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OHAI - Q1 2016 OHA Investment Corp Earnings Call

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Kurt Hoffman *Imperial Capital - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the OHA Investment Corporation first-quarter earnings 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. 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 will now turn the call over to Steven Wayne, the Company's President and CEO.

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

Thank you, operator. Good morning. I would like to welcome all of you to our Company's first-quarter 2016 earnings call. I'm 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 10-Q that was filed on Tuesday. Let's start on page 4, which summarizes the developments for OHAI in the quarter ended March 31, 2016 and touches on a few items of note that occurred following the end of the first quarter.

Unfortunately, the persistent 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 $0.64 per share in the first quarter of 2016 to $4.85 from $5.49 at the end of 2015. During the quarter, we experienced $13.4 million of write-downs in three of our legacy energy assets, Castex, Shoreline, and Talos, which accounted for virtually all of the $13.5 million of write-down in the quarter. These write-downs resulted in a decline in our energy exposure from 41% to 36% of the investment portfolio.

Most notably in the quarter, we placed our investment in Shoreline on nonaccrual status, took an additional write-down in our Castex investment, which continues to pay us dividends in kind, rather than cash, pursuant to our agreement with them; and more positively, as noted on our prior conference call, finalized phase 1 of the ATP/Bennu litigation in our favor.

ATP/Bennu remains a complex litigation situation, and my comments here are qualified entirely by the detail in the 10-Q. We will continue to work diligently to maximize the value of our legacy energy assets and reduce the energy concentration of the portfolio over time.

In the broader credit, financial, and commodity markets, we have seen continued volatility and economic signals have been mixed in the US and abroad. In the liquid credit markets most related to OHAI, particularly the leverage loan and high yield markets, the softness that we saw in the latter part of 2015 continued into the first six weeks of 2016. Since mid-February, there has been a considerable snapback in these markets and the capital raising environment has improved, although more slowly for middle-market issuers.

As mentioned above, our investment portfolio of non-energy assets experienced virtually no change on an aggregate basis during the quarter, and the value of our current level 2 assets is generally up since quarter end.

From a financial standpoint, we finished the quarter with $1.8 million in net investment income, or $0.09 per share, and declared distributions of $0.06 per share. After a small $1.6 million investment purchase in January, our outstanding balance on our $72 million investment facility at the end of March stood at $67.5 million, which left us essentially fully invested.

Before I turn the call over to Cory to provide more detail on the financial results for the first quarter, I do want to mention a few items of note that occurred following the end of the quarter. First, in April, our $9 million investment in KOVA was realized at par plus accrued interest. This legacy non-energy investment yielded an unlevered IRR of 14.8% and the principal proceeds were used to reduce the balance of our investment facility.

Second, beginning on March 31 and through last week, we've sold $5.5 million face value of our Hanson second lien term loan in multiple transactions at a weighted average price of 98.3% of par. Proceeds from $4.5 million of settled trades have gone to further reduce the balance of our investment facility.

Finally, on May 9th, we executed an amendment and extension of our investment facility, which was due to mature on May 23rd. The amendment, among other things, extends the maturity date to July 29, 2016 and reduces the committed amount to $54 million, which represents the principal balance outstanding on the investment facility as of May 9th.

The extension requires that we use the cash proceeds from any returns of capital on our portfolio investments to prepay the investment facility and no further borrowings will be available to us. In addition, OHAI is permitted to accrue but is prohibited from paying management and incentive fees to OHA through the new maturity date.

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

Cory Gilbert - *OHA Investment Corporation - CFO*

Thank you, Steven. The financial headlines for the first quarter can be found on page 6. Our investment income for the quarter totaled $5.2 million, or $0.26 per share. Base management fees were $830,000 and incentive fees were $100,000 for the first quarter.

Our net investment income totaled $1.8 million, or $0.09 per share. We recorded net realized and unrealized losses totaling $13.5 million, or $0.67 per share, during the quarter, primarily related to write-downs in three of our legacy energy-related investments.

Altogether, we reported a net decrease in net assets from operations of $0.58 per share. After our $0.06-per-share dividend declared in March and paid in early April, our net asset value declined to $4.85 per share, an 11.7% decline from the end of 2015.

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 fair value below $10 million at least annually.

This quarter, we sought and received third-party positive assurance on six of our eight Level 3 investments that have any fair value. These assets represent 90% of the total value of our level 3 investments.

