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Q4 2023 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 and Year-End 2023 Conference Call. Today's conference call is being recorded. (Operator Instructions)

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

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

Thank you, operator, and welcome to Oaktree Specialty Lending Corporation's Fourth Fiscal Quarter and Year-end 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.

Joining us on the call today are Armen Panossian, Chief Executive Officer and Chief Investment Officer; Matt Pendo, President; Chris McKown, Chief Financial Officer and Treasurer; and Matt Stewart, our Chief Operating Officer.

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, the expected synergies and savings associated with the merger with Oaktree Strategic Income II, Inc., the ability to realize the anticipated benefits of the merger and 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 of its shares on its website.

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

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

Thanks, Mike, and welcome, everyone. Thank you to all on the call for your interest in and support of OCSL.

We generated strong fourth quarter and full year results, supported by attractive new deployment activity, elevated repayments, tailwinds from higher interest rates, as well as the completion of our merger with Oaktree Strategic Income II, Inc. or OSI2 in January. Full year fiscal 2023 adjusted NII was $2.47 per share, up from $2.12 for fiscal 2022. These results reflect growth in the earnings power of our portfolio over the course of the year, driven by higher interest income from our predominantly floating rate portfolio, combined with wider spreads on new investments and bolstered by synergies from the OSI2 merger.

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We delivered our highest annual level of adjusted net investment income under Oaktree's management, building upon the momentum we have generated since taking over management of the company six years ago. Based on the ongoing strength of our earnings, our board approved a quarterly dividend of $0.55 per share, which was consistent with the prior few quarterly distributions. Our board also declared a special distribution of $0.07 per share in an effort to pay out substantially all taxable income for the year and minimize the possibility of paying excise tax.

Now looking at our fiscal fourth quarter results, adjusted net investment income per share was $0.62 for the quarter, consistent with the prior quarter. We reported NAV per share of $19.63, up $0.05 per share from the prior quarter. The quarterly increase was mainly the result of earnings in excess of our quarterly dividend and steady marks in our portfolio. Our investment activity was lighter in the fourth quarter at $87 million of new investment commitments. Armen will provide more detail, but in summary, the relatively modest origination total for the fourth quarter reflected the seasonal summer slowdown in our market as well as our highly selective approach to investing amid the uncertainty in the current economic environment. That said, we continue to see a steady stream of opportunities and overall deal flow is healthy as we move into our new fiscal year.

Despite the more muted quarter, we had solid originations in full year 2023 as we leverage the Oaktree platform to originate over $700 million of new investment commitments representing about 25% of the portfolio today. This is particularly noteworthy, given these assets were originated during one of the most detractive environments for private credit that we've experienced in recent memory, driven by higher interest rates, resulting in attractive deal characteristics such as lower leverage and loan to values, better terms and wider spreads.

On the repayment front, we received $364 million from paydowns and exits in the fourth quarter. While market activity has been generally slower given higher interest rates and fewer M&A transactions, we continue to receive steady levels of repayments including in some of our junior debt positions, and we have also been opportunistically selling out public debt investments. In total, about 30% of our portfolio turned over in fiscal year 2023. We believe this is attributable to our differentiated portfolio of private loans, and we have also been opportunistically selling some of our public debt based on the recent strength in the credit markets.

Over the course of the fiscal year, our portfolio turnover has resulted in a positive shift in our investment composition. We've seen our first lien investments increase from 71% as of September 30, 2022, to 76% as of September 30, 2023. At the same time, we've experienced a decline in second lien investments, which decreased from 16% to 10% over the same period. This shift underscores our emphasis on improving the risk return profile of our portfolio and aligning our investments with the ever-evolving market conditions.

Credit quality improved modestly during the quarter and remains solid overall, with four investments on nonaccrual status at quarter end, representing just 1.8% of the portfolio at fair value and 2.4% of the portfolio at cost.

As I noted earlier, the merger with OSI2 continues to positively impact our business. We have been realizing the benefits of scale gained from the transaction and remain on track to achieve $1.4 million worth of operating expense synergies on an annual basis. We've also been working to further bolster OCSL's capital structure post-merger. In the June quarter, we increased the size of our syndicated credit facility to $1.2 billion from $1.0 billion and extended the maturity by two years to 2028 without an increase to the spread that we borrow at of 200 basis points over SOFR. We also consolidated the credit facility acquired from OSI2 with our existing Citibank facility and pushed out the maturity by two years to 2027. Most recently in August, we successfully issued $300 million in senior notes due in 2029. Together, these transactions improved our funding profile by boosting our unsecured borrowings to 57% and investment capacity to over $1 billion, which allows us to pursue continued growth in the years ahead.

