# Pearl Diver Credit Company (NYSE: PDCC)

## Rating: Buy

Price Target: $20.00
Share Price: $17.95

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### Company Data

| | |
|---|---|
| Average Daily Volume (M) | 0.0034 |
| 52-Week Range | 16.98-21.90 |
| Shares Outstanding (M) | 6.796 |
| Market Cap (M) | 121.99 |
| Enterprise Value (M) | 147.79 |
| Total Cash (M), mrq | 7.66 |
| Total Debt to Assets | 23.2% |

### Estimates

| FYE: Dec | | 2024A | 2025E |
|---|---|---|---|
| NAV | Q1 | N/A | $18.33 |
| | Q2 | N/A | |
| | Q3 | $20.05 | |
| | Q4 | $19.89 | |
| EPS | Q1 | N/A | -$0.90 |
| | Q2 | N/A | |
| | Q3 | $0.48 | |
| | Q4 | $0.51 | |
| NII/Share | Q1 | N/A | 0.504 A |
| | Q2 | N/A | 0.51 E |
| | Q3 | $0.401 | 0.52 E |
| | Q4 | $0.504 | 0.52 E |

### One-Year Performance Chart



As of June 27, 2025. Source: E-Trade.

**June 30, 2025**

## Pearl Diver Credit: An Alternative Play on Yields.

**Initiating Coverage of Pearl Diver Credit with Buy Rating and $20 Price Target**

### Overview

Pearl Diver Credit Company Inc. ("PDCC") is an externally managed closed-end investment company to invest primarily in collateralized loan obligation (CLO) tranches. It is externally managed by Pearl Diver Capital LLP, a specialist credit manager founded in 2008. PDCC's strategy is to generate high recurring current income by acquiring junior CLO securities (equity and sub-debt tranches) secured by pools of floating-rate senior secured corporate loans by mainly U.S. issuers. The portfolio is diversified across 50 CLOs with 1,700+ underlying obligors and industries with 100% U.S.D exposure. The top industry exposures include Software (9.0%), Healthcare (5.2%), and Chemicals (4.3%). The underlying loans are typically non-investment-grade (predominantly BB/B-rated) secured loans. As of April 30, 2025, PDCC held ~$149 million (fair value) of CLO assets, and that included financing by issuing $34.5 million (liquidation preference) of 8% Series A preferred stock (due 2029) and modest reverse-repo borrowings. Net assets were about $124.6 million as of March 31, 2025, with net asset value (NAV) of $18.33 per share. NAV declined by $1.56 from the previous quarter due to increased market risk that affected the risk premiums on CLO equity tranches.

Markets have been extremely volatile following the Trump administration's imposition of tariffs on Liberation Day (April 2, 2025), which caused several U.S. trading partners–including China, Canada and the EU–to adopt retaliatory and

countermeasures. A subsequent period of negotiations stabilized the credit markets; however, uncertainty and downside risks remain, resulting in bond market volatility and a spike in credit spreads across non-investment grade high yield bonds. Despite these headwinds, we estimate PDCC will continue to pay **$0.22/ share** in monthly dividends in the medium-term range, representing a current yield of approximately **15%**. Our estimate is based on current CLO yields, the credit outlook for U.S. credits, and management's strategy of active credit and loss management, generating **total returns** in the mid-teens range.

PDCC's stock is trading around $17.50, and we are initiating with a $20 price target and a **Buy** rating. We are basing our target price at 1.09 x NAV.

The volatility in the credit markets post the April 2025 spike in credit spreads has mitigated significantly. We expect the portfolio NAV to stabilize and improve based on current market conditions and the near-term outlook on credit.

**Rationale**

PDCC's portfolio NAV and share price are a function of the movement in credit spreads in conjunction with overall sentiment in the bond markets. EPS declined in Q1 2025 to $-0.90/share, largely driven by mark-to-market movements, offset by low loss rates with stable net investment income (NII) at $0.50/share. In our view, PDCC management has demonstrated expertise and discipline in managing credit origination and selection, leading to below benchmark loss rates of approximately 0.7%. There is also a positive carry on the portfolio Weighted Average Spread (WAS) and the cost of capital (WACC) to on a total return basis, to keep the distributions consistent without impacting the NAV. We expect the NII/share to remain **stable at around $0.50/share per quarter**, keeping yield in the **12-15%** range.

| Strengths | Challenges |
|---|---|
| • Strong manager track record with loss rates well below industry and benchmark indices over a 10-year period<br>• A sophisticated and quantitative approach to credit selection and active credit management using proprietary AI/ML algorithms<br>• Strong credit outlook for U.S. issuers and continued outperformance of the senior secured leveraged loan indices over Business Development Companies (BDCs) | • Volatility in the bond markets sparked by uncertainty in global tariff policies, post Liberation Day announcements<br>• Increase in input costs and margin pressures due to tariffs can create inflationary pressures<br>• Underlying portfolio is a leveraged play on non-investment grade credits that are most sensitive to market swings, potentially grinding the NAV |

PDCC Portfolio WAS and WACC
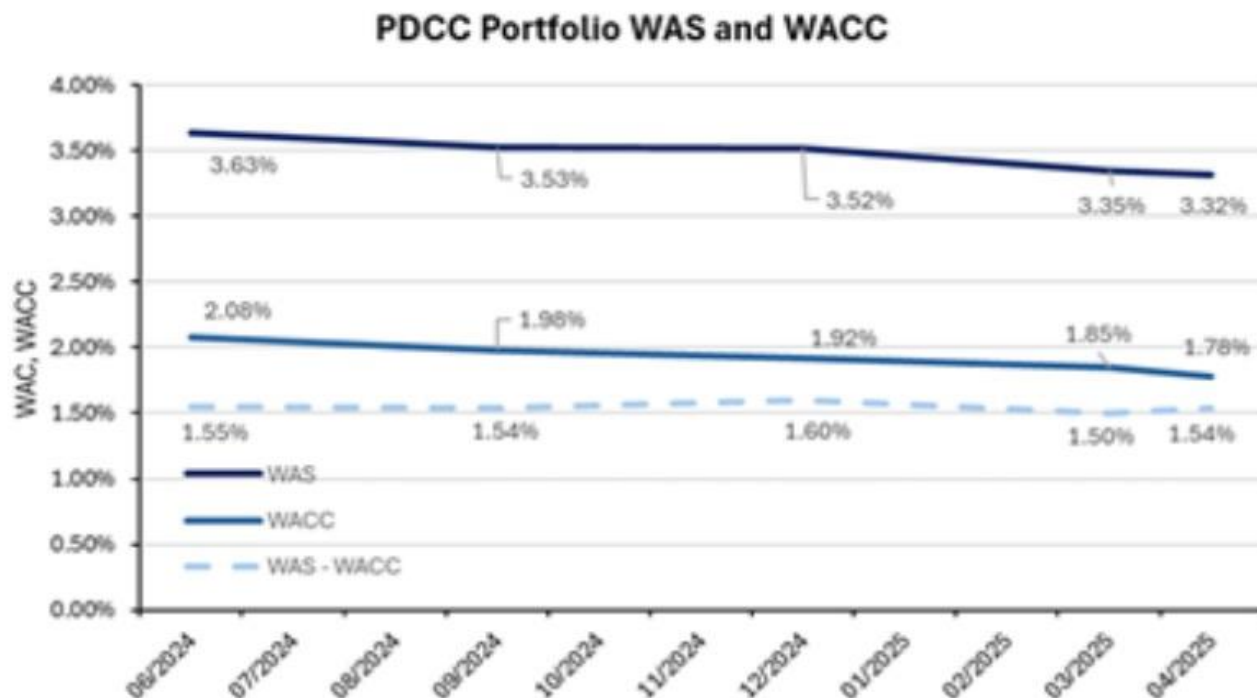
*Source: Pearl Diver Credit Company*

