



Panel #3 - Analysts and Investor Panel - Key to Picking and reviewing BDCs for Clients

Wednesday, June 11, 2025

DAN SILVER: Okay. Well, thank you everyone, and welcome back from the break. My name is Dan Silver, I am a portfolio manager at Closed-End Fund Advisors and I would like to welcome you to our “Analyst and Investor Panel: Keys for Picking and Reviewing BDCs for Client Portfolios”. I’ll tell you what, why don’t each of you take the opportunity to introduce yourself. Mitch, you got the mic.

MITCHEL PENN: Sure, I’m Mitchel Penn, I’m from Oppenheimer, I cover the BDCs. Just by way of background, when I got out of business school, I actually made loans, I actually made private placements back in the eighties, I actually lent money to Nike, funded the Jordan expansion, so I’ve actually worked out loans, run bankruptcies, so I’ve got some experience. I then ran a \$20 billion fixed-income portfolio at ETNA for a couple years, and then went onto Legg Mason, ran taxable fixed income, and then went over to the equity side. I worked for a guy by the name of Bill Miller from 2001 through 2012, running The Equity Group for Bill, and then started covering BDCs in 2014 at Janney, and then moved over to Oppenheimer in ’01, so been covering them for about 10 or 11 years. You’ll see as we get into this, we are data-driven, so everything we do is done by data, and that’s just the by-side mentality.

JOHN COLE SCOTT: Great. Most of you do know me, but John Cole Scott, and in this role I’m the president of CEF Advisors, we’re a separate account-focused investment firm for income investors, we use BDCs, closed-end funds, and interval funds, and we had a closed-end fund data business with a partnership back in ’08, it became an independently sourced data business in 2011, and by 2014, I’m chuckling because a lot of the people, I started doing this in 2014, we added BDCs to our data file. We later that year found a great partner to create a

UIT of BDCs, which I actively select every four months for SmartTrust, we've been doing that for 11 years, and basically allowed me to grow our data business by asking questions, my questions, the advisor questions, the things I heard on panels, and really had a lot of enjoyment of using BDCs as a sector of closed-end funds. They're a very similar structure, they're closed-ended management companies as you guys in this room understand, and we really use our primary analysis at CEF Advisors of it's the price to book or price to expectations, there's real discounts and fake discounts, sometimes premiums, especially in quality BDCs, they're not necessarily expensive.

We also do a lot of work in the dividend and looking to analyze how comfortable and sustained it is, and if we do think that it has risk, or we get a price that we're comfortable with that risk for a dividend, but the major thing that really leverages my experience is the manager analysis, the really trying to understand the curiosity, the platform, the portfolio, the governance, and over the years leaning on analysts like Mitch to ask harder questions and think more deeply about the structure.

DAN SILVER: Okay. So before I get into some of my questions, this panel's going to be a little bit different, so let's make it a little bit more interactive. If you have a question, just raise your hand, we don't have to wait until the end, we'll take 'em in real time. If there's something that someone says that you think is interesting or you have a question about it, literally just raise your hand and stop me, and then let's address that.

So I will kick it off with the first question, and the question is about rates, the outlook and NIM, so the expectation is that the Fed is going to, at least somewhat, lower rates, and the question is where do you see portfolio yields and NIM by the end of the year? And repricing, hedging, how do you think that'll play out for the listed BDCs?

MITCHEL PENN: Sure. So what's real nice about the BDCs is in their financial statements they actually tell you what their expected, like if interest rates drop 50 basis points or 100 basis points, what the impact is on earnings. And so we don't know what the Fed's going to do, but what we can do is we can run, and we do publish a report that looks at what happens if interest rates drop 100 basis points and 200 basis points. In the average BDC, if interest rates drop 100 basis points, their earnings would decline by 7.3%, or roughly 1% of ROE, so if a BDC is returning 10% and they lower rates 100 basis points, you're doing an ROE of nine,

and that's with them taking no actions to deal with it. So BDCs have plenty of levers that they can employ.

