

17. EQUITY IPO AUCTIONS

17.1 Overview

IPO = “Initial Public Offering”

Auctions have been very successful in distributing government securities.

They have not been successful in distributing corporate securities.

Traditional IPO methods have never been in lower esteem than they are today.

Even so, there is no rush to equity IPO auctions.

17.2 IPO Methods

Book building

Firm selects underwriter after presentations by investment banking firms.

Underwriter solicits indications of interest from potential investors.

Underwriter/issuer set offering price.

This is not a market clearing price. Typically:

Quantity supplied < quantity demanded (at price)

Underwriter retains sole discretion over allocation.

Final outcome involves rationing by seller (on the basis of “relationship”)

17.3 Fixed price/universal offer/open offer

This method has similarities to book building:

Underwriter judges market conditions.

Underwriter/issuer set offering price.

Difference from book building:

If there is an oversubscription, allocation is pro rata.

Underwriter does not have control over allocation.

Widely used in Europe and Asia, but losing ground to bookbuilding.

Not used in US

Auctions

Usage worldwide is very low.

But used exclusively in Israel and Thailand

Available in US through W.R. Hambrecht's OpenIPO.

17.4 Issuer interests

- ▶ Maximum offering revenue
- ▶ Investor clientele (prefer “long-term” investors)
- ▶ Ongoing research coverage
- ▶ Market liquidity after the IPO.
- ▶ Publicity value of first-day “pop”
On average, IPO's close their first day of trading substantially above the offering price.
- ▶ Negative publicity attached to a failed or withdrawn offering.
- ▶ The IPO is only the first step in what will (hopefully) be a series of subsequent offerings
 - Follow-on offering of equity
 - Issues of debt, warrants, etc.

17.5 Underwriter interests

- ▶ Ongoing investment banking relationship with firm.
 - ▶ Profits from market-making activities in the firm's stock.
 - ▶ Relationships with other clients
 - ▶ Commission income from brokerage clients
- CSFB allocates shares of a hot IPO to customer X. X flips the shares on the first day for a large profit. X kicks back part of the profit to CSFB via “commissions” on other trades.
- In January 2002, CSFB paid out about \$100 million to settle claims that it had split IPO profits with customers.

- ▶ Investment banking fees

17.6 Spinning

Spinning: when the underwriter allocates underpriced shares to favored clients (including clients who are in a position to give the firm investment banking business).

Then (1997)

“The spin desk: Underwriters set aside IPO stock for officials of potential customers – coincidentally or otherwise, work frequently follows for the investment bank – bribery or just business” (WSJ, 11/12/1997)

“It’s a bribe, no question about it,” contends Robert Messih, a managing director at Salomon, Inc., which doesn’t have a brokerage arm or engage in spinning. “You pay them off and expect you’re going to get treated in kind when they do the transaction.”

And five years later (2002)

“Salomon’s Grubman resigns; NASD finds ‘spinning’ at firm.” (WSJ 8/16/2002)

[There is] evidence compiled by NASD’s enforcement arm that Salomon allocated shares of hot IPO’s to clients.

Congress is also investigating how Salomon allocated IPO’s.

Salomon has denied the allegations.

Mr. Grubman: “I don’t recall. I’m not saying ‘no’. I’m not saying ‘yes.’”

17.7 W. R. Hambrecht OpenIPO

Online equity IPO auctions

Basic format: Multiple-unit sealed-bid.

Offering price may be set below the auction-clearing price.

If the offering price is below the clearing price, everyone who bid the clearing price or higher gets a pro rata allocation.

Example 1M shares offered. At \$10/share, there is a demand of 1M shares. At \$9/share, the demand is 1.25M.

If the offering price is set to \$9/share, everyone who bid \$9 or above gets $1/1.25 = 80\%$ of the quantity they sought.

Overallocation option: Underwriter options to purchase additional shares at the offering price (as in a traditional IPO)

We would not expect a large opening day run-up in the stock price because there is relatively little rationing.

OpenIPO (from its website)

Our impartial Internet-based auctions, which allow the market to determine pricing and allocation, are dramatically changing the financial services landscape.

WR Hambrecht + Co's first innovation was OpenIPO which is based on an auction system designed by Nobel Prize-winning economist William Vickery. All qualified bids are treated equally, and the results are an offering price we believe reflects what people are willing to pay for a stock, and a greater likelihood of share allocation to long-term investors.

