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New kid on the block

FT Partners' McLaughlin discusses new investment bank

*On April 10, E*TRADE Group Inc. (ET) announced plans to acquire three business units of onsite active trading leader Tradescape Corp. for up to $280M in stock, including $180M in earn-outs. The next day, Financial Technology Partners LLC — the investment bank that advised Tradescape — formally announced its existence.*

*The investment bank that focuses exclusively on financial technology had been operating in what managing partner Steve McLaughlin calls "stealth mode" during its first three months of operation. Still, word got out on the Street, and the firm now has eight members and business in its pipeline. FT Partners launched on a high note, considering that the E*TRADE/Tradescape deal is one of the more significant of the year for brokerages looking to attract active and day traders. On April 8, Ameritrade Holding Corp. (AMTD) said it plans to buy Datek Online Holdings Corp., which also caters to active traders, for $1.36B.*

McLaughlin and FT Partners see opportunity in financial technology, the point where financial services intersects with technology to form the world's financial system infrastructure. Investment banks, big and small, have either assigned their technology-related groups or the financial services groups to cover the space. But few, if any, have bankers who are conversant in both.

*Until late 2001, McLaughlin was a senior investment banker with Goldman Sachs & Co., which he joined in 1994. While there, he worked with a roster of companies that included American International Group Inc. (AIG), Accenture Ltd. (ACN), S1 Corp. (SONE) and unit VerticalOne/Yodlee Inc., Stafford Trading Group, SoundView Technology Group, Standard & Poor's, BenefitPoint Inc., MortgageIT, Advent Software Inc. (ADVS), HNC Software Inc. (HNCS), ProBusiness Services Inc. (PRBZ), E*TRADE and Tradescape. McLaughlin received his master's degree from the Wharton School of Business.*

He spoke recently with S.M. Pugh, editor of SNL Financial's Securities and Investments Mergers & Acquisitions. *The following is an edited transcript of their conversation.*

SNL: How did the Tradescape/E*TRADE deal get going? How did it transpire and how did you get them together?

McLaughlin: Tradescape has been courted by all of the online brokers over the past couple of years and has had many acquisition proposals. However, they remained interested in staying private. The company is 60%-owned by the Amanat family, which is the family of Tradescape Corp.'s CEO, Omar Amanat.

They chose to hold off and grow the business. They're very glad they did, because when they decided to sell the company in December, there was actually a very robust group of buyers interested in the sector, because of how beaten down the average online brokerage has been over the past year and how resilient the active trader business has been on a relative basis.

Tradescape was the largest, most profitable [active trader business] and had the best traders in the industry and had the best technology in the industry. So while there were probably five or six active trading firms for sale, the rumor is that none of them was considered nearly as valuable as Tradescape.

Hadn't E*TRADE been trying to get its own platform for active traders turbo-charged?

E*TRADE caters to the active trader using a technology they had been licensing and recently acquired from A.B. Watley [Group Inc. (ABWG)]. That's for the active trader who trades online. The Tradescape acquisition was an acquisition of professional trading software, which is quite different from what people call active trader software.

The difference is professional traders trade every day of the week. It's a job for them. It's their living. They make money by trading every day, making money on small spreads and not holding overnight positions. They live and breathe inside Tradescape's wholly owned offices. So these people come into work every day at Tradescape and sit down and trade, sometimes a million shares a month. These are not people sitting at home in their underwear, trading for long-term gain. These are people making hundreds of trades a day.

E*TRADE was really not in that business at all.

You have done some work with E*TRADE and Tradescape before.

I knew both companies very well from my days at Goldman Sachs and had worked on a $500M financing for E*TRADE. I believe it was the first time E*TRADE had used anyone other than Robertson Stephens for leading their financing work.

Regarding Tradescape, we had done general advisory work for them for free for a while when I was at Goldman Sachs. When I left, Omar Amanat, the CEO, was delighted that we created FT Partners because, quite frankly, he thought a lot of the bulge-bracket firms weren't properly focused on this space, especially the middle-market companies, and cannot give them the kind of service that they would give an AIG, for example. But to Omar Amanat, his $300M company is just as important to him as Hank Greenberg's $100B company is to him. And he needs the same exact kind of attention that the big bulge-bracket firms give someone like Hank Greenberg. Omar's feeling is that he had previously hired, and left, two premier bulge-bracket investment banks that he had been extremely dissatisfied with. When he found out that we had formed and we were very, very knowledgeable about his space and also very expert in M&A, and could provide him the same kind of attention that the $100B company would get, he jumped at the opportunity. And he's probably going to be our best salesman.

