THE IPO REVIEW Q2 2020

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Each quarter, we review international IPO activity. The report provides readers with in-depth information on the latest listings as well as broader economic factors impacting the IPO market both in the U.S. and across the globe.

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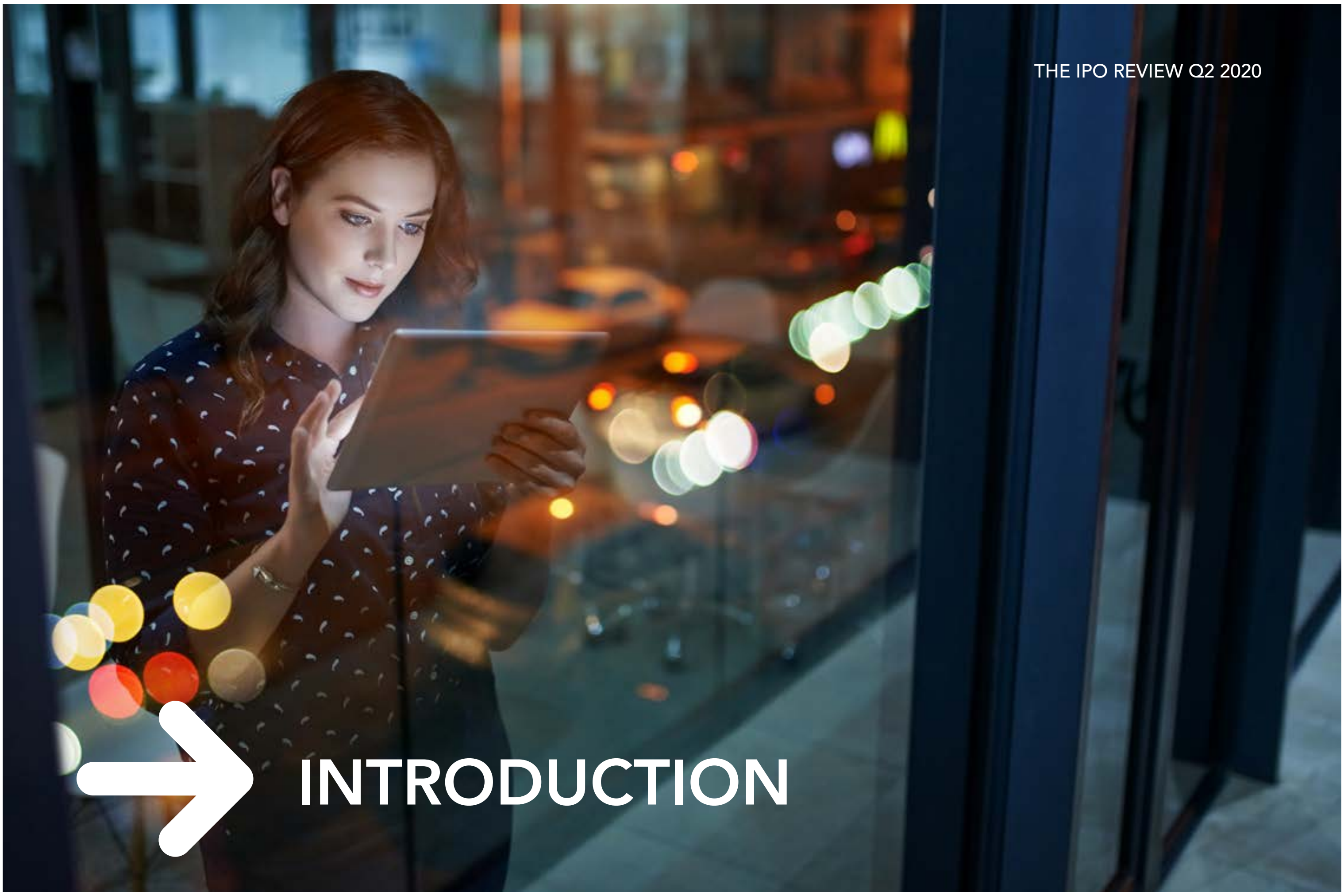

INTRODUCTION

Markets and listing companies are responding practically to the pandemic. The New York Stock Exchange was closed for two months but continued online. Businesses going public have begun to find virtual roadshows more of a help than a hindrance. Now that they can reach investors in just a few days, and even over the weekend when necessary, it may be a modus operandi that is here to stay.

