

The Complete PIK-ture

A guide to private credit trends since 2021

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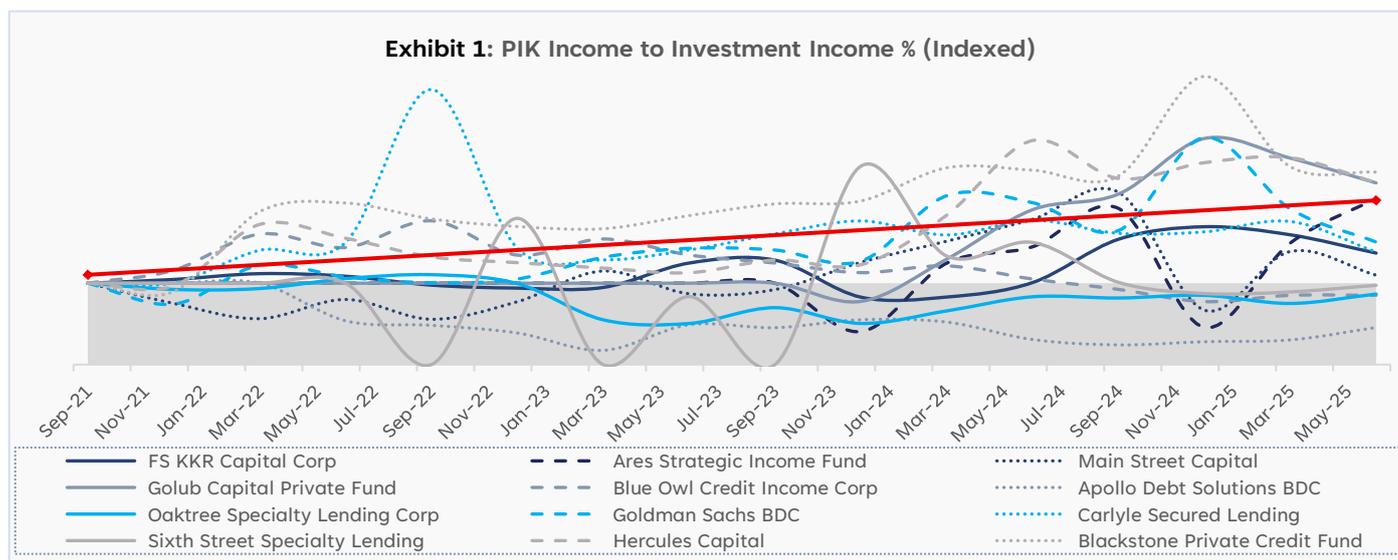
Executive Summary

- ❖ **Payment-in-kind (PIK) interest, an innovative structure to defer interest payments, is being used more often in private credit**, driven by relatively higher interest rates and pressure on borrowers with potentially high or weak financial performance.
- ❖ PIK usage has increased in a post-pandemic world as we moved into rate hikes and lenders moved toward capitalising more interest and increasing leverage on already stressed borrowers. **As interest rates normalise but pressure on banks remain, private lenders jump to fill the lending gap, resorting to innovative structures including payment-in-kind.**
- ❖ Increase in PIK-based lending may not mean an immediate crisis is brewing – **but is often a sign of imminent stress in the market.** A bubble behavior is beginning to show, not in the form of weakening private credit fundamentals but in adjacent aspects especially **around valuation, credit rating and liquidity rights.**
- ❖ **Despite credit fundamentals in order** (seen by consistent LTVs and asset coverage ratios for private credit funds), **cracks in terms of non-financial parameters are beginning to appear.** We believe that defaults rates have still not surged because:
 - Valuation opacity due to lack of observable market prices and complexity of deal structures make it challenging for investors and regulators to assess potential threats.
 - Covenant-lite terms delay the likelihood of formal default, as weak covenants allow underperformance to persist without triggering a default event.
 - Smaller lender groups (often sole lenders) streamline negotiations, make it easier to agree to amendments, and avoid reporting technical defaults, unlike broadly syndicated loans involving many lenders and complex negotiations.
- ❖ Critical market participants in the banking and investing world – JPMorgan Chase, UBS, Bank of America, GIC, Bank of England, IMF, Moody's – all have voiced their opinions on the systemic issues coming to the fore in private credit, driven by valuation opacity, ratings mismatch, and ineffective underwriting.
- ❖ Private banks have been recommending private credit in a high interest, low yield environment as a panacea for all income needs. **Valuation opacity and increased focus on PIK based compensation by managers puts more onus on family offices to pay close attention to this particular asset class.** We expect divergence to arise - not just between managers but also between different strategies.
- ❖ The private credit market – that has grown from \$300 billion to \$2.3 trillion globally in 15 years - **Suddenly Looks Vulnerable.**

The Current PIK-ture

- ❖ Private credit (PC) or private debt investments are debt-like, non-publicly traded instruments provided by non-bank entities, such as private credit funds or business development companies (BDCs), to fund private businesses. **Private credit is typically extended to middle-market firms with annual revenues between \$10 million and \$1 billion but has grown rapidly in recent years to fund larger companies that were traditionally funded by leveraged loans.**
- ❖ **PIK (Payment-in-Kind) interest refers to interest that is contractually accrued and capitalized onto a loan's outstanding principal rather than paid in cash, enhancing stated returns while elevating repayment, valuation, and overall credit risk for lenders.**
- ❖ **PIK interest is being used more often in private credit, driven by relatively higher interest rates and pressure on borrowers with potentially a lot of debt or weak financial performance. PIK is a useful way for lenders and borrowers to manage periods of stress, offer temporary liquidity, and help with restructuring; its increasing use warrants careful monitoring. With rates rising in 2022, PIK has become a lever for BDCs to structure flexibility in loans and allowing borrowers to tide over the immediate interest payment burden.**

As depicted in Exhibit 1, the PIK income for 8 of 12 BDCs reviewed, increased over the last 16 quarters, resulting in the mean (red line) PIK income increasing by 80%.

