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Lessons learned from 258 IPOs

The IPO Survival Guide

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With thanks to the entire team at Stockopedia for their support and contribution to this research project over the last 6 months

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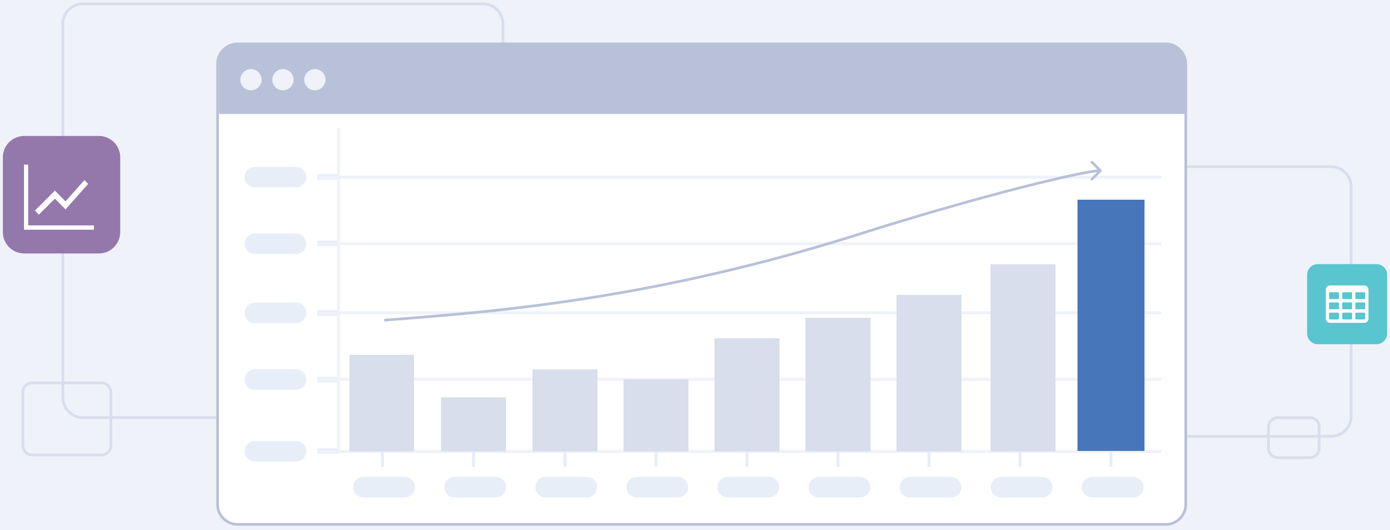
Table of contents



Introduction

There are few events in the stock market that are quite as highly anticipated as Initial Public Offerings (IPOs). The excitement of a new listing, the rush of trading activity that follows, and the hype and the headlines from the financial press all serve to draw retail investors in. But what are these investors really being sold?

Once the dust has settled are you left holding the next big stock market winner, or shares in a company you barely know, that have been sold to you by those with a vast informational edge?

IPOs are a crucial part of financial markets, allowing companies to transition from private to public and unlocking precious access to capital. For existing investors, IPOs can be a lucrative time to exit. For investment banks and advisers, they can be hugely profitable. For institutional investors, they can provide early entry into new stocks at knockdown prices.

For individual investors, the benefits are much less clear: Are IPOs an opportunity to buy into cutting edge multibagger opportunities, or are they a mechanism for savvy insiders to offload ex-growth companies at nose-bleed valuations? The answer, as you'll find in this report, is a bit of both...

In The IPO Survival Guide, the team at Stockopedia answers the question of how to approach IPOs. This guide summarises an extensive research project we conducted, comprising 258 UK listed IPOs over a five year period from January 2016 to May 2021. From that, we've been able to uncover unique insights into the world of IPOs that you can implement straight away to make better and more informed investment decisions.

This comprehensive data set allows us to answer several key questions:

- How do IPOs perform over the short-term (less than a year)?
- Are there any IPOs that one should definitely avoid?
- Could you benefit from buying an IPO at the issue price?
- Are good quality and cheap IPOs more likely to outperform?
- Do IPOs in certain sectors perform better?
- How do IPOs perform over the longer-term?
- Does market cap at float impact performance?
- How do retail investors perceive the risks and rewards of IPOs?

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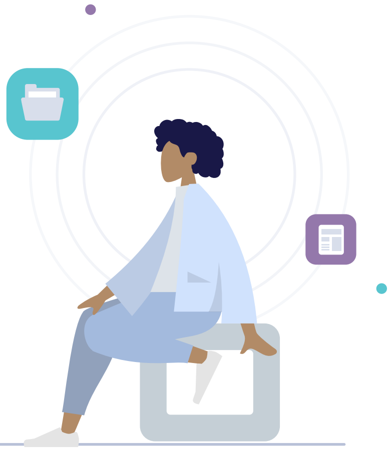
Key insights into the performance of UK IPOs



- IPOs, on average, tend to rise after the initial float, reaching a high around 6 months later. Performance then begins to drop as interest wanes. The **strong average performance figures after 1 year are largely driven by a small number of well-performing IPOs.**

- On a median basis, the **3 to 6 month timeframe seems to be the sweet spot for holding IPOs** in the short-term, if you buy them at open on the first day of trading. When you adjust for extreme values, **the central tendency is for IPOs to perform extremely poorly over the long-term.**

- Investors maintain a decent chance of success of picking an IPO winner over short-term time frames up to 6 months. However, after 1 year, the probability inverts and **there is a much higher chance of underperformance if investors hold on for too long.**

- It's best to **avoid large and mid cap IPOs as they are more likely to underperform.** This may be because private equity and venture capital use public markets as an exit route where they know there are forced buyers. **On average, small & micro caps outperformed across nearly all timeframes assessed.**

- The **AIM IPO market** has provided some astonishing returns for private investors over prolonged periods, **beating the Main Market by some distance on average.** International Main Market IPO listings are riskier and worth avoiding for the most part.

- Due to the higher likelihood of picking a multibagger, the **Health and Tech sectors have offered the best chances for sustained IPO success over the past 5 years.** Financials and Energy have remained strong performers, whilst Consumer Cyclicals, Telecoms and Utilities have provided sub-par returns.

- Analysis shows that applying factor investing principles to new listings, by selecting those with the **strongest quality and value characteristics, statistically improves your chances of picking a winning IPO in the long run.**

- There is a remarkable track record of success of IPO issue prices shooting up when the market opens. The current market structure seems to mean that **this is, unfortunately, only really a benefit to financial institutions.** Private investors are often unable to take advantage of underpriced IPOs.

An examination of the academic studies published on IPOs supports our findings throughout this study, whilst we have also explored areas that have often been overlooked in much of the existing research.

The IPO Survival Guide is free but we hope and expect that the findings herein will pay dividends for retail investors that take the time to read it.

01

The anatomy of an IPO study

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About the study

Thousands of data points were collated from a range of different sources, allowing us to carry out an in-depth analysis of all UK IPOs over the period from 1st Jan 2016 - 1st May 2021.

Building a database

Price histories

Were queried from Stockopedia's database at systematic intervals for each individual company post-IPO to assess the overall aggregated IPO performance over different timeframes.

StockRank histories

Stockopedia’s proprietary StockRanks were queried from our database to evaluate the role of how exposure to factors like Quality and Value can influence an IPO’s performance.

Issue prices

Were gathered from a comprehensive list published by the London Stock Exchange to determine whether IPOs are typically undervalued or overpriced prior to actual flotation.

Sector classifications

Each company’s major economic sector classification was queried to better understand which sectors offer private investors the best chances of IPO success.

Calculation methods & disclaimers

- Unless otherwise stated, all performance calculations are calculated from the opening price, on the first day of public trading, rather than the issue price. Issue price figures are also utilised in the study, but these are specified.

- Unless otherwise stated, all performance charts are based on the mean/average figures from the data set. Median figures are also assessed through the study, but these are specified.

- Takeovers were accounted for by using the last close price.

- Delisted securities due to bankruptcy were accounted for by attributing a -100% return in order to avoid 'survivorship bias'.

- We have excluded all investment trusts, funds & holding companies from the study to ensure that the IPOs are comparable across standard equity listings.

- Price histories taken from an adjusted prices database, which accounts for all share placings, splits and buybacks.

- Data set included 258 UK IPOs over the period 1st January 2021 - 1st May 2021. It is worth noting that the data set gets smaller over time.

- Final price histories used in the study were taken on the 15th June 2021.

If you would like to see a full list of all the IPOs we assessed in our study, then please do check out the link to this spreadsheet here.

If you have any further questions about the study, feel free to reach out to us and we'll be happy to respond.

02

How IPOs work

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Background and history of recent IPOs

Private to public

Initial Public Offerings take place when a private company wishes to trade its shares on the stock market. It often coincides with the company raising funds by selling shares to new investors. It's a popular way for companies to raise the capital they need to fund their growth ambitions, without overburdening themselves with debt. It also enables existing owners and directors to sell some or all of their holdings in the company.

Once a company has made the decision to float on the stock exchange, it will engage investment bankers and financial institutions to help it understand investor appetite. A date, price and estimated market value for the IPO will then be set.

In the lead up to an IPO, the company must ensure it complies with the financial regulations set out by the Financial Conduct Authority (FCA) in the UK. The company will then publish its prospectus pre-IPO, outlining its vision for the future and some of the important historical information and risks for investors to consider.

Funding rounds

After a company and its legal advisers have reviewed and published all of the necessary documentation, the deal underwriters will start marketing large pre-IPO purchases with their institutional clients. Companies tend to prefer this route of selling directly to major institutional investors with deep pockets, as it's often a more efficient and reliable transactional structure overall.

Once all the funding is secured the company will float on the exchange and private investors will be able to purchase shares at the market rates from the first day of trading.

A key problem in the way that most IPOs are structured is that individual investors are essentially excluded from taking part - except when companies specifically choose to include them. As a result, private investors don't have obvious routes to the kind of information that is made available to institutions prior to the flotation. This information asymmetry is a crucial failing. Not only are private investors unable to buy shares at the issue price, they also have an information disadvantage right from the start.

2021 - A remarkable year for IPOs

The global Covid pandemic had a short, sharp negative impact on world stock markets, but the recovery was swift. In periods of economic turmoil, IPOs tend to stop while companies and their advisers wait for conditions in which they are more likely to secure new investment at the highest possible price. Despite all the uncertainty, IPOs rebounded strongly from the second half of 2020 onwards...

Indeed, 2021 has proved to be a remarkable year for IPOs. The first quarter saw levels of IPO activity not seen since 2007, with £5.6 billion raised (according to Ernst & Young) and this isn't showing any signs of slowing down. In fact, the UK chancellor of the exchequer is proposing changes to streamline the IPO process for companies wishing to list on UK exchanges.

High profile names such as Deliveroo, Darktrace, Dr Martens and Moonpig all IPO'd in 2021, and this helped to generate even more excitement around new listings. Other companies are also expected to float on the London markets, including Brewdog, Monzo and McLaren to name a few.

In the absence of any severe macroeconomic shocks, and assuming the pandemic recovery continues, it is reasonable to assume that higher levels of IPO activity may persist over the medium term.

