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Carlyle Secured Lending, Inc (0CT3YW-E)

Q3 2024 Earnings Call

CORPORATE PARTICIPANTS

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OTHER PARTICIPANTS

Bryce Rowe
Analyst, B. Riley Securities, Inc.

Melissa Wedel
Analyst, JPMorgan Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to Carlyle Secured Lending, Inc.'s Third Quarter 2024 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] 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's conference call to discuss the earnings results for the third 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-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. 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 section of our 10-Ks and our 10-Qs. 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 one-time 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 BDCs and Deputy CIO for Global Credit at Carlyle. On today's call, I'll give an overview of our third quarter 2024 results and discuss the quarter's investment activity and portfolio positioning. I'll then hand the call over to our CFO, Tom Hennigan.

In the third quarter, our financial performance continued to benefit from stable credit performance as well as the higher base rate environment. During the quarter, we generated net investment income of $0.47 per share and adjusted net investment income of $0.49 per share after adjusting for certain accelerated debt issuance costs related to our CLO reset. Our adjusted NII represents an annualized yield of nearly 12% based on our 9/30 NAV. Our board of directors declared 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 September 30th was relatively flat at $16.85 per share, down modestly from the prior quarter.

Deal activity has continued to strengthen in the second half of 2024. While repricing activity continued, new issue spreads stabilized in the third quarter. This is despite the persistence of increased competition and cross market refinancings between the broadly syndicated and private credit markets. Our originations in the third quarter were up significantly year-over-year and our pipeline continues to grow. We expect volumes to remain strong in 2025 as the M&A pipeline expands. We continue to benefit from the One Carlyle platform, which differentiates us in the core middle market.

While increasing origination activity is a positive for our strategy, we remain focused on overall credit performance and maintaining a highly diversified portfolio. As of September 30th, our portfolio is comprised of 175 investments in 128 companies across more than 25 industries. The average exposure in any single portfolio company is less than 1%, and 94% of our investments are in senior secured loans. The median EBITDA across our core portfolio at quarter end was $85 million. As always, discipline and consistency drove performance in the third 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 third 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 third quarter was $56 million, modestly lower compared to prior quarter, due primarily to a lower average portfolio balance and lower weighted average yields. Total expenses of $31 million were flat versus prior quarter as one-time expenses associated with the CLO reset offset reduced total interest expense for both a lower average outstanding debt balance and lower rates. The result with net investment income for the third quarter of $24 million or $0.47 per share. Importantly, adjusted for the expenses associated with the CLO reset, adjusted NII was $25 million or $0.49 per share.

Our board of directors declared the dividends for the fourth quarter of 2024 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 December 31st. This total dividend 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 and we've consistently outearned our dividend, resulting in $1.40 per share of cumulative spillover. At the same time, the total dividend level also represents an attractive yield of nearly 11% based on the recent share price. And looking ahead, we remain confident in our ability to meet and exceed our $0.40 base dividend. That said, the combination of expected lower base rates, tighter new issue spreads and portfolio repricing activity, we do expect to see some contraction in earnings in coming quarters relative to the historical highs we've achieved over the last two years.

On valuations, our total aggregate realized and unrealized net loss was about $5 million for the quarter. The largest contributor was a decline in value at one of the positions in our MMCF JV. However, we successfully exited our position last month at a price materially higher than our 9/30 valuation. And of note, some of our legacy healthcare names continue to improve, highlighted by incremental markups on [indiscernible] (00:08:15). In terms of credit performance, we continue to see overall stability in credit quality across the portfolio. And as preview in last quarter's call, non-accruals decreased to only 0.6% of total investments at fair value, as we exited our investment in emergency communications at a price in line with our 6/30 fair value. And we continue to work towards favorable solutions with the other two borrowers currently on non-accrual status.

