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Tech startups needed critical cash outlays to fuel boom

By Barbara Grady I Business Writer
Inside Bay Area

BACK IN THE 1960s when California was known for its hippies and Silicon Valley for its peach orchards, three financiers from the East and the Midwest saw the beginnings of something else unique to this region — remarkable technology innovation.

William Hambrecht, Sanford Robertson and Thomas Weisel saw new companies sprouting up around the invention of the microprocessor. They wanted to invest in them, but Wall Street's prevailing logic was investing in large companies. Small companies with hard-to-understand technologies were dismissed as too risky.

"They just didn't get it," Robertson said of his New York-based firm that turned down most of the technology investments he suggested, including Fairchild Semiconductor, which spawned Intel Corp. and played a pioneering role in the development of the semiconductor industry.

So Robertson as well as Hambrecht and Weisel — who were similarly disillusioned with Wall Street — set about creating their own investment banks out here in San Francisco to fund new growth companies.

Thus was created the Wall Street of the West and an era in which the likes of Apple Computer, Sun Microsystems, America Online, Dell, Pixar Animation Studios, Amazon.com, eBay and scores of others grew from little garage-based shops with cool inventions to large, publicly traded companies employing thousands of people and producing computers, software and e-commerce for the masses.

Now in 2006, as technology investment begins to revive after five years of bust and tepid recovery, Hambrecht, Robertson and Weisel are frequently honored for creating the West Coast's financial industry and asked for advice on how to re-create it.

Hambrecht helped lead the way, founding Hambrecht & Quist in 1968. A year later, Robertson founded Robertson, Coleman & Siebel, which added the name Weisel when Thomas Weisel joined the firm in 1972.

By 1978, that firm split in two with Weisel heading up Montgomery Securities and Robertson forming Robertson Stephens & Co."Two things we did differently. We hired engineers to be our analysts — because to make a decision about which semiconductor company to underwrite is a technology question not a financial one. Secondly, we were willing to do small deals," Hambrecht, now 70, said about how H&Q differed from Wall Street firms. "Traditional firms were almost too prosperous to take an interest in Silicon Valley."

For two decades, Hambrecht & Quist, Montgomery Securities, and Robertson Stephens raised capital to fund the growth of small, innovative companies in technology and biotechnology. To grease the wheels, these banks established extensive research departments whose analysts provided potential investors with insight about the various new technologies being developed, computer networks, routers, memory chips, disk drives, work stations, database software, personal computer applications and so on. They also held conferences inviting tech companies to present themselves to investors. Lastly — and perhaps most importantly for greasing the wheels — they built relationships with venture capitalists so that small companies and investors in these companies could see a path from startup to payback that might embolden them to go forward with an idea.

"The best merger I ever did was introducing Kleiner and Perkins to each other," Robertson said, referring to the two founders of the most influential VC firm in Silicon Valley.

In creating this new-style investment bank, Hambrecht, Robertson and Weisel helped build the Silicon Valley ecosystem of entrepreneurism that to this day attracts engineers with ideas.

"All three gentlemen are GIANTS," said Jerome Engel, executive director of the University of California, Berkeley's Lester Center for Entrepreneurship and Innovation. "Without their efforts in creating a special marketplace for venture capital-funded companies to go public, the whole special phenomenon we call Silicon Valley may never have happened — or certainly not in the same way to such unique global status."

The National Venture Capital Association this spring awarded Robertson, 75; Hambrecht, 70; and Weisel, 65, for Lifetime

Achievement. And a new crop of investment banks, including ThinkEquity Partners LLC, JMP Securities LLC and Weisel's own new firm, Thomas Weisel Partners LLC, are borrowing a page from their playbooks.

"At ThinkEquity, we are not trying to re-create Montgomery, Robertson and HQ. We are trying to fill a hole with those firms being gone and supply the critical thing that investors and growth companies need: focused attention," said Michael Moe, chief executive of ThinkEquity, who learned investment banking from years at Montgomery Securities.

