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The IPO market in 2022: a bend in the road but not the end

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Background of PwC's 2022 IPO study

After the stellar 2021 IPO year, the significant and sudden drop in IPO activity in 2022 prompted us to study the main drivers of IPO activity in the Netherlands, Germany, France, and the UK, for simplicity's sake together referred to as "selected markets in Europe" or simply "the selected markets." We examined one-off events, macroeconomic policy changes and the effect of regulations and how they impact IPO volumes. Recent events such as the Russia-Ukraine war, COVID-19, and the implications of Brexit, provide new insights as to how market participants respond to exogenous shocks in global equity markets.

Our study combined quantitative methods (regression analysis) and qualitative methods (interviews with 12 capital markets participants and advisors). This approach enabled us to look beyond quantitative data by improving our evaluation and getting a bigger picture of the IPO activity in the selected markets in Europe.

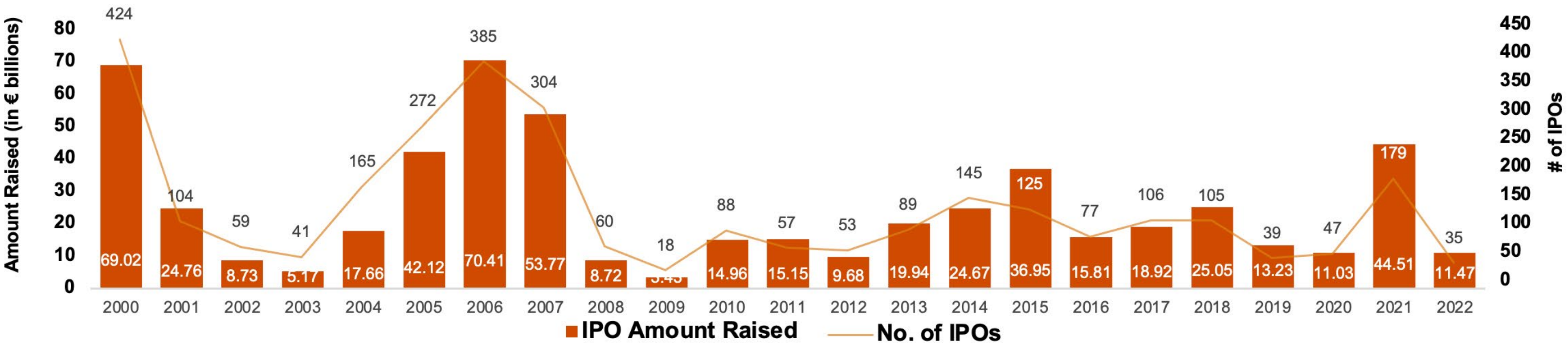
IPO activity in the selected markets in Europe has taken a sudden plunge as geopolitical risks mix with economic weakening

The current global equity market is experiencing a downturn due to several factors that have affected equity market volatility and thereby the IPO market. In fact, 2022 IPO activity in the selected markets experienced a sudden downturn and one of the most severe droughts since the dot-com bubble of 2000.

2021 saw the highest IPO activity since 2007 which was further supported by strong equity market performance in Europe, with the Euro STOXX 50 reaching an all-time high in November 2021.

However, 2022 saw a sudden drop of IPO activity. This reflects a darkening mood across the economy, with double-digit inflation, and a strong rise in interest rates. The selected markets in Europe saw 35 IPOs in 2022 raising €11.47 billion, compared to 179 IPOs in 2021 raising €44.51 billion. This represents a drop of 80.4% in IPO volumes, and 74.2% in money raised. It is also worth noting that the Porsche IPO that took place in September 2022 raised €9.08 billion, making it the largest IPO in Europe (with regards to market capitalisation) in over a decade. This distorts the 2022 data.