I'll finish by touching on our financing facilities and leverage. It's been a busy last few months as we continue to improve our positioning on the right side of our balance sheet. As mentioned on last quarter's call in early July, we closed a reset of the 2015-1 CLO, extending the reinvestment period end maturity date by four years and reducing the cost of debt by more than 20 basis points within that vehicle. In September, we successfully received investment grade ratings from both Moody's and Fitch. And then in October, we issued $300 million of unsecured notes with a 6.75% fixed rate, which we swapped to a floating interest rate of SOFR plus 3.23% beginning in August 2025. This transaction further diversifies our financing sources and will repay the 2024 unsecured notes that mature in December, while providing additional capital to fund new investment opportunities.

At quarter end, statutory leverage was about 1.05 times and net financial leverage was about 0.9 times. With leverage at the low end of our target range of 0.9 to 1.25 times, we have capacity to deploy capital into attractive opportunities in the accelerating deal environment.

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 report that the merger between CGBD and Carlyle Secured Lending III, announced on our second quarter earnings call, remains on track to close by the end of the first quarter of 2025, subject to approval from CGBD's stockholders and satisfaction or waiver of other customary closing conditions. We continue to have high conviction in the strategic benefits the transaction will provide to CGBD, including an increase in scale and liquidity, a reduction in 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 $8.92, which will occur shortly before close of the proposed merger. We believe that this exchange is shareholder friendly and demonstrates Carlyle's support for the ongoing success of CGBD. We expect to distribute proxy materials related to the merger in the coming months and urge all stockholders to vote in the merger approval process upon receiving a formal notification.

As we look towards year end, 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 attractive new originations, and 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 Bryce Rowe from B. Riley.

Bryce Rowe Q
Analyst, B. Riley Securities, Inc.

Thanks. Good morning. I wanted to just maybe start on the outlook from a portfolio perspective and just get a feel for what the pipeline kind of looks like right now. And any thoughts around balance sheet leverage at this point? I think, you highlighted that you're at a relatively low point from a balance sheet leverage perspective and the sister BDC is, to the best of my knowledge, carrying even lower leverage. So, just wanted to get a feel for how that could ramp as the two BDCs possibly come together, especially in light of some of the commentary around M&A picking up.

Justin V. Plouffe A
Chief Executive Officer, President & Interested Director, Carlyle Secured Lending, Inc.

Yeah, sure. Bryce, this is Justin. I'll take the sort of macro question and then maybe I'll ask Tom to talk about the balance sheet leverage. So the short answer is we're optimistic. Our originations were up last quarter. I think the pipeline I would characterize as meaningful and increasing. We certainly expect M&A activity to continue to pick up in Q4 and in the first quarter of next year. So, we're very, very focused on the deployment that we need to do prior to the merger. And I think that the market is it's coming our way in that respect in terms of deal volume. Now, of course, there is downward pressure on spreads, but that's market wide phenomenon. We're really focused on deploying into great credits and that's really what we're going to try to do over the next six months.

Specifically, on the amount of leverage, Tom, do you want to comment on that where we are?

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

Yeah. Absolutely, Bryce. And our target at merger close is 1.1 across the combined entities and as of 9/30, 0.9 as CGBD. But right now, our pipeline, Justin noted, very solid on the new deal front. Repayments looking a little bit lighter this quarter. At least that's our current crystal ball and expectations. So, right now, we're closer to 0.95 times and by quarter end we think we'll be north of 1.0 or at least that's based on our current visible pipeline right now. So, we think we're well on our way to achieving that 1.1 rough target when we get to the merger consummation in the first quarter.

Bryce Rowe
Analyst, B. Riley Securities, Inc.
Q

Okay. And, Tom, just to be clear, the 0.95 and the 1.0 comment you just made, that is just CGBD specific or is that pro forma?

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

Just CGBD.

Bryce Rowe
Analyst, B. Riley Securities, Inc.
Q

Yeah. Okay. And then – and maybe just some commentary around the repayment volume. I certainly appreciate that the pipeline looks strong. And as you progress towards the end of the year, deals are coming together from an origination perspective. Is that continuing or are you continuing to see pressure from a repayment perspective? I think, if I just kind of look at maybe the last seven quarters, you've had kind of repayments that have outpaced the originations. So, just trying to get a feel for how that could change in the dynamic that will make that change?

