IPO ANALYSIS

Research on upcoming IPOs for selected candidate companies.

SolarWinds

Niu Technologies

Upwork

October 2018

VentureDeal

SolarWinds Initiates Effort For $500 Million IPO

Quick Take

SolarWinds (SWI) intends to raise gross proceeds of $500 million from a U.S. IPO, according to an S-1 registration statement.

The firm provides IT infrastructure software for a range of network, systems, database, and security management functions.

SWI is growing topline revenue at a decelerating rate and has a heavy debt and accruing dividend load typical of private equity-owned IPO candidates.

When we learn more details about the IPO from management, I'll provide a final opinion.

Company & Technology

Austin, Texas-based SolarWinds was founded in 1999 to develop and provide IT infrastructure management services to organizations of any size.

Management is headed by President and CEO Kevin B. Thompson, who has been with the firm since 2006 was previously CVP and CFO at SAS.

SolarWinds continuously engage with technology professionals to understand the challenges they face in maintaining high-performing and highly available on-premise, public and private cloud and hybrid IT infrastructures.

With the gained insight, the company has managed to build products that solve IT management challenges in ways that technology professionals want them solved.

Original investors in SolarWinds include Bain Capital Ventures, Austin Ventures, and Insight Venture Partners. The firm was taken private in 2015 by private equity firms Thoma Bravo and Silver Lake for $4.5 billion.

Customer Acquisition

The company markets and sells products directly to technology professionals with a high-velocity, low-touch digital marketing, and direct inside sales approach that they call "selling from the inside."

SWI's sales team gains insight from their THWACK community with over 150,000 registered users and manages this data to products according to SolarWinds' standardized pricing and contract terms.

Sales and marketing expenses as a percentage of revenue have been dropping as the table below shows, indicating increased efficiencies since 2016:

Sales & Marketing Expenses vs. Revenue

Period	**Percentage**
1H 2018%	27.4%
2017	28.2%
2016	45.3%

(Source: Company Prospectus and IPO Edge)

Market & Competition

According to a 2018 market research report by Markets and Markets, the global remote infrastructure management market was valued at $23.65 billion in 2017 and is projected to grow to $41.27 billion by 2022, representing a CAGR of 11.8% during the period between 2018 and 2022.

The main factor driving market growth is the increasing need for seamless, value-added, and reliable Quality of Service (QoS).

The storage management segment is expected to dominate the market in terms of market share and is projected to grow considerably during the forecast period due to the increasing need among enterprises for managing servers remotely and monitoring servers for any risk or attack.

Major competitors that provide or are developing IT infrastructure management software include:

- HCL Technologies (HCLTECH.NS)
- Fujitsu (OTCPK:FJTSY)
- Tata Consultancy Services (TCS.NS)
- Capgemini (CAP.PA)

- Sensiple
- Nityo Infotech
- Locuz

SolarWinds operates in several IT management service provider categories.

Financial Performance

SWI's recent financial results can be summarized as follows:

- Growing topline revenue
- Increasing gross profit
- High and growing gross margin
- Uneven cash flow from operations

Below are the company's financial results for the past two and ½ years (Audited PCAOB for full years):

	Predecessor	Successor		Successor	
	Period From January 1 Through February 4,	Period From February 5 Through December 31,	Year Ended December 31,	Six Months Ended June 30,	
	2016	2016	2017	2017	2018
				(unaudited)	
Revenue:					
Subscription	$ 6,551	$ 126,960	$ 213,754	$ 100,041	$ 128,291
Maintenance	29,500	145,234	357,630	168,203	195,767
Total recurring revenue	36,051	272,194	571,384	268,244	324,058
License	11,276	149,900	156,633	72,322	74,573
Total revenue	47,327	422,094	728,017	340,566	398,631
Cost of revenue:					
Cost of recurring revenue[1]	9,551	46,238	60,698	29,689	34,595
Amortization of acquired technologies	2,186	147,517	171,033	84,268	88,286
Total cost of revenue	11,737	193,755	231,731	113,957	122,881
Gross profit	35,590	228,339	496,286	226,609	275,750
Operating expenses:[1]					
Sales and marketing	47,064	165,355	205,631	101,128	109,096
Research and development	32,183	65,806	86,618	42,893	48,526
General and administrative	79,636	71,011	67,303	35,785	40,252
Amortization of acquired intangibles	917	58,553	67,080	32,875	33,781
Total operating expenses	159,800	360,725	426,632	212,681	231,655
Operating income (loss)	(124,210)	(132,386)	69,654	13,928	44,095
Other income (expense):					
Interest expense, net	(473)	(169,900)	(169,786)	(84,484)	(76,476)
Other income (expense), net[2]	(284)	(56,959)	38,664	15,400	(74,463)
Total other income (expense)	(757)	(226,859)	(131,122)	(69,084)	(150,939)
Loss before income taxes	(124,967)	(359,245)	(61,468)	(55,156)	(106,844)
Income tax expense (benefit)	(53,156)	(96,651)	22,398	(9,414)	(19,919)
Net loss	$ (71,811)	$ (262,594)	$ (83,866)	$ (45,742)	$ (86,925)

