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OHAI - Q2 2015 OHA Investment Corp Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the OHA Investment Corporation second-quarter report. (Operator Instructions) Please note, today's program is indeed 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 Bob Long, the Company's President and CEO.

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

Thanks, Roland. Good morning. I would like to welcome all of you to our Company's second-quarter 2015 earnings call. I'm joined on the call today by Cory Gilbert, our new Chief Financial Officer.

The presentation we are 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 this morning.

Let's start on slide 4, which lists the highlights of the Company's third quarter under OHA management. As I mentioned on our last call, we are pleased to welcome Cory Gilbert as our new CFO. Cory joined us from ORIX USA, where he was the CFO of their commercial mortgage business. Cory has moved our finance function to Fort Worth, alongside OHA's 90 other finance and operational professionals there, and we expect that co-location with the broader OHA platform will provide some efficiencies over time.

Cory has completed the hiring of our new finance team, including Neha Patel, our Controller. This was the last key step in the transition from the former management team to OHA.

Now, moving on to our numbers. NAV as of June 30 declined to $7.16 per share, driven primarily by markdowns in three legacy energy investments. We declared a dividend of $0.12 per share, consistent with earnings.

Continuing to diversify the portfolio, we deployed $19 million in three investments outside of the energy sector. We experienced our first realization of an asset originated by OHA in the second quarter; specifically, Citadel Plastics refinanced our $10 million participation in its second-lien term loan in connection with the sale of the company. We recognized an unlevered IRR on Citadel of 15.8%, including a 2% call premium. In addition, we exited our Spirit investments for $1.1 million, slightly more than our last mark, further reducing our energy exposure.

We continued our stock repurchase program pursuant to a 10b5-1 plan. And we bought 297,000 shares for $1.6 million during the quarter.

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

Cory Gilbert - *OHA Investment Corporation - CFO*

Thank you, Bob. Thanks for the introduction. I am looking forward to the opportunity.

The financial headlines for the second quarter can be found on slide 6. On our income statement, our investment income for the quarter totaled $5.9 million, or $0.29 per share, a 23% increase from the first quarter, due to an increase in the size of our investment portfolio and the 2% call premium earned in connection with the Citadel repayment. The weighted average yield on our portfolio investments as of June 30 was 10.9% on a fair value basis and 9.4% on a cost basis, unchanged from March 31.

During the quarter, we added three new investments with a weighted average yield of 9.1%. Management and incentive fees were $854,000 for the second quarter, which included a $139,000 incentive fee.

Our net investment income totaled $2.5 million, or $0.12 per share, an increase of $329,000 or $0.01 per share from the first quarter. We recorded net realized and unrealized losses totaling $3 million, or $0.14 per share, during the quarter, primarily related to our energy investments. Bob will discuss these markdowns in detail in a moment.

We continued the practice we began two quarters ago to seek positive assurance 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, Appriss and Contour.

We asked for, and received, positive assurance on seven of our nine Level 3 investments this quarter. These assets represented 91% of the total value of our Level 3 investments at June 30. We did not ask the third-party to review our valuation of the other two Level 3 investments this quarter.

On slide 7, 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 $7.27 per share. Net investment income was $0.12 per share.

The benefit from repurchasing shares was $0.03 per share. This was offset by the second-quarter dividend of $0.12 per share, and the net adjustments in the value of our investment portfolio totaling $0.14 per share, reducing our net asset value per share to $7.16, for a change of $0.11 per share or 1.5% for the quarter.

Slide 8 shows the net investment income section of our income statement for the second quarter of 2015, compared to the results for our first quarter of 2015 and for the second quarter of the prior year. Investment income increased by approximately $1.1 million from the first quarter of 2015, due to a larger investment portfolio balance from new investments added during the quarter and a $200,000 call premium earned on the Citadel loan repayment during this quarter. Compared to the same quarter in prior year, investment income increased $400,000 primarily as a result of an increase in our investment portfolio, which was partially offset by a decrease in the weighted average yield on our investment portfolio.

Management and incentive fees to our advisor were $176,000 higher in the second quarter of 2015 compared to the first quarter, primarily as a result of the $139,000 incentive fee incurred this quarter, whereas there was no incentive fees incurred in the first quarter. Management and incentive fees were $450,000 lower compared to the same quarter prior year, primarily as a result of the lower management fee structure in the OHA investment advisory agreement.