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

Yeah. We do see that reversing this quarter based I think it just higher overall volume on the new deal side and then difficult to time repayments, but at least as of right now in terms of known repayments in the book, it's lighter this quarter than it's been the last couple of quarters.

Bryce Rowe
Analyst, B. Riley Securities, Inc.
Q

Okay. And then, Justin, you made a comment kind of early in your prepared remarks about spreads stabilizing. I think we've heard a lot about spread compression in the space and have heard a couple comments here recently that spreads feel like they're stabilizing. Any – maybe expand that comment for us a little bit, if you don't mind?

Justin V. Plouffe
Chief Executive Officer, President & Interested Director, Carlyle Secured Lending, Inc.
A

Sure. I mean, I would say that for our typical first lean or unitranche deals, we did see significant reduction in kind of the 12 months ending in the summer at the end of Q2. Since then, stabilization in the, let's call it, so four 500 to 550 area, we seem to be sticking there a little bit; now, who knows what the future will bring. And I will say that as rates go down, if they go down more towards the kind of 4% terminal value that the market is predicting, we may even see spreads widen out a little bit of history is that indicator, typically when we see reductions in base rates, we do get a little bit of spread widening. So, I think there's reason to believe based on the deal flow that we have and based on the reduction in rates in September and maybe tomorrow, that spreads may stick where they are and maybe even widen a little bit.

Bryce Rowe
Analyst, B. Riley Securities, Inc.

Q

Okay. That's helpful. Thank you, guys.

Justin V. Plouffe
Chief Executive Officer, President & Interested Director, Carlyle Secured Lending, Inc.

A

Thank you.

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 today. You've addressed a lot of them. I was hoping that you could touch on trends that you're seeing just in terms of fundamentals; and I apologize if I missed that earlier. But in terms of revenue growth and EBITDA, what are you seeing within the portfolio and what are you seeing within the opportunity set to deploy new capital?

Justin V. Plouffe
Chief Executive Officer, President & Interested Director, Carlyle Secured Lending, Inc.

A

Yeah. I would say fundamentals are strong. Companies in our book, as a general matter, they continue to grow; revenue, they continue to grow; EBITDA across the market, the level of distress is on the lower end. There are always credits that we're eyeing, of course, that have idiosyncrasy issues. But across the book, I would say, it's a relatively benign credit environment. Companies seem to have survived the significant rise in rates over the past couple of years, generically better than I think the market expected. So, from a credit perspective, we're relatively pleased with where the market is; and the new opportunities we're seeing, we're seeing good companies. There are strong credits and we like the companies we're seeing. I'd characterize the market overall right now as pretty constructive.

Melissa Wedel
Analyst, JPMorgan Securities LLC

Q

Okay. And just to put maybe a finer point to it, in terms of revenue growth versus EBITDA growth across your portfolio generally, are you seeing one growing faster than the other and any general range that you could provide? Thank you.

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

A

Yeah. Melissa, I think when you go back two years, three years, when inflation start to hit, definitely the top line was growing faster than the bottom line. We saw 12 months, 18 months ago that reverse refinery margins were catching up and we saw margin expansion. So, you go back a couple of quarters, we had revenue and EBITDA growth in the low-double digits, 10%, 12%. We've seen that slow down a little bit and probably just based on inflationary pressures going away. So, we're seeing those growth rates and margins stabilize in more the mid-single digits. So, still healthy growth, just probably not, we'll call it, the inflation driven higher overall growth rates we were seeing, let's say, a number of quarters back.

Melissa Wedel
Analyst, JPMorgan Securities LLC

Q

Thank you.

Operator: Thank you. [Operator Instructions] 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.

Thank you, everyone, for joining us today. We really appreciate all your attention, and we will speak with you in next quarter. Thank you so much. That'll conclude the call.

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