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OHAI - Q3 2015 OHA Investment Corp Earnings Call

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CORPORATE PARTICIPANTS

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Cory Gilbert *OHA Investment Corporation - CFO*

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Brian Bode *Morgan Creek Capital Management, LLC - Analyst*

PRESENTATION

Operator

Before we begin, I would like to remind everyone that the remarks today 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.

I would now like to turn the call over to Bob Long, the Company's President and CEO.

Bob Long - *OHA Investment Corporation - President and CEO*

Thanks, Alia, good morning. I'd like to welcome all of you to our Company's third-quarter 2015 earnings call. I'm joined on the call today by Cory Gilbert, our Chief Financial Officer. The presentation we're about to review was posted to our website earlier today under the events and presentations heading of the investor relations tab. We also refer you to our quarterly report on Form 10-Q that was filed yesterday.

I'd like to start on page 4 with some observations on the last 12 months, the period in which OHA has managed the Company. Our goal was and is to maximize the value of the legacy portfolio and to deploy capital in attractive new investments that diversify our income stream away from energy and over time increase the earnings of the Company. We've made material progress, but market conditions have limited that progress.

As all of you know, oil prices have decreased approximately 50% since September 30, 2014, the day OHA took over management of the Company. Initially the price decline was more dramatic with respect to the front end of the price curve. However, over recent months, the curve has flattened out, meaning that the projected prices in the later years have now also dropped materially.

Natural gas presents a similar story and gas has declined meaningfully since quarter end with the front month price of gas dropping below $2 at one point in October. We've included two pages in the appendix to our materials that illustrate these price changes.

The consequence of the dramatic decline in commodity prices has been substantial write-downs in our legacy portfolio. Over the last 12 months, the energy-related write-downs totaled $29 million, or approximately $1.42 per share. This was the primary driver of our net asset value per-share decline from $8.11 to $6.71 per share, a loss of 17% over the last year.

Another consequence of these market conditions has been to delay our diversification of the portfolio away from energy. We believe that some of our energy companies, particularly Castex, at 28% of the portfolio, would likely have refinanced our investment by now under more accommodating market conditions.

At quarter end we reached the point where energy companies now constitute less than half, 47% to be specific, of the portfolio, down from 74% when we assumed management. But this concentration means that energy will continue to be a big part of our story for the next few quarters at a minimum.

As I reflect on the one-year anniversary of OHA management, I note that despite the write-down in energy assets, there are several positive developments.

Namely we've invested approximately $85 million in new portfolio companies, validating the thesis of OHA's origination capability. We deployed the maximum amount permitted under our credit facility to repurchase our stock at prices accretive to our net asset value. We also brought in a new Board, new financial management, and a new senior legal and compliance officer, all with backgrounds consistent with a major institutional asset management firm.

We've strengthened the valuation process by increasing the use of an independent valuation firm and made improvements to other key elements of our infrastructure. We've used our workout expertise in realizing two of the legacy energy assets and maximizing the value of the others. And, in general, we've applied all the resources of a $27 billion investment management firm to this BDC with $193 million of assets.

We intend to continue bringing these resources to bear on the company for the benefit of our stockholders, of which OHA is one of the largest. Moving on to the key points for this quarter on page 5.

Our NAV declined 6% this quarter to $6.71 per share with 91% of that decrease attributable to energy investments. We made three new investments for a total of $8.9 million, and we'll cover those in detail later. Huff, a legacy energy investment was realized for $5 million, equal to our fair value for this asset at June 30.

We declared a dividend of $0.12 per share.

We completed our stock repurchase program in the third quarter. In total, we bought 444,000 shares at an average price of $5.46 per share. These repurchases were accretive to beginning of the year net asset value by $0.04 per share.

I mentioned that we have added 10 new assets to the portfolio since September 30, 2014. Two of those have been realized at attractive IRRs.

Last quarter we talked about the realization of Citadel which produced a 15.8% unlevered IRR. Our second realization of a new asset was Foundation, an $18.5 million exit that occurred in the fourth quarter and produced at 18.8% unlevered IRR. We think that the Citadel and Foundation investments illustrate the type of high-quality investments that OHA can source for this Company.

I'll now turn the call over to Cory to discuss the financial results.

Cory Gilbert - *OHA Investment Corporation - CFO*

Thank you, Bob. The financial headlines for the third quarter can be found on page 7.

On our income statement, our investment income for the quarter totaled $5.1 million or $0.25 per share, a 14% decrease from the second quarter. This was due to our decision to place our investment in the ATP/Bennu royalty on non-accrual during the quarter, with income only recognized to the extent of cash received. Moreover, the prior-quarter investment income included $380,000 in one-time fee income-related to loan payoffs and modifications.

