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AINV - Q3 2020 Apollo Investment Corp Earnings Call

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PRESENTATION

Operator

Good afternoon, and welcome to Apollo Investment Corporation's earnings conference call for the period ended December 31, 2019. (Operator Instructions)

I will now turn the call over to Elizabeth Besen, Investor Relations Manager for Portfolio (sic) [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 the 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 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 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.



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

Thank you, Elizabeth. I'll begin today's call with a review of the progress we've made over the past few years followed by an overview of the results for the quarter. Following my remarks, Tanner will discuss our investment activity for the quarter and will also provide an update on credit quality. Greg will then review our financial results in greater detail. We'll then open up the call to questions.

Over the last several years, we have made significant progress derisking the portfolio and building a well-diversified portfolio of first lien floating rate corporate loans. Our progress is evident by the improvement in our credit metrics. For example, 82% of our corporate lending portfolio is first lien loans compared to 29% in June 2016. Over this period, our weighted average attachment has declined from 2.7x to 0.9x. Our portfolio is much more granular as evidenced by the decline in our average borrower exposure in our corporate lending portfolio from \$23.7 million in June 2016 to \$16.4 million today.

We have also significantly reduced our exposure to noncore and legacy assets, which are higher on the risk spectrum and have more volatile returns. At the end of June 2016, noncore and legacy assets totaled \$1.065 billion. At the end of December 2019, noncore and legacy assets totaled \$358 million, a 66% decline. Net proceeds from the sale and repayment in noncore and legacy assets totaled approximately \$600 million over this period. We continue to seek to monetize or restructure our remaining noncore assets with the ultimate goal of maximizing value for our shareholders.

Additionally, over the last few years, AINV has been able to take advantage of 2 important regulatory release, exemptive relief to co-invest and a reduction in our asset coverage requirement. The Apollo Direct Origination Platform originates a significant amount of senior floating rate loans, which are available to AINV, given exemptive relief and are within our target spread range, given our ability to use more leverage.

Given our ability to co-invest with the broader Apollo platform, we have been able to participate in large commitments while maintaining relatively small hold sizes on AINV's balance sheet. In addition, AINV was fortunate to be in a unique position to already have all the origination necessary to implement a prudent lower risk portfolio growth strategy when it adopted the reduced asset coverage requirement. Both of these regulatory releases allowed us to build a diversified, granular portfolio of first lien floating rate loans.

In this regard, since April 2018, when we began to invest in lower-risk assets following the passage of the Small Business Credit Availability Act, we have made approximately \$2.4 billion of new corporate lending commitments. \$1.9 billion of those commitments are currently outstanding, of which approximately \$1.5 billion are funded. All of those are performing.

Lastly, we have implemented a number of shareholder-friendly actions, which demonstrate our commitment to creating value for our shareholders. In May 2018, we announced changes to our fee structure, including adding a total return requirement to our incentive fee calculation. We also permanently lowered our management fee to 1.5% and further reduced the management fee to 1% on assets in excess of 1x debt to equity. Second, AINV has been actively repurchasing stock. We believe that stock buybacks are the most accretive use of shareholder capital when the stock is trading at a meaningful discount to NAV. Our Board has authorized 5, \$50 million plans for a total authorization of \$250 million. To date, we repurchased over \$208 million of stock below NAV, which has accreted \$0.68 to NAV per share. We believe the combination of AINV's fee structure changes and active stock repurchase program demonstrate our commitment to creating value for our shareholders.

Moving to the December quarter, we continued to successfully implement our plan to prudently grow our portfolio. We had a strong origination quarter and grew our portfolio by approximately 6%, by increasing our exposure to first lien floating rate corporate loans sourced by the Apollo Direct Origination Platform. During the quarter, we also reduced our exposure to second lien loans and to our noncore and legacy assets. Second lien sales and repayments totaled \$62 million and noncore and legacy asset repayments totaled \$46 million. Given our strong net investment activity, our net leverage ratio increased to 1.43x at the end of the quarter. As stated on our prior conference calls, this leverage level is consistent with our expectation that we will operate between 1.4 and 1.6x.

