

Blue Owl Capital Corporation
Q1 2024 Earnings
May 9, 2024

Presenters

Craig Packer - Chief Executive Officer
Jonathan Lamm - Chief Financial Officer

Q&A Participants

Brian McKenna – Citizens JMP Securities
Mark Hughes - Truist Securities
Robert Dodd - Raymond James

Operator

Good morning, everyone, and welcome to Blue Owl Capital Corporation's first quarter 2024 earnings call. I'd like to remind listeners that remarks made during today's call may contain forward-looking statements, which are not a guarantee of future performance or results, and involve a number of risks and uncertainties that are outside the company's control. Actual results may differ materially from those in forward-looking statements, as a result of a number of factors, including those described in OBDC's filings with the SEC.

The company assumes no obligation to update any forward-looking statements. Certain information discussed on this call and in the company's earnings materials, including information related to portfolio companies, was derived from third party sources, and has not been independently verified. The company makes no such representations or warranties, with respect to this information.

Yesterday, Blue Owl Capital Corporation issued its earnings release, and posted an earnings presentation for the first quarter, ended March 31st, 2024. These should be reviewed in conjunction with the company's 10-Q filed yesterday with the SEC. The earnings press release, earnings presentation, and 10-Q are available on the investor section of the company's website, at blueowlcapitalcorporation.com. With that, I'll turn the call over to Craig Packer, Chief Executive Officer of OBDC.

Craig Packer

Good morning, everyone, and thank you all for joining us today. We are pleased to report another quarter of strong earnings, delivering attractive returns to our shareholders, while maintaining our consistently high credit quality across the portfolio. Net investment income was \$0.47 per share for the quarter, equating to a 12.1% return on equity. The strength of our earnings and continued credit performance drove another quarter of record net asset value per share, at \$15.47 for the first quarter.

We once again delivered a compelling ROE, while also growing the book value of our portfolio. Since we spoke to you last quarter, the interest rate outlook has shifted considerably. The market is now expecting rates to continue to stay elevated, with limited to no fed cuts over the course of the year. At the same time, the U.S. economy has remained solid. We believe, overall, this presents a good environment for direct lenders, particularly those like Blue Owl, with a long-term track record of credit selection.

Given our focus on floating rate investments, our earnings benefit from a prolonged higher rate environment. At the same time, the performance of our portfolio reflects both the strength of the economy and our high underwriting standards, and therefore, our credit performance has been resilient. Since inception, we have worked hard to ensure that we deliver attractive returns to our shareholders across all rate environments. This has allowed us to pay a stable or growing regular dividend in each quarter since our IPO in 2019.

For the first quarter, we paid a \$0.37 regular dividend, reflecting the \$0.02 increase that our board approved last quarter. Even at this higher level, our regular dividend is well covered, as we over earned the dividend by \$0.10 this quarter. In addition, our board has declared a supplemental dividend of \$0.05 for the quarter, for a total dividend of \$0.42, which equates to a nearly 11% dividend yield. We believe our increased regular dividend, combined with our supplemental dividend framework, benefits our shareholders by providing an attractive baseline dividend yield, with additional predictable income as we over earn the level in the higher rate environment.

Looking to our portfolio companies -- on average, we continue to see steady top and bottom line growth on both a quarter over quarter and year over year basis. Our borrowers were well positioned coming into this year, having successfully navigated a full year with higher interest rates, by growing revenues and profitability, adjusting cost structures, and managing cash flow and working capital, where needed. We believe our companies are faring well by design, as we have intentionally invested in large, high quality businesses and recession resistant sectors, often backed by operationally sophisticated, private equity sponsors who have large equity investments in these businesses.

Our portfolio has a weighted average EBITDA in excess of \$180 million, and an average loan to value ratio of less than 45%. Across the portfolio, our average interest coverage ratio is currently 1.6 times. Over the last few quarters, we have expected coverage to trough at around 1.5 to 1.6 times, which is about where we are now. Borrowers have been paying SOFR rates of 5 to 5.25% for more than four quarters. If SOFR rates remained in this range over the course of the year, as the market currently expects, then we are currently at trough coverage levels and should remain here.