Just to give you a sense, what we saw in Q1 was BDCs reduce leverage, and we think that was because of the uncertainty that was created around the government policies, the tariffs and the government was laying off a lot of their employees. There were a lot of things going on that created the uncertainty, so BDCs got conservative, they lowered their leverage. One of the things they can do is they can lower their borrowing costs, and that's through looking at their bank lines, and we've seen a number of BDCs over the last 12 months renegotiate the spreads on their bank lines with their banks.

The other thing they can do is the SBIC has a lending program, very reasonable levels, and that's available to the BDCs. I talk to the SBIC folks, and it's one of their more profitable programs. They can duration match their assets with their liabilities better, right? So it's interesting, when interest rates rose, a lot of BDCs had fixed rate debt, and that was very beneficial, but now that debt is maturing. And you heard Bob Marcotte talk earlier about they thought they were going to sit in floating-rate debt because that's the most attractive, and so I think BDCs are evaluating these different options. The other is the floors, so BDCs, when they make a loan, those loans have floors, and I know Trinity spoke earlier, their floors are higher than other BDCs.

So the last point I'm going to make is they can increase risk, and I don't think of this as a negative, they might increase the percentage of equity they take on a transaction, so there are a couple BDCs out there that they'll make a loan and they'll ask for a couple of percent in equity. That can add up over time, and so it's a nice way to supplement, if your yields aren't very high, you can supplement with some equity.

JOHN COLE SCOTT: Great, so to chime in a little bit, we look at it a little differently because we're just trying to more tactically invest at the right time, at the right allocation for our clients, it's driven from some of the same factors. So we talked about it earlier in the fireside chat, understanding the type of leverage that the BDCs have, and so while we have the current cost of their leverage, where we model that cost going forward, also looking, as I said earlier, I think around a year ago BDCs had almost 120, I think 8% average core NII cushion for current policies, the average distribution has come down 4%, and now we're sitting at just 104.5% cushions. What I find cool, I'm a data person, about average data is half of the

data is the other side of that answer, and so when we work with our UIT product for example, we're trying to lean into the leverage that aligns better for outcome, the better dividend coverage, the better ROEs, and if they can get through and make some money, it's easier to cover their dividend. At the same time, we've also seen management also sometimes willing to reduce some of the incentive fee to support the dividend short term, not forever usually, which can just help.

And so the long answer is we are overweight considering rates being lower in six to 12 months, and so when we're making decisions on BDCs, we're trying to bleed through the fundamental data, which is as Mitch said, is given quarterly in great depth, to make some above average decisions. But luckily we don't own only one BDC, and we can change our mind every day if we need to or choose to.

MITCHEL PENN: One comment I want to make is when SOFR, if the Fed does cut rates, that means the risk-free rate is coming down, so equity discount rates should come down. Now that assumes that credit, it hasn't caused a recession and credit is somewhat normal. We've talked, if you want to see more on this, Aswath Damodaran at NYU does a really good research on equity discount rates. But just because the yield or the returns of a BDC are coming down, if it's in line with the market, the equity discount rate may be coming down as well, it may not change the valuation. There are a lot of factors, it's complicated.

JOHN COLE SCOTT: You're right, and then as we look at what else we can buy to hit the notional term for our income clients, if rates are coming down, then preferred equity is coming down and investment grade is coming down, and high yield and senior loan, these are not going the other direction. So I'd say it's a relative game as well as we look forward in the rates.

DAN SILVER: You mentioned high yield, so that's kind of in the right direction of my next question, which is about credit quality and nonaccruals and the trajectory. Nonaccruals have inched up, certainly in select industries, select BDCs lately, and the question is, do you expect further deterioration or a plateau, say now through the end of the year? I'm curious if there are maybe sectors that you think deserve the greatest scrutiny or pockets of nuance that you'd want to call attention to?

MITCHEL PENN: Sure. It's interesting, we don't look at nonaccruals, and the reason we don't look at nonaccruals is BDCs can manage that number. I'll give you an example, a BDC, I think

it was about a year and a half ago, had two big loans that they got the keys back, and those two loans were on nonaccrual for a quarter, and once they got the keys back they were re-structured to equity and called performing. And so because they can manage that number, there's no way for us to use it, so what we do instead is we track realized and unrealized gains and losses for every BDC, and we've done that for the last, I don't know, 10 years. Just to give you a sense, in 2008, the average BDC had a 10% markdown on its portfolio, right? That was the Financial Crisis. So that 10% was basically unrealized, and the next five years, the realized losses equaled 10% over those five years, and it simply reversed the unrealized, the loss was taken day one in the unrealized section. In 2020, Covid hits in February, and when the BDCs report in March, the average loss for a BDC was 7% in their portfolio. Now they recouped 5% by year end, because again it's unrealized.