## Business Summary

PDCC began operations on July 9, 2024. **Net Investment Income (NII)** was approximately $6.75 million for the period from July 9-December 31, 2024 ($3.32M in Q3 2024 and $3.43M in Q4 2024), followed by $3.4M in Q1 2025. On a per-share basis, given 6.80 million shares, NII was approximately $0.50/share each quarter. However, net income in Q1 2025 swung to -$0.90/share in Q1 2025 due to an unrealized loss of $9.6 million in the portfolio. This was a direct impact of widening credit spreads, increased discount rates and mark-to-market losses in a portfolio mainly comprised of non-investment grade credits.  PDCC pays **monthly dividends** of $0.22/share), implying an annualized dividend yield of 14.8% on the April 30, 2025 share price. This increase in yield is attributed to the decrease in price due to the widening of credit spreads and not to any increases in distribution rates, which are expected to remain stable in the near future. **Return on Equity (ROE)** has been positive, a function of the effective yield of the portfolio net of incentive fees being charged by the investment manager. Incentive fees amounted to $604,720 in Q4 2024 and $603,528 Q1 2025. PDCC operates a permanent capital vehicle that will have short term mark-to-market fluctuations resulting in NAV volatility. The NAV has dropped to $18.33/share as of Q1 2025, declining by 8% from $20.00/share at inception in July 2024. The stock typically trades close to its NAV and offers an attractive yield of 14.8% at these levels.
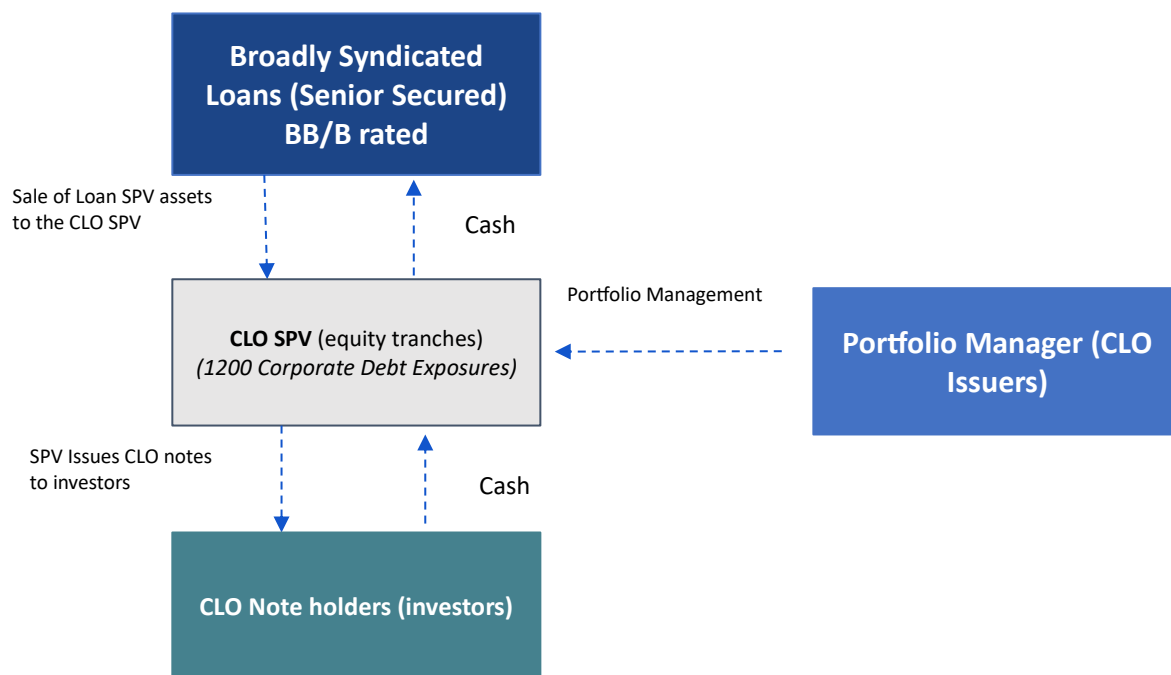
## Transaction Structure

PDCC invests **through special purpose vehicles (SPVs)**. Each CLO is a bankruptcy remote special-purpose vehicle that issues multiple debt tranches (rated AAA to BB) and retains an equity tranche. PDCC holds a mix of CLO equity and high yield CLO debt. The block diagram below illustrates the typical structure of a CLO. It has raised capital via common equity (shares) and 8% series-A term preferred equity. PDCC's assets are predominately **CLO securities comprised of CLO equity tranches**. Each CLO SPV holds a pool of senior secured loans to corporate obligors (e.g. Asurion LLC, TransDigm Inc., Cloud Software Group.) PDCC's top 10 obligors each account for ~0.4–0.7% of NAV. The CLO's liabilities are issued to outside investors, and PDCC as an equity holder receives the residual cash flows after paying the CLO debt coupons.

PDCC's portfolio is highly diversified by issuer and sector. As noted, it held approximately 50 different CLO equity investments across 33 CLO managers as of Q1 2025, with exposure to unique corporate obligors and 1,700 underlying loans. Broadly speaking, each CLO is backed by a portfolio of senior secured loans to U.S. companies, spanning sectors such as technology, healthcare, consumer, industrials, and energy. PDCC **invests primarily in equity and junior debt tranches of CLOs collateralized by portfolios of sub-investment grade, senior secured floating-rate debt, issued by many distinct U.S. companies across several industry sectors**. The portfolio's underlying loan base has an **average credit rating of B+/B**, reflecting broad exposure within the high-yield loan market. Weighted average portfolio yield was 15.57 % in Q1 2025, increased by floating-rate coupons, quarterly reinvestment gains, and widening spreads.

Leverage has been limited (roughly 23.2% of assets in debt), via margin and a preferred stock offering, and liquidity of the CLO equity positions is good via broker markets.
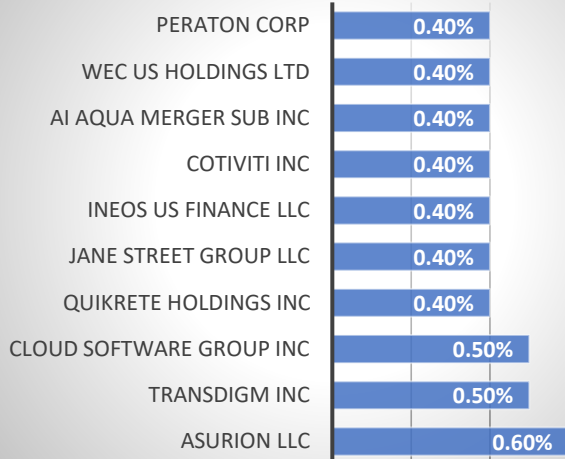
## Credit Quality

PDCC's assets are largely below-investment-grade and CLO equity is unrated. Typically, CLO debt tranches carry ratings from AAA to BB. Underlying loans include many highly leveraged borrowers (e.g. tech and healthcare leveraged buyouts). PDCC's effective portfolio yield of 15.57% reflects this risk profile. However, diversification and CLO structural protections (priority payments to CLO debt) provide buffers. Credit protection to the senior debt tranches comes from the equity tranche that offers the first loss exposure to any default provisions. In addition, credit enhancement derives from an overcollateralization of approximately 5% and through the excess spread between the weighted average yield of the portfolio and interest paid out to the debt tranches in each CLO.  As of March 31, 2025, the aggregate fair value of investments of $165.8 million far exceeded total debt of $34 million, with an asset coverage of 398% per $1,000 per preferred share. PDCC also held 4.4% of its assets in cash/short-term investments at Q1 2025, reducing immediate liquidity risk.

