The Krygier Report

An exclusive newsletter from Mark J. Krygier, Vice President & Portfolio Manager | May 2019 www.krygierwealthmanagement.ca

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Need a Lyft? Try Uber…

Recently we saw the debut of "new-world" drive-share company Lyft Inc. make its way onto the public stock markets. Its newly issued shares first started trading on March 29th , as its "IPO" (Initial Public Offering) beat out its larger competitor Uber to the race to go public. Lyft's IPO price of $72 may have made its founders wealthy, especially as it "opened" trading at $87.24, up over 21% from the IPO price, but buyers of its shares as an IPO who did not sell on the open, or for those who bought shares after they started trading on the public markets, well…not so much. At the time of writing this newsletter, Lyft's stock was trading at $58.60, down 18.6% from the initial IPO price, and down a whopping 36% from its opening trading price a few weeks before. While recent prices are slightly better than the lows of $55.56 it hit barely two weeks after it started trading, so far, it has not exactly been a money-maker – except for the founders of course. Naturally, in this world of "transparency", we also have to consider that the Private Equity or Venture Capital funds that helped take the company public, not to mention the investment banks underwriting the deal, also made a lot of money for bringing the company from private company status to the public markets.

For retail investors, trying to get in on the potential growth of "ride-sharing", or any other new concept company, investing in an IPO can have a lot of appeal. Firstly, it gives one "bragging rights" at the proverbial water cooler, that one is connected with the "right" people just to be able to get access to the IPO. Secondly, those that try to price an IPO will generally try to leave some "money on the table", so that early investors in it get some return for the risk capital they are willing to put out of their own pockets, and getting in at the IPO price at least gives one certainty with regards to one's maximum risk exposure. However, beyond the greed of trying to pick-up a short-term winner and the accompanying bragging rights, a longer-term investor has to really consider whether it makes sense to participate in any IPO. Part of this decision-making has to include information about who is taking the company public and for what reason. Going "public" gives a company "currency" of publicly-traded shares, which can be used to purchase other companies, rather than using valuable cash to do so. To get some understanding of managements' views of a company's future after it goes public, reading its prospectus can be enlightening. For instance, in the latest new concept IPO, "Pinterest", which offers web-based picture album-making, the prospectus describes its business model as, "a media-rich utility that satisfies both emotional and functional needs." Huh? As they say, "that and a dollar will get you a coffee." My water, gas and electricity are utilities, things I need. One doesn't need Pinterest at all.

So who were the early, "pre-IPO", investors in Lyft? They included activist investor Carl Icahn, Didi Kuaidi, a Chinese ridesharing company, Andreessen Horowitz and Founders Fund, two large venture capital firms, Rakuten, a Japanese e-commerce company, as well as Prince Alwaleed bin Talal of Saudi Arabia. Interestingly, despite being prominent supporters of Lyft, the venture funds each sold $75 million of their stock holdings to Prince Alwaleed, shortly after the shares started trading. Consider why they would sell the shares so early. As Jared Dillian, portfolio strategist, comments, "They're not selling because they think it's going higher." In business, it is normal practice to give incentives to senior management to motivate them to grow the company's profits. Growth in the business should be reflected over time in its stock price, which rightly aligns the interests of management with those of its shareholders (or "partners"). However, it is highly strange that the CEO of Uber stands to benefit immensely, simply based on the price that gets set for its upcoming IPO – you read correctly, not for growing the company's earnings, not for meeting long-term business plan objectives, which ultimately benefit all shareholders, rather; just for getting a particular (high) price when its starts trading. How does that incentive fit within the notion of aligning interests of management with that of shareholders? As Mr. Dillian summarizes, "Never buy a private equity or venture capital backed IPO."

Finally, it is crucial to get some understanding about how a given company intends to grow its earnings over time, and more importantly, its profitability or "bottom line". Whether it's Lyft, Uber, Pinterest, Airbnb, etc., does the business model lend itself to being profitable over time? Mr. Dillian refers to many of these new concept companies as "intractable businesses", as he states, "Lyft basically has no shot at making money. Uber has no shot at making money." Is that the type of "investment" into which you want to sink your hard-earned money?

Bottom line

The hype of IPOs is always exciting, and watching management of the latest "new concept" company "ring the bell" to open the markets is a great photo-op. However, investing in hype is often that, as when the hot air comes out of a balloon, it has only one direction to head and that's down. Taking an "Uber" is easy, affordable and convenient; investing in it is an altogether different decision.

Global benchmarks
As at April 30, 2019 (Canadian $ Returns)

Asset class	1 year	3 years	5 years
S&P/TSX Composite T/R (Canada)	9.6%	9.1%	5.6%
S&P 500 TR - US$	13.5%	14.9%	11.6%
NASDAQ Composite - US$	14.6%	19.2%	14.5%
MSCI Europe Index Price Return	-1.8%	6.2%	2.5%
MSCI Emerging Markets	-3.4%	11.1%	5.8%
China S.E Shanghai A Price Return	-2.1%	2.5%	11.5%
MSCI World Index Price Return	8.9%	11.6%	9.5%

Asset class	1 year	3 years	5 years
30-year U.S. T-Bond - US$	7.0%	1.0%	4.8%
10-year U.S. T-Bond - US$	6.9%	0.4%	2.5%
Long GOC Bond (2048)	11.5%	2.5%	6.0%
10-year GOC Bond	7.6%	1.6%	3.6%
5-year GOC Bond	4.9%	0.9%	2.1%
3-month CDN T-bill	1.5%	0.9%	0.8%
US$/CDN$ (1.3386)	4.3%	2.2%	4.1%

Source: RBC Capital Markets Quantitative Research

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