**Offers – points of detail**

This element explains underwriting, bookbuilding, price stabilisation, rights of withdrawal and global offers.

**Underwriting**

Underwriting is a fundamental part of an IPO. When a company is looking to raise a substantial amount of capital it would not want to go through the considerable time and cost of offering shares only to find that it does not receive all the proceeds from the issue.

As such, the company usually appoints an underwriter to underwrite the issue: this party is usually the investment bank (which may also be acting as sponsor and financial adviser on the IPO). Appointing an underwriter provides the company with comfort that (once the investors have been identified) the proceeds of the offer will be received. In larger IPOs, a lead underwriter co-ordinates the underwriting of the issue, bringing in sub-underwriters to share the underwriting obligation.

The underwriter (and any sub-underwriters, as applicable) will be obliged to subscribe, as principle, for any shares in the IPO for which investors cannot be found or in relation to which the identified investor fails to pay (this latter concept is referred to as ‘settlement risk’).

In practice, the biggest risk for the underwriter(s) in the IPO is reputational: the risk of being associated with an IPO which is not successful.

This risk incentivises the investment bank to ensure that the ‘equity story’ which the company is telling in its IPO is compelling, that the company is well-run, that its management team have the right credentials and that the offer is suitably marketed and priced.

**Underwriting: an example**

A company wishes to make an offer of 100,000,000 ordinary shares to the public at an issue price of £1 each. It appoints an underwriter to underwrite the issue. If the issue is a total success, the underwriter will not be obliged under the underwriting agreement to purchase any of the shares being offered. However, if investors only subscribe for 75,000,000 ordinary shares, the underwriter is committed to purchase the remaining 25,000,000 ordinary shares itself. The company will still receive the full proceeds of the issue. However, the underwriter may offset its risk (and potential liability) by entering into arrangements with a number of sub-underwriters who sign sub-underwriting letters with the lead underwriter and agree to purchase a specific number of the shares not taken up.

**The underwriting agreement**

The underwriting agreement is entered into between the company and the lead underwriter (or group of underwriters). It is an essential document in an IPO and it is crucial that the company’s directors understand the conditions and warranties to which the company will be signing up. The underwriting agreement is usually prepared by the lawyers to the lead underwriter (or group or ‘syndicate’ of underwriters) and it is often heavily negotiated.

The company needs to ensure that it has its underwriting arrangements agreed before it announces the issue. The underwriting agreement will be signed immediately before the prospectus is issued.

In an IPO with a retail element, the underwriting obligation will be conditional on the signing of the pricing statement (which confirms the agreed offer price) by the company and the underwriters.

Effectively, this means that, in any IPO, the underwriter’s obligation will not be fully binding until the price has been agreed by the underwriters at the completion of the bookbuilding process: this means that the underwriter’s risk is fairly low.

**Bookbuilding: how bookbuilding works**

Bookbuilding is a way of setting a price for an offer by obtaining indicative ‘bids’ from investors to acquire specified numbers of shares at a specified price or prices. It involves the investment bank running a book of interest in the shares from interested investors. Its purpose is to establish the demand for the shares at different price points, so that the company and/or selling shareholders can see whether sufficient buyers can be found for the number of shares they want to sell at a price they consider acceptable (i.e. matching supply and demand).

The formal process of bookbuilding will usually begin on or shortly after Launch, when the price-range prospectus is approved by the FCA and published (or the pathfinder is available), and will continue until the offer price is determined by the investment bank and announced, approximately one to two weeks after Launch.

The investment bank and the broker will contact their clients prior to Launch to gauge interest in the issue. The bank and the broker will use the services of bookrunners to do this. Then, on Launch, the bookrunners will use the prospectus (or pathfinder) to provide the clients with the formal terms of the issue. The investors then give non-binding indications of interest and state the price they would be willing to pay for the shares. Based on these bids, the investment bank can determine a realistic price or prices for the shares and can have an accurate indication of the likely level of take up.

All investors who receive an allocation of shares pay the same price, irrespective of their bids. In principle, the company issuing shares has the final say over issue price and allocation; in practice, the price and allocation decisions are usually made jointly between the company and bookbuilder and, sometimes, the company’s corporate finance advisers. Allocations are typically determined by reference to a range of factors, including free float requirements; size of bid; and whether the investor is likely to be a supportive long-term shareholder.

