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PRESENTATION

Operator

Good day and welcome. Thank you for joining the Oaktree Specialty Lending Corporation's Fourth Fiscal Quarter and Year-End 2022 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, you may 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.

Our speakers today are Armen Panossian, Chief Executive Officer and Chief Investment Officer; Matt Pendo, President; and Chris McKown, Chief Financial Officer and Treasurer. Also joining us on the call today for the question-and-answer session is 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 timing or likelihood of the closing of the merger with Oaktree Strategic Income II, Inc.; the expected synergies and savings associated with the merger; 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 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. The company encourages investors, the media and others to review the information that it 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 finished our fiscal year with strong momentum driven by increasing asset yields, productive origination activity and excellent credit quality.

Full year fiscal 2022 adjusted NII was $0.71 per share, up from $0.64 for fiscal 2021. These results reflect the 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, continued portfolio repositioning and optimization, and ongoing credit stability.

Importantly, this marked our highest annual level of adjusted net investment income under Oaktree's management and represents the tremendous progress we have made since taking up our management of the company five years ago. Importantly, we are well positioned for the year ahead as rising interest rates have bolstered the earnings power of our portfolio. 86% of our loans are floating rate, and we expect our interest income will continue to rise in tandem with increasing base rates.

Given the strength and consistency of our earnings as well as the potential for continued solid results, our Board increased our quarterly dividend by 6% to $0.18 per share. This was the tenth consecutive quarterly increase and represented a 16% increase from the distribution we announced a year earlier. Notably, our dividend is up nearly 90% from its pre-pandemic level at the close of fiscal 2019.

Our Board also declared a special distribution of $0.14 per share primarily as a result of increased taxable income derived from our foreign exchange hedge positions as well as certain taxable equity gains.

Turning to our fourth quarter results.

Adjusted net investment income per share was $0.18 for the quarter compared with $0.17 for the prior quarter. We reported NAV per share of $6.79, down 1.5% from the prior quarter and down 6.7% from a year earlier. The quarterly decrease primarily reflected credit spread widening on debt investments and unrealized losses on certain equity investments, partially offset by undistributed net investment income.

Looking more closely at the portfolio, we originated $97 million of new investment commitments in the fourth quarter. Most of these were private placement transactions to a diverse group of companies and the yield on new debt investments was 9.9%. We received $146 million from paydown and exits in the fourth quarter. This included exits and paydowns of lower-yielding investments at slight gains to their previous fair value.

We continue to selectively reinvest proceeds into higher-yielding attractive opportunities. Given our experience across multiple cycles and our ability to draw upon the breadth of the Oaktree platform, our origination activity continues to be strong in the current quarter. And while credit markets have experienced one of the most challenging years on record, we are finding some of the most attractive opportunities we've seen in a long time.

Credit quality remains pristine. We continue to have no investments on nonaccrual. This reflects the breadth of our sourcing and our disciplined and prudent approach to investing selectively across a wide range of opportunities.

As we end the fiscal year, I also want to touch on our entry into a merger agreement with Oaktree Strategic Income II, Inc., or OSI 2, which was announced in September. We believe this transaction represents a compelling opportunity for shareholders of both OCSL and OSI 2. We expect it would create a larger, more scaled BDC with just over $3 billion in total assets, increase our trading and liquidity and should improve our access to the debt capital markets.

We also anticipate that it will create efficiencies and cost savings to drive NII accretion over both the near and long term. Importantly, consummation of the merger remains on track. On October 24, we filed a registration statement on Form N-14, which is currently under review by the SEC. Once the registration statement is declared effective, we will schedule the OCSL and OSI 2 shareholder meetings and begin mailing materials to shareholders. We expect the transaction will close in the first calendar quarter of 2023, subject to shareholder approval and satisfaction of other closing conditions as outlined in the merger agreement.

And finally, this year, our proxy statement will include a proposal which, if approved by the shareholders and implemented by the Board, would result in an amendment to our Certificate of Incorporation to affect a reverse stock split of outstanding shares of common stock at a ratio of 1 for 3. We believe that this will benefit OCSL shareholders as we'll bring our stock price more in line with our BDC peer group and OSI 2's NAV per share. We look forward to receiving your approval for this proposal as well as the OSI 2 merger.

