

Blue Owl Capital Corporation
Q1 2025 Earnings Call
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Presenters

Mike Mosticchio - Head of BDC Investor Relations
Craig Packer - CEO
Logan Nicholson - President
Jonathan Lamm - CFO

Q&A Participants

Brian McKenna – Citizens JMP Securities
Mickey Schleien - Ladenburg Thalmann
Casey Alexander - Compass Point
Robert Dodd - Raymond James
Sean-Paul Adams - B. Riley Securities
Finian O'Shea - Wells Fargo
Maxwell Fritscher - Truist Securities

Operator

Good morning, everyone, and welcome to Blue Owl Capital Corporation's First Quarter 2025 Earnings Call. As a reminder, this call is being recorded. At this time, I'd like to turn the call over to Mike Mosticchio, Head of BDC Investor Relations.

Mike Mosticchio

Thank you, operator, and welcome to Blue Owl Capital Corporation's First Quarter 2025 earnings conference call. Yesterday, Blue Owl Capital Corporation issued its earnings release and posted an earnings presentation for the First Quarter ended March 31st, 2025. These should be reviewed in connection with the company's 10-Q filed yesterday with the SEC.

All materials referenced on today's call, including the earnings press release, earnings presentation, and 10-Q, are available on the investor section of the company's website at blueowlcapitalcorporation.com.

Joining us on the call today are Craig Packer, Chief Executive Officer; Logan Nicholson, President; and Jonathan Lamm, Chief Financial Officer. I'd like to remind listeners that remarks made during today's call may contain forward-looking statements, which are not guarantees of future performance or results and involve a number of risks and uncertainties that are outside of 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.

With that, I'll turn the call over to Craig.

Craig Packer

Thanks, Mike. Good morning, everyone, and thank you all for joining us today. We delivered solid First Quarter results driven by the ongoing strong performance of our portfolio. As a reminder, we completed the merger between OBDC and OBDE on January 13th, so our First Quarter results now represent the combined company.

In the First Quarter, we generated an ROE of 10.2%, our 11th consecutive double-digit ROE, based on \$0.39 per share of adjusted NII. As discussed during our last earnings call, the decline from the prior quarter was anticipated. Our results last year significantly benefited from higher interest rates and elevated income from repayment activity, both of which have started to normalize.

Jonathan will go into more detail later on, but in the First Quarter, we experienced a lower level of one-time nonrecurring income as compared to the Fourth Quarter, as well as the remaining impact of interest rate cuts from last year.

As of quarter-end, our net asset value per share was \$15.14, down slightly from the prior quarter. That said, the fundamental performance of the portfolio remained strong, credit quality is solid, and our nonaccrual rate continues to be well below the industry average. While we're now operating in a more normalized earnings environment, we remain confident in the credit quality of the portfolio.

In light of events over the past month, I thought it would be helpful to share our perspective on the current economic and market environment. With uncertainty around tariff policy, the ensuing equity sell-off in April, and the possibility of an economic slowdown, we took the opportunity to reevaluate the health of our entire portfolio by re-underwriting our investments through the lens of potential scenarios for the months ahead.

Following this review, we are confident that OBDC is well-positioned to navigate these uncertain times. As was the case during the COVID pandemic in 2020 and the regional banking crisis in 2023, our portfolio is built for resilience during economic disruptions. Our team has been through seismic events before, and we are actively monitoring the portfolio in real-time, maintaining constant dialogue with our portfolio companies, sponsors, and partners to proactively address any issues that may arise.

While the economic outlook remains unclear, we believe we are entering this period from a position of strength. Performance across our portfolio companies remains healthy, which we believe is a result of our weighting towards defensive sectors. This stands in stark contrast to the public fixed income markets, which are more meaningfully skewed towards cyclical industries such as building products, retail, autos, energy, and chemicals, sectors in which OBDC generally has not invested.

As noted on our last earnings call, approximately 94% of our portfolio of companies are based in the United States and primarily serve domestic customers, limiting exposure to international trade disruptions. Our top sectors are primarily service-oriented such as healthcare, business services, financial services, or software, which reduces reliance on manufactured goods or commodities and minimizes direct impacts.

We estimate that our exposure to companies with significant offshore manufacturing is limited to mid-single digits of the portfolio. Additionally, these businesses generally have diverse product sourcing capabilities and experienced management teams that have successfully navigated previous tariff or supply chain disruptions.

