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Carlyle Secured Lending, Inc (0CT3YW-E)

Q4 2023 Earnings Call

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Melissa Wedel
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MANAGEMENT DISCUSSION SECTION

Operator: Thank you for standing by, and welcome to the Carlyle Secured Lending, Inc. Fourth Quarter 2023 Earnings Conference 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]

As a reminder, today's program is being recorded. And now I'd like to introduce your host for today's program, Daniel Hahn, Shareholder Relations. Please go ahead, sir.

Daniel Hahn
Managing Director, Carlyle Secured Lending, Inc

Good morning and welcome to Carlyle Secured Lending's fourth 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-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. 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.

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

Thanks, Dan. 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 fourth quarter and full year 2023 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 financial performance benefit from the higher base rate environment. In the fourth quarter, we generated net investment income of $0.56 per share, which is an increase of 8% from the prior quarter and represents an annual yield of 13% based on 12/31 NAV. This continues the trend upward from last quarter and the LTM period.

As a result of our continued execution of our strategy, the quality of our portfolio and our confidence in the future beginning this quarter, we are increasing the base dividend by $0.03 from $0.37 to $0.40 per share. Our board of directors declared a total first quarter dividend of $0.48 per share, consisting of our new base dividend of $0.40 plus an $0.08 supplemental, a total increase of 9% compared to the prior quarter and an increase of 8% on the base dividend.

Our net asset value as of December 31 was $16.99 per share. That's up $0.13 or approximately 1% from the September 30 period, primarily as a result of our Q4 earnings outpacing our dividend.

Turning now to the market environment. 2023 was defined by market volatility, slow private equity capital formation and muted M&A activity for most of the year.

For context, private equity deal activity and M&A activity were down significantly in 2023 compared to 2022 and 2021, though there was a pickup in M&A activity in the fourth quarter.

With this backdrop throughout the year, our investment team leveraged the breadth and depth of the OneCarlyle platform to drive value in the evolving market environment by generating significant volume across our existing portfolio of borrowers and Carlyle's broad sourcing network.

Leveraging our incumbencies allowed us to source transactions where we had diligence and information advantages and existing portfolio companies accounted for approximately half of our deal closings during the year.

Our flexible origination capabilities enabled us to source transactions from the lower end of the middle market at $25 million of EBITDA and opportunistically all the way up to $450 million of EBITDA in the last year. That includes sponsored and non-sponsored companies across North America and Europe.

Outside of our core middle market strategy, we leveraged the OneCarlyle network to source complimentary differentiated specialty lending transactions within the asset based and recurring revenue markets. These trends were evident throughout the year and continue with fourth quarter origination activity.

We continue to be pleased with the overall credit performance of our existing portfolio with revenue and EBITDA up quarter-over-quarter and since inception.

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Compared to the prior year, portfolio company revenue and EBITDA both expanded by an average of approximately 13% and compared to the prior quarter, 1% and 3%, respectively.

Non-accruals were stable in the fourth quarter. And as Tom will discuss in detail later, we expect these levels to improve in the coming quarter.

Tactical origination activity, strong credit fundamentals and the current rate environment drove record income for CGBD. Despite the rising base rate environment over the last two years, we have been intentionally conservative with our dividend through the cycle.

In our view, our new dividend policy, which Tom will expand upon later, provides a sustainable base dividend along with the transparent framework for supplemental dividends that will investors to better anchor their expectations.

Lastly, I'd like to spend a few minutes on current positioning. Our portfolio remains highly diversified and is comprised of 173 investments in 128 companies across over 25 industries.

The median EBITDA across our portfolio at the end of the quarter was $76 million. The average exposure in any single portfolio company is less than 1% and 95% of our investments are in senior secured loans.

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

Thomas M. Hennigan

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

Thanks, Aren. Today, I'll begin with a review of our fourth 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 fourth quarter was $63 million, up about $2 million from the prior quarter.

This increase was driven by the continued positive impact of base rates and an increase in both other income and OID acceleration, which were aided by prepayment activity.

Total expenses of $34 million were flat versus prior quarter. Of note, total interest expense was up modestly as base rates stabilized during the quarter.

The result was net investment income for the fourth quarter of $28 million or $0.56 per share, up nearly 8% from the prior quarter. And this level represents an all-time high for core NII in any quarter.

Our board of directors declared the dividends for the first quarter of 2024 at a total level of $0.48 per share. That's comprised of the new $0.40 base dividend, plus an $0.08 supplemental, which is payable to shareholders of record as of the close of business on March 29.