03

Insights into the overall performance of IPOs

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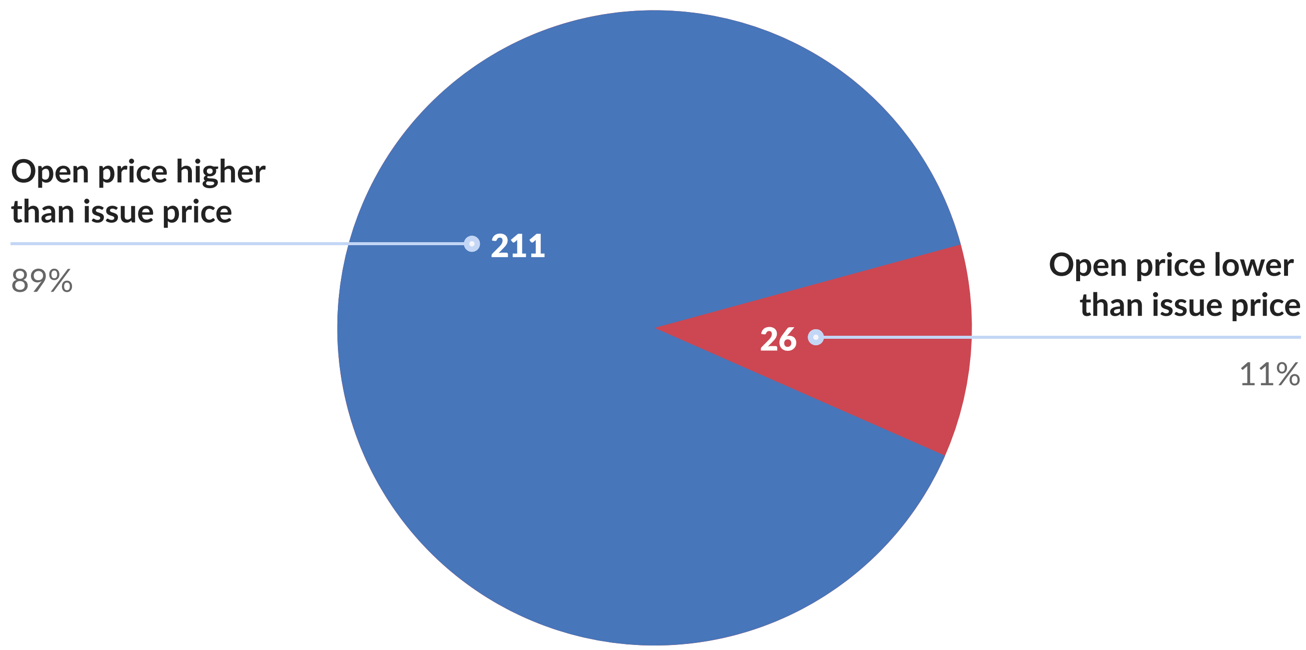
The issue price - where the City profits, and private investors aren't allowed in

The issue price vs. the opening day

Arguably one of the most interesting findings from the research that we carried out was the above-average success rates from buying IPOs at their issue price. The challenge for investors is that this is easier said than done. To be able to purchase an IPO at the issue price, the company floating has to open up to private investors pre-float, which rarely happens.

Instead, the financial institutions and their clients buy up the shares directly and then sell them to the market after the IPO takes place.

89% of IPOs open higher than their issue price



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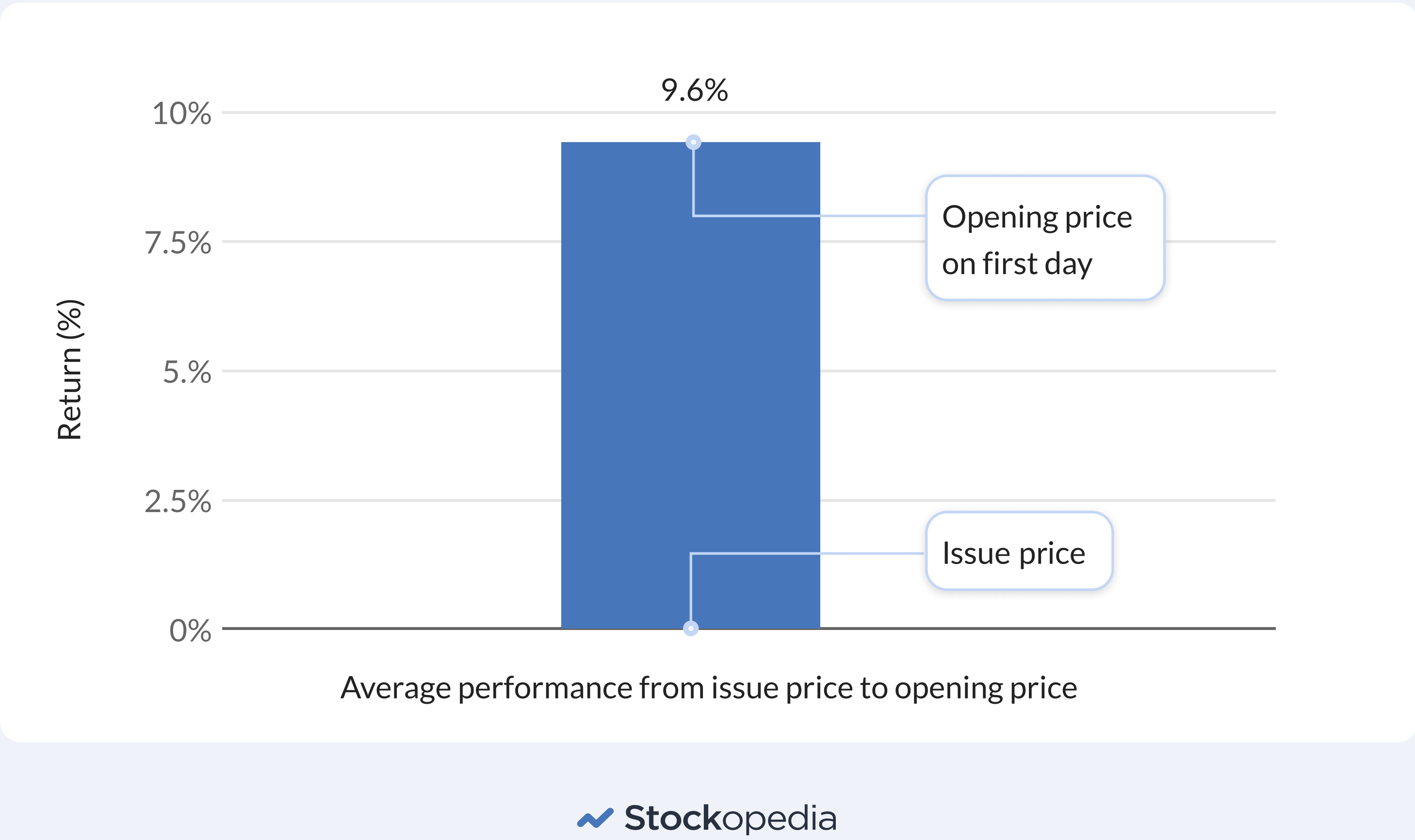
This is a great shame because our analysis found that of the 237 IPOs that experienced a price movement from the issue price compared to the opening price, 211 were positive (the equivalent of an 89% hit rate). Furthermore, the average price "pop" from the issue price to the opening price on the first day of trading is nearly 10%.

On average, IPOs open nearly 10% higher than the issue price



You could, in theory, adopt a randomised strategy of buying IPOs at their issue price, selling immediately at the open and consistently make money. However, we found that the IPOs that are accessible by private investors don't actually tend to perform in this way, and we can look to Deliveroo as a prime example.

Key insight

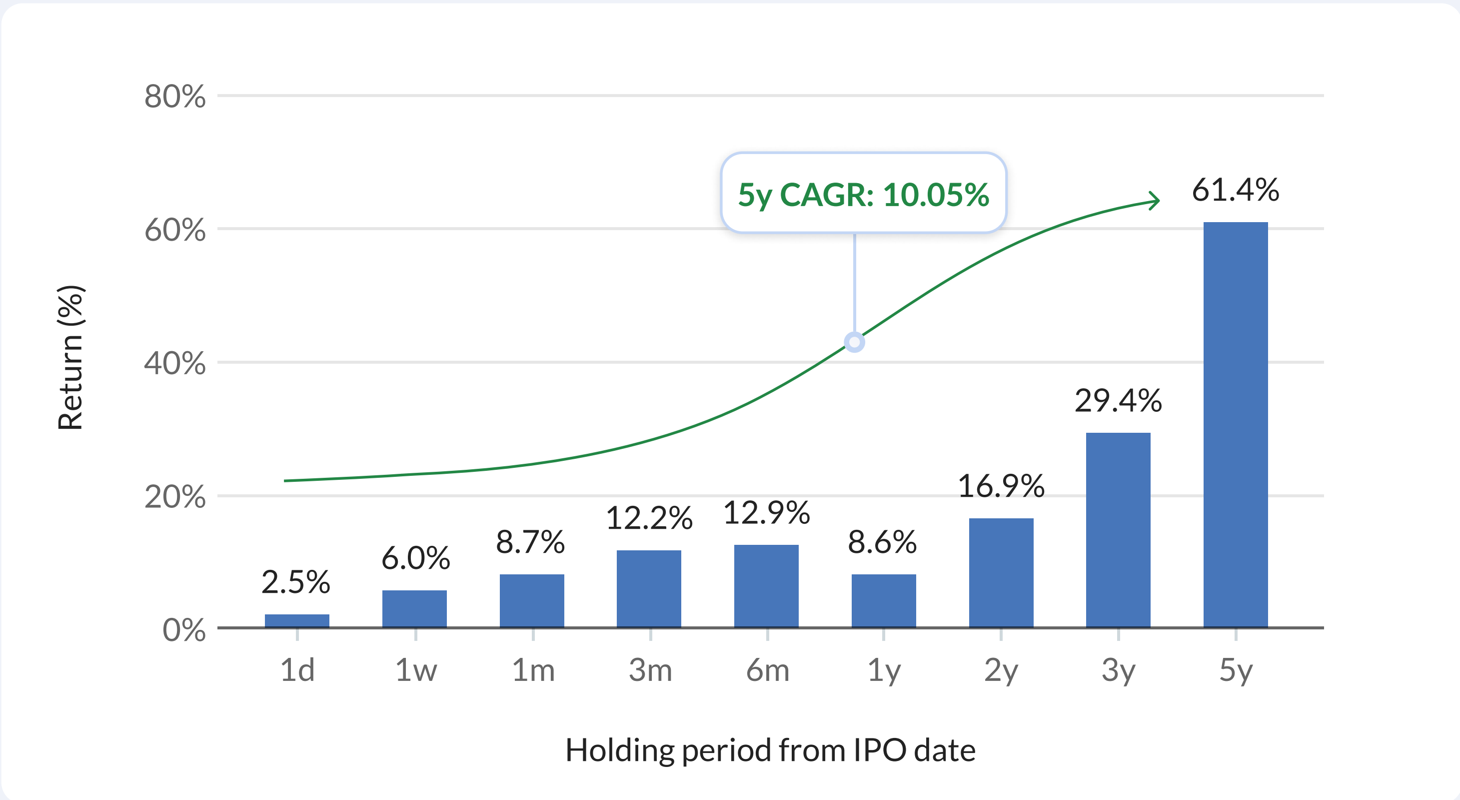
The majority of IPOs immediately trade higher than their issue price. The current market structure seems to mean that **this is, unfortunately, only really a benefit to financial institutions.** Private investors are often unable to take advantage of underpriced IPOs.

IPO performance - the average doesn't tell the full story

Average IPO performance

The average UK IPO performance chart below provides an interesting overview of the aggregated average performance of IPOs across different time horizons. We can see that, on average, the performance over the initial 6 month period for IPOs is positive. In fact, share prices tend to rise quite steadily up until the 6 month mark, before subsequently tailing off 1 year after IPO.

The mean UK IPO performance is 10.05% annualised over 5 years



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One theory for this pattern is that the initial excitement created by a new stock market prospect leads to significant buying pressure in the first months after an IPO, which contributes to the strong opening performance. However, as interest fades and shorter-term investors start to sell their positions, the share price retreats.

