company, has returned 232% to IPO investors.

YYTD percentage increases in closing prices



2: Renaissance Capital's US IPO index, an aggregation of all US IPOs, has significantly outperformed the broader market, returning 34.5% against the S&P 500's 15.2% as of October 31. First Trust's IPOX-100 Index fund has also shown outperformance, returning 21.7% as of October 31.