BESSEMER TRUST

A Closer Look

IPOs and Shifting Market Trends

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In Brief

- **Despite a volatile year for equities, the IPO (initial public offering) market proved to be surprisingly strong in 2020, and many signs indicate IPO volume will remain elevated in 2021.**
- **The recent IPO boom diverges from the past two decades, which saw a decline in listed public companies as many firms opted to remain private longer and merger and acquisition activity increased relative to public offerings.**
- **Despite comparisons to the dot-com bubble of the late 1990s, recent IPOs differ from prior waves in several key ways. Additionally, the IPO process itself is changing with a rise in direct listings and SPACs (special purpose acquisition companies).**
- **Bessemer's approach has been to employ disciplined fundamental analysis when evaluating investments in newly public companies. Bessemer portfolios with alternatives have benefited from investments in early-stage growth companies, many of which have recently gone public.**

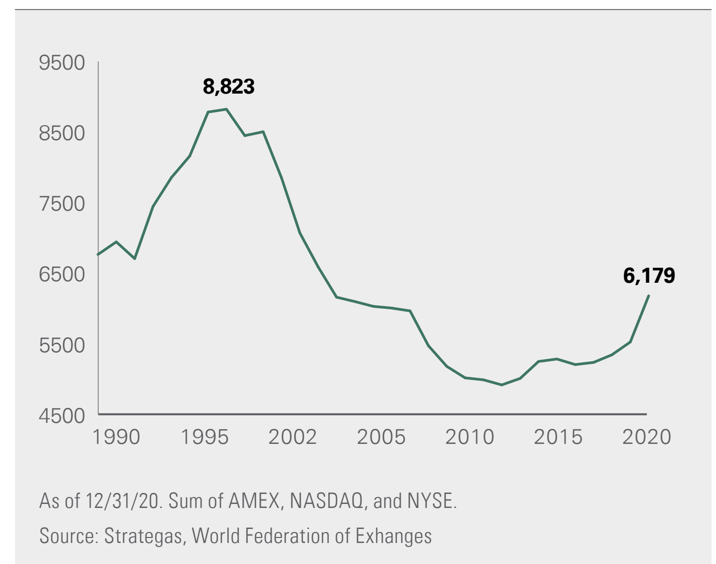
The IPO boom of 2020 marked a reversal from the prior decade's subdued IPO market as companies often decided to raise money in the private markets instead of making their public debut. U.S. IPO capital raised, including SPACs, was roughly $140 billion in 2020 with traditional U.S. IPO volume more than double the yearly average since 1990, surpassing even the height of the dot-com bubble. Many factors drove recent IPO activity, including the effects of the COVID pandemic and new liquidity opportunities, such as SPACs. Roughly 80% of the money raised in public markets in 2020 fell within the healthcare, technology, and SPAC categories. Bessemer portfolios have carefully navigated these shifting public-private market dynamics, benefiting from our platform's exposure to both markets.

Fewer Public Companies and IPOs as Companies Stay Private Longer

The past two decades saw a clear decline in the number of U.S. public companies as businesses elected to remain private longer and defer IPOs. The number of listed companies decreased substantially from over 8,000 in the late 1990s to roughly 5,500 in 2019 (Exhibit 1). From the mid-1970s to 2000, there were, on average, nearly 300 IPOs per year, but from 2000 to 2019 the

Exhibit 1: Number of Public U.S. Companies

Key Takeaway: The number of public U.S. companies has generally declined over the past two decades until recently.



As of 12/31/20. Sum of AMEX, NASDAQ, and NYSE.
Source: Strategas, World Federation of Exhanges

average dropped to just over 100 per year.[1] While the average age at IPO was less than eight years in the 1980s and 1990s, the age of U.S. companies now going public is approximately 11 years.[2] Companies have been staying private longer both because it became more difficult and less desirable to go public, but also because it became easier and more desirable to stay private.