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PEARL DIVER CREDIT COMPANY

**Broadly Syndicated Loans (Senior Secured) BB/B rated**

Sale of Loan SPV assets to the CLO SPV

Cash

Portfolio Management

**CLO SPV** (equity tranches)
*(1200 Corporate Debt Exposures)*

**Portfolio Manager (CLO Issuers)**

SPV Issues CLO notes to investors

Cash

**CLO Note holders (investors)**

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# PEARL DIVER CREDIT COMPANY

## Portfolio Highlights on March 31st, 2025

### Top 10 Obligor Exposure

| Obligor | Exposure |
|---|---|
| PERATON CORP | 0.40% |
| WEC US HOLDINGS LTD | 0.40% |
| AI AQUA MERGER SUB INC | 0.40% |
| COTIVITI INC | 0.40% |
| INEOS US FINANCE LLC | 0.40% |
| JANE STREET GROUP LLC | 0.40% |
| QUIKRETE HOLDINGS INC | 0.40% |
| CLOUD SOFTWARE GROUP INC | 0.50% |
| TRANSDIGM INC | 0.50% |
| ASURION LLC | 0.60% |

### Top 10 Positions

| Position | Exposure |
|---|---|
| HARVEST US CLO 2024 LTD | 2.80% |
| LCM 39 LTD | 2.90% |
| AMMC CLO 24 LTD | 3.10% |
| REGATTA XIX FUNDING LTD | 3.30% |
| RR 19 LTD. | 3.40% |
| RR 37 LTD. | 3.70% |
| SIGNAL PEAK CLO 14 LTD. | 3.90% |
| VOYA CLO 14 LTD | 4.00% |
| CQS US CLO 2023-3 LTD. | 4.30% |
| LCM 42 LTD. | 4.90% |

### Top 10 Industry Exposure

| Industry | Exposure |
|---|---|
| DIVERSIFIED FINANCIAL... | 2.90% |
| BUILDING PRODUCTS | 3.20% |
| INSURANCE | 3.50% |
| PROFESSIONAL SERVICES | 3.80% |
| COMMERCIAL SERVICES AND... | 3.90% |
| MEDIA | 4.00% |
| HOTELS, RESTAURANTS AND... | 4.30% |
| CHEMICALS | 4.30% |
| HEALTHCARE PROVIDERS AND... | 5.20% |
| SOFTWARE | 9.00% |

### Top 10 CLO Managers

| Manager | Exposure |
|---|---|
| NAPIER | 4.10% |
| YORK | 4.10% |
| VOYA | 4.20% |
| OAKTREE | 4.50% |
| CQS | 4.50% |
| INVESTCORP | 5.60% |
| PUTNAM | 5.60% |
| ARES | 7.30% |
| LCM | 8.30% |
| APOLLO | 12.10% |

## CLO Vintage Distribution



y-axis: % of Fund NAV
x-axis: Closing Date

- 2013: 1.20%
- 2015: 4.60%
- 2016: 1.40%
- 2018: 0.20%
- 2019: 3.50%
- 2021: 25.60%
- 2022: 20.20%
- 2023: 4.80%
- 2024: 23.80%
- 2025: 14.80%
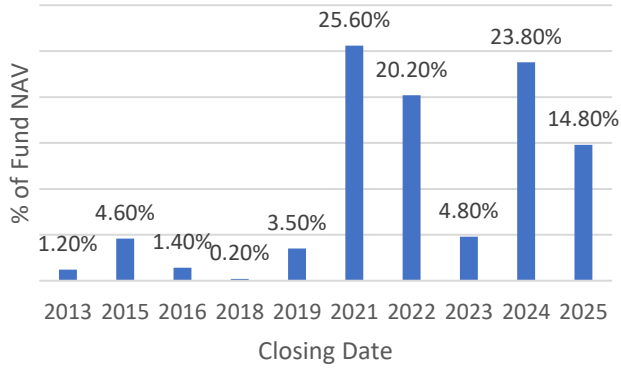
## CLO Reinvestment End Rate Distribution



y-axis: % of Fund NAV
x-axis: RED

- 2026: 23.30%
- 2027: 19.40%
- 2028: 4.20%
- 2029: 28.90%
- 2030: 24.20%
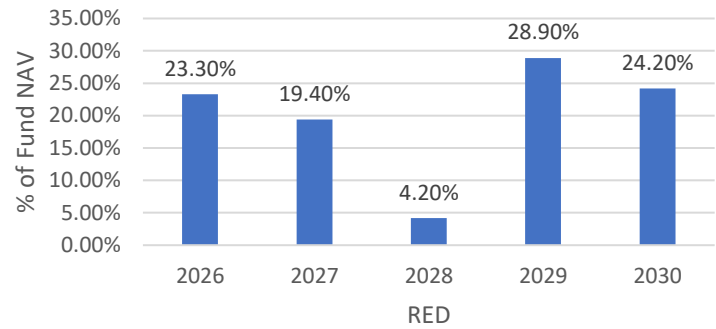
## Underlying Collateral Rating Distribution



y-axis: % of Fund NAV
x-axis: Moody's Rating

- A3 or above: 0.50%
- Baa1: 0.00%
- Baa2: 0.60%
- Baa3: 1.10%
- Ba1: 5.50%
- Ba2: 6.60%
- Ba3: 11.00%
- B1: 17.30%
- B2: 35.50%
- B3: 17.70%
- Caa1: 1.80%
- Caa2: 1.00%
- Caa3: 0.40%
- Below CCC: 0.20%
- N/R: 0.80%
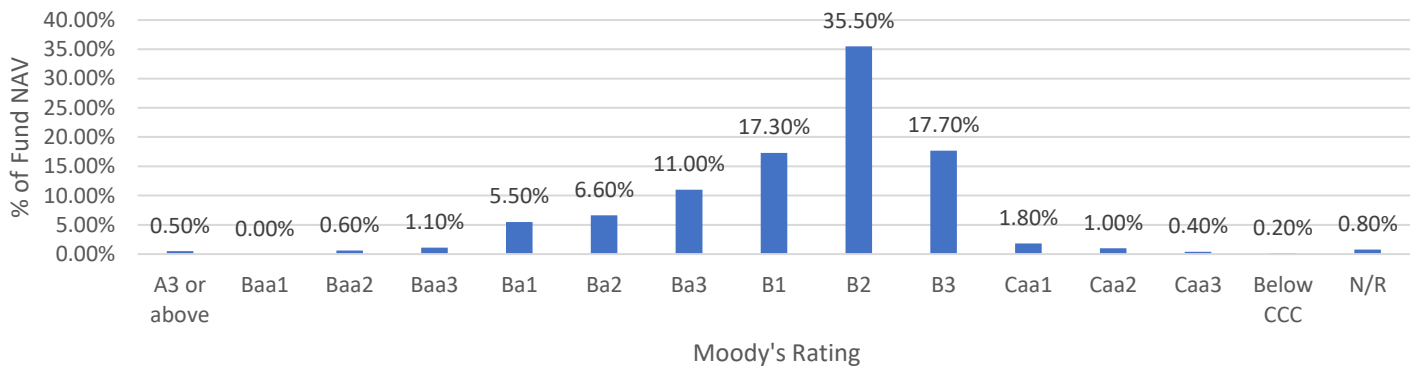
## Price Distribution of Underlying Obligors



