

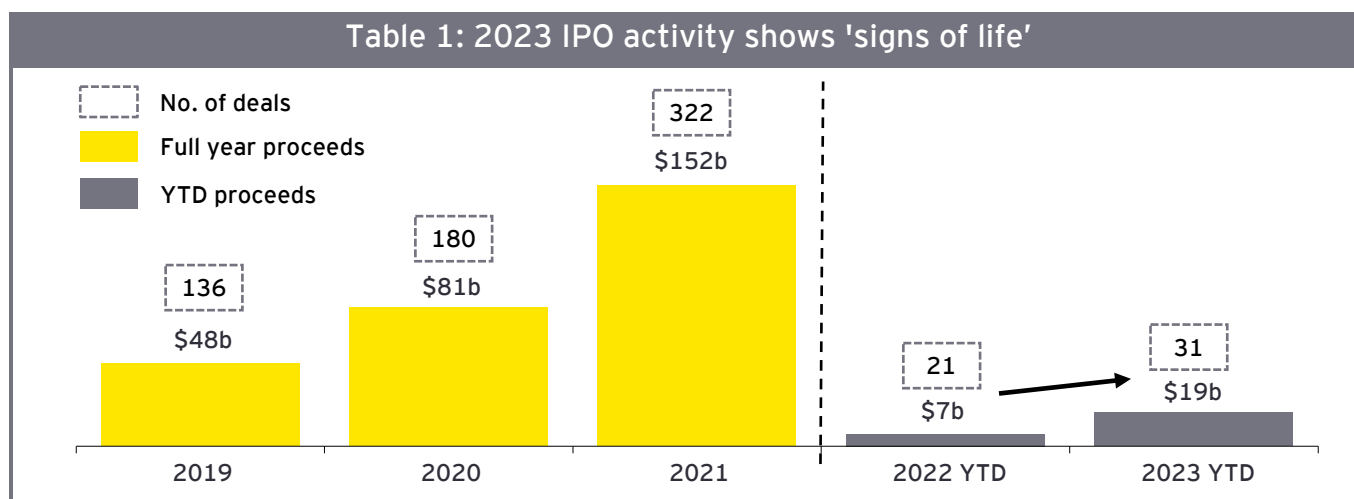
An aerial photograph of a city skyline at dusk, with numerous skyscrapers illuminated by their lights. The sky is a mix of blue and orange. A large yellow text box is overlaid on the left side of the image.

Equity capital markets update – green shoots begin to appear in the US IPO market

November 2023

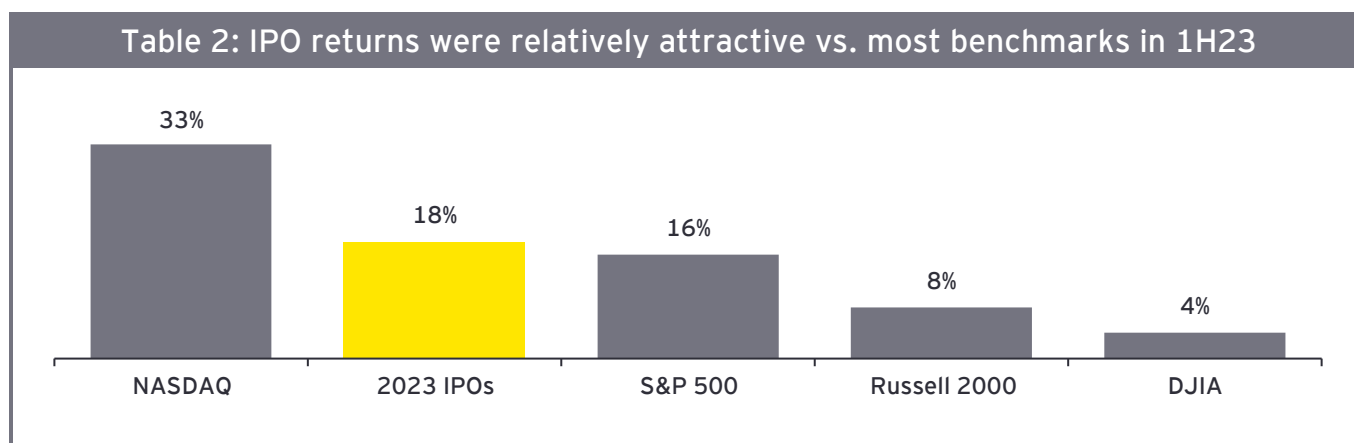
After a prolonged drought in activity, the US IPO market gradually reopened this summer

As the calendar turns to year-end, we examine the themes and trends that drove a recent reopening of the US IPO market. Over the past several years, select IPOs priced intermittently with mixed results. Inactivity was driven by a confluence of factors, including challenging market conditions, depressed valuations and a softening business backdrop across a variety of sectors. However, despite continued pressures across the equity markets, the August/September window hosted a cluster of IPO activity that could prove to be an on-ramp for the next class of prospective IPOs in the coming months.



