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OHAI - Q1 2015 OHA Investment Corp Earnings Call

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CORPORATE PARTICIPANTS

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Scott Biar *OHA Investment Corporation - Interim CFO, Chief Compliance Officer*

CONFERENCE CALL PARTICIPANTS

Vikas Tandon *Bastogne Capital - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the OHA Investment Corporation First Quarter Report. At this time all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, and instructions will follow at that time. (Operator Instructions). As a reminder, this conference is being recorded.

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 will now turn the call over to Mr. Bob Long, the Company's President and CEO.

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

Thank you. Good afternoon. I would like to welcome all of you to our Company's first quarter of 2015 earnings call. I'm joined on the call today by Scott Biar, 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 on Friday.

Let's start on Slide 4, which lists the highlights of the Company's second quarter under OHA management. Our net asset value as of March 31 declined 3% to $7.27 per share driven by four legacy energy investments. We earned net investment income of $0.11 per share. We declared a dividend of $0.12 per share, which we paid on April 8, consistent with our strategy of paying a dividend reflecting our core sustainable earnings.

Continuing to diversify the portfolio we deployed $21.2 million in two new investments outside of the energy sector. The first realization of an asset originated by OHA was announced in Q1. Citadel a $10 million investment made in November is expected to be realized in May in connection with the company being acquired. The projected unlevered IRR on Citadel is 15.9% including a 2% call premium.

We launched a stock repurchase program right after our fourth quarter earnings call in March and during the last two weeks of March we repurchased 72,500 shares of stock. We continued those repurchases pursuant to 10b5-1 plan in Q2 and we have bought another 201,500 shares in April and May.

Looking forward, we believe we have a meaningful pipeline of investment opportunities that will continue to diversify the portfolio and, over time, grow its earnings power. At this point, we have approved two new investments totaling [$10 million] and we plan to be fully invested or substantially so during the second quarter (company corrected after the call).

As most of you know, Scott Biar has held the title of interim CFO since OHA became our advisor on September 30. We've always planned to relocate our finance function to Fort Worth where our team will join with OHA's 85 other finance and operations professionals. Scott and the rest of the finance team are committed to continuing their careers in the Houston area rather than relocating to Fort Worth, and thus they joined us from the prior advisor on an interim basis.

I'm pleased to announce that we've hired our new team led by Cory Gilbert as our new CFO. Cory will join us in mid May from ORIX USA where he was the CFO of their commercial mortgage business. After a brief transition, we plan for Cory to take over for Scott around the time of the annual meeting in June. We will provide a more detailed introduction to Cory on our next call.

Scott has been a great partner for OHA and we're extremely grateful to Scott, Mary Ann Birchfield, our Controller, and Van Tran, our Assistant Controller, for their work with us during the transition. We wish them all the best.

I now will turn the call over to Scott to discuss the financial results.

Scott Biar - *OHA Investment Corporation - Interim CFO, Chief Compliance Officer*

Thank you, Bob, for the kind words, and good afternoon everyone. The financial headlines for the first quarter can be found on Slide 6. The weighted average yield on our portfolio investments as of March 31, 2015 increased slightly to 10.9% on a fair value basis and 9.4% on a cost basis, compared to 10.4% and 9.2%, respectively, as of December 31, 2014. The two new investments we entered into this quarter raised the overall weighted average.

Our gross investment income for the quarter totaled $4.8 million or $0.23 per share.

Management fees were $700,000 for the first quarter, consistent with the fourth quarter of last year. As we discussed in our last call, under the OHA Advisory Agreement, which took effect on September 30 of last year, the base management fee is calculated at a lower rate than our previous advisory agreement, and the fee calculation excludes cash and treasury bills acquired at quarter end for regulatory compliance purposes. Consequently, the quarterly management fee is approximately $0.5 million lower than it would have been under our previous advisory agreement.

Our net investment income totaled $2.2 million or $0.11 per share.

We recorded net realized and unrealized losses totaling $4.1 million, or $0.20 per share, during the quarter, primarily related to our energy investments. I'll discuss these markdowns in more detail in just a moment.