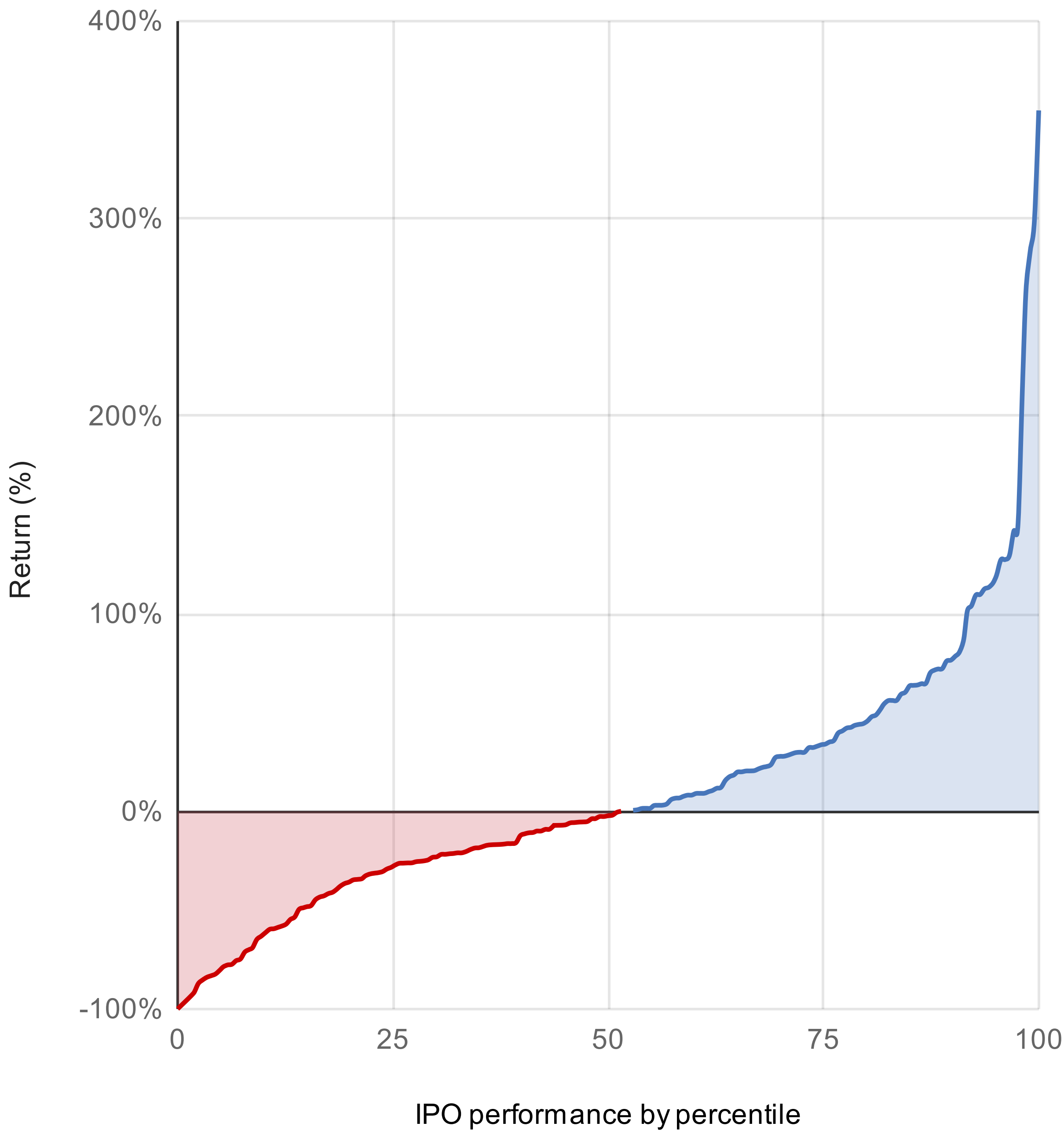
After 1 year, the average performance starts to pick up again, rising to a 61.44% average return over 5 years. This is the equivalent of a +10% compound annual growth rate, which most investors would be delighted with. However, as we'll discuss in further depth, this impressive feat has been achieved largely due to a handful of exceptional multibaggers…

The uneven performance distribution of IPOs

To illustrate the extent to which a few exceptional multibaggers impact upon the average performance figures, we can refer to the 1 year IPO performance distribution chart overleaf. The near vertical rise from the top 90-100 decile shows how a small number of remarkable multibaggers distorts the average performance figures. We also found that this trend becomes even more pronounced over time.

Over one year, the top decile of performers significantly distorts the average performance of IPOs

1 year return (%) from IPO



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Key insight

IPOs, on average, tend to rise after the initial float, reaching a high around 6 months later. Performance then begins to drop as interest wanes. **The strong average performance figures after 1 year are largely driven by a small number of well-performing IPOs.**

Median performance shows the true risks of IPOs for the private investor

Median IPO performance

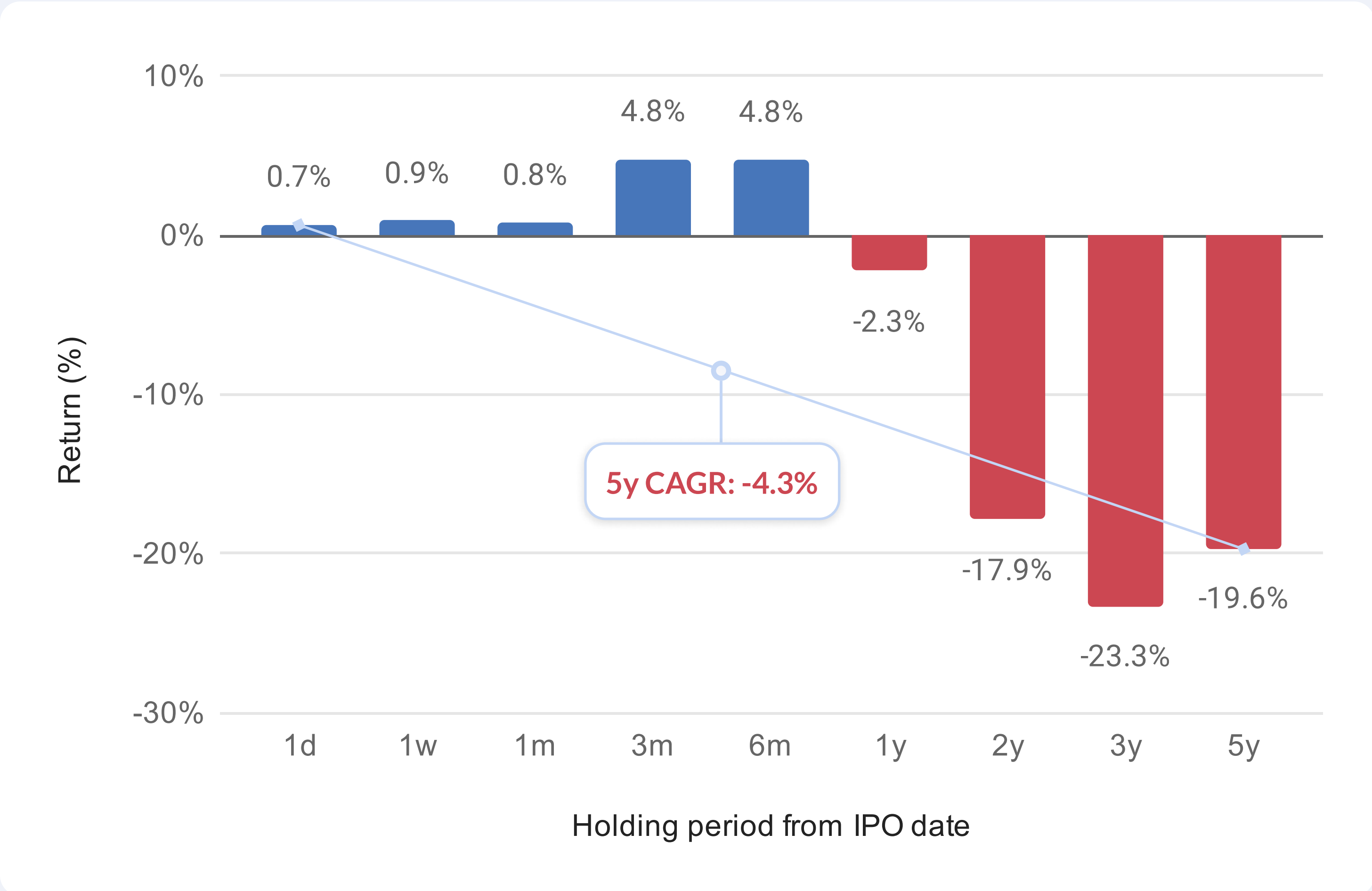
The contrast between the average and median performance of IPOs is more revealing. We include median performance figures in this analysis to remove the impact of outliers that otherwise skew the results.

The result is an underlying IPO performance chart that looks very different to the average performance chart in the previous section. While we continue to see positive performances from IPOs for up to 6 months, all performance figures are markedly lower.

The performance dip at the 1 year point mirrors the average performance chart, but what is striking is the extent of this fall. After 1 year, the median performance figure for IPOs turns negative and continues on a downward trend, reaching a low after the third year post-IPO. We calculated a negative compound annual growth rate of -4.28% median over 5 years.

This number might look even worse when you consider the relative performance of the FTSE All-Share over this time period, and the opportunity cost of capital…

The median UK IPO performance is -4.3% annualised over 5 years



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Key insight

On a median basis, the 3 to 6 month timeframe seems to be the sweet spot for holding IPOs in the short-term. When you adjust for extreme values, **the central tendency is for IPOs to perform extremely poorly over the long-term.**

The difficulty of picking long-term IPO winners

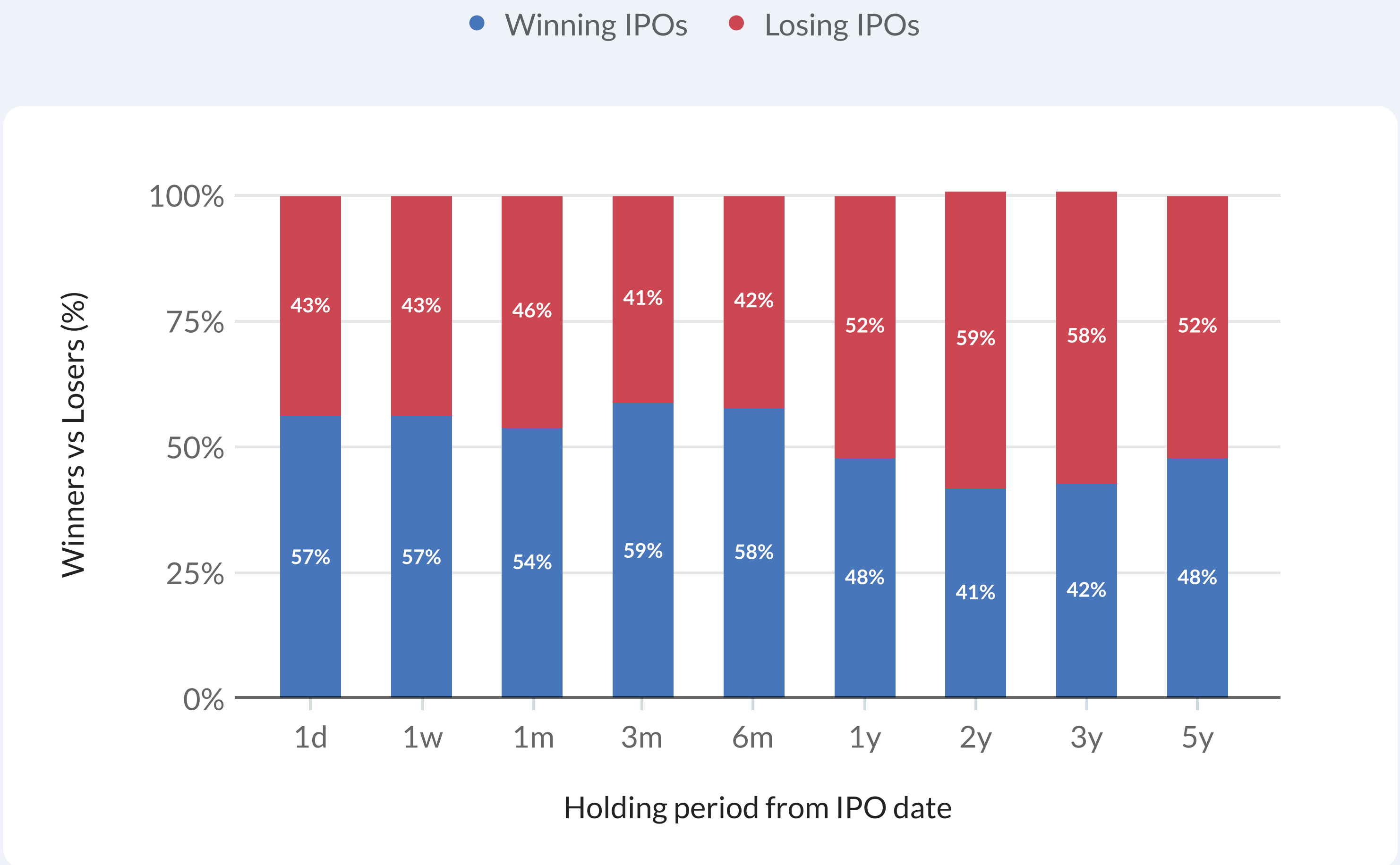
Winning & losing IPOs across holding periods

