



Developed markets special situations credit

Navigating the perfect storm in the European midmarket

Executive Summary

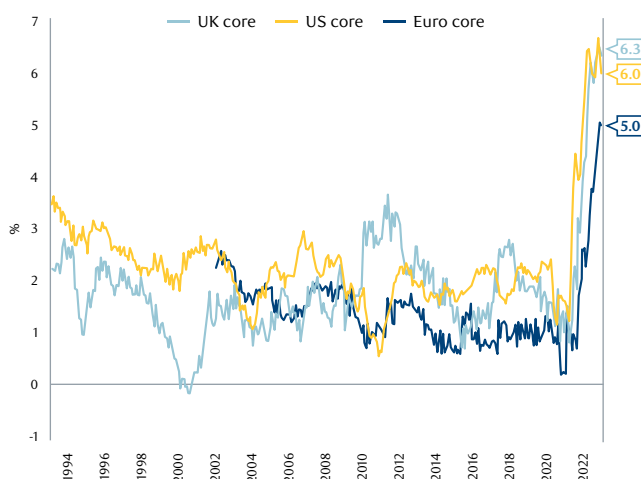
- The challenging environment of 2022 catalysed a once in a decade opportunity for specialist distressed investors.
- In Europe, the opportunity in the midmarket is unusually broad, spread across multiple countries and multiple sectors.
- Experienced distressed investors have the knowledge and the relationships to capitalise on situations offering downside protection and asymmetric upside.

The distressed landscape: a perfect storm

The past few quarters have amounted to a perfect storm for European corporates. Years of ultra-accommodative monetary policy and excess liquidity were followed by higher inflation and a hawkish response from Central Banks.

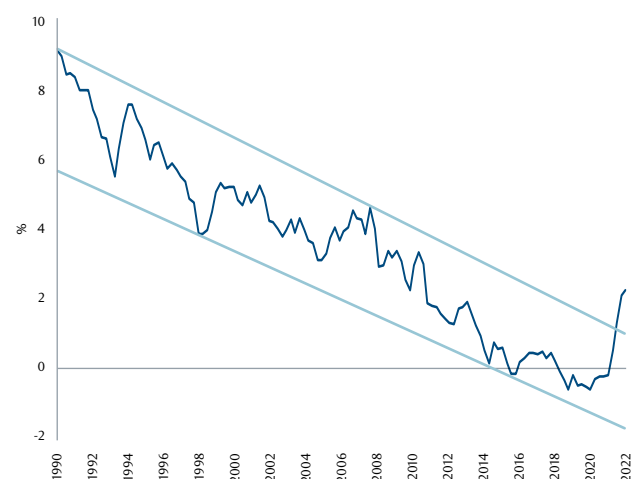
Inflation turned out to be higher and longer-lasting than anticipated (see Figure 1). Central Bankers globally raised rates, translating to a breakout from a thirty-year downward trend channel (see Figure 2). The tone of debate remained hawkish at the end of 2022 in the US, the UK and Europe and even in Japan.

Figure 1: Core inflation rate – UK, US and Eurozone



Source: Macrobond, as at 28 December 2022.

Figure 2: Breakout from thirty-year downward trend channel in rates



Source: Bloomberg, as at November 2022.

The impact of these dramatic long-term changes was exacerbated by shorter term events including:

- the ongoing covid lockdowns in China
- the war in Ukraine
- the spike in energy prices
- a cost of living crisis
- labour force pressures and industrial action

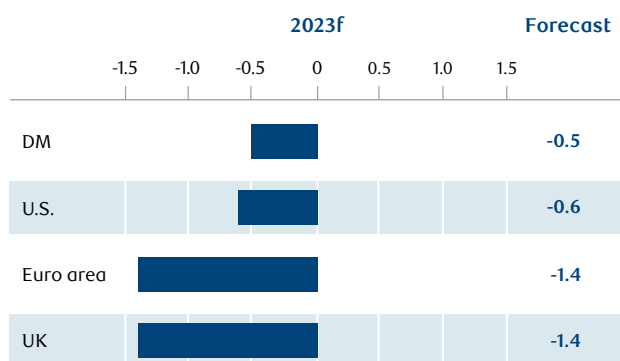
In combination these have created the conditions for recession in Europe in particular, and we expect this to be protracted. Even if one problem disappears, other challenges are likely to remain and, this time around, Central Banks will not be able to simply react with huge injections of liquidity given current levels of inflation.

