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The Unitranche – What it is, and Why it Matters (Fourth of a Series)

THE LEAD | October 28, 2015

There are two kinds of unitranche providers. Both provide the entire financing to the borrower at a given spread in one debt tranche. But one type bifurcates the tranche into first-out and last-out term loans to different lenders. The other doesn't.

As we've discussed in previous instalments of our unitranche series, one-stop structures are becoming increasingly bespoke. Depending on the issuer and the specific requirements of the transaction, these structures can include asset-based revolvers, terms loans, even mezzanine debt. The common denominator is borrowers deal with one document and one lender. What happens among the lenders is a different story.

The classic bifurcated provider was the SSLP program between GE Antares and Ares. Under that Agreement Among Lenders (AAL) GE took the first-out piece and Ares the last-out. Since the sale of GE Capital's sponsor finance business to Canadian Pension Plan earlier this year, Ares has partnered with Varagon Capital to create a similar program. Antares Capital continues to provide unitranche financings as part of CPP.

Other middle market firms have adopted a similar partnership approach on unitranche. NewStar, for example, has teamed up with Blackstone/GSO taking the second.

The non-bifurcated strategy seems to be more common and is typified by Golub Capital. Golub lends in one strip with no first or second-out tranching.

There are some advantages to bifurcation. It offers natural alignment with each lender's investment profile – lower leverage and moderate yields for the first-out, and higher yield and leverage for the second-out. A bank as first-out lender can also provide the RC.

Bifurcation can also be used on a deal-by-deal basis as a yield enhancer. Let's say a $100 million unitranche is structured initially at 7%. The arranger can sell $20 million of a first-out to a bank at 4%, which boosts the yield of the remaining piece to 7.75%.

The breadth of one-stop providers spans a number of disciplines. On the larger end of the scale, Apollo, Cerberus, Fortress, Guggenheim, Macquarie, Sankaty, TCW, and TPG can speak for size, substituting for bonds when the high-yield market is off-line.

In the middle market, BDCs have proven to be natural homes for higher yielding paper. These unitranche managers include American Capital, Fifth Street, Goldman, and THL Credit. Solar Capital (with two BDCs) has further enhanced its unitranche capacity by adding an investing partner (Voya).

Other midcap managers that are active unitranche lenders include Babson, MidCap Financial, Monroe Capital and NXT.

Regardless of who your lender is, unitranche players agree nothing is more important than knowing who you’re dealing with.

Next week we conclude our series with a look at key unitranche concerns for lenders and borrowers.