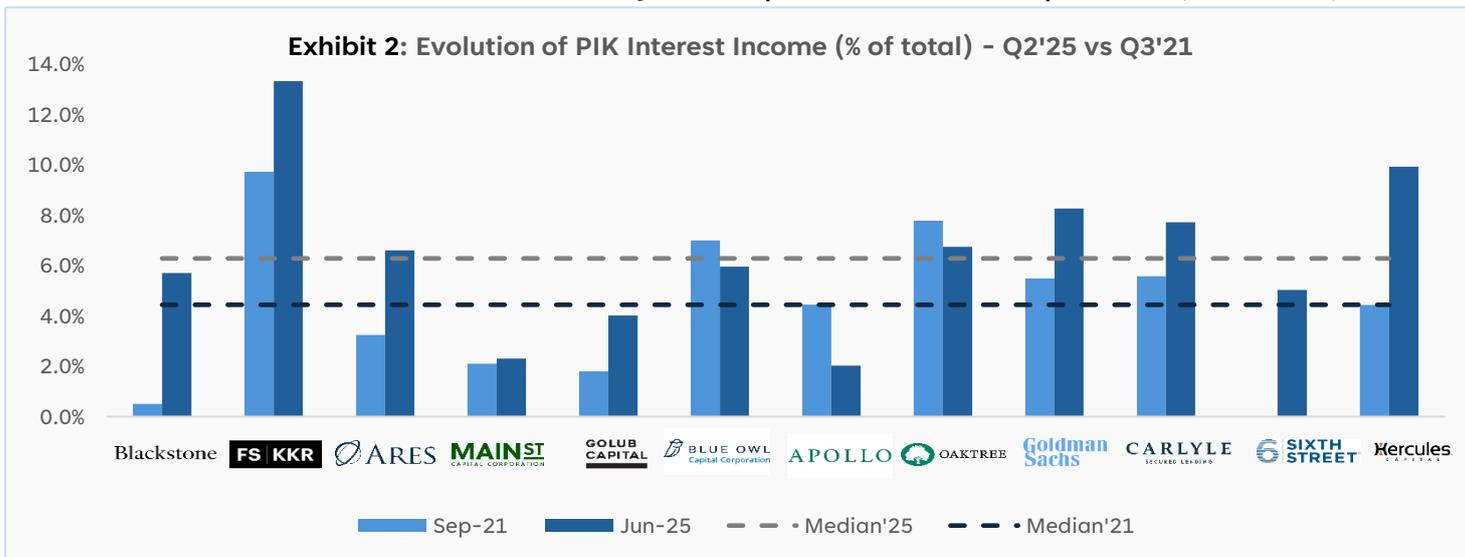


Note: For Ares and Golub Capital, data begins in Q3'23 instead of Q3'21 ¹.

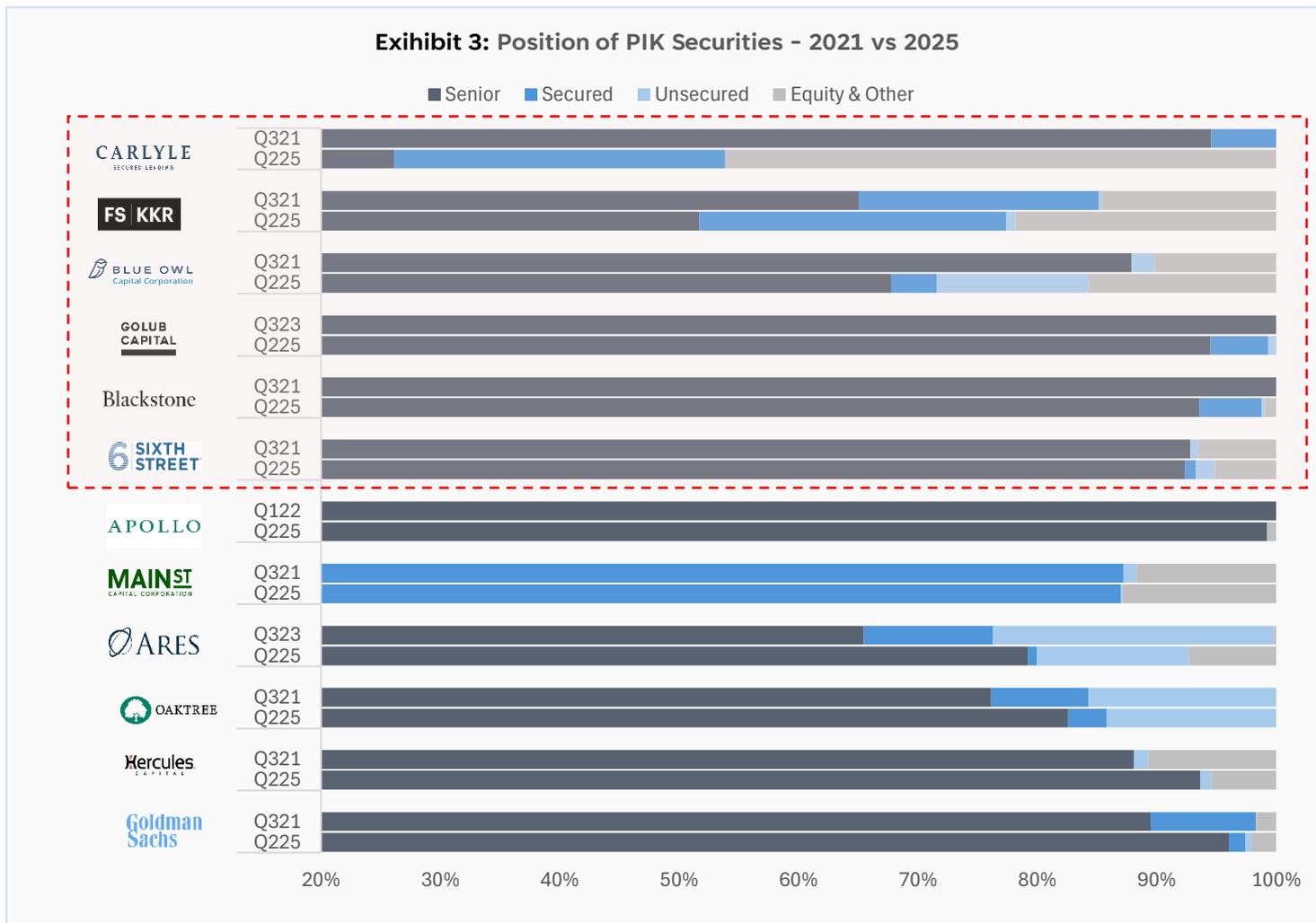
- ❖ Rising PIK usage can create issues for lenders (private credit funds such as BDCs) and investors (LPs investing in such PC funds), by adding difficulties to cash flow and capital management and adding regulatory hurdles. To address these risks, some

