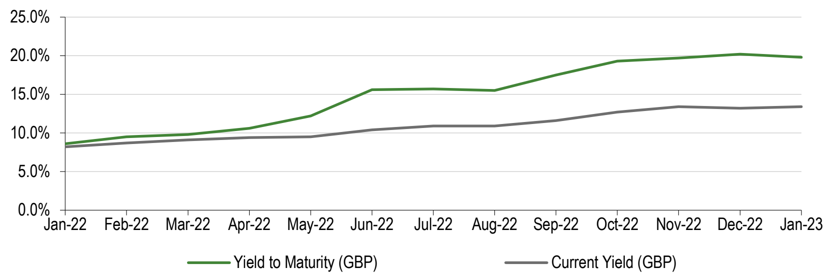
CVC Income & Growth

Equity-like return potential on senior secured debt

Investment trusts

FY22 was the first year since its inception that CVC Income & Growth (CVC IG) saw a negative NAV total return (TR). Its euro and sterling share classes produced NAV total negative returns of c 8.3% and 6.8%, respectively, which compares with 3.3% and 1.9% negative TRs by the Credit Suisse Western European Leveraged Loan Index (CS WELLI) in euro and sterling terms, respectively. This was primarily the result of downward mark-to-market valuation adjustments (resulting in unrealised losses for CVC IG), driven by price declines in the European loan market amid higher risk aversion. Meanwhile, defaults in the European loan market remained low at 0.4% in 2022, based on the Morningstar European Leveraged Loan Index (with no defaults in CVC IG's portfolio). Subsequently, European loan markets rebounded strongly in January and February 2023, leading to 6.7% and 6.9% returns for CVC IG's euro and sterling share classes, respectively (therefore allowing CVC IG to almost fully recoup the 2022 loss).

CVC IG's yield to maturity and current yield went up visibly in recent months



Source: CVC IG

Why invest in CVC IG now?

At the current market price of its debt investments (weighted average at 86.4% of par), CVC IG provides a favourable combination of portfolio yield and downside protection. The average yield to maturity across its portfolio stands at 18.1% in the euro bucket and 19.8% in the sterling bucket, which may be considered attractive, equity-like returns. In the context of the risk profile of CVC IG's portfolio, we note that (1) CVC IG invests in a diversified pool of loans, mostly to large corporates (weighted average EBITDA of more than €300m), particularly defensive and mature businesses across different industries, (2) 80% of its portfolio at end January 2023 was in first lien, senior secured debt (with typical recovery rates of 65–70%), (3) weighted average loan to value across the portfolio was 60% at end January 2023 and (4) CVC IG focuses on investing in Western Europe and the US, with no exposure to emerging markets.

Valuation: Discount back at pre-2020 levels

CVC IG's sterling class shares' discount to NAV narrowed recently to c 4% from the 5–10% seen throughout most of H222. That said, it is broadly in line with pre-pandemic levels. CVC IG provides conversion facilities, active trading in treasury shares and a semi-annual tender facility (subject to a specific limit).

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24 March 2023

Price	**97.4p/€0.86**
Market cap	**£126m/€89m**
NAV*	**£132m/€97m**
NAV per share*	101.23p**/€0.9239***
	€1.13/£
Discount to NAV	3.8%**/7.5%***
Yield	6.7%**/6.7%***
Ordinary shares in issue	129.5m**/105.1m***

*NAV as at end-January 2023; NAV per share as at 17 March 2023; **CVCG; ***CVCE.

Codes	CVCG, CVCE
Primary exchange	LSE
AIC sector	Debt – Loans and Bonds

Gearing

Gross and net gearing at CVC IG level	0.0%

Fund objective

CVC Income & Growth (CVC IG), formerly named CVC Credit Partners European Opportunities, 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 Western European sub-investment grade debt instruments. The portfolio is split into two pools: performing credit and credit opportunities. CVC IG has two classes of shares: sterling shares (CVCG, formerly CCPG) and euro shares (CVCE, formerly CCPE) traded on the 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.
- High yields at current entry prices in the context of mostly secured debt investments.

