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## Q3 2024 OAKTREE SPECIALTY LENDING CORP EARNINGS CALL

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# CORPORATE PARTICIPANTS

- **Dane Kleven** *Oaktree Specialty Lending Corp - IR*
- **Mathew Pendo** *Oaktree Specialty Lending Corp - President*
- **Armen Panossian** *Oaktree Specialty Lending Corp - Chief Executive Officer, Chief Investment Officer*
- **Christopher McKown** *Oaktree Specialty Lending Corp - Chief Financial Officer, Treasurer*

# CONFERENCE CALL PARTICIPANTS

- **Operator**
- **Finian O'Shea** *Wells Fargo - Analyst*
- **Melissa Wedel** *JPMorgan - Analyst*

# PRESENTATION

### Operator

Welcome and thank you for joining Oaktree Specialty Lending Corporation's third fiscal quarter conference call. Today's conference call is being recorded. (Operator Instructions)

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

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### Dane Kleven *Oaktree Specialty Lending Corp - IR*

Thank you, operator. and welcome to Oaktree Specialty Lending Corporation's third fiscal quarter conference call. Our earnings release, which we issued this morning, and the accompanying slide presentation can be accessed on the investor 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; and Chris McKown, Chief Financial Officer and Treasurer.

Before we begin, I want to remind you that the comments on today's call include forward-looking statements reflecting our current views with respect to 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 filing 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 today's call constitutes an offer to sell or a solicitation of an offer to purchase any interest in any Oaktree fund. Investors and others should note that Oaktree Specialty Lending uses the investor 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 website.

With that, I'd now like to turn it over to Matt.

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### Mathew Pendo *Oaktree Specialty Lending Corp - President*

Thanks, Dane, and welcome, everyone. Thank you for joining us today and for your interest in and support of OCSL. Our third quarter results were highlighted by continued strong origination activity and increased coupon income from our predominantly first lien portfolio. However, adjusted NII was $0.55 per share, down slightly from $0.56 for the prior quarter, as we experienced challenges at certain portfolio investments resulting in a decline in NAV and an increase in non-accruals.

In addition, our continued rotation into primarily first lien loans reduced our weighted average portfolio spread by approximately five basis points in the quarter. Our first lien investments have increased from just over 76% at June 30, 2023, to approximately 82% today. At the same time, second lien and unsecured debt investments decreased from 14% to below 8% over the same period.

Investments on non-accrual status at quarter end represented 3.7% and 5.7% of the debt portfolio at fair value and cost, respectively. That was up from 2.7% of the debt portfolio at fair value and 4.3% of the portfolio at cost last quarter.

We reported NAV per share of $18.19 down from $18.72 per share for the prior quarter. The decline primarily reflected unrealized losses on certain debt and equity investments, including the markdowns on the aforementioned non-accrual names.

We are collaborating with each company to address their unique circumstances. By leveraging our extensive experience and proven success in revitalizing underperforming investments, along with the substantial resources of Oaktree, we aim to achieve the best possible outcomes for our shareholders.

As a result that these non-accruals had in our earnings, Oaktree, our manager, agreed to waive $3.2 million of part one incentive fees for the quarter. This was on top of the $1.5 million of management fees Oaktree has been waiving each quarter since the OSI II merger that was closed in January of last year. As a reminder, last quarter, Oaktree also instituted a permanent reduction in our base management fee.

Effective July 1, the fee was reduced to 1% on gross assets from 1.5% and will be reflected in our current fourth fiscal quarter financial results. We expect this reduction will increase OCSL's adjusted net investment income annually by approximately $12 million or $0.15 per share. We believe that these decisions are a testament to Oaktree's strong commitment to aligning our interests with shareholders and to enhancing long-term enterprise value.

