



# THE **ABC's** OF BDCs (*BUSINESS DEVELOPMENT COMPANIES*)

John Cole Scott, CFS  
Chief Investment Officer  
Closed-End Fund Advisors, Inc

***Closed-End Fund Advisors is a Registered Investment Advisory Firm Specializing in Closed-End Fund & BDC Research, Trading and Management Founded in 1989***

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# What Is CEF Advisors?

- Investment Management, Research & Data
- Independent, Fee Only & Family Owned
- *“Scott Letter: Closed-End Fund Report”*
- Discretionary Management (20 SMA Models), Unit Investment Trust (UIT) Portfolio Consultant
- CEF & BDC News/SEC Alert & “CEFA’s Closed-End Fund Universe”
- Consulting with Institutional Investors and CEF Fund Sponsors
- CEFData.com: CEF/BDC Web Modules with Daily Data



***We seek to be the crossroads of BDC/CEF data, trends and news. We maintain strong relationships with Managers, Peers, Analysts and Fund Sponsors.***



[www.CEFadvisors.com](http://www.CEFadvisors.com)

Founded in 1989



# What is a Business Development Company (BDC) ?

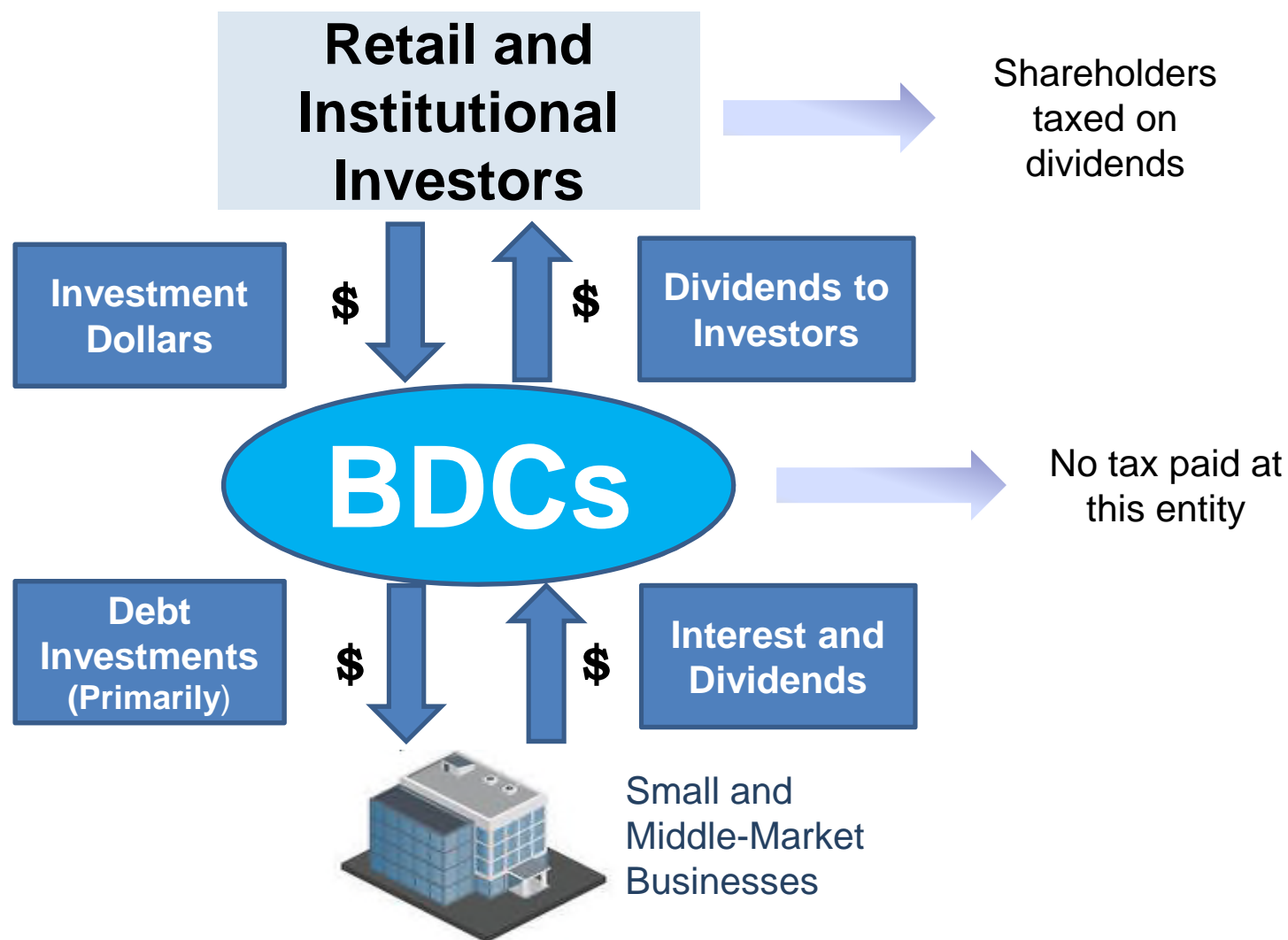
- Created by Congress in 1980 to provide an opportunity for individual non-accredited investors to participate in private investments
- Publicly traded closed-end funds that provide small, growing companies access to capital
- Domestically focused and required to offer portfolio companies '*managerial assistance*'.
- Tax-advantaged and earnings are passed through to investors in the form of dividends and distributions (similar to REITs and MLPs)
- Limited to 200% asset coverage (total assets / total debt) or “one turn” of leverage, excluding SBIC facilities.
- BDCs have gained interest since the Financial Crisis because traditional banks have generally reduced their focus on small business lending.



