

## Session 18

### Get in on the ground floor: The IPO story

#### *Test*

1. When a private business becomes a publicly traded company, which of the following best characterizes what happens to its riskiness as an investment?
  - a. The company's risk does not change.
  - b. The company becomes less risky, because it is publicly traded.
  - c. The company becomes more risky, because it is publicly traded.
  - d. The company's risk does not change, but the investors in the company are more likely to be able to diversify away some of that risk.
  - e. The company becomes more risky, but the investors in the company are more likely to be able to diversify away some of that risk.
  - f. The company becomes less risky, but the investors in the company are more likely to be able to diversify away some of that risk.
2. When a company decides to make an initial public offering, it usually uses an investment bank or banks to manage the offering. These banks generally offer an underwriting guarantee. Which of the following best describes this guarantee?
  - a. The bankers guarantee that they will deliver the fair price of the shares to the issuing company.
  - b. The bankers guarantee that they will deliver the highest price that they can get to the issuing company.
  - c. The bankers guarantee that they will deliver the intrinsic value to the issuing company.
  - d. The bankers guarantee that they will deliver the offering price (that they set) to the issuing company.
  - e. The bankers guarantee that they will deliver the book value of equity to the issuing company.
3. Which of the following best describes what studies that look at the offering date for IPOs have found?
  - a. The stock price for every IPO increases about 10-15% on the offering date.
  - b. The stock price for most IPOs increases about 10-15% on the offering date.
  - c. The stock price for some IPOs increases about 10-15% on the offering date.
  - d. The stock price increases, on average, about 10-15% across on all IPOs on the offering date.
  - e. None of the above
4. Assume that you decide to set up a mutual fund to invest in IPOs. To take advantage of the underpricing found in IPO studies, you decide to apply for an equal dollar allotment in every listed IPO. Which of the following can you expect to see in your portfolio?
  - a. An equally weighted portfolio of all IPOs.

- b. A portfolio that is weighted more heavily with under priced IPOs.
- c. A portfolio that is weighted more heavily with over priced IPOs.

*Explain. What can you do to mitigate this effect?*

- 5. If you invest in IPOs after the offering date and hold the stock for the long term (3-5 years), what do studies suggest about your returns?
  - a. You will generate positive risk-adjusted returns, i.e., you will generate higher returns on a risk-adjusted basis than you would have investing in seasoned stocks.
  - b. You will generate zero risk-adjusted returns, i.e., you will generate about the same returns on a risk-adjusted basis than you would have investing in seasoned stocks.
  - c. You will generate negative risk-adjusted returns, i.e., you will generate lower returns on a risk-adjusted basis than you would have investing in seasoned stocks.