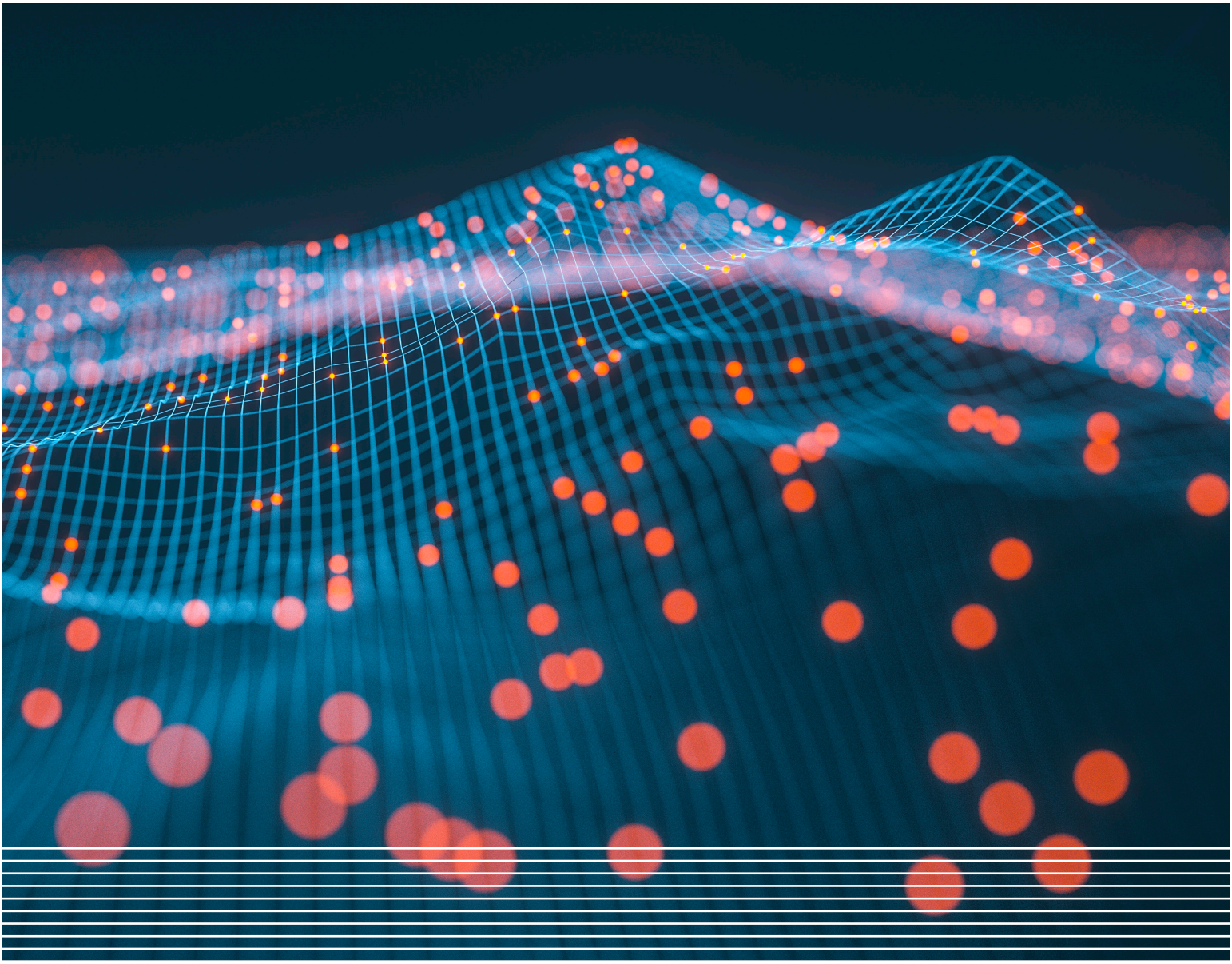

# Going Public: U.S. IPO Report

## Half Year 2020

PAUL HASTINGS

Securities & Capital Markets

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## Half-Year 2020 IPO Update

Although 2020 began with an active IPO market, with January and February 2020 deals pricing at a higher pace than the same period in 2019 (when the government shutdown effectively derailed the IPO market), deal flow ground to a halt after February this year, with market disruption from the novel coronavirus COVID-19 leading to only one traditional IPO over $75 million completed in the first half of March. Beginning in May 2020, though, the IPO market came roaring back, allowing those companies with IPO plans in the pipeline before the COVID-19 pandemic caused massive disruption to the markets to consummate their transactions. We saw issuers across all sectors—including issuers with larger deals over $300 million, return to the market. In addition, the market for special purpose acquisition companies (SPACs) was very active in the first half of 2020—and accelerating into the second half of 2020—with approximately 60 SPAC IPOs over $150 million coming year-to-date through August 31, and approximately 35 such deals in July and August alone. The number of SPACs in the market has also led private companies to pursue a three-track process, since in addition to pursuing a traditional IPO or sale transaction, those companies are now able to also consider an acquisition by a SPAC as an alternative path to going public and exiting the investment.

Our team reviewed deal terms of 28 of the IPOs that priced in the first half of 2020 with base deal sizes over $75 million (excluding special purpose acquisition companies (SPACs), real estate investment trusts and business development companies).

## Key Takeaways

- ***Despite Several Mega-IPOs, Medium-Sized Deals Still Prevail***. Smaller and medium-sized IPOs continued to dominate the market, with almost 45% of IPOs in our study being in the $100-$299M range. However, the first half of 2020 has seen a return of the "mega IPOs" over $750M, with almost 30% of deals in this range in the first half of 2020, compared to just over 15% for full year 2019, including deals by Warner Music Group and Reynolds Consumer Products.
- ***Life Sciences and Biotechnology Issuers, Along with SPACs, Dominated the First Half 2020 IPO Market, But Broader Sectors Returned Late in Q2 and Into Q3.*** Even more than historical trends, life sciences and biotechnology IPOs, in which issuers raise smaller amounts of capital, dominated the market by deal count. While these issuers accounted for approximately 34% of deals in full year 2019, they accounted for over 60% of deals in the first half of 2020. However, compared to Q1 2020, Q2 2020 saw the return of other sectors, with technology, media and telecommunications deals making up 11% of the deals in our study in the first half of 2020 (compared to 29% in full year 2019). As the IPO market rebounded late in Q2 2020, and into Q3 2020, we have seen issuers across all sectors accessing the IPO market, with several IPOs over the summer by financial services companies, industrials and consumer and retail companies.
- ***SEC Review Process Remains Streamlined, But Deals Are Taking Longer to Complete***. While the SEC comment process remains streamlined, with an average of three comment letters and an average of 15 comments in the first letter in the first half of 2020, compared to 19 for full year 2019, the time to market has increased by over a month, from an average of 111 days in full year 2019 to 144 days in the first half of 2020. This increase in time-to-market is likely driven less by the SEC process and more by the market slowdown and volatility caused by the COVID-19 pandemic. This average of 15 comments is also likely driven by the prevalence of life sciences and biotechnology IPOs, many of which are pre-revenue and therefore have simple and often immaterial historical financial statements, thus minimizing accounting comments. In addition, the average number of comments in the SEC's second comment letter dropped from an average of just over 5 comments in full year 2019 to just under 3 comments in the first half of 2020.
    - Interestingly, while companies conducting IPOs over $750M saw meaningfully more comments than other issuers in full year 2019, the average number of comments for these "mega IPOs" was in line with the market average of 15 (compared to an average of 24 comments in first comment letters for these mega IPOs in full year 2019).
    - Several life sciences issuers in our study saw as few as one comment letter, albeit with a higher number of comments than the average, with fewer accounting-related comments and more focused on disclosure changes that could be addressed with one round of revisions.

- SPACs are seeing even fewer comments—in the first half of 2020, SPACs over $150 million received an average of only one comment in their first comment letter, with 58% of SPACs receiving no comments at all and only 12% of SPACs receiving more than three comments (with no SPAC receiving more than six comments in the first letter). Further, based on recent SPAC deals, the speed through the SEC review process is quick—sometimes as quickly as eight weeks from organizational meeting to pricing.

- ***Q2 Saw a Return to Secondary Sales Following No Secondaries in Q1***. While none of the IPOs in our study from Q1 2020 had a secondary component, almost 30% of IPOs in Q2 contained a secondary component, leading to a total of 18% of issuers in the first half of 2020, compared to just under 30% of deals in full year 2019. The prevalence of life sciences and biotechnology IPOs likely drove this decrease in secondary components, since life sciences and biotechnology companies are able to access the public markets at an early stage in their lifecycle when exits are less common at time of IPO for founders and early stage investors. In addition, just under 12% of deals in Q2 included sales by issuers' insiders, while there were none in Q1 2020 and just under 30% in full year 2019. 43% of issuers had directed share programs in the first half of 2020, slightly down from full year 2019.

- ***Pricing Rebounded, with Half Year 2020 Pricing Exceeding Pricing in 2019***. Approximately 65% of IPOs priced above the midpoint of the range in the first half of 2020, compared to just under 50% in full year 2019. This marked a real change from Q4 2019, where more deals were pricing below the midpoint than above.

