



Business Development Companies

OLLI Investment Forum

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Artwork by Cindy Kalkwarf

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Agenda

My Personal Investment Style - Aggressive!

Objectives:

- (1) Supplement my income with dividend-bearing securities
- (2) Be recession-resistant

What Is a BDC?

BDC Market Overview

How To Evaluate a BDC

The Good And The Ugly

Conclusions: Get Your DRIP On

What is a BDC?

Investopedia Definition:

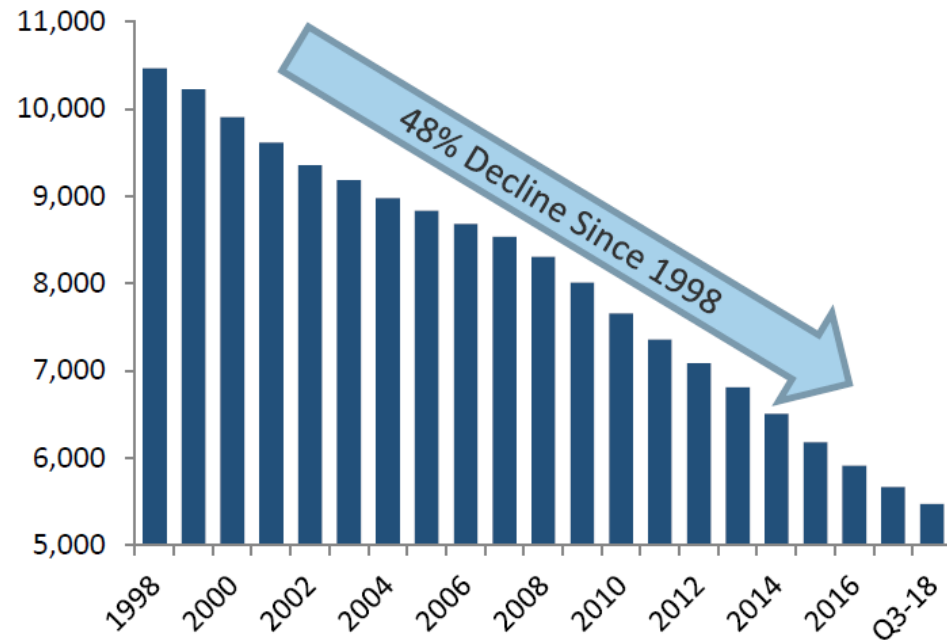
- Established in accordance with the Investment Company Act of 1980; Amended in March 2018
- A company that makes loans to small and mid-size businesses
- Regulated by the SEC
- Distributes 90% of net income to investors to avoid paying income taxes
- Similar to a REIT, but assets are loans to companies
 - Must maintain 70% of loans to small businesses
- Similar to Private Equity or Venture Capital for retail investors
- Most BDCs are publicly traded – some are not

Primary reason for investing:

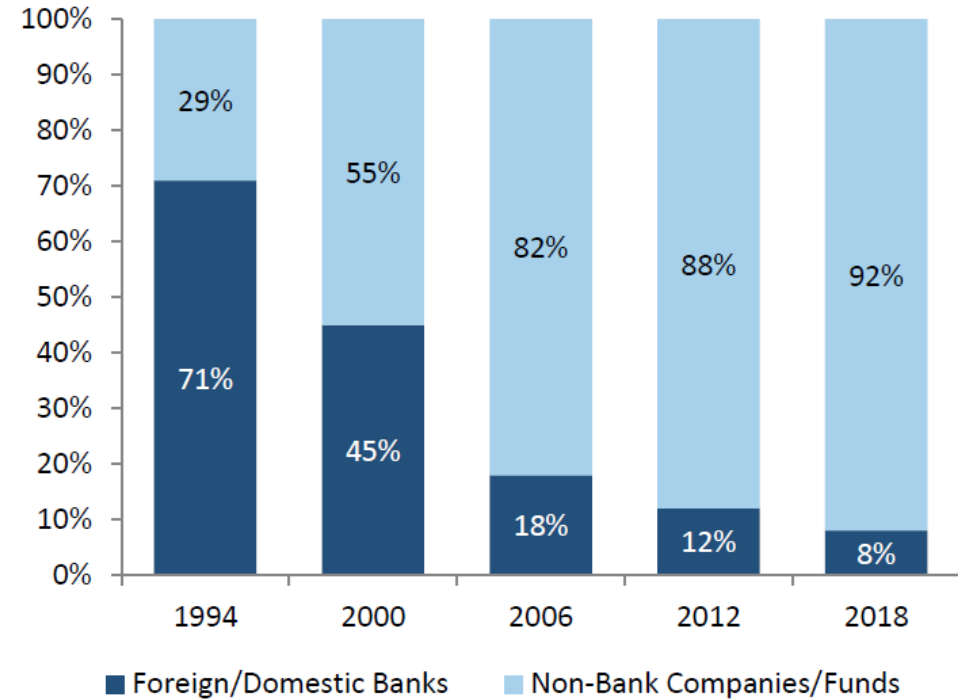
- High dividends with diversification
- Can result in very high returns in a buy and hold portfolio, with a Dividend Reinvestment Program (DRIP)

BDCs are filling a gap

Total Number of U.S. Banks Continues to Decline ⁽¹⁾



Banks' Share of the U.S. Leveraged Loan Market Continues to Shrink ⁽²⁾



Source: Ares Capital Corp and FDIC

Types of BDCs

Market Specialized or Diversified

- Specialized BDCs might invest defensively - Health care
- Diversified BDCs are just that
- International or US-only?

