SARATOGA INVESTMENT CORP.

July 20, 2020

Saratoga Investment Corp CLO, Second Quarter 2020

Dear Investors,

Saratoga Investment Corp CLO 2013-1 ('the Fund') had a successful first six months in 2020 during a period of historic loan market volatility. Despite the pandemic and resulting recession, the historic level of credit downgrades and the expectations for impending defaults, the Fund more than satisfied its debt overcollateralization ratios and made two full equity distributions in April and July 2020. Our Fund's strong performance during the past year resulted in a second consecutive nomination from Creditflux for Saratoga Investment Advisors as outstanding boutique CLO manager.

The Fund's April 2020 equity distribution was $2.0 million or 4.6% of our equity investment cost, and our July 2020 equity distribution was $1.38 million or 3.2%. For the last twelve months, our annualized equity distributions have been 17.0% of our equity cost.

With our most recent distribution in July 2020, the IRR since the December 2007 inception of this CLO is 15.3%. The IRR since Saratoga took over management of the CLO in July 2010 is 36.5%, representing the $19.5 million July 2010 CLO equity investment valuation, our $13.8 million equity investment as part of the December 2018 upsize, and our cumulative net cash distributions to equity of $53.6 million.

The Fund's smaller equity distribution in July was caused by both a sharp decline in LIBOR and a wider disparity between one month and three-month LIBOR rates set in April. While the three-month LIBOR (which we pay on our liabilities) had declined from 181 basis points in January 2020 to 116 basis points in April 2020, both one month and three-month LIBOR continued to plummet through the end of April. At April end, our borrowers in our loan investments were able to lock in one month and three-month LIBOR that they pay us at 30 and 50 basis points, resulting in a significant negative LIBOR arbitrage for our Fund through the July payment. We will reset the three-month LIBOR on our liabilities from 116 basis points in April to 27 basis points in July, which will sharply improve the Fund's impending profitability. Moreover, 46% of our loan assets now have minimum LIBOR floors of 75-100 bps (versus current one-month LIBOR of 18 bps which we would otherwise earn), which will directly benefit the Fund's profitability.

Our distributions exclude interest payments paid on our Saratoga Investment Corp's wholly owned B rated $2.5 million Class F-R-2 Note, and our unrated $7.5 million Class G-R-2 Note.

The Fund's recent performance is shown below:

$ millions	Assets under Management (AUM)	Weighted Average Risk Factor (WARF)	Weighted Average Spread (WAS)	Percentage of Portfolio rated CCC per S&P
Legacy CLO	$299.8	3037	389	6.3%
CLO at Dec 2018 close	$505.0[1]	2860	393	3.7%
CLO at Arp. 2020 Trustee Report	$501.5	3067	399	11.2%
CLO at Jul. 2020 Trustee Report	$499.1	3367	396	12.8%

1) Includes $3.5mm of assets held for sale

Our current portfolio consists of 235 issuers with an average spread of LIBOR plus 396. The average market price in our portfolio is 90.7, versus 90.2 in the current CS Leveraged Loan Index. We had five defaults from January to July 2020.

The Fund's total equity investment consists of $30 million in equity contributed in December 2007, plus $13.8 million contributed as part of the December 2018 Fund upsize. This investment has led to $64.2 million in equity distributions from 2007 through the most recent distribution in July 2020. The Fund's reinvestment period ends in January 2021.

Our list of loans with S&P issue ratings of CCC+ or lower consists of 31 individual names, representing 12.8% of our total portfolio, an increase from the prior quarter's 27 individual names representing 11.2% of our total portfolio.

Our investment spread continues to be significantly higher than most CLOs with similar WARFs.

