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Q2 2023 Oaktree Specialty Lending Corp Earnings Call

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PRESENTATION

Operator

Welcome, and thank you for joining Oaktree Specialty Lending's Corporation Second Fiscal Quarter 2023 Conference Call. Today's conference call is being recorded.(Operator Instructions) Now I would like to introduce Michael Mosticchio, Head of Investor Relations, who will host today's conference call. Mr. Mosticchio you may begin.

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

Thank you, operator, and welcome to Oaktree Specialty Funding Corporation Second Fiscal Quarter Conference Call. Our earnings release, which we issued this morning, and the accompanying slide presentation can be accessed on the Investors section of our website at oaktreespecialtylending.com.

Our speakers today are Armen Panossian, Chief Executive Officer and Chief Investment Officer; Matt Pendo, President; and Chris McKown, Chief Financial Officer and Treasurer. Also joining us on the call 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 expected synergies and savings associated with the merger with Oaktree Strategic Income to Inc., the ability to realize the anticipated benefits of the merger and our future operating results and financial performance. Our actual results could differ materially from those implied or expressed in the forward-looking statements. Please refer to our SEC filings for a discussion of these factors in further detail. We undertake no duty to update or revise any forward-looking statements. I'd also like to remind you that nothing on this call constitutes an offer to sell or solicitation of an offer to purchase any interest in any Oaktree fund. Investors and others should note that Oaktree Specialty Lending uses the Investors section of its corporate website to announce material information. The company encourages investors, the media and others to review the information 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 for your interest and support of OCSL. We appreciate your participation on this call. We produced strong results in our fiscal second quarter, driven by selective, but steady origination activity at attractive yields and the benefits of higher base rates on our predominantly floating rate portfolio. Floating rate loans made up 88% of our portfolio, enabling OCSL to capitalize on rising interest rates. We also further advanced our strategy of rotating out of public debt investments and redeploying capital into attractive and higher-yielding private credit opportunities.

Second quarter adjusted NII was $0.62 per share, up $0.01 from the prior quarter. The increase was driven primarily by higher total investment income that offset increased interest expense. We reported NAV per share of $19.66, up slightly from $19.63 for the prior quarter. The increase reflected net investment income in excess of our $0.55 per share quarterly dividend and was offset by a modest decline in the value of certain investments. Given the strong overall earnings, our board maintained our quarterly dividend at $0.55 per share. As a reminder, this is nearly double our pre-pandemic quarterly run rate of $0.285.

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We did move two investments on to nonaccrual status during the second quarter,though in each case, the challenges involved company-specific issues that we believe do not indicate broader credit events within our portfolio. In each of these situations, Oaktree is the senior lender in a control position, and we took small markdowns on these assets during the quarter as we expect resolution in the near term. The nonaccruals represented 2.5% and 2.4% of the debt portfolio at cost and fair value, respectively.

Our overall portfolio is solid. And in the case of nonaccruals, we will draw upon our long history of working through special situations to arrive at successful outcomes on behalf of our shareholders. Armen will address the specifics of these investments in a few moments.

Our investment activity for the second quarter was strong with $124 million of new investment commitments. Of these commitments, 96% were private direct lending opportunities and 100% were first lien, reflecting our emphasis on being at the top of the capital structure. The weighted average yield on new originations was attractive at 11.9%.

Additionally, we received $162 million from paydowns and exits in the quarter, including approximately $38 million lower yielding public investments. We also received a payoff on our investment in Immucor, a transplant and transfusion diagnostics company. Our position included a $23 million second lien term loan and a $9 million first lien term loan, which was repaid at a slight premium to par. While we expect market activity to slow due to higher interest rates and fewer refinancings, we continue to receive steady levels of paydowns, particularly in our non-sponsor portfolio.

Importantly, as we previously announced, we successfully closed our merger with OSI II in January, and we believe the combination will result in significant benefits for the combined company and substantial long-term value for our shareholders. With more than $3.3 billion of assets, the combined company has more financial flexibility and greater scale while adhering to our value-driven investment strategy. We also anticipate realizing operational synergies as well as interest expense savings from streamlining our capital structure.

