DSC MERIDIAN CAPITAL

DSC Meridian Capital LP is an opportunistic, event-driven credit investment firm founded by Sheru Chowdhry, the former Head of Credit Research & Co-Portfolio Manager of the Paulson Credit Fund (2004-2017). The firm seeks to generate absolute returns through the credit cycle. DSC Meridian will prioritize principal protection, liquidity and shorting at the top of the credit cycle, and then shift portfolio focus to capital appreciation and equity-like upside at the bottom of the cycle. DSC Meridian will invest both long and short, across small, mid, and large-sized capital structures, and across the full spectrum of credit opportunities from performing, stressed and distressed credit (bankruptcy reorganizations, litigations, liquidations) to post re-organization, event-driven equities and capital structure arbitrage. The firm integrates material ESG factors throughout the investment process and pursues an active corporate engagement strategy to help shape positive ESG-related outcomes.

April 1, 2021

Authors

Sheru Chowdhry
Founder & CIO

Paula Luff
Director of ESG Research & Engagement

Event-Driven Credit:
Climate Impact Through Corporate Engagement

Executive Summary: Approximately 190 countries have ratified the Paris Agreement, aiming to limit the global temperature rise this century to well below 2 degrees Celsius. To achieve this objective, many large asset owners are increasingly taking steps toward encouraging corporations to play their part. Through investor-led campaigns like CDP, Race to Zero, Climate Action 100+, and the Net Zero Asset Management Initiative, major asset managers are organizing to engage and push companies to ensure the world's largest corporate greenhouse gas emitters take action on climate change.

But in the high yield space, two significant problems exist for investors who want to own a decarbonized or "clean" diversified credit portfolio:

- Only 15% of issuers report Scope 1 and 2 greenhouse gas emissions
- And, even fewer of those have set targets to reach a 2-degree warming scenario

Because of this, it is virtually impossible to manage a portfolio fully aligned with the Paris Agreement. This creates an enormous challenge, but also an opportunity to pursue corporate engagement strategies to help companies in the high yield universe shape positive carbon outcomes.

Event-driven credit, as an investment strategy, is well-positioned to engage and help corporations reduce emissions and align with the Paris Agreement.

MSCI USD HY Corporate Bond Index						
Total Issuers	Disclose Scope 1 & 2 Emissions	%	Set Science Based Targets	%	Currently Aligned with 2C Scenario	%
963	143	15%	138	14%	105	11%

Source: DSC Meridian estimates, MCSI Carbon Delta

COMMON MYTHS

A common myth in ESG investing is that you cannot engage with companies as a credit investor: *executives do not want to talk to their creditor*s. As the fallacy goes, you can only have an impact in the equity markets, particularly in the long-only ESG thematic plays, like the wind value chain or the electric vehicle value chain. Another myth is that engagement can only make an impact from managers operating with illiquid mandates or private investment vehicles. We believe event-driven credit offers investors another source for impact investing, operating entirely within the liquid and public markets.

While investment grade companies can raise corporate debt very cheaply—for example, a 20-year bond—because their investors know the probability of default is low, a typical high yield bond has a maturity date of only four or five years with a higher interest rate. This means high yield issuers, besides having a higher debt servicing cost, are also typically accessing the capital markets every few years to refinance that high cost of capital. As such, we believe high yield issuers are more open to dialogue with managers like ourselves, because their viability depends on access to capital markets.

HIGH YIELD OPPORTUNITY

The MSCI USD High Yield Index represents approximately $1.5 trillion of debt and 2 billion metric tons of absolute, annual carbon emissions (scope 1 and scope 2).[1] For comparison's sake, annual emissions from the issuers in the high yield index are greater than the total emissions from the entire U.S. transportation industry.[2] Yet, high yield companies have largely been excluded from the sustainability discussion. This creates a substantial opportunity for event-driven credit investors like DSC Meridian, for whom collaborative engagement is core to our investment approach. This effort is bolstered by Paula Luff, our Director of ESG Research and Engagement. Paula is a sustainability veteran with over 20 years' experience leading ESG-related initiatives not only within corporations but also within asset management. Armed with this direct expertise, our strategy is uniquely positioned to engage with high yield issuers to shape positive carbon outcomes while also offering attractive absolute returns through the credit cycle.

