



Oppenheimer's Penn: 'Fairly Valued' BDCs

Friday, August 22, 2025



Chuck Jaffe, in this episode of The NAVigator podcast interviews Mitchel Penn, Managing Director of Equity Research for Oppenheimer & Co. Mitchel says that business-development companies are now "fairly valued" by the market, which means that their biggest potential gains for the remainder of the year will come from simply capturing dividend payouts. In 2026, with the industry likely facing interest rate cuts, BDCs will see their return on equity shrink in line with rate declines, saying that for every 1% cut in rates, BDC payouts would be expected to shrink in step. In an interview from AICA's BDC Forum in June, Penn noted that he was worried about a spike in credit losses that BDCs experienced in the first quarter of 2025; he said that pressure has passed, dramatically reducing his concerns about the potential for BDCs to disappoint investors.

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

CHUCK JAFFE: Mitchel Penn, managing director of equity research at Oppenheimer is here, we're talking about the state of business-development companies now on The NAVigator. Welcome to 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 is brought to you by the Active Investment Company Alliance, a unique industry organization representing the full spectrum of the closed-end fund business from investors and users to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator will point you in the right direction. And today we're looking in the direction of BDCs, and

we're doing it with Mitchel Penn, he is managing director of equity research at Oppenheimer & Co., and if you are looking for more information on the firm or on Mitchel, go to [Oppenheimer.com](https://www.oppenheimer.com). Now if you want to learn more generally about business-development companies, closed-end funds, and interval funds, check out [AICAlliance.org](https://www.aicalliance.org), that's the website for the Active Investment Company Alliance. Mitchel Penn, welcome back to The NAVigator.

MITCHEL PENN: Thanks, Chuck.

CHUCK JAFFE: We last spoke at the Active Investment Company Alliance's BDC Forum in New York in June, and at that point you mentioned that credit losses for BDCs for the first quarter of 2025 were more than double the level that they have been in the last couple of years, and while you couldn't be completely sure why that was happening, you had a couple of ideas. You said we might see what would happen moving forward, we might get a little more certainty and see whether we were starting a trend. So now we've got the second quarter numbers in the book, did the trend on losses continue, and what did it generally do to BDC performance in the second quarter?

MITCHEL PENN: So credit losses actually came back down to 112 basis points, they had been, as you mentioned, 246 in Q1, and the 112's more in line with the 100 basis points we expect to see on an annual basis. Just to give you a sense, so on a trailing five-year and four-year basis, credit losses averaged 81 basis points and 45 basis points, so what's interesting is credit came back down. I think first quarter was sort of a blip where a bunch of folks just took a lot of one-time items and just piled it into one quarter, so we're seeing the end of the last credit cycle that began around 2022 when the Fed began to raise rates and we sort of had a three-year seasoning of those loans and the losses really weren't that bad. Again, our four-year credit loss average is only 45 basis points, so anybody that got caught offside when the Fed started raising rates, the losses were not bad.

CHUCK JAFFE: We're now at a spot where we've gotten through at least the initial phase of tariffs, which we thought might have some impact, are we back to happy days are here again, smooth sailing? Or are we going to see significant changes when we wind up getting rate cuts, which we do expect but which seem to be priced in at this point?

MITCHEL PENN: That's a great question. So the way we think about BDCs right now is they're fairly valued at around book value, and our expected return on equity is around 10%, which

is in line with the core dividends, 11.8%, and if you added in the special and supplemental dividends that BDCs will sometimes pay, it's about 12.7%. And so we think most of the return you're going to see for the remainder of '25 is going to be in the dividend, and if BDCs struggle to cover the dividend, they have spillover income that can fund any earnings shortfall in '25. I think in '26 you bring up a really good point about the Fed, what happens if the Fed brings interest rates down, and the forward curve is forecasting about 130 basis points of rate decline. So for every 100 basis points of rate decline, the BDCs ROE will shrink by about 1% on average, and so if the average BDC is doing around nine or 10%, you might do eight or 9%, which isn't a big change. The thing to keep in mind is the risk-free rate is going down, so the equity discount rate that we use to value BDCs would also come down, so we don't think that the value of the BDCs will naturally change.

