Panelists discuss competition from credit platforms, and more from a traditional BDC manager standpoint during the 2021 AICA BDC Investor forum.

Thursday, May 27, 2021

Matt Pendo from Oaktree Capital Specialty Lending, Katie McGlynn from Blackrock TCP Capital Corp., Allison Rudary from Carlyle, and Krishna Thiyagarajan from SLR Capital Partners were panelists at the AICA BDC Investor Forum Event held on May 27, 2021. The moderator of the panel was Kenneth Burdon of Skadden, Arps, Slate, Meagher & Flom LLP. Read the transcript from the discussion below to hear insights from the panelists.

Kenneth Burdon

Matt Pendo

Katie McGlynn

Allison Rudary

Krishna Thiyagarajan

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[BDC Investor Forum 2021 - AICA (aicalliance.org)]

John Cole Scott: All right Ken, you want to come on up? I thought you might kick us off. Get the panelists on stage and then I'll drop off. Okay.

Kenneth Burdon: Hello everyone, I'm Ken Burdon. I'm an attorney at Skadden, Arps. I'd like to welcome everyone to today's first panel discussion, which is "Traditional BDC Managers: Competition for Credit Platforms". I think we've got a great panel to offer today with deep experience and a robust diversity of views. So to kick it off I'd like to invite each panelist to provide a brief introduction to the audience. Maybe start with Matt?

Matt Pendo: Sure, I'm Matt Pendo from Oaktree Capital. Our BDC that's publicly traded is Oaktree Capital Specialty Lending, OSCL is the ticker. And I am the president and chief operating officer of OCSL.

Kenneth Burdon: We've got Katie, I think.

Katie McGlynn: Yeah, thanks Ken. And thanks to John and his team for hosting us today. My name is Katie McGlynn and I am head of investor relations for BlackRock TCP Capital Corp., and I'm also a senior member of the BlackRock private credit team where I am responsible for product development, marketing, and investor relations for our US private capital team. I joined the team about three and a half years ago, and most recently prior to that I had the pleasure of working with Matt at Oaktree on the investor relations team. And just wanted to say that I think it's a really exciting time for private credit right now given a number of industry tailwinds that I think we'll talk about today. And BDCs are really attractive in a unique way for a wide range of investors to take advantage of those tailwinds, so looking forward to the discussion.

Kenneth Burdon: And we have Allison as well.

Allison Rudary: Hi, good afternoon everyone, my name is Allison Rudary. I am here representing Carlyle Group's BDC, TCGBDC.com, it's ticker CGBD. I joined the firm last year as their head of investor relations. And prior to that I had spent about 10 years on the sell side covering a wide range of financials including BDCs and the alternative asset managers. And a few years at JP Morgan right before joining Carlyle in their private bank, helping ultra-high net worth investors manage and navigate particularly the alternative asset space.

Kenneth Burdon: Great, thanks. Last but not least, Krishna.

Krishna Thiyagarajan: Hi guys, nice to meet you. My name is Krishna Thiyagarajan, I work at Solar Capital Partners, SLR Capital Partners. We have two BDCs, ticker SLRC and ticker SUNS. I'm the co-chief risk officer and portfolio manager across our cashflow business and across our private funds.

Kenneth Burdon: Great, thanks everyone. And just for the audience, I'd like to remind everybody that questions can be submitted through the Q&A function on the right of your screen. This forum and this panel is designed to be interactive, so please to don't hesitate to ask any question and participate in the discussion. We've also dedicated 10 minutes at the end of our hour timeslot here for Q&A.

So with that, I'd like to pose our first topic for discussion, which is the benefits of the BDC structure as a vehicle for middle market credit exposure. So what does that panel see as the thesis for middle market credit. What does it see as the key benefits for gaining exposure through a BDC structure? Maybe Allison can start us off.

Allison Rudary: Yeah, absolutely. So the primary benefit for especially the publicly traded BDCs is that it allows you to access an asset class that is fundamentally illiquid but in a very

liquid manner. And there are a number of publicly traded BDCs out there that investors can access, many of whom have different strategies and areas of the market with which they are most familiar or [inaudible]. And as a yield generating investment, you can use a public liquid easily accessible vehicle in an exchange-traded public stock to access what most of us do day-to-day. Which is to make investments that are functionally not liquid in small, predominantly domestic-based companies that you wouldn't otherwise be able to own. And I think that that public capital to private illiquid asset is really one of the main benefits of the structure. Key to this is that these investments because of their nature have really attractive returns to investors and this is a very efficient way to access that.

Katie McGlynn: Yeah, maybe just building on that I'd say that we've seen a huge influx of institutional capital into private credit. And that's for a number of reasons including obviously in today's low-yield environment private credit has historically provided investors with 300 to 400 basis points of yield premium. And so given the attractiveness of that asset class in today's environment, I think the BDCs really offer an attractive way for a wide range of investors who don't typically have access to those types of yields and those returns to be able to gain access, and again to Allison's point, in a vehicle that provides liquidity as well.

