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OCSL - Q1 2018 Oaktree Specialty Lending Corp Earnings Call

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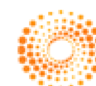

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PRESENTATION

Operator

Welcome, and thank you for joining Oaktree Specialty Lending Corporation's first quarter 2018 Conference Call. Today's conference call is being recorded. (Operator Instructions)

Now I would like to introduce Michael Mosticchio of Investor Relations, who will host today's conference call. Mr. Mosticchio, you may begin.

Michael Mosticchio - *Oaktree Specialty Lending Corporation - Investor Relations*

Thank you, operator, and welcome to all of you who have joined us for today's call to discuss Oaktree Specialty Lending Corporation's first quarter 2018 Financial Results. Our earnings release, which we issued this morning, and the slide presentation that accompanies this call can be accessed on the Investors section of our website at, oaktreespecialtylending.com.

Our speakers today are: Oaktree Specialty Lending's Chief Executive Officer and Chief Investment Officer, Edgar Lee; Chief Financial Officer and Treasurer, Mel Carlisle; and Chief Operating Officer, Matt Pendo. We will be happy to take your comments following their prepared remarks.

Before we begin, I want to remind you that our comments today will include forward-looking statements reflecting our current views with respect to, among other things, our future operating results and financial performance. Our actual results could differ materially from those implied or expressed in the forward-looking statements for any reason. Please refer to our SEC filings for a discussion of these factors. We undertake no duty to update or revise any forward-looking statements. I'd also like to remind you that nothing on this call constitutes an offer to sell or solicitation of an offer to purchase any interest in any Oaktree fund.

Investors and others should note that Oaktree Specialty Lending uses the Investors section of its corporate website to announce material information. Accordingly, the Company encourages investors, the media and others to review the information that it shares on its corporate website at oaktreespecialtylending.com.

With that, I would now like to turn the call over to our Chief Executive Officer, Edgar Lee.

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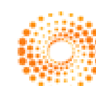

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Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

Thank you, Mike, and welcome, everyone, to our first quarter earnings call. I will begin with an overview of our progress since we began managing OCSL on October 17. Next, I will provide a review of the portfolio. Then Mel Carlisle will review our financial results and capital structure. Finally, Matt Pendo will discuss our dividend and our plans to enhance the portfolio's return on equity.

As noted on page 2 of the earnings presentation, we are pleased to report that in the short time since we began managing Oaktree Specialty Lending, we have made great progress in a number of key areas.

First, we monetized $314 million (sic) [$357 million] of investments since September 30, 2017, and through the end of January 2018. Importantly, all of these sales on average were executed within 25 basis points of our September 30, 2017, fair values.

Second, during the quarter, we originated $183 million of new investments. These investments were made across 12 industry sectors, and 60% of these were in first lien loans.

Third, we upgraded our operational infrastructure by integrating OCSL into Oaktree's platform. This integration included processes and systems related to accounting, valuation, compliance and information technology, and should lead to cost savings over time. I am pleased to report that as part of the integration, we also remediated a material weakness related to internal control over financial reporting that had existed since September 2015. Completing this integration was not an easy task, and we thank everyone at Oaktree for their efforts in achieving a smooth transition.

Fourth, we lowered our borrowing costs and enhanced our financial flexibility by closing a new $600 million credit facility and terminating the Sumitomo credit facility. In addition, our joint venture with Kemper merged its credit facilities, which should decrease costs at the JV and improve returns on our investment. We are pleased with our accomplishments, and look to take advantage of other opportunities that we believe will further enhance long-term shareholder value.

Turning to page 3, we provide a summary of the portfolio as of December 31. Overall, the debt portfolio performed well in the first quarter with a majority generating stable or improving operating trends. The portfolio had a fair value of $1.4 billion. Approximately 92% of the total portfolio was invested in debt instruments, of which, 57% was in first lien loans and 19% in second lien loans. 82% of our debt investments were in floating-rate securities. The weighted average yield on debt investments was 9%, which is down from 9.6% at September 30, reflecting our conservative approach to investing given the market environment. And, we believe this approach will position us well in the event of a future market dislocation.

The average debt investment was approximately $14 million at fair value. 12 of the total debt investments were over $30 million, and 39 were less than $10 million. In line with our goal to maintain a diverse portfolio with more evenly sized, high-conviction investments, we expect to reduce our exposure to loans below $10 million over time.

Part of our efforts last quarter was segmenting the portfolio into two primary categories: core; and non-core investments, which we thought would be helpful to share with you. We have dedicated significant resources to monetizing the noncore investments which do not align with Oaktree's long-term investment philosophy or objectives.

