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IFR Americas Awards

All for one and one for all – that seemed to be Alibaba's motto when it came time for the internet giant's record-setting IPO. Levelling the playing field turned out to be good business for all concerned in the US$25bn deal.

A WHOLE NEW LEVEL

BY ANTHONY HUGHES

In the old folk tale, only Ali Baba knew how to access the secret cave of treasure. But with the largest IPO in history, the real-world Alibaba has done a particularly good job of spreading the wealth around.

The company's New York Stock Exchange debut this year is already the stuff of legends: Alibaba shares have risen nearly 70% in less than two months. Yet the success of the US$25bn sale, one of the most eagerly awaited listings ever, was hardly pre-ordained.

Chinese companies pursuing US listings have a decidedly mixed record. The e-commerce giant itself had already faced down one stock crisis in Hong Kong, where Alibaba.com was delisted in 2012. And founder Jack Ma was warned to pay heed to the troubles of previous mega-deal IPOs, such as Facebook's disastrous debut two years earlier.

At first, Ma considered doing another Hong Kong listing. But as it became clear that the regulatory changes he considered necessary would take months (at least) to push through, he set his sights on the US market instead.

Chinese culture, it is said, values collective effort over individual achievement – and Ma seemed determined not to repeat the mistake of Mark Zuckerberg, whose stumbling Facebook IPO was dominated by just one bank.

For its adviser, the company turned to Rothschild, where Alibaba's head of corporate finance had earned his stripes. There, head of Asian equity advisory Claire Suddens-Spiers and head of North American equity advisory Matthew Sperling crafted engagement letters for a syndicate structure that omitted the lead-left role typical in most US IPOs.

Instead, there would be a level playing field among the six joint bookrunners selected: Credit Suisse, Deutsche Bank, Goldman Sachs, JP Morgan, Morgan Stanley and Citigroup.

"It could have been incredibly combative," said Anthony Kontoleon, head of global equity capital markets syndicate at Credit Suisse. "It could have been a client saying: 'We are going to reward you at the end based on what we hear and create an incentive structure where [the banks involved] don't collaborate'."

But it wasn't going to be anything like that.

New way to do it

All the work was to be shared among teams of two banks – "Noah's ark style", as one participant put it – that would handle everything from prospectus drafting to legal documentation, roadshow materials preparation, offer structure, public relations, financial modelling and investor targeting.

None of the bankers invited had been told in advance where the kick-off meeting in Hong Kong on March 25 would be held , and all had to wait with their cars for a call with the location 45 minutes before start time – the Aberdeen Marina Club, where Alibaba had booked using the fake name of a non-existent industry conference.

Every single attendee had to stand and state his name, to assure all present there were no journalists on hand. Even JP Morgan vice-chairman Jimmy Lee had to do it, and he was one of the most well-known people in the room – at least until Ma himself turned up, halfway through, to rally the troops.

With the deal now live, the most important task for the bookrunners was to reach consensus on the top 150 investors likely to participate. Each bank submitted a list, including the expected order size from each account. The data were cross-checked with each investor's largest known previous IPO allocation, and everything was consolidated into one master spreadsheet.

The process gave the syndicate further confidence that demand would be strong, even if market conditions were sour once the deal hit the road.

"It was not the amalgamation of six banks' best friends, which is sometimes what happens," said a second senior banker on the deal.

"There were pre-defined targets, pre-defined qualifications and really thoughtful approaches to how investors were bucketed. It was not your father's allocation process. It was probably the most sophisticated allocation process we have ever seen."

Just following orders

Still working in teams of two, the syndicate held "early-look" meetings in mid-June with the top 25 potential investors they had identified, which included visits to the company's futuristic campus in Hangzhou.

The bankers wanted to know how investors were valuing the company. Most were using the basic price-to-earnings multiple, not the price-to-sales multiple more common in tech IPOs. And most were lining Alibaba up against Tencent, another Chinese internet giant. But in yet another twist, the roadshow would start in the US instead of Asia. The syndicate wanted investors using US comps. Think Amazon, they said. Think Google. Think big.

