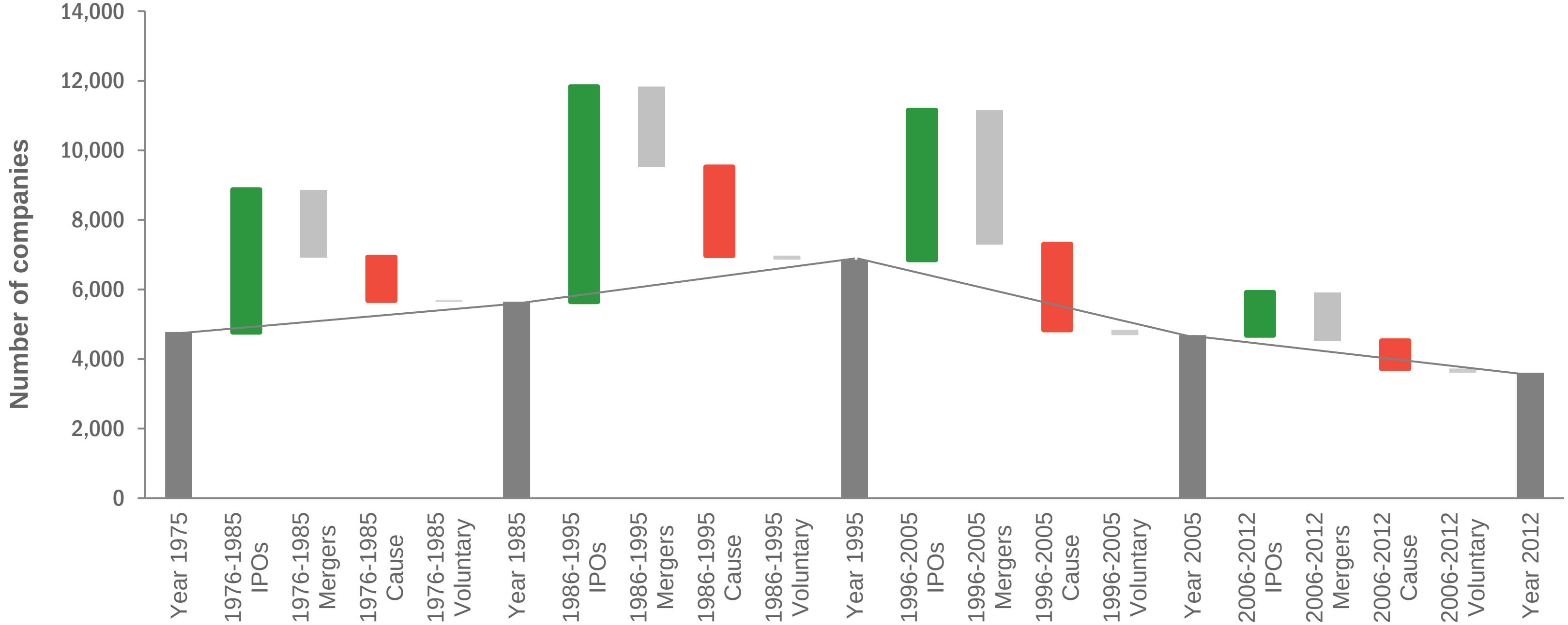
Why are more companies staying private?