All together, we reported a net decrease in net assets resulting from operations of $1.9 million or $0.09 per share. After our $0.12 per share dividend declared in March and paid in early April, our net asset value declined to $7.27 per share, a 3% decline from the beginning of the year.

We continued the practice we began last quarter to seek positive assurance from a third-party valuation firm on all Level 3 assets with estimated fair values in excess of $10 million every quarter, and on other Level 3 assets with any fair value at least annually. Level 3 assets are those valued using significant non-observable inputs. We may also seek third party assurance on smaller assets as we see fit, and we did that this quarter for Contour and Spirit. We asked for and received positive assurance on eight of our ten Level 3 investments this quarter, representing 91% of the total value of our Level 3 investments as of March 31. We did not ask the third party to review our valuation of the other two Level 3 investments this quarter, but we intend to do so later this year, in accordance with our policy.

On Slide 7, you'll find a graphical presentation of the quarterly results and their impact on our net asset value. Net asset value at the beginning of the quarter was $7.48 per share. Net investment income was $0.11 per share, the first quarter dividend was $0.12 per share and the net adjustments in the value of our investment portfolio totaled $0.20 per share, reducing our net asset value to $7.27 per share.

Slide 8 shows the investment income section of our income statement for the first quarter of 2015 compared to our results for the fourth quarter of 2014 and for the first quarter of 2014. Investment income declined by approximately $400,000 sequentially, primarily because fourth quarter

2014 investment income included $640,000 of pre-payment fees and unamortized original issue discount upon the early realization of our Nekoosa investment. Year-over-year investment income declined $1 million, primarily as a result of a decrease in the weighted average yield on our investment portfolio due to realizations of higher yielding investments during 2014 and due to our placing our investments in Spirit and Contour on non-accrual in the fourth quarter of 2014.

Management fees were $600,000 to $700,000 lower in the first quarter of 2015 and the fourth quarter of 2014, compared to the first quarter of 2014, as a result of the lower base management fee structure in the OHA Investment Advisory agreement.

Our net investment income for the first quarter of 2015 totaled $2.2 million, or $0.11 per share, compared to $2.6 million, or $0.13 per share, in the fourth quarter of 2014 and $1.9 million, or $0.09 per share, during the first quarter of 2014.

Turning to Slide 9, you can see the summary of realized and unrealized gains and losses in the portfolio for the relevant quarters. We recorded a realized loss of $4.3 million in the fourth quarter of 2014 upon the realization of our investment in Chroma, and we realized a loss of $9.4 million in the first quarter of 2014 upon the realization of our investment in GMX Resources. Both of these investments were made over four years ago, long before OHA became our manager and the realized losses were fully offset by the reversal of unrealized losses recorded in prior periods.

With respect to net unrealized losses, the entirety of such markdowns in the last two quarters have occurred in energy-related investments. Obviously, the energy sector has been in significant turmoil with the steep and sudden decline in oil and gas prices that began in the fourth quarter of 2014 and continued into the first quarter of 2015.

Talos is an offshore Gulf of Mexico oil and gas company. Our investment in Talos is $12 million face value of Talos's $300 million senior unsecured notes. Talos is a Level 2 asset, so we rely on pricing services or broker quotes at the balance sheet date to determine fair value. These notes were trading above par for most of 2014, but traded down to 91 as of December 31, 2014, which is where we marked our investment at that date and traded down further to 70 at the end of the first quarter, which is where we marked our investment as of March 31. Oil prices have rebounded meaningfully subsequent to the end of the first quarter--in fact, the month of April represented the largest monthly gain for oil prices in six years, closing up over 20%, and oil prices have continued to recover in May to near $60 a barrel. The Talos notes have recently traded in the mid-80s, recovering almost $2 million of the value reduction that we recorded in the first quarter.