This was by design. Since inception, we've built our portfolio to withstand turbulent economic environments and believe we will be a safe port in the storm. That said, we remain quite cautious about the impact of potential negative economic developments that our portfolio companies might face, including the possibility of broader recessionary pressures.

This is why we've taken a proactive approach in response to the recent policy announcements by focusing on what we can control and quickly addressing any challenges that arise. OBDC's defensive position as a senior secured lender with a low loan to values can mitigate risk experienced during uncertain markets and, in our view, positions us well to weather potential future volatility or a recession.

The majority of our portfolio companies are backed by private equity sponsors, who are skilled operators with significant equity investments in these businesses. This is particularly important during more volatile times, as these sponsors have substantial financial resources, including ample dry powder, to support their investments for extended periods of stress, as we saw during COVID.

Additionally, we are lead or co-lead lender on roughly 90% of deals and administrative agent on approximately 65% of our investments across our platform, which gives us direct access to real-time information on borrower performance. To date, we have not seen any material signs of stress such as increased revolver borrowings, requests for interest payment modifications, or late interest payments. We also benefit from a strong balance sheet and significant liquidity, supported by diversified and flexible funding sources to allow us to be resilient and invest across all market environments.

In summary, we believe our experienced team, defensively constructed portfolio, disciplined underwriting, and highly durable funding model have positioned us to protect our shareholders, regardless of what lies ahead.

With that, I'll turn it over to Logan for additional color on portfolio performance.

Logan Nicholson

Thanks, Craig. As just mentioned, the recent policy shifts subsequent to quarter-end only added to the uncertainty about when a pickup in M&A activity will materialize. Accordingly, originations were lighter this quarter. We recorded \$1.2 billion of new investment commitments and \$800 million of fundings, excluding joint venture and strategic equity activity.

Over 90% of First Quarter direct loan originations consisted of first lien investments, as we continue to believe that first lien and unitranche loans provide the most attractive relative value in the current market. As a result, over the last year, OBDC's first lien investments have grown from 73% to 77% of the portfolio.

While activity has slowed, we continue to find large high-quality opportunities during the quarter, including PCI Pharma, a \$4.5 billion transaction, led by Blue Owl, to refinance a syndicated loan. Notably, with an average deal size of approximately \$2 billion this quarter, we continue to see the market migrate towards larger, more diversified credits.

With the addition of First Quarter originations, the median EBITDA of our portfolio borrowers grew slightly to \$120 million, and weighted average EBITDA increased to \$215 million. Portfolio company revenues and EBITDA once again increased in the mid to high single digits year-over-year. We would highlight this is approximately double the U.S. GDP growth rate due to our durable noncyclical sector selection, which should provide our borrowers more cushion in a potential recession.

The portfolio also remains highly diversified, with an average investment size of approximately 40 basis points, and our top 10 investments represent approximately 22% of the portfolio, down from 24% in the prior quarter. Additionally, as Craig noted, our average LTV is just over 40%, which provides significant support underneath our capital.

Now, I'd like to touch on some credit metrics in our portfolio. The nonaccrual rate as of quarter-end was 0.8% at fair value and 1.4% at cost, compared to 0.4% and 1.9% in the prior quarter. The change reflects two additions, including National Dentex Labs, and the removal of three positions that were fully exited. Stepping back, our nonaccrual rate remains at the lower end of our broader sector averages.

Next, our internal rating system, which ranges from one to five as an indicator of portfolio health, remained steady, and the subset of names on our watch list was also stable quarter-over-quarter. Interest coverage remained steady at 1.8 times, based on current spot rates, up

from trough levels, as lower rates have benefited our borrowers, which should provide them a bit more flexibility during this period of uncertainty.

Finally, PIK income declined to 10.7% of total investment income from 13.2% last quarter, driven by several investments that were converted to all-cash pay, as well as the merger with OBDE, which had lower levels of PIK exposure. As we've highlighted in the past, the vast majority of this PIK was underwritten at inception, rather than as a result of credit issues, and these investments continue to perform as expected.

In closing, I want to echo the sentiment Craig shared. Our First Quarter results demonstrate the continued strength of our portfolio. We are closely monitoring our investments for potential tariff impacts, but we remain confident in our defensive positioning and proactive in our approach.

