

The Bigger PIK-ture

Bringing Clarity to Payment-in-Kind Structures in Private Credit

Some commentators have described payment-in-kind (PIK) interest as being everywhere and always a sign of borrower distress. In reality, private credit providers often offer PIK to the very best borrowers. For good borrowers, PIK options (whether utilized or not) can enhance borrower flexibility and increase both equity and lender returns. When structured thoughtfully, PIK options can support growth, preserve liquidity, provide an alternative to more expensive equity financing and align with long-term value creation. This paper explores the forms, timing and intent behind PIK, helping investors distinguish between cases where PIK is a sign of strength and where it is a sign of weakness. The key is not to fear PIK but to understand it.

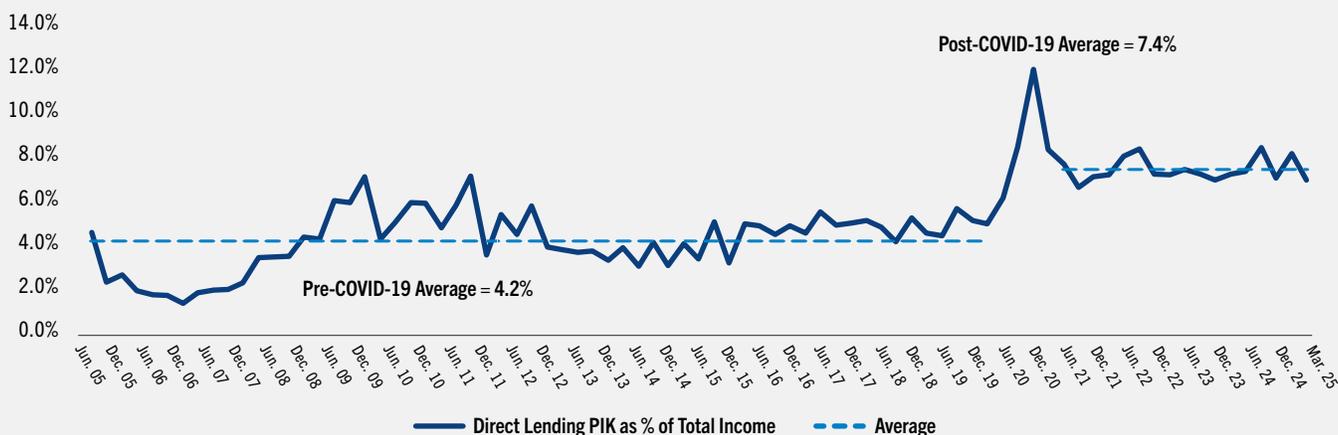
The Growth of PIK in Private Credit

Over the past decade, and particularly since the COVID-19 pandemic, PIK interest has evolved from a niche structuring tool into a mainstream feature of private credit (see Exhibit 1). This expansion has also sparked concern—and, at times,

confusion—among investors. A frequently asked question is, “What percentage of the portfolio is PIK?” Often, this single number is used (incorrectly) as a proxy for assessing portfolio stress, rooted in the historical association of PIK with distressed borrowers or subordinated debt—typically used when companies lack the liquidity to service cash interest.

However, this view is increasingly being seen as outdated.

Exhibit 1
PIKing Up the Pace in Private Credit



In today's direct lending environment, PIK has also become a flexible, strategic feature—not just a signal of distress. Private credit lenders are now incorporating PIK into select new senior secured loans as part of a customized financing solution designed to accelerate growth. In these cases, PIK is not a red flag. It is a feature, not a flaw: It gives borrowers the flexibility to reinvest cash into expansion while enhancing lender economics through higher yields.

In other scenarios, of course, PIK may be introduced to support a borrower facing financial pressure. In those cases, too, it is typically accompanied by improved terms for the lender and/or additional support from the private equity sponsor, such as a cash equity infusion. These structures can preserve value and create a bridge to recovery rather than signal inevitable impairment.

Understanding these nuances is essential to accurately assessing the risk and opportunity that PIK presents in a modern credit portfolio.

