08-May-2024

Carlyle Secured Lending, Inc (0CT3YW-E)

Q1 2024 Earnings Call

CORPORATE PARTICIPANTS

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Bryce Rowe
Analyst, B. Riley Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Thank you for standing by and welcome to the Carlyle Secured Lending First Quarter 2024 Earnings Call. At this time, all participants are in 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.

I'd like to introduce your host for today's program, Mr. Daniel Hahn, Shareholder Relations. Please go ahead, sir.

Daniel Hahn

Managing Director-Global Credit, Carlyle Secured Lending, Inc

Good morning and welcome to Carlyle Secured Lending's first quarter 2024 earnings call. With me on the call this morning is Justin Plouffe, 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'll 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 statement at any time.

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

Justin V. Plouffe

Chief Executive Officer, President, Interested Director & Deputy Chief Investment Officer-Global Credit, Carlyle Secured Lending, Inc

Thanks, Dan. Good morning, everyone, and thank you all for joining. I'm Justin Plouffe, the CEO of the Carlyle BDCs and Deputy Chief Investment Officer of Carlyle's Global Credit Platform. As you may know, Aren LeeKong, who was previously CEO of the Carlyle BDCs, resigned to pursue new opportunities professionally. We have benefited from Aren's industry expertise and leadership and thank him for his contributions.

For those of you on the line that I've not spoken with before, I've been part of Carlyle's Global Credit team since 2007. Besides focusing more broadly on managing growth and credit strategy of the Carlyle, I've also been a member of Carlyle's Private Credit Investment Committee since its inception. I look forward to taking on responsibility for the direct lending strategy, and I'll be working very closely with existing leadership, most notably Tom Hennigan and Mike Hadley. I've worked with Tom and Mike for over 12 years at Carlyle, and I'm excited to continue our partnership in support of Carlyle Secured Lending and the broader Carlyle Direct Lending platform.

And with that said, I'll focus my remarks today on three topics. First, I'll provide an overview of the first quarter 2024 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 higher base rate environment. In the first quarter, we generated net investment income of $0.54 per share, which represents an annualized yield of nearly 13% based on our 3/31 NAV. Our Board of Directors declared a total second quarter dividend of $0.47 per share, consisting of our base dividend of $0.40, plus the $0.07 supplemental. Our net asset value as of March 31 was $17.07 per share, up $0.08, or approximately 0.5% from the December 31 period, primarily as a result of our Q1 earnings outpacing our dividend.

Turning now to the market environment. Activity picked up in the first quarter of 2024, as the reopening of the syndicated loan market and tighter terms drove overall refinancing activity and rebalancing of private and public credit markets. LBO activity has picked up in 2024, and the broader M&A market is expected to become more active in the second half of the year, which we expect to result in an uptick in origination volume.

While we do not try to predict interest rates, our Chief Economist at Carlyle, Jason Thomas, is one of the few that saw significant rate cuts as improbable back in November of 2023. Now that the market consensus has caught up with them, we are pleased to report that despite interest rates stabilizing at higher than expected levels, Carlyle portfolio company data continues to show the real economy holding up well.

Although we've seen pricing pressure increase, particularly in the US upper middle market, the core middle market, where we operate, continues to be comparatively less volatile. Originations in the first quarter were up over 30% year-over-year, and our pipeline continues to expand with both regular way and differentiated deal flow. As a reminder, it's always been our goal to drive performance with a consistent approach to direct lending anchored in disciplined credit selection and conservative portfolio management. We remain focused on our core middle market strategy and benefit from the differentiation provided by our access to the OneCarlyle platform, while maintaining our ability to be dynamic in response to market changes.

While increasing origination activity is a positive for our strategy, we are most focused on the overall credit performance of our existing portfolio. Nonaccruals improved significantly in the first quarter, and as Tom will discuss in detail later, we completed the recapitalization of Dermatology Associates and successfully exited Direct Travel during the first quarter. Our portfolio remains highly diversified and is comprised of 174 investments in 131 companies across more than 25 industries.

