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Q4 2019 Oaktree Specialty Lending Corp Earnings Call

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PRESENTATION

Operator

Welcome, and thank you for joining Oaktree Specialty Lending Corporation's Fourth Fiscal Quarter 2019 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 - IR***

Thank you, operator, and welcome to Oaktree Specialty Lending Corporation's fiscal fourth quarter conference call. Our earnings release, which we issued this morning and the accompanying slide presentation can be accessed on the Investors section of our website at oaktreespecialtylending.com.

Our speakers today are Armen Panossian, Chief Executive Officer and Chief Investment Officer; Matt Pendo, President and Chief Operating Officer; and Mel Carlisle, Chief Financial Officer and Treasurer. We will be happy to take your questions following their prepared remarks.

Before we begin, I want to remind you that comments on today's call 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. Please refer to our SEC filings for a discussion of these factors in further detail. 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. The company encourages investors, the media and others to review the information that it shares on its corporate website.

With that, I will now like to turn the call over to Matt Pendo.

Mathew M. Pendo ***Oaktree Specialty Lending Corporation - President & COO***

Thank you, Mike, and welcome, everyone, to our fourth quarter earnings conference call. We appreciate your interest in and support of OCSL. We are pleased to report that the fourth quarter of fiscal year 2019 completed another strong year for OCSL.

We reported NAV per share of $6.60, finishing the year with our seventh consecutive quarter of increased NAV and full year NAV growth of $0.51 per share or 8.5%.

Net investment income was $0.12 per share for the fourth quarter consistent with the prior quarter and $0.48 for the fiscal year, up from $0.43 for the previous fiscal year. The annual growth reflected successful investment exits and realizations combined with lower operating and funding expenses.

We steadily monetized non-core investments over the fiscal year, which were reduced by $119 million or 37%. We also made progress reducing nonaccruals following the exits of four investments during the year.

In the fourth quarter, we received full repayment on one of our investments that was previously on nonaccrual. We also restructured an investment on nonaccrual status when we led the recapitalization of the borrower by converting our debt to equity and investing a modest amount of new capital.

I'd like to spend a few moments discussing these events in more detail.

Refac Optical Group, one of the largest optical retailers in the U.S., faced challenges last year following the departure of a key account, resulting in our loan not being paid off at maturity. We elected not to extend the maturity and instead entered into a forbearance arrangement with the company. We worked very closely with the private equity sponsor and management team on a solution to maximize value, and the company was able to sell one of its businesses, which covered the full $45 million of our debt at par, including all unpaid interest, default interest and fees.

This is an excellent example of our investment team's ability to proactively manage underperforming investments to maximize recoveries and deliver positive outcomes for our shareholders.

Another example during the quarter was the restructuring of our investment in Cloud5, formerly known as Thing5. Cloud5 is a provider of cloud-based IT hardware and services for the hospitality sector. The company experienced some headwinds following the loss of a large customer, and it went on nonaccrual status last year. We worked with the sponsor and management team to restructure our investment, converting our debt position to equity and providing a small amount of additional capital to support the company's expansion. As a result, we obtained a majority interest in the company, and there is no debt on the balance sheet, which we believe puts us in the best position to maximize recovery.

We are pleased with the recent performance of the company, and we are hopeful that it will continue to successfully execute its growth initiatives. Following these events, non-core investments have declined from $893 million since we began managing OCSL two years ago to $205 million or 16% of the portfolio. We continue to work diligently on maximizing the values of our remaining non-core investments, which we expect will continue to occur over time.

The fiscal year was also highlighted by our ongoing work to defensively position the portfolio. We remain focused on our risk-controlled approach to investing, lending to larger and more diversified middle-market businesses with lower leverage. As a result of our disciplined approach, our net new investments for the year did not match the pace of our portfolio payoffs and exits. And consequently, we paid down debt by approximately $160 million and reduced our overall leverage from 0.75x at the beginning of the year to 0.51x at year-end. At the same time, we made further improvements to our capital structure to reduce funding costs and improve our financial flexibility.

