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CGBD - Q4 2022 Carlyle Secured Lending Inc Earnings Call

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CORPORATE PARTICIPANTS

Linda Pace Carlyle Secured Lending, Inc. – Chairperson

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Daniel Hahn Carlyle Secured Lending, Inc. – Managing Director

CONFERENCE CALL PARTICIPANTS

Arren Saul Cyganovich Citigroup Inc., Research Division - VP & Senior Analyst

PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to Carlyle Secured Lending's Fourth Quarter 2022 Earnings Call. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the call over to your speaker today, Daniel Hahn. Please go ahead.

Daniel Hahn Carlyle Secured Lending, Inc. - Managing Director

Good morning, and welcome to Carlyle Secured Lending's Fourth Quarter 2022 Earnings Call. With me on the call this morning is Linda Pace, the Chair of our Board of Directors; Aren LeeKong, our newly appointed Chief Executive Officer; and Tom Hennigan, our Chief Financial Officer.

Last night, we filed our Form 10-K and issued a press release with a presentation of our results, which are available on the Investor Relations section of our website. Following our remarks today, we will hold a question-and-answer session for analysts and institutional investors. This call is being webcast, and a replay will be available on our website.

Any forward-looking statements made today do not guarantee future performance, and any undue reliance should not be placed on them. These statements are based on current management expectations and involve inherent risks and uncertainties, including those identified in the Risk Factors section of our annual report on Form 10-K. These risks and uncertainties could cause actual results to differ materially from those indicated. Carlyle Secured Lending assumes no obligation to update any forward-looking statements at any time.

With that, I'll turn the call over to Linda Pace.

Linda Pace - Carlyle Secured Lending, Inc. - Chairperson

Thank you, Dan. Good morning, everyone, and thank you all for joining us to discuss our fourth quarter and full year 2022 results. I will focus my remarks on 3 topics for today's call. I'll start with an overview of our fourth quarter results; second, I'll comment on the current market environment and investment activity; and finally, I'll conclude with a few thoughts on our full year 2022 performance.

We generated net investment income of $0.48 per share in the fourth quarter. This was an increase of 9% from core earnings in Q3 as the portfolio continued to benefit from higher base rates. We declared total first quarter dividends of $0.44, consisting of our new base dividend of $0.37, which we have increased for the third consecutive period, plus a $0.07 supplemental. We have now increased our base dividend rate by a total of almost 16% over the last 3 quarters and are pleased to highlight that the $0.37 per share is now back at our IPO level.

Our net asset value decreased by 1% in the fourth quarter to $16.99 per share, primarily due to the impact of widening market yields. We repurchased an additional $7.3 million of our common stock during the quarter, resulting in $0.04 of accretion to our net asset value per share.

Turning now to the market. The current environment continues to be lender-friendly, allowing us to selectively deploy capital into attractive opportunities. From a macro perspective, we have still not seen a recessionary contraction in the U.S. economy despite the increased velocity of Fed rate hikes, which occurred much more quickly than most market participants expected.

We've seen a reduction in the level of uncertainty around interest rates and a reduction in inflation levels. However, fixed income and private credit continue to see volatility, driven by less liquidity and capital formation across the debt markets. This backdrop informed our investment activity, and we remain focused on deploying primarily first lien capital at attractive yields with better economics and terms.

During the fourth quarter, we funded $129 million and saw total repayments and sales of $87 million. We ended 2022 with approximately $2 billion of investments at fair value.

Before turning things over to Tom, I'd like to spend a few minutes on our full year 2022 results. We generated net investment income of $1.93 per share which was an increase of 26% compared to the prior year. We declared total dividends of $1.64 per share during the year, resulting in dividend coverage of 118%. We also repurchased shares that provided an additional $0.14 of accretion to NAV during the year.

Our net asset value ended the year at $16.99 per share, up from $16.91 as of Q4 2021 due to strong fundamental credit performance. We're extremely pleased with these results and believe they demonstrate not only the power of our platform, but also our commitment to creating long-term shareholder value regardless of the market environment.

