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FSFR - Q2 2017 Fifth Street Senior Floating Rate Corp Earnings Call

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## CORPORATE PARTICIPANTS

**Bernard D. Berman** *Fifth Street Capital LLC - Co-President*

**Robyn E. Friedman** *Fifth Street Senior Floating Rate Corp. - Head of IR and SVP*

**Steven M. Noreika** *Fifth Street Senior Floating Rate Corp. - CFO*

## PRESENTATION

### Operator

Good day, ladies and gentlemen, and welcome to the Fifth Street Senior Floating Rate Corp. Second Quarter 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. I would like to introduce your host for today's conference, Robyn Friedman, Head of Investor Relations. Ma'am, you may begin.

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**Robyn E. Friedman** - *Fifth Street Senior Floating Rate Corp. - Head of IR and SVP*

Thank you, Terrence. Good morning, and welcome to Fifth Street Senior Floating Rate Corp.'s Second Quarter 2017 Earnings Call. I am joined this morning by Bernard Berman, Chairman and Chief Executive Officer; Steve Noreika, Chief Financial Officer; and Brian Walter, Head of Institutional Products.

Replay information for this call is included in our May 10, 2017 press release, and it's posted on the Investor Relations section of Fifth Street Senior Floating Rate Corp.'s website, which can be found at [fsfr.fifthstreetfinance.com](http://fsfr.fifthstreetfinance.com). Please note that this call is the property of Fifth Street Senior Floating Rate Corp. Any unauthorized rebroadcast of this call in any form is strictly prohibited.

Today's conference call may include forward-looking statements and projections that reflect the company's current views with respect to, among other things, future events and financial performance. Forward-looking statements may include statements as to the future operating results, dividends and business prospects of Fifth Street Senior Floating Rate Corp. Words such as believes, expects, seeks, plans, should, will, estimates, projects, anticipates, intends and future or similar expressions are intended to identify forward-looking statements, although not all forward-looking statements include these words. These forward-looking statements are subject to the inherent risks and uncertainties in predicting future results and conditions.

Certain factors could cause actual results to differ materially from those projected or implied in these forward-looking statements. New risks and uncertainties arise, over time, and it is not possible for the company to project those events or how they may affect it. Therefore, you should not place undue reliance on these forward-looking statements. We ask that you refer to our most recent filings with the SEC for important factors that could cause actual results to differ materially from these forward-looking statements and projections.

To obtain copies of our latest SEC filings, please visit our website or call Investor Relations at (203) 681-3720. FSFR undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. The format for today's call is as follows: Bernie will provide an overview of our results and Steve will summarize the financials. I will now turn the call over to Bernie.

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**Bernard D. Berman** - *Fifth Street Capital LLC - Co-President*

Thank you, Robyn. Before turning to our quarterly results, I would like to briefly discuss the leadership transition that occurred last month. On April 5, 2017, I was appointed as CEO of FSFR, following the resignation of Patrick Dalton. As you may know, I've been a partner as Fifth Street's external adviser for over 12 years and have served as Chairman of FSFR's Board of Directors since 2014. The leadership transition has been a smooth one, and I am excited to lead FSFR as it continues to execute on its strategy to enhance shareholder value. For the quarter ended March 31, 2017, FSFR generated \$0.17 of net investment income per share, slightly below our quarterly dividend of \$0.19 per share. Net investment income per share



## MAY 11, 2017 / 2:00PM, FSFR - Q2 2017 Fifth Street Senior Floating Rate Corp Earnings Call

was impacted by a one-time interest charge of \$400,000 related to the downsizing of our Citibank credit facility, as well as lower revenue due to the timing of our investment activity. Despite the one-time interest charge in this quarter related to downsizing the Citibank facility, we anticipate that we will save approximately \$500,000 annually in unused fees through the reinvestment period.

On a positive note, the March quarter was marked by credit stability and an increase in leverage back within our target range.

Turning to our portfolio. FSFR continues to maintain a diverse portfolio of senior secured floating rate loans. As of March 31, 2017, our portfolio consisted of senior secured floating rate loans, spread across 61 companies in 22 industries, with our largest investment, excluding our investment in our joint venture, accounting for 4.6% of total assets.

