Capitala

Completing a Deal Without a Track Record

A Practical Guide for Independent Sponsors in the Lower Middle-Market

Capitala Group

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Overview

The U.S. lower middle-market ("LMM") presents a compelling opportunity set; a generational ownership transition is accelerating as businesses owned by baby boomers are increasingly preparing to change hands in the coming years. More than half of these owners lack a formal succession plan, creating a steady supply of motivated sellers seeking capable buyers.

Conversely, the broader private equity market is feeling the strain of a prolonged exit slowdown from traditional buyout funds, with record levels of unsold companies. Downstream impacts of this slowdown are felt within private equity fundraising, as LPs cite reduced liquidity, thus reducing ability to commit to new funds. This backdrop has created room for independent sponsors (or "ISPs") who aren't bound by fund-life pressures.

The independent sponsor model has emerged as one of the most significant structural shifts in private equity over the past decade. On Axial, a deal network with more than 20,000 LMM members, independent sponsors closed more deals than any other buyer category in 2025, and the number of active ISPs has roughly doubled since 2019.

Even with market trends working in their favor, ISPs are often faced with a common conundrum: capital providers want to see a track record before committing to a deal, but building a track record requires closing that first transaction. Capitala understands this dynamic – since our inception, we've partnered with dozens of ISPs in deals representing well over $1 billion in aggregate transaction value. In just the last five years Capitala has backed six first-time ISPs.

Executive Summary

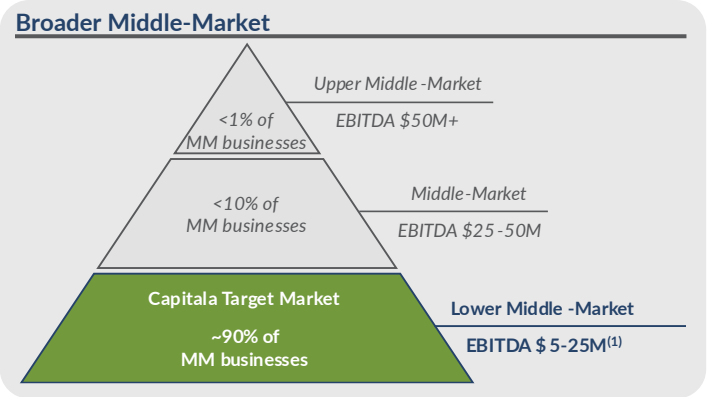
- The independent sponsor model has matured into a legitimate and growing segment of the PE landscape
- Capital providers, including SBICs, family offices, and dedicated independent-sponsor-focused funds, are increasingly willing to back first-time sponsors who are looking to close their first investment
- Factors in evaluating a first-time ISP include:
  - *Thesis Quality*: Does the ISP have a specific, defensible thesis grounded in industry expertise?
  - *Operating Experience*: Can the sponsor credibly add value post-close through operational insight and industry relationships?
  - *Personal Commitment*: Is the sponsor prepared to invest meaningful personal capital and dedicate full-time attention to the company?
  - *Deal Quality*: Is the opportunity itself attractive, well-sourced, and appropriately diligenced?
- Choosing the right capital partner is often the most consequential decision a first-time sponsor will make
- The ideal partner brings certainty of close, flexible capital structuring, patience, and a collaborative governance approach that supports the sponsor's role without displacing it

