EDISON

CVC Credit Partners European Opps

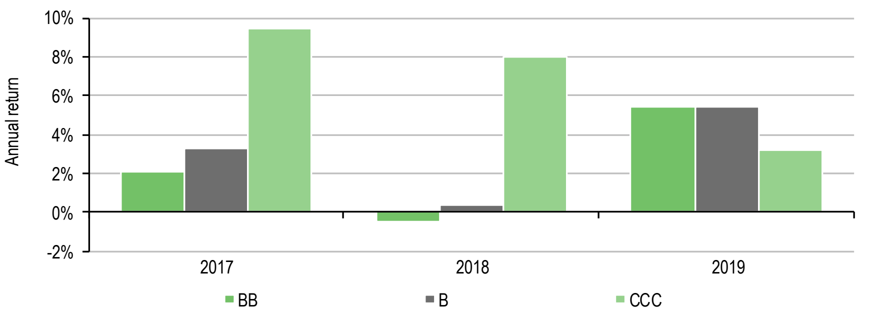
Restructurings starting to bear fruit

Investment companies
Debt: Loans and bonds

10 March 2020

CVC Credit Partners European Opportunities (CCPEOL) achieved an NAV return of 3.1% in sterling and 1.6% in euro terms in FY19. The investment vehicle through which CCPEOL invests achieved a gross return of 2.9% (in euro terms), behind its target of 8–10% per year. This was largely due to several restructuring processes within the credit opportunities pool taking longer than expected. However, these have shown good progress recently and, together with prospective new credit investment opportunities, now offer further upside potential for 2020. Meanwhile, the performing credit holdings delivered solid returns as the investment manager was able to profit from the recent 'flight to quality' in credit markets.

The flight to quality in 2019



Source: Credit Suisse Western European Leveraged Loan Index, Edison Investment Research

The market opportunity

CCPEOL offers investors daily traded exposure to a diversified portfolio of sub-investment grade debt, with facilities providing liquidity to investors and a buyback strategy limiting the discount to NAV. The portfolio is split into two pools: performing credit and credit opportunities. Whereas in the latter pool CCPEOL was focused on turnaround processes in existing investments in 2019, the investment manager is likely to source new stressed assets in 2020 to leverage its restructuring expertise. At the same time, it offers exposure to high-quality and highly liquid investments in the performing credit part of the portfolio.

Why consider investing in CCPEOL?

- Investment manager has 15 years' experience.
- Debt specialist with relatively un-constrained mandate, able to invest in situations where technicals diverge from fundamentals.
- Current depressed valuations in credit opportunities allow the investment manager (CVC European Credit Opportunities, CEC) to invest at an above-average YTM.

Valuation: Higher discount enhances yield to 5.7%

On average, both CCPEOL share classes have traded close to NAV since the fund was launched in June 2013. This is due to share conversion facilities, active trading in treasury shares and the quarterly tender facility. Recent market downturn due to coronavirus outbreak has brought the discount to a record-high 10.1% (including income).

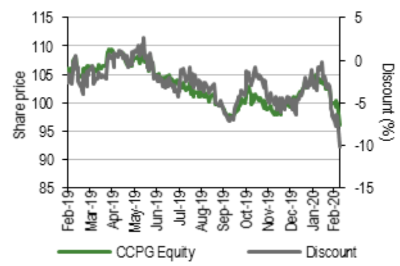
Price	**96.2p/€0.94**
Market cap	**£239.1m**
	€122.1m
AUM	**£263.9m**
	€130.7m

NAV*	105.65p
Discount to NAV	8.9%
NAV**	100.38c
Discount to NAV	6.4%

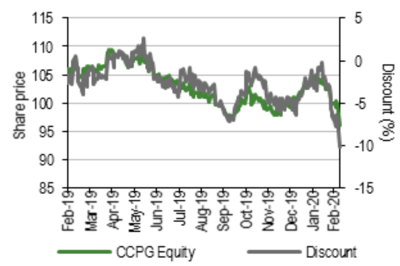
*CCPG. **CCPE. Excluding income. At 21 February 2020.

