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All Ahead Full: Private Credit Outlook 2022 (Fourth of a Series)

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Back in 2015 we introduced the concept of the “cargo-pants strategy” [link]. It was our observation that direct lenders saw the opening to compete against banks for leveraged finance deals, but needed virtual balance sheets to hold larger commitments.

Over time these managers raised multiple vehicles – CLOs, separate managed accounts, commingled funds, BDCs, etc. – to create loan storage pockets. They could then allocate commitments of size across vehicles without any holding outsized positions.

As pockets were added, hold sizes grew. Over the past six years direct lenders’ average holds expanded from $25-30 million to $100 million-plus. At the same time, the development of the unitranche [link] has given managers a competitive instrument to take share from loan arranging (not loan holding) banks.

In 2017, per Refinitiv LPC, only 28% of unitranches were above $250 million. Today that share is up to 77%. Migrating into the broadly syndicated market requires not just size, but also large cap terms. The most significant is cov-lite. We vividly remember not long ago hearing a private credit manager scoff at the idea of a cov-lite unitranche: “Who would do *that*?”

Yet it happened. The largest managers (with the biggest cargo pants) are pocketing $1 billion-plus unitranches, both in the US and Europe. Besides being highly leveraged, these megatranches sport sky-high purchase price multiples for growth-oriented software companies.

A timely example is Permira’s go-private for *Mimecast*. The cybersecurity services deal is just shy of $6 billion, with about $3 billion in financing. This issuer would typically access the BSL market. The managers’ likely unitranche structure side-steps the usual syndication process and provides the client certainty of execution.

As our *Chart of the Week* highlights, the growing size of private debt funds is contributing to what looks to be a trend for the future. Megatranches could reach $5 billion in size before too long, as the largest managers continue to scale.

What are the implications of these elephant hunts? While most are held among very tight clubs, will managers eventually seek to distribute paper to relationship accounts? Will that entail more of a market approach to terms? In short, will the buy-side begin to look like the sell-side?

While unitranche activity at $50 billion set a record last quarter (more than double 2Q), it’s still far from syndicated loans which totaled $200 billion. Nevertheless we expect to see extra-large cargo pants in 2022.