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AINV - Q2 2020 Apollo Investment Corp Earnings Call

EVENT DATE/TIME: NOVEMBER 05, 2019 / 10:00PM GMT

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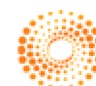

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PRESENTATION

Operator

Good afternoon, and welcome to Apollo Investment Corporation's Earning Conference Call for the period ended September 30, 2019. (Operator Instructions) I will now turn the call over to Elizabeth Besen, Investor Relations Manager for Apollo Investment Corporation.

Elizabeth Besen - *Apollo Investment Corporation - IR Manager*

Thank you, operator, and thank you, everyone, for joining us today. Speaking on today's call are Howard Widra, Chief Executive Officer; Tanner Powell, President and Chief Investment Officer; and Greg Hunt, Chief Financial Officer.

I'd like to advise everyone that today's call and webcast are being recorded. Please note that they are a property of Apollo Investment Corporation and that any unauthorized broadcast in any form is strictly prohibited. Information about the audio replay of this call is available in our earnings press release.

I'd also like to call your attention to the customary safe harbor disclosure in our press release regarding forward-looking information. Today's conference call and webcast may include forward-looking statements. Forward-looking statements involve risks and uncertainties, including, but not limited to, statements as to our future results, our business prospects and the prospects of our portfolio companies. You should refer to our registration statement and shareholder reports for risks that apply to our business and that may adversely affect any forward-looking statements we may make.

We do not undertake to update our forward-looking statements or projections unless required by law. To obtain copies of our SEC filings, please visit our website at www.apolloic.com.

I'd also like to remind everyone that we've posted a supplemental financial information package on our website, which contains information about the portfolio as well as the company's financial performance.

At this time, I'd like to turn the call over to Howard Widra.

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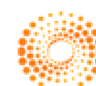

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Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

Thanks, Elizabeth. I'll begin today's call by providing a brief overview of our investment activity and financial results for the quarter. Following my remarks, Tanner will discuss the market environment, our investment activity for the quarter, and we'll also provide an update on credit quality. Greg will then review our financial results in greater detail. We'll then open the call up for questions.

During the quarter, we continued to successfully implement our plan to prudently grow our portfolio given the reduction in our asset coverage requirement. We had a strong origination quarter and grew our portfolio by 7% by increasing our exposure to first lien floating rate corporate loans sourced by the Apollo Direct Origination platform. Given our strong net investment activity, our net leverage ratio increased to 1.24x at the end of the quarter. Our corporate lending portfolio increased to 72% of the total portfolio, up from 68% last quarter.

First lien assets increased 77% of the corporate lending portfolio, up from 71% last quarter. The weighted average attachment point improved to 1.3x, down from 1.7x last quarter. Investments made pursuant to our co-investment order increased to 74% of the corporate lending portfolio at the end of September, up from 67% last quarter.

Our current pipeline is healthy, and we're confident with the pace of our new business volume. Consistent with our plan, we also successfully reduced our exposure to shifting assets and aircraft leasing. During the quarter, we sold 2 ships in our MSEA investment at a price above the internal allocated value, reducing our shipping exposure to 5% of the portfolio, down from 5.8% last quarter. In addition, Merx sold several aircraft during the quarter, which allowed Merx to repay capital to AINV, which reduced our investment to 12.9% of the portfolio, down from 14.5% last quarter.

Moving to our financial results. Net investment income for the quarter was $0.53 per share, reflecting the strong net portfolio growth as well as the impact from the total return feature in our incentive fee structure, which resulted in a partial incentive fee for the quarter. Net asset value per share was $18.69 at the end of September, down 1.6% quarter-over-quarter. The $0.31 net reduction in NAV per share was due in part to a $0.22 decline in the value of our oil and gas investments due to the decline in the price of oil, which negatively impacted the valuation of our investments, as well as a $0.06 loss due to the extinguishment of our 2043 baby bonds. The net loss was partially offset by net investment income in excess of the distribution and the accretive impact from stock buybacks.

I'd like to also provide a brief update on Merx. As previously discussed, our strategy includes reducing our balance sheet exposure to aircraft leasing, while growing Merx's earnings from servicing income. Merx continues to source transactions for other Apollo funds which generate servicing fee income from Merx.