Yield	5.7/5.9%
Ordinary shares in issue	248.9m/129.8m
Code	CCPG/CCPE
Primary exchange	LSE
AIC sector	Debt – Loans and Bonds

Share price/discount performance



Three-year performance vs index



52-week high/low	109.5p/€1.06	96.2p/€0.94
NAV* high/low	109.1p/€1.05	103.3p/€0.98

*Including income.

Gearing

Gross*	0.0%
Net*	0.0%

*At CCPEOL level.

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Edison profile page

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Exhibit 1: Company at a glance

Investment objective and fund background

CVC Credit Partners European Opportunities (CCPEOL) is a closed-end investment company, domiciled in Jersey and listed in London. It invests through a Luxembourg vehicle, CVC European Credit Opportunities (CEC), aiming to provide investors with regular income and capital appreciation from a diversified portfolio of predominantly sub-investment grade debt instruments. The portfolio is split into two pools: performing credit and credit opportunities. CCPEOL has two classes of share: sterling shares (CCPG) and euro shares (CCPE) traded on LSE.

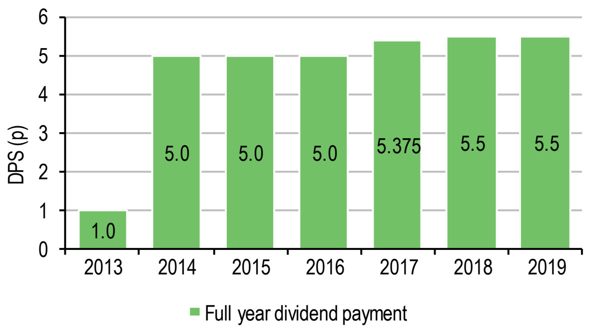
Recent developments

- 19 February 2020: no requests for conversion of shares in March.
- 27 January 2020: interim dividend declared at 1.375p/€0.01375 per share, ex-dividend date of 6 February 2020.
- 15 November 2019: 81,693,230 CCPG and 2,455,926 CCPE shares tendered for December quarterly tender process crossing 24.99% threshold, 76,796,296 CCPG shares accepted.
- 25 October 2019: scrip dividend facility suspended.
- 27 September 2019: half year report publication: NAV return at 1.43% (CCPE) and 2.13% (CCPG).

Forthcoming		Capital structure		Fund details	
AGM	April 2020	Ongoing charges	1.07% (FY18)	Group	CVC Credit Partners
Interim results	March 2020	Net gearing	Zero at CCPEOL level	Manager	Team-managed
Year end	31 December	Annual mgmt fee	1.0% at underlying fund level	Address	111 Strand,
Dividend paid	Quarterly (since FY16)	Performance fee	See page 6		London, WC2R 0AG
Launch date	25 June 2013	Company life	Indefinite	Phone	+44 (0) 20 7420 4200
Continuation vote	See page 6	Loan facilities	None at CCPEOL level	Website	www.ccpeol.com

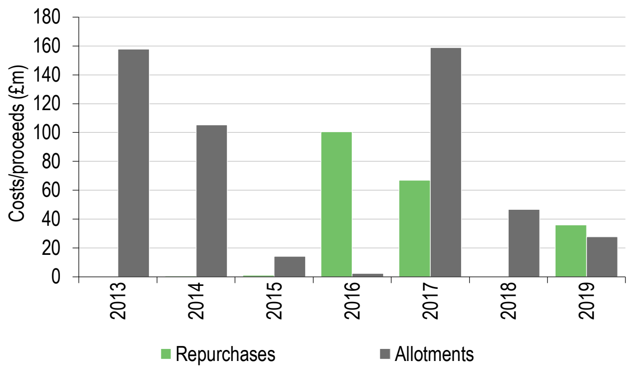
Dividend policy and history (financial years)

In Q217, CCPEOL raised its full-year dividend target to 5.5p/€0.055 per share, which had been 5.0p/€0.05 per share since its first full financial year. Dividends have been paid quarterly since H216, in May, August, November and February. Previously dividends were paid in two instalments. FY16 was a transitional period, when three dividends were paid.

