

In-House Counsel Roundtable Series – Current Issues for Business Development Companies

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What is a BDC?

A business development company, or BDC, is a type of closed-end fund that elects to be subject to certain provisions of the Investment Company Act of 1940 (Sections 54-65) (but is typically not a registered investment company under the 1940 Act).

- Created by Congress in 1980 to provide capital to small/middle market companies and restructuring companies
- Originally intended to provide retain investors access to venture capital
- May be managed internally or externally
- May be listed or unlisted
- Typically operated as a regulated investment company under Subchapter M of the Internal Revenue Code
- Subject to investing in “eligible portfolio companies”, BDCs are not required to adopt a particular investment strategy, although most tend to be credit-focused
- More flexible structure than a traditional registered closed-end fund
- Hybrid of an investment company and operating company—subject to Exchange Act reporting (e.g., 10-K, 10-Q and 8-K) vs. 1940 Act reporting (e.g., N-CSR and N-Q/N-PORT); Sarbanes-Oxley applies as though a BDC is an operating company

BDCs – A Quick History

- Prior to 2003, the largest BDCs were primarily internally managed (e.g., Allied Capital).
- In late 2003, Oxford Square Capital Corp. (formerly Technology Investment Capital Corp. and TICC Capital Corp.), an externally managed BDC, completed a \$130 million IPO.
- In 2004, Apollo Investment Corporation raised \$930 million in its IPO.
- By May 2004, 13 potential IPOs proposing to raise more than \$6.7 billion had been filed by externally managed vehicles (e.g., Thomas H. Lee Partners LP, Kohlberg Kravis & Roberts & Co. and Evercore Partners).
- Only a few BDCs were able to successfully complete an IPO in 2004, including:
 - Ares Capital Corporation
 - Prospect Energy Corporation (now known as Prospect Capital Corporation)
- The BDC IPO market has changed dramatically since that time.

Benefits of BDCs – Manager's Perspective

- Provide access to “permanent capital”
- Flow-through tax treatment and ECI/UBTI blocker (RIC election)
- Can charge “private fund”-like management fees (base management and incentive fees)
- Publicly available financial information through quarterly reporting (appealing to investors)
- ERISA exemption/no 25% plan asset limitation (except for “private” BDCs)
- Potentially more diversified portfolio (compared to private funds, SMAs)
- Reduced 1940 Act burdens compared to closed-end funds (leverage, affiliated transactions)

BDC Capital Markets Trends

- Limited number of IPOs since 2014 as fundraising has been largely focused on private BDCs
- Reduced number of follow-on offerings in 2018 (four year-to-date) as compared to 2017 (16 for the full year)
- Uptick in debt offerings in 2018 (12 baby bond offerings, two institutional notes offerings and four convertible notes offerings)
- Planning for effectiveness of modified offering rules as a result of SBCAA.
- Evaluation of joint venture arrangements
- Offshore capital raising
 - PennantPark Floating Rate Capital Ltd.
 - Medley Capital Corporation
 - Corporate Capital Trust, Inc.

Small Business Credit Availability Act (SBCAA)

The SBCCA was adopted as part of the omnibus spending bill signed in March 2018.

- Required asset coverage is reduced from 200% to 150%, subject to certain initial approval and ongoing reporting requirements. This effectively allows BDCs to incur double the amount of leverage (without giving effect to any SBIC exemptive relief) and permit BDCs to operate with a greater regulatory cushion with respect to use of leverage.
- A BDC must comply with a series of conditions, including initial approval by its board of directors or its shareholders (followed by current public disclosure of the approval) and ongoing periodic report disclosure (e.g., the amount of leverage incurred by the BDC, the asset coverage percentage and the principal risks associated with the BDC's leverage).
- A BDC that obtains board approval (i.e., a "required majority" vote) cannot increase its leverage until one year after the approval date. A BDC that obtains shareholder approval (i.e., more than 50% of votes cast), however, will be able to increase its leverage the day after such approval is obtained.
- Non-listed/private BDCs also must provide liquidity to investors who owned shares as of the approval date.

SBCAA (cont.)

Approximately half of publicly listed BDCs have announced their intent to pursue higher leverage under the SBCAA, and two have withdrawn their intention

- BDCs have announced plans to use higher leverage to pursue a range of strategies
 - Maintain existing investment philosophy but have “cushion” on regulatory leverage to reduce default risk
 - Move to more senior asset classes where assets are more conducive to increased leverage
- Financing considerations, including maintaining investment grade ratings along with access to the unsecured debt markets, have informed and shaped many BDCs’ strategies
 - Some BDCs have successfully amended credit facilities (or entered into new facilities) to be able to take advantage of increased leverage
 - Some are waiting for existing leverage (institutional notes, in particular) to mature
- Several BDCs have announced changes to fee structure in connection with approval of reduced asset coverage requirements

SBCAA (cont.)

The SBCAA also meaningfully changes how BDCs can be offered to investors, as it requires the SEC to streamline the offering, filing and registration processes such that BDCs will conduct offerings in a way similar to operating companies.

