

# Don't Let IPO Buzz Cloud Your Judgment

## TECHNOLOGY SECTOR REPORT

### For more information:

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Initial public offerings (IPOs) tend to attract a lot of investor interest, especially when the company is well-known. However, that excitement isn't always matched by investment returns. We recommend investors avoid most IPOs because these companies lack track records, do not trade on fundamentals, and are usually not yet profitable. Though familiarity with a product or brand can provide some comfort, investors in IPO's need to be more skeptical.

### **IPO Excitement Fades Fast**

The stock price of an IPO tends to rise on the day it begins trading. However, studies have shown that the initial excitement for most stocks that IPO tend to fade in the following months. Longer-term studies have consistently shown IPOs underperform even five years after the initial offering.

### **Higher Risk Potential**

IPO stock prices can be extremely volatile, since frequently there is little financial information about these companies and a short track record. Many IPOs are not yet profitable, which is often true for these companies even if they do have longer operating histories. IPOs may not be suitable for your investment objective or risk tolerance, and we generally recommend investors avoid most IPOs.

### **An Alternative to Traditional IPOs Becoming More Popular -**

A special purpose acquisition company (SPAC), or "blank check" company, raises capital in the IPO market for the purpose of acquiring a private company. SPACs have been around for decades but have become a popular option for private companies to go public. They have also attracted retail-investor attention as a way to gain exposure to emerging private companies at a relatively early stage. However, there are risks, and most SPACs significantly underperform the market.

The price performance of 30 consumer-facing technology companies following their IPOs between 2011 and 2021 is illustrated in **Figure 1** (below). On average, these stocks experienced a 40.7% price increase on the first day of trading, reflective of the excitement-driven demand often associated with high-profile IPOs. However, these stocks, on average, experienced a decline of roughly 0.4% in the three-month period following the first-day close, and a decline of roughly 13.3% in the six-month period following the first-day close.

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**Figure 1: Stock Price Performance Following IPOs**

Company	Ticker	IPO Date	IPO Price	First-Day Price Change	Price Change 3 Months After		
					First-Day Close	After First-Day Close	6 Months
LinkedIn	LINKD	5/18/2011	\$ 7.33	109.4%	-16.1%	-23.6%	
Pandora Group	P	06/15/2011	\$ 17.42	8.9%	-40.9%	-39.9%	
Zynga	GRPN	11/04/2011	\$ 26.11	30.6%	-6.4%	-61.8%	
Yelp	ZNGA	12/16/2011	\$ 9.50	-5.0%	37.2%	-41.9%	
Splunk	YELP	03/02/2012	\$ 24.58	63.9%	-36.2%	-10.5%	
Twitter	SPK	04/19/2012	\$ 35.48	108.7%	-17.7%	-11.2%	
Zulily	TWTR	11/07/2013	\$ 44.90	72.7%	21.0%	-31.7%	
King Digital Entertainment	ZU	11/15/2013	\$ 37.70	71.4%	6.0%	-7.7%	
GrubHub	KING	03/26/2014	\$ 19.00	-15.6%	-11.1%	-30.3%	
GoPro	GRUB	10/16/2019	\$ 34.00	30.8%	0.3%	4.7%	
Alibaba	GPRO	06/26/2014	\$ 31.34	30.6%	159.4%	111.9%	
GoDaddy	BABA	09/19/2014	\$ 93.89	38.1%	16.4%	-9.9%	
Etsy, Inc.	GDDY	04/01/2015	\$ 26.15	30.8%	7.8%	-3.6%	
Shopify, Inc. Class A	ETSY	04/16/2015	\$ 30.00	87.5%	-43.9%	-63.2%	
Fritbit, Inc. Class A	SHOP	05/21/2015	\$ 25.68	51.1%	13.8%	9.9%	
Zillow	FBIT	06/18/2015	\$ 29.68	48.4%	34.4%	-6.3%	
Square, Inc. Class A	Z	07/31/2015	\$ 27.50	78.9%	-25.6%	-22.2%	
Match Group, Inc.	SQ	11/19/2015	\$ 13.07	45.2%	-23.6%	-28.1%	
Trivago N.V. Sponsored ADR Class A	MTCH	07/01/2020	\$ 14.74	22.8%	-29.2%	-6.3%	
Snap, Inc. Class A	TRVG	12/16/2016	\$ 11.85	7.7%	1.3%	56.0%	
Spotify Technology SA	SNAP	03/02/2017	\$ 24.48	44.0%	-12.8%	-41.7%	
Lyft Inc Class A	SPOT	04/03/2018	\$ 149.01	12.9%	13.2%	18.7%	
Pinterest	LYFT	03/29/2019	\$ 87.24	-10.3%	-16.1%	-52.6%	
Uber Technologies, Inc.	PINS	04/18/2019	\$ 19.00	24.0%	5.6%	3.7%	
Chewy Inc.	UBER	05/10/2019	\$ 42.00	-1.0%	-4.6%	-35.0%	
Peloton Interactive Inc.	CHWY	06/14/2019	\$ 22.00	59.0%	-15.7%	-19.2%	
Casper Sleep Inc	PTON	09/26/2019	\$ 27.00	-4.6%	0.0%	-9.2%	
Airbnb Inc	CSPR	02/06/2020	\$ 14.50	-6.9%	-56.0%	-35.6%	
Rivian Automotive Inc.	ABNB	12/10/2020	\$ 68.00	212.8%	27.0%	1.0%	
	RIVN	11/10/2021	\$ 78.00	-26.0%	-17.0%	-62.6%	

Source: FactSet. Edward Jones does not follow any of these companies. Past performance is no guarantee of future results.

