CIFC Asset Management

Issue 17

CIFC Portfolio Intelligence

Navigating PIK Interest: Why Discipline Matters in Private Credit

February 2026

Miami
+1 786-652-3250

New York
+1 212-624-1200

London
+44 203-841-6195

Philadelphia
+1 215-972-8900

www.cifc.com

Featured Views and Insights

In our view, one of the most compelling attributes of a direct lending allocation for any investor is the opportunity for strong current cash yields. While some return is derived from fees, the majority of income for a direct lending fund is earned from the interest on loan investments, typically paid by the borrower monthly or quarterly. With base rates north of 3.0% (and forecast to remain at that level per Bloomberg SOFR forward curve data as of February 2026), this can represent an unlevered coupon of 8.0%-10.0%. For example, the average cash coupon across CIFC's outstanding direct lending loan investments was 9.2% as of year-end 2025. Funds will typically distribute interest income, at least quarterly, to investors.

However, we believe it is important for investors to understand that the interest rate charged by lenders may not always be entirely payable in cash. Certain lenders may utilize payment-in-kind ("PIK") interest. For this component of interest, if applicable, the borrower capitalizes the interest to the principal balance of the loan rather than paying it when due. While recognized as investment income when accrued, these earnings may not be realized and distributed until the loan is repaid in full. This may not be for several years, or potentially ever if the loan becomes impaired before maturity.

PIK interest generally arises in a few scenarios:

— **Upfront PIK:** Structured by a lender as part of the contractual interest rate at the inception of the loan.

— **PIK Toggle:** The original loan document provides the borrower the option to convert a portion of the cash coupon to PIK (may be subject to certain conditions or time restrictions). There may be a premium to the total coupon while the PIK toggle is active.

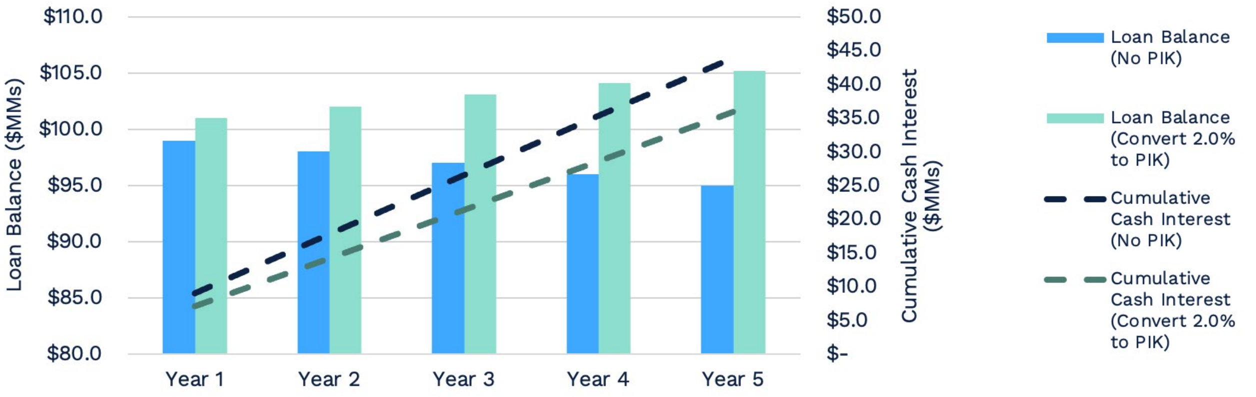
— **Amendments/Restructurings:** A loan may have all cash interest upfront, but if a borrower underperforms, lenders may amend all or some portion of the cash coupon into PIK until cash flow improves. Alternatively, PIK may be added on top of existing cash coupon to enhance returns to compensate for increased risk during a period of underperformance (e.g. following a financial covenant default lenders may charge a default rate in the form of PIK). Unlike PIK Toggle, this requires negotiation with the lender and is not solely at the election of the borrower.

PIK can have a significant impact on a loan over its life; in the example on page 3 for a $100 million loan, converting 2% of the overall coupon from cash to PIK at closing materially changes both the loan balance the borrower needs to repay ($10.2 million higher by year five) and the amount of cash interest the lender receives before maturity ($8.0 million less over the five years).

