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

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In October 2015 we published a series of articles on the unitranche, what we called "one of the most innovative, and increasingly popular, financing tools in the middle market." Those commentaries were consolidated into a white paper: "The Unitranche – What it is, and Why it Matters.".

In that white paper we covered the history of the unitranche, including its origins in 2007 with a $3.6 billion fund managed by Allied Capital (later acquired by Ares) and Antares Capital.

We also detailed the unitranche structure which, back then, was often bifurcated between first-out and last-out slices. Each of these components was provided by different parties and governed by an Agreement Among Lenders (AAL). In the event, that structure became too clunky for private equity sponsors to manage, and credit providers morphed to a truly single first-out tranche.

In 2016, soon after our special series, Ares reached a milestone by leading, for Thoma Bravo's Qlik Technologies, the first $1 billion unitranche. Subsequently, other mega-tranches came to market as issuers at the larger end of the market recognized the value of the one-stop.

The broadly syndicated market, after all, involved more time to distribute, more lenders to negotiate with, and more uncertainty on terms. As we told M&A magazine last week, "The syndication process depends on the arranger's read of the market clearing price. But they also rely on pricing flex in case the market moves. That uncertainty goes away with a private credit execution because the asset manager will hold the whole deal."

Over the past six years, as direct lenders have raised more capacity, hold levels have increased significantly. What we've dubbed "the arms race in private credit" is most evident in the prevalence of $500 million-plus unitranche financings. According to Refinitiv LPC, only 2.2% of overall one-stop volume fell into that category in 2016. By 2019 that share had risen to 7.6%.

The onset of Covid put a temporary hold on higher leverage loans. As our *Chart of the Week* depicts (courtesy Refinitiv), 2Q 2020 combined unitranche volume shrank to less than $4 billion. But activity returned as a semblance of normality was restored to the economy and capital markets. Volume for the second half of 2020 was about $25 billion vs. $16 billion for the first half. And with it came more mega-deals, with 13.6% representing $500 million or more facilities.

One-stop momentum continued into 2021. As evident in our *Chart*, volume is at record levels. Refinitiv data showed unitranches financed over 50% of 2Q buyouts, up from 43% in 1Q.

Next week we'll take a deeper dive into the competitive dynamics surrounding the current unitranche trend. We'll also look at resulting terms and credit metrics and how they compare to the public credit markets.