



HOULIHAN LOKEY

DIRECT LENDING UPDATE

Summer 2019



Introduction

Dear Clients and Friends,

Houlihan Lokey's Portfolio Valuation and Fund Advisory Services team is pleased to present the second Direct Lending Update.

We have included key trends for over 80 business development companies (BDCs) to help you stay ahead in this constantly evolving industry. We hope you find this update to be informative and that it serves as a valuable resource to you in staying abreast of the market. If there is additional content you would find useful for future updates, please don't hesitate to call or email us with your suggestions. We look forward to staying in touch with you.

Regards,

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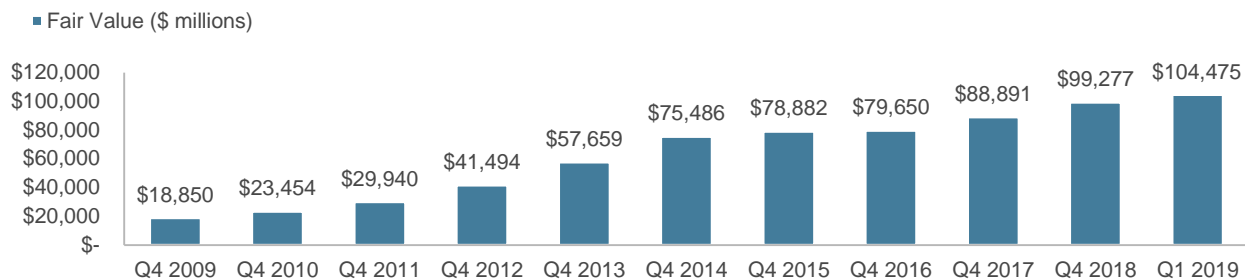


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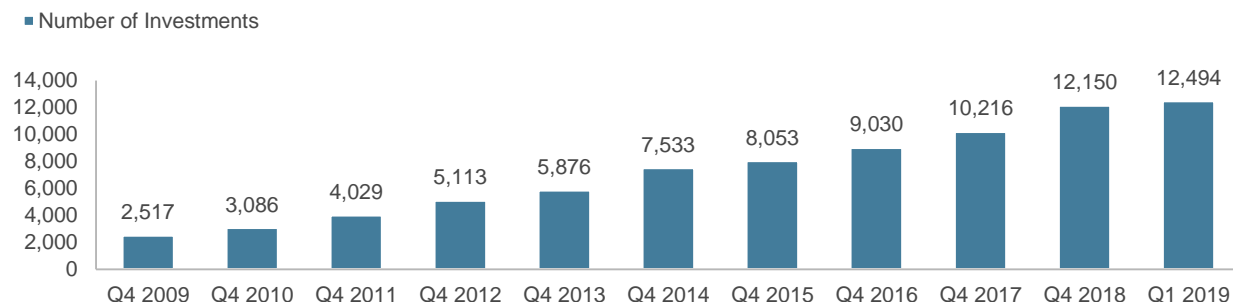
Key Trends

