



Trinity's Brown: Near-Shoring, Interest Rates And More Are Boons For Private Credit

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Chuck Jaffe, in this episode of The NAVigator podcast interviews Kyle Brown, chief executive officer at Trinity Capital. Kyle says that he sees the private-credit boom continuing, in part fueled by government efforts to generate business gains in the United States. That has created a new wave of capital expenditures, and a 20 percent year-to-date increase in demand for private credit, that is likely to power the private lenders for the foreseeable future. For Trinity, the company has doubled in size in roughly three years, but the current demand gives it room to grow further, and Brown says he believes business-development companies can handle the heightened demand without a significant increase in the default rate they are facing, adding that rate cuts could be another positive, reducing costs to stay profitable in the next phase of the rate cycle.

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

CHUCK JAFFE: Kyle Brown, chief executive officer at Trinity Capital is here, we're talking high yields in private credit markets now on 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 representing the full spectrum of the closed-end fund business from investors and users to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator will point you in the right direction. And today

we're looking into the private credit industry and we're doing it with Kyle Brown, chief executive officer at Trinity Capital, a business-development company that trades on the NASDAQ under the ticker symbol TRIN, and you can learn about the firm at TrinityCapital.com. If you're hunting for more information generally about BDCs, but also on closed-end funds and interval funds, go to AICAlliance.org, that's the website for the Active Investment Company Alliance. Kyle Brown, welcome back to The NAVigator.

KYLE BROWN: Good to see you, Chuck. Thanks for having me.

CHUCK JAFFE: We last spoke with you in 2022, and one of the things that has happened big time since then is not just that the market took off, but in 2022 you guys were providing high yields at a time when the market was not doing well, and the result of that was that it kind of turbo charged growth for what we've seen in '23 and '24, so in other words, when the market did better, well, venture-backed growth still had a tremendous amount of interest. So help understand where Trinity Capital is at now, and how that growth has played into what's been going on for you.

KYLE BROWN: You bet. I think it's a general trend across private credit really, continued growth of the private sector, banks shifting from lending directly to companies to lending to private credit firms, giving the private credit market the ability to continue that growth, and we really have benefited from that. We've been able to, since we talked last, we've doubled the size of our business, we are deploying north of \$1.5 billion to \$2 billion a year now in capital to rapidly growing companies that are sponsor-backed, either late-stage venture capital backed or pre-IPO, into the lower middle market, private equity sponsored companies that are \$3 to \$50 million of EBITDA, but really like you said, focused on growth where our capital is going towards marketing, sales, building the business for companies that are doing well despite what's going on from a macro sense. So the markets continue to grow, I think what we've seen over the last really five to 10 years is that private markets are here to stay, public companies have continued to decline in their number and the private market during that time frame has continued to grow, which creates really a new need for capital that we've been able to fulfill. Our business has experienced growth while maintaining that strong dividend and return for investors, we've not seen dilution happen there for our investors, so dividends have continued either consistent or growing over the last 23

quarters, and so our growth has not come at the determinant of the investor, we've been able to keep returns really steady during that season of growth.

CHUCK JAFFE: Consistent dividends and some measure of certainty is what investors really want, and in private credit obviously we are dealing with things where the investors are counting on you guys to do all the heavy lifting because they can't see what's going on, it's not like they can be watching the public companies and doing it, there's a lot of covenants that are in these deals that are really important to them. And what that means is that they're also, and you guys are also, looking for some measure of certainty, so we're in a market where although things have rebounded from April, et cetera, there's still a lot of uncertainty, and one of the key areas I would think would be where private credit should shine; which is if we're going to have nearshoring, we're going to have companies spending a lot of money on expenditures, and if they're doing that, they're going to need to finance that. So how do you balance that need, and have you seen the demand there, with the idea that there is a lot of geopolitical uncertainty that could change that all up pretty quickly?

