Nasdaq MAYER | BROWN Morgan Stanley

Direct Listings

The New Offering Paradigm?

November 3, 2021

Our panelists & guest speakers

SPENSER SKATES
Amplitude
Co-Founder & CEO

ASHLEY MACNEILL
Morgan Stanley
Managing Director, Head of Technology Equity Capital Markets

JEFF THOMAS
Nasdaq
Senior Vice President, Head of Western U.S. Listings and Capital Markets

ANNA PINEDO
Mayer Brown
Partner, Co-head of Global Capital Markets

BRIAN HIRSHBERG
Mayer Brown
Partner

MAYER | BROWN

Agenda

- The basics of a direct listing
- The stock exchange rules
- The investor education process, market-making, and liquidity
- Legal requirements and timing compared to an IPO
- Capital-raising in conjunction with a direct listing

The Basics of Direct Listings

Direct Listing: Defined

- A direct listing is the listing of a class of a company's equity securities for trading on a stock exchange without conducting an underwritten initial public offering ("IPO"), spin-off, or transfer of the listing from another stock exchange.
- The company thereafter becomes subject to the periodic reporting requirements under the Securities Exchange Act of 1934 (the "Exchange Act") and the corporate governance requirements of the applicable stock exchange without any new shares being issued by the company to the public.
- As part of the direct listing, the company is required to file with the Securities and Exchange Commission ("SEC") a resale shelf registration statement solely for the purpose of allowing the company's existing shareholders to sell their shares.

Why a direct listing?

1. List Without Selling Shares
2. Liquidity for All Shareholders
3. No Lock-ups
4. Auction-Based Price Discovery
5. Equal Access for All Buyers and Sellers
6. Transparency/ Financial Guidance

Comparison to a Traditional IPO

- Unlike a traditional IPO, which has a lock-up, a direct listing provides liquidity for a company's existing shareholder base, some of whom have purchased their shares in the private capital markets.
  - As a result, no new capital is raised by the company.
- However, similar to an IPO, a company conducting a direct listing will need to demonstrate compliance with all applicable SEC and stock exchange requirements.
- The requirement to have a resale registration statement declared effective in connection with a direct listing results is substantially similar SEC Staff review process.
- A direct listing does not have the typical IPO "investor safeguards," such as the traditional book-building process to assess interest, inclusion of key institutional investors, selling a fixed number of shares into the market, the underwriter's overallotment option, and customary underwriter stabilization activities.

Comparison to a Traditional IPO *(cont'd)*

- The company's management plays a very limited role in determining the direct listing's initial reference and opening trading price compared to a traditional IPO.
- In a traditional IPO, the shares sold in the IPO would normally be held through Cede & Co., which acts as the nominee for the Depository Trust Company ("DTC"); however, in a direct listing, for shares to be eligible for trading on the applicable exchange, a stockholder interested in selling shares must ensure appropriate transfer shares.
- A direct listing must satisfy the shareholder requirement. For Nasdaq Global Select market that is 450 Round Lot Holders with at least 225 holding unrestricted securities with a market value of at least $2,500.

Direct Listing Advantages

- No dilution for shareholders, as no new shares are issued by the company.
- Permits registered resales of shares by affiliates without complying with the volume limitations and holding period conditions that would typically apply (however, registration is required like an IPO).
- Market-based pricing that is available versus an “IPO discounted” price or a private resale platform.
- Only one direct listing to-date has had a lock-up requirement, compared to the vast majority of IPOs that have lock-up requirements.
- Overall costs tend to be comparable to an IPO, albeit advisor fees tend to be less, given smaller syndicate structures.

Liquidity for Existing Shareholders

- Existing shareholders of the company may benefit from the company becoming a publicly reporting company.
- The existing shareholders now have a “mark” for their securities (for example, a venture or private equity holder can now mark the securities in its portfolio based on the trading price of the issuer's stock).
- Existing shareholders will have an easier time selling under Rule 144.