Those already listed have turned to shareholders to bolster depleted balance sheets, just one of the capital raising methods we discuss in this quarter's article. Meanwhile, investors look to technology to put the world back on track, with Nasdaq recovering its Q1 losses and Shanghai's tech IPOs being consistently and massively over-subscribed.

Market Roundup

London

Fortune 500 company insurer ***China Pacific Insurance***, boosted Shanghai-London Stock Connect's credentials in June with a £1.5bn GDR listing in London, the largest capital raise by a Chinese company outside greater China so far this year. China's third largest insurer has some £235bn of AUM and is to use the proceeds to build an overseas investment platform.

Blackfinch Spring, a venture capital trust, was the only London IPO for the first two months of the second quarter. It raised £3.4m to invest in fast growth, tech-focused disruptors including start-ups. This comes against a backcloth of difficult times for VCTs, with investments down on 2019 as they struggled to tempt investors into high-risk positions in the shadow of COVID-19. In June, a 20-year track record saw ***Puma Alpha VCT's*** management able to raise £5.9m for new investments.

New York

Nasdaq overtook NYSE in IPOs after the latter was shut down, when two traders were diagnosed with COVID-19. Although NYSE operated online perfectly adequately, it suffered from not having the powerful marketing tool of the opening bell for companies launching onto its market. Healthcare dominated listings this quarter, but there was a warm reception for e-tailers and internet-led businesses.

In the first software IPO of the year, ***ZoomInfo*** raised $935m. The market intelligence platform – unrelated to the video conferencers – combines data analytics software to analyze 14 million companies. With its 200,000-subscription base, the company achieved a valuation of $8bn on debut, with shares almost doubling shortly afterwards.

Warner's IPO lived up to the hype. Despite the company's warnings about interrupted music, film and television recordings, the listing garnered proceeds of $1.9bn from a $12.75bn valuation. Back in 2011, the UK's richest man, Len Blavatnik, took the studio private with a cash purchase of $3.3bn.

30-year-old decking and home improvement company ***Azek***, commanded a $3.4bn valuation when raising $765m to pay down debt. The company believes that trading prospects are strong with millennials increasingly entering the housing market.

Second-hand car sales firm ***Vroom*** benefitted from increased interest in online retailers with a $2.5bn valuation and $500m, despite a drop in revenue and having to initiate a fire sale to reduce stock.

Albertsons, owners of Safeway and other grocery chains, raised $800m to lower its gearing. It was third-time lucky for the Cerberus-led backers after previous attempts failed on investor push-back.

The virus has highlighted the need for digital solutions and the US's surprisingly traditional, broker-led insurance market is adapting accordingly. When insurance comparison site ***EverQuote's*** shares peaked, its rival ***SelectQuote*** brought forward its IPO, achieving a strong valuation of $3.25bn and new proceeds of $360m.

Hong Kong

Sino-US tensions were behind the decision of two Chinese giants to list in Hong Kong despite an existing US share market presence. China's second biggest retailer, ***JD.com***, raised $3.9bn on HKSE six years after its Nasdaq listing. The raise was to keep up the chase on no.1 rival Alibaba, which raised $13bn earlier this year.

Likewise, gaming giant, ***NetEase*** raised $2.7bn in Hong Kong despite having listed on Nasdaq in 2000. The company's CEO said it was "returning to a market in which we share a closer mutual understanding".

Hong Kong's relaxation of listing rules for biotechs in 2018 proved timely for what is widely perceived to be a COVID-19-proof sector. In April that year, the exchange allowed drug and medical companies to go public pre-revenue as well as pre-profit.

Notable among a string of healthcare firms launching highly successful listings this year were Chinese heart valve manufacturer ***Peijia***. They had to arrange a larger $302m raise to meet shareholder demand and surged 74% at debut, and cancer drug maker ***Kintor Pharmaceutical's*** $240m raise was 500 times over-subscribed. Fellow oncology specialist ***Akeso Bio*** had its paperwork sent back in December, but this quarter got the tick and raised $314m.

Mobile payments platform ***Yeahka*** raised $197m despite a COVID-19-ravaged Q1 performance. Shareholders looked to past performance and the company's ability to grow revenue per customer by over 50% last year.

Shanghai

Shanghai raced ahead of is mainland rival (as well as all other exchanges), raising $15.6bn to Shenzhen's $4bn so far this year. It is the SSE's most active half-year for five years, boosted by the Nasdaq-style STAR market, which now accounts for over a third of its listings.

