

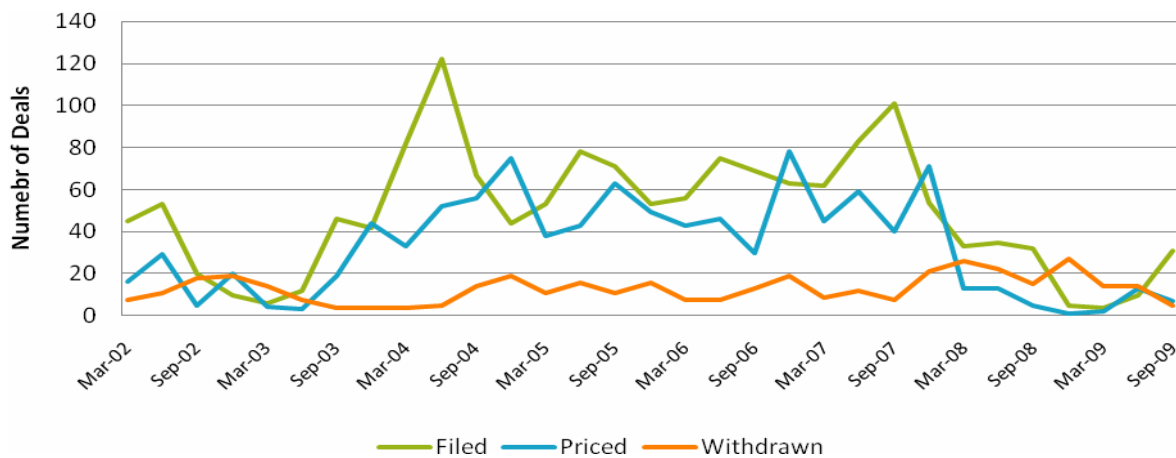
## Financial Crisis Shapes US IPO Rebound

September 8, 2009

While the IPO market has taken the first steps toward healing, a glimpse into the growing pipeline reveals that the path to full recovery will be different than those that followed prior economic downturns. As the IPO market rebounded from a moderately deep recession in 1991, the leading industry sectors were business services, technology, retail and health care. Remember Broderbund Software, Checkers Drive-In, KooKooRoo and MedImmune? Today, the tech, healthcare and retail growth stories that have driven past market revivals have been conspicuously absent from the latest wave of IPO hopefuls. This makes sense, given the historic consumer shut-down and the anti-business and investment rhetoric emanating from Washington. In their place, there is a pool of unusual candidates shaped by an era of cheap credit and the unprecedented mortgage crisis that followed. At least for the near term, it appears that the IPO market will be dominated by opportunistic investment vehicles and businesses from the mid-decade buyout bubble.

- After an uptick in filing activity, there are 67 companies in the active IPO pipeline<sup>1</sup>, up from 29 in March 2009
- Mortgage REITs represent 19% of the active IPO pipeline
- 12 of the last 26 IPO filings have been from private equity portfolio companies
- Filings from mature companies with familiar stories reflect lingering risk aversion
- Venture-backed names have dwindled to less than 10% of the active pipeline

Quarterly Pipeline Activity: 2002-Present



Source: Renaissance Capital

**Blast from the past:** How many of the top 20 IPO underwriters from 1991 still exist? Answer at end of commentary.

<sup>1</sup> Includes companies that have filed an IPO registration statement or amendment within the last year. Excludes postponed deals and SPACs.

## A REIT-led Revival?

Financials currently make up nearly 30% of the active pipeline, led by mortgage REITs (19%) looking to capitalize on cheap government financing and a massive supply/demand imbalance to build portfolios of distressed real estate assets. We discuss the prospects of the mortgage REIT market at length in an August 27 piece; in short, the fate of the remaining 13 IPO candidates in the active pipeline depends on the Fed's willingness to keep the monetary spigots open and its plans to prop up troubled asset prices with taxpayer guarantees. With an investment strategy similar to that of Starwood Property Trust (STWD), 2009's largest IPO so far, Annaly-backed CreXus Investment (CXS) will be the first to test the waters in mid-September. Although all these REITs share similar strategies and offer exposure to attractive mortgage sector yields, investors are discriminating among the IPOs based on management pedigree. Further, REIT IPO performance has been mixed thus far, with an average stock return of 7%.

