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Q3 2019 Oaktree Specialty Lending Corp Earnings Call

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PRESENTATION

Operator

Welcome, and thank you for joining the Oaktree Specialty Lending Corporation's Third 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 third 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 Chief Executive Officer and Chief Investment Officer, Edgar Lee; Chief Financial Officer and Treasurer, Mel Carlisle; and Chief Operating Officer, Matt Pendo. We will be happy to take your 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 a solicitation of an offer to purchase any interest in any Oaktree fund. Investors and others should note that Oaktree Specialty Lending uses the Investors section of its corporate website to announce material information. Accordingly, the company encourages investors, the media and others to visit its corporate website to obtain investor-related material.

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

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

Thank you, Mike, and welcome, everyone, to our third quarter earnings conference call. We appreciate your interest in OCSL.

We are pleased to report another quarter of strong results, highlighted again by NAV growth, solid earnings, continued progress on monetizing non-core investments and an ongoing conservative financial position.

NAV per share increased $0.05 from the previous quarter. This marked the sixth straight quarter of NAV growth, demonstrating the solid credit quality of our portfolio and the success of our portfolio repositioning efforts since we started managing OCSL in 2017.

Our portfolio produced net investment income per share of $0.12 in the third quarter, relatively consistent with the first two quarters of the year. Contributing to investment income this quarter were call protection and prepayment fees received on two loans that were paid off during the quarter.

In one instance, our $30 million investment in U.S. Well Services, a provider of fracking services in oil and gas basins, was repaid. As you may recall, this investment was part of a $75 million 1-year loan that Oaktree made to the company, which OCSL participated in alongside with other Oaktree funds. During the quarter, our loan was refinanced, generating an IRR of over 60% and a money multiple of 1.17x in just over 5 months.

The third quarter was also highlighted by continued progress in repositioning the portfolio as we realized approximately $27 million from the monetizations of non-core investments. I will discuss one of these exits in more detail later.

Additionally, we maintained a conservative financial position during the quarter. We are exercising caution and discipline given the current market environment and the late stage of the economic cycle, and as a result, leverage was down slightly to 0.58x, below our long-term target range of 0.70x to 0.85x. That noted, we remain active in the market and are well positioned to take advantage of market dislocations as we have about $330 million of dry powder for new investments at quarter end.

Now I would like to share our view on the overall market environment. The competitive lending environment we experienced earlier in the year continued through the most recent quarter. There is a tremendous amount of capital targeting direct lending opportunities, extending a borrower-friendly environment in which some direct lending funds are approaching loan deals aggressively and taking on excessive risk. This translates into credit spreads that continue to be tight and generally covenant structures and terms that we find less attractive.

While we are not seeing widespread signs of credit deterioration, increasing number of direct lending funds are experiencing deterioration in several of their loans. These pressures may eventually help encourage a rebalancing of the direct lending market and create more attractive opportunities.

In keeping with our strategy, we continue to focus on the near-term investment objectives we outlined on our last call: maintaining diversity across issuers and industries, focusing on senior secured opportunities; lending to larger, more diversified businesses; and seeking borrowers with lower leverage levels.

OCSL's portfolio characteristics were generally stable from last quarter. As of June 30, we had $1.5 billion of investments diversified across 105 companies in 36 industries. 80% of the portfolio was invested in senior secured loans, of which 54% were first lien.

In addition, we continue to weight the portfolio towards larger middle market companies with lower amounts of leverage. The median annual EBITDA of companies in our investment portfolio increased to $130 million in the quarter, up from $99 million in the same quarter one year ago, and 57% of our companies generated EBITDA in excess of $100 million. Leverage at our portfolio companies was 5.0x at quarter end, well below the overall market leverage levels of over 5.5x.

Moving on to our non-core portfolio. As mentioned earlier, we monetized $27 million in non-core investments during the quarter, $21 million of which came from the sale of an airplane in our aviation subsidiary. We were able to complete the sale at a premium to our plane's prior quarter mark, which drove gains of approximately $3 million. Following the sale, our aviation subsidiary's fair value is down to approximately $15 million in just one aircraft. Notably, the remaining plane is an Airbus A320 that is leased to a high-quality counterparty, and as a result, we are confident that we will carry out a successful sale process to exit the remaining balance of this investment.

