EDUCATIONAL ARTICLE

Evaluating Non-Traded BDCs

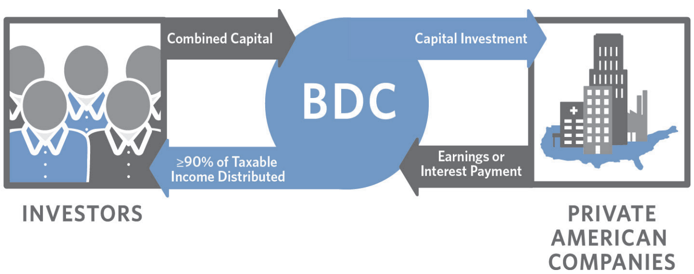
PRESENTED BY CNL SECURITIES

Understanding a product's potential risks, advisory teams, financing strategy and market performance can help investors and financial advisors evaluate the potential of a non-traded business development company (BDC) as a viable investment option.

Investments in BDCs combine the capital of investors, giving them access to the debt of private American companies, an asset class that has historically exhibited lower correlation than more traditional asset classes. BDCs are entities that invest primarily in the debt of private American companies with additional investments in the equity of those same businesses.

These investments, which can be traded or non-traded, are primarily regulated by certain provisions under the U.S. Investment Company Act of 1940. (Refer to Figure 1 for an illustration of how BDCs work.) This article provides information on the different factors that need to be considered when evaluating a non-traded BDC as a viable investment option.

Figure 1. How a BDC Works[1]



SUITABILITY AND POTENTIAL RISKS

Prior to investing in any type of product or asset class, it is important to know an investor's suitability. While some states may have higher suitability standards, non-traded BDCs typically require an investor to have either a net worth and annual gross income of at least $70,000 or a net worth of at least $250,000.

In addition, it is essential to understand any potential risks associated with an investment. General risks pertaining to non-traded BDCs include:

- **Loss of Money.** Investing in a non-traded BDC may be considered speculative and involves a high degree of risk, including the risk of a substantial loss of the initial investment.
- **Illiquidity.** Non-traded BDC investments are considered illiquid, which means there is a limited ability to sell shares and liquidation may be at less than the original amounts invested.
- **Long-Term Duration.** Due to their illiquidity, non-traded BDC investments are also not considered short-term.
- **Lack of Redemptions.** A non-traded BDC's redemption plan could be subject to suspension, modification or termination at any time, and there is no guarantee of distributions or that distribution rates will be sustained.
- **Limited Distributions.** As with any non-traded investment, distributions can never be guaranteed. This is because distributions paid from sources other than cash from operations are not sustainable over the long-term, and can reduce the funds available to investors and for portfolio acquisition.

All investors should carefully read an investment's prospectus and discuss the pros and cons of any alternative investment with their financial advisor.

ADVISORS AND SUBADVISORS

Another fundamental consideration when evaluating a non-traded BDC is the team managing the company and its portfolio. While the BDC's advisor is typically responsible for overall management, in practice, non-traded BDCs tend to partner with a subadvisor that provides portfolio management services and access to investment opportunities. It is important to note that many non-traded BDCs have little to no operating history, thus relying on the advisors of the company. This may cause conflicts of interest and payment of substantial fees to the advisors and its affiliates.

Figure 2. Advisor/Subadvisor Competencies

Several important considerations when evaluating an advisor and/or subadvisor include:

- **Experience.** Typically, investors look to experienced management teams who are familiar with private debt markets and who are knowledgeable beyond the secondary markets to include originating investments.
- **Performance.** While past performance is no guarantee of future results, the BDC's track record and that of its advisor and subadvisor merit attention. For example, what percentage of loans in the portfolio have defaulted and what percentage have been recovered? Does this span a short or long period of time, and how does this compare to the advisor and subadvisor's longer term performance?
- **Resources.** Individuals need to become familiar with the advisor's and subadvisor's range of knowledge in the industry, as well as any financial, underwriting and operational resources at their disposal.
- **Strategy.** Lastly, it is important to know the advisor's and subadvisor's investment philosophy, and whether it aligns with the stated objectives of the BDC.

