



**Analyst Interview Covering:
Fifth Street Finance Corp. (FSC-NYSE)**

CEOCFO-
Members
Login

**January
16, 2009
Issue**

The Most Powerful Name In Corporate News and Information

Energy | Resources | Mining | Healthcare | Bank | Services
| Semiconductor | Biotechnology | Communications | Waste-Management

Capital Goods | Canadian | Technology | Green | Retail | Security | Authentication | Business-Banks | Oil & Gas | Community Banks

Drug-Development | Financial | Clean Energy | Specialty-Finance | Business-Services | Global-Services | Metals

Business-Development | Commercial-Bank

CURRENT ISSUE | COVER ARCHIVES | INDEX | CONTACT | FINANCIALS | SERVICES | HOME PAGE

Fifth Street Finance Provides An Attractive Opportunity For Investors To Invest In A Portfolio Of Debt Investments That Were All Made After The Peak Of The Credit Cycle

Fifth Street Finance - Profile:

Fifth Street Finance Corp. is a specialty finance company that lends to and invests in small and mid-sized companies in connection with an investment by private equity sponsors. Fifth Street Finance Corp's investment objective is to maximize its portfolio's total return by generating current income from its debt investments and capital appreciation from its equity investments.

BIO:
Greg Mason
President and Senior Equity Analyst
Specialty Finance Sector
Stifel, Nicolaus & Company, Inc.

Mr. Mason is a Vice President and Senior Equity Analyst at Stifel Nicolaus with a focus on the specialty finance sector. Prior to joining Stifel Nicolaus in 2007, Mr. Mason was an equity analyst for six years with A.G. Edwards and has followed a number of financial sectors including life insurance, P&C insurance, asset management, mortgage REITs and credit cards. He received a Masters in Business Administration from St. Louis University in May 2007. In 2001, Mr. Mason graduated from Southwest Baptist University with a B.A. in Business Administration with concentrations in finance, economics, management & marketing. Mr. Mason holds the Chartered Financial Analyst (CFA) designation and is a member of the St. Louis Society of Financial Analysts.

**Financial
Specialty
Finance**

**Stifel,
Nicolaus
&
Company,
Inc.
One South
Street
Baltimore,
MD 21202**

*Click here
for CEO
interview:*
**Fifth
Street
Finance
Corp.
(FSC-
NYSE)
445
Hamilton
Avenue,**

<p>Suite 1206 White Plains, NY 10601 Phone: 914-286- 6800</p>

Interview conducted by: Lynn Fosse, Senior Editor, CEOCFOinterviews.com, Published – January 16, 2009

CEOCFO: Mr. Mason, please tell us about the universe that you cover.

Mr. Mason: “I cover Business Development Companies and these companies were created to provide investments to small businesses. The government wanting to encourage investment into small businesses, created the BDC structure, so that as long as made investments to U.S. small businesses and they paid out all of their earnings as a dividend, they would not have to pay federal income taxes. Therefore, it was a way to develop a structure that would encourage both debt and equity investments to private companies.”

CEOCFO: How does Fifth Street Finance fit in with the group that you cover?

Mr. Mason: “We try to cover the entire BDC industry. Fifth Street Finance went public back in June of 2008 as a Business Development Company and we wanted to include it in the 18 Business Development Companies that we follow.”

CEOCFO: Why does Fifth Street Finance stand out from the crowd?

Mr. Mason: “We remain very concerned about debt and equity investments that were made during the peak of the credit cycle, which we define as mid-2006, through mid-2007. During that time, we saw the debt and equity values not account for the risk that were inherent in those investments. We saw debt investments charge very low interest rates, have weak covenants, and have excessive leverage well above historical norms. One of the things that is unique to Fifth Street Finance is because of the timing of their IPO, June 2008, as well as the time that they raised capital prior to their IPO, which was in mid-2007, most of the investments in their portfolio have been made after the credit markets began to crack in July of 2007. Because of the timing of its capital raises Fifth Street Finance has the ability to put its capital to work, making investments in businesses, after the credit cycle had cracked. Therefore, we think that provides an attractive opportunity for investors to invest in a portfolio of debt investments that is substantially built after the credit bubble had popped.”

CEOCFO: What do you like about the management team at Fifth Street?

Mr. Mason: “What we like is that in our view, the president and CEO, Leonard M. Tannenbaum, has really focused on surrounding himself with very good and very smart people. While we recognize that the leadership and vision of the company comes from the top, particularly with a company that is making numerous investments into many small businesses, it takes a team to be able to effectively underwrite those investments. Mr. Tannenbaum recognizes that a CEO isn’t underwrite and monitor all of these companies by himself, so he has built what we believe is a very strong team around him. Mr. Tannenbaum himself is a very smart individual and has a good track record, but he isn’t afraid to hire smart people and build a solid team.”

CEOCFO: How are they weathering the current situation and why do you think they are in a good position in today’s economy?