In addition, this quarter was an important inflection point in the make up of our noncore portfolio. The noncore portfolio decreased by approximately \$67 million through the combination of repayments and unrealized losses, reducing noncore assets to 12% of the portfolio. In addition, the risk attributable to our remaining noncore portfolio has decreased due to the successful restructuring of our investment in Carbonfree Chemicals during the period. The combination of this restructuring and the accretive impact of the reinvestment of the proceeds received from our noncore

and legacy repayments have allowed us to have a smaller and better collateralized noncore portfolio while improving the overall earnings profile of Apollo investment.

Moving to our financial results. Net investment income for the quarter was \$0.54 per share, reflecting the net portfolio growth and the total return feature in our incentive fee structure, which resulted in a nominal incentive fee for the quarter. It is important to note that average leverage for the quarter was 1.27x, implying that the larger portfolio will continue to drive earnings growth in the current quarter. Net asset value per share was \$18.27 at the end of December, down 2.3% quarter-over-quarter. The \$0.42 net reduction in NAV per share was due to a \$0.54 net loss on the portfolio partially offset by net investment income in excess of the distribution of \$0.09 and a \$0.02 accretive impact from share repurchases. Noncore and legacy assets accounted for \$0.51 or 95% of the net loss. Oil and gas accounted for \$0.19 for the loss, legacy assets for \$0.18, renewables, \$0.13 and shipping \$0.01.

Turning to our distribution. The Board has approved a \$0.45 per share distribution to shareholders of record as of March 20, 2020.

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

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

Thank you, Howard. The environment for middle-market lenders remains highly competitive, given the significant amount of capital 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 \$491 million and \$399 million, respectively. New debt commitments were all first lien floating rate loans. These new commitments were across 28 companies for an average commitment size of \$17.6 million. The weighted average spread over LIBOR of these new commitments was 612 basis points, within our target range of 500 to 700 basis points for incremental assets. The weighted average net leverage for new commitments was 5.3x within our range of 4 to 5.5x. Lastly, 85% of these new commitments were made pursuant to our co-investment order.

Sales totaled \$15 million and repayments totaled \$212 million for total exits of \$227 million, resulting in net funded investment activity of \$172 million, excluding Merx and revolver activity. During the quarter, we reduced our exposure to second lien loans and noncore and legacy assets. Second lien sales and repayments totaled \$62 million, including PSI, DigiCert and PT Intermediate. Noncore and legacy asset repayments totaled \$46 million, including \$34 million from asset repackaging, a legacy asset, \$5 million from Glacier, one of our oil and gas investments and \$6 million from 2 of our renewable assets.

In addition, net fundings on revolvers were \$1 million. We also received a net repayment of \$2 million from Merx. Net fundings totaled \$171 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 December, investments on nonaccrual status represented 0.7% of the portfolio at fair value, down from 1% last quarter and 2% at cost, down from 2.1% last quarter.

Moving on to our credit metrics. The weighted average asset spread on the corporate lending portfolio decreased 16 basis points to 651, down from 667 last quarter and compared to 612 basis points 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 of our investments decreased from 5.5x to 5.27x and compared to 5.3x for new commitments. And the weighted average attachment point of the portfolio declined from 1.3x to 0.9x. The average interest rate -- interest coverage improved -- remained at 2.5x. As we've said in the past, we view this trade-off of yield for credit quality as a positive at this point in the credit cycle.

With that, I will now 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 \$68.5 million for the December quarter, down \$1.8 million or 2.6% from the prior quarter. The decrease was attributable to lower recurring interest income and fee income partially offset by higher prepayment and dividend income, despite positive net investment activity, recurring interest income declined due to the decline in LIBOR and lower spread on new investments compared to investments sold or repaid and the cadence of activity during the quarter.

Fee income was \$1.2 million, down from \$2.2 million last quarter. Prepayment income was \$2.8 million, up from \$2.1 million last quarter and dividend income was \$3.2 million, up slightly from \$2.8 million last quarter. Expenses for the quarter were \$32.3 million, down \$2.3 million or 6.7% quarter-over-quarter, primarily due to a significant lower incentive fee and lower interest expense.

Recall, the incentive fee was revised to include a total return requirement with a rolling 12-quarter look back beginning from April 1, 2018, and was put into effect on January 1, 2019. Interest expense declined slightly due to a decline in the weighted average funding cost given the redemption of the baby bonds in the prior quarter and the increased utilization of the credit facility, which benefited from the decline in LIBOR partially offset by a higher average debt balance given the portfolio's growth.