The point I'm trying to make is BDCs are marked to market, and if you're looking at the realized and unrealized losses, you're getting real-time data on the problems, and that's why we do it and we found it very effective. Just to give you some numbers, on a trailing five-year basis, the average BDC has 82 basis points of loss, and on a trailing four-year basis, it's 48 basis points of loss. Now let me give you the numbers for 2023, 110 basis points, for 2024, 103 basis points, in Q4 of 2024 it was 138 basis points, so it was pretty consistent around that 100 to 138, but in Q1 it was 246, and that's because of this uncertainty, right? A lot of unrealized losses due to the uncertainty and the spread widening, and we don't know what's going to happen but we're monitoring it.

The point is, the BDCs are taking those losses and you can see where they are. And by the way, there is a big dispersion in losses, so the top quartile, the losses on a trailing five years are actually a gain of 169 basis points, and on a four-year trail, it's a gain of 241 basis points, so that's the top quartile. The bottom quartile has 329 basis points of loss in a five-year trail, and 320 basis points of loss on a four-year trail. I remember in the prior grouping, they said with the uncertainty we're going to see a divergence in performance, it's there, that's my point. If you use the realized and unrealized losses and track it like we do, and you can get it through our research, you'll see who is good at credit and who's struggling in credit. We have quartiles for all these things. We found it the most efficient, and it's a good predictor of how they're going to perform going forward.

JOHN COLE SCOTT: And so in many ways we'll agree with Mitchel in those analyses, however what we've found useful at our firm is to look at the way BDC managers have put loans on nonaccrual and taken them off, get a sense of whether we feel are they early, aggressive, or they late, only as the board and other advisors push them to make that assertion? Pretty much every data point I can think of that we use every day for our client portfolios is never perfect and needs to be used in concert with other data. We also do, just because in some ways it's easier to digest to the advisors that buy our product, is a talk about net asset value, but it is true, you can manipulate both of these figures, but you can look at what did they say back in 2021? What did they say back in 2016? How did it work for the loans? We rate managers as aggressive or conservative in their assertions, and that really helps us look at the data.

Going in toward the index, this is the 37 equal-weight listed BDC funds, currently nonaccruals are trending 1.48%, and while in some ways that doesn't matter, it has been ticking up, which shows managers are putting more loans on nonaccrual. The fair market value at cost right now is 3.14, that number has grown in the last few years, as you imagine, talking to the losses that Mitchel referenced. And so when we think about the decisions we're making, we are using historical behavior for funds that have a history, and that's both for funds that have a history of being a public fund, but we also are taking the newer funds that are in the market, whether it's NCDL or KBDC, MSDL, and analyzing them when they were private, and their financials and how they handled the reporting back then before they were public to make some of these considerations on our outlook for the sector.

And then at the same time, we are general overweight, market weight, underweight in our exposure to different BDCs, and we generally as I mentioned earlier, we use them 1% to 2.5% generally max in a client portfolio, sometimes less for taxable accounts, we can't forget about marginal taxes. And there's always room, if you still like the manager and the fund but the pricing goes against you, to add a little bit more at that level, versus if you were to have 5-6% in a client portfolio in one BDC and it goes against you, that's hard to buy more of in our experience as these things come to fruition.

MITCHEL PENN: One thing I didn't talk about is we focus on return on equity, and to us that's after gains and losses, right? There are a lot of folks who focus on NII because that seems to correlate with the dividend. What we find, and this will give you a perspective, the average

return for the group, the five-year trail, the five-year average is 10.13% ROE. The top quartile, the average return is 15.89%, the bottom quartile, the average return is 4.77%, so there's about a 10% gap there. Look, the second quartile's not bad at all, it's 12.09%, and the third quartile's 8.43%, so it's really just the fourth quartile, if you're in there, you've got to take some action, right? And that's typically where we see BDCs bring in new management folks to help with the underwriting. And by the way, the ROE is correlated with the credit losses because we've run that.

