Not delivered: how Deliveroo was unable to live up to its investors' expectations on its IPO

Deliveroo Holdings PLC (LON: ROO) – Market Cap as of 10/04/2021: £4.66bn

Introduction

On the 31st of March, Deliveroo made its debut on the London Stock Exchange. The deal had been presented as a sound victory for the post-Brexit London stock exchange and a path forward for future tech IPOs. The food delivery company's market premiere is the biggest London has seen since 2011 Glencore's IPO.

Nevertheless, despite Deliveroo's hopes of racking up an £8.9bn valuation, the company opened at £7.4bn figure instead. Arguably, investors had shown restraint and did not buy into the perennially loss-making company. Even with the COVID-19 pandemic, which significantly increased the number of takeaway deliveries, the company made a £226m loss last year. With its IPO, Deliveroo followed the steps of similar, also loss-making businesses such as Uber, Lyft, and DoorDash. Almost two weeks from the market debut, the stock is down by 53% from its 31st March high.

About Deliveroo

Deliveroo, co-founded in 2013 by the pair Will Shu and Greg Ostrowski, is a food delivery business. Since its inception, it has grown rapidly and currently operates in 12 countries – focusing on Europe, Middle East, and South Asia. As of 2020, it directly employs around 2,300 people, however, the foundation of its business model is the army of 110,000 riders. Possibly, the controversies regarding the workforces' salaries and protection schemes are among the most contested issues regarding Deliveroo. Alongside these contentions, the company is also a serial loss-maker, with no profit recorded since its inception.

Deliveroo's Business Model

The company's business modus operandi relies on the 110,000 self-employed riders, commissions from restaurants, and delivery fees that are used to pay the drivers. The main difference between Deliveroo and other food delivery apps is that it focuses on high-quality restaurants. Possibly, that allows the company to charge higher fees and commissions for operating on its platform. Joining the platform usually requires payment of a one-off fee of around £220 and a further 25% to 45%commission on every order made through the app.

Further, for frequent customers there is the "Deliveroo Plus" service. For £11.49 per month, the customer receives a free delivery for orders above £10, special discounts, and 24/7 customer service. The service became more expensive last year, increasing by more than 40% from £7.99.

More recently, the company introduced the "Deliveroo Editions" intending to offer dishes from a collection of cuisines, tailored for home delivery. The concept is carried out through partnerships with delivery-only restaurants or "ghost kitchens" whose business model is to cook dishes for takeaway only. Sixteen such kitchens are currently running, mostly in the UK.

However, despite being ranked as one of the fastest-growing companies in FT's 2018 and 2019 rankings, the pandemic surprisingly did not help Deliveroo as much as it probably had hoped. Despite a 54% revenue upswing in 2020, it was still not able to break even. Its reliance on big restaurant chains that remained closed down due to the pandemic, was exposed. Arguably, with the acceleration of the vaccine programs and prospects of restaurants finally reopening for longer periods, Deliveroo will have it even harder to balance the books.

Adding insult to injury, Deliveroo faces challenges to its treatment of riders, who often earn less than the minimum wage and lack elementary protection such as sick leave. More recently, a report by the Independent Workers' Union of Great Britain and the Bureau of Investigative Journalism found that a third of the surveyed riders earned less than £8.72 an hour, which is the national minimum wage for people aged over 25. And the sentiment is not in Deliveroo's favour – last March the UK Supreme Court ruled that Uber drivers require greater labour protections.

Arguably, the poor treatment of its riders, as well as the unfavourable legal sentiment towards the gig economy, could further strain its already underperforming business model.

Industry Overview

Currently valued at approximately $151.5bn, the worldwide online food delivery industry, with its revenues growing at a CAGR of 6.36%, is expected to be worth $182.3bn by the end of 2024. Within this industry, besides Deliveroo the key players are Just Eat Takeaway, Uber Eats, DoorDash, and Delivery Hero, to name a few.