Source: Sutherland Asbill & Brennan, Triangle Capital  
Data from CEFdata.com



# BDCs Provide Access to Private Debt Investments



# The BDCs Structure

- Provide retail investors with access to high yielding, private market investments historically only available to large institutional investors
- ‘Permanent Capital’ for long-term investment horizon
- Shares traded on national exchanges, providing daily investment liquidity
- Flow-through tax treatments results in meaningful dividend income potential to investors and there is no entity-level-tax
- Public financial information through in-depth quarterly reporting
- BDC Portfolios are typically diversified
- Reduces risk typically associated with private equity or debt investments
- Generally focused on “middle market” lending which has historically lower default rates and higher recovery rates, offering downside protection
- SEC restrictions on leverage (debt/borrowing) levels prevent BDCs from becoming over leveraged



*Source: Sutherland Asbill & Brennan LLP, Triangle Capital*





# Closed-End Fund Advisors

## Asset Class Annual Returns 2005 - 2015

2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD	2006 - 2015
REIT 30.52%	World Stock 17.12%	Corporate Debt -3.52%	Senior Loan 76.30%	BDC 50.99%	MLP 13.87%	BDC 34.48%	US Stock 32.38%	REIT 27.15%	Preferred 5.47%	BDC 18.02%	MLP 13.08%
BDC 29.49%	MLP 12.61%	Muni Bond -5.09%	MLP 75.63%	MLP 35.63%	Muni Bond 10.63%	World Stock 17.39%	MLP 27.59%	US Stock 13.68%	REIT 4.23%	MLP 15.94%	BDC 9.52%
World Stock 27.16%	US Stock 5.57%	HY Bond -26.39%	HY Bond 57.51%	REIT 23.89%	Corporate Debt 7.77%	US Stock 15.99%	Convertible 26.60%	Convertible 9.97%	Muni Bond 3.32%	Senior Loan 15.83%	Convertible 9.31%
MLP 27.06%	Covered Call 5.07%	Convertible -29.44%	Convertible 45.63%	Convertible 15.68%	REIT 5.35%	HY Bond 15.58%	Covered Call 20.84%	Muni Bond 9.26%	US Stock 1.38%	HY Bond 15.32%	US Stock 9.14%
US Stock 15.78%	Corporate Debt 4.78%	Preferred -32.02%	BDC 42.78%	HY Bond 15.19%	HY Bond 4.38%	Senior Loan 14.33%	BDC 16.33%	Covered Call 7.87%	Corporate Debt -0.06%	REIT 9.75%	HY Bond 8.55%
Covered Call 14.64%	Convertible 3.95%	Covered Call -33.38%	World Stock 42.14%	US Stock 15.06%	US Stock 2.11%	Convertible 13.63%	World Stock 15.78%	Corporate Debt 7.47%	Covered Call -0.57%	Corporate Debt 8.97%	Senior Loan 7.53%
Convertible 12.03%	Muni Bond 2.81%	US Stock -37.00%	Preferred 32.12%	Senior Loan 14.98%	Covered Call 2.02%	REIT 13.40%	Senior Loan 11.73%	Preferred 6.86%	Convertible -1.15%	Convertible 8.53%	Covered Call 6.93%
HY Bond 11.77%	HY Bond 2.19%	MLP -37.11%	Covered Call 27.91%	Covered Call 13.69%	Senior Loan 1.48%	Covered Call 11.22%	HY Bond 7.42%	MLP 4.80%	Senior Loan -3.45%	US Stock 7.84%	World Stock 6.39%
Senior Loan 8.82%	Senior Loan -0.50%	REIT -42.54%	US Stock 26.45%	World Stock 11.60%	Convertible -3.76%	Preferred 10.81%	REIT -1.74%	Senior Loan 3.02%	HY Bond -4.64%	World Stock 6.29%	REIT 6.12%
Corporate Debt 5.58%	BDC -14.17%	BDC -45.07%	REIT 21.90%	Corporate Debt 8.72%	BDC -7.18%	Corporate Debt 9.17%	Corporate Debt -1.02%	HY Bond 2.50%	BDC -4.69%	Preferred 5.88%	Corporate Debt 5.59%
Muni Bond 5.30%	Preferred -17.69%	World Stock -45.24%	Corporate Debt 17.02%	Preferred 6.36%	Preferred -7.93%	Muni Bond 7.42%	Muni Bond -2.55%	World Stock -3.44%	World Stock -5.25%	Covered Call 5.40%	Muni Bond 4.82%
Preferred 1.92%	REIT -20.97%	Senior Loan -51.37%	Muni Bond 14.63%	Muni Bond 2.45%	World Stock -13.33%	MLP 4.80%	Preferred -6.75%	BDC -7.79%	MLP -34.07%	Muni Bond 4.21%	Preferred -0.09%

