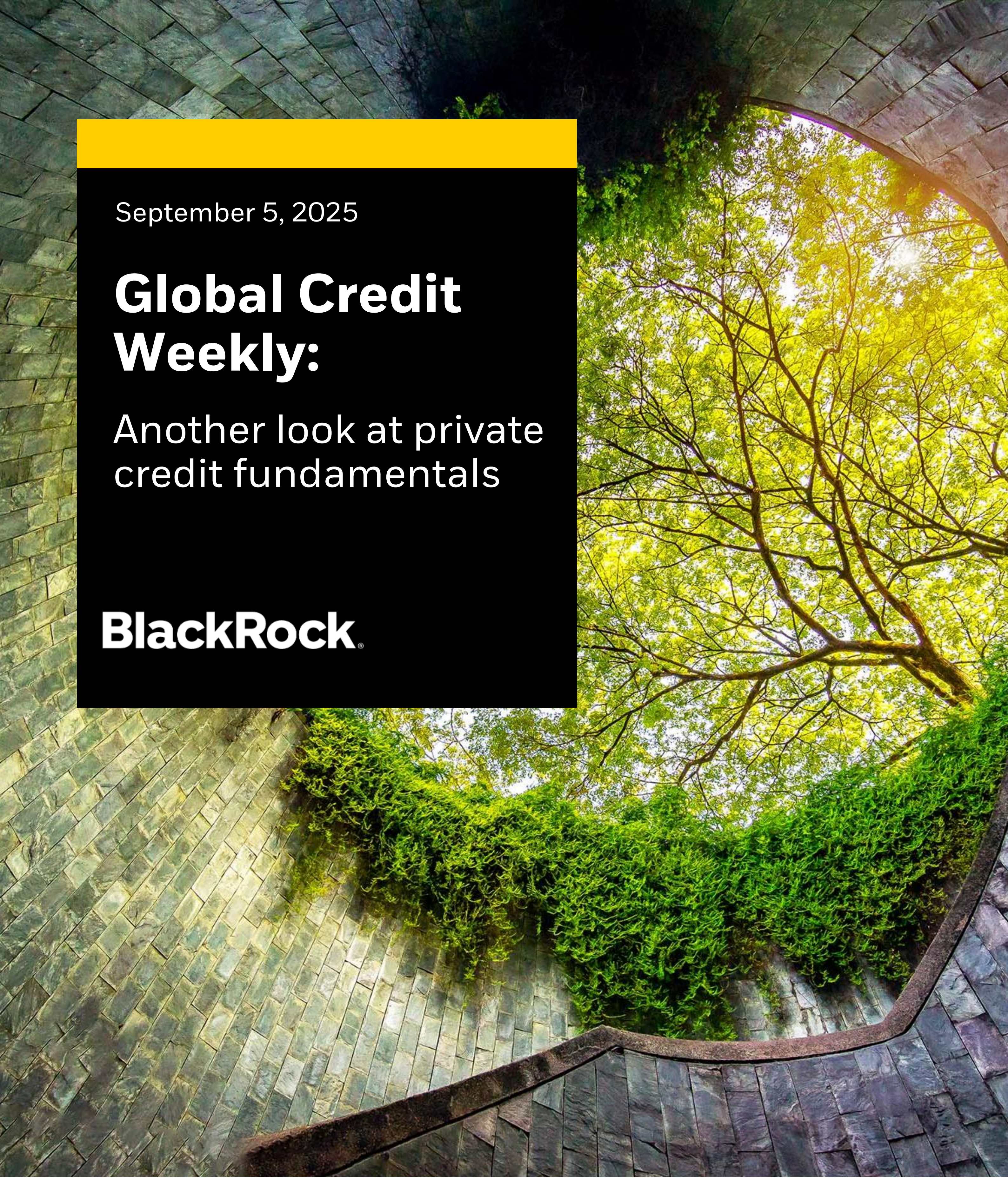

September 5, 2025

Global Credit Weekly:

Another look at private credit fundamentals

BlackRock

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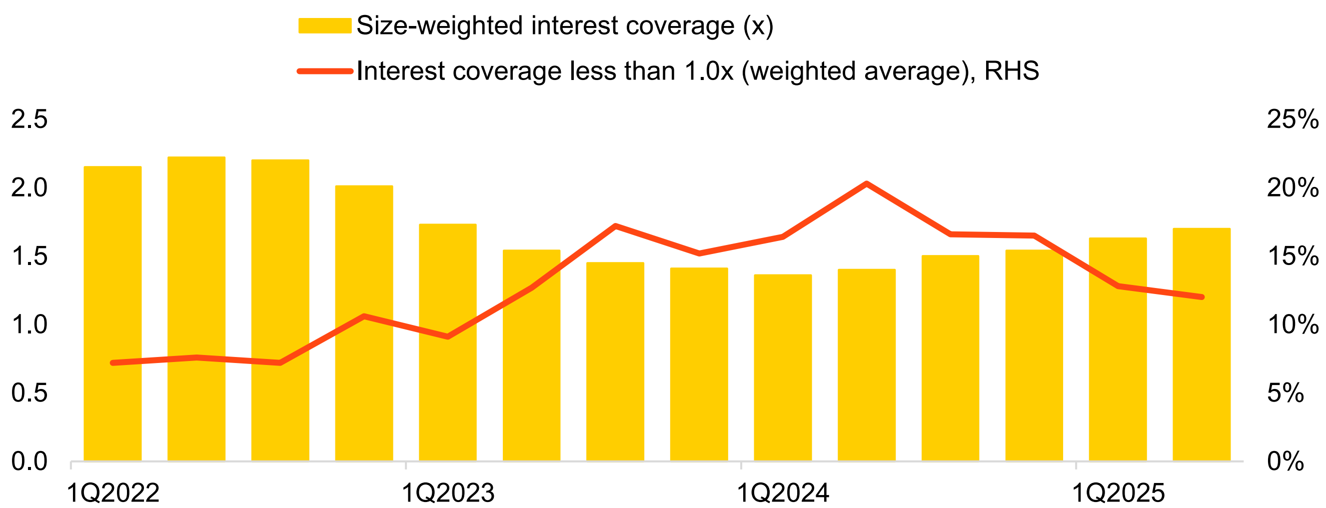
Key takeaways

