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After Taking Heat for Its Dutch Auction Model, WR Hambrecht May Have the Last Laugh

Freddie Mac buys in, and Wall Street firms may be next

Two years ago Wall Street chuckled as an upstart investment bank, WR Hambrecht + Co, began holding Dutch auctions for initial public offerings, with the hopes of eventually licensing the technology to other investment banks. Now, one market turn and one major endorsement later, several investment banks and other financial players are seeking access to the firm's auction technology—and no one is laughing anymore.

In a major coup WR Hambrecht has agreed to develop a customized version of the firm's auction technology for Freddie Mac's reference note sales. The first auction is slated for early next year and six to eight more will follow throughout the year. Freddie Mac's first reference note and bond auction was held two years ago, and since then the market has grown to about \$125 billion.

In addition, some big Wall Street investment banks have contacted WR Hambrecht in hopes of inking a similar agreement, said several executives at the firm, who expect a major firm endorsement early next year. Wall Street players, once cool to the idea, confirmed Hambrecht's success at starting to convert its rivals. "In the age of electronic trading and the unprecedented access that individual investors now have, Wall Street is looking at the auction model as a way of appealing to more than just institutional investors," said Stu Francis, head of global technology banking for Lehman Brothers. In recent months Hambrecht has been talking to "just about everyone" on Wall Street about using the auction technology, and people are taking a hard look at it this time around, Francis said.

"It wouldn't surprise me if a big investment bank came out with a plan to use auctions like this," he added. "I mean, the current IPO process has lots of pluses, but

in some ways it could be done better."

Any such alliances would go a long way to validating the brainchild of Bill Hambrecht, who left his other namesake, Hambrecht & Quist, to start WR Hambrecht in late 1997. "Traditional Wall Street investment banks may hate the Dutch auction, but they won't

Dutch auction model, the latest one in May when the market had already begun to turn sour. The firm has long hoped to license the product to others, but until the Freddie Mac breakthrough, few thought it would succeed.

But the terrible market for new issues may actually help the way WR Hambrecht oper-

W.R. Hambrecht's Dutch treat

Open IPO* (equity)	Date	IPO price	Status
Nogatech, Inc.	5/18/00	\$12	In August, Nogatech was acquired by Zoran Corp. for \$170 million in stock.
Andover.Net Inc.	12/8/99	\$18	In February, Andover.Net was acquired by VA Linux Systems Inc.
Salon.com	6/22/99	\$10.50	Salon sunk with the rest of the Net's content sites, now at around \$1 a share.
Ravenswood Winery Inc.	4/9/99	\$10.50	After a slow start, the winemaker rebounded to around \$13.50 a share.
Open Book (debt)	Date	Amount	Status
Dow Chemical	8/15/00	\$300 mil.	Dow sold a \$300 million bond offering in first online auction of corporate debt.

* Withdrawn IPOs include Aristole International, Inc. on Nov. 10; Sightsound.com Inc. on Sept. 26; and GreatFood.com, which was acquired by 1-800-FLOWERS.com, after filing.

say it's a failure," said Bruce Mann, senior managing director and head of mergers and acquisitions at WR Hambrecht. He declined to say which Wall Street firms have contacted the firm, but Michael Evelyn, Hambrecht's co-head of debt capital markets, suggested that there will be more announcements similar to the arrangement made with Freddie Mac early next year.

Hambrecht has done four IPOs via the

ates. The Dutch auction method often allows issuers to raise the maximum amount of capital possible, without the headaches of a first-day pop, subsequent flipping and price decline. And with those first-day doublings and triplings of IPO share prices relegated to the dustbin of financial history (for now), Hambrecht's deals may not look so pale by comparison. "It's a tough market right now," said John McCracken, managing director and head of corporate

finance at WR Hambrecht. "A lot of companies can't get additional capital, but I think our process allows us to take public companies that otherwise couldn't go at this time."

Hambrecht expanded its auction model in August, underwriting the first-ever online auction of corporate debt, a \$300 million bond deal for the Dow Chemical Co. Due out next year—online auctions for second-



Bill Hambrecht's Dutch auction brainchild is finally catching on.

ary offerings, convertibles and junk bonds.

"We've been pretty public in our marketing of OpenBook (the debt auction model) and that we'd be willing to share the technology with other investment banks," Evelyn said. "The Dow Chemical offering validated the model by offering fair access to a good security."

Still, even relationships with big names like Dow Chemical and Freddie Mac haven't gotten WR Hambrecht the respect from its peers that executives feel the firm deserves. "Hambrecht has been way out there," said one West Coast investment banking rival, requesting anonymity. "They've really fallen off the radar." Of course, he could be speaking geographically. Situated between Chavo's Mexican takeout and a Korean auto body shop far away from San Francisco's financial district,

the firm's nondescript headquarters hardly reeks of tech-bubble excess, only the inflated real estate values it has spawned.

Such attitude from their rivals may beg the question: After all the derision WR Hambrecht has suffered for its Dutch auctions, why is Wall Street so eager to enlist now?

Pressure from clients?

"I think some of the pressure is coming from the client side," said Evelyn. "We've had many discussions with both large and small investment banks, either directly or in conjunction with a client of theirs." In those cases, it's the client that is pushing to sell its securities via the auction system to maximize the capital raised; and it's the investment bank, reluctant to lose the client's business, that agrees to seek a working agreement with Hambrecht.

The auction process used by Hambrecht combines proprietary software with a method of providing complete transparency for the underwriters, the issuer and the buyers of the securities. For that reason alone, Mann said, investment bankers don't like it. "The auction process takes away the smoke and mirrors of the investment bankers, and they don't want to lose their smoke and mirrors," he says.

Although dismissed by investment banking rivals, the auction process has won over some market experts. "It does rationalize the process," said Randall Roth, senior analyst for Renaissance Capital, which runs the \$100 million IPO Aftermarket Fund. "The stock price is not manipulated like in traditional underwritings." Because of this lack of price manipulation—which often leads to those massive first-day pops many IPOs have seen—it's fairer to the investor, and it allows the company to raise the most amount of money without

leaving any on the table, Roth explained.

Here's how it works: After a traditional road show and marketing period, investors weigh in with bids, listing the number of shares they want and how much they'd pay for them. The bids are then stacked, and the firm runs down the list until all the shares are sold. All bidders then get the lowest price offered for the shares.

For example, say a company wanted to sell 1,000 shares in a price range between \$10 and \$12 per share. If one investor offers to pay \$12 for 200 shares, another offers \$11.50 for 400 shares, another offers \$11 for 300 shares, and a fourth investor offers \$10.75 per share for 300 shares—all shares would be sold at \$10.75, because that's the lowest bid by which all 1,000 shares will be sold. However, some or all of the investors may get less than the number of shares they've asked for since the total number requested exceeds the shares offered. This prorating of shares and the lower price paid by almost all shareholders guarantee some upside in the aftermarket.

It's not a perfect situation, however, Roth added. Because of the lack of pop on these stocks, the auction process doesn't fully compensate the investor for the risk he is taking and, in fact, may require more support from the underwriter in the aftermarket.

Still, the boys at Hambrecht think they've got a winner, and say everybody is starting to take notice. "It's just a better mousetrap," McCracken said. "In fact, we're kinda manic about the auction process." Manic or not, if Hambrecht's auction model proves to be one way to get deals done during this market downdraft, Wall Street is sure to take notice.

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WR HAMBRECHT + CO