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OHAI - Q3 2016 OHA Investment Corp Earnings Call

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CORPORATE PARTICIPANTS

Steven Wayne *OHA Investment Corporation - President and CEO*

Cory Gilbert *OHA Investment Corporation - CFO*

CONFERENCE CALL PARTICIPANTS

Steve Martin *Slater Capital Management - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the OHA Investment Corporation third-quarter report, September 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 CCompany's website or to the SEC's website to review those filings. The CompanyC 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'sC President and CEO.

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

Thank you Breea. Good afternoon. I'd like to welcome all of you to our company's third 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 this morning.

Let me start by addressing the delayed filing of our 10Q and the postponement and rescheduling of this quarter's conference call. As we disclosed last Wednesday, which was the filing deadline for our Third Quarter 10Q, we were informed by Ernst & Young, our external auditors, on November 7th, just two days before the deadline, that they would not be able to complete their review required by Regulation S-X of our interim financial statements that were to be included in our 10Q. They had discovered that an E&Y Global Limited member firm's pension plan had invested in a fund managed by a third party, which had in turn invested in an underlying fund managed by Oak Hill Advisors, OHAI's investment advisor. As a result of that investment, E&Y informed us that they were in the process of assessing whether E&Y's objectivity or impartial judgment was impaired with respect to their role as OHAI's independent auditor. Late last week, after evaluating and remediating their breach of independence by selling the investment, E&Y concluded that their objectivity and impartial judgment were not impaired and they can continue to serve as auditors for OHAI. OHAI agreed with that conclusion, and we subsequently filed our 10Q this morning. We apologize for having to postpone and reschedule the call on such short notice, but we were not aware of that investment prior to November 7th and the independence issue that arose was entirely out of our control. Thank you for being with us today.

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

During the quarter we realized $14.1 million from the portfolio, all of which came from investments made by OHA since we assumed management of OHAI. This included $10.0 million from our investment in EFS, which was paid off at 101, and $3.8 million from the partial pay-down of our 2nd lien investment in Appriss at par. The EFS investment, which was made in December 2014, generated a gross unlevered IRR of 11.0%.

Net Asset Value declined four percent, or $0.19 per share, in the third quarter of 2016 to $4.61, from $4.80 at the end of second quarter. Our legacy asset portfolio continues to weigh heavily on our NAV. During the quarter we experienced $4.2 million of net write-downs across the OHAI portfolio. That, however, was comprised of $7.2 million of net write-downs across the legacy asset portfolio and $3.0 million of write-ups from OHA investments. In fact, as you will see later in the presentation, every one of the OHA investments in our portfolio experienced an increase in fair value in the third quarter.

From a financial standpoint, we finished the quarter with $1.7 million of Net Investment Income, or $0.08 per share and declared distributions of $0.06 per share. As we announced in September, we completed the refinancing of our investment facility with a $56.5 million credit facility from Midcap Financial. We drew down $40.5 million to refinance our prior facility and pay transaction expenses, and that remains our balance today.

Relating to our investment in Castex, as you may recall, on July 1st, we delivered a Preferred Unit Put Notice, exercising our contractual put right. We have previously noted that this was only the first step in a potentially lengthy process, and did not expect Castex to satisfy our put in cash during the initial 90 day phase. The 90 day period expired on September 29th without cash payment, and as a result, our make-whole increased to 18% and certain rights have attached.

In the third quarter of 2016, the debt capital markets continued the strength we have experienced since mid-February, and the capital raising environment, particularly in the U.S., has remained strong. Through September 30th, the U.S. high yield market has returned 15.3% and was up 21.6% from the February 11th lows. That strength continued into late October, although we have experienced some turbulence over the past few weeks. This weakness notwithstanding, year-to-date gains in the U.S. High Yield market stood at 14.7% through last Friday. While issuance in the U.S. high yield and leveraged loan markets remains vibrant, a large percentage of the volume has been in refinancings and repricings, rather than transactions requiring new financing. In the syndicated middle market, in particular, the volume of loan issuance (for loans of $350 million and under) is more challenging with volume down 45% through the first 9 months of 2016 versus the same period last year. All of this makes for a challenging environment in making new investments.

