ECM Update: Between Victory and Failure

Introduction

After a challenging 2023, in the first two quarters of 2024, the Equity Capital Markets activity has been recovering. As of May 2024, the ECM volume YTD accounted for $108bn, compared to $171bn for the whole 2023. Moreover, since the beginning of the year, convertibles were issued for more than $36bn, doubling the volume of the first half of 2023. The activity was particularly strong in Q2, when 20 firms went public, marking the highest number since Q4 2021. This growth is primarily fueled by a more stable macroeconomic environment, characterized by a resilient US economy. Despite high interest rates and inflation, consumer spending and overall business investment remained positive. The Q1 IPO activity was mainly driven by life sciences and biotech companies, while Q2 saw broadening participation from other industries, including tech, consumer markets and financial services.

We believe that ECM activity in Q4 will keep following this increasing trend in both volume and quantity, with a robust pipeline of IPOs from sectors such as technology, healthcare, and consumer goods. This growth will be primarily due to expectations of interest rate cuts resulting in an optimistic sentiment among investors. Despite this optimistic outlook and data, 2024 saw also a series of withdrawn IPOs, mainly due to bad market conditions and low demand.

Pershing square: Failed Ambitions

In July 2024, the American billionaire and hedge fund manager Bill Ackman announced his plans to launch, through its investment management firm Pershing Square Capital[AEX:PSH], a new U.S.-based closed-end fund, Pershing Square USA. Ackman aimed to publicly list the fund on the New York Stock Exchange under the ticker PSUS, aiming to raise a total amount of $25bn and offering the shares for $50 each.

The fund will seek to achieve its investment objective primarily by investing in common stocks that its investment adviser PSCM believes exhibit significant valuation discrepancies between current trading prices and asset fair value. The largest proportion of the fund's investment portfolio will be invested in 12-15 core long-term holdings in large-cap, durable growth, investment-grade, free cash flow-generating North American companies. This total number of companies held in the investment portfolio may increase over time depending on the economic or market conditions or other considerations.

Some of the key featurs of Pershing Square USA include low fees and fast access to capital. It will not apply any performance fee, aiming to significantly increase NAV performance over time, and the flat management fee will account for 2% and will be waived for the first 12 months. Moreover, Pershing Square will be structured as a closed-end fund, meaning that the number of total shares will be fixed and traded on the secondary market, and investors won't be able to redeem them.

A week before Pershing Square USA's IPO, which was set to be on Tuesday 30th July 2024, Bill Ackman encouraged existing PSCM shareholders to participate in the Initial Public Offering. This request was expressed in a private letter written by the American billionaire, which was revealed by a regulatory filing. This public gaffe contributed to the diffusion of rumors about a potential IPO delay. On Monday 29th July the company filed with the SEC a preliminary prospectus for the initial public offering indicating an aggregate offering size of 40m shares,

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for a total of $2bn dollar – a significantly lower amount compared to the previously announced size of $25bn. Moreover, in connection with the offering, the company anticipated to grant the underwriters a 45-day option to purchase up to an additional 6m common shares solely to cover over-allotments, if any. Global coordinators and bookrunners for the IPO included Citigroup[NYSE:C], UBS Investment Bank[NYSE:UBS], BofA Securities[NYSE:BAC] and Jefferies[NYSE:JEF].

However, on Tuesday, the intended IPO date, Bill Ackman withdrew plans for an initial public offering since investors' demand appeared to be lower from original expectations. The main concerns that resulted in the lower-than-expected demand are that the new vehicle might trade at a discount to the net assets held by the fund after the IPO. This is indeed exactly what happened with Ackman's European vehicle Pershing Square Holdings and it is common among closed end funds. Shares cannot be redeemed by investor but must be sold by them to exit the investment, increasing the offering of the stocks and lowering in the price. Historically closed-end fund tended to trade at a discount to their net-asset value and very few managed to trade at premium. After announcing the retiring of the IPO, the American billionaire explained to the media: "While we have received enormous investor interest in PSUS, one principal question has remained: Would investors be better served waiting to invest in the aftermarket than in the IPO? This question has inspired us to reevaluate PSUS's structure to make the IPO investment decision a straightforward one. We will report back once we are ready to launch a revised transaction."

At the end of August, Bill Ackman announced his plans to launch again the initial public offering of the investment vehicle, including additional incentives to capture the interest of investors. These incentives include providing early investors in Pershing Square USA with the right to buy extra shares in the vehicle in the future at a fixed price through warrants.

