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Carlyle Credit Income Fund NYSE:CCIF Q2 2024 Earnings Call Transcripts

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Table of Contents

Call Participants 3
Presentation 4
Question and Answer 7

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Mickey Max Schleien
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Presentation

Operator

Good day, and thank you for standing by. Welcome to the Carlyle Credit Income Fund Second Quarter 2024 Earnings Call. [Operator Instructions] Please be advised that this conference is being recorded.

I would now like to hand the conference over to your speaker today, Alex Sperandio. Please go ahead.

Alex Sperandio
Product Specialist

Good morning, and welcome to Carlyle Credit Income Fund Second Quarter 2024 Earnings Call. With me on the call today is Lauren Basmadjian, the Fund's Chief Executive Officer; Nishil Mehta, the Fund's Portfolio Manager; and Nelson Joseph, Fund's Chief Financial Officer.

Last night, we issued semiannual financial statements and a corresponding press release and earnings presentation discussing 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 semi-annual report on the Form and CSR. These risks and uncertainties could cause actual results to differ materially from those indicated. Carlyle Credit Income Fund assumes no obligation to update any forward-looking statements at any time.

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

Lauren Michelle Basmadjian
CEO & Trustee

Thanks, Alex. Good morning, everyone, and thank you for joining CCIF's quarterly earnings call. I would like to start by reviewing the fund's activity over the last quarter.

We maintained our dividend at $0.105 per share, which is now declared through August of 2024, equating to a 15.95% annualized dividend based on the share price as of May 28. The monthly dividend is covered by CCIF's second quarter net investment income of $0.33 and further supported by $0.64 of recurring cash flow.

We deployed the remaining proceeds from the preferred stock offering, making new CLO investments during the quarter of $20 million with a weighted average GAAP yield of 19.4%. The aggregate portfolio weighted average GAAP yield was 20.8% as of March 31.

Switching gears, I'd like to discuss the current market environment for both senior secured loans and CLO equity. Carlyle is one of the world's largest CLO managers with over $50 billion of assets under management, providing us with differentiated insight into the senior secured loan and CLO market.

CLO market activity has surged through the first 4 months of 2024. In total, CLO issuance through April reached $66 billion, which is a 65% increase year-over-year and the highest on record through the first 4 months of any year. This record-setting demand reflects the increased arbitrage in relative value versus other risk asset classes.

Additionally, CLO managers are capitalizing on tighter liability spreads to refinance or reset existing CLOs. Refinancing and reset volumes of $19 billion and $39 billion, respectively, through April 2024 have already surpassed full year 2023 volume of $5 billion and $20 billion.

As far as performance for companies, we don't have full first quarter 2024 results but are encouraged by the roughly 50% of borrowers are reported thus far as well as the full fourth quarter of 2023 data.

During the fourth quarter of 2023, we saw EBITDA growth of 8%, which outpaced revenue growth of 5% and 70% of borrowers produced free cash flow, demonstrating borrower focus on improving debt service.

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When we look at the over 600 U.S. borrowers that Carlyle managed CLOs lent to, only 2% have interest coverage under 1x.

The market is currently pricing in 1 to 2 rate cuts down from the approximate 7 rate cuts projected at the beginning of the year. This better reflects Carlyle's initial 2024 outlook and believe that even if we do experience rate cuts this year, we will be operating in a higher rate environment for some time.

We think this is a positive for CLO equity distributions as they benefit from higher base rates as long as defaults and distressed exchanges don't increase significantly. For example, the second quarter median CLO equity distributions based on April payments were 4.8%, the highest the CLO market has experienced since the fourth quarter of 2015. That said, despite the strong distributions, we continue to experience rating agency downgrades in the loan markets, oftentimes focused on contraction and borrowers' interest coverage. For example, in March, Altice France, one of the CLO market's largest single obligor was downgraded to CCC.

