



# PennantPark Floating Rate (PFLT)

Updated August 12<sup>th</sup>, 2021 by Samuel Smith

## Key Metrics

<b>Current Price:</b>	\$13.2	<b>5 Year CAGR Estimate:</b>	6.2%	<b>Market Cap:</b>	\$509.1 M
<b>Fair Value Price:</b>	\$12.0	<b>5 Year Growth Estimate:</b>	0.1%	<b>Ex-Dividend Date:</b>	8/17/21
<b>% Fair Value:</b>	110%	<b>5 Year Valuation Multiple Estimate:</b>	-1.8%	<b>Dividend Payment Date:</b>	9/01/21
<b>Dividend Yield:</b>	8.6%	<b>5 Year Price Target:</b>	\$12	<b>Years Of Dividend Growth:</b>	0
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	C	<b>Last Dividend Increase:</b>	N/A

## Overview & Current Events

PennantPark Floating Rate Capital Ltd. is a business development company that seeks to make secondary direct, debt, equity, and loan investments. The fund also aims to invest through floating rate loans in private or thinly traded or small market-cap, public middle market companies, equity securities, preferred stock, common stock, warrants or options received in connection with debt investments or through direct investments. It generally invests in the United States and to a limited extent non-U.S. companies. It aims to invest in companies not rated by national rating agencies. The firm has a market capitalization of approximately \$509.1 million and produced roughly \$82.8 million in revenue in 2020. PennantPark Floating Rate Capital Ltd. is managed by PennantPark Investment Advisers, LLC.

PennantPark Floating Rate reported third quarter earnings on August 4<sup>th</sup>, 2021. Total investment income for the quarter decreased 8.2% to \$20.9 million from \$22.8 million in the year-ago quarter. The yield on debt investments stood at 7.5%. Meanwhile, the company invested \$248.3 million during the quarter in ten new and sixteen existing portfolio companies with a weighted average yield on debt investments of 7.5%.

That said, the company's sales and repayments of investments for the same period totaled \$283.3 million. Cash equivalents at quarter end stood at \$48.7 million compared to \$57.5 million in September 30, 2020. Meanwhile, FQ3 net investment income was \$0.27 compared to \$0.26 in the year-ago period. PennantPark's portfolio totaled \$1,035.8 million, which includes \$883.2 million of first lien secured debt, \$17.6 million of second lien secured debt and \$135.0 million of preferred and common equity.

## Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
<b>EPS</b>	\$1.75	\$1.25	\$1.38	\$0.77	\$1.25	\$1.20	\$0.87	\$0.29	\$0.47	\$1.02	<b>\$1.12</b>	<b>\$1.20</b>
<b>BVPS</b>	\$14.0	\$14.2	\$14.2	\$13.7	\$14.1	\$13.9	\$13.7	\$13.0	\$12.31	\$12.43	<b>\$12.50</b>	<b>\$13.00</b>
<b>DPS</b>	\$0.91	\$1.03	\$1.08	\$1.12	\$1.14	\$1.14	\$1.14	\$1.14	\$1.14	\$1.14	<b>\$1.14</b>	<b>\$1.14</b>
<b>Shares<sup>1</sup></b>	6.9	14.9	14.9	26.7	26.7	38.5	38.8	38.8	38.8	38.5	<b>38.7</b>	<b>40.0</b>

As a BDC, PennantPark Floating Rate pays out virtually all of its profits out via dividends. As a result, whenever the business suffers an impairment from meaningful loan losses, its book value will decline with little means of regaining that value. As a result, we expect book value per share to gradually decline over time and, with it, earnings per share. The only thing that would meaningfully boost earnings per share is an increase in interest rates. Given that the company invests primarily in floating interest rates, rising interest rates would especially help PennantPark Floating Rate.

However, we do not foresee interest rates rising meaningfully over the next few years as the Federal Reserve is committed to supporting the economic recovery, and therefore expect book value per share and the dividend per share to be stagnant over the next half decade. However, we do expect book value per share to increase a little bit from current levels as the economy continues to recover as it remains suppressed from pre-COVID-19 levels.

<sup>1</sup> In millions

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## Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Avg. P/E	---	7.3	11.0	9.9	14.6	11.3	11.4	13.3	42.0	18.0	<b>8.1</b>	<b>11.4</b>
Avg. P/B	0.78	0.91	0.96	0.97	0.82	1.00	0.99	0.85	0.94	0.86	<b>1.04</b>	<b>0.95</b>
Avg. Yld.	4.1%	7.1%	7.6%	7.8%	10.0%	8.1%	8.3%	9.8%	9.3%	10.8%	<b>8.6%</b>	<b>9.4%</b>

For BDCs, we prefer to use Price-to-Book-Value for our primary valuation metric instead of Price-to-Earnings. We believe that a slight discount to book value is warranted given the high leverage applied and general riskiness of the business model. Although the dividend has grown over time and book value has not dropped too much. As a result, we believe that 0.95 is a fair Price-to-Book-Value multiple, making shares appear somewhat overvalued at present.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	---	52%	82%	78%	145%	91%	95%	131%	393%	243%	<b>70.4%</b>	<b>95%</b>

PennantPark Floating Rate does not have any meaningful competitive advantage and was not active during the Great Recession. However, given that the majority of its loans are in the BB – CCC range, we can infer that many of them would struggle to perform under distressed conditions.

