More Money, More Problems

February 2024

Nineties hip-hop artist, Notorious B.I.G., may as well have written "Mo Money, Mo Problems" about credit mega-fund capital deployment

- Mega-fund private credit managers have been forced to abandon the core-middle market and move upstream to efficiently put their capital to work
- The mega-fund managers are often competing with each other, as well as banks and the broadly syndicated loan market, for the largest deals in the market, which puts downward pressure on the yield premiums and covenant protections
- Investments in the core-middle market have historically benefitted from higher yields, lower average leverage multiples, and strong protective covenant packages compared to upper-middle market and broadly syndicated loans

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Private credit as an asset class has grown to $1.4 trillion in assets under management since the Global Financial Crisis[1]. This rapid growth of private credit has resulted in the appearance of mega-fund managers. According to Briarcliffe Credit Partners, "the top 10 private debt managers today account for nearly one-third of the AUM for the entire asset class[1]."

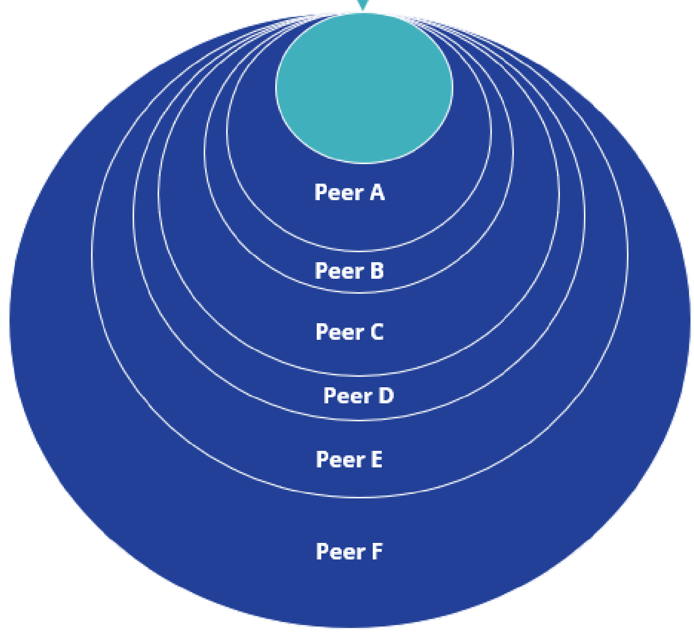
The top five largest private credit firms raised more than $340 billion from 2017-2022, compared to a total of $322 billion in capital raised by the 30 largest private credit managers from 2008-2013[1]. This rapid growth in fundraising dollars has forced the mega-fund managers to abandon the core-middle market and move upstream to be able to efficiently put their capital to work.

[1] *Source: Private Debt Investor: The Decade as of June 2023*

PennantPark Target Position Size	$50-$150M

Debt Capital Raised in Past 5 Years

	Implied 1% Position
Peer A ($19 billion)	$190M
Peer B ($21 billion)	$210M
Peer C* ($46 billion)	$460M
Peer D* ($58 billion)	$580M
Peer E ($67 billion)	$670M
Peer F* ($117 billion)	$1.2B

