BainCapital

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Flexible Capital as a Strategic Tool for the Middle Market

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Represents Bain Capital Credit's views as of the date of this publication and is subject to change.

Overview

Key takeaways

1. Core middle market companies, with $25-75M of EBITDA, increasingly need financing beyond senior debt. Yet private credit growth has concentrated in senior direct lending, leaving the flexible capital that can meet those needs less crowded.
2. Longer private equity hold periods, higher-for-longer rates, and a looming maturity wall are straining sponsors and their portfolio companies. Flexible capital can fund growth and refinancing without dilution or loss of control.
3. Seniority is not the only source of downside protection. Flexible capital spans from subordinated debt to common equity and, used selectively, can pair disciplined downside management with upside potential.

Executive summary

A mix of structural and cyclical forces is reshaping financing needs in the middle market. In this paper, we will explore the factors changing middle market borrowers' access to capital, the opportunity flexible capital presents, and Bain Capital Credit's distinctive investment approach.

While senior secured debt has delivered compelling returns over recent years, benefiting from elevated base rates and strong downside protection, the current market environment rewards flexibility. Sponsors increasingly seek capital solutions that extend beyond traditional lending structures, creating opportunities for capital providers with a broader toolkit. Flexible capital enables investors to calibrate risk and return, support complex situations, and deliver bespoke financing solutions that address sponsor needs while generating attractive risk-adjusted returns.

The middle market opportunity

The middle market, offers an attractive opportunity for private credit investors, supported by strong borrower quality, consistent deal flow, and favorable competitive dynamics. Companies in this segment are typically led by experienced management teams, supported by established systems, and maintain disciplined, levered balance sheets—characteristics that contribute to their durability and adaptability. The segment is also larger than the $100M+ EBITDA cohort, where traditional fundraising has concentrated despite limited supply, and continues to benefit from a steady pipeline of companies scaling up from the lower middle market. Finally, middle market deal activity is less reliant on change-of-control transactions and remains highly attractive to private equity sponsors. At the same

time, barriers to entry for lenders remain elevated due to borrowers' preference for long-term partners with structuring expertise. Together, this dynamic means scaled solution providers face healthy deal volume and constrained competition, which can translate into better pricing, stronger structures, and more selective deployment.

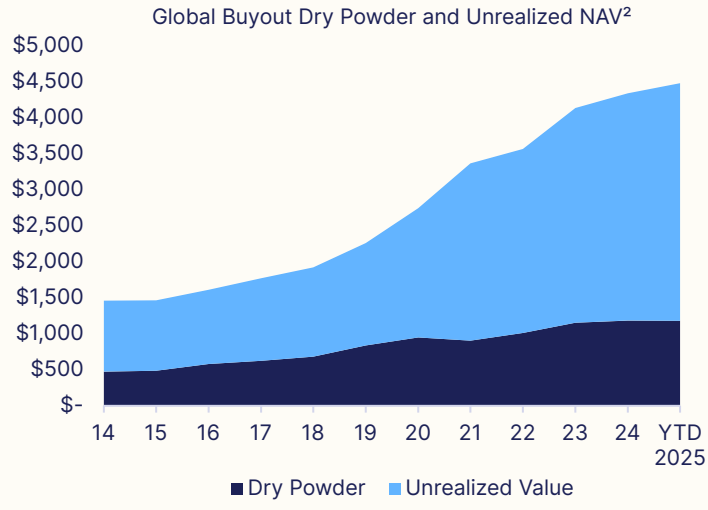
Factors shifting the balance of sponsor needs toward flexible capital