- Our base case for the past several months has been for a somewhat more challenging growth-inflation mix in the U.S., as economic activity moderates from the above trend pace of 2023-2024, and inflation remains modestly above the Federal Reserve's (Fed) 2% target. Against this backdrop, we anticipate the Fed's rate cutting cycle – which began in September 2024 and has been on pause so far in 2025 – will ultimately resemble 'normalization' cuts to lessen the degree of the restrictive stance, vs. a deep 'easing' into accommodative territory.
- This macroeconomic landscape has refocused market participants on the degree of fundamental strength in the corporate credit market. As we have highlighted previously, the signaling from liquid credit has been generally constructive – albeit with some pockets of stress amid elevated dispersion – as the market continues to climb the so-called 'wall of worry'. This leaves us comfortable with our view to *selectively* move down in quality, to capture incremental yield.
- In this *Global Credit Weekly*, we turn our attention to the private credit market, refreshing our fundamental analysis from early June. Our review of the 2Q2025 data released from a range of third-party data sources reveals incremental improvements in interest and fixed charge coverage ratios, realized loss rates which remain below historical average levels, and the largest magnitude of aggregate EBITDA growth in multiple years.
- That said, dispersion remains evident across a range of factors, including company size, sector, and vintage. And away from the more 'traditional' credit metrics, we are closely monitoring trends – and important nuances – related to payment-in-kind (PIK) utilization, covenant defaults, and non-accrual rates, as potential signposts to watch as catalysts for additional dispersion. In our view, this underscores the importance of manager selection, credit underwriting and structuring, workout expertise, and origination capabilities, among other variables.

Exhibit 1: U.S. private credit interest coverage metrics improved in 2Q2025
Size-weighted interest coverage ratios for U.S. firms tracked by Lincoln International's Proprietary Private Market Index, and the weighted average share of firms with interest coverage less than 1.0x (RHS).

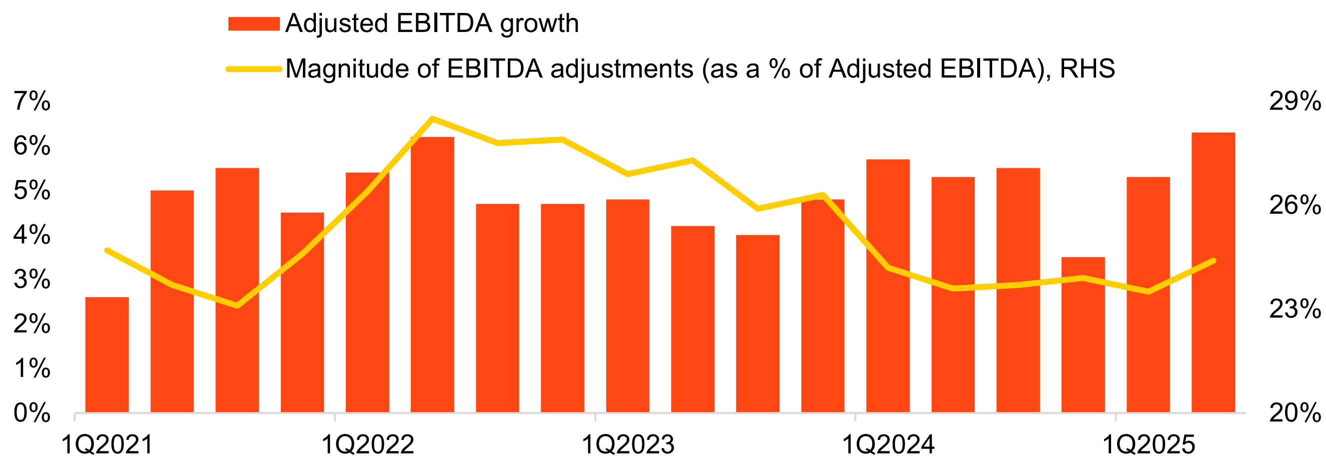


Source: Lincoln International Proprietary Private Market Database, BlackRock. As of 2Q2025 (most recent). Interest coverage = LTM EBITDA / Interest.

