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OHAI - Q4 2017 OHA Investment Corp Earnings Call

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CORPORATE PARTICIPANTS

Cory E. Gilbert *OHA Investment Corporation - CFO*

Steven T. Wayne *OHA Investment Corporation - CEO and President*

CONFERENCE CALL PARTICIPANTS

Kurt M. Hoffman *Imperial Capital, LLC, Research Division - MD of Institutional Research Group*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the OHAI Corporation Fourth Quarter, December 31, 2017 Report Conference Call. (Operator Instructions)

Before we begin, I would like to remind everyone that today's remarks may include comments which could be considered forward-looking statements and such statements are subject to many factors that can cause actual results to differ materially from our expectations as expressed in those forward-looking statements. Those factors are described in more detail in the company's SEC filings, and I refer you to the company's website or to the SEC's website to review those filings. The Company undertakes no obligation to publicly update or revise any forward-looking statements, which speak only as of today's date. As a reminder, this conference call is being recorded. I would now like to turn the call over to Steven Wayne, the company's President and CEO.

Steven T. Wayne - *OHA Investment Corporation - CEO and President*

Thank you, Sabrina. Good morning. I would like to welcome all of you to our company's fourth quarter 2017 earnings call. I am joined on the call today by Cory Gilbert, our Chief Financial Officer.

The presentation we are about to review was posted to our website earlier this morning under the Events and Presentations heading of the Investor Relations tab. We also refer you to our annual report on Form 10-K that was filed yesterday.

I'll now turn to Page 4 and provide an overview of 2017. The end of 2017 marks thirteen quarters under OHA's management of OHAI, and while we are pleased with the success of our investment activity since September 2014 that has broadened OHAI's investment focus away from energy, our investment portfolio continued to experience losses in our legacy energy assets in 2017. NAV declined again in 2017 by $1.62 per share, from $3.99 at the end of 2016 to $2.37 at December 31, 2017. During the year, we experienced $31.6 million of net write-downs related to our legacy energy investments or approximately $1.57 per share in NAV reduction. We also took $2.5 million of write-downs, or $0.12 per share of our investments in OCI, our lone remaining non-energy legacy portfolio company.

During OHA's tenure, through December 31, 2017, OHAI has invested $139.4 million in new assets, all outside of the energy industry, in 18 new portfolio companies. In 2017, we made investments in five new portfolio companies totaling $20.5 million and a $1.4 million add-on to an existing OHAI portfolio company. We also had portfolio realizations of $33.7 million related to eight OHA investments. I'll talk more about the portfolio activity later on the call.

From a financial standpoint, we finished the year with $1.0 million of GAAP Net Investment Income or $0.05 per share and declared distributions of $0.08 per share during the year. The Company generated $0.06 per share of taxable income in 2017, of which 100% has been deemed to be distributed to our shareholders. Cory will provide more detail on the financial results in a few minutes.

I will now turn to Page 5, which summarizes the developments for OHAI in the 4th quarter. As I mentioned previously, we ended 2017 with an NAV of $2.37 per share. NAV actually increased in the fourth quarter 1% or $0.03 per share from $2.34 at the end of the third quarter. In the fourth quarter, there were no material net valuation change as the positive valuation changes were offset by negative valuation changes. As you will see later in the presentation, our investment in Talos was marked up by $1.3 million during the quarter but was partially offset by $1 million of write-downs in our investments in OCI. Also, during the quarter, we recognized $695,000 or $0.03 per share, of tax benefit in connection with the Tax Cut and Jobs Act. Cory will discuss the tax impact in more detail later on the call. From a net investment income perspective, we earned $0.02 per share on a GAAP basis for the fourth quarter.

During the quarter, the Company had realizations of $14.9 million related to three OHA investments, including the full realizations of our Appriss and Royal Adhesives investments. In November, we entered into an Incentive Fee Waiver agreement with our external advisor, OHA, whereby OHA has agreed to waive any incentive fees earned relating to 2017 and 2018. With this Waiver agreement now in place, the capital gains fee of $89,000 for 2017 that would have otherwise been payable at December 31, 2017, has been waived.

