

Inside Micro-cap Finance



**What most people
know about micro-cap
investment banking
is just the tip of
the iceberg**

By Liza Grant Smith

Image: iStockphoto.com, Amanda Rohdes

On their best day, investment banks that focus on the micro-cap segment are revered. Given the right opportunity, they can generate extremely lucrative returns and endear themselves to clients by playing a pivotal role in a company's success.

On their worst day, however, these same banks face an uphill battle to locate attractive prospects, negotiate the industry's competitive environment and overcome a list of challenges plaguing the micro-cap segment.

We see the end result in the form of tombstone ads and press releases, but rarely consider the behind-the-scenes

work it takes to post even one check in the win column. For an insider's perspective, four successful firms discuss their thoughts on the industry pros and cons and what they would change if they ruled the investment world.

Opportunity Knocks

"Bigger is better" seems to be an underlying theme in a variety of industries. Investment banking is no exception. Firms are hot to hook the big fish. After all, the big fish should translate into a heartier meal. The problem? Everyone is wise to the proposition. As a result, the waters

are overcrowded with those fishing for the biggest deals from the biggest companies. This overpopulation in one pond sets the stage for a strategic opportunity in another.

"Everybody wants to move up the food chain. What that always does is create a void," says Bruce Jordan, president of Midtown Partners & Co., LLC. "It creates a need to be served in the micro-cap space for those looking to fund deals that are below \$25 million and even more of a void for those who focus on deals under \$10 million."

Midtown is one of the boutique firms poised to capitalize on this

micro-cap void. With offices in New York and Florida, the Firm specializes in private transactions, the majority of which are PIPE (private investment in public equity) deals. The Firm's business has been aided by the difficulties small companies currently face in the traditional IPO market. By privately negotiating sales of its securities to individual accredited investors or institutional funds, micro-caps can obtain capital from a PIPE transaction faster and cheaper than in a public offering. Midtown has borne witness to the product's popularity. With a team of only 12, the Firm has completed 25 PIPEs in the past 18 months.

In addition to being neglected, micro-caps are also inherently needy. While it doesn't sound like a selling feature, some firms are drawn to the challenge of digging in and getting their hands dirty.

"We like the challenge," says Vicki Barone, a senior managing partner at Bathgate Capital Partners LLC. "We like seeing a company go from its infancy trading on the OTC Bulletin Board to trading on NASDAQ and sometimes on to bigger exchanges. It's rewarding to see these companies succeed and to be a part of their success."

With 20 of its 65 registered professionals focusing on investment banking and corporate finance, Bathgate targets high-growth micro-cap companies. The Firm specializes in providing early capital to public companies or those they feel they can help get public. Bathgate's people have professional backgrounds in a variety of fields, allowing the firm to avoid industry specificity and post deals in a multitude of industries, including everything from oil/gas to high tech to biomed.

At the end of the day, however, capitalizing on opportunity and becoming involved would be pointless without profits. Despite the smaller market capitalization, deals involving micro-cap companies have the potential for substantial returns. Successfully realizing the profit potential is where the skill comes in.

"The fun part about dealing with micro-cap companies is that the upside is so great. If you catch the right

deal at the right time, your investors — and, in turn, your client — can do really well," says Steven Pollan, CEO of Atlas Capital Services, LLC.

This win-win proposition is fundamental to Atlas, which prides itself on being a relationship-oriented boutique investment bank. The Firm focuses on a maximum of four to six companies a year, doing roughly 15 transactions with them over the 12-month period. Capabilities range from capital raising and M&A to a full range of advisory services.

If It Were Easy, Everybody Would Do It

Despite the upside, investment banking for micro-caps is not without its share of challenges. Some might say it has more than most.

While the neediness of micro-caps is a selling point, it is also a hindrance. Sophistication typically comes with size. Micro-caps are often like a promising pitcher not quite ready for the major leagues.

"There's always some element to a micro-cap company which isn't quite where you need it to be to move it to the next level," says Barone.

This limitation, anything from management to product development, necessitates additional work and time commitment on the part of investment partners. Barone claims that a common problem for micro-caps is the inability of a company's founder to recognize his or her limitations. Their emotional investment makes it difficult for them to accept changes despite the potential for financial return. After a lot of discussion and hand-holding, it is often the reality of public market valuation that sells the idea.

"If they would really stop and think about the prospect of the business growing, then suddenly their piece of the pie, despite it being a smaller piece of the pie, can be worth ten times as much," she says. "If you take two companies, one public and one private, and compare them side by side, the public company has a higher valuation. This means its owners and shareholders have more value, and it's liquid."

On the opposite side of the coin,

some micro-caps are too eager to make a move, causing a wealth of problems from a structural point of view.

"Many small companies rush to go public in order to raise financing without focusing on structure and having the right people in place to worry about what's important in terms of structuring a company that's right for public markets," says Pollan.

According to Glen Torregiani, a vice president at Atlas, this desire for funding can result in another misstep by micro-caps.