- ***Underwriting Commissions Are Trending Towards the Historical Norm of 7%, Reflecting The Decrease in High-Profile IPOs where Issuers Had Been Able to Negotiate Lower Fees.*** In full year 2019, just under half of IPOs included underwriting discounts of 7%, which has been the historical norm for IPOs. In the first half of 2020, approximately 60% of IPOs included a 7% underwriting discount, reflecting a return to historical norms. Sponsor-backed companies, on the other hand, have been successful in negotiating lower underwriting commissions, with almost 80% of the sponsor-backed deals in the first half of 2020 negotiating underwriting commissions below 7%.

- ***Two Years of Financial Information Has Become the New Normal—Particularly for Life Sciences and Biotechnology IPOs.*** 90% of EGCs in our study relied on JOBS Act accommodations to present only two years of audited financial statements and two years of selected financial statements—underscoring that these trends are "the new normal." After the JOBS Act was passed in 2012, few companies availed themselves of this accommodation, but by full year 2019, we saw approximately 67% of EGC issuers presenting two years of audited financial statements and approximately 58% presenting two years of selected financial statements. While this prevalence may be driven by the number of life sciences and biotechnology companies coming to market with limited operating histories—making a longer term financial presentation either inapplicable or unnecessary for marketing—we are seeing two-year presentations across sectors, including in both financial services IPOs and consumer & retail IPOs, which in full year 2019 had only a minority of EGC IPOs presenting two years of financials. Interestingly, while a small number of EGCs did present four or five years of selected financials in full year 2019, none elected to do so in the first half of 2020, and only 10% of EGC issuers presented a third year of selected financials. Since over 90% of IPOs are by EGCs, this represents over 80% of the broader IPO market presenting only two years of financial information.

- ***Despite Some Trends in Q4 2019 Towards IPO Issuers that Were Profitable, IPO Issuers in the First Half of 2020 Largely Were Unprofitable, Led by Life Sciences and Biotechnology IPOs***. Approximately 77% of IPO issuers in the first half of 2020 presented net losses on a GAAP basis, compared to 67% for full year 2019. This comes as a bit of surprise given that only 60% of IPO issuers in Q4 2019 presented a net loss and is likely driven by the prevalence of life sciences and biotechnology IPOs, where the IPO market is more accommodating of unprofitable issuers coming to market, even before generating revenue. Nonetheless, the percentage of issuers presenting non-GAAP financial measures such as EBITDA or Adjusted EBITDA remained consistent around 40% compared to full year 2019. With the return of broader industry sectors to the IPO market in late Q2 and into Q3, we expect to return to historical norms.

  - Just under 40% of IPO issuers in the first half of 2020 disclosed a material weakness in internal controls over financial reporting, generally in line with full year 2019.

  - Just under 30% of IPO issuers in Q1 2020 were "pre-revenue", compared to only 21% for full year 2019 and 40% in Q1 2020. The return of issuers outside of the life sciences and biotechnology industry in Q2 started to normalize this trend compared to the historical average.

- ***Equity Incentive Plans Continue to Reserve Sizeable Portions of Capital for Executive Compensation, Commonly With Evergreen Provisions Allowing That Amount to Increase Without Shareholder Approval***. Employee stock ownership programs—through equity compensation plans and employee stock purchase plans—continue to be adopted as a way to incentivize management. IPO issuers in the first half of 2020 reserved approximately 10.6% of their outstanding share capital for these plans—the prevalence of life sciences and biotechnology issuers in Q1 2020, which saw a much higher average of 13.6%, has been moderated to historical trends with the return of broader industry sectors in Q2 2020.
  - Approximately 65% of IPO issuers in the first half of 2020 adopted these plans with "evergreen" provisions that automatically increase the number of shares reserved for issuance under the plans without further shareholder approval. This represents an increase from the approximately 60% of issuers we saw in full year 2019 with such evergreen provisions, but moderating the 80% of IPO issuers with such plans in Q1 2020.
  - Just under 70% of IPO issuers also went public in the first half of 2020 with employee stock purchase programs, which allow employees to purchase company shares through payroll deductions, usually at a discount to market prices. This represents an increase from the 60% of issuers we saw in full year 2019 adopting such programs.
  - Sponsor-backed companies were less likely to have employee stock purchase plans, with just over 30% of sponsor-backed IPO issuers having those plans in 2020 (compared to approximately 65% in full year 2019). Evergreen provisions were also less frequent than the market-wide average, where just over 40% of sponsor-backed companies in the first half of 2020 went public with evergreen provisions.
- ***While Q1 2020 Saw an Absence of Multi-class Voting Structures, Which Are Rare among Life Sciences and Biotechnology IPOs, Over 20% of Issuers in the First Half of 2020 Had Multi-class Voting Structures, Marking a Return to the Common Feature We Saw in 2019 When Almost 40% of IPO Issuers Had Multi-class Voting Structures***. Over the past several years, there has been an increasing trend towards multi-class voting structures, with almost 40% of IPO issuers in full year 2019 adopting multi-class structures in which founders or majority shareholders retain high vote stock and are issuing low vote stock to the public. Due to the prevalence of life sciences and biotechnology IPOs, of the IPO issuers in our Q1 2020 study, none adopted these types of structures. However, we saw a return in Q2 2020, with over 30% of issuers in Q2 2020 going public with multi-class voting structures. Further, while several of these multi-class voting structures included the more aggressive 20:1 voting ratio that we saw in full year 2019, the majority of issuers with multi-class voting structures were at a voting ratio of 10:1 or lower, representing a reset to more historical norms when voting ratios were 3:1 or 5:1. Other key governance measures, though, remained consistent with full year 2019. Interestingly, sponsor-backed companies continued to see only about 20% of issuers with multi-class voting structures, although they had higher incidence than the market generally around the right to call special meetings and to act by written consent.
- ***A Majority of IPOs are Using Test-the-Waters to Gauge Market Interest Prior to Formal Roadshow.*** A majority of IPO issuers are using test-the-waters communications to gauge market interest, and given the passage of Rule 163B in late 2019, this accommodation is now available to all issuers, regardless of size.
- ***The SPAC IPO Market Remains Very Active, with Approximately 57 Deals with a Median Deal Size of $300 Million and an Average Deal Size of $417 million for SPAC Deals Completed through the End of August, with More than 30 Deals Pricing in July and August Alone***.
  - Two-thirds of SPACs listed through the end of August listed on the New York Stock Exchange.
  - Approximately 37% contained units consisting of half of a warrant, while approximately 38% contained units consisting of one-third of a warrant and 25% contained another fraction (e.g., one-quarter, one-fifth or one whole warrant).
  - Almost one-quarter of these deals included forward purchase contracts.
  - 80% of these deals gave the SPAC 24 months to complete the initial business combination, with 16% having 18 months to complete those transactions and 4% having 21 months to complete the transactions.

## Looking ahead

- ***The IPO Market in May and June Has Led to a Resurgence of IPOs over the Summer, and We Expect September and October to be an Active Market in Advance of the Fall Presidential Election.*** Since the end of April, the IPO market has rebounded significantly from the near shutdown in March following the onset of the Covid-19 pandemic, with many IPOs in the pipeline for September and October, with more issuers planning to hit the market in the first half of 2021.

- ***Companies Able to Market Their Success During the COVID-19 Pandemic are Likely Going To Seek to Access the Market***. The COVID-19 pandemic has given certain issuers that have performed well during—or even benefitted from—the pandemic the ability to market through the recession caused by the pandemic, and we expect that issuers that can demonstrate continued or increased strength through the pandemic are likely going to lead IPOs going into the end of 2020 and the first half of 2021. Issuers across sectors—such as consumer and retail companies, technology companies and financial services companies—will be marketing their competitive strengths and strategies with the COVID-19 pandemic in mind. We expect that companies that can demonstrate how the pandemic has accelerated pre-existing trends—like the move towards e-commerce—will be able to successfully access the markets. In addition, as we saw in early July, with the IPOs of two public benefit corporations, we expect to see more mission-driven companies seek to access the public markets and market their stories in the backdrop of the pandemic.

- ***Sponsors May See the Public Markets as More Attractive Than Private Sales***. Going into the latter half of 2020 and into the first half of 2021, we expect that there may be an uptick in IPOs by sponsor-backed companies, as the public markets may be deemed better options for valuation compared to the private markets. We have started to see sponsor-backed deals return to the market in Q2 and into Q3 2020. This would represent a shift away from trends in the last decade.

