EDISON

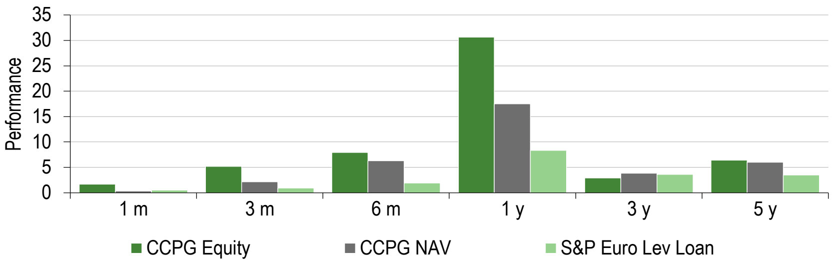
CVC Credit Partners European Opps

Strong 2021 performance and dividend hike

Investment trusts

CVC Credit Partners European Opportunities (CCPEOL) has delivered a 22.23% NAV per share total return (CCPG shares) over the last 12 months, outperforming the high-yield debt indices. The shares have returned 30% as the discount to NAV narrowed to 5%. The manager has stayed positive on the market with a focus on the upper CCC and lower B segments and this seems to have paid off. CCPEOL remains optimistic but more cautious; it has cut its credit opportunistic basket from 67% of gross assets in February to 55% at the end of July. The portfolio performance and improved market outlook has led CCPEOL to raise its annual dividend to 5p/5c per share in April after a 0.5p/0.5c hike in September 2020.

CCPEOL outperformed the S&P Euro Leveraged Loan Index (%)



Source: Refinitiv

Why invest in high-yield debt now?

The high-yield debt market recovery has been significant since the crash in Q120, yet CCPEOL's portfolio still has a YTM of 8.6% and a cash yield of 8.1%. Corporate debt issuance continues to be strong, supported by refinancing and merger and acquisition activity. Therefore, while bargains are not as easy to find as in recent quarters, there is still a good and diverse supply of investment opportunities.

The analyst's view

We expect that government and central banks will remain pragmatic as they taper off their support measures. As such, we do not expect an economic cliff edge scenario. This is good news for high-yield debt and should help keep markets buoyant. At the same time, current debt prices allow less room for macro disappointments. Inflation concerns are growing, which could be a real negative for some debt instruments. However, 78% of CCPEOL's portfolio is floating rate instruments, whose prices should not experience too much volatility as central banks hike their policy rates since their coupons payments also increase.

Valuation: Dividend yield 4.8%/5.1%

Both CCPEOL's share classes have traded close to NAV (excluding the exceptional market turbulence) since the fund launched in 2013 due to share-conversion facilities, active trading in treasury shares and the quarterly tender facility (subject to a specified limit). The recent dividend increases due to resilient portfolio performance result in yields of 4.8% (CCPG) and 5.1% (CCPE).

NOT INTENDED FOR PERSONS IN THE EEA

13 September 2021

Price	**104.5p/€0.98**
Market cap	**£163.4m/€114.0m**
AUM	**£171.7m/€120.8m**
NAV* per share	1.10p
Discount to NAV	5%
NAV** per share	1.03c
Discount to NAV	5%

*CCPG. **CCPE. Excluding income. At 9 Sept 2021. €1.10/£

Yield	4.8%*/5.1%**
Ordinary shares in issue	156.4m/116.4m
Code	CCPG/CCPE
Primary exchange	LSE
AIC sector	Debt – Loans and Bonds

Gearing

Gross and net gearing at CCPEOL level	0.0%

Fund objective

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.

Bull points

- Investment manager has 15 years' experience.
- Debt specialist with relatively unconstrained mandate, so can invest in situations where technicals diverge from fundamentals.
- The fund has historically outperformed high-yield debt indices.

Bear points

- Investments default risk as government and central bank support measures are tapered off.
- Inflation risks could lead to higher interest rates, which could hurt corporate loan quality.
- Macro shocks can affect risk perception.

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Market outlook: Positive but impairments still key risk

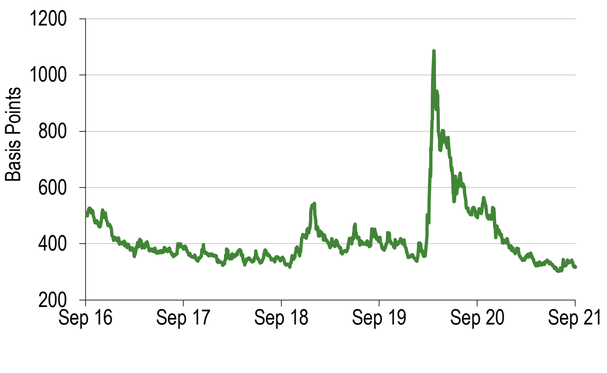
Financial markets have remained generally upbeat, and this is also true for the high-yield loan market, since our last note in January 2021. The markets have been boosted by good progress on the COVID-19 vaccines rollout and government and central bank measures to support the economy.

