

# “A Disruptive Financial Firm For people who **THINK** for themselves.”

**F**or the past nine years **WRH+Co** has been pioneering the use of a Dutch Auction **OpenIPO**<sup>®</sup> as the most efficient and fair process to use for an Initial Public Offering. From our first offering in 1999 for Ravenswood, a California winery raising \$10 million, to the Google auction of 2004, the Morningstar auction of 2005, through to 2007 with offerings for Interactive Brokers Group (\$1.2 billion), Clean Energy (\$138 million), and most recently NetSuite (\$185 million), we have established a record that we believe has validated our initial hopes for the auction. WRH+Co has attracted remarkable companies and management groups for transactions that on balance have performed very well for the long-term buyers of those offerings.



“Why we call ourselves a disruptive firm  
for people who **think** for themselves.”

**Disruption** – When we were getting started one of our partners introduced us to **Clayton Christensen** of the Harvard Business School, who had just published his seminal work The Innovators Dilemma. Clay recognized WRH+Co as a Disruptive Business Model and agreed to become a board member. We approached the market with a disruptive strategy to do high-end and large volume Freddie Mac dealer auctions to gain credibility and low-end non-consumption auctions, offerings too small or early for the bulge firms such as Ravenswood and Peet's Coffee & Tea. The hope was to ultimately attract the high-profile auction that would cause a market tipping point. Google, Morningstar, and now our three 2007 offerings, Interactive Brokers Group (IBKR), Clean Energy (CLNE), and NetSuite (N) have certainly moved us in this direction. Time will tell whether this is the turning point, but we believe that these deals have had a significant disruptive impact on the market.

During this time, I was fascinated to watch the market develop almost exactly as Clay Christensen said it would. The initial reaction from our investment banking brethren ran the gamut from:

**"It will never work"**

**"It might work for small deals"**

**"You need us to explain your company to the market"**

**"It only works for large, well-known companies, and you're not Google"**

**"It might work for some companies, but if you want all our services. . ."**

Clay's main point has been that the culture and cost models of the incumbents make it almost impossible for them to compete with our business model, and their natural movement will be to move "up market" by offering more services. Their biggest problem has been dealing with the "hidden profits" that were generated by allocating deeply discounted deals to their largest accounts, who reciprocated with even higher commissions. Some of this was a product of the Internet Bubble, but it is extremely difficult for a large, successful underwriter to give up the power of arbitrary allocation and price to the market without a discount for his favored accounts. Fortunately, many of the large firms have moved toward proprietary trading business and equity underwriting is no longer as major a part of their business model, so we have started to see more firms move towards the auction model.

While we have been living our own "disruption" journey, we started to apply the same principals to our venture investing and to our underwriting selection. Looking back over our record at H&Q, the truly great venture investments and underwritings such as Genentech, Apple, Adobe, Netscape, and People Express were, with the wisdom of hindsight, truly disruptive.

At WRH+Co the outstanding performers like Google, Morningstar, New River, Interactive Brokers Group, and NetSuite all have disruptive elements and strategies. When we look at a prospective offering, it is the first thing we look for.

Most recently we decided to restructure our research efforts around disruption. We feel that our experience with Clay and his associates has improved our ability to understand the process and identify those "disrupters" that offer unusual investment opportunity. We are also starting to create some money management products around this strategy that will be announced in the near future.

Living and breathing disruption is harder than I thought. It flies in the face of accepted wisdom to optimize profitability and move "up market" and many people in financial services have been very successful with traditional processes. We've had our share of moves towards conventionality, but I do feel we are now back on the original page and are committed to a "disruption" strategy both for our auction business and for our investing philosophy.

While I've attempted to briefly summarize disruption, I would encourage anyone who really wants to understand it to **read Clay's books**, or better yet, go to HBS for his class! The subject is fascinating and subtle, and I have not done true justice to it.

“**And People who think for themselves.** Looking back over the past nine years, it’s hard to find a group of more **independent thinkers** than those who made the decision to use the auction.”

Reed Foster at Ravenswood went first, followed by Gerry Baldwin at Peet’s, David Talbot and Mike O’Donnell at SALON, Patrick Byrne at Overstock, R.J. Kirk at New River, Eric Schmidt, Sergey Brin, and Larry Page at Google, Joe Mansueto at Morningstar, and in 2007, Thomas Peterffy at Interactive Brokers, Boone Pickens at Clean Energy, and Larry Ellison and Zach Nelson at NetSuite. They joined others who were willing to think outside the box and make decisions that fly in the face of conventional Wall Street wisdom. We think those decisions did make great economic sense, and both shareholders and long-term investors benefited, but I think the most important common thread to their decision was a desire for fairness and a level playing field for both buyer and seller. Ask them yourselves, but I think that’s what really influenced them.

We include both our institutional and individual accounts in our auctions because, again, we had to buck up against long held allocation processes that, perhaps in the short run, seemed not in their interest to give up.

Last summer, I was at a conference with Clay Christensen where Michael Mauboussin, CTO of Legg Mason, remarked that he was the second largest successful bidder in the Google auction. I do think the auction process works for the long term investor such as Michael who “thinks for himself” and we intend to continue to attract those kinds of investors to the auction. I might add that I am delighted to see how many of our individual accounts participate and still hold many of our offerings.

Again, we thank all the sellers and buyers of our auctions who have made them successful and we will continue to make every effort to find unique opportunities, create level playing fields, and bring real value to both issuers and investors.