Now turning to our investment activity, which remains strong during the quarter, with $339 million of new investment commitment, our third consecutive quarter of commitments in excess of $300 million. We continue to find attractive opportunities across sponsor, non-sponsor, and discounted publicly traded credit investments, generating net portfolio growth for the quarter, even as we maintain our highly selective approach to investing amid the competitive market environment.

Consistent with this investment approach, our new originations were made at attractive yields with lender-friendly deal structures and terms. including lower leverage and loan to values. The weighted average yield on new originations was 11.1%, consistent with the prior quarter. Paydowns and exits in the quarter generated $186 million of proceeds, down from $323 million in the second quarter.

As the broader refinancing market activity has picked up this calendar year, we continue to receive steady levels of paydowns. As we have discussed previously, approximately 30% of our portfolio turned over in fiscal year 2023, and that trend has continued through the first nine months of our current fiscal year. We believe this demonstrates the strength of the overall portfolio and our underwriting and selection process.

As we see portfolio exits, it is largely because these companies have met their respective financial goals, enabling them to pay down debt, refinance at lower rates, or sell at attractive prices to larger competitors. We pursue opportunities and make investment decisions with these outcomes in mind, so we believe that these payoffs and paydowns validate our initial investment decisions.

Turning to the right-hand side of our balance sheet, as always, we maintain ample liquidity to meet funding needs. At quarter end, our net leverage ratio was 1.1x, up modestly from the prior quarter, primarily reflecting our net portfolio growth. We had $828 million available on our credit facilities, and $96 million of cash. Our Board approved a quarterly dividend of $0.55 per share consistent with the prior quarterly distribution.

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

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### **Armen Panossian** ***Oaktree Specialty Lending Corp - Chief Executive Officer, Chief Investment Officer***

Thanks, Matt, and hello to everyone. I will start by providing an overview of our portfolio activity during the quarter and finish with comments on the current market environment.

With over $3 billion of fair value, our portfolio remains well diversified across 158 companies at the close of the third quarter. Our focus remains to invest at the top of the capital structure, with 86% of the portfolio invested in senior secured debt and first-link positions, representing 82% of the portfolio at fair value.

Further mitigate risk, we focus on larger, more diversified businesses. The median portfolio company EBITDA at the end of the third quarter was approximately $147 million. and leveraging our portfolio companies was 5x, which was roughly in line with the prior quarter and well below overall middle market leverage levels.

Despite the elevated interest rate environment, our portfolio companies are performing well. Portfolio's weighted average interest coverage based on current base rates was in line with the prior quarter at 1.9x. As Matt noted, during our third quarter, we originated $339 million of new investment commitments across 11 new and 9 existing portfolio companies. The diversity of our originations is evident in key examples from the quarter.

I will start with Sorenson, the world's leading provider of communication tools for individuals that are deaf and hard of hearing. The company combines patented technology with human-centric services, connects signed and spoken languages. This was a sponsored deal of which Oaktree committed $417 million with 2% of original issue discounts, and a coupon of SOFR plus 5.75%. OCSL was allocated $54 million of this transaction.

Another example is TDS, a public company which owns an 83% equity interest in UScellular and wholly owns TDS Telecom. UScellular trades on the New York Stock Exchange and has an approximate market capitalization of $4.6 billion and is the fifth largest US wireless company.

TDS Telecom is the seventh largest US incumbent local exchange carrier which offers broadband video and voice in rural areas across 32 states. Oaktree invested $300 million in a term loan priced at SOFR plus 7% with 3% of original issue discounts and a $75 million delayed draw of term loans. OCSL was allocated $31 million of the total commitments for this deal.

Next, Adevinta is one of the largest global operators of online classified marketplaces. With operations in 10 countries serving approximately 1 billion people, Adevinta has 25 category-leading positions, such as mobility, real estate, and jobs. The company generates revenue from classified listing fees and advertising revenue. Oaktree invested $150 million in a term-length facility for this sponsored deal at Euribor, plus 5.75%, with 2% of original issue discounts. OCSL was allocated EUR28 million of this transaction.