Bob will make some additional comments on ATP later in the call. The weighted average yield on our portfolio investments as of September 30 was 10.1% on a fair-value basis and 8.5% on a cost basis, approximately 80 to 90 basis points lower than our portfolio yields at June 30, 2015.

During the third quarter, we added three new investments with the weighted average yield of 9.4%. Base management fees were $758,000 for the third quarter. There was no incentive fee incurred this quarter.

Our net investment income totaled $2.1 million or $0.10 per share, a decrease of $417,000 or $0.02 per share from the second quarter. As Bob mentioned, we recorded net realized and unrealized losses totaling $8.7 million or $0.43 per share during the quarter, primarily related to our energy investments. Bob will provide additional comments on these mark-downs in a moment.

We continued the practice we began three quarters ago to seek positive assurance on our valuations from a third-party valuation firm on all Level 3 assets with fair values in excess of $10 million and to do that every quarter. We will also seek positive assurance on other Level 3 assets with any fair value, those below $10 million, at least annually. This quarter we sought third-party positive assurance on two assets below $10 million, Shoreline and Contour.

We asked for and received positive assurance on seven of our nine Level 3 investments this quarter. These assets represent 92% of the total value of our Level 3 investments at September 30.

On page 8, 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 $7.16 per share; net investment income was $0.10 per share. This was offset by the third-quarter dividend of $0.12 per share and the net adjustments in the value of our investment portfolio totaling $0.43 per share with $0.39 related to our write-downs in our energy-related investments, reducing our net asset value per share to $6.71, for a change of $0.45 or 6% for the quarter.

Turning to page 9. This page shows net investment income section of our income statement for the third quarter of 2015 compared to our results for the second quarter of 2015 and for the third quarter of the prior year. Investment income decreased by approximately $826,000 from the second quarter of 2015 driven by placing our investment in ATP on non-accrual and one-time fees recognized in the second quarter related to loan payoff and modifications.

Compared to the same quarter in the prior year, investment income decreased $485,000, primarily as a result of two of our investments being placed on non-accrual status during the fourth quarter of 2014 and a lower weighted average yield on portfolio investments. Management and incentive fees to our advisor were $96,000 lower in the third quarter of 2015 compared to the second quarter, primarily as a result of the $139,000 incentive fee incurred in the second quarter whereas there was no incentive fee incurred in the third quarter. Management and incentive fees were $496,000 lower compared to the third quarter in the prior year primarily as a result of the lower management fee structure in the OHA Investment Advisory Agreement.

Interest expense for the quarter was $957,000 or $0.05 per share compared to $894,000 or $0.04 per share in the second quarter of 2015 and $405,000 or $0.02 per share in the same quarter of the prior year. Increased interest expense in the third quarter of 2015 was due to increased average borrowing levels supporting our larger investment portfolio.

Our net investment income for the third quarter of 2015 totaled approximately $2.1 million or $0.10 per share compared to $2.5 million or $0.12 per share in the second quarter of 2015. That contrasts with an approximately $2.8 million loss or $0.14 loss per share during the third quarter of 2014.

Turning to page 10. You can see the summary of realized and unrealized gains and losses in the portfolio for the relevant quarters. The realized capital gains and losses are relatively small, so let's look at the net unrealized losses. There a significant driver of our mark-downs was our energy-related investments which contributed $7.9 million or 91% of the $8.7 million net unrealized loss recognized in the third quarter.

To discuss the investment portfolio more in detail, I would like to turn the call back over to Bob.

Bob Long - *OHA Investment Corporation - President and CEO*

Thanks, Cory. Let's go to page 12. This is now a familiar page to our investors, so I'll only address the meaningful changes during the quarter.

Castex is a gas producer and our $50 million face amount of Castex preferred stock is our largest investment. The mark-down of Castex is one of the most important events of the quarter. In Castex, our scheduled payment is an 8% quarterly cash dividend, plus a so-called "make-whole" that increases our total expected return to 12% at redemption.

When we took over this portfolio, we thought the Castex preferred stock provided an attractive return for the risk. Despite that assessment, since Castex was callable at any time, it was not prudent to mark the investment above the call price, which is the face amount plus the accrued make-whole necessary to reach the 12% threshold. More recently, we deemed the 12% return to represent fair value. But as of September 30, in light of the decline in gas prices and other factors, we marked Castex down by $3 million.

