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OHAI - Q4 2015 OHA Investment Corp Earnings Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the OHA Investment Corporation fourth-quarter report.

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 provide 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 Wayne - *OHA Investment Corporation - President & CEO*

Thank you, operator. Good morning. I would like to welcome all of you to our Company's fourth-quarter 2015 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 annual report on Form 10-K that was filed yesterday.

This is my first conference call since being named President and CEO on January 15, 2016. I want to thank my predecessor, Bob Long, for his service and contributions to OHAI over the past five quarters. While I am new to this role, I am not new to OHAI or our investment manager, Oak Hill Advisors.

I joined OHA in 2006 and am a senior member of its investment team and help lead the firm's middle market private lending activities. I also was instrumental in originating and effecting the transaction whereby OHA became the external manager of OHAI on September 30, 2014 and have been a member of OHAI's investment committee since that date.

I'll now turn to page 3 and provide an overview of 2015. 2015 marks the first full fiscal year under OHA's management of OHAI, and while we are pleased with the new investment activity since September 2014 that has broadened OHAI's investment focus away from energy, the continued headwinds from low and volatile oil and natural gas prices and general turmoil in the energy space have prevented us from further reducing the Company's concentration in energy investments. While our investment portfolio's exposure to energy has declined from 74% in September 2014 to 41% at the end of 2015, we had hoped it would be much lower by now.

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. Unfortunately, the decline in energy prices led to a significant reduction in the value of our legacy energy assets and, in turn, our net asset value. NAV declined almost $2 per share in 2015 from $7.48 at the end of 2014 to $5.49 at December 31, 2015. During the year, we experienced $38.1 million of write-downs, or approximately $1.88 per share in NAV reduction as a result.

In the broader credit and financial markets, we have seen increased volatility and economic signals have been mixed in the U.S. and abroad. The liquid credit markets most related to OHAI, particularly the leveraged loan and high yield markets, softened in the quarter ended December 31, 2015 as the Fed raised interest rates for the first time in almost a decade, turmoil persisted in the energy markets and concerns grew over the Chinese economy. Our portfolio was not immune to the market volatility as our non-energy assets experienced write-downs and mark-to-market losses in 2015 of $2.9 million or $0.14 per share.

During OHA's tenure, OHAI has invested $110.5 million in new assets, all outside of the energy industry, in 12 new portfolio companies. In 2015, we made eight new portfolio company investments totaling $73.7 million and had portfolio realizations of $38.8 million. $28.7 million of the realizations in 2015 resulted from the full repayment of two OHA investments, one made in Q4 2014 and the other in Q1 2015, and these were realized in an average dollar weighted IRR of almost 18%. I'll talk more about investment activity in the portfolio later in the presentation.

From a financial standpoint, we finished the year with $10 million of net investment income or $0.49 per share and declared distributions of $0.48 per share. After a small $1.6 million investment purchase in January, our outstanding debt balance stands at $67.5 million as of yesterday on our $72 million credit facility, which leaves us essentially fully invested. This facility matures in May of this year and efforts are underway to refinance.

Cory will provide more details on the financial results in a few minutes. Operationally, we ended 2015 on firm footing having closed our Houston office during the year and relocated our finance function to OHA's operations and accounting center in Fort Worth, Texas. Cory came aboard in May, and we now have a strong and experienced accounting team dedicated to OHAI.

We hired Lisa Price as our new Chief Compliance Officer in our New York office. Lisa also joined us in May from a top tier law firm with a strong 40 Act practice. We are pleased with the quality of the team we now have in place.

Now turning to page 4 and developments in the fourth quarter. As I mentioned previously, we ended 2015 with an NAV of $5.49 and approximately 60% of 2015's decline came in the fourth quarter. Specifically, NAV in the fourth quarter declined 18% or $1.22 from $6.71 per share at September 30.

In the fourth quarter, write-downs on our legacy energy assets totaled $21.6 million or $1.07 per share, while write-downs and mark-to-market losses on the remainder of the investment portfolio totaled $3.8 million or $0.19 per share. In Q4, our largest portfolio investment, Castex Energy 2005 LP, elected to pay us dividends in-kind, rather than cash pursuant to our agreement with them.

