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ENTREPRENEURIAL EDGE

Despite Downturn, Financing Exists for Small Companies

By JAMES FLANIGAN

WITH all the grim earnings news from corporations and banks lately, not to mention the continuing credit squeeze and widespread talk of recession, it would seem that most small companies, too, would be having a hard time finding financing.

But that was not the case at a recent conference in Southern California, where 1,000 investment professionals came from all parts of the United States to hear and talk to 330 aspiring companies — 50 of them from China. Many of the companies sought by investors were developing environmental, clean energy, cellphone, water treatment and biomedical technologies.

The economic gloom actually encouraged the crowd, said Byron Roth, chairman of Roth Capital Partners, the Newport Beach, Calif., investment bank that was the host of the conference. These days, Mr. Roth said, "established large companies may not offer earnings growth but we can show investment managers fast-growing small companies that few people in broader markets know about."

In addition, he said, investors with capital have less competition for choice properties "because large investment banks and hedge funds are affected by the financial crisis and forced to hold back." Most companies at the Roth conference, in February, are publicly traded on Nasdaq and related over-the-counter markets.

"What I like about these conferences is that I find small, growing companies before everybody else does," said Joseph C. McNay, who attended the Roth conference. Mr. McNay is chief investment officer and managing principal of Essex Investment Management, a firm based in Boston that handles $2.4 billion in investments for institutional and private family funds.

The crowds and enthusiasm were similar at the Montgomery & Company Technology Conference in March in Santa Monica, Calif., which attracted more than 500 investors and 160 companies. Most companies at the Montgomery conference were privately held and worked mainly in the fields of social networking games and communications services for mobile communications devices.

"The sentiment was very optimistic," said James W. Montgomery, the chairman of the firm, which has been raising money for small companies in media, communications and health care for 20 years. "There is plenty of capital around because venture capital hasn't been in a bubble mode in recent years like real estate and debt markets."

It is also a good time for mobile phone companies "because the infrastructure of the Internet has been built out," Mr. Montgomery added. "So companies selling entertainment and services for phones can innovate on the Internet."

To be sure, financing for small companies is less generous and flamboyant than it was a few years ago, said Kenneth Kalb, a serial entrepreneur who has just started Analog Analytics, a company that he presented at the Montgomery conference. In recent years, the venture investment climate became overheated, Mr. Kalb said.

“Private equity firms and venture capitalists would pour money into Internet solutions, investing more than $100 million and looking to earn 5 to 10 times their money in three to five years,” he said. “Now, it has returned to a business with more reasonable valuations. Small amounts of capital are invested but capable of earning a return in two to three years.”

Fortunately, Internet services do not need a lot of capital to get going, he added. “My investor group and I started the company for $1 million,” said Mr. Kalb, who has founded and led two other companies in the last decade, selling the latest one last year. Analog Analytics uses database software to pinpoint for advertisers specifically who is seeing and reacting to their ads in newspapers, television and billboards.

Thomas Unterman, managing partner of Rustic Canyon Partners, a venture capital investment firm, agrees that the days are “long gone when investors looked for returns of 10 times their money in three years.” But there are hotly favored fields today. “Anything clean or green technology, like solar energy, will attract funding immediately,” Mr. Unterman said.

Twenty-five “green track” companies presented at the Roth conference, including Basin Water Inc., a company that converts contaminated groundwater to drinking water and maintains water systems for municipalities and private companies. Based in Rancho Cucamonga, Calif., the company, which had $18 million in revenue last year, is expanding operations across the United States, said Michael Stark, president and chief executive. “I presented at the Roth conference to keep up awareness of our company in the investment community, not to raise capital,” Mr. Stark said.

California has no monopoly on entrepreneurial companies, Mr. McNay of Essex Investment said. “These days, good small companies crop up in Boston and Chicago, Austin, Tex., and many other places,” he said. “But California does have more of them.”

Mr. McNay particularly liked the array of Chinese companies that Roth Capital brought to the conference. Those companies included China BAK Battery, a firm from Shenzhen, China, that makes lithium-ion batteries, and Sutor Technology Group, a Changshu company that makes steel finishing products for use in electrical appliances.

“Today’s China companies are just like the small entrepreneurial outfits with a lot of promise that we helped bring along in the early 1990s,” Mr. Roth said.

He reported that at least 10 acquisition or special financing transactions were initiated during the four-day conference. And possibly more long-term business was initiated because several “blank check” special purpose acquisition companies attended, Mr. Roth said.

Those companies, known as SPACs, raise money for the purpose of acquiring and then operating an existing company. One example is the Heckmann Corporation of Palm Desert, Calif., which was formed last November with $450 million of capital raised by two underwriters, Credit Suisse and Roth Capital.

Richard Heckmann is chief executive of the new company, which will spend $1.7 million organizing itself and researching which companies to acquire and operate. His board includes former Vice President Dan Quayle; Alfred E. Osborne Jr., senior associate dean at the Anderson School of Management at the University of California, Los Angeles; and Lou Holtz, a former football coach and television analyst.

Mr. Heckmann founded, built up and sold four companies over the last four decades, including U.S. Filter, a water treatment firm now owned by Siemens, and K2, a sporting goods company he sold last year to the Jarden Corporation. “I saw this bubble bursting years ago,” Mr. Heckmann said in an interview. “Private equity funds, swelled by debt, were buying companies in sporting goods and every other field, bidding up prices for no good reason.”

But now, in the downturn, he sees a new picture. “Companies can’t raise debt so there are opportunities for equity investment,” Mr. Heckmann said.