2 IPO Stocks
You Should Consider
&
3 Even Better Spinoff Stocks

TSI Wealth Network
MAKING YOU A SUCCESSFUL INVESTOR

2 IPO Stocks You Should Consider—and 3 Even Better Spinoff Stocks

TABLE OF CONTENTS

Introduction: Exercise caution with IPOs 1
IPO process works against most investors....................1
Still, good IPOs do come along 2
IPOs we recommend
IPO pick #1: Dropbox.................... 2
IPO pick #2: PagerDuty....................3
Spinoffs unlock hidden value....................4
Spinoff pick #1: Raytheon Technologies 5
Spinoff pick #2: Otis Worldwide 6
Spinoff pick #3: Carrier Global 6

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INTRODUCTION: EXERCISE CAUTION WITH IPOS

There have been a lot of high-profile initial public offerings, or IPOs, over the last couple of years. Prominent names include Airbnb, DoorDash, Snowflake, Lightspeed POS and Zoom Video, as well as Uber and Lyft. That can create unwarranted expectations and investor interest.

Some IPOs over the first two or three years following their listing have performed well, but most haven't. That's not unexpected—as we've often pointed out, IPOs tend to come to market when it's a good time for the company or its insiders to sell. That may not be, and often isn't, a good time for you to buy.

This report outlines the IPO process, its drawbacks for most investors, but also identifies two IPOs that we recommend as buys. That's in addition to sharing with you the power of a special form of new listing—Spinoffs. We offer three spinoff picks with particularly bright outlooks.

IPO PROCESS WORKS AGAINST MOST INVESTORS

Human nature puts the odds against you when you invest in new stock issues (also known as IPOs or Initial Public Offerings).

The company or its insiders decide when to bring a new issue to market. And as mentioned, they mostly do so only when it's a good time for the firm or its insiders to sell stock to the public. That means new issues tend to come to market when the company or its industry is enjoying what may be a temporary improvement in business or profit. If the improvement is only temporary, this generally isn't a good time for you to buy.

Investment industry practice makes things worse. Financial institutions know how to package a new issue to make it seem like a great deal. This tends to raise the price that you pay for a new issue, compared to a stock that is already trading in the market. That's another reason why new issues tend to be overpriced in relation to a balanced assessment of their prospects. In addition, the underwriting process adds costs, for commissions (usually 5% to 7% of the funds raised), plus legal and accounting expenses.

Meanwhile, long-term studies show that, on average, new issues tend to do worse than comparable stocks over a variety of time periods.

Professor Jay R. Ritter of the University of Florida updated his long-time study of more than 7,000 new issues that came on the market in the U.S. from 1980 through 2013. He studied returns on the new issues for the first five years after issue, in two ways.

The average yearly return over five years on the new issues was 3.1% below the return on existing stocks with the same market capitalization (or "market cap," the value of all shares each company had outstanding). When Ritter matched the new issues with existing stocks that had comparable ratios of book value to market value, the new-issue performance shortfall shrank to 2.0%.

Both comparisons in the study show that new issues actually beat existing issues in the first six months of trading. That's when "hot new issues" (new issues that shoot up in price the moment they come on the market) have their biggest impact, and bring up the average new issue performance. However, hot new issues are generally unavailable to the average investor.

That's because brokers reserve their best new issues for their biggest and most co-operative clients—those who do a lot of trading, or who buy every new issue the broker offers them. If you rarely buy new issues, you will rarely if ever be able to buy a significant portion of the best new issues.

STILL, GOOD COMPANIES WITH GOOD PROSPECTS DO GO PUBLIC EVERY YEAR.

One key Successful Investor way to cut IPO risk—and distinguish the good from the bad—is to wait till the next market slump and/or recession comes along. Then take a fresh look at how recent new issues are performing.

A market slump and/or recession tends to have a negative impact on many stocks. That's especially so with IPOs, which tend to be juniors. But if a recent IPO holds up well, it may indicate that the stock has a brighter-than-average future.

You may find some of these companies have experienced business success, despite stock-market and economic turmoil. But their stock prices may have declined, or languished, because the IPO hoopla has died down.

