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IPO Sweet Spot Report

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Lessons from the enduring tech companies of this century.

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As players turned coaches, we are obsessed with two things. One, we study the category game playbook. We watch tons of game film and work hard to emulate the strategies and disciplines that the world's most successful category kings followed to earn their crowns. Two, we also obsess about the game clock. That's what led us to invest more than three quarters of a million dollars in a research agenda to understand just exactly how timing impacts the outcomes of category kings. Timing is critical to win the category game. How can you win a game if you don't understand the game clock?

Our Play Bigger data science team executed a multi-year program to analyze all of the funding data from venture-backed companies since the turn of the century. Our team, led by Lucas Ramadan, mined and interrogated the data until it revealed the truth about a number of key factors. 1) How fast companies were producing marketing cap, and 2) When companies produced enduring value.

IPO Sweet Spot

1. Research Findings
2. Analysis of Why the IPO Sweet Spot Exists
3. Brain Science Connection
4. Implications
5. Methodology

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RESEARCH FINDINGS

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Category Kings earn

76%

of the market cap of their space.

Since 2000,
4,424 American venture-backed technology companies raised a Series A financing.

* US Companies Series A or equivalent financing from a Venture Capital company. Source: PrivCo.

Only

69

of these companies went public (IPO).

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We analyzed,

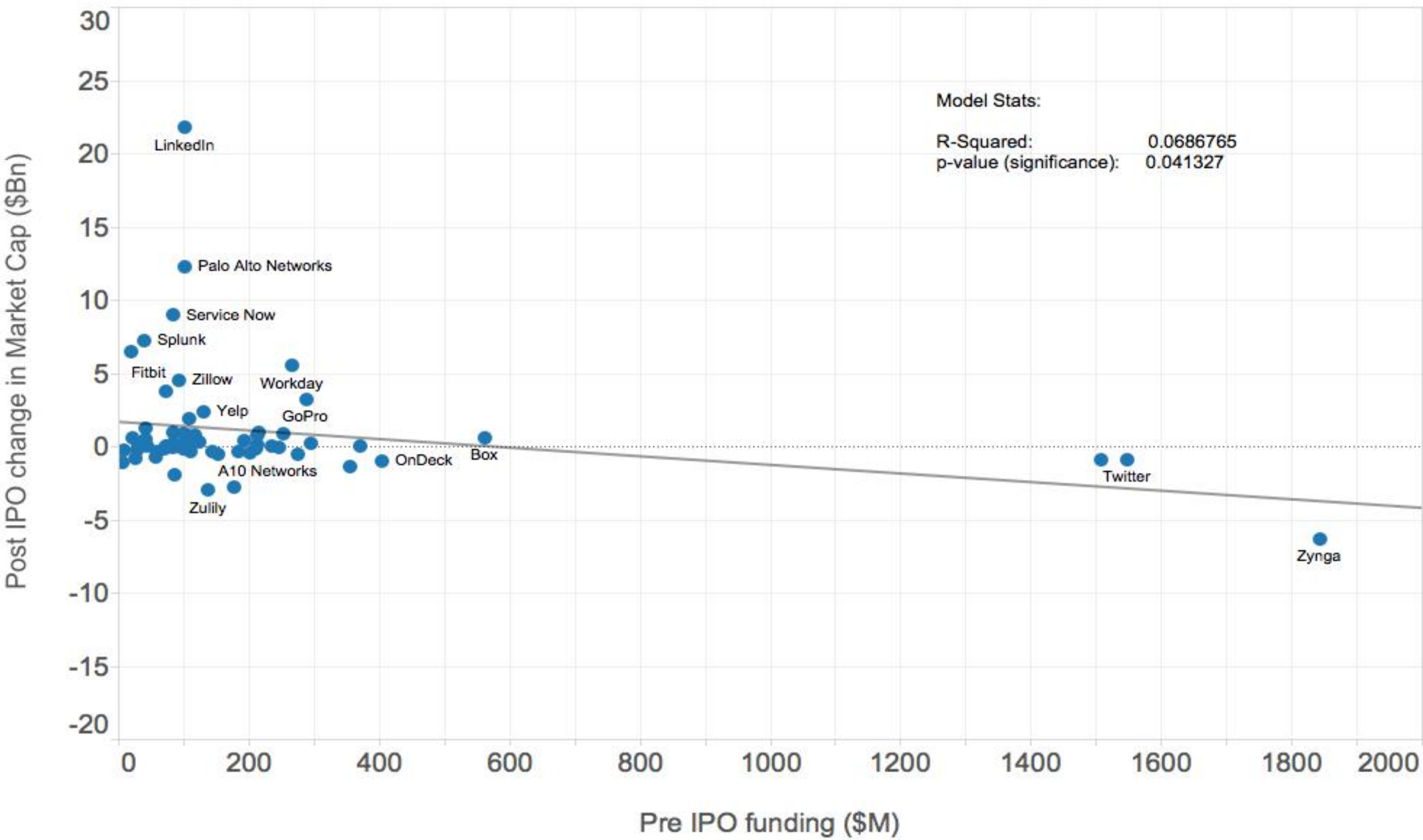
the impact of money & time on enduring value

