

Riding the IPO Wave: The Outlook for West Coast Companies

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By **Martin Wellington, Hank Barry and Tom Duley** | August 29, 2019 at 02:57 PM

This year is shaping up as one of the hottest IPO years on record, despite starting out literally frozen as a result of the December 2018 sell-off and the shut-down of the SEC entering the New Year. The west coast is in many respects leading the way, with more IPOs recorded in the first half of the year than in the past four years combined, according to the [Los Angeles Business Journal](#). It is not surprising that the IPO wave is strong across multiple sectors that are the traditional strengths of the west coast market, including biotech, Internet and e-Commerce, and software.

Setting aside broader economic factors beyond the scope of this article, one factor contributing to the current IPO boom is the relative ease of preparing for the offering afforded by developments in the regulatory environment. The advent of confidential SEC review of registration statements, initially enacted under the JOBS Act of 2012 signaled the beginning of a far less risky way for private companies to prepare for the IPO. In the last several years, the IPO-friendly SEC under Chairman Jay Clayton, coupled with further reforms under the recently enacted FAST Act, have further streamlined the SEC review process for IPOs such that companies can now get from the organizational meeting to the roadshow faster than ever before.

Looking at west coast IPO activity by sector:

Biotech

With the biotech IPO window open for so many years, it's becoming harder to ignore a list of things that could narrow the opening if not shut it altogether: a domestic political environment that may put pressure on drug pricing and the taint of the opioid crisis, in addition to the broader macro-economic and political environment. And yet, science sells: Investors continue to make bets on biotech. Biotech investing requires optimism against all odds – specifically, against the odds of any given drug candidate obtaining regulatory approval.

Despite the risks, west coast biotech companies continue to have successful IPOs at very early stages. [Atreca, Inc.](#), for example, raised nearly \$125 million in June 2019, without a single molecule in human clinical trials, showing that investors remained willing to accept risk where they see promising drug discovery technology. A different approach to beating the odds is building a pipeline with multiple “shots on goal”. This was the approach of BridgeBio Pharma, Inc., which had 15 programs in clinical trials when it filed its [S-1](#). The company raised [\\$348.5 million in its IPO](#) in June, which remains the biggest U.S. biotech IPO thus far in 2019. A biotech company's science must inspire investors with hope; but BridgeBio's IPO suggests that investors reward companies that tilt the odds in their favor.

Internet and e-Commerce

Uber, Lyft and Pinterest followed the increasingly popular road for unicorns of taking advantage of ample sources of private capital to defer the IPO and build operational scale. Each of these companies, like others in the sector that have grabbed fewer headlines, deployed this pre-IPO capital aggressively to drive dramatic user growth, service offerings and geographic expansion on the theory that at full scale profitable unit economics, or the profit contribution of each incremental transaction, will catch up with

and surpass their big investment in operating expense. The initial market reception for these companies indicates investors believe in their ability to ultimately drive profit, with each company raising well over \$1 billion on market capitalizations in the tens of billions in their IPOs, notwithstanding sizable losses. With a robust pipeline of Internet IPOs reportedly in store for the second half, time will tell how long the appetite for mega offerings in the sector will last.

Software

First half 2019 software IPOs highlight investors' continuing appetite for subscription-based offerings for businesses, which offer predictable revenue and operating results as well as "sticky" customer relationships—meaning high retention rates over time. While not attracting the eye-popping valuations of the top Internet debuts, Zoom Video Communications, CrowdStrike and Medallia each traded at multi-billion dollar valuations on their first day. Zoom led the pack, garnering a roughly \$16 billion market capitalization by recording over \$330 million in fiscal year 2019 total revenue with Internet-like growth rates of over 100% and turning the corner to profitability in its most recent year. Closing its first day with over \$11 billion in market capitalization, CrowdStrike also saw 100-plus percent annual revenue growth rates while recording total FY '18 revenues of about \$250 million and expanding net losses as it invests to promote that rapid growth. Medallia posted \$313 million in fiscal 2019 total revenue on a 20% annual growth rate, but showed accelerating revenue growth and nearly break-even results in the first quarter of fiscal 2020. Medallia closed first day trading with a \$4.5 billion in market capitalization. With revenue run rates all in the same general neighborhood, these three IPOs offer interesting insights into how the Street weighs revenue growth versus profitability, even in the software sector.

Outlook

The question on everyone's mind is how much longer this IPO window will stay open, and of course, the answer is no one really knows. So far, this IPO window has

withstood, in addition to the government shut down, rising and ebbing threats of both trade wars and other international conflicts, national political turmoil in the U.S. and Europe and an extraordinary run of high volatility in major market indices, among other factors. In the past, such developments have served to at least slow down if not shut down the IPO market. However, in the present run they seem more fuel for companies to get public while the getting is good.

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