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Why Good Management Matters:

Saratoga BDC Sustains Solid Performance, Surmounts Discreet Credit Stress

Saratoga Investment Corp. (NYSE: SAR), a publicly listed business development company (BDC) that provides debt financing and equity capital to middle market companies, continues to exhibit a high-performing lower middle market core portfolio and provides a good market opportunity for investors, despite two recent discrete non-accruals that dented its stock price, Saratoga's CFO says.

The non-accruals have been restructured, leaving only $4.4 million of at-risk capital remaining on both these investments, according to Henri Steenkamp, Saratoga's Chief Financial Officer, Chief Compliance Officer, Treasurer, and Secretary.

Challenges over the last nine months with two of the fund's portfolio companies raised investor concern and impacted its net asset value (NAV) per share and return on equity (ROE) in the short-term. This after Saratoga had only had one realized loss over the past 12+ years on over $2 billion of capital invested by the Saratoga management team. The fund's managers have since moved to control and restructure both investments with the prior sponsors and owners. With the recent write-downs, the fund's most recent 12-month return on equity (ROE) is 4.4%, less than half of what it has historically maintained over the past ten years, resulting in the BDC's stock trading at about 85% of NAV, Steenkamp says.

"When you take out these two investments, our fair value is 3.3% higher than our cost on the rest of our core non-CLO portfolio," Steenkamp said. When you factor in a first quarter that showed "no new surprises" and reflected otherwise "strong" non-CLO performance, nothing has fundamentally changed for the BDC, he added.

"If you look at our return on equity, it's still 10.5 % over the last 10 years — well in excess of the BDC industry average of 6.7%," he said. "We've outperformed the industry 1.6 times over the last ten years even with the recent write downs."

The public company also manages a $650 million collateralized loan obligation (CLO) fund and co-manages a joint venture (JV) fund that owns a $400 million collateralized loan obligation (JV CLO) fund.

Steenkamp says nothing has changed in the way management underwrites credit and continues to maintain the high credit standards the Saratoga team has historically demonstrated. By staying focused on the successful long-term path the firm has been on, there is no reason to be believe it cannot return to its historically consistent ROE of over 9%.

"The tenure and longevity of our management team, steeped in private credit with the ability and experience to manage control equity, has always been strong on providing follow-on capital to existing portfolio companies, which reflects about 75% of our originations," Steenkamp said. "That should assist in continuing our long-term trajectory of growth as appropriate in the current markets."

SAR

Saratoga Investment Corp. is a publicly listed BDC with the NYSE ticker symbol "SAR" and has been managed since 2010 by Saratoga Investment Advisors, LLC, an affiliate of Saratoga Partners. The fund focuses on the lower end of the middle market, targeting primarily U.S.-based companies with annual revenues between $10 and $150 million and EBITDA in excess of $2 million.

As of May 31, 2024, Saratoga Investment's total assets under management was $1.096 billion, an increase of 1.1% from $1.084 million as of May 31, 2023, and a decrease of 3.8% from $1.139 billion as of last quarter.[1]

Steenkamp emphasizes that Saratoga prides itself on having the largest management ownership in the BDC space at 12.5%. That means that management — the individuals at Saratoga Partners — invests its own money with that of the BDC's shareholders into the middle market businesses the BDC targets. "Management ownership in the fund they manage is key," Steenkamp says. "With our management team owning more than 12% of the public float of SAR, for every dollar invested by the BDC, 12 cents is the management team's own money. Our interests are therefore very aligned with our shareholders as we invest the BDC's valuable capital."

SAR is also higher levered than other BDCs, but its leverage is unencumbered by covenants — a feature that sets it apart from its contemporaries and which is especially important in tough market conditions. Much of the fund's leverage is public unsecured bonds, or baby bonds, that effectively have no corporate covenants. The fund's credit facilities have no recourse to the BDC, and are contained within an interest-only covenant-free borrowing structure. And the BDC's credit sources also include covenant-free ten-year debt issued by the U.S. Small Business Administration.

"Even though our leverage is elevated as compared to the BDC industry average, we're protected by the structure of our leverage. We believe structure is even more important than rate when it comes to understanding leverage" Steenkamp says.

Learn more about Saratoga Investment Corp. and review the individual fund profile for SAR at CEFData.com.

References and Disclosures

[1] Saratoga Investment Corp. Announces Fiscal First Quarter 2025 Financial Results

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