Solar Capital Ltd. Issues Letter to Stakeholders

April 1, 2020

NEW YORK, April 01, 2020 (GLOBE NEWSWIRE) -- Solar Capital Ltd. (NASDAQ: SLRC) (the “Company” or “Solar Capital”) announces today that it issued an open letter to its stakeholders regarding a business update amid the coronavirus (“COVID-19”) pandemic.

The full text of the letter follows:

April 1, 2020

Dear Valued Stakeholder,

We hope you and your family, friends, and colleagues remain healthy and safe during this pandemic. Our thoughts are with all of our stakeholders, including our portfolio company owners and employees, sponsors, investors, lenders, rating agencies, advisors, vendors, and the dedicated employees across Solar Capital and the Company’s investment advisor, Solar Capital Partners, LLC (“SCP”), who are working from home with full business continuity.

During this time of uncertainty, we want to keep the communication channels open and provide the highest possible transparency with our stakeholders. While we are early in the process of understanding the full, potential impact that the COVID-19 pandemic may have on our business, we are providing this update to reassure our stakeholders that we believe Solar Capital is well-positioned to weather this storm.

Our management philosophy has been defined by our commitment to invest as principals, creating a meaningful economic alignment with our fellow investors. As the result of our significant SLRC share purchases since inception, and including recent purchases by all of our executive officers, our senior management team now owns approximately 7% of our outstanding common stock. Additionally, all members of the investment team have a significant percentage of their annual compensation invested in SLRC stock, many of whom have also purchased SLRC shares this year. We believe our significant ownership creates a critical alignment with our stakeholders. Moreover, our management team’s recent share purchases in the face of this crisis demonstrate the team’s confidence in the Company’s defensive portfolio, stable funding, strong liquidity, and favorable positioning to make new investments.

During the past few years of frothy market conditions, the “easy” path would have been to aggressively grow our portfolio through higher risk investments, and in so doing incur increased portfolio leverage. As the saying goes, “A rising tide lifts all boats.” Instead, given our focus on long-term value creation, we maintained our underwriting and investment discipline. While no one could have predicted that this record-long economic expansion would end so abruptly and catastrophically, we have proactively managed our business to position us for an inevitable downturn.

Specifically, we undertook a multi-year initiative to build and acquire niche specialty finance and asset-based lending (“ABL”) businesses, which have historically exhibited lower default and loss rates throughout business cycles compared to more traditional cash flow lending. We also migrated the Company’s portfolio to predominantly first lien senior secured loans. In both our cash flow and specialty finance businesses we have remained patient and intentionally under-levered in order to preserve liquidity for a potential market dislocation when risk-adjusted returns are generally more attractive. Additionally, we have approached our funding profile and liquidity with the same conservatism, including transitioning a significant portion of our liabilities to unsecured fixed rate term debt.

Unfortunately, due to the current circumstances that are taking a horrific toll not only on our economy but on human life as well, the tide has gone out. While we expect to have stress in our portfolio given the sheer magnitude of the disruption, we feel confident in Solar Capital’s future. We have spent the past decade preparing the Company to successfully navigate through rough waters such as the current environment. Below, we provide an update on our business and how it has benefited from these efforts.

Significant Liquidity

Credit Facilities and Available Capital

In February 2020, Solar Capital secured an additional $75 million commitment to the Company’s primary credit facility, bringing total commitments to $620 million. As of March 27, 2020, due to positive net portfolio repayments experienced during the first quarter, the Company had no borrowings under its $545 million and $50 million revolving credit facilities and had approximately $60 million of cash on hand. Currently, our borrowing base far exceeds our revolving credit facilities, which provides us with full access to this capital, bringing our total available capital to over $650 million.