Krishna Thiyagarajan: I would also just echo my colleagues. One other real advantage of the BDC structure is the patience it allows considering it's a permanent capital vehicle. It really allows folks to withstand, and we'll probably cover some of it when we talk about portfolio construction, but cycles and hits in the economy. Including the pandemic that unfortunately the world experienced. And that's a very critical point, unlike situations where you have an investment period and a run-off period, it really allows you to invest, getting to know now just the sponsors who back these companies but also the management teams, and really have a thesis around your portfolio construction. And it also allows you to do a lot of different asset classes. So for example, at SLRC we do do cashflows with large sponsors in the upper middle market, but we also do a lot of specialty finance, a lot of life sciences. And the BDC structure for all of us allows for a lot of flexibility in terms of structuring these investments to provide yields to investors.

Matt Pendo: I'll just pick up on a couple comments and just echo them. The BDCs, all of our BDCs are publicly traded, so you can buy and sell them every day the market's open, so they're very liquid. They have independent boards of directors that sign off on the valuation every quarter and approve the management contract. We file 10-Qs, 10-Ks, we have research analysts that follow us, we issue press releases, all of our investments are disclosed in the 10-Qs and the 10-Ks, so there's a tremendous amount of transparency into our investing, to our liquidity. We're also, in the case of many of the BDCs, part of a larger asset management or credit platform, so you're really able to leverage and have all the benefits that a large asset manager provides.

In the case of Oaktree we manage north of $150 billion of assets, we're known as a very bottom's-up, risk oriented credit manager. So all those benefits come to the shareholder of the BDC being part of Oaktree. And I think that's a huge, huge advantage that the retail investor has that as people commented, most institutionals, this kind of private credit asset is of interest by institutional investors, this allows the retail to have the same benefits.

Kenneth Burdon: Great, and maybe the panel could talk a little bit more about some of the other things that might make BDCs attractive relative to other types of vehicles for investing in private credit. I see we've had a few questions come in here, in particular what's the advantage of investing in a BDC as opposed to private offerings from the BDC sponsors? At least when you're talking about a sophisticated investor like a qualified purchaser. And then maybe we could touch a little bit more on some of the things that have helped BDCs, at least through the Covid pandemic, looking at the leverage limits under the 40 Act and how that may help benefit BDCs, and the advantages of the BDC as a non-bank lender.

Matt Pendo: Katie, you want to go first? We'll keep rotating?

Katie McGlynn: Yeah, so I think we've covered off the key benefit, which is really liquidity, right? There's also the volatility in public equity markets, which can be a negative but can also be a positive way for investors to access a BDC at a discount. So like you saw over the last year, that BDCs traded down given the volatility in the markets earlier in the year, but I think as John mentioned, have provided a total return of 19% since that period. So that can also provide I think an opportunity.

Allison Rudary: I would echo that. I think the primary benefit of a BDC structure as opposed to going to a direct offering, which is an absolute great way to take a stake in this, is that because our peer set, our publicly traded peer set is so large, you're not dependent upon any given fund manager that's in the market. These are permanent capital vehicles, there are a lot of us, the liquidity and the equity data that you can get is both a risk but it also can be a very, very big opportunity. It's also very tax-efficient, this is a 1099 dividend, the ordinary income paying thing [inaudible], as a personal investor it doesn't [inaudible] the 40 Act [inaudible].

Krishna Thiyagarajan: I would actually echo Matt's point that he made, which is really about transparency. I think by definition the structure requires the income to be distributed, the financials relative to some other different kinds of structures out there are a little more straightforward for the investor to follow. I think critically some of these statutory leverage requirements even though there are two terms which relative to certain fund structures is not a lot of leverage. Really most BDCs operate at probably closer to a target leverage of 1.2 to 1.3 times because most of us like to keep our investment-grade ratings which is really what drives our cost of capital to provide the yield we want for shareholders.

So I think a couple of those different factors, in addition to the fact that unlike depending upon a BDC strategy but a lot of us don't really play in the broadly syndicated market, and there's a tremendous amount of value to being able to structure deals with covenants and insure that we want to give the kind of protections with the capital preservation being of utmost importance.

Matt Pendo: Yeah, and just [inaudible] Krishna's point about the portfolio construction versus a private fund and the permanent capital nature. All of our BDCs, the portfolio is known. So if you're interested in buying it, it's not a blind pool or a fund that we're raising and then we're going to invest. You can go today, look at each of the loan in the portfolio and come up with your own view of whether you like it or not. But for the most part we're fully invested, there's

not a ramp period that's already occurred, and you can look at every loan in the portfolio. Every quarter we'll update that, that's in the financial statements. So the transparency, the liquidity, both in terms of buying and selling I think are a big difference versus a private fund that has kind of the ramp period then the liquidation period.