17.8 Case histories

There have been eight IPO auctions to date

Ravenswood

Wine producer, April 9, 1999, RVWD

Auction price = \$10.50/share (= issue price)

Underwriter's option not exercised

Underwriter's discount = 4% (vs. "traditional" 7%)

Opening day closing price approx. unchanged (vs. "traditional runup")

Salon.com

Web content provider, June 22, 1999

Auction price = \$10.50/share (= issue price)

Underwriter's option exercised

Underwriter's discount = 5%

Opening day closing price approx. unchanged

Andover.net

Web site operator, December, 1999)

Issue size: 4 mm shares

Auction price = \$24/share

Offering price = \$18/share (if you bid \$19/share, you didn't get anything)

Underwriter options exercised for 1.2mm shares

Closing price on opening day up 252%

Nogatech

May 17, 2000

Offered at 12; closed the next day at 9.

Peets Coffee

January 2001

Initial offer range: 10-14; later reduced to 8-12

Offered at 8; underwriter's option exercised; first day close +17%

Briazz

OpenIPO: Briazz, Inc.

Briazz, Inc. OpenIPO Auction Results



The OpenIPO auction for Briazz, Inc. has been completed. Briazz has set an offering price of \$8. All auction participants with bids at or above the offering price will receive approximately 70% of the shares bid for.

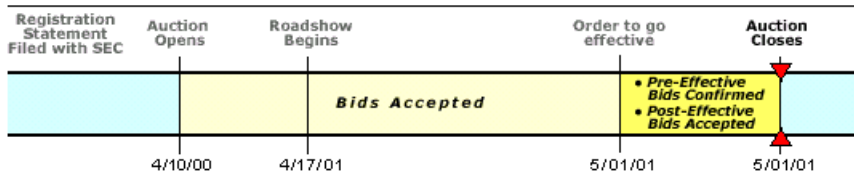
Successful bidders should be able to see the executed trade in their brokerage accounts on . To view the completed trade, [log in to your WRH+Co brokerage account.](#)

Briazz prepares and sells high-quality, branded lunch and breakfast food for the "on-the-go" consumer.

View [final prospectus](#) (dated 05/01/01)

Offering Type	OpenIPO	Total Shares Offered	2,000,000
Exchange	NASDAQ	Issuer	2,000,000
Symbol	BRZZ	Shareholders	0
Lead Manager	WR Hambrecht + Co	Price	\$8
		Deal priced on	5/02/01

Auction Timeline



Underwriting commission 6%.

On opening day, traded up to 8.40; closed at 8.03

Briazz, Inc. as of 3-Oct-2001



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Overstock.com

OpenIPO: Overstock.com, Inc.

The OpenIPO auction for Overstock.com, Inc. has been completed.



Overstock has set an offering price of \$13. All auction participants with bids at or above the offering price will receive a pro-rated percentage of the shares bid for, rounded to the nearest 100 shares. The pro-rata percentage for the entire offering is approximately 60%.

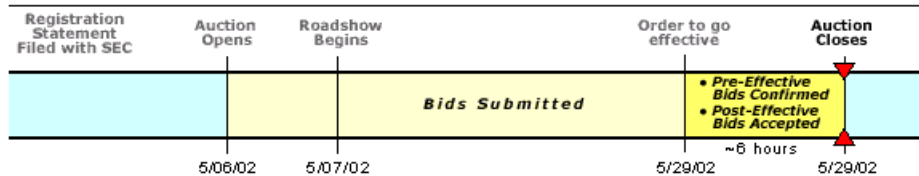
Successful bidders should be able to see the executed trade in their brokerage accounts on 05/30/02. To view the completed trade, [login to your WRH+Co brokerage account](#).

Overstock.com is an online "closeout" retailer offering discount brand-name merchandise for sale over the Internet.

View [final prospectus](#) (dated 05/29/02)

Offering Type	OpenIPO	Total Shares Offered	3,000,000
Exchange	NASDAQ	Issuer	2,155,000
Symbol	OSTK	Shareholders	845,000
Lead Manager	WR Hambrecht + Co	Price	\$13
Co-Manager(s)	Cantor Fitzgerald	Trade Date	05/29/02

Auction Timeline



Genitope Corporation

OpenIPO: Genitope Corporation

The OpenIPO auction for Genitope Corporation has been completed.



