



# Sixth Street Specialty Lending (TSLX)

Updated February 20<sup>th</sup>, 2023 by Nikolaos Sismanis

## Key Metrics

<b>Current Price:</b>	\$19.48	<b>5 Year CAGR Estimate:</b>	8.4%	<b>Market Cap:</b>	\$1.59 B
<b>Fair Value Price:</b>	\$20.00	<b>5 Year Growth Estimate:</b>	0.0%	<b>Ex-Dividend Date:</b>	03/14/2023
<b>% Fair Value:</b>	97%	<b>5 Year Valuation Multiple Estimate:</b>	0.5%	<b>Dividend Payment Date:</b>	03/31/2022
<b>Dividend Yield:</b>	9.4%	<b>5 Year Price Target</b>	\$20.00	<b>Years Of Dividend Growth:</b>	2
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	C	<b>Rating:</b>	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 78 investments, with no company making up more than 2.8% of its net assets. Additionally, the portfolio aims to achieve adequate industry diversification, with Business Services, Internet Services, and Financial Services, accounting for 14.4%, 13.9% and 12.8% of its exposure, respectively, amongst 13 other industries. The \$1.59 billion company has assets worth about \$2.6 billion and is based in San Francisco, California.

On February 16<sup>th</sup>, 2023, Sixth Street Specialty Lending reported its Q4-2022 and full-year results for the period ending December 31<sup>st</sup>, 2022. For the quarter, net investment income came in robust at \$52.6 million, up 13.9% year-over-year. Thus, NII/share was \$0.65, two cents higher year-over-year, while NAV rose by 0.73% to \$16.46 compared to last year. The increase in net investment income was due to a larger portfolio of companies and a higher weighted average total yield on debt, which rose by 320 bps year-over-year to 13.4%. Further, TSLX's weighted average interest rate of debt rose by 330 bps to 5.6%. Finally, LIBOR was higher as well due to the ongoing hikes in interest rates. All variables combined led to the company's weighted average spread over all floating rate investments rising from 8.5% to 8.7% year-over-year. For the year, NII/share was \$2.13, up from \$1.97 in fiscal 2021. For FY2023, we expect NII/share of \$2.00.

The company also increased its quarterly base dividend by one cent to \$0.46. TSLX has historically paid supplemental and special dividends. However, we have utilized the base dividend rate of \$1.84 in our calculations.

## Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
<b>NII/share</b>	---	\$1.68	\$1.18	\$2.34	\$1.86	\$1.86	\$2.34	\$2.19	\$1.97	\$2.13	<b>\$2.00</b>	<b>\$2.00</b>
<b>DPS</b>	---	\$1.53	\$1.56	\$1.56	\$1.75	\$1.78	\$1.81	\$2.29	\$3.65	\$1.82	<b>\$1.84</b>	<b>\$1.84</b>
<b>Shares<sup>1</sup></b>	---	50.5	54	58.6	60	64	66.1	67.2	77.7	78.2	<b>78.2</b>	<b>100.0</b>

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

<sup>1</sup> Share count is in millions.

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expenses more than they could boost its interest earned. It's worth noting that the company has never cut its base dividend despite total dividends in FY2022 being lower than those paid in FY2021.

## Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/NII	---	8.2	11.4	13.6	9.6	10.4	10.5	9.2	11.6	9.2	9.7	10.0
Avg. Yld.	---	6.3%	8.3%	8.2%	8.9%	9.4%	8.7%	8.7%	10.3%	9.2%	9.4%	9.2%

The ongoing rising-rates environment has compressed the stock's valuation multiple compared to last year's average. 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 9.4%. However, the actual yield for the year is likely to be higher, considering any special dividends throughout the year. 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

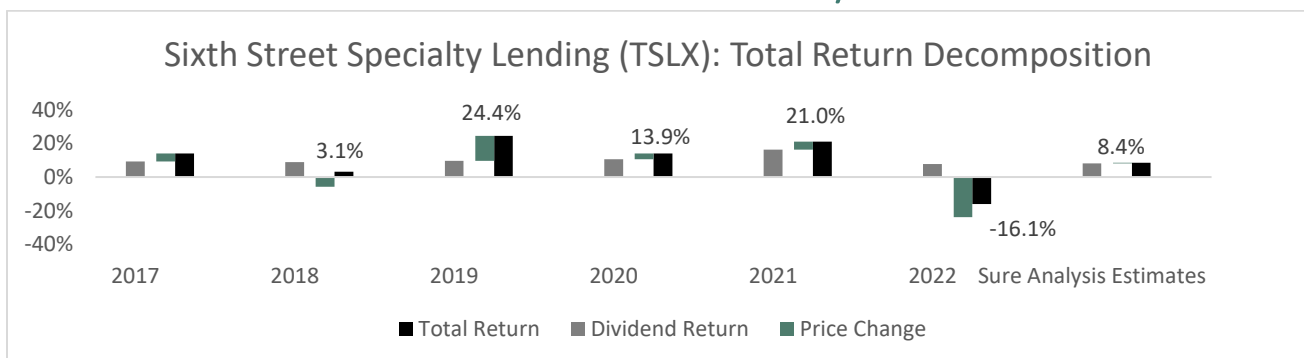
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	---	91%	132%	67%	94%	96%	77%	105%	185%	85%	92%	92%

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 8.4% through 2028, 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 any supplemental payouts.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Revenue</b>	41	66	93	78	152	130	141	179	206	236
<b>SG&amp;A Exp.</b>	5	6	9	13	13	11	13	13	13	14
<b>Net Profit</b>	40	67	85	64	137	112	119	155	178	212
<b>Net Margin</b>	97.4%	100.8%	91.8%	81.3%	90.1%	85.7%	84.4%	86.3%	86.4%	89.8%
<b>Free Cash Flow</b>	(430)	(290)	(149)	(191)	(42)	82	119	(378)	145	2.5
<b>Income Tax</b>	0	0	1	2	2	3	3	4	6	0.4

## Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Total Assets</b>	833	1,039	1,304	1,507	1,676	1,720	1,730	2,281	2,339	2,552
<b>Cash &amp; Equivalents</b>	162	3	2	2	6	7	11	14	3	1.6
<b>Total Liabilities</b>	353	464	468	686	723	751	667	1,162	1,177	1,276
<b>Accounts Payable</b>	13	18	50	26	23	23	25	26	28	31
<b>Long-Term Debt</b>	332	432	396	642	681	703	608	1,094	1,110	1,186
<b>Shareholder's Equity</b>	480	575	835	821	952	969	1,063	1,119	1,161	1,276
<b>LTD/E Ratio</b>	0.69	0.75	0.47	0.78	0.71	0.73	0.57	0.98	0.96	0.93

## Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Return on Assets</b>	6.8%	7.2%	7.3%	4.5%	8.6%	6.6%	6.9%	7.7%	7.7%	8.7%
<b>Return on Equity</b>	12.1%	12.7%	12.1%	7.7%	15.5%	11.6%	11.7%	14.2%	15.6%	17.4%
<b>ROIC</b>	6.9%	7.4%	7.6%	4.7%	8.9%	6.8%	7.1%	8.0%	7.9%	9.0%
<b>Shares Out.</b>	---	---	50.5	54.0	58.6	60.0	64.0	66.1	67.2	77.7
<b>Revenue/Share</b>	0.78	1.28	1.72	1.44	2.55	2.17	2.20	2.71	3.06	3.04
<b>FCF/Share</b>	(8.29)	(5.58)	(2.77)	(3.53)	(0.70)	1.37	1.86	(5.72)	2.16	0.03

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

### Disclaimer

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