

WHY DETROIT'S FUTURE DEPENDS ON CALIFORNIA

# California Business

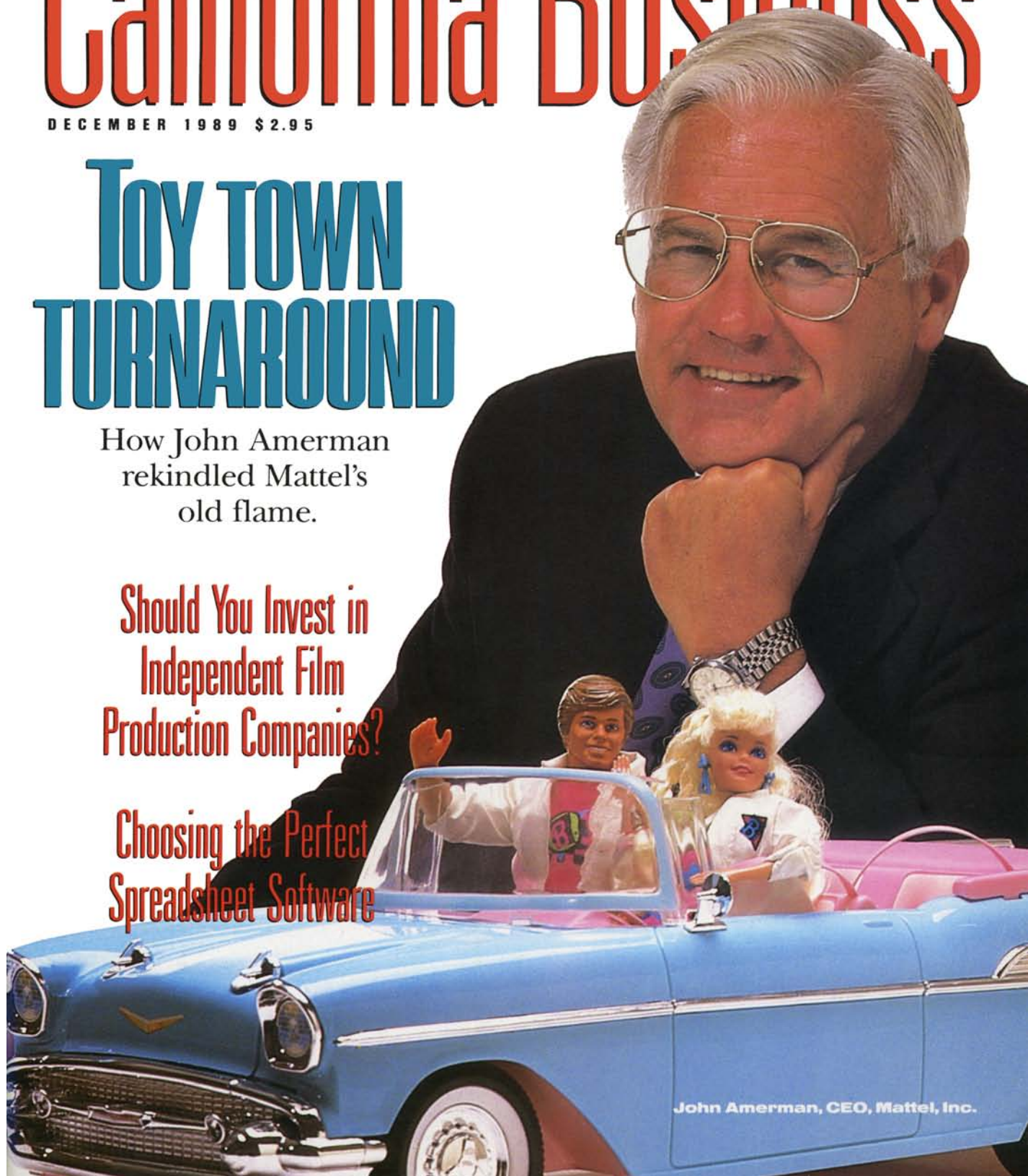
DECEMBER 1989 \$2.95

## TOY TOWN TURNAROUND

How John Amerman  
rekindled Mattel's  
old flame.