As described on page 4, you will see that we have core investments that we intend to hold and non-core investments that we intend to exit over time. We further classified our non-core investments as performing or underperforming.

Generally speaking, core investments are those we identified that are attractive to the company based on their risk return profile and align with our portfolio management strategy. As of December 31, core investments made up $625 million of the portfolio. This category includes $232 million of investments that Oaktree originated or recommitted to since becoming the investment adviser. In addition, Strategic Credit funds and accounts lent to 5 of the same borrowers in OCSL's portfolio, which represented $106 million as of December 31. Since September 30, our core investments have grown meaningfully, increasing by $110 million or 21%. The core investment category now represents approximately half of the portfolio at fair value.

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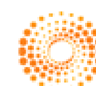

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The remaining half of the portfolio was invested in non-core investments. Despite being categorized as non-core, over 80% of these companies are performing. During the quarter, the non-core investment portfolio experienced a meaningful reduction, with approximately $200 million or 27% of non-core performing investments monetized in Q1. Importantly, on average, we exited these investments within 25 basis points of their previous fair value marks.

On page 5, we provide additional details on the non-core performing investments. As mentioned earlier, these investments are performing well, have relatively low amounts of leverage and are exhibiting stable to increasing revenue and EBITDA trends. However, these investments do not align with Oaktree's long-term investment objectives due to any number of reasons, such as the company's size or overall portfolio concentration levels. As a result, we do not intend to retain these investments over the long term.

As of December 31, the portfolio held $536 million of non-core performing investments, including $431 million of debt investments and $105 million in equity and limited partnership interests. Another $61 million are publicly quoted liquid loans, and the remaining $321 million are less-liquid debt investments. While this last category of investments is less liquid, we believe a meaningful portion of these investments can be monetized before 2019 through refinancings and asset sales, especially in the context of the current robust market conditions. Already, we exited 11%, or $49 million, of debt investments in January 2018 alone.

With respect to non-core performing equity and limited partnership investments, we believe we will be able to exit a meaningful portion of these positions by the end of 2018, and are currently exploring several paths to monetize some of these investments.

Turning to page 6, as of December 31, $122 million of the portfolio was in non-core underperforming investments. Roughly half of these borrowers are in active sale processes. With respect to the remaining companies, we continue to maintain an ongoing dialogue with management teams and their financial advisors to discuss options, including balance sheet restructurings, asset sales, or other exit opportunities. We continue to believe there is significant value in these positions.

As highlighted on page 7, during the quarter, we originated $183 million of investment commitments, in thirteen new and one existing portfolio company, which includes $35 million of co-investments with Oaktree's other funds. 60% of these investments were first lien loans, 26% were second lien loans and 14% were unsecured investments. These investments were diversified across 12 industries.

Over the past few years, a tremendous amount of capital has been raised in private credit, which has created a highly competitive, borrower-friendly environment characterized by lower yields and aggressive deal structures. In this challenging market, we are taking a measured, conservative approach to investing. We continue to pursue a number of investment opportunities with attractive returns relative to their underlying risk profiles, which will enhance the overall yield of the portfolio. Longer term, we anticipate market dynamics to become more balanced and provide meaningfully more attractive investment opportunities, which will allow us to deploy a significant amount of cash we are generating from monetizing non-core investments.

Lastly, I'd like to discuss our long-term portfolio objectives. Our goal is to create a diverse, high-quality portfolio of investments. We look to lend in well-structured, appropriately-priced opportunities. We will invest in private loans in both the sponsor and non-sponsor markets and in industries that can support levered balance sheets.

As we reposition the portfolio, we are targeting investments of $30 million to $50 million in size and a mix that emphasizes senior secured lending. We would anticipate the vast majority of the portfolio to be comprised of first and second lien loans. I'd like to note that these targets may vary depending on the market environment.

And now I'd like to turn the call over to Mel Carlisle, Chief Financial Officer and Treasurer to discuss our financial results in more detail.

Mel Carlisle - *Oaktree Specialty Lending Corporation - CFO & Treasurer*

Thank you, Edgar. Net investment income in the first quarter was $13.3 million or $0.09 per basic and diluted share. This was up sequentially from $11.5 million or $0.08 per share last quarter, primarily due to lower interest expense and partially offset by lower total investment income.

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Total investment income for the first quarter was $33.9 million, down sequentially from $35.7 million in the September quarter. This was primarily due to the smaller size of the portfolio and a lower-weighted average yield on debt investments.

Net expenses for the quarter were $20.6 million, down from $24.3 million in the prior quarter, reflecting a $3.2 million decrease in interest expense due to lower average borrowings during the quarter. Excluding interest expense, net expenses declined by $0.5 million sequentially to $11 million, primarily due to lower management fees and G&A expenses, partially offset by an increase in professional fees. Net expenses for the first quarter also included $1.8 million in one-time items, primarily related to professional service fees.

