



## Bridgepoint Private Credit Teach In | 22 November 2022

Adam Key:

Good afternoon and thank you for joining us to those of you on the webcast. Just before I hand over to Andrew Konopelski for this afternoon's teach in on Bridgepoint's credit strategy, I'd just like to say that we'll hold questions from the webcast and the lines over until the end and take them in one block so that we make good progress because we do have an hour slot. So I'll hand over to Andrew. Thank you very much.

Andrew Konopelski:

Great, thank you. As Adam introduced me, my name is Andrew Konopelski. I'm the managing partner of Bridgepoint Credit and I will apologise for my voice. I'm getting over a cold, so I'm feeling a little froggy today, but we have an hour to get through a fair bit of material, so I'm going to try to get through all three strategies as well as a bit of what we're doing on ESG. And I think that the key messages that I hope to leave you with today are: credit is a fairly rapidly growing part of Bridgepoint, when we joined, well I joined in 2010, October 2010 when we merged, sorry, 2020 when we merged EQT Credit and Bridgepoint credit, we had about [€]7 billion of AUM. I think in June we had about ten and a half billion [Euros] and that's grown since. So a fast growing part of the firm.

We also derive a very unique knowledge advantage from being part of Bridgepoint, which I'll talk about a bit and how we do credit and how we invest the capital. There is a very strong benefit to being part of an integrated firm, but also integrated capital credit business, which we can talk about. And I think there's a high consistency in how we invest those three strategies. So while I'll talk about them individually, there are some overarching themes that we can cover. Well, maybe just on slide two, I'm not going to introduce Bridgepoint to you other than to say that credit today is roughly 30%, it's about a third of the total AUM invested across the three strategies we're going to talk about. So over on slide three, maybe if we lead into that. So while there are three strategies, we very much invest as a single team with different leadership on top of each strategy, if you will.

But really credit is a continuum. We invest in corporate cash flow credit and the boxes are really there because they represent different risk/rewards that our LPs are looking for. So maybe if I talk you through them very briefly. Syndicated debt is currently our CLO strategy. We have just over a billion Euros in three CLOs with the fourth one being warehoused.

As you'll know probably from other managers, CLOs are really focused on broadly syndicated loans, very diversified portfolios. We own about 140, 150 different credits today. And we do that through kind of CLO technology where we as Bridgepoint are holding the retention capital through a vehicle, which we

can talk a bit more about. Direct lending is, I'd say the core of the platform. It's about 7 billion of the AUM that we're managing today.

And this is a classic uni-tranche type strategy where we are supporting primarily European financial sponsors to make acquisitions, typically their initial acquisition of a company. We're very often the sole lender. We are negotiating the documentation in that. And we are looking for 7 to 9% un-levered returns. Okay, in fairness, that was the target return, we launched the fund. The world has moved on a little bit in terms of where Euribor is, so probably a little bit north of that. But classic first lien, secured, uni-tranche, "sleep at night" type credit is what we're aiming for there.

And then credit opportunities is actually the first strategy we began investing back in 2008 when we founded the platform. And this is looking at slightly higher risk, higher return, let's say mid-teens type target returns and working with companies that have either challenged access to capital, need some form of slightly more complicated structured solution or investing in secondary market opportunities where loans have traded off due to headwinds in the individual industries or in the overall macro environment like we're seeing right now.

We are currently raising for our third vintage of direct lending and our fourth vintage of credit opportunities that are both in the market. But the benefit, if you talk about the benefit of this platform, is really that these three strategies work quite well together. And they provide us with a very high degree of relevance such that when we're talking to financial sponsors to entrepreneurs, we can provide a range of solutions across our different strategies.

So you can have a single conversation, you can provide the single solution. Certainly, in terms of sourcing, we're talking to 150 financial sponsors across Europe. We deal with most of them on a fairly regular basis, but it feeds the whole platform in terms of having those conversations. There's obviously a knowledge angle with over 220 credits that we can share across and a wide degree of skill sets. Not every credit goes exactly to plan. But having teams that deal with the slightly trickier situations, whether it be restructurings or not, it's quite useful to have it all in one platform.

Slide four is probably one of the key ones, which is Bridgepoint is very powerful organisation in terms of the knowledge advantage that it brings to credit. And there are three planks to that. The first resides in the organisation itself, almost 200 investment professionals, 35 years of track record and of knowledge of memory, 10 local offices out there in the local communities. It's very powerful for us because we look at similar mid-market businesses to get access to those networks, to get access to that knowledge. We can internalize that into our own due diligence. And really this is all about making better investment decisions. Where can you bring knowledge to bear to make the best investment decisions you can? So the firm being part of an integrated firm that does share, that has a collegiality and that has I'd say an openness and a willingness to help other business lines. Very, very powerful.

One of our, I'm going to say unique attributes, because I appreciate a lot of people can put this on a page where I'm not sure it works quite the same way, is what we kind of think about is our industrial network. So we have over 300 what we call industrial advisors, ex-CEOs, ex-CFOs that are kind of around the organisation, many of whom are contracted with us that help us on our due diligence and we think bring an angle. Because if you look at my CV, I am a financial person. I've worked for a bank. I've worked for a hedge fund. I've worked for an investment manager. I've never actually run a business other than this one. So it's quite powerful when you can put our financial knowledge together with the operational knowledge of those individuals to get a better view of the companies you're lending to and really to protect your downside and then obviously tapping into the sector teams.

Then we also reach into the portfolio companies that Bridgepoint owns through Bridgepoint Europe, but also Bridgepoint Development Capital for a bit more granular knowledge. But very, very powerful overall and you'll hear me talk about it a bit as we go through because it's been a real hallmark of what we do

and how we do it over the past 14 years. In terms of team, we're about 60 investment professionals, 11 partners, quite an experienced team, but also one that's worked together for quite a long time. So quite valuable from the combination of how do you challenge one another, but how do you support one another?