y-axis: % of Fund NAV
x-axis: Loan Market Price

- <70: 1.60%
- 70-80: 0.80%
- 80-90: 4.00%
- 90-95: 4.50%
- 95-97.5: 8.70%
- 97.5-100: 48.20%
- >=100: 32.20%
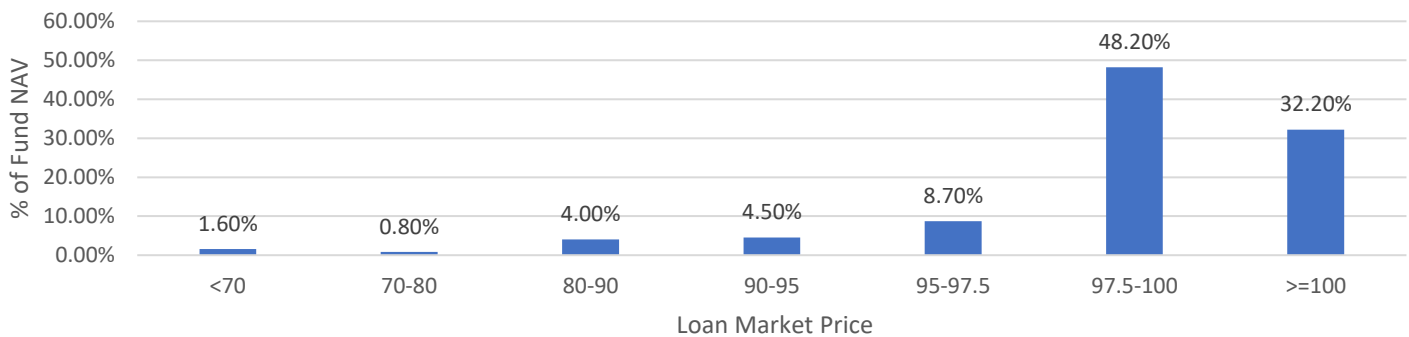
*Source: Pearl Diver Credit Company*

## CLO Equity Returns

CLO equity tranches offer high carry and have historically generated strong returns. In aggregate, actively managed CLO equity typically yields **double-digit annual cash returns** (paid quarterly). This reflects high CLO arbitrage between loan coupons and CLO debt for a residual tranche that effectively acts as a first loss piece in the CLO structure. Recent performance has been supported by those high interest rates ("carry") rather than price gains. In recent years, U.S. CLO indices showed positive total returns (across the capital stack) for over a year into mid-2025, largely driven by high carried income. If default rates remain low, CLO equity holders like PDCC can expect to capture close to 15%+ annualized returns. PDCC's own NAV has declined modestly since its IPO, and management reported 2024 cumulative distributions and retention consistent with double-digit yields. However, in Q1 2025 the NAV declined significantly to $18.33 from $19.89 in Q4 2024 due to unrealized losses caused by widening credit spreads and marking-to-market of the positions. PDCC's portfolio reported a net loss of $9.6 million, with NI dropping to -$0.90 per share from $0.50 per share in Q4 2024. Future performance will depend on defaults in the loan collateral and market valuation; but for now, fundamentals in the underlying portfolios remain strong. There was also an underlying improvement in the credit quality of the portfolios per management commentary and the manager's credit selection process based on low default rates and some rotation of credits. Typically, CLO Equity is compared to BDC Equity, but they offer different risk/return characteristics.

Leverage is a key driver of returns in this space as CLO Equity is typically a leveraged play on senior secured loans as the first loss piece. Leverage can range from 10-15 times, amplifying returns (yields on CLO equity tranches) and providing arbitrage opportunities, or, conversely, grinding down NAV with unrealized mark-to-market losses if risk premiums increase. That was exemplified in Q1 2025, when NAV of the PDCC portfolio declined. Inflationary pressures could also be a headwind, as evidenced during the 500bp rate hike in 2022 that led to several senior secured loans trading down to 90 cents on the dollar.

## CLO Equity vs. BDC Equity

- **CLO Equity:** 14–18% average annualized returns (2018–2025), with higher volatility and sensitivity to credit cycles. High leverage risk.
- **BDC Equity:** 9–12% average annualized returns, with lower volatility but more exposed to direct lending and idiosyncratic risk. Low to moderate leverage risk.

CLO equity offers higher return potential, but with greater complexity and risk, especially in stress scenarios.

## Risks

A key risk to the NAV of the PDCC portfolio is its sensitivity to interest rates. Rising interest rates are generally neutral to positive for PDCC, since most underlying loans are floating rate securities, with higher rates boosting loan coupons. Conversely, falling rates would reduce cash flows on floating loans. Tariffs or macro shocks that negatively affect corporate earnings could increase defaults: a 1–3% increase in loan defaults from the current very low levels could impair CLO equity values. However, PDCC's diversification mitigates default rate risk, accommodating up to a maximum of 3% of loans defaulting, based on stress tests on the underlying portfolios. This also accounts for net loss rates (actual defaults) for senior secured loans in the 30-35% range with recovery rates at 65-70%. These default rates would modestly impact equity tranches given over-collateralization and multi-year amortization. In stress scenarios, PDCC's NAV would drop as CLO valuations fall, but the high-yield (15%+) coupon stream and credit hedges (e.g. diverse industries) would mitigate some of the impact. A key feature of PDCC's portfolio performance has been the historic loss rate since inception of their funds. PDCC has tracked loss rates in its senior secured loan book of approximately 0.7%, well below the loss rates tracked by benchmark indices. The fund's value will fluctuate with loan spreads; but for now, PDCC has shown only minor unrealized mark-to-market gains (Q4'24 saw a $0.5M unrealized gain) followed by a loss of $9.6 M in Q1 2025, reflecting relatively stable loan prices. Inflationary pressures, resulting in higher interest rates is a potential headwind that could result in higher credit spreads for non-investment grade credits. This was evident in 2022 when the Federal Reserve went through a tightening period with a 500bps rate hike to offset inflationary pressures, but PDCC's robust credit selection process coupled by a strong performance in the senior-secured loan space proved to be mitigating factors.