Meeting of SEC Advisory Committee on small and emerging companies

15 February 2017

Building a better working world

Public listings are on the decline since mid-1990s

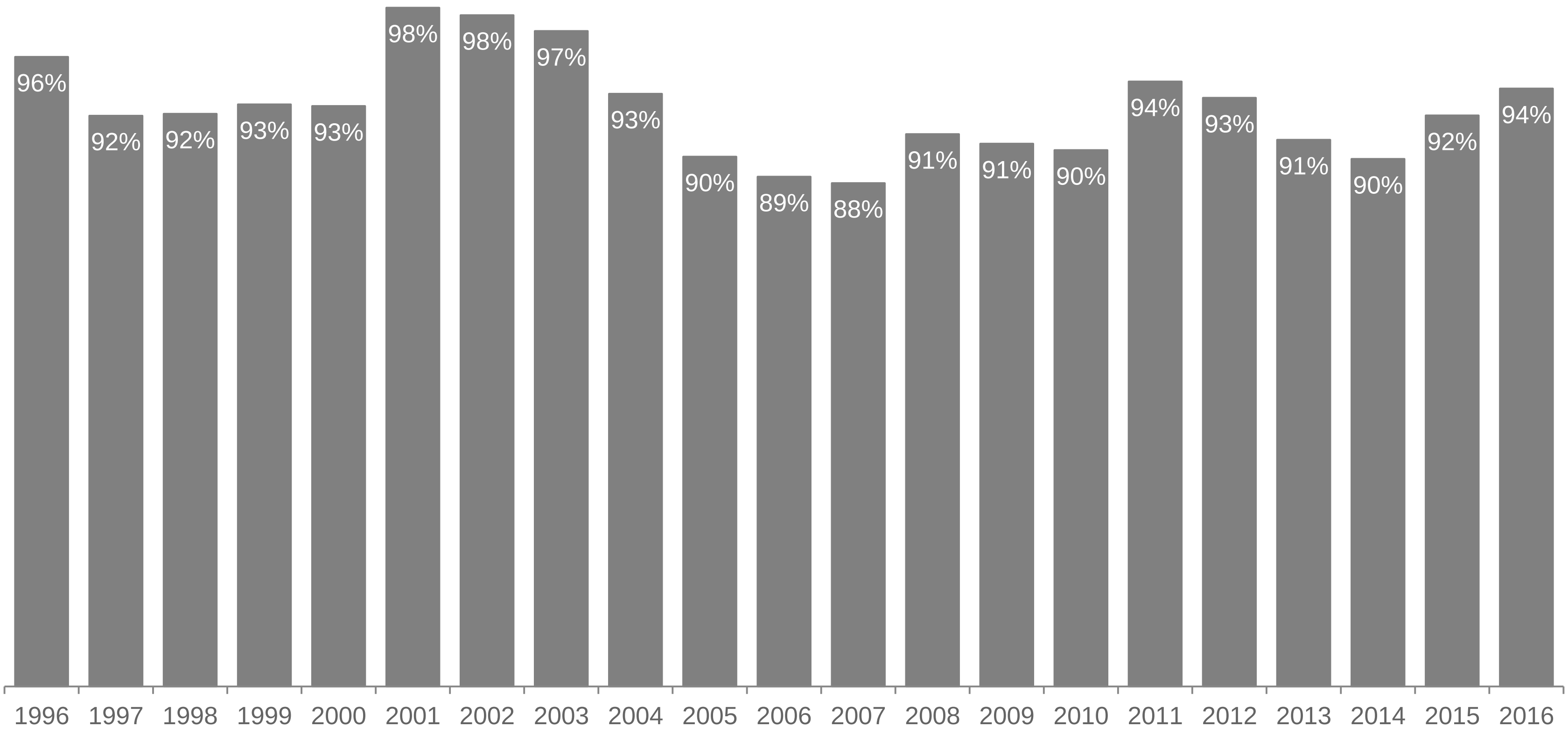


Source: Craig Doidge (Rotman School of Management at the University of Toronto), G. Andrew Karolyi (Johnson Graduate School of Management at Cornell University), and Rene M. Stulz (Fisher School of Business at The Ohio State University), "The U.S. listing gap," *The National Bureau of Economic Reseearch*, May 2015, © 2015, NBER. Data include US domestic companies listed on NYSE and NASDAQ excluding investment funds and trusts.

- The number of public companies has decreased by more than 50% since the 1996 peak. This decline is mainly due to M&A activity among public companies and delistings for cause (noncompliance) offset by IPO activity.
- Over this period, very few companies voluntarily went private.
- Delistings for cause have decreased since 2005 which suggests that higher listing requirements and SOX reforms have had an effect on the quality and sustainability of listed companies.

More than 90% of IPOs listed on domestic exchange
Trend continues; 6% of global 2016 IPOs were cross-border listings

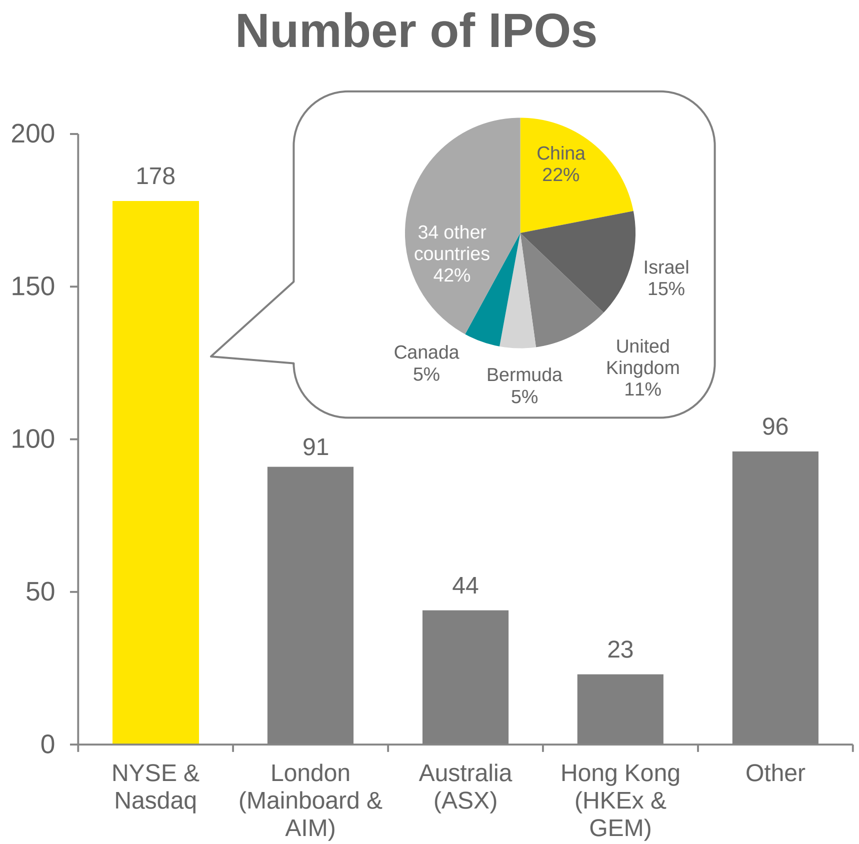
1996–2016 domestic IPOs as percentage of annual global IPOs