Internally managed or Externally managed

- Internally managed BDCs work for shareholders
- Externally managed BDCs work for the managers
 - Can result in conflicts of interest
 - BUT external managers may own a large stake

Hybrids

- Equity stakes in clients
- Own property and collect rent rather than loans
- Management services

Typical BDC Capitalization

Assets

- First Lien secured loans
 - 75% of portfolio is very good
- Second Lien secured loans
- Senior secured loans
- Mezzanine Loans
- Warrants
- Equity Stakes
- Board seats
- Partnerships and JVs
- Venture Debt
- Hedges

Liabilities

- Primary loans from large banks
 - Revolving credit facilities
- Preferred stocks and dividends
- Common Stocks and dividends
- Notes
- Convertible Notes
- Bonds
- SBA licenses
- Hedges

Critical question: Are the loans and notes laddered properly?

The Case for Investing in BDCs

- Tailwinds:
 - Strong economy
 - Tax reform
 - Small Business Credit Availability Act (2018) increased leverage limits (now 2:1)
- Rising interest rates benefit BDCs!!
 - Borrow at fixed rates and then,
 - Provide floating rate loans to clients
- No double taxation!
 - Taxes they would have paid are paid out in dividends
- Average 9.6% annual dividends, paid quarterly or monthly
- Portfolio quality is improving and yields increasing
- Bankruptcy among BDCs extremely rare
 - Interest payments take precedence in the event of customer default
- Dividend Reinvestment Programs (DRIP) are powerful incentives for investing

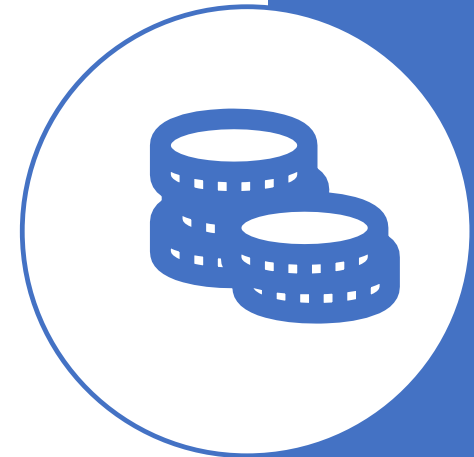
Largest BDCs

- There are approximately 50 BDCs registered with the SEC
- Top 2 are Internally managed
- “Return” means return on equity
- “Yield” is set by stock price and is the market’s assessment of risk

	NAV	Dividends	Return	Yield	
Internally Managed	HTGC	10.38	1.26	12.1%	9.4%
	MAIN	24.09	2.89	12.0%	6.3%
	TPVG	13.59	1.54	11.3%	
	MRCC	12.95	1.40	10.8%	
	TSLX	16.47	1.78	10.8%	
	TCRD	10.10	1.08	10.7%	
	GLAD	8.32	0.84	10.1%	
	NMFC	13.58	1.36	10.0%	10.1%
	GSBD	18.13	1.80	9.9%	
	TCPC	14.51	1.44	9.9%	
	FDUS	16.41	1.60	9.8%	
	FSK	7.84	0.76	9.7%	
	CGBD	17.66	1.68	9.5%	
	AINV	19.41	1.80	9.3%	
	ARCC	17.16	1.56	9.1%	9.3%
	GBDC	16.10	1.40	8.7%	
	SUNS	16.81	1.41	8.4%	8.3%
	PFLT	13.82	1.14	8.2%	
	PNNT	9.11	0.72	7.9%	
	PSEC	9.39	0.72	7.7%	
	MCC	5.90	0.40	6.8%	
	OCSL	6.09	0.38	6.2%	

How to Evaluate a BDC

- The success of any REIT or BDC is directly tied to how much debt they take on AND portfolio performance
- Read the Blogs on Seeking Alpha
 - Scott Kennedy, BDC Buzz, High Yield Investor (HYI)
- BDC Financials: Are Dividends, Net Asset Value (NAV), Funds from Operations (FFO) increasing?
- Is the dividend sustainable?
 - What is the dividend history? Increasing dividend is excellent
 - Calculate Payout ratio: $\text{Dividends} / \text{Funds from Operations (FFO)}$ – should be <1.0
 - Calculate Debt to Net Asset Value – varies, but should be $< 50\%$. $>100\%$ is a bad sign
 - Calculate Cash Flow Yield = FFO/NAV : 10% or more is good
 - Calculate Return on NAV (Equity) = $\text{Dividends} / \text{NAV}$. Should be 6-12%.
- What is the quality of the portfolio?
 - Percent of first liens should be $>60\%$
 - Percent of assets or number of loans on non-accrual should be $<1\%$
- Does the BDC focus on particular business sector(s)?



