SARATOGA INVESTMENT CORP.

Research Studies and Opinions

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Pimm Fox, Bloomberg Radio

Taking care of business. How about business development corporations; what are BDCs and how do they fit into your investment plans? Chris Oberbeck is the President and the Chief Executive of Saratoga Investment Corp. and he joins us from New York.

Chris, great to have you with us here on Bloomberg. Describe what are business development corporations.

Chris Oberbeck, Saratoga Investment Corp.

Business development corporations are flow-through investment vehicles, kind of like real estate investment trusts; because rather than investing in real estate they invest in business loans. Basically, loans to smaller middle-market companies across the US. They are highly diversified and like a REIT they have a flow through of interest earnings on those loans. So, it’s like investing in bank loans to a broad base of businesses across the US.

Fox

How did you get started in the world of BDCs, because I know that Saratoga Investment Corp. is one of them?

Oberbeck

Well, our history is as a private equity investment firm. So over the years we borrowed from BDCs. So, we were very familiar with BDCs and other sources of financing for our leveraged loans, when we did private equity investments. And recently in 2010 we made an investment in a publicly traded BDC and renamed it Saratoga Investment Corp. and we took over the management of that company. That's how we've been in the business recently.

Carol Massar, Bloomberg Radio

Chris, talk to us a bit about what you're investing in. These are smaller companies, midsize companies… kind of a real play on what supports a lot of our economy, isn't it?

Oberbeck

Yes. We focus on companies that generally earn in the $3-$25 million EBITDA level. What is important about what BDCs do for the economy is a lot of these companies are so small relative to what bank regulators think banks should be lending to that they don't get a lot of access to traditional bank credit. So the BDCs are able to step in and allow these companies to borrow maybe 3, 4, even 5x EBITDA with a BDC's involvement. Where if they were borrowing from a bank they might only be able to borrow 2x. So it allows them to do more with their assets; acquire companies, grow, do recapitalizations and those types of things.

Massar

Why do BDCs have a role in an investor's portfolio?

Oberbeck

If you're an investor generally speaking, traditionally you have an allocation between equities and fixed income. And generally when people think about fixed income they think about bonds, and often people look at maybe high-yield bond funds, or municipal bond funds as a place for them to earn current income, which they might not get necessarily as much from the stocks as they would get from their bonds.

So, when you're looking at your bond portfolio you can invest in treasury bonds, you can invest in high-grade corporates, low-grade corporates, which would be high-yield bonds. If you look at a high-yield bond fund today it's generally yielding around 5.5% or so and there is a certain credit characteristic and profile that those bond funds have.

Whereas if you were to invest in the BDCs, on average they're returning a 9.4% yield. So that is 4 percentage points more than high-yield bonds at this point in time today.

The underlying assets that a BDC invests in are largely senior loans. They may stretch into the mezzanine area, but they are well underwritten, managed private loan investments in smaller middle-market companies and the aggregate yield is substantially higher than high-yield bonds.

I'm not suggesting that people should sell all of their high-yield bond funds and buy BDCs, but there is a place for BDCs in the spectrum of an individual's fixed income investment portfolio.

Fox

What's the most important thing that investors should know about any potential investment in a BDC? What's the number, or the thing that they ought to be really made aware of?

Oberbeck

I think what they should be made aware of is that they're investing in a lesser known… a lesser-scrutinized area of the market and there are incremental returns to be gotten as a result of that. That's represented by the yield; the yield is very stable and companies have been very solid performers. I think if you look at the whole history of the BDC industry it's been a very solid, durable investment that yields substantially more than it probably should, and largely because it's not well known.

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