

SEEKING ALTERNATIVES

by Sydney LeBlanc

Devastated by the massive destruction of almost \$10 trillion of assets on Wall Street, clients and advisors alike are searching for alternative investments to help them regain losses and better diversify their portfolios. But the search may be over. There is now a single source of opportunities for financial advisors: An Alternative Investment Bank! A source that specializes in alternative investments.

Today, more than ever, investors, advisors and firms are seeking alternatives to the traditional capital markets products. We are all painfully aware of the financial losses and escalating problems attributed to the markets and the economy since 2008. Some individuals have suffered worse than others, but the majority has suffered in some way --loss of retirement income, loss of college savings, loss of confidence in the public markets and perhaps, worst of all, clients' loss of trust in their financial advisors.

As an independent advisor or RIA, what can you bring to the table today that is new? What can you offer that will re-build that trust and help clients on the road to economic recovery? Clients are past the fact that you are not responsible for the market volatility or the economic climate. It's not your fault; they understand that. You've done the hand-holding, the answering of questions, the assurances that you are vigilant and focusing on due diligence and risk management planning. But, each month when clients open their statements, they are still discouraged and wondering, "What can my advisor do to help me now? What has he/she done for me lately that is going to set me back on the right investment path?"

If your clients were buy-and-hold, long-only investors in the last decade, this was probably the first time they have lost significant assets in the public markets. What can you do for these clients? The elusive answer to this question makes having conversations with them more difficult. Especially if you don't have a solution.

You cannot continue to do business the same way with the same relationships anymore. We all know the definition of "insanity." Albert Einstein said it is "*Doing the same thing over and over again and expecting different results.*"

The industry is changing, advisors are changing, clients are demanding more and expecting equity-like returns without the market volatility. Investors are seeking private transactions, alternatives to the public markets and government intervention where they have zero control. Now is the time for advisors to offer a high alpha product.

Now is the time to have a relationship with an investment bank.

The Alternative Investment Bank: Waveland Capital Group

According to Michael J. Greer, Chairman and Chief Executive Officer, Waveland Capital Group LLC, Irvine, California, the reason you, as an advisor, need to establish a relationship with an investment bank is because it allows you to completely serve your high net worth (HNW) clients. “Sixty-eight percent of America’s wealth resides in the hands of the small business owner,” said Greer. “These business owners have aspirations to eventually become owners of *large* firms. So, what does it take? Simply put, it takes three things to grow a large business: time, money and people. SBOs have put in the time and hard work; many times they need to bring in creative people, but don’t have the funding to do so. What collapses time for the SBO and allows them to go from small to big? The capital, of course. We provide that expansion capital.”



Michael J. Greer

He continued, “If you want to build or grow a HNW practice, you’ll need the tools to service the small business owner — so, you must have a relationship with an investment banking firm. How many financial advisors or RIAs currently are strategic partners with an investment bank firm? Very few. Not only is it a necessity today, it also is prestigious for your clients. Look at the most powerful financial services firms in America---they are investment banks. Goldman Sachs, Morgan Stanley, JP Morgan. They have brokerage operations to support their efforts, but they’re known as investment banks, not brokerage firms.”

Greer said for advisors’ HNW clients, they need a *complete suite* of solutions, from wealth management to corporate finance. This can be difficult to find, and difficult in terms of due diligence as well. And in terms of private

equity, there tends to be a real lack of good “institutional quality deal flow” available to their retail clients. Many broker-dealers lack the expertise and the access. “The exceptional deal flow is confined to the venture funds and private equity funds that raise money primarily from institutions, and to firms like Waveland with unique and deep connections within certain industries,” said Greer.

