Longchamp Hybrid Credit 2028

October 2022

Executive Summary

Summary

Longchamp Asset Management launches its first fixed-maturity fund : the "Longchamp Hybrid Credit 2028"

I. Longchamp Hybrid Credit 2028, is a EUR fixed maturity fund which invests in a static portfolio of bonds. The "buy and hold approach" is implemented by investing at inception in a concentrated portfolio of carefully selected Corporate Hybrid Bonds

II. The Fund's holdings will be Corporate Hybrid Securities issued by blue-chip European issuers :

   i. Corporate Hybrid Debt is a segment of the credit market that currently offers extremely attractive risk-adjusted yields

   ii. The market is currently dislocated and offers one the best entry points ever with a combination of historically wide spreads and the highest EUR rates in over 10 years

   iii. Issuers include Investment Grade rated European National Champions such as EDF, Total Energies, Eni, Repsol, Veolia

III. Cash flows at the fund level will be progressively returned to Investors :

   i. Revenues : Accumulated coupons will be returned yearly on the annual payment date

   ii. Capital : Upon of each bond redemption, the capital will be returned on the capital redemption date

   iii. Over the last 6 months of 2028, the remaining portfolio of bonds with an expected maturity 2028 or longer, will be sold progressively for a full return of capital no later than December 2028

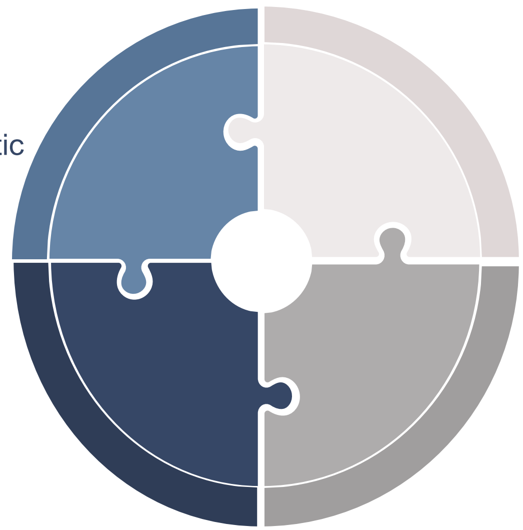
IV. The Target total return for investors will be 7-8% per annum net of fees

V. Longchamp has chosen to structure the fund as an Actively Managed Certificate ("AMC"), issued by BNP Paribas. Actively Managed Certificate constitutes an extremely efficient vehicle in terms of time to market and implementation costs.

Summary

FIXED-TERM FUND

- Final maturity on Dec 2028
- Target Yield: 7-8%
- Holdings: 9 securities
- Portfolio defined at inception and static until redemption



CORPORATE HYBRIDS

- Very Attractive spread and yield entry point
- IG-rated names with appealing yields
- Diversified universe of EUR-denominated bonds

RULES & FEES

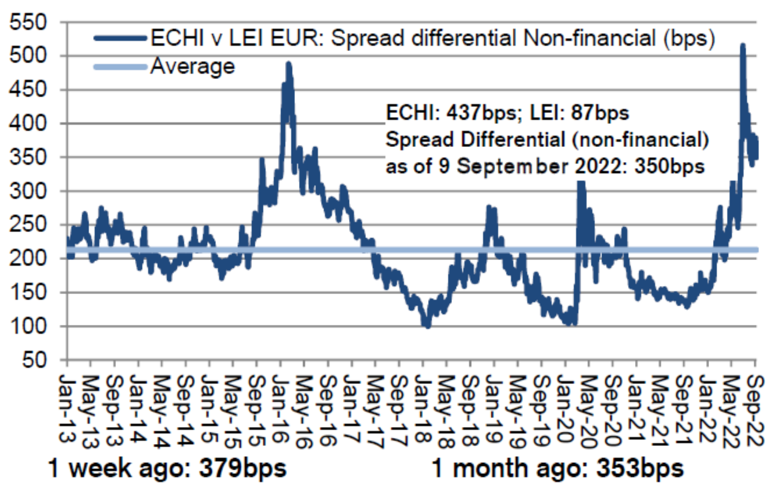
- Low-cost solution
- Liquidation of fund at maturity
- Secondary market based on portfolio NAV
- No transaction costs
- Management fee of 0.70% p.a.

