EXPERT Q&A

Finding new ways for US lower mid-market borrowers to 'get to yes' is creating opportunities for flexible managers that can put capital to work quickly, says Metropolitan Partners Group's Daniel Leger

Unlocking value in the lower mid-market

Q There have been some negative headlines about private credit and direct lending in recent months. How are lenders considering their future approach to credit investing under these circumstances?

There has indeed been a lot of negative press regarding direct lending in recent months, as a number of high-profile frauds have been well-publicised and some questionable practices have received increased scrutiny. While some of the headlines have been sensational, much of it has centred on the main structural challenges in the sponsor-backed segment of the market – namely, the use of excessive leverage (especially in software-as-a-service related businesses) and the dominance of covenant-lite loans.

All too often, direct lenders are pricing their loans to perfection as they operate in a very competitive market where the terms are set by private equity firms and, if things do not proceed as planned, the lenders often lack the protections to take remedial measures.

In our conversations with investors, these structural challenges have been an ongoing concern for the last several years. The recent headlines have now brought it to everyone's attention which we think is a healthy development as it will allow a renewed focus on some of the old school fundamentals of direct lending.

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Q What are some of the key trends you're seeing right now in the US lower mid-market?

The US lower mid-market continues to be defined by an absence of meaningful capital as banks in the US continue to ignore it. Many of our former peers have been acquired by competitors or grown their AUM to such an extent that they are now forced to compete for the attention of core mid-market businesses. The lower mid-market is, of course, enormous in size and the only limiting agent is a manager's intellectual curiosity and network.

We assess opportunities in terms of 'fishing holes', which are sectors and sub-sectors of the market where there are microeconomic factors that justify our efforts and where our capital can produce a sufficiently high marginal productivity of debt (MRPD), or return on capital. Recent fishing holes include housing affordability, niche aerospace and for-profit education.

Housing affordability has risen in importance as housing access in the US is fundamentally a consumer balance sheet and liquidity problem. A number of innovative businesses are seeking to address this issue, ranging from healthcare payment strategies to alternative mortgage structures.

Aerospace, by contrast, is a supply-driven issue because the problems facing the likes of Boeing and Airbus will not be resolved in the near future. This creates tremendous demand in after-market aircraft parts. We have provided senior secured debt to help finance these fast-growing businesses and expect to do more in the coming months.

In the past 18 months, we have explored children's sports and programming within the for-profit education fishing hole. We looked closely at children's baseball camps and gymnastics classes before ultimately funding an asset-rich summer camp deal in May of 2025. While many of these sports programmes had attractive economics, only summer camps provided the downside collateral and the recession-proof dynamics that justified making a long-term commitment.

Q How can direct lenders differentiate themselves from competitors in what is an increasingly crowded market?

"The US lower mid-market continues to be defined by an absence of meaningful capital as banks in the US continue to ignore it"

The best way for managers like us to distinguish ourselves in the US lower mid-market is to invest time and capital in sourcing opportunities that demonstrate a strong use case for our cost of capital and then finding a way to 'get to yes'. Given the complexity of some of our deals, a commitment of 'getting to yes' represents our efforts to help great owner-operators solve problems. The real-world problems that our portfolio companies experience have less to do with optimising the cost of capital and more to do with their need for flexibility and speed, as well as the certainty of closing the deal and securing a long-term partner.

All too often our borrowers express frustration with the lenders that they've previously tried to engage. In their opinion, many lenders are too binary in their approach and focus much of their due diligence on ways to say no as opposed to providing a creative solution that can help a great borrower realise their growth potential.

Q How do you justify the premiums you receive?

Looking at the 175-plus deals that we've executed since our inception, we can see that we are being paid three types of premiums by the market: an access premium, a work premium and a complexity premium.

Given the constraints US businesses face in raising capital in the lower mid-market, being paid an access premium for our capital is to be expected. But it's not just getting access to capital at a particular moment in time; rather, for our portfolio companies, it's about having a long-term capital provider that can grow with the borrower and, when the moment comes, help them to refinance our debt or execute on a sale of their business.

We typically structure our senior secured loans as multi-draw facilities, which allows us to underwrite the opportunity at multiple points over the course of the loan. This structure also provides comfort to the borrower that as they execute on their business plan, they have a partner to get them to the next level and beyond.

From time to time, we come across opportunities that rightfully fall into the work or complexity premium. In the first instance, think of a very profitable business without clear, consolidated financials. The work involved here is to perform our own quality of earnings and to stand up a functional financial model, something the borrower might lack because lower mid-market companies are often defined by excellent owner-operators and management teams but they frequently lack institutional-quality CFOs and reporting processes.

On the other hand, we sometimes encounter borrowers who, as they have bootstrapped their growth over many years, have legacy corporate structures that are often byzantine in nature and consist of several distinct entities, junior partners and shareholders. In these situations, we require that the borrower reconfigure their corporate structure in a very short period of time, creating clear lines of ownership and liabilities, so that we may gain the level of trust and certainty needed to fund our loan and help them grow. ■

Daniel Leger is senior managing director and head of investor relations and marketing at Metropolitan Partners Group