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 good day, everyone. I'll begin with comments on the market environment. Although the strength of the U.S. job market endures and the economy expanded modestly in the calendar third quarter, macro conditions continue to warrant our full attention. Challenges such as persistently high inflation, tightening monetary policy, a surging U.S. dollar and slowing consumption, weigh on markets and lurk as threats to both the domestic and global economies late in 2022 and heading into 2023.

The Federal Reserve's aggressive actions to tame inflation by rapidly raising interest rates have dominated the credit market story in 2022. While fixed rate assets are negatively impacted by rising treasury yields, most leveraged loans have floating rates that reset higher and generate more income as short-term interest rates continue to rise.

However, floating rates are a double-edged sword. Rising interest expenses clearly hinders some borrowers. When a borrower struggles to service floating rate debt, the company's problem can quickly become the loan investor's problem.

Keep in mind that while higher interest rates are intended to tame inflation, the process takes time. As such, companies are facing the prospects of elevated borrowing costs at a time when input costs are at the highest level in four decades and the global economy is slowing.

While many companies were able to pass through cost increases to customers in the first half of 2022, this capacity is now likely low, especially for those that are smaller or in cyclical industries. Near-term default risk is fairly low as companies have limited maturities in the next two years and many still have relatively high levels of cash on their balance sheet because of savings accrued during the height of the pandemic.

The more interest rates rise and the longer they remain elevated, the more likely it is that the cracks in loan fundamentals could widen and eventually lead to greater instability. At Oaktree, we have lived through many of these cycles that have been able to capitalize on them. Having ample capital, a long-term perspective and the conviction needed to withstand short-term volatility are all key ways on how we have succeeded in these types of environments and how we plan on continuing to do so.

Moving forward, we believe caution is necessary when navigating such unsteady markets where we also continue to draw upon our team's long history of opportunistic investing to identify compelling new deals. We are prudently growing our portfolio, as Matt noted, selectively investing across both the sponsor and nonsponsor-backed markets while maintaining excellent credit quality.

With all that in mind, we are focused on relative value and are investing where we can find the best risk-adjusted returns. We are utilizing the full scope of Oaktree's scale and resources to invest across multiple markets with a diversified group of issuers.

We are leveraging Oaktree's ability to negotiate and structure customized private deals that provide downside protection. Altogether, we are carefully deploying capital on favorable terms to further build our portfolio and generate strong returns for our shareholders.

Now turning to the portfolio. At the end of the fourth quarter, our portfolio was well diversified with $2.5 billion at fair value across 149 companies, up from 138 a year earlier. 87% of the portfolio was invested in senior secured loans, with first lien loans representing 71%, underscoring our emphasis on the top of the capital structure.

We continue to target larger, more mature businesses that operate in noncyclical, defensive or structurally growing industries that tend to be diversified companies with lower amounts of leverage, which we believe reduces risk and contributes to our consistently solid credit quality.

Overall, our borrowers have been navigating the current inflationary environment very well and have continued to experience solid performance despite the challenging market conditions. Median portfolio company EBITDA as of September 30 was approximately $130 million, up modestly from $128 million in the prior quarter.

Leverage in our portfolio of companies was relatively steady at 5x, well below overall middle market leverage levels. The portfolio's weighted average interest coverage declined slightly to 2.7x as of September 30 from 3x in the prior quarter due to rising base rates.

We leveraged the Oaktree platform to originate $97 million of new investment commitments across 6 new and 5 existing portfolio companies in the quarter. The majority of these new investments in terms of dollar amounts were in more defensive industries such as life sciences and application software, reflecting our cautious approach to growing our portfolio. We also participated alongside other Oaktree funds and accounts in purchasing two hung loan syndications at attractive discounts to par.

Importantly, our origination activity is steady early in our new fiscal year. We originated over $100 million of investment commitments in 5 new private deals in the month of October. In total, these deals were attractively priced with a weighted average yield of 12.6%, and 100% were senior secured.