Kenneth Burdon: So picking up on some of those liquidity points and trading points, can you talk a little bit about, we all hear about discounts to net asset value and how that plays into the BDC market. We also kind of had a question come in here about expense ratios and how you look at those versus your peers. So on the investor front when they're looking at discounts to net asset value and looking at expense ratios, how should investors think about that?

Matt Pendo: Krishna, you want to go first? Your turn.

Krishna Thiyagarajan: Sure. Look, I think as it relates to discounts to NAV, that's obviously depending upon how liquid, which most of us among the larger BDCs are, is the market's reflection on its view in terms of a couple of things, one is dividend sustainability. I would echo Matt's point, and I just want to make sure the audience appreciates this, but in a private fund what tends to happen is it takes typically a couple of years to not only ramp the fund but once the investment period is done when the credit [inaudible] providers start deleveraging. Which effectively means once the investment period is done you get into a turbo whereas you're getting redemptions your credit [inaudible] gets paid down. That really has an impact in terms of the current yield that you're able to offer investors. So the permanent capital aspect first of all allows you to provide a steady stream dividend yield, whether that's 8 or 9%.

As it relates to discount to NAV, it's really the market's view on, A, dividend sustainability, and how you mark your book. That's where the transparency matters. If you look at pretty much most BDC financials, just for the benefit of the audience here, one of the most important aspects of a BDCs financials are really the fair value of the assets. Which is listed in a schedule that lists out each individual investment, what sector they're in, and you can actually as an investor track to see what's been going on with the marks. So what you find is there's obviously multiple reasons, there're macro factors such as Covid. When at the height of Covid, BDCs were trading anywhere from 50 to 60 cents of NAV, clearly the market was highly concerned that what they would consider as not a big public corporations might not be able to withstand the pandemic. And then that certainly came back, I think pretty much on average most BDCs NAV is slightly higher than pre-pandemic, which is a great sign for the sector to be healthy.

But more importantly, discounts to NAV is really multiple factors; dividend sustainability, any sort of portfolio concentration issues, and volatility. So it's like anything else where an investor who really takes the time to look at the universe, has a basket of names, understands the strategy of each BDC, there's no one good or bad strategy. That's the whole point of having a portfolio if you're an owner. You essentially diversify your exposure and look at each BDC, both its liability and asset structure, and come up with your view.

Matt Pendo: Yeah, and I would [inaudible], you talked about discount to NAV. But to Krishna's point, the dividend, we in OCSL, we look at both NAV and how the NAV's performing, particularly through the pandemic, and the dividend. We've been able the last few quarters

through the pandemic, going into the pandemic we had a lot of dry powder and were very cautious about the environment, which really benefited us through the pandemic. So our NAV, our dividend's actually increased through the pandemic. And the discount, our discount to NAV's decreased pretty significantly. But besides the NAV, there's also the dividend, those two things kind of go hand in hand, and we like having a nice balance between the two. Because we talked to investors, some investors that really focus on the dividend, there's others that really focus on NAV or net asset value or the net worth. Both are important, because for every investor that's focused on the dividend, [inaudible], and there's also that are focused on NAV and growing NAV as a way to increase value to the shareholders.

Kenneth Burdon: Katie, did you have any views on that as well.

Katie McGlynn: I'll just quickly add on to that, to the point of NAV stability. I think that going into the pandemic there was a lot of skepticism from investors in terms of how BDCs would perform through a downturn since many BDCs hadn't been public through the prior downturn. And so I think what you saw was a lot of the stronger managers were, to Krishna and Matt's point, able to increase NAV. And so just a good reminder on the strength of a lot of the platforms within the BDC sector.

Matt Pendo: As we talk about the market environment, one of the fundamental things in private credit that's happened is the role of the banks. Because a lot of the loans that we all make were loans 10-20 years ago the banks made. And for regulatory and cost and other reasons, the banks have decided just to rather than make all individual loans, they make one loan to us, to the BDC [inaudible] borrows from banks, and then we turn around and we make the loan. I think as lenders we're much more flexible, we're much more creative, I think we can move quicker, there's a lot less regulatory costs and burden. And I think both for us and the banks it's a win-win because their business model is more to, if I just make one loan to Oaktree Specialty Lending, then that's a lot better than having to make 40 loans to a bunch of companies. So that's the role we play. That's a trend that's been going for a while and I think that's going to continue because it's better for the borrower, it's better for us, and it's better for the bank.

Kenneth Burdon: Just to close out the discussion on BDCs as a structure, again we've got some great questions coming in. Does anyone on the panel have a view about whether BDCs are better suited for retail investors versus institutional investors? We do also just have a question about [inaudible], how do BDCs manage the risk [inaudible]? I think we kind of talked about that some and maybe we might get into that a bit in the next section of our panel, but just wanted to put that on the table for the discussion to close out this first half.