Our origination activity remains strong, and we have a robust pipeline of opportunities, even in this higher interest rate environment.

Now let's take a closer look at credit quality. As Matt noted, we experienced an increase in non-accruals during the quarter, driven by the additions of Pluralsight, Auven, and the mezzanine tranche in Dialyze. Additionally, we recorded $42 million in net markdowns during the quarter, primarily driven by Pluralsight and our equity investment in SiO2.

I will start with the new additions to the non-accruals. Pluralsight is a leading provider of technology skill development solutions via its cloud-based learning platform, primarily in the financial services and technology verticals. The difficult macro environment and increased competition have created challenges for the top line while the rapid rise in interest rates has pressured the company's liquidity position.

In response to these issues, the company appointed a new CEO in April of this year with the mandate of improving operational and financial performance. Lenders are engaged in an active dialogue with the sponsor and the company regarding the most logical path forward. We took a meaningful markdown on our position to better reflect the current situation.

Turning to Auven Therapeutics Holdings, which is a private company that invests in therapeutic platforms and assets. Since making the loan in December of 2020, we have received principal repayments throughout our hold period that exceed the original loan amount. The $7.1 million par position that remains represents PIK interest. And given the collateral package backing loan, we are comfortable that the remaining amount is fully covered.

Next, Dialyze. Provides hemodialysis services directly to patients in skilled nursing facilities. Our original investment in Dialyze was composed of a first lien term loan and warrants. In connection with amendment activity and funding incremental amounts on the term loan, we received a relatively small mezzanine loan at zero cash cost. We put this smaller mezzanine loan on non-accrual as the company's plans to achieve profitability have taken longer than originally forecasted.

Turning to SiO2, an investment that we have discussed on past calls. As a reminder, the company emerged from bankruptcy last year, and we received equity in connection therewith. The company has a new management team in place. However, they recently reduced their forecast for the year. As a result, we felt the prudent action was to mark down our equity position to better reflect the current economics.

In general, the higher interest rates of the last two years have materially increased the interest burden for levered companies. This has heightened the potential for more borrowers to find it challenging to service this more expensive debt.

We're closely monitoring all of our portfolio companies and the overall health of our portfolio with respect to how this interest rate environment is impacting their performance. We are engaged and working with companies to the extent that we need to address their specific situations.

We continue to draw upon our long history and proven expertise in turning around challenged investments, and we are well positioned to manage through this type of market with the goal of maximizing outcomes for our shareholders.

With that in mind, I'll turn to our view on the market environment.

During the fiscal third quarter, credit markets continue to rally as investors priced in the end of the interest rate hike cycle, given the slowing inflationary pressures. Credit investors are seeking opportunities to put capital to work in anticipation of declining future interest rates.

While new issuance favors private credit, the market is experiencing more competition as syndicated loan activity picked up during the first half of 2024. The private credit markets also remain optimistic that M&A activity will increase in the second half of this year.

In general, private market borrowers remain healthy, demonstrating EBITDA growth and favorable coverage ratios. However, we remain focused on the fundamental risks that many have heard me express before. Higher interest rates for an elongated period could present challenges for companies that carry high levels of debt. Although the pace of inflation has slowed, it remains an issue for companies and consumers alike.

We are also diligently monitoring companies that will require refinancing in the near future. If market conditions become more constrained, these companies may find it challenging to obtain essential capital.

In the current environment, we believe it is prudent to remain cautious. With Oaktree's resources, expertise, and experience, we continue to be disciplined in our relative value philosophy. We are thoughtfully evaluating investments across the sponsored and non-sponsored back markets. We are executing our thorough due diligence process and only investing in opportunities that meet our rigorous standards.

