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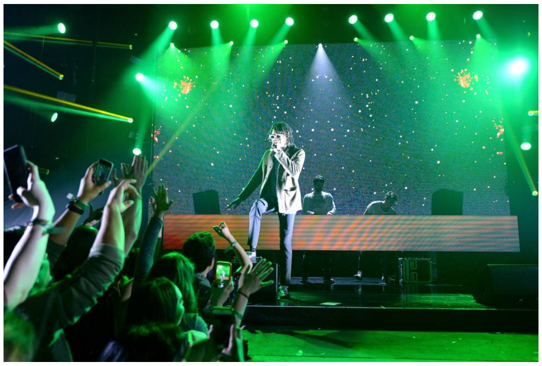
MARKETS

‘Spotify Rule’ Would Help New York Stock Exchange Woo Unicorns

Big Board tweaks its rules regarding direct listings, an alternative to traditional IPOs



Rapper Wiz Khalifa, Drew Taggart and Alex Pall of the Chainsmokers perform during the Spotify best new artist nominees celebration earlier this year in Los Angeles. PHOTO: KEVIN MAZUR/GETTY IMAGES

By Alexander Osipovich and Maureen Farrell

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The New York Stock Exchange is seeking to change its listing standards as it vies for Spotify AB and other hot startups that are considering an unusual tactic called a direct listing.

Direct listings allow companies to have their shares trade publicly, without raising money as in a traditional initial public offering, and there aren’t restrictions on when insiders can sell shares. The NYSE in March filed with the Securities and Exchange Commission to tweak its rule book on the process, a move the agency will rule on in coming weeks.

Approval by the SEC would remove an obstacle that prevents companies such as Spotify from using direct listings to list on the Big Board, lawyers say. Making it easier for closely held firms to use this approach could help the NYSE attract “unicorns,” or startups valued at $1 billion or more.

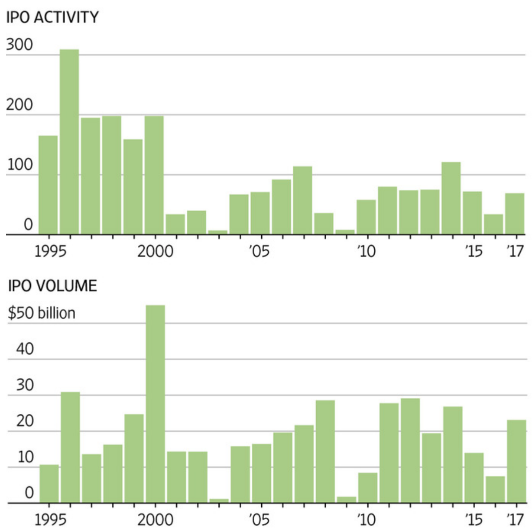
“It’s the Spotify rule,” said Cromwell Coulson, president and chief executive of OTC Markets Group Inc., which operates trading platforms for securities that aren’t listed on U.S. exchanges.

The NYSE, a unit of Intercontinental Exchange Inc., competes fiercely with Nasdaq Inc. for listings. It clinched a victory this year by winning the coveted IPO of Snap Inc., owner of the disappearing-message app. It will also get the debut of Spotify if the music-streaming service goes public as planned, according to people familiar with the company’s plans. But Nasdaq has been the go-to exchange for direct listings by private companies for the past decade. So far, Nasdaq has completed about a half-dozen direct listings of private companies since 2006, while the NYSE has had none, according to representatives for the two exchange groups.

The NYSE told the SEC in a May 16 letter that the change would address a “significant competitive disadvantage” it faces against Nasdaq. The SEC has until June 29 to approve the proposal, reject it or launch deliberations that could delay a final decision for months.

Sluggish IPOs

U.S. IPO deal activity has trended lower for more than a decade. The New York Stock Exchange is seeking approval for 'direct listings' from startups that want to go public without raising money.



Note: Data for each year are through May 24.

Source: Dealogic

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In a direct listing, a company transfers its shares to an exchange and lets them trade publicly without being underwritten by a Wall Street bank, as is the usual case in an IPO. The approach is often used by companies that are traded in the lightly regulated over-the-counter markets but want to switch to the NYSE or Nasdaq. But it is a rare move for private firms, which typically use IPOs to go public.

Direct listings would allow unicorns to avoid hefty underwriting fees, which can amount to tens-of-millions of dollars. The listings also could make it easier for existing shareholders of these companies to cash out more quickly. That is because they don't necessarily involve lockup periods, which are rules designed to protect new investors from a deluge of selling by making insiders wait before they can unload shares. Executives can also discuss the company publicly. In a typical IPO, the SEC mandates a quiet period before the offering.

But there is a greater risk that the company's shares will flop on the first day of trading, since there are no underwriters to prop up the price. The botched IPO of Facebook Inc. in 2012 weighed on the company's shares for months after the debut.

"What the [NYSE] rule change does is it responds to the unicorns that have enough cash that they want to be publicly traded without going through an underwriting," said Douglas Ellenoff, a partner at Ellenoff Grossman & Schole LLP.

If Spotify lists in this manner and its stock performs well, other technology firms may consider the same route. Airbnb Inc. is among the companies said to be watching Spotify's debut to see whether it could do something similar if it goes public, said people familiar with the home-rental service company's plans.

The NYSE and Nasdaq have suffered from a sluggish IPO climate in recent years, losing out on listing fees as cash-rich tech firms such as Airbnb and Uber Technologies Inc. have chosen to stay private.

While the IPO volume in the U.S. has more than tripled to $23 billion raised via 69 listings for this year through Wednesday, according to Dealogic, bankers and lawyers expect such offerings to remain muted going forward.

Spotify, last valued at $8.5 billion, has been seeking input from bankers and NYSE personnel about how a direct listing could work. The Swedish company could go public as soon as late 2017, said people familiar with the process.

The NYSE's proposal would change the way it gives a private company permission to do a direct listing. Such companies must have at least $100 million of publicly held shares once they go live on the exchange. Under its current rule, the NYSE must check whether the company meets that standard by using two different methods—getting a valuation from a third party, and from the last price of its shares in the private market—and taking the lesser of the two.

While Spotify and other unicorns are big enough to meet the $100 million threshold, there is a technical issue that prevents them from passing the test. It involves the NYSE's definition of a private market, which doesn't include the sorts of transactions in which private shares change hands today, lawyers say.The NYSE's proposal would fix that by letting the exchange rely solely on a third-party valuation, as long as the value of the company's publicly traded shares exceed $250 million.

The NYSE, the traditional home of blue-chip stocks, has eased its rules in recent years to attract companies that otherwise would go to Nasdaq. Last year, the Big Board moved to loosen its rules for special-purpose acquisition companies, which are entities with no assets that are raising cash for acquisitions.

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