Source: Dealogic. | YTD data as of October 31, 2023. Includes SEC registered offerings \$30m+, excluding BDCs, SPACs, and foreign issuer, fixed-price IPOs.

In 2023, IPO buyers (public equity market investors) and sellers (VCs, financial sponsors, founding investors) were more willing to transact than over the past several years. Certain issuers found the IPO market to have more value as an exit alternative or capital structure tool than selling their businesses or staying private for the foreseeable future. In some of these circumstances, delaying growth while waiting for a more constructive new issue market became an untenable strategy, especially in situations where sellers required near-term liquidity. As sought-after assets approached the market at conditioned valuation levels, investors were open to evaluating the IPO asset class for new ideas and potential alpha generation, which gradually reopened the IPO market.

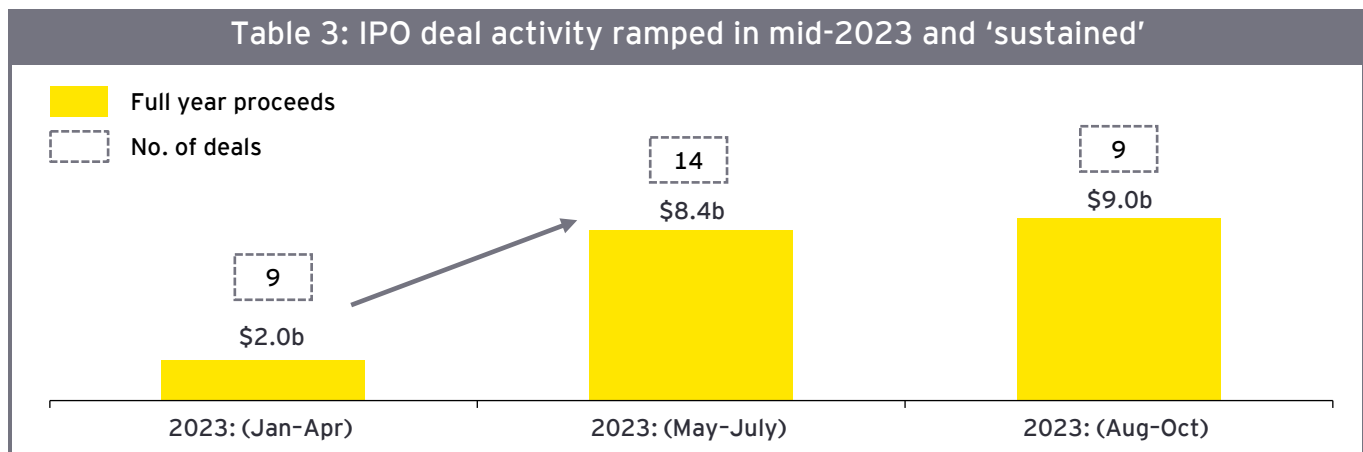


Source: Capital IQ, Dealogic. | YTD data as of June 30, 2023. Includes SEC registered offerings \$30m+, excluding BDCs, SPACs, and foreign issuer, fixed-price IPOs. Gray shading denotes average offer/current for 2023 IPOs as of June 30, 2023.

IPO issuance has gained momentum, but a 'recovery' is in the early innings and critical pillars are still taking shape