Unfunded Commitments

As of March 27, 2020, Solar Capital had unfunded commitments of approximately $126 million, which included $44 million designated as potential growth capital to Crystal Financial, a portfolio company that the Company controls. The other unfunded commitments largely consist of contingent delayed draw term loan commitments related mostly to add-on acquisition financing in our cash flow lending business, as well as incremental financing commitments to life science companies tied to capital or operating thresholds or benchmarks, totalling $70 million. Delayed draw term commitments are also typically subject to leverage covenants that prevent portfolio companies from calling additional debt without a viable and oftentimes preconditioned business purpose. Importantly, at this point, less than $12 million of the Company's $126 million of unfunded commitments are for revolvers that can be fully drawn by the borrowers. As a result, aggregate unconditioned funding commitments represent less than $12 million of our $650+ million of available capital today.

Payment-in-Kind (PIK) Interest

As of December 31, 2019, we had only one loan with a PIK component to its interest rate. Cash interest and dividends represented over 99% of our Q4 2019 gross investment income.

Today, Solar Capital has the most available capital in its history. The Company has substantial liquidity to continue supporting existing portfolio companies, opportunistically make new investments, and fund quarterly distributions to its shareholders.

Strong Balance Sheet

Investment Grade Ratings and Diverse, Longstanding Lender Group

Solar Capital is currently rated investment grade by Moody's Investors Service and Fitch Ratings, which provides the Company with access to the investment grade term note markets. Across both its unsecured and secured lending facilities, the Company has longstanding relationships with a strong and diversified group of lending partners.

Leverage

Since inception, Solar Capital has taken a conservative approach to leverage and has consistently operated well below its stated target range. On December 31, 2019, the Company's net leverage was 0.64x relative to our target range of 0.9x to 1.25x and significantly below the regulatory limit of 2:1 total debt-to-equity. As of March 27, 2020, the Company's estimated leverage is 0.51x net debt to equity, based on quarter-to-date portfolio activity and assuming no change to Solar Capital's December 31, 2019 net asset value. Solar Capital's low leverage provides a significant cushion to covenant levels and the regulatory limit of 2:1 total debt-to-equity.

Unsecured Debt

As of March 27, 2020, Solar Capital had $446 million of fixed rate unsecured notes including the issuance in December 2019 of $200 million of unsecured notes, consisting of $125 million of five-year notes and $75 million of seven-year notes. At March 27, 2020, approximately 86% of the Company's funded debt was comprised of unsecured term notes, which gives the Company significant unencumbered assets and provides meaningful overcollateralization of its combined $670 million secured credit facilities whose revolvers are undrawn as of today.

Long-dated Financing

The Company has no near-term debt maturities, having termed out its primary credit facility to 2024. In addition, it has staggered maturities of its unsecured fixed rate notes from 2022 through 2026, with a weighted average maturity of mid-2023. With a weighted average maturity on the funded portfolio loans of May 2023, the Company's assets and liabilities are essentially matched. Importantly, we believe that these weighted average maturities, over two years from now, provide Solar Capital with runway to manage through the current economic contraction.

As a result of these liability management efforts, we believe that the Company has entered this period of dislocation with its strongest balance sheet in history.

Defensively Positioned Portfolio

Asset Class Composition

Solar Capital's portfolio has benefited greatly from SCP's strategic initiative to expand its origination platform through the development and acquisition of specialty finance businesses. As of December 31, 2019, only 25% of our Comprehensive Investment Portfolio[1] exposure was in senior secured cash flow loans with the remaining 75% in our senior secured asset-based, equipment finance, and life science lending strategies.

The significant influx of private capital to senior secured cash flow lending to sponsor-owned companies over the past few years resulted in a highly competitive lending environment characterized by record levels of leverage, EBITDA (earnings before interest, taxes, depreciation, and amortization) add-backs, and loose covenant structures. We allowed the Company's exposure to cash flow loans to shrink as a percentage of its total portfolio given the elevated risk and terms that did not meet our strict underwriting criteria. In prior economic downturns, asset-based loans collateralized with significant borrowing bases and financial covenants generally provided higher recovery rates than those supported only by cash flows with few or no maintenance covenants.

We believe our non-traditional ABL platform through Crystal Financial adds an element of counter-cyclicality to our portfolio, as their business model of financing companies in transition has historically seen an elevated opportunity set during market dislocations.