Before I turn the call over to Cory to provide more detail on the financial results for the third quarter, I do want to mention some portfolio activity of note that occurred following the end of the quarter.

Since September 30th, we have realized a total of $16.1 million from the repayment of three OHA portfolio investments: Kronos, BioClinica and Hanson, each at various call premiums, and we have made one $5.5 million investment in a new portfolio company.

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

Cory Gilbert - *OHA Investment Corporation - CFO*

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

Our investment income for the quarter totaled $4.3 million, or $0.21 per share.

Base management fees were $707,000 and incentive fees were $181,000 for the third quarter.

Our net investment income totaled $1.7 million, or $0.08 per share.

We recorded net realized and unrealized losses totaling $4.3 million, or $0.21 per share, during the quarter.

All together, we reported a net decrease in net assets from operations of $0.13 per share. After our $0.06 per share dividend declared in September and paid in early October, our net asset value declined to $4.61 per share, a 4% decline from the end of the second quarter.

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

Page 7 shows the net investment income section of our income statement for the third quarter of 2016, compared to our results for the second quarter of 2016 and for the third quarter of 2015. Investment income decreased by $52,000 from the second quarter of 2016, driven by lower interest and dividend income. Compared to the same quarter prior year, investment income decreased approximately $767,000, primarily due to a decrease in our average investment portfolio balance.

Interest expense for the third quarter 2016 was $768,000 or $0.04 per share, compared to $975,000 or $0.05 per share, in the second quarter of 2016 and $967,000, or $0.05 per share, in the same quarter of the prior year. The decrease in interest expense is due to the lower average balance drawn on our credit facility.

Management and incentive fees to our advisor were $121,000 higher in the third quarter of 2016 compared to the second quarter 2016 as the result of $181,000 of incentive fees incurred in the third quarter partially offset by lower base management fees. Compared to the same quarter prior year, management and incentive fees were $130,000 higher primarily as a result of $181,000 incentive fees incurred in the third quarter 2016. There were no incentive fees incurred in the third quarter of 2015.

Other G&A expenses for the third quarter 2016 were $971,000 or $0.05 per share compared to $1.3 million, or $0.06 per share for the second quarter of 2016 and $1.3 million or $0.06 per share for the same quarter prior year. Quarter over quarter G&A expenses decreased due to lower employee related expenses and legal costs. G&A expenses were lower compared to the same quarter prior year primarily as a result of lower personnel related expenses and the second quarter 2015 expenses included legal settlement costs related to Phase 1 of our ATP litigation.

As a result, our net investment income for the third quarter of 2016 totaled $1.7 million, or $0.08 per share, compared to $1.3 million, or $0.06 per share, in the second quarter of 2016 and $2.1 million, or $0.10 per share during the third quarter 2015.

Moving on to page 8, you can see the summary of realized and unrealized gains and losses in the portfolio for the relevant quarters.

There were no realized gains or losses during the quarter, so let's focus on the bottom half of the page where we detail the unrealized gains and losses.

With respect to net unrealized losses this quarter, the significant driver in write-downs related to Castex, ATP/Bennu and Shoreline, legacy energy related investments, and a write-down in our legacy non-energy investment in our Class A shares in OCI. Unrealized gains were concentrated primarily in our level 2 investments. Steven will discuss these changes later in the call.

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.

Net asset value at the beginning of the quarter was $4.80 per share.

Net investment income was $0.08 per share.

This was offset by the third quarter dividend of $0.06 per share,

and the net negative adjustments in the value of our investment portfolio totaling $0.21 per share,

These all combined to reduce our net asset value per share to $4.61, for a quarter over quarter decrease of $0.19.