US Stock – S&P 500 Index; REIT – Wilshire REIT Index; MLP – Alerian MLP Index; BDC – Wells Fargo BDC Index; High Yield Bond – Bank of America Merrill Lynch US HY Index; Preferred – S&P Preferred Stock Index; World Stock – MSCI All Country World Index - Ex US; Sr Loan - Morningstar US Senior Loan Funds Index; Muni Bond - S&P Municipal Bond Index; Covered Call - S&P 500 Stock Covered Call Index; Convertible - BofA Merrill Lynch All U.S. Convertibles Index; Corporate Debt - S&P 500 Bond Index. Returns data are total returns which include dividends and capital appreciation. "2006 - 2015" column shows yearly average for each sector. You cannot invest directly in an index. Past performance is not an indication of future results. Current year data for all indexes except "BDC Index" is sourced from index provider documents as of 9/30/2016. Wells Fargo BDC Index is sourced from Google Finance. Historical data is sourced from Bloomberg and Morningstar.





# Closed-End Fund Advisors

## Closed-End Fund Discount / Premium 2005 - 2015

2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 - YTD	2006 - 2015
BDC 17.77%	BDC 10.73%	MLP -4.22%	MLP 10.99%	MLP 7.93%	HY Bond 4.81%	HY Bond 8.27%	BDC 8.03%	BDC 1.69%	MLP -6.10%	Preferred 0.02%	MLP 0.89%
Convertible 1.25%	US Stock -1.29%	REIT -4.29%	Investment Grade 0.49%	HY Bond 2.99%	MLP 3.36%	MLP 4.82%	MLP 1.95%	Convertible -3.17%	Muni Bond -6.44%	Muni Bond -0.26%	HY Bond -1.38%
HY Bond -0.65%	MLP -1.82%	Investment Grade -5.75%	HY Bond -2.97%	Muni Bond 0.57%	Investment Grade 0.14%	Investment Grade 4.32%	Senior Loan -0.12%	HY Bond -3.48%	Investment Grade -6.81%	Investment Grade -2.01%	Investment Grade -2.55%
US Stock -2.10%	Convertible -2.02%	Muni Bond -6.20%	Muni Bond -3.31%	Investment Grade 0.23%	Muni Bond -0.53%	Preferred 2.87%	HY Bond -0.63%	MLP -4.54%	Preferred -6.89%	HY Bond -3.61%	BDC -2.59%
World Stock -2.70%	Senior Loan -2.75%	Preferred -8.28%	Preferred -4.24%	Senior Loan -0.02%	Senior Loan -1.27%	Muni Bond 1.99%	Investment Grade -2.92%	Investment Grade -4.93%	Convertible -7.98%	MLP -4.57%	Muni Bond -2.98%
Muni Bond -2.74%	Muni Bond -3.11%	Convertible -8.66%	World Stock -5.31%	Covered Call -1.97%	Preferred -1.61%	BDC 0.81%	Muni Bond -3.65%	Muni Bond -6.40%	BDC -8.61%	Covered Call -5.51%	Preferred -4.02%
Covered Call -3.34%	HY Bond -3.25%	World Stock -8.85%	Convertible -6.25%	Convertible -2.09%	Convertible -2.40%	Senior Loan -0.37%	Preferred -3.83%	Senior Loan -6.49%	Covered Call -8.11%	Senior Loan -6.33%	Convertible -4.08%
MLP -3.52%	World Stock -3.37%	US Stock -8.86%	Covered Call -7.30%	Preferred -2.55%	BDC -2.92%	Convertible -3.25%	REIT -5.65%	Covered Call -6.62%	HY Bond -8.41%	BDC -6.67%	Senior Loan -4.48%
Senior Loan -4.68%	Preferred -4.14%	HY Bond -10.47%	Senior Loan -8.43%	BDC -3.37%	REIT -4.48%	REIT -5.20%	Convertible -6.22%	Preferred -6.73%	Senior Loan -8.70%	Convertible -7.34%	World Stock -6.56%
Preferred -4.82%	REIT -4.22%	Covered Call -11.45%	REIT -9.66%	World Stock -4.03%	World Stock -5.69%	World Stock -7.47%	Covered Call -8.13%	World Stock -9.04%	World Stock -11.00%	US Stock -10.67%	Covered Call -6.76%
Investment Grade -4.93%	Covered Call -4.44%	Senior Loan -11.64%	US Stock -10.56%	US Stock -7.34%	Covered Call -7.41%	Covered Call -8.83%	World Stock -8.15%	US Stock -9.63%	US Stock -11.00%	REIT -10.80%	REIT -7.37%
REIT -8.25%	Investment Grade -5.37%	BDC -18.23%	BDC -31.78%	REIT -9.10%	US Stock -8.27%	US Stock -9.66%	US Stock -9.32%	REIT -10.63%	REIT -12.21%	World Stock -11.18%	US Stock -7.81%