We reduced the value of our overriding royalty interest in the Telemark oil and gas properties formerly operated by ATP, currently operated by Bennu Oil & Gas, by $2.4 million in the first quarter of 2015. Bob will update you shortly on recent developments in the legal proceedings. As we have discussed in the past, the uncertainties regarding the ultimate timing and amount of cash flows expected to be generated from the producing wells and any future wells at Telemark impact our valuation. During the quarter, we reduced the fair value of our investment to reflect our current view of these risks and uncertainties.

We reduced the value of our investments in Spirit by $800,000 in the first quarter of 2015 and recorded significant write downs on Spirit in 2014. Spirit is an oil and gas exploration and production company focused on increasing production from mature wells. The value of Spirit's properties is highly sensitive to oil prices as a result of the relatively high lifting costs associated with these properties, as compared to newer wells. The reduction in the fair value of our Spirit investments this quarter is largely a function of the further reduction in oil prices during the first quarter. This investment remains on non-accrual.

Contour, as we have discussed in the past, is a highwall coal mining company and the market and regulatory environment for highwall mining in the areas in which Contour operates remains very challenging. We reduced the value of our Contour investment significantly in 2014 to $4.5 million and placed the loan on non-accrual. During the first quarter of 2015, we injected $440,000 into Contour to fund current operating losses. That $440,000 was based on our 80% ownership percentage and Contour's management team also stepped-up with $110,000 based on their 20% ownership. Contour is starting work on a couple of contracts that we believe may enable the company to fund its operations in the near term. Our Contour investment remains on non-accrual status as of March 31, and we have written down our incremental $440,000 investment during the quarter to zero.

In the case of both Contour and Spirit we own the most senior debt in the capital structure and are the majority equity owner. So we're well positioned to influence the outcome. We're working proactively with management of these companies to improve results, maximize value and create liquidity events if and when appropriate.

Turning to Slide 10, you can see that the reduction in net asset value during the first quarter of 2015 can be largely attributed to the reductions in value of our investments in the Talos notes and the ATP / Bennu overriding royalty interest resulting in a 3% decline in our net asset value to $7.27 per share.

To discuss our investment portfolio in more detail, I will now turn the call back over to Bob.

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

Thanks, Scott. Now I would like to talk about our portfolio starting on Slide 12. This page reflects the way we at OHA are thinking about the assets in this transitional phase to a more diversified portfolio. As you can see, the bulk of our portfolio is composed of performing energy assets, with 3% of our assets on non-accrual and almost half now residing in sectors other than energy. All the key information is presented here, so I'll only address the meaningful changes during the quarter.

Starting with our largest investment, Castex. This gas producer continues to meet our expectations. The $570,000 write up shown reflects the quarterly make-whole that is accruing at 4% per annum on top of the 8% cash coupon.

Moving on to ATP/Bennu, this remains a complex litigation situation and my remarks here are qualified entirely by the detail in the Form 10-Q. In fact, I think that reading the Form 10-Q is essential to fully comprehending this update. The good news is that we've reached a tentative settlement with Bennu that covers some of the issues between us. Pursuant to that settlement and described in more detail in the Form 10-Q, we and Bennu have jointly filed for an Agreed Judgment stipulating that our royalty is a real property interest and was never part of the bankruptcy estate. However, the Agreed Judgment is subject to a hearing in the bankruptcy court and the trustee will likely object, as may other parties. If we're successful at the hearing, and the Agreed Judgment is entered in the form we and Bennu have proposed, that would be a significant step toward mitigating the risk that our royalty could be re-characterized as some form of debt instrument and resolving Phase I of the legal proceedings. While the legal developments continue to progress generally positively, the value of the underlying assets on which we have a royalty has deteriorated. Since we own a royalty interest, we receive 5% of the oil and gas revenues produced from the Telemark wells until our investment is recovered. The estimated value of those oil and gas reserves declined during the quarter, as Scott discussed earlier.

In light of the various facts and circumstances, we have marked ATP down from 89% of principal at year end to 79% at March 31. We should emphasize that there are clearly both legal and business risks around this investment.

Scott has already addressed Talos, Contour and Spirit, so I'll now move on to the investments beyond the energy sector.