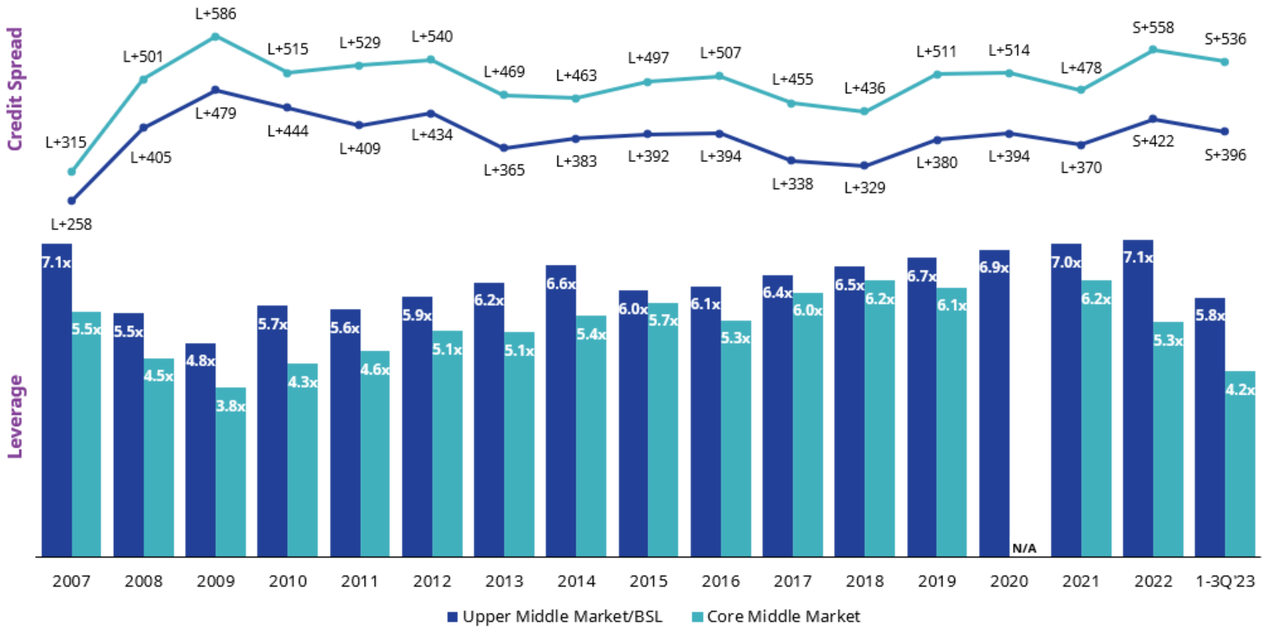


Source: Private Debt Investor PDI 100 rankings December 2023. Peers include Golub Capital, Crescent Capital, Oaktree Capital Management, Blackstone, HPS Investment Partners, and Ares Management. Capital amounts are based on the amount of private debt investment capital raised by firms over the past five years. Area of circles is roughly proportional to the size of the implied 1% position.
** Signifies publicly traded asset management company.*

Put simply, investing $50 to $150 million in a deal is not an efficient approach when deploying tens of billions of dollars. Mega-fund managers must target much larger investments to deploy their capital raised. At PennantPark, we invest in the core-middle market, defined as companies with earnings of $10 to $50 million. We are disciplined fundraisers, targeting fund sizes that are appropriate for our segment of the market.

Why are we so committed to the core-middle market? As shown in the graph on the following page, investments in the core-middle market have historically benefitted from higher yield premiums, lower average leverage multiples, and stronger covenant packages compared to upper-middle market and broadly syndicated loans. This can translate to increased returns with stronger downside mitigations for our investors.

The Core Middle Market Offers a Yield Premium with Lower Risk



Source: Refinitiv as of September 2023. Core Middle Market is defined as Issuers with revenues of $500M and below, and total loan package of less or equal to $500M. Upper Middle Market and BSL are defined as syndicated or direct/clubbed deals that have either revenues or total loan package of $500M or greater. Broadly Syndicated Loans are denoted as "BSL". For 2020 Refinitiv does not have sufficient observations at this time to provide data for MM.

The mega-fund managers are often competing with each other, as well as banks and the broadly syndicated loan market, for some of the largest deals in the market. This increase in competition has put downward pressure on the premiums earned and has eroded many of the structural protections that are afforded in the core-middle market, where there is less competition among managers.

Many of the mega-fund managers are publicly traded and are pressured to achieve aggressive AUM growth to support their stock price. At PennantPark, we remain a private, independent, asset manager, with our fiduciary responsibility solely to our investors.

We welcome a conversation; please contact invest@pennantpark.com or the professionals listed on the next page.

Contact Us

About PennantPark:

PennantPark is an independent middle market credit platform with $6.8 billion of assets under management. The firm is headquartered in Miami with additional offices in New York, Chicago, Houston, Los Angeles, and Amsterdam. PennantPark primarily invests in the core middle market, defined as companies with earnings of $10 million to $50 million. Our industries of focus include business services, government services, healthcare, consumer, and software/technology. In addition to middle market CLOs, the firm offers its investment strategies through a range of public and private fund structures.

PennantPark Contacts:

Scott McCabe

Managing Director; Head of Private Wealth Distribution

mccabe@pennantpark.com

Juan Ledezma

Senior Associate; Fundraising & Investor Relations

ledezma@pennantpark.com

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