ACTIVELY MANAGED CERTIFICATE (AMC)

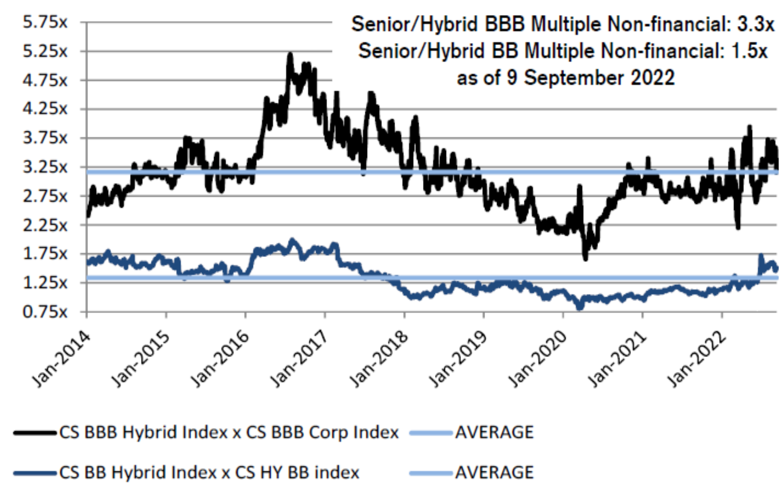
- Issuer : BNP Paribas
- The fund structured as a security
- Longchamp selects and purchases the portfolio
- BNP holds the portfolio
- Simple and efficient investment vehicle

Opportunities in the Corporate Hybrids market

- **Market sell-off YTD** following central banks' hawkish monetary policies. The iBoxx EUR Non-Financials Subordinated index is **down 17.4% YTD**
- Spreads over the liquid Eurobond index increased from 200bps at the beginning of the year to 350bps today (chart 1), **which compares to the average 10Y spread level of just above 200bps.** IG senior spreads remain well below hybrid reset spreads (chart 2), at respectively 3.3x ad 1.5x for BBB and BB, meaning that **issuers are encouraged to call their hybrid bonds at the 1st call**.



Source : Credit Suisse



Source : Credit Suisse

- Current hybrid **ask prices in EUR are about 80%**, which shows a positive convexity until redemption at 100%
- Coupon step-up applies if bonds are not redeemed at 1st call, with most being variable and more costly that issuing new hybrid debt

Selected Portfolio offers combination of carry and capital gains

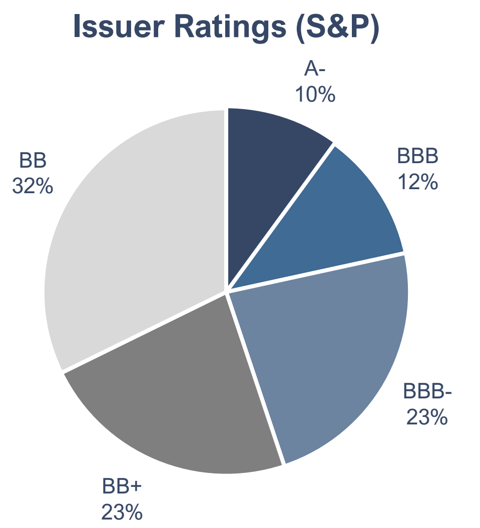
- Nine positions on diversified names whose fundamentals are strong and validated by our credit fund portfolio manager Jean Fau.
- We selected issues from larger **IG-rated European blue-chip companies** (average market capitalization of €54bn, range from €16bn to €134bn), with a **large carry**, a **defensive business profile** and a **low probability of non-call**
- The universe was filtered to bonds with **yields >4%, liquid EUR-denominated issues** (EU500m+ outstanding), followed by a qualitative assessment
- Our portfolio will generate added value both from coupons (3.5%) and below-par prices (ask price 78.39%), with issuers willing to call their bonds at 100%