Interest expense for the quarter was $894,000 or $0.04 per share, compared to $652,000 or $0.03 per share in the first quarter of 2015, and $551,000 or $0.03 per share in the same quarter of the prior year. Increased interest expense in the second quarter of 2015 was due to greater utilization of our investment facility.

Our net investment income for the second quarter of 2015 totaled approximately $2.5 million, or $0.12 per share, compared to about $2.2 million or $0.11 per share, in the first quarter of 2015, and approximately $1.5 million or $0.07 per share during the second 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. Starting with realized capital gains, in late June, Spirit sold substantially all of its assets, and we received $1.1 million of net proceeds, slightly more than our value at March 31, after taking into account transaction expenses and related liabilities. As part of that transaction, we realized a capital gain of $255,000 on our royalty interest.

While we are on the topic of Spirit, the term loans and the preferred units remain outstanding, since they were not fully repaid with the sale proceeds. Until Spirit is wound down, which may take several quarters, the Spirit investment will be reflected in our financial statements at a zero value.

With respect to net unrealized losses, the significant driver of markdowns over the last two quarters has been the legacy energy investments, including the $3 million of net write-downs we took in the second quarter. Continued pressure on oil and gas prices have had a negative impact on the energy sector that began in the fourth quarter of 2014 and continued through the second quarter of 2015.

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

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

Thank you. Thanks, Cory. Let's go to slide 11. As you can see, at quarter end about half of our portfolio was composed of legacy energy assets, with the other half now residing in sectors other than energy. All the key information is presented here, so I will only address the meaningful changes during the quarter.

Starting with our largest investment, Castex, this gas producer continues to meet our expectations. The $590,000 write-up shown on the slide reflects the quarterly make-whole that is accruing at 4% per annum in addition to the 8% cash coupon. We continue to believe that Castex has the ability to refinance our preferred stock and will do so in advance of July 2016, when we have the right to put the preferred to Castex.

Moving on to ATP/Bennu. This remains a dynamic and complex litigation situation, and my remarks here are qualified entirely by the detail in the 10-Q. As we discussed on the last call, we 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 10-Q, we and Bennu jointly filed for an Agreed Judgment, stipulating that our royalty is a real property interest that was never part of the bankruptcy estate. However, the Trustee objected to that settlement, as we expected.

The judge heard the arguments of the various parties in late May and announced that he would dismiss the Trustee's claim for postpetition royalty payments from the Telemark properties. However, the judge did not rule on the Trustee's pre- and post-petition claims regarding Gomez, which total approximately $11.9 million; and instead, the judge took those issues under advisement. The court's decision is still pending.

Now moving on from the legal developments to the business side. We own a royalty interest pursuant to which we receive 5% of the oil and gas revenues produced from the Telemark wells. For a significant period during the first part of the year, the Titan production facility that serves the Telemark properties was offline for maintenance reasons, some of which was regularly scheduled maintenance and some of which was not. In addition, Bennu experienced other challenges in the field that further reduced production.

The Titan facility is back online, and Bennu is addressing the other production issues. However, the payments we received during the second quarter were very modest and lower than our projections.

Also, while we believe the reserves to which our royalty applies are more than sufficient to eventually return our investment, that conclusion 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 are more cautious in our views on the drilling of new deepwater wells in the Gulf, and that perspective impacted our valuation.

When we assessed all the various facts and circumstances, we marked ATP down to 71% of the total sum at June 30 from 79% at March 31. And as we have noted on every call, we should emphasize that there are clearly both legal and business risks around this investment, and the situation remains fluid.

Shoreline is an E&P company primarily focused on the inland areas and shallow waters of southern Louisiana. Its production is approximately two-thirds gas and one-third oil. During the second quarter, Shoreline sought and received a waiver of certain covenants from its lenders in return for a 75 basis point increase in our interest rate and a 25 basis point fee.

Shoreline's near-term prospects are largely dependent on the production from one well. And that concentration, along with other trends, led us to mark Shoreline down further to 77% of par.

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 issue. Talos is a Level 2 asset, so we rely on pricing services or broker quotes at the balance sheet date to determine fair value.