Since year end, there are several developments that I would like to mention. First, our $11.5 million principal amount investment in Talos was redeemed at par upon maturity on February 15. The redemption amount was $2.9 million, or $0.14 per share, greater than Talos' fair value of $8.6 million at December 31, 2017. As a result of this realization, the energy exposure in our investment portfolio is now 0%, absent any positive valuation changes in our zero fair value energy investments, Castex and ATP, that remain on our schedule of investments.

Next, we have added almost $10 million of net new investments during the first quarter of 2018 so far. I look forward to discussing these new investments on next quarter's call in May. Lastly, we exercised our option to extend our credit facility with MidCap through September 9, 2018.

Before I provide a brief backdrop of the market environment in which we operate, I want to comment on the Review of Strategic Alternatives that was discussed on our last earnings call. As both the investment advisor and a shareholder of the company, we are surely disappointed by the magnitude of write downs in the legacy investment portfolio. While we are proud of the meaningful success of new investments made under OHA leadership, these gains have only cushioned the substantial losses. It has always been OHA's objective to maximize shareholder value, and we are mindful of the expense burden relative to a sub-scale investment portfolio.

OHAI's Board of Directors has decided to explore a variety of options that could provide more scale to OHAI. These options could include, among other things, raising additional capital, a merger or joint venture with another party, the acquisition of existing investment portfolios or other strategic transactions. To assist OHAI in this process, the Board has retained Keefe, Bruyette & Woods,Inc, or KBW, as its financial advisor and investment banker. While we are actively working with KBW to explore these options and committed to taking actions that we believe will maximize shareholder value, there is no assurance that the Company will execute on any of them. No specific timetable or formal process has been set, and OHAI does not to expect to comment further or periodically provide updates to the market with additional information unless and until the Company's Board of Directors has approved a specific transaction or otherwise deems disclosure appropriate or necessary.

Now turning to the leveraged credit markets private equity activity, which generally drives new money financing opportunities in the below-investment-grade credit markets, continued its recent decline in the fourth quarter of 2017 as private equity deal count declined 21% and capital invested declined 22% compared to levels in the fourth quarter of 2016. Private equity activity also declined compared to the third quarter of 2017.

2017 performance in the U.S. high-yield market was strong, although the fourth quarter did show signs of slowing down as the broad high-yield index ended the quarter up only 40 basis points. For 2017, the U.S. high-yield market was up a total of 7.5%. High-yield spreads have continued to hover at levels near their post-financial crisis tights.

In the leveraged loan market, 2017 was a record year for U.S. institutional new issue activity, although a significant amount of this activity was repricings and refinancings rather than new money deals. In 2017, this market returned 4.3%.

As interest rates have increased over the past six months, we have seen the loan market outperform the HY market. So far in 2018, the HY index is down -1.0%, while the loan index is up 1.5%. LIBOR is up considerably and will have a significant impact on both the yields of our floating rate assets and the cost of our borrowing, which is LIBOR based. 3-month LIBOR has gone from 1.33% at the end of the third quarter to 2.29% today, an almost 1% increase.

Activity in the middle market slowed down in the fourth quarter of 2017. Issuance of syndicated middle market loans (deals with loan amounts of $350 million or less) decreased in the fourth quarter to $9.2 billion from $10.2 billion in the third quarter. Similarly, issuance by companies with EBITDA of $50 million or less decreased from $3.8 billion in the third quarter of 2017 to $1.6 billion in the fourth quarter of 2017. In both the broadly syndicated and middle markets, new issue yields have increased due to the rise in LIBOR, but new issue spreads have contracted, mostly offsetting the LIBOR gain. According to LCD, the average first lien spread to LIBOR for middle market borrowers is 410 basis points, the lowest since 2007.

And lastly, as you may have seen last week's massive omnibus spending bill that was approved by the Senate and the House and signed into law by the President included several provisions that are favorable for BDCs. Most notably is the ability to allow BDCs to increase their leverage from 1:1 to 2:1.

I will now turn the call over to Cory to discuss the financial results for the 4th quarter.