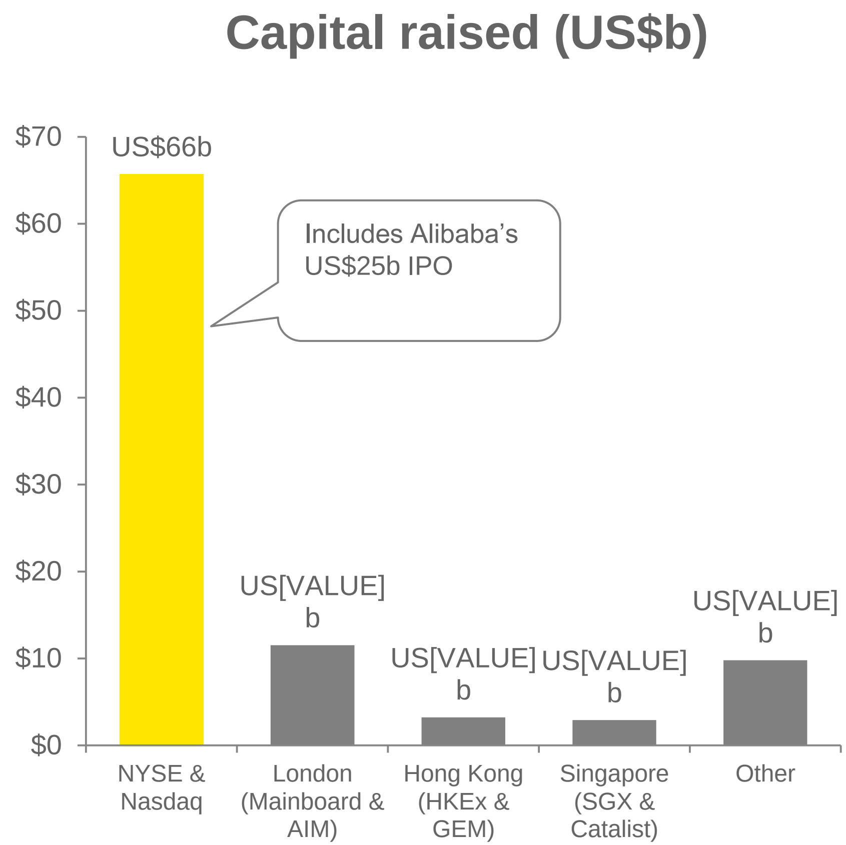


A foreign listing is where the domicile of the primary exchange (or the secondary exchange for dual listings) differs from the listed company domicile. For dual listings, all funds are allocated to the primary stock exchange. Deals by Chinese companies on HKEx are not considered foreign listings.
Sources: Dealogic, Thomson Financial, EY research.

From 2012 to 2016, US exchanges were the preferred markets for cross-border listings

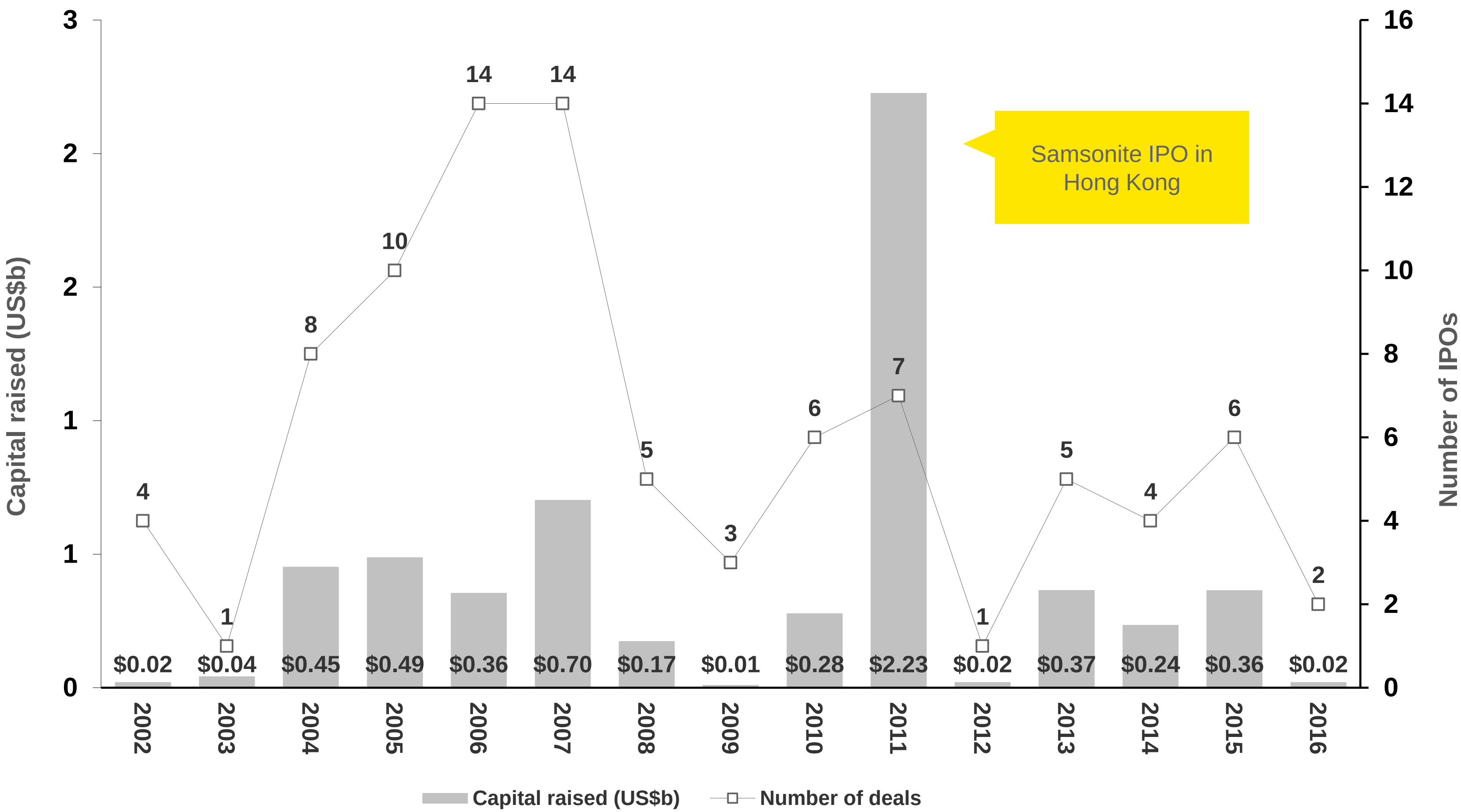
2012–2016 top stock exchanges for cross-border listings





