Lessons for the IPO class of 2023 & 2024

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Introduction

"What lessons should the IPO class of 2023 and 2024 learn from the 2021 intake and most importantly what actions should they be taking now in preparation for the next wave?

Much has already been written about the IPO class of 2021, and yes many share prices are deeply underwater but was IPO orthodoxy really thrown aside in the stampede to float or has this cohort been unfairly classed as failing?

Thank you to all of the advisers, brokers, analysts and fund managers who contributed to this report. Your support is always greatly appreciated and never taken for granted."

Mark Reed *(founder of M7 Communications)*

Misfits or misunderstood

The UK IPO class of 2021 has certainly gained a well-documented reputation. Profit warnings, collapsing share prices and even a bankruptcy within their intake have all been used to trash the reputation of the entire year group and indeed raise questions about the effectiveness of the IPO process itself. There is a widely held belief and fear in the City that the legacy of the class of 2021 will loom long and large in the minds of burned fund managers and will ultimately delay the time and pace of the much needed re-opening of the IPO market.

But are we all collectively guilty of viewing them through the same narrow, singular lens? A less reported fact is that of the main market IPOs in 2021, excluding special purpose and acquisition vehicles and investment trusts, almost 80% met or exceeded market expectations in their first year as a listed company, including high profile consumer facing stocks Deliveroo, Trustpilot and Moonpig as well as tech stocks such as Darktrace and Alphawave IP.

It is certainly true that the stars aligned in early 2021 for an IPO stampede fuelled by a wall of cheap money, which was propping up consumer spending as well as driving up asset prices. Punchy company valuations encouraged founders to list, whilst fund

managers who were struggling to deliver outperformance from a shrinking pool of largely, fully valued, mature stocks, needed the alpha that IPOs can and should deliver. Analysts, brokers and indeed PR advisors played their part, supporting the argument that Covid had accelerated the structural and permanent shift to an online world of shopping and work, providing a limitless, upwards only growth curve for companies at the vanguard of this transition.

This report looks beyond the headlines, drilling down into the data to assess the quality and performance of the Class of 2021 to determine whether its reputation is well deserved or an unfair mischaracterisation. We look to identify the common threads running through both the out-performers and the under-achievers and understand the key lessons for the next wave of IPO applicants. The report concludes with practical and actionable advice for those looking to be in the IPO class of 2023 and 2024.

Executive summary

Not guilty

Undeniably there has been some quite spectacular individual company implosions in this cohort but as a collective the UK IPO class of 2021 looks unfairly treated, caught up in the wider market turmoil and global de-rating that followed the invasion of Ukraine and surging inflation. Judged purely on the factors within their control, **almost 80% of 2021 main market listings actually met or exceeded their full year expectations.** Furthermore as a collective, 2021 IPOs, which on average were down 26% by 31 December 2022 from their float price, outperformed both the broader AIM market (-32%) and Nasdaq (-27%) indices over the same time period, though falling short of the FTSE All-share index (+3%), which was bolstered by its exposure to energy stocks.

Performance by sector is illuminating. Three of the five best performing main market IPOs in 2021 were in the tech sector. **Ecommerce operators – MADE, Seraphine, In the Style, musicMagpie and Parsley Box - accounted for all five members of the -90% club** across AIM and the main market. Covid's impact on ecommerce operators is mainly seen in unrealistic future growth expectations, which assumed that the accelerated transition to online was permanent and irreversible, rather than in historic 2020 financials, which look broadly consistent with pre-Covid trends.

The macro-economic backdrop, which was pointing upwards in the spring of 2021, but subsequently nosedived, as evidenced by **consumer confidence declining to record levels (-41 in December 2022 according to data provider Gfk), is arguably the main driving factor of the poor performance of many, but not all ecommerce stocks**. Even the most agile of consumer stocks were not immune from this powerful, cyclical downturn.

Profit replaced growth as the key focus of most private company scale-ups and not just because of the need to extend cash runways, but its importance in an IPO is less clear and arguably overstated. There are only two main market 2021 IPOs still in the money – Darktrace and Auction Technology – and neither were profitable prior to listing, whilst two of the worst performing stocks - Seraphine and ProCook - both reported a three year profit track record prior to IPO.

