Conference Call
Investcorp Recording
February 10, 2021

Operator: Welcome to Investcorp Credit Management BDC scheduled earnings release of second quarter-ended December 31, 2020. Your speakers for today's call are Mike Mauer, Chris Jansen, and Rocco DelGuercio. Operator assistance is available any time during this conference by pressing *0. A question-and-answer session follows the discussion. I'll now turn the call over to your speakers. Gentlemen, you may begin.

Michael Mauer: Thank you operator and thank you to all of you for joining us today. I'm joined by Chris Jansen, my co-chief investment officer, and Rocco DelGuercio, our CFO. Before we begin, Rocco will give our customary disclaimer regarding information and forward-looking statements. Rocco?

Rocco DelGuercio: Thanks, Mike. I would like to remind everyone that today's call is being recorded and that this call is property of Investcorp Credit Management BDC. Any unauthorized broadcast of this call in any form is strictly prohibited. Audio replay of the call will be available by visiting our investor relations page on our website at ICMBDC.com. I would also like to call your attention to the safe harbor disclosure in our press release regarding forward-looking information and remind everyone that today's call may include forward-looking statements and projections. Actual results may differ materially from these projections. We will not update forward-looking statements unless required by law. To obtain copies of our latest SEC filings, please visit our investor relations page on our website. At this time, I'd like to turn the call back to chairman and CEO, Michael Mauer.

Michael Mauer: Thanks, Rocco. Activity in the quarter ending December 31 was robust. As economic and political uncertainty began to resolve, primary loan activity increased. We also began to see straight re-financings, dividend recaps, and re-pricings emerging in the broader market. We made investments in three new portfolio companies and fully realized investments in four portfolio companies this quarter. One of our new investments was a refinancing, two of our realizations were due to dividend recaps of our portfolio companies.

In this type of a market, we are disciplined, we continue to focus on credit quality, on loan structure, and on economics. We have found that by staying nimble with positions relatively smaller than many of our competitors, we can identify opportunities and avoid mispriced, poorly structured loans. Sector selection remains a key tool for avoiding distress in the portfolio. We have zero investments in the hospitality, restaurants, and traditional retail sectors by design. Most of our borrowers have recovered well from the early effects of the pandemic. In addition, we are evaluating any of them that might be eligible for second round PPP. Our investment activity during the quarter was roughly consistent with the character of our pipeline. We invested in one middle market syndicated loan and three club loans. This is squarely where we want to be: investing in the core middle market.

Chris will go into detail about our investments and realizations during the quarter and then Rocco will discuss our financial results. I'll finish with commentary on our leverage, Investcorp's share repurchases, our dividends, and our outlook for the next few months. As always, we'll end with Q&A. With that, I'll turn it over to Chris.

Chris Jansen: Thanks Mike. We made first lien investments in four portfolio companies this quarter, including three new portfolio companies. We also had full realizations on four investments during the quarter and one significant partial realization. First, we funded a second draw under Deluxe Entertainment Services' super priority term loan. As we noted last quarter, the entire facility was repaid in full not long afterwards. Our fully realized IRR was extremely high given the short-term nature of this loan. Second, we made an investment in the first lien loan to Veregy. Veregy is an energy services company providing environmentally efficient upgrades to systems for the municipal, university, school, and hospital markets. Our yield at cost is 7.8%. Third, we invested in the first lien loan to Klein Hersh. This club deal supported the LBO of the company by New State. Klein Hersh is a leading retained executive search firm focused on the healthcare and life sciences verticals. Our yield at cost is 9.7%.

Finally, we invested in Adaptive Spectrum and Signal Alignment, or ASSIA. This first lien club deal provided the company with additional capital for growth. ASSIA provides software to communications services providers worldwide. Their products improve connectivity for their broadband customers. Our yield at cost is 13.2%.

