SOUTHLAND CAPITAL MANAGEMENT

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HEADLINE NEWS

Wishing all a Happy Holiday Season with Best Wishes for a Healthy and Happy New Year!

BDC DIVIDEND REPORT CARD

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All the dividend announcements are in from the 21 Business Development Companies ("BDCs") for the third quarter of 2009, and we're reassured after several quarters of deteriorating pay-outs. ***16 BDCs left their dividends unchanged from the prior quarter, and 5 increased the dividend. There were no dividend decreases or new dividend suspensions.***

Still, there are 4 BDCs whose dividends are suspended (including American Capital which paid out a Special Tax distribution in the quarter). The number would have been five if we included Patriot Capital, which was acquired by Prospect Capital on December 2 2009 (and which also paid out a Special Distribution in the fourth quarter). The good news, though, is that when Allied Capital gets acquired by Ares Capital (ARCC) early in 2010, the number of BDCs not paying out a distribution will be down to 3. Moreover, MCG Capital (MCGC) has been hinting that it will resume distributions in 2010. If that should happen, we'll be tracking 20 BDCs, and 18 will be paying a regular dividend.

Looking into the fourth quarter of 2009, 12 BDCs have already reported their pay-out. 8 have kept their distributions unchanged from the third quarter, and 4 have upped the pay-out. However, one of the four is GSC Investment (GNV) which is making a Special Distribution, but otherwise has suspended regular distributions. On the plus side, we were impressed with BlackRock Kelso (BKCC) which doubled its distribution to $0.32 from $0.16. The Company had reduced the distribution earlier in the year to conserve capital, but was able to resume its pay-out at a level more in line with its earnings.

We project the fourth quarter, when all the results are in, should look like the third quarter with 5 companies increasing the dividend and 16 unchanged. However, the jury is still out on what will happen with Kohlberg Capital (KCAP) which is in dispute with its lenders, and with the energy specialized BDCs whose earnings are bouncing around with commodity prices.

In aggregate terms, the BDC industry paid out $4.47 in distributions in the third quarter of 2009 (excluding the Special Distribution by American Capital). This is slightly higher than the $4.41 registered in the IIQ of 2009, which suggests the BDC industry has stabilized. Still, the IIIQ 2009 results are 45% down from the same quarter a year ago. Looking forward, we expect the IV Q of 2009 will increase to $4.62, a 3% increase over the third quarter, but 32% down from the IVQ of 2008.

We'd sum it up this way: the BDC industry's dividend paying capacity peaked in the IQ of 2008, dropped in every subsequent quarter until the IIIQ of 2009 (that's 5 quarters of decline). Now, distributions have leveled out and are slowly growing back. We're impressed that most of the BDCs managed to maintain paying a regular dividend through the worst recession since the Great Depression. To quantify, a maximum of 4 of the 21 BDCs we track (5 out of 22 if PCAP is included) suspended their dividends, but 17 BDCs managed to continue making quarterly distributions. ***Even more impressive, 6 BDCs maintained or even increased their dividends during the recession.***

KNOW WHEN TO FOLD 'EM…

In another article in this Newsletter, we're reporting how the BDC Industry's dividend paying bottomed out in the IIIQ of 2009, and is projected to increase in the fourth quarter. All of that notwithstanding, our job is to be vigilant at all times, and we would rather be safe than sorry. In the last month our constant reading and re-reading of Earnings Reports, 10-Qs, SEC filings and Message Boards (very dysfunctional but we do get occasional ideas), has caused us to become skeptical about the prospects of three companies on our Buy List. If the last recession has taught us anything (and we learned more than we care to admit) is to "shoot first and ask questions later". Or put another way, we aim to sell off any position should we have doubts about the ability of the company to maintain its dividend.

We sold out of a closed-end bond fund which specializes in high yield bonds when the latest earnings report showed there was a serious disconnect between the dividend being paid and its earnings. With a buoyant stock price we were able to sell our position at a gain. We also sold out of a specialty BDC when we became concerned that increasing problem investments might cause a dividend cut down the road, even though the company in question has no liquidity problems. Again, we feel we may be ahead of the curve, and sold out at a profit. We also sold out a BDC which specializes in lower middle market buy-outs because we began to question the commitment of its lenders to renewing its Revolving Line of Credit on expiration in 2010. We incurred a very modest Realized Loss, more than offset by our two Realized Gains. In all these cases, we'd prefer to sit on the sidelines and wait for the next round of quarterly financial disclosures before-re-evaluating what we will or won't buy.

As this is the Holiday edition of the Newsletter we should end with some good cheer. We're happy to point out that we added two new companies to our Buy List in the last 30 days. Both companies faced liquidity challenges earlier in 2009, but have managed to turn matters round by de-leveraging their balance sheets, and shifting their loan portfolios into more diversified, lower risk investments.

PROSPECT CAPITAL CLOSES ACQUISITION OF PATRIOT CAPITAL

As previously reported in our Headline News, ***Prospect Capital Corporation announced on December 2, that it had completed the acquisition of Patriot Capital Funding, Inc.*** whereby Patriot merged with and into Prospect. Immediately prior to the consummation of the Merger, Patriot paid a final distribution to its shareholders in an amount equal to its undistributed net ordinary income and capital gains through December 2, 2009, pursuant to the terms of the Merger Agreement. The amount of the final dividend was $0.38 per share and was paid 10% in cash and 90% in newly issued shares of Patriot common stock. The total cash distributed was $821,000 and an additional 1,862,862 shares of Patriot common stock were issued. The shares of Patriot common stock issued in connection with the final distribution were converted into shares of Prospect common stock in accordance with the terms of the Merger Agreement. "We are delighted to close this acquisition for mutual benefit of Prospect and Patriot shareholders," said Grier Eliasek, President and Chief Operating Officer of Prospect. "As previously disclosed, we have an active pipeline of new originations as well as other potential portfolio acquisitions, including a sizeable portfolio under negotiation about which we hope to disclose more details in the weeks to come."

NEWSLETTER

Keeping investors and prospective investors updated on the activities of Southland Capital Management and BDC Fund II

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