OCI does business under the name of "Care Options for Kids", and provides home health PT services in Texas, and this firm continues to perform well. The improvement in OCI's EBITDA led us to mark up our equity investment by 22% versus year-end, although we still hold the equity at 84% of cost. The OCI debt is now callable at par, so we maintained our value at par and the $108,000 increase in value primarily represents PIK interest for the quarter.

As mentioned earlier, we expect our first realization of an investment made by OHA during the second quarter. In November, we invested in the second lien term loan of Citadel, a producer of engineered composites and thermoplastics. A strategic buyer has announced the acquisition of Citadel, and the buyer has committed financing. We expect the deal to close in May and our loan to be called at 102% of par, generating about $300,000 of income from the call premium and unamortized OID. For our short holding period, we expect to earn a 15.9% un-levered IRR.

Gramercy Park, our CLO residual interest, continues to outperform our underwriting. At quarter-end, this security was quoted at 85% of face value, up from our purchase at 78%. Moreover, the quarterly cash flows have also exceeded expectations. Taking into account both the mark up and the cash flows, we had a $700,000 gain on our $7 million investment in Gramercy as of March 31, in addition to receiving a 12% current return.

We'll cover our new investments, Foundation and Hanson, later when we talk about our investment strategy.

Slide 13 focuses on the yield in our portfolio, both as yield versus cost and yield at the current value. Overall, 96% of our portfolio produces a current yield with the 4% comprised of the non-accruals and equity interests. As you can see, the largest portion of our portfolio produces a current yield ranging from 7% to 10%. Interestingly, this section highlights the way we account for the Castex make-whole. The 4% make whole is not recognized as current income but is reflected in the value. So Castex yields 8%, the cash coupon on a cost of $50 million, and 7.2% on a fair value basis, or the 8% cash coupon divided by the fair value of $55.5 million. The 4% make whole amount will be recognized as income when realized.

This slide and the prior one illustrate the way we at OHA think about the risk in our portfolio. We focus on each asset's fair value as a percentage of principal and the yield at current fair value, plus the movement in those numbers as the best measures of risk.

Slide 14 demonstrates our continuing evolution toward a more diversified portfolio. On this slide you can see that our energy exposure has decreased to 56% of the overall portfolio at March 31, down from 64% at year-end and 74% when OHA became our advisor on September 30, 2014. During Q2, we added exposure to the building materials sector through two new investments.

Slide 15 illustrates more elements of the transition. We now have 15 active investments as compared to 13 at year-end and only 10 at September 30. The concentration in our two largest assets Castex and ATP continues to decrease, now totaling 40% of the total portfolio. And the other half of the portfolio, shown on the left side of these pie charts, is now spread among 13 companies rather than eight, with the average size of those investments declining to about 4.5% of our portfolio versus 7.5% on September 30.

The pie charts on Slide 16 present the various forms taken by our investment portfolio. Here again you can see the impact of our six new investments. Each of those was a debt investment, so our proportion of debt continues to increase. Note that the equity and equity-linked investments relate primarily to the legacy energy portfolio and they include a debt-like preferred in Castex that constitutes 29% of the portfolio. We continue to evolve the portfolio toward floating rate assets and now have only slightly more fixed rate assets than floating rate assets. Given the relatively short tenor of many of our fixed rate assets, we do not consider potential interest rate movements to be a meaningful risk at this point.

Slide 17 provides a graphical summary of the developments in our investment portfolio since OHA assumed the advisor role in September. We've had $21 million of realizations, primarily Nekoosa, with some principal amortization from various investments. We invested $58 million in six new investments, plus the portfolio experienced a small amount of PIK interest and OID amortization. The portfolio value was reduced by $16 million of net write downs in the legacy energy portfolio, bringing us to $193 million, for a $22 million increase in the portfolio at work.

Slide 19 addresses our stock repurchase plan. During our call on March 12, we announced a $2.4 million stock repurchase plan, representing the maximum amount approved by the Company's lenders under our credit facility. We made this decision because we believed the accretion benefits outweighed the costs of reducing the scale of the company and the float in our stock.

