Private Credit 101

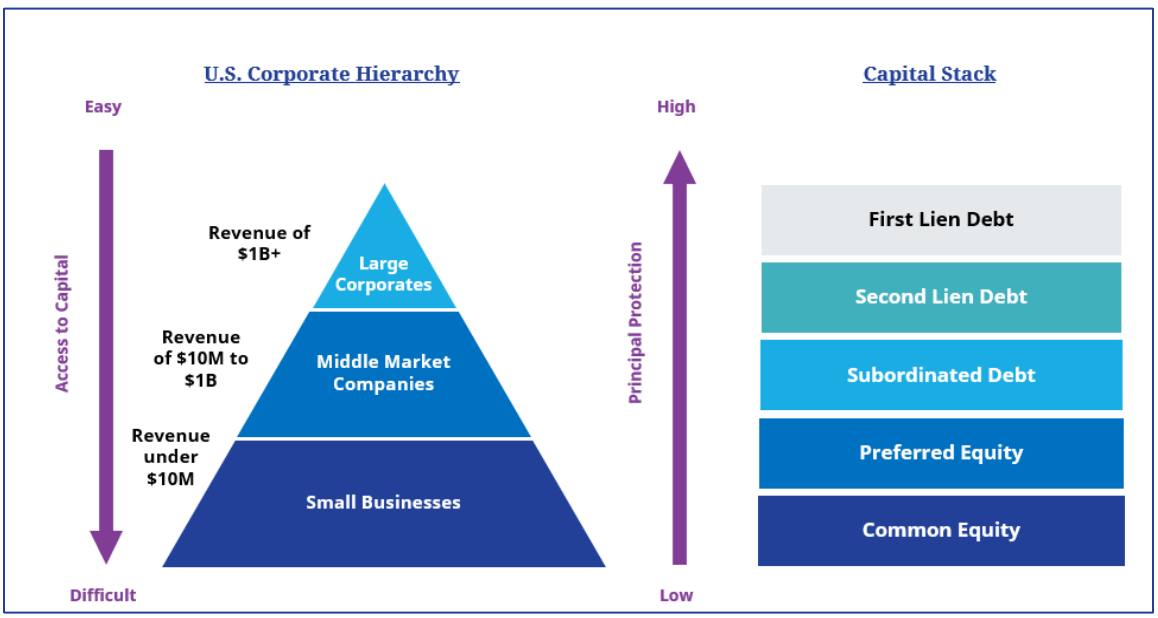
March 2024

Private credit, specifically direct lending, is gaining popularity in investor portfolios. With all of this talk about private credit strategies, how about a little refresher?

What is Private Credit?

Private credit refers to debt privately originated by an asset manager without the intermediation of a bank or traded on any public market. This direct approach can achieve greater efficiency, confidentiality, and certainty of closing for the borrower than borrowing from a bank. The lender typically benefits by securing tight financial protections and higher yields. Unlike public debt, rating agencies do not rate private credit loans.

There are various types of private credit strategies across various segments of the market. Across market segments, private credit can span the capital stack of small businesses, up to very large corporations.



For illustrative purposes only.

What Are the Different Types of Private Credit Strategies?

- **Direct Lending:** Direct lending loans are made to a corporate borrower for business expansion, acquisitions, or refinancing. These loans are generally senior in the capital structure (first-lien), however, direct lending can also be offered as subordinated debt, or unitranche, which combines different tranches of debt into a single loan facility. These loans are generally structured as floating-rate and tend to be issued to sponsor-backed borrowers (private equity-owned businesses).

- **Mezzanine Debt:** Mezzanine debt typically reflects private credit and private equity characteristics. It consists of loans that are subordinate in the capital structure and have additional features, such as preferred equity, to compensate investors for their investment risk. These loans are also typically provided to sponsor-backed borrowers (private equity-owned businesses).

- **Distressed Debt:** Distressed debt consists of loans to distressed companies in bankruptcy or on the precipice of bankruptcy. These loans can span the capital stack as senior secured, subordinated, or mezzanine debt. The purpose of these loans is to lend a borrower money, usually at a high interest rate, with the intention of restructuring the company to become profitable.

- **Special Situations:** These loans are typically made to distressed companies or those about to undergo a material event, with the intention of gaining control of the company. Similar to distressed debt, special situation loans can span the capital stack.

- **Real Estate Debt:** Debt used for real estate development or investment in existing real estate assets. Real estate debt can span the capital stack.

- **Infrastructure Debt:** Debt used for infrastructure development and investment in existing infrastructure assets. Infrastructure debt can span the capital stack.

At PennantPark, within our Senior Debt Strategy, we focus on Direct Lending. These debt instruments are directly originated first-lien loans in the core middle market. Our Senior Debt Strategy targets profitable, growing, cash-flowing companies with $10-$50M in earnings across five primary sectors: healthcare, government services, software & technology, consumer, and business services. Our direct lending deals are structured with floating-rate yields, over a specified reference rate (usually LIBOR or SOFR), at the top of the capital structure, with a minimum of two financial covenants.