of these companies.

What we discovered blew us away.

There is no correlation between how much money a tech startup raises and post-IPO value created.

Pre-IPO funding .v. Post IPO value creation
All companies



Pre IPO funding vs. Delta MCAP. The marks are labeled by Company name. Excludes Facebook.

However,
there is a material correlation between company age and post-IPO value creation.

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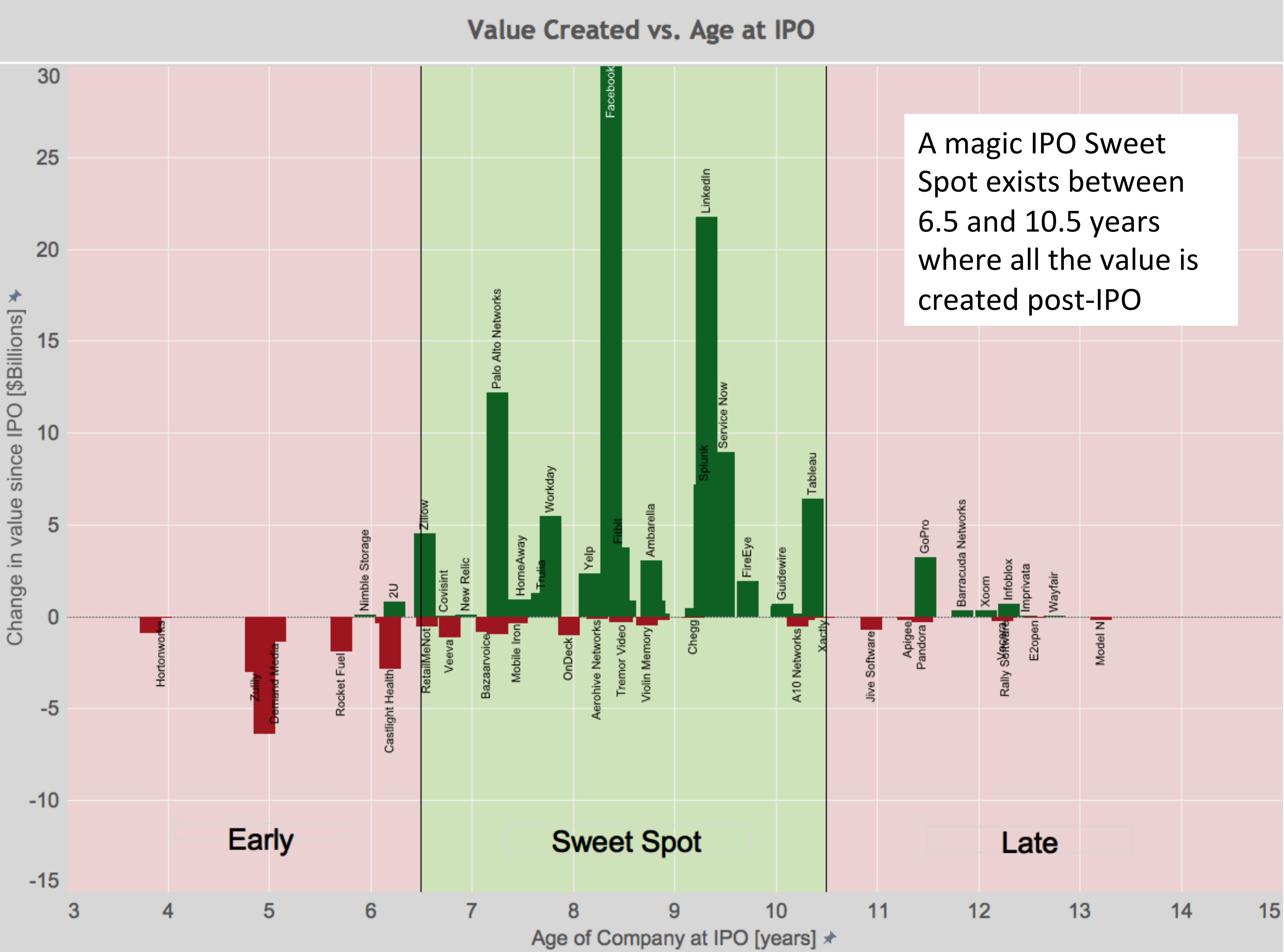
Value Created vs. Age at IPO
Change in value since IPO [$Billions]
Age of Company at IPO [years]
A magic IPO Sweet Spot exists between 6.5 and 10.5 years where all the value is created post-IPO
Early
Sweet Spot
Late
Hortonworks
Zulily
Demand Media
Rocket Fuel
Nimble Storage
Castlight Health
2U
Zillow
RetailMeNot
Covisint
Veeva
New Relic
Bazaarvoice
Palo Alto Networks
Mobile Iron
HomeAway
Trulia
Workday
OnDeck
Yelp
Aerohive Networks
Facebook
Fitbit
Tremor Video
Ambarella
Violin Memory
Chegg
Splunk
LinkedIn
Service Now
FireEye
Guidewire
A10 Networks
Tableau
Xactly
Jive Software
Apigee
Pandora
GoPro
Barracuda Networks
Xoom
Rally Software
Infoblox
Imprivata
E2open
Wayfair
Model N

