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IPO's Hit or Miss

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IPO's Hit or Miss

The term initial public offerings, better known as an IPO, was not widely used until the 1990's. An initial public offering is used to describe the first time a company decides to trade its shares on the public market. A range of about seven hundred fifty to a thousand companies switch from being privately owned to being publicly traded a year. One main reason companies change to public trading is to raise funds for their companies. Choosing to switch to an IPO can be very expensive for a company, as opposed to issuing debt, because of the money that has to be paid to the different people involved in the process of an IPO, such as the underwriters spread, lawyers and auditors. However, IPOs are ideal for companies who show growth in their earnings and have a lot of public interest. [2 & 7]

Advantages and disadvantages

A privately owned company is not obligated to sell shares and does not have to disclose much information about its business. A publicly owned company sells portions of its shares to the market, has to disclose financial information to the Board of Directors quarterly and be registered with the Securities and Exchange Commission, also known as SEC. Selling shares to the public can open many doors for the company in regards to raising capital and even increasing their chances of getting better rates when they decide to issue bonds. It can also increase the company's liquidity as stocks can be used as employee incentives, and makes it easier to raise money in the future. Going public has disadvantages as well because the company must comply with certain rules and regulations given by the SEC. There is a chance one can lose partial control of their company as IPOs are costly, and there is some separation of ownership and increased disclosure as a result. [2 & 8]

Steps of an IPO

The process of going public can be very lengthy; one must choose an investment bank, register with SEC, go on a “road show”, choose a price range, and set a final offering price closer to the opening date. The first step is choosing an investment bank, and this can be a long process because the company should look into the company’s reputation, client base, and their support in the secondary market. The investment bank prices a company, decides how much money the company should raise and decides the amount of shares it should make available on the secondary market in comparison to the company’s value. A portion of the shares stays with the company while the remainder is made available to sell to the public. Companies can always issue more stock than they originally did from their IPO depending on the performance of the company.

Filing with SEC is another process that takes time as the application asks the filer to describe what the company is doing and why. Initial prospectus gives the SEC an estimate of how much the share will go for and how many will be sold. In its final prospectus it is given the correct number of shares and prices. It is adjusted a few times until the SEC either denies it or approves it. The company then chooses what exchange to use and its symbol. The “road show” is when the investment banks, lawyers and senior management team go around to investors and present this IPO to them. It is at this point that the company can either lose investors or gain some depending on how well you present your IPO. The pricing of an IPO considers the company's future earnings and market data in regards to companies in the same field. After all of this, the final price is set based on demand and the final offer price is given the night before the IPO. [4]

