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Private Equity, Public Exits

January 2010 PE-backed IPO update

Private Equity, Public Exits is published monthly by Ernst & Young to provide insight and analysis on capital markets trends as they apply to the private equity-backed IPO market.

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PE-backed deals finish the year strong; solid pipeline queued up for 2010

It's likely that all but the most optimistic observers were surprised by the momentum with which new issuance resumed once the capital markets finally reopened to new deals in the second half of 2009. The initial public offering (IPO) markets continued their roll through the end of the year, with companies raising \$19.97b in December, bringing the 2009 total to \$115.8b in 615 separate deals. The fourth quarter saw \$63.1b in new deals brought to market, a 62% increase over the \$38.8b raised in 3Q09 and a world away from the fourth quarter of 2008, when only \$3.5b was raised as global markets became gridlocked.

Private equity (PE) firms likewise continued to usher new companies into the public ownership. There were 37 sponsored deals that priced during the fourth quarter, raising an aggregate \$11.5b in total proceeds, more than two and a half times the \$4.5b raised by PE-backed deals in the third quarter and representing 70% of the \$16.4b total dollars raised by PE-backed companies during 2009. By value, PE deals accounted for 14.2% of all IPO dollars raised in 2009, up from 10.8% the prior year. US listings in particular were PE-heavy; 33% of all the dollars raised on US exchanges in 2009 were by sponsored companies.

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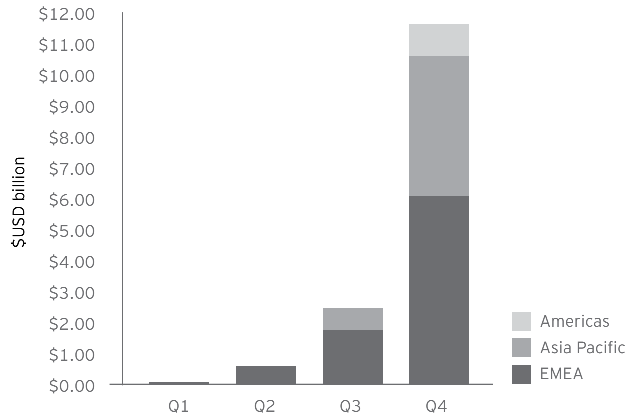
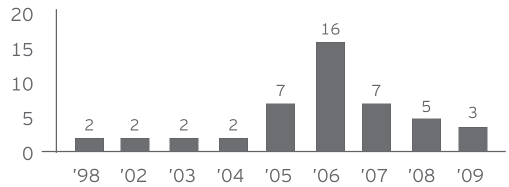
Figure 1: 2009 PE-backed IPOs by region:



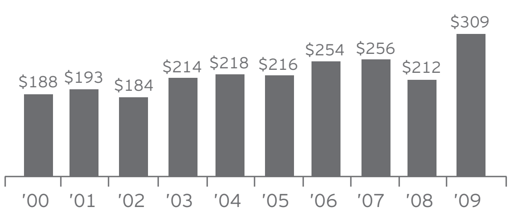
Source: Dealogic

Figure 2: Holding periods; 2009 PE-backed deals by entry date



Source: Dealogic

Figure 3: Average PE-backed IPO values 2000-09



Source: Dealogic

Overview of 2009 activity; China sees rich valuations

- The Americas and the Asia-Pacific region were both prolific producers of sponsored deals during 2009, with $8.5b and $7.1b in value, respectively. Both regions produced 25 companies that listed during the year. Companies based in the Europe, Middle East and Africa (EMEA) region trailed by a considerable margin. It produced only three companies that went public, which raised an aggregate $780m in proceeds (Fig. 1).
- The growth in China was in many ways the most interesting story of the year. Investment in the region is increasing dramatically, suggesting that recent new issuance is just the tip of the iceberg. Valuations for IPOs in the region have been extremely rich, to the extent that Chinese regulators are currently pondering ways to curb excess speculation that they fear could lead to an asset bubble. The recently opened Chinext exchange in Shenzhen, which was was designed to provide a venue for smaller, high-growth companies, has enacted a set of regulations to encourage companies to put excess funds raised during their IPOs to judicious use by prohibiting them from using more than 20% of their excess IPO proceeds to supplement working capital or to repay bank loans in a single year.
- China also yielded one of the largest follow-ons of the year — the China Pacific Insurance deal in December. The company listed in Shanghai in late 2007 and launched a dual-listing in Hong Kong in mid-December 2009, raising $3.1b. Among the company's minority investors is The Carlyle Group.