I take it that your fees will be lower than they would have been at Goldman.

Actually, not necessarily. Because we offer the same type of expertise and multiples of the senior-level attention that a firm would get at a bulge-bracket investment bank, we're actually able to charge fees equal

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to [a premier investment bank's.] Or, in some cases, firms will pay us more than they would a bulge-bracket investment bank, because we can offer them senior-level attention and industry expertise they could have a hard time finding elsewhere. We work with our clients to find an arrangement to pay us for performance, and typically our performance will be better than what they could expect at another bank. So we would essentially get paid more for delivering more.

How did you identify the niche?

I spent from 1994 up through late 2001, working first in the financial institutions group at Goldman Sachs in New York, focused 100% on M&A, and then the last three years focused 100% on financial technology, which is the fusion between financial services companies and their technology providers — the real infrastructure for the financial system of the U.S. and the world.

Over the past three years it became very evident to me that this was a niche that was extremely under-served, not only by the big investment banks, but the regional investment banks and the boutique technology investment banks that were out there.

Typically, what we're seeing is that financial technology companies are being served out of general technology groups, general software groups, out of IT services groups or out of financial services groups. You don't have anyone who really focuses on the cross-section of financial services and technology.

If you look at a company like ADP [Automated Data Processing Inc. (ADP)], which is in payroll processing and is also in brokerage services — clearing, settlement, software and brokerage processing — they're typically covered by bankers, who may cover outsourcing companies like [Electronic Data Systems Corp. (EDS)], not people who cover financial technology companies, like SunGard [Data Systems Inc. (SDS)], Advent Software and Tradescape.

So we understand our customers, their acquisition targets, their competitive issues and their own businesses, in most cases as well as they do.

What is your strategy?

Our strategy is to deliver the highest-quality execution in investment banking to companies from the financial technology sector by targeting companies that are looking for that level of attention.

With that, we feel we can highly differentiate ourselves from our competitors and win a large enough amount of business to be very profitable over the years.

I take it from what you're saying that you're not focusing on middle-market deals, that because of your specialization, you would go for any size deal.

We would go for any size deal on the high end, but a lot of the deals in this space are in the middle market and are with private companies typically not focused on by large investment banks. And we will certainly work with larger public companies, given that a lot of their acquisition targets are in the middle market. And a lot of the sale candidates will, therefore, be in the middle market.

What we're not doing is we're not focusing on dot-com companies, and we're not targeting small-capital raises and small-ticket M&A. We're in the middle market and above.

What have you got in the pipeline?

You saw we announced the Tradescape deal, which was sizable, valued up to $280M. We've only been in existence for three months and we've done one of the biggest deals in the sector, outside of Datek and Ameritrade.

We're also going to be advising MarketXT, Tradescape's ECN, on their strategic issues, which could be strategic partnerships and/or financing, and ultimately, a potential larger transaction. In addition, we have a number of sale assignments going on right now and a number of strategic advisory assignments we're working on.

So we see the pipeline as strong, given the stage we are in, and we haven't even begun to market ourselves. We just officially announced FT Partners the other day. We have been flying under cover for the first few months of our formation. And we are now going out to the public in a selective manner.

What's driving the consolidation in your sector?

What's driving the consolidation is a need for the large users of technology to get all or most of what they need from as few vendors as is humanly possible. And there's a drive for consolidation of vendors by the large user.

For example, you don't want to get all your services from 100 vendors; you'd rather get them from 10. In that case, they are much more integrated and much more functionally efficient internally. And, therefore, it drives the cost down significantly, as well.

In addition, the synergies associated from the middle-market companies that are being acquired by the larger companies makes it attractive for those companies to sell. Therefore, you are seeing a lot more activity in that space.

Do you have an exit strategy for your firm, and what is it?

The only exit strategy we have is to keep growing the firm. We're not looking to sell the firm or merge the firm. Our team is a team looking for long-term growth in our business, and not looking for an exit right now at all.