- The direct lending industry has grown considerably over the past decade as traditional bank lenders have given way to non-traditional lenders like BDCs.
- BDC assets under management have grown from \$18.9 billion in Q4 2009 to \$104.5 billion at the end of Q1 2019, an increase of over 450%. The number of investments held by BDCs has grown from 2,517 to 12,494 over the same period.
- The percentage of BDC assets categorized as non-accrual was 2.7% as of Q1 2019, which is in line with the past several quarters.
- Arguably the most impactful event in the BDC space over the past decade was the passage of the Small Business Credit Availability Act (the “BDC Bill”) in March 2018 which, among other things, effectively allows BDCs to increase leverage from 1:1 debt-to-equity to 2:1 debt-to-equity by reducing the asset coverage requirement from 200% to 150%. Our last Direct Lending Update covered this topic in detail.
 - Most of the BDCs elected to increase their leverage limit. For some it became effective immediately and for some others, after a 12-month cooling-off period.
 - One reason BDCs are electing a higher leverage limit is to be able to shift their investment portfolios to lower yielding, more senior securities while generating similar portfolio level returns by utilizing higher portfolio level leverage. Since the passage of the BDC Bill, we have seen first lien assets increase from 58% of total BDC portfolios as of Q1 2018 to 65% as of Q1 2019. We expect this trend to continue as the 12-month cooling-off period ends for many of the BDCs.
 - Debt-to-equity ratios for public BDCs has increased since the passage of the BDC Bill as well, with several BDCs closer to, or over, the historical 1:1 limit. Again, we expect this trend to continue over the next several quarters.
- Average first lien fair value yields were 9.74% as of Q1 2019, down 13 basis points from Q4 2018. Average second lien fair value yields were 11.33% as of Q1 2019, down eight basis points from Q4 2018.
- As of Q1 2019, portfolio company industries with the highest first lien fair value yields were business services (10.20%), industrials (9.66%), and consumer, food, and retail (9.65%).
- As of Q1 2019 portfolio company industries with the highest second lien fair value yields were consumer, food, and retail (11.75%), industrials (11.45%), and real estate, lodging, and leisure (11.32%).
- BDC Indices have performed slightly better than the High-Yield Corporate ETF (HYG) over the past five years as measured by total return. The Wells Fargo BDC Index has a five-year total return of 20.6% while the S&P BDC Index has a five-year total return of 20.4%, both of which are slightly higher than the 19.5% total return for HYG.
- In general, we have observed that larger BDCs trade at higher price-to-NAV multiples than smaller BDCs. For example, as of July 15, 2019, BDCs with market capitalizations over \$1 billion had an average price-to-NAV of 1.09x, while BDCs with market capitalizations between \$500 million and \$1 billion had an average price-to-NAV of 0.94x and BDCs with market capitalizations less than \$500 million had an average price-to-NAV of 0.83x. This may be evidence that scale continues to be a vital differentiator in this increasingly competitive yet still highly fragmented BDC industry.

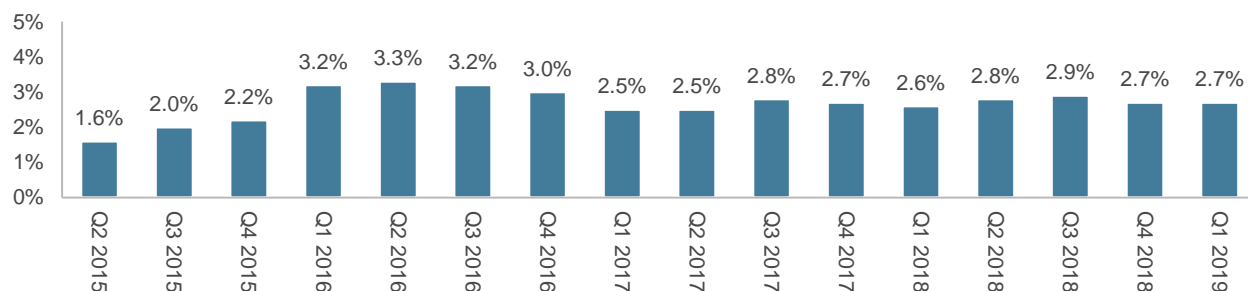
Fair Value of BDC Portfolios¹ (\$ in millions)



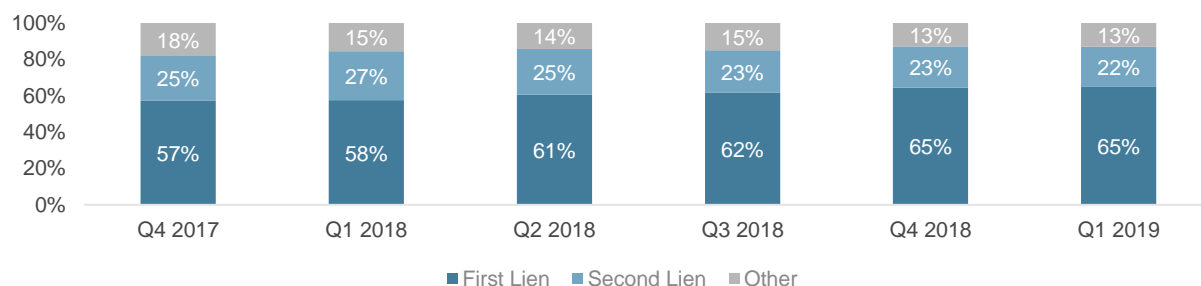
Total Number of Investments in BDC Portfolios²



Non-Accrual Investments as a Percentage of Total Portfolio³



BDC Portfolio Composition by Seniority Based on Fair Value⁴



Source: Advantage Data

(1) Reflects the fair value for BDC portfolio tracked by Advantage Data.

(2) Reflects the total number of investments for all BDCs tracked by Advantage Data.