Genitope has set an offering price of \$9.00. All auction participants with bids at or above the offering price will receive a pro-rated percentage of the shares bid for, rounded to the nearest 100 shares. The pro-rata percentage for the entire offering is approximately 89%

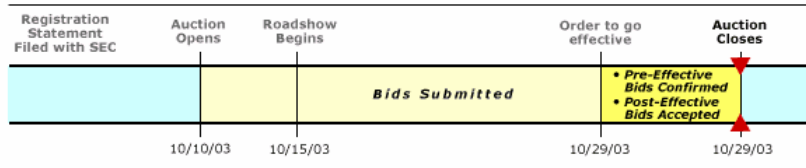
Successful bidders should be able to see the executed trade in their brokerage accounts on Thursday, October 30, 2003. To view the completed trade, [login to your WRH+Co brokerage account](#).

Genitope Corporation is a biotechnology company focused on the research and development of novel immunotherapies for the treatment of cancer. Immunotherapies are treatments that utilize the immune system to combat diseases. The company's lead product candidate, MyVax personalized immunotherapy, is a patient-specific active immunotherapy that is based on the unique genetic makeup of a patient's tumor and is designed to activate a patient's immune system to identify and attack cancer cells.

View [final prospectus](#) (dated 10/29/03)

Offering Type	OpenIPO	Total Shares Offered	3,700,000
Exchange	NASDAQ	Issuer	3,700,000
Symbol	GTOP	Shareholders	0
Lead Manager	WR Hambrecht + Co	Price	\$9.00
Co-Manager(s)	Punk, Ziegel & Company Brean Murray & Co., Inc.	Trade Date	10/30/03

Auction Timeline



The offering price of \$9 was at the low end of the indicated rate (\$9-\$13); the stock closed at \$10 on the day of offering.

GENITOPE CP
as of 29-Apr-2004



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Summary

In the eight cases, only Andover.Net had a large opening day run-up.

Participation in auction?

17.9 Why aren't equity IPO auctions successful and frequent?

In all markets, it takes time and effort to figure out what we should be willing to bid (or ask) for something.

Valuation in IPO's is particularly difficult.

IPO's have large information asymmetries.

The initial investors and management know much more about the company. It is costly for potential buyers to investigate thoroughly.

We can avoid this effort if a credible market price has been established by others ("informational efficiency")

Can a small investor be a free rider, i.e., piggy-back on the information gathering of others?

In a single-price auction, all buyers pay the same price. So why don't I put in a high bid for a small amount. Let Fidelity, Vanguard, etc. determine a fair price?

If Fidelity and Vanguard can't get a fair return for their information gathering efforts, why should they play?

If Fidelity and Vanguard don't play, will I?

The market breaks down.

In this story,

The underpricing serves to compensate the institutional investors for their information gathering efforts.

Underwriter's control over allocation is necessary.

17.10 Google

What's being sold?

Two classes of stock, differing in voting power.

Class A: one vote per share

Class B: ten votes per share

The IPO is for the Class A shares.

Mechanism

Sealed bid Dutch auction

Bids will specify quantity desired and price.

Multiple bids okay.

Bids judged "speculative or manipulative" will be rejected.

Order book will be visible to management and underwriter only (not bidders).

Excerpt from the S-1

The Pricing Process

We expect that the bidding process will reveal a clearing price for the shares of Class A common stock offered in our auction. ...

The initial public offering price will be determined by the underwriters and us after the auction closes. We intend to use the auction clearing price as the principal factor to determine the initial public offering price and, therefore, to set an initial public offering price that is near or equal to the clearing price.

However, we and our underwriters have the ability to set an initial public offering price that is below the clearing price.

The other factors we may consider in determining our initial public offering price include:

- ▶ Our goal of setting an initial public offering price that results in the trading price for our Class A common stock not moving significantly up or down relative to the market in the days following our offering.

- ▶ The prices bid by professional investors.
- ▶ Our assets, current or expected financial performance or book value.
- ▶ Other established criteria of value.

Our initial public offering price may not necessarily bear a direct relationship to any one of these factors.

The Allocation Process

Once we and our underwriters have determined the initial public offering price, our underwriters will begin the allocation process. ...

One of our objectives is to establish an initial public offering price that is equal or nearly equal to the auction clearing price....

In the event that the number of shares represented by successful bids exceeds the number of shares we and the selling stockholders are offering, our underwriters will need to allocate the offered shares across the successful bidder group.

Our underwriters, in consultation with us, expect to use one of two methods to do so—pro rata allocation or maximum share allocation. With either method, our objective is to set an initial public offering price where successful bidders receive at least 80% of the shares that they bid for in the auction.

We may increase the size of our offering or take other actions designed to accomplish this objective.

Etc.

Does an individual's bid have any significance?

Can the auction succeed without broad institutional participation?

Why does Google use a *sealed bid* auction?