We have now received a second straight dividend payment from them in-kind and expect in-kind dividends to continue through 2016 if oil and natural gas prices remain at current levels or decline. We took a $10.3 million write-down on this preferred stock position in the quarter representing almost half of the legacy energy portfolio write-downs in the quarter, and now carry it at $43.9 million which represents 25.1% of our investment portfolio as of December 31.

After realizing $18.7 million from the pay-off of our second lien investment in Foundation Building Materials in October, which was a Q1 2015 investment, we were able to re-deploy those proceeds and an additional $6.6 million of capital into three non-energy related portfolio companies for a total of $25.3 million of new capital invested in the quarter.

One positive development I would like to mention relates to ATP/Bennu. As in prior quarters, this remains a complex litigation situation and my remarks here are qualified entirely by the detail in the 10-K. Subsequent to year end, on February 4, our Motion for Agreed Judgment was granted and a Final Judgment was entered determining among other things that our ORRIs are real property interests.

The final judgment resolves Phase 1 of the litigation in our favor. This resolution of Phase I should not negatively affect our rights in Phase II which should principally relate to the statutory lien claims and the proper calculations regarding royalty payments necessary to cause termination of the ORRIs. I will now turn the call over to Cory to discuss the financial results for the fourth quarter.

Cory Gilbert - *OHA Investment Corporation - CFO*

Thank you, Steven. The financial headlines for the fourth quarter can be found on page 5.

On our income statement, our investment income for the quarter totaled $6.2 million or $0.31 per share, a 22% increase from the third quarter. This was due to increased interest and dividend income in the quarter, fee income related to the recognition of a call premium in connection with the payoff of Foundation Building Materials, and loan modification fees. Base management fees were $883,000 and incentive fees were $830,000 for the fourth quarter.

Our net investment income totaled $3.2 million or $0.16 per share, an increase of $1.1 million or $0.06 per share from the third quarter. We recorded net realized and unrealized losses totaling $25.4 million or $1.26 per share during the quarter, primarily related to write-downs of our legacy energy related investments. Steven will provide additional comments on these markdowns in a moment.

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 all Level 3 assets with any fair value.

Turning to page 6. Page 6 shows the net investment income section of our income statement for the fourth quarter of 2015 compared to our results for the third quarter of 2015 and for the fourth quarter of the prior year. Investment income increased by approximately $1.1 million from the third quarter of 2015 driven by increased interest and dividend income, call premium income, and loan modification fees earned during the quarter.

Compared to the same quarter in the prior year, investment income increased $1.1 million primarily as a result of an increase in our average portfolio investment balance and the call premium and loan modification fees mentioned above.

Management and incentive fees to our advisor were $1 million higher in the fourth quarter of 2015 compared to the third quarter primarily as the result of the $830,000 incentive fee incurred in the fourth quarter whereas there was no incentive fee incurred in the third quarter. Management and incentive fees were $1 million higher compared to the fourth quarter in the prior year primarily as a result of higher 2015 base management fees and no incentive fees incurred during the fourth quarter of 2014.

Other G&A expenses for the quarter were $337,000 or $0.02 per share compared to $1.3 million or $0.06 per share in the third quarter of 2015 and $1.3 million or $0.06 per share in the same quarter prior year. Quarter-over-quarter G&A expenses were $939,000 lower due to $521,000 expense credit recognized in the quarter from OHA relating to the reconciliation in the fourth quarter of the $2.5 million expense cap agreed to by OHA in their first 12 months of their Investment Advisory Agreement. In addition, third quarter 2015 G&A included $335,000 of expense related to the settlement of Phase I for ATP/Bennu.

G&A expenses were lower compared to the same quarter prior year primarily due to lower personnel, occupancy, and insurance costs. Interest expense for the quarter was $946,000 or $0.05 per share compared to $967,000 or $0.05 per share in the third quarter of 2015, and $522,000 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.

The increased interest expense in the fourth quarter of 2015 compared to the same quarter prior year was due to increased average borrowing levels supporting the growth in our investment portfolio.

