

MONROE CAPITAL

US Unitranche – here to stay

Monroe Capital's president and chief executive, **Ted Koenig**, answers questions about the origins and future of unitranche financing in the US middle market.



"... THE AVERAGE COST OF CAPITAL ON UNITRANCHE TRANSACTIONS REMAINS CONSTANT OVER TIME, RATHER THAN INCREASING AS THE MORE SENIOR DEBT IS PAID OFF OR AMORTIZED FIRST"

Ted Koenig, president and chief executive of Monroe Capital

Q Unitranche lending was popular at the height of the financial crisis, why does it remain relevant today in a healthier economy?

Koenig: Unitranche financing, a loan that blends senior and subordinated debt into one lending instrument, has remained popular with borrowers well after the financial credit crisis. At the height of the crisis, unitranche financing became a widely used tool amongst borrowers seeking capital beyond the scarce traditional bank resources available at the time. Today, capital availability has returned to pre-crisis levels, but borrowers continue to utilize unitranche lending as a preferred method to fund acquisitions or buyouts due primarily to its simplicity, certainty of close and ease of implementation. The borrower works with one set of documents and negotiates with a single party, as opposed to involving two or three different parties and further delaying or complicating the potential transaction. Additionally, the average cost of capital on unitranche transactions remains constant over time, rather than increasing as the more senior debt is paid off or amortized first.

Q Given the attractiveness of unitranche lending, what are key criteria for investors when evaluating private credit managers?

Financing markets have become very competitive in recent years for middle market managers, increasing the need to be sharp, responsive and nimble to remain relevant. For investors evaluating potential managers, key factors to consider should include:

- Experience in the middle market

- Ability to generate proprietary deal flow
- Track record of quality performance over various credit cycles
- Size and depth of investment platform
- Efficient deal underwriting and closing process

Meticulously evaluating and understanding these aspects are critical to the long term success and value-add brought to investors. At Monroe, we understand that due diligence is a significant process for many investors to gain comfort with the business, and we always welcome the opportunity to thoroughly participate and build relationships.

Q For Monroe, what is the mix between unitranche loans and other loan types? What kind of borrowers desire this type of lending structure?

Monroe offers two types of unitranche financing – an enterprise value cash-flow loan structure and an asset-based loan structure. A cash-flow loan is a type of debt financing that utilizes expected cash flow and enterprise value of the borrowing company as collateral for the loan. An asset-based loan provides companies with additional financing when a collateral formula based ABL lender is unable to provide the capital needed. Both of these types of financings are often used to fund buyouts, acquisitions or dividend transactions. Other types of loans offered by Monroe include senior secured directly originated loans, club senior loans, junior and second lien loans, and opportunistic private credit transactions. Typically, senior

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secured directly originated loans are the majority share in a portfolio (>50%), followed by a mix of unitranche, club and second lien loans.

Q One of the criticisms of unitranche lending is the lack of lender transparency with the various loan parties, what is your opinion of this?

An attractive quality of the unitranche deal structure is the simplicity offered by a single credit agreement that blends senior and junior debt. Most often, Monroe is the only loan party in a transaction as we have the capacity to hold the entire loan amount. In other instances, we may bring in one

of our dozen bank lending partners. This allows us to deliver a completely transparent one-stop, highly predictable credit relationship to our borrowers.

Q How has spread compression impacted unitranche lending in the past 2-3 years and how is it effecting the lending landscape today?

In recent years, unitranche yields have tightened from between nine and 11 percent to the seven to nine percent range, according to research by Forbes magazine. We have seen a steady rise in its popularity as US banks have become increasingly regulated by stricter leveraged lending

guidelines handed down following the financial crisis. Today, most M&A financings use some form of unitranche financing as traditional mezzanine financing has largely been displaced. This has resulted in a more simplified and cost effective capital structure which has had an effect on the ability of buyers to pay higher purchase price multiples in M&A transactions.

Q Where does Monroe see the future of unitranche lending?

Unitranche lending has become an integral part of the capital structure of most middle market M&A transactions. We have been actively utilizing this financing product for over ten years. Our borrowers appreciate the simplicity of documentation, the certainty of closing, and the overall cost effectiveness of the product. We have formed an active partnership program with many US regional banks to implement unitranche financing throughout the country. Europe has recently embraced unitranche financing as the list of private credit funds operating in Europe has increased dramatically. I think it is safe to say that the future is bright for unitranche financing. ■

Monroe Capital Management Team (from left to right): Jeremy VanDerMeid, Ted Koenig, Michael Egan, Zia Uddin, Tom Aronson



ABOUT THEODORE L. KOENIG AND MONROE CAPITAL:

Theodore L. Koenig is the President, CEO and founder of Monroe Capital LLC, a \$2 billion private credit asset manager headquartered in Chicago, with offices in Atlanta, Boston, Charlotte, Dallas, Los Angeles, New York and San Francisco. Founded in 2004, Monroe is a leading provider of senior and junior debt and equity co-investments to middle-market companies throughout the US and Canada. Investment types include unitranche financings, cash flow and enterprise value based loans, acquisition facilities, mezzanine debt, second lien or last-out loans and equity co-investments. Monroe has been frequently recognized as a “best in class” firm by the US Small Business Administration, Global M&A Network, and Private Debt Investor.

Prior to founding Monroe Capital in 2004, Mr. Koenig was President and CEO of Hilco Capital LP, a junior secured/mezzanine debt fund established in 2000. Previously, he spent 13 years at the Chicago-based law firm of Holleb & Coff as partner and co-chair of the firm’s corporate law, mergers and acquisitions and business finance groups. Mr. Koenig is a graduate of the Kelley School of Business at Indiana University in accounting with high honors and Chicago-Kent College of Law with honors. Mr. Koenig is an industry expert in the middle market credit lending space, and is a frequent lecturer to various businesses and financial organizations; he is also a Director of the Commercial Finance Association, and a member of the Turnaround Management Association and the Association for Corporate Growth.