CVC

CVC-CRED: The Case for European Private Credit

Private Credit has rapidly expanded, filling the gap left by traditional sources of financing as a reliable source of capital across market cycles. The challenges of 2022-2023 highlighted the strength of private credit, providing liquidity when the public markets were closed.

CVC-CRED primarily invests in privately negotiated senior secured loans, that benefit from a secured position within the capital structure.

The European private credit market offers attractive risk-adjusted returns, driven by its unique local dynamics, diverse geographies which only select, specialist managers with deep infrastructure can tap into. CVC-CRED benefits from its ability to utilise the CVC Network and the firm's position as the largest private equity manager in Europe to aide sourcing and due diligence throughout the investment process.

Whilst the European private credit market is smaller than the U.S, it is a compelling landscape from an investment perspective due to its attractive pricing and conservative underwriting which only limited managers can access.

The Growth of Private Credit

The growth of the private credit asset class has been significant in recent years and now accounts for c.20% of the leveraged finance market, with expectations that it will reach a c.30% share over the longer-term.[1]

Historically, debt financing has been dominated by banks and the public leveraged loan / bond markets, but **there has been a gradual trend away from these traditional lending sources**, with borrowers increasingly adopting private credit solutions. Following the Global Financial Crisis in 2007 and 2008, these traditional sources of financing declined, and as such private credit has filled the gap and grown its market share – with further acceleration in recent years due to the 'closing' of the public credit markets during "risk off" periods in 2022 and 2023.

Private credit comes in many shapes and sizes, operating as an alternative debt financing source that offers businesses solutions across the capital structure, providing them with greater flexibility and execution certainty than the public credit alternatives. The three most common buckets of private credit are;

- Senior secured loans;
- Subordinated debt; and
- Distressed/opportunistic debt.

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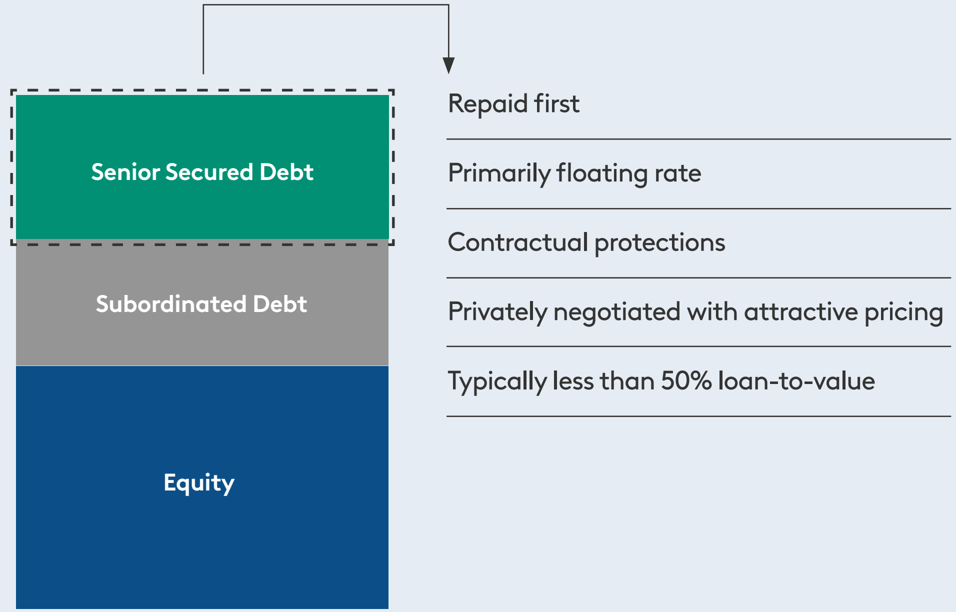
Senior secured loans are the most senior in the capital structure and generally have a priority pledge over the assets and equity of the borrowing company. Subordinated debt is junior to senior secured loans, and comes in several forms such as Payment-in-Kind (PIK) securities and Preferred Equity. Finally, distressed debt is where companies have defaulted or entered bankruptcy and their credit instruments trade at a significant discount to par.

CVC-CRED primarily invests in privately negotiated senior secured loans, that benefit from a secured position within the capital structure, combined with typically first-lien security – promoting strong recovery rates in the event of a default. **The loans targeted by the strategy are focused on high quality sponsor-backed companies, with conservative capital structures, and strong credit metrics** such as low loan-to-values and moderate leverage, with a clear focus on capital preservation through economic cycles.