With that, I would like to turn the call over to Armen to provide more color on our portfolio activity and the market environment.

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

Thanks, Matt, and hello, everyone.

I'll begin with comments on the market environment. The economy grew in the calendar third quarter, supported by a strong U.S. job

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market. However, broader macro conditions remain vulnerable due to the presence of higher interest rates and slowing earnings growth. This is particularly evident in the leveraged credit markets where we believe investors are increasingly exposed to tail risks. These risks arise as borrowers struggle to service increasingly expensive debt, especially those that are burdened with high costs on floating rate loans, which have become more expensive following the Fed's aggressive campaign to raise interest rates over the past two years.

When we examine this further, we see that many companies, particularly those with outstanding leveraged loans or private debt borrowed heavily at a time when interest rates were near zero. As a result, they now have capital structures that may be unsustainable in today's higher-for-longer interest rate environment. Importantly, the amount of debt represented by these markets is substantial. Not only have the U.S. broadly syndicated loan and private credit markets grown roughly twofold and sevenfold, respectively, since the global financial crisis of 2008, but the proportion of lower quality debt in these markets has also increased. By the end of the third calendar quarter, loans of credit ratings of B or below represented almost 75% of U.S. leveraged loans compared to roughly 35% prior to the financial crisis.

When the weakest segment of the credit markets is both sizable and more vulnerable than usual, investors face a heightened risk of increased defaults and lower-than-anticipated recovery rates. If this were to happen, both performing and distressed credit investors are likely to encounter an expanded set of challenges and opportunities.

At Oaktree, as we have navigated through many economic cycles, we've gained valuable experience that has allowed us to capitalize on opportunities, which is why we are optimistic about what might be ahead for OCSL. Our ample capital and commitment to navigating short-term volatility have been instrumental in our success to date and of our strategy moving forward.

To be sure, we believe caution remains necessary. But we are confident in the resilience of our portfolio that is well equipped to endure any potential economic downturn. This is evidenced by our elevated repayment activity throughout the fiscal year, highlighting the strength of our portfolio. We expect to continue selectively investing across both the sponsor and nonsponsor backed markets, methodically pursuing attractive opportunities as they arise.

Now turning to the overall portfolio. At the end of the fourth quarter, our portfolio was well diversified at $2.9 billion at fair value across 143 companies. We continue to focus on investing at the top of the capital structure, favoring larger, more diversified businesses to contain risk. 86% of the portfolio was invested in senior secured loans, with first lien loans representing 76% of the portfolio at fair value. Median portfolio company EBITDA as of September 30 was approximately $109 million and leverage in our portfolio companies was steady at 5x, well below overall middle market leverage levels. The portfolio's weighted average interest coverage based on trailing 12-month performance was steady at 2.2x.

In the September quarter, we originated $87 million of new investment commitments across three new and three existing portfolio companies. All of these originations were first lien, including a $41 million add-on commitment to Keter, an end-to-end recycling and waste managed services company. We also committed $30 million across two prominent application software companies: Forcepoint, a provider of network security and Finastra, a global financial software company. I wanted to spend a few moments to delve into our approach to lending to the software sector, which now represents 16.5% of our total investments.

First, we focus on lending to large enterprise software businesses with mission-critical solutions that deliver significant added value to their customers. Second, we look for companies with a diverse customer base, reducing their reliance on any single industry and enhancing overall performance stability. Third, we generally partner with a select group of private equity sponsors that have significant domain experience in the sector. And finally, we have deliberately steered clear of the more aggressively priced transactions prevalent in the market in 2021 and 2022. As an experienced investor in this space, we believe that the risk/reward proposition in most of these deals wasn't favorable. As a result, we passed on all of the software transactions we evaluated from September 2021 through September 2022.

As we begin the new fiscal year, our origination activity is steady. We have a strong pipeline of opportunities that we anticipate will fund prior to calendar year-end.

