

# KKR Credit Income Fund (ASX: KKC)

Review

13 September 2024

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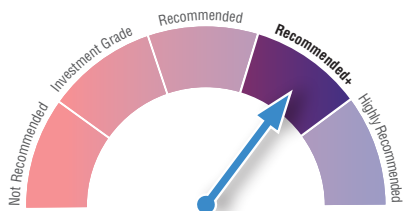
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Note: This report is based on information provided by KKR Australia Investment Management Pty Ltd as at 30 June 2024.

### Rating



### Key Investment Information (as at 31 August 2024)

ASX Code:	KKC
Unit Price (\$)	\$2.32
NAV per unit (\$)	\$2.45
Units on Issue (m)	322.5m
Market Cap (\$m)	\$748.3
Listing Date	November 2019
Target Total Return	6%-8% p.a
FY25 Target Distribution	8.50% p.a*
Distribution Frequency	Monthly
Structure	Listed Investment Trust (LIT)
IIR Investment Classification	Fixed Income
Responsible Entity	The Trust Company (RE Services) Limited
Investment Manager	KKR Australia Investment Management Pty Ltd
Investment Advisor	KKR Credit Advisors (US) LLC
FX Exposure	Fully hedged to AUD
Fees (incl. GST):	
Management Fee (p.a)	0.902%
RE Fee (p.a)	0.025%-0.03% p.a
Other Expenses (p.a)	0.26% p.a.
Performance Fee	5.125% of the net return above the performance hurdle, subject to the High Water Mark
Performance Hurdle	RBA Cash Rate + 4% p.a, subject to a High Water Mark

\*Based on the FY25 target distribution of 20 cents per unit and the NAV as at 30 June 2024.

The investment opinion in this report is current as at the date of publication. Investors and advisers should be aware that over time the circumstances of the issuer and/or product may change which may affect our investment opinion.

## PRODUCT SUMMARY

KKR Credit Income Fund ("KKC" or the "Fund") listed in November 2019. The Fund is structured as a listed investment trust (LIT) and seeks to offer investors exposure to a fixed income investment offering a regular monthly income stream and long-term capital appreciation over a full market cycle through an investment in two credit investment strategies: (1) the Global Credit Opportunities strategy ("GCO strategy"); and (2) the European Direct Lending (EDL) strategy. The Fund initially had a long term target of 50% to the GCO strategy and 50% to the EDL strategy, which the Fund met after becoming fully invested in the EDL strategy. However, moving forward the allocation is likely to be closer to 60% GCO strategy and 40% EDL strategy. As at 30 June 2024, 60% of the Fund was allocated to the GCO strategy and 40% to the EDL strategy. Details regarding the underlying investments is provided in the below report. KKC has a total return target of 6%-8%p.a. on average over the medium-term. The target distribution is set prior to the commencement of the financial year and will reflect the forecast cashflow for the Fund over the financial year period. The Fund has announced a target distribution of 20 cents per unit for FY25, which is equivalent to 1.67 cents per unit per month and represented a yield of 8.5% based on the NAV as at 30 June 2024. Distributions were initially paid quarterly with the distribution frequency increased to monthly from July 2021. The Manager is paid a fee of 0.88% p.a. (plus GST) of the NAV of the Fund and is eligible for a performance fee of 5.125% of the net return above the hurdle rate (RBA Cash Rate + 4.0%), subject to a High Water Mark. Fees are only charged at the Fund level with no fees charged in respect of the direct investment in KKR funds.

## INVESTOR SUITABILITY

An investment in KKC is suitable for investors seeking to generate an enhanced income through a portfolio offering a different exposure and risk profile to other fixed income LITs on the ASX. Given the nature of the underlying investments, we view the Fund to be at the high-end of the risk spectrum for fixed income with exposure to predominantly sub-investment grade securities. While the Fund listed in November 2019, the Manager has a long history and substantial experience in credit markets across the fixed income spectrum. The exposure of the Fund has changed over time as the capital was called for the EDL strategy. The addition of the EDL strategy to the portfolio was designed to lower the volatility associated with the overall portfolio and diversifies the portfolio from both a geographic and asset perspective. The GCO strategy is a traded credit strategy which means the portfolio will experience volatility in line with daily mark-to-market valuations. The distinction between traded credit and private credit (direct lending) is an important one and one that investors should ensure they understand.

## RECOMMENDATION

Independent Investment Research (IIR) has maintained its **Recommended Plus** rating for the KKR Credit Income Fund (ASX: KKC). KKC provides investors exposure to one of the preeminent asset managers in the credit market globally, particularly when it comes to sub-investment securities. While the vehicle has had its challenges, the underlying investment strategies have delivered as expected. The buy-back program provided liquidity for investors seeking to exit, however we view the cessation of the buy-back program and the distribution of the capital being used for that program now being distributed to investors to be a positive, with unitholders now receiving a more attractive yield for the risk being taken. This has been reflected in the discount, with the discount narrowing substantially since the reallocation of income and capital returns to investors. There is an increasing amount of uncertainty in global markets. It is during these markets that we expect the Manager to outperform the broader market due the Manager's diligent research and credit selection processes and active management of the portfolio.

## SWOT

### Strengths

- ◆ The Manager has extensive resources with a team of 165 dedicated investment professionals. The Manager has strong underwriting skills and through the cycle experience, which IIR views as important for success in the credit strategies that KKC is exposed to.
- ◆ The Fund offers a differentiated exposure to other fixed income LITs on the ASX. With the full deployment of the EDL through KLPE II, the Fund has benefited from a diversified exposure across traded loans and high yield bonds in the US and direct lending across Europe.
- ◆ We view the fees as reasonable for this style of investment and we note that the fees are only incurred at the Fund level. No management or performance fees are incurred at the underlying investment level.
- ◆ The Fund has achieved its distribution target on an annual basis with the Fund meeting the target distribution set prior to the commencement of each financial year and currently offers an attractive yield. While the Fund has met its distribution target, it has not achieved its target total return of 6%-8% p.a. since listing to 30 June 2024 with the NAV returning 5.3% p.a. and unitholder returns of 4.6% p.a. The total returns has been impacted by both market conditions and structural decisions.
- ◆ While investing in the two strategies has added complexity to the Fund, the addition of the EDL strategy has achieved the objective of reducing the volatility of the NAV.
- ◆ The cessation of the buy-back program and the capital that was being used for the program now being distributed to unitholders has resulted in the Fund providing a much more attractive distribution yield and one that is competitive on a risk-adjusted basis when compared to other fixed income LITs on the ASX.

### Weaknesses

- ◆ While the underlying investments have performed as expected, the Fund has been adversely impacted as a result of some of the structural arrangements implemented (or not implemented), in the early years of the Fund. The adverse impacts from the FX hedging were a key detractor from the performance of the Fund as was the structure which impeded the ability to move capital between strategies. The Manager took steps to rectify this which investors have benefited from.
- ◆ The structure is complex with the closed-ended nature of the EDL investment providing additional complexities with regards to the reinvestment of capital. There is the potential to move to an ever green structure for the EDL strategy which we believe would simplify the structure with a fixed amount of capital able to be allocated to the EDL strategy without the potential for the flow of funds to have to move between the two strategies or potentially sit in cash in the event of a timing mismatch between the payback and drawdown of capital from the closed-ended funds currently invested in for the EDL allocation.
- ◆ It has taken some time for the Manager to understand the listed investment trust structure market dynamics. This has been a contributor to the discount at which the Fund has traded. However, the Manager has improved on this front with the latest decision regarding ceasing the buy-back program and distributing the income to investors having a positive impact on the price at which the Fund trades in relation to the portfolio.

