THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

OCSI - Q1 2018 Oaktree Strategic Income Corporation Earnings Call

EVENT DATE/TIME: FEBRUARY 09, 2018 / 4:00PM GMT

CORPORATE PARTICIPANTS

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

Matt 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 First Quarter 2018 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 first quarter 2018 financial results. Our earnings release, which we issued this morning, and the slide presentation that 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 Executive Officer and Chief Investment Officer, Edgar Lee; Chief Operating Officer, Matt Pendo; 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 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. Accordingly, the Company encourages investors, the media, and others to review the information that it shares on its website at oaktreestrategicincome.com.

With that, I would now like to turn the call over to Edgar Lee, Chief Executive Officer.

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

Thank you, Mike, and welcome, everyone, to our first quarter earnings call. I will begin with a brief overview of our progress since we began managing OCSI on October 17. Next, I will provide a review of our portfolio. Then, Mel Carlisle will review our financial results and capital structure. Finally, Matt Pendo will discuss our dividend and our plans to enhance the portfolio's return on equity.

As noted on page 2 of the earnings presentation, we are pleased to report that in the short time since we began managing Oaktree Strategic Income, we made good progress on important near-term initiatives for optimizing the portfolio and the company's capital structure.

First, we monetized $151 million of investments during the quarter. $71 million were full repayments at or above par, and there were sales of $80 million in 17 issuers. Importantly, all of these sales on average were executed within 25 basis points of our September 30, 2017, fair values.

Second, during the quarter, we originated $136 million of new investments in 17 new and 3 existing portfolio companies. These investments were made across 16 industry sectors, and 96% of these were in first lien loans.

Third, we upgraded our operational infrastructure by integrating into Oaktree's platform. This integration included processes and systems related to accounting, valuation, compliance and information technology and should lead to cost savings over time.

I am pleased to report that as part of the integration, we also remediated the material weakness related to internal control over financial reporting, which initially occurred in 2015. Completing this integration was not an easy task, and we thank everyone at Oaktree for their efforts in achieving a smooth transition.

Fourth, we lowered our borrowing costs and enhanced our financial flexibility by amending and extending our credit facility with Citibank at very attractive pricing and terms.

We are pleased with our accomplishments and look to take advantage of other opportunities that we believe will further enhance long-term shareholder value.

Turning to page 3, we provide a summary of the portfolio as of December 31. Overall, the portfolio performed well in the first quarter, with a majority of companies generating stable or improving operating trends.

The portfolio had a fair value of $541 million. Approximately 86% was in first lien loans and 3% was in second lien loans. 100% of the debt portfolio consisted of floating-rate investments. The weighted average yield on debt investments was 7.1%, down from 7.5% at September 30, reflecting our conservative approach to investing given the current market environment. And we believe this approach will position us well in the event of market dislocations.

Part of our efforts last quarter was segmenting the portfolio into two primary categories, core and non-core investments, which we thought would be helpful to share with you. We have dedicated significant resources to monetizing these non-core investments, which do not align with Oaktree's long-term investment philosophy or objectives. If you turn to page 4 of this presentation, you will see that we have core investments that we intend to hold and non-core investments that we intend to exit over time. We further classified our non-core investments as performing or non-accrual.

Generally speaking, core investments are those we identify that are attractive to the company based on their risk-return profile and align with our portfolio management strategy. As of December 31, core investments made up $338 million of the portfolio. Oaktree originated or recommitted to $153 million since becoming investment adviser.

In addition, Strategic Credit funds and accounts lent to four of the same issuers in OCSI's portfolio, which represented $39 million as of December 31. Since September 30, we increased core investments by $129 million or 62%, and core investments now represent 70% of our portfolio at fair value, excluding our investment in the Glick JV.

As of December 31, non-core investments were $146 million and consisted of $140 million of performing investments and $6 million of non-accrual investments. These numbers are pro forma for the significant progress we made reducing the non-core portfolio. During the quarter, we monetized approximately $148 million or 52% of non-core performing investments. Importantly, we exited these investments on average within 25 basis points of their previous fair value marks.

Turning to page 5, we provide an overview of non-core performing investments. These investments are performing well, a majority of which are lower levered and exhibiting stable to increasing operating trends. However, these investments do not align with Oaktree's long-term approach to investing due to a number of reasons. For example, these may be in industries that we do not have much expertise with or may be sized small relative to the overall portfolio. As a result, we do not intend to retain these investments over the long-term.

As of December 31, non-core performing investments comprised $140 million, primarily consisting of first lien loans. Of the $140 million, $55 million are publicly quoted liquid loans. While the remaining $84 million of debt investments are less liquid, we believe that we will be able to monetize a meaningful portion of them before 2019, if current market conditions continue.

Over the last few years, a tremendous amount of capital has been raised in private credit, which has created a highly competitive borrower-friendly environment characterized by lower yields and aggressive deal structures. In this challenging environment, we are taking a measured, conservative approach to investing.

During the quarter, we originated $136 million of investment commitments in 17 new and three existing portfolio companies. 96% of these investments were first lien loans and 4% were second lien. These investments were diversified across 16 industries.

Lastly, I'd like to discuss our long-term portfolio objectives. Our goal is to create a diverse portfolio of investments that generates a stable source of income for our investors. We look to lend in well-structured, appropriately priced opportunities.