During the quarter, Apollo Global had a initial close for a fund focused on aircraft leasing. As previously disclosed, Merx will be the exclusive servicer for aircraft purchased by this fund. AINV will also receive a fee offset against fees due to its adviser associated with capital deployed by this new fund.

Moving on, the equity market did present us with what we believe was an attractive opportunity to repurchase our stock. We consider stock buybacks below NAV to be a component of our plan to deliver value to our shareholders. Since the end of the quarter, we have continued to repurchase stock. The company currently has approximately $41.9 million available for stock repurchase under the current authorization. We intend to continue to repurchase our stock should it continue to trade at a meaningful discount to NAV.

Turning to our distribution. The Board has approved a $0.45 per share distribution to shareholders of record as of December 20, 2019. We know that many of you are focused on the impact of lower interest rates on our ability to cover our distribution. We expect that our earnings power will continue to grow in excess of the impact of declining interest rates as we continue to grow our portfolio. Incremental assets are now benefiting from the lower 1% management fee given that our debt-to-equity ratio was above 1x, and we also remain focused on reducing noncore assets, which are generally nonyielding or lower yielding.

With that, I'll turn the call over to Tanner to discuss the market environment and our investment activity for the quarter.

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Tanner Powell - *Apollo Investment Corporation - President & CIO of Apollo Investment Management*

Thank you, Howard. Overall, middle market loan volumes during the quarter declined as lenders have become more selective and are pushing back on aggressive deals and terms. Middle market loan yields remained flattish as the decline in LIBOR was offset by higher spreads, OID and fees. The environment for middle market lenders remains highly competitive, given the significant amount of capital that has been raised for U.S. middle-market lending.

As Howard mentioned, during the quarter, our investment activity focused on first lien floating rate corporate loans sourced by the Apollo Direct Origination platform. New investment commitments and fundings were $377 million and $358 million, respectively. All new commitments were first lien floating rate loans. These commitments were across 22 companies for an average commitment size of $17.1 million. The weighted average spread over LIBOR of these new commitments was 604 basis points, within our target range of 500 to 700 basis points for incremental assets. The weighted average net leverage for new commitments was 5.4x, within our target range of 4 to 5.5x. Lastly, 94% of these new commitments were made pursuant to our co-investment order.

Sales totaled $20 million and repayments totaled $136 million for total exits of $156 million, resulting in net funded investment activity of $201 million, excluding Merx and revolver activity. We sold 2 ships in our MSEA investment during the quarter at a price above the internal allocated value, generating $12.5 million of net proceeds to AINV and reducing our shipping exposure to 5% of the total portfolio, down from 5.8% last quarter.

In addition, net funding for revolvers totaled $24 million. We also received a net repayment of $17.9 million from Merx from the sale of several aircraft in its portfolio. Net fundings totaled $207 million, including Merx and revolver activity.

Now let me spend a few minutes discussing overall credit quality. No investments were placed on or removed from nonaccrual status. At the end of September, investments on nonaccrual status represented 1% of the portfolio at fair value, down from 1.7% last quarter and 2.1% at cost, down from 2.5% last quarter. The decline was primarily due to the write-downs on both Spotted Hawk and KLO Holdings. The decline in Spotted Hawk was primarily due to the decline in the price of oil. Regarding KLO, our investment was placed on nonaccrual status last quarter due to the underperformance from lower customer demand, consolidation challenges and higher costs. The company's liquidity position has continued to weaken. The company expects to complete a comprehensive restructuring in the coming months.

Moving on to our credit metrics. The weighted average asset spread on the corporate lending portfolio decreased 19 basis points to 667, down from 686 last quarter and compared to 604 for new commitments. The lower average spread is due to the decrease in second lien exposure and the increase in first lien exposure.

The weighted average net leverage for investments increased from 5.43x to 5.5x and compared to 5.4x for new commitments. And the weighted average attachment point of the portfolio declined from 1.7x to 1.3x. The average interest coverage improved slightly, increasing from 2.4x to 2.5x. We view this trade-off of yield for credit quality as a positive at this point in the credit cycle.

With that, I will turn the call over to Greg, who will discuss the financial performance for the quarter.