Despite the higher rates, we haven't seen any pickup in stress across the across the portfolio. We continue to have a small number of borrowers who are on our watch list, but this subset has remained relatively static over the last few quarters. While companies with more constrained

liquidity will likely face heightened pressure in coming quarters, we believe we have the resources in place, across both our team and the financial sponsors supporting these companies, to appropriately manage these situations. We believe our recovery focused underwriting, paired with our leadership position on our investments, will allow us to optimize our outcomes.

We serve as the administrative agent or lead lender on the majority of our loans, affording us advantageous access to diligence during the underwriting process, influencing and negotiating the credit documentations, and control over any amendment or workout situation. This is further evidenced in our non-accrual rate, which remains low, at 1.8% of debt investments at fair value, across five investments.

Overall, our borrowers are growing revenue and EBITDA; the number of challenges positions is small; and our credit performance remains strong. These achievements reflect our continued focus on credit selection and proactive portfolio management, which remains unwavering, even as economic conditions shift. With that, I'll turn it over to Jonathan to provide more detail on our financial results.

Jonathan Lamm

Thanks, Craig. We ended the quarter with total portfolio investments of \$12.4 billion, outstanding debt of \$7 billion, and total net assets of \$6 billion. Our first quarter NAV per share was \$15.47, another record, and a \$0.02 increase from the fourth quarter, attributable to the continued over-earning of our dividend. In terms of deployment, we continued to see more normalized repayment levels, at \$1.2 billion. While these repayments were matched by a comparable level of new originations, new fundings were only approximately \$1 billion in the quarter. Given this gap in net funded activity, we saw a small decrease in leverage again this quarter, ending the quarter at 1.04 times, down from 1.09 times.

Turning to the income statement -- as Craig mentioned, we earned NII of \$0.47 per share, an increase of 4% versus the prior year, and one of our highest quarters since inception. NII was down \$0.04 per share from the prior quarter, primarily reflecting our lower average leverage and the impact from portfolio mix shift, as we saw a large amount of second lien investments repay, with capital redeployed into first lien investments. In addition, we saw a modest impact from a non-recurring item in interest expense.

Turning to our dividend -- the board declared a supplemental dividend of \$0.05 per share for the first quarter, which will be paid on June 14th to shareholders of record on May 31st. The board also declared a second quarter regular dividend of \$0.37, which will be paid on July 15th to shareholders of record as of June 28th. We continue to accumulate spillover income, because of over earning of our dividend. We estimate our spillover income is currently approximately \$0.30 per share, which is a strong advantage that provides stability to our regular dividend.

OBDC continues to benefit from its flexible balance sheet and well diversified financing structure. We ended the quarter with liquidity of \$2.4 billion, well in excess of our unfunded commitments

of approximately \$1.1 billion. As a reminder, in January, we opportunistically raised \$600 million in new, five-year unsecured notes, which were subsequently swapped to floating rate. A portion of the proceeds were used to repay our \$400 million unsecured notes that were set to mature in April 2024. The remaining proceeds were used to pay down a portion of our secured debt.

Since our last earnings call, we saw further differentiation from the rating agencies and the BDC sector, towards recognizing the highest quality issuers. In the first quarter, Moody's revised OBDC's outlook to positive, from stable; and Fitch upgraded OBDC to BBB flat, with a stable outlook. We hope this trend of differentiation by the various agencies will continue in the near future. With that, I'll turn it back to Craig for closing comments.

Craig Packer

Thanks, Jonathan. To close. I'll spend a few minutes on the current market environment and what we're seeing today. In terms of activity, the first quarter was lighter, overall, than what the market was generally expecting. While we continue to believe there is substantial pent up desire for private equity firms for return capital to LPs by exiting companies, and that increased clarity on the rate environment could drive more M&A activity, we have not yet seen this materialize. The public loan markets were significantly more active than they were in 2023, with the vast majority of this activity being repricing or refinancing transactions, which do not generate new loan supply.

Many borrowers were able to take advantage of the supply demand imbalance to access the public market and refinance higher spread loans. This represented a shift in the market dynamic compared to last year, when we saw a sizable number of previously public capital structures refinanced in the direct lending market. We believe this is in line with the natural market dynamics in which the public and private market coexist. We expect that, at times, the public market will pull back and we'll see private credit step up to serve as the primary capital provider.