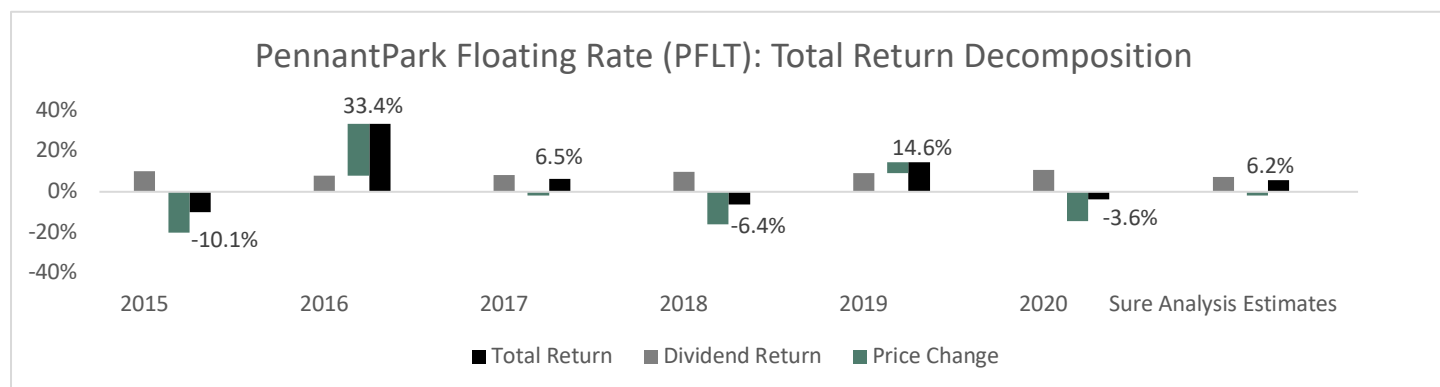
PennantPark Floating Rate also has a highly leveraged balance sheet and a payout ratio that often nears or exceeds 100% of earnings. While the company can probably sustain this model while the economy is running smoothly – as the growing and stable dividend over the past decade has shown – it may collapse if the economy experiences a significant and prolonged downturn that would cause its loans to underperform.

Management seems to have steered the company through the COVID-19 crisis well so far, thanks in part to the stimulus and bailout packages that were provided to small businesses. However, given the low quality of the balance sheets undergirding the portfolio and their high leverage, in a real sustained downturn we expect things to go much worse. Given the high payout ratio, we would also expect a dividend cut to follow.

## Final Thoughts & Recommendation

PennantPark Floating Rate has a strong track record of a stable dividend and offers investors decent 6.2% annualized total return potential and a 8.6% dividend yield. It also trades slightly below its book value. For investors looking to hedge their portfolio against rising interest rates, its exposure to floating interest rates is a major plus. That said, the high leverage and lower quality loans underpinning the portfolio mean it is not a low-risk investment opportunity. Shares earn a Hold rating.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	---	14	14	24	17	38	41	50	20	23
SG&A Exp.	---	2	2	2	2	3	4	4	4	4
Net Profit	---	12	12	21	13	33	36	33	11	18
Net Margin	---	84.2%	83.3%	86.9%	72.4%	88.8%	88.8%	67.5%	57.2%	81.2%
Free Cash Flow	---	(48)	(124)	(22)	(2)	(165)	(77)	(208)	(121)	(5)

## Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	121	178	329	373	416	631	747	1,076	1,152	1,148
Cash & Equivalents	7	4	5	13	21	29	19	72	63	58
Total Liabilities	29	83	119	158	43	256	289	541	649	671
Accounts Payable	26	4	16	5	12	18	26	66	19	11
Long-Term Debt	---	75	100	147	30	232	257	468	624	653
Shareholder's Equity	92	96	210	215	373	376	458	536	503	477
D/E Ratio	---	0.78	0.47	0.69	0.08	0.62	0.56	0.87	1.24	1.37

## Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	---	---	4.7%	5.8%	3.2%	6.4%	5.3%	3.7%	1.0%	1.6%
Return on Equity	---	12.7%	7.8%	9.7%	4.3%	8.9%	8.7%	6.7%	2.2%	3.8%
ROIC	---	---	5.0%	6.1%	3.3%	6.6%	5.5%	3.9%	1.1%	1.6%
Shares Out.	6.83	6.85	9.59	14.90	16.29	26.73	30.27	38.30	38.77	38.77
Revenue/Share	---	2.07	1.50	1.58	1.06	1.41	1.35	1.30	0.51	0.58
FCF/Share	---	(6.98)	(12.98)	(1.49)	(0.14)	(6.19)	(2.53)	(5.44)	(3.13)	(0.13)

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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