Direct Listings Make Headlines

COULD BE YOU

MAY 19, 2021
"Squarespace (SQSP) stock on NYSE in direct listing, not IPO" Fast Company

SEP 30, 2020
"Palantir Grabs $21 Billion Valuation, but Debut Comes With a Hiccup" WSJ

SEP 29, 2021
"Warby Parker opens at $54.05 per share in public debut on NYSE" CNBC

APR 14, 2021
"Coinbase stock debuts on Nasdaq in direct listing" CNBC

SEP 30, 2020
"Asana valued at $5.5 billion after direct listing debut" LA Times

SEP 28, 2021
"Amplitude starts trading on Nasdaq in direct listing" CNBC

MAR 10, 2021
"Roblox goes public at $41.9 billion valuation in direct listing" VentureBeat

JUN 20, 2019
"Slack shares surge 48% over reference price in market debut" CNBC

MAY 26, 2021
"ZipRecruiter Rises 8.5% in Trading in Direct Listing Debut" Bloomberg

OCT 1, 2020
"Thryv Holdings hits Nasdaq with direct listing" Dallas Business Journal

APR 3, 2018
"Spotify valued at nearly $30 billion in unusual Wall Street debut" CNN

How has market practice evolved since the first direct listings?

- Several issuers that have pursued direct listings have had active private secondary trading programs that provided a sense of market valuation.
- Given that direct listings did not allow issuers to raise capital, many issuers completed significant private placements before undertaking their listings. For example:
  - Amplitude completed a **$150 million** financing in June 2021
  - SquareSpace completed a **$300 million** financing in March 2021
  - Roblox completed a **$520 million** financing round in January 2021
  - Palantir completed a **$500 million** financing round in June 2020
  - Asana completed a **$200 million** financing round in June 2020
    - All occurred approximately three months before the companies' direct listings
- Recently, by contrast, companies like Coinbase and Warby Parker completed direct listings without raising capital beforehand.

Direct Listings Outperforming Traditional IPOs?

- According to one study, since Spotify's IPO in 2018, eight companies that have gone public through a direct listing have outperformed the S&P 500 and other indices that follow IPO performance.
  - The stock prices of these eight companies have risen an average 64.4% from opening trading prices. The S&P 500 gained 26.8% and the Renaissance Index gained 31.1% in the same timeframe.
- However, there may be more to the story…

The Stock Exchange Requirements

Listing on an Exchange

- In parallel with the resale registration statement process with the SEC, the issuer and its counsel must also review the listing requirements for the applicable stock exchange.
- The issuer can pursue an exchange listing (filing the traditional exchange listing application) provided that it meets the objective listing criteria for the exchange.
- The issuer also will have to contact at least three investment banks that are willing to be “market makers” in the security once it is listed. Nasdaq will help identify these market makers.
  - Each market maker will have to submit a letter to the exchange certifying that it is prepared to make a market.
- Listing on an exchange, without having undertaken an underwritten IPO and having had the securities placed with investors, may not result in a liquid trading market for the issuer’s securities; and there may not be any banks committed to facilitating trading in the stock.

Nasdaq Direct Listing Standards

- In 2019, the SEC approved Rule IM-5315-1 which clarified the rules to qualify for a Direct Listing on the Nasdaq Global Select Market tier in conjunction with an effective registration statement.
- The rule clarifies the circumstances under which an issuer that has not previously registered a class of its securities under the Exchange Act may list its securities without undertaking a public offering of its securities under the Securities Act.
- Nasdaq will consider the market value of the securities of a company that have been trading on a private secondary market prior to the Nasdaq listing and determine whether a company has met the market value of publicly held shares listing requirement for the exchange based on an independent third-party valuation that shows at least $250 million.