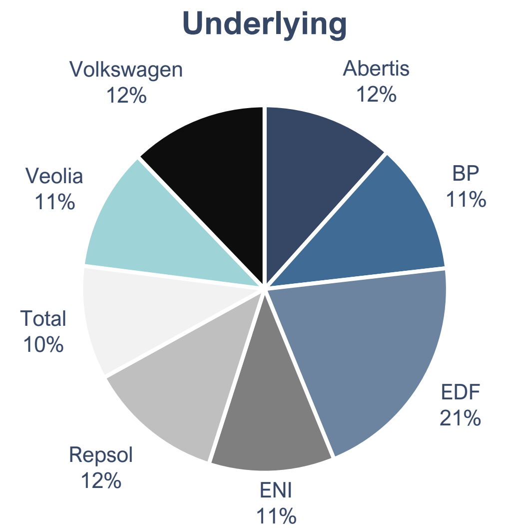
Detail

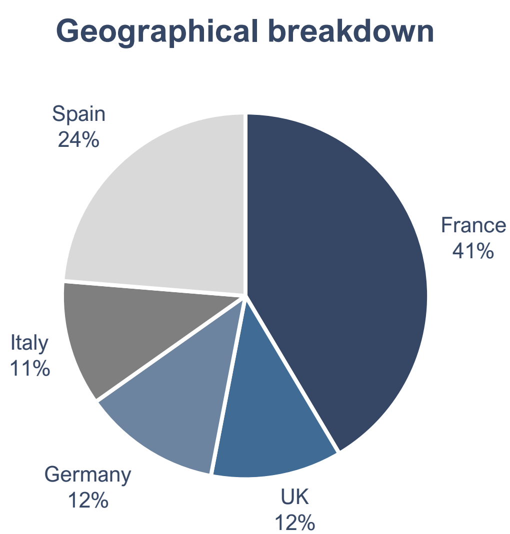
	Currency	Weight	Coupon	YTM	Yield to Call	Next Call Date	OAS (Risk)	BB Comp	S&P	Moody's	Clean Price	ISIN
LONGCHAMP HYBRID OPPORTUNITIES 28		**100.00**		**6.64**	**8.77**		**464**	**BBB-**	**BB+**	**Baa3**	**78.39**	
Consumer Discretionary		**12.18**					**465**	**BBB-**	**BBB-**	**Baa2**	**86.21**	
VW 4 ⅝ PERP	EUR	12.18	4.625	6.69	7.69	27-June-2028	465	BBB-	BBB-	Baa2	86.21	XS1799939027
Energy		**44.76**					**445**	**BBB**	**BBB**	**Baa2**	**75.99**	
BPLN 3 ⅝ PERP	EUR	11.56	3.625	6.73	7.64	22-March-2029	438	BBB	BBB	Baa1	80.14	XS2193662728
ENIIM 3 ⅜ PERP	EUR	11.10	3.375	6.67	8.54	13-July-2029	468	BBB-	BBB	Baa3	74.38	XS2242931603
REPSM 4.247 PERP	EUR	12.07	4.247	7.23	8.40	11-September-2028	484	BB+	BB+	Ba1	81.27	XS2186001314
TTEFP 3 ¼ PERP	EUR	10.03	3.250	5.48	6.82	17-July-2036	382	A-	A-	A3	68.16	XS2432131188
Industrials		**11.63**					**515**	**BB**	**BB**		**79.91**	
ABESM 3.248 PERP	EUR	11.63	3.248	6.98	11.27	24-November-2025	515	BB	BB		79.91	XS2256949749
Utilities		**31.43**					**476**	**BB**	**BB-**	**Ba1**	**71.46**	
EDF 2 ⅞ PERP	EUR	10.89	2.875	6.78	10.84	15-December-2026	507	BB	B+	Ba1	74.37	FR0013534351
EDF 3 ⅜ PERP	EUR	9.74	3.375	7.61	10.11	15-June-2030	536	BB	B+	Ba1	65.21	FR0013534336
VIEFP 2 ½ PERP	EUR	10.80	2.500	5.60	7.59	20-January-2029	391	BB+	BB+	Baa3	74.80	FR00140007L3

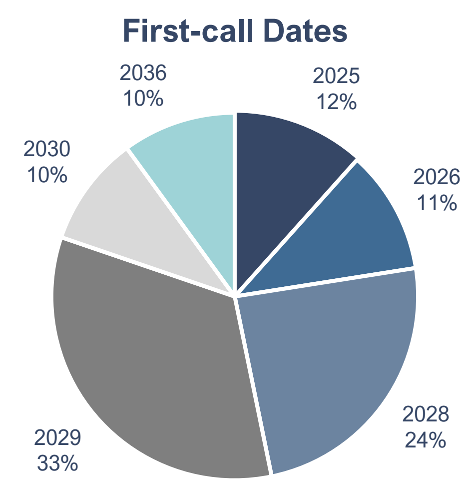
Portfolio Characteristics:

Diversified with strong names in defensive sectors





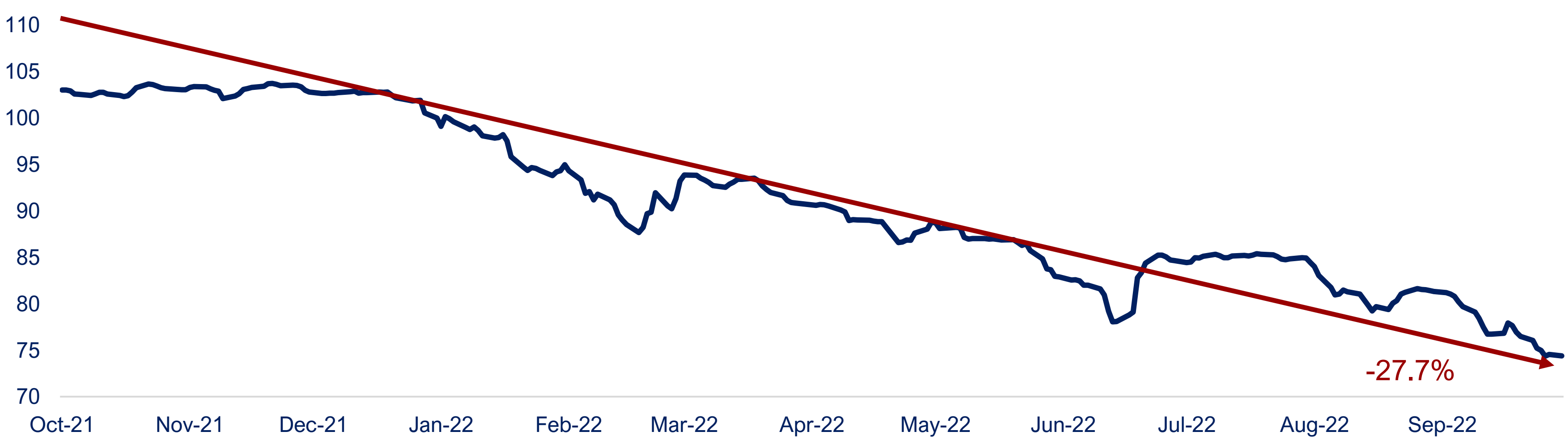




Focus on the EDF situation: low prices despite nationalization

- EDF is currently facing **increasing pressure on revenues / earnings** (government measures to cap power prices) combined with an **upcoming nationalization process** (official tender launched by end-September)
- On the back of the stronger strategic support from the French government (AA-rated), **Fitch upgraded EDF' rating to BBB+** with a stable outlook while other rating agencies are yet to decide
- Beyond the nationalization, there is a high possibility that EDF will withdraw from the hybrid segment to fund exclusively in cheaper senior bonds **increasing the likelihood of calls at the first call date**, notably for the NC 2026 in the portfolio