Continued momentum, coupled with our robust liquidity and the deep resources of Oaktree, positions us well for the year ahead.

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

Chris McKown ***Oaktree Specialty Lending Corporation - MD, CFO & Treasurer***

Thank you, Armen. OCSL delivered another quarter of strong financial performance, finishing the fiscal year 2022 on a high note. In the fourth quarter, we reported adjusted net investment income of $33.7 million or $0.18 per share, up 7% from $31.4 million or $0.17 per share in the third quarter. The increase was primarily driven by higher interest income resulting from rising base rates, partially offset by lower prepayment fees and higher interest expense.

Net expenses for the fourth quarter totaled $34.3 million, up $11.5 million sequentially. The increase was mainly due to a $6.8 million reversal of accrued capital gain incentive fees in the prior quarter that did not recur in the fourth quarter, $3.9 million of higher interest expense as a result of the impact of rising rates on the company's floating rate liabilities and slightly higher Part I incentive fees and seasonally higher professional fees.

Turning to our credit quality, which continues to be excellent. As Matt mentioned, we had no investments on nonaccrual at quarter end. With respect to interest rate sensitivity, OCSL remains well situated to continue to benefit from a rising rate environment. As of September 30, 86% of our debt portfolio at fair value was in floating rate investments. Our strong earnings in the fourth quarter were primarily due to the higher base rates, which in turn, drove our interest income higher.

We expect the most recent rate hikes will continue to have a positive impact on earnings. If base rates as of September 30 were in effect for the entire quarter, we estimate that our adjusted net investment income per share would have been about $0.015 higher, resulting in adjusted NII of $0.20 per share.

Now moving to the balance sheet. OCSL's net leverage ratio at quarter end decreased slightly from the June quarter to 1.06x. As a reminder, last quarter, we announced that we were increasing our leverage target higher to a range of 0.9x to 1.25x debt to equity.

We believe this range is appropriate given the portfolio's strong credit quality, and it provides us with increased capacity to deploy capital where we may see an expanded set of investment opportunities given the ongoing market volatility.

As of the September 30, total debt outstanding was $1.35 billion and had a weighted average interest rate of 4.4%, up from 3.2% at June 30 due to higher base rates. Unsecured debt represented 48% of total debt at quarter end, up slightly from the prior quarter.

At quarter end, we had ample liquidity to meet our funding needs with total dry powder of approximately $524 million, including $24 million of cash and $500 million of undrawn capacity on our attractively priced credit facilities.

Unfunded commitments, excluding unfunded commitments to the joint ventures, were $175 million, with approximately $142 million of this amount eligible to be drawn immediately as the remaining amount is subject to certain milestones that must be met by portfolio companies.

Shifting to our two joint ventures. At quarter end, the Kemper JV had $385 million of assets invested in senior secured loans to 60 companies, up from $365 million last quarter driven by new originations. The JV generated $2.2 million of cash interest income for OCSL in the quarter, up from $1.9 million in the third quarter as a result of the portfolio's continued strong performance and the impact of rising interest rates on floating rate investments. We also received an $875,000 dividend consistent with the prior quarter. Leverage at the JV was 1.7x at quarter end, up slightly from the prior quarter.

The Glick JV had $147 million of assets as of September 30, up from $142 million at June 30. These consisted of senior secured loans to 43 companies. Leverage at the JV was 1.4x at quarter end, and we received $1.4 million of principal and interest repayments on OCSL's subordinated note in the Glick JV during the quarter.

In summary, we are very pleased with our financial results for the quarter and full fiscal year. We believe our solid portfolio and strong balance sheet position us well for the year ahead.

Now I will turn the call back to Matt.

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

Thank you, Chris. Our strong financial results for the quarter enabled us to generate an annualized return on adjusted net investment income of 10.7%. We have generated an average ROE of just under 10% over the last four quarters. While we are pleased with our recent results, we believe OCSL remains well positioned to maintain our strong ROE going forward.

First, we believe OCSL continues to be positioned well for this rising rate environment. As Chris noted earlier, with the vast majority of our investment portfolio in floating rate assets, we expect that further increases in base rates will positively impact our net interest margin.