How to Evaluate a BDC, cont'd

- Is the BDC externally managed? Or internally? HUGE difference
 - How is management incentivized?
 - AUM or Dividend growth?
- Insider holdings?
- What are the qualifications of the managers?
- Who are the major investors / holders?
- Check Relative Strength Index (RSI) - look for dips
 - If < 30 – good! If > 70 – hold off
- Short interest?
- What is the BDCs sensitivity to economic cycles? Beta?
- Do they have a Small Business Administration guarantee / license?
- Analyst opinions – ie Fidelity, Morningstar
- Ratings from S&P, Moody's or Fitch? BBB or better is good.





The Good:
Main Street
Capital
(MAIN)

MAIN is a Principal Investor in Private Debt and Equity

Hybrid debt and equity investment strategy, internally managed operating structure and focus on Lower Middle Market differentiates MAIN from other investment firms

Internally-managed Business Development Company (BDC)

- IPO in 2007
- Over \$4.1 billion in capital under management⁽¹⁾
 - Over \$2.9 billion internally at MAIN⁽¹⁾
 - Over \$1.2 billion as a sub-advisor to a third party⁽¹⁾

Primarily invests in the under-served Lower Middle Market (LMM)

- Targets companies with revenue between \$10 million - \$150 million; EBITDA between \$3 million - \$20 million
- Provides single source solutions including a combination of first lien, senior secured debt and equity financing

Debt investments in Middle Market companies

- Issuances of first lien, senior secured and/or rated debt investments
- Larger companies than LMM investment strategy

Debt investments originated in collaboration with other funds

- First lien, senior secured debt investments in privately held companies originated through strategic relationships with other investment funds
- Similar in size, structure and terms to LMM and Middle Market investments

Attractive asset management advisory business

Significant management ownership / investment in MAIN

Headquartered in Houston, Texas

⁽¹⁾ Capital under management includes undrawn portion of debt capital as of December 31, 2018

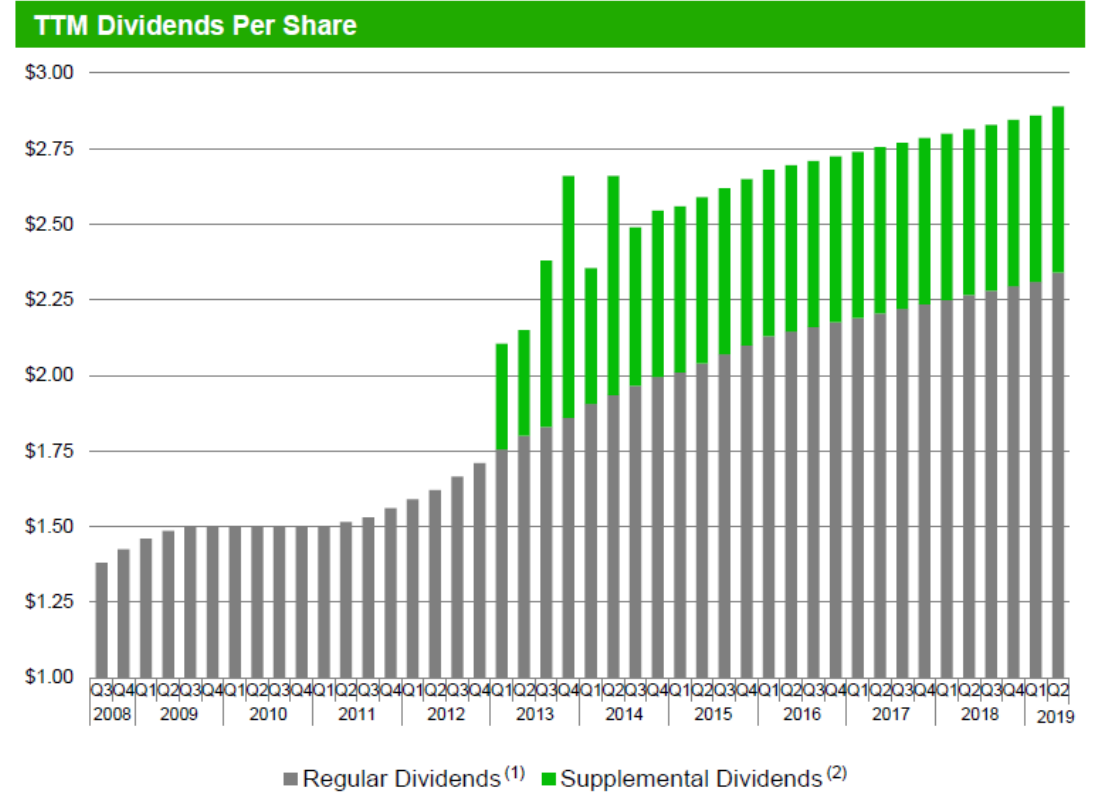
Post-IPO TTM Dividends Per Share – Sustainable Growth

**Dividend
Track Record
– excellent!**

Cumulative dividends paid or declared from October 2007 IPO (at \$15.00 per share) through Q2 2019 equal \$25.420 per share⁽¹⁾

Recurring monthly dividend has never been decreased and has shown meaningful (82%) growth since IPO

Based upon the current annualized monthly dividends for the first quarter of 2019 and the annualized semi-annual supplemental dividend declared for December 2018, the annual effective yield on MAIN's stock is 7.5%⁽³⁾, or 6.1%⁽³⁾ if the supplemental dividends are excluded