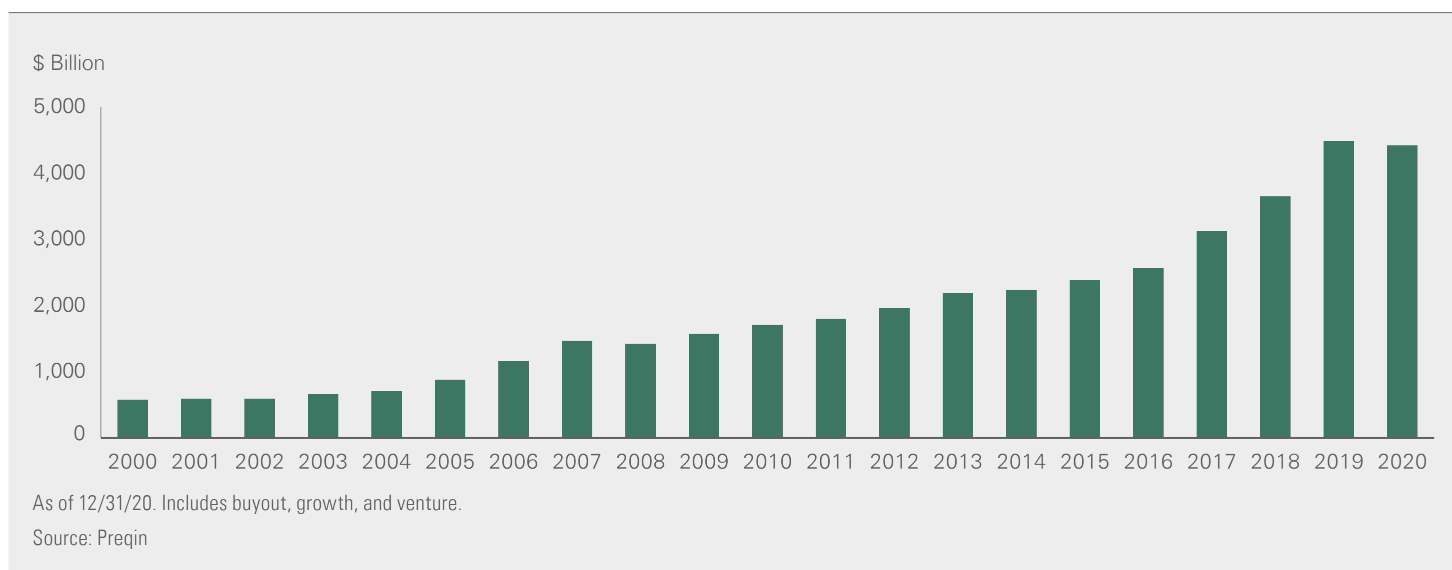
It became harder for companies to go public as increased costs, including higher regulatory, legal, and IPO expenses, placed an additional burden on small companies looking to IPO. For example, the Sarbanes-Oxley Act, a federal law passed in 2002, tightened accounting rules for public companies after several accounting scandals.

Meanwhile, new laws made it easier for private companies to sell securities to qualified investors, bolstering funding from private equity and venture capital. Government actions dating back to 1996 paved the way for startups and private backers to raise capital by loosening the application of anti-fraud rules governing share sales and increasing the number of investors allowed in private market funds. Specifically, the 2012 JOBS Act expanded the number of private shareholders that companies are permitted before being forced to disclose financial information from 500 to 2,000 (and excluded employees from the total). Thus, staying private enabled startups to avoid the extra work associated with regulatory disclosures while allowing these companies to focus on growth rather than the quarterly earnings expectations of public shareholders.

The growing private equity market prompted a shift in the way that American entrepreneurs raised money to build their companies. The number of private equity-backed companies rose dramatically as private assets under management skyrocketed from $578 billion in 2000 to $4.4 trillion in 2020 (Exhibit 2). Meanwhile, as public company investors have recognized the compelling growth opportunities available in the private markets, many mutual funds and hedge funds have established dedicated pools of capital to invest in the last private rounds of financing. This strategy, known as crossover investing, enables these investors to establish meaningful positions in these high-growth companies pre-IPO, while allowing private companies to raise large rounds of financing previously only available through public offerings.

Exhibit 2: Private Equity Assets Under Management

Key Takeaway: Private equity assets under management have grown exponentially from 2000 to 2020.



As of 12/31/20. Includes buyout, growth, and venture.

Source: Preqin

[1] Goldman Sachs

[2] Jay Ritter, University of Florida

Another factor contributing to the decreased number of public companies in the early 2000s was the increase in private company exits through mergers and acquisitions. While the majority of venture exits used to be IPOs, over time a higher proportion of venture exits became sales of the business. Furthermore, while M&A exits used to be fairly focused on strategic buyers, venture capital and buyout firms have increasingly sold their portfolio companies to other private equity firms. Along with these shifts, the secondary markets for private shares have matured significantly. Employees and early investors can achieve meaningful liquidity before an IPO or M&A exit, which further reinforces these companies' ability to stay private longer.