Should You Invest in  
Independent Film  
Production Companies?

Choosing the Perfect  
Spreadsheet Software



John Amerman, CEO, Mattel, Inc.



# CALIFORNIA SPLIT

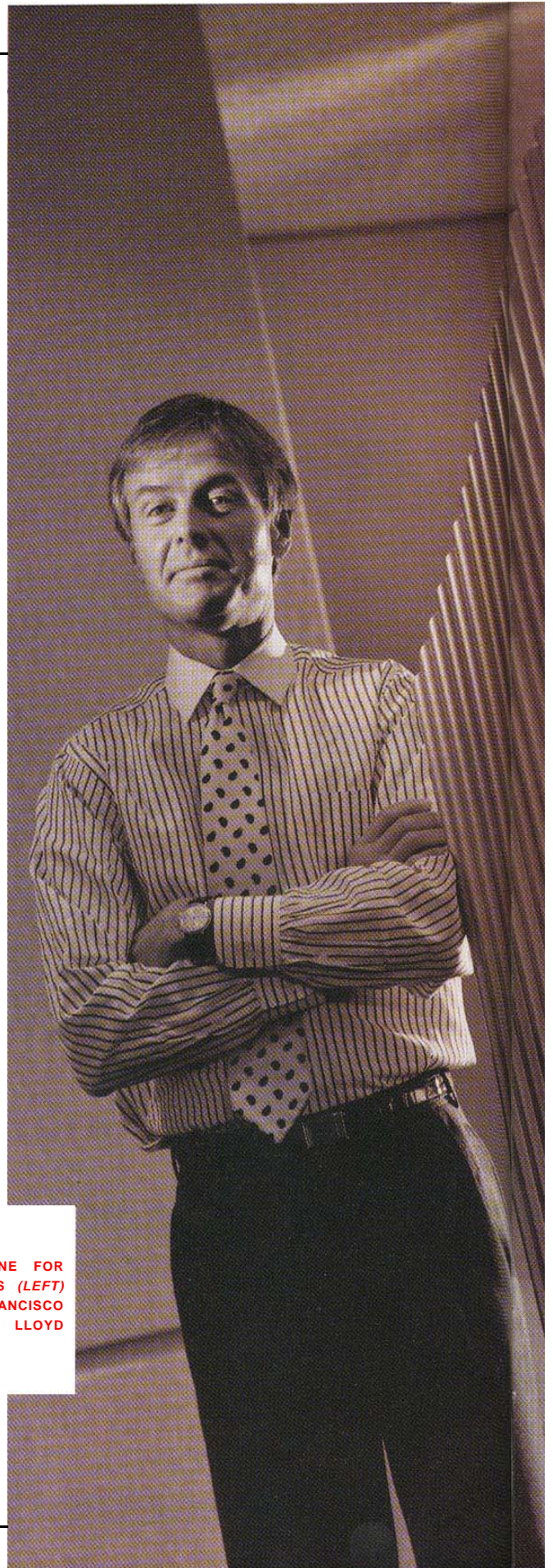
*Sutro & Co. is the oldest brokerage house in the West and a San Francisco institution. But will its growing emphasis on corporate finance lure it southward?*