PE firms exit investments, reduce debt

- While many PE firms used the open window as an opportunity to exit long-held investments (Fig. 2), another significant driver behind many of the year's deals was the opportunity to reduce debt loads acquired over the last several years. Of the PE-backed companies that went public in 2009, 45% cited repayment of debt as a use of proceeds. One of these was Dollarama — the company used the entire $325m in IPO proceeds for the repayment of debt. The company's sponsor, Bain Capital, declined to sell shares on the IPO, preferring to delay its exit until the stock had found a stable footing in the public markets.

Average deal sizes increase

- A handful of large deals during 2009, including Myer Holdings and Hyatt — coupled with a number of low-value deals — sent average deal volumes for the year higher. The average sponsor-backed deal raised $309m in 2009, the highest average of the last 10 years. It was 46% higher than 2008 and 21% higher than in 2007 (Fig. 3).

Several deals break the $1b mark

Figure 4: Top deals of 2009

Company	Exchange	Offer date	Net proceeds	Sponsor
Myer Holdings Ltd	Australian Stock Exchange	30 Oct 09	$1,862m	Newbridge Capital, TPG
Hyatt Hotels Corp	New York	4 Nov 2009	$1,093m	Goldman Sachs Capital Partners
Talecris Biotherapeutics	Nasdaq	30 Sep 09	$1,064m	Cerberus, Ampersand
Cobalt International Energy	New York	15 Dec 09	$958m	Goldman Sachs Capital Partners, Carlyle/ Riverstone
Dollar General	New York	12 Nov 09	$824m	Goldman Sachs Capital Partners, KKR, Citigroup
Avago Technologies	Nasdaq	5 Aug 09	$745m	Silver Lake, KKR
Adani Power	Bombay	3 Aug 09	$626m	3i Group
Gartmore Group	London	11 Dec 09	$609m	Hellman & Friedman
Yingde Gases Group	Hong Kong	30 Sep 09	$470m	Baring Private Equity
CETIP – Camara de Custodia e Liquidacao	Sao Paulo – Novo Mercado	26 Oct 09	$450m	Advent International

Note: currency shown in US$.

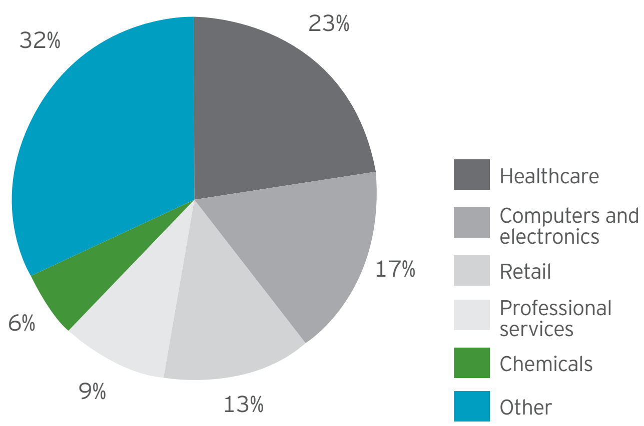
Source: Capitol IQ, Dealogic, regulatory filings

- Several deals broke the billion-dollar barrier in 2009 (Fig. 4). Australian retailer Myer Group represented the largest deal of the year, with $1.9b raised, followed by Hyatt Hotels and Talecris Biotherapeutics, each raising approximately $1.1b.

- A handful of deals were cancelled during the year, as early indications suggested that investor reception would be unfavorable. Another deal, Birds Eye Foods, had filed for an IPO but ultimately received a superior offer from a corporate acquirer backed by The Blackstone Group.

- Deals early on in the year were characterized by belonging to countercyclical industries. Education companies Bridgepoint and Rosetta Stone marked the first deals of the year. The education sector has historically done well in economic downturns as people become more interested in enhancing their attractiveness to employers. They were followed by discount retailers like Dollarama and Dollar General and a raft of health care companies. As the year progressed, sector diversification increased, and several technology, energy and industrials were added to the mix. Health care ultimately led the class of 2009 PE-backed deals, with 23% of IPOs launched. Along with technology and retail, they made up more than half of the year's new deals.

