

State of SMB lending



Financial lookback- Q1 2026

Foreword

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Small businesses are the engine of the American economy. They generate nearly half of GDP, employ more than half the private-sector workforce and absorb a level of financial risk that most larger companies can hedge, diversify or simply walk away from. And yet, for most of the history of institutional credit, the tools built to evaluate them were designed for someone else entirely.

Credit scores built for consumers. Income documentation frameworks built for W-2 employees. Underwriting funnels that treat a three-year-old HVAC contractor the same way they treat a Fortune 500 subsidiary. The mismatch between the complexity of small business financial life and the bluntness of traditional credit infrastructure is not a minor inefficiency. It is the reason capital has historically flowed past the businesses that need it most.

Ocrolus was built to close that gap. Over the past decade, we have processed tens of millions of financial documents across more than 175 SMB lending relationships, building what we believe is the most comprehensive real-time view of small business financial behavior in the industry. We see payroll flows and tax remittances. We see insurance payments appear and disappear. We see the moment a business starts leaning on overdrafts, and the moment it stops. We see which industries carry their costs differently, which geographies cluster risk and which payment rails signal formality or its absence. This is not survey data or credit bureau data. It is the actual financial behavior of small businesses, observed directly from their bank accounts.

That depth of visibility is what makes this report possible, and why we believe it represents something meaningfully different from the market commentary that already exists.

Starting this quarter, Ocrolus will publish a two-part SMB Lending Health Report on a quarterly basis. **Part One** covers the operational lookback: a systematic read on how small businesses are managing their cost structures, cash flows, obligations and payment behavior. Part Two, which you are reading now, is the financial lookback: a deeper analysis of margins, debt service coverage, industry-level risk concentration and the signals that inform forward-looking credit decisions. Together, these reports are designed to give lenders, investors and policymakers a grounded, transaction-level view of small business financial health, one that builds quarter over quarter into a continuous record of how the market is actually moving.

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We have chosen to publish this work quarterly, because the small business lending environment does not stand still. Conditions that look stable in one quarter can shift materially in the next, and the lenders who respond fastest are almost always the ones who saw the change coming in the data before it showed up in their loss rates. Our goal is to give those lenders an earlier signal and a clearer view.

The findings in Q1 2026 are worth reading carefully. Acute stress, overdrafts, NSF events, high-strain cash flow, is genuinely declining. That is real progress. But payroll burden is rising, fixed obligations have climbed to a two-year high and insurance incidence has been falling steadily for six consecutive quarters. The surface looks calmer. The underlying cost structure does not.

That tension, between improving liquidity signals and rising structural costs, is the defining characteristic of the small business credit environment entering 2026. Understanding it requires exactly the kind of transaction-level evidence this report is built on. We hope it serves you well.

David Snitkof is the General Manager of SMB at Ocrolus, where he leads the company's business unit focusing on small business lending. He previously co-founded Orchard, a pioneering data and transaction platform for online lending acquired by Kabbage in 2018, and served as Head of Analytics and Data Strategy at Kabbage. He is a frequent writer and speaker on financial technology, credit, and the future of data-driven lending.

SMB financial lookback: Q1 2026

Overview

The first quarter of 2026 reflected a modest shift in the financial condition of SMB loan applicants. Margins and debt coverage softened from the stronger levels reached in mid-2025, and the share of businesses generating positive operating income dipped just below 50% for the first time in the observed nine-quarter window. At the same time, several year-over-year indicators remain encouraging. Net income improved substantially versus Q1 2025, and the share of businesses with stressed debt-service coverage remains lower than a year ago.

Overall, the data points to a combination of seasonal normalization and ongoing cost pressure. Payroll burden moved back toward levels last seen in early 2024, while median Debt Service Coverage Ratio (DSCR) moderated from the highs reached in mid-2025, falling to 0.34x after peaking at 0.62x two quarters earlier.

Payroll is the primary story

Payroll costs as a share of revenue rose to 16.5% in Q1 2026, up 1.4 percentage points from 15.0% in Q4 2025 and 1.2 points from 15.2% in Q1 2025. This was the largest single-quarter increase in the nine-quarter series and contributed meaningfully to softer margins and lower debt coverage.

The broader trend provides important context. Payroll burden declined steadily from Q1 2024 through Q2 2025 before rising again entering 2026. The current reading closely matches Q1 2024 levels, when margins also experienced seasonal compression. If that historical pattern repeats, payroll pressure could ease through Q2.

Payroll-to-revenue

Quarterly trend among active SMB loan applicants in the lending sample.