Our first realization during the quarter was Deluxe's super priority term loan which I mentioned a moment ago. We had a significant partial realization of our loan to Deluxe Toronto Ltd as well. Deluxe's creative division was sold and the proceeds fully repaid the super priority loan and were sufficient to partially repay both the Toronto loan and Deluxe's US term loans which are a parri-passu tranche that we do not hold. We have received partial repayment since quarter end, and we expect that our recovery will continue to improve as additional sums are received over the coming quarters.

Our second full realization was RPX which repaid its loan during the quarter. Our realized IRR was 9.0%. North Star Group repaid its loan during the quarter as well and we elected not to participate in the dividend recap. Our fully realized IRR for North Star was 7.8%. KIK Custom Products also refinanced its loans during the quarter. KIK was an opportunistic investment for us and we're pleased to have realized a 10.9% IRR on the loan despite its Libor plus 400 coupon.

We have not had any investment activity since quarter end. Using the GIC Standard as of December 31, our largest industry concentration was professional services at 12%, followed by energy equipment and services at 10.2%, construction and engineering at 9.7%, trading companies and distributors at 9.6% and commercial services and containers and packaging, both at 6.4%. Our portfolio companies are in 24 GICS industries as of quarter end, including our equity and warrant positions. As of December 31, our portfolio company count was 37 versus 38 at September 30. I'd now like to turn the call over to Rocco to discuss our financial results.

Rocco DelGuercio: Thanks, Chris. For the quarter ending December 31, 2020, our net investment income was $3 million or $0.22 per share. I'd say the value of our portfolio was $257.7 million compared to $261.3 million at September 30. Our portfolio's net increase on operations this quarter was approximately $3.1 million. Our new debt investments during the quarter had an average yield of 11.8% and realizations and retainments during the quarter also had an average yield of11.8%. Fully realized investments had an IRR of 34.3%. The unusual high IRR is attributable to Deluxe Entertainment's super priority term loan which is an outlier. The weighted average yield of our debt portfolio was 9.76%, an increase of 51 basis points from September 30.

As of December 31, our portfolio consisted of 37 portfolio companies. 87.2% of our investments were first lien, 4.9% of our investments was second lien, and 4.4% of our portfolio was in uni-tranche loans. The remaining 3.5% is invested in equities, warrants and other positions. 99.6% of our debt portfolio was invested in floating rate investments and 0.4% in fixed rate investments. The average Libor floor our floating rate investments was 1%. Our average portfolio company investment was approximately $7 million. Our largest portfolio company investment was PGI at $12.2 million and our largest single investment is Empire Office at $11.7 million. We were 1.43x levered as of December 31st compared to 1.53x levered as of September 30. We have two investments on nonaccrual as of December 31.

Finally, with respect to our liquidity, as of December 31, we had $3.8 million in cash, $4.7 million in restricted cash, and $16 million capacity under our revolving credit facility we can get. Additional information regarding the composition of our portfolio is included in our form 10-Q which was filed yesterday. With that, I'd like to turn it all back over to Mike.

Michael Mauer: Thank you, Rocco. Our guidance on leverage remains at target of 1¼ to 1½x in this environment, period. Last quarter, we were above that target at 1.53x. This quarter, our leverage came down into our target range of 1.43x. We anticipate that our investment activity will keep us around this target range. We covered our December quarterly dividend with NII, and we expect to cover our current quarter as well. As we committed to do, we waived the portion of our management fee associated with base management fees over 1x leverage.

Our board of directors declared the distribution for the quarter ended December 31, 2020 of $0.15 per share payable on April 1, 2021 to shareholders of record as of March 12. The board also declared a supplemental distribution of $0.03 per share on those same dates. We believe that this dividend level is stable, and the supplemental distribution is a proven method to capture the additional earning power of the portfolio.

Investcorp has made two separate commitments to purchase ICMB shares. Investcorp did not make any open market purchases under its 10b-5 program this quarter. To date, 281,775 shares have been purchased since the inception of that program. Secondly, Investcorp has committed to purchase shares at NAV. Investcorp did not make any purchases between September 30 and December 31 and has purchased 227,000 shares to date.

