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THE NEWSLETTER OF THE BDO CAPITAL MARKETS PRACTICE

INITIAL OFFERINGS

U.S. IPO ACTIVITY COMES TO VIRTUAL HALT IN Q1 OF 2016

JANUARY'S HIGHLY VOLATILE STOCK MARKET LED TO PULL BACK OF OFFERINGS

After several years of robust activity, stock market uncertainty has brought a deep freeze to initial public offering (IPO) activity in the U.S. during the initial months of 2016. In fact, January marked the first month that not a single IPO took place since September of 2011 when confidence was severely shaken during the Eurozone crisis.

With just 8 IPOs for the quarter, activity is down 76 percent from Q1 2015 and, similarly, total proceeds ($0.7 billion) are down 87 percent year-over-year. This makes Q1 2016 the least active quarter in both offering activity and proceeds raised in seven years (1 IPO and $0.7 billion in proceeds in Q1 2009), when markets were still roiling from the financial crisis.*

Certainly stock market volatility – the Dow plunged more than 1,000 points in one week this year - has played a major role in closing off the spigot of new offering businesses. However, there is a long list of additional factors – a perfect storm if you will – that have contributed to the lack of deals. They include:

- Poor IPO Performance. A majority of the 170 companies that made their initial offerings last year are now trading below their IPO price. Poor returns lead to lack of appetite for additional risk.
- Private Financing. The availability of private funding at very favorable valuations, especially in the technology sector, has led many potential IPO candidates to postpone their offerings indefinitely.
- The M&A Alternative. Investors aren't the only ones running from risk. A surge in M&A activity – deals reached an all-time high in 2015 - has led many IPO candidates to opt for the certainty of a sale over the risk of an offering.

Weak growth in China, the continued drop in oil prices and uncertainty surrounding interest rate hikes by the Federal Reserve are additional contributing factors to the dearth of offerings.

BDO CAPITAL MARKETS PRACTICE

BDO USA is a valued business advisor to companies making public securities offerings. The firm works with a wide variety of clients, ranging from entrepreneurial businesses to multinational Fortune 500 corporations, on a myriad of accounting, tax and other financial issues.

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** Renaissance Capital is the source for all historical data related to the number, size and returns of U.S. IPOs.*

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"After three consecutive years of strong growth, the U.S. market for initial public offerings experienced a steep drop in 2015, as virtually every statistical category – offerings, proceeds, filings and returns – were down significantly year over year. Expectations for an increase in IPOs 2016 were not optimistic, as the BDO IPO Outlook survey of capital markets executives at leading investment banks forecast zero growth for pricings. However, very few were forecasting the almost complete shut-down of pricings that we experienced in Q1," said **Ted Vaughan, Partner in the Capital Markets Practice of BDO USA**. "The extreme volatility of the stock market in Q1 – the Dow closed up or down more than 200 points 19 times during the first two months of the year – severely reduced investor appetite for risk and made it very difficult for underwriters to price a new offering with confidence."

2016 Q1 U.S. IPO TREND TRACKER

	2015	2016	+/-	10 yr. high	10 yr. low
IPOs	34	8	- 76%	64 (2014)	1 (2009)
Proceeds	$5.5B	$0.7B	- 87%	$19.1B* (2008)	$0.7B (2009)
Avg. Deal	$159M	$88M	- 45%	$1.59B* (2008)	$140M (2012)
Filings	48	24	- 50%	106 (2014)	4 (2009)

* Heavily impacted by March 2008 $17.9 billion VISA IPO
Source: *Renaissance Capital, Greenwich, CT (www.renaissancecapital.com)*

INDUSTRIES

All eight Q1 IPOs were in the healthcare/biotech sector. This continues an ongoing trend as the healthcare sector has led all industries for three consecutive years (2013-2015).

Prior to the healthcare industry's recent run of IPO leadership, the health of the U.S. IPO market was tightly linked to the offerings coming from the technology sector, as tech offerings led those of any other industry for six of the previous seven years (the lone exception was 2008 when the financial crisis brought activity to a halt). In recent years, the abundance of private financing at very favorable valuations has kept many of these technology companies away from the public markets. However, as public technology stocks trade down, these high valuations from private investors are likely to be increasingly difficult to achieve. Should private funding close up on these businesses, it could signal a return of tech companies to the public markets.

RECOVERY FORECAST

The uncertainty permeating today's markets is reflected in investors retreat from risk. This severely impacts interest in IPOs, young startups with little history of profitability or revenue growth.

Public markets have seen a recovery from the major drops in January, but it will likely take a sustained rally before investors have the risk tolerance to support a robust IPO market. Those businesses that can accurately judge when investor's appetite for risk has returned, are likely to be rewarded, but that is a difficult forecast to make.

Failing an unexpected debut by a big-name company, such as Uber, Airbnb or Snapchat, 'caution' is likely to remain the watchword for the investment community in the near term, making an increase in IPO activity a slow process.

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"Although stock market performance has stabilized a great deal since January's roller coaster ride, it will most likely take a sustained rally before many offering businesses begin to price again," said **Paula Hamric, a Director in the Capital Markets Practice of BDO USA**. "In the current climate, businesses are reluctant to be the first to launch their IPO for fear of having to offer a much larger discount than normal to incentivize investors who have stepped away from these offerings. A steep discount in offering price greatly reduces the capital raised from the IPO and, just as important, takes a toll on the company's overall evaluation."

When a recovery does occur, look for healthcare, technology and consumer businesses with strong growth profiles and name recognition to lead the way. A key component to the return of offerings is the ability of these businesses – especially technology companies – to reconcile the valuation differences between the public and private markets.

Once offering businesses decide to 'bite the bullet' and accept pricings at current public valuations, the table will be set for stronger IPO performance. Improved performance will lead to more offerings, which will eventually lead to better pricings.

"It's important to remember that prior to the uncertainty brought about by January's stock market turbulence, the number of IPO pricings had already begun to slow considerably in the latter half of 2015. Moreover, there is no Alibaba, Facebook, Visa or other giant offering waiting in the wings to trigger a sharp turnaround in the market's psychology. This points to potentially slower offering activity for the remainder of 2016," said **Chris Smith, a Partner in the Capital Markets Practice of BDO USA**. "If the public markets remain cool to risk, companies desperate to raise capital are soon expected to pursue additional rounds of private funding. However, private financing is likely to be increasingly challenging as venture capital and private equity firms that are unable to exit overvalued startups will demand lower valuations in new financing rounds. Eventually, these businesses will have to choose between pursuing a dilutive private investment round, an IPO priced well below their most recent private valuation – as Square and Box did last year – or a sale to an acquirer at a lower, but certain price."

MARK YOUR CALENDARS...

CAPITAL MARKETS EVENT SCHEDULE

(April - June)

The following is a list of upcoming conferences and seminars of interest for capital markets and underwriting executives:

MAY

May 2 - 4
ACG InterGrowth 2016
Hyatt Regency
New Orleans, Louisiana

May 5
NVCA Leadership Gala & Summit
The Palace Hotel
San Francisco, California

May 9-12
IFC Global Private Equity Conference
Ritz Carlton
Washington, DC

May 10
De-Mystifying IPOs and Understanding Capital Market Opportunities
BDO USA
Costa Mesa, California

May 18-19
Private Equity Americas Forum
Sofitel
New York, New York

JUNE

June 6-9
SuperReturn U.S. 2016
Renaissance Boston Waterfront Hotel
Boston, Massachusetts

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