Turning to page 7, shows the net investment income section of our income statement for the first quarter of 2016, compared to our results for the fourth quarter of 2015 and for the first quarter of 2015. Investment income decreased by approximately $1.1 million from the fourth quarter of

2015, driven by lower interest income primarily due to lower fee-related income earned and the result of placing our investment in Shoreline on nonaccrual during the first quarter. Year over year, investment income increased approximately $300,000, primarily as a result of the increase in our average portfolio investment balance.

Interest expense for the first quarter of 2016 was $1.1 million, or $0.05 per share, compared to $946,000, or $0.05 per share in the fourth quarter of 2015 and $663,000 or $0.03 per share in the same quarter of the prior year. Quarter over quarter, interest expense remained relatively flat due to the continued utilization of our investment facility. Year over year, the increase in interest expense was primarily due to higher average borrowing levels supporting the growth in our investment portfolio.

Management and incentive fees to our advisor were $783,000 lower in the first quarter of 2016 compared to the fourth quarter of 2015, primarily as a result of the lower incentive fees incurred in the first quarter of 2016. Year over year, management's and incentive fees were $252,000 higher as a result of higher base management fees in the first quarter of 2016. No incentive fees incurred in the first quarter of 2015.

Other G&A expenses for the first quarter of 2016 were $1.3 million, or $0.06 per share, compared to $337,000, or $0.02 per share for the fourth quarter of 2015, and $1.3 million, or $0.06 per share for the same quarter prior year. Quarter over quarter, G&A expenses were $950,000 higher as a result of the $521,000 expense credit from OHA, which was recognized in the fourth quarter of 2015, relating to the reconciliation of the $2.5 million expense cap, plus higher legal and audit fees incurred for the first quarter of 2016.

G&A expenses were flat year over year as higher legal and audit fees were offset by lower personnel costs. As a result, our net investment income for the first quarter of 2016 totaled $1.8 million, or $0.09 per share compared to $3.2 million, or $0.16 per share, in the fourth quarter of 2015. Net investment income for the first quarter of 2015 totaled $2.2 million, or $0.11 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. The realized capital gains and losses are relatively small, so let's look at the net unrealized losses.

There, the significant driver of the write-downs continues to be our energy-related legacy investments, specifically Castex, Shoreline, and Talos, which contributed $13.4 million, or 99% of the $13.5 million net unrealized losses recognized in the first quarter. Steven will discuss these write-downs later in the call.

Turning to 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 $5.49 per share. Net investment income was $0.09 per share. This was partially offset by the first-quarter dividend of $0.06 per share and the net adjustments in the value of our investment portfolio totaling $0.67 per share. These all combined to reduce our net asset value per share to $4.85 for a change of $0.64.

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 I mentioned earlier, we ended the year almost fully invested based on our current investment facility. As a result of this and no meaningful realizations during the quarter, our investment activity was limited to a $1.6 million addition to our existing position in Berlin Packaging.

As shown here, OHA has been able to invest $112.2 million in new portfolio investments since September 30, 2014, which we believe validates the thesis of OHA's origination capability. At the end of the first quarter, the fair value of our portfolio investments totaled $163.8 million, and as noted on the bottom of the page, they are almost evenly split between floating-rate and fixed-rate investments.

Turning to page 12, despite investing almost $114 million in the past six quarters, the size of our portfolio has decreased 4% since September 2014, driven by $67 million in valuation changes in almost $60 million from realizations.

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

Page 14 has 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 Castex, Shoreline, and Talos.

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 expected return to 12% at redemption.

Per the agreement, since the company has now PIK'd us in three consecutive quarters, the total return upon redemption has now increased to 13.5%. Preferred unit holders have a put right starting on July 21, 2016, which is more fully described in footnote 9 of the Schedule of Investments in our 10-Q. As a result of the declining energy prices and other factors, the fair value for our Castex investment was reduced from $43.9 million at year end to $39.2 million at March 31, 2016.

Shoreline is an E&P company also with large exposure to natural gas. We marked this $13-million face-value second lien term loan at $0.70 at year end. Towards the end of March, the company indicated to its second lien lenders that due to material changes in its reserve base, operational issues, declines in production and continued low commodity prices, they did not expect to make their next interest payment to the second-lien lenders, which was due on April 22nd.

As of March 31, 2016 we placed the loan on nonaccrual status and marked it at 25%, resulting in a $5.8 million write-down. Subsequent to quarter end, Shoreline did not, as expected, make the April interest payment to the second-lien lenders.