Historical Premium / Discount expressed as average value over each year. 2016 YTD Premium / Discount average value as of September 30, 2016. "2006 - 2015" column shows yearly average for each sector.

Data sourced from Closed-End Fund Advisors 'CEFU Report' and Telemet. Past performance is not an indication of future results

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# Closed-End Fund Advisors

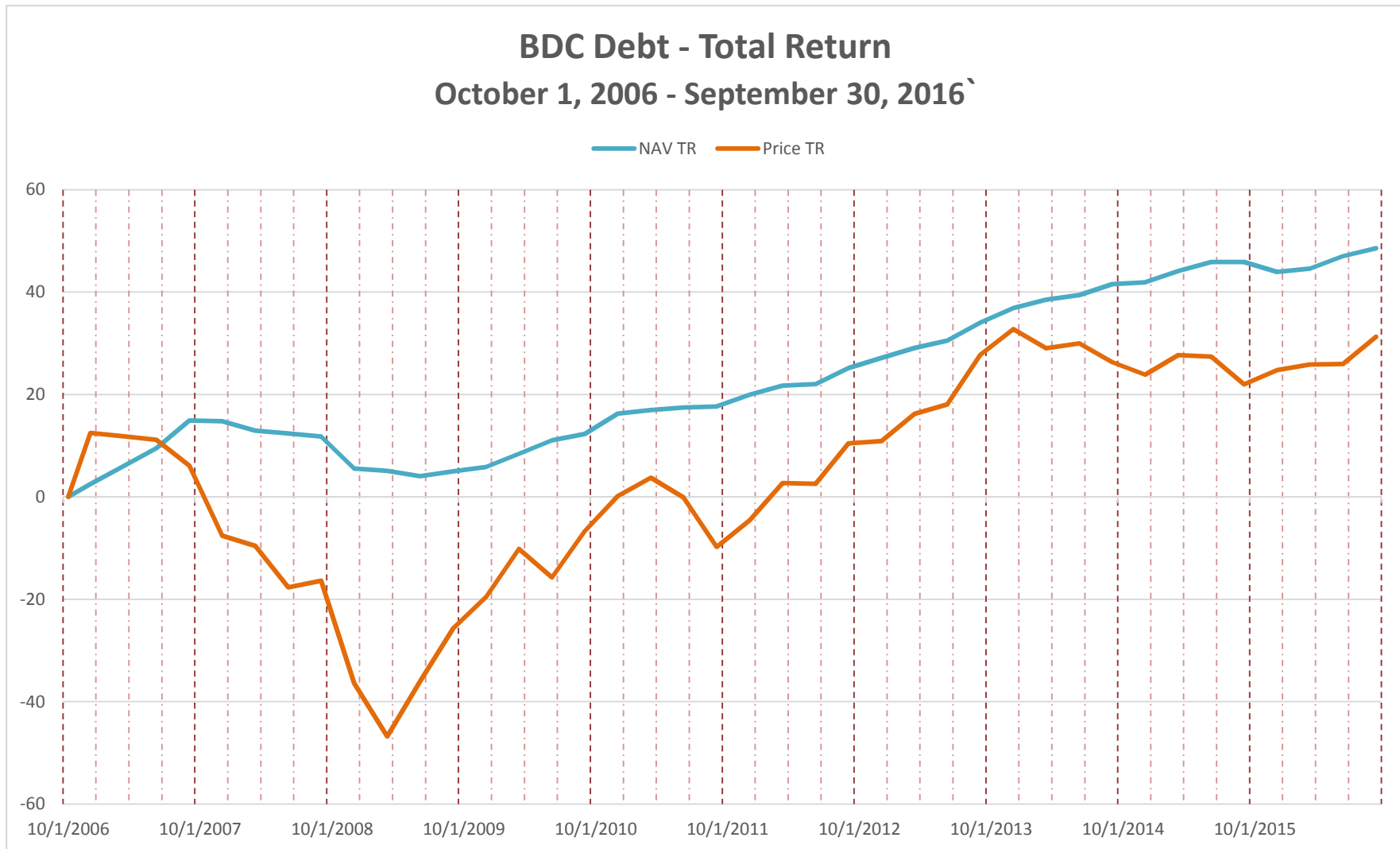
## Closed-End Funds - NAV Total Return Correlation (10 Year)