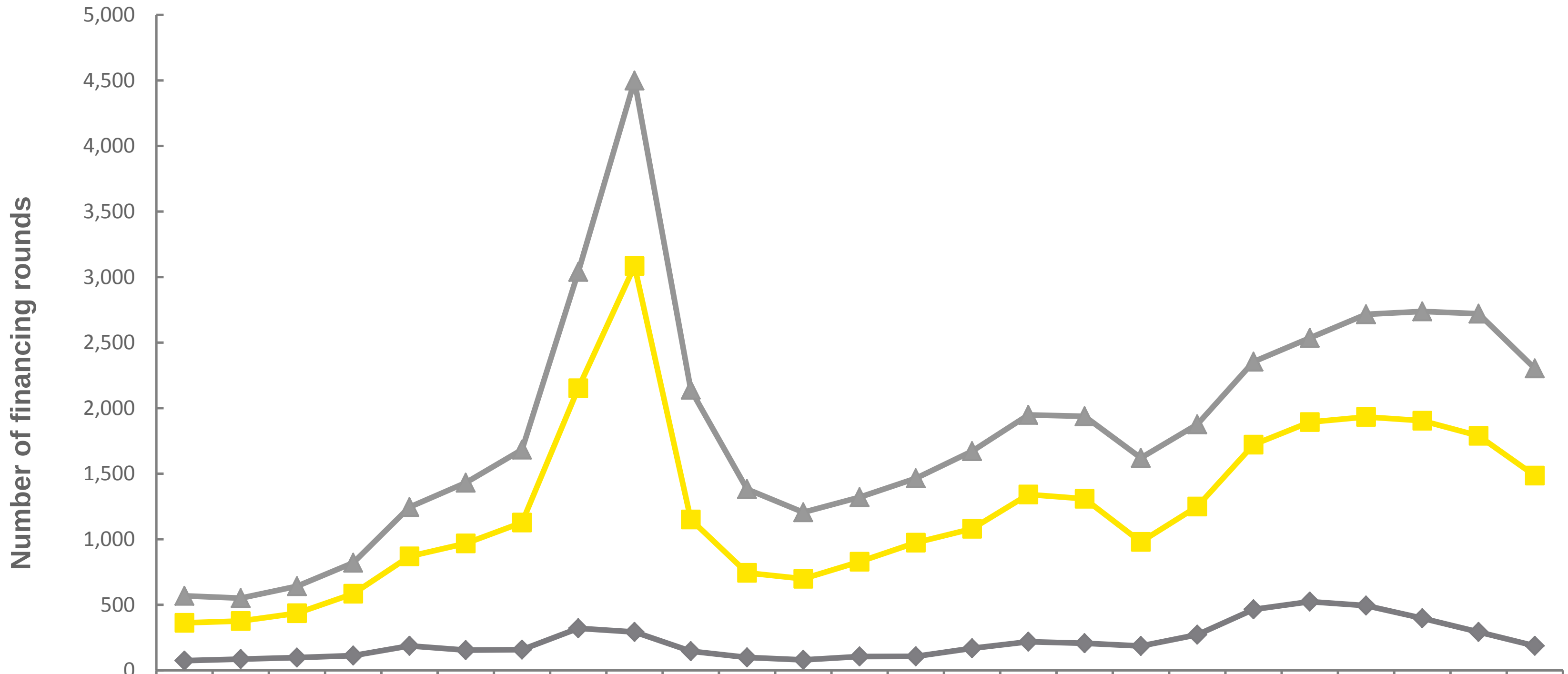
A foreign listing is where the domicile of the primary exchange (or the secondary exchange for dual listings) differs from the listed company domicile. For dual listings, all funds are allocated to the primary stock exchange. Deals by Chinese companies on HKEx are not considered foreign listings.
Sources: Dealogic, EY research.

And very few US companies are listing abroad



Based on IPO activity on non-US exchanges by US domiciled companies, excluding dual listings
Source: Dealogic