The final material change I will note involves Talos, an off-shore 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 30% of par, a decrease from 43% of par at December 31st. Recently, the Talos notes have traded up slightly and are currently quoted in the mid-30's.

So let's move on to another snapshot of our investment portfolio of a 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 12.9% and 10.3% based on fair value and cost respectively at March 31, 2016. This compares to 13.3% and 11% respectively at the end of the prior quarter.

The primary drivers of these changes quarter over quarter relate to Shoreline moving to nonaccrual, therefore, removing it from the performing investment universe and the decreased cash flows received in the quarter on the ATP investment, on which income is recognized only to the extent it is received.

As shown on page 16 we have 17 active investments as compared to 10 at September 30, 2014. Ten of these are new investments made by OHA, and they constitute 47% of the portfolio on a fair-value basis.

Now to wrap things up, as you may know, there has been some modest price improvement for energy commodities since quarter end, but the current price environment for oil and natural gas still pose 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 the refinancing of our investment facility, and while there are no guarantees, we expect to have a refinancing in place prior to July 29, 2016. We believe that our progress in the ATP litigation, the investments made by OHA currently in the portfolio, and the further diversification of the portfolio away from energy will be helpful in that regard.

Thanks for your time today, and I'll now turn it over to the operator to coordinate the Q&A process.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Our first question comes from the line of Kurt Hoffman with Imperial Capital. Your line is open. Please go ahead.

Kurt Hoffman - *Imperial Capital - Analyst*

Morning, guys.

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

Morning, Kurt.

Kurt Hoffman - *Imperial Capital - Analyst*

Can you talk about the potential ways this Castex position could play out and what you think the most likely outcomes are? From the new disclosure, it does look like it does become somewhat painful to the equityholders if they don't redeem you. What's the game theory here? Any shot they redeem us near the put date? Any shot this is something that becomes equity and there is a restructuring of this thing a year from now? I know it's difficult to look into the future, but as things sit now, I'd imagine you have some way of thinking about all this.

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

I think there are a lot of different ways of thinking about it, and, really, we're not at liberty to talk about it. Clearly, we could figure out ways to move up the capital structure, down the capital structure. There's a lot of different ways we could approach it, and, frankly, we're not at that point yet to -- where we've had or engaged in those discussions.

The one thing I'll say just to comment in terms of our expectation clearly is absent some material change or reason that we would not -- obviously, our view is that we will go ahead and begin the put process in July. But one thing I should -- what we don't expect is them to satisfy that put immediately in cash. I think given the conditions of the market, of the financing conditions for oil and gas businesses, I don't think that would be something that we would expect as an outcome as a result.

As you know, and as we described more fully now in the footnote in the schedule of investments, it is a process that plays out over time and does get more penal to the equity. So, obviously, there is some sticks we have in terms of pushing along a resolution to the capital structure.

Kurt Hoffman - *Imperial Capital - Analyst*

What percentage of the preferred that's outstanding do you guys own?

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

65.8%, I believe, is the exact number. It's somewhere between 65% and 66%. We're the only institutional investor. The rest of the preferred is held by management and individuals. We are the only institutional investor. It is 65.4% of the preferred is held by OHAI.

Kurt Hoffman - *Imperial Capital - Analyst*

Okay, great. Where do you stand on the stock purchases -- stock buybacks that you talked about on the last earnings call? Or, I guess they were affiliate purchases.

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

Not stock buyback, what was referenced in the last call was an interest in purchasing more shares by OHA. We were not able to purchase any shares in the last open window. We continue to, I've been told, have an interest in purchasing up to $1 million worth of stock during the next window period.

Kurt Hoffman - *Imperial Capital - Analyst*

What prohibited you in the most recent window?

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

I don't want to get into the details. Clearly, there's a lot going on with respect to refinancing and other things. And, clearly, we need to be comfortable that, during the window period, we are not in possession of information that is unfair in terms of our purchasing of shares.

Kurt Hoffman - *Imperial Capital - Analyst*

Okay. Thanks.

Operator

Thank you.

(Operator Instructions)

That does conclude today's Q&A portion of the call. I'd like to turn the call back over to Steven Wayne for any closing remarks.

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

Thank you, operator. Again, thank you for your attendance today. We appreciate your support and we'll look forward to speaking to you again next quarter.

Operator

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