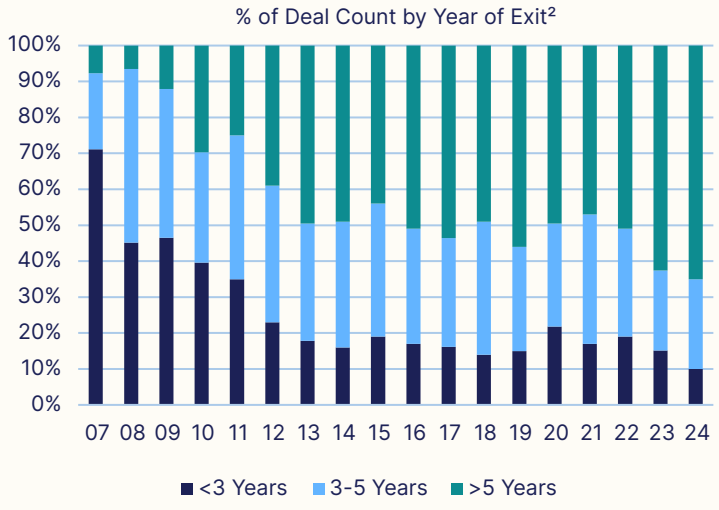
1. Extended private equity hold periods drive flexible capital demand

Private equity continues to build on decades of sustained expansion. We believe dry powder raised across the industry will continue to create demand for new debt. In addition to the growth in dry powder, unrealized value has surged in recent years as private equity firms have held onto their portfolio companies for longer. According to data from Hamilton Lane, 65% of buyout deals have been held for five years or longer.

This trend is fueled by a combination of elevated interest rates and a shifting macroeconomic environment, causing a widening gap between would-be buyers and sellers. The lack of transaction activity has slowed down realizations and distributions in the private equity industry, adding pressure to sponsors to return capital to their investors. We believe this trend will further drive demand for realizations and additional growth initiatives to middle market sponsors.

EXHIBIT 1 **Lower exit environment driving longer private equity hold periods**





(1) Source: Preqin. Data as of the most recently available date, September 30, 2025. (2) Source: Hamilton Lane (as of October 2025). Data as of December 31, 2024.

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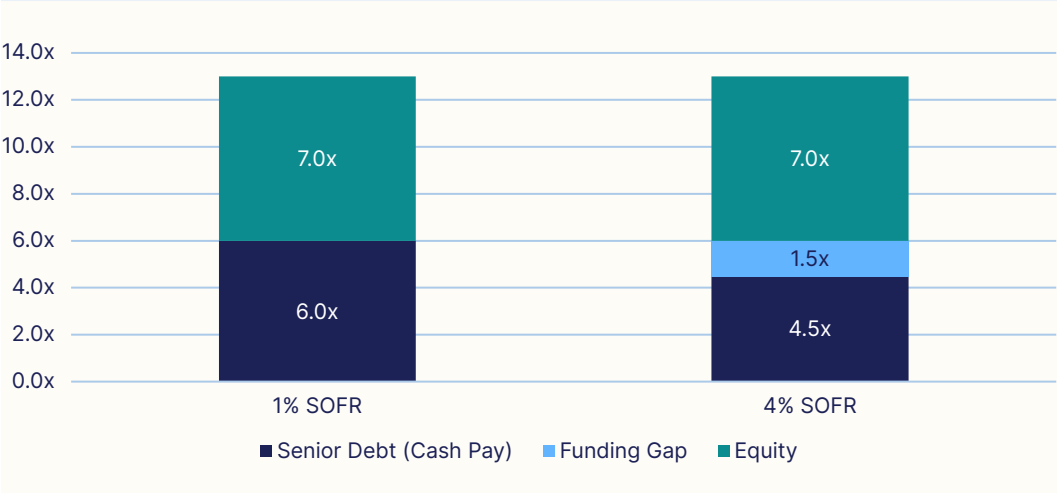
2. Higher-for-longer interest rates reduce capacity for floating rate senior debt

Despite interest rate cuts in 2025, base rates remain elevated relative to prior vintages, driven by higher inflation levels. As a result, traditional floating-rate senior debt can be less sufficient in maximizing company financing needs for middle market companies. Flexible capital provides an opportunity to reduce a company's cash interest burden while simultaneously unlocking greater capacity to fund growth initiatives and finance new buyouts.