Now turning to credit quality. At December 31, a total of eight debt investments were on non-accrual status, which represented 3.2% of our portfolio at fair value. In the first quarter, net write-downs were approximately $45 million. These write-downs were concentrated in three portfolio companies that experienced further deterioration during the quarter.

Realized losses were $300,000 in the quarter as the vast majority of our exits were loan payoffs that occurred at par or the redemption price. Net asset value declined to $5.81 per share at December 31 from $6.16 per share at September 30. Total debt outstanding at December 31 was $630 million with a weighted average interest rate of 4.79%, and our debt-to-equity ratio was 0.77x.

Since we began managing OCSL, we have taken a number of steps to optimize our liabilities and our cost of capital. On November 30, we closed a new credit facility that expands our borrowing capacity and provides us with enhanced financial flexibility at very attractive pricing and terms. The total capacity of the facility is $600 million, up from the previous credit facility's capacity of $525 million, and the interest rate on the facility ranges from LIBOR plus 2.25% to 2.75%. We also expanded the lending syndicate by adding five new banks. Our new credit facility positions us with ample flexibility and liquidity to support our business. We believe our ability to access capital markets and establish this new credit facility demonstrates the confidence in the Oaktree platform and our approach to credit investing.

At the Kemper joint venture, we and our joint venture partner merged the two credit facilities in order to more efficiently fund the vehicle. To further simplify our capital structure, we paid off and terminated the Sumitomo Bank credit facility during the quarter. We will no longer pay utilization fees on this facility.

At quarter end, cash and cash equivalents were $46 million, and we had $395 million of undrawn capacity on our new credit facility. Unfunded commitments outstanding at the end of the quarter were $99 million, primarily due to portfolio companies with revolving credit facilities or delayed draw term loans.

As Edgar mentioned, we completed the process of integrating OCSL into Oaktree's platform during the quarter. This included the transition of OCSL's operational infrastructure, including all accounting, valuation, compliance and the information technology functions. Going forward, we expect to benefit from shared services and the economies of scale that come with being part of a large platform. Very importantly, as part of this integration, we were able to remediate the material weakness related to internal control over financial reporting, which initially occurred in 2015.

Now I'd like to turn the call over to Matt Pendo, our Chief Operating Officer, to discuss our dividend and our plans to enhance the return on equity of our portfolio.

Matthew Pendo - *Oaktree Specialty Lending Corporation - COO*

Thank you, Mel. Let me first begin with the dividend. As you saw in our press release, we declared an $0.085 dividend per share, payable to shareholders on March 30. This dividend represents a payout of approximately 90% of the net investment income generated by the portfolio in the first quarter. We plan to pay dividends based on the earnings generated by the portfolio.

As we continue to reposition the portfolio, we are focused on several opportunities designed to increase our return on equity. These include, first, rotating out of lower-yielding broadly-syndicated loans into higher-yielding loans originated by Oaktree. As of December 31, approximately $80 million of the portfolio consisted of such lower-yielding loans.

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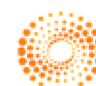

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Second, redeploying non-income generating investments comprised of equity, limited partnership interests and non-accrual loans. As of December 31, there were $41 million of non-accruals and $110 million of non-interest bearing equities and limited partnership interests.

Third, realizing cost savings from leveraging Oaktree's operational platform. We would expect future savings related to trade settlement, internal audit and information technology, among other areas.

Fourth, deployment of approximately $27 million of previously uninvested cash proceeds that were previously held at SBIC subsidiaries.

Fifth, maintaining a primarily floating rate investment portfolio that will benefit from rising interest rates. Currently 82% of the debt portfolio is floating rate.

And sixth, realizing lower operating costs from optimizing our credit facilities.

With that, we're delighted to take your questions. So operator, please open up the lines.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question will come from Rick Shane of JPMorgan.

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

Really, two things. One is, interestingly enough, you sold off about $68 million worth of investments this quarter. And given the remarks on the portfolio, I would have thought there would have been significant unrealized losses with that. But the reality is there were not. I'm curious what that's telling us about what was sold during the quarter? And is it going to be harder for you to sell the investments that have been marked down that are clearly underperforming?

Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

Hi, Rick. It's Edgar here, and thank you for the question. Before we answer your question, I'd like to clarify my prepared remarks. In my prepared remarks, I incorrectly stated that we monetized $314 million of investments in the quarter. The correct number is actually higher, and it's $357 million of investments that were monetized between September 30 through January of 2018. With respect to your question around monetizations and not having experienced losses there. As we outlined in the presentation, we have broken the portfolio down into core and non-core investments. And the non-core investments, as you can see, had a significant portion of what we defined as performing investments. From our perspective, the marks on those investments and the marks on the entire portfolio are ones that we feel good about, and we think we accurately reflect the current conditions of these companies. The investments that were sold were a mix of ones that were high-performing, medium-performing and low-performing companies, generally. So I would say it's been pretty broad-based in terms of the monetizations. And so I wouldn't read into too much that the remaining portion of the portfolio only has investments that are more difficult to monetize over time.

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

Okay. A follow-up to that. The conventional wisdom is that when you came in and took the markets the last quarter, the idea was to be very, very conservative so that there wouldn't be additional write-downs to NAV going forward. I am curious what has changed in the ensuing quarter? The investments that were written down, has there been an adverse development in those businesses? Or is what you're seeing marking those to market based on being out there specifically positioning those investments for sale and getting a sense of where the market is?

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Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

Well, we're certainly disappointed by the reduction in the total asset value. I would say the write-downs was relatively modest at 2.9% of the total value of the investments. And I emphasize that we feel confident about the 12/31 valuations. The write-downs were highly concentrated at 4 borrowers, which accounted for about 80% of the total write-down. So it was not broad based, it was a very specific. The 4 borrowers that experienced the write-downs were Dominion Diagnostics, Maverick Health, Adventure Interactive and Edmentum. In all of these situations, we were well aware last quarter that a subset of these investments might be experiencing some form of operational or financial stress. So I wouldn't say it was a surprise to us. With respect to these investments, we determined that further write-downs were appropriate this quarter due to a combination of factors, some of which included compression of industry valuation multiples and,as well as in certain circumstances, a potential need for additional capital. This quarter, we wrote down a subset of these loans to negligible amounts. So there's a limited amount of potential for future losses there. I'd say that two of these investments that experienced additional write-downs are first lien loans that, we believe, still have significant value as reflected in the remarks. One of these investments that was written down is actually experiencing significant growth in contrast to those that were experiencing some financial strain. In that situation, we don't anticipate an impairment in the investment based on the information we have today. But the investment was written down because the company is considering raising additional capital to support growth. And that capital could potentially come in structurally senior to our investment and therefore, we had to adjust the discount rate used on that investment. So although we experienced some write-downs this quarter, we believe the portfolio has a lot of potential to generate long-term capital appreciation. So hopefully, that provides some additional context on what to have from the remarks.

Operator

The next question comes from Chris York of JMP.

Christopher York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

So on the topic of the dividend, you managed the expectation for reduction in the last call. But given that the plan is to pay future dividends based on the earnings generated by the portfolio, maybe, Matt, for you, what is your expected ROE upon portfolio stabilization?

Matthew Pendo - *Oaktree Specialty Lending Corporation - COO*

Sure, and thanks, Chris, for the question. What we try to outline on what is page 12 of the deck was really the levers and opportunities that we see to increase the ROE over time. And if you just kind of walk through in a little more detail, there's $80 million of the broadly-syndicated loans, the yield L plus 400 or below. If you can redeploy that at given 300 to 400 basis points higher, that could generate additional $2 million to $3 million of interest income. [There is $151 million between the non-accruals of $41 million, and then you have $110 million of equities and LP interests]. (corrected by company after the call) Again, if you assume you can redeploy half of that at L 600 to 800, you get another $6 million to $8 million. We mentioned the $27 million of the trapped cash that was a SBIC subsidiaries, that cash is, in essence, just sitting there and not earning any income. So if we can redeploy that into portfolio assets. And then, Mel talked about the expense reductions and synergies from the credit facilities and the other cost savings. In the quarter, we had $1.8 million of non-recurring cost. You layer on top of that, the fact that 80% of our debt investments are floating rates, and right now, we've got 2/3 of our debt portfolio in fixed rate. So there is -- obviously, all this extended LIBOR increases those benefits there. So if you put that all together, and I don't know when, I can't give you a timeline on when that happens or if we can achieve all of these, but if we put all these together, you can do the math. It gets to a high single-digit ROE, again, assuming you hold all things constant. So to answer your question, ROE from their dividends. That's kind of how we look at the opportunities ahead of us.

Christopher York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Helpful. Is that high single-digits kind of 8 to 9? And then does that expectation include the forward curve? I know you talked a little bit about the sensitivity there. And then lastly, how long do you think that takes? Or what is your expectation for stabilization?