Gregory William Hunt - *Apollo Investment Corporation - CFO & Treasurer*

Thank you, Tanner. Beginning with the income statement. Total investment income was $70.3 million for the September quarter, up from $66.5 million for the June quarter, an increase of $3.8 million or 5.7%. The increase was attributable to the higher interest income, dividend income and fee income partially offset by lower prepayment income. When excluding prepayment income in the $3.3 million catch-up interest we received last quarter from our investment in Sprint, interest rose 7.1%, in line with the growth in the portfolio. Prepayment income was $2.1 million as compared to $2.9 million last quarter. Fee income was $2.2 million as compared to $900,000 last quarter. Dividend income increased quarter-over-quarter as we received dividends from both Merx and MSEA.

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Expenses for the quarter were 36 -- $34.6 million, up from $32 million in the prior quarter due to higher interest expense and management fees given the growth in the portfolio. As a reminder, the management fee was reduced from 1.5% to 1% for assets in excess of 1x debt-to-equity. For the September quarter, a 1% management fee was applied to approximately $180 million worth of gross assets.

In addition, $1.9 million of incentive fees were accrued during the quarter, impacted by the total return provision in our fee structure.

Net investment income was $0.53 per share for the quarter compared to $0.50 per share for the June quarter. Net leverage at the end of September was 1.24x compared to 1.03x at the end of June. During the September quarter, we funded $105 million into NFA Group and then subsequently, in October, sold down approximately $65 million of our position to achieve our desired whole size. Adjusting for the impact of NFA, net leverage would have been approximately 1.19x. Average leverage during the quarter was 1.13x, up from 0.93x during the June quarter. The net loss on the portfolio for the quarter was $24.3 million or $0.36 per share. The net loss was primarily attributable to our investments in Spotted Hawk, one of our oil and gas investments and KLO, which was placed on nonaccrual status in the quarter.

As Howard mentioned, in mid-August, we redeemed $150 million of our 6.78% (sic) [6.87%] unsecured notes due in 2043. As a result, we recognized a realized loss of approximately $4.4 million or $0.06 per share on the extinguishment of the notes during the quarter. Net asset value per share was $18.69 at the end of September compared to $19 at the end of June. The $0.31 decrease as previously mentioned by Howard was primarily in our noncore oil investments, KLO and a loss from the extinguishment of our debt.

The average corporate lending portfolio yield for the quarter was 9.4%, down 50 basis points quarter-over-quarter. This decline was due to a combination of a decrease in LIBOR and a reduction in the weighted average spread of the portfolio, which decreased 19 basis points from 686 to 667 bps primarily due to asset deployment into first liens and a reduction in our exposure to second liens.

On the liability side of our balance sheet, we have $1.58 billion worth of debt outstanding at the end of the quarter. As we mentioned last quarter and given the current rate environment, we continue to evaluate alternative sources of capital with a particular emphasis on diversifying our funding sources. Our weighted average interest rate on our average debt for the quarter was 4.6%, down from 5.2% last quarter. If you exclude the 2043 notes, which were repaid during the quarter, the weighted average annualized interest costs would have been approximately 4.5% for the quarter.

Lastly, regarding stock buybacks, during the quarter, we repurchased 880,000 shares at an average price of $16.15 for a cost of $14.2 million. And since quarter-end and through yesterday, we have repurchased an additional 502,000 shares at an average price of $15.65 per share for a total cost of $7.8 million.

This concludes our prepared remarks. Operator, and please open the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from the line of Rick Shane from JPMorgan.

Richard Barry Shane - *JP Morgan Chase & Co, Research Division - Senior Equity Analyst*

Look, I think you touched upon this during your prepared remarks, but just love to explore this a little bit more. When we look at the 4 nonaccruals from last quarter, in general, we saw further deterioration in the fair value marks. I'm curious if that is a function of what we're seeing in the market, which is that...

(technical difficulty)

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Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

I think, Rick, we lost you.

Elizabeth Besen - *Apollo Investment Corporation - IR Manager*

Operator, can you hear us?

Operator

Indeed, we can. Rick, I believe you may have actually put your line on mute? Are you still there?

I believe Rick Shane is having some problems with his phone. We'll move to the next question. Our next question is the line of Fin O'Shea from Wells Fargo Securities. Fin?

