Canadian IPO Market Outlook
Will IPOs break through the economic clouds in 2019?
Key North American IPO market statistics 01
Macroeconomic backdrop sets the stage for 2019 02
Market and sector performance:
Canada and U.S. chart separate paths 04
IPO market activity expected to moderate 06
2019 IPO outlook summary 10
About us 11
Key North American IPO market statistics

Now that 2018 is behind us, it is time to take “stock” of what happened in 2018 and what that means for the capital markets and IPO activity in 2019 here in Canada. As 2018 drew to a close, North American markets were characterized by anxiety, uncertainty, and apprehension. While both the TSX and S&P 500 ended the year in negative territory, this does not tell the whole story. For most of the year, 2018 was a strong IPO new issue environment in North America, albeit more muted in Canada, supported by relatively low volatility and constructive equity markets.

With the outlook for 2019 looking less than clear out of the gate given the geopolitical and macroeconomic uncertainty overhang, we do expect North American IPO activity in the year ahead to be relatively subdued in comparison to prior years. Nevertheless, North American equity markets are expecting to welcome a number of high-profile new names to go public—with issuers, bankers and investors alike fervently hoping for stability to return and volatility to subside to allow for investor sentiment and market backdrop for IPOs to improve.

We continue to believe that investors will always be open to well-run companies with a solid track record of success, an ability to scale and a credible story—regardless of if they are positioned as growth stories looking to disrupt traditional industries or stable total-return or yield positive havens for income-oriented investors. In Canada, there continues to be a scarcity of such companies coming to market. As these new companies foray into the equity markets and chart their path forward, investors will be selective and opportunistically look for high quality issuers that present opportunities to generate an alpha return in their portfolios.

In this edition of Canadian IPO Market Outlook, we’ll focus on the notable trends from the past few months of 2018, and look forward to what 2019 may hold for prospective issuers, investors, and markets. We will also reference what we are seeing in the U.S. markets as it informs our overall view on the health of the IPO markets in general and influences Canada in particular.

### US

- **Number of IPOs**: 180
- **Total Proceeds Raised**: $50.0B
- **S&P 500 - 2018 Overall Market Return**: -7.0%
- **Aftermarket Performance of IPOs in 2018**: -2.7%

### Canada

- **Number of IPOs**: 11
- **Total Proceeds Raised**: $1.6B
- **TSX - 2018 Overall Market Return**: -12.2%
- **Aftermarket Performance of IPOs in 2018**: 2.8%

*Source: FPInfomart, TMX & Bloomberg (as of December 31th, 2018) for all Canadian listings with deal value > C$10 million and all U.S. listings with deal value > US$10 million (excluding SPACs)
Macroeconomic backdrop sets the stage for 2019

It is all about the rates
After a decade of rock-bottom interest rates, markets in North America and elsewhere entered into a new era of rising rates as central bankers took steps to guard against inflation and economic overheating. In Canada, the Bank of Canada increased its benchmark rate by 75 bps over 2018 but recently left it unchanged at 1.75% in December due to the relative softness of the Canadian economy. In the U.S., ongoing robust economic growth saw the U.S. Federal Reserve hike rates for a fourth time in 2018, raising rates by 25 points in late December and targeting a range of 2.25% to 2.5%. However, early 2019 has witnessed the equity markets venting their concerns and frustration with rates rising too much, too fast - with market participants now pricing in rate hikes to slow down considerably versus prior expectations.

Flattening yield curves – with markets waiting for a breather
The spread between long-term and short-term bond yields has been narrowing in both Canada and the U.S. This flattening yield curve suggests investors have begun to price additional risk into short-term yields – a move that has long been perceived as a leading indicator for potential economic contraction.
As Figures 1 and 2 show, equity markets have historically reacted negatively to flattening yield curves for that very reason as concerns rise around what a flat or “inverted” yield curve would mean with respect to economic growth going forward.

Concerns over slowing global economic growth, U.S.-China trade tensions, and anxieties around widespread geopolitical uncertainty drove headlines and investor sentiment in 2018—and will continue to do so in 2019, undoubtedly. All eyes will be on the central banks to see if a more overall dovish pause is taken to allow for the equity markets to catch its breath.
Market and sector performance: Canada and U.S. chart separate paths

It is not new news that the Canadian equity markets continued to underperform its U.S. counterpart. The reasons have been historically consistent—over exposure to resources and financials in the Canadian equity markets. This relative underperformance of the Canadian equity markets is clearly shown in Figure 3 below.

