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PRESENTATION

Operator

Good morning, ladies and gentlemen. And welcome to the Fourth Quarter 2019 Solar Capital Limited Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to turn the conference over to your host speaker, Michael Gross, Chairman and Co-CEO. Please go ahead, sir.

Michael Stuart Gross - *Solar Capital Ltd. - Chairman, President & Co-CEO*

Thank you very much. And good morning. Welcome to Solar Capital Earnings Call for the quarter and year ended December 31, 2019. I'm joined here today by Bruce Spohler, our Co-CEO; and Rich Peteka, our Chief Financial Officer. Rich, before we begin, would you please start by covering the webcast and forward-looking statements?

Richard L. Peteka - *Solar Capital Ltd. - Treasurer, Secretary & CFO*

Of course. Thanks, Michael. I would like to remind everyone that today's call and webcast are being recorded. Please note that they are the property of the Solar Capital Limited and that any unauthorized broadcasts in any form are strictly prohibited. This conference call is being webcast on our website at www.solarcapltd.com. Audio replays of this call will be made available later today as disclosed in our earnings press release.

I would also like to call your attention to the customary disclosures in our press release regarding forward-looking information. Statements made in today's conference call and webcast may constitute forward-looking statements, which relate to future events for our future performance or financial condition. These statements are not guarantees of our future performance, financial condition or results and involve a number of risks and uncertainties. Additionally, past performance is not indicative of future results. Actual results may differ materially as a result of a number of factors, including those described from time to time in our filings with the SEC.

Solar Capital limited undertakes no duty to update any forward-looking statements unless required to do so by law. To obtain copies of our latest SEC filings, please visit our website or call us at (212) 993-1670.

At this time, I'd like to turn the call back to our Chairman and Co-Chief Executive Officer, Michael Gross.

Michael Stuart Gross - *Solar Capital Ltd. - Chairman, President & Co-CEO*

Thank you, Rich. Good morning, everyone, and thank you for joining us today. After market closed yesterday, we reported fourth quarter net investment income of $0.41 per share. This resulted in full year net investment income of $1.71 per share, exceeding our annual distribution of $1.64 per share. Our earnings power continued to reflect the benefits of Solar Capital's migration to a multi-strategy commercial finance platform that combines cash flow, asset-based and specialty finance businesses. In spite of the extended frothy credit markets and sponsor based cash flow lending, Solar Capital has benefited from a diversified origination platform that gives us the flexibility to invest in less competitive commercial finance niche markets where the risk return profile is more compelling.

During 2019, over 72% of our gross investment income was generated from our commercial finance businesses, and at December 31, commercial finance assets represented 75% of our $1.8 billion total comprehensive portfolio. At December 31, our net asset value was $21.44 per share, down roughly 1.4% per share from the year-end 2018. The year-over-year decline is primarily due to an unrealized loss on our 1 nonaccrual investment, partially offset by excess earnings of net investment income over distributions paid to shareholders. While Bruce, I and the entire solar team are extremely disappointed by the NAV decline, we believe there is a solid foundation to Solar Capital's net asset value.

The weighted average risk weighting of our current portfolio supports its belief and reflects the highest fundamental credit profile in the last 5 years. Across the portfolio, fundamental credit performance continues to be solid, supported by ongoing stable economic conditions and sustained corporate earnings growth in the U.S. Within cash flow lending, we continue to prioritize investments that are first lien, focus on upper middle market issuers backed by strong financial sponsors and avoid companies operating in cyclical industries.

Notably, at year-end, our second lien cash flow exposure was down to 4.8%. We will further derisk the portfolio by continuing to allow our remaining second lien investments to roll off. At December 31, 2019, 98.4% of our portfolio is performing on a cost basis with only one investment on nonaccrual status.

In 2019, we originated $736 million in new senior secured investments. Almost 90% of full year originations were in commercial finance assets, reflecting continued tightness in the upper middle market cash flow market, where we see elevated risk and compromised structures that do not meet our underwriting discipline.

At December 31, the weighted average asset yield of our comprehensive portfolio was 10.7%. Our barbell approach to portfolio composition, combining lower-yielding first lien cash flow loans with higher-yielding first lien specialty finance investments has enabled our portfolio to maintain superior yield in a declining rate environment, while also allowing our second lien cash flow investments to roll off.

In 2019, we made significant progress on 2 important initiatives that we believe creates long-term strategic value for Solar shareholders. First, we enhanced the platform scale of companies investment adviser, Solar Capital Partners. Last week, we held a final closing on institutional private credit funds that will have approximately $1.2 billion of incremental capital to co-invest alongside Solar.

With this final closing, Solar's investment adviser now manages approximately $6.5 billion of investable capital, solely focused on first lien cash flow and specialty-finance investment opportunities. This enhanced scale is particularly important given our investment preference for first lien investments in larger middle market companies, who we believe are better resourced to withstand economic cycles than the smaller peers. Hold sizes of up to $200 million across the platform creates a competitive advantage while allowing us to make appropriate portfolio diversification across the various funds.

The increased scale of our platform has already positively impacted our origination efforts, and we expect Solar Capital to significantly benefit from this development in the future.

