Session A: What’s Next for Private BDCs?

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Overview of the BDC model
## Overview of the BDC model

<table>
<thead>
<tr>
<th>Types of BDC Structures</th>
<th>Traded BDCs</th>
<th>Non-Traded BDCs</th>
<th>Private BDCs</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type of Offering</strong></td>
<td>Traditional IPO</td>
<td>Continuous offering up to a preset maximum amount</td>
<td>Private placement offering; generally, a capital call structure</td>
</tr>
<tr>
<td><strong>Initial Portfolio</strong></td>
<td>Either a blind-pool vehicle or acquisition of an existing portfolio</td>
<td>Acquired as shares are sold</td>
<td>Acquired as capital is called</td>
</tr>
<tr>
<td><strong>Initial Liquidity</strong></td>
<td>Listed on NASDAQ or NYSE</td>
<td>Periodic repurchase offers</td>
<td>Generally none, but may conduct periodic repurchase offers</td>
</tr>
<tr>
<td><strong>Lifespan</strong></td>
<td>Indefinite</td>
<td>Generally contemplate an exchange listing within a fixed 5-7 year period</td>
<td>Generally contemplate either winding down or an IPO or other liquidity event within a fixed 5-7 year period</td>
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How the BDC market developed

— Prior to 2003, the largest BDCs were internally managed
  • In 2004, Apollo Investment Corporation raised $930 million in less than three months, which ignited the growth in the externally managed traded BDC industry

— Franklin Square launched the first non-traded BDC in 2008 and TPG launched the first private BDC in 2011

— BDC assets aggregated approximately $112 billion as of today
The BDC industry today

99 BDCs operating today

- **29 private BDCs** with aggregate assets of $13 billion
  - AB Private Credit Investors Corporation
  - AG Twin Brook BDC, Inc
  - Audax Credit BDC Inc.
  - BC Partners Lending Corp.
  - Blackstone / GSO Secured Lending Fund
  - Crescent Capital BDC, Inc.
  - Flat Rock Capital Corp.
  - Goldman Sachs Middle Market Lending Corp.
  - Goldman Sachs Private Middle Market Credit LLC
  - Goldman Sachs Private Middle Market Credit II LLC
  - Golub Capital Investment Corporation
  - Golub Capital BDC 3, Inc.
  - Guggenheim Credit Income Fund
  - Hancock Park Corporate Income, Inc.
  - Monroe Capital Income Plus Corp
  - Muzinich BDC
  - New Mountain Guardian III BDC, L.L.C.
  - Oaktree Strategic Income II, Inc.
  - Owl Rock Technology Finance Corp.
  - Parkview Capital Credit, Inc.
  - Runway Growth Credit Fund Inc.
  - SCP Private Credit Income BDC LLC
  - Siguler Guff Small Business Credit Opportunities Fund, Inc.
  - TCG BDC II, Inc.
  - TCW Direct Lending LLC
  - TCW Direct Lending VII LLC
  - Venture Lending & Leasing VII, Inc.
  - Venture Lending & Leasing VIII, Inc.
  - Venture Lending & Leasing IX, Inc.
- **52 traded BDCs** with $40 billion aggregate market cap and $78 billion in assets
  - **4 traded BDCs** began as private BDCs
    - TPG Specialty Lending, Inc.
    - Bain Capital Specialty Finance, Inc.
    - TCG BDC, Inc. (fka Carlyle GMS Finance, Inc.)
  - TCG BDC, Inc. (fka Carlyle GMS Finance, Inc.)
  - Owl Rock Capital Corporation
- **18 non-traded BDCs** with aggregate assets of $21 billion
Private BDC model
What is a private BDC?