Cory E. Gilbert - *OHA Investment Corporation - CFO*

Thank you, Steven. The financial headlines for the 4th quarter can be found on page 6. Our investment income for the quarter totaled $2.6 million or $0.13 per share, a 6% decrease from the third quarter. Base management fees were $426 thousand and there was a $15 thousand reversal of incentive fees in the fourth quarter. Our net investment income totaled $367 thousand or $0.02 per share. We recorded net realized and unrealized gains totaling $697 thousand or $0.03 per share during the quarter, primarily related to tax benefits recognized in connection with the Tax Act and Jobs Act. All together, we reported a net increase in net assets from operations of $0.05 per share. After our $0.02 per share distribution declared in December and paid in early January, our net asset value increased to $2.37 per share, a 1% increase from the third quarter.

We continued our practice to seek positive assurance from a third-party valuation firm on all Level 3 assets with fair values in excess of $10 million on a quarterly basis. We will also seek positive assurance on other Level 3 assets with any meaningful fair value. This quarter, we also sought and received third-party positive assurance on 99% of our Level 3 assets with any fair value.

Page 7 shows the net investment income section of our income statement for the fourth quarter of 2017 compared to our results for the third quarter of 2017 and for the fourth quarter of the prior year. Investment income decreased by approximately $160 thousand from the third quarter of 2017 primarily due to $297 thousand of royalty payments received from our investment in ATP limited term royalty interest in the 3rd quarter of 2017. There were no royalty payments received during the 4th quarter of 2017.

Compared to the same quarter in the prior year, investment income decreased $1.4 million, primarily as a result of placing our investment in Castex on non-accrual status in January 2017, lower production payments from our ATP investment, and a decrease in the average portfolio investment balance.

Interest expense for the quarter was $956 thousand or $0.05 per share compared to $1.0 million or $0.05 per share in the third quarter of 2017 and $988 thousand or $0.05 per share, in the same quarter of the prior year. Quarter over quarter, the decrease in interest expense is due to a lower amount outstanding on our CreditFacility as the result of a $4.5 million pay-down in November. The lower average amount outstanding was partially offset by the increase in LIBOR.

Management and incentive fees to our advisor were $133 thousand lower in the fourth quarter of 2017 compared to the third quarter. The third quarter of 2017 included $104 thousand of estimated capital gains incentives fee while the fourth quarter of 2017 had a negative $15 thousand of capital gains incentive fee based on our final capital gains incentive fee calculation for 2017.

As previously mentioned, we entered into an Incentive Fee Waiver agreement with our advisor to waive any incentive fees earned related to 2017 and 2018. The $89 thousand of capital gains incentive fee that was waived is shown on our financial statements as a separate line item after "Net Investment Income before incentive fee waiver". Compared to the same quarter prior year, base management and incentive fees were $224 thousand lower, primarily as a result of lower 2017 base management fees.

Other G&A expenses for the quarter were $945 thousand or $0.05 per share compared to $865 thousand or $0.04 per share in the 3rd quarter of 2017 and $812 thousand or $0.04 per share in the same quarter prior year. Quarter-over-quarter, Other G&A expenses were higher due to an increase in legal costs incurred in connection with Castex' bankruptcy, partially offset by lower employee-related expenses.

G&A expenses were $133 thousand higher compared to the same quarter prior year, primarily due to higher legal costs. As a result, our net investment income for the fourth quarter of 2017 totaled $367 thousand or $0.02 per share compared to $323 thousand or $0.02 per share, in the third quarter of 2017. In comparison, net investment income for the fourth quarter of 2016 totaled $1.6 million, or $0.08 per share.

Turning to page 8 you can see the summary of realized and unrealized gains and losses in the portfolio for the relevant quarters. In the 4th quarter, we recognized a $695 thousand tax benefit or $0.03 per share, primarily related to the repeal of the corporate alternative minimum tax, or AMT, under the Tax Cut and Jobs Act that was signed into law on December 22, 2017. These AMT tax credits were generated between the years 2008 and 2012 and related to realized losses of certain legacy portfolio investments. Under the new tax laws, we are now eligible for a full refund of our AMT credit carryforwards, which will be repaid to us over a five-year period.

Now, let's look at the net unrealized gains and losses on the lower half of the page. For the 4th quarter of 2017, the total unrealized gain/loss remained relatively unchanged however, there were some meaningful valuation changes to a couple of our legacy investments; OCI, a legacy non-energy investment, and Talos, a legacy energy investment. Steven will provide more commentary on the portfolio valuation changes in a moment.

