



Oaktree Specialty Lending Corporation (OCSL)

Updated July 5th, 2023, by Patrick Neuwirth

Key Metrics

Current Price:	\$20	5 Year CAGR Estimate:	18.3%	Market Cap:	\$1.5 B
Fair Value Price:	\$20	5 Year Growth Estimate:	10.0%	Ex-Dividend Date¹:	09/14/23
% Fair Value:	98%	5 Year Valuation Multiple Estimate:	0.5%	Dividend Payment Date¹:	09/29/23
Dividend Yield:	11.3%	5 Year Price Target	\$32	Years Of Dividend Growth:	4
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Buy

Overview & Current Events

Oaktree Specialty Lending Corp. is a specialty finance company, or BDC. It provides lending services and invests in small and mid-sized companies. The company's investment objective is to maximize its portfolio's total return by generating current income from debt investments, and to a lesser extent, capital appreciation from equity investments. Its investments generally range in size from \$10 million to \$100 million and are principally in the form of the first lien, second lien, or collectively, senior secured, and subordinated debt investments, which may also include an equity component made in connection with investments by private equity sponsors. As of March 31, 2023, the investment portfolio accounted for \$3.2 billion at fair value diversified across 165 portfolio companies, with a focus on software (18.2%) and Pharmaceuticals (5.2%). The company was founded in 1995, has 1,100 employees, and is headquartered in Los Angeles, California.

On May 4th, 2023, Oaktree Specialty Lending Corp. released its second quarter fiscal 2023 results for the period ending March 31st, 2023. For the quarter the company reported adjusted net investment income (NII) of \$45.4 million or \$0.62 per share, up from \$37.1 million or \$0.61 per share in the first quarter and \$0.53 for the same quarter last year. The increase was primarily driven by higher interest income resulting from the larger investment portfolio and rising base rates, partially offset by higher interest expense, incentive fees, and operating expenses. During the quarter, the company continued its strategy of rotating out of public debt investments and reallocating capital into private credit opportunities that offer compelling and higher-yielding prospects. This strategy reflects Oaktree's focus on pursuing attractive returns and capitalizing on its robust pipeline of private credit investments. The weighted average yield on new debt investments was 11.9%, up from 11.6% as of December 31, 2022, primarily due to higher base rates. Additionally, a significant highlight of the quarter was the successful completion of the merger between Specialty Lending Corp. and Oaktree Strategic Income II, Inc. ("OSI2") on January 23, 2023, which added \$572.1 million of investments at fair value. The management is optimistic about sustaining this momentum in the future, indicating their confidence in the company's positioning and ability to capitalize on investment opportunities.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
NII	\$2.70	\$2.37	\$0.30	-\$1.35	-\$4.17	\$0.99	\$2.67	\$0.84	\$4.38	\$0.48	\$2.50	\$4.03
DPS	\$3.31	\$3.00	\$2.36	\$2.16	\$1.40	\$1.20	\$1.14	\$1.17	\$1.53	\$1.95	\$2.20	\$2.94
Shares²	39	50	48	47	47	47	47	60	61	61	67	69

The company has a net investment income growth rate of -17.5% per year over the past nine years and +20.4% over the past five years. In 2016 and 2017, the net investment income was negative, while the company continued to pay dividends. We expect net investment income to increase by 10% per year for the next five years. The company has been able to increase its yearly dividend payout for 4 consecutive years. Over the last five years, the average annual dividend growth rate is 12.9%. In February 2023, the company increased its quarterly dividend by 1.9% from \$0.54 to \$0.55 per share.

¹ Estimated date

² In millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	10.3	12.2	73.4	--	--	14.8	5.7	17.0	4.3	44.8	7.8	8.0
Avg. Yld.	1.9%	10.4%	10.7%	13.0%	9.2%	8.2%	7.6%	8.2%	8.2%	9.1%	11.3%	9.1%

During the past decade shares of Oaktree Specialty Lending Corp. have traded with an average valuation of about 22.8 times earnings and today, it stands at 7.8. We are using 8.0 times earnings as a fair value baseline, implying the potential for a valuation tailwind. The company's dividend yield is currently 11.3% which is above the average yield over the past decade of 9.7%. Both imply the stock is somewhat undervalued.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Payout	123%	127%	787%	--	--	121%	43%	139%	35%	406%	88%	73%

