Despite Decline in IPO Activity, US Capital Markets Remain Strong in 2015



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Although the number of U.S. IPOs in 2015 is down compared to this time last year, the U.S. equity and debt markets continue to remain strong. The number of follow-on equity offerings is up 41 percent from last year, with a total of 374 issuances thus far raising approximately \$105 billion in proceeds. The follow-on equity market continues to be positively impacted by the strength of the stock market, substantial M&A activity, and the continuation of private equity and venture capital funds liquidating investments in issuances that went public in recent years. In the debt market, both the investment-grade and high-yield bond markets are robust, ahead of figures from last year both in the number of deals and proceeds raised.

IPO Market

The U.S. equity market experienced a slowdown in IPO activity in the first quarter of 2015. After 2014's record-setting year, with 64 IPOs priced in the first quarter, only 34 IPOs priced in 2015's first quarter.² The \$5.4 billion raised in those offerings amounted to the lowest IPO proceeds raised since the third quarter of 2011. IPO activity in 2015 has been affected by IPO activity in 2014, which cleared the IPO pipeline; a vigorous M&A market, which has offered a compelling alternative exit strategy for private equity and venture capital investors; and the increased availability of late-stage financing at healthy valuations, which has provided private companies with the flexibility to delay their IPOs.³ With 48 IPOs priced in the second quarter, however, the market has heated up, particularly in June. This, combined with the successful debuts for companies that have recently gone public — including Univar and Fitbit — could increase issuance activity in the second half of the year.

Industry Highlights. While there were fewer public issuances in every sector in the first quarter of 2015 as compared to the fourth quarter of 2014, the health care sector represented almost half of 2015's first-quarter IPO activity. With 16 IPOs in the first quarter, health care issuances in 2015 followed 2014's trend, mainly driven by activity among biotechnology and small medical device companies. Investors in biotechnology companies appear to be more selective in 2015, which can explain a portion of the slowdown. The financial sector was the next strongest, primarily driven by a surge in real estate investment trust (REIT) IPOs.

Private Equity and Venture Capital. In contrast to the dominance of private equity- and venture capital-backed IPO activity in the first quarter of 2014, 2015's first quarter was relatively quiet, and this trend has continued in the second quarter. In fact, with only five companies brought public, the first quarter of 2015 turned out to be the least active quarter since 2009 for private equity-backed IPOs.

Looking Ahead. We expect the record number of 2014 issuances, increased M&A activity and the availability of late-stage financing may continue to impact IPO activity for the remainder of 2015. However, we believe that these factors likely have only delayed issuances, as evidenced in part by the recent surge in activity. Notwithstanding the volume of activity in 2014, a significant pipeline of private companies remains, and

¹ As of June 11, 2015. Source: Thomson Reuters. All follow-on offering data herein derived from Thomson Reuters.

² As of June 18, 2015. Source: IPO Investment firm Renaissance Capital (<u>www.renaissancecapital.com</u>). All numerical IPO data herein is derived from Renaissance Capital, including the company's "1Q 2015 US IPO Quarterly Review," March 31, 2015, which includes IPOs with a market capitalization of at least \$50 million and excludes closed-end funds and SPACs.

³ Leslie Hook, "Private Share Trading Takes Off as Tech Companies Shun IPOs," Financial Times (June 2, 2015), http://www.ft.com/intl/cms/s/0/27e9444c-0879-11e5-85de-00144feabdc0.html#axzz3dtVqSNY6.

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late-stage investors will need an eventual exit, which could result in a substantial uptick in IPO activity for the remainder of the year and beyond.

Investment-Grade and High-Yield Debt Markets

Both the investment-grade and high-yield bond markets have experienced a robust 2015, driven in large part by increased M&A activity as well as the continued desire of issuers to complete deals before interest rates rise. The Federal Reserve is expected to begin increasing rates later this year, though when and by how much remains to be seen, particularly given recent economic data that was softer than anticipated. Notwithstanding this expectation and the resulting volatility, both the investment-grade and high-yield markets have remained favorable to issuers, and attractive to investors, as we near the halfway mark of 2015.

Investment-Grade. Investment-grade debt issuances through May 2015 totaled nearly \$600 billion, significantly ahead of volume in both 2014 and 2013. Issuances in May 2015 alone nearly topped the highest monthly total on record.⁴ A significant portion of the issuances has been either M&A-related or to fund returns to shareholders, including through share repurchases, with volume driven by seven jumbo-sized issuances totaling \$10 billion or more: Actavis (\$21 billion), AT&T (\$17.5 billion), AbbVie (\$16.7 billion), Microsoft (\$10.75 billion), Qualcomm (\$10 billion), Shell International Finance (\$10 billion) and Oracle (\$10 billion). There was only one issuance of that size in the first half of 2014 (Apple at \$12 billion) and only three such issuances during all of 2014. The start of 2015 also has seen REITs issuing bonds to take advantage of favorable market conditions and to fund acquisitions, as well as the return of issuers that have not accessed the market in several years.

High-Yield. The volume of high-yield issuances through May 2015 also has been strong, outpacing that for the same period of 2014. Just over half of the issuances were for refinancings, followed by over a quarter to fund M&A activity, including Valeant Pharmaceuticals' \$10.1 billion offering in March 2015 to finance its acquisition of Salix Pharmaceuticals, the second-larg-

est high-yield deal ever behind the Numericable issuance in April 2014. Issuers continued to enjoy relatively low coupons and issuer-friendly terms, including success in placing longer-dated (10-year) bonds, notwithstanding the expected increase in interest rates. The energy sector also accounted for a significant number of new issuances, with several oil and gas companies issuing high-yield bonds both in traditional marketed deals and in direct placements with investors for increased liquidity or to reduce leverage or interest expense through debt exchange offers. However, bankruptcy filings, missed interest payments and restructurings by more distressed energy issuers resulted in an increased default rate for the sector and for high-yield bonds overall (in May 2015 reaching the highest rate since 2009, according to S&P).

Looking Ahead. Debt market participants will continue to keep a close watch on the Federal Open Market Committee, with many looking to the committee's September 2015 meeting or beyond, for increases in interest rates. With historically low yields on bonds, even a small increase in interest rates could have a significant impact on the bond market. However, given the lack of other higher-yielding investment alternatives, investor demand for yield and the fact that the bond market has long-expected interest rates to begin rising this year, the effect on the market may be more tempered and not a repeat of the volatility created by the 2013 "taper tantrum."

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Strong capital markets activity through the first half of 2015 should continue through the next few months and possibly the rest of the year. The strength of the U.S. economy, lower interest rates and M&A deals should continue to drive activity in both the debt and equity markets.

Summer associate James G. Sheridan contributed to this article.

⁴ The sources of data on investment-grade and high-yield bond issuances are from HighYieldBond.com, LeveragedLoan.com, SIFMA.