We are located in eight offices, all of which overlap with Bridgepoint. Again [it] comes back to the value of a local network working side by side sharing knowledge. Six of those eight offices are investment offices. Luxembourg is where we have our GP and our head of credit investor relations sits in Madrid. But a very international team, which you'll all be aware is what you need to operate successfully in Europe – says the American! But to know how to navigate different countries, different cultures, but also speak the languages is what gets you into those local communities and gets you access to deal flow.

So with that, maybe if we start with direct lending and we turn over to slide seven please. I'm guessing that most people know what direct lending is. I don't know you all, but I think it's probably pretty well trodden at this point in time. So in terms of how we look to do it, and I mentioned “sleep at night” upfront and that's really what this is. You're looking after your downside. You're not looking to necessarily push the investment return by taking more risk. That kind of defeats the purpose of building a well diversified first lien, secured, senior / uni-tranche portfolio. We are focused very squarely in the middle market. We define that as roughly 10 to 75 million Euros of EBITDA. You'll see the average of our current portfolio is 25 million of EBITDA, so 25 to 30 is roughly the average we're kind of looking at. And most of them are clustered quite closely around that.

That actually overlaps very nicely with where Bridgepoint as a firm focuses. So again, coming back to using knowledge, using access, it's quite powerful that we actually overlap in terms of our focus. 79% un-levered IRR's. But again, another overlap with the firm is just the types of businesses we're looking for. We're obviously looking for very resilient businesses. You'll see we have a very strong focus on healthcare, TMT and business services. Again, tapping into I think some of our strongest sector teams internally, but those same kind of high EBITDA margin businesses, Bridgepoint is well known for. So our average EBITDA margin about 30%. Very important in times like this in terms of a pass through any inflation that you see coming your way, whether that be labour, whether that be other input costs, but usually high margins indicate a certain market position where you can put those back through. ESG very important to what we do across the platform. I'll talk about that a bit at the end. But as I also mentioned, we tend to try to be the sole lender in these transactions. It's really about being able to structure the deal to make sure the documentation is robust. That's where you get a lot of your downside protection from. Not every credit is going to go perfectly to plan, but if you have a well-structured document and you have a team that knows where they need to be putting emphasis when negotiating with the sponsor, with the entrepreneur, it does give you early warning signals and it gives you a chance to try to remediate the credit if it's gone wrong.

Maybe over on slide eight just in terms of how we trying to do this. And this is, direct lending is a bit of a flow business, right? The objective is to see every transaction in the market, to screen them down, and to make sure that you're well positioned to do the deals that you want to do. And then hopefully to position yourself to get the last look. To work with the sponsors you want on the assets you want and get paid what you want for it. That's the golden triangle.

I mentioned the three sectors we really focus on quite heavily being healthcare, technology, and services where I think we have a very good long track record, quite a lot of internal knowledge and we can use the firm. We avoid cyclical businesses for a reason. It's very in vogue to say that right now, but if you go back four or five years, it was not the same for everybody. Somebody's been lending to all those industrial businesses and consumer facing [ones] – there's nothing wrong with those businesses, we need them in our economy – but they do tend to be more volatile. You don't always sleep well at night if

you've lent to a lot of consumer facing or industrial businesses. This strategy is not really intended to do that, although we do have a spattering in there, but we've stayed away from retail, consumer discretionary, heavy industrials.

I mentioned knowledge angles and I'm going to continue to bang on [about] it, but really this is about that kind of knowledge bank slide that I talked to. It's – you want to get away from being a desk top lender – the whole idea is what else do you bring for your LPs but how else can you judge your risk? You're looking for people that can actually embed themselves in your process and provide you with advice. And the best advice they can give you is that “Andrew, there are things changing in this industry. You may not see them. But I live in this industry and I can tell you all about them. I would suggest that you avoid this credit” because in a portfolio like this where you actually make your alpha is avoiding losses. You are unlikely to go out and find that one deal that's going to deliver 2x the type return that somebody else is making.

But you can do it by just prudent management. And then obviously with a robust structure. This comes back to documentation. To give you a few statistics, the average loan to value, and we're going to take the value in context here, right? Because the market has moved a little bit on us in the past 12 months. It was less than 40% when we made the loans in our most recent fund. So that it just gives you a nice bit of headroom so that if the market does move, you still have a fair bit of proper cash equity value behind you to provide you with a buffer. That also goes for cash flow conversion. The average interest cover in our loans prior to LIBOR rising, right – so I'm going to put a caveat again – was about 2.8 times. That provides you with a very nice buffer because we all realised that interest rates were at some point going to rise.

You don't know when it's going to happen, but you're insulating yourself against future events. Today that's obviously come down, but we still have all cash flow positive businesses. And again, robust structures. Floating rate is very positive in that it provides incremental return for our LPs and obviously for the firm where we're an investor or have made a GP commit. But you have to make sure that the increase in the interest that you're earning doesn't then become a negative if you have greater loss rates that wipe that out. So that's the balance you're trying to find. Slide nine just gives you a sense of what we've done the last three funds. You can see the fund size on the left hand side, BDL being Bridgepoint direct lending. First fund 2015, second fund 2018, third fund 2023. Okay, actually we started investing this last year, so let's call it '21. But scaling up the funds, but you can see a consistency in the middle in terms of diversification by sector.

I talked about it, but you can kind of see it written down on the page. And then on the right hand side, I think our bias is written pretty clearly in terms of what we like to invest in and where we think we have an angle versus where we don't. But this has left us, I think in very, very good stead coming into the period that lies ahead. I'm not a macro-economist. So I'm not going to sit here and prognosticate about what next year is going to look like, but it's going to be a little bit bumpy. I think in the European economy, but I believe that our portfolios are pretty well bedded in, given that we've had a pretty defensive mindset for the period that we've been building them.