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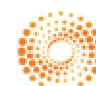

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Matthew Pendo - *Oaktree Specialty Lending Corporation - COO*

Sure. So high single-digits, we're assuming just the LIBOR curve, okay? I mean, I cannot predict LIBOR, but just the market prediction of a forward curve in there. And it's too premature to give you specific timeline. We'll give you updates every quarter on the progress we're making. You've seen some of the progress in this quarter, and we'll keep you updated as we make progress.

Christopher York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Okay. Fair enough. And then looking at slide 4, it's just a clarifying question. Could you provide us the weighted average yield across the 3 buckets of core, non-core performing and then non-core underperforming, which may be similar to the $80 million, $41 million in nonaccruals and then $110 million of equity?

Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

Sure. Why don't we pull that information together and come back to you.

Christopher York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Okay. And then you talked in last question with Rick a little bit about the declines, which were concentrated in Maverick, Dominion, Adventure and then Edmentum. It was interesting, Edgar, with your comments on potential for the long-term capital appreciation. So my follow-up question is twofold. Are you interested in adding any additional capital in either of those two companies? And then secondly, which company specifically is considering raising growth capital?

Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

I appreciate the question. What I say is, due to nondisclosure arrangements, we're limited with respect to what amount of detail we can provide on individual companies. So I can't comment specifically on which company is raising capital. And because these situations are fluid, I can't comment on how we'll approach those situations at this particular point in time. But I would say, just to frame it for you, we're not going to put good money after bad. And to the extent we think there is real upside potential in these situations, we would take that into careful consideration when assessing whether to put additional capital into these companies.

Christopher York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Okay. Makes sense. And then you did put in the presentation you exited -- in the press release as well, $92 million of investments, which appear to be concentrated in software. Where did you exit those investments relative to the December market?

Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

All of these situations were exited at par or better.

Christopher York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Great. And then last one, professional fees. You kind of laid out the potential for reductions there. I was just kind of curious on how much in this quarter would you consider would be non-recurring or elevated that could be subject to reductions as the portfolio stabilizes?

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Matthew Pendo - *Oaktree Specialty Lending Corporation - COO*

So, as I stated in my comments, the $1.8 million of non-recurring fees, we were taking at it to the second quarter. I think, the second quarter should be relatively flat, taking into account those non-recurring costs.

Operator

The next question is from Ryan Lynch of KBW.

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

First one. If I look at what you guys classify as non-core underperforming investments, there is about $122 million you identify, $41 million is in nonaccrual investments. So my question is, what is the remaining $80 million of non-core underperforming investments that are still on accrual status? And what is the outlook for those investments? It just feels like a pretty big chunk of investments are still on accrual status, but are clearly stressed in some way as you guys have identified.

Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

Right. So we won't be providing or disclosing individual company breakouts, where companies fit between the various buckets. But what I would say, in terms of companies that are sitting in the underperforming noncore portfolio, they tend to be made up of investments with certain characteristics that, or that have certain characteristics. For example, the borrowers are experiencing more meaningful amounts of financial operational stress. These are, oftentimes, situations where the borrower has an increased likelihood of undergoing some form of balance sheet restructuring if there isn't an asset sale or new third-party capital, or there may be an unusually high risk of the company suffering -- or the investment suffering some form of permanent impairment there. And the companies that are accruing are continuing to accrue and are sitting in the underperforming noncore investment bucket. I'd characterize those investments as ones where the marks reflect what we think the potential recovery could be in those situations, based on the information that we have today and based on its current valuation environment. In these situations, some of these companies are undergoing active sale processes right now as we speak, which could lead to higher -- ultimate sale prices than where we have these positions marked, but again that just depends ultimately on those processes. And I'd say that the situations that are in non-accrual, the companies continue to generate a significant amount of unlevered free cash flow and are able to continue to support the interest on those investments at this time.

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

Okay. That makes sense. So the investment is, basically, the ones that are on accruals status, still, you guys have a mark down to values that you guys feel comfortable with. No further write-downs given the current information you guys have?

Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

That's correct.

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

Okay. And you guys might have mentioned this, but can you guys quantify the operating cost savings that you guys expect to receive from leveraging Oaktree's platform?

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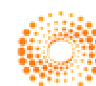

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Mel Carlisle - *Oaktree Specialty Lending Corporation - CFO & Treasurer*

Sure. Good question. I'll give you some examples as compared to the former manager on an annual basis. For audit services, we recently changed auditors from PWC to EY, and we expect to save $1.3 million on an annual basis in that change. Taken into account that Oaktree has a stronger internal control environment, we expect to, over time, reduce those to more reasonable audit fees. In relation to administration, taking into account that the former manager outsourced many of the functions that we handle internally. We can provide those services at a cheaper cost. We expect that, on an annual basis, to be $1.2 million.