With these monetizations, non-core investments have declined from $893 million since we began managing OCSL to $273 million as of June 30. Of the remaining non-core investments, five are nonaccrual, totaling $87 million or 6% of the portfolio at fair value. We continue to work diligently on maximizing the values of our remaining investments, which we expect will continue to occur over time.

Given our conservative posture and patient approach, we identified fewer origination opportunities that met our standards in the third quarter. While we evaluated more than 200 potential transactions during the quarter, we originated $67 million across seven investments, down from $100 million in the previous quarter. First lien loans accounted for 94% of the third quarter investments. Three of these transactions were add-on investments to support the growth of existing portfolio companies, while four were new portfolio company investments made across the primary and secondary markets.

The most prominent investment for the quarter was a $40 million loan to Lightbox, a commercial real estate data and software provider with market leading positions in certain niches. In aggregate, Oaktree funds lent $90 million to the company and led its $190 million first lien financing. The loan carried an attractive rate at LIBOR plus 500 and a favorable covenant package. The loan is supported by $379 million of equity capital cushion.

The average yield for all of our originations was 8%, down modestly from the previous quarter. Although our conservative approach has muted the overall yield on new investments, we are confident that this is a prudent way to generate income in the near term, especially given the current volatile geopolitical and macro environment.

In summary, we are very pleased with our strong third quarter results. We hold a defensive portfolio that we believe will continue to deliver attractive risk-adjusted returns to our shareholders, and we believe we are well positioned to navigate the changing market conditions.

With that, I'd like to turn the call over to Mel to discuss our financial results in more detail.

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

Thank you, Edgar. OCSL reported another quarter of strong financial results. Total investment income was $36.7 million, down slightly from $38.2 million in the second quarter. The $1.6 million decline was due to lower interest income, including PIK interest income, and was partially offset by higher fee income.

Interest income was down by $1.4 million quarter-over-quarter, primarily the result of recognizing $4.6 million of non-recurring OID accretion related to Dominion Diagnostics in the second quarter. This was offset by OID acceleration and make-whole interest from payoffs.

PIK interest income was down from the second quarter as we exited our investment in Maverick Healthcare last quarter. Now nearly all the PIK income we receive is from our investment in Alvatek, a senior secured bond that we originated in the December quarter. Fee income was up during the quarter primarily driven by prepayment fees that we received from the U.S. Well Services repayment.

Operating expenses, excluding management fees and interest, were up $141,000 mainly driven by slightly higher professional fees. As a result of these items, net investment income was $16.6 million, down $1.1 million from the prior quarter.

Turning to net asset value. NAV increased to $6.60 per share from $6.55 per share on March 31. Contributing to the sequential increase were income in excess of our dividend and net gains on exited investments. However, offsetting these were mark-to-market valuation adjustments on some of our holdings.

The credit quality of the portfolio remains stable between quarters, as no new investments were added to nonaccrual in the quarter. As of June 30, 6.4% of our debt investments at fair value were on nonaccrual status as compared to 6.1% at March 31. This represents five positions, down from six, as we exited our investment in Advanced Pain Management, which had previously been written down to zero.

With respect to leverage, our leverage ratio decreased to 0.58x from 0.64x on March 31 as the portfolio shrank slightly during the quarter. We experienced $138 million in payoffs and exits, which was greater than the $74 million of investment fundings.

As of June 30, total debt outstanding was $543 million and had a weighted average interest rate of 5.1%, unchanged from the prior quarter. Cash and cash equivalents were $6 million at quarter end, and we had $330 million of undrawn capacity on the revolving credit facility.

Shifting now to the Kemper joint venture. As of June 30, the JV had $349 million of assets invested in senior secured loans to 51 companies. This compared to $347 million of total assets invested in 49 companies last quarter. Leverage at the JV was 1.3x at June 30, flat with last quarter. During the quarter, we amended and increased the size of the JV's credit facility from $200 million to $250 million, and at quarter end, the credit facility had $63 million of undrawn capacity.

Now I will turn the call over to Matt.

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

Thank you, Mel. We continue to execute on our plan to increase ROE on several fronts, which has resulted in solid returns for OCSL. We have steadily exited noninterest-generating investments and further strengthened our foundation of core earning assets.

