Shorting Facebook Is a Pricey Proposition, For Now

By Steven Russolillo

Short sellers looking to pounce on Facebook’s disappointing debut in the public markets will have to pay a hefty premium.

About 18 million Facebook shares are on loan, considered a proxy for short-selling activity, according to figures from securities-financing tracker Data Explorers, a Markit company. That’s about 4% of the free float of shares on the open market, which is a pretty low amount when compared to other bigname tech IPOs. By comparison, more than 70% of LinkedIn shares were out on loan after the company’s IPO last May.

The limited supply of Facebook shares on loan has been coupled with high demand, driving the price to short Facebook even higher. The cost to borrow Facebook shares is in the most expensive universe of stocks that Data Explorers tracks.

Facebook shares are up 2.6% to $31.70. The gains come after shares dropped 8.9% yesterday, and 11% on Monday. The stock priced on Friday at $38, which at the time valued the company at about $104 billion.

Investors who want to short shares borrow the stock and then sell it, betting that the price of the shares will fall and that they can buy them back at a lower price for return to the lender. In order to borrow the shares, the investors have to pay the owner a fee, normally an annualized percentage of the stock’s value.

“It typically takes about five days for shares to be allocated, settle and make their way into securities lending programs, where they can be lent out to prime brokers who sell short on behalf of their clients,” says Alex Brog, an analyst at Data Explorers. “As more supply finds its
way into securities lending programs and volume in the option market starts picking up, the cost to short gets significantly cheaper and the risk of recall or squeeze decreases as well."

That dynamic looks like it’s already playing out today. Short interest in Facebook shares surged this morning, according to Andrew Shinn, director of research for Astec Analytics, a unit of SunGard. That has, at least temporarily, driven down the cost to borrow shares from a high level. But it still remains elevated and will likely continue to be volatile in the coming days and weeks.

“So far this morning, however, it’s easier for short sellers to secure borrowed shares,” Shinn says. “Nevertheless, the cost-to-borrow Facebook is just as volatile as the stock…Short sellers that want to short Facebook may want to lock in a borrow sooner rather than later.”

**UPDATE:** Shinn forwards some updated data on short-selling activity in Facebook shares. Turns out, the cost to borrow Facebook shares is more than four times cheaper now than what it was yesterday. Facebook went from being the 40th-most-expensive U.S. stock to borrow yesterday to dropping out of the top 500 today.

Shinn explains the mechanics behind the sudden reversal:

> Regarding the volatility in the cost-to-borrow, and how it was high yesterday and now it’s (relatively) inexpensive, this is not surprising, because the securities lending market is just like any other market where supply/demand meet. So many lenders were hoping for high borrowing costs because they’d make more money for their institutional clients. But we could very well see borrowing costs stay low or increase as supply and demand continues to change. For instance, if institutional investors that are lending shares decide to sell their FB shares and recall their loaned shares, that would constrict supply, and send borrowing costs higher, all else equal.
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