

## Outlook for 2009 IPOs

### Volume will stay low, but we expect returns to improve

- IPO activity will be low in 2009, but new issues could produce healthy returns
- High-growth stories are less likely to be successful as investors lean toward defensive sectors
- Private equity may be a source of several large deals toward the end of the year
- Although many companies have withdrawn IPO filings, there are still 100+ US operating companies in the pipeline
- As in 2008, there will likely be several privatizations going public on foreign markets

With IPO volume low, many investors will be tempted to ignore the IPO market altogether as we move into 2009. This may be a mistake. Historical precedent suggests that IPOs in periods of low issuance can generate very strong returns as companies are forced to become more realistic with their proposed valuations in order to successfully raise capital, thereby creating opportunities for investors.

The trend in the fourth quarter 2008 supports this pattern. Globally, only six companies were able to raise over \$100 million in the fourth quarter, down 97% year-over-year. These six IPOs, however, have performed very well relative to the year's earlier IPOs as well as the broader equity markets and on average are trading 17% above their offer prices. The two most recent offerings, Japanese social networker Gree (3632.JP) and US online education company Grand Canyon Education (LOPE), have gained 65% and 45%, respectively, since going public. In the case of Grand Canyon, the company was only able to complete its IPO by selling shares at a price 37% below the midpoint of its originally-proposed range because of investor pressure on the valuation; the lower IPO price allowed these investors to realize strong aftermarket returns.

While IPO issuance as a whole will continue to be low in 2009, certain sectors will prove more resilient than others. In the US, 2008 saw a dramatic fall in the number of tech, healthcare and consumer IPOs as investors heavily discounted future growth of risky companies. We expect this trend to continue in 2009, a view that is shared with the majority of venture capitalists, according to the National Venture Capital Association Predictions Survey. Instead of trying to pitch portfolio companies at rock bottom prices, many venture capital firms would rather help them navigate through the downturn as private companies and then look for an IPO when the economy rebounds. Another area of the IPO market that dried up in 2008 was the SPAC market, which we expect to remain slow, if not stagnant, because of (i) the large backlog of blank check companies that have not yet made an acquisition and (ii) fewer attractive acquisition targets given the weak economic environment.

With US investors avoiding these areas of the market, we expect more defensive areas such as education, health services, energy and defense to supply the majority of 2009 IPOs. Another significant source of upcoming IPOs may be the private equity industry, as many portfolio companies need to refinance debt in the near future; with the credit markets frozen, equity financing may be the only viable option. Two members of Forbes' list of the 25 largest private-equity-owned companies (coated paper manufacturer NewPage and oil/gas pipe distributor McJunkin Red Man) have filed for IPOs, while some others, such as Toys R Us and Dunkin' Donuts, are rumored to be preparing for public offerings.

### Large Private-Equity-Owned Companies

Company	'07 Sales (\$ bil)	Private Equity Owner(s)
GMAC	\$31.5	Cerberus Capital
HCA	\$26.9	KKR, Bain Capital
Toys R Us	\$13.8	KKR, Bain Capital, Vornado Realty
Aramark	\$13.2	Goldman Sachs, CCMP, THL, Warburg Pincus
Dollar General	\$9.9	KKR
CDW	\$8.2	Madison Dearborn
First Data	\$8.1	KKR
Keystone Foods	\$5.6	Lindsay Goldberg
NewPage*	\$4.7	Cerberus Capital
McJunkin Red Man*	\$4.0	Goldman Sachs

\*Filed for US IPO

Source: PEdatabase.com

In total, 169 companies have filed for a US IPO. 62 of these are SPACs, the majority of which are unlikely to go public. On the other hand, we expect a fair number of the 107 operating companies to complete IPOs, especially as the pipeline has already undergone a shakeout with 97 companies withdrawing their IPO filings. The companies that remain are fairly large by traditional IPO standards (average revenue of \$535 million) because investors are looking for companies with solid fundamentals that are more mature and less risky than typical public offerings. Among the notable names in the US pipeline are Mead Johnson, a Bristol-Myers pediatric nutrition company; language-learning software provider Rosetta Stone; KKR portfolio company Avago Technologies, formerly the semiconductor division of Agilent; healthcare payment solutions firm Emdeon; and specialty steel product distributor Edgen Murray Limited.

## Recent IPO filings

Company	Description	LTM Sales (\$ mil)	File Date
FriendFinder Network	Online social networking and multimedia entertainment company.	\$265	12/23/08
Bridgepoint Education	Provides online postsecondary education programs.	\$180	12/22/08
Mead Johnson Nutrition	A leading provider of infant formula and other pediatric nutrition products.	\$2,844	12/18/08
Alon Brands	Operates 306 7-Eleven convenience stores and markets the FINA brand of motor-fuels.	\$1,363	11/12/08
Edgen Murray	A distributor of specialty steel products to energy infrastructure markets.	\$1,079	09/24/08
Rosetta Stone	A leading provider of technology-based language learning solutions.	\$161	09/23/08
Emdeon	Provides revenue and payment cycle management solutions to the healthcare industry.	\$832	09/12/08
Avago Technologies	A leading supplier of high performance analog semiconductor devices.	\$2,398	08/21/08
Verisk Analytics	Provides risk management solutions based on proprietary data and statistical models.	\$819	08/12/08
A123 Systems	Provides rechargeable lithium-ion batteries and battery systems.	\$42	08/08/08

Source: Renaissance Capital's IPOHome.com

On major non-US exchanges, there are a host of companies planning to attempt IPOs. In recent years, privatizations by Asian and Eastern European nations have been a source of several large IPOs, and 2009 is shaping up in a similar vein. In China, four state-owned asset management companies are restructuring in preparation for 2009 IPOs, while government-owned Dubai real estate developer Nakheel is looking to raise as much as \$15 billion this year. The Indian

government has expressed interest in divesting ownership stakes in several public sector undertakings, including Oil India and hydroelectric power utility NHPC (which together are looking to raise over \$700 million). A \$10 billion IPO of India-owned telecom BSNL that was delayed in 2008 may also resurface. In Europe, the Polish government plans to privatize coal miner Bogdanka and power producer PGE. In addition to these companies, we know of at least 40 companies that are expected to attempt IPOs on non-US exchanges in 2009, and doubtless many others will be monitoring the market looking for an opportunity to go public.

We believe that there is a large global pipeline of companies waiting in the wings, representing well over \$100 billion in potential offerings, and that many of these companies will attempt to raise capital in 2009. While not all will be successful, those that are may generate significant returns as they will likely be attractively priced. As we pointed out in our study, "When Will the IPO Market Return?" and our 2008 Annual Review, in the 1970s, it took several years for IPO volume to return to pre-recession levels, but in the interim period, initial IPO returns improved for several years in a row. IPOs also performed very strongly in the aftermarket as the broader market gradually recovered. Stocks that went public during the 1975-1979 period on average returned almost 140%, or 34% annually, during their first three years of trading. While we are not expecting the IPO market to fully recover in 2009, we believe that there will be opportunities for IPO investors to buy shares of companies with solid fundamentals at attractive valuations. If history is any guide, then 2009 will be the start of an IPO recovery, albeit a slow one, that may be very profitable for those who have not been scared off by the turmoil of the past year.