### Opportunities

- ◆ KKC offers investors exposure to an actively managed portfolio of sub-investment grade debt securities in the US and direct lending exposure in Europe, exposure to which is not available to retail investors outside of a professionally managed investment vehicle. The nature of the Fund may provide global diversification to the fixed income component of an investor's portfolio and the sub-investment grade investments provide elevated yield prospects.
- ◆ The Fund provides the opportunity to gain exposure to what IIR considers to be one of the preeminent managers in the sub-investment grade fixed income market.

## Threats

- ◆ The GCO strategy is a sub-investment grade strategy, predominantly investing in the lower-end of the ratings spectrum of the asset class, specifically B and CCC. While the Manager invests in this sector of the market due to the appealing investment opportunity and the additional yield that can be generated, investors should accept that this segment of the market encompasses a greater level of risk and will likely experience heightened volatility when compared to other fixed income investments. The additional levels of volatility that can be experienced were highlighted during the events of 2020.
- ◆ The Fund invests in global securities and therefore will be exposed to FX movements. The Manager will seek to hedge these exposures; however, the Fund may be impacted from movements in FX if hedging is not implemented effectively.

## PRODUCT OVERVIEW

The Fund seeks to provide investors with attractive, risk-adjusted returns through an investment in a diversified portfolio of income generating alternative credit investments. The Fund provides exposure to two credit investment strategies managed by the credit investment teams of Kohlberg Kravis Roberts & Co. L.P. ("KKR") - (1) the Global Credit Opportunities strategy ("GCO strategy"), a long-only traded credit strategy that provides exposure to an actively managed portfolio of predominantly high yield bonds and leveraged loans; and (2) the European Direct Lending (EDL) strategy, which provides exposure to a portfolio of predominantly senior secured loans to European companies with an EBITDA of €25 million or greater. Details regarding each of the strategies is provided in the Underlying Investments section below.

The Fund's investment objective is to provide a regular income stream as well as to achieve capital appreciation over a full market cycle. The Fund targets a total return of 6% - 8% p.a. through the market cycle. The annual target distribution is announced prior to the commencement of the new financial year and is based on the forecast cashflows of the Fund for the financial year period. The Fund announced a target distribution of 20 cents per unit for FY25, which represents a yield of 8.5% based on the NAV of the Fund as at 30 June 2024.

At the IPO, the Fund committed the 50% of the capital to the GCO strategy and 50% to the EDL strategy. The EDL strategy invested in the KKR Lending Partners Europe II Fund (KPLE II), a closed-ended fund which called capital as investments were identified. It took approximately 3 years for the capital to be fully committed to KPLE II, with capital drawn from the GCO strategy as capital was called. With KPLE II fully committed, KKR has established KPLE III, the third iteration of the KPLE fund series, which KKC has committed capital to. As capital is repaid from the investments in KPLE II, the capital will be redistributed to KPLE III when capital is called. We note that there may be a mismatch in the timing which may result in the capital invested in the GCO strategy or held in cash. To avoid this complication in the future, the Manager has floated the potential for an ever green structure to be created for the EDL strategy once KPLE III has been fully committed. We believe this would simplify the structure for KKC and allow for a more stable allocation to the EDL strategy over time.

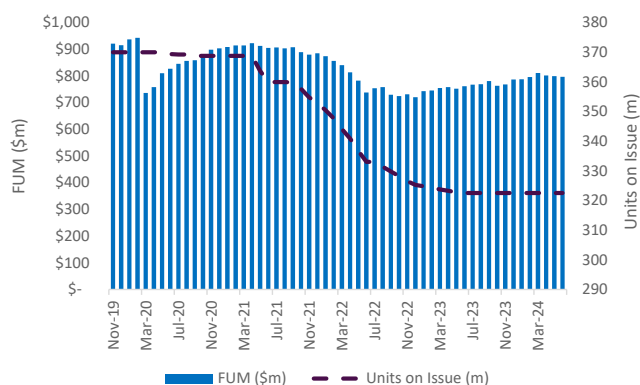
The Fund pays a management fee of 0.88% p.a. (plus GST) of the NAV of the Fund, payable monthly in arrears and the Manager is eligible for a performance fee of 5.125% of the net annualised return of the Fund (adjusted for distribution) above the RBA Cash Rate plus 4.00% p.a, subject to a High Water Mark. The performance fee is paid annually or where there is the issue or redemption of units. If payable, the performance fee is calculated by applying the performance fee amount to the average adjusted monthly NAV during the performance period, being the financial year.

## Fund Growth

The FUM and number of units on issue has declined since inception as a result of an aggressive buy-back program undertaken by the Fund. Since initiating the buy-back program in 2021, the Fund bought back over \$100 million in units in an attempt to address the persistent and sizable discount at which the Fund was trading.

The Company ceased the buy-back program in June 2023, making the decision to distribute the income being used for the buy-back program to unitholders instead. This was a welcome announcement by the Fund, resulting in a boost to the distribution to unitholders and has made the distribution yield more attractive and competitive with other fixed income LITs. Investors welcomed the decision with the discount continuing to narrow since the change was made.

#### Units on Issue and FUM



#### Launch of GCOF Fund

In December 2022, KKR launched its AUD denominated Global Credit Opportunities Fund through an unlisted unit trust structure (GCO AUD Fund). The GCO AUD Fund provides exposure to its flagship GCO strategy (100% AUD hedged) with a monthly distribution.

The GCO AUD Fund can invest up to 20% of its portfolio in KKC units if KKC is trading at a discount. This mechanism provides the potential for the GCO AUD Fund to support the KKC unit price at times of dislocation. To date the GCO AUD Fund has not acquired any KKC units. We note in the event the GCO AUD Fund does acquire KKC this may result in increased levels of volatility in the unit price with the Manager potentially selling KKC units to meet redemption requests.

## UNDERLYING INVESTMENTS

The investment strategy of the Fund remains unchanged with the capital raised invested across two underlying investments: (1) Global Credit Opportunities strategy (GCO strategy); and (2) European Direct Lending (EDL) strategy through KKR Lending Partners Europe II Fund (KLPE II). With KLPE II has closed and is fully deployed, KKC has committed to invest in KLPE III.

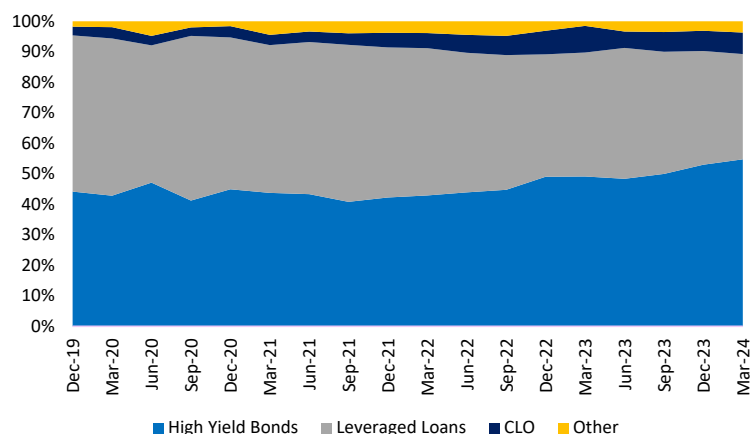
We take a look at the two underlying investments in detail below. For detailed information regarding the investment process refer to the IIR KKC IPO report published in September 2019.

#### Global Credit Opportunities (GCO) Strategy

The GCO strategy provides exposure to KKR's Opportunistic Credit Strategy (OCS), one of the flagship credit strategies of KKR. The strategy had ~US\$4.2b FUM as at 30 June 2024. The GCO strategy is a long-only traded credit strategy that provides exposure to an actively managed portfolio of sub-investment grade credit, predominantly high yield bonds and leveraged loans. The strategy invests across the seniority spectrum, however has historically had a focus on senior credit, both secured and unsecured.

