

# SOUTHLAND CAPITAL MANAGEMENT, LLC

Month	BDC Fund II*	S&P 500 TR	Nasdaq Comp	Dow Jones	Russell 2000 (DRI)
October - 2009	-10.05%	- 1.86%	- 3.64%	0.00%	- 6.79%
November - 2009	7.45%	6.00%	4.86%	6.51%	3.14%
December - 2009	7.95%	1.93%	5.81%	0.80%	8.05%
January - 2010	- 0.71%	- 3.60%	-5.37%	- 3.46%	- 3.68%
February - 2010	9.21%	3.10%	4.23%	2.56%	4.50%
<b>Inception to Date</b>	<b>13.16%</b>	<b>5.39%</b>	<b>5.46%</b>	<b>6.31%</b>	<b>4.56%</b>

\* Performance shown is net of all fees & expenses including management & performance fees. Past performance is not necessarily indicative of future performance. This material does not constitute an offer to sell (nor the solicitation of an offer to buy) interests in BDC Fund II, LP (the "Fund"). Offering is made by Private Placement Memorandum from a Principal only.

## CONTENTS

### PAGE I

#### FEBRUARY RESULTS.

The Fund experienced record breaking results in February 2010.

#### FEDERAL RESERVE KEEPS RATES LOW

#### MERGER ACTIVITY PICKS UP

#### BDCs CONTINUE RAISING NEW EQUITY

PNNT 8th BDC to raise new equity.

### Page 2

#### DIVIDEND ROUND - UP

Here we review 9 BDCs who have announced dividends.

#### A WORD ON HTGC

Management's strict view on paying out dividends.

#### ARES & ALLIED

Aries acquisition of Allied Capital almost complete?

## FEBRUARY 2010 RESULTS

*We had a record breaking month in February: up 9.21%.* We hear from PartnersAdmin, who tracks the broader market and generates these return tables independently, that we handily beat all the indices we compare ourselves against for the month. Even though it's mentioned in small print in the Table above, we want to remind everyone that *the returns given are net of all expenses and SCM's fees.*

Of course, we don't want to make too much out of one month's results. More telling is that the cumulative gain from inception of the Fund five months ago is 13.16%. To put that into perspective that return is twice the increase in the Dow Jones Index over the same period, which was the best performer of the 4 indices we are compared against.

March has started well at time of writing, with most of the portfolio stock prices up over the end of February and the results will benefit from numerous dividend distributions scheduled for the month. We don't expect March to match February's record breaking performance. There may even be a market correction. However, we remain comfortable with the overall market environment, which is pointing towards stable or higher dividends and an improvement in earnings, bad debts and capital availability.

## FED KEEPS RATES LOW

The Federal Reserve has decided to hold interest rates at a record low and pledged

to keep them there for an "extended period" to nurture the economic recovery and lower high unemployment. Just a few days ago, three top central bank officials said "a soft economic recovery marked by high unemployment and tame inflation should allow the U.S. Federal Reserve to keep interest rates low for a long time".

For the Fund, this implies that we will continue to benefit from very low borrowing rates on margin debt for at least 6 months, and maybe twelve months. How low is low? *The Fund has been borrowing at a rate under 1.2%. Given that the yield on the BDC assets we invest in are in excess of 11%, the net margin between income and interest expense is above 10%.*

## MERGER ACTIVITY PICKS UP

The stock market has had a few winning days on signs that companies are becoming more optimistic about the economy. More merger activity brought reassurance that business leaders expect the recovery to continue.

## BDCs CONTINUE RAISING NEW EQUITY

By our count, *PennantPark Investment Corporation (PNNT) is the eighth Business Development Company (BDC) in recent months to raise new equity.* PennantPark on March 3, 2010 announced that it has entered into an agreement to sell 5,000,000 shares of common stock at a public offering price of

\$10.00 per share, raising approximately \$50,000,000 in gross proceeds.

A few days before, American Capital raised additional equity at a price below NAV, despite having suspended dividend payments for the last twelve months.