Additionally, with our increased leverage target range, we have the opportunity to continue deploying more leverage at the portfolio level. However, we will only grow the portfolio as we find opportunities that are consistent with our investment approach that we believe offer an attractive risk reward [proposition](added by company after the call).

And as we have discussed on prior calls, we continue to benefit from higher ROEs being generated at our joint ventures. During the fourth quarter, both joint ventures delivered ROEs in excess of 13% as they are benefiting from the rising rates and modestly higher levels of leverage as they prudently grow their portfolios.

In conclusion, we are very pleased with our strong fourth quarter and full year financial results against this volatile market backdrop. Our portfolio is healthy, and we are well positioned to capitalize on this increasingly attractive investment environment with our expanded leverage target and ample dry powder.

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 today comes from Kevin Fultz with JMP Securities.

Kevin Fultz ***JMP Securities LLC, Research Division - VP & Equity Research Analyst***

Congratulations on a really nice quarter. I want to start with digging in a bit more on the investment landscape and how you're thinking about leverage. You had a fairly normal quarter in terms of repayments. And on the other side, origination activity was relatively light. So I'm curious if that was intentional deleveraging in the portfolio or more so driven by the attractiveness of investment opportunities that you were seeing in the market in the September quarter.

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

Thanks for the question. This is Armen. I think part of it is we are just cautiously navigating the markets. We received repayments that were -- as part of our -- especially our nonsponsor lending activities, a catalyst that occurred in those borrowers that generated a repayment. We were careful about where we redeployed capital and how we redeployed. But also, there is a little bit of an end of quarter timing dynamic.

We did originate a very substantial amount of new deal flow in the month of October that could have happened in the fiscal fourth quarter. So we were just really managing a forward pipeline irrespective of the absolute end of the quarter, but staying quite vigilant on credit quality and not really looking to back up the truck in this current market environment.

Kevin Fultz ***JMP Securities LLC, Research Division - VP & Equity Research Analyst***

Okay. That makes sense. And then my follow-up is related to PIK income, which, I think, in the absolute is relatively immaterial, but it did increase roughly 16% compared to the June quarter. I'm just curious if you could talk about what drove the increase, whether that was amendment-driven or if you originated or purchased new investments that were structured with a PIK component.

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

Yes. I'll give you a general answer then I'll hand it over to Chris. But big picture, we did not have any amendments that were material that caused that increase in the PIK income. It was origination of new investments, especially in our life sciences area that are characterized as PIK. It is not indicative of any change in credit quality at all. I don't know, Chris, if you have anything to add to that?

Chris McKown ***Oaktree Specialty Lending Corporation - MD, CFO & Treasurer***

No, Armen. I think that covers it.

Operator

And our next question will come from Bryce Rowe with B. Riley.

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

Just maybe a follow-up on the line of questioning from Kevin there. Armen, you noted in the prepared remarks the 12.6% yield on the new private deals that you've done so far in October. Can you talk a little bit about the pipeline? Does the pipeline kind of look like that, which would obviously be a good thing? And then wanted to also kind of dig into the mix of sales versus repayments for this last quarter, if you would.

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

Sure. Just in terms of the pipeline, I would say that the October quarter I think is indicative of the pricing that we are generally seeing for our type of deals in the market. We are also seeing a broader market widening and more traditional sponsor-oriented direct lending that ourselves as well as our peers consider.

So yes, I feel very good about the pipeline as we sit here today in terms of pricing. We are still quite vigilant in terms of credit quality, really not knowing how deep a recession, if a recession were to occur, how deep would it go, and when the markets will recover. So we aren't really looking to significantly increase our leverage and originate debt that is pro-cyclical. But yes, I would say generally speaking, the pipeline is quite strong and the pricing is meaningfully wider today than what it was 9 months ago, for example.

In terms of our sales and our repayment, I don't know, Matt Stewart, if you want to chime in and give a little bit of a sense for that rotation?

Matthew Stewart ***Oaktree Specialty Lending Corporation - Senior VP & COO***

Sure. It's Matt Stewart. It was a mix of both. There were some significant repayments we received on a few portfolio companies throughout the quarter. And then we also sold during the quarter, a few names, either higher dollar-priced term loans and rotated into some better opportunities or privates.