IPO Sweet Spot – Key Findings

1. Companies that hit the IPO Sweet Spot create 113% of all market cap created post IPO.

2. Companies that go public early destroyed $18 billion in market cap post IPO.

3. Companies that go public early are 94% sure of losing value post IPO.

4. Companies that go public late produce very little incremental market cap - just over 1% of all value created.

2

OUR ANALYSIS OF WHY THE IPO SWEET SPOT EXISTS

The big question is why is company age material to post-IPO success?

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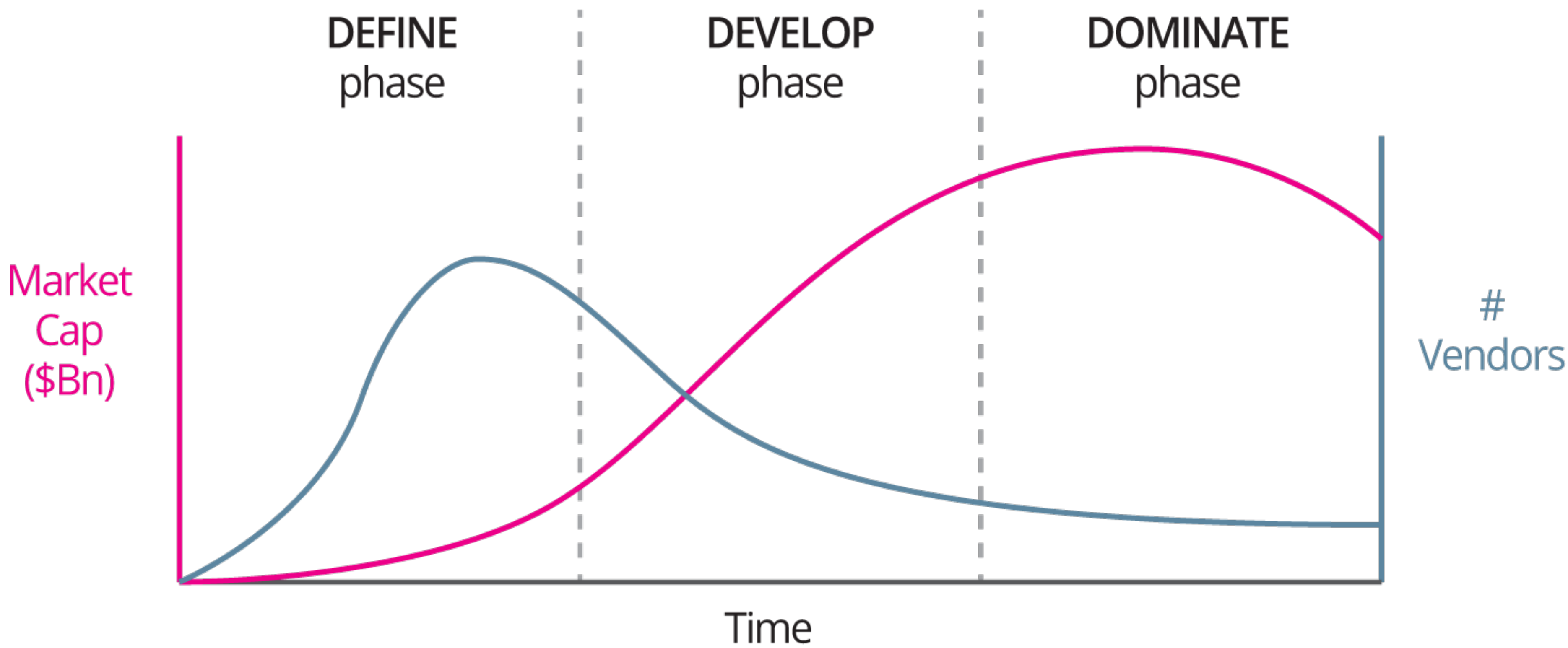
We wondered whether the IPO Sweet Spot was related to the Category Value Curve?

Category Value Curve



* Adapted from: P. A. Geroski, “The Evolution of New Markets”, Oxford University Press, 2009

