MV Capital Management Weekly Market Flash

Candy Crush: End of the Silly Season?

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Stop us if you've heard this one before: an Internet company with an unproven, highly risky business model values itself at gajillions of dollars and offers its shares to credulous investors who never seem to learn their lesson…

2014 has been a choppy year for equities thus far, with the S&P 500 struggling to keep itself above the level at which it ended 2013. But weakness in the broad market has not stopped entrepreneurs and venture capitalists from enjoying the most fecund environment for initial public offerings – IPOs – since the final spurt of the dot-com bubble in the first three months of 2000. Sixty-two new issues have been priced and offered so far this year. But this week gave a sign that the good times may be coming to an end. That sign has a befitting name: "Candy Crush".

Crushed

This past Wednesday King Digital Entertainment PLC, a U.K. company with an online game application called Candy Crush Saga, went public with a $6.8 billion price tag. That's right – a company known for a single (albeit extremely popular) game was deemed to possess a higher market worth than Avon Products or Goodyear Tire, to name just two well-known brands that have been around for a much longer time. That valuation was based on the set offering price of $22.50. On this day, though, the market did not agree with the numbers wisdom of King and its investment bankers, JPMorgan. Share prices quickly went into freefall and finished the day at $19.00, 15.9% below the offering price. Perhaps virtual lollipop hammers which crush gumdrops are not all they're cracked up to be…

Rotation Ahead?

King's miserable opening performance was not entirely of its own doing; there are other signs of a chill in the high growth sectors of late. Earlier in the week the red-hot biotech sector gave up more than 6% in a broad two day sell-off, sparked by concerns over a Congressional inquiry into the pricing practices of Gilead Sciences, a maker of drug treatments for hepatitis C. The blues surrounding the King IPO caught other tech names in its downdraft – sector darlings Twitter and Facebook, among others, were big losers that day. In the broader market we see the evidence slowly mounting for a rotation away from growth back into value sectors and styles.

Beware the IPO Hype Machine

IPOs are sexy: there is hype and glitz and new gizmos ready to turn the world as we know it upside down. But they often have considerably less appeal as smart investments. There are exceptions, of course. Google's shares today are worth more than 1,000 times where they debuted in 2004. But those are the exceptions, not the rules. Most IPO companies do not, in fact, go on to "change everything" as the hype promises. Maybe those lollipop hammers really can beget a category killer for the ages. But in our opinion it may be a bet worth not taking.

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