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VCs Assess Fallout From Lehman Brothers Loss

By Brian Gormley and Tomio Geron | VentureWire

The potential demise of Lehman Brothers Holdings Inc. could take a big sponsor of initial public offerings out of play at a time when venture capitalists are struggling to take their companies public.

Lehman Brothers, which has filed for Chapter 11 bankruptcy, is looking to shop portions of itself, including its investment-banking business. Several venture-backed companies in registration to go public list Lehman as part of their investment-banking syndicate, including Eyeblaster Inc., a provider of online advertising technology, and LogMeIn Inc., which sells remote connectivity products.

Lehman is also the fifth-largest U.S. mergers and acquisitions advisor, according to Dealogic. It ranks right behind Merrill Lynch & Co., which agreed to be sold to Bank of America Corp. Lehman is also in advanced discussions to sell its investment-management division, which includes venture capital arm Lehman Brother Venture Partners, the firm said Monday.

This year, only seven venture-backed companies have gone public, well off from the pace in 2007, when 69 such companies staged IPOs. The loss of a significant underwriter won't help matters.

"When you're down to an oligarchy, it makes it harder to be able to get the best out of companies," said Mark Heesen, president of the National Venture Capital Association. "You hope that the remaining investment banks continue to be as aggressive on behalf of venture-backed IPOs."

Lehman's bankruptcy has forced Peter Barris, managing general partner of New Enterprise Associates, to rethink plans to take public at least one company, Echo Global Logistics Inc., a Chicago seller of technology used for transportation and logistics needs. The company, which filed for an IPO in April, listed Lehman as one of the firms that was to usher it to the public markets.

"With Lehman on the cover, now there's a question of what to do now," Barris said. "You've got to deal with it."

While many believe Merrill's underwriting unit will continue in some form at Bank of America, the fate of Lehman's underwriting group is unclear.

"Lehman is probably more of a concern because while some teams should get picked up, it does take another player out of the marketplace," said Javier Rojas, managing director of Kennet Partners.

The loss of Lehman's analyst team could be a blow if it is not bought out, Rojas said. For companies seeking an underwriter, analyst teams are important to getting information to investors.

"You want to work with an underwriter who has a strong analyst team that understands your company and can communicate your story well to the Street," Rojas said. "Those teams are expensive to field. It takes big banks...to field those teams."

As bad as the Lehman news is, however, it's not a disaster, some venture investors said. Good companies can find other investment banks to take them public. In the life sciences industry, for example, plenty of investment bankers are calling venture capitalists about potential deals, said Alan Frazier, managing partner of Frazier Healthcare Ventures.

"I think there's definitely room for a somewhat smaller Wall Street," Frazier said. "The great bankers and analysts at Lehman Brothers will be well placed somewhere else, for sure."

Of greater concern than the potential loss of an underwriter is the volatility that companies face when trying to go public, said Jim Shapiro, general partner of Kearny Venture Partners. "It's the bear market, it's the broad financial problems that the market's experiencing" that are curtailing IPOs, Shapiro said. "The last couple of days accentuate that."

Even if other banks pick up Lehman's business today, the turmoil raises questions about how many players will be around for the long term to facilitate deals.

The needs of venture-backed companies going public are very different from that of large financial institutions or real estate conglomerates that have been seen on the market recently, Heesen said.

The consolidation of the banking industry in the 1990s, such as Chase Manhattan Corp.'s 1999 acquisition of Hambrecht & Quist Group, resulted in some negative effects, but a group of entrepreneurial bankers did emerge, and that could happen again. It could also create an opening for some existing boutique investment banks.

"I'd assume this consolidation will free more people who have been more on the banking side to pursue entrepreneurial ambitions [to] create a next-generation investment bank focusing on emerging companies," said Rick Heitzmann, managing director at FirstMark Capital.

Even before Lehman's downfall, venture-backed IPOs were almost non-existent this year, so the primary exit option today is a trade sale.

"No doubt, fewer investment banks being active reduces the bandwidth for companies looking for IPOs," said Bob Ackerman, managing director of Allegis Capital. "But that's not an acute problem today because of the general turmoil in the market and lack of receptivity to IPOs."

Even so, some venture investors feel that the best companies can still get onto the public markets. "I think healthy companies will always get public, I just think the bar will go up significantly," said William Rosenzweig, managing director of Physic Ventures.

—With additional reporting by Ben Charny and Roger Cheng