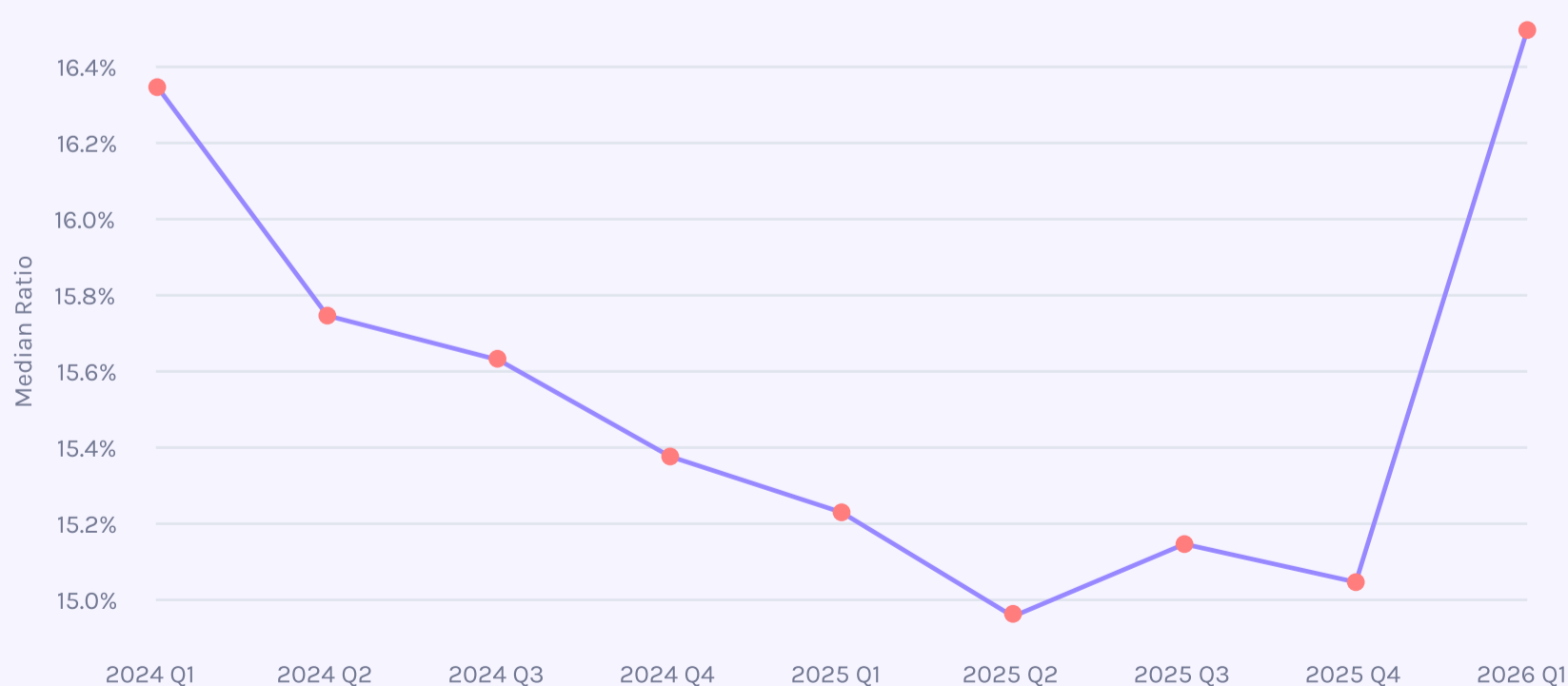


Exhibit 1: Payroll-to-revenue – nine-quarter trend

Median payroll-to-revenue from Q1 2024 through Q1 2026. The Q1 2026 reading of 16.5% matches the Q1 2024 level, reversing nearly two years of gradual improvement in a single quarter.

Insurance costs also moved modestly higher, rising 26 basis points quarter-over-quarter to 2.4% of revenue after trending down through most of 2025. While this may suggest that insurance-related relief is stabilizing, tax and debt-service ratios remained largely unchanged.

