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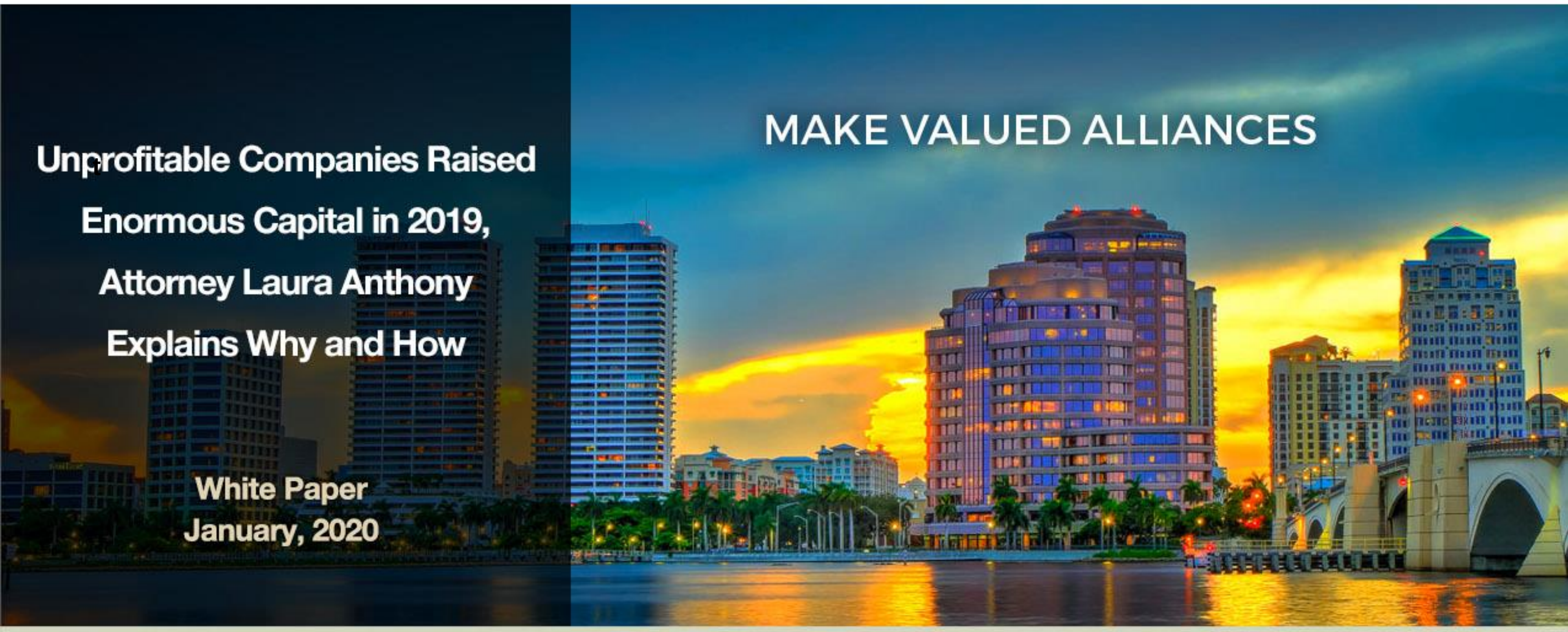

Unprofitable Companies Raised Enormous Capital in 2019, Attorney Laura Anthony Explains Why and How

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Somewhere, way in the back of your closet, you may have a white cotton sport jacket or a business suit with shoulder pads. They're garish, woefully out of style, but you can still remember when they were the height of couture, and wearing them felt so very natural. Every time you considered parting with these treasures from the past, you just couldn't pull the trigger.

For reasons unknown, style being a fickle mistress, you wake up one day and you see one or two of the "in" crowd wearing parachute pants and moon shoes with Velcro closures. Voila, everything old is new again.

Fashion and finance share the same fundamental characteristics. People either forget how ridiculous some of these clothes and trends actually were, or, inversely, they remember them as being better than they actually were. Hence, history repeats itself over, and over, and over again.

Recently it seems that investors have either forgotten the gut-wrenching heartbreak of the dot-com bubble or have come to miss the radical volatility so much that they're back for more. In the past year, unprofitable companies such as Uber Technologies Inc., Lyft Inc., and Pinterest Inc. have collectively raised more capital by going public than has been raised in any other year since the year 2000.

