RUBRIC CAPITAL

February 18, 2026

We internally joke about "Doomers," the many economic prognosticators that are predisposed to warn of impending disasters that almost never happen. It's risky business to go on the record with a bearish call since bearish calls are rarely right, but just as I worried about Silicon Valley Bank, I worry we have systemic risk in our financial system that merits discussion. We are concerned about the risks inherent in levered private assets, specifically levered private credit and private equity. As we will explain in detail in this longer-than-usual letter, we believe poor incentives led to an industry that grew too fast and began marketing its assets to the wrong investors. Irresponsible industry executives pitched a notion of a better credit mouse trap that (while having some merit in its early days) became nothing more than a way of avoiding mark-to-market exposure. They sold it to foundations and institutional investors, to wealth management clients and then ultimately to Main Street. As the industry expanded, it sold less sophisticated investors some of the most illiquid assets in the world by promising increased liquidity that will almost certainly prove ephemeral in any modest period of stress. This capital was aggressively deployed in a bubble-like environment created by excessive flows with industry executives willing to do anything to maintain unsustainable dividends and yields. It's a toxic brew of compressing margins, increased leverage, structured liability management, PIK interest, poor credit underwriting and AI.

The story of the demise of Silicon Valley Bank rhymes with what we are witnessing in levered private credit. It was a bank that owned illiquid over-valued assets and funded those assets with industrial depositors who ultimately realized that they did not want to hold the bag for the poor decisions of the bank's executives. It was a game of flows and when the flows reversed, SIVB failed. News coverage of the excesses of the levered private credit market and zombie private equity is still in its infancy. We think it's only a matter of time before the poor behavior comes to light - dividends will get cut, liquidity will tighten, flows will reverse, gates will be put up, pro-rata distributions will become the news, and the bubble will burst. The bursting of this bubble will likely start well before we see credit quality erosion due to overexposure to both zombie private equity portfolio companies and technology companies exposed to AI disintermediation risk.

We think a "run on the bank" is inevitable and would recommend all investors to get out of levered private credit while they still can. This is the story of a $2.0+ trillion market on the precipice.

Incentives Matter – Hedge Fund Stakes Go Bust

This whole fiasco can be traced, in large part, to a series of hedge fund investments made 15 to 20 years ago. For a period of time, hedge fund GP stakes were a hot commodity. Then a series of these hedge fund investments went spectacularly wrong, in many cases, without anything nefarious or ill-intentioned occurring. Take Chris Shumway. In late 2010, Chris was at the top of his game and had just secured an investment by Goldman Sachs into the General Partner (GP) of his fund for an 8% equity interest. After attempting to transition from CIO to CEO, a wave of redemptions triggered by a key-man clause led him to abruptly shut down the fund in 2011, almost overnight turning Goldman's investment into a zero.[1] The industry that invested in

[1] https://www.bloomberg.com/news/articles/2011-02-15/shumway-returning-money-shows-perils-of-investing-in-hedge-fund-managers

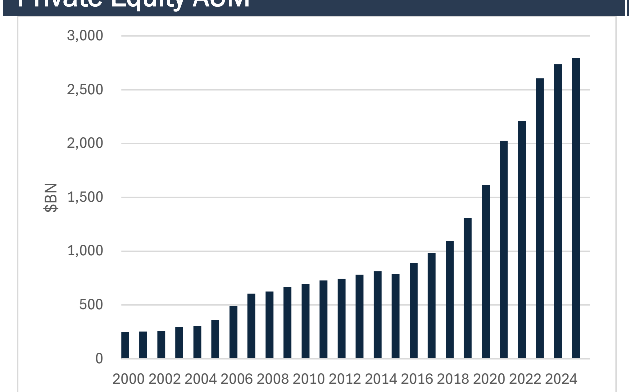
stakes in asset managers took notice and concluded that investing in hedge funds was too risky, instead devoting its time and attention to private equity (PE). The players in that industry correctly surmised that private equity draw-down vehicles were longer term in nature and had less risk of sudden closure. Limited competition from hedge funds led to elevated valuations for ownership stakes in private equity firms. These lofty valuations required private equity firms to significantly grow their assets under management (AUM) to be successful investments. Unlike hedge funds whose incentive fees are based on assets that predominately get marked-to-market daily, private equity fund returns need to be assessed as funds wind down, a process that takes many years. As a result, incentive fees are often unpaid until the tail end of a fund's life. Those payments are viewed as episodic and less valuable to the market than annual asset-based management fees known as Fee Related Earnings (FRE). Private equity businesses grew FRE aggressively as each fund vintage grew larger, and they ventured into new businesses like private credit and real estate. Renamed *alternative asset managers*, many decided to IPO with the same historical mantra of finding ways to increase annual asset-based fees.

As public companies, the alternative asset managers' focus on FRE became manic and in some instances their incentives stopped aligning with their fund investors, particularly in private credit. Just like in the private market, public market investors value alternative asset managers primarily based on FRE, creating a powerful incentive asymmetry: each incremental dollar of FRE is capitalized at a high multiple (as high as 30x), while incremental performance fees are capitalized at a much lower multiple (<10x). Unsurprisingly, publicly traded asset managers rationally optimize AUM growth and fee generation, with performance serving primarily as a means of sustaining fundraising momentum rather than maximizing returns.

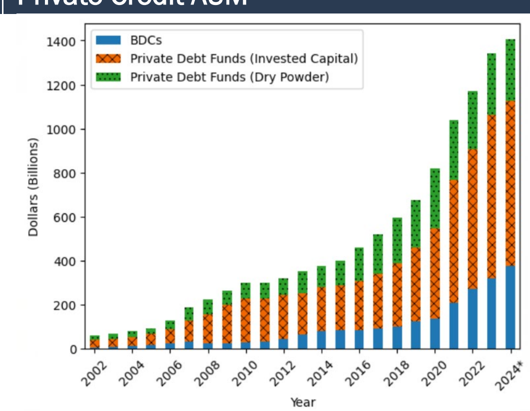
The result is a reflexive system in which *capital gathering* is rewarded more than *capital appreciation*.

While the private equity strategy was the first to see a surge in AUM, asset managers looked to other streams of FRE growth – most notably in private credit, whereby they were able to charge private equity-like fees to lend capital for private equity buyouts. ***Importantly, and in contrast to PE, some of the most prominent private credit managers treat all fees (management fee <u>and</u> performance fee above a hurdle) as FRE. As soon as the money gets lent out, that capital becomes more valuable than any other investment they can make. They have every incentive to raise as much private credit capital as possible and deploy it as quickly as possible. Caveat emptor.***

Private Equity AUM



Private Credit AUM



Note: Includes North American Buyout funds
Source: Preqin, Federal Reserve, LSEG

<u>**How Illiquid is Levered Private Credit? It's Like Selling Ice to Eskimos (but less likely)**</u>

Levered private credit is a $1.5-2 trillion market that is designed to be illiquid. There is limited public information on how much it trades annually, so we checked in with an investment bank who we believe held the largest market share in private credit trading volumes in 2025, and were told that they traded $500 million for the year. By the bank's own account, this $500 million is a disingenuous figure as it only represents transactions between existing lenders, ***meaning no real volume traded with third parties over the course of the year.***

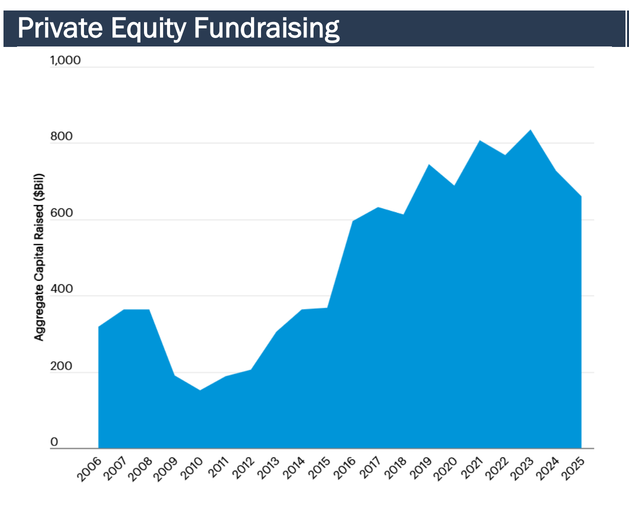
Private equity sponsors are not obligated to let private credit investors share financial information on their holdings outside of their existing lender groups. That opacity isn't a bug - it is a feature of levered private credit. Why put financial information into the public domain if it might enable a trade that marks the asset below par? Par equals strength, and any transaction that risks a negative mark is bad for a sponsor's equity holding. The status quo of illusory par paper that never trades is a perfect solution.

