EDISON

CVC Credit Partners European Opps

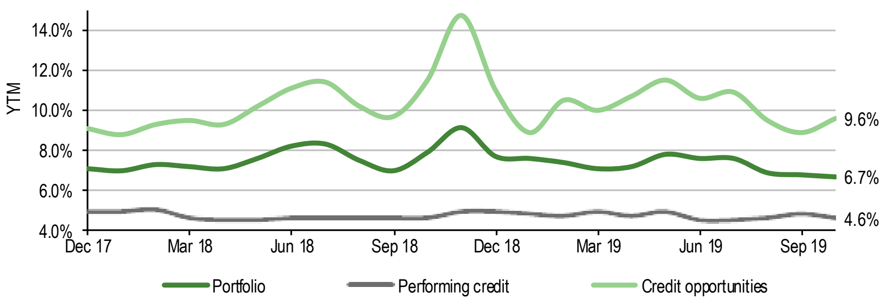
Actively working on credit opportunities

Investment companies
Debt: Loans and bonds

28 January 2020

CVC Credit Partners European Opportunities (CCPEOL) aims to achieve a blend of capital growth and income (it targets gross total returns pre fees of 8–12% pa, with c 5pp from income). It maintains two pools of assets – performing credit with assets acquired close to par and credit opportunities consisting of discounted assets. CCPEOL's one-year NAV total return (to 10 January) was a modest 3.4% for the sterling shares and was assisted by positive returns in November and December. Throughout most of the year, performance was driven by the performing credit bucket. In turn, credit opportunity returns were muted as the company was working on a number of restructuring processes that we understand started to bear fruit at the end of 2019.

Yield to maturity (YTM) of the whole portfolio is currently 6.7%



Source: CVC Credit Partners European Opportunities, 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 buybacks limiting the discount to NAV. Given current volatile market conditions, the investment manager is able to source investments for the opportunities bucket at attractive risk-adjusted pricing. This may translate into attractive returns on successful restructuring once market sentiment improves.

Why consider investing in CCPEOL?

- Investment manager's 15 years' experience, currently with US$24bn debt under management.
- Debt specialist with relatively less constrained mandate, able to invest in situations where technicals diverge from fundamentals.
- Depressed valuations in credit opportunities allow the investment manager (CEC) to invest at an above-average YTM.
- Share price lagged NAV recently, resulting in above-average discount.

Valuation: Minimal discount with 5.3% yield

On average, both CCPEOL share classes have traded close to NAV since the fund was launched. Following the Q418 sell-off, the discount (excluding income) widened slightly and currently stands at 2.5% for CCPG shares and 1.6% for CCPE. CCPEOL offers an above 5% dividend yield, largely covered by coupons.

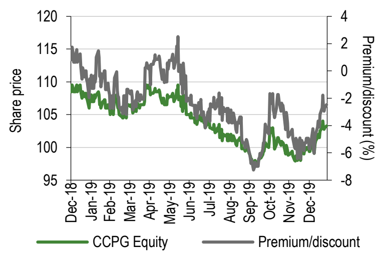
Price	**103.3p/€0.99**
Market cap	**£336.8m**
	€130.0m
AUM	**£345.4m**
	€132.0m

NAV*	105.87p
Discount to NAV	2.5%
NAV**	€1.0058
Discount to NAV	1.6%

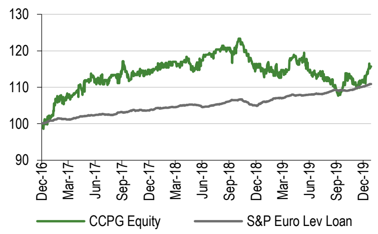
*CCPG. **CCPE. Excluding income. As at 27 December 2019.

Yield	5.3/5.6%
Ordinary shares in issue	326.2m/131.3m
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	97.4p/€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

CVC Credit Partners European Opportunities is a research client of Edison Investment Research Limited

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, 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.

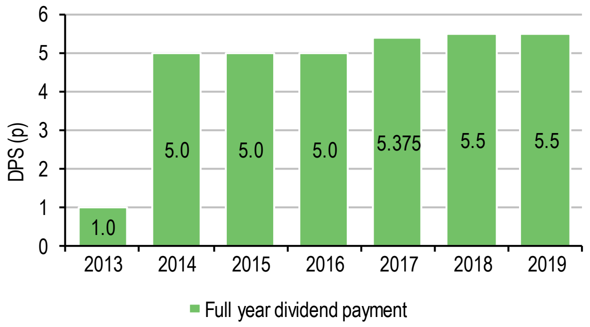
Recent developments

- 27 January 2020: Interim dividend declared at 1.375p/€0.01375 per share, ex-dividend date on 6 February 2020.
- 18 November 2019: No requests for conversion of shares in December.
- 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
Annual 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 10		London, WC2R 0AG
Launch date	25 June 2013	Company life	Indefinite	Phone	+44 (0) 20 7420 4200
Continuation vote	See page 10	Loan facilities	None at CCPEOL level	Website	www.ccpeol.com

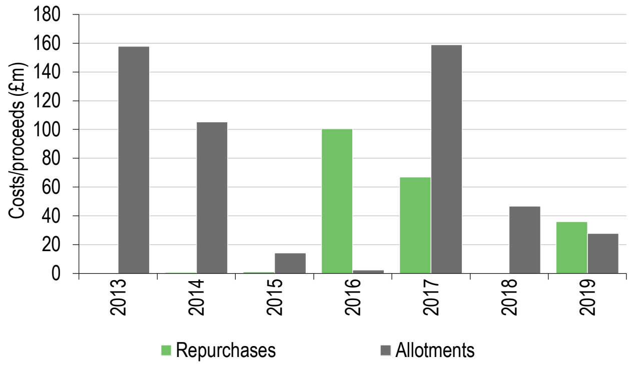
Dividend policy and history (financial years)

From Q217, CCPEOL has raised its full-year dividend target to 5.5p/€0.055 per share, having 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.