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

Okay. That's very helpful. And then, what's your guys break out of core versus non-core assets. You guys, in your presentation, you excluded the senior loan fund from that analysis, so that's not in either bucket. So I just wanted to know how do you guys view that -- the senior loan fund going forward?

Matthew Pendo - *Oaktree Specialty Lending Corporation - COO*

Sure. So as it relates to the JV, we continue to have an active dialogue and a very good dialogue with our JV partners. We continue to look at opportunities to put assets in there that makes sense. As we mentioned, we consolidated the credit facilities on there. So it's something that we have in place, it's financed, seamlessly good assets that are appropriate we can put them in and we have a good dialogue with our partner there.

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

Okay. So just to be clear. That is the strategy you guys intend to continue to utilize going forward?

Matthew Pendo - *Oaktree Specialty Lending Corporation - COO*

Yes. And it's something that we look at every quarter. And I think, one of the things we're focused on is optimizing it as opposed to just utilizing it.

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

Okay. And then just one last one on slide 7, when you guys go over your new originations, it looks like about 20% of your new originations were oil and gas related -- or actually, sorry, about 30% of your new originations were oil and gas related. So can you just talk about -- obviously that's a very volatile industry, it's probably on the upswing right now, but certainly has a lot of commodity exposure risk there. So can you just talk about why was that high percentage this quarter?

Mel Carlisle - *Oaktree Specialty Lending Corporation - CFO & Treasurer*

Sure. So really, that was in the category, I think you're referring to the oil, gas refining and marketing business. And it was related to one particular investment where we were investing in a loan at par that was yielding almost 10% there that had a shorter maturity. The company was generating ample liquidity. The company doesn't take on significant underlying oil or commodity risk. It does a pretty good job of hedging it. And it was a situation where the company was actively pursuing a longer-term refinancing of the loan. So there was an anomaly in the market where we were able to invest in a situation that we felt that was just providing outsized returns in a situation that had relatively low-commodity risk there.

Operator

The next question comes from Christopher Testa of National Securities Corporation.

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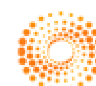

Christopher Testa - *National Securities Corporation, Research Division - Equity Research Analyst*

Just sticking with the theme of non-core assets. So of the roughly $431 million, in noncore performing debt, can you give us an idea of how much of that is set to mature over the next several quarters? Or how much has call protection expiring over that time frame?

Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

I don't have the data in front of me right now, but we can follow up the with you on that.

Christopher Testa - *National Securities Corporation, Research Division - Equity Research Analyst*

Okay. I mean, what I'm trying to get at Edgar, is just kind of ballpark estimate on how much you're thinking that you may have to actually actively sell in the market? And that's not necessarily a bad thing, of course, in today's market versus how much you're expecting to just be repaid or refinanced out of it, if you just kind of have a ballpark estimate off the top of your head?

Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

I don't have a ballpark estimate. Although I would say based on our experience so far in the portfolio, if I take a step back and say that the market is very strong. It's very robust out there, and there is a significant amount of capital, as all of you know, that's entered into the private lending space. And what we've experienced over the last two quarters to our benefit is it increased velocity and turnover in the portfolio. Now I can't comment on whether that velocity will continue on its current pace, but it has been quite more robust than where I would have originally thought it would have been. And the exit prices on those situations have been very attractive thus far. As I look at the balance of the remaining investments, as we noted earlier, there's been a significant amount of turnover. Over 11% of this noncore debt bucket has already turnover in January alone. And as we look across the remaining investments there, we still see a significant amount of opportunity for loans to be refinanced. And I would say that, consistent with my earlier comment, that the market is very robust, and there is a lot of capital in the marketplace chasing too few opportunities. I can tell you, we have received a tremendous amount of inbound interest in purchasing loans from us as well. So again, I can't tell you the speed at which the $431 million will turn over other than to say that there's been a lot of interest in these positions.

Christopher Testa - *National Securities Corporation, Research Division - Equity Research Analyst*

Okay. That's fair. And of the 13 new companies you guys invested in, only one of those was a co-investment with Oak. Just curious if you could kind of just discuss a more high-level point of view, just the co-investment opportunities with Oak, and which particular verticals that you think will be best utilized in conjunction with public vehicle?

Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

I appreciate the question. So we would imagine that there's great opportunity here. Part of the reason we think there's going to be a decent amount of opportunity here long-term is, as you've probably heard other managers comment on in the past, as you try to finance larger and larger loan opportunities, there are fewer and fewer managers who can provide or have significant capital to provide large loans. And as a result, those opportunities tend to be less efficiently priced, tend to be with companies that are much bigger, more diversified, more stable businesses that can weather economic cycles much better than smaller companies can. And so we find those incredibly attractive opportunities, and we're able to leverage some of the other pools of capital at Oaktree. What's interesting about Oaktree is, we do have a number of different verticals or funds at Oaktree. And so there isn't any one specific vertical that, I would say, is the only vertical that we would be working with. But for example, we would be working with our core strategic credit strategy for opportunities that tend to be non-sponsored companies that may be a little bit more opportunistic in nature. Then we may partner with, for example, our senior loan funds or our middle-market direct lending funds or our mezzanine funds, again, depending on the type of opportunities. So there are a range of pools of capital that we work with to be able to fund significant loans

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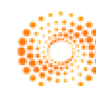

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in size. And I can say to you that we are working on one today, a very large loan that hopefully, we will bring to the finish line and be able to report back to you at our next quarterly call.

Christopher Testa - *National Securities Corporation, Research Division - Equity Research Analyst*

Got it. Yes. I mean, what I'm getting at with that is, I know that you guys have made a number of -- kind of $30 million loans and you're looking to exit the sub-$10 million loans. But I'm just wondering how are you thinking about this holistically across the Oak platform, because if you're making, let's say, a $40 million, $50 million or even $100 million loan across the Oak platform, but you have a $10 million hold size within OCSL. Well, that's not a knock on OCSL, that's advantageous and diversified and it's still a larger borrower. It's not to a [dink] you'll $10 million loan in and of itself. So I'm just trying to figure out like how you're looking at that more holistically, I guess.

Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

Absolutely. The OCSL shareholders and investors will benefit, because we'll be able to have a much more diversified portfolio than we might have been able to achieve at OCSL as a stand-alone company outside of the Oaktree platform. Here, we're able to get exposure to very large borrowers without having to over concentrate OCSL.

Christopher Testa - *National Securities Corporation, Research Division - Equity Research Analyst*

Got it. And this is just a question that's come up with a lot of the institutions I speak with. I mean, have there been any internal discussions surrounding reimplementing the total return hurdle that was finally influenced by Fifth Street that you guys removed? It just seems that there is a lot of concern that if NAV continues to step down, but you guys could potentially put more assets to work and continue to earn an incentive fee despite NAV declines that that's out of the line with shareholders. So I'm wondering if there's been any internal discussions on implementing that type of feature?

Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

And I don't think that's something we're considering implementing right now, and I think we're focused on managing the portfolio and generating appropriate returns for the investors.

Operator

The next question comes from Jonathan Bock of Wells Fargo.

Jonathan Bock - *Wells Fargo Securities, LLC, Research Division - MD and Senior Equity Analyst*

Edgar, would you be able to walk through -- I know you were mentioning CITGO as an investment. But you mentioned of the $180 million that you put to work, $35 million were done in conjunction with Oaktree, kind of getting to the point of shared resources. What were those loans?

Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

So in terms of loans, new investments and there are 13 line item investments during the quarter that would include some of the other ones and I won't go through all of them, but some of them include Navicure, strategic materials, buying oil and gas, 99 Cent stores.

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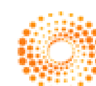

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Jonathan Bock - *Wells Fargo Securities, LLC, Research Division - MD and Senior Equity Analyst*

So those were -- and just to make sure I'm right. So again and maybe I didn't ask you right, but $183 million put to work in the BDC-or-so, $35 million done in concert, right, meaning that Oaktree bought somewhere else and one of their funds given exemptive relief. So you're saying that wasn't a CITGO hold that were -- or was it 99 Cent stores, what were those loans, again? Just to make sure we've got it right.

Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

I'm sorry. Maybe I misunderstood your question. So the one that was a coinvested with another Oaktree fund was Datto.

Jonathan Bock - *Wells Fargo Securities, LLC, Research Division - MD and Senior Equity Analyst*

Datto of which was $34 million. Okay. Great. So we'll leave this as, perhaps, kind of the exemplary new model in which you're going to be partnering with your other funds to write big checks. So walk us through the size of the overall tranche to Datto? And whether you were the lead agent on the transaction?

Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

In the case of Datto, we were not the lead agent on Datto. We were actually one of the largest lenders in Datto. We were the incumbent on one of the companies that was merged into Datto that was owned by the equity sponsor there.

Jonathan Bock - *Wells Fargo Securities, LLC, Research Division - MD and Senior Equity Analyst*

Okay. Okay. So...

Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

The overall tranche was much larger.

Jonathan Bock - *Wells Fargo Securities, LLC, Research Division - MD and Senior Equity Analyst*

What was the overall tranche size?

Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

I can get you the exact number. I don't want to miss -- misstate it up somewhere.