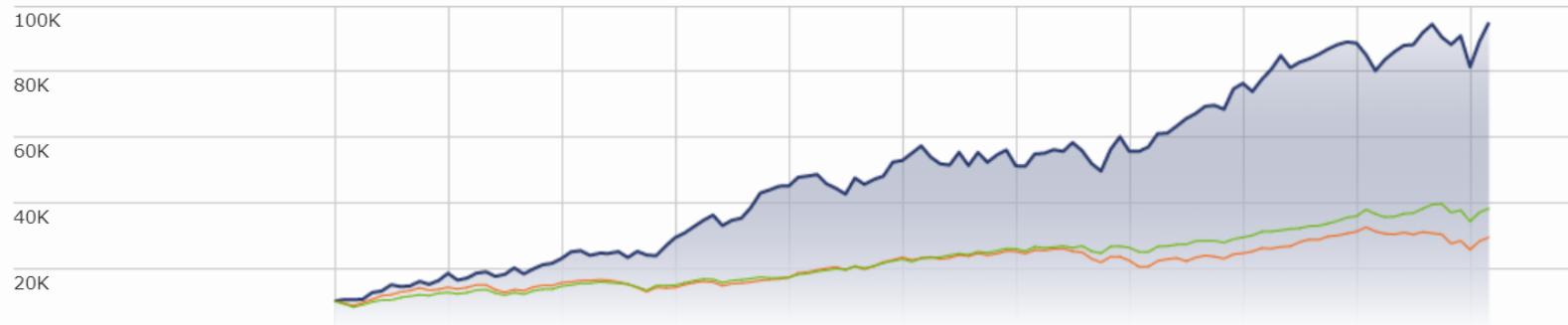


The Good: Main Street Capital (MAIN)

Compare

Growth of 10,000 MAIN

● MAIN ● Asset Management ● S&P 500 TR USD

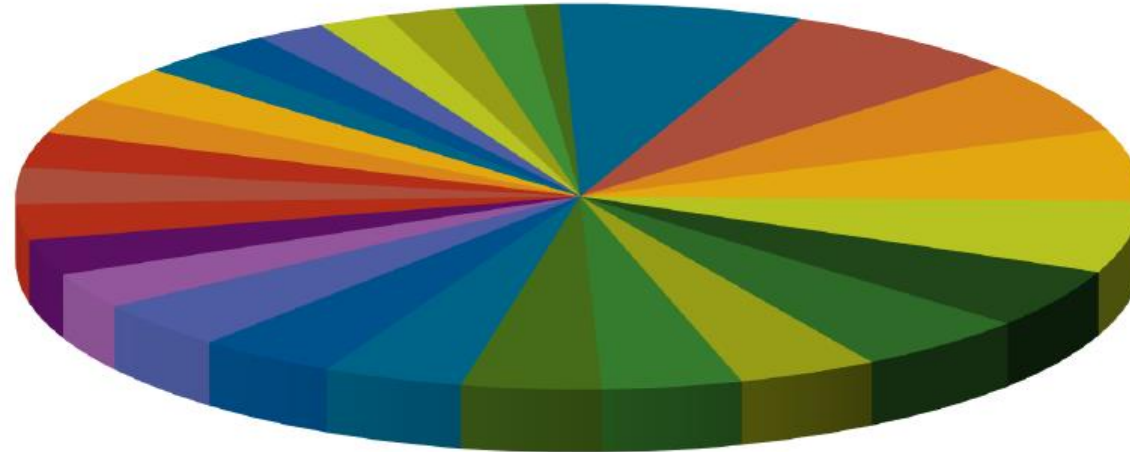


History (02/28/2019)	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	YTD
MAIN	79.07	22.15	26.09	51.77	16.44	-2.75	8.55	35.83	15.64	-7.73	16.56
Asset Management	42.12	9.83	-9.40	21.38	36.03	7.76	-11.19	9.92	26.99	-17.61	14.48
S&P 500 TR USD	26.46	15.06	2.11	16.00	32.39	13.69	1.38	11.96	21.83	-4.38	11.48
+/- Asset Management	36.95	12.31	35.49	30.38	-19.59	-10.52	19.74	25.91	-11.35	9.88	2.09
+/- S&P 500 TR USD	52.60	7.08	23.97	35.76	-15.95	-16.44	7.17	23.87	-6.19	-3.34	5.08
Dividend Yield %	9.31	8.25	7.39	5.65	5.77	6.84	7.26	5.93	5.64	6.80	5.92
Market Cap USD Mil	175	342	566	1,055	1,303	1,318	1,466	1,950	2,308	2,071	2,413

Trailing Total Returns MAIN

Source: Morningstar

Total Portfolio by Industry (as a Percentage of Cost) ⁽¹⁾



■ Construction & Engineering, 7%	■ Media, 6%
■ Machinery, 6%	■ Energy Equipment & Services, 6%
■ Commercial Services & Supplies, 5%	■ Diversified Telecommunication Services, 5%
■ Specialty Retail, 4%	■ Internet Software & Services, 4%
■ Leisure Equipment & Products, 4%	■ IT Services, 4%
■ Aerospace & Defense, 4%	■ Food Products, 4%
■ Electronic Equipment, Instruments & Components, 3%	■ Hotels, Restaurants & Leisure, 3%
■ Oil, Gas & Consumable Fuels, 3%	■ Health Care Providers & Services, 3%
■ Professional Services, 3%	■ Computers & Peripherals, 3%
■ Software, 3%	■ Communications Equipment, 2%
■ Containers & Packaging, 2%	■ Construction Materials, 2%
■ Road & Rail, 2%	■ Distributors, 2%
■ Building Products, 2%	■ Internet & Catalog Retail, 1%
■ Other, 7%	