Nasdaq Direct Listing Standards *(cont'd)*

- The valuation must be provided by an experienced and independent valuation firm and be as of a recent date.
- A valuation agent will ***not*** be considered "independent" if:
  - the agent or any affiliate owns in the aggregate as of the valuation date more than 5% of the class of securities to be listed;
  - the agent or an affiliate has provided investment banking services within the 12 months preceding the valuation date; and
  - the agent or an affiliate has been engaged to provide investment banking services to the company in connection with the proposed listing or related financings or other related transactions.
- For an issuer that has securities that have traded on a foreign regulated exchange and is seeking to list the securities on the Nasdaq, Nasdaq will determine whether the company has met the price-based listing requirements based on the most recent trading price of its securities on the foreign trading market.
- The Nasdaq rule is applicable to companies that apply to list their securities upon the effectiveness of a registration statement that registers the resale of securities held by existing security holders, which acquired such securities in private placements.

NYSE

- A similar rule was approved by the SEC for the NYSE in 2018, in order to facilitate direct listings.
- A company also must comply with the other NYSE listing requirements including:
  - At least 400 beneficial owners of round lots of 100 shares
  - At least 1,100,000 publicly held shares
  - A minimum $4.00 share price
  - Satisfaction of either the “earnings” or the “global market capitalization test”
  - Compliance with the applicable corporate governance requirements

The Role of Financial Advisor and the Exchange

The Role of Financial Advisor and the Exchange

- Financial Advisors in a Direct Listing = Investment Banks
  - Not a syndicate because it’s not an underwritten offering
  - But, it is still a group of investment banks because there are multiple financial advisors
- What is the Financial Advisor **allowed** to do in a direct listing?
  - Help prepare and draft the registration statement
  - Help prepare and draft investor presentations
  - Collect feedback from potential buyers and sellers (which cannot be shared with the company)
  - Consult with the exchange with respect to the opening price
  - Provide research (generally 25 days following the direct listing)

The Role of Financial Advisor and the Exchange *(cont'd)*

- What **can't** the Financial Advisor do in a direct listing?
  - May not plan investor meetings
  - May not participate in investor meetings
  - May not underwrite the offering (no book-building process)
  - May not stabilize stock or provide price support

The Role of Financial Advisor and the Exchange *(cont'd)*

- Nasdaq provides all Financial Advisors in a Direct Listing with access to the Nasdaq Bookviewer
  - Provides an aggregated and anonymized visual display of the current order book
  - Calculates the Current Reference Price during the price discovery process
  - Updates the Current Reference Price, number of paired shares, and order imbalance every second
  - Data is identical to what the stabilization agent receives during a traditional IPO

MAYER | BROWN

Investors

- What does this dynamic mean for investors? Are investors in direct listings the typical IPO investors?
  - Are investors sector investors?
  - The dynamic between investors and the issuer is often quite different in the sense that, in the lead up to an IPO, the issuer will usually have undertaken multiple rounds of private financing, often even completed a financing in close proximity to the IPO. Many of the issuers that have undertaken direct listings have been closely held by PE and VC firms with holdings that have not been broadly dispersed.
  - Also, in the lead up to a traditional IPO, the IPO underwriters generally will undertake multiple rounds of test the waters meetings prior to flipping from confidential to public filing, so by the time the actual roadshow commences, institutional investors are fairly well familiar with the IPO issuer.
  - Often, there is less time for the institutional investor and IPO investor community to become familiar with direct listing issuers

Documentation Requirements

Documentation Requirements

- The issuer must have declared effective a registration statement covering the resale of shares held by the company's existing shareholders.
- This registration statement will be on a Form S-1 for domestic issuers or on a Form F-1 for foreign private issuers.
- The issuer must also file a Form 8-A for Exchange Act purposes.
- Existing shareholders must deposit their shares through DTC after the effectiveness of the resale registration statement in order to resell their shares on the stock exchange.
- A resale registration on Form S-1/F-1 will contain substantially similar information to that contained in a primary S-1/F-1 (or IPO S-1).
  - A few items will differ such as the price range, the plan of distribution, and related selling stockholder disclosures.
- As a result, the drafting process, the diligence process, and the process with the auditors in connection with financial statement preparation will be similar.

