UNIVERSITY OF ROCHESTER

William E. Simon Graduate School of Business Administration

Finance 423 | **Professor G. William Schwert**
Corporate Financial Policy & Control | Fall 2006

Quiz # 1: Take-home
due at the beginning of class on Monday, October 9, 2006

Write a brief answer to the following questions. Relate your answers to the information in the attached articles from *Fortune* and the *Wall Street Journal* and to the readings and class discussion in FIN 423. Limit your answers to no more than three (3) double-spaced (11 point fonts or larger and 1" margins on all sides) pages. ***This is an individual assignment. If you collaborate, you risk failing the entire course.***

1. What were some of the unusual features of the Google IPO compared with a firm-commitment underwritten offering?

2. Google's stock price rose dramatically after the IPO. Why did this happen? Was this unusual compared with other "Dutch Auction" IPOs?

3. Many Wall Street investment bankers carped about what a flop the Google IPO was. Based on the subsequent behavior of Google's stock price and trading volume (available in an Excel spreadsheet on the web page), do you think the Google IPO was a "flop"? *Why, or why not?*

THE WALL STREET JOURNAL.

Engine Trouble: How Miscalculations and Hubris Hobbled Celebrated Google IPO --- Euphoria Ebbed, Tech Stocks Sagged, Till Firm Cut Size, Priced at a Low $85 a Share --- Blow to Dutch-Auction Method

By Kevin J. Delaney and Robin Sidel
2,562 words
19 August 2004
The Wall Street Journal, p. A1
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Google Inc. may have needed Wall Street after all.

The Web-search giant's quest to reform the Street through an unconventional initial public offering backfired, as Google yesterday sharply cut the size of its stock sale and then set an IPO price far lower than it had anticipated: $85 a share.

A combination of Google's own hubris, stubborn investors and a deteriorated technology market transformed what was billed as the hottest IPO of this short century into a rather messy affair. The auction closed late yesterday afternoon after the Securities and Exchange Commission declared the IPO effective. After reviewing the bids, Google late yesterday set the $85 price. That was 37% lower than the top of the $108-to-$135 it had declared to regulators last month as the expected range.

The price "says that a type of auction going out to the public like this is a failure because it raised uncertainties to such a level that people backed away," said Matthew Rhodes-Kropf, an auction theorist at Columbia University's business school in New York. By creating uncertainty, it "got Google a worse price than they could have gotten using a standard mechanism," he said. Mr. Rhodes-Kropf had himself bid last week, at $120 a share, but he revised that yesterday to $95.

The price was also at the bottom of a reduced range of $85 to $95 a share that the Mountain View, Calif., company had indicated earlier yesterday. Google declined last evening to comment on its lowered price.

Earlier in the day, Google had announced that investors and company insiders, including young co-founders Sergey Brin and Larry Page, were more than halving the number of shares they planned to sell, because of a lower expected price. Google's two main venture-capital investors, which initially planned to sell 4.5 million shares, pulled back from selling entirely. The IPO ended up including a total of 19.6 million shares, down sharply from the 25.7 million expected until yesterday.

Google also disclosed yesterday that the SEC had requested more information concerning a possible "quiet period" violation related to an interview of the founders in Playboy. SEC rules bar companies from making comments that could be interpreted as soliciting interest in an IPO. There may be more regulatory problems to come. A person familiar with the matter said the SEC's separate inquiry into unregistered shares and options issued by Google in recent years includes examining whether it violated financial disclosure regulations for a year or longer as a result. Google declined to comment.

The result yesterday was a far cry from the great expectations, built up over the months and weeks leading up to the IPO, that demand for Google's shares would help reignite demand for new tech stocks and pioneer a way for new companies to do an end run around Wall Street's old cozy ways. Instead, investors scrambled to place or lower their bids early yesterday following Google's announcement in the morning. Meanwhile, those who hadn't signed up for the offering last week were locked out of bidding at the lower price.