And now, I'll turn over the call to Jonathan to provide more detail on our First Quarter financial results.

Jonathan Lamm

Thank you, Logan. Before discussing our financial results, I want to review the non-GAAP accounting adjustments we introduced this quarter due to the accounting treatment of our recent merger with OBDE. We did this to help make our post-merger financials more comparable to pre-merger results.

Under the asset acquisition method, we recognized an \$83 million purchase discount on the assets acquired from OBDE, which resulted in a one-time unrealized gain to OBDC in the First Quarter. This purchase discount will be reversed out of the realized gains into total investment income each quarter as the legacy OBDE loans mature or are realized. In the First Quarter, this amortization income represented approximately \$0.02 per share.

Importantly, we have amended our investment advisory agreement to revise the calculation of incentive fees to ensure that any income or net realized gains arising solely from the merger accounting treatment will have no impact on the incentive fees payable to Blue Owl. This non-cash amortization will be reflected in our results going forward, and we're happy to discuss this further with you in Q&A or offline to the extent you have any questions.

Now turning to our results, we built upon the momentum established in 2024 and delivered another quarter of solid financial performance to begin the year. Following completion of the merger with OBDE, we ended the quarter with total portfolio investments of nearly \$18 billion, total net assets of nearly \$8 billion, and total outstanding debt of approximately \$10 billion.

Our First Quarter NAV per share was \$15.14, down \$0.12 from the last quarter. The decline was primarily driven by changes in credit spreads and write-downs on a small number of high focused investments.

Turning to the income statement, we reported adjusted net investment income of \$0.39 per share, down \$0.08 from the prior quarter, which was in line with our expectations. As discussed on our last earnings call, the decline primarily reflects a meaningful reduction in one-time income, including early repayment activity and a dividend we received in the Fourth Quarter, which together contributed approximately \$0.05 to last quarter's NII. In addition, the remaining one-third of the 100 basis point interest rate cuts that were implemented last year flowed through earnings, as well as a small amount of spread compression of approximately 10 basis points.

Similar to prior quarters, we over-earned our base dividend, resulting in the Board declaring a \$0.01 supplemental dividend based on our First Quarter results, which will be paid on June 13th to shareholders of record as of May 30th. As a reminder, we implemented a programmatic supplemental dividend framework to allow shareholders to benefit from the higher returns associated with the increased rate environment, which has worked as designed.

The Board also declared a Second Quarter base dividend of \$0.37, which will be paid on July 15th to shareholders of record as of June 30th. We believe OBDC is well positioned for the evolving rate environment, and that the base dividend continues to be supported by our adjusted earnings, with 106% dividend coverage.

Further, our spillover income remains healthy at approximately \$0.34 and equates to nearly a full quarter's worth of base dividends. We believe having a meaningful undistributed spillover supports our goal of maintaining a steady dividend through volatile and varying market conditions.

Moving to the balance sheet, we are entering the year on a solid footing, as our diversified capital structure positions us to withstand the current environment. We finished the quarter with net leverage of 1.26 times, up from 1.19 times, and just outside of our target range of 0.9 to 1.25 times, which is partly attributable to the one-time leveraging event of the merger with OBDE. We also had visibility into a couple of large repayments that slipped into April, and as a result, we expect net leverage in Q2 will be within our target range.

Since the merger closing in January, we have taken several steps to optimize our capital structure and reduce funding costs at OBDC. During the First Quarter and post quarter-end, we reset two CLOs and amended two of our bilateral SPVs, reducing interest expense for each and extending maturities for most of the facilities.

In April, we've repaid OBDE's \$142 million July 2025 notes, which was modestly accretive to net investment income, as the notes had a higher interest rate as compared to OBDC's cost of funding.

Lastly, as a reminder, we pre-funded the \$425 million of unsecured notes that matured in March by opportunistically raising \$400 million through a reopening of OBDC's March 2029 unsecured notes last quarter, which priced at a swap spread of SOFR plus 192 basis points, near secured credit facility pricing levels. These changes represent our continuing efforts to actively improve our liability structure and optimize ROE post-merger.

