5 Burning Questions Heading Into The 2020 IPO Market

By Tom Zanki

Law360 (January 1, 2020, 12:04 PM EST) -- Coming off a choppy 2019, the initial public offerings market heads into the new year with a record-breaking bull market intact, though companies and their advisers will have to contend with political uncertainty surrounding the presidential election.

Here are five trends to watch in the 2020 IPO market.

Will the Election Hasten Timetables?

With the presidential election 11 months away and a primary season that is already dominating news cycles, lawyers generally expect that companies in the IPO pipeline will prefer to go public sooner rather than later and avoid the distraction of a volatile political climate.

January is typically not a huge month for IPOs; the IPO season tends to begin in earnest in spring. But for companies that have begun to advance through the U.S. Securities and Exchange Commission filing system, lawyers say early 2019 could be an opportune time for certain issuers to go public.

“You may be seeing more IPOs potentially in January as people try to get ahead of even the primaries,” Sidley Austin LLP partner Samir Gandhi said.

Whatever the political environment, broader macro conditions appear to be supportive of IPOs, which are time-sensitive transactions that depend on market windows being open.

The U.S. economy is in its longest-ever economic expansion while the stock market is in its longest bull run in history, plus interest rates remain at historic lows and the federal government has shifted toward deregulation under President Donald Trump. These factors have served to provide a friendly climate for capital-raising, despite trade wars and chatter about a potential recession.

The year 2019 produced more than 200 IPOs including offerings from blank-check companies — a feat that happened only four times this decade. Results were choppy, however, thanks to weak returns from big companies like Uber and Lyft. And activity slowed after heavily hyped co-working giant WeWork canceled its IPO.

But given the perceived soundness of economic conditions, many capital markets lawyers are preparing for a fresh start to 2020 before politics eventually takes over the country’s attention.
“One would foresee that, at least up until election time, there are tailwinds to continue this growth,” Skadden Arps Slate Meagher & Flom LLP partner David Goldschmidt said. "However, as you get closer to the election we would expect more volatility in the market."

**Will Health Care Continue to Dominate?**

Technology “unicorns” — a term for private startups valued at $1 billion or more — were all the rage in 2019 as a wave of high-profile companies went public after years of amassing private capital. Eyes focused on big names like Uber, Lyft and image-sharing company Pinterest.

But beneath the headlines, a steady supply of health care-related companies generated an outsized portion of the IPO pipeline. According to research firm Renaissance Capital, health care-related companies, consisting mostly of biotechnology firms, generated 43% of IPOs. That was far more than any other sector, eclipsing technology, which ranked second at 25%. Biotechnology and life sciences IPOs are often smaller and thus draw less publicity.

Covington & Burling LLP partner Eric Blanchard expects continued strength from life sciences companies in 2020. Blanchard was part of a Covington team that steered a $150 million U.S. IPO for German drug company BioNTech, which develops individualized therapies that fight cancer by stimulating a patient's immune system. BioNTech went public at a valuation of $3.4 billion, making it the third-largest biotechnology firm to list in the U.S. in the past decade.

“There continue to be very interesting, groundbreaking scientific discoveries that are driving the pipelines for these biotech companies that are going public,” Blanchard said.

Gandhi said biotechnology companies are chugging along in the IPO pipeline, noting that “people are still willing to take on risk, especially on cancer therapy drugs.” But other segments of the health care sector, including hospitals, could be impacted by political uncertainty in 2020.

President Trump in November signed an executive order calling for health care pricing transparency that is being challenged by hospitals that argue it would force them to reveal confidential pricing information. The broader health care industry is frequently in the crosshairs of Democratic presidential candidates like Sens. Bernie Sanders, I-Vt., and Elizabeth Warren, D-Mass., who are pushing for universal Medicare.

“The question is really whether the health care sector is going to get affected by a lot of this political rhetoric that is out there,” Gandhi said.

**Will Crypto and Cannabis Go Mainstream?**

Apart from conventional industries, nascent sectors like cryptocurrency and cannabis are becoming more visible in capital markets.