The impact of these shifting public-private market dynamics is especially evident if one looks at the movement of assets — not just companies. Taking into account public company acquisition of private businesses as an IPO substitute, a sizeable amount of assets has become public through acquisition by a public company rather than IPO. Essentially, industry consolidation and M&A activity have also played a role in the decreased number of publicly traded companies.

The 2020 IPO Boom

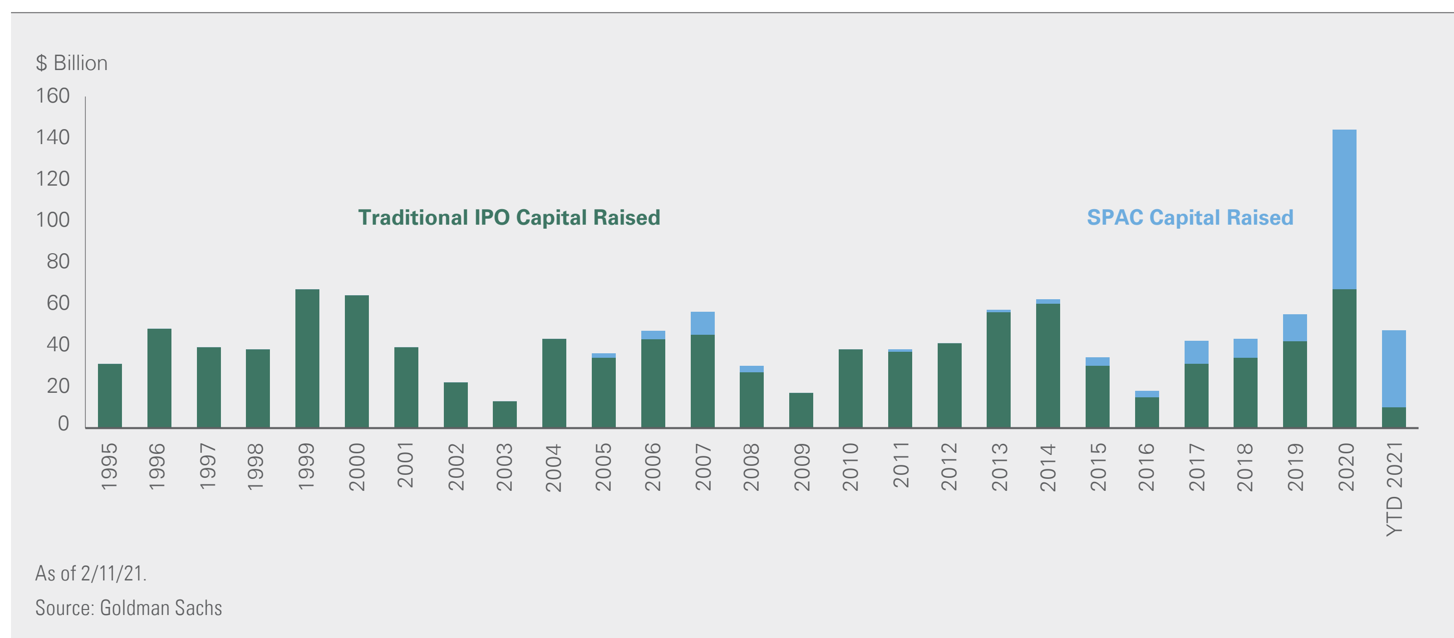
Bucking these recent public-private market trends, 2020 was a surprisingly good year for IPOs (Exhibit 3). This was especially unexpected given the backdrop of a volatile equity market as typically ideal IPO market circumstances include low volatility and broadly elevated stock prices. This begs the question: Why are companies deciding to go public now?

Some companies could be wary of waiting too long and may reason that now is their best opportunity. Companies may be trying to achieve the sweet spot of going public after maturing but before their growth trajectory slows. For example, some have attributed Uber's and Lyft's initial post-IPO struggle in the public market to waiting too long to go public.

Others may be seeking to take advantage of a public market that currently has a big appetite for IPOs, especially for technology and growth-oriented companies. Public markets have been increasingly rewarding high-growth companies with big valuations, a change from a few years ago when lofty private market valuations might have seemed tougher to achieve in the public market.

Exhibit 3: U.S. IPO Capital Raised

Key Takeaway: 2020 was a big year for IPOs after several years when many companies opted to stay private longer.



