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Earnings Call
CM Finance Fiscal Fourth Quarter Earnings Release
September 9, 2014 at 4:30 PM ET

Operator: Welcome to the CM Finance Fiscal Fourth Quarter Earnings Release Conference Call. Your hosts for today's call are Mike Mauer and Jai Agarwal. An operator is available anytime during this conference by pressing *0. A question and answer session will follow the presentation. I would like to now turn the call over to your speakers. Please begin.

Mike Mauer: Thank you, operator. This is Mike Mauer. Good afternoon everyone. I'd like to thank you all for joining us. Before I begin my remarks, I'd like to first thank Anthony Scire who's here with us today, formerly our interim CFO, and introduce Jai Agarwal, our new CFO, and ask him to discuss some general information and a discussion about forward-looking statements. Jai?

Jai Agarwal: I'd like to remind everyone that today's call is being recorded. Please note that this call is a property of CM Finance Inc. and that any unauthorized broadcast of this call in any form is strictly prohibited. Audio replay of the call will be available by using the telephone numbers provided in a press release announcing this call. 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 may also include forward-looking statements and projection. We ask that you refer to our most recent filing with the SEC for important factors that could cause actual results to differ materially from these projections. We will not update our forward-looking statements unless required by law. To obtain copies of our latest SEC filing, please visit our website at www.cmfnc-inc.com. At this time, I'd like to turn the call back to our Chairman and CEO, Mike Mauer.

Mike Mauer: Thank you, Jai. Market conditions remained challenging as we concluded our fiscal year, both in the middle-market where we focus and in the broader syndicated market. Trends we observed last quarter have persisted through the spring and into

the summer - high leverage multiples, issuer-friendly structures and tight pricing were pervasive in the broader credit markets which had a definite effect on financing conditions in the middle and lower middle-markets.

We have remained extremely selective in our new investments and have opportunistically invested in a mix of syndicated and club middle market transactions. All of our new [debt](#) investments in 2014 have been either first or second lien loans. Despite continued pressure on yields and terms in the syndicated markets, from time to time we have seen opportunities there. The majority of our focus however is in the true middle market which is less sensitive to the technical pressures of the inflows and outflows from the high yield and loan mutual funds.

Last quarter, we mentioned that we thought some of the pressure on the middle-market from larger leveraged finance was [abating](#). That has certainly played out in opportunities we have seen and there has been strong correlation between borrower-friendly terms and more liquid credits. Our focus continues to be on sourcing less liquid, high quality investment opportunities and gradually transitioning our portfolio away from more volatile, liquid names toward what we think are more compelling risk/reward dynamics in the middle market.

In the first six months, calendar six months for 2014, we made 16 investments including nine new portfolio companies. Seven of those investments were in the past quarter including six new portfolio companies. We have 24 companies in our portfolio as of our fiscal year-end with a total fair value of approximately \$273 million. We grew the portfolio by over \$46 million in the quarter at the high end of the goal we set for ourselves.

As I mentioned on our call in May, our pipeline has been quite robust and we're pleased with the rate at which we're converting these opportunities into investments. We closed on loans to six new portfolio companies in the quarter as well as a seventh loan via the refinancing of Bennu. All of our new investments were in senior secured loans - four are first-lien loans and three are second-lien loans. Although I'd like to note that two of our second-lien loans have no first-lien debt drawn ahead of those tranches that we have invested in.

The average yield on debt investments in the quarter was 11.03% in line with our target yield for the portfolio more broadly. During the quarter, our investment in

ICA repaid in full. This loan was a short-term financing for a large public Mexican infrastructure and construction company. It was unsecured and a non-qualifying asset. So this repayment improves our ratios on both those measures. Our unleveraged, realized IRR on ICA was 14.6%.

Last quarter, we discussed our position in Endeavor. As of August 27th, we sold our last remaining position in the loans. Endeavor's fundamental performance was not in line with our expectations. We're pleased to be able to realize a gain on this position in spite of that fact. Our unlevered IRR including the re-financing earlier this year on Endeavor was 12.3%.

Aside from Endeavor, we also sought two repayments in full since our fiscal year-end ended June 30th. In two of our smaller positions, MF Global and Active Media, our IRR on MF GLOBAL was 14.3% and our IRR on Active Media was 13.8%. We're very pleased with the result of these investments.