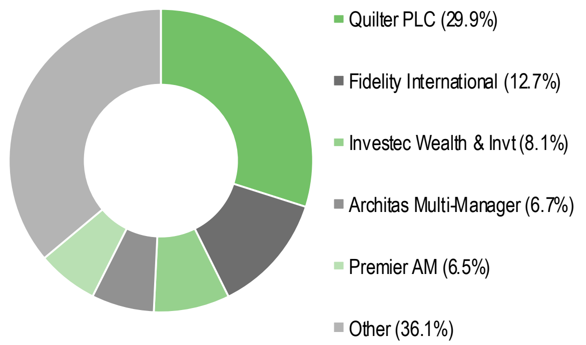


Share buyback policy and history (financial years)

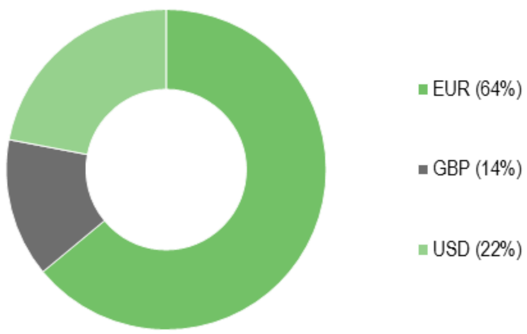
CCPEOL operates a contractual quarterly tender system, a monthly conversion facility between sterling and euro share classes and may issue shares from treasury in response to market demand. The chart below is for sterling shares (CCPG); repurchases include tendered shares and repurchases and allotments both include share conversions and the placing of treasury shares.



Shareholder base (at 25 February 2020)



Currency breakdown at 31 January 2020



Top five issuers (at 31 January 2020)

			Portfolio weight %	
Company	**Country**	**Sector**	**January 2019**	**January 2018***
Concordia	UK	Healthcare and pharmaceuticals	2.6	N/A
Civica	UK	Electronics	2.5	2.8
Doncasters	UK	Diversified/conglomerate service	2.5	N/A
Swissport	Switzerland	Diversified/conglomerate service	2.4	N/A
Kirk Beauty	Germany	Retail Stores	2.3	N/A
Top 5 (% of holdings)			**12.3**	**12.9**

Source: CVC Credit Partners European Opportunities, Edison Investment Research, Refinitiv. Note: *N/A where not in end-December 2018 top five.

2019: A year of 'flight to quality' in credit markets

In FY19, CCPEOL's investment vehicle (CEC) delivered a 2.9% gross return, which was behind its 8–10% target. That said, CEC's overall inception-to-date (itd; since April 2009) performance remains solid at 10.8% per year. After accounting for ongoing charges (including management fee) at the CEC and CCPEOL level, CCPEOL's gross return translated into an FY19 NAV total return of 3.1% for the sterling shares and 1.6% for the euro shares. Year to date (to 21 February 2020) CCPEOL posted a healthy 2.1% NAV TR in sterling terms (2.0% in euro), which we believe was due to a combination of positive developments in the credit opportunities portfolio coupled with credit spreads tightening in the broader market.