So, what are the implications for corporates? We see this as a perfect storm as companies' business models are being hit by a weaker consumer, higher costs of goods sold and higher borrowing costs, as well as supply chain disruption - and it is hard to find a sector that is not being impacted by these factors. In many cases, after years of easy money, companies have become over-leveraged, and rate rises pose existential challenges to them.

It's worth noting that these challenges came at a time when economies had not fully recovered from the covid pandemic, with companies in various sectors still facing its residual effects and trying to cope with the withdrawal of the government support measures.

We believe that these macroeconomic factors will lead to an increased pipeline of opportunities for distressed investors which is likely to last a number of years. Distressed opportunities are seen at all stages of the economic cycle for company or sector-specific reasons.

Figure 3: Global growth forecast (annual %)



Source: Consensus forecast as reported by Bloomberg, 21 November 2022. RBC GAM forecasts, October 2022.

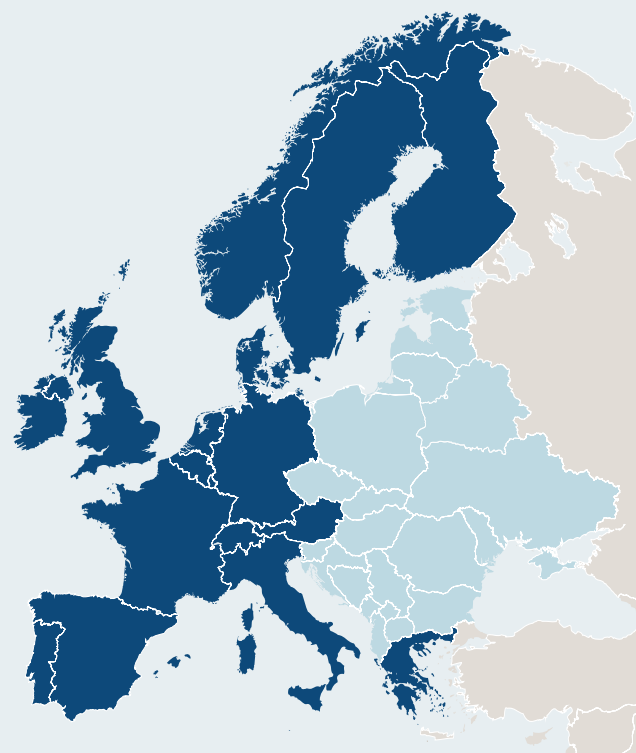
Why Europe? Why the midmarket?

We focus on single names in the European midmarket which we define as companies with enterprise values in the range of EUR0 to EUR500m. This represents a large investment universe and, although the rating agencies are predicting default rates lower than during the Global Financial Crisis, we make the point that the market is twice the size now than then.

Europe is the epicentre of global stress and distress. We have already seen a dramatic increase in the number of situations on our watchlist and this is likely to continue. Midmarket companies in particular are less diversified and less resilient. They have less access to capital markets and are more reliant on bank funding, leaving them vulnerable when banks' lending appetite decreases.

In our focus area we see only limited competition. We aim to deploy EUR20-30m in each investment and we are aware of only a small number of competitor firms. Our broader peer group consists of larger, multibillion dollar funds that need to focus on the smaller number of much larger capital structures.

To sum up, we believe that the European midmarket is characterized by many opportunities and limited competition. As a European based manager, RBC BlueBay is well placed to analyse, understand and capitalise on these opportunities.



Sources of investment opportunity (3-5 year time horizon)

Public Credit Markets

The European High Yield and Leveraged Loan markets amount to approximately EUR600 billion.

Both markets traded off significantly during 2022 and we have been reviewing opportunities in a diverse range of sectors; cinemas, shipping, healthcare, oil & gas, chemicals, real estate, retail, manufacturing, autos, autoparts, food, agriculture, commodity traders, glass, fibreglass, paper and packaging.

In many cases, we are looking at companies that only survived the challenges of the pandemic as a result of liquidity provided by governments and central banks. Markets gave them credit for full recoveries, rallying aggressively through 2020 and 2021. However, their over-leveraged balance sheets mean that they are now ill-prepared to withstand the pressure on margins from reduced sales and higher costs.

In our view, many of these companies will need to restructure their balance sheets or explore other capital market solutions to survive, at a time when the era of almost unlimited liquidity is at an end.

In addition to high yield and leveraged loan names, we have seen opportunities in 'fallen angels' from investment grade markets, particularly in the real estate sector, where some business models are fundamentally unable to cope with increased borrowing costs at the same time as asset values are declining. The convertible bond market too has provided opportunities in the shape of busted convertibles which can offer asymmetric upside and high current yields.