This total dividend level reflects an increase of 9% over the previous $0.44 per share and reflects the earnings power and stability of our portfolio despite a complex macroeconomic environment.

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Our base dividend coverage of 140% for the quarter remains above the BDC peer set average, and we've grown the base dividend by 25% since 2022. At the same time, the total dividend level also represents an attractive yield of over 12% based on the recent share price.

In terms of the forward outlook for earnings for the rest of 2024, we see stability at the $0.50-plus level based on the latest interest rate curves and our current conservative positioning on leverage.

Despite rising rates, we've maintained a conservative disciplined approach that we believe will enable us to continue consistent dividend payouts in a variety of rate environments, including when rates normalize, to remain highly confident in our ability to comfortably meet and exceed our new $0.40 base dividend, and continue paying out supplemental dividends each quarter.

And going forward, we're going to shift to a floating supplemental dividend construct and target paying out at least 50% of excess earnings through the supplemental dividend, which will allow us to be flexible as the portfolio evolves and base rates fluctuate.

On valuations, our total aggregate realized and unrealized net gain was about $0.5 million for the quarter, supported by a slight net positive movement in valuations. This increase in valuations combined with Q4 earnings exceeding the dividend resulted in our NAV increasing from $16.86 to $16.99 per share.

Turning to the portfolio. We continue to see overall stability in credit quality across the book. Similar to last quarter, there were no new non-accruals and no additions to our watch list, which are deals with risk ratings 4 or 5.

Total non-accruals were effectively flat quarter-over-quarter. And we're very pleased to report that Dermatology Associates was successfully recapitalized in early February with the lenders taking equity control. So we expect an improvement in non-accruals when we report March results. We continue to proactively manage the portfolio and are working with sponsors to ensure borrowers have adequate liquidity.

You'll see that PIK interest ticked up over the course of 2023. In almost all cases when we provided PIK relief for existing borrowers, that was accompanied by significant equity support from the sponsor.

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 1.2 times and net financial leverage ended the quarter modestly lower, right about 1 turn, the lowest level since early 2022. This positioning allows us to remain opportunistic as the macroeconomic environment evolves and deal activity looks to pick up in 2024.

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

Aren LeeKong

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 investment strategy.

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We are primarily focused on making senior secured floating rate investments to US companies backed by high quality sponsors primarily in the mid-market.

Market demand for private credit remains high, and we continue to focus on sourcing transactions with significant equity cushions, attractive leverage levels, strong documentation and attractive spreads relative to not only the current market, but also historical originations through our disciplined underwriting, prudent portfolio construction, and conservative approach to risk management.

With attractive new originations, a stable portfolio and reduced non-accruals, we benefited from continued execution of our strategy in 2023 and remain committed to delivering a non-volatile 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. And thank you so much.

QUESTION AND ANSWER SECTION

Operator: Certainly, one moment for our first questions. And our first question comes from the line of Bryce Rowe from B Riley. Your question, please.

Bryce Rowe
Analyst, B. Riley Securities, Inc.

Q

Thanks a lot. Good morning.

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

A

Hey, Bryce how are you doing?

Bryce Rowe
Analyst, B. Riley Securities, Inc.

Q

I'm good. I'm good. Thanks, Aren. I wanted to maybe piggyback on some of the prepared comments there around a potential pickup in activity. We've heard that from other BDCs. And if you could kind of just help us think about what that might look like, especially relative to the leverage profile of your balance sheet at this point. I mean, you've noted that you're at one of the lowest leverage points in quite a while. So just kind of want to understand how that could evolve over the course of 2024.

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

A

Yeah. So as usual, you ask a question probably has multi facets. So when we think of leverage, I'll just start there, and Tom and Dan [ph] should hop in a bit like (00:14:03) but that is a sort of multivariable topic.

So one, we're able to in today's market originate loans that add [ph] S plus, 6%-plus (00:14:15). I think last year the average loan in CGBD was probably around [ph] S plus 6.50% (00:14:20). The team here will tell me if I'm off by a few basis points.

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You're able to actually pay out that sustainable and non-volatile cash flow stream, which is actually the ultimate product of any BDC without being over levered.

And Bryce, you and I and the team talked about this behind closed doors many times. The goal here isn't to run hot just for the sake of being invested, the goal here is to pay off [ph] debt, that (00:14:47) non-volatile cash flow stream.