Turning to liquidity, we ended the quarter with over \$3 billion of total cash and capacity on our facilities, which was over 2 times in excess of our unfunded commitments that can be immediately drawn. Importantly, we have no material short-term maturities, and our robust liquidity position provides us with more than ample unfunded capacity to meet any near-term funding needs. Overall, we remain very pleased with our results and believe that our balance sheet is well-positioned for a more uncertain environment ahead.

And now I'll hand it back to Craig to provide final thoughts for today's call.

Craig Packer

Thanks, Jonathan. The recent volatility across stocks and public fixed income markets has signaled a potential shift in the investment landscape. In periods like this, we believe private credit is poised to capitalize on market volatility by providing support to borrowers and sponsors facing challenges in accessing financing.

While leverage at OBDC is towards the high end of our target range, we remain agile and able to deploy capital strategically as repayments come in, which allows us to be patient and pick our spots as we find opportunities.

Last year we experienced a significant number of refinancings, which impacted the overall spread of our portfolio. However, at this point, we believe most of this refinancing activity has played out, which means we have the ability to operate with a high-quality portfolio that benefits from stable spreads. This positions us well to be patient and selective, knowing that as public markets continue to experience volatility, the value of the certainty we offer to borrowers only increases.

While it was too early to say how long this environment will last, we're confident in our ability to take advantage of opportunities, given our capital, resources, and long-term investing time horizon to navigate what lies ahead. Looking forward, while macroeconomic uncertainty persists, the market is anticipating a significant reduction in interest rates, which will impact our earnings. That said, we believe our stable earnings profile and compelling risk-adjusted returns will continue to make us an attractive option for investors, even in a lower rate environment.

As we've mentioned throughout today's call, our portfolio is performing well, reflecting the continued strength and resilience of our borrowers. The stability of our portfolio gives us confidence in maintaining our dividend level for the remainder of 2025.

To close, we are very pleased with our First Quarter results and the seamless execution of the merger. We're confident in our ability to navigate a more challenging environment ahead, all while delivering attractive returns to our shareholders.

Thank you for your time today, and we'll now open the line for questions.

Operator

Thank you. At this time, we'll be conducting a question-and-answer session.

Our first question is from the line of Brian McKenna with Citizens JMP Securities. Please proceed with your questions.

Brian McKenna

Craig, it would be great to get your perspective on how the macro unfolded over the past several months. I know you gave a little bit of color, but for some time now, we've talked about just how tight spreads were as banks were really active, and then there's just this lack of new M&A transactions. We finally got some volatility. Banks did pull back. So, I'm just curious, from your seat, how have spreads trended from February to March, and then from March into April and May?

And then at the OWL Investor Day back in February, you stated, "I don't know, I haven't seen it yet," when speaking about the forthcoming recovery in M&A. So, here we are. There's been no change in the broader M&A backdrop. Do you have any updated thoughts on where we go from here? And then if activity remains more muted on the M&A side, does that have any implications on OBDC?

Craig Packer

Okay. Thanks, Brian. There are a few pieces in there, so if I don't get to all of them, remind me. My quote/unquote, "I haven't seen it yet." I think that's held up well over time. So, I think I was probably spot on there.

To try to hit some of the themes that you're asking about, just to pull the lens back, last year was a moderate M&A environment with a really strong broadly syndicated loan market and rates-- spreads tight. And so, there was a lot of refinancing last year. There were a lot of public and private market dollars chasing a moderate amount of deal flow, and that resulted in spread compression.

The hope this year was that there would be a resumption in M&A. I think there was a lot of optimism with the new administration that it would be deregulatory. That would result in M&A with the private equity firms needing to return capital. So, there was a hope that would result in more deal flow, more opportunities to deploy, and potentially, improved spread environment.

What's happened so far this year is, given there's just been, after the initial, I think, optimism around a new administration, there's been a lot of uncertainty created by tariffs in particular. And that's had a chilling effect on M&A. Both private equity, but just in general, the uncertainty around tariffs has created a muted M&A environment, and I think most people expect that to continue for a while. Until there's greater clarity, it's hard for companies to want to buy and sell and for there to be an active M&A environment. And so, I think that will continue to be the case.

On the spread front, the public loan market, really closed up. It's opened up a little bit now, but the extreme volatility of a month or so ago really impacted the public loan market, so that bid went away. And so, spreads, I think, have stabilized. Our hope would have been, in an environment with a lot of public market volatility, that spreads would widen. Typically that's what you would see. We haven't seen that yet.

