

Revisiting IPOs in London

Tougher times but some encouraging signs



Edison themes

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In total, 126 companies listed on the London Stock Exchange in 2021, with 66 on AIM and 60 on the main board, the strongest showing since 2014. This raised £16.8bn, of which c £3.2bn was raised for AIM companies. Only the US and Chinese markets saw more capital raised for new listings in 2021. That year also saw a very strong market for follow-on offerings, with £32.4bn being raised by issuers, £6.2bn of this raised on AIM. This activity was coupled with political and regulatory pushes to make London more competitive as a listing destination, which we detailed in our [IPO boom in London](#) report of November 2021. Six months from this last report and the new issues have been subdued by markets retreating in the face of rising inflation and interest rates accompanied by the Russian invasion of Ukraine. Q122 saw 19 companies list, raising £397m, compared to Q121 when 22 companies listed, raising £5.4bn. There are still encouraging signs that London is taking strides towards becoming a more competitive market, most notably on the private and venture capital side.

Edison themes

As one of the largest issuer-sponsored research firms, we are known for our bottom-up work on individual stocks. However, our thinking does not stop at the company level. Through our regular dialogue with management teams and investors, we consider the broad themes related to the companies we follow. Edison themes aims to identify the big issues likely to shape company strategy and portfolios in the years ahead.

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Continued outflows from UK equities in April 2022

Data from Calastone show continuing outflows from UK equities, with investors pulling £836m from UK equity focused funds in April, beating the record set in January 2022. Two-thirds of UK focused funds saw outflows, with small- and mid-cap funds bearing the brunt of the selling. ESG focused funds continued to see inflows and UK focused funds with an income bias also fared well. The report had one stark statistic: of the £49bn invested in equities funds since January 2015, no net new money has flowed into UK-focused funds. Initially the negative sentiment around UK equities was a consequence of Brexit, then flows to more attractive (US) growth markets as technology and healthcare boomed through the pandemic. The expected flow back to UK stocks on valuation and exposure to old economy names anticipated in late 2021 vanished by March 2022 with the onset of inflation, rising rates and the invasion.

Outflows attract M&A and venture capital

We made the case in our November 2021 report that the UK was one of the most undervalued markets in the world. The UK has long been out of favour for its mix of value and cyclical names; Susan Noffke, head of UK equities at Schroders, commented in December 2021 that 'Somebody's buying UK shares, it's just not stock market investors at present'. The comment related to a report Schroders published looking at the c 350 constituents of the UK MSCI IMI Index at 31 December 2011. Over the next decade, 112 of these were acquired, with 68 of them acquired by an overseas company. A further 14 delisted for other reasons (eg administration). There has also been a greater focus on the UK from US venture capital firms. The \$10.2bn US venture capital investment in high-growth UK companies in 2021 was a record. Sequoia Capital, an early backer of the likes of Apple and Google and which currently has a stake in one-fifth of the world's unicorns, opened a London office in 2021 citing that the UK and Europe are on the verge of a technology take-off. An argument for the better public market valuations in the US compared to the UK has been the deeper pool of growth funds. Early signs are that this is starting to change.

Review of 2021 IPO and follow-on activity in London

Exhibit 1 shows in dollar terms the IPO and follow-on fund-raising activity for the top five active markets globally. London's 126 IPOs were its highest in terms of number of IPOs since 2014 and the highest since 2007 in terms of proceeds raised. The IPOs were evenly balanced between the Main Market (60 IPOs) and the junior AIM market (66 IPOs). The larger Main Market listings attracted more of the IPO proceeds, with £13.7bn raised on the Main Market and £3.2bn raised on AIM. The year saw two innovative listings. Wise (WISE.L) completed a direct listing, and Hambro Perks Acquisition Company (HPAC.L) was the first special purpose acquisition company (SPAC) to list in London following the UK listing rule changes in August 2021.