Our team has worked together through multiple market cycles. Over the past few months, we have seen continued competition for deals as well as the expected follow-on effect of that competition: being tighter pricing, weaker structures, and fewer protections for lenders, especially in the larger deals. Structural weaknesses always begin in the large syndicated market before moving into the middle market.

As an example of the kind of signals we watch for, KIK Custom Products refinanced the loan we were invested in this past December. In January, they repriced that new loan. We intend to combat that faulty environment by focusing our pipeline on core middle market loans including club deals. The portfolio is also well diversified and contains a mix of sponsor and non-sponsor companies. By staying disciplined and seizing the opportunities we are presented with, we intend to manage the portfolio through this cycle as we have through past cycles with the focus on consistent income generation and preservation of shareholder capital.

Operator: Ladies and gentlemen, at this time, we will conduct the question and answer session. If you would like to state a question, please press *1 on your phone now, and you'll be placed into the queue in the order received, or press # anytime to remove yourself from the queue. Please listen for your name to be announced and be prepared to ask your question when prompted. Once again, for asking a question, please press *1 on your phone now. Our first question comes from Christopher Nolan. Please state your question.

Christopher Nolan: Hey guys, Deluxe. Deluxe Entertainment Services is the new investment made in the quarter, is one of the new investments made in the quarter, is that correct?

Michael Mauer: Chris, there was new money made invested during the quarter. I'll let Chris walk through it, but it was part of facilitating the sale of the company. So, there was money put in during the quarter to facilitate the sale that was then in the waterfall of super priority. Chris, I don't know if you want to go into more detail.

Chris Jansen: Yes. Thanks, Mike. Chris, that loan was fully paid out. It was senior structurally to our existing exposure and we got a nice fee for doing that. So, it made perfect sense to do that, hundred percent correct.

Christopher Nolan: Okay. You invested and then exited within the same quarter?

Chris Jansen: Yes.

Michael Mauer: Yes.

Christopher Nolan: Got you. Then I guess the change in yields of roughly 50 bips, any reason particularly for that?

Michael Mauer: Yes. If you look at the average of everything that came out, RPX, North Star, the Allsups, the KIK, Pixelle, etcetera, the weighted average yield there was at 7.4% and that was heavily weighted down between 6.5% to 7.5% across four different names, the RPX, North Star, Allsups, and KIK. Those were, on average, close to 7% but the overall average coming out was 7.4%, and the three new investments at $17 million were at an average of 10.64%.

Christopher Nolan: Got you. Mike, do you anticipate that the new investments will continue in that 10% to 11% yield range and thus, the overall yield will continue to go up?

Michael Mauer: I would say that the overall, we're focusing on 10-plus or minus and if I was going to give a range, I'd say that it's 9% to 10%, not 10% to 11% and I hope to outperform, not underperform, but I think that 9% to 10% is – and at the higher end of that, closer to 10%, but I think 11% would be too high of an assumption right now.

Christopher Nolan: Right.

Michael Mauer: There will be some but on average.

Christopher Nolan: Final question is on Empire Office which is a large office furniture dealer in New York City. I know the loan has a couple years to run out but given the impact that COVID had on that office market, is this a credit that we should be keeping an eye on given its size?

Michael Mauer: I will pass it over to Chris but I'd say we have kept a very close eye on it and we're very happy with management and the way they've managed it but I'll let Chris – obviously, we can't go into details from an NDA but I'll let Chris talk about it.

Chris Jansen: Yes. Thanks, Chris. This is one where the owner is the founder – actually, I think he's the son of the founder and he's ran the company for quite a while. Performance is really consistent with what we had anticipated and honestly, above where personally I thought this company was going to be. Their revenue has been down, the EBITDA has basically been flat. So, in my personal view this has well outperformed what you would think in general, if you saw a big presence in the New York City market, with office furniture, you would be gasping. We knew that would not be the case. However, personally, I feel like that they've outperformed. They do have operations in Florida as well, so they have diversified a bit.

