**IPO (Initial Public Offering) process in the US Banking system**

**IPO Definition:** An IPO is the process of offering shares of a private company to the public for the first time, transforming it into a publicly traded company. This allows the company to raise new capital by selling shares to investors.

**Steps in the IPO Process**

**Selecting an Investment Bank:**

The company chooses an investment bank to advise on the IPO and provide underwriting services. The bank is selected based on criteria such as industry expertise, reputation, past IPO success, and ability to syndicate the deal with other underwriters to attract potential investors.

**Due Diligence:**

The company conducts extensive due diligence to assess various aspects, including reputation, internal controls, financial results, regulatory compliance, legal standing, and management team credentials.

**IPO Filings and Pricing:**

Weeks before the IPO, the company issues an initial prospectus (red herring) that does not include the IPO price, the number of shares, or the amount of money being raised. This document is an SEC regulatory document (S-1 registration statement) with company information and financials.

The underwriters and the issuing company agree on a valuation and offering price range included in an amended prospectus for offering IPO shares. The offering price is determined based on valuation, company growth estimates, comparables with public companies, and demand from potential investors.

**Underwriting and Pricing:**

The underwriter acts as a broker between the issuing company and the investing public to help the company sell its initial set of shares. The underwriter drafts several documents, including the engagement letter, letter of intent, and underwriting agreement.

The underwriter determines the IPO price through meticulous assessments, often discounting the price to ensure a successful IPO debut.

**IPO Pricing and Allocation:**

The IPO offer price may be within the initial range or higher or lower in a revised range, depending on IPO share demand factors. The underwriters determine a specific offering price for new stockholders on the IPO day to buy IPO shares through underwriter allotment.

**Market Stabilization:**

After the IPO, the underwriter carries out after-market stabilization to ensure order imbalances are managed by purchasing shares at the offering price or below it. This activity is only allowed for a short period and allows the underwriter to trade and influence the price of the issue.

**Transition to Market Competition:**

After the initial 25-day quiet period mandated by the SEC, the company transitions to market competition. During this period, investors rely on market forces for information regarding their shares, and the underwriter assumes the roles of advisor and evaluator.

**Key Considerations**

**Market Capitalization and Performance:**

The IPO is considered successful if the company’s market capitalization is equal to or greater than the market capitalization of industry competitors within 30 days of the initial public offering. Alternatively, the performance of the IPO is in question if the difference between the offering price and the market capitalization of the issuing company 30 days after the IPO is more than 20%.

**IPO Pricing and Allocation:**

* The IPO price is determined through assessments by the underwriters and the issuing company, based on factors like valuation, growth estimates, and investor demand.
* Underwriters use methods like book-building to gauge investor interest and set the final IPO price.
* Shares are allocated to both institutional and retail investors through the underwriters.

**Regulatory Compliance:**

* IPOs in the US are regulated by the SEC under the Securities Act of 1933.
* Companies must comply with SEC filing requirements and disclosure rules throughout the IPO process.

**Costs and Benefits:**

* IPOs involve significant costs, including banking and legal fees, but offer benefits like raising capital, increasing company prestige, and providing liquidity for existing shareholders.

**The main benefits of an IPO (Initial Public Offering) for a company in the US banking system are:**

**Fundraising:** Going public through an IPO allows companies to raise significant capital that can be used for various purposes like expansion, R&D, debt repayment, etc.

**Exit Opportunity:** An IPO provides an exit route for existing shareholders, such as venture capitalists, who can monetize their investments.

**Increased Brand Equity:** Going public can boost a company's public profile and credibility, leading to increased trust from consumers and investors.

**Reduced Cost of Capital:** After going public, companies can access capital markets more easily and at a lower cost compared to other financing options like bank loans.

**Use of Stock as Payment:** Public companies can use their stock as a means of payment, such as for employee compensation or acquisitions, instead of relying solely on cash.

**Liquidity for Investors:** IPOs provide investors with the ability to buy and sell shares on the open market, increasing the liquidity of their investments.

**Fair Allocation for Retail Investors:** Regulatory changes have aimed to ensure that retail investors have a better chance of getting IPO share allocations, even in oversubscribed offerings.

**IPO Activity and Trends**

* The number of IPOs in the US has fluctuated significantly over the years, with a record high
* of 1,035 IPOs in 2021 and a low of just 62 in 2009.
* In 2022, there were 181 IPOs in the US, while in 2023 there were 154 IPOs. The market is showing signs of recovery from the pandemic lows.
* The total value of IPOs in the US has also varied widely, reaching a high of $271.3 billion in 2020 and declining to $48.9 billion in 2022.
* The largest IPOs in the US as of 2023 include Uber ($8.1 billion), Airbnb ($3.5 billion), and Snowflake ($3.4 billion).

**IPO Performance**

* The average first-day return (underpricing) for US IPOs from 1980-2023 was 19.0%. This has varied significantly by time period, with the highest underpricing of 64.6% occurring during the 1999-2000 dot-com boom.
* The percentage of IPOs that doubled in price on the first day of trading has also fluctuated, from a high of 79.1% in 2018 to a low of -48.1% in 2020 during the pandemic.
* Longer-term, the average 3-year return for US IPOs has been -19.5% compared to the overall market. Performance has varied by the size and profitability of the issuing company.

**Underwriting and Investors**

* The top investment banks that have underwritten the largest US IPOs include Goldman Sachs, Morgan Stanley, and JPMorgan Chase.
* Institutional investors and high-net-worth individuals typically receive the majority of IPO share allocations, though regulatory changes have aimed to improve retail investor access.
* The key trends in IPO activity in the US from 2000 to 2024

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**Outlook for 2024**

* Analysts predict more optimistic outcomes for the second half of 2024, driven by factors like steady interest rates, investor optimism, and economic recovery.
* However, challenges like tightening regulations, cybersecurity threats, and high market volatility remain for 2024 IPOs.

**Number of IPOs by Year**

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**IPO Proceeds**

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**Largest IPOs**

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The US IPO market has experienced significant volatility in both the number of deals and total proceeds over the past two decades, with the market currently showing signs of recovery from pandemic lows, though facing new macroeconomic and regulatory challenges. IPO performance has also been mixed, with high levels of first-day underpricing and negative long-term returns compared to the broader market.