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Carlyle Secured Lending, Inc (OCT3YW-E)

Q4 2024 Earnings Call

CORPORATE PARTICIPANTS

Nishil Mehta

Managing Director & Head-Structured Credit, The Carlyle Group

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Thomas M. Hennigan

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

OTHER PARTICIPANTS

Finian O'Shea

Analyst, Wells Fargo Securities LLC

Melissa Wedel

Analyst, JPMorgan Securities LLC

Derek Hewett

Analyst, BofA Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good day, and thank you for standing by. Welcome to Carlyle Secured Lending Inc. Fourth Quarter 2024 Earnings Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, Nishil Mehta, Head of Shareholder Relations. Please go ahead.

Nishil Mehta

Managing Director & Head-Structured Credit, The Carlyle Group

Good morning, and welcome to Carlyle Secured Lending Lending's conference call to discuss the earnings results for the fourth quarter of 2024. I'm joined by Justin Plouffe, our Chief Executive Officer; and Tom Hennigan, our Chief Financial Officer.

Last night we filed our Form 10-K 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. Today's conference call may include forward-looking statements reflecting our views with respect to, among other things, the timing or likelihood of the closing of the proposed merger, the expected synergies associated with the proposed merger, the ability to realize the anticipated benefits of the proposed merger and our future operating results and financial performance. These statements are based on current management expectations and involve inherent risks and uncertainties, including those identified in the risk

factors sections of our 10-K. These risk and uncertainties could cause actual results to differ materially from those indicated. CGBD assumes no obligation to update any forward-looking statements at any time.

During this conference call, the company may discuss certain non-GAAP measures as defined by SEC Regulation G, such as adjusted net investment income or adjusted NII. The company's management believes adjusted net investment income, adjusted net investment income per share, adjusted net income and adjusted net income per share are useful to investors as an additional tool to evaluate ongoing results and trends for the company without giving effect to onetime or non-recurring events, and are used by management to evaluate the economic earnings of the company. A reconciliation of GAAP net investment income per share. The most directly comparable GAAP financial measure to adjusted NII can be found in the accompanying slide presentation for this call. In addition, reconciliation of these measures may also be found in our earnings release filed last night with the SEC on Form 8-K.

With that, I'll turn the call over to Justin, CGBD's Chief Executive Officer.

Justin V. Plouffe

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

Thanks, Nishil. Good morning, everyone, and thank you all for joining. I'm Justin Plouffe, the CEO of the Carlyle BDC's and Deputy CIO for Carlyle Global Credit. On today's call, I'll give you an overview of our fourth quarter and full year 2024 results, including the quarter's investment activity and portfolio positioning. I will then hand the call over to our CFO, Tom Hennigan.

In the fourth quarter, CGBD continued to benefit from stable credit performance and a higher base rate environment. During the quarter, we generated net investment income of \$0.47 per share, which represents an annualized yield of over 11% based on our 12/31 NAV. Our Board of Directors declared a total fourth quarter dividend of \$0.45 per share, consisting of our base dividend of \$0.40 plus a \$0.05 supplemental dividend. Our net asset value as of December 31 was \$16.80 per share compared to \$16.85 per share as of September 30. Our direct lending platform achieved record highs for deployment in both the fourth quarter and the full year of 2024. CGBD was a beneficiary of this activity, growing its portfolio by about \$100 million in the quarter. Overall, we continue to remain selective in our underwriting approach, evidenced by a close rate of approximately 5% on new deals over the last 12 months.

We continue to seek quality at the top of the capital structure, with 94% of our 2024 originations in first lien investments and an average loan to value under 40%. Over the course of 2024, we made significant strides to deliver short and long-term value to investors. First, we proposed a strategic affiliate merger with Carlyle Secured Lending III or CSL III. We expect the merger to deliver increased scale and liquidity, eliminate the CGBD preferred stock dilution overhang and reduce aggregate costs, all while seamlessly continuing our existing investment strategy. Next, we obtained investment grade ratings from both Fitch and Moody's, allowing us to issue our first ever institutional bond deal. Finally, we took steps in the first quarter of 2025 to optimize the long-term earnings power and capacity of our joint ventures, which Tom will discuss later in greater detail.

To start 2025, we have focused on increasing our origination activity while continuing to prioritize overall credit performance and maintaining a highly diversified portfolio. As of December 31, our portfolio was comprised of 189 investments in 135 companies across more than 25 industries. The average exposure in any single portfolio company is less than 1% of total assets, and 93% of our investments are in senior secured loans. The median EBITDA across our portfolio was \$88 million. As always, discipline, consistency drove performance in the fourth quarter and we expect these tenets to drive performance in future quarters.

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, Justin. Today, I'll begin with an overview of our fourth quarter financial results. Then I'll discuss portfolio performance, before concluding with detail on our balance sheet positioning. CGBD had another strong quarter on the earnings front.