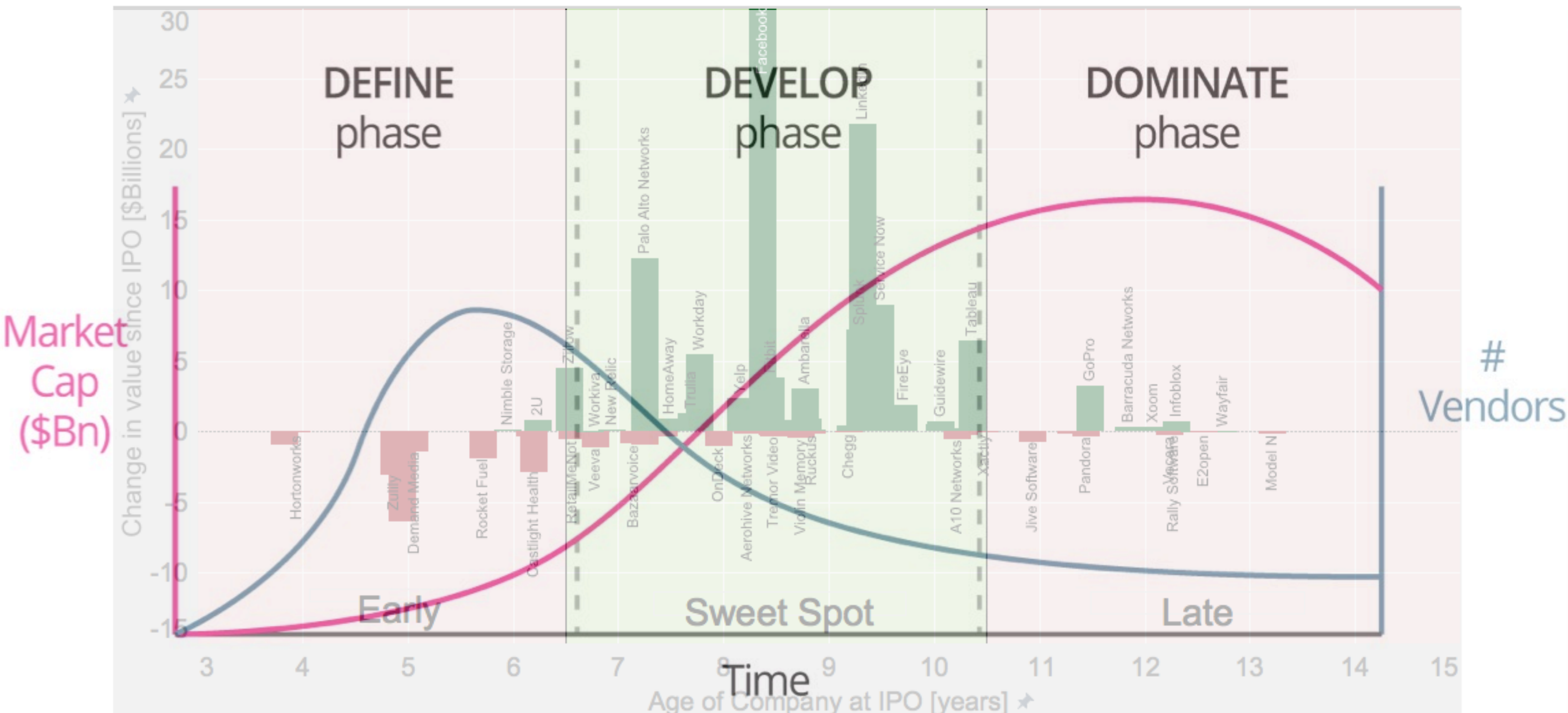
Geroski Curve

In a market's earliest stage, the number of companies (he calls them providers) in the space explodes. This is the phase when the new category is first defined and a gaggle of entrants are scrambling to solve the problem. In the middle phase, the number of companies dives as the king emerges and competitors disappear (the king starts sucking up all the economics). In the last phase the number of companies bottoms out as the king dominates and reigns over the market. At the same time, the market value of the whole category rises slowly in the first stage as a category gets on its feet, then like a rocket in the middle stage as the category catches on. In the last stage -- the domination stage -- value peaks and then tails off as the category matures.

Research by Paul Geroski, author of *The Evolution of New Markets*.

So we overlaid the two models…

Category Value Curve & the IPO Sweet Spot



And we had a powerful ah-ha.

Companies that go public in the “develop” phase of the category value curve generate the vast majority of value.

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So we asked ourselves:

Why would the “develop” category phase correlate with the sweet spot rather than the stage of the company or product?

The answer lies on how our brains work and how long it takes for a category to become material.

BRAIN SCIENCE CONNECTION

It turns out that companies and products don’t live in space. They live within a container in a customer or user’s mind.

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That container is a category.

People Need Categories

In a world exploding with new product offerings

- Categories are mental tags used to organize explosion in new offerings
- You have to have a problem before you buy a "solution"
- Categories create hierarchies of value
  - Must have
  - Nice to have
  - Not interested

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Brain Science

In times of uncertainty we turn to categories

- The Anchoring Effect: early information effects all information that comes after
- When we hold an opinion that differs from others, our brains produce an error signal, warning us that we are probably wrong
- More than 50 cognitive biases push us to decisions *not* based on facts and logic, but on instincts

Two sources: Daniel Kahneman, Thinking Fast and Slow & Cris Evatt's Brain Biases blog Brain Sort

Categories are the way people discover and relate to companies and products.