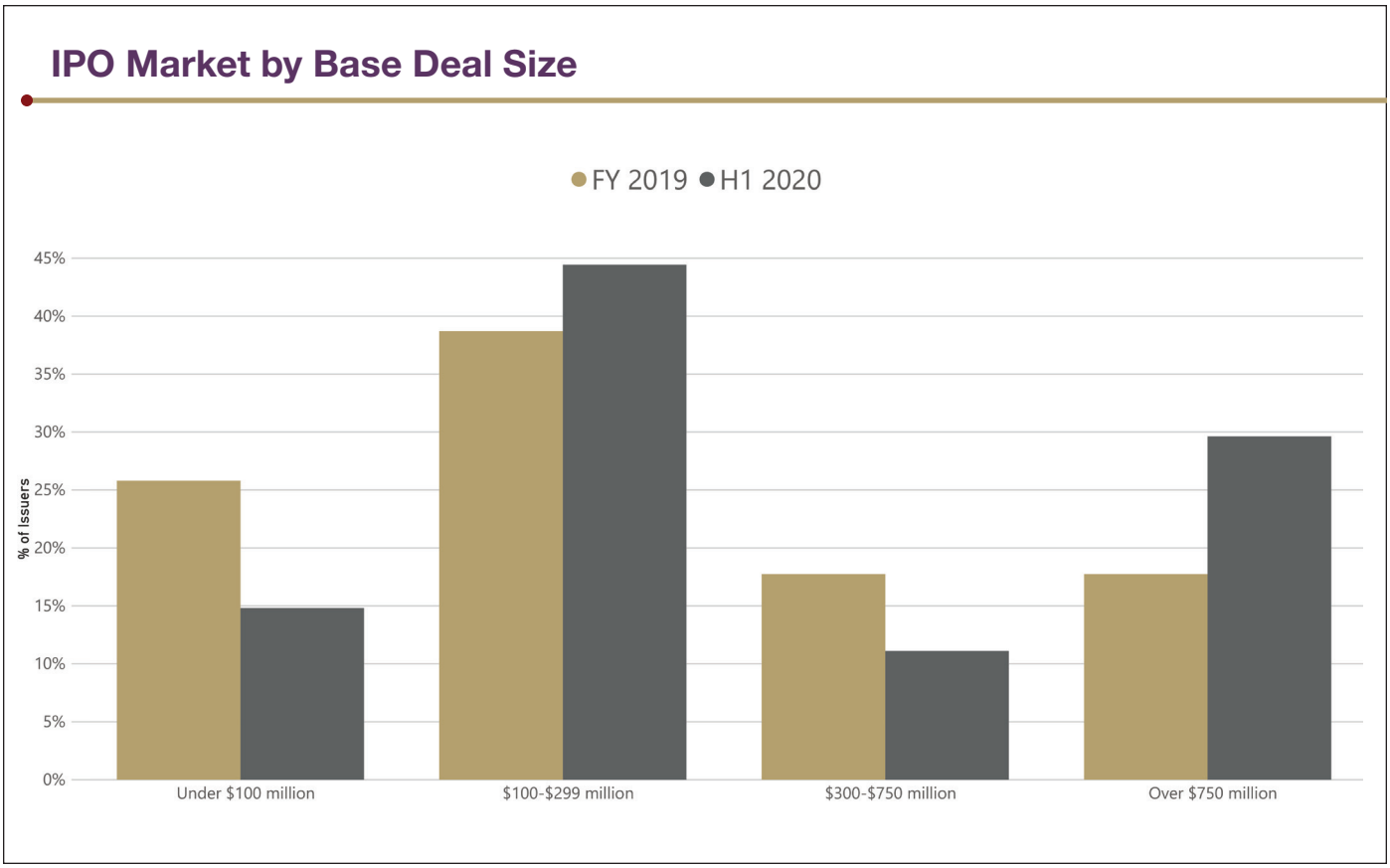
- ***Issuers Continue to Prepare IPOs for Opportune Market Windows.*** Issuers continue to prepare IPOs and confidentially submit draft registration statements, with a view towards optionality and taking advantage of market windows that have opened in the second half of 2020. Companies working with a view towards hitting the market in 2021 are starting their preparations, with the goal of being ready to go when market windows are available.

- ***Virtual Roadshows Are the New Norm***. As financial markets professionals and issuers shifted to the "new normal" of working remotely, the IPO preparation process and marketing process has gone virtual. As industry participants have adjusted to the new normal, virtual drafting sessions have been used to prepare filings, and companies have successfully used electronic roadshows and other virtual meetings to conduct their roadshow presentations. This has resulted in a number of IPO roadshows being completed with fewer marketing days as well. In addition, given the absence of in person meetings, few—if any—hard copies of prospectuses are being printed and distributed as part of the roadshow and marketing effort.

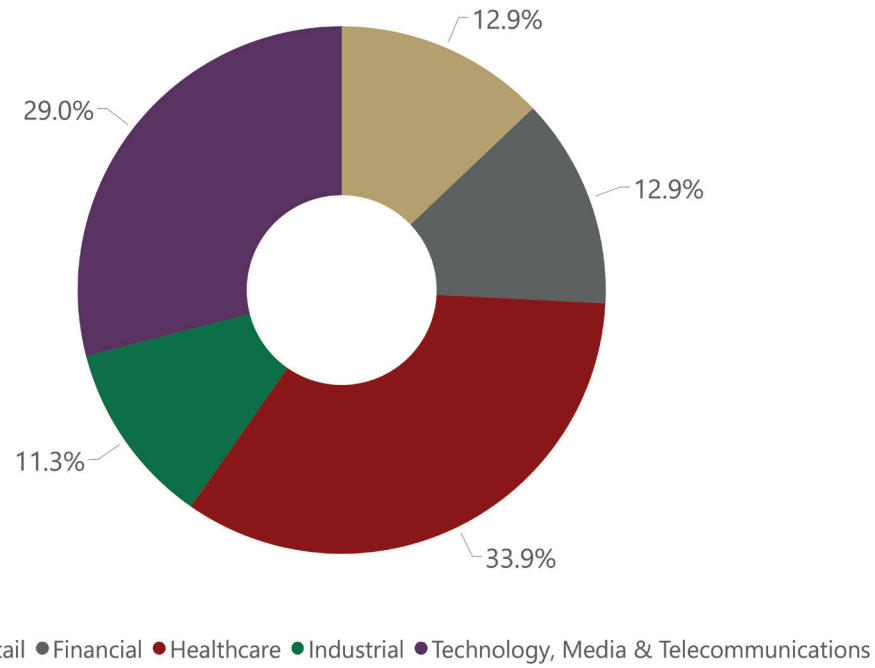
- ***COVID-19 Will Be an Increased Focus of Disclosure and Marketing, and Perhaps Part of Non-GAAP Financial Measures.*** As with any issuer preparing disclosures under the SEC rules, IPO issuers will be expected to clearly disclose the impacts of COVID-19 on their business, operations, financial results and prospects. Understanding the impacts of COVID-19 on the issuer will be top of mind for underwriters and potential investors.

- ***Investors Will Continue to Focus on Profitability and Governance.*** Since the fourth quarter of 2019, we began to see an increased focus on profitability and governance for issuers outside of the life sciences and biotechnology industries. We expect to see that trend continue, with investors focusing on companies that are profitable and have governance features that are more shareholder friendly, such as single class voting.