The ICE BofA European High Yield Index has been hovering between 293bp and 312bp since early April 2021. This compares to 440bp 12 months ago. The corresponding US index paints a similar picture, and is ranging between 303bp and 340bp compared to 503bp a year ago.

We expect the government and central bank support to be tapered off with some care and do not envisage a cliff-edge scenario for the economy. However, the economic recovery may disappoint, and there may be greater than expected unemployment and therefore impairments remain the key risk into 2022. We also note that impairments are a lagging phenomenon in the economic cycle and, while markets are likely to see through this, actual credit events clearly affect related investments. We note that government debt levels are elevated and inflation risks are building up.

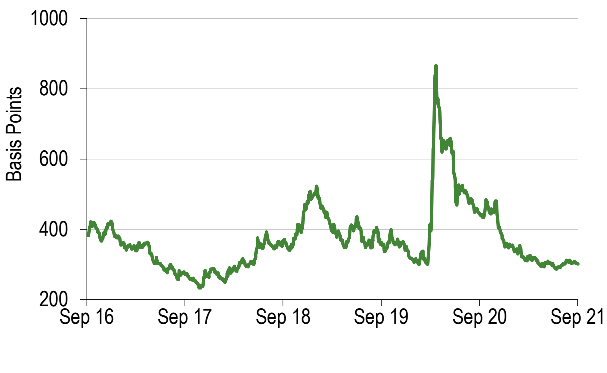
Default rate expectations for 2021 have been coming down. Back in December 2020, S&P Global Ratings forecast that defaults would be 8% for European high-yield debt by September 2021, but the numbers have been lower (the peak was 6.1% in March 2021 and has been coming down). In March 2021, Fitch forecast default rates at 2% and 3% for high-yield bonds for 2021 and 2022 and 3.5% and 4.0% for leveraged loans for the same two years.

Exhibit 1: ICE BofA US High Yield Index



Source: Refinitiv

Exhibit 2: ICE BofA Euro High Yield Index



Source: Refinitiv

Fitch in its European Leveraged Loan Chart Book published in August 2021 stated that the sector 'outlook is bright with some clouds'. The clouds refer to the fact that the share of credits rated 'ccc' remained high compared to previous cycles and that 'any portfolio upgrades represent 'amend-and-extend' exercises on pandemic-affected credits that improved liquidity and maturity headroom while leaving leverage levels high. In addition, balance-sheet restructurings led to upgrades that reflect improved credit metrics while operating recoveries remain speculative'.

S&P in its Credit Conditions Europe Q3 2021 note from June 2021 has European credit risk at 'high' having been at 'very high' when we wrote our note in January 2021. This risk trend is rated as unchanged. It has the risk from inflation pressures, worsening credit conditions and financial markets as 'elevated' and this risk trend is rated as 'worsening'.

The fund manager: CVC Credit Partners

CVC Credit Partners is a subsidiary of CVC Capital Partners, a global investment manager with nearly US$115.3bn of assets under management (US$28.7bn in credit) at 30 June 2021, specialising in private equity and private debt. CVC Capital Partners employs more than 250 investment professionals across 24 offices worldwide, with 64 focused on credit investments. The investment manager maintains a database of more than 4,000 credits from which it selects investment opportunities for its various portfolios on the basis of in-depth fundamental analysis.

Manager's view: Still positive

CEC has been bullish on the market throughout 2021, looking to take advantage of market dislocations caused by the COVID-19 pandemic and the central-bank and government stimulus. The fund delivered an 8.5% return in the first six months of the year, which is a very good performance, at a pace well above the 8% plus target for the year. CEC remains positive and feels that good opportunities remain, albeit less abundant than six months ago and requiring greater caution in selection.

CEC expects leveraged loan issuance to remain busy (it is at its busiest since 2017) and continue to grow, therefore supplying new investment opportunities. The outlook for mergers and acquisitions and private equity activity remains good and is supportive of greater leveraged loan issuance.

Although there are natural question marks regarding the shape or the recovery, CEC sees government and central bank stimulus remaining supportive and this helps loan quality as well as boosting debt markets.