Private Credit Markets

European bank lending amounts to approximately EUR7 trillion, a figure similar to the European investment grade, high yield and leveraged loans markets combined. This sets Europe apart from the US, where c. 70% of funding originates from the capital markets.

Private credit is impacted by the same macroeconomic drivers as its public counterpart. Compared to previous recessions this century, banks have neither the appetite nor the ability to support troubled companies. Workout teams have been reduced in size and banks are penalised from a regulatory capital perspective for holding problematic assets on their balance sheets. Consequently, banks will look to sell problematic assets and we are aware of a number of situations when banks have pressed the eject button and called in loans when companies have faced challenges, even though an operational turnaround was possible.

“I said there were storm clouds, big storm clouds. It’s a hurricane... That hurricane is right out there down the road coming our way. We just don’t know if it’s a minor one or Superstorm Sandy.”

Jamie Dimon, Chief Executive Officer
JPMorgan Chase, 1 June 2022



Investment strategy

As a result of these factors, we focus on single name European midmarket companies. Over the next 2–5 years we are expecting that a significant amount of European midmarket companies will need to restructure unsustainable capital structures. Some of these restructuring events will fail, triggering distressed asset sales and liquidations.

Through active, hands-on investment management driven by forensic credit analysis, we believe there is significant upside potential in targeting select opportunities where we can actively direct company restructurings and drive turnaround stories. At heart, we aim to generate attractive returns by buying at low prices while remaining senior in the capital structure.

Through a concentrated strategy targeting 25-50 positions over the next few years, we are looking to source the most attractive deals in the European midmarket for distressed and special situations.

For investors who have a long-term time horizon, the midmarket sector of the European special situations credit market presents an exciting opportunity set with the potential to deliver high-teens returns. We believe this market offers a rare asymmetric profile of attractive upside returns at the same time as a limited downside.

These investment opportunities fall into four categories:

Stressed investments

- Intrinsically cheap bank debt or bonds
- Performing investments
- Price likely to revert to par
- Includes Covid-19 affected credits

Distressed investments

- Bank debt or bonds at deep discounts
- Financial/Operational restructurings
- Debt-for-equity swaps
- Distressed Private Equity transactions

Refinancing/Rescue financing

- Refinancing of stressed companies
- Structural seniority
- Advantageous lending terms
- Warrants or equity kickers

Other investments

- Liquidations
- Orphaned Situations
- Hard Asset Purchases
- Other Special Situations



Deal sourcing

Relationships are critical for sourcing of differentiated investment opportunities.

The European distressed community is small and relationship-driven. Our team has over 130 years of aggregate relationship-building and investment experience in the space, with a deep network of professional counterparties, meaning that we can source differentiated deal flow in the European special situations midmarket.

The value of the team's proprietary sourcing networks is enhanced by RBC BlueBay's broader research and trading capabilities. RBC BlueBay, which is part of RBC Global Asset Management, manages over US\$95¹ billion in fixed income assets, with broad research channels and market-leading intellectual capacity. The firm has an integrated investment and research function, where trade ideas and research are shared across all investment professionals. This integration enhances the team's sourcing capabilities and allows us to mine the most appropriate and attractive investment opportunities.



¹ Assets under management incorporate funds managed by BlueBay Asset Management and RBC GAM US which are managed within the BlueBay investment platform. As at 30 November 2022.

The BlueBay Developed Markets Special Situations Team

- European presence for a geographic advantage.
- Specialist country skillsets within the team for local market connections and deal sourcing.
- Sector-agnostic approach – we follow distress, not industries.
- Three decades of experience in special situations investing through five major global recessions.
- Relationship-based approach – our strategy is powered by deep networks built over 30+ years.

Author

Adam Phillips

Partner, Head of DM Special Situations, RBC BlueBay Asset Management



Adam Phillips joined BlueBay in October 2020 as Head of Special Situations within Developed Markets. Adam has 30 years' experience in special situations and distressed investing having previously been Head of Investments at Blantyre Capital, European CIO of Marathon Asset Management and Head of European High Yield & Distressed at Lehman Brothers. Prior to that, Adam was Head of the Asian Distressed team at Standard Bank and he started his career at British & Commonwealth Merchant Bank in structured and property finance. Adam holds an MPhil in Land Economy from Cambridge University and BA in Economics from Heriot-Watt University.