After witnessing the considerable disparities between the average and median performance figures for IPOs, we decided to analyse holding periods. We evaluated how each IPO had performed from its opening price on the first day of trading to determine the number of IPOs that returned positive or negative contributions over each time frame.

The analysis demonstrated that if you purchase IPOs at the earliest opportunity, the overall success rates are more favourable, up until the 6 month point. Indeed, a 3-6 month holding cycle offers an average 58% chance of picking a winner. We can see that across each of these short-term time frames, the odds are in your favour if you pick an IPO to purchase at random.

The story changes considerably when you view the proportion of winners vs losers from 1 year and beyond. The success rate initially falls to just over 48% after a year, but plunges to 41% and 42% after years 2 and 3 respectively. This illustrates the difficulty of picking a long-term IPO winner.

The longer you hold an IPO, the lower your chances of seeing positive returns



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Key insight

Investors maintain a decent chance of success of picking an IPO winner over short-term time frames up to 6 months. However, after 1 year, the probability inverts and **there is a much higher chance of underperformance if investors hold on for too long.**

04

IPO performance by size, sector, market & factors

Avoid large caps for IPO success

IPO performance across market capitalisation groupings

Private investors today are constantly bombarded with information on high profile IPOs. In 2021, the UK has seen some big names such as Deliveroo, Darktrace, Dr Martens and Moonpig all float on the London markets and these have regularly been in the news pre and post-IPO. High profile IPOs like these have delivered mixed results, with some starting off on the right foot whilst others have flattered to deceive. But what do the statistics say?

This was perhaps one of the key findings of our study: small caps and micro caps significantly outperform their large cap and mid cap peers across almost all holding periods.

From the analysis, we can see that, on average, micro caps are the best performers over the shorter timeframes. The volatile nature of micro caps means that even relatively low-levels of share trading volume can facilitate big upward or downward swings and these findings suggest that the former could be having an impact.
It is worth bearing in mind that a small subset of these micro caps drive these impressive gains.

At Stockopedia, we use the following classifications:

Micro-Cap	Small-Cap	Mid-Cap	Large-Cap
< £50m	£50m - £350m	£350m - £2.5bn	> £2.5bn

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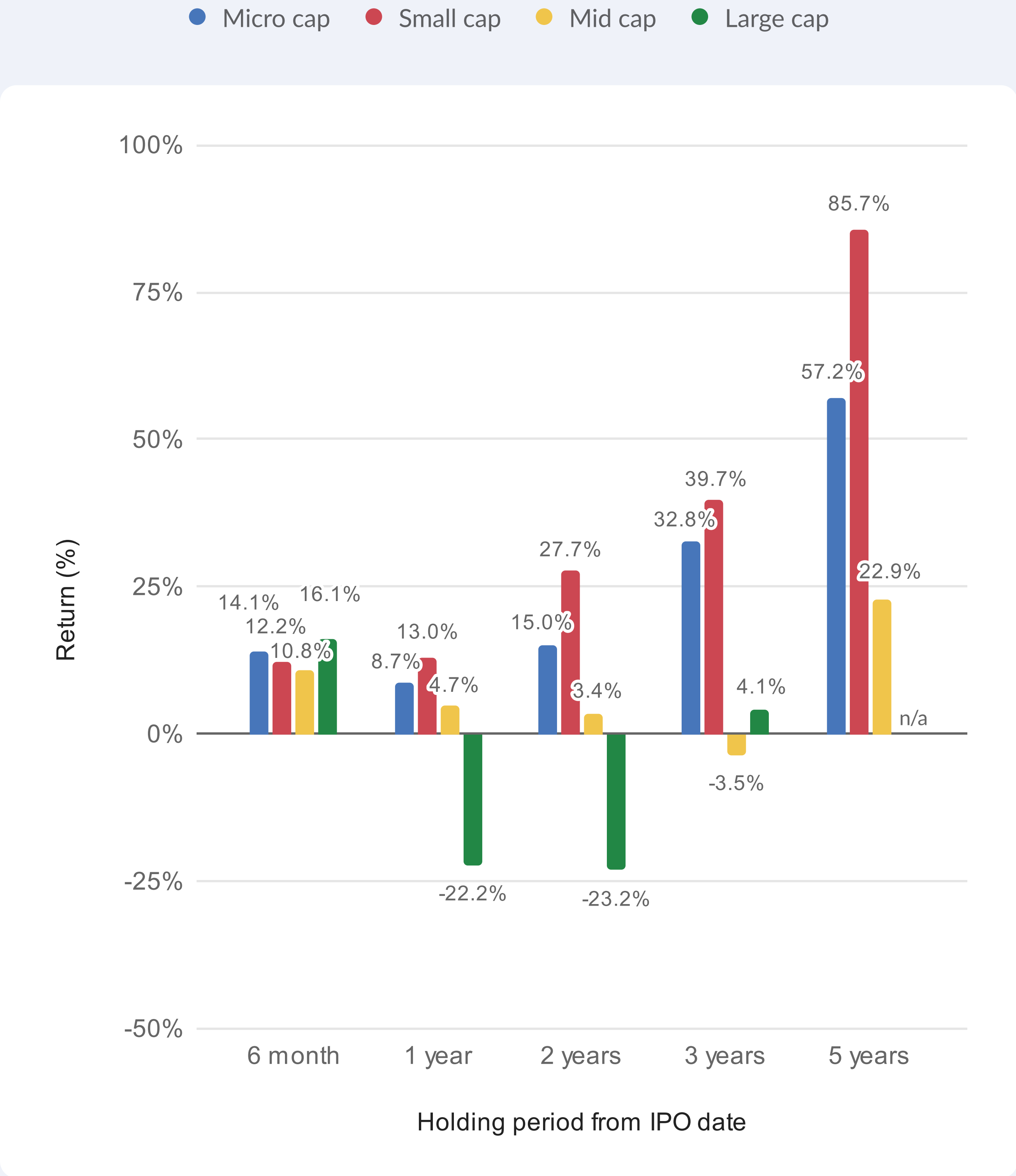
Over time, we see that small caps lag slightly behind their more volatile micro cap counterparts, but take-off after the 1 year mark. Over 5 years, the average performance of small caps reaches an impressive 85%, comfortably ahead of all other size groups.

Most surprising is the fact that large caps, on average, generate a negative performance in excess of -20% between 1 and 2 years after IPO. There isn't a high number of large caps to choose from on the London markets, and the sample size is small in this data set, but it raises questions about the heavy promotional activity around high profile IPOs that aren't necessarily the best investment opportunities in the IPO space.

Our theory is that the combination of aggressive IPO pricing by company advisers, together with heavy promotion to private investors, leads to excessive flotation prices that are prone to dropping back once trading commences. In these instances, the company valuation could be at risk of being stretched and the market quickly corrects it once the shares begin changing hands.

Throughout our analysis, we found that smaller sized companies, which are often under researched, undercovered and underappreciated by the market, outperform on almost all metrics assessed. The small cap and micro cap groupings inevitably carry some higher risk, but offer greater opportunity for capital gains and contain the vast majority of multibaggers.

Small and micro-cap IPOs outperform across almost all holding periods



n/a - There were no qualifying Large Cap stocks over the 5 year time period.

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Key insight

It's best to **avoid large and mid cap IPOs as they underperform.** This may be because private equity and venture capital use public markets as an exit route where they know there are forced buyers. Small & micro caps outperformed across nearly all timeframes assessed.

Case study

Deliveroo

One of the IPOs to grab many of the headlines in 2021 was Deliveroo. The food delivery giant, founded in 2013, floated on the London Stock Exchange on 31 March 2021 and was widely regarded as one of the highest profile IPOs of the last decade.

Deliveroo's IPO was advertised by the media, financial institutions and through the company's own app, in order to attract investors. Private investors were able to access the IPO at the issue price (through apps such as PrimaryBid) and many bought in at £3.90, which valued the company at £7.6 billion - some 6.4 times FY20 sales - despite it never having made a profit.

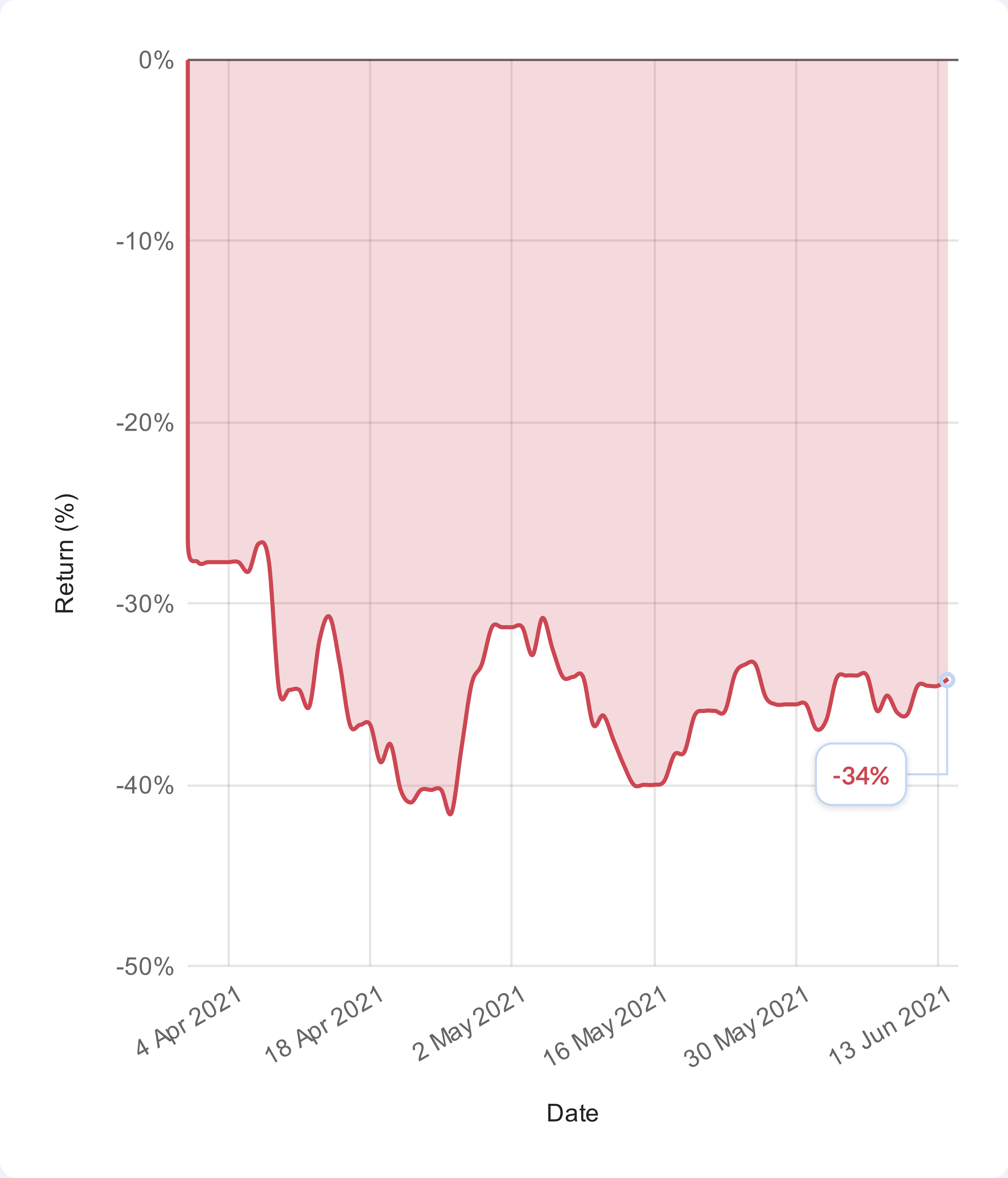
After opening at £3.31 on the first day of trading, the investors who bought in at the issue price were already nursing a 15% loss. The share price on the first day went on to reach as low as £2.71 intraday, before closing 13.3% down at £2.87.