As we optimize the portfolio, we are targeting investments of $10 million to $20 million, and a mix that emphasizes first lien loans. We also anticipate complementing the portfolio with a modest amount of second lien loans. I'd like to note that these targets may vary depending on the market environment.

And now I'd like to turn the call over to Mel Carlisle to discuss our financial results in more detail.

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

Thank you, Edgar. Net investment income in the first quarter was $4.5 million or $0.15 per basic share. This was down sequentially from $5.5 million, or $0.19 per share in the fourth quarter of 2017, primarily due to a smaller average portfolio and a modestly lower average yield on our investments.

Total investment income for the first quarter was $10.7 million, down sequentially from $11.8 million in the September quarter. This was primarily due to a lower weighted average yield on investments and a smaller average portfolio size during the quarter, as loan payoffs and exits exceeded fundings.

Net expenses for the quarter were $6.2 million, down slightly from $6.3 million in the prior quarter, reflecting lower management fees, incentive fees and G&A expenses, partially offset by higher professional service fees. Net expenses for the first quarter also included $0.6 million in one-time items, primarily related to professional services fees.

Now turning to credit quality. At December 31, only 1% of the portfolio was on non-accrual. This is consistent with last quarter and down slightly from a year ago.

Net realized losses were $4.4 million, primarily due to the sale of our first lien investment in New Trident Holdcorp during the quarter, which was previously written down. Net unrealized gains were $1.7 million.

Net asset value declined to $9.84 per share at December 31, from $9.97 per share at September 30.

Total debt outstanding at December 31 was $254 million with a weighted average interest rate of 3.57%, and our debt-to-equity ratio was 0.88x. At quarter end, cash and cash equivalents were $46 million, and we had $96 million of undrawn capacity on our credit facilities.

As part of our efforts to optimize our capital structure, last week, we amended and extended our secured revolving credit facility with Citibank. The total capacity of the facility is $100 million, and the maturity date was extended by three years to January 2023. We were also able to obtain lower interest rate margins on our borrowings, which will help enhance our earnings going forward. We believe that our amended credit facility positions us well with ample flexibility and liquidity to support our business.

At quarter end, there were $40 million of unfunded commitments outstanding, which were primarily related to portfolio companies with revolving credit facilities or delayed draw term loans.

As Edgar mentioned, we completed the process of integrating OCSI into Oaktree's platform during the quarter. This included the transition of OCSI's operational infrastructure, including all accounting, valuation, compliance and information technology functions. Going forward, we expect to benefit from shared services and the economies of scale that come with being part of a large platform.

Very importantly, as part of this integration, we were able to remediate the material weakness related to internal control over financial reporting, which initially occurred in 2015.

Now I'd like to turn the call over to Matt Pendo to discuss our dividend and our plans to enhance the return on equity of our portfolio.

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

Thank you, Mel. Let me first begin with the dividend. As you saw in our press release, we declared a $0.14 dividend per share payable to shareholders on March 30. This dividend represents a payout of approximately 91% of the net investment income generated by the portfolio in the first quarter. We plan to pay dividends based on the earnings generated by the portfolio.

As we continue to optimize the portfolio, we are focused on several opportunities designed to increase our return on equity. These include: first, rotating out of lower-yielding broadly syndicated loans into higher-yielding loans originated by Oaktree. As of December 31, approximately $55 million of the portfolio consisted of such lower-yielding loans.

Second, redeploying non-income generating investments comprised of equity and non-accrual loans. As of December 31, there were $7 million of non-interest bearing equities and non-accruals.

Third, modestly increasing our second lien holdings in the portfolio.

Fourth, realizing lower borrowing costs as a result of refinancing the Citibank credit facility.

Fifth, maintaining a floating-rate investment portfolio that will benefit from rising interest rates.

And sixth, realizing cost savings from leveraging Oaktree's platform. We expect future savings related to trade settlement, internal audit, and information technology, among other areas.

In conclusion, the credit quality of the portfolio is solid, and we have opportunities to enhance earnings over time as we take advantage of being part of the Oaktree platform.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we do have a question from George Bahamondes of Deutsche Bank.

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

Just want to make sure I caught this. You mentioned one of the objectives or key focuses will be rotating out of lower-yielding broadly syndicated loans. Did you say that was 55% of the portfolio at 12/31?

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

No. It's $55 million of non-core debt investments.

Operator

And this concludes our question-and-answer session. I would like to turn the conference back over to management for any closing remarks.

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

Thank you, operator, and thank you, everyone, for listening in today. I just want to make a couple of points in closing to summarize the call for today: First, the credit quality of the portfolio is solid; second, we have made good progress in optimizing the portfolio as 52% of the non-core portfolio has already been monetized; third, we have integrated onto the Oaktree platform; and fourth, as Mel mentioned, we have already refinanced the Citibank secured revolving credit facility. These 4 actions put us well on our way to capitalizing on the opportunities to increase our return on equity that lie ahead of us. I'd like to now turn the call back to Mike.

Michael Mosticchio - *Oaktree Strategic Income Corporation - Investor Relations*

Thanks, Matt, and thank you, everyone, for joining us for our first fiscal quarter conference 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) 344-7529 for U.S. callers or 1 (412) 317-0088 for non-U.S. callers with the replay access code 10115430 beginning approximately 1 hour after this broadcast. Thank you.

Operator

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