We hope our firm offers a solution for asset owners who are focused on meeting their return objectives while also decarbonizing their portfolios.

CHALLENGES WITH EMISSION DISCLOSURES

When we looked at the equity market and the companies comprising the Russell 1000 Index, we found only 41% of the companies disclosed data on Scope 1 and 2 greenhouse gas (GHG) emissions to CDP (formerly the Carbon Disclosure Project), a non-profit organization running a global disclosure system used by investors, governments and companies. And, of those companies that disclosed their emission data, only 25% received an A or A- grade, which speaks to the quality and completeness of the disclosure.[3]

The numbers shrink even further when looking at the number of companies by market cap. In 2020, only 17% of the smallest half of the Russell 1000 Index reported their Scope 1 and 2 data to CDP. 65% of the largest half reported to CDP.

When we looked at the 963 companies in the MSCI USD HY Corporate Bond Index, we found only 15% or 143 issuers provided actual Scope 1 and Scope 2 emissions data. With a dearth of available disclosure data, even asset owners who

[1] MSCI Carbon Delta, ISS, DSC Meridian estimates as of 2/28/21
[2] US Environmental Protection Agency, June 2020
[3] http://ga-institute.com/fileadmin/ga_institute/images/FlashReports/2020/Russell-1000/G&A-Russell-Report-2020-FINAL.pdf

are highly motivated to align their portfolios with the Paris Agreement and reward companies making positive steps cannot currently create or manage a decarbonized, diversified portfolio. Small and mid-cap companies are getting more pressure to disclose—from regulators, investors, and even their employees—but they lack the resources of larger companies to do so. The G&A institute shows an increase in reporting, but the companies in our small and mid-cap universe are lean, resource-constrained, and often do not know where to start in terms of target setting and disclosure.

It is not only consumer-facing companies that are being asked to up their ESG game, but business-to-business as well, because their customers have increasing supply chain sustainability requirements. Organizations like Know the Chain are rating larger companies in several industries based on their supply chain practices and Scope 3 emissions. Smaller companies in the value chain need to punch above their ESG weight but lack the resources to fully implement ESG best practices and disclose performance. These companies are not well-covered either by the sell-side or the ESG data providers, but through engagement we have found they are managing one or two ESG risks well as part of operations. This good work is often overlooked because companies do not report on it.

Companies lacking resources to report on their ESG targets and achievements are generally rated lower than peers that do report. This is because the ESG ratings agencies rely on publicly available information in their analyses. If a company doesn't issue a report, it is overlooked, or data is estimated based on industry classification. Disclosure is key to improving ESG scores, but smaller companies, overwhelmed by the various reporting frameworks and competing stakeholder demands, often don't know where to begin. We have found that our in-house ESG expertise is highly valued by our portfolio companies as they navigate this complex landscape. As a result, many companies are eager to dialogue as they need the help and guidance to address the seemingly daunting sustainability initiatives being asked by investors. This problem creates an untapped market ripe for impact for a fund with extensive experience in productive engagement in the high yield space.

CHALLENGES ALIGNING WITH THE PARIS AGREEMENT

To achieve the objectives of the Paris Climate Agreement, corporations must decarbonize. Beyond the first step of appropriately disclosing their emissions data, another enormous challenge exists with high yield issuers—only 11% of the issuers currently have a 2-degree Celsius warming potential or below. Said differently, only 9% of the $1.5 trillion of high yield debt outstanding in the U.S. is currently aligned with the Paris Agreement.

89% of the issuers in the High Yield Index need to take immediate, aggressive steps to set science-based targets and reduce emissions over time.

If we look at the United Nations' Sustainable Development Goal #13 "Climate Action," there are 6,488 companies covered by ISS (Institutional Shareholder Services) whose business activities negatively contribute to advancing it. Only 2,703 companies had neutral or some positive contribution to advancing the goal of "Climate Action."

70% of companies covered by ISS need to focus on addressing their impact on climate change.