Christopher Nolan: Yes.

Chris Jansen: This is where again, you have management team that's an owner that is accustomed to the ups and downs in the office market.

Michael Mauer: Right. To Chris' point, he's quickly reacted on the cost front -

Christopher Nolan: No, thank you very much for the detail.

Chris Jansen: Thanks.

Operator: Our next question comes from Paul Johnson. Please state your question.

Paul Johnson: Hey, good morning, guys. Thanks for taking my question, or good afternoon, I should say. I know I asked last quarter, I just kind of want to ask again and get your thoughts. I'm just curious that you said that several of the portfolio companies had been relatively impacted by COVID and that's kind of held back appreciation during the last couple of quarters. At the same time, we've seen quite a few BDCs mark their books up fairly meaningfully over the second half of 2020. Is that still the case with the portfolio? Is it the same kind of pressures on these businesses that are holding it back? Any kind of commentary you could share would be great.

Michael Mauer: Yes. Listen, I'd say I can't comment on how all this goes through their valuation. We think that we've done a very thorough and fair valuation of portfolio. I'd highlight two credits that continue to weigh on us and COVID-related to some degree into a lot. One is 1888 Industrial Services' slow recovery, the oil markets are coming back, the oil service is coming back. We've put that B loan on nonaccrual in the current quarter and we are watching it closely and we talk to them at least once a week so we're hands-on.

The other one is PGI. Without PGI you would have seen a nice I think in line with the market recovery on NAV. PGI, we marked down during the quarter. We had seen a recovery from COVID actually, COVID benefitting in the second quarter of 2020. We saw a significant slowdown of that benefit in the second half of the year, and so we've become a bit more conservative as we look at that valuation given that we don't have the same tailwinds that we had in the second quarter. That's another one that we continue to watch but hopefully that gives you a little bit of color.

Paul Johnson: Yes. No, that's really good color. Did you by any chance have that number off your hand with what the markdown was with PGI this quarter?

Michael Mauer: I think I do. I think that was $2.8 million. Chris, you can check me on that, and I'll follow up if that's different but it's $2.8 million down between the two blanks -

Chris Jansen: Yes, it's right, Mike, $2.8 million, correct.

Paul Johnson: Okay. Thanks. I appreciate that. I'm trying to make sure I understand this right. I understand you explained it Chris as well in your prepared remarks but the Deluxe piece that remains in the portfolio, the nonaccrual, why I guess is that on nonaccrual if the investment repaid - and I guess if I'm understanding it right, the super seniority term loan that you provided, was that almost akin to a bridge loan to the company?

Michael Mauer: The answer is yes.

Chris Jansen: Mike, I got this.

Michael Mauer: Okay. Go ahead.

Chris Jansen: Yes, it was a bridge loan to facilitate the sale of the business. Deluxe no longer has any operating businesses so when they sold the business, typically, as is typical in these M&A transactions, the sale of the business involved the creation of escrows which will be released in time subject to final adjustments, and so that where we carry Deluxe now reflects our evaluation of the probability and amount of collecting. I believe there's three or four different escrows involved.

Paul Johnson: Okay.

Chris Jansen: Once we receive those couple of payments, we'll no longer have any exposure to Deluxe.

Paul Johnson: Okay. Yes, and at this point it's a fairly small piece that remains in the portfolio. Bigger picture, looking at kind of I guess - obviously COVID has affected quite a bit of almost in everything that we do. How has that affected any of your relationships with partners that you've worked with in the past? Has that forced you to change your approach in any way? Are you working with the same partners or maybe even a more defined select list of partners that you've worked with in the past and has that in any way changed the way that you sourced business?

Michael Mauer: I'll take first shot and see if Chris wants to add anything but, in a word, I'd say no. The only thing it's done is, in this environment, it ramps up the dialog around sourcing new opportunity and we still are partnering in club deals with the same partners that we partnered before plus new partners but the new partners are people we had a dialog with before. So, if you look at our portfolio, we may partner with somebody two or three times out of the 37 investments. We've never had a concentration of partners. At the same time, the advisors, boutiques, lawyers, etcetera, we've got a dialogue with. We've got one that we're working on right now with one of those advisors. So, I don't think it's really changed the dynamic. Chris, I don't know if you want to add anything there.

