

The background features a collage of US currency. At the top left is a portion of a \$100 bill showing an eagle. To its right is a \$20 bill featuring a horse. Below these are various other bill denominations, including a \$5 bill with the word 'SHARES' and a \$10 bill with the number '10'. The bills are arranged in a layered, overlapping fashion.

IPO INVESTING IN 2021

The logo consists of a stylized white bird or wave shape above the text 'The Motley Fool'.

The Motley Fool

MAKING THE WORLD SMARTER, HAPPIER, AND RICHER

IPO INVESTING IN 2021

THE FOOLISH PHILOSOPHY

Investing alongside us in *IPO Trailblazers* means you're fully aware of one statistic: **3.4%**.

A recent internal study at The Motley Fool revealed that over a 10-year holding period, **only 3.4% of companies — 74 out of 2,172 — were responsible for all \$2 trillion in total economic gains from IPOs.**

Therefore, the probability of achieving our goal of 4 times our investment over 10 years from *each and every* IPO Trailblazer is exactly zero.

Yes, we fully expect many of these companies to stumble along the way. And while we do think many of our investments will make you money, we also anticipate that **just a few of these companies will ultimately drive the bulk of our investing returns.**

HOW WE'LL WIN

Given the difficulty in discovering those exceptional 3.4% of all IPOs, we've put a pretty high hurdle on which companies make it into the *IPO Trailblazers* portfolio.

We're searching for companies that:

- ▶ **Bring "newness" to the market**, something the market has never seen before or that literally no other company can do.
- ▶ **Are run by visionary leaders** targeting massive market opportunities.
- ▶ **Have the potential to dominate** a particular niche or industry. In our greatest investments, these businesses will move beyond dominating their niche and will become worldwide superstars.

Based on those key factors, we're allocating our capital accordingly: investing in high-conviction businesses while also maintaining the flexibility to start small, learning positions.

There are two types of positions that we will hold in our IPO portfolio: Trailblazers and Firestarters:

Trailblazers

- ▶ Full-position IPO stock picks
- ▶ Purchased in large investment rounds roughly every six months
- ▶ We believe these have the best shot at hitting 4 times our investment in 10 years

Firestarters

- ▶ Smaller positions of \$2,000 each for exciting opportunities
- ▶ Used as a way to get skin in the game for higher-risk-profile companies
- ▶ No targeted allocation schedule
- ▶ Could become a Trailblazer
- ▶ If our excitement fades, we may decide to sell

Let's take a hypothetical example, Billy the Mann's BBQ Bonanza (ticker BBBQ), which files an S-1 on October 16. It then goes public during the first week of November. After researching and studying this company, which has a 126-year-old family BBQ recipe that it sells to upscale grocery chains, we decide it's worth a Firestarter position.

We then issue a Firestarter recommendation to you at any time, either before the company lists shares or after. The important point to keep in mind is that we're not waiting for our Trailblazer scheduled rounds to invest. We can start a small position as needed.

So, back to our example. Let's say that after interviewing management, we come to appreciate and respect the way they build the culture at BBBQ and expand their product lines and market. They actually have very good relationships with their key suppliers, which gives them an advantage. We're more convinced of BBBQ's 4x potential. At that point, we'll put a larger investment into the business at our next Trailblazer round (or even in later rounds).

Starting a position, learning as the business evolves, and adding more to that position is an excellent way to invest in IPOs. And following alongside us, we believe, is the best way to ensure that you get the most from your *IPO Trailblazers* experience.

UNDERSTANDING VOLATILITY

In a 2009 interview, Charlie Munger, vice chairman of **Berkshire Hathaway** [NYSE: BRK-B] and Warren Buffett's right-hand man, was asked how concerned he'd be if Berkshire shares dropped more than 50%. He abruptly cut in, replying:

“ Zero. This is the third time that Warren and I have seen our holdings in Berkshire Hathaway go down, top tick to bottom tick, by 50%. I think it's in the nature of long-term shareholding that the normal vicissitudes in markets mean that the long-term holder has the quoted value of his stocks go down by, say, 50%. ”

The data supports Charlie Munger. We're not surprised by that!

Munger's mindset applies well to *IPO Trailblazers* investors. The ability to manage our temperament, to hold our companies for the very long term, and to do great research are competitive advantages we have over most of the investing world.