"Hopefully, we can create that bridge from idea to reality," he said.

Robertson, Hambrecht and Weisel each spoke with this newspaper recently about the technology investment climate past and present.

"There were three cycles" to the technology economy that evolved out here, Hambrecht said in an interview. "The first, from the late 1960s to the late 1970s, was semiconductor-driven — it was the evolution of the speed of chips that allowed all the hardware to be developed.

"Then in the 1980s as the speed and performance of computers got better and better, the next era was software. The Adobes and Oracles and Microsofts of the world evolved where people developed applications to use all the hardware," Hambrecht continued.

"Then the 1990s was the Internet. Suddenly, there was a technology that used all the speed and power of hardware and the sophistication of software in a way that allowed everybody to use it. So it really took technology to the consumer market in a fundamental way."

Those phases also described where investment was focused over three decades.

Weisel's Montgomery Securities was headquartered on Montgomery Street in downtown San Francisco. "We were all doing essentially the same things, serving the venture capital market and young emerging growth companies and researching new areas," Weisel said of the three firms huddled around a part of San Francisco that came to be known as "The Other Street" in a reference to a counterpart to Wall Street.

"I was trying to find interesting growth companies that my institutional clients might invest in," Weisel said.

Weisel, originally from Wisconsin, caught some of the fever of technology innovation happening in Silicon Valley while an undergraduate at Stanford University. After Stanford, he went to Harvard Business School. But as soon as he could, he returned to the West.

Robertson, from Chicago, and Hambrecht, from Long Island, N.Y., each started their careers on the East Coast and were transferred out here with those firms before starting their own firms.

Through the 1980s and 1990s, H&Q, Montgomery Securities, and Robertson Stephens supplied research to the investing world and advice and underwriting services to hundreds upon hundreds of small VC-funded technology and biotechnology firms.

In time, they became the envy of Wall Street firms, which by the mid-1980s realized they were missing out on something.

In the 1980s, the larger New York firms stepped into the action and developed technology investment arms. Goldman Sachs and Merrill Lynch underwrote the IPOs of Microsoft Corp. and Oracle Corp., respectively.

"We certainly created a financial community out here, and it attracted not only the local firms but also the big New York firms. HQ was successful and with success breeds competition," Hambrecht said.

"By the mid-1990s, it was aggressively competitive, and the major firms did everything they could to marginalize the specialty underwriting firms," he said.

Still, H&Q, Montgomery, and Robertson dominated the IPO underwriting of technology. Weisel estimates that the three firms handled between 40 and 50 percent of the thousands of IPOs that took place during the 1990s, the height of the creation of the technology economy.

Then came the speculative bubble of technology investment in the late 1990s, when the prices of technology IPOs climbed into the stratosphere and technology stocks traded at many multiples of future sales while more rational guidelines of pricing targets such as price-to-earnings ratios were passed over.

Robertson describes the late 1990s as almost an unfortunate time for Silicon Valley.

"The 1990s were the speculative time. Many of the really great companies were built way earlier. Hewlett-Packard, Applied Materials, Sun Microsystems, AOL," Robertson said. "By the late 1990s, many of the companies coming public were really not technology companies; they were using technology," he said. "It was really a boom in the use of technology," he said. Practically anyone with a Web site thought he or she had a potential business. While many Web-based companies formed at the time were indeed valuable and some became icons such as eBay and Amazon.com, others had weak business models or management but often found funding anyway.

"A VC would fund a startup Internet company and six months later take it public," Robertson said, adding that sometimes the IPO price would value the company at 10 to 30 times the VC's investment.

"I thought it was really obvious that a crash was going to happen because of the valuations and lack of quality" of some of the companies. "Not all," he added, since some valuable companies created then have endured to this day.

Robertson in 1999 had warned in a U.S. News & World Report interview — as well as to his own analysts — that a crash was inevitable. "I was about nine months too early," and generally not heeded.