In February, we amended, extended and upsized our credit facility, resulting in better pricing terms and flexibility. And we received shareholder approval to modify asset coverage requirements, providing more cushion on financial covenants. And finally, as you know, on September 30, Armen Panossian was appointed CEO and CIO of OCSL. Armen has assumed portfolio management responsibilities for Oaktree's BDCs and Strategic Credit, the team that is responsible for managing OCSL's portfolio.

Armen is a respected investor with extensive experience in opportunistic and performing credit. He joined Oaktree in 2007 as a member of our distressed debt investment team, where he focused on many of the group's successful credit investments. In 2014, he moved on to our U.S. senior loan strategy, where he assumed portfolio management responsibilities. In this role, Armen built an impressive track record that included improved performance and growth in our U.S. Senior Loan strategy and strong returns in Oaktree CLOs.

Armen's background, investment acumen and significant leadership experience makes him the ideal leader for OCSL. We are fortunate to have a deep bench of highly talented investment professionals and leaders to draw from at Oaktree, and we are confident that Armen will lead the company to its best years ahead.

With that, I will now turn the call over to Armen.

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

Thanks, Matt, and hello, everyone. Before discussing the market environment and the portfolio, I'd like to say that I'm thrilled to be part of OCSL's management team. I'm excited to lead the company in its next chapter, and I look forward to meeting with many of you over the weeks and months ahead.

As Matt mentioned, I've been at Oaktree for nearly 13 years, starting in our distressed debt group and then went on to run our U.S. Senior Loan group. While I managed a different strategy, I'm quite familiar with the Strategic Credit investment team and the BDCs. Throughout my career at Oaktree, I have spent a lot of time working with the Strategic Credit team, oftentimes investing alongside them. In fact, I even hired some of the professionals who are now on that team. I'm fortunate to join and manage a very strong team that has done an outstanding job in repositioning and managing OCSL's portfolio over the past two years. I look forward to building upon all of their great work.

Now I'll share our view on the overall market environment. The direct lending and syndicated loan markets continue to be impacted by the same trends that we have been experiencing for the last couple of years. There continues to be an abundance of capital, willing to invest in the space, which is mainly driven by ongoing demand from institutional investors, including BDCs, CLOs and other private lending vehicles. As a result, the market remains very competitive and borrower friendly. We continue to see tight spreads in both the direct lending and broadly syndicated loan markets, with spreads in the direct lending market tightening relative to the broadly syndicated loan market.

Borrower fundamentals, meanwhile, remain relatively stable as they continue to benefit from the steadily growing U.S. economy. However, we are seeing signs of weakness in certain sectors of the economy, as well as isolated company-specific events and credit deterioration in certain loans held by a number of direct lending funds. We believe that this could create more attractive investment opportunities for OCSL down the road. While we remain disciplined and defensive in our investment approach, we are mindful of relative value and investing where we can find the best risk-adjusted returns.

As a reminder, drawing upon the vast resources of the Oaktree platform, we are able to source from multiple origination channels, including middle-market sponsor finance, nonsponsor, broadly syndicated loans and bonds. This diversity provides us with a unique set of investment opportunities and allows us to optimally construct our portfolio.

Given these dynamics, we originated $138 million of new investment commitments across nine issuers during the fourth quarter. Four of these were add-ons to existing borrowers, while the balance were made in the primary and secondary markets.

Our largest origination this quarter was to PaySimple, also known as Evercommerce, a service commerce platform that provides business management, integrated payments, marketing and other solutions to small- and medium-sized businesses. The company was seeking capital to support future growth initiatives and to recapitalize its balance sheet following an equity investment by a prominent private equity firm. In aggregate, Oaktree funds invested $60 million in the first lien, of which OCSL was allocated $38 million. The loan is attractively priced at LIBOR plus 550 basis points and was supported by a healthy equity cushion of 77%.

The average yield for all of our debt originations was 7.7%, down modestly from the previous quarter, and 89% were first liens. While our conservative approach has resulted in a slightly lower overall yield on new investments, we are confident that this is a prudent way to invest today, especially given the current competitive market environment.