(3) Reflects cost of non-accrual investments as a percentage of total portfolio cost for BDCs tracked by Advantage Data.

(4) Represents the aggregate composition of all BDC portfolios tracked by Advantage Data.

Average BDC Fair Value Yields by Seniority¹

	Q4 2018	Q1 2019	Change
First Lien	9.86%	9.74%	-0.13%
Second Lien	11.41%	11.33%	-0.08%

Average BDC Fair Value Yields by Industry—First Lien¹

Industry	Q4 2018	Q1 2019	Change
Business Services	10.41%	10.20%	-0.21%
Financial Institutions	9.13%	9.11%	-0.02%
Consumer, Food, and Retail	9.68%	9.65%	-0.03%
Energy	9.85%	9.50%	-0.35%
Healthcare	9.46%	9.38%	-0.08%
Industrials	9.76%	9.66%	-0.10%
Real Estate, Lodging, and Leisure	9.45%	9.38%	-0.07%
Technology, Media, and Telecom	9.75%	9.59%	-0.15%

Average BDC Fair Value Yields by Industry—Second Lien¹

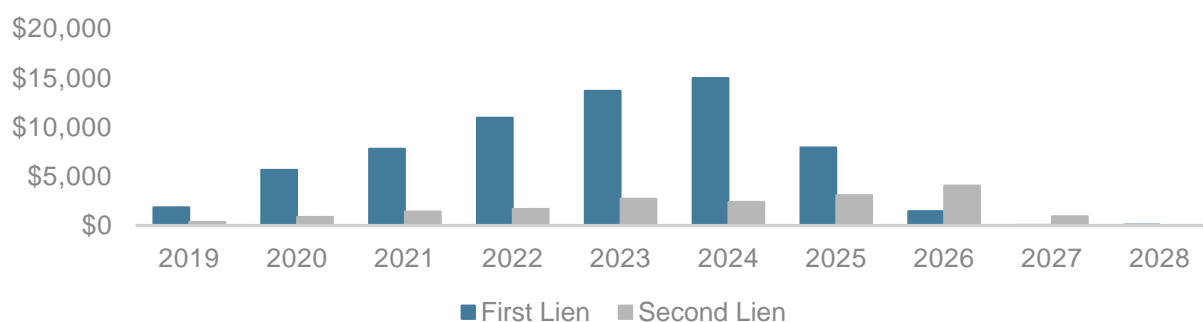
Industry	Q4 2018	Q1 2019	Change
Business Services	11.33%	11.24%	-0.09%
Financial Institutions	11.29%	11.25%	-0.04%
Consumer, Food, and Retail	11.72%	11.75%	0.03%
Energy	10.76%	10.84%	0.08%
Healthcare	10.80%	10.90%	0.10%
Industrials	11.56%	11.45%	-0.11%
Real Estate, Lodging, and Leisure	11.63%	11.32%	-0.31%
Technology, Media, and Telecom	11.39%	11.21%	-0.18%

Source: Advantage Data

(1) Fair value yield is based off of reported fair value, stated maturity, and stated interest rate. Represents data for all BDCs tracked by Advantage Data. Excludes outliers.

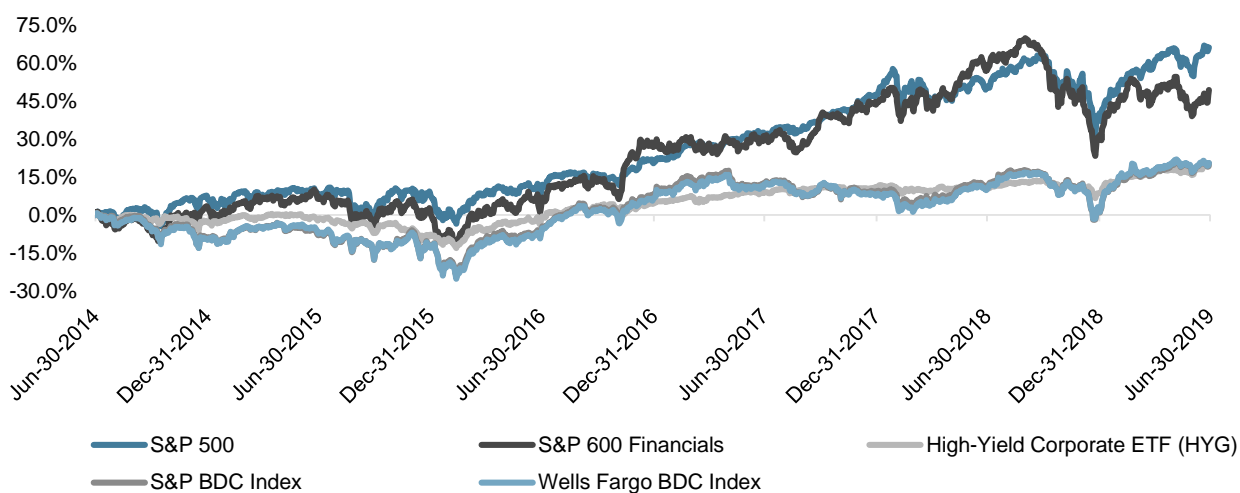
(2) Represents the principal balance of maturities for all BDCs tracked by Advantage Data