Finian Patrick O'Shea - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

Just a small question first, and it's great news to hear on the Merx Aviation side. Are you able to give any context on the level of the fee rebates or servicing [fee] received? And then sorry if I missed it, will this be part of the -- would we see this on the reimbursements line or somewhere else?

Gregory William Hunt - *Apollo Investment Corporation - CFO & Treasurer*

Yes. With regard to Merx, the way our agreements work with both the manager in the aviation fund when capital is deployed, we will receive a servicing fee at the Merx level. So that will impact the cost structure of Merx and also the income and ultimately, the valuation. Also, the manager will rebate to the fund 20% of any management fees and incentive fees. The incentive fees will be paid at the end of the term of the fund, which is probably 6 to 7 years but the management fee would be current. So once the equity is deployed, we will earn that. So I think we'll start reporting as we start receive -- well, you'll see it in the -- obviously, in the income statement from the fee rebates, and then we'll also highlight the Merx impact.

Finian Patrick O'Shea - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

Got it. I have a follow-up on the MidCap side. It sounds like you're expanding there. There was a purchase of P&Cs franchise financing. You guys talked about growing that platforms verticals more. Can you talk about the impact to Apollo? Will you -- should we expect to see a wider funnel? Or will you focus the -- BDC still on the core cash flow, life science strategies, for example?

Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

Yes. I mean I think as a general sort of strategic matter across Apollo, whether MidCap or Apollo, we're looking to expand sort of our origination reach, especially in areas where we think there's some guardrails around them, so we can have some sort of proprietary access. Franchise finance has historically -- has been a section of sort of commercial lending, which has historically been relatively economically resilient and has a pretty sort of long-term history of steady granular performance. So that business made sense overall for what we're trying to do across the board of Apollo and MidCap. To the extent that those acquisitions like franchise generate assets that work for AINV, you would expect AINV to do some. So what does work mean? It means effectively be the low loss given default and have -- and hit our yield hurdle. And if the franchise deals do that, we would expect to do some of them. A lot of the loans in that platform are smaller, but there are some that where -- there are equity-backed groups that own 40, 50, 60 franchises that have -- that look like cash flow loans. And now we sort of have the expertise and the relationships with the franchisors to do them well.

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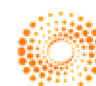

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Operator

And our next question is the line of Kyle Joseph from Jefferies. Kyle?

Kyle M. Joseph - *Jefferies LLC, Research Division - Equity Analyst*

Congratulations on a good quarter. I think first question for Tanner. You gave us -- you obviously walked through your nonaccruals and at least have some incremental energy weakness in the quarter. But stepping back from those, could you give us a sense for the broader portfolio performance outside of those industries and outside of the troubled credits?

Tanner Powell - *Apollo Investment Corporation - President & CIO of Apollo Investment Management*

Yes, sure. And this will rhyme with what we've said in previous quarters, as well as frankly, I think some of the headlines that you see just across the Wall Street Journal and the like. There's definitely been a deceleration. And if we look at our performance, we're still showing positive revenue growth, but -- and something that many of our borrowers have had to grapple with it has become a more difficult margin environment, whether it be in terms of wages, freight costs and certain commodities pressuring the margins. And so for one of another quarters in a row, you've seen less earnings growth than you saw revenue growth, but clearly positive, clearly still positive, but at a decelerating rate.

We like -- I would argue many of our peers had been very sensitive to more cyclical businesses in light of where we are in the cycle, but that's clearly an element where we do have some of that exposure, where you're starting to see some weakness on the manufacturing side and more just than typical idiosyncratic-type situations.

Kyle M. Joseph - *Jefferies LLC, Research Division - Equity Analyst*

Got it. That's helpful. And then, Greg, just talking about margins here, obviously, you had a nice debt pay down to reduce your cost of funds, and we're balancing that with a lower rate environment and ongoing movement higher up the capital spectrum. But as you think about your yields going forward with some offsets on the cost of funds side, where do you see that trending both in the near term and the longer term?

