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MAM 183: Tim & Tom Talk IPO's Transcription

Tim: Welcome to the podcast this is Tim Mullooly. Today I'm here with Tom Mullooly and we're going to be talking all about IPO's or initial public offerings. There's a lot to know about IPO's. Some people don't really know what to make of them or if they're good or not to buy or what should we do with them. We're going to kind of spell it out for you, get into the what to know about IPO's.

Tom: Tim, I think really before we get into anything further about initial public offerings or IPO's, why don't you just explain to our listeners what is an initial public offering.

Tim: Right, probably a good place to start, an IPO, initial public offering is also, it's the first time that a stock of a private company is offered to the public. The company has been private for a little while, they decide we want to go public and offer some shares of stock to the outside world so they have an initial public offering.

Tom: When I'm buying shares of XYZ or ABC on the stock market and it's been trading for years and years, how much money does XYZ or ABC actually get when I buy their stock?

Tim: They don't get any of that.

Tom: Right, yeah so the only time that a company gets money from through a stock sale is the initial offering. The first time that they are, because they're the sellers of the stock, anytime that you're selling stock you get money in your account. When you're buying stock, you're taking money out of your account and you're investing it into something. The initial public offering is the first time that you're going to be permitted to buy the stock.

It's also the only time that the company actually gets the money from this sale. Now there are times where companies will do what's called secondary offerings. They take some of their shelf stock and they say we're going to issue five percent more shares as a way to raise money for the company. Really, the biggest way for people to get in on the ground floor unless you're an insider is through that initial public offering. I think a lot of people, new investors may not understand when you're buying shares of Microsoft, Microsoft doesn't get that money. You're actually just trading hands with someone else who's looking to sell Microsoft and you're buying their shares, that's really how it works.

Tim: Yeah and there's a lot of different market adages that you'd hear about IPO's. Sometimes if an IPO goes down people will say, well that's just the insiders selling their shares, why would you want to buy the company if the insiders are selling.

Tom: That's a really good point and a lot of IPO's or initial public offerings, if they don't work out that seems to be the recurring theme that you hear, well the insiders are selling which technically is true.

Tim: It's true but it's easy to say that in hindsight.

Tom: There's so many reasons why a stock can go down. Very few of them have anything specifically to do with that company, maybe their sector's out of favor, maybe that the market went down, the market was pulling back when the company went public. That's out of everybody's control. Yeah, we hear that a lot when folks buy or there's a popular initial public offering that a lot of people want and the stock goes down. Well the insiders are selling, why would you ever want to buy if insiders are selling.

Tim: Right but then it also works on the flip side as well. There's another adage, people can say well hey, if you bought ten shares of Google back at the IPO you'd be a millionaire by now. Again, hindsight is always 20/20. It's so easy to sit back here, play Monday morning quarterback and say yeah, you probably should've or it would've been a good idea to buy Google at the IPO if you could have but you know.

Tom: The news this week as we're recording this, some people are making note of the fact that Amazon has been publicly traded now for 20 years. If you had bought Amazon at the IPO and held onto it this entire time for 20 years you'd be a lot better off. I don't even know what the percentage returns are, they're gigantic. However, the likelihood of someone buying shares of Amazon on the IPO and holding onto them for 20 years is very small, very small. There are a lot of people who bought Amazon, sold Amazon, made a profit, bought it again, made more money, bought it, lost money. Amazon was an extremely volatile stock remember for 20 years we've been hearing from the company that they didn't make a profit this quarter. That freaks a lot of people out because a lot of people like to value their stocks based on what the companies are earning and what they're projected to earn.

If you have a company that is obviously doing billions of dollars in sales but they don't have any profit, that alarms people. That gets people very nervous. I think we're seeing the same kind of thing in some other newer companies that are trading. Brendan mentioned in one of our meetings about how Netflix had an 80% draw down at one point. To understand what draw down means, an 80% draw down would mean if you had a $100 stock and it had an 80% draw down, that stock is now $20. That would be hard to hold onto for anyone no matter what unless you're the mother of the chairman or the founder of the company. That would be really, really hard to do. I scoff when I see these news articles that say you know if you bought fill in the blank on the IPO and today, all these years later it's worth the national debt, 20 trillion dollars ...

Tim: It's just easier said than done when it comes down to it. The short term nature of so many people out there today just wanting to flip in and out of stocks, holding something for 20 years is not something a majority of investors do. It just doesn't happen.

Tom: It's I guess it's easy to say your broker calls you and says, you have 100 shares of, just listen to this scenario, broker calls you and says we got a hundred shares of this IPO for you. It was priced at 34, it just opened for trading at $160 a share, what do you want to do? First of all, you don't even want to know the name, you just made 125 points for free times a hundred shares, your broker just handed you $12,500 for free, what are you going to say?

