Ambassade de France aux Etats-Unis
Mission pour la Science et la Technologie

Technological Innovation and Investment Banks in the United States : Interview with Dr. John Piret of Newbury Piret & Co

Our interview, conducted in English, is the result of a fruitful collaboration with the French-American Chamber of Commerce, New England Chapter. The text below will appear in English in the Chamber's quarterly newsletter, *Le Courrier*. I extend great thanks to Ms. Chantel Gibson, who transcribed the interview, as well as to Ms. Lynda Inséqué, with whom I developed this French version.

Boston, January 25, 2010
A. Mynard

Section 1/4: Introduction and Definition of Investment Banks

Contexte

The Office of Science and Technology of Boston (MS&T), directed by Antoine Mynard, is closely interested in the issues of innovation, technology transfer and entrepreneurship. It is well-known that in the United States, the financing of innovation is largely private, whereas in France the mechanisms of intervention and accompaniment of innovation belong to both the public and private spheres.

In the United States, investment banks play a very important role, parallel to that of venture capital enterprises and angel investors. The financial crisis of 2008 so impacted the economy of innovation because all aspects of American finance were affected in one way or another.

The legislative and executive branches of the state and federal government are quite conscious of this reality. The very first declaration of the new Director of the SBA (Small Business Administration), Karen G. Mills, was to call on banks for increased support of innovation and small businesses. However, the budget of the SBIR, the only federal support program for technological innovation, has only increased marginally despite positive feedback from National Academies. The SBIR budget has only reached 3-4 billion dollars per year; in contrast, the venture capital market has risen to 15 billion (2009 figures). This figure should also include the input of banking, harder to measure but nonetheless meaningful. The true lever of innovation in the US is located, then, in the private financial and banking system, and not in the arena of public agents.

In order to improve our knowledge of private banks' financing of innovation, the MS&T met with Dr. John Piret, of Newbury Piret & Co. (NPC), a well-known Boston investment bank. This office works to put together mergers and acquisitions as well as fundraising for private companies.

A Brief Introduction of John Piret

Dr. Piret manages M&A and Financing transactions for middle-market public and private companies. He is the Principal Appraiser for the firm and is expert at valuing technology companies; he is an Accredited Valuation Analyst (AVA).

Previously, he was President and founder of Corion Technologies Inc., a maker of static electricity elimination equipment for process industries.

He started at the Center for Geostatistics and Mathematical Morphology [Fontainebleau France], where he used Applied Probability techniques to plan mining projects and to characterize materials and fluid flows. He was then a Visiting Lecturer in Chemical Engineering and in Geostatistics at the University of Wisconsin - Madison.

He subsequently worked in several engineering roles including Vice President - Technology for two start-ups in Houston TX, developing and applying new technologies for oilfield exploration & production, and performing technical & economic evaluations of oil-producing properties.

Dr. Piret is a Docteur ès Sciences Physiques [Mines ParisTech/Paris VI). He received an AB in Applied Mathematics from Harvard University, and Masters' degrees in Chemical Engineering and in the Management of Technology from MIT.

He is a Director of Nascent Technology Corporation, a UAV avionics company, a member of the President's Council of the Olin College of Engineering, and a mentor for MIT's Venture Mentoring Service. He served on the Advisory Committee for Shareholder Responsibility for Harvard University's Endowment fund.

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MS&T: Newbury Piret & Co is an investment bank. What is an investment bank? What are your main activities?

J.P.: The term investment bank can be confusing because there are several forms of investment banks. Basically, it is an agent for a client who wants certain financial services. One type of financial service is a merger or acquisition, where clients approach us seeking to buy or sell a company. The second thing we do is raise financing, both for growth purposes and for an acquisition. We'll raise different levels of securities (equity, mezzanine debt[1]), restructure it, and identify and negotiate with potential investors.

Some investment banks or what people would call investment banks are really business brokers: they put sellers in contact with potential buyers. We do everything "from soup to nuts." When a company wants to sell, we help them prepare for the sale, we put together an offering memorandum, we personally contact potential buyers, we help our client negotiate,

[1] Mezzanine Debt : situation where a hybrid debt issue is subordinated to another debt issue from the same issuer

and we take them through to closing. It can be a 6-12 month process, so we work very closely with our clients.