	MLP	BDC	Convertible	HY Bond	Muni Bond	Senior Loan	Preferred	World Stock	Cov Call	US Stock	REIT	Investment Grade
MLP	100%	48.1%	78.6%	77.0%	38.6%	71.3%	46.7%	66.0%	69.8%	66.7%	49.2%	59.6%
BDC	48.1%	100%	46.9%	42.8%	14.2%	40.8%	12.6%	44.5%	45.5%	40.1%	26.9%	21.7%
Convertible	78.6%	46.9%	100%	96.1%	51.6%	91.2%	72.8%	91.8%	92.1%	93.0%	77.1%	83.7%
HY Bond	77.0%	42.8%	96.1%	100%	57.5%	96.1%	77.1%	86.8%	84.1%	90.0%	83.1%	89.2%
Muni Bond	38.6%	14.2%	51.6%	57.5%	100%	60.1%	47.6%	41.5%	33.3%	35.7%	45.2%	57.3%
Senior Loan	71.3%	40.8%	91.2%	96.1%	60.1%	100%	67.5%	77.7%	75.4%	83.6%	76.2%	80.5%
Preferred	46.7%	12.6%	72.8%	77.1%	47.6%	67.5%	100%	74.9%	67.4%	81.6%	80.2%	93.5%
World Stock	66.0%	44.5%	91.8%	86.8%	41.5%	77.7%	74.9%	100%	91.3%	92.3%	73.2%	82.9%
Cov Call	69.8%	45.5%	92.1%	84.1%	33.3%	75.4%	67.4%	91.3%	100%	94.6%	76.6%	74.1%
US Stock	66.7%	40.1%	93.0%	90.0%	35.7%	83.6%	81.6%	92.3%	94.6%	100%	84.8%	85.7%
REIT	49.2%	26.9%	77.1%	83.1%	45.2%	76.2%	80.2%	73.2%	76.6%	84.8%	100%	82.8%
Investment Grade	59.6%	21.7%	83.7%	89.2%	57.3%	80.5%	93.5%	82.9%	74.1%	85.7%	82.8%	100%

Correlation of 3 Month NAV Total Return values between 9/30/2006 and 9/30/2016.

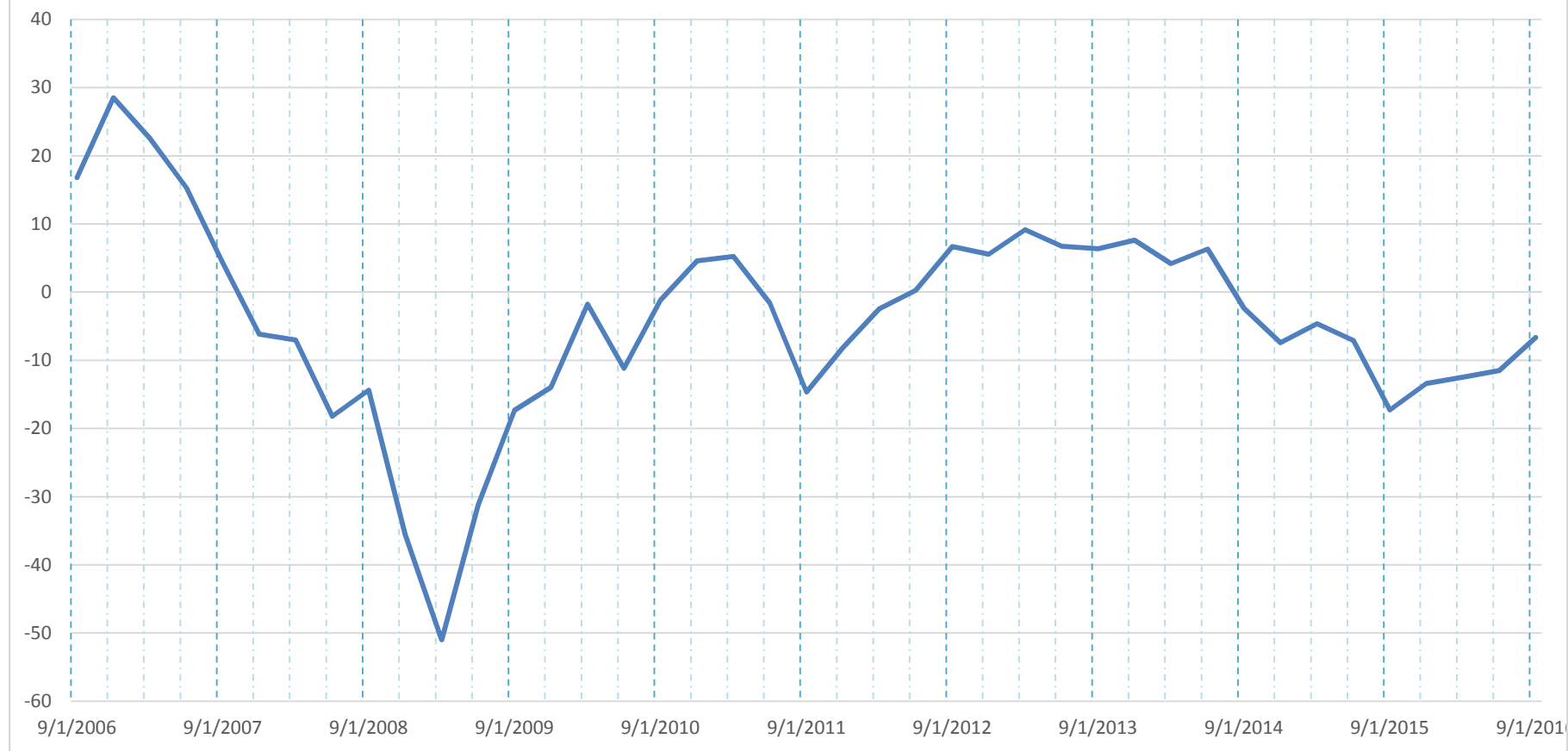
Data sourced from Closed-End Fund Advisors 'CEFU Report' and cefadata.com . Past performance is not an indication of future results