As mentioned on our first-quarter call, Talos notes were rebounding in price during the second-quarter. And at quarter end, Talos was trading at 87% of par, and thus we marked it up from 70% of par March 31. Recently the Talos notes have traded down.

Contour faces a very challenging market and regulatory environment for coal, as we have discussed in prior calls. We reduced the value of our Contour investment in the second quarter by approximately $1.9 million to $3 million.

This includes a write-off of the $360,000 of additional capital that we provided to the company during the second quarter. The $360,000 was based on our 80% ownership percentage; and the management team also funded $90,000 based on their 20% ownership. Our Contour investment remains on non-accrual status as of June 30.

After the end of the quarter, 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 a $150,000 amendment fee that was recognized in the second quarter.

OCI is our healthcare business and provides home health PT services in Texas. OCI's EBITDA continued to improve over the last few months, and consequently, we marked up our equity investment by $732,000 to $2.8 million or 114% of our cost. The OCI debt is callable at par, so we maintained our value at par; and the $120,000 increase you see in value primarily represents PIK interest for the quarter.

Kova is a manufacturer of consumable products and controls for the urinalysis testing market. Over recent periods, Kova's performance has weakened, and there was a management change in May. During the quarter we wrote down KOVA by $900,000 to 90% of par.

We have already talked about the successful realization of Citadel and we will cover our new investments, Royal and WASH later, when we talk about our investment strategy.

So, let's move on to the yield comparison on slide 12. This table focuses on the yield in our portfolio, both as yield versus cost and yield at the current value. We think that this table is another useful way to assess the risk in our portfolio.

Overall, the portfolio yields 10.9% on a fair value basis, unchanged from last quarter. In the aggregate, 97% of our portfolio produces a current yield, with a3% comprised of the non-accruals and equity interests. For the 97% of assets that do provide a current yield, the weighted average yield is 11.7% versus fair value.

Since we covered this table in detail last quarter, I will only address the major developments here. Talos traded back up to 87% of par, and its current yield at fair value is now 11.3%, down from 14.1% last quarter.

In contrast, at our new mark of 90% of par Kova now yields 14.5% at current value, up from 13.1% when we valued it at par. Similarly, Shoreline now yields over 14% at our current value, of 77% of par at the end of the last quarter.

Let me correct myself: our current yielding investments actually produce 11.2% on a fair value basis.

Slide 13 demonstrates our continuing evolution toward a more diversified portfolio. During Q2, we added exposure to the building materials sector and made an investment in WASH, a provider of outsourced laundry services, which we classify in "Other".

Our energy exposure decreased to 52% of the overall portfolio at June 30, down from 74% when OHA became our advisor on September 30, 2014. Moreover, adjusted for the Huff exit in July, our energy concentration would now approach only 50%.

As shown on slide 14, we now have 15 active investments, as compared to 10 at September 30. Seven of these new investments were made by OHA, and they constitute 34% of the portfolio on a fair value basis. We are also pleased that the concentration in our two largest assets, Castex and ATP, continues to decrease, now totaling 38% of the total portfolio.

The pie charts on slide 15 present the various forms taken by our investment portfolio. Here again you can see the impact of our seven new investments. Although there is only modest change from last quarter, that is because the addition of new floating-rate debt investments during the quarter was offset by the Citadel repayment of an asset with the same profile.

While about half our portfolio has a fixed rate, we don't consider potential interest rate movements to be a meaningful risk at this point. We hold that view in light of the relatively short duration of many of our fixed-rate assets, including Castex at 28% of the portfolio, an investment we expect to be refinanced in the next year.

Slide 16 provides a graphical summary of the developments in our investment portfolio since OHA assumed the advisor role in September. We have had nearly $33 million of realizations, primarily Citadel during this quarter and Nekoosa Coated Products during the fourth quarter, with some principal amortization from various investments.

We invested $77.5 million in eight new portfolio companies, plus the portfolio experienced a small amount of PIK interest and OID amortization. The portfolio value was reduced by $19 million of net write-downs, primarily in the legacy energy portfolio, bringing us to $198 million, for a $27 million increase in the portfolio at work.

