Conference Call
Investcorp
May 10, 2022

Operator: Welcome to the Investcorp Credit Management BDC scheduled earnings release for third quarter ended March 31st, 2022. Your speakers for today's call are Mike Mauer, Chris Jansen, and Rocco DelGuercio. Operator assistance is available anytime during this conference by pressing star (*) zero (0). A question-and-answer session will follow the presentation. I'll now like to call over to our speakers. You may begin.

Mike Mauer: Thank you, Operator. Thank you for joining us on our third 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 statements. Rocco?

Rocco DelGuercio: Thanks, Mike. I would like to remind everyone that today's call is being recorded and that this call is a 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 over to our chairman and CEO, Michael Mauer.

Mike Mauer: Thank you, Rocco. I'd like to start by updating Investcorp's ownership stake in ICMB. On Thursday, May 5th, Investcorp entered into a stock purchase agreement to purchase 2.165 million shares at the March 31 NAV from Cyrus. Cyrus was an original seed capital investor in the predecessor private fund and the anchor investor in ICMB. Cyrus has been invested in ICMB for over 10 years between the predecessor fund and the existing BDC. This position has created significant overhang in the stock as Cyrus was an unnatural long-term holder with an excess of a 20% position. Investcorp's intention in buying the stock was multifold. This demonstrates continued commitment to ICMB and conviction in the underlying value of the investment at NAV. It also reduces the overhang on the stock and allows all shareholders to see this commitment and benefit from the reduced overhang.

This past quarter, we saw the broader market face significant volatility and a slowdown in a number of transactions in the loan market driven by geopolitical events. The majority of transactions we saw were either LBOs or refinancing's. We have typically found that in a highly competitive market environment, our best opportunities come from companies we already lend to, as these deals tend to have better structures. As we continue to see strong competition for deals, we see pressure coming from both higher pricing and higher closing multiples. However, we remain focused on credit quality and are selective about the structures we are willing to lend into, and thorough in our due diligence process. This quarter, we were successful in deploying our capital at an average yield of 8.25%.

We made two new investments and invested in three of our existing portfolio companies, none of which were covenant lite, in a sponsor-friendly environment. We also continue to execute under the plan to co-invest in equity positions with Investcorp's North America Private Equity group, with more momentum in the pipeline under that plan. We continue to focus on the portfolio rotation that we began earlier this year while maintaining our credit discipline. This part quarter, we opportunistically sold out of positions in the portfolio in favor of new opportunities with higher yield and better loan structures. Our investment activity during the quarter continues to be balanced between club loans and middle-market, lightly syndicated loans. We have also furthered reduced our exposure to Energy, Equipment and Services, which represents 5.4% of the portfolio compared to a year ago, at 10.1%. Additionally, we continue to make progress with legacy credit issues in the portfolio. We completed the restructuring of Fusion Connect in January. I'll speak more about that later in the call.

Chris will now walk you our investment activity during the March quarter and after quarter end. After his discussion, Rocco will go through our financial results. I'll finish with commentary on the restructuring of Fusion Connect and our non-accrual investments, our leverage, the dividend, and our outlook for the rest of 2022. As always, we'll end with Q&A. With that, I'll turn it over to Chris.

Chris Jansen: Thanks, Mike. We invested in two new portfolio companies this quarter as well as three existing portfolio companies. We fully realized our positions in five portfolio companies and also refinanced our position in Gexpro, and fully realized our position in the Fusion exit loan.

We invested in the first lien loan in AHF Products, which supported the LBO by Paceline Equity Partners. AHF Products is a leading producer of hard surface and solid wood flooring in North America. Our yield at cost is approximately 7.4%.

We made our second equity co-investment alongside Investcorp's North American Private Equity group. S&S Truck Parts LLC, listed in our scheduled investments as Pegasus aggregator, is one of the largest suppliers of new aftermarket parts for medium and heavy-duty vehicles.