¹ Source: GIA analysis, Bloomberg, Company BDC Filings

credit managers use strategies like strict loan terms, regular covenant checks, frequent financial reviews, and close borrower relationships. Median contribution of PIK in interest income increased by ~200bps in the last 16 quarters (Exhibit 2).



Note: For Ares and Golub Capital, data begins in Q3'23 instead of Q3'21². Refer BDC Names mentioned in Appendix 1

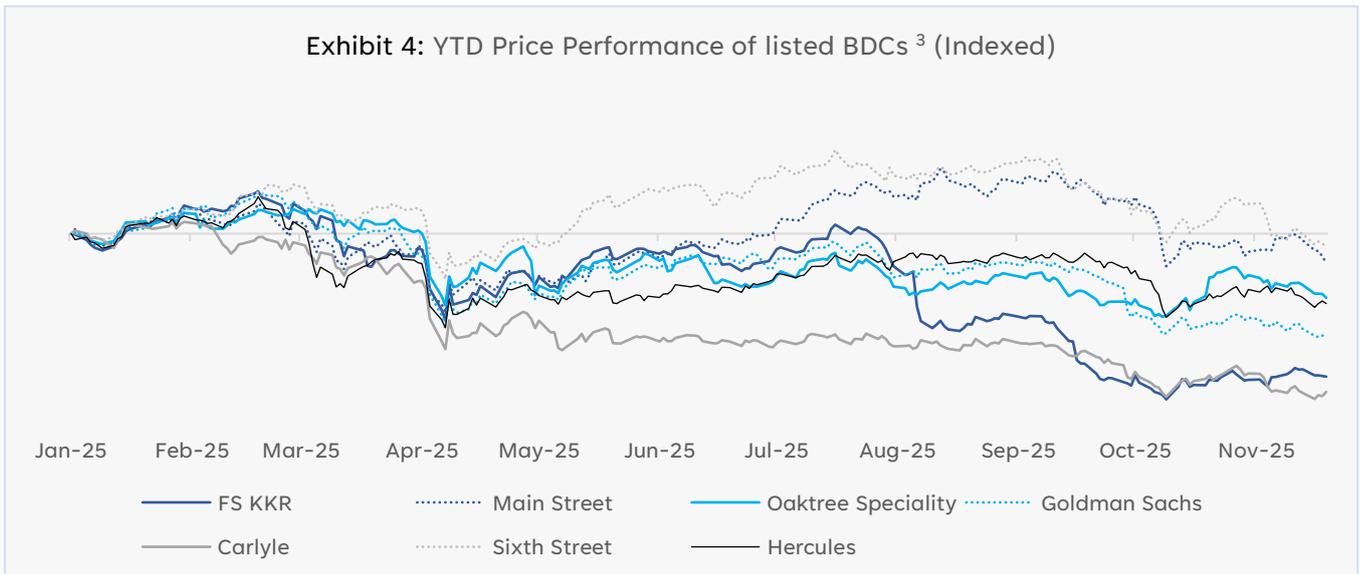


Note: For Ares and Golub Capital, data begins in Q3'23 instead of Q3'21². Refer BDC Names mentioned in Appendix 1