## Private Equity: Liquidity at Last?

As we predicted in our 2009 outlook, the private equity industry is emerging as another major contributor to the IPO pipeline. On the supply side, buyout debt and pools with early-to-mid-decade vintages are approaching maturity, meaning that portfolio companies will have to be monetized. Thus, it is not surprising that 12 of the past 26 new filings dating back to mid-July have been from private equity-backed firms. On the demand side, the strong reception of LBO companies Emdeon (EM) and Avago (AVGO) may signal increasing investor appetite for strong cash generators, even if they come to market with less-than-stellar balance sheets. Nonetheless, valuation remains the key to successful new offerings. Will private equity fund manager's internal valuations stand up to the scrutiny of public investors? If not, how eager will they be to trade off performance fees for liquidity?

Recent Private Equity Filings						
Company	Filing Date	Business Description	LTM Sales*	EBITDA Margin	Proposed Deal Size*	
Dollar General	20-Aug-09	The largest discount retailer in the US with 8,577 stores.	\$10,834.1	9%	\$750.0	
AEI	18-Aug-09	Operates power and natural gas infrastructure in Latin America, Europe and Asia.	\$8,310.0	13%	\$862.5	
InfrastruX Group	10-Aug-09	Leading US electric power and natural gas infrastructure contractor.	\$800.1	11%	\$290.0	
Vitamin Shoppe	23-Jul-09	A leading specialty retailer and direct marketer of vitamins.	\$620.4	10%	\$143.8	
RailAmerica	28-Jul-09	Largest owner and operator of short line and regional freight railroads in North America.	\$486.6	29%	\$300.0	
HealthPort	17-Aug-09	Provides electronic medical record transmission services for hospitals and health systems.	\$285.1	13%	\$100.0	
Addus HomeCare	17-Jul-09	Provides home-based personal care, skilled nursing and rehabilitative therapies.	\$252.2	8%	\$69.0	
Ancestry.com	3-Aug-09	Operates a subscription-based online community for researching family histories.	\$210.3	32%	\$75.0	
Mirion Technologies	13-Aug-09	Provides radiation detection systems for nuclear, defense and medical end markets.	\$191.5	16%	\$100.0	
Gain Capital	31-Aug-09	Provides an online foreign exchange trading platform (Forex.com) for retail customers.	\$180.0	44%	\$125.0	
Archipelago Learning	3-Sep-09	Provides subscription-based online education services for students K-12.	\$39.5	29%	\$75.0	
Cobalt International	4-Sep-09	Independent E&P firm with deepwater prospects in the Gulf of Mexico / West Africa.	\$0.0	n/a	\$1,150.0	

\*In millions. Source: Renaissance Capital.

In addition to Dollar General, leading private equity shop KKR has indicated that it is preparing as many as five other portfolio companies for an IPO. With a backlog of companies snapped up during the bubble years, it is unlikely that private equity peers will let KKR have all the fun, which could provide a regular stream of new filings for some time to come.

#### Large Private Equity-owned Companies

Company	LTM Sales*	Private Equity Owner(s)
HCA	\$29,181.0	KKR, Bain Capital, Merrill Lynch
Toys R Us	\$13,482.0	KKR, Bain Capital, Vornado Realty
Aramark	\$12,791.6	Goldman Sachs, CCMP, THL, Warburg Pincus
Dollar General	\$10,834.1	KKR
CDW**	\$8,150.0	Madison Dearborn
First Data	\$8,765.3	KKR
Hilton Hotels**	\$8,100.0	Blackstone Group
Freescale Semiconductor	\$4,013.0	Blackstone Group, The Carlyle Group, Permira, TPG Capital

\*In millions. \*\*Financial data as of FY07.