**By James Walsh**

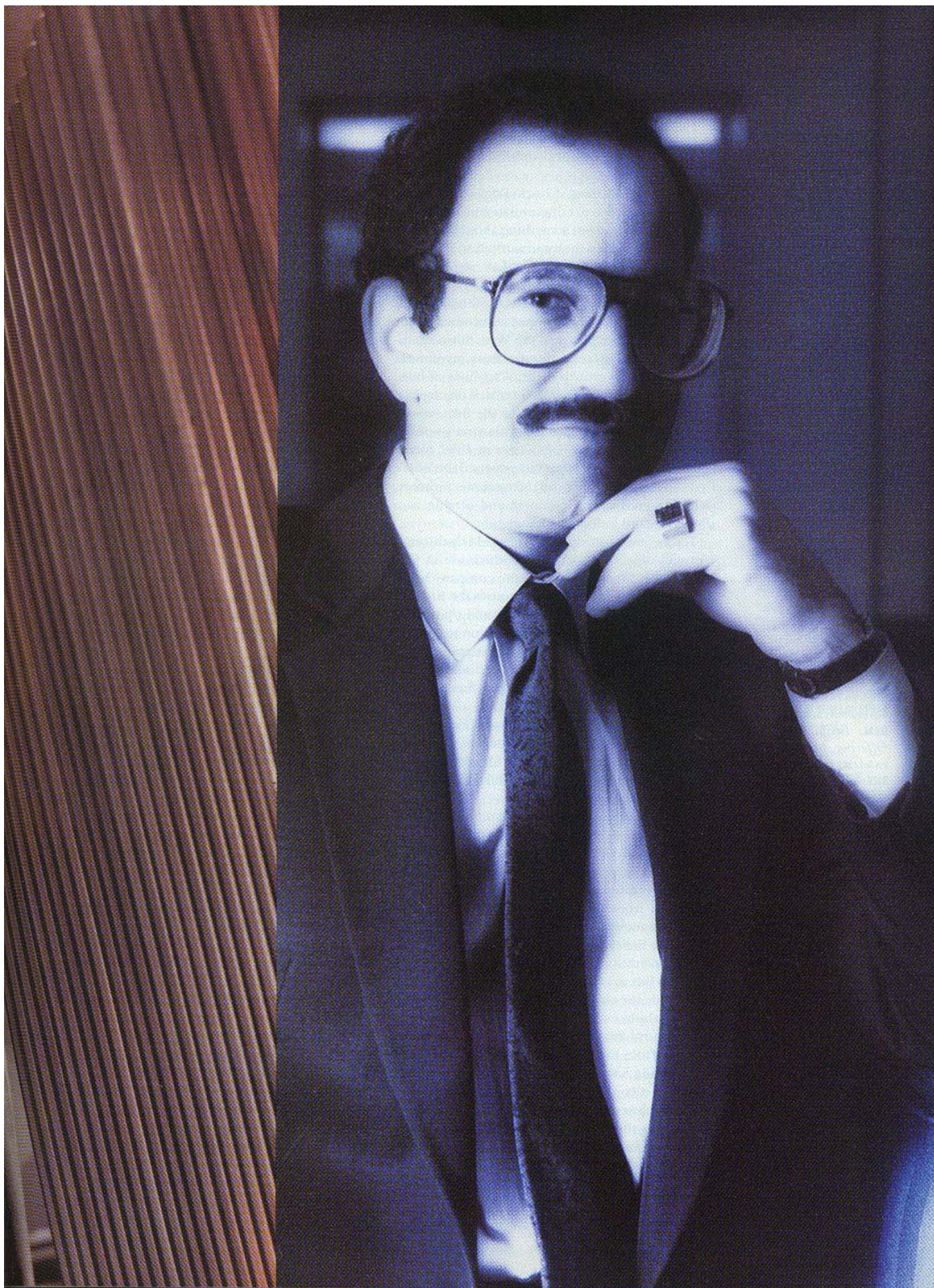
**T**he scene is very L.A. Freewheeling banking and free-flowing cash. ■ Lloyd Greif, executive vice-president and director of Sutro & Co., has been advising a maker of specialty automotive parts on financial matters through a couple of years of strong growth. Now the company is outgrowing its market. The CEO has decided to heed a Greif suggestion and acquire one of his suppliers en route to major integration.

He leaves a six-digit check for services rendered and as a retainer in Greif's office. "What guys—especially those with

ARE TWO HEADS BETTER THAN ONE FOR SUTRO & CO.? CEO CHARLES DAGGS (LEFT) RUNS THE FIRM FROM SAN FRANCISCO WHILE EXECUTIVE VICE-PRESIDENT LLOYD GREIF DOES THE DEALS IN L.A.









