

# BDC ROUNDTABLE

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September 16, 2009

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## Emerging Trends for BDCs in Today's Economic Environment

Attorneys Serving Clients Around the World

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- Market Position:
  - At the height of the market, BDCs had aggregate portfolio assets of approximately \$27.5 billion invested in approximately 1,500 small and middle market companies across the United States.
  - Actively traded BDCs had approximately \$21 billion in assets as of June 2009 as compared to approximately \$28 billion in assets as of September 2008.
- Contribution to Economy:
  - It is estimated that the BDC industry in the aggregate currently sustains approximately 1.5 million U.S. jobs.
  - BDCs can play a significant role in the future success of middle market companies by providing a much needed source of financing.

# Overview

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- BDCs have been affected by the financial crisis.
- Issues facing BDCs:
  - Declining stock price
  - Declining net asset value
  - Increase in unrealized depreciation
  - Compliance with 200% asset coverage ratio
  - Compliance with financial covenants in debt agreements
  - Inability to access the capital markets
  - Dividend payments

# Timeline of Financial Crisis

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## June 2008 – September 2008

- Financial Markets
  - Fannie Mae/ Freddie Mac seized by federal government
  - Bank of America buys Merrill Lynch
  - Lehman Brothers files for bankruptcy
  - Federal government provides AIG with an emergency loan
  - Bailout plan announced
  - Dow suffers largest one day drop
- BDC Industry
  - Equity markets available until June 2008
  - Impact of mark to market accounting under FAS 157

# Timeline of Financial Crisis

## October 2008 – December 2008

- Financial Markets

- Bailout plan is passed and signed
- AIG receives bigger bailout; GM and Chrysler receive \$17.4 billion from federal government
- Wachovia purchased by Wells Fargo
- Eleven of the world's largest banks are downgraded by S&P
- Jobless claims soar, budget deficit reaches record

- BDC Industry

- Stock prices drop, some falling below \$1.00
- Stocks trade at a discount to NAV
- Continued effects of mark to market accounting under FAS 157
- BDCs are unable to access the equity capital markets
- Dividend payments decrease or are suspended
- Compliance with covenants in debt agreements

# Timeline of Financial Crisis

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## January 2009 – March 2009

- Financial Markets

- Citigroup and Morgan Stanley merge
- Obama signs stimulus package
- Dow dips below 7,000

- BDC Industry

- Continued effects of mark to market accounting under FAS 157
- Going concern issues arise
- Compliance with covenants in debt agreements, including asset coverage ratio
- Deleveraging portfolio investments