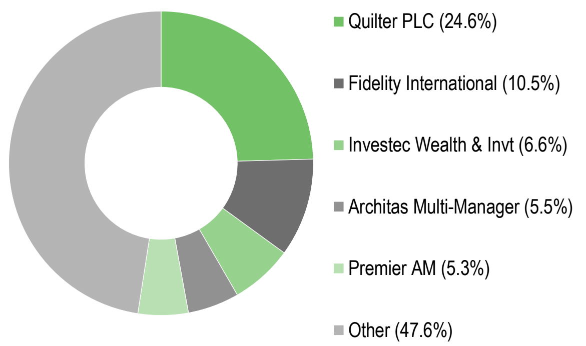


Share buyback policy and history (financial years)

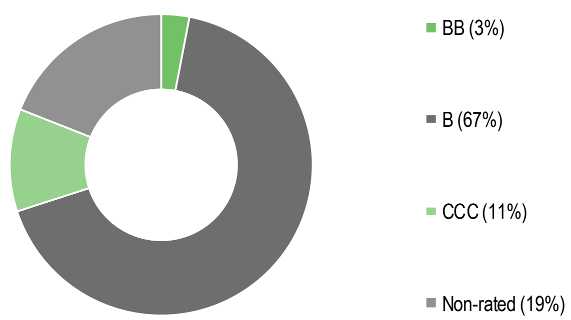
CCPEOL operates a contractual quarterly tender system, a monthly conversion facility between sterling and euro share classes, and may issue shares from treasury in response to market demand. The chart below is for sterling shares (CCPG); repurchases include tendered shares and repurchases and allotments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



Shareholder base (as at 27 January 2020)



Look-through credit rating (as at 30 November 2019)



Top five issuers (as at 30 November 2019)

			Portfolio weight %	
Company	**Country**	**Sector**	**November 2019**	**November 2018***
Civica	UK	Electronics	2.8	2.7
Concordia	UK	Healthcare and pharmaceuticals	2.7	N/A
Swissport	Switzerland	Diversified/conglomerate service	2.5	N/A
Dubai World	UAE	Diversified/conglomerate service	2.3	2.7
Kirk Beauty	Germany	Retail Stores	2.2	N/A
Top 5 (% of holdings)			**12.5**	**13.4**

Source: CVC Credit Partners European Opportunities, Edison Investment Research, Bloomberg. Note: *N/A where not in end-November 2018 top 5.

Fund profile: Daily traded fund with senior loans focus

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, CVC European Credit Opportunities fund (CEC, or 'the investment vehicle') 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 manager is often 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 assets that are senior in the capital structure of the issuer – first-lien loans and senior secured bonds (which currently represent 82% of NAV as at end-September 2019).

The portfolio is skewed towards floating-rate assets and issuers domiciled (or having the majority of operations) in Western Europe. CEC invests in large-cap companies, which had a weighted average EBITDA of €424m at end-September 2019 (down from €513m at end-Q119), which we believe still provides higher secondary liquidity and stronger credit fundamentals, leading to lower default rates in times of economic downturn.

The fund manager: CVC Credit Partners

CVC Credit Partners is a subsidiary of CVC Capital Partners, a global investment manager with nearly US$83bn of assets under management as at June 2019, specialising in private equity and private debt. CVC Capital Partners has around 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 deep-dive fundamental analysis.

The manager's view: Focus on fundamentals

CVC Credit Partners believes that the persisting risk-off attitude and the associated 'flight to quality' (triggered, among other reasons, by weaker global growth and trade tensions) offer some attractive investment targets on the credit opportunities side. The manager believes that valuations have bottomed out among existing exposures, with a potential rebound providing the possibility to exit opportunistic positions at more attractive prices in the near term. It believes that market sentiment and performance will be influenced by the decisions of central banks and their recent return to a more accommodative approach. On the performing credit side of the portfolio, while the new issue spread in the term loans B (TLB) debt in Europe remained relatively stable at close to c 400bp through 2019 (somewhat ahead of 2018), CVC highlights that this is mostly attributable to lower-rated debt entering the market, with higher-rated investments characterised by spreads at low 300s bp.

Regionally, CVC Credit Partners currently expects more compelling investment possibilities for its credit opportunities bucket in the US, while it remains Eurocentric in its performing credit pool. We understand that this is because of the higher quality of corporate credit in Europe at present (as illustrated by the ratio of rating downgrades to upgrades and overall rating levels, as shown further below) and the fact that pricing in Europe is more issuer-driven, compared to the US where price movements within the respective asset classes tend to be more uniform (potentially leading to the mispricing of individual assets).