"One of the challenges we face is when a small cap company thinks their best avenue to funding is to try and get as many banks on board as possible and get the word out to as many people as possible," Torregiani says. "As a result, you have banks tripping over each other and the wrong bank contacting too many funds. When the right bank comes in, who has the relationship and knows how to structure the deal, they find that it's already been put in front of too many players and hasn't been presented well."

Banks aren't the only ones micro-caps need to impress. Losing sight of investor needs can be detrimental. Years ago, investors could be sold on big ideas from micro-caps. However, as the segment became known for its failures rather than its successes, investors became more discerning. They began to look at the essence of a company and its ability to build assets rather than being enamored with its story.

"Investors are becoming more fundamentally oriented, which means the entrepreneurs of the companies have to think that way," claims Jordan.

This issue is complicated by the limited pool of investors available.

"You don't have as many investors out there that are willing to take a chance on a \$50 million market cap company as you do on a \$500 million market cap company, so your universe of potential investors is a little bit smaller," says Mike McCrory, CEO of I-Bankers Securities Inc. "They tend to be less liquid, so you have to work really hard at making sure you provide liquidity with proper exposure."

With offices in Switzerland, London and Milan, as well as New York and Dallas,

I-Bankers brings a focus on institutional distribution in Europe to U.S. small-cap deals. This differentiating factor has led to the Firm being on the cover of over 50 transactions since it was founded in 1996.

A Competitive Minefield

The investment banking world is full of stories, some of which aren't pretty. Intense competition among the larger firms has been known to result in intense battles and occasional bloodshed. The micro-cap segment, however, seems awash with more cooperation.

"I know that some of our bankers who have worked in the bigger-tier firms are amazed when they start working with micro-cap companies and see how we work together with other banking firms to make the transaction happen," says Barone.

Before you envision an industry permeated with group hugs and the strains of "Kumbaya," it's important to note that micro-cap investment banking is not always a rose-colored world.

"To be very matter-of-fact about it, everybody wants to do all the deals all by themselves. That's everybody's goal. What drives our business is fear and greed and greed and greed. Everybody wants to make as much money as they can, so they have the tendency to want to monopolize deals," says Jordan.

He points out, however, that greed is ultimately ineffective.

"What's important is getting the engagement done rather than doing the whole thing yourself."

It's not clear if everyone subscribes to the necessity for cooperation. Seasoned players understand the importance of maintaining a realistic and cautious perspective of the industry.

"Some of the friends that we have on the street we consider true and close friends and some of them you keep a little more at arm's length," says McCrory.

If I Ruled the World

Given the opportunity to change the world they're working in, micro-cap investment banks have more than a few suggestions.

"Taking advantage of unsophisticated companies that need help in certain

areas and not really listening to their needs is a big issue," says Pollan. "A lot of deals that I see get done are at the expense of the company rather than to the benefit of the company in terms of pricing, structure and many other things.

"It's like any other business. Some people have a long-term approach and some have a short-term approach. Usually those with a long-term approach make less money in the short term but stay around in the long term."

Barone's wish centers on the perfect micro-cap team.

"If I could come in and have a solid management team right from the start, it would make the transaction a lot smoother," she says. "Also, having a strong SEC counsel and a strong auditor are absolutely imperative in this marketplace with Sarbanes-Oxley."

For Jordan, it's the generalizations about micro-caps that he'd most like to get rid of. "For every success story, there are more failure stories," he says. "So it gets looked at by some people with a

bad eye because this is where all the people who can't really do anything are involved. That's not really the case.

"There's a lack of understanding about what's happening here, and in my opinion some of the great companies of the next one or two decades are going to emerge from this space."

With all the inherent challenges and no guarantee of rewards, micro-cap investment banking isn't always a glorious business. For those involved, however, the success stories make it worthwhile. I guess it all depends on whether you're a glass-half-empty or a glass-half-full kind of person and how hard you're willing to work. **VR**

Atlas Capital Services, LLC

www.atlascs.com

Bathgate Capital Partners LLC

www.bathgatepartners.com

I-Bankers Securities Inc.

www.i-bankers.net

Midtown Partners & Co., LLC

www.midtownpartners.com



The four firms speak to the value they believe **VALUERICH** brings to the micro-cap market.

"I think that ValueRich brings a new dimension that was lacking to the intermediation between the different aspects that surround the small-cap world. It's a good forum, and we see exposure through ValueRich to issuers, to other banks and to vendors that service both sides of the business." — *Mike McCrory, CEO, I-Bankers Securities Inc.*

"This is a face-to-face business. As sophisticated as we all are with technology, as much as we all use our e-mails and our phones, I can tell you that once you meet people face-to-face, transactions become easier." — *Vicki Barone, Senior Managing Partner, Bathgate Capital Partners LLC*

"It creates more awareness, and that's what we're always seeking. The more people who know about us, know about you, know about the activity that is occurring, hopefully it leads to more business for everyone." — *Bruce Jordan, President, Midtown Partners & Co., LLC*

"Anything that's done for these companies to get better exposure and have the market understand who they are and what they do is a very positive thing if it's done right." — *Steven Pollan, CEO, Atlas Capital Services, LLC*