As a result, our net investment income for the fourth quarter of 2015 totaled $3.2 million or $0.16 per share compared to $2.1 million or $0.10 per share in the third quarter of 2015. In comparison, net investment income for the fourth quarter of 2014 totaled $2.6 million or $0.13 per share.

Turning to page 7, 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 minor.

Let's look at the net unrealized losses. There, the significant driver of write-downs continue to be our energy related legacy investments which contributed $21.6 million or 85% of the $25.4 million net unrealized losses recognized in the fourth quarter.

Now turning to page 8, 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 $6.71 per share. Net investment income was $0.16 per share.

This was partially offset by the fourth-quarter dividend of $0.12 per share and the net adjustments in the value of our portfolio totaling $1.26 per share with $1.07 of that related to our write-downs in our energy related investments. These all combined to reduce our net asset value per share to $5.49 for a change of $1.22 or 18% for the quarter. Now to discuss recent investment activity and the portfolio, let me hand the call back over to Steven.

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

Thanks, Cory. Let's go to page 10. As I highlighted earlier and shown here, OHA has been able to invest $110.5 million in new investments validating the thesis of OHA's origination capability.

In the fourth quarter, our new originations totaled $25.3 million in three portfolio companies. Our largest new investment is in Kronos, a global workforce management software company. We purchased $12 million principal amount of their second lien term loan at a price of $101.25.

This asset pays interest at LIBOR plus 850 basis points with 125 basis point LIBOR floor. The current yield on this term loan based on December 31, 2015, fair value is 9.5%.

We added $8.3 million of principal amount to our position in TIBCO senior unsecured notes at an average price of 95.5%. We had previously acquired $1.8 million of TIBCO notes in the third quarter. TIBCO notes have a coupon of 11 3/8% and they yield 14.1% at fair value as of December 31.

Lastly, we purchased $5.5 million principal amount at a price of 95% of Berlin Packaging's second lien term loan. Berlin Packaging is a hybrid supplier and distributor of packaging and packaging services. This loan pays LIBOR plus 675 basis points with a 1% LIBOR floor and yields 8.3% at fair value as of yearend.

As we come to the end of 2015, our portfolio investments totaled $174.7 million and as noted at the bottom of the page, they are almost evenly split between floating rate and fixed rate.

Turning to page 11, despite investing over $112 million in the past five quarters, which includes $1.6 million of additional capital invested into legacy assets, the size of our portfolio has remained relatively constant since September 2014 as a result of almost $60 million of realizations and over $50 million in valuation changes.

Let's go to page 12. While the portfolio may be the same approximate size, 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 have substantially diversified the non-energy portion of our portfolio into a wide range of industries.

Turning to page 13 for a more granular 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, ATP/Bennu, and Talos.

As mentioned earlier, we took a meaningful 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 take 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 two consecutive quarters, the total return upon redemption has now increased to 13.5%. As a result of declining energy prices and other factors, we reduced our fair value for our Castex investment by $10.3 million in the quarter.

Moving on to ATP/Bennu. I addressed the status of the litigation earlier, so we'll only focus on 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 are entitled to this 5% share until we receive the return of our capital plus a stated rate at which point the royalty terminates.

Over the last few quarters, we have marked this investment down because we did not believe that our interest rate compensated us for the risk. Last quarter, in light of further declines in oil prices and other factors, we took the further step of placing ATP on non-accrual and only recognize revenue to the extent we receive cash, which was $815,000 for the fourth quarter. We did not recognize the additional $254,000 that reflects the contractual interest on the principal sum for the quarter but of course, we do add this amount to our legal claim for repayment.

We should note that our ATP valuation is to some extent dependent on Bennu drilling new Telemark wells and having access to the necessary capital to do so. In the current environment for oil, we are quite cautious in our views on the drilling of new deepwater wells in the Gulf over the near term, and that perspective affected our valuation.

When we assessed all the various facts and circumstances, we marked ATP down an additional $6.4 million at December 31 compared to our September 30 valuation, and now carry it at $11.8 million. As we have noted on past calls, we emphasize that there are clearly both legal and business risks around this investment and the situation remains fluid.

