Institutional Investor

September 27, 2021 • Institutionalinvestor.com

CORNER OFFICE

When Jonathan Bock Joined Barings, He Promised to Make BDCs Investor-Friendly. So Far, So Good.

Barings BDC's planned acquisition of Sierra Income will turn a product infamous for being unfriendly to shareholders into one of the best.

By Julie Segal

In his previous job as a research analyst at Wells Fargo, Jonathan Bock, CFO of Barings BDC, loudly pushed for transparency, lower fees, and better practices at business development companies. Now he's helping turn one of the worst BDCs into one of the best.

BDCs, which are essentially mutual funds that lend money to small and medium-size businesses, have grown from an obscure backwater to a fast-growing slice of private credit filled with offerings from the biggest names in asset management. In an environment in which the Federal Reserve has kept interest rates low for years, investors hungry for higher yields began to flock to these products. Bock, who joined Barings in 2018 after a dozen years as a sell-side research analyst, and who is also a managing director in the Barings Global Private Finance Group, helped fuel the growth of the sector by becoming a sometimes feared advocate for shareholders and relentlessly pushing for better standards with his quarterly Wells Fargo BDC Scorecard.

But it's still a sector in need of improvement — at least for shareholders.

Last week, the bar was raised when Barings BDC said it would buy Sierra Income Corp. Sierra's adviser is Medley Management, which has been at the center of a multiyear saga involving shareholder lawsuits, public critiques, and brazen conflicts of interest. Medley Management is now in bankruptcy.

Not only is the sale to Barings bringing the Sierra chapter of the Medley drama to an end, but shareholders of Sierra, a private BDC, will get protections rarely offered to investors. Barings BDC is part of $382 billion-in-assets investment manager Barings — itself owned by insurance company MassMutual.

Bock explained that Barings BDC is providing a $100 million credit support agreement, under which parent Barings LLC will take the first loss up to that amount for 10 years. Barings BDC is the only manager to offer such protection, according to the company and several third-party sources. It is also making a $100 million cash payment (from Barings LLC) to Sierra shareholders as part of a deal valued at nearly $624 million.

Legendary investor Leon Cooperman, founder of hedge fund Omega Advisors, put the Barings-Sierra deal in the context of where the BDC market is moving. The market has been penalizing firms that operate for the benefit of managers, not shareholders. These BDCs, along with others, have ended up trading at a discount to net asset value. This means that private BDCs won't be able to go public, locking shareholders into the illiquid vehicles.

"The market made a judgement. This is the right thing to do," Cooperman told *Institutional Investor*.

Shareholder-friendly moves also attract capital from the biggest pensions, endowments, foundations, and other institutions.

"You have to be shareholder-friendly if you want to attract capital. The deal makes sense. They bought it right, meaning they're buying back stock at a discount to NAV and not issuing new stock and not diluting anybody. The game is over, whether it's REITs, MLPs, or BDCs. It only works when stock sells at a premium to NAV," said Cooperman.

In another rare move, Barings BDC is increasing the hurdle rate, essentially raising the bar before the manager earns incentive fees. The rate will go from 8 to 8.25 percent — the highest in the industry — before the manager earns the 20 percent incentive fee.

In late May, the board of Sierra Income said it would look at strategic alternatives for the company. That kicked off a process in which asset managers were given an opportunity to take a look at the portfolio, which is primarily made up of bank club deals offering a healthy yield.

"Let's face it. It's always nice when BDC boards, and the industry for that matter, think more about what they can do for the shareholders, [rather than] simply what they can get away with. This transaction takes alignment one step higher in the industry," said Bock.

"It may take a while, and progress is never a straight line, but capital eventually moves the right way."

The deal with Barings closes a long period of uncertainty for shareholders in the Sierra BDC.

The saga of Medley Management began in earnest in 2017, when Brook and Seth Taube, the brothers who owned the majority of Medley Management, attempted to sell the advisor after years of generating subpar returns. After failing to get the price they wanted, Medley ultimately proposed an uber-complicated deal in which the shareholders of Medley Capital Corp., the BDC it advised, would buy the management company.

As part of the deal, Sierra — retail investors who rarely vote their shares — would merge with Medley Capital. The combined BDC would buy Medley Management at a far higher price — a 100 percent premium to its stock price at the time — than any firm had offered when the Taube twins were actively shopping it around. Even though the deal led to a proxy fight, public recriminations against Medley by activist shareholders, a Delaware trial that Medley lost, and a new search for an alternative, the transaction was ultimately approved by the board and shareholders in 2019. However, the Securities and Exchange Commission never gave its approval. Instead, the SEC issued Wells Notices to Medley Management, informing them that it was launching an investigation into the firm.