**SUTRO & CO.'S  
GREATEST  
CORPORATE  
FINANCE HITS**

**1 9 8 6**

**L.A. GEAR, INC.**

**DEAL:** Initial Public Offering  
**SIZE:** \$22 mil.

**CALPROP CORP.**

**DEAL:** Secondary Offering  
**SIZE:** \$9 mil.

**CAL FED INCOME  
PARTNERS, L.P.**

**DEAL:** Initial Public Offering, partnership interests  
**SIZE:** \$110 mil.

**1 9 8 7**

**ZENTEL, INC.**

**DEAL:** Issue Convertible Subordinated Debentures  
**SIZE:** \$16 mil.

**PERKINS FAMILY  
RESTAURANTS, L.P.**

**DEAL:** Initial Public Offering, partnership interests  
**SIZE:** \$66 mil.

**SAHARA CASINO  
PARTNERS, L.P.**

**DEAL:** Initial Public Offering, partnership interests  
**SIZE:** \$63 mil.

**TCW CONVERTIBLE  
SECURITIES FUND, L.P.**

**DEAL:** Initial Public Offering, partnership interests  
**SIZE:** \$210 mil.

**NEW STROUD'S INC.**

**DEAL:** acquired  
Stroud's Linen Whse.  
**SIZE:** less than \$50mil.

**BEL AIR SAVINGS &  
LOAN ASSN.**

**DEAL:** acquired by  
Topa Capital Corp.  
**SIZE:** approx. \$20 mil.

companies under \$100 million in sales—like about us as opposed to the major nationals is the fact that they can deal with senior people all the time," says Greif.

Thursday morning, Chuck Daggs calls Greif from San Francisco to congratulate him on the fee and frankly, to find out something about the client.

"Yeah that's often the way it works. San Francisco finds out about a client when L.A. deposits the check," sighs one manager.

Daggs is the CEO of Sutro & Co., the San Francisco stock brokerage that hopes to become a major corporate finance power in the West. Sutro's business plan calls for fees generated from investment banking to spur growth in its older lines of business. In application, the plan creates managerial and infrastructural problems for the firm, whose headquarters are now on California Street—only a few blocks from the offices where in 1858, tobaccoists Charles and Gustav Sutro opened the West's first brokerage house on Montgomery Street, weighing gold dust for miners and serving as a silver coin and bullion exchange.

Today, Sutro's troops are spread widely through 15 retail offices, all but two of which are in California; San Francisco houses the company headquarters while the L.A. branch houses the smallish public finance and institutional trading pits. And recently, the firm has undeniably begun to grow: It completed 39 corporate finance transactions in the last 21 months. But observers, including those within Sutro, wonder how far the firm can go before circumstances pull it apart.

"I've been thinking it over," says Greif calling several days after an interview. "The best way to put it is that Los Angeles sets the pace for the firm. This is where the business is.... In 1989, San Francisco makes no sense."

Over 130 years of history in San Francisco's financial district—that's a tradition to which Sutro employees quickly and frequently point. But Daggs and the other San Francisco executives are 400 miles geographically, and a million miles temperamentally, from the heart of California's middle market financial power, Los Angeles. For the time being, the firm is willing to settle for letting its corporate finance hotshots operate unfettered in Los Angeles. But an ambitious New York investment bank made the same Faustian bargain 15 years ago, and just about everyone knows what happened to Drexel Burnham Lambert.

Aside from tossing away over a century of history, moving Sutro's headquarters down the coast would be a concession to corporate finance that other employees probably aren't willing to make. Herein lies the managerial, and almost political, problem of Sutro's growth: The upstart bankers are outgrowing the brokers.

It's also a potential problem for the John Hancock Mutual Life Insurance company, which bought a money-losing Sutro two years ago.

"Clearly, we were buying Sutro with an eye to making money down the road," says Hancock spokesman Rich Bevilacqua. "So we wanted [them] to do what it took to turn the company around."