These non-aligned companies face immense challenges in this endeavor. It's one thing for a CEO to attend a sustainability conference and declare that the company will be carbon neutral by 2050. But for some companies in high carbon intensity industries, there aren't enough trees to plant to offset their emissions. Recycling waste, installing LED lightbulbs, and other marginal activities will not be enough to get to net zero. Instead, companies must transform their businesses, which requires leadership, the right incentive alignment, and a commitment to innovation and investment in technology.

These formidable challenges create an opportunity for experienced investors in the ESG space to influence and shape companies' ESG and carbon outcomes in a profound way. The brand of technical skill we have in-house at DSC Meridian is invaluable for these resource-constrained, lean enterprises that need a fit-for-purpose solution. The majority of small and mid-cap companies we have spoken with do manage at least a couple of ESG risks as part of their operations. Often, they benchmark themselves to large ESG leaders in other industries, as opposed to companies of similar size and focus. They struggle with materiality assessments and target setting. They are confused by the alphabet soup of ESG frameworks and assume an all-or-nothing approach to disclosure as opposed to a focused, fit-for-purpose solution.

Instead, they need to discern the three to five priorities that matter most to their business and demonstrate to their stakeholders they are rigorous about those tasks—setting meaningful reduction targets, identifying who is responsible for implementation, ensuring Board oversight and integration of ESG into the operating rhythm of the company. Investors are looking for decision-useful information and clear communication. In this way, our work is more nuanced than the stereotypical activist investor—instead of sharp elbows, we use active collaborative engagement and regular conversations to guide and sometimes augment what the company is already doing.

To achieve our goal of improving disclosure and company performance on climate metrics, we will measure the progress of companies in that regard and the portfolio over time, while remaining nimble and responsive as the science advances, as disclosure improves, and as the portfolio evolves.

AREAS OF HIGH RETURN & HIGH POTENTIAL IMPACT

By the very nature of their enormous size, larger institutions, like pension and sovereign funds, can only truly focus on the largest companies of the public equity sector. Certainly, we must give accolades to the largest asset managers who have made tremendous headway using their equity capital to vote proxies and push for change with the Fortune 500 companies. However, their approach is almost entirely equity-centric.

While there are many credit instruments that rank high on the impact scale, i.e. green bonds and sustainability bonds, their return expectations are much lower than an institution's long-term cost of capital. Within the ESG ecosystem, investor, media, and asset manager attention tends to focus on the big players—Starbucks, Amazon, Walmart—the typical colossal companies whose debt is rated investment grade and low yielding. Comparatively, high yield companies offer investors a universe of investable companies ripe for engagement and ripe for a higher return potential.

ESG is often treated in a portfolio as a "flavor of the month" or a perfunctory checking off of a box. But we are not looking to check a box—we are looking to move the needle. And DSC Meridian does not target concessionary returns. We are a hedge fund, first and foremost. We are fundamental investors who use ESG across the board as a strategic tool in our research process, in our underwriting, and engagement with companies.

WHY ENGAGEMENT IS SO IMPACTFUL WITHIN HIGH YIELD

We believe high yield issuers are more open to dialogue with managers like ourselves, because their viability depends on access to capital markets. Without event-driven credit investors, who would step up and support the bonds of a levered company with a high probability of default? Who would help a high yield issuer refinance its debt, albeit at a higher cost of capital than investment grade companies? CFOs welcome an open dialogue with DSC Meridian because we can be constructive about the fundamentals of their business as well as their sustainability challenges. We can engage with companies to set science-based targets with at least >8% year-over-year emissions reductions helping align them with the Paris Agreement and contribute positively to SDG #13, Climate Action.

This impact is very evident during an active corporate restructuring, where, as a creditor in the bankruptcy, we have influence to affect the company. In the moment when creditors own the company, enormous change is possible. The ground is broken, the soil is accessible, and we wield the tools, materials, and seeds to shape positive financial and sustainability outcomes long into the future. Creditors can hire or fire management, replace the board, divest businesses, or reorganize around sustainable businesses, establish board oversight in these areas, and even link executive compensation to sustainability performance. The DSC Meridian investment team has worked on restructuring over 100 companies collectively over the years. Having a keen understanding of the "restructuring" playbook presents a material opportunity to engage distressed companies and shape positive outcomes; we are well-positioned to engage companies and implement positive change.