Google's offering still amounts to by far the largest Internet IPO ever. At the $85 price, it raised $1.7 billion, easily surpassing the $431 million BarnesandNoble.com Inc. raised in 1999. It ranked as the 25th-largest for all U.S. IPOs, according to data compiled by Renaissance Capital. The price made the company, founded six years ago by two Stanford graduate students, worth $23 billion, almost equal to General Motors Corp.

Moreover, Google's business remains a phenomenal success story. Starting as a spare Web site that searched the Internet well, Google later began selling advertisements linked to the content of users' queries. Sales and net income soared. Analysts still rave about Google's financial performance and say its growth prospects remain strong, even with increasing competition from Yahoo Inc. and Microsoft Corp.

No final conclusions on the wisdom of Google's course can be drawn until shares begin trading. Some analysts say many investors who sat out the IPO because of uncertainty about the process and the price may look to buy shares once they start trading.

But the enthusiasm that greeted Google's IPO plans in late April largely dissipated over recent weeks, amid a series of missteps by the company and its bankers, resistance from Wall Street and investors, and a poor market for tech shares and IPOs in general.

"They managed to tee off the broader constituency of Wall Street, and it's obviously hurt them," said Brad Ruderman, head of Beverly Hills, Calif., hedge fund Ruderman Capital Partners, who was sitting out the Google auction. "Wall Street wins again."

The contraction of Google's offering lowered the likelihood companies will use the unconventional Dutch-auction process for future IPOs. It also raised questions about the direction of the market for tech shares and IPOs in general, as the Google tailwind many hoped for is less likely to materialize. As Google itself had noted, an IPO that didn't go too well could tarnish its strong brand. That could be significant: A recent consumer survey concluded that Google's real advantage over rivals is no longer one primarily of Web-search technology but of consumer affinity for the Google brand.

In the end, Messrs. Page and Brin may have themselves to blame for setting expectations too high, in regard to both the pricing and their ability to avoid Wall Street's usual ways. The $85 price was about where many financial experts had pegged the shares' values early on.

From the start, the founders made clear they considered Google a breed apart. They declared that "Google is not a conventional company," registering for an IPO that would rewrite the rules. Their aim, they said, was to use a more efficient process and level the playing field so small investors could buy their shares, too.

Critics quickly noted that much of what the founders laid out for the IPO contradicted this populist posture. The company set two classes of shares to retain control and said it wouldn't offer much future guidance to investors following the IPO. Moreover, a bunch of insiders decided the offering was a good chance to start cashing out of their stock.

In hindsight, the founders vastly overestimated individual investors' willingness to navigate the complex, unfamiliar auction process and pay a $100-plus price.

A Dutch auction aims to maximize the return to the company going public and to any early investors who are selling through the IPO -- not "leaving money on the table." The company accepts bids for a set number of shares at a specific price. Then it calculates the level, called a clearing price, at or above which it has orders for all shares offered. All investors who bid that much or more get to buy the shares they sought at the clearing price, even if they had bid higher.

In essence, Google was seeking to break the lucrative hold on IPOs of Wall Street's powerful underwriters. Traditionally, underwriters buy all the shares in an IPO from the issuing company or sellers and then decide which favored investors get to purchase them at the offering price. Customers who get in on the ground floor often profit handsomely from the "pop" of an IPO that rises steeply in the aftermarket.

"In a traditional IPO, there would be conversations between the sales force and institutions about price, and you'd be out there trying to guide the market before the deal," says Sam Schwartz of Bryant Park Capital in New York. "You would then set the price, based on the receptivity of the market."

This Wall Street system is time-tested, having priced countless IPOs during the 1990s stock-market boom. But with the Dutch auction, in the absence of a built-in advantage to those who got in early, many large investors decided to stick to the sidelines.

Google's method meant investor interest emerged only after the price guidance was given, forcing the company and its underwriters to guess at what price the investors would buy the stock.