Looking ahead, despite the broader competitive market dynamics, we are currently evaluating a number of interesting opportunities in our pipeline, including investments in the sponsor and nonsponsor markets that we believe present an attractive risk reward. That said, we continue to be patient, yet opportunistic in our investment approach, and we believe we are well positioned today with ample liquidity to take advantage of new investment opportunities in our pipeline.

Turning to the overall portfolio. The portfolio's characteristics were relatively stable from the June quarter. At September 30, we held $1.4 billion of investments across 104 portfolio companies in 49 industries. 79% of our investments were senior secured loans, of which 54% were first lien, 6% was in unsecured debt, 7% was in equity and LP interests and 9% consisted of investments in the Kemper JV.

We remain focused on defensively positioning OCSL's portfolio by maintaining diversity across issuers and borrowers, focusing on senior secured opportunities and lending to larger, more diversified businesses with lower leverage levels. To that end, the median portfolio company EBITDA increased to $155 million from $103 million in the same period one year ago. Leverage at our portfolio companies was relatively unchanged at 5.0x, well below our overall middle market leverage levels, which remain elevated.

In summary, we are pleased with the composition of our portfolio and with the ongoing progress of reducing the size and risk in the non-core portfolio. Fiscal 2019 was a solid year for OCSL, and we believe we are well positioned to continue to deliver attractive risk-adjusted returns to our shareholders in 2020.

Now I will turn the call over to Mel to discuss our financial results in more detail.

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

Thank you, Armen. OCSL delivered another quarter of solid financial performance, which also contributed to strong full year results.

During the fourth quarter, total investment income was $34.5 million, down from $36.7 million in the third quarter. The $2.2 million decline was due to lower interest and dividend income and was partially offset by higher fee income. Interest income was down by $2.3 million quarter-over-quarter, mainly due to higher OID acceleration on loan payoffs that we received in the June quarter as compared to the September quarter. In addition, interest income was lower due to the decline in LIBOR during the quarter as well as a smaller portfolio. Dividend income was lower by $600,000, primarily the result of the sale of an aircraft in our aviation subsidiary in the June quarter.

We recorded higher fee income quarter-over-quarter mostly due to higher prepayment fees from a number of loan payoffs, with the Refac exit being the largest contributor. Overall, the Refac monetization generated $3 million in interest income and fees in the fourth quarter. For the full year, total investment income was up $9 million, driven mainly by higher OID accretion and average interest income which was partially offset by lower dividend income.

Net expenses for the fourth quarter totaled $18.2 million, down $1.8 million from the June quarter. The decline was primarily driven by lower interest expense and lower incentive fees, mainly due to the decrease in investment income. For the full year, operating expenses decreased by $3.2 million as we reduced professional fees and other G&A expenses year-over-year.

Turning to net asset value. NAV was $6.60 per share at year-end, consistent with this level at June 30, and up 8.5% for the full year, contributing to the puts and takes for the fourth quarter was income in excess of our dividend and net gains on exited investments, primarily offset by unrealized write-downs of some of our quoted investments.

Moving to credit quality, as of September 30, three investments representing less than $3 million at fair value were on nonaccrual status, which represented just 0.2% of the debt portfolio. This is down from 6.4% in the June quarter and 9.6% at its peak in the December 2018 quarter.

The quarter-over-quarter decrease was mainly due to the two events that Matt discussed. First, the successful exit of our investment in Refac; and second, the restructuring of our debt investment in Cloud5, which is now classified as equity.

With respect to leverage, our leverage ratio decreased to 0.51x from 0.58x on June 30, as the portfolio shrank slightly during the quarter. We experienced $139 million in payoffs and exits, which was greater than the $129 million of investment fundings. As of year-end, total debt outstanding was $476 million and had a weighted average interest rate of 4.8%, down slightly from the June quarter. Cash and cash equivalents were $15 million at September 30, and we had ample liquidity with $385 million of undrawn capacity on the revolving credit facility.