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Turning to credit quality. We've experienced positive developments in our nonaccruals, which declined to 2.4% and 1.8% of the portfolio at cost and fair value, respectively. These improvements were largely attributable to the successful resolution of Athenex, which was fully repaid during the fourth quarter. As you may recall, we placed our investment in this company on nonaccrual earlier in the year after it was unable to secure approval of a key prescription drug. We had structured the loan with strong downside protection and held a senior position, which allowed us to secure repayment at par plus accrued interest and fees as the company sold assets and used the proceeds to pay off what it owed to OCSL, resulting in a realized IRR of about 20%.

Another portfolio company, SiO2, emerged from bankruptcy in August. We restructured our investment, which allowed us to place the first lien term loan back on accrual status. However, we did add a new investment to nonaccrual status in the quarter. Continental Intermodal Group, a provider of integrated logistics infrastructure and solutions to the oil and gas industry. This investment, which was made just prior to the onset of the COVID pandemic in January 2020, involved the financing from Oaktree to refinance existing debt. Over the past few years, the company has faced challenges related to the evolving landscape in oil and natural gas exploration. Nevertheless, because of structural protections in our loan, OCSL has been repaid on roughly 70% of its original funded amount to date, and the position had $16 million of fair value as of September 30, 2023. While the company is exploring options, we felt it was prudent to place it on nonaccrual status at this time.

It is important to note that our overall portfolio is in solid shape. And with each of these nonaccruals, we are leveraging Oaktree's extensive experience and workouts to achieve successful outcomes on behalf of our shareholders. In short, our robust capital and liquidity position, coupled with the resources of Oaktree, give us tremendous confidence in our ability to succeed in the years ahead.

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

Christopher McKown ***Oaktree Specialty Lending Corporation - CFO & Treasurer***

Thank you, Armen.

OCSL delivered another quarter of strong financial performance, finishing the fiscal year 2023 on a high note. For the fourth quarter, we reported adjusted net investment income of $47.8 million or $0.62 per share, up from $47.6 million and consistent with $0.62 per share in the third quarter. The slight increase on a dollar basis was primarily driven by higher adjusted total investment income and lower base management fees, which was partially offset by higher interest expense.

Net expenses for the fourth quarter totaled $54.4 million, up $0.9 million sequentially. The increase was mainly driven by $1.5 million of higher interest expense due to the impact of rising interest rates on the company's floating rate liabilities and was partially offset by lower base management fees due to a slightly smaller portfolio and continued realization of operating synergies from the OSI2 merger. As a reminder, we waived $1.5 million in fees during the quarter as part of the OSI2 merger.

Now moving to our balance sheet. OCSL's net leverage ratio at quarter end was 1.01x, down from 1.14x at the end of the June quarter as proceeds from repayments, exits and sales exceeded funded investment activity by $247 million in the quarter. That said, our net leverage continues to be within our targeted range of 0.9x to 1.25x. As of September 30, total debt outstanding was $1.7 billion and had a weighted average interest rate of 7.0%, including the effect of our interest rate swap agreements, up from 6.6% at June 30 due to the impact of higher interest rates. Unsecured debt represented 57% of total debt at quarter end, up from 36% at the end of the prior quarter. The mix has shifted due to our successful senior note offering in August, where, as Matt noted, we raised $300 million of senior unsecured notes due in 2029 at a rate of 7.1%.

In connection with the notes offering, we entered into an interest rate swap agreement whereby we received a fixed interest rate of 7.1% and pay a floating rate based on a three-month SOFR plus 3.126% on the entire notional amount of the notes. We view this as a natural hedge against our primarily floating rate assets in the event of short-term rates decline down the road.

At fiscal year-end, we continue to have ample liquidity to meet our funding needs with total dry powder of approximately $1 billion, including $136 million of cash and $908 million of undrawn capacity on our credit facilities. Unfunded commitments, excluding the unfunded commitments to the joint ventures, were $206 million with approximately $154 million eligible to be drawn immediately

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whereas the remaining amount is subject to certain milestones that must be met by portfolio companies before funds can be drawn.

Now turning to our two joint ventures. Our JVs continue to deliver robust performance to OCSL. Together the JVs currently hold $446 million of investments, primarily in broadly syndicated loans spread across 50 portfolio companies. For the quarter, the JVs generated ROEs of over 15%, a testament to the solid underlying credit quality and the positive impact of higher interest rates on the predominantly floating rate loans. Additionally, we received a $1.1 million dividend from the Kemper JV, which was consistent with the prior quarter. Leverage at each of the JVs remained generally in line with the prior quarter of 1.2x.