The investment manager points out that the increase in covenant-lite debt should not adversely affect liquid sub-investment grade credit, which has always been relatively ‘covenant-lite’, while restrictive covenants would be more of an indication of fundamental weakness of the borrower. That said, reduced lender protections and higher leverage (fuelled by low interest rates) do pose a higher risk to investors across the broader credit investments spectrum. CVC Credit Partners recognises that this will translate into increased default risk once interest rates start to rise and loans approach their maturity (and thus will require refinancing). In this scenario, as an active risk management model, CEC should still have access to a steady and attractive investment pipeline for its credit opportunities portfolio as the market responds to a weaker credit profile of the underlying issuers. Consequently, the fund is well placed to benefit from any market shocks causing downward pressure on loan prices given its flexible approach covering both performing credit and credit opportunities.

Market outlook: Lower ratings, more opportunities

The global economy has entered a slowdown phase, with central banks expecting a relatively subdued growth rate in the coming years. In December the ECB forecast 1.2% growth in the euro area economy in 2019 (from 1.9% in 2018) and 1.1% in 2020. Similarly, in September the Federal Reserve expected the US economy to post 2.2% growth in 2019 (from 2.9% in 2018), which subsequently decelerates to 2.0% in 2020. The markets are eyeing the tensions in international trade as one of the factors limiting growth. The sub-investment grade new issue market in Europe is returning to average volumes with year to date (ytd) (to end-November 2019) issuance only slightly below the prior year level (€149bn issued, -1% y-o-y), despite a very quiet Q119 (€30bn, -40% y-o-y).

While default rates remain low for now, there are signs of global deterioration in the quality of corporate debt reflected in issuer ratings (which may soon result in rising defaults). This is particularly true for the US, where the ratings downgrade/upgrade ratio reached 2.9x (last 12 months (LTM) as at September 2019, according to S&P) and CCC-rated debt currently represents 7.5% of outstanding leveraged loans. Even though corporate ratings in Europe have also deteriorated, the downgrade/upgrade ratio was lower than in the US at 1.6x (LTM as at September 2019 according to S&P). Moreover, 5.8% of European sub-investment grade corporate debt was rated CCC or lower as at July 2019. In this context, we note that CEC’s US exposure is just 16% of its portfolio, with the remainder largely invested in Western Europe.

As a result of the global slowdown, rating agencies have already expressed their expectations of default rates returning closer to historical averages in the near term. In the European market, S&P expects the default rate for speculative grade issuers to reach 2.8% by mid-2020. In the US, S&P forecasts the corporate debt default rate to reach 3.4% by mid-2020. Similarly, Fitch forecasts US leveraged loan defaults to rise to 3% in 2020 from the current 1.7% (LTM at September 2019). Still, these levels are visibly below the default rates seen historically during periods of economic stress. We believe that this is at least partially supported by the prevalence of covenant-lite loans (which represented well above 70% of newly issued institutional debt in 2017 and 2018) leading to fewer technical defaults. However, once defaulted, these loans are likely to exhibit lower recoveries, with S&P expecting current cycle senior secured and first lien debt recovery rates below 60% vs over 70% in previous cycles.

Default rates may be also contained by the fact that global growth concerns were addressed by major central banks through a more dovish approach to monetary policy. This has triggered a rally in fixed-rate debt in recent months, as illustrated by the US$15.7bn of net new inflows to high yield funds ytd (until mid-September 2019, according to Lipper) after seeing capital outflow in all of the previous five years (including US$45.7bn of outflows in 2018 alone). This partly explains why CCPEOL lagged somewhat the broader debt market rebound (with the S&P European Leveraged Loan Index one-year performance at +4.8% vs CCPG's NAV +3.4% as at 10 January 2020), as CEC's exposure to fixed rate investments stands at 11.4% as at end-November 2019. 85.6% of the portfolio is allocated to floating rate instruments, with the balance being others (3.0%, eg equity tranches of collateralised loan obligations (CLOs)).

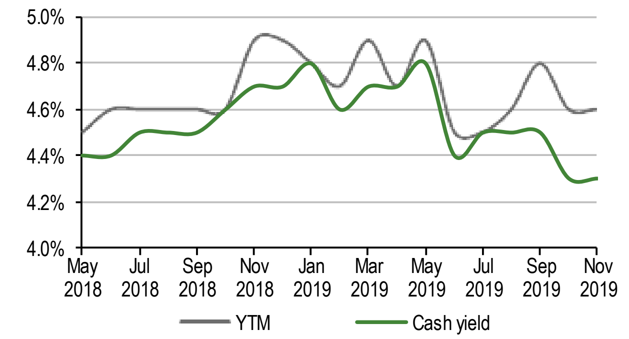
The persisting 'cheap money era' resulted in a high degree of investible capital on the market, which in turn meant corporates had easy access to financing with lower requirements set by moneylenders, resulting in higher accepted leverage, lighter covenants and lower-rating issuers successfully closing the deals. As a result, average new issuer leverage reached pre-crisis levels, with total debt to EBITDA averaging 5.2x in the US and 5.4x in Europe in 2018. Among US first-time issuers the share of speculative-grade ratings has increased to levels last seen around the dotcom bubble in 2000 – during the LTM period ending July 2019, c 34% of speculative-grade new issuers were rated B- or below. However, a continued 'flight to quality' in secondary markets may result in depressed prices of lower-quality leveraged loans (in particular those requiring restructuring). In this context, it is important that CLOs (which were absorbing the majority of leverage loans in recent years) are subject to a maximum exposure to loan collateral rated CCC or lower, at 7.5% of portfolio. The above may result in a rising number of investment possibilities in CCPEOL's credit opportunities bucket.

