Lead Left Interview – William Brady (Part 2)

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This week we continue our conversation with William P. Brady, a partner in the Corporate Department of Proskauer. He is also a member of the Finance Group as well as the Multi-Tranche Finance Group. Bill is a thought leader on unitranche financings and speaks at various junior capital, multi-tranche finance and related finance conferences and seminars.

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The Lead Left: Amazingly, I've also seen mezzanine tranches being added below first-out/last-out pieces.

William Brady: Yes, that makes matters interesting. Again, each lender class carries different terms and conditions, all governed by the AAL. In some cases, we end up with multiple AALs or a combination of AAL(s) as well as a more traditional intercreditor agreement.

For companies with significant working capital assets, a split collateral unitranche may be employed. An asset-based lending (ABL) revolving credit provides financing for the receivables and inventory, and carries a first lien on those assets. And a term loan finances, and has a first lien on the other assets, taking a second lien on the current assets.

TLL: And I suppose there are tweaks on all these alternatives, depending on the situation.

WB: Yes, everything gets thrown into the pot. The fun part is stirring it up to create what comes out the other end.

TLL: Bill, we keep hearing that the unitranche has never been tested in bankruptcy. True?

WB: The traditional bankruptcy waives in the two-document construct with a first lien and second lien have been tested.

There are intended to be fewer bankruptcies in a unitranche, because the AAL is supposed to encourage out-of-court settlements but they are just starting to be tested.

TLL: You mentioned the upside-down deal earlier. Explain how the first-out rights work there.

WB: Because there is such low leverage associated with the first-out, that tranche has few rights from a voting perspective. The last-out has the risk, so it drives the bus. Now in the event of a meltdown, both lenders will have their say. When the first-out isn't getting paid or first-out leverage is out of control, the first-out lender will have a voice.

TLL: What about the converse, when there's a large first-out component in the structure?

WB: That's the other end of the spectrum. In that case, and assuming the last-out lender is receiving a mezzanine-like return, the structure would follow "synthetic mezzanine." To obtain the requisite mezzanine yield, that lender likely has to skim off a much larger first-out loan. Both may have a required lender vote, but the first-out may have the ability to change certain covenants, up to a point, in an effort to replicate customary mezzanine-like cushions.

TLL: What should lending partners consider when it comes to working with other lenders?

WB: The unitranche structure more closely ties the lenders from different tranches together as they are parties to the same credit documents. As such, some of the AAL terms are intended to further the goal of creating a more cooperative interlender relationship when times get tough. In addition, many unitranche lenders will close multiple deals together based on the negotiated form of AAL. As such, it's important to choose a good commercial partner here even more so than in the one-off two document structures.

Contact:
William Brady
wbrady@proskauer.com