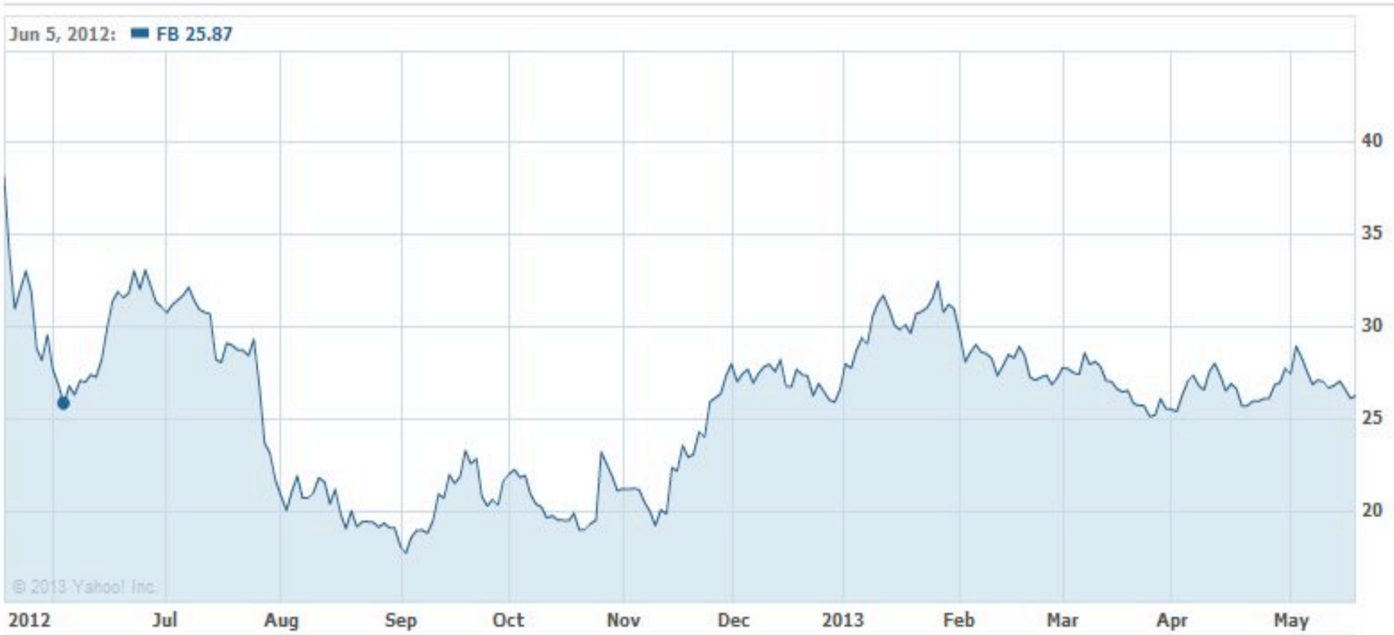
IPOs that were a Miss

Not every IPO goes according to plan. Some companies go in with the mentality to raise money as opposed to companies that want to properly price their shares and capitalize from there. One company whose IPO was a miss was Facebook. Facebook went public on May 18, 2012 with an opening price of $42 and closing at $38 a 9.52% decrease. Facebook's investment bank was Morgan Stanley with Michael Grimes as their underwriter. They had 2nd Quarter estimated revenues of 2012 from three different analysts: Morgan Stanley of $1.175 billion, JP Morgan of $1.182 billion, and Goldman Sachs of $1.207 billion. This information was disclosed to the investors they first presented to on their "road show".

Afterward, however, this changed as big investors were made aware of Facebook's performance and how it was deteriorating, whereas small investors were not. Big investors were told that Facebook believed that they would not make the estimated revenues for 2nd Quarter due to Facebook Mobile and the decline in time spent by users. Facebook makes most of its money through advertisements and it was found that many of their users were using Facebook Mobile in which advertisements cannot be shown in the app. The amount of time Facebook users spent on the website decreased as well, which gave the senior investment banker the idea that they weren't going to achieve the 2nd Quarter estimates. This quickly disenchanted the big investors aware of the changes in which the yearly revenue would be 3% less than the $5 billion predicted. Facebook users are mainly teenagers that barely have money, and therefore their cash flows will not be high, and as this is the provider of dividends this means that it doesn't make the company worth much. Three months post IPO, Facebook's price declined by 50% to a low number of $19.05 in August. (3)

*Prices from CNBC Quotes

Chart showing Facebook's trend 3 months post IPO, which physically shows the 50% decline. The next chart shows how its price never went higher than its IPO price one-year post IPO. One-year post IPO date its price declined by 38.10% from $42 to $26