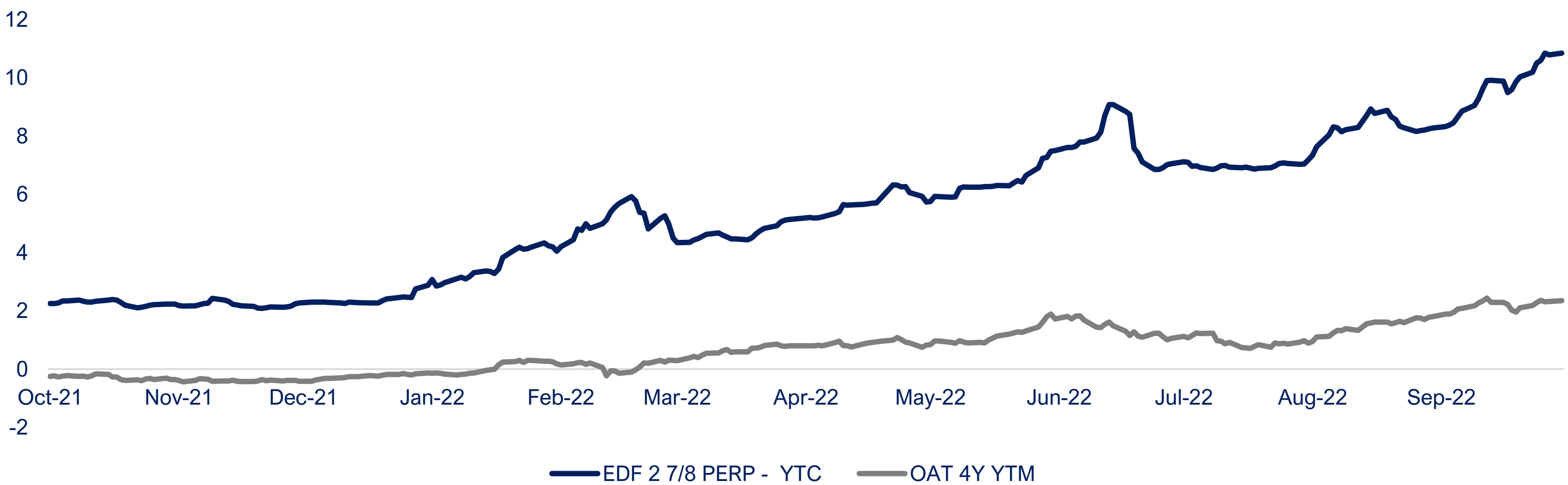
EDF 2 7/8 PERP - PRICE



Source : Longchamp AM

Focus on EDF (2): expected return of 10% p.a.

- **Expensive reset spreads favour first call decision** given EDF would be required to pay EUR 5y swap +3.373% p.a until 2031 in case of non-call in 2026
  - Spreads would go up to +3.623% until 2047 and 4.373% beyond
  - For the NC 30 (coupon: 3.375%), spread rises to EUR 5y swap +3.97% from 2030 then 4.72% from 2050
- **Provided that EDF remains IG-rated** – a situation further secured by the government buy-out – it makes sense to call their hybrid bonds **offering ~10% yield p.a. in EUR,** compare to 2.35% for a 4Y OAT (see graph)
- **The Fund anticipates investing 20% of its capital in EDF Hybrids**



Source : Longchamp AM

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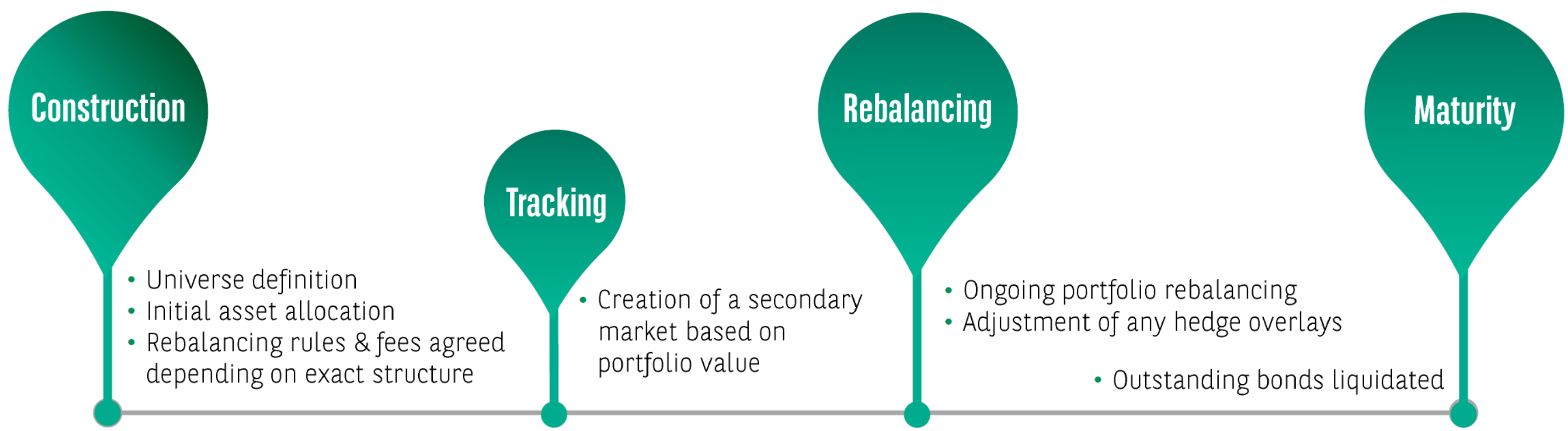
Building The Investment Vehicle

How Do AMCs Work ?