Shifting now to the Kemper joint venture. As of September 30, the JV had $361 million of assets invested in senior secured loans to 51 companies. This compared to $349 million of total assets invested in the same number of companies last quarter. Leverage at the JV was 1.2x at year-end, down slightly from the June quarter. Taking into account the settlement of all trades, net leverage would have been 1.4x. As a reminder, we also enhanced the joint venture's capital structure during the year by amending and increasing the size of its credit facility from $200 million to $250 million. The JV credit facility had $80 million of undrawn capacity at year-end.

Now I will turn the call over to Matt.

Mathew M. Pendo ***Oaktree Specialty Lending Corporation - President & COO***

Thank you, Mel. We continue to effectively execute and deliver solid returns for OCSL through a number of initiatives.

First, our ongoing progress positioning the Kemper JV for long-term success continued in the latest quarter. We added $46 million of new investments across seven issuers. Leverage was 1.2x, well below our longer-term target of 2.0x, leaving us plenty of runway to invest in opportunities.

We also continue to reduce our holdings of noninterest-generating investments, redeploying the capital into new investments. We received proceeds of $49 million from the exit of Refac, which can now be invested in income-producing assets. To illustrate the impact that these proceeds can have on earnings, assuming we are able to invest $49 million at our current debt portfolio yield of 8.9%, OCSL's ROE would increase by approximately 40 basis points annually. Following the exit of Refac, noninterest-generating investments were $102 million at quarter-end, a decrease from $152 million in the prior quarter.

Additionally, OCSL has the ability to increase returns by deploying more leverage at the portfolio level. While we have no near-term plans to exceed our target range of 0.7 to 0.85x, we are currently operating at 0.5x. So we have the opportunity to enhance returns as we find attractive investments and deploy higher leverage.

Turning now to the dividend. This morning, we announced a $0.095 dividend that is consistent with the prior six distributions. We intend to continue paying sustainable and consistent dividends that are supported by portfolio performance.

In conclusion, we are proud of our strong fourth quarter results and our work to reshape the portfolio by investing in assets that are consistent with Oaktree's disciplined, risk-controlled approach. As we look to fiscal 2020, we are confident that we have positioned OCSL's portfolio for continued strong earnings. We will continue to strategically leverage Oaktree's significant platform to identify attractive risk-adjusted investment opportunities that deliver value to our shareholders. Thank you for joining us on today's call and for your continued interest in OCSL.

With that, we're happy to take your questions. Operator, please open the lines.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

The first question is from Kyle Joseph with Jefferies.

Kyle M. Joseph ***Jefferies LLC, Research Division - Equity Analyst***

Start off on yields, I know you highlighted that yield on new investments has come down a bit. But if you look at the overall portfolio, the yields have really hung in there and are actually up a bit year-over-year. Is that primarily a function of just portfolio rotation and rotating nonincome-producing securities into actual income-producing assets?

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

Yes, that's exactly right. This is Armen speaking. We have been able to deploy some nonincome-producing assets into income-producing loans.

Kyle M. Joseph ***Jefferies LLC, Research Division - Equity Analyst***

Got it. And then looking at repayments. Obviously, they've been elevated, but can you give us a sense for your outlook for repayments now that the non-core book is -- has gotten to be the size that it is.

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

On the non-core specifically or on the overall portfolio?

Kyle M. Joseph ***Jefferies LLC, Research Division - Equity Analyst***

Overall portfolio, would you anticipate repayment levels kind of subsiding, given how much of the legacy book you guys have already exited?

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

It's hard to predict the pace of repayments, we feel good about the book. And when you do have a high-quality book with good borrowers in it, you tend to see repayments more frequently than you would like, but I don't think we can make a prediction on the pace of repayments, unfortunately.

Kyle M. Joseph ***Jefferies LLC, Research Division - Equity Analyst***

Got it. That's fair. And then one last one for me. Obviously, nice job exiting 2 nonaccruals. But of the assets you guys have originated, can you give us a sense for performance there, both in terms of revenue growth and EBITDA growth and any sort of -- any changes you've seen over the last 3 months?