Documentation Requirements *(cont'd)*

- The SEC review process also can be expected to be similar to the process undertaken in connection with an IPO registration statement.
- The SEC confidential review process applies to registration statements filed to register securities under the Exchange Act.
- An issuer that confidentially submits an initial registration statement under Section 12(b) of the Exchange Act must file it publicly at least 15 days prior to the anticipated effective date of the registration statement.
- Once the registration statement is declared effective, the issuer becomes subject to the Exchange Act reporting requirements, as well as corporate governance requirements.
- Generally, there will be no lock-up restriction on existing stockholders although contractual agreements can be reached with holders that would cause them to lock up their shares.
- There will be no traditional post-IPO quiet period.
- An issuer which completes a direct listing may not necessarily benefit from research coverage and will not have the same engagement with research analysts that it would have had in the context of an IPO.

Documentation Requirements *(cont'd)*

- Companies that are emerging growth companies ("EGCs") and smaller reporting companies ("SRCs") have scaled-back disclosure requirements under the federal securities laws, compared to other filers.
- The disclosure accommodations provided to EGCs and SRCs relate to:
  - Disclosure of executive compensation
  - Compliance with new or revised accounting standards
  - The number of years of financial statements

Capital-Raising in Connection with a Direct Listing

Direct Listings with a Concurrent Primary Issuance

- On May 19, 2021, the SEC approved proposed rule changes submitted by Nasdaq that allow companies to list in connection with a concurrent primary offering.
- The approved rule allows a company that has not previously had its equity securities registered under the Exchange Act, to list its equity securities on the Nasdaq Global Select Market at the time of effectiveness of a registration statement pursuant to which the company will sell its shares in the opening auction on the first day of trading.
- The SEC approved similar rule changes submitted by the NYSE on December 22, 2020.

Direct Listings with a Concurrent Primary Issuance *(cont'd)*

- In determining whether the market value requirement for an initial listing is satisfied, Nasdaq will deem the requirement to be met if the amount of the company's unrestricted publicly-held shares before the offering, along with the market value of the shares to be sold by the company in its opening auction, is at least $110 million (or $100 million, if the company has stockholders' equity of at least $110 million).
- For comparison, a company may list in connection with a traditional underwritten initial public offering with a minimum $45 million market value.
- Nasdaq will calculate the market value using a price per share equal to the lowest price of the price range disclosed by the company in its registration statement (shares held by officers, directors or owners of more than 10% of the company's common stock are excluded from the calculation).

Direct Listings with a Concurrent Primary Issuance *(cont'd)*

- The rule changes also amend Nasdaq Rule 4702 in order to add a new order type, the "CDL Order," which must be submitted by the company in the opening auction for the full quantity of offered shares and must be executed in full.
- The price of the CDL Order must be set at or above the lowest price and at or below the highest price of the price range established by the company in its registration statement.
- The CDL Order cannot be modified or cancelled by the company once entered.

Direct Listings with a Concurrent Primary Issuance *(cont'd)*

- On June 11, 2021, Nasdaq proposed to modify the Pricing Range Limitation such that a Direct Listing with a Capital Raise can be executed in the Cross at a price that is at or above the price that is 20% below the lowest price and at or below the price that is 20% above the highest price of the price range established by the issuer in its effective registration
- In addition, Nasdaq proposed to modify the Pricing Range Limitation such that a Direct Listing with a Capital Raise can be executed in the Cross at a price above the price that is 20% above the highest price of such price range, provided that the company has certified to Nasdaq that such price would not materially change the company's previous disclosure in its effective registration statement. Nasdaq also proposes to make related conforming changes.
- On September 24, the SEC issued an order that posed certain questions to help the Commission decide whether to approve or disapprove the proposed rule change. The SEC is, still, soliciting comments. https://www.sec.gov/rules/sro/nasdaq/2021/34-93119.pdf

Concerns Raised by Amendments

Concerns Raised by Amendments

- The SEC's consideration of the NYSE's amendment (which preceded the Nasdaq's amendment) to permit a concurrent capital raise were marked by disagreement among the Commissioners
- Two SEC Commissioners who dissented (Allison Herren Lee and Caroline A. Crenshaw), as well as certain investor protection groups, issued statements expressing concern that, because of the absence of traditional underwriters, the primary direct listing process will lack a key gatekeeper present in traditional IPOs which helps prevent poorly-run or fraudulent companies from going public.
- These two dissenting Commissioners suggest that guidance, as to what may trigger status as a statutory underwriter, should have been considered and concurrently provided.