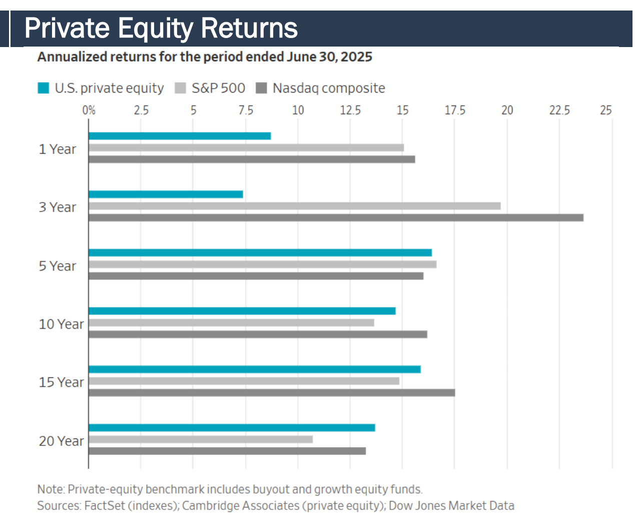
With this liquidity backdrop, a lot of questions might be raised if a private credit entity needed to raise cash to make redemptions. ***Can they sell any loans at all? If they can sell loans, do they sell a small portion of all their loans at the same time (BWIC) or a single loan? What kind of market discount will they be forced to take to sell these loans if a third party is to blindly guess on credit quality? Would a massive mark to compensate for the lack of transparency further accelerate redemption requests?*** Furthermore, why are private equity sponsors so private with their information and why are marks really that bad? What exactly are they trying to hide?

A Zombie Apocalypse too?

Private equity has had a good run. For the past couple decades, it seemed like you would constantly hear about record breaking fundraising - xyz "middle market" private equity firm raising a $5 billion fund followed by $10 billion followed by $20 billion. Institutional investors, following the late David Swensen's Yale Model, couldn't get enough PE. The model admittedly worked for a long time – high amounts of very cheap leverage combined with an unending flow of capital driving up valuations is a pretty good combo.

But eventually, a few things happened: 1) too many funds with commoditized strategies raised too much capital and overpaid for assets; 2) interest rates went up; 3) returns suffered; 4) portfolio company monetizations stalled; and 5) fundraising slowed.

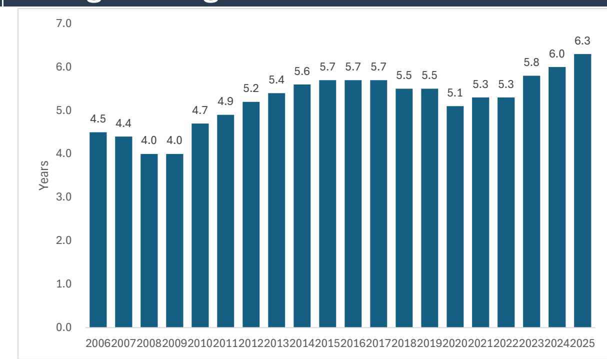




Unsold portfolio companies are now at a two-decade high of more than 31,000 companies, and over the past decade unrealized value by global private equity has tripled from $1.1 trillion to $3.2 trillion. There is only one reason why PE exits have declined so precipitously - sponsor valuation expectations are too high. In a normal world, owners of companies that need to sell reset their valuation expectations and then sell. By contrast, at healthy private equity firms, you are incentivized to hide poor investments until you can mask them with good ones such that you can continue to stay in the game. With zombie private equity firms, your fees go to zero on a total fund shutdown and who knows, maybe if you wait long enough someone might bail you out. In either instance, sponsors don't want information on how a company is performing to be accessible to the market. If news gets out on poor investment performance, you run the risk of not being able to raise another fund and, with a market stuffed with private assets looking for a home, any taint makes your business less valuable than the rest of the $3 trillion in private assets looking for a savior.

Distributions Are At All Time Lows

Average Holding Periods Have Risen



Source: Preqin

It appears the tide has begun to turn. In addition to reduced fundraising activity, LPs have been increasingly looking to sell their LP stakes on the secondary market. According to Jefferies' 2025 Global Secondary Market Review, LP-led secondary transactions reached a record $125 billion in 2025, up over 120% over the past three years. These transactions also come at a discount to the fund manager's stated net asset value ("NAV"); average LP portfolios transacted at 87% of NAV, with funds more than ten years old priced at 73% of NAV.

We think this negative feedback loop of poor performance, insufficient liquidity events, and declining fundraising will continue to pressure the private equity industry. We could draft a full letter diving into the bad asset marks and the many egregious excesses in the private equity market (including the use of continuation funds and the many ways they earn fees that are not aligned with the interests of their investors). For now, we will constrain ourselves and focus on private credit.

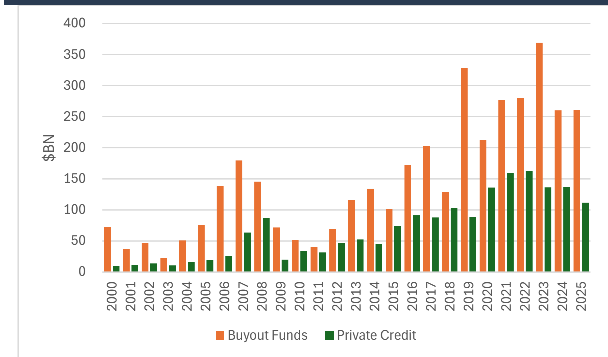
Hurray - Illiquid Levered Private Credit for the Masses

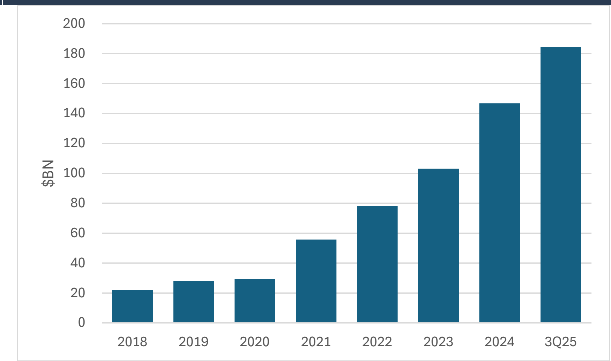
With an incentive to grow AUM as quickly as possible, particularly in private credit, the alternatives industry finally exhausted demand from institutional investors who were up to their eyeballs in private assets and realized that their portfolios were becoming too illiquid. Undaunted, the industry pivoted aggressively towards private wealth channels, primarily tax efficient registered fund entities called Business Development Companies (BDCs) and ultimately to the retail channel through something called an *interval fund*.

Relative to institutional draw-down funds, BDCs have smaller minimum check sizes, ostensibly appear to be more liquid and benefit from a tax efficient structure which, similar to a REIT, requires a payout of 90% of income.

The alternatives industry was very successful in growing the BDC channel. The top 10 public and top 10 private BDCs (which make up ~70% of total BDC assets) expanded from roughly $20bn of net assets in 2018 to over $180bn today.