(1) Excluding MAIN's Other Portfolio investments and the External Investment Manager, as described in MAIN's public filings, which represent approximately 5% of the total portfolio

Main is
Highly
Diversified

Great Trends

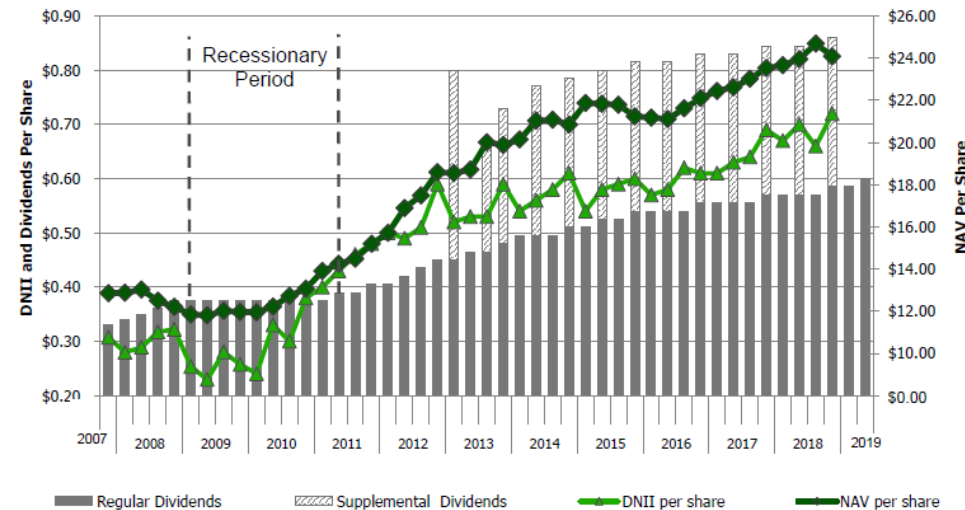


Quarterly Historical Dividend, Net Asset Value (“NAV”) Per Share Growth and Distributable Net Investment Income (“DNII”)

MAIN’s unique focus on equity investments in the Lower Middle Market provides the opportunity for significant NAV per share growth

MAIN’s efficient operating structure provides significant operating leverage, greater dividends and greater overall returns for our shareholders

MAIN’s dividends have been covered by DNII and net realized gains – MAIN has never paid a return of capital distribution



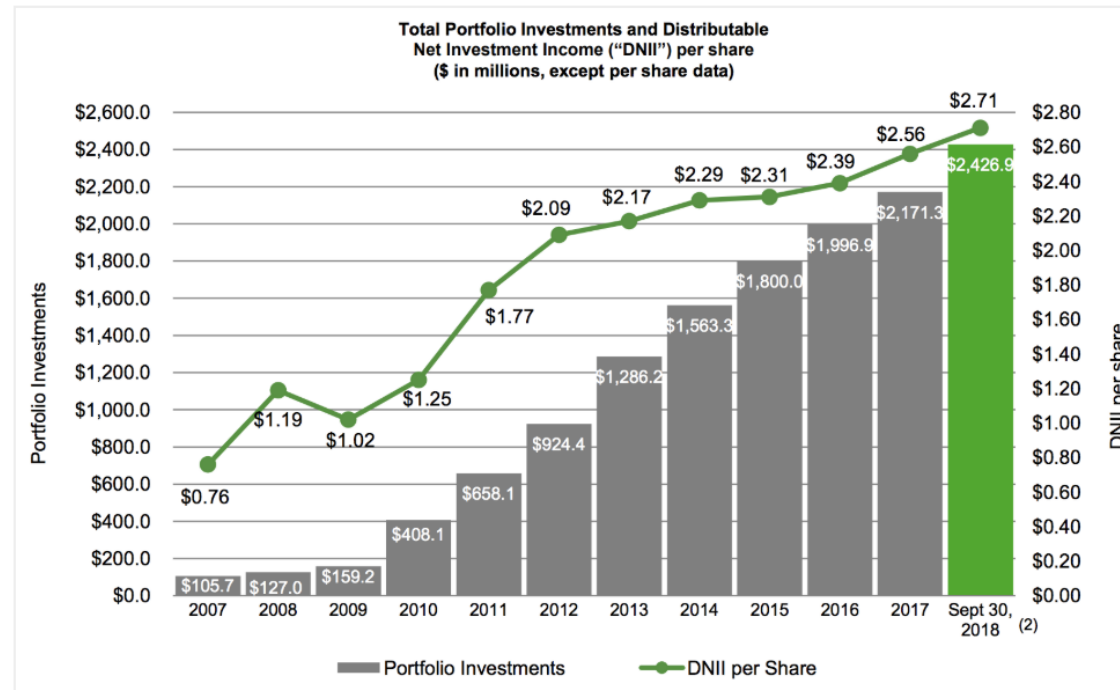
- Includes recurring monthly and semi-annual supplemental dividends paid and declared as of February 28, 2019.
- Annual return on equity averaging approximately 13.4% from 2010 through the fourth quarter of 2018