Tim: Let's take it.

Tom: Yeah, sell it.

Tim: Yeah.

Tom: Later we'll get through the details. That happened a lot in another time. It doesn't really happen that much anymore, very difficult to get shares on the IPO. They are handed out with a microscope and a meat slicer. It's really hard for individual investors to get shares of initial public offering especially really popular initial public offerings so they're hard to come by.

Tim: Yeah, speaking of the popular public offering that's in the news today, I'm sure you all are aware of it, Snap also known as Snap Chat, currently making headlines for their IPO a couple of months ago. Just recently they had to report their first quarter earnings which were not so hot. People are wondering is it time to reconsider owning Snap Chat or Snap. You just don't know at this point.

Tom: Well, it's hard to know.

Tim: Yeah.

Tom: Companies can't tell you when they file a registration statement what their earnings are going to be, well let's back up a second. It's hard for companies to even tell you when they're publicly traded what their earnings are going to be exactly in the next quarter. They'll usually give analysts a range. There are no analysts or there's very few analysts that follow companies that haven't been publicly traded yet. They won't put anything in their registration statement that's a forward looking statement about their earnings or their business prospects. You're pretty much buying them blind without a lot of information. You may get some balance sheet information to see how much debt the company has and what they're going to do in terms of retiring debt when they get some money from the stock sale. It doesn't really talk to much about what their business prospects are. That's really kind of word of mouth. A popular name like Snap Chat that was really widely anticipated. A lot of people were looking forward to this thing, don't know if it's going to work out. Facebook kind of went down the same path didn't it?

Tim: I was just going to bring that up. Facebook was originally valued at $38 a share, within the first month or so it dropped below $20 into the teens right after the IPO, similar to what's happening to Snap. You look at Facebook now and it's $147 a share.

Tom: Trading a lot higher.

Tim: There really is no way of knowing. That's just one example of the way that it worked out with Facebook. I just want to stress and I think Tom would say the same, not all IPO's are going to work out the way Facebook did. That's just a prime example of one that worked out to the upside.

Tom: There's been a lot of studies out there that show that if you buy initial public offerings and just focus on IPO's a lot of them don't work out. Remember it's a business plan that you're buying into. It's not necessarily a long string of earnings like a more established company that's been around for a long time. It's really hard to gauge what the future prospects are going to be. It becomes easier to flip an IPO if you've made a quick profit in it. It's really dicey when you're getting involved with initial public offerings because there's no chart, there's very few analysts who are even going to talk about it especially when it goes into it's quiet period. There's a lot of things that are just too dicey to tell. It really is for the speculators more than anything else.

Tim: There's just a lot of risk involved in the unknowns of the IPO and you really when it comes down to it, you have to do your homework and kind of realize or be self aware enough to know if you have the risk appetite to handle buying an IPO.

Tom: Now this, what I'm about to say is not a recommendation whatsoever but it's important to know that there's the IPO price and then there's the price where a company starts trading. A company can price their shares on a Thursday night after the market closes based on demand for their stock. Say they price their stock, they're going to sell 20 million shares at $31 a share. It's a widely anticipated IPO and the stock begins trading, it was priced at 31 but it starts trading at 38. If you got it on the IPO you get it without a commission and you get it at $31 a share. If it starts trading at 38, you've got a built in seven dollar profit. If it's a really popular company, there's going to be a lot of people looking to buy that stock at 38, 39 maybe $40. That's what kind of gives these things a little bit of gas, if they're really popular or there's a great deal of demand is that there's a good after market for people who didn't get it on the IPO to start buying it on the first day of trading. Again, highly speculative, not for everybody so unless you've got that large appetite for risk, IPO's, initial public offerings may not be for you.

Tim: It would probably be better served if you're a more moderate or conservative person not really ready to ramp up the risk, it'd be better off just waiting, seeing once the company gets established if they have a good track record. Obviously, you do your homework at that point and whether it would work out in your portfolio or not, at least you have some more of a background on the company and more details about it to know that it'd be a better fit for you.

Tom: Yeah.

Tim: Pretty much.

Tom: That's really it. Really, when it comes right down to it it's doing your homework and being more self aware to realize do you have the appetite to handle IPO's. There's always these glamorous moon shots that work out and there's a lot of duds in between, good topic to talk about in the podcast today.

Tim: Yeah that was a lot to process about IPO's. Hopefully now you can come out of listening to this podcast with a better understanding and sit down and think to yourself if you have the appetite for risk to hold onto one of these IPO's.

Tom: If you've got questions about an IPO or about an investment in general that you'd like us to talk about, you can reach out to us. Our phone number 732-223-9000 or you can find us on the web at Mullooly.net. Thanks for listening.