In addition, we are benefiting from reduced management fees for the next two years as Oaktree, our manager, has agreed to waive $9 million of base management fees in total, $6 million in the first year and $3 million in the second year.

In total, we have a strong balance sheet with robust levels of liquidity, and we are well positioned to continue delivering attractive returns to our shareholders. With that, I'd like to turn the call over to Armen to provide more on our portfolio activity and insight into the market environment.

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

Thanks, Matt, and good day, everyone. I'll begin with our view of the market environment. The Federal Reserve's interest rate hike campaign to tamp down inflation has begun to have its intended effect with tapering consumer prices that reached 40-year highs. However, inflation remains elevated and higher rates are putting downward pressure on loan demand, causing businesses to start to scale back on expansion plans in ways that could slow the economy enough to lead to a recession this year.

On top of all that, the recent failures of Silicon Valley Bank, Signature Bank and First Republic, along with the emergency sale of Credit Suisse in Europe could further tighten financial conditions, even if the Fed ceases interest rate hikes. In fact, according to Fed data, banks have already tightened their lending standards since the failures. This is important to monitor because U.S. regional and community banks are major providers of capital, which could meaningfully weigh on economic activity.

While we aren't predicting a severe recession or a material failure of the banking system, we think the events of the past quarter suggest that market volatility will continue and thus, prudent credit investors with available capital will be well positioned.

This creates potential growth catalysts for OCSL. We believe private credit funds may have significant and possibly long-lasting opportunities to fill the lending gaps resulting from the banks' inability to meet demand. Ultimately, we believe the fallout from all of this will likely benefit those private lenders such as Oaktree that have sufficient scale to provide debt financing for large-scale transactions and that aren't facing the types of problems that can result from lax due diligence.

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At OCSL, we have experience across all market cycles. And with strong capital and a long-term perspective, the conviction needed to withstand short-term volatility and continue to invest and generate strong returns for our shareholders. Our focus on relative value, coupled with our ability to negotiate and structure customized deals that provide downside protection allows us to invest across multiple markets and issuers with the ability to withstand the impact of a potentially deteriorating economic environment. And the successful completion of our OSI II merger and the greater scale it created gives us a timely advantage. From where we sit today, we are confident in our abilities to further deploy capital on favorable terms and generate consistently strong returns for our shareholders. Now turning to the overall portfolio.

At the close of the March quarter, our portfolio was well diversified with $3.2 billion at fair value across 165 companies, up from 146 a year earlier. We continue to emphasize larger, more diversified businesses that are better positioned to weather downturns or market turbulence.

Median portfolio company EBITDA as of March 31 was approximately $133 million, up slightly from $128 million in the prior quarter. Leverage in our portfolio companies was relatively steady at 5.1x, well below overall middle market leverage levels. The portfolio's weighted average interest coverage based on trailing 12-month performance declined slightly to 2.4x from 2.5x in the prior quarter due to rising base rates.

Turning now to our origination activity. Our $124 million of new investment commitments were spread over 6 new and 3 existing portfolio companies in the quarter.

Let's look at a couple of representative examples. First, Oaktree originated a $160 million commitment to finance the merger of Woodcraft and Paradigm Precision, leading suppliers of machine and fabricated aerospace components and assemblies based in Connecticut. Two private equity sponsors sought to merge the two companies together to create a leading aviation engine components manufacturer, which would serve top companies such as GE and Rolls-Royce among others.

This was a complex situation where our extensive aerospace industry knowledge and flexible investment approach allowed us to provide a solution to the sponsors. $12 million of this deal was allocated to OCSL. The loan was priced favorably at SOFR plus 700 basis points with strong downside protection.

Second, Oaktree originated a $100 million commitment to Harrow Health, a commercial-stage eye care company with a current market capitalization of approximately $750 million. OCSL was allocated $11 million. The company was seeking capital to fund its growth strategy by leveraging its unique positioning within the ophthalmology compounding space. This first lien deal was priced at SOFR plus 650 basis points, with call protection and covenants. We also received warrants which could provide upside and generate future capital gains.