JOHN COLE SCOTT: And I know we've long looked at, a lot of people talk about Mainstreet Capital, I think they yesterday closed above an 80 premium to book, and just look, yes, it's internally managed, but in addition to that, very high ROEs, or if you look at its outperformance versus its peer group, much of its NAV performance is the accretion of adding shares so far above net asset value it's almost doubled, even if you don't trust NAV perfectly, almost double the NAV total return for Mainstreet over long periods of time than the index average; which is when you can trade well because you have good ROE, because investors trust you, you can really add value at that high level because it's so positive for investors when you have an ATM or even potentially small secondaries in the market.

MITCHEL PENN: Yeah, and just to that point, when they issue shares that are accretive, it has no impact on ROE. In fact, it's tougher sometimes because it increases the book value and that's the denominator that you have to earn against. So that's why we like ROE, because it's very good at measuring performance.

DAN SILVER: Before we get into the ATMs, and also a question on capital allocations relates to buybacks. Mitch, I just have follow up. I know that the average mark is at 96%, how do you think about that 4% in relation to losses that we're seeing, and whether or not we're baking in a little bit more than we'll probably see.

MITCHEL PENN: Yeah, that's a great question. When we think about losses, we think about how many defaults could you see in a recession? So let's say it's 10% of your portfolio defaults, and then what's the recovery rate on that? We run those numbers, let me pull that up. We run those numbers for each of the BDCs, and what you find is that a lot of the stocks have priced in those defaults, and we use Moody's and S&P historical recovery rates, historical default rates, so you vary the defaults from 5% defaults up to 10% defaults. We'd always get calls when we first publish this report, and the BDCs would say, "Your numbers

are ludicrous, we would never have those kinds of defaults,” and I said, “We agree, but a person on the buy side, they want to see those kinds of numbers,” because if they’re ludicrous and the stocks still look attractive, that’s a big deal.

DAN SILVER: Okay, well shifting gears a little bit, I’d like to talk about dividend coverage, and this kind of dovetails with what we were talking about earlier. Basically the question is, given the potential for lower rates, which levers, whether it’s floors, fee waivers, supplementals, which ones do you think are more realistic? Or what are you expecting to see more of from a change standpoint in the back half of the year?

JOHN COLE SCOTT: I’ll take a first stab at this. As we look through the years of interest rate movements, how it’s impacted the BDCs we’ve invested in, we pretty much expect that the managers, once there’s a handful of double digit cuts, not like 10.01, but more sizable, it’ll be a lot easier for the cuts required to be in line with future forecasts to happen. We found, at least in the closed-end fund side, where a lot of my deeper history is, there were some large cuts to a closed-end fund, it was the Friday before January MLK weekend, I want to say 2012, and they did their second 50% cut, it was crazy what they did. They were trying to hide in a holiday, one more market day, we also find as they’re thinking about the way their BDC will trade, a lot of the investors we find that we talk to, even those with sizeable capital commitments to closed-end funds and BDCs, honestly don’t really notice a dividend cut until that dividend doesn’t land at the same dollar amount in their spreadsheet they keep monthly from whatever platform they have their stuff at. And so I’d like to think that we can’t have rates go down and generally BDCs not do something, and so we expect it to be more likely to be aggressive base cuts, because then they can grow from there and have a longer period of time since they cut the dividend once dividend cutting is no longer new and it’s more common because of the economics of the structure. I don’t know if you feel differently.

MITCHEL PENN: No, no. I think BDCs, they’ve done fee waivers in the past, they could cut their fees. I mean, these BDCs have grown quite a bit. We saw Golub, for example, a couple years ago cut their management fee because they said, “Look, we were a much smaller entity when we created this fee structure. Now we’ve grown over the years and we feel like we can cut it a little bit.” BDCs have to generate a certain ROE that’s in line with their competition, right? Think about it, you’ve got, let’s say a 10-year corporate bond, where does that trade? Is it 7%, is it 6%? And so you always have to be relative to what the alternatives are for investors, so

if they want to get capital and they want to grow, that ROEs got to be respectable relative to your alternatives because investors are going to buy what they think is appropriate.