Annual Fundraising from Institutional Funds	Net Assets of Top 10 Public and Top 10 Private BDCs





Source: Preqin, Bloomberg, Public Filings

We don't think most private wealth investors that have bought shares in private BDCs appreciate how difficult it will be to redeem assets, even in a modest downturn. While public BDCs are permanent capital vehicles, private BDCs require quarterly liquidity for investors, with funds typically able to cap quarterly redemptions at 5% of net assets. Individual investors can redeem 100% of their investment so long as total redemptions are under the 5% cap. **If *redemption requests are 10% of net assets, investors will be pro-rated by 50%. History shows that as soon as a fund starts to pro-rate, investors should expect severe liquidity restrictions and eventually gates (see Starwood REIT "SREIT").*** We expect that as soon as a single bad actor fund pro-rates, redemption queues will get massive across the sector and will lead to severe liquidity issues as funds have no way of selling assets as we explained above. We will explain the bad behaviors and liquidity issues of the BDC group later in this letter and why we think we are very close to a situation where pro-rates will begin.

The industry realized that the fleeting liquidity offered by BDCs would not sell well to retail investors that may legitimately need nearer term liquidity, so they began aggressively pitching semi-liquid solutions in the form of interval funds. Interval funds, like BDCs, offer quarterly liquidity, but with a key difference: they are required to repurchase at least 5% of outstanding shares and are not permitted to impose gates. ***These interval funds have now grown to more than $80bn in net assets, with roughly half coming from Cliffwater – a private credit research firm turned interval fund manager that, from what we understand, is already facing capital constraints. We believe that Cliffwater raised capital so quickly that it outsourced much of the deployment to other managers and is now facing a mismatch between its assets and liabilities. We would not be surprised if Cliffwater is the canary in the coal mine and will be the first domino in the "bank run" we foresee.***

<u>Let's Do It Like Enron – Playing with Cash Flows and Leverage</u>

BDC's are required to distribute 90% of income to investors and these distributions are the primary driver of returns for the sector. Any cuts to these dividends would significantly reduce returns and likely cause investors to redeem capital and redeploy it elsewhere. The surge of capital into private credit - combined with managers' incentive to deploy capital quickly to generate FRE - has driven spread compression. While the levered private credit BDC market grew $50 billion from 2020-2022, it only really exploded in 2023 when spreads reached 6.7%, growing by $105 billion from 2023-2025. Since that time, spreads have compressed over 120 basis points to 5.5%. This pressure on lending spreads is unlikely to abate as new issuance spreads have declined to a lowly 5.0%, indicating continued pressure on asset returns.

At the same time as asset returns are imploding, funding costs continue to increase. Public BDCs have on average 43% fixed rate debt, much of which was issued during the covid-era of low rates. As these mature and reset higher, BDCs will continue to see funding costs increase. In 2019, average BDC financing costs were 210bps above SOFR, in 2025 they sit only 70bps above SOFR - an unsustainably low level.

As BDCs get pressured from both the asset and liability side, distributions are going only one direction – DOWN.

Note:

Industry Returns Have Declined

	2018	2019	2020	2021	2022	2023	2024	2025
Portfolio Yield Less SOFR	7.6%	7.7%	8.3%	8.4%	7.6%	6.8%	6.5%	6.2%
Interest Costs Less SOFR	1.7%	2.1%	2.8%	2.7%	2.1%	0.0%	0.1%	0.7%
Total Net Spread	**5.9%**	**5.5%**	**5.5%**	**5.7%**	**5.5%**	**6.7%**	**6.4%**	**5.5%**
Industry New Issue Spreads	6.2%	5.9%	6.3%	5.9%	6.9%	6.6%	5.4%	5.0%

Spreads data based on average of ARCC, OBDC and BXSL
Source: KBW Research, Company Filings, Visible Alpha

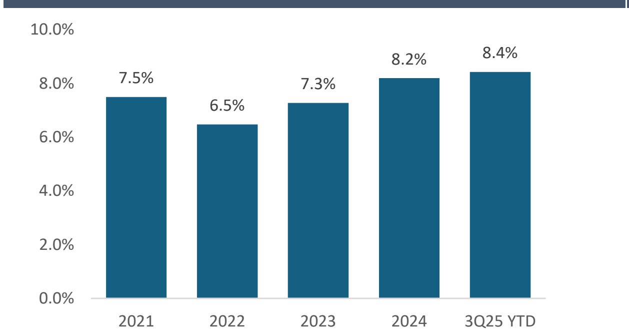
With most income already being distributed, BDCs, Interval funds and the like have little wiggle room to continue to pay out dividends that are no longer fully covered without taking on more risk or cutting them. This is leading to dodgy industry behavior with funds increasing leverage instead of taking their medicine and reducing distributions. ***We know of a specific product being sold by an investment bank to BDCs that allows BDCs to hide leverage between quarters so that it does not appear on quarter end financial statements. This product appears to be an almost repo-like loan against single assets to hide elevated intra-quarter leverage that gets placed back on balance sheet a few days after quarter end. Our key takeaway from this behavior is that distribution cuts are so worrisome that some bad actors are playing Enron-like accounting games.***

It's Raining PIK – Hallelujah

A further problem facing BDC liquidity stems from increased exposure to payment-in-kind (PIK) interest. Elevated PIK interest is also a key indicator of poor credit underwriting that we will address later in greater detail.

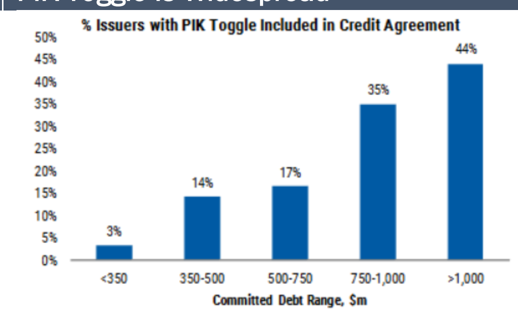
A large share of private credit loans includes PIK toggle features, allowing borrowers to defer cash interest payments. PIK toggles exist in nearly half of all larger loans for the first two years and typically only come with a 50bps penalty. While this preserves borrower liquidity in the short term, it reduces cash interest received, directly impairing a BDC's ability to fund dividends and meet liquidity needs.

PIK Trends



Source: Oppenheimer Research

PIK Toggle Is Widespread



Source: S&P, Morgan Stanley Research

Most BDCs have dividend coverage ratios of exactly 1.0x which include non-cash PIK interest; that means most funds don't have the cash flows necessary to make the distributions absent inflows or the use of leverage. As PIK interest expands in a credit cycle, the dividend coverage goes from bad to worse. PIK interest is also a tell-tail sign of financial strain. A company with even a single tranche of PIK interest is far riskier than one that is paying cash interest across its capital stack. We have seen instances where funds claim to only have 4% of interest income in PIK but 24% of all assets have a tranche of debt that is currently PIK'ing. ***We know that private credit underwriters realize that when a borrower utilizes PIK, it is a sign of stress. As we went through private credit's model based "marks", it became clear to us that borrowers with a tranche of debt that is PIK'ing do indeed see a mark down, but in most cases, those marks went from 100 to 99! The private credit alternative asset managers constantly claim to be conservative underwriters looking for downside protection in their investments - but are oddly very aggressive when marking their assets with already known stresses.*** We can't fathom a guess as to why.

