Trinity Capital's Brown On Double-Digit Yields And Venture-Backed Growth

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Kyle Brown, president and chief investment officer at Trinity Capital. Read the Q&A below as Kyle explains how the company's structure helps to support double-digit yields and makes them more secure than other high-yield investments, but also discusses the business-development company's exceptionally high yield relative to the rising interest rate and high inflation rates of today. He also talks about how those conditions impact the high-growth, venture-backed, early-stage companies that Trinity finances.

Kyle Brown

The podcast can be found on AICA's website by clicking here: https://aicalliance.org/alliance-content/pod-cast/

CHUCK JAFFE: Kyle Brown, president and chief investment officer at Trinity Capital is here, and we're talking about how all business-development companies, and all the yields they generate, are not created equal, this is The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. And today we're heading in the direction of business-development companies involved in lending

to venture-backed, growth-stage companies. And we're doing that with Kyle Brown, president and chief investment officer at Trinity Capital, which trades on the NASDAQ exchange under TRIN, and which you can learn more about at TrinityCap.com. If you want to learn more about BDCs generally, or interval funds and closed-end funds for that matter, check out AICAlliance.org, the website for the Active Investment Company Alliance. Kyle Brown, thanks for joining me on The NAVigator.

KYLE BROWN: You bet. Thanks Chuck.

CHUCK JAFFE: Kyle, if I did a quick introduction to Trinity Capital to the audience here, I'd be saying, "Hey, it's a $500 million market cap. It does high-growth, growth-stage companies, venture-backed investments. It's using venture debt and equipment financing, that's what's doing it. It went public, the IPO was early in 2021." And then I'd say, "And it has an annualized dividend of about 11%." And when everybody picked their jaw up after they heard "An 11% annual dividend", we'd have to explain to them how is this possible? Now some of it's in those things I was talking about that you guys invest in, but let's start with what might otherwise be something later in the conversation. How does Trinity produce this kind of dividend? And how does an investor go, "Okay, that's real. That's not something that scares me." Because normally big high yields, something's wrong.

KYLE BROWN: That's a good question, and there's going to be a point in the future where I don't have to explain this anymore, but the structure as an internally managed BDC, we're one of only few in the space, of all BDCs, the benefits of everything we do on and off balance sheet all go to our shareholders, 100% of it. We don't have a management company, there's not additional fees, this is going to be the core difference. And as we talk today, and you talk about outsized returns, the dividends, an increase in NII, a focus on ROE, these are things that you don't hear from normal BDCs. We've been around for a long time, we've been around since 2008 doing just this, generating the returns that we're talking about here. And so to us this is not new, we're obviously new to the BDC space, 2020 we became a BDC, publicly reporting BDC. We're able to do this because we are in a niche space, we do have some outsized returns because it's a niche business. But the bigger thing to focus on is that we're an internally managed BDC, management has the same shares as our shareholders, there's not some other management company. That alignment with our shareholders and the ability

for our shareholders to maximize returns by benefiting from everything we do on and off balance sheets is why you see the returns that you see here.

CHUCK JAFFE: That is part structure, and then the other side is what you're doing in the venture capital space instead of the venture-backed debt space. So let's talk about that space, because we're living in an environment with heightened inflation, rising interest rates, and with more potential for defaults and trouble. So that space, help us understand how it's working and why it's still working now.

KYLE BROWN: We're bullish on the space, the timing is really interesting for us. So in a nutshell, here's what we do. We provide an extension of runway for growth-stage companies. We provide everything other than what they can get in the form of cheap receivable financing from a bank, so this is alt bank type financing. Our companies are growing rapidly, 50% annual growth rate, they've raised significant equity dollars, $30+ million of equity from institutional and household investor names. We're coming in to help them beef up the balance sheet and create an extension of runway. Typically when we're looking at deals, we're looking at them and making sure they have 18-24 months of runway. These are all private companies, primarily private companies, financed and sponsored by private companies, and so we are seeing some headwinds. I'd say in our market right now we have a pretty robust investor base, the VC firms continue to raise capital. So contrary to many thoughts, if you compare this to maybe '08 or even 2000, this is not a matter of are companies going to get funding or not? In most cases it's much more about, at what valuation? So our portfolio has performed quite well, and going forward deals are happening, the conversation though is much more about, at what valuation? So what you're seeing is some more damaging down rounds, companies are struggling to get that capital because they raised it pretty healthy rounds in 2021. And so we're seeing a significant amount of equity being raised for these sponsors, record levels outside of 2021. Even today I think based on MBCA, 87% of all capital raised last year's already been raised this year, so there continues to be a very strong venture equity, growth-stage equity fundraising. And when we do deals, when we finance these companies, their sponsors, we're focused on sponsors that have raised funds in the last two years, so they have the availability of dry powder to support these companies. And so it's not a surprise for these companies to face headwinds, but they're looking at five to 10 year plans. The investors put money in these companies so that it can disrupt an old, archaic

