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OCSI - Q4 2017 Oaktree Strategic Income Corporation Earnings Call

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CORPORATE PARTICIPANTS

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Mathew M. Pendo *Oaktree Strategic Income Corporation - COO*

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

Michael Mosticchio *Oaktree Strategic Income Corporation - Investor Relations*

CONFERENCE CALL PARTICIPANTS

George Bahamondes *Deutsche Bank AG, Research Division - Senior Research Analyst*

PRESENTATION

Operator

Welcome, and thank you for joining Oaktree Strategic Income Corporation's Fourth Quarter and Fiscal Year 2017 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 - Investor Relations*

Thank you, operator, and welcome to all of you who have joined us for today's call to discuss Oaktree Strategic Income Corporation's Fourth Fiscal Quarter and Full Year 2017 Financial Results. Our earnings release, which we issued this morning and the slide presentation, which accompanies this call can be accessed on the Investors section of our website at oaktreestrategicincome.com. Our speakers today are Oaktree Strategic Income's Chief Operating Officer, Matt Pendo; Chief Executive Officer and Chief Investment Officer, Edgar Lee; and Chief Financial Officer and Treasurer, Mel Carlisle. We will be happy to take your questions following their prepared remarks.

Before we begin, I want to remind you that our comments today will include forward-looking statements reflecting our current views with respect to, among other things, our future operating results and financial performance. Our actual results could differ materially from those implied or expressed in the forward-looking statements. Please refer to our SEC filings for a discussion of these factors. 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 Strategic Income Corporation uses the Investors section of its corporate website to announce material information. Accordingly, the company encourages investors and media and others to review the information that it shares on its corporate website at oaktreestrategicincome.com.

With that, I would now like to turn the call over to Matt Pendo, Chief Operating Officer.

Mathew M. Pendo - *Oaktree Strategic Income Corporation - COO*

Thank you, Mike. It is a privilege to welcome all of you to our first conference call as the new investment adviser of Oaktree Strategic Income Corporation. On today's call, I'll provide a brief overview of the Company and of the Oaktree platform. Next, our Chief Executive Officer, Edgar Lee, will provide an overview of the portfolio; and Mel Carlisle, our Chief Financial Officer and Treasurer, will review our financial and operating results for the fourth quarter.

I would like to begin by thanking our stockholders for your vote of confidence and welcome you to Oaktree Strategic Income. We are very excited to be managing this company, and believe we are well positioned to leverage Oaktree's platform and resources and to do what Oaktree has done successfully for many years, invest.



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Since we became the investment manager of Oaktree Strategic Income on October 17, we have rebranded the BDC and it now trades on the NASDAQ Stock Exchange under a new ticker symbol, OCSI. We have also attracted 6 new Board members, including Board Chair, John Frank, Oaktree's Vice Chairman, who, over his 16-year tenure at Oaktree, has served as the firm's Principal Executive Officer and General Counsel. Additionally, the majority of the board is comprised of independent directors who have both investment and corporate governance experience and expertise.

The investment professionals that manage Oaktree's Strategic Credit strategy, which is led by Edgar Lee, have assumed responsibility for managing Oaktree Strategic Income. Edgar is Chief Executive Officer and Chief Investment Officer of the BDC. And Mel Carlisle, who has a 20-year history of working at Oaktree, is Chief Financial Officer and Treasurer.

Let me discuss in some detail how Oaktree's credit platform is a competitive advantage and provides many benefits for our BDC stockholders.

At September 30, Oaktree managed approximately \$100 billion in assets. Since our founding 22 years ago, Oaktree has been recognized for its expertise in credit and extensive experience in managing high yield, senior loans and private debt. Today, the firm manages over \$22 billion in high-yield assets and over \$11 billion in senior loans. Since 2005, we have invested \$10 billion in over 200 directly originated loans across multiple strategies, including Strategic Credit.

The firm's scale spans across credit asset classes, as Oaktree has a team of over 250 highly experienced investment professionals with a breadth of expertise in loan originations, due diligence, deal structuring and underwriting. As a result, OCSI will be supported by the tremendous resources and skill at Oaktree, including the ability to collaborate with our high yield, senior loan and other private debt teams.

Additionally, Oaktree is a trusted partner to many financial sponsors and management teams based on the commitments we make to our borrowers, our long-term view of investing and our ability to lend across market cycles. We also have a strong market presence and established relationships that often leads to a first look at proprietary opportunities.

With that, I'd like to turn the call over to Edgar.

Edgar Lee - *Oaktree Strategic Income Corporation - CEO & CIO*

Thank you, Matt. I'll begin with an overview of our investment objectives for Oaktree Strategic Income and then provide a review of our portfolio and our plans for it going forward.

Our focus for Oaktree Strategic Income is to invest primarily in first lien, floating-rate senior secured financings, in both the private placement and broadly syndicated markets, with the goal of generating a stable source of current income for investors. We intend to generate attractive returns across market cycles by investing in companies across a variety of industries that have resilient business models, strong cash flow generation and seasoned management teams.

Since we began managing Oaktree Strategic Income about 6 weeks ago, we have been reviewing each investment in the portfolio with the same due diligence we would apply to any new Oaktree investment, and I'm pleased to report that overall, the portfolio is in good shape.

At September 30, the portfolio had a fair value of \$560 million, including investments in loans to 67 companies and an investment in the joint venture with GF Equity Funding, which we refer to as the Glick JV.

Approximately 90% of the portfolio was invested in senior secured floating-rate debt instruments. 85% was in first lien loans and 5% in second lien loans. 10% of the portfolio consisted of our interest in the Glick JV, and less than 1% comprised equity investments in other portfolio companies. The weighted-average yield on debt investments was 7.5%. So far, we are encouraged by the relative stability of the yield in the portfolio.