Incremental fundamental improvement, in aggregate…

We first start with the Lincoln International Proprietary Private Market Database, which conducts quarterly valuations for over 6,250 portfolio companies and is estimated to capture 30% of all U.S. private equity-backed companies. In 2Q2025, 63.4% of U.S. companies tracked by Lincoln reported an increase in adjusted EBITDA, which is above the historical average of 60.6% (Exhibit 2). Average adjusted EBITDA growth was 6.3%, up from 5.3% in 1Q2025 and the highest level in the last five years. Additionally, the level of EBITDA adjustments in 2Q2025 was not outsized relative to the past few years (again, Exhibit 2).

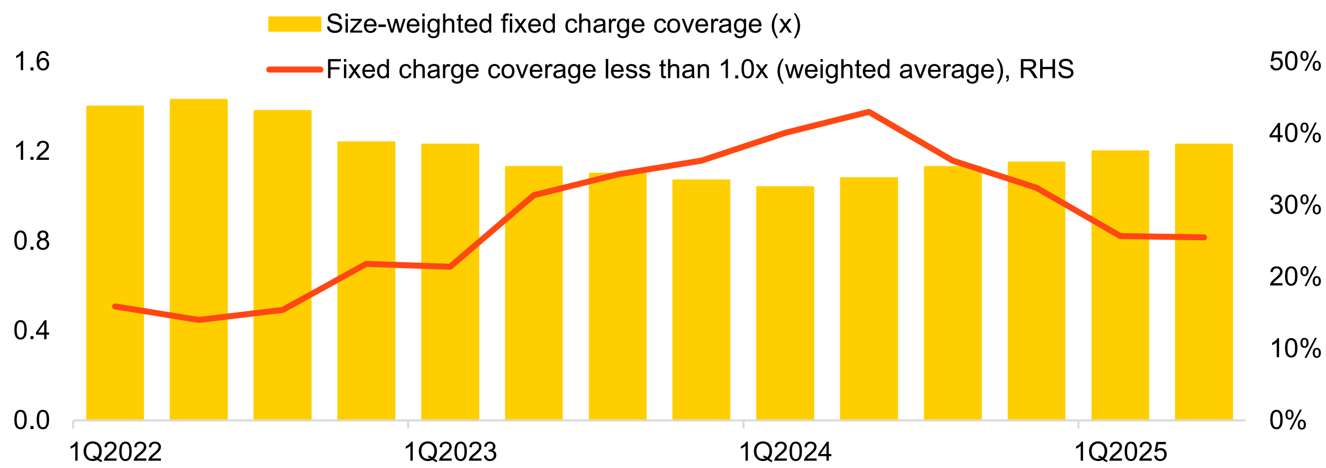
Exhibit 2: EBITDA growth in 2Q2025 was the highest in the past five years
Adjusted EBITDA growth (last twelve months, year-over-year) for U.S. firms tracked by Lincoln International's Proprietary Private Market Index, and the magnitude of EBITDA adjustments (RHS)



Source: Lincoln International Proprietary Private Market Database, BlackRock. As of 2Q2025 (most recent).

Additionally, as Exhibits 1 and 3 illustrate, interest and fixed charge coverage (FCC) ratios (also tracked by Lincoln International), improved slightly in 2Q2025, extending the trend of the past few quarters. The share of firms with very weak interest coverage ratios (i.e., below 1.0x) declined modestly, while the share of firms with FCC below 1.0x remained stable.

Exhibit 3: Fixed charge ratios showed some modest improvement in 2Q2025
Size-weighted fixed charge coverage (FCC) ratios for U.S. firms tracked by Lincoln International's Proprietary Private Market Index, and the weighted average share of firms with FCC less than 1.0x (RHS)



Source: Lincoln International Proprietary Private Market Database, BlackRock. As of 2Q2025 (most recent). Fixed Charge Coverage = (LTM EBITDA – Taxes - Capex) / (Interest Expense + (1% * Total Debt)). Capital Expenditures ("Capex") utilizes LTM Capex by default. If LTM Capex is not available, NFY Capex is utilized, and LFY Capex if both LTM Capex and NFY Capex are unavailable.

…but dispersion persists

The theme of dispersion has long been evident under the surface of private credit, and our analysis of the most recent data suggests this trend remains a defining feature of the asset class. This is consistent with the themes we have previously highlighted across U.S. consumer credit, commercial real estate, and liquid credit.

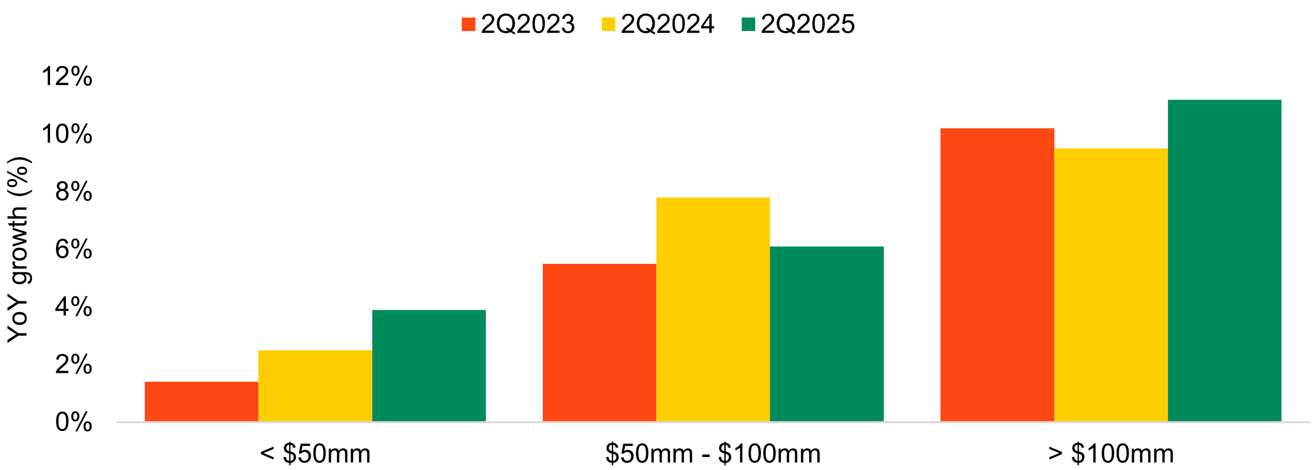
For private credit, such dispersion underscores the importance of manager selection, credit selection (vintage, sector, issuer), underwriting expertise, workout capabilities and origination opportunities.