The final material change I will note 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 43% of par, a decrease from 68% of par at September 30. Recently, the Talos notes have traded down even further and are currently quoted in the low 30s.

So let's move on to another snapshot of our investment portfolio, the yield comparison on page 14. 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 13.3% and 11% based on fair value and cost respectively at December 31, 2015. This compares to 10.3% and 9.8% respectively at the end of the prior quarter. The primary drivers of these changes quarter-over-quarter are the write-downs and mark-to-market changes during the quarter, the increased dividend rate at Castex, and the increased cash flows received on the ATP investment during the quarter, which income is recognized only to the extent received.

As shown on page 15, we now have 17 active investments as compared to 10 at September 30, 2014. Ten of these are new investments made by OHA, and they constitute 44% of the portfolio on a fair value basis.

Before we end today, I wanted to address the quarterly distribution that was announced yesterday. Please turn to page 17. Our Board of Directors declared a quarterly distribution in the amount of $0.06 per common share. This is obviously a departure from the $0.12 per share distribution that had been declared in the four prior quarters.

OHAI's general policy is that distributions should reflect the earnings power of the business over time while maintaining RIC status.

As evidence, the Company had net investment income in 2015 of $0.49 per share and distributions declared for the year of $0.48 per share. In determining this quarter's distribution, the Board with the assistance of Management considered many factors in the announcement for Q1.

Among those factors were: the expected earnings and cash flow of the business and differences between GAAP, tax, and cash earnings; the significant write-downs of the legacy energy assets and continued decline in energy prices; the payment in PIK from Castex, our largest investment in the past two quarters, and the expectations that payments in PIK will continue in 2016; the $0.12 distribution declared in December 2015 and paid in January 2016, 85% of which will be applied to our 2016 taxable distribution requirement. The ongoing process to refinance our credit facility, which matures on May 23, 2016. In future quarters, we'll continue to assess our distribution policy and determine what is sensible, reasonable, and in the best interest of the shareholders and OHAI.

Now to wrap up. As you know, the price environment for energy commodities has deteriorated since quarter end. If these conditions persist, they will continue to affect the substantial energy portion of our portfolio. On pages 20 and 21, you will see the current and selected historical price curves for both oil and natural gas.

I should also mention that we are in active dialogue on refinancing our credit facility. 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.

And finally, I've been advised that OHA or an affiliate of OHA intends to purchase up to $1 million of OHAI common stock when the Company's window period is open. OHA or its affiliates currently own 816,401 shares of OHAI or 4.05% of its outstanding shares.

Thank you 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)

And our first question comes from the line of Kurt Hoffman with Imperial Capital. Your line is now open.

Kurt Hoffman - *Imperial Capital - Analyst*

Good morning, everyone.

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

Good morning.

Kurt Hoffman - *Imperial Capital - Analyst*

You talked a little bit about this Castex investment a bit more. I mean, I'm looking at this -- this one investment is carried at over $2 a share, stock is trading around $3. You did write it down materially in the fourth quarter, but it's put-able I think in what about three months, maybe a little over three months. Are you marking that using some type of yield calculation or an estimated recovery?

And then secondarily, my understanding around that is that Riverstone made $150 million equity investment in Castex back in December 2014, and one of those Riverstone entities that made about $50 million of that investment is publicly traded, and just a few weeks ago they disclosed they were marking that investment still at cost, $50 million equity investment. Can you clarify whether it would be an event of default, or what remedies would be available to OHA in the event Castex doesn't redeem the preferred shares in July?

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

Thanks, Kurt.

I think we're rather limited in terms of how much we can talk about any of our portfolio companies outside of what we've already said, obviously due to confidentiality. We don't have complete visibility. We do get the information that we're generally provided on a regular basis.

I think we have talked about, yes, there is a provision in the preferred that allows us to be redeemed, although there is a relatively lengthy process by which that plays out that will take, we think, probably a year to six quarters to fully play out if they chose not to redeem us immediately. So they do have some ability to extend that.

