IPOs (with an eye on Lyft)

Christopher G. Lamoureux

April 12, 2019

Economically Small

Today there are some 3,600 publicly traded companies in the US, with an equity market capitalization of around $30 trillion. (Although the market value of the float – i.e., publicly traded shares – is closer to $24 trillion.

- IPOs captivate media for many reasons.
- We should bear in mind that the attention is not justified by the dollar amounts.
- The average IPO in 2018 raised $1.7 billion.
- Lyft's IPO on March 29, 2019 sold 30.7 million shares at $72 per share ($2.2 billion).
- When market closed on March 29, 2019 Lyft's stock price was $78.29.

IPOs occur in waves

- 1980 - 1991 Average 204 per year
- 1992 - 1999 Average 370 per year
- 2000 - 2013 Average 123 per year
- 2014 - 2018 Average 128 per year

Is 2019 a return to the hot IPO markets of the late 90's?

Largest US IPOs

IPO data has to be tempered by the very large foreign (esp. Chinese) offerings which are very different. (They provide a vehicle for Chinese dollar investments.) For example in September 2014, Alibaba did a US "IPO" that raised $25 billion.

1. GM (post bankruptcy) November 2009, $20.1 billion *raised*.
2. Visa March 2008, $17.9 billion.
3. Facebook May 2012, $16 billion.
4. Amazon 1997, $60 million.
5. Google August 2004, $1.7 billion.
6. Microsoft March 1986, $61 million.

Other notables: Goldman-Sachs May 1999, $3.7 billion and UPS November 1999, $5.5 billion.

Why?

- Unlike debt, equity does not encumber the firm with interest payments.
- Existing owners have a more liquid market in which to sell shares (often after a lock-out period).
- Being public may:
  - Provide a useful daily barometer of value.
  - Create good publicity
  - Enable better incentive packages for executives and employees.

The dark side?

- Being a publicly trade company places you under SEC regulations and analyst scrutiny.
- Requires expertise in investor relations.

My sense is that the costs here are often over-stated. For example, we hear that being publicly-traded forces a myopic perspective (focused on quarterly earnings). But this ignores the fact that owners want to maximize value.

Steps

- File a red-herring prospectus (Lyft March 18, 2019):
  - Select underwriters: JPMorgan; Credit Suisse; Jefferies.
  - Number of shares: 30.77 million.
  - Price range: \$62 -\$68.
  - Underwriters accompany corporate execs on *Road Show*.

Book building

Odd that at the point of a company raising external *public* capital for the first time, we abandon the capitalist system (i.e., the price mechanism) and instead use an opaque allocation rule.

Lyft's road show included:

- March 18-19: NYC meetings with small groups.
- March 20: Boston
- March 21: Lunch in NYC with larger group, including lunch at St. Regis Hotel.
- March 22: Baltimore.
- March 25: San Francisco, including lunch at Omni Hotel.
- March 26: LA and Kansas City.
- March 27: Chicago and Minneapolis.
- March 27: LA.

Road show -2-

- Managers I have spoken with tell me the investment banks are free-spending with the company's money on the road show.
- Book building – following the presentation, the bankers will pull the investors aside and ask them how much they would want at various prices.

On the offering date the investment banker sets a price and all shares are sold to the investors at that price. The allocation is strictly up to the bankers. Generally, the public will be shut out of hot IPOs as the bankers reward cronies by them allocating the lion's share.

I have always advocated an auction – which would determine a market price.

Over-allotment Option

- Aka: Green Shoe option
- 15% of the initial shares.
- Puts investment banker in a win-win situation:
  - Creates large short position to satisfy demand (at sales prices higher than offering price).
    - Note the rare exception to naked shorting restrictions in this special case.
  - If price continues to rise, then it exercizes the Green Shoe option
  - If the price falls, then it "stabilizes" by buying below offering price.
- Company sometimes surprised that it offered 15% more than the filing.

Underpricing

- Over the past 30 years the dollar-weighted average underpricing (relative to first-day closing price) is: 18.4%.
- In 2001-18 this is 13.4%.
- 1999-2000 it was 51.7%.
- 1980-1998 it was 13.3%.
- Lyft: $\frac{78.29-72}{72} = 8.7\%$.

Long-term performance

The average market-adjusted return on IPOs over the 3 years following the IPO: -18.4%.

Flops

- Anecdotally we see industry waves: Amazon super successful, but:
  - Pets.com 2000 raised $82 million and bankrupt after 9 months.
  - Webvan.com 1999 raised $375 million – bankrupt after 18 months.
  - etoys.com 1999 raised $166 million (jumped from offering price of $20 to $76 on first day trading) – bankrupt after 18 months.
- Perhaps the high demand for internet exposure allowed companies with no chance of success an opportunity to raise public equity. (Note in this case that all 3 of these flops have names that end in *.com*.

Trading / Shorting

- In the US in order to short a stock you have to borrow the shares from an owner.
  - Note that the investment banker (anticipating the over-allotment option) is a huge exception to this regulation.
- The book building process is not designed to identify prospective short sellers.
- A new technology can generate large differences in valuations.
- Large open interest in short-term put options. Bears may be buying puts.
- Look at put-call ratio to infer.

Trading / Shorting -Lyft

- The demand to short Lyft is high:
  - http://lamfin.arizona.edu/talks/LyftShort.txt "The Short Sellers are Coming for Lyft – But will they get squeezed?" *Fortune*. April 5, 2019
  - https://s3partners.com Fascinating research from S3 Partners.
- http://lamfin.arizona.edu/talks/LyftHolders.gif Lyft Owners (Bloomberg).