The second initiative is optimizing our capital structure and diversifying our funding sources. In the fourth quarter, we issued $200 million of unsecured notes in a private placement comprised of $125 million of 5-year notes and $75 million of 7-year notes. We now have approximately $450 million of unsecured fixed-rate notes at an average cost under 4.5%.

At December 31, 2019, our net leverage was 0.64x with approximately $450 million of unused borrowing capacity under its credit facilities. When including Crystal Financial and NEF Holdings, the company has approximately $600 million of unused borrowing capacity under its credit facilities, subject to borrowing base limits.

Solar is relatively low current and average leverage is deliberate. We are significantly below most of our BDC peers and is a reflection of our conservative approach and defensive portfolio positioning in what we believe is the latter stages of the current credit cycle. We intend to move closer to our target leverage range of 0.9 to 1.25x, but only as the market opportunity presents itself.

In addition to our bottoms-up debt investing, we continue to actively pursue controlled equity investments in specialty finance portfolio companies, add-on acquisitions and purchases of portfolios of commercial loans. We will be prudent with use of leverage, remain disciplined in our underwriting.

At this time, I'll turn the call over to our Chief Financial Officer, Rich Peteka, to take you through the financial highlights.

Richard L. Peteka - *Solar Capital Ltd. - Treasurer, Secretary & CFO*

Thanks, Michael. Solar Capital Limited net asset value at December 31, 2019, was $905.9 million or $21.44 per share compared to $925.4 million or $21.90 per share at September 30. At December 31, Solar Capital's on balance sheet investment portfolio had a fair market value of $1.5 billion in 108 portfolio companies across 28 industries, compared to a fair market value of $1.5 billion in 110 portfolio companies across 28 industries at September 30.

At 12/31, Solar Capital had $593.9 million of debt outstanding and leverage of 0.64x net debt-to-equity. When considering available capacity from the company's credit facilities, combined with available capital from nonrecourse credit facilities at Crystal and NEF, Solar Capital has approximately $600 million to fund its future portfolio growth, subject to borrowing base limits.

Moving to the P&L. For the 3 months ended December 31, 2019, gross investment income totaled $37.1 million versus $39.7 million for the 3 months ended September 30. Expenses totaled $19.9 million for the 3 months ended December 31, 2019, compared to $21.3 million for the 3 months ended September 30, 2019. Accordingly, the company's net investment income for the 3 months ended December 31, 2019, totaled $17.1 million or $0.41 per average share compared to $18.4 million or $0.44 per average share for the 3 months ended September 30.

Below the line, the company had net realized and unrealized losses for the fourth quarter totaling $19.3 million versus net realized and unrealized losses of $4.7 million for the third quarter. Ultimately, the company had a net decrease in net assets resulting from operations of $2.2 million or $0.05 per average share for the 3 months ended December 31. This compares to a net increase of $13.7 million or $0.32 per average share for the 3 months ended September 30, 2019.

Subsequent to year-end, the company received an additional $75 million commitment under its accordion feature of its credit facility, bringing total commitments to $620 million. We are pleased with the recent steps we've taken to optimize SLRC's financing facilities, which provide invaluable flexibility and further enhance Solar Capital Ltd.'s strong balance sheet.

In addition, post year-end, Solar Capital Ltd.'s investment-grade corporate rating was affirmed by Fitch Ratings, which is further testimony to Solar Capital partner's conservative investment in management philosophies and strong underwriting track record. The investment-grade ratings from both Moody's and Fitch provide important flexibility and efficiency in financing the company's growing balance sheet.

Finally, our Board of Directors recently declared a Q1 distribution for 2020 of $0.41 per share payable on April 3, 2020, to shareholders of record on March 19, 2020.

And with that, I'll turn the call over to our Co-Chief Executive Officer, Bruce Spohler.

Bruce John Spohler - *Solar Capital Ltd. - COO, Co-CEO & Interested Director*

Thank you, Rich. In 2019, we continued to execute on our key themes, including: continued runoff of our second lien cash flow portfolio, growth in our specialty finance verticals and further migration upmarket in both our first lien cash flow and commercial finance strategies.

As the cycle continues to lengthen, we're increasingly focused on positioning the portfolio defensively to weather any potential downturn. We're accomplishing this by staying senior in the capital structure and targeting larger borrowers.

To echo Michael's comments, Michael, I and the entire solar team are extremely disappointed by our recent decline in NAV due primarily to the write-down of our investment in IHS. Aside from this markdown, the overall financial health of the portfolio companies remains sound.

At year-end, the weighted average investment risk rating for Solar's portfolio was less than 2 based on our 1 to 4 risk rating scale, with 1 representing the least amount of risk. Based on this scale, the portfolio at year-end is the highest quality rated in over 5 years. As further indication of the strong underlying fundamentals of our portfolio, 99.5% of our portfolio at fair market value was performing at 98.4% at cost.

Our $1.8 billion portfolio is highly diversified, encompassing over 200 borrowers across 90 industries. The average investment per issuer was just over $8.5 million or 0.5% of the portfolio. At year-end, 98.6% of the portfolio at fair value consisted of senior secured loans comprised of approximately 92% first lien and 8% second lien senior secured loans. Of the 8% second lien loans, only 4.8% were cash flow loans and 3.1% were asset based loans.