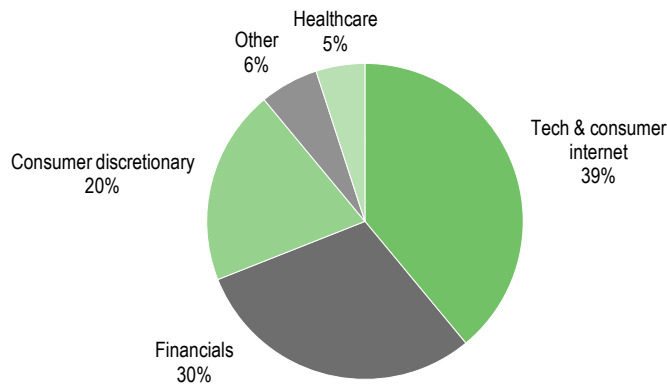
Exhibit 1: London ranked third globally for 2021 IPO proceeds

	Number of IPOs	Proceeds (\$bn)	% global total	Number of follow-ons	Proceeds (\$bn)	% of global total
United States	1,015	323	53%	1,245	294	36%
China	473	73	9%	387	113	14%
United Kingdom	126	21	4%	371	42	5%
Australia	124	24	3%	521	33	4%
Japan	117	18	2%	112	31	4%
Hong Kong	84	9	1%	209	87	11%

Source: Dealogic, Bloomberg, London Stock Exchange, Edison Investment Research

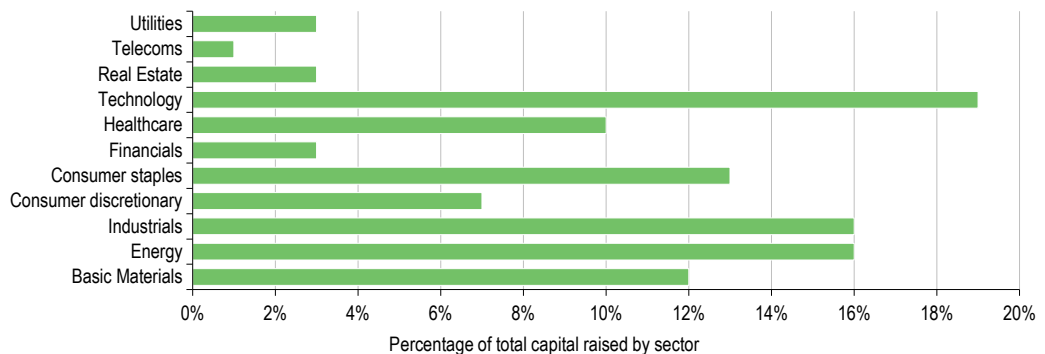
Exhibit 2 below shows the IPO proceeds for UK listings by sector for 2021, with over a third of the listings coming from high-growth technology and e-commerce businesses. The capital raised by sector on AIM was more broadly spread, as shown in Exhibit 3.

Exhibit 2: London 2021 IPO proceeds by sector



Source: London Stock Exchange

Exhibit 3: AIM 2021 capital raised by sector



Source: London Stock Exchange

London IPOs look to be holding up better than other markets...

With the caveat that with current market volatility, the data may change quickly, we have looked at the IPOs of 2021, comparing the prices as at close 2 May 2022 to their listing prices for the London, Euronext and Nasdaq markets. London IPOs are still on average positive, with a 6% return and 49% of companies trading below their listing price. For Euronext, 2021 IPOs are trading down 19%, with 87% of IPOs trading below their listing price. For Nasdaq, 2021 IPOs are trading down 15%, with 62% below their listing price.

...and continues to attract US capital

In total, 20% of the IPO proceeds on AIM for 2021 came from the United States. Our note on the [US equity markets](#) highlights that US equity investors continue to diversify away from US equities. US Treasury data show that in 2020, the UK represented 9% of US holdings of international equities. IPOs such as Auction Technology Group (ATG.L), Oxford Nanopore (ONT.L) and Darktrace (DARK.L) all attracted US investors.

Darktrace has c 40% of its register held by US investors. It had Needham & Co and Piper Sandler as part of the investment banking IPO syndicate to support the targeting of US investors, and arguably having US-based analysts already known to the US investment community provides comfort to these investors.

Regulatory update: Secondary raises to be made easier

Our [November 2021 IPO report](#) focused on a range of changes to make the UK more hospitable for growth companies and we detailed a number of measures proposed in the Kalifa UK fintech review and Lord Hill's listing review. The UK's Financial Conduct Authority (FCA) had at the time of our last paper already amended the UK Listing Rules to accommodate for SPACs, and as noted above the first SPAC listed in late November 2021.

