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Chris Oberbeck on private credit markets

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Chris Oberbeck, Chairman of the Board, CEO, and President of Saratoga Investment Corp., sat down with Jane King on October 24, 2024, for a NAVigator interview. Oberbeck shares his view of private credit markets — and the potential impacts of interest rate changes — and talks about Saratoga (SAR), the debt-focused business development company (BDC) that he represents. Oberbeck explains how BDCs can fill lending gaps for small, growing businesses, and how retail investors fit into that equation.

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JANE KING: Chris Oberbeck is chairman and chief executive officer of Saratoga Investment Corp., a publicly traded business-development company. He brings over 25 years of experience in leverage finance, from distressed debt to private equity, to his position. Welcome, Chris, great to have you here at the NASDAQ.

CHRIS OBERBECK: It's nice to be here.

JANE KING: So let's talk about private credit, and relative to its effectiveness and how attractive is private credit today?

CHRIS OBERBECK: Well, private credit's been on quite a journey I think over the last 10 years, to pick a date, it's grown enormously, like probably maybe 10 times in its size, and it has to do with several different things. One is the absolute growth of the private industry, private equity's grown a lot and there's a lot of the world that's now in the private sector and companies never go public, they just get bought and sold in the private world. And depending on their size, if you're below a certain size, like if you have a $50 million or a $75 million loan, that's not big enough to be a public credit, so you need to go to a private source. And then along the way banks regulation has increased, and so banks have a different regulatory framework than a BDC like we run, and so they're not able to do some of the loans that we're able to do because they're more customized. So for example, you might have a company that's growing rapidly, and if they get a bank loan they can only borrow X, and then that loan will have to be repaid over five years. Whereas we can do a loan like 3X or 4X, and we can not have any payments for four or five years, and as long as the company stays on track in its business plan and keeps growing, we can do that. So that's an instance where we can be very supportive of a company's growth more so than the flexibility of the banks. It's not that banks don't want to do it, but they have a regulatory framework which makes it difficult.

JANE KING: Yeah.

CHRIS OBERBECK: We also partner with banks too, and where the bank might do X, we might work with the bank and then add the two or three more X of loans in conjunction with the bank. So the bank can have the formula that works for them, and then we can add something that helps the company, and so it's more of a customized solution, credit solutions for smaller and mid-market companies.

JANE KING: Yeah, and adds liquidity it sounds like as well.

CHRIS OBERBECK: Oh yeah, tremendous liquidity. It allows companies to grow that might not otherwise grow, that might not want to be selling their equity privately, they can use their debt capital instead of equity.

JANE KING: So I imagine you have been keeping a close eye on interest rates.

CHRIS OBERBECK: Yes.

JANE KING: Been very interesting. Low, and then we of course had the increase and the cut this year from the Federal Reserve. How has that impacted private credit markets and BDCs?

CHRIS OBERBECK: Well, much of private credit, there's a whole spectrum of private credit, but where we play, we play in the floating-rate side. Most of our portfolio is first-lien debt and floating rate, so as rates have risen we've had a really great increase in spread and we're having record earnings now and that type of thing. And then obviously if the rates come down a little bit, that would attenuate that somewhat, I think the question though is how much are rates really going to come down? I think since the 50-basis point cut in September, the short end of the curve, like three months to six months is lower, but the long end of the curve is higher. And so the back end of the curve is all 50 basis points higher, so the market is pricing in increased rates in the future, and so that kind of calls into question whether is the Fed going to continue the cuts at the rate that's been predicted?

JANE KING: Right, and I feel like that's been in the stock market this week. All of a sudden it feels like we're positioning for maybe a different interest rate environment than we expected a month or so ago.

CHRIS OBERBECK: Yeah, I mean, I think if you go back, this has been going on for years, right? For years the forward market has predicted lower interest rates, and then it hasn't happened. I'm not saying it won't happen, but it hasn't. We had this one cut, but it doesn't look like there's a huge justification to go as far as some of the lower predictions.

JANE KING: That's right, yeah.

CHRIS OBERBECK: But again, it remains to be seen.

JANE KING: Right. How does the BDC industry and Saratoga, you touched on this a little bit, but work with the banks? And why is that an especially attractive environment for where we're at right now?

CHRIS OBERBECK: Well, again, I think companies, especially growing companies, and we focus on growing companies, they need capital to grow. I mean, you need more receivables, more inventory, if you have capital expenditures, if you've got to hire more people, you've got to open more offices and things like that, you need capital to grow. And then banks have a lot of great relationships, banks are present, they do a lot of things for a lot of companies, payroll, custody, all kinds of things, so banks have a tremendous amount of relationships. But because of the regulatory environment that they operate in, they're not necessarily able to lend as deep into the balance sheet a we are, and so we can partner with banks and stretch what they can do. So they maintain their customer relationship, we can work with them to help stretch the capital availability for the company to be able to grow.

JANE KING: Do you ever work with high-net-worth individuals or retail investors? Do they play a role in this ecosystem at all?

CHRIS OBERBECK: They do in a couple respects. One is we're a publicly traded company, so they can buy our stock. Our stock is currently yielding over 12%, and our portfolio yield is 12%, so it's a very attractive yield environment, the BDC world. And so that's one place for them to play, we also have some private funds, and so high-net-worth individuals can invest in the private side of what we do. Which is a similar thing to what we do in our public vehicle, but just private and we coinvest together.

JANE KING: And what about BDCs versus REITs?

CHRIS OBERBECK: Well, that's very interesting. I mean, I think traditionally people have a lot of faith in real estate in America and the market cap of the REITs is in the trillions, and it's been kind of a staple of people's yield-oriented portfolio, sort of like a cashflow source, right? Now there's a lot of questions about real estate in certain areas, especially commercial real estate, right? So the question is, if you have commercial real estate, what's going to happen of the value of those buildings if the lease rolls off and rent's coming down? There's a lot of questions in that particular sector, there's other questions in other sectors, but I think probably the most important thing to point out is that the REITs generally are in the 5% area yield, where the BDCs are like twice that. The BDCs are over 10% yield, in our case 12% yield, and so you can get more than twice the yield and you can get diversification. So instead of investing in real estate, you don't have to sell all your REITs but you should take a portion, if you have X amount in REITs, you should probably take a portion of that and have it in BDCs for diversification purposes. Because a BDC is lending to corporate companies as opposed to buildings, and so you have a diversification, and then while you're getting diversified which is a good thing, you get twice the yield. So I think it's a very attractive thing to consider.

JANE KING: Thank you so much, Chris. Thanks for your input on this.

CHRIS OBERBECK: All right, thank you.

JANE KING: Thanks. It's interesting. The ticker symbol is?

CHRIS OBERBECK: SAR.

JANE KING: SAR, okay. And it's the stock exchange?

CHRIS OBERBECK: Yeah.

JANE KING: Right. Yeah, that's what I thought. Okay, all right, cool. Thanks so much.

CHRIS OBERBECK: Fabulous. Great, thank you.

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