Below we look at a couple of IPOs—**Dropbox and PagerDuty**—that not only prospered during the pandemic but that have winning business models with the potential for exponential future growth.

And meanwhile, after our look at those two recent new issues, we also look at spinoffs (see below).

Spinoffs are another form of new listing that we think offer investors better chances of success than almost all IPOs. In fact, we can say without reservation that, in investing, spinoffs are the closest thing you can find to a sure thing. But more on that later ….

IPO PICK #1

DROPBOX INC. *(Nasdaq symbol DBX; TSINetwork Rating: Extra Risk)* has focused since 2007 on providing a way to synchronize computer files between registered users. Dropbox has since expanded its service offerings; it aims to improve productivity within organizations through their use of its expanding collaboration platform.

Currently, the company has over 700 million registered users across 180 countries. Most of them use its free, basic service with limited storage. Still, it has roughly 15.83 million paying users.

Dropbox launched its much-anticipated initial public offering (IPO) in March 2018. It raised a total of $756 million from the sale of 36 million shares at $21 a share. That was well above the company's proposed range of $18 to $20 per share.

Now, just over three years later, Dropbox seems to have passed the recession-survival test provided by the COVID-19 crisis.

On March 22, 2021, Dropbox completed the acquisition of DocSend, a secure document-sharing and data-analytics company with more than 17,000 businesses using its platform. Dropbox paid $165 million in cash for the firm.

DocSend aims to give its customers visibility into what happens to their documents after they send them. Instead of using traditional attachments, DocSend users can enable sign-in verification, control download capabilities, and easily require viewers to sign nondisclosure agreements before viewing documents shared with them. DocSend also provides real-time analytics into who is viewing each document, while allowing users to receive or provide instant feedback.

DocSend adds a layer of intelligence on top of the current Dropbox platform. For example, client services teams and creative professionals, who already rely on Dropbox to organize and collaborate on presentations and projects, can now use DocSend to deliver proposals and track engagement.

Meanwhile, they can use HelloSign to manage contracts and invoices. In 2019, Dropbox spent $230 million to acquire e-signature provider HelloSign.

What's more, secure sharing is central to the DocSend platform; this acquisition should help remove any lingering cybersecurity concerns for potential Dropbox customers.

Dropbox's balance sheet is strong, with cash of $1.9 billion and long-term debt of just $1.4 billion.

Unlike many tech stocks, Dropbox is profitable. However, it will continue to face intense competition from tech giants like Alphabet Inc.'s Google, Microsoft and Apple Inc. They've aggressively pushed into the cloud-storage market. (That's where users go online to access their data stored on remote servers.)

In response, Dropbox has ramped up its storage offerings for businesses in the hope those firms will also use its collaboration tools. As well, it has added new product features such as HelloSign and DocSend to convert more free users into premium customers.

Meantime, Dropbox has fewer than 16 million paying customers, or slightly more than 2% of its more than 700 million registered users. That gives it great growth potential just from existing free subscribers upgrading to paying users. On top of that, there's also the growth the company should see from improving and expanding its services.

We never recommend stocks just because they might be an attractive takeover prospect. But that is certainly a plus in this case. Any way you look at it, Dropbox's outlook is positive.

Dropbox is an IPO buy for aggressive investors who can accept some risk.

IPO PICK #2

PAGERDUTY INC. *(New York symbol PD; TSINetwork Rating: Extra Risk)* operates a platform that collects real-time data from software systems and devices and then notifies its IT customers of any incident that could harm their operations.

The company first sold shares to the public in an April 2019 initial public offering (IPO) at $24 a share. It started out trading around $35 a share, and rose to $60 in a couple of months. Then the new-issue hoopla wore off and the stock began to slump in the second half of 2019. The COVID recession began in March 2020, 11 months later.

PagerDuty shares hit a low near $13 that month. But the company's business prospered by applying artificial intelligence (AI) to help its customers shorten or avoid business disruption and save money.

Although the company is still in a money-losing early phase of expansion, it's generating fast revenue growth. In addition to the immediate financial benefit of this growth, it also helps PagerDuty build a body of knowledge that it can use to improve and expand its ability to serve both its existing and future customers.