As we outlined on prior calls, we have been working diligently to exit, restructure or improve underlying business performance at our stressed investments and maximize recoveries for our shareholders. To that end, during the March quarter, we exited our legacy investment in answers.com, a credit that had been a nonaccrual, although we subsequently committed to and retain a small portion of this facility that is on accrual status. At this time, we have only one investment on PIK non-accrual, which represents 1.6% of total debt investments at fair value or 2.7% at cost. Net asset value was relatively stable quarter-over-quarter, decreasing \$0.03 from the prior quarter to \$10.83. NAV was primarily impacted by under-earning our dividend by \$0.02 and was characterized by stable credit performance in our portfolio of companies.

Turning to the broader middle market. We believe this environment continues to be challenging, despite a rebound in volumes from the fourth quarter. An increase in demand from new market entrants and private credit funds has led to an increase in refinancings, which has resulted in significant spread tightening. As a result of this environment, we have selectively invested in credits that meet our risk-adjusted return parameters, closing \$83 million of investments during the March quarter.

Another broader theme in the middle market has been the continued increase in LIBOR. With 100% of FSFR's debt portfolio in floating rate loans, we believe our portfolio is well positioned to benefit in a rising interest rate environment. As of March 31, 80% of the total debt portfolio had a LIBOR floor of 1%. Since 3-month LIBOR is currently at around 1.18%, LIBOR floors of 1% have been exceeded, and going forward, FSFR should experience improving net interest margins, which should result in a benefit to earnings. This benefit should increase as 3-month LIBOR continues to rise, since over 50% of our capital structure is comprised of equity.

Turning to our balance sheet. We are pleased to have increased the utilization of our liabilities and operated within our target range of 0.8 to 0.9x debt-to-equity, ending the quarter at 0.87 leverage. As a reminder, in February, our Board of Directors declared a \$0.19 dividend at the June quarter, payable on June 30, 2017, to shareholders of record on June 15, 2017.

I will now turn the call over to our CFO, Steve Noreika, to discuss our financial results for the quarter in greater detail.

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**Steven M. Noreika** - *Fifth Street Senior Floating Rate Corp. - CFO*

Thank you, Bernie. We ended the second fiscal quarter of 2017 with total assets of \$612.9 million as compared to \$590.2 million at December 31, 2016. Portfolio investments totaled \$545.9 million at fair value and were spread across 61 companies at March 31, 2017. At the end of the March quarter, we had \$48.1 million of cash and cash equivalents, including restricted cash on our balance sheet. Net asset value per share was \$10.83 as compared to \$10.86 at the end of the December quarter. For the 3 months ended March 31, 2017, we generated total investment income of \$11 million and net investment income of \$5.1 million or \$0.17 per share. During the second quarter of 2017, we closed \$82.8 million of investments in 9 new and 2 existing portfolio companies and funded \$77.6 million across new and existing portfolio companies. We also received \$48.4 million in connection with full repayments and exits of 7 of our investments and an additional \$24 million in connection with other paydowns and sales of investments.

As of March 31, 2017, 87.6% of the portfolio consisted of senior secured floating rate loans, 11.3% of the portfolio consisted of investments in the subordinated notes and equity interests in FSFR Glick JV and 1.1% consisted of equity investments in other portfolio companies. At March 31, the average size of a portfolio debt investment was \$8.6 million and average portfolio company EBITDA was \$66.3 million. Only one portfolio company was on PIK non-accrual status, representing 1.6% of total debt investments at fair value or 2.7% at cost. FSFR's senior secured loan joint venture

## MAY 11, 2017 / 2:00PM, FSFR - Q2 2017 Fifth Street Senior Floating Rate Corp Earnings Call

with the Glick family had \$147.4 million in assets, including senior secured loans across 27 portfolio companies as of March 31. The joint venture generated \$1.4 million of income during the quarter for FSFR. The weighted average yield on our debt investments, including the return on the JV, was 8.4% as of March 31, 2017, and included a cash component of 8.1%. We ended the second fiscal quarter of 2017 at 0.87x debt-to-equity within our targeted range of 0.8 to 0.9x. As of March 31, we have \$177.6 million of notes payable outstanding relating to our securitization and \$97.8 million drawn on our Citibank and East West Bank credit facilities. I will now turn it back over to Robyn.

**Robyn E. Friedman** - *Fifth Street Senior Floating Rate Corp. - Head of IR and SVP*

Thank you for joining us on today's call. Terrence, please open the lines for questions.

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) And at this time, I'm showing no questions. I would like to turn the call back to management for any closing remarks.

**Bernard D. Berman** - *Fifth Street Capital LLC - Co-President*

Thank you for listening. We look forward to giving you further updates.

### Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. You may now disconnect. Everyone, have a great day.

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