There are a few statistics on slide 10 just in terms of the latest fund, if you're interested. It is investing, these are fees on invested capital businesses. So we are, I'd say on kind of linear investment pace, which is what we set out to do. There's no rush to invest this capital. We are not asset gatherers. We are investment managers, but 24 investments already in the fund. All investments that we would have made had we known where the world was headed because these investments have been made over the past 15 months, but about 1.6 billion committed. Again, high EBITDA margin, low LTV, a good spread across Europe, so there's no single country risk. I think one thing I'm quite not pleased about, but I think one

thing we've always focused on is not to over index to the UK. Yes, our headquarters is in London. Yes, we live in the UK. About half the team does, but we have a very good spread across Europe using

In all those local offices to drive deal flow, which I think just doesn't insulate us, but it does mean that you're not taking any individual country risk as you kind of look forward in terms of your portfolio performance, which I think is quite important for portfolio construction overall.

All sponsor backed businesses and an average of [€]25 million of EBITDA. Look, it's a boring strategy, but it's meant to be. The intention is to set out and do exactly what you tell your LPs you're going to do, and that's what ultimately gives you the license to operate and the reason that it's been growing so quickly as a strategy having started only in 2015 and now being about 7 billion Euros of AUM.

Maybe if we turn to maybe the slightly higher risk, higher return strategy in credit opportunities, and I'm on slide 12. I do not need to tell you what the market backdrop looks like. What I will say, and it's a little bit perverse, but this is the backdrop we love to see in credit opportunities. Anytime you have volatility, anytime you have uncertainty, anytime the market is slightly on tilt, it creates opportunity, creates opportunity when the banks aren't extending as much of their balance sheet as they had historically because it provides an opportunity for private capital to step in, we're benefiting from direct lending as well. We're also benefiting from, I'd say the higher creativity structured end that we can provide through credit opportunities. When secondary markets fall, risk premia rise, it provides a very nice opportunity for this strategy, so I think we're actually seeing probably the best market that we've seen since the GFC for certain, but it's really one where both primary and secondary investment opportunities are both really humming, which is nice because the way that you want to invest every credit strategy is on a relative value basis. If you can stretch out all the investment opportunities before you and pick your A star ones and there's enough to go around that you can build your entire portfolio from your very best ideas, it's halcyon days.

Well maybe what do we do in this strategy? What do we focus on? Again, using a very similar, I think, fundamental due diligence approach that we do in direct lending, so really trying to dig into companies as deeply as we can, using that industrial advisor network. We're looking for very similar types of companies. With both strategies, the term we use is kind of businesses that have a real reason to exist so if you took the company out of its value chain, its customers, its suppliers would miss it. The benefit, if that's the case, is that that company will always find a buyer. That is your downside protection, because in this strategy, while we're looking for downside protection, we're also looking for upside optionality. How do you deliver mid-teens type returns? You have to take some risk. You need something that looks like a bit of an equity kicker, whether that's an actual equity kicker through, say, warrants or options. It can actually be from buying things at a discount to par and then pulling them back. We can talk a bit more about that, but you need a bit of upside while still protecting your downside and making sure that your capital is preserved.

But it's a very flexible strategy with the intention of being able to pivot between say, primary and secondary markets to find the best relative risk reward at any given point in time, as the markets move, you try to move with it, but it's all still focused on corporate cash flow credit. There's no style drift. We're not going into things where we don't have a knowledge advantage. We tend not to do inanimate objects, for instance, we don't do rigs, we don't do ships, we don't do NPLs. This is companies that have a living, breathing heart to them that you actually can understand the fundamentals.

Maybe on slide 14, if I try to use this diagram, which may or may not be successful, to explain what it is we do, but I mentioned that we invest in both primary and secondary markets. Secondary is probably pretty easy to understand. We're buying loans and bonds at a discount to par. They might be a bit

bumpy along the way, but we generally expect to get par back. There may be some negotiations with sponsors, but it's not a loan to own fund, right? We are not ultimately looking to own the businesses that we're lending to, we're looking to maximize the return out of them. We tend to invest in businesses that are ... We've invested in some recently that are quite recession resilient, but have traded down on the back of the general macro situation from outflows from high yield and loan funds that have created an interesting buying opportunity. We started to look at more macro impacted names, maybe where input costs have started to weigh on margins and some investors that maybe don't have as in depth knowledge on the sector or the company that's decided to sell out and rotate into things that they do understand. It provides a nice opportunity to buy into that.

Then on the bespoke primary side, I jokingly sometimes call this indirect lending plus plus. You're lending money directly to a company to provide a solution, but you're doing it in a situation that can provide you with greater return potential than the 7 to 9% we're looking for in direct lending. What does that look like? It tends to be either it's called hybrid or growth capital, where you're lending to a business where the upside potential for the equity holder is so great that they're willing to pay some of those returns away. This is going to be typically businesses that are high growth but can't tap the capital markets and you're looking to structure some form of hybrid solution, usually firstly in secured that gives you good downside protection, but then also provides them with the optionality to go out and grow their business the way they want when they can't go to their local bank or they can't do another equity funding round.

It could be solution capital so think sponsors that maybe don't have enough capital to do the whole transaction. So looking for a solution that stretches across senior, junior, and maybe some form of structured equity, so you're helping them structure a holistic financing solution and you get paid very nicely if you can find solutions for people. Then we also haven't done much of this yet, but you're going to find more rescue capital coming down. There has been a bit of dislocation capital. I'm thinking of stuff that's come off the banks, they're rather long on some assets. That's not our normal stock in trade, but it has provided some interesting opportunities. But you put all that together and you have an awful lot of investment types in this type of market where you can build quite attractive portfolios.

Maybe to take a look at that portfolio, slide 15, this is everything we've done since the beginning of 2020, which is a decent time period I think, to see what the latest market looks like. But you can see if we start top left by seniority, about 70% has been secured, firstly and secondly, and then you have a portion of bonds, which is the subordinated portion here, and then there are some preferred equity, common equity, most of which is structured in a way. While it might be common equity, it tends to be a bit more convert, where we get some form of downside protection and then you give away a portion of the return and then you get a kicker on the upside to try and generate those kind of mid-teens plus type returns.

