Oaktree (Q2 2025)

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Corporate Speakers:

- Clark Koury; Oaktree Specialty Lending Corporation; Head-Investors
- Matt Pendo; Oaktree Specialty Lending Corporation; President
- Armen Panossian; Oaktree Specialty Lending Corporation; Chief Executive Officer and Chief Investment Officer
- Chris McKown; Oaktree Specialty Lending Corporation; Chief Financial Officer and Treasurer

Participants:

- Finian O'Shea; Wells Fargo; Analyst
- Melissa Wedel; JPMorgan; Analyst
- Paul Johnson; KBW; Analyst

PRESENTATION

Operator^ Welcome and thank you for joining Oaktree Specialty Lending Corporation's Second Fiscal Quarter 2025 Conference Call.

Today's conference call is being recorded. (Operator Instructions)

Before we begin, I want to remind you that comments on today's call include forward-looking statements reflecting current views with respect to, among other things, future operating results and financial performance. Actual results could differ materially from those implied or expressed in the forward-looking statements. Please refer to the relevant SEC filings for discussion of these factors in further details. Oaktree undertakes no duty to update or revise any forward-looking statements.

I'd also like to remind you that nothing on this call constitute an offer to sell or solicitation of an offer to purchase any interest in Oaktree funds. Investors and others should know that OCSL 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 is shared on its website.

Now, I would like to introduce Clark Koury, OCSL Head of Investor Relations who will host today's conference call.

Mr. Koury, you may begin.

Clark Koury^ Thank you, operator.

Our second quarter earnings release, which we issued this morning along with the accompanying slide presentation can be accessed on the Investor section of our website oaktreespecialtylending.com.

Joining me on the call today is Armen Panossian, Chief Executive Officer and Co-Chief Investment Officer; Matt Pendo, President; and Chris McKown, Chief Financial Officer and Treasurer.

I'll now turn the call over to Matt to provide an overview of our performance during the quarter and a couple of updates with regard to our capital structure. Matt?

Matt Pendo^ Thanks, Clark, and thank you to everyone for joining today. Adjusted net investment income was $39 million or $0.45 per share compared to $45 million or $0.54 per share in the first quarter. Our net asset value was $16.75 per share versus $17.63 in the prior quarter. These results reflect ongoing challenges with a few portfolio company investments, which we have been and continue to work towards restructuring or exiting.

We moved several of these investments to non-accrual and took additional write downs. As a result, investments on non-accrual status increased to 4.6% and 7.6% of fair market value and costs respectively. This compares to 3.9% and 5.1% in the first quarter.

On the positive side, we made progress in resolving several investments on non-accrual, including exiting our loan position in SVP-Singer, where we received proceeds totaling $5.7 million which was consistent with our mark as of December 31. We've also seen some increased sales activity in Avery, a luxury mixed use building in San Francisco. Sales picked up in the second half of calendar year 2024, and the trend has continued thus far into 2025.

Proceeds from sales go to repaying our loan, enabling us to redeploy capital into new income-generating investments. During the last quarter, we received proceeds totaling 10% of our cost bases, and we expect to receive additional repayments next quarter. In addition, in April, we received nearly $100 million from repayments on debt investments, all of which were realized as small premiums as compared to our March 31 valuation.

Now turning to our dividend. In line with our new dividend policy, we announced last quarter, our Board approved the base dividend of $0.40 per share, and a variable supplemental dividend of $0.02 per share for the second quarter.

With regard to our balance sheet, we successfully issued new unsecured bonds that mature in 2030 to refinance our existing bonds that matured in February 2025. Additionally, shortly after the quarter end, we successfully amended our senior security revolving credit facility, extending its maturity and reducing the interest rate from SOFR plus-2% to a range of SOFR plus-1.75% to 1.875%.

We appreciate the support of our bank group and believe that lower interest expense and associated fees will have a favorable impact on our net investment income. With these

positive changes to our capital structure and our leverage at its lowest level in over three years, we have ample dry powder for new investments as we navigate this volatile period.