Market Conditions

The first half of 2020 produced the greatest loan market volatility since 2009. After a very strong first two months of 2020, marked by significant spread tightening and robust primary issuance, market conditions in March 2020 changed dramatically as fears of the pandemic spread throughout the economy. Entire sectors of the US economy seemingly shut down overnight. Loan market investors had great concerns over the pervasiveness of the economic contagion and the duration of the recovery, resulting in a significant sell off throughout the loan market. For several weeks, almost all single B rated loans had no bids. The CS Leveraged Loan Index declined from 97.1 on January 21st to 76.5 on March 24th, before partially recovering to 85.6 on April 30th. The market price on March 24th was the lowest CS Leveraged Loan Index reading since March 2009.

The effect on the CLO market was dramatic. A CLO's ability to make equity distributions is put at risk by either a significant amount of defaults or when loan downgrades to a CCC or lower rating by either Moody's or Standard & Poors exceeds 7.5% of the total Fund portfolio. As risks of a significant economic contagion spread in March/April 2020, rating agencies downgraded large swaths of the loan universe, focusing primarily on companies without proven liquidity to survive for the next 1-2 years and also on weaker performing companies in industries at risk during the pandemic. By the end of May, Morgan Stanley reported that 28% of CLOs were failing at least one overcollateralization test, when virtually all CLOs had been in compliance as of December 2019.

Market conditions significantly affected the Fund during this period. The Fund has always sought a relatively high spread in its portfolio, selectively purchasing B2 and B3 rated loans which we believed had good credit metrics and whose lower ratings were perhaps due to smaller loan issue sizes. Many of these performing loans were nevertheless downgraded to CCC in March and April. During this period, the Fund CCC percentage rose from 4.3% in January 2020 to 12.8% in July 2020. Despite this large CCC percentage and unlike many other CLOs, our Fund remained well in compliance with all its overcollateralization ratios, due to good operating performance and high market prices in most of our CCC-rated companies.

The other consequence of this economic volatility has been the collapse of base interest rates, which results in the loan market becoming less attractive to total return investors but very attractive for CLO equity investors. The three-month LIBOR rate declined from 181 basis points in January, to 116 basis points in April, to 27 basis points currently. The collapse in base rates has resulted in sharp retail outflows from the loan market (seeking total return), and a significant increase in loan

spreads and LIBOR floors for new primary loans. Moreover, the secondary loan market continues to trade at a discount, with the broader CS Leveraged Loan Index currently marked at 90. **The combination of low secondary loan prices and high primary loan spreads has created some of the most attractive market conditions in years for new CLO formation.**

<u>Defaulted Loans</u>

The pandemic and related recession has had a significant effect on the US economy generally and on industries significantly affected by the resulting social restrictions and economic decline. During the quarter, we sold our $2.9 million position in 24 Hour Fitness, a national gymnasium chain whose operations were largely closed, for 29.5%. We also sold our $400,000 position in RGIS, an inventory support company used by retailers to manage inventory, for 56.5%. We also have a $900,000 position in Seadrill which we expect will be restructured by early next year.

We incurred defaults in small positions in the senior secured loans for Covia (an industrial minerals business), and GNC (an international vitamin retailer). Both companies are pursuing restructurings which will partially repay our positions, while also handing our bank group control of each company.

The Fund received a small term loan and common stock from the restructuring of McDermott International, an international contracting firm that incurred severe liquidity issues due to project overruns.

Our default rate for the twelve months through June 30, 2020 increased to 2.0%, which is our highest default rate since 2010, but still below market default rates of 3.2%. We remain cautious about the overall economy, however, and expect to see additional restructurings, depending on the duration of the pandemic and other economic factors.

<u>Summary</u>

We continue to execute the Fund's investment strategy of senior secured first lien loans in companies which have strong underlying businesses. We continue to be selective about our investments, preferring seasoned credits, or very low levered companies, while avoiding new investments on out-of-favor industries. We continue to limit purchases of loans to companies in B3 rated companies. **Our current investments at current ratings / spreads / prices are the most attractive that we have seen in a long time.**

We are also seeking equity capital to raise additional Funds to take advantage of existing market conditions in the loan market.

We will seek to extend the Fund's reinvestment period in early 2021.

If you have any questions, do not hesitate to contact Tom Inglesby at 212 906 7848.

Regards,

Saratoga Investment Advisors