

UNITRANCHE



Turning the world upside down

Unitranche loans are continuing to evolve with the wider private debt market as they make their presence felt on both sides of the Atlantic, writes **Claire Coe Smith**

In many ways, the unitranche product came of age over the last 12 months. Growing in popularity and maturing as a financing option on both sides of the Atlantic, private debt providers entered the mainstream as banks lost their crown as the only financing game in town.

In the US, the unitranche story was one of innovation, with the product range expanding as the number of lenders increased dramatically. Unitranche is now available across the upper and lower mid-market with facilities from \$10 million to \$500 million on offer and a platform of product options.

Stephen Boyko, co-head of the multi-tranche finance group at the law firm Proskauer in Boston, says: “The story last year in the US was one of a lot more lenders coming into the unitranche space, so it’s

now a pretty robust market, with literally dozens of lenders willing to create products. Unitranche has turned into much more of a platform, with people taking two-document deals, whether senior/mezzanine or first-lien/second-lien, and creating a unitranche synthetically.”

In both US and European debt financings, the unitranche market has long divided into straight and bifurcated deals, with the former referring to senior stretch loans that provide five or six turns of leverage as an alternative to a more traditional first-lien/second-lien, or senior/mezzanine, structure, with the lenders sharing the payments on a ratable or priority basis.

Bifurcated unitranche looks, on the face of it, like a single credit facility, but the loan is sliced into first-out and last-out loans, with the first-out lender getting

payment priority and last-out benefitting from skimmed interest and terms set out in an agreement between the lenders.

Historically, most of the deals in the US were bifurcated, while most in Europe were stretch senior, so-called straight unitranches, with the expectation that the Europeans would ultimately move towards the US model. In fact, the opposite proved to be the case in 2015.

The US market has moved toward a more simplified offering, Boyko says. “Most of the unitranche deals we are seeing this year are senior stretch loans, rather than the bifurcated unitranches, which in the past were more common. For the first time the majority of our unitranche deals are straight unitranches, and we see this as part of a theme of simplicity.” He sees this as a sign of maturity in the market.

UNITRANCHE

“For a number of years we have seen lots of players entering the market, and a lot of complexity around structures, and we are now starting to see a bit of settling out and more of our clients are doing the whole capital structure themselves, or bringing in a partner to do an ‘upside-down deal’.

“Our clients are really yield-driven, so when they find good deals with strong management teams in great industries they want to keep it. So they will give away the first turn or two, but they are largely holding the risk themselves.”

A new feature of the market is the upside-down deals that Boyko refers to, where there is a much larger last-out loan and a first-out that’s typically only a turn or two of leverage.

“About half the bifurcated unitranche deals we saw last year were these upside-down deals and that’s driven by the dominance of the business development companies (BDCs) in the market, who are the ones out there originating the deals, and then bringing in the first-out lenders,” says Boyko.

“It’s really turning the typical structure on its head, because the BDCs are securing the deals and taking the bulk of the risk, and then bringing in a partner to take out the first turn or two of leverage.”

ATLANTIC DIVIDE

Meanwhile, the European market, which had been expected to start bifurcating a lot more unitranche deals, has favoured the non-amortising stretched senior loan structures.

“In our opinion, there are two principal reasons why that bifurcated unitranche product hasn’t taken off in Europe,” says Faisal Ramzan, a partner with Proskauer in London. “First, there is a bit more of a lack of understanding of the nuances behind the bifurcated product in Europe,



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and a lack of familiarity. Secondly, there is significant liquidity in the European market, and a lot of debt funds, and banks, haven’t been able to deploy capital to the extent that they would have liked. So when deals have come to market, the funds have been able to make large investments and write slightly larger cheques.”

That said, Proskauer helped structure one of the first bifurcated unitranche deals in Europe at the end of 2014, and split deals are happening, with intercreditor agreements getting increasingly swift to negotiate as they are seen more often.

The result is a convergence in the structures on both sides of the pond coinciding with an uptick in the number of lenders and the availability of the product. The number of partnerships between debt funds and banks has also ballooned, particularly in the US.

Boyko says: “We have seen a lot of activity on the partnership side, and I think that’s because the banks are trying to make sure they are still in the flow of deals, because in a sense these large BDCs have very sizeable originating networks and are competing head to head with the banks.

“If the banks want to be lending a couple of turns into the structure, they really need to pick a dance partner. From the BDC perspective, they can lever up their returns by bringing in somebody else, so I think we will see a lot more of these joint ventures coming in 2016. I’m personally aware of three in documentation right now.”