EXHIBIT 2 **Illustrative capital structure under various rate environments**

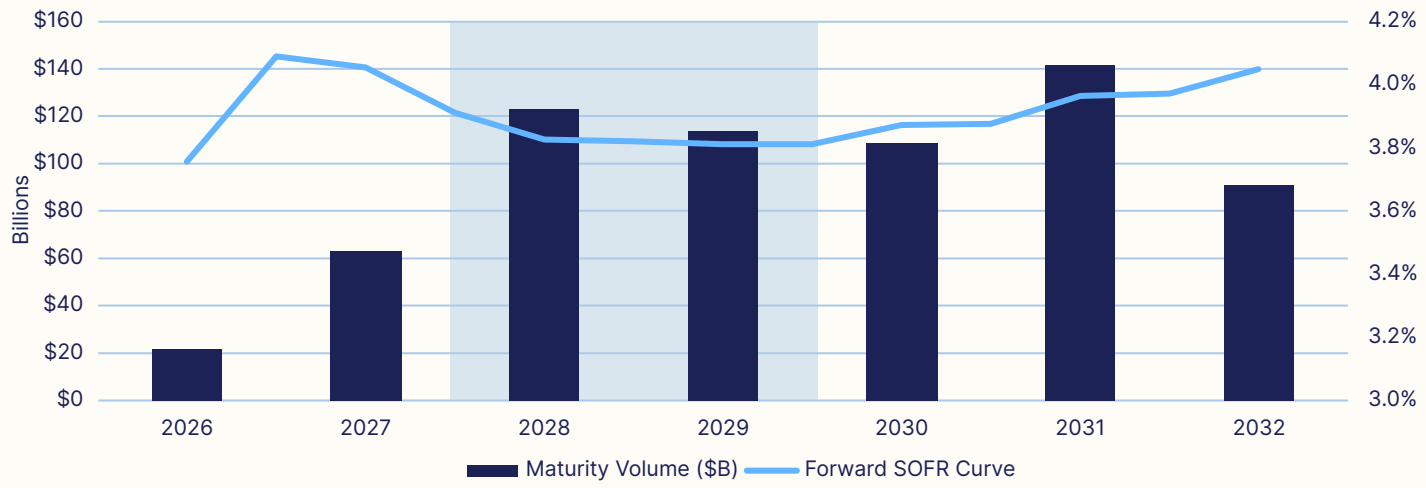


For illustrative purposes only. Actual results may vary. Past performance is not indicative of future results. Source: Bain Capital Credit analysis.

3. Looming maturity wall across the middle market

Private debt maturities will reach near-term peak volumes in 2028 and 2029. With sponsors addressing these maturities one to two years in advance, we expect sponsor activity to increase. Furthermore, with elevated base rates and many portfolio companies carrying legacy capital structures, refinancing will be more challenging, creating additional demand for flexible capital solutions.

EXHIBIT 3 **Private debt maturities by year**



Source: KBRA. Maturity volume data as of March 31, 2026. Forward SOFR curve data as of June 30, 2026. Source: Bloomberg. See "Endnotes" for important definitions, disclosures and information regarding returns, indices, and performance calculation methodologies.

