labusinessjournal.com

LOS ANGELES BUSINESS JOURNAL

Volume 36, Number 16 | THE COMMUNITY OF BUSINESS™ | April 21 - 27, 2014 • $5.00

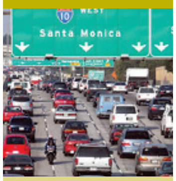
Up Front

Shaun Tuch made science fun, then transformed it into a business. PAGE 3

News & Analysis

Why BlackBerry is calling Patrick Soon-Shiong. PAGE 10

Op-Ed



C'mon, let's get going. It's time to unblock L.A. traffic. PAGE 67

MAIL TO:

Wham-O's Creditors Aren't Playing

MANUFACTURING: Law firm, rival say toymaker stashed assets.

By ALFRED LEE *Staff Reporter*

$36 million
Wham-O's liabilities, versus $31 million in assets

The list of products popularized by **Wham-O Inc.** is in itself a history of American ingenuity and marketing savvy: the Hula Hoop, Frisbee, Super Ball, Slip 'N Slide, Silly String and Hacky Sack, each a relic of the postwar boom and the subject of backyard family frivolity.

But today, the toy institution is fighting to keep creditors at bay. They claim the Woodland Hills company's owners – the fifth set since its co-founders sold it off more than 30 years ago – have racked up debts and avoided paying them by transferring assets to new entities.

The problems appear to stem from a combination of slow business and costly legal fights. Taiwanese competitor **Agit Global Inc.**, a maker of snow sleds and stand-up paddleboards, settled a patent lawsuit against Wham-O for $1.6 million in 2011, and has sued again to force it to pay. Meanwhile, **Goodwin Procter**, a law firm that represented Wham-O in other intellectual property claims, has sued, claiming the company hasn't paid $2.7 million in legal bills.

Company balance sheets filed in court show Wham-O had $36 million in liabilities in 2012, compared with only $31 million in assets.

Please see MANUFACTURING page 63

PHOTO BY THOMAS WASPER

On Sale: Sign promoting Mapfre insurance outside of a Northgate grocery in Norwalk.

New licenses rev up auto insurer's focus

By JAMES RUFUS KOREN *Staff Reporter*

Stop in a Vallarta supermarket and you'll see something new for sale next to the apples and jicama: auto insurance. Pitched particularly to Latinos, even illegal immigrants.

Madrid insurance giant **Mapfre** is stepping up its presence in California, with an eye on the state's Latino population – including undocumented residents who will soon be able to get driver's licenses, making it far more likely they'll buy car insurance.

And the Latino market is one where Mapfre executives think they have an edge, thanks to the company's big presence in South and Central America. Mapfre (pronounced "Mah-fray") does more business in Latin America than in its native Spain.

"People are waiting for a Hispanic insurance company," said **Antonio Huertas Mejias**, Mapfre's chief executive, who met with the Business Journal on a recent visit to Los Angeles. "If they like to eat Latino food, they'd like to have Latino insurance products."

And food is part of the company's expansion plans here. Mapfre has made deals with Latino-focused grocery store chains **Northgate González Markets** of Anaheim, **Vallarta Supermarkets Inc.** of Sylmar and **El Super** of Paramount. They have locations throughout Los Angeles and the rest of Southern California, and Mapfre insurance agents and information kiosks are already in 10 markets and will be in 10 more

Please see INSURANCE page 62

Businesses Fear Bill for Sick Days

GOVERNMENT: Employers say mandate would cost jobs.

By HOWARD FINE *Staff Reporter*

Thousands of local business owners will have to start paying their workers for sick leave under a proposed state law that business groups have tagged as a job killer.

The bill would require employers to give full-time workers at least three days of paid sick leave each year. It also explicitly states that workers can sue their employers for denying sick time or retaliating against them for taking it.

Local restaurateur **David Houston** said he would be hit hard by the bill. Houston, president of the **Barney's Beanery** chain in Los Angeles,

Please see GOVERNMENT page 62

Equity Firm Puts Money on Loans

INVESTMENT: Shackled banks open up market for Ares.

By MATT PRESSBERG *Staff Reporter*

Ares Management might be best known for big private equity deals, such as last year's purchase of Dallas luxury retailer **Neiman Marcus Inc.** But those big transactions are only a part of the company's business today.

