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The New Boutiques

By Tom Stein

As tech banker Ron Lissak looked up from his coffee at the San Francisco café where he was meeting the chief executive of a small, venture-backed company, he was surprised to find he wasn't the only fugitive of a big investment bank there. In fact, as he gazed around the room, Lissak saw two other investment bankers who, like him, had left their high-profile banks to start a new tech boutique—apparently the latest craze in Silicon Valley.

Lissak, who had just left Banc of America Securities and was extolling the virtues of Catapult Advisors (started by him and other tech-bust refugees from Goldman Sachs and Credit Suisse First Boston), recalls the moment as one of those weird coincidences that somehow captures the exact spirit of the times.

"I guess when your industry is in such turmoil, you can either become a taxi driver or you can strike out on your own and build a firm from scratch," he says. While the true number of tech bankers-turned-taxi drivers may well be zero, at least 20 tech banking boutiques have sprung up in the San Francisco Bay area in the last year alone, according to bankers. Indeed, when Lissak first got his license, the local National Association of Securities Dealers official wished him good luck after telling him he had just approved more than a dozen firms with the same business plan, and had several more waiting on his desk. Good luck, indeed!

One might wonder who would be crazy enough to launch a new boutique at perhaps the worst time in the history of the technology industry. After all, IPOs are virtually non-existent and M&A transactions have fallen off a cliff. For all of 2001, 26 U.S. tech companies went public, raising $10.7 billion, according to Thomson Financial. That's a far cry from the glory days of 1999, when 386 U.S. companies went public, raising $37 billion.

And almost nobody is counting on a quick recovery. The big investment firms are rapidly retreating from the tech sector. They are slashing jobs, hacking salaries, reorganizing units and desperately trying to eke out any business at all.

In fact, there are constant rumblings that some of the larger firms are pulling up stakes and kissing technology goodbye, at least for now. Possibly the biggest departure is that of Merrill Lynch & Co., which came to the tech party late and now has shut down its Silicon Valley office, no longer even employing a technology head and lumping technology into a global communications, media and industrials group.

Even Credit Suisse First Boston is a shadow of its former self now that star banker Frank Quattrone has been reined in, compensation has been cut back, and the firm, while not admitting guilt, has paid $100 million to settle charges that the firm received kickbacks from customers in exchange for access to IPO shares. After cutting 1,000 jobs in January, CSFB announced a new round of layoffs in March that is expected to hit tech bankers even harder.

And the top two tech leaders Morgan Stanley and Goldman Sachs are ducking for cover. Late last year, both firms were claiming they would not cut back their tech departments, saying that was because they did not over-hire when the market was hot. But now, according to Wall Street sources, Goldman is including a large number of tech bankers among the 2,000 additional ones expected to get the axe this year. Morgan Stanley has not announced any tech layoffs, but bonuses for all bankers are being cut severely.

In what seems a statement in itself—and certainly a sharp contrast to recent years—all four of these banks declined to comment for the story.

The odds may seemed stacked against them, but such turmoil at the big firms has inspired some maverick bankers to go out on their own. Ultimately, they hope to replicate the early success of the original tech-focused investment boutiques like Montgomery Securities, Robertson Stephens, Alex. Brown, and Hambrecht & Quist. Those boutiques, now part of giant banking institutions—BofA, Fleet Boston, Deutsche Bank and J.P. Morgan Chase respectively—are also experiencing mass layoffs on top of the identity crisis that has plagued them since being snapped up by bigger rivals.

But creating a successful tech boutique, even in the best of times, is no small feat. At the height of Internet mania, at least six so-called "next-generation" investment banks including E*Offering, Wit SoundView (now SoundView Technology Group), Epoch Partners, OffRoad Capital, and W.R. Hambrecht were created. Their stated goal was to use the Internet to freely disseminate information and democratize the industry so that individual investors would be equal to big institutions. In 1999 and 2000, these firms helped managed about 500 stock offerings that raised more than $100 billion, according to Thomson Financial.

But now that the bubble has burst, most of these firms are either out of business or struggling to survive. W.R. Hambrecht, for instance, is just barely hanging on and has imposed a $60,000 cap on base salaries for all employees. Meanwhile the assets of Offroad Capital were bought by the New York Private Placement Exchange last October and Goldman Sachs snapped up Epoch's assets last June.