KYLE BROWN: Yeah, you're actually hitting on something that we've seen a lot of recently. Equipment financing is a big part of what we do, providing mission-critical equipment financing to cover CapEx needs for companies that manufacture and develop something here in the US, and since the beginning of the year we've seen an over 20% increase in demand for CapEx spend for companies manufacturing here in the US. We are heavily focused on that right now, that's probably one of our largest drivers right now of growth, is equipment financing for US-based manufacturing. It's really not specific to any one industry, it's really across the board, we've seen increased demand for CapEx spend. That's actually how we cut our teeth back in 2008, was equipment financing to the lower middle market, we've leaned back into that in a big way right now. And actually we love that business as well because our loss rate historically has been under 22 basis points annually, when you factor in realized gains we actually have a negative loss rate, so it's a great business for us, we're uniquely positioned to support that lower middle market and late-stage VC companies with that CapEx spend. So yeah, that's a big and growing demand right now in the US, is CapEx spend for companies manufacturing here.

CHUCK JAFFE: I'm curious about that, because the good news is when I hear you talk about that increased demand I'm going, well, okay, that's actually seeing with the politicians who

said, “Hey, if we do this, that’ll be the result,” that’s actually getting some delivery on what we expected there. The flip side of that would be the potential for maybe a little bit more default. You’ve got companies that are facing a challenge, they weren’t necessarily planning on doing this, but kind of being pushed into doing this by policies. Because you mentioned how low the default rate is, how limited the losses have been, but how much do you worry that given these conditions we might see increased losses, at least in the industry? Obviously you’re going to try to avoid them, everybody’s going to, but how much do you worry that we might also be pushing to where some of that push creates more defaults?

KYLE BROWN: Well, I’ll just tell you how we think about and how we underwrite. When we’re underwriting and financing this equipment, we’re thinking about it in two ways; one, it has to be mission critical, the company cannot survive without it, they have to make a product with it, right? It has to be off the shelf, it cannot be specialized equipment, so this has to be equipment that can be utilized in other industries, for other companies doing other things. All of our facilities on the equipment side are primarily fully amortizing, so we’re getting repaid over a 24-36 month time period, so we’re getting our principal paid down right out of the gate. That combination of real value in the equipment, so if the company doesn’t survive or they can’t get to scale, we still have a piece of hard equipment that we can go pick up, we can go sell to the secondary market, that combined with the fully amortizing payments that we’re getting out of the gate. And when we underwrite, these companies have a couple years of cash life, so we typically get off risk, and that just means we’ve gotten our principal back within two years. So we underwrite in such a way where we can get the combination of that real liquidity value of the equipment combined with the fully amortizing payments received, we’re off risk within two years and everything after that is gravy, that’s additional return. So what you’re saying, that may exist, but in our world it does not because of how we underwrite, and that’s how we mitigate lending to growth oriented businesses. We don’t want specific equipment they can’t go off and sell on the secondary market, we make sure we have that real value there.

CHUCK JAFFE: What has been the impact on higher interest rates for longer as it relates to you guys and your activities? I mean, Trinity Capital has a dividend yield that’s about 14-14.5% last time I checked, and you guys have talked about being consistently in the double

digits, that's part of what you want to be doing, but what is the interest rate environment doing both in terms of your yield and also what you see happening broadly in the industry?

KYLE BROWN: Well, first off, I'll tell you, I don't actually want it to be a 14% dividend yield, we're a BDC, we're an internally managed BDC, we have to pay out 90+% of our income to investors, we make too much income and so we have to pay that out. The yield being high is a product of the stock being too low. I'm happy to say that out loud, I buy the stock with my own money all the time because I believe that, so that is why the yield is so high. We are still a newer public company, we're five years in, publicly reporting, we're trading 20-50% below our internally managed BDC peers, and I think over time we'll move towards that median value. So I think with regards to the stock, I think that it's great income, great income, but there's actually a ton of upside in just the stock price as well as we move towards more of an average between our peers. The consistent income nature of our business, we generate current income, so when we're lending, we've got over 100 borrowers, we don't have any PIC income, this is all current pay, we're generating anywhere from 11-14% yields on our underlying investments from our borrowers, and the rate impacts have been interesting. Even with rate cuts, what we have that's very different than almost all of the BDCs, is we have floor rates across the majority of our portfolio, so let's say rates get cut further from here, we currently sit, the majority of our portfolio is at its floor rates. So a decrease of say another 100 basis points, Fed cuts rates, actually there's a possible scenario here where we have a positive outcome for our portfolio because the cost of Trinity's debt will go down but the portfolio yields will not. So we have seen some decrease in that income because of rate cuts, but we've hit a point now where further rate cuts have little to no impact, in fact maybe a positive impact to our net income because the cost of our debt capital will go down. So rate increases had some impact on our portfolio, but we sit at such a low loan to value compared to the middle market or upper middle market when we loan to companies, we sit at 10-20% loan to value, and so an increased cost of the debt facility, it's not a make or break for these companies. A decrease has hurt all BDCs from the net income standpoint, but for us it's actually created an interesting scenario going forward, with the government or the president pushing significantly for rate cuts, if that does happen, we could see some really interesting benefits to Trinity, so we'll see what happens.