So for us, the leverage is really just a function of the rest of the strategy. So, in terms of a pickup in – and I'm just going through the fourth quarter. So there was a pickup in transactions in the fourth quarter and the first quarter has actually been stable to the fourth quarter.

The reality, though is our first question isn't, hey, how do we do 10 more deals? Our first question is, is the incremental transaction that we're doing and Bryce you and I have talked about this behind closed doors. Is it going to improve the current portfolio? Period.

So, when we think about whether we have to take up leverage, we think about how an uptick in volume impacts the fund, the first question is how many more deals can we do? The first question is, how do we actually create the cleanest, most, non-volatile cash flow streams that we can?

So that – is leverage going to stay down at 1 turn forever? No. We don't mean it to. But in this market, based on our current base returns, we actually have the benefit of being able to do that and same token that I'm sorry for, if this doesn't perfectly get to the question hopefully it's getting around it. Even if deal flow picks up, effectively I'd rather the biggest funnel to be able to choose the best deals.

So I'd rather always see more deals, but just because originations have seen more transactions has picked up, again my product and our team's productivity to you and the Street and this is kind of the strategy we try to execute is how do you create a clean portfolio [ph] that kicks off (00:16:27) the cash flows that you all can predict. Is that helping?

Bryce Rowe
Analyst, B. Riley Securities, Inc.

Q

Yeah, for sure. I appreciate it. Definitely gets to the meat of the question. And maybe a follow-up for Tom, since you talked about it in the prepared remarks, the Dermatology Associates investment crystallized here in February as you noted. Can you talk about what the mechanics of that might look like in the first quarter, given that you were actually carrying it at a fair value mark above cost?

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

A

Right. So, the new capital structure, like the similar structure, is going to have to two trance of the data first out and the last out, and then you'll see there'll be a new equity tranche on our SOI.

One important note is in the aggregate, our total fair value will be – our crystal ball guess is roughly unchanged. So total fair value is not going to change very much. It's just it'll be different instruments and there'll be more value moving from what is now our last out on nonaccrual to an equity tranche and then there'll be more debt on accrual status in those new tranches.

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So net-net positive impact on a quarterly, but full quarter basis of about $0.01 per share. No impact on fair value but – and non-accruals going down materially with that transaction in the aggregate being removed from non-accrual status?

Bryce Rowe
Analyst, B. Riley Securities, Inc.

Q

Yeah. Okay. Got it. And then maybe last one for me. You all had swapped out the fixed rate for a floating rate on the baby bonds. Maybe an obvious answer from you all, but if any thought around why do that as opposed as opposed to just keeping keep keeping a fixed rate there.

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

A

Bryce with the 8% when we're looking at our maturities at the end of 2024, we wanted to be measured and not put all our eggs in one basket and wait for the market to rebound. So we consider this kind of step one in addressing those upcoming maturities.

8.2% for the market was a good rate, but candidly, not a rate we wanted to stick with for any long-term amount of time. So thought the right thing to do would be to swap that. The floating certainly seeing the likelihood that base rates are going to come down. So over time paying much less than the 8.2%. And that's at least where the rate curves are going to go. That's what we anticipate happening with that instrument.

And in terms of, the next step is we're going to look to do potentially an index eligible deal, whether it be later in 2024, early 2025, increased our overall unsecured debt exposure. That's something that we'll be we're working on and looking we'll say, in the course of the next year.

Bryce Rowe
Analyst, B. Riley Securities, Inc.

Q

Got it. Okay. Thanks for that.

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

A

Bryce, thank you.

Bryce Rowe
Analyst, B. Riley Securities, Inc.

Q

Yup.

Operator: Thank you. One moment for our next question. And our next question comes from the line of Finian O'Shea from Wells Fargo Securities. Your question please.

Finian O'Shea
Analyst, Wells Fargo Securities LLC

Q

Hey, everyone. Good morning. So, Aren, appreciate the portfolio cover as it relates to the core middle market strategy and opportunistically partaking in the larger market and or ARR deals.

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So in these instances, does that mean the direct lending platform that that serves the BDC under you is opportunistically doing other styles? Or is it that the BDC complex is claiming this deal flow from other Carlyle credit verticals? And then second part there, are you still dedicated to the core middle market or are you drifting upmarket by design? Thanks.

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

A

Yeah. It's the first time the two math guys have been on an earnings call.

Finian O'Shea
Analyst, Wells Fargo Securities LLC

Q

So it should be a target school now.

