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"$2 Billion is the New $1 Billion": Unitranche Revisited (Last of a Series)

THE LEAD | August 19, 2021

In a recent conversation with a good friend in private credit, a veteran of the industry for many years, he reminded us of the history of one-stop financing. "In the beginning," he reminded us, "unitranche was a creature of broken markets. It was designed to step in when banks were backing away. Today it's accelerating when capital markets are very healthy."

The size of these financings has also grown in leaps and bounds. The 2007 GE Capital/Ares SSLP unitranche fund size *totaled* $3.6 billion. Today that could be filled with two deals.

How large could they get? We remember the same questions being asked about broadly syndicated loans in 2007. (*Trivia question: What was the largest BSL ever done?**) Instead of syndicating externally to unrelated CLOs and funds, as the investment banks do, direct lenders allocate internally across managed funds and related vehicles.

If the largest direct lenders collaborate, and if (the bigger 'if') sponsors agree to club them up, a $3 billion unitranche could come sooner rather than later, perhaps by year-end. After that, it's not hard to imagine a $5 billion uni, particularly with a large software company.

Fierce competition among lenders to put money to work is driving aggressive terms at an increased velocity since Covid. "It took a decade for us to get to a $1 billion unitranche," another credit manager noted. "It only took one year to create a cov-lite uni.

"It's one thing," he continued, "for larger borrowers to go cov-lite. But it's being offered by lenders who should know better to smaller middle market companies that don't deserve it."

Along with covenants, two other structural elements are forefront in unitranche arrangers' minds.

First is voting rights. For blockbuster deals, a handful of co-lenders are often committing large ($300 million or more) tickets. In these cases at least two lenders are often required on key issues. But if the lead arranger represents an outsized proportion of the financing, others can be dragged along, even on so-called "sacred rights" like maturity dates and reduction of principal.

Another is credit risk. Do highly leveraged mega private deals presage higher default rates as did the pre-GFC mega syndications? S&P's Abby Latour highlighted a bullish White & Case report (link) that in turn cited a Nuveen white paper. "Private debt defaults," she wrote, "never exceeded 2% last year. This is lower than defaults of leveraged loans and high-yield bonds.

"This lower default rate," she continued, "is likely a result of private debt lenders' typical approach to hold loans to maturity, leading to far more conservative selection when picking credits and (per Nuveen) "a proclivity for funding deals in defensive, asset-light sectors."

“After a volatile and challenging year,” the report concluded, “U.S. direct lenders moved into 2021 with reputations enhanced and teams strongly positioned to fund new deals.”

Whether aggressive jumbo unitranches will hurt those reputations down the road remains to be seen.

**** In October 2007 TXU became the largest BSL execution ever done with a total loan financing package of $25 billion.***

? From the Editor: The Lead Left will be on its annual August break and will return the week of Sept 6.