IPO boom in London

But will it last as UK equity funds see outflows?

Edison themes

1 November 2021

The first nine months of 2021 have seen 85 IPOs in London – 43 on AIM and 42 on the main board – the strongest showing since 2014, when 100 IPOs came to market in the first nine months (9M14). Only the US and Chinese markets have raised more capital than London during this period. Including follow-on offerings, $55bn has been raised, which is 27% of the equity capital raised in Europe during 9M21. There is a clear political and regulatory will to make London more competitive as a listing destination. However, we still see continued outflows from UK equity funds, with Emerging Portfolio Fund Research (EPFR) stating that despite overall inflows, UK-focused funds saw outflows of $9.4bn year to date, the sixth year of outflows. This does lead to questions about the sustainability of the London IPO market. There are signs, particularly in the small- and mid-cap sectors, that emerging clusters of companies in areas like video gaming, fintech and e-commerce are creating an ecosystem that allows investors to benchmark and value them at levels that make the UK competitive with the US as a listing destination.

Some notable trends in 2021's IPO activity

The IPO activity in 2021 suggests there is scope to attract secular growth companies to London. 43% of the IPOs were in technology and the e-commerce space, over 20 of the IPOs were founder-led businesses and there was a continued strong showing from the listed company sector. The float of Oxford Nanopore in London builds further presence in a sector that has seen some transitions from small-cap to billion-pound companies such as Oxford Biomedica, HUTCHMED and Abcam.

Continued outflows from UK equity funds

Despite more growth companies coming to London, we have yet to see the tide turn on outflows from the UK equity funds. The lack of secular growth and the underperformance of the FTSE 100 and FTSE All-Share indices compared to the US market have meant more money has gone to global rather than UK mandates. Concerns about Brexit, UK supply chain issues, inflation and the expectation that the Bank of England will raise rates resulting in the UK lagging developed market peers in a recovery have also contributed to outflows. Finally pension funds have been reducing exposure to UK equities to meet upcoming liabilities and manage risks.

Clusters of expertise are emerging

For the UK to compete and attract secular growth companies, its investment community needs to be able to grasp disruptive business models and be comfortable with the valuations that private equity and US markets afford these companies. Dan Ridsdale, Edison's managing director of TMT, has written that the UK will struggle to compete with the expertise and depth of capital that the US has for SaaS and cloud businesses. There are clusters of expertise the UK does have. It has recently joined the US and China in being one of three nations to have 100 'unicorn' status private companies. These growth companies are in sectors such as fintech, e-commerce, cleantech and healthtech, and are all areas the UK can build on. The success of the video gaming sector in the UK (eg Frontier Development) is attracting Devolver Digital, a Texas-based gaming company, to list in London at a £1bn valuation.

From the street

'There are a lot of US companies choosing to list on the London market today. Many of them eventually seek US dual listing, in many ways London is becoming the 'Minor Leagues' for eventually going public in the US. Because of our exposure and experience of UK investing, we are often the first public investor visit for companies choosing this path.'
Randy Baron, lead portfolio manager, Pinnacle Associates

Edison themes

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Companies mentioned in this report (Edison clients in bold)

Abcam (ABC.L)
Alphawave (AWE.L)
Arecor Therapeutics (AREC.L)
Belluscura (BELL.L)
Big Technologies (BIG.L)
BiVictriX Therapeutics (BVX.L)
Darktrace (DARK.L)
Deliveroo (ROO.L)
Frontier Development (FDEV.L)
HUTCHMED (HCM.L)
HydrogenOne Capital Growth (HGEN.L)
Keywords Studios (KWS.L)
LungLife AI (LLI.L)
Made Tech Group (MTEC.L)
Made.com Group (MADE.L)
Microlise Group (SAAS.L)
Moonpig (MOON.L)
Nightcap (NGHT.L)
Oxford Biomedica (OXB.L)
Oxford Cannabinoid Technologies (OCTP.L)
Oxford Nanopore Technologies (ONT.L)
PensionBee (PBEE.L)
Poolbeg Pharma (POLB.L)
Seraphim Space Investment Trust (SSIT.L)
Sumo Group (SUMO.L)
Supreme (SUP.L)
tinyBuild (TBLD.L)
Trustpilot (TRST.L),
Victorian Plumbing Group (VIC.L),
Wise (WISE.L)

Companies mentioned above do not translate into buys or sells as other themes (and valuation parameters) may conflict with this one.

