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Eric Sprott: Short sellers tarnished my IPO

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Star hedge fund manager Eric Sprott admits he was taken aback by his company's less than stellar stock market debut Thursday, and figures short sellers were behind the massive trading volume.

“I have to believe or think or conclude that there must have been some significant short selling,” Mr. Sprott, the founder, chairman, chief executive officer and controlling shareholder of Sprott Inc. [SII-T], himself a short-seller of no mean repute, said Friday.

“I can't believe that on a 20-million-share issue that 12 million shares, approximately, should trade – it's ludicrous, “ he said in a telephone interview before stock markets opened Friday and the shares fell again.

Priced at $10, the firm's IPO raised $200-million for Mr. Sprott and other employee shareholders, put about 16 per cent of the highly regarded Toronto hedge fund company in outside investors' hands and valued the firm at about $1.5-billion in all.

'I have to believe or think or conclude that there must have been some significant short selling,' star fund manager Eric Sprott said Friday a day after the less than stellar IPO of Sprott Inc. *(Charla Jones/The Globe and Mail)*

Sprott Inc.

Sprott Inc. continued to trade below its IPO price of $10 per share on Friday morning.

Far from delivering the sort of opening day pop that IPOs so often deliver, the shares plunged about 7 per cent to $9.31 at the opening bell on the Toronto Stock Exchange Thursday. They finished the day at $9.84, having traded at or above the IPO price only very briefly at midday.

The shares opened up six cents at $9.90 Friday, but quickly fell as far as $9.56 before recovering to $9.77 in late-morning trading.

Short sellers bet against companies. They borrow shares and sell them in the belief that the price will fall, enabling them to replace – and return – them more cheaply down the road, pocketing the difference as profit.

However, some Bay Street players questioned Mr. Sprott's interpretation of Thursday's events.

Investment bankers who help short-sellers said Friday that it is very difficult to short stock that has just been sold in an IPO. That's because it is tough to borrow stock in the early days when the shares have yet to actually land in the accounts of holders.

A speculator could take a risk and try a “naked” short, which involves selling shares first and hoping to be able to borrow them after a few days. But that's chancy and frowned upon by regulators.

Several analysts and investors said Thursday that, at 10 times Sprott's adjusted earnings before interest, taxes, depreciation and amortization, the firm's shares were expensive compared with those of several other already public asset managers.

Mr. Sprott said this depends on whether investors believe in the strategy of betting heavily on precious metals, energy and other resources his firm has used to generate sparkling returns and a reputation as one of Bay Street's brightest shops.

“It's certainly a robust valuation if you don't believe in what we do,” he said. “If you do believe in what we do, it's not that robust.”

He also argued that market players who think the resource and energy boom may already have peaked are dead wrong.

“Everybody in the world is trying to call the end of resources,” he declared. “They're just wrong every day and every day they look worse.”

Mr. Sprott also cited his firm's rapid growth and strong returns in defending the IPO price.

“We've done well for a long time, we're doing well this year and we think we're well-positioned,” he said. “If we can repeat our former performances, we will, I think, more than substantiate that valuation.”

Mr. Sprott would not speculate about when the shares might climb above the issue price.

However, he certainly was not willing to concede that his firm may be facing the same sort of phenomenon that greeted Gluskin Sheff & Associates, another Toronto-based money manager that went public in May, 2006, and also failed to generate a debut pop. Issued at $18.50, its shares fell 21 cents on their first day of trading, dropped as far as $12.50 in November of 2006 and did not rise above their IPO price until the following February.

“I don't know if I want to call it a phenomenon,” he said. “It's only been one day.”

With a file from reporter Boyd Erman