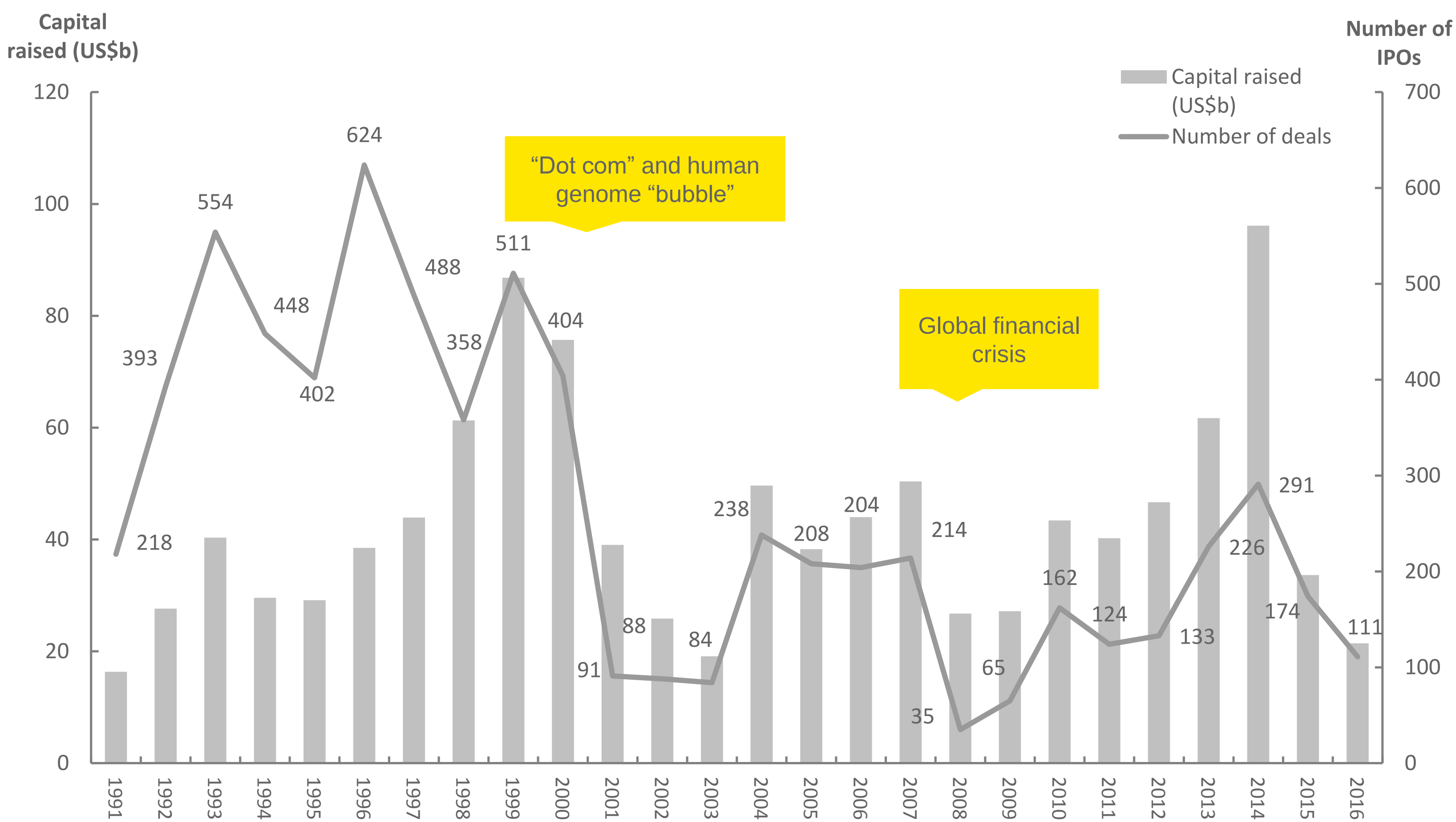
There has been an upward trend in VC-backed company formations ...



	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Second round	206	175	206	235	376	463	556	887	1,414	989	638	507	492	491	592	606	629	640	626	632	642	783	834	932	817
First round	288	290	339	473	682	814	969	1,832	2,792	1,005	646	618	724	867	912	1,124	1,103	794	978	1,257	1,370	1,439	1,507	1,497	1,299
Seed	74	86	97	112	187	154	158	320	293	146	98	80	105	107	168	218	206	186	272	465	524	494	397	292	187
Total	568	551	642	820	1,245	1,431	1,683	3039	4,499	2,140	1,382	1,205	1,321	1,465	1,672	1,948	1,938	1,620	1,876	2,354	2,536	2,716	2,738	2,721	2,303