² Source: GIA analysis, Bloomberg, Company BDC Filings

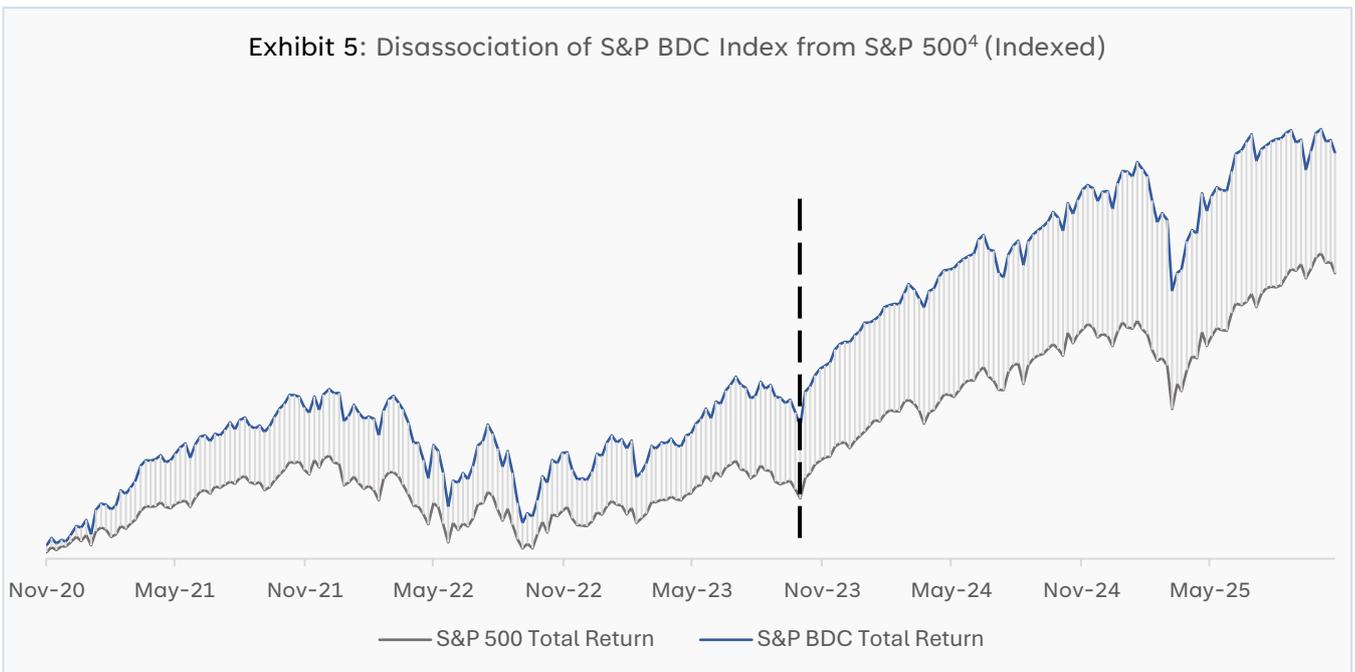
- ❖ Position of PIK across BDCs is deteriorating, with PIK exposure of 6 of the 12 BDCs shifting from First-Lien securities to Second-Lien, Unsecured, and Equity tranche securities (Exhibit 3). This shift is most evident for Carlyle, FS KKR, and Blue Owl, which may be linked to Blue Owl recently blocking redemptions (more on page 10).

- ❖ The price performance of BDCs have been declining in 2025, with NAVs trading at a discount for the 7 listed BDCs in our dataset, as on the date of this article (Exhibit 4).



Note: For Ares and Golub Capital, data begins in Q3'23 instead of Q3'21 ³. Refer BDC Names mentioned in Appendix 1

- ❖ Additionally, a disassociative trend between BDCs vs the broad underlying US stock market has been evident since late 2023 (Exhibit 5).