Securities broker and financial advisor ***Zhongtai Securities*** got top billing with a $440m raise. It was over 400 times over-subscribed, which is below average for the exchange. Two solar-related firms, ***Jinko Power*** and ***Trina Solar*** raised $366m and $350m respectively. China is the biggest producer and buyer of photovoltaic panels and solar-generated electricity there is now cheaper than from the grid.

Capital Raising

How Listed Companies Are Securing Their Finances

With a deep recession looming, businesses are intensely focused on access to credit and their ability to raise capital. Public companies tend to have more options in this regard than private businesses, but market conditions and the shifting financial landscape are playing a part in determining appetite and availability. We at EQ are working closely with our listed and soon-to-be-listed clients on improving their capital structuring, and this article shares both a general background on capital raising and more specifically what is changing in the wake of COVID-19.

Marketability

The IPO itself will usually be the most transformative event in a company's capital structuring. The shift from a generally narrow, hands-on investor base to vast and anonymous international markets opens up the potential for significant capital inflows. The desire to retain control usually tempers the allocation of shares, and the average percentage of a company sold at IPO in the US is no more than 28%. Straddling this average are start-ups and special purpose acquisition vehicles which might offer up to 100%, while those with established markets and revenues tend to be lower: Google and LinkedIn were both below 10%. Some companies such as Slack and Spotify chose direct listings: reaping the benefits of a listing and market access without actually issuing any new shares to the public. Over a quarter of companies worldwide (and an even higher proportion in Europe and Asia) keep their powder dry and do not raise any fresh capital when they list.

Of course, once a company has successfully placed itself on the market, it then has the opportunity to increase its shareholder base or capital with further issues. This has been done in a variety of ways in the last few months as companies look to shore up their cash reserves because of uncertainties around the pandemic.

The quickest and simplest method of extracting further capital from new or existing shareholders is a placing. This is a more limited issue of shares, usually to a targeted (and often institutional) group of investors. There are fewer regulations to tackle and no need to produce a prospectus. In response to the crisis, the FCA has accepted a recommendation from the industry to increase the placing limit of 10% of shareholding to 20%. In April this year, the retailer Asos raised £247m through a placing to strengthen its balance sheet after a virus-affected slump in sales, followed by caterer Compass (£2bn), insurer Informa (£1bn) and in June, William Hill (£224m).

Although share prices have generally been holding up well following recent placings, the dilution that the process entails can alienate shareholders. A rights issue will instead offer them the ability to purchase – usually discounted – shares in proportion to their existing stake. In June, for example, Whitbread raised £1bn from its shareholders to ride out the hospitality shutdown. Richard Wheatley, EQ's Head of Corporate Advice, has found shareholders to be supportive of the rights issues his team has managed through the present crisis.

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We've seen very strong shareholder engagement, and in one case a 99% take-up of the issue. The virtual meetings we've hosted are certainly a different way for our clients to communicate with their shareholders, but they've responded very positively to the challenging circumstances and to the calls for protective capital.

Borrowing Time

The prospect of a long period of post-COVID-19 ultra-low interest rates has driven many investors to the stock market, providing welcome liquidity. For the very same reason, many public companies have been turning in the other direction: away from the stock market and towards cheap debt. Shareholder equity and debt are not interchangeable. Incoming shareholders tend to be relaxed about building up defensive cash piles or rewarding founders, but banks are generally reluctant to see their loan money going straight into owners' pockets rather than being deployed for growth. Conversely, debt will often be the better fit for shorter-term working capital requirements than bringing in new shareholders, which might prove an unnecessary dilution of equity or too administratively burdensome.

Leading up to the pandemic, debt had already been piling on. Historically low interest rates have seen eight years of year on year growth in debt among listed companies. A recent market researchers survey showed record borrowing levels for PLCs in the UK last year of £443bn: a rise of almost 6% between 2018 and 2019 alone.

Public companies are not, of course, one amorphous mass, and within the survey, there are surprising sectoral differences. Consumer goods as a sector take the most debt, while oil is also a traditionally heavily geared industry which in the UK has more than quadrupled borrowing levels in the last ten years. Meanwhile, parsimonious retailers and lean, mean telecoms companies have not increased gearing levels overall.

Is this debt level dangerous now that we are facing a crisis? There are mitigating factors. The debt burden has been shared out more widely, with forty-three new UK banking licences granted in the eight years since the crash. Also, it is the larger companies that are hoovering up most of the debt, while those outside the FTSE 100 are relatively unchanged in their gearing. Average PLC debt stands at 2.6 times operating profit, below the widely perceived red zone of 4 times OP. Also, cash reserves have been building almost in parallel, suggesting war chests were being built rather than cash flows being under strain.

