Zipcar Golden IPO's Dark Lining: a $50 Million Blunder by Underwriters

By Steve Puma | April 28th, 2011 1 Comment

On April 13th, Zipcar, the well-known, and wildly popular, car-sharing company, was celebrating a key milestone in every start-up's growth: a very successful initial pubic offering (IPO) of its stock, to the tune of $180 million raised. By the next day, the company's stock was up to $28 per share, a rise of 60%, over its initial price of $18 per share.

To most, this would seem like a pretty amazing day for everyone involved. However, as Business Insider's Henry Blodget points out, this was not the case. Although a huge jump in stock price is great for institutional investors, who will earn the difference in price, when their Zipcar stock is re-sold, it means that the company missed over $50 million in potential earnings from their sale of stock!

Blodget accuses Zipcar's underwriters, Goldman Sachs and JP Morgan, of "wildly underpricing the deal, and selling Zipcar's stock to institutional clients, way too cheaply," which is a staggering display of either ineptitude or outright cronyism on behalf of those investment banks.

Although IPO pricing is certainly not exact, setting an appropriate price is a huge part of the underwriters' job. In addition, a slight discount on price is to be expected. Blodgdet explains: "it's true that underwriters always try to modestly under-price deals, to the tune of a 10%-15% 'IPO discount'…If there were no discount on IPOs, there would be little incentive for big investors to play ball before the offering: They'd just wait until the stock started trading and buy it then. This, in turn, would make it harder for companies to raise capital. So the modest discount, in which companies and underwriters reward investors with a good deal, makes sense."

(Although crazy post-IPO stock rises have happened, such as during the dot-com bubble days, they usually come because of a breakthrough technology, whose amazing growth could not have been predicted. A primary example would be Google—there was simply nothing in the past to reliably compare it to.)

Goldman and Morgan's margin goes well beyond a typical discount, and beyond the expected margin for error. Although at the forefront of the car-rental industry, the level of investor interest in Zipcar's stock should not have been a very difficult thing for these "wizards of Wall Street" to asses. Quite the contrary: they may be all too good at it, and are simply passing the savings along to their institutional customers.

> **The institutions that bought the Zipcar stock last night are now 50% richer, just by virtue of being good clients of Goldman Sachs and JP Morgan. And that money came right out of the pockets of Zipcar and the Zipcar investors who sold on the deal.**

Blodget doesn't really mince words, in what he thinks is really going on (emphasis mine): "If Zipcar can sustain a price of $27 a share this morning, Goldman and Morgan should have sold it to institutions at $23-$24. *[at the writing of this article, Zipcar shares were at $26.50]* Because the stock was instead sold at $18, **Zipcar and Zipcar's existing investors just got screwed by Goldman Sachs and Morgan Stanley to the tune of $50 million.** That is an outrageous price. And the windfall accrued to the huge institutional clients of Goldman Sachs and JP Morgan. And don't think that Goldman or Morgan is going to let those clients forget it."

Not being a finance lawyer or SEC regulator myself, I have no way of knowing if there is any way to *prove* that shady dealings were involved in Zipcar's IPO. But, If I were Zipcar's CEO (or any of the company's other pre-IPO investors), April 15th would have had me asking my lawyers some very serious questions about this transaction.

At a minimum, it certainly seems that IPOs are one more area of finance that needs to be more closely scrutinized, and, perhaps, more tightly regulated.

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Steve Puma is Director of Business Development for SABA Motors, and a sustainability writer/consultant. His

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