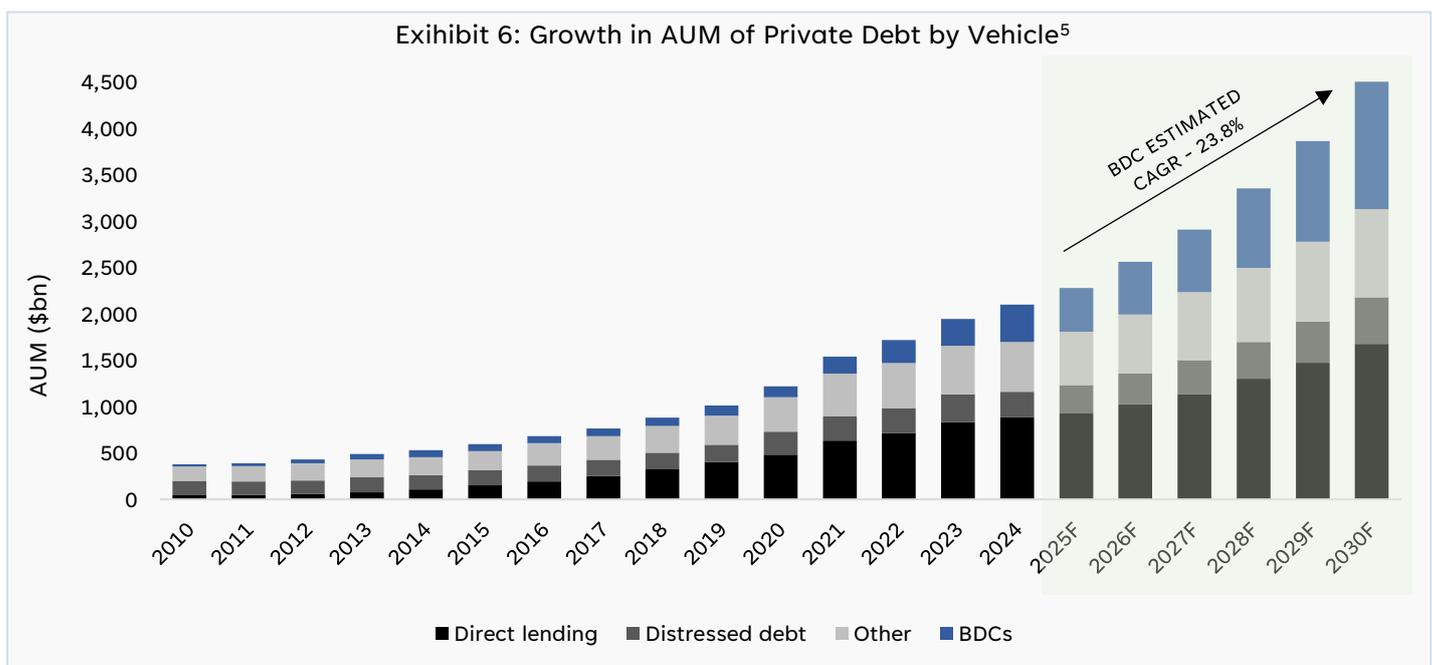


³ Source: GIA analysis, Bloomberg, Company BDC Filings

⁴ Source: S&P CapIQ

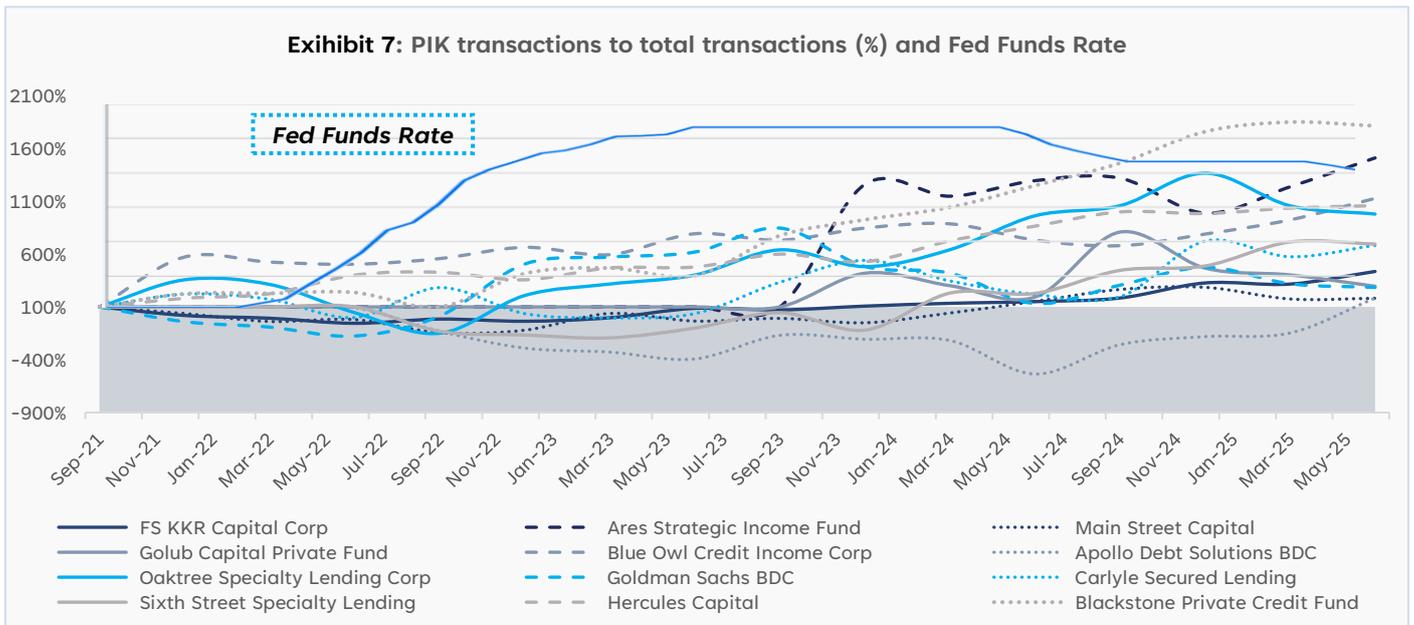
How did Private Credit get here?

- ❖ Once the domain of pension funds, global insurers and the uber-wealthy institutions, **private credit is undergoing a quiet transformation across family offices and private investors jumping on the bandwagon.** The result is one of the fastest-growing segments in investing - 4x faster than traditional institutional businesses. (Exhibit 6)
- ❖ Business Development Companies (BDCs) are regulated by the Securities and Exchange Commission under the Investment Company Act of 1940 and primarily invests in small and mid-sized companies. **These are mostly structured as semi-liquid perpetual evergreen funds.**
- ❖ **BDCs allow new investors to buy and redeem stakes periodically rather than invest for a fixed period are transforming access.** One key reason is putting funds to work on Day 1 rather than a traditional drawdown structure which issues capital calls through committed fund structures.



- ❖ Payment-in-kind interest (PIK) usage has increased in a post-pandemic world as we moved into rate hikes and lenders moved toward capitalising more interest and increasing leverage on already stressed borrowers. **As interest rates normalise but pressure on banks remain, private lenders jump to fill the lending gap, resorting to innovative structures including payment-in-kind.** (Exhibit 7)

⁵ Source: Preqin



Note: For Ares and Golub Capital, data begins in Q3'23 instead of Q3'21 ⁶. Refer BDC Names mentioned in Appendix 1

❖ **Private credit bore the brunt of distress in the broader lending space with recent distress situations** driven by company-specific misconduct and governance failures, notably fraud, rather than broad credit deterioration or macro conditions. Such instances bring to the forefront the lapses in basic underwriting checks and balances, either at the time of investment or at asset appraisals.

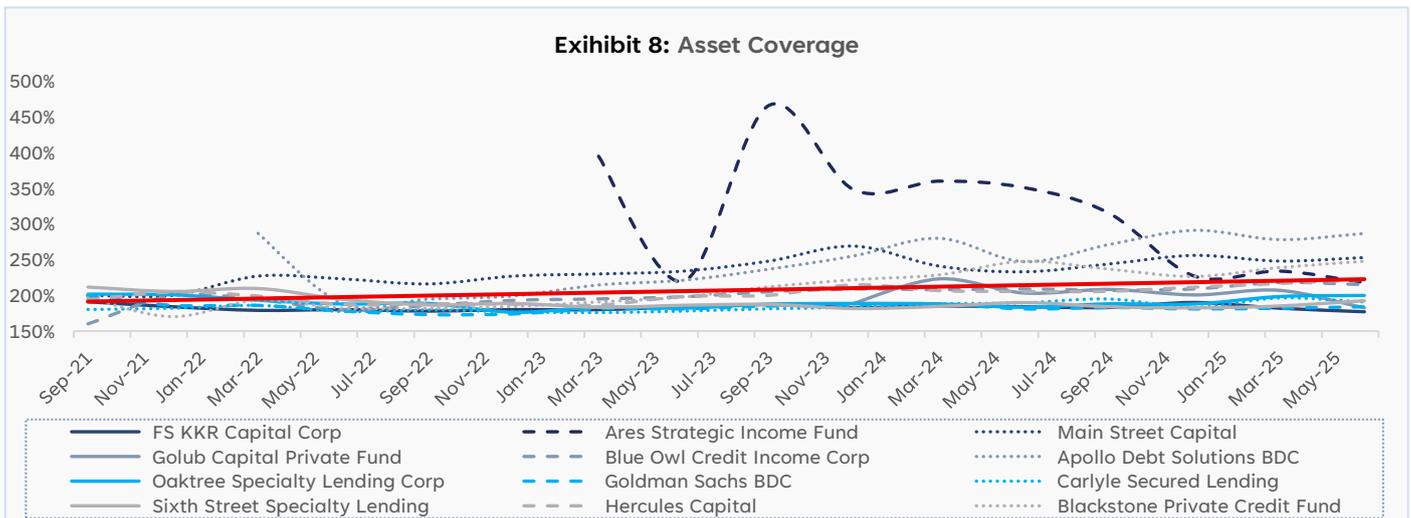
- **Tricolor**, a subprime auto lender catering primarily to undocumented and underbanked borrowers, falling into bankruptcy amid allegations of fraud, including “double-pledging” vehicle collateral across multiple lenders
- **First Brands**, an aftermarket auto parts supplier collapsing due to an aggressive, debt-fuelled acquisition strategy that relied heavily on obscure off-balance-sheet financing and reportedly engaging in asset double-pledging.

