

Lead Left Interview – Jason Block & Fred Buffone (Part 2)

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This week we continue our conversation with Jason Block, partner and chief investment officer and Fred Buffone, principal, of Freedom 3 Capital. F3C provides tailored junior capital solutions to middle market companies by providing a combination of junior capital securities to generate current income and capital appreciation. *Second of two parts* – [View part one](#)

The Lead Left: Who is your biggest competition?

Jason Block: We don't seem to run into the same people very often. Other funds focused on non-sponsored investments show up from time to time as do the mid-sized BDC. In general, the company is only speaking to two or three people in a process. However a consistent source of competition is the transaction not happening. The owner may want to buy out his brother, but it doesn't have to happen. He might want to buy the local competitors, but if he doesn't, he still has a great business.

TLL: Aren't non-sponsored deals challenging?

JB: All investments are challenging. But with non-sponsored companies, you do your own work. That's both a plus and a minus. We commission exactly the kind of third party work we want, rather than just accept what a sponsor is ordering. Timing to closing is significantly longer. We often have to spend a lot of time and money on due diligence. But in the end, it helps us build a better relationship with management and the owners. These relationships can really help when things don't go right. Being the trusted advisor when things aren't going well keeps you in the room and gives you influence in decisions. This can be really important and has helped us get our money back in tough situations.

TLL: What about the fact that without a sponsor you don't have a deep pocket to go to.

Fred Buffone: A sponsor is only as good as their willingness to put money in and you know it depends where they are in a given fund's lifecycle. Families, on the other hand, have their reputation and honor at risk. To protect those things, they may do something that disadvantages the equity and benefits the debt. But to the family owner, it's more than just money as the capital will benefit the family name for the next generation.

TLL: Could you give us an example of that?

JB: There are quite a few, but recently an entrepreneur wrote a \$10 million check to fund growth capital and get a covenant waiver from the senior and junior debt holders. He was more focused on the time to improve the business under the waiver than he was on the IRR on the \$10 million. In fact, you could argue that the \$10 million did not increase his exit value. But he is a man of honor and he wanted his company to have a chance to grow further.

FB: In another case, we worked for three years in an industry we know well. The goal was to refinance the company's balance sheet and buyout a minority partner. The key to our strategy was to offer the refinancing first. Because after the refinancing, the minority equity would be unable to force an exit for another six years. Once we completed the first step, it forced them to the negotiating table. Under our proposal the family went from 51% ownership to 94%. We were able to get 6% of the company as part of our investment debt investment.

JB: We got a sub 5x leveraged second lien with a 10% cash coupon and 6% of free equity. That equity was worth nearly 15 points of value at closing.

TLL: *How's your portfolio doing?*

FB: It's doing well. The one borrower that wasn't doing well just got sold. Ironically he's been our best reference since we were a good partner through the tough times. We always think in terms of a win-win with our portfolio companies.

JB: As a mezz investor we don't own the company and we can't take control. So we try to figure out how to work with the equity and the senior debt. Like we said earlier, we are in the people business. You have to listen to what is important to everyone and try to create great solutions. Thank goodness, right now the portfolio is performing well. But we know something will go wrong and we hope that we've built the relationships and can work as a team to help the company work through a difficult time.

TLL: *What's your pitch versus other competitors?*

JB: Nothing is ever exclusive. So we simply try to listen and be a good long-term thoughtful partner. Integrity is a key; we try to be straight up with our partners so we're all on the same page from Day 1. If we can understand a business better and speak the same language as the management and the owners, we can often convince them to work with us. It is not always about price – although pricing has to be fair – how you treat someone and how you help them grow their business for the longer term can really help.

FB: Look, we're not for everybody. Sometimes you need a piece of debt that's a bespoke piece of paper to fit the company. It's about crafting solutions. To get our returns, call protection – real non-call – not 3/2/1 and equity upside are all important.

Our capital is recyclable – our time is not. We invest our time and effort in our portfolio companies and as such, we might be more expensive in the short term. But we hope we help people grow their companies faster and make more in the long term. Owners with a longer time horizon tend to see our value add and its more than just our coupon and equity participation.

TLL: *Why should a borrower work with a small firm such as Freedom 3?*

JB: We are really good at listening to them and solving for the company's needs. The borrower does not have to plug into our form. So much of the current mezz market isn't bespoke anymore; its become a syndicated product where you buy off a book and a meeting. We play where there is no capital markets solution. The borrower wants to know who we are as people. After all, at some point we'll be sitting in their board room and working with them!

TLL: *What's your view of where we are in the cycle?*

JB: I've been saying for three years we're at the peak, so I've been wrong. It feels like 2007. The economy is in a slow growth phase; there's never been a period in history like this. We think about structure and performance

of each investment through the cycle. We looked at an airline travel dependent business. When the recession hits, this company probably survives. But we needed to put in flexibility so that it could weather the downturn.

And where else can you get yield now? High yield index funds? You'll get 5-6% if you're lucky. We make huge excess spreads versus liquid credit. Because of this, I think we'll see continued flows into our asset class. But at some point, one issuer in the market will default, and a trickle effect will lead to a bunch of other defaults. If you get defaults, your total return goes way down – particularly, if you are not experienced at the hard work that goes into getting your money back during the tough times. Then money will flow out. Cycles still exist, hopefully the next one won't be too bad.

TLL: Finally, gentlemen, what's been your biggest surprise since starting the firm?

JB: [Jason pauses for a long time]. That is an interesting one. No one has asked us that. But I have really been surprised at how much fun it's been. I knew I would enjoy having our own firm and also I knew how hard it would be. But as my wife said, "I have never seen you work so hard and never have you had this much fun." At Freedom 3, we get to debate about the people we want to work with. Everytime we make an investment, it's like a marriage. We truly get to become partners and advisors with some great people.

We always knew we couldn't do it alone. Our partners and friends – including competitors like Mike Hall and Sandeep Alva who showed us how to start our own firm – have been all been incredibly helpful. We couldn't do it without everyone's support and guidance.

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