We also have some lower yielding opportunities that we've been holding onto for a long time that we were able to rotate into some of the private pipeline that Armen mentioned that came in October. So it was a mix of both. Rough numbers is kind of 75% repayments and 25% sales on those.

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

Okay. That's helpful. And then maybe one more for me on the JVs. You noted increased levels of income, higher portfolios and higher leverage within both -- balance sheet leverage within both JVs. Is the intention to kind of continue to build some leverage here? Or will we level out over the next couple of quarters?

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

This is Armen. I don't think we could give forward-looking guidance on that. But I would generally say that in the broadly syndicated loan markets, which is really the majority of the asset base in those joint ventures, we did see volatility in the markets. We saw buying opportunities at nice discounts of well-structured paper. And that's why the leverage went up because we were buying assets. But I wouldn't want to make a forward-looking statement because our consideration and perception of that market may change. So I couldn't tell you whether it will sort of level off here or grow. But we like the positions we own, we like the positions we bought, and that's why the leverage went up a little bit.

Operator

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

Erik Edward Zwick ***Hovde Group, LLC, Research Division - Research Analyst***

To start just asking a question about the weighted average yield on the new debt commitments here in the most recent quarter, the 9.9%, which was kind of below the 10.6% in the whole portfolio, and I would have expected that to be maybe higher to what you referenced that you're seeing in October with the [12th handle on]. So curious if you could just provide any color whether that was related to some certain specific borrowers that were larger, maybe lower risk or things like that, that drove that yield up in the most recent quarter here.

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

Yes. I can't say that I have an apples-to-apples comparison that would help you figure out the differences. I don't think that the new origination in October is all that reflective of higher risk. I think it's just kind of borrower-specific one to the next that creates a little bit of a delta. But I can't say that I have any sort of specific comparison that would help answer that question.

We did, however -- I think one maybe driver of that is we did buy some large hung bridge loans that you might have heard of in the market that were hung on the bank balance sheets as well as some smaller bond issuances that were also hung. And generally speaking, I would say the yield to maturity on those positions was lower than what we typically see on our private investments. So I think that might have skewed the numbers a little bit.

But what I would say about those purchases, whether they're the hung deals or the bonds, they are at dollar prices that are meaningfully lower than the average in the market and create an opportunity for convexity and a pull to par in a very high-quality credit and over a recovery period of 2 or 3 years rather than to maturity.

The total return opportunity in those types of situations would either meet or exceed that what we typically would see in a near par price private loan. So I think there is a little bit of a -- maybe a little bit of a disjoint there. When you're buying discounted paper in the public market and you're comparing against near par paper in the private market, there is a yield-to-maturity difference, but probably not a yield-to-recovery basis.

Erik Edward Zwick ***Hovde Group, LLC, Research Division - Research Analyst***

That makes sense. And then my -- question I had today was regarding -- I think you mentioned for your portfolio companies, the debt service coverage ratio was down quarter-over-quarter from 3 to 2.7. But that 2.7 is still, I think, meaningfully above a number of your peers. I'm just curious as you're talking to your company, staying in touch with them, how are they feeling about the operating environment?

Are they slowing down investment for growth or potentially deleveraging in light of having their interest go up? Or how are they feeling at this point that you can provide any anecdotal evidence there?

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

Sure. And this will be kind of raw, but I would say, first of all, the decline in the fixed charge coverage is mainly due to an increase in base rates. It isn't really due to any sort of degradation on -- in a meaningful way, of credit quality or of performance. But with that said, I would make the following comments.

The first is, generally speaking, companies that we cover in the market, either in our portfolio or outside of our portfolio, are seeing rising commodity and labor costs and the impact that, that has on their bottom line. And therefore, they are increasing prices. So generically, I would say companies are seeing increases in revenue, really driven by higher prices rather than greater volumes sold.

But that is being offset by the labor and commodity cost inflation. And therefore, from a cash flow perspective or an EBITDA perspective, they aren't seeing tremendous growth on that line generally. I would say there's some that are doing better on the EBITDA line, some doing worse. And I think they are all being mindful of cash balances and liquidity because of the uncertain economic backdrop that we're in right now.