- **Actively Managed Certificates give the ability to quickly take advantage of market opportunities by deploy capital in a commingled portfolio** (in this case a corporate hybrid bonds portfolio) in a **simple and cost-efficient** manner
- Investors are provided with a **single instrument to gain exposure to a target set of instruments** selected by the portfolio manager while benefitting from economies of scale from pooled investments

AMC LIFE CYCLE

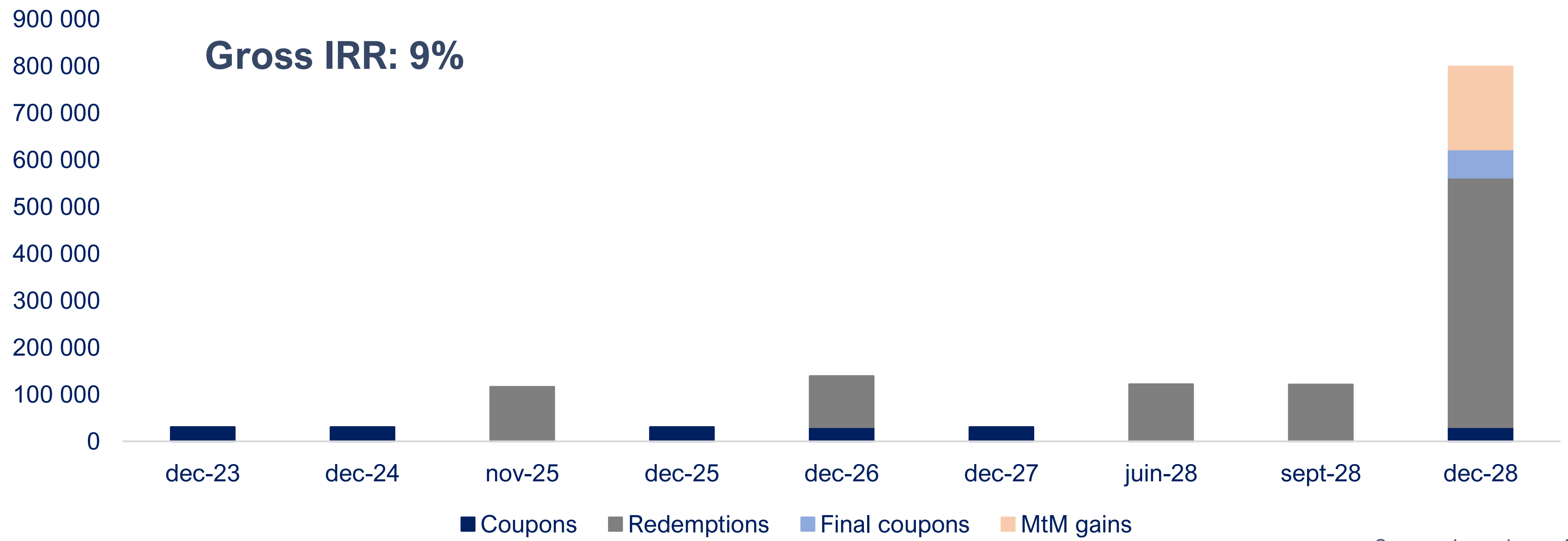


Source : BNP Paribas

Distribution Schedule (est.)

- Initial investment of up to the dedicated amount
- Each year, a 3% coupon is distributed
- At each bond redemption, prior to the fund maturity, capital is refunded to investors
- At maturity, investors receive :
  - 100% of capital (*assuming recall*)
  - 3+% coupon p.a paid from previous coupons and market gains (below-par initial bond prices)