In December 2021, the UK FCA issued new rules that allow for dual-class share structures in the Premium Segment (which allows for companies to be included in indexes) and a reduction of the free float requirements from 25% to 10%.

The new listing rules now permit dual-class share structures that would allow founders to protect their companies from unwanted takeovers. The rules set out for the new dual-class share structure include:

- The dual-class structure must survive for a maximum of five years;
- the maximum weighted vote ratio is 20:1;
- the extra weighted shares can only be held by or on behalf of a director of the company; and
- the weighted voting can only be exercised on removal of a director or after a change of control.

A set of further rules changes are anticipated to make secondary issuance easier for companies as part of the UK Treasury's Secondary Capital Review, which started in October 2021. Under these proposals, which aim to make secondary raises faster and cheaper for companies, there would be a permanent increase in the pre-emption limit to 20%, meaning companies would be able to raise capital quickly without having to offer a full rights issue to all shareholders, which adds to the time and cost of a fund-raising. The UK Treasury's Prospectus Regime Review is proposing to streamline prospectuses for secondary issuance and make it easier for issuers to publish forward-looking information such as profit guidance.

Growth in venture capital activity

A UK venture capital associate recently commented that they were seeing more US venture capitalists competing, and in many cases outmuscling them, on deals they were working on.

The deep pockets of the US venture community have allowed companies to be backed with such a wall of capital that they can outcompete their peers on marketing and talent acquisition, etc. It has also allowed US growth companies to remain private for longer and consequently to arrive onto public markets as much bigger companies with multi-billion-dollar valuations.

We had touched on this in our last report when looking at how the UK market can close the gap to the valuations afforded to companies in the United States. The depth of capital and expertise needs to be developed to bridge the gap. We are unlikely to be able to compete with the US expertise in large-scale software-as-a-service (SaaS) or cloud businesses, but there are verticals such as fintech, e-commerce, digital health and gaming where the UK is starting to build this expertise.

Sequoia Capital's opening of its London office was notable given its history of backing some household names early (Apple and Google), and its current position of being a holder of a fifth of the world's unicorn (+\$1bn valuation private) companies. Its arrival in London suggests that one of the best technology bet makers in the industry thinks that Europe (including the UK) is on the cusp of a technology take off.

Sequoia takes the view that technology winners advance exponentially. In 2021, 20 UK tech start-ups reached unicorn status, bringing the total to 75. Each of these unicorns has teams that have experienced exponential growth and are likely to form or join new companies to repeat the feat.

This growth has not come overnight, but through 'decades of ecosystem building and an acceleration of the digital transformation across all industries' according to Sarah Guemouri, a principal at venture capital firm Atomico.

Sequoia also points to three of the top five computer science programmes being in Europe (Oxford, Cambridge and ETH in Zurich) and European governments investing heavily in coding, with 5.7 million coders in Europe compared to 4.4 million in the United States. It also points to the US tech majors all opening up research and engineering offices in Europe, and Sequoia continues to meet founders of technology businesses who have had exposure to these offices.

Other notable US venture capital firms that have set up a London office include General Catalyst and Bessemer, who both opened their offices in 2021.

Alongside the venture capitalists there is a growing pool of innovative private capital platforms being set up in the UK. SquareBook, Regionally and CrowdX have all stepped in to fill a gap to enable private companies to raise money on platforms that operate in similar fashion to an exchange, while JP Jenkins has set up a facility to allow private company shares to be traded daily to provide liquidity.

All this points to an active venture capital sector in the UK. A record \$25.5bn was raised for private tech start-ups (more than London raised in IPOs) in 2021, double the total raised in 2020, with 40% of this capital coming from the United States. Fintech is a core sector for this investment, with over half of the money going into fintech. London's strength in financial services and technology and a regulator that is supportive of this ecosystem have benefited fintech. Other areas of investment included telecoms, health tech and enterprise software.

Ideally, we would like to see more domestic growth investors supporting this. There is still a small number of growth investors in the UK who can support pre-IPO or late series funding rounds (eg Jupiter and Fidelity). On IPO, there are public equity growth funds (eg Ballie Gifford, Polar Capital)

but for them to allocate more capital to growth companies, there needs to be a greater supply of high quality growth IPOs. If Sequoia Capital is right, we hopefully will start to see this.

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