Krishna Thiyagarajan: Yeah, I would say just a couple of points there. I think BDCs are very, very well suited for a retail investor. If you look at most institutions, large institutions have the ability to access different asset classes directly. They can invest in private equity, they can invest in multiple different asset managers, as opposed to a retail investor who might not have that sort of access. Because I think just taking a step back, just to again make sure that the audience gets the benefit, ultimately it's about what are the investments in BDCs? And in most cases these are not investments which are done in a four-day period, these require a tremendous amount of diligence, it requires working with financial sophisticated sponsors, Hoping that each BDC has

built a track record in multiple sectors, each BDC has its own view on strategy, portfolio diversification, and all of those points.

But I do believe that the retail investor really gets the benefit of getting exposure to an asset class which is highly structured. Most BDCs have a large percentage of their portfolio that has got covenants, [inaudible] 100% of it is covenants. And as I said, it's not just about cashflows. Several BDCs have some interesting niches, we do cashflows, we do specialty finance, we do life sciences. And ultimately it's about not trying to chase one asset class to the extent markets are dynamic, they change over time. So to try to get the best risk-adjusted returns in a permanent capital vehicle is an excellent way to get a consistent dividend yield. So from that perspective I would say it certainly lends itself to retail investors who frankly have been in a market for a long period of time where outside of investing in munis and some other opportunities, it's been difficult to get consistent yields.

Allison Rudary: Yeah, I would also add that I don't see the investor community for BDCs as an either or. We all have institutional investors who invest actively in BDCs, and we also have investors that are very, very intelligent on our space who might run portfolios that are focused on smaller cap, mid-cap names, on income, on financials. So I think from a retail versus institutional, we're a publicly traded company and we've got both. I do think though for the retail community specifically, being able to access this particular asset class, the BDCs are a very, very attractive vehicle to do so because our underlying are typically not something that could be traded. Institutional investors have a huge importance for our market because they do a ton of work on us and are a major constituency for all of us.

Katie McGlynn: And I'd just add too that sometimes in the retail community there's an [inaudible] private markets are also more risky. But historically actually, direct lending has provided premium returns to high-yield and leveraged loans with actually a lower loss rate. And that's for some of the fundamental reasons that Krishna touched on earlier, the fact that our loans are structured to be senior in the capital structure, they're often backed with collateral, and we also structure them with covenant protections that help to protect on the downside.

Matt Pendo: Yeah, and just picking up on what Allison said, we have both institution and retail investors in our BDC. It's for all the reasons we talked about, not only liquidity but the ramp up and ramp down in the portfolio, that appeals to both institutional and retail. And particularly with the investors, this is a great way for them to get access to the larger investment platform in the case of Oaktree. Howard Marks was one of our founders, chairman, people who follow Howard's readings and his investment philosophy, you have access to that philosophy through the BDC whether you're institutional or retail. We find that's really attractive to both institutional and retail in a very transparent, daily traded ability. Just look at to pick up Katie's point, the performance, we'll cover this a little bit later but the performance of all of us on the call, our BDCs during the pandemic, post-pandemic, it's pretty extraordinary and should give both retail and institutional investors a lot of comfort in how we structure our loans, how we look at risk, and how we manage the portfolios.

Kenneth Burdon: I think that's a great segue into the second topic that we'd like to put out for discussion here, which is your approach to portfolio construction. There's different flavors and

different approaches that everybody has and I think it'd be great to hear about that. So to link what we were just talking about with what we're going to talk about, can you talk a little bit about risk in portfolio construction and how you manage that? We were touching on that. And we've heard some discussion about covenants, maybe we can expand upon covenants a bit more, and the diligence process for these private credit investment opportunities versus how that might be done for public credit.

Krishna Thiyagarajan: Sure.

Matt Pendo: Go ahead.

Krishna Thiyagarajan: Yeah, so look, I think basics of portfolio construction for most BDCs, I'll certainly just speak for SLR, is obviously diversity. I think [inaudible] to no matter what asset class you're investing is to not generally staking our positions that are greater than 2-3% of any given portfolio. But I think beyond that, in some cases there's also asset class diversification. For example, our portfolio has only about 20-30% cashflow. A lot of the portfolios are asset based, where there's actually collateral behind [inaudible], we've got a life science portfolio. And what we've found is depending on the asset class, sometimes it can be correlated to the broadly syndicated market and some don't. But ultimately I think to your point on covenants, this is not about just having a financial covenant, it's really also about some of the structuring aspects Katie and Allison referred to, which is about the quality of the earnings that you're underwriting because you actually get third-party reports to review.

You spend about two months on some of the larger deals, where you're getting involved with all of the different protections you need. If you look at the broadly syndicated market, there have been a lot of high profile situations where investors who thought they were a first lien ended up being a third lien, just because things that were taken for granted like sacred rights and documents aren't sacred anymore. So these are the kind of things that as a direct lending investor, we are closely in a club deal with maybe three likeminded to four likeminded investors with reputable financial sponsors really provides you with the kind of protections that your investors need because capital preservation is critical when you're in the debt business. Because the good ones pay off and the ones that are troublesome tend to stay around and it's about capital preservation. So I would say it's diversification by issuer, diversification by asset class, and really taking the time to do your due diligence.