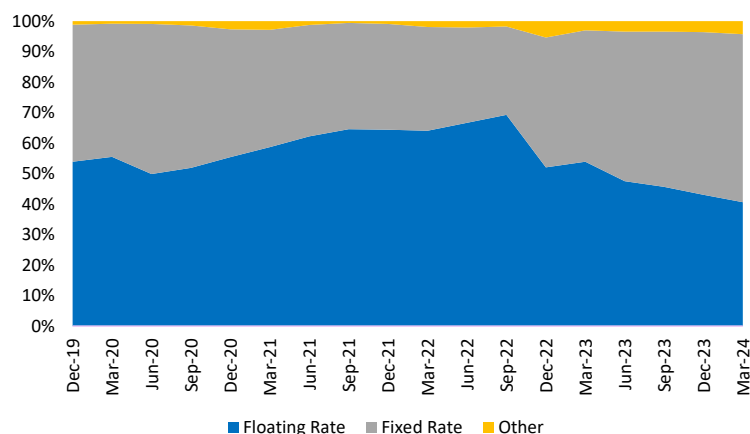
A traded credit strategy will typically experience greater levels of volatility (particularly sub-investment securities) than credit strategies that focus on direct lending (private credit), where capital will typically only be impaired in the event the loan amount is not fully recouped and loans often not marked-to-market.

## GCO Strategy Asset Allocation



The asset allocation between high yield bonds and leveraged loans results in a mix of floating and fixed rate security exposure with high yield bonds typically fixed rate securities and leveraged loans typically floating rate securities.

## GCO Strategy Fixed and Floating Rate Exposure



The portfolio is concentrated with the Manager seeking to take advantage of its knowledge, experience and skills to provide exposure to the most attractive risk-adjusted opportunities as opposed to broad market exposure. This is key to the Manager's investment philosophy.

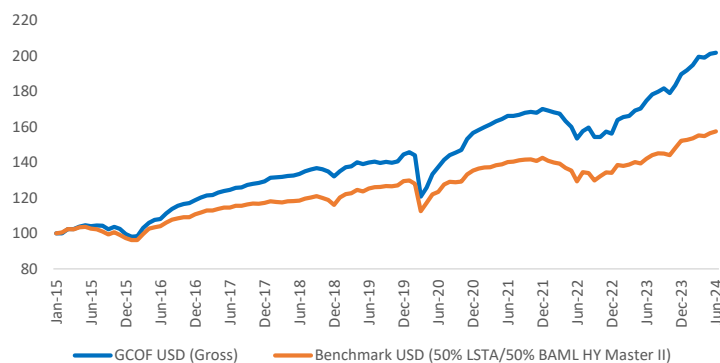
The below highlights the portfolio composition of the GCO strategy as at 31 March 2024. The level of concentration is not reflected in the issuer numbers due to the increased exposure to CLOs, which translates into multiple issuers being recognised for a single CLO investment.

## GCO Portfolio Composition as at 31 March 2024

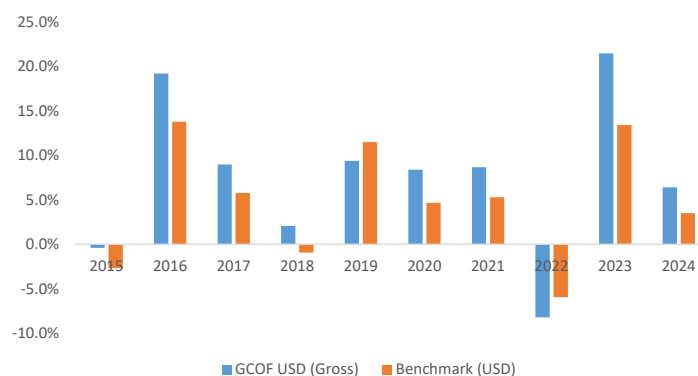
Number of Issuers	151	Security Type:	
Number of Assets	203	Bond	54.7%
Interest Rate Exposure:		Loan	34.6%
Fixed Rate	55.1%	CLO	7.0%
Floating Rate	40.7%	Other	3.7%
Other	4.2%		

Since the establishment of the GCO commingled strategy for institutional and retail investors in January 2015, the strategy has generated a total return of 7.7% p.a. to 30 June 2024 on a gross basis. This compares to the benchmark (50% BAML HY Master II Index/50% S&P LSTA LL Index) of 4.9% p.a. We note that returns are in USD.

The GCO strategy declined by more than the market during the COVID-19 market sell off however, recovered strongly and outperformed over subsequent periods.

**GCO Strategy Gross Performance (USD)**

Looking at the performance of the GCO strategy by calendar year, the strategy has outperformed the benchmark in 7 of the 9 full calendar year periods since its establishment. The GCO strategy lagged the benchmark during the market sell-off in 2022, however, recovered strongly and delivered strong outperformance in 2023 and outperformance in the first half of 2024.

**GCO Strategy Gross Performance****GCO Strategy Performance Metrics (as at 30 June 2024)**

	<b>GCO Strategy (Gross, USD)</b>	<b>Benchmark (USD)</b>
<b>Total Return:</b>		
1 year	15.5%	10.8%
3 year (p.a.)	6.7%	4.0%
5 year (p.a.)	7.6%	4.7%
Since Inception (January 2015, p.a.)	7.7%	4.9%
<b>Risk (since inception):</b>		
Standard Deviation (p.a.)	7.8%	6.4%
Maximum Monthly Drawdown	-16.1%	-12.1%
Down Market Capture	0.91	na
Up Market Capture	1.25	na
Market Capture Ratio	1.38	na

The concentration on the quality of the issuer and its ability to repay the capital and service the interest requirements is designed to deliver preservation from capital loss while also delivering enhanced returns. In this part of the market, defaults are inevitable. For the most part the detailed, bottom-up investment assessment of companies has resulted in the strategy experiencing a lower level of defaults than the benchmark. This is highlighted in the below table which shows the defaults over the last four financial year periods.

Default Rates		
	GCO Strategy	Benchmark
FY21	1.14%	1.88%
FY22	0.0%	0.43%
FY23	1.51%	2.05%
FY24 (to 31 March 2024)	0.26%	1.67%

Source: KKR

### European Direct Lending (EDL) Strategy

KKC has a long-term target allocation of 50% to its European Direct Lending strategy. The Trust commenced its allocation to the EDL strategy in the third quarter of 2020, and had achieved approximately 80% of its target allocation by the end of 2023. The allocation has been invested in the KKR Lending Partners Europe II Fund (KLPE II) as capital is called. The Fund's investment in the EDL strategy by way of KLPE II is now fully deployed. With a fixed term of 6 years, plus the potential for a 2-year extension, the Fund has committed capital to KLPE III to continue the investment in the strategy as the capital from KLPE II is returned.

KLPE II and KLPE III represent the follow-on funds to KLPE I, a European direct lending fund that made its first investment in May 2015, raised a total of US\$847.6m and marked the end of its investment period in March 2019. The three funds are based on the same strategy, albeit with nuanced differences in target markets reflecting changing dynamics in the European private debt market.

KKR Credit's underwriting is based on a fundamentally-driven process developed by its involvement in credit markets since 2004 and its longer involvement in private equity. The team is led by professionals with many years of experience in investing and managing large pools of capital, in both the debt and equity capital markets.

Examining KKR Credit's European private credit deal hit rate and the consistency of hit rate over time is a good indicator of credit underwriting standards and discipline. Of the over 2,900 deals seen since 2015 only 102 deals, or less than 4%, have been funded. We note this hit rate has remained relatively consistent over time which suggests consistency of discipline, process and rigour.