Throwback to the past

To their immense credit, the new boutiques are not trying to overhaul the system as were their Internet-spawned predecessors. Michael Moe of ThinkEquity Partners, one of the new boutiques, says he is quite content to play by the existing rules. A former research analyst at Banc of America Securities, Moe sees his new firm as a throwback to the past rather than a model for the future. "There used to be firms like Montgomery that focused on growth companies and provided advisory services, but then they were bought by commercial banks," says Moe. He adds that even though bulge-bracket banks such as Goldman Sachs and Morgan Stanley do have significant tech practices, they tend to ignore the smaller clients because those deals do not generate enough revenue.

These big institutions became critical to the market when its size was large: with their brokerage reach, they became the machine of distribution for IPOs. Gargantuan M&A deals also necessitated banks with capital and clout. But now the tech market has returned to the pre-bubble tranquility, when boutiques were the banks of choice.

With this in mind, Moe believes there is no better time to start a boutique. He thinks that larger banks are so busy with their own internal problems such as cutting staff and shutting down offices that they have lost sight of their customers and are letting relationships fall by the wayside. "The entrepreneurs and venture capitalists of Silicon Valley still want and need investment banking services," he insists. "But they also want to see which firms are staying committed to the market. They want to see which firms are rolling up their sleeves and getting to work. These tough times actually present a great opportunity for us to make our name. We are fighting for every deal and competing on our brains not our brawn."

ThinkEquity has gotten off to a quick start, finishing its first year with $15 million in revenue and a small profit, according to Moe. The firm plans to double its business this year and has already established expertise in the e-learning sector. Last year, ThinkEquity represented Classroom Connect, which was sold to a unit of Reed Elsevier Plc for an undisclosed amount last August, as well as Achieva, which was acquired by Kaplan Inc. for less than $24 million in January.

While the tech banking community seems willing to give ThinkEquity a fighting chance, many insiders are not so optimistic about some of the other newly formed boutiques. "Some of these outfits are being started by guys who were asked to

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leave their previous firms and really don't have the skills or smarts to succeed," says one banker.

The intense skepticism might be due to the fact that most of these boutiques are a year old at best. But there are a couple that got started during the boom whose status shows just how big the risks are.

The Weisel Model

The most noteworthy of these is Thomas Weisel Partners in San Francisco. Many industry people believe that if Weisel can't make it, nobody can. The firm, which was founded by former Montgomery Securities superstar Thomas Weisel, shot out of the gate in the late '90s thanks to a booming market and its aggressive tech coverage. As part of its rapid expansion, the firm built a large trading floor, leased expensive property, and staffed up to more than 800 employees during the peak.

Menkes could not be reached for comment, and Weisel declined to comment on his departure.

Still, Weisel is battling against negative public perception. "Given what has happened to technology, people don't believe we have a viable business," admits Shafir. "They refuse to believe we are actually doing pretty well." Weisel is proud of the fact that revenues were down only 30% despite a very difficult environment that crippled other firms. All told, the firm completed 59 transactions (IPOs, M&A deals, secondaries, private investments in public equities and private placements) valued at $51 billion in 2001, he said.

Going forward, the smaller banks like Weisel ardently believe they will be able to sneak into the accounts once controlled by the big guys. They argue that even though deals are scarce and competition is fierce, the unmitigated turmoil at the big banks has created new pockets of opportunity for nimbler boutiques. "There has been a complete meltdown within the bulge bracket," says one tech banker. "This was a sector that was overstaffed well beyond a reasonable capacity. There was a widespread belief that the technology engine would never run out of steam and there would always be plenty of deals."

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Now that the market is in hibernation, many wonder whether Weisel can survive the chill. The firm has already slashed more than a hundred jobs, and insiders say there are much deeper cuts to come.

The biggest problem with Weisel, according to former employees and industry watchers, is that the firm concentrated on technology to the exclusion of all other sectors. One former employee who resigned from Weisel said the firm did start off with expertise in other sectors such as retailing and consumer goods, but the bankers and analysts in those sectors were largely shoved aside once the tech boom hit.

Though Weisel is still very much a tech shop, it is now a big proponent of diversification. The firm is reestablishing itself in the consumer business and is moving into healthcare as well as aerospace and defense. "We are not just desperately trying to diversify," insists Mark Shafir, director of investment banking at Weisel. "We made our healthcare bet two years ago and we stuck with the space, even at time when VCs and other firms were abandoning it."

