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Conference Call  
CM Finance  
February 8, 2018

**Operator:** Welcome to today's CM Finance Earnings Release Conference Call. Your speakers for today's call are Mike Mauer, Chris Jansen and Rocco DelGuercio. Operator assistance is available at any time during this conference by pressing star (\*) 0. A question and answer session will follow the presentation. I'll now turn the call over to your speakers. Please begin.

**Michael Mauer:** Thank you, operator. Thank you all for calling in today. Joining me are Chris Jansen, my Co-Chief Investment Officer; and Rocco DelGuercio, our CFO. Before we begin, Rocco will give our customary disclaimer regarding information and forward-looking statements. Rocco?

**Rocco DelGuercio:** Thanks, Mike. I would like to remind everyone that today's call is being recorded and that this call is a property of CM Finance Inc. Any unauthorized broadcast of this call in any form is strictly prohibited. Audio replay of the call will be available by visiting our Investor Relations page on our website at [www.cmfnc-inc.com](http://www.cmfnc-inc.com).

I would also like to call your attention to the Safe Harbor disclosure and our press release regarding forward-looking information, and remind everyone that today's call may include forward-looking statements and projections. We ask that you refer to the most recent 10-Q filing for important factors that may cause actual results to differ materially from these projections. We will not update forward-looking statement unless required by law. To obtain copies of our latest SEC filings, please visit our Investor Relations page on our website. At this time, I'd like to turn the call back over to our Chairman and CEO, Michael Mauer.

**Michael Mauer:** Thank you, Rocco. As in past quarters, I will begin with our observations about the leverage finance market. Chris will then review the past quarter's investment activity, and then Rocco will walk you through our financial results. I will conclude with our outlook for the portfolio.

Our origination looks at directly sourced investment opportunities as well as opportunistically at investments that are syndicated and available in the secondary markets. The syndicated markets remain borrower-friendly. In 2017, 75% of loans tracked by LCD were covenant-light. 2017 marked a record year in the leverage loan market with over \$600 billion in issuance. Issuance eased in the fourth quarter from last year's levels. 2017 middle market issuance showed a significant increase from prior year, with activity in every quarter of 2017 exceeding the corresponding quarter of 2016.

High leverage, weak definitions and significant adjustments all contribute to an environment where the structure and documentation of loans available in the market add to the risk profile of potential investments. Directly sourced loans, including our recent investments in Zinc Oxide, Montrose Environmental, and Liberty Oilfield Services have improved our portfolio yield as well as given us investments with significant structural protections for our capital. The team's attention to loan structure, including covenants, repayment provisions and documentation is an essential part of our investment process. While many of our peers approach origination through the lens of sponsor finance, we leverage the investment team's relationships and our strategic partnerships with Cyrus and Stifel to look outward into the broader middle market.

Our pipeline is focused largely on direct lending opportunities, including sponsored companies, public companies and privately-owned businesses. The potential transactions in our pipeline are focused on secured lending opportunities for quality management teams and companies, where we can invest capital with attractive risk-return characteristics.

I'd now like to turn the call over to Chris to discuss our portfolio activity.

Christopher Jansen: Thanks, Mike. We made four investments during the quarter, two of which were to new portfolio companies and two of which were to existing portfolio companies. We also had two realizations during the quarter.

As I mentioned on our last call, we made a first lien loan and co-invested in the equity of Zinc Oxide, a producer of a key raw material used in tire manufacturing as well as chemical [Audio Gap] was approximately 12.1%.

We made an investment in the new second lien loan for ZeroChaos, a provider of workforce management solutions globally. Carlyle is the sponsor of the company. Our yield at cost was approximately 10.5%.

We also added to our position in AP Gaming as part of the incremental loan raised in December; Apollo remains a sponsor here. Our yield at cost was approximately 7.3%.