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

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### **Christopher McKown** ***Oaktree Specialty Lending Corp - Chief Financial Officer, Treasurer***

Thank you, Armen. As Matt noted, we reported an adjusted net investment income of $45.2 million, or $0.55 per share as compared to $44.7 million or $0.56 per share in the second quarter. The slight increase on a dollar basis was primarily driven by lower part one incentive fees, net of fees waived, partially offset by lower adjusted total investment income and higher interest expense. The per share decrease for the quarter was driven by an increase in weighted average shares outstanding.

Adjusted total investment income decreased by $1.8 million in the quarter and was adversely impacted by placing certain investments on non-accrual status. Additionally, non-recurring income stemming from OID acceleration as well as prepayment fees and amendment fees were down from the prior quarter. These factors were partially offset by higher coupon interest income driven by growth in the investment portfolio.

Net expenses for the third quarter totaled $50.4 million, down $2.3 million from the prior quarter. As Matt noted, the decline was primarily driven by $3.2 million lower part I incentive fees, net of fees waived, as a result of the part I incentive fees waived by Oaktree during the quarter.

Now, moving to our balance sheet. OCSL's net leverage ratio at quarter end was 1.10x, up from 1.02x at the end of the March quarter. Newly funded investment activity of $293 million exceeded proceeds from repayments and sales of $186 million, enabling us to grow the portfolio, but the markdowns taken in the quarter tempered that growth. Our net leverage continues to be within our targeted range of 0.9x to 1.25x.

As of June 30, total debt outstanding was $1.74 billion and had a weighted average interest rate of 7.0%, including the effect of our interest rate swap agreements, consistent with the level at the end of the March quarter. Unsecured debt represented 55% of total debt at quarter end, down slightly from the prior quarter.

Our liquidity remained strong at just over $900 million at quarter end, including $96 million of cash and $828 million of undrawn capacity on our credit facilities. Unfunded commitments -- excluding unfunded commitments to the joint ventures were $264 million, with approximately $219 million eligible to be drawn immediately, whereas the remaining amount is subject to certain milestones that must be met by portfolio companies before funds can be drawn.

Turning now to our two joint ventures, our JVs continue to deliver strong performance. Together, the JVs currently hold $477 million of investments, primarily in broadly syndicated loans spread across 50 portfolio companies.

For the quarter, The JVs again generated attractive annualized ROEs, which combined were approximately 13.2%. This is a testament to the underlying credit quality of the portfolios and their predominantly first lien composition.

Leverage at the JVs was 1.4xin aggregate at quarter end, up from 1.3x in the prior quarter due to a slight increase in unrealized depreciation in the underlying portfolios, partially offset by repayments received from portfolio companies during the quarter.

In summary, despite the credit events that we experienced in the quarter, we continue to believe that our strong balance sheet and attractive investment opportunities position us well for the remainder of fiscal year 2024.

With that, we appreciate your participation on the call today and for your interest in OCSL. We are happy to take your questions.

Operator, please open the lines.

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# QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Finian O'Shea, Wells Fargo.

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### Finian O'Shea *Wells Fargo - Analyst*

Hey, everyone. Good morning. First question, and apologies if I missed this somewhere, but the part one fee waiver this quarter, is that truly one time, or might it relate to something like returns or the dividend for some period of time going forward?

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### Armen Panossian *Oaktree Specialty Lending Corp - Chief Executive Officer, Chief Investment Officer*

Hey, Finn. It's Armen. Thanks for the question. No, the part one fee waiver is truly one time. We have done few waivers in the past relating to transactions. You may recall the OSI entity mergers, but we viewed that it was appropriate to take a one-time waiver this quarter. It is not ongoing.

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### Finian O'Shea *Wells Fargo - Analyst*

Okay. Thanks. And then Armen as well. I wanted to ask about the Oaktree at the platform level, now that you're at the helm and presumably some changes are going on, can you talk about your vision for Oaktree and perhaps if you seek to turn it into more of a volume shop? I know you mentioned that you maintain the relative value philosophy, but will things sort of drift that way? And would you attribute any platform changes to the recent credit experience? Thanks.