Why the Opportunity Exists

LMM Landscape and Attractiveness

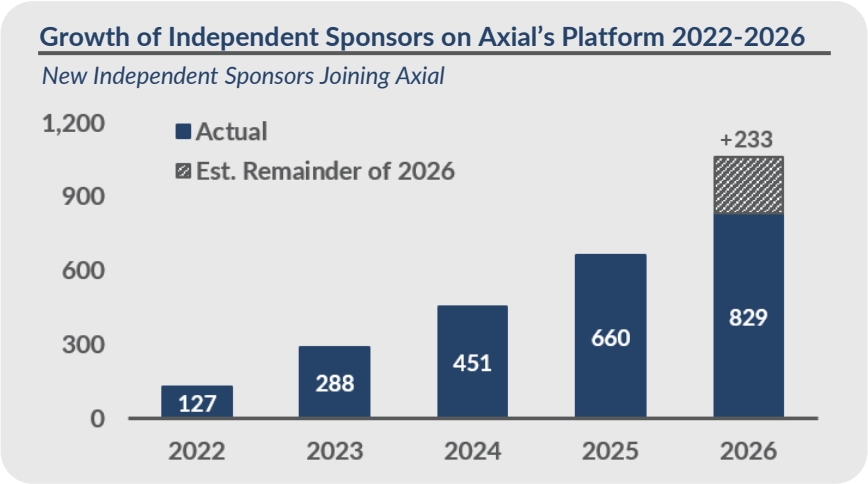
The U.S. lower middle-market is vast, fragmented, and underserved by traditional sources of capital. Banks have steadily retreated from lending to smaller businesses over the past two decades, and non-bank lenders now represent a growing majority of commercial credit outstanding. This structural shift creates opportunities for well-positioned independent sponsors and capital partners working together to provide both capital and operational support to businesses that institutional buyers overlook.

The baby boomer retirement wave compounds this opportunity. McKinsey estimates that approximately six million U.S. small and medium-size businesses will change ownership by 2035, with roughly one million viable sale candidates representing up to $5 trillion in enterprise value. Many of these businesses are profitable, well-established enterprises with loyal customers and strong market positions, but they lack sophisticated financial infrastructure or formal succession plans. They need a buyer who is patient, operationally engaged, and willing to partner with a management team through a transition.



Dynamics within Middle-Market Private Equity

Traditional private equity faces headwinds that reinforce the independent sponsor opportunity. Global buyout fundraising fell 16% in 2025 to $395 billion, with the number of closed funds down 23%. Distributions as a share of NAV have remained below 15% for four consecutive years, an industry record. Mid-tier managers are particularly at risk, struggling to exit assets or raise successor funds. This creates openings for nimble independent sponsors who can move quickly on deals that larger firms pass over or cannot efficiently process. The independent sponsor model is particularly well-suited to the lower middle-market segment, where relationships, sector expertise, and creative structuring help to drive outcomes.



The Rise of Independent Sponsors

The number of active independent sponsors has approximately doubled since 2019, reaching over 2,000 in 2026. This growth reflects the model's fundamental appeal: deal-by-deal flexibility, lower overhead than a traditional fund, and the ability to concentrate time and resources on individual opportunities. Senior PE professionals, investment bankers, and industry executives are increasingly choosing the independent sponsor path because it allows them to source deals first and raise capital only for specific transactions. In turn, preserving autonomy and accessing the lower middle-market's rich opportunity set.

Attracting Capital Partners

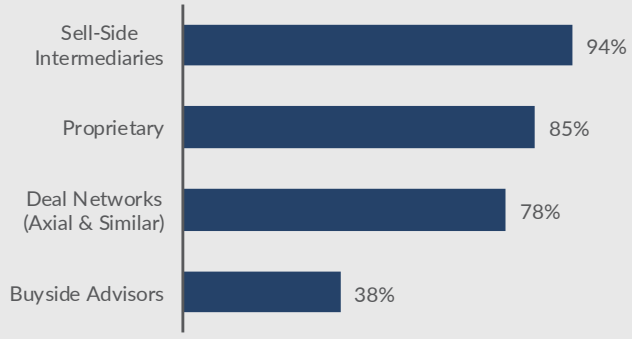
Capital providers evaluating a first-time independent sponsor are not simply checking a yes or no box for "has closed a prior deal." They are assessing a broader set of facts that indicate whether a sponsor can manage a transaction process and, more importantly, manage the company. In its simplest form, value creation in lower middle-market companies boils down to two components: growth in the business (EBITDA and free cash flow) and entry versus exit valuation multiples. Capital providers generally look for a demonstrated ability to drive one or both of those variables.