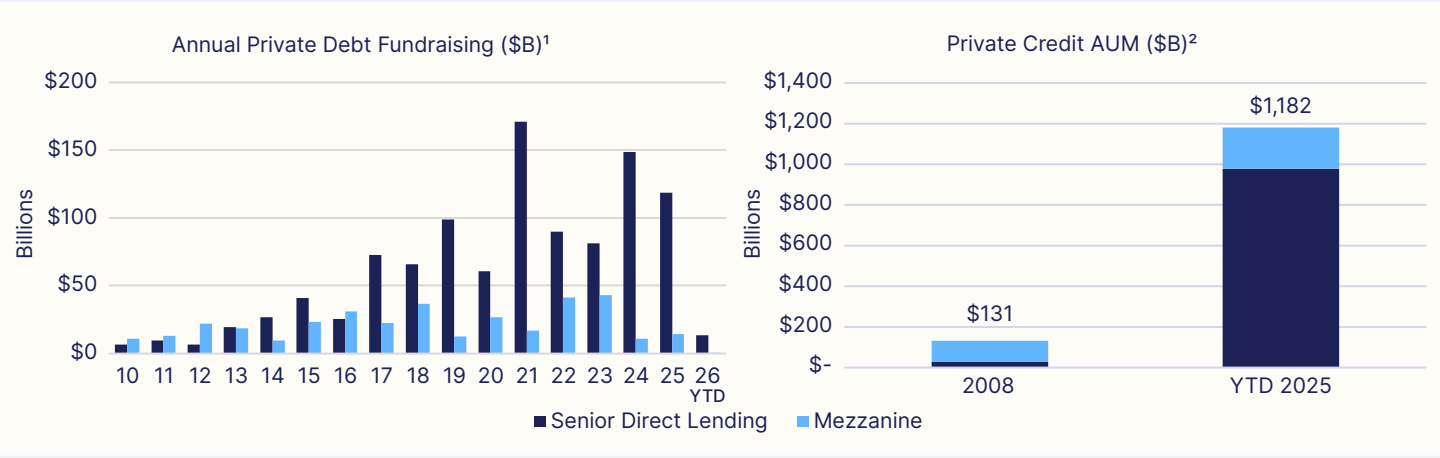
Thinking differently

When conditions become more complex, investors often emphasize seniority as a proxy for downside protection. However, positioning alone does not always determine risk—or return. Rapid growth in private credit has been heavily concentrated on senior direct lending, particularly within the large cap and upper middle-market market segment, driving increased competition and downward pressure on pricing and lender protections.

Flexible capital provides valuable and differentiated financing solutions across the capital structure. It includes a wider set of securities beyond senior secured, including subordinated debt, preferred equity, or common equity that offer enhanced return potential while being able to maintain a strong emphasis on downside management. Many borrowers access this market, including traditional private equity sponsors, independent sponsors, and family- or management-owned businesses. Borrowers generally value flexible capital for structured support to pursue growth, acquisitions, recapitalizations, or other strategic initiatives. Today, flexible capital has become a critical component of the middle market financing landscape, enabling company owners and management to navigate complexity without resorting to dilutive equity, or control-oriented capital.

Looking across private credit debt strategies, we believe there is significantly less competition, both in terms of funds raised and the number of providers financing flexible capital solutions through "Mezzanine" strategies as compared to Senior Direct Lending. This creates an opportunity to secure attractive lender terms and to act as a price maker rather than a price taker given less supply in the market, lessening competition.

EXHIBIT 4 **Supply-demand imbalance of flexible capital strategies relative to senior direct lending**



(1) Source: PitchBook. Data as of March 31, 2026. (2) Source: Preqin. Data as of December 31, 2008, and September 30, 2025.