CEC sees its performing book continuing to be well placed for stable income over the longer term, while credit opportunities remain a fundamental alpha driver in the short to medium term.

CEC's view remains that the best opportunities are in lower B- and CCC-rated investments as well as structured investments such as collateralised loan obligations (CLOs). It notes that it has been seeing continued 'compression in stressed credit markets' but feels this could stabilise until the end of the year.

Asset allocation

Current portfolio positioning

CEC's base strategy is to target a broadly balanced allocation across performing and opportunistic instruments. To take advantage of the market dislocation because of the COVID-19 pandemic crisis, CEC significantly rebalanced the weight of the portfolio towards the opportunistic basket. The performing-opportunistic split was 61% to 39% in December 2019, but the opportunistic weight peaked at 67% in November 2020 with a cash position of only 1.7%.

As we discuss in the performance section, this repositioning enabled the fund to have a positive performance in 2020 despite the pandemic crisis and the market collapse in March 2020.

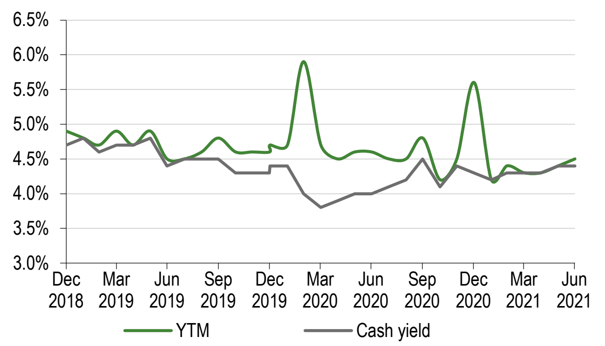
Exhibits 3, 4 and 5 show the extreme price volatility that we have seen in both the performing and leveraged loan markets.

CEC trimmed its opportunistic basket to 55% at the end of July 2021. This basket is still larger than the performing credit basket since CEC remains positive on the high-yield market, although with greater caution after such an extended market rebound.

At the end of July, the performing credit portfolio average market price was 99.6. It is back to the level of the beginning of 2020 (99.8). The yield to maturity (YTM) of the portfolio is 4.5%, with a cash yield of 4.4%. This compares with 4.6% and 4.3% at the beginning of 2020.

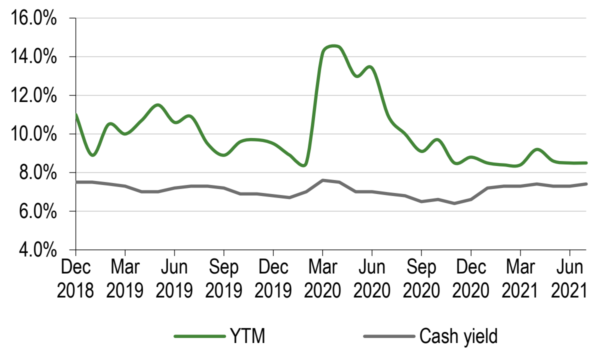
The credit opportunities portfolio's average price is now 93.6. This represents a significant rebound from the 77.0 trough at the end of March 2020. The portfolio's YTM of 8.5% and a cash yield of 7.4% at end-July. At the beginning of the year, these were 9.5% and 6.8%, respectively. A relatively good performance regarding impairments has boosted the portfolio's cash yield.

Exhibit 3: YTM and cash yield – performing credit



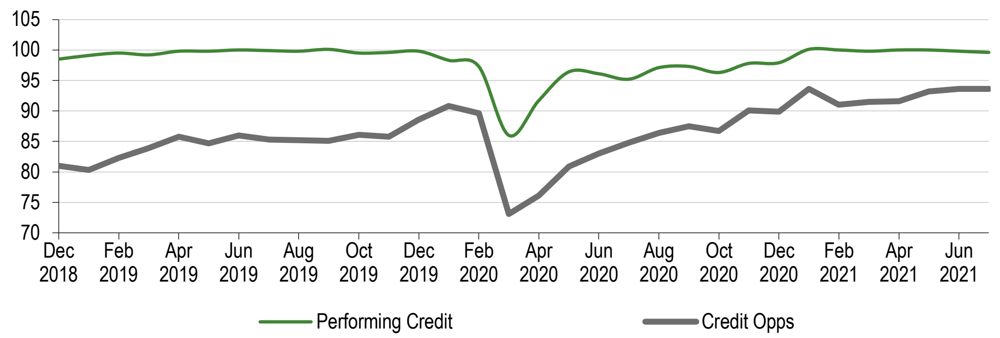
Source: CVC Credit Partners European Opportunities

Exhibit 4: YTM and cash yield – credit opportunities



Source: CVC Credit Partners European Opportunities

Exhibit 5: Average price – performing credit and credit opportunities



Source: CVC Credit Partners European Opportunities

CEC has maintained its strategy in recent months of staying positive on the market while being overweight on defensive sectors such as healthcare, media, telecoms and food retail.