As the technology economy was heading towards its speculative bubble and burst, the investment banks were being squeezed from another side as well. A consolidation in the banking industry led big banks on a shopping spree for brokerages and investment banks. H&Q, Montgomery Securities, and Robertson Stephens were all acquired.

Chase Manhattan Bank bought Hambrecht & Quist and folded it into JP Morgan. NationsBank bought Montgomery Securities. Bank of America bought Robertson Stephens, then BofA sold Robertson Stephens to BankBoston. Then Fleet Financial merged with BankBoston to create FleetBoston Financial, which decided it didn't want a West Coast investment bank that by 2002 was no longer making money. Robertson Stephens was shut down in July of that year.

As the crash and recession happened, the big banks shrunk their investment banking divisions, laying off analysts and underwriters.

The units they had built up to compete with the West Coast specialty banks were reduced, leaving again a gap in coverage and underwriting of small growth companies.

In that environment, Weisel formed Thomas Weisel Partners. Many of the analysts and investment bankers at the Montgomery unit of NationsBank jumped ship to join Weisel at his new firm.

"The big New York companies have eliminated 40 to 50 percent of the names they research since the bust, including the names of all small-cap growth companies," Weisel said. "So I do think there continues to be a market for work on emerging growth companies."

Meanwhile, the market for technology investment is slowly coming back. "We have triple the number of IPOs we had at the bottom" of the crash, he said. But even the recovered amount is nothing near the number of IPOs done yearly in the technology boom.

"The dynamics have changed quite a bit since the 1990s," Weisel said of the current financial and technology investment climate.

Robertson and Hambrecht agreed.

For one thing, some smaller companies with good products and proven sales records are nonetheless reluctant to go public because of the costs and administration required by the Sarbanes-Oxley legislation.

Still others say an IPO might bring disappointment, such as the one in May by Vonage Holdings Corp. when the opening day price fell rather than climbed despite Vonage's favorable reputation.

ThinkEquity's Moe said a gap still exists in the market, a gap once filled by H&Q, Montgomery, and Robertson.

"I still think there is missing infrastructure. While we have done well, we are teeny compared to what Montgomery, Robertson and H&Q were," Moe said. "You have a gap between when ideas and companies get started and what a New York firm still thinks is their" size investment, which typically starts at $1 billion.

He described the market as "still kind of cautious. They remember that if you put your hand on the stove, it burns."

Hambrecht and Robertson have each founded new companies since their banks were acquired or closed. And each firm is a variation on the theme of investment banking — variations that seem to flow from lessons learned during the bubble.

Hambrecht formed an open-auction IPO underwriter, WR Hambrecht & Co., to do open auctions in an open Internet-based way along the lines that Google made famous with its IPO.

"It seemed to me that because of the incredible growth of this whole technology world and the underwriting going on in the 1990s, when IPOs' first-day action brought huge price jumps, the underwriting became driven by its own profitability instead of what we were supposed to do for the client," Hambrecht said. A practice of underpricing initial public offerings became widespread in the late 1990s, leading to the huge price jumps on opening day. "It distorted the whole process," he said. Many investment banks were later chastised for this practice and sometimes sued.

Hambrecht's OpenIPO process uses the Internet as a clearinghouse to price a deal through obvious and transparent supply-and-demand equilibrium. His firm has handled IPOs of such companies as Morningstar, Traffic.com and Peet's Coffee & Tea.

Robertson, in turn, started Francisco Partners, a buyout firm that takes undervalued divisions of public companies and makes them private. As the firm describes it, "we take mature or maturing technology companies at inflection points," or times of change or opportunity when the full value of the company or division is masked by the change or transition. Francisco Partners invests in a majority stake in these companies and then manages them back to their full potential. As investors, they gain with the returning health and prosperity of the companies they help manage. Some of its companies under management include Barracuda Networks, Credence semiconductor and C-MAC MicroTechnology.

The firm has been so successful that Francisco Partners just closed on a new fund in June, doubling the amount of investment money under management to $5 billion.