Consumer behavior is a key aspect of the global online food delivery industry. According to a McKinsey industry report, once consumers sign-up for an online delivery application, 80% shall not leave this application which inevitably leads to a very strong type of "winner takes all" type of market environment. What impacts consumer satisfaction the most is the wait time for food, followed by the quality of the food. Lastly, it has also been shown that more than 80% of food delivery orders were placed for one's home and that approximately 75% of weekly orders are placed during the weekend.

Some general key trends in the online food delivery industry are an increase in disposable incomes and internet penetration, increasing smartphone sales, innovation, and an increase in the product offering. On a more specific note, some key trends and consumption shifts that will have an important impact on the future of the industry include a shift to healthier foods, consumers developing more exotic tastes, convenience products upgrading, an increase in "free-from" foods (food without specific ingredients) to adapt to various intolerances, as well as the rise of clean labels and sustainability concerns. Digitalization is also one of the most important factors impacting the food delivery industry. Technological developments in the food industry, such as the use of ghost kitchens, help to increase profitability. The quantity of ghost kitchens seems to have increased during the coronavirus outbreak, as they focus on making food alone, cutting down labor costs in addition to rent costs given that there is no need for indoor/outdoor dining. COVID-19 has affected the industry, and there is always a possibility of a different external factor with a huge impact on the industry going forward.

IPO Structure

Deliveroo offered 314,615,381 shares in its IPO, two-thirds of which consisted of newly issued and the remaining were existing. Current shareholders, which include Amazon, experienced a 13.9% dilution as a result. All of the publicly traded shares are Class A shares with one vote per share, as per the new dual-class share system. Class B shares carrying 20 votes per share are exclusive to the founder and CEO, Will Shu, who will control 52% of the voting power despite holding only 5.1% of the capital. FTSE 100 has guidelines against such a system, therefore Deliveroo will not be a part of the index, although the rising popularity of dual-class listing, especially among technology companies, may force FTSE to reconsider its position.

The range suggested by the underwriters, Goldman Sachs and JP Morgan, was between £3.90 and £4.60 per share. In the end, Deliveroo was priced at the bottom end and offered shares at £3.90, which would have given the company a market capitalization of £7.5bn. Even at this price, Deliveroo became the largest tech IPO in Europe so far in 2021 and the largest in Britain in a decade. The company itself raised a little over £1bn while the shareholders sold shares worth slightly less than £500m.

	Immediately prior to Admission(1)			Immediately following Admission			Percentage of voting rights immediately following Admission
Shareholder	Class A Shares	Class B Shares	Issued share capital(2)	Class A Shares	Class B Shares	Issued share capital(2)	
Will Shu	—	90,570,400	6.1%	—	92,742,241	5.1%	52.0%
Amazon Investor	233,022,400	—	15.8%	215,286,288	—	11.9%	6.0%
Index Investors	150,889,000	—	10.2%	139,404,336	—	7.7%	3.9%
DST Investors	148,676,600	—	10.1%	137,360,328	—	7.6%	3.8%
Greenoaks Investors	132,819,800	—	9.0%	122,710,444	—	6.8%	3.4%
T. Rowe Investors	118,676,800	—	8.0%	129,776,800	—	7.2%	3.6%
Fidelity Investors	107,318,200	—	7.3%	175,318,200	—	9.7%	4.9%
Bridgepoint Investors	82,249,800	—	5.6%	75,989,494	—	4.2%	2.1%
Accel Investors	80,521,800	—	5.4%	74,393,018	—	4.1%	2.1%

Source: Deliveroo's Pricing Statement

One key aspect of the IPO structure was the involvement of retail investors, who had an opportunity to buy shares in advance as long as they were customers of Deliveroo. The inclusivity is unique since traditionally IPOs are directed at financial institutions like hedge funds, private equity firms, and investment funds of other corporations, whereas unconditional trading starts later. 70,000 amateur investors bought stocks worth approximately £50m through the platform PrimaryBid. They were left frustrated, however, since trading was restricted until April 7th while the value of their investment was tumbling. Deliveroo had the option to cancel the IPO and void all trades until the same date but decided against it.