Over the subsequent months, the share price continued to drift lower, only finding support at £2.25. For investors who did buy at the issue price and had held on up to this point, this represented a loss of 42.3%.

In the immediate aftermath of floating, Deliveroo was named the worst IPO in London's history by a plethora of mainstream news outlets. The episode served as a reminder of how volatile and uncertain IPOs can be, and why investors would be wise to remain wary of over-publicised large cap IPOs. We've carried out an in-depth analysis of Deliveroo's IPO here.

Deliveroo IPO performance

% return from issue price to 15th June 2021



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The average AIM IPO almost doubles over a 5 year period

IPO performance by UK market

Providing further support to the idea that small and micro cap IPOs outperform mid and large caps is the fact that the average IPO performance on the Alternative Investment Market (AIM) beats that of the UK Main Market by a considerable margin across almost all timeframes.

AIM is the London Stock Exchanges's trading venue for smaller, growth-oriented companies. Its lighter-touch regulation and lower costs attract smaller firms, and the market has strong appeal among private investors.

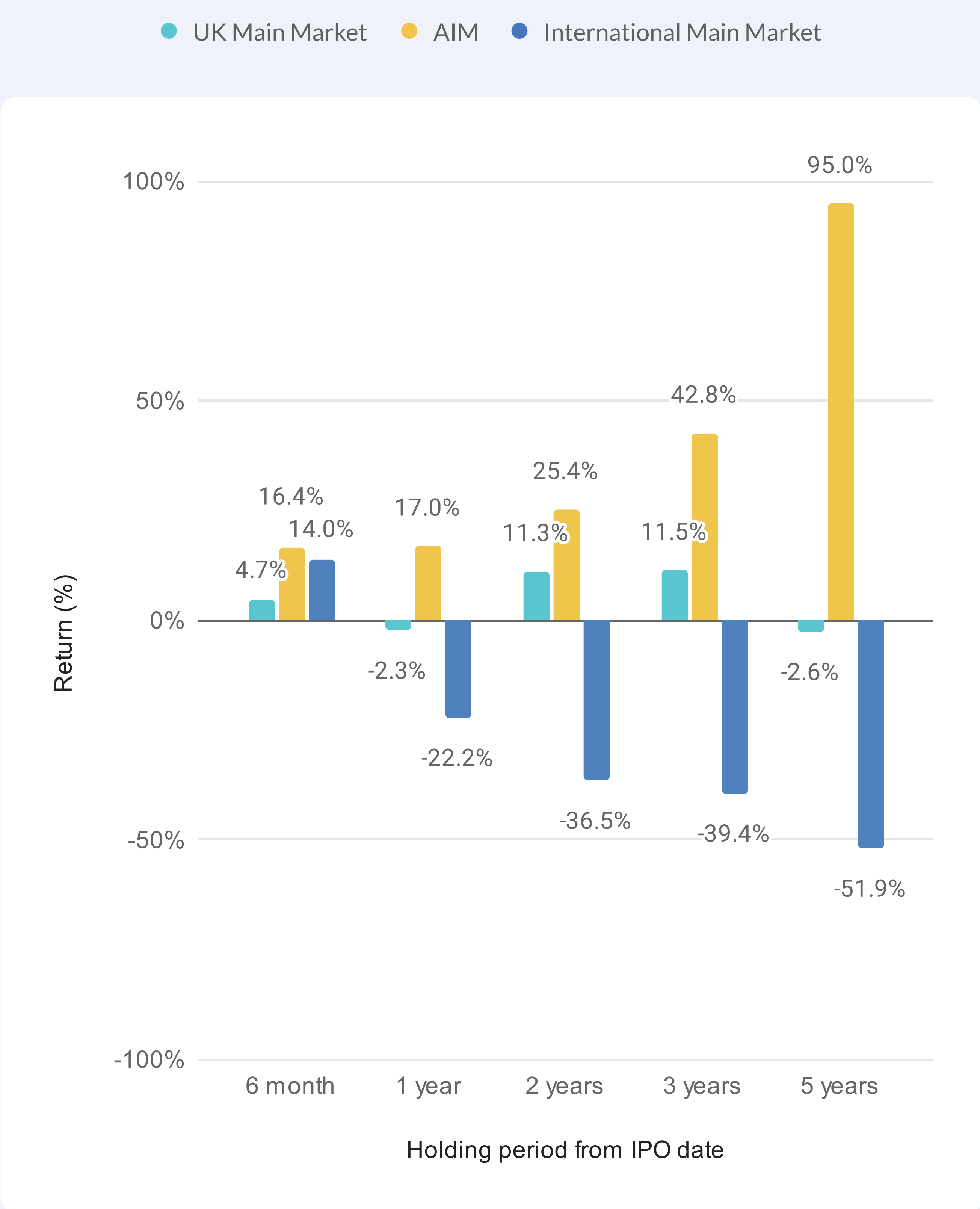
This study shows that the average AIM IPO almost doubled over a 5 year period, whereas the UK Main Market return was negative. This striking outperformance is evident from the 6 month mark onwards, with AIM beating the main indices over every time period thereafter.

AIM's outperformance was boosted by some phenomenal performers, of course, but the win rate overall was much higher than we anticipated. Comparing the opening price on the first day of trading, to our cut off point on the 15th June 2021, we found that over 58% of AIM IPOs went on to generate positive returns.

In recent years there has been growing caution among UK investors over foreign domiciled companies looking to raise money on the UK markets. Whilst the requirements to list in the UK remain robust, the practices of companies abroad are more vague and they can be subject to foreign jurisdictional risks, which rules them out for certain investors.

From our small sample of International Main Market listings, we can see that investors would do well to avoid foreign company IPOs over the longer-term. The consistently negative performance figures recorded after 1 year typically signal the start of further struggles to come, with the average International Main Market listing ending -52% lower after 5 years.

AIM IPOs outperform impressively vs. Main Market IPOs



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Key insight

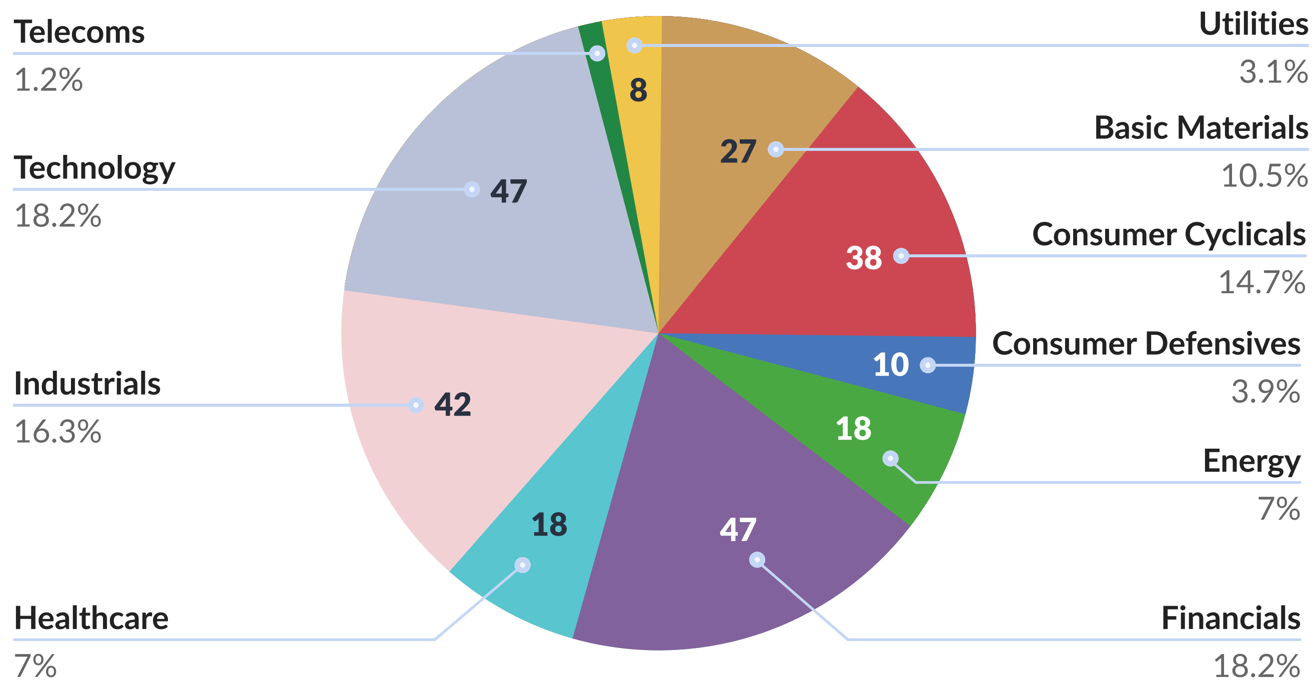
The **AIM IPO market has provided some astonishing returns for private investors** over prolonged periods, beating the Main Market by some distance. International Main Market IPO listings are riskier and worth avoiding for the most part.

Healthcare and Tech IPOs have excelled over the past 5 years

IPO performance by major economic sector

Before examining the performance analysis for the 10 major economic sectors, it's interesting to note that the number of IPOs by sector (since 2016) was almost identical to the UK market structure as a whole that we publish on Stockopedia. A notable exception was in the Technology sector, which despite its relatively modest size in the UK market has seen a high number of IPOs in recent years.