Unpacking PIK

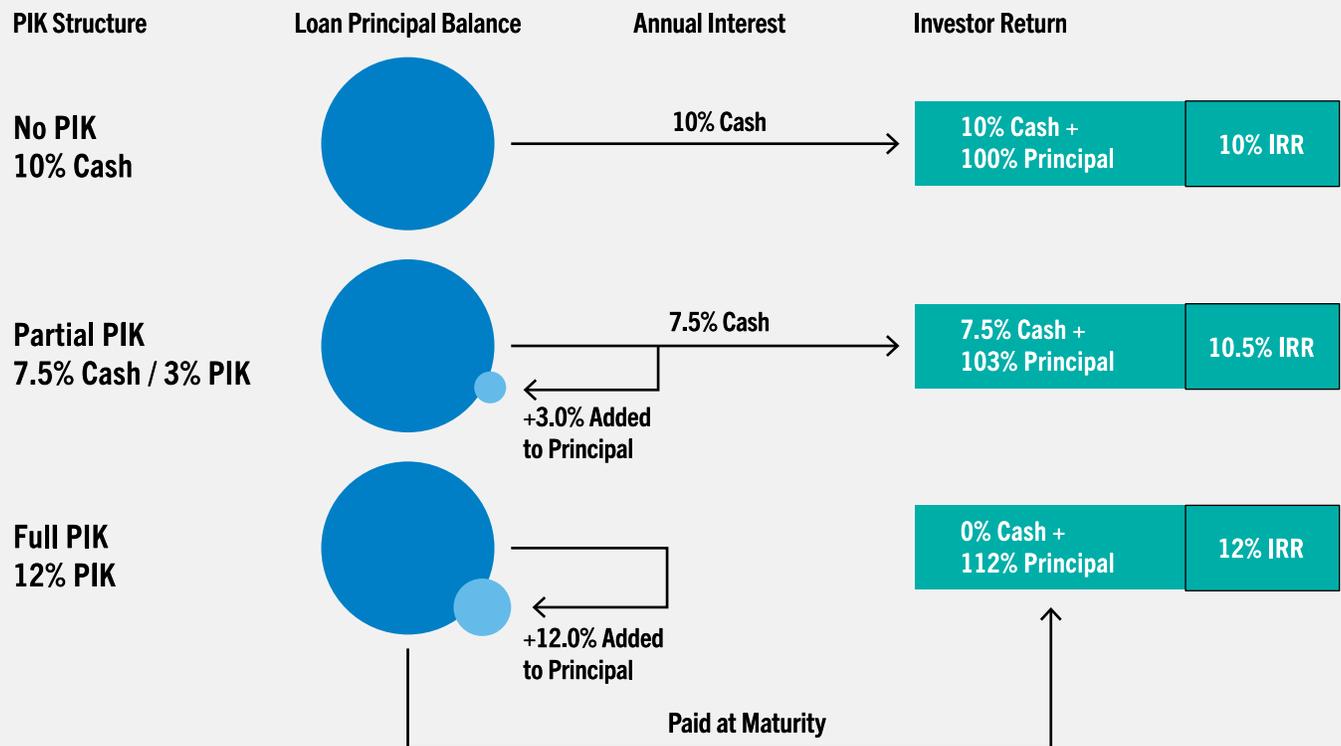
At its core, PIK interest is a mechanism that allows borrowers to defer cash interest payments by capitalizing them—essentially adding the accrued interest to the principal balance of the loan. This structure enhances borrower liquidity (allowing them to use cash for other purposes, not the payment of quarterly loan interest), while lenders are compensated through a growing loan balance and, typically, a higher overall yield.

The PIK payment structure can take several forms, each with distinct implications for both borrower and lender.

- 1. Partial PIK:** This is a hybrid structure where a portion of the interest is paid in cash, and the remainder is capitalized. This approach balances liquidity management with lender cash flow (with modestly lower cash flows but higher principal and total return).
- 2. Full PIK:** In this case, all interest is paid in kind, with no cash interest component. This structure maximizes cash preservation for the borrower while generating higher returns for the lender via a higher non-cash interest rate and compounding returns (based on higher principal amounts).

Exhibit 2

PIK Now, Pay (More) Later



Source: Golub Capital internal analysis. For illustrative purposes only.

Evaluating PIK: Context, Timing and Borrower Health

PIK interest is often misunderstood as a blanket indicator of borrower distress. A common investor question—“What percentage of the portfolio is paying PIK?”—oversimplifies a nuanced credit feature. The reality is that PIK must be evaluated through the lens of its context, timing and underlying borrower fundamentals.