Credit Selection Hit Rate											
	2015	2016	2017	2018	2019	2020	2021	2022	2023	1H'2024	Total
Deals Reviewed	137	145	319	355	388	338	327	425	400	105	2,939
Deals Screened	71	43	51	54	67	73	87	110	100	32	688
Deals Funded	8	7	5	9	11	12	13	17	16	4	102
Hit Rate (%)	6%	5%	2%	3%	3%	4%	4%	4%	4%	4%	3.5%
Amount Invested (USD, \$billion)	0.7	0.7	0.4	1.2	2.1	1.9	2.2	2.3	1.6	1.1	14.2

KKR Credit have sought to capitalise on the sizeable commingled capital by targeting larger European direct lending deals to upper mid-market European companies (€50m EBITDA +). The belief is larger companies have stronger more stable performance leading to less defaults compared to smaller companies, which leads to better fund performance in the long term. This can be seen in the performance of KLPE II, with no defaults or losses to date.

The Manager adopts a proactive approach to portfolio management and will step in early if an investment shows signs of credit deterioration through adverse operational developments. KKR Credit has over 25 dedicated European team members and can utilise the investment and operational expertise of the over 100-person global private credit investment team. In addition, KKR Credit may also leverage the restructuring expertise of KKR's special situations team.

As of 30 June 2024, KLPE II has recorded a realised unlevered gross IRR of 10.4% p.a. and was generating a weighted average all-in-yield of net IRR of 8.4% p.a. The yield performance is broadly consistent with KKR Credit's global direct lending funds, which target to generate 9.5%-11.5% gross IRR and 8.5%-10.5% net IRR. This represents a consistent approximately 300 bps premium over the syndicated loan market. This is largely the illiquidity premium that can

be derived from a well-structured and managed portfolio of direct loans and is a key appeal of the segment.

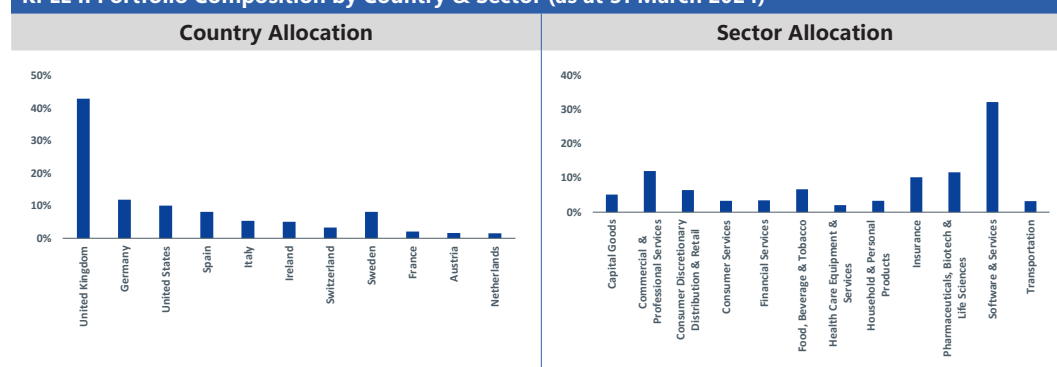
The KLPE II Fund closed in September 2020, with the fund securing capital commitments of US\$865m. With the leveraged sleeve, the fund has US\$1.3b buying power. We note KKC only invests in the unlevered sleeve of the fund and will be fully hedged to AUD.

As at 31 March 2024, the portfolio was invested across 35 issuers, 11 countries and 12 industries. The majority of investments are senior secured loans. The portfolio composition is detailed below. To date the majority of loans have performed as expected with no defaults as at 31 March 2024. The level of risk and performance of the portfolio is monitored carefully.

#### KLPE II Portfolio Composition as at 31 March 2024

Number of Issuers	35	KKR Credit Role:	
Weighted Average EBITDA	\$137m	Sole	9.2%
Interest Rate Exposure:		Lead	11.4%
Fixed Rate	1.4%	Club	47.1%
Floating Rate	98.6%	Co-Lead	32.3%
Individual Loan Balance		Loan Type:	
\$10m-\$25m	5.2%	Senior Secured	86.8%
\$25m-\$50m	20.3%	Senior Unsecured	2.8%
\$50m-\$100m	31.5%	Subordinated	10.4%
\$100m-\$200m	24.5%		
>\$200m	18.5%		

#### KPLE II Portfolio Composition by Country & Sector (as at 31 March 2024)



The two underlying strategies are combined to improve overall diversification (by geography, market segment, mark-to-market volatility, risk profile, and investment strategy) without diluting the high conviction nature of either as well as providing exposure to two differentiated strategies for Australian retail investors. The diversification of risk profile is particularly important, with the lower volatility direct lending strategy damping the volatility of the GCO strategy.

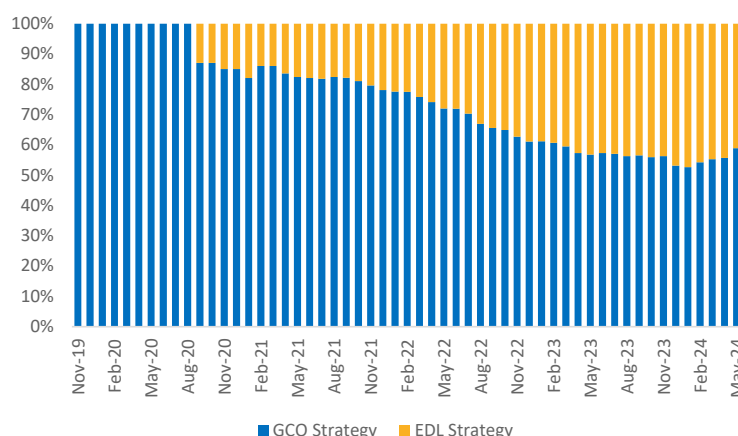
While there are distinct differences in the underlying strategies, there are conversely also substantial similarities, which is important to the thematic consistency of the Fund. Both strategies are managed according to the KKR investment philosophy and process which is based on deep fundamental bottom-up analysis and prudent underwriting and which draws on the broad resources of KKR and its competitive advantages. Both are relatively easy to understand, being predominately senior in the capital structure and largely eschewing esoteric credits. And both strategies have a strong track-record and inherent ability to deliver attractive risk-adjusted returns throughout the credit cycle and preserve capital for investors.

## KKC PORTFOLIO POSITIONING

As per the Product Disclosure Statement (PDS) issued for the IPO, the capital raised was initially invested in the GCO strategy until such time capital was called for investments made through KLPE II. The Fund commenced its allocation to the EDL strategy in the third quarter of 2020 with KPLE II currently fully deployed. As at 30 June 2024, the Fund was 60% invested in the US focused GCO strategy and 40% invested in the EDL strategy (KLPE II). KKC has committed capital to KPLE III with capital repaid from KPLE II being recycled into KPLE III. The Manager has flagged the potential for future iterations of the KPLE fund to be

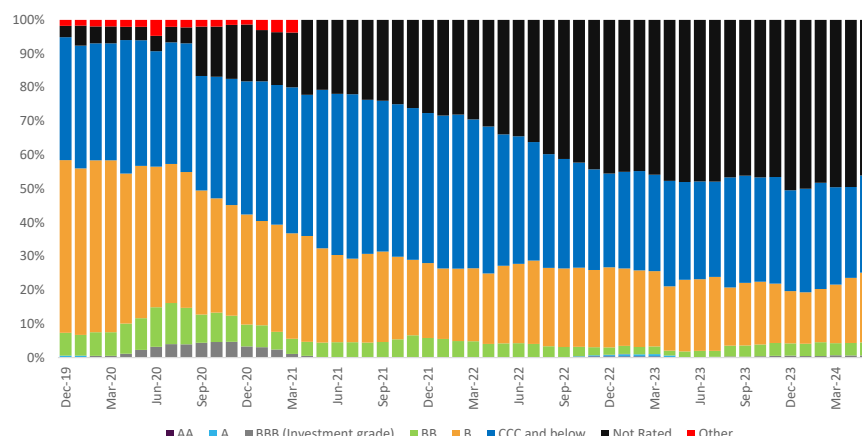
structured as an open-ended fund, which would simplify the KKC structure and likely result in a long-term allocation of 60% to GCO strategy and 40% to EDL strategy.