During the quarter, we drove down funding costs at our JVs by refinancing the credit facilities in each vehicle. We put in place new three-year facilities with a new lending partner and were able to reduce pricing by 75 basis points, SOFR plus 200 basis points. We are pleased with this outcome as it will be accretive to the ROEs of the JVs.

In summary, we are very pleased with our financial results for the quarter and the fiscal year, and we continue to believe that our strong balance sheet positions us well for fiscal year 2024.

Now I will turn the call back to Matt for some closing remarks.

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

Thank you, Chris.

Our strong financial performance for both the quarter and full year has enabled us to generate an annualized return on adjusted net investment income of 12.6% during the September quarter and 12.1% for the full year. Our results have been underpinned by several factors. We've been experiencing the benefits of rising interest rates and have had successful investment repayments and sales while maintaining discipline in our capital deployment. Our balance sheet has been strengthened through our recent notes offering, providing us with ample liquidity to invest. And as Chris noted, our joint ventures have excelled, consistently delivering mid-teen returns on equity in the most recent quarter.

Looking ahead, we are committed to maintaining our strong performance as we remain disciplined in all aspects of our operations. Our portfolio continues to be very well positioned, and our robust relationships and deep underwriting expertise equip us to capitalize on any future volatility that might arise in the market. We are proud of our growth and our earnings over the past several years and are confident that we remain very well positioned to continue delivering attractive returns going forward. As always, we appreciate your participation on the call today and for your interest in OCSL.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

At this time, we will take our first question, which will come from Bryce Rowe with B. Riley.

Bryce Rowe ***B. Riley Securities, Inc., Research Division - Senior Research Analyst***

I wanted to start with some of the repayment activity that you noted, a bit elevated relative to maybe what we've seen over the last -- even last couple of years. Could you talk about kind of the nature of the exits? What was prepayment or repayment versus sale. And then I wanted to also ask about the comment you made about kind of seasonality versus selectivity in terms of the origination activity, hoping you might be able to kind of parse that out for us.

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

Sure. This is Armen. I'll take the second question first.

So in terms of seasonality, the summer months were a little bit slow in terms of just activity. I think the rise in base rates that started last year became sort of a reality for folks this year. And so M&A volumes are down materially this year and that's why the -- I would say, the slowdown occurred in the summer months. There also has been a fair portion of technology-related transactions this year with some large tech take privates. But outside of tech, I wouldn't say that thematically, any one industry has been a big driver of origination. In tech, it's mainly the reason deals are still getting done is that there is at least perceived growth for those tech companies, and they're willing to write really large equity checks on those tech deals, 60%, 70%, 80% types of checks and still be able to underwrite to nice growth for those businesses. So those deals are getting done.

With that said, we do expect a pickup in origination activity back to sort of the upper end of our quarterly origination activity in the last four or five quarters. For the quarter ended 12/31, I hesitate to provide very detailed guidance on that because some deals could fall into January. But we are -- we do have a fair number of deals in the pipeline that are expected to fund this quarter, that will be meaningfully higher than the originations that we saw in the quarter ended September 30. For guidance purposes, though, I would just say that a lot of those originations are going to be happening sort of later in the first fiscal quarter or fourth calendar quarter. So I wouldn't model a full quarter's worth of income associated with those, but you will see a pretty big pickup.

In the case of payoffs versus sales in terms of the exit, most of the $309 million or so of proceeds was from payoffs, about 75% was from payoffs and the rest were from sales. In the case of some of them, it was -- there was a life sciences investment, I think a big one was our investment in Jazz Acquisition or Wencor, which is a private equity owned company that got sold to a strategic.

So I wouldn't say thematically there is anything really going on that drove the payoffs, but I think there were just some surprises in terms of repayments. For example, we also got a repayment in our position in Apptio, which was a software name that fully paid off as well. So some chunky payoffs in software, including WP Engine, and then some more idiosyncratic things like the Wencor repayment that occurred upon the sale of that business.

Operator

And our next question will come from Ryan Lynch with KBW.

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

First one I had was with your new unsecured notes that you guys issued, you guys swapped out the rate to a floating rate. You guys have done that in the past. I'm just curious, is that more sort of a rate call given where base rates are today and to kind of better match your portfolio in case rates fall? Or is that something that's more a policy change where you guys are just going to start swapping out unsecured notes to floating rate and basically have an entire floating rate liability structure?

Matthew Stewart ***Oaktree Specialty Lending Corporation - COO***

It's Matt Stewart.