Portfolio and Net Investment Income

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Main Street Capital Corporation (MAIN)

[Research](#) · [Dividend Growth](#) · [Payment Schedule](#) · [Dividend Safety](#) · [Valuation](#) · [Financials](#)



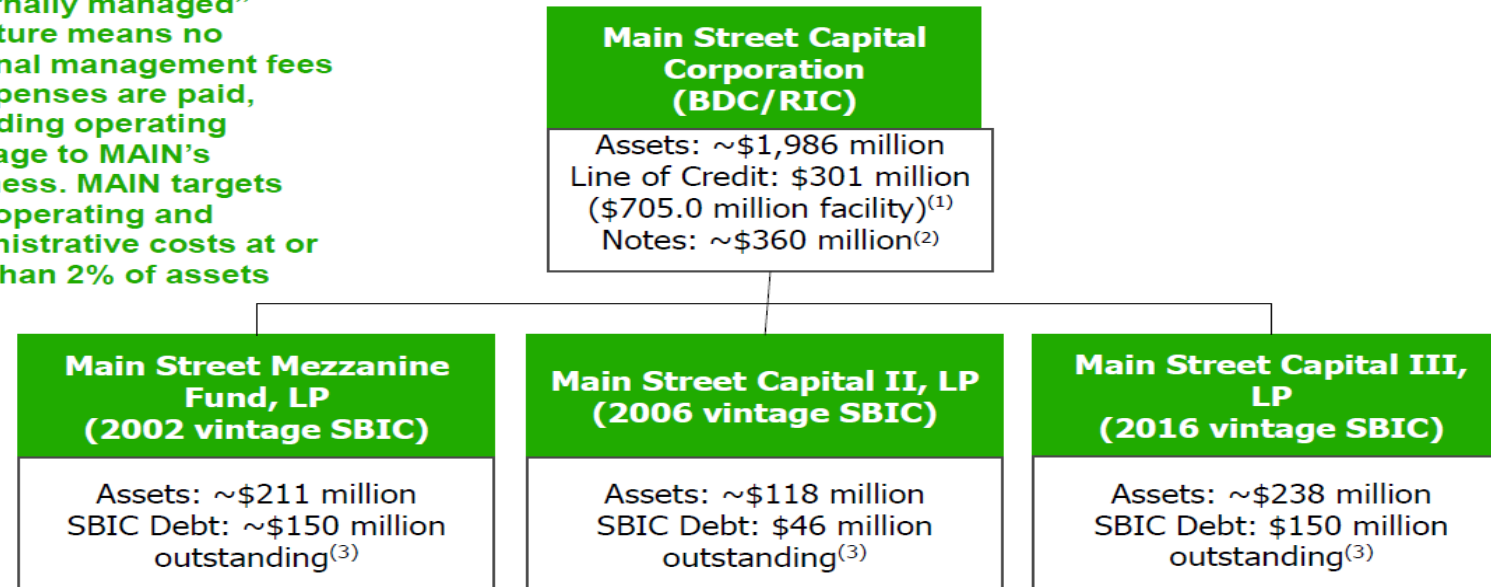
Source: Main Street Investor Presentation

Differing Investing Criteria in the 3 Businesses



MAIN Corporate Structure – Internally Managed

“Internally managed” structure means no external management fees or expenses are paid, providing operating leverage to MAIN’s business. MAIN targets total operating and administrative costs at or less than 2% of assets



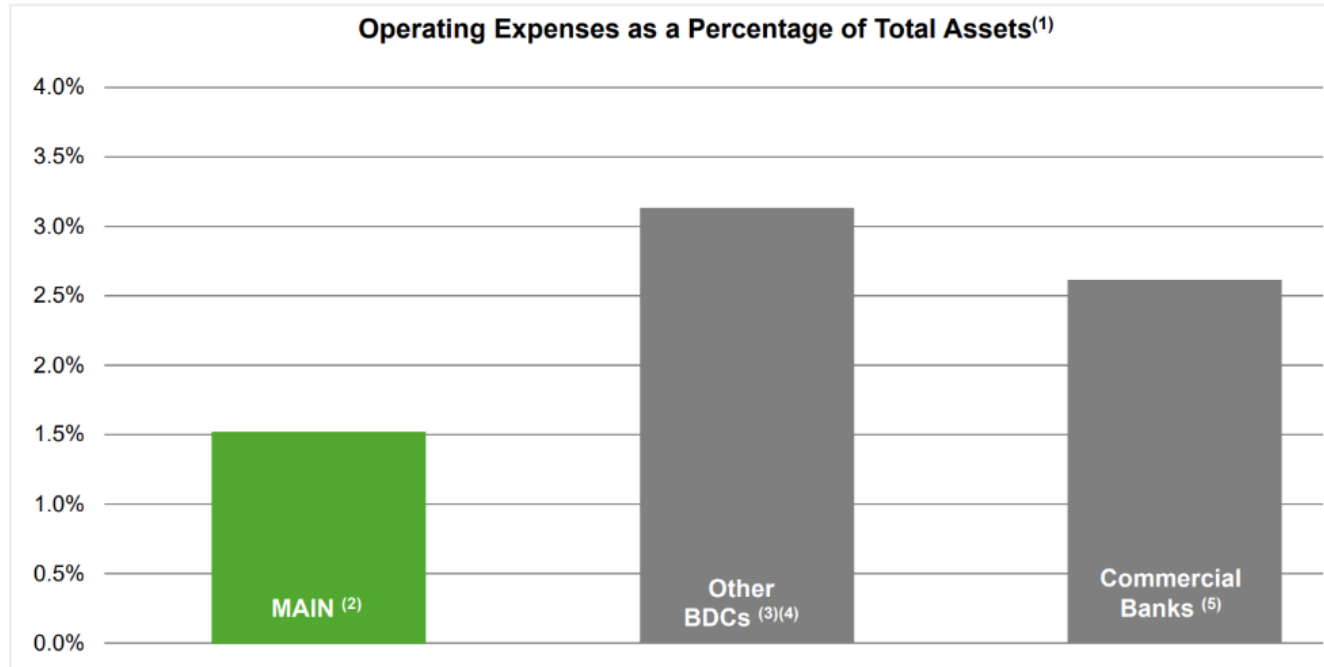
(1) As of December 31, 2018, MAIN's credit facility had \$705.0 million in total commitments. MAIN's credit facility includes an accordion feature which could increase total commitments up to \$800.0 million