Looking ahead, our pipeline remains robust as we are evaluating a range of interesting investment opportunities that we believe present an attractive risk reward.

Turning to credit quality. As Matt mentioned, we moved two investments to nonaccrual during the quarter. The first is an investment that we made into SiO2 material science, an advanced material sciences company that has invested in new technology for the packaging and containment of biological drugs and molecular diagnostics. The company made a significant investment to build up production capacity for the COVID vaccine, but as the global supply glut of COVID vaccines and as the pandemic receded, the company needed to pivot its business and reconfigure facilities for non-COVID demand, which is still strong but off from peak levels.

The best way for the company to right size its capital structure, which included several tranches junior to our first lien term loan, was through a reorganization. Oaktree committed approximately $60 million of debt financing in addition to its initial $205 million loan to provide stability through expedited restructuring, while the company continues operations in its normal course of business. OCSL's total investment was marked at $50 million at quarter end or approximately 88% of par. We believe that we are well covered on the term loan and the DIP, given the collateral of a state-of-the-art U.S.-based manufacturing facility and proprietary IP of their unique packaging technology, which has an appeal to a wide variety of customers. We believe that SiO2 is well positioned for long-term success.

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The second nonaccrual event included an investment that we made in conjunction with Oaktree's Real Estate Group in early 2021 to a luxury residential condominium developer in the San Francisco market. While we have received material repayments on our initial investment as units were sold over the course of the last two years, the recent rise in mortgage rates and the challenging environment for the technology industry has weighed on sentiment in the San Francisco market and has significantly pressured condo sales.

In February, we did not extend our loan to the borrower, and we have been in discussions about a modification of extension terms to facilitate the sale of the building by the sponsor. We believe that we are well covered on the loan, and we put it on nonaccrual status as the sponsor is working to sell the property. OCSL's total investment was marked at $23 million at quarter end, or approximately 98% of par.

Once again, as Matt noted, in both of these instances, the challenges involved company-specific issues that we believe do not indicate broader credit issues within our portfolio, and we expect to resolve each situation in the near term.

In summary, our strong liquidity position and experience across various cycles, coupled with the breadth of the Oaktree platform, position OCSL very well for the second half of fiscal 2023. Now I will turn the call over to Chris to discuss our financial results in more detail.

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

Thank you, Armen. Before discussing our financial results, I would like to address the GAAP accounting related to our merger with OSI II. Similar to our previous merger with OCSI, the fair value consideration paid to acquire OSI II as determined under GAAP was based on OCSL's stock price at the time of the merger. This resulted in a purchase price premium as OCSL was trading at a premium to NAV, which was allocated to the acquired OSI II assets based on their fair market value. OCSL's initial cost basis for the assets equaled their fair value at the time of the merger, plus the purchase premium. Upon re-marking the assets back to their fair values following the merger's completion, OCSL recognized a one-time unrealized loss equal to the purchase price premium of $20.7 million. This one-time loss was a non-cash event. Going forward, each credit investment acquired from OSI II will amortize from its new cost basis to par over its remaining life. We have updated our non-GAAP measures to exclude the impact of the income accretion as well as any gains or losses arising solely from the OSI II merger accounting adjustments. More information is available in our earnings release and slide presentation.

Turning now to our results. OCSL delivered another quarter of strong financial performance, building upon the momentum from the first quarter.

For the second quarter, we reported adjusted net investment income of $45.4 million or $0.62 per share, up from $37.1 million or $0.61 per share in the first quarter. The increase was primarily driven by higher interest income resulting from our larger investment portfolio and rising base rates, partially offset by higher interest expense, part 1 incentive fees and operating expenses.