EXEMPTIVE RELIEF

Another important consideration is whether the BDC has been granted exemptive relief, which allows co-investment alongside listed affiliates on originated loans.[2] Because a BDC may only co-invest with affiliates that are listed in the exemptive relief order, it is important to know who these affiliates are. For instance, if the BDC has a subadvisor:

- Are its affiliates included in the exemptive relief?
- Do listed affiliates add significant loan capacity and, thereby, help provide access to deals of a size that the BDC may not otherwise be able to fund?
- Lastly, does the exemptive relief allow the BDC to co-invest with affiliates who represent institutional investors?

Examining these questions can help investors and financial advisors acquire more information on the BDC's investment capabilities.

STRATEGY AND ASSET MIX

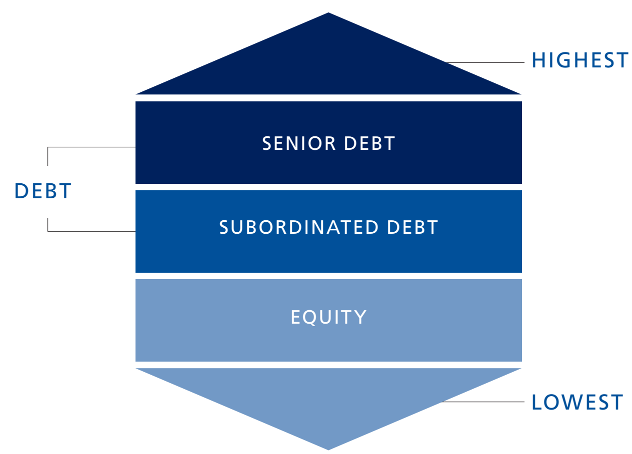
Non-traded BDCs have a variety of options when investing in private American companies. In addition, all BDCs have to invest at least 70 percent of their assets in private U.S. companies. Consequently, it is important to understand the non-traded BDC's strategy and asset mix prior to making an investment decision. Below are five main areas a BDC's management team looks at when investing in a company. These are:

1. **Industry** (i.e., the types of industries in which the non-traded BDC will invest).
2. **Company Size** (i.e., small, medium and large).
3. **Capital Structure** (i.e., senior or subordinated debt and equity).
4. **Asset Mix** (i.e., liquid or illiquid).
5. **Interest Rates** (i.e., floating or fixed).

Please keep in mind that, while these are not the only five things a BDC evaluates in a company before investing, it is important for an individual to know a BDC's general strategy prior to making an investment decision. Also, while there is no guarantee a loan will be repaid or that a loan will not default, the management of the loans' portfolio provides a certain amount of protection. In addition, loans to private companies are structured as contractual agreements that stipulate the repayment schedule and interest rate terms.

Besides contractual returns, loans almost always have priority claims to company cash flows as compared to equity holders, which provides an additional level of protection. Figure 3 illustrates a typical repayment priority hierarchy, with senior debt being the first recipient of payments from cash flows.

Figure 3. Cash Flow Repayment Priorities



Private debt is often associated with floating interest rate structures, which can protect against the potentially negative effects of rising interest rates. Consequently, it's important to consider the mix of floating and fixed-rate loans in the portfolio.

Figure 4. Asset Mix and Liquidity

	SECONDARY MARKET	PRIMARY ISSUANCE	ORIGINATIONS
Description	Purchase existing loans	Newly originated loans allocated among a syndicate of lenders	Newly originated loans negotiated by the advisor
Terms	Only price is negotiated and determined by a market	Price and terms are negotiated by participants	Price and terms are negotiated in-house by the advisor
Performance Drivers	Credit selection, underwriting, ongoing monitoring and other publicly available information	Proprietary sourcing, credit selection, underwriting and ongoing monitoring	Proprietary sourcing, credit selection, underwriting and ongoing monitoring
Typical Advantages	High liquidity allows for opportunistic buying/selling	Favorable pricing (original issue discount), negotiation ability on nonprice terms	Covenant structure with a typically higher yield; potentially fee income
Valuation	Valued by an active trading market	Valued by a less active market and with company input	Valued with little to no market input, but with reliance on management in conjunction with a third party

More Liquid

Less Liquid

Note: These characteristics are for comparative purposes only between secondary and direct origination, and are not reflective of these characteristics for other security types. For comparative purposes, secondary debt is more liquid than direct origination debt. However, both are less liquid than a traditional fixed income investment, especially under unfavorable market conditions. Finally, valuation of certain assets is typically determined by a board of directors or similar valuation committee based on input from multiple sources.