Exhibits 4 and 5 use data from Lincoln International to demonstrate how two elements of dispersion – borrower size and industry exposure – have corresponded to variations in LTM adjusted EBITDA growth over the last three years. While EBITDA growth was positive across all company size categories, larger borrowers have generated higher growth rates, likely reflecting the incremental financial flexibility and resources often available to more scaled companies.

That said, EBITDA growth by industry shows more variation from year to year. For example, EBITDA growth rates for consumer companies have fluctuated by nearly 7 percentage points from 2Q2023 to 2Q2025, compared to business services, which have changed less than 1 percentage point.

Exhibit 4: EBITDA growth has favored larger borrowers

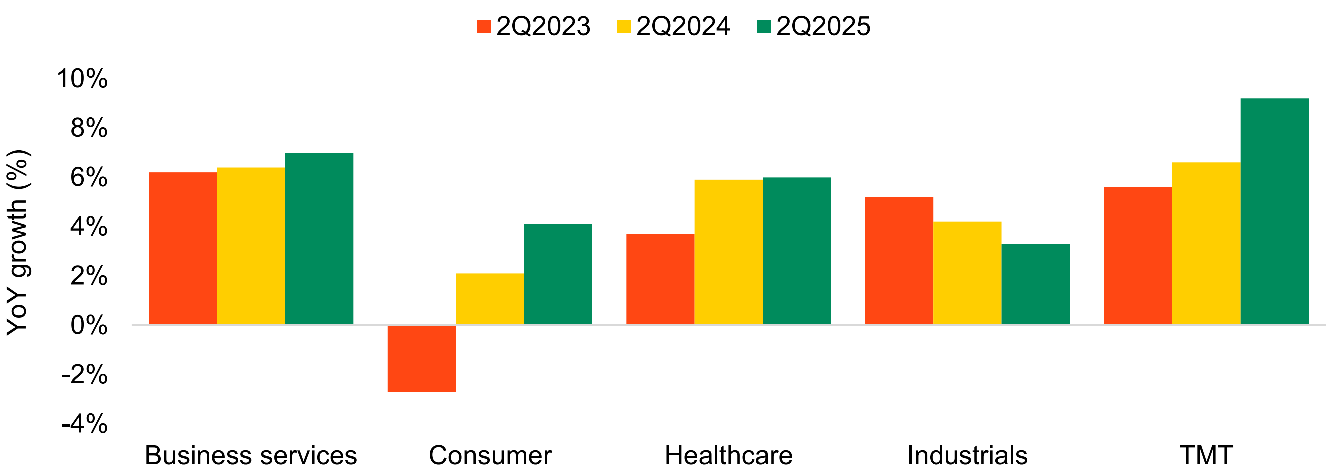
Year-over-year, last-twelve-months' adjusted EBITDA growth, by company size (annual EBITDA)



Source: Lincoln International Proprietary Private Market Database, BlackRock. As of 2Q2025. © 2025 Lincoln Partners Advisors LLC. All rights reserved. Used with permission. Third-party use is at user's own risk.

Exhibit 5: Some sectors have demonstrated more variation in EBITDA growth rates

Year-over-year, last-twelve-months' adjusted EBITDA growth, by industry



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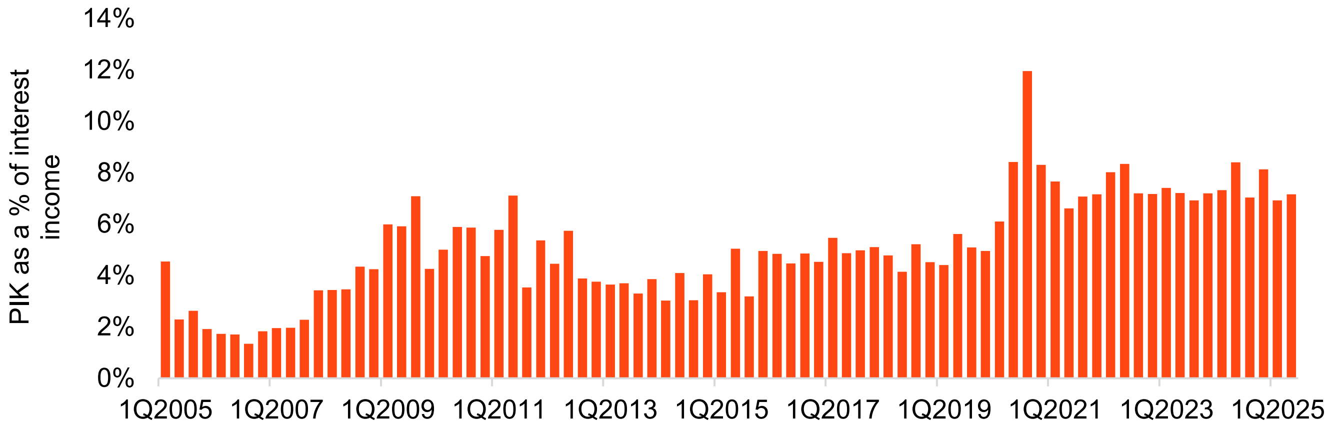
PIK: directionally informative, but requires nuance