Performing credit: Focus on high-quality debt

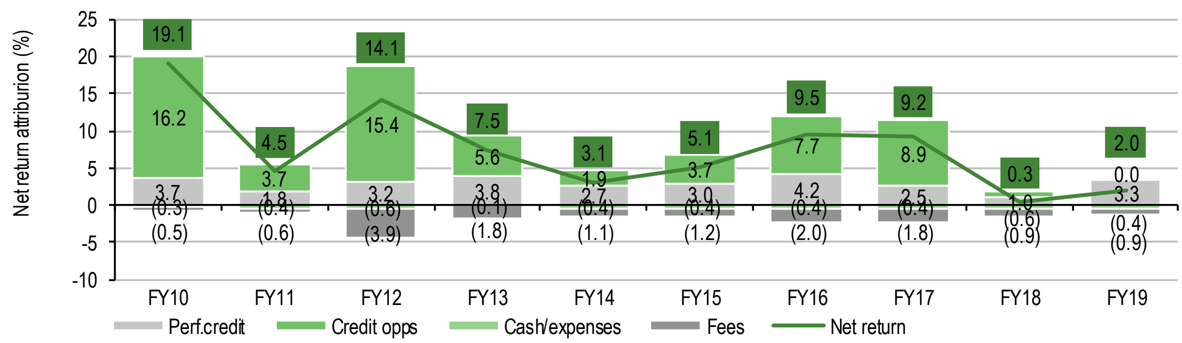
The performing credit strategy delivered a gross return of 7% in FY19, which is at the top of its 4–7% target, translating into a 3.3pp gross return attribution at the portfolio level (in line with historical averages and compared to 1.0pp in FY18). As expected by the investment manager, debt markets in 2019 were characterised by a 'flight to quality', as illustrated by the BB institutional loan spreads tightening to 221bp in January 2020 from close to 300bp in mid-2019, according to S&P. The investment manager was able to benefit from this trend by overweighting high-quality and highly liquid (but still mostly sub-investment grade) investments. This is illustrated by the decrease in CCPEOL's combined exposure to non-rated and CCC-rated debt by 10pp to 25% of the portfolio over the year, as well as minor (1%) exposure to triple-A assets at end-January 2020. Consequently, the average price of CCPEOL's performing credit pool increased to 99.8% of par at end-FY19 from 98.5% at end-FY18.

Credit opportunities: Restructuring processes starting to pay off

In contrast, the return on the credit opportunities portfolio in FY19 was 0% (vs its target of 7–20+% per year), affected by delays in restructuring processes within existing investments (while new investments in this area were limited). We note, however, that returns from this part of CEC's portfolio tend to vary on a year-by-year basis (see Exhibit 2), as the investment manager sources investments in periods of risk-off attitudes, which should subsequently deliver value on successful restructurings. Consequently, despite the credit opportunities portfolio missing its targets in FY14, FY18 and FY19, it still delivered an annualised return of 16% pa since CEC's inception in April 2009 to end-2019.

Moreover, we note that positive performance in Q419 and strong year-to-date performance indicate the restructurings are starting to bear fruit. The investment manager presents an industrial and aerospace company as one of the key contributors. This company is undergoing a managed sell down, with the first-lien term loan well covered by the indicated sum-of-the-parts value. The process initiated in August 2019 and successful disposals triggered a loan price appreciation, as illustrated by the US$ term first-lien loan price rising from 70% of par in August 2019 to 85% in February 2020. CEC targets an IRR of over 20% on this investment. The management indicates that several further ongoing processes are nearing completion and should be reflected in CCPEOL's valuation in the near term.

Exhibit 2: Historical net return attribution (investment vehicle)



Source: CVC Credit Partners, Edison Investment Research. Note: Data from first full year of operation. Ytd to 30 September 2019.