Golden Goose's Abrupt IPO Withdrawal: What Happened, Why It Matters, and the Consequences

In a surprising shift of events, Golden Goose, the Italian luxury sneaker brand known for its €500 distressed sneakers, pulled its planned IPO just days before its debut on the Milan Stock Exchange. Permira, the private equity firm that owns the brand, decided to withdraw the offering despite months of preparation, leaving investors and advisors surprised and the European IPO market rattled.

The Golden Goose IPO was expected to be one of the highlights of 2024, with the company aiming to raise approximately €600m and a valuation projected to reach ~€3bn. The brand, popular among celebrities like Taylor Swift, boasted solid financials, with 2023 revenues up 17% to almost €590m and operating profit growing by 23% to ~€130m.

Fund manager Invesco had committed $100m as a cornerstone investor, and seven banks were collaborating to build the IPO book. By Tuesday, just days before the planned listing, the offering was oversubscribed, signalling strong demand. Yet, despite all these positive signals, Francesco Pascalizi, the dealmaker leading the investment for Permira, shocked the market by pulling the IPO. This decision followed a series of intense internal discussions and reflected Permira's growing concerns about market conditions and investor sentiment.

Despite the oversubscription, the IPO faced several challenges. Firstly, the demand was not coming from the right sources. While hedge funds and short-term investors filled the order book, long-term, institutional investors – the kind needed to anchor a successful IPO – were notably absent. Major players like BlackRock [NYSE: BLK] and Singapore's GIC did not commit to the offering, raising questions about the sustainability of the demand.

Moreover, political uncertainty in Europe further complicated the situation. Following recent European elections, in which far-right parties made surprising gains, French President Emmanuel Macron called snap parliamentary

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elections. This move sent shockwaves through the European markets, particularly hitting luxury stocks like LVMH [PA: LVMH] and Moncler [MI: MONC]. As concerns grew, Permira feared a potential sell-off in Golden Goose shares post-listing, leading to reputational and financial damage.

The PE firm had reasons to be cautious. Its previous high-profile IPO of Dr. Martens [LON: DOCS] in 2021 had started well but quickly soured. The iconic boot-maker has since issued five profit warnings, and its shares have plummeted over 80%, leaving a bitter taste in investors' mouths. With that experience fresh in mind, Permira was not willing to take another chance on a high-risk public offering.

Additionally, Golden Goose's listing faced several headwinds beyond Permira's concerns. The pricing of the IPO had already been scaled back. Initial estimates placed the company's valuation at €3bn, but the price range was eventually set to value it between €1.7bn and €1.9bn – significantly lower than expected. This 25-30% discount, particularly when compared to luxury peers like Moncler, raised concerns and diminished enthusiasm among investors.

National Grid: Powering the ECM Market

In June this year, National Grid plc [LSE: NG] has closed the largest UK equity offering over the past 15 years since Lloyd's Bank 2009, issuing about £6.8bn by way of fully underwritten rights issue. It has been the second biggest ECM deal this year and the largest utility and energy equity rights issue worldwide, ever. The capital raise is part of a wider five-year, £60bn investment plan by the energy company to fund the UK electricity transmission system and accelerating the electricity distribution to adapt to the demand created by low-carbon technologies. Additional funding is planned to be raised by selling a liquefied natural gas terminal in the east of England, as well as its US onshore renewable business. Furthermore, it has just sold its electricity system operator to the UK in the beginning of September for an enterprise value of £630m. The recent offering is unique in terms of size, narrative and fee structure, as discussed in the following.

About National Grid

National Grid is an energy company operating in the UK and the US, headquartered in London, owning and operating electricity and natural gas transmission networks, as well as producing such commodities in the US. The company owns the largest electricity distribution network, serving nearly 8 million customers in England and Wales. Apart from network operations and origination, the supplier owns a corporate venture capital fund, National Grid Partners, and an investment arm developing, operating and investing into large scale energy projects and technologies. The company has been public since the 11th of December 1995, with its listing on the London Stock Exchange [LSE: LSEG.L] and has expanded into the US via acquisitions in 2000. The company has about 31k employees, generating £19.9bn in revenue and £2.3bn in total profit in the fiscal year 2023/24. National Grid heavily advertises themselves being at the centre of a shift to a clean-energy based economy, promising to be emission free by 2050. By their £60bn investment plan, the company is planning on refinancing approximately £750m in outstanding hybrid bonds with call dates in the next 15 months and fuelling their growth plan with the majority of proceeds.