Before I turn it over to Armen, I want to remind you about the meaningful steps we took to more closely align our interests with shareholders. Earlier this year, we amended our incentive fee structure by implementing a total return hurdle, and Oaktree purchased $100 million in OCSL shares at a meaningful premium to the share price, which provided us with additional capital to deploy into our pipeline.

Also, in July of last year, we reduced our management fee to 1% on all assets. We believe these actions demonstrate our commitment to shareholders and to enhancing the long-term earnings power of the portfolio.

I'll now turn over to Armen to more detail on non-accruals and our investment activities.

Armen Panossian^ Thanks, Matt. I'll start with additions to our non-accruals. Two companies were added to non-accrual status during the quarter. The first was Mosaic Companies, a designer, distributor, and retailer of specialty wall and mosaic tile, floor tile, and slabs. Mosaic operates three distinct business segments, and the sponsor had initiated sale processes for all three. Unfortunately, each of these segments are expected to be impacted by tariffs, which affected the sponsor's efforts to sell. Two of those processes were paused during the quarter. The sale of the third segment closed shortly after quarter end, resulting in a meaningful cash paydown of approximately 50% of our total position.

Pro forma for the repayment, we took a conservative approach in valuing the remaining assets, leading to a markdown of approximately 76% on the unsold portions. Despite being placed on non-accrual, the material cash recovery reflects progress in our efforts to manage and resolve the position. We are actively working to sell the remaining two business segments.

The second edition was SIO2, a manufacturer of a hybrid material that combines glass and plastic for medical use in diagnostic tubes, vials, and syringes. Our prior position in the company was restructured in August of 2023. And this quarter, we placed the restructured loan on non-accrual due to the company's continued cash needs. We marked down the loan by about 69% at quarter end. The company recently signed a new contract and is pursuing several other opportunities and license agreements. We remain focused on supporting the company in these strategic initiatives.

Although it's not new to our non-accrual list, Dialyze is another investment where we took a significant markdown. We placed the company's first lien term loan on non-accrual in the December quarter, given the company's ongoing cash needs. We continue to be actively engaged with management and other stakeholders to evaluate the best path forward, but unfortunately, the situation has not materially improved, and this quarter, we marked the loan down by about 76%. While we're clearly not pleased with how SIO2 and

Dialyze have trended, these two positions now represent less than 1% of the portfolio at fair value.

Turning now to investment activity for the quarter. We committed $407 million of capital across 32 investments, consisting of 24 new borrowers and 8 existing borrowers. This compares to 13 investments totaling $198 million in commitments last quarter. The weighted average yield on our new debt investments was 9.5% versus 9.6% in the prior quarter. Increasing portfolio diversification remains a focus as we took the number of positions to 152 from 136 last quarter.

We continue to emphasize investments at the top of the capital structure and consistent with the first quarter, approximately 84% of the portfolio was invested in senior secured loans, including 81% in first lien loans. To mitigate risk in the current environment, we are prioritizing investments in larger, more diversified businesses that have the financial and operational ability to withstand uncertain times.

As of March 31, the median EBITDA of our portfolio companies was approximately $158 million and $16 million increase from the prior quarter. The leverage in our portfolio companies was steady at 5.4 times, well below overall middle market leverage levels. The portfolio's weighted average interest coverage based on current base rates declined slightly to 1.8 times compared to 2.1 times last quarter.

Looking at our second quarter originations, I'd like to highlight two noteworthy loans we made to Vantive and Barracuda. The healthcare sector remains a strong focus for us, given its critical need and sustainable outlook.

Vantive is a global leader in the development and manufacturing of capital equipment and consumables for both acute and chronic dialysis therapies. As a recognized innovator, Vantive holds the number one position in the non-clinical peritoneal dialysis market, demanding approximately 73% market share. This financing facilitated Carlyle Group's acquisition event structured as a $2.5 billion first lien term loan and a $450 million revolving credit facility. Oaktree provided $425 million of the term loan, which carries a coupon of SOFR plus-5%, along with $77 million of the revolving credit facility. OCSL was allocated $61 million of the total deal.