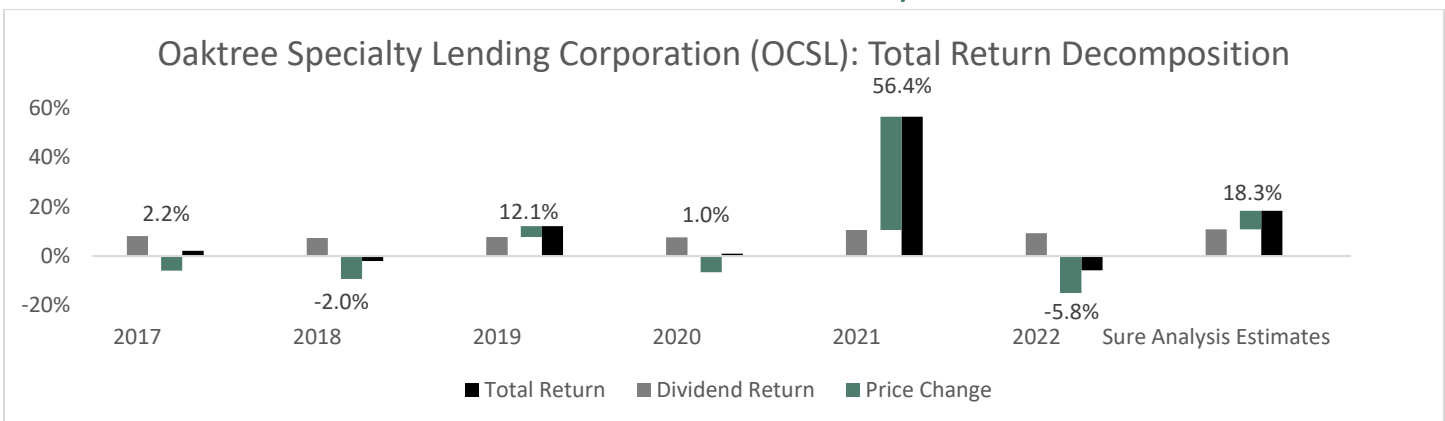
During the past five years, the company's dividend payout ratio has averaged around 150%. At present, Oaktree Specialty Lending Corp.'s dividend could be considered relatively safe since the quarterly adjusted investment income of \$0.62 covered the quarterly dividend of \$0.55. Management believes that it has been very conservative in its approach to dividends.

Oaktree Specialty Lending Corp.'s business model centers around investing in various debt instruments, such as senior secured loans, subordinated loans, and mezzanine loans. The company primarily generates revenue through interest income earned on its loan investments. It may also earn revenue from fees charged for structuring and arranging financing transactions and from dividends received from equity investments. Oaktree's management has a strategy of rotating out of public debt investments and allocating capital into private credit opportunities. By targeting private credit, Oaktree can access potentially higher-yielding investments and take advantage of compelling opportunities in the private market. Its main competitive advantage comes from its management expertise and scale as being in the top 12 of the largest BDCs.

Final Thoughts & Recommendation

Oaktree Specialty Lending Corp. is a well-diversified investment company with a \$3.2 billion investment portfolio diversified across 165 portfolio companies. Its 11.3% dividend yield provides investors with attractive income. The BDC business model does tend to struggle during recessions, so conservative investors should keep that risk in mind. We estimate total return potential of 18.3% per year for the next five years based on a 10% earnings-per-share growth, the dividend yield, and a valuation tailwind. Shares earn a buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	111	125	29	(44)	(184)	57	127	52	248	39
SG&A Exp.	12	13	14	23	15	11	8	7	9	9
Net Profit	102	113	15	(67)	(197)	47	126	39	237	29
Net Margin	91.6%	89.9%	52.9%	153%	107%	81.6%	99.2%	75.0%	95.6%	74.7%
Free Cash Flow	(462)	(546)	146	165	487	54	216	(153)	(231)	22
Income Tax				-	-	1	1	(2)	4	4

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	2,072	2,668	2,586	2,343	1,616	1,551	1,481	1,641	2,636	2,646
Cash & Equivalents	143	87	138	118	53	13	15	39	29	24
Total Liabilities	703	1,190	1,233	1,201	748	693	550	726	1,324	1,401
Accounts Payable	4	10	9	6	6	7	4	3	8	12
Long-Term Debt	646	1,152	1,199	1,149	675	637	473	709	1,269	1,301
Total Equity	1,369	1,478	1,353	1,142	868	858	931	915	1,313	1,246
LTD/E Ratio	0.47	0.78	0.89	1.01	0.78	0.74	0.51	0.78	0.97	1.04

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	5.9%	4.7%	0.6%	-2.7%	-9.9%	3.0%	8.3%	2.5%	11.1%	1.1%
Return on Equity	9.0%	7.9%	1.1%	-5.3%	-19.6%	5.4%	14.1%	4.3%	21.3%	2.3%
ROIC	6.0%	4.8%	0.6%	-2.7%	-10.3%	3.1%	8.7%	2.6%	11.3%	1.1%
Shares Out.	39	50	48	47	47	47	47	60	61	61
Revenue/Share	2.82	2.51	0.54	(0.86)	(3.90)	1.22	2.71	1.11	4.59	0.64
FCF/Share	(11.73)	(10.94)	2.72	3.27	10.33	1.14	4.59	(3.25)	(4.27)	0.37

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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