We also do valuations, an inherent part of an investment banker's work. In a merger or acquisition, valuation is obviously central, but it is also key for regulatory purposes, for instance for reporting to the IRS[2] after an acquisition. With every sale there's a difference between the book value, the hard asset value and the purchase price. The difference is called *goodwill*[3]. Up until a few years ago, that was put in the balance sheet as goodwill and it depreciated over time. Now, the goodwill is broken up into identifiable intangible assets. These assets are not depreciated, but they're tested every year to see if the valuation holds. We do a lot of work on intangible asset valuation.

Section 2/4 : Innovation and Investment Banks

MS&T: How would you describe your role as an investment banker in innovation? What are you doing to encourage the emergence of innovative small businesses?

J.P.: We do work with both relatively early stage and late stage companies. For larger companies, we sell divisions or technologies. For smaller companies, we raise money. For example, a biotech company might need $25 million to develop its product. They'll come to us and say, "We'd like to hire you to raise $25 million." We tend to work with middle to late stage startups; Incubators are too early for us. Our companies usually already have seed money to get off the ground, so we focus on institutional sources such as venture capital funds, institutional sources. The key for us is the amount of money being raised. If we can't raise above $5-$8 million, it doesn't make sense for the company to hire us because it's too expensive.

A bank like ours is paid in two ways. Concerning the valuation of assets, it could be through a typical fixed fee service contract negotiated with our client. When we are dealing with investment activity (fundraising, etc), our fees consist of a monthly retainer and a success fee. Naturally these two elements are negotiated with the client.

MS&T: What is the role of investment bankers relative to venture capital firms?

J.P.: We're an agent or a service company; VCs are an actual investor. They are more intimately involved in the key innovation companies than we are. Very often, they are on the board of directors of these companies. However, some of the thought processes that we go through are similar. When we take on a client, it's crucial to look at it from the point of view of a venture capitalist. We have to figure out whether a venture capitalist would be interested in order to ensure our success.

The job is really different. Venture capital is a long term process, in the sense that VCs make an investment in a company and their involvement with the company is not just a one-time

[2] IRS : Internal Revenue Service
[3] Goodwill : An intangible asset which provides a competitive advantage, such as a strong brand, reputation, or high employee morale.

event associated with a transaction. They will spend 3-5 years helping the company to succeed, so they have to figure out much more what the chemistry is. It's not just the technology; it's the management that they're investing in.

MS&T: What is the value added of an investment bank in comparison to venture capitalists and angel investors? To other banks?

J.P.: When we help a client to raise money, we first put together an Offering Memorandum (OM) to present to potential targets. This OM is a selling document which puts forward the positive aspects of the client’s operation: management, markets, competition, and future earnings. We also prepare the client for meetings: we put together a presentation, rehearse the CEO, and go over answers to questions and issues likely to come up during the discussions.

We contact the top person in the target directly, as opposed to when a company sends a business plan to a VC firm where it is first reviewed by a junior associate. Since the client is presented by a reputable investment bank, the opportunity is likely to be considered worthwhile to consider among all the opportunities that VCs receive and review.

Finally, we know a lot more investors than our clients and we are experts at managing the entire process. Therefore, we usually get a better deal than our client could alone, and we increase the probability of their being funded. VCs usually prefer that an investment bank not be involved[4].

Section 3/4 : Methods and Circumstances

MS&T: Valuations of intangible assets are one of the skills of investment banks in innovation. What are your methods?

J.P.: When most of a company’s value is in intangibles, such as intellectual property, all its economic value is realized in the future. So we produce discounted cash flow models and/or compare the company to “comparable” companies that have either done transactions or are public. This last is easier to do in some industries, like biotech, where there are many public early stage companies.

In order to choose comparables, we have developed various parameters to take into account. In the biotech industry, we’ll look at the type of products, the stages in the FDA process, and the contracts they have with pharmaceutical companies. These R&D contracts are an indicator of interest and therefore value. Sometimes, a valuation based on these parameters might not make sense - if everyone wants a certain “hot” product, the price may skyrocket and create a local high value. In which case, we’ll have to adjust the model.

As to discounted cash flow models, for example, last year an individual investor hired us to do a valuation for a medical device company in Woburn. We did cash flow analyses over 15 years. We looked at development costs, commercialization costs, and possible product

[4] This point of view is shared by venture capitalists, [editor’s note].

cannibalization[5]. It was heavy duty math modeling with detailed inputs: how many salesmen would be required, the cost of the salesmen, the probabilities that one product would get through the FDA...