(2) \$185.0 million of 4.50% Notes due December 2022 and \$175.0 million of 4.50% Notes due December 2019

(3) MAIN opportunistically prepaid \$4.0 million of existing SBIC debentures during the quarter ended March 31, 2018. As a result, the current effective maximum amount of SBIC debt financing capacity under its three existing licenses is \$346.0 million

operating costs and higher profitability compared to its BDC and bank peers. Specifically, the firm's operating expenses as a percentage of assets are 1.5% compared to an average of 2.6% for commercial banks and 3.1% for externally managed BDCs.

MAIN keeps costs low



Source: Main Street Investor Presentation

MAIN Financial Evaluation

- Dividends, FFO, increasing over 10 years – a good start
 - NAV slight decrease in 2018
- Payout ratio = 83%, not including special dividends. Good.
- Debt to NAV = 0.65. Good.
- Cash Flow Yield: 12% Excellent. Best in class.
- Return on NAV = 12.1% Excellent. Best in class.
- Non-accrual rate = 6 investments / 184 total. 1.3% of fair value. OK.

Other factors

- S&P Rating of BBB
- \$4.1B in assets provides economic scale
- Internally managed – dedicated management, no conflicts of interest
- Management and BoD own 3.3% of stock, \$112M
- Operating expenses are 1.5% of assets – much better than banks
- Three SBA facilities
- Short ratio = 4%

Analyst opinions

- Scott Kennedy: “BUY” Target price \$42.15
- Simply Safe Dividends: 65 = Safe
- Fidelity: 1.8 Bearish
- Morningstar: One analyst “HOLD”
- BDC Buzz: MAIN is “one of the best-managed BDCs”

The Ugly: Medley Capital (MCC)