Our first realization of the quarter was Redbox, which repaid its loan in full in October. Our fully realized IRR was approximately 13.5%

Finally, PR Wireless, which does business as Open Mobile was both one of our realizations and one of our investments during the quarter. Sprint and Open Mobile completed their previously announced joint venture agreement. [Audio Gap] 14.5%. We, alongside the other prior lenders, made a new loan which yields approximately 7.1% at cost. Our new loan is fully guaranteed by Sprint. [Audio Gap]

Our portfolio company count has increased by one since September 30, from 23 to 24 today. As of December 31st, our largest industry concentration was in business services at 23.5% of the portfolio at fair value. Oil, and oil and gas services represented 19.3% of our portfolio, split as follows: 11.3% oilfield services and 8.0% E&P. Entertainment and leisure was our third largest concentration at 14.2%, followed by healthcare at 8.0%, and environmental services at 6.8%.

I'd now like to turn the call back to Rocco to discuss our financial results.

Rocco DelGuercio: Thanks, Chris. For the quarter, our net investment income was \$3.7 million or \$0.27 per share. As of December 31, the fair value of our portfolio was \$286.5 million compared to \$271.9 million at September 30. Our investment activity accounts for \$11.8 million increase in our portfolio. We also had a \$1.2 million unrealized depreciation from investments in the quarter.

As of December 30, the weighted average yield of our debt portfolio including amortization was 10.25% versus 10.67% at September 30. The major driver of the decrease in our average yield was a differential in yield between investments made

and realized during the quarter. Our new investments had an average yield of 8.9% versus a 12.5% average yield on realized investments.

As of October 1, we removed Bird from non-accrual status, leaving us with no access on non-accrual. Our debt portfolio comprised of 96% floating rate and 4% fixed rate investments. Both one- and three-month LIBOR are in excess of the applicable floors on all our loans.

Our average portfolio company investment was just under \$12 million. Our largest portfolio company, PGI, was \$25.4 million. Our second largest portfolio company, Caelus, was \$22.9 million. As of December 31, 50.1% of our portfolio was in first lien investments, 44.9% of our portfolio was in second lien investments, 0.3% was in unsecured debt and the remaining 4.7% was in equity and warrant positions. Additional information regarding the composition of our portfolio is included in our Form 10-Q which was filed yesterday.

We were 0.69 times levered as of December 31, compared to 0.75 times levered as of September 30. With respect to our liquidity, as of December 31, we had \$5.4 million in cash, \$1.7 million in restricted cash and \$32.2 million of capacity under our revolving credit facility with UBS.

With that, I'd like to turn the call back over to Mike.

Michael Mauer: Thank you, Rocco. Our marks this quarter increased by an aggregate of \$1.7 million, offset by \$500,000.00 in accretion, with five marks that changed by half a million dollars or more. These were AAR, Bird Electric, Dayton Superior, Endemol and Trident.

AAR completed its restructuring just over one year ago. Since that time, the company's results have stabilized and begun improving, especially as the price of oil has spurred additional activity in the D.J. Basin. We increased our mark on the second-out Term B loan from 65 to 75 this quarter.

Bird Electric benefited from improving fundamentals as well as significant work associated with hurricanes in 2017. We increased the mark on our preferred equity position by approximately \$1 million this quarter, and as Rocco mentioned, removed it from non-accrual status.

Dayton Superior was marked down from 94 to 88 this quarter. The company's results did not meet our expectations and leverage is higher than we'd like to see, although the prospect for significant federal infrastructure spending and operational improvements at the company give us reason for optimism.

Our mark on Endemol improved from 86 to 95 this quarter. Endemol's results continue to improve as we have marked up the position by an aggregate of 18 points over the past two quarters.

Finally, our position in Trident Health was amended and partially restructured this quarter. We now hold a position in the Tranche A second lien loan, Tranche B second lien loan and a preferred position at the holding company. When comparing our position at September 30th to December 31st, the aggregate value of our marks on Trident Health decreased from 58 to 52. Importantly, our net claim has not been reduced. We continue work constructively with our other stakeholders toward a longer-term solution for the company's debt structure.

We remain committed to paying a sustainable dividend to our shareholders. We earned in excess of our dividend in December quarter, and our run rate portfolio yield and portfolio size position us to continue to cover our current dividend rate. We are sensitive to repayment and reinvestments of capital. And in the current market environment, we recognize that unscheduled repayments and repricings may occur with little warning. That said, we are managing our pipeline with an eye toward directly sourced opportunities which are less directly tied to market conditions.

