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The IPO Q2 Update

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Each quarter Equiniti reviews both the UK and international IPO activity. The aim is to provide our readers with in-depth information on the latest listings as well as wider economic factors impacting the IPO market both in the UK and across the globe.

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Executive Summary

After a quiet first quarter, IPO activity across the world markets sparked up in Q2. The number of unicorns charging onto the New York exchanges was dizzying and easily propelled NYSE into the top spot for listing activity. The implications for investors and the economy of these growth-over-profit super-caps is explored in this quarter's article. Meanwhile, London has also been enjoying the spring, seeing an upturn in activity and the hosting of major overseas company IPOs as it maintains its strong global credentials.

UK IPO Market Q2 Round Up

Network International Holdings was the first premium listing of 2019 and a rather landmark event for London. With its £2.2bn mcap and £1.1bn raise, the Dubai-based payments processor is the largest IPO on any global exchange from Africa or the Middle East. It is also the largest London IPO since AIB in 2017. The firm, 10% owned by Mastercard, has capitalised on the rapid growth of cashless payments in the AME area.

This could only serve as encouragement to **Finablr**, a fellow UAE-based payments and FX provider. The majority owner of Travelex achieved a valuation of £1.2bn and raised £153m, sufficient to cut debt and fund expansion plans.

It was all silver lining for fellow FX provider, **Argentex**, which attracted £14m of AIM money and a valuation of £142m. The company has been growing substantially year on year while maintaining unbroken profitability.

There was more than back-of-the-sofa change for **Loungers** when it raised £62m on AIM, implying a market cap of £198m. Since being formed by three friends in Bristol in 2003, it has grown to around 150 Lounges and Cosy Clubs. Far from turning into couch potatoes with the money raised, they now look to take it to 400 units.

US Solar Fund shone as the second premium listing of 2019, raising £153m from the main market. A sister fund had already invested $800m in Australian solar and the principals see greater potential for renewable investments in the US, being the second largest market after China.

Aquila European Renewables Fund is investing closer to home and will now be busy recycling the £136m successfully raised from the main market.

Riverstone Credit Opportunities Income raised £77m in its main market IPO. The closed end company will provide finance to energy companies, which it believes are not being serviced by traditional lenders.

Blencowe Resources extracted £340k from AIM to buy mineral exploration companies in Africa, Asia and the Middle East. The first deal appears to relate to a graphite mine in Uganda, providing a key ingredient for lithium batteries.

Bermele raised just under £1m on the main market to invest in late-stage biopharma opportunities. Rather than being confined to purchasing companies, Bermele will widen its net to start-ups and research centres as well.

Watches of Switzerland had an enthusiastic main market reception for its IPO and a mcap of £650m. The firm owns Goldsmiths and Mappin & Webb and has launched into the US market. The focus of its £155m raise was to wind down debt.

Trainline proved to be a big-ticket item with a well-received main market IPO, valuing it at just under £2bn and a deal size of £1.1bn. The rail and coach platform, latterly under KKR's wing, grew ticket sales by 20% last year.

Overseas Exchanges

New York dominated the IPO market in the second quarter as the year of the unicorn got into full swing. NYSE executions in May alone were more than the last five months of 2018. With only one super-cap each so far in 2019, **Hong Kong** and **Shanghai** were left in the shadows after enjoying the two top honours last year.

Uber drove most of the headlines with the largest float of the year so far. The $82bn valuation – already under the 12-figure mcap it had originally aspired to – appeared challenging after Lyft had already lost 30% of last quarter's listing price. In the end, a valuation of $75.5bn was achieved and a raise of over $8bn. This will aid its diversification into more general mobility and delivery, including shipping.

With gig-focused IPOs struggling, it was always going to be interesting to see how Israeli freelance services provider **Fiverr**, which actually owns the trademark on the word gig, would fare. In fact, NYSE gave it a high five, raising $111m and valuing it at $650m, seeing its shares climb 90% on the first day.

Beyond Meat is using science and technology, along with plant-based ingredients, to provide solutions to the challenges posed by our global reliance on livestock production. An industry-changing event, Beyond Meat's IPO encourages others to think outside traditional options and drives awareness about impacting change with consumer choice. Since their May 2019 IPO, the industry has rallied around them, resulting in rising stock prices and developing leading partnerships.