On page 9, you'll find a graphical presentation of the components of the quarterly results and their respective impact on our net asset value per share.

Net asset value at the beginning of the quarter was $2.34 per share. Net investment income was $0.02 per share. This was partially offset by the fourth quarter distribution of $0.02 per share, and the net positive adjustments in the value of our investment portfolio totaling $0.03 per share. These all combined to increase our net asset value per share to $2.37, for a quarter-over-quarter increase of $0.03 per share, or 1%.

Now to discuss recent portfolio activity, let me hand the call back over to Steven.

Steven T. Wayne - *OHA Investment Corporation - CEO and President*

Thanks, Cory. Let's go to Page 11. As shown here, OHA has been able to invest $139.4 million in 18 new portfolio companies since September 30, 2014, which we believe demonstrates OHA's origination capability for OHAI. Since closing the new credit facility just over 5 quarters ago, we have made 6 investments in nonenergy portfolio companies totaling $27.6 million of par value.

Turning to Page 12. During that same period, we have realized $143.3 million of investments, including $104.8 million through the full or partial realization of OHA investments. $92.4 million of this has come from the full realization of nine investments.

At the end of the fourth quarter, the fair value of our Portfolio Investments totaled $64.9 million, excluding the $19.9 million of cash on our balance sheet and as noted at the bottom of the page, our investment portfolio is split 75% / 25% between floating rate and fixed rate investments. Also, 72% of our portfolio investments based on fair value, were classified as level 2.

Moving to Page 13. This page presents the realized and unrealized returns for the 18 portfolio company investments OHA has made through December 31st, 2017, since becoming OHAI's investment advisor. This page further underscores OHA's ability to originate investments for OHAI. The nine fully realized investments generated a dollar-weighted average gross IRR of 13.6% on an unlevered basis, and when you include the $8.0 million of TIBCO that we sold in the 3rd quarter of 2017, this increases to 14.0%. The remaining unrealized investments based on prices as presented in our December 31, 2017 financial statements have a dollar-weighted average gross IRR of 13.1% on an unlevered basis. I will note that even though these investments are still classified as "Unrealized", as shown on the prior slide, several of these investments (Berlin and Equinox) have had partial realizations to date. The return shown in this presentation and discussed today are unaudited and provided for informational purposes - and these gross IRRs are presented before any fees or expenses.

Turning to Page 14. Despite investing $141.1 million over the past 3+ years (which includes $1.7 million of additional investments in legacy portfolio companies) the size of our portfolio by fair value has decreased 62% since September 2014, driven by $117.2 million in net negative valuation changes and $143.3 million of realizations.

Let's now go to Page 15. As shown in the past two quarters' presentations, this page better illustrates and explains the significant decline in NAV that OHAI has experienced since September 30, 2014, when OHA became the investment manager of OHAI. As shown here, on that date, the portfolio consisted of $171 million of investment assets in 10 portfolio companies, concentrated heavily in the energy industry. The price of West Texas Intermediate crude oil, or WTI, was over $90 a barrel, but almost immediately started dropping, falling to around $50 a barrel at the end of 2014. In early 2016, WTI was under $30 a barrel and today it has recovered to the mid $60s. This commodity price movement, in conjunction with a similar movement in the price of Natural Gas, which remains under $3, took its toll on these legacy energy assets. Over the past 13 quarters, we have had to write-downs or mark down approximately $110 million of the original $171 million of investment assets or almost 65% of the fair value. Most of that $110 million of write-downs and mark-downs ($106.9 million) has come from the 7 legacy energy assets that totaled $127 million of the $171 million of investment portfolio. As noted below, the amounts written-off and marked down shown here do not take into account any additional investment, paid-in-kind interest or dividends or discount accretion subsequent to September 30, 2014. Also, as we know now with the redemption of Talos at par, $3.2 million of that loss has been reversed.