Current portfolio positioning

At end-November 2019, the proportion of the portfolio held in credit opportunities increased significantly, to 40% from 34% in November 2018. This is despite the fact that the market rebound since early 2019 was not uniform, with the price recovery of CCPEOL's credit opportunities pool more muted than in the performing credit portfolio (leading to steady build-up of exposure to the latter). The reason behind this was the temporary increase in CCPEOL's cash position in November 2018 to a relatively high level (14% of the portfolio) in response to the ongoing market downturn of Q418, as well as the exit from its largest exposure at the time, Saur (5.2% of GAV at end-October 2018). Part of the excess cash was used to opportunistically purchase credits that had sold off. Consequently, the average price of assets in the credit opportunities portfolio was 85.8% of the nominal value at end-November 2019 compared to 83.4% a year earlier (and 89.3% at end-October 2018), providing scope for par building. As depressed valuations in the credit opportunities bucket prevailed throughout 2019, CEC's exit opportunities were rather limited and required more extensive restructurings ahead of exits in a more attractive environment. At end-November 2019 CEC had already completed some of its restructurings and more are expected to contribute positively in the near term. The investment manager increases its exposure to junior tranches of CLOs (single B and BB) as their pricing remains attractive compared to the liquid high-yield (HY) market.

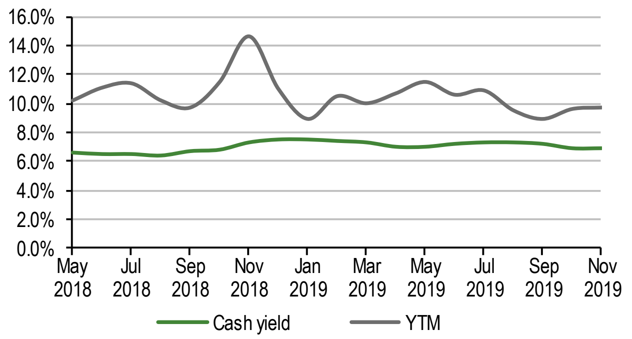
In the performing credit segment, the investment manager's focus in the secondary market in recent months has been on exiting positions that were trading close to historical highs, in particular fixed rate HY bonds. In the primary market, the investment manager is focused on defensive sectors in higher-rated, large and liquid senior secured parts of the capital structure. At end-November 2019, CEC held on to its single B HY positions as it expected positive performance into the year-end, given the compressing durations. Consequently, the average cash yield within the performing credit bucket decreased by 0.2pp since September 4.3% at end-November 2019, while the current yield across the whole portfolio was 5.9% at the end of November 2019 (+0.2pp y-o-y and down from 6.4% at the end of September 2019).

Exhibit 2: Performing credit: YTM and cash yield



Source: CVC Credit Partners European Opportunities, Edison Investment Research

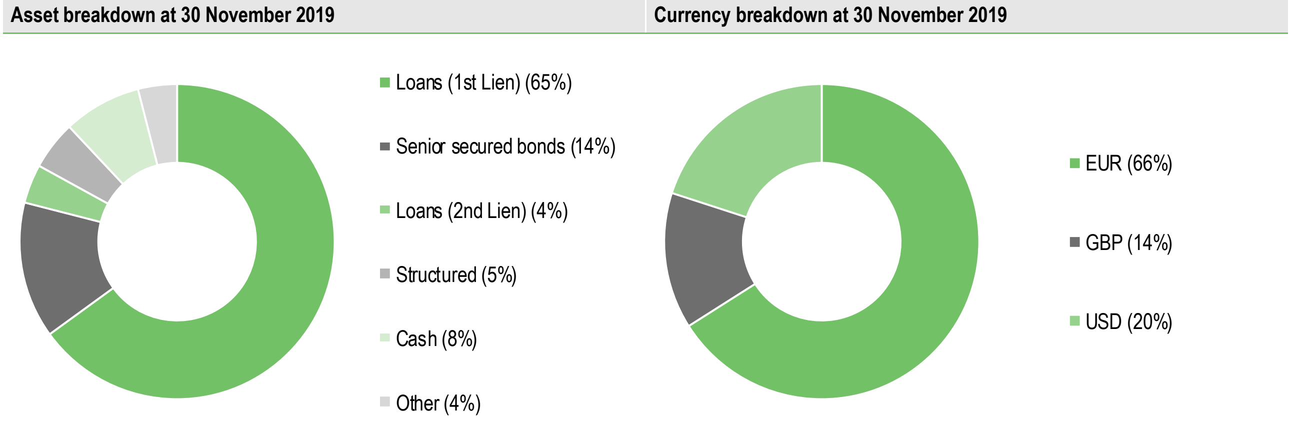
Exhibit 3: Credit opportunities: YTM and cash yield



Source: CVC Credit Partners European Opportunities, Edison Investment Research

CEC maintained its defensive positioning, with 87% of its portfolio at end-November 2019 allocated to senior secured assets (first-lien loans, senior secured bonds and cash) compared to 92% at end-November 2018 and 88% at end-October 2018 (see Exhibit 4, lhs chart). Interestingly, CEC's euro exposure increased to 66% (by 10pp y-o-y) at the expense of the US dollar. While the investment vehicle primarily focuses on Western European issuers, these companies are typically large and may have borrowings in multiple currencies, which may explain the mismatch between US issuers (12%) and US dollar assets (20%).