The median EBITDA across our core portfolio at the end of the quarter was $81 million. The average exposure in any single portfolio company is less than 1%, and 95% of our investments are in senior secured loans. As always, discipline and consistency drove performance in the first quarter, and we expect these [ph] trends (06:02) to drive performance in future quarters.

I will 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 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 Justin previewed, we had another strong quarter on the earnings front. Total investment income for the first quarter was $62 million, down slightly from prior quarter, as the decrease in prepayment and amendment fees was offset by an increase in OID acceleration, primarily from the successful exit of our investment in Direct Travel.

Total expenses of $34 million were flat versus prior quarter. Of note, total interest expense was down modestly, as base rates stabilized during the quarter and we had a lower average outstanding debt balance. The result was net investment income for the first quarter of $28 million, or $0.54 per share. And while that's down $0.02 per share compared to our all-time high from last quarter, it's still well above the prior year comparable period.

Our Board of Directors declared the dividends for the second quarter of 2024 at a total level of $0.47 per share. That's comprised of the $0.40 base dividend, plus the $0.07 supplemental, which is payable to shareholders of record as of the close of business on June 28.

This total dividend level reflects our new 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 135% 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 nearly 11% based on the recent share price.

In terms of the forward look for earnings for the rest of 2024, we continue to see support at a $0.50 per share level based on the latest interest rate curves and our current conservative positioning on leverage. 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 $0.40 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, supported by net positive movement in valuations. This increase in valuations, combined with Q1 earnings exceeding the dividend, resulted in our NAV increasing from $16.99 to $17.07 per share.

Turning to credit performance, we continue to see overall stability in credit quality across the portfolio. Similar to last quarter, there were no new nonaccruals and no additions to our watch list, which are deals with risk ratings 4 or 5. The major headline this quarter is that total nonaccruals fell to only 0.2% of total investments at both fair value and amortized cost, the lowest level since our IPO in 2017. This was aided by the successful recapitalization of Dermatology Associates in February, which we previewed during last quarter's call. And we also completed the sale and exit of Direct Travel in Q1, another successful turnaround story which came off nonaccrual back in mid-2022.

We continue to proactively manage the portfolio and are working with sponsors to ensure borrowers have adequate liquidity, as we expect rates to remain higher for longer. While we're not immune to credit issues, transactions like Derm and Direct Travel highlight the capabilities of the broader Carlyle platform to maximize recoveries when challenges arise with portfolio companies.

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 are 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 1.13 times, and net financial leverage ended the quarter modestly lower at 0.95 times. This positioning allows us to remain opportunistic as the macroeconomic environment evolves, and deal activity looks to pick up at the second half 2024.

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

Justin V. Plouffe

Chief Executive Officer, President, Interested Director & Deputy Chief Investment Officer-Global Credit, Carlyle Secured Lending, Inc

Thanks, Tom. I would like to finish by highlighting the consistency of our investment approach and to reiterate our overall investment strategy. We're primarily focused on making senior secured floating rate investments to US companies backed by high-quality sponsors, primarily in the core middle 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 the market and historical originations through our disciplined underwriting, prudent portfolio construction, and conservative approach to risk management.

With attractive new originations, a stable portfolio, and reduced nonaccruals, we benefited from the continued execution of our strategy 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. Thank you.

QUESTION AND ANSWER SECTION

Operator: Certainly. [Operator Instructions] 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

Hi. Good morning. Wanted to maybe start on the comments around kind of market activity and the pickup that we've seen. I think we've certainly heard that from many other market participants. Can you talk about your appetite for kind of taking part? Obviously, the balance sheet is pretty well-positioned with lower balance sheet leverage and you could certainly step in if you wanted. Just kind of wanted to – want to get a sense for how you're thinking about pricing today versus maybe what's in the portfolio and how you kind of view risk/reward of investments today.

Justin V. Plouffe
Chief Executive Officer, President, Interested Director & Deputy Chief Investment Officer-Global Credit, Carlyle Secured Lending, Inc

A

Hey, Bryce, this is Justin. Thanks for your question. Yeah, we're active. We're active. We're participating. As you said, we're in a good position to put capital to work, and our pipeline is really picking up and we're excited about that. In terms of pricing, pricing has come in somewhat. There's a lot of activity in the broadly syndicated market that's priced much tighter than our market. But it does kind of come over to us a little bit in the form of tighter pricing.

