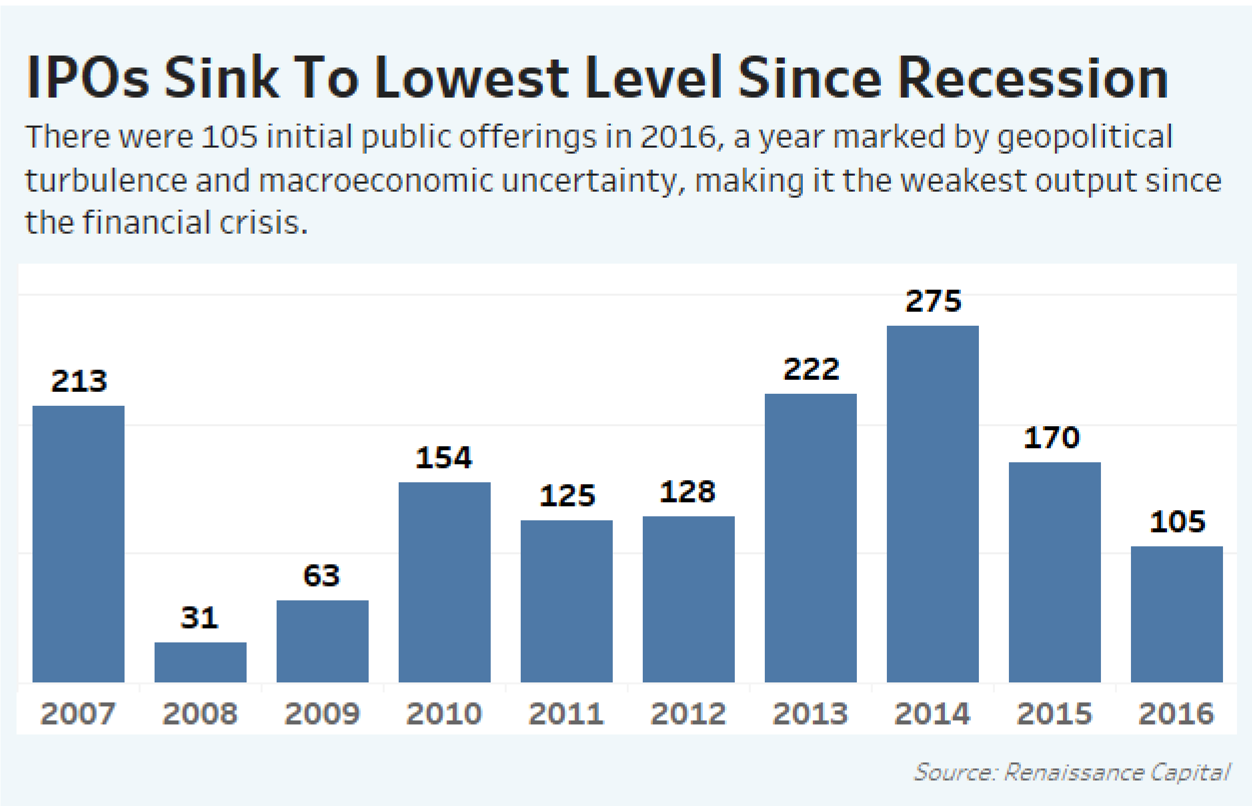
Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

5 Trends That Shaped The IPO Landscape In 2016

By **Tom Zanki**

Law360, New York (December 22, 2016, 1:54 PM EST) -- With the holidays in full swing, the market for initial public offerings is essentially shut for the balance of 2016, bringing to an end the worst year for U.S. IPOs since the financial crisis.

For capital markets attorneys, already eyeing a more deal-friendly 2017, the end can't come soon enough. Through Thursday, only 105 U.S. IPOs had priced, the lowest output since only 63 companies priced during crisis-era 2009.



Globally, the picture wasn't much better. Only 1,087 IPOs raised $132.8 billion, marking the lowest volume since 2012, according to researcher Dealogic. The U.K. and surrounding Europe were hit by Brexit fallout while even strongholds like Hong Kong cooled off from prior gangbuster levels.

Reasons for the swoon vary. But market uncertainty, the disconnect between private and public valuations and plentiful alternatives to IPOs, including a fairly healthy mergers and acquisitions market, loomed large. Here are five trends that shaped the IPO market over the past year.

Volatile Markets Chill IPO Climate

The year was weak from the outset. January failed to produce a single U.S. IPO, marking the first month without an initial offering since September 2011. Plus, the entire first quarter closed with a paltry eight deals — all relatively small biotech offerings.

Though it's easy to forget now while equity markets are roaring — the Dow Jones Industrial Average is approaching 20,000 for the first time — stock indexes plunged about 15 percent in the first six weeks of 2016 amid furious selling, chilling the environment for equity offerings in general.

The early part of 2016 was marked by macroeconomic uncertainty and plunging oil prices, extending an IPO slowdown that dated back to August 2015 when turmoil over Chinese markets and concerns about potential interest rate hikes dampened sentiment.

By late January, lawyers and bankers emerged from an annual health care investment conference sponsored by J.P. Morgan pessimistic about deal flow. The broader market picked up by May before tapering off again by summer, jolted by the U.K.'s shocking vote to exit the European Union.

Deal-making showed renewed life after Labor Day as 36 IPOs priced in September and October, marking the strongest two-month stretch of 2016. Activity cooled again as the rancorous U.S. presidential election neared and, save for a few December deals, died as the year wound down.

For capital markets attorneys, the past 12 months marked a bumpy period of fits and starts.

"The markets were cautious, and the overall volatility in the stock market caused by the election and Brexit were enough to really put a damper on things," Orrick Herrington & Sutcliffe LLP partner Chris Austin said.