The quarterly weighted average interest cost declined 39 basis points from 4.59% to 4.2%. The average quarterly debt outstanding balance increased by approximately \$90 million from \$1.5 billion to \$1.58 billion. Net investment income was \$0.54 per share for the quarter compared to \$0.53 per share for the September quarter.

Net leverage at the end of December was 1.43x compared to 1.24x at the end of September. Average leverage during the quarter was 1.27x, up from an average of 1.13x during the September quarter. The net loss in the portfolio for the quarter totaled \$35.9 million or \$0.54 per share. Approximately \$34 million or 59% of the net loss was attributable to our noncore and legacy assets, including our investments in Carbonfree, Glacier, Solarplicity and Spotted Hawk. Net asset value per share was \$18.27 at the end of December compared to \$18.69 at the end of September.

Turning to the portfolio's composition. Our total assets had a fair value of \$3 billion at the end of December and consisted of 151 companies across 27 industries. We ended the quarter with core assets representing 88% of the portfolio, up from 85% at the end of September and compared to 80% a year ago. Noncore assets decreased to 12% of the portfolio, down from 15% at the end of September and 20% a year ago. First lien assets increased to 82% of the corporate lending portfolio, up from 77% last quarter and up from 62% a year ago. The weighted average attachment point improved to 0.9x, down from 1.3x last quarter. Investment made pursuant to our co-investment order increased to 76% of the corporate lending portfolio at the end of the quarter, up from 74% last quarter and 59% a year ago. The average corporate lending portfolio yield for the quarter was 9%, down 40 basis points quarter-over-quarter. The decline was due to the combination of a decrease in LIBOR and a reduction in the weighted average spread of the portfolio, which decreased 16 basis points from 667 to 651, primarily due to our increased exposure to first lien and our reduced exposure to second lien investments.

On the liability side of our balance sheet, we had \$1.79 billion of debt outstanding at the end of the quarter. We continue to evaluate alternative sources of capital, with a particular emphasis on diversifying our funding sources.

As you may have seen, last week, Fitch lowered AINV's credit rating from BBB minus to BB+ stable. While we are disappointed by Fitch's actions, we believe that we have built a high-quality senior loan portfolio, which more than offset our increased use of leverage. Middle market CLOs with loans of identical credit quality often are rated higher. We believe the improved risk profile of our portfolio will result in earnings stability, which is in the best interest of our stakeholders.

Lastly, regarding stock buybacks, during the quarter, we repurchased 502,000 shares at an average price of \$15.65 for a total cost of \$7.8 million. Given the recent rally in the stock, no shares have been purchased since early November.

This concludes our prepared remarks. And operator, please open the call to questions.



QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll take our first question from the line of Kenneth Lee with RBC Capital Markets.

Kenneth S. Lee - *RBC Capital Markets, Research Division - VP of Equity Research*

Just one on the asset sales, it looks as if you got some sales within the legacy and noncore side of the portfolio. Wondering what your expectations are right now for any further sales within that portfolio in the near term?

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

So it's sales and repayments, right? So there was one meaningful sale and then -- of around \$30 million and the remainder was repayments on some of the existing assets. And so we would -- we expect to continue to have sort of repayments on -- because we're focused on sort of liquidity on all of these and getting a return of capital. So obviously, wholesale excess of any of these assets is sort of binary. But if you look at Glacier, for example, we received \$5 million during the quarter and each of the last 3, 4, 5 quarters, I don't know exactly, we have received capital, and we'll receive capital this quarter as well. So we would expect to have 2 sources of liquidity in that portfolio, which is: one, continue to receive capital to pay down the exposure; and then, continue to work towards significant restructurings or exits, which can happen sort of effectively anecdotally.

Kenneth S. Lee - *RBC Capital Markets, Research Division - VP of Equity Research*

Okay, very helpful. And just one follow-up, if I may. In terms of the portfolio positioning, you talked about the first lien as a percentage of portfolio increasing this quarter. And that's just being consistent with the overall macro outlook. Do you expect this trend to continue over the next few quarters in terms of the positioning? Just wanted to get your thoughts on that?

