Q3 2023

UBP DISTRESSED OPPORTUNITY FUND I

Quarterly Comment

For Professional Investors in Switzerland or Professional Investors as defined by the relevant laws.

Market Comment

- The third quarter of 2023 saw a pullback in global markets with most asset classes, including global equities and bonds, ending the quarter in negative territory. The only exceptions were commodities and High Yield (HY). Equity and bond volatility increased during the quarter, although only moderately. Developed Market (DM) equities were down -3.4% in Q3, keeping the YTD gains well into double digits (+11.6%), while Emerging Markets (EM) lost -2.8% in Q3 and settled at +2.2% YTD. In DM, the Japanese market was one of the few in positive territory in local terms (+2.5% in Q3, +25.7% YTD for the TOPIX). The weakening of the JPY vs major trading partners (-12.5% vs USD YTD) continues to be a tailwind. The other positive outlier in Q3 was the UK market, supported by the relatively good performance of energy stocks. In the US, the S&P 500 was down -3.3% in Q3 and is up +13.1% YTD. In terms of styles, value (-1.7%) outperformed growth (-4.9%) over the quarter, which only modestly reduced the YTD gap which sees growth still outperform value by a large degree.
- In Fixed Income, DM government bonds, EM Debt and investment grade were down, negatively impacted by the rise in bond yields. On the bright side, HY managed to be in positive territory, thanks to the high carry and the shorter dated profile the asset class is exhibiting, spreads remained stable over the quarter. On the other end, inflation linked securities were the most negatively impacted by the slow-down in inflation data. The focus of fixed income investors, which had been focused on the level of peak rates, has now started to switch to how “higher for longer” rates will affect the economy and fiscal sustainability. On the economic front, the sharp rise in oil prices in Q3 constituted the main headwind and increasing signs of a slowdown are impacting markets. The other interesting observation is that the correlation between stocks and bonds was once again positive in Q3. For asset allocators, this is a reminder that alternative strategies should be key to diversify against some of the risks the economy and markets are facing.
- As described more in more detail below, the current market environment provides a compelling set of opportunities for our UBP Distressed Opportunity Fund I, which invests in a broad range of distressed securities in the US and Europe through specialist partners each investing in specific assets in their respective markets.

Sources: UBP, Bloomberg Finance LP, BofA Merrill Lynch

All performance figures are given net of fees. Past performance is not a guide to current or future returns. See full disclaimer at the end of the document.

Performance Review

- The UBP Distressed Opportunities Fund (Class A) returned +15.8% in Q3 23 and +19.8% YTD. Good and improving operating profits at the underlying specific businesses in the portfolio were the main drivers to positive returns during the quarter. Each of the three sleeves contributed positively to returns.
- The European Distressed sleeve returned +45% in Q3. The industrials company was the main contrbutor, it delievered very strong operating results as falling energy prices positively impacted the firm's bottom line. The European Hotels returned +12.8% in Q3. The external valuation was positive, reflecting the beginnings of the capex program and continued solid operating results over Q3. Finally, the liquidation of the CLO sleeve posted +8.1% in Q3 as positions were sold at a premium.

	NAV	Fund AUM	Q3 2023	YTD 2023
Class A	**109.21**	**USD42.3m**	**+15.8%**	**+19.8%**

Source of data: UBP. Past performance is not a reliable indicator of future results. The value of investments can fall as well as rise. Past performance figures are stated in the currency of the share class and calculated with dividends reinvested; they are free of ongoing charges. The calculation does not account for sales commissions and other fees, taxes and applicable costs to be paid by the investor.

Portfolio Activity

- During Q3 we instructed the CIFC team to sell the portfolio of CLOs as they looked fairly valued at the time and require lower interest rates to retain value. The capital will be reinvested into stressed corporate credit opportunities which appear to be undervalued and should recover from current lows.

European Hotels - Pygmalion

- Total allocation as of the end of Q3 2023 ~41% (unchanged from Q2)
- As a reminder, in April 21 we purchased two hotels in Florence from a private owner who had gone into default on their loan. Following significant negotiations with the original owner, the position was purchased at ~40% discount to local average prices and ~60% discount to construction costs, with the local bank in the original transaction provided the new financing. In Q3 23, the Hotel sleeve returned +12.8%. The external valuation was positive for the quarter reflecting both the commencement of the capex program and continued good operating profits over the quarter.
- Q3 23 was a solid trading quarter for the hotels, ending the quarter with occupancy at ~90-95% vs the budget of ~90%. There was some variation over the quarter as August is a seasonally quieter month for the city given the high temperatures. Occupancy was robust in October however it is expected to fall in line with a seasonal slowdown into yearend. Business will mainly be driven by domestic leisure and business travel over this period. Bookings are good into 2024 and they see a continued consumer trend of spending focused on travel vs goods.
- Operating costs at the hotels appear to have stabilised with utilities costs down from extremely high levels of late 2022/early 2023, and the new air conditioning chillers installed in 2023 appear to be making an impact on energy savings. Staffing costs are seeing incremental increases due to natural turnover at the hotels. However, the team highlighted that wage inflation is not as high compared to other European countries as there is very limited collective bargaining or unionisation. The only cost increasing of note is fresh produce for the food and beverage.
- Overall, the hotels generated high net operating income over Q2 and Q3 and this excess meant the agreed capex program began in Q3 23, earlier than projected (in 2024). Looking forward the plan is to spend ~EUR4m on capex, split into two phases; the low season late 2023/early 2024 is focused on largely the common areas of both hotels, including dining areas, and then low season late 2024 will mainly be focused on room upgrades in the Metropole. In Q3, the initial works were on the Garden Inn, fitting out the retail outlet in the lobby and essential works on the underground car park.
- The loan financing the properties, which the fund was able to take on at a distressed price during the pandemic from an NPL situation, is due to be refinanced in 2024. The team have begun work to look at refinancing options with local operators.