Exhibit 4: Portfolio analysis



Source: CVC Credit Partners European Opportunities, Edison Investment Research

CEC's US weighting fell by 7pp over the 12 months to end-November 2019 even though it reduced its minimum permitted weighting in Western European securities in June 2018 (from 70% to 60%) (Exhibit 5). This is partly as a result of increased swap costs. The biggest fall was in its exposure to Luxembourg, which is not stated as one of its main positions at end-November 2019 (end-H119 exposure was 0.9%), while at end-November 2018 it constituted 8% of the portfolio. This is partly a result of global French-Dutch telecom Altice restructuring its financing (it made up 2.5% of the portfolio at end-January 2019). While exposure to Germany increased by 2pp to 14% of the portfolio, the investment manager avoids any meaningful exposure to export-oriented German companies, which currently face macroeconomic headwinds. In total, 23% of the portfolio is invested in UK debt, potentially leaving part of CCPEOL's returns exposed to Brexit-related tensions.

Exhibit 5: Portfolio – geographic exposure by country of issuer

	End- November 2019	End- November 2018	Change (pp)
UK	23%	21%	2.0
France	14%	12%	2.0
The Netherlands	14%	10%	4.0
Germany	14%	12%	2.0
US	12%	19%	(7.0)
Spain	9%	6%	3.0
Luxembourg	N/S	8%	N/A
UAE	N/S	3%	N/A
Other	14%	9%	N/A
Total	**100%**	**100%**	

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

In terms of major changes to sector exposure (Exhibit 6), healthcare and pharmaceuticals is the leader, representing 13% of the portfolio (up 2pp y-o-y) due to a steady increase over several months since April 2018 to January 2019 (and has subsequently remained broadly stable). CEC's largest portfolio holding (2.8% of gross asset value (GAV)) is Civica, an international software business focused on the public sector with revenues of £373m in 2018. We note that CEC still has significant exposure to retail stores at 10% of GAV (flat y-o-y). As per the company, holdings in the area are more weighted towards retail services (such as marketing), and there is limited exposure to high street shops or casual dining. The largest holding in this sector is Kirk Beauty (2.2% of GAV, one of the top five issuers), a vehicle created by CVC Capital in 2015 to take over Douglas – Europe's leading specialist retailer of beauty and personal care products headquartered in Germany. Overall, the industry exposure is broad, illustrating the diversified nature of the CEC portfolio.

Exhibit 6: Portfolio – industry exposure

	Portfolio end-Nov 2019	Portfolio end-Nov 2018	Change (pp)
Healthcare and pharmaceuticals	13%	11%	2.0
Retail store	10%	10%	0.0
Diversified/conglomerate service	10%	8%	2.0
Chemicals, plastics and rubber	7%	8%	(1.0)
Broadcasting & entertainment	6%	9%	(3.0)
Electronics	5%	7%	(2.0)
Telecommunications	5%	5%	0.0
Insurance	5%	N/S	N/A
Finance	4%	4%	0.0
Business services	4%	4%	0.0
Hotels, gaming and leisure	3%	N/S	N/A
Telecommunications	N/S	5%	N/A
Metals and mining	N/S	3%	N/A
Diversified/conglomerate mfrg	N/S	3%	N/A
Cargo transport and logistics	N/S	3%	N/A
Other	28%	26%	N/A
Total	**100%**	**100%**	

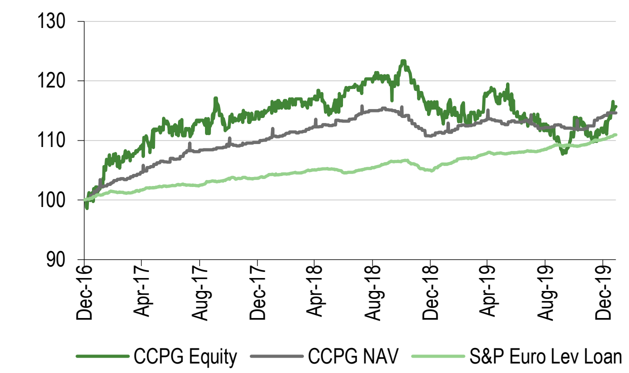
Source: CVC Credit Partners European Opportunities, Edison Investment Research. Note: N/S=not separately stated; may be included in 'other'.