With that, I'd like to hand the call over to our CFO, Tom Hennigan.

Thomas M. Hennigan - Carlyle Secured Lending, Inc. - CFO & Chief Risk Officer

Thank you, Linda. Today, I'll begin with a review of our fourth quarter earnings. Then I'll provide further detail on our balance sheet positioning, and I'll conclude with a discussion of our portfolio performance.

As Linda previewed, we had another strong quarter on the earnings front. Total investment income for the fourth quarter was $56 million, up from the prior quarter after taking into account the onetime impact of direct travel in Q3. This increase was driven by higher benchmark rates, a higher average investment balance and an increase in dividend income from our JVs. This increase was partially offset by lower OID accretion and fee income.

Total expenses increased in the quarter from $29 million to $31 million, primarily due to higher interest expense from rising base rates on our financing facilities. The result was total net investment income for the fourth quarter of $25 million or $0.48 per share, up 9% versus $0.44 per share of core earnings in Q3. Furthermore, this is substantially above our core earnings of about $0.40 per share each quarter in the first half of 2022.

Our Board of Directors declares a dividend for the first quarter of 2023 at a total level of $0.44 per share. That's comprised of our new $0.37 base dividend, up from the prior level of $0.36 plus a $0.07 supplemental, which is payable to shareholders of record at the close of business on March 31.

In terms of the forward outlook for earnings, based on the combination of higher benchmark rates and attractive economics on new investments, we see continued growth in NII for the first quarter, with further upside throughout the rest of 2023 based on the latest rate curves. So we remain highly confident in our ability to comfortably meet and exceed the new $0.37 base dividend and continue paying out supplemental dividends each quarter. And as Linda mentioned, $0.37 was the base dividend at IPO and we're very pleased to be back at this level.

On valuations, our total aggregate realized and unrealized net loss was $13 million for the quarter. This decrease was primarily driven by unrealized losses from widening market yields.

Next, I'll touch on our financing facilities and leverage. We continue to be well positioned on the right side of our balance sheet. Statutory leverage was about 1.3x and net financial leverage ended the quarter at 1.16x. So while up modestly compared to prior quarter, our leverage remains comfortably within our target range. This positioning allows us to effectively deploy capital given the attractive yields and terms available for new investments in the current market.

I'll finish with a review of the portfolio and related activity. We continue to see overall credit stability and credit quality across the book. The total fair value of transactions risk rated 3 to 5, indicating some level of downgrade since we made the investment was flat this quarter.

Total nonaccruals increased from 1.9% to 2.9% based on fair value due to the addition of PPT Management. However, we expect further developments for that investment in the coming months, which will result in restoring the position to accrual status. In addition, we anticipate any credit softness from the current macroeconomic headwinds will be buffered by further upside on the Dermatology Associates and Direct Travel positions.

With that, I'll turn it back to Linda.

Linda Pace - Carlyle Secured Lending, Inc. - Chairperson

Thanks, Tom. We view 2022 as a year of very strong performance for the company, which we believe translated into excellent performance for our stockholders. We generated almost 18% of total return for our shareholders, which included a solid double-digit dividend yield and price appreciation in our stock price. This return represented the best total return experience for shareholders of all publicly traded BDCs with a market capitalization of over $500 million for the year.

I would like to take a moment to thank the entire Carlyle team for all their hard work, they are the reason we were able to deliver this top-tier performance. Lastly, before opening up the call for questions, I'd like to introduce our newly appointed CEO, Aren LeeKong.

Aren C. LeeKong - Carlyle Secured Lending, Inc. - CEO & Director

Thanks, Linda. I would like to actually take this moment to publicly thank you. You've played an instrumental role in building a best-in-class credit platform over the last 20-plus years. Your contributions to the success of the platform are impressive and have been invaluable. It has been an absolute pleasure to spend my time working with you and the Carlyle Secured Lending team as part of my role on the Board of Directors over the last few years. I've also worked with a number of the senior members of Carlyle's Global Credit platform in various forms over the better part of the previous 2 decades.