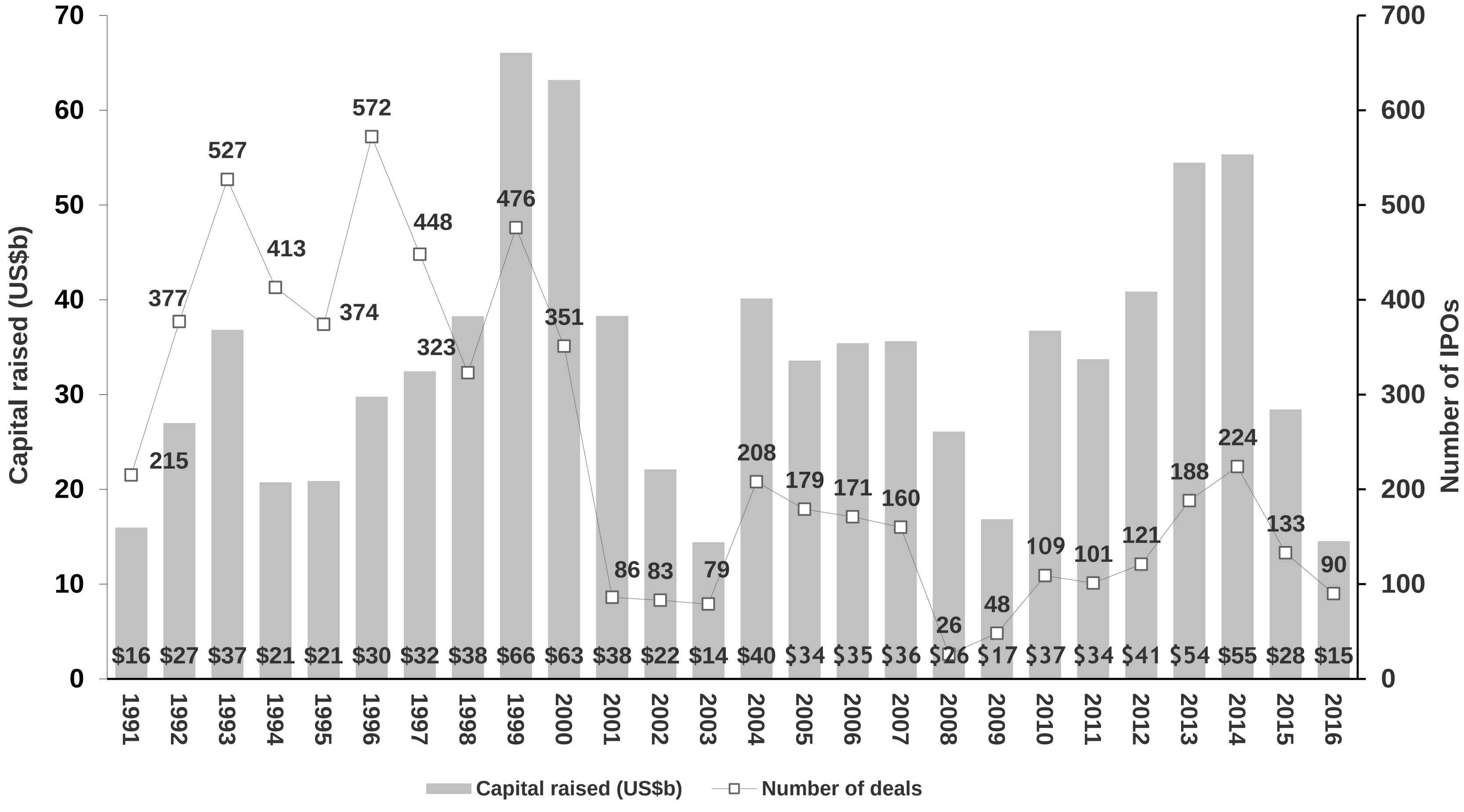
Venture capital includes all investments made by venture capitalists or venture capital-type investors, i.e., those making equity investments in early-stage companies from a fund with multiple limited partners.
Source: Dow Jones VentureSource.

... however, IPOs have not kept pace



Based on IPO activity on US exchanges including cross-border deals, excludes special purpose acquisition companies (SPACs) and business development companies (BDCs).
Sources: Dealogic and EY Analysis.

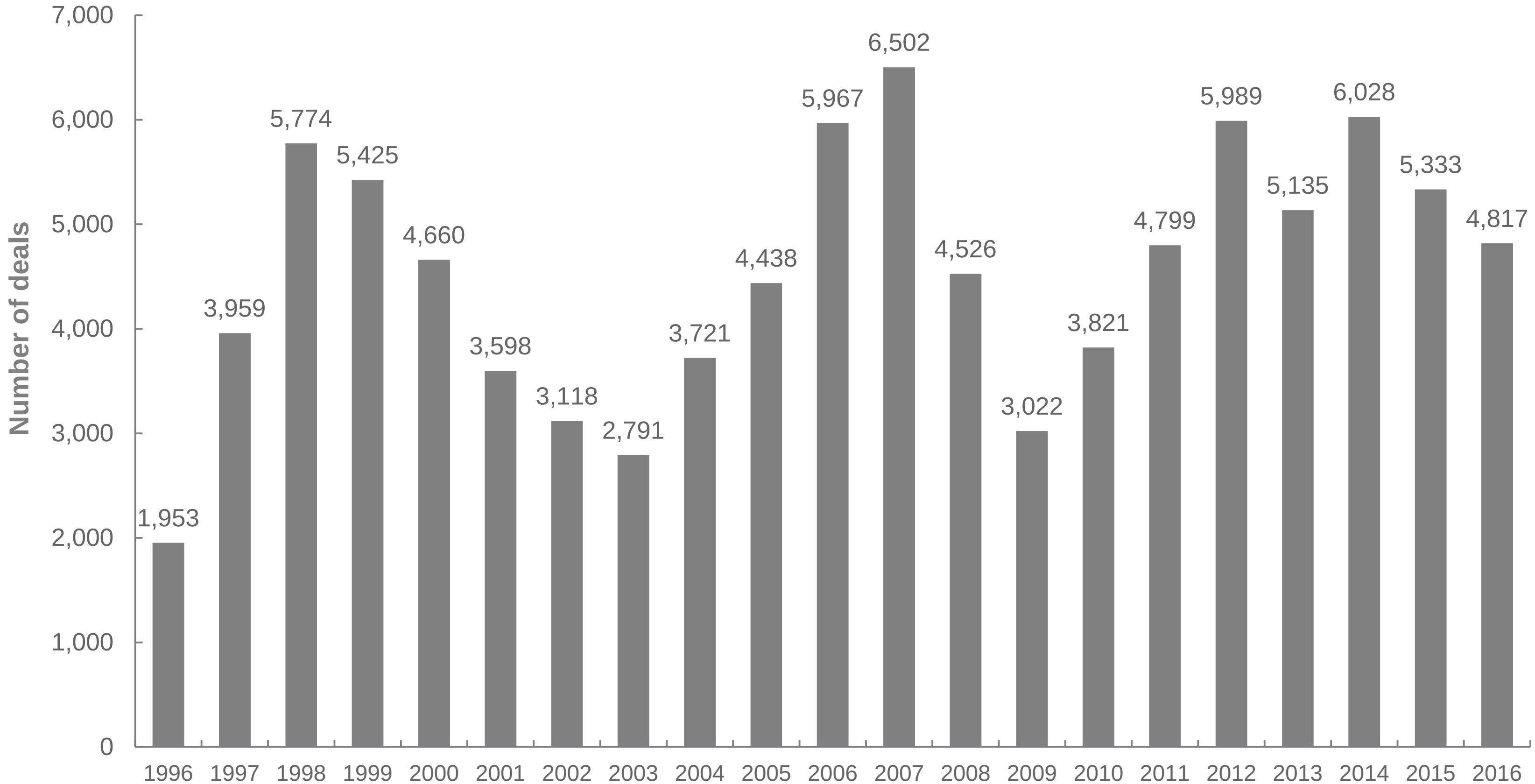
US IPO listings by US domiciled companies