Bringing our second lien cash flow portfolio to below 5% highlights our continued focus on reducing exposure to investments which carry more risk and we believe is prudent in today's environment. Based on our current visibility, we expect our second lien cash flow exposure to be under 1% by midyear.

At year-end, our weighted average asset level yield was 10.7%. By focusing on our niche commercial finance verticals, we've been able to maintain asset-level yields above 10% despite a decrease in LIBOR as well as spread compression in cash flow lending. Notably, we've been able to maintain these double-digit yields while actively reducing our exposure to second lien cash flow investments.

Including our activity across all 4 business lines, originations for the year totaled $735 million and repayments were $645 million, resulting in net portfolio growth of about $90 million. Due to our ongoing selectivity and cash flow lending, in the face of continued frothiness in this segment, approximately 90% of our originations in 2019 were in our specialty finance strategies.

Let me now update each of our investment verticals. Cash flow. At year-end, cash flow portfolio was $450 million or approximately 25% of our comprehensive portfolio, it is invested across 23 borrowers with an average investment, $20 million. These companies had a weighted average EBITDA of $65 million which, again, highlights our commitment to finance larger businesses, which we believe will be better positioned to withstand a potential downturn.

During 2019, we originated $90 million of first lien senior secured cash flow loans and experienced repayments and amortization of approximately $67 million. Our investments in 2019 came largely in the form of delayed draw of fundings and increasing our investment in existing credits, a continuation of our preference to grow with companies that we know and like.

During the fourth quarter, we further marked down our second lien cash flow investment in IHS, which we had placed on nonaccrual in the third quarter. The company is a provider of wellness solutions and is currently evaluating strategic alternatives with the support of the sponsor as well as our co-lenders.

Across the rest of our portfolio, we are continuing to see healthy financial performance. At year-end, the weighted average trailing 12-month EBITDA grew over 9% reflected in this continued growth. For the portfolio of companies in our cash flow segment, leverage through our security was just under 5x which is a downtick from third quarter, where it was about 5.2x and our interest coverage is approximately 2.6x. In addition, the weighted average yield of this cash flow portfolio was 8.7%.

Now turning to Equipment Finance. Our Nations Finance strategy invested just under $150 million for 2019 and had repayments of just over $140 million. At year-end, the portfolio was approximately $396 million of funded equipment loans. The portfolio was invested across 134 borrowers with an average exposure of just under $3 million.

As a reminder, included in this business segment are Equipment Financings held both directly on Solar's balance sheet as well as in our 100%-owned portfolio subsidiary that holds certain investments for tax efficiency purposes.

The Equipment Financing asset class represents 22% of our total portfolio. 100% of NEF's investments are in first lien loans and the weighted average yield was approximately 10%.

2019 comprehensive investment income for the NEF segment totaled $21.7 million.

Now let me turn to our asset-based segment. At year-end, our asset-based portfolio totaled approximately $644 million, representing 36% of our totaled portfolio, was invested in 36 borrowers with an average loan size of $18 million. The weighted average yield was 12.7%.

During 2019, we funded approximately $315 million of new asset-based loans and had repayments of just under $280 million. During the fourth quarter, one of our asset-based companies experienced fraud. We've been exiting this investment through a bankruptcy process and have fully reserved for this last year and are currently working to maximize the recovery of this investment. Crystal, our ABL platform, paid Solar Capital a dividend for 2019, equating to 10.7%.

Now finally, let me turn to our Life Science segment. At year-end, the portfolio totaled just under $290 million. The portfolio consisted of 16 borrowers with an average investment of approximately $18 million. Our Life Science portfolio represented 16% of the total portfolio and over 26% of Solar's 2019 gross investment income.

During 2019, the team originated $182 million of new investments, while repayments and amortization totaled just under $160 million. The weighted average IRR on our Life Science investments realized during this past quarter was just under 15%. The weighted average yield on the current portfolio was approximately 10.5%, excluding any success fees and warrants.

In conclusion, Solar's portfolio activity in 2019 represents a continuation of the investment themes that have been driving our portfolio over the last couple of years: reducing our second lien cash flow exposure, focusing our new origination activity on first lien loans to existing portfolio companies in defensive sectors and increasing our investments in specialty finance assets, where we are able to get both tighter structures and more attractive risk-adjusted returns.

Given the current market environment, we intend to remain patient and deploy capital selectively, preserving our flexibility to capitalize on compelling opportunities that may arise from a market dislocation.

Now I'll turn the call back to Michael.

Michael Stuart Gross - *Solar Capital Ltd. - Chairman, President & Co-CEO*

Thank you, Bruce. In closing, we would like to thank our Solar Capital shareholders for their support over the last 10 years, many of whom have been with us since inception. Over the last decade, we've been able to deliver a nearly 12% internal rate of return to those shareholders while increasing net asset value since our IPO. We believe that our success is largely driven by our conservative and disciplined approach to underwriting, combined with our migration to a diversified multi-strategy platform.

Our priority is to manage risk and to not chase returns. Our conservative philosophy has led us on a differentiated path for many of our BDC peers. We have built a multi-strategy direct-lending platform with senior professionals that have deep asset class experience and expertise investing across and through cycles.