And at other times, public markets will be more active, and activity will be balanced between the two markets, which is what we're experiencing now. At the same time, we've also seen increased fundraising in the private credit markets. As a result of these trends, we have seen some pressure on loan spreads this year. Some of this was evident in our portfolio, where certain higher spread positions were paid down or refinanced with lower pricing, while new originations came into the portfolio at lower, although still attractive levels.

Having said that, given where base rates are, we are still earning over 11% in total yield across the portfolio, which we believe remains a very compelling rate of return for a portfolio comprised of predominantly first lien loans and high quality, upper middle market companies. While there has been increased activity in the public loan market, the secular trend towards direct lending continues, as sponsors increasingly recognize the benefits of private financing solutions.

A pickup and M&A activity should drive more deal activity in both the public and private markets and improve the spread environment. One notable theme this quarter, was the refinancing of

many of our second lien loans, with roughly 40% of our existing second lien positions repaid this quarter. I wanted to take a minute to reflect on our approach to second lien investing, which has been consistent since inception. We've always had a very high bar for our second lien investments, focusing on businesses with scale and very strong credit metrics.

The average enterprise value of our second lien borrowers is roughly double that of our first lien positions. These borrowers typically have performed very well. Looking at the second lien investments which were refinanced this quarter -- on average, EBITDA grew by approximately 50%, and these companies de-leveraged by roughly 1.5 turns during the period that we held the loans. So the credit profile of these investments improved significantly, and it was natural that they would look to recapitalize.

Across these names, we realized more than 1.3 times our money on average, a strong track record that reflects our team's highly selective approach and deep underwriting capabilities. Finally, I'd like to take a moment to note that we are approaching the one year anniversary of our first BDC investor day, which we hosted in May of 2023, and which many of you participated in. I'd like to look back on the progress that we have made since then.

Last May, we outlined the potential for upside to our share price, which was then trading at 0.87 times book value. We believe we could achieve a higher valuation for our shareholders by continuing to share, in more detail, our story with the market, including how we approach underwriting, portfolio construction, and portfolio management, as well as the emphasis we place on a flexible liability structure, all of which allow us to maintain our track record of excellent credit quality.

This is on the back of multiple, tangible initiatives to demonstrate our confidence in our portfolio, including increasing our regular dividend, putting in place our supplemental dividend framework, announcing a new, \$150 million repurchase program, and creating an employee backed investment vehicle to purchase additional shares of OBDC. As a result of these activities, today, OBDC is trading at book value.

Investors who purchase shares of OBDC on investor day have received a 30-plus percent total return, broadly outperforming the S&P and our BDC peers. We are pleased to see the market recognize the strength of the portfolio and to deliver these returns to our shareholders. With that, thank you for your time today, and we will now open the line for questions.

Operator

Ladies and gentlemen, if you would like to ask a question, please press * 1 on your telephone keypad, and a confirmation tone will indicate your line is in the question queue. You may press * 2, if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the keys.

One moment, please, while we poll for questions. And our first question comes from the line of Brian McKenna with Citizens JMP. Please proceed.

Brian McKenna

Thanks. Good morning, Craig and Jonathan. Hope you both are doing well. A question on the trajectory of the investment portfolio, to start -- it declined 2% in the quarter. It seems like the majority of the decline was just the timing of new investments being funded, and then the timing of repayments. But, just curious your thoughts here?

And then, with leverage where it is, getting back down to 1x, should we expect to see the portfolio expand from here, as deal flow is set to pick up? And then, what I'm getting at -- what does all this mean for the trajectory of NII, following a \$15 million, sequential decline in the quarter?

Craig Packer

Sure, Brian, good morning. Deal activity across the market was a little lighter than we would've hoped for, given generally strong economic conditions. And so we had higher repayments and new originations weren't quite at pace -- it was pretty close -- but weren't quite at pace. I think in terms of the outlook, sitting here the last few weeks, we've seen a pickup in activity. We'll see if that holds.

My hope is, over the course of the year, that deal activity will pick up and we'd like to get the leverage a bit higher in the portfolio, staying within target leverage range. I think that's achievable. We also had a lot of repayments in the quarter. I'm not sure if that pace of repayments will continue. I think with a pickup in deal activity at some point over the next quarter or two, we should be able to get the leverage back up and earn back some of that income.

I do think that there will continue to be some spread pressure, given strong market conditions in the public market and the private markets, and some continued refinancing of some of the higher spread positions. And I think those trends will generally, sort of balance each other out -- higher portfolio investments, with a little bit of wind in our face on spread.