Private credit spreads are stable. I think different market participants might call it 25 basis points wider, or maybe 50 basis points wider. But I think there's also deals that are getting done at really the same spread they would have gotten done a couple of months ago. So, I think it's not going any tighter. Our hope is to have it go wider. We are certainly pushing for that in the instances where we think it's appropriate.

But there remains pretty modest deal flow. And so, the deals we're seeing are good quality. You saw we had an active quarter. I think we'll continue to have an active year. Our portfolio companies, we have a significant number of incumbencies. And they are constantly doing add-on acquisitions that are smaller but allow us to deploy capital. I think spreads--my hope is at some point there'll be a pickup in activity and spreads will go wider a bit, but we're not seeing that just yet.

You know, it's a fine environment for investing. I'd like to see more deal flow. I'd like to see a little bit better economic terms. But the quality's very good, and the portfolio companies are holding up very well. So, hopefully that captures the gist of what you're asking about, but if I missed any piece of it, just remind me.

Brian McKenna

I think you got most of it, if not all of it. So, that's super helpful. Appreciate that. There were clearly a few questions in that, so I just have one quick follow-up. Is there any updated timeline around the public listing of OTF now that that merger is complete?

Craig Packer

There's nothing for us to disclose here. We've obviously completed a number of strategic transactions, the merger of OBDC and OBDE, the merger of our two private tech funds. We take a very front-footed approach with trying to find ways to deliver value for our shareholders, talk to our Board regularly about all those activities.

And so, our tech fund, I don't have anything to report on it, but our tech fund, now combined, the private tech funds would be one of the largest, most consequential BDCs if it were a public company. So, if we found a window where we think that makes sense, then we would explore that, as we have some of these other strategic transactions.

We actively look at each of our funds regularly to see what makes sense, but nothing more specific to report.

Brian McKenna

Okay. I'll leave it there. Thanks, Craig.

Craig Packer

Thanks, Brian.

Operator

The next questions are from the line of Mickey Schleien with Ladenburg Thalmann. Please proceed with your question.

Mickey Schleien

I wanted to ask a spread question as well, but you explained it very thoroughly, so my other question is related to share repurchases. I realize there are windows which open and close for share repurchases, but why not rotate some of the repayments you've received into buying shares during the recent periods of volatility, which would seem to be a great use of capital?

Craig Packer

So, we have a share repurchase program. We've also instituted an ATM program. You know, we look at both tools regularly, weekly, daily. As you note, there are windows for share repurchases, and they're meaningful windows, which I won't get into precisely here, but they're measured in weeks, not in days.

And so, if there are environments that line up with our windows to buy shares, that's a conversation that we'll have with our Board. It was not that long ago that we've been above book value. So, these things move quickly, and they have to line up. We've used the share repurchase in the past, and we can look at using it again.

I agree with your instinct, which is we think that our stock trading where it is is not reflective of the fundamentals of the portfolio performance, which continues to be excellent. The yield on our stock today, on our base dividend, is close to 11%, and we haven't had any credit issues. And our peers that have comparable credit quality are trading at book value. We trade at \$0.90 of book value.

So, we agree with the sentiment that our stock is attractively priced. Obviously, the capital is very valuable to deploy, so we always weigh that. But it's something that we will continue to look at.

Mickey Schleien

So, if I understand correctly, that recent period of volatility where we saw a sharp selloff over a few days, it just didn't coincide with one of the windows being open. Is that correct?

Jonathan Lamm

That is correct.

Mickey Schleien

Okay. Thank you for that. That's it.

Operator

Thank you. Our next question comes from the line of Casey Alexander with Compass Point. Please proceed with your questions.

Casey Alexander

This is for Jonathan. Jonathan, not being as familiar with the liability structure that you inherited from Blue Owl III, I'm curious if there's anything in Blue Owl III's liabilities that you inherited that are going to offer some opportunities to rationalize some of those liabilities at lower cost.

Jonathan Lamm

It's a great question. It's something that we definitely talked about at the time of the merger, that we felt that there were going to be opportunities. We've already started to take advantage of some of those on the secured side by repricing certain drop-down facilities that we have in place, as well as repricing the CLO. Subsequent to quarter end, we took out notes that we had issued at OBDC III that were a high coupon as well, at the first possible chance to take those notes out.