We also like service providers with recurring cash flow models and made an investment in Barracuda, a provider of cloud enabled, email data and network cybersecurity solutions for middle market and small to mid-size businesses. This financing sits alongside the company's syndicated first lien and second lien term loans, and proceeds were used to bolster the company's liquidity position. Oaktree led this transaction and provided $100 million the total $200 million term loan priced at SOFR plus-6.5%. With OCSL receiving $15.5 million.

We believe these transactions highlight the strength of Oaktree's deal sourcing platform and our capacity to participate in larger scale opportunity. Advantages we believe set us apart from other market participants.

I'll now turn to an overview of exit and repayment activity during the quarter. Investment exits slowed in the second quarter, totaling $279 million primarily driven by fewer sales within our liquid portfolio. As you may recall from our remarks last quarter, we took advantage of strength in the public credit markets late last year and sold certain investments that we believe were fully valued.

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

Chris McKown^ Thank you, Armen. In our second fiscal quarter ending March 31, 2025, we delivered adjusted net investment income of $38.7 million for $0.45 per share as compared to $44.7 million or $0.54 per share in the prior quarter. The decrease was primarily driven by lower total investment income, partially offset by reduced interest expense and Part 1 incentive fees during the quarter.

Adjusted total investment income in the quarter declined $9.9 million compared to the prior quarter, primarily due to a decrease in interest income resulting from a smaller average investment portfolio, the impact of placing new investments on non-accrual status, and declining reference rates.

Net expenses declined $3.8 million from the prior quarter, driven by a $2.4 million decrease in interest expense due to lower outstanding borrowings and lower reference rates on our floating rate liabilities, and a $1.5 million decrease in Part 1 incentive fees, net of fees waived, reflecting the impact of the total return hurdle.

Now moving to our balance sheet. Our net leverage ratio at quarter end was 0.93 times, down from 1.03 times last quarter. As of March 31, total debt outstanding was $1.47 billion and had a weighted average interest rate of 6.7%, including the effect of our interest rate swap agreements. This is up from last quarter, primarily reflecting the impact of refinancing our 3.5% fixed rate bonds that matured in February with new bonds that mature in 2030.

In connection with issuing the new bonds, we entered into an interest rate swap agreement translating to a coupon of SOFR plus-2.19%. Unsecured debt represented 65% of total debt at quarter end, up from about 59% last quarter. We have plenty of dry powder to fund investment commitments with liquidity of approximately $1.1 billion. This includes $98 million of cash and $1 billion of undrawn capacity on our credit facilities following the recent amendment that Matt described earlier.

Unfunded commitments excluding those related to the joint ventures were $273 million approximately $252 million of which can be drawn immediately, as the remaining $21 million is subject to portfolio companies meeting certain milestones before the funds can be drawn.

Our target leverage range remains unchanged at 0.9 times to 1.25 times. We are currently at the low end of that range due to a combination of successful investment exits,

Oaktree's $100 million equity investment in the March quarter, and our prudent approach to deploying capital given market volatility.

Turning now to our joint ventures. Together, the JVs currently hold $440 million of investments, primarily in broadly syndicated loans spread across 54 portfolio companies. During the second fiscal quarter, the JVs again generated attractive annualized ROEs, which were approximately 10.6% in aggregate. Leverage at the JVs was 1.3 times, up slightly from last quarter. In addition, we received a $700,000 dividend from the Kemper JV.

With that, I would like to turn the call back to Armen to provide some color on the market environment.

Armen Panossian^ Thanks, Chris. Before opening the call up to questions, I'll provide some brief commentary on the market environment. Since the end of the second quarter, we have experienced some of the most volatile public market conditions since the pandemic in March 2020.

There is significant uncertainty surrounding the trade environment, including what new tariffs may arise, potential retaliatory measures from other countries, and how long these policies will remain in place. Despite the wide range of potential outcomes, we believe we can make the following observations with some certainty.