Chris Jansen: No, nothing to add.

Paul Johnson: Okay. I just actually have one last question I wanted to ask if that's all right. I was hoping to maybe get an idea of one investment in the portfolio. I think it's marked pretty stable quarter over quarter, but it's been marked, fairly a discounted mark of Bioplan. Did you guys get any kind of update on that company in what exactly that business is?

Michael Mauer: Chris, do you want to take that?

Chris Jansen: Yes. Bioplan, there's not much of an update on Bioplan. The sponsor has been very, very supportive of the deal but we're under confidentiality. This is another one where, and I'll personalize this a little bit. Personally, the company is performing a lot better than I had anticipated but the numbers are still down from pre-COVID. The company basically sells testing products for fragrances. So, they have shifted their business and their product mix to get away from some of the more contagious types of sprays and stuff like that. Again, the sponsor's supportive and the lenders have been very constructive here and we own the first lien and there is a second lien behind us in addition to an equity sponsor. That's really all I can say because of confidentiality.

Paul Johnson: Sure, okay. I appreciate that. Thanks for taking my questions and thanks for the comments and have a great day.

Michael Mauer: Thank you.

Chris Jansen: Thank you.

Operator: Our next question comes from Matt Jaden. Please state your question.

Matt Jaden: Hey all, afternoon and thanks for taking my questions. First one on market competition; any color you can give on leverage spreads and documentation relative to pre-COVID levels on the deal flow that you're seeing?

Michael Mauer: Yes, it's an interesting question because what we're seeing is if you start at the top of firm value for new LBOs, things that are exposed or at risk because of COVID just aren't trading. So, things that are insulated or COVID beneficiaries have traded but with that tends to mean is that what we're seeing is things are trading at a little bit higher multiple than maybe pre-COVID, but that's a little bit of the statistical sample that you're dealing from because you don't have the same companies being sold. We're seeing similar multiples of leverage that we saw pre-COVID. We're seeing bigger equity checks than we saw pre-COVID to get those done. In two of the new investments we did, it was just shy of 50% equity going in on those.

So, leverage similar equity a bit higher and spread's maybe a little bit tighter and the other thing is that we are focusing more in this environment in the last six, eight months and I'll call it $10 million EBITDA to $50 million EBITDA, and less on the $50 million to $150 million. On the larger, the hundred-plus EBITDA where we've done a lot historically, I think the competition is more, I think the structural points are more aggressive, and the larger players are trying to take the whole tranches, so it's an area that we've kind of avoided and we've been very active in club deals, two to 10 players down in our neighborhood.

Matt Jaden: Okay, that's helpful. Then just one more if I could on leverage. At 1.43, at the upper end of the 1.35 to 1.5 range, are you all comfortable running it at that level? Is the plan to deleverage a little bit more or – how are you thinking about leverage going forward?

Michael Mauer: I'd start saying we're comfortable where we are. I think on the last call we were at like 1.53x, similar question there. We said, "Listen, I'm not sure if we'll be below 1.5x for the December quarter." We are below it. We continue to look at new investments. We continue to think that there are two or three portfolio companies that are at a high probability of getting repaid or refinanced and so we want to make sure we continue to keep ability to reinvest. So, that may mean that we may go slightly above and come back down but, in the neighborhood, we are is an area we're very comfortable right now.

Matt Jaden: Great. That's it for me. I appreciate the time.

Michael Mauer: Thank you very much.

Operator: Once again, if you would like to ask a question, please press *1 on your phone now. At this time, we have no further questions.

Michael Mauer: Thank you very much. We appreciate it and we will talk to everyone soon.

Operator: This concludes today's conference call. Thank you for attending.

- End of Recording -