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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Dropbox Could Set Tone For More 'Unicorn' IPOs

By **Tom Zanki**

Law360 (February 27, 2018, 9:18 PM EST) -- A planned initial public offering by file-storage giant Dropbox Inc. could influence whether more of Silicon Valley's elite corps of venture-backed startups — a deep roster of richly valued, private technology companies commonly called "unicorns" — follow suit in 2018, experts say.

San Francisco-based Dropbox, which made its first public filing toward a $500 million offering on Friday, could price the deal by late March in what would be the first major venture-backed tech IPO of the year. Deals lawyers will watch closely to see how the market receives Dropbox, as it's going public during a relatively active IPO market that's nevertheless been quiet for tech.

"People have been tiptoeing around instead of jumping in, so hopefully this helps," Cooley LLP partner David Peinsipp said.

Dropbox was last valued at $10 billion, according to venture capital database CB Insights, putting it near the top of the so-called unicorn category, which is reserved for private companies that have achieved valuations of $1 billion or more. Flush with private capital, many unicorns are able to put off IPOs and the rigors of public scrutiny longer now than in previous eras.

Deal makers note that Dropbox alone won't determine the IPO timetables of similarly valued companies because such decisions are made on a case-by-case basis. But the cloud-storage giant's headline-grabbing IPO could be a bellwether, signaling how receptive investors are to large deals.

"It's a big offering," said Ropes & Gray LLP partner Craig Marcus. "If it goes well, that will certainly give some tail winds to the rest of the market. If it doesn't go well, that will cause people to think about whether they should take their company out if Dropbox couldn't get out well."

The Dropbox IPO will also be scrutinized because it comes about one year after another large unicorn, Snapchat maker Snap Inc., went public. Snap shares initially rallied but plunged by summer after disappointing quarterly reports, and they spent much of the year trading below their IPO price of $17. No additional large unicorns followed Snap in 2017, although less well-known technology startups like Mulesoft Inc. and Okta Inc. priced smaller IPOs and fared better.

Some deals lawyers say it's more important that Dropbox doesn't fare poorly than that it has a robust debut, noting that a weak entry into public markets could dissuade other startups that can easily raise capital elsewhere. One among an array of tech-focused private investors is SoftBank, which last year launched a $100 billion Vision Fund that's heavily investing in technology firms.

"If this [Dropbox] falls flat and doesn't perform that well, it is going to be that much more difficult to get large unicorns to go public," said Davis Polk & Wardwell LLP partner Alan Denenberg.

Among large unicorns — meaning those valued at $10 billion or more — six businesses, including Dropbox, were listed by IPO research firm Renaissance Capital in its 2018 preview as candidates to go public this year. One of the companies on that list, home-rental giant Airbnb Inc., has since said it won't launch an IPO in 2018.

Transportation app Lyft, bookmarking website Pinterest and Chinese e-commerce company Meituan-Dianping were also listed as 2018 IPO candidates, along with music streaming service Spotify. But Spotify is reportedly planning to go public through an unconventional direct listing, whereby the company would skip hiring underwriters and list its shares directly on an exchange.

Ride-hailing company Uber, the largest unicorn, with an estimated $68 billion valuation, has said it is aiming for a 2019 IPO. There are 229 unicorns total, according CB Insights, including many in California.

Dropbox, which lets users manage files online across desktop and mobile devices, said it is going public to increase its capitalization and financial flexibility. The IPO will also enable the company's shareholders to access public equity markets if they want to sell shares.

Venture capital heavyweight Sequoia Capital is the company's largest shareholder, owning a one-quarter stake, according to the IPO registration statement. Co-founders Andrew Houston and Arash Ferdowsi, plus venture capital firm Accel Partners and asset manager T. Rowe Price, also own stakes in the company.

Dropbox is going public amid robust growth, though lately at a slower clip. The company reported $1.1 billion in revenue last year, up 31 percent from $845 million in 2016, though less than the 40 percent increase from 2015 to 2016. Dropbox isn't profitable, but its losses have shrunk from $325.9 million in 2015 to $111.7 million last year.

Jay Ritter, a University of Florida professor who studies IPO activity, said Dropbox's offering shows confidence in the IPO market because it comes just weeks after a period of volatility rattled investors. The Dow Jones index fell 10 percent in early February but has since improved.

Ritter also noted that the company's improving financial health bodes well. While Dropbox reported a $111.7 million loss, he noted that costs totaling $164.6 million were attributable to stock-based compensation, which involves handing out stock options and restricted shares to employees rather than cash.

"Dropbox is a unicorn that is not bleeding cash, so it's not being forced to go out and raise money," Ritter said.

To boost its bottom line, Dropbox will look to convert more free users into paying ones. Currently, only 11 million of the company's 500 million registered users pay for its services, although Dropbox estimates that 300 million of them have characteristics — including specific email domains, devices and geographies — that are likely to make them paying users over time.

Dropbox is also going public with a multiclass share structure that will enable founders to maintain outsize voting power through Class B shares that carry 10 votes per share. The company is selling Class A shares to the public that will carry one vote each.

The web storage company is also establishing Class C shares that have no voting power, but those won't be for sale in the IPO. Lawyers speculate that the company could be reserving the option to issue no-vote shares as a currency for future acquisitions.

Dropbox notes that companies with multiclass share structures, which are opposed by institutional investor groups that argue that they diminish the voice of shareholders, are barred by certain index providers, a fact that could diminish the value of its shares. Indexes FTSE Russell and Standard & Poor's took action last year after a backlash against Snap, which issued no-vote shares in its IPO.

"These policies are very new, and it is as of yet unclear what effect, if any, they will have on the valuations of publicly traded companies excluded from the indices," Dropbox said in its registration statement. "But it is possible that they may depress these valuations compared to those of other similar companies that are included."

Investors will have the biggest say in deciding whether Dropbox's multiclass share structure, which is common among certain technology companies, is a concern. If Dropbox's offering fares well, lawyers say that many private companies contemplating an IPO will take note.

"A healthy acceptance in the market for Dropbox would certainly be something banks would point out to unicorns and say, 'This looks like it could be a good year for IPOs,'" Peinsipp said.

Dropbox is represented by Wilson Sonsini Goodrich & Rosati PC, and its underwriters are advised by Simpson Thacher & Bartlett LLP.

--Editing by Mark Lebetkin and Catherine Sum.
