

Recalibrating the machine

Investment banks refocus in the face of IPO market's malaise

BY MARK CALVEY

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The Bay Area's emerging growth investment banks are hunkering down, shedding staff, and in some cases, revamping their business models to weather the financial storm.

Many are shifting their focus to private placements of financings and M&A activity, while others are looking for more recurring revenue for their services. The IPO market is moribund.

"It's not as if we're experiencing a slowdown. It's more like someone came in and hit the switch to off," said Michael Moe, CEO of ThinkPanmure.

"In our first seven years, we were going full throttle," Moe said. "But in the last 15 to 18 months, there's been more hunkering down so that we can be sure when the storm's over we'll be able to resume our growth."

ThinkPanmure, formerly known as ThinkEquity before last year's merger with British investment bank Panmure Gordon & Co., shed 10 percent of its staff last spring.

"We still believe the greatest growth is in front of us. I'm as optimistic as I've ever been for a firm like ours," Moe said, demonstrating the tenacity needed to steer an investment bank through today's treacherous waters.

Signs of pessimism abound.

KPMG, for instance, recently surveyed venture capitalists and found most — 40 percent — don't expect to see a steady stream of IPOs until 2010. A quarter aren't holding out hope till 2011, while 12 percent say that IPO activity will never again reach historic average annual levels.

Optimists point to those same figures and see signals of a potential bottom.

"It's hard to say what October is going to look like, much less 2010," Moe quipped.

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600 people. And the second quarter provided little cause for hope.

"The difficult economic environment continued to challenge our performance, and we don't anticipate significant improvement in market conditions in the

near future," Chairman and CEO Thomas Weisel said in announcing second quarter results. He did note that revenue growth in its banking operations doubled between the first and second quarter, with the recent acquisition of Westwind Partners

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contributing almost a third of total banking revenue.

Some top bankers question whether taking companies public will ever again serve as the foundation of their business. In that camp is Benjamin Howe, CEO of America's Growth Capital, a Boston emerging growth investment bank with an office in the Bay Area.

"The market has changed dramatically," Howe said.

He points to the higher threshold that's required of a company going public in the wake of the Sarbanes-Oxley Act, which means many of Wall Street's top-tier firms are eager to be the lead manager of these larger companies making public debuts.

Howe says his firm has avoided layoffs by maintaining a lean operation, now employing about 40 professionals and hiring very selectively.

Merriman Curhan Ford also shed staff this year.

"We essentially looked at the businesses we're in and assessed who would we hire today," said Jon Merriman. The firm cut about 35 positions, bringing total employment at MCF to about 150. The firm expects paring its workforce will save \$7 million on an annualized basis — a significant amount of money these days.

MCF's net loss for the second quarter was \$5.1 million, compared with profit of \$2.3 million a year ago.

"There's been a level of wealth destruction in the financial sector like we saw with the dot-coms," Merriman said. "Not adjusting to current circumstances will kill you."

And the growing risk aversion among investors sent many shares of the fast-growing companies that these banks cater to right into the cellar.

"The pundits are focused on the big downward move by the likes of Bank of America, but if you own a \$5 stock that goes down to a buck, it's painful," Merriman said. "It was a shock to the system. Everyone just pulled away from the poker table."

In addition to shedding staff, Merriman Curhan Ford is focusing on operations that will generate recurring revenue. About six months ago, the firm stepped up its focus on its OTCQX service — which allows foreign companies to access U.S. capital



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markets. In return, these companies pay MCF a monthly fee.

MCF is also combining its primary research, which generates regular revenue through a subscription model, with its traditional research. The other parts of an investment bank's business, such as sales and trading with its dramatically compressed commissions, or investment banking, with the current slowdown under way, isn't covering the costs of producing research.

"We need to get paid on a more consistent fashion for our research," Merriman said. "If people don't realize that, they've just got their heads in the sand."

MCF plans to conduct its annual investment conference featuring several emerging growth companies in San Francisco next month, right up the street from BofA's annual investment conference that caters to America's largest companies.

MCF generated almost 30 percent of its revenue from recurring payments in the second quarter, up from 14 percent from the year-earlier period. But Merriman's goal is to get recurring revenue to half or more of the firm's overall revenue — a sign of just how much the industry has changed for the region's emerging growth investment banks. At one time, brokerage commissions could pay for the firm's basic operations, while investment banking and other services provided for such things as bonuses and profit.

Those days are history. But Merriman is more convinced than ever that there's demand for their services.

"Given the absolute destruction in 2008, there's even more of a need for firms like ours," Merriman said, noting that fast-growing, mid-sized public companies require advice, financing and market-making services. "This portion of the public company universe is woefully underserved."

Merriman hinted that the firm plans to look more like a merchant bank in the future, with bankers assessing transactions with an eye toward whether the firm's own money should be invested.

Investor dollars have become much more risk averse, so sealing deals and financing are taking much longer to close.

"Institutional investors' massive move into commodity trades — the metals, corn and oil — have pulled capital away from micro-company creation," Merriman said, adding that the firm made a big bet against oil last month because too many people were convinced oil was heading to \$200 a barrel. "As these trades unwind," he said, "it will help the overall economy and help the funds flow into micro-companies."

"We'll start to feel it pretty quickly," he added. "I think we'll really start to see it in the fall."

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