



BDC Reporter's Marshi Sees A 'Golden Age' Ahead

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Nicholas Marshi, editor of the *BDC Reporter*. Read the Q & A below as Nicholas says that business-development companies are heading into 'a bit of a golden age' over the next few years as a result of low interest rates continuing to help with the cost of capital, improved credit conditions generally,



and thanks to mergers that have swallowed up some of the weaker players in the field. It all combines to make Marshi's take on the BDC sector as good as it has ever been in his two decades covering the field. Marshi also gives his take on the sector's second-quarter earnings picture, which looks like it will see nearly all BDCs return to record NAV levels, completing the strong bounce-

Nicholas Marshi back from a disastrous fall early in 2020.

The podcast can be found on AICA's website by clicking here: <https://aicalliance.org/alliance-content/pod-cast/>

CHUCK JAFFE: Nicholas Marshi, editor of the *BDC Reporter* is here, and we're talking business-development companies and the current quarterly earnings season, this is The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. And today, it's pointing us in the direction of Nicholas Marshi and business-development companies, BDCs. Nicholas runs the *BDC*

Reporter, which is the only daily online publication covering the business-development company space. You can learn much more about him and the Reporter at BDCReporter.com, and on Twitter @BDCReporter. And if you're looking to learn more about closed-end funds, business-development companies, interval funds and more, go to AICAlliance.org, the website for the Active Investment Company Alliance. Nicholas Marshi, thanks so much for joining me on The NAVigator.

NICHOLAS MARSHI: Hi Chuck, it's lovely to be here.

CHUCK JAFFE: We are just getting into earnings season, not just for BDCs but for companies in general. But before we talk about this one, let's give a little bit of historical context. Because we're normally talking about closed-end funds and not necessarily always keeping up with what's happening with BDCs. So give us a little bit of a review, because BDCs have been killing it this year.

NICHOLAS MARSHI: They have, but before they were killing it, they were killed. So I'm going to take you back a little bit, Chuck, to the end of February 2020, BDCs were doing very well. And then as we all know, the pandemic came along, and in 40 days the sector prices dropped 50% to their lowest level since the Great Recession. Dividends were cut left, right, and center, and some were even suspended. And it looked at the time back in March, like we were facing a tsunami of bad debts and a huge drop in income across the board, and it really seemed like the sector was about to implode. And then very quickly as we all know, things recovered. The PPP program helped many BDCs, the level of defaults increased but then tapered off by the summer, and as you've said, prices came roaring back and have since gone on an upward rampage, increasing by over 100% over the last five quarters. We peaked in mid-June whenever BDC was up in price for the year, and many, many stocks are at all time high and trading at double-digit multiples.

CHUCK JAFFE: Now let's fast-forward, things of course have been going so well, we're about halfway into BDC reporting season in terms of how many have reported and how many are yet to go. It has been great but is this just the snapback from that pain that we suffered? Or is this setting us up for a tremendous stretch run for the rest of the year?

NICHOLAS MARSHI: Well, we had a terrible first quarter of 2020, but ever since then BDC NAV per share, which is one of the key metrics that we like to look at which tells you the value of the BDCs are from a book basis, have been improving. Second quarter was much

better than the first, and the third quarter was better than the second, the fourth quarter was great. And then the most recent quarter, the first quarter of '21, every single BDC was up on a book basis, which we've never seen before. And in fact at this point, 11 of the 41 BDCs that there are out there, have higher book value per share now than they did at the end of 2019. So this quarter's important to see if this trend can continue and support the very high prices that have occurred because of the improvement.

CHUCK JAFFE: Do you believe that that trend's going to continue? I mean, obviously positive up-trend, but we have to get more of the BDC populace above 2019 levels to say, "Hey, it's a full recovery."

NICHOLAS MARSHI: Oh yes, I'm a believer, Chuck. The analysts tend to focus on what the earnings are going to be, but what I do is I look a lot at NAV per share, and I think NAV per share will continue to improve across the board. Not only in this quarter but also in future quarters, but let's not get ahead of ourselves. Also, and very important to investors, we see dividend increases coming. We've already had several, and I expect that somewhere between a quarter and half of the BDCs out there will be increasing their payouts in 2021 over what they paid out in 2020.

CHUCK JAFFE: Let's put those things together. You've got higher NAVs, and I want to know what's driving that, and you've got dividend increases, and I want to know what's driving that.

