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Q1 2021 Oaktree Strategic Income Corporation Earnings Call

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CONFERENCE CALL PARTICIPANTS

Christopher Gastelu

PRESENTATION

Operator

Welcome, and thank you for joining Oaktree Strategic Income Corporation's Fiscal First Quarter Conference Call. Today's conference call is being recorded. (Operator Instructions)

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

Michael Mosticchio *Oaktree Strategic Income Corporation - IR*

Thank you, operator, and welcome to Oaktree Strategic Income Corporation's First Fiscal Quarter Conference Call. Our earnings release that was issued this morning and the slide presentation that accompanies this call can be accessed on the Investors section of our website at oaktreestrategicincome.com.

With us today are Armen Panossian, Chief Executive Officer and Chief Investment Officer; Matt Pendo, President and Chief Operating Officer; and Mel Carlisle, Chief Financial Officer and Treasurer. We will be happy to take your questions following their prepared remarks.

Before we begin, I want to remind you that comments on today's call will include forward-looking statements reflecting our current views with respect to, among other things, the timing or likelihood of the merger closing, 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. 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 Strategic Income 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 will now turn the call over to Matt.

Matt Pendo *Oaktree Strategic Income Corporation - President & COO*

Thank you, Mike, and welcome, everyone, to our First Quarter Earnings Conference Call. We appreciate your continued interest in and support of OCSI, and we hope everyone listening is well.

We began fiscal year 2021 with very strong earnings and originations while maintaining solid credit quality. NAV was up 4% to \$9.38 per share, approximately 97% of its pre-pandemic level, as tighter credit spreads in the liquid loan and private debt markets drove higher valuations in our portfolio in the December quarter.

Net investment income for the first quarter was \$0.14 per share, up 7% from the prior quarter, driven by lower interest expense that was due to a small decrease in outstanding borrowings as well as lower Part I incentive fees, which Mel will explain in more detail.

Based on the strength of OCSI's earnings, our Board of Directors declared a cash dividend of \$0.155 per share, an increase of 7% from the

prior quarter's distribution and the second consecutive quarterly distribution increase.

We continued to build momentum and generated another solid quarter of origination activity. During the quarter, we originated \$55.8 million of new investment commitments, exceeding the \$34.3 million of proceeds from prepayments, exits, other paydowns and sales during the quarter. All of our new investments in the quarter were first lien loans, attractively priced and spread across a wide array of businesses and industries. The weighted average yield on new debt investments was 8.2%, which compares favorably to the approximately 5% weighted average yield on the investments that we exited during the quarter.

Our asset quality remains excellent. Our focus on larger and more resilient companies that we believe are more likely to prove recession-resistant continues to support our credit quality. As of quarter-end, excluding the Glick JV, we continue to have no investments on non-accrual, and we are confident in the ability of our borrowers to navigate what we hope are the final months of this pandemic.

We also remain well capitalized with ample liquidity to continue to invest and to meet our funding requirements. At December 31, liquidity included \$13.6 million of cash and \$87.2 million of undrawn capacity on our credit facilities.

Before I turn the call over to Armen, I wanted to provide an update on OCSI's plan to merge with and into Oaktree Specialty Lending Corporation, an affiliate business development company that is also managed by Oaktree.

As we discussed in our last call, we expect this will create a larger, more scaled BDC with increased trading liquidity, potentially broadening our institutional shareholder base and may improve access to lower-cost sources of debt. We also anticipate that it will drive NII accretion over both the near and long term.

We are confident that now is the right time to move forward with this merger. Both portfolios have strong credit quality, and our transition out of non-core assets that we've been working on since 2017 is nearly complete. The registration statement has been declared effective, the proxy solicitation process has begun, and the merger is on track to close by the end of the current quarter. With our shareholders and OCSL shareholders scheduled to vote on the transaction on March 15, we encourage all shareholders to review the proxy materials and vote your shares accordingly.

With that, I will now turn the call over to Armen.

Armen Panossian *Oaktree Strategic Income Corporation - CEO & CIO*

Thanks, Matt, and good morning, everyone. I'll begin with our view on the environment. The recovery in credit and equity markets that developed in calendar 2020 has continued into this year, underpinned by extraordinary fiscal and monetary stimulus and also supported to an extent by gradually improving economic conditions and consumer sentiment. Investors are also encouraged by the rollout of COVID-19 vaccines and commitments by the new administration to step up the inoculation process in hopes of vaccinating enough people to end the pandemic later this year. And yet, valuations feel elevated and might not necessarily reflect current macro conditions or the prevailing outlook for gradual economic growth this year.