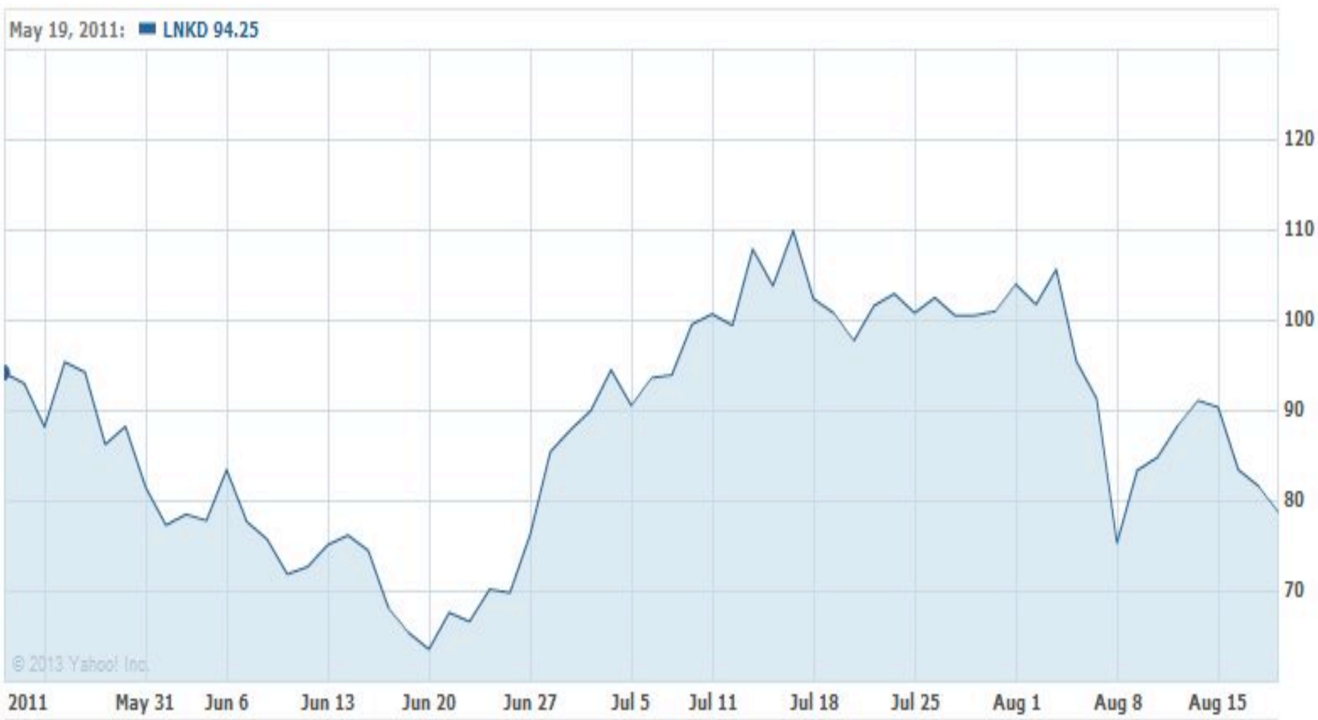
*Prices from CNBC Quotes

IPO's that were a Hit

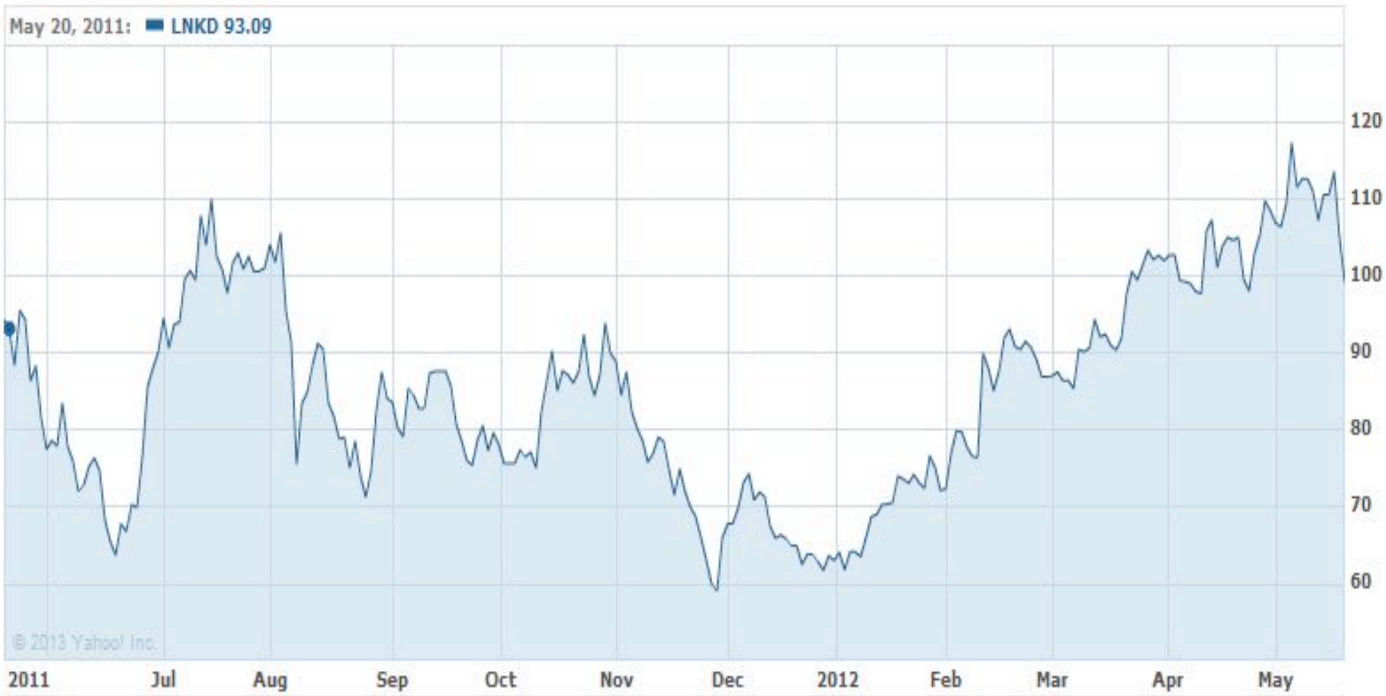
LinkedIn, on the other hand, had a different approach: they were all about correctly pricing and capitalizing their company. LinkedIn made $15.4 million in 2010 and it was predicted that it would increase once it went public. It was the only social media to go public at the time, which benefited LinkedIn. It was the biggest Internet IPO since Google's IPO in 2004. LinkedIn has a different kind of users as opposed to Facebook. LinkedIn users have profiles to network with professionals, tending to have a much older crowd. Just as Facebook, LinkedIn makes money from advertisements but also profits from premium subscription options and field sales. Field sales are made by directly soliciting customers, agencies and resellers.