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

A

Yeah. So let me start from the first question, which is a great one. So our knitting is core middle market. So if you think about the – for our entire platforms that's a great question. If you think about the median EBITDA of a company that we lend to, it's about $76 million.

With that said, we have a pretty big and this is all within direct lending and the private credit business, we have a large origination footprint. So for us, when I think and the team thinks about direct lending, my ultimate goal I'm going to go back to the previous question is we're putting together a big portfolio with the average position being less than 1%. So my ultimate product is the cash flow stream that kicks out.

So in the first half of last year when there were a lot fewer transactions to be had, it was the first time in many years where, quite frankly, the terms of the upper part of the market, so, well north of $100 million EBITDA, we were able to get spreads that were on top of the mid-market, so call it [ph] 675, 700 (00:22:00), we're able to get covenants and we're able to get terms that were the same.

So from a from a risk standpoint in the first half of the year, opportunistically, we're able to do direct lending and we had to make a choice for our investors what is the safe – what is safer? If I can get similar terms, similar protections and similar spread to the mid-market and actually have the protection of a much larger business, which historically hasn't had those covenants and hasn't had those protections, we opportunistically went up market.

By the second half of the year, and you and I talked about this behind closed doors as well as the upper part of the market got a little bit more crowded, CLO bid came back significant retail flows went into other direct lending strategies and some of our peers, we skewed back down to the core mid-market and that core mid-market, again, I'd define is somewhere between 25 – in the second half of the year, probably $25 million to $75 million.

The point on ABL strategies, we do have a team focused on asset backed lending and when we think about asset backed lending, it is to core middle market companies. But as opposed to being a structure to cash flow loans, we are literally thinking about our downside protection being true assets, receivables, cash, et cetera, real estate.

And then we have obviously a very big software practice who also reports with up to me and that team opportunistically has done some ARR deals. We are quite frankly, been probably less exposed to ARR than some

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of our peers. But again, my goal and this doesn't sound – this isn't going to sound sexy, my goal is how do you get overpaid for taking less risk?

So again, we're focused on direct lending once in a while. If I can go up market, if that market's dislocated, we do it and we did it first half of last year. Today, we're probably more focused on the mid-market, though opportunistically we do go upmarket if something is attractive. Hopefully that answers the question.

Finian O'Shea
Analyst, Wells Fargo Securities LLC

Q

Yes, very much. Thank you. And to get back to Dermatology Associates, sorry, if I missed any of this part of the dialogue. But it sounds like you just took control or received control. But this, of course, had been a long challenged credit where you had restructured the debt somewhat previously.

So can you give some more color on the state of the investment now? Do you plan to put more money into it or maybe immediately bring in a new sponsor partner? And then has the EBITDA trajectory stabilized or is it still in decline? Thanks.

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

A

Let me tackle the last part first, because that's one of my favorite questions or answers. That company has exhibited 12 consecutive quarters of EBITDA growth, steady performance, continued upward trend, modest increase every quarter, but 12 quarters in a row coming out of the pandemic of EBITDA increases.

In terms of future, it's stable growth, we're not looking to shoot for the fences and get – and put in material new dollars to grow it. We're going in now as a new equity group, assess the right time to exit the investment.

We're going to invest prudently, don't have any grand slams ` the company's performance is stable and improving, and we'll look at the right time to exit the investment.

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

A

And [ph] Finn (00:25:46), it's a good question I think where we are in the cycle, we here at Carlyle Direct Lending spent a lot of time a year plus ago, I think it was behind the scenes, looking at our processes, figuring out exactly how to be prudent and more careful in terms of, again, being proactive in situations that were teetering.

So I would say that we're kind of – we're not in the first inning of that for our portfolio. We're close to the end of the game and we're – we have full control of it. I think a lot of our peers are just on the front end of that.

So for us part of the boring stuff is you're not going to – Tom's is not going to be in front of the Street like we are today, saying, hey, we've turned the corner without those 12 consecutive quarters of positive numbers.

So for us, the key is to making sure that we have a clean portfolio when we come to you and we're being conservative. So we feel pretty good about where things are.

Finian O'Shea
Analyst, Wells Fargo Securities LLC

Q

Awesome. Thank you both.

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

A

I appreciate you. Hopefully we get you for the next quarter, too, [ph] Finn (00:26:55).

Finian O'Shea
Analyst, Wells Fargo Securities LLC

Q

Absolutely.

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

A

All right. Talk to you later, man.

Operator: Thank you. One moment for our next question. And our next question comes from the line of Arren Cyganovich from Citi. Your question, please.

