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CGBD - Q1 2023 Carlyle Secured Lending Inc Earnings Call

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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Carlyle Secured Lending First Quarter 2023 Earnings Call. (Operator Instructions) Please be advised today's conference is being recorded. And I would like to hand it to your speaker today, Daniel Hahn. Please go ahead.

Daniel Hahn

Good morning, and welcome to Carlyle Secured Lending's First Quarter 2023 Earnings Call. With me on the call this morning is Aren LeeKong, our Chief Executive Officer, and Tom Hennigan, our Chief Financial Officer.

Last night, we filed our Form 10-Q and issued a press release with the 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 Aren.

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

Thanks, Dan. Good morning, everyone, and thank you all for joining. I will focus my remarks on three topics for today's call. I'll start with an overview of our first quarter results. Next, I'll touch on the current market environment. And finally, I'll conclude with a few thoughts on our investment activity and current positioning.

Starting off with earnings. The first quarter was another strong quarter as the portfolio continued to benefit from higher base rates and attractive pricing on new investments. We generated total net investment income of $0.50 per share in Q1, which represented an increase of 25% versus our prior year core earnings and resulted in dividend coverage of 136%. We declared total Q2 dividends of $0.44 consisting of our base dividend of $0.37, which is in line with our first quarter base plus a $0.07 supplemental.

As Tom will detail later, our net asset value increased from prior quarter to $17.09 per share, primarily driven by our Q1 earnings outpacing our dividend.

Turning now to the current investment environment. The terms and pricing available to us today continue to be lender friendly. Recent deal activity indicates a potential recovery in broadly syndicated and high-yield markets. Though even with those green shoots sprouting, sponsors have continued to turn to private credit as the preferred financing source for the majority of LBO transactions.

From a macro perspective, bank stress initially increased volatility in Q1 but the knock-on effects of those events were limited. Despite the Federal Reserve's best efforts, inflation remains persistent with companies continuing to pass through price increases to the consumer. As a general note on our portfolio, over the last 18 months, we've seen stability in the credit quality of our book. The majority of our companies have been able to appropriately adapt to the current inflationary environment, and we pay close attention to any companies that we think may have a difficult time passing through cost inflation to customers in the long run.

While Q1 is traditionally a seasonally slow quarter for deal activity, broader market volatility weighed further on M&A activity at the beginning of 2023 and led to an even slower quarter for capital formation. With this as the backdrop, we remained disciplined and focused on deploying primarily first lien capital at highly attractive yields. In line with the broader market, new originations were down. But despite this, we remained highly selective.

The weighted average yield at cost of these transactions was higher than the new fundings in the fourth quarter. Additionally, newly funded investments had more attractive economics than first quarter repayments. We ended Q1 with approximately $2 billion in investments at fair value.

Lastly, I'd like to spend a few minutes on our current portfolio positioning. While this was my first quarter of leading the business, our strategy remains consistent. We are focused on primarily making investments to U.S. companies backed by high-quality sponsors in the middle markets.

The median EBITDA across our core portfolio at the end of the first quarter was $73 million. Supplementing our core portfolio, we leveraged the sourcing capabilities of complementary lending strategies within the broader Carlyle network and capitalized on significant global resources that the firm has to offer to help us manage our risk.

Our approach allows us to remain focused on disciplined underwriting, prudent portfolio construction and conservative risk management. Our portfolio remains highly diversified and is comprised of over 170 investments in more than 130 companies across over 25 industries. The average exposure to any single portfolio company is less than 1% and 95% of our investments are in senior secured loans, so we feel very well positioned in the current environment.

I'll now hand the call over to our CFO, Tom Hennigan.

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

Thank you, Aren. Today, I'll begin with a review of our first quarter earnings then I'll discuss portfolio performance, and I'll conclude with detail on our balance sheet positioning.

As Aren previewed, we had another strong quarter on the earnings front. Total investment income for the first quarter was $58 million, up 4% from the prior quarter. This increase was primarily driven by higher benchmark rates.

Total expenses increased in the quarter from $31 million to $33 million. Similar to last quarter, this was primarily due to higher interest expense from rising base rates. The result was total net investment income for the first quarter of $26 million or $0.50 per share, up 4% versus $0.48 per share in Q4. This recent level of earnings is materially above our quarterly core earnings from earlier in 2022, which ranged from $0.40 to $0.44 per share.

Our Board of Directors declared the dividend for the second quarter of 2023 at a total level of $0.44 per share. That's comprised of the $0.37 base dividend plus a $0.07 supplemental, which is payable to shareholders of record as of the close of business on June 30.

This total dividend level of $0.44 allows us to build NAV in the face of an increasingly complex macroeconomic environment. At the same time, it also represents an attractive yield of over 10% on NAV and over 12% on the latest share price, which we view as a very healthy level.

In terms of the forward outlook for earnings, we still see some potential for modest upside in NII compared to Q1 levels based on the combination of higher benchmark rates and attractive economics on new investments. So we remain highly confident in our ability to comfortably meet and exceed our $0.37 base dividend and continue paying out supplemental dividends each quarter.

On valuations, our total aggregate realized and unrealized net gain was about $1 million for the quarter. This increase was primarily driven by unrealized gains from tightening market spreads, combined with some mixed results for individual credits. While we continue to see overall stability in credit quality across the book, we are actively monitoring each of our investments to identify any early signs of deterioration.

The total fair value of transactions risk-rated 3 to 5 indicating some level of downgrade since we made the investment was up modestly this quarter. Total nonaccruals increased from 2.9% to 3.5% based on fair value due to the addition of American Physician Partners. Aren noted that most of our portfolio companies have reacted well to the inflationary environment. The exception has been a couple of our health care services book, namely American Physician and ProPT, where labor shortages and wage inflation have persisted. And the structural nature of the businesses makes it difficult for those management teams to pass along these cost increases.

Despite underperformance in these two names, we continue to see financial performance improvement and positive valuation migration in investments like Direct Travel and Dermatology Associates.

I'll finish by touching 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. This is in line with the prior quarter and 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.

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

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

Thanks, Tom. I would like to finish by reiterating that we remain highly confident in our strategy and portfolio construction and are excited to apply our disciplined sourcing and underwriting approach during such an attractive vintage for direct lending.

I'd like to now hand the call over to the operator to take your questions. Thank you.

Operator

(Operator Instructions) At this time, I would like to turn it back to the speakers for any further comments.

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

Thank you so much. Everyone, we appreciate your partnership, and we look forward to speaking to you in the future. Have a great day.
