

LOOKING AHEAD: EQUITY CAPITAL MARKETS OUTLOOK

With Lord Hill's review of the UK listing regime now published and under consideration by HM Treasury, the 2021 IPO market in full swing, and the ink (finally) drying on Brexit, we gaze into our ECM crystal ball and consider the likely trends and developments in the months ahead.

IPO market: highly active but outlook uncertain

Pent-up investor demand

The IPO market roared back to life in Q4 2020, following a six month hiatus as investors diverted their attention to - and directed their cheque books at - the wave of COVID-19 capital raisings taking the immediate form of accelerated bookbuild placings and, later, rights issues and other pre-emptive offerings.

The Hut Group which floated on the standard segment of the London Stock Exchange in September 2020 was heavily oversubscribed and gave an indication of the pent-up investor demand. With a valuation of £5.4 billion, it was the UK's largest IPO in five years - until it was surpassed this month.

Early signs in 2021 were promising. Seven companies have already joined the premium segment this year, with Dr. Martens admitted with a £3.7 billion market capitalisation. Deliveroo joined the standard segment with a market capitalisation just shy of £8 billion.

While uncertainty remains in terms of ongoing lockdown and travel restrictions, companies and advisers alike are now more confident and enthusiastic in terms of conducting investor marketing and analyst briefings using electronic and virtual means. We expect investor sentiment will be further encouraged by the progress of the COVID-19 vaccine programme and continued government and central bank stimulus. The IPO outlook looks promising: there remains a strong pipeline of IPO candidates in the process of coming to the market at present across a range of sectors with a focus on tech-led businesses and life sciences.

It will be interesting to see whether the immediate market reaction to the IPO of Deliveroo will be sustained through and beyond the stabilisation period and what effect that may have on tech-focused listings in particular, including those with dual-class or similar governance structures.

London's competition

While Amsterdam did - at least for a moment - steal London's mantle for EU share and carbon trading, and gained a head-start in terms of attracting special purpose acquisition companies (SPACs) looking to list, our view is that, certainly in the near term, the London Stock Exchange will continue to benefit from London's pool of capital and market infrastructure. The Hill reforms, described below, will help to level the playing field.

Turning to London's other main competitor, the US has historically dominated IPO league tables both in terms of offering larger pools of capital and higher valuations. It has the added appeal of permitting flexible shareholding and voting structures which are favoured by founders, particularly in the fields of life sciences, e-commerce and technology, who wish to retain control of their business and decision-making power after floating on the public market.

Promising regulatory developments – Lord Hill's review

The HM Treasury's commission of the Lord Hill's review and, indeed, the Budget presented on 3 March, was therefore a timely indication of the UK Government's determination that post-Brexit London retains its competitive edge in financial services and is considered the listing venue of choice.

Lord Hill's key recommendations, which are currently under consideration by the HM Treasury, include:

- Dual class share structures

Modernising listing rules to allow dual class share structures in the LSE's premium listing segment, such that founders and/or early venture investors can, post-IPO, continue to enjoy enhanced voting and/or economic rights by virtue of a second (B / weighted) class of shares.

Lord Hill has recommended that dual class share structures be accompanied by additional corporate governance safeguards, including:

- a maximum duration of five years and a maximum weighted voting ratio of 20:1, to ensure that holders of the B class shares have a minimum economic interest in the company;
- limitations on who can be holder(s) of the B class shares, to ensure that they are engaged in the running of the company, i.e. as directors;
- limitations on enhanced voting rights of B class shares, to ensure the B class share holder(s) remain as a director and the ability to block a takeover; and
- limitations on transfer of the B class shares, such that they must, on transfer, convert into ordinary shares without enhanced voting and/or economic rights.

Whether the reaction of certain institutional investors to, and the immediate aftermarket of, the Deliveroo IPO will cool down the market desire to allow dual-class structures and facilitate founder-led tech listings will remain to be seen.

We expect that this will be a very company-specific analysis and that there will continue to be demand for tech listings even with these kinds of governance structures, just as there was for The Hut Group IPO in 2020, for the right companies.