IPO Rationale

Even before the pandemic forced people into their homes and restaurants to put up the shutters, food delivery apps had already been steadily gaining popularity, which translated into revenues and in some (though rare) instances profitability. Ease of use, the growing number of such apps, restaurants' willingness to participate, and the younger generation's familiarity with fintech all contributed to this trend. From 2015 to 2019, the collective revenue of such apps increased 152% in the US, 84.6% in the UK, and 116.6% in the rest of Europe. Deliveroo has the second-highest market share in both UK and Europe (excluding the UK), with 33% and 21% respectively, behind Just Eat Takeaway and ahead of Uber Eats in both cases.

Then came COVID-19, which propelled the industry into being the lifeline of the food and beverages sector, Deliveroo's revenues increased by 54% and business doubled as many customers and restaurants signed up for the first time. DoorDash, an American food delivery app, seized the moment with an IPO on NYSE on the 9th of December, 2020. Although initially the underwriters considered a range of $90-95 per share, in the end the IPO was priced at $102 per share. The stock closed the day at $189, up by more than 85%. The resounding success of DoorDash IPO along with high expectations from the industry encouraged Deliveroo to go public.

Additionally, several tech companies making their listing on London Stock Exchange revived hopes of London retaining its position as a tech center, much to the delight of the government endeavoring to reassure investors on the UK's position as a financial center. The prominently successful debut of the Hut Group, an e-commerce firm based in Manchester, was the most significant highlight of the UK's 2020 IPO market. As the biggest London listing by market cap since that of Royal Mail in 2013, it netted the company £920m and yielded a valuation of around £6bn. All the while, Hut Group was facing corporate governance concerns with regards to the position of CEO and Chairman, Matthew Moulding, who would hold a majority of shares thanks to a two-class share structure. Deliveroo also faced questions regarding its governance and used the same share structure, so the key takeaway from the Hut Group IPO was to march on.

Finally, Deliveroo has ambitious plans for 2021, encouraged by a surge in restaurants joining the platform. Within the UK, the target is expanding into at least 100 more towns and cities and reaching two-thirds of the population. Globally, the company desires to double the sites it operates in, introduce on-demand grocery delivery which is currently offered in the UK, and grow its network of ghost kitchens. Raising capital for these projects was likely the main driver behind the decision to go for an IPO.

Market Reaction

According to some analysts, Deliveroo's IPO was deemed as the worst IPO in London's history. The stock plunged as it started trading on the 31st of March 2021 and the shares closed 26% below their original listing price, which was assumed to be overvalued. This plunge wiped approximately £2bn off of Deliveroo's original market cap, and it lost another 2% on Thursday. According to analysts, a variety of factors led to this disastrous performance, including concerns over working conditions, pricing, timing, increased regulatory risks facing gig economy companies, and volatile global market conditions in addition to uncertain business prospects.

Several of Deliveroo's advisers were quick to blame short sellers for this result, however data from IHS Markit showing only 4.65m shares on loan based on Thursday night's settlement indicates a very low level of shorting. Others in the market raised questions about the company's roadshow suggesting Deliveroo had priced its offering badly, especially after several British fund managers expressed their concerns on its dual-class share structure.

Lastly, it is worth mentioning that Goldman Sachs bought about £75m in Deliveroo shares, equal to nearly a quarter of the value of the shares traded, to stabilise the price of Deliveroo's shares as part of the greenshoe mechanism used in IPOs.

Underwriters

Goldman Sachs and JPMorgan were the joint global coordinators on Deliveroo's IPO, and Bank of America, Citi, Numis and Jefferies acted as the joint bookrunners for this initial public offering.

TAGS: IPO, Deliveroo, London, food delivery, ghost kitchens, DoorDash