The company also ignored some advisers' counsel to delay the offering until September, when vacations would be less distracting to investors.

And it blithely pushed forward into one of the worst markets for tech stocks and IPOs in recent years. The Nasdaq Stock Market is down nearly 15% from its January high, after a 50% rise in 2003.

Google's attempt to keep Wall Street on a short leash was to have serious consequences. For regulatory and logistical reasons, the company needed a roster of investment banks to be part of the process. But it and its co-lead underwriters -- Morgan Stanley and the Credit Suisse First Boston unit of Credit Suisse Group -- kept the 26 other brokerage firms in the underwriting syndicate in the dark on many matters.

They antagonized them by demanding letters of credit from the firms in case their clients didn't make good on their bids, backing off only in the face of fierce resistance. They proposed small fees and, in some cases at least, little or no commission for the sales force -- removing an incentive for pushing Google shares to rich individuals and small institutional buyers. Amid these issues, Merrill Lynch & Co., which operates one of the nation's biggest "retail" brokerage networks, dropped out of the offering. A Morgan Stanley spokeswoman declined to comment. A CSFB spokeswoman couldn't immediately be reached for comment.

Tim Ghriskey, chief investment officer of money manager Solaris Asset Management, said Wall Street firms "were not as active" as they usually are in selling an IPO. For one thing, he said, no one from the lead underwriters called him as they usually do to introduce the deal or to tell him about the investor road show when it was in New York. "There didn't seem to be a lot of interest from the underwriters in spending a lot of time on this deal," he says. The relatively low "fees might have been part of that."

Ultimately, with its ambitious IPO, Google escalated the traditional antagonism between Silicon Valley and Wall Street into a larger, more bitterly fought battle. The moment of truth for Google apparently came Tuesday afternoon, as the deadline for bidders drew to a close.

As late as Monday, all seemed to be going well. CS First Boston and Morgan Stanley sent a message to the other banks in the syndicate telling them to urge investors to get their bids in on Tuesday. Google, meanwhile, asked the SEC to declare its registration effective as of 4 p.m. EST Tuesday and had initially planned to close the auction around that time.

Some analysts and investors speculated that Google's intent to end the bidding after just three business days meant it was pleased with demand. By Tuesday, it was clear to Google demand wasn't powerful. Its

representatives asked for a one-day extension, telling the SEC it was going to slash the estimated price range for its IPO by more than 20%.

There were other missteps along the way. Google said that its co-founders and some other investors would sell shares as part of the IPO, an unusual move, and disclosed that its general counsel faced possible SEC action for alleged securities violations while at a previous employer, a charge he denied.

When Google executives, including Messrs. Brin and Page and CEO Eric Schmidt, met with mutual-fund and hedge-fund investors at New York's Waldorf-Astoria Hotel the day after the pricing announcement, the presentation was light-hearted, and thin on details. Some investors sitting in the ballroom began speculating with each other whether the executives had spent any time practicing the presentation, or if they were winging it.

Glenn Krevlin, a New York hedge-fund manager who runs Glenhill Capital LLC, said he had no interest in the stock after attending the road show. "They didn't tell you anything. They came across as high and holy," he said.

By the end of the meetings, some large investors were grumbling, unhappy that Google wasn't willing to give any details in its meetings or in the prospectus about the company's existing relationships with partners or about what Google was going to do with all the money it was raising. "Their mantra was `Trust us,' " said Anna Nikolayevsky, who runs hedge fund Axel Capital Management, and considered buying shares before deciding against it. "That doesn't work for a company with a high price if you have no idea what the future will bring."

By early August, the downdraft in tech stocks, rumors of delays, and investor grumbling helped fuel a growing negative buzz. Google settled two disputes with rival Yahoo by giving it shares potentially worth more than $200 million. It disclosed details of a possible securities violation related to previous options grants and share issuances, something that triggered an informal inquiry by the SEC. The Playboy interview with Messrs. Brin and Page surfaced.