Michael Hertz
Senior Managing Director and Head of Direct Lending Underwriting

Mr. Hertz is responsible for managing our research and underwriting function and serves as a member of our Direct Lending Investment Committee. His previous roles include responsibility for sourcing, structuring and negotiating new direct lending investments in the New England region and co-managing our research and underwriting team. He has over 19 years of experience in middle-market M&A and leveraged lending transactions across a wide range of industries. He holds a Bachelor of Science (Finance) from the University of Delaware's Alfred Lerner College of Business and Economics.

Illustration of the Impact of PIK

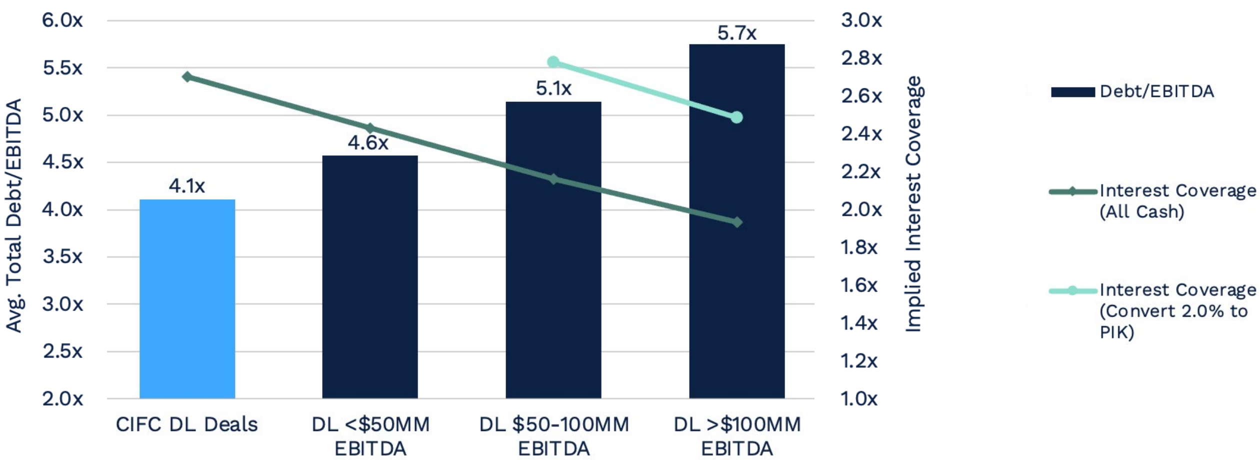


Please refer to End Note 1 for further information.

While it can be a healthy yield enhancement tool in certain situations, PIK can also be used by lenders to mask cash flow tightness and justify higher leverage than a company can support. The latter is likely to be more common in upper market deals where leverage tends to be materially higher. As shown below, higher borrower leverage (Total Debt/EBITDA) at closing is a key driver of implied interest coverage of a loan. The ability of a borrower to cover debt service with cash flow is directly tied to the ultimate risk of payment default. We observe that lower middle market companies tend to have lower leverage and better interest coverage metrics. On larger, higher levered deals, interest coverage is much lower, assuming the same cash coupon. By using PIK, upper market lenders can inflate interest coverage at the cost of less cash income today and greater principal at risk on the back end. Borrowers may take advantage of this (e.g. through PIK toggle) to defer a payment default that otherwise may have occurred. This is especially concerning in covenant-lite loans where there are no other guardrails on deteriorating financial performance.

PIK can be used by lenders to mask cash flow tightness and justify higher leverage than a company can support.

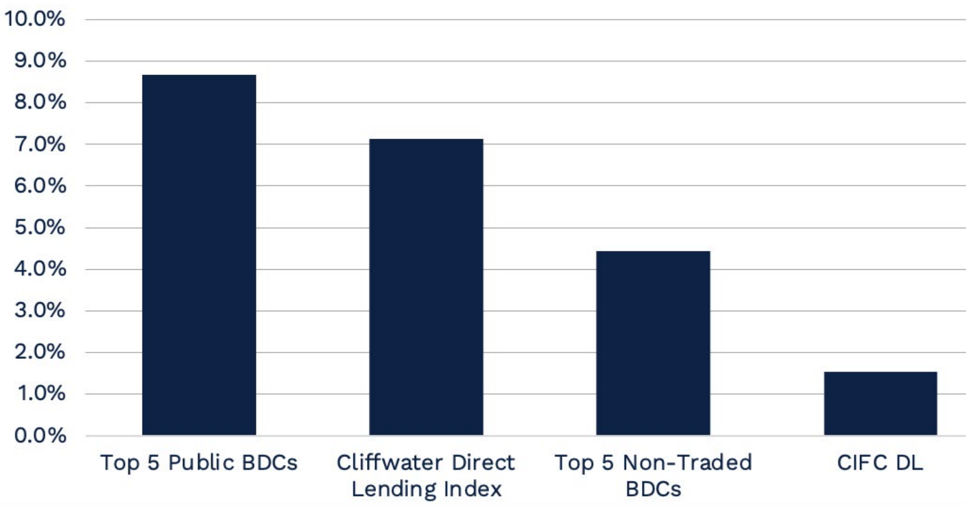
Leverage and Interest Coverage by Borrower Size