During the quarter, we received proceeds of $6 million from three positions and have rotated out of over $100 million of non-interest generating investments this fiscal year. The remaining non-interest generating investments comprise $152 million or approximately 10% of the portfolio, which represents a significant opportunity to increase overall portfolio yield.

Additionally, our efforts to optimize the Kemper JV are contributing nicely to our results. The JV added $17 million in investments across 5 companies during the quarter, all of these were first lien loans.

As Mel mentioned, the JV increased its credit facility capacity by $50 million to $250 million and now has $63 million of available capacity. We expect that over time, the JV will increase leverage as it incrementally adds investments. Leverage at quarter end was 1.3x, well below the longer-term target of 2.0x.

Furthermore, OCSL has the opportunity to increase returns by deploying more leverage at the portfolio level. We are currently operating at less than 0.6x, so we do have the ability to enhance returns as we find attractive investments and deploy higher leverage.

Finally, we continue to rotate out of broadly syndicated loans with yields below LIBOR plus 400 basis points, positioning the portfolio for improved yield. During the third quarter, we owned $20 million of these lower-yielding broadly syndicated loans, down from $32 million in the second quarter. Over time, we plan to replace these investments with higher-yielding proprietary investments.

Now turning to the dividend. Our Board approved a $0.095 dividend today, maintaining the level of the five prior quarters. As you know, we are determined to pay sustainable and consistent dividends, supported by portfolio performance.

And lastly, I want to provide an update on the proxy initiatives that we put before shareholders with respect to the pending Brookfield transaction with Oaktree, as well as modifying the asset coverage requirements applicable to OCSL.

As you may recall, in light of Brookfield Asset Management's merger agreement with the parent of our investment advisor, Oaktree Capital Group, we sought shareholder approval of a new Investment Advisory Agreement between Oaktree and OCSL. The new Investment Advisory Agreement will become effective when the merger closes. Notably, other than changing the date of its effectiveness, the terms of the new Investment Advisory Agreement remain unchanged from those in the existing agreement.

At the same time, we asked shareholders to approve an increase in our leverage limits by modifying our asset coverage requirements. Importantly, we sought this change in order to provide us with additional operating flexibility to deploy capital as the market becomes more favorable. As a reminder, with these new leverage limits, our base management fee will be reduced to 1% on all assets financed using leverage above 1x debt-to-equity.

We are pleased to report that both of these proposals received overwhelming approval from shareholders, and we thank all those that voted their shares and participated in the meeting.

In conclusion, as we look to the remainder of this fiscal year and into 2020, we are confident we have positioned the portfolio for continued strong results. We will strategically deleverage Oaktree's expertise and resources 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) Our first question will come from Chris York of JMP securities.

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

So maybe, Edgar or Matt, I just have one question this morning. So I calculated the payout ratio of your earnings fiscal year-to-date, I think it's below 80%, and that's below the 90% threshold generally associated with maintaining a BDC's reg status. So the question is twofold. Are there historical tax loss carry forwards that are currently shielding the distribution requirement and the payment of excise taxes? And then when can investor expect a dividend increase to a level closer to your earnings?

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

So on the -- Rick, it's Matt -- or sorry, Chris. On the last part of your question, the things that we're focused on, as I said before, is really the earnings in the portfolio translating into the dividends. And in the first and second quarters, we had some nonrecurring, non-cash items related to OID accretion accruals, particularly with Dominion. And in the current quarter, we had higher interest and fee income related to U.S. Well, so it was about $3.5 million and Dominion was $1.2 million. So those are items that we've had in the most recent quarters. So we're kind of waiting to work through those. Obviously, it's a volatile environment out there right now around interest rates and markets. So we're kind of weighing all those things as we pour through it.

In terms of the specifics on the tax, I want to circle back with you, there's -- we obviously watch that and there's spillover and ways to manage it. So I don't have a specific number for you right now.

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

Okay. Just so -- to be clear on the earnings, so what would you think is the core net investment income, I guess, this quarter that would be comparable to your dividend? So if I calculate a payout ratio, adjusting for some of those onetime items, what would we use in that denominator?