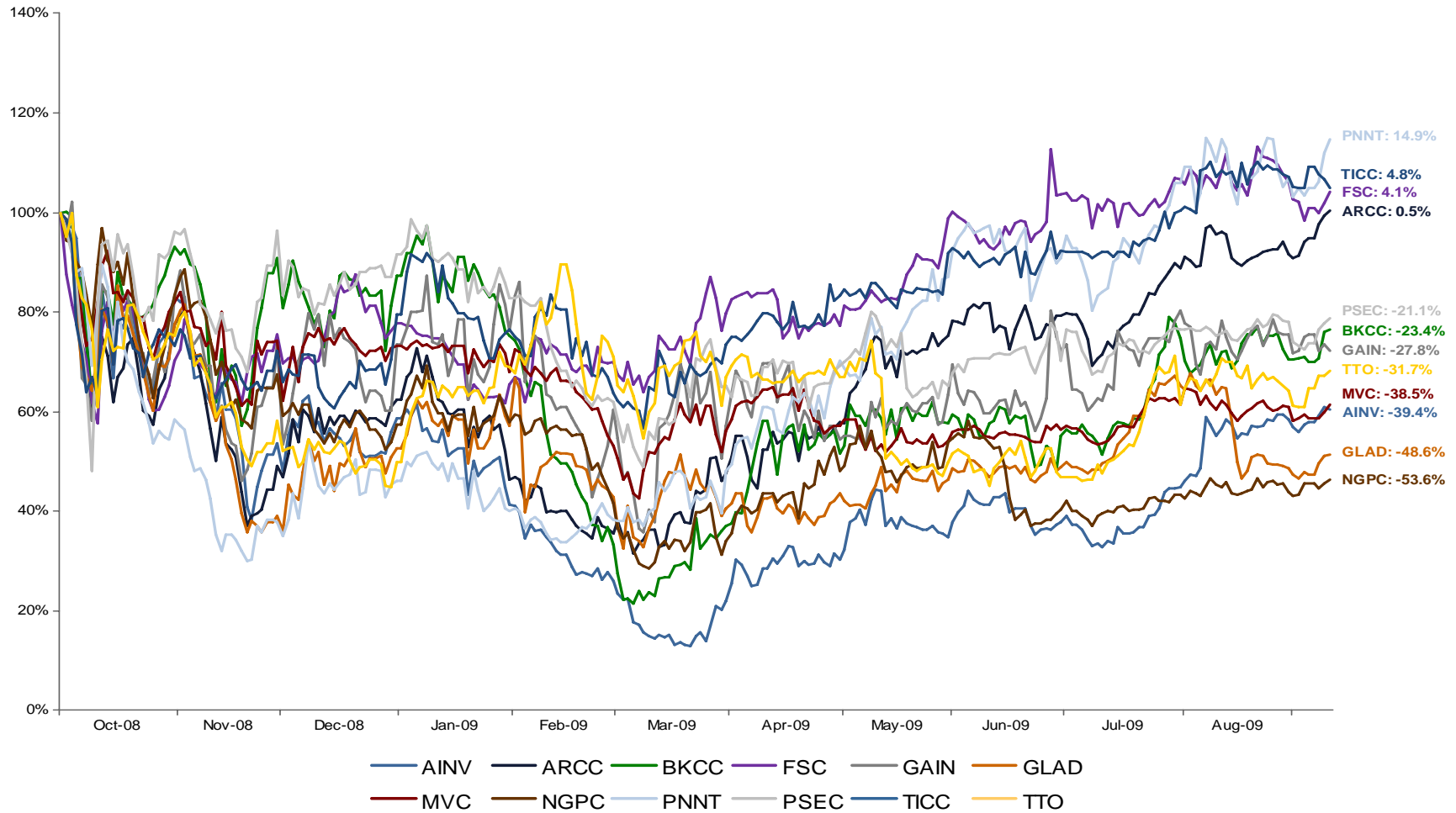
# Timeline of Financial Crisis

## April 2009 – September 2009

- Financial Markets
  - Obama Administration announces comprehensive regulatory reform, including executive compensation reform
  - Small bank failures
  - Lending market continues to contract
  - Bank of America Settlement
- BDC Industry
  - Stock prices begin to rise
  - Discount to NAV decreases
  - Offerings completed
  - FAS 157 has less of an impact
  - Debt restructuring
  - Consolidation within the BDC industry begins