Finally, I've been fortunate enough to spend the end of 2022 and the first couple of months of this year solidifying relationships with the deep bench of talent that exists within Carlyle direct lending and across the broader Carlyle platform. I could not be more impressed. I have every confidence in this team and in their ability to continue to deliver the results that our shareholders have come to expect.

So with that said, thank you all for joining. And operator, please open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Arren Cyganovich of Citi.

Arren Saul Cyganovich - Citigroup Inc., Research Division - VP & Senior Analyst

Maybe you could just talk a little bit about the environment right now, how private equity sponsors are thinking about the market and whether or not you feel like there's going to be an increase in any kind of deal opportunities as we enter the year?

Linda Pace - Carlyle Secured Lending, Inc. - Chairperson

Sure. It's Linda. I'll start and let the team chime in. So yes, I guess we have a pretty good, unique inside view given that we're part of the Carlyle Group. And what I can tell you is the deal environment is not that easy, but there's still activity. And the big benefit to folks like ourselves and others in the private credit market is we're really seeing a pullback from the traditional sources of lending activity.

So the banks and the high-yield market, the CLO market really have not been that active. So private equity sponsors, when they do want to do a deal and Carlyle will be in the mix on this, they're going to private credit because they can get the certainty of execution. They get term sheets that don't have just incredible flex language that can give banks and out for anything they deem abnormal. And they can have -- in this environment, maybe they're paying a little bit more, maybe they're not. They're not getting as loose terms, but they're not getting super onerous terms either. So the private credit markets, of which BDCs like ourselves, are obviously a part of, are the beneficiaries of that. So we continue to expect to see deal flow, not -- but enough that we can be highly selective in what we're picking. Is anybody else?

Aren C. LeeKong - Carlyle Secured Lending, Inc. - CEO & Director

Yes, it's Aren LeeKong. Nice to meet you, Arren. So I'd say in the first quarter, the new transactions we have, and I'm literally looking at our pipeline and closed deals as we speak, we're seeing obviously, base rates are higher. Spreads are a lot closer to 700 basis points over. That is going to continue. And Tom has already spoken about it today that is going to continue to be a positive impact to the portfolio, if you think about what is coming up for maturity over the next year or 2 years. Those transactions are going to be replaced, which are sort of 520 to 540 basis point spread transactions are going to be being replaced with 675 to 700 plus spread transactions. So that is going to continue to provide positive momentum.

We're seeing, as Linda alluded to, our leverage levels on new transactions are quite attractive to historical with wider spreads. Because of the dearth of capital in the large liquid market and just period because the world is a little bit rockier, we are seeing tighter documents effectively. There's nothing in our pipe that doesn't have covenants. So it is a positive market for new transactions.

And as you alluded to, Arren, I think we view what's in our portfolio is quite attractive. So we're also taking this opportunity for -- to be very close to our sponsors and work with them on transactions that we know have spent lots of hours knowing the companies, to figure out how to keep those credits in our portfolio at more attractive rates for our shareholders. So that's sort of what we're seeing right now. And quite frankly, we do have the ability to be selective and we're taking full advantage of that.

Arren Saul Cyganovich - Citigroup Inc., Research Division - VP & Senior Analyst

That was good color. I appreciate that. The second question I had was on the PPT nonaccrual. I think in the prepared remarks, you had mentioned that you expect that to go back to accrual. I don't know if you can add any commentary as to what would potentially improve that situation.

Thomas M. Hennigan - Carlyle Secured Lending, Inc. - CFO & Chief Risk Officer

Arren, it's Tom. We're working through, what I'd say, a little bit guarded what we can say, because it's an active situation on an investment. We're working through, I'd say, your typical amendment process for a deal that has underperformed and we would anticipate a new capital structure for that business and a positive outcome in terms of our position in that credit probably that one next quarter.

Operator

I would now like to turn the conference back to Linda Pace for closing remarks. Madam?

Linda Pace - Carlyle Secured Lending, Inc. - Chairperson

Thank you. And thank you, everyone, for joining us today, and we look forward to speaking with you next quarter. Have a great day.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.
