08-Nov-2023

Carlyle Secured Lending, Inc (0CT3YW-E)

Q3 2023 Earnings Call

CORPORATE PARTICIPANTS

Aren LeeKong
President, Chief Executive Officer & Director, Carlyle Secured Lending, Inc

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

MANAGEMENT DISCUSSION SECTION

Operator: Hello and welcome to the Carlyle Secured Lending, Inc. Third Quarter 2023 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speaker presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded.

It is now my pleasure to introduce [ph] Daniel Harn (00:00:39), Shareholder Relations.

Unverified Participant

Good morning, and welcome to Carlyle Secured Lending's third 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 LeeKong

President, Chief Executive Officer & Director, Carlyle Secured Lending, Inc

Thanks, [ph] Dan (00:01:53). Good morning, everyone. And thank you all for joining. As has become custom, I will focus my remarks on three topics for today's call. First, I'll provide an overview of the third quarter financial results. Next I'll touch on the current market environment. And finally, I'll conclude with a few comments on the quarter's investment activity and portfolio positioning.

Starting off with earnings, we continue to see our portfolio yield benefit from the higher base rate environment. In the third quarter, we generated total core NII of $0.52 per share, which is an increase of 18% from the prior year and represents an annualized return on equity of 12.4%, continuing the trend upward from last quarter and the

LTM period. Our Board of Directors declared a total fourth quarter dividend of $0.44, consisting of $0.37 of base dividends, plus a $0.07 supplemental, both of which were in line with the prior quarter. Our net asset value as of September 30 was $16.86 per share, up $0.13 or approximately 1% from the June 30 period, as a result of our Q3 earnings outpacing our dividend and net positive movement in valuations.

Turning now to the current environment. Private credit continued to take share from the BSL market and we've seen sponsors continue to favor the private credit market to finance the limited number of new LBO transactions. Refinancing transactions drove the majority of activity during the quarter, which included a number of high profile BSL names being refinanced by the private credit space. Similar to prior quarters terms and pricing during third quarter leaned favorably to lenders. However, we continue to remain highly selective in putting new money to work and look for new transactions to improve the credit quality of our book and are accretive to CSLs ROE.

The weighted average spread of new investments outpaced the spread on the third quarter's repayments for the fifth quarter in a row. We continue to see the trend for leverage in LTBs and platform originations improved. On a year-to-date basis, average leverage in LTBs and new originations decreased by approximately one term and 5% respectively. Originations benefited from the One Carlyle Platform, both in the US and Europe. As discussed last quarter, we are focused on complementing our traditional sponsor pipeline with other sources of transaction flow, including Carlyle generated and non-sponsored transactions. Outside of new deals, we continue to see momentum in mining the existing portfolio for add-on transactions that provide incremental economics and allowed for improvements in cap structure of current portfolio companies.

Lastly, I'd like to spend a few minutes on current positioning. Our portfolio remains highly diversified and is comprised of 171 investments in 124 companies across over 25 industries. The average exposure in any single portfolio company is less than 1% and 94% of our investments are in senior secured loans. We continue to be pleased with the overall credit performance of our existing portfolio with revenue and EBITDA up quarter-over-quarter since origination. In addition, despite persistent inflationary pressures, our borrowers' EBITDA margins have generally remained stable. The leading EBITDA across our core portfolio at the end of the quarter was $80 million. And importantly, we've not seen any meaningful increase in the level of non-cash add backs.

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

Thomas M. Hennigan

Chief Financial Officer & Chief Risk Officer, Carlyle Secured Lending, Inc

Thank you, Aren. Today, I'll begin with a review of our third 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 third quarter was $61 million, up modestly from the prior quarter. The continued positive impact of higher base rates was partially offset by a lower average investment balance. Total expenses of $34 million also inched up versus prior quarter, again due to higher interest expense from rising base rates. The result was total investment income for the third quarter of $26 million or $0.52 per share in line with prior quarter. Importantly, this recent level of earnings is materially above our quarterly earnings from 2022. Our Board of directors declared the dividends for the fourth quarter of 2023 at a total level of $0.44 per share. That's comprised of a $0.37 base dividend plus the $0.07 supplemental, which is payable to shareholders of record at the close of business on December 29.

Similar to prior quarters, the total dividend level of $0.44 per share allows us to bolster NAV in the face of an increasingly complex macroeconomic environment. Our base dividend coverage of over 140% is among the highest in the BDC peer set. And we've grown the base dividend by nearly 16% since May 2022. At the same time, the total dividend level also represents an attractive yield of over 12% on the share price as of September 29. In terms of the forward outlook for earnings, we see stability in the $0.50 plus level based on the combination of the current forward interest rate curve and attractive economics on new deals.

Despite rising rates, we've maintained a conservative disciplined approach that we believe will enable us to continue consistent dividend payout in a variety of rate environments, including when rates normalize. So we remain highly confident in our ability to comfortably meet and exceed our 37% base dividend and continue paying out supplemental dividends each quarter.

On valuations, our total aggregate realized and unrealized net gain was about $3 million for the quarter, supported in part by tightening market spreads and improvement in valuations in some of our healthcare names. This increase in valuations combined with Q3 earnings exceeding the dividend resulted in our NAV increasing from $16.73 to $16.86 per share.

Turning to the portfolio, we can see this overall stability in credit quality across the book. Importantly, this quarter, there were no new non-accruals and no additions to our watch list, which deals with risk rating four or five. Total non-accruals were effectively flat quarter-over-quarter. As we continue to see financial performance improvement and positive valuation migration in investments like Dermatology Associates and Bayside, which is formerly known as [indiscernible] (00:08:56).

And as Aren noted, most of our portfolio companies continue to weather the inflationary environment very well. And we remain confident in the credit strength of our overall portfolio.

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. Leverage is down quarter-over-quarter and we're intentionally running leverage conservatively at the lower end of our target range to maintain the flexibility to invest in attractive opportunities.

Statutory leverage was about 1.3 times and net financial leverage ended the quarter modestly lower at 1.06 times, the lowest levels in over a year. This positioning allows us to opportunistically deploy capital, given the attractive yields and terms available for new investments in the current market environment.

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

Aren LeeKong

President, Chief Executive Officer & Director, Carlyle Secured Lending, Inc

Thanks, Tom. I would like to finish by highlighting the consistency of our investment approach and reiterate our overall strategy. We're primarily focused on making senior secured floating rate investments to US companies backed by high-quality sponsors, primarily in the mid-market. We utilize a rigorous approach based on disciplined underwriting, prudent portfolio construction and conservative risk management. While market demand for private credit remains high, our approach has not changed, and we remain focused on sourcing differentiated lending opportunities via the breadth and scope of the One Carlyle Platform. I'd like to now hand the call over to the operator to take your questions. Thank you.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] I'm showing no further questions. So with that, I hand the call back over to CEO, Aren LeeKong for any closing remarks.

Aren LeeKong

President, Chief Executive Officer & Director, Carlyle Secured Lending, Inc

Thank you so much, everyone. Look forward to speaking to you all in your scheduled calls. And thank you for the support. Have a great day.

Operator: Ladies and gentlemen, thank you for participating. This concludes today's program, and you may now disconnect.