Proskauer

Talking Trends with Arcmont

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In **Women in Private Credit: Talking Trends**, we dive into the world of private credit through the lens of eminent women in the field — from professionals at the forefront of industry leadership to our own lawyers. Together, we navigate the trends and topics influencing private credit against the backdrop of today's ever-evolving geopolitical landscape.

In our latest edition, Proskauer private credit partner Harriet West engages with Arcmont's Co-Head of the Capital Solutions strategy, Alice Cavalier, demystifying private credit capital solutions financings, including exploring the benefits of this flexible strategy and what this exciting section of the market may have in store in 2025.

What is a capital solutions strategy and what can be covered by this which often cannot be served by more traditional direct lending strategies?

Alice Cavalier, *Arcmont*: At Arcmont, we define the Capital Solutions strategy as a flexible, sponsor-friendly strategy, focused on providing bespoke financing solutions that cannot be served by traditional lending strategies due to risk or return limitations. This would typically include senior lending to performing businesses in "unloved" sectors such as aerospace, industrials or automotive, subordinated lending and quasi-equity in bespoke transactions, as well as refinancing and liquidity solutions for businesses experiencing short-term challenges. The Capital Solutions strategy also seeks to take advantage of periods of market dislocation when loans and bonds come under pressure, to enter the capital structure of performing businesses at a discount and realise the intrinsic value of these businesses once the market conditions normalise.

In our experience traditional lenders like banks and direct lending funds are increasingly retreating from complex financing and more cyclical sectors to focus on vanilla senior lending to larger, PE-backed businesses. Therefore, a very significant portion of the European economy is left orphaned, with limited or no financing solutions. Flexible capital providers like Arcmont Capital Solutions play a crucial role in supporting sponsors and businesses with bespoke financing solutions, also with attractive potential returns for investors.

Harriet West, *Proskauer*: Capital solutions strategies often mean different things to different market participants. Typically such strategies cover an unaddressed capital need in a creative manner and encapsulate products such as: financings to performing credits but in “challenging” sectors or jurisdictions; financings to support businesses with cyclical or unique cashflows; or to support a business through more challenging periods (especially given the number of unexpected macro-economic factors that have been present in the market over the past few years).

We are also seeing such strategies encompass a range of debt and equity products, such as minority co-investments, preferred equity, warrants or convertible notes, often in combination with debt products such as senior, unitranche, junior or Holdco PIK. As market participants are moving away from seeing debt and equity as completely isolated investment strategies, we typically see capital solution offerings sitting between traditional direct lending and distressed lending strategies. Credit opportunities and capital solution strategies can provide liquidity to borrowers and sponsors on a minimal dilution basis, but also offer a compelling blend of risk and return for private credit investors. Here at Proskauer we provide fully integrated cross-disciplinary legal advice for private capital providers operating in this space.

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Alice Cavalier, Co-Head of the Capital Solutions, Arcmont Asset Management

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The private credit market has faced some significant challenges and opportunities over the past few years in the context of geopolitical tensions, a suppressed M&A deal fow, volatility within the public markets, rising inflation and higher interest rates. How does an “all weather strategy” benefit from such conditions?

Alice Cavalier, *Arcmont*: Over the past four years, financial markets have been unsettled by the Covid-19 pandemic, geopolitical tensions, supply chain disruptions, rising inflation, and the consequential tightening of central bank monetary policies. We believe that a flexible investment mandate like Arcmont Capital Solutions allows consistent capital deployment, seeking out strong opportunities in many different guises. Since 2020, the different phases in the economic cycle have consistently presented opportunities to invest from the capital solutions strategy and we believe that the current economic environment continues to offer a sizable opportunity set.

As an example, the widespread dislocation of capital markets during the early stages of the pandemic presented opportunities for discounted debt purchases as well as tailored financing for high quality businesses facing short-term liquidity issues. With soaring inflation and supply chain disruptions in the aftermath of the pandemic, businesses found themselves under increased pressure, exacerbated by increased debt burden as monetary policy tightened in major economies. In this context, Arcmont Capital Solutions was also able to take advantage of market dislocation and retrenchment of traditional lenders to provide tailored financing solutions to borrowers, with strong potential returns for investors.

Harriet West, *Proskauer*: Opportunistic credit strategies are often designed to thrive in all economic conditions – allowing them to perform when other areas of the market are facing challenges. Heading into 2025 with interest rates stable, macro-economics slightly more benign and refinancings tricky in the direct lending market for those assets outside of a private credit fund's preferred lending criteria – capital solution options can provide a resolution, especially for performing businesses needing to inject liquidity or reshape their capital structures. Diversification is often key within this area of the market - a combination of debt and equity products and to some extent public and private exposure across investments, shields the overall investment portfolio from the risks of fluctuation in one area of the market.

How important is the ability for Arcmont Capital Solutions to adapt and pivot within the credit opportunities marketplace?

Alice Cavalier, *Arcmont*: We believe that a flexible investment mandate, ranging from tailored senior and subordinated private lending solutions to secondary debt purchases and hung syndications, is key to take advantage of strong opportunities in each period of the economic cycle. By maintaining a diversified toolkit and presence across the capital structure, such a mandate can pivot to the some of the most appealing opportunities as cycles evolve. Our dedicated team uses its experience in complex lending to identify the opportunities that have the potential to generate a premium whilst maintaining rigorous risk management.

How much does customisation play a role?