We do this all the time by the way with BDCs, so we talked about that fourth quartile, those BDCs, because they earn, let's say an average 4-5% ROEs, we buy the bonds, because you can buy the bonds and the bonds yield 7-8%, and the bonds are attractive. And look, it makes sense, right? They're higher in the capital structure, they have a better return than the BDC, and so that's how we think about these things.

I did find by the way my notes on the recession losses, so in a recession we calculate that book value for the BDCs would fall between 18% and 24%, and if you think about it, if you're trading at 75% of book, you've priced in most of the losses that you're going to see. And I think if you can find a BDC that's priced 75% of book or below, and they've generated a decent ROE, whether it's 7%, 8%, 9%, that's the kind of thing where you may, if you want to take a risky position, that's the kind of stuff you might do as a portfolio manager if you wanted to add some risk or alpha to your portfolio.

JOHN COLE SCOTT: I'll just add quickly, it's not unique, but bruised not broken, so while we always love the BDCs that are the best behavior, they often can trade relatively expensive to where they have historically in their peer group. We're thoughtful on paying more for better quality, but trying to find those with a thesis to where their current discount, where it's 5% or 10% or possibly more than a comparable peer group analysis is a chance to do well. And then maybe we've done a different job on the front end with our clients about volatility being the benefit, clients pretty much add money when there's volatility on the downside, not sell, is we actually really can appreciate planning for how we'll handle the unknown event next, and which BDCs we'll own in different environments. Which did include a couple years ago when Silicon Valley Bank was having issues, I called Mitchel before the opening, he was gracious enough to give me his take, which meant we bought a lot of Hercules that day, and at a really attractive price for our clients. I don't know if that helps.

DAN SILVER: So I will have a follow up for that but, Mitchel, if I could just go back to something that you were just hinting at. So there is this pressure, no one wants to cut the base dividend, but at the same time, it's probably the right thing for the long-term math because you don't want to see a NAV decline. Correct me if I'm wrong, there are a lot of BDCs that aren't earning

enough to cover the dividends, so how do you think about that push and pull? Because the valuation perspective over here, and then--

MITCHEL PENN: Yeah, we don't know what the right answer is, but I can frame the problem so you understand the issue. If a BDC is earning, let's say 5%, and they're paying a dividend, remember the average dividend in that fourth quartile was around 14%, let's just say it's 15%, and so the difference between the 15% dividend and let's say the 5% ROE is 10%, right? That's return of capital. A simple explanation, if you have a business, you buy a business for \$100 and you say I'm going to pay myself a dividend of \$10 every year, if you only earn \$5, that business is now worth \$95, you paid yourself \$10, it was worth \$100, but you only earned \$5. The same thing happens with BDCs, if they don't earn their dividend, they're returning capital, and you see that in the NAV decline. Here's a simple test, and when you go back to your office do this, take any BDC and just get a 10K, and add up the net income and add up the dividend for each year, and see what the difference is. And then take a look at the starting NAV and the current NAV, and you should be able to dial it right in, it'll be the difference, the amount you underearn is the decline, or if you over-earn, it'll be the increase in NAV.

The issue we have is, so now if you run the model, that business goes out of business in 10 years, right? It just goes to zero. And by the way, the NAV has already declined, because remember they were earning 4% and they're paying out 14%, so the NAV is already declined, so that dividend yield on NAV is like implying that they're going to get a 12% ROE, right? My point is, it's not possible, they've been doing 4%, they could get better, but they're not going to go from 4% to 12% overnight. We think BDCs should conserve capital, fix the underwriting issue, or whatever the issue is, and then pay what they earn, and then once they get it steady, they can figure out what the right dividend approach is, and then they have a loyal shareholder group.

The thing that we like to see with management teams is they explain to investors what they're trying to do. I'll give you a great example, I was talking to a BDC a couple weeks ago and they were asked on a call, "Would you buy back shares?" because the stock was at 80% of book, and they said, "No." So I got on the call with them privately and I said, "Well, what price would you buy back stock?" and they wouldn't answer. And I go, "Well, that doesn't make any sense. How are you thinking about your business if there's no price?" I said, "And

if you're not willing to buy your stock at 80% of book, how do you expect investors to buy your stock at 80% of book," right? They just need to come up with a strategy to deal with it and not hide it, is I guess what I'm saying.