Net expenses for the second quarter totaled $50.3 million, up $10 million sequentially. The increase was mainly due to $7.1 million of higher interest expense as a result of the impact of rising interest rates on the company's floating rate liabilities combined with a larger portfolio resulting from our merger with OSI II in January. We also recorded higher base management fees on the larger portfolio and professional fees due to seasonality in our larger portfolio. Despite the sequential increase in professional fees, we are pleased to note that consistent with what we messaged when we announced the OSI II merger, we are on track to achieve $1.4 million worth of operating expense synergies on an annualized basis.

With respect to interest rate sensitivity, OCSL still remains well situated to continue to benefit from a rising rate environment. As of March 31, 88% of our debt portfolio at fair value was in floating rate investments. Our strong earnings in the first quarter were again due to the higher base rates, which in turn drove our interest income higher.

Now moving to the balance sheet. As we highlighted on our last call, OCSL's net leverage ratio at quarter end declined from the December quarter to 1.14x, primarily the result of the OSI II merger. Leverage is now modestly higher than the midpoint of our target range of 0.9 to 1.25x debt to equity. As of March 31, total debt outstanding was $1.8 billion and had a weighted average interest rate of 6.2%, up from 5.6% at December 31 due to higher base rates. Unsecured debt represented 37% of our debt at quarter end, down

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modestly from the prior quarter, again, due to the OSI II merger.

At quarter end, we had ample liquidity to meet our funding needs with total dry powder of approximately $379 million, including $44 million of cash and $335 million of undrawn capacity on our attractively priced credit facilities. Unfunded commitments excluding unfunded commitments to the joint ventures were $237 million, with approximately $184 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 $393 million of assets invested in senior secured loans to 56 companies, down from $409 million last quarter, primarily driven by exits from two investments.

The JV generated $3.2 million of cash interest income for OCSL in the quarter, up from $2.6 million in the fourth 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 a $1.1 million dividend consistent with the first quarter dividend. Leverage at the JV was 1.4x at quarter end, unchanged from the prior quarter.

The Glick JV had $131 million of assets as of March 31, down from $138 million at December 31. These consisted of senior secured loans to 39 companies. Leverage at the JV was 1.2x at quarter end, and we received $1.5 million worth of principal and interest payments 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 we continue to believe that our strong balance sheet positions us well for the remainder of the fiscal year. 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 12.6%, up from 11.9% in the prior quarter. While we are very pleased with the growth in our earnings for the past several years, including our solid second quarter results, we continue to believe OCSL remains well positioned to maintain and even build upon our strong ROE going forward.

First, we believe OCSL continues to be positioned well for this rising rate environment. As Chris noted earlier, with 88% of our investment portfolio in floating rate assets, we expect that further increases in base rates will positively impact our net interest margin.

We also continue to benefit from higher ROEs generated at our joint ventures. During the second quarter, both joint ventures delivered ROEs of over 14% as they are also being positively impacted by the rising rate environment.

And as I noted earlier, we expect that the cost savings and management fee reductions resulting from the OSI II merger will also support our returns.

In conclusion, we are very pleased with our strong first half of our fiscal year. Our portfolio is on solid footing, and we are well positioned to continue to capitalize on this increasingly attractive investment environment with our ample dry powder. We believe that our solid portfolio and strong balance sheet position us well for the remainder of the fiscal year. 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 line.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) and the first question will come from Kevin Fultz from JMP Securities.

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

In your prepared remarks, you mentioned that non-sponsored paydowns picked up in the quarter. I'm just curious if you could discuss what drove a pickup in non-sponsor paydowns and your expectations for that to persist over the next few quarters.

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

This is Armen. Our non-sponsored deal activity really relates to catalysts and certain initiatives taken on by a company using our capital to fund growth or some sort of transformation in the business. When those transformations occur, there tends to be a pay down because the company's enterprise value changes materially or its ability to generate cash flow changes materially to the positive. It's hard to predict the timing of such paydowns, but it's a nice balance to the portfolio that in an environment like today where you usually don't see very much in terms of refinancing of sponsor-led deals, our non-sponsored side, when these catalysts do work out, result in a good outcome in terms of return of capital to OCSL. I can't make any predictions about the future, but we would expect that given the performance of a lot of our non-sponsor deals that we will have periodic repayments over time.