Our investment activity in the quarter grew our portfolio by \$11.8 million. Our leverage was 0.69 times as of December 31, which is slightly below our target of plus or minus 0.75 times. We are comfortable at our current leverage level and we'll strive to keep our leverage between 0.65 and 0.85 times.

We fully earned our incentive fee in the December quarter, and we expect to earn our incentive fees in the current quarter as well. Our Board of Directors declared a distribution for the quarter-ended March 31, 2018 of \$0.25 per share, which will be payable until April 5, 2018 to shareholders of record as of March 16. We believe our

dividend level is consistent with our ability to generate NII without reducing our investment quality or changing our focus from secured lending opportunities.

As pipeline and market opportunities permit, we will sell positions in lower yielding loans in favor of direct investments with more attractive yields and structures. We continue to have additional opportunities to rotate the current portfolio out of lower yielding, more liquid assets in favor of direct investments in the future.

Since this time last year, our average position size has decreased by approximately \$1 million, and our total number of portfolio company investments increased from 19 on December 31, 2016 to 24 on December 31, 2017. We have improved our diversification, lowered our risk profile, all while underwriting conservatively, focusing on quality management teams, sustainable capital structures, security packages and financial covenants for the protection and preservation of value over the long-term.

Operator, please open the line for Q&A.

Operator: Ladies and gentlemen, at this time we will conduct the question and answer session. If you would like to state a question, please press star (\*) 1 on your phone now and you'll be placed into the queue in the order received. Please press pound (#) at any time to remove yourself from the queue. Please listen for your name to be announced and be prepared to ask your question when prompted. Once again to ask a question, please press star (\*) 1 now.

Our first question comes from Chris Kotowski from Oppenheimer. Please state your question.

Chris Kotowski: Yes, good afternoon. Your press release noted the average new investment in the quarter yielded 8.9% and the total yield went down from 10.67% to 10.25%. And so I guess a question is, is that 8.9%, is that representative of what you characterized as the more liquid lower spread kind of investment or is that - do you think the yield on what you expect to self-originate?

Michael Mauer: Thank you very much for the question. So, that 8.9% is made up of several components and when you dig through the numbers, they're a little more than half a dozen and some of that is draw under revolver of AAR, AP Gaming, PR Wireless,

U.S. Well. Those are all existing names that are in I'll call it a high-6 to mid-7s range.

The two new investments that were not in the portfolio prior are Zinc Oxide or Zinc Borrower LP and ZeroChaos. Those two names were a 12.06% yield and a 10.51% yield. When you add in the incremental borrowing from the other previously held names, our average is 8.93%. So, if you look at new originated direct lending, we are still focused around the 10%-plus and those names continue to point toward that.

That having been said, there's a little over 15% of the portfolio that is in more liquid names. And there's four or five of those names and you can go through them and look at them and those are basically 7% or just shy. I think the exact number is 6.95% average yield across those names. And those have good liquidity and we would look to rotate out of some of those as more opportunistic names come in; and we talked about this last quarter and from that standpoint, that would be accretive to the overall yield on the portfolio. Hopefully that makes your question.

Chris Kotowski: Yes. And then you flagged that all the loans are through the LIBOR floors now and so I'm curious, like if we think about the December rate hike, that 25 basis point rate bump, when should we see that reflected in the interest income for the quarter? Is that a first quarter event or a second quarter event?

Christopher Jansen: Yes, Chris, it's three-month LIBOR is in the high 1% right now. So, it all depends on how LIBOR is acting and reacting to that news, but we will see that on a current basis. Because most of our loans are 1% floors and we've been above 1% for at least the last six to nine months.

Chris Kotowski: Okay.

Christopher Jansen: Even on a lagging basis. Because they'll set the LIBOR three or six months forward, so we will see that contemporaneously with the market moves and in...

Chris Kotowski: All right. Theoretically, the December bump helped for 1Q.

Christopher Jansen: Correct.

Chris Kotowski: All right, okay.

Christopher Jansen: Hundred percent.

Chris Kotowski: And then lastly, I was wondering, your term lending facility, I guess it matures December 19. When does it become time to think about what - or can you outline for us your plans for the right-hand side of the balance sheet and liability management strategies over the next year or two?

Rocco DelGuercio: Hey, Chris. It's Rocco. Actually, we extended that an extra year. When we added the revolver...

Chris Kotowski: Okay.