The future challenge

We are more optimistic in the timing of the re-opening of the IPO market than many, given the symbiotic relationship that exists between fund managers and companies and the realignment in valuation expectations that has already played out in both public and private markets. But **the next IPO class will undoubtedly face a more selective and demanding investor audience, combined with a more challenging, non-linear backdrop in**

which to demonstrate a proven business model. Three year historic financials in a 2023 IPO would cover 2020, 2021 and 2022; two years of Covid and a cost of living crisis.

For some sectors, including tech a proven business model may mean patented IP or annual recurring revenues (ARR), although **for ecommerce, profitability, despite its limitations as an indicator of post listing performance is likely to be a prerequisite for a future IPO.** Furthermore to obtain any value for international operations we would expect they too will have to demonstrate profitability at listing.

Six action points for the IPO class of 2023 and 2024

Our detailed analysis in Chapter 2 of common themes and red flags in the class of 2021 reinforces our belief that **there is no singular magic formula for a successful IPO.** We do however believe that a two year run way is optimal to best communicate your external message, and internally have the executive team, infrastructure and reporting systems in place to cope with the pressures of an IPO process.

In Chapter 3 of this report we set-out our six key action points that companies contemplating an IPO should be executing on now. From an external perspective we argue that **a 100 page plus IPO prospectus is a poor sales document** and there is a need to first warm-up the market, with business comms across key targeted media.

From an external comms perspective in the two years prior to an IPO we recommend:

Dedicate a section of the company website for disclosure of comprehensive corporate/financial information
-about us sections on company websites are typically wholly inadequate

Use of half yearly reporting
-need to start acting like a plc in waiting

Early agreement of segmental reporting and KPIs
-to be used across external comms

Internally in the two years ahead of IPO we recommend:

Upscaling the size and quality of the finance team and their systems
-IPOs can and do fail owing to a lack of internal resource
-Need to ensure long term growth forecasts are based on sound foundations

Appoint the Board and resolve any corporate governance issues early
-Two years ahead of IPO for CEO and CFO and one year for the chairman
-74% of main market listings met this target for CEO and CFO – 42% for chairmen

Appoint auditors two years in advance of listing
-Failure to do this is a significant red flag for many investors
-Risks not being able to demonstrate clean historics

Headline performance looks dismal

The frustration of investors is clear to see when you look at the headline data below. Chart one shows that one pound invested equally across the entire IPO class of 2021, covering AIM and the main market would at the 31 December 2022 be worth just 74p, before accounting for dividends. Further analysis shows investors have lost money in three quarters of 2021 IPOs, with only one in four still in the money. In five companies investors have all but been wiped out, suffering losses in excess of 90% (the -90% club).

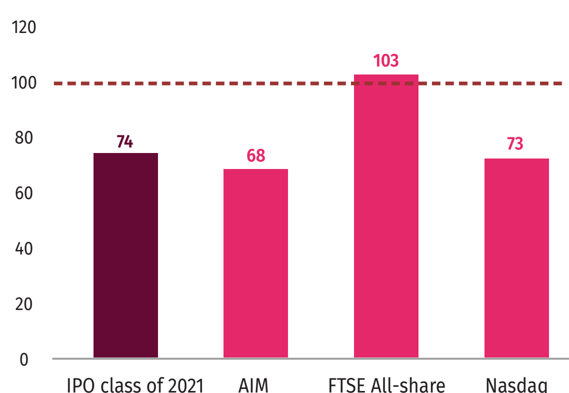


Chart 1: Value in pence at 31 December 2022 of a £1 investment in the IPO class of 2021 benchmarked against market indices

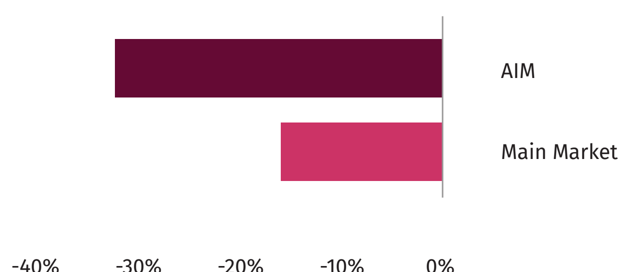


Chart 2: Share price performance of IPO class of 2021 by market at 31 December 2022

40% of 2021 IPOs more than halved in value
5% of 2021 IPOs lost more than 90% in value
Only 1 in 4 2021 IPOs are in the money

Context is key

Geopolitical tensions, surging inflation, rising interest rates and fears of recession spooked global markets, causing a de-rating across sectors and equity markets. This is also evident in chart 1 which compares the IPO performance with the movement in comparable leading indexes over the same time period, taking the starting point for the index benchmarking as 30 June 2021, through to 31 December 2022.

