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OHAI - Q2 2016 OHA Investment Corp Earnings Call

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CORPORATE PARTICIPANTS

Steven Wayne *OHA Investment Corporation - President, CEO*

Cory Gilbert *OHA Investment Corporation - CFO*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the OHA Investment Corporation second-quarter report, June 30, 2016, 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's 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 will now turn the call over to Steven Wayne, the Company's President and CEO.

Steven Wayne - *OHA Investment Corporation - President, CEO*

Thank you Andrea. Good morning. I would like to welcome you all to our Company's second-quarter 2016 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 this morning under the Events and Presentations heading of the Investor Relations tab. We also refer you to our quarterly report on Form 10Q that was filed last Friday.

Let me start by saying we were pleased that during this quarter, the current price environment for Oil and Natural Gas improved from the first quarter of the year. However, it remains volatile and still poses a challenge to all industry participants and specifically to the energy portion of our portfolio. We continue to work diligently to maximize the value of our legacy energy assets and reduce the energy exposure in the portfolio over time.

I'll now turn to page 4, which summarizes the developments for OHAI in the quarter ended June 30, 2016, and touches on a few items of note that occurred following the end of the second quarter.

During the quarter, we realized $16 million from the portfolio, which included $10.4 million from our legacy investment portfolio and $5.3 million from the sale of a significant portion of our investment in the Hanson second lien term loan. As mentioned during our last earnings call, in April, we realized $9 million from our investment in KOVA, a legacy non-energy investment made in February 2013. This investment generated a gross unlevered IRR of 14.8%.

Also during the quarter, we exited Contour, the legacy high wall coal mining company. This investment was originally made in October 2010 and we completed the sale of our equity and debt interests back to Contour for $1.5 million, before transaction costs. As a reminder, we had valued our investment in Contour at $1 million as of March 31. The Contour sale generated a realized loss of $10.1 million.

As mentioned earlier, we also sold $5.4 million principal in our Hanson second lien term loan at an average price of $98.5, which resulted in a realized gain of $199,000 or $0.01 per share and a gross unlevered IRR of 16.1%.

Despite higher average prices in the second quarter for both oil and natural gas compared to the first quarter, the historically low commodity price environment for Oil and Natural Gas continues to weigh on the value of our legacy energy assets and, in turn, our Net Asset Value. NAV declined $0.05 per share in the second quarter of 2016 to $4.80 from $4.85 at the end of the first quarter. This decline largely stems from approximately $1.1 million of net realized and unrealized losses in the period.

During the quarter, we experienced $4.1 million of write-downs in two of our legacy energy investments, $2.7 million in Shoreline and $1.4 million in Castex, which continues to pay us dividends in-kind rather than cash, pursuant to our agreement with them. These write-downs were offset by a net $3 million of positive changes in value throughout the remaining investments in our portfolio.

From a financial standpoint, we finished the quarter with $1.3 million of Net Investment Income, or $0.06 per share, and declared distributions of $0.06 per share. As we are required to pay down our existing investment facility as we receive return of principal through realizations, our outstanding balance at the end of June on our investment facility stood at $52.3 million.

In the second quarter of 2016, the debt capital markets experienced a major reversal from the negative trends and high volatility of the first quarter. Since mid-February, there has been a considerable snap-back in these markets, particularly in the U.S., and the capital raising environment has improved. At the lowpoint, which was reached on February 11, 2016, the U.S. high-yield bond market was down 5.1% for the year. Since that date, through June 30th, the U.S. high-yield market has returned over 15% and was up 9.3% year-to-date.

The strength has continued into the third quarter, and as of yesterday, year-to-date gain in the High-Yield market stood at [13.4%].

Despite this strong performance in the U.S. high-yield market, we have seen a significant pick up in default activity during the year, predominantly in the energy and metals & mining sectors. As mentioned above, our investment portfolio of non-energy assets experienced an overall increase in valuation on an aggregate basis during the quarter and each of our current level 2 assets, as of yesterday, are up since June 30th.

Before I turn the call over to Cory to provide more detail on the financial results for the second quarter, I do want to mention a few items of note that occurred following the end of the quarter. First, on July 1, we delivered a Preferred Unit Put Notice to Castex, exercising our contractual put right. This is only the first step in a potentially lengthy put process and, as we said during our last call, we do not expect Castex to satisfy our put in cash during the initial 90-day phase.

Second, in July, we realized $10 million investment in EFS upon repayment at par plus a 1% prepayment fee. This was an OHA sourced investment that was purchased in December 2014 and generated a gross unlevered IRR of 11%. The principal proceeds were used to reduce the balance on our investment facility to $42.3 million.

And finally, on July 28th we executed an amendment and extension of our investment facility, which was due to mature on July 29th. The amendment, among other things, extends the maturity date to September 15, 2016, and reduces the committed amount to $42.3 million, which represents the principal balance outstanding on the investment facility as of July 28th and as of today.