In Europe, alternative lenders’ market share had been expected to skyrocket, the unitranche providers have not had it all their own way.

Ben Davis, a partner with the law firm Reed Smith in London, and a regular advisor to large debt funds, says: “The market share of the alternative lenders has been holding reasonably steady in the UK, despite predictions that it would increase to levels seen in the US, and that is partly because the banks continue to be reasonably competitive. They have developed a European version of term loan B that is price competitive to unitranche, with some additional flexibility in terms of covenants, and so it really is a very competitive landscape.”

He adds: “The banks are putting up a good fight, but the unitranche providers really are very flexible in terms of what they can offer, and have a huge amount of capital to deploy, so they are finding ways to make themselves relevant and continuously innovating.”

Several significant deals have highlighted the ability of European unitranche providers to finance larger mid-market transactions. Notably, last November Ares



BlueBay Asset Management provided a unitranche facility to Silverfleet Capital in its acquisition of Masai Clothing Company, one of the first such financings in Denmark

provided one of the largest bilateral unitranche yet executed by a debt fund in Europe, when it underwrote a €300 million financing package for French investment firm Eurazeo to buy Irish tax-free shopping firm Fintrax. The package included a €250 million unitranche loan and €50 million of undrawn lines.

The same month, Intermediate Capital Group provided a £155 million (\$224 million; €201 million) unitranche loan to UK gaming company Gala Bingo.

“There are now maybe two or three debt funds in the market that are able to underwrite a £200 million-£300 million unitranche facility, which really makes the unitranche market able to compete against the term loan B and high-yield products and takes them to another level at the upper end of the mid-market,” says Davis.

At the same time, unitranche is moving beyond the UK, France and Germany and into new jurisdictions in Europe. Last year, BlueBay Asset Management provided a unitranche facility to Silverfleet Capital in connection with the acquisition of a Danish womenswear brand, Masai Clothing Company, in one of the first unitranche financings in Denmark, and EQT Partners provided a unitranche facility

to refinance Mikeva, a care provider in Finland, in one of the first unitranche deals in that country. Romain Cattet is a partner at Marlborough Partners, the debt advisory business. He says that the acceptance of the unitranche product on the demand side really shifted in Europe in 2015: “Private equity guys can be quite conservative, and they didn’t know who these guys were, and had their existing banking relationships, so it took a bit of time to accept that the debt funds weren’t necessarily aggressive, but were alternative lenders with a commercial mindset.

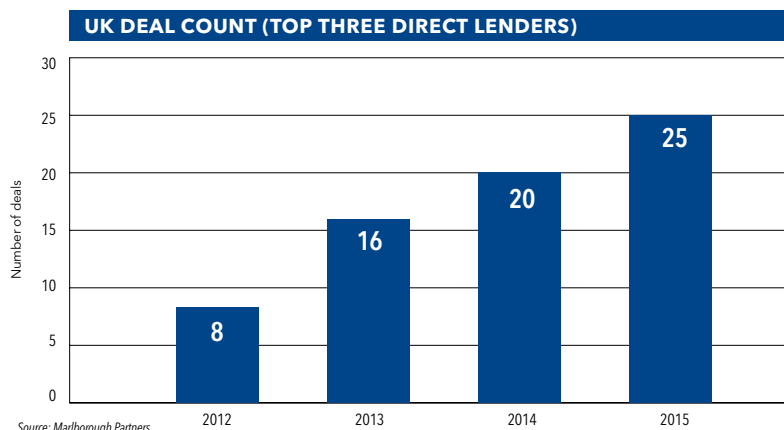
“That took two or three years, and, meanwhile, many, many more debt funds came into the market and the product got more flexible, cheaper, and the funds started to lend bigger amounts.”

Chris Lowe, who leads the leveraged finance team at EY in London, adds: “Last year was a year of maturity in the unitranche market, where it very much became the norm that the credit funds featured in nearly every process that we advised on. The emergence of new funds also slowed massively, so it was the year when new funds probably peaked. Last year we saw more fund deals than bank deals for the first time.”

It looks like unitranche came of age. ■

NEW PLAYERS

Marlborough estimates that there are now roughly more than 70 credible direct lenders in Europe with dry powder by fund ranging from €250 million to €2 billion-€3 billion. Back of the envelope calculations, it says, would suggest dry powder in the region of more than €35 billion, assuming an average of €500 million to deploy.



Source: Marlborough Partners