Figure 5: Sector breakdown



Source: Dealogic

December deals show some pricing weakness as investors stay on the sidelines

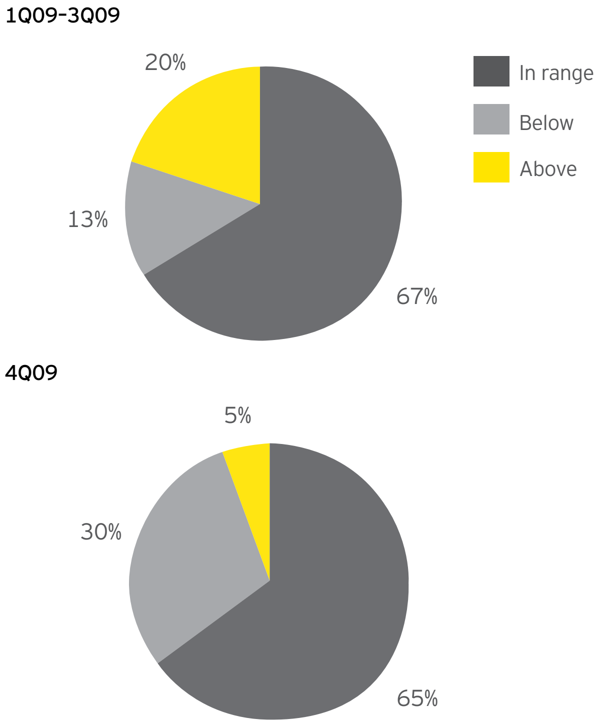
Figure 6: December PE-backed IPOs

Company	Exchange	Offer date	Gross proceeds	Range	Offer price	First day close	December 31 close	Sponsor
Movetis NV	Brussels	3 Dec 09	$147m	$15.86-$20.09	$17.21	$18.63	$18.03	Gewestelijke, KBC, Quest for Growth, BIP
Kaisa Group Holdings	Hong Kong	3 Dec 09	$445m	$0.45-$0.57	$0.45	$0.44	$0.38	Carlyle Group
Kar Auction Services	New York	10 Dec 09	$332m	$15.00-$17.00	$12.00	$12.03	$13.79	Kelso & Co, Parthenon
PCD Stores	Hong Kong	10 Dec 09	$434m	$0.21-$0.26	$0.25	$0.33	$0.39	3i Group
Concord Medical Services	New York	11 Dec 09	$132m	$9.50-$11.50	$11.00	$9.50	$8.64	Carlyle Group
Gartmore Group	London	11 Dec 09	$609m	$4.08-$5.39	$3.59	$3.54	$3.46	Hellman & Friedman
Shengli Oil & Gas	Hong Kong	14 Dec 09	$235m	$0.23-$0.35	$0.28	$0.24	$0.27	Apollo
Cobalt International Energy	New York	15 Dec 09	$958m	$15.00-$17.00	$13.50	$13.50	$13.84	Goldman Sachs, Carlyle / Riverstone
Team Health Holdings	New York	15 Dec 09	$184m	$14.00-$16.00	$12.00	$12.81	$14.02	Blackstone Group
Kraton Performance Polymers	New York	16 Dec 09	$151m	$16.00-$18.00	$13.50	$13.51	$13.56	CCMP Capital, TPG

Source: Bloomberg, Dealogic, regulatory filings; includes operating company IPOs with proceeds over US$100m

- Pricing became more difficult in in the fourth quarter, with almost one-third of PE-backed deals pricing below range and only 5% pricing above, compared with 20% that priced above-range in the first nine months of the year (Fig. 7). December proved especially challenging; just 8 of 14 deals priced within or above their expected ranges.
- This weakness was generally attributed to three factors:
  - A crowded calendar: investors had significantly more deals from which to choose in the final months of the year, and IPOs competed with one another for attention. This was in stark contrast to earlier in the year.
  - Softening deal quality: at the beginning of the cycle, only companies with extremely compelling stories dared attempt to go public; the market is now normalizing.
  - Year-end defensive posturing: the massive rally in public equities for most of 2009 left many investors content to sit on gains booked earlier in the year and unwilling to commit money to new investments.