Tech 'Unicorns' Slow to Go Public

Apart from macro concerns, industry-specific weaknesses affected the IPO landscape. Technology offerings were conspicuously absent in early 2016, largely because many venture-backed tech startups have achieved lofty private valuations over the past few years — so high that experts are widely skeptical that those valuations are sustainable in the public realm.

Not a single "unicorn" — a term for private companies valued at $1 billion or more — went public until late June. As long as companies could raise money privately, and recent regulations have made it even easier to defer going public, Silicon Valley's elite have mostly been happy to stay private

But that trend could be changing. Communications software firm Twilio Inc., a San Francisco-based unicorn, broke the ice in late June with a smash $150 million IPO that soared 92 percent in debut trading. Twilio priced at a modest $15 per share, but investors embraced the stock, suggesting the market will embrace reasonably valued tech startups.

Two more unicorns, Nutanix Inc. and Coupa Software, followed with similarly impressive debuts in September and October, and several smaller tech companies saw positive aftermarket returns. At the same time, data show that venture funding is pulling back after sizzling stretch in 2014 and 2015, raising the odds that more companies will get off the sidelines and tap public markets.

“The private markets were so hot that there was no incentive to go public,” Austin said, adding that cooling venture funding combined with recovering public markets could shift that dynamic. “The companies that went out [in 2016] in general did quite well, which bodes well for 2017.”

Once-Blazing Health Care Sector Cools

The health care and biotech sectors, while still frequent visitors to capital markets, saw their output fall sharply in 2016. Through Dec. 15, health care deal flow was down 46 percent from year-ago levels, according to IPO researcher Renaissance Capital.

Even so, health care represented the most active sector of IPO issuers. The industry relies heavily on biotechs, a capital-hungry segment of mostly prerevenue firms that urgently need cash to fund expensive drugs still in development.

But given weak market demand, many biotechs downsized their offerings, which already tend to be relatively small compared with other IPOs, to well below $100 million. Plus, many of those same companies relied on insider buying from existing investors to complete their deals.

Still, other biotechs chose to merge into existing public companies that have had their product candidates fail and bypassed the IPO process altogether. Liver treatment developer Albireo Ltd. merged in May with embattled Nasdaq-listed BioDel Corp., injecting fresh product candidates into the combined company, while privately held immunoncology firm Leap Therapeutics merged in August with Nasdaq-listed MacroCure Ltd., bringing with it an esophageal cancer drug in development.

“That’s very representative of a trend,” Morrison & Foerster LLP partner Anna Pinedo said of the merger route. “It’s gotten so difficult for companies to go public. They have been in the queue for so long, they are looking at this as an opportunity.”

Attorneys say blowups in the specialty pharma area, including financial struggles at beleaguered drugmaking giant Valeant Pharmaceuticals International Inc. that sent its shares plunging, also hurt health care issuances. Institutional investors for pharmaceutical and biotech investors often overlap.

“That had at least a psychological, depressing effect on investors’ appetite during the course of the year,” Covington & Burling LLP partner Don Murray said.

Dual Tracks Are a Widely Traveled Path

Amid jittery markets, companies will exhaust alternatives. The most common exit path for existing shareholders of a private company besides an IPO is through an acquisition, which provides immediate finality without worrying about future performance of public markets.

Extending a trend of recent years, many companies in 2016 pursued a so-called dual-track process in which they file IPO documents while simultaneously courting acquisition bids. Several IPO candidates this year found the latter option more enticing.

Bain Capital-backed cybersecurity firm Blue Coat Systems Inc was acquired for $4.7 billion in June by Symantec Corp while pharmaceutical services provider inVentiv Health Inc. in August sold half of itself for $3.8 billion to private equity firm Advent International. And just last week, Amsterdam resort operator Playa Hotels & Resorts BV, which filed for an IPO in September, instead chose to be bought by private equity-backed blank check company Pace Holdings Corp. for $500 million.

Estimates for how many IPOs are considered dual track are elusive since there is no formal structure that differentiates such a deal — it's essentially a negotiating strategy — and certain rules allow companies to file IPOs confidentially, making it harder to track exactly who is in play. But attorneys say it only makes sense for companies to consider all options.

“We generally have been counseling clients that, before you flip to public, if M&A is a possibility, run your process at that juncture, and see if you are going to get the valuation you want,” Pinedo said.

Debt Markets Fuel M&A Alternatives

Cheap debt continued to be ample in 2016, fueling the M&A market that provided an alternative to IPOs. Debt-financed transactions were aided by historically low interest rates that remained in effect despite a tiny increase to the Federal Reserve's benchmark rate in December 2015.

Easy access to money enabled many private equity buyers to acquire IPO candidates from other private equity backers, taking potential issuers out of the pipeline, such as the InVentiv deal. Data show just 30 private equity IPOs in 2016 have raised $8.8 billion this year, according to Renaissance Capital, marking the lowest points since 2009-2010.

“A lot of the deals that otherwise would have IPO'd instead chose to sell to a financial buyer, and you saw a lot of sponsor-to-sponsor deals,” Kirkland & Ellis LLP partner Josh Korff said. “In that environment, it's going to be tough to IPO."

Strategic buyers, meaning operating companies looking to gain a competitive edge in their industry, were also quick to snatch candidates from the IPO pipeline. Symantec's acquisition of Blue Coat was a prime example indicative of a wider trend. Attorneys expect that dynamic to remain in play in 2017.

“When you start hearing speculation that a company is about to go public, you often see strategic buyers enter the fray very late in the process just to gauge whether there is an opportunity to acquire the company before it goes public and gets valuations that may become unattractive for a buyer,” Goodwin Procter LLP partner Rezwan Pavri said.

--Editing by Christine Chun.