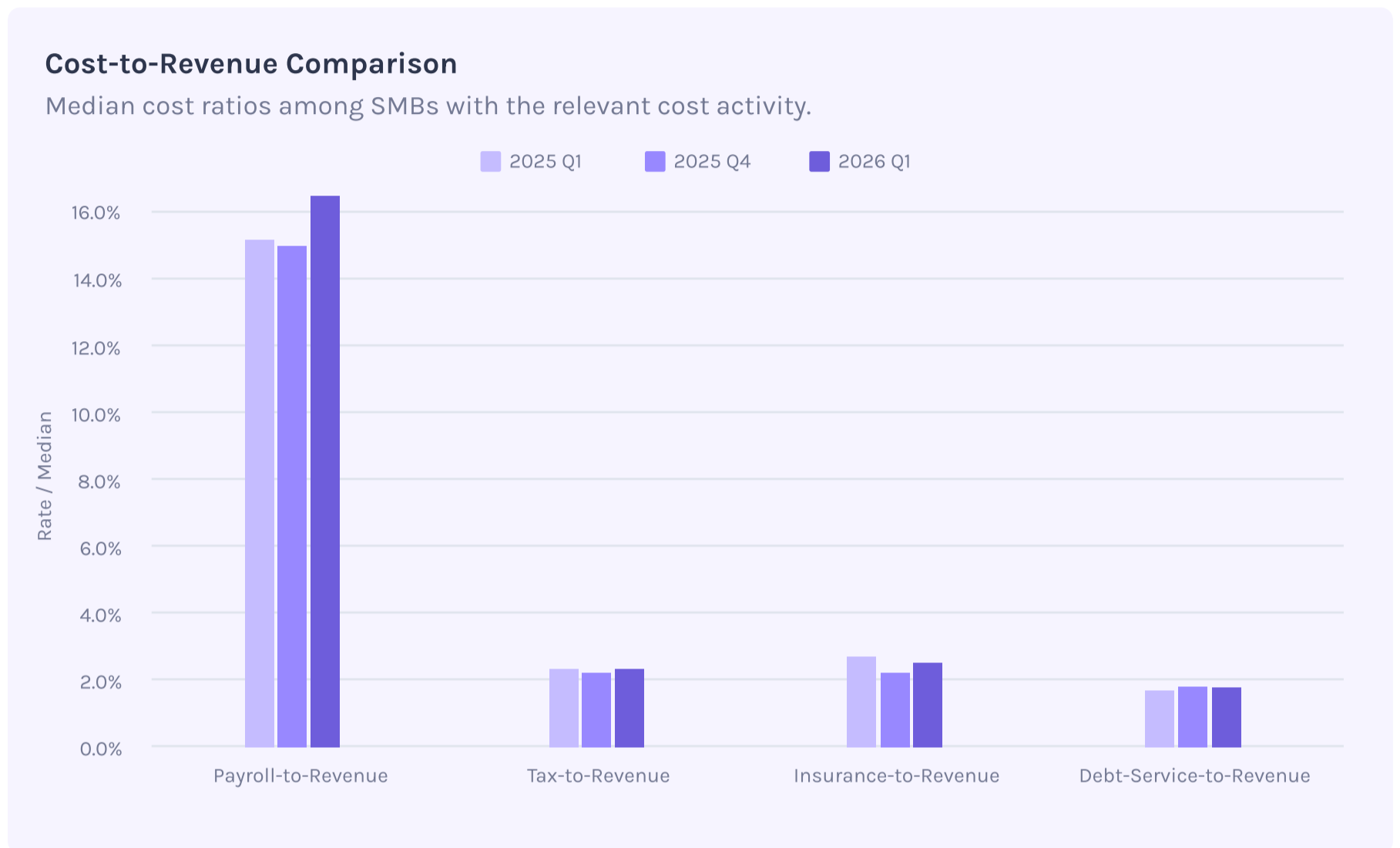


Exhibit 2: Cost-to-revenue comparison

Median payroll, tax, insurance and debt-service ratios across the three comparison quarters. Payroll shows the largest absolute increase in Q1 2026 across every category and both comparison periods. Insurance reversed its declining trend for the second consecutive quarter.

Margins softened across the board

Median operating margin reached -0.1% in Q1 2026, down 37 basis points from Q4 2025 and 30 basis points from Q1 2025, moving slightly into negative territory for the first time in the observed window. Net margin reached -1.1%, while the share of businesses generating positive operating income declined to 49.6%.

The longer-term trend remains important here as well. Operating margin was also negative in Q1 2024 before improving significantly through mid-2025. The current quarter represents a return toward those earlier seasonal levels after several stronger quarters.

Operating margin

Quarterly trend among active SMB loan applicants in the lending sample.