By geography this is the one strategy where we do invest a little bit in North America, but 80% of it is core Europe and you'll notice if you look at the names, it's largely Northern Europe, tend to be the geographies, well, at least in the past, that have had maybe the strongest economies, but they also tend to have the legal systems where you can judge the workout if something goes wrong. There's a clearer path and you can price in that path if you need to. Quite a bit in the Nordics, quite a bit in Germany, you can see the UK has actually been underweight, although that probably picks up a little bit given where we are in this country.

Then by sector, you'll see the core sectors of Bridgepoint writ large, but again, technology, healthcare, business services overweight, is again, looking for the same types of businesses that we look at in direct lending and across the platform, but just ones that are facing a different type of challenge.

Then I think the best way sometimes to describe the strategy is on slide 16, which is where do you make your money and how do you make it? Although we talk about things like equity and equity upside, it is still a fundamental credit strategy. And you can see that 80% of the return that we've generated since inception has come from credit related elements of the investments, so about 50% of the total return has come from interest, two-thirds of that interest cash, one-third of that interest PIK [payment in kind]. There's a pull to par component, which is buying those attractive assets at a discount to par and getting paid back par in a few years time, and then you can see that the equity kicker or that equity like upside through conversion, et cetera, is about 20% of the overall return. But this is kind of what we mean when we say downside protection, which you get from the credit focused elements, and then you get that upside optionality, which puts a little bit of extra MOIC [Multiple Of Invested Capital] into the fund.

Then I think I've spoken to all these terms on slide 17 or all these figures. The one that I think is quite powerful, yeah, it's great to have a nice realised IRR since inception. It's the loss rates I think really come through. This is the same in direct lending, and we haven't had any losses in direct lending, I would expect that, but in this strategy where we're delivering higher returns, the loss rate's been exceptionally low. Again, that comes down to how you use an organisation like Bridgepoint to understand the risks you're taking.

Then the last strategy, our syndicated debt or CLO strategy. There's not that much to say about it, I think, other than maybe how we invest it because we are investing the firm's capital here because Bridgepoint have committed to the balance sheet to the originator vehicle in which we're holding the retention piece, either horizontal or vertical. We issued three CLOs to date. This has been a fairly fallow year. The market's been, as you may have seen, it's been a little bit tricky. One, because the issuance of new syndicated loans since Russia's invasion of Ukraine at the end of February has been quite meagre so the supply hasn't really been there and then the arbitrage between the liabilities and the assets hasn't quite worked out to be optimal to want to issue a CLO. I think this all comes back to the point that we are not asset gatherers. There's no pressure provided to get out and just issue it. We want those revenues.

I think it's important that we do take, I think, a very systematic approach and that we are trying to optimise returns both for our investors but also for the firm as we think about when the right windows are. We do have a warehouse that is currently partly ramped, it's only €30 million invested, which has been quite positive from the standpoint that loans have come off this year. They're at a much more attractive price point now than they were in say, January, February, so we've taken a very, despite this being open almost all year, we've taken a very deliberate slow approach to putting any risk into it. But maybe the thing to do is to turn over, if you turn over to slide, I'm going to skip slide 20. The interesting thing that I find with CLOs, and let's go to slide 24, is that it's a very, very transparent market. Every quarter, actually every month if you want it, you can get statistics on every CLO in Europe and the US and can compare yourself. In terms of benchmarking, it's one of absolutely the best, certainly from a managerial standpoint, but also from the team standpoint. I think the way we invest this, I actually probably could have introduced that first, but it's actually written on these pages pretty well, which is we're focused on those same high quality, resilient businesses so what you would expect to see from our CLOs is what you see on this page, which is we actually have the highest average portfolio price in Europe, which is just telling you about the quality of a portfolio. Again, you don't need to shoot the lights out on every asset you're trying to put in here because the leverage does most of the work for you if you have a robust portfolio and you minimize losses.

The equity nav, so the net asset value of the equity, we are second in Europe, which is both first quartile, so it tells you about the quality of the portfolio. The last one, which I keep asking John to change, MVOC is Market Value Over Collateralization. Again, it's a good thing, so you want to be in the first quartile, but this tells you about the quality of the portfolios that we're building and the type of reputation and the

types of what we want to be known for in the market. Then the next, on slide 23 will show you the flip side, which is about the bad stuff in the portfolio, which is the triple C rated, the higher risk names, and again, we're first quartile, our holdings of triple C or lower rated assets is quite small. Again, we've deliberately gone towards core investments in the same types of industries that you've heard me talk about for the last half an hour but trying to build a very strong, robust portfolio that can come through any market environment unscathed with as low a default as possible.

If we want to flip back to slide 23, you'll see the statistics, but again, it's pie charts with a large number of wedges on it because this is a much more diversified portfolio. But again, average LTV, 41%, average senior leverage, five times, average value cover, obviously the converse of LTV, 60%. Nice buffers, nice cushions built in.

We have a pretty strong bias in this as well. I think it's a strategy, it's a program that's started quite well. In a normal market, we'll look to do about two CLOs a year. This has not been a normal market this year.

Maybe with that, I won't belabour this, but I do want to highlight it because it is something that I think is very important to us. I'm on slide 25 now in the ESG section. There's obviously been a big focus from our investors, there's been a big focus from the firm, both in terms of sustainability, DE&I, ESG, whatever you want to call it, we've had a big push for the past five or so years. Six months ago, we hired our first credit focused ESG specialist to help us try to kick on. We had very positive UN PRI ratings. We've also had LPs share with us two of the individual assessments they've had done by consultants during their due diligence process for our latest funds and we score top in Europe in terms of our approach. We're trying to bring a lot of this to bear in our portfolios.

I think there are a number of different aspects to this. Maybe if we go to slide 26, I'll just give you a real high level on how we think about this because in my mind, it's quite simple why we do this and there are two main reasons. One is it's about risk. I think businesses that fall on the wrong side of what we consider to be positive ESG principles tend to be more subject to governmental regulation, maybe increased taxes. They tend to come up against a bit more buffer. Now a lot of them are quite profitable and a lot of them do very, very well, but ultimately

They do have a bit more volatility in terms of their outcomes, we find. The other, which I think is equally as important is, we're looking to build portfolios that our LPs but also our team can be proud of. I think it's become a very important factor for retention in terms of people being proud of what they do and how we do it. So we tend to assess companies based upon two things. One is their solutions, what they do, how they do it, are they supporting some of the UN SDGs or not? And then we look at their practices internally. And again that comes down to risk. And if you tell me that a company has no cybersecurity protection, that they score very poorly on that, I'm going to say, "No, thank you." Because it could potentially be a risk and we shouldn't be lending to that type of company.