Other than on the Riverstone side, I can say we obviously can see the same public filings you see and did note that they marked it at their cost at year end, and that would obviously imply a significant valuation for the enterprise based on their mark, but beyond that, I really can't comment on Riverstone either.

Kurt Hoffman - *Imperial Capital - Analyst*

Okay. I hadn't realized that on the put date, is that a process where they can extend the put date, or is that a matter of if they don't -- if they actually don't redeem it after you have asked them to, you have to pursue it through some type of court process. Can you clarify what that means?

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

There actually is a rather lengthy process that allows them to extend it for various reasons. And it -- I'm talking about beyond to the point where they actually had a legal requirement to fulfill the put at that point. Then if they didn't fulfill it we would have a legal process. What I was referring to was what we think is the process -- the put process under the agreement.

Kurt Hoffman - *Imperial Capital - Analyst*

So it's not really a July 1 put.

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

It is the start of the put process, but yes, it is. That is the put date at which that process starts.

Kurt Hoffman - *Imperial Capital - Analyst*

Okay. Well, my interpretation of the public filings was that it was a hard put July 1, send us our money, not give us another 18 months. Okay.

And in terms of the $1 million share purchase OHA was talking or Oak Hill or an affiliate was talking about making, would that just be through open market transactions? And is there a period of time that's contemplated there?

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

So the details of that are not all laid out whether it's going to be open market purchases or through a 10b5-1 plan, but we're going to determine that relatively quickly.

And in terms of that, we do have policies here in terms of when windows are open. The window is now open after the filing of the 10-K, and just to be clear, it's $1 million of purchase, not 1 million shares, $1 million of stock. So we'll be working on that over the next few days throughout this window period.

Kurt Hoffman - *Imperial Capital - Analyst*

Okay. Thanks.

Operator

Thank you. And our next question comes from the line of Jeff Larson with Claragh Mountain Investments. Your line is now open.

Jeff Larson - *Claragh Mountain Investments - Analyst*

Good morning.

I've got a technical question first and then a general question. The technical question is over incentive fees paid. How mechanically are incentive fees calculated that can be paid with the write-downs in micro realizations that we had?

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

I'm sorry. I didn't hear the tail end of the question.

Jeff Larson - *Claragh Mountain Investments - Analyst*

How can the incentive fees be paid in a period where there's such significant write-downs?

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

So, standard, I think, with most BDC management agreements are incentive fees are split into two different categories, one tied to capital gains and another tied to investment income. Our -- I think our agreement around that is generally standard through the industry, and it's calculated according to GAAP and according to our financial results.

Jeff Larson - *Claragh Mountain Investments - Analyst*

Okay. I'll look in the K then.

The second question is much more general. I will compliment you on the job that you do in terms of disclosure and transparency and you've done with the portfolio so far, but you've fought against some incredibly difficult market conditions. And with the stock trading at about a 45% discount and at asset value, it's almost impossible to grow the asset size of the Company beyond the existing asset size and any growth through investment income. I mean, at what point do you consider more dramatic steps than buying back 1.5% of the market cap for the Company and maybe trying to find a possibility to combine with a more efficient entity or to just liquidate the portfolio in general and generate a 70% plus gain for the shareholders?

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

Well, look, obviously, as we talked about on this call, there's a lot of uncertainty in many respects, many different views in terms of our two legacy assets, Castex and ATP, and I think in my view, it's just as difficult -- it will be very difficult for anybody to get their arms around those given some of the uncertainties in energy and oil prices. We'll obviously consider any alternatives that we think would make sense for the Company and the shareholders. But at this point, we think continue on the path that we've been executing on and working to maximize the value of those assets is what we're doing for now.

Jeff Larson - *Claragh Mountain Investments - Analyst*

Thank you.

Operator

Thank you.

(Operator Instructions)

And I'm showing no further questions at this time. I would like to turn the conference back over to Mr. Steven Wayne for any closing comments.

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

Thank you, operator.

Again, I'm glad everyone could join us today, and I appreciate it and look forward to the rest of the year. Thank you very much.

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.