Please refer to End Note 2 for further information. Information as of December 31, 2025.

Because of the dynamics discussed above, while larger lenders tend to use more upfront PIK and PIK toggles, in our experience PIK is less common in the lower middle market. CIFC Direct Lending typically utilizes this tool only for amendment situations and not upfront. In those situations, the lender can judiciously decide how to best utilize PIK to maximize recovery and benefit the lender and not just the borrower/owner. As shown below, when compared to CIFC Direct Lending, PIK's recent contribution to investment income is approximately 3x higher for the five largest non-traded BDCs and 6x higher for the five largest public BDCs.

PIK % of Investment Income – YTD September 2025



Please refer to End Note 3 for further information.

In our opinion, investors should look beneath the numbers to understand portfolio composition and select a manager with the experience and discipline to use PIK responsibly, structure loans appropriately, and maximize current cash yield.

As private credit becomes more widely adopted by investors and commonly covered by the press, understandably, questions arise around topics like use of PIK in lieu of cash coupon. In our view, the prevalence of this dynamic in upper market managers' portfolios makes this a valid concern in those instances. In contrast, the better structural attributes of lower middle market loans include much more limited use of PIK features. We believe that this highlights a recurring theme within the asset class – private credit is not homogenous and manager matters. In our opinion, investors should look beneath the numbers to understand portfolio composition and select a manager with the experience and discipline to use PIK responsibly, structure loans appropriately, and maximize current cash yield.

End Notes

1. CIFC model of a representative $100 million loan, assuming 1% annual principal amortization, base rate of 4.0%, spread of 5.0% cash or 3.0% cash/2.0% PIK.
2. Data per LSEG Loan Connector, total leverage for direct lending deals between Q3 2020 and Q4 2025 averaging the published quarterly average data; CIFC Direct Lending average total leverage data for closed deals between Q3 2020 and Q4 2025 and includes debt junior to CIFC. Interest coverage is illustrative for a loan at the displayed leverage point assuming 9.0% cash coupon. Scenario shows interest coverage with 2% of the cash coupon converted to PIK.
3. Top 5 Public and Non-Traded BDCs are based on LSEG LPC's Middle Market Connect 3Q2025 BDC Analysis dated Dec 3, 2025 and BDC 10-Q filings for September 2025. CIFC Direct Lending is based on CIFC's investments and Cliffwater Direct Lending Index is trademark of Cliffwater LLC, both as of September 30, 2025. The Cliffwater Direct Lending Indexes (the "Indexes") and all information on the performance or characteristics thereof ("Index Data") are owned exclusively by Cliffwater LLC and are referenced herein under license. Neither Cliffwater nor any of its affiliates sponsor or endorse, or are affiliated with or otherwise connected to, CIFC, or any of its products or services. All Index Data is provided for informational purposes only, on an "as available" basis, without any warranty of any kind, whether express or implied. Cliffwater and its affiliates do not accept any liability whatsoever for any errors or omissions in the Indexes or Index Data or arising from any use of the Indexes or Index Data, and no third party may rely on any Indexes or Index Data referenced in this report. No further distribution of Index Data is permitted without the express written consent of Cliffwater. Any reference to or use of the Index or Index Data is subject to the further notices and disclaimers set forth from time to time on Cliffwater's website at: https://www.cliffwaterdirectlendingindex.com/disclosures.

Confidentiality and Disclaimer

This newsletter has been prepared by and contains selected information about CIFC Asset Management LLC and its affiliates (collectively, “CIFC”) and about the assets that CIFC manages. This newsletter is for informational purposes only. This newsletter is not, and is not intended to be, an offer to sell, or a solicitation of an offer to purchase, any securities or any other interest in CIFC or in any fund, account or other investment product or assets managed by CIFC or to offer any services. Any such offering and sale would be made only on the basis of certain transaction documents and, as the case may be, a final offering circular and related governing and subscription documents (together, “Transaction Documents”) pertaining to such offering and sale and is qualified in all respects and in its entirety by any such final Transaction Documents. For further disclosures, please refer to https://adviserinfo.sec.gov/

Past performance is not indicative of future results. Any investment is subject to risk.

