

US IPOs on Top Again

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After last year's surge of IPOs in the Asia-Pacific region, US IPO issuance has taken the top perch so far in 2011. The reasons for this are several, but chief among them are the increasing quality and growth potential of US IPOs relative to Asia-Pacific offerings and the broad underperformance of Asia's equity markets. US IPO momentum is also building with a pipeline of high-profile deals. While the year is just beginning, and trends can shift quickly, here are some of our high-level insights into recent IPO market trends.

Key takeaways:

- US IPO activity is up significantly year-over-year and besting the rest of the world
- Chinese issuance is down due to deteriorating issuer quality and China growth concerns
- The buy-side stared down private equity IPO backers in 2010; now valuations are reasonable
- Tech stocks are performing well due to fundamental quality and growth prospects
- High-profile names are coming (HCA, Toys "R" Us, LinkedIn, Skype, Freescale, Pandora)

US IPO Activity Up

So far this year there have been 24 US IPOs, an 85% increase from the 13 seen in the first month and a half last year. These IPOs raised \$8.1 billion, up materially from \$1.9 billion last year, in part due to multi-billion offerings from Nielsen (NLSN) and Kinder Morgan (KMI). After strong IPO issuance in November and December, the IPO market seems to be sustaining the momentum seen at the end of 2010. These are signs that the IPO market is back to normal levels of issuance that is expected in a growing economy.

The increased US activity is occurring at the same time as a slowdown in international IPO activity. So far this year, there have only been nine IPOs outside the US with a deal size above \$100 million, down more than 50% from 19 in the comparable period last year. The US share of IPO proceeds stands at nearly 70% year-to-date, a significant jump from the 19% share for all of 2010.

China Issuance Down

While the Chinese New Year may be keeping Hong Kong activity slow, we believe the reason for the lack of US-listed Chinese IPOs is that US investors have balked at the poor quality, high DSOs, opaque revenue and expense recognition policies, insider issues and generally not-ready-for-prime-time characteristics of some Chinese offerings. News stories about accounting frauds and weak post-IPO financial results posted by several Chinese firms also soured interest in the country's deals toward the end of last year.

Valuation Discipline Leads to Positive Performance

Investors remain valuation sensitive and many deals continue to face pricing pressure. 14 of the 24 US IPOs so far this year (58%) have priced below the midpoint of their ranges, a similar percentage to the whole of last year (61%). The main reason for last year's downpricings was consistent pressure on private equity deals, 70% of which priced below their midpoints. This year, by contrast, four of the six private equity deals have priced at or above the high end of the range and all but one is trading above its offer price. The high overall percentage of discounted deals so far in 2011 is instead attributable to early-stage biotechs and pharmas, which are typically the companies most likely to struggle to complete deals given their risk profiles. Many of these cash-strapped IPOs are in urgent need of financing and are therefore willing to downsize deals in order to complete offerings; in several cases, insiders bought shares on the IPO in order to help get them done (in some cases taking as much as 50% of the deal), with the benefit of future liquidity justifying the further investment.

Performance has been strong. As of February 18, only seven of the 24 deals were trading below their offer price (last year, almost 50% were below their offer price at the same date). Three high-profile PE deals (Kinder Morgan, Nielsen and BankUnited) were all well-received. The common thread between all three is stable businesses with strong and highly visible cash flow; Kinder Morgan benefits from fee-based contracts and high barriers to entry, Nielsen is a clear market leader with deep customer relationships and BankUnited has loss guarantees from the federal government. In addition, underwriters and backers may be learning to pitch these deals at more reasonable

valuations instead of being overly aggressive when setting the initial range. With a growing backlog of PE-backed companies itching to tap the public markets, we hope this is the case.

Tech Shines

The most notable industry sector is technology and communications, which has seen several diverse companies (Demand Media, NeoPhotonics, Epocrates, Velti and InterXion) all garner strong receptions. Interest in these companies has generally been driven by strong recent and forecasted growth, and in all five cases, investors have been willing to overlook some fundamental concerns and focus on top-line growth. As we saw last year, with US economic growth muted, investors are looking to the IPO market for secular growth stories.

High-Profile Pipeline

With 34 private equity-backed deals currently in the pipeline, including big names like Toys “R” Us and Freescale, and many others in the shadow backlog, issuance from the private equity space is expected to play a bigger role in 2011. Hospital operator HCA, which is expected to raise over \$4 billion on March 9, will be the next high-profile one to test the waters in the US, while ISS (a Danish facilities management company) is rumored to be prepping for a \$2-\$3 billion offering in Europe next month.

In addition, the large number of telecom, tech and social networking companies in the pipeline may signal that the US economy is finally about to grow with new companies raising capital for job creation. Household names such as Skype, LinkedIn and Pandora have already filed and Groupon, Zynga, Facebook, and HomeAway are reportedly gearing up for IPOs. In addition, there are dozens of other venture-backed US companies in the software, digital media and mobile sectors in the shadow pipeline.

Overall, the current lull in the IPO market does not disguise the fact that activity remains strong relative to last year and is so far almost back at pre-crisis levels. With high-profile deals being well-

received and overall IPO returns healthy, we expect this to continue. HCA's multi-billion offering in March will be the largest PE-backed IPO in history and LinkedIn will be the inaugural social networking IPO.

About Renaissance Capital

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