



Sixth Street Specialty Lending (TSLX)

Updated May 3rd, 2024 by Nikolaos Sismanis

Key Metrics

Current Price:	\$20.89	5 Year CAGR Estimate:	7.4%	Market Cap:	\$1.93 B
Fair Value Price:	\$20.70	5 Year Growth Estimate:	0.0%	Ex-Dividend Date:	06/14/2024
% Fair Value:	101%	5 Year Valuation Multiple Estimate:	-0.2%	Dividend Payment Date:	06/28/2024
Dividend Yield:	8.8%	5 Year Price Target	\$20.70	Years Of Dividend Growth:	2
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Hold

Overview & Current Events

Sixth Street Specialty Lending is a specialty finance company focused on providing flexible, fully committed financing solutions to middle-market companies principally located in the US. The fund provides primarily first-lien senior secured loans, mezzanine debt, non-control structured equity and common equity. Management aims to co-invest with other firms to maximize the potential for organic growth, acquisitions, market or product expansion, restructuring initiatives, recapitalizations and refinancing. As of its latest filings, Sixth Street's portfolio includes 124 investments, with no company making up more than 2.6% of its net assets. Additionally, the portfolio aims to achieve adequate industry diversification, with Business Services, Internet Services, and Human Resource Support Services, accounting for 17.0%, 15.1% and 10.8% of its exposure. The \$1.93 billion company has assets worth about \$3.5 billion and is based in San Francisco, California.

On May 1st, 2024, Sixth Street Specialty Lending reported its Q1 results for the period ending March 31st, 2024. For the quarter, net investment income came in robust at \$52.4 million, up 22% year-over-year. NII/share was \$0.59, six cents higher year-over-year. NAV rose by 3.5% to \$17.17 compared to last year. The rise in investment income was due to a larger portfolio of companies and a higher weighted average total yield on debt, which rose by 10 bps year-over-year to 14.0%. However, this metric actually fell by 20 basis points sequentially.

Further, TSLX's weighted average interest rate of debt also fell by 20 bps to 7.6%. Finally, SOFR was stable. All variables combined led to the company's weighted average spread over all floating rate investments staying stable at 8.3%. For FY2024, we expect NII/share of \$2.30. We are using the annualized rate of the company's quarterly \$0.46 dividend in our estimates. However, the company is likely to declare several special dividends this year, as has been the case frequently since 2017. The company declared a supplemental dividend of \$0.06 with respect to Q1.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
NII/share	\$1.68	\$1.18	\$2.34	\$1.86	\$1.86	\$2.34	\$2.19	\$1.97	\$2.13	\$2.31	\$2.30	\$2.30
DPS	\$1.53	\$1.56	\$1.56	\$1.75	\$1.78	\$1.81	2.29	\$3.65	\$1.82	\$2.10	\$1.84	\$1.84
Shares¹	50.5	54.0	58.6	60.0	64.0	66.1	67.2	77.7	78.2	85.1	92.1	110

Being a BDC (Business Development Company), we believe Net Investment Income (NII) and NAV (Net Asset Value) are the meaningful variables to measure TSLX's performance. Since Sixth Street has chosen to register as a BDC, the company is required by law to distribute at least 90% of net income to shareholders. As a result, its distributions have gradually grown in line with its net investment income per share.

Whenever TSLX generates additional income, as in FY2019 and FY2020, management issues special dividends, as depicted in the FY2020's and FY2021's table entries, to meet its regulatory requirements.

We are forecasting no NII/share and DPS growth moving forward, to be prudent, as rising rates could pressure the company's financial expenses more than they could boost its interest earned. It's worth noting that the company has

¹ Share count is in millions.

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never cut its base dividend despite total dividends in FY2022 being lower than those paid in FY2021. This was due to more substantial special dividends in FY2021.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/NII	8.2	11.4	13.6	9.6	10.4	10.5	9.2	11.6	9.2	7.6	9.1	9.0
Avg. Yld.	6.3%	8.3%	8.2%	8.9%	9.4%	8.7%	8.7%	10.3%	9.2%	12.0%	8.8%	8.9%

We believe the current P/NII closely reflects both TSLX's successful history of growing its financials and the ongoing risks related to higher interest rates (e.g., fewer investment opportunities for TSLX amid increased cost of capital). As per BDCs' purpose to distribute the majority of their net income to shareholders, TSLX's dividend yield has been quite lofty, fluctuating in the high single-digit range. Shares are currently trading with a base dividend yield of 8.8%. However, the actual yield for the year should be notably higher, as we expect TSLX to keep declaring supplemental dividends over time. Shares trade at a notable premium compared to NAV. However, this has been a recurring theme for TSLX amid its operating excellence.