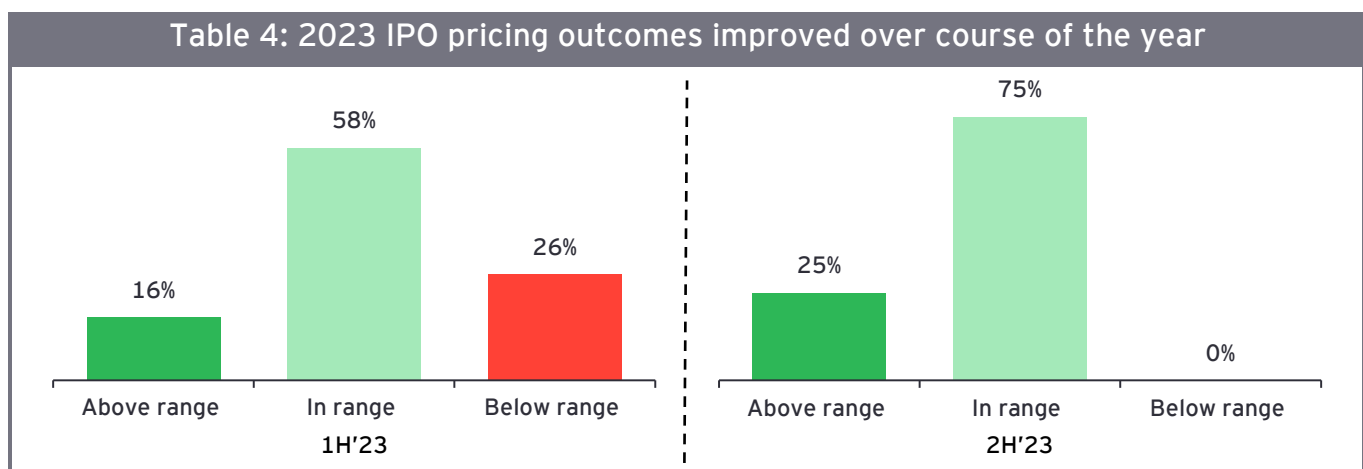
IPO market momentum is driven by various factors, with pricing outcomes and initial aftermarket trading performance particularly significant. Investment banks are keenly aware that for IPO momentum to grow, deals must (1) attract substantial investor engagement and (2) offer investors attractive returns to offset the outsized risk profile attached to the asset class. Initial transaction launch terms for the recent IPO class included measured valuation metrics compared to reference comps, enticing strong investor participation. This required issuers/sellers to be more open to launching transactions at valuations below peak levels, acknowledging the current new issue market reality. Without a heightened willingness by sellers to transact, the market may not have reopened on the timeline that it did.

From May to July 2023, 14 IPOs priced, raising nearly \$8.4b in proceeds, compared to five IPOs for \$1.3b in proceeds over the same period in 2022. This was the most deal activity over a compressed period since late 2021.



Source: Dealogic. | YTD data as of October 31, 2023. Includes SEC registered offerings \$30m+, excluding BDCs, SPACs, and foreign issuer, fixed-price IPOs.

As investors became comfortable with deals, processes and outcomes, anecdotally, they became more aggressive on certain deals. In situations with strong book-building momentum, issuers upwardly revised their marketing price ranges and often priced above the elevated ranges. Anchor investors, as well as long-only investors, concentrated at the top of the order book augmented their IPO allocations in the aftermarket.



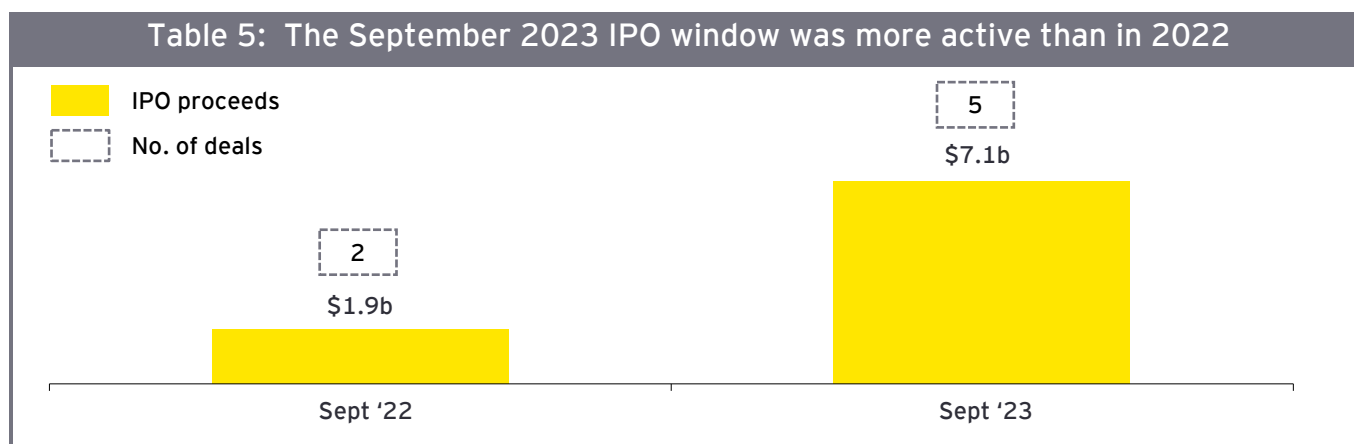
Source: Dealogic. | YTD data as of October 31, 2023. Includes SEC registered offerings \$30m+, excluding BDCs, SPACs, and foreign issuer, fixed-price IPOs.