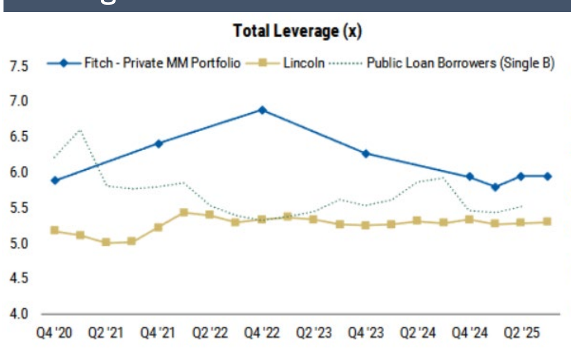
<u>**Every Crisis Has a Good Arb – Liability Structuring**</u>

Every financial crisis needs a little structured credit to add "fuel" to the fire. If the levered private credit game is to maximize spreads to optimize near term returns, Collateralized Loan Obligations (CLOs) are the vehicle of choice to reduce funding costs. Both public and (shockingly) private BDCs have been using CLOs to tranche out liabilities and have provided significant equity support to backstop these entities. CLOs mandate that every credit in the CLO be rated and, at issuance, most of these entities have 90-95% of loans rated in the B-range with 5% allowed to be C+. While these structures may save private credit entities over 200 bps on funding costs relative to corporate level bond issuance, this issuance cost arbitrage is not free. The CLO AAA and AA tranche owners understand that the underlying credit in the structure is poor, so they require a thick tranche of equity and multiple structural triggers to trap cash disbursements. The structural triggers that shut off cash flow to the equity holders (in this case the levered private credit underwriters), include a) rising PIK interest; b) declining interest coverage tests; or c) credit deterioration or downgrades. ***Importantly, when these triggers are hit, cash flows to equity are diverted to senior tranches - cutting liquidity to the levered private credit entities when they need it most, accelerating stress rather than alleviating it. With liquidity already a concern, any credit hiccup will result in these structures adding "fuel" to the proverbial "fire".***

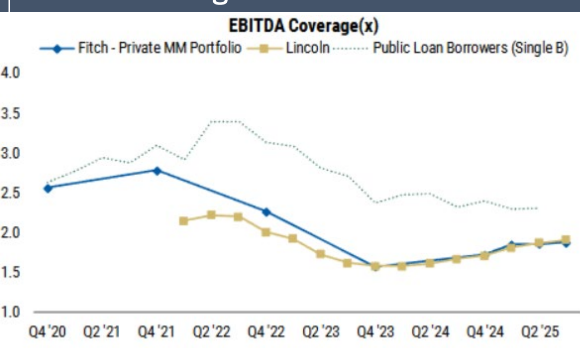
<u>**2025 was an Amazing Year – Maybe as Good as 2008? Credit was Plentiful**</u>

Before we even talk about software, it's important to re-contextualize the risk associated with private credit. The primary use for private credit loans has been to fund private equity LBOs. These deals typically carry extremely high leverage, leaving little room for error. According to Fitch and Lincoln International, leverage across the direct loans they track is ~5.3-5.9x, with interest coverage ratios at ~1.9x.

Leverage Trends	Interest Coverage



Source: Fitch, S&P Capital IQ, Bloomberg, Lincoln International, Morgan Stanley Research



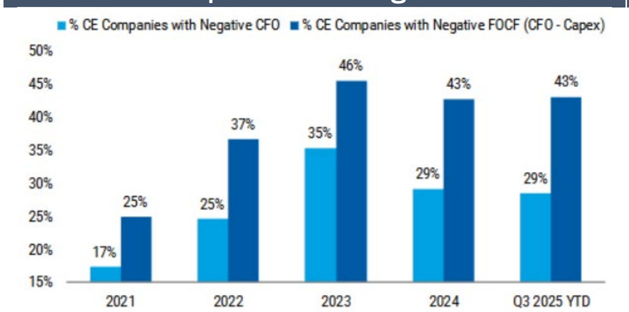
Source: Fitch, S&P Capital IQ, Bloomberg, Lincoln International, Morgan Stanley Research

These are median figures.

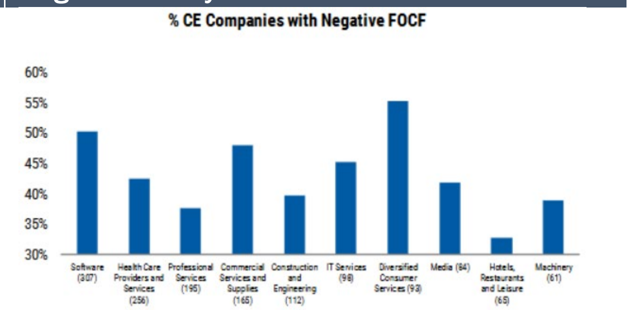
As part of our diligence on the levered private credit sector, we spoke to a manager of a private BDC that we hold in high regard. As part of that conversation, he lamented that the underwriting standards in 2025 were the worst he has seen in his 25 years in the finance industry. He shared with us that in prior underwriting cycles, leverage peaked at 6.5x EBITDA but in 2025, leverage increased to over 8.5x EBITDA. He highlighted loose covenants (if they existed at all), increased availability of PIK and general underwriting decay resulting from intense competition and the tsunami of capital added to the sector. While we don't have access to any hard data to validate his peak leverage numbers, we doubt any of these numbers are directionally incorrect.

While 1.9x interest coverage does not sound so bad, it is not indicative of a universe of borrowers capable of making their interest payments on time or using excess cash flows to pay down debt. The calculation of interest coverage does not account for the free cash flow generation capacity of a borrower. ***According to S&P, 43% of levered private credit borrowers have negative free cash flow.***

Percent of Companies with Negative FCF	Negative FCF by Sector



Source: S&P, Morgan Stanley Research



Source: S&P, Morgan Stanley Research

The industry has already started to show signs of stress. ***According to a recent report from Lincoln International, 30-40% of deals maturing in the next two years have already extended maturity once, a possible sign of credit problems or an inability to find alternative financing elsewhere. The report also found that in the 11% of loans with PIK, 58% had "bad PIK" (i.e., didn't have PIK from the onset) and the average LTV in this cohort was 76%, up from 39% at inception***.

We want to address the notion that thicker "uni-tranche" structures are a competitive moat that will lead to better recoveries in the event of levered private credit defaults. As a brief introduction, many of the loans to private credit are "uni-tranche." Instead of doing a 5x levered loan paired with 2x of mezzanine debt, they're offering a single tranche, 7x first lien senior secured loan. In a multi-tranche structure, the most junior tranche is in the first loss position, while in a uni-tranche structure the senior secured loan is in the first loss position. In the event of a 30% loss to debt holders in a restructuring, the straight math would suggest a full hit to the junior tranche in a multi-tranche structure but just the 30% hit to a uni-tranche structure. While *ceteris paribus* this math is accurate, it negates a unique attribute to the credit profile of the current levered loan market: its enormous exposure to asset light businesses like software. With hard assets, like real estate or plants, recoveries can be solid even with poor operating performance. However, in a world with AI dis-intermediation risk, how good will recoveries be in asset light businesses? We suspect this uni-tranche structure will have minimal impact on expected recoveries and will instead be a mirage to investors in private credit as they wonder how they lost so much money investing in first lien senior secured credit.

Pluralsight Turned Out to be Plural Losses

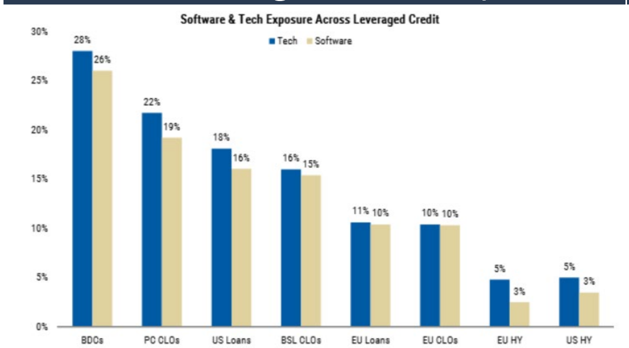
Software and asset light recoveries might turn out very poorly. Take the current recoveries on Vista Equity's ill-fated investment in Pluralsight. This is a deal that was completed in 2024 for $3.5B, funded with private credit loans totaling $1.7B. Based on publicly available information, there was a debt for equity swap in 2025, in which $1.2B of Pluralsight debt was forgiven in exchange for a new $500million loan and 100% of the equity of the company. We know that in the fourth quarter of 2025, Oaktree Specialty Lending (OCSL) had the new Pluralsight equity marked at zero and the restructured debt marked at 70 cents on the dollar. The implied recovery on the total enterprise was in the high single digits (9 cents) and the recovery on the private credit loan is currently 21 cents, which might still be marked too high.