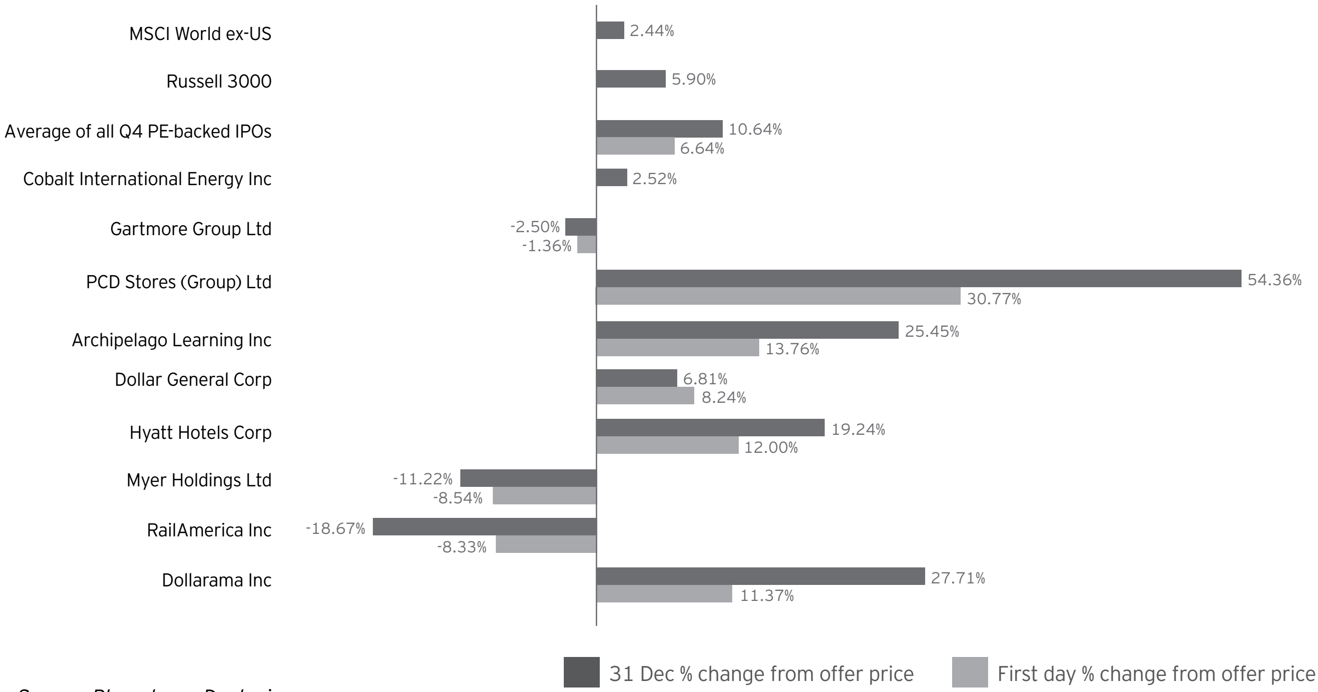
Figure 7: Pricing trends relative to expected range



Source: Dealogic

Aftermarket performance mostly positive; average PE deal ends 2009 up 11.6% over offering price

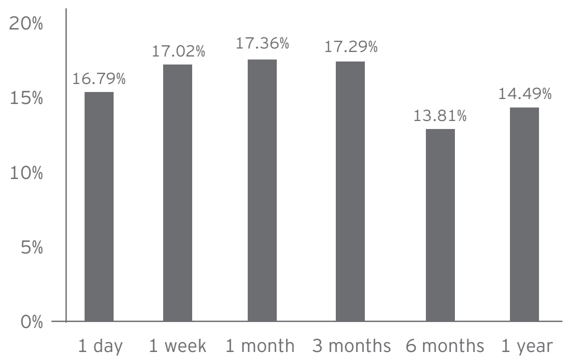
Figure 8: Secondary market performance of selected Q4 PE-backed IPOs