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

Yes, it's a good question. And I wouldn't say that there is a meaningful median or mean. But anecdotally, I would say, in the U.S. economy, in both broadly syndicated loans that we would look at and some of the private loans that we look at, revenue growth is in the mid-single digits. EBITDA, it really depends on the company and the industry. We've seen most businesses, I would say, have anemic EBITDA growth despite having some revenue growth. Part of the challenges in terms of profitability is a tight labor market, as well as some volatility in commodities. So I wouldn't say there's a tremendous takeaway other than the market and the economy is stable, but I wouldn't say it is as strong as it was 2 or 3 years ago in terms of year-over-year revenue and cash flow growth.

Operator

The next question is from Rick Shane with JP Morgan.

Melissa Marie Wedel ***JP Morgan Chase & Co, Research Division - Analyst***

It's Melissa on for Rick today. Armen, congratulations and welcome. I was hoping you guys could touch on the equity position. I understand you did the restructuring, I believe it was Cloud5, you said and restructured that deal and took some equity instead of debt, made a small incremental investment. Given that you do want to ultimately rotate out of the illiquid or sort of nonincome-producing positions, how high might you be willing to take the equity component of that portfolio if other restructuring opportunities come up?

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

Thanks for the question, Melissa. It's really a case-by-case basis. I don't -- we don't have a target in mind in terms of equity. In fact, we would like to have the equity position at zero. But with that said, we are always looking to maximize outcomes and recoveries given challenging situations on behalf of our shareholders. And so sometimes you have to take equity to do that and to be able to bridge to a medium- or longer-term outcome that we think is value-maximizing.

Mathew M. Pendo ***Oaktree Specialty Lending Corporation - President & COO***

Yes. Melissa, it's Matt. The point I would make is, since we've taken over the management of the BDC, we've worked name by name to reach at what, we think, is the best outcome as opposed to, kind of setting parameters or a broad-brush approach. It's really just been name my name. We think that results in the best outcome, and we're going to continue to do that.

Melissa Marie Wedel ***JP Morgan Chase & Co, Research Division - Analyst***

Okay. I just...

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

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I would also mention in terms of equity, also, I mean, once in a while, we do invest in some warrants along as kind of a kicker attached to some of our loan positions, but those are just more yield enhancement rather than a strategic view towards adding equity.

Melissa Marie Wedel ***JP Morgan Chase & Co, Research Division - Analyst***

Got it. And can you remind me, was Cloud5 a legacy investment? Or is that one that came from your team?

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

No, it's a legacy investment.

Melissa Marie Wedel ***JP Morgan Chase & Co, Research Division - Analyst***

Okay. I guess my last follow-up question for you would be around the syndicated market, and apologies if I missed it and you covered it already. Given some volatility in that space and an increased allocation, kind of, opportunistically there something you guys are considering?

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

We're always considering relative value between bonds, loans and private debt. And you're right that the broadly syndicated market is a little bit more dislocated than either high-yield bonds or direct lending. The reason for that is there's been over $50 billion of retail outflows out of the broadly syndicated market over the last 12 months. And CLO formation, while it's been strong most of the year, it's tailed off here in the fourth quarter. And so that buyer base, which is actually a very rating-sensitive buyer base is a little bit weaker than it was. But even away from the CLO investor universe, there really isn't incremental fund formation of meaningful scale to buy loans that aren't structured optimally for CLO execution. So if you do have a B3 corporate family rating loan and if it's a loan that was done perhaps 2 years ago with spreads that are -- that were tighter than they should be today, those loans are trading at a discount in the mid-90s. And so we are seeing some opportunities to invest in that space. But obviously, we're not looking to add credit risk of meaningful scale into OCSL. And so it's really a relative value case-by-case underwriting, but we are seeing some opportunities there.

Operator

Your next question is from Ryan Lynch with KBW.

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

First, Armen. Welcome to your new position as CEO of OCSL.