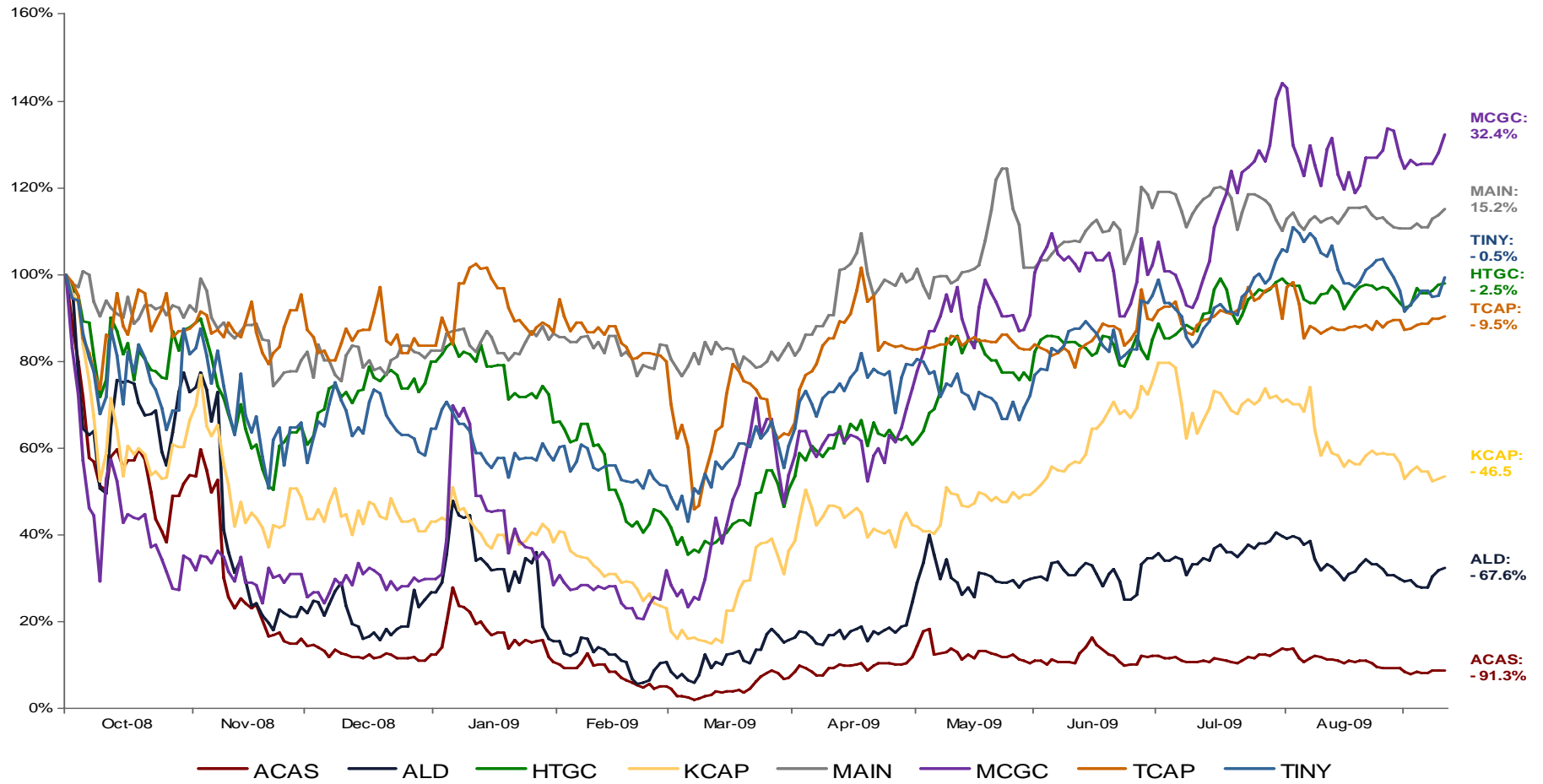
## EXTERNAL BDC: INDEX GRAPH

Indexed to 100% as of October 1, 2008

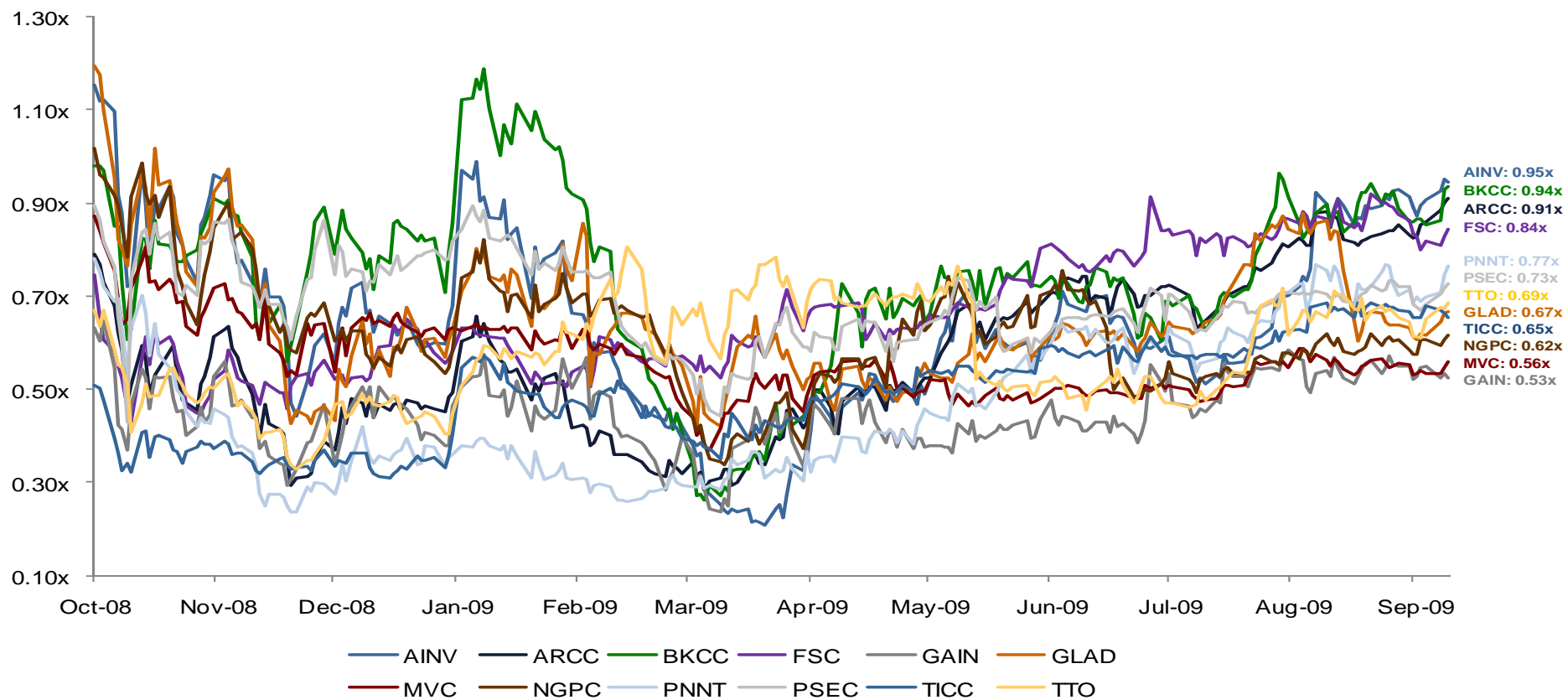


## INTERNAL BDC: INDEX GRAPH

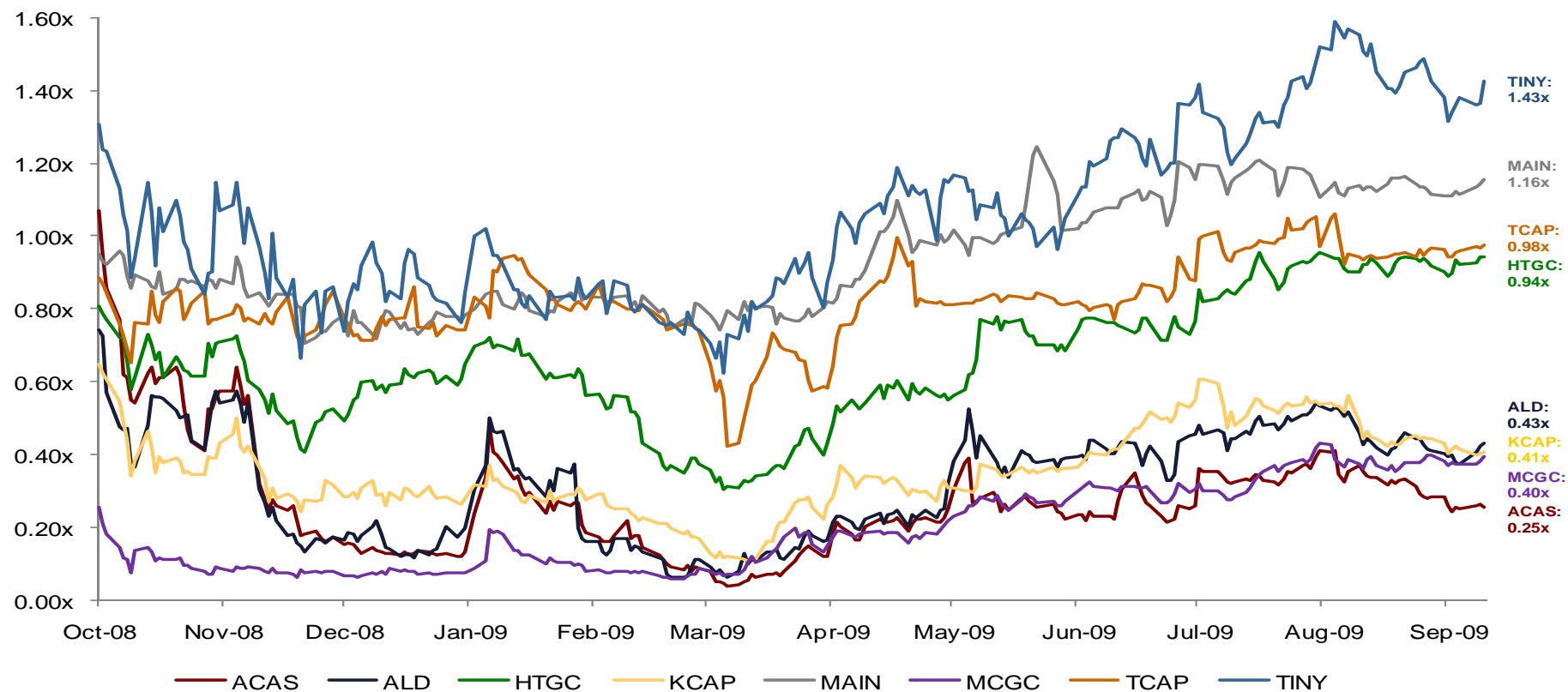
Indexed to 100% as of October 1, 2008



EXTERNAL BDC: PRICE / NAV



INTERNAL BDC: PRICE / NAV



# Strategies for the Current Market Environment – Accessing the Capital Markets

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## Sales below net asset value