Despite an optimistic outlook for a pickup in M&A activity earlier this year, activity has been slow and is likely to remain that way until we have more clarity around the economic outlook. We expect many lenders will be more cautious around capital deployment as they focus on the health of existing portfolio companies.

In this environment, companies that were once supported by easy credit and low interest rates are now grappling with tightening liquidity, rising borrowing costs, and disrupted supply chains driven by global trade upheavals. It will be a couple of quarters before tariffs roll through the supply chain and impact portfolio company performance, so it's too early to assess the real impact now.

That said, well in advance of the actual tariff announcements, we were considering their potential impact on existing and prospective investments. This heightened focus factored into our underwriting and risk evaluation, and we are proactively selling investments within our liquid portfolio that we perceive to have more exposure to negative impact from tariffs.

We are also focused on further diversifying our portfolio by selectively investing in companies we believe are well positioned to deliver attractive returns given market uncertainty caused by tariffs, as well as inflation and high interest rates.

Recently, there's also been an uptick in demand for capital solutions or rescue financing, which could benefit managers like Oaktree that have significant experience and expertise

in this area. Historically, in periods of market volatility, our firmwide DNA has enabled us to capitalize on opportunities while others are sidelined, and we have the dry powder to do so again if appropriate opportunities arise.

In closing, we believe OCSL is well positioned to navigate the current market environment and to deliver attractive risk adjusted returns to our shareholders over the long term. We appreciate your participation on our call today, and now we will take your questions.

Operator, please open the line.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) The first question comes from Finian O'Shea with Wells Fargo.

Please go ahead.

Finian O'Shea^ Hey everyone, good morning. First question, did you lean in to any liquid markets, structured finance, or syndicated loans in April?

Armen Panossian^ Hey Finn, it's Armen. We were a little active but not very because we were then and continue to be concerned that the tariff situation is not resolved. And so what happened in April was, yes, it started off with a sell-off in high yield bonds, senior loans to a lesser extent in structured credit. But there's been a rebound in the back half of April, and so we've taken more of a measured approach given that recovery.

Finian O'Shea^ Okay. It was helpful, and just a second higher level question. Armen you mentioned, remaining focused on the larger and diversified businesses I think that's been the language or narrative for a while. Can you hit on like high level how successfully you've been effectuating that, are you out there finding adequate issuers that fit within your box on a credit and structure perspective for direct lending or is this a challenge. And then sort of part B there, the losses experienced are -- what's the sort of overlap? Are they the company -- are they generally smaller EBITDA or do they overlap with that sort of core focus? Thanks.

Armen Panossian Good question. So in terms of size Fin, the market ebbs and flows. So late last year when the markets were pretty strong and wide open from a banking perspective, we saw spreads tightening in broadly syndicated loans, we saw spreads tightening in high yield bonds, and we saw new issuance in senior loans, creation of CLOs, and we saw tightening in direct lending as well.

And in the larger borrower segment, we found that or the borrowers found that they could get better pricing and looser legal terms from the broadly syndicated loan market versus direct lending. So it was, I would say it felt a little bit more challenging or the trend did not feel so great for the ultra large cap, the $100 million, $150 million plus EBITDA

category for new deals. Well, it didn't feel so great in the back half or the fourth quarter -- fourth calendar quarter of last year.

With some of the volatility we've been seeing in the markets though in the last 1.5 month, we are seeing a pullback in new issuance activity from the banks and so we are seeing a return of some larger borrowers into the direct lending market, post liberation day. And so the pipeline from that perspective is, I would say on the margin better for issuing direct loans to very large borrowers. With that said, M&A deal volume is not as robust as we would like it to be overall as a market.

Now the reason for that is in the fourth quarter after President Trump was elected, there was, I would say some positive feelings about where the market would go and where rates would go, President Trump generally at that time was considered to be somebody who would lean on lower rates, would lean on deregulation, and those would be good things for deal flow and the transaction of sponsor to sponsor LBOs.