Amount raised by IPOs in the selected markets in Europe



IPO activity in Europe between 1 January 2000 and 31 December 2022 (Source: Dealogic)

Several additional factors play a role in contributing to the low level of IPO activity in the selected markets in Europe

Our study shows that several other factors explain the poor performance of the IPO activity in the selected markets in Europe in 2022:

- **Unsustainable performance affecting the IPO peak in 2021:** the strength of IPO markets in 2021 was largely driven by a decade of artificially low interest rates, which increased the attractiveness of equity markets compared to bond markets, and thereby caused a shift in portfolio allocation away from the long-term average. Furthermore, following a period dominated by the uncertainties surrounding COVID-19, companies took advantage of high valuations coupled with low market volatility in 2021, and IPO activity popped. As interest rates increase again, equity markets will lose some of their attractiveness, and IPO markets will come down to sustainable levels.
- **Investors are refocusing on companies with sustainable profits and long-term value creation:** the immense volume of capital available enabled a wider range of companies to seek a public listing, as investment criteria were loosened. However, facing an increased cost of capital and a deteriorating economic outlook, investors have become increasingly cautious and re-focused on companies with sustainable profits and long-term value creation. As a result, there have been numerous instances of companies changing their IPO plans.
- **Loss of risk appetite by investors:** as equity markets deteriorated in 2022, so the share prices of recently listed companies fell further than market averages. This holds especially true for the after-market performance of SPACs. Globally, but especially in the US, 2022 saw a rise in de-listings of SPACs, which adversely impacted global investor sentiment. This loss of risk appetite by investors has directly affected IPO activity in the selected markets in Europe.
- **Flushed out IPO pipeline:** The high equity market valuations seen in 2021 led to a lot of PE-backed firms accelerating their IPOs. As a result, the 2022 IPO pipeline became smaller as a large number of IPOs were brought forward and went public already in 2021. Further, the UK saw many companies that held off going public during the uncertainty of Brexit and the COVID-19 pandemic launch their IPOs in 2021.

Companies going public in the coming periods will need to differentiate themselves to succeed

Our study shows that IPOs that are likely to take place in the coming periods can be split into two categories:

1. **Companies with a unique business model and/or an interesting equity story:** early-look meetings with institutional investors have shown that IPOs are currently not an attractive option. Companies going public under the current market conditions should compensate for this lack in market attractiveness. Therefore, institutional investors are shifting focus towards more interesting and unique companies, such as founder-led companies, that are otherwise unlikely to get exposure to public markets, or companies facilitating the energy transition.
2. **Companies that are less sensitive to valuations:** for example, non-core businesses of large organizations that need to be spun-off in an effort to optimize portfolios, or companies with near-term strong cash flows.

The importance of industry attractiveness and a strong equity story increases in tough market conditions

The attractiveness of industries changes constantly, and investors are more likely to flock to companies belonging to attractive sectors at a given point in time. Industry attractiveness is a result of relative levels of profitability, which are affected by macroeconomic factors, and by relative valuation levels, which are driven by diverging levels of risk averseness. In 2022 for example, the oil and gas sector experienced a resurgence in attractiveness as its profitability was turbocharged by higher oil prices. On the other hand, companies in sectors that seemed attractive last year are not as IPO-able in 2022. An example of this are e-commerce retailers that flourished during COVID-19 due to a rise in online sales. However, with the effects of COVID-19 diminishing, the industry has struggled to remain as attractive among investors. Thus, companies are unable to control this factor single-handedly.

However, industry is not all important as companies can differentiate themselves from industry competitors with a good equity story. The equity story relates to how a company positions itself relative to its competitors and can be easily translated into specific KPIs that funnel investor appetite to a company. Therefore, companies are able to single-handedly control this factor better as compared to industry attractiveness.