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

Thank you.

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

As I look at your background, Armen, you are the head of Oaktree's performing credit, which includes really oversight of senior loans, high-yield bonds, convertibles, structured credit, emerging markets, mezzanine as well as the direct lending strategy as well as the BDCs now. That's a very wide range of very heavy responsibilities. So how are you allocating your time? And how do you have enough time to allocate to actually be focused in on OCSL managing that entity?

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

That's a great question. And I think it's a multipart answer. First, the team that manages Strategic Credit and the BDCs is in place, and it's a team that I know very well. And so there is sort of a seamless transition as it pertains to that team remaining and managing the portfolio.

Second, Edgar and I joined Oaktree at roughly the same time in the distressed debt group, sort of grew up together in the distressed debt strategy, have a very similar view on credit and a view on investing informed by how things evolved in the global financial crisis. Given that background, it was the most natural fit for me to take over for Edgar upon his departure. And we think that there will be really very little to no style drift just given that consistency in background and investment type.

In terms of my other responsibilities, I'm fortunate to have a team of portfolio managers managing each of the individual strategies. And so my responsibilities are more in terms of oversight and information sharing across the various strategies in terms of knowing where the most attractive relative value resides, best practices across those different strategies and geographies. And so I'm not digging in on emerging market investments on a single-name basis. But interfacing with our portfolio managers in each of those underlying strategies is actually, I believe, linear to the benefit of our OCSL shareholders because we will have a view on adjacent asset classes that may influence both technical and fundamental outcomes that could be interesting for OCSL. And it is certainly more than a full-time job, but my attention is very much focused on the Strategic Credit strategy in terms of portfolio management responsibilities.

Obviously, OCSL is a very material part of that. And we're really looking to expand our reach in the origination there. The other thing I would say is, while I was the portfolio manager for our Senior Loan strategy. I did, earlier this year, promote one of our senior members of that team to become an assistant portfolio manager, and now he has taken over as the sole portfolio manager for that strategy upon my departure from that group and appointment as CEO of OCSL. So it's certainly busy, but it's very manageable. And I think it's a very exciting time to be able to look across different asset categories and invest in OCSL with that knowledge in mind.

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

Okay. That's really helpful and really good color and background on the transition and how you split your activities. I had a question on capital deployment and leverage utilization. Basically since Oaktree has taken over this entity, we've continued to see your leverage continue to decline. And there was one quarter where it increased, but basically every quarter has declined. Now I know within that, there's a lot of rotating out of non-core assets that can probably push up repayments a little bit over this time period. But you guys have a leverage target of 0.7 to 0.85. You guys are now at 0.51, so significantly below that. Can you guys grow leverage? And how important is it to utilize higher leverage in this competitive environment, that doesn't really seem to be meaningfully changed, while still being patient and prudent and sticking to your knitting?

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

Yes. I mean, there's certainly a balance there. We would like to get our leverage levels up into the range that we have indicated. The fact that we're below that is because we just haven't seen attractive direct loan -- direct lending opportunities. As you know, there's been a significant amount of fund formation in direct lending over the last 5 to 7 years, the assets under management in that asset class have more than doubled in that time frame. And we feel that chasing highly cyclical businesses in direct loans that are highly levered, and as spreads have tightened in, the typical sponsor-backed direct loan that we're seeing getting done in the market is just not attractive enough from our perspective. And so we would like to originate loans that are a little bit off the beaten path, more opportunistic in nature, lower levered and working with borrowers that maybe just aren't the classic fit for a typical direct lending fund or for OCSL execution. And as you might imagine, to be able to do that requires a meaningful investment in origination, it requires patience and it requires turning over a lot of stones until you find a real nugget of value. That's what we're focused on doing. We will increase leverage as we do widen our pipeline or increase our pipeline. But we're also not going to chase the highly cyclical market that is developed at this point in direct lending.