In the two weeks of trading after we launched the repurchase program and before quarter end, we spent $400,000 buying 72,500 shares at an average price of $5.16, or a 31% discount to our year end NAV. Since then we have continued to purchase more shares under a 10b5-1 plan. As of May 7, we had purchased a total of 274,000 shares at an average price of $5.31 per share. So we've now purchased 1.3% of the outstanding shares at an average discount of 29% to our year end NAV and spent a total of $1.4 million. That leaves us $1 million of remaining capacity to continue repurchasing shares. If fully utilized to repurchase shares at current price levels, the repurchase program would retire about 2.2% of our shares and increase our NAV per share by $0.04. We believe these share repurchases are in the best interest of our stockholders. Our 10b5-1 plan currently remains open. We intend to continue purchasing shares on an opportunistic basis.

Slide 21 provides a brief overview of the OHA platform and how it supports our company's activities. OHA benefits from continuity in our leadership and a consistent, deep value, bottoms-up credit culture that has led some of the world's most sophisticated investors to entrust us with over $26 billion of capital. We think that our expertise, infrastructure and relationships will help us build and manage a high-quality portfolio for this company.

Slide 22 focuses on OHA's private lending capability. OHA has an extensive track record in private lending and we've invested over $3 billion during the last 13 years. We have been an active player in private lending for 20 plus years and we believe that we enjoy significant relationships there that will continue to drive deal flow. Now with seven months under OHA management, we are confident that the OHA platform is well-positioned to grow this portfolio with high quality assets.

Slide 23 covers our new originations, totaling $21 million during the first quarter of 2015. Our largest new investment was Foundation Building Materials, a national distributor of wallboard and other building products. We purchased $18.7 million of the second lien term loan that was issued in connection with a major acquisition. The current yield on this loan is over 12%. OHA made a previous investment with this sponsor, and that history, plus the relationship with the lead investor in the second lien term loan, were instrumental in helping us secure this opportunity.

We also invested $2.5 million in the second lien term loan of Hanson Building Products, a manufacturer of concrete and clay bricks and pipes in North America and the UK. The sponsor acquired Hanson from a global building products company in a classic corporate carve out. In this transaction we were brought in very early and provided useful feedback to the banks syndicating the deal. Our investment yields 11.5% at our current value. Earlier today we purchased an additional $5 million of the Hanson second lien term loan in the secondary market.

At the beginning of the second quarter we had $25 million of availability under our credit line, and we currently plan to maintain about $5 million as undrawn capacity at all times, leaving us $20 million to invest. During the second quarter we've already committed -- we already spent $5 million and we committed another $4 million to a new portfolio company, but those new investments are basically offset by the $10 million of proceeds expected from Citadel. So we still have about $20 million of capacity, and we plan to be fully invested or substantially so during the second quarter.

As we noted in the 10-Q, we've enhanced our public disclosures of the key risks around our portfolio and expanded our use of an independent valuation firm. After some reflection and some dialogue with industry participants, we decided that a risk rating system did not add anything material to our disclosures, so we're no longer using a risk rating system.

Now to wrap up, looking back on two quarters with OHA as our advisor, we're pleased with our progress to date. We have strengthened the evaluation process by expanding our use of an independent valuation firm to provide positive assurance on our marks and increased the transparency we provide to investors. We reduced our quarterly distribution to a rate we believe to be sustainable, given our current portfolio and credit facility, and our decision to repurchase the maximum amount of stock allowed by our lenders demonstrates our commitment to deploy capital responsibly.

With regard to the portfolio, we've leveraged the strength of the OHA platform to add six new investments, totaling $58 million at a weighted average current yield of 10.6% versus our cost. This reduced our energy concentration from 74% to 56% and increased the number of active portfolio companies from 10 to 15. We plan to continue adding new investments and to be fully invested during this quarter. We have a great deal of more work to do, and we know that we need to continue earning your trust with each and every decision we make.