London calling

Equity markets have been extremely active globally. In response to the pandemic, corporates sought to diversify their sources of finance, and strengthen balance sheets and market positions, taking advantage of the once in a lifetime industry disruption to consolidate. Investment is also being made to grow market share or take advantage of customers prepared to do things in a new way.

The corporates' need for capital was met by equity markets, buoyed by supportive monetary and fiscal policies globally and resurgent retail investors, whom as a consequence of working from home found they were making more savings and had time to look at putting those savings to work in a market made more accessible through technology: notably financial apps and better connectivity.

London has prospered. In terms of initial public offering (IPO) capital and follow-on (FO) capital, it is third behind the United States and China for capital raised in 9M21. In Europe, it accounted for 27% of capital raised and its growth market AIM accounted for 52% of capital raised on European growth markets during this period. The 85 IPOs, which include Wise's direct listing, were evenly balanced between AIM, which had 43 IPOs, and the Main Market, which had 42 IPOs. This is the highest number of IPOs since 2014, when we saw 100 IPOs in the first nine months.

Exhibit 1: Top 10 exchanges in terms of equity capital raised in 9M21

Exchange name	IPO capital raised ($m)	No of IPOs	FO capital raised ($m)	No of FOs	Total capital raised ($m)	Total no of deals
Nasdaq	149,027.8	540	126,806.9	739	275,834.8	1,279
NYSE	106,685.1	226	128,825.3	341	235,510.4	567
HKSE	23,582.7	63	74,783.5	248	98,366.2	311
Shanghai	31,908.0	198	31,235.2	87	63,143.2	285
LSE	18,954.1	85	35,914.0	399	54,868.1	484
Shenzhen	16,489.0	171	34,331.5	165	50,820.5	336
Frankfurt	11,201.4	16	15,656.2	74	26,857.6	90
ASX	5,395.5	122	21,272.5	677	26,668.0	799
BSE	9,704.7	64	15,334.5	82	25,039.2	146
NSE	9,680.1	54	15,319.5	76	24,999.6	130

Source: Dealogic data compiled by Edison Investment Research

Within the IPOs there were some notable trends:

- 43% of the IPOs were in technology and consumer internet retailing. These include names such as Moonpig (MOON.L), Wise (WISE.L), Deliveroo (ROO.L), Made.com Group (MADE.L), Darktrace (DARK.L), Trustpilot (TRST.L) and Alphawave (AWE.L).
- There were over 20 founder-led IPOs including Nightcap (NGHT.L), Supreme (SUP.L), tinyBuild (TBLD.L), Victorian Plumbing Group (VIC.L), PensionBee (PBEE.L), Microlise Group (SAAS.L), Big Technologies (BIG.L), BiVictriX Therapeutics (BVX.L) and Made Tech Group (MTEC.L).
- There was a flagship IPO in healthcare with Oxford Nanopore (ONT.L) raising £603m and continued support for smaller life science companies, with at least five other life science IPOs including Oxford Cannabinoid Technologies (OCTP.L), Arecor Therapeutics (AREC.L), LungLife AI (LLI.L), Poolbeg Pharma (POLB.L) and BiVictriX Therapeutics (BVX.L). There was also the IPO of Belluscura (BELL.L), which is headquartered in Texas, on the medical devices side.
- The listed investment company sector continued to be active with 10 IPOs. In this sector, my colleague Sarah Godfrey has tracked IPOs and six did not get away during this period, suggesting a c 60% success rate. The sector continued to attract interest in alternative assets such as infrastructure, property and music royalties, but also some new strategies such as HydrogenOne Capital, which invests in clean hydrogen, and Seraphim, which invests in space

technologies. 25% of the follow-on capital raised in the London market in the first nine months was in the listed investment company space.