Overall the IPO class of 2021 has performed better than the AIM market and in-line with the technology led Nasdaq, which does suggest that criticism has been overdone. The relative strong performance of the FT All-share index, which is actually up some 3% is largely explained by its sizeable exposure to in-demand energy stocks.

Chart 2 highlights a large divergence in IPO performance between markets, with those companies listing on AIM faring twice as poorly as those opting for a main market listing; AIM IPOs falling by an average 32%, compared to 16% on the main market. To some degree this is to be expected given that AIM is typically associated with higher risk, earlier stage companies but the extent of the differential is surprising.

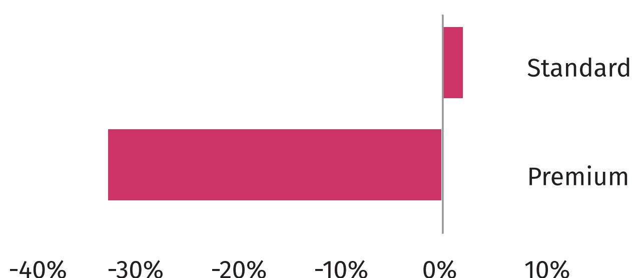
IPOs are expected to generate a higher return than those companies already listed, essentially to compensate investors for their higher risk. However, the fact that the average AIM IPO performed in-line with the broader AIM index does negate much of the criticism levied at the class as a whole.

Not so premium after all

Conventional wisdom, reflected in the London Stock Exchange's own Main Market Listing report, is that premium listings are lower risk and as such have access to a broader range of investors at a lower cost of capital; a premium listing requires meeting higher standards 'over and above' those set forth in EU legislation, including the UK's corporate governance code. However, the analysis in chart 3 highlights quite the opposite, with premium listings down an average of 32% over the period, compared to an average 2% increase for standard listings.

The data for standard listings is materially distorted by a strong performance of a handful of tiny acquisition vehicles. However, there is no disputing the fact that premium listings make up more than half the members of the -50% club and two of the members of the -90% club.

Chart 3: IPO performance of premium and standard main market listings



Ecommerce and tech are chalk and cheese judging by performance alone

An analysis of performance by sector is revealing. Technology stocks, which under our definition excluded ecommerce operators, accounted for three of the five best performing main market IPOs. In stark contrast all five members of the -90% club across the main market and AIM were in ecommerce; Parsley Box, In the Style, musicMagpie, Serpahine and MADE, the latter entering administration in November 2022. There but for the grace of an AIM market suspension for failing to publish its audited final results on time, lays a sixth ecommerce 2021 IPO, Revolution Beauty, whose shares were down 88% before trading was temporarily halted at the start of September 2022.

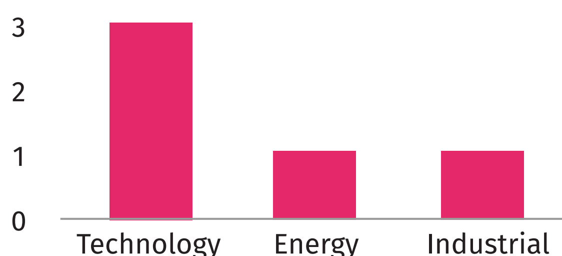


Chart 4: Top five performing main market IPOs by sector

Chart 5: Members of the -90% club by sector (main market and AIM)

Chapter 2: Common themes and red flags

Looking beyond sector and market it is instructive to analyse the position of companies ahead of their listings to identify the common threads running through the out-performers and indeed, any consistent red flags pervading through the under-achievers. We focused our detailed analysis on the main market IPOs in 2021 in order to validate or refute the widely held proposition that many companies were rushed to market in 2021, with unproven business models and performance temporarily boosted by Covid. We excluded special purpose and acquisition vehicles from our analysis, given their typical lack of any meaningful trading history and investment trusts, leaving us with 19 IPOs to analyse. On average the share price of these 19 stocks was down a massive 55% since IPO.