(Source: SWI S-1)

Total Revenue

- Through Q2 2018: $398.6 million, 17.0% increase vs. prior
- 2017: $728.0 million, 55.1% increase vs. prior
- 2016: $469.4 million

Gross Profit

- Through Q2 2018: $275.8 million
- 2017: $496.3 million
- 2016: $263.9 million

Gross Margin

- Through Q2 2018: 69.2%
- 2017: 68.2%
- 2016: 56.2%

Cash Flow from Operations

- Through Q2 2018: $106.1 million
- 2017: $95.7 million
- 2016: $232.7 million

As of June 30, 2018, the company had $278.1 million in cash and $2.9 billion in total liabilities.

Free cash flow during the six months ended June 30, 2018, was $98.9 million

IPO Details

SWI intends to raise $500 million in gross proceeds from an IPO of its common stock.

Management says it will use the net proceeds from the IPO as follows:

We intend to use our net proceeds from this offering for general corporate purposes, including working capital, capital expenditures and continued investments in our growth strategies [...] and to repay [an as-yet-undisclosed amount] of the borrowings outstanding under our second lien term loan. As of June 30, 2018, we had $315.0 million of debt outstanding under our second lien term loan. The second lien term loan matures on February 5, 2025, and bears interest at a variable rate, initially 9.03%. All of the outstanding borrowings under our second lien term loan that were incurred within one year of the date of this prospectus were incurred to refinance outstanding debt.

Management's presentation of the company roadshow is not currently available.

Listed bookrunners of the IPO are Goldman Sachs, J.P. Morgan, Morgan Stanley, Credit Suisse, BofA Merrill Lynch, Evercore ISI, Macquarie Capital, RBC Capital Markets, Barclays, Citigroup, Jefferies, Nomura Markets, Baird, JMP Securities, KeyBanc Capital Markets, and SunTrust Robinson Humphrey.

Commentary

SWI is a typical private equity-owned firm attempting to go public after being taken private just a few years ago.

The firm's financials show the effects of the take-private transaction, its subsequent acquisition of LOGICnow, and ongoing ownership by private equity firms.

SWI has significant debt load typical of a private equity-owned firm, and it will likely use most, or all of the IPO proceeds to pay down this debt.

Additionally, the firm has $627.9 million of unpaid but accruing dividends due to its private equity firm shareholders, and these dividends are in addition to the $2.87 billion in total liabilities.

So, SWI has quite a hole to dig itself out of to reduce debt service and pay off the accruing dividends.

Furthermore, of the $5.2 billion in total assets as of June 30, 2018, $4.7 billion is ‘goodwill’ and ‘intangible’ assets. So, there isn’t much in the way of hard assets that SWI owns.

The market opportunity for SolarWinds is large and growing, as enterprises of all sizes are continuing a historic transition from legacy, on-premises systems to the cloud.

The IPO has an extremely large and varied list of underwriters and book-running managers, in part due to its size, which I expect to increase from its current placeholder figure of $500 million.

I generally don’t favor private equity-owned IPOs, as they frequently underperform post-IPO. Also, the firms that own them typically sell into the IPO, which is a negative signal for IPO investors. They’re great investments for the private equity firms that own them, but frequently not so great for IPO investors.

Niu Technologies Files For $150 Million U.S. IPO

Quick Take

Niu Technologies (NIU) intends to raise gross proceeds of $150 million from a U.S. IPO, according to an F-1 registration statement.