Perhaps more important, the firm received what many on Wall Street believe was a life-saving $75 million cash injection from Nomura Holdings Inc., a parent company of Japan's largest securities firm, Nomura Securities. The money gives Nomura a seat on Weisel's advisory board and a 3.75% ownership stake in the firm. Nomura will also contribute $125 million to Weisel's private equity funds, which invest largely in technology, telecom and healthcare.

But in what some see as an ominous sign, Weisel recently lost the head of its private equity division, Alan Menkes, who bolted to start his own LBO fund. Insiders say that Weisel's private equity portfolio was in such dismal shape, Menkes had no real hope of making any serious money if he remained with the firm.

Capitalizing on chaos

Another small firm reeling from the disruption is SoundView Technology Group Inc., formerly Wit SoundView. In the middle of March, the company's share price fell 24% after the announcement of declining revenues and possible layoffs. "A recovery now seems further on the horizon than we originally anticipated," admitted CEO Mark Loehr in a statement at the time.

But Soundview is also determined to capitalize on the chaos and recently landed a co-manager role in the Synaptics IPO. As the first tech IPO of 2002, Synaptics Inc., a maker of computer touchpads, was a deal on everyone's radar screen. After opening its first day of trading at $11 a share, the stock has climbed an impressive 30%.

But getting to market was a long, arduous journey for the firm, which first filed to go public more than a year earlier. Synaptics began interviewing banks for its IPO in October of 2000. After meeting with 18 potential candidates, the firm finally selected on Bear, Stearns & Co., as the lead underwriter and Banc of America, ABN Amro, and ING Baring as co-managers. But things started to unravel in the summer of last year, when BofA and Amro laid off waves of bankers, including the teams chosen by Synaptics. "This did not make us feel all warm and fuzzy," concedes Russ Knittel, chief financial officer at Synaptics. "It was such a miserable year for tech bankers, I guess we shouldn't have been surprised."

Synapatics had no choice but to revisit the firms it had met with initially. It ultimately selected tech boutique Soundview to fill the gap. "Soundview didn't make our first shortlist, but we liked their analyst very much," says Knittel. "We got a sense that our deal was important to the whole organization." Mark Loehr, CEO of Soundview, says clients are putting more and more emphasis on stability and are looking to do business with firms whose personnel remains relatively constant. "The fact that we still had our same team in place made us very appealing to Synapatics," he says.

Indeed, Soundview and other boutiques believe persistence and relationship building are the keys to survival in these turbulent times. "You have to be determined and patient," says Paul Deninger, managing director at technology M&A specialist Broadview. "During the bubble, companies wanted to know what was hot. Now clients are looking for investment bankers to provide great advice whether or not it results in any immediate revenue for the banks. But down the road, these firms will remember who gave them good advice."

He insists that the tech industry is a very tight-knit community and that CEOs and VCs need bankers now more than ever. Clients, he says, are eager to know what the IPO climate looks like today and when it's likely to improve. The want to understand the likely characteristics of technology companies that will be successful when the market finally rebounds. And they want to know which business models will make it, and which won't. Above all, he says, CEOs and VCs are keeping tabs on who is sticking around and who is bailing, and that eventually they will start rewarding bankers accordingly.

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Bart Schachter, a general partner with VC firm Blueprint Ventures, says many of his portfolio companies suffer from an overall lack of attention from the banks. "With the demise of some of the smaller competitive banks and the retrenchment of the larger ones like Morgan, Goldman, and CSFB, there is a major void in tech banking," he says. "But clearly, the demand for their services is still there." He adds that his companies, which mostly play in the communications sector, need assistance with everything from follow-on private financings to structuring M&A transactions.

They may be needed, but the reality is that tech bankers—at least those left standing—are in a state of paralytic shock. They are dumbly gazing out at barren vistas where once hundreds of their coworkers sat—and they are wondering when they too will take a bullet. "When bankers are worried, they work less hard and are less effective," says Jim Feuille, head of tech banking at UBS Warburg. "There is a subtle change in the energy level, and that has a negative impact on their desire to build relationships and compete aggressively."