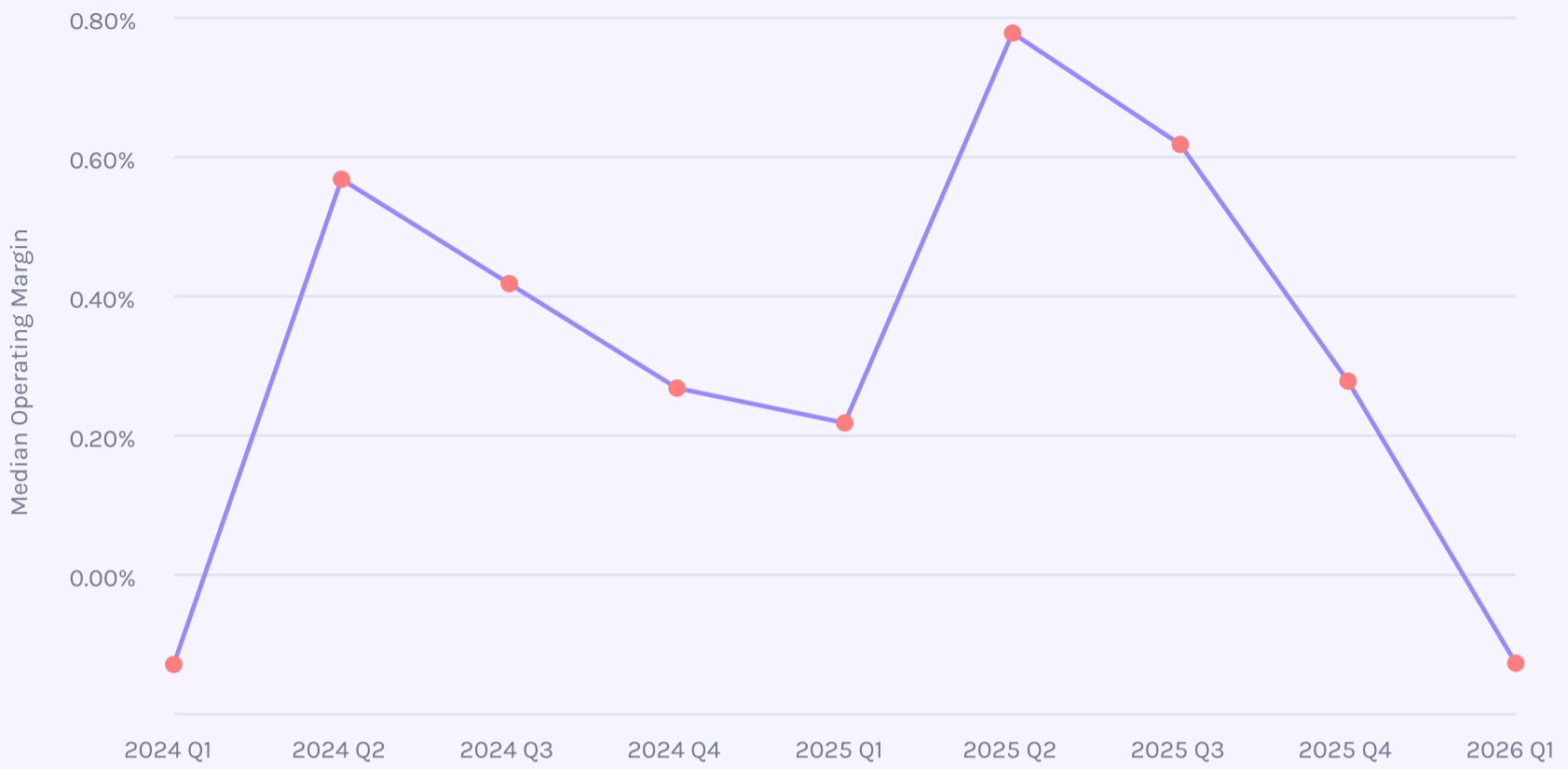


Exhibit 3: Operating margin – nine-quarter trend

Median operating margin from Q1 2024 through Q1 2026. After peaking at +0.8% in Q2 2025, operating margin declined for three consecutive quarters, returning to the negative territory last seen in Q1 2024. The symmetry between the two Q1 troughs is consistent with a seasonal pattern.

Financial health incidence comparison

Most recent quarter vs prior quarter vs prior-year same quarter.

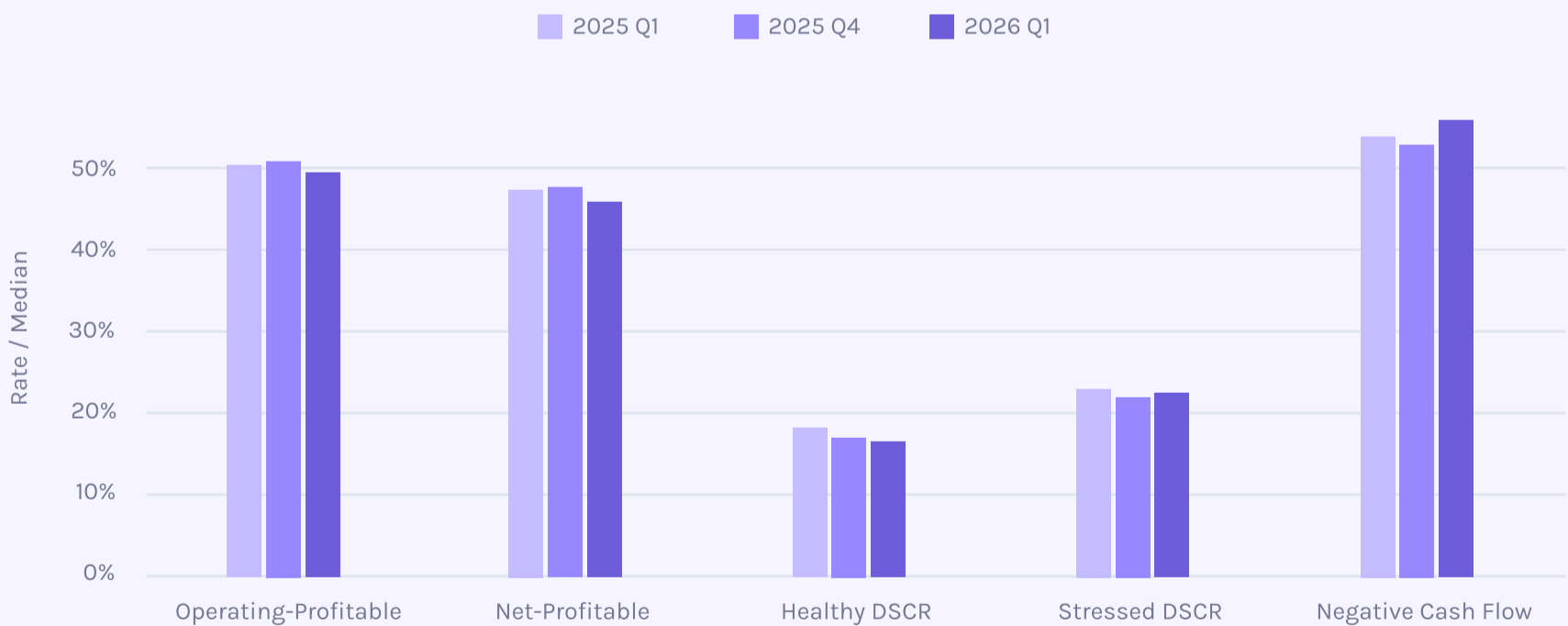


Exhibit 4: Financial health incidence comparison

Share of applicants meeting each financial health threshold across the three comparison quarters. The operating-profitable share crossed below 50% in Q1 2026. Negative cash flow share rose to 56.0%, the highest of the three periods shown. Stressed DSCR share ticked up quarter-over-quarter but remains below the Q1 2025 level.