The July extension contains substantially identical terms and conditions to the previous extension granted on May 9th, but with the addition of an increase in spread on Eurodollar and Base Rate Loans to 5.25% and certain milestones that need to be met with respect to the negotiation of a new investment facility. Further details about the extension can be found in our second-quarter 10-Q and press release issued July 28, 2016.

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

Cory Gilbert - *OHA Investment Corporation - CFO*

Thank you, Steven. The financial headlines for the second quarter can be found on page 6.

Our investment income for the quarter totaled $4.4 million or $0.22 per share. Base management fees were $767,000 and no incentive fees were incurred for the second quarter. Our net investment income totaled $1.3 million or $0.06 per share.

We recorded net realized and unrealized losses totaling $1.1 million or $0.06 per share during the quarter.

All together, we reported a net increase in net assets from operations of $0.01 per share. After our $0.06 per - share dividend declared in June and paid in early July, our net asset value decreased to $4.80 per share, a 1% decline from the end of the first quarter.

This quarter, we sought and received third-party positive assurance on all six of our Level 3 investments that have any fair value.

Turning to page 7, shows the net investment income section of our income statement for the second quarter of 2016, compared to our results for the first quarter of 2016 and for the second quarter of 2015. Investment income decreased by approximately $784,000 from the first quarter of 2016, driven by lower interest and dividend income, primarily due to the decrease of our investment portfolio and placing our investment in Shoreline on non-accrual in the first quarter. Compared to the same quarter prior year, investment income decreased approximately $1.5 million as a result of placing our investments in ATP and Shorelines on non-accrual in prior periods and lower non-recurring loan fees.

Interest expense for the second quarter 2016 was $975,000 or $0.05 per share, compared to $1.1 million or $0.05 per share in the first quarter of 2016 and $904,000 or $0.04 per share in the same quarter of the prior year. Quarter over quarter, interest expense decreased due to lower average balance drawn on our investment facility. Compared to the same quarter prior year, the increase in interest expense was primarily due to higher average borrowing levels supporting the growth of our investment portfolio and higher interest rates.

Management and incentive fees to our advisor were $163,000 lower in the second quarter of 2016, compared to the first quarter of 2016, as a result of lower total assets subject to the base management fee and no incentive fees incurred in the second quarter 2016. Compared to the same quarter prior year, management and incentive fees were $87,000 lower, primarily as the result of no incentive fees incurred in the second quarter of 2016 compared to $139,000 of incentive fees incurred in the second quarter of 2015.

Other G&A expenses for the second quarter 2016 were $1.3 million, or $0.06 per share, compared to $1.3 million, or $0.06 per share for the first quarter of 2016 and $1.6 million or $0.08 per share for the same quarter prior year. Quarter over quarter G&A expenses were flat as higher personnel costs were offset by lower professional fees.

G&A expenses were lower compared to the same quarter prior year primarily as a result of nonrecurring professional fees associated with the transition to the new investment advisor.

As a result, our net investment income for the second quarter of 2016 totaled $1.3 million, or $0.06 per share, compared to $1.8 million, or $0.09 per share, in the first quarter of 2016 and $2.5 million or $0.12 per share during the second quarter 2015.

Turning to page 8, you can see the summary of realized and unrealized gains and losses in the portfolio for the relevant quarters. Starting with the realized section, the net realized capital loss recognized this quarter relates to the sale of our investment in Contour, a legacy energy portfolio company, in late June for $1.5 million, $500,000 more than our value at March 31, before taking into account transaction costs.

As part of that transaction, we realized a capital loss of $10.1 million on the sale of the 800-membership units in Contour and extinguishment of the debt investments. Also during the quarter, we sold $5.4 million of the Hanson second lien term loan, resulting in a realized gain of $199,000.

With respect to net unrealized losses this quarter, the significant driver in write-downs related to Shoreline and Castex, legacy energy-related investments, and a mark-tomarket decline in our investment in TIBCO. Steven will discuss these changes in asset value later in the call.

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

Net asset value at the beginning of the quarter was $4.85 per share. Net investment income was $0.06 per share.

This was offset by a second-quarter dividend of $0.06 per share and the net adjustments in the value of our investment portfolio totaling $0.05 per share, which includes a $0.01 adjustment for rounding.

These all combined to reduce our net asset value per share to $4.80, for a change of $0.05.

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

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Steven Wayne - *OHA Investment Corporation - President, CEO*

Thanks, Cory. Let's go to page 11

We ended the second quarter fully invested based on our current investment facility and made no new investments during the quarter. As shown here, OHA has been able to invest $112.2 million in 15 new portfolio investments since September 30, 2014, which we believe validates the thesis of OHA's origination capability for OHAI.

During that same period, we have realized $75.3 million of investments, including $44.4 million through the realizations of OHA investments in Citadel Plastics, FBM, Hanson and EFS, which generated a weighted average gross unlevered IRR of 16.0% on these four investments. .

At the end of the second quarter, the fair value of our Portfolio Investments totaled $148.2 million- and as noted at the bottom of the page, they are almost evenly split between floating rate and fixed rate investments. Also as noted below, 41% of our assets based on fair value were classified as level 2.