But ultimately, what we want to do is deploy through cycles [ph] into great (13:21) companies, and we're going to do that whether or not pricing is as attractive as it was 12 months ago, or whether the market has moved slightly tighter as it is today. I mean, to put it in context, right, we're still making first-lien senior secured loans at potential returns that historically look like equity-like returns. And anytime you can do that, where you can invest in credit at something that looks historically like equity-like returns, we think that's attractive environment and we're going to be very active in this environment.

Bryce Rowe
Analyst, B. Riley Securities, Inc.

Q

Okay. And I think, over the – maybe the last few quarters, you've tried to take advantage of your incumbency position, mining the portfolio for opportunities within. Has that played out, or are there still some opportunities within the portfolio as well right now?

Justin V. Plouffe
Chief Executive Officer, President, Interested Director & Deputy Chief Investment Officer-Global Credit, Carlyle Secured Lending, Inc

A

Incumbency is always a very strong factor. I think it's benefited us this past quarter definitely. But I would also say that I think there's more to come. I don't think it's completely played out. And it's also not just incumbency in individual companies, but your relationship with that sponsor across the portfolio. We're very, very focused on that, and it hopefully will lead to some great origination opportunities for the rest of the year.

Bryce Rowe
Analyst, B. Riley Securities, Inc.

Q

Okay, great. Couple more for me, you all successfully did a baby bond offering, I guess, last year and swapped to a floating rate. You've got some debt that's coming due at the end of this year. Just any thoughts around that maturity, especially considering what feels like a pretty open market for [ph] at least open (15:14) capital – debt capital markets at this point?

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

A

Hey, Bryce, good morning. It's Tom.

Bryce Rowe
Analyst, B. Riley Securities, Inc.

Q

Hey, Tom.

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

A

A couple thoughts on that. Number one, as you noted, our bonds mature at the end of this year. We're in active dialogue with our bankers, and we've been earmarking at potential index eligible deal later in 2024 or early 2025. I'll also note our CLO, which is a big part of our capital structure, went out of reinvestment period at the end of last year. Now the AAAs are very attractively priced on that vehicle.

So, as those notes amortize, they'll become less attractive. A couple quarters ago, it makes sense to continue to keep that structure in place. But now that AAAs have come down materially for the middle market, we're actively looking at resetting that vehicle to position the overall capital structure for the long term. So – and we anticipate that will be our two big – the two big focus points in 2024 is the bond deal and then resetting the CLO.

Bryce Rowe
Analyst, B. Riley Securities, Inc.

Q

Okay. Okay. All right. Last one for me, you've stepped up the dividend here and dividend coverage looks quite healthy. And I think even based on the asset sensitivity tables, even in down rate scenarios, you look pretty good, at least from a base dividend perspective. Any thoughts around continuing to step up the dividend? And it just feels like – it feels like there's some room for it to move higher and that's going to look a lot different than most of your BDC peers.

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

A

Hey, Bryce, on that point, it's something we discuss every quarter. We feel very comfortable with the $0.40 as – at the base. We noted that, now we'll call it variable floating rate on the 50%-plus on the supplemental. So something we'll continue to evaluate. [ph] But we think at least for (17:08) right now, we're certainly very comfortable, conservative position where we are with the $0.40 base and the 50%-plus on the excess.

Bryce Rowe
Analyst, B. Riley Securities, Inc.

Q

Okay, great. Thanks for your time.

Operator: Thank you. [Operator Instructions] And this does conclude the question-and-answer session of today's program. I'd like to hand the program back to Justin Plouffe for any further remarks.

Justin V. Plouffe

Chief Executive Officer, President, Interested Director & Deputy Chief Investment Officer-Global Credit, Carlyle Secured Lending, Inc

Thank you so much. Thanks, everyone, for joining the call. We appreciate your support, and we'll speak with you again next quarter. That will conclude the call.

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