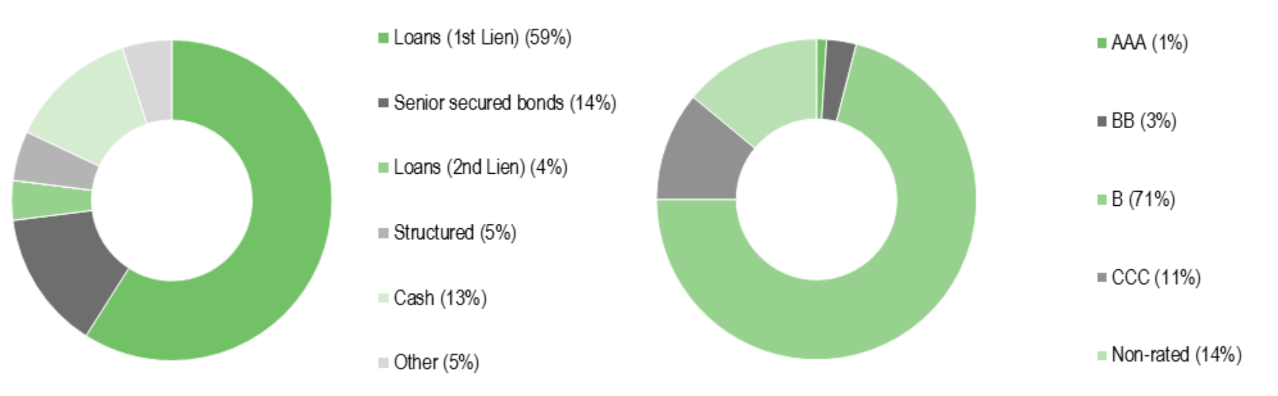
Current portfolio positioning

At end-January 2020, CCPEOL's portfolio continues to be skewed towards floating-rate (84.5% of the portfolio, broadly flat year on year) senior debt (85.5% of gross asset value (GAV) -4pp y-o-y). CEC invests in large-cap companies with a weighted average EBITDA of over €400m (compared to €585m a year earlier), which are domiciled or have most of their operations in Europe. In total, 64% of assets are euro denominated, while the largest country exposure is to US-based companies at 28%.

The assets held in the portfolio at end-January 2020 represent a 5.7% cash yield on average and are valued at 6.5% YTM (compared to 7.7% at end-2018). The decrease in YTM during 2019 followed the tightening spreads and higher-quality investments in the performing credit portfolio (current YTM at 4.7%, down 0.1pp since end-2018), as well as ongoing restructurings in credit opportunities (YTM at 8.9%, down 2.1pp).

Exhibit 3: Portfolio analysis

Asset breakdown at 31 January 2020	Look-through credit rating (at 31 January 2020)



Source: CVC Credit Partners European Opportunities, Edison Investment Research

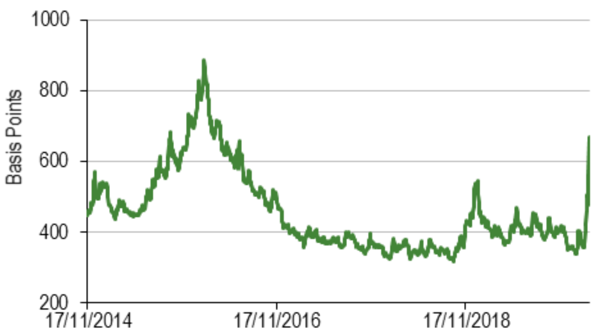
Outlook for 2020: New opportunities ahead

In the **credit opportunities portfolio**, CEC searches for investments to leverage its expertise in turnaround situations and buy in to assets at depressed valuations. The investment manager highlights that refinancing activity in recent years has been high but there were some companies 'left behind', which are now in a stressed situation facing upcoming maturities. We also believe the availability of bargain purchases should be amplified by two major trends in the global economy: the ongoing ‘flight to quality’ described above, resulting in a widening difference between investment grade and high yield spreads, and the signs of global economic slowdown, which triggered deratings of debt assets as described in detail in our January 2020 note. Further debt market volatility may come from the recent coronavirus outbreak.

Within the **performing credit portfolio,** the investment manager intends to continue the strategy it followed in 2019 – harvesting tightening spreads in the upper range of sub-investment grade ratings. The exposure to higher-rated debt is likely to increase as long as overall market conditions lead to tightening spreads in this asset subclass. We note that according to Bloomberg, Partners Group is considering the imminent sale of Civica, which is currently the second-largest single exposure in CCPEOL’s portfolio (2.5% of GAV at end-January 2020). Although further details are not available, we note that most senior private debt agreements include a prepayment fee in the case of an ownership change.

At present, CEC favours sub-investment grade loans over high-yield (HY) bonds (63% vs 14% exposure at end-January 2020) and is likely to maintain this approach into 2020 given the low-spread environment seen in recent months, which makes pricing bonds (which are more widely publicly traded) more vulnerable to any changes in market sentiment. Global capital markets are watching political tensions and looming global economic slowdown and are likely to be prone to short-term selloffs as seen in Q418, and currently amid coronavirus outbreak. In recent weeks, spreads went above the peak of the Q418 sell-off. In the US, HY spreads widened to 668bp (9 March 2020) from 356bp on 14 February. Similarly in Europe, spreads moved to 539bp from 305bp in less than a month. Consequently, the investment manager does not consider the current risk-reward profile of HY bonds as attractive.