Now, so there was a lot of activity at least in terms of discussions late last year and early this year as to, hey, 2025 issuance is going to be very strong and M&A volumes will be strong, but the tariff announcements have thrown a wrench in that and it just seems like private equity sponsors generally are reticent to do deals to pending kind of what's going to happen with these tariffs because it leans on higher rates, it leans on more inflation.

And it -- and all of that is sort of bad for valuation multiples, so there is a -- I think somewhat of a pause happening right now in two respects. One is private equity sponsors doing new deals, and two, corporate borrowers that have some level of tariff related exposure, i.e., part of their supply chain runs through a non-US market, or they part of their sales go to a non-US market.

We're seeing that there is a pause in building up of inventory, a pause in CapEx spending, and given that backdrop I would expect as -- I would expect to see continued sort of reservations around deal activity for a few months at least, so that's kind of the current condition around deal flow large cap but the deals that are getting done so high quality businesses that are somewhat insulated from tariff impacts that are still being LBO'd, and there have been some announcements in the last few weeks.

So deals are happening just at less of a rate. Those deals are getting done more frequently in the direct lending market rather than broadly syndicated loan market. So we are engaged in those situations, our pipeline for the quarter so far -- for this quarter that we're in so far is actually pretty good, just given some of that pull back from the bank so we feel good about that condition.

And to answer your second question about the markdowns, no, look, the markdowns are not in large cap sponsor lending. The markdowns unfortunately it's all -- it's been the same names for a few quarters now for a couple of years now that I kind of weighed on performance and I don't -- there isn't anything thematic about them, but other than late

year, mid last year with Pluralsight which was a very large LBO that had some issues, which I think we've discussed in the past and has been pretty well known in the market.

Other than that one situation, the rest of them are sort of idiosyncratic situations where just businesses have not executed the way they should have. In the case of SIO2, a business that was doing incredibly well during COVID, took a lot of that profitability and spent it on new R&D that didn't pan out unfortunately. And so it's -- that's not really a large cap issue or a big versus small business issue. It's a deal where the execution around that technology just did not meet expectations.

Finian O'Shea^ Okay. Thank you.

Armen Panossian^ Thank you.

Operator^ The next question comes from Melissa Wedel with JPMorgan.

Please go ahead.

Melissa Wedel^ Good morning. Thanks for taking my questions. Really trying to discern sort of run rate NII, given the markdowns on the portfolio, and the additional changes in non-accruals, it seems like with some stabilizing base rates this could be sort of what we could expect in that -- given no changes in base rates, this could be a run rate level NII. Is that fair to say or are you seeing other things happening in the portfolio that could impact that?

Chris McKown^ Hey Melissa, it's Chris. Thanks for the question. I'll get it started and Armen and Matt want to chime in, please feel free. I think a couple of things we're focused on, we mentioned in our prepared remarks that we finished the quarter at 0.93 times net leverage, so definitely kind of the low end of our range and where we been operating historically.

Our average portfolio throughout the quarter was a little bit lower versus prior quarters. So we're going to -- as Armen I mentioned going to be patient around deployment, but over time we are mindful of the fact we're lowering our leverage range than where we've been operating.

And then I think, the other focus and I think Matt mentioned a couple of his comments just around, working through some of these situations on the non-accruals, turning those into cash producing assets is definitely a continued focus of ours.

Matt Pendo^ And I think, Melissa it's Matt, the other area continue to focus on is the JV's, and putting more assets in there running leverage, a little bit higher there. They invest mostly in BSL, so those are -- it's relatively more easy to deploy there than in some of the private assets that the sales cycle is a little bit longer. So that's just the other point I'd make.

Melissa Wedel^ Sure. And I mean to that point on leverage and then deploying within the joint ventures. I mean, obviously this quarter, it seems very different from even the March quarter when we look at sort of the repayment levels that you've seen in the portfolio and exits repayments and exits over the last three quarters they've been pretty sizable. Should we be expecting any slowing of repayment activity during this period of volatility, or would you expect that to remain pretty elevated?

Armen Panossian Melissa, this is Armen, I could take a crack at that. So a couple things, in terms of liquid credit in the back half of last year, especially the fourth quarter as the markets were pretty tight, we actually -- we're just generally a net seller of liquid credit and so we actually de-levered the JVs as a result of that.