Based on IPO activity on US exchanges by US domiciled companies, excludes special purpose acquisition companies (SPACs) and business development companies (BDCs).
Source: Dealogic

EY

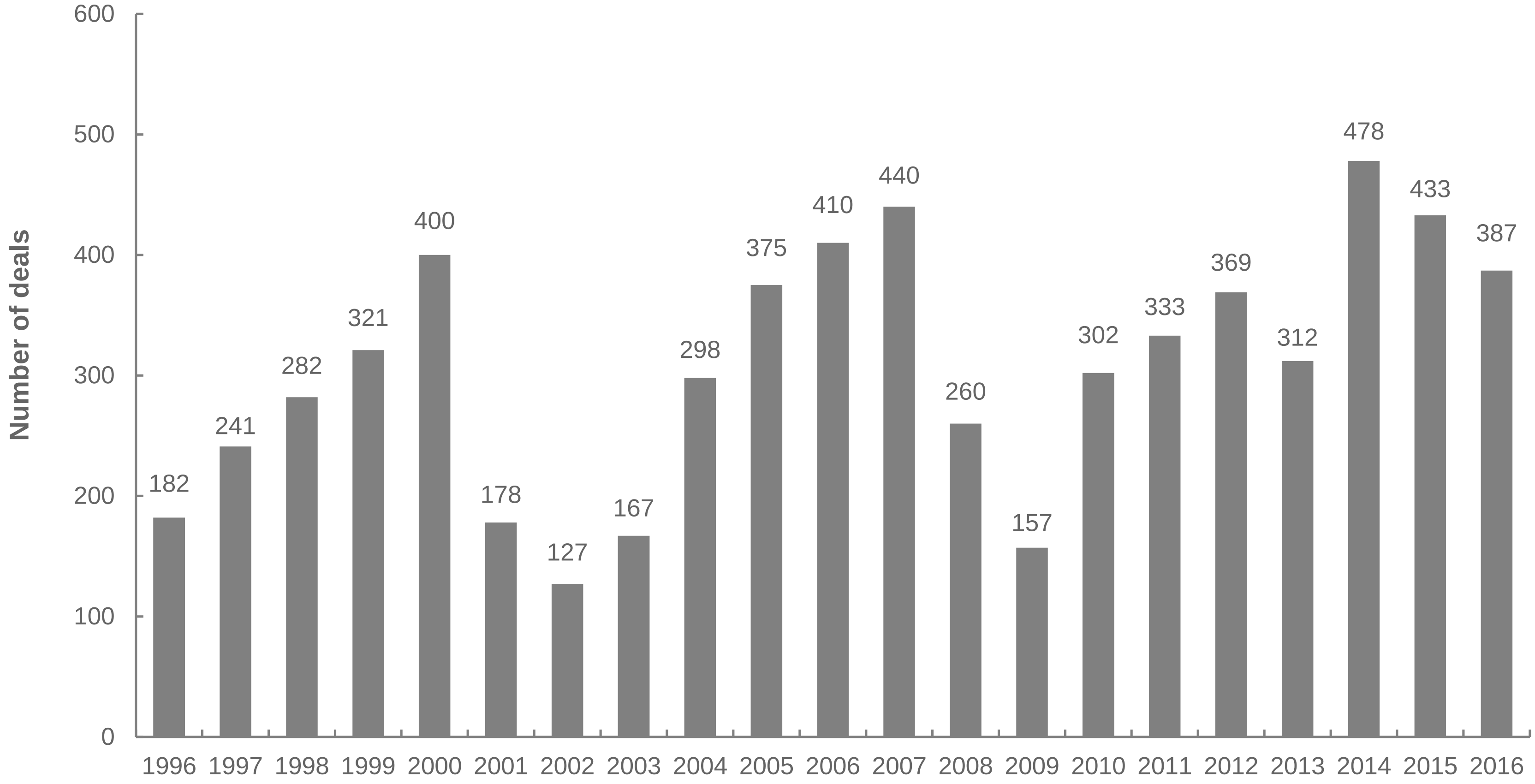
Acquisitions of US private companies remain robust



Sources: Dealogic and EY Analysis.

