SARATOGA INVESTMENT CORP.

Research Studies and Opinions

Why Work With Saratoga Investment Corp.?

A Q&A

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Question: Why should a smaller middle-market company work with Saratoga Investment Corp.?

We are a value-added partner, not just a deal-maker. Yes, we lend money. But, we also offer our extensive experience in how to get a deal done the right way on the front end, as well as help in managing a business along the way. If a company has opportunities or problems down the road, it wants somebody with experience and depth of permanent capital. We play for the long game, not the short-term. We're long-term thinkers, creative financiers and problem solvers.

For example, we can help you do an acquisition. We have a portfolio company right now with an owner who was considering selling the company, or bringing in a substantial private equity investor, or doing an acquisition. He was trying to sort through all that, and whether he wanted to take out a personal dividend.

Ultimately, we signed a term sheet enabling him to sell a little bit of equity to us, borrow a substantial sum of money from us, take out a $6 million dividend and complete the acquisition. The deal we negotiated with him means he'll have it all. We allowed him to do that rather than bringing in a minority equity partner, which would have diluted his stake enormously. Before he talked to us, he wasn't sure he was ready to do the deal, and he was considering selling out completely. We said, "Look. If you sell your company now it's worth X. Do this deal, merge the two businesses, and when you sell your company down the road, you could be talking about 3-5x." The partnership we formed together allowed him to think through the alternatives and make right choices that will be immensely profitable for him.

Executives in smaller businesses often don't have experience in capital markets. They started a business, built from the ground up, and they have become successful. They don't have the experience necessary to have a breadth of understanding about capital markets, business valuation and financial engineering.

Question: Are you are saying that Saratoga Investment Corp. not only supplies capital, but strategy, as well?

Yes.

Question: You were talking about the owner. Would that also be true for a CFO in a smaller middle-market company?

Yes, it is true for the CFO as well. Sometimes smaller middle-market businesses have CFOs who have had little experience with capital markets. For some smaller companies, the CEO acts as CFO and the CFO is more of a controller. In that situation, we can add a lot of value, and help the CEO who is often so busy that he doesn't have the time to think of his business as analytically as an experienced CFO would.

In other words, in the smaller middle-market, we often find executives who are forced to move from the operational world to the corporate financial world, and the transition is a big one.

We're working with a company in the oil field service industry. They never really borrowed any money. They built their business on cash flow. They never had to spend a lot of time with corporate finance and the underlying analytics for their business, and so they have a big project to improve their systems, reporting and move to more data-driven decision making in order to be able to borrow significant amounts.

There is another company in the cosmetics business with a small asset-based loan. They've never had to deal with a cash-flow lender. They've been able to grow through well-designed products, and they've been successful. But, if they had a little more of a corporate financial perspective, they might have grown faster, bigger, better and more profitably. With a more sophisticated approach to corporate finance, they might have gotten to or past where they are now, but much sooner.

Question: Isn't it true that, as an equity investor with companies, there is an alignment of interest? Saratoga Investment is not a bank, where the dominant thinking is liquidation value.

That's a good point. In most of our deals we are an investor in equity, as well as debt so we're a partner with management and ownership.

Question: Spell that out, please?

Generally speaking, if we make a loan to a company of X dollars, we will invest in equity along the order of 10% of X. So we're not a controlling equity investor. But, we're looking for equity upside. We invest in a company where we think the equity is going to be worth more. A bank in this market generally looks at assets, a borrowing-base of accounts receivable, inventory, equipment. Ours is a totally different way of thinking.

Question: The reason you do it is that when you decide to lend money to a company, you have concluded that its business is good, and has great potential, and you want to share in the equity appreciation?

Yes. However, it's also part of the partnership with the company. By investing in equity, you're saying that you believe in them, and that deepens the relationship

We might also get board observer rights, because sometimes the debt we provide may have some equity risk. A bank might lend you money against assets. If something goes wrong, they can liquidate the company and pay back the debt. But we make loans where you can't liquidate that way. Our loans are business-value loans. We make cash-flow loans based on enterprise value. So, we're aligned with maintaining and improving the enterprise value, because that maintains and improves our credit. So how a company is managed, its growth prospects, all of the operational aspects are important to us because that is how we get paid back.

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