Harriet West, *Proskauer*: Customisation is often one of the crucial factors at play in capital solutions strategies, which differentiates them from more traditional direct lending strategies. There is no “one size fits all” here and creative thinking on the commercials, structuring and legal documentation underpins such transactions. This customisation adds a layer of complexity which means deals do not follow a single form.

For example, a unitranche financing with a 5-10% minority co-invest tends to follow a more typical “market” position especially in respect of the minority lender consent rights and the drag/tag rights. However, when you embark on a transaction combining a second lien debt instrument, a 25% equity co-invest and convertible warrants or a transaction with unitranche financing to a cyclical business in Eastern Europe, alongside an ABL piece, the complexities and negotiation are inherently more involved.

Alice Cavalier, *Arcmont*: In our experience traditional lenders and syndicated markets are increasingly retreating from complex lending due to their lack of appetite but also as their high cash pay or amortising financings are often not viable for the borrowers, especially in the current macro and rate context. This has created a window for flexible capital providers to deliver solutions tailored to the needs of borrowers today. This can include complex transactions like carve-out, take-private, liquidity financing, or rebalancing of capital structure, as well as atypical borrowers, such as performing businesses in cyclical or unloved sectors. Private equity sponsors frequently turn to private debt managers for these transactions, and are often willing to pay a premium to work with a more flexible, reliable partner. In fact, we are very often contacted directly by private equity sponsors, especially in the context of these complex transactions.

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> **Harriet West,** Partner, Proskauer

What documentary trends have you seen in the area?

Harriet West, *Proskauer*: It is difficult to track the trends in quite the same way that we can with direct lending unitranche transactions, given as highlighted previously the bespoke structuring and terms mean that more is up for discussion between parties. Whilst we have started to see sponsors active across a range of strategies try to migrate terms and precedents from unitranche lending or Holdco PIK lending on "competitive" high performing assets into these credit opportunities financings, generally capital solution lenders have been more focused on, and successful in retaining, certain protections.

In legal documentation this can play out in numerous ways, but there is more focus on maintenance of lender protections in a downside scenario. This often results in increased financial reporting and governance controls, more meaningful financial covenants and more robust collateral packages.

Do you find there is much competition in this area of the market?

Alice Cavalier, *Arcmont*: Arcmont is one of the largest private lending platforms in Europe, with historical presence in all major European economies, deeply rooted relationships with private equity sponsors, and a clear scale advantage over many private lenders. The strength of the Arcmont platform is a clear strength for our Capital Solutions strategy, in terms of sourcing, scale and deal execution. The strategy also benefits from a dedicated team that brings further sourcing and credit expertise. There are very few equivalent sponsor-friendly capital providers in Europe. As a result, we are often contacted directly by private equity sponsors who are looking for a trusted partner, and we usually compete with a very limited number of other lenders.

Harriet West, *Proskauer*: Generally complexity limits competition and consequently we often see this area of the market, relatively under capitalised, with traditional lenders or those funds with mainstream direct lending strategies often shying away from transactions with intricate business requirements or lengthy diligence processes. However, whilst there has been increased competition within the direct lending market recently, we have seen an increase in investors and private credit funds starting to explore credit opportunities strategies.

Given the inherent complexities and customisation required for such transactions, this area of the market is exceptionally relationship driven, with lenders focused on a long-term commitment to these partnerships. As you mention, Alice, relationship driven deal sourcing can be crucial in this area. It is important for sponsors and borrowers, lenders and their respective advisers to work closely together to curate a workable package for all stakeholders, with the capital provider having a thorough knowledge of the borrower's specific requirements and circumstances.

What trends do you predict for 2025 and beyond within this area?

Alice Cavalier, *Arcmont*: We believe that 2024 has been a very successful year for the strategy, both in terms of deployment and realisations, and we expect 2025 to remain very active. With geopolitical tensions, interest rates, and economic outlook stabilising, we expect a recovery in M&A volumes this year. We also expect a large volume of opportunities driven by maturity walls in both private and public markets especially in the more complex businesses where traditional players typically have limited appetite. Public markets have tightened significantly, but we still see attractive opportunities with borrowers facing short-term challenges, or looking to fix their capital structure inherited from the low-interest rate environment.

Harriet West, *Proskauer*: Whilst the outlook for 2025 predicts interest rate cuts and M&A volumes to increase, unrelenting geopolitical volatility and industry-specific challenges still have the potential to create stress for borrowers. For those borrowers with complex needs or falling outside of the sectors, businesses or jurisdictions that fit the "competitive" direct lending arena, we expect them to be looking outside the traditional remit for financing solutions, providing capital providers within that area with a real opportunity.

We'd expect to see more capital flowing into capital solutions strategies and a continued increase of this type of activity in 2025. As margin and fees remain subject to downward pressure and competition high in direct lending – investors and managers will be looking for higher returns that are available in these flexible capital transactions.

For more than 20 years, the Private Credit Group at Proskauer has been intrinsically involved in the evolution of the industry, working on pioneering structures and products. Our technical strength, combined with our expansive experience, makes us the Firm of choice for first-in-kind transactions. Acting as strategic partners to our clients across industries and jurisdictions, our team of lawyers has expertise in U.S. and Europe-centric transactions, as well as North American and European cross-border transactions.

Proskauer Women in Private Credit offers a knowledge sharing and peer network platform for females active in the private credit market. **Click here to register your interest in receiving future updates**.

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- **Harriet West**
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