By last week, a number of investors, including some mutual funds and hedge funds, were on the sidelines, frustrated by the price and a registration process that some found cumbersome. Others said an auction process aimed at creating as high an initial price as possible rather than a first-day pop for investors gave them little incentive to bid.

In July, "when they came out with triple digits, I said, `You've got to be kidding me,' " says Michael Beberman, 39, who runs a computer store in New Brunswick, N.J., and originally planned to bid but decided against it.

"They should have started out at a lower price," says Dan Chung, president of fund manager Fred Alger Management Inc. in New York, which bid on Google's shares this week. "It's left a bad taste in a lot of people's mouths."

An official at Jacob Asset Management, which specializes in Internet stocks, says the now-cheaper Google shares look attractive. But the firm didn't bid because the old higher price range discouraged it from even registering to bid for shares in the auction. (Investors had to register by last Thursday to qualify for the auction bidding.) Darren Chervitz, the company's research director, says the fund will consider buying shares after the IPO, depending on where they trade.

The new price range is "more in line with our evaluation," says Mr. Chung of Fred Alger Management, which bid on Google's shares this week. "It's still not yet cheap though."

THE WALL STREET JOURNAL.

Heard on the Street

Google Shares Prove Big Winners -- for a Day --- Despite Run-Up Confusion, Flubs, Investors Who Bought in Auction At $85 IPO Price Had 18% Gain

By Gregory Zuckerman

1,641 words
20 August 2004
The Wall Street Journal, p. C1
(Copyright (c) 2004, Dow Jones & Company, Inc.)

INVESTORS WHO WENT through the cumbersome auction for Google Inc. shares were feeling particularly lucky yesterday.

The countdown to Google's initial public offering of stock was filled with confusion, frustration and miscues. The first day of trading was no different. But shares of the Internet search-engine company proved to be big winners, at least for a day.

The stock closed at $100.34 on the Nasdaq Stock Market, up 18% from the reduced $85-a-share IPO price in heavy trading -- some 22 million shares traded, which was more than the 19.6 million shares sold. While some of the gain can be chalked up to the fact that the projected offering price had been reduced in the days leading up to the IPO, it still was an impressive price "pop," especially in a dreary IPO market and in the midst of another down day for the technology-heavy Nasdaq Composite Index.

Any investor who paid $17,000 for 200 shares of Google in the auction was sitting on more than $3,000 in quick paper profits.

Google's two founders, Sergey Brin and Larry Page, did quite a bit better: The 38 million shares that each still holds after the IPO rose almost $600 million in value, to about $3.8 billion for each man. A Google spokeswoman declined to comment.

Yesterday's closing level remains below the $108-to-$135 range that Google originally estimated for its shares, but investors still called the debut a success.

"It's a pleasant surprise," said Dan Chung, president of fund manager Fred Alger Management in New York, which bought shares in the auction. "I thought it would open up modestly higher and then meander."

The climb in price seemed to justify the move by Google's founders to cut back the number of shares they sold at the $85 debut, as well as the decision by Google's venture-capital investors against selling any shares in the IPO, betting on a higher price down the road. Late Wednesday, Google sold 19.6 million shares at $85 each, netting $1.67 billion in the biggest "auction-style" IPO.

IPOs often begin trading with a measure of disorder, as investors gear up to trade and market makers try to figure out where a stock should open, and Google's had its share of problems. Like a runner jumping out of the blocks a bit too early, one unidentified brokerage firm making a market in Google's shares prematurely posted several trades of a few hundred shares at prices as high as $140.92, setting traders abuzz. But the stock was still in what traders refer to as the "quote-only period," when firms post quotes, rather than trades. The Nasdaq was awaiting word from the lead underwriters of the deal -- Morgan Stanley and Credit Suisse Group's Credit Suisse First Boston -- that trading could begin, says a

spokeswoman for Nasdaq. Nasdaq officials notified the brokerage firm of the flub, and it removed the trades from its order book.