Several other factors contribute to the success of an IPO such as:

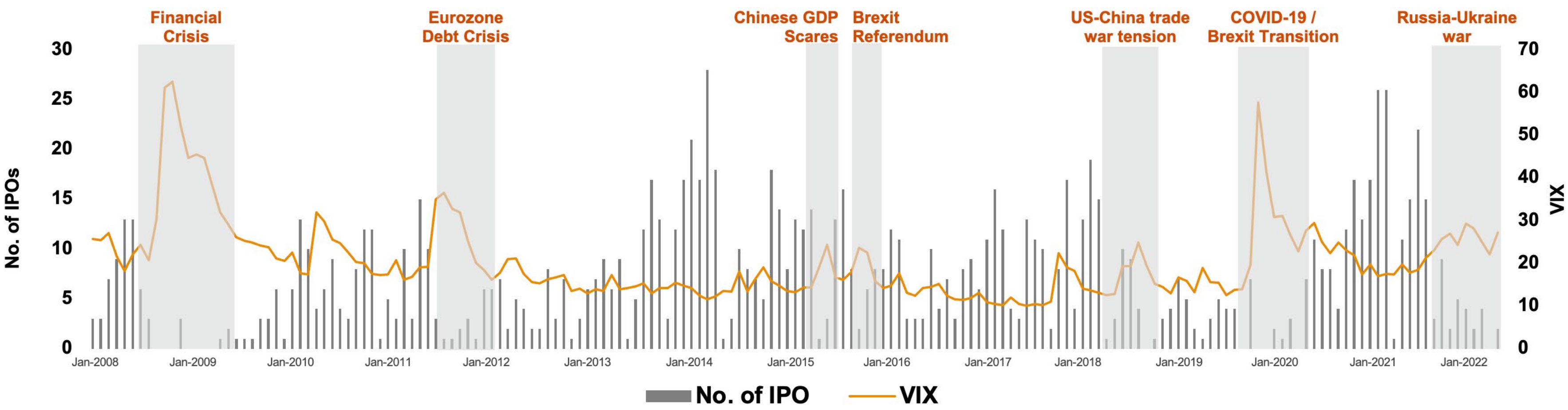
Market volatility strongly drives IPO windows, but markets tend to restabilize themselves

Market conditions have an enormous impact on the listing location and timing to go public. Companies view market timing as one of the biggest concerns when considering an IPO, as companies prefer not to go public during volatile equity market conditions.

Our study shows that market volatility and global IPO activity have a strong negative relationship. Historically, when the VIX is lower, the IPO window is considered "open". Conversely, when the VIX is higher, the IPO window is considered "closed" and the number of IPOs decreases significantly. As an example, instances such as the Suez Canal obstruction and the lockdowns in China had resulted in supply chain disruptions that led to commodity price rises starting in H2 2021. This resulted in a steady rise in inflation and a decrease in equity markets starting in November 2021. However, the Russia-Ukraine war catapulted inflation higher, and led to strong rises in interest rates across Europe. This unexpected event was like throwing gas on a fire and led to a spike in market volatility and thereby threw the IPO window shut.

Additionally, we also observed that the MSCI World Index performed better when the VIX was lower, and its performance declined as the VIX rose. This rise and decrease in equity valuations impact the attractiveness of

Market volatility and global IPO activity



Market conditions and impact on global IPO activity (Source: Dealogic and CBOE) undertaking an IPO, as it affects the amount of money that can be raised with issuing a same number of shares.

We also noted that one-time events have the biggest impact on IPO activity. One-time events create immediate uncertainty, leading to a sudden risk-off (or risk-on) stance by investors; for example, they sell their equity investments to avoid holding a position above a new fair market value. This universal reaction causes a strong uptick in selling (or buying), which directly increases equity market volatility in the short-term. The inability to determine a new fair market value also closes the IPO window.

However, in the medium- to long-term, investors have had time to process the impact of the one-off event. Hence, they are able to determine a new fair market value for their holdings. This will re-open the IPO window.

Thus, markets tend to re-stabilize themselves from the short-term impact of these events.

