IPO Rebound Leads Capital Markets Recovery At Midyear

By **Tom Zanki**

Law360 (July 1, 2024)

Capital markets activity moderately accelerated in the year's first six months, buoyed by the highest level of initial public offerings in three years, signaling a busy second half for deal-makers at least until the November presidential election.

The pickup in IPOs and related equity deals coincided with more debt-raising, spurred by an increase in acquisition financing, as market participants adjusted to higher borrowing costs after two years of interest-rate hikes intended to tame inflation. Capital markets advisers described activity as steady overall, albeit far from the **aggressive fundraising** of 2020-2021.

"People are willing to approach capital markets again, although they're being cautious and much more methodical about it," Simpson Thacher & Bartlett LLP partner Heidi Mayon said.

IPOs Lead Pickup in Equities

Some 69 companies raised $16.9 billion through IPOs in the first half of the year, beating comparable periods for 2022 and 2023 in both offerings and proceeds, according to research firm Renaissance Capital. The result resembles something of a middle ground: better than the IPO slump of the past two years, but below the breakneck pace at the start of the decade.

This year's recovery has been anchored by large companies that boast sizable revenue, some of which are profitable. Such factors appeal to discerning investors after the wave of early stage, unprofitable startups that went public in 2021, often to poor returns.

"What's changed from previous IPO cycles is certainly a predilection toward scale," said Daniel Klausner, a managing director at investment bank Houlihan Lokey. "Scale is really important: scale of revenues, scale of company and certainly scale of market cap."

Renaissance Capital said 21 IPOs in the second quarter of 2024 alone raised $100 million or more, the most of any quarter in three years. Private equity-backed cruise operator Viking Holdings Ltd. completed an upsized **$1.5 billion IPO** in April, the year's largest to date.

And most IPOs are pricing within or slightly above their expected ranges, showing that investment banks are cautious not to oversell new listings, given investors' sober mood.

"Quite frankly, banks are being very careful," Klausner said. "They want deals to work. They are not coming out with unreasonable valuations. They're very conscious of that and are pushing back on valuation to both companies and sponsors."

The comparatively stronger market for new listings has spurred only a handful of IPOs from venture-backed technology startups, an elite universe of private companies often called "unicorns" if their valuations exceed $1 billion. More unicorns could join the IPO fray in the second half, though experts said they will face a more restrained market compared with the 2021 boom, when many software firms went public at historically high multiples.

Yet there is plenty of buzz regarding artificial intelligence. Several unprofitable companies with AI ties, including cybersecurity software firm Rubrik Inc., chipmaker Astera Labs Inc. and diagnostics firm Tempus AI Inc. **raised sizable IPOs** in the first half of the year.

Attorneys say many AI-focused startups are eager for capital at various stages of the funding cycle, from early-stage private rounds to potential IPOs. Winston & Strawn LLP partner Keerthika Subramanian expects more companies at the "nexus of biotech and AI" — or those that address health-related needs — will prepare for new listings in the near term.

"We're going to see more companies at this nexus successfully tapping the IPO market," Subramanian said. "There's a lot of investor demand and appetite for companies who are marketing products that leverage AI. That's definitely something to keep an eye on in the second half of 2024 and in the coming year of 2025."

Biotechnology is a capital-hungry sector that historically generates an outsize flow of IPOs. Such companies have slowly returned to public markets, posting mixed results recently. Neurological drug developer Rapport Therapeutics Inc.'s shares rallied after its **$136 million IPO**, while immunology firm Alumis Inc. **downsized its IPO** last week and saw shares fall in debut trading.

Covington & Burling LLP partner Brian Rosenzweig is watching the biotechnology sector, noting there is a "long backlog" of life sciences companies planning IPOs depending on market conditions. Many of these prospects have already filed plans confidentially with the regulators, he said.

"We've seen an uptick in companies beginning preparations for IPOs," Rosenzweig said. "Either to hit the market in Q4, or targeting January or early February."

Near-term IPO candidates otherwise **consist mostly of large companies**, several of which report more than $1 billion in annual revenue. Real estate investment trust Lineage Inc., private equity-backed business software firm Solera Corp., hospital operator Ardent Health Partners Inc. and occupational health services provider Concentra Group Holdings Parent Inc. filed IPOs in June that could go to market in July.

Apart from IPOs, existing public companies are also raising additional capital. Convertible bonds, by which listed businesses sell bonds that can be converted to stock if shares hit a certain price, reached their highest clip in this year's first half since 2021, according to data provider Dealogic. And more companies are conducting secondary or follow-on equity offerings, which can be a precursor to more IPOs.

"We are starting to see the beginnings of companies accessing the equity markets for secondary transactions, which is fantastic, because those transactions tend to happen prior to the IPO market opening up," Simpson Thacher's Mayon said.

Debt Markets Post Steady Rise

Debt capital markets have also rebounded from their post-pandemic slump as companies adapt to higher rates after the near-zero interest policies of 2020-2021. The rise is partly driven by an improving mergers and acquisitions market, which is driving demand for more acquisition financing.

Data show that investment-grade companies, or the largest companies with the best credit ratings, are the steadiest issuers of debt. And high-yield bonds, meaning those that pay investors higher interest to offset a greater risk of default, are also rising relatively quickly.

"Compared to last year, we're getting many more phone calls on new high-yield deals, and also some acquisition-related, structuring questions that I wasn't getting from bankers last year," Simpson Thacher partner David Azarkh said.

Some 173 companies raised $131.9 billion in high-yield bonds through June 28, according to Dealogic, up from 90 companies that raised $80.4 billion in the same period last year.

Debevoise & Plimpton LLP partner Paul Rodel said the reopening of the high-yield market after two down years marks a turning point. He noted an increased interest in leveraged buyouts from private equity funds, who have cash arsenals they are ready to deploy.

"When you focus on the dry powder at the private equity funds, you say to yourself there is more optimism on the high-yield side," Rodel said.

More companies are also tapping debt markets to satisfy refinancing needs. Some $2 trillion in global corporate debt is scheduled to mature by the end of 2024, according to a recent memo by Skadden Arps Slate Meagher & Flom LLP, plus more debt is due in 2025. Companies generally start to refinance bonds a year or two ahead of maturity, meaning the foreseeable future is likely to be active for new debt issuance.

Timing may vary. Companies are likely keeping an eye on the Federal Reserve for potential interest rate cuts in order to minimize costs. Such companies already face the prospect of refinancing at higher interest compared with older debt issued just a few years ago.

"There are a fair amount of companies who have debt maturities that they need to refinance in the next two to three years," Covington partner Kerry Burke said. "But I do think companies are trying to be strategic about when they go into the markets."

Attention Shifts Toward the Fed, Election

Whether the Fed cuts interest rates could boost equity markets as well. Speculation that the Fed would cut rates two or three times in 2024 hasn't materialized as inflation fears persist, though the central bank in June said it expects to cut rates once by year's end.

Apart from the Fed, the looming presidential election in November will likely transfix the market's attention in the early fourth quarter. Capital markets offerings typically pause starting a week before Election Day before resuming in earnest the following year.

Attorneys and bankers said they expect a busy period in early summer, plus another post-Labor Day rush before activity settles down. Winston & Strawn's Subramanian said many companies that have filed IPOs confidentially with regulators have flexibility on when they go public, enabling them to adapt to any political or economic uncertainty.

Companies with less urgent funding requirements are "waiting to commence the process entirely until after the election is over," Subramanian said. "And then hopefully at that point there's also a little bit more clarity on when the Fed expects to cut rates."