When the nine-day roadshow began on September 8, the syndicate – still working mostly in two-bank teams – headed off to see more than 2,000 investors in New York, Boston, Baltimore, Los Angeles, San Francisco, Kansas City and Chicago, and London, Hong Kong and Singapore.

Wall Street heavyweights rushed to Ma's side. Morgan Stanley chief executive James Gorman and Credit Suisse boss Brady Dougan introduced Ma at separate events in New York; the latter, a lunch at the legendary Waldorf Hotel, featured a guest list some 900-strong. Jimmy Lee went on the road with the company, as did Tyler Dickson, Citigroup's head of global capital markets origination.

It immediately became clear that demand was not a problem. Some orders were so large that they represented up to 30% of the investor's assets under management – and many times the percentage they would ordinarily devote to one stock. Books were covered on day one.

But the "most sophisticated allocation system ever seen" allowed the syndicate to screen out the noise in the order book and focus on the highest quality investors with a history of holding long term in the sector. Sticking with just the top 150 accounts, the book was covered in four days.

The extreme diligence paid off handsomely. Alibaba's 11 times subscription bettered the IPOs of Facebook (five times), General Motors (seven times) and Visa (five times). And the syndicate scored a rare 100% hit ratio – every investor Alibaba met with put in an order. Final books were an eye-watering US$275bn.

"We saw strong demand not only from traditional buyers, but also from global macro hedge funds that don't normally play the IPO calendar in size," said Rothschild's Sperling.

"Many investors saw the attractiveness of being able to use one stock to play the China theme – and trends such as the rise of the Chinese consumer and the internet – through a single stock," he said. "[One] that would be a mega-cap with a large float and trading liquidity."

Shares and shares alike

In line with company wishes, banks again divvied up the responsibilities. Credit Suisse was sole agent on the directed share programme, while Citigroup ran depositary receipts. Morgan Stanley did billing and delivery. CS and MS jointly handled lock-up release. And Goldman Sachs – having handled Twitter's brilliant IPO the previous November – won the coveted stabilisation role, beating bids from JP Morgan and Morgan Stanley, which was still bruised from the Facebook snafu.

Barclays was brought in as designated market-maker to lead price discovery. Alibaba went for conservative final pricing of US$68 a share.

Yet again, attention to detail served the Alibaba team well. The banks and the company had run several weekend tests with the NYSE to make sure it could handle an expected record flood of orders. The tests "really did contribute to a very smooth opening", said NYSE head of global listings Scott Cutler.

But Goldman chose to wait more than two hours before giving the green light to press the button and begin Alibaba trading. Goldman wanted as many orders as possible in the system before getting under way.

The stock surged 38%, opening at US$92.70. But there was only a 1.3% difference between the opening and closing price even as more than 270m shares, or 0.7 times the deal size, were traded. Goldman had no need to support the price.

"Opening the stock at a stable price was important to ensuring that shareholders continued to build upon their IPO allocations," said David Ludwig, Goldman Sachs's head of technology, media and telecommunications ECM.

"The trading patterns were consistent with what we communicated to the market, helping provide validation for investors to continue adding to positions."

The stabilisation house had done its job. The six banks shared in a US$50m incentive fee as part of US$300m in total underwriting fees shared among the broader syndicate.

And Alibaba proved it had known how to access the treasure all along. ●

Leveraged loans are in vogue. Banks, issuers and investors love them, pushing issuance close to record highs in 2014. Regulators, however, face a far more daunting challenge: succeeding in supporting a fast-growing industry while reining in its riskier tendencies.

THIRST VERSUS PRUDENCE

BY ELLIOT WILSON

How much is too much? When should financial service providers, seeking risk to fund reward, be reined in – and when do rules go too far, threatening the very lifeblood of the banking sector?

Financial regulators have battled this conundrum for years, always striving for a reasonable balance. Sometimes they fall short – witness the financial crisis, caused by excessive risk-taking and a deficit of smart regulation. The ensuing reaction – understandable if not always logical – was to tie lenders up in knots, suffocating them with rules in an attempt to prevent a repeat of 2008.