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

Well, I mean, the payout ratio is -- that we've targeted is in the low 90s of net investment income. There's -- every quarter, there's been, as I mentioned before, kind of OID accretion or fees, et cetera. So it's really -- and those are really hard to predict kind of quarter-to-quarter. So if you kind of run your models and look at kind of the steady state in investment income, the other thing that we're focused on is taking some of the nonaccruals and turning them into accruing assets. So all those are just various inputs we have. I don't want to kind of give you the specific projection, but you can use that to kind of run through your models.

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

And Chris, if I can just add to what Matt mentioned, if you look at our dividend stream over time, over the past year, it's been a combination of return of capital as well as an income dividend. For investors, it's actually been quite advantageous because in our return of capital, there's a sort of tax efficiency associated with it because we do have a significant amount of net operating losses, which, again, provide some tax efficiency to those distributions in those circumstances.

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

And then just a follow-up. Is that the reason why you're not accruing any excise tax because you have those NOLs?

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

Exactly. There's a certain amount of -- because of return of capital versus income distributions.

Operator

Our next question comes from Rick Shane of JPMorgan.

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

I just want to talk a little bit about ongoing portfolio rotation. You cited specifically $130 million of assets that are generating income, and we can all do sort of the math on what that would represent from a P&L perspective. I am curious, though, and again, I understand that leverage is a very fungible concept in that you guys have leverage capacity with the new rules. But are those investments that in -- within your discipline are underlevered? And so as that capital is recycled, would we actually expect to see not only an -- a migration to earning assets, but actually, more than $130 million of assets replacing that?

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

So Rick, it's an interesting way to look at those assets. I don't think we quite think of it as methodically as you do in that sense. It's really a reflection of what are the investment opportunities in front of us and do we think they reflect good risk/reward. So while you are correct in your statement that, theoretically, the $130 million of assets are underlevered, even if we translate those $130 million into cash and then we redeploy the $130 million into new loans. While we could lever those loans up and, therefore, net deploy well in excess of $130 million, we may not do so if we can't find enough good assets to invest in beyond the $130 million, for example.

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

Yes. I don't think -- look -- go ahead.

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

Just to pick up on, it's Matt, what Edgar said, the leverage -- the portfolio leverage we run isn't influenced by the nonaccruals, it's influenced by the investment opportunities.

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

Got it. Look, and I agree with you in that, and I think it's part of the strong philosophy of the company, which is that you don't solve for how big the portfolio should be, the portfolio size is defined by the opportunity that you guys perceive. But I am, at the same time, assuming that, that opportunity does present itself, curious about how big -- how that pool of capital could be translated into facing that opportunity?

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

You are absolutely right, Rick, on that point. If you think about the total earnings potential of the company, if we were able to translate that $130 million into accruing assets and lever those assets, the earnings opportunity here could be meaningfully larger than what they are today.

On that point about leverage, we do have a significant amount of what we consider sort of dry powder here available to invest in the marketplace. As we commented in our prepared remarks and as you've seen in our materials, leverage has declined at the company this past quarter. Part of that is a reflection of a strong refinancing environment and part of that is a reflection of us not being satisfied with the types of opportunities that we're seeing before us today. That is not a reflection of not necessarily finding enough -- or originating enough opportunities, it's just a reflection of we don't necessarily like the opportunities before us. I think that's served us well. As we begin Q3 or we've begun August here, we've seen a significant amount of volatility. And you've heard folks at Oaktree in the past publicly comment about market is priced for perfection. Our general view was, as we were approaching the end of Q2, that the market was really priced for perfection. A lot of aggressive behaviors in the marketplace and ones that we just did not just feel comfortable with. And I think as we've seen in August, as the markets have sold off, especially equity markets on Monday, we can see that people didn't leave a large margin for error and we saw some pretty significant downward pressure on the marketplace and a significant amount of anxiety in the markets these days. And we're hopeful that those anxieties will continue to escalate to a certain extent because it will position us well to take advantage of those because we are -- we aren't in our optimal leverage target right now and we do have the ability to deploy a significant amount of capital, still.

Operator

Our next question comes from Ryan Lynch of KBW.

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

If I look at your guys' leverage over the last several quarters, it just continues to kind of tick lower. I wondered if you could kind of comment what you think is the main driver. Is it more of a lack of an opportunity set of new investments given the competitive environment? Is it more that you guys are kind of pushing investments out, trying to exit them as you rotate the portfolio? Or is this just some intentional positioning for lower leverage given that we are just later in a credit cycle?