## Valuation and Modeling

Cash flow modeling is a critical component of CLOs, incorporating prepayment, default, net loss, recovery lag, reinvestment, CLO call date, and CLO call price assumptions. A leveraged loan has a typical term of five years; however, the loan's expected average life is shorter due to prepayment. The constant prepayment rate (CPR) is the proportion of a loan's principal that is assumed to be prepaid annually. CPR's typically range from 25% to 35%. CLO collateral is primarily senior secured leveraged loans rated CCC to BB. The default assumptions are based upon the historical default rates by rating category, industry, sector, and the current credit cycle. A constant default rate (CDR) is the proportion of principal in a pool of loans that is expected to default in a given period. The CDR typically ranges from 1.5% to 2.5% depending on the ratings of the loans in the CLO. PDCC's track record of loan defaults is well below these industry standards. PDCC also estimates how much of a loss it will incur once a loan defaults. Leveraged loans are primarily senior secured loans and historically have some value even after they default. Based on current recovery rates, loss estimates range from 20 to 50% for first lien senior secured leveraged loans, based on industry sector. An additional factor to be taken into account is

recovery lag, defined as the time from the date of default until receipt of the recovery amount on the defaulted assets. An average recovery lag is 12 months. Reinvestment assumptions are used to estimate the prices at which the CLO manager will be able to reinvest loan proceeds in new loans in the future. As loans pay off during the reinvestment period, the CLO manager will reinvest the proceeds into new loans based on market conditions. CLO call date is another metric that forms a part of the valuation of the portfolio. It is the expected date the CLO can be called or redeemed after the expiration of the reinvestment period. The call date ranges from six to twenty-four months after the end of the reinvestment period. CLO call price typically depends on the market price of the underlying loan collateral and falls into the $97-$99 range.

## Management and Track Record

PDCC's investment adviser **Pearl Diver Capital LLP** is led by co-founders Indranil Basu (CEO) and Chandrajit Chakraborty (CIO), both veterans of quantitative credit investing. The team of 20+ professionals spans New York and London offices. Pearl Diver has managed open-end funds and closed-end credit funds on the private side since 2008, and its credit teams emphasize rigorous bottom-up loan analysis using proprietary data models. The firm's analysts aggregate data from CLO managers globally, along with monthly trustee reports, giving them an informational edge on deal pricing and loan fundamentals. Historically, Pearl Diver's funds have delivered strong risk-adjusted returns in corporate credit. For example, Pearl Diver reports that its annualized default rate on CLO investments since 2015 has averaged 0.71%, less than half the 1.62% annualized default rate of the overall leveraged loan market. This suggests a rigorous credit selection process that also results in high recovery rates. Pearl Diver's open-end CLO funds (e.g. the Pearl Diversified Credit Fund in Europe and similar U.S. funds) have outperformed high-yield benchmarks over credit cycles. However, we stress that past performance does not guarantee future returns.

_**AI/ML Methods**_: Pearl Diver utilizes a quantitative approach to credit selection that employs AI/ML-based technologies to identify mispriced loans. The company has a proprietary loan database of 2,500+ fully credit underwritten names and implements a trading price-driven algorithm that creates tranches of credits and benchmarks them quantitatively to create an individual credit risk profile that may differ from that of the rating agencies. The credit team then re-rates the loan depending on deviations from benchmarks to analyze mispriced credits. Pearl Diver utilizes this algorithm to create a loan rating distribution, and a customized default vector for every CLO.

Pearl Diver also scrapes approximately 30,000 CLO trustee reports annually of approximately 2,500 CLOs to map out all CLOs being traded. This technology utilizes data analytics, machine learning and natural-language processing techniques to mine unstructured text data from trade offers in chat rooms/posts to generate unique proprietary scores. The engine then extracts trading prices; bond offers and updates from these unstructured sources of data in real-time. The average value of these simulations is then used to create a comprehensive probability density function of said probabilities.

This is a rigorous quantitative-driven approach to loan origination and credit selection that gives the PDC LLP team a competitive edge to exploit arbitrage opportunities and mitigate losses in their portfolios.

Pearl Diver also has an automated CLO equity infrastructure software, that utilizes AI/ML to model cash flows via LIBOR Forward Curves, Call/Reset probability, and CDR/CPR vectors, when a new trustee report is released. These models are integrated with Pearl Diver's CLO ratings generated from their trading price driven algorithm to generate current cash flow projections. Sensitivity analysis is used on the cash flows to generate comprehensive morning summaries of equity opportunities, highlighting the most lucrative ones based on highest IRR (internal rate of return).

*Mark-to-Market*: A key feature for a CLO investor is to have an accurate mark-to-market pricing tool to value CLOs. PDCC uses independent third-party valuations from Markit to mark its portfolios to have an unconflicted process. The internally developed proprietary Mark-to-Market pricing model along with the unconflicted third-party valuation provides confidence and assurance to investors to manage risk and fraud, as many CLOs are not traded publicly. PDCC's Mark-to-Market (MTM) pricing tool, which capitalizes on the unstructured data scraped from texts/chat rooms by the deal origination engine, and data points scraped from the trustee reports also helps the PDCC team to identify lucrative trading opportunities in CLOs that are mispriced. For each CLO tranche, these sets of scraped data are encoded into a feature vector. Specifically, each CLO vector contains data such as over-collateralization ratio, interest coverage ratio, CCC bucket (% of low-rated loans), and weighted-average-risk factor (average risk of the borrower defaulting). This vector is then passed into a regression-based model and, using a process called feature engineering where-in, variables of predictive, independent CLO characteristics are extracted for each tranche. Each characteristic has its own unique weight - or role in determining the price of the CLO tranche. The model is trained on these characteristics by minimizing out-of-sample error for historical data. The optimized model uses the information obtained from training to estimate current price of each CLO tranche.

*Portfolio Management Style and Risk Analysis*: The PDCC team uses an analytical framework to break the risk profile of a CLO into three dimensions: default risk, liquidity risk, and average portfolio spread. Default risk is determined via the rating generated by the loan pricing algorithm, overlaid with proprietary credit team views of underlying loans. Liquidity risk is determined by the trading volume and depth of underliers from most to least liquid. Average portfolio spread measures the return premium held over a benchmark for holding the loan portfolio. These three metrics are used to determine the average financial position of each CLO manager, found by an ML algorithm that groups the managers based on conservatism (risk taken versus risk avoided). Typically, more conservative managers thrive in weaker markets and vice versa. The PDCC team follows a disciplined, research-driven style to select CLO managers. They periodically rebalance the CLO mix (e.g. buying new issue CLO equity in the primary market) and reinvest loan repayments. The key attributes for manager selection include 1) identifying CLO Managers within each distinctive style to construct a portfolio of

CLOs that is market neutral and 2) identifying managers that are potentially underpriced by the market. Cash is held only temporarily. Risk management includes regular stress tests (e.g. higher default scenarios) and monitoring of CLO manager performance. Trading is relatively infrequent (CLO positions are semi-liquid), so turnover is low.

*Underwriting and Sourcing*: The team sources CLO tranches from primary and secondary markets. Due diligence involves examining each CLO manager's portfolio and proprietary loan models. Managers apply PDCC's quantitative screening and scenario analysis to assess loan credit quality and structuring covenants. The firm favors diversified portfolios of floating-rate loans, focusing on senior-secured status and relatively stable cash flows. PDCC's investment process also emphasizes structural features such as over-collateralization and interest coverage to mitigate losses.

Pearl Diver Credit Company is governed by a board that has independent members along with the internal management team operating under standard closed-end fund arrangements. Administrative and fund accounting services (CCO) are outsourced to SS&C ALPS. PDC LLP is the Independent Adviser to the fund.