A hybrid between a private fund and a traditional BDC

- Typically sponsored by large private equity firms with existing investor relationships
  - Shares are generally only sold to accredited investors
- May contemplate a liquidity event
  - Exchange listing or some other liquidity mechanism including, with proper relief and authorizations, a spin-off or merger
- BDC reporting, governance and investment limitations
  - Reporting required by the Exchange Act of 1934 (the 1934 Act)
  - Compliance with the Investment Company Act of 1940 (the 1940 Act)
Advantages of launching as a private BDC

1. **Capital Commitment Structure**: Allows committed funds to be drawn as investment opportunities arise

2. **Optionality**: “Liquidity Events” may be determined in the future; fee structures may be different before and after a liquidity event

3. **Potentially Shorter Process**: Form 10 may be effective in as little as 60 days and no need for listing process

4. **Fewer Filings**: Private placement eliminates the obligation to complete the “blue sky” registration process faced by non-traded BDCs sold in a continuous offering

5. **Structuring Advantages**: BDC/RIC structure mitigates the need for an offshore feeder fund structure for foreign/tax-exempt investors

6. **No Withholding on Certain RIC Dividends**: Non-US investors not subject to US tax on interest-related, short-term capital gain, or long-term capital gain dividends
What’s next for private BDCs?
Liquidity
Liquidity events – what?

The private BDC’s subscription or LLC agreement may specify the contemplated liquidity event or give the board discretion.

- Exchange Listing – Traditional IPO
- Exchange Listing – Direct Listing
- Merger
- Spin-Off
Liquidity events – when?

Many private BDC subscription or LLC agreements provide that a liquidity event must be conducted within a set period of time

– Often not more than 5-7 years following the initial closing, subject to extension for a limited period of time at the discretion of the board

– This allows the board to extend the BDC’s private period if market conditions are not favorable to a liquidity event

– If a liquidity event is not conducted within the required period, the BDC may be required to liquidate and wind down

– Based on their terms, approximately 12 private BDCs are expected to have a liquidity event (or wind-down) within the next 6 years
Liquidity events – when?

Practical considerations

- Consider whether organizational or subscription documents will give the board optionality with respect to specific liquidity events
  - Optionality allows the board to decide which exit event is in the BDC’s best interest based on market and other conditions at the time
  - Shareholders may prefer certainty; but, following an exit event, disapproving shareholders generally have an opportunity to sell their shares
  - Specific exit events may be structured to give shareholders additional optionality (for example, whether or not to remain in current BDC following a spin-off)
**Liquidity Events – when?**

Practical considerations – exchange listing

- Advisory fee structure may be different before and after an Exchange Listing
  - Allows for a different advisory fee during the BDC’s ramp up period
  - Generally needs to be built into documents prior to the private BDC’s initial closing (or will require additional approvals)

- Fees paid to the independent members of the Board of Directors may be different before and after an Exchange Listing

- Lock-Ups may be agreed to in subscription agreements to avoid having to obtain from numerous shareholders
Liquidity events – how?
Exchange listing – traditional IPO

– File Form N-2 to register the issuance of new shares under the Securities Act
  • SEC comments
– List shares on a stock market
  • May require organizational documents and compliance materials to be updated

– Solicitation
  • Road show
  • Press releases

– Underwriting Agreement
  • Pricing
  • Comfort letter
  • Legal opinion

– Requires Board Approval
Liquidity events – how?
Exchange listing – direct listing

– File Form N-2 to register resale of already issued shares
– Satisfy “public float” requirements
– List shares on stock market (only existing shares – no new shares issued)
– Do not need underwriters or a roadshow
– Following listing, shares may be sold pursuant to any applicable lock-ups and Rule 144 restrictions
Liquidity events – how?
Exchange listing – examples

— Traditional IPO
  • TPG Specialty Lending, Inc.
    • Launched in 2011 - Initial public offering in March 2014
  • TCG BDC
    • Launched in 2013 - Initial public offering in June 2017
  • Bain Capital Specialty Finance
    • Launched in 2015 - Initial public offering in November 2018
  • Owl Rock Capital Corporation
    • Launched in 2016 - Initial public offering in July 2019

— No BDCs have direct listed
Liquidity events – how?

Merger

– Board approval required
– Disclosure
  • Generally requires combined proxy/registration statement
– Taxable nature of transaction
– Shareholder approval matters
– Impact on existing financing arrangements
– Other Considerations
  • Fairness opinion
  • Pro Forma financial statement issues
  • Fair Value adjustments
– BDC may be merged with or into an affiliated or non-affiliated BDC
Liquidity events – how?
Affiliated merger

– Additional considerations under the Investment Company Act

– Rule 17a-8 under the 1940 Act excepts a “merger, consolidation, or purchase or sale of all or substantially all of the assets” of a fund from the provisions of Section 17(a)

– To rely on Rule 17a-8, the board of directors of each fund must satisfy certain rules.