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

I think it's a little bit of the latter of the last two points you made. A couple of thoughts around your comments. One, as you saw in Q4 of last year, our deployment of capital picked up quite a bit, and that was because in Q4, we saw some pretty significant market disruptions, as all of you are aware of. When those disruptions happen, what we see consistently over time is that direct lenders or private credit funds tend to step back from the marketplace. You would think that, that is the time when these funds would step into the marketplace, but what we find consistently is that they step back from the marketplace, which creates really interesting opportunities for us. So as markets get weaker, our deployment tends to pick up. It's not always the case, but it tends to pick up in a pretty meaningful way, one.

Two, when we look at the market place overall, it really -- we look at it in terms of a risk/reward basis. A lot of managers might look at investments or loans that they make in terms of a yield perspective, that they can make 6% yield or an 8% yield. We really look at it as what's the reward? How many dollars can I make? And what's the potential for us to lose dollars here? How many bps or, therefore, how many dollars can we lose? And what we were seeing in this past quarter and we've seen it over the beginning part of this year as the market has been very strong was that, that risk/reward ratio was increasingly becoming unfavorable and it didn't make sense for us as fiduciaries to be investing our investors' dollars into that and into what we considered suboptimal situations. As you can see and you've seen from other BDCs, other direct lenders, you hear it anecdotally in the market place, there have been plenty of managers who have made some pretty poor quality loans to, one, have capital deployed; but two, did it because they thought they could earn an incremental 1% per year; but three, unfortunately, have been suffering losses of 20 to 30 points. And when we look at those risk/reward ratios, we struggle to see how those are prudent situations to get involved in where to make 1 point a year incremental, you have to take on the risk of losing 20 to 30 points to the downside. So that's what we were seeing in the market place, and we've seen more loans start to really struggle in the marketplace. And we saw fewer good quality opportunities and, therefore, really decided to curtail some of our lending activity in the short term.

Having said that, I would caution investors to not measure us from quarter-to-quarter, but rather think of it -- take a longer term view. And as we mentioned in our prepared remarks on U.S. Well Services, for example, that loan was a loan that we made in Q4 at a time that market was dislocating. We were refinanced out of that loan. We generated an IRR well over 60%. The money multiple on that loan in five months was 1.17x money. If you think about a traditional loan that you would make in today's environment, if we had done it in Q2, that loan probably would have generated about maybe a 9% IRR on an unlevered basis with a money multiple maybe of 1.1x, 1.2x over a 2- to 3-year period. So if I can find opportunities in a marketplace where we can generate high IRRs, good money multiples and manage our downside risk but that comes with the lumpiness of capital deployment from quarter-to-quarter, I would rather take that than introduce our investors to significant downside risk just to have our originations and leverage up in a single quarter.

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

That's good color, and I definitely agree on focusing on the longer-term as well as not reaching for 1 point at the risk of losing 20 on the downside. And that kind of brings me to my next question. On slide 15, you guys outlined 4 opportunities to increase your return on equity. And certainly, I would say, points 2 through 4 are all opportunities that rely on finding attractive investments in the market to deploy capital into, growing leverage, utilization of the JV with Kemper and rotating to higher-yielding proprietary investments. If the market conditions for direct lending remain unchanged, as they are today, which as you've explained are pretty tight and pretty competitive, how confident are you that you can successfully achieve those opportunities that you've outlined, particularly opportunities 2 through 4, which rely on an attractive opportunities in the market?

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

So it's Matt. I think if you look back, as we've taken over as the manager here, I think we've done -- we've taken action in points 1 through 4. And I think every quarter, there'll be different levels of activity. As Edgar mentioned, given the investment environment, we saw in the last quarter, our originations were lower. But as Edgar mentioned U.S. Well, we did that loan a year ago. We've done things like Allen Media, since we have taken over as managers. So I think you can see opportunities, since we've taken over really in the last year, even in the last two quarters, we have been able to put on some higher-yielding proprietary investments. And four, If you look over the last couple of quarters, we have put additional investments in Kemper, so we've done that. The leverage target is #2, that we haven't done. In terms of just looking at the numbers here, we've taken in the last year leverage down from 0.75x to 0.58x. So that one, we're just waiting with dry powder for the opportunity to deploy. But all these things in the last year, quarter-to-quarter we've done. So we still feel pretty confident we can do that. But we're going to be thoughtful and opportunistic. And every day, things change, as we've seen this week, so that creates opportunities for us.

