

EXPERT Q & A

Both senior lending and junior capital dealflow are poised for a significant resurgence as uncertainty eases and M&A activity returns, say Churchill Asset Management's Derek Fricke and Jill White



A lending revival

Q How would you characterise the state of the direct lending market as it relates to senior lending and junior capital?

Jill White: From a senior lending perspective, we expect to see a strong pick-up in M&A activity as GPs come under increasing pressure to generate distributions for LPs. That recovery was originally expected to take hold earlier in the year but was delayed due to uncertainty surrounding economic policy, including tariffs. While scaled and relationship-driven managers have been able to remain active, supported by robust portfolio activity, we are now beginning to see momentum building with new LBOs as well.

Tariff policies are impacting the nature of the assets that are coming to market. The businesses that are being

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financed by senior lenders today primarily have US-based supply chains and revenues, and are not significantly exposed to international trade.

Derek Fricke: We are seeing more and more sponsors exploring creative junior capital financing alongside senior debt, whether that involves a bifurcated first lien, second lien structure, traditional senior mezzanine or some other middle-of-the-balance-sheet payment-in-kind note or holdco solution. Sponsors are interested in the art of the possible when exploring capital solutions. These opportunities are being driven not just by new platform

acquisitions, but also from continued M&A for existing portfolio companies.

We believe pipelines will continue to grow as some of the uncertainty in the market subsides. In fact, we recently carried out a survey with 164 mid-market sponsors that revealed that more than three-quarters expect more normalised activity either in the second half of this year or by Q1 2026. Furthermore, 76 percent anticipate completing two to three exits from their portfolio in the next year. I don't foresee a spike like the one post-covid, but I do expect a meaningful increase in activity in the coming months.

Q How do market dynamics in the core mid-market differ to the upper mid-market and large-cap today?

DF: When we refer to the core

mid-market, we are talking about sponsors that buy underlying platform companies with between \$10 million and \$100 million of EBITDA. Generally, these sponsors will be managing funds of \$750 million to \$2 billion. What we are seeing in businesses of this size is continued top-line and EBITDA growth. Because the US mid-market is largely a service-based economy, and therefore more insulated from cross-border geopolitical risk and tariff uncertainty, this part of the market is relatively stable.

As you go into the upper mid-market and large-cap buyout space, however, there tends to be a greater preponderance of cross-border transactions and more currency exchange risk. At the same time, the exit market in that space is typically predicated on large-scale strategic activity and initial public offerings, whereas in the core mid-market, businesses can be sold to a broader base of strategics and other financial sponsors.

JW: From a senior lending standpoint, the risk-adjusted returns that can be achieved in the core mid-market are highly attractive because these are businesses that have shown stability through cycles, including the ability to pass through pricing during inflationary periods. At the same time, these industries are still fragmented. That means there is an opportunity to grow platforms through tuck-in acquisitions as well as through organic measures.

We also like the fact that there is an opportunity to take multiple bites of the apple with high-quality assets in the mid-market. Financing a business with one sponsor, continuing to support the borrower as it grows, and having the ability to continue supporting that company with its next owner in a fresh deal is compelling.

Q How are you approaching underwriting in the current environment?

JW: We are a relatively conservative

lender and so we haven't changed our approach to underwriting significantly in the current environment. We have always put modest levels of leverage on our businesses, which is why we didn't get into any real liquidity crunches during the rising interest rate period.

DF: Our fundamental underwriting philosophy is the same across the senior lending and junior capital strategies, in that we target service-orientated, high free cashflow, recurring revenue and high-margin business models. Diversification is then also critical across position sizes and sectors.

We stay clear of cyclical, commodity-driven and asset-intensive industries, but we invest across business services, financial services, healthcare services, tech-enabled services and industrial services, partnering with sponsors that have the know-how and expertise to bring to bear in those sectors.

Q How would you describe LP appetite for senior lending and junior capital right now?

JW: Investor appetite for senior lending remains strong across both the institutional and private wealth channels, as private debt tends to shine during periods of market dislocation. The broader syndicated loan market tends to exhibit volatility, while private debt tends to remain more stable. As a result, investors are attracted by the risk-adjusted returns offered, as well as the potential for income generation and diversification away from public markets.

DF: We are seeing a lot of appetite for junior capital solutions as a complement to senior debt exposure. Junior debt affords LPs the potential to lock in attractive mid-teen yields by taking what we consider to be subordination risk rather than any incremental underlying credit risk. LPs like the fact that they can secure this yield in a predominantly fixed-rate portfolio and they find it an attractive way to get duration

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DEREK FRICKE

given that the average hold for junior debt is around six years.

Q What will it take for private debt managers to continue to deliver attractive risk-adjusted returns in today's uncertain macroenvironment?

JW: It is important to have a strong base of long-term GP relationships in order to maintain selectivity. You need to be able to turn down one transaction without fearing that you won't be shown the next. In our case, we benefit from our position as an LP in US mid-market PE funds, making our partnerships quite durable and resilient. Track record through the cycles is also critical, of course, as is scale. Finally, I would point to alignment. Managers need to invest significant capital alongside investors on the same terms.

DF: I agree that relationships, scale, execution and track record are all differentiating factors that help to ensure you are the lender to receive the first call. I would also emphasise the importance of not having a one-size-fits-all approach, but rather being able to customise solutions to meet a sponsor's needs. ■

Derek Fricke is a senior managing director and the head of direct investments for the junior capital and private equity solutions investment team at Churchill Asset Management, and Jill White is a managing director and the deputy head of the firm's underwriting and portfolio management group

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