Just sometimes, though, regulators take a deep breath and clear their heads. They forget the torrid events of the recent past, and search for words that treat financial providers as responsible adults capable of weighing risk, shouldering responsibility, and harnessing their wilder and riskier (pre-crisis) tendencies.

That approach – prudent and watchful – is the one adopted by US regulators over leveraged loans. By any measure this is a market enjoying a golden era. Total US issuance hit a record high of US$1.25trn in 2013, according to Thomson Reuters data, with deal numbers nudging the 3,000 mark.

This year saw a strong first half, a drastic third-quarter wobble and then markets stabilising again by October. Volumes, said HSBC's global head of leveraged and acquisition finance Richard Jackson, were "up there ahead of pre-crisis record levels", following a "very good year for M&A financing, and for leveraged finance in general".

Total issuance in the current year through to November 7 reached US$922bn, slightly down on last year's record numbers but a 50% increase over the same period in 2012.

A steady flow of activity was interspersed by a few acquisition-led blowout deals. In April, US-Singaporean chip developer Avago Technologies secured US$5.1bn in financing to back its

US$6.6bn acquisition of LSI Corporation. In September, Burger King raised US$7.25bn in financing to back its US$11bn purchase of Canadian coffee and doughnut chain Tim Hortons.

More of the same

Most analysts suggest that activity will remain strong heading into the new year. Bankers interviewed for this story point to "more of the same" going into 2015.

Christina Padgett, a senior vice-president in Moody's US corporate finance team, tipped issuance to be underpinned by a strong US economy and low rates of corporate defaults.

"Moody's expects the US leveraged loan market to stay attractive going into 2015 as rates are likely to stay low, and defaults are unlikely to rise," she said. "There's a lot of liquidity out there in the market, so when investors look at this space they are looking at pretty good credit conditions."

But hang on

Some, though, worry that the US market has become a bit too frothy for its own good, and that riskier practices redolent of the pre-crisis era may again be creeping back into play.

On November 7, it became clear that those worriers included US regulators. That was the day that three federal agencies, the Federal Reserve, the Federal Deposit Insurance Corporation, and the Office of Comptroller of the Currency, noted in their annual Shared National Credits review that leveraged loans comprised US$254.7bn, or 74.7%, of total SNC "criticised" assets in 2014, up from US$227bn the previous year, despite accounting for barely a fifth of all regulated lending.

"Criticised" assets are defined in the SNC review as those rated on a broad scale stretching from "special mention" all the way down to "loss".

This matters, and to both regulator and regulated. For US lenders, struggling for traction in a world dominated by rock-bottom interest rates and throttling rules, the market has become something of a panacea, offering both risk and reward.

"Leveraged loans provide respite to under-pressure banks by generating returns as well as underwriting fees," said Heath Tarbert, a partner in Allen & Overy's US bank regulatory group.

Yet some worry that banks have – again – gone too far, and are failing to temper their predisposition for risk. Regulators warn of finding weak underwriting standards on deals and shaky risk management practices.

Bankers deny the charges but the accusations are beginning to stick. Moody's Padgett points to a clear "deterioration in credit quality consistent with a market" saturated with buyside demand, and deals offering increasingly aggressive terms and conditions.

Federal agencies have, so far, opted for a softly-softly approach to regulating this vibrant corner of the market. In March 2013, the Fed and the OCC introduced guidelines, rather than hard-and-fast rules, that counselled banks not to underwrite loans with debt-to-earnings ratios of more than six times. Exceed that number, came the attendant warning, and your bank will face tougher oversight, including tougher assessments of loan-loss rates in future stress tests.

Yet banks have opted, all too regularly, to view those guidelines as gates rather than barriers. This year's SNC review noted that 15% of all loan transactions completed in the 15 months from June 2013 were leveraged by at least eight times debt to earnings.

