BDCs Have Been In Buying Territory Through The Pandemic, Says Rowe

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Chuck Jaffe, in The NAVigator podcast, interviewed Bryce Rowe, senior equity research analyst for business-development companies at National Securities Corp. Read the Q & A below as Chuck revisits with Bryce in his return to The NAVigator, business-development companies now. In his last appearance—just days before the stock market bottomed out from its winter swoon and as the country was just entering the pandemic shutdown, Rowe said that beaten-down BDCs were a strong buy. Now, despite a solid run up along with the market, Rowe says that the bulk of business-development companies he watches—and especially those focused on credit spreads—remain worth buying, presenting both great value and strong upside potential.

Bryce Rowe

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

CHUCK JAFFE: Bryce Rowe, senior equity research analyst at National Security Corp. is here and we're talking business-development companies now on The NAVigator. This is 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's 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 will point you in the right direction. And today it's pointing us in the direction of Bryce Rowe who, well, we talk about covering the entire gamut, he is an analyst, he is senior equity research analyst covering business-development companies for National Securities Corp. If you want to learn more, NationalSecurities.com, they're on Twitter @Your_National. And if you want to learn more about closed-end funds, business-development companies, interval funds, everything that falls under the closed-end umbrella, you can go to AICAlliance.org, the website for the Active Investment Company Alliance. Bryce Rowe, thanks for joining me again on The NAVigator.

BRYCE ROWE: Good to be here, Chuck.

CHUCK JAFFE: When last we spoke, we were days ahead of the market bottoming out. It was the third week of March, which meant it was the first real week of pandemic shutdown and the last full week of that bear market we had in February and March. At the time when things were so dark, you were turning very positive, it was significant buying opportunity for business-development companies. Now we're at a spot where things seem a lot lighter, the market's had that rebound going back to near all-time highs, but where are you on BDCs right now? Is it time that they've come far enough that we have to pull back or are the opportunities still there?

BRYCE ROWE: That is a really good question, Chuck. I think the opportunity is still there and still there in a pretty meaningful way for select business-development companies. If we went back to March of this year, the average price in net asset value for the BDC group was just above 40%. And with today being Thursday October, 22nd, we're seeing the price to net asset value for the BDC group in the low 70% range. In normal times you see that average metric in the mid to high 90s. So I think with select business-development companies, there is significant upside still to be had.

CHUCK JAFFE: Select business-development companies. The select part here is where the art comes in behind the science of those numbers. Help us understand, who are we selecting or what are we selecting and why? What areas of the market are particularly attractive via BDC, and what are maybe not so attractive?

BRYCE ROWE: So from a select perspective we look at a business-development company's ability to preserve capital, and by that we mean essentially investing in companies and not losing money. There are some BDCs that do that well and there are some BDCs that don't do that so well. So the companies we're recommending right now has generally shown an ability to preserve capital over time by investing and not losing their shareholders money.

CHUCK JAFFE: From the standpoint of the percentage of the universe that is buyable, what falls in buy territory? Because back when we spoke in March, it was almost everything.

BRYCE ROWE: It was. It was. So today we're recommending eight BDCs, eight of the actual 13 that we cover, so we're a little more than half. I will say that my universe of BDCs, my coverage universe includes some of the higher quality names that have shown that ability to preserve capital. We're talking about names like Capital Southwest Corporation. Names like Saratoga Investment, Oaktree Specialty Lending, Barings BDC, those are just four examples of BDCs that have shown an ability to preserve capital over time and are trading at significant discounts to their net asset value when they should probably be trading closer to their net asset value.

CHUCK JAFFE: BDCs are tough enough for average investors to understand, but like closed-end funds they are a way to buy businesses at discounts, etcetera. One of the areas that BDCs seem to be most attractive, not only just where they're at now but kind of in general when you're saying, "Hey, is this something I want to add to my portfolio?" is on the credit side, is trying to make sure you're doing right by credit spreads. Is that an area where there's a particular opportunity in BDCs?

BRYCE ROWE: It is actually, Chuck. I think about BDCs, and when you first kind of hear and learn about them, they seem confusing. They're really not, they're essentially just lending money to small businesses generally based in the U.S., and they're lending that money alongside in most cases a private equity sponsor or owner of a business. You think about a BDC, a BDC is providing the debt capital for a business, whereas a private equity company is providing the equity capital. Typically the valuations of publicly traded BDCs will fluctuate with credit spreads. When credit spreads are high, BDC valuations are lower. And when credit spreads are lower, BDC valuations are higher. And when we think about credit spreads, credit spreads are high when there's credit stress in the market. So today when you look at credit spreads, they're at a level today that would suggest that BDC valuations should be 10-15% higher than they actually are today. There's more worry out there in BDC valuations than what credit spreads are telling us today. So yes, today is a good time to be putting money to work in the BDC market.

CHUCK JAFFE: Some folks would say we're talking Greek when we start talking credit spreads, etcetera. They think more about interest rates and the interest rate picture. But how do the two work together in terms of we're in a lower for longer interest rate environment? That's not likely to change, so somebody who's trying to figure this one out might go, "Okay, well you've got that opportunity you're talking about, but do we wind up seeing that opportunity cash in if the broad interest rate picture doesn't actually change?"

BRYCE ROWE: That's a great question. As a lender you do worry about the general level of interest rates, and we do think that interest rates are going to be lower for longer. For BDCs its certainly an issue, but there are some things that mitigate the risk of lower for longer in the interest rate picture. Number one is there are pricing floors associated with BDC investments. Meaning that once the short-term interest rate goes below 100%, that lower interest rate level is not going to affect the BDC's deal that they're getting on an investment. So that's number one, and then number two, BDCs do not carry much leverage on their balance sheet, especially relative to other lenders like banks. And when you have more leverage, that really magnifies the impact of lower for longer interest rates. So the fact that BDCs have lower leverage makes them less susceptible that lower for longer interest rate picture.

CHUCK JAFFE: Bryce, great stuff. Thanks so much for joining us. I look forward to checking in with you and see where the BDCs have gone a few months from now.

BRYCE ROWE: I look forward to it as well, Chuck. Thanks for having me today.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I am Chuck Jaffe and you check out my show on your favorite podcast app or at MoneyLifeShow.com. To learn more about closed-end funds, interval funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. They're on Facebook and LinkedIn @AICAlliance. Thanks to my guest Bryce Rowe, senior equity research analyst at National Securities Corp. Learn more about him and the firm at NationalSecurities.com or on Twitter @Your_National. The NAVigator podcast is available every Friday, please subscribe on your favorite podcast app and join us again next week to learn more about investing in closed-end funds. Until then, stay safe everybody.

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