Figure 3. Canada and U.S. stock market performance

Canadian equity markets saw Information Technology as the only real bright spot with a material sector gain of 10% on the year.
While both the TSX and S&P 500 struggled in the second half of 2018, sector performance varied widely between Canadian and U.S. markets (Fig. 4 & 5). Canadian markets saw Information Technology as the only real bright spot with a material gain of 10% on the year followed by Consumer Staples with 1%; all other sectors had negative performance and TSX heavy weights such as Financials, Materials and Energy were all down by greater than 10%, pulling the TSX along with them.

In the U.S. markets, Healthcare and Utilities were the only sectors with positive performance and sectors that have significant representation such as Industrials and Financials (combined, making up 24% of the S&P 500) had negative performance of 16% and 15% respectively, dragging down the S&P 500 in 2018.

**Figure 4. S&P/TSX sector performance 2018**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Sector Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information Technology</td>
<td>4%</td>
</tr>
<tr>
<td>Consumer Staples</td>
<td>3%</td>
</tr>
<tr>
<td>Telecom Services</td>
<td>5%</td>
</tr>
<tr>
<td>Real Estate</td>
<td>3%</td>
</tr>
<tr>
<td>Industrials</td>
<td>10%</td>
</tr>
<tr>
<td>Utilities</td>
<td>4%</td>
</tr>
<tr>
<td>Aggregate Index</td>
<td>34%</td>
</tr>
<tr>
<td>Financials</td>
<td>10%</td>
</tr>
<tr>
<td>Materials</td>
<td>2%</td>
</tr>
<tr>
<td>Healthcare</td>
<td>6%</td>
</tr>
<tr>
<td>Consumer Discretionary</td>
<td>19%</td>
</tr>
<tr>
<td>Energy</td>
<td></td>
</tr>
</tbody>
</table>

Source: CapitalIQ January 1st 2018 to December 31st 2018

**Figure 5. S&P 500 sector performance 2018**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Sector Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>Healthcare</td>
<td>14%</td>
</tr>
<tr>
<td>Utilities</td>
<td>3%</td>
</tr>
<tr>
<td>Consumer Discretionary</td>
<td>13%</td>
</tr>
<tr>
<td>Information Technology</td>
<td>26%</td>
</tr>
<tr>
<td>Real Estate</td>
<td>3%</td>
</tr>
<tr>
<td>Aggregate Index</td>
<td>7%</td>
</tr>
<tr>
<td>Consumer Staples</td>
<td>14%</td>
</tr>
<tr>
<td>Financials</td>
<td>10%</td>
</tr>
<tr>
<td>Industrials</td>
<td>2%</td>
</tr>
<tr>
<td>Materials</td>
<td>3%</td>
</tr>
<tr>
<td>Telecom Services</td>
<td>6%</td>
</tr>
<tr>
<td>Energy</td>
<td></td>
</tr>
</tbody>
</table>

Source: CapitalIQ January 1st 2018 to December 31st 2018
Recap of 2018 IPO activity
While 2018 was an even stronger year for the U.S. in terms of IPO activity, Canadian volumes were more muted. A total of 11 IPOs raising C$1.6 billion of proceeds were completed in Canada (below the past 5 year average of C$3.2 billion) while 180 IPOs raising US$50.0 billion of proceeds crossed the finish line in the U.S. (slightly above the 5 year average of US$49.6 billion).3,4

As shown in Figures 6 and 7, there were issuers across a variety of sectors that were able to access the capital markets in 2018. In Canada, Real Estate, Materials and Healthcare were the most active sectors and in the U.S., Technology, Healthcare and Consumer Staples were the most active sectors in terms of IPO activity.3,4

Figure 6. Canadian IPOs deal value per sector

Source: FPInfomart IPOs by sector from 2013 to 2018 (deal size > C$10 million & excluding SPAC’s)

Figure 7. U.S. IPOs deal value per sector

Source: Dealogic U.S. IPOs by sector from 2013 to 2018 (deal size > US$10 million & excluding SPAC’s)
Rising volatility suggests IPO lull for the short term

There is a direct, inverse relationship between market volatility and IPO activity. The Volatility Index (VIX) showed major volatility spikes during the year (Fig 8). February’s spike was driven by investor worries that inflation fears would lead to higher interest rates, while in Q4 investors were more concerned by a slowing economy, trade-related sabre-rattling and the spectre of additional interest rate hikes. The more recent heightened volatility suggests we are in for something of a lull in IPO activity in the short term. However, as global uncertainty recedes, issuers and private equity sponsors will be eagerly waiting for the return to market normalcy in order to move forward with their transactions that they have been patiently preparing for.