There's an adage in finance that provides insight into IPOs: the one's you want you can't get, and the ones you can get you don't want. Just like the final days before the dot-com crash, these underwater companies are overvalued. Analysts are often overly optimistic, putting their thumbs on the scale so to speak. Ultimately, the reason why these market entrants flopped on the open doesn't matter. The only thing that investors care about is that the corresponding share prices sank like a rock in a pond.

Once again, all are reminded that gravity is a law, not a suggestion. All things go down remarkably faster than they go up.

It seems impossible, or at least improbable, that the investment public would pay to see the same bad movie twice. However, like most unbelievable events, there is a very simple explanation.

The investors that fueled the dot-com bubble of 2000 may have been bruised and battered by the collapse of the NASDAQ, but they all came away wiser and equipped with more well-honed instincts in terms of market dynamics. These survivors now constitute the smart money investors.

To contemporary speculators, the dot-com bubble is indeed a formidable legend, but not a firsthand experience. They know the companies Uber, Lyft and Pinterest, or at least they know the names, and feel secure investing in a product or service that they themselves use on a regular basis. All things being equal, the overvalued companies going public today are far more credible than their counterparts from two decades ago. Even so, their valuations are still over inflated, their bottom lines are in the red, and even their celebrity cannot bolster their corresponding share prices.

Long story short, the economy rallies, it peaks, it declines, and the process starts all over again. This is an easy concept to explain, but when the indexes are consistently reaching new record highs, it is difficult to instill the importance of historical perspective and temperance into the average retail investor.

So, there have been a few lackluster IPOs recently; some investors are disappointed, the media is eating up the bad news, and a the few sky's-the limit companies are now a bit tarnished. Take the emotion out of the dynamic and it's not as bad as it seems.

In 2012 Facebook went public. The IPO was the biggest in technology and one of the biggest in Internet history, with a peak market capitalization of over $104 billion. The company originally aimed for a valuation of anywhere from $28 to $35 per share.

Facebook was a juggernaut and public demand was strong, particularly from retail investors. It seemed logical for the underwriters to agree on an offering price of $38 per share, the top of its target range.

About 48 hours prior to the opening bell, Facebook announced that they had increased the amount of the highly anticipated IPO shares by 25%. After all, public demand was strong so it only made sense to give the people what they want. All in all, 421,000,000 shares would be sold in the frenzied IPO.

A week after Facebook shares were gobbled up at $38 the first day of trading, the share price closed at $26.81, a decline of 30%. Losing 30 cents on the dollar has never, and will probably never, constitute a catastrophe, but investors were livid.

The morning of the Facebook IPO, anyone with a pulse and a computer was convinced the company's share price would be a bottle rocket. IPO investors were deprived of their rocket-ship ride to the moon and, to rub salt in the wound, the share price even declined.

As to be expected, the blame game began. Fingers were pointed, and analysts were blamed for using the Facebook IPO as a way to gain national exposure. The national media was interviewing any and all financial experts at a breakneck pace and if there was ever an opportunity for an unknown market guru to break into show business, this was it.

According to Wikipedia, Sterne Agee analyst Arvind Bhatia pegged the company at $46 in an interview with The Street. The interviewer cautioned Bhatia against what she perceived as Bhatia's low valuation, suggesting the stock could rise to "60, 70, 80 dollars" and could shoot up to $60 on the first day of trading.

On May 17, the day before the offering, analyst Jim Krapfel of Morningstar suggested that only a 50% or better increase on the first day would be seen positively: "anything under that would be underwhelming." Lee Simmons of Dun & Bradstreet predicted more modest first-day gains, in the range of 10 to 20%.

The icing on the cake was oh so sweet. Not a single analyst interviewed by Reuters predicted a day-one decrease in Facebook's IPO shares – not one.

The Facebook IPO came and went, some hoopla ensued, and everyone cooled their heels, licked their wounds and moved on.

By July 20, 2018, Facebook shares traded above $209 and this price was not some flash-in-the-pan anomaly. Shares currently trade in the $175 to $190 range, and the company continues to overcome every last obstacle that is dropped in their path: dubious privacy policies that resulted in a political consulting firm gaining access to tens of millions of users' data, accusations that their response to Russian agents exploiting their platform by planting fake news and espousing violent rhetoric, and even accusations that Facebook itself is designed to be addictive.