The firm provides smart electric scooter urban mobility solutions to users in China and Europe.

NIU is growing rapidly as a company with a large market share of the ‘smart e-scooter’ market.

Company & Technology

Beijing, China-based Niu Technologies was founded in 2014 to improve non-rural mobility through the design, manufacturing, and commercialization of smart electric scooters and related mobility services.

Management is headed by CEO Yan Li, who has been with the firm since 2016 and was previously Principal at KKR/Capstone.

Niu Technologies has developed a portfolio of electric scooters consisting of three series, N, M and U, with multiple models or specifications for each series.

The company also provides related connectivity solutions and value-added services to its users. Through the cloud-based NIU app, users can receive real-time information relating to their smart e-scooters.

Investors in Niu Technologies included Future Capital Discovery Fund, GGV Capital, Glory Achievement Fund, and IDG Capital. (Source: CrunchBase & F-1)

Customer Acquisition

The company has adopted an omnichannel retail model, integrating the offline and online channels, to sell their products and provide services.

NIU sells its products through its online store, third-party e-commerce platforms, and a "city partner" system in China. It comprised of 205 city partners with 571 franchised stores in over 150 cities in China, and 18 distributors in 23 countries overseas as of June 30, 2018.

Sales and marketing expenses as a percentage of revenue have been trending downward as the table below indicates:

Sales & Marketing Expenses vs. Revenue

Period	**Percentage**
1H 2018	12.6%
2017	10.8%
2016	25.3%

(Source: Company Prospectus and IPO Edge)

Market & Competition

According to a 2018 market research report by P&S Market Research, the Chinese electric scooters and motorcycles market is projected to grow to $12 billion in 2025, representing a CAGR of 6.1% between 2018 and 2025.

The main factors driving market growth are the increasing pollution awareness among people and growing urbanization.

The share of lithium-ion battery-powered scooters is expected to grow significantly over the forecast period due to the declining prices of lithium-ion batteries and its advantages over lead-acid batteries.

Major competitors that provide or are developing e-scooters include:

- Segway-Ninebot Group
- Yadea Group Holdings (1585.HK)
- AIMA Group
- Zhejiang Luyuan Electric Vehicle
- Razor
- Uscooter

Financial Performance

NIU's recent financial results can be summarized as follows:

- Strong growth in topline revenue, although at a decelerating rate
- Increase in gross profit
- Growth in gross margin
- Swing to positive and growing cash flow from operations

Below are the company's financial results for the past two and ½ years (Audited GAAP for full years):

	For the Year Ended December 31,			For the Six Months Ended June 30,		
	2016	2017		2017	2018	
	RMB	RMB	US$[2]	RMB	RMB	US$
			(in thousands)			
Selected Consolidated Statements of Comprehensive Loss Data:						
Net revenues	354,810	769,368	116,270	285,074	557,079	84,188
Cost of revenues[1]	(367,587)	(714,670)	(108,003)	(263,494)	(477,185)	(72,114)
Gross (loss)/profit	**(12,777)**	**54,698**	**8,267**	**21,580**	**79,894**	**12,074**
Operating expenses[1]						
Selling and marketing expenses	(89,754)	(83,065)	(12,553)	(35,852)	(70,229)	(10,613)
Research and development expenses	(33,090)	(39,493)	(5,968)	(21,166)	(56,054)	(8,471)
General and administrative expenses	(90,839)	(76,412)	(11,548)	(36,965)	(233,317)	(35,260)
Total operating expenses	**(213,683)**	**(198,970)**	**(30,069)**	**(93,983)**	**(359,600)**	**(54,344)**
Operating loss	**(226,460)**	**(144,272)**	**(21,802)**	**(72,403)**	**(279,706)**	**(42,270)**
Change in fair value of a convertible loan	—	(43,006)	(6,499)	(24,815)	(34,500)	(5,214)
Interest expenses	(2,320)	(3,154)	(477)	(1,089)	(3,905)	(590)
Interest income	661	1,007	152	450	1,329	201
Investment income	370	2,316	350	775	1,204	182
Foreign currency exchange (losses)/gain	(6,280)	1,613	244	(245)	(403)	(61)
Government grants	1,308	833	126	719	1,111	168
Loss before income taxes	**(232,721)**	**(184,663)**	**(27,906)**	**(96,608)**	**(314,870)**	**(47,584)**
Income tax expense	—	—	—	—	—	—
Net loss	**(232,721)**	**(184,663)**	**(27,906)**	**(96,608)**	**(314,870)**	**(47,584)**