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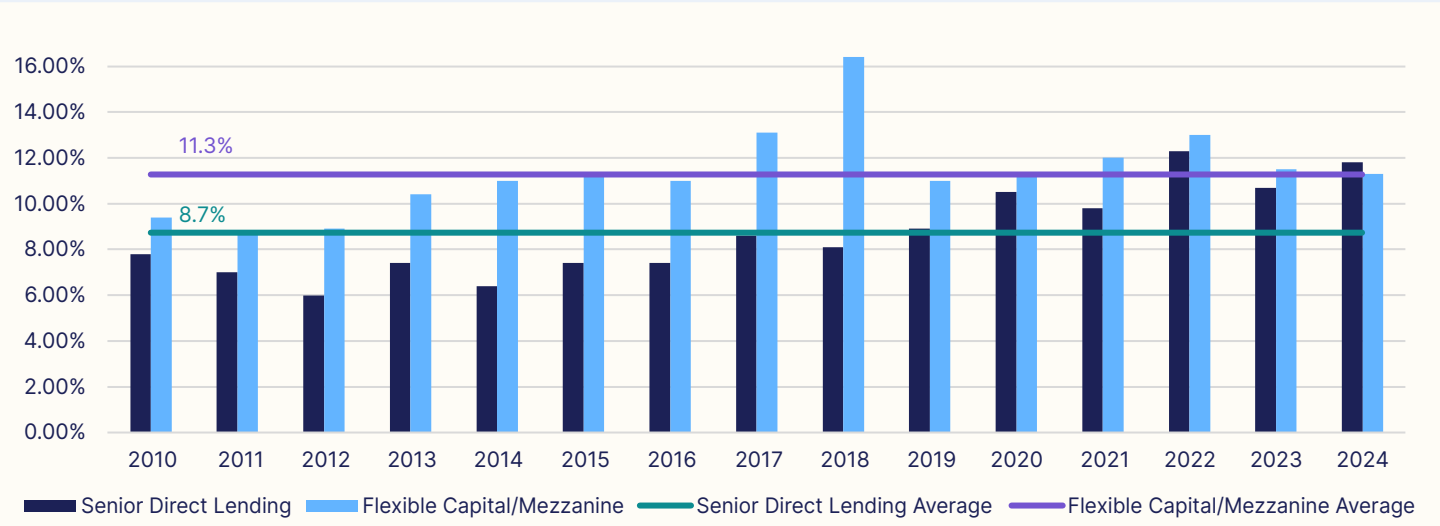
Flexible capital/mezzanine funds have historically provided investors attractive returns across various rate environments supported by higher fixed rate debt exposures. While senior direct lending returns have been elevated in recent years, the gap has begun to shift back in favor of flexible capital strategies.

EXHIBIT 5 **Private credit returns by vintage year**



Source: Pitchbook. Data as of December 31, 2024. Returns presented above are based on the Global Private Debt benchmark and are net of fees. Flexible Capital / Mezzanine = Mezzanine; Senior Direct Lending = Direct Lending. Targeted results may not be achieved. Target performance is hypothetical in nature and has inherent risks and limitations. Past performance is not indicative of future results. Actual results may vary.

How flexible capital works

Flexible capital is typically provided in response to performing middle market borrower needs through two forms: buyout support and capital solutions:

Buyout support finances leveraged buyouts for both traditional and non-traditional sponsors: fund-less sponsors, search funds, and family- or management-owned businesses. Sourcing typically runs through a sponsor coverage network or sponsor coverage networks and the broader platform relationships. Structures typically involve subordinated debt and preferred equity for traditional sponsors; senior secured debt alongside common equity co-investments for non-traditional sponsors.

Capital solutions address more complex financing needs for performing borrowers: tuck-in acquisitions, growth capex, senior deleveraging, dividend recapitalizations, and shareholder buyouts. Sourcing typically draws on the same sponsor network, supplemented by senior lenders and banks for situations requiring creative solutions. Structures are deliberately flexible: subordinated debt, preferred equity, common equity, warrants, or HoldCo structures, calibrated to the borrower's actual needs.

The composition of flexible capital needed for middle market borrowers has evolved alongside changing macroeconomic and market conditions. In the 2010–2017 period, activity was relatively balanced between buyout support and capital solutions, reflecting a healthy M&A environment and robust economic growth. As the post-GFC expansion began to moderate during 2018–2021, growth expectations became less bullish and market volatility increased, culminating in the disruption caused by COVID-19. More recently, higher interest rates, lower sponsor M&A activity, and a widening gap between buyer and seller expectations have driven a meaningful shift toward capital solutions opportunities, which has driven the majority of our investment activity in recent years.