If structured properly, direct lending strategies have the potential to generate returns similar to, or higher than, other credit investments, with less risk and less volatility. Below, we outline the three primary reasons that investors are increasing their allocations to direct lending.

Why Invest in Direct Lending?

Investors are increasingly allocating to private credit, and direct lending is gaining particular attention. According to a survey by Mercer Investments and CAIS, 98% of the 260 participating financial advisors were already investing in private credit, and 68% planned to increase their allocations over the next 12 months[1]. What are the expected benefits?

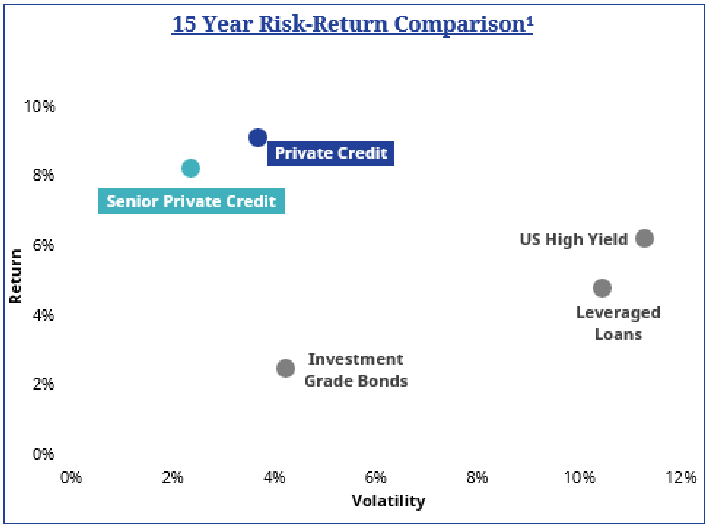
- **Principal Protection:** Since 2005 direct lending has had a ~50% lower annual loss rate[1] compared to public high-yield loans. Additionally, given its senior place in the capital stack, direct lending has a lower risk of principal loss compared to private equity. Furthermore, direct lending typically consists of a single lender and borrower instead of a group of multiple lenders, as seen in the public markets. This direct collaboration often results in more efficient workouts following a payment default, which can lead to greater recovery rates.

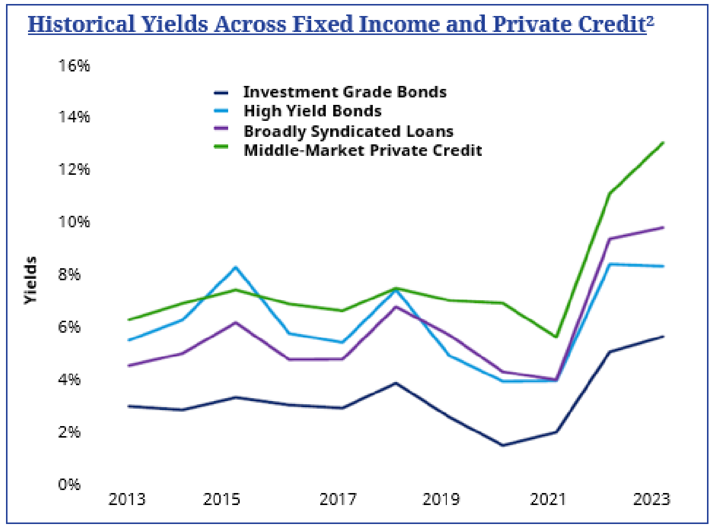
- **Premium Income Generation:** Direct lending loans typically offer investors higher yields than traditional fixed-income investments to compensate them for the illiquidity risk they take on (the inability to trade the loan in the public markets). Additionally, most direct lending loans are structured with floating rates. Floating-rate loans will provide higher yields than traditional fixed-income investments, regardless of the interest rate environment. As such, direct lending can offer investors consistent, predictable, current income.

- **Diversification:** Given its low correlation with the public markets, direct lending has historically provided diversification benefits. Unlike traditional fixed-income securities, which decrease in value when rates increase, direct lending typically benefits from increased rates, as the floating-rate yields rise in tandem. Furthermore, given the illiquid

[1] *Why Private Credit Is the Alternative Asset Class Everyone Covets | February 2024*

nature of direct lending, it has not historically been subject to the volatility of the public markets. Direct lending can also offer supplemental diversification benefits from other private credit strategies within a portfolio.





Note: Past performance is not necessarily indicative of future results. Invested capital is at risk. Volatility is measured using standard deviation.