Together with our enhanced scale, our ability to address comprehensive financing requirements across the borrower's capital structure enables us to be a solutions provider to middle market companies. Most importantly, it gives us the flexibility to allocate capital to the most attractive, risk-adjusted investment opportunities. For Solar Capital, this has resulted in a differentiated portfolio with a mix of asset classes having lower correlation, lower volatility, lower risk and built-in countercyclical protection compared to a pure cash flow portfolio.

As we move deeper into the current credit cycle, our portfolio has become much more diversified and much more defensive. Today, only 25% of our portfolio exposure is a -- to senior secured cash flow loans, the lowest exposure in our history, and 75% is to our asset-based and Life Science lending strategies.

Our specialty finance loans have many structural protections through borrowing bases and covenants, are less correlated to the liquid credit markets, provide greater downside protection and historically have proved to be less volatile than cash flow lending through market cycles.

In addition, we believe our asset-based lending and lender finance platforms add an element of counter cyclicality as investment opportunities in those verticals should become more attractive in an economic downturn.

Meanwhile, we have the flexibility to pivot towards cash flow loans when conditions in the sponsored finance market improve. We believe our vision, investment philosophy and conservative portfolio approach have served solar capital shareholders well. Bruce, I and the Solar team remain committed to enhancing long-term value for Solar Capital shareholders in all of our decisions.

We believe that our adviser's ability to hold up to $200 million across its platform provides a competitive advantage that will increasingly benefit SLRC.

With the final closing of Solar Capital Partners' institutional private fund this month, the increased scale provided should positively impact Solar in the form of incremental investment opportunities through an enhanced origination effort. The results should be both increased diversification and an even greater ability to be highly selective across our asset classes. We believe we are uniquely positioned to navigate the current environment, take advantage of market dislocations and can outperform across market cycles on a relative and an absolute basis.

At 11:00 this morning, we'll be hosting an earnings call for the fourth quarter and 2019 results of Solar Senior Capital or SUNS. Our ability to provide traditional middle-market senior secured financing through this vehicle continues to enhance our origination team's ability to meet our clients' capital needs, and we continue to see the benefits of this value proposition in our deal flow.

We appreciate your time. Operator, would you please open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Rick Shane of JPMorgan.

Richard Barry Shane - *JP Morgan Chase & Co, Research Division - Senior Equity Analyst*

I'd like to talk just a little bit about portfolio rotation and investments. If we look over the last year, I think, sort of back of the envelope, you had one new name enter your top 10 investments in terms of size. And given sort of a steady maturity of the portfolio, we would expect more rotation than that.

I realize that you're investing in different strategies. But I am curious if you're sort of not continuing to plant seeds in that top 10, how you think about the sustainability of the dividend until you've seen an opportunity to become more aggressive?

Bruce John Spohler - *Solar Capital Ltd. - COO, Co-CEO & Interested Director*

Yes. I think it's in a couple of comments, Rick. As we mentioned, our focus really, and particularly in the cash flow segment, but throughout our segments has been to take advantage of the increased scale of the platform to take larger aggregate positions across our platform between our various pools of public and private capital so that we can continue to take larger holds and be more of a solutions provider to our prospective borrowers.

You know we believe that in most of our segments, larger is lower risk, whether it's ABL, Life Sciences or cash flow. But importantly, the larger capital base allows us to increase the diversification across each pool of capital.

So for SLRC, our average hold positions have been coming down and yet across the entire platform our hold position in a given investment might be growing. And so as we've been raising more capital, we have actually been adding on to positions, but most of them have been across the platform and trying to continue to take down any concentration we may have so that we're fully diversified across Solar's balance sheet.

Richard Barry Shane - *JP Morgan Chase & Co, Research Division - Senior Equity Analyst*

Got it. Okay. So the expect -- so what we're seeing empirically is consistent, and the idea is that actually until Solar gets substantially larger and hold sizes go up, you'll see more granularity in smaller bites?

Bruce John Spohler - *Solar Capital Ltd. - COO, Co-CEO & Interested Director*

Yes, but increase the number of positions because we're pursuing more opportunities where -- are relevant where Solar on its own may not be able to participate because we would never take a $100 million hold, for example, you'll see Solar take $25 million rather than what might have been $40 million in the past. And yet, the platform will take $100 million and be positioned to grow with that investment.

And so that's where most of our new capital has been growing is to small positions in Solar at new investments and topping up in investments that are more seasoned on the platform.

Operator

Your next question comes from the line of Chris Kotowski of Oppenheimer.

Christoph M. Kotowski - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

The first thing is I had is kind of on a linked-quarter basis, gross investment income was down nearly $3 million. And I was wondering, is there a reversal from -- a meaningful reversal from IHS? Or is it -- what kind of drove that decline, in particular?

Bruce John Spohler - *Solar Capital Ltd. - COO, Co-CEO & Interested Director*

Sure. There was not a reversal related to IHS, there was a onetime reversal related to an investment where we thought we had a warrant gain that actually didn't come to pass. And so we backed that out in Q4. So -- but it was not related to IHS.

Christoph M. Kotowski - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Okay. And I don't suppose you can size that for us, the warrant gain?

Richard L. Peteka - *Solar Capital Ltd. - Treasurer, Secretary & CFO*

It was probably about $0.015.

Christoph M. Kotowski - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

$0.015. Okay. And then you mentioned a fraud loss at Crystal?