Across both buyout support and capital solutions needs, our investments focus on downside management with upside potential. Senior secured and second-lien investments emphasize capital preservation through strong covenant packages, priority in the capital structure, and lender control, making them well-suited for stable, cash-flowing businesses. Subordinated debt investments sit higher in the capital structure relative to equity, relying on enterprise value support and often incorporating PIK features while still maintaining debt-like protections. Preferred and common equity investments provide greater flexibility and potential upside participation, often alongside governance rights that align investors with sponsors

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and management teams. Typical features of each security type are summarized below:

EXHIBIT 6 **Typical flexible capital features**

	Senior secured (first lien)	Subordinated debt		Preferred equity	Common equity
		Second lien	Mezz Holdco notes		
Borrower characteristics	• Sponsored or non-sponsored • Skew to smaller companies • ARR, cash flow or asset backed	• Primarily sponsored • Skew mid-size to larger companies • Senior debt exhibits wide covenant cushions and maturity runway • Typically underwritten where equity value sits beneath the investment			• Sponsored or non-sponsored • High-growth companies • Attractive entry valuation • Anchored by a debt security
Control of tranche	Often a majority or sole lender	Often a majority or sole lender		Often a majority or sole lender	• Small minority (sponsored) • Sizeable minority or majority (non-sponsored)
Coupon	Floating; mostly cash pay	Floating/ Fixed;cash and/or PIK	Fixed; mostly PIK	Fixed; mostly PIK	N/A; return driven by equity upside potential
Typical spread/ return	500-800bps	700-1,100bps	12-15%	14-17%	20-25%
Debt incurrence protections	✓	✓	✓	✓	• Board observer rights enhance info. flow in minority positions
Restricted Payment Protections	✓	✓	✓	✓	• Full board seats offer voting rights over budgets, capex spending, capital raising transactions, M&A, key management hires, etc.
Financial covenants	✓	✓	X	X	• Minority positions protected by standard shareholder rights
Exit Rights	Contractual Maturity	Contractual Maturity		Contractual Maturity / Economic Incentives for Redemption	

Prospective investors should also bear in mind that past or targeted investment characteristics or portfolio construction may not be indicative of future investment characteristics or portfolio construction. Prospective investors should not place undue reliance on any such hypothetical information. Targeted spreads and returns are presented on a gross basis before the deduction of fees and expenses and are based on past investment performance and future expectations of market conditions. Targeted results may not be achieved. Target performance is hypothetical in nature and has inherent risks and limitations. Actual results may vary. For illustrative purposes only.

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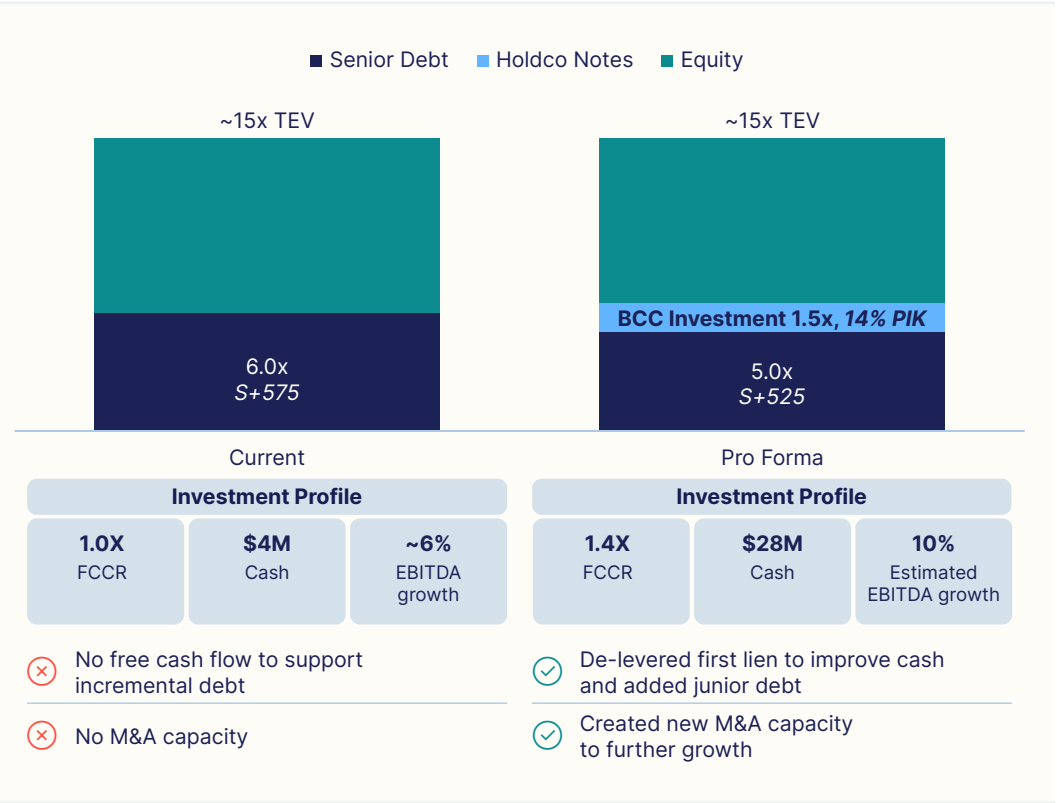
CASE STUDY