I think given the volatility in the last four to six weeks in the public markets and our anticipation of further volatility in those markets given what I would expect would be a challenging tariff backdrop for a while, I would expect that we will find some opportunities to deploy into the joint ventures and increase their leverage again.

We're looking for good deals that are or good companies that are trading discounted. And we don't think it's there yet. They traded off 2 points, 3 points maybe 3.5 points in late March and into April, and they've recovered, maybe half of that point move, and so -- and if you look at high yield bonds, the spreads had widened to 435, 440-ish during that time frame. They're now back to sort of 375.

They are pretty volatile though, quite sort of up and down, but we think that as performance starts to show up in the second calendar quarter this year and into the third, there's probably going to be volatility in the public credit and equity markets that we think we could take advantage of for the JVs.

In the case of private credit, we actually have had some exits, since the end of the quarter, and so, I think we -- those are more idiosyncratic, not really reflective of necessarily a tightening credit story. It was just situations that resolved. So I think our repayments for the quarter are not going to be immaterial. I think they will be up for the quarter end of June. I think they'll still be significant enough, but again -- but yeah, I think your instinct is correct that if the markets are volatile that generally speaking repayments, refinancing should slow down and I would expect to see that over the coming quarters as well.

Melissa Wedel^ Thanks very much.

Operator^ (Operator Instructions) The next question comes from Paul Johnson with KBW.

Please go ahead.

Paul Johnson^ Thank you. Thanks for taking my questions. Just on the kind of run rate question of income, just looking at the portfolio yield this quarter I think it was down 50 basis points or so. But if I take a quick average of just kind of the debt portfolio yield

quarter over quarter, it looks like it's down a little over 100 basis points. So I'm just curious, like is there any kind of one time stuff that's flowing through there, that would -- is this yield, I guess that we have today reflective of kind of what you think the portfolio should generate going forward?

Chris McKown^ Yeah. Hey, it's Chris. Appreciate the question. Yeah, I think a couple of factors. I think looking at sort of the quarter on quarter decline in interest income, part of that is just due to reference rate declines in the December quarter rate sets for about half the book were based on 9/30 base rates, so those reset at the end of December in light of the rate cuts that happen in the fourth calendar quarter, that plays through in the March quarter.

That's part of it. And your -- as far as the quarter on quarter decline in yield seeing from the 10.7% we reported last quarter to the 10.2% this quarter, majority of that of about 30 bps worth was due to the impact of the new non accruals which we've -- just and a little bit of just, I'll call it lingering timing with respect to reference rate resets and also some spread compression quarter on quarter. So I do think that, where we're at now is the decent run rate viewed on the book.

Paul Johnson^ Okay, thank you for that. And then, you partly answered my question here, but on the JV the 10.6% ROE, is that a net ROE as opposed to like an operating ROE on the JV?

Chris McKown^ So that's looking at the NII of the JV. And I should say the NII plus the coupon interest on the subordinated note.

Paul Johnson^ Okay, because that's pretty close to what you're generating on the balance sheet, so it sounds like you may find some opportunities to increase leverage there and put some investments into the JV. So with leverage I guess what do you think you could potentially get the JV to in terms of an ROE over time?

Chris McKown^ That's -- I think it'd depend on the opportunity set. I mean, certainly getting back up into the call it the 11%, 12% context I think is achievable. But will ultimately depend on the opportunities that we're seeing there.

Paul Johnson^ Appreciate it. That’s all for me.

Operator^ Thank you. This concludes the question and answer session.

I would like to turn the conference back over to Clark Koury for any closing remarks.

Clark Koury^ Thank you, operator and thank you all for joining us on today's call. A replay of the earnings call will be available in approximately one hour, and you can access that on the Investor section of OCSL's website. Please feel free to reach out to me, and team with any questions you may have. Thanks again for your participation and support.

Operator^ The conference has now concluded. Thank you for attending today's presentation.

You may now disconnect.