Let's now go to Page 16. While the portfolio may be smaller, this chart does show a material difference in the composition and diversification of today's portfolio. Although our energy exposure was down to 10% at year-end, as I just discussed, too much of this reduction in energy exposure has come unfortunately from the losses in the legacy energy investments. Away from the energy positions, we have substantially diversified our portfolio into a wide range of industries. I will note that our legacy position in OCI, shown here as therapy services, does constitute just over 20% of our investment portfolio plus cash today.

Let's move on to Page 17. I will focus my comments on the meaningful changes in the portfolio during the quarter. On a positive note, our remaining legacy energy asset, the $11.5 million principal amount investment in Talos Production's senior unsecured notes, which as I have mentioned earlier in the presentation was redeemed at par on February 15, 2018, increased in value during the fourth quarter by $1.3 million.

Moving on to our largest decline in fair value for the quarter, OCI, our last non-energy legacy portfolio company investment. Although we kept the overall fair value of our investment in OCI's Subordinated Note flat quarter-over-quarter, OCI continues to pay us substantially in Payment-In-Kind, or PIK, which resulted in a $965 thousand unrealized loss reflected during the quarter. We also took a $79 thousand write-down in our OCI equity investment during the quarter.

OCI, a home health provider of pediatric therapy services to Medicaid patients in Texas, has been negatively impacted by Medicaid reimbursement rate reductions, which were initially proposed in June of 2015 and were officially implemented by the state of Texas effective December 15, 2016. Even prior to the implementation of these rate reductions, OCI experienced pressures on rates in certain parts of its business and reductions in visit volumes. As a result, the operating performance and cash flow have continued to suffer.

In May of 2017, the Texas Legislature agreed to the 2018/2019 biennium budget. The new budget, which went into effect on September 1, 2017, restored approximately 25% of the rate cuts subject to a number of specific provisions relating to pediatric therapy reimbursement. OCI has started to see the benefit of the rate restoration, and management continues to address its cost base and reduced visit volumes and is pursuing operating initiatives to best position itself for success in the new rate reimbursement environment.

As part of the effort to navigate the challenging rate environment, OCI announced on January 30th , 2018, that it had been selected as the preferred provider by Superior HealthPlan, covering approximately 167,000 member lives in the Texas, Travis service delivery area and Central medicaid Rural Service Area covering 15% of all Texas counties. OCI will perform speech, physical and occupational therapy in all practice venues for pediatric members aged three years and older as well as adults. This preferred provider arrangement commenced on March 1, 2018.

There were no other significant valuation changes during the quarter across the rest of the portfolio, but as you see on our schedule of investments and as I mentioned earlier, we did have two significant divestitures as a result of pay-downs: Appriss' second lien term loan in the amount of $9.3 million and Royal's second lien term loan in the amount of $5.5 million. As was shown back on page 13, our investment in Appriss was initiated in

November 2014 and generated a gross IRR of 10.9% on an unlevered basis. Our investment in Royal was initiated in June 2015 and generated a gross IRR of 9.6% on an unlevered basis.

Although there were no change to the fair values of our $0 value legacy energy investments, I want to provide an update on Castex and our ATP limited term royalty interests. As noted last quarter, on October 16, 2017, Castex announced that it, together with certain affiliates, had filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code. According to the filing, Castex and its affiliates entered into a restructuring support agreement with pre-petition lenders holding approximately 86% in principal amount of claims under the pre-petition credit facility. On February 26, 2018, we agreed to a settlement and agreed to withdraw our confirmation objections to the Debtors' Joint Plan of Reorganization under Chapter 11 of the Bankruptcy code in exchange for the potential to receive cash and warrants in the reorganized company. This agreement was approved by the court on February 27, 2018. At this time, we are unable to determine the value of any recovery we may receive as a result of the settlement, which is dependent upon the ultimate pool of unsecured claims. Therefore, until we are in a position to determine the value and likelihood of a recovery, we continue to estimate at a $0 fair value of our investment in Castex at December 31, 2017, for financial statement purposes.