Flexible credit in action

Owned by an experienced private equity sponsor, the company had successfully expanded through acquisitions and more than 60 new store openings, generating over $50 million of EBITDA. While operating performance remained strong, growth had been financed primarily with senior debt. Rising base rates significantly increased cash interest expense, leaving limited free cash flow to fund additional expansion or acquisitions despite substantial underlying enterprise value.

Traditional financing options were insufficient, as incremental senior debt would have further increased the company's cash burden and equity capital would have been dilutive. Instead, we structured a $75 million HoldCo PIK investment designed to improve the company's financial flexibility. Approximately $50 million was used to reduce senior debt, enabling lower borrowing costs and the reinstatement of a new acquisition facility. The remaining capital funded continued greenfield expansion without increasing cash interest obligations.

EXHIBIT 7 **Company capital structure**



Source: Bain Capital Credit analysis. Data as of September 2025, unless otherwise noted. See Endnotes for disclosures and methodology.

When capital structure, not business fundamentals, is the constraint, flexible capital can align sponsors, lenders, and management teams to unlock growth and create value.

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In closing

As the middle market continues to evolve, we believe investors will need to look beyond traditional assumptions about risk and capital structure positioning. Flexible capital offers a differentiated approach, one that can adapt to complexity, align with sponsor needs, and pursue attractive risk-adjusted returns. Across market cycles, flexibility is a competitive advantage and, in this specific instance, serves as a strategic tool for managing risk and expanding opportunities.

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ENDNOTES

Definitions

1. "Default Rate" is calculated as $ Defaulted Par divided by $ Invested. Total represents Cumulative Default Rate since inception.
2. "Loss Rate" is the default rate multiplied by difference between: (1) Par and (2) Recovery Rate for each outlined period, and measures total impact of default losses on investment population, net of recoveries.
3. "Loss Adjustment" represents the dollar amount of defaulted assets applied to the cash flows to generate the total impact to IRR of default losses on the investment population, net of recoveries. "Dollar amount of defaulted assets" is equal to (Defaulted Par Amount) (1 – Recovery Rate).

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General Market and Credit Risks of Debt Securities. Debt portfolios are subject to credit and interest rate risk. "Credit risk" refers to the likelihood that an issuer will default in the payment of principal and/or interest on an instrument. Financial strength and solvency of an issuer are the primary factors influencing credit risk.

Limited Amortization Requirements. From time to time, the Fund will invest in debt that will typically have limited mandatory amortization and interim repayment requirements. A low level of amortization of any debt, over the life of the investment, will increase the risk that a portfolio company will not be able to repay or refinance the debt held by the Fund when it comes due at its final stated maturity.

High Yield Debt. From time to time, the Fund will invest in high yield debt, a substantial portion of which is rated below investment-grade by one or more nationally recognized statistical rating organizations or are unrated but, in the adviser's opinion, of comparable credit quality to obligations rated below investment-grade, and have greater credit and liquidity risk than more highly rated debt obligations. High yield debt is generally unsecured and is often subordinate to other obligations of the obligor.