(Source: NIU F-1)

Total Revenue

- Through Q2 2018: $84.2 million, 95.4% increase vs. prior
- 2017: $116.3 million, 113% increase vs. prior
- 2016: $54.6 million

Gross Profit

- Through Q2 2018: $12.1 million
- 2017: $8.3 million
- 2016: ($2.0 million) gross loss

Gross Margin

- Through Q2 2018: 14.4%
- 2017: 7.1%
- 2016: Negative

Cash Flow from Operations

- Through Q2 2018: $8.7 million cash flow
- 2017: $12.1 million cash flow
- 2016: ($18.9 million) cash used in operations

As of June 30, 2018, the company had $23.7 million in cash and $97.0 million in total liabilities. (Unaudited, interim)

Free cash flow during the six months ended June 30, 2018, was $6.8 million.

IPO Details

NIU intends to raise $150.0 million in gross proceeds from an IPO of ADSs representing underlying Class A shares.

Class A shareholders will be entitled to one vote per share and Class B shareholders, which are the co-founders and senior management of the firm, will be entitled to four votes per share.

This serves to allow existing shareholders to retain voting control of the company after losing economic control. The S&P 500 Index no longer admits firms with multiple share classes into its index.

Management says it will use the net proceeds from the IPO as follows:

for upgrade and expansion of manufacturing facilities;

for research and development;

for distribution network expansion; and

the balance for general corporate purposes, including funding potential investments and acquisitions of complementary business, assets and technologies, although we currently do not have any specific plans and are not negotiating any such investments or acquisitions.

Management's presentation of the company roadshow isn't currently available.

Listed bookrunners of the IPO are Credit Suisse Securities, Citigroup Global Markets, and Needham & Company.

Commentary

NIU is a fast-growing, next-generation manufacturer of what it calls 'smart electric scooters,' primarily for Chinese and European markets.

The scooters are capable of receiving over-the-air updates to adjust performance and operation.

The firm has also created a companion smartphone app that provides users with real-time data about their scooters as well as providing the company with additional data - 'over 462 data points covering 72 dimensions.

NIU's financials show tremendous growth in terms of topline revenue as well as gross profit, gross margin and a swing to positive cash flow from operations.

However, NIU is losing money at just as fast a rate and has shown no path to profitability in recent periods.

The market opportunity is forecasted to grow at a reasonable 6%, although as connected scooters demonstrate greater convenience and value for younger demographics in urban settings, that figure may increase.

The competition isn't sitting still, with management noting that competitors are now providing companion smartphone apps and other 'smart' aspects to their offerings.

According to a management-cited report by CIC, the firm 'led in China's lithium-ion battery-powered electric two-wheeled vehicles market with market shares of 26.0% and 39.5% in terms of sales volume and sales value, respectively, compared to 6.7% and 7.0% for the number two player.'

Credit Suisse is the lead underwriter for the IPO. IPOs led by the firm over the last 12-month period have generated an average return of 18.7% since their IPO. This is a middle-tier performance result for all underwriters.

On the legal side, like many Chinese firms seeking to tap U.S. markets, the firm operates within a VIE structure or Variable Interest Entity.

U.S. investors would only have an interest in an offshore firm with contractual rights to the firm's operational results but would not own the underlying assets.

This is a legal gray area that brings the risk of management changing the terms of the contractual agreement or the Chinese government altering the legality of such arrangements. Prospective investors in the IPO would need to factor in this important structural uncertainty.

Upwork Proposes Terms For $135 Million IPO

Quick Take

[Upwork](https://www.upwork.com/) ([UPWK](https://seekingalpha.com/symbol/UPWK)) and selling shareholders intend to sell $135 million worth of common stock in a U.S. IPO, per an amended [registration statement](#).

The company operates an online marketplace that enables individuals to find work offered by job posters, for full-time and part-time projects.

Given Upwork's topline revenue growth rate, strong financial metrics, an EV/Revenue valuation of approximately 5x, an EV to Gross Services Volume [GSV] of 1.36x, the IPO appears reasonably valued.