**How bookbuilding works – a summary**

**Diagram:** made up of two columns. The column on the left hand side has three text boxes. First text box reads ‘Prior to launch’ with a downward arrow to the second text box reading ‘Upon Launch’ with a downward arrow to the third text box reading ‘1-2 weeks after launch’. A horizontal dotted line connects ‘Prior to launch’ to the first text box in the right hand column which reads ‘Investment bank and broker contact clients to gauge interest via bookrunners’. There is a horizontal dotted line from ‘Upon Launch’ to the second and third text boxes in the right hand column. The second text box reads ‘Bookrunners use prospectus / pathfinder to provide client with formal terms of issue.’ The third text box reads ‘Investors give non-binding indications of interest and acceptable price.’ There is a horizontal dotted line from ‘1-2 weeks after launch’ to the fourth text box in the right hand column reading ‘Investment bank determines realistic price for shares and likely take-up. Price announced.’ There are downward arrows between each of the text boxes on the right hand side. **End of diagram.**

**Stabilisation: price stabilisation and over-allotment options**

Price stabilisation involves supporting the share price of new issues for a limited period of time after the shares have been admitted to listing and trading.  Price stabilisation is overseen by the FCA. The FCA does not wish the newly listed companies’ shares to increase or decrease too much.

Price stabilisation is often achieved by way of an over-allotment option. An over-allotment option gives the stabilising manager (usually the investment bank) an option to acquire a specific number of shares over and above the number of shares that the company is offering. For this reason, you will often see that the prospectus refers to additional shares that may be issued.

This process, which lasts for a limited period, is designed to help support the share price of the newly issued shares and so avoid fluctuations in price that may have more to do with market speculation than the economic fundamentals of the issuer.

This gives investors confidence to invest, knowing that the price will be stabilised for a period of time after trading commences.

**Right of withdrawal**

When using a published prospectus, there is a risk of a supplementary prospectus being required where a significant new factor or material mistake/material inaccuracy comes to light after approval of the prospectus but before the later of the commencement of trading in the shares or the closure of the offer. The publication of a supplementary prospectus may trigger withdrawal rights under PRR 3.4.1/Art. 23(2) UK Prospectus Regulation.

Pursuant to PRR 3.4.1/Art. 23(2) UK Prospectus Regulation, a person who has agreed to purchase or subscribe for shares may withdraw their acceptances within two working days after the publication of a supplementary prospectus, provided that the new factor, mistake or inaccuracy arose or was noted before the delivery of the securities. An issuer may choose to extend the period of two working days, but this is unlikely in practice.

Note: The above provision stipulates that withdrawal rights apply where the prospectus ‘relates’ to a public offer (i.e. where the prospectus is required because there is an offer to the public under Art. 3(1) UK Prospectus Regulation/s.85(1) FSMA and there is no available exemption). This means that the right of withdrawal will not apply to an institutional-only offer where a prospectus is produced only for the purposes of admission under Art. 3(3) UK Prospectus Regulation/s.85(2) FSMA.

**Global offers**

An offer of shares in more than one country is often called a global or international offer. When a company makes a primary offer, it generally wants to raise as much capital as possible. If the offer is just confined to investors in the UK, the company may not be able to raise as much finance as it would like. By offering the shares to overseas investors, a company expands its potential pool of investors.

Particularly on larger IPOs, shares are often offered to investors in the United States because the US is the world’s largest capital market. The securities regulations which apply in overseas jurisdictions are different and may be more onerous than those which apply in the UK. To comply with overseas regulations in full would generally be prohibitive in terms of legal fees. However, shares are often offered to selected institutional investors in overseas jurisdictions to take advantage of local exemptions. In the case of the United States, shares are offered only to Qualified Institutional Buyers or QIBs and/or Accredited Investors (depending on which exemptions are being relied upon).

Global offers are not used for all IPOs. A company may not have a presence overseas and therefore may not attract foreign investment or it may not want foreign shareholders. However some companies have overseas subsidiaries and choose to open the offer to those jurisdictions. If the company is a well-known brand it may choose to capitalise on its international presence. Investment banks have operations in most financial centres around the world and share offers are marketed to their overseas clients to increase the amount of capital that may be raised by a company.

**Summary**

* A company will usually appoint a lead underwriter to co-ordinate the underwriting of the issue and provide certainty that the proceeds will be received.
* Bookbuilding is a process (on or shortly after launch) of investors giving non-binding indications of interest and price they are prepared to pay, in order for the investment bank to determine a realistic price and likely level of take-up.
* Price stabilisation involves supporting the share price of new issues for a limited period of time after the shares have been admitted.
* A party who has agreed to purchase / subscribe for shares may have a right to withdraw that acceptance following publication of a supplementary prospectus.
* Some companies may wish to market and offer shares to overseas investors, in which cases foreign regulation / exemptions must be considered.