

REFINITIV STREETEVENTS

EDITED TRANSCRIPT

CGBD - Q1 2022 Carlyle Secured Lending Inc Earnings Call

EVENT DATE/TIME: MAY 04, 2022 / 12:30PM GMT

CORPORATE PARTICIPANTS

Linda Pace Carlyle Secured Lending, Inc. - Chairperson & CEO

Taylor Boswell Carlyle Secured Lending, Inc. - CIO, President & Director

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

Daniel Hahn Carlyle Secured Lending, Inc. – Managing Director

CONFERENCE CALL PARTICIPANTS

PRESENTATION

Daniel Hahn Carlyle Secured Lending, Inc. – Managing Director

Good morning, and welcome to Carlyle Secured Lending's First Quarter 2022 Earnings Call. Last night, we issued an earnings press release and detailed earnings presentation with our quarterly results, a copy of which is 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 undue reliance should not be placed on them. These statements are based on the 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 that could cause actual results to differ materially than those indicated. Carlyle Secured Lending assumes no obligation to update forward-looking statements at any time.

With that, I'll turn the call over to our Chief Executive Officer, Linda Pace.

Linda Pace - Carlyle Secured Lending, Inc. - Chairperson & CEO

Thank you, Dan, and good morning, everyone, and thank you all for joining us to discuss Carlyle Secured Lending's first quarter 2022 results. Joining me on this call are our Chief Investment Officer and newly appointed President, Taylor Boswell; and our Chief Financial Officer, Tom Hennigan.

Today, I'm going to focus my remarks on 3 topics. First, I'll provide an overview of this quarter's financial results. Second, I'll touch on investment activity and the current environment. And finally, I'll conclude with a few thoughts around our current positioning.

Let me begin with an overview of our financial results. Despite an increasingly complex market backdrop, we once again generated strong earnings this quarter. Our total net investment income was \$0.47 per common share, which included \$0.07 of nonrecurring income derived from the successful exit of our investment in SolAero. We declared a total dividend of \$0.40 per share, representing an annualized yield on our stock of over 11%. The dividend payments are comprised of our \$0.32 base dividend, plus \$0.08 of our regular supplemental dividend of recurring earnings above the base dividend. As Tom will detail later, we expect dividends, which have landed between \$0.38 and \$0.40 in recent quarters, to remain in that range with the potential for upside as we progress through the rest of the year.

Net asset value per share of \$17.11 saw positive progression for the eighth consecutive quarter, up 1.2% from Q4 '21. As Tom will discuss further, strengthening credit performance, especially in our watchlist names, drove our first quarter's results and outpaced any negative valuation impact from widening market yields or inflation-driven earnings impacts. This allowed us to deliver NAV, which now stands 3.3% above our pre-COVID level and higher than our NAV in Q2 '19 when Taylor and I joined the leadership team.

We repurchased an additional \$7 million of our common stock in the quarter, resulting in \$0.03 of accretion to our net asset value. As we have consistently said, we remain active repurchasers of our stock at its current valuation levels, given the attractiveness of the returns for our shareholders.

In total, we have repurchased almost 10 million shares or 16% of our float since the commencement of our share repurchase program, demonstrating our firm and continued commitment to shareholders.

I'll now turn to this quarter's investment activity in the current environment. We funded \$114 million of new investments in the first quarter, almost all of which were in a first lien position. This compares with repayments and strategic sales of \$159 million during the first quarter. As a result, we ended the quarter with just under \$1.9 billion of investments, essentially flat versus last quarter. As Taylor will describe later, the investment environment is changing and becoming more complicated. With competition remaining intense, we will continue our approach of being highly credit selective and defensively oriented. In this moment of higher uncertainty, we are comfortably operating at a funded asset level closer to the bottom of our target leverage range as our income generation prospects remain solid.

Finally, a couple of organizational items to note. As you no doubt saw, we've changed our name in the quarter from TCG BDC to Carlyle Secured Lending. As you've heard from us before and we'll continue to say, our strategy is to leverage Carlyle's integrated investment platform to drive edge at each step of our investment process from origination to underwriting to portfolio management. We believe this new name better connects the company to the inherent strength of our manager as well as to the fundamental nature of our underlying investment activity. For the avoidance of doubt, our ticker CGBD will remain the same.