As of 2/11/21.

Source: Goldman Sachs

Finally, newer liquidity options like direct listings and SPACs have increased exit opportunities for many venture-backed companies (see sidebar, page 5).

Bessemer's Approach to IPOs in the Public Markets

Bessemer portfolio managers conduct disciplined analysis when evaluating purchases of newly listed securities. We do not buy IPOs just for the first day "IPO pop" given our long-term approach to investing, but rather invest in a newly public company if we believe the company is likely to compound earnings growth over the long term. While Bessemer internal portfolio managers tend not to participate directly in IPOs, some of our external managers, especially ones with growth-oriented styles, participate in IPOs and also invest in recently public companies that align with the mandate's investment philosophy.

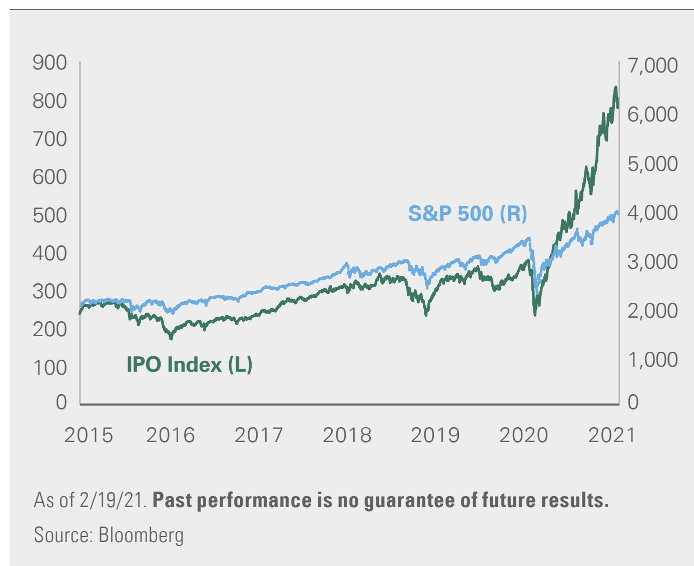
Because the pandemic has pulled forward the adoption of digital-based commerce, infrastructure, and communications, the prospects for many digitally native companies have increased rapidly over the past year. Several 2020 IPOs offer a glimpse of the acceleration of structural trends taking place within the U.S. economy, notably within cloud software and food delivery platforms. Bessemer portfolios have exposure to recent IPOs Snowflake and DoorDash via external managers.

The most extreme examples of recent IPO exuberance are not a core part of our platform. Portfolio managers are especially careful to avoid paying top dollar for newly minted public companies with limited future growth prospects. Ultimately, business models matter, and our portfolios prioritize investments in quality companies with strong fundamentals, competitive moats, and defensible and sustainable margin profiles — whether or not they are newly public companies.

Even though Bessemer's direct public markets exposure to IPOs is fairly limited, it is important to closely follow and analyze recent IPO market developments given the potential macro and portfolio implications. Shares of companies that have gone public in recent years have by and large performed well as investors clamor for a piece of innovative companies with strong growth prospects (Exhibit 4). During 2020 the IPO Index rose 110% relative to the S&P 500 price gain of 16% with technology and internet companies supporting the strong IPO gains. Still, it is worth mentioning that historically IPO performance relative to the S&P 500 has been more mixed with IPOs notably underperforming the S&P 500 over the five years prior to 2020.

Exhibit 4: IPO Performance Relative to S&P 500

Key Takeaway: The IPO Index outperformed the S&P 500 in 2020, though it underperformed the S&P 500 over the five years prior.



As of 2/19/21. **Past performance is no guarantee of future results.**

Source: Bloomberg

While the recent outperformance and rate at which companies are now going public evoke memories of the late 1990s, there are some key differences between recent IPOs and their dot-com predecessors. While unprofitable companies are indeed going public at a rate not seen since the tech bubble, many of these companies have prioritized growth over profit but have a clear path to breakeven and could be profitable if they moderate their growth ambitions. Additionally, today's IPOs represent companies that are larger and more mature relative to prior years. Many startups in prior IPO waves went public just a few years after their founding (Amazon, for example, went public with a market cap of less than $500 million just three years after it was founded). While we acknowledge there may be pockets of exuberance in the IPO market, we believe the meaningful differences between the current IPO market and the dot-com bubble indicate there is minimal risk that the recent IPO market strength will trigger a repeat of the late 1990s dot-com bubble bursting.