PIK at Origination: A Strategic Tool

When PIK is structured at the time of origination—particularly for healthy, resilient businesses—it is typically part of a deliberate, risk-calibrated strategy. In these cases, PIK is negotiated to support growth, manage liquidity or align with a borrower’s capital deployment plan. Far from being a red flag, this form of PIK can enhance flexibility and enable value creation without compromising credit quality.

PIK “Toggle”: For Borrower Optionality

PIK toggle structures, which allow borrowers to switch between cash and in-kind interest at will, introduce more complexity. PIK toggles are typically temporary in nature, often lasting two years, and are designed to provide short-term flexibility. The rationale behind the toggle is critical. A borrower opting for PIK to reinvest in high-return growth opportunities presents a vastly different credit profile than one toggling due to liquidity constraints or deteriorating fundamentals. In this case, investor judgment and borrower transparency are key.

“Mid-Life” PIK Amendments (Restructured PIK): A Signal, Not a Sentence

When PIK is introduced mid-loan via amendment, it typically reflects emerging stress. This may indicate a weakening financial position or a need to preserve cash. However, it can still be a value-preserving move—particularly when paired with meaningful concessions from the borrower, such as a sponsor equity infusion or an operational turnaround plan. In these cases, lenders may view temporary PIK relief as a bridge to recovery, not a path to impairment.

The bottom line: context is everything. PIK should not be viewed as inherently good or bad. Instead, it should be assessed based on:

- The timing of its implementation
- The rationale behind its use
- The underlying health and trajectory of the borrower

When tied to a fundamentally sound business, PIK can be a smart, risk-adjusted feature that supports long-term value creation. When linked to a distressed borrower, it may signal elevated risk. Even then, however, it can be part of a thoughtful restructuring strategy. For investors, the key is not to fear PIK but to understand it. A nuanced view enables better risk assessment, more informed portfolio monitoring and, ultimately, stronger credit outcomes.

Exhibit 3

A Quick Peek: A Framework for Understanding PIK

Less Risky

PIK at Origination

- Borrower and lender agree to let loan PIK at the loan’s reception
- Lender has insight into how cash savings will be used

PIK Toggle

- Borrower can choose between a cash or PIK coupon
- Lender has less certainty if they will receive a cash coupon

More Risky

Restructured PIK

- PIK introduced to a loan that previously had no PIK optionality
- This is not ideal as it potentially shows growing distress in a borrower

Ultimately, PIK should be evaluated through the lens of the borrower’s current financial health, liquidity position and strategic intent. Its implementation can signal either prudent capital management or emerging stress—context is key to determining whether its use is constructive or concerning.

Note: Synthetic PIK is excluded from this chart. Synthetic PIK refers to situations where a borrower uses another form of debt, such as drawing on a revolving credit facility or delayed draw term loan, to fund cash interest payments. While not as contractually structured as PIK, it has a similar economic effect by increasing leverage and preserving cash, effectively adding debt to the borrower’s balance sheet.

Source: Golub Capital internal analysis. For illustrative purposes only.

A Deeper Dive: What's Driving the Growth in PIK?

The recent rise in PIK interest across direct lending markets has prompted an important question from investors: “Is this a sign of growing borrower stress or a reflection of private credit’s evolving sophistication?” As with most credit dynamics, the answer is nuanced. There are two fundamental drivers behind the rise in PIK.

PIK as a Competitive Structuring Tool

One key driver of the growth of PIK is its increased use as a proactive structuring feature that lenders can deploy for prospective borrowers. Direct lenders are including PIK—particularly toggle features—at origination to offer more flexible, bespoke financing solutions that appeal to sponsors and borrowers. PIK gives borrowers more tools in their toolkit to navigate changing environments, allowing them to manage interest obligations across a range of base rate scenarios or other potential liquidity headwinds. Private direct lenders may view their provision of PIK as a powerful inducement when

dealing with larger borrowers who might otherwise seek funding in public markets (where PIK loans are much rarer).