Downgrades may continue to pressure CCC tests and CLOs and highlights the importance of understanding the underlying collateral and the risk in each CLO equity position.

I will now hand the call over to Nishil Mehta, our Portfolio Manager, to discuss our deployment and the current portfolio.

Nishil Mehta
Portfolio Manager

Thank you, Lauren. We continue to leverage Carlyle's long-standing presence in the CLO market as one of the world's largest CLO managers and 15-year track record investing in third-party CLOs to deploy a diversified portfolio CLO equity investments.

As of March 31, our portfolio comprised 41 unique CLO investments managed by 24 different collateral managers, sourced primarily in the secondary market.

We continue to target recent vintages of Tier 1 and Tier 2 managers with ample time remaining in the reinvestment period. We also opportunistically invested in several CLOs that are nearing the end of their reinvestment periods, at-risk adjusted returns that we believe are attractive where we leverage our credit analysts to determine the true tail risk in the portfolios. Given spread compression across the liabilities year-to-date and improving CLO arbitrage, we made our first CLO equity primary investment in the fund.

We continue to leverage our in-house credit expertise of 26 U.S. and 9 European credit research analysts to complete bottom-up fundamental analysis on the underlying loan portfolios of CLOs.

The following are some key stats on the portfolio as of March 31. The portfolio generates a GAAP yield of 20.8%, on a cost basis, supported by cash on cash yield of 25.13% on CLO investment quarterly payments received during the quarter.

The weighted average years left in the reinvestment period is approximately 2.4 years, providing CLO managers the opportunity to capitalize on periods of volatility to improve portfolios or reposition them.

The weighted average junior overcollateralization cushion of 4.54%. We believe this is a healthy cushion to offset a gradual increase in defaulted loans.

The weighted average spread of the underlying portfolios was 3.65%. And the percentage of loans rated CCC by S&P was 5.8%, providing a fair amount of cushion below the 7.5% limit and CLOs.

As a reminder, once the CLO has more than 7.5% of its portfolio rated CCC, the excess over 7.5% is marked at the lower of fair market value and the radiancy recovery rates and reduces overcollateralization cushion. And the percentage of loans trading below 80 was limited at 3.3%.

I will now turn it over to Nelson, our CFO, to discuss the financial results.

Nelson Joseph
Principal

Thank you, Nishil. Today, I'll begin with a review of our second quarter earnings. Total investment income for the second quarter was $7.3 million or $0.61 per share. Total expenses for the quarter was $3.3 million. Total net investment income for the second quarter was $4 million or $0.33 per share. Net asset value as of March 31 was $7.88 per share.

Our net asset value is based on the bid side mark we received from our third party on the CLO portfolio. We continue to hold one legacy real estate asset portfolio. The fair market value of the loan is $2 million. The third party we engage to sell our position continues to work through the process to maximize proceeds.

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During the second quarter, we sold 570,000 of our common shares in connection with the ATM offering program at premium to net proceeds of $4.5 million. We view the ATM program as an efficient and accretive way to grow the fund.

We expect the current dividend policy of $0.105 per month will be covered by GAAP net investment income on a go-forward basis. The monthly dividend is further supported by cash on cash yield of 25.13% on the CLO investment quarterly payments, resulting in $0.64 of recurring cash flow. Quarterly payments received in April totaled $10.3 million or $0.82 per share compared to $3.7 million of dividends paid in the quarter or $0.304 per share.

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

Lauren Michelle Basmadjian
CEO & Trustee

Thanks, Nelson. We continue to believe that CCIF is well positioned to provide investors with an attractive dividend yield that is expected to be fully covered by GAAP net investment income. We remain focused on applying a disciplined CLO investment process to assess the underlying collateral in each CLO equity position that we look to invest in.
I'd like to now hand the call over to the operator to take your questions.

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Question and Answer

Operator

[Operator Instructions] Our first question comes from Mickey Schleien with Ladenburg Thalmann.

