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%
FYE - 2012	28.21%	16.00%	15.19%	7.25%	16.34%
January - 2013	6.08%	5.18%	4.06%	5.77%	5.96%
February - 2013	1.45%	1.36%	0.57%	1.40%	1.33%
March - 2013	2.42%	3.75%	3.40%	3.73%	4.62%
Year to Date	10.23%	10.61%	8.21%	11.25%	12.39%
Inception to Date	36.86%	59.87%	53.96%	50.09%	65.09%

* 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. The indices included above are presented only to provide a general indication of U.S. Stock market performance for the periods indicated and not as a standard of comparison because they are unmanaged, broadly based indices.

March 2013 RESULTS

The Fund was solidly up again in March: 2.42%. We are very pleased with the performance because market conditions were choppy during the period due to concerns that the Cyprus crisis would have a knock on effect across Europe. The volatility index, which had reached a multi-year low in late February and early March jumped 27% in a few days in mid-March. Our principal sector: Business Development Company stocks were weak in March (albeit after many months of positive returns). Nonetheless, thanks to higher than average dividends, and continued strength in other sectors such as BDC Notes, High Yield Bonds and Floating Rate Loans we still had a very positive month.

The above notwithstanding, we were not able to beat the major indices, which reached historic highs in the period. The month's leader was the Russell 2000, up 4.62%. The S&P with a 3.75% gain just beat out the Down Jones by two bps, with the NASDAQ last at 3.40%.

Year-to-date, the Fund is up a very strong 10.23% in just 3 months. We are ahead of the NASDAQ at 8.21%, but behind the other indices modestly, where the 2013 to date leader is the small cap oriented Russell 2000, up 12.39%. This suggests that the "risk-on" trade, as many commentators have been saying, is very much up and running.

Inception To Date returns for the Fund continue to climb from month to month. After 42 months in business, we are up 36.86%, after all fees and expenses. Of course, given the boom stock market conditions, we are still trailing the major indices. Again the Russell 2000 is the top performer over this extended period with a 65.09% gain, and the smallest gain belongs to the Dow Jones belongs to the Dow Jones, up 50%. Our Inception To Date returns are still paying the price of the 2011 market swoon, but we remain optimistic that we will make up ground lost. Later on in this Newsletter we've included a discussion of how the

Fund has performed since altering investment strategies, and the bottom line results will surprise you.

We will close by reporting that the Fund continued to out-perform the various hedge fund market indices for the month and YTD, even though our peers are increasingly in a "risk-on" mode. Newspaper reports suggest hedge funds are bullish about market prospects and "long" positions are at record levels. According to Hedge Fund Intelligence, March was "broadly positive" for hedge funds with the composite up 1.15% and 2.55% on the year. Still, the Fund is out-performing the hedge fund composite in 2013 by 4 to 1.

BDC FUND VERSION 2.0: AHEAD OF THE PACK

Any regular reader of our Newsletter will have read our myriad discussions of how we changed our investment and risk management approach following the Euro-crisis in the summer and fall of 2011. In a nutshell, we've broadened our investment universe to add BDC Notes, High Yield Debt and Floating Rate Loans to the BDC Common Stocks we invest in. This has resulted in a quadrupling of the Fund's investments in portfolio. We believe increased diversification is a great benefit to the Fund by reducing volatility (when one investment is down, another is up) and improving liquidity (with smaller positions across a larger number of investments, we can buy or sell positions faster than ever before as market conditions change).

(At time of writing, we are tracking over 110 different investments. Thanks to the expansion of the BDC market, we are tracking 36 different companies and 21 different issues of BDC Notes. There are more new equity and debt issues coming out every month. In the last few weeks one new BDC has gone public, three existing companies have issued new tradable debt issues and a new Floating Rate "actively managed" Exchange Traded Fund has been launched).

At the end of March 2013, we reached the fifteen-month anniversary of the Fund's revised strategy, so we thought it would be useful to analyze our performance to date. We asked our independent administrator, PartnersAdmin, to calculate the Fund's performance over the January 1, 2012 to March 31, 2013 period, and compare the results with the corresponding data for the major indices. We were very encouraged by the results:

According to PartnersAdmin, BDC Fund II is up 32.63% in the last 15 months, and has managed to out-perform all the other indices. The leading index is the Russell 2000, with dividends re-invested, which is up 30.75%. The S&P is up 28.31%, and the worst performer was the Dow Jones, up 19.32%.