CHUCK JAFFE: We have been waiting as equity investors for a small cap rally, to see smaller companies, middle market companies, et cetera, wind up picking up. When it comes to the BDC market, how much do we think there will be pressure on any of these companies at some point that shows up because of tariffs? Because it was anticipated, but we really haven't seen it yet, the same way that a lot of things get anticipated by the market but don't necessarily show up.

MITCHEL PENN: Yeah.

CHUCK JAFFE: Is this trouble coming?

MITCHEL PENN: So when we talk to BDCs, the average BDC has about 5% direct exposure to tariffs, which is relatively minor, however indirectly if the economy slows, it could impact credit. One of the things that we've heard from folks who've dealt with tariffs, is that both parties, so if you're a supplier or if you're the consumer, they're going to share some of that tariff expense in the beginning, right? Nobody wants to ruin their business by making the consumer eat the entire tariff, and so my guess is they want to see how this plays out over time, so initially the tariff will be borne by the supplier and by the manufacturer, and then it'll ultimately switch over to the consumer over time. I think this is sort of a feeling out time with tariffs, so we don't expect this year to have a big impact from tariffs, we want to watch it next year. If it becomes a permanent tariff, then I think you'll see how it shakes out. And if you have a product that everybody wants and there's no substitutions, then you're going to get the consumer to pay for that tariff because they can't use a substitute and it's important

to them, and if your product has a lot of substitutes, then you as the manufacturer might bear the cost of the tariff because they have plenty of substitutes they can go with. It's a matter of who has the power, and we just have to see how that plays out over the next year or so.

CHUCK JAFFE: What will that do in terms of what you are buying and selling? How much would that create a change in turnover? Because investors in BDCs, and obviously that's what you do, don't tend to be high turnover investors necessarily, they're looking for situations that they believe are safe and going to deliver the return they're expecting, but they're not necessarily turning over the portfolio. Would you expect more portfolio turnover in a market where you see that kind of action?

MITCHEL PENN: No, I think because they only have 5% direct exposure, it's probably not going to have a lot of impact on a specific BDC. The indirect exposure if the economy slows, that may have more impact on specific BDCs that might take more risks. So for example, if a BDC has a large percent of their portfolio in sub-debt, equity, and preferreds, they tend to be a more risky security in the portfolio, so they have a riskier portfolio. In an economic downturn, if we did have a recession, those might suffer more than a company that does all first liens and has a higher quality portfolio. So that's where you could see some differentiation, but we don't anticipate a lot of people flipping out of BDCs into other BDCs. We only have eight buys out of the names we cover, and so we think those names are the ones that can weather a recession, they've weathered it in the past.

CHUCK JAFFE: The audience I think would be in an uproar if I didn't at least ask, is one of those names, one or two of those names, really the exemplar for why somebody, like if you're looking at a BDC, this is the poster child for why you're a BDC investor right now?

MITCHEL PENN: So TSLX, they have a terrific history of generating high returns on equity, their average ROE has been around 12-12.5%. We like Ares, they've done around 11%. We like Golub who's done around 9% ROE. We like OBDC, which is Blue Owl, they've done around nine or 10% ROEs. Those are the names that we would focus on, these are companies that have been around for a while and they've generated high returns on equity, and their stock price is around book. TSLX trades at a little more of a premium, but they generate a higher return, but the others trade around book, between 1-1.1 times book, those are the ones we look at.

CHUCK JAFFE: Mitchel, great stuff. Always appreciate the chance to chat with you, thanks so much for joining me again on The NAVigator.

MITCHEL PENN: Thank you.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe, and yeah, that's me, I'm Chuck Jaffe and I'd love it if you would check out my hour-long weekday show by going to [MoneyLifeShow.com](https://www.MoneyLifeShow.com) or by searching for it wherever you find your favorite podcasts. Now if you want to learn more about business-development companies, interval funds, and closed-end funds go to [AICAlliance.org](https://www.AICAlliance.org), that's the website for the Active Investment Company Alliance. Thanks to my guest Mitchel Penn, he's managing director of equity research at Oppenheimer & Co., you can learn more about the firm and its offerings at [Oppenheimer.com](https://www.Oppenheimer.com). The NAVigator podcast has something new for you every Friday, make sure you never miss an episode by subscribing or following along on your favorite podcast app, and if you liked this podcast, please leave a review and tell your friends, because that stuff helps. We'll be back next week with more closed-end fund fun, and until then, happy investing, everybody.

Recorded on August 22nd, 2025

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