We remain cautious about assuming too much about the success of vaccines at this stage or the pace of economic growth in the year ahead. As such, we continue to approach new investments defensively. We think it is important to view market enthusiasm with caution and approach investment opportunities conservatively. We remain focused on protecting the downside in our investments and seeking appropriate compensation for risks taken.

Fortunately, we are able to draw upon Oaktree's scale and resources to invest across multiple markets with diversified issuer bases, enabling OCSI to focus on stable and lower-risk sectors, including companies either unaffected or even positively impacted by COVID. We continue to identify compelling opportunities in the life sciences and technology areas that are delivering health care solutions or capitalizing on the increased level of digital commerce. We're also seeing direct lending opportunities to businesses that are not easily underwritten via traditional cash flow-based methodologies, as well as companies that need capital to bridge the gap from the pandemic to a normalized post COVID-19 economy.

Now turning to the overall portfolio performance. At the end of the first quarter, the portfolio was well diversified with \$521 million invested at fair value across 78 companies. 89% of the portfolio consisted of senior secured loans, of which, 86% were first lien. We continue to favor larger, more diversified businesses. And as a result, our median portfolio company EBITDA is approximately \$124 million, a larger-than-typical middle market company.

As we have throughout the pandemic, we remain in close contact with management teams and private equity sponsors, and we are confident in the ability of our portfolio companies to manage through the current environment. Their liquidity positions are generally strong, and our strong credit quality reflects this.

Turning now to investment activity. During the quarter, we found numerous opportunities in companies with attractive risk/reward profiles in defensive sectors, as well as unique opportunities requiring specialty structured terms. I'd like to take a moment to discuss in more detail compelling investments we made in the first quarter. Let me start with a couple of our more opportunistic originations this quarter.

Wencor is an independent, low-cost aftermarket services and parts provider for the commercial aerospace sector working with a diverse base of several hundred airline customers. Due to the pandemic and the grounding of over 50% of the global fleet, airlines have deferred maintenance to preserve liquidity. Wencor sought a loan to extend from the current challenging environment to what it expects will be a resurgence in needed repairs as airline travel rebounds post pandemic amid pent-up demand. Oaktree was the sole provider of a \$50 million first lien incremental term loan with a \$30 million first lien delayed draw term loan able to be drawn by the company through September of this year. The term loan was priced at LIBOR plus 7.5%. OCSI was allocated \$10 million of the loan.

LATAM airlines is one of the world's largest airlines, and it is the largest airline in Latin America. The company filed for Chapter 11 bankruptcy protection to restructure its set and ensure operational continuity as the business adapted to the pandemic. LATAM sought to raise a significant amount of capital as part of its restructurings, and this led to an over \$800 million total commitment from Oaktree. OCSI participated alongside our flagship Opportunities funds in this deal, which was attractively priced and structured. The pricing was LIBOR plus 9.75% on a cash basis, or 11% PIK. OCSI was allocated \$6 million of the loan.

I want to share one more example that is emblematic of our focus on burgeoning technology businesses. Thrasio is a company that acquires Amazon e-commerce brands, typically from mom-and-pop operators that lack the infrastructure to scale, and then operates these brands with upgraded marketing, product development and supply chain management. Thrasio has acquired about 80 brands since its inception, making it a leader in this arena. It is at the forefront of modern digital commerce, and benefits from the momentum and strength of the Amazon marketplace. The company, which has a conservative leverage profile and significant equity cushion, sought financing to fund its continued growth. And Oaktree committed \$85 million of the first lien term loan with pricing at LIBOR plus 7%. OCSI was allocated \$10 million of the loan.

We continue to assess unique and attractive opportunities like these across a range of industries. With our strong liquidity and the resources of Oaktree, we are in excellent position to pursue new investments now and as part of our merged operation with OCSL.

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

Mel Carlisle *Oaktree Strategic Income Corporation - CFO & Treasurer*

Thank you, Armen. OCSI delivered another quarter of strong financial performance. For the first quarter of fiscal year 2021, total investment income was \$9 million, consistent with the September quarter.

Net expenses for the quarter totaled \$5 million, down \$0.2 million from the previous quarter. The decline was mainly due to \$0.4 million lower interest expense resulting from lower average borrowings and \$0.3 million lower Part I incentive fees. This was partially offset by \$0.6 million higher professional fees incurred in connection with the pending merger.