We're not the equity holder, so we can't go in and change these policies. We can try to convince. We can point things out and we can ask for them to make some remediation, but we can't actually control them. So we tend to score things and monitor them. The other thing we're looking to do is, which I think quite a few are taking up with, which is great, which is on slide 27, it's just incentivisation. A lot of this is about raising the dialogue with companies and some of the smaller sponsors. Not every sponsor has the breadth or the size, the scale that Bridgepoint does to be able to have a dedicated five person sustainability ESG team, and have all the playbooks that go with it. They just don't. If you have a fund that's a billion in size and that's your second fund, you probably haven't gotten to that point yet in terms of building out your internal architecture.

So if we can bring some of that to some of these sponsors and, we can raise the dialogue with CEOs and CFOs in terms of trying to promote some of the things that we believe are important as a firm, we think it impacts positively on the whole industry so, one of the ways we've been doing that is with margin



ratchets. Some of them I think have been quite positive and quite innovative. We work with one company, which is Company 1 in the UK, that has a lot of ex-service members [military veterans] that are often prone to mental health issues. So we've agreed with the company that they will run a mental first aider program to try to support their employees. So we kind of set a margin ratchet based upon mental health first aid, which is actually something we as a firm are taking very seriously, but it's also a way to work with a company to incentivise them to take actions which we think are positive for their company but also for their employees.

So anyways, it's a nice way I think, to try to bring ESG to life a little bit for some of the companies that we invest in. We can spend all day talking about that, but I won't. So maybe if I wrap up, I think, just on slide 29, I think you should always ask yourself why do you exist? We ask why do companies exist? We should ask ourselves what do we provide to our LPs and how do we differentiate ourselves? And I think that's what we've tried to put down on slide 29 and what do we bring to corporate credit investing in Europe? Hopefully, you see that we have a similar thematic investing style to the firm. We are reasonably targeted in terms of what we do and how we do it, but that's held us in very good stead. It's also the best way to use the knowledge from across the organisation. We are very collaborative and very strong sourcing angle. We've pushed into those local offices, which gives us a huge competitive advantage to see all that deal flow so that we can pick the best ones that are coming through the system.

But I think the way we really differentiate is on that due diligence. I don't think there's another sponsor in Europe on the credit side that has access to the resources and knowledge that we do and the way they use them. And what makes that work is the firm culture. The sharing of knowledge only works if people are willing to and they want to. But then I think we also bring that ESG focus and we bring a very strong, both debt and equity, toolkit, which is very important. It's great to put money out, but it's only when you get it back in that it actually has a positive impact on your fund returns and on your LP cash flows. You've got to be able to get it out and get it back. So I think we're pretty well positioned. As we sit here today, we've now been, as a combined credit business, just over two years in Bridgepoint and I think it's going phenomenally well, and I feel like we're going from strength to strength. So that's a lot from me. How do you want to do questions?

Adam Key:

We'll start with questions in the room and if you could please use a microphone for the benefit of those online - whoever is asking the question.

Andrew Coombs:

Good afternoon. Thanks for doing this. Not sure if this is working, but I'll try anyway. It's Andrew Coombs from Citi. I guess my first question, just actually coming back to the point you made at the end there, two years with Bridgepoint. Can you talk about how ... You're talking about culture and due diligence being your real KPI. How have things changed versus your previous owner to moving to Bridgepoint? What are the major changes that have happened as part of your business? That'd be my first question. I've got a second one after that.

Andrew Konopelski:

Yep. So it's interesting because the organisations and I'd say the access to information and such is similar. I think the biggest change has been, I'd say senior level support. And I'd say just the general collaboration of the organisation has really helped us push on. The fact that we're roughly a third of the AUM, I think puts us in a slightly different category than we were at EQT, and I think also as being a

pretty material acquisition, which was made during the time of COVID lockdowns, it was also I think a very strong statement to the firm. I think we've talked about how we sourced capital from Dyal, we've gone public for a reason in terms of building a balance sheet and to be able to do transactions like this. But that was a very positive message I think to people internally and the way we were embraced positively? That's how you get culture and information flowing. So look, it's nice to be wanted.

Andrew Coombs:

If I ... fundraising and deployment dynamics, there's no real step change between owners?

Andrew Konopelski:

We've grown significantly since we've been here. And again, I think that's the positive step, which is the positive momentum comes from a number of different places. The support's been fantastic. Fundraising is just a ... It's a baseline of support. It was one of the things that we kind of looked into when we were joining, right? Because the firm, we shared a joint ambition for credit, which was quite powerful in terms of how we're going forward, so.

Andrew Coombs:

And then my second question would just be, is there any overlap in your corporate portfolio with the private equity business, and is there any potential for conflict of interest?

Andrew Konopelski:

Very, very, very little. So in the CLO, there is some, so we are ... for full transparency, 'cause it's all out there anyways, Bridgepoint are one of the named sponsors, it's probably the sponsor #3, something like that. But you're talking about small parts of large syndicated deals that are actually tradable. So there's no potential for conflict there. And then in our direct lending business, we don't lend to Bridgepoint businesses, not because we don't like them, but because we want to be the sole lender, and being the sole lender in an equity owned business doesn't make sense. But I think what we found over the years – we found this in EQT as well – the deal flow is so significant that you don't need to do those couple [of] transactions.

Arnaud Giblat:

Hopefully it works. I'm Arnaud Giblat from BNP Exane. I've got three questions, please. Can you talk, so you helpfully gave some numbers in terms of coverage, confidence, loan to value. If we focus in maybe on the lowest decile, the worst performing part of your portfolio, could you provide some stats there? Are there any risks there?