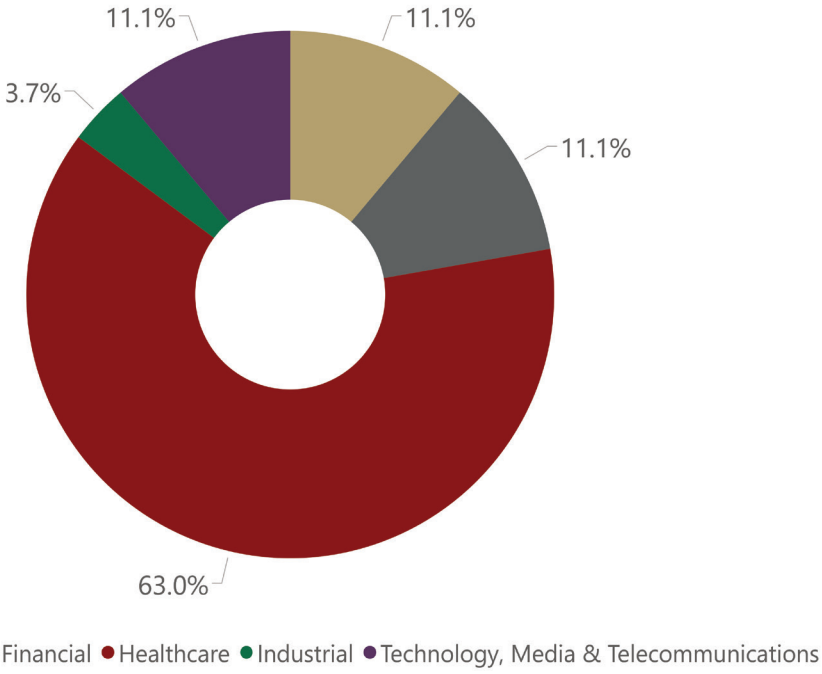
## IPO Overview



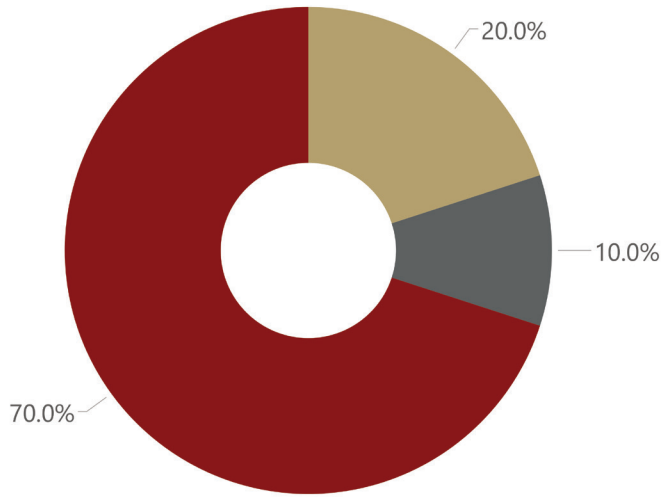
## 2019 IPO Market by Sector



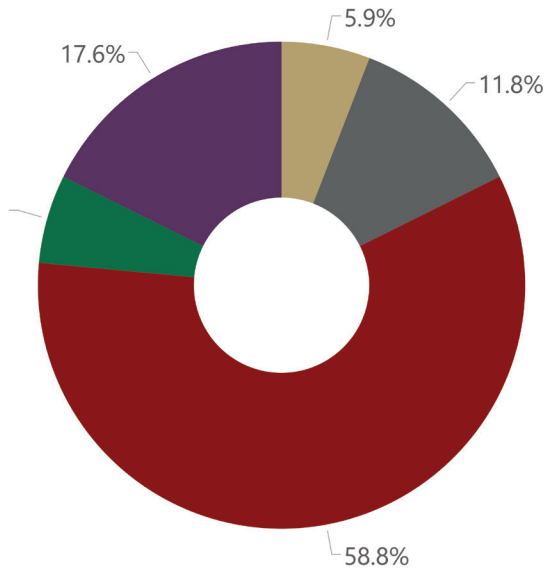

## H1 2020 - IPO Market by Sector



## Q1 2020 - IPO Market by Sector

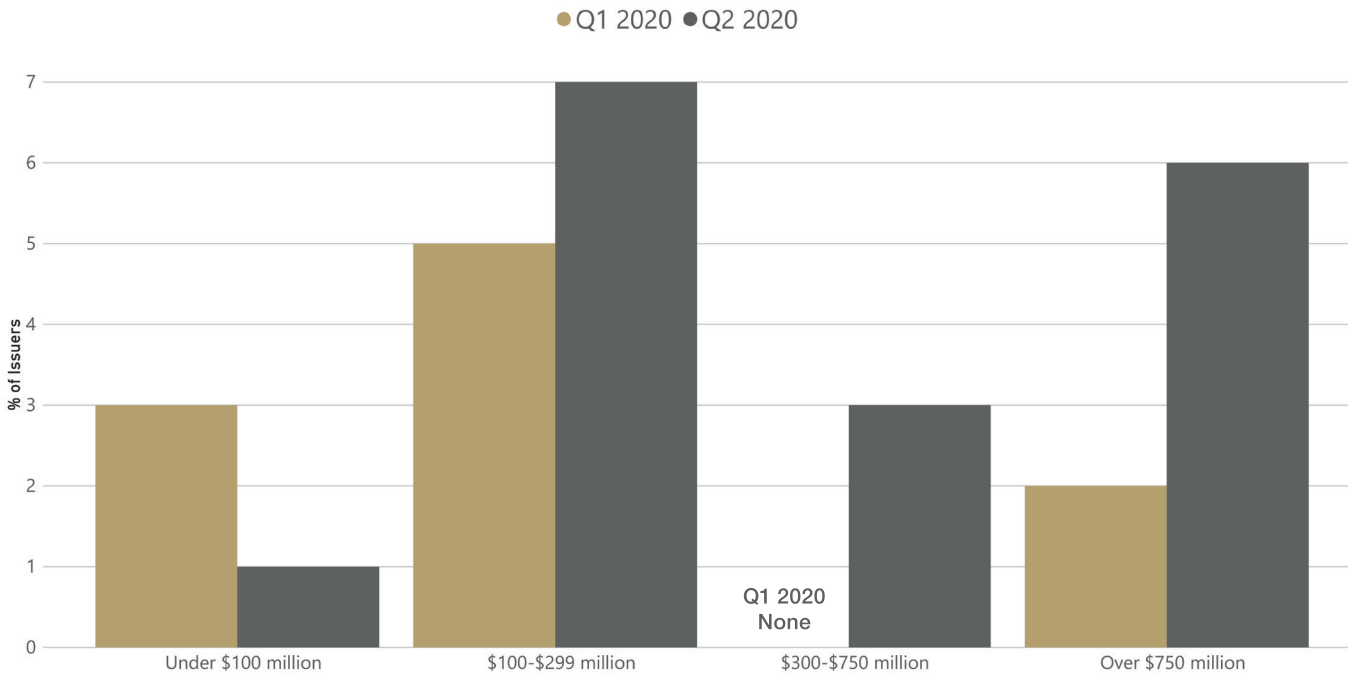



## Q2 2020 - IPO Market by Sector




Consumer & Retail ● Financial ● Healthcare ● Industrial ● Technology, Media & Telecommunications

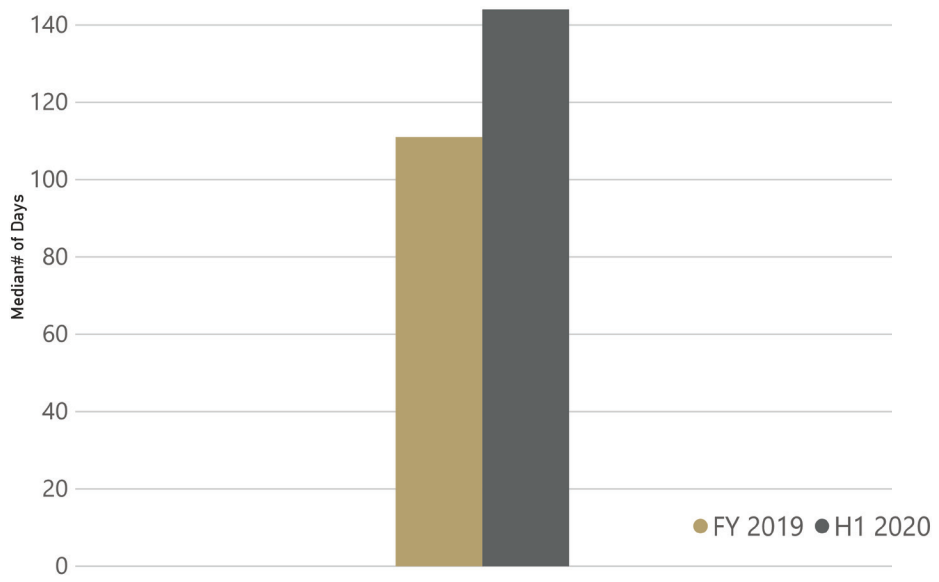
## Q1 and Q2 2020 - IPO Market by Base Deal Size



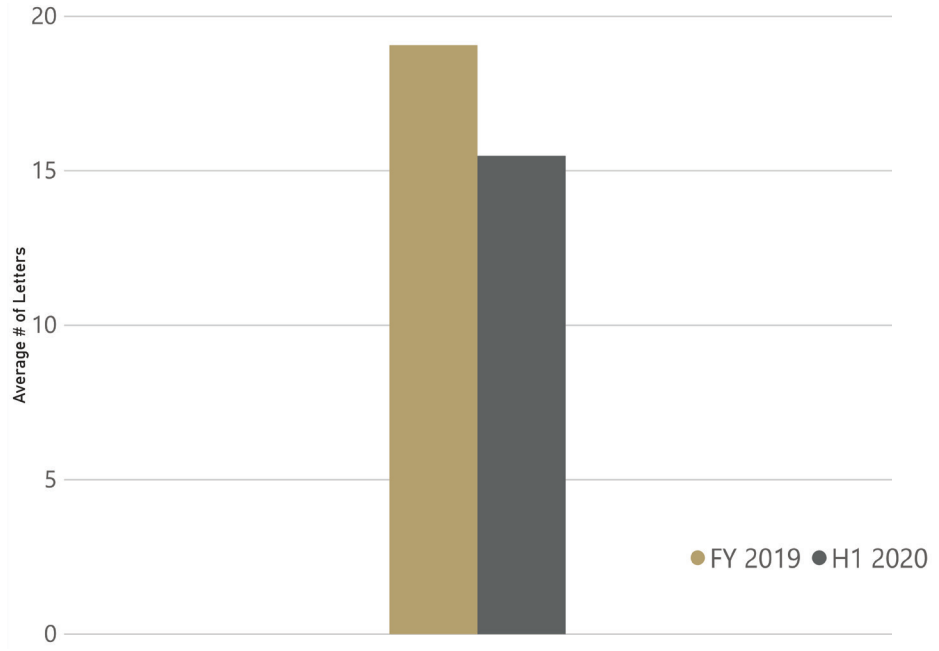
## IPO Timing and SEC Review

### TIMING FROM FIRST SUBMISSION TO PRICING

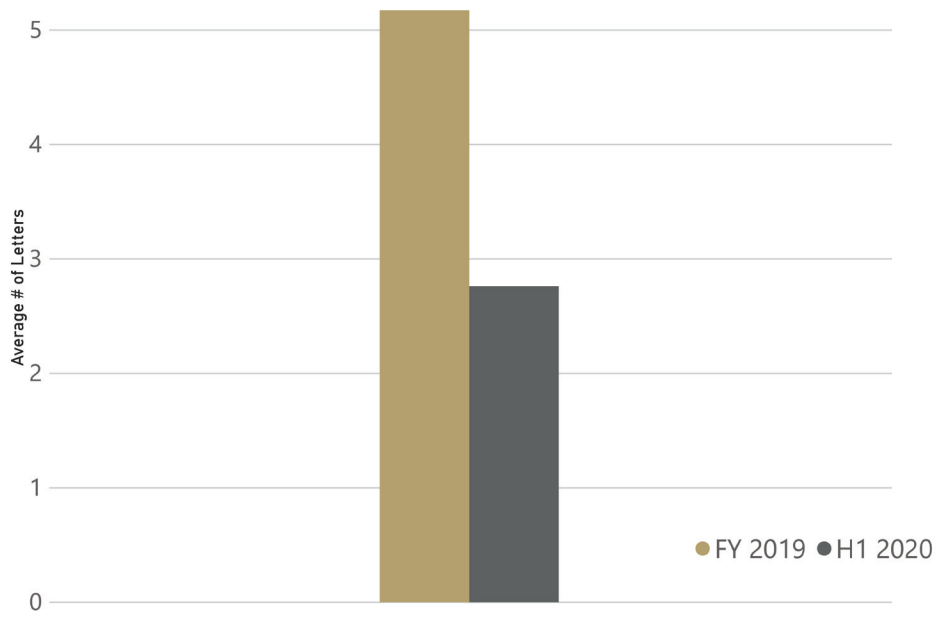
#### Median Days Between Submission and Pricing