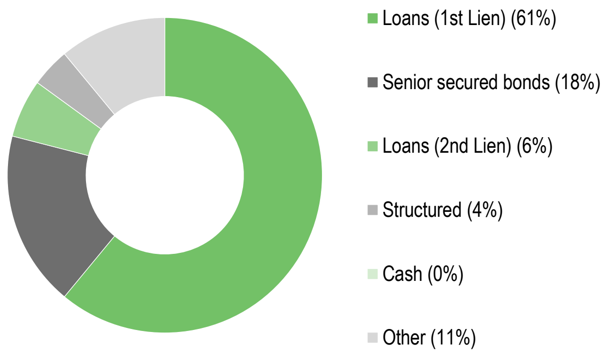
We note that the weight of CCC-rated investments has increased but this could also be a function of some ratings downgrades. The weight has increased from 18% in January 2021 to 26% at the end of July. The weight of non-rated securities has remained stable at 11%. There have been corresponding declines in the weight of higher rated (BB and B) securities as yields have continue to compress and affect the search for yield.

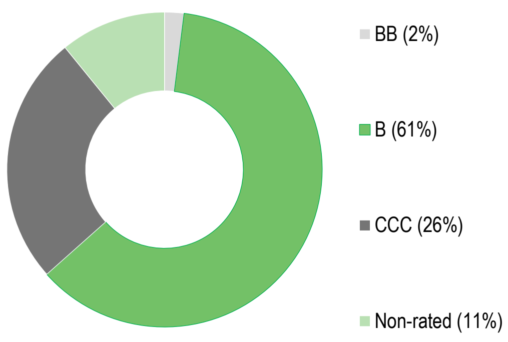
Defensive assets (first-lien loans, senior secured bonds and cash) make up 79% of the portfolio. This is in line with its investment strategy of focusing on senior secured assets. However, we note that defensive assets were 88% of all assets at the end of 2020.

As of end July, 60% of the fund is euros, 16% in British pounds and 24% in US dollars.

Exhibit 6: Portfolio analysis

Asset breakdown at 31 July 2021	Loan rating breakdown at 31 July 2021





Source: CVC Credit Partners European Opportunities

Over the last 12 months, the most significant change in country weightings has been the increase in the weight of US from 13% to 19% as shown in Exhibit 7.

Exhibit 7: Portfolio – geographic exposure by country of issuer

	End-July 2021	End-July 2020	Change (pp)
UK	22%	25%	-3
France	11%	13%	-2
Netherlands	17%	17%	0
Germany	11%	14%	-3
US	19%	13%	6
Spain	4%	7%	-3
Luxembourg	3%	N/S	3
Other	17%	11%	6
Total	**100%**	**100%**	

Source: CVC Credit Partners European Opportunities, Edison Investment Research. Note: N/S = not separately stated; may be included in 'other'.

Exhibit 8 details the breakdown of portfolio's industry exposure, which continues to be broad, illustrating the diversified nature of CEC's portfolio. The exposure has not changed that much over the last 12 months; the reduction of retail stores from 9% to 5% is the most noteworthy change. The largest holding in the hotels sector is CEC's investment in European Camping Group, a company that CEC knows well and had benefited from the increased trend towards domestic holidays ('staycations') and camping/driving holidays instead of flying.

Exhibit 8: Portfolio industry exposure

	Portfolio end-July 2021	Portfolio end-July 2020	Change (pp)
Healthcare & pharmaceuticals	15%	13%	2
Hotels, gaming & leisure	10%	10%	0
Chemicals, plastics & rubber	8%	10%	-2
Electronics	6%	7%	-1
Retail store	5%	9%	-4
Finance	5%	5%	0
Cargo transport & logistics	5%	N/S	5
Diversified/conglomerate mfrg	5%	N/S	5
Diversified/conglomerate service	4%	5%	-1
Business services	4%	N/S	4
Telecommunications	4%	5%	-1
Other	29%	25%	4

Source: CVC Credit Partners European Opportunities, Edison Investment Research. Note: N/S, not separately stated; may be included in 'other'.