Private credit has grown markedly in recent years as a result of both supply and demand-side dynamics, as borrowers benefit from the asset class's flexibility and investors enjoy elevated returns that would not be otherwise achieved in public credit markets.

"Increasingly a portfolio allocation to private credit is compelling..."

Where do we invest in the capital structure?
Illustrative borrower capital structure



1 Bank of America, 17 May 2024

The Case for European Private Credit

CVC believes that the current market opportunity for European private credit is particularly strong, and that developments over recent years are driving a sustainable structural change in the long-term opportunity set, which builds on the already robust and consistent market opportunity experienced by CVC Credit in its close-ended funds. As part of a wider trend experienced in private credit, the retreat of traditional sources of financing has meant private credit investors are in a strong position to negotiate lender friendly terms when engaging with sponsors. Given a combination of factors, namely pricing and underwriting standards, we believe European private credit is a nascent asset class, and an exceptional opportunity for managers. The market remains fragmented due to its complexity in contrast to the homogeneous U.S. market, meaning only those specialist managers with deep infrastructure across the continent can access this unique opportunity set.

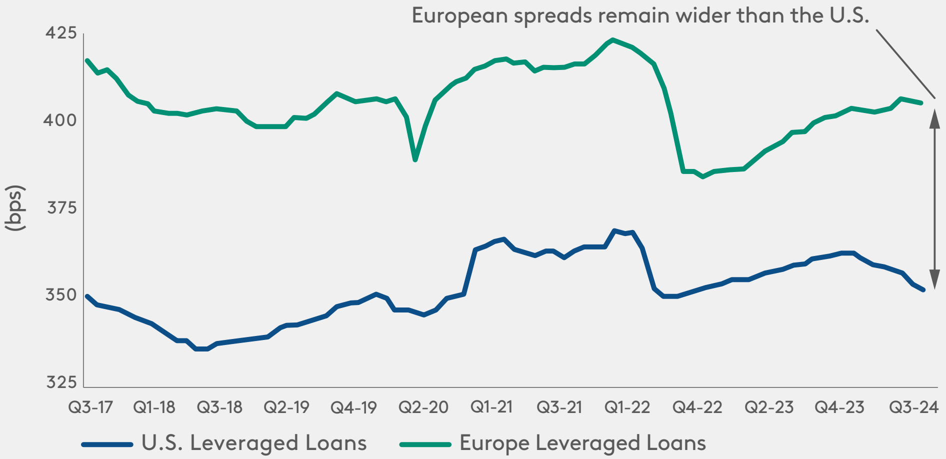
First, from a pricing perspective we believe Europe is particularly attractive due to the heterogenous nature of the market and historical leveraged loan pricing vs. the U.S.. Since 2017 European leveraged loans have, on average, traded c.50bps wider than the U.S., as illustrated in Figure 1 below, and continue to trade wider in today's market. We believe there is an argument that this delta is similarly reflected in the private markets, where there is less visibility with regards to pricing, and the more diverse and complex nature of the region also benefits lenders.

Whilst both U.S. and European private credit command premiums over their BSL equivalents we believe European private credit offers a more attractive premium due to the market being less mature and structurally more complex.

The U.S. faces more severe pricing pressures due to the sophisticated nature of the BSL market, which has increased further in 2024 as loan issuance has resumed following soft volumes in 2022 and 2023. By contrast, European lenders, particularly at the middle/upper-middle market level, the market segment which CVC typically operates in, are not able to access the BSL and high yield markets as easily which means there is less downward pricing pressure from the liquid credit markets. As a result, the European market remains largely insulated from the extreme technical pressures evident in the U.S. due to the fragmented, complex nature of the market, as well as the restricted nature of capital. Europe is still a predominantly institutional and bank-centric market, with limited flows from insurance, the nascent wealth market, middle market CLOs and large aggregators such as sovereigns.

Consequently, specialist managers who have developed deep infrastructure across the continent are in a unique position to provide financing solutions. Local sponsors trust local lenders, and managers that understand these local dynamics and regulations are much better positioned to source investments and drive attractive structuring and pricing vs. the much more competitive and transactional U.S. market.