The next material change involves Talos, an offshore Gulf of Mexico oil and gas company. Talos is a Level 2 asset, so we rely on pricing services or broker quotes at the balance sheet date to determine fair value. Talos traded down to 68% of par, a decrease from 87% of par at June 30. Recently the Talos notes have traded down even further.

Moving on to ATP/ Bennu. As in prior quarters this remains a dynamic and complex litigation situation, and my remarks here are qualified entirely by the detail in the 10-Q. Despite the mark-down in this position, there's good news on the legal front for ATP. On October 14, we reached an agreement that would, if approved by the bankruptcy court, along with the proposed Agreed Judgement with Bennu, which we described last quarter, substantially resolved Phase I of the ATP litigation.

I'll refer to those two agreements collectively as "the settlement". This settlement would eliminate the risk that we would be required to disgorge the $35 million of payments made on our royalty since August 2012, based on an alleged re-characterization of the royalty. In this settlement, the trustee would release its claims against us, and receive a payment of approximately $300,000.

There is an extensive legal process involved to finalize the settlement and we estimate that the process will be completed early next year. The settlement is contingent upon bankruptcy court approval. Other parties may oppose the settlement and there can be no assurance that it will be approved or ultimately become effective.

If the settlement does become effective, then we can move on to Phase II of the litigation. Phase II principally relates to certain statutory lien claims and to potential disputes on the terms of the royalty including the calculation of the payments necessary to cause termination of the royalty.

My description here is an overview and does not include all the key details. Those are provided in our 10-Q and the October 14 press release and I strongly encourage you to carefully review our extensive disclosure on this issue. All that said, we do view this settlement as a material positive development.

Now moving on from the legal developments to the business side. As a reminder, we own a limited term royalty interest pursuant to which we receive 5% of the oil and gas revenues produced from the Telemark wells. We're entitled to this 5% share until we receive a return of our capital plus an interest rate, at which point the royalty terminates.

Over the last few quarters, we've marked this investment down because we did not believe that our interest rate compensated us for the risk. This quarter, in light of further declines in oil prices and other factors, we took the further step of placing ATP on non-accrual. Starting in July, we only recognized income to the extent of cash received, which was $385,000 for this quarter.

We did not recognize the additional $650,000 that reflects the contractual interest on the principal sum for the quarter. But of course, we do add this $650,000 to our legal claim for repayment. As Cory explained, this change to non-accrual status was a significant factor in our quarter-over-quarter decline in net investment income. We should note that our ATP valuation is, to some extent, dependent on Bennu drilling new wells in Telemark and having access to the necessary capital to do so.

In the current environment for oil, we're quite cautious in our views on the drilling of new deepwater wells in the Gulf over the near-term and that perspective impacted our valuation. When we assessed all the various facts and circumstances, we marked ATP down by $1.6 million at September

30 compared to our June 30 evaluation. As we've noted on every call, we should emphasize that there are clearly both legal and business risks around this investment and the situation remains fluid.

Contour faces a very challenging market and regulatory environment for coal as we've discussed in prior calls. Our valuation is significantly influenced by the potential value of Contour's assets, particularly its three highwall mining units. Based on some recent reported sales of similar machines, plus other factors, we reduced the value of our Contour investment in the third quarter by $1 million to $2 million. Our Contour investment remains on non-accrual status.

In July 2015, Huff refinanced our investments. We received proceeds of $5 million, equal to our principal, plus the carrying value of our warrants and royalty, and we also received $150,000 amendment fee that was recognized in the second quarter. We've already talked about the successful realization of Citadel and we will cover our new investments, Bioclinica and TIBCO later, when we talk about our investment strategy.

Let's move on to the yield comparison on page 13. This table focuses on the yield in our portfolio, both as yield versus cost and yield at the current value. Overall, the portfolio yields 10.1% on a fair value basis, down 90 basis points from last quarter.

The primary drivers of the decline were moving ATP to non-accrual status and the pay off of Huff, a relatively high returning asset. In the aggregate, 97% of our portfolio produces a current yield, with the 3% comprised of the non-accruals and equity interests. For the 97% of assets that do provide a current yield, the weighted average yield is 10.3% on a fair-value basis.

Since you've seen this table in prior quarters, I will only address the major developments that don't flow directly from the valuation changes already discussed. The yield on Shoreline increased during the third quarter. Shoreline is an energy company that produces a mix of about two-thirds gas and one-third oil.

During the third quarter we amended our second lien term loan to Shoreline to increase our interest rate by 25 basis points in cash and 50 basis points in PIK in exchange for the waiver of certain covenants. Consequently, although our mark of 77% of par is essentially unchanged quarter over quarter, the current yield increased from 14.3% to 16%.