Exhibit 9: Top five issuers (at end-July 2021)

Company	Country	Sector	Portfolio weight %	
			July 2021	July 2020*
Doncasters	UK	Diversified/Conglomerate Manuf.	4.9	N/A
Colouroz	Germany	Chemicals, Plastics and Rubber	3.6	2.9
Civica	UK	Electronics	3.4	2.7
European Camping Group	France	Leisure	2.7	2.8
D&G	UK	Finance	2.4	N/A
Top five (% of holdings)			**17.0**	**14.5**

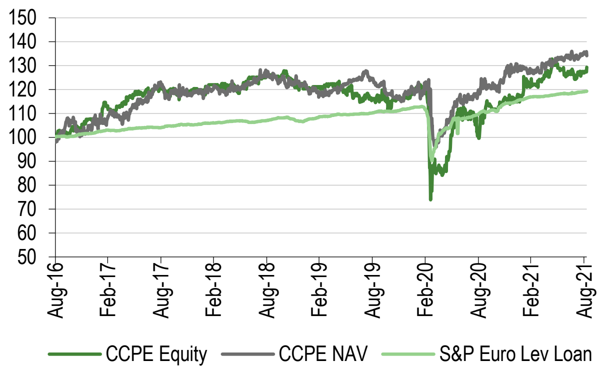
Source: CVC Credit Partners European Opportunities, Edison Investment Research, Refinitiv. Note: *N/A where not in end-July 2020 top five.

Performance

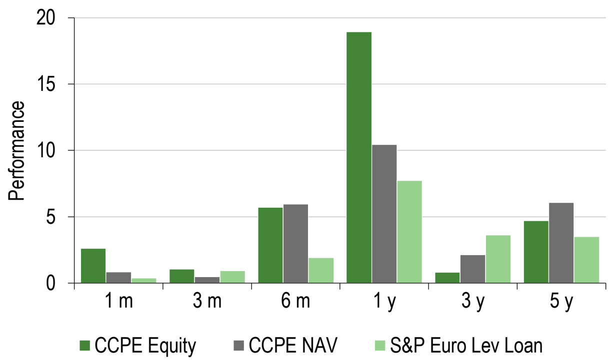
CCPG shares have had a strong performance over the last 12 months with a total return of 30.7% to 3 September 2021. This has been driven by the net asset value (NAV) total return, which was 22.3% in the last 12 months, and the decline in the discount to NAV. CCPE shares and NAV have performed similarly (CCPE's NAV per share total return was 20.4% in the same period). In the exhibits 10-12 we have used the CCPE in the comparison since the two indices shown are in euros.

Exhibit 10: Investment company performance to 9 September 2021

Price, NAV and index total return performance, five-years rebased



CCPE price, NAV and index total return performance (%)



Source: Refinitiv, Edison Investment Research. Note: Three- and five-year performance figures annualised.

Exhibit 11: CCPE share price and NAV total return performance, relative to indices (%)

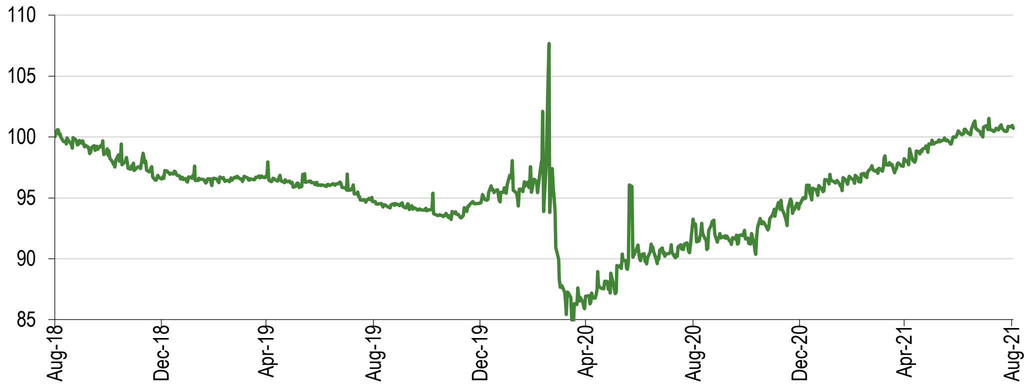
	One month	Three months	Six months	One year	Three years	Five years
Price relative to S&P Euro Lev Loan	2.1	2.2	3.8	10.7	(8.8)	7.1
NAV relative to S&P Euro Lev Loan	0.2	2.0	5.3	12.2	(2.6)	10.2
Price relative to ICE BoA Euro HY EU & Western Europe	2.4	2.1	2.7	10.4	(11.7)	3.3
NAV relative to ICE BoA Euro HY EU & Western Europe	0.2	2.0	5.3	12.2	(2.6)	10.2

Source: Refinitiv, Edison Investment Research. Note: Data to 9 September 2021. Geometric calculation

CCPEOL has continued to outperform the indices as shown in Exhibits 11 and 12. It has done this over most of the periods. As we highlighted in our previous note, Remaining positive on the market in January 2021, the manager has actively sought to take advantage of the crisis to buy assets that had been excessively marked down by the market and rebalancing the portfolio accordingly. This strategy seems to have paid off so far.

