THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

PTMN - Q4 2019 Portman Ridge Finance Corp Earnings Call

EVENT DATE/TIME: MARCH 09, 2020 / 6:30PM GMT

CORPORATE PARTICIPANTS

Edward Joseph Goldthorpe *Portman Ridge Finance Corporation - Chairman, CEO & President*

Edward Udall Gilpin *Portman Ridge Finance Corporation - CFO, Secretary & Treasurer*

Patrick Schafer *Portman Ridge Finance Corporation - CIO*

CONFERENCE CALL PARTICIPANTS

Christopher Whitbread Patrick Nolan *Ladenburg Thalmann & Co. Inc., Research Division - EVP of Equity Research*

James Christopher Roumell *Roumell Asset Management, LLC - President & Portfolio Manager*

Paul Conrad Johnson *Keefe, Bruyette, & Woods, Inc., Research Division - Associate*

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Portman Ridge Finance Corporation Conference Call. An earnings press release was distributed Friday afternoon. If you did not receive a copy, the release is available on the company's website at www.portmanridge.com in the Investor Relations section. As a reminder, this conference call is being recorded today, Monday, March 9, 2020. This call is also being hosted on a live webcast, which can be accessed at our company's website at www.portmanridge.com in the Investor Relations section under Events.

Today's conference call includes forward-looking statements and projections, and we ask that you refer to the Portman Ridge most recent filings with the SEC for important factors that would cause actual results to differ materially from those projections. Portman Ridge Finance Corporation does not undertake to update its forward-looking statements unless required by law.

I would now like to introduce your host for today's conference, Mr. Ted Goldthorpe, Chief Executive Officer of Portman Ridge Finance Corporation. Mr. Goldthorpe, you may begin.

Edward Joseph Goldthorpe - *Portman Ridge Finance Corporation - Chairman, CEO & President*

Thank you, and good afternoon, and thank you for joining us for our earnings call. Today, Portman Ridge announced its fourth quarter 2019 and 2019 fiscal year financial results. 2019 was a very active year for Portman Ridge. In April, we closed the externalization transaction for KCAP. In mid-December, we received shareholder approval in completing the merger with OHA Investment Corporation. And at the end of December, we successfully completed the refinancing of our revolving credit facility, reducing borrowing costs and increasing our investment capacity for our business going forward.

We remain very excited about the integration transformation of the OHA merger. Prior to the end of the year, we monetized close to 40% of the legacy OHA investments at around NAV and have already reinvested or identified reinvestment for the bulk of those proceeds. We will continue to opportunistically rotate out of those assets as reinvestment opportunities arise. We anticipate that the incremental NII generated from OHA portfolio to pay back the transaction costs in approximately 3/4, which equates to an approximate 120% annual yield on the investment.

As required with the merger, Portman announced a stock buyback program to repurchase up to $10 million of stock over the next year through open market purchases, and we'll look to opportunistically purchase shares subject to blackout periods.

Available cash and restrictions in our existing bond indenture. Transition to the state of the markets, right now, the liquid credit markets are experiencing the most volatility that we have seen since the energy downturn in 2015 and 2016, and even -- and more so even than in December 2018, as a result of the COVID-19 headlines. Although it is too early to see an impact in our underlying portfolio companies, we are monitoring the situation closely and are in contact with companies that we perceive to have some amount of exposure.

Generally, we have a negligible exposure to the most likely to be impacted sectors such as auto, energy, leisure, hospitality, travel and airlines. As it relates to our primary market, directly originated middle-market loans, we have not seen the volatility or recent rate cuts trickle down to widening spreads, but the deal activity has picked up, given the need for certainty. However, if volatility continues and the impacts of COVID-19 become more apparent, we would anticipate widening spreads as a response. We're very cautious on underwriting new loans, given the uncertain impact of the coronavirus, both on the economy and micro factors, namely supply chains, raw material pricing and availability and end-market demand.

With that, I'll turn the call over to Ted Gilpin, our CFO, for a brief overview of the financial results for the quarter. And then Patrick Schafer, our Chief Investment Officer, for a review of our investment activity before concluding the call with some additional remarks.

