2 Reasons Investors Should Avoid IPOs

Description

There's nothing like a new issue that can generate a lot of excitement in the markets. We saw it with **Snap** a few years ago, and this year there was a lot of anticipation surrounding **Uber** as well. **Beyond Meat Inc** (NASDAQ:BYND) has had a terrific showing since going public, as its value has more than doubled since it began trading.

Its plant-based burgers have proven to be a hit with consumers and investors have been eager to own the stock as there's definitely a lot of growth potential there.

The problem, however, is that while IPOs can be fun and exciting to buy, they aren't the safest investments. The world's most successful investor, Warren Buffett, has no interest in buying IPOs, and that alone should have investors asking why. Given the success we've seen with Beyond Meat and other popular IPOs, investors might think it's a sure thing. Unfortunately, it's often far from it and there are a couple of reasons why I wouldn't bother with buying the latest IPO either, regardless of the company going public.

Returns aren't as good as advertised

If you can be one of the lucky few with access to an IPO at its offering price, then you can definitely earn a good return on day one. While investors of Beyond Meat who were able to buy at $25 made out very well on day one or even up until now, for most investors, that wasn't a possibility. Instead, the price for the general public was really $46, which is what the stock opened at.

While in Beyond Meat's case it would still have turned out to be a good buy, with the stock climbing to over $72 on day one and rising even higher since then, the returns that the media often reports of an IPO jumping a certain percentage is often inflated, as it's counting from the offering price. And while it's not wrong, it can certainly be misleading to investors who think they can make those returns too if they buy on day one.

One of the best investments this year has been in Canadian-owned **Lightspeed POS Inc.** (TSX:LSPD). Unlike Beyond Meat, however, it didn't have a big surge on day one and from its open price of

$18.10, it rose as high as $20.22. However, it would go on to hit over $36 by the end of June. The reason for the jump in value came at the end of May when the company released its Q4 results, which brings me to another important issue with IPOs:

There are a lot of unknowns

While investors do get a prospectus they can read before a company goes public, it's not going to do much for an individual investor in determining where the stock will go. As the information is technically public knowledge, we can say that the company's profits, its margins and its past growth have already been priced into the offering price. Investors can gain insight into the company and make their own individual assessment of what they feel the stock is worth, but it may not be very helpful in predicting where it will go.

The big reason that Lightspeed's stock went on to double wasn't because of anything in its prospectus; rather, it was because the company beat expectations in Q4 and its price target was raised. These are two things the company never had to deal with before: earnings expectations from the markets and analyst price ratings.

Lightspeed and other new issues face a lot more scrutiny and that can make it very challenging to set and meet targets for sales and profits now that there's a lot more pressure to perform.

Knowing how a company will perform once going public is a big unknown, and investors shouldn't assume that it will operate the same way that it did when it was private. There will be more questions, more reports and more things the company will need to focus on. For some public companies, [going back to being private just makes a lot more sense](#).

CATEGORY

1. Investing

TICKERS GLOBAL

1. NASDAQ:BYND (Beyond Meat)
2. TSX:LSPD (Lightspeed Commerce)

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Date
2025/06/29
Date Created
2019/07/05

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