AC Advantage – Credit Strategies

June 2020

INVESTMENT STRATEGY

The AC Advantage Fund aims to generate 10-12% annual net returns by investing in non-distressed European credit opportunities with a semi-liquid bias:

• The investment thesis revolves around taking advantage of the current large premia in European illiquid credit, where there is close to no competition to purchase assets and where the manager can set the terms (as opposed to being a price taker as in liquid markets). Structures are generally highly collateralized providing attractive risk adjusted returns

• The opportunities are derived from either market inefficiencies (regulatory capital affecting banks' ability to lend) or classical behavioral finance shifts in risk appetite where asset trading levels are temporarily well below their fair value.

• Additionally, the strategy targets hung deals in the leveraged loan space where underwriting banks require to sell down their position at steep discounts

• The strategy benefits from decorrelation to bond and equity markets, and low mark to market volatility

• Proprietary sourcing capitalizing on Arcano´s strong relation to sponsors and access to management teams via our investment banking business arm

• Approximately 80% of the portfolio will be senior secured

• The Fund will invest in a closed end format in a portfolio of 30-40 investments

FUND FACTS - SIF *Luxembourg*

Legal Name	Arcano Fund
Investment Vehicle	SIF - SICAV
Fund Type	Open-End Fund
Country of Residence	Luxembourg
Fund Inception Date	15-mar-2018
Custodian	UBS Luxembourg
Administration	Northern Trust
AIFMD	Arcano Capital SGIIC
Auditor	PwC
Fund Currency	EUR
Valuation Dates	30/31 Mar-Jun-Sept-Dic
Minimum Investment and fees	
Class FSI (> €5M)	0.8% man. fee + perf. fee*
Class FI (> €1M)	1.0% man. fee + perf. fee*
Class FR (> €250k)	1.5% man. fee + perf. fee*

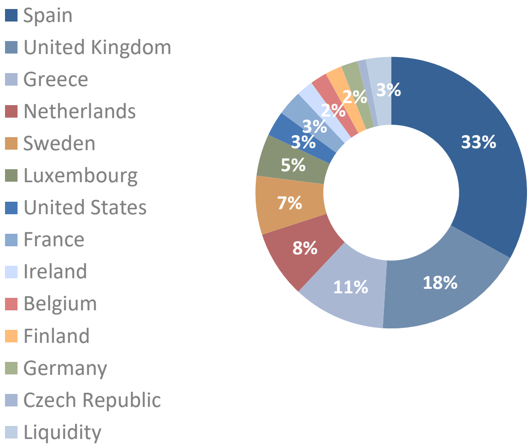
** 15% p.a., hurdle rate 5% p.a.*

PORTFOLIO MANAGERS

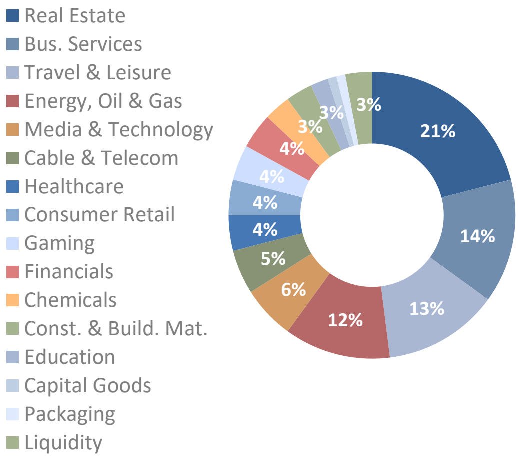
Emilio Hunolt	PM
Manuel Mendívil	CIO

PORTFOLIO DIVERSIFICATION

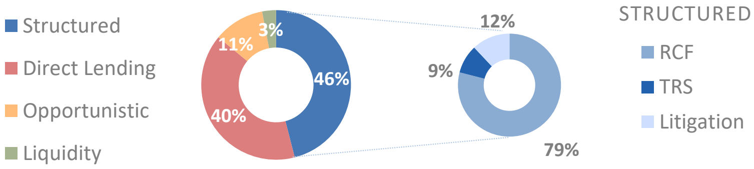
COUNTRY



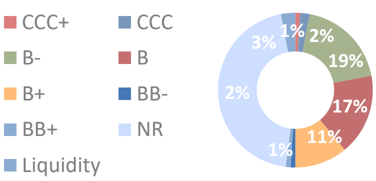
INDUSTRY



ASSET TYPE

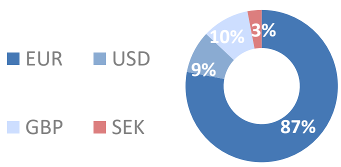


RATING



CURRENCY

100% Hedged



PORTFOLIO MANAGER UPDATE

First of all I hope this note finds you and yours well and safe.

Following the severe stress in the markets in Q1, we have seen markets normalizing during Q2 at the same accelerated pace of events of those seen in Q1. Benefiting from the performance of the RCF subfund and also thanks to the mostly positive news coming from our portfolio companies, the return for share class F has been +6.1%.

All 3 asset classes in the fund have contributed positively to the returns:
1. **Structured credit**: we currently have 46% of the fund invested in structured credit, mainly RCFs but also smaller positions in litigation, TRS and CLOs. In the quarter we have seen a +3.8% contribution to returns derived from these investments. The main driver for the appreciation being the recovery of the underlying leveraged loans.
2. **Opportunistic**: the HY portfolio, currently representing 11% of the fund, has been a strong contributor to returns +1.8%. The main move being that of Kloeckner of circa 40 points.
3. **Direct Lending**: representing 40% of the fund the performance for the quarter of +0.5% has proven underwhelming following the mark down of project Phoenix which we discuss in more detail below.

