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The Evolution of Unitranche

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The use of unitranche loans, commonly used to fund private equity-backed acquisitions, management-led buyouts and corporate refinancings, is on the rise. The Deloitte Alternative Lender Deal Tracker published at the end of last year highlighted that there were 233 alternative lender or unitranche transactions in the 12 months ending Q3 2015, which was an increase on 202 transactions in the preceding 12 months and 109 transactions in the year before that. But why is the unitranche market share growing and how is the unitranche product evolving?

Unitranche lenders have a well-known track record for speed of execution, flexibility of capital structures, increased leverage, higher individual hold positions, funding further growth and supportive lending relationships. However, while this may have explained the emergence and initial popularity of the unitranche product, does this explain all of the growth in the market? These features clearly remain very attractive to private equity sponsors and corporates, but in an environment where certain banks have upped their game, how else have private debt funds been able to distinguish themselves and support the market?

The first very discernible trend is the launch of larger private debt funds in 2015, such as BlueBay's €2.1 billion direct lending fund and ICG's €3 billion senior lending fund. These jumbo funds give certain unitranche providers increased armoury to underwrite larger transactions and some can provide underwrites in excess of £200-300 million. This allows them to compete in a market otherwise dominated by traditional high yield and syndicated loan financings. ICG's £155 million underwrite for Caledonia's acquisition of Gala Bingo and Ares' €250 million underwrite for Eurazeo's acquisition of Fintrax are good examples of these larger deals. We can expect to see more of these transactions in 2016 as the unitranche product moves into the territory of upper mid-market transactions, particularly given the (at times) lacklustre performance of the high yield market and the occasional stuttering in the syndication market. At the opposite end of the size spectrum, we are also seeing other private debt funds focus more on the smaller end of the market and financing businesses with EBITDA of €5m upwards.

Secondly, the continued innovation and flexibility of private debt funds is driving the development of blended unitranche transactions, where the unitranche sits alongside a cheaper term loan provided by a bank and thereby reducing the overall cost of capital for the borrower. These transactions can often take the form of first out/second out structures (where the bank holds the lower margin, first ranking piece of term debt and the fund holds the higher priced, second ranking piece of term debt), and what we are seeing is that each transaction is customised for the most appropriate capital structure. The key challenge on these transactions will often be implementing sensible intercreditor terms between the two lenders, and good progress has been made in 2015 in developing a market position.

Another innovation to emerge during 2015 is the combination of ABL facilities and unitranche financing. This can be a compelling proposition for those businesses which favour ABL financing, as it allows for an enhanced leverage, a more efficient use of working capital and the use of cheaper debt. This structure was recently illustrated on the refinancing of IGM Resins by HIG Whitehorse and Deutsche Bank.

The continued evolution of the market is also taking private debt funds further afield. While unitranche is the dominant mid-market financing product in the UK and France, and continuing to take hold in Germany, we are seeing the unitranche product being accepted in new European markets. BlueBay's financing of Silverfleet's acquisition of Masai Clothing (Denmark), EQT's refinancing of Mikeva (Finland) and Pricoa's financing of Carco (Italy) highlighted this trend in 2015.

These developments are supporting the continued evolution of the unitranche product and we will certainly see further innovation during 2016, not least because the inherent nature of the product is its flexibility and adaptability to suit the needs of the market.

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