Exhibit 4: BofAML US high-yield credit spread



Source: Refinitiv

Exhibit 5: BofAML euro high-yield credit spread

Source: Refinitiv

CCPEOL enters 2020 with an ample cash position at 13.2% of GAV as at end-January 2020. This reflects the payment schedule of debt securities, which results in a higher cash positions at the turn of the year (11% in January 2019, 10.6% in January 2018). The cash should be deployed swiftly early in 2020, as CEC invests mostly in highly liquid debt and is actively trading its assets (especially within the performing credit portfolio), as highlighted by its portfolio turnaround of around 1.6x in 2019. Additionally, the investment manager believes 2020 should offer plenty of investment prospects for the credit opportunities portfolio and it is likely to increase its weighting to these investments in 2020 (from 39% at end-2019).

Peer group comparison

The significant share of the overall portfolio in stressed assets weighed on CCPEOL's 2019 performance and the NAV return lagged its peers in both share classes. Despite short-term underperformance, the five-year return remains above its peers and the broader subsector average. Annualised NAV TR since inception (June 2013) stands at a creditable 5.6%, and the dividend yield is in line with other debt-focused peers.

Although CCPEOL itself does not charge a performance fee and does not use leverage, they are applied at the investment vehicle level. The management fee is 1% of the NAV per year; the performance fee amounts to 15% over the 5% hurdle rate and is subject to a high water mark. The investment vehicle may gear up to 100% of net assets and the actual leverage was 22.3% of the NAV at end-FY18 (latest available data).

Every quarter investors can tender up to 24.99% of the shares for repurchase at a price close to NAV. Every month the CCPG shares can be converted into CCPE shares and vice versa. To supplement this, CCPEOL actively trades its treasury shares and may issue new shares to meet investor demand, which effectively minimises the discount (since CCPEOL's launch in June 2013 it has averaged 0.1%). CCPEOL's board would be required to propose a continuation vote if the average discount to NAV exceeded 10% over any rolling 12-month period or if net assets fell below €75m (currently c €436.0m).

Exhibit 6: Selected peer group at 8 March 2020*

% unless stated	Market cap (£m)	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	Ongoing charge	Perf. fee	Discount/ premium (ex-par)	Net gearing	Dividend yield
CVC Credit Partners Euro Opps GBP	**239.1**	**4.2**	**13.4**	**32.7**	**1.1**	**No****	**(8.9)**	**100***	**5.7**
CVC Credit Partners Euro Opps EUR	**106.4**	**2.1**	**9.5**	**30.2**	**1.1**	**No****	**(6.4)**	**100***	**5.9**
Alcentra Eur Floating Rate Inc	101.3	7.5	13.3	24.9	1.1	No	(4.8)	96	4.7
Axiom European Financial Debt Fund	81.7	13.9	26.3		1.5	Yes	(12.9)	100	6.7
NB Global Floating Rate Income	334.8	11.2	15.2	25.1	1.0	No	(12.5)	100	5.7
Peer group average (3 funds)	**172.6**	**10.8**	**18.3**	**25.0**	**1.2**		**(10.1)**	**99**	**5.7**
Subgroup average (11 funds)	**134.1**	**4.5**	**11.0**	**27.9**	**2.0**		**(11.1)**	**99**	**4.4**
CCPG rank in peer group	**2**	**4**	**3**	**1**	**3**		**3**	**2**	**3**
CCPE rank in peer group	**3**	**5**	**5**	**2**	**3**		**2**	**2**	**2**

Source: Morningstar, Edison Investment Research. Note: *Performance to 31 January 2020. TR: total return, in sterling terms (CCPE in euro terms; CCPG shares are hedged back to euros). Net gearing is total assets less cash and equivalents as a percentage of net assets (100=ungeared). **At the CCPEOL level a performance fee is charged and leverage is applied at the investment vehicle level.

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