We note that as CCPEOL's portfolio consists of both loans and bonds (sourced from Europe and the US), none of the indices presented in Exhibit 11 is a perfect comparator.

Exhibit 12: CCPG NAV total return performance relative to S&P European Leveraged Loan Index over three years



Source: Refinitiv

Peer group comparison

Exhibit 13 compares CCPEOL's performance to its sector average and two of its closest peers. CCPEOL has outperformed the sector average across the various periods shown in the table. Axiom European Financial Debt and NB Global Floating Rate, the two closest peers, have also performed strongly and have had even higher returns. However, we note that even these two peers have differences – for example, Axiom focuses just on debt from financial institutions, which is usually more subordinated than CCPEOL's investments and, unsurprisingly, Axiom's fund has had greater volatility in its performance.

CCPEOL's ongoing charge and gearing are about average for the sector. Its 4.8% dividend yield (5.1% for the CCPE) although lower than Axiom and NB's is above the sector average of 3.7%.

Although CCPEOL does not charge a performance fee or use leverage (as is shown in Exhibit 13 in the data from Morningstar), they are both applied at the investment vehicle level as discussed earlier in the note.

Exhibit 13: Selected peer group at 6 September 2021*

% 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
CCPEOL(CCPG) sterling**	**163.4**	**22.2**	**13.5**	**38.0**	**1.5**	**No**	**(5.2)**	**100**	**4.8**
CCPEOL (CCPE) euros**	**97.3**	**20.4**	**8.7**	**29.0**	**1.5**	**No**	**(4.9)**	**100**	**5.1**
Axiom European Financial Debt Fund	85.9	22.3	26.5	46.9	1.4	Yes	(9.3)	97	6.4
NB Global Floating Rate Income	220.0	21.1	22.7	31.5	1.1	No	(13.2)	95	5.3
Subgroup average (2 funds)	152.9	21.7	24.6	39.2	1.3		(11.2)	96	5.8
Sector average (10 funds)	115.6	17.5	(2.3)	20.3	1.6		(13.5)	100	3.7
CCPG rank in peer group	2	2	3	2	1		2	1	4
CCPE rank in peer group	3	4	4	4	1		1	1	3

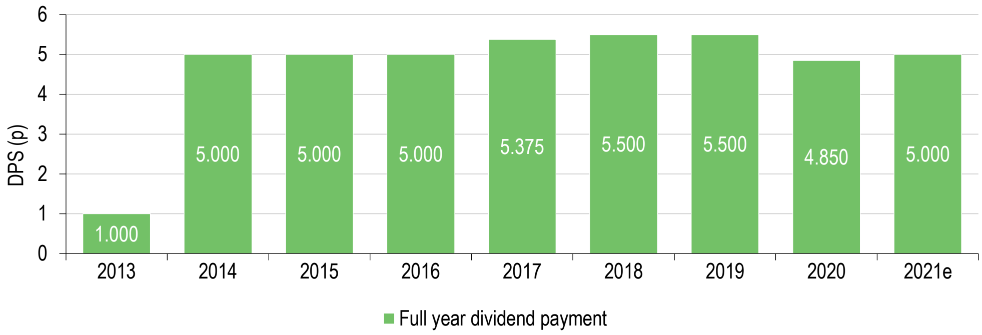
Source: Morningstar, CVC Credit Partners European Opportunities, Edison Investment Research. Note: *Performance to 31 July 2021. TR: total return, in sterling terms (CCPE in euro terms; CCPG shares are hedged back to euros). Net gearing is total assets less cash and equivalents as a percentage of net assets (100=ungeared). **At the CCPEOL level a performance fee is charged and leverage is applied at the investment vehicle level.

Dividend policy and record

CCPEOL raised its target annual dividend from 4.5p per CCPG and 4.5c per CCPE to 5p and 5c respectively in April 2021. This increase is underpinned by CCPEOL's good portfolio performance and better market conditions. This change comes 12 months after CEC had reduced its target from 5.5p/5.5c to 4p/4c due to the pandemic. At the time, the board had said that it was keeping the 8% total return target and that it planned to raise the dividend when market conditions justified it. CEC had already raised the dividend to 4.5p/4.5c in September 2020.