I wouldn't say that anybody is kind of ringing the alarm bells and worrying too much about an increase in default rates right now. But it is a risk factor that we watch very closely in the market, in our portfolio and look to, as best as we can, make sure that we are invested in companies that could or would weather an economic cycle really well, with excess cash flows, with levers that they could pull to manage their liquidity to what could be a rough patch, but obviously, nobody knows right now.

Operator

Our next question will come from Ryan Lynch with KBW.

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

First question I had, I wanted to follow up on your commentary regarding the hung deals. I think you said you had 2 hung deals that you guys participated in, in the September quarter. I would just love to hear what was the thought process behind those deals? How is that market activity going right now? Are you seeing a lot of those in the marketplace? Is that a market that you expect to participate in?

And then also, on that note, what were the size of those 2 hung deals? And then also, where do you guys classify those in your security types? Are those classified as private placements because you guys only had about $4 million of the secondary market? I would have thought those would have been classified as secondary market purchases.

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

Great. So we bought $10 million to $12 million of each, both were first lien primary issuances. I don't think they're listed as private placements or...

Chris McKown ***Oaktree Specialty Lending Corporation - MD, CFO & Treasurer***

Primaries.

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

Primaries. So we list them as primaries on the balance sheet. Now in terms of the market overall, the hung deals tend to be the largest deals in the market that we're committed to by the investment banks over the last 12 months.

They are typically not small deals for those banks. They're -- the hold sizes or the commitment sizes for the banks are in the billions. And so the reason that's important is these tend to be very, very large borrowers owned by very, very large private equity firms putting in very, very large equity checks.

They tend to be the leaders in their respective industries. And so from an underwriting perspective, ignoring the capital structure for a moment, these companies tend to be quite stable through cycles. And so when we see that, we say, okay, well, what is the right price for these positions given the underlying market backdrop? And we noticed that in light of how large these loans are and how dislocated the bank syndication market is right now, that there is a technical imbalance that has overshot the risk profile of the underlying credits. In other words, the technical profile is far worse than the credit profile is of these particular investments.

Now are there a lot of these? Not really. There aren't dozens and dozens of hung loans that we would be willing to consider. But there are several that are in the market now, both in U.S. and in Europe. And just given Oaktree's global reach, we do and are looking at several of these types of situations. I wouldn't be surprised if we participated in more, but they're all considered on a one-off basis. They're all sort of credit by credit, bottoms-up underwriting as we would do in a private deal and just taking advantage of the technical imbalance that is causing the banks to sell these positions at material losses, and create an attractively priced and yielding asset for the BDC.

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

Okay. That makes sense and that's helpful color on kind of the thought process of surrounding those deals and what you're thinking about going forward. Another question I had was -- you guys have set out -- I think you guys have operated the business at a pretty conservative leverage ratio. And I think you've spoken about you want to keep a conservative leverage ratio and then, during times of dislocation, to opportunistically grow leverage during those dislocations.

How would you view today's marketplace? Because clearly, there's very attractive deals that are occurring in the marketplace today regarding spreads, leverage, LTVs, those sort of things. But yet, there also hasn't been a lot, I would say, disruption yet flowing through the financials of businesses today. That's -- but maybe there's some, but that's certainly going to grow over the coming quarters and into 2023.

So do you view an environment today with significantly better structures and terms on deals, yet we haven't really seen the financial disruption yet? Do you view that as an opportunistic environment to grow your portfolio? Or do you have to see that decline in fundamentals of these businesses first that would further dislocate the market where it would be a time to opportunistically grow your portfolio?

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

Yes. It's a good question. And I think what you need to do is separate technicals from fundamentals. So to your point, the fundamentals, broadly speaking, in the market are showing some cracks. The fundamentals are showing some cracks in the economy. They are not to the level that I would say is indicative of deep distress or rescue lending opportunities.

We have not seen a material uptick in rescue lending opportunities at this time like we did in 2020. During the second and third quarter of 2020, we were very actively increasing our leverage profile because we did see those types of both market and economic dislocations that created outsized return opportunities in a very managed risk profile.