UK IPOs by Sector



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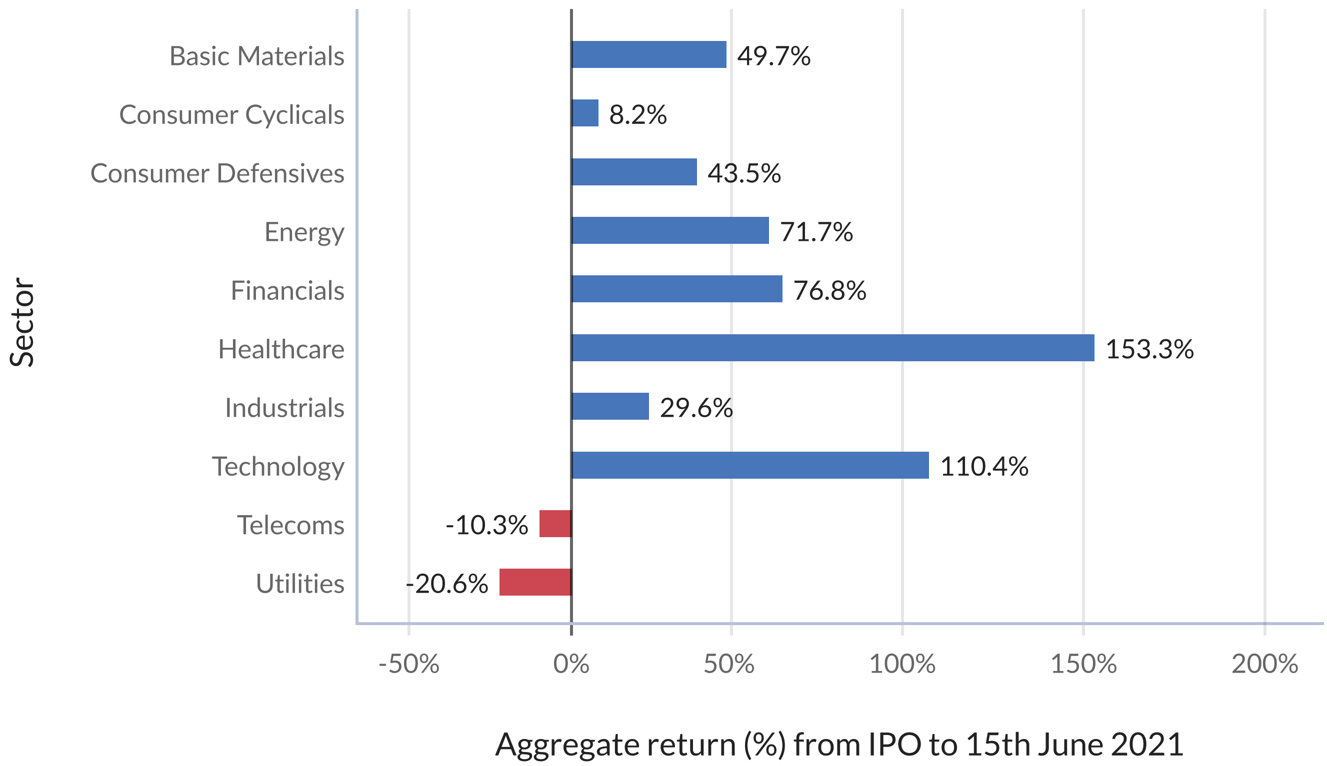
Perhaps unsurprisingly, if you look at the aggregated average all-time performance figures by sector, the healthcare and technology sectors are the ones that really stand out. These sectors have excelled over the past 5 years, as our economy and way of life become increasingly dependent on the innovations in these areas. The Covid-19 pandemic has also acted to accelerate this trend.

Healthcare and Tech produce the best all-time returns for UK IPOs



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The financials and energy sectors also offered promising returns for IPOs. The only notable underperforming sectors were consumer cyclicals, telecoms and utilities. It's worth bearing in mind that the sample size for telecoms and utilities was small, but this carries on the theme that we've seen over the last decade, with telecoms and utilities being largely out of favour.

Some of the greatest IPO success stories have come from the health and tech sectors. The all-time performance figures from IPO to 15 June 2021 for a few of the top performers are listed below:

Name	Sector	Performance (IPO - 15 June 2021)
Dev Clever Holdings	Technology	1685%
Maxcyte Inc	Healthcare	1141%
Cerillion	Technology	996%
Renalytix AI	Technology	802%
Blue Prism Group	Technology	764%
Polarean Imaging	Healthcare	485%
Novacyt	Healthcare	460%
Skinbiotherapeutics	Healthcare	399%
The Panoply Holdings	Technology	267%
Team17 Group	Technology	253%

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The average IPO in both sectors more than doubled, and exactly half of the top 20 performers from our data set came from the health and tech sectors.

Key insight

Although the odds of picking big IPO winners are low, if you are going to find one - **Healthcare and Technology have been the places to hunt over the past five years.** Financials and Energy have remained strong performers, whilst Consumer Cyclicals, Telecoms and Utilities have provided sub-par returns.

Case study

Dev Clever Holdings

The top IPO performer in our entire data set was Dev Clever, a small software development company founded in 2013. Dev Clever has managed to transform itself into an established digital innovation brand in a short space of time, boasting a sophisticated client list of blue-chip companies, such as Britvic, Whitbread and Mitchells & Butlers.

The company's IPO on the Main Market in 2019 enabled it to deliver on its growth strategy, targeting key initiatives across its three core business channels: Engage, Educate & Experience. Through Dev Clever's proprietary software platforms and immersive frameworks, its clients are able to better engage, acquire and retain their customers through experience, rewards and incentives. It's proven to be an excellent business model for the company, with Dev Clever going on to win some major contracts after its IPO.

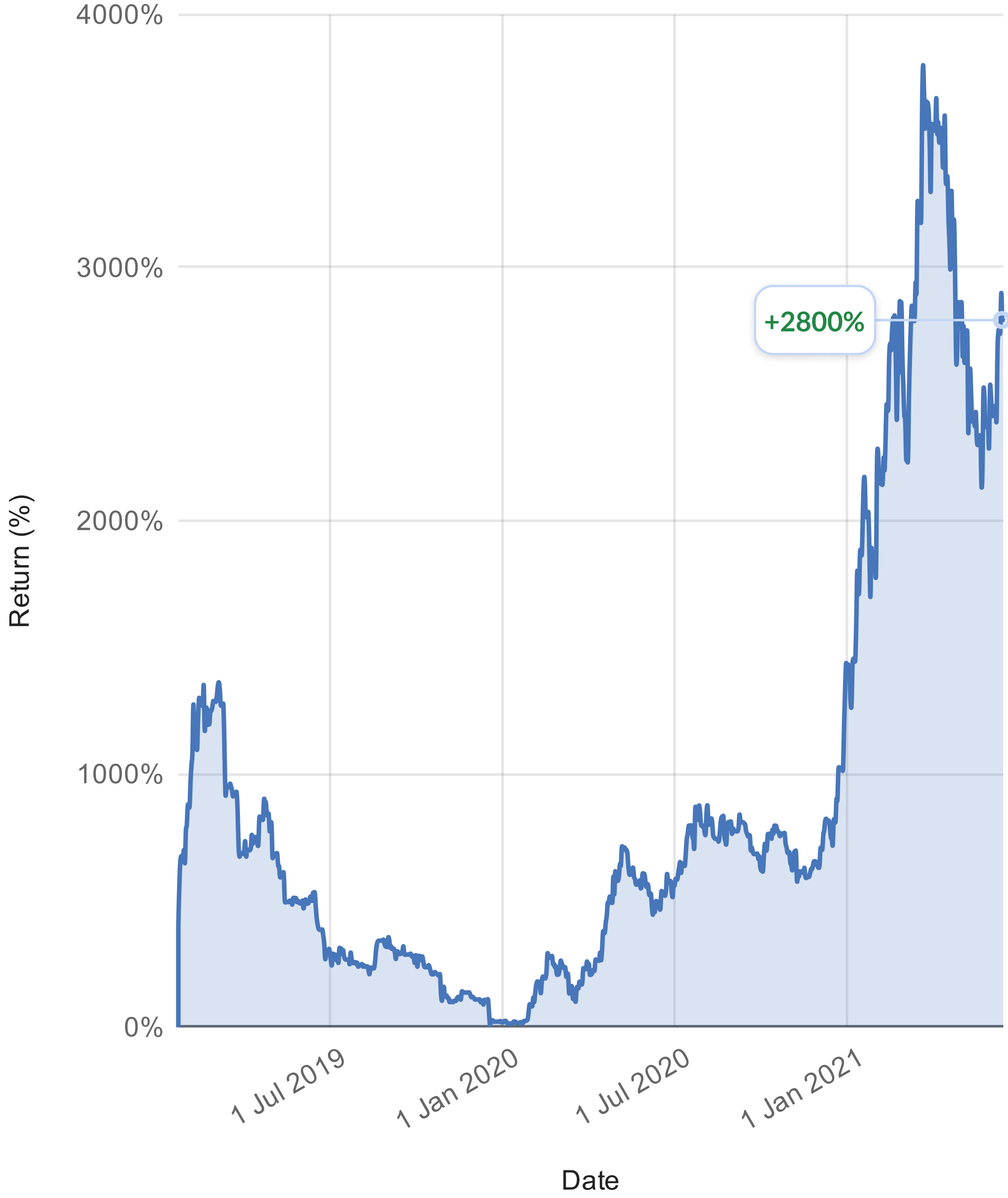
On the first day of its IPO, Dev Clever's share price more than doubled, and it went on to record a staggering 738% rise in its first full month after listing. However, those gains had entirely disappeared after 1 year, with the shares down -26% from their opening price at IPO.

Nevertheless, the business continued to develop its proprietary technology, launch new initiatives and secure important contract wins. This led to an extraordinary share price recovery, with the shares going on to more than ten-bag.

Whilst there may be more fireworks in the technology or healthcare sectors, our analysis found them to offer the best chances of meaningful long-term capital appreciation for IPOs, due to the higher potential for rapid EBITDA growth and multiple expansion.

Dev Clever Holdings IPO performance

% return from issue price to 15th June 2021



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Do better quality, lower price IPOs outperform?

The discipline of owning shares with exposure to proven drivers of returns in the stock market, such as Quality (financial strength) and Value (cheaply priced) - known as factor investing - has become increasingly popular over the past decade. But what role do these kinds of factors play in the success of IPOs?

There hasn't been much academic research into the success of factor investing when it comes to IPOs. Evidently, it is hard to gather much information about the value, quality, momentum, growth, or income attributes of a security when there's little financial history that is readily available.

One can always take a closer look at a company's prospectus documents to get a good idea of the overall financial health of a company, but the real picture will start to emerge a few months after listing, when the interim or annual results are published. For this reason, we assessed the quality and value characteristics of IPOs using Stockopedia's StockRanks - specifically the dual-factor Quality & Value Rank (QV Rank). Our goal was to determine whether high-quality and cheap IPOs go on to provide superior returns.

Factor investing and IPOs - the QV Rank

Over the past 50 years, knowledge of what drives outperformance in the stock market has made huge strides. Academics and industry professionals now agree that long term investment returns are heavily influenced by exposure to some very powerful factors.

These factors include Value (stocks that are cheaply priced), Quality (businesses that are strong and well financed) and Momentum (stocks that are on an improving trend and rising in price).

At Stockopedia, we calculate the StockRanks - a set of rankings daily for every share in the market. Using our database of more than 2000 fundamental and technical ratios we rank every stock relative to every other across their Quality, Value and Momentum. These rankings are published for every stock daily from zero (worst) to 100 (best), and aim to give investors the ability to quickly make more informed decisions about their investments.

Quality	92
Value	97
Momentum	31
Stock**Rank**™	87

Since we started tracking the StockRanks in 2013, higher ranked shares have tended to outperform the market and lower ranked shares have tended to underperform the market. But what part do these factors play in the success of IPOs?

