Lead Left Interview – Mike Hall and Bill Dietz

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Last July when we chatted with Mike Hall of Yukon Capital Partners [link], the firm was poised to wrap up its second mezzanine fund raise. This week we check in with Mike and his partner, Bill Dietz, for an update.

The Lead Left: Mike and Bill, sounds like congratulations are in order.

Michael Hall: Thanks, Randy. We issued a press release [link] back in October. The fund target was $300 million. Credit Suisse was our placement agent again. We ended up hitting our hard cap of $400 million.

Bill Dietz: Our first fund at Norwest Mezzanine was $250 million, and the second was $400 million. Our first fund at Yukon was $238 million; our second was $400 million. So you can see the natural evolution. The evolution and size of our funds fit well with our equity partners.

TLL: What were the lessons for this time around? Was it a tougher raise?

MH: We launched the first Yukon fund in the worst of times: 2008. Compared to that, we're tickled to death. LPs are very focused on strategy, attribution, track record – we had no issues with that.

TLL: Did you note any new behavior from LPs in general?

MH: Nothing new. When we completed our Fund I raise in 2009, the new world order was firmly established. Some who co-invested before the crisis are gone. We've picked up a few who wanted to co-invest. We added a few consultants and advisors, but they're similar to PE in terms of behavior.

BD: Take a look at the parties who are interested in mezzanine. It's a smaller universe than private equity, so it's important to keep in touch with what they're doing.

MH: It's a smaller addressable market for mezz. Probably 15—20% of the overall middle market.

TLL: Coming out of the credit crisis you certainly were positioned well.

MH: Our timing was helpful. But we're not averse to problems. Mezz interest payment blockages are joyful and rapturous events! We like default interest, even if it's not cash pay.

TLL: Did you have overlap in LPs between the first Yukon fund and the second?

BD: Not all our LPs came into Fund II. But a vast majority did. Some insurance companies have changed their strategy to focus more equity co-investments. Some banks which had been in our previous fund have Volcker issues. But endowments, foundations, and pension funds – all know and like mezz assets.

TLL: Did LPs have concerns about distintermediation of mezz by second lien and unitranche?

MH: We got some of those questions from new investors, but existing guys understand. To give you a sense of demand, of the $400 million we're raised, almost $135 million is already invested or committed. 2014 has been a very strong year.

BD: Our team has decades of experience across economic cycles and mezzanine cycles. There are certain tactics you need to employ in this environment. When financing is readily available, we focus on relationships. Private equity needs perfection to hit their 20%-plus return goal. They need mezz partners who will confidently support them through tough times.

TLL: What other tactics are important?

BD: We have a very efficient credit decision process that is led by the partners. We are intimately familiar with the borrowers. It's not some nebulous investment committee. That direct and centralized approach is valued by GPs.

TLL: How has mezz performance been in general?

MH: Mezz outperforms private equity in tough times. It has a fixed yield, and less beta than the equity. We had just launched Fund I when Lehman hit. As you recall, that crippled world-wide LP markets. The economy was cooling, so we were stuck with a prolonged fundraise.

TLL: Timing is everything.

MH: Mezz investing was great in '08. In '09 and '10 it was still great, but LPs were illiquid. Still good in '11 and '12. Then in 2013 and 2014 there was an influx of capital. There have been 40 new BDCs a year, new CLOs, etc. But they don't do mezz in any material way.

TLL: How do you find proprietary deal flow?

MH: Devin Matthews has a great article on deal sourcing. The standard response to this kind of market is to generate more numbers with more people. But efficient markets require senior people doing the marketing. Ours is that kind of model.

To be continued the week of March 2

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