Exhibit 2: Top 20 European exchanges in terms of equity capital raised in 9M21

Exchange	IPO capital raised ($m)	No of IPOs	FO capital raised ($m)	No of FOs	Total capital raised ($m)	Total No of deals
London	18,954.1	85	35,914.0	399	54,868.1	484
Frankfurt	11,201.4	16	15,656.2	74	26,857.6	90
Stockholm	7,018.6	70	14,627.8	136	21,646.4	206
Euronext Paris	3,779.2	29	12,216.7	53	15,995.9	82
Euronext Amsterdam	11,716.8	15	3,505.4	14	15,222.1	29
Madrid	1,966.6	4	11,438.4	12	13,405.0	16
Copenhagen	609.8	17	8,190.0	14	8,799.8	31
Oslo	4,141.8	52	4,415.8	89	8,557.5	141
SIX Swiss	2,029.9	4	3,467.1	18	5,497.0	22
Helsinki	1,226.6	15	4,110.0	18	5,336.5	33
Euronext Brussels	1,947.7	4	3,113.9	15	5,061.6	19
Moscow	2,638.2	3	1,783.8	6	4,422.0	9
Borsa Italiana	972.1	22	2,807.3	16	3,779.4	38
Athens	-	0	2,766.8	4	2,766.8	4
Warsaw	1,353.3	3	1,315.5	5	2,668.8	8
Lisbon	176.8	1	2,458.7	2	2,635.5	3
Iceland	734.3	4	-	0	734.3	4
Vienna	-	0	591.6	3	591.6	3
Euronext Dublin	14.1	1	512.3	2	526.4	3
Luxembourg	-	0	322.7	2	322.7	2

Source: Dealogic data compiled by Edison Investment Research

Exhibit 3: AIM has dominated growth markets for total capital raised, First North has raised more in IPO proceeds

Exchange name	IPO capital raised ($m)	No of IPOs	FO capital raised ($m)	No of FOs	Total capital raised ($m)	Total No of deals
London Stock Exchange – AIM	2,938.8	43	6,590.9	229	9,529.7	272
First North Stockholm	3,424.5	54	2,387.3	75	5,811.8	129
Paris – Alternext	21.2	2	1,048.3	15	1,069.5	17
First North Finland	583.7	11	151.2	7	734.8	18
Borsa Italiana – AIM Italia	613.0	19	55.7	2	668.7	21
Frankfurt Stock Exchange – Scale	105.2	1	216.3	10	321.5	11
First North Denmark	135.8	14	19.1	3	155.0	17
Oslo Axess			80.2	9	80.2	9
Madrid Stock Exchange – Alternative Market	53.4	2			53.4	2
First North Iceland	40.9	2			40.9	2
BX Swiss	16.4	1			16.4	1
Paris Marche Libre			13.1	2	13.1	2
First North Estonia	1.0	1			1.0	1

Source: Dealogic data compiled by Edison Investment Research

Capital flows are going the other way

The success of the London market in the first nine months in terms of capital raised for corporates is at odds with another trend we are seeing, namely a flow of capital away from UK focused funds. Globally the Investment Association estimates there are £75tn of assets under management. The US accounts for just under half of this at £33tn (see Exhibit 4). The UK is the second largest centre in the world, accounting for around 37% of assets managed out of Europe.

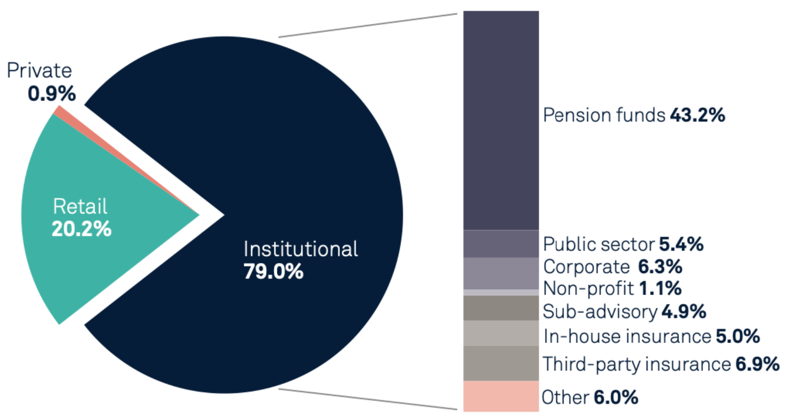
Exhibit 4: Global assets under management by region