1. *Data as of 9/30/2023. All of the quarterly standard deviations are then annualized. "Private Credit" and "Senior Private Credit" are represented by the Cliffwater Direct Lending Indices. "Leveraged Loans" is represented by the Morningstar LSTA US Leveraged Loan Index. "US High Yield" is represented by the Bloomberg US Corporate High Yield Index. "Investment Grade Bonds" is represented by the Bloomberg US Aggregate Bond Index. The indices presented are not subject to fees or expenses and it is not possible to directly invest in any index presented. Unlike the indices presented, PennantPark could employ leverage, which will increase the volatility of PennantPark's investments and will magnify the potential for loss of amounts invested.*
2. *Source: BofA Q4 2023 Chartbook – 2024: A Foundational Year, BoFA Global Research. "Investment Grade Bonds" is represented by the ICE BofA AAA U.S. Treasury Index. "High Yield Bonds" is represented by the ICE BofA High Yield Cash Pay Index. "Broadly Syndicated Loans" is represented by the ICE BofA Global Broad Market Corp (Hedged) Index. "Middle Market Private Credit" is represented by the Cambridge Associates Private Credit Index.*

Contact Us

About PennantPark:

PennantPark is an independent middle market credit platform founded in 2007 by private credit industry veteran Art Penn (most recently Managing Partner at Apollo Credit). As of March 2024, PennantPark has invested $18.5B in over 700 private credit transactions since its inception. We have $7.0B in AUM today from some of the world's largest and most sophisticated institutional investors. 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

Important Information:

©2024 PennantPark Investment Advisers, LLC ('PennantPark') is an investment adviser registered with the US Securities and Exchange Commission ('SEC'). Registration is not an endorsement by the SEC nor an indication of any specific level of skill. Products or services referenced in this document may not be licensed in all jurisdictions, and unless otherwise indicated, no regulator or government authority has reviewed this document, or the merits of the products and services referenced herein. This document and the information contained herein has been made available in accordance with the restrictions and/or limitations implemented by applicable laws and regulations.

In considering the past performance information contained herein, recipients should bear in mind that past performance is not a guarantee, projection or prediction and it is not a guarantee or indication of future results. Invested capital is at risk. There can be no assurance that any product or service referenced herein will achieve comparable results, or that they will be able to implement their investment strategies or achieve their investment objectives.

An investment with PennantPark in any advised fund is suitable only for sophisticated investors and requires the financial ability and willingness to accept the risks and lack of liquidity that are characteristic of an investment in such funds. Investors must be prepared to bear such risks for an extended period. There can be no assurance that any investment will be profitable, not lose money, or achieve the other intended purposes for which they are made. Investing with PennantPark will expose the investor to various risks including, but not limed to, the following: 1) Lack of Liquidity Risks including lack of permitted withdrawals, lack of secondary market, and lack of transferability 2) Interest Rate Volatility Risks 3) Use of Leverage Risks 4) Securitization Risks 5) Credit Market Disruption Risks 6) Investing within a Highly Competitive Market Risks 7) Default by Borrowers Risks 8) Recovery on Bad Debt Risks including cost of recovery 9) International Market Exposure Risks 10) Inflation and Deflation Exposure Risks. This is not intended to be a complete description of the risks of investing with PennantPark. Investors should rely on their own examination of the potential risks and rewards. The firm brochure (Form ADV 2A) is available online at www.adviserinfo.sec.gov or upon request and discusses these and other important risk factors and considerations that should be carefully evaluated before making an investment.

This document is directed at and intended for sophisticated investors. The information contained here does not constitute, and is not intended to constitute, an offer of securities and accordingly should not be construed as such. Information in this document does not constitute legal, tax, or investment advice. Before acting on any information in this document, current and prospective investors should inform themselves of and observe all applicable laws, rules and regulations of any relevant jurisdictions or obtain independent tax, legal, or investment advice.

Statements in this document are made as of the date hereof unless stated otherwise herein, and neither the delivery of this Document at any time, nor any sale hereunder, shall under any circumstances create an implication that the information contained herein is correct as of any time after such date. Certain information contained herein concerning economic trends and performance is based on or derived from information provided by independent third-party sources. PennantPark believes that such information is accurate and that the sources from which it has been obtained are reliable. PennantPark cannot guarantee the accuracy of such information, however, and has not independently verified the assumptions on which such information is based. Certain statements contained in this Document, including without limitation, statements containing the words “believes,” “anticipates,” “intends,” “expects,” and words of similar import constitute “forward looking statements.” Additionally, any forecasts and estimates provided herein are forward-looking statements. Such statements and other forward-looking statements are based on available information and the views of PennantPark as of the date hereof. Accordingly, such statements are inherently speculative as they are based on assumptions that may involve known and unknown risks and uncertainties. Actual results and events may differ materially from those in any forward-looking statements. Further, any opinions expressed are the current opinions of PennantPark only and may be subject to change, without notice. There is no undertaking to update any of the information in this document. No person has been authorized in connection with this document to give any information or to make any representations other than as contained in this document and, if given or made, such information or representation must not be relied upon as having been authorized by PennantPark Investment Advisers, LLC (“PennantPark”) or PennantPark’s affiliates.