#### KKC Historic Portfolio Composition



The portfolio is focused on sub-investment grade credit. The GCO strategy is predominantly invested in B and CCC rated securities. This is reflected in the below graphic, which shows the KKC portfolio ratings exposure since listing. The average exposure to B and CCC and below rated securities since listing to 31 May 2024 was 63%. The Not Rated securities in the below primarily refer to the investments in KLPE II and averaged about 30%.

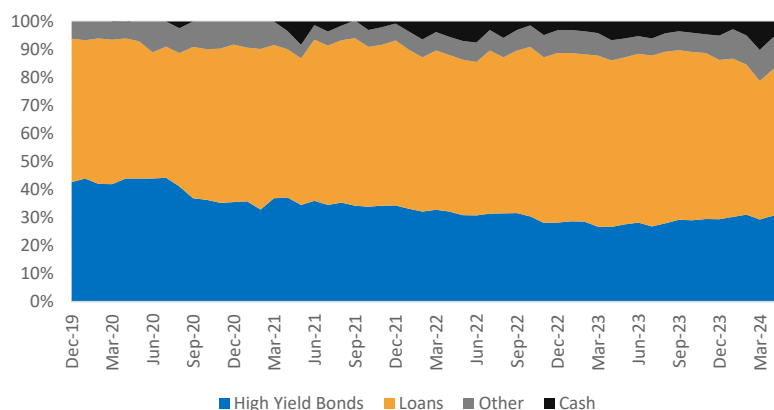
#### Historic KKC Portfolio Ratings Exposure



The portfolio is exposed primarily to high yield bonds and leveraged loans through the GCO strategy and corporate loans through the EDL strategy. As at 31 May 2024, the portfolio had a 49% exposure to Loans and a 30% weighting to High Yield Bonds.

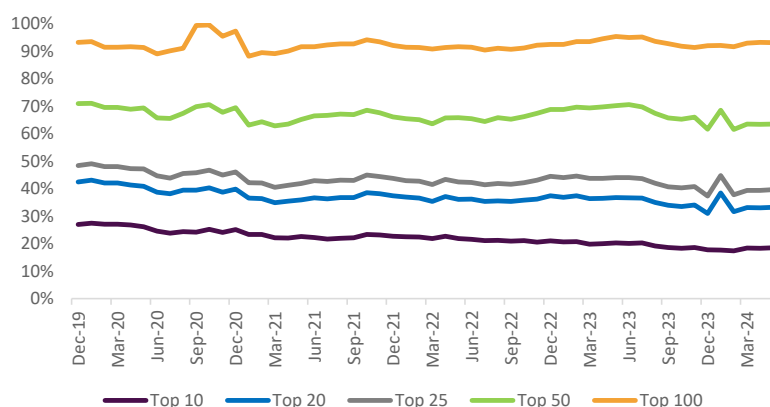
The Fund has remained largely invested throughout its history with less than 10% in cash at any given time. Depending on the timing of the expected capital drawdown from KPLE III and the repayment of capital from KPLE II, the Manager may hold increased levels of cash during the transition period. High Yield Bonds are typically fixed rate securities while loans are floating rate securities. As such, the portfolio provides exposure to a mix of interest rate structures with the high yield bonds exposed to duration risk and loans exposed to the movement in cash rates.

### Historic Asset Type Exposure



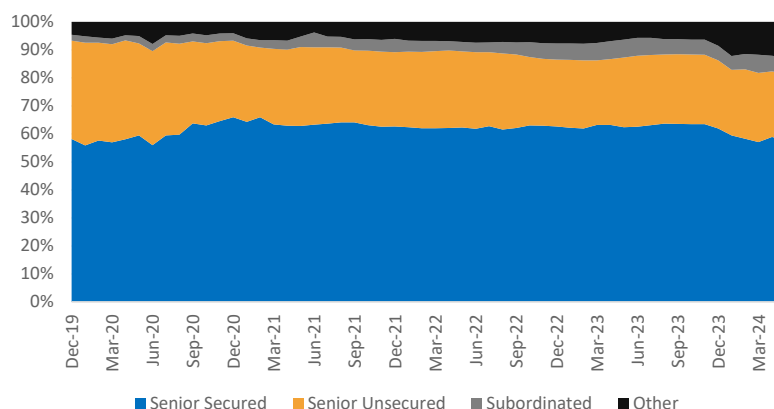
The GCO strategy is considered to be concentrated with the Manager seeking to construct a portfolio of 60 to 80 core positions, from which the majority of return is expected to be generated. This compares to the BAML High Yield Master II Index which comprises 1,200 securities. The deployment of the EDL Strategy increased KKC's issuer diversification, with KLPE II Fund invested across 20-49 issuers. The top 10 holdings have historically accounted for 17%-30% of the portfolio with the top 25 holdings accounting for 40%-50% of the portfolio.

### GCO Strategy Portfolio Concentration



The Fund focuses on the senior tranches in the capital structure. Since listing, senior exposure (secured and unsecured) has accounted for more than 80% of the portfolio. As at 31 May 2024, the portfolio has around 6% in subordinated exposure, and 13% in other types of credit including CLOs (Collateralised Loan Obligations).

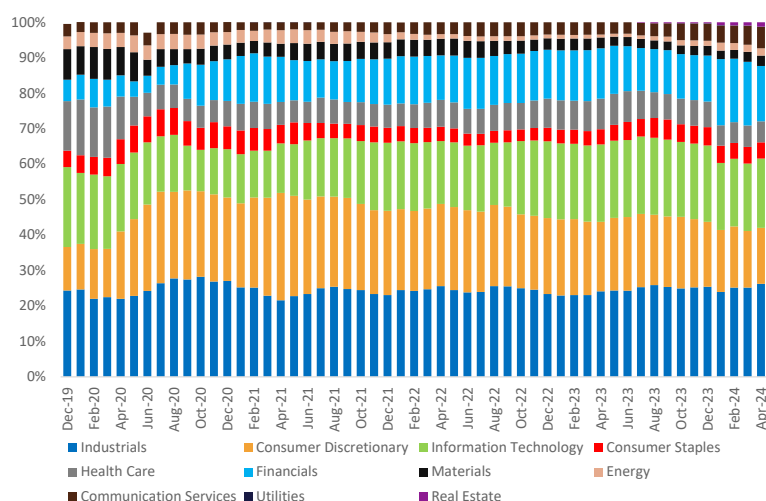
### Historic Senior vs. Subordinated Exposure



The Manager has been very active with the portfolio experiencing significant sector rotations through time. Since listing, the portfolio has reduced exposure to the IT and Healthcare sector and increased exposure to Consumer Discretionary. From September

2020, there was also an increase in exposure to the Financials sector. The Portfolio has had very little exposure to sectors such as Utilities and Real Estate.