On similar lines, **Impossible Burger** has just raised $300m, but have decided to do this privately.

In second place behind Uber was **Avantor**, raising $2.9bn for the life sciences supplier. Investors looked beyond large losses to its 6-million product line and sales to 180 countries.

While Uber and Lyft took much of the spotlight, other unicorns enjoyed quieter, more successful listings. Cloudco Zoom, which took on Google and Microsoft with the philosophy of simple products that "just work", achieved an impressive market cap of $16bn.Platform service provider **Pager Duty's** shares buzzed on launch, closing 60% up. Even the social medium **Pinterest**, dubbed an "undercorn" for its slower growth, rose 20% in its first week.

Chewy is an online pet supplies company often criticised for employing too many humans. Despite the high-cost base and losses, the PetSmart subsidiary was valued at just under $9bn and raised £1bn.

Cyber security company **CrowdStrike** enjoyed unusually high public recognition for its role in discovering Russian hackers in the US election. Valued at $3bn in June 2018, the $612m raise equated to a valuation nearly four times that amount just 12 months later.

Luckin Coffee steamed onto NASDAQ, with shares on its $570m raise jumping 50% on launch. The Chinese business was only founded in 2017 but they've already got Starbucks in its sights, having opened 2,400 stores in 28 cities in what is a predominantly tea-drinking country.

Europe's biggest IPO of the year was the €2bn raise for payment services firm **Nexi**, valuing the Italian company at €7bn. This transaction alone dwarfed the €700m raised in the first three months on the continent.

Hong Kong is in the doldrums. The top performer of 2018 has struggled to maintain momentum. Its largest 2019 IPO was to be billion-dollar-plus raise for real estate developer **ESR Cayman**, but this has now been delayed because of market volatility. HK is now the third-ranked exchange by 2019 IPO proceeds to date.

China has approved the first handful of IPOs for its new **Shanghai Technology Board**, the less regulated and bureaucratic exchange designed to allow new economy companies an easier domestic listing. South China Morning Post reports 89 companies applying for a listing in the first month, with ambitions to raise over $13bn.

The timing is unfortunate, however, with investors rattled by the strain on Washington-Beijing trade tensions and Chinese stock prices generally in retreat. This has translated into delays to tech IPOs and their valuations are reportedly down an average 20-30%.

More positive international relations were to be seen in the first fruit of the Shanghai-London Stock Connect, a new initiative between the two exchanges. **Huatai Securities**, a brokerage firm, successfully listed on London raising $1.53bn with a valuation of $1.6bn.

The Return of Pre-Profit IPOs

New York Outgrows Profit and Profits from Growth

The over-subscription for the Lyft, Uber and Chewy IPOs has shown the popularity of companies yet to achieve a profit. Mainstream media commentators have been quick to highlight their unprofitability as if it were a strange phenomenon. However, a record-breaking 83% of US IPOs were loss-making in the 12 months leading up to their float. What is driving such high numbers and, given the US exchanges' ability to influence global sentiment, what does it mean for the IPO market generally?

Although waiting for a positive bottom line before listing might garner a wider shareholder base, fast growth, pre-profit companies feel the pressure to list in order to inject capital but also to spread the risk inherent in their business model. The red-carpet reception given to them can only serve to encourage: pre-profit IPOs have actually outperformed profitable ones by 4% in their first week of trading. But what does unprofitability mean for their investors?

Is Profit Over-Rated?

Investors in unprofitable companies can justifiably point to Amazon. The company had not yet got into the black when it floated in 1997 and is now the most valuable public company in the world. Enterprises that can aggressively grow their share of a large and expanding market will always attract investors irrespective of their net figures.

Profit is the ultimate objective of business and every investor will have his or her own patience threshold. Shareholders do generally accept, however, that high growth and high profits are difficult to achieve simultaneously. Often, they trust that a company can in the future pivot its focus away from headlong expansion and towards margins. As Indian conglomerate Bharti's billionaire chairman Sunil Mittal rather breezily puts it, "You can choose to be very profitable very quickly if you don't want to grow."