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

Yes. I mean that's where we're focused. I mean we -- at our current leverage level and our -- and the makeup of our portfolio, we believe we have good earnings power consistent with where we've guided. And one of the key legs of the stool, if you will, of that is predictable credit quality. And so the way we deliver that is by staying high up in the capital structure.

Operator

Your next question is from Rick Shane with JPMorgan.

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

So when we look at the nonaccruals, there's been sort of a steady write-down of fair value there over the last 3 quarters. Is there a continued deterioration? Or are you just taking a more conservative approach? What are you seeing as we look at that -- those 4 investments.

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

Well, it's almost all Spotted Hawk, and it's almost all driven by commodity prices. Right. So this is not a fundamental company change other than the cost of the commodity. It's not exclusively that but it's almost all that.



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

The other issue is that, look, I think there are 2 divergent trends here. One is that the operating EPS, the NII at this point is steadily covering the dividends. You guys have done a good job moving in the right direction there in taking advantage of the higher leverage. At the same time, NAV continues to decline. How do you reconcile those 2 trends? And how do you ultimately reverse the NAV issue?

Gregory William Hunt - Apollo Investment Corporation - CFO & Treasurer

So on the one side, obviously, we're focused on having the capital that we have available to be at work and generating revenue to be sufficient to cover the dividend. So as you noted, we're sort of there with the portfolio. Then we have this noncore portfolio, which has a lot of assets like Spotted Hawk or portions nonearning or the renewables, which are in equity, which are not generating a cash return, right? So on average, that portfolio is producing somewhere in the 6s or 7% -- 5.6%. Yes. So depending on the dividends that are paid off the shifts in a given quarter and so our focus is sort of twofold, is maximizing the return on those assets in order to ensure that NAV doesn't decline all that much. But at the same time, focus on getting that capital back because it can be reinvested at sort of double the return.

So put another way, if you look at -- as I mentioned in my comments, we received \$600 million off over the last 2.5 years on a \$1.050 billion portfolio. So there's been like \$100 million of write-down roughly, while we received \$600 million of proceeds. If you took that same percentage on the portfolio -- I'm not at all predicting that the hope and expectations to recover it all, but if we got 85% of our cash back tomorrow, you would have another reduction in NAV of \$40 million, \$50 million, and you'd have a significant increase in earnings. And so because we put that to work at 9% in sort of in the normal course. And so we'd rather not have those 2 countervailing trends, but we feel like that where the losses in NAV are occurring, one, they've been driven a lot by commodity prices and so they can change. We'd rather not have that risk, they can change. But two, they've been -- that reduction in NAV has been joined by a return of a lot of the capital in the noncore, which then has been put to work, which has then been able to drive NII. So obviously, as that noncore portfolio goes down, the level of possible write-off goes down. And so we're focused on that. So everybody can have total clarity. But we feel like, at the point where we're covering our dividend, it's now mostly economic upside to the shareholder, even if -- meaning, we'll be able to pay the dividend, \$1.80 a share consistently and cover -- and even beyond, even if we continue to realize more volatility due to the commodity prices in these assets.

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

Got it. Okay. And then last question. I mean, look, you guys are approaching your leverage targets. And that in a continued strong market will prove to be a good deployment of capital. The flip side is, if we were to see dislocation like we saw back in 2012, where there's some pressure in terms of NAV, and that causes the leverage ratio to go up. And you guys aren't able to sort of lean into a more opportunistic market. How do you feel about that trade-off, given where you are right now in terms of leverage?

Gregory William Hunt - Apollo Investment Corporation - CFO & Treasurer

We feel like, first and foremost, in order to sort of change the narrative for our business was to have a stable, predictable earnings stream, which we feel like we have in these assets. And they're quality assets, sort of set up from a portfolio structure perspective to perform well through the cycle. If the market changes and there's more opportunities to deploy capital, we feel like the combination of normal course repayments and our ability to sort of effectively cherry-pick those opportunities off the platform, which is going to be -- because the capital is there on the Apollo Platform. And so given our ability to sort of just have some capital be generating as well as sort of sell some assets that still remain liquid on our balance sheet, that we'll have the ability to sort of on the margins, take advantage of that opportunity. But of course, not as much as if we would have levered 0.5 to 1, but enough that we will be able to benefit from it.