Rocco DelGuercio: ...we extended that out an extra year, so it's actually [\[Crosstalk\]](#).

Chris Kotowski: Oh. Okay. All right, great. Thank you. That's it for me.

Operator: Our next question comes from Paul Johnson from KBW. Please state your question.

Paul Johnson: Sorry about that. I was on mute there. First, I wanted to congratulate you real quick on a pretty good quarter. I only have one question was around U.S. Well Services. Just kind of with, obviously, the positive momentum in the energy markets in the fourth quarter with the price of oil increasing and those markets doing fairly well now, I'm just wondering what needs to happen in order for the investment in U.S. Well Services to sort of participate in that and continue to increase in value?

Chris Jansen: Yes, it's a question of potential liquefying that investment. When we run U.S. Well versus the comps, the publicly traded comps, we take a pretty sizeable discount to the valuation metrics, which are based on an LTM revenue, based on thousands of horsepower and based off the LTM EBITDA. So, if we were to put the numbers where Keane and Liberty, which did an IPO, which we didn't mention on our remarks, a couple of weeks ago trade at, the numbers will be a lot higher than that. As you know, this is a restructured loan and the majority equity holders are the lenders and we're unclear as to the timing if the company will pursue a sale or some kind of liquefying event for the equity.



Paul Johnson: I see. So, it's all in the comps.

Chris Jansen: It's all the comps and when the comps kind of go a little haywire to the good side, we don't really - we try not to reflect that or we don't - we discount that for the lack of perceived liquidity. There is some liquidity in these instruments but we're very, very comfortable where we have it marked.

Paul Johnson: Sure, thanks. Those are all my questions.

Operator: Our next question comes from Robert Dodd from Raymond James. Please state your question.

Robert Dodd: Hi, guys. A couple of semi-housekeeping questions. On the - just the total investment income in the quarter, was there anything one-time in that? Obviously, Bird came off non-accrual, etc., but even then, it seems like a pretty big jump given the portfolio size didn't change that much and the newer investments were relatively lower yield. So, was there any kind of accelerated amortization or prepay for you or anything like that embedded in the total number this quarter?

Michael Mauer: Yes, Robert. I'll take a little bit of shop but I'll let Rocco also jump in to the extent anything he wants to expand on. I'd say there were two significant components. One-time item was acceleration related to the repayment on PR Wireless. But I'd say equally, if not more important is, we look at the ongoing in our confidence in continuing to cover the dividend and earn our incentive fee is that in the prior quarter, if you remember, we had gotten, early in the quarter, several repayments and we were very diligent about trying to make sure that we went into good investments; we did not rush to redeploy. And some of the cash was literally invested in the last 48 hours of the September quarter, and then there was another investment made within the first day or two of the December quarter. So, when you think about the actual average assets invested during the quarter, they went up significantly from an NII perspective.

Robert Dodd: Right, right. So, Rocco, can you quantify roughly what the PR Wireless impact was, in the top line?

Rocco DelGuercio: Hey, Robert. It's Rocco. So that was actually PR Wireless, which is about when you factor in the acceleration of accretion, was about \$900,000.00 and we also had a pay down of - we had a repayment of Redbox, which was I believe about \$140,000.00 in accelerated accretion, so slightly over a million dollars I would think.

Robert Dodd: Got it. Got it, perfect. And then a second one, Mike, on - and this maybe I may have misheard and it may have been an oversight - in your prepared comments, you said that in this quarter, obviously you fully earned the incentive fees in this quarter. And then the second part of that, so it was expect to earn them in upcoming quarters. I noticed in the second part of that statement, it didn't say fully. Was it "fully" omitted in the second part? Because I might have just misheard it. And if it was, can you give us any color as to why you chose to omit it in the second half?

Michael Mauer: Yes, the reason omitting, if you look back I think over time, we've avoided saying the word "fully" from anticipated. But I would say we expect to earn a significant amount of that incentive fee, if not fully earn it. I'm not sure on the "fully", but significant amount, we are very comfortable with.

Robert Dodd: Fair enough. Thank you. And then my last question, if I can, buyback. When I look at deploying capital like the follow-on on PR Wireless, 7.1%. Right now, you can buy your own stock at a current yield almost double that, and at a 40-point discount on an NAV basis. Why is investing in PR Wireless - that's just one example, right - at 7% a better deal than buying your own stock?