Once the shares began trading, at 11:55 a.m. EDT, the stock jumped. The first trade in Nasdaq trading was at $100, up almost 18% from the IPO price. The stock quickly slipped to as low as $95.96, but remained well above the IPO price. The stock then turned higher again, but ended regular trading below the early-afternoon high of $104.06.

The performance was impressive in another downbeat day for the market, when the Nasdaq index declined 0.63%, or 11.48 points, to 1819.89. And Google shares showed surprisingly limited volatility, trading in a relatively narrow range throughout the day.

The surge came in part because many large and individual investors had ignored the **Google IPO**, figuring the original price estimate of $108 to $135 was too expensive. Others were dissuaded by the cumbersome Dutch-auction method, in which the price was set based on per-share bids made by investors. The offer price under such an auction is the highest at which there are orders for all shares being offered.

Tuesday, once Google slashed its price range to $85 to $95, even those investors who now sensed a bargain were prevented from shifting gears and participating in the IPO, because it was too late for them to register for the auction.

Yesterday was the first opportunity these investors had to pick up shares, and some of them jumped at the chance.

"The registration period was over before the cut in price was announced, so firms that would have wanted to participate at $85 were locked out," says Jack Ablin, chief investment officer at Harris Trust & Savings Bank in Chicago, who is considering buying shares.

But much of the activity seemed to come from individuals, though institutions picked up their activity at the end of the day. During Google's first hour of trading, the average size of a trade was 309 shares, according to market-data analysis from Birinyi Associates Inc. For the day, the average trade was 315 shares, suggesting that many big institutions that typically buy blocks of thousands of shares remained on the sidelines. In comparison, the average trade in Yahoo Inc. stock yesterday was about 420 shares, while Microsoft Corp.'s average trade was 613 shares.

"It isn't unusual for individuals to dominate trading in hot IPOs, and this one was geared to individuals," says Jeff Rubin of Birinyi.

But the fact that an eye-popping 22.1 million Google shares changed hands, more than the 19.6 million sold in the auction, indicated that many investors decided to flip their stock to score quick gains, perhaps unconvinced that the price climb will last. In this regard, it seems the goal of Google's founders to sell stock to long-term shareholders went unrealized. Still the pair succeeded in distributing shares beyond the mutual funds, hedge funds and Silicon Valley insiders who usually are the only ones able to get their hands on hot tech IPOs.

"If you sit back and look at the end result, more money went into the pockets of the people that deserved it," says Jeff Matthews at hedge fund Ram Partners. "If anything, it's showing us the Dutch auction can work."

The question now for investors: Is the price right to get in? During much of the lead-up to the **Google IPO**, analysts were busy figuring out how the company should be priced in relation to other tech

companies, such as Yahoo and eBay Inc. But investors need to figure out whether there is upside to buying at these levels. At yesterday's closing price, the stock is more expensive on an earnings-per-share basis than Yahoo, the company Google is most often compared with. Still, that price remains more reasonable on a cash-flow basis. John Tinker, an analyst at ThinkEquity Partners in San Francisco yesterday put a $120 price target on Google, arguing that growth should continue for Internet advertising.

But Andrew Schroepfer, founder of Tier 1 Research, a stock-research firm, placed a "neutral" rating on the stock, saying that at yesterday's levels Google already is fully priced, and is unlikely to rise another 15% soon. "It's no longer a buy for everybody," he says.

Many investors remain on the sidelines, wary of resistance for the stock in the coming weeks, as insiders likely will begin selling at least some of their shares. Starting 15 days after the first day of trading, lockup agreements, which restrict the sale of shares, will begin to expire on 4.6 million shares held by current and former employees. A second set of lockups expires after 90 days, allowing the sale of an additional 38.5 million shares, while another 24.3 million shares could potentially be sold after a lockup ending 120 days after the deal. Another 24.3 million shares may be sold after the 150-day period, and after 180 days lockups on 171 million shares will begin to expire.