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### Armen Panossian *Oaktree Specialty Lending Corp - Chief Executive Officer, Chief Investment Officer*

Thanks, Finn. Yeah, so look, Oaktree, when it was founded in 1995, at its core is a credit shop, specifically a below-investment-grade and unrated debt investment firm, both on a performing and non-performing basis. That is the roots of the firm. We're going to continue managing the business with that legacy in mind, and we're not going to do anything that's unnatural from a growth perspective.

We are -- in terms of the manager, a private company. We are a majority owned by Brookfield Asset Management, but we are really focused on credit and especially below investment grade and unrated credit, and not looking to do anything unnatural from a growth perspective.

I think the performance in the recent quarters has really nothing to do with any sort of platform shifts. These are unfortunate idiosyncratic situations in a small handful of credits, but unfortunately, were large enough positions to have hurt our NAV in the last couple quarters.

I think thematically, it was businesses, we could kind of bucket them in different ways, but I think if we were to look at sort of the biggest theme, it would be businesses that did actually really well during COVID and coming out of COVID had some stumbles.

And I think at the time were considered very strong investments and had very high valuations from the ownership of those businesses. But again, since then, there's been some stumbles. And that's kind of the explanation. It is certainly an unfortunate situation for us as well as the equity owners of those businesses. But it really has nothing to do with Oaktree as a platform and any decisions we may or may not have made.

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## Operator

Melissa Wedel, JPMorgan.

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## Melissa Wedel *JPMorgan - Analyst*

Thanks for taking my questions. I was trying to square the circle a little bit. Your comments about remaining, I think, cautious in this environment, but then also just sort of looking at the level of net deployment, I'm wondering if that was sort of just -- it was pretty elevated this quarter. I'm wondering if that's a function of sort of timing in the way things came together, or if you would expect activity levels and repayment levels to remain high or pickup?

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## Armen Panossian *Oaktree Specialty Lending Corp - Chief Executive Officer, Chief Investment Officer*

Thanks, Melissa. I think there was a little bit of timing. We saw a slowdown last year, last calendar year, as base rates were higher, so were spreads. I think there was some M&A activity that was pent up in the pipeline.

And as that M&A activity has picked up this year, we have seen some elevated originations. The spreads are tighter this year than they were last year, and I would say fairly meaningfully so. And we are cautious about new LBOs as well as existing ones, given the elevated base rate environment.

So we are being cautious. We are very mindful of valuation multiples, leverage multiples, loan-to-values. And you can see it in our origination, most of what we did was first lien. And the overall portfolio, given some of the repayments we've received in junior debt, has really meaningfully migrated, as Matt mentioned in his comments, to a substantially first lien portfolio.

But we are definitely seeing an uptick in deal volume, refinancing taking us out of positions, as well as new LBOs, new M&A, giving us the opportunity to invest selectively with the sponsors that we've done a lot of repeat business with.

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## Melissa Wedel *JPMorgan - Analyst*

Okay. And then as a follow-up to Finn's question, definitely to your point that this was a one-time fee waiver in the June quarter. I'm also wondering if you can remind us how much undistributed NII there is per share. Thanks very much.

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## Christopher McKown *Oaktree Specialty Lending Corp - Chief Financial Officer, Treasurer*

Hey, Melissa, thanks for the question. This is Chris. In terms of undistributed NII, our adjusted NII came in at $0.55 per share, so right in line with that dividend payout.

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### Operator

This concludes our question and answer session. I'd like to hand things back over to Mr. Kleven for any final remarks.

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### Dane Kleven *Oaktree Specialty Lending Corp - IR*

Thanks, Alan. 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 investor section or by dialing 877-344-7529 for US callers and +1-412-317-0088 for non-US callers with the replay access code 2416934 beginning approximately one hour after this broadcast. Thank you all

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### Operator

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

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