At the point of the 2008 crash, the average PLC debt to equity ratio peaked at 89%. Cutting gearing levels became the order of the day (signaling the likely trend post-COVID-19) and by 2012 had fallen to 64%, drifting back up to 73% by 2019.

Lending Credence

In terms of bank facilities, business dynamics and the purpose of borrowing and term sought will generally inform the type of debt taken. Overdrafts give the most flexibility and smooth out cashflow fluctuations but can be withdrawn on demand by banks (and often were in 2009). Trade finance works for exporters, loans for front-ended transactions and asset finance sits well with high capex enterprises. Invoice discounting is one of the oldest forms of finance and suits growing businesses, while supply chain finance - aka reverse factoring - benefit larger firms.

Banks can take a while to catch up with industry changes and some of the newer and more innovative PLCs find them hard work. A brick and mortar company producing tangible, readily-invoiceable goods into an established market will certainly expect to attract bank debt more easily than a cloud-based business offering new industry services under phased or complex contracts.

Commercial banks tend to adhere to the umbrella-in-the-sunshine-only principle and reduce lending in recessions. UK businesses have therefore been turning to HM Treasury's COVID-19 Corporate Financing Fund with fifty-three companies absorbing £16.2bn of loans.

The commercial banking sector, however, is still proving more active than after the 2008 crash. Because of beefed-up tier 1 capital requirements, banks' liquidity is better now than then. The problem is that the coming recession is not being compared with 2008 but to the devastation of the South Sea Bubble in 1720. To obviate potentially problematic bank credit lines, PLCs are therefore already tapping into an alternative source of debt.

Ah, Bond. We've Been Expecting You

Corporate bonds traditionally pick up the slack from banks in downturns. After an initial sell-off in March when pandemic news first hit home, major bond markets recovered strongly, and issuances are now reaching dizzying heights. Europe had its two busiest bond months in March and April this year and the most activity since 2009.

In the US, the trillion-dollar new bond sales mark was reached in record time in 2020. Exxon Mobil and Verizon were early adopters as COVID-19 hit sales, with Coca Cola, McDonald's, GEC and T-Mobile et al. quickly following suit to fill the cash vaults. Amazon broke records on its recent $10bn issuance.

More significantly, companies like Boeing have easily raised bonds of $25bn, and companies from such stricken industries as cruise lines and hotel chains have also successfully secured bond lifelines. Their cause has been considerably helped by the Federal Reserve's loud participation as a purchaser. The European Central Bank has clearly taken note and has included corporate bonds as well as government bonds in its economic stimulus package.

Bonds have the advantage of making borrowing predictable by setting a coupon rate over a term of the issuer's choosing. There is an information requirement, but PLCs are generally well prepared in that area already. The borrowing company can also determine whether bonds are secured and where they rank as creditors. The fixed nature of a bond can also be a disadvantage, however. While a bank might show understanding if a company suffers a bad episode, bondholders cannot flex terms. Interest to bondholders are paid ahead of dividends, so when profits are squeezed there can be a magnified effect on the share price.

Balancing Out

Structuring the right mix of equity and debt (and short-term and long-term financing) is a never-ending balancing act for PLCs. Equity is permanent capital, while debt is temporary, but there are pros and cons to both. Over-diluting shareholders on the one side and overloading debt on the other can be fatal errors. The headwinds of an economic depression will make this tightrope sway with pressures to de-gear while maintaining sufficient cash reserves.

However, the banks that survived 2008 are battle-hardened and wiser and new entrants hungrier, while capital markets are more sophisticated and agile than ever before. There is strong demand for bonds in an ultra-low interest environment, and shareholders are proving philosophical about dividend cuts and pricing the future rather than brooding over the present. Listed companies are therefore entitled to feel optimistic about support from resilient and increasingly diverse sources of funding.

If you decide to raise capital by issuing equity, we would be happy to discuss with you and your advisors, the mechanics and the practical steps involved ensuring we deliver a smooth and seamless process.

Starting your IPO journey

EQ has many years' experience bringing companies to market, from preparation to launch and on to life post-IPO. Our unbeatable service has supported the technical and logistical elements of the highest-profile listings in the U.S. and we can do the same for you.

To find out more, contact our team at relationships@equiniti.com

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