Slide 18 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 continued to do so in the second quarter under a 10b5-1 plan. During the second quarter we repurchased 297,000 shares for $1.6 million at an average price of $5.47 per share.

In July, we completed the purchase program as described on the slide. In the aggregate, we purchased a total of 440,000 shares or 2% of the outstanding shares, at an average price of $5.46 per share and an average discount of 27% to our year-end NAV. These repurchases were accretive to our NAV by $0.04 per share.

Slides 20 and 21 provide a brief overview of OHA and its private lending business that should now be familiar to you. We believe the breadth and depth of OHA's platform has been beneficial to our Company in sourcing and evaluating new investments, and that the firm's extensive work-out experience has been helpful in addressing the challenged assets in the legacy portfolio.

Slide 22 covers our new originations, totaling $19 million during the second quarter. Our largest new investment was Royal, a leading manufacturer of high-value specialty sealants and adhesives. We purchased $10 million of the second-lien term loan that was issued in connection with the company's acquisition.

The current yield on this loan is 8.5% versus fair value. OHA's deep relationship with the sponsor acquiring the business was essential to us securing this opportunity.

We also invested $4 million in the second-lien term loan of WASH Multifamily, the second-largest provider of outsourced laundry equipment services for the multifamily housing sector in the US and Canada. Our investment was made in connection with the acquisition of the company and currently yields 8% on fair value. OHA knows this sector quite well and has made similar investments in the past.

Finally, we added $5 million to our position in Hanson Building Products, a manufacturer of concrete and clay, bricks, and pipes that we discussed last quarter. Hanson currently yields 11.1% on fair value.

At the beginning of the third 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 $10 million of capacity at the beginning of the quarter.

The Huff exit added $5 million of capacity. As of yesterday we have committed about $5 million during the third quarter, although we should acknowledge that some of those commitments may not close. So right now we have about $10 million to invest.

On our last call we expressed optimism that we would be fully invested by now. We remain selective in adding high-quality investments to this portfolio, and our originations did not reach the expected level in Q2. We do expect to be fully invested by the end of the third quarter.

Now to wrap up. We are keenly aware of the weakness in energy prices that has continued into the third quarter and its impact on our portfolio. However, between new investments and exits, and including activity to date in the third quarter, we are just about to reach a tipping point where the majority of our portfolio is in sectors other than energy. Moreover, about 97% of our energy exposure is in four larger companies with more diversified business models than those that we have exited.

I should also mention that we are in active dialogue on refinancing our credit facility. We believe that our progress toward a more diversified portfolio will be helpful to achieving more attractive terms on a new facility.

Under OHA management we have invested in eight companies totaling $77.5 million, and realized one of those investments at an attractive return. The remaining seven investments yield 10.3% 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) Vikas Tandon, Bastogne Capital.

Vikas Tandon - *Bastogne Capital Management - Analyst*

Hey, guys. Thanks for taking the questions; I'll try to run through them somewhat quickly. I just have a few here.

One on the numbers. Looking at the Other G&A line, it increased materially from the first quarter to the second quarter, by over $300,000. Can you give any color as to what that was?

Cory Gilbert - *OHA Investment Corporation - CFO*

Yes. This is Cory Gilbert. The increase in the G&A expenses was related to increase in professional fees related to the hiring of two individuals for the BDC.

Vikas Tandon - *Bastogne Capital Management - Analyst*

Okay. So should we expect G&A as we go forward to drop down to the $1.3-million-ish it was in the first quarter? Or is $1.6 million the new run rate?

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

Well, we certainly -- this is Bob. The $300,000 was clearly a one-time event. We don't give guidance, but clearly the number you identified -- and good question -- the difference you identified was a one-time event related to the transition out of the old management team and the transition in of Cory and Neha.

Vikas Tandon - *Bastogne Capital Management - Analyst*

Perfect. Okay; that's what I figured. Thank you for that.

Then, Bob, just on ATP, I know you guys had the hearing in May. You guys did the follow-up briefs in July. Obviously the judge has already said we are good to go on Telemark; but we are waiting on Gomez.

Do you have any sense as to when we might see a decision? And can you provide any color at all? Just, I don't know if you were there in the court, but how it went or what your lawyers walking away, how they felt.