Dividends are paid quarterly, in February, May, August and November. A scrip dividend (the facility to receive additional shares rather than a cash dividend payment) was suspended in October 2019 due to limited interest from shareholders.

Exhibit 14: Dividend payments per share



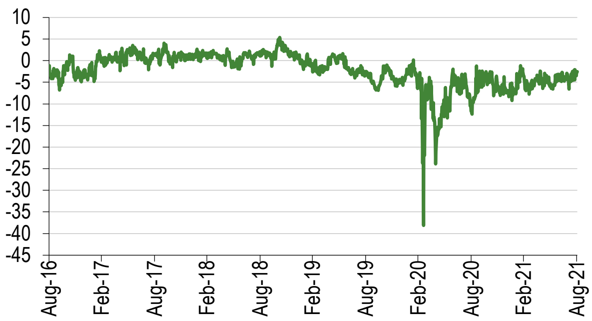
Source: CVC Credit Partners European Opportunities

Discount

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.

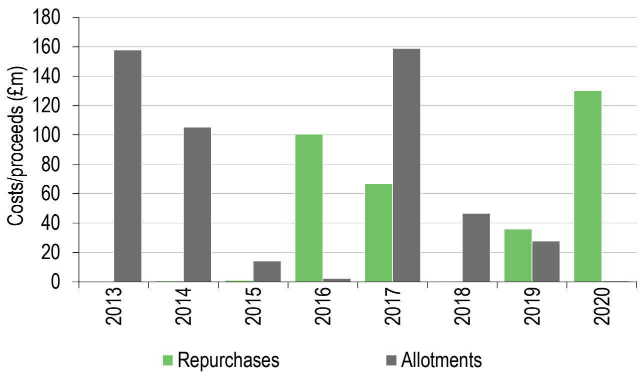
CCPEOL's conversion facilities minimise NAV discount/premium fluctuations. Since inception CCPG shares have traded at an average discount of 1.1% to cum-income NAV until end February 2020 and before the COVID-19 crisis, with the discount widening in more distressed environments. During the COVID-19 crisis, the discount went as high as 38% on 19 March. The discount has been declining and it was 5% on 3 September 2021.

Exhibit 15: CCPG share price premium/discount to NAV (cum-income) over five years (%)



Source: Refinitiv, Edison Investment Research

Exhibit 16: Buybacks and issuance



Source: Morningstar, Edison Investment Research

Fund profile

CCPEOL was launched in June 2013 and is a Jersey-domiciled, London-listed, closed-end investment company with a focus on opportunities in leveraged credit. It invests solely in a Luxembourg-based investment vehicle, CEC, via preferred equity certificates (PECs). CEC has an actively managed portfolio of sub-investment grade debt assets with an annual turnover of c 100%, which also involves trading within an issuer's debt structure (ie assets with different maturities, currencies and seniority). Its portfolio is divided into two main pools: performing credit (assets acquired at close to par with the intention of generating returns from recurring interest payments/coupons) and credit opportunities (discounted assets with revaluation potential).

The investment manager is sometimes involved in restructuring activities to unlock the revaluation potential of the credit opportunities investments. Returns come from a mixture of income and capital appreciation with target aggregate gross returns of 8–12% pa (4–7% pa from the performing portfolio and 7–20% pa from the credit opportunities portfolio). Around 5% pa is expected from the income component. The investment vehicle focuses mostly on senior assets in the capital structure of the issuer: first-lien loans and senior secured bonds (87% of NAV at end-November 2020).

The portfolio is skewed towards floating-rate assets and issuers domiciled (or with the majority of operations) in Western Europe. CEC invests in large-cap companies, which had a weighted average EBITDA of more than €400m at end May 2020 and which we believe still provide higher secondary liquidity and stronger credit fundamentals, leading to lower default rates in times of economic downturn.

Andrew Davies, CCPEOL's manager since inception, has moved from managing the portfolio to being promoted within CVC Credit Partners to take full charge of the stressed credit/credit opportunities portfolios across the CVC credit platform; in essence, it is a wider responsibility over and above this strategy in isolation. Davies is on the investment committees for credit opportunity strategies within CVC so he is still very relevant to that part of this portfolio, which continues to have a ~50% allocation to credit opportunities.