Allison Rudary: Yeah, and I want to build on Krishna's comment and talk about the benefits that investors get from having active management in portfolio construction. So one thing that Carlyle's team is very focused on is making sure that the types of loans that we make are relatively less-- our portfolio as a whole is relatively less exposed to cyclical industries. So because we are functionally buy and hold investors for the overwhelming majority of our core book, we really want to focus on making investments to companies that have defensible, repeatable, understandable, and predictable cashflow. Because ultimately that's really what's going to drive underlying portfolio performance to you the shareholder.

I'll just give you a statistic from our book, if you were to look at the diversity in industry in TCG's portfolio, what you would find is that it actually has cyclicality that is roughly 55% of the

broader broadly syndicated loan market. That's one of those benefits that you get when you're not buying an index of traded loans, we are all very active choosers of each dollar that goes into the ground.

Matt Pendo: Go ahead, Katie. Go ahead, Katie.

Katie McGlynn: Thank you. I was just going to add that our team has actually been in this market, making loans to middle market companies for over two decades. So something we pride ourselves on is that long history of experience. We're also industry aligned, so we have industry specialized yield teams. And then also we manage two strategies, so direct lending and special situations, and it's the same teams working across both of those two strategies. So we kind of look to find opportunities that are maybe a little unique, not widely understood, where we can really add value and leverage those relationships that we've built over our two decades of experience.

Allison Rudary: Yeah, that's very much a benefit that Matt has spoken of, of having that platform approach when you own a BDC like Oaktree or Carlyle or TCB BlackRock, Solar, even though the publicly traded pool, a BDC is one, is a very contained, understandable pool of loans. You have the benefit behind that of these global world-class asset managers and all of the benefits of that, the advisor can then kind of come down and then just like Katie was talking about, of having other pools of capital, other areas of expertise.

Matt Pendo: Yeah, and I think just picking up a little bit the diligence in the process. I'll just spend a second on the process of a private credit loan versus a broadly syndicated loan. In a broadly syndicated loan, the deal, the offering, the company, it's announced in the morning and it's priced that day or maybe the next day. But it's a day. In the case of the private loans, rather than in a day, it's weeks or months of working with the company, understanding their issues, understanding the collateral, understanding the manager team, understanding the issues. Understanding in the case of Covid, their cashflow and cash burn, and how much runway do they have given the impact of Covid. So it's a totally different process and that allows you to do more credit work, to do more work on covenants and covenants that really matter, understand the management team, understand the sponsor and their vision for the company.

So it's a completely different underwriting and diligence format then you have in the broadly syndicated market. And many of the loans in the broadly syndicated market go into CLOs or other things that move into a vehicle, whereas with in private credit and the BDCs, we all know we keep those on our balance sheet until they're refinanced or mature. So the lens is, "We're going to own this for a long time. Let's make sure we're being thoughtful, we understand the risks." And I think that's one of the reasons why through cycles, through the pandemic our credit performance has been pretty extraordinary. In OCSL right now we have no assets on non-accrual even though we're at the tail end or have exited a very serious health pandemic, which is I think pretty extraordinary.

Krishna Thiyagarajan: I think actually that's a super critical point Matt just made. One of the things that's probably not obviously to a lot of the audience is, as much as these are private companies, the sponsors are generally relationships most of us have where they've done multiple

deals. But you're not waiting at the end of the quarter to hold your breath to find out what could be going on when something like a pandemic happens where it's a once in hopefully 100 year event. In most of our cases because we're generally pretty meaningful as part of the capital structure, in most of these companies the dialogue can be as frequent as weekly. Because they understand that as a pretty important lender in the capital structure we need to know what's our contingency planning, what is the liquidity profile, how much cash runway do we have, do they need flexibility that's warranted? So the level of information flow is extremely different from being a high-yield investor or even just being an equity investor. Which I think is a very, very critical part and also it helps that your generally speaking senior secured not [inaudible], and in a lot of cases first lien, that really allows you to be [inaudible] risk, especially if you've structured the documents well.

Matt Pendo: The other thing just picking up on the market point I made. If you flip it around, if we talk about the banks, how they [inaudible] the market, if you think about the sponsors or the companies, they really like dealing with us because they know we're going to be there the whole time, we understanding their business, if there's issues or things we need to work on or they need we're there for them. So the companies and sponsors really prefer dealing with us than a bank or a CLO lender or something where the money where you're never sure six months from now who you're dealing with. So you've got those critical forces going on that I think have really helped our industry and our performance from both the borrower and the lender.