Closing Date	Issuer	Amount Raised	Price Per Share	Most Recent Net Asset Value Per Share Prior to Offering	Underwriters
08/19/09	Ares Capital Corporation	Approximately \$109.6 million in net proceeds	\$9.25	\$11.21	J.P. Morgan Citi UBS Investment Bank Wells Fargo Securities SunTrust Robinson Humphrey BMO Capital Markets Stifel Nicolaus
08/18/09	Apollo Investment Corporation	Approximately \$173.0 million in net proceeds	\$8.75	\$10.15	Citi BofA Merrill Lynch J. P. Morgan Wells Fargo Securities SunTrust Robinson Humphrey BMO Capital Markets RBC Capital Markets Keefe, Bruyette & Woods
08/12/09	Triangle Capital Corporation	Approximately \$14.6 million in net proceeds	\$10.42	\$11.31	RBC Capital Markets BB&T Capital Markets Morgan Keegan & Company, Inc. Sterne Agee
07/23/09	Fifth Street Finance Corp.	Approximately \$87.8 million in net proceeds	\$9.25	\$11.94	Wells Fargo Securities UBS Investment Bank Stifel Nicolaus Oppenheimer & Co. RBC Capital Markets BB&T Capital Markets Janney Montgomery Scott Gilford Securities Incorporated <a href="http://www.sutherland.com">www.sutherland.com</a>