In terms of investments in current portfolio companies, our existing loan to Gexpro was refinanced in January as part of a larger transaction which backed several acquisitions. Our yield at cost on Gexpro's funding revolver is approximately 7.5%, and term loan and delayed draw is approximately 7.4%. We also made an additional investment in the equity of Techniplas to support an asset purchase of a molded product facility sold by Lyle Industries. As part of Fusion's restructuring process, we were a joint lead arranger on the new first lien term loan, which has a yield at cost of approximately 9.6%. We also participated in the company's new Series A preferred equity, which has a PIK coupon of 12.5% and a yield at cost of approximately 13.1%. Mike will provide additional detail about Fusion's restructuring later in the call.

Turning now to our realizations, our loan to Gexpro was repaid in full as the company refinanced in January. Our fully realized IRR was approximately 10.4%. Our second realization was ProFrac Services. ProFrac completed the acquisition of FTS

International in March, and we were refinanced out of our position. Our fully realized IRR was approximately 9.9%. We also received repayment in full for Fusion's exit loan as the position was refinanced through the broader restructuring of the company. Our fully realized IRR was approximately 14.1%. We exited several investments opportunistically this quarter in order to reduce our leverage and rotate into higher our yielding credits. We fully realize our position in Veregy with an IRR of approximately 9.7%, Qualtek with an IRR of approximately 8.7%. Flow Control with an IRR of approximately 8.1%, and Galaxy with an IRR of approximately 7.2%.

After quarter end, we invested in one new portfolio company, one existing portfolio company, and had two realizations in existing portfolio companies. First, the new Gexpro loans made in the first quarter were repaid in April as the company merged with Lawson Products. Our fully realized IRR in the term loan was approximately 19.7%. Although, we are pleased with the return on the revolver in the delayed draw, the IRRs are not meaningful given the short holding period. We invested in the club financing for American Nuts, which supported the refinancing of the company, and the acquisition of DSD Merchandisers. American Nuts provides procurement, processing, and packaging services of nuts, seeds, and dried fruits. The acquisition of DSD Merchandisers creates a fully and vertically integrated business. Our yield at cost is approximately 9.9%.

Lastly, we fully realized our position in Klein Hersh as the company simultaneously refinanced its loans and converted to an ESOP. Our fully realized IRR was approximately 11.8%. We also invested in a new transaction. Our yield at cost is approximately 9.2%.

Using the GICS Standard as of March 31st, our largest industry concentration was Trading Companies and Distributors at 9.5%, followed by IT Services at 9.2%, Internet and Direct Marketing Retail at 9.0%, Professional Services at 7.8%, and Household Durables at 7.1%. Our portfolio companies are in 20 GICS industries as of quarter end, including our equity and warrant positions. As of March 31st, we had 35 portfolio companies, a decrease of three from December 31st. I'd now like to turn the call over to Rocco to discuss our financial results.

Rocco DelGuercio: Thanks, Chris. For the quarter ended March 31, 2022, our net investment income was $1.8 million or $0.12 per share. The fair value of our portfolio was $242.0 million compared to $269.4 million on December 31. Our portfolio's net decrease from operations this quarter was approximately $63,000.00. Our investments in debt purchase during the quarter had an average yield of 8.25%, while realizations and repayments during the quarter had an average yield of 8.59%, and fully realized investments had an average IRR of 9.56%. The weighted average yield of our debt portfolio was 8.14%, a decrease of two basis points from December 31.

As of March 31, our portfolio consisted of 35 portfolio companies; 91.8% of our investments were first lien, the remaining 8.2% is invested in equity warrants and other positions. 91.3% of our portfolio was invested in floating rate increments, and 0.5% in fixed-rate investments. The average floor on our investments was 1.04%. Our average portfolio company investment was approximately $6.9 million, and our largest portfolio company is Fusion at $13.4 million. We had a gross leverage of 1.71x and net leverage of 1.63x as of March 31 compared to 1.74x gross and 1.39x net, respectively, for the previous quarter. Our net leverage adjusted for open sales and open purchases was 1.41x as of March 31 compared to 1.61x for the previous quarter.