We also work for companies and auditors to produce financial reports for the IRS in terms of purchase price allocation with respect to goodwill. The difference between tangible assets and purchase price, is broken up into identifiable intangible assets like patents, copyrights, customer list, and in-place workforce.

MS&T: In 2009, the volume of mergers & acquisitions (M&A) had an exceptionally low volume[6], Reuters estimated $1 970 million, the lowest volume for five years, approximately 47% of the 2007 level. The period has also been harmful for VC. Have you had a downturn?

J.P.: Since mid-2008, we've seen a significant downturn in activity in mergers and acquisitions. If you're selling a company and the markets and your sales are down, your valuation will be low so you wait. There was an increase in distressed sales, as well as restructuring companies and divesting units.

MS&T: Markets are important factors affecting development of your business. How do you conceive this new year 2010? Will it be good for innovation and entrepreneurs in general?

J.P.: Things are picking up. People are coming back and engaging in transactions, both for innovation and regular business. The venture capitalists are in a tough situation. We could see a loss in the number of venture capital funds. Venture capitalists are seeking exits from private equity funds or doing strategic sales. The venture capitalists have to get their returns right so they can get their next fund. When they invest, they think they'll put in this much here, that much there, and then we'll exit - that's their plan. But when the IPO market dies or they can't find other people to come in the next round, then they have to put more money than they expected in the company. They need to get out one way or another.

There was a feeling last year in that there would be a lot of secondary sales of private equity portfolio companies, but in fact not much of that happened because of disagreements in pricing. The funds couldn't justify selling at very low values because the returns would be like suicide, in terms of the probability of raising another fund. This year there will have to be more imagination and more trade sales -- selling to a similar company, strategic sales, as opposed to selling to another stage of investor to be able to get their exit.

Section 4/4 : Ecosystems of Innovation and French-American Differences

MS&T: Newbury Piret & Co is located in Boston, why this choice? Do you see any advantage to be here? How would you characterize the ecosystem of innovation in Boston? In your opinion, what differentiates it from other major cities of technology?

[5] **Cannibalization** refers to a reduction in the sales volume, sales revenue, or market share of one product as a result of the introduction of a new product by the same producer
[6] The part that happened in the US is the most important

J.P.: Boston is one of the 3 or 4 great centers of innovation in the US. So the level of innovation and entrepreneurship go hand in hand with the money to make it happen. Boston has a very strong financial industry. The mutual fund industry[7] basically comes from here, venture capitalism essentially started here as well, and it's been a very strong financial center in the US for a long time. Even though Boston is not that big a place, essentially every kind of tech industry is represented, with the possible exception of microprocessor manufacturing which tends to be on the west coast or Texas. The ecosystem is highly varied, so it's robust. With all these universities, there's a lot of sourcing. There's a close community of innovators, entrepreneurs, and investors, which is good for networking. The Boston community is very proud of its position, it’s important that people are aware of it and they think it should be sustained.

MS&T: What is impeding the development of financing innovation in France? Experts say that it is the difficulty for young entrepreneurs to find money, a banking system that responds poorly, and a weak venture capital market. What is your point of view?

J.P.: There is a venture capital industry in France, but its growth is a chicken-and-egg issue. The opportunities produced by French science don't get offered to the investors as much as they should be. The problem is, if you're in the VC business you need to have a lot of opportunities. If you don't, how do you raise money?

There are 3 necessary elements: a tech innovator, the money, and an entrepreneur. You need all three because it's not usually a good idea to have a scientist running a company. The mindset is not right. Next you have to get these people talking to each other. The entrepreneurial motivation needs to be there.

I did research in France 25 years ago, and my impression then was that very few scientists were interested in starting companies. Whereas you go over to a place like Harvard or MIT, and everyone's talking about starting companies. MIT has all sorts of places where students can start companies. The main thing that is lacking is the willingness or motivation of the scientists to go out and try to do this thing. That is what is blocking it. If more opportunities were there, there would be more venture capitalists there.

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[7] An open-ended fund operated by an investment company which raises money from shareholders and invests in a group of assets, in accordance with a stated set of objectives

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Source
Dr. John Piret, 01/14/2010