Mr. Mason: “I think that with the businesses that they have invested in, there is no doubt that they are feeling the effects of the economic slowdown, like many other businesses. As we analyze in our last research report, we estimate that the EBITDA (Earnings Before Interest Taxes And Depreciation) for their companies since the investments were made, have declined about 15%. Therefore, the earnings of their businesses are being impacted by the slowing economy. Having said that, I think what Fifth Street Finance has been able to do is because their investments have been made after the peak credit bubble, they have been able to put in strong covenants, tight covenants for all of their debt investments. They have been able to go into these investments with eyes wide open, knowing that we are heading into a recession and that EBITDA values are likely to decline. Therefore, even though we are seeing credit deterioration in the portfolio, at this point, for most of the investments it has not caught management by surprise and was not unexpected at the time the investments were made.”

CEOCFO: What is their financial picture like today?

Mr. Mason: “We actually view their financial picture pretty favorably. Fifth Street has no debt right now. BDC’s by law can be levered 1-to-1 debt:equity, meaning a BDC first raises equity capital from shareholders, then for every dollar of equity capital, they can actually go to a bank and borrow another dollar. Fifth Street Finance has raised about \$300 million in equity investments and by law, they could go out to a bank and borrow another \$300 million to make investments. In fact, that’s what most of the BDCs have done. However, Fifth Street Financial has not used any of that leverage potential. They have \$50 million that they could potentially borrow from Bank of Montreal, but they have not borrowed from that credit facility yet. When we asked on the conference call if they were going to seek additional credit facilities, so that they could borrow up to another \$300 million in debt, they said no, because right now the market does not want exposure to companies that have employed a significant amount of leverage.

We think operating with limited leverage helps out for a few reasons. Number one is that they don’t have the concern of having to deal with a lender that has provided them money to make a long term investment, who could decide that they want their money back. In that case, what do you do with the long-term investment that you need to liquidate today? In this environment that leads to trouble. Second, it also provides them additional capital in the future, if they so choose, because they can borrow \$50 million from Bank of Montreal and make new investments in a pretty attractive market today. Finally, Fifth Street has the flexibility, if they deem that the time is right to do so, to go out and get additional credit facilities, which would provide them with even more capital to make new investments. Many of the other BDCs we cover have a limited amount of excess capital that they can use to make new investments.”

CEOCFO: What is your current rating for Fifth Street and your target?

Mr. Mason: “We have a ‘buy’ rating, with a \$9.00 price target.”

CEOCFO: What else should potential investors be aware of when they are looking at Fifth Street Finance?

Mr. Mason: “Investors have to get comfortable with the business model, because you are investing in a management team that has invested money in a pool of loans to small businesses. To be honest, in the current environment, you tell investors that you have an opportunity to own debt and equity investments in small businesses, people shy away from that today. Therefore, that is one of the reasons why Fifth Street and the entire BDC sector is trading at such a significant discount to book values. Investors are concerned that as the economy continues to slow down that there could be additional problems in these portfolios, with small businesses that cannot make their interest payments to lenders like Fifth Street. In our minds this is the biggest

risk associated with Fifth Street Financial and the BDC sector overall.”

CEOCFO: With that said, you do have your ‘buy’ rating for Fifth Street Finance; final thoughts, why should people be looking to invest?

Mr. Mason: “We believe, if investors can find good companies in industries where people are afraid to invest, they can typically generate very strong returns. We like Fifth Street Finance because it has no leverage on its balance sheet; it invested nearly all of its equity capital after the credit market cracked and doesn’t have any legacy debt investments from the bubble. In addition, you have a dividend policy that is being developed as the portfolio grows that is rational and sustainable. We think adding all of those together while being a contrarian investor and investing in this sector when it has been beaten down provides a good opportunity.”

Disclosures: Stifel, Nicolaus & Company, Inc. or an affiliate managed or co-managed a public offering of securities for Fifth Street Finance Corp in the past 12 months. Stifel, Nicolaus & Company, Inc or an affiliate has received compensation for investment banking services from Fifth Street Finance Corp in the past 12 months. Stifel, Nicolaus & Company, Inc. expects to receive or intends to seek compensation for investment banking services from Fifth Street Finance Corp in the next 3 months. Fifth Street Finance Corp is provided with investment banking services by Stifel, Nicolaus & Company, Inc. or was provided with investment banking services by Stifel Nicolaus or an affiliate within the past 12 months. Fifth Street Finance Corp is a client of Stifel, Nicolaus & Company, Inc. or an affiliate or was a client of Stifel Nicolaus or an affiliate within the past 12 months.

disclaimers

Any reproduction or further distribution of this article without the express written consent of CEOCFOinterviews.com is prohibited.

“Because of the timing of its capital raises Fifth Street Finance has the ability to put its capital to work, making investments in businesses, after the credit cycle had cracked. Therefore, we think that provides an attractive opportunity for investors to invest in a portfolio of debt investments that is substantially built after the credit bubble had popped.” - Greg Mason, President and Senior Equity Analyst, Specialty Finance Sector, Stifel, Nicolaus & Company, Inc.

ceocfointerviews.com does not purchase or make recommendation on stocks based on the interviews published.