As of March 31, we had six investments on non-accrual, which included all three investments in PGI as well as Deluxe and two investments in 1888. With respect to our liquidity, as of March 31, we had $7.6 million in cash, of which, $4.7 million was restricted cash, with $7.3 million of capacity under our revolving credit facility with Capital One. Additional information regarding the composition of our portfolio is included in 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. We're proud of the progress that we have made repositioning the portfolio, and we continue to remain selective in our new investments. We continue to focus on adding club deals that were originated through the team's relationship, as well as add-on investments and refinancing the existing portfolio companies. We remain focused on the credit quality of our deals, including a comprehensive evaluation of loan credit and documentation and downside protection.

Fusion completed its restructuring in January. We were joint lead arrangers on the new first lien loan, which refinanced Fusion's exit loan. We were also a backstop party to the company's new money Series A preferred equity. By virtue of our backstop commitment, as well as investments in the Series A preferred equity, we received warrants with a fair value of $636,000.00. The takeback loan, which was the goal for the company's debt, was equitized into Series B equity and will convert to common shares upon the receipt of regulatory approvals, which we anticipate will occur later this year. We also received out-of-the-money warrants. The restructuring significantly de-levered Fusion's balance sheet and positions the company to execute on its growth initiatives.

Our gross leverage this quarter was 1.71x above our guidance of 1.25x to 1.5x, and three basis points lower than last quarter. Our net leverage was 1.63x. Due to the timing of investments and repayments, our leverage remained above the target range. As mentioned last quarter, we expect to see our gross and net leverage generally converge, with both around the high end of our target range. As for May 2nd, our gross leverage was 1.48x and our net leverage was 1.45x, at the high end of our target range.

As we have previously stated, the Advisor will waive the portion of our management fee associated with base management fees over 1.00x leverage. We did not cover our March quarterly dividend with NII. Through the fiscal year-end to date, the company has earned its dividend and is expected to earn its dividend through the fiscal year ending June 30, 2022. Our board of directors declared a distribution for the quarter ended March 31, 2022, of $0.15 per share, payable on July 8 to shareholders of record as of June 17. We believe the dividend level is stable and sustainable, and that it represents an attractive yield given the market price of ICMB stock.

As mentioned earlier, we continue to remain selective on our new investments and our portfolio repositioning strategy. We are focused on improving industry concentration and diversification and managing our average position size, all which helps manage risk. Our investment strategy has not wavered. We are focused in investing in primarily first lien loans, preserving capital and maintaining a stable dividend while creating upside to the NAV through our existing and new equity investments. As we enter the last quarter of our fiscal year, we expect to continue executing on our strategy, and expand on diversity and stability of our portfolio. 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 star (*) one (1) on your phone now, and you will be placed into the queue in the order received, or press pound (#) at any time to remove yourself from the queue. Once again, to ask your question, please press star (*) one (1) on your phone now. [Pause]

Operator: Our first question comes from Paul Johnson with KBW. Your line is open.

Paul Johnson: Yes. Good afternoon, guys. Thanks for taking my questions. First question is just about the market and the investment pipeline that you're looking to build. With just the advent of the unitranche and the growth of that product, and direct lenders and what they'd have to offer to the market, does that push out in any way the more traditional club deals and affected any syndicated deals that you guys participate in?