Beyond these more 'traditional' credit metrics, we are also closely monitoring payment-in-kind (PIK) utilization, covenant defaults, and non-accrual rates – all of which can provide incremental insight into potential fundamental pressures and possible catalysts for additional dispersion.

PIK interest is defined as interest that is 'paid' in the form of additional non-cash principal, as opposed to cash interest. While there are various ways to track PIK utilization, we believe monitoring PIK as a percentage of total interest income is among the most informative. Exhibit 6 demonstrates this metric for the Cliffwater Direct Lending Index (CDLI), which has remained rangebound since 2021, averaging 7.4%. The CDLI is an index of over 20,000 USD middle market loan holdings, representing over $485 billion in assets under management (AUM). We view it as a proxy for the U.S. direct lending market, which is the largest strategy by AUM in the private credit universe (per Preqin).

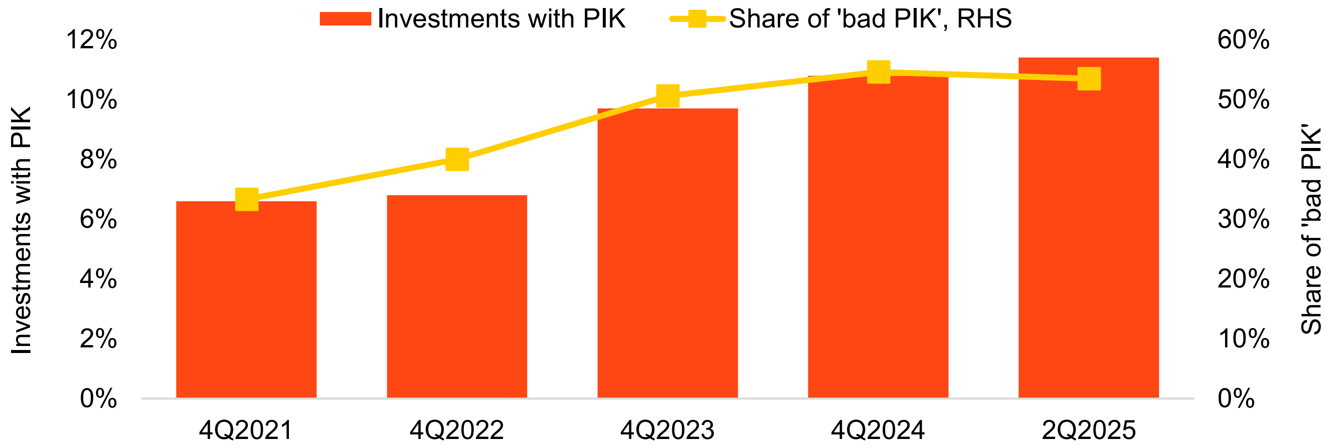
That said, the label of 'PIK' is nuanced. When included as an option for a borrower in the *original* credit documents (to provide additional flexibility to invest in near-term growth prospects), the presence of PIK may not, in isolation, signal stress. By contrast, PIK that is amended into a credit agreement *after* origination, may indicate (unanticipated) stress. An analysis from Lincoln International draws a distinction between so-called 'good PIK,' and 'bad PIK.' As of 2Q2025, Lincoln International estimates that 11% of investments reviewed have a PIK option, and about half of those with a PIK option have 'bad PIK' which was added after the time of underwriting (Exhibit 7).

Exhibit 6: PIK as a percentage of total interest income has remained range-bound since 2021
Payment-in-Kind (PIK) as a percentage of total interest income for the Cliffwater Direct Lending Index



Source: Cliffwater Direct Lending Index, BlackRock. As of June 30, 2025 (most recent).

Exhibit 7: The share of investments with 'bad PIK' has edged down vs. late 2024
For the U.S. companies tracked by Lincoln International, the share of total investments with PIK interest, and the share of PIK-paying investments with 'bad PIK' (i.e., without PIK at close, but have PIK now), RHS



Source: Lincoln International Proprietary Private Market Database, BlackRock. As of 2Q2025. Used with permission. Third-party use is at user's own risk. Data represented above considered Senior and Unitranche Term Loans.