Example for a €1 million commitment



Source : Longchamp AM

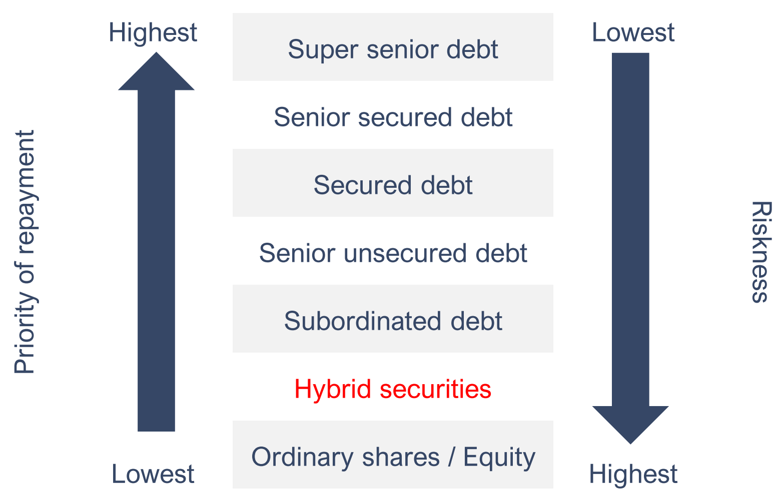
Vehicle Terms

Fund	Longchamp Hybrid Credit 2028
Investment Manager	Longchamp Asset Management
Legal Structure	AMC (Actively Managed Certificate)
Domicile	France
Issuer	BNP Paribas Issuance
Custodian	TBD
Auditor	PwC
Compliance	Jornet Finance Consulting
Dealing Day (“DD”)	TBD
Subscription/Redemption Deadline	TBD
Settlement	Payment (cash) and delivery (shares /units) shall occur within 4 BDs following the relevant Dealing Day (DD+4BDs)
Launch Date	TBD
Reference Currency	EUR
Share Classes	Distribution
Management Fees	0.70%
Performance Fees	10%
Hurdle Rate	5%
Target Return (net of fees)	7-8% p.a
Redemption before Maturity	One-month notice / 2% early redemption fee

The Corporate Hybrid Market

What are Corporate Hybrid Bonds

- Corporate Hybrids are **subordinated bonds sharing both debt and equity characteristics,** hence the term Hybrid. They have been issued by non-financial companies since 2003 - German industrial company Linde issued the first hybrid bonds in the market
- Corporate hybrids are often attractive to issuers because **they are regarded as partly equity by the credit rating agencies (1)**, which helps support issuer credit ratings.
- Corporate hybrids offer **opportunities to investors to benefit from idiosyncratic situations at attractive yields**, which is a must-have in a low interest rate environment.



(1) Recognition of equity content / credit by the rating agencies and S&P in particular (ratio tends to be 50%/50%)

Source : Longchamp AM, Invesco

Characteristics

- Corporate Hybrids are a **mix of bond** (coupons are scheduled) **and equity** (perpetual) that rank at the bottom of the debt structure (between senior unsecured debt and equity), reflecting the **option to defer coupon payments and extension risks.** As such, **they offer a higher yield than senior bonds**
- Issuers have the **possibility to defer coupons payments**, in which case coupons are capitalized until they are paid. Issuers are then **not allowed to pay dividends or launch shares buyback programs**
- Extension risks occur when the issuer decides not to redeem the bond at 1st call (see slides 17 & 18)
- **Hybrid issuance is on the rise** as companies are willing to strengthen their balance sheets in the context of rising interest rates with less accommodative central banks

Anatomy		EDF 2.875% perp
Perpetual or very long dated		Perpetual
Deeply subordinated		Ba1 (Moody's)/ B+ (S&P) vs Baa1/BBB
Callable at the issuer's option		December 15th 2026
Periodic coupon resets and step up	*Example*	2.875% until call, EUSA 5y + 3.373%...
Option coupon deferral		At issuer's discretionary
Early redemption clauses		On rating, tax, accounting events

Corporate Hybrids Benefits

➢ **For issuers:**

IMPROVE CREDIT RATING	➢ 50% equity uplift by rating agencies (only 50% debt vs 100% on senior or sub)
CAPITAL WITHOUT DILUTION	➢ No voting rights / No dividend
ACCOUNTING	➢ Equity under IFRS (if perpetual) which reduces financial leverage
LOW-COST	➢ The coupon is tax deductible / Compares favourable to cost of equity

➢ **For investors:**

HIGHER YIELD	➢ Premium vs senior / sub bonds due to lower rank in the debt structure
PRE-FIXED CALL	➢ First call date tends to be fixed 5 years after the issuance, unless extension