One Relationship with an Entire Alternative Investment Suite

Greer said his firm discovered early on that the family of offices (in particular), the RIAs, and the broker-dealer community appreciate the opportunity to rely on one relationship instead of five or six that would require intensive due diligence. “Instead of having to seek out someone for private equity, real estate, oil and gas, and distressed debt, they should have the convenience of one relationship with an entire alternative investment suite,” he said. “Our investment team includes people who have domain knowledge in each one of those specific verticals. We believe what we are offering has never been offered before. We are the single source of opportunities for the financial advisors. We approach it with an *investment banker* mentality, not a *syndicator* mentality, which is a much more sophisticated approach to the creation and management of the product.”

It may be from a typical independent broker-dealer’s standpoint, one with a large network of advisors, that the behind-the-scenes work needed for healthcare or technology private equity deals would be beyond its capabilities. It simply may not be set up to do the analysis. A firm needs access, expertise, ongoing monitoring of the investments and reporting capabilities on all the deals. Greer suggested that if the BD can conduct the due diligence on just *one* company that provides the expertise across the different investment verticals, it creates the opportunity for their advisors to offer these asset classes to their clients. In essence, they could plug into the Waveland Investment

Bank platform and become a strategic partner.

Waveland History: A Ten-Year Overnight Success

CEO Greer, who co founded the firm in August of 2000, has served in various aspects of the financial services industry dating back to 1981. About the early days of Waveland, Greer said, “We had previously been with a boutique investment bank that focused on early-stage medical device company financing. We were providing access to high net worth capital as an alternative to venture capital funds. So, we formed Waveland initially to focus predominantly on the same thing. Here in Orange County, California, we’re one of the top three or four areas in the U.S. in terms of medical device company start-ups. From Orange County south to San Diego, the overall healthcare industry opportunities are simply huge. In addition, I have both a public and private oil and gas company background, with a transaction history going back to 1987. With this experience, in 2001 I was able to recognize that the depressed oil and gas sector was poised to enter a long term uptick in the cycle. So I dusted off some of my old oil and gas contacts and aligned our firm initially with a small public oil and gas company, started by a guy that worked with me during my public company days. We formed a Waveland oil and gas company, and aggregated our investors into limited partnerships to invest as single entities alongside independent oil and gas companies. Back then, we killed ourselves to raise \$1.5 million for our first drilling fund. Today our average fund is \$20 million.”

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Greer explained that there is a “comfort factor” for advisors who sell oil and gas drilling partnerships, for example. “The energy business offers this product where the independent broker dealer community is used to a certain knowledge level with that product. Initially, we created relationships with broker dealers and their advisors with our oil and gas drilling funds. Then, once these firms got to know us better and concluded that we were a sophisticated group of professionals who were also involved in corporate finance and investment banking — they became open to looking at our private equity vertical.”

Greer explained that while the firm’s private equity practice initially focused on healthcare, particularly medical device, the firm added an information technology vertical in 2003, investing alongside some of the better known venture funds in Silicon Valley. “At that time, very few firms were successfully raising retail private equity money. You need the ability to fund, if you want to compete institutionally, and you have to aggregate retail money fast enough to fund a deal. So it can be a “chicken and egg” situation,” he said.

Since its inception, Waveland has raised in excess of \$500 million. The firm raised all of its capital internally from its own client base until 4Q 2004. At that time, two independent broker-dealers signed on to market one of their oil and gas projects. And that was just the beginning, said Greer. “In 2005 we began expanding that network of broker dealers and our fundraising accelerated, culminating in our record year in 2008 where we raised more than \$100 million.”

He added that in the last quarter of 2008 when things were “looking gloomy in our industry” Greer made a conscious decision to take advantage of the market downturn to perfect Waveland’s business plan, its story and image.

He decided there was a significant opportunity for the company to help fill a void in the IBD and HNW markets, and attack that void to take market share when other investment firms were cutting back. That was the beginning of what they now call the concept of “The Alternative Investment Bank”. It offers multiple investment verticals, structured for HNW investors, which are exclusive to Waveland. “Out of our institutional approach,” said Greer, “we can offer a proprietary suite of alternative investment products to the financial advisor/broker-dealer community, RIAs, family offices, and trust companies. All under an institutional banking “umbrella” focused on corporate finance and M&A.”