Looking at the liquid loans market, as a reference for the RCF sub-fund, the gross performance of the CS Lev loan index has been -3.8% as of July 8th, outperforming EU HY by 1%. The speed of the recovery was as unexpected as the speed of the drop in Q1. The strong action by Central Banks brought back confidence and liquidity followed in due course leading to a rapid recovery. There has been fairly limited volume trading hands on the way up.

The default expectation has been revised down by the major research shops to circa 4% from their original 7-9%. This ties up well with what we are seeing in our portfolios. Companies with robust business models have gained access to capital markets and received sponsor support in order to fully avoid a liquidity event and therefore a default. Lenders have proven amicable and shown flexibility when waiving covenant terms for a few quarters.

We have seen several companies repaying their RCF drawings. By no means we are back to a normalized market but certainly these repayments point to a slow normalization. CFOs have now much better visibility on the cash needs of their companies, so we can expect those business that have not been materially impacted by COVID to go back to use their RCF in line with their working capital needs. Note that some of the cash coming back will be used to continue settling the latest purchases.
Average drawings which peaked at 80% on the settled portfolio have now, at the time of writing this note, dropped to 60%. We have seen repayments from various industry sectors including building materials, oil&gas distribution, business services and chemicals. When looking at loan prices sector dispersion has seen some compression in Q2 but remains elevated with companies in the most affected sectors still trading in the 80s.

The opportunistic positions have performed well in the quarter in line with the overall HY market. Noteworthy has been Kloeckner Pentaplast, PVC packaging producer, whose strong results led to a steep price appreciation of the subordinated notes of circa 40 points.
As anticipated in Q1 project Phoenix, 3 franchised aesthetic clinics, has been highly impacted by the crisis during the lockdown. The timing of the crisis has been unfortunate as the business was showing some signs of improvement ahead of the crisis. The tight liquidity combined with the large costs of reopening the clinics and lack of top line visibility has pushed the sponsor to keep the clinics closed and evaluate their options including a reorganization under concurso. We have been working very closely with the master franchiser and sponsor looking to facilitate the transfer of the assets to the master franchiser, who in our view, is materially better positioned to extract value from the clinics. Given the large uncertainly associated with this investment at this point in time we have marked the credit down to 20% as of June which has had a relatively minor impact on returns given the small position size we originally entered into with this investment.

The direct lending portfolio is performing well, including project Step (Quabit), Spanish real estate developer which we had on watchlist back in March. The company has secured extended terms and partially refinanced debt with its main lenders, giving them the necessary time to restart their commercial activity and proceed to the sale of 300 units that were ready to complete.
Additionally, and as we write this note, we are being repaid the loans on project Marcus (Quartiers), Swedish real estate company listed in the Stockholm stock exchange and active in the hospitality sector in the South of Spain. Senior secured transaction with 2nd lien rights over a portfolio of 99 properties rented out as holiday apartments and with a LTV nearing 40%. The position represents 4.2% of the fund and is achieving a 16% IRR and 1.2x money multiple.
Furthermore, Project Hyperion, Greek renewable energy, is it is final stages of being sold to a trade buyer. If successful and closing occurring during Q3 the investment will return 30% and a 1.2x money multiple.

The pipeline of opportunities remains more active in liquid/semiliquid markets where we are looking at BB rated CLO tranches. Having said that we are currently working on an asset backed lending project and we do expect to see a large number of opportunities in the new money financings space towards the end of the year as the government financing programs dry out.

We have categorized the portfolio by severity of impact of COVID in their business models. Less than 20% of the portfolio is in affected sectors like real estate development, travel and leisure and gaming. As of today, and with the exception of project phoenix mentioned earlier, we don't expect to see losses in any of the companies in that segment derived from defaults. There is no liquidity gap to cover and as mentioned earlier companies have shown strong access to capital markets and sponsor support. Most of the portfolio has presented moderate impact (mainly a slowdown in demand) or very limited impact with some of the business having seen no disruption at all.

SHARE CLASS PERFORMANCE (Net of fees and distributions)

Class	Curr.	Type	Fees	ISIN	Bloomberg	Issue	NAV	Incept.	QTD	YTD
Class F	EUR	Dist.	Founder	LU1720131637	ARACRSF LX Equity	Jun-18	101.90	1.90%	6.06%	-8.48%
Class SI	EUR	Dist.	0.8% + Perf fee	LU1773287070	ARACSSI LX Equity	Mar-19	99.60	-0.40%	5.97%	-8.62%
Class I	EUR	Dist.	1.0% + Perf fee	LU1773286932	ARACRSI LX Equity	Dec-18	100.33	0.33%	5.91%	-8.71%
Class R	EUR	Dist.	1.5% + Perf fee	LU1773286775	ARACRSR LX Equity	Dec-18	99.59	-0.41%	5.79%	-8.93%
Class I-USD	USD	Dist.	1.0% + Perf fee	LU1991106912	ARACSIU LX Equity	Jun-19	99.96	-0.04%	6.34%	-7.40%

Arcano Capital S.G.I.I.C. S.A.U.
C/ José Ortega y Gasset, 29
28006 Madrid. – Spain
+34 91 700 38 80

INVESTOR RELATIONS

Pedro Hamparzoumian phamparzoumian@arcanopartners.com
Jaime Gil-Delgado jgildelgado@arcanopartners.com
Carlos Osés coses@arcanopartners.com