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Op Assist Earnings Call
Conference Call
November 14, 2023 at 12:30 PM ET

Operator: Welcome to the Investcorp Credit Management BDC Incorporated Schedules Earnings Release for first quarter ended September 30, 2023. Your speakers for today's call are Mike Mauer, Suhail Shaikh, 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 now like to turn our call over to your speakers. Please begin.

Michael Mauer: Thank you, operator, and thank you for joining us on our first quarter call today. I'm joined by Suhail Shaikh, my Co-CIO and President of Investcorp Credit Management BDC, 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 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 relation 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 filing, please visit our investor relations page on our website.

At this time, I would like to turn the call back over to our Chairman and CEO, Michael Mauer.

Michael Mauer: Thanks, Rocco. The September quarter marks the first quarter of our fiscal year. We saw primary deal activity in the middle market increase characterized by acquisition financing, and to a lesser extent, LBO and refinancings, as well as dividend recapitalizations. Since our last call, we saw our pipeline increase at a healthy rate, albeit at a slower pace compared to historical norths. We remain optimistic that deal activity in the primary market will continue to pick-up over the next few quarters and that we will continue to see compelling investment opportunities.

Our investment activity during the quarter was characterized by opportunistic investments in the secondary market. Importantly, we invested in four new companies and added to our positioning one existing portfolio company. These investments were all in borrowers we are familiar with, have previously invested in, or have exposure in our other managed funds across the platform. The weighted average yield of our debt investments made during the quarter was 12.3%, a 20 basis-point decrease in the weighted average yield of investments that were made during the quarter ended 6-30.

Additionally, we continue to remain highly selective when it comes to new investments. We are specifically focused on lending into companies that are sponsor-backed, have financial covenants, high free cash flow, and are recession resilient businesses. As we look at our borrowers' operating performance and the credit quality of our performing portfolio continues to remain stable. Our weighted average interest covered ratio for our performing debt investments is approximately two times, and our loan to value ratio is approximately 41%.

Looking ahead to the rest of the fiscal year, our focus is on portfolio management and risk mitigation. We are focused on our nonperforming investments and reducing this amount. We continue to work towards diversifying our investments in new borrowers to reduce our position sizes to an average of 2.0% to 3.0% of our current portfolio, and to work with our current borrowers that have covenant or liquidity issues in this high interest rate environment.

We increased our number of borrowers to 40 from 36 as of 6-30 and the number of GICS industries across our portfolios to 24 from 21 when compared to the previous quarter ended June 30th. During the quarter and post quarter end, we had two repayments. As mentioned on our last call, we are also expecting several repayments over the next few quarters. Our dividend coverage is an important consideration when making new investments.

Suhail will now walk through our investment activity during the September quarter and after quarter end, Rocco will go through our financial results, I'll finish with commentary on our nonaccrual investments, our leverage, the dividend, and our outlook. As always, we'll end with Q&A.

With that, I'll turn it over to Suhail.

Suhail Shaikh: Thank you, Mike. As Mike mentioned, the quarter's activity was a continuation of executing on opportunistic investments in the secondary market and selectively looking at near buyout financings. Sponsored middle market, direct earning, new money volume in the quarter was approximately 36% lower year over year. However, we saw primary deals pick-up during the quarter and have continued to see it increase post quarter end. Our pipeline remains robust and we believe that we can continue executing on our investment thesis, as Mike mentioned.

During the quarter ended September 30th, we invested in four new portfolio companies and one existing portfolio company. We also fully realized our position in one portfolio company. During the quarter, fundings for commitments and new investments totaled approximately $15.5 million at cost with a weighed average yield of approximately 12.3%. In the same period, the payments total approximately $6.8 from one investment that I mentioned with an investment IRR of approximately 16.4%.

Let me now take you through our investment activity. First, we invested in the first lien term loan of Axiom Global. Axiom is a leading provider of expert legal talent, offering legal counselling and representation services. Axiom is a portfolio company of Permira, a sponsor we know well. We have been an investor in Axiom for a few years in our other portfolios and we were able to purchase it at an attractive price. Our yielded cost is approximately 13.9%.

We also invested in the first lien term loan of Congruex. Congruex is a Crestview Partners portfolio company, and provides mission critical end-to-end engineering, construction, and maintenance services to a diverse customer base in the broadband and other adjacent industries. Our yielded cost is approximately 12.2%. This was also a secondary purchase for the portfolio. Congruex has been a portfolio company of ours in other funds for several quarters.

We also made a secondary investment in Multi-Color, also known as “L-A-B-L” or “LABL,” a CD&R portfolio company. LABL is a global leader in the prime label manufacturing industry. Our yielded cost is approximately 10.9%. As with Axiom and Congruex, Multi-Color or LABL was also a secondary purchase of a name that we own in other vehicles that we manage.