Figure 1
European and U.S. Leveraged Loan Spreads

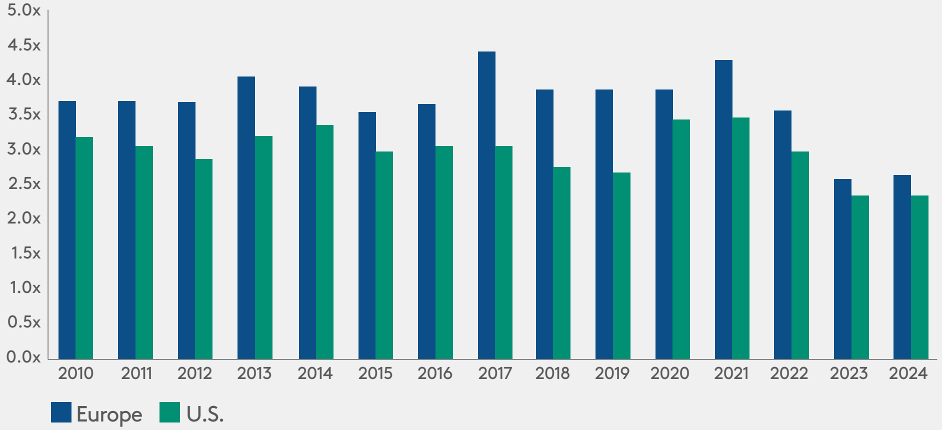


Source: S&P LCD. U.S. Leveraged Loans represented by the Morningstar LSTA US Leveraged Loan Index. European Leveraged Loans represented by the Morningstar European Leveraged Loan Index.

> **"CVC-CRED benefits from a pan-European presence underpinned by the CVC Network, the largest private equity manager in Europe."**

Local offices in Europe	Investment professionals
12	~180

Figure 2
European and U.S. LBO Interest Coverage Ratios Since 2010



Source: Pitchbook LCD, as at June 2024. Interest Coverage Ratios defined as EBITDA / Cash Interest. Note, U.S. data only includes issuers with EBITDA of more than $50m. Prior to 2011 media and telecom loans are excluded.

CVC-CRED benefits from a pan-European presence underpinned by the CVC Network, which drives broad origination through its twelve local offices in Europe and approximately 180 investment professionals. Access to local investment professionals within each of these markets brings a deep understanding of the distinct business environments that exist in each locality, greatly aiding the origination and diligence process.

Moreover, although the European private credit market is smaller than its U.S. counterpart, this has not undermined underwriting standards, and in fact interest coverage ratios for leveraged buyouts have consistently been higher than the U.S. since 2010, as demonstrated by Figure 2. Interest coverage ratios for European LBOs as at year-end 2023 were 2.6x, compared to 2.4x in the U.S. Thus, despite the U.S. being a larger and more mature market, with companies operating at higher levels of EBITDA, European deals are more conservatively structured, and are also pricing wider than the U.S., providing an attractive risk-adjusted return with strong downside risk management.

"The dynamics in Europe highlight the importance of a strong origination engine, and established local market presence, which CVC Credit benefits from through the long-standing CVC Network."