Greer emphasized that the firm takes an *investment banking approach* to the creation of the product, instead of a *syndication approach*.

Private Equity and Advisor Comfort Level

Greer understands that many advisors are not experienced or comfortable with the private equity asset class. They don’t know if the company is a good investment or not; they don’t know how to analyze the deals, nor do they have the time. They are more confident with the traditional oil and gas and real estate direct investments. In addition, the broker-dealer needs to have a source for the product they can rely on and can trust. Waveland has operating expertise internally--- just like a venture fund--- that can actually manage each company from a financial and operational perspective and help nurture that company to an exit. Said Greer, “Nothing matters at the end of the day unless you can exit the product, get liquid, and capture a profit. That’s what an advisor wants for his or her clients.”

Mitigating the Risk: Their Criteria and Their People

One of Waveland’s strong suits is the skill and strategies they use to try and take the capital risk out of the equation. When they look at their deals, the risk mitigation begins there: by having the criteria for a firm to have at least \$5 million in revenue with \$1million of earnings. “It is not

a matter of ‘can the firm financially survive’ — that’s not necessarily a risk.” Greer said that’s why they stay away from the early-stage venture deals. “We taking later-stage, expansion capital opportunities--- they are already up and running and thriving ... this is growth capital. The risk is in the execution: Can they execute, deliver, and take the company to the next level to successfully move toward an exit of \$100 million of valuation or better? That’s the challenge. That’s why we help mitigate the risk by putting our own people inside the deals with them; we are their sole source of capital. In essence we put an ‘insurance policy’ into every deal we do. But, of course, as we all know, there is always risk ... to the economy, the asset class. I say to advisors — Is this the place for all of your or your clients’ assets, absolutely not. Is this the place where you need to have 25-30% in private equity to have a fighting chance to regain or make some money? Absolutely.

Capital Formation: Their “Sweet Spot”

Greer explained that Waveland is a *middle market* investment bank. “Because we value our strategic partnerships, we are glad to help out if it fits our “sweet spot,” which is between \$15-50 million in capital raise transactions,” he said. When asked why they choose this range he said, “Because it’s ‘above the weeds’ — we really don’t want the \$2 million deals. At that higher level, it is profitable for us, for their company, and they are a higher quality deal at that point. But, it’s not so far up the tier that we are knocking heads with the really big guys. We want to be a big fish in “our” pond.”

On the merger and acquisitions work, though, Greer said they are more comfortable doing much bigger deals. “We typically take on deals of \$25 million in enterprise value and up,” he explained. “We have a disciplined approach to the clients that we take on. More often than not, they must have a minimum of \$4-5 million of EBITDA (earnings before interest, taxes, depreciation and amortization). The firm typically is contracted up front to handle a client’s eventual M&A exit. It is an Inception-to-Success

relationship. We advise on the deal, help raise money, assist as an operating partner, instill one of our folks on the client's board (it's important to have good board governance on the deal) and then advise and execute on the exit of the company."

Greer explained the concept of their fiscal discipline strategy that they instill in each deal. "It's a shared service called 'Our CFO.' We have a Fortune 27 CFO that our president brought with him, so now we can offer the quality of a professional CFO from a Fortune 27 firm at a fraction of the cost that we plug into our portfolio companies.

We have transparency into all of the financials. So, with the board governance as an operating partner, the fiscal discipline, building trust through transparency and then working toward the exit, it's a complete partnership. If they want us to find an acquirer, we do that work too. If they want to take the company public, we have feeder relationships with firms and we also participate in the public offering with them.

Calling All Advisors: A Good Deal For Your Clients; A Good Deal For YOU!