So, there's more there to do. And as the call dates come up, we'll certainly be able to take advantage of that.

Operator

Thank you. The next question is from the line of Robert Dodd with Raymond James. Please proceed with your questions.

Robert Dodd

You've answered the spread and M&A one really clearly, and Casey got the liability one. So, the Board one. Going back to your opening remarks here, at this point in your underwriting case when you're looking at new deals, what are you ranking, maybe qualitatively, not quantitatively

necessarily, as the probability of a near-term recession? You always put one in to your underwriting case, and a lot of your businesses, they're not that economically sensitive because of the services side. But how has that kind of near-term view, like the second half of '25. Has that view changed on the probability of a meaningful or moderate economic slowdown?

Craig Packer

I'll try to answer your question, but I'm going to try to give a broader lens to it. The economy can be gangbusters, and we're running downside cases. Every deal, every investment we've made in our history has a recession case in it. Every deal in our history has a liquidation case in it. So, we're extremely downside focused, and it's a hallmark of our underwriting process.

In addition to that, as you note, we're investing in businesses that are not that cyclical. That is also a hallmark of our investment process. Software, insurance brokerage, healthcare, food and beverage, mostly U.S. businesses, mostly stable, mostly annuity-like revenue streams. That's what we like to invest in.

I'll also repeat what we said in our prepared remarks. We're not seeing any economic weakness in our portfolio companies. Now, we are not a forward indicator of the U.S. economy because we're selecting into the most stable parts of U.S. economy, so we wouldn't see it. But we're not.

If what you're asking me is are we especially concerned about an economic slowdown in our underwriting process, I think the answer is yes, we are. We follow economic developments as closely as I think most investors would. And there have been seismic changes to U.S. trade regulations that many feel are going to potentially impact the economy later this year.

And so, of course we're taking a serious look at that and factoring that into our base case rather than our downside case. So, I think that that's just sort of responsible lending in this kind of environment. And we are downside in orientation, so we're taking that into account, and it's probably our expectation.

It's not going to change the kinds of investments we're making because we would have already selected out of the type of investments that would be most impacted by that type of a downturn. But it certainly, on the margin, makes you that much more cautious about how much leverage you put on a business that, even though it's not cyclical, every business is impacted if there's a recession, and even very stable ones. So, we are certainly factoring that in, and we insist that that introduces a level of caution as we look to deploy additional capital.

Robert Dodd

Now, the businesses have been combined. The asset base is bigger. You've got a little bit more room, arguably, now under your non-qualified bucket or any of these other diversified lending strategies that you follow between Wingspire, etc. I think I asked you about this last quarter. But any incremental thoughts on, now that they're combined, bigger balance sheet, how much

of that non-pure traditional first lien – I'm not saying it's higher risk or anything, but those differentiated strategies you want within this vehicle?

Craig Packer

So, as you're alluding to, at OBDC previously, we had fairly meaningful investments in a number of essentially portfolios of assets in an asset-based lending business. We have a syndicated loan joint venture, our aircraft and railcar equipment finance. Give or take, those are measured in the low double digits of the asset pool.

OBDE had much less. And so, we would certainly look to true-up the combined portfolio and essentially get a portion of incremental exposure by just getting the combined asset base to where OBDC was previously.

These have been really good investments. Again, the underlying pools of assets within each of these investments are diversified pools of loans typically. We have a life insurance settlements business, a joint royalty business. They're diversified underlying pools that have delivered, depending upon the structure, low to mid-teens ROE.

So, they're accretive to OBDC. We think they're risk appropriate. And over time, we'd like to continue to grow our exposure to the existing ones. And if we could find one or two additional strategies to invest in, we would do that as well.

Again, today it's combined low double digits. We're going to be patient as we grow this. But, over the next couple years, if we could take that number up to 15% versus 12%, I think that would be very valuable for shareholders. And we're working with experienced teams that have good deal flow, chunky opportunities, and we'll look to support them and find good investments through that venue.

Robert Dodd

Thank you.

Operator

Our next question comes from the line of Casey Alexander with Compass Point. Please proceed with your questions. Mr. Alexander, please go ahead with your questions.