NICHOLAS MARSHI: Okay, so NAVs. NAVs are going up, I guess really for two main reasons. First of all, in the dark days of 2020, many investments got written down a lot because nobody knew what was going to happen, and many companies looked like they were going to go to the wall. Of course since then, so much money has flooded into the markets, and even some of what we would call some of the worst companies which were on life support at one point, have come back, and some have been sold or have been refinanced. And all of that has increased the asset values of BDCs, which works its way down to their net asset value. That's a very good thing. And also, many BDCs own equity stakes in their portfolio companies. And as you know, everything is worth more than ever before, and BDCs have been benefiting from that, and that process will continue in this quarter and probably in future quarters. And so those two together are helping increase book value per share. On the dividend side, two main things really on the dividend side. Initially when the Fed reduced rates and LIBOR dropped,

all the BDCs saw their income drop because all of them are paid on a floating-rate basis. Now as time has gone by, the BDCs have been able to go and reduce their own cost of capital by refinancing their secure debt and mostly their unsecured debt. Where a BDC before might have been paying 4 or 5% for unsecured borrowings, they can now pay 4%, 3%, and very recently we saw a BDC raise money at 2%. And these far lower interest costs are going to work their way through the income statement and improve earnings and therefore increase dividends.

CHUCK JAFFE: All of that sounds positive. I never liked to hear all the positives and not hear the negatives, so is there any bad news out there?

NICHOLAS MARSHI: Yeah. Yeah, you have to take the rough with the smooth in this sector. And the very success of the BDCs and of the leverage lending of late means there's dog eat dog competition going out there for new loans. When that happens, what you get are lower spreads on loans and weaker covenants. There's no escaping it, so there is some pressure on overall portfolio yield as BDCs have to make some concessions to borrowers in that way. Another subtlety is that in the last year or two, many BDCs made concessions to their investors to keep their dividend and their earnings supported, and that involved waivers of various kinds, of their fees. Now that everything is going well again, as you can imagine, the BDC managers want to charge full boat to their investors. And so even if the BDCs themselves increase their earnings, most of that may go to the managers rather than the investors. So you really have to know your individual BDC to know if you're in that boat or not.

CHUCK JAFFE: Let's talk a little further about some individual BDCs. As we said, we're more than halfway into BDCs reporting for the second quarter. Is there anything among the ones that have not reported, the things that are going to making BDC headlines in the days and weeks ahead? Anything there you'd particularly point like, "Hey, watch for this one, it's particularly interesting"?

NICHOLAS MARSHI: Yeah, in every quarter there's some which are more interesting than others. And in this case, have a look at FS KKR Capital, which has a ticker FSK. This is now the second biggest BDC because FSK recently bought out its brother BDC, FSKR and it is now competing with Ares Capital to be the largest BDC, and this is run essentially by KKR. And it's had some credit problems in the past that really aren't KKR's fault, they inherited them from a prior manager. And now with their new heft and a few years to turn things around, it'll be

interesting to see if they're making any progress in that direction. And then there's Logan Ridge Finance, which used to be call Capitala till a few days ago. It used to be called Capitala Finance, and they've got a new manager and they've got a new strategy, and they have not been paying a dividend of late. But with a new manager, we want to see if they are going to find a way to start paying their shareholders a dividend, and that's worth looking out for. And finally I'll mention Apollo Investment, AINV is the ticker, this is a turnaround story. It's been a turnaround story for several years because Apollo made the mistake a few years of investing in energy, shipping, and aircraft leasing. All of which took it on the chin in 2020, but all of which are looking much better in 2021. That might give the manager a chance to get rid of some unloved assets and get back on the straight and narrow path. That will also be interesting to see when they report.

CHUCK JAFFE: Always happy to look at the short-term stuff and we've been focused on the quarter, but I'd be remiss if I didn't point out that at *BDC Reporter* you tend to project long term, which not a lot of folks do. You tend to look out a couple of years. With that being the case, what do the next five years look like?

NICHOLAS MARSHI: Yeah, you know it's easy to get caught up in the problems of this quarter or that quarter. But BDCs really are long-term investments, partly because they invest in long-term assets like loans which typically have maturities of five to seven years, and so you really have to take a long-term perspective on them. And we do, we project out the dividend for every BDC over a five-year period. And Chuck, I've been saying this for a while, I think the BDC sector is set for a bit of a golden age in the next few years because credit conditions have improved so very much from where they were before, and because some of the weaker players have been absorbed by some of the bigger players, and because interest rates are very low and that's really helping their costs of capital as we've discussed. So I think the prognosis for the BDC sector is about as good as it's been in all of the 20 years that I've been looking at it.

CHUCK JAFFE: Well, we'll take that as a strong positive and we'll have you back down the line to see how things are progressing and how that's playing out. Nicholas Marshi, it's been a pleasure, thanks for joining me on The NAVigator.

NICHOLAS MARSHI: Thank you so much.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. And yes, I'm Chuck Jaffe and you can learn all about my hour-long weekday show on your favorite podcast app or by going to MoneyLifeShow.com. To learn more about interval funds, closed-end funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. Thanks to my guest, Nicholas Marshi, editor of the *BDC Reporter*, the only daily online publication covering business-development companies. Get more information at BDCReporter.com and on Twitter @BDCReporter. The NAVigator podcast is new every Friday, follow along on your favorite podcast app and come back next week to learn more about investing with closed-end funds, business-development companies, and interval funds. Until that next time, happy investing everybody.

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