

CHICAGO--( [BUSINESS WIRE](#) )--Fitch Ratings has affirmed the long-term Issuer Default Rating (IDR) and secured debt rating of Apollo Investment Corporation (Apollo) at 'BBB'. Fitch has upgraded the senior unsecured debt rating to 'BBB' from 'BBB-'. The Rating Outlook is Stable. These actions are being taken in conjunction with a broader industry review, which includes seven business development companies (BDCs), and coincides with the publication of an industry report titled 'Business Development Companies - A Comparative Analysis: 2014', which is available on Fitch's website.

### KEY RATING DRIVERS

The upgrade of Apollo's senior unsecured debt rating reflects the decline of secured debt in the capital structure, which Fitch believes increases the amount of assets available for unsecured debt holders and improves the company's funding flexibility. At Dec. 31, 2013, unsecured debt accounted for 39.6% of total debt, compared to an average of 28.6% for the BDC peer group.

The affirmations of Apollo's IDR and secured debt rating reflect Apollo's low leverage, improving asset quality, demonstrated access to capital markets, improvements in core operating performance, maintenance of strong dividend coverage, and solid access to deal flow and investment resources of the asset manager, Apollo Investment Management, L.P. (AIM), an affiliate of Apollo Global Management, LLC (AGM).

Rating constraints include Apollo's more recent strategy shift into the senior secured middle-market space, which does not yet have performance history through a full credit cycle, the capital markets impact on leverage, given the need to fair value the portfolio each quarter, dependence on the capital markets to fund portfolio growth, and a limited ability to retain capital due to dividend distribution requirements.

An additional constraint is Apollo's investment concentration in portfolio company Merx Aviation Finance Holdings (Merx), an aircraft lessor, which represented approximately 6.9% of total assets at December 31, 2013. Although Fitch believes Merx has the potential to produce attractive risk-adjusted returns, it will depend on the company's ability to prudently deploy capital in a highly competitive market. Several BDC peers have similar investment concentrations in asset-backed lenders, albeit with exposure to more diverse

## Fitch Affirms Apollo Investment Corp.'s IDR at 'BBB'; Outlook Stable

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portfolios of loans. Fitch would like to observe the performance of Merx over a longer period of time to assess management's selectivity in the space.

Operating performance improved in the nine months ended Dec. 31, 2013, relative to the same period a year earlier, as an increase in investment income offset higher expenses. Interest income increased 13.5%, as a 50 basis point (bp) decline in the debt yield was offset by a larger investment portfolio. Dividend income increased 85.6%, due to Apollo's investment in structured products as well as a special dividend from portfolio companies, Booz Allen and Ranpak Corp. The total investment income yield on the debt portfolio was 11.4%.

Asset quality has been steadily improving. Non-accrual investments amounted to 0.4% of the portfolio at fair value and 1.1% at cost at Dec. 31, 2013, a slight increase from 0.3% at fair value, and a decrease from 3.2% at cost a year earlier. Fitch expects asset quality to improve further as Apollo focuses on investing in senior secured debt. Investments originated since its new strategy implementation in 2012 account for approximately 70% of the total portfolio.

At Dec. 31, 2013, leverage, as measured by debt to equity, was 0.66x; within management's long-term targeted range, and up slightly from 0.63x a year earlier. Fitch expects leverage to remain within the targeted range, and near the current level as revolver drawings from increased origination activity is offset by opportunistic equity offerings and repayments during the year.

Apollo's liquidity profile remains solid with \$12.6 million on-balance-sheet cash and \$759 million of availability on its secured revolving credit facility, subject to borrowing base requirements, at Dec. 31, 2013. Additionally, cash flows from investment repayments and exits have been significant, amounting to \$1.6 billion during the nine months ended Dec. 31, 2013, compared to \$1.1 billion in the same period a year earlier.

Fitch believes net investment income coverage of the dividend is strong, amounting to 106% during the nine months ended Dec. 31, 2013, compared to 101.2% in the same period a year earlier, adjusted for management and performance-based incentive fee waivers and expense reimbursements, as a result of stronger investment income generation. Fitch views positively the improvement in net investment income coverage of current-period dividend declarations.

The Stable Outlook reflects Fitch's expectations for modest improvements in operating performance in 2014, the maintenance of strong liquidity, and sustained dividend coverage from net investment income.

That said, Fitch sees a number of emerging industry challenges that could pressure ratings, or at least increase rating differentiation amongst BDCs over a longer-term horizon. These challenges include a potential increase in regulatory leverage limits and increased competition, which are yielding tighter market spreads and looser underwriting terms, including higher underlying portfolio company leverage and weaker covenant packages. Should competition continue to intensify, market yields could decline further, which would reduce earnings generation and pressure dividend coverage for the space.

### RATING SENSITIVITIES

Although positive rating momentum is not likely in the near term, positive rating action could be influenced by consistent operating performance through market cycles, further improvements in asset quality, stable cash earnings coverage of the dividend, and a larger unsecured funding component. In addition, a longer track record of Apollo's successful execution of its strategy shift into senior secured middle-market loans through a credit cycle would be viewed positively by Fitch.

Negative rating action could be driven by an increase in leverage above the targeted range, resulting from material unrealized depreciation, and/or an increase in the proportion of equity holdings without a commensurate decline in leverage. Additionally, increased portfolio concentrations of non-diversified portfolio companies, declines in operating performance, a prolonged increase in non-accrual levels or weaker dividend coverage would also be viewed unfavorably from a ratings perspective.

Headquartered in New York, NY, Apollo is an externally managed business development company formed in 2004 with an objective to generate both current income and capital appreciation through debt and equity investments. As of Dec. 31, 2013, the company had investments in 101 portfolio companies amounting to approximately \$3.2 billion at fair value.

Fitch has upgraded the following ratings:

--Unsecured debt to 'BBB' from 'BBB-'.

Fitch has affirmed the following ratings:

--Long-term IDR at 'BBB';

--Secured debt at 'BBB'.

The Rating Outlook is Stable.

Additional information is available at '[www.fitchratings.com](http://www.fitchratings.com)'

Applicable Criteria and Related Research:

-- 'Global Financial Institutions Criteria' (January 2014);

-- 'Investment Manager and Alternative Funds Criteria' (December 2013).

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Global Financial Institutions Rating Criteria

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=732397](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=732397)

Investment Manager and Alternative Funds Criteria

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Additional Disclosure

Solicitation Status

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