I'd like to conclude by taking a moment to congratulate some members of our large and capable team who assumed formal roles at Carlyle Secured Lending in the quarter. Taylor Boswell, who I mentioned was appointed to President, has also joined the company's Board of Directors. He has been integral to the success of the company over the past 3 years and his new title and role on the Board are reflective of his outstanding leadership. In addition, you will note we admitted Jonathan Pearl, Vice President and Head of Sponsor Coverage; Michael Hadley, Vice President and Head of Underwriting; and Alex Popov, Vice President and Head of Illiquid credit as newly elected officers of the company. Each of these professionals are long-tenured members of the Carlyle team. We're fortunate to have such a deep bench of talent here, and we welcome their more prominent role at Carlyle Secured Lending. Thanks for joining us this morning.

I'd like to hand the call over to our President, Taylor Boswell.

Taylor Boswell - Carlyle Secured Lending, Inc. - CIO, President & Director

Thanks, Linda. As usual, I'll begin today by sharing some macroeconomic perspectives derived from our global investment footprint. And after that, I'll provide comment on the current credits and investment climate. The last time we reported earnings, we spoke about the ongoing transition we perceived from 2021's one-way market to what was shaping up to be an increasingly complex investment environment in 2022. And we did that just 1 day before Russia's tragic invasion of Ukraine commenced, which has, of course, only further complicated the picture.

As a starting point, it is worth saying that we have conducted intense portfolio reviews in recent months and are happy to report we have no consequential known direct exposure to business operations in Russia, Ukraine or Eastern Europe broadly. With our focus on middle market lending in the U.S., which is 90% of our underlying exposure, this is not a surprising conclusion. In addition, given our portfolio maintains a heavy noncyclical overweight, we see little direct impact from the volatility and dislocations experienced in commodity markets.

Based on this largely domestic lower cyclicity exposure profile, our primary investment focus in recent months has been the knock-on inflationary impact, principally in food and fuel, which are currently layering in on top of an already inflationary environment. Through the first quarter, and as far as our data indicates continuing in the second quarter, U.S. consumer spending remains resilient on the back of strong balance sheet and supportive labor market conditions. But these conditions may not persist, and we must respect that as we progress through this environment. As for our borrowers, they generally continue to report success passing through increased inflationary costs. But just like us, corporate management teams are adjusting to a business environment that is fundamentally different from the trending markets which dominated most of the last decade. They have much work left to do to ensure the preservation of margin in this evolving and complex world.

So while we do see a favorable base case for credit performance developing, we must also acknowledge it will be several quarters before the net annualized impacts of increased costs and price recovery are fully settled and known for any given borrower. Not surprisingly, coming out of COVID, we redoubled our focus both in new underwrites and portfolio management on understanding the detailed puts and takes affecting the current

and near-term performance of each borrower, something that has only become more critical as inflationary pressures built in recent months. We will stay vigilant and focused on these topics.

Now despite all the aforementioned complexity, our portfolio performed extremely well again this quarter. Ultimately, the continued recovery from our watchlist and COVID-impacted names outweighed both inflation-driven earnings or market yield-driven valuation impacts, resulting in another quarter of positive NAV progression. We now have amassed 8 consecutive quarters of increases, while our NAV stands 3.3% higher than pre-COVID levels. We fully exited one of our nonaccrual names, SolAero, realizing \$9 million of proceeds in excess of our Q4 '21 mark. After several years of working to turn around the business, we're happy to report the successful outcome for both SolAero and our company. Importantly, our 3 remaining nonaccrual investments all continue on a positive trajectory, a trajectory which if it holds, will likely result in the return to accrual status for portions of those exposures this year.

Finally, I'll comment on transaction volumes, which are also topical in today's environment. After exiting a record year in 2021, M&A, leverage loan and high-yield volumes market-wide were down in Q1 '22 by 17%, 9% and 38%, respectively, quarter-over-quarter. Private transactional markets are healthy, but they are also facing tough comps and took a bit of a breather after a hectic Q4. It's important to say, even in this environment, we continue to see ample attractive investment opportunities as private credit took meaningful share from liquid markets in the first quarter and more importantly, our already strong platform continues to grow its capabilities.

Currently, we have a strong transaction pipeline developing in Q2. Overall, we remain extremely comfortable with both our funded asset position as well as our ability to maintain that position in any investment environment. So it's a complex world for sure. But at Carlyle Secured Lending, we're happy to report that portfolio construction, credit performance and income generation all remain well positioned. Clearly, we are generating consistent income well in excess of our base dividend, and we expect that to continue.

We're frequently asked, why don't you take the base dividend up? Well, first, you'll recall, our dividend policy complements our base dividend with consistent quarterly supplemental dividends of excess recurring income. So investors are already getting the benefit of those excess earnings. Second, given the complexity of today's environment, we assess that this is not the time to reach for risk in order to push earnings. Rather, this is a time to be highly selective on new investments until better clarity develops on the impacts of this inflationary environment. We're fortunate to generate one of the strongest dividend yields in the industry, while operating towards the low end of our target leverage range. That's just fine by us right now because this strong positioning lets us focus on what matters most, delivering a long-term sustainable income stream.