Source: PEdatabase.com

In a similar vein, August also brought newsworthy filings from high-profile brands Dole Food and Hyatt Hotels. Although both are controlled by wealthy private investors instead of buyout firms, they share some common threads with their PE-backed peers. For instance, Dole Food's balance sheet is still weighed down by debt from a 2003 buyout led by real estate mogul David Murdock. In contrast, the liquidity demands of heirs to Jay Pritzker's fortune appear to be the driving force behind Hyatt's proposed IPO during a particularly rocky period for the travel industry.

Here is a rundown of prospective offerings with interesting, if not checkered, provenances:

- **AEI** – In June 2006, Prisma Energy International was the last subsidiary stripped from Enron's bankruptcy shell, fetching \$1.8 billion from a private equity fund run by London-traded Ashmore Investment Management (ASHM.L). Now called AEI, this holding company owns and operates energy infrastructure assets in 19 emerging markets, and its portfolio has grown to include 120,000 miles of power transmission lines, 2.2 GW of power generation capacity and 4,800 miles of natural gas and NGL pipelines.
- **Dollar General** – Perhaps the most ballyhooed new filing of 2009, KKR portfolio company Dollar General operates 8,577 small-box discount stores in 35 states. The Goodlettsville, TN-based company was publicly traded from 1968 until 2007, when it was acquired in an LBO transaction valued at \$7.3 billion. Though consumer belt-tightening has taken a toll on the retail sector, Dollar General posted impressive 13% same-store sales growth in its April quarter and has an opportunity to broaden the company's footprint while lease rates and construction costs are low.

- **RailAmerica** - This short line rail operator was publicly traded from 1992 until 2007, when was scooped up by Fortress for \$1.1 billion as part of the private equity giant's massive buying spree in freight transportation, which also included Florida East Coast Railway and equipment leasing firm Interpool. RailAmerica's assets include 40 railroads with over 8,000 track miles running in 27 states and three provinces in Canada. The company plans to use proceeds from the IPO to pay down a portion of the principal from its \$740 million notes offering in June 2009 that was used primarily to repay the company's remaining balance of its bridge loan facility.
- **Dole Food** - One of the most recognized food brands in the world with roots dating back over 158 years, Dole Food Company markets and distributes more than 200 products in over 90 countries. The 2003 take-private transaction by real estate mogul and then CEO David Murdock, however, left the company saddled with a heavy debt burden that Dole recently made a priority to scale back. Despite aggressive efforts, including asset sales and improving margins, the company remains highly leveraged at nearly 5x operating cash flow and an IPO is an opportunity for the company to strengthen its balance sheet.
- **Hyatt Hotels** – Founded by Jay Pritzker in 1957, Hyatt currently manages a chain of 413 hotels, resorts and ownership properties located in 45 countries. Hyatt Corporation and Hyatt International began trading as separate public companies in the 1960's, but were taken private by the Pritzker family in 1979 and 1982, respectively. With the moderately-leveraged company's revenues down 19% in the 1H09, the impetus for the August filing appears to be liquidity, as Pritzker's fortune is set to be split among 13 feuding heirs.

### Traditional Venture Capital Awaits its Turn

After producing an average of 70 IPOs a year from 2004-2007, the venture capital community was relatively barren of IPO activity in 2008 and 2009. Year-to-date, the VC community has completed four IPOs including healthcare IT firm Medidata Solutions (MDSO), network management software maker SolarWinds (SWI), restaurant reservation services provider OpenTable (OPEN) and remote connectivity software provider LogMeIn (LOGM). While performance of these deals has been strong for the most part, averaging a 25% return, their size and profitability levels hardly fit the mold of a typical small, venture-backed IPO. The average sales and EBITDA margins for the aforementioned four venture-backed IPOs were an uncharacteristic \$83 million and 21%, respectively.

