Goldman Sachs Exchanges: The Markets

Are there green shoots in the IPO market?

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Sam Grobart: A report from the world of equity capital markets where, after a long quiet period, things may be picking up again. This is The Markets, a new podcast series from Goldman Sachs Exchanges. Hi, I'm Sam Grobart. Today, I'm joined by Lizzie Reed, global head of the equities syndicate desk in investment banking, and we're going to talk about how companies are accessing capital in this current environment and what the trajectory looks like for the months ahead. Lizzie, thanks so much for joining us today.

Lizzie Reed: Thank you.

Sam Grobart: So 2022 was clearly a year in which a lot of companies pulled back from issuing new stock. How is 2023 comparing so far?

Lizzie Reed: So if you look at global issuance year over year, we're up about 6%. In US listed or the Americas business, we're actually up 30%. So that's a positive change to what was a very quiet year last year. So what are the drivers of ECM issuance? There's a couple of categories, and I'm sure you'll ask me about IPO markets.

Sam Grobart: Absolutely.

Lizzie Reed: I'm sure you'll ask me about convertible markets.

Sam Grobart: That, too.

Lizzie Reed: But the drivers of issuance to date are, number one, think about it as, like, consumers of capital. So if you are a, for example, a therapeutics company, you're going to fund your business for R&D on the back of clinical trial for a drug, whether the market's up, down, or sideways. You're not price insensitive, but you're going to go raise capital. So I put that in the camp of, for example, consumers of capital, opportunistic raises.

Another big driver of issuance this year is actually secondary, so monetizations of existing positions. If you look at, for example, the sponsor and VC community, in 2022, volumes were down between 80-85% year over year. And so there hasn't really been a lot of secondary activity driven from that cohort of potential sellers. So this year, we've seen an uptick of secondary monetizations from that community.

And in addition to that, we've seen active issuance from corporate cross-holdings. So large corporations who invested strategically in an asset that might look to basically monetize a portion or all of that asset. And so the big driver has been secondary in nature.

And then obviously convertible bond markets is doing extremely well in terms of notional volume, but those have been the big drivers.

Sam Grobart: Let me dig into that with you for a quick second. The expectation, of course, is that rates may continue to rise in the months ahead. Do you feel like the people that you're talking to have factored all of that in and that's added into their model going forward?

Lizzie Reed: Yeah, I think there's growing consensus that the Fed is on the back half, right, of their hiking cycle. And as a result of that, there's more clarity in terms of what the forward could look like. In addition to that, I think that, from an investment positioning perspective, investors are sitting on tremendous high cash balances, and they're not paid all the time to sit in cash, even though obviously we're getting a good return right now. And so I think it's definitely shifting to a more conducive market in terms of driving potential issuance.

Sam Grobart: So let's talk about IPOs. Obviously, that market has been relatively quiet for the past year, but we're starting to see some new activity. What kind of companies are coming to market? And what qualities in those companies are investors looking for?

Lizzie Reed: Yeah, it's exciting to see the IPO market reopening. If you look in the past 18 months, the majority of issuance has been skewed towards a corporate action. So IPOs that have come out of large corporations on spin companies. We're just starting to see the more regular way IPO market reopened, whether it's sponsor backed or founder led. And I think what investors are really looking for in terms of quality of company are, one, highly durable; two, strong margins; three, strong cash flow conversion, modest leverage, and an A++ management teams. And it's been really interesting to see the shift from investing in ultra growth unprofitable companies in 2021 to a change in terms of the metrics.

The IPOs that have come to market have been very strong companies that, quite frankly, can IPO in any market. And they've gotten to a point where they wanted to proceed forward.

Sam Grobart: You just said that it's good to see the IPO market reopening. A lot of people are asking that Sam Grobart: When will it reopen? But you're basically saying that's yesterday's news.

Lizzie Reed: Yeah, Sam, I've been one of the more optimistic and forward-leaning people about the IPO market because, in reality, the IPO market has been open. It hasn't been a case where there hasn't been demand for new companies, particularly from the investing company. It's more about has the equilibrium of valuation for what a corporate, a sponsor, a board wants to achieve matches with the investment point evaluation from the investor community. And so that bid-ask spread continues to collapse and become more palatable.

And so it's really important, like, the IPO market is open. The question is: Does the company want to proceed with it? And that's been a big shift in the past couple of months, and we've seen more supply.

Sam Grobart: Is there any global analysis to be made here? Are there regional differences that you're seeing?

Lizzie Reed: I think there's regional differences in process of going public. How do you do investor education? What is the requirement in terms of how long are you in the market? How do you build your order book? There's distinct aspects by each region. But generally speaking, the market's opened globally, and we've seen activity in Europe, we've seen activity in Asia, we've seen activity in the US, we've seen activity in other regions of the world. So I think it's more of a process question, quite frankly, than a regional bias, so that's also a good data point.

Sam Grobart: You did mention convertible bonds. I am going to ask you that question. Of course, that's debt, which includes an equity component. Those bonds have picked up a lot this year. What are you seeing in that part of the market?

Lizzie Reed: Convertible bonds are a tremendous product for issuers right now. And I think, if you look at volumes, just global convertible volumes year over year, they're up 175%.

Sam Grobart: Wow.

Lizzie Reed: That's a big difference. Now, why? One, in a rising interest rate environment, a convertible bond looks more attractive. You've seen year to date particularly in the Americas business more investment-grade rated companies look at convertible bonds and issue them large in scale.

In addition to that, it's a diversified investor base, so it's not your traditional straight debt, investment-grade rated buyer. It's not a pure equity buyer. It's more of a diverse, bespoke investor base that participates in convertible offerings. And so it's also a good way that, if you are looking at shareholder expansion and creation, you can access another dedicated pocket of capital.

Sam Grobart: You were just talking about investor bases. I want to ask you about one of those. A couple of years ago obviously, a major theme in markets was the rise of the retail investor. Where do you see that cohort now?

Lizzie Reed: Yeah, the retail investor is an incredibly important component of the IPO market, particularly because how much they hold of public equities globally. And in 2022, there was an absence of the retail investor. In 2023, as we navigate this particular macro cycle in consumer spending, we're seeing that the retail investors start to heal slowly and re-enter the ECM space. And it's a good data point in terms of the forward trajectory of the calendar, but it's very consistent and slow healing. And hopefully a part of the distribution aspect of the capital markets space that will recover quickly in the second half of this year, if not in 2024.

Sam Grobart: All right, Lizzie, last question. What are you going to be paying attention to next week?

Lizzie Reed: It's going to be a quieter week in terms of global issuance because of the July 4th holiday. We're in corporate earning blackout, though I don't anticipate that there'll be an uptick in terms of issuance is going to happen on a global scale in next week's business. I think the most important thing that we all are doing right now is really preparing our issues that, when the market does reopen after Q2 earnings, that if there's a window to access liquidity, they're prepared to do so. And so it's a little bit more of a preparation mode next week and probably the next two weeks versus being in execution mode on actual raising the couple. So it's a little bit more of a quieter week for the banks.

Sam Grobart: Lizzie, really appreciate all the insight. Thanks so much.

Lizzie Reed: Thank you, Sam.

Sam Grobart: That does it for another episode of The Markets. Be sure to subscribe on Apple Podcasts, Spotify, or wherever you get your podcasts. I'm Sam Grobart. Thanks so much for listening.