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

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

Thanks Cory. Let's go to Page 11

As shown here, OHA has been able to invest $112.2 million in fifteen new portfolio investments since September 30, 2014 which we believe validates the thesis of OHA's origination capability for OHAI. This is through September 30th, 2016 and does not include the $5.5 million investment made subsequent to quarter-end that I referenced earlier. During that same period, we have realized $89.5 million of investments, including $51.5 million through the full and partial realizations of OHA investments in Citadel Plastics, FBM, Hanson, EFS, Bioclinica, Gramercy and Appriss. The realizations from Citadel, FBM, EFS and Hanson through September 30, 2016 generated a weighted average gross unlevered IRR of 16.0%. Though most of 2016, we have not been in a position to make any new investments due to the limitations of our previous investment facility. After closing the new MidCap credit facility on September 9th, we did not make any new investments before September 30th and we ended the quarter with $16 million available to draw for new investments. As I mentioned earlier, we realized a total of $16.1 million since quarter end and have made one $5.5 million investment in a new portfolio company, so we now have approximately $10.5 million of cash earmarked for new investments, in addition to the $16 million available under the new credit facility.

At the end of the third quarter, the fair value of our Portfolio Investments totaled $131.1 million - and as noted at the bottom of the page, they are split 53%/47% between floating rate and fixed rate investments. Also, as noted below, 42% of our assets, based on fair value, were classified as level 2.

Turning to Page 12

Despite investing almost $114 million in the two years (which includes $1.7 million of additional investments into legacy assets), the size of our investment portfolio has decreased 23% since September 2014, driven by $72 million in valuation changes and $89.5 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. 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. I will focus my comments on the meaningful changes in the legacy asset portfolio during the quarter.

During the quarter our most significant reduction of value came from Castex, 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). Under the terms of the original investment, we are entitled to an additional "make whole" that would increase our total return at redemption. Per the agreement, since the company PIK'd us more than three consecutive quarters, the total return upon redemption previously increased from 12% to 13.5%. Preferred unit holders had 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 eight of the September 30, 2016 Schedule of Investments in our 10Q, and as I said earlier, we did not receive cash pursuant to the put during the initial 90 day phase, which ended September 29th. As a result, our make-whole further increased from 13.5% to 18% and certain rights have attached. Our valuation methodology for our Preferred stock is driven by a determination of Castex's Enterprise Value as of the valuation date. As a result of a decline in enterprise value assumption, based largely on updated reserve information, which we are provided twice a year, we reduced the value of our Preferred Stock investment in Castex during the quarter from $39.1 million at June 30, 2016 to $34.7 million at September 30, 2016.

In Q3, we wrote down 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, our valuation is conditioned on the oil price curve and level and expected timing of production as of a valuation date. Our updated assumptions on September 30th produced a value of $12.3 million, a $1.4 million decrease from June 30th. I would like to mention, as more fully described in the 10Q, that during the quarter, the bankruptcy judge in Texas overseeing the ATP litigation granted our motion to dismiss, with prejudice, phase 2 of the ATP litigation. While we are encouraged by this positive development, the dismissal by the Bankruptcy Court does remain subject to the District Court's review.

During the quarter we reduced the value of our equity investment in OCI Holdings by $1.2 million. OCI is a home health provider of pediatric services to Medicaid patients in Texas. We have a 20.8% diluted equity ownership position in OCI, in addition to a $16.7 million subordinated note investment. OCI's business has been subject to potential Medicaid reimbursement rate reductions by the State of Texas, which have been subject to dispute since June of 2015. While those direct rate reductions have not yet been implemented by Texas, OCI has seen some pressures on rates in certain parts of their business and reductions in visit volumes due to the general industry uncertainty that persists. As a result, recent operating performance has declined and we reduced the value of our equity position as of September 30, 2016.