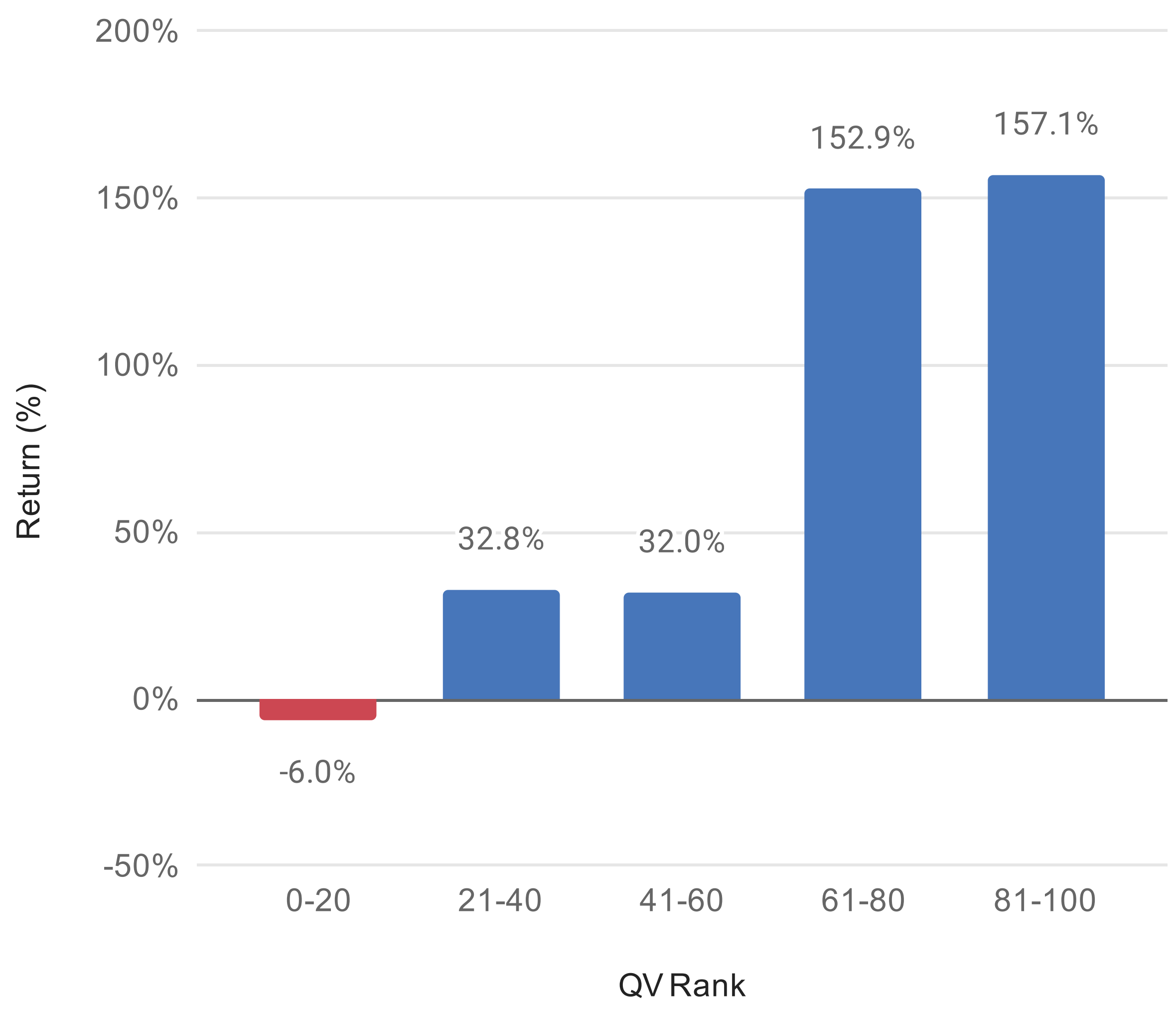
Given that newly-listed companies have no price history and no track record when it comes to broker forecasts or earnings progression, it is not easy to use Momentum as a meaningful guide early on. But the two main factors of Quality and Value can be very useful…

In the IPO Survival Guide we used the **Crossover QV rank** - a dual-factor approach that combines the Quality and Value Ranks. This single measure (where a rank of 0 is poor and 100 is excellent) provides an instant assessment of the appeal of any stock's combined Quality and Value. A high QV rank indicates that a stock is both high-quality and cheap, whereas a low QV rank indicates an expensive, 'junk' stock.

Using the median figures once more, to remove the possibility of outliers distorting the results, we see that the high QV rank basket of IPOs provides significantly better returns than lower ranked IPOs. The median figure for 60+ StockRanks returns is over 150%, whilst the performance is negative for the lowest ranked QV IPOs.

IPOs with a Stockopedia combined Quality & Value Rank of 60+ go on to significantly outperform

Median aggregate return (%) from IPO to 15th June 2021



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Key insight

Analysis shows that selecting IPOs with the **strongest quality and value characteristics, statistically improves your chances of picking a winning IPO in the long run.**

Case study

Strix

One of the highest QV ranked shares in our data set was kettle safety controls specialist, Strix. A global leader in water heating, temperature control, steam management and water filtration systems, the company has a long track record of success in its niche markets.

Established in 1982, Strix has gone on to take a 38% global share of the kettle control market. Over 10% of the global population from around 100 different countries use Strix's products on a daily basis.

From the company's pre-IPO AIM Admission Document, investors could see that this was a company with steady revenue growth in recent years, generating consistently high levels of profitability to the tune of over £30 million Adjusted EBITDA per annum since 2007. In the Admission Document, Strix also declared that it continues to innovate on its product range, enabling it to stay ahead of its competition and make further market share gains.

These kinds of high quality niche product businesses have a tendency to outperform the market over the long-term. In Strix's case, it offered private investors a great opportunity to acquire a market leader, with profitable and growing operations.

Testament to the quality and value characteristics of the company, six months after it floated it had a had a QV Rank of 83. Having finished its first day of trading 30% up, Strix went on to return a cool 150% from its IPO in 2017 (at the time of writing). It is also noteworthy that there have been lower levels of volatility seen with the company's share price. This is perhaps due to the nature of high QV companies providing additional stability in the form of more consistent and predictable earnings.

Strix IPO performance

% return from issue price to 15th June 2021

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Insights from private investors' perceptions of IPOs

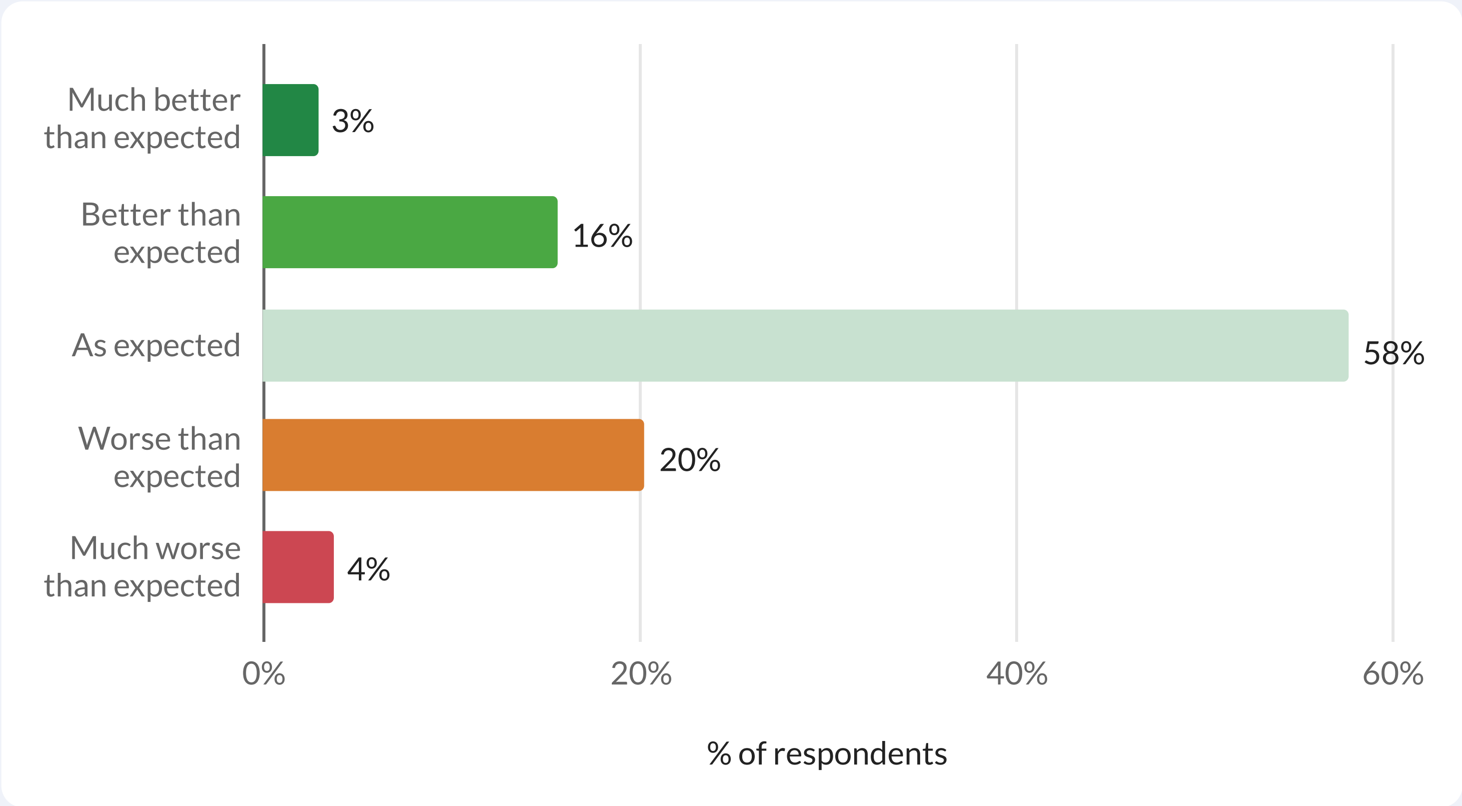
One of the main routes of entry into IPOs for many individual investors are major UK investment platforms like interactive investor.

Services like interactive investor provide upcoming IPO information - as well as the ability to trade them - and it will often be here that investors first learn about these new opportunities. We joined forces with interactive investor to survey their website visitors about how they perceive IPOs, their reasons for investing in them and their expectations about what the returns might be.

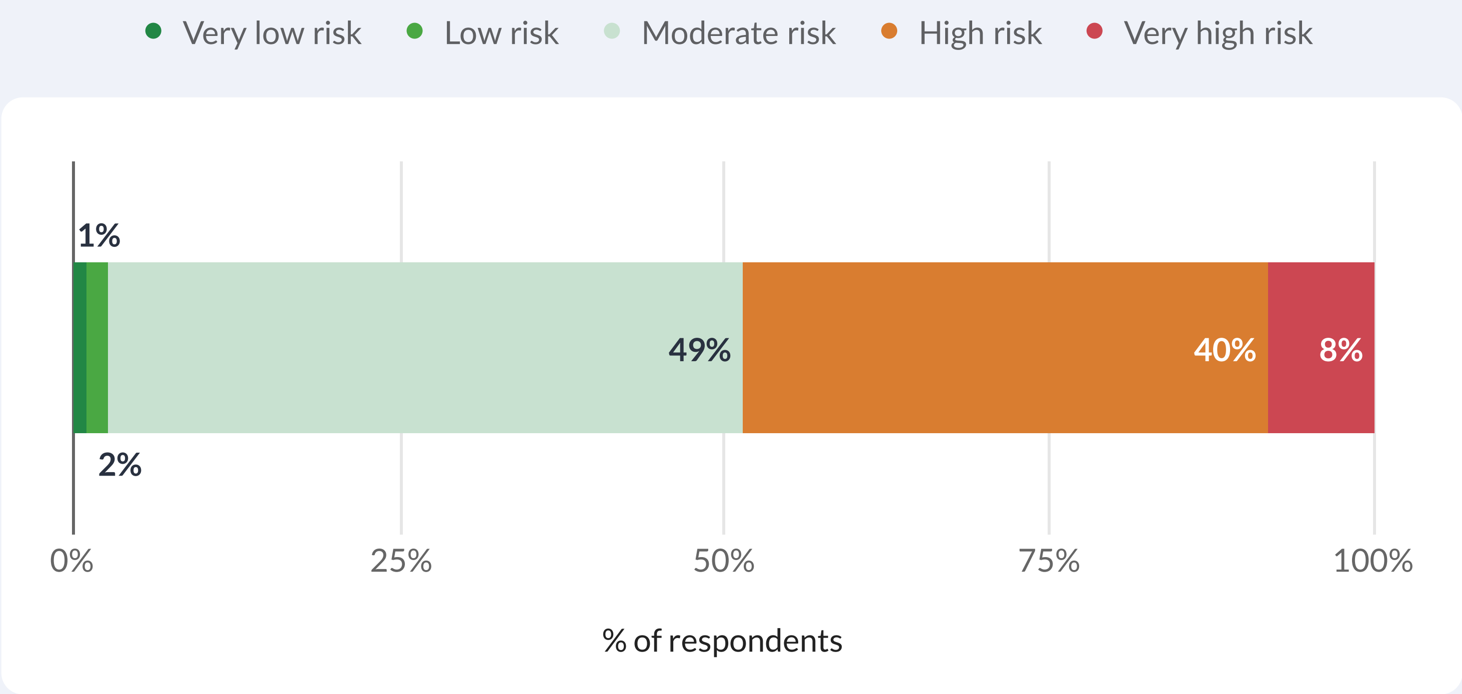
We asked the following questions to 1,200 visitors to the interactive investor website:

- If you have invested in IPOs before, how well have your investments performed?
- How risky is investing in IPOs, in your opinion?
- Why would you/do you invest in IPOs?