In the United Kingdom, this newsletter is issued by CIFC Asset Management Europe Ltd, which is authorised and regulated by the Financial Conduct Authority.

This newsletter is based in part on certain assumptions, particularly about future performance, which have inherent limitations and will be affected by any changes in the structure, criteria or assets involved in particular transactions. There is no assurance that an investment will achieve comparable results or that the entire principal investment will not be lost. No representation is made that the scenarios described herein are accurate or complete or do not contain errors, or that alternative assumptions would not be more appropriate or produce significantly different results. Views and statements expressed herein are those solely of CIFC and subject to change without notice.

Certain information contained herein constitutes “forward-looking statements,” which can be identified by use of forward-looking terminology such as “may,” “will,” “should,” “expect,” “attempt,” “anticipate,” “project,” “estimate,” “intend,” “seek,” “target,” “continue,” or “believe,” or the negatives thereof or other variations thereon or comparable terminology. Due to the various risks and uncertainties, actual events or results in the actual performance of investments may differ materially from those reflected or contemplated in this newsletter.

No assurance is given that the target returns specified herein will be achieved, as such is estimated without the benefit of actual trading and does not reflect the impact that material economic and market factors might have had on CIFC’s decision making if it is actually managing client’s money. Even if such performance is met, client’s actual returns may be lower due to expenses, taxes and other factors. There is no guarantee that assets contemplated will be available in the future.

The distribution of this newsletter in certain jurisdictions may be restricted by law. This newsletter is being communicated only to and directed only at persons where it is permitted by applicable law in the jurisdiction in which those persons reside or conduct business. Accordingly, recipients represent that they are able to receive this newsletter without contravention of any applicable legal or regulatory restrictions in their jurisdiction.

This newsletter is provided to you on the understanding that, as a sophisticated institutional investor, you will understand and accept its inherent limitations, will not rely on it in making any investment decision. In making any investment decision, you should conduct, and must rely on, your own investigation and analysis of the data and descriptions set forth in this newsletter, including the merits and risks involved.

This newsletter is not to be construed as legal, regulatory, business, accounting or tax advice. You should consult your own attorney, business advisor, accountant and tax advisor as to legal, regulatory, business, accounting and tax advice.

Any reproduction or distribution of this newsletter, in whole or in part, or the disclosure of the contents hereof, without the prior written consent of CIFC, is prohibited. By retaining the newsletter, you acknowledge and represent to CIFC that you have read, understood and accept the terms of this newsletter. You hereby agree to return to CIFC or destroy this newsletter promptly upon request.

Benchmarks and indices are presented herein for illustrative and comparative purposes only. Such benchmarks and indices may not be available for direct investment, may be unmanaged, assume reinvestment of income, do not reinvest dividends, do not reflect the impact of any trading commissions and costs, management or performance fees, and have limitations when used for comparison or other purposes because they, among other things, may have different strategies, volatility, credit, or other material characteristics (such as limitations on the number and types of securities or instruments than CIFC. It should not be assumed that performance or the volatility of any securities included in the strategy will correspond directly to any comparative benchmark index. We make no representations that any benchmark or index is an appropriate measure for comparison.

For our privacy notice, see https://cifc.com/us-privacy-notice or https://cifc.com/eu-privacy-notice.

In Switzerland, CIFC Asset Management Europe Ltd is registered with Ombudsstelle Finanzdienstleister (OFD) in accordance with Article 74 et seq. of FinSA.

CIFC is not making any representation with respect to the eligibility of any recipients of these materials to acquire the interest in any products described herein under the laws of Korea, including, but without limitation, the Foreign Exchange Transaction Act and regulations thereunder. None of the products described herein have been and will not be registered under the Financial Investment Services and Capital Market Act of Korea for public offering in Korea and none of the interests may be offered or sold directly or indirectly, in Korea or to any resident of Korea or to any persons for re-offering or resale, directly or indirectly in Korea or to any resident of Korea (as defined under the Foreign Exchange Transaction act of Korea and its Enforcement Decree), except as permitted under the applicable laws and regulations of Korea.