Michael Mauer: Let me go back for a second and then I'll answer that. Part of the reason on the prior question on why you don't - where I don't, we don't say "fully" is if you look over time, our repayments come very lumpy and unpredictable. So, that, we want to caveat a little bit. Because if we get a bunch of repayments in the next two weeks that go to cash, we're not going to just make sure we reinvest it so we'd cover the dividend and we're going to do the right thing by shareholders, like we did over the summer and redeploy in a prudent manner. So that adds a little bit of uncertainty.

The second piece on the buyback is that we have had discussions over time with directors and management and everything else. And if we were over a billion

dollars in NAV, this is something that we think would make sense from a shareholder standpoint.

One of the things that we think contributes to where we trade, which gets into should you be looking at buying it back, is that we are below \$200 million NAV and we don't have a lot of liquidity. And to the extent that we'd go and do some buyback that may be accretive, we think it is not in the long-term interest of shareholders because we become less relevant; our ability to go in and help drive on some of the deals that we can today, that ability goes down; and that that is in the interest of shareholders, the long-term objective to cover our dividend, produce returns and make sure that we are relevant in what we do.

Robert Dodd: Okay. I appreciate that. Thank you.

Michael Mauer: Yes. Thank you, Robert.

Operator: Our next question comes from Greg Mason from Ares Management. Please state your question.

Troy Ward: Hi. Good afternoon, guys. This is Troy Ward with Ares. Hey, I just want to kind of follow-up a little bit on Robert's question more just, Mike, on what is the long-term strategic vision for you and CM obviously? I think you just crossed your four-year anniversary of a public company. I don't think there's any way you thought that you'd have the current equity base that you have, but that's been the reality and quite honestly, we don't see you going into a trading position where you can raise new equity. So, at what point does that low equity base that you just used as a rationalization not to buy back stock, that's just where you're going to be for the foreseeable future, if not indefinitely. What is your strategic vision for this? If you're talking about long-term shareholder value, maybe it isn't just "Keep doing what we've been doing. Let's find something that can unlock that value, which could be buybacks, which could be a strategic combination of some sort?" Would you like to comment on that?

Michael Mauer: Hi, Troy. Thanks for the question, and I do appreciate it. We constantly are looking at and discussing with some of your old colleagues and competitors, bankers, about what is it that we can do, what is it that makes our stock trade where it is and we constantly reevaluate and, you know, I think one of the key things that if we look

back over the four years, there's probably two or three different stories there, but one of the stories was people said, "Well, look at this Energy. You've got 15% plus or minus in Energy and that's a real problem." I think that we've proven over the last two years ability to manage it, that it's good return, and we continue to be focused around making sure that's right-sized and that we have upside from where it is today.

But we also believe that part of it over the last three or four months is because we didn't redeploy cash really quick in the September quarter, the market and some of the analysts said, "Oh, you didn't cover your dividend this quarter, you're not going to cover it going forward," and we more than covered it and we expect to continue to cover it.

So, part of it is getting through some of the current uncertainties and stability around portfolio and expectations from the analysts; and when we look at size and we can point to people like Alcentra and others who have done secondaries who were our size from an NAV over the last two, three years, that in a market that - unless what we're accepting here and I do not accept it - that the BDC asset class is going to trade at 90% of NAV as a class except for a handful of people, that if we do what we're supposed to be doing and we continue to make traction like we did with Montrose on sourcing interesting opportunities out of our Stifel network and some of our other networks, that when the market is trading the asset class at an NAV to NAV premium, that we will be within a band that makes sense.

That having been said, we continue to listen to anything that anyone wants to say, including all of you as far as suggestions. We are not stuck in one view.

Troy Ward: Great. Thanks for that commentary, Mike.

Michael Mauer: Thank you.

Operator: Once again if you would like to ask a question, please press star (\*) 1 on your telephone keypad now. At this time, there are no further questions.

Michael Mauer: Operator, I just want to thank everyone who dialed-in today and thank everyone for joining us and we look forward to talking next quarter. Thank you.

Operator: This concludes today's conference call. Thank you for attending.

- End of Recording -