- Changes will include:
 - Forward incorporation by reference;
 - WKSI qualification and automatic shelf registration statements;
 - Use of free-writing prospectuses and related safe harbor communication rules; and
 - Prospectus delivery/notice of sale rules.
- The SEC has one year following the date of enactment (i.e., March 24, 2019) to adopt amendments to existing rules. If the SEC does not meet that deadline, BDCs may deem those amendments as having been completed consistent with the legislation.
- No proposed rules have been issued to date.

BDC M&A/Consolidation Trends

- PFLT/MCG Merger (2015)
- Ares/ACAS Acquisition (2016)
- Oaktree/Fifth Street Acquisition (2017)
- Franklin Square/KKR Partnership (2017)
- Triangle Capital/Benefit Street Partners/Barings Asset Sale and Acquisition (2018)
- Medley Roll-Up (Announced 2018)
- Several others have either publicly announced exploration of strategic alternatives and/or begun confidential processes

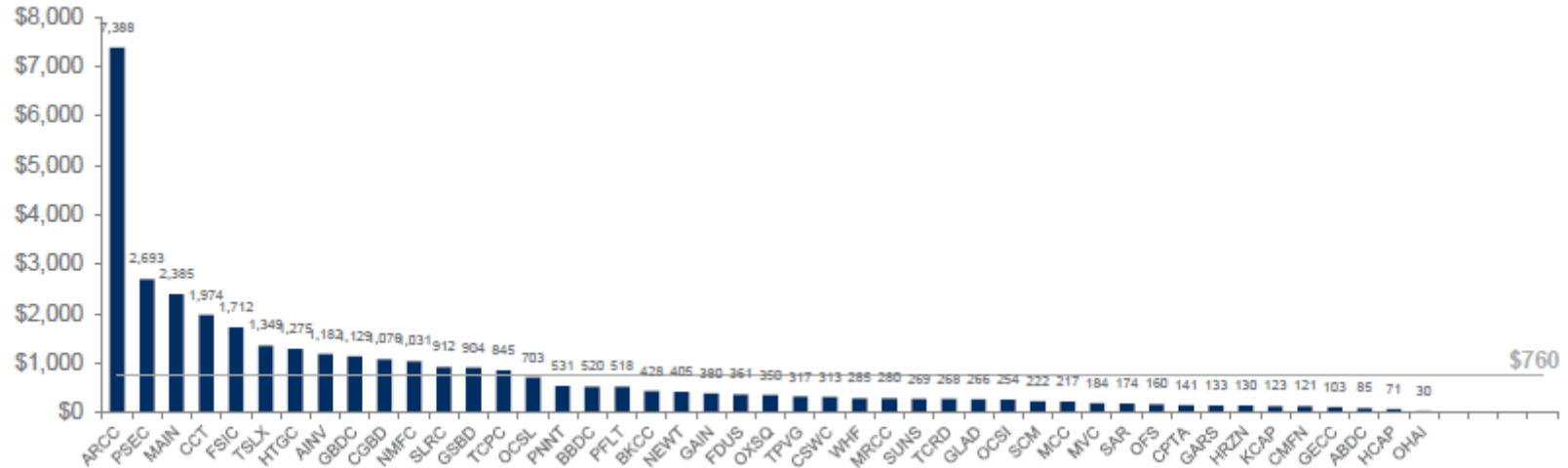
2019 Predictions

- Opportunities arising under SBCAA
- Outlook for offerings as increased leverage is deployed
- Outlook for private BDCs as liquidity deadlines approach
 - Liquidity events can include:
 - Listing
 - IPO and listing
 - Merger with another BDC (whether or not affiliated)
 - Orderly liquidation and wind-up
- Continued discussions surrounding consolidation