Public market values for software companies are deteriorating rapidly. Since the end of September 2025, the IGV (iShares Expanded Tech-Software Sector ETF) is down more than 30%. This decline belies a significant deterioration in the enterprise value of software companies which should cause private credit investors to worry that maybe the LTV's they underwrote might be a tad too high.

AI is Really Not a Problem – Jensen Told Me So

Until the past two years, software companies were the golden children of the stock market. It is therefore unsurprising that private credit gravitated to these high-growth, asset-light businesses, particularly given the low loan-to-value ratios implied by elevated valuation multiples. Today, approximately 20-30% of private credit loans are to software companies, although this likely understates the exposure as some business services and healthcare technology companies possess many of the same characteristics.

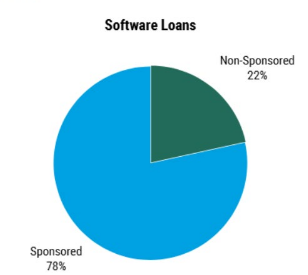
Private Credit Has Higher Software Exposure…



Source: PitchBook | LCD, Morningstar, S&P Global, ICE BofA, Morgan Stanley Research

And Is Primarily Private Equity Backed

Exhibit 20: Around 80% of loans in the software sector are sponsor-backed



Source: LCD Morningstar, Morgan Stanley Research

While it is difficult to predict precisely which companies will be disintermediated by AI, the sector appears increasingly vulnerable to disruption. Low reported loan-to-values (LTV) can be misleading: a loan originated at a 35% LTV offers limited protection when the borrower is levered 6x or more and faces structural revenue risk. In such cases, the probability of impairment is meaningfully higher than headline LTVs suggest, and recoveries for asset-light software businesses are likely to be poor.

But according to OWL's Co-CEO, Marc Lipschultz, it should be fine:

> "But then folks that actually understand this, like, let's say, I think we can all agree Jensen Huang has a pretty good understanding of AI, say this idea that AI is the end of software is one of the most ridiculous things he's heard."
>
> "Our software companies have hundreds of millions of dollars of average EBITDA that are deeply embedded in Fortune 500 work processes. And for those, we've got to pause and think, there's not just a matter of technology, there's the adoption of behavior. ***And for those on the call that are thinking Fortune 500 companies are going to take all their software and just rip it out and just say, I'll just ask ChatGPT, that's simply not the way it works. Don't take my word for it again. We're not technologists, take Jensen Huang's word for it.***"

- *Marc Lipschultz, 4Q25 Earnings Call, February 5th, 2026*

Now that we know that all software companies are obviously great and none will get disintermediated, as Jensen told us, we should lend them as much money as possible. And because their durability and growth is all but guaranteed, we shouldn't worry about typical cash flow metrics in the short term, because eventually they will become highly profitable. Enter the ARR (annual recurring revenue) loan. The concept is simple – annual recurring revenue is so sticky that it's basically guaranteed cash flow, so we should measure borrowing capacity against this metric; plus, these businesses are not optimizing cash flow because they are in growth mode. Let's also not forget that the enterprise values of these businesses are generally very high multiples of ARR – so what's 4x ARR in leverage amongst friends when the business is valued at 20x ARR, all while generating zero or negative EBITDA?

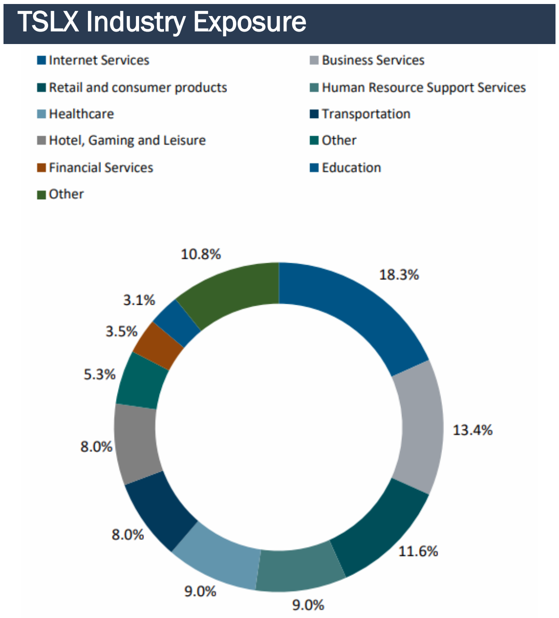
The slide below from Blue Owl's marketing materials reads like satire.

As mentioned earlier, BDC's stated software exposure likely vastly underestimates the true numbers. Bloomberg highlighted this in an article last week:

> "At least 250 investments, worth more than $9 billion, weren't labeled as loans to software firms by one or more of the BDCs, even though the companies borrowing the cash are described that way by other lenders, their private equity sponsors, or the firms themselves. The discrepancies, market watchers say, underscore broader concerns about private credit, a famously opaque industry marked by inconsistent reporting standards, complex fee structures and significant discretion over valuation practices."

- Bloomberg News, "Private Credit's Software Bet Is Even Bigger Than It Appears" February 13, 2026

It is no wonder that on the same day, the management of Sixth Street Specialty Lending (TSLX) decided to "get out in front" of the issue. After all, one might wonder how they are the only BDC with zero software exposure as shown below.



Source: TSLX Earnings Presentation 12/31/25

> "We understand many of our peers map the industry exposure differently from us with a specific software classification which is intended to illustrate enterprise software exposure. We do not view software as a stand-alone industry but instead we view it as a mission-critical tool that enables a broad range of end-user markets. For that reason, our industry disclosure is organized by end-markets such as healthcare, business services, and financial services rather than by specific products or delivery mechanisms used to serve those markets. We believe this is a better approach to risk management as a primary driver of credit performance is the health and demand of the end markets being served rather than the technology used to deliver the service. **At this moment in time, however, we felt it beneficial to our stakeholders to provide a more comparable figure to our peers. We have mapped our portfolio to enterprise software exposure which comprises approximately 40% of our total portfolio by fair value.**"

- *Robert Stanley, TSLX CEO, 4Q25 Earnings Call, February 13th, 2026*

We go into further detail on Blue Owl below.

We are starting to see some initial signs of the embedded credit risk in private credit being realized. This last quarter, BlackRock TCP Capital (TCPC), a public BDC, reported a 19% NAV decline driven by $95mm in losses concentrated in the technology sector. Two of the six problem credits were tied to the Amazon retail sales ecosystem. Non-accruals rose to 9.6% at cost and net leverage spiked to 1.45x, well above their target range of 0.90-1.20x.

<u>ARCC Example</u>

While every BDC has its own unique flavor, we thought it made sense to highlight the largest public BDC, Ares Capital Corporation or ARCC. Ares is generally regarded as a blue-chip private credit lender, so surely its BDC is the gold standard.

Yet a closer look at ARCC's disclosures shows a shift toward higher risk. Only 61% of assets are invested in first lien senior secured loans, indicating meaningful movement down the capital stack. It owns 8.6% of equity securities, 8.4% of preferred equity securities and 5.4% in subordinated loans.