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

Okay. Yes, I appreciate the willingness to be patient and prudent in an environment that is very competitive and where you may not be seeing some of the best risk-adjusted returns. But that would bring me, I guess, to maybe my next question regarding share repurchases. If the market environment, you don't deem attractive opportunities outside of your existing portfolio to the level to actually grow the portfolio and increase leverage, one way you can do that is purchase shares, particularly if you're trading at a significant discount to book value, which you are. So what are your views on share repurchases?

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

Well, we've considered many different ways to enhance shareholder value. On share repurchases, we are not advocating doing that at this time. First of all, it reduces the float on the shares. And second, we would like to use our capacity that we have in OCSL to grow the book. I am obviously very familiar with what sort of a pipeline we have seen this year. But I do think that we need to make a renewed effort to looking at more deals, expanding our pipeline, widening our funnel. And so I'm not prepared to say that we have turned over all the stones that we need to turn over before we could advocate a share buyback.

Mathew M. Pendo ***Oaktree Specialty Lending Corporation - President & COO***

And Ryan, it's Matt. Just to add to that, and it's a very good question, and we've discussed it with our Board every time we get together. The one other thing to add to Armen's answer is one of the things that, as we mentioned previously, we're very focused on is obtaining an investment-grade rating. So increasing our leverage through share repurchase, obviously, is something that, from a ratings perspective, is not a positive. So that's just one other consideration that we add to the mix whenever we look at this.

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

Yes. No, that make sense trying to get the investment-grade rating. I Get the negative that it has on that. I would just say, as a follow-up -- and I also understand the want to grow the portfolio versus actually repurchase shares, but I would say in the absence of portfolio growth, which hasn't happened really over the last couple of years, it seems that share repurchases could be a nice complement to that.

So that's all -- those are all my questions. I appreciate the time today.

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

Thanks, Ryan.

Operator

(Operator Instructions)

The next question is from Jim Young with West Family Investments.

James Young ***West Family Investments, Inc. - VP & Investment Analyst***

Armen, you'd mentioned that you're seeing some weakness in certain parts of the economy. Could you elaborate and be a little bit more specific, please?

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

Sure. Well, energy, obviously, we are seeing both exploration and production companies as well as services attached to those businesses having problems both on the onshore and offshore part of that market. We are seeing some commodity-oriented weakness in some chemicals. We are seeing some autos slow because -- especially, those that are exposed to Europe and China. So I wouldn't say the pockets of weakness are necessarily tied to one another, but there are some idiosyncratic issues developing in the markets that we're watching.

And the other thing is, I would say, generally, leverage levels are higher today than they were 5 years ago, 4 years ago. And companies, especially leverage buyouts that were very aggressive in nature and included significant synergy assumptions, I would say that those haven't worked out on a broad basis. And therefore, those companies that were supposed to grow into their capital structures have not, I would say, by and large. But there certainly are outliers there. There are businesses that have done quite well in executing on synergies. So I wouldn't say it's every business out there, but the markets have been very aggressive and forgiving, and that we expect will come home to roost at some point?

James Young ***West Family Investments, Inc. - VP & Investment Analyst***

And the second question is that you'd mentioned that if you redeploy some of the assets from nonincome to income-producing that it'd basically benefit the ROE by about 40 basis points on an annualized basis. Can you give us a similar benchmark, if you increase leverage from 0.5x to 0.6x, what would be the incremental ROE benefit on an annualized basis? And is that a benefit? Is that a linear benefit?

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

Yes, this is Armen, again, I think we should probably follow up off-line on that. I don't have that on the tip of my tongue, but we're happy to run that calculation and get it to you off-line, if you'd like.

Mathew M. Pendo ***Oaktree Specialty Lending Corporation - President & COO***

Yes. And Jim, it's Matt. I was never very good at math. So let me make sure I get the numbers right before we give it out on a recorded line.

Operator

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

Michael Mosticchio ***Oaktree Specialty Lending Corporation - IR***

Thank you again for joining us for our fourth quarter earnings conference call. A replay of this 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 1 (412) 317-0088 for non-U.S. callers, with the replay access code 10135791, beginning approximately 1 hour after this broadcast.

Operator

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