There are even some highly vocal political types who claim that Facebook is too powerful, if there actually is such a thing where shareholders are concerned. This is all pretty astonishing for a company whose IPO was bemoaned as a debacle.

The moral of the story is that somewhere along the line, the term IPO experienced a paradigm shift or a severe mass misinterpretation at the very least. An initial public offering is just that: a jumping-off point, the first opportunity for retail and institutional investors to pony up and purchase a fractional ownership in a company that was once "invitation-only," meaning privately held.

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Valuation, Expectation and Anticipation

Going public seems like a run-of-the-mill process to the man (or woman) on the street. A promising, well-managed, innovative private company needs capital to grow and what better way to accomplish this than by giving everyone a chance to buy a slice of the pie. The real mysticism is the manner in which IPO shares are priced. This process is known as the valuation; equal parts science, art and understanding how badly retail and institutional investors want in.

There are three established approaches to valuation used by investment bankers; financial modeling, comparable company analysis and precedent transaction analysis. In a perfect world, financial gurus can combine these three methods and determine a fair and reasonable price for the IPO shares. At the end of the day the aforementioned is all a best-guess.

This is where the IPO world goes sideways.

Once the share price is determined by the issuer (the company going public) and their investment bankers, the actual IPO share price can be set lower to theoretically provide the day-one investors with an incentive to purchase the IPO shares. Conceptually, this makes perfect sense.

The issuer has no obligation to set the share price lower than what they believe the market will accept, but since this has happened in the past, IPO investors have come to expect this from every IPO. Since people generally scream about their successes from the rooftops and never mention their failures, the legend of the hot-issue IPO continues to thrill the investment public.

Backing up a step, let's remember that the definition of the term IPO says absolutely nothing about a share of stock being sold at a price lower than its calculated value.

To believe that the term IPO means anything else is somewhat reckless. However, the misinterpretation or misunderstanding of three simple letters, I-P-O, has endured for so long that its true meaning is almost without fail, overlooked, even though so many of these issues fail to rally on opening day.

When an IPO's share price fails to close on opening day higher than the debut price, investors begin to harp on the fact that an unprofitable company went public to begin with. This form of naysaying fails to take one important fact into consideration. Financials for all public companies are fully disclosed so any and all potential investors can decide for themselves how much risk they are willing to assume.

Like any other issue, each IPO must be evaluated independently, one has nothing to do with another. Potential investors must conduct their own due diligence objectively, without being influenced or becoming emotionally biased by any preconceived notions about the mystique of initial public offerings.

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Palm Beach securities attorney Laura Anthony and her experienced legal team provide ongoing corporate counsel to small and mid-size private companies, OTC and exchange traded public companies as well as private companies going public on the Nasdaq, NYSE American or over-the-counter market, such as the OTCQB and OTCQX. For more than two decades Anthony L.G., PLLC has served clients providing fast, personalized, cutting-edge legal service. The firm's focus includes, but is not limited to Regulation D and Regulation S and PIPE Transactions, securities token offerings and initial coin offerings, Regulation A/A+ offerings, as well as registration statements on Forms S-1, S-3, S-8 and merger registrations on Form S-4; compliance with the Securities Exchange Act of 1934, including registration on Form 10, reporting on Forms 10-Q, 10-K and 8-K, and 14C Information and 14A Proxy Statements; all forms of going public transactions; mergers and acquisitions including both reverse mergers and forward mergers; applications to and compliance with the corporate governance requirements of securities exchanges including Nasdaq and NYSE American. Palm Beach attorney Laura Anthony is also the author of SecuritiesLawBlog.com, the producer and host of LawCast.com, Corporate Finance in Focus, and a contributor to The Huffington Post and Law360.

Ms. Anthony is involved throughout the community of Palm Beach. She is on the board of directors for the American Red Cross for Palm Beach and Martin Counties, and provides financial support to the Susan Komen Foundation, Opportunity, Inc., New Hope Charities, the Society of the Four Arts, the Norton Museum of Art, Palm Beach County Zoo Society, the Kravis Center for the Performing Arts and several other organizations. She is also a financial and hands-on supporter of Palm Beach Day Academy, one of Palm Beach's oldest and most respected educational institutions. She currently resides in Palm Beach with her husband and daughter.

Ms. Anthony is an honors graduate from Florida State University College of Law and has been practicing law since 1993.

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