Page 14 demonstrates our continuing evolution toward a more diversified portfolio. During Q3 we added exposure to the pharma services sectors through Bioclinica and to the information services sector through TIBCO and the Appriss add-on. As previously noted, our energy exposure decreased to 47% of the overall portfolio at September 30, down from 74% when OHA became our advisor on September 30, 2014. Note that the Foundation exit will remove $18.5 million from the 14% building materials segment shown here.

As shown on page 15, we now have 16 active investments as compared to 10 at September 30, 2014, 9 of these are new investments made by OHA and they constitute 39% of the portfolio on a fair-value basis. The pie charts on page 16 present the various forms taken by our investment portfolio and these figures did not materially change during this quarter.

Page 17 provides a graphical summary of the developments in our investment portfolio since OHA assumed the advisor role. We've had over $38 million of realizations, primarily Citadel and Nekoosa Coated Products during the fourth quarter of last year with some principal amortization from various investments.

We've invested $86.4 million in 10 new portfolio companies, plus some small add-ons to legacy investments, and the portfolio experienced a modest amount of PIK interest and OID amortization. The portfolio value was reduced by $27.8 million of net write-downs, primarily in the legacy energy portfolio, bringing us to $193 million for a $22 million increase in the portfolio work.

Page 19 addresses our stock repurchase plan. In March we announced a $2.4 million stock repurchase plan representing the maximum amount permitted by the Company's lenders under our credit facility. As you will recall, we made this decision because we believed the benefits of accretion outweighed the costs of reducing the scale of the Company and the float in our stock. We began repurchasing shares in the first quarter and completed the program in the third quarter. In the aggregate, we purchased 2% of the outstanding shares and the program was accretive to our beginning-of-the-year net asset value by $0.04 per share.

On page 21, we cover our new originations totaling $9 million during the quarter. Our largest new investment is Bioclinica, a provider of specialty outsourced services to the pharmaceutical and biotech industries. We purchased $4 million of the first lien notes issued in connection with the Company's acquisition of a drug safety business. The current yield on these notes is 8% on a fair-value basis.

We also added $3 million to our Appriss second lien term loan to finance the Company's purchase of a related business. Appriss yields 9.4% at fair value.

Finally, we purchased $1.8 million of the TIBCO senior unsecured notes. TIBCO is a software and middleware business that we've followed closely for some time. Subsequent to quarter end, we've added another $5.2 million to our position in the TIBCO notes. TIBCO currently yields 11.4% on fair value.

At the beginning of the fourth quarter, we had $15 million of availability under our credit line. We currently plan to maintain $5 million as undrawn capacity at all times, so that left us with about $10 million of capacity at the beginning of the quarter. The Foundation exit added about $19 million of capacity. As of yesterday, we've invested about $17 million during the fourth quarter leaving us with about $12 million to invest.

Now to wrap up. As you know, the price environment for natural gas has further deteriorated since quarter end and the oil market has not improved. If these conditions persist, they will continue to affect a substantial energy portion of our portfolio. I should also mention that -we are in active dialogue on refinancing or extending our credit facility. We believe that our progress in the ATP litigation and the further diversification of the portfolio will be helpful in that regard.

Under OHA management, we've invested in 10 companies totaling approximately $85 million and realized 2 of those investments at attractive returns. The remaining 8 investments yield 9.5% on a fair-value basis. We plan to continue leveraging the OHA platform to source attractive investments for the Company and thereby grow net income and our dividend over time.

Thanks for your time today. I will now turn it over to the operator to coordinate the Q&A process.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Brian Bode.

Brian Bode - *Morgan Creek Capital Management, LLC - Analyst*

I was hoping that you guys could give a little bit more color on the refi of the credit facility and if that would enable a new stock buyback program.

Bob Long - *OHA Investment Corporation - President and CEO*

Good question. So we're currently working on the refinance or extension of our credit facility and it wouldn't be appropriate to comment on specific terms. As we approach this new credit facility or extension, we will ask our lenders to give us the capability to buy more stock back. Under our current facility we cannot buy anymore, but we will ask for that ability in the new or extended credit facility.

Brian Bode - *Morgan Creek Capital Management, LLC - Analyst*

Okay, great.

Operator

And I'm showing no further questions. I would like to turn the call back over to Bob Long for any closing remarks.

Bob Long - *OHA Investment Corporation - President and CEO*

Thank you and thanks to all of you for joining us. To the extent you have further questions arising from the 10-Q, you can reach us via the email listed on our website. We appreciate your interest in OHA Investment Corporation and we look forward to speaking with you again next quarter. Thank you

Operator

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