Profitability

Of the 2 main market IPOs still in the money, neither were profitable prior to listing

Profitability is arguably the most important metric to determine whether a company's business model is proven or not. Chart 6 shows that of the 19 main market IPOs just under 50% were profitable in the year prior to listing, which does on the face of it support the view that many of the class of 2021 were not ready to list. This is reinforced in chart 7, which shows that 64% of the worst performing shares, defined as those where the share price has fallen over 50% (the -50% club), were loss making in the year prior to listing.

It is also clear however that a track record of profitability is no guarantor of a successful IPO or indeed much of an indicator as to its post listing share price performance. Yes it is true that MADE hadn't reached profitability prior to listing but equally Seraphine, down over 90% and ProCook down over 80%, both had a three year track record of profitability prior to listing. This is also not a phenomena limited to just ecommerce either; technology stock Alphawave IP had a three year track record of profitability prior to listing and its shares are also down over 50% since IPO. On the flip side Darktrace was loss making prior to IPO and it is one of only two companies whose share price remains above its float price.

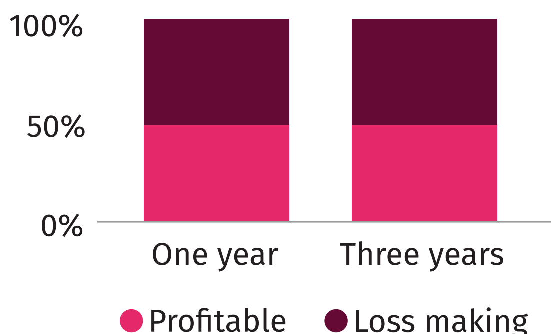


Chart 6: Percentage of main market 2021 IPOs with a profit track record prior to listing

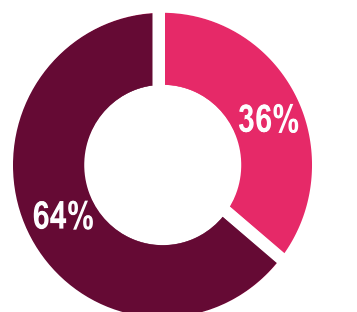


Chart 7: Percentage of main market 2021 IPOs where the share price is down 50% with a profit track record prior to listing

Cash maybe King but not all Kings perform

3 of the -90% club reported positive cash generation in the year prior to IPO

Cash generation is less subjective than profitability and accordingly an important measure of the success of any business model. Over 70% of main market IPOs reported positive cashflow in the year prior to listing, which is more than the number of companies reporting a profit (chart 8). However, like profit, it looks to be a poor indicator of future share price performance, with 64% of the -50% club reporting positive cash generation in the year prior to IPO. Indeed, two companies reporting a three year track record of positive cash generation are members of the -90% club.

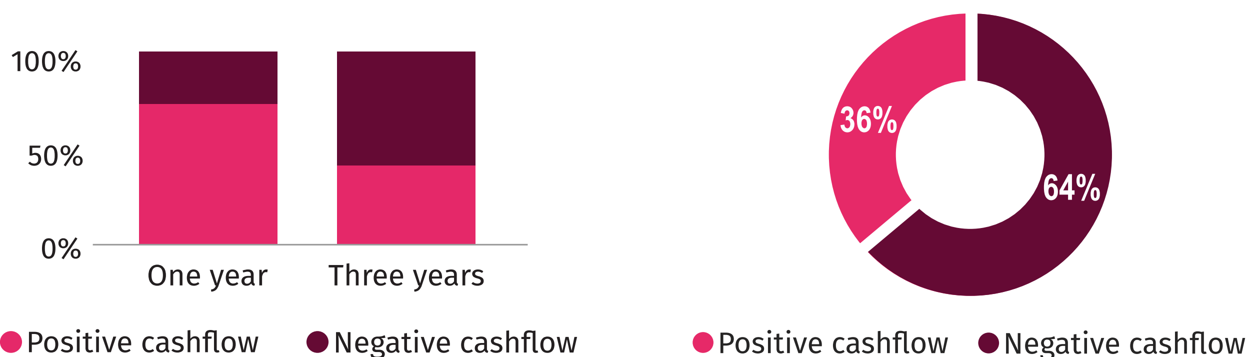


Chart 8: Percentage of main market 2021 IPOs with a positive cash generation track record prior to listing