In less robust book-building scenarios where headwinds during marketing cannibalized investor demand, certain issuers made later-stage valuation concessions to price their deals as opposed to postponing or pulling transactions – a positive mark for the product and market.

Assets brought to market in the May to July window were a collection of consumer products companies, and sizable, stable businesses carved out of larger conglomerates. A sponsor-backed high-growth restaurant issuer was a deal calendar highlight, pricing a \$365 million IPO in mid-June. The company increased its marketing range, then priced \$2 above the upwardly revised range. The stock price doubled on the first day of trading and was the best-performing consumer IPO since December 2020. This transaction suggested that the investor community was (1) refocusing on growth stories, (2) actively seeking innovative ideas via the IPO market, (3) motivated to outperform their benchmarks, and (4) willing to pay more than the investment community expected for discernable and measurable growth plans.

Expectations for a more pronounced IPO calendar post-Labor Day began to set in

Building on the summer momentum, expectations increased for more meaningful IPO deal activity post-Labor Day. In mid-to-late August, new public filings indicated several high-profile issuers were gearing up to access the public markets imminently.



Source: Dealogic. | YTD data as of October 31, 2023. Includes SEC registered offerings \$30m+, excluding BDCs, SPACs, and foreign issuer, fixed-price IPOs.

While modest in number, the five September IPOs (three technology and two biotech) were important for the market. These deals raised \$7.1 billion in proceeds, which was the highest IPO dollar volume month since November 2021. Included in these deals were (1) the largest IPO since November 2021, (2) the first venture-backed, technology IPO in over 21 months, and (3) issuers from various technology subsectors, including semiconductors and enterprise software as a service (SaaS). Investment banks carefully managed these transactions to maximize chances for success through significant pre-deal marketing and valuation sound checking. Additionally, for several of the transactions, the launch valuation was well below the valuations for prior private funding rounds. Adjusted valuations drove significant over-subscription levels, increasing the odds of successful trading in the aftermarket. Key themes emerged across these highly anticipated IPOs that ultimately de-risked execution, summarized below for reference:

- ▶ Attractive valuation discounts relative to public reference comps; conservative valuations helped find a middle ground for buyers and sellers to transact
- ▶ Extensive pre-roadshow testing-the-waters meetings allowed for funds and IPO anchor investors to meet with management early and often
- ▶ Succinct roadshows contained broader market exposure and accelerated execution
- ▶ Anchor investors accounting for sizable allocations, disclosed at launch, drove confidence at the onset of marketing

- ▶ Tight free float (10% or less)/smaller-than-typical deal sizes created scarcity value, aiding trading performance in the aftermarket
- ▶ Strong, profitable businesses or businesses that have the controls in place to turn a profit in the near term
- ▶ Businesses with healthy cash runway, leveraging the IPO as a capital structure tool and not a liquidity line

Of the five IPOs in September, two were priced above the initial marketing price ranges – two priced at the high end and one priced at the midpoint. On average, these IPOs finished up +15% on their first day of trading, a key marker used by investors, banks and issuers to evaluate pricing outcomes and after-market.