Bear points

- Higher default rate risk with economic downturn.
- Inflation risks could lead to higher interest rates, which could hurt corporate loan quality.
- Macroeconomic shocks can affect risk perception.

Analyst

Milosz Papst +44 (0)20 3077 5700

investmenttrusts@edisongroup.com

Edison profile page

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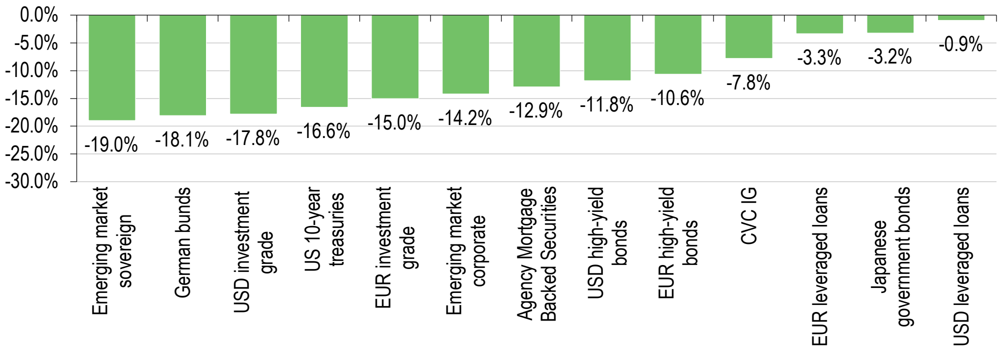
FY22 loss now nearly fully recouped

CVC IG posted a 7.8% decline in NAV TR terms in 2022 (with a negative gross return of 7% for both the performing credit and credit opportunities bucket), which represents some underperformance compared to the broader European loan market (see Exhibit 1).

Exhibit 1: FY22 performance of selected credit assets

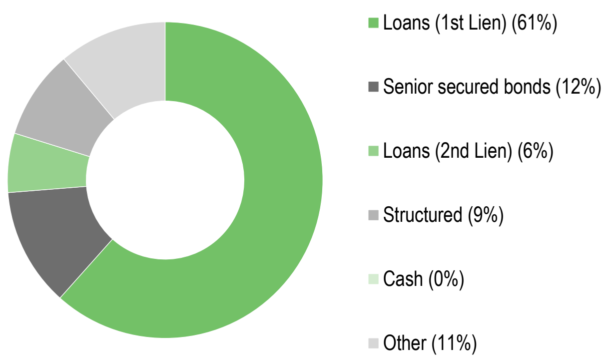


Source: CVC IG

There are a few reasons for this, the first being that CVC IG uses leverage at the holding level, normally at c 30–40% of the investment vehicle's NAV (33.3% at end June 2022), which leads to additional volatility, both on the downside and on the upside.

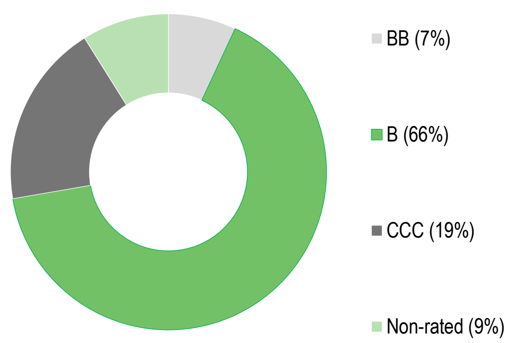
Secondly, CVC IG does not have a pure-play loan portfolio, but also invests in other debt securities. These include equity and debt tranches of collateralised loan obligations (CLOs), which represented c 9% of its portfolio at end-January 2023 (CVC IG may invest up to 20% of its gross assets in CLOs), see Exhibit 2. CLOs saw a greater de-rating throughout 2022, but rebounded more strongly in January and February 2023, which CVC IG took advantage of by realising some positions (including part of the BB CLO tranches it bought at attractive prices during the forced sell-off induced by the UK's mini budget announcement last year). Moreover, CVC IG has part of its portfolio in high-yield bonds (c 12% at end-January 2023), which are normally fixed-rate and were therefore affected by the increasing base rates last year. We note that, as per CVC IG's statement released on 20 March 2023, it does not hold additional tier 1 bonds issued by Credit Suisse or by any other issuer.