Chart 9: Percentage of main market 2021 IPOs where the share price is down 50% with positive cash generation prior to listing

Covid winners

0 main market ecommerce IPOs look to have Covid inflated revenues prior to listing

An analysis of main market IPOs does not support the view that the class of 2021 was packed full of Covid winners. The reported sales growth rates for consumer IPOs including Moonpig, Dr Martens, MADE, Seraphine and ProCook were not materially higher (benchmark +25% differential) in the year prior to listing than the rate of growth achieved in the previous year, before the onslaught of Covid. Taking MADE as an example, its rate of annual revenue growth was actually lower, reporting 16% growth for the year ended 31 December 2020, compared with 22% in the previous year. Whilst many of the technology IPOs including Pod Point, Alphawave IP and Auction Technologies did show an accelerated growth rate in the last year prior to listing this looks to be more reflective of their respective long term demand trends rather than a temporary Covid boost.

Management tenure

Over 60% of the -50% club had their CEO and CFO in situ for at least 2 years

Everything else being equal the length of tenure of the CEO and CFO prior to IPO provides confidence in the strategy and the team's ability to deliver it. We looked for management teams where the CEO and CFO had both been in situ for at least two years prior to the IPO. We also looked at the tenure of the chairman prior to IPO, looking for a tenure of at least one year prior to listing. Almost three quarters of companies had their executive team in place for at least two years prior to listing, again not supporting the view that companies were ill prepared for IPO. Even when looking at the -50% club, over 60% had their executive management team in place for at least two years prior to listing. The majority of chairman still look to be parachuted in prior to IPO, with less than half in situ for at least one year prior to listing, although again there looks to be limited correlation with post IPO performance.

74% of companies had their CEO and CFO in situ for at least two years prior to IPO

Only 42% of companies had their chairman in situ at least one year prior to IPO

Auditors

64% of main market IPOs had their auditors in place for at least two years prior to listing

There is a widely held view within the investment community that the reporting accountants on a listing should be in place for at least two audits prior to an IPO, in order to provide the greatest confidence in the accuracy and completeness of the financials and KPIs detailed in the Prospectus. For some fund managers not having auditors appointed for at least two years prior to an IPO is a red flag. However, with auditors only opining on past performance, it is perhaps not surprising that this does not appear to be an accurate predictor of future share price performance. Companies including MADE, Deliveroo and Moonpig, whose shares are all members of the -50% club all had their auditors in place for at least two years prior to listing. On the flip side ProCook and Seraphine whose shares have both fallen over 90% did not.

Chapter 3: Prep for the IPO class of 2023 and 2024

The two key challenges facing the next class

Over and above a realignment in valuation expectations, which already looks to have played out in both listed markets and recent private company funding rounds, we see two key challenges facing the next IPO class.

1. A more demanding investor audience

Notwithstanding the broader market context, many fund managers have been badly burned by the performance of high profile 2021 IPOs. There is however a deep seated symbiotic relationship between fund managers and IPO candidates, with the former needing the alpha that the later can and should provide and the later needing the access to capital which the former provides. This mutuality will ensure the IPO market re-opens. But memories last long and when the re-opening does occur we expect fund managers to be more selective and demanding; the bar will have been raised.

2. Harder to evidence a proven business model in a non-linear world

At the same time as the bar is being raised, demonstrating the necessary performance will become more difficult. A prospectus typically contains a company's three year financials and KPIs prior to listing. For those listing in 2023 this will cover the period 2020, 2021 and 2022; two years impacted by Covid and one by the cost of living crisis. Holding off an IPO until 2024 doesn't make a listing any easier, requiring disclosure of 2023 financials; a year likely to be mired by recession. Voluntarily providing a longer historic record if a company had the data, say five years to go back pre-Covid could be part of the solution, though greater weight will inevitably be given to performance in the most recent years.

Company valuations at listing are based on projected future earnings, which are in themselves predicated on past performance. Few companies will be able to show the linear, upward only growth curve in their three year historic financials that fund managers have grown to expect. This is not just the case for consumer facing businesses, but many B2B companies will also have been materially impacted by inflationary pressures, supply chain issues, labour shortages and declining GDP.

IPO prep – six key actions now for IPO readiness

Two years in the making

IPO readiness needs to start long before the commencement of a formal process. From a PR perspective alone we would argue for at least a one year and ideally a two year runway, primarily because of two key factors.