More than one-third of the assets of the Century City financial firm are now in loans to companies, not investments in them. It's Ares' fastest-growing segment and a key driver behind the meteoric rise of the company. And it drove Ares' decision last month to raise $100 million by going public.

Regulations that followed the credit crisis have

Please see INVESTMENT page 61

SPECIAL REPORT
REAL ESTATE QUARTERLY

STAGING COMEBACK: Clarett West's Eastown mixed-use project is part of a Hollywood boom that is adding thousands of residential units and millions of feet of office space.

BEGINNING ON PAGE 21

Investment: Equity Firm Banks on Direct Loans

Continued from page 1

hamstrung commercial banks, particularly in lending to small and medium-size companies, sending this business to specialty finance companies such as Ares that don't have to play by the same rules.

Adam Coffey, chief executive of **Wash Multifamily Laundry Systems** in El Segundo, is a different kind of Ares client, though – he turns to Ares to supplement lending he gets from commercial banks.

"Small companies are using direct lenders because their risk profile is different from a bank's," said Coffey, whose company rents washing machines and dryers to apartment complexes and borrows from Ares in an aggressive growth strategy that doesn't fit into the new normal for banks. "They have looser credit requirements than the traditional senior lenders do. In many cases, a direct lender is all they can get."

Ares was co-founded in 1997 by a group of former executives from New York private equity firm **Apollo Global Management** led by **Antony Ressler**, who is still chief executive. The firm employs 700 people in 15 offices across the United States, Europe and Asia, and is headquartered on the 12th floor of the Creative Artists Agency building on Avenue of the Stars – the one with the hole in it.

Ares divides its business into four segments: direct lending, real estate, corporate bonds and private equity. Private equity now comprises 14 percent of the company's assets under management, compared with direct lending's 34 percent.

According to the firm's IPO filing, the direct-lending division has more than 400 client companies in the United States and Europe. Citing the "quiet period" imposed by the firm's pending IPO, Ares declined to speak to the Business Journal for this article.

The firm announced March 31 that it would go public and use the money to grow the business.

PHOTO BY THOMAS WASPER

Small Business: Chief Executive Adam Coffey next to a mural at Wash Multifamily Laundry Systems in El Segundo.

Banks bow out

The direct-lending boom has come to Ares as commercial banks' share of cash-flow loans to private middle-market companies fell to 9 percent last year, the lowest since 2007, according to data from S&P Capital IQ, a New York business analysis firm. The middle market is defined as companies with less than $50 million in earnings before interest, taxes depreciation and amortization.

Domestic banks issued less than 1 percent of these loans in the first quarter of this year, evidence that they've almost completely exited the business. In the early 2000s, their share was about 50 percent.

Alternative financiers have been happy to fill the void. Ares does its direct lending in the United States through its business development company, **Ares Capital Corp.**, which is already public. These types of companies, called BDCs, are essentially publicly traded private equity funds that choose that classification for tax purposes. Their main line of business is investing in loans to middle-market companies.

According to data from New York investment bank Keefe Bruyette & Woods Inc., total investments from BDC's have skyrocketed from a low of $2.3 billion in 2008 to $18.7 billion in 2013, growing at nearly 30 percent a year from 2011. Ares Capital is the biggest player in the space by far, with its 2013 total of $3.5 billion making it 55 percent larger than the second place company, **Apollo Investment Corp.**, Apollo's BDC.

In all, Ares Management has gone from $5 billion in assets under management to $73 billion in the last 10 years.

This shift in direct lending from banks to nonbanks can be traced to the threat and eventual reality of new banking regulations resulting from the 2008 financial crisis. Commercial banks now have to contend with tighter lending standards that had been looming since the crash and went into effect in May. These standards limit the amount of leverage banks can provide many businesses without raising concerns by regulators or rating agencies, which could lead to requirements to hold more capital, reducing yields. The agencies could also lower the ratings on the loans.

"For the traditional lenders, the spigot got turned off," said **Andrew Apfelberg**, a partner at Century City law firm **Greenberg Glusker** who specializes in corporate finance in the middle market. "Between the regulation and the tight credit, some investors saw an opportunity to get creative."

Through private equity companies such as Ares and other nonbank entities, these investors began to put their money into loans that were harder for banks to make, especially after they had their hands burned holding bad debt during the crash and were understandably cautious.

Senior debt from a specialty finance company can be at least 50 percent more expensive than a comparable product from a commercial bank, making it an attractive space for investors seeking yield.