Casey Alexander

I just want to make sure that the variable dividend structure is going to be toggling off of adjusted earnings and not the GAAP number.

Jonathan Lamm

Casey, that is correct. It's off of adjusted.

Casey Alexander

Okay, great. Thank you.

Operator

The next question comes from the line of Sean-Paul Adams with B. Riley Securities. Please proceed with your questions.

Sean-Paul Adams

I think you already touched on part of this question earlier in the call. But now that the OBDE merger has closed, what kind of specific operational efficiencies besides just the refi's are you guys tracking? I believe earlier in the quarter you had mentioned expecting maybe 50 to 75bps of ROE uplift from portfolio optimization. How far along are you in realizing those gains, and when would we see the full benefit to OBDC?

Logan Nicholson

Sure. Maybe I'll start and pass it to Jonathan, because there's two fronts that we highlighted at the time of the merger. First was, I'd call it market dependent and investment-related ROE optimization efforts. Some of those are exactly what Craig was just talking about, is continuing to deploy to accretive JVs as strategic equity opportunities, like our platforms, Wingspire, as one example. And OBDE was underweight some of those opportunities. And so, getting that back up as part of the combined portfolio would be top of that list. And that certainly takes time to deploy into the assets at that level, but it's something that we're already working on.

Additionally, there are others where OBDE was a slightly different portfolio mix, and part of that is market opportunity set dependent. Today we see the best relative value, as mentioned during the call, in the first liens and unitranche. But we are open, if the return opportunity and the relative value opportunity improves, to looking at second liens or junior capital, where OBDE was also underweight.

So, some of them are more market dependent. JVs is more time dependent. And we're working on those now. And then there are cost structure sides, which I'll let Jonathan touch on.

Jonathan Lamm

So, on the operating expenses, you get to see those sort of pull through rather quickly. And so, in Q1, we were able to already see approximately 10 basis points of what I'll call synergies on a relative basis to where OpEx was across a number of categories in 2024.

Sean-Paul Adams

Got it. I appreciate the color. Thank you.

Operator

Thank you. Our next questions are from the line of Finian O'Shea with Wells Fargo. Please proceed with your questions.

Finian O'Shea

I might be piggybacking on Robert's question here, but I wanted to go back to spread as well. Appreciating the contemporary puts and takes, longer term, you and your large market peers have these burgeoning wealth products, and you're going more and more upmarket in deployment. So, do you think there's more of a firmly secular trend downward on spread? And if so, will the public BDC continue to stay on that bus or pivot more meaningfully toward higher spread – I think you mentioned ABF or just other sort of old school private credit strategies.

Craig Packer

Just as a level set, the spread in our portfolio at the end of this quarter, it was 590 over. I think it's an excellent spread. Even with base rates where they are, that's an absolute all-in return of north of 10% for a portfolio of primarily first lien assets to good companies. So, spreads have come in.

I don't think it's a secular shift. I think it's a cyclical shift. The strength in the broadly syndicated loan market, which is a market that we do compete with, drove spreads down last year in an environment with light M&A. Give us a window where either there's more M&A or a closed public loan market, and I think spreads will widen. So, I view it as just a typical cycle, not a secular shift.

You're right that there's been a growth in the nontraded BDCs in the wealth channel. That's a channel that we participate in. But at the same time, the addressable market for those deals have expanded in pace. The growth in that channel is what's allowing us to finance deals that are \$3, \$4, or \$5 billion at a clip. And so, the market is growing as the capital is growing to support that market. And the private equity firms are choosing to use direct lending solutions to finance bigger deals in a way they never have before because they like the solution, and we get a premium to the public markets.

So, that all feels good to me. I also think that the larger deals are just really good credits. And I think that this is an area that observers just don't fully give us credit for. When we're financing deals that are \$3 or \$4 or \$5 billion, these are \$8, \$10 billion companies with \$4 billion equity check from private equity firms. The industry is just much higher quality than it was 10 years ago, and I think it's one of the reasons why I expect it will continue to perform from a credit standpoint.

In terms of our strategy for OBDC, our strategy is going to remain the same. We have been, from the beginning, focused on credit quality versus all else. And we continue to think that the quality of the upper middle market company is attractive, and that's where we seek to play.