Appendix: Market Data

BDC Market – General Data

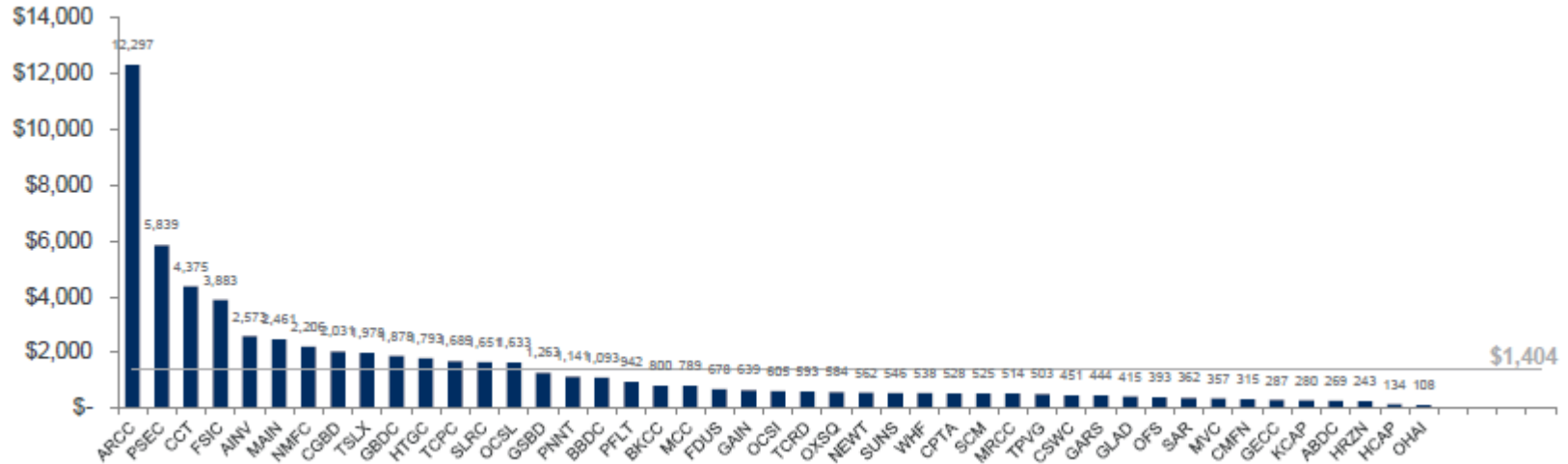
Market Capitalization (\$MM) as of September 21, 2018



Source: Raymond James

BDC Market – General Data

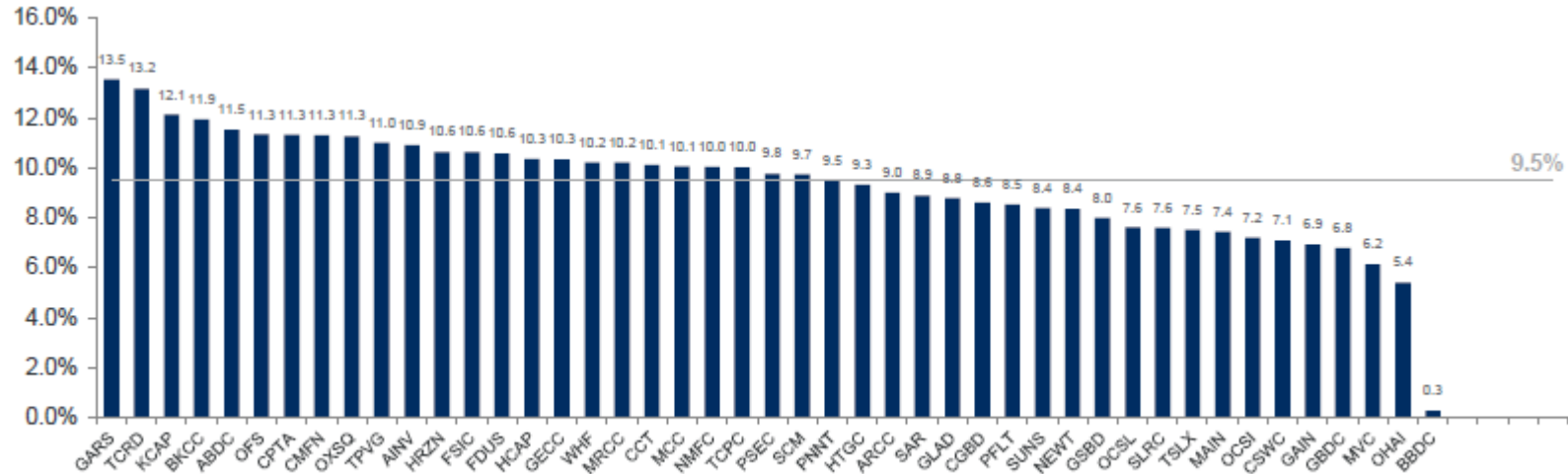
Assets (\$MM) as of September 21, 2018



Source: Raymond James

BDC Market – General Data

Dividend Yield as of September 21, 2018



Source: Raymond James

Dividend rate uses current dividend annualized

MAIN includes supplemental dividend

Recent BDC Offerings

- Common Stock
 - TriplePoint Venture Growth BDC Corp.
 - Saratoga Investment Corp.
 - Hercules Capital, Inc.
 - TPG Specialty Lending, Inc.
- Institutional Notes
 - Prospect Capital Corporation
 - TPG Specialty Lending, Inc.
 - Ares Capital Corporation
- Convertible Notes
 - New Mountain Finance Corporation
 - Goldman Sachs BDC, Inc.
 - TPG Specialty Lending, Inc.
 - GSV Capital Corp.
- Retail Notes (Baby Bonds)
 - THL Credit, Inc.
 - New Mountain Finance Corporation
 - Hercules Capital, Inc. (two issuances)
 - Monroe Capital Corporation
 - Saratoga Investment Corp.
 - CM Finance Inc.
 - Prospect Capital Corporation
 - OFS Capital Corporation
 - Newtek Business Services Corp.
 - Fidus Investment Corporation
 - Great Elm Capital Corp.

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