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

But those opportunities going forward really depend on your guys' view and the attractiveness of deploying capital into the market, which can be out of your control?

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

Yes. Although, I mean, Ryan, like the last -- the private credit direct lending environment for the last year has been pretty robust and we still manage to get stuff done, so -- but we're going to be choosy and picky.

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

Ryan, I think a couple of things worth noting. One, as we've said in the past, we encourage investors to think about investments in our portfolio on a total return basis, not just on an interest income bearing basis. So while our total assets in the portfolio or our leverage may have been declining, what doesn't accurately necessarily get reflected in financials, LTM financials and others in the BDC space is the capital appreciation upside. We're little bit different than other BDCs because of the nature of this portfolio in that there is a pretty significant amount of equities and other opportunities here that are trading or have a fair market value below par that create potential for capital appreciation in the future. Obviously, there's no guarantee that'll be created. But I think if you look at our past performance over the last couple of years since managing the portfolio that there has been a pretty decent amount of capital appreciation that has been created. So we can create value for shareholders even if we don't necessarily increase leverage in the short term. And I'd encourage people not to discount that necessarily.

Two, in terms of some of the points that have been outlined on Page 15, a couple of things to think about when you think about the optimal leverage on a portfolio or your ability to lever a portfolio. If we think about it in the context of a commercial bank perspective where you're looking at net interest margin, over the last several quarters, as we've been driving down the cost of our capital by renegotiating our credit facility cost of capital with our borrowings by refinancing out high-cost fixed-rate debt and so on and so forth, we're actually creating the opportunity for us to basically use that leverage in a way and take advantage of a market where our yields overall are coming down but we're creating or we're increasing our ability to generate NIM by driving down our cost of liabilities, which allows us, theoretically, to push up our leverage levels over time, again if we find interesting investment opportunities.

When we think about the investing environment where we say that we're more cautious, that is absolutely true, but that doesn't mean that we don't find opportunities coming up. What ends up happening, though, is when the market is very strong and you have a strong lending environment, the opportunities come in the door in a more episodic way, as opposed to a consistent way. And so in Q3 or in any future quarter, it's quite possible that even if the market is strong that we all of a sudden see a pretty significant pickup in our net deployment, just because there were some unique situations that we were able to identify or create that just happened to match up with a particular quarter. So I wouldn't look at our historical and say that, that is necessarily a good predictor of our future deployment. Because of the nature of the lending that we do, it can be episodic and -- at points in time, and it doesn't necessarily always correlate to the overall lending environment.

On this point about the Kemper JV, it is an area and a tool that we are utilizing today. Unfortunately, because when markets are very strong, we do experience a fair amount of refinancings. And so sometimes when markets are very strong, that treadmill picks up speed quite a bit, but we do look at the Kemper JV as a tool, especially in periods where we may not find as many attractive overall opportunities, we do use that as a tool to enhance ROEs, and we think that's a great tool for us to use in more robust environments, for sure.

Operator

Our next question comes from Kyle Joseph of Jefferies.

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

Thanks for answering my questions. Most have been asked and answered, but I just wanted to follow up. You guys have referenced some volatility picking up recently in the market. You guys, obviously, have a portfolio of over 100 companies. At the company-specific level, have you seen any changes in terms of top line or EBITDA growth trends in your portfolio?

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

That's a great question, and thank you for the question. I would say that, generally, things have been stable. I would say that we are seeing slowing growth as a general comment, and that's because of the breadth of our portfolio, we get -- and for that matter, the breadth of the Oaktree platform. We get a pretty good view into the U.S. economy because we touch so many industries here at Oaktree. And I would just generally say that it's been more sluggish. I wouldn't say that we're seeing negative trends necessarily, it's just not as robust as maybe where we were a year ago.

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

Okay. And then one follow up on that. So given a little bit more sluggishness, a shifting rate environment, have you seen any sort of shifts in terms of competitor strategies? Any higher demand for fixed rate debt or anything like that over the last few months?