Arren Cyganovich
Analyst, Citigroup Global Markets, Inc.

Q

Thanks. Question on maybe just the competitive dynamics activities increase...

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

A

Hey, Arren, do you mind – we can't – you're a little muffled.

Arren Cyganovich
Analyst, Citigroup Global Markets, Inc.

Q

I'm muffled. Sorry. Better?

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

A

Sure.

Arren Cyganovich
Analyst, Citigroup Global Markets, Inc.

Q

Sorry about that. I guess from a competitive standpoint, activity is increasing whether [indiscernible] (00:27:42) spreads are tightening a bit, how is that changing, I guess, relative to maybe three or six months ago?

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

A

Yeah. I've listened to a few of our peers' calls and that seems to be a common question. So, I've been saying this a lot recently, this time isn't different. Usually, when you're getting outsized returns, just what we learn in economics 101 as capital comes in to try to attract those outsized returns and that's what gets the spreads to go back to normal.

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I would say that relative to. First quarter and first half of last year, we're – and again, I'm giving you directional numbers. I actually don't have them off the top of my head, so the average deal we're seeing was probably close to [ph] 675, 700 (00:28:32) but that's not normal.

So relative to an abnormally wide spread and quite frankly, a very high base rate where base returns were going to be 13%-plus, things have come in significantly since then.

I'd say at the upper end of the market, if you are talking about a transaction that is north of $100 million, it could easily be considered for the BSL market in a previous life. Those transactions have certainly gone from north of [ph] 600 (00:29:09) to somewhere between the larger and [ph] 500 (00:29:13) and up to [ph] 550 (00:29:15).

For a regular direct lending deal that is mid-market, what we're seeing is somewhere between [ph] 550 and 625 (00:29:26) on average. So those have come in.

With that said, with base rates still where they are, you are achieving sort of a historic level of return without much leverage. And what you haven't seen or at least we've been – we try to be disciplined here. But what you're seeing the upper part of the market, certainly covenants have look alike or the existence of covenants looks a lot more like the BSL market there. So there's a lot more [ph] call it light (00:29:55) in the upper end of the direct lending market.

In the regular way mid-market I'd say more times than not you're seeing covenants and then the documentation is still holding in. I'd also say what else is holding in is leverage levels.

So just because of the overall, even if spreads have come in, you're still talking about a [ph] 5.30 (00:30:15) base rate, give or take. So the average leverage level that we're seeing hasn't really increased much. You're still talking about low-5s and in some cases high-4s. So you're still seeing a fairly low amount of leverage.

So what I'd say is, depending on where you are and this goes to the previous persons – the previous analyst question, that's why we're opportunistic as to where we play.

There are certain times for certain parts of the market that are much more competitive and aggressive and we, at times, avoid those so that we can actually get over paid in other parts of the market.

I would say the larger market is probably the most competitive today [indiscernible] (00:30:55) and that's why we're being a little bit more opportunistic. The mid-market, I think you're seeing a little bit more value there, more likelihood of covenants, more likelihood of stronger documentation. And I'd say for all of the market, not just the mid-market, I would say the leverage levels are continuing to be lower than historical leverage levels. Is that – does that work Arren?

Arren Cyganovich
Analyst, Citigroup Global Markets, Inc.
Q

Yeah, that's helpful. Thanks. And then just a quick one on your other income Ii think you said that was up kind of quarter-over-quarter due to the prepayment activities happening, you see more prepayment fees. Would you expect that your other income might revert back to more of your long term historical in this kind of environment or would that be expected to come back down over the past three preceding quarters?

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

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Arren, it's Tom. When we look at other income or event driven income, we look at a combination of total OID acceleration plus other income and that line item generally will move based on repayments, amendment activity and historically that has been a little under $4 million per quarter. Earlier in 2023 based on lower prepayment activity, it was lower in a couple of quarters. It was more like $3 million per quarter, even less than $3 million.

This quarter, that combined number was about $4.5 million. So relative to the historical trend, it was about a $0.5 million, about $0.01 higher than the historical trend line. It was a pop versus the rest of 2023, which was abnormally low. So, yes, a pop for 20 – for the fourth quarter, but only about $0.01 higher than the historical average.

Arren Cyganovich Q
Analyst, Citigroup Global Markets, Inc.

Got it. That's helpful. Thank you.

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

Thank you.

Operator: Thank you. [Operator Instructions] One moment for our next question. And our next question comes from the line of Melissa Wedel from JPMorgan. Your question, please.