Total investment income for the fourth quarter was \$56 million in line with prior quarter due primarily to higher average portfolio balance and increased dividends from the JVs offset by a lower weighted average yield. Total expenses of \$31 million were flat versus prior quarter as a higher average outstanding debt balance offset lower interest rates. The result with net investment income for the fourth quarter of \$24 million or \$0.47 per share; flat compared to GAAP net investment income and down \$0.02 per share compared to adjusted net investment income in the prior quarter. Our Board of Directors declared the dividends for the first quarter of 2025 at a total level of \$0.45 per share. That's comprised of the \$0.40 base dividend plus a \$0.05 supplemental dividend, which is payable to stockholders of record as of the close of business on March 24.

This total dividend level reflects our variable supplemental dividend policy of paying out at least 50% of excess earnings, which allows us to be flexible as the portfolio evolves and base rates fluctuate. Our base dividend coverage of 118% for the quarter remains in line with the BDC peer set average. At the same time, the total dividend level also represents an attractive yield of about 10% based on the recent share price. On valuations, our total aggregate realized and unrealized net loss was about \$4 million for the quarter. The largest contributor was a markdown on our investment in Aimbridge, partially offset by markups in the value of the MMCF I JV and our equity position in SPF formerly known as [ph] Durham Grove (00:08:18).

Turning to credit performance. We continue to see overall stability in credit quality across the portfolio. There was little change during the quarter in risk ratings distribution and non-accruals were largely flat at 0.6% of total investments at fair value. During the quarter, we completed the restructuring of JEGS Automotive, which remained on non-accrual status as of 12/31, and our team has been dedicating significant resources to Maverick, working closely with the sponsor and management team to best position the company for improved financial performance. And while our non-accrual rate may fluctuate from period to period, we're confident in our ability to leverage the broader Carlyle Network to achieve maximum recoveries for underperforming borrowers.

Now, moving on to the credit funds, we took steps over the last couple of months to optimize our joint ventures. First, we consolidated MMCF II onto CGBD's balance sheet to address the static nature of that vehicle. Additionally, we're in the process of extending the investment period of MMCF I by three years and also closing a new credit facility which should materially improve ROA. Both these transactions enhance the earnings profile of the broader portfolio while increasing our non-qualifying asset capacity, thereby providing greater flexibility for complementary transactions and other strategic partnerships.

I'll finish by touching on our financing facilities and leverage. We strengthened and diversified the right side of our balance sheet throughout 2024, most notably with the issuance of our inaugural institutional bond in October. \$300 million of unsecured notes with a 6.75% fixed rate. In September, we successfully received investment grade ratings from both Moody's and Fitch. And as a reminder, in early July, we closed the reset of the 2015-1 CLO, extending both the reinvestment period and maturity date by four years, and reducing the cost of debt by more than 20 basis points within that vehicle. These transactions provided additional diversification to our financing sources, repaid the 2024 unsecured notes and provided additional capital to fund new investment opportunities.

The quarter end statutory leverage was about 1.2 times, and net financial leverage was right about one turn. With leverage comfortably within our target range of 0.9 times to 1.25 times, we have capacity to deploy capital into attractive opportunities and what we believe will be an accelerating deal environment in 2025.

With that, I'll turn the call back over to Justin.

Justin V. Plouffe

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

Thanks, Tom. As a final point, I'd like to reiterate that the merger between CGBD and Carlyle Secured Lending III remains on track to close by March 31, subject to approval from CGBD stockholders and satisfaction or waiver of other customary closing conditions. We distributed proxy materials related to the merger in January and urge all stockholders to vote their shares in advance of our special meeting of stockholders on March 26. We continue to have high conviction in the strategic benefits that the transaction will provide to CGBD, including an increase of scale and liquidity, a reduction in aggregate costs from operational efficiencies and accretion to both earnings and NAV per share.

As a reminder, Carlyle has agreed to exchange its existing convertible preferred shares for common stock at a price of NAV rather than the existing dilutive conversion price of \$8.87. We believe that the preferred stock exchange is stockholder friendly and demonstrates Carlyle's support for the ongoing success of CGBD.

As we approach the end of the first quarter, market demand for private credit remains strong. We continue to focus on sourcing transactions with significant equity cushions, conservative leverage profiles and attractive spreads relative to market levels. With a growing pipeline of new originations, a stable portfolio and low non-accruals CGBD stockholders are benefiting from the continued execution of our strategy. As always, we remain committed to delivering resilient, stable cash flow stream to our investors through consistent income and solid credit performance.

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] Our first question comes from the line of Finian O'Shea from Wells Fargo.

Finian O'Shea

Analyst, Wells Fargo Securities LLC

Q

Hey, everyone. Good morning. Just a question on the JV. I think, Tom, you said it all pre the unqualified asset bucket capacity, are you suggesting you might do something else there or should we expect a re-ramp of the first JV or perhaps a new and a similar one like will that be replaced with a similar thing with nothing or with something else?