With such trickledown effect, we expect the lending industry to branch out in different directions – Private Credit, Broad Syndicated Lending (BSL), Significant Risk Transfer (SRT), Mezzanine, and Direct Lending to have differentiated underwriting mechanisms and attract investors with distinct portfolio construction objectives and yield expectations from each of these unique lending strategies.

⁶ Source: GIA analysis, Bloomberg, FRED, Company BDC Filings

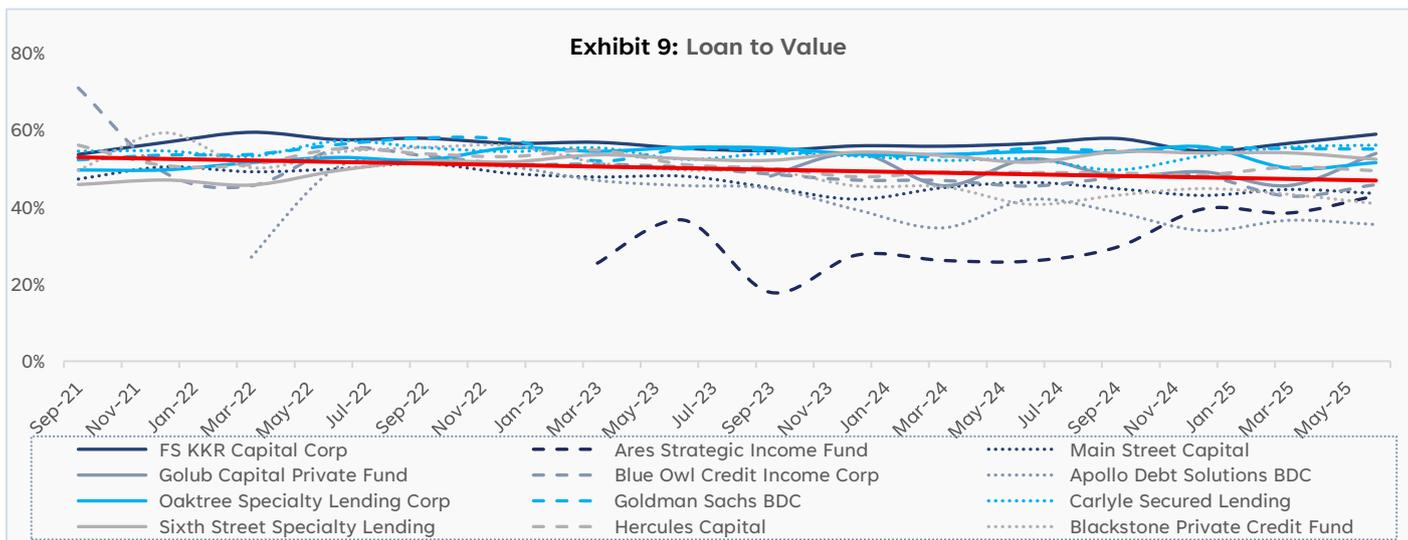
Our View

Increase in PIK-based lending may not mean an immediate crisis is brewing – but is often a sign of imminent stress in the market. A bubble behavior is beginning to show, not in the form of weakening private credit fundamentals but in adjacent aspects especially around valuation, credit rating and liquidity rights.



Note: For Ares and Golub Capital, data begins in Q3'23 instead of Q3'21 ⁷. Refer BDC Names mentioned in Appendix 1

As seen in Exhibit 8 and Exhibit 9, the ‘asset coverage ratio’ and LTV ratio have trended almost flat over the period of 4 years across all BDCs, with “fundamentals” largely trending at 200-250% and 40-60% respectively. **However, cracks in terms of non-financial parameters are beginning to surface.**



Note: For Ares and Golub Capital, data begins in Q3'23 instead of Q3'21 ⁸. Refer BDC Names mentioned in Appendix 1

⁷ Source: GIA analysis, Company BDC Filings

⁸ Source: GIA analysis, Company BDC Filings

Recent Events of Consequence

❖ From Hero to Zero:

- [Renovo](#) (Home Renew Buyer Inc.), a recently touted large player in the home improvement industry filed for bankruptcy under Chapter 7.
- Blackrock held majority of the company's \$150mn private debt; had valued the debt at 100 cents on the dollar last month, slashing it to zero last week.