Mike Mauer: Thanks, Paul. It's Mike. Before I answer your question, Rocco just hit me that I misspoke earlier in the call. The distribution that the board of directors declared is for the June 30 quarter ended, not March 31, I just want to correct that. Coming back to your question, we were seeing actually a reasonable pipeline of deals to look at. The emergence of the unitranche that you're talking about, and I'll use the names generically, but Blackstone, KKR, Apollo, these large multibillion-dollar direct lending vehicles, they tend to focus on a lot larger deals than we focus on. The deals we're focused on are typically on the low side, 40 to 60 million in tranche up to a couple hundred million. My experience in running into and talking to a lot of former colleagues at some of those places, are that probably around the upper end of that range I just gave is where they get interested. So, deals that are under 100-150 million, it's almost hard for them to do them when you look at their allocation policy across all vehicles. So, they are very focused on the middle market that is probably 50 to 200 million of EBITDA. So, those tranches, by definition, are 200 to 500 million. It's really not affecting us at this point, and we are still seeing many club deals and less of the lightly syndicated from regional banks, but very good flow from partners in the club arena.

Paul Johnson: Got it. I appreciate that. Another question just under the remarks for the portfolio – or for the BDC this quarter, just a little bit of a write down in the quarter, $1.9 million or so. Is that related to more mark to market spread widening, or is there any specific credit deterioration that's baked into that?

Chris Jansen: Hey, Paul. It's Christ Jansen. It's all due to a little bit of spread widening from beginning of the first quarter from 12/31 to 3/31. Anecdotally, spreads are coming back in. From a performance perspective, the numbers we have seen in the fourth quarter and early in the first quarter of this year have been surprisingly healthy. We haven't really seen any pockets of resistance or downward pressure from an operating viewpoint. It's just been either spread widening or, in the case of Techniplas, which is a large equity position for us, it's just been the market comps have gone down by almost two full turns; nothing to do with the operating from either Techniplas or really anything within the portfolio.

Paul Johnson: Got it. I appreciate that. I also have a question on the dividend level. I know that you mentioned in your prepared remark that the board and the company believes it's at a sustainable level where it is today. Just given the gap from NII this quarter to the dividend, I'm just hoping you could maybe talk about the leverage that you have to pull in order to get NII back within that dividend range and anything that could help improve that. Is it rates, is it refinancing, or just anything – any sort of color you can have on that would be great.

Mike Mauer: Sure, Paul. I'm glad you asked that because probably a lot of more color around. We came in at $0.12; the dividend is $0.15, that gap at three, two-thirds of that gap is the excise tax that is one time in the quarter. So, if it weren't for the excise tax, we would have been $0.14. The leverage, while the headline continues up in this 1/7, this quarter was – we had a bunch of sales that hadn't settled and things like that. We would have been below in the target range if the receivables had been cash from a net perspective, or that cash we had, we would have paid down the Capital One facility. So, running the portfolio around the level that we are, gets us to that $0.15.

Rising rate environment will help all things be equal. That having been said, I think people, including yourself, who've followed us for a while, watched us over the last four to six years move from what was a 60% first lien to, today, a 90% first lien. But given the inflation and the outlook, I think we would expect to stay in this 80 to 90% first lien, at least, range because we've got rising rates but we also have rising risk around the inflation in companies.

Paul Johnson: Got it. Appreciate that. My last question, if I can, it's just on the large holder selling out or partially selling out this quarter, Cyrus Partners. I'm just curious if you have any details as far as – with that partner that was contributing or impacted in any way, or was there any relationship there prior to the sale of their position. I'll also ask if you were in dialogue with them in any way, or any of your other large shareholders on potentially, further exits of those large insiders?

Mike Mauer: Let me start at the last part. I'm not aware of any near-term exit by any existing shareholder today, Cyrus or anyone else. I can't speak for what their plans are from a liquidity, from a appreciation, et cetera, but I'm not aware of any. I do talk to our shareholders. Cyrus has been a great partner for a very long time. Dating back to the predecessor fund, it's well over 10 years that Cyrus was involved in this, from seeding the original private funds, and there has been a view for a while that they wanted to get some liquidity. So, this was creating overhang, and it was an opportunity for us to show to conviction around the NAV value and to relieve some of that overhang.

Paul Johnson: Got it. I appreciate it. That's all I have today. Thanks for taking my questions.

Mike Mauer: Thank you, Paul.