We may see a bit of that leak in the second quarter, but sort of expect it to pick up as the year wears on. It's hard to predict precisely, quarter to quarter. But those are the two trends.

Brian McKenna

Okay, great. Helpful. Thanks, Craig. Just to follow up -- you and the team have done a great job getting OBDC back to book value. And it's actually trading decently above that. Given how this and OBDE are trading, do you have any updated thoughts around the timeline of merging these BDCs? What ultimately needs to take place before you move forward on merging the two?

Craig Packer

Sure. We are really pleased with how OBDE has traded, post-listing. We're really pleased with how OBDC is trading now, above book value -- a long time coming. And we're really appreciative that the market is seeing the quality of the portfolio and that attractive return profile. I would note that OBDC, while it's above book value, still trades at a discount to some of our peers. And so we think there's still the opportunity for price appreciation of OBDC.

In terms of a potential merger -- I don't have any update, other than what we said at the time of the listing of OBDE, which is, we continually look at what's best for the shareholders of both companies, and discuss this with our boards and each company regularly, with an eye towards delivering attractive shareholder value. Obviously, the portfolios have tremendous overlap. And there's an industrial logic to why they would make sense, combined. And we have talked, previously, about the logic of us having one larger publicly traded BDC.

But, when we think, for each company -- when the board -- there's a transaction that will deliver value, then, we'll pursue it, obviously, and keep folks updated on it. So certainly, an environment with strong credit performance in each portfolio, with both stocks trading well, with BDCs trading at high valuations -- certainly those are the kinds of conditions that give you the opportunity to look at those transactions. But, you know, there's complications.

OBDE still has lockups. The first lockup hasn't come off yet. And so, we'll take all these factors into account carefully. But to answer your question, I think the conditions are certainly present for a number of factors that we would consider. And we'll have to consider all the factors.

Brian McKenna

Okay. I'll leave it there. Thanks for taking my questions.

Craig Packer

Thanks, Brian.

Operator

And our next question comes from the line of Mark Hughes with Truist Securities. Please proceed.

Mark Hughes

Yeah, thank you. Good morning. Hey, Craig. Hey, Jonathan. Non-accruals are still very low, but ticked up just a little bit. And maybe one company added to non-accrual. Could you talk about that, and then the four companies that I think were on non-accrual? Any updates there?

Craig Packer

Sure. We actually added two and took one off. But the one of significance, was a company called Hearthside. It's a packaged food manufacturer. It's got some public loans and bonds. And we're in a second lien. So there are some folks that follow the credit that may have some familiarity to it. It's a large company. It's had some headwinds on costs, and a bit of weakness on customer demand.

We marked it down pretty meaningfully, and felt, at this moment, it was appropriate to put it on non-accrual. We're still earning cash interest on it, but, we made the judgment, as we make on every name, in totality, that we felt it was appropriate to put it on non-accrual. The other name was quite small. So I don't think it's worth, necessarily, going into.

No updates on the other non-accruals. We work these positions hard to try to maximize our ultimate recovery. And no particular developments to call out. They're all marked, we think, appropriately. We look at the marks and the non-accrual status for all these names, plus other names, each quarter, to make sure we're properly accounting. And really Hearthside, was the development this quarter.

Mark Hughes

Understood. Any broader trends in amendment activity?

Craig Packer

It's really been consistent with the last few quarters. Amendment activity is modest. We have a few amendments each quarter. Every quarter, we have a large number of minor amendments, housekeeping type amendments, but we have a few material amendments this quarter. No change. There's a few each quarter.

I think the lack of pickup in serious amendment activity really speaks to the strong, underlying performance of the companies. The companies continue to do well. The economy continues to be a good one. There continues to be growth in all of our sectors, in revenues, and in EBITDA. And so, despite higher debt service, the companies are finding ways to manage through that, and resulting in continued, moderate amendment activity.

Mark Hughes

And then, Jonathan, you mentioned a modest impact from a non-recurring -- I think an interest expense item. Can you size that?

Jonathan Lamm

It was a little less than a penny, but close to a penny. And it was related to, effectively, the takeout of one of our CLOs.

Mark Hughes

And then, with the capital markets activity this quarter -- what's the incremental impact on interest expense, kind of before or after?

