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Lead Left Interview – Mike Hall and Bill Dietz (Part 2)

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This week we continue our conversation with Michael J. Hall and Bill Dietz, managing partner at Yukon Capital Partners. Yukon provides mezzanine capital to middle market businesses with a focus on deals controlled by private equity sponsors. The firm was poised to wrap up its second mezzanine fund raise. *Second of two parts – View part one*

The Lead Left: Still, there are real competitive pressures.

Bill Dietz: Yes, thanks to the stability of the economy and business in general. Regardless of availability of capital, sponsors tend to seek higher leverage and cheaper financing. No question our competitors have an influence. We're losing and walking away from more deals as a result.

Michael Hall: But as we've said, with eight deals in the new fund already, we're like flies at a picnic at the moment.

TLL: Are all eight buyouts?

MH: Yes, with one add-on. As a data point, our average total closing leverage for Fund I was 3.8x. Fund II is slightly lower than that, so far. We're ok having the same yield but lower leverage. Our sponsor/partners know it's not the most prudent thing to always push leverage as far as it will go.

TLL: What size sponsors are you targeting?

BD: The average fund is around $300 million, with the smallest $50 million, and the largest $2 billion. The average Ebitda is mid-high teens. We'll go as low as $4-5 million, and as high as $50 million.

TLL: Mike, give us examples of current mezz terms.

MH: It's still a 2% up-front fee with 12% cash and PIK on top of that to yield a low to mid-teens cost of capital. There are plenty of larger deals with 9-11% cash and no PIK. We're a bit higher because we play in tougher industries like healthcare and auto. And when you're earning two-and-twenty on your capital, you can't charge the issuer 9%. And we've had no losses yet.

TLL: What about call premiums? 103?

MH: We have a deal now that's 104, 103, 102, and 101. Another transaction that's 105, 103, 101. Both of those are for $10 million ebitda companies. I think the pricing data that SPP publishes is pretty fair.

TLL: How about non-calls?

MH: We're not big fans of non-calls. We had one for a $60 million ebitda business; it was a three-year no-call provision! That was an outlier, for sure. The sponsor didn't care. We don't mind getting paid back; we've never had a problem re-investing our cash. There are plenty of good deals to look at.

TLL: How would you describe the overall deal environment?

MH: Slow and steady. It's now an international, professionals-only game. But it benefits long-time players or "adults" as we like to say. The market is a bit more crowded, certainly, and valuations are full. But there haven't been a lot of new entrants at the lower end of the middle market.

BD: At the larger end, there is a lot of competition for the best deals. We are finding good opportunities in more challenging deals and industries. Healthcare and business services in particular, but we're more cautious on cyclicals.

TLL: You mention healthcare and auto. What other sectors do you like? Dislike?

MH: We're not fans of regulated industries, like financial services. Same with natural resources, but we like businesses that service them. Autos and building products are still attractive, though they were *very* attractive in '10 and '11. Back then they were a screaming home run, though no one knew where the floor was on demand. Now autos aren't closer to the bottom than the top. Homeowners still have a long way to go before prices get back to where they were. People are still paying cash to sell their homes.

TLL: How about more consumer-oriented sectors?

BD: Consumer goods are tough, but there are opportunities like our investment in a "quick-serve" restaurant with a lots of stores.

TLL: What's been the biggest surprise for you so far this year?

MH: That M&A has done as well as it has. There's not too much cash, there's too little deal flow! PE has to grow businesses, which is tough given the slow economy. It hasn't brought sellers off the sidelines.

TLL: And with rates as low as they are…

MH: Hey, the mortgage payment on my floater just went down again!

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