In 2018, subsequent to the market swings experienced in February, volatility subsided allowing for 6 of the 11 Canadian IPOs to price during Q2 or 55% of the total deal flow for the year. It was a similar case in the U.S., where over 57 of the 180 deals priced in the same period or 32% of all deals for 2018.3,4

The more recent heightened volatility suggests we are in for something of a lull in IPO activity in the short term.
Canadian IPO aftermarket performance had a few bright spots

Overall, the average aftermarket performance of Canadian IPOs for 2018 (Fig. 9) has been positive, with a lacklustre 2.8% return which exceeds the broader stock market performance in Canada — but therein lies the challenge with computing averages. In reality, only 5 of the 11 Canadian IPOs from 2018 saw positive returns while the balance are unfortunately down from the issue price. Some of the bright performers from 2018 included Minto REIT and AltaGas Canada both posting double digit returns. Certainly, many of the 2018 IPOs in Canada were not immune to the market weakness experienced in late 2018.

For 2019, it will be important for investors and prospective issuers alike, to dive into the investment stories of individual companies and have high conviction around the relative investment merits versus similar publicly traded peers. Moreover, it will also be important for reasonable valuation levels to be established that accurately reflect growth - but also provides for robust investor support to drive strong aftermarket performance.

Figure 9. Canadian IPO aftermarket performance (since IPO)

For 2019, it will be important for investors and prospective issuers alike, to dive into the investment stories of individual companies and have high conviction around the relative investment merits versus similar publicly traded peers.
Cannabis: Canada’s newest growth industry enters a period of consolidation

The tremendous excitement—dare we say hype—surrounding Canada’s fledgling, fast-growing cannabis industry appears to have settled down somewhat in the months after the federal government officially legalized recreational cannabis in October 2018. Prior to this, Canada was home to two issuers completing IPO’s on Canadian exchanges, The Green Organic Dutchman and Charlotte’s Web, as well as Tilray, the first global pure play cannabis company to complete an IPO on a U.S. exchange with a resounding 315% return on its IPO price. Canada’s cannabis industry has likely reached a maturation point, and rather than welcoming all new companies to the fold, the sector is much more likely to be entering a period of evolution, and with that, consolidation.

We expect that the issuer activity in the cannabis sector is likely to fall and focus on later stage companies with proven success. That said, we believe the usage of both IPO and RTO (Reverse Takeover) methodologies for issuers to list will continue as a result of successful RTO’s by large, well established names such as Medmen and Green Thumb Industries. Interest in M&A activity is expected to pick up as companies angle to gain competitive advantages, efficiencies, and scale. Licensed producers will need to have considerable scale, particularly in the U.S., in order to attract the marginal investor dollar still available to deploy into the sector.

What sector is next on the horizon?

The cannabis sector certainly provided Canadian markets with a jolt of energy and excitement in the past couple of years. As the industry matures, investors are searching for the next burgeoning opportunities. We are still waiting for an immediate successor to emerge. Certainly, blockchain, fintech, and artificial intelligence (AI) are seen as some of the “next big things” on the business landscape and Canada is being recognized as a leader in many of these areas, particularly AI. Currently, these industries and companies operating within them are not at the inflection point where an IPO would make sense, but this will change as they continue to evolve and their products and services continue to commercialize and scale.

An IPO of these types of entities underscores the growing need for more “made in Canada” success stories in the technology sphere along with the retention of valuable intellectual property to remain on this side of the border.

Oil and gas: For now, its potential remains stuck in the ground

Geopolitical uncertainty, worries over global economic growth, rising U.S. shale oil production, and the ever-present struggles to build new pipeline capacity all contributed to a sharp drop in oil prices in the back half of 2018—the last thing Alberta’s economy and beleaguered oil and gas industry needed. The Alberta government’s production cuts may boost prices slightly, but there is little positive news in the immediate future for the sector and oil and gas investors.

It is well known that there is a tremendous amount of private capital currently tied up in Canada’s oil and gas industry with nowhere to go. Given how severely limited oil and gas IPO market activity has been in recent years, significant positive developments—such as a sustained increase in related commodity prices—could in theory trigger many private equity sponsors to opportunistically monetize their energy investments in the public markets through an IPO – with many of these investors having held their investments well beyond their initial investment horizons. Much will depend on the state of oil prices and the actual oil and gas companies’ readiness to go to market.
2019 IPO outlook

As economic clouds gather, markets poised for high-profile IPOs
Volatile markets and worries over slowing economies, trade wars, and potential recessions may persuade some companies to remain on standby until the economic “tea leaves” are clearer. Yet those concerns are not deterring high profile North American companies like Uber, Lyft and others from potentially going public.