Operator: As a reminder, if you do have a question, please press star (*) one (1) on your touchtone keypad. Our next question comes from Robert Dodd from Raymond James. Your line is open.

Robert Dodd: Hi, guys. Just following up on that last part of Paul's question. Perhaps you can give some color on this. If the goal was for the manager to give investors comfort in their belief in NAV, wouldn't it have made more sense for the manager to tender the $15 million of stock for all investors rather than take out one particular investor, because, obviously, if you believe in NAV, equal opportunity for everybody to sell to the manager rather than concentrate the financial benefit there to one investor?

Mike Mauer: Yes, Robert. Thank you for the follow-up. If that were the only objective, I would agree, but having a 25% shareholder who's been in for 10 years had another objective alongside in parallel, and we were trying to solve for several items at the same time. So, that was the road we chose.

Robert Dodd: Okay. Understood. In your prepared remarks, Mike, you mentioned a comment about you're making progress on some of the non-accruals. Obviously, the names are the same, but can you give us any more color on what progress has been made? Obviously, you've talked on prior quarters, it's a long-term process, multi-year in many cases, but can you give us an update there?

Mike Mauer: Yes. There's a lot of names we have rotated out of, and maybe it's a great point that on our next call, we should just highlight over the last 12 to 18 months how we have actually rotated, and give you some granularity around that. A couple of names that we have spent time around - I'll let Chris talk - these are all works in progress, but lots of momentum on bringing in advisers, bringing in management, shifting strategies. Techniplas, we equitized the debt. We went in to the equity with Jordan, who was a third party coming into the situation, putting fresh cash in. There's been small tag on acquisitions made, there's been facility shutdown, there's a new CEO. It's actually performing quite well, but comps are weak because of what's going on in the auto industry, globally, but the company is performing quite well, and we feel very, very good about that. Fusion, new management is installed. There's a lot of activity going on, looking at whether or not it's small acquisition that need to round out the product sweep in order to make it an attractive strategic alternative for others, or whether or not there are some businesses that did not make sense and those are being addressed, but new management and recapitalize that to reduce the debt and put it in preferred equity. So, that's another major one when you look at it. I'll let Chris talk to PGI.

Chris Jansen: Yes, PGI is - the new owner in there has been doing a great job at actually managing the business and preserving whatever value is there. It is hard to be too optimistic on that being a large increase from where we are right now, but we feel rock solid about the valuation that we have on it now. We are looking for that to increase a bit, but not make up close to anywhere the losses, unfortunately.

Robert Dodd: Okay. I appreciate that. Thank you.

Mike Mauer: Robert, I just appreciate all the questions, and Paul also, around - we knew that when Investcorp did the purchase, it would have questions. I just want to reiterate, that's at the Investcorp level. We know they own the manager, but it's not the manager and it's not the BDC.

Robert Dodd: 100% understood. Last one, if I can, on the dividend. You said you expect to earn the dividend in the fiscal year. Just to clarify, is that before or after tax? Are you awarding the dividends with the excise tax payments or excluding that?

Rocco DelGuercio: Hi, Paul. It's Rocco. Yes, with the excise tax payment.

Robert Dodd: Got it. Thank you.

Operator: Thank you. We have a question from Christopher Nolan from Ladenburg Thalmann. Your line is open.

Christopher Nolan: Yes, hi. Most of my questions have been asked. On 1888, and excuse me if you've answered this, it seems like you have a non-accrual PIK loan but then you have an accruing cash loan, and I'm just trying to get clarification around that.

Mike Mauer: Yes, the first priority is expected to be able to pay the interest and the principle there. The non-accruing PIK is where we have a question right now as we go through our evaluations, on whether or not that will be realized, and we'll continue to evaluate that on an ongoing basis.

Christopher Nolan: Great. That's it for me. Thank you.

Mike Mauer: Okay.

Operator: Thank you. We have no further questions in queue at this time.

Mike Mauer: Thank you, everyone. We appreciate the time and look forward to talking after the next quarter. Thank you.

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

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