Operator

Your next question is from Casey Alexander with Compass Point.



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

A couple of questions. One, in relation to the debt side, the liability side of the balance sheet, I mean you're upwards of 75%, 80% covered by the facility. In what vehicles do you think you have available to you, especially in light of the Fitch downgrade to diversify the liability side of the balance sheet?

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

Yes. So Casey, we have -- we still have investment-grade rating from Kroll. And we feel very comfortable that we can either attack the debt market and/or the convert market. Rates that are acceptable to us as we look at where our portfolio growth is going to come from.

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

Okay. If I calculate adjusted NII for the quarter, I come up with \$0.43 a share. And looking at where LIBOR is going forward, even with the expansion of the balance sheet, it seems to me that you guys -- you really need everything to go right to cover the dividend and comfortably cover the dividend. And frankly, not very many first lien senior secured loan funds have a dividend on NAV that is in excess of 10%. Wouldn't it offer investors a better total return if you were to adjust the dividend to a level where you were beating the dividend consistently and building NAV over time? Wouldn't that, frankly, make more sense?

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

I think, no. I think your adjusted number is probably a little bit low, based -- I think it's a little bit low, but call it in the \$0.43 to \$0.45 range. Our average leverage for the quarter was lower than where we're at right now. So that drives another \$0.03-or-so to our NII. And as our portfolio grows sort of like our recognition of fees also sort of -- it will tend to expand. So there isn't -- I wouldn't say we're just creeping over it. So I think the -- our view is that the expectation of the shareholders is for us to deliver the return that we promised over the past 2.5 years, and we feel like we can do that. We also feel like, though, fully employed at this -- and right now, LIBOR has almost hit the worst possible point for us. Because if it goes down much more, our floors kick in. If it goes up, we make more money. So despite LIBOR being at that level, we've gotten to a point where we can cover the dividend. And when you say everything has to go right, I mean, if we keep our leverage levels there, we will cover it. The -- and then the question is how do we grow NAV in some other ways? And there are some other ways with some capital gains with tagalong equity investments we're doing with the value we're driving at Merx, with some of those things. And so I don't think that we think it would be necessary to change the dividend. And we think of all the times we -- since I started being associated with AINV when the dividend sort of was cut to this level, this is the point where we've been most secure in covering it.

Operator

Your next question is from Chris York with JMP Securities.

Christopher John York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Greg, I know your portfolio companies are now hedging commodity risk, but what effect has the decline in the spot year-to-date for crude had on your portfolio? Or maybe even specifically Spotted Hawk today? And then secondly, if oil stays at the spot rate, are any of your portfolio companies in a precarious spot to cover debt service or require an equity injection?



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

So the spot price doesn't drive the valuation, right? The longer-term curve drives the valuation. So the movement in the prices don't directly correlate to the valuation as of the snapshot of that day. That said, the long-term projection of prices today is different, not lower in all respects, but lower in most respects than it was a month ago. And so the valuation of sort of the 2 oil deals that are currently on the book would be down some. That, in the short term, given that they've been generating cash and paying down debt, at least in the case of Glacier and Spotted Hawk, it's been, sort of, for the most part, stable from a cash flow perspective, and they have some hedges in place. We don't expect there to be sort of meaningful cash needs. Obviously, it could affect their ability to pay down debt. But in the short term, we don't. There's no question though if oil sat -- it's \$50 now, but if oil sat at \$40 for an extended period of time, that would create some issues, but not where it is today in the medium term. Is that -- does that answer?

Christopher John York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Yes. So I mean I looked at the forward curve, and yes, it's moved down a little bit too with the spot here. Yes. And so I'm just trying to think of if the spot even on forward curve had peaked?

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

I don't want to give you the exact number. I mean we have a number based on last week, but like last Friday, when we asked the same question you just asked. And the thing is, Brent is relevant for one company, WTI is relevant for another one. Those curves look differently, prices, the prices on the curve are actually up in 2023 and 24, which impacts some of sort of our expected stuff coming out of the ground in our valuation. All of which is to say, the quarterly valuation of these companies based on those long-term curves are a little bit frustrating. Because they don't necessarily speak to what the value will ultimately be when we get to that period of time. That said, if oil's sitting at \$60, it's better for the companies than it sitting at \$50. And so you tend to see the geography move in that direction. And so given the sort of the drastic move in oil over the past month, you would expect more of that this quarter, if it didn't change. But just like when it goes up, it doesn't drastically go up, it wouldn't be as drastically down as well. Like it's from \$60 to \$50, it's 18% decline. It's not something like that in terms of value.