**Be Aware of These Key Considerations: First Days of Trading**

If, after considering the price risk associated with IPOs at the outset of public trading, you decide to still purchase the stock, there are a few key considerations that we believe the prudent investor should understand:

**1) Opening price will likely be different from the official IPO price.** New issues can experience extreme volatility in the first few hours and days of trading in the secondary market. When the company's stock opens for secondary trading and becomes more widely available for individual investors, it is possible the price will be significantly different from the IPO price set by the security underwriters. In addition, new issues often do not begin trading at the moment the market opens.

**2) Use a limit order.** Once you understand the risks of purchasing a stock during its first public trading days, and have determined that the investment is suitable for your portfolio, you should determine the highest price you are willing to pay for the stock and place a limit order for this price. Placing a limit order allows investors to set the maximum price and control what they are willing to pay for a share of a stock. However, if the stock does not trade at or below the limit order price, the stock will not be purchased and the limit order will not be filled.

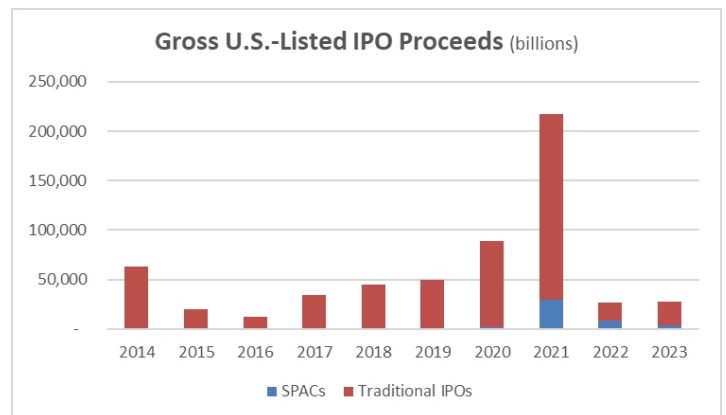
**3) Orders are not accepted until after the IPO is priced.** Edward Jones typically does not accept orders

until after the IPO has been priced. Thus, orders are generally not accepted until the morning the new issue is to begin trading. In addition, Edward Jones is not permitted to accept market orders for any IPO prior to its trading in the secondary market.

**Special Purpose Acquisition Companies**

A special purpose acquisition company (SPAC) is a shell company (a company without active operations), which raises capital in the IPO market for the purpose of identifying and acquiring a private company. Often referred to as a "blank check company," SPACs have been around for many decades, but their popularity has increased significantly in recent years. As illustrated in **Figure 2**, gross proceeds from U.S.-listed SPAC IPOs totaled over \$29 billion in 2021. However, U.S.-listed SPAC IPO proceeds fell dramatically the following two years, as did IPO activity more broadly amid a sharp rise in interest rates.

**Figure 2. Gross IPO Proceeds 2014 through December 31, 2023 (\$billions)**



Source: S&P Capital IQ and Edward Jones

SPACs can provide an opportunity for retail investors to gain exposure to emerging, private companies at a relatively early stage. However, returns for SPACs have consistently underperformed the broader S&P in recent years.\*\*

**Recent Trends in SPACs**

Investor sentiment toward SPAC IPOs over the last several months has waned, as these companies have severely underperformed the broader market. In addition, increased regulatory scrutiny of SPAC IPOs has contributed to a deceleration of SPAC filings with the SEC. Then number of U.S.-listed SPAC IPOs decreased from 125 in 2021 to only 31 in 2023. We

believe that heightened market volatility in the near term, expectations for interest rates to remain elevated, and increased regulatory scrutiny are likely to be headwinds for future SPAC activity.

### Advantages

SPAC sponsors can generally raise capital quickly and at relatively low cost. By not identifying a specific target company at the time of the SPAC IPO, sponsors can also avoid extensive disclosure requirements associated with traditional IPOs. A merger with a SPAC can enable a private company to go public with greater ease and efficiency relative to traditional IPOs. It can also provide greater certainty of price and deal terms.

### Disadvantages

There are virtually no disadvantages for the SPAC sponsor. Upon completing a SPAC IPO, the sponsor can typically shop for 18-24 months for a company to acquire. If an acquisition is not made, cash held by the SPAC is returned to shareholders.

For investors, there are several disadvantages. At the time of the SPAC IPO, the sponsor has not typically identified a specific acquisition target. SPAC investors are putting their faith in the ability of the sponsor to acquire a private company at an attractive valuation. Prior to announcing an acquisition, SPAC shares may trade higher or lower, and investor liquidity may be limited by weak trading volumes.

Once the sponsor has announced an acquisition, the SPAC may seek shareholder approval, but it may not be required. If the SPAC proceeds with the acquisition, shareholders may remain as investors in the new operating company or redeem their shares.

*If the investor elects to redeem their shares, or if the SPAC fails to complete an acquisition, investors are only entitled to their proportionate share of cash held by the SPAC based upon the number of shares owned, not the amount of capital invested. For example, if the SPAC IPO price was \$10 per share and an investor acquired 100 shares in the open market at \$11 per share, the investor's share of trust assets would be only \$1,000, not \$1,100.*

Finally, while IPO investors provide most of the capital, sponsors may acquire equity interests at more favorable terms. There may also be changes to the capital structure just prior to completing the

acquisition that are beneficial to sponsors but made at the expense of shareholders.

### Investing Versus Speculating

Familiarity isn't enough. Even if you know the company's products and think they're great, make sure you've done your homework about the company's prospects and valuation before making an investment. If the track record of the company and its management is short or if the company is not yet generating profits, buying a stock on this basis is more speculation than investing. While the allure of buying into a new publicly traded company is exciting, it is important that investors maintain a long-term focus for their investments that fit with their objectives and risk tolerance.

\*\* Source: FactSet. Past performance is no guarantee of future results.

### Analyst Certification

I certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers; and no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report.

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