Mickey Max Schleien
Ladenburg Thalmann & Co. Inc., Research Division

I want to start by asking about what drove the realized and unrealized losses during the quarter at a time when the markets were quite healthy.

Nishil Mehta
Portfolio Manager

Mickey, it's Nishil here. It's good to hear from you. It's a good question. So I think the realized and unrealized losses is I think it was just the mark-to-market adjustments that we saw from our third party. As you might remember, our valuations are based on true third-party marks. And it's really just the adjustments that we saw quarter-over-quarter net of the strong distributions we received in January.

Mickey Max Schleien
Ladenburg Thalmann & Co. Inc., Research Division

Okay. I understand. And Nishil, I haven't had a chance to really go through the portfolio. But at a high level, what is the opportunity to continue to refi and reset and take advantage of this tighter CLO liabilities that are available now?

Nishil Mehta
Portfolio Manager

Yes. So it's a great question. So CLO liabilities continue to tighten in the overall market, similar to what we're seeing in spread compression across all of fixed income asset classes. And so with the tightening, we are continuing to opportunistically refinance and reset the portfolios. So we're in active dialogue with the CLO managers in our current portfolio to effectuate that. Just an example, one of those shorter-dated CLOs that we purchased that had limited time in the reinvestment period, we just priced the reset of that extending the life of that vehicle by 5 years.

Mickey Max Schleien
Ladenburg Thalmann & Co. Inc., Research Division

And I imagine that has a strong impact on that CLO's NAV, correct?

Nishil Mehta
Portfolio Manager

Correct. Yes. We would only proceed with the refinancing and reset if we deem it to be accretive. And so we've found this reset to be highly accretive to the equity. And so we proceeded with the reset there.

Mickey Max Schleien
Ladenburg Thalmann & Co. Inc., Research Division

Yes. That's good news. And lastly, just want to touch on the distribution. I wanted to ask you where the undistributed taxable income stands, considering how high cash flow per share is running, which is sort of a surrogate for taxable income versus the distribution? And what's the board thinking about doing in terms of managing UTI?

Nishil Mehta
Portfolio Manager

Yes. So it's -- the dividend policy is something that we discuss with the Board every quarter. As I think everyone might be aware of taxable income for CLOs can be pretty hard to predict. You did mention that recurring cash flows could be a good proxy, but then taxable income can vary significantly whether it's due to refinancings and resets or just the underlying trading that CLO managers complete in the portfolios.

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So it is something that we're tracking and fully appreciate that. If taxable income is closer to the recurring cash flow, then we're currently not close to meeting the regulatory requirement. But at this point, we feel comfortable with our current dividend policy, but we'll continue to assess that on a quarterly basis.

Operator

[Operator Instructions] Our next question comes from Matthew Howlett with B. Riley.

Matthew Philip Howlett
B. Riley Securities, Inc., Research Division

The investment strategy, I think you said that you're focused on sort of recent issue Tier 1, Tier 2 managers is paying off with some of the GAAP yields you're reporting here. But I think you mentioned you did one deal that exited to reinvestment period and you also did one new primary issue deal. Did I hear that correctly?

Nishil Mehta
Portfolio Manager

Yes, Matt, it's good to hear from you. It's Nishil. So within our portfolio today, you are correct. We've been mainly focused on transactions that typically have at least 2 years left in reinvestment period to higher-quality CLO managers, which we consider to be Tier 1 and Tier 2. And most of our portfolio was deployed in the secondary market because that's where we saw a better relative value.

We have done one primary investment recently. Just as CLO debt spreads have tightened, the arbitrage, which is a spread between the loans and the financing has greatly improved this year.

And so we do like the relative value of CLO primary equity now. So we have deployed within the primary market. And then we also opportunistically invested in 3 transactions that are nearing the end of the reinvestment period, and that's where we thought the relative value was very attractive. But that's really where we took advantage of the in-house credit expertise that we have. Given Carlyle is the world's largest probably syndicated CLO manager, with 35 credit analysts in-house, we are able to do a bottoms-up fundamental analysis on each loan to get comfortable with the higher risk that's associated with a CLO that's nearing the end of the reinvestment period.