Pieter Staelens has taken over the role of portfolio manager. He is a managing director of CVC Credit's Performing Credit team based in London and joined CVC in 2018. Before joining CVC, he worked at Janus Henderson Investors in London, where he was involved in various high-yield strategies and a credit long/short strategy.

Gearing

There is no gearing at the CCPEOL level, but the investment vehicle may gear up to 100% of net assets. At end-FY20, the investment vehicle had borrowings of 27.67% of NAV. There is a €175m (€161m outstanding) line from Bank of America Merrill Lynch, which has recently been extended to September 2022 and the cost reduced from Euribor +170bp to Euribor +135bp (zero floor). CCPEOL can repay and redraw up to 30% of this amount. There are various collateral and portfolio tests, but CCPEOL has retained significant borrowing headroom even through the peak of the crisis.

Fees & charges

CCPEOL is a self-managed fund that delegates investment management to CVC Credit Partners, which also manages the investment vehicle. We calculate the ongoing charges at an annualised 1.5% in FY20; this was 1.19% in FY19 and FY18. This includes an annual management fee of

1.0% pa, charged at the investment vehicle level. CEC's operating expenses are not accounted for in these ongoing charge calculations and instead are reflected in the value of PECs held by CCPEOL. A performance fee (subject to a high-water mark) of 15% of excess returns may be paid at investment vehicle level if total annual returns exceed 5%.

In April 2021, the board voted to reduce the management fee from 1.0% to 0.9% of NAV, effective 1 May 2021. The new fee structure allows for further step-down reductions if assets under management (AUM) increase beyond certain levels. The current ratchet marks are €500m, €750m and €1bn AUM. The management fee drops by 5bp at each point with a floor at 0.75% pa.

Capital structure

CCPEOL is a Jersey-domiciled, closed-end investment company with an unlimited life. However, the investment vehicle is intended to wind up in 2031 (subject to the investment manager's decision to extend it). CCPEOL's board would also 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 fall below €75m.

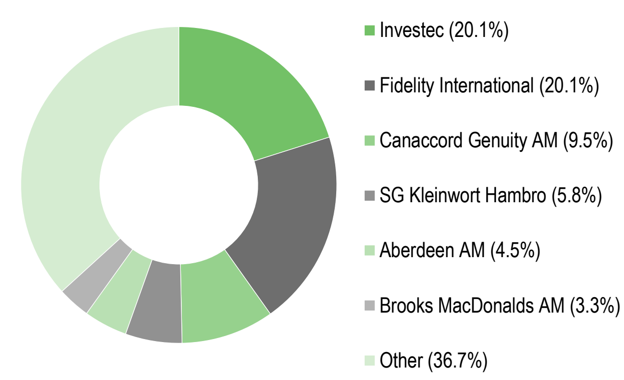
CCPEOL has two share classes: sterling shares (CCPG, 156.4m shares in issue) and euro shares (CCPE, 116.4m). CCPE shares carry one voting right compared with 1.17 for each CCPG share. The company actively manages its capital structure to reflect investor demand by running a quarterly tender facility, a monthly currency conversion facility and purchasing and selling treasury shares. CCPG shares are hedged back to euros to eliminate exchange rate volatility.

Before the exceptional market turbulence last March, every quarter investors could tender up to 24.99% of shares for repurchase at a price close to NAV. In April, the board won approval to allow this quarterly limit to be reduced to a minimum of 10%. However, so far all requested tenders have been executed and the level of requests has not been as high as anticipated in April.

Every month, CCPG shares can be converted into CCPE shares and vice versa. To facilitate 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%).

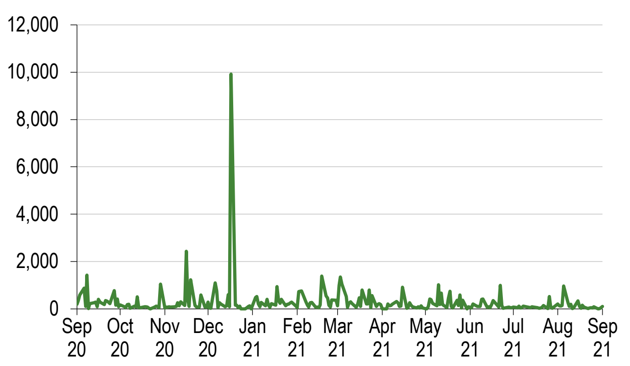
There are no loans at the CCPEOL level although, as previously mentioned, the investment vehicle itself uses gearing.

Exhibit 17: Major shareholders (August 2021)



Source: Refinitiv

Exhibit 18: Average daily volume, CCPG (£000s)



Source: Refinitiv

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