- Standard listing segment

Rebranding the LSE's standard listing segment so it is no longer perceived as the poor substitute to a premium listing, and promoted as a venue for companies of all types.

At the moment, only premium listed companies are eligible for inclusion in the FTSE indices (and, by extension, most tracker funds). This has historically (further) reduced the appeal of standard listed companies in the eyes of investors. Lord Hill has recommended that investor groups should be encouraged to develop guidelines such that companies on the rebranded-standard listing segment would be eligible for inclusion within the leading indices.

- Prospectus regime

A fundamental review of the prospectus regime so that prospectus requirements (both in terms of content but also the need for such a document in the first place) are tailored to, and differentiated between, admission of the company to a regulated market and subsequent offers to the public. The overriding concern is to ensure that documentation requirements are appropriate for the nature and circumstances of the particular transaction being undertaken and the needs of the target investor.

- Free float liquidity

Lowering the absolute free float requirement (i.e. the amount of a company's shares that must be held by the public, as opposed to the company's directors, employees or majority shareholders) from 25% to 15% and allowing companies of different sizes to use other measures to demonstrate liquidity. For high growth and private equity backed companies looking at listing venues, the existing free float requirements are seen as a strong deterrent.

15% remains an arbitrary number, though, and it is a pity that there is no alternative metric proposed to allow a certain number of shareholders to constitute a free float, or other indicia of prospective liquidity.

- SPACs

Liberalising the rules around trade suspension of SPACs on announcement of a potential acquisition, with additional shareholder protections such as voting and redemption rights at the time of the acquisition.

Other recommendations include greater disclosure of forward-looking information, greater involvement of retail investors, and an impact assessment of the research analysis rules introduced as part of the wider IPO process reform in July 2018.

While these recommendations will need to be considered, and then consulted on, by the HM Treasury and the Financial Conduct Authority, and it will be some time before any changes are adopted and implemented (we are currently expecting late Q3/early Q4), we are encouraged by the prevailing regulatory environment and hopeful that this will translate into greater volumes of activity on the London Stock Exchange.

Capital raisings: another record year?

As discussed in our [rights issue best practice briefing](#) and [ECM podcast](#) last year, we saw record amounts of equity raised as companies rushed to solve short-term liquidity problems, shore up balance sheets and reduce net debt as part of their immediate response to COVID-19.

Only five placings and one open offer have been announced to date this year by Main Market companies, and we are advising on The Restaurant Group's firm placing and placing and open offer. We expect the demand for capital raisings to return towards the end of the calendar year.

Businesses are now assessing their longer term liquidity needs and financing arrangements in light of the sustained and ongoing impact of COVID-19 and related business restrictions, evaluating their business model and strategy in light of the new trading environment and consumer expectations, and undertaking a general MOT of their operations and financial position.

// The recovery may take some time to gather momentum, and the passage of time can turn liquidity problems into solvency problems. //

Jerome Powell, US Federal Reserve Chair
13 May 2020

As furlough subsidies and government support taper off and are eventually withdrawn in Q3, or become less attractive to new applicants or existing companies who wish to increase their funding limits (for instance, in the way that the government is introducing dividend suspensions and executive pay conditions as part of securing new or increased Coronavirus Corporate Financing Facility funding), more companies will once again look to the equity markets.

Unlike the initial wave of accelerated bookbuild placings, we expect the bulk of capital raisings this year to be done by way of documented placings and pre-emptive offers. Last year there were nine rights issues by Main Market companies between March and the end of December - three of which we acted on (Rolls-Royce, International Consolidated Airlines and Whitbread) - plus 13 open offers (usually alongside a documented placing), a number of which we also advised on.

While there was broad support in the market for recapitalisations last year, shareholders and prospective new investors did, on each occasion, consider whether the company in question had articulated a clear, convincing rationale for its equity raise and its proposed use of proceeds. We expect even closer scrutiny of upcoming capital raisings by investors and regulators alike - the best practice points highlighted in our [rights issue best practice briefing](#) remain highly relevant.