Lastly, I want to provide an update regarding our limited term royalty interest in certain assets of ATP. As in prior quarters, this remains a complex situation and my remarks here are qualified entirely by the detail in the December 31, 2017 10K. After Bennu and its platform subsidiary, Bennu Titan, filed for bankruptcy and production was halted in the 4th quarter of 2016, we wrote down the fair value of our investment to $0. We have maintained that valuation for this quarter as we have not yet been notified that production on these wells has re-commenced. As we describe more fully in Note 7 to our financial statements in our 10K, in August of 2017, Statoil USA E&P acquired the leases to certain wells on which we hold a royalty interest. On November 1, 2017, the Bankruptcy court approved the sale of the Titan Production facility to Statoil. We believe it is possible that Statoil will resume production from one or more of these wells soon. Statoil has requested we sign the division order confirming our proportional ownership of produced hydrocarbons. If production does resume, the Company expects that Statoil will distribute monthly royalty payments.

As to the status of the ATP bankruptcy litigation, while the bankruptcy court has ruled in our favor regarding Phase 2 of the ATP litigation, which was upheld by a district court, the matter is still under appeal at the Fifth Circuit. Oral argument was held on February 7, 2018, and we are awaiting the Fifth Circuits ruling.

So, let's move on to another snapshot of our investment portfolio, the yield comparison on Page 18. This table focuses on the yield in our portfolio both as it relates to cost and fair value. Based on our current yielding investments, which includes any PIK component from performing investments, our portfolio yields 13.2% and 14.0% based on weighted average cost and fair value, respectively, at December 31, 2017. This compares to 12.4% and 13.1%, respectively, at the end of the prior quarter. Our portfolio yields at December 31, 2017, excluding our investment in OCI, were 9.8% and 10.2% based on weighted average cost and fair value, respectively.

As shown on Page 19, we have 14 active investments as of December 31, 2017, including the $0 value investments in ATP and Castex and our minimal residual CLO investment, as compared to 10 investments at September 30, 2014. Ten of these are new investments made by OHA and they now constitute 59% of the investment portfolio on a fair value basis.

This ends our formal presentation for today. I will now turn it over to the operator to coordinate the Q&A process.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And the first question will come from the line of Kurt Hoffman with Imperial Capital.

Kurt M. Hoffman - *Imperial Capital, LLC, Research Division - MD of Institutional Research Group*

Apologies if I missed this, I had to hop off momentarily, but I just wanted to ask with respect to OCI, if I'm reading the footnotes correctly, it looks like the amendment to allow the company to PIK that L plus 12% expired at the end of 2017. Just wanted to see where that stood today.

Steven T. Wayne - *OHA Investment Corporation - CEO and President*

We have not formally extended any additional amendment. We're still in someways just operating under the same structure. We continue to PIK the majority of the interest, although they are paying us 2% of the penalty interest in cash every month, and that has continued the past couple of months as well. And we continue to work with the company on sort of the next amendment, and there's just not more really I can say about that at this point.

Kurt M. Hoffman - *Imperial Capital, LLC, Research Division - MD of Institutional Research Group*

Is there any reason to believe this new deal you were talking about with Superior HealthPlan would allow them to increase the cash portion there?

Steven T. Wayne - *OHA Investment Corporation - CEO and President*

Obviously, certainly, we would like to try and move this investment back to as much cash as we can, and that is part of what we're working on with the company to try and understand when and if it may be able to pay us additional cash interest and when. So that's all part of the amendment process that we're working through with them.

Operator

(Operator Instructions) And the next question will come from the line of [Robert Bligh].

Unidentified Analyst

Wayne, I was just curious about the ability to maintain your current level of dividend. That is the end of my question.

Steven T. Wayne - *OHA Investment Corporation - CEO and President*

Look, as we've said in the past, we -- our policy is generally to try and live within our means. We continue -- we made $0.02 in the fourth quarter and our dividend was $0.02, and the board will continue to evaluate the dividend policy based on the -- both historical and expected results of the business. So I can't really comment more about that, we don't provide projections. So I think we'll continue along that policy. It's probably the best way I can describe it.

Operator

Thank you, and I'm showing no further questions at this time. I would now like to turn the conference back over to Mr. Steven Wayne for further remarks.

Steven T. Wayne - *OHA Investment Corporation - CEO and President*

Thanks, operator. I want to thank everybody for their time today, and I look forward to speaking with you again next quarter.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude your program. You may all disconnect. Everyone, have a great day.