Ares also couldn't help itself and got involved in structured credit vehicles including a 3.8% stake in the subordinated certificates in a middle market lending entity partnered with Varagon Partners (owned by the Man Group), as well as an 8% position in Ivy Hill Asset Management, its wholly owned CLO manager. Ivy Hill aggregates loans – many of which are sourced from ARCC – and securitizes them via CLOs, typically retaining junior debt or equity tranches. As we described earlier, cash flows to CLO equity are structurally subordinate and can be partially or entirely shut off if credit performance deteriorates, or CLO tests are breached. Despite this risk, Ivy Hill-related income accounted for roughly 10% of ARCC's total investment income.

PIK interest represents to us a key indicator of credit performance and underwriting. Approximately 16% of ARCC's investment income is currently pay-in-kind, further reducing cash earnings available to support dividends and liquidity.

Consistent with broader private credit trends, 24% of the portfolio is exposed to Software & Services companies, likely understating its true exposure to a sector that is both asset-light and increasingly vulnerable to AI disruption and overvaluation.

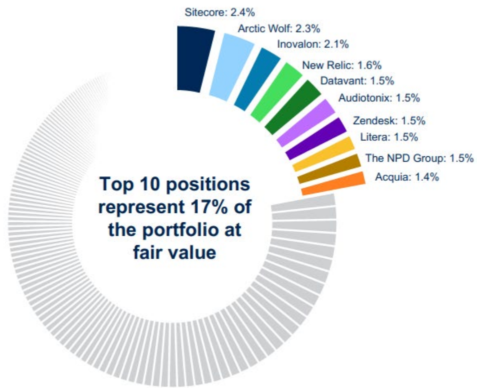
<u>Blue Owl Example</u>

As a result of the market's love for high growth software and technology companies, it's not surprising that there were vehicles raised to be even more overweight these companies. One such example is Blue Owl Technology Finance (OTF). Despite having only two industries totaling 32% of assets that contain the word "software," many of the assets categorized in other industries are software companies, in line with our earlier discussion.

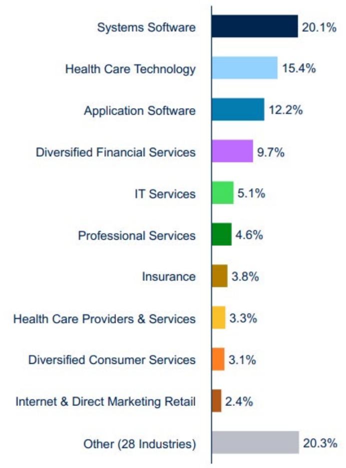
Just looking at the top ten positions, we found four companies totaling 7% of assets that were classified in other sectors: Inovalon (Healthcare IT), Datavant (Healthcare IT), Litera (Diversified Consumer Services) and Circana (Food & Staples Retailing).

OTF Sector and Company Exposure

Borrower Diversification



Industry Diversification



Source: OTF

On top of what now appears to be riskier industry exposure, OTF also has a precarious asset allocation. While 80% of the portfolio is in 1st and 2nd lien loans, it provides some disclosures on its borrower profile that are concerning. ***The most common pushback on software risks is that the loans have very low LTV. As we can see in the table below, the weighted average enterprise value is $5.8bn, the EBITDA is $282mm and the net LTV is 33%. We can therefore imply that on average these businesses are valued at 21x EBITDA, and that innocuous 33% LTV implies 6.8x leverage!***

And that's just their higher quality assets!

The unsecured equity has a weighted average enterprise value of $26bn on $1.1bn of revenue, implying the businesses are valued at 24x revenue. Nothing to see here.

OTF Asset Mix

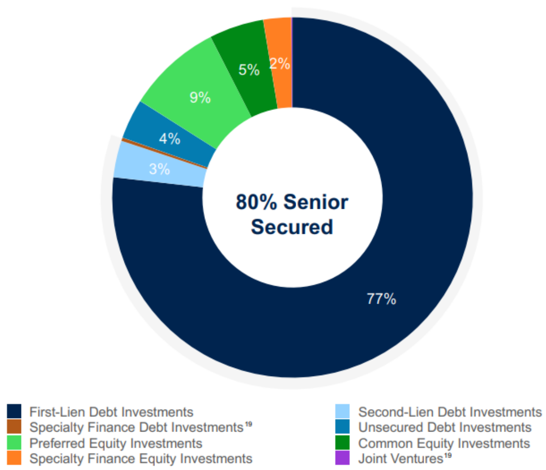
$12.9bn Portfolio Size[9]

185 Portfolio Companies

38 Portfolio Industries

$282mm Portfolio Company EBITDA[10] (First and Second Lien)

10.1% Debt Portfolio Yield[11]



Weighted Average Borrower Statistics[10]:

First & Second Lien (80.1% of portfolio by FV)	Q2'25	Q3'25
Revenue	$904mm	$950mm
EBITDA	$266mm	$282mm
Net LTV[20]	32%	33%
Enterprise Value	$5.2bn	$5.8bn

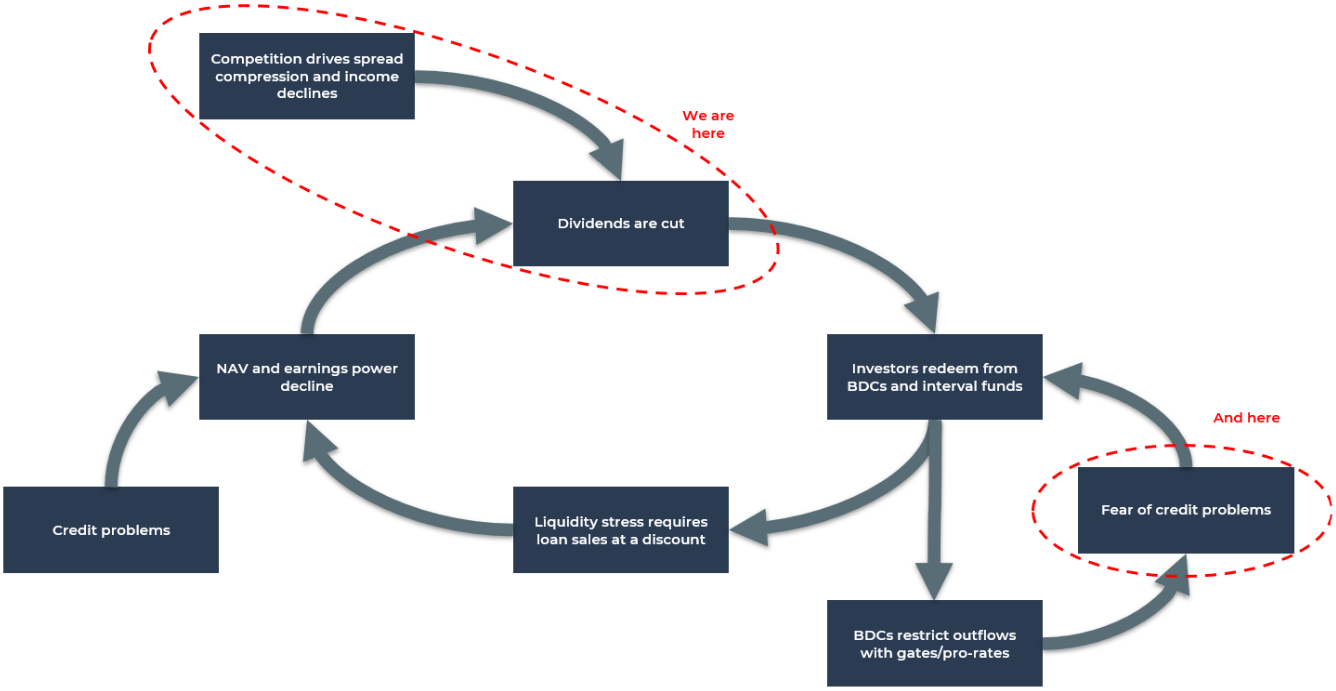
Unsecured Equity (17.5% of portfolio by FV)	Q2'25	Q3'25
Revenue	$991mm	$1,062mm
Enterprise Value	$24bn	$26bn

Source: OTF

It's also not a coincidence and totally unsurprising in our view that OTF's private sister BDC Blue Owl Technology Income Corp (OTIC) had 15% of net assets redeemed at the end of January.