Kenneth Burdon: We had an interesting question just come in too. Can anyone talk about a specific non-accrual issue they worked out and one they didn't and what that meant for shareholders? Do we have a general enough case study that somebody might be able to just give a general overview of?

Katie McGlynn: I can give an example, and it wasn't actually a non-accrual but a challenged credit at the start of last year. We leant to a software company that provides software to auto dealerships, and obviously in April of last year most auto dealerships were not open. So that company didn't ultimately go on non-accrual but we did help them navigate through that challenging period, and I think that really speaks to the value of working with a private lender. Where first we did have covenants in place, so that allowed us to come in and negotiate directly with the borrower and help them through this period. And then when autos recovered quite quickly, I think probably more quickly than anyone anticipated last year, then that borrower got back on track. But in the meantime, again we were able to work with them. Whereas if they had borrowed in the liquid credit markets, they probably wouldn't have gotten that flexibility for what ended up to be a pretty short period of dislocation.

Kenneth Burdon: Kind of playing a little bit on the Covid theme, has Covid impacted any of you to your portfolio construction? What kind of loans you are looking at making now. What kind of protections you might want now as opposed to later. Who you might be lending to now as opposed to previously.

Krishna Thiyagarajan: Yeah, I would say at least from our portfolio perspective, what Covid really taught us was, probably helps to not be purely focused on non-cyclicals. That just is something depending upon everyone's view, very, very difficult sometimes to predict when

you're in illiquid loans with five, six year maturities with the good ones as I said, paying off within three years. When's the right time to enter a cyclical? So again, different portfolio managers have different strategies, but I think for us personally speaking to industries like healthcare, healthcare services, insurance brokerage, software, a lot of business with what I call recurring revenue streams, reoccurring revenue streams, really served us well.

I think what we were surprised by is while certainly stay-at-home was pretty tough on a lot of companies as you can imagine, a lot of these companies had a reason to exist, essential services, they kind of snapped back pretty quickly. And depending upon the sector you were in, if you were in healthcare you really benefited from the CARES Act, where specifically for a lot of companies with any sort of Medicare exposure, the government essentially provided [inaudible] for these businesses and flushed them with liquidity. What we've found on our asset-based lending side was, perversely with all the capital that came in, these companies didn't require the working capital [inaudible] otherwise wanted with those getting PPP loans.

And on the sponsor side, because we were on the upper end of the middle market, there's probably only just one company that probably needed a liquidity injection. But outside of covenant holidays that you have to provide when you suddenly go from X amount of revenue to zero for a couple of months, it was mostly about showing that flexibility and working with sponsors. Because that's exactly to Katie and Allison's point as to why you get to participate in a direct lending market where you can make quick positions as opposed to being part of a larger bank platform where they'll just have different check boxes as to what they can live with from an amendment perspective on that.

Matt Pendo: I think for us, this was kind of Allison's point earlier, when we underwrite a credit and think about it, it's why does this company exist? Why does it need to exist? What are what is its core business proposition? And while we do some sponsor lending, we also do a lot of non-sponsor lending, so lending directly to companies. Then it becomes really focused on what's the business rationale here? What's the moat? What's the collateral? We like to have three or four ways to get repaid. A loan could be refinanced, the company could be sold, the company could merge, a company could sell part of its business or its IP. So we're looking for multiple avenues to exit and really dig deep into what's this fundamental company, what their business is all about, and how defensible is it and what's the need for it?

And to Krishna's point, we've found many companies in our portfolio, actually quite a few companies in our portfolio really benefited from the pandemic. They were able to pivot the business to the extent that business needed to be pivoted. We had one healthcare company that came up with a Covid test. I think, particularly in the middle market, I think generally companies, they're not bureaucratic, they can respond, and I think they responded extremely well to open new lines of business, focus on cash. And I think the whole BDC space really benefited because the companies pivoted where they needed to pivot and their performance has been pretty staggering in terms of weathering a very, very significant health issue.

Katie McGlynn: I think that's an excellent point on the resilience of the middle market. So there's data actually that in the last year middle market companies actually cut jobs a quarter of the rate of their large corporate counterparts, and actually the revenue decline in 2020 was also

less than a quarter or what it was in larger corporates. So the middle market really proved to be very adaptable and resilient over the last year.

Kenneth Burdon: And so just kind of a counterpoint coming in is how much of the resiliency do you think has been driven by due diligence, risk management, portfolio construction versus the amount of fiscal stimulus that came in during the pandemic? Then broadening out from that, kind of looking forward as to what the next issue might be that we all need to deal with. How are you thinking about inflationary pressures and what that might do to long portfolios and BDCs generally?