PagerDuty's platform sits on top of a company's technology systems, taking in data. As it receives the data, it then uses analytics and artificial intelligence (AI) to "learn on the go," to prevent adverse events from recurring. It learns from problems solved and applies its findings to future use. The company's software platform aims to help clients take action in real time to save lost revenue and retain clients, while limiting damage to their brands and reputations.

PagerDuty's platform is accessible by mobile app for Apple's iOS and Google's Android systems. That makes it easy for teams to take action, 24/7. The app lets clients view schedules, add responders, escalate, and deploy custom actions remotely.

For example, San Francisco's online fresh grocery store Good Eggs uses PagerDuty to analyze signals from its refrigeration units to improve food freshness. The data it gathered in the process has benefits for all PagerDuty clients who deal in refrigerated goods.

All this is increasingly important for companies as consumers become more digitally savvy and demanding. They want food delivered to their home from the restaurant of their choice within an hour; they want to stream a movie on an iPhone while waiting in line at the airport, or do their shopping from the couch with just a few clicks on a smartphone.

PagerDuty's customer base exceeds 13,800 firms globally, including Slack Technologies, Zoom, NBCUniversal, the PGA Tour, and TD Bank.

The company now holds cash and investments of $560.3 million. Its long-term debt of $217.5 million is just 6.8% of its market cap.

PagerDuty continues to invest heavily in research and development (R&D) to position itself as the market leader in innovation and technology. In fiscal 2021 (ended January 31), it invested $64.6 million in R&D, or a very high 27.9% of revenue.

Meantime, the company operates in a very competitive niche. Rivals include Datadog, OpsGenie (acquired by Atlassian), VictorOps (acquired by Splunk) and ServiceNow. Still, PagerDuty continues to be successful in attracting and holding on to clients. It has a 95%-plus subscription renewal rate.

The company has lots of growth ahead as businesses—from major corporations to small firms—place more and more emphasis on dealing with customers digitally. PagerDuty also has lots of room for expansion internationally. It now generates only around 22% of its revenue outside of the U.S. To top it off, the company could conceivably be an attractive takeover candidate for any number of major tech firms that want to move into its growth markets.

PagerDuty is an IPO buy for aggressive investors who can accept some risk.

SPINOFFS UNLOCK HIDDEN VALUE

One of the ways a company can try to unlock its own hidden value is by creating a separate company out of a subsidiary. The parent company can either sell stock in the new company to the public, or spin it off—hand the stock out to its own investors, as a special dividend or "spinoff." In the past few years, it has become common to do both.

Often, the parent company starts by selling a portion of the new company to the public, to establish a market and a following among investors. That way, by the time of the spinoff, stock in the new company may be liquid enough to be sold relatively easily, or retained with some confidence as a worthwhile investment.

In our experience, and in most academic studies of the subject, this helps the parent and the spinoff. Both generally do better than comparable companies for at least several years after the spinoff takes place.

Spinoffs are the closest you'll get to a 'sure thing'

Again, we can say without reservation that, in investing, spinoffs are the closest thing you can find to a sure thing.

And in fact, we've had great success with a number of spun-off stocks over the years. That's especially true of the many spinoffs we have recommended that have gone up after they began trading, and have later attracted a takeover bid at a substantial premium over the market price.

Needless to say, things don't always work out this well. Spinoffs and their parents do sometimes run into unforeseeable woes. But on the whole, in investing, spinoffs are the closest thing you can find to a sure thing.

Here are a couple of examples of spinoff successes we've recently handed to our subscribers:

In December 2019, precision-testing equipment and tools maker Danaher Corp. (symbol DHR on New York) spun off its dental products supplier Envista Holdings, (symbol NVST on New York). We recommended both Danaher and Envista as buys—and that recommendation has paid off. Danaher is up 85.7% since then, and Envista shares are up 74.8%!

In late February 2020, diversified industrial company Ingersoll Rand (symbol IR on New York) spun off its climate control technologies unit Trane Technologies plc (symbol TT on New York). We liked the look of both new companies—and Ingersoll Rand is now up 51.8%, with Trane up a whopping 91.7%!