Financially Troubled Companies. From time to time, the Fund invests in the obligations of companies that are financially troubled and that are either engaged in a reorganization or expect to file for bankruptcy. Investments in financially troubled companies involve significantly greater risk than investments in non-troubled companies, and the repayment of obligations of financially troubled companies is subject to significant uncertainties.

Bank Loans. The investments of the Fund at times include interests in loans originated by banks and other financial institutions. The loans invested in by the Fund may include term loans and revolving loans, may pay interest at a fixed or floating rate and may be senior or subordinated.

Priority of Repayment for Certain Investments. The characterization of the Fund's investments as senior debt or senior secured debt does not mean that such debt will necessarily be repaid in priority to all other obligations of the businesses in which the Fund invests. Furthermore, debt and other liabilities incurred by non-guarantor subsidiaries of the borrowers of senior secured loans made by the Fund are often structurally senior to the debt held by the Fund. In the event of insolvency, liquidation, dissolution, reorganization or bankruptcy of a portfolio company, the debt and other liabilities of such subsidiaries will generally be repaid in full before any distribution can be made to an obligor of the senior secured loans held by the Fund.

Risks of Secured Loans. Fund have in the past and may in the future invest in secured loans that are over-collateralized at the time of the investment, but such secured loans nonetheless may be exposed to losses resulting from default and foreclosure. Therefore, the value of the underlying collateral, the creditworthiness of the borrower and the priority of the lien are each of great importance.

Distressed Investments. The Fund is also generally authorized to invest in the securities and obligations of distressed and bankrupt issuers, including debt obligations that are in covenant or payment default. Such investments generally are considered speculative. The repayment of defaulted obligations is subject to significant uncertainties. Defaulted obligations might be repaid, if at all, only after lengthy workout or bankruptcy proceedings, during which the issuer might not make any interest or other payments and the amount of any recovery is typically affected by the relative seniority of the Fund's investment in the capital structure of the issuer. In addition, distressed investments are more likely to be challenged as fraudulent conveyances and amounts paid on those investments will be subject to avoidance as a preference under certain circumstances.

Structured Products. The adviser has in the past and will in the future cause the Fund to invest in structured products, including assets typically referred to as "CLO debt" and "CLO equity." These investments will typically consist of equity or subordinated debt securities issued by a private investment fund that invests, on a leveraged basis, in the bank loan, high yield debt or other asset groups. The Fund's investments in structured products will be subject to a number of risks, including risks related to the fact that the structured products will be leveraged. Utilization of leverage is a speculative investment technique and will generally magnify the opportunities for gain and risk of loss borne by an investor in the equity or subordinated debt securities issued by a structured product.

Mezzanine Debt. The mezzanine investments in which the Fund intends to invest are typically contractually or structurally subordinate to senior indebtedness of the applicable company, or effectively subordinated as a result of being unsecured debt and therefore subject to the prior repayment of secured indebtedness to the extent of the value of the assets pledged as security. In some cases, the subordinated debt held by the Fund will be subject to the prior repayment of different classes of senior debt that is "layered" ahead of the debt held by the Fund. In the event of financial difficulty on the part of a portfolio company, such class or classes of senior indebtedness ranking prior to the debt held by the Fund, and interest thereon and related expenses, must first be repaid in full before any recovery will be had on the Fund's mezzanine or other subordinated investment. Subordinated investments are characterized by greater credit risks than those associated with the senior or senior secured obligations of the same issuer.

Investments in Direct Lending. The Fund may make investments in the debt of companies directly. Direct lending by the Fund may be riskier than other more established asset classes. Such investments are often negotiated directly with the company itself, with a private equity sponsor, or with another third party, as applicable. As a result, these investments are not broadly syndicated to a large, diverse group of lenders by a financial institution in the manner of bank loans, high yield bonds, or other similar assets in which the Fund invests. The Fund may be the only lenders or part of a small, concentrated group of lenders invested in this part of the company's capital structure. These investments are generally highly illiquid. There is a risk the Fund may not be able to sell or otherwise dispose of these assets or that any such disposition may be on terms that are not favorable to the Fund.



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