Shoreline is another E&P company with large exposure to natural gas. We marked this $13 million face value second lien term loan down to $500,000 as of June 30th. As mentioned in prior calls, we placed Shoreline on non-accrual status after they defaulted on their debt and stopped paying interest in early 2016 due to material changes in their reserve base, operational issues, declines in production and continued low commodity prices. Even though the company had not yet filed for bankruptcy as of quarter end, we took the further step to completely write-off our remaining $500,000 of value in this position. Following quarter end, on November 2nd, Shoreline did file Chapter 11 in Texas.

Our only other legacy asset is a $12 million principal amount investment in Talos Production's senior unsecured notes, which as a level 2 asset, we rely on pricing services or broker quotes at the balance sheet date to determine fair value. At quarter end, Talos was valued at 46.375% of par, up from 35.25% of par at June 30th, resulting in a mark to market increase of $1.3 million in the quarter.

As I noted before, every one of our remaining 9 investments held as of September 30, 2016, all of which are OHA portfolio investments made since September 2014, increased in fair value in the quarter, by approximately $3 million in total. Seven of these investments are level 2 investments, while the remaining two are level 3 investments.

So, let's move on 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 11.8% and 8.9% based on fair value and cost, respectively, at September 30, 2016. This compares to 12.8% and 10.2%, respectively, at the end of the prior quarter.

As shown on Page 16, we had 13 active portfolio companies at September 30, 2016, as compared to 10 at September 30, 2014. Nine of these are new investments made by OHA, and they constitute 46% of the portfolio on a fair value basis at September 30, 2016.

Now to wrap 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 earlier in the year, still poses a challenge to all industry participants. If these conditions persist, they will continue to affect the energy portion of our legacy portfolio.

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

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Steve Martin with Slater.

Steve Martin - *Slater Capital Management - Analyst*

Thanks very much.

Steven, what's your intention on deploying your cash and renegotiated debt capacity?

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

Look,, operator. I think the way we look at it, as I alluded to in the earlier comments, we're in the fortunate position now to actually have some liquidity and availability to invest, which we haven't been in that position over the past almost a year. The market is not particularly great from an investing environment right now. So even though we understand the need for us and the potential cost of being under-invested, we don't necessarily feel that we have a timetable or a rush to get the funds invested. So we're working hard to deploy that capital and I think we're hopeful that we'll get it deployed over the next quarter or two. But we're going to wait and make sure we find good investments, as I think the shareholders of this Company know that obviously more damage can be done long-term if you make poor investments. And we're going to make sure we deploy this capital to opportunities that we think are good and sound investments.

Steve Martin - *Slater Capital Management - Analyst*

Are there any specific industries that you're either looking at or shying away from?

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

Certainly in the latter you won't see us making any new and additional energy investments. The portfolio is over-weighted to that. But we're looking across all industries. Obviously, we're taking a little bit of a pause, and throughout the firm and trying to understand the implications of the recent political election and how that may alter, in terms of our view, in terms of some industries, both positively and negatively. We're going to continue to do what we said we're going to do, which is deploy this capital in this entity on a diversified basis across the middle market. So I can't really target any specific industries that we have, but clearly we're going to be mindful of any industry concentration.

Steve Martin - *Slater Capital Management - Analyst*

One last question: are you focusing exclusively on new issue? Or are you looking at secondary opportunity?

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

We'll look at both. We try to source the best opportunities that we're looking at across the firm, whether they be in new issue, originated deals, or in secondary opportunities where we can buy meaningful enough position that it makes sense to add it to this portfolio. So we're open to all of those and looking at opportunities throughout all of those areas.

Steve Martin - *Slater Capital Management - Analyst*

Thank you very much.

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

Thank you.

Operator

(Operator Instructions)

I'm not showing any further questions at this time. Mr. Steven Wayne, please proceed with any further remarks.

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

Thanks, Operator. Just want to thank everybody for their time today and I look forward to speaking with you next year.

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.
