TELLARO CAPITAL PARTNERS

Investment Committee Insights

October 2026

Institutional Private Credit | Senior Secured Lending



Paper Income

In September the cost of capital rose; in October the strain it had been deferring began to show. Non-accruals climbed, net asset values fell at nearly every lender, and a rising share of reported yield was interest accrued rather than cash collected. Income booked is not income received.

Reporting period: calendar month ended October 31, 2026. Data and transaction information are derived from publicly available sources. Estimates and approximations are identified where applicable.

~6.9%	6.3%	-5%	9.3-10%
MEDIAN PIK SHARE OF INCOME	**BROAD DEFAULT RATE**	**MEDIAN BDC NAV, YOY**	**UNITRANCHE ALL-IN YIELD**
Up to 24.7% at some funds. Income booked, not yet collected in cash.	Fitch's August record; 47% is extensions, PIK, or missed interest.	Lower at 34 of 36 funds. The marks have started to move.	Up ~35 bps in the quarter, entirely from the base rate.

MARKET THESIS

The Federal Reserve held rates on October 28, leaving the target range at 3.75% to 4.00% after September's hike, but the decision was split: two governors dissented in favor of a further increase, and the chair kept a December move firmly in view. A pause is not a pivot. For borrowers carrying floating-rate debt the cost of capital stopped climbing for a month without coming down, and the reported results that arrived during October showed what the preceding year of elevated rates had been quietly storing up.

Underwriting comes down to three judgments: where a loan attaches, whether its cash flow is defensible rather than merely recurring, and whether its structure preserves value. October tested the second in an unusually literal way. Across the largest lenders a growing share of reported income was payment-in-kind, interest accrued to principal rather than received in cash, and non-accruals rose while net asset values fell at 34 of 36 business development companies. The reported yield on private credit has rarely looked better; the cash behind it has rarely been more in question.

The implication is that the quality of income now matters more than its headline level. A loan paid in kind is a loan whose borrower could not pay in cash, dressed as a loan performing normally, and a book that reports a 10% yield while a rising fraction of it capitalizes is reporting a return it has not collected. Accordingly, Tellaro underwrites to cash income and treats accrued income as a claim on a borrower already under strain, never as evidence that the credit is sound.

CREDIT SIGNALS

Three patterns in the month's reported results, read as evidence of where the strain has surfaced.

Signal 1: The strain is now in the reported numbers, not just the forecast.

Evidence. Mid-year reports filed through the fall showed listed business development companies carrying non-accruals at a median above 3% of cost, up at roughly two-thirds of funds, with 10 now above 3% and several above 5%. Net asset value per share fell at 34 of 36 funds, a median decline near 5% over the year, and net investment income failed to cover distributions at 22 of them. The ratio of downgrades to upgrades reached its worst level since the measure began in 2022.

Interpretation. For most of the cycle the case for calm was that defaults remained low. That case is weakening from inside the lenders' own statements. Falling net asset values and rising non-accruals are the marks beginning to acknowledge what a year of elevated rates did to the weakest borrowers, and uncovered distributions tell a lender that the income funding those payouts is thinner than the headline suggests. The reckoning the market kept describing as future has started to arrive.

Read-through: *weight a lender's falling net asset value and rising non-accruals more heavily than its reported yield; the first two are being measured, the third is increasingly accrued.*

Signal 2: A rising share of income is accrued, not collected.

Evidence. Payment-in-kind income reached a median near 7% of total investment income across the largest funds, and above 10% at 9 of them, with one booking nearly a quarter of its income in kind. The composition of this year's record defaults is equally telling: by one measure 47% of recent private credit defaults involved maturity extensions, payment-in-kind conversions, or missed interest, and extensions alone accounted for 41%.

Interpretation. Payment-in-kind converts a borrower's inability to pay cash into additional principal and additional reported income at the same time, flattering a lender's earnings in precisely the periods when the underlying credit is deteriorating. When nearly half of what is formally counted as default is extension or capitalization rather than loss, the headline default rate understates strain while the headline income overstates performance. Both distortions favor the appearance of health over its substance.

Read-through: *read payment-in-kind income and amendment activity as deferred loss, and discount any yield built on them before comparing one lender to another.*

Signal 3: The public market has priced it ahead of the private marks.

