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How Companies Are Adapting to Volatile Capital Markets and Planning Ahead

Contributing Partners

P. Michelle Gasaway / Los Angeles

Danny Tricot / London

Counsel

Philip M. Dear / Los Angeles

Adam M. Howard / London

Associate

Kathryn Gamble / London

Key Points

- Market uncertainty led some companies to delay or reconsider IPO plans in 2023, but strategic planning and advance preparation can better position companies to execute on opportunities in 2024.
- Despite the rise in interest rates, companies were able to remain agile in response to market opportunities by proactively analyzing their balance sheets and capital structures to successfully execute a significant number of debt transactions.
- Companies also continued to look to creative financing strategies, including alternative public equity transactions as well as private capital.

2023 Market Backdrop

U.S. and European capital markets in 2023 proved remarkably resilient in the face of challenges that read like a top 10 list of major market disrupters:

- A rapid rise to higher-for-longer interest rates.
- Inflation.
- Failures of well-established banking institutions.
- Tightening credit and loan standards.
- The U.S. debt ceiling crisis.
- The continuing war in Ukraine.
- The outbreak of hostilities in Israel and the Gaza Strip.
- The (repeated) possibility of a U.S. government shutdown.
- Continued recession concerns.
- Overall economic and geopolitical uncertainty heading into a U.S. presidential election in 2024.

Benchmark interest rates reached new highs this year, with the Federal Reserve's federal funds rate at its highest level in more than 20 years, the Bank of England's rate hitting a 15-year high and the European Central Bank raising its rate to the most elevated it has been since the launch of the euro in 1999. As a result, both stocks and bonds experienced significant volatility in valuations in 2023, and new issues overall were negatively impacted.

Strength, patience, creativity and nimbleness allowed many companies to successfully navigate the challenges and execute transactions in periods when the markets were open only briefly. The IPO window inched open at points, the debt market appeared to accept the new normal of higher interest rates, and issuers and financing sources continued to explore creative alternatives to traditional capital markets transactions.

Heading into 2024, both issuers and investors should focus on positioning themselves to leverage market opportunities as they arise. Advance preparation, exploring financing alternatives and remaining agile in execution can position companies to adapt to changing capital market norms, act opportunistically and achieve their financing objectives.

(For an update on capital markets in Asia, see "Chinese Issuers See Progress on US Audit Issue and HKEX Reforms, but US Policies Could Impact Tech Companies.")

Anticipating Positive Signs in the IPO Market

The IPO market is often seen as a barometer for economic health and corporate growth. Initially, there were signs that 2023 could mark the end of the "IPO drought," the longest stretch of low issuances in more than 30 years. Shares of Mobileye and Porsche, which went public in late 2022, continued to trade above their IPO prices. Arm, Hidroelectrica,

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One Manhattan West
New York, NY 10001
212.735.3000

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Instacart, Klaviyo, Oddity Tech, Schott Pharma and Birkenstock all went forward with highly anticipated IPOs in the second half of 2023.

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The large IPOs in 2023 featured profitable companies with cornerstone investors (either financial or strategic), as well as non-deal roadshows, traditional shareholder lock-ups and conservative valuations — hallmarks of IPOs that are well received by the market. However, while many of the 2023 IPOs were met with strong demand and price increases in early trading, most have since traded below their debut prices due to rising interest rates and other challenges, including geopolitical turmoil.

Of the 157 U.S. IPOs in 2023 as of December 1, only approximately 38% were trading above their IPO prices, while in Europe, approximately 65% of the 102 European IPOs stayed above their IPO prices.[1] For companies in the U.S. and Europe that had their IPOs in 2021 and 2022, only 21% and 30%, respectively, for the U.S. and 19% and 42%, respectively, for Europe were trading above their IPO prices.

Market uncertainty led some companies that were contemplating going public in 2023 to delay or reconsider their plans. The U.S. IPO count through December 1, 2023 (157), even when annualized for a full calendar year, was low compared to median counts from the last 10 years (272). Europe saw a similar decline in IPOs, with the year-to-date count (102), even when scaled to a full calendar year, being low compared to median counts from the last 10 years (211). However, many companies are still preparing for near-term IPOs, anticipating greater market stability and a more receptive market in 2024.