Edward Udall Gilpin - *Portman Ridge Finance Corporation - CFO, Secretary & Treasurer*

Thank you, Ted. Good afternoon, everyone. There are a lot of moving parts this year at Portman, starting with the externalization in April and a merger with OHAI in December. Both transactions had effects to NII and NAV in the period. As of December 31, 2019, our NAV stood at $152.2 million or $3.40 per diluted share, down from $158 million or $4.23 per share at the end of 2018, a decline of approximately $5.8 million. The component parts of the change were as follows: An increase of approximately $25 million from the merger with OHAI, including a day 1 unrealized gain of $6.4 million, of which $2.5 million was realized in the quarter; a decrease due to realized and unrealized losses of $20.9 million, due mainly to Tank Partners and CLO equity positions; over distributions of $8 million, caused mainly by transaction expenses associated with the externalization; and the final piece being the issuance of approximately 7.4 million shares for the OHAI transaction.

Net investment income for the full year 2019 was $3.1 million, or $0.08 per share as compared to $10 million and $0.27 per share last year. Net investment income was adversely impacted in 2019 by approximately $4.8 million of nonrecurring transaction costs associated with the externalization or approximately $0.13 per share. Net investment income for the third and fourth quarter was $0.06 per share, right in line with our current quarterly distribution.

On the liability side of the balance sheet, concurrent with the merger with OHAI, Portman refinanced its revolving credit facility with a rate of LIBOR plus 325 with a new revolving credit facility with a rate of LIBOR plus 285. As of December 31, 2019, we had $77.4 million of 6 1/8% bonds due 2022. And $79.6 million of drawings under our new revolving credit facility. For an asset coverage ratio of 195%, above the statutory requirement for BDCs of 150% but below the required 200% coverage ratio of our existing 6 1/8% notes. In February of 2020, the time of our dividend declaration, the revolver had been paid down such that Portland was above the 200% required ratio.

Finally, as Ted mentioned in his opening remarks, our Board has authorized us to repurchase up to $10 million in stock over the next year, subject to market conditions and certain other limitations. The stock repurchase program will give us additional flexibility to manage our capital and drive shareholder value through accretive stock repurchases. We intend to start purchasing equity as soon as practically possible but, in the very short term, need to consider both blackout periods and the leverage covenant of our bonds.

We believe we are in a good position to earn our distribution, and we will continue to evaluate our debt structure and mix between fixed and floating rate debt.

With that, I'd like to turn the call over to Patrick Schafer, our Chief Investment Officer.

Patrick Schafer - *Portman Ridge Finance Corporation - CIO*

Thanks, Ted. Starting on Page 5 of the presentation posted on the Portman's website. During the quarter and excluding the OHAI merger, we made investments into 4 borrowers, 2 of which were existing portfolio companies and 2 of which were brand-new borrowers. In aggregate, these investments totaled $7.1 million of face value, 76% of which were first lien securities and the remaining net investment being add on to the Great Lakes joint venture. The weighted average spread on these first lien securities was 617 basis points.

Additionally, over the quarter, we proactively exited 23 positions, 11 of which were OHAI positions that had an aggregate carrying value of $24.9 million, 8 of which were legacy KCAP positions that had an aggregate carrying value of $13.8 million and the remaining 4 were BC-sourced assets that had an aggregate carrying value of $12.5 million.

In aggregate, these sales resulted in a $118,000 loss relative to the carrying value as of September 30 or December 17 in the case of the legacy OHAI assets. Of the unrealized loss in the investment portfolio during the quarter, approximately 95% of it was attributable to the legacy CLO positions. Excluding these positions, the remaining investment portfolio was essentially flat quarter-over-quarter.

With respect to the quarter as a whole, when BC Partners took over management of KCAP on April 1 of this year, the company had $165.7 million of debt securities marked at a blended price of 91.9% of par and had a stated spread to LIBOR of 658 basis points, excluding nonaccruing assets. On an equivalent basis, excluding the nonaccruing asset of OCI, which was acquired with the OHAI portfolio as of December 31, Portman Ridge has $194 million of debt securities marked at 92.9% of par and yielding a spread to LIBOR of 700 basis points on accruing debt securities.

There were 3 incremental nonaccruals during the quarter, 2 of which were Legacy OHAI nonaccruals and the other portfolio of company was -- a company that was supposed to restructure -- completed restructuring during the quarter but was delayed. Our expectation is that the restructuring will be completed by the end of March or early April, at which point, the new securities will be accruing.

Finally, moving to Slide 6. You can see the progress we have made in rotating the portfolio subsequent to the externalization in OHAI merger. KCAP legacy and noncore assets have declined by 32% during the year, and we have already reduced the legacy OHAI portfolio by 41%.

With that, I will turn the call over to Ted Goldthorpe.