Gregory William Hunt - *Apollo Investment Corporation - CFO & Treasurer*

Well, I think if you look at our spreads for the quarter compared to last quarter, last quarter, we were about 550 bps, and this quarter, we're 604. I think we've -- I think when we're looking at new originations, I think we've flattened out a bit. And I think so we'll be in that range. The 6, which is in our target range and our modeling of 500 to 700 bps. So I think that, that is good. And I think we'll continue to use the credit facility on also the balance on rate reductions. I also would say that when we looked at our LIBOR loans, most of the impact of the recent drop in -- by the Fed had already been kind of somewhat partially impacting this quarter already, because if you look at where LIBOR was trading in the end of June and July, and it pretty much baked in the most recent adjustment. So I think that will also -- so I think consistently, you'll see kind of where we -- our earnings power will continue to grow as we add assets. But I think we're in a good place at this point.

Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

I'll just comment quickly. Is -- there has been a modest widening in spread that is offsetting some of the pressure in LIBOR, as we mentioned in our prepared remarks. Keep in mind that many of the deals that we're doing, oftentimes, there's a long lead time between when we are indicating on those deals and they actually get executed. So the effects of that change in market pricing sometimes operates with a lag as it often does in the middle market.

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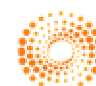

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Operator

And our next question is from line of Casey Alexander from Compass Point.

Casey Jay Alexander - *Compass Point Research & Trading, LLC, Research Division - Senior VP & Research Analyst*

Yes. First of all, and maybe this is nothing. But the $111 million draw on the revolver. So it just sounds like a lot to have happened in one quarter. Was there anything idiosyncratic about that level of draws that went out to revolvers? And did any of those revolvers go to companies that are on nonaccrual?

Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

No, nothing on nonaccrual. That's normal course for ABL revolvers. Right, for those revolvers. So that's not like cash flow revolvers that are strung up because they're challenged for liquidity. There might be little pieces of that. But -- and the vast majority of that is effectively ABL draws, which are also netted out by ABL paydowns. So we report the net activity as well, which is something in the $50 million range. So what we tried to sort of clarify in the reporting, and actually, if it's not clear, we'd love your feedback to how to make that clearer on a normal course.

Casey Jay Alexander - *Compass Point Research & Trading, LLC, Research Division - Senior VP & Research Analyst*

Okay. Great. That is helpful. You talked about the $12.5 million proceeds from the sale of 2 ships as being above your internal allocated value. Is that internal allocated value different than what those ships were on the balance sheet for? Or is that -- are you calling that the same number?

Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

It's the same number. The reason why we use that terminology is because it's -- those 2 ships sat in a company with 8 or 9 ships. And so those 2 came out. And the value of the company is -- we value the company. The company is a buildup of each of those ships. If we sold each of the ships at their internal allocated value or above, we would recover above the value of the whole thing. But we don't value it by putting an exact number on each ship from the outside valuation firm's perspective, if that makes sense.

Casey Jay Alexander - *Compass Point Research & Trading, LLC, Research Division - Senior VP & Research Analyst*

Yes, it does.

Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

So it was a good catch because we perfectly use that, but it's effectively slightly above what we valued the shipset, so these 2 ships.

Operator

(Operator Instructions) Our next question is line of Robert Dodd from Raymond James. Robert?

Robert James Dodd - *Raymond James & Associates, Inc., Research Division - Research Analyst*

Just a clarification first. On the Merx, the management fee rebate, that will be a contra expense item rather than a top line item, right?

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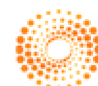

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Gregory William Hunt - *Apollo Investment Corporation - CFO & Treasurer*

Yes, yes.

Robert James Dodd - *Raymond James & Associates, Inc., Research Division - Research Analyst*

Got it, got it. And then on a very helpful color on kind of the broader market in terms of revenue growth, EBITDA growth and everything. When I look at on page, I guess, 6 of your presentation, the weighted average net leverage. If I look at the second lien, for the last couple of quarters, that's gone from 5.89x to 6.26x. But at the same time, you haven't actually deployed any new second lien, so that's kind of -- I mean, you probably exited some. So is it a consequence of exits? Or is it an indicator that there's deterioration in EBITDA in the second lien book that maybe outpaces the broader deterioration in -- or the broader EBITDA trends that you're seeing in the portfolio?

Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

So very much the former. With the caveat, also, not surprisingly, that the best candidates for refinancing are those that have delevered the most. And so you'd naturally expect that to occur, wherein there's an adverse selection, right, where we're levered seconds are coming out. We have not deployed, I think, say, for a handful of million into the second lien. In terms of debt performance versus the first lien book, I couldn't point any material difference in terms of the operating environment for either company. I will say, however, our second lien deals happen -- you typically skew to bigger companies. But with that, nothing else to say about the relative performance of our first lien credits versus our second lien credit.

Robert James Dodd - *Raymond James & Associates, Inc., Research Division - Research Analyst*

And then just to that point, if I can, one more on the bigger companies. I mean as a company gets larger, obviously, it probably gets more overseas customers, et cetera, versus domestic, and domestic environment seems a bit better than the global environment right now. So you're seeing any delta between performance between who's got exposure more focused domestic versus increasing international exposure?

Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

Yes, and I don't think it necessarily breaks down first lien, second lien, by and large, given our mandate for U.S. domestic businesses, we are less -- we're fortunately less weighted towards international jurisdictions. And -- but that said, there are certain idiosyncratic instances across the portfolio, whether it be the effect of the tariffs, or as you alluded to, the relatively poor economic environment internationally. Again, not expected to be widespread in our portfolio given our mandate for 70% U.S. domestic lending to U.S. businesses.

Operator

And our next question is from line of Paul Johnson from KBW.

Paul Johnson

My question is around -- as I look at your dividend today, it's, I think, about a 9.6% yield or so on your book value, I believe, from the presentation, your debt portfolio yield is about 9.6%. I think you can essentially get that slightly higher. I think it was like a 9.8% yield on your core portfolio. But even as you rotate your assets into your sort of ideal core portfolio, do you still see enough opportunity under your strategy and also the specialty verticals to enhance income and earnings to maintain the dividend, especially as incentive fees kick back in?

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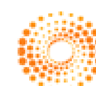

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Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

Yes. Yes. I think we sort of were somewhat consistent about this in terms of sort of just the math, which is that as our portfolio grows to our -- the target leverage, which we have said is 1.25 to 1.4, or maybe we sort of would say the 1.5 or something now. That earnings power, especially given the 1% management fee, effectively covers the decreasing yield. And not only it covers the decreasing yield, but also it covers the decreasing LIBOR. Let's -- so let me sort of put that another way because when we -- 18 months ago, we sort of had projected that at 1.25x leverage, the leverage isn't at were at today -- at the yields we expected to be at, which was a little bit of a higher LIBOR, around 10%, we could make $0.46 or $0.47. Obviously, because LIBOR is now lower and our -- and yields are compressing at that 1.25, we don't get there. That's why I'm saying 1.4, or 1.45, but we still have room within our strategy to be able to cover that. There are a couple variables that impact each quarter which is our fee income, which has been actually average the pretty steady amount over the last 3 years but could change quarter-over-quarter. So we feel pretty good about where that needs to be in order to sort of cover the dividend. So hopefully, that's sort of clear. So we consider -- I mean we build up on this model. If we have -- if we have yield compression, spread compression, as Greg said, I think that sort of leveled off and we have LIBOR going down. Obviously, our cost of debt goes down as well. We do not need to have that much more leverage than we have today in order to sort of consistently cover the dividend.

Paul Johnson

Okay. Got it. That's great color. I know there's been a couple of questions on leverage, portfolio companies, but one thing I wanted to ask about and spend time a little bit is the leverage on first lien new commitments. I believe that's increased a little bit over the past few quarters from 3.9x back in March to about 5.4x this quarter. Is that just a function of the market and investment funding? Or is that anything more specific to your strategy?

Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

No, I think it was actually a little bit of a mathematical anomaly. We were long a deal NFA, which we said we sold down over the quarter and that -- it has 6.2x leverage at closing.

Gregory William Hunt - *Apollo Investment Corporation - CFO & Treasurer*

And it was $100 million. So in our first liens for the quarter, the originations were $264 million and $100 million of that was NFA, and we sold it down at 30%. So it's skewing -- it's really skewing that number.

Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

So we should have corrected -- or we haven't corrected for it previously when we're launching, so we just kept that in the numbers. But it created -- which if you took that noise out, it would be very close to what it was last quarter.