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

Okay. That makes sense. And then just one more if I can. I'm curious if you saw an increase in amend requests from borrowers this quarter. And if you could discuss your expectations that to potentially pick up over the next few quarters here.

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

Yes. I mean it's certainly more topical this quarter versus a year ago. I wouldn't say that it has materially picked up. But certainly, there are more discussions with borrowers. But I wouldn't say we have a statistically significant sample or a material enough pickup to really dig deep and pull out any sort of conclusion around that at this time. For the market overall, however, I would expect that over the coming quarters, there will be more discussion both on the topic of amendments and waivers as well as solutions to bloated capital structures.

I think with the higher base rates, one should expect that some of the most aggressive capital structures put in place over the last few years will be upside down, and will need some incremental capital either in the form of PIK preferred capital or additional equity capital or somebody lenders in the existing capital structure converting part of their position to PIK. So I would expect that activity is going to pick up generally in the market. And I think it creates an opportunity for Oaktree, just given the nature of our platform. So it's a good question. It's one we're watching very closely. But at this time, we're not seeing in our portfolio, at least any sort of meaningful pickup to comment on.

Operator

And the next question will be from Erik Zwick from Hovde Group.

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

Wanted to start just looking at the new investment commitments in the quarter at 100% first lien. I'm curious if that was more just kind of discretionary in your part or not seeing any attractive second lien opportunities and what that might mean? I guess the total portfolio percentage is up to 75% now. So I guess curious also if you have a kind of target percentage for that first lien at this point?

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

I wouldn't say that we necessarily have a target per se of first lien, but we have seen more attractive risk-adjusted returns in first lien loans that are new issue versus junior in the capital structure. With base rates where they are and with spreads widening a bit in the first calendar quarter of this year versus a year ago or 1.5 years ago, you really don't have to stretch for risk and go junior in the capital structure to earn 11%, 12%, 13% unlevered returns or unlevered yields on those loans. And similarly, if you think about where a second lien or a junior piece of the capital structure must price for it to make sense, it sort of needs to price around 14%, 15%, 16% if the first lien is pricing at 12%.

And at that type of pricing, usually a well-heeled sponsor or owner of a business, would rather fund incremental equity and not pay a lender mid-teens returns. So it's a combination of us not wanting to go into the second lien because it's a little bit riskier than we would like and a little bit riskier than you really need to take on. And those sponsors and owners that we want to do business with have the capital to invest in the equity. And so in new deals, in new sponsor-led transactions, we are routinely seeing greater than 50% equity checks. And that compares very favorably to a year or 1.5 years ago, where equity checks were more routinely 35% or 40%.

So I would say it's just a better quality market, and we're getting, I think, some really nice returns in new issue loans in the low double

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digits without having to stretch for junior instruments and the capital structure. I expect that going forward, in the next couple of quarters, I wouldn't expect to see a material uptick in second liens. And it's probably on balance, we would see flat to declining second liens in the portfolio. I just can't comment on the quantity or the percentage allocation. But I think we generally are seeing better opportunities in first, and we'll probably migrate the portfolio on the margin more towards first rather than second.

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

Then also noticed within the quarter, just one secondary market purchase and that was down from the 14% in the prior quarter. So curious if that was reflective of just a few opportunities or the prior quarter really just had an outsized opportunity set relative to the most recent quarter?

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

Yes. The public markets were pretty strong in the first quarter. High yield was up a little over 4%. Senior loans were up about 3.5%. When you see that type of movement in the markets, we generally kind of hang back and pick our spots. When we do see more volatility, that's when we kind of lean into the public markets more. So I would say, for the most part, we were probably better sellers of public credit than we were buyers of it in the quarter. That could change, given volatility. We have, obviously, a very active publicly traded book at Oaktree across our platform and evaluate relative value in public versus private every day, frankly. So we saw some good opportunities in private. We took those opportunities rather than leaning into public given the strength in the market there.