This means that category growth is governed by how fast our brains can change in an uncertain new world.

So the answer is…

The IPO Sweet Spot exists because of how long it takes to change people's thinking, user behavior and purchase decisions at scale.

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IMPLICATIONS

Changing the perception in a user's or buyer's mind is job #1.*

* A special shout out to the legendary Al Ries and Jack Trout and their marketing classic "Positioning, the battle for your mind", McGraw-Hill. 1976.

That’s why the CEO’s of tomorrow will be category designers.


Thank
You
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If you would like the long version of this research report, please contact mary@playbigger.com

This information is solely for informational purposes. Objects in mirror are closer than they appear. Coffee is a hot beverage that will burn your crotch. In the event of a water landing, pray your airplane captain is “Sully” Sullenberger. Johnny Cash was right. Party on Wayne.

WARNING: All products contain nuts.

METHODOLOGY

Play Bigger Research Agenda

At Play Bigger we are students of the category design game. We invest heavily in qualitative and quantitative research to understand both the playbook and the timing to win the game. We have a deep database of every tech company founded since 2000 and we published our first report on Time to Market Cap in November 2014.

Play Bigger Methodology

To move from assumptions and anecdotes to facts we assembled a team of data scientists and business executives to comb through a variety of data sources to create a fact-based database.

The research examined financial transactions from 851,512 companies searching for companies that were U.S.-headquartered, venture backed, in the technology industry and founded since 2000. We only included transactions that occurred between January 1, 2000 and June 30, 2015.

We narrowed the dataset to 30,575 financial transactions associated with 8,640 companies.

We further refined the dataset to 4,421 companies who had what we considered a legitimate Series A financing from a venture capital company.

Process

The research was conducted using a primary data source from PrivCo (http://www.privco.com). The PrivCo team provided us with what we believe is accurate, complete, hard-to-find and timely private company data.

We also used other sources such as Google finance, Bloomberg, Wikipedia, etc. We wrote python code to manipulate and extract the data. We also downloaded data where APIs weren't available.

We developed custom python code to extract and manipulate data.

The bulk of our analytics were conducted with Tableau 9 (http://www.tableau.com).

Definitions

We defined a number of terms used throughout our research:

- Market Cap is measure of a company's value and is typically calculated by multiplying the number of shares outstanding by the current share price. In this report we establish a company's market cap in one of three ways:
  - Public market capitalization as reported by 3rd parties such as Bloomberg, Google finance, etc;
  - Purchase price at the time of acquisition of the company by another entity
  - The most recent post-money valuation from a private financing transaction
- Time to Market Cap is a term created by Play Bigger to measure of how long it takes a company to reach seminal valuation / market capitalization milestones.
- IPO Sweet Spot is a term created by Play Bigger to describe the sweet spot of post IPO value creation. Lucas Ramadan is the data scientist who discovered it.
- Category King is a term created by Play Bigger to describe the company who achieves the dominant position in a given space as measure by market cap. Our research indicates that Category Kings attain 76% percent of the market cap in their sector.

About Play Bigger

Dave, Al and Christopher are former entrepreneurs and operating guys turned coaches. We have founded and built companies, served as CMOs, CEOs and senior executives of large public technology companies.

Every year we are lucky enough to partner with a few venture-backed technology firms to help them create a new category or win their current category battle. We work with all stages of the technology outfit, from earlier stage startups and large publically traded companies. Our goal is to help CEOs, CMOs and executive teams to create an un-fair competitive advantage through a new, strategic approach to positioning called category design.

Category design is the discipline of creating and monetizing new markets. It is the new strategic, enterprise-wide strategy for positioning companies to win in new markets. A category design strategy is purpose built to empower companies to define, develop and dominate a new market category, conditioning the market to demand a new solution, and generate material category and company value.

More information about Play Bigger can be found at the www.playbigger.com and by following the company on Twitter @playbigger, Facebook, and Linkedin.