Source: Bloomberg, Dealogic

- Consistent with the broader equities markets, global IPO aftermarket performance was quite positive. Largely driven by outperformance in the Chinese markets, the average IPO (both sponsored and independent) in 2009 closed out its first day up 37.1% over its offer price and closed out the year up 41.4% over its offer price. In the US, performance was more muted, although still positive, with the average deal up 8.4% on its first trading day and closing out the year up 19.7%.
- Most PE-backed deals performed well in the aftermarket. Globally, the average PE-backed deal in 2009 traded up 9.5% on its first day and closed on 31 December up 11.6% over offering price. The median performance for PE-backed deals in 2009 was 5.6% and 6%, respectively, for first day and year-end (31 December 2009) closes. Performance moderated as the year progressed, with fourth quarter deals trading up 6.6% on their first day and closing out the year up 10.6%
- Significant outperformers included Lepu Medical, which gained 119% on its first day on China's ChiNext market. The stock retreated over the balance of the year in volatile trading, but ultimately hung on to the bulk of its initial gains to end the year up 76.6%. In the US, Rosetta Stone closed up its first day up 39%, but steadily lost ground over the year to close essentially in line with its offer price. Fashion retailer Rue21 also performed extraordinarily well, closing its debut day up 27.9% and ending the year up 47.8%.
- An analysis of sponsor-backed IPOs between 2000 and 2009 illustrates some interesting trading patterns in the year immediately following the launch; the average first-day increase in value over offer price for deals priced during the period was just under 16.8%. Values stayed relatively stable through the first three months and even drifted modestly higher. At the six-month marker, however, the average deal lost approximately 3.5% of its value — most likely from lockup-related selling pressure — before resuming on an upward path.

Figure 9: PE-backed IPO trading values relative to offering price for IPOs priced between 2000-2009



Pipeline remains strong and suggests increased European activity

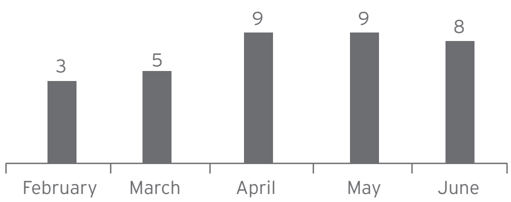
The pipeline of new deals, both sponsor-backed and independent, continues to build. There are currently 30 PE-backed companies in registration, and more are said to be in the final stages of preparing to file. Recent activity hints at a pickup in Europe in particular; New Look, the British retailer backed by Apax and Permira, filed in early December to list on the LSE. Also, Belgian chemical producer Tamico NV, backed by CVC Capital Partners, recently announced it was seeking as much as $230m on the NYSE Euronext.

Many of these companies are actively and openly pursuing a dual-track exit process. UK retailer Pets-at-Home, for example, sponsored by Bridgepoint Capital, reportedly hired several investment banks to prepare for a potential IPO, while simultaneously soliciting bids through an auction managed separately. The company was ultimately sold to KKR for an undisclosed amount.

Lockup expirations loom

In the next three months, lockups will begin expiring on the first wave of PE-backed IPOs. While always a tricky time in the exit-realization process, this stands to be compounded by the limited number of liquidity events over the last two years and ensuing pressure from limited partnerships (LPs) anxious for distributions. Funds that hold shares beyond the IPO will need to walk a fine line between giving their investors want they want and managing the liquidation of their remaining shares in an orderly manner. An imbalanced move may create a market imbalance from which the newly floated company has difficulty recovering (and which makes future sales of stock difficult).

Figure 8: Upcoming PE-backed lockup expirations



Source: Dealogic

In many ways, post-IPO realization is one of the weakest links in the private equity value-creation chain; it's the stage at which an investment is subject to the vagaries of the public market at large, and during which a fund has the least amount of control over its destiny. Still, the decisions made during this stage are critical to preserving the value created over the last several years. Funds planning sales or in-kind distributions over the next few months should remain in close contact with their bankers to identify developing trends and market events that could impact the timing, size, or means of such sales.

Did you know?

Getting an early start is critical. Even in a challenging economy, companies that outperform the overall market prepare early for their transformational IPO journey by acting like a public company at least 12 months beforehand by implementing critical changes to their strategic and corporate tax planning, management team, financial accounting, reporting and internal control systems.