Christopher John York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Got it. That's helpful. I'm just trying to understand the pain points there at a price level for potentially Spotted Hawk, maybe you talked about the short term. So if it was at \$55, \$50 over the next 12 to 18 months, what pain points that would cause? But I'll just move on. So secondly, I mean, Casey asked this little bit, and I guess it was on your capital structure. Obviously, 80% of your debt capital is tied to your bank revolving credit facility. And then you did mention the downgrade below IG, you do have Kroll investment grade, but how should investors think about the sustainability of just that one stream? And then the potential to diversify, you talked about on-balance sheet securitization, which would be a good form of debt capital, but what do you think is the sustainable cost of your debt capital at full leverage?

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

Well, I mean, I think as we said, we're at 4.2% that may -- if we did a bond offering or a convert, that would go up slightly, given the size of an offering that we may do. But I don't think it will be meaningfully -- maybe you're closer to 4.4%, 4.5%. I mean it's still a very favorable cost of capital in the marketplace.

Christopher John York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Got it. And then I would have to review the covenants, but is there any pricing adjustments in your bank credit facility on the downgrade there?



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

No. No, because it's really -- it's just for our sub-debt -- it's really for our sub-debt is the rating.

Christopher John York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Okay. And then, Howard, last one here. You talked a little bit in your prepared remarks about exemptive relief benefiting AINV. Absolutely, that's true. The reason why I bring it up is that Apollo does have involvement with the coalition for business development, so prompting me to just revisit your potential update on the likelihood for exemptive relief for BDCs in the application of AFFE this year?

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

Right. So that has been actually withdrawn, okay, that approach at this point. And we've gone more toward a legislative approach and working with the fund of funds application or the fund-to-fund rules that are being looked at by the SEC and change. So we're looking at that as a better approach. And I think the good thing is that we -- the SEC became very familiar with this topic, and withdrawal of our application, which was really a function of the direction that they were going in with the fund-to-fund rules.

Christopher John York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Got it. Greg, does the withdraw of that application change your potential identification of a probability of the removal of AFFE this year to BDCs?

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

No. I don't -- if we're able to get it in the fund-to-fund rules, it actually has a better chance of getting done than it did as a stand-alone exemption that we were asking for.

Operator

Your next question is from Kyle Joseph with Jefferies.

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

Most of my questions have been asked and answered. Just a few modeling ones. In terms of dividend income, were there any one-timers in the quarter? And what's a good run rate to look for going forward?

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

No. I think you're fine at \$2.8 million to \$3 million. It's really coming out of our shipping investment and Merx.

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

Got it. That helps. And then it looks like PIK income increased in the quarter? What specifically drove that?



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

Yes. So what drove it was Bumble Bee, which had their restructuring approved this week. And we've restructured our position and been paid down on it, partially subsequent to on a quarter end. Those...

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

I was going to say, just stepping back, broadly appreciate Tanner's color on the portfolio metrics. But just simplified in terms of growth both revenue and EBITDA, can you tell us where we are versus 3 months ago and versus even a year ago?

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

Yes, sure. It's very much been a continuation of the trends that we've seen, wherein growth on an organic basis is still positive from a revenue standpoint, but EBITDA or earnings growth is underperforming the magnitude of revenue growth as our companies are grappling with a number of cost pressures, be it -- and depending on the industry, obviously, things are more pronounced. But freight costs have gone up, wage and in certain places, notwithstanding the most recent downdraft in commodity prices -- commodity price pressures. And so you've seen that in a -- that, frankly, has been something we've seen for the last couple of quarters and continued through Q4.

Operator

Your next question is from Ryan Lynch with KBW.