Richard L. Peteka - *Solar Capital Ltd. - Treasurer, Secretary & CFO*

Yes.

Christoph M. Kotowski - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Why I'm curious, in particular, well, whatever color you can give us on that? And then, I guess, my question really is, does that flow through to NAV? Or does that just show as reduction of income at the Crystal level but does not flow through to the parent company, NAV?

Richard L. Peteka - *Solar Capital Ltd. - Treasurer, Secretary & CFO*

Sure. So as we mentioned it, it's been fully reflected. Although we are pursuing remedies, there's not a lot I can say because it's with the Justice Department. But we have fully reflected it in the NAV. Fortunately, Crystal also had some onetime gains last year in some of their assets and some warrants that were also realized and somewhat mitigated this fraud. But it's been fully reflected in their NAV and we're pursuing our remedies.

Operator

Your next question comes from the line of Casey Alexander of Compass Point.

Casey Jay Alexander - *Compass Point Research & Trading, LLC, Research Division - Senior VP & Research Analyst*

I'm trying to sort of foot with what seems like a contradiction to a certain extent that for the year you had total originations in cash flow loans of $90 million. And a lot of those were add-ons, and you've very capably described your conservative attitude towards the cash flow market, particularly in relation to covenants and structures of deals.

And at the same point in time, you closed on $1 billion institutional private credit fund, which is clearly geared to competing in the very market where the structures and terms are the most difficult. And so I'm having trouble sort of footing that contradiction in terms. And maybe you can clear that up for me.

Richard L. Peteka - *Solar Capital Ltd. - Treasurer, Secretary & CFO*

Sure. So just to clarify for a moment. The institutional fund is investing across our strategies. So it is capital that is flexible whose investment mandate is to go where SLRC goes. And so effectively, as our Life Science team is looking to compete in $75 million, $100 million holds, to my earlier comments,

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we wouldn't put that in SLRC and, therefore, wouldn't have been able to compete for that investment opportunity, some of which are the lower risk best opportunities as you go to the larger public Life Science companies, for example.

And so this now allows -- you should think of it as a co-invest vehicle alongside of SLRC that allows each of our strategies, be it commercial finance, where we have been mostly focused or cash flow, should we find better opportunities to scale up as SLRC is looking to be nimble in these strategies. So it is exactly a mirror fund and is not focused on, to your point, the frothy cash flow market.

Casey Jay Alexander - *Compass Point Research & Trading, LLC, Research Division - Senior VP & Research Analyst*

But that fund doesn't own an equipment finance originator, and it doesn't own an ABL company. So how can it replicate that portion of the portfolio?

Bruce John Spohler - *Solar Capital Ltd. - COO, Co-CEO & Interested Director*

It co-invests alongside an SLRC. So when a transaction, for example, is too big for Crystal, their hold size is, at max, $25 million to bridge to the other point, if there's a deal bigger than that, historically, we didn't really have a chance to compete in that. Now we have the ability to bring the capital alongside and do as much as $100 million across that in the institutional funds we have. Origination funnel even larger.

Casey Jay Alexander - *Compass Point Research & Trading, LLC, Research Division - Senior VP & Research Analyst*

All right. I appreciate the comments on Crystal. So I -- and just to clarify, because Crystal was marked down $4 million quarter-over-quarter that's the reflection of the issue that happened within the Crystal portfolio?

Bruce John Spohler - *Solar Capital Ltd. - COO, Co-CEO & Interested Director*

Yes.

Richard L. Peteka - *Solar Capital Ltd. - Treasurer, Secretary & CFO*

Yes.

Casey Jay Alexander - *Compass Point Research & Trading, LLC, Research Division - Senior VP & Research Analyst*

Okay. And then lastly, PPT Management Holdings, you added to the position but marked the position from $99.5 million down to $92 million, which is somewhat inconsistent with each other. Do you have any color on that one?

Richard L. Peteka - *Solar Capital Ltd. - Treasurer, Secretary & CFO*

Yes. So PPT has a small pick element, it's a loan that was restructured about a year ago. It is progressing, but part of the restructuring was an agreement to temporarily pick part of the loan. So that's the addition that you're seeing there, Micky. Casey, I'm sorry.

Casey Jay Alexander - *Compass Point Research & Trading, LLC, Research Division - Senior VP & Research Analyst*

A $4 million addition quarter-over-quarter?

Richard L. Peteka - *Solar Capital Ltd. - Treasurer, Secretary & CFO*

No. I don't show a $4 million increase. I'll take a look.

Casey Jay Alexander - *Compass Point Research & Trading, LLC, Research Division - Senior VP & Research Analyst*

Okay. I'll go back and double check it.

Operator

Next question comes from the line of Robert Dodd of Raymond James.

Robert James Dodd - *Raymond James & Associates, Inc., Research Division - Research Analyst*

Just going back to Crystal and NEF, if we can. On Crystal, I mean, underlying, not talking specifically about the fraud issue. But when we look at the financials for Crystal, ex the provision for credit losses, everything looks pretty consistent year-over-year. But with the provision, obviously, was up substantially. Is that an indicator of anything that's going on within the portfolio? Or is that tied to that fraud issue?

