PennantPark Floating Rate (PFLT)

Updated February 23rd, 2024 by Samuel Smith

Key Metrics

Current Price:	$11.5	**5 Year CAGR Estimate:**	7.6%	**Market Cap:**	$700 M
Fair Value Price:	$10.6	**5 Year Growth Estimate:**	-0.3%	**Ex-Dividend Date:**	3/15/24[1]
% Fair Value:	109%	**5 Year Valuation Multiple Estimate:**	-1.6%	**Dividend Payment Date:**	4/02/24[2]
Dividend Yield:	10.7%	**5 Year Price Target:**	$10	**Years Of Dividend Growth:**	2
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 $700 million. PennantPark Floating Rate Capital Ltd. is managed by PennantPark Investment Advisers, LLC.

On February 8th, 2024, PennantPark Floating Rate Capital Ltd. announced its financial results for the first quarter of fiscal 2024. PennantPark Floating Rate Capital Ltd. maintained stability amidst broader market challenges in Q1 2024. Net investment income (NII) came in at $0.33 per share, in line with analyst expectations. PFLT's focus on a portfolio of primarily floating-rate loans proved an advantage in an environment of rising interest rates, supporting continued income generation. The company's Net Asset Value (NAV) experienced a slight increase from the previous quarter. PFLT continued its track record of distributing reliable income as it maintained its monthly dividend of $0.095 per share. This consistency signals ongoing value creation for its shareholders. PennantPark management reiterated confidence in the benefits of the company's floating-rate loan portfolio strategy. They also highlighted PFLT's proactive portfolio management and focus on credit quality to navigate any economic hurdles. Additionally, management expressed positive sentiment toward the potential for PFLT to grow through targeted new deals and accretive investments throughout 2024.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$1.38	$0.77	$1.25	$1.20	$0.87	$0.29	$0.47	$1.02	$1.18	$1.33	***$1.29***	***$1.23***
BVPS	$14.2	$13.70	$14.10	$13.90	$13.70	$13.00	$12.31	$12.62	$11.77	$11.13	***$11.15***	***$11.00***
DPS	$1.08	$1.12	$1.14	$1.14	$1.14	$1.14	$1.14	$1.14	$1.14	$1.19	***$1.23***	***$1.23***
Shares[3]	14.9	14.9	26.7	26.7	38.5	38.8	38.8	38.8	45.3	58.7	***61.6***	***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

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[1] Estimated
[2] Estimated
[3] 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.

economy into recession. Therefore, we expect book value per share and the dividend per share to be fairly stagnant over the next half decade.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Avg. P/B	0.82	1.00	0.99	0.85	0.94	0.86	1.00	0.96	0.96	1.03	***1.03***	***0.95***
Avg. Yld.	10.0%	8.1%	8.3%	9.8%	9.3%	10.8%	8.8%	10.1%	11.1%	10.7%	***10.7%***	***11.8%***

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. Given that the dividend has grown over time and book value has not dropped too much, we believe that 0.95 is a fair Price-to-Book-Value multiple, making shares appear slightly overvalued at present.

Safety, Quality, Competitive Advantage, & Recession Resiliency

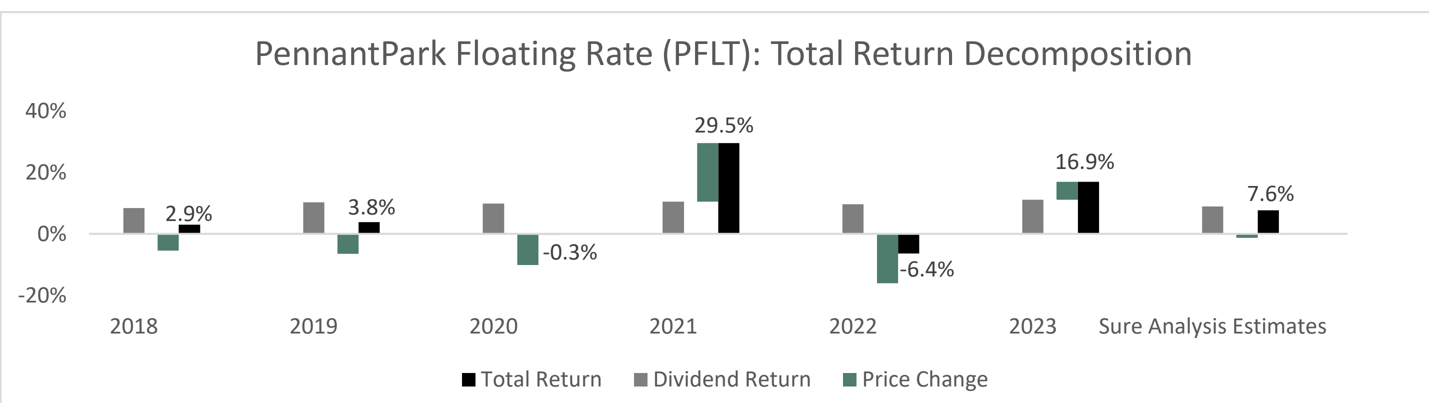
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	78%	145%	91%	95%	131%	393%	243%	112%	97%	89%	***95%***	***100%***

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 7.6% annualized total return potential and an attractive 10.7% dividend yield. It trades roughly in line with 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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	24	17	38	41	50	20	23	62	12	42
SG&A Exp.	2	2	3	4	4	4	4	2	3	4
Net Profit	21	13	33	36	33	11	18	57	3	39
Net Margin	86.9%	72.4%	88.8%	88.8%	67.5%	57.2%	81.2%	91.3%	29.7%	93.1%
Free Cash Flow	(22)	(2)	(165)	(77)	(208)	(121)	(5)	50	(50)	

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	373	416	631	747	1,076	1,152	1,148	1,171	1,224	1,179
Cash & Equivalents	13	21	29	19	72	63	58	50	48	100
Total Liabilities	158	43	256	289	541	649	671	680	697	525
Accounts Payable	5	12	18	26	66	19	11	23	12	20
Long-Term Debt	147	30	232	257	468	624	653	653	673	495
Shareholder's Equity	215	373	376	458	536	503	477	491	527	654
LTD/E Ratio	0.69	0.08	0.62	0.56	0.87	1.24	1.37	1.33	1.28	0.76

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	5.8%	3.2%	6.4%	5.3%	3.7%	1.0%	1.6%	4.9%	0.3%	3.3%
Return on Equity	9.7%	4.3%	8.9%	8.7%	6.7%	2.2%	3.8%	11.7%	0.7%	6.7%
ROIC	6.1%	3.3%	6.6%	5.5%	3.9%	1.1%	1.6%	5.0%	0.3%	3.3%
Shares Out.	14.9	14.9	26.7	26.7	38.5	38.8	38.8	38.8	45.3	58.7
Revenue/Share	1.58	1.06	1.41	1.35	1.30	0.51	0.58	1.60	0.28	0.83
FCF/Share	(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.