#### Average Number of SEC Comments in First Letter



## Average Number of SEC Comments in 2nd Letter




**2019 – Median No. of SEC Review Comment Letters Received by Issuers**

**3**

**H1 2020 – Median No. of SEC Review Comment Letters Received by Issuers**

**3**

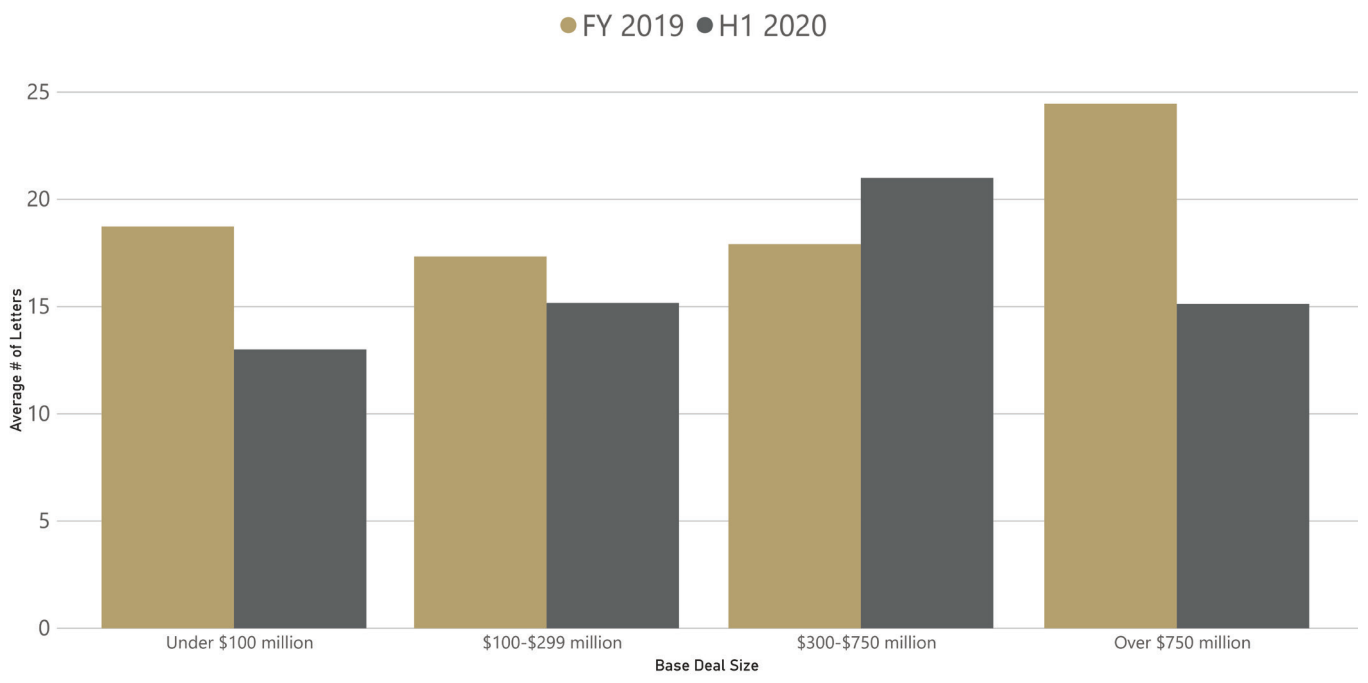
**2019 – Median No. of Days Between Issuers' Initial Submission and Pricing**

**111**

**H1 2020 – Median No. of Days Between Issuers' Initial Submission and Pricing**

**144**

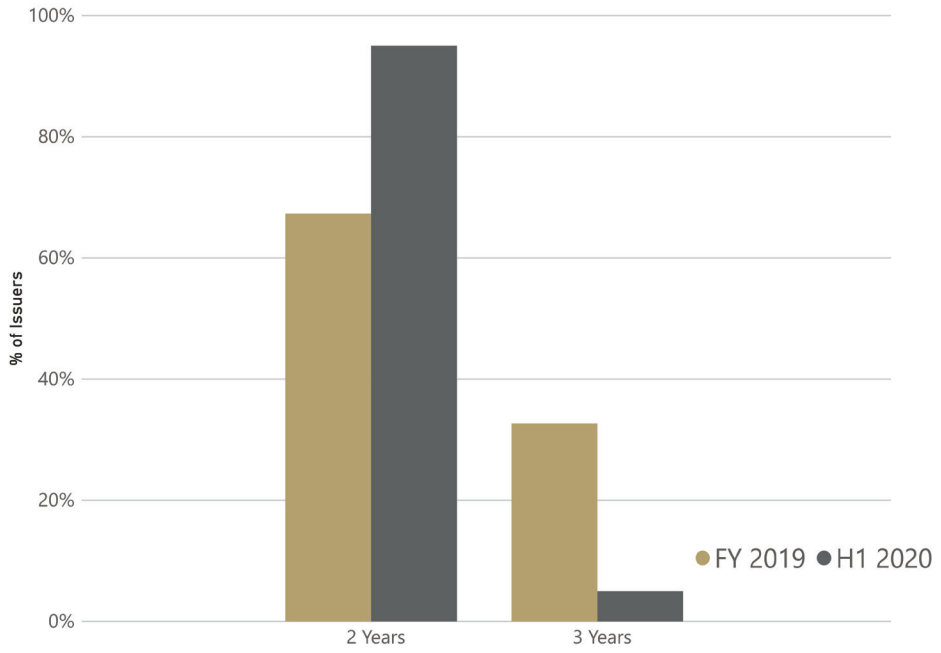
## Average Number of SEC Comments in First Letter



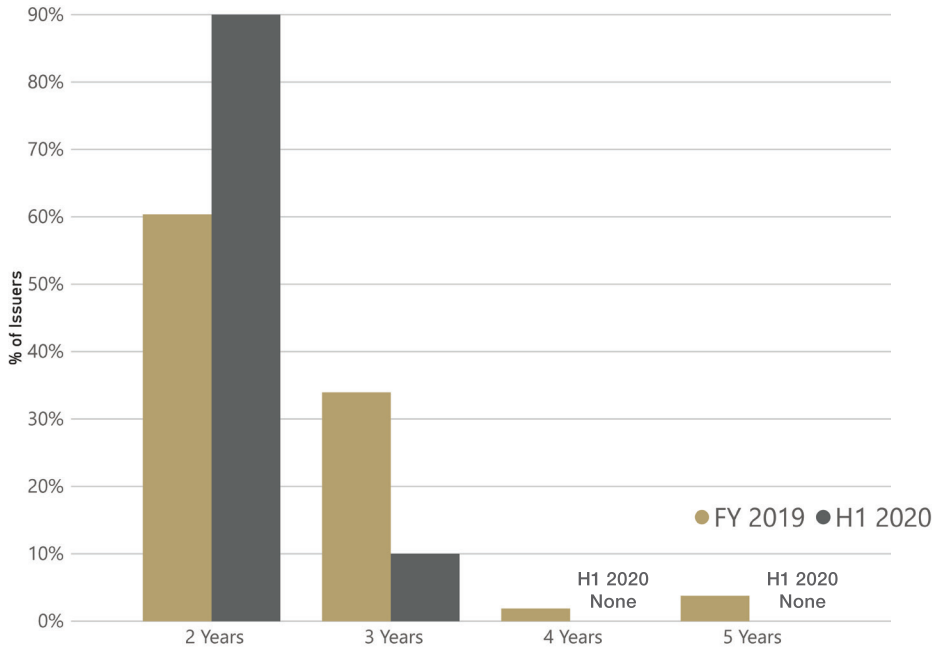
## Issuer Profile: Financial Background of IPO Issuers