Debt Maturity for BDC Portfolio Companies by Year² (Principal in \$ millions)



Cumulative Total Return (%) as of June 30, 2019

	1 Year	5 Year
S&P 500	10.1%	66.3%
S&P 600 Financials	-5.8%	49.4%
High-Yield Corporate ETF (HYG)	8.0%	19.5%
S&P BDC Index	7.5%	20.4%
Wells Fargo BDC Index	8.5%	20.6%



Source: Bloomberg.

BDC Market Snapshot

(Dollars in millions, except per share data)

Company Name	Ticker	Market Cap.	Price at 7/15/2019	Price/ 52 wk High	LTM Price Change	Price as a Multiple of NAV	LTM ROA	LTM ROE	Div. Yield	Debt/ Equity
Large Cap										
Ares Capital Corporation	ARCC	\$ 7,775.68	\$ 18.24	100%	10.3%	1.06x	4.8%	11.4%	8.8%	0.9x
FS KKR Capital Corp.	FSK	\$ 3,182.96	\$ 6.09	74%	-21.4%	0.78x	3.1%	17.6%	12.5%	0.8x
Main Street Capital Corporation	MAIN	\$ 2,671.30	\$ 42.59	100%	10.9%	1.74x	5.1%	12.0%	7.0%	0.7x
Prospect Capital Corporation	PSEC	\$ 2,458.68	\$ 6.70	88%	0.4%	0.74x	5.1%	6.6%	10.7%	0.7x
Hercules Capital, Inc.	HTGC	\$ 1,351.95	\$ 13.00	92%	-0.5%	1.26x	5.4%	14.5%	9.5%	1.1x
TPG Specialty Lending, Inc.	TS LX	\$ 1,291.57	\$ 19.56	92%	7.5%	1.20x	6.2%	11.7%	9.1%	0.7x
New Mountain Finance Corporation	NMFC	\$ 1,199.77	\$ 13.71	95%	-1.0%	1.02x	4.6%	8.7%	9.9%	1.4x
Apollo Investment Corporation	AINV	\$ 1,118.36	\$ 16.43	91%	-3.6%	0.86x	4.8%	5.3%	11.0%	0.9x
Golub Capital BDC, Inc.	GBDC	\$ 1,092.39	\$ 18.03	91%	-3.3%	1.13x	3.8%	7.7%	7.8%	1.1x
Mean				91%	-0.1%	1.09x	4.8%	10.6%	9.6%	0.9x
Mid Cap										
TCG BDC	CGBD	\$ 929.81	\$ 15.34	76%	-10.6%	0.89x	4.6%	4.7%	10.2%	1.0x
Bain Capital Specialty Finance, Inc.	BCSF	\$ 929.70	\$ 18.00	86%	NM	0.91x	4.0%	6.6%	9.1%	0.9x
Solar Capital Ltd.	SLRC	\$ 863.81	\$ 20.44	93%	-1.4%	0.93x	3.6%	7.7%	8.0%	0.6x
BlackRock TCP Capital Corp.	TCPC	\$ 841.53	\$ 14.32	96%	-2.0%	1.01x	5.1%	5.0%	10.1%	1.0x
Goldman Sachs BDC, Inc.	GSBD	\$ 795.17	\$ 19.73	87%	-9.2%	1.14x	5.4%	5.3%	9.1%	1.0x
Oaktree Specialty Lending Corporation	OCSI	\$ 752.73	\$ 5.34	93%	14.3%	0.82x	4.3%	17.1%	7.5%	0.6x
Barings BDC, Inc.	BBDC	\$ 503.87	\$ 9.94	80%	-15.8%	0.86x	2.3%	NM	4.8%	1.1x
Mean				87%	-4.1%	0.94x	4.2%	7.7%	8.4%	0.9x
Small Cap										
PennantPark Floating Rate Capital Ltd.	PFLT	\$ 454.41	\$ 11.72	84%	-14.5%	0.89x	4.6%	2.9%	9.7%	0.9x
PennantPark Investment Corporation	PNNT	\$ 423.05	\$ 6.31	80%	-10.9%	0.71x	3.9%	5.1%	11.4%	1.1x
Newtek Business Services Corp.	NEWT	\$ 422.52	\$ 22.10	91%	7.5%	1.44x	1.2%	12.8%	8.1%	1.2x
BlackRock Capital Investment Corporation	BKCC	\$ 419.90	\$ 6.10	92%	3.2%	0.85x	4.8%	1.9%	11.8%	0.4x
Fidus Investment Corporation	FDUS	\$ 398.75	\$ 16.30	99%	12.7%	0.99x	4.6%	11.4%	9.8%	0.7x
Gladstone Investment Corporation	GAIN	\$ 373.85	\$ 11.39	90%	-3.3%	0.92x	1.1%	21.4%	8.2%	0.5x
Capital Southwest Corporation	CSWC	\$ 370.14	\$ 21.15	87%	16.1%	1.14x	4.8%	10.4%	9.3%	0.7x
