Beyond Direct Lending: The Capital Solutions Opportunity

Private credit continues to evolve. David Brooks, Co-Head of Capital Solutions at Arcmont Asset Management, discusses opportunities, areas for caution, and the growing role of Capital Solutions and NAV Financing. 'Investors are broadening exposure beyond traditional direct lending.'

By *our editorial team*

Private credit has attracted significant inflows in recent years. Is there still enough value available for new investors?
'Despite significant inflows into private credit in recent years, we believe the opportunity set is expanding faster than available capital. Demand for private financing continues to be supported by substantial private equity dry powder, ongoing bank retrenchment and a significant refinancing requirement across European leveraged finance markets. As a result, we believe attractive opportunities remain available across the asset class.

We continue to view private credit as relatively early in its adoption cycle. Some allocators are still building initial private debt allocations, while more mature investors continue to increase target allocations as the asset class becomes a larger component of strategic portfolios. At the same time, investors are broadening exposure beyond traditional direct lending into adjacent strategies such as Capital Solutions, NAV Financing, asset-based lending and credit secondaries.

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These segments offer differentiated sources of return, driven less by market beta and more by complexity, sourcing capacity and access. As a result, we continue to see attractive opportunities across both established and emerging areas of private credit.'

Where do you currently see the most attractive risk-adjusted opportunities within private credit, and why?
'We currently see some of the most attractive risk-adjusted opportunities in Capital Solutions and NAV Financing, where we believe demand for bespoke capital continues to outpace specialist lender supply. Subdued M&A activity, extended private equity holding periods, and a more challenging exit environment have increased demand for flexible liquidity and refinancing solutions. At the same time, the number of lenders with the scale, structuring expertise and sponsor relationships required remains limited. This supply-demand imbalance continues to support attractive lender economics, stronger documentation and robust downside protections.

NAV Financing complements this opportunity set by providing senior secured exposure against diversified portfolios of private assets, often combining portfolio diversification, contractual downside protection and attractive risk-adjusted returns.

More broadly, we believe both that Capital Solutions and NAV Financing are becoming established sub-asset classes within private credit, supported by structural demand for bespoke financing and alternative liquidity solutions.'

What do you believe the market is getting wrong about private credit today?
'One common misconception is that all software-related lending opportunities have become unattractive because of AI disruption. We believe this is an overly simplistic view.

Artificial intelligence is undoubtedly creating winners and losers, but its impact varies significantly across business models and extends well beyond software.

We believe companies with embedded, mission-critical solutions and high switching costs will continue to generate strong recurring revenues and high customer retention. In some cases, AI may even strengthen competitive positions by improving products, reducing costs or creating new revenue streams.

The key is detailed underwriting rather than broad sector exclusion. Investors who dismiss an entire sector risk missing attractive opportunities and underestimate AI's potential impact on other sectors.'

Could you walk us through a recent transaction that illustrates the type of opportunities you are pursuing today?

'A recent example is an investment in a leading UK-based children's nursery operator that required a flexible financing solution as an alternative to selling the business. The business was performing strongly and attracted interest from PE and strategic buyers, but management believed offers failed to reflect its long-term value. At the same time, the dislocated M&A market offered limited alternatives.

As the sole lender, we provided a bespoke senior secured refinancing solution with equity warrants, where speed, certainty and flexibility were critical. The transaction illustrates key themes underpinning our Capital Solutions strategy: providing non-dilutive capital where traditional financing options are constrained, structuring downside protection through senior secured lending, and selectively participating in equity-linked instruments. The owner retained control while securing materially greater liquidity than alternative structures available at the time.'

Where have you become more cautious over the past year, and why?

'We have become somewhat more selective in certain areas of junior capital where spread compression has outpaced the improvement in underlying fundamentals.

Although junior capital has generated attractive opportunities in recent years, spreads in the syndicated markets have since compressed materially. Although HoldCo PIK (Payment-in-Kind) financings continue to offer a reasonable premium to the senior secured debt in the same deal, the absolute return has declined. By contrast, we have seen that spread compression has generally been more limited across private markets, where transactions remain relationship-driven and highly customised. As a result, we believe the relative attractiveness of certain private capital solutions opportunities has improved compared with some junior capital segments.

One important advantage of our flexible mandate is the ability to allocate capital across different parts of the capital structure and pursue whichever opportunities offer the most attractive risk-adjusted potential returns at a given point in the cycle.'

Which segments of private credit are likely to offer the greatest opportunities over the next three to five years?

'We continue to expect significant opportunities in the core direct lending market, supported by substantial private equity dry powder, resilient company fundamentals and a large refinancing requirement across European leveraged finance markets.

Beyond direct lending, we believe Capital Solutions will be a particularly attractive area. The combination of delayed exits, a more challenging macroeconomic backdrop and approaching debt maturities is creating increasing demand for flexible liquidity and refinancing solutions. We expect this dynamic to remain in place for several years.

We also see growing opportunities in real estate-backed solutions. With a difficult backdrop since 2022, market dislocation has created attractive entry points in selected situations where capital remains scarce despite resilient underlying asset fundamentals.

Finally, we expect NAV Financing to continue evolving into a distinct asset class as private equity sponsors increasingly seek portfolio-level liquidity solutions for mature investments and continuation strategies.' ■

Disclaimer
This is for illustrative purposes only to provide an overview of Arcmont's intended investment strategy and focus. There is no guarantee that any plans or strategies discussed herein will be pursued or achieved.

David Brooks

Co-Head of Capital Solutions, Arcmont Asset Management

SUMMARY

We believe private credit remains a compelling opportunity, driven by refinancing demand, bank retrenchment and private equity dry powder.

In our view, Capital Solutions and NAV Financing offer attractive risk-adjusted potential returns, driven by strong demand and limited lender supply.

AI is reshaping industries; identifying winners and losers requires robust underwriting and a company-specific assessment of risks and opportunities.

A flexible investment approach enables capital allocation to the most attractive opportunities across the private credit spectrum.

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