Two crypto-related companies went public in November — Chinese bitcoin miner Canaan Inc. and SilverGate Capital Corp., a California bank that serves cryptocurrency investors and exchanges. Earlier in 2019, cannabis products company Greenlane Holdings Inc. went public, marking the first U.S.-based business involved in cannabis to list on the Nasdaq.
Lawyers say they don’t expect a rash of similar companies to go public in 2020 in the U.S., largely because of legal and regulatory complications. Cannabis remains a controlled substance under U.S. federal law, while U.S. regulators are still adapting to cryptocurrencies, which can resemble securities, commodities or currencies depending on the context.

For now, crypto and cannabis companies remain on the periphery of U.S. capital markets. But both sectors are being watched by attorneys for long-term implications.

“You see a lot of private capital running into both of those segments, which is inevitably going to lead to those issuers seeking to access liquidity in some form or fashion,” Fenwick & West LLP partner Jamie Evans said.

Will There Be More Direct Listings?

The past 12 months saw the second notable direct listing, a process by which a company lists on a public exchange without selling new shares. Workplace messaging app Slack completed a direct listing in June, more than a year after music streaming giant Spotify did the same.

This novel alternative to an IPO could benefit select large companies, meaning those that are already well-capitalized but seek other benefits of going public, including allowing their early investors to sell their shares without restrictions. A direct listing can also save a company underwriting fees, since it is not hiring underwriters to market new shares.

Home-rental giant Airbnb and code-sharing software company GitLab are rumored to be considering direct listings in 2020. As this approach gains in popularity, the stock exchanges want to make direct listings more attractive for companies by allowing them to raise new capital.

The New York Stock Exchange wants to amend its rules to allow companies to sell new shares through direct listings, rather than simply listing their existing shares. Nasdaq said it also plans to submit a rule-change proposal that would let companies raise capital in a direct listing.

For the most part, lawyers say they expect most companies to continue opting for traditional IPOs, which offer certain advantages including hiring an underwriting team to drum up interest in a company’s offering. But lawyers note that direct listings could make sense for companies that already have broad name recognition and a large investor base.

“It’s the new, new thing,” Evans said, noting that late-stage private companies often inquire about the feasibility of a direct listing. “Everyone is interested in talking about it.”

Will SPACs Stay on the Attack?

The direct listing isn’t the only alternate means to access public markets apart from an IPO. Companies can also go public by being acquired by a special purpose acquisition company, or SPAC, which are shell entities that raise money through IPOs in order to acquire a business.

Also known as blank check companies, this segment of the IPO market is growing steadily. According to Datalogic, 59 blank check companies went public in 2019, raising $13.5 billion as of Dec. 19. That eclipsed the 46 blank check IPOs that raised $10.8 billion in 2018 and surpassed the prior record of $12.1 billion in blank check proceeds set in 2007, just before the financial crisis.
Blank check offerings are something of a hybrid between an IPO and a merger, in which issuers are required by stock exchanges to set aside 90% of proceeds in a trust for a later acquisition. Issuers have a certain time frame to complete an acquisition — usually 18 to 24 months — or IPO investors are promised their money back.

For the acquired company, being bought by a SPAC can provide a path to public markets during a time when the IPO market may not value that particular company. Acquirers typically have expertise in a certain sector or geography and hunt for what they see as bargains.

SPACs span a gamut of industries, including health care, energy, real estate, industrials, media, and increasingly fintech and cannabis. At some point, lawyers expect the blank check market will cool, but they point out that the sector is more mature now than it was when it began in the 1990s and later crashed during the financial crisis. This is evidenced, lawyers say, by the fact that reputable investment banks and private equity backers are flocking toward SPACS.

“We are seeing high-quality sponsors looking at this space and considering going out,” said Winston & Strawn LLP partner Joel Rubinstein. “So I see pretty strong momentum going into 2020.”

--Editing by Jack Karp.