Evidence. Listed business development companies traded at discounts to net asset value of 10% to 20% through October, with some vehicles at 40% to 50%, while redemption requests at the largest non-traded funds averaged about 13% of shares for the quarter, down slightly but still well above the roughly 5% that quarterly programs will honor. The Federal Reserve's October hold, delivered over two dissents that wanted more, offered no relief to the rate that caused the strain.

Interpretation. The public market, which prices daily, has already written down what the private marks are only beginning to concede, and the gap between a vehicle's stated net asset value and the price a buyer will pay for it is a real-time estimate of how far the marks still have to travel. Persistent redemption pressure against capped gates says the same thing from the investor side. When traded prices and quarterly marks diverge this far, the traded price is usually the earlier and the more honest number.

Read-through: *treat the discount to net asset value as the market's estimate of unrecognized loss, and underwrite new credit as though the marks, not the prices, will move to close it.*

WHAT CHANGED IN UNDERWRITING

Loan pricing in the third quarter moved almost entirely through the base rate. Unitranche spreads held near 500 to 575 bps over SOFR, essentially unchanged, while all-in yields rose to roughly 9.3% to 10%, a quarterly increase of about 35 bps that came from the rate rather than from any widening of credit compensation. A lender is earning more, but it is being paid more for the same risk by the Federal Reserve, not more for greater risk by the market.

The strain concentrates where the arithmetic is tightest. Credits underwritten in 2021 and 2022 carry median net leverage near 6.5 to nearly 7 turns and median cash interest coverage of roughly 1.7x to 1.8x, against a covenant floor commonly set near 2.5x. Those loans were sized for a base rate that was supposed to fall; instead it rose. A borrower at 1.8x coverage has already spent most of its margin for error, and the lender's options narrow to two: insist on cash and risk the default, or accept payment-in-kind and convert a cash problem into a larger balance due later. The first records the loss; the second defers and enlarges it.

Newer vintages are better placed, underwritten near 5 turns with coverage above 2x, which is the clearest evidence that the market has relearned caution. How the 2021 vintage resolves as it reaches maturity over the next several quarters is not yet knowable, and a lender is not paid to predict it. A lender is paid to avoid funding its repetition, and to price the next loan for the cash the borrower can actually produce.

TELLARO READ-THROUGH

Underwrite to cash interest coverage, not reported yield, and size new debt so the borrower services it in cash at today's rate rather than a lower one it may never see. A credit that clears its coverage test only by paying its interest in kind is not covering its interest; it is borrowing to appear to. Where coverage already runs below 2x, reduce exposure before the maturity that forces the question.

SECTOR ROTATION

Sorted by whether the cash to service debt is actually arriving, the month's sectors separate clearly.

Software

Software remains the sector where recurring revenue most often substitutes for examined cash flow. A subscription book renews, but at a 9% to 10% cost of debt the question is whether it converts to enough cash, after the reinvestment a growth plan consumes, to pay interest without recourse to payment-in-kind. The better software credits do; the ones that do not are where accrued income is quietly replacing collected income.

Healthcare services

Healthcare carries durable demand but thin and worsening conversion. Labor inflation and reimbursement pressure compress margins while a higher coupon raises the cash the business must find, and roll-ups assembled on blended multiples are the common home of extensions and payment-in-kind. Demand that cannot be converted to cash does not service a loan.

Industrials and asset-based credit

Tangible, cash-generative industrials and genuinely asset-backed structures are wearing the environment best. Cash arrives on a schedule, collateral exists outside a going-concern assumption, and there is little temptation to capitalize interest because the borrower can pay it. These are the credits a lender wants more of when income quality is the question.

Consumer and retail

Consumer credits tied to discretionary spending face the clearest cash-flow test as a slowing economy meets a still-elevated rate, and the month's distressed take-private offer for a national fast-food chain is a reminder that a familiar brand is not a defensible cash flow. Cyclical revenue and a high fixed coupon are a poor combination.

TELLARO READ-THROUGH

Concentrate new lending where interest arrives in cash: asset-based structures, tangible industrials, and the software and healthcare credits that genuinely convert. Step back from borrowers whose performance depends on capitalizing their coupon. When income quality is in question, a schedule of actual cash receipts is worth more than a schedule of contracted revenue.

INVESTMENT COMMITTEE CASE STUDY

Each issue examines one transaction as Tellaro's investment committee would, using public information only. This month: the agreement, announced in October 2026, for GTCR and Elliott to take CCC Intelligent Solutions private at an enterprise value of approximately $6.1 billion. CCC provides software to the property-and-casualty insurance economy, connecting insurers, collision repairers, and parts suppliers, and it entered the deal growing revenue around 10% with

adjusted EBITDA margins near 44%. Financing terms were not disclosed. The credit is instructive precisely because the business is excellent, which is where the discipline is hardest to hold.