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

Not that I can think of off the top of my head. Not really a dramatic shift.

Operator

Our next question comes from Finian O'Shea of Wells Fargo.

Finian Patrick O'Shea ***Wells Fargo Securities, LLC, Research Division - Associate Analyst***

Just a couple on co-investment. Can you remind us on the private credit platform? Is there a specific direct lending cohort, whether it be the BDC and more similar funds that are able to eat first on the allocation -- on the origination you generate and then have a broader overflow claim for your broader private credit group? Or is the whole group entitled to deal flow based on allocable capital?

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

So thank you for the question, Fin. So under our exemptive relief order, every strategy that could participate in a private direct loan that meets Board-established criteria has the opportunity to participate -- or has a requirement, I should say, to show us all of their opportunities through the BDC. The reverse does not hold true. But every opportunity that any other strategy at Oaktree -- that is generated by any other strategy at Oaktree that meets the Board-established criteria, they must show those opportunities to the BDC. The BDC will then -- and the team managing the BDC will evaluate those opportunities. If we would like to participate in those opportunities, we will put an order in for that opportunity, and all the other strategies that -- or that strategy that originated the opportunity has to put in an order as well. They will be allocated their pro rata amounts of that opportunity based on their order size. And the order size will be based on, in part, by portfolio criteria and demands, strategy as well as just available lending or investing capacity.

Finian Patrick O'Shea ***Wells Fargo Securities, LLC, Research Division - Associate Analyst***

That's very helpful. And you were saying, though, in the sense of the reverse, the -- from your group as it relates to the BDC, the Oaktree Specialty Lending eats what it wants and then it's overflow. Is that what you were saying as well?

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

So any opportunity that is originated by the investment team that manages the BDCs here, those opportunities do not have to be shown to any other strategy at Oaktree. Under the exemptive relief order, they are not required to do so. So to the extent, for example, if we had a $500 million private loan opportunity and the BDCs collectively that are managed by the strategic credit group only wanted to participate in $100 million of that loan, there would technically be $400 million of available -- loan available. The BDCs could then go to the balance of Oaktree and ask does any other strategy want to participate in the loan? But those are the ones that would effectively serve as the overflow, theoretically, under the exemptive relief order, and I am talking specifically to the exemptive relief order.

Finian Patrick O'Shea ***Wells Fargo Securities, LLC, Research Division - Associate Analyst***

All right. Well, I appreciate the color. And one more on origination. Does the advisor or any affiliate of the advisor receive economics from the upfront work before allocating to the BDC?

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

No.

Operator

Our next question is a follow-up from Chris York of JMP securities.

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

Just one follow-up strategic question. So presumably a component of the investment thesis of Oaktree to acquire the contracts of both BDCs from Fifth Street was to potentially take advantage of future disruption among direct lenders and then utilize the managers to distress the expertise, which you've done a good job of demonstrating with the resolution of your non-core investments. So now we've started to see some BDCs acquire some subscale BDCs, and we expect BDC M&A to continue. So the question to you is, do you consider yourself as a strategic buyer of either other BDCs or portfolios today?

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

Both, theoretically.

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

The answer is yes.

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

No. We -- it's a great question, Chris. And obviously, there's been a number of BDCs and portfolios setup and transacting over the last couple of quarters. Oaktree doesn't generally; comment on our M&A strategy other than we would say that we'll explore and look at all of these opportunities, and if they make sense, we will pursue them.

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

Yes. And whether it's an exciting BDC or a portfolio, we look at all those. I think -- to your point, I think we have the scale and expertise to do those type of things. And we would expect -- I personally would expect to see more of those opportunities present themselves over the next year. I mean you're starting to see a few kind of subscale BDCs continue to have -- or start to have more credit issues.

Operator

We have no further questions, Mr. Mosticchio.

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

Thank you, again, for joining us for our fiscal third quarter 2019 earnings conference call. A replay of this conference call will be available for 30 days on OCSL's website in the Investors section or by dialing (877) 344-7529 for U.S. callers or 1 (412) 317-0088 for non-U.S. callers with the replay access code 10133101, beginning approximately 1 hour after this broadcast.

Operator

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