### EMERGING GROWTH COMPANIES

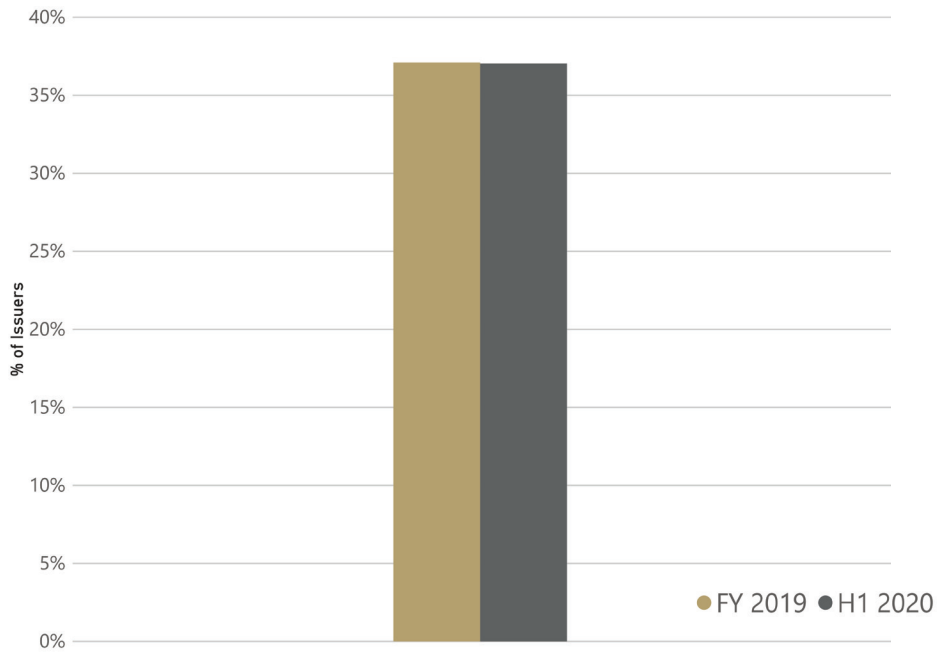
### Historical Period of Audited Financials by EGCs



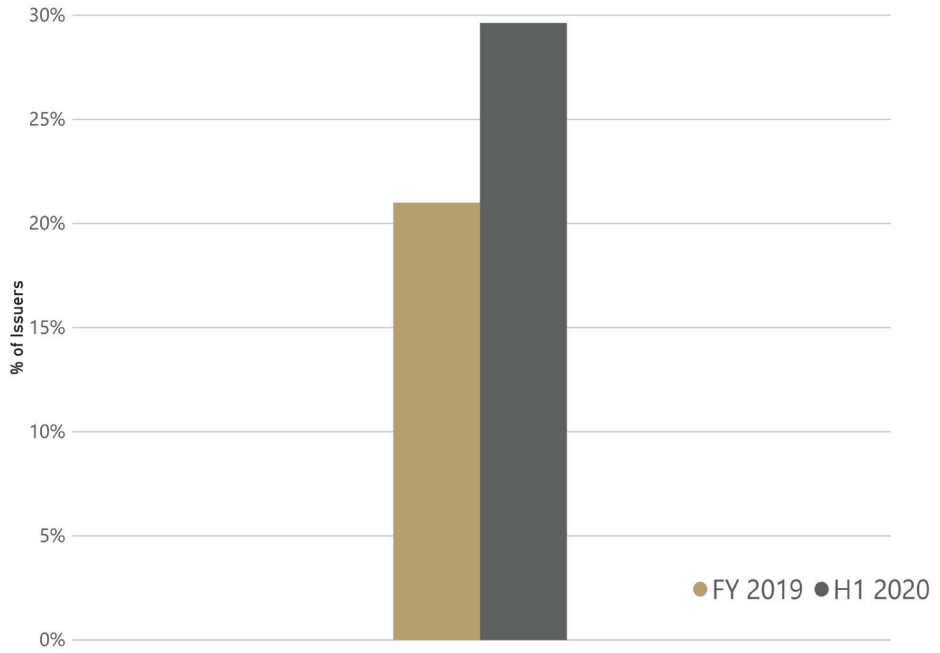

### Historical Period of Selected Financial Information Disclosed by EGCs



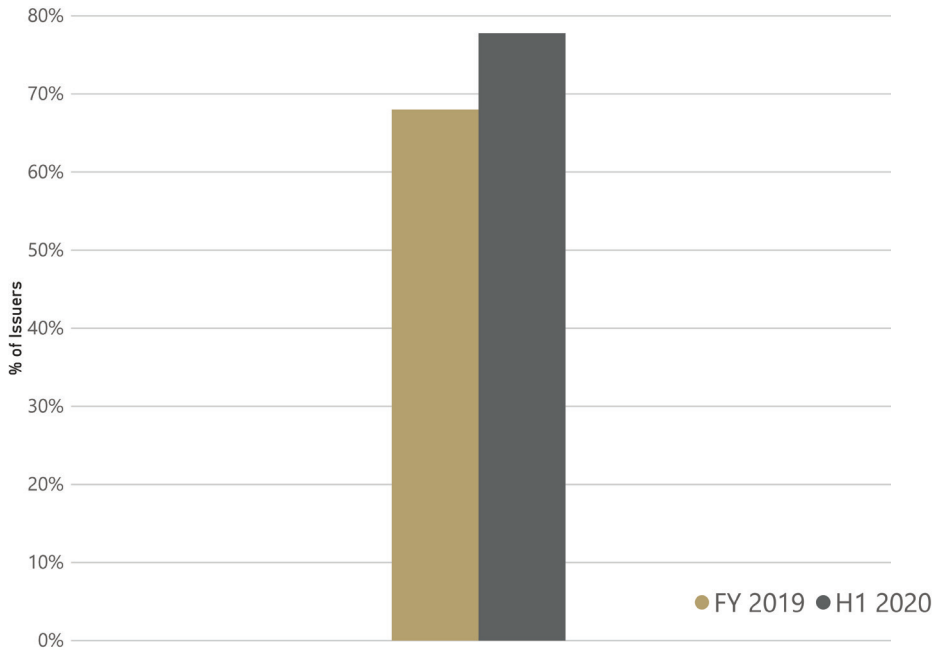
## Percentage of Issuers Disclosing a Material Weakness of Internal Controls Over Financial Reporting



