The Growth of Private Credit

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An explanation behind the rise in popularity of this all-weather asset class.

- Structural trends, including banking regulations, interest rates, and the growth of private equity buyout transactions have contributed to the asset class' growth
- Investors are allocating to private credit direct lending due to its historical ability to provide consistent income generation, an attractive low volatility return profile, downside protection, and diversification from public markets
- Borrowers are seeking direct lending due to the ease, speed, and simplicity of the transactions

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Private credit as an asset class has existed for decades, so why is everyone talking about it now? To level-set, when we use the term private credit, we are referring to debt that is privately originated by an asset manager, without the intermediation of a bank or traded on any kind of public market.

Many will have heard experts reference today as the "Golden Age" of private credit. BlackRock, the world's largest asset manager, reports that the asset class has more than tripled since 2015, to $1.6 trillion in assets under management, and projects that the market will hit $3.5 trillion by 2028[1]. According to Preqin's 2023 report on private debt, 63% of survey respondents reported that they are planning to increase their private credit allocations in the long term[2].

We believe several structural trends have contributed to this growth over time.

Increased Banking Regulations: Banking regulations implemented in the 1980's through the Global Financial Crisis forced banks to pull away from their traditional lending practices, which created a void in the market. Regulatory burdens make it very difficult for banks to lend to small and mid-sized businesses. Alternative asset managers were able to provide a stop-gap for that void. As a result, private direct lending has become an imperative source of capital for American

[1] *Source: The Definitive History of Private Credit, February 2024 and Markets Media: BlackRock Says Private Debt Will Reach $3.5tr by 2028*
[2] *Source: Preqin Global report 2023: Private Debt*

core middle-market businesses to obtain growth financing. Borrowers are willing to pay more for private credit loans for simpler access to financing, confidential negotiations, as well as certainty of close and speed of execution.

The Search for Yield: In the wake of the Global Financial Crisis, the Federal Reserve cut interest rates dramatically to help stimulate the economy. As a result, investors were starving for yield in their fixed-income portfolios. Private credit, specifically direct lending in the core-middle market, is often structured as floating rate loans, with first lien spreads historically 500-700 basis points over the Secured Overnight Financing Rate "SOFR". As a result, private credit can be a great way for investors to achieve yield in their portfolios in any interest rate environment. This factor has positioned private credit to become a "core" allocation within investors' private markets portfolios. Investors appreciate private credit's historical ability to provide current income, lower volatility, diversification benefits, and attractive risk-adjusted returns with loss rates that are comparable (or better than) public markets[3]. According to Christophe Fritsch, Global Head of Alternative Credit at Axa IM, "…Both institutional and retail investors are actively looking for less correlated assets, higher yields, lower volatility, downside risk management and floating-rate exposure to be defensively positioned and earn compelling risk-reward returns which alternative credit provides…"

The Growth of Private Equity Buyout Market: The rise in private equity buyout activity in the middle market has also contributed to the growth of private credit. According to research from the American University, the number of publicly traded US companies has fallen roughly 50% from 8,090 companies in 1996 to 4,266 companies in 2019[4]. Private equity providing an alternative source of capital to the public equity markets plays a large role in this trend. Private equity sponsors partner with private credit managers to facilitate acquisition transactions. Adam Wheeler, co-head of Barings' global private finance group, says demand for private credit has "materially grown due to the record levels of private equity dry powder in the market." This is exemplified by 4Q 2023 direct lending buyout volume, which grew 22% since the prior quarter[5].

At PennantPark, we have been investing in the core-middle market of private credit since our founding in 2007. As such, the PennantPark investment strategies have demonstrated consistent returns and downside protections throughout various market cycles. We have invested through the Global Financial Crisis, COVID-19, and regional banking failures, all with an annualized loss rate of just 9 basis points since our inception. We stick to what we know: investing in the core middle market, defined as businesses with earnings of $10 to $50 million,

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[3] *BlackRock Alternatives: The Growth of Direct Lending, February 2023*
[4] *Wallstreet Fintech: The Definitive History of Private Credit, February 2024*
[5] *Source: LSEG LPC's Middle market Connect: The Middle Market Opportunity as of January 2024*

across five defensive sectors of expertise: healthcare, government services, software & technology, consumer, and business services.

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

Contact Us

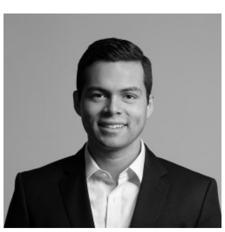
About PennantPark:

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). 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

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