Meantime, here's a recent example of a double spinoff that paid off in a big way for our subscribers, and we think both—Otis Worldwide and Carrier Global--still have gains ahead. What's more, their spinoff parent, Raytheon Technologies, is also a spinoff pick.

SPINOFF PICK #1

RAYTHEON TECHNOLOGIES CORP. *(New York symbol RTX; TSINetwork Rating: Above Average)* took its current form in April 2020 with the merger of **United Technologies Corp.** (old symbol UTX and a long-time recommendation of our *Wall Street Stock Forecaster* newsletter) and **Raytheon Co.** (old symbol RTN).

Under the terms of the deal, Raytheon shareholders received 2.3348 shares in the combined company for each share they held. Those shareholders now own 43% of the new company; United Technologies investors own the remaining 57%.

The combined firm is a leading maker of commercial aircraft equipment, electronic systems for military aircraft and radar systems, and guided missiles.

Raytheon now has four main divisions: Collins Aerospace makes aircraft control systems, navigation equipment and cabin interiors (33% of total revenue); Pratt & Whitney makes jet engines (29%); Raytheon Missiles & Defense makes land and sea-based missile defence and radar systems (20%); and Raytheon Intelligence & Space specializes in communications equipment and satellites for government intelligence agencies and corporate clients (18%).

The U.S. government is the new company's biggest customer, accounting for 46% of its revenue in 2020. Sales to foreign military customers (through the U.S. government) supplied an additional 8%.

Since the April 2020 merger, Raytheon's shares are up 73.6%.

Raytheon Technologies is a spinoff buy.

Meanwhile, just before the merger with the old Raytheon, United Technologies completed the planned spinoffs of its Otis (elevator) and Carrier (heating and air conditioning equipment) operations as separate public companies.

Investors received 0.5 of a share in **Otis Worldwide** for each United Technologies share they held. They also received one share in **Carrier Global Corp.** for each UTX share.

SPINOFF PICK #2

OTIS WORLDWIDE CORP. (*New York symbol OTIS; TSINetwork Rating: Average*) is the world's largest maker of elevators and escalators.

Demand for new elevators and escalators is starting to rebound as more businesses reopen following COVID-19 shutdowns. In the latest quarter, Otis's revenue rose 14.9%, to $3.41 billion from $2.97 billion a year earlier. Sales of new equipment (43% of the total) jumped 29.8%, while service revenue (57%) gained 5.8%.

In response to the pandemic, the company cut capital spending and other costs. As a result, earnings jumped 19.1%, to $312 million from $262 million. Otis spent $300 million on share buybacks in the quarter, which is why earnings per share rose at a faster pace of 20.0%, to $0.72 from $0.60.

For all of 2021, Otis expects its sales will improve 4% to 6%. It also sees its earnings per share increasing roughly 13% to $2.86. The stock trades at 28.9 times that estimate. That multiple is reasonable considering Otis's high market share and long-term growth prospects. The $0.96 dividend yields 1.2%.

Otis's shares have jumped 82.9% since the April 2020 spinoff—but we think they can go higher.

Otis Worldwide is a spinoff buy.

SPINOFF PICK #3

CARRIER GLOBAL CORP. (*New York symbol CARR; TSINetwork Rating: Average*) is a leading maker of heating, ventilation and air conditioning (HVAC) equipment. It also makes fire and security products, such as smoke detectors, as well as refrigeration equipment.

In the latest quarter, Carrier's sales jumped 20.9%, to $4.70 billion from $3.89 billion a year earlier. That's mainly due to strong demand for residential HVAC equipment, particularly in North America. Higher sales to businesses also contributed to the gain.

Earnings before one-time items rose 39.5%, to $427 million from $306 million; earnings per share improved

37.1%, to $0.48 from $0.35, on more shares outstanding.

The company will probably earn $2.06 a share in 2021, and the stock trades at a reasonable 23.6 times that forecast. The $0.48 dividend yields 1.0%.

Carrier's shares have jumped a whopping 234.6% since the April 2020 spinoff—but we think they still have room to rise.

Carrier Global is a spinoff buy.