According to an article by Alina Selyukh and Clare Baldwin "In 2010, fifty-six percent of LinkedIn's net revenue came from field sales, while 44 percent came from online sales." It was sold with an IPO price of $45 and opened at $83 on May

19, 2011 on the New York Stock Exchange. It closed at $94 with a 109% increase from its IPO price making the company worth 8.9 billion by the end of the opening day. LinkedIn had Morgan Stanley, Bank of America and JP Morgan Chase & Co. as their underwriters, selling 7.84 million shares. A week prior to opening, LinkedIn priced its shares at $32 to 35 per share valuing it at $3 billion after the IPO. The night before the price was set at $42 to $45 per share. LinkedIn had a 75% increase from its IPO price, 3 months post IPO. It had a 102% increase from its IPO price, 1-year post IPO. According to its opening price 3 months post IPO LinkedIn had a 4.81% decrease and a 30.18% increase one-year post IPO, which is shown in the charts below.[9 & 11] *Prices from CNBC Quotes



The above chart shows the decrease from its opening price of $83 to its price 3 months post its IPO date at $79 showing its 4.81% decrease.



*Prices from CNBC Quotes

The previous chart shows the increase from its opening price of $83 to its price one year post IPO date of $99 a 30.18% increase.

Twitter

One company that might be going public in the next 12-14 months is Twitter. Twitter has been scaling their strategies in regards to advertisement. Before, only certain individuals could advertise by invite only on Twitter and now just about anyone globally can advertise on it. It has become an autonomous process where one no longer has to even speak to anyone at Twitter as any business can just pay and advertise on the website. Twitter amplify is the contract they have with global advertising companies such as Starcom and WPP, where Twitter receives all the advertisement money since the ads are online rather than in print. WPP allows the advertisements to target certain people that want what is being advertised. These scaling opportunities are giving twitter higher numbers and increasing its value. Twitter was analyzed by Privco and is expected to have 750 million in revenues this year and 1.4 billion in revenues for 2014.

Twitter is on the radar because they just hired the lead tech banker from Morgan Stanley Cynthia Gaylor, who was involved with LinkedIn, Facebook, Zynga, Pandora and many more companies in helping transition them from private to public. Twitter is expected to follow the path of LinkedIn and properly price their IPO and capitalize. It is expected that in the 3rd quarter they will be S1 Filing and 4th Quarter IPO. Twitter has a10 billion valuations, pricing the IPO at 25 or 30 billion and is expected to grow into a 40 to 50 billion-dollar company. Twitter has 1/7 of the valuation of Facebook, with the same revenues as Facebook did when they first were going public but is expected to do better than Facebook.(1 & 5)

Conclusion

IPO's can be a hit or miss with some companies and is not a short process. The idea of going public can be a spectacular idea for certain companies with the correct amount of funds and correct timing. Companies that aren't well known don't get much attention from investors especially because investors want to invest in an IPO that's popular and will sell. I've personally have witnessed some management teams come pitch their IPO at the firm I work for and how these not so well known companies don't get much attention from the investors. The stock market is very volatile that sometimes it is hard to see how well a company will do on the stock market. It will be interesting to see if Twitter goes public because its popularity has increased traumatically in the last couple of years with 200 million monthly active users around the world.

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