# Debt-Focused BDCs Total Return



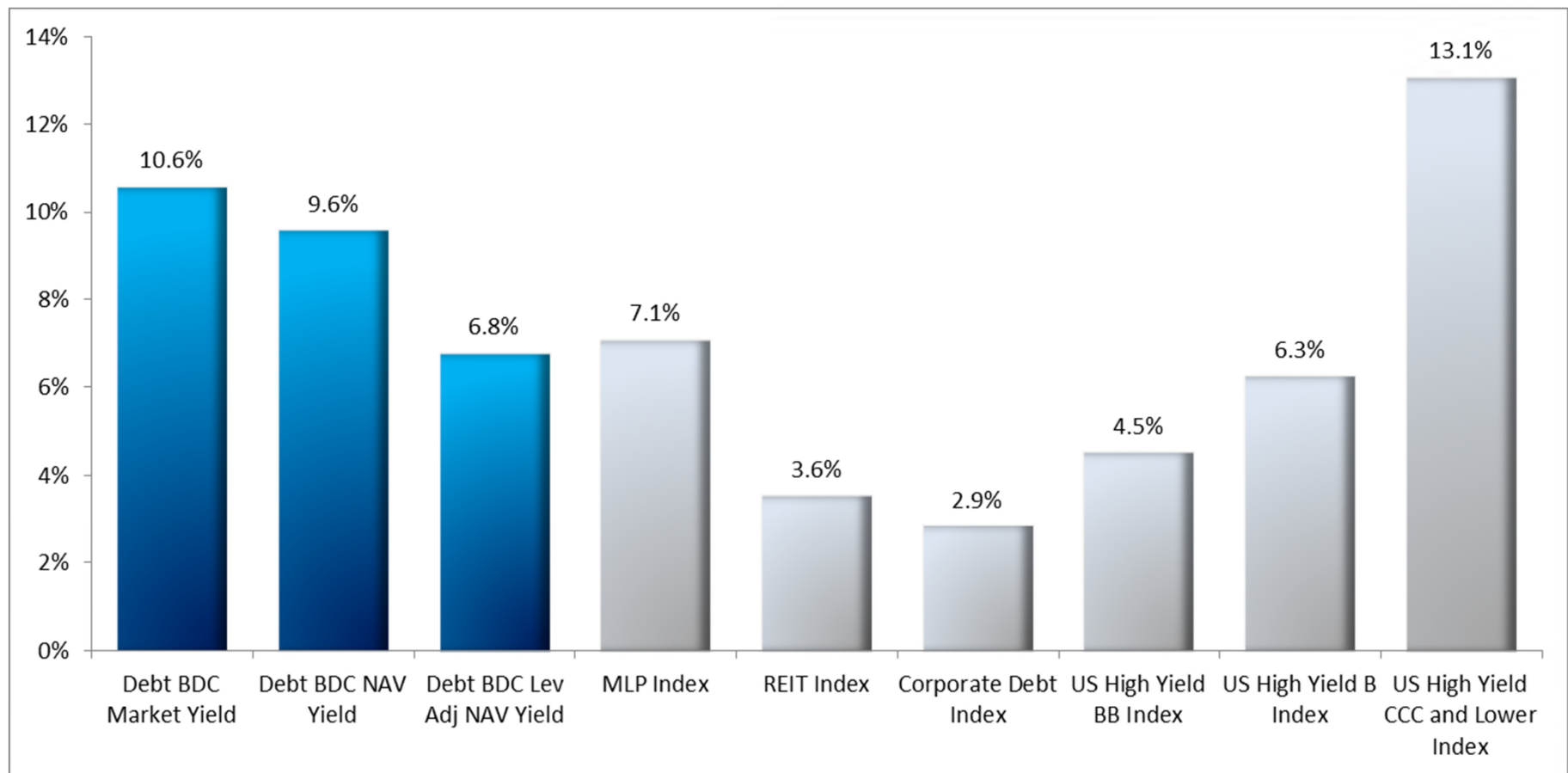
# Debt-Focused BDCs Discount

BDC Debt - Average Discount / Premium  
October 1, 2006 - September 30, 2016





# BDC Yield Comparison



*BDC Data as of 11/11/2016, Index Data as of 9/30/2016*

*MLP Index: **Alerian MLP Index**; REIT Index: **Wilshire US REIT Index**; Corporate Debt Index: **S&P 500 Bond Index***

*US High Yield Indices : **BofA Merrill Lynch US High Yield (BB Rated, B Rated, CCC and Lower Rated )***



# CEFA's BDC 'Trifecta' Analysis

## Suggested BDC Research Process

1. **Discount Direction:** BDCs trade at prices in relation to the quarterly net asset value (NAV). NAVs are the 'anchor point' for BDC pricing. We seek BDCs where discounts can recover or are sustainable vs. potential to widen dramatically. Small premiums can be healthy for a BDC.
2. **Dividend Sustainability:** Research the reoccurring income produced by a BDC (*Adj Core NII coverage avg 96.3%\**) as well as trends in the sector and the past policies of the BDC. Dividends are policies from the BoD are not promises like coupon payments on bonds or the BDC loans themselves. Review Libor floors, and use of fixed vs. variable leverage.
3. **NAV Total Return:** Manager performance after costs is important as poor results often impact the price investors use as the 'anchor point' for BDCs. This also helps confirm that management can produce investment returns after their cost. BDC loan creation is not typically a cheap and easy task, but shareholders need to know that management costs are in check with their results. *Avg BDC NonLev Expense Ratio: 6.6%\**