Turning to page 12, Despite investing almost $114 million in the past 7 quarters which includes $1.7 million of additional investments into legacy assets, the size of our investment portfolio has decreased 13% since September 2014, driven by $68 million in valuation changesand $75 million of realizations.

Let's move on to page 13, While the portfolio may be smaller, this chart does show a material difference in the composition and diversification of today's portfolio. As noted earlier, we unfortunately continue to remain heavily exposed to energy, but we have substantially diversified the non-energy portion of our portfolio into a wide range of industries.

Turning to page 14 for a more detailed look at today's portfolio and changes during the recent quarter. This is now a familiar page to our investors, so I will only address the most meaningful changes during the quarter, those being declines in Shoreline, Castex, and TIBCO and the increases in ATP, Gramercy, and Talos.

Shoreline is an E&P company with large exposure to natural gas. We marked this $13 million face value second lien term loan at a $500,000 value as of June 30th. As previously mentioned in the Q1 earnings call, the company indicated in the first quarter to its second lien lenders that due to material changes in its reserve base, operational issues, declines in production and continued low commodity prices it did not expect to make interest payments to the second lien lenders.

We placed the loan on non-accrual last quarter and wrote it down significantly. Although the company has not yet filed for bankruptcy, we believe there is a good chance it will, and based on the information we have received, we felt it necessary to take an additional $2.7 million write-down during the quarter.

As mentioned earlier we took another write-down in our investment in Castex. Castex is an E&P company with a large exposure to natural gas in Louisiana. Originally a $50 million face investment, we hold an 8% redeemable preferred stock that pays an 8% cash dividend, or 10% if paid in kind. We are entitled to an additional make whole that increases our total return to 12% at redemption.

Per the agreement since the company has now PIK'd us for four consecutive quarters, the total return upon redemption has increased to 13.5%.

Preferred unit holders have a put right starting on July 1, 2016, and we exercised this right on July 1. The put right and redemption process is more fully described in footnote seven of the June 30, 2016, Schedule of Investments in our 10Q and as I said earlier, we do not expect to receive cash pursuant to the put during the initial 90-day phase.

Just to be clear, we basically maintained the fair value of our investment in Castex during the quarter the fair value slightly declined from $39.2 million to $39.1 million at June 30, 2016, but due to the amount PIK'd during the quarter, a writedown of $1.4 million was necessary to arrive at our June 30, 2016, fair value.

TIBCO is a software company focused on middleware, event processing and business intelligence and analytics. We hold $10.1 million face position of their 11.375% senior unsecured Notes. TIBCO is a level 2 asset, so we rely on pricing services or broker quotes at the balance-sheet date to determine fair value.

At quarter-end, TIBCO was priced at 79.5% of par, down from 87.5% of par at March 31. Recently, the TIBCO notes have moved back up from June 30 levels and are currently quoted in the mid-80%s.

On the positive side, we wrote up our investment in the ATP/Bennu limited-term royalty interest. We own a royalty interest pursuant to which we receive 5% of the oil and gas revenues produced from the Telemark wells. As our valuation is largely based on the present value of the royalty payments we expect to receive over time, June 30 valuation was helped by the significant increase in commodity prices versus the first quarter.

Other noteworthy marktomarket increases during the quarter came from level 2 assets Talos a legacy energy investment and Gramercy our only CLO equity position. Talos increased from 30 to 35.25 during the quarter and is now quoted in the mid 40s and Gramercy increased from 49.5 to 54.875..

So let's move to another snapshot of our investment portfolio - the yield comparison on page 15. 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 yielded 12.8% and 10.2% based on fair value and cost, respectively, at June 30, 2016. This compares to 12.9% and 10.3%, respectively, at the end of the prior quarter.

As shown on Page 16, we had 15 active investments at June 30, 2016, as compared to 10 at September 30, 2014. Ten of these are new investments made by OHA and they constitute 48% of the portfolio on a fair value basis at June 30, 2016.

Now to wrap things up - As you may know, there continues to be significant volatility in energy commodities and the current price environment for Oil and Natural Gas, while certainly improved from the first quarter of the year, still poses a challenge to all industry participants. If these conditions persist, they will continue to affect the energy portion of our portfolio.

On pages 18 and 19, you will see the current and selected historical price curves for both Oil and Natural Gas.

Although it goes without saying, I will also mention that we continue to be in active dialogue on refinancing of our investment facility. And while there are no guarantees, we expect to have a refinancing in place prior to September 15, 2016. We believe that our progress in the ATP litigation, the investments made by OHA currently in the portfolio, and the further diversification away from energy will be helpful in that regard.

Thanks for your time today, and for your continued interest in OHAI. I will now turn the call over to the operator to coordinate the Q&A process.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). I am showing no questions in queue. I would now like to turn the call back to Steven Wayne for any further remarks.

Steven Wayne - *OHA Investment Corporation - President, CEO*

Thanks. I just 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 the program and you may all disconnect. Everyone, have a great day.