These investment firms needed to find a way to deliver solid returns to their investors, and small businesses now spurned by their local bank were looking for financing. It was only natural that they would find each other.

"As regulations changed and the BDC's came in, suddenly you found you had this whole other alternative," Apfelberg said. "In some senses, those guys could be more flexible."

The primary customers for direct loans from firms such as Ares are small companies for whom such lenders have become often the only choice.

Craig Enenstein, chief executive of private equity firm **Corridor Capital** in West Los Angeles, also focuses on investments in lower-to middle-market companies. He said that small businesses, particularly those with annual Ebitda of less than $3 million, have an especially tough time finding traditional financing.

"It's very hard to find a conventional cash-flow loan," Enenstein said. "These specialty finance companies have filled a void that's been created by commercial banks walking away from that part of the market."

Companies that don't fit a certain established model or those tied to an industry such as homebuilding that went through a dramatic boom-bust market cycle have an even harder time getting bank loans, which is why many of them have led the charge toward firms such as Ares.

"These direct lenders are able to get involved in businesses that might be a little bit more hairy," said **Jeffrey Sklar**, a partner at Century City law firm **Sklar Kirsh** who chairs the firm's corporate practice. "A commercial lender might not be able to wrap his head around it."

Bigger companies, too

However, it's not only small or unusual companies that can't get bank loans that are finding a place for specialty finance firms on their balance sheets. Coffey's laundry business, for instance, has annual revenue of more than $1 billion and uses commercial banks to provide its senior debt. Big businesses such as Wash Multifamily Laundry use specialty lenders such as Ares to fill out their total debt picture and allow them to carry the amount of leverage that management, and not a bank credit committee or rating agency, deems appropriate.

Wash earns an annual Ebitda of more than $100 million. Rating agencies don't like companies taking on senior debt that exceeds four-and-a-quarter times Ebitda, so Wash has that multiple – $425 million – in senior loans from a syndicate of commercial banks. But it also has $75 million in junior debt from Ares.

"Above that (4.25 multiple), you have a harder time raising it through senior lenders such as commercial banks," Coffey said. "A company like Ares comes in and takes a second lien position behind the senior lenders. You'll pay a little bit higher interest rate, but it's a good way to round out your capital structure."

Ares charges an interest rate that is roughly double what Wash pays its senior lenders, but Coffey sees it as a cost of growing the business. Being able to tap into this extra debt frees up money needed to expand the company.

"We're a growth company," Coffey said. "We've doubled in size in the last five years. Growth in its very nature consumes capital."

Private equity firms such as Ares entered direct lending for the returns, but they're finding the business has other perks, such as the ability to bring potential target companies into their orbits before taking an equity position.

"If a company's in a cash-flow crunch and you're willing to give them a loan to tide them over, you're basically getting your hooks into them to then convert to equity later or take out by writing an equity check" Apfelberg said.

Small businesses struggling to find traditional financing are also finding upside as the big firms such as Apollo, Ares and **Blackstone Group** in New York are expanding their activity in direct lending.

"This is something they're able to take advantage of now that didn't exist in the same way 10 years ago," Sklar said. "If the banks, for whatever reason, are not able to give them a competitive product, there's other sources now that may be able to."

The increased competition in this space is starting to benefit borrowers in other ways, too, as specialty finance firms are now fighting among themselves over some of the same business. A source involved in private equity deals who spoke to the Business Journal on the condition of anonymity because he works with direct lenders said they have recently started undercutting each other, as certain lenders have been offering loss-leader terms to borrowers in order to boost market share.

Commercial banks are finding a roundabout way to get in on the action, too. Ares Capital recently announced that a group of 18 banks had raised the firm's credit line by $110 million, charging it a low interest rate.

And banks are now increasing their lending to Ares Capital to make the loans they no longer can. The banks' risk is spread out among its entire portfolio, while Ares Capital takes on the risk of each individual loan and pockets the spread as its payment.

Apfelberg thinks this reallocation of riskier debt to direct lenders such as Ares Management is a positive consequence of the banking crisis.

"I think the role that commercial banks play in most people's mind is conservative, safe, traditional," he said "And that's where maybe it does make sense to use public money or federal money to bail out some of these institutions or regulate them a little more. However, investors in these loans are not your average Joe, They're looking for returns by assuming a higher risk."