We have managed to achieve these results while maintaining a sensible risk profile, with higher volatility investments representing a maximum of 50% of total assets and while continuing the Fund's mandate to generate a very high level of distributable income. We continue to be focused as much on capital preservation as generating gains, and thanks to our diversified portfolio and single investment limits, are able to turn on a dime when market conditions deteriorate to minimize losses by de-leveraging and/or changing the risk profile of the portfolio. Admittedly 15 months is a short period in a long-term investment and we are not resting on our laurels, but to be beating all the major stock market indices at a time when they have been setting records with our much more conservative investment approach is worth mentioning.

YOUR FUND IN THE NEWS

The BDC industry has seen much more press than before in the last few months. The mainstream business publications were excited last week by the announcement that financial behemoth Goldman Sachs plans to launch a publicly traded Business Development Company in the summer. Bloomberg News wrote a major piece entitled "Goldman Sachs Targets Small Loans in Yield Hunt: Credit Markets". The journalist who wrote the article interviewed us at length. We were quoted 3 times in the piece, which dealt with both the Goldman Sachs story, as well as the expansion of the sector (a perennial subject of ours). We have attached the article below, which is a useful summary of much of what we've been discussing in these pages for months.

Goldman Sachs Targets Small Loans in Yield Hunt: Credit Markets - Bloomberg 4/9/13 4:21 PM

Bloomberg

Goldman Sachs Targets Small Loans in Yield Hunt: Credit Markets

By Sridhar Natarajan - Apr 8, 2013

A Goldman Sachs Group Inc. (GS) unit is joining firms from Ares Capital Corp. (ARCC) to Fifth Street Finance Corp. (FSC) in raising about $2 billion to lend to companies unable to tap public markets as investors seek to extract high yields.

Goldman Sachs Liberty Harbor Capital LLC, which is organized as a so-called business-development company and primarily lends to companies earning less than $75 million, plans to raise money in an initial public offering, according to a March 29 regulatory filing. Last week, New York-based Ares Capital, the

largest BDC, raised about $290 million by selling shares, while Garrison Capital Inc. completed its IPO. Fifth Street Finance said it may raise $1 billion.

The flurry underscores the lengths investors are willing to go to in order to generate returns as the Federal Reserve keeps benchmark interest rates near zero for a fifth year. While the debt the BDCs are buying generate yields of 10 percent or more, it doesn't typically trade.

"Banks have largely abandoned the field in direct lending to the mid-market and it's been taken over in the last few years by BDCs and private funds," Nicholas Marshi, the chief investment officer at Southland Capital Management, said in a telephone interview from Santa Monica, California. Marshi manages funds that invest in BDCs.

'Significant Opportunities'

There are "significant opportunities" for lenders as about $400 billion in loans from smaller, private firms mature in the next four years, according to a report from investment bank Keefe, Bruyette & Woods Inc.

BDCs, which typically pay out most of their earnings as dividends and get tax exemptions, usually lend to private companies and hold the debt to maturity. The leverage at the firms cannot exceed a debt to equity ratio of 1.

"Think of the BDCs as the intermediary between banks and non-investment grade credit," Leonard Tannenbaum, the chief executive officer of Fifth Street Finance, said in a telephone interview. "By issuing bonds and raising equity, we are able to increase our holding size."

Fifth Street Finance said in an April 5 regulatory filing that it may raise as much as $1 billion to make investments in small and mid-sized companies.

Recommendation Cut

The Federal Deposit Insurance Corp.'s revised assessment guidelines may limit the attractiveness of such loans to some banks, providing less competition for BDCs, Jonathan Bock, an analyst at Wells Fargo & Co. wrote in a March 26 report.

Bock cut his outlook for the sector to "market weight," citing new investment yields near historic lows.

Elsewhere in credit markets, the cost of protecting corporate debt from default in the U.S. fell. The Markit CDX North American Investment Grade Index, which investors use to hedge against losses or to speculate on creditworthiness, declined 0.9 basis points to a mid-price of 86.03 as of 11:20 a.m. in New York, according to prices compiled by Bloomberg.

The index typically falls as investor confidence improves and rises as it deteriorates. Credit-default swaps pay the buyer face value if a borrower fails to meet its obligations, less the value of the defaulted debt. A basis point equals $1,000 annually on a contract protecting $10 million of debt.