Performance: LT positive alpha despite ST slowdown

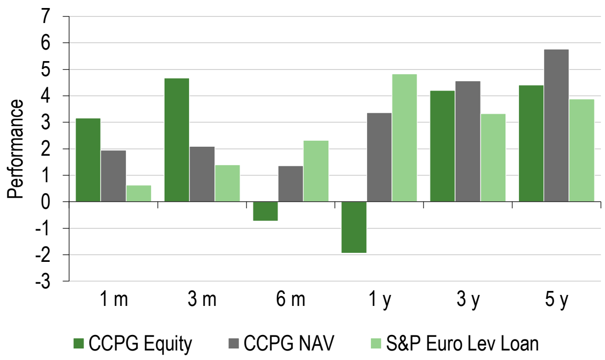
Over the last twelve months (to 10 January 2020) CCPG shares delivered a 3.4% NAV total return (1.8% for CCPE shares), which was enabled by recent strong performance (one-month NAV total return at 1.9% for CCPG and 2.1% for CCPE). We understand that strong one-month performance may have been assisted by the credit opportunities portfolio. The latest available data of the investment vehicle are at end-September 2019, when CEC delivered a 1.7% total gross (pre-fees) return ytd. Over this period, performing credit pool delivered 2.8% attribution, while credit opportunities contributed negative 0.7% to the result. After accounting for the ongoing charges (including management fee) at CEC and CCPEOL, this translated into an NAV net total return of 1.7% for CCPG shares (0.7%% for CCPE shares). While the short-term performance falls short of CEC's long-term target annual returns of 8–12%, the annualised gross return since inception in June 2013 remains intact at 11%.

Exhibit 7: Investment company performance to 10 January 2020

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



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



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

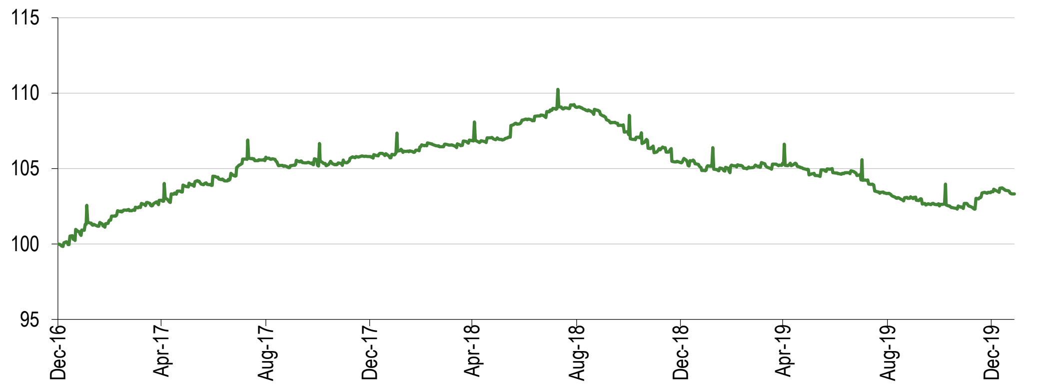
Exhibit 8: CCPG share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	SI*
Price relative to S&P Euro Lev Loan	2.5	3.2	(3.0)	(6.5)	2.6	2.6	1.8
NAV relative to S&P Euro Lev Loan	1.3	0.7	(0.9)	(1.4)	3.6	9.4	5.8
Price relative to Credit Suisse Lev Loan	2.4	3.2	(2.7)	(6.1)	3.8	3.2	6.2
NAV relative to Credit Suisse Lev Loan	1.2	0.6	(0.7)	(1.0)	4.8	10.0	10.4
Price relative to CS Western European HY	1.8	1.9	(3.8)	(11.1)	(0.1)	(1.9)	(4.9)
NAV relative to CS Western European HY	0.6	(0.6)	(1.7)	(6.3)	0.9	4.5	(1.2)

Source: Refinitiv, Edison Investment Research. Note: Data to 27 December 2019. Geometric calculation. *SI=since inception. Inception date is 25 June 2013.

The ytd gross return (to end-September 2019) of the whole portfolio of 1.7% was largely driven by the performing credit bucket, which delivered a gross return of 5%, in line with its annual target of a 4–7% return (and contributed 2.8pp to the overall portfolio performance). Meanwhile, the gross return from the credit opportunities bucket was -2% due to the risk-off attitude in the market coupled with few exits from restructuring processes. However, the investment manager highlights that several restructuring initiatives within the portfolio are largely finalised and may translate into positive returns from exit events in the upcoming months. That said, we understand that this may depend on a rebound in prices of these kind of credit investments (unless they are held to maturity when they could be redeemed at par).

Exhibit 9: CCPG NAV TR performance relative to S&P Euro Leveraged Loan Index over three years

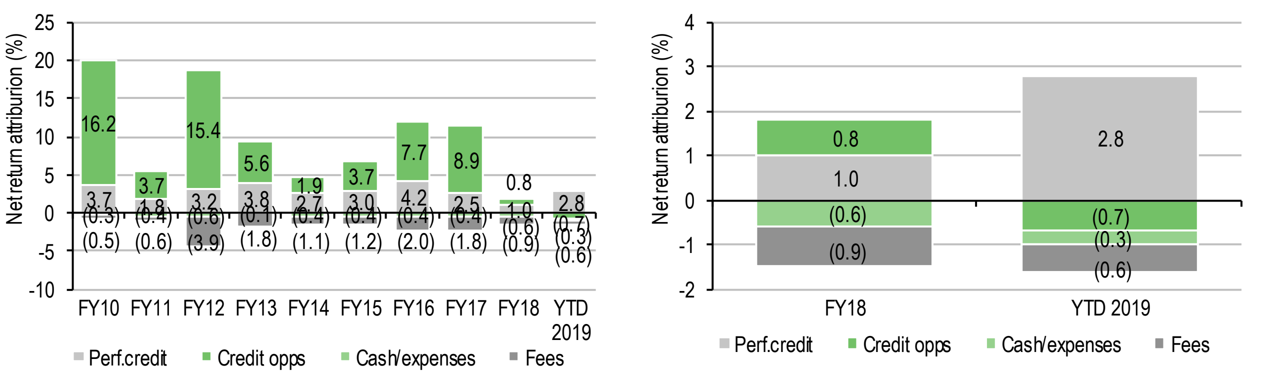


Source: Refinitiv, Edison Investment Research. Note: TR=total return.