### DIVIDEND ROUND UP

With two months of the year gone, it's time for our monthly review of BDC announcements. There are 21 companies we track, and of those **9 have announced first quarter 2010 dividends. As expected, the news to date is encouraging: 2 companies raised their dividend (Fifth Street Finance by 11%), 6 were unchanged and just 1 reduced its payout.** In addition Allied Capital shareholders are promised a Special Distribution in the next few weeks if they vote for their pending merger with Ares Capital.

Last year's first quarter was the worst for dividend reductions in the BDC industry's history: 9 companies cut their distributions. By contrast we expect total reductions this quarter once all the companies have reported to be somewhere between 1 and 3 companies, and we expect more companies to increase their dividends than the 2 announced to date.

DIVIDEND	SCORECARD
INCREASED	2
UNCHANGED	6
DECREASED	1

### A WORD ON HERCULES TECHNOLOGY (HTGC)

Hercules Technology - a BDC which specializes in lending into the life sciences area, is the only BDC to date to cut its distribution in 2010. The divvy was reduced from \$0.30 in the IVQ of 2009 to \$0.20 in the IQ of 2010. We knew that management had announced a strict policy of only paying out in dividends what the Company earned in taxable income but we were surprised by the reduction. However, after reviewing the 10-K, the Earnings Report and listening to the Conference Call, we came to the conclusion that the distribution cut resulted from HTGC's conservative lending posture in a still

difficult economic environment. What's more we were convinced that earnings would bounce back later in the year as the Company's considerable backlog of new deals hits the books. Finally, we remain satisfied with the Company's substantial liquidity available in the form of cash, SBIC borrowing capacity and two untapped Revolvers from commercial banking lenders. At first the stock price swooned, but the Fund bought more to dollar cost average down its positions. In recent days the market seems to agree with our assessment as the stock price has bounced back to pre-dividend announcement levels.

### Ares Capital Acquisition of Allied Capital: Almost Done

It's coming down to the short strokes in the acquisition of Allied Capital (once the second largest BDC) by Ares Capital. In the first week of March we had a joint Conference Call of the senior managers of Ares and Allied detailing the very obvious benefits of a merger of the two companies. At the same time a sweetener was offered the shareholders of Allied Capital if they voted for the acquisition: a \$0.20 per share Special Dividend payable in cash on the day the deal is consummated. It's a shameless ploy but it will probably play in Peoria.

We hope this is not a jinx, but the merger should close by the end of March. We've been big supporters of Ares in recent months and have been buying regularly. We calculate that even if the Allied deal does not go through Ares will earn a \$15mn break - up fee and will still be sitting with low leverage, high liquidity and very few bad debts. If the deal does close, Ares Capital will become the market leading BDC. Sadly, Allied Capital will disappear, and our universe of BDCs tracked will drop to 20. Thankfully there's talk of new BDC IPOs waiting in the wings. Plus there is KKR, the original private equity behemoth, talking about getting a U.S. stock market listing and announcing a dividend. If that should happen and the yield meets our minimum criteria we may be adding KKR to our non-BDC tracking list.

*We continue writing extensively on the BDC industry on BDC Reporter and Seeking Alpha.*

## NEWSLETTER

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

Office:

1221 Ocean Blvd., Suite 208

Santa Monica CA 90401

**Nicholas Marshi**

Chief Investment Officer

Contact: 310-395-8174

Email:

[nmarshi@southlandcapitalmanagement.com](mailto:nmarshi@southlandcapitalmanagement.com)

**Bill Hansen**

Chief Marketing Officer

Contact: 760-485-1252

Email:

[bhansen@southlandcapitalmanagement.com](mailto:bhansen@southlandcapitalmanagement.com)

Visit us @

[www.southlandcapitalmanagement.com](http://www.southlandcapitalmanagement.com)

Accredited Investors: Please contact us for login information.

Follow our Blog @

[www.bdcreporter.wordpress.com](http://www.bdcreporter.wordpress.com)

Follow our articles @

[www.seekingalpha.com/author/nicholas-marshi](http://www.seekingalpha.com/author/nicholas-marshi)