Andrew Konopelski:

Lowest decile. I mean there're always businesses that are not performing exactly as you thought they might, right? Then the question becomes does that impair your value? I need to speak for the different strategies, because you can take different remediation. So in the CLO business you can sell them, if you don't like the direction they're going. In direct lending, you're in that, and really what you're looking to do is establish a dialogue with management teams and with the sponsor to make sure that you're getting the information that you need to assess what's actually happening in the business, and then to think about what other steps you might want to take. You can also use it to leverage better economics to reflect the higher risk that you might see in the outcome. So I'd actually have to go away and pull

some statistics. In our direct lending business, we have had one partial debt for equity swap, where a portion of our debt was converted.

That was going back about two years now. And that was ironically one of our only cyclical businesses. And coming into Covid, they had a difficult time. It was an auto parts maker, but generally it's in very, very good health. There are underperformers in terms of where you would want them to be, but I think with this macro backdrop, that's going to happen. I think it's more about at what point does it get concerning that something is fundamentally changed in the market outlook or in the way the company was doing business where you feel like the business model might be broken, and there are no broken business models. Even the one that we had to do a partial debt for equity swap on, it's just because it's cyclical and it went through a bit of a swoon during Covid, so we took the necessary action. It was quite consensual and we'll get our money back, so we're going to make a very good return on that, I suspect.

Arnaud Giblat:

Maybe just framing it a bit more broadly, where would you see the default rate in the market going? How do you position versus that?

Andrew Konopelski:

That's a good question. I was actually reading some research on that the other day. I don't actually have a view in terms of the overall default rate. I mean I have a view on our portfolio on whether or not we should be on that or not, because it depends on which – if you talk about defaults, there are two ways to talk about it: one is, if you talk about it from a CLO context, you're really talking about where you've had an interest nonpayment, so you've actually had a cashflow default. We can also talk about it because 90+%, which we didn't talk about, 95% of our direct lending loans for instance, have maintenance covenants. So you will have some in the next few years that breach a maintenance covenant, but those are usually set at somewhere around 60% LTV. So there's still a lot of value left if you breach just a maintenance covenant. And we will see some.

I think in the latest estimate I saw in syndicated debt was next year could rise, or in the next, 2024 could rise to about 3% or thereabouts. And then it comes down to recoveries and such. I would certainly expect us to be inside that, partly because the selectivity, if you take out what we think are the most volatile segments being consumer retail and a lot of the industrial, by definition, you should have a slightly more stable, higher value portfolio.

Arnaud Giblat:

And finally, on deployment investments, you've talked about a linear pace of deployment. What's the outlook there? I mean obviously, lot fewer deals, but more opportunities.

Andrew Konopelski:

Yeah, it's been a good year, partly because the bank market has been largely shut, so any sponsor that was looking to raise capital has largely turned to direct lending. So even then it wasn't linear within the year because, the end of Q1, early Q2 was quite quiet because of what was happening in Ukraine. But no, I think the outlook – it's funny because the banks' deployment of balance sheet tends to dovetail reasonably well with the level of M&A activity – so I think as we see banks maybe become a little bit more active, I would expect M&A activity to pick up. So I think we've almost had this buffer, where M&A activity has been declining a bit in the second half of this year, but because the banks aren't in, we've actually taken share, some of that share – I'm thinking direct lending now – some of that share would be given back, but you'd expect it to be compensated with a bit more M&A.

Now I do think that the long term trends are very clear. Are we ever going to end up in a US style situation where it's 90% to funds and 10% to banks? No, I don't think so. But private debt has been taking share quite dramatically for the last, well, decade. And I think that will continue, and then we'll find a stasis, because I think the days of large bank underwrites are probably, at least for mid-size companies, are coming to an end. I think we've, the other thing we've seen is a mentality shift in the sponsor community in Europe. If you go back even five years, you almost had to convince sponsors sometimes to line you up against the bank solution and talk about the differences. Why would you do this versus that? Because you're going to pay more for our debt. I think now every sponsor is looking to private debt as a potential solution, and they're making that call on day one, which just means that the acceptance is there, which is partly what's driving the growth.

Arnaud Giblat:

Sorry, I lost one. If you can also talk about forward pricing. Forward pricing in direct lending and in CLOs.

Andrew Konopelski:

Yeah so, direct lending we've seen in this year, so if we go Q1 to now, you've seen an uplift of about 75 to 100 basis points. That's probably ticking up a little bit higher. And it depends a little bit where you take your average from, but, plus LIBOR, right? So the all in cost or, I'm going to flip it around. The all in return to us has increased quite dramatically. If we think about three year swap rates being just under just about 3%, you're actually talking about 4% higher return for our LPs going forward than the beginning of the year. So it's a fairly material increase for the borrowers. It's a very nice return for our LPs, so long as it's not compensated by greater defaults and losses.

Arnaud Giblat:

The entire book is floating?

Andrew Konopelski:

The entire direct lending book is floating. Credit opportunities owns a little bit of fixed rates. We can buy bonds as well, but I think we looked at the other day, it's about 80% floating, and some of those bonds have been bought quite recently. And then we can, I mean the risk premia in credit opportunities is a little bit more volatile, and in terms of – it's also subject to certain technical factors – I mean loans have rallied about five to six points in the past three weeks because the CLO bid has come back, but there's been no supply, so now it's overpriced. But the risk premium has stepped out quite significantly, and you're seeing all in returns, 8 to 10% for unlevered decent risk. Okay. Some comes inside that, but if you have to issue a new loan today, it's going to come at LIBOR plus 500 to 550 and a 95 OAD [Option-Adjusted Duration], so it's quite expensive to borrow via the syndicated debt market, partly because the CLO market hasn't really ramped back up, like the M&A market, it's all on tilt still a little bit.

Operator:

Ladies and gentlemen, we will now take questions from those dialed in. If you're dialed in to the call and would like to ask a question, please signal by pressing star one on your telephone keypad. We will pause for a moment to assemble the queue.