Source: Simply Safe Dividends

Payment Schedule

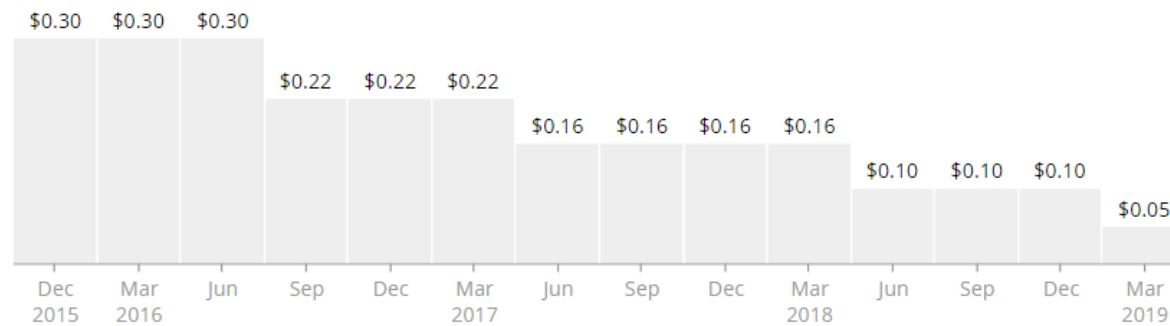
Frequency
Quarterly
Mar, Jun, Sep, Dec

Annual Payout
\$0.20
Per Share

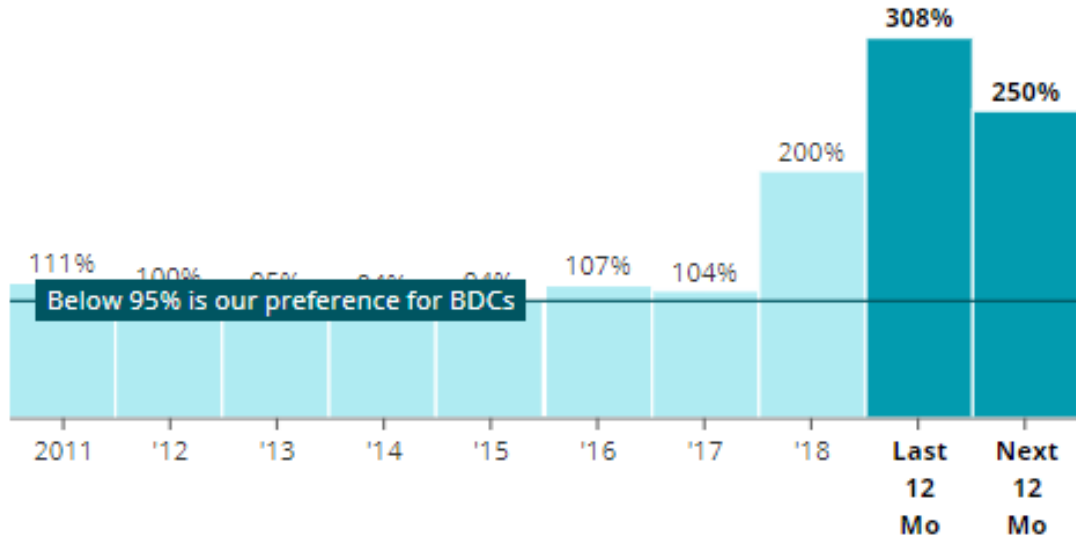
Ex-Dividend
Feb 21
Past

Pay Date
Mar 12

Recent & Upcoming Payouts



Earnings Payout Ratio



Earnings Per Share



The Ugly: Medley Capital (MCC)

Source: Simply Safe Dividends

Growth of 10,000 MCC

■ MCC ■ Asset Management ■ S&P 500 TR USD



History (02/28/2019)	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	YTD
MCC				52.60	5.15	-22.60	-5.63	13.70	-21.17	-40.23	31.95
Asset Management				21.38	36.03	7.76	-11.19	9.92	26.99	-17.61	14.48
S&P 500 TR USD				16.00	32.39	13.69	1.38	11.96	21.83	-4.38	11.48
+/- Asset Management				31.21	-30.88	-30.36	5.56	3.77	-48.16	-22.62	17.48
+/- S&P 500 TR USD				36.59	-27.24	-36.29	-7.01	1.74	-43.00	-35.85	20.47
Dividend Yield %			5.96	9.00	10.54	16.02	15.96	13.85	13.41	17.29	10.12
Market Cap USD Mil				417	557	543	423	409	284	145	188

Trailing Total Returns MCC

MCC total return?
I don't think so.

Source: Morningstar

Change In NAV Per Share

	Price/NAV	Yield	1 Year	3 Years
GAIN	0.91	8.0%	20.8%	44.7%
MAIN	1.54	7.7%	2.4%	13.4%
FDUS	0.93	10.4%	2.6%	8.6%
TSLX	1.21	9.4%	1.0%	7.3%
ARCC	1.01	9.6%	2.8%	4.0%
NMFC	1.01	10.1%	-3.0%	1.1%
GBDC	1.14	7.7%	-0.4%	0.5%
PNNT	0.77	10.2%	-0.5%	0.3%
SUNS	1.04	8.3%	-3.2%	-0.2%
HTGC	1.34	9.5%	-0.6%	-0.4%
PFLT	0.95	8.8%	-1.4%	-0.5%
TCPC	1.02	9.9%	-4.5%	-4.4%
GLAD	1.13	9.3%	-5.9%	-4.8%
CGBD	0.86	11.3%	-5.7%	-5.8%
GSBD	1.14	8.9%	-2.4%	-7.0%
MRCC	1.01	11.2%	-8.1%	-10.8%
HCAP	0.82	9.3%	-4.1%	-13.6%
FSK	0.81	11.9%	-15.7%	-13.8%
HRZN	1.12	9.0%	-0.7%	-16.0%
AINV	0.81	11.7%	-3.9%	-16.1%
OCSI	0.87	7.5%	-4.2%	-17.0%
GARS	0.71	12.3%	-10.0%	-24.7%
ABDC	0.68	9.6%	-9.7%	-25.7%
OCSL	0.83	7.3%	6.5%	-26.4%
TCRD	0.72	12.5%	-12.9%	-27.3%
KCAP	0.83	11.4%	-13.1%	-27.3%
BBDC	0.89		-18.2%	-27.9%
CPTA	0.65	12.8%	-14.6%	-30.3%
BKCC	0.86	11.9%	-9.7%	-30.5%
MCC	0.58	6.2%	-27.2%	-44.0%
Average	0.94	10.0%	-4.6%	-9.6%

Special dividends
and/or recent dividend
increases

Previous and/or
potential dividend
reductions

BDC Buzz
Ratings

Conclusion – BDC market gets no respect!

- BDCs are for investors willing to accept a higher level of risk
- For buy and hold investors - not for day-trading
 - MUST assess dividend sustainability
 - MUST include DRIP for maximum benefit
- PLEASE be selective
- Leverage limits recently increased
 - SBCAA legislation enables BDCs to increase their leverage from 150% to 200% of gross assets- good!
 - Banks and REITs have much higher leverage limits
- Rising interest rates - slow and telegraphed well in advance
 - BDCs offer floating rate loans as protection
- GLTA

Sources

Seeking Alpha

- BDC Buzz
- Scott Kennedy
- Colorado Wealth Management
- High Yield Investor

Fidelity

Morningstar

Simply Safe Dividends

BDCInvestor.com

SEC reports