There's one BDC that would always get on their call and say, "We've never had a loss," and we know they had losses, we track these numbers. The market understands, they didn't trade like they didn't have a loss, they traded where they should have traded given their ROE. The point is the market's pretty efficient and BDCs have really grown. When I first started it wasn't as efficient, and you could say things and people would believe you, but not anymore. These are very sophisticated BDCs these days, the competition is high and so you should be straight with your shareholders, and it's only good for you as a BDC if you figure out what the strategy is because you want to be around, right? You don't want to keep paying out capital back to your shareholders. And that same one I said, "Well, if you're paying a dividend of X and you're only earning Y, you're giving them back capital anyway, you might as well repurchase the shares, it's better economically for you and the shareholder."

JOHN COLE SCOTT: One of the quotes yesterday at the Dechert event was, "Bad news doesn't age well," and it is absolutely true. Going back to previous conversations, as you know, we finally got active in this space when there were options to be selective and make management choices than just having to own five liquid BDCs to be diversified, and that has only compounded in the 11 years we've covered this sector, to where there's even larger and better brand name options, and sometimes the brands do well, sometimes they don't. Being able to vote with our shareholders fee is a very powerful thing, and being able to have public records of what the BDC management team said they were going to do, what they saw coming, and to piece together over time which ones. We had a BDC management team tell us, I want to say last year, to get out of the stock before a merger of a private into a public because they thought it could impact the stock price, so we owned the fund at the time, we got out of it by the date of the transaction, and it did go down wider and later we got back in. I can tell you as an investor in this space, I'm not going to believe everything that people tell me, but when a management team says, "You may want to consider underweighting us or being out of our fund for a while," and then it proves to be a good decision, it does bolster confidence in their ability to speak to you about what their business is, and also to remind us of which management teams have been forthcoming, answers the harder questions, gives

thoughtful and deep answers to the different analysts on their call every quarter. To us that's very important.

DAN SILVER: I'm going to piggyback on that and put you both on the spot. I think we're dancing around naming names, and I think it's time to do that. Mitch, I would be thrilled if you could give us one or two picks, and maybe outline why you think that they are interesting.

MITCHEL PENN: Sure. So I always struggle with this, because when we talk to investors, we always stress that you should own a basket, and we typically run with five. In the economic world we live in today, it's even more uncertain, right? And so just giving you two names would be disingenuous, so what I'm going to do is give you your five, and then I'll select two and go through them, they're the most conservative. By the way, we have nine buys out of 33 names, and those nine are TSLX, OBDC, GBDC, ARCC, Ares, CCAP, Trinity, Fidus, GAIN, and New Mountain. The five that we would recommend in the basket right now is TSLX, OBDC, GBDC, Ares, and CCAP, and if you push me to two out of the group, TSLX and OBDC would be my two.

And the reason is that, so let me give you some numbers on TSLX so you understand. So TSLX has generated a 12.6% ROE since its IPO, on a trailing four, two, and one-year basis, it's 12.6, 12.8, and 11. They have five-year credit gains of 39 basis points on average, and four-year credit gains of 15 basis points on average, so they don't have losses, and they don't have equity. Their portfolio, I'm going to talk about next, 93% of their portfolio is in first liens, and 1% is in second liens, 1.5% in mezz, and only 4.6% in equity and other. To have gains where you don't have much equity, that's pretty good. Where they make money is their loans are customized and they charge fees, high fees on those custom loans. And so they don't have a lot of competition from your typical BDC, because most BDCs do cookie cutter or standardized loans, this wouldn't fit into that. The other comment I want to make is liquidity, they have over a billion dollars of liquidity with only \$175 million of unfunded commits. And the last point I'll make about TSLX, they thrive in chaos, because they're able to customize a loan, so they can get collateral.