***CEFA feels that getting any of these items wrong can negate good investment research***



# Leverage Used by BDCs

1. Traditional Leverage is capped at a 1:1 ratio
2. SBIC Debentures (19 BDCs have them) through the SBA offer cheap fixed cost leverage for additional investments
3. Fixed Leverage vs. Variable Leverage
4. Baby Bonds, Convertible Bonds, Institutional Bonds, Credit Facilities, and Private Notes
  - Average BDC leverage amount: 41.9%
  - Average debt-to-equity ratio: 0.63 (regulatory maximum is 1 not including a SBIC)





# Types of Loans Held By BDCs

1. First Lien Loans: 54.8%
2. Second Lien Loans: 19.1%
3. Unsecured Loans: 12%
4. Equity/Other: 14.1%

- Avg Portfolio Turnover: 28.3%
- Avg Variable Loans: 80% / Fixed: 20%
- Libor Floors: 41% at 1.01% Avg Level
- Avg Loan Size: \$10.8M
- 74% of Loans Under \$25MM
- Average Maturity 4.1 with a range of 2 Years to 6 years
- Avg No of Loans: 114 from 98 Companies



# Current Public BDC Average Data

<b>Current Discount</b>	<b>-7.7%</b>
<b>3 Year Avg Discount</b>	<b>-5.6%</b>
<b>3 Year % Days Premium</b>	<b>33.3%</b>
<b>3 Year Rel Price Range</b>	<b>43.6%</b>
<b>3 Year Discount Low</b>	<b>-29.9%</b>
<b>3 Year Discount High</b>	<b>16.5%</b>
<b>Yield</b>	<b>10.6%</b>
<b>Leverage %</b>	<b>41.9%</b>
<b>% Debt Investments</b>	<b>88.9%</b>
<b>Fixed Leverage</b>	<b>44.6%</b>

*Data as of 11/11/2016*

<b>Variable Debt / loans</b>	<b>70.0%</b>
<b>Non Accrual</b>	<b>1.7%</b>
<b>3 Year Avg Non Accrual</b>	<b>1.0%</b>
<b>Energy %</b>	<b>4.8%</b>
<b>CLO %</b>	<b>2.2%</b>
<b>2 Year Beta</b>	<b>0.76</b>
<b>Avg No Employees</b>	<b>76</b>
<b>Employee to Co Ratio</b>	<b>2.2</b>
<b>Institutional Ownership</b>	<b>29.8%</b>
<b>Insider Ownership</b>	<b>9.7%</b>