Matthew Philip Howlett
B. Riley Securities, Inc., Research Division

Do you get compensated to be a higher yield for those given there's the rate, where there's less optionality with the reinvestment period ending. Just curious on what type of -- what do you say relative value? How much yield pickup is there on those type of deals?

Nishil Mehta
Portfolio Manager

Yes. So that's exactly right. So the -- when I say relative value, it is the incremental expected return that we're expecting. I don't have the numbers off the top of my head, but it was pretty meaningful versus other opportunities that we're seeing. And as I mentioned earlier, we've already reset one of them. So now that deal has a full 5 years left in the reinvestment period, and we're looking at options for the other 2 as well.

Matthew Philip Howlett
B. Riley Securities, Inc., Research Division

Right. That's the real opportunity if you can find those. I appreciate that. Second question is on with the spread compression you've seen, how much in terms of tiering between managers about the credit curve, looking at the BB market, is there anything notable that's changed? I'm assuming you want to stay up Tier 1 and Tier 2, given the spread compression. Just talk about the relative value in terms of the credit curve and the manager tiering.

Nishil Mehta
Portfolio Manager

Yes. So there continues to be tiering as we've historically seen in markets where spreads or fixed income spreads are tightening the basis and the tiering also compresses. So right now, in this type of market, we think it's so appropriate to focus on the higher quality. We may look to invest in Tier 3 managers at a different time period where that spread basis is widening, where we think we are being

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compensated enough for that additional risk. It's just right now, it's fairly tight just given where spreads have moved over the past 6 months or so.

Matthew Philip Howlett
B. Riley Securities, Inc., Research Division

Got you. Great. Last question on the capital structure. I mean, it's nice to see that Series A come down in yield, it's trading almost at [26]. Can you tap back an issue like a [dribble out] like an ATM on that? And what's the outlook? I mean as you grow that equity base, just talk about financing options, would you -- what would be next, would you look at, a 7-year, 10-year bond market? I mean, just talk about the financing options that could become available to Carlyle credit as you continue to grow?

Nishil Mehta
Portfolio Manager

Yes. If you think about the capital structure today, so the preferred issuance, it's about $52 million. Our equity base is slightly under $100 million. So from a target leverage standpoint, we're kind of exactly where we want to be. We could consider doing -- adding the preferred to the ATM program. Right now, we haven't done that just given we are at a target leverage point. But we may like to do that in the future, especially given, as you mentioned, the Series A is trading at a premium, so a lower yield than we issued at.

I think on a go-forward basis, look, we're going to look to see what all the options are that are available. Historically, the peers have typically issued either baby bonds or preferreds. If we could issue longer dated at attractive coupons, but that's always a benefit to the fund, just given where base rates are today and how it's elevated, that's really why we chose to do the 5-year and more importantly, have a shorter non-call period because if base rates do come down, which is only upside in terms of the financing, we could call that baby bond within the 2 year -- after the 2-year non-call period.

Matthew Philip Howlett
B. Riley Securities, Inc., Research Division

Got you. Well, I tell you, I mean you're growing accretively. Your financing options, I mean, your cost of financing is going down and then you're finding these terrific yields, I mean this should just keep on propelling itself as you get -- as you continue to grow. So Congrats, look forward to the update on the dividend and so forth.

Operator

[Operator Instructions] And I'm not showing any questions at this time. I'd like to turn the call back over to Lauren for any closing remarks.

Lauren Michelle Basmadjian
CEO & Trustee

Thank you. We look forward to speaking to everyone next quarter, if not sooner. Please feel free to reach out if you have any questions, and thanks again for all the support.

Operator
Thank you. Ladies and gentlemen, this does conclude today's presentation. You may now disconnect, and have a wonderful day.

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