I'll give you an example, when I was a lender we had money out to Mexicana Airlines, and it was during the Latin America debt crisis, and the Mexican debt was literally trading at a penny. And the CEO of Mexicana called me and said, "We can't pay you back," and I said,

“That’s okay, we have the planes as collateral, just leave us the planes.” I said, “You can put ‘em in Houston Airport.” And he said, “Well, we don’t want to give you the planes.” I said, “Well, then you have to pay me off.” He said, “Okay, I’ll pay you off.” And I said, “By the way, we have a [inaudible 0:43:03] on the early payout.” He said, “You want the [inaudible 0:43:07] too?” I said, “It’s in the document,” and so we got the [inaudible 0:43:12], the payoff, and in the middle of the Latin American debt crisis. So my point to you is you can structure things in chaos, where you can get repaid, and so I don’t worry too much about industries. Because I think BDCs are smart and I think they understand that they can make a loan even in companies that others might not lend to if they get certain collateral or they have covenants or whatnot, and that’s what you look for, and TSLX has been good at that.

In terms of OBDC, historical ROE since IPO is at 9.9%, the four, two, and one-year ROE’s are 10.7, 11.7, and 10.4. Five-year credit losses are 29 basis points, and four-year credit losses are three basis points. They take a little more risk, first liens are 77%, second liens are 5%, sub-debt is 2%, and joint ventures is 2%, and 3% preferreds, and 10% equity. So they do take a little more risk, and they have plenty of liquidity, they have \$3 billion of liquidity against a \$1.9 billion of unfunded commitments, so it gives you a sense. And if you read any of our reports, the information I just gave you, those are our basic paragraphs of what we do when we look at any BDC, but those two stand out. Go ahead.

AUDIENCE QUESTION: I just have a question about TSLX. [inaudible 0:45:09]

JOHN COLE SCOTT: True. It actually hit a 52-week high yesterday, which I don’t disagree with anything Mitch said about the quality of the platform, but it’s definitely one that we would be just thoughtful over these current prices.

AUDIENCE QUESTION: [inaudible 0:45:26] just curious, Mitch, do you even take that into account [inaudible 0:45:34]?

MITCHEL PENN: We do, and TSLX went through our price target, and what we’ll do is we’ll update at the quarter, so we typically don’t update it mid-quarter. We use whole dollars, they don’t let us use cents on our targets, and this is why we like a basket, because it’s not perfect, right? Look, I’ve managed portfolios for a long time, and I will tell you, you make mistakes. So yeah, it’s rich, but in 2020 when Covid hit, it was my only buy because I trusted management. It is rich, and what I say to people on TSLX is put in a bid a little bit below the market so that you get it towards our price target. I’m playing defense here in picking two

names, because I know you're not diversified if you're just in two names, but yeah, OBDC has been our top pick this month. So you're right, it's a little bit of a discount, it's got good returns, a little riskier portfolio.

JOHN COLE SCOTT: I'm going to go ahead and give some of our thoughts, but I'll say that we are able because we're in a different environment than Mitchel is as a BDC analyst to make decisions very actively, not being a research company directly. So we bought TSLX, as I mentioned earlier, during Covid, with Ares, with Mainstreet, with Golub and another one I can't think of, because they all went down dramatic amounts to discounts that were very tasty to our clients. I decided to pick two, and I think everyone knows I often would pick one for the podcast with Chuck sometimes, they're very different stories. And so Nuveen Churchill or NCDL is trading around a 10% discount, which is about 3% wider than the total peer group average, not just liquid names, and about 6% wider than its one-year average, and it gives a yield right around the index, which we like, and has better reported coverage of its dividend. And while the next data point has changed, it has a very low gross non-leverage expense ratio, but those fee waivers just rolled off, so that number will be ticking higher in future quarters in our data business. Very solid one year ROE at 10 and change percent, and because it's such a new public BDC, they've yet to report any nonaccruals, and the fair market values are sitting right at cost, which is a positive thing. And so as we think about the size of the Churchill platform, the resources they have to deal with workouts and whatever happens next, we really like 90 cent dollars into a relatively low-cost BDC historically speaking.