Finally, we also invested in FleetPride, an American Securities Capital Partners backed company. FleetPride is a national distributor of off-to-market parts for the US heavy-duty trucking industry. Our yielded cost is approximately 10.4%. This is a name we have been tracking for a while. In addition, given Investcorp’s private equity arm used to own the business several years ago, we were able to leverage their expertise to diligence our investment.

Then our last investment, which was the addition of our existing position to AMCP Clean Acquisition Company, also known as PureStar. This is a good example of an opportunistic secondary purchase of a credit that we already owned and were able to source some paper for an attractive price. PureStar is a portfolio company of Cornell Capital. It is one of the largest commercial laundry providers to the hospitality industry in the US. We invested in the first lien term loan. Our yielded cost is approximately 15.2%.

During the quarter, we fully realized our position in Fusion’s term loan which was refinanced. We remain investors in Fusion’s preferred and common equity. Our fully realized IRR was approximately 16.4%, as I mentioned earlier. After quarter end, we invested in three new portfolio companies and fully realized our position in two portfolio companies.

First, we supported the LBO of Alphia by PAI Partners. Alphia is a contract manufacturer of premium dry pet food ingredients. We invested in the first lien term loan and our yielded cost is approximately 10.7%. We have been investors in

Alphia through our other funds and were able to re-underwrite the risk for the new LBO.

Second, we invested in the first lien term loan of Victra, also known as LSF9 Atlantis Holdings LLC. Victra is the largest exclusive independent retailer for Verizon Wireless. We purchased Victra in the secondary market at an attractive price. Our yielded cost is approximately 13.7%. Our team has had a long-standing history with this name.

We also made a propriety preferred equity investment in Discovery Behavioral Health, a Webster Equity Partners portfolio company. Discovery is one of the largest providers of residential and outpatient treatment for behavioral health services across eating disorders, mental health, and substance abuse. Our yielded cost is approximately 20.4%.

We fully realize our position in the first lien term loan of Advanced Solutions International, also known as ASI. We originally invested in the first lien term loan and preferred equity in September 2020 of ASI. We remained invested in the preferred equity. Our fully realized IRR on the term loan was approximately 10.8%. We also fully realized our position in the first lien term loan of Cook & Boardman, which was repaid as part of an LBO by Platinum Equity. Our fully realized IRR was approximately 8.5%.

As Mike mentioned, I'd also like to note that the GICS Standard was updated in May of this year. As such, our industry capitalizations for existing portfolio companies have changed in some cases, and our industry ratings have also changed. As of September 30th, our largest industry concentrations were trading company and distributors at 17.1%, professional services at 11.5%, followed by IT services at 7.5%, software at 6.15%, and containers and packaging at 6.1%. Our portfolio companies are in 24 GICS industries as of quarter end, including our equity and warrant positions, which is an increase of three industries from the previous quarter.

I'd now like to turn the call over to Rocco to discuss our financial results.

Rocco DelGuercio: Thanks, Suhail. For the quarter ended September 30th, 2023, our net investment income was $1.6 million for $0.11 per share. The fair value of our portfolio was

$223.4 million compared to $220.1 million on June 30th. Our net assets were $83.8 million, a decrease of $3.9 million from prior quarter. Our portfolio's decrease from operation this quarter was approximately $1.7 million, our debt investments made during the quarter had an average yield of 12.3%, and the realization and repayments during the quarter had an average yield of 14.6% and an average IRR of 16.4%. The weighted average yield of our debt portfolio was 11%, a decrease of 150 basis points from June 30th.

As of September 30th, our portfolio consisted of 40 portfolio companies. 89.7% of our investments were first lien and the remaining 10.3% is invested in equity warrants and other positions. 99.7% of our debt portfolio was invested in floating-rate instruments and 0.3% in fixed rate investments. The average floor on our debt investments was 1.1%, our average portfolio company investment was approximately $5.6 million, and the largest portfolio company investment is Bioplan at $13.6 million. We had a gross leverage of 1.58 and a net leverage of 1.41 as of September 30th compared to 1.54 and 1.44 respectively for the previous quarter. As of September 30th, our non-accrual investments as a percentage of fair value was 10.6% compared to 4.1% for the quarter ended June 30th.

With respect to our liquidity, as of September 30th, we had approximately $14.3 in cash, of which $14.2 million was restricted cash with $28.8 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 our call back over to Mike.

Michael Mauer: Thank you, Rocco. As mentioned earlier, we continue to remain focused on portfolio management and risk mitigation, especially for our borrowers that are experiencing periods of stress. We added three borrowers to nonaccrual, including two investments in ArborWorks, CareerBuilder, and Klein Hersh last out term loan.