Michael Stuart Gross - *Solar Capital Ltd. - Chairman, President & Co-CEO*

Unfortunate that -- fortunately or unfortunately, it's tied to the fraud issue, and that's it.

Robert James Dodd - *Raymond James & Associates, Inc., Research Division - Research Analyst*

Okay. Got it. And then just on NEF, same kind of issue, right, provision up -- ex provision earnings were pretty stable year-over-year with the provision, obviously, it lost a little bit of money. Can you -- that's a business also where overall size, et cetera, the dividend from NEF has come down '18 to '19 fairly substantially. Is that, that dividend decline just tied to kind of economic return after the provision? And do you have any color you can give us on the comfort level for dividend sustainability coming from NEF? Because, obviously, at this point, it's $145 million at cost and fair value and not generating a lot of income, directly, right? Obviously, it contributes in other ways, but...

Richard L. Peteka - *Solar Capital Ltd. - Treasurer, Secretary & CFO*

Yes. I think it's -- I apologize because it goes back to the statement that we make every quarter to try to clarify, but it is confusing. As you may recall, NEF, the business, is in the subsidiary, along with some of the assets for tax purposes. However, the disproportionate number of their assets are on our balance sheet. Again, whether it's in the subsidiary or on balance sheet, it's 100% owned by SLRC. So we look at it on a consolidated business basis. And the income has vacillated since we've owned NEF between $5 million and $6 million a quarter and continues to do so. So last quarter, on a consolidated basis, it was just over $5 million. The quarter before, it was around $5.5 million. We think that, that $5 million to $6 million a quarter, when you look at it on a segment basis between the assets on balance sheet and the assets in the subsidiary, that's a very good run rate as we're looking forward.

Robert James Dodd - *Raymond James & Associates, Inc., Research Division - Research Analyst*

Got it. Got it. And then just another one, kind of following up on Casey's question in a way. The cost of NEF and the costs of Crystal, their operating expenses are essentially borne by the BDC since they own the equity and the contribution that they get is after paying the expenses at NEF and Crystal as well. So now from what it sounds like the institutional fund seems like it's going to get the benefit of co-investing with some of the capital, but without bearing the expenses because they exist at the BDC, not at the manager. Can you -- is that correct? And is there going to be any kind of compensation structure to the BDC for shared costs?

Richard L. Peteka - *Solar Capital Ltd. - Treasurer, Secretary & CFO*

Sure. Sure. And this really goes to Crystal rather than NEF. As you know, NEF's typical loan size is about $2 million to $3 million. So we don't see the fund as allowing NEF to scale up and facilitating any benefit to SLRC. So we don't expect co-invest to occur there.

Crystal, however, we do believe that the primary benefit to SLRC will be increased volume in larger transactions where on a stand-alone basis SLRC would not have been competitive. There are a number of transactions where we have syndicated out, and we will -- increasingly, you need to have that hold size to expand our opportunity set to be closer to $100 million. So that is one benefit for SLRC shareholders is greater growth, and we think, in larger, lower risk opportunities.

However, the institutional funds have also agreed to pay a servicing fee back to SLRC BDC into Crystal, the subsidiary to compensate for the ongoing management of those assets.

Operator

Your next question comes from the line of Ryan Lynch of KBW.

Ryan Patrick Lynch - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Just had a couple of questions today. I kind of wanted to follow back up on the movements in interest income linked quarter. So I know you mentioned there was about $0.015 of a onetime reversal, which is around $600,000 or so. But going back to Chris's question, I mean, interest income fell by about $3 billion linked quarter.

The portfolio was about the similar size quarter-over-quarter, and the portfolio yield was comping at about 10.7%. So I'm just trying to understand what caused a pretty meaningful drop excluding even the onetime reversal?

Richard L. Peteka - *Solar Capital Ltd. - Treasurer, Secretary & CFO*

Sure. So the other major components are both the combination of LIBOR coming down roughly 40 bps or so in the quarter. And as you know, we are all floating rate investments other than over at Nations Equipment. And then additionally, as you saw, our Life Science business had fewer repayments quarter-over-quarter. Repayments for us in Life Science, given the nature and the structure of those loans with large repayment fees and success fees tend to generate outsized income.

It is variable quarter-to-quarter, depending upon repayments. The good news is we didn't have as many repayments. We like these assets and like to keep them longer. But the Life Science repayment income will vacillate quarter-to-quarter, and that was down in Q4.

Ryan Patrick Lynch - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Okay. That makes sense on the Life Sciences portion. And then I wanted to go kind of a longer-term question here. I think in your prepared comments, you talked about, you would like to get up to your target leverage range of 0.9% to 1.25%. But you're only going to do that if the market really presents good opportunities to do so. And if I look at your growth really since the first quarter through the end of the fourth quarter, really the portfolio is kind of held at constant of $1.5 billion. And so my question is that as we look at least in the near term, there's a lot of capital being raised. It continues to be a very competitive environment for private, direct lending. Of course, I know you have your specialty lend verticals. But overall, it just remains a pretty competitive environment. And that can persist for multiple years in the future.

So are you comfortable running meaningfully below your current leverage target for multiple years until some sort of downturn happens and it makes the market increasingly favorable? Or do you guys ever plan on just the market is what it is and getting that leverage up close to your target range and just doing the market deals, even if it is a more competitive frothier environment?