## Fees and Expenses

PDCC's advisory fee is **1.50% p.a. of total equity** (calculated quarterly). There is also an **incentive (performance) fee** of 15% of net investment income above an 8% annualized hurdle return with a built-in "catch-up" feature of 2.35924% per quarter (9.42% annualized). No fee is paid unless quarterly NII exceeds 2.00% per quarter (8% annualized hurdle rate). For Jul–Dec 2024 the adviser earned a $1.085M incentive fee (15% of NII above the hurdle) while the incentive fee paid out was $604k for Q1 2025. The fund's reported expense ratio (annualized since inception) is approximately 6.60% including all operating expenses, interest expense and incentive fees and about 3.50% excluding interest expense and incentive fees. The advisory fees for Q3 and Q4 2024 were approximately $987K (0.8% of NAV), with incentive fees at $1.085M (0.8%) and other expenses (directors' fees, admin).

PDCC also has an 8% Series A **term preferred stock** (fixed coupon) due 2029. This provides leverage in addition to small borrowings. As of April 2025, there was $34.5 million net preferred stock outstanding. The required asset coverage for this preferred is high (~500% of par at Q4'24), which places PDCC roughly in the Regulated Investment Company style structure rather than a typical 200% coverage BDC.

## U.S. Credit Markets & Leveraged Loans

**High-Yield (BB) Corporate Bonds:** PDCC performance and NAV can be sensitive to movements in credit spreads on non-investment grade credits. Spreads on BB-rated bonds have tightened over the last few years. The ICE BofA U.S. BB High Yield Index OAS (option-adjusted spread over Treasuries) was around 420 basis points in June–July 2022 and has since compressed to 236 bps as of April 2025.

Correspondingly, the effective yield on that index has fallen significantly from its February 2023 peak to April 2025 before the spike, post Liberation Day. Despite the spike in spreads, high-yield yields remain attractive by historical standards, well below the highs of 2022. Equity markets have stabilized, and credit spreads are near the tight end of recent ranges, after the recent widening, reflecting strong demand (especially from insurance and retail funds) and a benign default outlook on corporate non-investment credits. Despite the correlation of credit spreads to market movements of High Yield Bonds, senior secured loans have structurally a greater cushion to default risk, outperforming High Yield Bonds during the 2008 financial crisis, for instance.
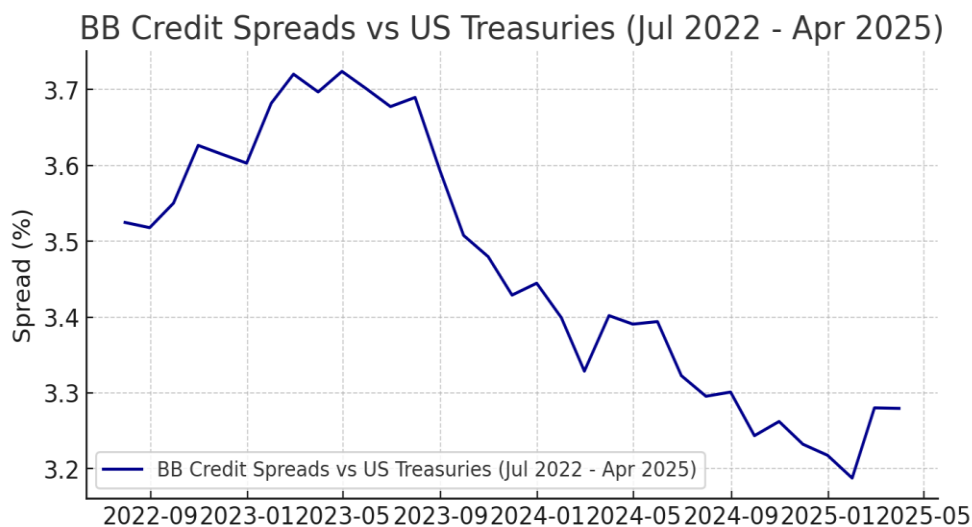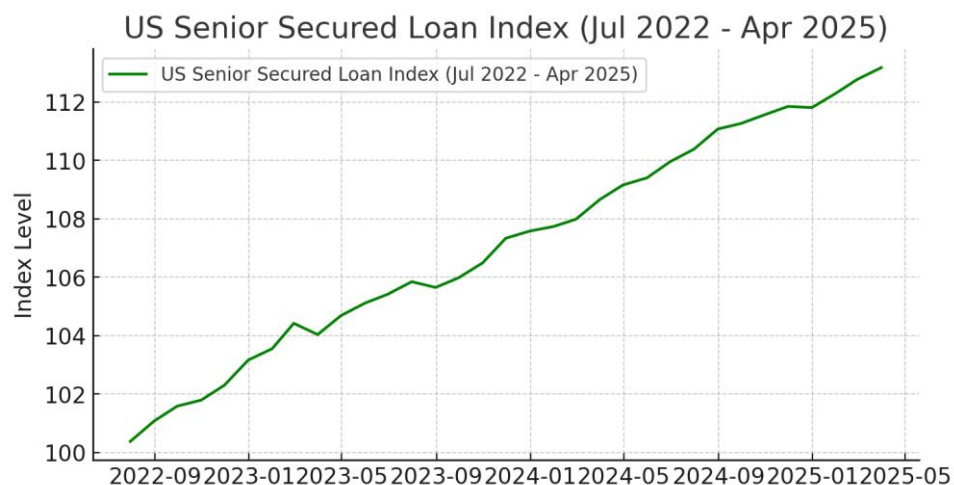


*Source: FDIC*

**Senior Secured Loans**

The U.S. leveraged loan market (e.g. the LSTA senior secured loan index) has delivered positive returns and carries yields even higher than BB bonds (often in the 7.0–8.0% range). Loans have benefited from floating coupons (L+500–600 bps in 2025) and stable prices. Notably, the loan market saw **15 consecutive months of positive total returns** through mid-2024, driven primarily by carry in a high-rate environment. Spreads have also compressed after 2022 with current typical discount margins (D/M) on the S&P/LSTA Index at roughly 475 bps. The leveraged loan index is roughly flat-to-slightly up since July 2022 (as rates fell in 2023–2024), and performance is positive but subdued given high starting yields. This bodes well for PDCC CLO portfolios whose performance is highly dependent on their loan origination capabilities and exploiting arbitrage opportunities.

**Issuance Trends**

U.S. syndicated loan issuance has remained substantial despite higher rates. According to LSEG (LoanX) data, total U.S. syndicated lending was about **$2.4 trillion in 2025**, down 17% from $2.9 trillion in 2022. Of this, roughly $737 billion was leveraged loans (term loans to corporates), down 13% from $850B in

2022. Thus, even after a downshift post-2021, issuance remains robust compared to prior cycles. This has been driven by high refinancing and PE financings (yielding mostly low-amortization or covenant-lite structures) and by floating-rate demand (especially CLO refinancing and new CLO warehousing). These are positive long-term tailwinds in this space validating the performance and issuance of CLO bonds.