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

I was not there and we don't have any color on when the judge will rule, unfortunately. Beyond our disclosure, I really can't add anything. Obviously we are disappointed that he has not already ruled, and we look forward to resolving this litigation.

Vikas Tandon - *Bastogne Capital Management - Analyst*

Fair enough. Then on marking it down, I know you said specifically they had a -- the Titan vessel was off-line for maintenance longer than you, thought. It's back online now, and that caused the Q2 payments to come in below what you expected. Are you starting to see any pickup there in the third quarter, or is it too early to know if you're going to see any pickup back to the levels you expected?

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

The Titan facility was off-line. The Mars pipeline, which is operated by Shell, that feeds off of Titan was also off-line. That was scheduled maintenance. So it's all that, plus some challenges in the wells, to be clear, also impacted production.

We don't see -- the way these royalties work and all the ones that we have in our portfolio -- I think it's industry-standard: there's a 60-day delay between the production and when you receive your payment. So we have not yet seen the pickup that we hoped to see based on these maintenance issues being resolved.

Vikas Tandon - *Bastogne Capital Management - Analyst*

Okay, perfect. Then two more quick ones. You mentioned you're in discussions on a new bank deal. I know the existing bank deal I believe runs out in May; I think that's the expiration.

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

That is correct.

Vikas Tandon - *Bastogne Capital Management - Analyst*

Along with upsizing the deal, obviously you guys completed what you could do on the stock buyback so far, what you had under the old deal. And you bought at what seemed an attractive 27% discount to NAV, and now we trade at a bigger discount.

Is there any chance that we can get some more room in the new bank deal for further buybacks? It seems like you guys are doing a really good job moving away from energy. But if you look at kind of lazy Seeking Alpha articles, guys don't seem to care.

So buying something that you guys are getting independent marks on at a 30% discount seems pretty attractive to me. Is that something that's part of the conversation?

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

Absolutely. With respect to our new lenders, we will seek the ability to repurchase new shares.

Vikas Tandon - *Bastogne Capital Management - Analyst*

Okay, got you.

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

Just to be clear, additional shares beyond what we have already purchased. It is absolutely part of the conversation.

Vikas Tandon - *Bastogne Capital Management - Analyst*

And is this, hopefully, you think a 2015 event, getting this bank debt refinanced? Or do you think it's going to take a while?

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

I don't really have a prediction. It's certainly our goal to get it done during 2015, and we are balancing that with the continued progress in our portfolio on the energy side.

Vikas Tandon - *Bastogne Capital Management - Analyst*

Okay. Then just one last one for me. I know you mentioned that Castex is puttable in July 2016. And our sense has been that they frankly have the capacity on their existing bank facilities to take you guys out now. Sort of a two-part question.

One, why hasn't Castex been refinanced at this point? It's a little surprising to me that they haven't done it yet, given the put date.

Then as a follow-up, and this sort of relates to Castex, but I think -- I'm assuming you guys are running the sensitivities on oil prices. If the bears are right and we have $25 oil, do you have any sense as to what that looks like for further markdowns you have to take?

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

I will address Castex first. You've correctly identified the key point: it is puttable in July of next year. So we also expect them to refinance us.

What we do know -is that is a decision that will be made by their management team. They are a private company andthe discussions we have had regarding that I can't share.

But we operate in the broader energy markets. We understand that company well. We understand companies like it.

And the key point for us is -- and I think for our investors is -- Castex has the ability. The markets would accept a refinance from Castex.

Vikas Tandon - *Bastogne Capital Management - Analyst*

Right. Okay.

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

As for oil prices, we are well aware of the decline in price since June 30. We do monitor that carefully. We think about the impact on our portfolio.

But as for $25 oil, I can't predict for you what the sensitivity would be. It would obviously be a negative event for our portfolio.

Vikas Tandon - *Bastogne Capital Management - Analyst*

Okay; fair enough. All right, I'll stop it there. Thanks for taking the question, guys. And as I've said on the last few calls, thanks again for the great detail you provide on the portfolio.

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

Thank you.

Operator

(Operator Instructions) I'm showing no further callers in the queue. I would like to turn the call back over to Bob Long for any concluding remarks.

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

Thank you, Roland, and thank 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 really 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 very much for your participation. This does conclude the program. You may now disconnect. Everyone have a wonderful day.

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