Dual-track exit strategies remain common

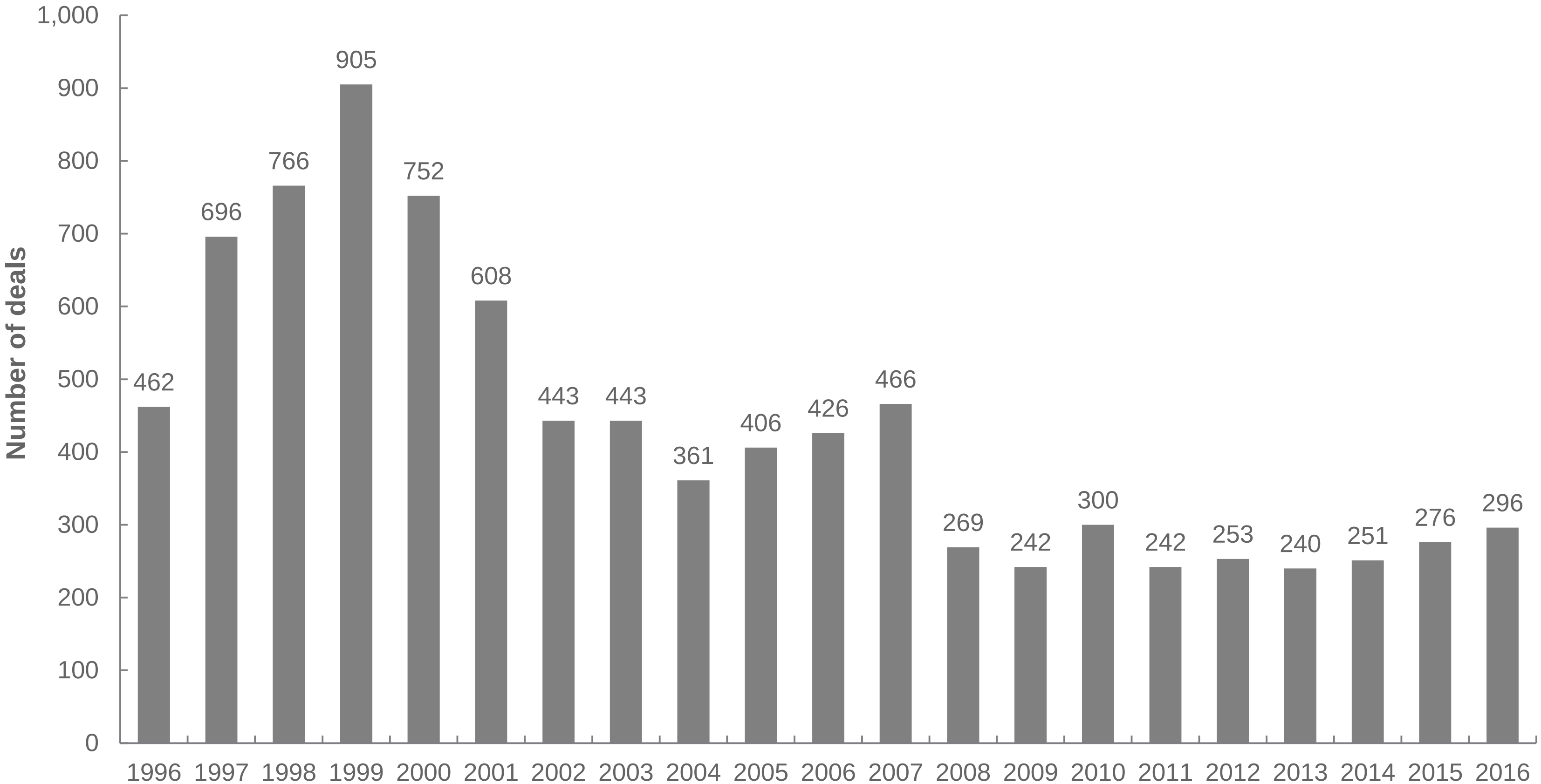
Acquisitions of US private companies with values >US$100m



Sources: Dealogic and EY Analysis.

EY

Acquisitions of US publicly traded companies have fallen along with the number of public companies



Sources: Dealogic and EY Analysis.

Why are more companies staying private?
In short: ‘Because they can’

Why go public?

- Access source of (typically) lower cost capital
- Currency for acquisitions
- Shareholder risk diversification (especially true in biotech)
- Liquidity for founders, investors and employees
- Brand identity

Why stay private?

- Increased availability of private capital: larger amounts, from different pools at higher valuations
- More disclosure equals potential loss of competitive advantage
- More operating flexibility: short-term mentality of public investors and activists
- Regulatory burden and risk
- Other: class-action lawsuits, short sellers, proxy fights, lack of analyst coverage, etc.

Factors that may explain why companies stay private longer

- Venture capital, private equity (PE) firms and sovereign funds have substantially increased available capital to invest and are struggling to invest the money they raise. PE exits are more likely to be strategic sales rather than IPOs.
  - McKinsey showed in a recent study that the capital invested in private tech companies grew from US$11b in 2005 to US$75b in 2015 and almost tripled from 2013 to 2015.
  - Uber was able to raise more than US$8b from PE firms and sovereign funds and US$3b of private debt over 7 years whereas Facebook “only” raised US$2.4b of private equity over the same period of time a few years before.

- Interest rates are at an all-time low, which provides private companies with opportunities for direct financing at a low-cost (through debt) and provides strategic buyers with low cost capital to acquire private and smaller public companies.

Factors that may explain why companies stay private longer

- Light-asset models: with the digital transformation, start-up companies' business models require less capital than the old industrial economy, which reduces the need to seek public funding.

- The JOBS Act of 2012 increased the accredited investor limit for registering with the SEC from 500 to 2,000 and excluded employees receiving exempt equity awards. This change allows private companies, especially in the tech industry, to remain private longer, as long as their financing needs can be otherwise covered through private debt and PE capital.
  - Google and Facebook decided to undertake their IPO process when they reached the 500 investor limit.

- Decimalization, tick size changes, reduced availability of analyst coverage and related effects on trading profitability reduce the incentive of intermediaries to take small, private companies public. Public investors have a preference for larger deals with more public float/liquidity.

EY

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the US.

1702-2193591
ED None

ey.com