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Op Assist Earnings Call
Conference Call
November 15, 2022

Operator: Welcome to the Investcorp Credit Management BDC, Inc. Schedules Earnings Release of First Quarter ended September 30th, 2022. Your speakers for today's call are Mike Mauer, Chris Jansen, and Rocco DelGuercio. Operator assistance is available at any time during this conference by pressing 0#. A question-and-answer session will follow the presentation. I would like to now turn the call over to your speakers. Please begin.

Mike Mauer: Thank you, operator, and thank you for joining us on our first quarter call 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 statement. Rocco?

Rocco DelGuercio: Thank you, Mike. I would like to remind everyone that today's call is being recorded and that this call is the 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 our latest SEC filings, please visit our Investor Relations page on our website. At this time, I would like to return the call back to our chairman and CEO, Michael Mauer.

Mike Mauer: Thank you, Rocco. This September quarter marks the first quarter of our first fiscal year. Macro factors continue to be dominant influence on the private debt markets. We continue to see the Fed tight monetary policy further driven by prolonged inflationary pressures. Interest rates increased further and credit spreads have continued to widen in the middle market. Equity markets have been notably volatile as well. Despite the slowdown in the U.S. economy and broader market volatility, the credit quality of our portfolio remains stable and overall underlying portfolio companies operating performance has been generally steady. We believe we are well positioned to benefit from further increases in interest rates. The primary market saw a slowing new issuance activity toward the end of the quarter and the pace of refinancing activity in the broader market has significantly slowed as well. This naturally leads to fewer new investments. For context, we made four new investments during the quarter. Over the prior four quarters, we averaged 6.5 new investments per quarter. The investments we made during the quarter were concentrated on club deals where we typically find more favorable structural protections in pricing. All of our new investments were sponsor-backed and none were coming in light. This quarter, we were successful in deploying our new capital at an average yield of 10%. We remain highly selective when investing in new opportunities and systems in our investment process. As always, we are committed to investing in structures with higher yields, stronger covenant protection, and lower closing leverage multiple. Given the macro environment, we have become increasingly focused on sector selection and lending to industries with resilient end markets that have recession-resistant and countercyclical attributes. In addition to becoming incrementally more selective on new deals, we also continue to be diligent in our portfolio management and risk mitigation. Chris will now walk through our investment activity during the September quarter and after quarter end. Rocco will go through the financial results. I'll finish with commentary on our NAV, nonaccrual investments, our leverage, the dividend, and our outlook for 2023. As always, we'll end with Q&A. With that, I'll turn it over to Chris.

Chris Jansen: Thanks, Mike. We invested in four new portfolio companies and fully realized our positions in two portfolio companies this quarter. First, we invested in the club financing for AmeriQuip LLC to support the acquisition of the company by JMC Investment. AmeriQuip is a designer and manufacturer of add-on equipment for OEMs in the construction, waste, lawn care, and snow removal markets. Our yield on cost is approximately 10.9%. We also invested in the revolver, term loan, and common equity of Archer Systems, and the acquisition of the company by Fortress Investment Group. Archer is an outsource provider of administrative services focused on providing mass tort settlement services. Our yield on cost is approximately 9.9%. We invested in Evergreen North American Industrial Services, a portfolio company of the Sterling Group. We invested in the revolver and term loan. Evergreen is a provider of industrial cleaning and related specialty cleaning services. Our yield on cost is approximately 9.5%. We also invested in the club financing of PVI Holdings, Inc. to support the LBO of the company by middle ground capital. PVI Holdings is a leading flow control distributor focused on MRO applications in diverse end markets. Our yield on cost on PVI is approximately 9.7%. We also fully realized our position in Lennox as the company made a substantial acquisition and refinance its debt. Our fully realized IRR was approximately 12.5%. Lastly, we fully realized our position in Oilfield Water Logistics, which was acquired by Pilot Water Solutions. Our position was refinanced as part of that transaction. Our fully realized IRR was approximately 9.7%. After quarter end, we invested in one new portfolio company and have had no realizations. We invested in the club financing for Flat World Solutions to support the acquisition of the company by Boeing Capital. Flat World is a business process outsourcing company that provides technology and outsourcing services to a variety of end markets. We invested in the revolver, first lien term loan, and common equity. Our yield on cost is approximately 10.6%. Using the GICS standard as of September 30th, our largest industry concentration in the portfolio was professional services at 13.7%, followed by IT services at 9.5%, Internet and Direct Marketing retail at 8.5%, trading company and distributors at 8.2%, and commercial services and supplies at 6.4%. Our portfolio of companies are in 22 GICS industries as of quarter end, including our equity and warrant positions, which is an increase of two from the previous quarter. As of September 30th, we had 37 portfolio companies, also an increase of two from June 30th. I'd now like to turn the call over to Rocco to discuss our financial results.