METRICS AND PERFORMANCE

Finally, it is important to consider a BDC's financial stability prior to determining its viability as an investment option. A good way to start is by looking at the metrics used to assess its performance. Metrics and performance considerations include the BDC's:

- **Distribution rate**, which can be an indicator of its income-generating potential. Distributions, however, can be paid from sources other than taxable income, which may not be sustainable and may reduce an investor's returns and may be deemed return on capital.
- **Performance returns**, which can be calculated by taking into account the BDC's net asset value plus reinvestment of distributions.
- **Advisor expense support**, is commonly used in new funds and tapers off as the fund matures and may be waived or deferred to allow for reimbursement over time.

More information about these and other metrics and performance considerations can be found in the product's quarterly financial filings and the prospectus, or by talking to a financial advisor.

IN BRIEF

Before investing in a non-traded BDC, it is important to understand all suitability standards, the product's potential risks, who the advisors and subadvisors are and the investment's strategy and asset mix, as well as key metrics and performance considerations. As with any investment, individuals should discuss all investment options with their financial advisor — there may be room for traded and non-traded BDCs in a portfolio, depending on their liquidity and diversification needs.

[1] If the BDC is also a regulated investment company (RIC), it must meet a number of requirements, including distribution of at least 90 percent of its taxable income to maintain its status and avoid corporate income tax.

[2] There are three types of loans: originated, proprietary and syndicated. Originated loans are new loans that are underwritten for the first time by the advisor and sub-advisor, while proprietary loans are those that, while originated in nature, are specifically underwritten by the advisor to meet the exclusive needs of a particular company. Syndicated loans are offered by a group of lenders, called a syndicate, who work together to provide funds to a single borrower. One of the main goals of loan syndication is to spread the risk of loan default across multiple lenders.

Neither the U.S. Securities and Exchange Commission, the attorney general of the state of New York nor any other regulatory agency has passed on or endorsed the merits of this offering. Any representation to the contrary is a criminal offense.

Non-traded business development companies (BDCs) may implement a share repurchase program and, if they do, they are typically limited to the amount of shares, which may be repurchased. The program may be suspended, modified or terminated by the board of trustees at any time.

The investment strategy of a non-traded BDC is focused primarily on privately held companies, which presents certain challenges, including extending loans to those with potentially low credit quality and a lack of publicly available information. Leverage can increase expenses, add interest rate risk and may magnify performance volatility.

Distributions are not guaranteed in frequency or amount. Distributions paid can exceed earnings and may not be based on the investment performance. Rather, they can be supported by the advisors' fee waivers, and paid from offering proceeds and/or borrowings along with cash from operations.

This is not an offer. Securities can be offered by a prospectus only, which should accompany or precede this material. CNL Securities distributes a non-traded BDC named Corporate Capital Trust II. Since investing in non-traded BDCs is not suitable for all investors, a prospectus should be read carefully by an investor before investing. Investors are advised to consider the investment objectives, risks, charges and expenses before investing. The Corporate Capital Trust II prospectus contains this and other information about the program. The prospectus is available at SEC.gov and CorporateCapitalTrustII.com, and may be obtained by calling 866-650-0650.

To learn more about non-traded BDCs, investors should contact their financial advisor. Financial advisors are encouraged to visit **cnlsecurities.com** or contact CNL Securities, member FINRA/SIPC, at **866-650-0650**.

CNL Securities
CNL Center at City Commons
450 S. Orange Ave.
Orlando, FL 32801-3336

CSC-ENTBDC-11-01-16
CSC-1116-16155-INV

CNL Securities