Krishna Thiyagarajan: Yeah, on the fiscal stimulus, it's really a tale of two things. Most of our portfolio companies frankly didn't benefit from at least the Covid-related stimulus that was provided just because they were owned by financial sponsors and they were effectively rules around being about to access PPP loans because when you own portfolio companies it got consolidated and didn't meet some of the tests required. So I would actually say again there is definitely some really harsh tales to be learned if you were in cyclicals in certain sectors. But for the most part when you look through the universe, these companies [inaudible] on their own. Sure, as it came it essential services business like healthcare, they certainly benefited from the CARES Act, a lot of liquidity. But for the most part I would just echo Matt's point and a few points made that it was really about [inaudible] management teams.

And again I would remind everyone, these are pretty sophisticated sponsors who have been around for a while and kind of know how to think about optimizing costs, improving margins. And what we've actually found is coming out of the pandemic, we're not out of it yet, fingers crossed for everybody, but the margins have fundamentality improved. Because when you get into those kinds of situations where it's all hands on deck, some of those improvements sometimes can be lasting because there's always inefficiencies in the system that you take out. So certainly across our portfolios, [inaudible] margin profile for the businesses which are predominantly the case, performing at levels at or higher than when the pandemic started has been better.

Matt Pendo: Yeah, I think I'd agree with that. Most of our companies under the CARES Act didn't have access to that financing, so they didn't [inaudible] that. The thing we're focused on now from an underwriting perspective is the post-pandemic, what's going to be the impact to these companies to the extent they got a Covid boost, how sustainable is that? How's that going to change over time? And you mentioned inflationary pressure, how is that going to impact these businesses? The supply chain, supply chain issues and how that impacts these businesses.

But as we talked earlier, we're able for all these issues, one, for new investments, due diligence, ask the questions, work with the management team. And likewise for existing investments, you have the same sort of relationship and dialogue with the management team, and understanding what's going on, what they're seeing, and work with them if need be. I would say while we're watching these things, we're not really seeing impacts on the companies quite yet. But we're aware of it, we're able to work with them, they're able to work with us, they like working with us. So that's kind of how the process works. Which is very different than in the liquid markets where you just don't have that access and dialogue, and insight and dialogue with the sponsor or

the founder of the company who's got pretty much their entire net worth built on it. So it's a very I think helpful dynamic to the BDC space in our portfolios.

Allison Rudary: [inaudible] because we get the inflationary pressure question quite often from investors because we are seeing pockets in the economy where there is absolutely pressure on input prices. There are supply chain issues and production issues from folks in the pandemic either taking manufacturing offline too conservatively and not getting back on quick enough. Our Carlyle's house view is, and there's an op-ed about this from our chief economist in today's journal which you can see, is that we do think for the time being the most of these inflationary pressures that we're seeing right now are transitory.

But to Matt's point, in addition to all of the data we have as a global asset manager, we have dialogues with our sponsors and with our companies all the time. So if there are issues around price mechanisms, pass-through mechanisms, input substitution, these are things that we can talk to our portfolio companies with and about every day. Again, that's a really different way of portfolio management then you would get in most other asset classes. I think it's one of the reasons why true direct lending and true middle market lending can be such an attractive space.

Krishna Thiyagarajan: Look, the other interesting point, inflationary trends. Again, there's a lot of different points of view I've heard on it, in terms that is to say short-term trends, is that just because of some of the supply chain and logistic issues that's shot a lot of commodity prices through the roof? Or is it something that's long-term with all the fiscal stimulus taking place? That's one of the other advantages, looking at most BDCs you'll see they're predominantly floating rate investments. So by definition, if there is upward pressure on interest rates that enures to the benefit of the investors. So if you really think about it, as long as you're not probably stuck in certain industries where you're getting hurt, just having a floating component to your coupon where most of us are, almost all of the investments are index to LIBOR which will potential transition to the SOFR or what not, interest rate increases can be your friend. Now having said that, you obviously don't want the kind of increases that start stressing a business' liquidity, but certainly that's just something also for the audience to think about because these aren't high yield bonds with fixed-rate coupons.

Kenneth Burdon: Great, so we're going to open Q&A, and I've been holding on to one question to kind of try and kick that off. The question was, "How does the panel view the impact of SPAC boom on opportunities in the BDC space?" I think that's a great and interesting question that I would love to hear everybody's view on.

Krishna Thiyagarajan: Great exit option for some of our portfolio companies. To Matt's point, it's certainly, the SPAC boom has inflated some of the enterprise values. And we're pure debt investors, we don't do much via equity, and so we have actually seen a couple of our portfolio companies that would have found a traditional home with usually another financial sponsor or in some cases is strategic, being able to exit through a SPAC. And we've seen it in a couple of situations. And very nice outcomes including one situation where the business was performing fine, it wasn't knocking the cover off the ball but certainly with a lot of the SPAC [inaudible] formation and a lot of pressure to find an interesting business to justify some of these SPACs,

we've certainly seen that as becoming a pretty important exit alternative as we think about our own risk of being an investor.

Katie McGlynn: Yeah, 100% agree. We haven't seen a ton of examples where our portfolio companies have gone the SPAC route, but I think just the more options you have for equity support for portfolios companies the better. And as you've seen the number of public companies reduced by half, and this just gives companies another option to be able to go the public route ultimately.