**T**he main reason for Sutro and brokerages like it to expand into investment banking is simple: Corporate finance is far and away the most profitable activity the firms can undertake. Fees generated from advising even small- to mid-size companies (Sutro's self-proscribed target) on public offerings, LBOs and mergers and acquisitions can be huge and relatively cheap to produce. While the average size of a Sutro-sponsored transaction has stayed—by design—under \$100 million, the corporate finance operation's earnings have grown from \$4.9 million in 1987 to an estimated \$20 million this year.

And there's a substantial indirect benefit of corporate finance work—it creates products for the retail stock brokerage to sell. "That's the most important synergy," says Daggs.

Retail brokerage—the backbone of Sutro's history—has become an extremely low profit margin affair. Low-cost brokers like Charles Schwab & Co. and Kennedy, Cabot, Lodge have forced the commissions of even high-end brokers down as low as a few percentage points. And higher-volume institutional trading, which Sutro also does, has even lower margins.

"Clearly, corporate finance will be the engine which will drive our other operations: the institution stock trading, the bond trading, the retail brokerage," concludes Daggs. "But corporate finance covers a lot of ground."

Ultimately, Daggs argues, no matter how important it may be, the investment banking Sutro is doing in Southern California hasn't reached any sort of critical mass in terms of shaping the firm. "If you ask me, the most important growth area for this firm is research," he says. "I want to hire about six new analysts in the next 18 months. Research is what will separate us from our competition. And it will find product for both the corporate finance and brokerage sides."

But if the flow of money is any indication, John Hancock Insurance might take issue with that thought. Hancock has made \$250 million available for Sutro to buy into the deals it advises. And this is where the biggest profits of all are to be had. Even Daggs admits that "the two biggest strengths that Hancock brings Sutro are name recognition and an expanded capital base."

While it has only taken a substantial piece in two smallish deals so far, more equity stakes are to come. With Hancock ready to get into corporate finance, Greif finally has the cash to take equity positions: "These guys from Hancock are ready to get into mezzanine financing and things like that. They've set up the Capital Growth Fund just for it."

Daggs and Greif agree on major points of



strategy, but two more disparate perspectives would be hard to come by in a relatively small firm.

The self-consciously well-appointed Chuck Daggs is an archetypal modern manager (*Thriving on Chaos* and a dozen other handbooks line the bookshelves in his office overlooking California Street). With trim features and calm demeanor, he'd fit easily into the Marin County or Orinda/Moraga country club sets.

"I see our competition as Merrill Lynch and Bear Stearns, not the other regional operations, really," he says. "We plan to take advantage of Asian capital markets. Several of our recent deals have involved Asian parties. But our growth isn't just a macroeconomics thing—we're hedged against interest rate exposure and things like that. Our focus is on one client at a time." At the helm of an aggressively growing company, Daggs is very ... smooth.

Greif, on the other hand, is definitely more frenetic. He talks with the breathless enthusiasm of an L.A. dealmeister—like a Hollywood agent or a junk bond trader. His office is littered with the debris of activity: prospectuses, marketing reports, sample products, newspaper clippings.

"I talk to all kinds of guys out there—lawyers, accountants. These are the guys who know where the best growth companies are. Also, of course, existing clients," he says, sitting under a photo of one existing client, L.A. Gear CEO Robert Greenberg, and looking west over Wilshire Boulevard. "An existing client hooked us up with the Thai group Unicorn, to whom we just sold Bumble Bee Tuna."

Greif alone accounted for 40 percent of Sutro's corporate finance fees in 1988. And his reputation is still just beginning to grow.

"Let me put it this way, four of the major national firms told us we couldn't do the financing to acquire Pinkerton's in 1987," says Tom Wathen, CEO of the Van Nuys-based security firm CPP/Pinkerton's Inc., "Lloyd went out there and found the money. He just outperformed them."

Where's the balance between Greif and Daggs?

**K** eith Pinoseault, until late September the company's president and chief operating officer, should have been a mediating vehicle between the two perspectives. But sources in the firm say he was never close to playing such a sophisticated role. That may have been part of the reason he resigned.

