Undermining the underwriters

Can a little San Francisco boutique forever change the way companies go public?

By Justin Schack

Underwriting initial public offerings has long been a cash cow for Wall Street, which has convinced corporate clients that shepherding new stocks into the market is a delicate art, suited only for the most skilled and experienced intermediaries.

Upstarts and skeptics have tried to dispel that idea. One notable attempt was last year's IPO of Internet search giant Google, whose founders insisted on an online Dutch auction that took a lot of control — and fees — away from traditional underwriters.

Now another development in the IPO market may further marginalize conventional bankers: the emergence of the "IPO adviser."

Electronic-payment-services company VeriFone Holdings became the first to use such an adviser on its $154 million IPO late last month. VeriFone priced and distributed the shares through a conventional syndicate of five big investment banks. Lehman Brothers and J.P. Morgan Chase & Co. were joint book runners, and Banc of America Securities, Credit Suisse First Boston and Goldman, Sachs & Co. acted as comanagers. But for most of the other work on the deal — drafting regulatory filings, working on valuation, even helping to pick the underwriters — VeriFone retained a tiny San Francisco boutique, Financial Technology Partners, which earned a healthy chunk of the overall fees.

VeriFone executives were unable to comment on the choice of FT Partners because of quiet-period regulations surrounding securities offerings. But a source familiar with the company's thinking says one reason that it hired an IPO adviser was to have an independent entity value the company. Because big investment banks are also looking to please their investor clients, they sometimes underprice new offerings, reducing the proceeds raised by the corporate client.

Another big plus for the initiator is that a single IPO adviser can keep a company's intentions secret until the client is ready to market the deal. Going the traditional underwriting route usually means interviewing several banks nine months to one year in advance of pricing, hiring underwriters and having them do the prep work before filing the deal with regulators. In this case, withdrawing or delaying the deal can prove embarrassing and damaging to the company because its intent to go public is more widely known.

VERIFONE HOLDINGS
Initial Public Offering

Number of shares: 15.4 million*
Offer price: $10 per share
Proceeds: $154 million*
Ticker symbol: PAY
Underwriters: Lehman Brothers, J.P. Morgan Chase & Co. (joint book runners); Banc of America Securities, Credit Suisse First Boston, Goldman, Sachs & Co.
IPO adviser: Financial Technology Partners

**One half of the IPO shares were offered by VeriFone. The other half are being sold by early investors.*

Source: Company filings.

For FT Partners, a seven-person merger advisory boutique founded two years ago by former Goldman banker Steve McLaughlin, acting as an IPO adviser allows it to help clients with securities offerings without adding the costly infrastructure — scores of analysts, traders, salespeople, lawyers and syndicate professionals — that firms must have to price and distribute deals.

"When we talk with clients about what we do, this opens people's eyes to include us in discussions that they might not normally include a boutique in," says McLaughlin, 36.

VeriFone is paying FT Partners an advisory fee of $1.25 million, according to the IPO prospectus. Rather than taking the customary 7 percent of proceeds, the underwriters will split 6 percent, or $9.24 million. (The deal hit a minor snag when a Lehman employee e-mailed potential clients regarding the transaction three days before it came to market, but VeriFone has said it doesn't believe that the e-mail violated securities laws. Lehman declines to comment.)

At McLaughlin's request, his firm's fee is being paid in VeriFone shares valued at the offering price of $10 each, which FT Partners cannot sell for six months. Should the shares appreciate by then (they were trading at $12 in early May), the firm's payout could be much higher than $1.25 million. "We're a very big believer in the management team and the growth story," says McLaughlin.

He expects both FT Partners and other boutiques to win more advisory mandates for IPOs and other securities offerings over time. The firm is currently working on a similar assignment, but McLaughlin won't identify the client.

Should more companies start using IPO advisers, it would significantly alter what it means for traditional Wall Street firms to underwrite these deals. Already sharing fees among larger syndicates than in the past, the big banks may just have to get used to having less to divvy up. ii