industry, and it's going to take five to 10 years to do it. So the fact that we're facing headwinds right now, it's not a make or break, it's not this binary event that happens, am I going to get money or not? It's much more about, at what valuation?

CHUCK JAFFE: Well, you talked about headwinds, it's interesting. If somebody goes to check the chart on Trinity Capital, they're going to see that when the market started this year in the tank, you guys were going up, you didn't peak until late March. You have struggled since then a little bit, relative to where you had peaked of course, not necessarily relative to the rest of the market entirely. But how does heightened volatility, how much of the issue is heightened volatility and what's happening in the market versus what you're investing in and what's happening with interest rates?

KYLE BROWN: So listen, I would love to say that we are not correlated to the stock market in public equities, our business model. And the truth is, our stock prices, our business isn't necessarily. So when you talk about, "Hey, you've got an 11% dividend," it's actually better than that. Based on our stated dividend, it's a 15% dividend today, we've got over $60 million of spill-over. The idea that supplemental dividends would continue in the BDC space, we have to distribute those at some point, so the idea that it would continue for some time, it makes a lot of sense, right? So it's actually a much higher return, we have been pulled down with technology stocks. At the end of the day there's no other reason for it, we've been spilling out good news this entire year, unfortunately the stock's been pulled down with technology stocks. And so there's not a great reason other than there is a correlation between our stock price and the stock market. So far there has not been a correlation between our business model and what you see headwinds out there in the marketplace.

CHUCK JAFFE: So let's talk about that a little bit further; the venture market, high risk, high reward, and of course all the risk picture does get skewed when people have to pay more to access money and the rest. We have been through a period where for the longest time it kind of felt like you could throw the darts and they'd all hit something, you might not get bullseyes but you'd get points. It feels like intuitively the environment is changing even if we're not seeing a lot of defaults and closures. Is the environment changing? Or what's your overview on the venture market?

KYLE BROWN: Listen, I can't speak to even my peers and their portfolios. I can tell you, when we finance companies we are not financing ideas on the back of napkins. These are real

companies with real technology. They have a moat built around their technology, there's enterprise value there. They're significantly far down the road, I think our average revenue run rate is approaching $30 million. They've raised significant equity dollars from firms that have the availability of dry powder. They might face headwinds, they might have difficulty, but inherently there is real value in the technology, there's a liquidity value at some point. So when I look at us compared to our BDC brethren out there, we've got companies that are growing rapidly in the face of headwinds, they have sponsors, multiple sponsors with the availability of dry powder. Now they may be ruthless on their valuations if that company needs additional capital, but compare that to our peers in the BDC space and our middle market companies that have maybe lackluster EBITDA now that they're facing headwinds without sponsors, who finances those companies? That seems like a difficult scenario, they're going to be going back to the lender. And in our scenario it's much different. We're senior secure primarily, again, it's real technology with real liquidation value, and they're going to get financing at some price. And we don't care necessarily what that valuation is because the majority of our returns, that really high-growth yield that you'll see in the mid-teens, it's made up of rate and fee primarily, and no pick, right? Primarily no pick. So rate is high, fee, and then we get more. And so the last thing I'd say is we have this really interesting opportunity, and historically losses that we've experienced have been offset by warrant gains, and then the warrant gains have far exceed that to provide outsized returns for our investors. So in 70% of the loans that we issue, we get warrants from these companies. In 30% we get some contractual obligation, some fixed fee at the end of the facility. And so there's this additional upside that covers our losses historically, and then provides outsized returns to investors, which is the other answer to your question. How do you have these outsized returns? Well, it's because we have very low loss rate, and whatever do have there has been historically covered by the warrant gains, and then we have this outsized return by additional warrant gains.

CHUCK JAFFE: Kyle, really interesting, I wish we had more time to talk about it. We don't but we'll just have to do this down the line as we check in to see how things play out in your space.

KYLE BROWN: I love it. Great, thanks Chuck.

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