Another Blue Owl BDC, Blue Owl Capital Corporation (OBDC), has been a heavy user of CLO leverage. Because the BDC is acting as a CLO manager, the assets or loans for those CLOs still sit on its balance sheet, while the CLO debt appears as a liability. In reality, OBDC owns equity in a CLO. We estimate OBDC has $1.2bn of equity in its CLOs, which represents 16% of its net assets. As discussed earlier, cash flows to CLO equity can be shut off in times of credit stress.

While this is a very heavy topic, it made it easier to write about by coming up with pithy/funny headlines and make it seem more comedy than reality, which we wish were true. If our attempts at jest failed, we apologize. We can't say humor is one of our natural strengths. In summary, here is a chart we put together that highlights how we expect this unwind to play out.



Portfolio Update – Q4

During the fourth quarter, the equity portfolio averaged a long exposure of 184% and a short exposure of 110% for an average gross and net exposure of 294% and 74%, respectively. Including our credit portfolio, which is generally uncorrelated to the markets, the fund had an average long exposure of 193% and an average short exposure of 110%, for an average gross and net exposure of 303% and 83%. The fund averaged a beta-adjusted net exposure of 36%.

Investment Updates

Talen (TLN)

The past few months have been eventful for Talen, whose stock has been volatile with the rest of the IPP space. A summary below of recent events, and our view on some of the current debates surrounding the industry:

On January 16th, Talen announced the acquisition of 3 high-quality assets in Ohio/Indiana for a purchase price of $3.5bn and immediate FCF per-share accretion of over 15%. The purchase increases Talen's scale and fits nicely with the Company's flywheel strategy of accretively deploying free cash flow into assets that are well positioned to be contracted with high quality counterparties. This is the second attractive deal that Talen has announced in the past year (the first being the $3.5bn acquisition of two Combined-Cycle Gas Turbines (CCGT) in Pennsylvania and Ohio at over 50% FCF/share accretion), and hopefully puts to rest the misguided notion coming from certain parts of the marketplace that "Talen is a better seller than buyer given its cost of debt."

Almost concurrently with Talen's January acquisition announcement, the White House and PJM governors released a proposal to support the procurement of additional generation in PJM, similar to the "Reliability Backstop Alternative" (RBA) introduced by the Joint Stakeholder group last November[2,3]. While much remains to be ironed out, the key points of shared interest and agreement among PJM stakeholders are clear: (1) a one-time, extraordinary auction to avoid creating perverse incentives that could encourage the retirement of existing assets; (2) procurement limited exclusively to the identified megawatt shortfall, so as not to over-procure additional supply; and (3) support for so-called "bring your own generation" (BYOG), which would substitute for megawatts otherwise sourced through the backstop procurement. Nearly all large hyperscale load participants have indicated a willingness to pay their "fair share" to address this resource adequacy concern through either the RBA or BYOG mechanisms. In addition, PJM recently agreed to extend the existing $325/MW-day price cap for two additional auction years, through 2030, while stakeholders continue to refine the details of this procurement.

What's all the regulatory fuss about? In short, we believe certain sell-side analysts, focused primarily on engagement farming among generalists and "power tourists," have manufactured a regulatory overhang in IPP-land where none exists. In fact, we view the alignment of the White House (including the National Energy Dominance Council), Mid-Atlantic governors, PJM, large-load hyperscalers, and IPPs as highly *constructive* for power producers such as Talen, which are positioned to play a critical role as the U.S. navigates the intertwined challenges of affordability, resource adequacy, and speed-to-power in an emerging geopolitical race for AI supremacy. While no stakeholder benefits from blackouts or brownouts, concerns around resource adequacy —and the need to cap PJM capacity prices—underscore an unavoidable reality: the PJM power market is already tight and is likely to tighten further as AI-driven large loads come online in increasing magnitude through the end of the decade. At a time when investors are acutely focused on which asset-light and service-oriented industries may be disintermediated by AI, ownership of incumbent, steel-in-the-ground IPPs—selling long-term contracted power to investment-grade hyperscalers enabling the AI revolution—represents an asymmetrically attractive proposition.

Where can the stock go from here? In Talen's September 2025 Investor Update (updated in January for subsequent M&A), management laid out a path to $40 to $45 of FCF per share, exclusive of commodity upside from higher energy margin. Using a valuation multiple of 15x, reflective of the long-term visibility of investment-grade counterparty cash flows currently, or expected, to be contracted, leads us to a target price in excess of $600/share.

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[2] https://www.pjm.com/-/media/DotCom/committees-groups/cifp-lla/2025/20251119/20251119-item-02c---joint-stakeholder-package--executive-summary.pdf

[3] https://www.pjm.com/-/media/DotCom/committees-groups/workshops/rbpw/2026/20260217/20260217-item-02b---cross-sector-reliability-coalition---talen-amazon-cpv---presentation.pdf

Viatris (VTRS)

We last wrote about Viatris in our Q2 2024 letter. Just as VTRS started to get recognition for its deleveraging and portfolio changes, the company received significant bad news in December of 2024. The FDA sent a warning letter and import ban as a result of manufacturing issues at its Indore facility in India. This resulted in a $385mm hit to EBITDA in 2025. In addition, broad concerns about tariff policy weighed on the stock in the first half of 2025. As a result, the stock suffered a drawdown of 35% from when the FDA warning letter was released through early April 2025 at the peak of the tariff fears. We reduced our position to zero, avoiding some, but not all, of this drawdown. We re-initiated our position over the past summer once it became clear that tariffs wouldn't significantly impact the company, and that Indore manufacturing problems wouldn't be a continued headwind.

Excluding Indore, Viatris's business has been very stable. 2025 is the third consecutive year of positive operational revenue growth (excluding divestitures, FX, and Indore). Looking forward, we expect Viatris to continue to grow organic topline in 2026. This year presents a large opportunity for new generic launches given the large dollar amount of LOEs (loss of exclusivities). Indore should become a small tailwind instead of a headwind. 2026 should be the first year since Mylan and Upjohn merged that headline revenue and EPS will grow. We believe Viatris will re-rate as the consistent organic performance comes through on headline numbers. We expect the company to continue to allocate capital to capital return and accretive tuck-in acquisitions.

Viatris has several catalysts coming up in 2026. The catalyst we are most excited for is the phase 3 read-out for Selatogrel, a self-administered subcutaneous injection for patients experiencing the symptoms of a heart attack. This read-out should happen towards the end of the year. Conceptually, time is muscle during a heart attack. Every minute an artery stays blocked, more heart muscle dies and doesn't come back. Selatogrel works by inhibiting platelet aggregation. It stops the clot from growing and may help dissolve a fresh clot before it has time to harden. Selatogrel achieves therapeutic levels in ~15 minutes, preventing significant heart damage between the time of the heart attack and the time the patient reaches the emergency room.