We continue to actively manage our portfolio. In light of the strength in the syndicated loan market, we've reduced several positions where we feel the risk/reward trade is out of balance. Endeavor was obviously one of those situations. We've maintained ourselves somewhat defensive, focusing on making senior secured investments with strong collateral coverage, lower leverage multiples and better covenants. We've improved our average yield in the portfolio from 10.17% as of March 31 to 10.44% as of June 30 and today, it stands at 10.61%. Even as we've grown the portfolio from \$227 in March 31 to \$260 million today, you will note some decrease from June 30 to today, which is a result of the realized investments I discussed earlier.

Our progress towards our 11% target yield won't always be linear, but we're very pleased with the direction headed to date. During our fourth quarter, we also positioned the portfolio towards a more secured mix of investments. On March 31, we had 36% first-lien, 46% second-lien, 11% senior secured and 6.5% unsecured notes. At June 30th, we improved that mix to 41% first-lien, 49% second-lien, 9.5% secured notes and zero unsecured notes. We are very pleased to be able to take a more secured position in the portfolio and at the same time, improving our average yield.

There are a number of opportunities in our pipeline today. All yields north of 10%. Some into the low-teens. All are secured and all our investments, we anticipate having a significant influence over the final structure and documentation. We have three deals in our pipeline approximating \$30 million to \$50 million in aggregate that we expect to close either later this month or early October. All the deals we're working on currently are first or second-lien.

As you all know, timing on deals can slip, but we feel good about the opportunities here whether they close and fund in this first fiscal quarter or early in the second quarter. We made great strides since our IPO in February and we hope you're as excited as we are as we enter our new fiscal year.

I'd also like to discuss our portfolio leverage. Over time, we continue to target a 0.6 or 0.7 times leverage. In March 31, we were 0.34 times leverage. At June 30, it's 0.38 times leverage. We're in ongoing discussions with our current leverage provider about extending and upsizing the facilities. We're also in discussion with other providers. As the portfolio grows overtime, having adequate lines available to us will be key to maintaining our target leverage. During the quarter, we earned approximately \$313,000 in base management fees. In our first fiscal quarter ending September 30, based upon our pipeline in the portfolio today, we expect to earn a significant portion of our base management fee. On a run rate basis, we are expecting to fully earn our base management fee in the second fiscal quarter and begin partially earning our incentive fee during that quarter. Additionally, we continue to work with outside counsels, Sutherland, on our application for the SBIC license.

Finally, our Board has declared a dividend of 33.75 cents per share which will be payable on October 1 to shareholders of record as of September 18. With that, I'd like to turn the call back to Jai to review our results for the final three months of our fiscal year ended June 30. Jai?

Jai Agarwal:

Thanks, Mike. Our investment portfolio totaled \$273 million on a fair value basis as of June 30. Our net investment income for the quarter of \$4.6 million or 34 cents per share. As of June 30, our portfolio included approximately 48% first-lien debt, 51% second-lien debt, both including the senior secured notes as well as 1% [\[involved\]](#). The weighted average yield on our portfolio was 10.44%. Our debt portfolio was comprised of 89% floating rate and 11% fixed rate investment. Our

average portfolio company investment was approximately 11 million, and our largest portfolio company investment was approximately 20 million.

Additional information regarding the composition of our portfolio is included in our Form 10-K filed yesterday. With respect to liquidity as June 30, we have \$9.1 million borrowed under our \$50-million revolving credit facility. As of the close of business yesterday, we have 20 million outstanding under the facility leaving us with 30 million of availability to fund new investments as well as a cash balance of \$88 million. With that, I'll turn the call back over to Mike.

Mike Mauer: Thank you, Jai. In conclusion, I'd like to reiterate our goals. We continue to target portfolio growth of \$25 to \$50 million per quarter which we believe we'll hit on average. For the next few quarters, we're targeting an 11% unlevered yield on our portfolio of debt investments. To help us generate the growing dividends for our shareholders, we continue to take a disciplined approach to underwriting, lending in to sound capital structures for strong underlying companies with appropriate structural protection for our and your capital. Prudent underwriting is a paramount importance to us here at CM Finance. With that, operator, please open the line for Q&A.

Operator: Thank you. As of this time, we will take questions. If you would like to ask a question, please press *1 on your phone now and you'll be placed in a queue in the order received or press # 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, if you would like to ask a question, please press *1 on your phone now.

The first question comes from Robert Dodd from Raymond James. Please go ahead, Robert.