#### Historic Sector Exposure

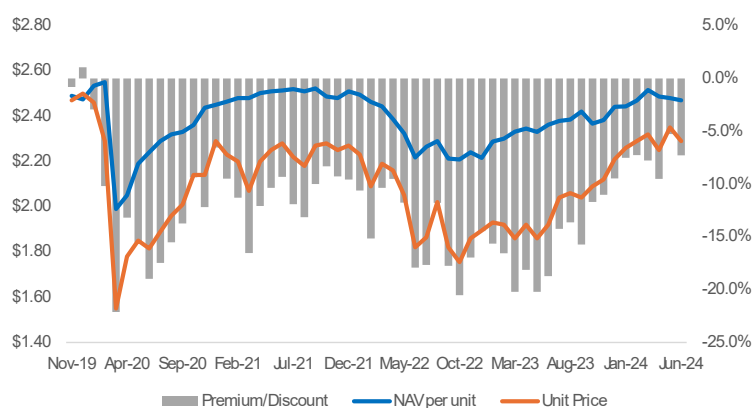


## PERFORMANCE ANALYTICS

KKC's NAV has been volatile throughout its history. The timing of the listing, shortly before the COVID pandemic, and the full exposure to the GCO strategy at this point in time saw the NAV experience a heightened drawdown. After recovering to a large extent from the global pandemic sell-off, the portfolio was then impacted by the inflationary environment which saw interest rates raised globally at one of the fastest paces on record and fears of a recession resulting in another drawdown in the market. The performance of the portfolio combined with structural issues has contributed to the Fund trading at a discount to NAV throughout its history.

The Fund has implemented a number of initiatives to narrow the discount, including an aggressive buy-back program which saw the Fund buy-back over \$100 million in units over a three year period. The Fund was using income generated to satisfy the buy-back program which meant the yield being delivered to unitholders was being impacted. While the buy-back provided liquidity to those investors seeking to exit, in our opinion it wasn't the best use of capital given the yield being offered by other fixed income LITs. The cessation of the buy-back program in June 2023 and the redistribution of the income being used for this program to unitholders has had the greatest impact on the discount, with the discount narrowing since this time. The increase in the distribution yield has provided a much more attractive distribution yield for investors and made the Fund more competitive with its peers.

#### NAV and Unit Price History



Source: KKC, Iress, IIR.

From a NAV perspective KKC has delivered a cumulative total return of 5.3% p.a. since listing. Unitholder returns have lagged as discussed above with a return of 4.6% p.a. While unitholder returns have lagged since listing, in more recent times unitholder returns have

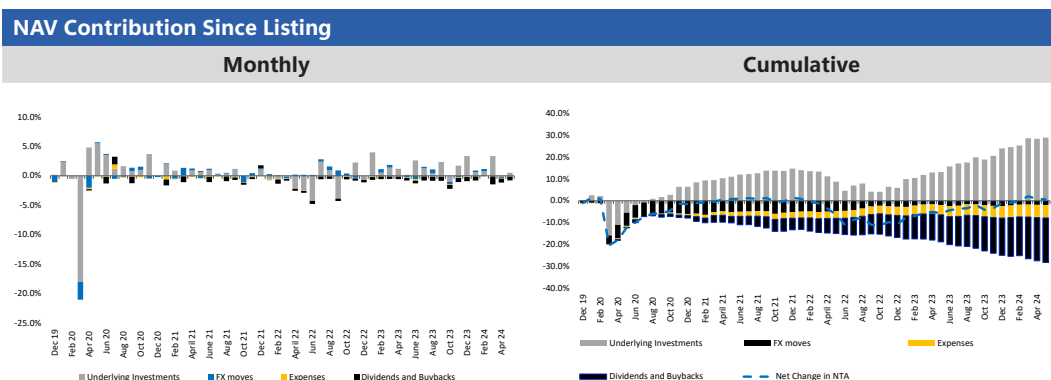
outperformed the NAV returns as a result of the narrowing of the discount. Over the 12-months to 30 June 2024, the Fund delivered unitholder returns of 30.6%. This compares to the NAV return of 13.5%.

As mentioned above, the NAV experienced heightened volatility in the initial years of listing. This is highlighted by the standard deviation figures below when compared to the benchmark for the GCO strategy (50% LSTA/50% BAML HY Master II (USD)). Over the 3 years to 30 June 2024, the NAV had an annualised standard deviation of 5.8%. This compares a standard deviation of 12.3% since listing. We note the composition of the portfolio has changed over time as well with the increased exposure to the EDL strategy reducing the portfolio volatility.

Performance Metrics (to 30 June 2024)			
	NAV	Unit Price	GCO Strategy Benchmark*
<b>Cumulative Total Return:</b>			
1 year	13.5%	30.6%	10.8%
3 year (p.a.)	5.9%	7.7%	4.0%
Since Listing (p.a.)	5.3%	4.6%	4.8%
<b>Risk:</b>			
Standard Deviation (3 year, p.a.)	5.8%	14.6%	5.7%
Standard Deviation (since listing, p.a.)	12.3%	22.2%	8.2%
Maximum Monthly Drawdown	-22.0%	-32.3%	-12.1%
Maximum Drawdown Peak to Trough	-22.0%	-38.0%	-13.3%

\*50% LSTA/50% BAML HY Master II (USD).

The below provides a breakdown of the contributors to the movements of the Fund's NAV on a monthly basis since listing to 31 May 2024. The NAV has largely recovered the losses resulting from the drawdowns in March 2020 and again in 1H'2022. A significant detractor for the 2020 NAV drawdown was the FX exposure with the FX exposure having a -5.2% influence on the NAV to 31 March 2021. We note that FX exposure has had a much less significant contribution to returns since the Manager made the structural improvements in 2021 including separating GCO strategy to a SMA and modify its FX hedging arrangement. As of 31 May 2024, the cumulative contribution to NAV from FX moves was -1.9% for the period since KKC's listing.

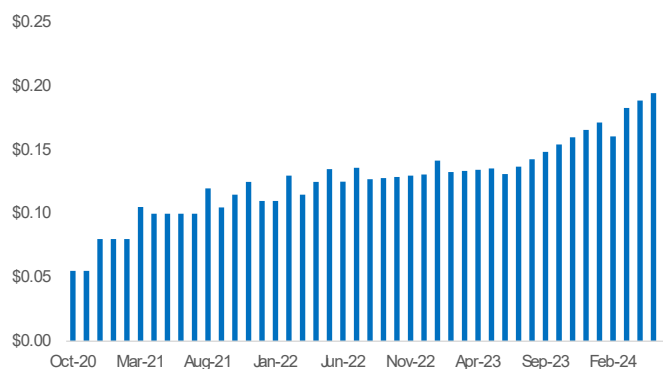


The Fund initially paid a quarterly distribution before moving to a monthly distribution for the FY22 period. The Fund announces the target annual distribution before the commencement of a new financial year period and pays a stable monthly distribution for the period with the final distribution incorporating any additional income generated by the Fund during the financial year period.

The below chart shows the rolling 12-month distribution amount paid by the Fund. The distribution amount has increased over time as a result of a combination of increased income from the underlying investments as a result of increased interest rates and cessation of the buy-back program which has resulted in a greater portion of income being distributed to unitholders.