Direct Listings, SPACs, and the Changing Process of Going Public

After largely remaining constant since the 1980s, the process of going public is changing as companies explore direct listings and SPACs (special purpose acquisition companies) as an alternative to the traditional IPO. In a direct listing, companies float existing employee and investor shares on the open market, enabling employees and private investors the option to monetize their stakes in the public market. Historically, direct listings only gave the public access to existing stock and did not allow companies to raise new funds. However, the rules have recently changed to allow for additional money to be raised.

One advantage of a direct listing is that it allows a company to float its shares on an exchange without hiring banks to underwrite the offering. Thus, companies can save on fees and bypass some of the restrictions of standard IPOs, such as lockups that prevent insiders from immediately selling their shares. So far, direct listings have a limited sample size with mixed results. While both Spotify and Slack shares suffered immediately after their respective 2018 and 2019 direct listings, Palantir, on the other hand, saw large share price appreciation after its 2020 debut. While direct listings have only been used by a handful of major companies so far, they are expected to gain traction in the near future given the rule change that allows direct listings to include raising new capital.

SPACs, or special purpose acquisition companies, exploded in recent months as an alternative to the traditional IPO. These blank-check companies raise money by listing on stock exchanges with the goal of acquiring a private target and taking it public through a reverse merger. Shareholders can redeem their investment in full plus interest if they vote against the proposed transaction or sell their shares on the open market before the acquisition. The SPAC asset class raised over $70 billion, or roughly half of total IPO proceeds for 2020, a dramatic increase from the average of 10% over the prior 10 years. The recent SPAC frenzy may be indicative of more demand for IPOs than companies able to go public and raises questions of speculative euphoria.

Key benefits of a SPAC relative to an IPO are efficiency and regulation under merger rules rather than public offering rules. A SPAC transaction can be completed in months while a full process for a traditional IPO often takes much longer. SPACs also generally receive less regulatory scrutiny given the minimal disclosures upon listing since the target has not yet been acquired, and then during the merger process companies can provide financial projections to investors. However, a big negative is that SPACs often have a very expensive fee structure for investors. Meaningful dilution is a core feature of the SPAC process, which can be quite costly for post-merger shareholders. Furthermore, there are many valid questions as to whether all the recently launched SPACs will successfully acquire a target before the expiration of the typical two-year search period. Since SPAC investors are generally asked to commit capital before an acquisition target is identified, SPACs generally do not align with Bessemer's philosophy of long-term investment in quality companies with strong fundamentals.

IPOs Benefiting Bessemer's Private Equity Program

Bessemer's private equity program benefits from the supportive IPO environment, as IPOs represent an important step on the path to liquidity. As companies stay private longer and enter the public markets at a more mature stage, more value accrues to the companies' private investors, highlighting the advantage of accessing high-growth companies early in their lives in the private markets. Bessemer portfolios with alternatives have participated in the success of many recent public offerings, including traditional IPOs, such as Affirm, Airbnb, Lucira Health, and Wish, and direct listings, such as Asana and Palantir Technologies. We have also seen a number of our private equity-backed companies enter the public markets by merging with SPACs, including DraftKings, E2open, Hims, and QuantumScape.

Our private market exposure has been largely concentrated in technology and healthcare, focusing on existing trends that the pandemic has accelerated, such as cloud software and life sciences. For example, pharmaceutical research and development has seen an increase in attention from the general public due to the industry's role in developing vaccines and therapies to combat COVID-19. Biotechnology had a strong showing in 2020 in terms of IPOs, though we note that biotechnology companies often go public at relatively early stages compared to technology companies; they're usually pre-revenue and in the clinical trials phase of development.

Bessemer's private equity program has good visibility into the pipeline of future IPOs, and many promising companies are poised to go public in 2021. Looking ahead we expect the IPO environment will remain strong, especially for companies participating in the innovation economy.

With special thanks to Director of Private Markets Lisa Corcoran and the private markets team for their contributions.

Our Recent Insights

A Brief Update on Bitcoin and Blockchain Technology — Investment Insights (January 2021)

2021 Outlook: Reopening, Recovery, and Growth — Quarterly Investment Perspective (First Quarter)

2020 Election Update: Additional Implications — Investment Insights (December 2020)

In Pursuit of Return and Income — Quarterly Investment Perspective (Fourth Quarter)

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