IPWhoa: What to know before joining this year's IPO parade

April 4 2019, by Stan Choe

In this March 29, 2019, file photo Lyft co-founders John Zimmer, front third from left, and Logan Green, front third from right, cheer as they as they ring a ceremonial opening bell in Los Angeles. Lyft gave investors a lesson in how quickly a company's market value can change. The ride-hailing company's stock surged more than 20% from its IPO price on Friday. But by the first hour of Lyft's second day of trading, the stock had fallen below the IPO price of $72. (AP Photo/Ringo H.W. Chiu, File)

We use Uber to go places, Slack to chat with co-workers and Pinterest to save our favorite ideas. Why not own a piece of these companies that increasingly dominate our daily lives?

That's the question for many regular investors as a parade of well-known technology companies are expected to make their stocks available to everyone for purchase this year, not just big pension funds and wealthy people. Lyft was at the head of the line when it had its initial public offering of stock, or IPO, on Friday.

It's tempting to buy stocks of companies whose products or services we see or use so often. But "investing in what you know" doesn't mean buying Uber because you request a ride every other day. It means knowing whether Uber will get enough customers at high-enough prices to become profitable, and at what level.

"Don't jump in with both feet just because you use the product," said Kathleen Smith, principal at Renaissance Capital, which researches IPOs. "You're not going to know the value."

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A stumble after a first-day pop perhaps should not have been a surprise, given the track record for IPOs. Here are some considerations if you want to join the IPO rush, which may include such companies as Uber and video-conferencing service Zoom.

DO IPOs PERFORM WELL?

Yes and no.

The first day of trading for an IPO is often a great one, when enthusiasm is surging. IPOs have returned an average of 17.9% in their first day of trading, according to data from 1980 to 2016 compiled by Jay Ritter, an IPO specialist at the University of Florida's Warrington College of Business. That would count as great year for an S&P 500 index fund.

But IPOs go on to return an average of 21.9% in the three years following their IPO, lagging the market.

Some IPOs tend to do better over the long term, notably those that bring in more revenue. Since 1980, companies with $1 billion or more in revenue (in 2015 dollars) have returned an average of 42.7% in the three years following the IPO. That's better than the market.

Smaller companies, meanwhile, have historically had better first-day gains than their bigger IPO rivals but go on to return an average 20.2% over three years. That's well below the market.

In this March 29, 2019, file photo a sign for Lyft is displayed on a car in Los Angeles. Lyft gave investors a lesson in how quickly a company's market value can change. The ride-hailing company's stock surged more than 20% from its IPO price on Friday. But by the first hour of Lyft's second day of trading, the stock had fallen below the IPO price of $72. (AP Photo/Ringo H.W. Chiu, File)

WHAT ABOUT THIS CROP OF IPOs?

While Lyft, Uber and other upcoming IPOs are big names, many of them lose money. It's a growing trend. Last year, about eight of every 10 companies going public were unprofitable, according to Ritter. That's the highest percentage since 2000, the height of the dot-com bubble.

To be sure, companies going public today tend to be much more seasoned. Since 2008, the median age for an IPO company has been at least 10 years. That's roughly double the age of the typical company going public in 1999 or 2000, at 5 or 6.

With greater age often comes higher revenue. Last year, the typical tech IPO made 10 times more in sales than the median in 2000, even after adjusting for inflation, according to Ritter.

"IPOs are risky, but given the track record of tech over the last 10 years since the recession, they've been the shining stars, they've been where the growth is," said Karyn Cavanaugh, senior markets strategist at Voya Investment Management.

WHAT IF I DON'T LIKE BUYING INDIVIDUAL STOCKS?

One of the biggest trends in investing over the last decade is the move toward index funds. Picking stocks on one's own—or trusting a fund

manager to do it—can be risky and expensive. Instead, investors are flocking to index funds that own baskets of many stocks, such as all those in the S&P 500 index, and generally come with low fees.

IPO stocks eventually filter into index funds. Dropbox, for example, had its IPO last year, and its shares are already in more than two dozen ETFs, such as Vanguard's Total Stock Market ETF and the iShares Expanded Tech Sector ETF.

One ETF focuses specifically on recent IPOs. The Renaissance IPO ETF will add Lyft shares later this week, and it tracks an index that holds companies that have had an IPO within the last two years, giving more weight to the bigger ones. Its returns have topped the S&P 500 over the last three years, although it has lagged since its 2013 inception.

Volatility has become part of the reputation for IPOs. "I think IPOs are the Rodney Dangerfield of asset classes," said Renaissance Capital's Smith. "Everyone who wants to feel like they're conservative or smart picks on IPOs, saying 'Don't go there.'"

But she said IPOs today are different from 1999 and 2000, with more rigor around researching them. "If you want to focus on this and feel you can tolerate the volatility, you can get outsized returns," she said.

Even so, market strategists say average investors eager to snap up shares in the latest IPO would do well to skip the frenzied early days of trading and buy later, or wait until the stock makes its way into an index fund.

"If these companies are going to stay around and be good investments, they will be in the future," said Tom Martin, senior portfolio manager with Globalt Investments. "Let the hype go out. Be an investor, not a gambler."

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