DSCR trends warrant monitoring

Median DSCR among debt-bearing applicants declined to 0.34x in Q1 2026, down from 0.46x in Q4 2025 and 0.44x in Q1 2025. Within the nine-quarter series, DSCR peaked at 0.62x in Q3 2025, making the recent moderation notable from both a seasonal and trend perspective.

A DSCR of 0.34x means the typical debt-bearing applicant generated approximately \$0.34 in operating cash flow for every \$1.00 of debt service due during the quarter. Many businesses continue to rely on financing inflows, reserves or revenue variability alongside operating cash flow to manage obligations. Q2 2026 will provide an important signal as to whether the recent decline stabilizes alongside historical seasonal patterns.

DSCR (Median)

Quarterly trend among active SMB loan applicants in the lending sample.

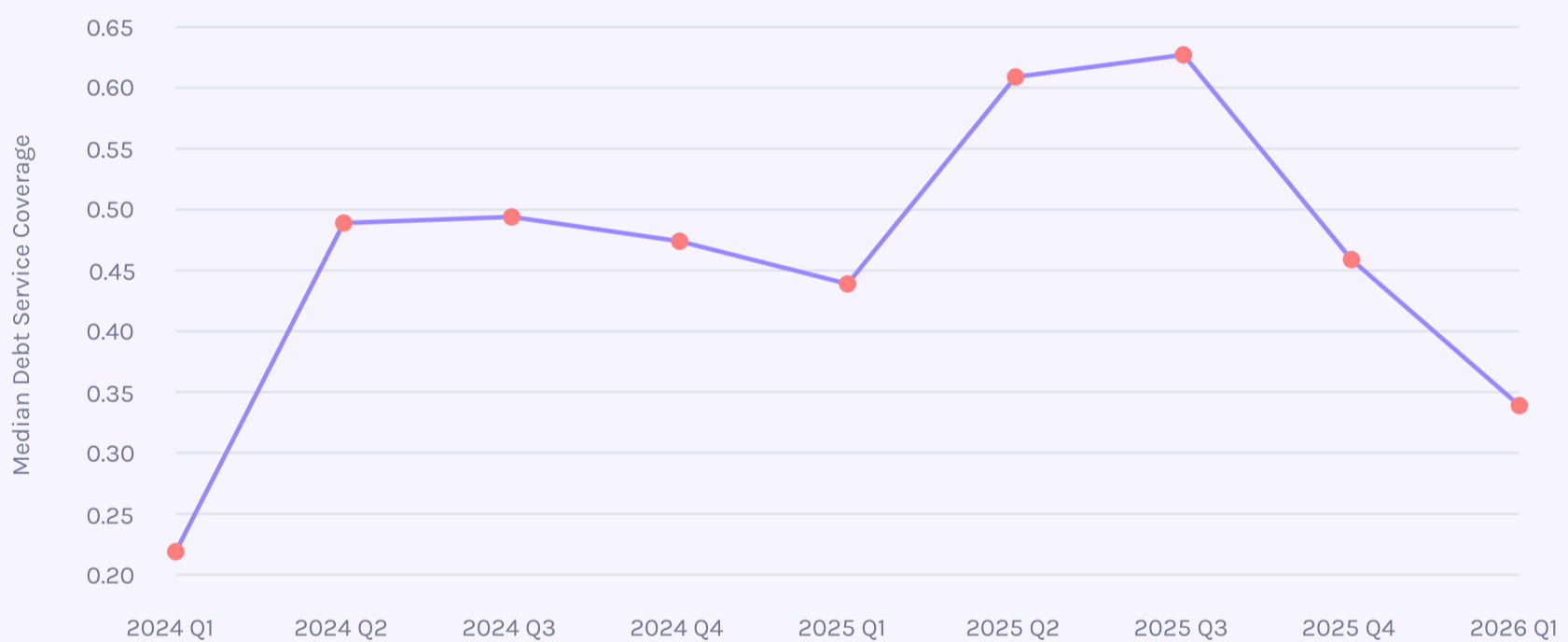


Exhibit 5: DSCR (median) – nine-quarter trend

Median DSCR from Q1 2024 through Q1 2026. Coverage peaked at 0.62x in Q3 2025 and has since dropped for two consecutive quarters to 0.34x. The velocity of decline – more than 0.28x in two quarters – is the most notable feature of the series.

Importantly, the share of applicants with stressed DSCR levels below 1.0x increased only modestly quarter-over-quarter to 22.6%, and remains below both the Q1 2025 reading and the Q1 2024 peak. While median coverage ratios softened, broader stress incidence continues to compare favorably year-over-year.

