

FINANCIAL SERVICES

## Is profitability necessary for a good IPO?

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Making profits is the goal of every young business. Or is it? This year has seen a record number of companies having successful IPOs before ever reaching profitability.

Investors have not gone mad quite the opposite, in fact.

The value of a stock has never really been about current profits. For young companies it has always been about the future.

Investors are betting that these young companies are poised for greater things.

Not by the book

Few remember that Amazon was a money-losing bookseller when it went public in 1997. It lost money lots of money until 2003.

Smart investors held on, seeing huge potential in the volume the company could achieve.

Now Amazon is not only profitable, it is one of the highest-valued stocks on the market.

No one wants to miss the next Amazon.

That does not mean that profits are not important, however.

Take the case of Uber and Lyft. To keep investors a company should be able to show a pathway to profitability. Both of these companies had highly-valued IPOs in 2019, but now both are trading for well below their offering price.

Neither car-ride service has been able to convince investors that they will become profitable.

In the second quarter of 2019, Uber lost \$5 billion. That is in *one quarter*. That helps explain why a stock that originally traded at more than \$40 is now worth less than \$30, and why investors and talent are leaving Uber in waves to join startups with a better outlook.

Looking at Uber helps explain why the WeWork IPO was dramatically withdrawn recently.

WeWork's prospectus showed 2018 revenue of an impressive \$1.8 billion, but losses of a frightening \$1.9 billion. The

IPO was pulled as the expected value of the company dropped.

But losses do not mean a company cannot have a successful IPO.

Food for thought

Beyond Meat, the plant-based meat alternative company, has yet to post a profit. But investors who believe that the market is poised for a product like this have driven the stock price from an initial \$65.75 to over \$145.

Investors are betting on the public's growing desire to eat healthier.

Varying industries can also dictate the need for profit.

In the biotech industry, companies often run years without a profit. But when the profits come, they can be huge.

Twist Bio, a biotech company working to deliver synthetic DNA, has yet to earn money, but has climbed 64 percent in value since its IPO last October.

Elon Musk is perhaps the master of telling the future profit story.

Tesla which has bounced in and out of profitability has a market value higher than the Ford Motor Co., even though its output is a fraction of Ford's.

Investors believe that Tesla is more valuable because of its vision for the future and lead in electric vehicles.

So, profits matter to investors, but it is not necessary for a good IPO.

A company's vision is more important. The story that is shared with the market helps investors assess the trajectory of a company.

Investors bet on the future, not the present.

IF YOU ARE a CEO looking to take your company public, focus as much on your vision and how you communicate your vision as you do on your current financials.

If investors have confidence you know where you are going, you will maximize value.

If you are an investor, however, think through the story and see if it really seems plausible.

Sometimes a money-losing company is a huge opportunity, but sometimes it is a dog with a good storyteller at the helm.

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