Melissa Wedel Q
Analyst, JPMorgan Securities LLC

Good morning. Thanks for taking my question. Most of mine have already been asked and answered. I wanted to follow up on one of the slides in particular with the risk rating distribution. This is a really – it seems like an aside, given how strong it seems like the fundamental performance is of companies across the portfolio broadly. But did notice a very small tick-up in three- and four-rated portfolio companies. I guess, the question is, to the extent that you are seeing portfolio companies with any particular challenges, where is that coming from? Is it still inflationary pressures or labor costs? Curious what you're seeing? Thank you.

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

So maybe I'll start. And Melissa, thank you for the question and Tom, hop in. So, risk ratings and just so you have it, we behind these risk ratings, we have three or four other processes that we run to ensure that we have our arms around everything.

The overarching theme I'd give you though, is sometimes when we're moving things from [ph] 2 to 3, 3 to 4 (00:34:24), it is less of function. Certainly [ph] to five (00:34:28) there's a functions [ph] of those serious (00:34:29) issues. But in many cases, Melissa, it's more of a function of us ensuring that we are putting the appropriate level of resources around Carlyle on names well ahead of when something goes wrong.

So I think one of the issues that, we've forgotten in direct lending sometimes is, if something's wrong, if you are managing your book and you actually are looking at your numbers and you designed the documentation correctly, you have 12 months, 24 months long ahead of time to start preparing.

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So I'd start that with the slight movement from [ph] 2s or from 3 to 4s (00:35:12) that's generally going to be particularly slight – not fire alarms. That's generally going to be us saying, hey, we want more resources to look at a name or two.

Then the last piece I'll tell you is, relative to a year ago, a year ago a lot of what we're seeing was inflationary driven. So you would have heard a year ago when we had our issues in the healthcare space and then took care of them and we've taken care of them at this point. A lot of that was about inflationary pressures.

This past year, if you look at our overall portfolio and then hand it to Tom, the inflationary theme, though it may still be there in small parts but I think average business was up about 13% in revenue and just a little bit north of that in EBITDA.

So, you are – by definition revenue and EBITDA are either growing in line and as of late EBITDA was outpacing that. So, I'd say a year ago the inflationary theme was the conversation today not as much.

And by the way, Melissa, I'll tell you, like a year ago, it was a theme today, not as much. Today it's changed so much that we, you and colleagues and the analysts feel that – one of the other questions no one's asked is what your view on foreign interest rates?

So think about the fact that we're asking – we're talking about interest rates being cut and on the same call asking about inflationary pressures. So I think we turn that corner generally knock on wood on our portfolio. Tom, what did I miss?

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

Let's say specific to the changes in the risk ratings this quarter or the dollars on the page that four categories is two loans, two positions that contributed to fair value increase.

One is Dermatology, which has continued to inch up every quarter. The other is [ph] Pro-PT (00:37:02) which is now called [ph] Bayside (00:37:03). That's the other deal that's on non-accrual with value that again improved. So it's slightly up.

So the four movement this quarter, that's a positive. Our two deals on non-accrual with value actually going in the right direction.

In the three category, that increased about $15 million was driven primarily by two deals. When I say the three category, it means to Aren's point, we're focused on it, risk has increased, [ph] profitably up for (00:37:26) those particular credits. Leverage is up. EBITDA is likely down from when we closed. But importantly, we're not worried about losing money. And so we're focused on it, but we're really not worried about losing money.

The particular themes for those deals. One is consumer discretionary deals. We don't have very much in the portfolio, but we've seen lower demand in consumer driven businesses and then across our industrials book just destocking and one of the credits just had a – we have a couple of credits in the book and that was one of the downgrades, just a general destocking in the current environment.

So those are a couple of themes I've mentioned in terms of as we're looking at deals that migrates from that two to three categories.

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

A

Much more idio – relative to a year ago where everything was inflation. Now it's more idiosyncratic and we're on top of it. Does that help, Melissa?

Melissa Wedel
Analyst, JPMorgan Securities LLC

Q

Got it. That's very helpful. Thank you.

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

A

Thanks for joining the call.

Operator: Thank you. This does conclude the question-and-answer session of today's program. I'd like to hand the program back to Aren LeeKong for any further remarks.

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

Thank you, operator. Everyone, thanks for joining. We look forward to talking to you later in the day. We appreciate your partnership and talk to you next quarter.

Operator: Thank you, ladies and gentlemen for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.

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