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European Distressed – Brigade

- Total allocation as of the end of Q3 2023 ~13%. This is incrementally lower by quarter end due to performance of the overall fund.
- Mannok is an Industrials company based in Northern Ireland, UK. Their main business line is producing cement and building materials, and they also run a small packaging company.
- As a reminder, Mannok completed restructuring (and rebranding) in early 2021 and is in the process of stabilising and growing revenues following the restructuring and pandemic. The Fund holds a piece of the firm's post re-org equity. The position was written up significantly by the external valuer in Q3. EBITDA generated over Q3 far exceeded budget as any fall in energy costs now directly increase the firm's profitability. From the excess cash generated, the company paid down ~EUR10m of debt which was accretive to the equity (which DOF owns). This was the first time since 2015 that the company has produced excess cash sufficient to reduce the debt. The packaging part of the business also continued to perform well given the firm produces sustainable packaging which is in high demand.
- Last 12 months rolling EBITDA (to Sep 23) was EUR47m, exceeding the EUR26m budget. For reference as of August 2023 the last 12 months sales were EUR313m sales vs ~EUR308m in August 2022. Manufacturing EBITDA was ~EUR37m and their EV was EUR160-200m, based on 4-5x multiples. With the excess cash they aim to reduce the company's debt by a further ~EUR10m in the coming months.
- As the firm achieves further growth targets in the next 12-18 months, they aim to refinance the remainder of their debt and eventually list or sell to a strategic buyer.
- The other position in the portfolio is EG Group, a large owner of service stations in UK, US, Europe and Australia. The fund holds a slice of the company's preference shares and attached warrants.
- The company's Q2 results (and preliminary Q3 results) were modestly negative however, EG traded sideways as they continued to actively address their near-term debt maturities (2024/25) and the overall size of their debt.
- Over the course of 2023 they have both pushed out their 2024/2025 ~USD8bn maturity wall and reduced the overall amount of debt (to USD6.1bn). In Q1 they completed a USD1.5bn sale and lease back of US assets, then in Q2 announced the sale of their UK assets to ASDA Group (the owners of EG are also majority owners of ASDA). This transaction closed in Q3 and cash received directly went to paying down debt. In early Q4 they refinanced a significant portion of their debt out to 2028 with a combination of loans and bonds. Given the modest fall in EBITDA in 2023, overall firm leverage remains ~5.5x and they want to work towards bringing this to ~4.5x over time. Interestingly the company received both a rating upgrade and downgrade from two of the main ratings agencies which seemed to reflect both the weaker EBITDA but also the significant progress in addressing their debts.
- The company expects to organically grow EBITDA over the next 1-2 years then look for a strategic sale or listing. The PE owners are incentivized to find an exit given the high coupon on the preference shares which steps up each year.

US Structured Credit, CLOs – CIFC

- Total allocation as of the end of Q3 2023 is ~5% (reduced from Q2).
- The book returned +8% in Q3 with gains across all three sub-sectors.
- CLOs lagged the broader markets earlier in the year, however once the US medium sized bank troubles receded and loan prices recovered, CLO prices across the tranches and vintages recovered well over the year. Loans are trading back up ~94-97c.
- In Q3 we instructed the CIFC team to sell the book as CLOs look fairly valued in current market conditions and require lower interest rates to retain value. The capital will be reinvested into stressed corporate credit opportunities which appear to be undervalued and should recover from current lows.

Cash

- Given the sales of the CLOs, cash rose to ~34% by the end of Q3.
- Cash was transferred to Brigade to invest across European stressed and distressed names and was actively invested over the weaker month of October.

Outlook & Conclusion

- We believe there is a continuing opportunity set in specific areas of the markets, particularly small and medium sized companies where new issue market is looking too expensive in a high rate environment. What is also interesting is companies that had been recovering from the pandemic are now coming under increasing cost pressure and won't be able to maintain new elevated debt levels. Those sectors with high staff or materials inputs such as retail, leisure, and industrials may see pressure to restructure.
- The headwinds in 2022 were strength in US dollar and the sharp jump in input costs for the underlying companies, which squeezed profits. Some of these pressures appear to have peaked and look to be easing through 2023. While portfolio companies are aware of potential recession risks on the horizon, they have already weathered a turbulent 2022 and are actively addressing debt balances. With the fund fully invested the focus over the next few years will be position sales either via IPO or trade sales.

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