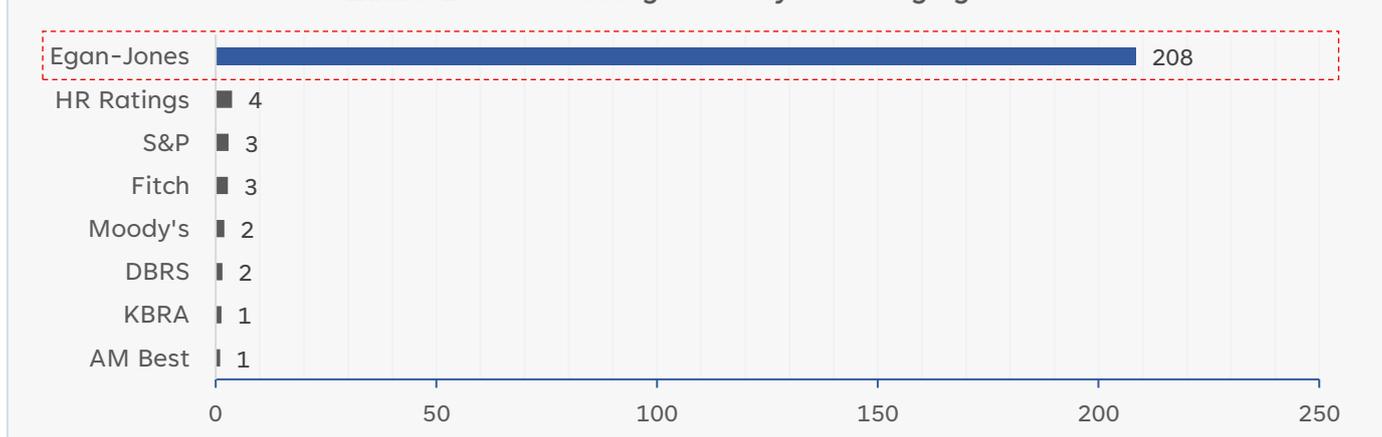
❖ Valuation divergence:

- Valuation divergence in private credit is getting harder to ignore. Apollo priced a loan to software company [Medallia](#) at 77 cents on the dollar in Q3'. A rival fund co-managed by KKR/FS valued the identical loan at 91 cents.
- That 14-point spread represents the largest gap yet in regulatory filings, exposing how much discretion lenders have in determining what their investments are worth.
- Such kind of divergence tends to emerge only when performance starts slipping. As valuation firms typically offer ranges rather than a single figure, lenders are left to interpret their own recovery outlooks.

❖ The case of the rate shopper:

- The rise of smaller, specialist rating agencies that are ticking the box for compliance of investment has sparked fears that private capital groups are "shopping" for the most favorable credit scores.
- Egan-Jones, a father-son run credit ratings enterprise, churned 3,600+ ratings last year with 20 analysts (~200 per analyst compared with an industry average of ~40).
- Egan-Jones and rivals such as HR Ratings, Kroll Bond Rating Agency and Morningstar DBRS have captured almost all of the new growth in privately rated securities held by insurers, while private ratings from the Big3 (Moody's, S&P and Fitch) have been largely flat.
- **Most BDCs considered in our analysis have begun to distance themselves from specifically Egan-Jones.** (Exhibit 10)

Exhibit 10: Credit Rating Per Analyst - Rating Agencies



❖ BDCs blocking redemptions:

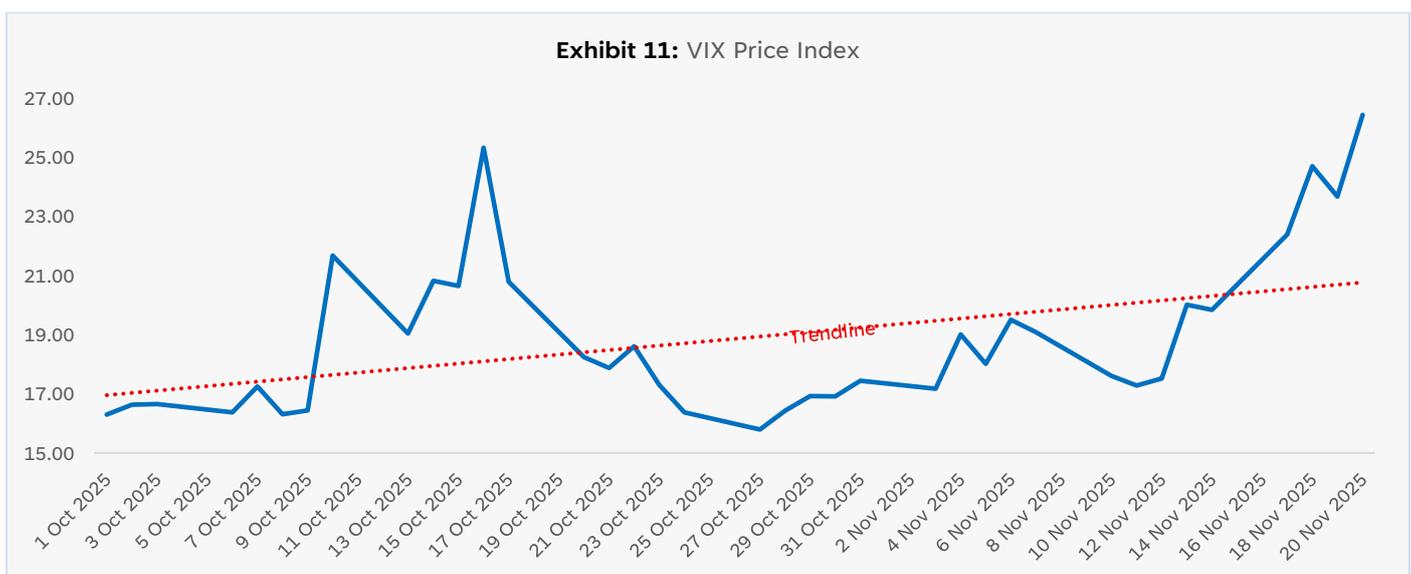
- [Blue Owl](#) is merging 2 of its funds - a private one and a listed one. The listed one trades at a 20% discount - resulting in a 20% loss in NAV for the unlisted fund LP post the share swap.
- To avoid the liquidity frenzy, Blue Owl has blocked redemptions. Such a move not only questions the fully liquid and redeemable nature of private credit when a fund blocks redemptions, but also signals a stress buildup, basis how some private credit funds themselves trade at a discount to the value of their underlying portfolio, signalling a stress buildup. (also refer Exhibit 4 above)
- At the time of writing this article, Blue Owl scrapped the merger after the investor backlash that sent the share price tumbling. The redemption program is expected to be reinstated by Q1'26 subject to Board approval.