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Deal structure and narrative

Announced on May 23d and closed on June 12th, about 1bn new ordinary shares have been issued by National Grid at 645 pence per new share in a 7 for 24 rights issue, meaning that a holder of 24 shares would receive 7 additional ones at a 35% discount calculated after dilution. Approximately 91% of the total number of new shares have been accepted by the shareholders. The close to £7bn in generated cash equal to about 17% of its pre-announcement market capitalisation. The stock had a steep drop of about 10% after the publication of the plan on May 23d, influencing the FTSE 350 Utilities Index heavily, which fell by 6.2%. The stock has since recovered and reached a similar level to prior to the announcement.

An interesting fact is that National Grid is paying out about £2bn in dividends annually, meaning in about four years they would have redistributed their capital raise back to their shareholders. Why would they not cut their dividend for a few years and avoid paying unusually high fees to the investment banks brokering the deal? Using their own cash flow would be a sufficient source of funds and the huge amount of cash is not needed at once. A few issues oppose this few and showcase why it is a common European practice to avoid cutting dividends. First of all, the company would have hurt its capital structure, essentially increasing the cost of capital due to a possibly much harsher fall in its stock price. Capital structure aside, the main motivation will be the large proportion of income funds on its shareholder list. Abruptly ending the lucrative dividend scheme would force them to liquidate their position and National Grid would instead have to market themselves to growth investors, which would possibly end up in a financial disaster. This also explains the additional sell off of entities not related too closely to the core business, as they also do not affect the dividend by much and thus offer possibilities to raise money. Although dividends per share will fall approximately 15%, the company will still prevail as an attractive dividend yielding investment to most.

Due to the sheer size of the offering, the banks involved in the process, JPMorgan Chase & Co [NYSE: JPM] and Barclays plc [LSE: BARC.L], which were surprisingly the only two brokers, have been paid combined fees of allegedly more than £140m without taking much risk due to the hefty discount of the newly issued shares compared to the actual share price. The question arises whether such fees and were justified given the risk profile. Craig Coben, former global head of equity capital markets at Bank of America wrote in the Financial Times: "Whoever the bankers are: Feel free to go get drunk and take credit at all the parties", commenting on the deal and fee structure. Not only did the two banks earn record fees but they also scored easy points for the ECM league tables. Reason for the low risk taken on by them, is that they would only find themselves in jeopardy if the overall share price sank beneath the price of the newly issued ones, which were given out at a 35% discount after dilution, a large margin of safety. Furthermore, there were no sub-underwriting institutional investors involved, which are usually taking on between 30-50% of the new shares, as well as no other banks, even those that had lent money to National Grid and might have anticipated their own participation. A plausible reason for the company's choice could be that they wanted the deal to happen in a timely matter without any information spilling and possibly influencing the share price beforehand. However, in this case companies usually release underwriting tickets right after the initial announcements with a very short acceptance period of only up to a day to give other banks the opportunity to join the issuance. As this has not happened, it clearly highlights the exceptional work of professionals from both banks in relationship building and corporate finance expertise which has led to this lucrative deal.

The unique size of the deal in times where IPOs and equity offerings are rare, showcases that the market is beginning to recover, be it slowly and in a rather risk-free environment. The heavy discount factor on the newly issued shares demonstrates that ECM deals are possible but are still limited by caution, ensuring that no party along

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the line is left with too much risk or even a loss. Nevertheless, National Grid has successfully completed its capital raise, and the participating banks have profited from it, as well.

Conclusion

In summary, the Equity Capital Markets landscape is gradually recovering, evidenced by increased activity and successful capital raises. While optimism prevails, recent IPO withdrawals, especially in the Middle Market sector, highlight the importance of strong institutional investor support and market conditions. The cancellation of high-profile transactions such as the Pershing Square IPO have a wider, negative impact on the general market sentiment and might influence the decision-making of others. As firms like National Grid demonstrate the potential for significant offerings, the market remains cautious yet hopeful. The coming months will be crucial in determining whether this upward trend can sustain itself, as the interplay of macroeconomic factors, investor sentiment, and geopolitical developments continues to shape the ECM environment. Ultimately, adaptability and strategic planning will be key for companies aiming to thrive in this evolving market.

TAGS: Bill Ackman, Convertible Bonds, ECM, Equity Capital Markets, European IPO Market, Financial Services IPOs, Golden Goose, Healthcare IPOs, High Interest Rates, IPO, Investor Sentiment, Life Sciences IPOs, LSE, London Stock Exchange, Luxury Sector, Macroeconomic Stability, National Grid, NYSE, New York Stock Exchange, Permira, Pershing Square, Private Equity, Public Offerings, Rights Issue, Technology IPOs, US Economy

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