Corporate Finance Alert

Skadden

Skadden, Arps, Slate, Meagher & Flom LLP

June 26, 2014

If you have any questions regarding the matters discussed in this memorandum, please contact one of the attorneys listed on page 3 or your regular Skadden contact.

Follow us on Twitter @SkaddenArps

Beijing
Boston
Brussels
Chicago
Frankfurt
Hong Kong
Houston
London
Los Angeles
Moscow
Munich
New York
Palo Alto
Paris
São Paulo
Seoul
Shanghai
Singapore
Sydney
Tokyo
Toronto
Washington, D.C.
Wilmington

First-Half Activity Energizes US Capital Markets in 2014

The U.S. equity and debt markets experienced a strong first half of the year. In the first quarter, the U.S. IPO market was the busiest since 2000, more than doubling the number of IPOs from the same period last year. The second quarter was nearly as active, bringing the year-to-date total to 134 IPOs.[1] In the debt markets, speculation about Federal Reserve interest rate hikes and continued bond purchases — or lack thereof — motivated issuers of investment-grade bonds to take advantage of favorable interest rates, contributing to an increase in the amount raised in the first half of this year compared to the first half of 2013.[2] Although there were fewer high-yield issuances in the first half of 2014 compared to 2013, the market remained solid, with second quarter issuances stronger than the first quarter in both volume and proceeds.

IPO Market

The IPO market grew substantially in the first half of 2014, with a more than 40 percent increase in the number of deals compared to the same period in 2013. Although the IPO market has experienced pockets of volatility, and certain sectors such as biotech may have cooled since the first quarter, overall, the market is continuing at a steady pace.

Industry Highlights. A number of sectors have contributed to the increased activity, with notable IPO totals in health care (49), technology (34), energy (16) and financial services (15) as of June 23. The health care sector was the most active in the first quarter, driven largely by biotechnology issuers, which accounted for 26 of the quarter's 64 IPOs, followed by the technology sector. Interestingly, the 44 health care and technology IPOs in the first quarter accounted for only 36 percent of total IPO proceeds for the quarter, while the 11 financial services and energy IPOs accounted for 44 percent of total proceeds. Additionally, companies with no profits represented many of the IPOs in 2014, continuing the trend over the last few years in the number of more speculative companies making their public debuts.

Private Equity and Venture Capital. Across industries, private equity- and venture capital-backed IPOs dominated the first quarter, making up 56 of the 64 issues and totaling nearly as many as the first half of 2013 (63). Proceeds from private equity- and venture capital-backed IPOs increased by \$3.2 billion and \$2.6 billion, respectively, in the first quarter compared to the same period in 2013. The pace of private equity- and venture capital-backed IPOs may be tempered somewhat in the second half of 2014 in light of the uptick in M&A activity, which may now provide an alternate exit strategy.

1 As of June 23, 2014. Source: IPO investment firm Renaissance Capital (www.renaissancecapital.com). All numerical IPO data herein is derived from Renaissance Capital, including Renaissance Capital's 1*Q 2014 US IPO Quarterly Review*, March 31, 2014, which includes IPOs with a market capitalization of at least \$50 million and excludes closed-end funds and SPACs.

2 As of June 23, 2014. Source: Thomson Reuters. All debt data herein is derived from Thomson Reuters.

Four Times Square
New York, NY 10036
212.735.3000

Looking Ahead. Increased volatility among equities of new and more speculative companies affected the IPO market toward the end of the first and beginning of the second quarters, including when downward pricing adjustments plagued three issuers in one week in mid-April. Yet, given that equities and other asset classes have stabilized since then and that more issuers — publicly or not — have entered the IPO pipeline, we believe the remainder of 2014 will continue to be busy absent any significant intervening events. The first quarter experienced the most crowded pipeline since 2007, with 103 companies making initial filings compared with 36 in the first quarter last year. As emerging growth companies continue to embrace the confidential filing process afforded to them by the JOBS Act,[3] the pipeline is even more crowded than publicly available information indicates. We also may see an industry shift in the second half of the year, with an increase in IPOs by companies in sectors other than health care and technology, including those in financial services.

Investment-Grade and High-Yield Debt Markets

The Federal Reserve's decision to continue reducing its bond purchases (popularly known as "tapering") has had a significant impact on both the U.S. investment-grade and high-yield debt markets. Investment-grade debt issuers have taken advantage of low interest rates before such reductions in bond purchases occur, and we expect this trend to continue before quantitative easing ends in late 2014 or 2015.

Investment-Grade. Issuers continued to take advantage of a unique time in which interest rates are currently low but expected to rise in the near-term future, using the cash influxes for a variety of purposes, including share repurchases, refinancings and acquisitions. Issuers raised more capital in the first half of 2014 than in the same period last year.

High-Yield. The number of high-yield debt issues during the first half of 2014 decreased compared to 2013, however, historically low interest rates and a perceived lack of near-term default risk has continued to elicit investor demand for high-yield securities. Just as it influenced issues in the investment-grade debt market, the Federal Reserve's quantitative easing has had an impact on the terms of new high-yield debt issuances. Issuers in the high-yield market continued to enjoy low coupons and issuer-friendly covenant packages. While there was no significant deterioration in covenant protection, greater flexibility in restricted payments, asset sales and affiliate transaction covenants continued into 2014. Last year's reemergence of "payment-in-kind" (PIK) toggle notes also continued into this year. Use of proceeds shifted, with an increase in funds for M&A activity and a decrease in bank loan refinancings, particularly as a result of a very strong leveraged loan market with redemption provisions more flexible than bond terms.

* * *

Capital markets trends during the first half of 2014 may well continue through the next several months. On June 18, the Federal Reserve announced a cut in its monthly bond purchases to $35 billion, reduced its growth forecast for 2014, and released its inflation forecasts. Although the Federal Open Market Committee stated that the U.S. economy has "rebounded" in recent months, the Fed gave no indication that it will raise interest rates appreciably in the short term. If interest rates and volatility remain low beyond October, when the Fed could end its bond purchases, then it would not be surprising for the current issuer-favorable environment to continue through the end of 2014 and even beyond.

Even if interest rates remain low through 2014, other factors could temper growth in the U.S. IPO and debt markets. A resurgence in the M&A market, which already has occurred this year, could siphon energy away from the current IPO market (however, this could generate further demand for high-yield debt to fund such acquisitions). Additionally, external political factors, including the situations in both Iraq and Ukraine, could have adverse effects on the U.S. and global economies.

3 *See* "The JOBS Act: The Resurgent IPO Market and What We Learned in Year Two" (Jan. 16, 2014), available at http://insights.skadden.com/.

(Attorney contacts appear on the next page.)

Attorney Contacts

New York Office

David J. Goldschmidt
212.735.3574
david.goldschmidt@skadden.com

Stacy J. Kanter
212.735.3497
stacy.kanter@skadden.com

Michael J. Zeidel
212.735.3259
michael.zeidel@skadden.com

Phyllis G. Korff
212.735.2694
phyllis.korff@skadden.com

The authors wish to thank summer associate Stephen L. Ham for his contributions to this article.