We find that, even in the light touch engagement, the ESG conversation gives us a more fulsome picture of the quality of management and their focus on strategy execution. Our in-house ESG expertise is highly valued by companies and as a result, we gain access to a range of executives within the firm that we may not normally have the opportunity to engage. Depending on which ESG issue we're probing, we may speak with the chief human resources officer who focuses on talent, the chief information officer around data privacy and cybersecurity, the head of environment, health and safety, or the head of sustainability, to name a few. We are exposed to a wider range of corporate management: insight that helps us fill in information gaps on some of those qualitative issues we look at in the investment process. All of this leads to better underwriting and higher conviction in our investments.

CASE STUDY: CRUISE LINE "C"

As part of ESG integration, we examine our portfolio sector by sector to assess each company's carbon footprint and compare it to its peers. During a recent portfolio review of our cruise line holdings, we noticed that Cruise Line C was a clear outlier with higher emissions and a higher warming potential than its peers according to third party ESG data: an odd finding, considering that the companies' businesses are very similar and they burn the same fuel.

When we dug into the company's own disclosures, Cruise Line C's sustainability report lacked clear, decision-useful information, which we guessed contributed to its lower third-party ESG rating. However, we identified existing positive momentum, including a new Board committee with sustainability oversight and a new ESG department in charge of ESG integration and disclosure.

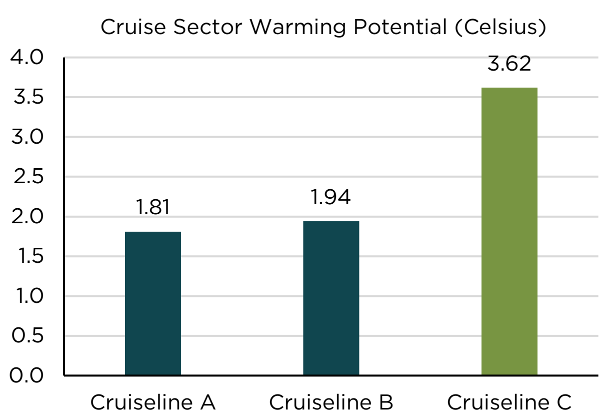
No executive wants their company to be an industry laggard by any metric. When we shared the bar charts below, they caught the immediate attention of the CFO. Cruise Line C had a higher warming potential and their unsecured bonds traded at wider levels then peers. This simple graph led to a series of meetings. The CFO's feedback was almost exactly what we hear from many of our high yield issuers: ***ESG was a strategic priority, but the company was resource-constrained***. It was clear that they would greatly benefit from our consultation and we offered to advise the team on a fit-for-purpose initiative.

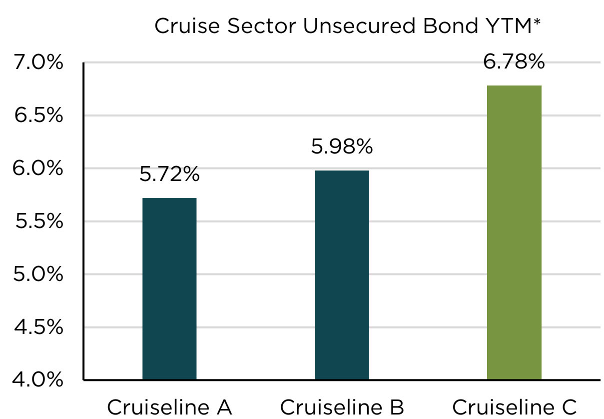
Today's engagement is wide ranging in scope: helping them understand "best practices" in their sector, connecting them with the ESG ecosystem including thought-leaders, non-profit organizations, and invitation-only industry events, helping them improve communications with ESG ratings companies, and, lastly, advising them on sustainability strategy and implementation. The company is currently working to be the first cruise line to report using the SASB framework (report to be issued later this year), then begin to address the Paris Agreement and setting science-based emissions reduction targets in 2022. If next year, Cruise Line C attempts to align with Paris, we feel that our efforts to limit temperature rise this century, no matter how small a part we played, will have made real impact.