Michael Stuart Gross - *Solar Capital Ltd. - Chairman, President & Co-CEO*

That's a great question. It's something that our entire team talks about all the time. And I think we start from the standpoint that, as you know, we own 6% of this company ourselves. And so every time our team makes a loan, they take out -- used to be their calculator, now in most cases their iPhone and they calculate how much of that loan is actually -- are they personally exposed to. And what that creates is a scenario where people say, if I'm not willing to put my own money into that loan restructure, I'm not going to put the rest of my shareholder partners' loans into it. So it's a long way of answering the fact that we are totally comfortable running low leverage and under invested, if we don't see the opportunity set that we're comfortable putting our own money into. That said, with the benefit of the larger scale we have, we do see the opportunity to grow our specialty finance portfolio in this current environment the way things are today. So we would expect some growth there. We are actively looking at new acquisitions that could be episodic, in one transaction could take our leverage up to our target as we've done things like Crystal and NEF in the past. And there will come a point where there will be dislocation in the cash flow market, and that will grow.

But again, we are totally comfortable running at 0.65x leverage and accept low returns in this environment. We're not willing to take on the risk that's associated with just putting assets on your books.

Ryan Patrick Lynch - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Okay. So it's a complicated issue, there is not one correct answer for that. I appreciate the color.

Michael Stuart Gross - *Solar Capital Ltd. - Chairman, President & Co-CEO*

Look, and to state the obvious, the party that suffers the most from not running fully levered is ourselves personally. As you know, from this business model, BDCs get paid on assets invested. And we're sitting here today, being willing to compromise our fee stream to make sure we put the right opportunity set in front of our investors.

Bruce John Spohler - *Solar Capital Ltd. - COO, Co-CEO & Interested Director*

But to Michael's point, we are, across the team, significant shareholders, and we're not prepared to take a short-term perspective.

Operator

Your next question comes from the line of Mickey Schleien of Ladenburg.

Mickey Max Schleien - *Ladenburg Thalmann & Co. Inc., Research Division - MD of Equity Research & Supervisory Analyst*

I was hoping to delve a little bit more into IHS. I realize there's not a lot you can say. But can you perhaps expand on what are the issues that IHS is facing? And any color on timing for either a restructuring or an acquisition of the company?

Bruce John Spohler - *Solar Capital Ltd. - COO, Co-CEO & Interested Director*

Yes, unfortunately, to your opening comment, Mickey, there's not a lot we can say. I think that this is a company in the wellness sector. It has some real strategic value in terms of their positioning. I think that it does require some investment in the business where they have been a little bit under-invested. And so suffice it to say that we and the sponsor and our co-lenders are pursuing strategic alternatives to figure out how to best maximize this value is really the short answer. But -- so we're running through processes. I think they will come to fruition in the first half of this year. And again, it's about trying to position the company and their strength to make sure that they have additional capital in order to make some investments to enhance the business longer term.

Mickey Max Schleien - *Ladenburg Thalmann & Co. Inc., Research Division - MD of Equity Research & Supervisory Analyst*

Okay. That's helpful, Bruce. And just going back to the Crystal portfolio turnover rate, you mentioned it was low in the fourth quarter. Is there something seasonal about the fourth quarter? Or is that more of an idiosyncratic event? And how is it looking in terms of portfolio turnover this quarter?

Bruce John Spohler - *Solar Capital Ltd. - COO, Co-CEO & Interested Director*

Sure. So turnover, it was Life Science and Life Science in the fourth quarter did not have the same elevated level of repays. But -- no, it's more very systematic. You'll see companies come to market. Sometimes, we'll let them go. Sometimes, there'll be an opportunity to refinance and extend. We had a few of those in the fourth quarter where businesses have performed extremely well, and we decided to stay with them, tap into the fact that we had this increased scale across our platform and do additional investments into companies to extend our duration. Because as you know, this is a 2-year average life asset class in Life Sciences. So it's all good, long term. It just didn't generate short-term repayment income because we were able to keep some investment a little bit longer in our portfolio.

Mickey Max Schleien - *Ladenburg Thalmann & Co. Inc., Research Division - MD of Equity Research & Supervisory Analyst*

And this quarter, how is it looking?

Michael Stuart Gross - *Solar Capital Ltd. - Chairman, President & Co-CEO*

I think we have good visibility for the first half. It's hard to predict quarter-to-quarter. Because, again, we're not in control of these things. But I think we feel comfortable that we'll have some nice realizations within the first 6 months of the year. We just don't know how much that will be first quarter, how much be second quarter.

Mickey Max Schleien - *Ladenburg Thalmann & Co. Inc., Research Division - MD of Equity Research & Supervisory Analyst*

Okay. Appreciate that. Just a couple more questions. I saw that the value of SOAGG declined. I'm curious whether that was just simply due to the payment of the dividend they made to you or to something else?

Richard L. Peteka - *Solar Capital Ltd. - Treasurer, Secretary & CFO*

Yes. Exactly, that's the dividend.

Bruce John Spohler - *Solar Capital Ltd. - COO, Co-CEO & Interested Director*

The fundamentals are doing well. This is our airline portfolio, as you know, and these were released about a year or so ago, and the fundamentals continue to be great. It's just the math, to your point, about reflecting the dividend out.