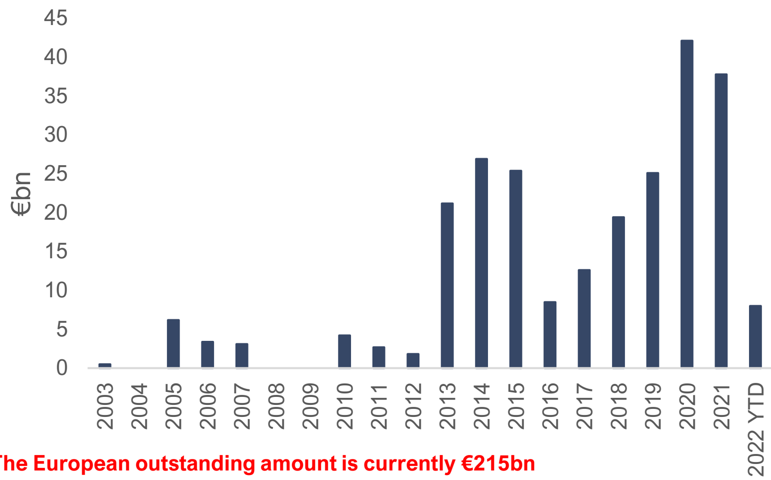
Extension Risk justifies higher yield for Investors

- Market stress leads investors to tend to **price an exaggerated extension risk whereby hybrid issuers would not call their bonds at the first call date**
- Hybrid issuers have **3 options at the first call date** :
  - Calling & Replacing : For issuers willing to keep hybrids to **strengthen their balance sheet** / **keep the equity content for rating requirements**
  - Calling & Not replacing : For issuers **not needing to keep the same amount of equity content**[1] / **decide to leave the hybrid segment**
  - Not calling : For issuers under financial stress **considering issuance spreads for a new hybrid as too high relative to the reset spreads of the existing one**
- **In our portfolio, we picked names that are expected to call their bonds at 100%**
- At the current hybrid bonds price of our selection, we believe the extension risk is limited fundamentally as issuers are encouraged to call them

(1) Calling and not replacing a hybrid, against S&P's demand, may lead to a loss of equity content for all or some of its other outstanding hybrids

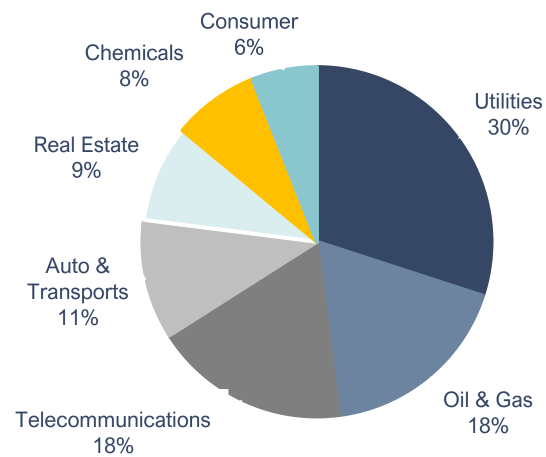
The European Hybrid Market

Issuance slowdowns during market correction

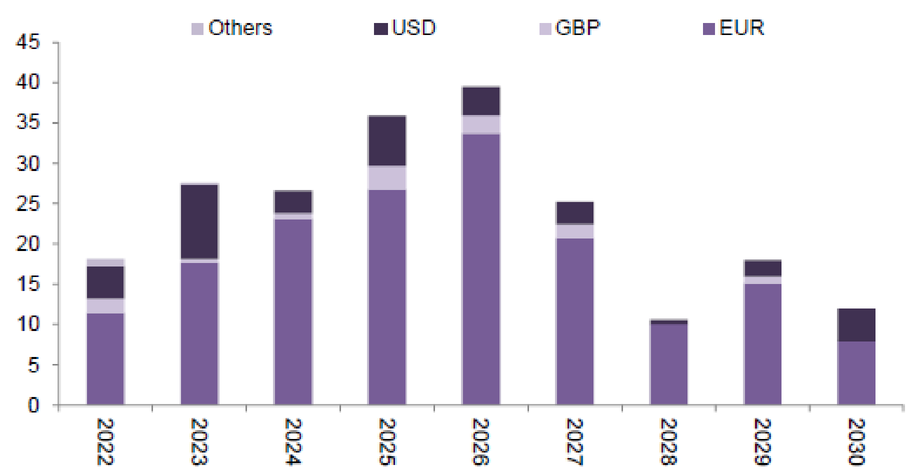


The European outstanding amount is currently €215bn

Issuers are spread across defensive sectors



Next call dates calendar over 8 years



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