

Fitch Affirms Solar Capital at 'BBB-'; Outlook Stable

Written by Australian Business

CHICAGO--([BUSINESS WIRE](#))--Fitch Ratings has affirmed Solar Capital, Ltd.'s (Solar) long-term Issuer Default Rating (IDR), secured debt rating, and unsecured debt rating at 'BBB-'. The Rating Outlook is Stable. These actions are being taken in conjunction with a broader industry review, which includes seven business development companies (BDCs), and coincides with the publication of an industry report, titled 'Business Development Companies - A Comparative Analysis: 2013', which is available on Fitch's website.

KEY RATING DRIVERS - IDRs and SENIOR DEBT

The ratings affirmations and Stable Outlook reflect Solar's low leverage, consistent operating performance, solid asset quality, adequate liquidity, experienced management team, and diversified sponsor relationships.

Rating constraints include a moderately concentrated portfolio, the capital markets impact on leverage given the need to fair-value the portfolio each quarter, dependence on the capital markets to fund portfolio growth, and a limited ability to retain capital due to dividend distribution requirements.

Leverage, as measured by debt-to-equity, amounted to 0.23x at YE2013, or 0.09x net of cash, which is far below management's articulated target of 0.7x. Fitch believes current leverage levels reflect management conservatism due to the competitive capital markets environment and Solar will deploy additional leverage as additional risk-adjusted opportunities become available.

Fitch views conservative management of leverage as appropriate given Solar's concentrated equity investment in Crystal Capital Financial Holdings LLC (Crystal), a diversified asset-based lender, which represented 28% of portfolio fair value as of YE2013. Solar's total equity exposure is high relative to peers, with preferred and common equity amounting to 35.8% as of Dec. 31, 2013. However, Fitch believes the concentration risk is somewhat mitigated by Crystal's diversified portfolio of 27 asset-based or secured loans outstanding to 23 borrowers, none of which are on non-accrual. Still, Crystal is a levered vehicle and Fitch notes the embedded leverage.

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Solar's liquidity profile remains sound with \$137 million of balance sheet cash and \$490 million of availability on its secured revolving facilities, subject to borrowing base requirements, at Dec. 31, 2013. Cash flows from investment repayments and exits have been significant, amounting to \$587.4 million in 2013.

Net investment income diminished materially in 2013, reflecting a smaller portfolio due to realizations of large legacy investments and a lower spread environment in which to redeploy capital. As a result, Solar cut its dividend in the third quarter from \$0.60 to \$0.40. Fitch viewed the cut favorably, and believes current dividend coverage is adequate. Net investment income amounted to \$0.42 per share in the fourth quarter 2013, but benefited from prepayment and amortization fees related to investment exits. Management has expressed confidence in earning its dividend, particularly considering the substantial balance sheet cash yet to be invested. Meaningful growth is not expected in the near term.

RATING SENSITIVITIES - IDRs and SENIOR DEBT

Positive rating momentum is believed to be limited in the near-term given Solar's investment portfolio concentrations, equity concentration with the Crystal investment, and untested access to the public equity and institutional debt markets.

Solar's leverage is expected to increase to management's stated target of 0.7x over time. Fitch believes leverage should be conservatively managed due to the company's equity concentrations in the investment portfolio. Aggressive use of leverage not commensurate with the company's risk profile could lead to negative rating actions. Additionally, negative rating momentum could develop from declines in operating performance; deterioration in credit quality, weaker dividend coverage, and/or an inability to access the debt or equity capital markets when necessary would also be viewed unfavorably from a ratings perspective.

More broadly, Fitch sees a number of emerging industry challenges that could pressure ratings, or at least increase rating differentiation amongst BDCs over a longer-term horizon. These challenges include a potential increase in regulatory leverage limits and increased competition, which are yielding tighter market spreads and looser underwriting terms, including higher underlying portfolio company leverage and weaker covenant packages. Should competition continue to intensify, market yields could decline

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further, which would reduce earnings generation and pressure dividend coverage for the space.

Headquartered in New York, NY, Solar is an externally managed BDC, founded in November 2007 and completing an initial public offering in February 2010. As of Dec. 31, 2013, the company had investments in 40 portfolio companies amounting to approximately \$1.1 billion at cost.

Fitch has affirmed the following ratings:

Solar Capital, Ltd.

--Long-term IDR at 'BBB-';

--Senior secured debt at 'BBB-';

--Senior unsecured debt at 'BBB-'.

The Rating Outlook is Stable.

Additional information is available at ' www.fitchratings.com '

Applicable Criteria and Related Research:

--'Global Financial Institutions Criteria' (January 2014);

--'Investment Manager and Alternative Funds Criteria' (December 2013).

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Global Financial Institutions Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=732397

Investment Manager and Alternative Funds Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=725057

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