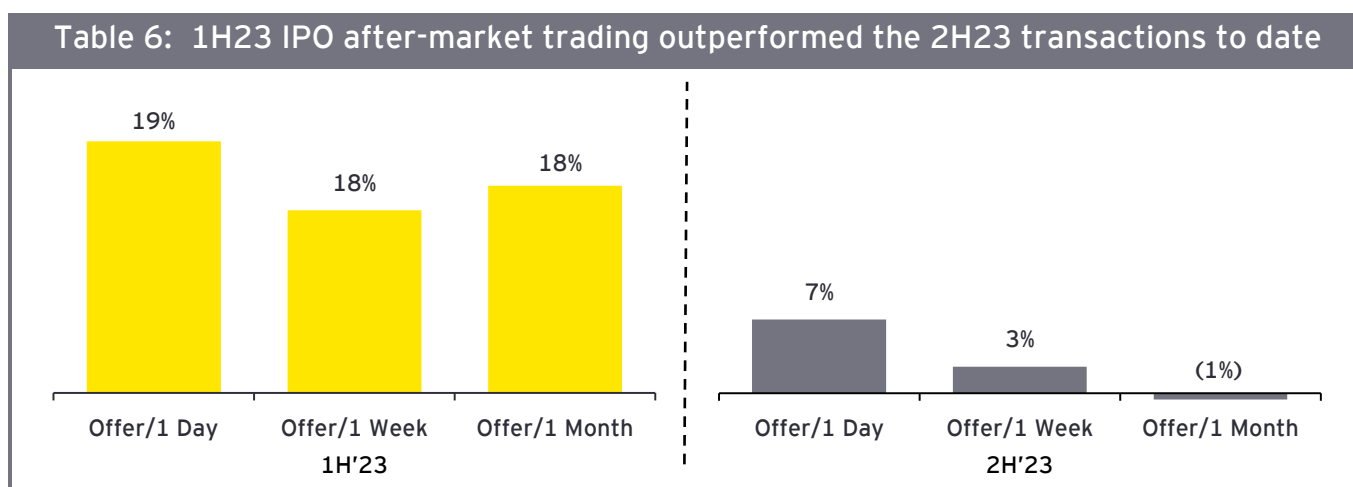
| September IPOs | Deal 1 | Deal 2 | Deal 3 | Deal 4 | Deal 5 |
|-----------------|----------|----------|----------|---------|--------|
| Pricing outcome | High end | High end | Midpoint | Above | Above |
| Offer/1-Day | 24.7% | 33.3% | (4.4%) | 12.3% | 9.2% |
| Offer/Current | (3.4%) | 7.8% | (35.8%) | (17.9%) | (5.0%) |

Data as of October 31, 2023

With the successful pricing outcomes of these IPOs, equity capital markets participants (buyers and sellers alike) prioritized deal activity over broader macro questions and concerns that began to elevate throughout September and beyond.

In October, a well-known sponsor-backed consumer company launched a \$1.5 billion IPO, the third largest US IPO of the year. Key marketing points included the company's strong brand momentum, significant revenue growth under its new ownership, and anchor investors disclosed on the prospectus at launch. The offering priced within its marketing price range. This transaction represented the first highly levered, sponsor-backed IPO of this magnitude since 2021 and included a substantial secondary share component of ~\$1b. The stock finished its trading debut down 13% and is currently down significantly from IPO price. Regardless, the transaction got done, though only time will tell when these types of transactions can consistently generate the returns required to regain sufficient confidence in the broader IPO market.

While IPOs earlier in the year outperformed in the after-market, deals that came over the last several months have had to deal with a more challenging trading environment.



Source: Dealogic. | YTD data as of October 31, 2023. Includes SEC registered offerings \$30m+, excluding BDCs, SPACs, and foreign issuer, fixed-price IPOs.

Recent macro data offers little help for an equity market recovery

At the September FOMC meeting, Fed Chairman Jerome Powell's comments hinted at the possibility of one or more Fed funds rate increases in 2023 and ultimately "higher rates for longer." The shift to a more hawkish stance and its impact on broader market sentiment made it difficult to (1) draw deeper conclusions about the initial wave of post-Labor Day IPOs and, more broadly, (2) evaluate the true state of the new issue market. Additionally, the depressed performance of US equities in September (S&P traded down 5%, representing the worst-performing month of the year) did little to support aftermarket performance for these IPOs. The three high-profile technology IPOs traded at or below issue price within the first few weeks of pricing, despite substantial demand and oversubscription during marketing, suggesting that support for equities in general and specifically new issues was wavering.

In mid-October, economic data for September was released, revealing higher-than-expected Consumer Price Index figures and the largest monthly increase in employment since January 2023.¹ These data points showcased the resilience of the economy and labor market, which has helped to keep consumer spending strong. However, despite this "positive" macro news, the equity market read-through was the data would keep rates elevated for longer, as it suggested inflationary pressures in the economy would persist. As a result, risk assets experienced a sell-off, with the Russell 2000 and small-cap growth stocks leading the decline.² These stocks, which are typically more leveraged and with outsized exposure to economic fluctuations, face additional headwinds that certainly could impact potential IPO issuer supply. Most recently, an October gauge of consumer sentiment dropped to its lowest level since May. The combination of challenging economic data, depressed equity markets and lackluster performance out of the new IPO class is certain to impact the IPO calendar into year-end and in the first quarter of 2024.