*Source: cefdata.com*



# How Have BDCs Faired in a Rising Rate Environment?



Group / Sector	# CEFs	Avg Total Return on Mkt Pr.	% Funds w/ Neg TR Perf	Avg Yield Change %	% CEFs with Dividend Changes
Specialty Equity Funds	34	30.60%	11.8%	5.65%	79.4%
Taxable Bond Funds	95	19.30%	4.2%	-2.06%	81.1%
National Municipal Bond Funds	89	17.10%	2.3%	-18.91%	96.7%
State Focused Muni Bond Funds	93	12.92%	12.4%	-15.70%	100%
<b>Debt Focused BDC Funds</b>	<b>5</b>	<b>31.94%</b>	<b>0.0%</b>	<b>4.42%</b>	<b>100%</b>
Average Traditional CEF	361	28.48%	6.4%	-2.50%	97.2%
S&P 500 TR	42.33% TR				
Barclays Global Agg. Bond Index	16.96% TR				
Barclays Municipal Bond Index	13.26% TR				

*The time period for the tables in this article is March 1, 2004 through September 28, 2007. Avg. Yield change is expressed in percentage terms. If the yield went from 8% to 7% the calculation would be -12.5%, not -1%. Also, the column that shows the percentages of funds with dividend changes includes funds with increases, and is meant to help show which areas of the CEF universe are likely to have a higher number of funds that change their distribution policies over time..*

*Index Data from Thompson Reuters. CEF data from CEF Universe Data and Yahoo Finance.*



# Risks of BDC Investing

1. Poor Management
2. Credit Risk
3. Discount Risk
4. Dividend Risk
5. Poor Fee / Shareholder Alignment
6. Quarterly NAV, subjective fair value estimates could take sudden and quick losses
7. Liquidity, Bid/Ask Spread Risk
8. Market Prices can be volatile, especially during earnings season or on headline risk and risk off trading.
9. Libor floors, variable leverage, spread widening
10. Irrational trading behavior of retail shareholders




# BDC Historical IPOs

	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
Number of IPOs	1	6	4	5	7	5	1	1	5	1
Average Assets In \$ millions	\$120	\$575	\$78	\$96	\$101	\$98	\$87	\$141	\$138	\$203
Total New CEF IPO Assets in \$ Billions	\$0.1	\$3.5	\$0.3	\$0.5	\$0.7	\$0.5	\$0.1	\$0.1	\$0.7	\$0.2

**10 Year Average:** 3.6 Funds per year, \$164M Ave Fund, \$0.7 Billion Per Year



# Opportunity for BDC Investing Today

- You can be selective with 40+ options
  - Lack of recent IPOs can help improve demand for shares of current BDCs
  - BDCs loans are typically secured which can offer better downside protection when there is economic, sector or company level of risk
- 
- The image shows a close-up of a gold-colored pocket watch and a matching key resting on a document. The document has the word 'Investing' printed in a large, serif font. Above it, the words '12 WAYS' are partially visible. The watch has a white face with black numerals and hands. The key is ornate and made of the same metal as the watch.
- BDC loans are typically variable in nature, offering a good chance to increase income when interest rates eventually rise
  - BDCs are generally diversified by sectors, geography and most contain 50-150 separate companies in the portfolio
  - BDCs are dually regulated by FINRA and the SEC and contain independent board of directors
  - BDCs have regularly traded above NAV, providing extra potential up-side performance from current levels

***Full list of Public BDCs at [www.BDCUniverse.net](http://www.BDCUniverse.net)***





# Speaker's Biography



## **John Cole Scott, CFS** *Chief Investment Officer of Closed-End Fund Advisors*

Mr. Scott has worked at Closed-End Fund Advisors since 2001. He sits on the firm's investment committee and holds the FINRA 66 License and the Certified Fund Specialist designation (CFS). He is a graduate of The College of William and Mary and has been quoted and interviewed widely in the financial press and presented at conferences and for investment groups on more than 40 occasions.

### **John Cole Scott, CFS**

#### **EXPERIENCE**

**CIO of Registered Investment  
Advisor Focused Exclusively on CEFs  
and BDCs since 2001**

#### **EDUCATION**

**College of William & Mary  
Bachelor of Science in Psychology  
2000**

In 2008 John founded *CEFA's Closed-End Fund Universe*, a comprehensive weekly data service covering 240+ data points for all US listed closed-end funds and 210+ for BDCs. He also founded and manages The CEF Network group on LinkedIn and is editor of the firm's blog. John is a past board member of The Richmond Association for Business Economics (RABE), and serves on the Investment Committee for The New York State Society of The Cincinnati.





DATA, RESEARCH & INVESTMENT MANAGEMENT

Closed-End Fund Advisors

**Thank You For Attending  
Questions?**



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