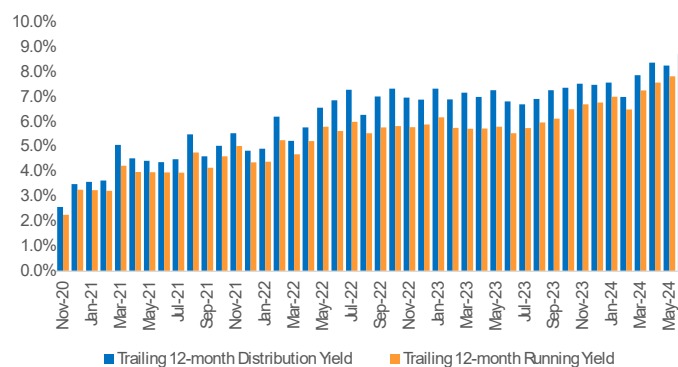
The Fund announced a target distribution for the FY25 period of 20 cents per unit, equating to a monthly distribution of 1.67 cents per unit, the same as the target distribution for the FY24 period.

## Rolling 12-month Distribution Amount



The Fund has achieved its annual target distributions to date with the Fund offering an attractive distribution yield as at 30 June 2024. The distribution yield has been above the running yield due to the discount at which the Fund has traded, highlighting that the discount has provided an attractive opportunity to generate an enhanced yield from the portfolio.

## Trailing 12-month Distribution &amp; Running Yield



## PEER COMPARISON

KKC is one of seven fixed income LITs on the ASX. KKC provides exposure to a portfolio of traded credit (high yield bonds and leveraged loans) and private credit through the EDL strategy. The Fund provides exposure to a portfolio of fixed income investments that offer exposure to a differentiated portfolio to existing LITs. There are some elements of cross-over with other LITs, however as a total portfolio, the strategy is unique.

Previously we viewed NBI Global Corporate Income Trust (ASX: NBI) and Partners Group Global Income Fund (ASX: PGG) as the most relevant peers to KKC given they both invest in global markets. With both NBI and PGG no longer listed on ASX, KKC provides a unique listed vehicle with investment exposure to global securities, with many of its peers focused on domestic securities.

## ASX Fixed Income LIT Key Features

LIT	Code	Market Cap (\$m)*	Underlying Investments	Credit Quality	Distribution Frequency	Target Distribution
Gryphon Capital Income Trust	GCI	\$681.2	RMBS & ABS	Investment Grade & Sub-Investment Grade	Monthly	RBA Cash Rate + 3.5%
KKR Credit Income Trust	KKC	\$758.0	Corporate High Yield Bonds, traded loans and Private Credit	Sub-Investment Grade	Monthly	8.5%**
Metrics Income Opportunities Trust	MOT	\$732.1	Corporate Loans	Sub-Investment Grade	Monthly	7.0%
Metrics Master Income Trust	MXT	\$2,195.5	Corporate Loans	Investment Grade & Sub-Investment Grade	Monthly	RBA Cash Rate + 3.25%

**ASX Fixed Income LIT Key Features**

LIT	Code	Market Cap (\$m)*	Underlying Investments	Credit Quality	Distribution Frequency	Target Distribution
Perpetual Credit Income Trust	PCI	\$516.9	Diversified	Investment Grade & Sub-Investment Grade	Monthly	RBA Cash Rate + 3.25%
Pengana Global Private Credit Trust	PCX	\$160.6	Fund of Fund Private Credit	Senior, subordinated & equity-linked	Monthly	7.0%
Qualitas Real Estate Income Fund	QRI	\$720.2	CRE debt	Senior & Mezz debt	Monthly	RBA Cash Rate + 5.0% - 6.5% &

\*As at 31 July 2024.

\*\* Target Distribution Yield is determined at the beginning of each financial year and is calculated based on the target annual distribution amount and the NAV as at the end of each financial year.

Source: ASX, Company/Trust documents, IIR.

KKC's management fees are in line with the median management fees of the peer group and is one of the few fixed-income LITs that charges a performance fee.

**ASX Fixed Income LIT Fees**

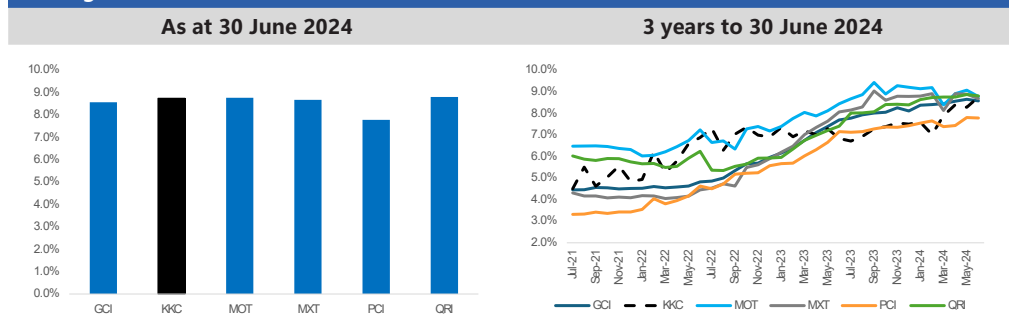
LIC/LIT	Code	Management Fee (incl. GST)	Performance Fee	Performance Fee Hurdle
Gryphon Capital Income Trust	GCI	0.72%	na	na
KKR Credit Income Trust	KKC	0.902%	5.13%	RBA Cash Rate +4% p.a. subject to High Water Mark
Metrics Income Opportunities Trust	MOT	1.03%	15.38%	RBA Cash Rate +6% p.a.
Metrics Master Income Trust	MXT	0.60%	na*	na*
Perpetual Credit Income Trust	PCI	0.72%	na	na
Pengana Global Private Credit Trust	PCX	1.20%	20.0%	RBA Cash Rate + 6.0% with a floor of 7.5%
Qualitas Real Estate Income Fund	QRI	1.50%	20.5%	8.0% p.a., subject to High Water mark over a three-year period

\*SPDF II and REDF are eligible for performance fees of 15% of the outperformance of the target returns for the respective funds.

**Distributions**

KKC's distribution yield has increased as the risk-free rate has increased and its strategy returns improved. KKC's yield is at the high-end of the peer group as at 30 June 2024. This is considered appropriate given the level of risk in the portfolio. KKC's portfolio is considered to be at the higher end of the risk spectrum when compared to its peers given the high-yield and traded loan segments in which the Trust invests.

When looking at the trailing 12-month distribution yield over the 3 years to 30 June 2024, KKC's yield lagged its peers during the 2023 and early 2024 period. This is attributed to a combination of the exposure to fixed income securities and the reduced distribution with a portion of the income being used for the buy-back program.

**Trailing 12-month Distribution Yield**

## Performance

From a performance perspective, KKC's portfolio has performed well in the 12-months ending 30 June 2024 but lagged all but one in the peer groups over the 3-year period.

From a volatility perspective, KKC returns are much more volatile compared its ASX listed peers. The high-risk profile can be attributed to the investment in higher risk segments of the credit market. Being a global strategy, FX movements can also add to return volatility, although the portfolio is fully hedged to AUD. We note that KKC provides exposure to both traded credit and private credit while some of its peers provide exposure purely to private credit. Given these loans are often not marked-to-market, the capital often experiences lower levels of volatility than traded credit securities.

Given PCX only recently listed, it is not included in the below table.

NAV Risk & Returns (as at 30 June 2024)						
	GCI	KKC	MOT	MXT	PCI	QRI
<b>Total Cumulative Returns</b>						
1 year	9.7%	<b>13.5%</b>	9.9%	9.4%	10.2%	9.3%
3 year (p.a.)	6.8%	<b>5.9%</b>	10.3%	7.2%	5.9%	7.5%
<b>Standard Deviation</b>						
1 year	1.2%	<b>4.8%</b>	1.2%	1.1%	0.6%	0.2%
3 year (p.a.)	1.1%	<b>5.9%</b>	2.4%	1.0%	1.4%	0.8%

Unitholder returns for all LITs in the peer group outperformed the NAV returns over the 12-months to 30 June 2024. There was demand for fixed income as an asset class which saw a number of the LITs narrow or eradicate the discount at which they were trading, boosting unitholder returns.

