

Leverage Risk: Portfolio Company vs. Fund Level Leverage

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- We believe effective management of leverage at both the portfolio company and fund levels is crucial for balancing risk and return in private credit investments
- By focusing on companies with conservative debt-to-EBITDA ratios and employing prudent fund-level leverage practices, PennantPark seeks to mitigate default risks and pursue attractive risk-adjusted returns for investors

I. Portfolio Company Leverage (Debt/EBITDA)

Managing debt-to-EBITDA¹ ratios, or portfolio company leverage, is critical for assessing a company's financial health. This ratio helps evaluate a company's financial ability—or inability—to satisfy its debt obligations. A higher leverage ratio may indicate increased default risk, as companies with substantial debt relative to earnings could face challenges in servicing their debt obligations, particularly during periods of economic stress.

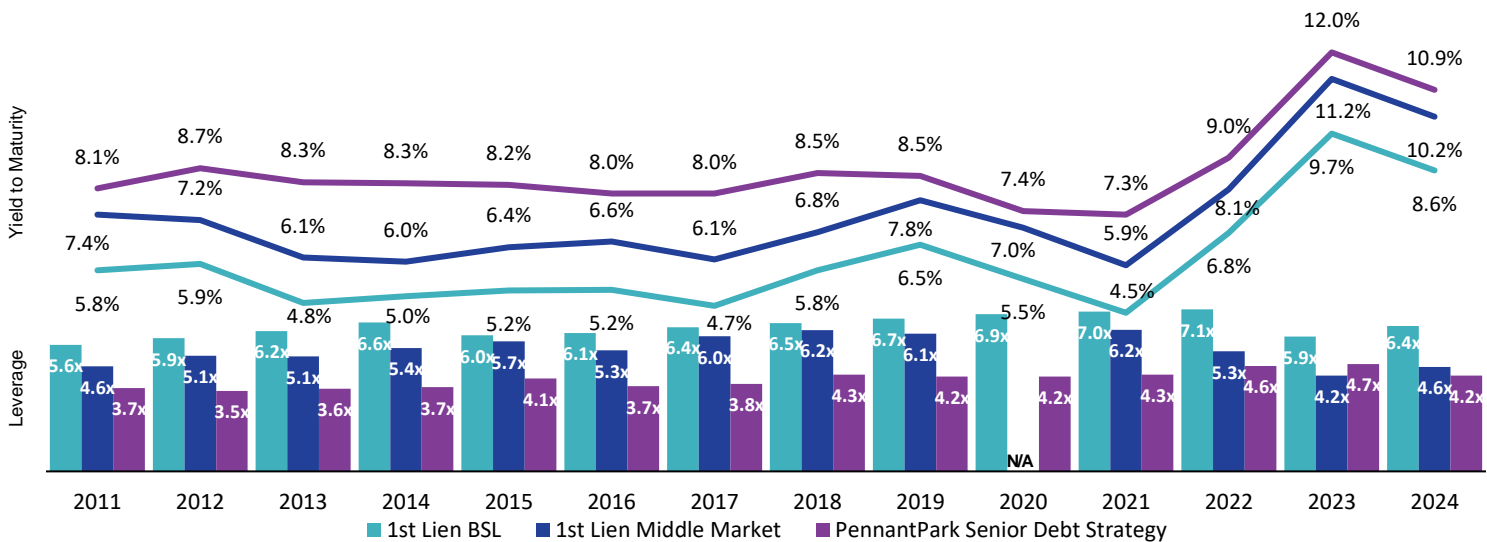
Conversely, a lower leverage ratio could indicate more manageable debt levels relative to earnings, which can contribute to financial stability under many market conditions. Companies with lower leverage may have a greater capacity to service debt, including interest and principal payments.

At PennantPark, we focus on lending to companies with manageable leverage, ensuring they generate sufficient operating cash flows to meet their debt obligations, even during economic slowdowns. We typically target leverage multiples of 4.0x to 5.0x for first lien loans, whereas upper middle market managers generally target leverage multiples of 5.0x to 7.5x for first lien loans.

By focusing on conservative leverage multiples, we seek to manage risk during downturns when portfolio companies may face balance sheet pressures. Additionally, PennantPark underwrites each potential investment to recessionary downside scenarios. Our stress test models include, but are not limited to, the following factors:

- Simulating how companies perform in a scenario similar to the Global Financial Crisis (GFC) or COVID-19 pandemic
- Evaluating outcomes when companies lose their largest customers and / or suppliers
- Assessing impacts of declining margins
- Modeling various macroeconomic and recessionary scenarios, where revenues and EBITDA are reduced by 10-50%

PennantPark Selectivity: Higher Yields with Lower Leverage²



Note: Past performance is not necessarily indicative of future results. Invested capital is at risk.

Source: LSEG. As of 12/31/2024. Middle Market is defined as Issuers with revenues of \$500M and below, and total loan package of less or equal to \$500M. Broadly Syndicated Loans 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". Market data averages only include data available from LSEG for the time periods referenced. For 2020, LSEG does not have sufficient observations at this time to provide data for First Lien Middle Market.

II. Fund-Level Leverage (Asset-backed credit facility)

Fund-level leverage represents the amount of borrowing a private credit fund undertakes relative to its net asset value (NAV). Essentially, this measures how much debt the fund itself is using to finance its investments. A higher fund-level leverage ratio means the fund is borrowing a larger proportion of its capital, which can amplify both potential returns and risks. During economic downturns, fund-level leverage may magnify losses, as higher debt levels can increase liquidity pressures, potentially leading to asset sales at unfavorable prices.

Key Considerations of Fund-Level Leverage During Economic Downturns:

- **Increased Credit Risk:** As a company faces financial challenges, the likelihood of default increases, prompting funds to hold larger capital reserves to absorb potential losses. This can limit the ability to achieve optimal investment diversification and constrain returns over time.
- **Investment Valuations:** During economic volatility, the value of private credit investments can fluctuate, impacting the NAV of the fund. These valuation shifts, in turn, may increase capital needs to maintain reserves, further intensifying pressure on the fund's liquidity and return potential.

The use of fund-level leverage must be carefully managed to ensure the fund maintains flexibility and avoids taking on excessive risk. PennantPark employs a disciplined approach to fund-level leverage, striking a balance between leveraging facilities for growth and safeguarding against liquidity risks in challenging market conditions.

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

About PennantPark:

PennantPark is an independent middle market credit platform founded in 2007 by private credit industry veteran Art Penn (Co-Founder and former Managing Partner at Apollo Credit). As of 2025, PennantPark has invested over \$26 billion in over 780 private credit transactions since its inception. Our clients include some of the world's largest and most sophisticated institutional investors. We are in the process of expanding our offerings to focus on the private wealth market. The Firm is headquartered in Miami and has 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. PennantPark offers investment strategies through various public and private fund structures, including BDCs, LP drawdown vehicles, CLOs, SMAs, and joint ventures.

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Endnotes:

1. EBITDA stands for earnings before interest taxes depreciation and amortization.
2. Source: LSEG. As of 12/31/2024.