	Assets under management (local currency)	Assets under management (£ equivalent)
United States	$45tn	£33.0tn
Europe	€7tn	£24.4tn
UK		£8.6tn
France		£4.1tn
Germany		£2.2tn
Switzerland		£1.9tn
Netherlands		£1.3tn
Japan	¥700tn	£5tn

Source: The Investment Association Annual Survey September 2021

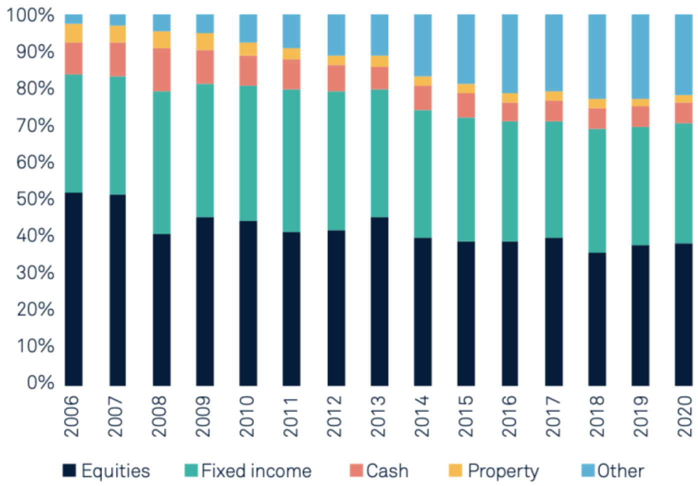
The make-up and allocation of the UK assets under management are shown in Exhibits 5 and 6. The largest client group for the asset management industry is pension funds, which account for 43% of total assets under management, unchanged from 2019. Retail is the next significant group, accounting for 20%, which grew from 19% in 2019. In terms of allocation, the proportion allocated to equities has fallen over the last decade, from 45% in 2010 to 39% in 2020. This used to be close to 50% in 2006 but a significant shift to fixed income and cash happened in 2008 in the wake of the financial crisis. The growth in other is driven by greater investment in private markets and solution strategies such as liability driven investment.

Exhibit 5: Assets under management by client type in 2020



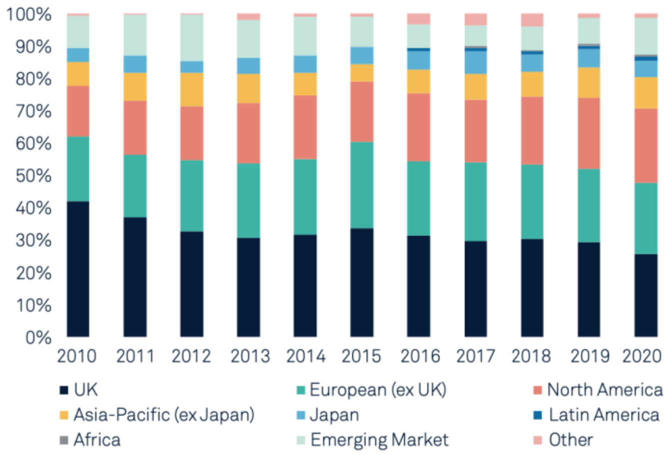
Source: The Investment Association Annual Survey September 2021

Exhibit 6: Global assets allocation of UK managed assets 2006–20



Source: The Investment Association Annual Survey September 2021

Exhibit 7: UK equities by region (2010–20)



Source: The Investment Association Annual Survey September 2021

Within equities, the percentage allocated to UK equities has fallen from 40% in 2010 to 26% in 2020. Despite overall inflows to equities, UK focused funds have seen withdrawals since 2015, with EPFR reporting that in 2021 a further $9.4bn has been withdrawn year to date (to 24 October) making it likely that UK funds would have endured six straight years of net outflows.

