

## MEZZANINE

# Asian firms' family matters

Mezzanine financing is being considered by family businesses as they seek acquisitions and wealth transitions, writes **Adalla Kim**

**A**libaba became a case study in business succession planning when the New York-listed e-commerce giant announced that founder Jack Ma would hand over the chairmanship to the current chief executive, Daniel Zhang, a year after the 10 September announcement.

With so much wealth being created in Asia, the approach of founders in facilitating a smooth transition of the business – and wealth to the next generation – is a major talking point.

At present, founders remain a dominant force. Software businesses provide a good example, according to Brian Sheth, Vista Equity Partners co-founder and president.

“Most software companies, including the three biggest software companies in the world, are dominated by their founders,” noted Sheth, speaking at the Milken Institute Asia Summit 2018 held in Singapore in September.

Moreover, family-owned businesses have delivered stronger revenue growth and higher levels of profitability, according to a report released by Credit Suisse, *Credit Suisse Family 1000 in 2018*, in September.

The report shows that in 2017, non-Japan Asia-based family-owned companies listed on stock exchanges generated a 25.6 percent greater cashflow return on investment than their non-family owned counterparts and had delivered 4.2 percent outperformance in annual average share price return since 2006.

But how are these family-owned companies looking to achieve their ambitions?



**Sheth: founders are still dominant**

**“[MEZZANINE FINANCING] CAN BE USEFUL IN SOME SPECIFIC SITUATIONS, SUCH AS IF ONE FAMILY MEMBER WANTS TO BUY OUT ANOTHER FAMILY MEMBER, MEZZANINE DEBT CAN BE USED AS BRIDGE FINANCING WHILE AVOIDING ANY EQUITY DILUTION”**

**Peter Lee**

Notably, a Deloitte survey, *Next generation family businesses*, shows that acquisitions and forming strategic alliances are their top priorities – and mezzanine is playing a role in helping them with both.

## ALLIANCES

As evidenced in Deloitte’s survey, family businesses are seeking acquisition financing and forming strategic alliances.

“[Mezzanine financing] can be useful in some specific situations, such as if one family member wants to buy out another family member, mezzanine debt can be used as bridge financing while avoiding any equity dilution,” says Peter Lee, a Hong Kong-based financial advisory partner and head of family office services at Deloitte, the London-headquartered consultancy firm.

Non-sponsored lenders which work with founders and family-owned businesses are also seeing succession planning

# MEZZANINE

issues emerging. Among non-sponsored financiers providing mezzanine tranches, a New York-headquartered private debt manager, Jason Block, partner and chief investment officer of Freedom 3 Capital, tells *PDI* that transitions such as succession planning or buying out minority stakes account for 25 to 30 percent of Freedom 3 Capital's business.

Block also agrees with Lee that use of mezzanine financing is a secondary concern.

"I don't think I would ever say think about mezzanine financing for succession planning. I would simply advise an owner or founder that they need to think about succession planning – period. Think about it early and reaffirm those plans every three to five years. Decide who the next leader is. Give them the roadmap and guidance to be ready to replace the founder or current owner," he says.

Specifically, Freedom 3 Capital spans general growth financing, M&A financing for acquiring complementary businesses, carve-outs from either a public company or from a larger entity, and recapitalisations.

The manager has a closed-end fund, Freedom 3 Investment III, sized at over \$194 million as of 9 March, according to a Securities and Exchange Commission filing.

The fund targets non-sponsored

**"THE TYPICAL BANK LOAN MAY NOT WORK [FOR FAMILY SUCCESSION PLANNING] BECAUSE THEY MIGHT NOT HAVE ENOUGH ASSETS FOR SECURITISATION. SO, MEZZANINE FINANCING CAN BE A VIABLE SOLUTION"**

Peter Lee

lending to mid-market firms with a transaction size, ranging from \$10 million to \$200 million, and a three- to seven-year term. The firm typically targets an internal rate of return between 14 to 18 percent per annum – with a coupon between 10 and 13 percent and an equity upside to get the total return.

Fred Buffone, a principal and Block's colleague at Freedom 3 Capital, points to the long-term horizon that family owners and family offices have. "They are thinking about it not in a seven year-bond life cycle but over the course of a generation," he notes.

## DOWNSIDE

Still, there are pitfalls and downsides to mezzanine financing for succession planning. Typically, the cost is higher than that of traditional bank lending, according to Lee.

However, the mezzanine structure can be customised as per the needs of a family's succession planning.

"The typical bank loan may not work [for them] because they might not have enough assets for securitisation. So, mezzanine financing can be a viable solution," Lee adds.

According to him, 50 percent of respondents to the latest survey have a succession planning problem. And he reiterates the importance of having the succession plan in place and starting it early.

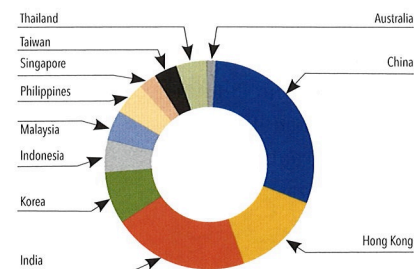
His observation is that conflicts might not happen in the first generation, but they can occur eventually.

Another variable is that the family dynamics keep changing as the family grows.

"In so many cases, [we have seen] the family businesses break up and unable to continue because of disputes among the members. They split up and all the shareholders and the businesses are gone," he says. ■

## ASIAN DOMINANCE

China records the highest representation in family-owned companies, in number terms, with 159 companies, followed by 121 firms in the US and 111 in India



**342**

Total number of family-owned companies in public markets in China, India and Hong Kong



**\$2.85trn**

Total market share of family-owned businesses across the top three countries

## TOTAL MARKET CAP

China continues to top the ranking, globally, with \$1.38trn in total market-cap