Before moving to the Q&A, I do want to emphasize again the importance of completing your proxy card. By now, most of you should have received your proxy statement relating to the annual meeting to be held on June 10. Unlike many public companies who are owned primarily by institutional investors, we are held primarily by retail investors. So your vote counts, and it's important that you return your proxy card promptly to help us minimize the expense of achieving a quorum and conducting our annual meeting. You can vote your shares by phone, by mail or on-line. Instructions are on your proxy card. Please vote your shares today.

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). And our first question comes from the line of Vikas Tandon of Bastogne Capital. Your line is open. Please go ahead.

Vikas Tandon - *Bastogne Capital - Analyst*

Great. Thanks for taking the question, guys, and thanks again for the detailed call. Couple of quick questions; just want to make sure that I heard some things right. On the Talos notes, Scott, I think you mentioned that those things have traded back up into the mid 80's kind of around of 85% now. So if the quarter ended today, that's kind of $2 million of the write down -- of the $2.5 million -- you'd get back?

Scott Biar - *OHA Investment Corporation - Interim CFO, Chief Compliance Officer*

That's correct.

Vikas Tandon - *Bastogne Capital - Analyst*

Okay. And then on ATP, I believe you said you wrote it down from $0.89 on the dollar to $0.79 on the dollar. And that was obviously a mix of process and then, obviously, what happened with oil prices making Telemark worth less? The filing, and I apologize, because I honestly haven't had a chance to go through the filing in detail that you guys have with Bennu, I just saw that you had it. Is that a settlement related to declaring both the Gomez and the Telemark ORRIs were real property that couldn't be rejected or is it just related to Telemark ORRI?

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

Vikas, this is Bob, I will address that. So our position is, we have the ability with Bennu to resolve both. The trustee may take a different point of view and enhance the litigation, but you put your finger on one of the key issues.

Vikas Tandon - *Bastogne Capital - Analyst*

Okay, got you. So you guys are going to try to have, but you're trying to settle that both Telemark and Gomez, that Bennu says they have the right to step in for both of those, effectively?

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

Yes.

Vikas Tandon - *Bastogne Capital - Analyst*

And can you just give me any sense with the rise in oil prices here, I mean is ATP something like that could also be written up this quarter, because of the rise in oil prices, or is it really the process driving, kind of how you're thinking about the market more than the valuation of the Telemark assets?

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

I can't speculate on where the quarter will end up. We took into account the decline in oil prices and hence the decline in the value of the Telemark assets when we marked our position at quarter-end and we'll take into account all the facts and circumstances at the end of this quarter.

Vikas Tandon - *Bastogne Capital - Analyst*

Okay, and then one last one from me, if I can sneak one last one in. So your credit facility expires, I think, in May of 2016 so we're coming up on sort of a year to go. I know you guys have kind of $20 million of dry powder and thanks for walking through sort of the bridge to the dry powder and you want to put that all to use.

Is it time yet to start approaching the banks about an expanded credit facility to give you guys more powder, I mean, it seems like with the new investments you're finding interesting stuff to do, the Citadel thing is already been paid off. So have you started that conversation and then I would tag on to it, just because I have to, in that conversation could you talk to them about an expanded ability to repurchase shares to the extent they still traded a material discount to NAV?

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

Yes, we started the conversation and will be even more focused on it now that we have a new financial team in place, the proxy filed and mailed, and these Q1 results behind us. Look, the question of an expanded flexibility to repurchase shares is definitely in the conversation with our banks. And we will have to weigh that against all the other terms. But it is definitely on the list of things to consider in the new credit facility.

Vikas Tandon - *Bastogne Capital - Analyst*

Got you, okay. Great, well, thank you very much for the time and great job with the quarter.

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

Thank you.

Scott Biar - *OHA Investment Corporation - Interim CFO, Chief Compliance Officer*

Thanks.

Operator

Thank you. (Operator Instructions). And I'm showing no additional questions, I would like to turn the conference back over to Mr. Bob Long for any closing remarks.

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

Well, thank you very much. We appreciate your time and your continued interest in our company. We look forward to talking with you during our next quarter call and thanks again for your interest in OHA Investment Corporation.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program, and you may all disconnect.

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