The review also identified a welter of key weaknesses at banks engaged in leveraged lending, including poor credit analysis, a lack of justification for asset valuations, and a tendency to rely on financial projections provided solely and wholly by the issuer.

Last year's guidelines, moreover, demanded that borrowers should demonstrate an ability to repay 50% of the value of the loan within seven years. In November 2014, 77% of borrowers were projected to hit that target, down six percentage points from the previous year.

In a joint statement issued on November 7, the trio of agencies led by the Fed warned that banks should not "heighten risk by originating and distributing poorly underwritten and low quality loans". Any institution "unwilling or unable to implement strong risk management processes" should down tools "until their processes improve sufficiently".

In November, lenders were told that in order to extend fresh credit to a borrower previously criticised by regulators, they would have to meet the same exacting standards of a new loan.

Blurred guidelines

Banks, for their part, have pushed back, complaining that guidelines are either too vague or that agencies have offered conflicting advice. Most market players describe it as an arbitrary and blunt tool being used to shape and form a nuanced and thriving market.

To Tarbert, the guidelines' definition of a leveraged loan appeared consciously blurred. "Reading through the guidance, even as a lawyer it is a challenge to figure out exactly what is and what isn't defined as "leveraged", he said.

Then there is the fear that tighter guidelines will lead to a fall-off in issuance, particularly among fast-growing firms with the greatest need for working capital.

Dan Whalen, head of loan syndications, Americas at BNP Paribas, said the guidelines issued by the Fed were "increasingly having an impact", and were proving "damaging to smaller, lower rated businesses' ability to access the US capital markets".

Taking air out of the tyres

Some have sympathy for regulators, who find themselves in a tricky spot. On the one hand, they do not want to further undermine US lenders, already pressed beneath a mountain of new rules. Regulators also see the danger inherent in disintermediating domestic banks out of such a profitable market.

A slew of non-bank and foreign service providers have all dipped their toes into the US leverage loan market this year, including Jefferies Group, Macquarie Capital, and Nomura Holdings, and more are expected to come.

On the other hand, they want and need to cover their backs in case the economy and the market go sour. The question, as ever, is where to draw the line. Even bankers admit to the need to temper some of the excesses of leveraged finance.

"There is a need to take some of the air out of the tyres," said a leading US banker. "But the key will be to do it carefully. We all want to see this market continue to succeed."

So far at least, that wish is being fulfilled. Issuance is likely to remain strong, said Moody's Padgett, with the deal pipeline, based on M&A financing and leveraged buyouts, looking "pretty good" going into the first quarter of 2015.

And so far, regulators, in an admirable attempt to allow a fast-growing market to find its own equilibrium, have opted to wag fingers and criticise and cajole from the sidelines, rather than temper and meddle.

Will banks in turn prove willing and able to react like responsible adults, and rein in their more reckless tendencies in the leveraged loan space? Only time will tell. •