The lockup period is unusually short -- this year it took 176 days, on average, before shares of an IPO could be sold. Moreover, there is a greater likelihood that some insiders will be selling in the coming weeks. That is because Google's venture-capital investors, led by Kleiner Perkins Caufield & Byers and Sequoia Capital, elected against selling any shares in the initial public offering, betting they could get a better price down the line. Analysts predict that the firms will begin selling the shares, putting pressure on the stock by adding supply to the market.

"I would expect the VCs to unload some of their shares," says Mr. Schroepfer. "The stock will settle and then the lockups become a pressure."

At the same time, underwriters on the deal have 30 days to choose whether to sell 2.9 million additional shares, the so-called greenshoe option common in IPO deals. The firms haven't yet sold those shares, according to people close to the matter; if Google shares stay up, these additional shares also likely will be sold.

While a prestigious deal for the underwriters, it wasn't a windfall. In fact, the underwriters were given a 2.8% fee on the **Google IPO**, which compares with a 7% fee on a typical public offering, though large deals like Google's usually net bankers 4.2%, according to Thomson Financial. The fees are the third-lowest on record for U.S. IPOs of $1 billion or more. Morgan Stanley and CSFB each earned $23.4 million on the deal.

THE WALL STREET JOURNAL.

A Second Chance To Buy Google? --- As Company Insiders Get Their First Opportunity To Sell Stock, Shares Could Dip Temporarily

By Jeff D. Opdyke and Jane J. Kim
1,360 words
2 September 2004
The Wall Street Journal, p. D1
(Copyright (c) 2004, Dow Jones & Company, Inc.)

ANYONE WHO didn't get enough Google hoopla during the company's initial public offering two weeks ago can take heart: The popular Internet search-engine company is again putting a bundle of stock on the open market.

Today marks the end of Google Inc.'s first so-called lockup period, meaning some company insiders will be free to sell their shares -- in this case, more than 4.57 million of them -- to the public. Often, the end of a company's post-IPO lockup period causes the stock to take a hit because of the fear that millions of additional shares will soon flood the market. For investors who missed out on the stock's surge right after the company went public, the question is whether this represents another series of buying opportunities.

The shares eligible for sale today are just the beginning. During the next six months, insiders -- the executives, employees, company directors and the venture capitalists who originally backed the company -- will have the right to sell off more than 270 million shares of the company. That's nearly 14 times the amount of stock Google sold at its IPO just two weeks ago.

Like just about everything involved with the **Google IPO**, this series of lockup expirations is unusual. Typically, insiders in companies that go public are prohibited from selling their shares for 180 days, a provision traditionally imposed by a company's investment bankers. But as it did with its quirky Dutch auction-style IPO, Google also established its own lockup provisions that begin unfolding unusually early. The company was able to do this because it sidestepped the traditional underwriting processes.

In Wall Street's eyes, the 270 million shares eligible to be sold over the next six months constitute a huge "overhang." They could temporarily drive down the value of Google stock or, at the very least, keep a lid on its appreciation. Thus, the coming lockup expirations could soon provide another -- and cheaper -- entry point. Current shareholders, meanwhile, should prepare themselves for what may well be a bumpy ride during the next few months.

"We're now coming to that moment of truth," says John Tinker, a managing director with ThinkEquity Partners, which has a "buy" rating on the stock. "There are a staggering number of shares that could come due."

Lockup provisions are standard in just about all IPOs and are designed to prevent insiders from immediately dumping their shares and pushing down the stock's price. Typically, insiders want a lockup period as short as possible so that they can profit quickly off their holdings; underwriters prefer longer lockups so that additional shares don't swamp the market and undermine the price.

Already, Google shares have come under pressure, falling from more than $113 to yesterday's close at $100.25 on the Nasdaq stock market. The stock's heavy trading volume should help absorb the impact of any new shares that may come to market after this first lockup period.