Mickey Max Schleien - *Ladenburg Thalmann & Co. Inc., Research Division - MD of Equity Research & Supervisory Analyst*

So it was accrued to NAV and now you booked it to income. I understand.

Bruce John Spohler - *Solar Capital Ltd. - COO, Co-CEO & Interested Director*

Exactly.

Mickey Max Schleien - *Ladenburg Thalmann & Co. Inc., Research Division - MD of Equity Research & Supervisory Analyst*

And lastly, I think, Robert mentioned some sort of impairment at the equipment in NEF. But I'm not -- can you just repeat, was there some sort of impairment in NEF that caused an impairment in the valuation?

Bruce John Spohler - *Solar Capital Ltd. - COO, Co-CEO & Interested Director*

No. It would reflect -- no, it was very slight, but that's reflecting comparables. Valuation didn't move materially. He was mentioning how the distributions come and have declined from the subsidiary and our commentary was around the need to look at it on a consolidated basis when you look at the income collapsing the assets on balance sheet as well as the ones in the wholly-owned subsidiary. And that's been rather consistent in the 5 -- in the 8 quarters or so that we've owned NEF between $5 million to $6 million on a combined basis.

Mickey Max Schleien - *Ladenburg Thalmann & Co. Inc., Research Division - MD of Equity Research & Supervisory Analyst*

No. I do understand that, Bruce, but the valuation did come down. Did you just say that was due to comps?

Bruce John Spohler - *Solar Capital Ltd. - COO, Co-CEO & Interested Director*

Yes.

Operator

Your next question comes from the line of Finian O'Shea of Wells Fargo Securities.

Finian Patrick O'Shea - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

Just had a follow-on to one of Robert Dodd's earlier questions on the Crystal fees. Understanding the servicing fees are usually pretty nominal, and the origination fees or engine platform, et cetera, is very valuable. Does this arrangement with the private fund suggest that Crystal can't build out the capabilities to club up or syndicate itself?

Bruce John Spohler - *Solar Capital Ltd. - COO, Co-CEO & Interested Director*

You mean selling to third parties?

Finian Patrick O'Shea - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

Yes. So couldn't Crystal sell down to the third -- yes.

Bruce John Spohler - *Solar Capital Ltd. - COO, Co-CEO & Interested Director*

So the borrowers in the marketplace are such that you are much more competitive if you can speak for the entire transaction. And they want to have long term, the same lender. So they don't want to wake up and find that we sold off our loan to other people. And that's in all of our asset classes, not just in Crystal. It's in Life Science. It's in cash flow. So they want the lender to be the sole holder at the end of the day.

Finian Patrick O'Shea - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

Okay. And another question on Life Sciences, understanding that there's amortization there. It's been fairly stable in size, your other specialty lines have grown. Is there anything on -- is this just kind of some one-off repays type thing over the past couple of quarters? Or is that an area that there's not a lot of flow out there or not good terms out there? Just any context on the Life Sci book?

Bruce John Spohler - *Solar Capital Ltd. - COO, Co-CEO & Interested Director*

Sure. As we mentioned, the Life Science book actually has grown from a standing start a few years ago to just under $300 million. And the challenge, though, for Life Sci is that it is a short duration asset class because they tend to lend to these businesses very late in their development. They are typically being sold to strategic buyers or taken public soon after our loan and so we end up having an average hold period of about 22 months.

And we just benefited recently from not having as many repayments. Although to Michael's comment a moment ago we do expect more repayments in that portfolio to accelerate in the first half of this year. So it is a short duration asset class, has a lot of velocity to the underlying assets. We're thrilled that the team has been able to grow it to just under $300 million. We think there is more growth over the next year or 2, particularly benefiting from the increased scale so that Solar can now use this institutional co-invest fund to compete in the $100 million to $150 million investment opportunity. So we expect growth here. And when you see the portfolio not facing tremendous redemptions, that's a good thing, but they're coming.

Finian Patrick O'Shea - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

Okay. No, that's helpful. Understanding it's short-term and such. And does the $100 million to $150 million bracket in that area, does that mark a material difference in the nature of what you've been doing? I think you're generally commercial stage nearing the exit. Is there any different texture that we'll see here in that book?

Bruce John Spohler - *Solar Capital Ltd. - COO, Co-CEO & Interested Director*

Great question. No, if anything, they'll probably be a little closer to exit because, by definition, if they're borrowing $100 million to $150 million that means they are well capitalized because as you know we lend very low loan to equity value here. Equity being defined as cash invested in the business over its life. And so that means they're bigger, larger companies that have been more -- better capitalized and invested in for a longer period of time. So if anything, those will probably be even shorter duration, but it's not instead of what the team has been doing already. This is just expanding the opportunity set for them. But directionally, they are a little bit lower risk investments for that sector.

Operator

Thank you, ladies and gentlemen. I would like to turn the call back over to speaker Michael Gross, Chairman and Co-CEO. Go ahead, sir.

Michael Stuart Gross - *Solar Capital Ltd. - Chairman, President & Co-CEO*

We thank you all for your attention today and all your insightful questions. And we look forward to talking to those of you who are following SUNS in the next minute. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation. And have a wonderful day. You may all disconnect.

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