And I would also offer that I think that spreads in smaller deals are the same as the upper middle market. And I know there'll be others out there that will argue otherwise, but that's not what we're seeing. We look at everything that's out there, and we think it's pretty comparable. So, we think we're getting better quality for comparable spreads.

I also think that a portfolio of high-quality, upper middle market loans that's diversified and that's yielding 11% holds up really well in this environment. I don't think we have to change our strategy. I think our strategy is delivering great returns for investors. And so, I think that's all working.

We, as you know, and as many know, at Blue Owl, we have expanded our credit platform. We have gotten into alternative credit or asset-based lending, which some will use that term. That's a capability that we didn't have in scale before. That may produce opportunities for us to occasionally put some of those assets into the BDC if we think that they're of proper credit quality and can deliver kind of the consistent income that we're known for.

But that's really on the margin. We're not looking to change our strategy. And I think that this will continue to be attractive risk-adjusted return for investors.

Finian O'Shea

Very good. Thanks. And just a follow-up, Jon, you mentioned spillover as support in the evolving base rate environment. Does that mean if base rates go more firmly against us here, that you'll run that down and earn below the dividend until that's through, or what will your posture be if and when SOFR pushes earnings below the dividend?

Jonathan Lamm

We view spillover income as good for helping to sustain the dividend during periods of volatility. That was what I had indicated in my prepared remarks. We're not at all saying that we would use the spillover and run it down if we were permanently impaired in terms of our income relative to the dividend. We're just not at that point now.

And so, what we're saying is having the cushion of spillover income to sustain the dividend for a quarter or so during a period of volatility is what you use it for. But we like that cushion, and in no way are we indicating that we would run it down and utilize it in order to sustain a dividend that's not earnable for the long term. So, in a much, much lower rate environment, we're having a different conversation.

Finian O'Shea

That's helpful. Thanks so much.

Operator

Our next question is from the line of Maxwell Fritscher with Truist Securities. Please proceed with your questions.

Maxwell Fritscher

I'm on for Mark Hughes. Can you provide any color on what you're seeing in the pipeline in terms of mix of new versus incumbent borrowers, and then maybe even types of deals you're seeing, terms, covenants? Anything in particular to call out?

Logan Nicholson

Sure. It's been remarkably consistent with prior quarters. And so, to Craig's point, we didn't necessarily see the tick up in M&A in the late Fourth or early First Quarter. And so, it's been a consistent First Quarter. More than half of our deal flow in the First Quarter came from existing borrowers, add-ons and refinancings. And the majority of the cases, when there was a refinancing, we were able to do additional size. And so, incumbencies have been a majority source of our deal flow.

Looking forward, our pipeline for the Second Quarter is trending in the same direction, quite a bit of existing borrower transactions, more than half, and sporadic M&A. There's been quite a few attractive deals already announced, one deal north of \$4 billion that was publicly announced just a few weeks ago, and there are a few more that we're looking at in the pipeline that are quite attractive and sizable. So, no change to the landscape relative to Q1 from a pipeline perspective, and still fairly attractive and up in scale.

Maxwell Fritscher

And then you'd mentioned the decrease in PIK from borrowers transitioning to cash pay. Do you have any visibility in the near, maybe medium term, for other borrowers to do the same?

Logan Nicholson

Sure, exactly right. So, in the First Quarter, we had five names that went from partial PIK to fully cash pay. And so, we do have visibility to others likely going off their PIK options. Again, some of these windows, it is at the borrower's option. And so, sometimes it's voluntary and sometimes it's time-based.

But we do have visibility, and we expect our PIK to be consistent. We at this point have had a number of quarters in a row back through the full year 2024 where we've been range-bound on PIK, and we've had now a couple of quarters of decline. So, we would expect our PIK to be consistent based on our visibility so far.

And also, last year we had the benefit of a number of refinancings. So, opportunistic refinancings of junior capital into de-levered capital structures, into first liens or simply takeouts with cash flow. And, you know, to the extent that the markets are open and active in terms of refinancings, we will continue to see that.

Maxwell Fritscher

Very good. Thank you.

Operator

Thank you. At this time, I will turn the floor back to management for further remarks.

Craig Packer

Thanks, everyone, for joining. We're always available. If you have any follow-up questions, just reach out. We feel really good about the quarter and appreciate everyone joining the call. Have a great day.

Operator

This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation. Have a wonderful day.