Robert: Hi, guys. Congratulations. Just kind of extending that point you made, [\[Unintelligible\]](#). On the attachment points that you're seeing on these deals, are you seeing any material shifts when we look at some of the [\[S&P data\]](#), which obviously are higher-end of the market; some of the larger deals that's spoken and done; that very, very high multiples and given obviously you're going to - first things separately, but can you give us any more color on where you stand from that perspective in terms of the deals that you're finding attractive at this point.

Mike Mauer: Yes, Robert. I'm going to talk anecdotally because I did not [\[give\]](#) the latest investment, but in the broader syndicated market, those multiples continue to be elevated. I have not seen that abating at the margin depending on the industry. We've actually them seen them go up. We've not participated broadly in those. In the middle-market, the attachment point has been maintained if anything, we've come down on one or two. One or two might be up a little bit but the pipeline continues to be second-lien, generally speaking, have been attachment points; sub-4, not sub-3 but sub-4. The first liens really have not - where it's more of a first-lien [\[unit for us\]](#). They've not gone over three to four times in total. Some are sub-3. They've got a two and a one.

Robert: Perfect. Thank you.

Mike Mauer: Thank you, Robert. We appreciate it. Operator?

Operator: As a reminder, if you like to ask a question, please press *1 on your phone now. The next question comes from Merrill Ross from Wunderlich Securities. Please go ahead.

Merrill Ross: Thank you. Would you explain your investment in PR Wireless? I think that a - as a [\[Unintelligible\]](#) Open Mobile telephone. It looks like you bought into it at a discount to private and also [\[Unintelligible\]](#).

Mike Mauer: Yes.

Merrill Ross: Currently, it was downgraded by Moody's so just put that in context first.

Mike Mauer: Sure. Open Mobile is, I believe they are the fourth largest wireless operator in Puerto Rico. They've got a long history. We looked at the transactions initially probably about six to eight months ago. We have done the transaction at that point. Again, it was around underwriting and not return standards at that point. There were two things that we're waiting to get more data on. One has started to play out and that was whether or not they had [\[hidden trust\]](#) as far as their earnings in subscribers, insurance, and everything else. We are more comfortable with that as we got later in the year and probably the most critical thing was they had an outstanding - a contract with Verizon that was rolling off and was up for renewal and it had not been renewed. As of the recent [\[Unintelligible\]](#) - one of the

critical things - it was at that [\[GCF\]](#) renewed. So that contract is in place and that gave us comfort in their market. They have a key player. There's a couple of key players that do not have captive ownership in Puerto Rico. One of those is Verizon. There's another one, which is the largest mobile operators in the world, so it continues to be more [\[appetite\]](#) at least in our assessment. Then from a risk/return standpoint, sitting there with a yield of approximately 12.8% on it in [\[warrant\]](#) seems to be a compelling play.

Merrill Ross: Thank you. That's interesting.

Mike Mauer: Just as a reminder, that is a first-lien investment.

Operator: Our next question comes from Allison Taylor from Oppenheimer. Please go ahead, Allison.

Allison Taylor: Hi, guys. Thanks. I actually missed, and I apologize for this, the new investments that you had put on since quarter-end.

Mike Mauer: So since quarter-end, I think you're saying since June 30th?

Allison Taylor: Yes, exactly. So I guess it's this one, yes.

Mike Mauer: We had one new investment. It is Endemol. It is an 11.55% yield. The fair value of that is 13.8 million.

Allison Taylor: Okay, thank you.

Mike Mauer: That would fall into a nice return but also one that we think will have a fair liquidity over time. It will be a non-qualifying [\[from a basket\]](#).

Allison Taylor: Okay, all right. Thanks so much. So far, it sounds like from June 30 to current, asset gross is not - because you had several repayments and then one sale. So, you're not quite yet in positive and effortless territory?

Mike Mauer: Exactly, and that would be, I mentioned earlier \$260 million being the portfolio as of today versus \$273 million at quarter-end.

Allison Taylor: Got it. Thanks so much. I appreciate it.

Mike Mauer: Got it.

Operator: As a reminder, if you like to ask a question, please press *1 on your phone now.
[Pause] At this time, it appears there to be no further questions.

Mike Mauer: Well, operator, I'd like to thank you for hosting this and I'd like to thank everyone for dialing in. We appreciate everyone's time and we look forward to moving forward. Thank you.

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

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