With that, I'd like to turn it over to Tom.

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

Thank you, Taylor. Today, I'll begin with a review of our first quarter earnings, then I'll provide further detail on our balance sheet positioning and 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 first quarter was \$48 million, up from \$44 million in the prior quarter. Upside performance was primarily driven by the income received from the exit of our investment in SolAero, which had been a nonaccrual position. Excluding this onetime income, top line performance was essentially flat versus prior period. Noting that total dividend income from the 2 JVs was again \$7.5 million, in line with the last few quarters.

Total expenses increased modestly in the quarter from \$22 million to \$23 million as higher incentive fees were partially offset by lower interest expense and lower management fees. The result was net investment income for the first quarter of \$25 million or \$0.47 per common share, that matches the highest level in the history of the company. And even after adjusting for nonrecurring SolAero income, we still achieved \$0.40 for the quarter. On May 2, our Board of Directors declared the dividends for the second quarter of 2022 at a total level of \$0.40 per share. That's comprised of the \$0.32 base dividend plus an \$0.08 supplemental, which is payable to shareholders of record as of the close of business on June 30.

Last quarter, we discussed the fact that most of our loans have LIBOR floors while our floating rate debt does not. So we may see some mild earnings impact on second quarter results. This simply means instead of the \$0.40 plus per share we've achieved the last 2 quarters, we may be a touch lower in 2Q as LIBOR as of 3/31 was close to the level of our typical 1% floor. However, the current curves indicate benchmark rates will become a positive earnings driver sooner than previously anticipated. In the back half of 2022, we begin to see a net positive impact. And again, for every 33

basis points of additional increase in LIBOR, we'll experience a \$0.01 increase in NII each quarter. And away from LIBOR, as Taylor mentioned, we also expect a positive earnings impact this year from further improvement in our current nonaccrual loans. In each of the last 4 quarters, we've earned and distributed at least \$0.38 per share. All things considered, our shareholders should have confidence that future quarterly payments for the balance of 2022 will continue to meet or exceed this level.

On valuations, our total aggregate realized and unrealized net gain was \$5 million for the quarter, the eighth consecutive quarter of positive performance. The net gains were driven by higher valuations on our watchlist names and an increase in the valuation of our investment in the MMCF JV, partially offset by the negative impact of widening market yields and to a lesser extent, inflation-driven earnings impacts at certain borrowers.

Next, I'll touch on our financing facilities and leverage. We continue to be very well positioned on the right side of our balance sheet. Statutory leverage was just under 1.2x, while net financial leverage was slightly under 1 turn of leverage. So we ended the quarter right at the bottom end of our target leverage range.

I'll finish with a review of the portfolio and related activity. We continue to see net improvement in credit quality across the book, especially in positions with historical credit issues. The total fair value of transactions risk-rated 3 to 5, indicating some level of downgrades since we made the investment, improved again this quarter by \$6 million in the aggregate. Total nonaccruals decreased to 3.7% based on fair value, driven by the exit of SolAero. And regarding other high-focus positions, we continue to see improvement in the fundamental performance and outlook for both Dermatology Associates and Direct Travel. Those 2 borrowers account for the vast majority of current nonaccruals. We continue to see these positions not as risk, but as opportunity for both NAV and NII expansion this year.

With that, back to Linda for some closing remarks.

Linda Pace - Carlyle Secured Lending, Inc. - Chairperson & CEO

Thanks, Tom. Before I turn the call over to the operator, I'd like to reiterate that, as always, we are focused on using our platform to directly originate the widest possible range of private credit transactions in the market. We then apply our platform's capabilities and expertise to select only the highest quality credit profiles. From there, we build a diversified portfolio designed to deliver sustainable through-cycle income. We feel exceptionally well positioned to continue to meet that goal even in this complex environment. Thanks for joining us today.

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

Operator

(Operator Instructions) And I'm currently showing no questions at this time. I'd like to turn the call back over to Linda Pace for closing remarks.

Linda Pace - Carlyle Secured Lending, Inc. - Chairperson & CEO

Thank you. And I guess everyone is going to be pretty easy on us this quarter. So appreciate your attention today. And if you think of anything you want to talk to us about, please feel free to reach out over the next couple of days. Take care, everyone.

Operator

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

DISCLAIMER

Refinitiv reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES REFINITIV OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2022, Refinitiv. All Rights Reserved.