As shown in Exhibits 8 and 9, CCPEOL's NAV performance has lagged the S&P Euro Leveraged Loan Index since the market turn in September 2018. This is mostly due to a general decline in loan prices, which had a greater impact on the more challenged credits in CCPEOL's credit opportunities portfolio. This was partially reversed in late 2019, which we believe could be due to successful turnarounds performed within credit opportunities portfolio. In the long term, CCPEOL has outperformed the selected indices over three and five years. As a reminder, as CCPEOL's portfolio consists of both loans and bonds (sourced from both Europe and the US), none of the indices presented in Exhibit 8 is a perfect comparator.

Exhibit 10: Historical net return attribution (investment vehicle)

Since inception | **2018 – September 2019**

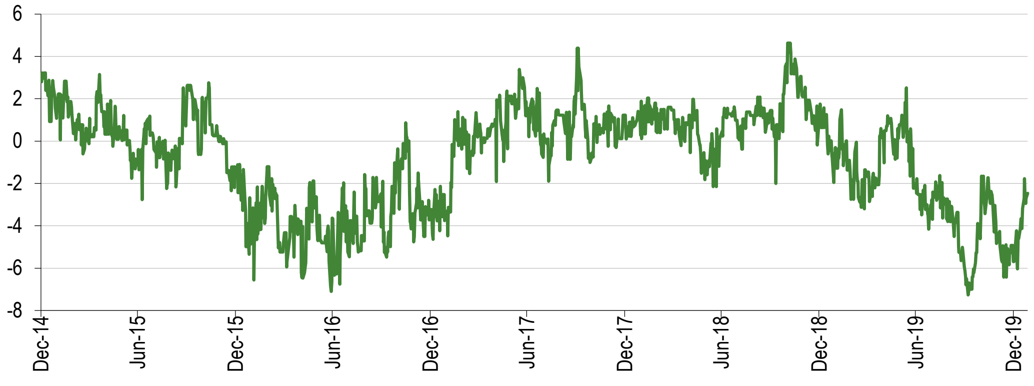


Source: CVC Credit Partners, Edison Investment Research. Note: Data from first full year of operation. Ytd to 30 September 2019.

Discount

CCPEOL's conversion facilities minimise the NAV discount/premium fluctuations. On average, since inception CCPG shares have traded at a negligible discount of 0.3% to cum-income NAV, with the discount widening in a more distressed environment (eg 2016 amid the first Brexit referendum or in 2019 amid trade tensions and concerns about global growth). The all-time widest discount of 7.3% was reached in October 2019, with the shares still trading at an above-average discount of 2.5%. We understand this is partially a function of overall elevated liquidity concerns of investors due to the Woodford case. It is worth noting that most of the trading in CCPEOL's shares is executed through the tender facility rather than on the stock exchange, which magnifies the impact. Having said that, the investment manager has highlighted that the whole strategy (including CCPEOL) saw net inflows ytd despite the overall risk-off mood.

Exhibit 11: CCPG share price premium/discount to NAV (cum-income) over five years (%)



Source: Refinitiv, Edison Investment Research

Capital structure and fees

CCPEOL is a Jersey-domiciled closed-end investment company with an unlimited life. However, the investment vehicle is planned to wind up in 2031 (subject to the investment manager's decision to extend). 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 €551.0m). The actual discount to cum-income NAV has so far never exceeded c 8%.

CCPEOL has two share classes: sterling shares (CCPG, 326.7m in issue) and euro shares (CCPE, 130.7m in issue). 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, as well as purchasing and selling treasury shares. CCPG shares are hedged back to euros to eliminate exchange rate volatility.

CCPEOL is a self-managed fund delegating the investment management to CVC Credit Partners (CVC), which is also the manager of the investment vehicle. CCPEOL calculates its ongoing charge at 1.07% pa based on the FY18 accounts (FY17: 1.19%), which includes its operating expenses and 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 are instead 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 the investment vehicle level should total annual returns exceed 5%.

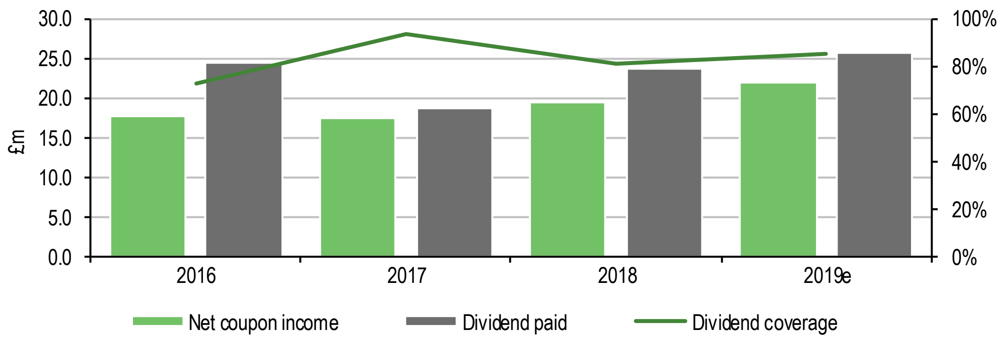
There is no gearing at the CCPEOL level, but the investment vehicle may gear up to 100% of net assets. At end-FY18, the latter had borrowings of €174.4m, equivalent to c 22.3% of NAV (FY17: 24.5%).