Sourcing

How an ISP finds a deal matters as much as the deal itself. Supporting a sponsor who won a broadly shopped process does not answer the question of "why" the sponsor should be supported, and in many cases, it likely means the business was purchased at a market multiple premium. The independent sponsor would then need to demonstrate an ability to generate a strong return despite a higher entry valuation.

Channels Used for Deal Origination

Independent Sponsors Rely on Multiple Channels to Source Opportunities



Multiple answers accepted

Proprietary deal sourcing and finding opportunities off market is often the most effective channel for first-time sponsors. Off-market or lightly marketed opportunities may allow an ISP to invest in a business with more room for error in the entry valuation. Building a relationship with the business owner also allows the sponsor to become more familiar with the asset and develop a more grounded thesis.

Regardless of channel, the critical question capital providers will ask is: "Why should we back you?" What about your background, network, or thesis gives you an edge over other sponsors in generating above-average returns for your capital partners?

Thesis Development

A well-constructed investment thesis is often the single most important document a first-time sponsor produces. It answers the "why" by establishing your bona fides: your knowledge of the industry, the specific opportunity you see, and the support infrastructure you have built around yourself.

Being able to demonstrate how you plan to grow the business, organically and/or inorganically, with specificity is a key to providing validity to the thesis. For example, when talking about organic growth, discuss in detail how you would augment the sales function of the business and what the driver would be. For inorganic growth, as an example, demonstrate how M&A opportunities exist in this sector, inclusive of any preliminary targets.

Advisory boards also play a meaningful role in establishing credibility. Assemble advisors who complement your own experience. Examples may include a seasoned CFO, a sector executive with a relevant network, or a former investment professional who has experience in the industry. An advisory board demonstrates to capital partners that you have built a support structure beyond yourself and that your thesis is informed by direct experience.

Personal Evaluation

Capital providers evaluate the ISP at a personal level, seeking references from former colleagues, business partners, and industry contacts. They will assess whether you have relevant deal experience, even if you have not personally closed a transaction as a lead sponsor. Relevant prior roles such as a management position within the industry, investment banking, corporate development, consulting, or others can help contribute to the picture.

Personal capital commitment is also a strong signal. Capital partners increasingly expect sponsors to contribute cash alongside any reinvested transaction fees. Demonstrating that you have meaningful personal capital at risk communicates conviction and alignment.

Sources of Sponsor Equity Contributions

Citron Cooperman Independent Sponsor Report

Multiple responses allowed	2026 Report
Contribute own funds	84%
Raise equity from friends and family	32%
Raise equity from other investors	27%
Roll closing fees into equity	66%
Other	1%

Quality of the Deal Itself

Ultimately, the quality of the transaction speaks volumes. A first-time sponsor presenting a well-sourced, well-diligenced opportunity with clear value creation potential can overcome a thin resume.

Structuring the First Transaction

The Importance of Choosing the Right Partner

This is perhaps the most consequential decision a first-time independent sponsor will make. The capital partner is not simply a funding source; they are a counterparty that sellers will diligence, a reference that management teams will call, and a governance partner you will work alongside for years. The wrong partner can kill a deal before it closes, through anything from a slow process or a narrow mandate that can't adapt to the deal's capital needs.

The appropriate capital partner brings value beyond capital, often through operational resources, banking relationships, or institutional credibility. And they bring capital appropriately sized to the opportunity, rather than forcing a deal into a structure that serves the provider's deployment needs rather than the company's requirements.

Practical Matters[2]

A strong relationship with a capital partner begins with alignment.

Fee structures in independent sponsor transactions have become increasingly standardized. Common market terms include a closing fee of 2% to 5%, a management fee of 3% to 5% of EBITDA (often with a floor and cap), and carried interest of 10% to 25% that may step up at higher return thresholds. Independent sponsors who expect above-market economics may find it harder to secure the right capital partner.