Nor does the transition from growth to profit take much imagination. Studies repeatedly find ratios between market share and return on investment. A classic paper by Harvard Business Review in 1975 found that market share was, in fact, the biggest influence on the bottom line.

This is down to economies of scale, the ability to administer prices once dominant and because the management skills used to capture a market can be transferred to profit generation.

Rapid expansion is more easily translated into perceived opportunity for platforms and network companies like Facebook and Uber, especially when they are also first movers. Customer numbers can increase exponentially because the more people joining a network like Facebook the more reason there is for others to join it. Likewise, as passengers subscribe to Uber, the more reason there is for drivers to join the network and therefore even more passengers sign up and so on in a happy upward spiral. After strong initial growth, there is also a more effective barrier to new entrants and a relatively captive market that will bear higher pricing and have inherent big data and marketing value.

So What's the Problem?

The dash for growth can leave casualties. To penetrate new markets and keep up its rate of expansion, operating costs and new product investment will generally increase rapidly. Shareholders will typically tolerate these only if growth rates are maintained. Share prices of US unicorns have fallen by as much as 75% when expansion has fallen off.

Although unprofitable companies outperformed profitable stock in the first week of trading, this was short term only. Over three years the profit-generators returned 30.4% against the pre-profits' 12.6% according to analysis by The University of Florida.

As they enter the public market, a major difficulty is assigning an objective value to pre-profit companies. Benchmarking is less scientific, and investors are ultimately dependent on projections. As the Sage of Omaha is often quoted as saying, "Forecasts may tell you a great deal about the forecaster, they tell you nothing about the future." Shareholders have to take a leap of faith that a company can and will re-orientate their business towards profitability even though the ability to do so has not yet been demonstrated and may not yet even be an agenda item.

Another good reason to pause and reflect is that, although the 83% of IPOs being pre-profit is an all-time high, there is an historical echo. It's just not a very encouraging one: at the height of the dotcom bubble it was 81%.

Does This Mean Another Crash Is Heading Our Way?

Comparisons with the turn-of-the-millennium dotcom era are not entirely fair. In those heady days there was not always revenue growth to mitigate the unprofitability. Pets.com raised $83m in its IPO against sales of only $619k and had to be put down within a year. Investors, many of whom still carry the scars from the burst bubble in 2000, now have more respect for business fundamentals.

The context is also less frothy. In 1999 476 US companies listed on NYSE and NASDAQ while in 2018 there were only 134. 1999 saw the record 85% NASDAQ composite increase but in 2018 there was a 4% fall. Although most unicorns are being greeted onto the market with enthusiasm, the unalloyed optimism surrounding the millennial dotcom IPOs is absent.

The main players are also different. Technology accounted for three quarters of the 1999 US IPO cohort whereas in 2018 they made up just over one quarter. As noted in our last IPO review, technology companies are now opting to stay private for longer. Instead, biotechs are now more dominant, enjoying a record year in 2018, raising $8.2bn on NASDAQ alone. These companies have a more accepted and established pre-profit business model with their very front-ended research costs. To balance this, they usually go public with a stable of products at least at the advanced clinical trial or regulatory approval stages.

IPO companies are also now more mature. In 1999 the average age of a listing company in the US was 5 years and now it is 11. Even if most IPOs are unprofitable, there is at least more track record behind them than 20 years ago and therefore a better chance of determining the direction of travel and likelihood of success.

Wider Ripples

Other exchanges and their investors have naturally taken note of the pre-profit trend in the US and are adapting accordingly. Most notably, China is in the process of relaxing its profitability requirement for "new economy" IPO candidates. This should allow it to harness more of the Chinese companies presently accounting for a third of global IPO activity but mostly opting to list overseas.

There is the potential for more fundamental fall-out. As above, pre-profit IPOs featured significantly in the dotcom crash in 2000 and the longer-term implications of their resurgence are yet to be seen.

One effect already evident, however, is on investment culture generally. More attention and tolerance is shown to fast growth and market first movers than steady dividend generators. In turn, this might begin to deter more risk-averse players such as pension funds from participating in new economy businesses, and without their influence at AGMs profit might slip still further down the to-do list.