Dividend policy and record

CCPEOL targets an annual dividend of 5.5p per CCPG share and €0.055 per CCPE share, which currently translates into dividend yields of 5.3% and 5.6%, respectively. Dividends are paid quarterly, in February, May, August and November at 1.375p/ €0.01375 per CCPG/CCPE share. Since Q417, CCPEOL has offered investors a scrip dividend (the facility to receive additional shares rather than a cash dividend payment), but due to limited interest from shareholders, and resulting relative high administration costs per share, it suspended the facility in October 2019.

We have decided to examine what part of CCPEOL's dividend payments is covered exclusively by its coupon income, ie excluding any capital gains from active trading and pull to par effect (see our previous note for a detailed explanation of our methodology). Consequently, we arrive at a coverage ratio of over 80% for the last three years (ie 2016–18), suggesting that CCPEOL was able to cover most of its dividend payment with its coupon inflows. The interim dividend paid in November 2019 of €/£0.01375 per share was well covered by the cash position held as at end-October. The current coupon yield at the portfolio level stood at 5.9% at end-November 2019 (up 0.2pp y-o-y). Please note that CCPEOL's reported current yield does not include income from its CLO equity tranches (received on a quarterly basis), which increased their weighting in the portfolio. We understand that these currently represent no more than c 3% of the portfolio (no structured finance assets a year earlier) and normally offer a yield of around 10–15%.

Exhibit 12: CCPEOL's estimated dividend coverage



Source: CVC Credit Partners European Opportunities, Edison Investment Research

Peer group comparison

CCPEOL is a member of the Association of Investment Companies' Sector Debt – Loans and Bonds, which contains 13 debt funds. The subgroup excludes various investing mandates present in the broader sector, such as structured finance, direct lending and property debt. In Exhibit 13 we show an even smaller group of peers that broadly focus on leveraged loans and other opportunities arising from bank deleveraging. Over the period of one year both CCPEOL's share classes were the weakest performers in the peer group and were below average for the AIC subgroup. Over three years the sterling shares performed in line with two out of three peers and ahead of the broader sector average, while the euro-denominated shares underperformed peers and posted a return close to sector average. Similarly, over five years the sterling shares slightly outperformed the peer and sector averages, while euro shares were in line with the sector. Ongoing charges are below average for the selected peer group, but as explained in the capital structure and fees section, the company's ongoing charges do not account for operating expenses incurred at the investment vehicle (CEC) level. Similarly, performance fees may be charged at the CEC level. Both share classes trade at a narrower discount than peers and the sector average. In common with the rest of the peer group, the listed fund does not use gearing, although leverage is applied at the CEC level (22.3% of NAV at end-2018), as discussed earlier. CCPEOL's dividend yield is in line with close peers and above the average for the broader sector.

Exhibit 13: Selected peer group as at 27 January 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	**336.8**	**3.0**	**14.0**	**31.9**	**1.1**	**No***	**(2.9)**	**100***	**5.3**
CVC Credit Partners Euro Opps EUR	**130.0**	**1.5**	**10.3**	**26.2**	**1.1**	**No***	**(1.0)**	**100***	**5.6**
Alcentra Eur Floating Rate Inc	101.3	6.2	13.4	24.5	1.1	No	(5.9)	96	4.7
Axiom European Financial Debt Fund	86.3	21.2	29.4		1.5	Yes	(8.5)	100	6.4
NB Global Floating Rate Income	382.5	13.7	14.8	25.0	1.0	No	(7.8)	100	5.2
Peer group average (3 funds)	**190.1**	**13.7**	**19.2**	**24.8**	**1.2**		**(7.4)**	**99**	**5.4**
Subgroup average (11 funds)	**141.9**	**4.4**	**10.8**	**28.5**	**2.0**		**(8.9)**	**99.0**	**4.2**
CCPG rank in peer group	**2**	**4**	**3**	**1**	**3**		**2**	**2**	**3**
CCPE rank in peer group	**3**	**5**	**5**	**2**	**3**		**1**	**2**	**2**

Source: Morningstar, Edison Investment Research. Note: *Performance to 31 December 2019. 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 CCPEOL level – performance fee is charged, and leverage is applied at the investment vehicle level

The board

CCPEOL's board was broadened to four directors on 21 February 2019 following the appointment of Stephanie Carbonneil. She currently serves as managing director and head of investment trusts at Allianz Global Investors and has nearly 20 years of experience. The other three directors have all been in place since the listed fund's launch in 2013. The chairman, Richard Boléat, qualified as a chartered account and has spent his career in financial services. Mark Tucker is a former hedge fund and derivatives broker/dealer, and is a chartered fellow of the Chartered Institute for Securities and Investment (CISI). David Wood was a founding partner of CVC Cordatus (a predecessor to CVC Credit Partners) and also worked as co-head of leveraged finance at Deutsche Bank. All four directors are non-executive and deemed independent of the manager.

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