Uber and Lyft are not the only big tech names considering 2019 IPOs. Airbnb and Slack are also expected to go public in 2019, though their timing is not yet clear. For years, private equity enabled these firms to grow rapidly as a private company. Now, the time has come for their potential public market debut.

Despite the economic worries weighing on the minds of governments, business leaders and investors alike, 2019 could prove to be the biggest year yet for technology IPOs. In 2018, 46 tech IPOs raised US$15.5 billion, which was the best result since 40 companies raised US$37.9 billion in 2014. 2019 could potentially surpass that figure as these companies evolve past their private sources of capital and begin to explore the public realm.

The abundance of private capital, together with the stock markets’ current softness, will likely convince some private companies to simply sit tight and bide their time before pursuing an IPO.

Look past the clouds and get ready
There will always be public investor appetite for the right IPO as long as markets remain constructive. Craig Alexander, Chief Economist of Deloitte Canada, states in his Economic outlook: January 2019, “We expect 2019 to be a year of economic moderation internationally and in Canada”.

Furthermore, with 2020 looking a bit more uncertain, we expect a number of issuers to accelerate any plans to go public into 2019 so long as their business plans and equity story allow for it. Investors remain eager to find companies whose products or services have the potential to disrupt industries and traditional ways of doing business. They are constantly searching for opportunities to be on the side of the disruptors—not the disrupted—and back tomorrow’s winners over today’s champions. As well, investors will always be looking for companies with a track record of growth and success, the ability to scale, a solid management team, appropriate risk/reward profiles and a credible story to tell.

Worth the wait – it is all about the track record
Uber, Lyft and other tech companies preparing for 2019 IPOs perhaps best illustrate how IPOs have changed in recent years. To be certain – this is not just a U.S. based trend, but applies to many Canadian private companies. Many private companies are just waiting longer—and growing larger—before turning to the public markets, funded by ever-growing pools of private capital eager to find a home. In doing so, these companies have been able to establish a more extensive track record of performance.

Our advice to companies considering whether to pursue an IPO in 2019 and the foreseeable future is this: Get ready now. Look past the gloom and pessimism of the market which at some point will subside, and begin to prepare your business in order to execute an IPO when the opportunity comes knocking. This type of forward thinking is what will position many founders, management teams and private equity sponsors to work from a position of strength to ensure that all their “ducks are in a row” and to maximize optionality for whatever path is right for them—when the timing and value is right. Consider the need for an advisor to act as a guide and craft your story to attract interest from the market. When the window opens to execute, will you be ready?
About us

Deloitte IPO Advisory services is an end-to-end service provider that utilized a comprehensive framework for advising and preparing companies for the initial public offering and beyond. This can include analyzing a company’s strategic alternatives, getting “IPO ready,” helping to coordinate the overall process and providing independent capital markets advice throughout the process. The group comprises a dedicated team of professionals from investment banking, equity capital markets, private equity, financial reporting, risk, tax, and consulting backgrounds.

Deloitte’s leading IPO Advisory practice is differentiated in the marketplace through its dedicated Capital Markets team, providing issuers with independent advice relating to key IPO success factors, including equity story, value, market timing, pricing strategy, underwriter selection, fee negotiations, roadshow and investor targeting strategy.

To learn more about our services, contact your local Deloitte contact or one of our Deloitte IPO Advisory professionals.

Endnotes

1. Source: Bank of Canada, as of December 31st
2. Source: U.S. Department of Treasury, as of December 31st 2018
3. Source: FPInfomart, (as of December 31st, 2018) for all Canadian listings with deal value > C$10 million (excluding SPAC’s)
4. Source: Dealogic (as of December 31st, 2018) for all U.S. listings with deal value > U.S.$10 million (excluding SPAC’s)
5. Source: Deloitte - A society in transition, an industry ready to bloom, 2018 cannabis report
6. Source: Barron's
7. Dealogic as of December 31st, 2018
8. Bloomberg as of December 31st, 2018
Contacts

Jennifer Maeba
Partner
IPO Advisory Services
416-301-8491
jmaeba@deloitte.ca

Robert Nardi
Partner
IPO Advisory Services
514-393-5203
rnardi@deloitte.ca

David Dalziel
Partner
IPO Advisory Services
416-601-6298
ddalziel@deloitte.ca

Jason Novakovski
Partner
IPO Advisory Services
403-261-8104
jnovakovski@deloitte.ca