Jonathan Bock - *Wells Fargo Securities, LLC, Research Division - MD and Senior Equity Analyst*

No problem, we can search the loan services as well. Okay. So then, moving to a question of -- Matt, you talked about generating improved risk-adjusted returns for investors. And clearly, a 9.8% new secured loan originated by Oaktree given your relationships can be an attractive investment. But if you truly believe your NAV, why wouldn't you be looking to buy more of it at $0.75 on the dollar?

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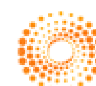

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Matthew Pendo - *Oaktree Specialty Lending Corporation - COO*

So let me make a couple of statements in which you're getting at in terms of that. We understand and appreciate the stock buybacks. I think that's what they're getting at, Jon.

Jonathan Bock - *Wells Fargo Securities, LLC, Research Division - MD and Senior Equity Analyst*

Yes, yes.

Matthew Pendo - *Oaktree Specialty Lending Corporation - COO*

So that's something we review with our board, and we're always looking at. So that's one piece of it. The other thing that you saw in last quarter and we have small open windows in volume and other restrictions, but Oaktree itself purchased shares of OCSL in the last open window. So I can't discuss any future plans regarding Oaktree, but that's something that did happen last quarter and we continue to look at.

Jonathan Bock - *Wells Fargo Securities, LLC, Research Division - MD and Senior Equity Analyst*

So we appreciate that, and we understand that it's a near tool of many to create shareholder value. Having a manager and as a buyer is also attractive, but to the extent that balance sheet is also used in that process is powerful as well. And then, as we think about the moves in the larger and in some of these kind of big ticket items. Again, Datto, for example, I understand that writing larger checks might be seen as a less competitive market given that there are only a few that can do it. That being said, that few continues to grow day-by-day with more folks raising capital. And given the competitiveness of public debt markets and I'm going to absent volatility recently, it would seem that the leverage is high and spreads continue to tighten and might be more so in this market relative to, perhaps, some of the lower-end of the middle market. Would you agree or disagree with that?

Matthew Pendo - *Oaktree Specialty Lending Corporation - COO*

Well, if we look at in the back, which you said, let's look at yields. Empirically, I think data would support that concept, that statement. But I think it would be missing an important aspect which is the risk profile of some of those situations and the leverage of those situations.

Jonathan Bock - *Wells Fargo Securities, LLC, Research Division - MD and Senior Equity Analyst*

Okay. I appreciate that. And then, just as a brief follow on. So CITGO, that was a additional add. So I mean, when I think of the Datto at $34 million that you added to, the additional $30 million of the oil and gas company was effectively just a new security where you were the only lender in the first-lien stack?

Matthew Pendo - *Oaktree Specialty Lending Corporation - COO*

No. We were not.

Jonathan Bock - *Wells Fargo Securities, LLC, Research Division - MD and Senior Equity Analyst*

Okay. So how was this deal originated?

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Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

In the oil and gas area, we were able to purchase it in the secondary market from other sellers.

Jonathan Bock - *Wells Fargo Securities, LLC, Research Division - MD and Senior Equity Analyst*

From other sellers at 9, 8.

Operator

The next, we have a follow-up question from Chris York.

Christopher York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

My follow-up question is big picture and reflective. So Edgar, you get in the driver seat for about 4 months now as external manager resulting from transformative acquisition at Oaktree. So as you look in the rearview mirror and reflecting the journey, I've been curious to learn what has been the biggest observation or the learning experience that you've come across managing the BDC relative to your expectations before acquiring the contract?

Edgar Lee - *Oaktree Specialty Lending Corporation - CEO & CIO*

I would say, generally, overall, it's been in line with our expectations, overall. I guess, I'll give you a couple of quick comments. One is, as I mentioned earlier, the velocity of the turnover in the portfolio has been above our expectations and that is we think going to be ultimately long-term beneficial for investors in terms of the valuation work and the work on the portfolio, we would say that's been actually, reasonably in line with where we thought it would be. But overall, I would say, it's generally been in line with where we thought we would be except for that the pace of the portfolio turnover has been more robust than we would have thought.

Operator

And this concludes our question-and-answer session. I would like to turn the conference back over to Michael Mosticchio for any closing remarks.

Michael Mosticchio - *Oaktree Specialty Lending Corporation - Investor Relations*

Thank you. And thank you, all, again for joining us for our first fiscal quarter 2018 earnings call. A replay of this conference call will be available for 30 days on OCSL's website in the Investors section or by dialing (877) 344-7529 for U.S. callers, or 4 -- or 1 (412) 317-0088 for non-U.S. callers, with a replay access code 10115438 beginning approximately 1 hour after this broadcast. Thank you.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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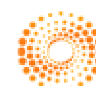

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