For the quarter, OCSI reported net investment income of \$4 million or \$0.14 per share, up 7% from \$3.7 million or \$0.13 per share for the fourth quarter of fiscal year 2020.

Turning to credit quality, which remains excellent. As Matt noted, at quarter-end, excluding the Glick JV, we had no investments on non-accrual, consistent with the prior quarter.

Moving to the balance sheet. During the quarter, we funded \$43 million in investments, which was more than the \$34 million in payoffs and exits. However, our net leverage ratio decreased to 0.87x from 0.91x at September 30, mainly due to the increase in NAV and approximately \$17 million of unsettled purchases. As of December 31, total debt outstanding was \$253 million and had a weighted average interest rate of 2.6%, consistent with the prior quarter as LIBOR remained unchanged during the quarter.

At quarter-end, we had total liquidity of approximately \$101 million, including \$14 million of cash and \$87 million of undrawn capacity on our revolving credit facilities. Excluding the Glick JV, unfunded commitments were \$33 million, with approximately \$29 million of this amount eligible to be drawn immediately. The remaining amount is subject to certain milestones that must be met by portfolio companies.

Shifting now to the Glick joint venture. As of December 31, the JV had \$154 million of assets invested in senior secured loans to 42 companies. This compared to \$138 million of total assets invested in 40 companies last quarter. Two investments held by the JV which represented 1.3% of the portfolio at fair value were on non-accrual status. Leverage at the JV was 1.3x at December 31, down slightly from 1.4x last quarter.

Although our subordinated note investment in the Glick joint venture remains on non-accrual status, we continue to benefit from the earnings power of the JV's underlying investment portfolio, which generated \$1.4 million of net investment income during the first quarter, consistent with the prior quarter. This income was used to repay outstanding principal on the subordinated notes, of which \$1.2 million was distributed to OCSI in January. This distribution represented \$0.04 per share. And although OCSI is still not recognizing interest income, its share of the net investment income generated by the JV effectively translates into below the line income at OCSI. Given the JV's continued solid performance over the last three quarters, we will evaluate the accrual status of the JV at the end of the March quarter.

Now I will turn the call back over to Matt.

Matt Pendo *Oaktree Strategic Income Corporation - President & COO*

Thank you, Mel. The defensive repositioning that we launched in 2017 has largely been completed, and we feel very good about our current holdings.

As Armen noted, our overall pipeline of potential transactions remained strong and we expect to continue to identify compelling investment opportunities throughout fiscal 2021. We will also continue to position the portfolio for an improved yield by rotating out of lower-yielding investments priced at LIBOR plus 400 or lower. We made good progress on this initiative in the quarter as we opportunistically sold \$14 million of these types of investments. At December 31, we had \$39 million of these lower-yielding loans, which we plan to replace over time with higher-yielding proprietary investments.

In conclusion, we are very pleased with our strong first quarter performance. We are also looking forward to the pending merger with OCSL as we believe that this combination benefits both sets of shareholders through scale, portfolio diversity and expected earnings accretion. We are excited about the future for the combined company and remain confident that we will continue to identify new, attractive, risk-adjusted investment opportunities, enabling us to deliver improved returns to our shareholders.

Thank you for joining us on today's call and for your continued interest in OCSI. With that, we're happy to take your questions. Operator, please open the line.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Chris Gastelu of CGA.

Christopher Gastelu

Congrats on a good quarter, another good quarter. And also congrats on guiding OCSI to a nice conclusion once that merger wraps up. I guess on earnings day, you guys will be able to have lunch going forward since this 12:30 time slot will be available.

My one question, are you able to give any update on the premerger tax distribution? I know there was a number in the proxy. But I don't know if you had any further update at this time.

Armen Panossian *Oaktree Strategic Income Corporation - CEO & CIO*

Mel, do you want to answer that?

Mel Carlisle *Oaktree Strategic Income Corporation - CFO & Treasurer*

Sure. There's not an update. The number we included in the proxy, it should come out pretty close to that.

Operator

(Operator Instructions) Showing no further questions, I'll now turn the call back over to Michael Mosticchio.

Michael Mosticchio *Oaktree Strategic Income Corporation - IR*

Thanks, Melissa, 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 Oaktree Strategic Income's website in the Investors section, or by dialing (877) 344-7529 for U.S. callers or (412) 317-0088 for non-U.S. callers, with the replay access code 10151068, beginning approximately 1 hour after this broadcast.

Operator

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

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