Company & Technology

Mountain View, California-based Upwork was founded in 1999 as eLance to operate an online platform for freelance workers and the people and organizations seeking to hire them.

Management is headed by President and CEO Stephane Kasriel, who was previously SVP of Product and Engineering at the firm.

Upwork's platform uses machine learning technologies to reduce inefficiencies associated with searching for, contracting and collaborating with, freelancers for short-term and longer-term projects.

The company offers a 'direct-to-talent' approach, reducing reliance on intermediaries such as staffing firms, recruiters, and traditional agencies while providing features that help instill trust in remote work.

Some of the platform's features include communication and collaboration, time tracking, invoicing, and payment.

Investors in Upwork include Benchmark, FirstMark, T. Rowe Price, New Enterprise Associates, Jackson Square Ventures, Stripes Group, Globespan Capital Partners and Sigma Partners, among others. (Source: CrunchBase and S-1/A)

Customer Acquisition

In 2017, more than 80% of the company's client registrations came through direct and non-paid online channels. The company collects insights and trends from its platform to drive public relations coverage.

Upwork uses email and lifecycle marketing initiatives to retain, cross-sell, and upsell existing clients. The company also has a dedicated enterprise sales team, which helps new and existing clients build and execute awareness campaigns through offline workshops, online webinars, and marketing events that drive additional revenue.

Sales and marketing expenses as a percentage of total revenue have been increasing as the figures below show. This indicates *reduced* efficiencies as the firm scales its operations:

Sales & Marketing Expenses vs. Revenue

Period	**Percentage**
1H 2018	29.6%
2017	26.2%
2016	22.8%

(Source: Company Prospectus and IPO Edge)

Management said for the quarter ended June 30, 2018, its 'client spend retention' was 106%. This is likely a form of the subscription 'net dollar retention rate.' When this figure is above 100%, it is a sign that the firm is succeeding in increasing its revenues from customers in the measured cohort.

Market & Competition

According to a 2017 market research report by Ask Wonder, the total number of freelancers available in 2017 was about 154 million people worldwide.

The main factors driving market growth are the need to escape corporate environment demands and the rise of digitization, such as smartphone apps that have made it easy for workers to find jobs, whether full-time or part-time.

North America accounted for 77 million freelancers in 2017, more than half of the workforce in the same year.

Major competitors that provide or are developing a freelance platform include:

- Freelancer (FLN.AX)
- Freelance.com
- The Adecco Group
- Randstad (RAND.AS)
- LinkedIn (MSFT)
- GitHub
- PayPal (PYPL)

Financial Performance

UPWK's recent financial results can be summarized as follows:

- Growing topline revenue, at an accelerating rate
- Strong growth in gross profit
- Uneven but upwardly trending gross margin
- Fluctuating cash flow from operations, but positive in 1H 2018

Below are the company's financial results for the past two and ½ years (Audited PCAOB for full years):

	Year Ended December 31, 2016	Year Ended December 31, 2017	Six Months Ended June 30, 2017	Six Months Ended June 30, 2018
	(in thousands, except per share data and percentages)			
Consolidated Statements of Operations Data:				
Revenue:				
Marketplace	$138,484	$178,046	$ 83,938	$ 107,413
Managed services	25,961	24,506	11,593	14,486
Total revenue	164,445	202,552	95,531	121,899
Cost of revenue(1)	62,578	65,443	30,953	40,074
Gross profit	101,867	137,109	64,578	81,825
Operating expenses:				
Research and development(1)	37,902	45,604	21,005	26,303
Sales and marketing(1)	37,437	53,044	23,701	36,087
General and administrative(1)	35,446	37,334	16,463	22,395
Provision for transaction losses	5,550	4,250	1,784	2,720
Total operating expenses	116,335	140,232	62,953	87,505
Income (loss) from operations	(14,468)	(3,123)	1,625	(5,680)
Interest expense	858	960	430	1,085
Other (income) expense, net	908	62	(185)	422
Income (loss) before income taxes	(16,234)	(4,145)	1,380	(7,187)
Income tax benefit (provision)	1	22	(11)	(9)
Net income (loss)	$(16,233)	$ (4,123)	$ 1,369	$ (7,196)

(Source: Upwork S-1/A)