Ryan Patrick Lynch - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

First one, I wanted to talk about your leverage range. When you guys initially passed the 2 to 1 leverage, you guys had a leverage range of 1.25 to 1.4x, that target leverage range has increased over time to the current 1.4 to 1.6x. I'm just wondering, it seems to be in an environment that we are today, which has a lot of competitiveness, we're obviously over 10 years removed from the last credit cycle. I'm just wondering how you guys are getting comfortable increasing your target leverage range? It would seem to be that you would want to increase that range in environments where you're seeing robust activity and there's very good deal flow and very good risk/rewards, which I don't think is how most market participants would characterize this market. So can you just talk about, in this environment, how are you getting comfortable? And what is the thought process of increasing this target leverage range?

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

Well, so the first thing I'd say is, we are seeing very good deal flow. And that's because of what we've sort of focused on for the last few years is that the amount of deal flow that AINV has to take off so the overall origination of the platform is such a small part that even if deal flow across the platform is more constrained because of the market dynamics you talked about, there's a lot of deal flow available to sort of get -- just sort of pick off the stuff that builds our portfolio the right way. So we had said 1.25 to 1.4 over sort of really the amount of time to get to about the end of this year. That's what we said about 18 months ago, which is what we've gotten to and we continue to sort of have these opportunities. And sort of what you're asking, similar to one of the previous questions is, don't you want your dry powder for other things.

So the first answer is, we want to -- we believe, and we believe that it is corroborated by sort of the significant amount of capital that we raised from institutional investors for the same assets across our platform versus a lot of our competitors that we have a very good engine producing proprietary assets. At AINV, the leverage that it's employing, obviously, is high versus historical levels for BDCs, but low actually versus a lot of commercial finance or specific investors leverage these assets. And that's because when you build a portfolio -- when you have a wide funnel and you build a portfolio that's granular and broad-based, the ranges of outcomes even in sort of the stretcher part of the cycles is narrowed quite a bit. So we -- so the overall answer is, we are being circumspect across our whole platform. Our origination takes into account the challenges of the

markets. We reject a huge amount of deals. And we, like a few of our competitors, let's take Ares and Golub, for example, because of the size of our platforms and the size of our origination teams still have the ability to sort of differentiate ourselves. Because of like our size and the depth -- size and depth of our relationships to have enough assets for AINV to grow. And just sort of, Ryan, like the last point I'll say is the leverage loan portfolio at MidCap has not grown over the past year, even though there's been a lot of origination. And that's because it is a larger, more stable -- it's already had as much runoff as it generates new business. And it spreads those assets awful lot of balance sheets. So we view the market like you view the market. We just have a very big funnel of deals coming through.

Ryan Patrick Lynch - Keefe, Bruyette, & Woods, Inc., Research Division - MD

Okay. That's helpful color. Just one more for me, and I'm not sure if you mentioned this. But if you kind of hold the portfolio realized and unrealized gains and losses neutral next quarter under that assumption, what percentage of your incentive fee would you guys expect to earn? Would you expect to earn half, 0 or what -- I'm just kind of trying to get a gauge of where that incentive fee is looking to shake out, holding that portfolio depreciation or appreciation constant?

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

If there were no losses next quarter, we'd pay the full incentive fee.

Operator

Your next question is from Robert Dodd with Raymond James.

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

Probably a couple for Greg. On the downgrade, you've addressed it a couple of times. If I look at -- I mean, obviously, if you shift the mix from the facility to more notes or other things, the blended cost would go up. But when I look at the 2025 notes out there trading, they look to me to be trading above par before the downgrade and still above par now. So do you think the Fitch downgrade is going to have any meaningful impact on your kind of like-for-like borrowing costs rather than -- I mean you mentioned it might go up to 4.4 if the mix of types of borrowing shifts. But do you think that downgrade's actually going to affect your like-for-like kind of borrowing cost on the notes side?

Gregory William Hunt - Apollo Investment Corporation - CFO & Treasurer

No. I don't think so. No. And I think I just quickly did the math, it actually only goes up to 4.3 if you do a \$200 million offering. And you'll be inside of the cost of funds on the -- on the bonds that are outstanding. So...

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

All right. Got it. Got it. And then one more, if I can, which is, I'm having some trouble making -- tallying some things on the PIK income on the P&L, in the Q in the notes, \$2.6 million was recognized, but in the cash flow or elsewhere in the Q, right, there was almost \$13 million capitalized. That's the biggest delta that I've ever seen from you guys. I mean was that also related to Bumble Bee? Or could you give us any color on reconciling that because it's a pretty big gap?