Edward Joseph Goldthorpe *- Portman Ridge Finance Corporation - Chairman, CEO & President*

Thank you. As Patrick noted, we've made significant progress in the last 3 quarters of the year, and repositioning the portfolio, and we continue to feel good about the composition of the book. As we've discussed in the past, CLO equity has experienced volatility during the year and the quarter and likely will continue to do so going forward. Since March 31, the CLO equity positions have been reduced as a percentage of fair market value from 19% to under 12% of our portfolio, and we continue to look for opportunities to reduce our exposure.

During the quarter, we completed 2 transactions alongside other BC Partners entities pursuant to our co-investment order and continue to leverage the broader BC Partners platforms on transactions going forward as this capability is crucial to our ability to compete with the other major market participants.

During 2020, we will continue to work towards reducing noncore and low-yielding assets, both from the OHAI and legacy KCAP portfolios and exiting our structured credit exposure in a thoughtful manner. We believe the portfolio is trending in the right direction, and we will continue -- we look forward to continuing our repositioning work.

Additionally, we will continue to look at both traditional and nontraditional acquisition and merger candidates but consider these opportunistic and not essential to generate healthy, stable returns for shareholders.

Finally, on Slide 8, lays out graphically, the improved earnings power of the business since March 31. Through a combination of new asset origination, the OHAI merger, improving spreads on the existing portfolio and investing in our Great Lakes joint venture, we've increased yields on NAV by 166 basis points in spite of declining LIBOR headwind. As mentioned previously, we hope to see the market volatility ultimately related to higher spreads in our primary market.

Thank you for your ongoing support. And with that, we'd like to turn the call over to the operator for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Christopher Nolan with Ladenburg Thalmann.

Christopher Whitbread Patrick Nolan - *Ladenburg Thalmann & Co. Inc., Research Division - EVP of Equity Research*

Ted Goldthorpe, can you give any guidance in terms of where you think the CLO portfolio will be by the first quarter as a percentage of the total portfolio?

Edward Joseph Goldthorpe - *Portman Ridge Finance Corporation - Chairman, CEO & President*

I would say, as of now, I think it's going to be around the same level. The credit markets didn't really move. The current markets were relatively benign until the last couple of days. And you've seen big moves in leverage loan pricing. So -- but I would say, as a percentage of the total portfolio, I would expect it to probably be down a little bit, but I don't think -- as of right now, we don't see it being down materially.

Christopher Whitbread Patrick Nolan - *Ladenburg Thalmann & Co. Inc., Research Division - EVP of Equity Research*

Great. And then in your comments earlier, you mentioned a 3-quarter payback for the OHAI deal. Is that payback to NAV per share or to EPS dilution? I missed it.

Edward Joseph Goldthorpe - *Portman Ridge Finance Corporation - Chairman, CEO & President*

Yes, sorry. No, we probably -- it's probably our fault. No, when you just look at the embedded transaction costs and you overlay the embedded earnings growth or earnings contribution when you net off interest costs, it's about a 3-quarter payback. So in the fourth quarter, we obviously -- part of our NAV reduction was obviously onetime transaction costs related to the transaction, but we recouped those just through additional earnings power over the next couple of quarters.

Christopher Whitbread Patrick Nolan - *Ladenburg Thalmann & Co. Inc., Research Division - EVP of Equity Research*

Okay. And then, I guess, I applaud the share repurchase. And given current market conditions, I understand, but I know management is talking about repurchasing shares at 1x NAV over the past year at some point. Where do we stand with that? I mean totally understandable if it's going to be put on hold for a while. But...

Edward Joseph Goldthorpe - *Portman Ridge Finance Corporation - Chairman, CEO & President*

Yes. I mean there's 3 components to it. One is our incentive fees were taking at stock at NAV. So instead of us taking in cash like most managers, we're actually going to take ours in stock. So -- and our shareholders applaud us for doing that. In terms of the stock buyback, particularly when you look at where our stock is trading relative to NAV, we think it makes a lot of sense for us to buy back stock. We obviously have to wait that versus blackout periods and our leverage. But I think it's our intention to buy back some stock.

And the third part of it is, I think management continues to have a strong desire to buy back stock personally because I think it sends a great message to the shareholders and we think our stock is cheap. So I think you might also see some -- to the extent possible, you may also see some management insider buying as well.

Operator

(Operator Instructions) Your next question comes from Jim Roumell with Roumell Asset.

James Christopher Roumell - *Roumell Asset Management, LLC - President & Portfolio Manager*

Thank you, and thank you for your last comment and your commitment to the shares on behalf of both Insiders and the company itself. My question is on the dividend and maybe you covered this in your opening remarks, I was a little way coming on. But can you give a band, so to speak, of given what you see where the dividend, you've basically just earned the $0.06. If I understand you correctly, when you absorb the benefits of OHAI, can one glean from that, that's pushing off of the $0.06? And so the $0.06 is more likely go up than down versus other offsets. So where might the dividend kind of be throughout this year?