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

Makes sense. And last one for me, just I appreciate that the Slide 12, where you've outlined your liquidity positioning and you're certainly very amply positioned as you kind of outlined. Just curious, and given some of the market dynamics today, macroeconomic dynamics as well as some of the challenges in the banking sector could present an opportunity where obtaining additional funding could become more difficult, not specifically for Oaktree, but just for maybe that the BDCs in general. So just curious how you think about managing liquidity today when expanding those resources could become more and more challenging here in the near term?

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

I definitely agree with your premise that one should expect that generally access to funding is going to be more challenging in the coming quarters versus the prior 4 or 5 quarters. And the largest, most diversified, well-balanced credit managers are going to continue to have access, whereas maybe smaller ones will have limited access. I think that will likely mean that firms like Oaktree that do have that type of history and relationship will frankly grow and benefit from this part of the cycle. We, as a firm, generally speaking, grow when the cycle turns rather than when it's procyclical.

So it's a good time for us. But I think your question is very appropriate. I would expect that some number of smaller managers, smaller BDCs, probably will have challenges in accessing either the public markets or the lending markets, just given some of the issues with the regional banks, given some of the issues even with the larger banks and regulatory oversight, probably becoming more intense rather than less intense over the coming quarters. We have always structured our capital structure in a way in anticipation of bad outcomes. We've never predicted a bad outcome, but we always ask ourselves, what do we need to believe for the worst-case scenario and how are we positioned if that were to take place. So our capital structure is very much delivered or structured in contemplation of that type of scenario.

And so we feel very good about access to capital. We feel very good about our banking relationships. We feel very good about our access even to the unsecured markets. So I think overall, we feel like this is a position of strength for us, and we're going to continue to manage our liquidity very closely. I don't know if anybody if Matt or Matt, anything to add there?

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

Erik, it's Matt Pendo. The only thing I'd add is if you think about the size of OCSL, we've talked about this a lot, both in terms of originating assets and then on the capital structure. But the size of OCSL in the context of Oaktree, I think it's the right size. So as Armen said, we have very good relationships with our banking partners. We have very good relationships with our unsecured bond investors.

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When we've accessed the market, we've, I think, accessed the right amount of capital. The bonds have traded well at least with the banks are good. So I think when you look at kind of the quantity of capital in OCSL and how we have it diversified across banks and bonds, I think that's a key strength.

Operator

And the next question is from Ryan Lynch from KBW.

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

First one I just want to touch on, you mentioned one of the nonaccruals, beaver, I was just curious, I would love to hear some more details on that because when you first hear about a building in Downtown San Francisco, that certainly sparks a lot of red flag. This is a residential building. So that's obviously much better than like an office building. But I would just love to hear how you expect this to be resolved? Is this going to be resolved over time as they sell additional units that you guys will get paid over time? Or are they looking to sell the whole building? And then do you have any sense of your loan-to-value on this position? Obviously, that's probably subject to change, but what sort of cushion do you think you have at this point?

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

Yes. Thanks, Ryan. Some information about that deal. So first of all, we originated that deal in early 2021. And since then, actually, out of the gates, we had very strong sales, and about half of the loan was already repaid at par plus exit fees and clipping a coupon of SOFR plus 825. So I want to make sure that much is out there where this isn't like a typical corporate loan where you get 1% amortization and you have a bullet at the end. I mean we've gotten almost 50% of the principal repaid plus exit fees, et cetera.

In terms of the forward outlook, I think the sponsor here, or the owner of the building, is a very well-heeled, very well-known amazing operator of a variety of different types of real estate, including high-end residential. We are giving them the benefit of time, and we're going to continue to clip our coupon and benefit from that as we give time to that manager to have more of an orderly liquidation. It could result in a block sale of the remaining units of the building. It could be kind of one by one.

The units are still selling just at a lower sales pace. But at high enough dollars per square foot that we are well covered on our loan. The latest transactions in the building are meaningfully higher than our dollars per square foot basis. I don't want to put out a loan to value per se, but we are well covered. And we're not concerned about impairment of the loan. It's just a matter of time, not a matter of if we get out of it.

