

PE Hub

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Churchill's Anne Philpott: 'Investors will flock to junior capital to lock in long-term, fixed rate return stability'

'Junior capital offers delayed draw capacity, which is a critical source of funding for sponsors with buy-and-build investment strategies seeking to make post-closing acquisitions.'

As part of PE Hub's ongoing series of Q&As with private equity thought leaders, we turn to Anne Philpott, managing director on the private equity and junior capital team at Churchill Asset Management, to explore the role of junior capital in buy-and-build strategies.

What is driving the demand from mid-market borrowers for junior credit?

Junior capital can broadly be defined as subordinated, middle of the balance sheet, direct lending debt that yields mid-teens returns, typically in the form of mezzanine and second lien term loans.

A defining characteristic of junior capital is dynamism – its flexibility to evolve and innovate to meet the changing demands of sponsors. The past two years exemplify this, as it helped sponsors combat higher-for-longer interest rates and lackluster new buyout volume.

Junior capital is "patient capital" that can provide flexibility for cash interest to be turned off with a payment-in-kind toggle. PIK toggles enhance liquidity for healthy, growing companies that might be facing certain constraints. Instead of paying quarterly interest, borrowers can



Anne Philpott, Churchill Asset Management

redeploy cash towards growth initiatives, which ultimately accretes to the overall enterprise value.

Despite the slowdown in new buyout volume, sponsors continued to play offense and aggressively pursued tuck-in M&A for their existing portfolio companies. Junior capital offers delayed draw capacity, which is a critical source of funding for sponsors with buy-and-build investment strategies seeking to make post-closing acquisitions.

What types of products are private equity sponsors looking for, and why?

The private equity firms we partner with seek both structures equipped for growth and flexibility and trusted lenders that can write large check sizes (rather than syndicating to a large, disparate group of lenders). Sponsors continue to lean on smaller groups of core lenders that have the capital and creativity to construct capital structures that will support long-term value creation.

What benefits does the middle market offer versus the large cap market?

We believe that traditional mid-market high-quality companies, with EBITDAs between \$15 million and \$75 million, generally tend to be more growth-orientated, less cyclical, and more service-focused. Importantly, mid-market companies have multiple ways to win and are not reliant on public market health; given the smaller size, sponsors can more easily add value through professionalization and drive outperformance with more "low hanging fruit" available.

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How do you anticipate the demand for specific junior capital solutions to evolve in the mid-market in 2025?

We are bullish on junior capital. The asset class has grown in popularity due to its demonstrated durability through market volatility. We estimate that private credit will continue to dominate buyout financing and take market share from traditional bank lending.

As the yield premium widens and senior lending yields revert to long-term averages, we anticipate investors will flock to junior capital to lock in long-term, fixed rate return stability. Experienced

credit managers who offer a wide breadth of creative capital solution offerings, will continue to receive priority deal flow from sponsors.

How do you expect the new administration to affect credit for private equity?

Focusing on policy most relevant to the mid-market private credit and private equity landscape, the administration is likely to be supportive of private credit. The two most relevant policy topics are regulation and antitrust matters, and tariffs.

The administration has signaled it

will make deregulation a priority and is likely to become less involved in antitrust matters. These actions will likely lead to increased M&A activity which will benefit the asset classes.

Tariffs can pose as a headwind, but most businesses in mid-market private equity tend to be service oriented and don't rely on sourcing from China and Mexico where the impact of tariffs will be most pronounced. Furthermore, private equity has already lived through the first round of tariffs from President Trump's first term and should be equipped to address future potential tariffs.