Business quality. CCC is a high-quality, mission-critical software platform with deep network effects: insurers, repair shops, and suppliers transact on it, and each added participant raises the cost of leaving. Margins near 44% and double-digit growth describe a genuinely strong franchise, not a marginal one.

Revenue durability. Revenue is recurring and, unlike much of software, genuinely defensible: the platform sits inside the claims workflow of the insurance industry, switching costs are high, and demand does not turn with the economy. This is as close to defensible recurring revenue as the sector offers.

Cash conversion. Here the underwriting begins rather than ends. High-margin software converts well in steady state, but a business taken private to keep growing will spend to do so, and the cash available to service debt is what remains after that spend. At a 9% to 10% cost of debt on a $6.1 billion enterprise, the question is not whether CCC is profitable but whether free cash flow after growth investment covers cash interest with room to spare.

Customer concentration. Concentration is low and diversified across insurers and thousands of repair facilities. The more relevant exposure is to the health of the auto-insurance and collision economy itself, which is steadier than most end markets.

Capital structure and purchase multiple. A $6.1 billion take-private at a mid-teens or higher multiple of EBITDA implies a substantial equity check from two sophisticated owners, which supports a low attachment point. The caution is not the quality of the asset but the price paid for it: a rich multiple leaves less enterprise value per dollar of debt than the headline margin suggests, so the attachment should be measured against conservative earnings, not the entry case.

Collateral. As with all software, the collateral is intangible: contracts, code, and the enterprise value of a going concern. Recovery depends on the platform remaining intact and subscribed, which places the weight on cash flow and structure rather than on anything that could be sold in a liquidation.

Sponsor. GTCR and Elliott are experienced, well-capitalized owners, and the pairing of a control sponsor with a large credit-oriented investor is a constructive ownership group for a lender. Capability improves the odds the business is managed through stress; it does not change the coupon.

Recovery analysis. Recovery rests on sustained subscription cash flow and a low attachment beneath a large equity check. The risk that matters is not demand but conversion: if growth spending or an integration misstep compresses free cash flow while the coupon runs near 10%, the pressure to relieve the strain through payment-in-kind would be real, and a lender that permitted it would be converting a strong credit into a deferred one. Recovery is protected by sizing to cash and refusing that option in advance.

Primary risks. First, the rich purchase multiple and the thin enterprise value per dollar of debt it leaves. Second, free-cash-flow compression from growth spending at a high cost of capital. Third, any structural latitude to capitalize interest. Fourth, the longer-run question of how artificial intelligence reshapes claims-and-repair software, which bears on terminal value more than near-term cash. Fifth, the intangibility of recovery if the going concern falters.

Structural mitigants. Debt sized to free cash flow after growth investment, not to revenue or to a steady-state margin; a cash-pay interest requirement with payment-in-kind barred or tightly capped; a maintenance cash-coverage covenant with real headroom; limits on debt-funded acquisitions; and information rights on net revenue retention and cash conversion, which turn before the income statement.

INVESTMENT COMMITTEE VERDICT

Would Tellaro lend? Yes, senior and low, and only on cash. CCC is among the better businesses a lender will see this year, with defensible recurring revenue and a strong ownership group, and a conservative senior position beneath a large equity check is sound. The single condition that matters is the one the month argues for: the loan must be serviced in cash, with payment-in-kind barred and coverage sized to free cash flow after growth spending, not to the entry case. Lent that way, quality and structure reinforce each other. Lent with a payment-in-kind toggle for flexibility, even this credit becomes a candidate for the paper income that defined October

DOCUMENTATION WATCH

October's documentary lesson is narrow and important: the term that matters most now is the one governing whether interest is paid in cash.

A payment-in-kind toggle is an option granted to the borrower, exercised in exactly the states of the world where the lender most needs cash and information. It relieves a coverage covenant by removing the cash test the covenant exists to apply, and it does so quietly, raising reported income while cash receipts fall. In a benign market it is a convenience; in this one it is the mechanism by which a deteriorating loan continues to look like a performing one.

The same logic runs through amendments and extensions. Each is a lender's legitimate tool for managing a credit through a rough patch, and each, used to avoid recognizing a problem rather than to solve it, converts a present loss into a larger future one. That 47% of this year's defaults arrived through extension, capitalization, or missed interest rather than through clean payment failure is evidence that the documents are increasingly being used to defer the moment of recognition.