Broken deal costs are an important practical consideration. Diligence, legal, and process expenses on failed transactions are typically addressed through reimbursement provisions that are negotiated in advance with the capital partner. Understanding how your capital partner handles broken deal economics before you begin spending on diligence is essential for a first-time sponsor managing limited resources.

Governance arrangements typically involve a negotiation with the capital partner on the basis of equity capital contributed to the transaction. Maintaining control of the board or asset can be an important consideration for a first-time independent sponsor, which can in turn help to build that sponsor's track record.

Capitala Group: A Capital Provider for Independent Sponsors

Capitala Group has been investing in the U.S. lower middle-market for 28 years, with more than $3 billion invested and managed across nearly 200 companies. Independent sponsor partnerships are a core channel for the firm and our strategy. Capitala has partnered with independent sponsors on over $1 billion in cumulative transaction value and these partnerships remain a dedicated focus for the firm.

What distinguishes Capitala as a capital partner for first-time sponsors:

- **Willingness to back emerging sponsors**: evaluating the quality of the deal, the depth of the thesis, and the credibility of the sponsor. The firm has supported several first-time ISPs, including six in the last five years.
- **One-stop capital solutions**: Capitala provides flexible debt and equity capital to help solve the specific capital need at close. Typical investments for Capitala range between $10-50 million.
- **Speed to close**: our flexible capital mandate means the independent sponsor can work with one institutional counterparty instead of coordinating several, which can shorten timelines and reduce execution risk.
- **Collaborative governance**: Capitala takes board seats and invests meaningful minority equity stakes alongside independent sponsors, with specifics varying by transaction. This creates genuine alignment without displacing the sponsor's operational role.

Case Study[3]

Capitala's partnership with Spur Ridge Capital in the acquisition of Axis Medical demonstrates how the firm supports independent sponsors through their first institutional transaction. Capitala provided flexible debt and equity capital, enabling the transaction to close within 30 days. The opportunity was compelling because of both the quality of the company and the investment thesis developed by the independent sponsor team. The sponsor possessed deep knowledge of both the industry and opportunity and assembled an independent advisory board to help guide the business.

Closing and Additional Resources

The first deal an independent sponsor completes can undeniably be the hardest, but success can be achieved through preparation and positioning of the opportunity in front of the right group of capital partners. Build credibility through the depth of your thesis and the quality of your advisory network. Source opportunities where your sector expertise creates a genuine advantage. Choose a capital partner who is not only willing to back a first-time sponsor but is structured and experienced in doing so.

Capitala Group has been that partner for more than two decades and across dozens of independent sponsor transactions. If you are developing a thesis, evaluating an opportunity, or exploring whether the independent sponsor model is the right path for you, we welcome the conversation.

Capitala CONVERSATIONS
INSIGHTS | CONNECTIONS | GROWTH

Spotify *Apple Podcasts*

Capitala Conversations Podcast Series

For more on how Capitala partners with independent sponsors, listen to the first two episodes of Capitala Conversations, available on Spotify and Apple Podcasts. Links to each platform included here.

Endnotes

Page 3:

(1) Capitala typically targets businesses with $5-20 million in LTM EBITDA.

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(2) Percentages ranges concerning economics are provided by the Citrin Cooperman 2026 Independent Sponsor Report.

(3) This case study represents one specific transaction which may not be reflective of all partnerships with Capitala.

Data Sources

Independent Sponsor News (ISN); Axial, 2026 Independent Sponsor Report; McGuireWoods, Independent Sponsor Deal Survey; McKinsey, The Great Ownership Transfer; Bain, Global Private Equity Report 2026; Citrin Cooperman, 2026 Independent Sponsor Report.

Notes and Disclaimers

All Capitala-specific data is reflected as of June 30, 2026, unless otherwise specified.

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