Rocco DelGuercio: Thanks, Chris. For the quarter ended September 30, 2022, our net investment income was $2.3 million or $0.16 per share. The fair value of our portfolio was $239.2 million compared to $233.7 million on June 30th. Our portfolio's net increase from operations this quarter was approximately $1.7 million. Our debt investments during the quarter had an average yield of 10%, while realizations and repayments during the quarter had an average yield of 10.6%, and fully realized investments had an average IRR of 11.6%. The weighted average yield of our debt portfolio was 11.9%, an increase of 190 basis points from June 30th, approximately 64% of the change is a result of the increase in LIBOR SOFR. As of September 30th, our portfolio consisted of 37 portfolio companies. 91.8% of our investments were first lien, and the remaining 8.2% is invested in equity, warrants, and other positions. 99.6% of our debt portfolio was invested in floating rate instruments and 0.4% in fixed rate investments. The average floor on our debt investments was 1.04%. Our average portfolio company investment was approximately $6.5 million, and our largest portfolio company is Fusion at $14 million. We had a gross leverage of 1.64 times and a net leverage of 1.56 times as of September 30th compared to 1.57 gross and 1.48 net, respectively, for the previous quarter. As of September 30th, we had seven investments on nonaccrual, which included all three PGIs, three investments in 1888, and one investment in Deluxe. With respect to our liquidity, as of September 30th, we had $7.4 million in cash, of which $6.5 million was restricted cash with $25.5 million of capacity under our revolving credit facility with Capital One. 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 the call back over to Mike.

Mike Mauer: Thank you, Rocco. First, I would like to address the NAV decline in the quarter. Last quarter, we expected the current quarter NAV to recover modestly. There were two primary reasons that we haven't seen this recovery materialize as expected. First, we saw the spread tightening that had occurred in the beginning of the previous quarter reversed itself in September. From September 1st to the 31st, the trailing 4-week average spread from B- to BB widened by 34 basis points. Second, we saw a significant downward move in the equity market. Public equity comp are the most significant driver of our evaluation of TechnoPlus, and as a result of the decline in the public equities, we did not see the recovery in our evaluation that we had expected as of early September. Part of our current quarter NAV decline was attributable to a decrease in the marks for Arcade, Bioplan, ArborWorks, and CareerBuilder. On Bioplan, we are unable to discuss the situation due to confidentiality reasons. ArborWorks experienced some volatility during the quarter due to a decline in disaster recovery business as a result of a historically low year in terms of buyer acreage burn in the region that ArborWorks serves. We underwrote the investment expecting some lumpiness of the results and are comfortable with the business over the long term. As discussed in the previous quarter, CareerBuilder's underlying business has been experiencing challenges of some type. CareerBuilder sold a small segment business, Workterra, a benefits administration technology provider in late October. There are now three business segments remaining. For confidentiality reasons, we can't give any additional information about the company's performance. We continue to remain optimistic for a positive conclusion for our investments, and we think that the short maturity provides a driver for M&A or capital markets activities. Our gross leverage this quarter was 1.64 above our guidance of 1.25 to 1.5. Our net leverage was 1.56. As mentioned last quarter, we expect to see our gross and net leverage continue to converge. As of November 7th, our gross and net leverage were 1.61 and 1.6. As we have previously stated, the adviser will waive the portion of our management fee associated with the base management fees over one turn of leverage. We covered our September quarterly dividend with NII. The company is expected to earn its dividend through the next quarter ending December 31st.