But investing in *IPO Trailblazers* requires you to think and act differently, especially amid all the euphoria and panic associated with dramatic price swings. This requires us to manage what Buffett calls his greatest achievement as an investor: our emotional temperament.

Ultimately, we'll win as we make outstanding stock selections, allocate our capital wisely across Trailblazer positions and Firestarter positions, and keep our cool when volatility strikes.

THE PRINCIPLES OF WINNING

In order to win over the long run, we ask that you commit to these five core Principles of Winning:

- 1 Own at least 25 Motley Fool recommendations.
- 2 Hold your IPO Trailblazers ideally for at least 5 years.
- 3 Relish volatility: Know that these stocks will routinely rise or fall 30% to 50% or more.
- 4 Know that 5%–10% of our stocks will likely drive more than 80% of our returns.
- 5 Follow our quarterly stock rankings to see where to add new money.

We look forward to investing and learning alongside you. Let's blaze new trails together, Fools!

FIRESTARTER RECOMMENDATION

BUY LEMONADE

Lemonade is a Firestarter investment — a way for us to invest in exciting IPO opportunities with enormous potential that might have a higher risk profile than our Trailblazers. We invest a small amount in each Firestarter to get some skin in the game, learn more as these businesses evolve, and see if they could one day become Trailblazers.

Lemonade [NYSE: LMND] aims to disrupt the typical insurer's business model by using cutting-edge technology to make the experience of buying insurance and making claims fast and hassle free. Lemonade also wants its insurance to be affordable enough to appeal to younger customers. Its use of reinsurance arrangements with outside insurance-company peers avoids adversarial relationships with its policyholders, and its status as a public benefit corporation allows Lemonade to make charitable giving an essential part of its culture.

LEMONADE'S TRIPLE THREAT

1. Lemonade Is Carving Out a Niche With Its Tech-Savvy, Customer-Friendly Insurance

In the past, buying homeowners or renters insurance could take hours to gather all the information an insurer would need to decide whether it would write a policy for you. **Berkshire Hathaway's** [NYSE: BRK-B] Geico became famous for its promise of 15-minute savings on car insurance, and other carriers took that lesson to heart.

But in today's world, 15 minutes is an eternity. That's why Lemonade has used the power of artificial intelligence to streamline things as much as possible. Just a two-minute chat on your mobile device with Lemonade's Maya AI, answering around a dozen questions, is usually enough to get a quote. And that quote is often less expensive than you'll find from traditional homeowners or renters insurance carriers.

That efficiency comes in handy with customer service as well. Need to file a claim? A chat with AI Jim can get things started in just a few seconds. From there, Lemonade's CX.AI platform can go through the claims process with minimal human interaction, handling a third of all communications with policyholders.

KEY TAKEAWAYS

Lemonade uses artificial intelligence to expedite the insurance process for consumers.

The co-founders set up Lemonade as a public benefit corporation to gain the trust of their customers through the support of social causes.

70% of Lemonade's customers are under 35, creating a base of potential lifelong customers.

Its strategy includes buying reinsurance to pass along risk to third-party insurers and donating leftover funds to charities that customers choose.

2. Visionary Co-Founders

Lemonade's ambition comes from CEO Daniel Schreiber and COO Shai Winger, who co-founded the company in 2015. Both have jumped into insurance headfirst after having spent most of their careers in the tech industry. Schreiber has a law background and experience at companies including SanDisk. Winger most recently founded the gig-worker website **Fiverr** [NYSE: FVRR].

The two leaders see the trend toward automation of traditional business as an unstoppable force, and they want Lemonade to replace legacy insurance carriers that can't adapt to changing times. Schreiber and Winger are willing to take a long-term perspective in grabbing market share from larger, better-known rivals to become "the world's most loved insurance company."

Schreiber and Winger set up Lemonade as a public benefit corporation in order to reflect their belief that values have value. Specifically, they believe they can create a meaningful relationship with customers based on a sense of community.

3. Lemonade Has the Potential to Take Center Stage Worldwide

Lemonade wants to be the preeminent insurer of the next century, and that means catering to prospective customers when they're young. Fully 70% of Lemonade's customers are under 35, and 90% of them did not switch from a previous insurance carrier. Lemonade is grabbing first-time insurance buyers and aiming to keep them for life.