Depending on the time horizon, different macroeconomic factors play a critical role in the level of IPO activity

Our study shows inflation to be the leading macroeconomic factor driving IPO activity in the short-term, as it impacts expectations of where interest rates will go, and thereby equity valuations. We expect actual interest rates to have a medium-term impact on IPO activity, as the impact thereof is not immediately visible. The rise in interest rates decreases the attractiveness of equity markets against bond markets for investors, as the yield on newly issued debt increases. From a company perspective however, the rise in interest rates makes debt financing more expensive. However, equity financing has also become more expensive, as a rise in interest rates causes equity market valuations to come down. Thus, aside from idiosyncratic factors, a company's financing decisions will be based on the relative impact of interest rates on equity markets and bond markets. Finally, a rise in interest rates increases the expectation of a recession, which depresses both equity and debt markets.

In the long-term, actual real GDP growth rates and regulatory changes also have an impact on IPO activity. Real GDP growth rates reflect company activity. Thus, the more activity there is, the more financing will be required, be it equity or debt financing. The correlation of GDP growth on companies' financing requirements is positive and we can expect to see a decline in IPO activity if the recession bites hard and GDP declines. Similarly, regulatory changes do not consistently impact IPO activity in the immediate short-term due to their transitionary nature. However, as regulations become implemented so their impact on IPO activity becomes more evident in the longer-term.

For now, the IPO outlook remains sluggish as the equity markets experience a bumpy year

As the current market slowdown is still unfolding, the factors discussed above continue to affect the current IPO market and the outlook for the near future. The IPO outlook for 2023 depends largely on the development of inflation; a slowdown in inflation will decrease the required rise in interest rates and the associated decrease in attractiveness of equity markets, which may cause IPO activity to pick up in H2 2023 and gradually cause the IPO window to open in H1 2024, with traditional IPO activity to open in the course of 2024. Yet a few large IPOs may need to take place before IPO activity can fully resume.

Thus, while the outlook for IPOs looks weak in the short-term, we noted that the need for equity financing remains as important as ever and will lead to IPO activity being postponed rather than permanently cancelled. Thus, in the mid- to long-term, IPOs will remain an attractive option for companies to access capital as investors will look to create alpha in their portfolios and on their investment returns. Moreover, there is still a robust pipeline of IPO-ready companies primed to access public markets.

Finally, five main factors will drive the attractiveness of IPO activity in the near future:

1. **Development of inflation:** a decrease in inflation to normal levels will create expectations that the rise in interest rates can slow down, or that rates could even fall, which would increase equity valuations.
2. **Relative levels of company valuations:** valuations have fallen in both public and private markets. Ultimately, the extent of this fall will determine what market remains the most attractive.
3. **Availability of funds:** there is still an abundance of capital in the system for both corporate and PE firms to fund deal activities. And as volatility keeps putting a brake on IPO activity, alternative sources of capital or transactions may be more likely in the short-term, including PE suitors.
4. **Interest rates and cost of borrowing:** recent interest rate hikes have made both equity (through a decrease in equity valuations) and debt financing more expensive for companies. The relative increase in costs in both markets will determine how attractive a market remains compared to the other. Furthermore, higher interest rates would make leveraged buyouts unattractive as internal rates of return (IRR) drop below the PEs required targets. This will decrease the ability of PE firms to do (larger) deals.
5. **Company-specific factors:** IPOs that are likely to happen in the immediate short-term are anticipated to be companies that are either too big to sell in a private M&A transaction, are IPOs resulting from spin-offs and therefore less sensitive to valuations, are companies with a unique equity story, or finally companies with strong cash flows in the short-term.

Basis of preparation

Data for the IPO activity in this report is derived from data provided under license by Dealogic. Dealogic retains and reserves all rights in such licensed data. Data in this report is based on the pricing (or completion) date on the stock exchanges in the selected markets in Europe between 1 January 2000 and 31 December 2022. Only completed transactions with a minimum of €5 million raised have been included. Transaction proceeds include the overallotment option (if exercised). In case IPOs took place on two or more exchanges, the full amount of money raised was attributed to all exchanges.

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