Lack of Traditional Underwriter Involvement and Section 11(a) Standing

- The SEC's order approving the NYSE's amendment notes that whether a financial advisor is deemed a statutory underwriter depends on the facts and circumstances.
- Regardless, the SEC goes on to note, given that a registration statement is filed and declared effective, direct listings are subject to the existing liability and disclosure framework.
- Traceability, according to the SEC, is a "judicially created" notion and not unique to direct listings. The SEC noted that:
  - "…concerns regarding shareholders' ability to pursue claims pursuant to Section 11 of the Securities Act due to traceability issues are not exclusive to nor necessarily inherent in Primary Direct Floor Listings. Rather, this issue is potentially implicated anytime securities that are not the subject of a recently effective registration statement trade in the same market as those that are so subject."

Tracing Requirements and Securities Liability

Tracing Requirements and Securities Liability

- Primary direct listings could exacerbate existing challenges investors face in recovering losses for false or inaccurate statements made in public offerings.
- Generally, in order to assert claims under Section 11 of the Securities Act, plaintiffs are required to “trace” their purchases to a registration statement.
- In April 2020, in a case of first impression, this presumption regarding the tracing requirement for Section 11 claims in a case involving a direct listing was initially dispensed with as it would lead to a result that was at variance with the policy objective of the legislation.

Section 11 Litigation

- An action was brought against Slack, which had undertaken a direct listing, after a September 2019 press release in which Slack disclosed that its revenues were adversely affected by customer credits relating to service disruptions and the disclosures were followed by stock drop.
- November 2019: Slack moved to dismiss the federal court complaint on the basis that plaintiffs lacked standing to sue under Section 11; Slack claimed plaintiffs did not know and could not prove that they had purchased registered shares.
- April 2020: Court denied Slack's motion to dismiss for lack of standing, and on other grounds, and the decision was under review by the US Court of Appeals for the Ninth Circuit.
- September 20, 2021: Ninth Circuit affirmed the federal court's denial of Slack's motion to dismiss in a 2-1 decision.
  - Characterizing the issue as one of first impression, the Ninth Circuit held that even "...unregistered shares sold in a direct listing are 'such securities' within the meaning of Section 11 because their public sale cannot occur without the only operative registration in existence."
  - The Ninth Circuit departed from precedent, limiting "such security" under Section 11 to mean "that the person must have purchased a security issued under that, rather than some other, registration statement."
  - In Slack's direct listing, the Ninth Circuit determined, "...the same registration statement makes it possible to sell both registered and unregistered shares to the public."
- The decision may result in plaintiffs viewing the Ninth Circuit as a more favorable forum for securities class actions against companies that go public through a direct listing.

Additional Resources

Read:

[Primary Direct Listings: A Hybrid Approach to a Traditional IPO Alternative]

Harvard Law School Forum on Corporate Governance

[SEC Approves Nasdaq's Direct Listing Rule]

Harvard Law School Forum on Corporate Governance

FREE WRITINGS + Perspectives

OUR FREE WRITINGS & PERSPECTIVES BLOG PROVIDES NEWS AND VIEWS ON SECURITIES REGULATION AND CAPITAL FORMATION.

The blog provides up-to-the-minute information regarding securities law developments and commentary on developments relating to private placements, IPOs, and other securities topics.

SUBSCRIBE

Writing on the Wall

Translating Securities with Mayer Brown

FOR EXPLANATIONS OF OVER 900 SECURITIES, DERIVATIVES, FINANCIAL SERVICES, AND CAPITAL MARKETS TERMS AND PHRASES.

writingonthewall.com