SARATOGA INVESTMENT CORP.

Research Studies and Opinions

The BDC and Change in Ownership Financing

A Q&A

Christian L. Oberbeck
Chairman of the Board and CEO
Saratoga Investment Corp.

Question: Who should consider change of ownership financing?

Entrepreneurs who have founded companies and built them up who may have been "all in" for much of their careers, and they are looking at estate planning and asset diversification. They recognize at some point in time they are no longer going to be working as hard and as intensely as they are now. And so, they might look at change of ownership financing as a way to take some chips off the table, but still retain an interest. Or, they can do an outright sale. This is one class of people who are "prime targets" for BDC financing -- entrepreneurs in their 50s or 60s thinking about asset diversification.

Another perspective is that sometimes entrepreneurs take a company to a certain level, but they're not necessarily the best equipped to manage it at a much larger scale. So, they seek transition from an entrepreneurial company to a more corporate culture, which has a more institutional type of managerial structure.

Question: To be able to provide equity to the new professional management team?

That's another reason. In change of ownership financing, a recapitalization, a change of ownership occurs but many of the equity holders stay in, certain new and existing managers may be brought into the equity. Then there is a change of ownership that is an outright sale where new and existing managers may also be brought into the equity. There are reasons for both.

Question: What is the typical process for change of ownership?

Usually entrepreneurs are represented by an investment banking firm that runs a competitive process, if it's a change of control, to identify a reasonable number of parties to compete for the best value and, importantly, the right ownership fit.

Question: Where does one find the capital for financing?

Equity capital might come from private equity funds, from wealthy individuals or from independent sponsors. In terms of debt capital, the mezzanine and first and second lien debt might come from BDCs. There are also mezzanine funds, and then the senior capital might come from BDCs or conventional banking institutions who supply senior debt capital.

Question: What does the BDC bring that a bank might not?

A BDC can lend deeper into the capital structure than a bank. Banks are regulated, and their loans have to conform to regulatory elements such as covenants, maximum leverage and collateral coverage. A BDC isn't as constrained by such regulations. A bank takes depositor money. A BDC manages investor money. It's a different class of entity and regulation.

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