DSCR metric	Q1 2026	Q4 2025	Q1 2025	QoQ ▲	YoY ▲
Median DSCR	0.34x	0.46x	0.44x	-0.12x	-0.10x
Healthy share (≥1.25x)	16.6%	16.9%	18.0%	-0.3pp	-1.4pp
Stressed share (<1.0x)	22.6%	22.1%	23.1%	+0.5pp	-0.5pp

Industry risk remains concentrated

Performance continued to vary significantly by industry. General Freight Trucking, Local and Landscaping Services remained relatively strong across profitability and coverage metrics. Roofing Contractors, Full-Service Restaurants and Residential Remodelers continued to face more pressure across operating margin, net margin and stressed DSCR measures, while also representing a meaningful share of financing activity within the sample.

The operating margin versus DSCR scatter highlights a continued divide between industries maintaining positive margins and stronger coverage, and those operating with tighter profitability and below-1.0x coverage levels.

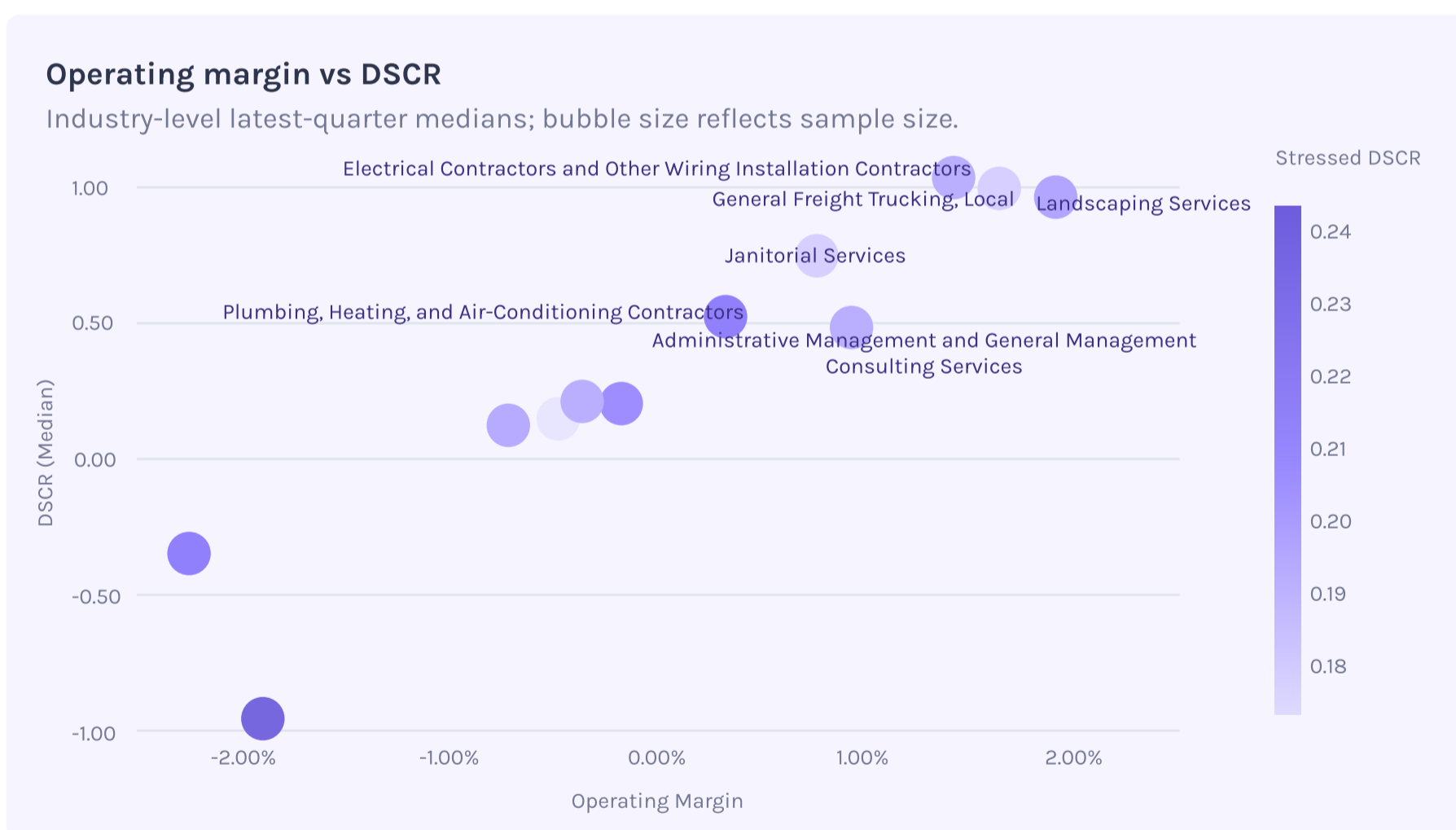


Exhibit 6: Operating margin vs. DSCR – industry scatter

Industry-level median operating margin plotted against median DSCR for the latest quarter, with stressed DSCR share shown as a color scale. Industries in the upper right (positive margin, DSCR above 1.0x) include Electrical Contractors, General Freight Trucking and Landscaping Services. Industries in the lower left – Roofing Contractors, Full-Service Restaurants – combine negative operating margins with below-1.0x coverage and higher stressed DSCR share.

Top industries by stressed DSCR share

Share of debt-bearing SMBs with DSCR below 1.0 in the most recent quarter.