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

Okay. Just one clarification on it. You said you're happy to give time to clip the coupon. The loans on nonaccrual, correct. So does that mean that you guys are still collecting interest and then using that to pay down your cost basis or both...

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

No. The coupon is not being paid in cash, but it is not forgiven either. So we have put it on nonaccrual out of an abundance of caution. We expect to get a substantial portion of that coupon over time. But given the current conditions of carrying costs for that sponsor, we're in negotiations with them now, but we understand the cash flow pressure is not a good thing, and we would, as part of just kind of buying some time, we will continue to earn our coupon, and have a right to collection of it, but not a current cash pay.

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

And then the other question I had was, I'd love to just hear your thoughts on the level of deal activity you're seeing in this environment. There's obviously been a huge drop in sponsored bat, ovo opportunities out there given all the things that are going in the marketplace, all the uncertainties and risk and those sort of things and the pricing and interest rates. But you guys played in a lot of different markets, including the non-sponsor marketplace. So I think we all understand that there's very good deals when a company -- when a lender such as yourself make a new deal in this environment that the terms are very good. I'm just kind of looking for the level of deal activity that you guys are seeing in maybe some of those non-sponsored or other channels?

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

Yes, it's a good question. So the non-sponsored deal flow has never been consistent enough to draw enough comfort in a forward outlook or pipeline. It's always been -- we speak with companies, management teams, advisers all the time, and there may be periods of time where there makes a lot of sense to do a deal because of the idiosyncracies of that situation. I wouldn't say non-sponsored deal flows materially picked up given the current environment. It's certainly more costly to borrow today than it was a year or two ago for these types of companies. So at the end of the day, they still need to make the equity math work.

With that said, there are some industries like life sciences, where there has been a material drop in the equity market multiples. -- for those businesses over the last two years. And it is far less dilutive to those businesses to get $150 million or $200 million in a private loan than to issue $100 million or $200 million in the public equity markets. So we are seeing, I would say, consistent to maybe slightly upticking deal flow over the last year or 2 or 3 in life sciences, in particular. And we continue to originate there. That's the largest area of our non-sponsored direct lending from a sector perspective. And I wouldn't say that, that slowed down at all. In fact, I would say it's probably moderately increasing in terms of the number of deals that we're looking at.

Operator

And the next question will be from Melissa Wedel from JPMorgan.

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

I wanted to quickly touch on dividend policy as you have sort of a reverse trend. You have a long track record of doing very small dividend increases quarter-over-quarter. You've obviously maintained current levels into the June quarter despite really over earning that level currently. Just want to understand how you're thinking about that and whether we should read into that announcement as to what you think the interest rate environment could be going forward?

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

Thanks, Melissa, it's Matt. Good question. I wouldn't read too much into it in terms of what the future holds. I think I read into it that there's obviously a lot of volatility and news coming out of the market kind of every day. I think we've also been very conservative in our approach to the dividend. This quarter, the adjusted investment income was $0.62. The dividend was $0.55. So I think there's a lot of conservatism in that. But just owing to the uncertainty volatility in the market, we thought it prudent to let's just kind of keep it at $0.55 for this quarter. We have, to your point, we have increased it really almost double pre-pandemic. But at this point, the dividend yield on NAV is north of 11%. Our ROE for the quarter was north of 12.5%. So we feel very good about the dividend coverage, very good about the earnings and the ROE. But just kind of given all the uncertainty out there, it seemed to make sense to just keep it $0.55. That over-earning goes to NAV, grows NAV, in which we have a history of doing. So that's really kind of how we thought about the dividend for this quarter.

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

As a follow-up, I wanted to circle back to something that Armen talked about in prepared remarks, I believe, around sort of the opportunity created by tighter lending standards. I think you meant broadly, but also particularly within the regionals. Can you elaborate on that a little bit and talk about what that might mean for your opportunity set? What types of companies, how large things you wouldn't look at? Just want to pull on that thread a little bit.