A number of factors are driving these outflows:

- Pension funds have been gradually reducing exposure to equities in response to greater scrutiny over risk management, accounting and regulatory oversight, and the demographic profile of the UK (as baby boomers approach retirement) resulting in more being allocated to fixed income to match upcoming liabilities. The Pension Protection fund data show that pension funds have cut their exposure to UK listed equities from 26% in 2008 to 3% in 2020.
- Retail platforms have been directing investors towards global mandates rather than UK mandates. In part this is driven by performance. £100 invested into the FTSE All Share 10 years ago would now be worth £143; investing the same in US indices would have resulted in £329; while the same in Germany would have resulted in £369. The five-year performance of the FTSE All Share and the FTSE 100 stand at 3% and 8.1%, which has led investors to seek returns in the US market in particular. The lack of technology stocks on the FTSE 100 Index has been cited by some platforms as one of the reasons for this shift.

- More recent outflows have been as a result of the uncertainty around Brexit, the supply chain issues the UK is facing, which business leaders have said could last until 2023, the rising costs of goods and inflation and the likelihood that the Bank of England will look to raise rates in response. All these suggest the UK will recover at a slower rate than other countries.

To provide some balance, it should be noted that AIM and the FTSE 250 have performed extremely well over the last five years (see Exhibit 8). This should suggest that there is a greater propensity to attract interest, which is borne out in recent ONS data, which shows that retail has a greater propensity to own non FTSE 100 shares.

Exhibit 8: AIM and FTSE 250 indices stand out in terms of five-year performance

Index	Five-years	One-year	2021 YTD
AIM 100	53.9	22.3	1.3
AIM All Share	50.4	26.6	5.3
FTSE 100	3.0	21.7	10.1
FTSE 250	28.0	29.2	12.5
FTSE 350	6.9	23.0	10.6
FTSE All Share	8.1	23.7	10.9

Source: Refinitiv. Note: Year to date priced as at close 29 October 2021.

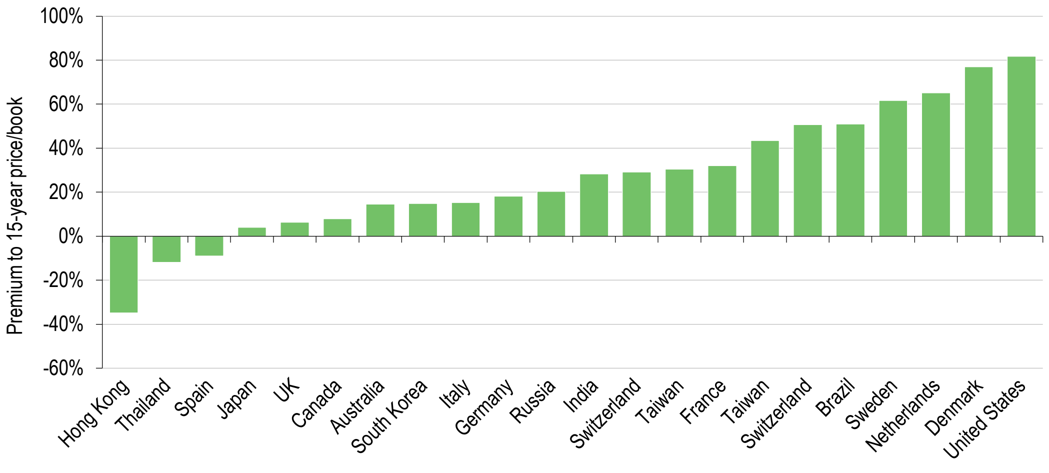
How to make UK equities more attractive

Chicken and egg

There is an argument that the UK remains one of the most undervalued markets in the world. Alastair George, our equity strategist, points out that 'In a global equity landscape where significant overvaluation seems to be the rule rather than the exception, the UK stands out as one of the more reasonably valued markets. The UK has a forward price/book multiple of only 1.8x, which is in line with its long-term average.'

While an argument can be made that growth has had a strong run and may be overbought, the pandemic has accelerated disruption through technology and a market lacking exposure to structural growth companies is likely to continue underperforming. Year to date (to 29 October) the FTSE 100 (+10.1%) has lagged the S&P (+24.5%), and unless the lag in performance changes we are unlikely to see a reversal in outflows from UK equity funds.