So far, it's doing a good job. Its customer count more than doubled in 2019 to 643,000 and has continued to grow in 2020. Moreover, by offering renters insurance, Lemonade gets its foot in the door and sets the stage for customers to stick with it when they buy their own homes and need more comprehensive insurance policies. That's a lucrative strategy, because homeowners pay roughly 6 times as much in premiums, on average, as renters do.

THE KEY TO LEMONADE'S BUSINESS STRENGTH

As attractive as Lemonade appears to insurance shoppers, understanding its true competitive advantage requires diving into the complex world of reinsurance. Lemonade keeps about 25% of total premium payments to offset its fixed costs. With the remaining 75%, it pays claims, and it buys reinsurance policies to slough off some of its risk onto third-party reinsurers. That strategy helps Lemonade avoid catastrophic losses from storms and other natural disasters, limiting risk to levels that are easier for the insurer to handle.

Anything left over from that 75% (the "float") it gives to charities that customers choose. Lemonade asserts that this move should make customers less likely to overstate claims, because they're essentially taking money from a worthy cause rather than from a deep-pocketed, faceless insurer. Meanwhile, Lemonade's shareholders can count on that reliable 25% fixed fee coming in during good times and bad. And as the number of customers and size of premiums grow, so will the company's revenue and profits.

WHAT WOULD MAKE LEMONADE A TRAILBLAZER

The property, casualty, and life insurance market is a \$5 trillion industry globally, and it's highly fragmented and ready for disruption. Most people need insurance, so it's largely a recession-proof business.

Yet Lemonade will have to overcome significant obstacles. Its business model relies on reinsurers being willing to work with it, and if Lemonade's overall claim history proves to be loss heavy, reinsurers might charge more or refuse to offer coverage. Higher reinsurance premiums could jeopardize Lemonade's ability to keep 25% of premiums for its own expenses, while an outright refusal to offer coverage would put Lemonade's entire business model at risk.

Also, rival insurers could build their own AI-based apps to mimic Lemonade's efficiencies. The company also has to keep regulators happy, especially in light of concerns about the data it collects and how it uses that information.

Lemonade will have to keep growing quickly, but even the company itself isn't sure how successful it will be. Lemonade is counting on much of its customer base moving from renting to owning their homes as well as buying other insurance lines like its newly launched pet insurance. Ideally, policyholders will add even more coverage in new lines once the insurer starts offering them. Given the limited data and experience, how things play out in these first few years after its IPO will be critical in assessing the durability of Lemonade's business model.

Finally, we'd prefer to see Lemonade invest its insurance float in socially responsible companies. Outright charitable gifts have an impact, but with just \$600,000 donated in 2019 — less than 1% of total revenue — Lemonade might not be charitable enough to make customers happy.

If Lemonade can address these concerns and make good on its full potential, then we'd be comfortable making the stock a Trailblazer. For now, we're comfortable making a Firestarter-sized bet that Lemonade's optimism will prove to be warranted.

FIRESTARTER RECOMMENDATION

BUY 10X GENOMICS

10x Genomics is a Firestarter investment — a way for us to invest in exciting IPO opportunities with enormous potential that might have a higher risk profile than our Trailblazers. We invest a small amount in each Firestarter to get some skin in the game, learn more as these businesses evolve, and see if they could one day become Trailblazers.

A 10-year-old girl trying to live a normal life with cystic fibrosis.

A 43-year-old man battling lung cancer.

A 79-year-old woman fighting COVID-19.

Each of them benefits from medical advances that have been made thus far. But there's a lot we still don't know about these and other diseases.

10x Genomics [NASDAQ: TXG] makes technology that helps unravel the secrets of the human body and how it responds to disease. The “10x” in the company's name signals its focus on paving the way for medical research with the greatest potential for exponential advances.

The company's systems enable researchers to explore the complexity of biology: cell-to-cell variations, how the arrangement of cells can give rise to disease, which genetic variations link to specific traits and diseases, and a whole lot more.

Achieving groundbreaking medical advances isn't just pie-in-the-sky wishful thinking for 10x Genomics. Its systems have already helped scientists make new discoveries that are critical in the understanding of diseases — even helping uncover previously unrecognized cell types.

Those are impressive accomplishments for a company that was only founded eight years ago and launched its first product in 2015. Since then, 10x Genomics has installed more than 1,650 of its systems across the world.