Greer said Waveland is interested in partnering with those advisors who want a relationship with an investment bank. They provide everything from capital formation, mergers and acquisitions, consulting ... most every service that a traditional investment banking firm offers. "Said Greer, "The beauty of our structure is that the advisors whose clients need access to capital, we can help out. If the advisor, trust company, family office, or RIA brings that relationship to us and asks us to help, we offer

10% of our investment banking fee. And because we are an operating partner, we have a carried interest in every deal---in the form of either warrants or carried interest in the energy deals, and we share that with the advisor as well ... we call it our Financial Advisor Net Worth Building Model."

"[Advisors] might think about building a net worth position for themselves where they own equity in all of the deals in which they put their clients ... You can look your client in the eye and say, 'my financial upside is side-by-side with you in every one of the deals that we do. "

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He also said that an advisor may want to consider that instead of investing their own personal net worth in their own company stock or the company's stock they are affiliated with, they might think about building a net worth position for themselves where they own equity in all of the deals in which they put their clients. Said Greer, "You can look your client in the eye and say, 'my financial upside is side-

by-side with you in every one of the deals that we do. That is the beauty of our deals."

Something to Think About

Clearly, our industry is in transition. Over the past 30 years, there have been three major changes or transitions in our business. The first was May Day in 1975, which ushered in brokerage commission deregulation and the end of fixed commissions. The next major change to our way of doing business was the introduction of fee-based and fee-only business. Now, we are seeing a shift from traditional to non-traditional products, public to private asset classes, and are also realizing that alternative investments are no longer an "exclusive" solution just for foundations and endowments like Harvard, Yale, Princeton and the super wealthy. Now, you can answer those hard questions like "What can you do for me NOW?" that your clients keep asking. Said Greer, "Now advisors, RIAs and others in the industry have an Alternative Investment Bank they can rely on with a complete suite of

solutions, from wealth management to corporate finance. The alternatives approach is not a fad; it is the future. If you don't offer your clients alternative investments, they will seek them out on their own."

For more information about Waveland Capital Group, LLC, the Alternative Investment Bank, please visit www.wavelandgroup.com



Waveland Answers Your Questions About PE Deals

Why can't advisors find the exceptional PE deals? Larger PE and VC shops generally rely on larger institutions and endowments and do not solicit investment from the broker-dealer network, family offices or individual investors.

What elements of PE should advisors be looking for? Well researched and well structured deals, with experienced management teams and proprietary, potentially game-changing technologies addressing real problems.

What type of advisor/wealth manager does WCP enjoy working with? We work with a wide variety of advisors, but they tend to have a client base made up of entrepreneurs who realize both the challenges and the upside potential of PE investments.

What are some of the benefits of PE? The most prominent include upside potential due to being paid to assume risks (e.g., illiquidity and lack of transparency), preferred stock with venture industry-standard protective provisions, longer-term management focus, etc.

What is the potential for reward? Through lower relative valuations, warrants/options, and protective provisions associated with preferred stock, we try to provide investors with deals that are structured to offer venture capital upside with significantly mitigated risk.

Some of the myths/misconceptions of PE? That PE is substantively riskier than public equities; with diversification, the risk of PE investing can be largely ameliorated and should provide more than adequate compensation by lower valuation/higher upside potential; a study of 55 venture firms by the University of Pennsylvania showed PE risk to be roughly equal on a collective basis to small and mid-cap stocks and only slightly riskier than larger stocks.

What role does PE play in a HNW investor portfolio? We believe it should be a significant part of most investor's portfolios, though it is typically underweighted in the portfolios of individual investors; it is generally (and probably rightfully) considered to be in the higher reward and higher risk categories vs. cash, fixed income investments and large-cap equities. Some sophisticated investors prefer to invest more in high-impact investments like PE vs. lower perceived-risk public equities alongside lowest-risk investments like T-Bills.

What is PE Risk Management? Protective provisions, such as liquidation preference, seniority vs. common stock, voting rights, anti-dilution protection, and board representation are generally unique to PE.

What does an advisor have to know about the ways you structure PE transactions? They should carefully study term sheets – of the target investments and of the SPIVs, if applicable. We can discuss in any amount of detail the various features of our transactions, which we design to correspond to VC industry standards.