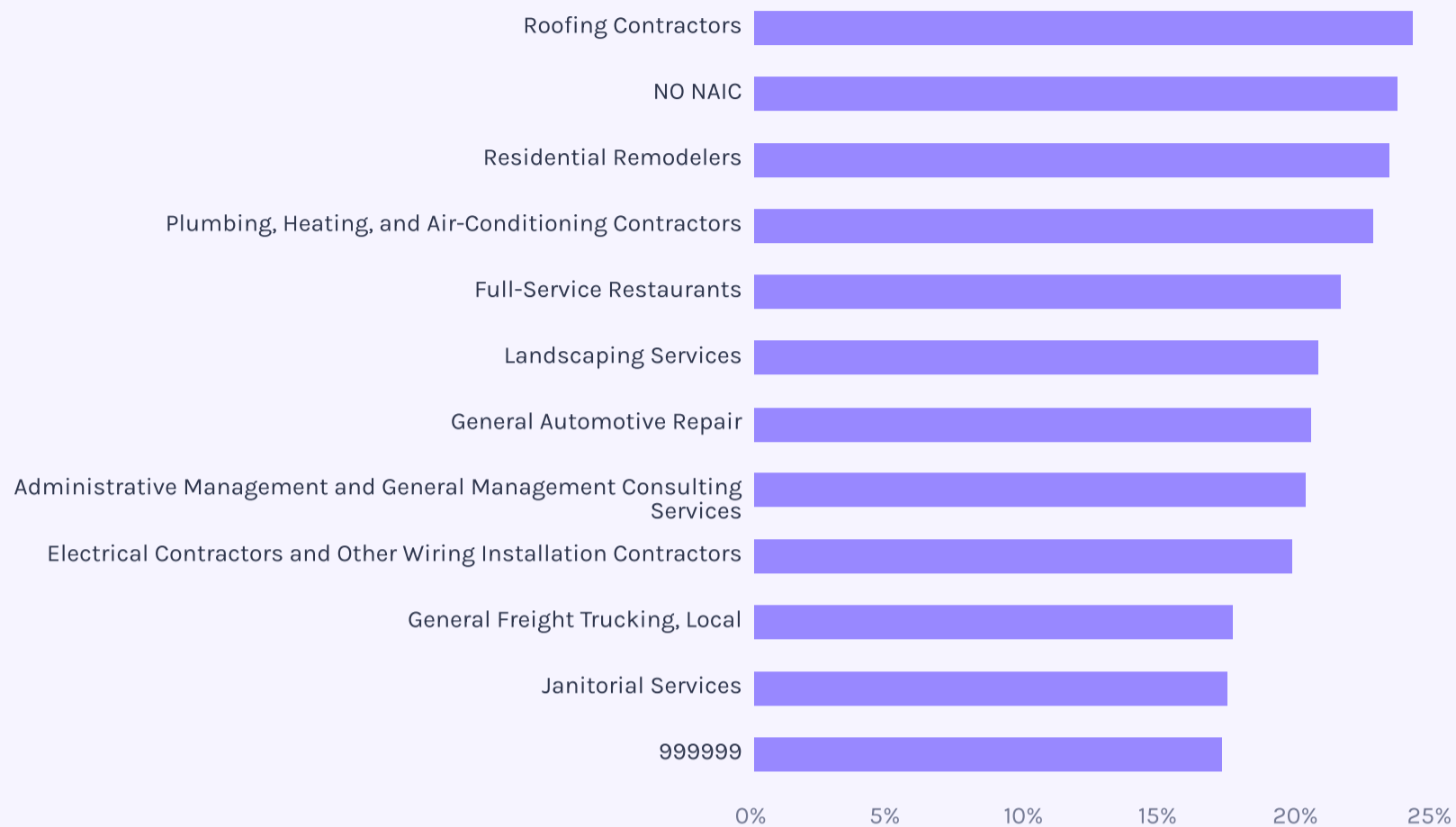


Exhibit 7: Top industries by stressed DSCR share

Share of debt-bearing applicants with DSCR below 1.0x by industry, most recent quarter. Roofing Contractors (24.5%) lead on stressed share, followed by the unclassified segment (23.9%) and Residential Remodelers (23.6%). Even the best-performing industry on this metric carries a 17.4% stressed share – underscoring that coverage stress is broad-based, not isolated.

Year-over-year context

While the quarter-over-quarter picture reflects some softening, the year-over-year view remains more balanced. Stressed DSCR share is lower than a year ago, and the operating-profitable share is only modestly below the Q1 2025 level. Net income at the portfolio level also improved substantially, moving from -\$24.3B in Q1 2025 to -\$11.2B in Q1 2026.

Portfolio P&L waterfall – 2026 Q1

Aggregated revenue and cost stack across all active SMB loan applicants in the most recent quarter.