The company conducted its IPO in September 2019, and the shares jumped 35% on its first day of trading. The stock has been on a roll in 2020, and we think 10x Genomics' success will continue.

KEY TAKEAWAYS

10x Genomics makes biotechnology systems that help study how the body responds to disease.

Its market share potential, percentage of revenue from consumables, and expanding install base make it a triple threat.

Co-founder and CEO Serge Saxonov has an impressive genetics technology background, a long-term focus, and skin in the game.

10x's industry-leading technology, which has already enabled breakthroughs celebrated in the scientific community, gives it a competitive advantage.

10X GENOMICS' TRIPLE THREAT

The global life sciences market tops \$50 billion annually. 10x's current systems address roughly \$13 billion of the total market, and the company thinks that it will be able to go after much of this market over time as it rolls out new products.

10x's flagship product is its Chromium platform, which enables scientists to divide millions of cells into segments and analyze them cell by cell. This analysis includes measuring the activity of genes and of immune cells and their targets. The company's Visium platform allows researchers to analyze molecules spatially, which is important because how they're structured can be important to their functioning.

14% of 10x's total revenue stems from sales of its instruments, and services account for 2%. But 10x makes most of its money from the sales of consumables needed for testing.

Revenue totaled \$246 million in 2019, a 68% jump. That's only a drop in the bucket compared to the company's addressable market. But its market share should rapidly increase as its expanding install base fuels recurring revenue growth from consumables.

A VISIONARY CEO

CEO Serge Saxonov co-founded the company and previously worked as vice president of applications at genetic systems analysis company QuantaLife, which was acquired by **Bio-Rad** [NYSE: BIO] in 2011. Before that, he was the first employee at personal genomics company 23andMe, where he served as founding architect and director of R&D. Saxonov defined the initial concept of 23andMe's DNA testing product and built the core technology that supported it.

After 10x Genomics' IPO last year, Saxonov was asked about the company's plans for 2020. His response: "I tend to think more in terms of decades." That's the kind of attitude we like to see in CEOs.

We also like to see skin in the game. Saxonov has that, too: He owns 2% of 10x's class A shares and 7% of its class B shares.

10X GENOMICS HAS THE POTENTIAL TO TAKE CENTER STAGE WORLDWIDE

10x Genomics' technology has made possible scientific approaches that have been lauded by the industry. *Science* magazine heralded the ability to track embryo development cell by cell as its 2018 "Breakthrough of the Year." Science journal *Nature Methods* named single-cell multimodal omics (analyzing cells one at a time simultaneously) as its 2019 "Method of the Year."

Most people aren't aware of these accolades or the scientific progress that they represent. But we're living in what some call a "century of biology": Biological advances over the next few decades could revolutionize how diseases are diagnosed, treated, and even cured. 10x Genomics' systems could pave the way for these groundbreaking achievements.

THE KEY TO 10X GENOMICS' BUSINESS STRENGTH

There's one overarching factor behind 10x Genomics' business strength: Its technology is simply better than its rivals'. 10x's Chromium and Visium platforms offer higher resolution at massive scale.

For example, 10x's single-cell gene expression and immune profiling solutions can measure up to 80,000 cells in one run. This dramatically increases the chances of finding cells that cause diseases. These solutions also boast typical cell capture rates (the percentage of total cells measured) of 65% — a lot higher than levels achieved by rival systems.

10x's Feature Barcoding technology also stands out as an important competitive advantage. It enables customers to add a bar code to any biological feature in a cell that they want to analyze and perform multiple experiments in parallel.

WHAT WOULD MAKE 10X GENOMICS A TRAILBLAZER

First, we're looking more at how 10x holds its own against new players entering the market. The company has already reduced the list price of its Chromium Controller system and faces continued pricing pressure from competition. We think that 10x will be able to compete effectively, but we want to see more evidence that we're right.

Second, it would be great (though not required) to see a favorable resolution to ongoing patent infringement litigation between 10x and Bio-Rad. The two companies are slugging it out in court over patents related to key technology that 10x uses.

In the meantime, we're definitely excited about the potential for 10x's systems. We fully expect the company will continue being a trailblazer (with a small "t") in advancing medical knowledge. And we remain optimistic that 10x could become a big-t Trailblazer in the future.

The Motley Fool owns shares of 10x Genomics, Berkshire Hathaway (B shares), Fiverr International, and Lemonade.