The objective of market domination held by many pre-profit unicorns will necessarily continue to clash with anti-trust and competition rules in the developed economies. If the domination objective is shared by ever-increasing numbers of publicly owned companies – and not just a few tall poppies like Google and Facebook - then pressure on regulators to relax rules will grow and consumer dynamics and choice must then change in its wake.

Pre-profit listings are now mainstream. The effects are yet to be seen but can be expected to extend well beyond the red-carpeted trading floor.

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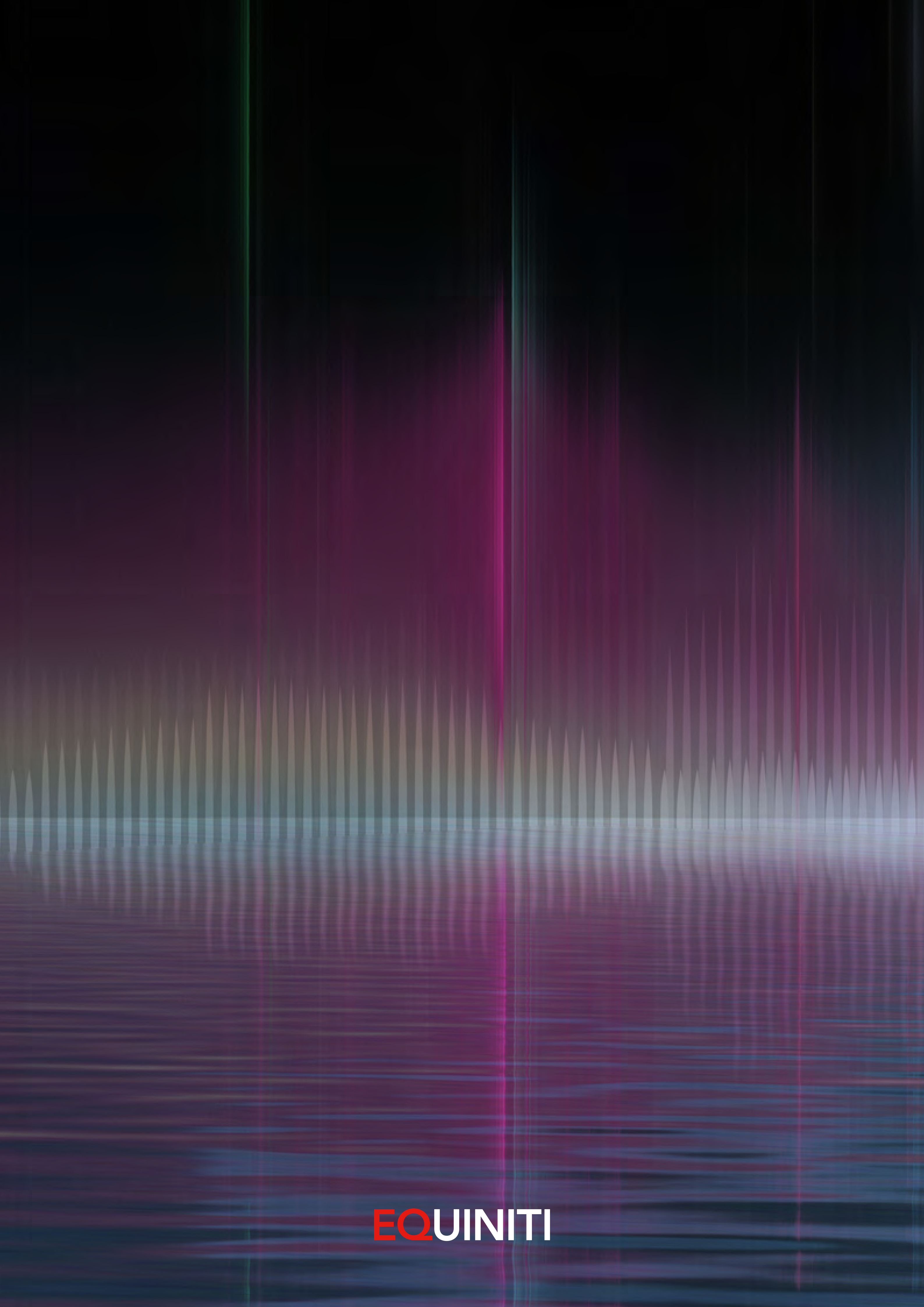

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