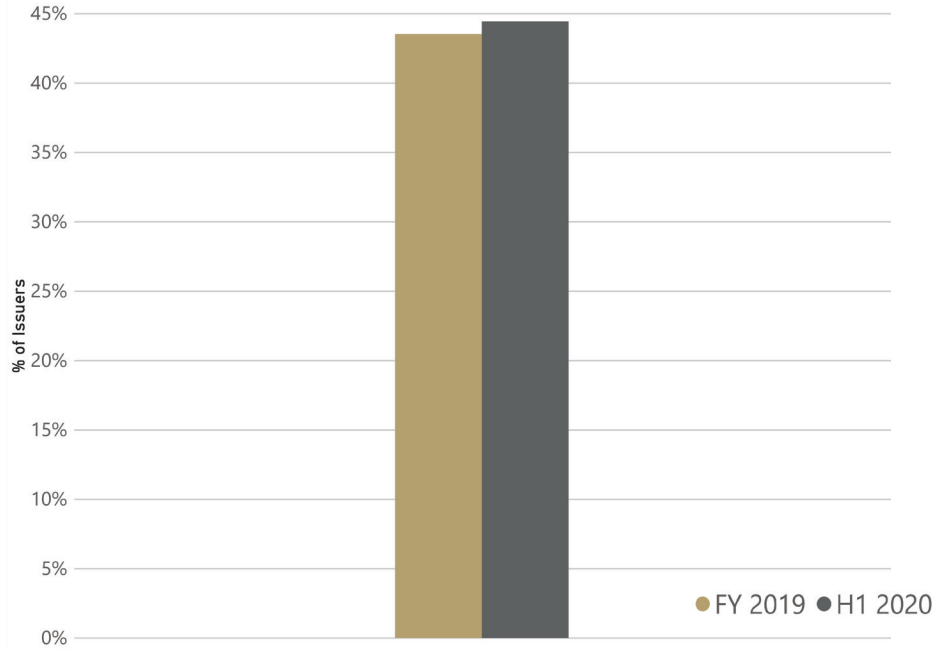

## Percentage of Issuers at "Pre-Revenue"



## Percentage of Issuers Presenting a Net Loss

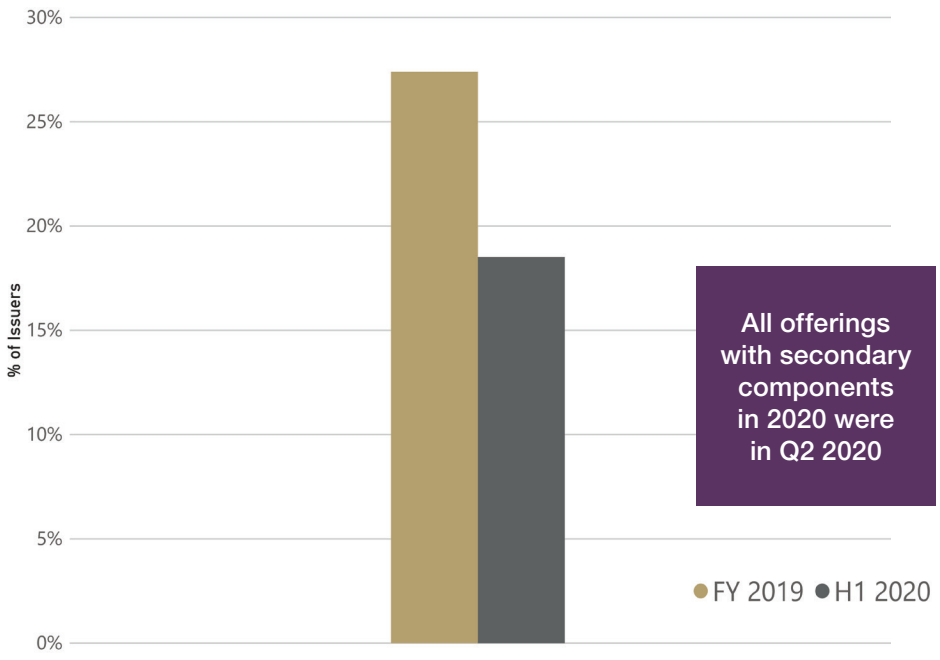



## Percentage of Issuers Presenting "Adjusted EBITDA" Financial Information

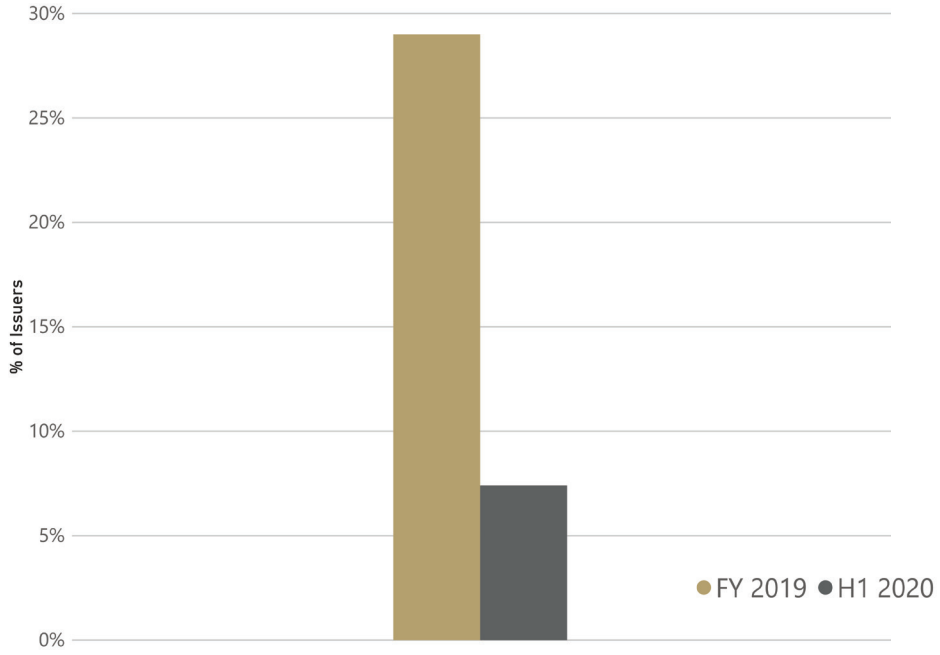


## SECONDARY OFFERINGS AND INSIDER PARTICIPATION

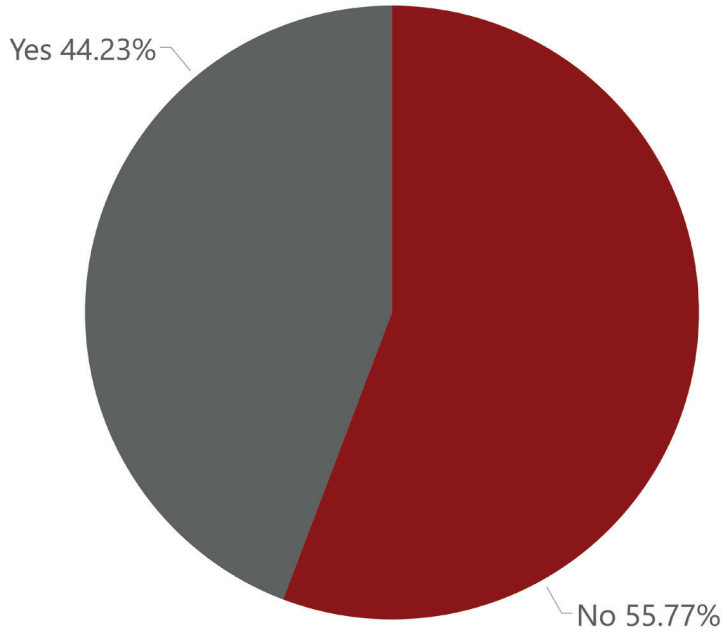
### Percentage of IPOs with a Secondary Offering Component



