


**SCM**
**SOUTHLAND**  
 Capital Management LLC

Month	BDC Fund II*	S&P 500 TR	Nasdaq Comp	Dow Jones	Russell 2000 (DRI)
FYE — 2009	4.37%	5.49%	6.91%	7.37%	3.49%
FYE — 2010	73.04%	15.07%	16.91%	11.02%	26.85%
FYE — 2011	-46.38%	2.11%	-1.80%	5.53%	-4.18%
January - 2012	14.08%	4.48%	8.01%	3.4%	7.07%
Year to Date	14.08%	4.48%	8.01%	3.40%	7.07%
Inception to Date	10.48%	30.18%	32.58%	30.06%	35.18%

\* Fund's inception was October 1, 2009. 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.

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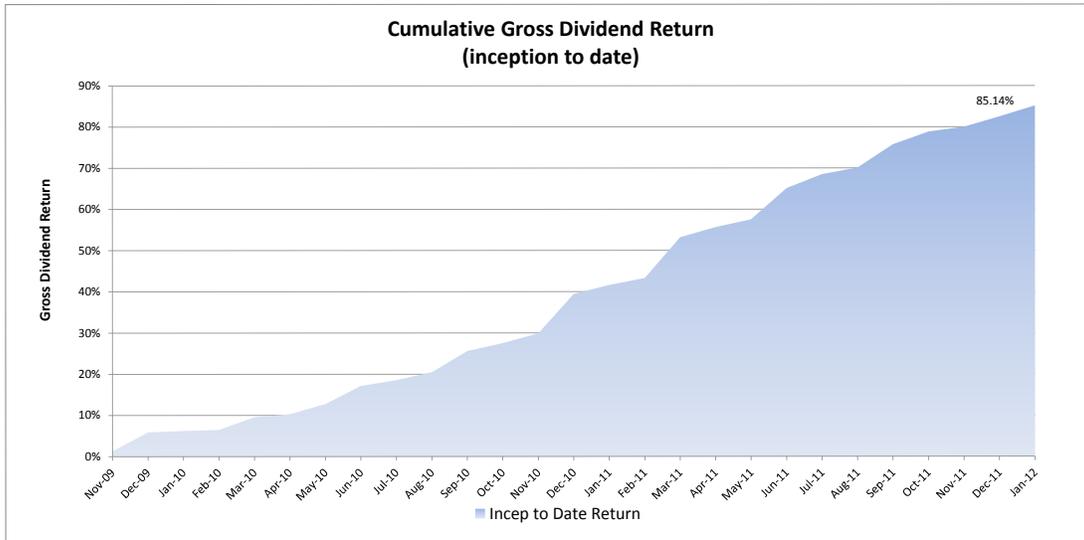
## JANUARY 2012 RESULTS

January 2012 was an excellent start to the year for BDC II: up 14.08% for the month. The Fund was ahead of all the indices we compare ourselves to. The closest index was the NASDAQ, which was up 8.01%, and the laggard was the Dow Jones up 3.4%. We should also note that we've been informally tracking the Fund's performance against the only BDC Exchange Traded Fund (ticker: BDCS), which is based on a Wells Fargo index of sector performance. In January 2012, the BDCS was up 6.3%. Our own Buy List of 19 companies was up 6.4%. The average "hedge fund" according to a news report was up 2.65%. The Fund's outsized return for January compared to all the above can be attributed to our use of leverage, which averaged 200% during the period.

Skipping to inception to date returns, the Fund is up 10.48% after 28 months from its launch. The return is only a third of the other indices, which range from 30.06% (the Dow Jones index) to 35.18% (the Russell 2000, with dividends reinvested). The Fund's returns lag due to the impact of the May-November 2011 decline and the negative impact of leverage that amplifies losses. In the absence of a BDC index that covers the entire period, we compared the Fund's result to the performance of the Financial Sector ETF (ticker XLF), which was down 6.5% for the 28 month period, according to data on Yahoo Finance.

## CASH ON CASH RETURN

Two years and 4 months after inception, **the Gross Dividend Return reached 85.1%**. To remind any new readers, the Gross Dividend Return tracks the total dividends received by an investor in the Fund from its inception expressed as a percentage of their original investment. Expressed in numeric form, an investment of \$1,000 at October 1, 2009 in the Fund would have received \$851 in dividends through the period in question.



## PERFORMANCE 2012 TO DATE

There has been a sea change in market sentiment since December 2011. The markets appear to have set aside concerns about a catastrophic failure of the financial system emanating from the Eurozone. Moreover, there is renewed optimism about the direction of the U.S. economy, even in the face of an almost certain recession in Europe. Nonetheless, the European crisis (which has many more acts to play out) still has the ability to capture the headlines for short periods.

As we write in greater detail in the CIO Commentary (5 pages this month!), the BDC sector has undeniably been in “rally mode” since December 19<sup>th</sup> 2011. This accounts for the Fund’s break-even performance in December (the first half of the month saw the market dipping sharply), the big gains in January 2012, and continued momentum into February (the BDCS was up 2.5%, and our portfolio is up over 3.0% through February 13, 2012).

Can the “rally” continue? Certainly, BDC prices continue to trade at multiples of earnings 10-25% below historical levels. Using the BDCS as a proxy, the current stock price would have to increase by 12.6% to reach its April 29, 2011 high. Our own data suggests BDC prices will have to rise another 16% to reach their prior 52 week high. Moreover, industry performance, with only a couple of exceptions, continues to be excellent and the analysts continue to see higher earnings in 2012 versus 2011 for virtually all the 30 BDCs in business. Average yields for new investments are at 11.0%, substantially higher than REIT investments (under 5%), Master Limited Partnerships (7.0%) and high yield bonds (7.5%). Market conditions are so good that no less than 6 BDCs have raised new equity capital in recent weeks and as many again are expected to come to market in the weeks ahead if market conditions continue to be favorable.

However, the BDC market has been taking a breather in recent days. Judging by the BDCS chart, the sector peaked on February 3<sup>rd</sup>, has zigzagged since and is currently 1.0% off that February 3<sup>rd</sup> high. This most recent period has coincided with the Waiting For Godot Greek crisis, still playing out as we write this. Will the BDC market resume its climb when and if the Greek debt saga comes temporarily out of the headlines? Or, will the BDC market consolidate at this level or even drop down? We don’t know, but we’re confident that—barring a last minute Greek default—that we are unlikely to revisit the lows of October and August last year. (On October 3<sup>rd</sup> 2011, the BDCS was 18.4% lower than the level of February 9<sup>th</sup> 2012).

The Fund cannot predict what will happen next. However, we are monitoring developments very closely and changing our investment mix as we go along. The Fund uses its leverage capability with Pershing (which is working out very well as our new custodian and prime broker) to increase investments in common stock when the “rally” appears to be ongoing. If we become concerned that the 7 week bull market in BDC stocks has come to a (temporary) end, we will sell off a portion of our common stock investments in favor of BDC and leveraged debt investments, which are less volatile. For the moment, the “rally” appears to be still underway.

## NEWSLETTER

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

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