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

Sure, Melissa. I think that the regionals are obviously are more focused, generally speaking, on smaller businesses than we have been historically. The regionals also, to some extent, some of the larger regional support back-leverage facilities for investment managers as well. I think the statement I made is more of a general statement that with them taking a step back, there are certain asset classes and sizes of businesses, as well as investment managers, that will also have to take a step back or will have a gap in funding. We certainly do have local sourcing people across different jurisdictions.

We're seeing the impact of the regionals being less involved with possible deal flow coming our way. We are seeing the beginnings of what could be portfolios coming for sale out of regionals. We are very cautious on those portfolio transactions. We've done them a lot at Oaktree, but we want to make sure that the underlying assets in those portfolios are large and manageable whereby whatever position

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we buy, we actually have a really substantial seat at the table rather than a small participation in a large loan. The opportunity sets widened as a result of that type of stress or distress. And then at the large banks, one should expect the regulatory oversight of what they do and how they use their balance sheets to earn syndication fees will take a toll.

For now, the markets are giving a breather to loan prices, to broadly syndicated loan prices, because there just isn't very much new issuance in broadly syndicated loans. But my expectation would be that if there was a sudden need or desire or shocks to the market that caused more syndication to be necessary that the broadly syndicated loan market is suffering from a lack of liquidity and could materially trade down if there was a sudden inflow or a sudden need for new issuance there.

So I think given that unsteady equilibrium that appears to be the case in the broadly syndicated loan market, we're finding the best opportunities in supporting large sponsors in doing new deals. That's probably the best risk-adjusted return that we're seeing in the private credit market currently, first lien deals with very large sponsors running a 60% equity check and paying us 12% in a company that has $75 million to $700 million of EBITDA.

The number of deals has declined in that ZIP code versus a year or two ago, but the quality of those deals is meaningfully better today than it was a year or two ago. So we're pretty excited about that opportunity. And we expect for that to continue to be an investment opportunity for us in addition to some more wider kind of portfolio types of considerations that could come our way, and we could selectively participate if it makes sense.

Operator

(Operator Instructions) The next question will be from Bryce Rowe from B. Riley.

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

I wanted to maybe ask a little bit about balance sheet leverage and recognizing that it did go down here in the quarter. I guess some of that was just natural with OCSI II being a little less levered from a balance sheet perspective. But any commentary around that decline in leverage? Was it deliberate in the face of what we're seeing in the market and maybe priming the pump for whatever opportunities might come around? Or was it just kind of natural flow of what happened quarter in, quarter out.

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

So I mean, I think part of it is we like the level we're at -- we finished the quarter, I think it's 1.14, right in the middle of our range. So it gives us plenty of capacity to deploy capital, we don't feel constrained at all in our liquidity, our capital, our ability to deploy capital to the interesting opportunities. So we like that aspect of it. The OSI II merger was deleveraging. They were less levered than OCSL, and we obviously expected that to close. So that was part of our kind of calculus. But I really just think of it as we're in a comfortable spot. We've got lots of liquidity. It's an interesting time to invest. We always like to have to be really less leverage than any of our peers because we like that opportunity and flexibility provides us.

So I would just take away, we're really comfortable where we are. We've got a lot of dry powder. We're seeing a lot of interesting things. And we expect there to potentially be more in the future. So we're really, really comfortable where we sit right now.

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

And Bryce, it's Matt Stewart as well. During the quarter, after the OSI II merger, we also had some low-yielding assets, both in OCSL and from OSI II that we sold throughout the quarter given the strength in the public markets that Armen mentioned. So we were able to sell upwards of $40 million in the public to make room for future privates as well, all in the high 90s.

Operator

And ladies and gentlemen, we have no further questions at this time. So I'd like to turn the conference back over to Michael Mosticchio for any closing remarks.

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

Great. Thanks, Chad, 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 863 948 beginning approximately 1 hour after this broadcast.

Operator

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

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