First Lien Senior Secured Weighting

As of December 31, 2019, our Comprehensive Investment Portfolio was invested 98.6% in senior secured loans. Specifically, 90.7% was in first lien senior secured loans, 4.8% was in second lien senior secured cash flow loans, 3.1% was in second lien senior secured asset-based loans, and less than 1.4% was in equities. During Q1 2020, our second lien cash flow portfolio was further reduced through a loan repayment at par. In addition to being highly selective in our cash flow loan originations, we have let our higher risk second lien cash flow loan portfolio roll off and have not made any new second lien cash flow loan investments in over four years. The first lien security position of the vast majority of our investments should result in less time devoted to workout situations, providing our investment team with greater capacity for deploying our significant available capital into new, opportunistic investments with appropriate risk-adjusted return profiles.

Industry and Issuer Diversification

As of December 31, 2019, our $1.8 billion Comprehensive Investment Portfolio consisted of over 200 issuers across approximately 90 industries. The portfolio is highly diversified, with an average exposure per issuer of approximately $8 million, based on fair value as of December 31, 2019. Our largest industry exposures were health care providers & services (10.8%), banking & finance ABL (8.5%), retail ABL (7.4%), pharmaceuticals (7.1%), health care equipment & supplies (6.1%), multi-sector holdings (3.9%), and software (3.4%). During Q1 2020, our exposure to retail ABL declined with the full repayment of a loan in this sector. Our cash flow loan exposure direct to oil & gas, other commodity-oriented verticals, travel, leisure, and consumer discretionary industries, remains de minimis, as we have avoided cyclical sectors.

Fundamental Strength

Our investment philosophy has been to invest as if we are late in the credit cycle. The fundamentals across our portfolio at year-end 2019 were healthy with only one loan on non-accrual, representing 1.6% of Solar Capital's portfolio at cost. The weighted average leverage of our first lien cash flow investments was 4.9x net debt to EBITDA and the weighted average EBITDA of our issuers was $65 million at 2019 year-end. We continue to believe upper middle market companies generally have greater scale, access to capital, and are better resourced to navigate a downturn.

From our vantage point, the majority of our portfolio companies entered the current crisis on solid footing, which should help them manage the challenges ahead. The SCP investment team has an open, constructive dialogue with the owners and management teams of our portfolio companies as we continue to assess their financial status, liquidity needs, and business prospects.

The severity and duration of the economic contraction is expected to impact companies whose loans are held in private credit portfolios and we will not be immune. However, while it is still too early to know the extent of the stress, we believe we are well positioned to deliver shareholder value. In addition, the $2 trillion economic stimulus package recently passed by Congress and signed into law by the President is designed to provide financial assistance to small businesses. We expect this assistance to reach many of the businesses to which we provide financing.

Solar Capital entered this downturn with what we believe to be a defensively positioned, high quality portfolio constructed in anticipation of a market disruption.

Consistent Approach to Valuation
Since inception, Solar Capital has been conservative in its valuation process and will maintain the same rigorous approach to determining fair market value through this market disruption.

It is important to remember that Solar Capital is not simply a portfolio of leveraged middle market loans. Relative to most of our business development company peers, we are a unique combination of 75% specialty finance loans and 25% senior secured cash flow loans. Our valuation process is a combination of a bottoms-up fundamental credit analysis with a top-down overlay based on technical metrics from our principal credit markets for our cash flow loans and valuations of specialty finance companies for our commercial finance businesses. Historically, our cash flow assets and values have been less correlated with the broadly syndicated loan market given our exposure to more defensive industries, the absence of cyclicals, and higher quality credit metrics including weighted average leverage as well as tighter covenant structures. Importantly, since inception, our quarter-end valuations have generally been at or lower than our subsequent realized values.