Given the makeup of our asset mix, which is about 90% floating rate, we did it to better match our assets and liabilities. We do have one fixed rate note that's still fixed today, which is our '25, which is $300 million and that matches roughly our fixed rate assets on our -- on the left side of our balance sheet. But going forward, we're taking the approach of matching our liability mix. So all of our secured facilities are floating. And then our two -- our most recent bond deal and then our '27s are also floating. So we're matching our assets and liabilities from that perspective.

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

Okay. And then one thing, which was a positive surprise to me. You guys were able to sounds like lower the spread on your credit facility in your JV by 75 basis points. Should we expect that to flow through to any higher distributions from those JVs going forward?

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Matthew Stewart ***Oaktree Specialty Lending Corporation - COO***

It's Matt again. We should expect a pickup of that 75 bps across the liability structure. Going forward, we would have to declare a dividend with our JV partner. So it's up to our JV board. But all else being equal, that 75 bps savings should flow through the bottom line, which we either accrete through earnings through a potential distribution or it will accrete to NAV. So either way, that 75 bps is accreting through the BDC.

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

Okay. And then one last question, maybe just a higher-level question for you, Armen. It sounds like some of the market commentary you gave sounds a little bit cautious given where people financed some of their liability structures over the last couple of years and kind of the big movement in rates. I'm just curious, fundamentals for private credit when you look at revenues and EBITDA growth has been pretty healthy over -- throughout 2020, '23 . I'm just curious as if we roll into 2024, you've already seen sort of the decline in longer-term rates. Certainly, the forward LIBOR curve and the Fed funds probabilities continue to trend lower, especially with a report like today. Does your more cautious stance start to change if we start to see sort of rate cuts or if inflation comes down more materially, which implies the greater likelihood of rate cuts earlier or kind of in 2024?

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

It's a good question. So I don't think we will see material rate cuts in the front end of the curve, which is kind of what matters for floating rate assets and liabilities, without a meaningful recession. I don't think the Fed is just going to cut rates because it can. I just don't think they're positioned to do that unless and until there's a meaningful economic issue. So I think that the rates are -- while they might not be this high for a long period of time, into 2025 or 2026, I do think that rates are going to be materially higher for the foreseeable future versus what they were in 2018 or 2019 or 2021.

So with or without a recession, I think that there will be stress and a reason to be very cautious. So without a recession, there will be highly levered businesses that fail because they can't make their principal and interest as it comes due. With a recession, I think you see a broader issue in the economy. And just a little bit of a data point for you using the broadly syndicated loan market as a benchmark, about 50% of the broadly syndicated loan market is B3 rated by Moody's. I would say that's pretty similar to a good chunk of private credit in terms of credit quality that was issued in 2018 or 2019. Of that, roughly 50% of the market, 60% will have a 1:1 fixed charge coverage ratio or lower at the end of this year. And so I think that that's 30% of a $1.5 trillion broadly syndicated loan market, that's a fair bit of sort of issues that need to be handled. And I think as those defaults pick up and they roll through, the banks are going to have a tough time stepping up to kind of support the market.

So I think there's going to be -- a long-winded answer to a fairly short question, which is I just think that there's going to be stress and fits and starts. And I think that looking backward at performance of businesses over the last 12 months being surprisingly good relative to what we thought it would be, it doesn't necessarily mean that it will remain surprisingly good in the next 12 months because we have had a pretty stimulative environment. We've had a few trillion dollars of stimulus through the CHIPS Act, the Inflation Reduction Act, the Infrastructure Act. And those are all -- those all help us sort of band-aid our way through a pretty challenging economic picture, and I think it has buoyed the economy more than anybody thought. But I think that that's going to start rolling off.

And then we're going to get into an election year where what the Fed does with rates may be called into question because of that election overhang. So a lot -- I think there's a lot of uncertainty out there and the reason to be cautious. I don't think that rates will decline just because inflation is heading in the right direction. I don't think rates will decline until you actually see a meaningful economic issue.

Operator

(Operator Instructions) Our next question here will come from Melissa Wedel with JPMorgan.

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Melissa Wedel ***JPMorgan Chase & Co, Research Division - Analyst***

First, I wanted to touch on the yield on new investments. I think it was Slide 10 in the deck. Looks like there's been -- I know there's been some noise in that line item quarter-over-quarter, but notice that the yield on new commitments in the September quarter was 12%. It was down about 60 bps quarter-over-quarter. I was just hoping you could elaborate on sort of what's driving that? And if you expect sort of a lower yield on new commitments versus the rest of the portfolio to kind of persist over the next few quarters.