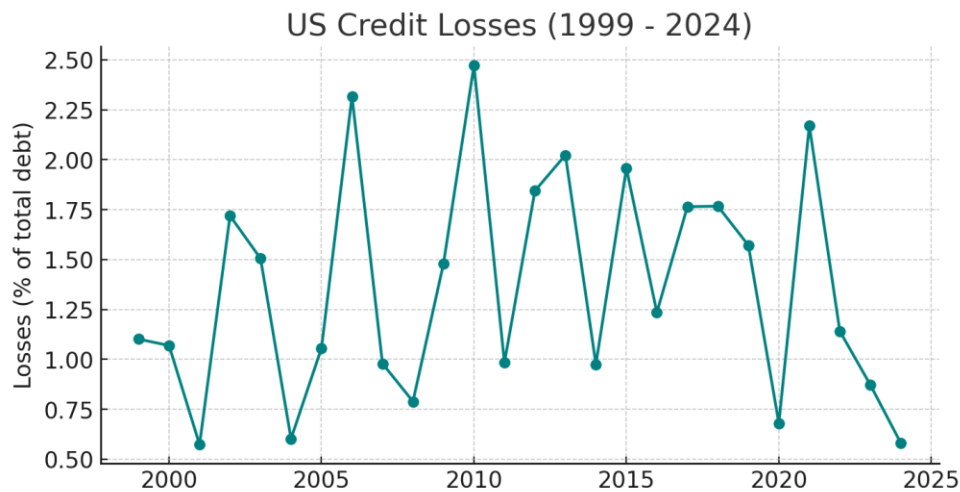*Source: FDIC*

**Leveraged Loans – Tariff Uncertainty**

Loan issuance and CLO capacity remain strong, and new issue spreads tightened in early 2025. Yields are high enough to cushion returns even if spreads widen modestly. On the other hand, rising inflationary pressures (including from tariffs) and slowing growth create uncertainty. S&P Global projects the U.S. leveraged loan default rate could edge up to 1.6% by year-end 2025 (from ~0.7% in 2024), per FDIC filings in a baseline scenario, given the late cycle rise in credit stress. If tariffs and global weakness intensify, we expect that rate could climb higher (e.g.: 3.0% under a severe shock). Meanwhile, covenants remain relatively loose, but banks and CLO managers are generally cautious on highly cyclical industries (retail, autos, energy, and media). In summary, we believe leveraged loans should continue to generate solid high-single-digit total returns (via coupons and principal), but credit selection is key in 2025. PDCC's hands-on quant-driven approach and strong track record in managing default risk since inception is an added advantage in such market conditions, where managers with a strong track record in credit selection tend to outperform.

## U.S. Credit Losses

U.S. banks have also been raising reserves for credit losses. In 2023 the industry provision expense **increased** as banks anticipated asset quality pressures. For example, FDIC data show the Q4 2024 provision expense was **$22.3 billion** (still above pre-pandemic norms) and essentially matched net

charge-offs, keeping the reserve balance stable. The chart below illustrates quarterly bank provisions spiking during 2020 and rising again in 2022–2025. Banks loss provisions were higher primarily for commercial real estate and consumer loans, while credit quality broadly remained sound, with delinquency rates still low. Stable unemployment and rising asset values have so far limited realized losses, but the recent rise in provisions signals caution.



*Source: FDIC*

**Corporate Credit**

U.S. corporate credit ratings are still strong overall. Aggregate credit losses in 2024 remained low, with increases expected only as maturities come due. Historical data (from BIS and others) show large spikes in credit losses only during severe recessions (e.g. post-2008 and the 2020 pandemic). Current credit spreads and ratings transitions suggest any losses over 2024–25 will be modest by historical standards, unless growth shocks hit.

From PDCC's perspective, **credit-quality metrics are still manageable** with the overall delinquency rate remaining under 1%, and only certain commercial real estate and consumer segments showing rising signs of stress.

**Tariffs and Treasury Yields**

Trade policy after the Liberation Day announcements and period of negotiations between the U.S and its allies in Europe and China has been a major market overhang. Announcements of higher U.S. tariffs on imports in April 2025 led to volatility in Treasury yields. Initially, 10-year yields **fell** from 4.17% to 3.96% as investors sought safe havens. However, after markets calmed and apparently discounted policy, yields rebounded sharply to over 4.35% within days. In other words, tariff news first drove a flight-to-quality rally in Treasuries, but the effect was quickly reversed. This episode illustrates the complexity: tariffs can damp growth (lowering yields) but also spark inflation concerns (raising yields when the shock passes).

Overall, trade tensions have **increased uncertainty** in the yield curve: the Fed's "dots" now show fewer rate cuts expected, and 10-year yields remain above 4%.

**Federal Reserve & Credit Markets**

The Federal Reserve has maintained a cautious stance. In early 2025 the Fed kept the federal funds target at 4.25–4.50% noting rising uncertainty (partly from tariffs) in the economy. FOMC members currently project two rate cuts later in 2025, indicating a slower easing path than markets had priced earlier. The March 2025 Summary of Economic Projections showed **lowered GDP growth** expectations of about 1.7% in 2025 and continued two hikes priced into the year. This reflects the Fed's view that inflation may be stickier, partly due to trade-policy effects on prices.

Credit markets have so far reacted calmly to Fed policy: investment-grade and high-yield spreads are near multi-year lows even with the Fed on hold. Primary issuance across bonds and loans remains robust, helped by solid household and corporate balance sheets. However, tighter Fed policy (even without further hikes) will eventually cool growth. S&P Global cut its U.S. GDP forecast for 2025 and removed expected rate cuts, noting that tariffs and resurgent inflation undermine consumer demand. In essence, credit markets look through near-term noise, but credit quality reflects slower growth. Into 2025, corporate earnings have been more or less flat, with sector-specific strains (e.g. retail, autos, energy) slowly building that could impact credit spreads and generate headwinds to NAV for the PDCC portfolios, notwithstanding the underlying diversification of obligors.

**U.S. Credit-Loss Outlook**

After strong post-pandemic growth (~3–4%/yr in 2021–22), U.S. GDP growth is decelerating. The Fed's new projection of ~1.7% growth for 2025 suggests the economy is around or below trend. Inflation remains above 2% (core CPI ~3% in early 2025) largely due to rents and supply-chain issues (including tariffs). Consumers have thus far remained resilient – retail sales in early 2025 surprised on the upside, but there are warning signs. Tariffs effectively raise prices on many consumer goods, squeezing real incomes. Anecdotally, there have been reports of "panic buying" ahead of tariff deadlines (especially durable goods). Still, high savings and a strong labor market have so far prevented a sharp pullback in spending.

Looking at credit losses, most forecasts see only a moderate rise. Corporate profits have held up, so bond defaults remain low (Moody's reports default probability around 9% in Feb 2025, not excessive). S&P's baseline has loan defaults rising only modestly (~1–2%) by 2025 with credit losses staying below the Global Financial Crisis levels. Likewise, U.S. banks' net charge-offs are running well below 0.5% of loans industry-wide. Thus, absent a severe recession, systemic credit losses (both corporate and household) should stay near or below their historical averages. This outlook bodes well for PDCC's portfolios and its bottom-up approach towards active management of its portfolio of senior-secured loans, both through primary issuance and trading in the secondary markets.