Leveraging the Solar Capital Partners Diversified Commercial Finance Platform
We believe our team's expertise and ability to provide financing across cash flow and traditional and non-traditional ABL solutions should enable Solar Capital to continue to support its existing portfolio companies and opportunistically make new investments during this period of turmoil. Our ABL team is highly experienced in working with companies under financial stress including asset liquidations and bankruptcies. Crystal Financial's model of originating asset-based loans for companies in transition has historically thrived during industry specific and previous economic downturns. Additionally, our senior cash flow loan investment professionals have significant private equity experience and have managed credit portfolios through several economic cycles.

Low Sensitivity to Changes in Interest Rates
The recent, significant reduction of short-term interest rates engineered by the Federal Reserve to stabilize the U.S. financial system should have a muted impact on the earnings power of the Company's portfolio. Approximately 75% of the Company's total portfolio is floating rate based, of which 78% of these loans have a LIBOR floor, with a weighted average floor of 1.1%. The 25% of the portfolio with fixed rate loans are primarily equipment financings. Today, Solar Capital has $446 million of fixed rate term debt, and its $620 million primary floating rate credit facility, as well as the $50 million floating rate credit facility, do not have LIBOR floors. As of March 27, 2020, 14% of our funded liabilities were floating rate with no LIBOR floor. Therefore, at the current time, we expect the Company's net interest rate margin for Q1 2020, in accordance with the contractual interest rates on our loans, to decline by approximately 40 basis points, which compares favorably to an 82 basis point drop in LIBOR.

Scale across the Solar Capital Partners Platform Will Benefit Solar Capital
As a result of recent fundraising, the SCP platform has over $6.5 billion of investable capital including potential leverage, with over $3 billion available to make new investments. SCP's private funds maintain a co-investment strategy with Solar Capital, which provides the Company access to attractive co-investment opportunities in upper middle market companies that it otherwise would not have with its capital base alone. Now more than ever, SCP's scale should serve as a competitive advantage for Solar Capital.

Importantly for Solar Capital, this scale and flexibility to finance cash flow and asset-based solutions for larger companies ($100 million - $300 million EBITDA) is a significant advantage today.

Positioned to Be Opportunistic
Traditionally, the greatest investment opportunities exist during periods of market dislocation, when capital is scarce. With over $650 million of available capital and a strong foundation given our current high-quality portfolio and low leverage, we believe the Company is positioned to originate attractive new investment opportunities while also supporting our existing portfolio companies as needed. Our patience and willingness to remain underinvested provides us the foundation to be opportunistic.

In conclusion, the team is confident in Solar Capital's currently defensively positioned portfolio, stable funding sources, strong liquidity, and potential to capitalize on new opportunistic investments.

We hope that all of you are in good health, and we would like to thank the unsung heroes in the health care profession and the essential service workers on the front lines of this crisis.

Kind regards,

Michael Gross & Bruce Spohler, Co-Chief Executive Officers
& the entire Solar Capital Team

About Solar Capital Ltd.

Solar Capital Ltd. is a closed-end investment company that has elected to be treated as a business development company under the Investment Company Act of 1940. A specialty finance company with expertise in several niche markets, the Company primarily invests in leveraged, U. S. middle market companies in the form of senior secured cash flow and asset-based investments.

Forward-Looking Statements

Statements included herein may constitute "forward-looking statements," which relate to future events or our future performance or financial condition. These statements are not guarantees of future performance, conditions or results and involve a number of risks and uncertainties, including the impact of COVID-19 and related changes in base interest rates and significant market volatility on our business, our portfolio companies, our industry and the global economy. Actual results may differ materially from those in the forward-looking statements as a result of a number of factors, including those described from time to time in our filings with The Securities and Exchange Commission. Solar Capital Ltd. undertakes no duty to update any forward-looking statements made herein, unless required to do so by applicable law.

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[1] The Comprehensive Investment Portfolio is comprised of Solar Capital Ltd.'s investment portfolio, Crystal Financial's ("Crystal") full portfolio and NEF Holdings, LLC's ("NEF") full portfolio, and excludes the fair value of the equity interests in Crystal and NEF.

Source: Solar Capital Ltd.