This material has been provided to Destra Capital Investments by a third party. We believe all of the information to be factually correct, however it is subject to change without notice. The opinions presented are of the third party that has provided the information and may not be the opinions of Destra Capital Investments.

This copy provided to you by Destra Capital Investments LLC. This is not an investment recommendation or solicitation to buy or invest in any security or product.



Destra Capital Investments
443 N Willson Ave.
Bozeman, MT 59715
877.855.3434
www.destracapital.com
member FINRA/SIPC

This document may be produced and issued by the following entities: in the European Economic Area (EEA), by BlueBay Funds Management Company S.A. (the ManCo), which is regulated by the Commission de Surveillance du Secteur Financier (CSSF). In Germany and Italy, the ManCo is operating under a branch passport pursuant to the Undertakings for Collective Investment in Transferable Securities Directive (2009/65/EC) and the Alternative Investment Fund Managers Directive (2011/61/EU). In the United Kingdom (UK) by BlueBay Asset Management LLP (BBAM LLP), which is authorised and regulated by the UK Financial Conduct Authority (FCA), registered with the US Securities and Exchange Commission (SEC) and is a member of the National Futures Association (NFA) as authorised by the US Commodity Futures Trading Commission (CFTC). In Switzerland, by BlueBay Asset Management AG where the Representative and Paying Agent is BNP Paribas Securities Services, Paris, succursale de Zurich, Selnaustrasse 16, 8002 Zurich, Switzerland. The place of performance is at the registered office of the Representative. The courts of the registered office of the Swiss representative shall have jurisdiction pertaining to claims in connection with the distribution of shares in Switzerland. The Prospectus, the Key Investor Information Documents (KIIDs), where applicable, the Articles of Incorporation and any other applicable documents required, such as the Annual or Semi-Annual Reports, may be obtained free of charge from the Representative in Switzerland. In Japan, by BlueBay Asset Management International Limited which is registered with the Kanto Local Finance Bureau of Ministry of Finance, Japan. In Australia, BlueBay is exempt from the requirement to hold an Australian financial services license under the Corporations Act in respect of financial services as it is regulated by the FCA under the laws of the UK which differ from Australian laws. In Canada, BBAM LLP is not registered under securities laws and is relying on the international dealer exemption under applicable provincial securities legislation, which permits BBAM LLP to carry out certain specified dealer activities for those Canadian residents that qualify as "a Canadian permitted client", as such term is defined under applicable securities legislation. The BlueBay group entities noted above are collectively referred to as "BlueBay" within this document. The registrations and memberships noted should not be interpreted as an endorsement or approval of BlueBay by the respective licensing or registering authorities. Unless otherwise stated, all data has been sourced by BlueBay. To the best of BlueBay's knowledge and belief this document is true and accurate at the date hereof. BlueBay makes no express or implied warranties or representations with respect to the information contained in this document and hereby expressly disclaim all warranties of accuracy, completeness or fitness for a particular purpose. Opinions and estimates constitute our judgment and are subject to change without notice. BlueBay does not provide investment or other advice and nothing in this document constitutes any advice, nor should be interpreted as such. This document does not constitute an offer to sell or the solicitation of an offer to purchase any security or investment product in any jurisdiction and is for information purposes only. This document is intended only for "professional clients" and "eligible counterparties" (as defined by the Markets in Financial Instruments Directive ("MiFID")) or in the US by "accredited investors" (as defined in the Securities Act of 1933) or "qualified purchasers" (as defined in the Investment Company Act of 1940) as applicable and should not be relied upon by any other category of customer. No part of this document may be reproduced, redistributed or passed on, directly or indirectly, to any other person or published, in whole or in part, for any purpose in any manner without the prior written permission of BlueBay. Copyright 2023 © BlueBay, is a wholly-owned subsidiary of RBC and BBAM LLP may be considered to be related and/or connected to RBC and its other affiliates. ® Registered trademark of RBC. RBC GAM is a trademark of RBC. BlueBay Funds Management Company S.A., registered office 4, Boulevard Royal L-2449 Luxembourg, company registered in Luxembourg number B88445. BlueBay Asset Management LLP, registered office 77 Grosvenor Street, London W1K 3JR, partnership registered in England and Wales number OC370085. The term partner refers to a member of the LLP or a BlueBay employee with equivalent standing. Details of members of the BlueBay Group and further important terms which this message is subject to can be obtained at www.bluebay.com. All rights reserved.

Published January 2023.



RBC BlueBay
Asset Management