CHUCK JAFFE: Expound on that a little bit further. The benefits to Trinity, if we see rate cuts, would be more activity?

KYLE BROWN: Well, so we've got a half of billion line of credit led by [inaudible 0:11:16] in a syndicate of banks, that's floating rate, right? So if rates go down, the cost of our leverage will go down. Our underlying loans to our over 100 borrowers are either fixed because they're equipment financing, or they're floating rates but they have floor rates, meaning we're not just going to see our net income continue to dwindle down as rate cuts happen, we have floor rates that create a foundation, a basis for what the cost of that facility is, and even if rates get cut another 100 or 200 basis points, our loans don't change with our borrowers, that's why we could see some benefit there across the portfolio.

CHUCK JAFFE: And in terms of what you see going forward, the economy seems to be in a spot where although people worry about what might happen with the market, recession risks and all that other sort of stuff seem to be very minimal. So for you, if you're not worried about those things, is that pretty clear sailing? I would imagine in the private credit market that when recession is looming, those are the scary times, these times shouldn't be scary, are they?

KYLE BROWN: You know, we have operated this business successfully through five administrations, we have seen multiple ups and downs from a macro sense since the Great Financial Crisis, there were over 8,000 public companies back then, there are under 4,000 public companies today. The private credit market has grown, regulations have made it more difficult for banks to lend money directly to companies, this isn't going anywhere, this is only growing, in some ways it's just beginning and becoming more and more robust. So I think that we underwrite in such a way where we're able to get off risk quickly, and the majority of our portfolio has already turned over from three years ago, so we don't have long standing credits that are just dwindling in the portfolio, we're continuing to underwrite and make new investments based on what's going on today. And so I would tell you we constantly have our eye on the ball, trying to understand the impacts of tariffs, the impacts of rates, the reshoring of manufacturing to the US, how that impacts customers, how that impacts their costs of goods, et cetera. We think about all these things of course, but I think the business model stands regardless of what's going on, and Trinity Capital has proven through multiple administrations and multiple cycles that we can be profitable, we can shift, we can ebb, we

can flow, and end up on top. I'm confident that regardless of what happens, and I'm sure something will, we'll figure out a way to keep our eye on the ball and deliver great returns for investors.

CHUCK JAFFE: We will be watching what happens and I'm sure we will touch base with you again. Meanwhile, thank you so much for taking a little time out of paradise on a family trip to join us here on The NAVigator. Enjoy the holiday, we'll talk to you again down the line.

KYLE BROWN: Thanks, Chuck.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe, and I'm Chuck Jaffe and I'd love it if you'd check out my hour-long weekday show on your favorite podcast app or by going to MoneyLifeShow.com. To learn more about business-development companies, closed-end funds and interval funds go to AICAlliance.org, that's the website for the Active Investment Company Alliance. Thanks to my guest Kyle Brown, he's chief executive officer at Trinity Capital, a business-development company trading under the ticker symbol TRIN, learn more about the company and what it does at TrinityCapital.com. With the exception of holiday weeks like this one, The NAVigator podcast has something new for you every Friday, make sure you never miss an episode by subscribing or following along on your favorite podcast app, and if you like this podcast, leave us a review and tell your friends, because that stuff really does help. We'll be back next week, and until then, happy investing, everybody.

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