

LIFTING THE LID-As Baidu opens lock-up, experts see shares slide

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By Scott Malone

NEW YORK, Dec 16 (Reuters) - Shares of Baidu.com Inc. (BIDU.O: [Quote](#), [Profile](#), [Research](#)) have fallen as much as 9.7 percent since Tuesday, when the company said it would allow insider shareholders to start liquidating their holdings more than a year earlier than was planned at the time of its initial public offering on Aug. 5.

And that decline may be exactly what the Beijing-based Chinese Web search engine operator wanted, IPO experts said.

Often described as the Chinese equivalent of Google Inc. (GOOG.O: [Quote](#), [Profile](#), [Research](#)), Baidu's IPO had one of the wildest performances of the year.

Its shares climbed from a \$27 offer price to a \$153.98 high in their first two days of trading, before easing off to their more recent range between \$64 and around \$85. The shares were trading midday on Friday at \$67.58 on the Nasdaq.

One reason the shares are priced so highly, experts said, is that there are so few of them available. Baidu offered 4.6 million shares in its IPO, just 14 percent of the 32.9 million shares outstanding.

Baidu's owners agreed with the banks underwriting the deal -- Goldman Sachs (Asia) LLC, a unit of Goldman Sachs Group Inc. (GS.N: [Quote](#), [Profile](#), [Research](#)) and Credit Suisse First Boston, a unit of Credit Suisse Group (CSGN.VX: [Quote](#), [Profile](#), [Research](#)) -- to hold their shares through February 2007, an 18-month lock-up period.

On Tuesday, they disclosed a change to that arrangement, which over the next two months will more than triple the number of Baidu shares available on Nasdaq, called the "float."

On Dec. 19, 3 million shares will be released from the lock-up, with another 7.1 million shares following on Jan. 31. That would raise the float from 4.6 million shares to 14.7 million.

The remaining 18.2 million shares would be covered by the original lock-up agreement, according to a Baidu spokesman, which also limits the amount of holdings any individual shareholder covered by the original lock-up deal can sell.

Lock-up deals are agreements reached prior to an IPO between the underwriters and a company's owners that the owners will not sell additional shares other than those offered through the IPO for a specified time period, typically around 180 days. Lock-ups are not required by U.S. regulators.

"The purpose of the lock-up is to create the perception that the folks running the company, the early investors, are in it for the longer term -- they're not just cashing out in the IPO," said Timothy Pollock, a professor who studies IPOs at Penn State University in State College, Pennsylvania.

Lock-ups, however, by limiting the supply of shares available on the public market, also serve to lift a stock's price.

Baidu's revised lock-up deal, by increasing the supply of shares available and reducing insider holdings, may well result in a slide in Baidu's share price, experts said.

But, they said, inducing such a slide now could help avoid a sharper drop-off if the company released all 28.3 million shares from the original lock-up at the same time.

"In those cases in which you have IPOs that trade far above their issue price, anything that you can do to minimize that cliff effect on the day of the lockup expiration is in general a good thing to do," said Don Straszheim, chairman of Straszheim Associates Inc., of Los Angeles.

Straszheim was among the first to call Baidu shares overvalued as they hovered near the \$150 mark. He said he now considers a price range of \$50 to \$75 "reasonable" for Baidu.

"Sometimes," said Jay Ritter, an IPO expert and professor at the University of Florida in Gainesville, Florida, "an underwriter is comfortable with ending a lock-up period early if they think that the public float is limited and the stock price has kind of run away from the fundamentals."

"This is a situation where from the first day of trading it was difficult to justify the price on the basis of fundamentals," Ritter said.

On the other hand, Penn State's Pollock noted there's a limit to the logic of avoiding the cliff.

"Just because it all becomes available on one day doesn't mean they (inside shareholders) have to sell it on one day," Pollock said.

"It does undermine the integrity of the process, in my mind, if they can go change their expiration periods."

More important than the change in the lock-up itself, experts said, is for outside investors to watch how aggressively insiders take advantage of the changed terms.

"A longer lockup, especially by executives, is certainly a vote of confidence in the company that investors do pay attention to," said Ritter.

"And so," he said, "if the stock price has been boosted by that vote of confidence -- the long lockup -- shortening the lockup eliminates that extra vote of confidence..."

"More cynically, you could also say existing shareholders want to take advantage of the situation and get out while the getting is good."

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