As part of the growing trend of shareholder engagement, we also expect to see a continuation of the trend for companies to include a retail offer - using Primary Bid or a similar platform - alongside any institutional placings, particularly where the company has a significant retail shareholder base. As shown on the IPO of Deliveroo, and on other forthcoming IPOs, Primary Bid or other solutions have a similar role to play on documented equity offerings as they do on accelerated bookbuilt placings and we expect to see those facilities be used more often.

Post-Brexit landscape: more “wait and see”

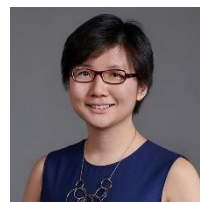
In the short term (the next 3 to 6 months), we do not anticipate any significant regulatory changes in this area. Beyond that, however, we may see some genuinely radical changes as a result of Lord Hill’s review.

As to whether the UK’s prospectus regime or market rules will diverge away from EU rules - so far the government and regulators have said very little. Our working assumption is that divergence is likely to occur only in instances where it is fairly evident that the advantages of diverging will outweigh the disadvantages. One thing that will force the issue, though, is when the EU introduces new legislation, or makes changes to existing EU legislation. For the time being, it is still a case of “wait and see”.

CONTACTS



RICHARD SMITH
PARTNER
T: +44 (0)20 7090 3386
E: Richard.Smith@slaughterandmay.com



YVONNE LEE
SENIOR COUNSEL
T: +44 (0)20 7090 3839
E: Yvonne.Lee@slaughterandmay.com



REBECCA COUSIN
PARTNER
T: +44 (0)20 7090 3049
E: Rebecca.Cousin@slaughterandmay.com



JOHN PAPANICHOLA
PARTNER
T: +44 (0)20 7090 3031
E: John.Papanichola@slaughterandmay.com

Our ECM work during the COVID-19 pandemic

Rights issues and other documented offerings

- **Rolls-Royce** on its recapitalisation which comprised a £2bn rights issue, a £2bn bond offering and a £1bn loan facility
- **IAG** on its rights issue which raised gross proceeds of €2.75bn
- **Countrywide** on its proposed recapitalisation which included a £90m firm placing and placing and open offer
- **Whitbread** on its rights issue which raised gross proceeds of approximately £1bn
- **De La Rue** on its firm placing and placing and open offer which raised gross proceeds of £100m
- **Costain** on its firm placing and placing and open offer which raised gross proceeds of £100m

Placing and retail offers

- **The Restaurant Group** on its firm placing and placing and open offer which raised gross proceeds of approximately £175m and entry into long-term refinancing arrangements
- **Essentra** on its cash box placing to institutional investors and its associated offer to retail investors which raised gross proceeds of approximately £100m
- **Ocado** on its concurrent three-legged £1bn capital raise which comprised a £650m share placing to institutional investors, a £7m share offer to retail investors and a £350m offer of convertible bonds to institutional investors
- **Young & Co.'s Brewery** on its cash box placing to institutional investors and its associated offer to retail investors which raised gross proceeds of £88.4m
- **William Hill** on its cash box placing to institutional investors and its associated offer to retail investors which raised gross proceeds of approximately £224m
- **SEGRO** on its placing to institutional investors and its associated offer to retail investors which raised gross proceeds of approximately £680m
- **IWG** on its cash box placing to institutional investors and its associated offer to retail investors which raised gross proceeds of approximately £320m
- **Bloomsbury Publishing** on its placing which raised gross proceeds of approximately £8.4m
- **The Restaurant Group** on its cashbox placing which raised gross proceeds of approximately £57m
- **ASOS** on its cashbox placing which raised gross proceeds of approximately £247m
- **Hays** on its cashbox placing which raised gross proceeds of £200m

Others

- **SEGRO** on its secondary listing on Euronext Paris
- **PrimaryBid** on a number of retail offers including in relation to the placing of shares in Compass Group

London
T +44 (0)20 7600 1200
F +44 (0)20 7090 5000

Brussels
T +32 (0)2 737 94 00
F +32 (0)2 737 94 01

Hong Kong
T +852 2521 0551
F +852 2845 2125

Beijing
T +86 10 5965 0600
F +86 10 5965 0650

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