Exhibit 9: Forward price to book by market compared to 15-year averages



Source: Refinitiv, Edison Investment Research calculations

To overcome these problems, innovative growth companies need to be convinced that London is a more attractive market to list on than one of the US or European exchanges. To make this happen, two things need to take place in our view:

- Implementing the changes proposed by two government sponsored reviews to make the UK a more hospitable market for growth companies: The Kalifa review, which proposes a range of recommendations to make fintechs thrive in the UK, and Lord Hill's listing review, which we cover in more detail below.
- Creating an ecosystem to allow investors to understand and benchmark the business models of innovative companies and afford them the valuations that makes the UK competitive against the US or private equity markets. This is arguably a greater hurdle to overcome. As one investor put to us: 'regulation has made it harder to get to know high-technology companies in the IPO process and in general. This makes it harder to pay up for great scalable businesses. In conjunction with the high valuations paid by private equity and the enormous resources they have to get to know a business, this makes the UK market more 'lemony' than in the past'.

However, there are signs that in certain clusters, the UK is becoming competitive. We examine this in more detail in the theory of clusters section below.

Lord Hill's listing review

The asymmetry in governance and reporting between private companies and listed companies remains a barrier to convince entrepreneurs to bring their businesses to the public markets. Many tech entrepreneurs have pointed out the significant rewards available to managements teams of successfully scaling their businesses in a private arena compared to the listed market.

Some of this gap is naturally going to narrow as institutions continue to increase their exposure to private markets and impose similar standards of reporting and governance that they have in the public markets.

Lord Hill's review also has a number of proposals to help narrow the gap and further reduce the friction to companies listing. Among the proposed changes are:

- Allowing founders more control of their businesses through the inclusion of dual class shares in the premium listing segment. At present, those companies with a second class of share that affords founders more control around the future of their businesses are excluded from the premium list, and thus from funds that track the index.
- Reducing free float requirements, to allow founders to retain a greater share of a business, including reducing the percentage requirement to be on the premium and standard list from 25% to 15% subject to satisfying liquidity requirements.
- A review of the prospectus regime, aiming to make it easier to include retail in secondary and primary issuance.
- Relaxing the listing rules around special purpose acquisition companies (SPACs), particularly the rules that currently require a suspension of trading when an acquisition target has been identified, potentially locking in some investors who may not support the acquisition.
- Allowing for the provision of forward-looking statements in prospectuses and amending liability regimes for issuers and directors in providing this forward guidance.
- Using technology to allow retail investors to more easily participate in company voting.
- Equalising debt and equity tax treatment for sources of funding.
- Reviewing the provision of research under MiFID II and the current IPO regime.

These proposals are being taken forward through two separate consultations. HM Treasury has issued a UK Prospectus Regime Review to overhaul the current prospectus regime and the Financial Conduct Authority has issued the Primary Markets Effectiveness review, a consultation to examine how primary markets could work more effectively for both issuers and investors.

The latter carries a proposal to have a minimum market capitalisation threshold of £50m for issuers listing on the standard or premium segments. Companies with smaller market capitalisations would be listed on AIM or one of the other growth markets such as Aquis.

The theory of clusters

We see the theory of clusters in everyday life. Technology companies flock to Silicon Valley, bankers flock to Wall Street and filmmakers go to Hollywood. The network effect of these clusters promotes competition, accumulation of specialised knowledge and access to better infrastructure across verticals.

In much the same way, possibly one way London is starting to overcome the challenge of fund managers appreciating growth businesses is building on success stories. Texas-based games developer Devolver Digital is expected to list in London at a $1bn valuation. This follows a number of successful video gaming and associated stocks listing in London over the last decade: Sumo, Keywords Studios, Codemasters (which has now been acquired by EA Sports), Frontier Developments and tinyBuild.