Since quarter end, there has been continued developments in ArborWorks. While we are bound by confidentiality, the company's operating environment remains challenged and we continue to have an active dialogue with all parties. While CareerBuilder continues to pay its interest, the company's fundamental performance has been weak for some time, so we put the loan on nonaccrual as we believe there is significant doubt of full recovery of principal. We continue to make progress rotating the portfolio and expect progress on the remaining nonaccrual over the next 12 months. Our NAV per share declined 4.46% from the previous quarter end. Our gross leverage this quarter was 1.58, above our guidance of 1.25 to 1.5 times, our net leverage was 1.41 times which is within the target range, and as mentioned last quarter, we expect to see our gross and net converge. As of November 6th, our gross and net leverage were 1.68 times and 1.51 times.

As we have previous stated, the advisory will waive the portion of our management fee associated with base management fees over one-times leverage. The company is expected to earn its dividend through the next quarter ended December 31. On November 9th, 2023, the board of directors declared a dividend for the quarter ended December 31, 2023 of $0.12 per share, as well as the supplemental distribution of $0.03 per share, both payable on January 8th, 2024 to stock holders of record as of December 14th, 2023. It is worth noting that the $0.03 supplemental distribution is related to fiscal year 2023 spillback.

As we look to the rest of our fiscal year, we will continue to work on rotating and diversifying the portfolio, all while focusing on mitigating risk in our borrowers experiencing short-term periods of stress or volatility. Our investment strategies have not waivered and we continue to remain focused on capital preservation and maintaining a stable dividend. We are optimistic about our pipeline, our ability to deploy capital in high-quality investments.

That concludes our prepared remarks. Operator, please open the line for Q&A.

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 7# on your phone now, and you will be placed in the queue in the order received, or press 7# 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.

Our first question comes from Mr. Paul Johnson with KBW. Go ahead.

Paul Johnson: Yes. Good afternoon, guys. Thanks for taking my questions. Just a couple for me, but in terms of investments that you made during the quarter, it sounds like there’s decent amounts of secondary activity. Can you just speak to what you guys are seeing in the secondary market versus what you can receive obviously in the primary market, and if that's more of a one-time 3Q type of thing or if secondary types of purchases are something you'd probably expect to remain more active with in the future quarters.

Suhail Shaikh: Paul, thank you for the question. This is Suhail. Let me take that in a couple of different ways.

I think the investments that we made are investments that we own in other portfolios that we manage. So, while they were secondary opportunities, I think these are investments that we have and we were able to find attractive opportunities to pick up additional paper that ICMB benefited from. So, we always are looking for things in the marketplace to add to our positions, to see what we can add, or frankly, in some cases, even sell if we think there is an opportunity to get out of a position at a healthy rate of return. So, that's part one of the question.

Part two is I think as we mentioned, subsequent to the quarter end, we had a couple of investments that we made that are brand new investments that are not secondary investments, and those are Alphia that I mentioned and Discovery Behavioral Health. Both of those are new investments. Now, Alphia was one that we had in our portfolio, it's getting refinanced, and we re-underwrote that risk as part of a new buyout and it's part of a new buyout. Discovery was a brand-new investment.

So, I think our pipeline is actually reasonably healthy, but we're being super selective about what to go after, how to tackle, and frankly, credits that we know right now, we'd rather own more of those than go into things where we don't like the structure or the pricing of. Hopefully that answers your question.

Paul Johnson: Yes, that's very helpful. Thanks for all the detail on that. My next question is just kind of on NII this quarter, $0.11 cents. I know Mike said that we expect to cover the dividend next quarter, the core dividend. I guess what do you foresee next year? Do you look at this quarter as sort of a depressed level of NII where you expect that to obviously trend back up to the core dividend level or possibly higher? What sort of levers do you have to move NII up from this quarter just being at a low level?

Michael Mauer: Yes, Paul, it's Mike. Thank you for the question. I think it's an area that I know you're focused on the ED analytics as we are. There are a couple of key levers that we focus on. One, and the elephant in the room, is our nonaccrual levels are high and we need to get those down.

There are two ways to get those down; one is to complete working with the group to convert that back to an accrual status in some way, shape, or form. I can't go into any more detail on that just given where we are in discussions. So, that's working with the company and the sponsor. The other one is if, and Suhail mentioned this before, there are opportunities to sell that and reinvest it in what we think are good, new investments. That's another lever. Then the second area is we've got equity, some of which we've bought and coinvest and some of which we've gotten restructured for. So, that is a function of working with the other lenders, the company, etcetera, to convert those.

Those are the levers, the obvious levers, and we are really working to, and we've said this before, rotate the portfolio, and we've done a lot of rotating but we've got more work to do on that front.

Paul Johnson: Thanks for that, Mike. Last question for me. Unless anything's changed, I believe Investcorp is still like around the 10% owner of the stock based on the position that they bought several years ago. If I'm just looking back, I mean NAV is down fairly materially since that time, I mean around 43%. I believe the NAV's declined since that quarter that Investcorp came in to be advisor. I mean I guess what is Investcorp's level of engagement here? How active are they with the business today versus when they came in? I'm just curious, kind of trying to get our thoughts around what they think of performance and what sort of the plan is going forward here.