The next one's more the bruised not broken, CGBD, which has been a BDC for, I want to say like six years, though I don't have it right in front of me. It's right now at a 15% discount, we would argue though the discount's wider not just because of regular conditions of BDCs, but because of the merger of the private fund into the public fund recently. Its one-year average is closer to net asset value, and so these are very attractive compared to its self-metrics, which is very common for us to use at CEF Advisors. Yield's still not crazy, 11 and change percent. Both these yields are right in the midpoint of the peer group average, and again, not as low of expense ratio, about 2.3 gross non-leverage, below peer group, and again, dividend coverage above the index at 109. Nonaccruals are, I'll say moderate, at 1.98, and the fair market value has already been marked down 4%, and the ROE for one year is only 8.2%, so

it's our recommendation that the extra 5% of discount is probably taking those other issues into account. We typically own way more than even five BDCs for any client at any one given time, these are meant more as examples of the ways we think about these funds, the data that we care about, and the type of entry point consideration we're able to do. Honestly, a week from now those nine names could change because markets are always evolving.

DAN SILVER: Okay, I think with that, any questions from the audience? Does anyone have one pressing, burning question?

JOHN COLE SCOTT: I'm going to start naming names.

DAN SILVER: Yeah, we'll see. Okay, up here.

JOHN COLE SCOTT: Thank you.

AUDIENCE QUESTION: [inaudible 0:50:08]. I was fascinated in the past when you talked about good rock and bad rock and neutral rock, and I think you wrote a paper years ago about this. Can you just touch on that a little bit?

JOHN COLE SCOTT: Yeah, so return on capital can be real in BDCs, it's far less common because a lot of traditional closed-end funds, especially in the last two years, have basically like muni bond funds yielding 8%, it is not being earned at the portfolio level, it's basically wide discounts, it's kind of a democratized tender, and so I'd say the main difference there is it being fueled by net asset value performance. I'd say the math that you would use for BDCs would be different partially because they tend to not generally trade much below par, at least the sector. Right now they're a neutral, and there's times that they're 10% premiums, there's definitely times that they're wider. The return on capital or principal that Mitch was talking about earlier, it can live. We do find that if you're talking about the dividend classification of the 1099 in a taxable account, doesn't often have return on capital for BDCs, I'm sure it's happened, I can't think of seeing in our data recently. But what I think Mitch was alluding to, if you're not earning the return on equity and you're overpaying, you're basically delaying painful future net asset value, the ability of working capital to fuel new loans, to keep the dividend going, but conceptually return on capital is less prevalent in BDCs from a tax perspective, and while it exists, it doesn't happen nearly as much in my experience. I don't know if you have any more to add to that, Mitch.

MITCHEL PENN: Yeah, we just see it when BDCs underearn, is where we see it. Most BDCs, it's such a young industry, they don't want to return capital through share repurchases. They'll

do it, and you've seen it. Where you see it is when Blue Owl came public, they have a buyback, and I think OTF, I think it's their tech fund is coming, they're going to register the shares, and I think they agreed to buy back some shares, I don't remember, but that's where you might see it, but you don't typically see it. You may see it years from now when the industry gets saturated and people raise too much capital and they just don't have enough to invest in or they're not seeing investment opportunities, but we haven't gotten to that point. Right now it's sort of a unique situation with the private equity, the M&A market is real soft and it's just because the uncertainty, it's hard to price deals. The key to a strong M&A market is when the buyers and the sellers agree on price, right? And with all the uncertainty, the buyer thinks it's worth a lot less than the seller thinks it's worth, right? And so you need some more clarity, and that way the deals can start to happen again, and you'll get more activity.

DAN SILVER: All right, with that, I would like to thank our panel, and I think that we are all good.

JOHN COLE SCOTT: Thank you, a couple closing remarks without moving. Really could not say that while we wish this was 1,000 people, we had a great group, we had great content, we thank each of you for being here. We couldn't do this without our memberships at AICA, couldn't do it without our sponsors, Katten, Oppenheimer, to help us get the resources to pay for today. Really, we make everyone to pay to be in the room because you want quality people to come in, learn, network. We hope to continue to grow this event for years to come and to create an opportunity for you guys to get to know each other better, to build relationships in this industry, and to broaden the resources available to you whether you're an individual investor, financial advisor, institutional investor in the space, or the BDCs themselves. A little heartburn a month ago when we had to change locations, but this place is better in some ways, worse in some ways, the way every location is, but truly thank you. We're about to hit our seventh fiscal year, and if we didn't get great feedback from people like you, we would not keep doing this, so just thank you so much.

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