Jonathan Lamm

The unsecured that we issued this quarter relative to the unsecured that we took out, which were unswapped, it was accretive to interest expense.

Mark Hughes

Thank you.

Craig Packer

Thanks, Mark.

Operator

As a reminder, ladies and gentlemen, if you would like to ask a question, please press * 1 on your telephone keypad. And our next question comes from the line of Robert Dodd with Raymond James. Please proceed.

Robert Dodd

Good morning. On your comments on second lien -- 40% repaid in the quarter, and then that got redeployed. On the one hand, all your second liens are repaying quite nicely, probably faster than you'd like. And then, on the other hand, there was one new non-accrual, which was a second lien. So can you give us, kind of an update on your thoughts on where you would like that to be, as a percentage of the portfolio?

Obviously, spreads can be a little higher, not crazy, because they tend to be much bigger companies. But what's your view -- would you like to actually increase that from here? And is that realistic, if the first lien BSL market comes back and a lot of the second liens tend to be behind that? So is there room to grow it, and would you like it to?

Craig Packer

Thanks, Robert. Look, our approach to second lien has been really consistent, since inception. We only do them on really high quality businesses that are large and stable, with lots of equity cushion beneath us. We are favorable on doing second liens in those types of companies, if the attachment point and the detachment point are appropriate. And, obviously, the reason we like them, is they generate meaningfully higher spread.

And so, if those opportunities present themselves, then we'll do them. If they don't, we won't. The environment in the last six to nine months, there just hasn't been a lot of second liens. The sponsors have really favored unitranche financing. And so we haven't seen a lot. We certainly haven't seen ones that were attractive to us. So in this market environment, I'm happy to run primarily first lien portfolio, the first lien percentages, as you know, it's the highest it's been for us in years.

So a safer portfolio. If we get an environment where there are more second lien opportunities that hit our investment criteria, then we would take it -- take the percentage back up. I'm certainly comfortable where we were running, if not even a bit higher. But I just don't see that happening, in the short term, given the deal flow that we're seeing. We don't solve for percentages. We solve for the best opportunities, you know, that we're seeing. And right now, it's primarily unitranche.

It stands to reason if, given how strong the syndicated market is, that as new deal flow reappears, that we'll see more second lien opportunities as the year unfolds. Haven't seen it yet. But it wouldn't surprise me if we did. And if that's the case, then we'll strongly look at those opportunities.

Robert Dodd

Got it. Thank you. On your comment on -- haven't necessarily seen deal activity materialize yet, which obviously is true. Are you seeing any increase in books coming in, etc., the preliminary stages of deal activity ramping up, and then it's hitting gridlock, when it comes to buyers and sellers agreeing on price? Can you give us a sense of what the stages of the pipeline look like? Is it close to a big ramp up in the activity, or is that just not really here yet?

Craig Packer

Sure. So I made the comment a minute ago. You might not have heard it, but just to repeat it -- in the last four to six weeks, we've seen more activity that could result in M&A, some take private opportunities and some sponsor to sponsor opportunities and some add-on acquisitions. So I would say green shoots for new M&A, but not yet coming to full fruition. I think there's some chatter about pure M&A processes pick up with books. And the sponsors have some chatter around that.

It's sort of too early for me to really say that that's going to result in a lot more deal flow. But first quarter was light. I think that we're seeing green shoots that could result in more deal flow. The deal flow we're seeing come in today might not close in the second quarter. That might be third quarter activity. I think the first half of the year will still be a kind of a light deal flow environment. But hopefully, by the third quarter, things have improved.

Robert Dodd

Okay. I appreciate that. I did miss that. Thank you.

Craig Packer

All right. Thanks. Anything else, Robert?

Robert Dodd

That's it for me. Thanks.

Craig Packer

All right, thank you.

Operator

Ladies and gentlemen, as a reminder, if you'd like to ask a question, please press * 1 on your telephone keypad.

There are no further questions at this time. I'd like to hand the call back to Craig Packer for closing remarks.

Craig Packer

All right, well, I guess we've worn everyone out, or we've answered everything in our prepared remarks. Look, we appreciate everyone spending time with us today. If you have any further questions, please reach out to our team. Really pleased with the quarter, and look forward to speaking with everyone soon. Have a great day.

Operator

This concludes today's conference. If you would please disconnect your lines at this time? Have a great day.