On November 11th, our board of directors declared a distribution for the quarter ended December 31, 2022, of $0.13 per share and a supplemental distribution of $0.02 per share, both payable on January 10, 2023, to shareholders of record on December 15, 2022. While we are officially reducing the regular dividend of $0.15 per share, the net effect this quarter is unchanged from previous quarters. We believe that proactively setting the dividend at this level is appropriate as we continue to focus on a leverage range of 1.25 to 1.5 times. We believe the new dividend level continues to represent an attractive yield given the market price of ICMB stock. Our portfolio is well positioned to navigate further market challenges. The operating performance of our underlying portfolio companies continues to be strong. Looking ahead, we remain highly focused on risk management and finding investment opportunities with strong structural protection and attractive investment characteristics. Our ultimate goal has not wavered and is, as always, focused on capital preservation and maintaining a stable dividend. That concludes our prepared remarks. Operator, please open the line for Q&A.

Operator: Thank you very much. Ladies and gentlemen, at this time, we will conduct the question-and-answer session. If you would like to state a question, please press 7# on your phone now. 7# and you will be placed in the queue in the order received. Press #7 again at any time to remove yourself from the queue. Please listen for your name to be announced and be prepared to ask your question when prompted. We are now ready to begin. The first person we have a question for is Sean-Paul Adams with Raymond James. Go ahead, please.

Sean-Paul Adams: Hey, guys. In relation to your markdowns for last quarter, you had a greater than average proportion of markdowns related to credit. Can you give us a little bit of the breakdown of your estimates of credit markdowns versus market spread adjustments for this quarter?

Mike Mauer: For the December quarter?

Sean-Paul Adams: Yes, sir.

Mike Mauer: Is that the question? The December quarter, we're just starting to do our reviews for the quarter. So, we really have no estimates at this point. I'll let Chris make any general comments about the quality of the portfolio.

Chris Jansen: Yes. Thanks, Mike. Overall, the portfolio is performing according to plan. I think like anybody out there who deals in credit, obviously, the sharp rise at short-term rates has given us some cause for concern on interest coverage levels. On the other side of that, in the many years that Mike and I and the team have been doing this, we've never seen this level of interest coverage in deals, and that's due to the fact that a lot of the deals we have, have 35% or 40% to 60% of equity underneath them. Just as far as the specific credits, Mike have walked through the couple of credits where we had some issues last quarter. This quarter, we're not really thinking about anything too differently. But as Mike said, it's very, very early on in the process. Hopefully, that's helpful.

Sean-Paul Adams: Yes, that's perfect. Thank you.

Chris Jansen: Sure.

Operator: Thank you very much. Next question is Christopher Nolan with Ladenburg Thalmann. Go ahead, please.

Christopher Nolan: Hey, guys. Given the increasing uncertainty of the economy, any plans in terms of trying to take some risk off the portfolio? You already cut back the base dividend, but nonaccruals were up this quarter, leverage went up, and it seems like if the economy really does tank that you guys would be vulnerable to some material impacts.

Mike Mauer: Yes, Chris. Thank you very much for the question. A couple of things. The leverage was up a bit. Some of that is timing, as you know, where we've got some visibility on repayments, refinancing. Sometimes there's a little bit of a mismatch of committing to a new deal before something comes on. I wouldn't read too much into the movement that you saw on a net leverage basis. It was not, in our view, material from quarter-to-quarter. But you are right, it's above our range, and we want to get in the range of the 1.25, 1.5. As we look at the environment, we are concerned that it will deteriorate. We get paid to be pessimistic, not optimistic. From an existing portfolio, we continue to watch. We continue to have dialogue with our borrowers to think about what is happening and what is coming. We're seeing fairly resilient top line. We do see some cost pressures. But as Chris stated, we've got significant equity cushions. I think one of the key things is every new investment we're doing right now, we're focused around really three things, and that is the equity cushions are growing from where they have been historically. Recently, on average, we've been over 50% equity cushion. We are getting financial covenants at least one in every deal we're doing. We're not doing any covenant lights, new deals, and we're very focused. I think this is one of the critical things in a tough environment around when you look at EBITDA, how - I'll call it, clean EBITDA is how much there is as far as adjustments in it, and as part of our underwriting, those are all critical things. We start out with very good low leverage, and even at SOFR where it is good interest coverage, but we do need to be very focused on all of that.