Now the number-two man in San Francisco is Charles Murphy, an executive vice-president who is nominally head of corporate finance. He lays out the general, and predictable, direction that Sutro plans to take in expanding its investment banking: "We're looking to establish a niche for ourselves among mid-size growth companies in the West." The same thing can be heard in a hundred offices from Spring Street to Sutter Street.

It's not unusual that a firm with growth plans as ambitious as Sutro's should feel some strains. Fundamentally, the question at hand is: Where will the

retail side be if the corporate finance side continues to present the Hancock owners with the strongest performance and potential growth?

Specifically, the question is: Will Sutro remain a San Francisco company?

With the exception of the biotechnology bastion across the Bay, major corporations and tourism are the staple of San Francisco's economy. Neither is part of Hancock's plans to see Sutro grow into a middle-market (deals worth up to \$250 million) investment power. That's L.A.'s strength.

Ironically, it's Greif who likes the status quo. He's in a growth market, while the bulk of management sits in San Francisco making sure all the more mundane hassles of running a business are resolved. "I really don't miss the political headaches, settling interoffice disputes—all that kind of thing," he says with relief.

If there are logistical problems with the headquarters so far away, Greif doesn't mind them. It's a small price to pay for being able to remain an entrepreneur, rather than a manager. Meanwhile, Daggs and Murphy make nervous jokes about closing the executive offices on California Street and moving them to Flower.

And what about Hancock? The ultraconservative outfit has been headquartered in Boston for over a hundred years, happily outside the East Coast's corporate finance hotbed. It wouldn't likely be excited about the expense of changing the Sutro head office. On the other hand, "Hancock bought Sutro & Co. as a profit center," says Rich Bevilacqua from Hancock's tower in Boston. "Corporate finance is the profit center of Sutro."

All this leads to the off-the-record consensus at Sutro that a double headquarters in Los Angeles and San Francisco will be the "solution." On the record, everyone at Sutro dismisses the idea.

**A** s the interview with Daggs ends, he mentions that he's flying down to La Jolla the next day to "see what's going on down there."

Is the La Jolla office on Fay Avenue with all the major financial players? He's not really sure. But a lot was on his mind that day. Pinoseault's resignation had been announced in the morning; Daggs was looking at a lot of employees who needed to be assured things were still going well.

Meanwhile, Greif has proposals stacked high in neat piles all along the walls of his office. He gets four calls in 45 minutes. "...And who says we'll stay at just \$100 million?" Greif asks in the midst of a barrage of rhetorical questions. "We could easily go double that size. And higher." With each conversation, with each step, he and Sutro seem to get farther and farther from the financial district near Market and California streets.

James Walsh is a staff writer.

1988

#### CALIFORNIA PLANT PROTECTION

DEAL: acquired Pinkerton's, Inc.

SIZE: \$136 mil.

#### SIERRA SPRING WATER CO.

DEAL: acquired by Anjou International (France)

SIZE: \$67 mil.

#### COMPUTERLAND CORP.

DEAL: sold 25 ComputerLand Stores

SIZE: \$25 mil.

#### THE VENDO CO.

DEAL: acquired by Sanden Corp. (Japan)

SIZE: \$27 mil.

#### THE HIBERNIA BANK

DEAL: acquired by Security Pacific National Bank

SIZE: approx. \$100 mil.

#### MONTEREY MUSHROOMS, INC.

DEAL: acquired by subsidiary of Amfac, Inc.

SIZE: \$26 mil.

1989

#### MOTHERHOOD MATERNITY SHOPS, INC.

DEAL: acquired by MMS, Inc., a unit of The Shansby Group

SIZE: less than \$50 mil.

#### THE PACIFICA CORP.

DEAL: acquired by MacraMedia Partners, Inc.

SIZE: less than \$50 mil.

#### JAC CREATIVE FOODS, INC. (JAPAN)

DEAL: acquired by International Multi-foods Corporation

SIZE: \$70 mil.

#### UNICORD CO., LTD. (THAILAND)

DEAL: acquired Bumble Bee Seafoods, Inc.

SIZE: \$269 mil.