CONCLUSION: A MARATHON, NOT A SPRINT

There is a reason so few investors are taking this approach: if it were easy, more people would be doing this. Unimaginable climate challenges require unprecedented business thought and strategy. DSC Meridian is engaged: helping shape ESG outcomes and financial performance. There is a neglected set of companies out there we are able to reach, representing a lot of emissions and a lot of debt. Not only do we help companies get to the starting line, but we also help them create long-term strategies that will create positive climate impact and compelling returns for our investors.

Our goal is to generate both investment alpha and climate alpha. Our multi-cycle approach to portfolio construction combined with an opportunistic, event-driven toolkit focused on exploiting mispriced corporate credit leads to investment alpha. Through corporate engagement we can exploit information asymmetries and better understand a company's carbon footprint. And, through security selection we can construct a portfolio that limits asset owner contribution to rising global temperatures and help shape positive carbon outcomes: lower carbon emissions lead to more sustainable businesses, better equity performance, and a lower probability of default, resulting in credit outperformance.





Source: DSC estimates, MSCI Carbon Delta, Bloomberg as of 1/31/21

LEARN MORE

If you would like to learn more about DSC Meridian, please contact:

- Jay Blount, Director of Business Development and Investor Relations. jay@dscmeridian.com
- Paula Luff, Director of ESG Research & Engagement. paula.luff@dscmeridian.com

IMPORTANT DISCLOSURES

This document is not an offer to sell or the solicitation of an offer to buy interests and/or shares in a fund managed by DSC Meridian Capital LP. An offering of interests or shares will be made only by means of a confidential private offering memorandum and only to qualified investors in jurisdictions where permitted by law.

All of these risks, and other important risks, are described in detail the Fund's Memorandum. Prospective investors are strongly urged to review the Fund's Memorandum carefully and consult with their own financial, legal and tax advisors before investing. The information in this investor presentation is current as of the date listed on the cover page and is subject to change or amendment. The delivery of this investor presentation at any time does not imply that the information contained herein is correct at any time subsequent to such date. Certain information contained herein has been supplied to DSC Meridian by outside sources. While DSC Meridian believes such sources are reliable, it cannot guarantee the accuracy or completeness of any such information.

The information presented herein is confidential and proprietary, and may not be (i) used by, or on behalf of, you for any purpose other than evaluating an initial or continued investment in the Fund, or (ii) disclosed by, or on behalf of, you to any third party, in each case except with the prior written consent of DSC Meridian. This investor presentation does not constitute an offer of interests or shares in the Fund to investors domiciled or with a registered office in the European Economic Area ("EEA"). None of the Fund, DSC Meridian or any of their respective affiliates currently intends to engage in any marketing (as defined in the Alternative Investment Fund Managers Directive) in the EEA with respect to interests or shares in the Fund. Receipt of this investor presentation by an EEA investor is solely in response to a request for information about the Fund which was initialed by such investor. Any other receipt of this investor presentation is in error and the recipient thereof shall immediately return to the Fund, or destroy, this investor presentation without any use, dissemination, distribution or copying of the information set forth in this investor presentation.

The fund does not need to be licensed for distribution to non-qualified investors with the Swiss Financial Market Supervisory Authority (FINMA) as a foreign collective investment scheme pursuant to Article 120 paragraph 1 of the Swiss Federal Act on collective investment schemes of June 23 2006 as amended (CISA). Accordingly, pursuant to Article 120 paragraph 1 of CISA the shares may only be offered, and an offering memorandum may only be distributed into or from Switzerland by way of distribution to qualified investors as defined in Article 10 paragraph 3 of CISA and its implementing ordinance, if the fund has appointed a representative and a paying agent in Switzerland. Investors in the shares do not benefit from the specific investor protection provided by CISA and the supervision by FINMA in connection with the licensing for distribution.