PIK utilization trends also emphasize dispersion

In line with the theme of dispersion, data from Lincoln International suggests that 'bad PIK' is more prevalent in smaller borrowers than larger ones. As demonstrated by Exhibit 8, 65% of loans with 'bad PIK' are attributed to borrowers with less than $50 million in EBITDA. This likely reflects a variety of factors, including the more limited financial flexibility of some smaller borrowers, for example. Further, larger borrowers, especially those with demonstrated access to syndicated markets, are more likely to secure PIK optionality in their original credit agreement (i.e., 'good PIK'), as private lenders may seek to entice the high-quality borrower to obtain financing from the private credit markets.

Data from KBRA's Direct Lending Index – an index of roughly 2,700 U.S. companies, with approximately $225 billion in private loans outstanding – unsurprisingly links PIK with a higher risk of financial stress. Indeed, 65% of issuers on KBRA DLD's "Default Radar Red" list, which suggests the borrower is at high risk of default, are currently using PIK interest. This compares to 14% in KBRA's broader loan universe (Exhibit 9). In our view, this dispersion highlights the importance of asset selectivity and active portfolio management. It also underscores the importance of nuance in understanding how PIK interest can reflect stress across the private credit universe as well as the borrower-specific terms of the PIK arrangements.

Exhibit 8: Smaller businesses represent a larger share of 'bad PIK'

Share of 'bad PIK' investments, or investments without PIK at close that have PIK now, by issuer's EBITDA

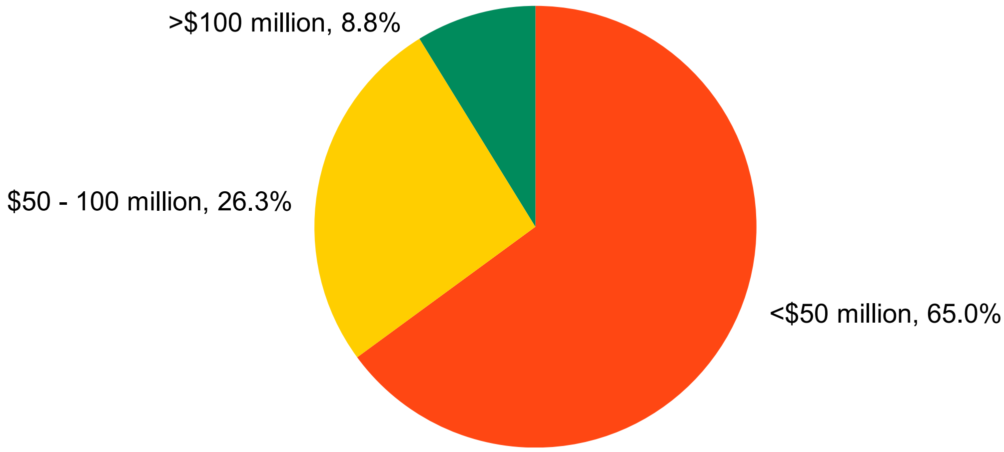


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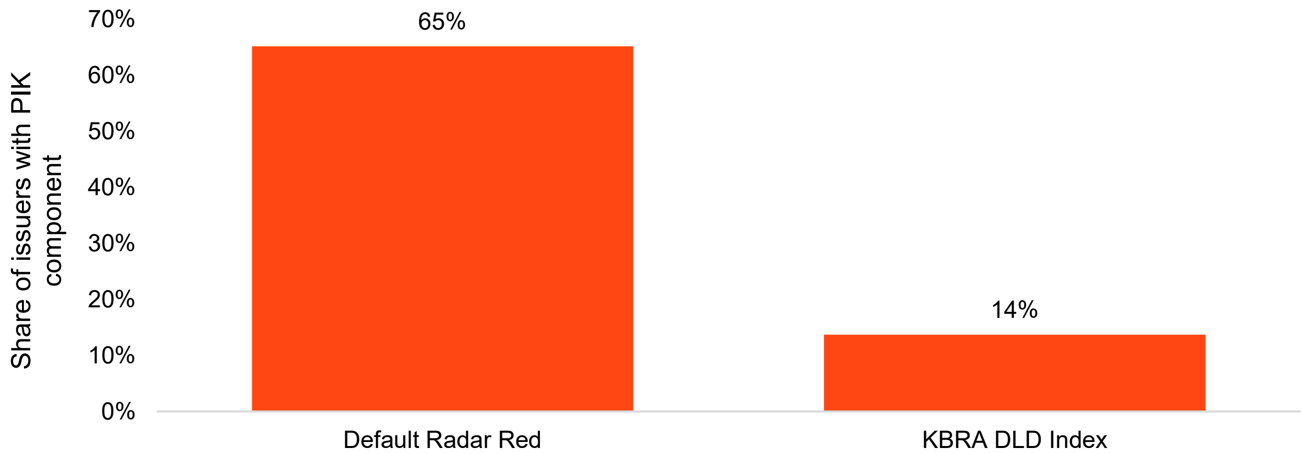
Exhibit 9: Data from KBRA DLD suggests stressed firms use PIK interest at a higher rate

Share of total issuer count using PIK interest in KBRA DLD's "Default Radar Red" list and broader Direct Lending Index