[pause]

There are no questions on the conference line, so we will head back to the room.

Tom Mills:

Thanks. Can I just ask, why is it that you only do sponsor backed deals in the direct lending fund?

Andrew Konopelski:

It's ... I think ... there are a few reasons. I mean the non-sponsored space is not quite as developed in Europe. And if I think about the non-sponsored space quite generally, but in Europe you're going to have entrepreneur-led or family-led type businesses. Family-led businesses are trickier for various reasons, one of which is often corporate governance.

It's also very often the family's name is above the door, so therefore, if you ever need to take remedial action, that can be quite challenging for various reasons. We do do some slightly more entrepreneur-led ones, but not in the ARR type financing mindset, but more like the, it's still largely owned by the entrepreneurs, they professionalise, they brought in some external investors, but they still own a majority. So while there is no sponsor behind them, those are still large, small percentages, partly because of just where the opportunity set is.

Partly because when you have a sponsor behind you, you get two things, you tend to get a bit more robust access to information upfront, with a second pair of eyes looking at it, and you have somebody that tends to have additional capital that they can put to work to protect that position in a downturn. And you expect that the company will be professionalised, in a way which then builds value for you. So it's ... I think if you're trying to do "sleep at night" credit, it's the way to go in terms of technology.

Tom Mills:

Thank you. And just on ... do you guys ever sort of force the portfolio companies taking the credit to hedge out the rate risk or just like the bonds or things like that?

Andrew Konopelski:

It's a very interesting discussion point. So, it used to be back in the early 2000s, you would put a hedging letter in place and they'd have to hedge two-thirds with the bank that was underwriting it, which was a nice little money spinner for the banks that were underwriting the debt. That then went away, it is now back on the table. So, we've recently gone out to all of our companies to assess their level of hedging. On the syndicated debt portfolio, we found that about 70%, okay, two-thirds responded to our request for information, and of those two-thirds, about 70% to 75% had hedged, some with caps, some with swaps.

On the direct lending side, it's not been as high. In fact, it's quite a bit lower. Interestingly, it's a slightly lower impact for direct lending because your initial margin's higher. So, let's just say 6% ... I mean state the obvious, we have a 6% margin and LIBOR goes from zero to three, that's a 50% uplift, whereas if you're borrow at 350 basis points over and you add 3%, you almost – for syndicated debt – you almost doubled it. So, we were glad to see the [hedging in the] syndicated debt businesses.

Tom Mills:

Yeah.

Andrew Konopelski:

But a lot of the direct lending ones have not. In new deals, we've been doing over the past two months, we have started having more direct conversations about their intentions and why or why not.

Tom Mills:

Is there any issue with companies having ineffective hedges going on?

Andrew Konopelski:

We have not found anybody that's put on the wrong hedge, if that makes sense. Or something that either doesn't work or actually creates the liability when they thought it was going to be an asset, sort of thing. I'm sure we will find that in some of the credit opportunities ones, because occasionally you find a company that just has a very long dated interest rate or FX swap that goes way out of the money and causes problems, but...

Tom Mills:

Okay. And just the final question, I appreciate you don't have much exposure to Bridgepoint portfolio companies but is there any other sponsors that you kind of over index to and including EQT from kind of...?

Andrew Konopelski:

We have some EQT exposure. We've not been lending to EQT for a long time, so we're not over indexed because it's only been the last two years that we've really been [able to lend to them since we have no longer been in their ownership] ... no, I mean, so we have lent to 61, I actually checked the number this morning because I thought it would come up. 61 sponsors in direct lending, so it's reasonably well diversified. There are some that we have done multiple deals with and that were actually somewhat important to as a lender as well.

So, there's a mutual respect that comes with that type of position in terms of one, access to the level of information, but then also the level of dialogue you have. You kind of know each other, and you tend to get the best out of one another, if that makes sense.

Tom Mills:

Yeah.

Andrew Konopelski:

I'd rather not name them if you don't mind because I'm not sure how they would feel about that.

Tom Mills:

Sounds good. Actually, sorry, one more thing. I don't think I saw in that, how you guys stack up in terms of fund performance and overall, in terms of quartiles and things like that?

Andrew Konopelski:

Yep. I don't think we put them in.

Tom Mills:

Okay.

Andrew Konopelski:

Yeah. We weren't sure if that was the best thing to put this afternoon.

Arnaud Giblat:

It's a very good question [inaudible].

Andrew Konopelski:

Yeah. Exactly. This is why I'm looking forward to a returns coming now, competitor's returns in the next year or two. Now, I think jokes aside, these types of periods tend to ... There's been a clustered effect in terms of returns, definitely in direct lending because. You could take almost any risk you wanted, and the company looked okay. I think it's only when you start to see a bit of volatility that you start to find out if the strategy you've employed, or what people say they're doing is actually what they're doing. So, I'm actually hoping for a bit of dispersion because interestingly in direct lending we have never set out to be a top quartile fund. Which may sound strange and perverse, but in order to be a top quartile fund, when interest rates were zero, you were taking a lot of risk. You're doing hold co-facilities, you're doing second-liens, you were doing non-sponsored transactions, you were doing slightly squirrely, highly cyclical ones that the banks didn't want to touch, so you had to push the risk.

So the question is risk/reward, I mean, which is why you need some form of volatility in the market to prove the downside protection. I mean, I think you can actually look at what we invested in, what we don't, and you could probably get a decent sense of the level of stability you should get from a 30% margin, 35% LTV, fairly resilient sector set type portfolio.

But the economy is big, somebody else is doing the industrials and the retail consumer names. We have a sense of who, but ... so we'll shake out. But then again, you don't wish ill upon the rest of the industry, because then you don't want LPs to look at it and say, "Well, I don't want to touch that because we don't know what those guys are doing." So ... I actually think, if we talk about direct lending, I think it's actually going to come through very, very well.