The U.S. two-year interest-rate swap spread, a measure of debt market stress, increased 0.18 basis point to 15 basis points as of 11:24 a.m. in New York. The gauge narrows when investors favor assets such as company debentures and widens when they seek the perceived safety of government securities.

BDC History

Bonds of Fairfield, Connecticut-based General Electric Co. are the most actively traded dollar- denominated corporate securities by dealers today, accounting for 5.6 percent of the volume of dealer trades of $1 million or more as of 11:27 a.m. in New York, according Trace, the bond-price reporting system of the Financial Industry Regulatory Authority.

Business-development companies are closed-end mutual funds that were created after legislators in 1980 amended the Investment Company Act of 1940 to facilitate private investment.

Allied Capital Corp., one of the earliest publicly traded BDC, was accused by David Einhorn, the founder of the hedge fund Greenlight Capital, of making fraudulent loans. In March 2009, its auditors expressed doubt about the company's ability to continue and in October of that year it was purchased by Ares Capital for $648 million in stock.

Einhorn's Greenlight is the fourth-biggest holder of Fifth Street Finance, Bloomberg data show.

Publicly listed BDCs have more than doubled since 2009 to more than 35, according to Southland's Marshi. Sales of junk-rated debt funds known as non-traded BDCs doubled to a record $2.8 billion last year, according to MTS Research Advisors.

Ares Fund

The companies, which operate with an average leverage of about 0.6 times, according to an April report from Keefe, Bruyette & Woods analysts Troy Ward and Greg Mason, use the money from borrowings and equity offerings to lend to smaller firms. BDC may also make equity investments.

Ares Capital held senior debt of about $3.6 billion, compared with about $669 million of preferred and other equity securities of its $5.8 billion investments, according to its Feb. 27 regulatory

SCM SOUTHLAND Capital Management LLC

filing. The company has a market capitalization of $47 billion, up from about $500 million four years ago, Bloomberg data show.

A new proposed legislation for BDCs seeks to increase the maximum allowable debt to two times total equity, Marshi said. “They could choose to borrow more money, which unfortunately makes the structure more riskier,” he said.

Interest in BDCs is rising just as Fed officials express concern that its asset purchase program and low interest rate policy is making investors search out ever-riskier deals to generate returns.

Loan Yields

Yields on speculative-grade bonds fell to a record low of 6.38 percent on March 28, Bank of America Merrill Lynch index data show. The average yield on middle-market loans has dropped to 6.83 percent from 11.55 percent at the end of 2009, according to S&P’s Capital IQ Leveraged Commentary & Data.

Goldman Sachs’s Liberty Harbor unit was funded by the parent company in November and has since invested about $73 million in eight companies, according to its March 29 filing. About 31 percent of that is in first-lien debt, and 60 percent in second-lien borrowings.

Consolidation of regional banks into money-center banks has reduced the focus on middle-market lending, diminishing the availability of credit and resulting in higher interest rates for the companies, according to the filing. Andrea Raphael, a spokeswoman at Goldman Sachs, declined to comment on how much may be raised in the IPO.

Goldman’s Arrival

Deposits at U.S. banks exceed loans by an unprecedented $2 trillion, Bloomberg data show. This is happening even as U.S. commercial bank assets loans have climbed to a four-year high of $1.5 trillion, according to data from the Fed.

“With an entrant like Goldman Sachs in the market, it obviously raises awareness,” Troy Ward, an analyst at Keefe, Bruyette & Woods, said in a telephone interview. “If you think about the size of the middle market, the assets that BDCs have available to invest is just a drop in the bucket.”

The annualized average credit losses in BDCs since 2006 has been less than 1 percent, with recovery rates higher than larger, more broadly distributed loans, according to Ward. Last year, BDCs raised $3.9 billion in IPOs and follow-on offerings, the most since 2007, according to Ward. More than $1 billion in debt was raised in about 15 issues, the most on record.

Open Market

“It’s a market that has just opened up,” Ward said about the firms issuing debt. “Before 2012, nobody had really tried, and within a few months these companies were able to tap this market and cut rates.”

Ares, which first came to the market with a $143 million offering, paid a 7 percent coupon on its 10-year preferred notes. When it returned to borrow more money in September, the firm paid 5.88 percent on its $175 million 10-year preferred debt. That compared with a 0.7 percent reduction on yields in the Bank of America Merrill Lynch Index for similarly-rated debt.

“Everything suggests that there will be very fast growth in this sector,” Marshi said. “You have to assume 20 percent annual growth until the next recession.”

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NEWSLETTER

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

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