Naturally, the newly formed upstart boutiques are trying to gain a foothold now that the established banks are in such disarray. Mike Hoffman and several associates bolted from CSFB last year to form their own firm called Probitas Partners, which provides advisory and fund raising services for institutional investors and venture capitalists. He says that at CSFB he was spending less and less time on establishing personal relationships with clients, and he found that very frustrating. "At the end of the day, relationships drive transactions," he says. "Over time, we want our clients to understand that we are not just out to make a sale, but are bringing them quality products that fit their investment needs."

Sanity questioned

Hoffman readily admits that many of his friends and co-workers questioned his sanity when he set out on his own, leaving CSFB. The temptation to start afresh, he says, was too hard to resist. He compares today's boutique builders to engineers in the late 1980s who, either disillusioned with their corporate jobs or let go after the '87 market crash, created a new wave of innovative technology companies that helped spark a decade of economic expansion. Plus, he adds, the ugly economic environment actually works in his favor. "Real estate is cheap, talent is plentiful, and personal relationships are more important than ever," explains Hoffman.

Christopher Lochhead, a well-known independent consultant to many high-tech companies and former chief marketing officer at Scient Corp., says the best bankers are not only getting more personal, they are also getting more creative. Because access to capital for many companies is so tight these days, bankers are structuring more bond offerings and are orchestrating so-called non-deal road shows. He is currently working with one publicly held company with a depressed stock price. "We are going on the road and meeting with buy-side folks who are interested in value stories and tech turnarounds," he says. "The investment bankers have been instrumental in introducing us to the right kinds of buyers so that we can do follow-on offerings and bond offerings."

Even though nearly all tech stocks are testing new lows, those familiar with the market insist there are still plenty of good M&A opportunities out there. True, the M&A fee pool is down 65%, according to tech M&A boutique Broadview. But experts argue that any tech company with either a halfway decent market cap or a solid cash position is in great shape to snap up rivals on the cheap. Take for example PeopleSoft Inc., which recently acquired the assets of Calico Commerce Inc. and Annuncio Software Inc. for a combined $10 million. That's a far cry from the billions of dollars it would have paid a year and half ago.

Not only did PeopleSoft pick up decent technology, it acquired a complementary customer base and deep domain expertise. Broadview's Deninger is currently advising his large-cap clients that the time to invest is when everyone else is on their back. "It's an error in judgment not to be aggressive," he says. "I think the only reason most companies are not being aggressive is because they are not getting good advice from their bankers."

The deal Deninger is most proud of recently is SunGard Data System Inc.'s acquisition of Comdisco Inc.'s disaster recovery business for $825 million. "Here you had a cash-rich company that used this depressed market to capitalize on a weakened competitor," he explains "Sunguard got technology assets, a client base, and a revenue stream that will let them solidify their market position. It was truly a visionary transaction in a difficult time." He argues that the smaller specialized banking firms are in a much better position to give good advice and pull off these kinds of bold transactions, mainly because they are staying in front of clients and maintaining their focus.

Consultant Lochhead insists that savvy CEOs and CFOs are desperately seeking bankers that can help them execute non-traditional deals in the next four quarters. "You can buy a tech company for just its cash position these days," he says. "But you need a good investment banker to conduct the due diligence and help you figure everything out."

That's somewhat easier these days, as bankers with time on their hands are hungrily working their Rolodexes. "You can actually sit down and have lunch with bankers these days," says Lochhead. "You no longer need to be a rock star for them to grace you with their presence."

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Bankers, for their part, are feeling pretty good about the clients. That's because they are getting a lot more respect. "Technology companies are taking longer to select an investment bank and they are starting to look at the quality of the individuals rather than just a big brand name like they did in 1999 and 2000," says Warburg's Feuille, a longtime Silicon Valley banker who was hired in 2000 to help increase the Swiss bank's tech business. While not a boutique, it has not cut deeply from its U.S. tech team, mainly because the group is small, with only 65 people, having been built up later than most. It is one of the few firms on record saying technology M&A deals will eventually pick up in 2002 and outpace last year's activity.

Feuille adds that, unlike in the past, clients are even starting to take his advice. "CEOs all thought they were the smartest things on the planet and that they would all be worth billions," he says. "There was nothing you could tell them that they didn't already know. Now, however, they truly want insight into what they should be thinking and how they should be positioning themselves. My job is actually enjoyable again."