Gregory William Hunt - Apollo Investment Corporation - CFO & Treasurer

Yes. We think Carbonfree -- it was our restructuring of the Carbonfree position. So we capitalized the PIK that was -- had not been capitalized prior...



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

Okay. So that was the previous nonaccrual that you now -- you not accrued PIK that you capitalized it, but you didn't run it through the P&L, right?

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

No. It has been run...

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

It had run through the P&L in prior quarters, and it was sitting as a interest receivable and that was capitalized in the restructuring of the debt.

Operator

And your final question comes from the line of Fin O'Shea with Wells Fargo Securities.

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

Just a follow-on Carbonfree. Can you give us, to the extent you're able, any context on the restructuring? Just seeing this was an affiliate's investment, so do they sort of trip any performance measure? And then a second part to that, how is -- is this de-risked beyond your position converting more so into equity? Or did -- at the company level, is there more reduced debt?

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

I'm not -- first of all, just let me clarify, you're saying it's an affiliate position. I'm not sure what you...

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

On your table, like your ownership percentage affiliate.

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

Okay. All right. So let me -- I don't think that's -- so there's 2 things that the restructuring did to make us more stable. It's basically, we -- the owner, the equity owner of the facility. Basically what was running this project both to produce profit as well as to build off an IP value off sort of a carbon-free technology. Our restructure basically changed our deal to sort of align us directly with that equity investor. So we had -- we both had debt on our operating company, if you will, and we had ownership in the IP that is monetizable in other places, we believe, and has raised money at a good valuation. And so what we have done in terms of sort of the stability of the -- so one, we've diversified our collateral, if you will. So we -- basically, the position now has both the previous collateral had before, which is this plant, and it also has this IP, which is separately -- has separate value. That's one. And two, because of that and because of allocating a portion of the value to that equity, the debt that the operating company is forced to carry is now much lower. So the cash flow profile of that entity is -- it's easy for it to service that debt. It's still driven by a commodity price. So it can still have some variability on its ability, but it now has less debt, so it has a much lower burden of debt. Also, no PIK, you don't want to accrue anymore. So it'll be -- it'll have something like \$33 million of debt that we'll pay steadily that it could cover, which is far less than it had covered before. And then we have the separate pool of value. And so we view it as meaningfully derisked from where it was before. Obviously, we wrote some down as well. So there's less debt. There's less debt to service and there's more collateral.



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

Okay. Appreciate that color. Just another follow-on on MidCap. There was a couple of questions. Can you talk about the MidCap funnel and its allocation across the accounts that's been obviously growing since Apollo acquired and since you now co-invest? But seeing you, Apollo, the BDC generally onboarding your L+600 last couple of quarters, is this reflective of the overall funnel? Or is there a tilt with on one hand the BDC at say, L+600 stuff and then on the other end, you're seeing SMAs with more allocation to the L+450 stuff? Would that be -- is there any directional tilt there? Or is it even keeled on allocation?

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

Well, it's not -- we have 6 or 7 separate investors that look to invest in deals, and they each have different criteria. Some return-based, some leverage-based, some industry-based, it could be anything. And so by and large what AINV is doing is the vast majority of the origination in our leverage loan book. There is not as much being done in the L+450 range, mostly because that's not where the market is. That's when people want effectively 4.5 to 5x debt as opposed to 3.5, 4x debt for the lower cost. So just to give you some numbers, MidCap did \$13 billion of new commitments last year. About 2/3 of that was in leveraged lending. So we know the other 1/3 is in life sciences, ABL, real estate. And when those deals make sense, that is part of the origination for AINV. And it probably makes sense, it basically means they're big enough that AINV can get enough size that it makes sense for them to do. The other 2/3 across our leveraged loan book, that \$6 billion is something like 80 or so loans. There's probably 20 of them that are below the yield profile that -- and I'm guessing, 15 to 20 of them that are below the yield profile that AINV may want to choose to do.

Operator

There are no further questions at this time. I will turn the call back over to management for any closing remarks.

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

Thanks. Thank you, everybody, for your time today and your continued support. Please feel free to reach out to any of us if you have any 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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