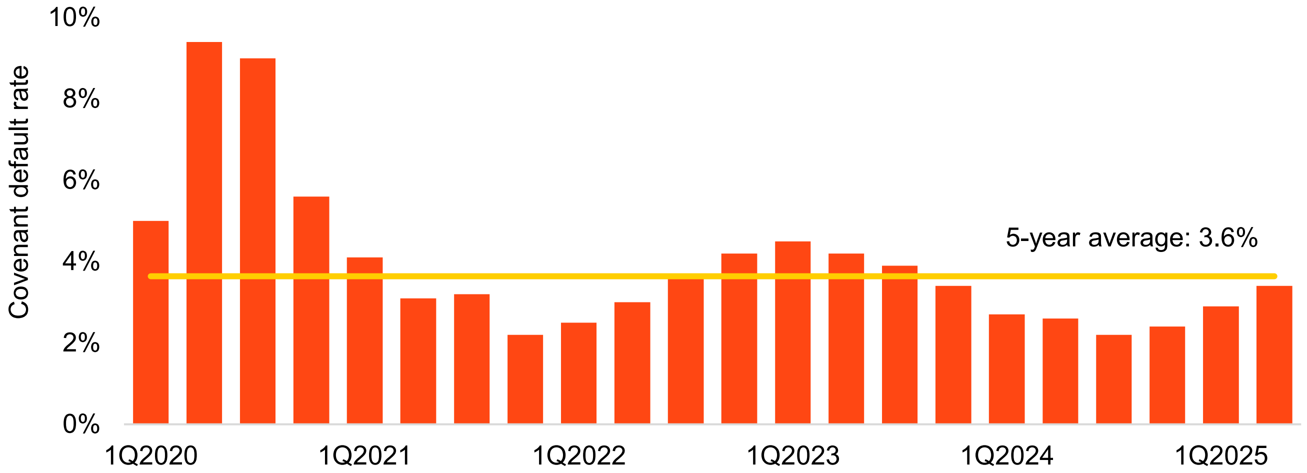
Source: KBRA DLD Default Research, BlackRock. As of August 19, 2025. KBRA DLD's Default Radar list is a color-coded watchlist capturing 197 companies. The "Red" segment, which captures 129 issuers as of August 2025, indicates KBRA DLD's perspective that the credit is at risk of default. Issuers appearing on the list are not guaranteed to default. Several factors are considered for inclusion, such as fair values. In general, issuers marked below 80 are contenders for Red status. Other factors include non-accrual status, fair values over time, maturity date, spread and industry.

Covenant defaults tick up, but losses remain contained

Beyond PIK, the directional trend in covenant defaults is also closely monitored by many market participants, as a barometer of potential financial pressure within private credit. From early 2023 through late 2024, the aggregate covenant default rate tracked by Lincoln International showed a consistent trend of improvement (i.e., decline). But over the past few quarters, the covenant default rate has increased: to 3.4% as of 2Q2025, compared to 2.2% in 3Q2024. Still, the aggregate covenant default rate is modestly below the five-year average of 3.6% (Exhibit 10).

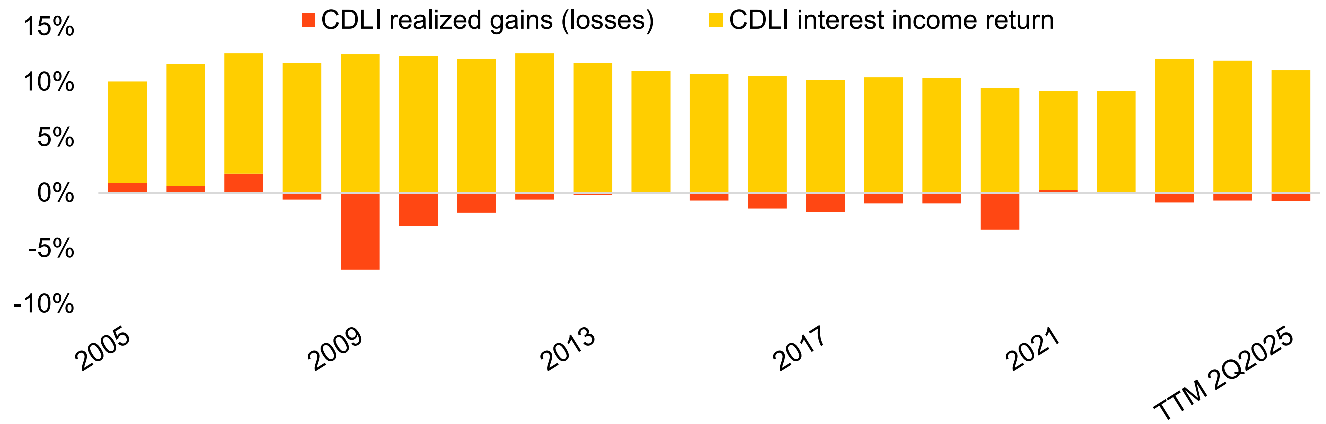
It is also important to note that a covenant default does not necessarily translate into a monetary default. For this reason, we view realized loss rates as more informative than covenant default rates. As Exhibit 11 illustrates, twelve month trailing realized losses for the Cliffwater Direct Lending Index in 2Q2025 of 75bp remained below the 10-year average of 104bp.

Exhibit 10: Covenant defaults ticked up in 2Q2025, but remain below the 5-year average
Aggregate size-weighted covenant default rate, and the 5-year historical average, for the U.S. portfolio companies included in the Lincoln International Proprietary Private Market Database



Source: Lincoln International Proprietary Private Market Database, BlackRock. As of 2Q2025. A default is defined by Lincoln as a covenant default (not necessarily a monetary default). The calculation is size-weighted and considers the total net debt balance for each of the portfolio companies that had a defaulting security in the respective quarter.