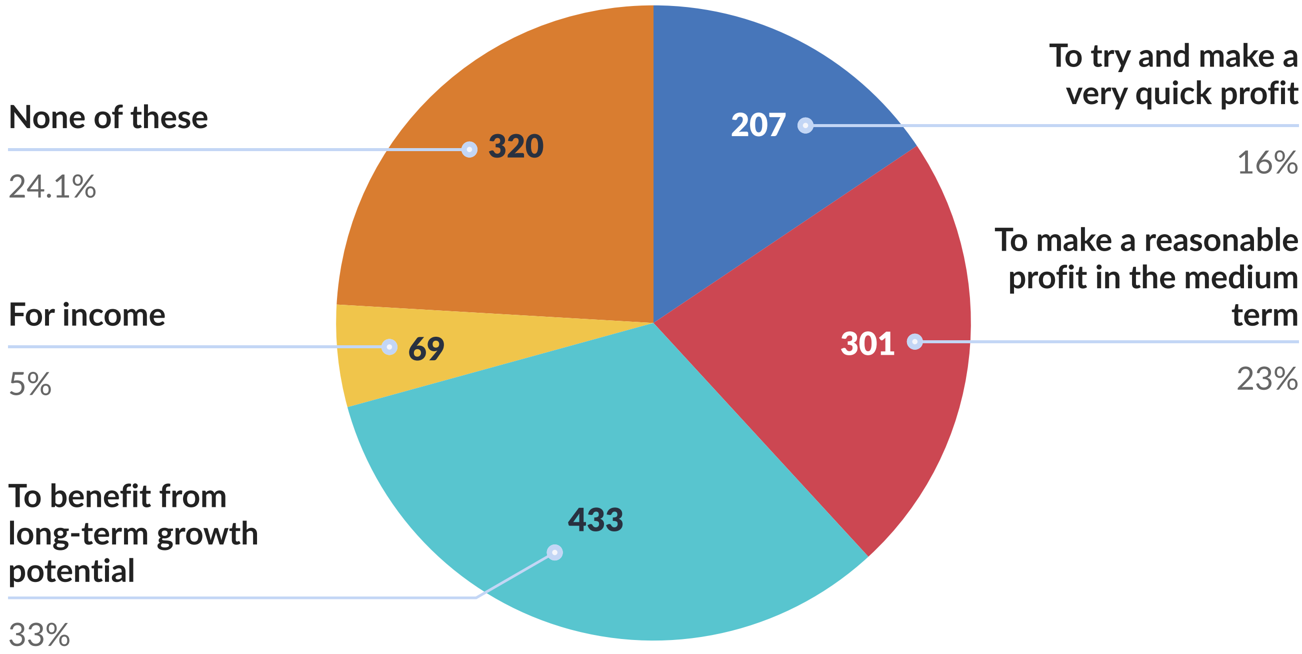
If you have invested in IPOs before, how well have your investments performed?



How risky is investing in IPOs, in your opinion?



Why would you / do you invest in IPOs?



Interestingly, the majority of respondents see IPOs as moderate risk, mid to long-term investment opportunities. This finding is very encouraging because it suggests that private investors are approaching new company listings as an opportunity to buy-and-hold the stocks involved.

It's likely that the client base of interactive investor is made up of proficient, self-directed investors, but it's unclear the extent to which they will know what to expect in terms of performance, on average, from the shares in new IPO companies.

In particular, the findings of our study show that IPO performance often deteriorates after six months. For longer term holders, this means that it's vital to consider factors like company size and sector, financial quality and valuation in order to increase the chances of success over the medium term.

05

Conclusions

IPO survival guide summary

Despite the excitement that tends to surround new IPOs, investing in them has historically been somewhat of a minefield for private investors. Our study of 258 IPOs that took place in the UK between January 2016 and May 2021 corroborates much of the existing research into how they perform.

On average, IPOs enjoy a first day 'pop', which almost exclusively benefits the institutional investors that are able to buy shares at the offer price. Thereafter, IPOs tend to perform well for six months, but subsequently fall back - with the median delivering a negative compound annual growth rate of 4.3% over 5 years. On a 1 to 5 year time horizon, the hit rate (the number of winners versus losers) falls below 50%, and at times comes close to just 40%.

But do these findings mean that you should avoid IPOs altogether? Not quite. While it's true that information asymmetry means that private investors are at an informational disadvantage, there are traits to look for that are associated with much better odds of success.

For a start, if you can buy IPO shares at the offer price - before they begin trading on the exchange - you might be able to benefit if there is a first day 'pop'. Frustratingly, most investors cannot buy shares at the offer price.

Given what we have found in this study, it is important to consider the motive behind a company's decision to float. Evidence shows that IPO outperformance has tended to be found in profitable, undervalued, small cap companies in innovative industries, which are aiming to raise capital to fund their growth plans.

In particular, look out for companies that display high quality metrics and are still relatively cheap at their first set of interim results. In this study, those factors had an influential bearing on performance over the longer term.

By contrast, larger companies that float on the stock market are much more likely to allow existing shareholders to ‘cash out’. This is a common route for private equity and venture capital firms to take their profits, as they know that many index tracker funds will be forced to buy the shares - and this can support potentially stretched valuations. With a carefully-crafted marketing campaign and promotion through the press, these shares can also be successfully sold to private investors post-IPO - often at inflated prices.

However, our research shows that - despite the narrative that surrounds many large cap IPOs - they are much riskier investments for private investors. Investing in large cap, low-quality, overvalued IPOs means you are far more likely to see a protracted period of underperformance. We hope that our analysis of 258 UK IPOs has helped to shed some light on the truths surrounding IPOs and provides a reference point for further research.

Key insights from our study

- ✓ IPOs, on average, tend to rise after the initial float, reaching a high around 6 months later. Performance then begins to drop as interest wanes. The strong average performance figures after 1 year are largely driven by a small number of well-performing IPOs.

- ✓ On a median basis, the 3 to 6 month timeframe seems to be the sweet spot for holding IPOs in the short-term. When you adjust for extreme values, the central tendency is for IPOs to perform extremely poorly over the long-term.

- ✓ Investors maintain a decent chance of success of picking an IPO winner over short-term time frames up to 6 months. However, after 1 year, the probability inverts and there is a much higher chance of underperformance if investors hold on for too long.

- It's best to avoid large and mid cap IPOs as they underperform. This may be because private equity and venture capital use public markets as an exit route where they know there are forced buyers. Small & micro caps outperformed across nearly all timeframes assessed.

- The AIM IPO market has provided some astonishing returns for private investors over prolonged periods, beating the Main Market by some distance. International Main Market IPO listings are riskier and worth avoiding for the most part.

- Due to the higher likelihood of picking a multibagger, the Health and Tech sectors have offered the best chances for sustained IPO success over the past 5 years. Financials and Energy have remained strong performers, whilst Consumer Cyclicals, Telecoms and Utilities have provided sub-par returns.

- Analysis shows that applying factor investing to new listings, by selecting those with the strongest quality and value characteristics after 6 months, statistically improves your chances of picking a winning IPO in the long run.

- There is a remarkable track record of success of IPO issue prices shooting up when the market opens. The current market structure seems to mean that this is, unfortunately, only really a benefit to financial institutions. Private investors are often unable to take advantage of underpriced IPOs.

Appendix - Academic IPO studies and their findings

Stockopedia's investigation into UK IPOs aimed to discover how investors should approach new flotations, how they perform on average, and how to improve the chances of investing in them successfully. One of the main findings is that IPOs usually enjoy a first day 'pop' and perform well for six months. But over the medium term, their fortunes tend to fade. How do these findings tally with existing academic research into IPOs?

Evidence from the UK

Analysis of IPOs in the UK consistently finds that they tend to enjoy strong short-term returns followed by much lower returns over three to five years. This was the finding of a 2007 research paper by Goergen, Khurshed and Mudambi entitled The long-run performance of UK IPOs: can it be predicted?, which studied 240 IPOs between 1991 and 1995.

A much larger study of 2,499 IPOs between 1975 and 2004 was done in 2009 by Gregory, Guermat and Al-Shawawreh (UK IPOs: Long Run Returns, Behavioural Timing and Pseudo Timing). The study found substantial evidence of IPO underperformance pestisting for three to five years post-floatation, but that smaller stocks in this period actually delivered the worst performance.

International evidence

Studies of European IPOs include a 2003 paper by Schuster entitled IPOs: Insights from Seven European Countries. This work looked at average returns from IPOs between 1988 and 1998 in France, Germany, Italy, the Netherlands, Spain, Sweden and Switzerland. Like other studies, it found that IPOs during that period tended to be underpriced in all markets, which led to early gains. But over three years, the results were mixed, with most territories (with the exception of Germany) seeing average returns that were either flat or negative.

In the United States, the most extensive research into IPO performance comes from Jay Ritter, a professor in the Department of Finance at the University of Florida. He maintains a regularly updated performance data set covering US IPOs.

This table shows the first-day and 3-year returns from US IPOs between 1980 and 2019. While the research is much more extensive it echoes the finding of our study in that first-day returns are often very strong but that longer run performance, particularly when adjusted for the market, are generally disappointing.

			Avg 3yr buy and hold return		
Sales (in 2019$)	No. of IPOs	Avg 1d return	IPOs	Market-adj	Style-adj
0 - 9.999mm	1,681	21.4%	-6.3%	-42.5%	-27.0%
10 - 19.999mm	699	28.1%	3.8%	-34.8%	-13.7%
20 - 49.999mm	1,485	22.9%	24.2%	-18.9%	-2.1%
50 - 99.999mm	1,399	18.0%	27.7%	-15.1%	-5.9%
100 - 499.999mm	2,208	13.2%	45.6%	3.1%	9.0%
>500mm	1,138	9.4%	37.5%	1.7%	1.4%
0 - 99.999mm	5,264	21.8%	12.7%	-27.5%	-12.6%
>100mm	3,346	11.9%	42.8%	2.7%	6.4%
1980 - 2019	8,610	17.9%	24.4%	-15.8%	-5.2%

Source: Jay R. Ritter, UF Warrington Faculty

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We would like to draw your attention to the following important investment warnings:

• The value of shares and investments and the income derived from them can go down as well as up.

• Investors may not get back the amount they invested.

• Past performance is not a guide to future performance.

Please note that all data in this document is historic and dated when this document went to print: July 2021

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