Looking ahead

While macroeconomic data and the aftermarket performance of recently priced transactions will influence, other factors will play a key role in driving supply going forward, including:

Prevailing public and private market valuations: Valuation levels are the primary driver for equity deal activity across cycles, and as such, improved valuations would certainly drive deal activity. A down cycle for multiples has and will likely continue to impact deal volumes. Businesses in sectors that are unlikely to reclaim peak valuations soon may be more inclined to push through and transact despite the valuation backdrop. When valuations are lower, deals tend to be smaller to minimize the dilutive impact and drive the supply/demand balance in the marketing process.

Capital needs: Not all growth businesses can wait for ideal market conditions to solidify ahead of capitalization decisions. Companies that raised capital 2-3 years ago in a historically low interest rate environment may need to explore funding alternatives including the traditional IPO route. Turning to the public markets to fund growth initiatives, expand operations, fund acquisitions, repay debt, and strengthen balance sheets is historically consistent with IPO deal drivers, and the capital-constrained environment over the past few years will likely require more companies to consider this path. Capital-intensive businesses with significant capex needs, such as home builders or serial equity issuers such as REITs, are subsectors that could help sustain IPO volumes going forward.

Investor/employee liquidity: Many companies and management teams use publicly traded stock and options issuance as a tool to reward, retain and compensate employees. Significant and attractive employee liquidity events are more difficult to conduct in the private market. Employees can become discouraged by the inability to monetize their stock, particularly when an IPO is perpetually delayed. Additionally, venture firms and financial sponsors have fiduciary obligations to their limited partners to return capital within a defined time/investment horizon. An IPO can facilitate both issues through the ability for employees and

¹ Employment Situation Report, October 2023, US Bureau of Labor Statistics.

² Capital IQ, October 2023

pre-IPO investors to sell shares and access liquidity through the public markets and can drive companies to push through less-than-ideal market conditions to get public.

The next significant IPO wave likely not arriving until ~2Q 2024

Now that 3Q 2023 is complete, the next tangible window for launching IPOs will open once issuers move past third quarter blackout periods and have insight into quarter and year-end financial information. Taking into account holiday slowdowns, the IPO window in 2023 is limited. The first quarter of 2024 is a narrow launch window and, thus, typically lighter in terms of IPO volumes due to audit staleness for calendar year-end companies in mid-February. If macro conditions become more constructive (including visibility on Fed rate peak and forward path) and the IPO market can support new issues, we could see a building pipeline post-2023 audit season into the back end of 1Q and 2Q 2024.

While Wall Street messaging on the prospect of 2023 IPOs has been unanimously bearish, we have consistently highlighted that sentiment can change quickly with potential drivers including a market uplift, visibility on an end to rate hikes (with a bias to cut), and positive pricing outcomes as IPOs come to market. During extended periods of favorable market conditions, IPOs came to market and traded relatively well. This emboldened larger, bellwether prospective IPO issuers that were in the pipeline to launch their transactions. As higher-profile IPOs garnered investor attention, more issuers considered moving forward with IPO plans. Recent market headwinds, driven by persistent inflation data, have countered this momentum.

There have been enough positive market data points over the past few months to encourage the next set of issuers in the shadow backlog to consider executing their deals in the next open window relevant to them. Companies with strong management teams, differentiated product offerings, competitive moat, strong financial positioning, and growth on the horizon should be able to navigate a route to the public markets if desired. The last 60-90 days of deal activity demonstrated that investors are not on "strike" and are willing to invest in the IPO asset class – for the right companies, at the right price. While the next substantive class of IPOs is probably 4-6 months away, if markets pick up over the next 6-8 weeks it would not surprise us if we see a spate of issuance both ahead of audit staleness in late January/early February or post audits in March/April.

Accordingly, our IPO-oriented client dialogue has increased over the past several months. With most projecting a volatile political and election cycle, the traditional September and November issuance windows in 2024 are likely to be impacted. Most companies are targeting 1H25 IPOs, with many considering preparations that could provide late 2024 IPO optionality if warranted.

As markets evolve, EY Capital Markets can be impactful. Prospective issuers that dismissed the IPO track for the foreseeable future due to business and market conditions may now rekindle their thinking and approach Wall Street in an accelerated but practical manner. Preparing for these conversations and getting support across processes and workstreams could be valuable. Additionally, companies counting on the M&A market for an exit may find that an elevated rate environment impacts acquisition valuations in a way that makes incorporating a dual-track IPO path a sensible mechanic to increase optionality, pricing tension, and ultimately value to stakeholders. Please let us know if a discussion around any of these potential processes or market conditions would be well-timed and helpful.

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