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Plugged In

Fewer, Cheaper Exits for Tech

By Mark Veverka

WHAT IF YOU WERE A VENTURE CAPITAList and you'd just selected Merrill Lynch and Lehman Brothers to take your prized portfolio company public?

Bad call. But the nightmare hypothetical raises questions about the value–or lack thereof–that bulge-bracket investment banks bring to emerging growth IPOs and mergers, especially when the financial industry is under siege.

The recent collapse of some of these big independent firms is likely to improve the fortunes of high-quality boutique banks that concentrate on smaller companies in technology, biotech and consumer goods, such as Cowen, Pacific Crest Securities and William Blair–to name just a few. The big firms' massive distribution is a big advantage, and they will still compete for deals. However, the track records of combined commercial/investment banks hasn't been too strong, particularly in tech finance. Witness Bank of America predecessor NationsBank's purchase of Montgomery Securities.

"It's going to open up some opportunities for us, (but) we aren't going to change our strategy," says Pacific Crest Chief Executive Scott Sandbo.

Pacific Crest, of Portland, Ore., focuses on technology and has been ranked No. 1 tech research boutique by Institutional Investor magazine six times.

"I think that the better boutiques will thrive because of their sector focus," says Scott Potter, who is the founding managing partner of San Francisco Equity Partners, a private-equity firm. "The boutiques tend to deliver better service anyway, and this meltdown will only further enhance that," says Potter, previously a software company CEO.

Rodney Altman, a senior partner at CMEA Ventures in San Francisco, posits that there is an opportunity for boutiques to grab share. "There's going to be less need for big investment banks" from start-ups, says Altman, a practicing physician who specializes in life-sciences venture capital.

Of course, what might be good for boutique investment banks isn't likely to be good for private-equity firms and venture capitalists, he says. "One of the potential pitfalls in which we all might share is (equity) dilution," Altman says.

The global liquidity crisis is going to make selling companies more difficult, whether through IPOs or buyouts. Merger financing will be tougher to come by, and internal valuations of private companies will need to be reset at lower prices, to the chagrin of firms that may have been funded at the top of the market. The decimated stock prices of potential acquirers adds insult to injury, making stock-based acquisitions less attractive or feasible.

Companies hoping to be sold in the next couple years will need to become more efficient or raise more capital, diluting early investors, including execs and employees. The IPO market will only get tougher than it already is.

Because venture and private-equity funds don't mark down their assets as quickly as the stock market does, it might be wise for growth investors to concentrate on existing tech and biotech stocks hit by the financial crisis, says Jon Merriman, chief exec of Merriman Curhan Ford, a boutique investment bank and brokerage. He should know. Merriman Curhan Ford (ticker MERR) shares fell to about a dollar last week, down from $6.50 in February.

Says Merriman: "Anyone putting money to work in stocks right now is going to kill it." ■