The portfolio included investments in companies across more than 30 industries. The largest concentrations were in the following sectors: Internet and application software and services, advertising, IT consulting and diversified support services, health care services and specialized finance.

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Our interest in the Glick JV, which invests primarily in senior secured loans to middle market companies, was valued at approximately \$58 million and includes both a subordinated debt investment and a subordinated equity interest in the JV.

New investment commitments for the quarter were approximately \$109 million and included 10 new and 7 existing portfolio companies. These were made by the previous investment adviser and do not necessarily reflect the type of investments we will be making going forward.

Fundings for the quarter were \$108 million, including \$77 million in loans to 10 new portfolio companies. These investments include broadly syndicated loans, which are generally more liquid and lower yielding than privately placed middle market loans. The remaining \$32 million were loans to 9 existing portfolio companies.

During the quarter, OCSI received \$71 million in proceeds from refinancings and monetizations of 8 investments. The environment for direct lending remains active, so a number of portfolio companies were able to refinance or repay their loans.

In the fourth quarter, 2 new investments were placed on a nonaccrual status, bringing the total to 3 investments on nonaccrual as of September 30, which represented 1.1% at fair value. Aside from the relatively small number of challenged credits, the overall credit quality of the portfolio remains stable. Approximately, 2/3 of portfolio companies reported year-over-year revenue growth as of September 30.

Now I will provide some color on the investment landscape and our expectations for originating new loans.

The landscape for direct lending is increasingly competitive as new participants continue to enter the market, and we are seeing more aggressive deal structures that include weaker covenants, high leverage or aggressive EBITDA add backs. Against this backdrop, we are being highly selective in making new investments. However, we believe that Oaktree's broad direct lending platform, combined with our ability to co-invest alongside our other funds, will allow us to maintain an active presence in the market. In fact, since we began managing the portfolio in late October, we have made several new investments. To give you a sense for our investment approach, let me briefly describe one strategic transaction we recently closed.

This is a \$15 million first lien senior secured investment in an aerospace component and assembly company that was purchased by a financial sponsor. It is attractively priced at LIBOR plus 650, with 1 point of OID. It has a well-structured covenant package and modest leverage. This company should benefit from positive secular trends, as well as long-term agreements with major investment-grade customers. We look forward to discussing additional transactions with you in the future and hope this gives you a sense for how we will leverage the Oaktree platform to source attractive investment opportunities and how we will structure and price transactions.

In conclusion, the credit quality of the portfolio is relatively solid, and we believe Oaktree Strategic Income is very well positioned to leverage Oaktree's scale and resources to deliver attractive and consistent returns to stockholders over time.

And now I'd like to turn the call over to Mel Carlisle, Chief Financial Officer and Treasurer, to discuss our financial results in more detail

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

Thank you, Edgar. Net investment income in the fourth quarter was \$5.5 million or \$0.19 per basic and diluted share. This was down sequentially from \$5.9 million or \$0.20 per share in the third quarter, driven primarily by lower interest income, partially offset by higher fee income.

As a reminder, a fourth quarter dividend of \$0.19 per share was previously declared and is payable on December 29, 2017, to stockholders of record on December 15.

Total investment income for the fourth quarter was \$11.8 million, including \$10.9 million of cash interest income as compared to \$12.2 million of total investment income in the third quarter. Net expenses for the quarter were \$6.3 million as compared to \$6.2 million in the third quarter.



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OCSI recorded \$20 million of net unrealized losses during the quarter, primarily due to write-downs on 3 portfolio companies and the investment in the Glick JV. There were no material realized gains or losses during the quarter. Net asset value declined to \$9.97 per share at September 30 from \$10.65 a share at June 30, mainly due to the unrealized losses in the quarter.

Total debt outstanding at September 30 was \$263 million with a weighted average interest rate of 3.26%, and the debt-to-equity ratio was 0.9x. At year-end, OCSI had \$36 million of unrestricted cash and cash equivalents and \$67 million of undrawn capacity on its credit facilities.

At fiscal year-end, the company also had \$44 million of unfunded commitments outstanding, primarily to fund portfolio companies with revolving credit facilities and delayed draw term loans.

With that, we're happy to take your questions. So operator, please open up the lines.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question will come from George Bahamondes of Deutsche Bank.

George Bahamondes - Deutsche Bank AG, Research Division - Senior Research Analyst

Just wanted to see if there are -- during the call for Oaktree Specialty Lending, I understand we're talking about a different company here now, but I was wondering if there are certain loans, either sizes or types that you guys are trying to cycle out of for OCSI. You had mentioned cycling out of loan balances below \$10 million. Is there anything like that, that we should keep in mind for OCSI?

Edgar Lee - Oaktree Strategic Income Corporation - CEO & CIO

I would say in OCSI, it's less a story about repositioning and more a story about finding great new investments to continue to create shareholder value here. To the extent any new risks arise in the portfolio, we'll actively manage them out, but as we mentioned earlier, we're overall relatively pleased with the condition of the portfolio.

Operator

We have no further questions, Mr. Moticchio.

Michael Moticchio - Oaktree Strategic Income Corporation - Investor Relations

Thank you. And thank you all for joining us on today's call. A replay of this conference call will be available for 30 days on Oaktree Strategic Income's website in the Investors section or by dialing (877) 344-7929 for U.S. callers, or 1 (412) 317-0088 for non-U.S. callers with the replay access code 10114279 beginning approximately 1 hour after this broadcast. And once again, if you would like a copy of the transcript or you need any help, please feel free to give me a call or e-mail us at Investor Relations. Thank you.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines. Have a great day.



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