Market View of Private Credit

- ❖ The Market continues to balance as banking behemoths present both sides of the same coin. On October 15, two Wall Street titans offered radically different visions of the private credit market.
 - JPMorgan Chase CEO Jamie Dimon: Warned investors that recent bankruptcies in private credit could be just the beginning: “*When you see one cockroach, there are probably more.*”
 - Hours later, BlackRock CEO Larry Fink: Struck a defiant tone on the earnings call: “*I’ve never been more excited about the future of BlackRock,*”. BlackRock has bet \$12 billion on private credit through its acquisition of HPS Investment Partners.
- ❖ Other banking behemoths, large financial institutions, sovereign wealth funds, and rating agencies chime in, calling out the elephant in the room:
 - **IMF:** *Head of IMF says risks in private credit market keep her awake at night.*
 - **GIC:** *Singapore’s GIC signals caution on private credit*
 - **Bank of England:** *Warns alarm bells’ ringing over private credit market*
 - **UBS:** “*Looming systemic risk’ from private credit ratings due to huge rating-agency arbitrage*”
 - **Bank of America:** “*S&P 500 at risk from 'forced selling' due to private credit stress*”
 - **Moodys:** “*Rising retail investor exposure to private credit, especially via open-ended funds or ETFs could pose liquidity risks to banks.*”

Conclusion

- ❖ If PIK has become increasingly common in the middle market, why have default rates not yet surged? Now we realize what maintains artificial resilience:
 - Valuation opacity due to lack of observable market prices and complexity of deal structures make it challenging for investors and regulators to assess potential threats.
 - Covenant-lite terms delay the likelihood of formal default, as weak covenants allow underperformance to persist without triggering a default event.
 - Smaller lender groups (often sole lenders) streamline negotiations, make it easier to agree to amendments, and avoid reporting technical defaults, unlike broadly syndicated loans involving many lenders and complex negotiations.
 - Frequent financial reporting, often monthly, gives lenders timely visibility into borrower's health, enabling proactive interventions - such as amendments - before issues escalate to default.
 - Middle market lenders typically maintain close, hands-on engagement with borrowers, which allows redressal before reaching default state.
- ❖ Recent events spooked investors about the stability of private credit that frantic selling **drove up the VIX “fear” index by 35% over the past month.** (Exhibit 11)
- ❖ Major institutions tallied their damage: JPMorgan took \$170 million in Tricolor losses; UBS disclosed over \$500 million in First Brands exposure; and Jefferies revealed \$715 million in questionable receivables.
- ❖ The private credit market – that has grown from \$300 billion to \$2.3 trillion globally in 15 years - **Suddenly Looks Vulnerable.**



- ❖ Like what you read? Click [here](#) for the backup data

Appendix:

PIK may be a great opportunity for borrowers to reinvest in growth (as displayed by borrowing by the tech sector), an option to add flexibility to the payment schedule, for troubled borrowers today looking to cash in on a timing difference lifeline.

The lenders on the other hand aim to “secure” a higher yield or return premium from principal and interest accruals and maintain flexibility to offer a retroactive amendment to avoid potential restructuring costs.

I. Approach & Methodology:

We measured the portfolio quality of 12 Private Credit Funds’ BDCs for last 16 quarters.

Name of BDC Web Link	Ticker	Status
Blackstone Private Credit Fund	BCRED	Private
FS KKR Capital Corp	FSK	Public NYSE
Ares Strategic Income Fund	ASIF	Private
Main Street Capital	MAIN	Public NYSE
Golub Capital Private BDC	GBDC	Private
Blue Owl Credit Income Corp	OCIC	Private
Apollo Debt Solutions BDC	ADS	Private
Oaktree Specialty Lending Corp	OCSL	Public NASDAQ
Goldman Sachs BDC	GSBD	Public NYSE
Carlyle Secured Lending	CGBD	Public NASDAQ
Sixth Street Specialty Lending	TSLX	Public NYSE
Hercules Capital	HTGC	Public NYSE

The key questions that that prompted us to do so were:

- *Is portfolio quality of PC firms deteriorating?*
- *What is driving growth in PIK interest?*
- *Does rising PIK pose challenges for BDCs?*
- *Does increased PIK signal a sign of weakening private credit fundamentals?*

In this piece, we measure PIK-oriented exposure in the private credit BDC portfolios of each of the 12 funds and its evolution since 2021 (last 16 quarters) to understand early warning signals, probability of default, or potential loss.

II. Parameters analysed:

1. PIK Interest Income as Percentage of Total Interest Income
2. Fair Value of PIK Assets as Percentage of Fair Value of Total Investment Assets
3. Number of PIK Assets / Securities as % of Total Number of Investment Assets / Securities
4. Loan to Value Ratio
5. Asset Coverage Ratio
6. Debt to Equity Ratio
7. Distributions
8. Fair Value of PIK Assets by Debt Tranche

III. Data Sources:

1. Fund and BDC issued reports – 10Q, 8K, 10K
2. Press
3. Bloomberg
4. GIA Analysis

IV. Caveats:

1. Disclosure inconsistency - Managers may differ in how they report PIK. They may show it as PIK income, capitalized interest, accrued interest etc. They have been combined in our analysis as they are similar in nature.
2. PIK is heterogenous – The risk in PIK associated with senior secured carries a different risk weight than PIK in a subordinated instrument or a unitranche with a weak(er) covenant.
3. PIK may be a rational restructuring tool – PIK may not always be a sign of imminent default, it is prudent to interpret PIK with sector and covenant context.