Exhibit 2: CVC IG's portfolio by asset class



Source: CVC IG

Exhibit 3: CVC IG's portfolio by rating



Source: CVC IG

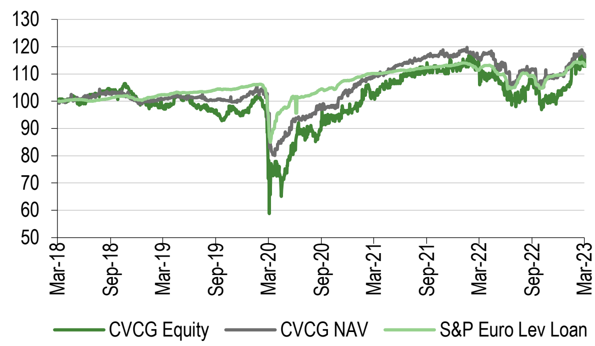
Finally, CVC IG's credit opportunities bucket (52.1% of portfolio at end-January 2023) has a higher exposure to CCC-rated loans than the broader loan market (resulting in 19% exposure across the entire portfolio, see Exhibit 3). CCC-rated loans visibly underperformed last year, with a 20.9% negative return for CCC loans within CS WELLI versus -3.2% for B-rated and +0.4% for BB-rated loans. This discrepancy (which was not observed in Western European high-yield bond markets in 2022) may have come, among other things, from selling pressure from CLOs (possibly in some cases driven by the need to remain within their CCC limit, which is typically 7.5% or below), but also from other investor groups.

Meanwhile, the default rate across the European loan market remained low at 0.4% in 2022, based on the Morningstar European Leveraged Loan Index. CVC IG had no defaults in the portfolio last year and we note that CVC's European performing credit portfolio has had a low default rate since 2006 at c 0.88% (vs 2.64% for the Morningstar European Leveraged Loan Index), with an even lower loss rate of 0.11% (thanks to a higher recovery rate on defaulted loans).

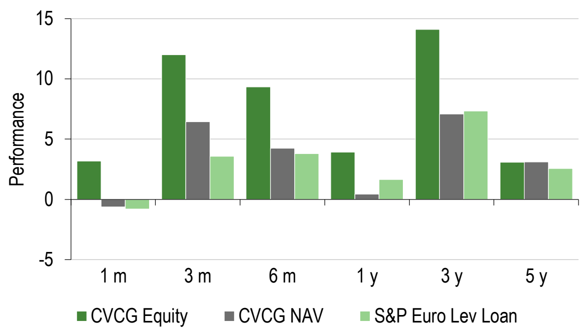
We note that CVC IG was able to almost fully recoup its 2022 losses in January and February 2023, bringing its 12-month NAV TR for the sterling share class to 17 March 2023 to 0.4%. Over the three and five years to 17 March 2023, the NAV TRs were 7.1% and 3.1% pa, respectively, which is broadly in line with the S&P Euro Leveraged Loan Index TR of 7.3% and 2.6% pa, respectively (see Exhibit 4). Since inception in April 2009, CVC IG has delivered a net return of 7.7% pa (close to its long-term target of 8% pa net of fees), with performing credit and credit opportunities delivering gross returns of 6% and 14%, respectively. Here, we note that CVC IG was able to achieve this result mostly in a low interest rate environment, with the current level of base rates providing an improved return potential going forward.