Matt Pendo: Yeah, while it may be interesting and SPACs are quite topical today, in our portfolio there's a few companies that may exit through a SPAC IPO but it's really a non-event. We're not making loans to pre-SPAC companies, pre-merger companies with the hope that they can be de-SPAC'd and we'll get repaid that way. We're not playing that, that's a very risky game to play certainly right now what you're seeing. That hasn't been a focus of ours, and we don't do PIPEs which is also part of the SPAC universe. So I think for us there could be a few exits here and there. And I think every day there's an article somewhere on SPACs, I think for us it's really not that impactful.

Kenneth Burdon: Go ahead, Allison.

Allison Rudary: No, I was going to echo what Matt said. It is another source of potential exit and liquidity but it's really not our day-to-day business and we certainly wouldn't underwrite that as an expectation on it happening. There's a number of different ways our portfolio companies can change ownership or move onto the next phase of their lives, but really we lend money to companies and we expect over a period of three, to six, to five years to get paid our coupon and to get paid back in full, that's our business.

Kenneth Burdon: Absolutely. And please everyone, we've got about five more minutes to go here. So if there's any other questions to come in, please send them in, we'll be happy to answer them. I will throw out I think another one, which is just in terms of viewing portfolio construction more in terms of the types of investments you might make. I know some of the BDCs on here are more, as Allison mentioned, kind of straight debt investing. And some dabble in some other areas too with acquisitions and buying businesses and looking more like a public PE or venture capital type investing strategy. Just kind of wanted to I guess get your relative views on that as something investors might want to look at. Maybe you might want to bring the idea of SPACs into that area too. Are any BDCs looking at SPACs themselves as a sponsor vehicle or kind of anything off the beaten path like that?

Krishna Thiyagarajan: Yeah, just from our perspective, one of the things about being a BDC is you want to have consistency of dividend yields to your investors. So for the most part, at least we don't dabble too much in straight equity where there could be a payoff a while from now, that's just really the business model. The business model is to create current income and we will distribute that income. Having said that, we certainly have done a lot via acquisitions in specialty finance vehicles that have been very interesting because some of these finance companies require capital to grow. A BDC that is able to acquire them really allows for a very nice home to be able

to get consistent yields, whether that being equipment leasing, whether that be in healthcare receivables, whether that be in non-traditional ABL. So certainly depending upon the BDC, if you get the right team and you get a right pool of assets, being able to provide them with permanency of capital to then take that income to distribute to your investors has certainly been a pretty interesting strategy for us.

Kenneth Burdon: Good, good. So I think the last question that we had come in here for the Q&A session, we've got three minutes here so maybe we could just kind of see what kind of views people have on this. But do you see issues for portfolios as result of the transition away from LIBOR?

Matt Pendo: So my view on this, this is for us who are old enough to know, this is like Y2K. Everyone knows it's coming, our assets are LIBOR-based, our liabilities for the most part from the banks, LIBOR-based. The whole world has LIBOR-based assets and liabilities. If we can't figure this out, we've had years to figure it out, it's been pushed out. So I don't see any issues. I think the fact that our assets are floating rate and LIBOR-based, I think that's a fairly attractive thing. People talked earlier, rising interest rates, what's the impact? For us particularly on the shorter end, rising interest rates is going to be a positive as opposed to fixed-rate, like a high-yield portfolio, there's a question about that. So being tied to a floating rate whether it's LIBOR or SOFR or whatever it is, I think it's a good thing. And I think this transition is, my prediction is it's going to be like Y2K.

Krishna Thiyagarajan: Yeah, I would concur. Most of our docs had language that specifically says, "We'll figure it out." Right now people are talking about SOFR, there's the Bloomberg Index, there's now something, there's some other SIBOR, not SIBOR but I forget, some other acronym. Folks are still debiting which one really represents direct lending the best, so there's more to come. Ultimately I don't think either to our clients or ourselves, we're going to be doing stuff with that preference rate to try to see if we can make more money or hurt the companies. I think it's just going to be figured out.

Allison Rudary: Yeah, and to use Matt's analogy, the Y2K analogy, we are by far not the only industry that is affected by LIBOR. It is deeply embedded across many, many, many financial institutions, and large ones, so there's a lot of people, a lot of really smart people who are doing a lot of work on this at all of our institutions as well as all of our counterparties and the global financial system as well.

John Cole Scott: All right, well guys, thank you so much. What a nice panel discussion to kick off the conference. Thank you Kenneth for moderating and everyone just doing an excellent, excellent job. We're going to take this back to the floor so people can get a little break before panel number two. Again, thank you again so much.

Matt Pendo: Thanks everybody.

Krishna Thiyagarajan: Nice meeting everybody. Take care.

Allison Rudary: Thank you all.

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