Selatogrel had strong phase 2 data across 345 patients with 89% achieving the primary endpoint. The drug was well tolerated with no major bleeding events. The phase 3 trial is an outcomes-based trial, and is expected to enroll 14,000 patients. The phase 2 data strongly indicates the drug works. Beyond the general risks of a phase 3 clinical trial, which admittedly are higher for an outcomes-based cardiovascular trial, there are two key risks we are focused on. First, can patients appropriately recognize heart attack symptoms and inject Selatogrel at the right time? Second, will we see any severe adverse bleeding events in the phase 3 trial? With regard to the first risk, the company has enrolled 10,000 patients so far. According to VTRS, it has received consistent feedback from principal investigators that patients are recognizing symptoms and injecting at the right time. For the second risk, the company has already been through 12 meetings with the data monitoring committee of the trial which has continued to allow the trial to progress. While the company hasn't disclosed the exact safety thresholds, it has described the safety criteria as very tight. Before Viatris licensed the asset, the Selatogrel trial was significantly underfunded. Since VTRS has taken control of the trial, it has significantly expanded the number of enrollment sites. As a result, the phase 3 trial will likely read out towards the end of 2026.

We think of Selatogrel as the "EpiPen for heart attacks." Currently patients receive an oral p2y12 inhibitor in the ambulance or emergency room, but they take several hours to be absorbed. Selatogrel acts like a bridge. However, a patient needs to have Selatogrel to use it. The ideal time to prescribe Selatogrel to a patient is when they leave the hospital after their first heart attack. Cardiologists are very conservative doctors, so commercialization of Selatogrel will require effort to change doctor's practices. With 800,000 heart attacks per year in the US alone, there is significant commercial opportunity for the drug.

In addition to an investor day in March, there will be a number of other smaller events for Viatris in 2026, including approval for Effexor for general anxiety disorder in Japan in H1 2026, approval of fast acting Meloxicam for acute pain in H2 2026, approval of a low dose estrogen patch for contraception in H2 2026, approval of phentolamine ophthalmic solution for presbyopia in H2 2026, and others.

The company has a stable base business growing constant currency topline at 1-2% and should generate low double digit organic EPS growth over the next three years from organic growth, cost cuts and buybacks. The company has a policy of returning 50% of free cash flow to investors via dividends and buybacks and will use the remaining 50% on business development. The company also has $815 million in proceeds from the recent sale of its Biocon Biologics stake to further allocate towards value enhancing actions. We believe consistent operational performance and pipeline catalysts in 2026 can drive a re-rating.

We think VTRS can trade at 8-10x our 2028e estimated EPS of $3.20, with another $5-10 per share of pipeline value, representing 60-100% upside just on the core business and 90-170% upside including the pipeline.

Canal+ (CAN LN)

Canal+ held a conference call on January 29th to update the market on its Multichoice acquisition. On the call, the company announced a synergy target of €400mm. This target is 2x our original estimate and includes both cost synergies and cash burn on Showmax. These synergies will phase in €150mm in 2026, €300mm by 2028, and €400mm by 2030. According to the CEO, these cost synergies are based on "what we know for sure", so we believe they are achievable targets.

Canal+ remained public during the takeover process, so management wasn't able to develop an operational plan until they took control of Multichoice on 9/22/25. That makes it all the more notable that four months after taking control, "More than €80mm of these cash synergies have already been secured." Despite this very positive release, the stock was only up 8% since the news. The next catalyst is March 11, when the company will announce its 2025 results and provide 2026 guidance.

Canal+ currently trades at 2.5x our 2028e EBITDA estimate of €1.7bn. Ultimately, we think the stock can trade at 8-10x this estimate, representing 280-380% upside.

SSP Group (SSPG)

SSP Group is an airport concessionaire: they operate restaurants in airports. I would venture that every reader of this letter has eaten at one of their establishments. In 2023 its largest peer, Autogrill (which we also owned), was taken out at a premium valuation, yet SSPG’s valuation has languished despite winning significant additional business and the steady normalization of global air travel. We believe this period of underperformance will end in 2026 as it ramps share repurchases and takes advantage of a structural dislocation caused by its 51% ownership of Travel Food Services (TFS), which listed on the Indian Stock Exchange last year.

IPOs in India have a notable quirk which plays into why 2026 matters so much for SSPG: the owners are required to float at least 25% of the shares within 3 years. The Kapur family, who operate TFS and own ~38% of the stock, sold the original 12% stake in the IPO. But SSPG has sole discretion on who sells the next 13%, and we believe SSPG will be the sellers in 1H 2026 as the lock-up expires. TFS currently trades at ~40x earnings, whereas SSPG ex-TFS trades below 10x, hence any SSPG sales that are used to fund buybacks are materially accretive to SSPG.

SSPG's feet are against the fire and its business has begun to perform well, improving margins and reducing capex to drive an inflection in FCF. Pouring additional capital from TFS sales into the buyback will accelerate FCF per share, which we believe will drive shares up more than 50% from current levels.

Zymeworks (ZYME)

We have been long-term investors in Zymeworks, impressed by management's practical approach to both the financial reality of biotech (it licensed Ziihera to Jazz Pharma in 2022, receiving almost the entire market cap in upfront cash with additional royalties and milestones) as well as its cost-efficient approach to derisked clinical development.

In Q4, Zymeworks unveiled a new corporate structure and strategy along with the success of Ziihera's GEA Phase 3 trial, which sets up that asset to become a multi-billion-dollar opportunity. This new strategy is focused on creating a flywheel of innovation and prudent financial management: either developing or acquiring novel assets, shepherding them through Phase 1/2, and partnering them off for asset-light economics with bigger pharma companies. In addition, Zymeworks now has the capability to deploy that capital accretively, either through buybacks (which it is doing now) or acquisitions.

We are excited to see how this next chapter unfolds and the risk/reward in the stock remains extremely compelling thanks to value of the Ziihera milestones and royalties, which now provide a backbone of value for Zymeworks shares, and a compelling pipeline that we believe is ripe for near-term partnership, unlocking additional upside in 2026.

Our DCF-derived valuation for the base Zymeworks royalty business and only its two clinically validated pipeline assets (with risk adjustment) yields a price target of $33, or ~50% upside from current levels. Any additional success from its development engine would drive incremental upside.

Liberty Global (LBTYA)

We had originally written this letter with some predictions about what Liberty Global would announce on its Q4 earnings, given the company had been previewing in prior calls its intention to break the business apart after years of underperformance. Its prior spin, Sunrise Communications, was executed a year and half ago, and at the time represented 20% of group EBITDA, but today those SpinCo shares are worth $12 per share, or approximately the same as the entirety of Liberty Global today.

We knew the success of Sunrise would presage additional corporate action and today Liberty announced a series of actions which proved our sights were set too low, since it had two ambitious transactions to announce which we believe set up Liberty for significant outperformance in the next two years and beyond.

First, it is buying the 50% of VodafoneZiggo it doesn't own today, while simultaneously announcing its intention to spin off the combined Ziggo + Telenet businesses together in a newly formed Benelux entity called Ziggo Group. We believe Ziggo group will have over $3.2 billion in EBITDA in 2027, and, assuming a significant haircut to peer valuations, we believe Ziggo Group SpinCo shares could be worth over $15 per share, or 23% more than the current price of LBTYA shares today. This valuation disconnect is even more extreme when you consider that LBTYA shares trade today at a discount to the cash and investments at the parent, a structure that has perpetually confused both investors and European telecom analysts who cannot reconcile the non-recourse capital structure at the operating companies with the clean asset value at the parent.

Second, LBTYA announced the creation of the largest UK NetCo (effectively a wholesale fiber infrastructure asset) through the acquisition of Substantial Group by its subsidiary Nexfibre, which has knock-on positive effects for both LBTYA's 50% interest in VMO2 as well as LBTYA's 25% stake in Nexfibre. This transaction creates a credible competitor to BT's Openreach (the incumbent fiber operator) and saves significant capex at VMO2, given it can now obtain wholesale access to significantly more homes without spending incremental capital, driving an inflection in FCF starting in 2027.

All told, these corporate actions will unlock significant value, and we believe LBTYA shares should trade at $30+ per share over the next couple of years as the Ziggo Group spinoff is completed and the benefits of the UK NetCo evolution begin to materialize.

David Rosen

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