Thomas M. Hennigan

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

A

Hey, Fin, good morning. Thanks for the question. Regarding the two JVs on MMCF II that's our second smaller JV. That was the one that we closed in 2020 was really more of a static type vehicle. So, taking those assets back on balance sheet, that's about \$70 million investment that now is a reduction in the non-qualifying bucket. The JV I, we do anticipate based on the extending that relationship by three years and inking – in the process of inking a very attractive credit facility, we're going to look to ramp up that facility materially in the future.

Based on the higher leverage profile under that new credit facility, we're actually anticipating, at least in the near term, of having a distribution of equity. So, a return of capital from that vehicle as well to create even more capacity. So overall, we'll look over time to put more equity in that vehicle. But at least in the near term, we'll actually have a return of capital we should see in the first quarter from both JVs.

In terms of the future, we're always working on different things and there's nothing in the very near term hopper. But certainly, we've got the flexibility now as we have very strategic conversations with partners in the marketplace. It's something we've got the flexibility and we've got some ideas that we're working on. But nothing imminent right now.

Finian O'Shea

Analyst, Wells Fargo Securities LLC

Q

Okay. Helpful. Thanks. And the tax line that dropped a bit in the fourth quarter, is that sort of a true up thing? And what's a good quarter to look out for excise tax expense for the rest of the year?

Thomas M. Hennigan

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

A

Yeah, good question. [indiscernible] (00:15:05) It was a year-end true up based on just the year end audit. And we'd anticipate if you look at the prior quarters in that general ballpark, maybe a little bit lower, but thinking that in the range from the prior quarters.

Finian O'Shea

Analyst, Wells Fargo Securities LLC

Q

Okay. I guess just one final one. You guys are doing well, trading well, like any discussion or idea of growth plans for this BDC?

Justin V. Plouffe

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

A

Yeah. Hey, Fin, it's Justin. Look, right now we're really just focused on putting capital to work and gone through the last part of the merger process here. Once we get done with that, certainly will be considering what the future of the fund and any potential growth initiatives look like. But we're not there yet. So, at the moment, nothing imminent. We're focused on the merger.

Finian O'Shea

Analyst, Wells Fargo Securities LLC

Q

Great. Thanks so much.

Operator: Thank you. One moment for our next question. Our next question comes from the line of Melissa Wedel from JPMorgan.

Melissa Wedel

Analyst, JPMorgan Securities LLC

Q

Good morning. Thanks for taking my questions. I was curious, in the fourth quarter, was there any outsized sort of fee income or prepayment income that we should be aware of?

Thomas M. Hennigan

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

A

Hey, Melissa, it's Tom. When you look at the combination of fee income and OID acceleration, it was actually probably lower than our historical average by about \$0.01 per share. The one thing I'll note is that in anticipation of winding down or taking that JV II on balance sheet, [indiscernible] (00:16:54) we had a pad of incremental dividend from that JV that runs through the JV income line.

Melissa Wedel

Analyst, JPMorgan Securities LLC

Q

Okay. Got it. Thanks for that. And then I was curious, I'm wondering if this is related to the JV II. On slide 7 in the presentation, you've always kind of laid out the weighted average yield on debt investments and then the weighted average yield on income producing investments at cost. And usually those are pretty tight, maybe 10 bps different. That was wider this quarter. It was 11.02% versus 11.07%. And I'm just curious, what's – I just want to understand that better.

Thomas M. Hennigan

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

A

Yeah. You'll see going forward that relates exactly to that JV extra dividend. So, the second line item is the JV's and a very small percentage of other equity investments. So based on the incremental JV payouts for this quarter, that resulted in about a 30 basis point or 40 basis point pop to that 11.7%. So more normalized, it's probably closer to about 11.3% or 11.4%. So, you should see next quarter those two numbers be closer.

Melissa Wedel

Analyst, JPMorgan Securities LLC

Q

Got it. Thank you so much.

Operator: Thank you. At this time, I am showing no further questions. I would – pardon me, I am showing one more question. One moment. Our next question comes from the line of Derek Hewett from Bank of America.

Derek Hewett

Analyst, BofA Securities, Inc.

Q

Good morning, everyone. What was the dollar amount of that incremental dividend related to the joint venture to in anticipation of the wind down? Thank you.

Thomas M. Hennigan

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

A

Hey, Derek, it was about \$1.2 million. So net impact on NII about \$0.02 per share for the quarter.

Derek Hewett

Analyst, BofA Securities, Inc.

Q

Thank you.

Operator: Thank you. At this time, I would now like to turn the conference back over to Justin Plouffe for closing remarks.

Justin V. Plouffe

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

Thanks, everyone, for joining the call today. Appreciate your engagement with us and we look forward to working with you going forward. Have a great day. Thank you.

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

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