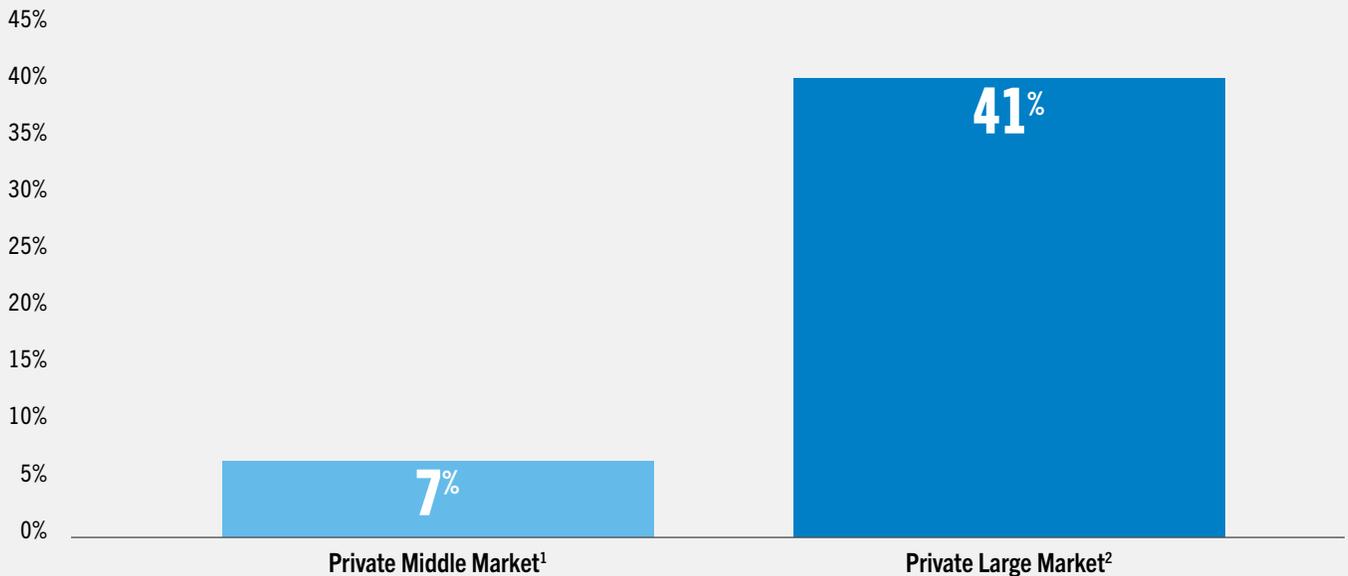
According to S&P Global, a 2024 review of over 300 private credit agreements found that 41% of large market deals (loan sizes of >\$750M) included a PIK toggle feature, compared to just 7% in the middle market (loan sizes of <\$750M) (see Exhibit 4). This underscores how the availability of PIK has become a differentiator for private direct lenders in competitive deal environments, particularly at the upper end of the market, which competes with the broadly syndicated loan market.

PIK as a Reactive Liquidity Tool

At the same time, some borrowers are turning to PIK out of necessity. During periods of higher interest rates, companies facing margin compression or liquidity constraints may activate toggle features or seek amendments to convert cash interest into partial or full PIK. These reactive uses of PIK, especially when tied to deteriorating fundamentals, can be more concerning and may signal elevated credit risk.

Exhibit 4

PIK Toggle Feature in Credit Agreements Executed in 2024



Source: S&P Global Ratings’ “Private Credit And Middle-Market CLO Quarterly: Unknown Unknowns Q2 2025”. S&P Global reviewed 304 credit agreements executed in 2024 to identify loan structures with a PIK toggle.

1. Private Middle Market comprises loans of \$750 million or less. The Private Middle Market loan data set includes 250 private credit agreements with 17 PIK toggle features.

2. Private Large Market comprises loans greater than \$750 million. The Private Large Market loan data set includes 54 private credit agreements with 22 PIK toggle features.

A Dual Narrative: Innovation and Stress

The growth in PIK reflects both structural innovation and cyclical pressure. On one hand, it enhances the private credit value proposition through flexibility and customization. On the other, it can serve as a short-term bridge for borrowers under financial strain.