Safety, Quality, Competitive Advantage, & Recession Resiliency

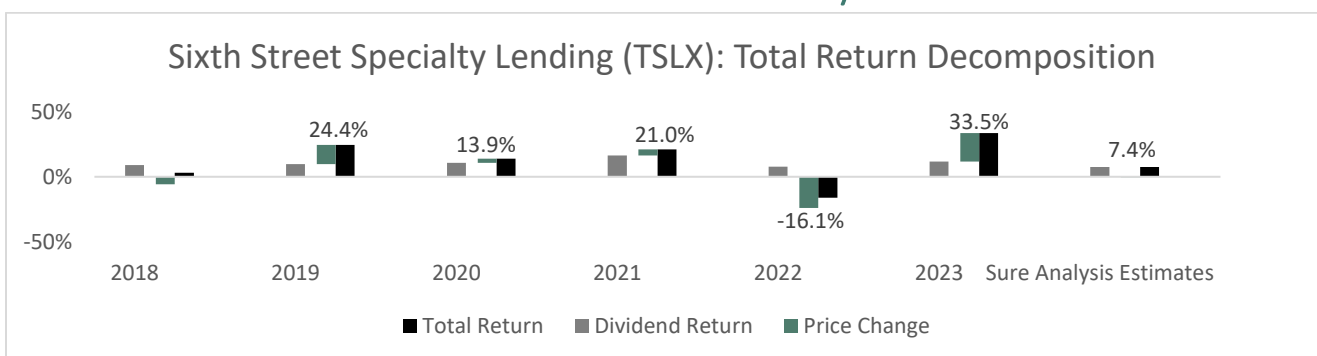
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Payout	91%	132%	67%	94%	96%	77%	105%	185%	85%	91%	80%	80%

At its current state, TSLX's base dividend remains covered by net investment income. However, there are some major risks to consider. Due to the company's obligatory payout requirements, there is little to no margin for capital maneuverings. Further, while the ultra-low LIBOR has helped increase its investment spreads, an increasing LIBOR could squeeze this surplus, leaving no room for profit against its sky-high financing through share issuances. As the company needs to pay out more dividends as it keeps issuing shares, a possible series of defaults by its borrowers can quickly trickle down to write-offs, dividend cuts and overall massive capital losses as seen with various BDCs throughout time. The company has been performing well so far, actively growing its NII/share and dividend while holding a diversified portfolio of investments. Still, a recession could adversely impact its results.

Final Thoughts & Recommendation

Sixth Street Specialty Lending is a high-quality, prudently-managed BDC despite its relatively short public-market history. While many of its industry peers cut their distributions during the pandemic, TSLX continued to grow its quarterly dividend and even paid back investment surpluses. We forecast that investors are likely to enjoy annualized returns of 7.4% through 2029, excluding special NII/share gains and special dividends. While shares earn a hold rating based on this forecast, total returns are likely to be more substantial, considering the company's supplemental payouts potential.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	93	78	152	130	141	179	206	236	136	273
SG&A Exp.	9	13	13	11	13	13	13	14	13	13
Net Profit	85	64	137	112	119	155	178	212	108	222
Net Margin	91.8%	81.3%	90.1%	85.7%	84.4%	86.3%	86.4%	89.8%	79.4%	81.3%
Free Cash Flow	(149)	(191)	(42)	82	119	(378)	145	2.5	(225)	(237)
Income Tax	1	2	2	3	3	4	6	0.4	3	2

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	1,304	1,507	1,676	1,720	1,730	2,281	2,339	2,552	2,837	3,344
Cash & Equivalents	2	2	6	7	11	14	3	1.6	10	1,217
Total Liabilities	468	686	723	751	667	1,162	1,177	1,276	1,495	1,847
Accounts Payable	50	26	23	23	25	26	28	31	0	0
Long-Term Debt	396	642	681	703	608	1,094	1,110	1,186	1,442	1,780
Shareholder's Equity	835	821	952	969	1,063	1,119	1,161	1,276	1,342	1,496
LTD/E Ratio	0.47	0.78	0.71	0.73	0.57	0.98	0.96	0.93	1.08	1.19

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	7.3%	4.5%	8.6%	6.6%	6.9%	7.7%	7.7%	8.7%	4.0%	7.2%
Return on Equity	12.1%	7.7%	15.5%	11.6%	11.7%	14.2%	15.6%	17.4%	8.3%	15.7%
ROIC	7.6%	4.7%	8.9%	6.8%	7.1%	8.0%	7.9%	9.0%	4.1%	7.3%
Shares Out.	50.5	54.0	58.6	60.0	64.0	66.1	67.2	77.7	78.2	85.1
Revenue/Share	1.72	1.44	2.55	2.17	2.20	2.71	3.06	3.04	1.75	3.21
FCF/Share	(2.77)	(3.53)	(0.70)	1.37	1.86	(5.72)	2.16	0.03	(2.87)	(2.78)

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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