# Strategies for the Current Market Environment – Accessing the Capital Markets

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Closing Date	Issuer	Amount Raised	Price Per Share	Most Recent Net Asset Value Per Share Prior to Offering	Underwriters
07/07/09	Prospect Capital Corporation	Approximately \$46.58 million in net proceeds	\$9.00	\$14.19	Fox-Pitt Kelton Cochran Caronia Waller Oppenheimer & Co. RBC Capital Markets BB&T Capital Markets Ladenburg Thalmann & Co. Inc. Maxim Group LLC
06/09/09	Main Street Capital Corporation	Approximately \$16.3 million in net proceeds	\$12.10	\$11.84	BB&T Capital Markets Morgan Keegan & Company, Inc. Sanders Morris Harris Janney Montgomery Scott Ladenburg Thalmann & Co. Inc.
05/26/09	Prospect Capital Corporation	Approximately \$64.04 million in net proceeds	\$8.25	\$14.19	Citi UBS Investment Bank BB&T Capital Markets
04/27/09	Prospect Capital Corporation	Approximately \$28.52 million in net proceeds	\$7.75	\$14.43	Fox-Pitt Kelton Cochran Caronia Waller SunTrust Robinson Humphrey Ladenburg Thalmann & Co. Inc.

# Strategies for the Current Market Environment – Accessing the Capital Markets

- Offerings of preferred stock
  - 1940 Act restrictions including:
    - Right to elect two directors and a majority of directors if dividends on such class of stock remain unpaid for two years;
    - No cash dividend may be declared, or distribution of assets be made, on common stock unless the preferred stock has, at the time of the declaration, a 200% asset coverage;
    - A BDC must maintain a 200% asset coverage on the aggregate of the preferred stock and any borrowings outstanding;
    - If the preferred stock is offered as part of a convertible issuance, that issuance must be approved by the BDC's shareholders;
    - The preferred stock must have voting rights equal to the common stock; and
    - A BDC can only have one class of preferred stock.
  - Proposed Rulemaking

# Strategies for the Current Market Environment – Accessing the Capital Markets

- Accessing the Capital Markets
  - Issue senior securities (convertible debt, warrants or rights)
    - Shareholder approval required
    - Expire by their terms in 10 years;
    - Exercise or conversion price of such securities is not less than the fair market value per share of a BDC's common stock but may be below NAV at the date of issuance of such securities;
    - May not exceed 25% of a BDC's outstanding common stock at such time (20% threshold in certain circumstances).

# Strategies for the Current Market Environment – Alternative Financing Sources

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- Small business investment companies
  - License approval required
  - Section 505 of the Recovery Act raises the maximum amount of leverage that an SBIC may receive, increases the amount an SBIC may invest in a single qualifying small business and streamlines reporting requirements.
  - Sets maximum SBA funding levels to SBICs at up to three times the private capital raised by the SBIC, or \$150 million, whichever is less and \$225 million for multiple licensees under common control.
  - Maximum leverage limits are \$175 million for single funds and \$250 million for multiple funds under common control who are licensed after September 30, 2009, and invest 50% of their dollars in low income geographic areas.

# Strategies for the Current Market Environment – Alternative Structures

- Externalization of internally-managed BDCs
- Banks/ Depository Institutions
- Non-Traded/ Continuous Offerings
- Downstream Asset Managers
- BDC Platforms
- Non-BDC Solutions
- Consolidation Within the BDC Industry
  - BDC to BDC
  - BDC to closed-end fund
  - BDC to operating company

## Conclusion

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- Middle market companies are in need of capital
- Fewer specialty finance companies and banks are willing and able to lend to the middle market
- Reduction in the availability of debt and equity capital
- Current economic environment could lead to opportunities for the BDC Industry