Yet, as independent research firm American Technology Research noted in a report released yesterday, it is "reasonable to assume that Google's shares could see . . . selling pressure going into major lockup

release dates, particularly this upcoming November and February," when substantially larger amounts of stock will be released.

One mitigating factor: Google's biggest stakeholders are subject to certain restrictions on how many shares they are allowed to sell. Under the Securities and Exchange Commission's Rule 144, so-called affiliates -- those investors who are typically directors, officers or who own more than 10% of the company's stock -- generally can only sell the greater of 1% of the outstanding stock or the average weekly trading volume during the last four weeks, per quarter.

The only people who can unload all of their shares are nonaffiliates who have held their stock for more than two years from the date the shares were first granted, says Gregg Berman, an IPO attorney for Fulbright & Jaworski LLP.

Certainly, just because shares are released for possible sale doesn't mean they'll all be sold. With a more traditional 180-day lockup, senior managers typically sell about 10% of their holdings. What happens with Google remains to be seen. Lower-level workers may opt to get out quickly to supplement their income and to prevent watching their paper wealth evaporate should a downturn on Wall Street send Google and other tech stocks reeling again.

Because it is in a so-called quiet period, in which the SEC limits company comments, Google won't discuss its unusually quick lockup period. But one of its motives may have been to give workaday employees and others -- such as consultants paid in stock instead of cash -- a quick exit, says David Menlow, president of IPOfinancial.com.

All of this is just the latest in what has proven to be one of the stranger episodes in Wall Street's IPO history. Google announced a year ago that it was considering a public offering of stock, prompting investors and investment bankers to salivate at the prospect of possible riches. But instead of following the traditional IPO process -- in which underwriters price the shares -- Google opted for the theoretically more democratic auction process, in which bidders determine the final sales prices.

Yet the process went awry when Google initially announced an expected price range well above $100, and well beyond the comfort range of most individual investors. Faced with lackluster demand for its shares, Google scaled back its offering, slicing the number of shares for sale and cutting the bottom of its price range to $85 a share, which is where the offering was ultimately priced.

With Google facing its first lockup expiration, investors can expect continued price weakness. Laura Field, an assistant professor of finance at Penn State, along with another researcher, found that a stock's price typically falls by about 1.5% on average in the days leading up to the expiration of its lockup period. For companies with a large venture-capital base -- like Google -- the performance tends to be about three times worse.

With Google trading around $100 a share, that would mean a price slip of a few dollars a share. But the drop could be more substantial. Consider Accredited Home Lenders Holding Co., which surged after its IPO and then saw its shares tumble more than 30% in the month before the expiration of its lockup period a year ago. In other recent IPOs, shares have sunk more than 20% in the two weeks prior to their lockup provisions expiring.

"The more shares a company is putting out there," Ms. Field says, "the more I'd be worried."

Going Twice

Two weeks after Google's initial public offering, its shares are going on sale again:

-- Beginning today and over the next six months, more than 270 million additional insider shares of Google will be "unlocked" and eligible to be traded.

-- When lockup periods expire, share prices typically fall, sometimes by a little, sometimes by a lot.

-- While insiders don't typically sell their entire stake, the fear they might usually weighs on the shares.

Google Goes to Market

More than 270 million insider Google shares will be eligible to be sold over the next few months.

-- Aug. 18: Google goes public at $85.00 per share.

-- Aug. 19: Google shares begin trading, closing at $100.34.