Edward Joseph Goldthorpe - *Portman Ridge Finance Corporation - Chairman, CEO & President*

Right. No, that's a great question. So we actually put a slide together that's in our supplement deck that I would point people to. It's on Page 8. But I think we've done a lot of things over the last 9 months to enhance earnings power. So coming into this year, we had a lot of tailwinds to earnings. And it's a combination of cheaper liabilities. Some of the asset origination we've done in higher spreads. And the offset to that is LIBOR has come down pretty dramatically the last couple of weeks. We do have LIBOR floors in a lot of our assets. Our liabilities -- some of our liabilities are fixed, but our floating rate liabilities don't have LIBOR floors. So we do have tailwinds just from like organically from the -- what we put into the business. But again, this LIBOR move in the last couple of weeks is going to be a headwind for all BDCs, not just ourselves.

So I think -- I mean, I think that the short answer is we feel good about our dividend. We felt really good about earnings growth pre-LIBOR moving. But with LIBOR moving down, I think it should be more than offset by the tailwinds. But again, that is a headwind that we're recently facing.

James Christopher Roumell - *Roumell Asset Management, LLC - President & Portfolio Manager*

Got it. So you're -- you think at this point, the tailwinds exceed the headwinds of LIBOR at this point?

Edward Joseph Goldthorpe - *Portman Ridge Finance Corporation - Chairman, CEO & President*

Yes.

James Christopher Roumell - *Roumell Asset Management, LLC - President & Portfolio Manager*

Okay.

Edward Joseph Goldthorpe - *Portman Ridge Finance Corporation - Chairman, CEO & President*

Yes. And again, because of LIBOR floor dynamic, if rates -- if short-term rates continue to go down, we actually do get some benefit out of it from the reasons I said before. So we're kind of at the -- LIBOR went from 2% to 1%, it hurts us earnings wise. LIBOR went from 1% to 0, which I'm not saying that's going to happen, but if it did happen, we do get some benefit from that.

James Christopher Roumell - *Roumell Asset Management, LLC - President & Portfolio Manager*

So my last question here is, what is -- can you give any color to the thinking that the commitment to the $0.06, given the -- where the balance sheet is now, might you be willing to finance the dividend for a quarter or 2 if it's not being earned to just kind of maintain it? I mean in other words, do you have sufficient liquidity on the balance sheet? Or do you want to match payout to actual earnings?

Edward Joseph Goldthorpe - *Portman Ridge Finance Corporation - Chairman, CEO & President*

I mean, again, I think the way to answer the question is we feel good about our dividends and feel good about our earnings power, particularly over the short term, but also over the long term. So I don't think there's any -- I don't think we foresee us under earn our dividend. To the extent we did, I don't think we'd make a rash decision to cut the dividend if that happened for 1 or 2 quarters. But as of now, as I said, I think we -- the intention over the course of the year is to over earn our dividend.

Operator

Your next question comes from Paul Johnson with KBW.

Paul Conrad Johnson - *Keefe, Bruyette, & Woods, Inc., Research Division - Associate*

I just wanted to ask you, I believe, and correct me if I'm wrong, you have a one-to-one covenant in your outstanding bonds. I'm just curious what your plans are for portfolio management going forward. Do you plan on kind of maintaining the portfolio where it is and using payoffs for potential debt paydown? Or do you plan on refinancing this debt in the near term? Just your thoughts around that, please.

Edward Udall Gilpin - *Portman Ridge Finance Corporation - CFO, Secretary & Treasurer*

Yes, sure. It's a good question. I mean, obviously, we still have -- while we have approval to go up to the new statutory limit of 2:1 that we still have that covenant in our old baby bonds. So obviously, market-dependent refinancing them is one option that we've been looking at, and we're prepared to do that, depending on how the markets shake out. If not, then we have flexibility within the current structure to get to a point where we can actually either refinance them or pay them down to certain -- to the extent we need to.

Operator

There are no further questions queued up at this time, I'll turn the call back over to the presenters.

Edward Joseph Goldthorpe - *Portman Ridge Finance Corporation - Chairman, CEO & President*

Great. Well, once again, we appreciate you dialing in, particularly on a stock market day like today. And if anybody has any questions, management is available to speak to any investor at any time. Thank you very much.

Operator

This concludes today's conference call. You may now disconnect.