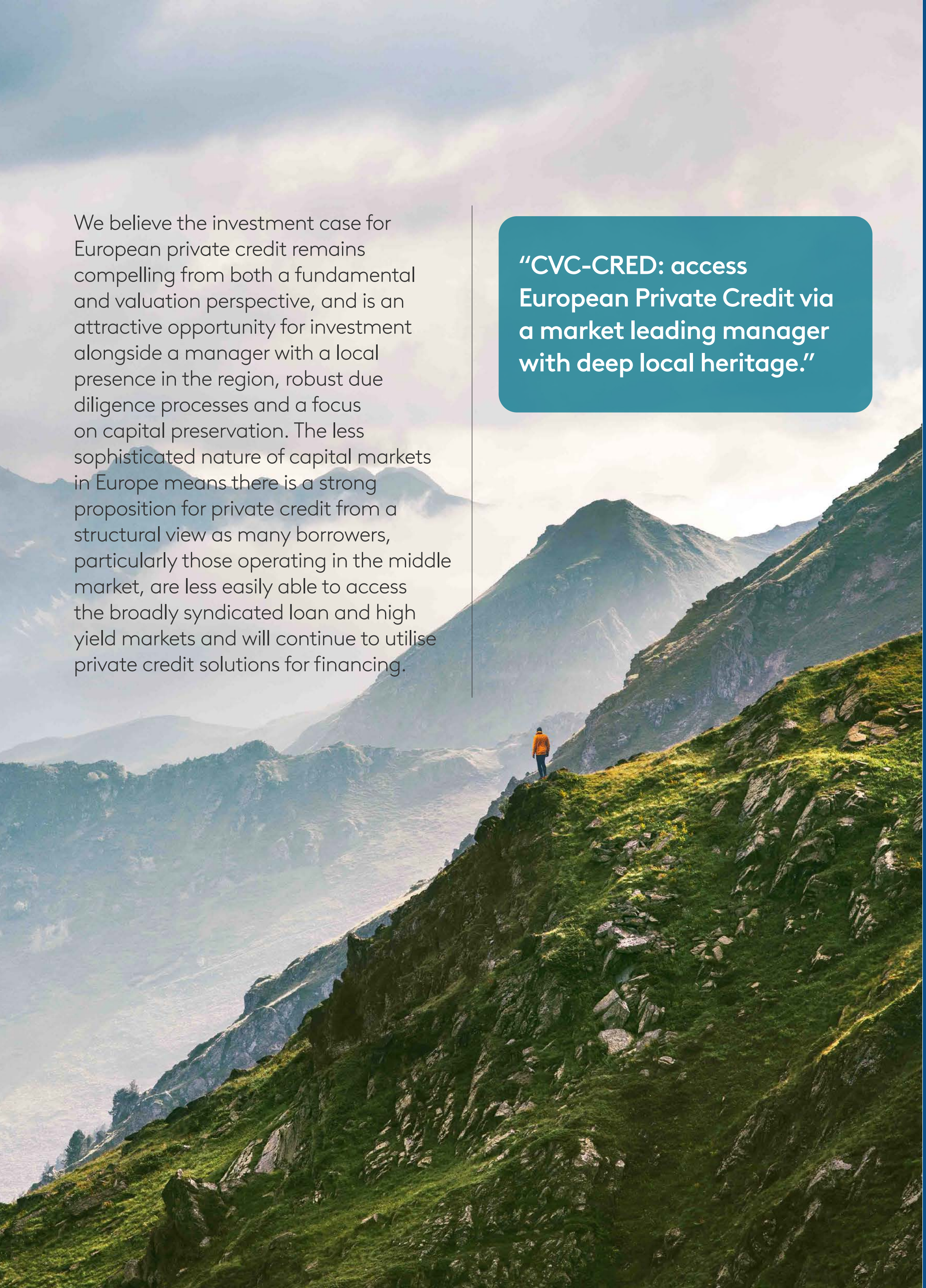
The opportunity set continues to evolve and is becoming increasingly attractive for lenders. We are seeing an acceleration of larger, higher quality issuers and high quality, sophisticated sponsors increasingly utilising the market, allowing managers such as CVC to create more diversified portfolios than ever, in turn reducing the risk profile as well.

The dynamics in Europe highlight the importance of a strong origination engine, and established local market presence, which CVC Credit benefits from through the long-standing CVC Network. Throughout the investment process, the Investment Team is able to benefit from the insight and experience of CVC Capital Partners, the largest private equity manager in Europe – having owned over 300 companies since its inception in 1981.[2]

CVC Capital Partners provides the European Direct Lending platform with the support and insight of over 280 investment professionals and operating partners, and crucially, direct access to its established network of 12 European offices, optimally dispersed to provide on-the-ground access and expertise in each of the core markets targeted by the Fund.[3] Access to the local investment professionals within each of these markets brings a deep understanding of the distinct business environments that exist in each locality. The Investment Team routinely call upon this specialist knowledge and market insight throughout the investment process, from sourcing through to due diligence, and as part of the ongoing portfolio management.

"We believe the investment case for European private credit remains compelling from both a fundamental and valuation perspective."

2 As at 30 June 2024.
3 Excludes CVC Secondary Partners & CVC DIF



We believe the investment case for European private credit remains compelling from both a fundamental and valuation perspective, and is an attractive opportunity for investment alongside a manager with a local presence in the region, robust due diligence processes and a focus on capital preservation. The less sophisticated nature of capital markets in Europe means there is a strong proposition for private credit from a structural view as many borrowers, particularly those operating in the middle market, are less easily able to access the broadly syndicated loan and high yield markets and will continue to utilise private credit solutions for financing.

> **"CVC-CRED: access European Private Credit via a market leading manager with deep local heritage."**