Whether that deferral proves prudent or merely postpones a larger loss will not be clear until the 2021 vintage reaches maturity. What is clear is that a lender cannot both grant open-ended payment-in-kind and claim to know how its book is performing.

> **TELLARO READ-THROUGH**
> On new credit, require interest in cash and bar or tightly cap payment-in-kind, and treat a maintenance cash-coverage covenant as the term worth paying for in spread. The option to capitalize interest is the option to be the last to know; a lender that keeps the cash test keeps its earliest warning, and in a market deferring strain through amendment, the earliest warning is the whole of the advantage.

TELLARO UNDERWRITING VIEW

October does not change how Tellaro underwrites; it raises the cost of the shortcuts. Reported yield, recurring revenue, and a low headline default rate each flattered the market this year, and each is precisely the figure a rising share of payment-in-kind and extension has made less reliable. The discipline is to look past the number that is reported to the cash that is collected.

In practice that means underwriting to cash interest coverage rather than accrued yield, and sizing debt to the free cash flow a borrower produces after the spending its plan requires. It means attaching low, beneath equity marked at conservative earnings rather than an entry multiple, because a rich price leaves thin enterprise value per dollar of debt however good the business. And it means refusing the payment-in-kind latitude that turns a struggling borrower into a performing line item, because the option to defer cash is the option to defer knowledge.

The clearest measure of a loan this year is not the yield it reports but the cash it remits. A book can show a 10% yield and collect materially less, and the difference, accruing quietly to principal, is the part most likely to be impaired. A lender that has indexed its sense of safety to reported income has indexed it to the wrong number.

Accordingly, Tellaro continues to favor credits that pay interest in cash from defensible operating cash flow, to bar the toggle that disguises when they cannot, and to judge every lender, including itself, by what it has collected rather than by what it has accrued.

CONCLUDING OBSERVATIONS

October was the month the strain stopped being a forecast. The Federal Reserve held, but the rate that did the damage stayed where it was, and the reported results that arrived during the month showed what a year of it had been storing up: non-accruals rising, net asset values falling at nearly every lender, distributions outrunning the income meant to fund them, and a growing share of that income accrued to principal rather than received in cash. None of it is yet a crisis, and the better credits are carrying the cost without difficulty. But the figure the market leaned on for comfort, a high and stable reported yield, is the figure the cycle has quietly made least trustworthy. A loan paid in kind is a loan whose borrower could not pay cash. The discipline that follows is the plainest in lending and the easiest to neglect in a good market: underwrite to the cash a borrower actually produces, and judge a book by what it collects, not by what it is owed.

MARKET DASHBOARD

The dashboard is arranged to read as evidence for the issue's thesis rather than as a data table. Figures are drawn from public market data and, where a precise monthly reading is unavailable, from the latest reported period; such cases are estimates.

Metric	Current	Prior	Signal
Fed funds target range	3.75-4.00%	3.75-4.00%	Held October 28 in a split vote; December hike live
FOMC dissents	2 for a hike	0	The hawkish bias did not ease with the pause
Term SOFR (3-month)	~3.9%	~3.95% (Q3)	The base rate held after September's hike
Unitranche all-in yield	9.3-10%	9.0-9.7% (Q2)	Up ~35 bps in the quarter, all from the base rate
Unitranche spread	SOFR + 500-575 bps	Flat	Credit compensation unchanged; the rate did the work
Fitch broad default rate	6.3%	Rising	August record; 47% is extensions, PIK, or missed interest
KBRA direct-lending default	2.5%	Rising	By count; the narrow measure still understates strain
Median PIK share of income	~6.9%	Rising	Up to 24.7% at some funds; income accrued, not collected
Listed BDC non-accruals	~3.05%	~2% a year ago	Up at two-thirds of funds; 10 now above 3%
Median BDC NAV, YoY	-5%	Lower	Down at 34 of 36 funds; the marks have started to move
BDC discount to NAV	10-20%	Narrower	Some vehicles 40-50%; the market prices it first
Non-traded redemptions	~13%	~13.9% (Q2)	Eased slightly; still above the ~5% quarterly gate
2021-22 vintage cash coverage	1.7-1.8x	Falling	Near the covenant floor before any new shock
Private credit dry powder	3.75-4.00%	3.75-4.00%	Held October 28 in a split vote; December hike live

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