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

I don't know, Matt, if you want to take that or I should take that?

Matthew Stewart ***Oaktree Specialty Lending Corporation - COO***

It's Matt Stewart. I think just -- it was a result of the deal flow that we saw during the quarter, as Armen mentioned, we did have a little bit more sponsor heavy originations this quarter, which came with a little bit lower spread in the 600 to 650 range. So I wouldn't view that as an indication of where we will be in the future with our non-sponsor origination capabilities as well. But I think it was just more around the makeup of the originations this quarter being more sponsor heavy than not.

Melissa Wedel ***JPMorgan Chase & Co, Research Division - Analyst***

Okay. And then I guess a follow-up to that point and given Armen's comments earlier about caution still being warranted in this environment, so there being some optimism about the opportunity set. Does the team have a view right now as to whether non-sponsor would be more attractive because of better spread, lower leverage? Or is this an environment where you really do want to skew towards strong sponsor support?

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

Yes, this is Armen. I wouldn't say that there is a big picture preference one way or the other. I think arguments can be made for both being a good way to create downside protection. In the case of the non-sponsored side, you got to think about those borrowers. They are taking on leverage to achieve a strategic initiative usually around growth. And with the cost of leverage as high as it is for a non-sponsored deal, it would be sort of 12% to 14% or 15%, just given where spreads are and given where base rates are. You can imagine that non-sponsored deal activity is a little slow because the return on equity for taking on that debt for this new initiative may not be what it used to be. And so those strategic investments that businesses would make in a lower rate environment are slowing down in the current rate environment. So that's part of the reason for the, I would say, the slowdown in origination activity on the non-sponsored side.

On the sponsored side, I don't think you could paint every sponsor or every company with the same brush stroke. There certainly are very attractive businesses that are being underwritten conservatively by private equity sponsors and the equity checks are routinely more than 50% in the current vintage of private equity deals. So the quality of deal flow is actually quite attractive. The spreads are a little bit tighter than non-sponsored. But I would say the risk-adjusted returns in sponsored deal flow is probably the most attractive it's been in a very long time, getting 11.5% to 12% coupons where sponsor is writing a 60% equity check feels pretty good relative to sort of historical standards. And if you are able to underwrite the business assuming sort of a downside case recession in 2024 or 2025. It's a good -- I would say it's a good vintage in sponsor-led deal flow that we're looking at right now.

Operator

And our next question will come from Erik Zwick with Hovde Group.

Erik Zwick ***Hovde Group, LLC, Research Division - Director***

Just one question for me today. Looking at the diversification of your portfolio by industry. I noticed a specialty retail at about 5.4%. And given there's some concern over the consumer and spending and saving levels today. Just curious if you could provide a little detail in terms of your portfolio companies? What segment of the consumer market they're serving and whether you're noticing any changes, either positive or negative in terms of the recent performance of those portfolio companies?

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

Yes. For specialty retail, it's really a couple of chunky investments that are more sort of branded retail. We're not really big into retail as would be more typical of a retail industry. And one of our retail -- a large position in our retail book, Melissa & Doug is a repayment that will be coming. So I think you will see that number kind of come down pretty materially.

We are seeing -- I wouldn't say a tremendous weakness in retail. But big picture, as we look at some industry-wide statistics, we are seeing some weakness in the consumer. It's not to the level of distress, but it is, I would say, troubling. I mean if you look at -- for example, if you look at new home sales or homebuilders and you look at their cancellation rates, they have picked up in the quarter ended September 30. The read-through to building products is not a good one. So we're looking at more macro indicators and seeing that the consumer is probably stronger than we thought it would be, but still weakening. If you look at credit card receivables, charge-offs or delinquencies, those are all starting to pick up a little bit in the recent months. So we are, I would say, cautious around the retail segment and not really looking to add. And you would, I think, find that in the next couple of quarters, our retail exposure will come down.

Operator

(Operator Instructions) At this time, we have no further questions. Mr. Mosticchio?

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

Great. Thanks, Joe, and thank you all for joining us on today's 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 4395893 beginning approximately one hour after this broadcast. We hope you have a wonderful holiday season, and we look forward to updating you again soon. Thank you.

Operator

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

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