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Beware! Unicorns have a habit of failing in public markets. Here's why

Synopsis
Zomato, which is valued at $9 billion, is generating revenues of close to Rs 2,000 crore, but incurring losses to the tune of Rs 816 crore. Mai analysts are scratching their heads, trying to figure out a way to value 'this giant' sitting on crores of losses, as public markets have a habit of searching for value in the financial statements.

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There has been excitement and euphoria among Indian equity **investors** over the IPO of new-age tech-driven company Zomato, which has already made it to the Club Elite of Indian Unicorns.

Unicorns tend to 'specialise' in the art of commanding billion dollar valuations, irrespective of their profitability, as deep-pocket investors from the **private equity** (**PE**) world willingly partake in the 'well-narrated rosy story, with the promise of thumping success in the future,' which discounts several years of earnings down the line.

One such Indian Unicorn with billion-dollar valuation, not Zomato, is now working hard to generate one rupee by burning Rs 700 plus (burning is a much more acceptable word in the PE world, when they prepare to destroy scarce economic resource in pursuit of future profits). That's the power they command.

Zomato, which is valued at $9 billion, is generating revenues of close to Rs 2,000 crore, but incurring losses to the tune of Rs 816 crore. Many analysts are scratching their heads, trying to figure out a way to value 'this giant' sitting on crores of losses, as public markets have a habit of searching for value in the financial statements.

Unfortunately, these concept stocks do not have any value to offer in their financial statements, except selling mighty dreams with rosy presentations, for which there is a ready buyer at every stage, who also pay higher valuations. That buyer is often referred to as the 'greater fool' in the private market, who seems to be simply following the mantra of 'higher the risk, higher will be the profit'.

But they are deep-pocket investors with high risk appetite. They are okay writing off even 100% of their investments as and when the need arises, and still move ahead with confidence. That's where public markets entirely take an opposite stance, by looking for substance in the financial statements for which they would like to pay by discounting visible future earnings.

Analysts apart, investors outside of the PE world too are equally perplexed over Zomato's valuation, as financials for this category of stocks will not offer any clue on valuations. These investors seem to be caught between greed and fear, as they want to own a piece of it at any cost, but at the same time fear losing capital, as the valuations are already at an astronomical high, without leaving anything on the table for the investors.

Decision making becomes more complicated when one looks at some of the e-commerce companies like Amazon, doing extremely well in public markets by delivering multifold returns to stock investors, which makes one try and want to not miss the bus.

Under these circumstances, the best thing for investors to do it to look at their listed peers and check how they are faring in public markets globally. Fortunately, we have several listed companies in the developed markets that belong to the 'Zomato Family' and offer similar services through tech platforms.

There was a lot of excitement surrounding unicorns like **Lyft, Uber**, We Work, Door Dash and Deliveroo before their listings, and they were touted as game changers in the tech space. Let us see what some of them have delivered to investors after migrating from private markets to public markets.

Lyft Inc got listed in the US markets in March 2019 at a debut price of $72, and saw a modest gain of 8%. This company operates a mobile app that offers vehicle hires, and is considered a tech giant in the US. After the listing day pop, the stock embarked on a southern journey and is still struggling below the issue price with a 52-week high and low of $68 and $21, respectively.

Uber Technologies listed in May, 2019 at an IPO price of $45 and proved to be a disaster on the debut day itself, as the stock settled below the issue price. It now quotes a 52-week high and low of $64 and $28, respectively.

Co-working space firm We Work planned an IPO at a valuation of $47 billion in 2019, but it got caught up in a controversy within a month and its valuation got trimmed down to $10 billion. That led to an adjournment of the IPO sine die. The company is still struggling, and it was reportedly still planning an IPO at a valuation of $9 billion.

In December 2020, food delivery app Door Dash made a dashing debut in the US at an issue price of $102, and closed the day with 85% gain, which valued the company at around $60 billion, 16-times its revenue. Its 52-week high-low range remained between $256 and $110 and the stock has never slipped below issue price, making it the only success story from this space in the public markets.

Deliveroo, another online food delivery company, achieved the dubious distinction of being the worst performing IPO in a debut on the London Stock Exchange, as it sunk 31% on the first day on March 31, 2021 from the issue price of 390 pence. The stock now languishes at 29% below issue price with a 52-week low of 224 pence.

These examples make it clear that public markets have a different approach to valuing such stocks compared with the private equity market. Therefore, there is no reason to believe that Zomato is going to deliver exceptionally high returns to investors over time.

It would also be wrong to compare a food delivery app with the likes of FANGs and expect similar wealth creation, as the customer base of social media giants like Facebook, **Twitter** and Google is entirely different from those in the food delivery business. More often, listing in public markets, especially for concept stocks, has only been providing exit routes for private equity players, by passing on their stakes to 'greater fools'.

While Zomato, prima facie, is issuing fresh equities worth Rs 9,000 crore, a few investors actually exited through secondary deals in February 2021 by selling stocks worth $319 million.

Co-founder and CEO Deepinder Goyal himself reduced his stake in the firm by 0.63%, worth $32.4 million, and now holds only 5.51%. Retail investors should weigh these factors and be utmost cautious before buying into such new-age companies, which may take their own sweet time to churn out profits and put investors on an unending wait for real wealth creation.

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