-- Sept. 2: First lockup period expires (15 days after IPO): 4.6 million additional shares eligible for public sale

-- Nov. 15: Next lockup period expires (90 days after IPO): 39.1 million additional shares eligible for public sale

-- Dec. 15: Next lockup period expires (120 days after IPO): 24.9 million additional shares eligible for public sale

-- Jan. 14, 2005: Next lockup period expires (150 days after IPO): 24.9 million additional shares eligible for public sale

-- Feb. 14: Final lockup period expires (180 days after IPO): 176.9 million additional shares eligible for public sale

First/Going Dutch

Two Cheers For The Google Ipo

Joseph Nocera
797 words
6 September 2004
Fortune, p. 42
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A few hours after Google began trading on Nasdaq--with the stock over $100 a share, up almost 20% from its $85 IPO price--we put in a call to William Hambrecht to gauge his mood. At 69, Hambrecht is a Wall Street renegade; back in the day, he co-founded the tech- oriented investment firm of Hambrecht & Quist, but more recently he's become perhaps the most visible spokesman for Dutch auctions-- the very method Google had just used to go public. Although CSFB and Morgan Stanley had co-led the deal,

Hambrecht's current firm, William R. Hambrecht & Co., had acted as an advisor to Google and had been one of the firms through which individual investors could bid for **Google IPO** shares.

As you may have noticed from reading the coverage leading up to the **Google IPO**, Wall Street hates Dutch auctions. With good reason: If the Dutch auction ever becomes the norm, investment banks will lose millions in underwriting fees. Almost all of Google's missteps leading up to the IPO--the foolish Playboy interview by Google's co- founders; the failure to register some pre-IPO stock; the high early price estimate put out by Google, followed by the somewhat embarrassing lowering of the price estimate--was somehow blamed on the method Google had chosen to go public, usually by anonymous Wall Street investment bankers muttering darkly to the Wall Street Journal. Then, after Google began trading, critics claimed that the auction had failed because Google hadn't raised as much money as it had originally hoped--and because the stock had had that 20% aftermarket "pop." (Part of the appeal of a Dutch auction is that the process will establish a "true" market price from the moment a stock starts trading--and eliminate the egregious one-day run-ups that characterized so many Internet IPOs.)

Hambrecht, however, was pretty sanguine about the whole thing. "I think it worked," he said. "Think about Google's objectives. It wanted its 100 million user base to have access to its IPO, and it did that. It wanted to get rational price discovery, and it did that too. They believed in a rational bidding process, and that's what the auction gave them."

When you stop and think about it, he's right. All the controversies that swirled around Google in the days leading up to its IPO could have happened just as easily with an old-fashioned Wall Street underwriting. Indeed, the IPO might not have even happened had Google gone the traditional route. The combination of Google's mistakes, investor skittishness, and a deteriorating market might well have caused a Wall Street underwriter to advise Google to fold its tent. "In this market, to raise $1.4 billion and establish a $23 billion market cap--that's pretty good," says tech entrepreneur Randy Komisar. "You could argue that it only got done because of the auction." Adds Hambrecht: "The fact that Google reset its offering--that's not a weakness of the auction, that's a strength." Google was getting what the market was giving it--no more and no less.

If anything, the real problem with the **Google IPO** is that the company succumbed to Wall Street pressure more than it needed to. While individuals used such firms as Hambrecht's to bid for shares, the Wall Street firms managing the deal insisted that the big buy- side institutions go through them. And those institutions were the ones demanding, in Hambrecht's words, "a discount." Hambrecht says that individuals bidding for stock through his firm were averaging around $97 a share--remarkably close to the first-day closing price. But the institutions didn't come in until they knew they were getting a price that was likely to pop right away. Old habits die hard.

So now the question is: Will other companies follow Google's IPO route? My own guess is, not anytime soon. Deserved or not, all the bad publicity Google received is likely to scare away others that might have been tempted to use a Dutch auction. But Hambrecht, who's been fighting this fight for nearly a decade, is more optimistic. "When people really think through what the auction accomplished and what Google did--that they got it done and the price was fair and that the market, not the underwriter, decided the price--I think it will be a strong, persuasive case," he says. "Companies are going to have to look at this." --Joseph Nocera

Now the question is, Will others follow Google's route? Probably not anytime soon.