**Sector & Tariff Impacts**

Tariff escalation will have uneven sector effects. Sectors in the portfolio that underperformed due to tariff uncertainty in Q1 2025 include

- Building products, due to weakness in housing and construction activity
- Retail, Food and Beverage, due to weaker consumer sentiment, inventory management and inflationary pressures
- Chemicals, due to softness in global industrial demand

An overall assessment of sectors that could be directly or indirectly impacted by tariffs, per rating agencies, is shown below:

| Sector | Direct Impact (Morningstar) | Indirect Impact (Morningstar) |
|---|---|---|
| Auto Manufacturing | High | High |
| Consumer Electronics | High | Moderate |
| Industrial Equipment | Moderate | High |
| Retail | Moderate | High |
| Agriculture | High | Moderate |
| Asset Finance (CLOs) | Low | Moderate |

Source: Morningstar

**Valuation and Outlook**

PDCC is a permanent capital vehicle that is managed with a mandate to mitigate loss rates via a quantitatively driven, robust credit selection process. It is expected to have short mark-to-market fluctuations, but the focus is on managing loss rates and underwriting capabilities to originate loans from both the primary and secondary markets. As such, the NAV of the portfolio could fluctuate from time to time, but the management has a long-term view to maintain a stable arbitrage via their credit selection process, portfolio monitoring and relative trade identification. We expect monthly dividends of $0.22/share to be fairly stable in the medium-term and NII/share to remain in the $0.50/share range per quarter. We expect the NAV to remain stable and grow moderately in the near term amid a benign credit environment for senior secured loans and falling credit spreads for non-investment grade debt. We issue a **BUY** rating on the stock on this basis with a price target at approximately 1.09 x NAV at $20 per share.

## Financials

| Pearl Diver Credit Company | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Earnings Model** | | | | | | | | | | |
| Year | 2024 | | 2025 | | | | 2026 | | | |
| Quarter | Q3 | Q4 | Q1 | Q2E | Q3E | Q4E | Q1E | Q2E | Q3E | Q4E |
| | | | | | | | | | | |
| Total Assets | 137,587,304 | 179,071,696 | 173,655,377 | 173,655,377 | 174,145,377 | 174,695,377 | 175,225,377 | 175,765,377 | 176,321,377 | 176,896,377 |
| Total Liabilities | 1,316,841 | 14,865,808 | 15,680,829 | 15,680,829 | 15,680,829 | 15,680,829 | 15,680,829 | 15,680,829 | 15,680,829 | 15,680,829 |
| Preferred Shares | 0 | 28,990,243 | 33,393,885 | 33,393,885 | 33,393,885 | 33,393,885 | 33,393,885 | 33,393,885 | 33,393,885 | 33,393,885 |
| | | | | | | | | | | |
| **Net assets** | 136,270,463 | 135,215,645 | 124,580,663 | 124,580,663 | 125,070,663 | 125,620,663 | 126,150,663 | 126,690,663 | 127,246,663 | 127,821,663 |
| | | | | | | | | | | |
| **Total Investment Income** | 3,946,115 | 5,439,244 | 6,015,004 | 6,039,064 | 6,063,220 | 6,087,473 | 6,111,823 | 6,136,270 | 6,160,815 | 6,185,459 |
| | | | | | | | | | | |
| Yields | | | | | | | | | | |
| | | | | | | | | | | |
| *Calculated Annual Investment Yield on Average Total Investments* | 11.77 | 13.91 | 14.84 | 13.79 | 13.98 | 14.04 | 14.10 | 14.15 | 14.21 | 14.27 |
| *post-Incentive Fee Annual Yield* | 7.998 | 10.137 | 10.981 | 11.203 | 11.258 | 11.312 | 11.367 | 11.421 | 11.475 | 11.529 |
| | | | | | | | | | | |
| Expenses: | | | | | | | | | | |
| | | | | | | | | | | |
| Incentive fee | 480,420 | 604,720 | 603,528 | 614,740 | 616,475 | 618,422 | 620,298 | 622,209 | 624,178 | 626,213 |
| Advisory fees | 427,773 | 559,868 | 614,388 | 604,321 | 606,026 | 607,940 | 609,784 | 611,664 | 613,598 | 615,599 |
| | | | | | | | | | | |
| **Total Fees** | 1,187,557 | 1,947,025 | 1,679,198 | 1,683,759 | 1,690,684 | 1,698,100 | 1,705,447 | 1,712,936 | 1,720,611 | 1,728,496 |
| | | | | | | | | | | |
| | | | | | | | | | | |
| **Total expenses** | 1,221,240 | 2,012,487 | 2,595,000 | 2,549,941 | 2,556,866 | 2,564,282 | 2,571,629 | 2,579,118 | 2,586,793 | 2,594,678 |
| | | | | | | | | | | |
| **Net Investment Income** | 2,724,875 | 3,426,757 | 3,420,004 | 3,489,123 | 3,506,354 | 3,523,191 | 3,540,194 | 3,557,153 | 3,574,022 | 3,590,781 |
| | | | | | | | | | | |
| Net investment income per share | 0.401 | 0.504 | 0.503 | 0.513 | 0.516 | 0.518 | 0.521 | 0.523 | 0.526 | 0.528 |
| Net income per share | 0.480 | 0.505 | -0.904 | 0.513 | 0.516 | 0.518 | 0.521 | 0.523 | 0.526 | 0.528 |

**DISCLOSURES**

**Analyst Certification**

The Research Analyst(s) denoted by an "AC" on the cover of this report certifies (or, where multiple Research Analysts are primarily responsible for this report, the Research Analyst denoted by an "AC" on the cover or within the document individually certifies, with respect to each security or issuer that the Research Analyst covers in this research) that: (1) all of the views expressed in this report accurately reflect the Research Analyst's personal views about any and all of the subject securities or issuers; and (2) no part of any of the Research Analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the Research Analyst(s) in this report.

I, Greg Mesniaeff, certify that (1) the views expressed in this report accurately reflect my own views about any and all of the subject companies and securities; and (2) no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by me in this report.

I, Prakash Hariharan, certify that (1) the views expressed in this report accurately reflect my own views about any and all of the subject companies and securities; and (2) no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by me in this report.

I, Tejas Prakash, certify that (1) the views expressed in this report accurately reflect my own views about any and all of the subject companies and securities; and (2) no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by me in this report.

**Explanation of Research Ratings (As of January 1, 2024), Designations and Analyst(s) Coverage Universe:**

Kingswood Capital Partners, LLC uses the following rating system:

Buy - Buy-rated stocks are expected to have a total return of at least 15% over the following 12 months and are the most attractive stocks in the sector coverage area.

Hold - We believe this stock will perform in line with the average return of others in its industry over the following 12 months.

Sell - Sell-rated stocks are expected to have a negative total return of at least 15% over the following 12 months and are the least attractive stocks in the sector coverage area.

Not Covered (NC) - Kingswood Capital Partners, LLC DOES NOT cover this stock and therefore DOES NOT have forecasts, projections, target price and recommendation on the shares of this company.

**Company-Specific Disclosures**

| Distribution of Ratings Kingswood Capital Partners, LLC | | | Investment Banking Services/Past 12 Months | |
|---|---|---|---|---|
| Rating | Count | Percent | Count | Percent |
| BUY | 7 | 77.78 | 2 | 28.57 |
| HOLD | 1 | 11.11 | 0 | 0.00 |
| SELL | 0 | 0.00 | 0 | 0.00 |
| NOT RATED | 1 | 11.11 | 1 | 100.00 |

As of May 2025.

Kingswood Capital Partners received compensation from Pearl Diver Credit Company during the past 12 months. Kingswood is not currently engaged by Pearl Diver Credit Company to provide investment banking or advisory services.

**Pearl Diver Credit Company Rating History**



As of June 27, 2025. Source: E-Trade.

**Other Disclosures**

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