Our strategy could, I suppose, be a merger someday with a larger entity. But we all left larger entities to do something on our own. So I could see us being a private company on our own for a very, very long time.

If you're trying to attract people right now, it must be a very, very good time to do that, given all the downsizing on Wall Street.

Even though we have been operating in stealth mode, word on the Street has gotten out there that we're in existence. And the people who know financial technology and understand the enormous potential that exists in the sector from a banking standpoint and the enormous hole that exists in the sector at the bulge-brackets, they're finding us.

What's your take on the current climate of M&A in general? And when might we see some pickup in activity and what would drive that?

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M&A in general has been slow, as people have been very wary about their cash position and their acquisition currencies. They're hoping for an uptick in valuation in stock values in their own business, and are looking to weaker, smaller competitors when that happens.

I think beneath the radar screen of the billion-dollar deals, you're seeing a lot of middle-market deals getting done. Right now, it's a buyer's market for middle-market companies. For the right middle-market companies, there are a lot of buyers.

It's a great time for the larger companies to pick up smaller, weaker companies that are in need of cash or are in need of synergies with a larger player. That being said, there are a few companies out there in every subsector, like Tradescape, that are "best in class," and clearly will be able to command multiple buyers and high prices.

What about a pickup in activity on a grander scale?

I don't think you'll see it on a grander scale until the overall economy picks up and CEOs get more comfortable that their stock prices have rebounded to stable levels or have bottomed out.

Does the climate for M&A differ in some way in the financial technology sector from the climate in general?

The financial technology sector is widely viewed as a very fragmented sector and a sector that needs a lot of consolidation. Other sectors are much more mature, like food and beverage or the auto industry, and have done a lot of consolidation in the past, whereas a lot of the financial technologies have just been developed over the past five or six years. The trend toward buyers consolidating vendors has really accelerated in the last year or two years. That is driving more M&A in that sector and will drive it in the future in the middle market. I still think the bigger deals will take more time to surface.

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SECURITIES & INVESTMENTS COMPANY ADVISORY RANKINGS

Year To Date

Deals Announced: 42

Aggregate Deal Value ($M): 2,526.8

Ranked by Number of Deals

Leading Financial Advisers	Total Deal Value ($M)	# of Deals
Lazard Freres & Co. LLC	117.3	3
J.P. Morgan Securities Inc.*	490.0	2
Merrill Lynch & Co.*	114.9	2
Berkshire Capital Corp.*	68.0	2

Ten financial advisers tied with one deal.

Leading Legal Advisers	Total Deal Value ($M)	# of Deals
Skadden Arps Slate Meagher & Flom*	185.2	4
Arnold & Porter*	NA	2

Thirty-four legal advisers tied with one deal.

Ranked by Deal Value

Leading Financial Advisers	Total Deal Value ($M)	# of Deals
Deutsche Bank Securities Inc.	1,360.2	1
Morgan Stanley Dean Witter	1,360.2	1
Salomon Smith Barney Holdings Inc.	1,360.2	1
J.P. Morgan Securities Inc.*	490.0	2
Financial Technology Partners LLC	**280.0**	**1**
Lazard Freres & Co. LLC	117.3	3
Merrill Lynch & Co.*	114.9	2
Freeman & Co. LLC	114.9	1
Berkshire Capital Corp.*	68.0	2
Keefe Bruyette & Woods Inc.	13.0	1

Leading Legal Advisers	Total Deal Value ($M)	# of Deals
Fried Frank Harris Shriver	1,360.2	1
Mayer Brown Rowe & Maw	1,360.2	1
Arnall Golden & Gregory LLP	490.0	1
Cleary Gottlieb Steen & Hamilton	490.0	1
Skadden Arps Slate Meagher & Flom*	185.2	4
Cahill Gordon & Reindel	114.9	1
Cravath Swaine & Moore	68.0	1
Perkins Coie LLP	13.0	1
Lowenstein Sandler PC	2.3	1
Quarles & Brady LLP	2.1	1

*Deal value not available for at least one transaction.

Includes whole-company deals for broker/dealers and investment advisers. Data as of 04/19/02. Terminated deals are not included.
Source: SNL Financial Services M&A DataSource