Total Revenue

- Through Q2 2018: $121.9 million, 27.6% increase vs. prior
- 2017: $202.6 million, 23.2% increase vs. prior
- 2016: $164.4 million

Gross Profit

- Through Q2 2018: $81.8 million
- 2017: $137.1 million
- 2016: $101.9 million

Gross Margin

- Through Q2 2018: 67.1%
- 2017: 67.7%
- 2016: 62.0%

Cash Flow from Operations

- Through Q2 2018: $10.4 million cash flow from operations
- 2017: ($4.0 million) cash used in operations
- 2016: $3.1 million cash flow

As of June 30, 2018, the company had $31.3 million in cash and $154.4 million in total liabilities.

Free cash flow during the six months ended June 30, 2018, was $9.1 million.

IPO Details & Valuation

UPWK intends to sell 6.8 million shares and selling shareholders want to sell 5.5 million shares of common stock at a midpoint price of $11.00 per share for gross proceeds of approximately $135 million.

The company will receive proceeds of approximately $75 million plus underwriter option purchases and minus fees.

Dragoneer Investment Group has indicated a non-binding interest to purchase shares of common stock up to $27.00 million in the aggregate. This is a new investor to the company an provides prospective IPO investors with a positive signal of institutional investor interest.

Assuming a successful IPO at the midpoint of the proposed price range, the company's enterprise value at IPO would approximate $1.13 billion.

Excluding effects of underwriter options and private placement shares or restricted stock, if any, the float to outstanding shares ratio will be approximately 12%.

Management plans to use the net proceeds as follows:

We currently intend to use the net proceeds we receive from this offering primarily for working capital and other general corporate purposes, which may include product development, general and administrative matters, and capital expenditures. We also intend to use a portion of the net proceeds we receive from this offering to repay approximately $10.0 million of indebtedness under our Loan Agreement.

Management's presentation of the company roadshow is available here.

Listed bookrunners of the IPO are Citigroup, Jefferies, RBC Capital Markets, Stifel, and JMP Securities.

Below is a table of relevant capitalization and valuation metrics:

Measure [TTM]	**Amount**
Market Capitalization at IPO	$1,144,874,478
Enterprise Value	$1,134,663,478
Price/Sales	5.00
Price/Book	8.43

Enterprise Value / Revenue	4.96
Enterprise Value / Gross Services Volume	1.36
Enterprise Value / EBITDA	-108.81
Earnings Per Share	-$0.12
Total Debt To Equity	1.12
Float To Outstanding Shares Ratio	11.79%
Proposed IPO Midpoint Price per Share	$11.00
Net Free Cash Flow	-$5,234,000

(Source: Company Prospectus and IPO Edge)

Commentary

I previously wrote about Upwork's IPO prospects in my analysis, First Look | Freelance Marketplace Upwork Files For $100 Million IPO.

In that piece, I highlighted the firm's growth since the financial crisis of 2008 and the rise of the 'gig' economy due to demand by companies for contract labor and improved technologies available for workers to access information and conduct business online.

Upwork has continued to invest in its platform by adding functionalities to reduce the friction in project management and improve retention rates by working to keep more revenue running through the marketplace.

UPWK's financials show accelerating topline revenue growth and strong growth metrics in every other major financial metric including free cash flow.

A negative aspect is that the firm's Sales & Marketing costs as a function of revenues have been increasing.

The market opportunity for online-sourced contract work is significant. But competition lurks, especially with companies such as Microsoft beginning to integrate its LinkedIn acquisition with its widely distributed Office suite.

Once this is accomplished, LinkedIn's ProFinder marketplace will be integrated within the Office Suite, offering a potentially major competitor to Upwork.

Citigroup and Jefferies are the lead underwriters for the IPO. IPOs led by these two firms over the past 12-month period have generated average returns of 2.9% and 25.1%, respectively, since their IPO. For Citi, this is a bottom level performance for all major underwriters. Jefferies' performance is a mid-tier result.

As to valuation, given Upwork's topline revenue growth rate, strong financial metrics, an EV/Revenue valuation of approximately **5x**, an EV to Gross Services Volume [GSV] of **1.36x**, the IPO appears reasonably valued.

Although the firm faces the prospect of increased competition from the likes of LinkedIn in the medium-term, UPWK's IPO prospects appear solid in the short-term.