Exhibit 11: Realized losses for the Cliffwater Direct Lending Index were contained through 2Q
Trailing 12-month interest income return and realized gains (losses) for the Cliffwater Direct Lending Index (CDLI)

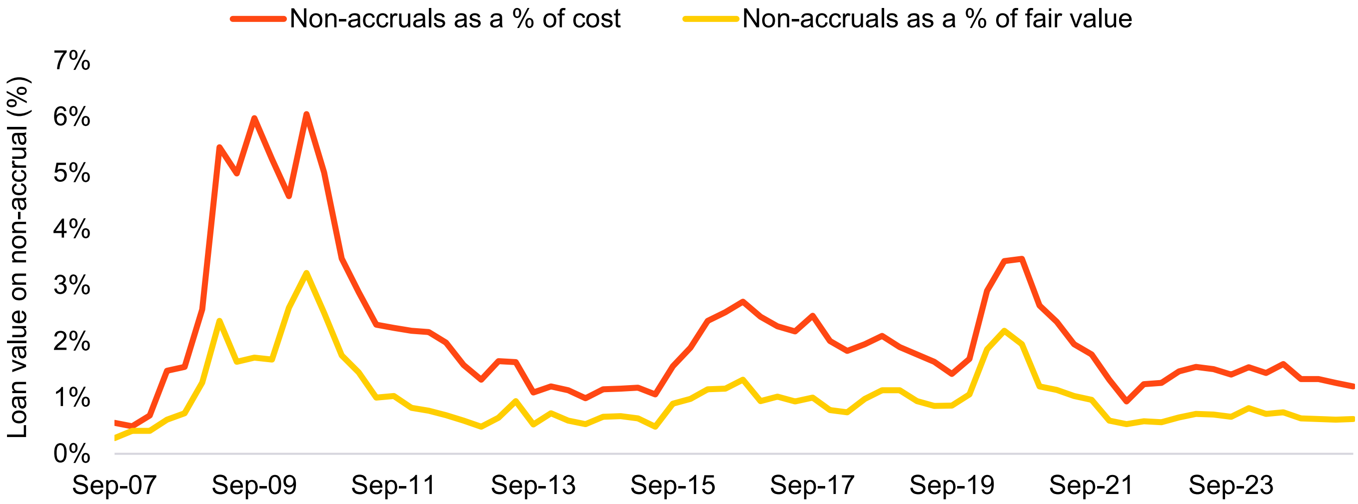


Source: Cliffwater Direct Lending Index, BlackRock. As of June 30, 2025 (most recent available). Realized gains in the CDLI can be driven by equity stubs, warrants, and gains on exited investments. These were more common in 2005-2007, when second lien and mezzanine loans were a greater portion of the CDLI. We exclude unrealized gains and losses in this chart. Long-term unrealized gains (losses) are approximately zero, as they either convert to net realized losses upon a credit default or are reversed when principal is fully repaid. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged, and one cannot invest directly in an index.

Additionally, non-accrual rates, which capture loans that are no longer current in paying interest income and would be considered in default, have continued at modest levels for the CDLI since 2021, even as the covenant default rate for the Lincoln International universe has modestly increased. As of 2Q2025, roughly 1.2% of the CDLI's loan value at cost was on non-accrual, suggesting $5.8 billion in aggregate value (Exhibit 12).

Exhibit 12: Non-accrual rates remain low by historical standards

Non-accrual rates (as a percentage of cost and fair value) for the Cliffwater Direct Lending Index



Source: Cliffwater Direct Lending Index, BlackRock. As of 2Q2025.

Unless otherwise stated, all reference to $ are in USD.

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Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

Changes in the rates of exchange between currencies may cause the value of investments to diminish or increase. Fluctuation may be particularly marked in the case of a higher volatility fund and the value of an investment may fall suddenly and substantially. Levels and basis of taxation may change from time to time.

Cliffwater Direct Lending Index (CDLI) is an index that assists investors to better understand private credit as an asset class. The CDLI seeks to measure the unlevered, gross of fees performance of U.S. middle market corporate loans, as represented by the underlying assets of Business Development Companies ("BDCs"), including both exchange-traded and unlisted BDCs, subject to certain eligibility criteria. The CDLI is an asset-weighted index that is calculated on a quarterly basis using financial statements and other information contained in the U.S. Securities and Exchange Commission ("SEC") filings of all eligible BDCs. Eligibility is set as all assets held by BDCs that (1) are regulated by the SEC as a BDC under the Investment Company Act of 1940; (2) have a substantial majority (approximately 75%) of reported total assets represented by direct loans made to corporate borrowers, as categorized by each BDC and subject to Cliffwater's discretion, and (3) file SEC form 10-Q (or 10-K, as applicable) within 75 (or 90) calendar days following the current Valuation Date. If a BDC meets the eligibility criteria, but has not filed its report on Form 10-K or 10-Q with the SEC at the time the index is reconstituted, asset information from its report will be included in the index at the time of the next reconstitution. This information is derived from sources that are considered reliable, but BlackRock does not guarantee the veracity, currency, completeness or accuracy of this information.

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