TriplePoint Venture Growth BDC Corp.	TPVG	\$ 370.06	\$ 14.91	99%	19.0%	1.10x	5.4%	13.8%	9.7%	0.5x
Oxford Square Capital Corp.	OXSQ	\$ 316.88	\$ 6.65	88%	-5.4%	1.00x	5.5%	-2.3%	12.1%	0.4x
WhiteHorse Finance, Inc.	WHF	\$ 288.47	\$ 14.04	92%	-4.2%	0.92x	4.6%	16.6%	10.1%	0.6x
Gladstone Capital Corporation	GLAD	\$ 279.13	\$ 9.51	96%	3.9%	1.17x	5.4%	3.3%	8.8%	0.7x
Stellus Capital Investment Corporation	SCM	\$ 266.95	\$ 14.12	92%	9.3%	0.99x	4.4%	11.8%	9.6%	1.0x
Solar Senior Capital Ltd.	SUNS	\$ 264.08	\$ 16.46	94%	-1.8%	1.00x	3.9%	5.9%	8.6%	0.8x
Oaktree Strategic Income Corporation	OCSI	\$ 244.87	\$ 8.31	94%	-1.2%	0.85x	3.8%	3.6%	7.6%	1.1x
Monroe Capital Corporation	MRCC	\$ 231.23	\$ 11.31	80%	-16.2%	0.89x	4.9%	4.5%	12.4%	1.4x
THL Credit, Inc.	TCRD	\$ 212.79	\$ 6.65	76%	-18.3%	0.74x	5.5%	-5.3%	12.6%	0.8x
Saratoga Investment Corp.	SAR	\$ 198.53	\$ 24.76	97%	1.3%	1.03x	4.7%	13.5%	8.9%	1.5x
MVC Capital, Inc.	MVC	\$ 165.91	\$ 9.36	94%	-2.8%	0.72x	3.2%	2.0%	6.4%	0.7x
Horizon Technology Finance Corporation	HRZN	\$ 164.78	\$ 12.17	90%	16.8%	1.05x	4.9%	9.2%	9.9%	0.8x
Capitala Finance Corp.	CPTA	\$ 159.83	\$ 9.93	100%	17.0%	0.86x	4.0%	-8.1%	10.1%	1.6x
OFS Capital Corporation	OFS	\$ 158.66	\$ 11.88	93%	2.8%	0.91x	4.6%	5.5%	11.5%	1.6x
Medley Capital Corporation	MCC	\$ 137.82	\$ 2.53	63%	-26.0%	0.50x	1.5%	-25.7%	7.9%	1.4x
GSV Capital Corp.	GSVC	\$ 129.84	\$ 6.57	78%	-5.9%	0.61x	-0.4%	5.2%	0.0%	0.2x
Garrison Capital Inc.	GARS	\$ 112.18	\$ 6.99	79%	-13.9%	0.67x	3.6%	-0.7%	13.2%	2.0x
Alcentra Capital Corporation	ABDC	\$ 107.19	\$ 8.33	95%	36.5%	0.75x	4.9%	2.6%	8.6%	0.6x
CM Finance Inc.	CMFN	\$ 102.15	\$ 7.50	78%	-14.8%	0.67x	5.5%	-3.6%	13.3%	0.9x
Portman Ridge Finance Corporation	PTMN	\$ 90.96	\$ 2.44	64%	-24.4%	0.63x	2.7%	-14.2%	16.4%	0.8x
Great Elm Capital Corporation	GECC	\$ 86.47	\$ 8.59	85%	-7.8%	0.79x	4.6%	2.6%	14.4%	0.7x
Firsthand Technology Value Fund, Inc.	SVVC	\$ 67.73	\$ 9.31	52%	-36.8%	0.35x	-1.9%	6.2%	0.0%	NM
Harvest Capital Credit Corporation	HCAP	\$ 64.07	\$ 10.38	89%	-6.9%	0.86x	4.4%	3.9%	9.2%	0.4x
180 Degree Capital Corp.	TURN	\$ 60.75	\$ 1.95	78%	-9.6%	0.74x	-1.7%	1.2%	0.0%	NM
Princeton Capital Corporation	PIAC	\$ 27.71	\$ 0.23	59%	NM	0.67x	0.9%	-0.2%	0.0%	NM
OHA Investment Corporation	OHAI	\$ 22.59	\$ 1.12	70%	-22.2%	0.61x	2.4%	-24.2%	7.1%	1.1x
Equus Total Return, Inc.	EQS	\$ 21.60	\$ 1.60	69%	-29.9%	0.46x	-3.3%	6.6%	0.0%	0.6x
Rand Capital Corporation	RAND	\$ 16.89	\$ 2.67	74%	5.9%	0.53x	0.8%	1.8%	0.0%	0.3x
Mean				84%	-3.7%	0.83x	3.3%	2.9%	8.5%	0.9x
High				100%	36.5%	1.74x	6.2%	21.4%	16.4%	2.0x
Mean				86%	-3.1%	0.89x	3.7%	4.9%	8.7%	0.9x
Median				90%	-2.8%	0.89x	4.6%	5.3%	9.2%	0.8x
Low				52%	-36.8%	0.35x	-3.3%	-25.7%	0.0%	0.2x