Exhibit 4: Investment company performance to 17 March 2023

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



CVCG price, NAV and index total return performance, annualised (%)



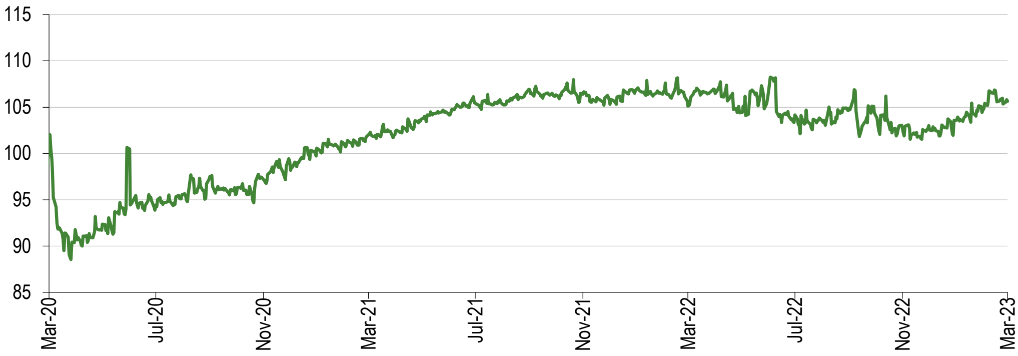
Source: Refinitiv, Edison Investment Research. Note: Three- and five-year performance figures annualised. Since inception: June 2013

Exhibit 5: CVCG 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	4.0	8.1	5.3	2.2	20.2	2.5
NAV relative to S&P Euro Lev Loan	0.2	2.8	0.4	(1.2)	(0.7)	2.7
Price relative to ICE BofA Euro HY EU & Western Europe	3.7	5.5	4.6	1.4	9.0	13.1
NAV relative to ICE BofA Euro HY EU & Western Europe	(0.2)	0.3	(0.3)	(2.1)	(9.9)	13.3

Source: Refinitiv, Edison Investment Research. Note: Data to 17 March 2023. Geometric calculation.

Exhibit 6: CVCG NAV total return relative to S&P European Leveraged Loan Index over three years

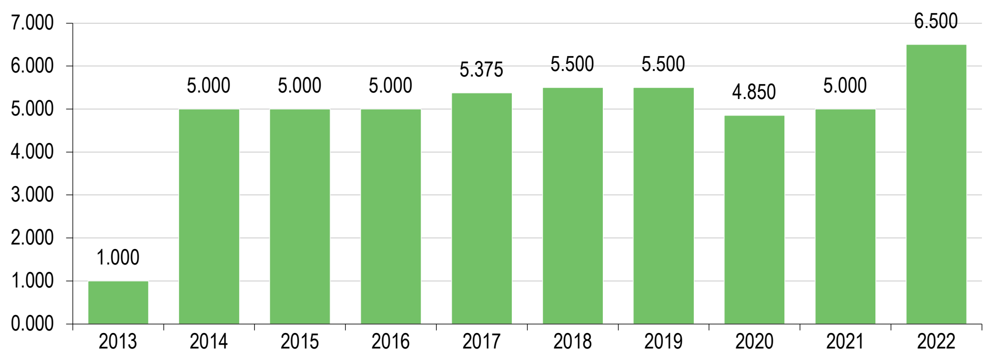


Source: Refinitiv

CVC IG's shares now offer a c 7.7–8.2% dividend yield

CVC IG's investment portfolio is mostly composed of floating rate debt (at least 75–80% in recent years, 84.4% at end January 2023), with coupons normally reset on a quarterly basis, and has therefore benefited from the recent base rate hikes, on top of widening credit spreads. Improved income generation encouraged CVC IG's board to increase the target annual dividend to 7c per euro class share (8.2% dividend yield at the current share price) and 7.5p per sterling class share (7.7% dividend yield), up from the 6c/6p annual target announced on 21 September 2022. The 11.7% and 13.4% running yields at end January 2022 on the euro and sterling share classes provide good dividend coverage despite not yet capturing the subsequent rate hikes. The board flagged that it will consider distributing a 'top-up' dividend in early 2024, although this depends on the actual income generated by CVC IG's portfolio, which in turn is dependent on macroeconomic developments and the base rate trajectory, for which the outlook remains uncertain at this stage. In this context, we also note that CVC IG's investment manager has waived its future right to receive an investment vehicle performance fee, effective from 1 January 2023.

Exhibit 7: CVC IG's historical dividend on the sterling share class (p)



Source: CVC IG

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