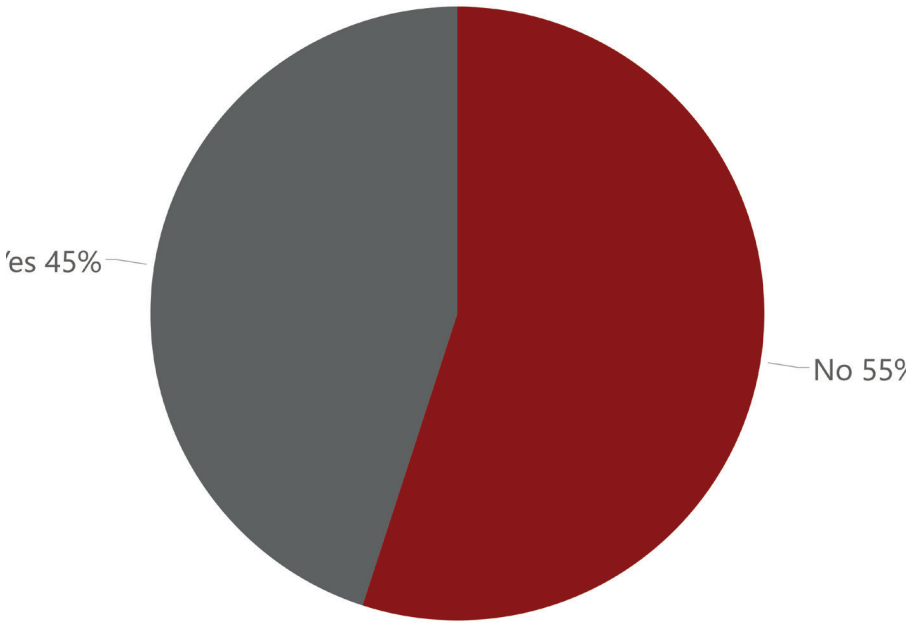

### Percentage of IPOs Involving Purchases by Issuers' Insiders



## FY 2019 - Percentage of IPOs Offering a Directed Share Program

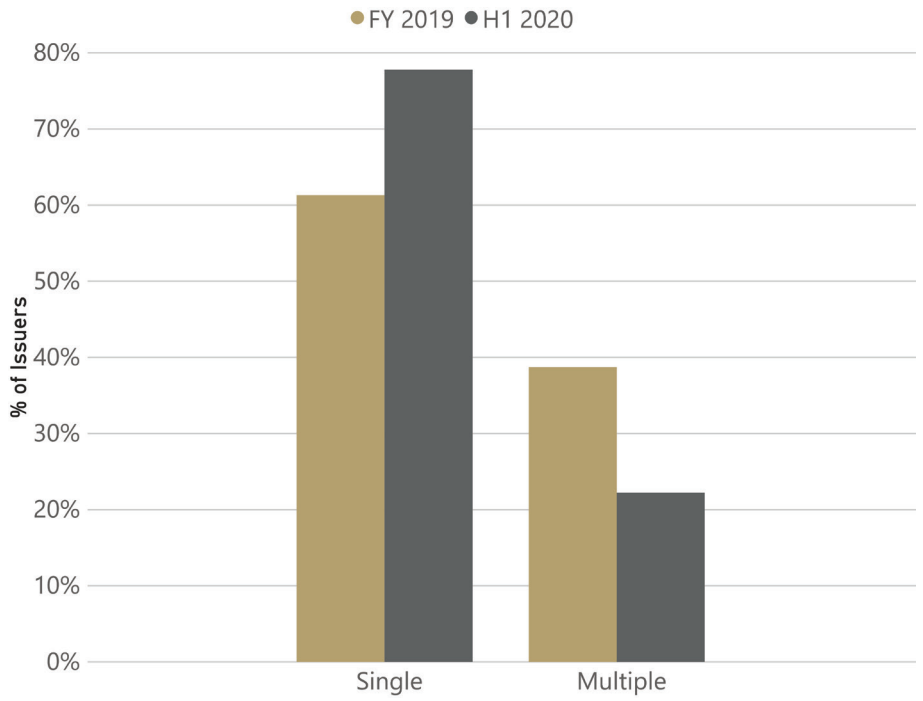



## H1 2020 - Percentage of IPOs Offering a Directed Share Program



## VOTING

### Percentage of IPOs with Multiple vs. Single Classes of Stock



## EQUITY INCENTIVE PLANS

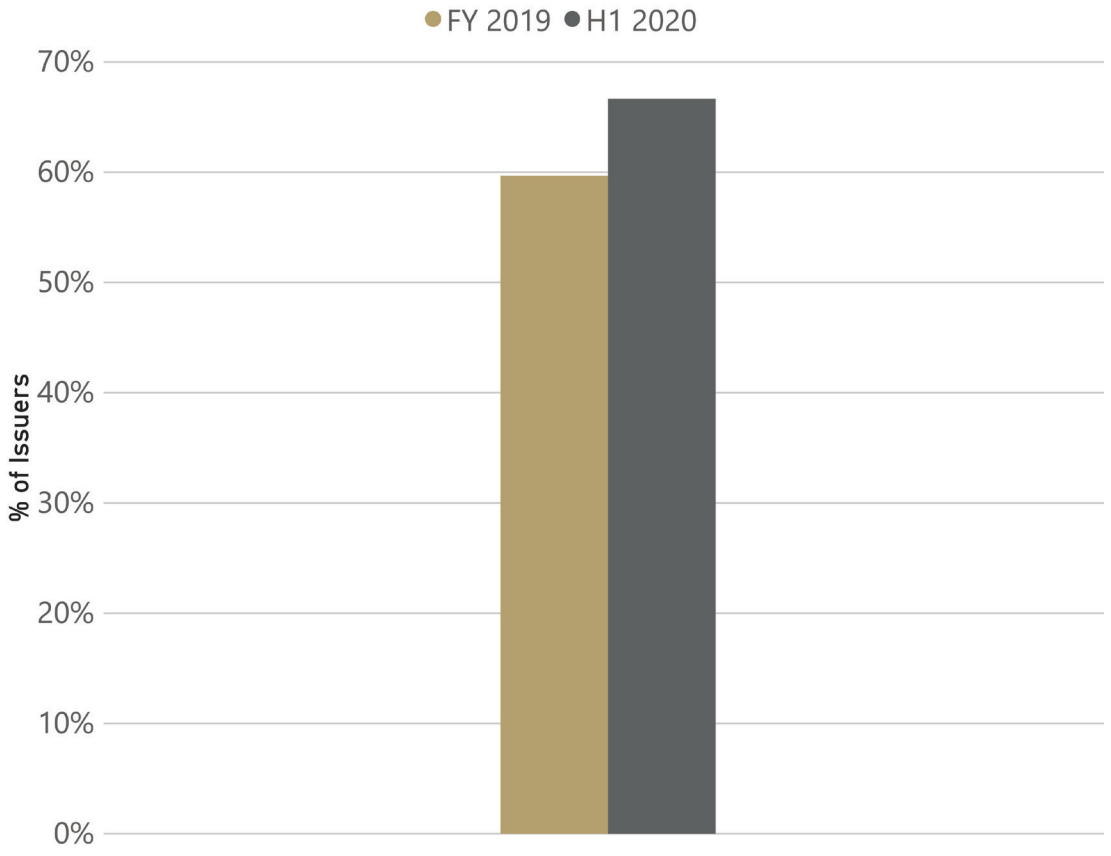
**2019 – Average Percentage of Issuers' Outstanding Stock Reserved for Equity Incentive Plans**

**10.3%**

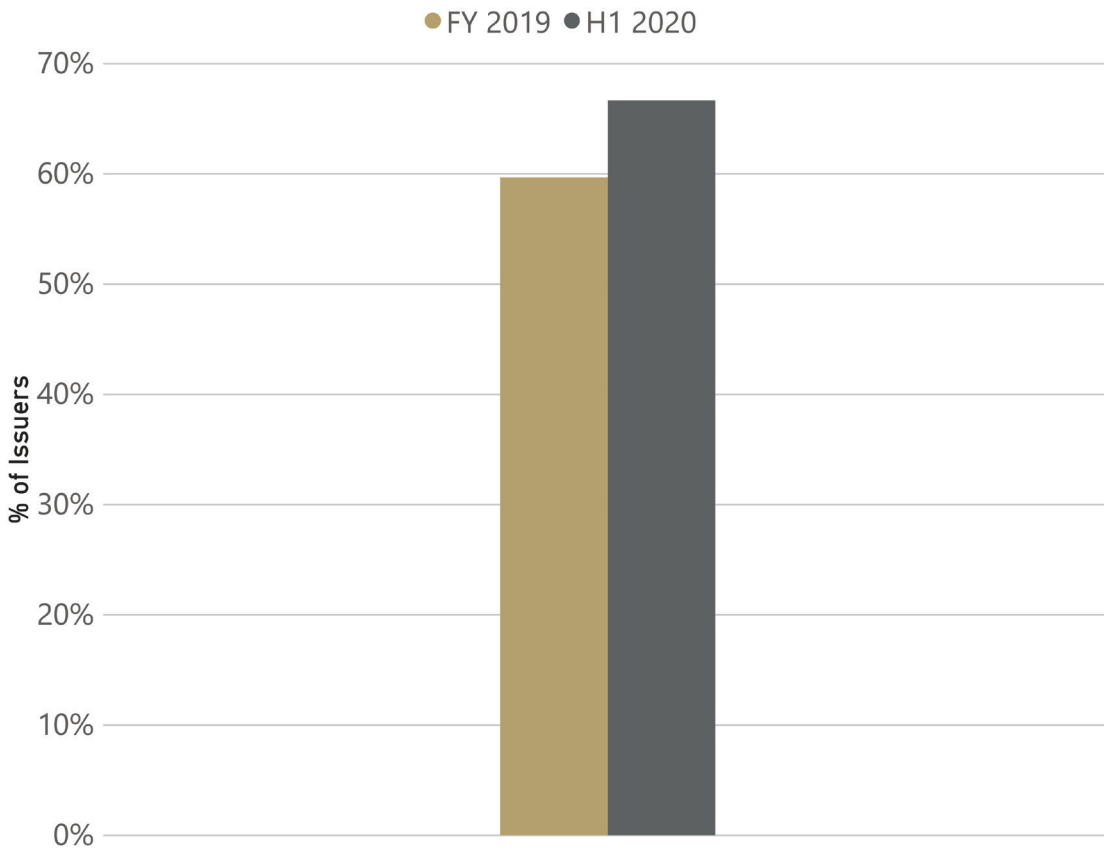
**H1 2020 – Average Percentage of Issuers' Outstanding Stock Reserved for Equity Incentive Plans**

**10.6%**

### Percentage of Equity Plans with an Evergreen Provision



## Percentage of Issuers Adopting an Employee Stock Purchase Plan

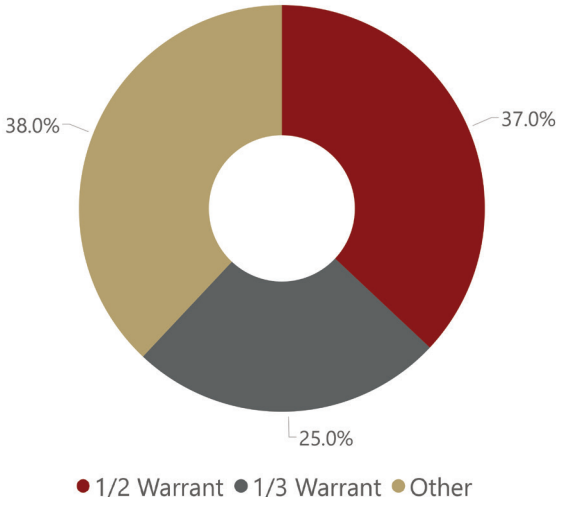


## SPAC IPOS

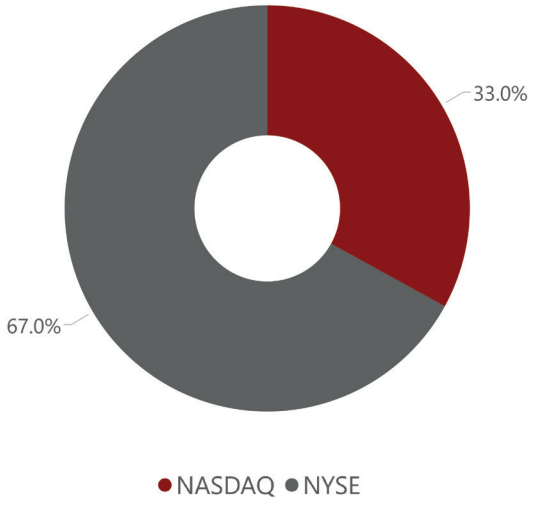
Year to date through August 31, 2020 for SPACs over $150M base deal size

| Average Deal Size | Percentage with Forward Purchase Contracts | Median Deal Size |
|---|---|---|
| $417M | 26% | $300M |

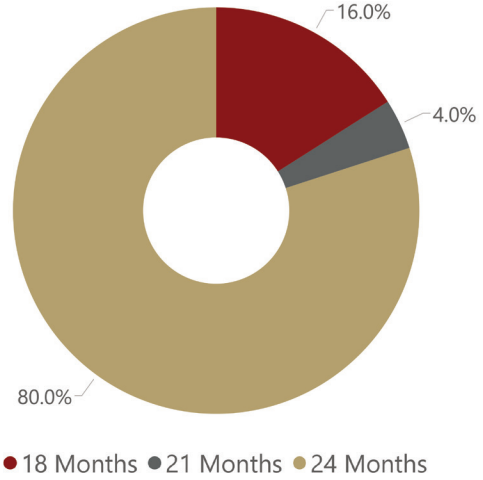
### Warrants in Units




### Listing Venue




### Time Period to Complete Business Combination



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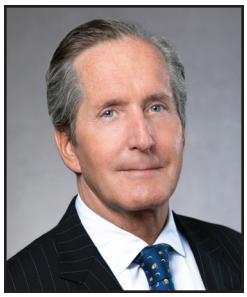

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