Source: S&P Capita

Note: as of July 15, 2019

NM refers to not meaningful

About Portfolio Valuation & Fund Advisory Services

Houlihan Lokey's Portfolio Valuation & Fund Advisory Services practice is a leading advisor to many of the world's largest asset managers, who rely on our strong reputation with regulators, auditors, and investors; private company, structured product, and derivative valuation experience; and independent voice. We have valued illiquid assets on behalf of hundreds of hedge funds, private equity firms, financial institutions, corporations, and investors. We rapidly mobilize the right team for the job, drawing on our expertise in a wide variety of asset classes and industries along with our real-world transaction experience and market knowledge from our dedicated global Financial Advisory Services business.

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Fair Valuation for Financial Reporting	Valuation Governance and Best Practices
Portfolio Acquisition and Divestiture Services	Fund Manager Valuation
Securitization and Regulatory Compliance	Fund Recapitalization and Transaction Opinions

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Washington, D.C.		



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Corporate Finance

2018 M&A Advisory Rankings All U.S. Transactions

Advisor	Deals
1 Houlihan Lokey	207
2 Goldman Sachs & Co	197
3 JP Morgan	154
4 Morgan Stanley	135
5 Jefferies LLC	117

Source: Thomson Reuters

No. 1 U.S. M&A Advisor

Top 10 Global M&A Advisor

Leading Capital Markets Advisor

Financial Restructuring

2018 Global Distressed Debt & Bankruptcy Restructuring Rankings

Advisor	Deals
1 Houlihan Lokey	63
2 PJT Partners Inc.	45
3* Moelis & Co.	36
3* Lazard	36
3* Rothschild & Co.	36

Source: Thomson Reuters
* Denotes tie

No. 1 Global Investment Banking
Restructuring Advisor

1,000+ Transactions Completed
Valued at More Than
\$2.5 Trillion Collectively

Financial Advisory

1999 to 2018 Global M&A Fairness Advisory Rankings

Advisor	Deals
1 Houlihan Lokey	1,073
2 JP Morgan	971
3 Duff & Phelps	728
4 Bank of America Merrill Lynch	660
5 Morgan Stanley	659

Source: Thomson Reuters. Announced or completed transactions.

No. 1 Global M&A Fairness
Opinion Advisor Over the Past
20 Years

1,000+ Annual Valuation
Engagements

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