These clusters allow investors to accumulate knowledge of the supply chain, competitive market, benchmark growth rates, financial metrics and valuations and to cross check information. According to Exhibit 10, the more peers, and/or the more homogenous an asset's class, the more likely investors are to have an opinion on valuation and participate, leading to a better spread of prices that leads to liquidity and a lower cost of capital.

Exhibit 10: Information and a broad peer group stimulates liquidity

Liquid markets	Illiquid markets
Large quantities of a homogeneous asset	Unique asset
Low selling cost	High selling costs
Low bid-offer spread	High bid-offer spread
Wide pool of potential buyers	Difficult to identify buyers
Sale can take place very quickly	Takes a long time to transact
Price can be accurately estimated	Difficult to estimate eventual price
Buyers and sellers have the same information	Information asymmetry
Recent transaction benchmarks	No reliable transaction benchmarks

Source: Edison Investment Research

This can of course go the other way. The recent spate of takeovers in the UK defence sector (Cobham, Meggitt and Ultra) has reduced the number of peers and specialist analysts covering the sector.

My colleague Dan Ridsdale has written on how the UK could develop. He points out that it is very hard for the UK or any other market to compete with the depth of capital and expertise available in the United States for large-scale software-as-a-service (SaaS) or cloud businesses. However, the UK can compete in areas where it has developed verticals such as fintech, e-commerce and digital health. He also notes that success follows success. Alphawave, which is a Canadian business, came to London because of the success of ARM.

We see two clues as to where those sectors or clusters could be:

- The private company space: the UK attracts more venture capital than its European neighbours and has just joined the United States and China as the only three nations to have more than 100 companies that have achieved 'unicorn' status by being valued at more than $1bn. 30 of these are in the fintech space. Other notable areas include healthtech, insurtech, food and drink, digital security, e-commerce and cleantech. Cleantech has seen significant investment, with BlackRock's Larry Fink commenting recently that he believes the next 1,000 unicorns will not be search engines or media companies, but companies developing green solutions.

- The changing nature of London's growth market: the other clue is to compare the constituents of AIM. Exhibit 11 shows the top 15 sectors by number of companies listed on AIM for October 2021 and 2006. The decline of the 'General Financial' sector has largely been post financial crisis consolidation in the sector. Today, AIM is dominated by software companies, but still has a strong heritage in natural resources and is still strong in life sciences.

Given the political and regulatory impetus to make London a more attractive listing destination, the growing clusters of success in growth industries, the resurgent IPO market and the growing cohort of successful private companies, there is hope that the small- and mid-cap markets in London are developing the seeds that might lead to more structural growth companies coming to London. London may well be reinventing itself. If it does, its pitch that it is a kinder home to small- and mid-cap companies than the United States might resonate.

Exhibit 11: Top 15 sectors on AIM by number of companies for October 2006 and October 2021

October 2006			October 2021		
Sector	No. of companies	Total market cap ($m)	Sector	No. of companies	Total market cap ($m)
General Financial	182	17,762	Software and Computer Services	90	22,681
Mining	174	23,001	Oil, Gas and Coal	83	8,032
Software & Computer Services	152	6,878	Industrial Metals and Mining	67	5,076
Support Services	140	9,886	Industrial Support Services	67	17,348
Media	114	6,247	Investment Banking and Brokerage Services	59	13,641
Oil & Gas Producers	95	19,349	Pharmaceuticals, Biotechnology and Marijuana Producers	55	24,171
Travel & Leisure	91	7,287	Precious Metals and Mining	39	5,402
Real Estate	74	12,663	Travel and Leisure	30	6,923
Pharmaceuticals & Biotechnology	67	5,596	Media	28	8,691
Electronic & Electrical Equipment	61	3,637	Retailers	24	11,593
Equity Investment Instruments	54	6,163	Electronic and Electrical Equipment	22	3,706
Health Care Equipment & Services	41	2,092	Medical Equipment and Services	22	3,864
Industrial Engineering	39	1,837	Real Estate Investment and Services	19	3,121
Technology Hardware & Equipment	37	2,267	Construction and Materials	19	7,512
General Retailers	36	2,967	Finance and Credit Services	16	2,341
Construction & Materials	25	2,594	Closed End Investments	14	1,147

Source: London Stock Exchange

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