That is not the case right now. So fundamentally, the economy is not at the place where I would say it's maximum pain. However, the technicals and the markets, generally, are ahead and remain ahead of the economy in most normal market cycles. The equity markets, debt capital markets are usually moving in anticipation of fundamental changes in the economy. And so you will always get a situation where the market overshoots the fundamentals, but then the fundamentals sort of catch up and you have a little bit of normalcy.

And sometimes the markets actually rebound faster, and you often see a rebound in the market as the fundamentals in the economy are actually bottoming. If you look at prior cycles, that actually occurs quite frequently. So it's hard to time it where you have both occurring. You have to be mindful of the structures that you put in place and the technical pressures in the market around fund flows that may be causing a competitive dynamic that's less than attractive. And you have to weigh that against potential future degradation and economic performance of the underlying companies and their ability to pay their principal and interest and other fixed charges.

So right now, what would I say in terms of fundamentals versus technical? Is it a great environment to increase leverage? We're seeing great pricing opportunities. We are seeing widening in sponsor-led or sponsor-owned private credit. We're seeing a widening in pricing and improvement in terms in that regard, and the sponsor side as well as the nonsponsor side, a decline in leverage on a per-deal basis. I would say, generally speaking, sponsors are putting in more equity in deals that are considering these days versus 6 or 12 months ago.

So all things are pointing to a more rational market because there are direct lenders and other investors that have taken a step or half a step back from the markets and created a more rational negotiating dynamic between borrowers and creditors. So that's good. But could it get worse? Absolutely. And so we are going to continue to reserve our leverage because we think that there probably will be some alpha-generating opportunities in direct lending over the next few quarters.

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

Okay. That's helpful backdrop. And I always do appreciate your prudent approach to investing and deploying capital and utilizing leverage. I just had one final question regarding the special dividend distribution of $0.14. I understand what generated those gains that you guys had.

I'm just curious, I'd like to hear more about the philosophy around the payout. You guys are doing a onetime special dividend. Was there a reason to pay that out in a onetime shot before year-end? Why -- did you guys consider doing a more supplemental type of dividend that was paid out over multiple quarters? And how is that $0.14 calculated? Did you guys -- do you guys want to run with a level of spillover income? Did you guys want to eliminate all of it? How is that number for the payout decided?

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

Yes. Brian, it's Matt. I'll take the kind of the philosophical parts of it, and then Chris can walk through the details. But we considered everything. We looked at -- it's the first time we've paid this dividend. But at end of the day, the decision was, let's return the capital to the shareholders. Let's not pay the excise tax. There is an excise tax like 4%. So in essence, let's return all the capital to the shareholders. Let them redeploy it as they see fit rather than kind of using it to build NAV or fund internally and pay the tax. So that's where we came out philosophically on this.

I know some of our peers do different things. But for us, it was, let's avoid the excise tax, let's pay the distribution to the shareholders. That's what -- kind of that was the amount of kind of the tax and all that or the income. I'll let Chris talk to specifics, but that -- philosophically, that's kind of how we -- where we landed.

Chris McKown ***Oaktree Specialty Lending Corporation - MD, CFO & Treasurer***

Yes. I think, Matt, I think you covered it pretty well, but that's right. We looked at what our taxable income was for the year, what we would need to pay out to try to minimize or outright avoid that excise tax, and that's where we shook out with respect to the $0.14 special.

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

Okay. Was there any thought of paying that out over multiple quarters or anything like that? Or why was it, I guess, the decision to pay before in kind of one-go? And did the closing of the merger, did you pay that out before that? Did that have anything to do with it?

Chris McKown ***Oaktree Specialty Lending Corporation - MD, CFO & Treasurer***

No. The merger had nothing to do with it. It was really -- it's a calendar year end kind of item. So we paid it out for the calendar year end. That's just kind of our approach. But yes, the merger had nothing to do with it.

Operator

And there are no further questions. I'd like to turn the conference over to Michael Mosticchio for any closing words.

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

Thanks, Cole, 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 8580879 beginning approximately 1 hour after this broadcast.

Operator

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