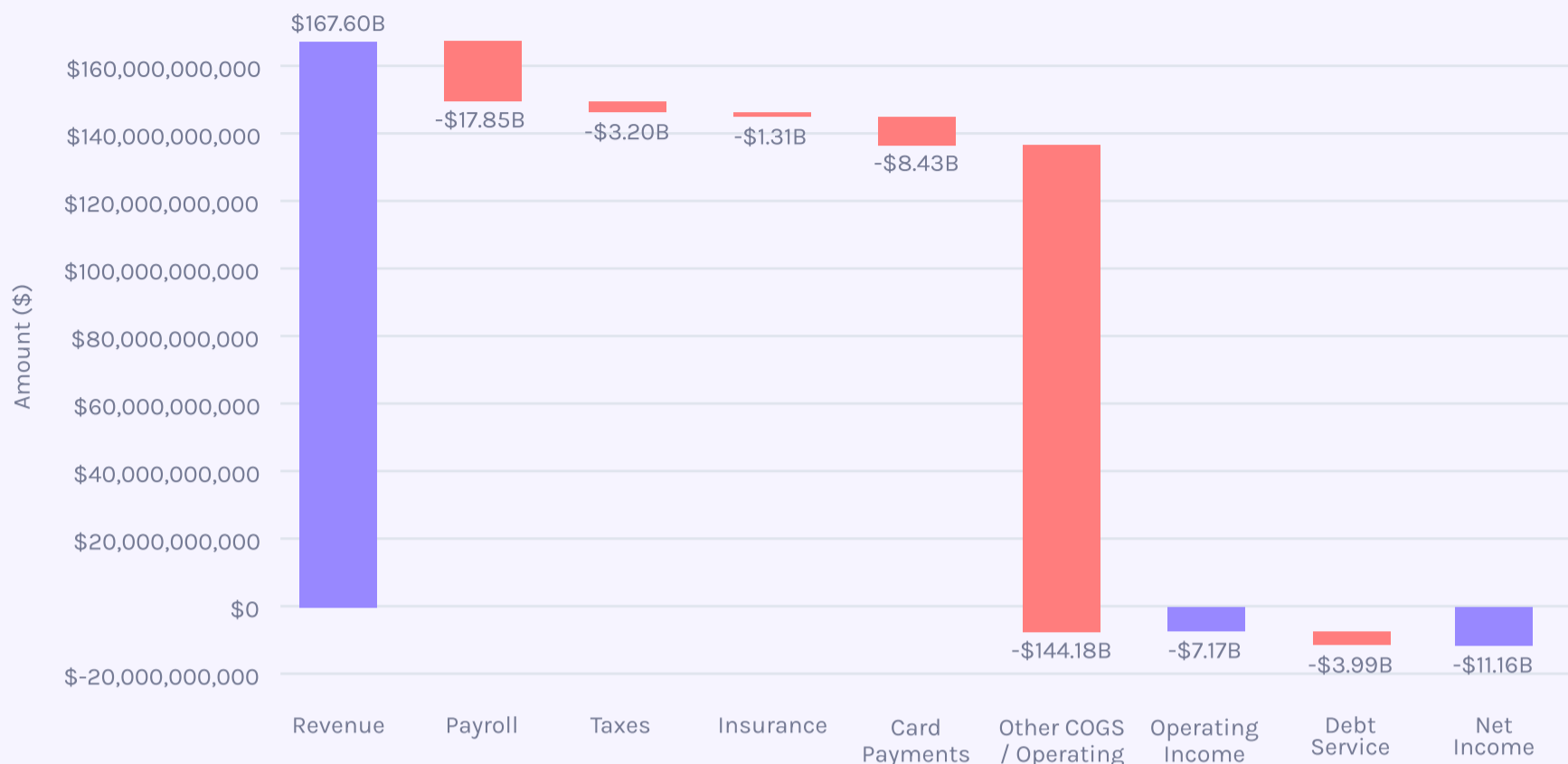


Exhibit 8: Portfolio P&L waterfall – Q1 2026

Aggregated revenue and cost stack across all active SMB loan applicants in the most recent quarter. Revenue of \$167.6B is reduced first by Other COGS/Operating (\$144.2B), then by payroll (\$17.9B), card payments (\$8.4B), taxes (\$3.2B) and insurance (\$1.3B), producing an operating loss of -\$7.2B. Debt service of \$4.0B brings net income to -\$11.2B.

The recurring seasonal pattern observed in early 2024 and early 2026 – elevated payroll burden followed by margin compression and subsequent recovery through Q2 and Q3 – will make the next quarter particularly important to watch.

Key takeaways

Payroll was the defining driver of the quarter. The 1.4 percentage point increase in payroll burden contributed directly to softer margins and lower coverage ratios. Historical trends suggest some potential for easing in Q2 if seasonality follows prior patterns.

DSCR trends will remain an important area to monitor. The decline from 0.62x to 0.34x over two quarters represents a meaningful shift from mid-2025 highs, making Q2 2026 an important checkpoint.

Year-over-year indicators remain more constructive than quarter-over-quarter comparisons alone might suggest. Stressed DSCR share improved versus last year, and net income showed material improvement.

Industry concentration risk continues to be consistent. Roofing Contractors, Full-Service Restaurants and Residential Remodelers remain under greater pressure across both profitability and coverage metrics, while General Freight Trucking and Landscaping Services continue to stand out positively.

Insurance costs are worth monitoring. Two consecutive quarterly increases following a sustained decline may indicate that a favorable trend is stabilizing, though current levels remain well below the highs seen in early 2024.