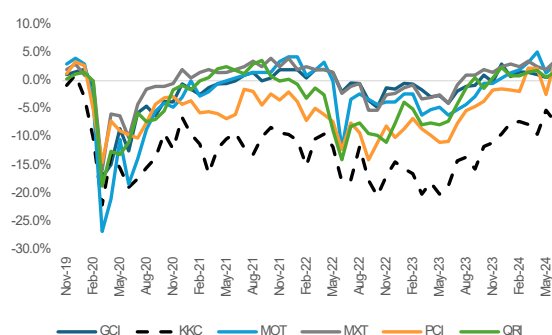
Unitholder Risk & Returns (as at 30 June 2024)						
	GCI	KKC	MOT	MXT	PCI	QRI
<b>Total Cumulative Returns</b>						
1 year	15.3%	<b>30.6%</b>	20.3%	17.7%	28.2%	19.6%
3 year (p.a.)	7.2%	<b>7.7%</b>	11.2%	7.8%	9.8%	7.6%
<b>Standard Deviation</b>						
1 year	5.1%	<b>9.7%</b>	5.7%	4.2%	9.6%	6.0%
3 year (p.a.)	5.4%	<b>14.8%</b>	10.9%	5.9%	10.6%	9.0%

## Premium/Discount

For the period from KKC listing to 30 June 2024, KKC has consistently traded at the largest discount to NAV of the peer group, with an average discount of 12.4%. This has been a result of a combination of the performance and relative attractiveness when compared to its peers from an income perspective.

A differentiating feature of KKC from many of its private credit peers, it does have the potential for a capital component to returns from the high yield bond exposure, however income will typically be the greatest return component. This compares to other fixed income investments in which returns comprise of income only with little to no capital return component due to the nature of the underlying investments.

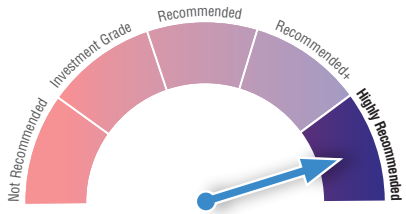
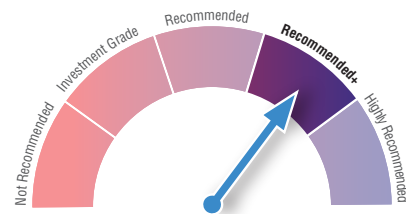
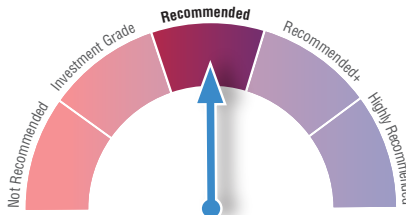
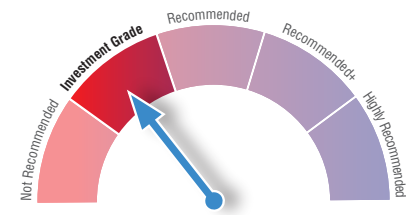
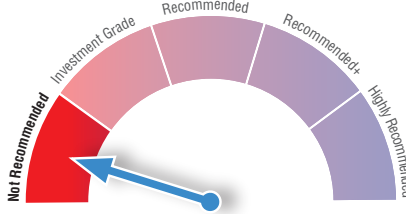
### Peer Group Historic Premium/Discount



## APPENDIX A – RATINGS PROCESS

### Independent Investment Research Pty Ltd “IIR” rating system.

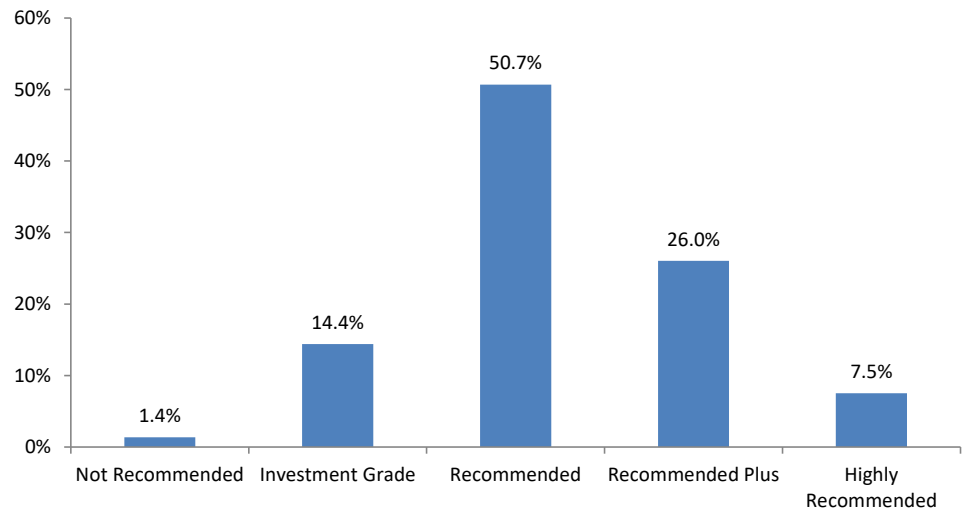
IIR has developed a framework for rating investment product offerings in Australia. Our review process gives consideration to a broad number of qualitative and quantitative factors. Essentially, the evaluation process includes the following key factors: product management and underlying portfolio construction; investment management, product structure, risk management, experience and performance; fees, risks and likely outcomes.

LMI Ratings	SCORE
Highly Recommended	83 and above
 <p>This is the highest rating provided by IIR, indicating this is a best of breed product that has exceeded the requirements of our review process across a number of key evaluation parameters and achieved exceptionally high scores in a number of categories. The product provides a highly attractive risk/return trade-off. The Fund is likely effectively to apply industry best practice to manage endogenous risk factors, and, to the extent that it can, exogenous risk factors.</p>	
Recommended +	79–83
 <p>This rating indicates that IIR believes this is a superior grade product that has exceeded the requirements of our review process across a number of key evaluation parameters and achieved high scores in a number of categories. In addition, the product rates highly on one or two attributes in our key criteria. It has an above-average risk/return trade-off and should be able consistently to generate above average risk-adjusted returns in line with stated investment objectives. The Fund should be in a position effectively to manage endogenous risk factors, and, to the extent that it can, exogenous risk factors. This should result in returns that reflect the expected level of risk.</p>	
Recommended	70–79
 <p>This rating indicates that IIR believes this is an above-average grade product that has exceeded the minimum requirements of our review process across a number of key evaluation parameters. It has an above-average risk/return trade-off and should be able to consistently generate above-average risk adjusted returns in line with stated investment objectives.</p>	
Investment Grade	60-70
 <p>This rating indicates that IIR believes this is an average grade product that has exceeded the minimum requirements of our review process across a number of key evaluation parameters. It has an average risk/return trade-off and should be able to consistently generate average risk adjusted returns in line with stated investment objectives.</p>	
Not Recommended	<60
 <p>This rating indicates that IIR believes that despite the product's merits and attributes, it has failed to meet the minimum aggregate requirements of our review process across a number of key evaluation parameters. While this is a product below the minimum rating to be considered Investment Grade, this does not mean the product is without merit. Funds in this category are considered to be susceptible to high risks that are not reflected by the projected return. Performance volatility, particularly on the down-side, is likely.</p>	

## APPENDIX B – MANAGED INVESTMENTS COVERAGE

The below graphic details the spread of ratings for managed investments rated by Independent Investment Research (IIR). The managed investments represented below include listed and unlisted managed funds, fund of funds, exchange traded funds and model portfolios.

### Spread of Managed Investment Ratings



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