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The Direct Listing Route to Going Public: Spotify's Counsel Offer a Guide

On April 3, Spotify went public. Here's a look behind the scenes at that process, which was carried out via a rare direct listing instead of through an initial public offering.

By Caroline Spiezio

Music streaming company Spotify made waves this year when it opted to go public via direct listing, breaking from the traditional IPO route that many other tech companies have pursued.

It's an unusual choice that experts said can boost shareholder liquidity and transparency if done right. Unlike an initial public offering, direct listings do not require the participation of underwriters, thus removing lock-up agreements and price stabilization activities and allowing existing shareholders to sell their shares immediately after listing at market prices.

It's also a route that, at the time Spotify's attorneys began working on the direct listing, had no clear road map to success. That's why Spotify's outside counsel from Latham & Watkins and general counsel Horacio Gutierrez authored a case study on the company's direct listing, published Thursday.

Free (Handout)

The Latham client alert commentary, titled "Spotify Case Study: Structuring and Executing a Direct Listing," walks through what kind of private company can pull off a direct listing, how to educate investors and how to go public without an underwriter, based on Stockholm, Sweden-based Spotify's experience.

"We at Latham & Watkins put a lot of thought and energy into coming up and implementing and executing a path that hand't been taken before," said Marc Jaffe, a Latham partner who worked on the direct listing. He said he and his case study co-authors wanted to share their experience as a learning opportunity for others.

Jaffe and his co-author, fellow Latham partner Greg Rodgers, said they've been on the receiving end of an increasing number of direct listing-related questions since Spotify went public, though other large private companies have yet to take that route.

That's in part because—as their case study lays out—the direct listing path is one that only a small set of private companies could manage. Rodgers laid out three criteria all prospective direct listing companies can or should meet.

"They shouldn't need money [or] additional capital, they should have a diversified and existing shareholder base and, then, three, it's very helpful if they're an established brand name with a simple business model," said Rodgers.

Spotify, which approached Latham in May 2017 about going public via a direct listing, was a company that checked all of those boxes, Rodgers said. He said the company wanted to provide existing shareholders greater flexibility than traditional IPOs do. Traditional IPOs include lock-up restrictions preventing insiders holding company stock from selling their shares for a period—usually between three to six months—after going public.

The company's outside counsel said Spotify also wanted a direct listing because it seemed to offer greater transparency. Unlike a conventional IPO, direct listing allowed Spotify's market valuation to be set by the market, determined by what price willing buyers and sellers exchanged shares for rather than a predetermined opening price.

"The company was focused on providing as much information to the market as possible to enable market-based price [determination] of the stock," Rodgers said.

He and Jaffe noted that Spotify held an "Investor Day" that qualified as a road show under the U.S. Securities and Exchange Commission's rules and lasted more than two hours, about twice as long as the average IPO equivalent, according to the case study. The meeting was livestreamed around the world and included presentations from all members of Spotify's leadership team.

The company also released guidance a week before trading commenced, issuing its financial outlook for the quarter and full year 2018.

Spotify's transparency goals and lack of an underwriter could have backfired, the Latham lawyers noted. Without an underwriter or set market price, Spotify's opening price could have fallen below the New York Stock Exchange's reference price of $132 per share, an estimate drawn from private transactions.

"Without an underwriter to purchase stock at a price that people know ahead of the listing … there is a higher chance of negative volatility in the stock, which could result in it going down upon listing," Rodgers said.

But that wasn't a problem at all. Spotify's opening price hit $165.90 per share, approximately 25.7 percent higher than the NYSE reference price, according to the case study. It closed at a lower price of $149.01, but that was still 12.9 percent above the reference price.

While the challenges and uncertainties of opting for a direct listing instead of an IPO remain, Rodgers said those risks may decrease if more companies choose to take the route.

"The big [challenge] we faced was the uncertainty of doing something new," he said. "That is always risky. That will decrease over time, as and if more people follow this path."

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