Recent data illustrates this duality. Structured PIK—where PIK is embedded at origination—began rising in 2021 as lenders increasingly used it to offer bespoke financing solutions to larger borrowers entering the market (see Exhibit 5). This trend leveled off by 2023, suggesting normalization of the feature in deal structuring. In contrast, materially modified PIK—defined as amendments where the PIK spread increases by 250 basis points or more—began climbing in late 2022, coinciding with

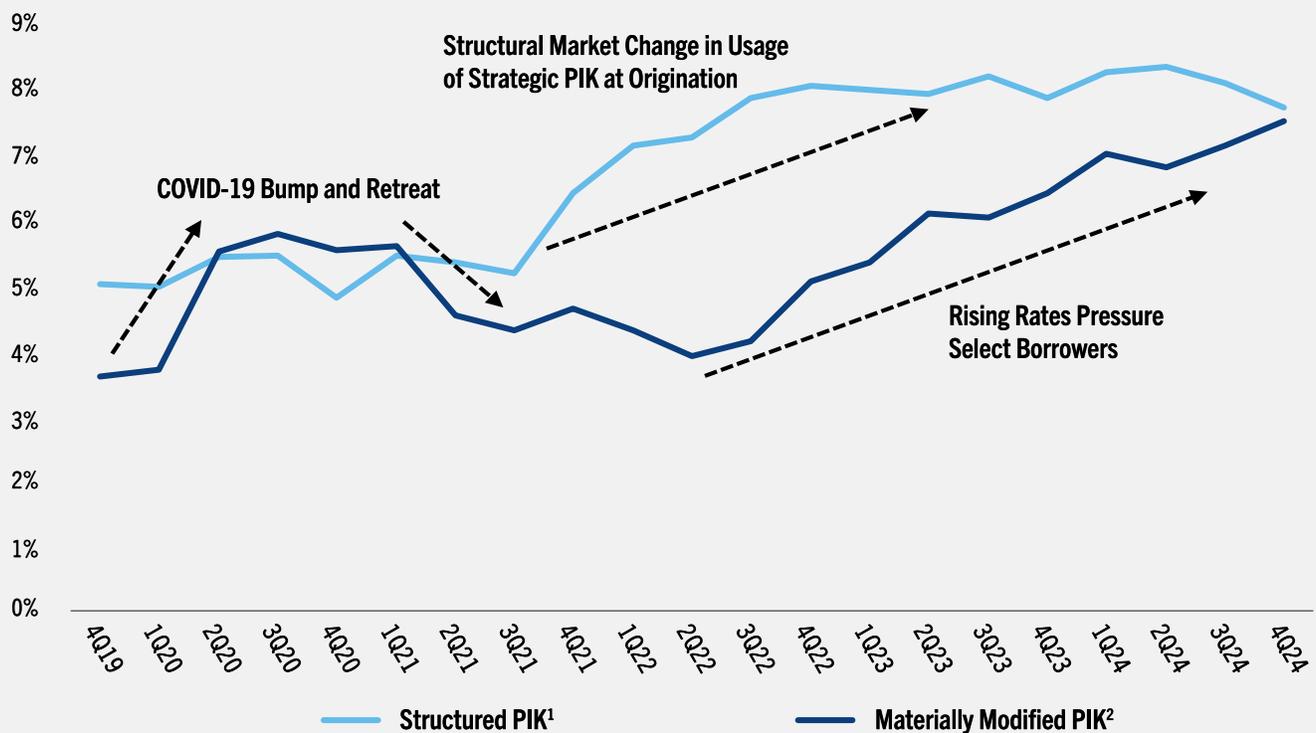
the lagging impact of the Federal Reserve’s rate hikes as borrowers sought relief from rising debt service costs.

Importantly, structured PIK and materially modified PIK have contributed roughly equally to the rise of PIK over the past four years, underscoring that this growth is driven by a blend of structuring innovation and reactive adjustments, not by a single factor. Together, these trends reinforce the fact that PIK growth is not monolithic. Understanding which dynamic is at play is essential to interpreting the credit signal behind PIK.

Exhibit 5

Drivers Behind the Rise of PIK

Weighted Average Portfolio Composition with PIK—Competitive Structuring versus Reactive Liquidity Tool PIK



Source: Golub Capital internal analysis utilizing the underlying data set provided by Raymond James Research. The data set represents approximately \$160 billion in business development company assets under management as of December 31, 2024.

1. Structured PIK refers to loans that included a PIK component at origination, where the PIK spread has not materially changed post-origination (defined as a change of less than 25 basis points).
2. Materially Modified PIK refers to loans where a PIK component was either introduced post-origination or the existing PIK spread had increased by 250 basis points or more.

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