- **The need to warm up the market through raising awareness and stimulating interest.** Companies will need to be able to satisfy the google due diligence test that investors and analysts will doubtless undertake as part of their investment decision. A company with limited or a poor google search history, lacking positive news and successes or indeed negative stories on page one of their search results, will struggle to convince investors that they are the next big thing and the leader in their field. Compounding the need for an extensive PR build is the fact that during the last six months prior to an IPO, companies should expect a PR blackout, where external corporate comms will be severely constrained.

- **A listing prospectus is a poor sales document.** There is no doubting a prospectus contains much valuable information for analysts and investors to pore over but few persuasive sales documents run to over 100 pages in length. Furthermore, fund managers may choose not to even look at a company's prospectus if they have no prior knowledge of the business.

Looking beyond PR to the other factors that are key to a successful IPO, and by success we define this to mean the performance of the shares post listing, the two year timeframe for preparation seems about right.

No single magic formula

If our analysis of the class of 2021 teaches us one thing it is that a successful IPO is not formulaic. Some companies in the -90% club had a three year track record of profitability, whilst Darktrace, which was loss making and didn't have its CEO and CFO in situ for two years prior to IPO, went on to become one of only two main market IPOs (excluding acquisition vehicles and investment trusts), which met its first year financial expectations and whose shares remain above their float price.

> ***"Condensed into its simplest form a successful IPO requires the construction of an investable equity story which management deliver on."***

In table 1 below we set out the key actions that we advise should be taken in the two years prior to IPO, which underpin the simple but hard to achieve statement above.

Table 1: Six actions to be taken now to maximise chances of a successful IPO

1.	**Increase corporate disclosure across own channels and build profile** Most companies are very poor at this. Private companies should leverage their own website and social media channels to include more investor/corporate information covering their market opportunity, strategy, field of operations, business model and financial performance; essentially the pillars of what will be their equity story. As private companies there is a no requirement to do so but the sooner companies looking to list adapt to the very public world the easier the transition will be. This should also help support warming up the market and building awareness and interest across the business media and potential investors. Hopefully more of a given but companies should also engage with the relevant business media to raise profile and interest, as well as developing relationships with the key journalists that one day will write their IPO launch story.
2.	**Find creative solutions to demonstrate financial progress in a non-linear world** Greater creativity will be needed, involving the use of charts, infographics and mini case studies over and above the simple reporting of the past three year historic financials in order to demonstrate financial progress, agility and success in a non-linear world. Not only will this involve careful thought but it will also need the capture of the relevant data over the entire three year period prior to listing.
3.	**Agree financial reporting and KPIs early** To ensure companies have the systems, resource and data to be able to report their three year historics in a manner which is consistent with how they plan to report as a listed company, they should make the necessary changes now. This will not only include deciding on segmental reporting but also KPIs. The agreed accounting should also be reflected in the filing of annual accounts with Companies House and with media. Consideration should also be given to reporting half-year results in order to ease the transition to plc life and ensure everything is in place to achieve this.

4.	**Upscaling the size and quality of the finance team and their systems** Finance teams need to be resourced well and early in order to be able to help shape the business model, produce detailed, achievable short and long-term forecasts, determine and set the optimum financing strategy and record the relevant accounting data for the agreed segmental reporting and KPIs. This will also require the early installation of sophisticated accounting software, over simple excel spreadsheets. Teams and systems will also need to be capable of answering probing questions from potential investors.
5.	**Appoint the Board and resolve any corporate governance issues early** In order to agree a strategy and be able to deliver on it, before and post IPO, it is important that the Board and the leadership team is in place early. Two years for the CEO and CFO looks sensible with one year for the chairman. Given fund managers are likely to be more demanding and selective, the CFO should ideally have a plc track record given the vital importance of managing and then at least meeting expectations. Avoid own goals by resolving potential corporate governance issues early. Following the weak post listing share price performance of both THG and Deliveroo it should be assumed that fund managers will demand full adherence to the governance code with no funnies.
6.	**Appoint auditors two years in advance of listing** Not doing this is a red flag for potential investors and it is also key to ensuring a company's ability to report on their chosen segmental reporting and KPIs, free from last minute accounting issues. Linked to this avoid a further red flag by ensuring non-accounting fees are not material in relation to audit fees.