– Ultimately, the Board of each fund, including a majority of the independent members of each board, must determine that a proposed merger is in the best interests of the shareholders of the fund and the merger will not dilute the interests of shareholders
Liquidity events – how?
Merger – examples

- Crescent Capital BDC, Inc. (a private BDC launched in 2015) has announced its intention to merge with Alcentra Capital Corporation (a publicly traded BDC) with Crescent Capital surviving
  • Following the merger, Crescent will apply to have its shares listed on NASDAQ

- Golub Capital Investment Corp. (a private BDC launched in 2016) has announced its intention to merge with Golub Capital BDC, Inc. (an affiliated, publicly traded BDC) with Golub Capital surviving
  • Following the merger, GCIC shareholders will receive shares of Golub Capital which are listed on NASDAQ

- Other examples outside the private BDC space include the merger of FS Investment Corporation and Corporate Capital Trust Inc. (both publicly traded BDCs) with FS surviving and the proposed merger of Sierra Income Corporation (a publicly traded BDC) and Medley Capital Corporation (a non-traded BDC) with Sierra surviving
Liquidity events – how?
Spin-Off

The private BDC contributes assets to a new BDC and shares of the new BDC are distributed to the private BDC’s shareholders

• Requires exemptive relief from the SEC
  • Relief from Sections 57(a)(1) and 57(a)(2) of the 1940 Act to allow the private BDC to transfer its assets to the New BDC while the private BDC and the New BDC are affiliated persons
  • Relief from Section 57(a)(4) and Rule 17d-1 of the 1940 Act to the extent the spin-off is considered a prohibited joint transaction
  • Relief from Sections 12(d)(1)(A) and 12(d)(1)(C) to allow the private BDC to 100% of the New BDC prior to the spin-off

• Requires board and shareholder approval
• Generally taxable
Liquidity events – how?
Spin-off – example

— TCW Direct Lending LLC was the first private BDC to receive exemptive relief to allow it to conduct a spin-off - this was the first time a private BDC received approval for a liquidity event that was otherwise prohibited by the 1940 Act

— A condition to TCW’s exemptive relief was that 25% of TCW’s Units were validly tendered for shares in the spun-off fund – this condition was not met and TCW ultimately did not complete the spin-off
Liquidity events – why?

Listing

— Allows shareholders to buy and sell shares on a national securities exchange

— After 12 months, most private BDCs listing a class of their equity will be “shelf eligible” which provides greater access to the capital markets

— With the adoption of offering reform, BDCs with a significant unaffiliated shareholder base may be eligible for WKSI status
Liquidity events – why?

Merger

- Shareholders receive a liquid security that may be sold on a national securities exchange
- Advantages of size – increased market cap may improve trading liquidity and lead to greater analyst coverage; greater opportunity to maximize use of leverage
- Economies of scale – redundant expenses are eliminated; potential for administrative synergies
Liquidity events – why?

Spin-off

— Allows shareholders to exchange some or all of their shares for shares of a new BDC that is public or intends to pursue a liquidity event or that may have a different investment strategy

— Shareholders may opt to remain invested in the original, private BDC
Liquidity events
Other considerations

- Lock-Up – if not initially included in the subscription agreement or organizational documents, underwriters or the BDC may want existing shareholders to be subject to transfer restrictions

- Registration Rights/Secondary Offering – following an Exchange Listing affiliates (generally, officers, directors and greater than 10% shareholders) who acquired shares prior to the Exchange Listing will only be able to resell their shares in accordance with Rule 144 manner of sale and volume restrictions
  - In order to allow affiliates to sell their shares more freely, the BDC may grant such affiliates registration rights or agree to a secondary/resale offering within a certain period of time
Liquidity events
Other considerations (con’t)

— Repurchase Plans – the BDC or a third party may agree to buy a certain portion of the BDC’s shares on the open market if certain conditions exist (generally, that shares are trading below NAV)
  • Generally subject to restrictions under Rule 10b5-1 and Rule 10b-18 of the Exchange Act

— Springing Provisions – certain provisions may be drafted to spring into effect (ie, increased director or management fees) or fall away (ie, key man provisions) following a liquidity event

— Termination Penalties/Assignment – in a merger, consider whether any of the non-surviving entity’s agreements have penalties for early termination; also, consider whether material agreements can be assigned