Currently, there are seven venture-backed deals in the active pipeline. While a few of the pipeline companies are mature, such as network security provider Fortinet, there are two more speculative candidates that could test investors' risk appetite before year end: A123 Systems, which provides lithium-ion batteries primarily for hybrid vehicles, and biotechnology firm Omeros. The former, in particular, will be a closely watched offering given the enormous amount of

recent VC funding in the alternative energy space. Both of these companies are much earlier in their growth phase than recent venture-backed IPOs, and successful offerings may help to reignite activity in the space.

Active VC-Backed Companies					
Company	Filing Date	Business Description	LTM Sales*	EBITDA Margin	Proposed Deal Size*
Prometheus Labs	19-Dec-07	A specialty pharmaceutical and diagnostics company focused on gastrointestinal disorders.	\$307.4	23%	\$100.0
Echo Global	30-Apr-08	Provides technology-enabled shipping and freight management services.	\$277.1	3%	\$100.0
Fortinet	10-Aug-09	Provides network security appliances to enterprises, service providers and government entities.	\$229.0	13%	\$100.0
A123 Systems	8-Aug-08	Provides rechargeable lithium-ion batteries and battery systems.	\$89.5	-82%	\$175.0
Nexsan	25-Apr-08	Provides disk-based storage systems for long-term digital information storage.	\$55.7	8%	\$80.5
Omeros	9-Jan-08	A biotech company focused on inflammation/pain and disorders of the central nervous system.	\$0.0	n/a	\$115.0

\*In millions. Source: Renaissance Capital.

Besides the social networking giants Facebook, Twitter and LinkedIn, there have been several other rumored IPO candidates from the VC community as the market began to recover in early March. Near-term, we expect the majority of new venture-backed IPO filings to come from the technology and alternative energy sectors. Potential IPO prospects from each of these industries include online games company Zynga, ethernet network equipment provider Force10 and property & casualty software maker Guidewire in the technology sector, and smart grid company Silver Spring, solar panel maker Solyndra and electric car manufacturer Tesla Motors in alternative energy.

## Conclusion

Although the pipeline heading into fall 2009 is relatively shallow by historical standards, the wave of recent filings provides more than enough dry powder to support a sharp uptick in pricing activity relative to the summer months. The last two days before the Labor Day weekend provided six new filings, the most in a 48 hour span since September 2007. Clearly, we are not expecting deal flow to return to the 200+ annual pace of 2005-2007 just yet, but a steady stream of IPOs would indicate economic and financial healing. Further, the 25% average return for IPOs priced in 2009 speaks to the fact that investors continue to find strong performance in unseasoned equities despite the limited deal flow (The FTSE Renaissance IPO Composite Index has also outpaced broader indexes with a 35% return YTD). While the IPO recovery won't be led by the small-cap, fast growth companies, successful offerings from the large cap IPO hopefuls may help prime the pump for the return of deals from the traditional tech, healthcare and retail sectors.

**Answer:** 3 – Goldman Sachs, Morgan Stanley and William Blair.

## About Us

Renaissance Capital LLC, founded in Greenwich, CT in 1991, is the global leader in IPO research. Its clients represent the "Who's Who" list of the largest and most active institutional IPO investors. In addition to IPO research, Renaissance Capital, in conjunction with its index partner FTSE Group, maintains the FTSE Renaissance IPO Composite Index, the definitive benchmark of IPO activity and performance. Renaissance Capital also provides IPO-focused investment management services as the advisor to the IPO Plus Fund (IPOSX), the first mutual fund to focus solely on investing in IPOs, and through separately managed institutional accounts.

Copyright 2009 by Renaissance Capital LLC, all rights reserved. The information and opinions in this commentary were prepared by Renaissance Capital analysts. The report does not constitute an offer to buy or sell any security. Renaissance Capital and/or the IPO Plus Fund may have investments in securities of companies mentioned in this report. The contents of this report may not be reproduced, stored in a retrieval system, or transmitted in any form without prior written consent.