Companies considering an IPO or other exit in 2024 or beyond can take advantage of the current slowdown in IPO activity to continue preparing for a transaction and be ready to move quickly when market opportunities present themselves. Strategic planning should include:

- Working with advisers to enhance the company's readiness for the public markets.
- Focusing on financial health.
- Refining the company's message for value creation.
- Analyzing exit strategies and alternatives.

European issuers and investors should also seek to work more closely with one another on narrowing the valuation gap, which has been stalling the IPO market. This is similar to the approach being seen in the U.S., where shareholders have been more willing to accept lower IPO valuations when compared to a previous funding round valuation.

Finding Selective Opportunities in the Debt Market

The challenges in the capital markets in 2023 also impacted the bond market. Higher interest rates meant higher bond coupons for issuers and, as a result, fewer bond issuances, with increased volatility leading to more uncertainty for both issuers and investors.

However, toward the end of the year, the debt markets began to stabilize, taking into account the higher-for-longer interest rate environment. Many issuers recognized that bonds, despite the increased cost, could offer a more appealing alternative than selling equity at a lower price than they desired.

Investment-grade companies, as well as high-yield issuers — some with inaugural bond offerings — were able to execute transactions successfully. Since September 1, 2023, U.S. issuers have closed over 520 investment-grade and 50+ high-yield bond offerings. In that same time, European issuers have closed more than 480 investment-grade and 40+ high-yield bond offerings.

In 2024, the debt markets will continue to feel the impact of higher interest rates, inflation and economic policy. Companies can best prepare themselves by:

- Analyzing their balance sheets for both near-term and future financing and refinancing needs.
- Reviewing and rationalizing their capital structure.
- Being prepared to move quickly to access selective opportunities.

1 IPO data includes traditional IPOs, SPACs, best efforts offerings and all other IPOs, regardless of deal size. The data in this article is from Bloomberg.

Exploring Alternatives to Traditional Financings

With uncertainty and volatility in the traditional capital markets, companies on both sides of the Atlantic continued to explore creative strategies to achieve their financing goals and capital structure objectives. Alternatives included:

- Direct listings.
- Registered directs.
- Rights offerings.
- Private investments in public equity (PIPEs).
- Direct lending or other private credit.
- Exchange offers and other liability management techniques.

Some employed a combination of these structures.

Direct listings. 2023 saw the return of a small number of direct listings in the U.S. Surf Air Mobility was the first direct listing in over a year, and it had been more than two years since any significant direct listing activity.

A direct listing allows investors in a company to begin trading their shares on an exchange without the company issuing shares or a large shareholder selling shares, as in a traditional IPO. With a direct listing, a company can go public without the expense of an IPO underwriting and without the share dilution.

However, direct listings do not typically raise additional capital and historically have had lower rates of return for investors than traditional IPOs. As a result, direct listings generally have not been widely used. They are often undertaken by companies without an alternative avenue to raise capital, or by very well-known and well-capitalized companies willing to forgo the IPO roadshow and debut.

Private investments. Given the volatility in the capital markets, many companies elected to sidestep the public markets altogether, relying on private investments from one or a few sophisticated investors. Depending on the company's and the investor's objectives, a private investment can be structured in any number of ways: as regular equity; a convertible or derivative security; a mezzanine or other debt-like instrument; or any combination of these.

The private investment can be an attractive way to raise capital, due to both speed of execution and increased flexibility in structuring the investment and pricing. In addition, companies can use the structure to achieve other objectives, combining a private investment alongside a strategic partner or in some other collaborative transaction. So far in 2023, U.S. companies have raised nearly $50 billion in direct loans across over 100 transactions.

An issuer contemplating a private investment or other financing alternative should carefully consider the alignment of the transaction and the investor with its strategy. For example, companies should think about future obligations, such as registration rights, as well as any additional rights that the investor may request, such as guaranteed rates of return, governance or approval rights and priority in the capital structure.

The type of investor is also important: Are they a long-term strategic partner for the company or may they trade out of the instrument in the near term?

For the company, it also is imperative to ensure that the terms of any investment do not unduly restrict the company from taking other necessary actions in the future when the public markets strengthen, including other financing and refinancing transactions.

Looking Ahead to Opportunities in 2024

Issuers and investors can best prepare for 2024 by positioning themselves to be nimble and leverage market opportunities as they arise. Companies considering transactions should work with their advisers to plan ahead, explore creative and alternative financing strategies, remain well informed about market terms and trends, and be agile in execution.