



PennantPark Floating Rate (PFLT)

Updated November 29th, 2022 by Samuel Smith

Key Metrics

| | | | | | |
|-----------------------------|--------|--|-------|----------------------------------|-----------------------|
| Current Price: | \$11.3 | 5 Year CAGR Estimate: | 8.5% | Market Cap: | \$516.4 M |
| Fair Value Price: | \$11.2 | 5 Year Growth Estimate: | 0.2% | Ex-Dividend Date: | 12/16/22 ¹ |
| % Fair Value: | 101% | 5 Year Valuation Multiple Estimate: | -0.2% | Dividend Payment Date: | 01/01/23 |
| Dividend Yield: | 10.1% | 5 Year Price Target: | \$11 | Years Of Dividend Growth: | 0 |
| Dividend Risk Score: | F | Retirement Suitability Score: | C | Rating: | Hold |

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 \$516.4 million. PennantPark Floating Rate Capital Ltd. is managed by PennantPark Investment Advisers, LLC.

On November 16th, 2022 PennantPark Floating Rate Capital Ltd. announced results for the Fourth Quarter and Fiscal Year Ended September 30, 2022. Investment income was \$28.8 million, up from \$21.6 million in the year-ago quarter. Investment income for the fiscal year ended September 30, 2022 was \$105.5 million and was attributable to \$89.1 million from first lien secured debt and \$16.4 million from other investments. Investment income for the year ended September 30, 2021 was \$82.7 million and was attributable to \$72.1 million from first lien secured debt and \$10.6 million from other investments, indicating that PFLT generated considerable growth year-over-year. The increase in investment income compared to the same periods in the prior year was primarily due to an increase in LIBOR and SOFR base rates and an increase in the size of the trust's interest-bearing portfolio.

Growth on a Per-Share Basis

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|---------------------------|---------|--------|---------|---------|---------|---------|---------|---------|---------|---------|----------------|----------------|
| EPS | \$1.25 | \$1.38 | \$0.77 | \$1.25 | \$1.20 | \$0.87 | \$0.29 | \$0.47 | \$1.02 | \$1.18 | \$1.21 | \$1.25 |
| BVPS | \$14.20 | \$14.2 | \$13.70 | \$14.10 | \$13.90 | \$13.70 | \$13.00 | \$12.31 | \$12.62 | \$11.77 | \$11.77 | \$11.90 |
| DPS | \$1.03 | \$1.08 | \$1.12 | \$1.14 | \$1.14 | \$1.14 | \$1.14 | \$1.14 | \$1.14 | \$1.14 | \$1.14 | \$1.14 |
| Shares¹ | 6.9 | 14.9 | 14.9 | 26.7 | 26.7 | 38.5 | 38.8 | 38.8 | 38.8 | 39.2 | 45.3 | 50.0 |

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 remain relatively stagnant over time and with it, earnings per share. The only thing that would meaningfully boost earnings per share is a large increase in interest rates. Given that the company invests primarily in floating interest rates, rising interest rates would potentially help PennantPark Floating Rate.

However, we do not foresee interest rates rising meaningfully more than they have already over the next few years as the Federal Reserve cannot raise interest rates too much or they risk crashing the stock market and sending the economy into recession. Therefore, we expect book value per share and the dividend per share to be fairly stagnant over the next half decade. However, we do expect book value per share to increase a little bit from current levels as the business continues to make accretive investments and issue shares whenever it is accretive to book value to do so.

¹ In millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|-----------|------|------|-------|------|------|------|------|-------|------|-------|--------------|--------------|
| Avg. P/B | 0.96 | 0.97 | 0.82 | 1.00 | 0.99 | 0.85 | 0.94 | 0.86 | 1.00 | 0.96 | 0.96 | 0.95 |
| Avg. Yld. | 7.6% | 7.8% | 10.0% | 8.1% | 8.3% | 9.8% | 9.3% | 10.8% | 8.8% | 10.1% | 10.1% | 10.1% |

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 roughly fairly valued at present.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|--------|------|------|------|------|------|------|------|------|------|------|------------|------------|
| Payout | 82% | 78% | 145% | 91% | 95% | 131% | 393% | 243% | 112% | 97% | 94% | 91% |

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.