THE YEAR IN NUMBERS

REVIEW OF THE YEAR 2014

■ BNP PARIBAS' FINE FOR BREACHING US SANCTIONS AGAINST TRADING WITH CUBA, IRAN AND SUDAN

US$8.9bn

■ ORDER BOOK FOR THE ALIBABA IPO, WHICH RAISED US$25BN FOR THE CHINESE E-COMMERCE COMPANY

US$275bn

■ SIZE OF THE OVER-THE-COUNTER DERIVATIVES MARKET AT THE END OF JUNE 2014, ACCORDING TO BIS

US$691trn

■ AMOUNT OF SWAP TERMINATIONS FACILITATED BY POST-TRADE PROCESSING FIRM TRIOPTIMA SINCE LAUNCH

US$520trn

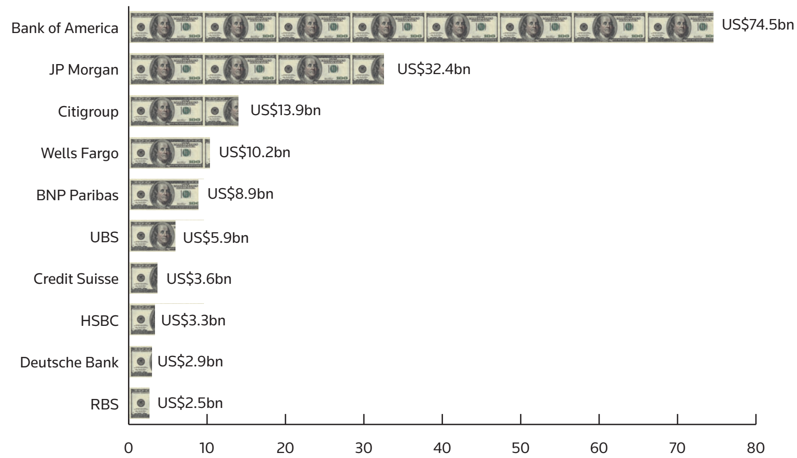
GLOBAL INVESTMENT BANKING FEES

	Managing bank or group	No of issues	Total US$(m)	Share (%)
1	JP Morgan	3,917	5,796.8	7.0
2	BofA Merrill	3,906	5,189.9	6.3
3	Goldman Sachs	2,382	5,021.6	6.1
4	Morgan Stanley	3,152	4,971.4	6.0
5	Citigroup	3,179	4,212.1	5.1
6	Deutsche Bank	3,162	3,926.4	4.7
7	Barclays	2,870	3,553.1	4.3
8	Credit Suisse	2,229	3,544.8	4.3
9	Wells Fargo	2,557	2,115.5	2.6
10	UBS	1,423	2,071.7	2.5
11	RBC	2,281	1,997.2	2.4
12	HSBC	3,241	1,699.3	2.1
13	BNP Paribas	2,139	1,473.6	1.8
14	Jefferies	765	1,215.6	1.5
15	Nomura	1,507	1,140.0	1.4
16	RBS	1,808	980.2	1.2
17	Mizuho Financial	2,494	950.2	1.1
18	Sumitomo Mitsui	2,396	895.4	1.1
19	BMO	1,318	845.5	1.0
20	Mitsubishi UFJ	2,197	822.0	1.0
21	Lazard	223	779.9	0.9
22	Credit Agricole	1,235	761.0	0.9
23	Societe Generale	1,163	737.0	0.9
24	Scotiabank	1,180	719.6	0.9
25	TD Securities	1,422	622.7	0.8
	Total	**38,907**	**82,683.0**	

Source: Thomson Reuters. Jan-Nov 2014

BANK FINES SINCE 2008

TOTAL SETTLEMENTS BY FIRM, RANKED



Source: Keefe, Bruyette & Woods

BIGGEST IPOS OF ALL TIME

PROCEEDS RAISED, US$bn

Issuer	Date	Nation	Proceeds
Alibaba.com Global trade starts here.	2014		25.0
中国农业银行 AGRICULTURAL BANK OF CHINA	2010		22.1
ICBC	2006		22.0
AIA THE REAL LIFE COMPANY	2010		20.5
VISA	2008		19.7
GM General Motors	2010		18.1
NTT docomo	1998		18.1
Enel	1999		16.6
facebook	2012		16.0
T Deutsche Telekom	1996		12.5
中国银行 BANK OF CHINA	2006		11.2
DAI-ICHI LIFE	2010		11.2
ROSNEFT	2006		10.7
AT&T	2000		10.6

Source: Thomson Reuters

BIGGEST INVESTMENT-GRADE BOND ISSUES OF ALL TIME

PROCEEDS RAISED, US$bn

Issuer	Date	Nation	Proceeds
verizon	2013		49.0
	2013		17.0
Medtronic	2014		17.0
abbvie	2012		14.7
Roche	2009		13.5
Pfizer	2009		13.5
	2014		12.0
BR PETROBRAS	2013		11.0
	2002		11.0
WORLDCOM	2001		10.1
BT	2000		10.0
ORACLE	2014		10.0
United Technologies	2012		9.8
KRAFT	2010		9.5

Source: Thomson Reuters