Christopher Nolan: As my follow-up, some of your non-accruals, like American Teleconference services and 1888 have been a non-accrual for a while. Is it better just simply just to exit out of these? Or is the anticipation that you can make a decent recovery.

Mike Mauer: I think it depends on the name you're talking about. On PGI or American Telecom, we are in a process of working through it. It's not one that you can just exit out of, neither one of these are. On 1888, it's in a sector that is robust, and we're working with them to try and find ways to maximize return on that. I think very different stories between the two.

Christopher Nolan: Thank you.

Operator: Thank you very much. Again, if you have any questions, please press 7# on your phone. Again, that’s 7# on your phone. Our next question comes from Mr. Ryan Lynch with KBW. Go ahead please.

Ryan Lynch: Hey, good afternoon. First question I had, and I'm not sure if you said this in your prepared comments and I missed it, but can you provide an update on where the weighted average interest coverage is on your portfolio today and how that compares to maybe six months ago or so?

Mike Mauer: Chris, I'll let you respond. I'm not sure we've ever given it on a consolidated basis, but go ahead.

Chris Jansen: Hey Ryan, it's Chris. Our interest coverages by and large have declined but are still in the two and a half plus coverage range as an average. We have had a couple of our companies well outperform. And that's probably about as much as I can give you at this point.

Ryan Lynch: Okay. That's fine. Then, just following up kind of on your commentary on the dividend. I'd love to just hear the overall framework you guys are thinking regarding dividend payouts. I mean, is the kind of the lowering of the core dividend but keeping the overall total dividend the same, is that more of a function of potential deleveraging of the portfolio or credit quality issues that you guys could potentially have just because when you look at your earnings today, you guys are going to have a tailwind of interest rates going forward, so it would appear that holding everything else equal, there should actually be accelerated earnings growth. But meanwhile, you guys are reducing kind of that core level of dividend payout, so I'd just love to hear the framework you guys had behind kind of changing the mix, even the whole dividend level the same but kind of changing the mix and reducing that core dividend level slightly.

Mike Mauer: Yes, Ryan, it's a great question. I'm glad you asked it because we probably could have spent more time on it or I could have spent more time on it in the prepared. But we did talk about trying to make sure we manage into that leverage ratio. That's one thing. The other is that as we've continued to invest, and we will continue to rotate the portfolio, we're not about maximizing the spread. We've seen spreads right now probably 25 to 50, 75. We're more focused on the subordination in this environment. So, on an absolute yield, I don't know that you'll see us get a widening plus a - widening of the spread plus the SOFR uplift. If you look at what happened to our - new investments were around 10%. What rolled off was above 10%. SOFR and LIBOR 150 plus or minus during the quarter of our numbers. Our overall was up around the same. Most of that's coming from that lift. When we think about the dividend, we want to make sure that the core dividend were always comfortable covering. Right now, we're comfortable covering both the core and the supplemental. But I think just from a signaling, we want to make sure that that core is around all the dynamics that we see going on right now.

Ryan Lynch: Okay. That's a fair approach, I think, going forward. Then just my last question, obviously, the stock, is that a pretty big discount to the book value and has been that way for a bit of time? Obviously, you all don't control the stock price or the valuation of your company, but you do control the fundamentals of your business and as we are rapidly approaching calendar 2023, what are some areas that you all are looking to improve upon the fundamental performance of Investcorp that you think that could hopefully increase investor interest and potentially close that discounted valuation?

Mike Mauer: Well, listen, we're the same old song and that we're always looking at strategic ways to grow it. We have not found the right one or have been successful in executing on one or two that we did like. But away from that, I think that's kind of outside of our control because those come and go. Inside our control, the other thing we're focused on is building the base of private, which will decrease the OpEx and will help again on the dividend and the performance. So, we've got to continue to build that base and we're actively working on that right now.

Ryan Lynch: Okay. That's all for me. I appreciate the time today.

Mike Mauer: Thank you very much.

Operator: Thank you everyone. It looks like we have no further questions.

Mike Mauer: Thank you, everyone. We look forward to talking to you next quarter.

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

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