Chapter 23: Raising Equity Capital

Ex. RealNetworks Greenshoe Provision

In 1997, Goldman Sachs and other banks took RealNetworks public with an IPO.

=> see Figure 23.3 and related discussion in section 23.2.3 of textbook

The underwriters bought 3,000,000 shares from RealNetworks at $11.825 per share, but sold 3,450,000 shares in the initial public offering at $12.50 per share (they sold the shares they bought plus the 450,000 shares they have the right to buy with the Greenshoe provision).

Implication: They are short 450,000 shares of RealNetworks.

Q: How does the Greenshoe provision protect the investment bankers as they support the stock price after the IPO?

1) After being issued at $12.50 per share RealNetworks stock quickly started trading at $19.375 per share because of high demand.

   => the underwriters cover their short position by exercising the greenshoe provision

   Additional profit = $303,750 = **450,000 x (12.50 – 11.825)**

2) Assume, instead, that RealNetworks stock had fallen to $8 per share when it started trading.

   => the underwriters cover their short position (and support the stock price) by purchasing shares in the open market at $8 per share

   Additional profit = $2,025,000 = **450,000 x (12.50 – 8)**

   Note: Underwriters have agreed to help support the price, so this additional profit is likely "spent" as buy up additional shares in an effort to drive up the price after IPOs.