Michael Mauer: There are two or three pieces to that answer and I think the critical one, which Rocco will go back and doublecheck it, but I'm pretty sure Bloomberg has it right, and I could be off by 30 days but somewhere June 1st, give or take 30 days, Investcorp increased its ownership to 24.9% of the stock. So, that was a statement a year and a half plus, I'll call it a year and a half ago give or take, of the commitment to the public BDC to put more money in.

The second thing is, are they focused on it? I will tell you that the CEO has a formal meeting scheduled every 30 days, a monthly meeting, with Suhail and I, to talk about it; what are we doing, how are we thinking about it. He's focused on it. It is, and was initially, a critical investment to think about how do we grow the platform and we need to make sure that the public BDC is part of that strategy and that we're doing the right thing by shareholders. So, it's got attention, it has gotten additional capital from the initial September of '19 investment, and trust me, we've got [Laughter] ongoing dialogue with our CEO beyond the formal meetings too.

Paul Johnson: Thanks for that, yes. Thanks for the direction on the ownership level. That's all for me. Thanks for taking my questions.

Michael Mauer: No problem, yes.

Operator: Thank you very much. Our next question comes from Mr. Robert Todd with Raymond James. Again, if you have any questions, please press 7# to open up your line. Go ahead please.

Robert Todd: Hi, guys. Just touching on the nonaccrual question again, Mike. I think in your prepared remarks, you made a reference to progress over the next 12 months. I mean is that the kind of timeframe we're looking at to resolve or to get the nonaccrual level down to something that might be more inline with the industry? Can you give us an idea of the timeframe we're talking about here?

Michael Mauer: Yes, Robert, I would love to say that I have a crystal ball that says "This is the quarter where it will be down below the industry average." I will tell you that we have active dialogue on almost everyone. I don't want to say everyone because even if you look at it, some of those really are not active restructurings. They're more in liquidation and some of those are small, but the major ones we are very focused on, we'd like to see those resolved in six months. I said 12 months. We don't know because we're not the sole lender and we deal with a group, and we have to manage a lot of constituents in that process, but I hope that it's much sooner than the 12 months.

Robert Todd: Got it, thank you. On the dividend, the $0.03 supplemental viewpoint, I think you also said that was to do with essentially last year's spillover. So, presumptively, that $0.03, the supplemental program, will not be continuing. I just want to be clear there with investor expectations. It's just going to be the base dividend going forward.

Rocco DelGuercio: Hi, Robert. It's Rocco. Yes, correct. You are correct.

Robert Todd: Got it, thank you. Then on, [Laughter] I asked Rocco about this last quarter, on the revolver with Capital One, we are now, it's less than 12 months to the, not maturity but to the reinvestment period expiring. Can you give us an update on what's going on, on that front?

Michael Mauer: Yes, and I know, as you said, we spoke about it on the last call, since this is the first quarter back after the annual call, we don't have the normal, I'll call it, 90 days in between calls. It's a shorter period in between.

Robert Todd: Right. [Laughter]

Michael Mauer: We have been on course. We haven't tried to accelerate those. There's nothing that's dragging, but we have an ongoing dialogue with them. It's going through, what I would call, a "normal" process. We do not anticipate any issues with Capital One as our revolver provider.

Robert Todd: Got it, thank you.

Michael Mauer: Sure.

Operator: Thank you very much. Our last question comes from Christopher Nolan with Ladenburg Thalmann. Go ahead please.

Christopher Nolan: Hi. Any guidance you can give in terms of where you think leverage is going to be, particularly in light of the increase in nonaccrual, and should we expect an excise tax in 2024 given a lack of a supplement? Thank you.

Michael Mauer: Rocco, you want to take the excise tax? I'll take the supplement.

Rocco DelGuercio: Yes. So, excise tax for sure. A few years back, as many of you guys know, a lot of the BDCs, they'll keep the excise distribution and pay the tax on it because it's cheaper on the financing. So, we will have an excise tax payment. If you look at the financial statements, it's kind of going to be the same one over and over again, the same one that we paid in the past.

Michael Mauer: Chris, on the leverage side, there's two pieces; there's the ratio and there's the nominal. So, leverage, we would expect to decrease our nominal amount because we have brought our NAV down, and so we continue to focus around the 1.25 to 1.50, which means that absolute borrowings will decrease from a target perspective to be in that range.

Christopher Nolan: Thank you.

Operator: Thank you very much. After that, we have no questions in the queue.

Michael Mauer: Thank you, everyone. We look forward to the next call in about 90 days. Thank you.

Suhail Shaikh: Thank you, everyone.

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

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