Paul Johnson

Okay. Okay. And last question. It's a simple one. I remember a number of quarters ago that you had some oil and gas hedges in your portfolio to protect against the downside of oil. Did -- could you remind me, for those -- did those run off? Or is that no longer part of the strategy? Or are they still on the portfolio?

Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

No. They ran off. And the hedging's done at the company level and has been a, I think, actually, relatively successful over the last year, part of Glacier's strategy, for sure, in terms of how they generated cash. But they're -- all the hedging's done at the company level now.

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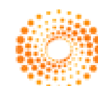

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Operator

And our next question is from the line of Rick Shane from JPMorgan.

Richard Barry Shane - *JP Morgan Chase & Co, Research Division - Senior Equity Analyst*

Anyway, 2 questions. First, what I was really getting at was, okay, nonaccruals showed a little bit of weakness in terms of valuation. Some of that's idiosyncratic. One in signal of an inflection point, though, more generally would be divergence between your better investments and your weaker investments. Are you starting to see that at all within the portfolio?

Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

No. No. So let me just first -- so the 2 significant write-downs and the nonaccrual deals are idiosyncratic. One on sort of restructuring credit and the other one is just on commodity prices. So no, like, macro trends for that. We have not seen a divergence. As Tanner said, probably a little slower growth this quarter than other quarters. But we don't see any sort of overwhelming trends in the portfolio that are notable. And even beyond the AINV portfolio but across a greater platform, where we see something that we can say this is a clear, at least leading indicator of an inflection point. Obviously, retail has been slow for a long time, unrelated to the economic sector, and there are some things that you can point to that feel that are noteworthy trends in sub-industries, but certainly not in our portfolio, like the -- there's always companies that performed better their investment case, and there's always ones that perform worse. But no difference in that sort of bell curve than there has been historically.

Richard Barry Shane - *JP Morgan Chase & Co, Research Division - Senior Equity Analyst*

Got it. Okay. Great. And then second question, and I like the way Paul framed the question related to dividend and ROE. When we've heard and spoken with some of your peers, they see higher end leverage more as a defensive opportunity during periods of market dislocation. Basically, historically, BDCs have been unable to deploy capital into attractive markets because they've traded below NAV and they don't have cushion. And in some ways, it sounds like you guys are headed to your NAV or your leverage targets basically in order to sustain ROE. I'm curious how high you would be willing to take leverage in a market dislocation in order to be able to take advantage of things? Or do you think that you're sort of using that dry powder now?

Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

Well, first, I want to sort of at least pivot your premise a little bit. Because the reason why we are deploying our leverage right now is because we believe we have the best senior debt origination platform in the country. And with our exemptive order and our ability to leverage up, that's now available for the BDC investors to take advantage of. And we believe that over the last few quarters, we've made that pretty clear. The diversity of our assets, the granularity of our assets, sort of the consistency of those assets. Unfortunately, obviously, some of that's colored by these historical investments we have, which don't let the numbers come through as much. But we think that as a strategy or as an investment option for people, getting sort of access to a relatively unique finance company mix of assets from the platform that we create is something that is of more value than playing sort of disconnects of the market at appropriate time. So we like our strategy.

That -- so then let's go to the next thing. Like what leveled are we comfortable getting our leverage to? I think what I would say is, historically, people would sort of say, I'm going to stop at 0.8x because they want it. And so I don't know if that translates in the new world at 1.6x or 1.8x because you need 0.2 cushion or 0.4 cushion, but I think we would say 1.6x. That's sort of where we think it's fully leveraged. If as a result of getting to 1.6x first on what we believe is sort of a quality portfolio, the market than disconnects and we don't have liquidity, I think we're pretty comfortable that we will internally generate enough liquidity to take advantage of those things as the portfolio rolls. I mean even in a tight market, these loans tend to -- loans and advertisings pay off, you create enough liquidity to take advantage of those types of situations. So I guess -- and people's narratives change all the time, depending on sort of what's available for them. For us, the strongest attribute we have is a significantly larger pipeline available than as compared to the size of this vehicle.

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Richard Barry Shane - *JP Morgan Chase & Co, Research Division - Senior Equity Analyst*

Got it. Okay. And so you're feeling like the funnel is big enough. I mean the counterpoint to that, I think, would be, if we think back and I may get my timing wrong, but I want to say it was the fall of 2012, there was a market dislocation. You guys were relatively highly levered. There was relatively less liquidity available to you. Some of your peers had more liquidity, and there was a divergence in performance over the next 6 to 12 months.

Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

There's no question that if the market disconnects and people invest money, especially if they invest money, which I'm not so sure they will do in this cycle as much as they did in the cycle you're referring to in broadly syndicated loans that trade down that can quickly recover. That's an investment opportunity just like buying gold at the right time would be. And -- but that's -- so there's no question having capital available for that, and timing it right is an opportunity that people should take advantage of if they have money and it sits right in front of them. We don't believe that we should be positioning our business to wait for that because we believe we can have a longer-term stable economic performance with a broad portfolio. That's more valuable in the long term, even if we miss that opportunity. Because what -- the reason why things diverged is because not so much that people made a lot of money on those trades. It's also that the people who weren't capable of taking advantage have lost a lot of money on the portfolio they carried into that. And we're building a defensive portfolio, so we don't believe that, that's the position will be and vis-à-vis, really almost everybody we compete with.

Richard Barry Shane - *JP Morgan Chase & Co, Research Division - Senior Equity Analyst*

Got it. No, look, it's a fair point. People don't pay you to time the market, they pay you to make good credit decisions, and that's ultimately what you're driving towards.

Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

And it -- look, I have not historically been as clear about this. I mean the -- our whole strategy is -- there is a 20-plus year origination history on our MidCap team through these cycles. And there's no question an economic cycle impacts everybody, but there are some time-tested things, portfolio diversification, being -- focusing on low loss given defaults, asset coverage even in cash flow loans, being in product sets that are -- that thrive in some challenged economic environments like asset-based loans. All of those things, all other things being equal, help you. And so we are very focused. That's why like the most important number we feel like almost in everything we show is the average borrower exposure. That 2 years ago, that was $27 million and $16 million now, and we're a much bigger business.

Operator

And our last question is the line of Casey Alexander from Compass Point. Casey?

Casey Jay Alexander - *Compass Point Research & Trading, LLC, Research Division - Senior VP & Research Analyst*

Yes. I'm sorry, I should have remembered to ask this before. But they're -- particularly in the upper middle market, there has been some discussion about some spillage, particularly on the leveraged loan market that would be rated single B and spill back into not a driving market opportunity, but an incremental market opportunity over and above what you might have normally seen. Have you guys seen any of that? Or does your group and the MidCap team sort of originate in a unique funnel that wouldn't necessarily participate in that.

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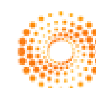

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Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

We have definitely seen it. I mean every sponsored deal that falls in the range that isn't -- that could have been broadly syndicated is now looking much more aggressively at -- to a -- and smaller -- lower middle market or smaller deals or broadly syndicated market are all single B credits, so they all fall in that category, are all looking at private execution, at least as an alternative and probably as a favored one. At the same time, that these assorted platforms and the larger platforms have more capacity to do that stuff, including Apollo. It's why, even though in the third quarter, we saw lots of metrics about middle market volume being down. You saw people like Owl Rock and Ares and us have origination above their targets because that's definitely driving market activity.

Casey Jay Alexander - *Compass Point Research & Trading, LLC, Research Division - Senior VP & Research Analyst*

Do you think that's sustainable for a while? Because I mean there have been times in the past where, like in the fourth quarter of 2016, where it was technical and some spilled out, then it corrected itself very quickly, but the ratio of downgrades to upgrades and U.S. leverage loans is running 3:1 and much higher than where it was in the past. And so do you think that perhaps this is a sustainable phenomenon for some period of time.

Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

Yes. I mean I think that -- our thesis here across the board of Apollo is that this is a secular change that they will be even driven by market challenges. But it will also be driven by the flexibility and the size of the capital available in the private market, which will even sort of work in markets that aren't -- don't have some noise in them. So yes, I mean I think that's our expectation, and I think our peers' expectation as well.

Operator

There are no further questions, and I will now turn the call back over to management for closing remarks.

Howard T. Widra - *Apollo Investment Corporation - CEO & Director*

All right. Thank you. On behalf of the team, thanks for your time today and your continued support. Please feel free to reach out to any of us if you have questions. Have a good night.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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