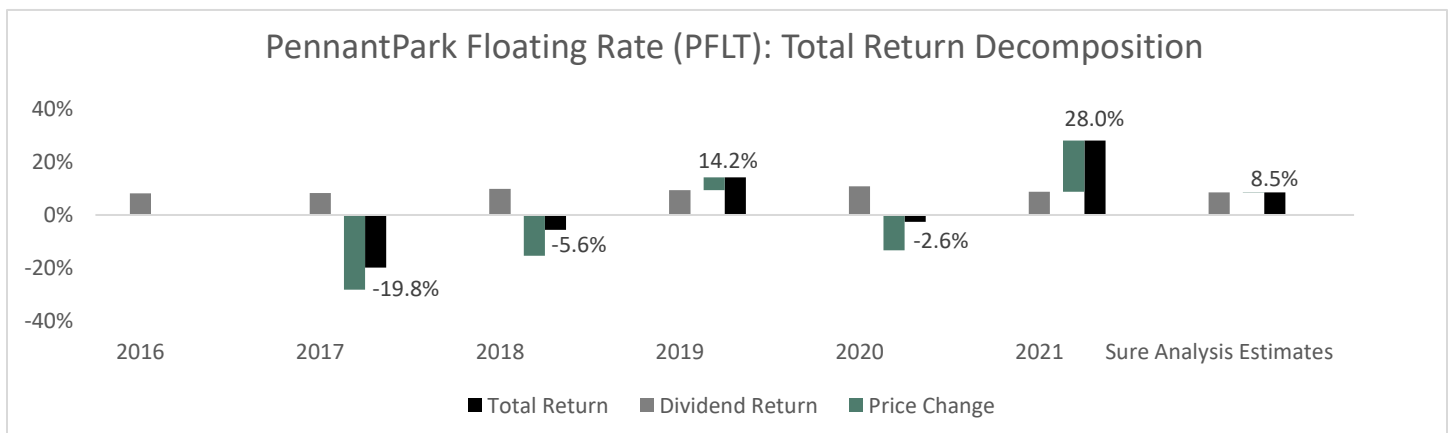
PennantPark Floating Rate also has a highly leveraged balance sheet and a payout ratio that often nears or exceeds 100% of earnings. While the company can probably sustain this model while the economy is running smoothly – as the growing and stable dividend over the past decade has shown – it may collapse 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, 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 get 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 paying a stable dividend and offers investors decent 8.5% annualized total return potential and an attractive 10.1% dividend yield. It trades slightly below its book value at the moment. For investors looking to hedge their portfolio against rising interest rates, its exposure to floating interest rates is a 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 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|----------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 14 | 24 | 17 | 38 | 41 | 50 | 20 | 23 | 62 | 12 |
| SG&A Exp. | 2 | 2 | 2 | 3 | 4 | 4 | 4 | 4 | 2 | 3 |
| Net Profit | 12 | 21 | 13 | 33 | 36 | 33 | 11 | 18 | 57 | 3 |
| Net Margin | 83.3% | 86.9% | 72.4% | 88.8% | 88.8% | 67.5% | 57.2% | 81.2% | 91.3% | 29.7% |
| Free Cash Flow | (124) | (22) | (2) | (165) | (77) | (208) | (121) | (5) | 50 | (50) |

Balance Sheet Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|----------------------|------|------|------|------|------|-------|-------|-------|-------|-------|
| Total Assets | 329 | 373 | 416 | 631 | 747 | 1,076 | 1,152 | 1,148 | 1,171 | 1,224 |
| Cash & Equivalents | 5 | 13 | 21 | 29 | 19 | 72 | 63 | 58 | 50 | 48 |
| Total Liabilities | 119 | 158 | 43 | 256 | 289 | 541 | 649 | 671 | 680 | 697 |
| Accounts Payable | 16 | 5 | 12 | 18 | 26 | 66 | 19 | 11 | 23 | 12 |
| Long-Term Debt | 100 | 147 | 30 | 232 | 257 | 468 | 624 | 653 | 653 | 673 |
| Shareholder's Equity | 210 | 215 | 373 | 376 | 458 | 536 | 503 | 477 | 491 | 527 |
| LTD/E Ratio | 0.47 | 0.69 | 0.08 | 0.62 | 0.56 | 0.87 | 1.24 | 1.37 | 1.33 | 1.28 |

Profitability & Per Share Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|------------------|------|--------|--------|--------|--------|--------|--------|--------|-------|--------|
| Return on Assets | 4.7% | 5.8% | 3.2% | 6.4% | 5.3% | 3.7% | 1.0% | 1.6% | 4.9% | 0.3% |
| Return on Equity | 7.8% | 9.7% | 4.3% | 8.9% | 8.7% | 6.7% | 2.2% | 3.8% | 11.7% | 0.7% |
| ROIC | 5.0% | 6.1% | 3.3% | 6.6% | 5.5% | 3.9% | 1.1% | 1.6% | 5.0% | 0.3% |
| Shares Out. | 6.9 | 14.9 | 14.9 | 26.7 | 26.7 | 38.5 | 38.8 | 38.8 | 38.8 | 39.2 |
| Revenue/Share | 1.50 | 1.58 | 1.06 | 1.41 | 1.35 | 1.30 | 0.51 | 0.58 | 1.60 | 0.28 |
| FCF/Share | (13) | (1.49) | (0.14) | (6.19) | (2.53) | (5.44) | (3.13) | (0.13) | 1.28 | (1.22) |

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

Disclaimer

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