It's going to come through very well, because you realise very quickly – access to information and the ability to have any form of remedial dialogue is immediate. And it's just ... I mean, I don't know if you ever tried to do a bank restructuring where you have a table like this and you have 20 people sat around it trying to come to a consensus view, oh, it's like pulling teeth. When you have a one-on-one conversation, you can sit down and just have a grown-up chat about, this is what's happening, this is what we propose to do, this is what we need, this is what we need.

And you can get to things very, very quickly, which actually lets a company get back to doing business the way it should be doing business, rather than management teams getting sucked into the stress of restructuring discussions and lawyers and accountants, mind numbing. Which is why I think that direct lending is actually very well placed, especially given, I think, the nice premia that we have in some of these loans, that we've taken into this period.

Tom Mills:

I just want to ask one about competition in the market. What are you seeing today? I mean a bunch of traditional asset managers moved into direct lending, let's say. Are you seeing more competition from new entrants and things or are you competing against the same other lenders that you have been over the last 10 years or so?

Andrew Konopelski:

It tends to be like the same. New people come and some people get bought, get rebadged, tends to be more or less the same. There aren't a whole lot of new entrants other than a few of the US guys that have come in, put teams on the ground, which takes a bit of time to ramp up, or have acquired. But I

think the only real trend we've seen is, recently, is I think they're doing slightly smaller tickets now. So on the slightly larger transactions you often see them kind of getting clubbed into a couple of people, where I think people's risk tolerance has maybe diminished just a little bit.

Tom Mills:

On debt maturity profile, what does that look like across the portfolio and direct lending? Typically, in the past has it been when maturities have come to an end, sponsors have typically exited and now you're seeing less exits so, how will that look like as maturities come up?

Andrew Konopelski:

Yeah. In some direct lending we tend to think of these things – I mean it's almost the classic kind of private equity life cycle. So, what's the average whole period of an equity deal? Four or five years. But you normally find some form of refi opportunity at year three. We actually tend to think ... so when you have fees, upfront fees, we tend to mentally amortise them over three years.

You tend to find that in hotter markets, maybe it's a little less; in cooler markets it's a little longer. You very rarely ever get to maturity. So, it has to be a ... Ironically, if you do get to maturity, you just made very nice money on cash, unless the company's distressed, then you're going to have to take some form of remedial action. But yeah, they tend – most of these businesses – because they're cashflow positive tend to deliver reasonably well and then the sponsor's going to want to refi you into either cheaper bank finance, or they're going to recap you at which point you have an opportunity to get out.

And then, in credit opportunities, it's basically this syndicated debt wall. It depends on where you're looking, but it's actually advantageous very often to invest slightly shorter, especially if you're invested in bonds, you take less duration risk, but you also have a catalyst point where you can get your money back, or have a tough conversation. Slightly different approach.

Arnaud Giblat:

One last question.

Yeah. I saw a PIK [Pay In Kind] was a big part of your return profile, do you have any PIK toggles?

Andrew Konopelski:

So, that was in credit opportunities.

Arnaud Giblat:

Yeah.

Andrew Konopelski:

We do have a few in direct lending. So, do you have any PIK toggles? We don't have any PIK toggles in credit ops. We have a few PIKs. So, we have a few where we've done subordinated pay in kind instruments and or you've taken some cash, some PIK. Now, keep in mind that's a historic 14-year view that the slide you're talking about, which is slide...

Arnaud Giblat:

Yeah.



Andrew Konopelski:

Slide 16. So that's a historic view. In direct lending, you occasionally would have one that has a portion of the interest that can be PIKed in exchange for a higher coupon, and they can usually PIK it for say a quarter here or a quarter there. Not usually consecutive quarters, they can [only] do it like twice. It's just to help with the – I mean in a zero-interest rate world, it was never used – in a slightly higher interest rate world, it might be used once or twice for to meet networking capital needs, something like that, if a company's a little bit tight or they need to make an investment – Cap Ex or something.

Yeah, I'm actually, I'm trying to think if we've ever ... I'm sure you've seen it. We do have ... the only time we've seen it in the past couple of years has been very acquisitive high growth companies that use every penny to acquire other businesses in their industry – and they decide to use your pennies as well.

I have a very dim view of PIK toggles in this current market, because I don't think you should be borrowing money such that you need to use our interest to meet your cashflow. Just means you should borrow less money. It's little things like fixed charge coverage ratios, they're back in vogue now.

So, who would've thought cashflow would be important!

Andrew Coombs:

Just a very quick one. I mean, you talked about BDL offering LPs making 400 basis points extra or all else equal, what does that mean for demand for BDL versus BCO? Are you seeing any change in mindset?

Andrew Konopelski:

Fractionally, or maybe not the way you think, so that we've actually seen people become much more interested in credit opportunities. In a benign world, we have zero-interest rates, and there's no trouble on the horizon. I mean, where we sat last December, the world was good, we were coming out of COVID, it was opening back up, growth rates were coming back, the labour force was getting back, shipping rates were coming back down, supply chains were still a little bit wonky, but they were... We came into 2021, thinking there's probably trouble somewhere out like 2022, probably trouble somewhere out there, but it doesn't look like it's imminent.

And then, Putin did something ... well, we know what he did. But so in that environment last December, credit opportunities was not in vogue. The question was, where are you going to find your returns in a really benign world where we probably have zero interest rates for the next three years? When the world's on tilt, everybody's like: "I want some of that" because that's the type of environment where you can buy things – especially in the secondary market – at a very nice price.

It's usually very good risk/reward because I mean, to be blunt, if you like the types of companies and type of equity that you can invest in, you should love the debt. And if the debt's paying you 15%, 17%, why not?

Yeah, but I think you find it's the one thing about ... direct lending tends to be more programmatic. So, direct lending will be more subject to similar trends as private equity. I'm going to have ... I as a pension fund, I'm going to have four managers, I'm going to deploy [€]150 [million] into three tickets this year, I'm going to use a consultant. That's very often their programmes and they build programmes whereas credit opportunities – almost in the name – tends to be a bit more opportunistic. When people smell it, they come for it and then they might decide not to do it for a vintage, then they come back.

Arnaud Giblat:

Thank you very much.

Andrew Konopelski:  
Thank you all.