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Independent Credit Research LLC

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August 2016 Preview

To illustrate the accuracy of our forecast, we recommend comparing our December 2015 projections with actual results.

In December 2015, we projected stronger 2016 high yield market and the thesis was that “Some healthy middle-market credit names will be the biggest winners in 2016, since they have been hurt more than liquid names in 2015.” “We believe that HY markets will rebound because there is a large number of technically oversold bonds, RATHER THAN BECAUSE WE BELIEVE THAT SPREADS WILL TIGHTEN FURTHER DUE TO ECONOMY IMPROVEMENTS.”

During the first 8 months of 2016, our recommendations have delivered healthy 28.1% absolute and non-annualized return to those investors willing to follow our calls. We sincerely hope that your results have been stronger... So far, this year we have added the following names under our research coverage:

- Fortescue metals
- IAM Gold
- Tibco Software
- iHeartMedia
- Calumet Specialty Products

We have currently turned our attention to several European and emerging markets opportunities. We do not share yet the enthusiasm of those private equity distressed investors buying the debt of distressed middle-market oil and gas drillers and other oil-related providers. We feel that timing of their future exit strategies is extremely uncertain and that these investments are potentially heavily illiquid. Investors may end up becoming proud owners of large amounts of oil and gas assets that they will not be willing to drill for a while due to consistently low prices...The price of oil development is the product of irrational behavior of many sovereign countries where the industry is either controlled or owned by the state. Governments of these countries often make decisions inconsistent with those learned and practiced by most of the U.S. based portfolio managers in their business school classrooms. U.S. administration, on the other hand, will let the market regulate the future of the large number of oil-related bankrupt companies in the U.S. and to a less extent in Canada. The idea of the U.S. oil independence was interesting but the execution and the ability to support the thesis have been impotent and inconsistent. As an investor in oil and gas, you are likely going to develop an illusion of alpha generation, rather than a fundamental investment thesis. Stay away but start exploring potential survivors outside bankruptcy courts – that’s our \$0.02 cents to fans of leveraged bets on oil and gas.

We feel that the nature of uncertainties related to metals and chemicals is completely different from the one of related to oil and gas. Recent examples of Fortescue, IAM Gold (and many other gold miners), and to a less extent, of Barmenco and Ausdrill, have been proving our thesis. China has developed a substantial overcapacity of steel and chemicals’ production. It is rationalizing steel supply and is trying to become the largest exporter of commodity-based chemicals in the Southern hemisphere. In the meantime, recent conference calls of Ausdrill and Boart Longyear suggest solid positive changes in the future of gold miners – more exploration drilling is being performed, and our Barmenco promises to become a beneficiary of these changes.

We still prefer investing in good companies, rather than making bets on the future market performance. We still like making capital structure arbitrage trades in good companies with egregious balance sheets. Before exploring the balance sheet, we normally explore the industry and the company’s place in the industry hierarchy. We certainly hope that this philosophy has helped us to generate decent average annual returns exceeding 25% on our recommendations during the last 7 years.

Results

1. Ace Cash Express notes have delivered 58.7% absolute return.
2. Affinion 2nd-lien debt and the 7.875% notes have delivered 6.6% and 7.8% returns, respectively, since the year start.
3. Algeco Scotsman – the 8.5% and the 10.75% notes have delivered 11.9% and 70.4% return, respectively, to investors.
4. Alliance One International has returned 25.5% yield to investors during the first 8 months of 2016.
5. Avaya Inc. – investors have made 6.4% total return in 2016 on a combination of several long-short trades.
6. Barmingo bonds have delivered 19.3% yield to investors in 2016.
7. CCFI notes have produced 127.8% return in 2016.
8. Dyncorp 10.375% notes brought investors 20.1% return through the period of our Buy recommendation.
9. Hexion 8.875% and 9.0% notes have brought 39.6% and 89.7% returns to investors in 2016, respectively.
10. SGMS 10% notes have delivered 40.9% return through 2016, while our equity short hedge has delivered zero return.
11. Our February call on Fortescue metals have brought investors in the 9.75% and the 6.875% notes 35.6% and 72.9% yields, respectively.
12. Tibco Software long-short call has brought negative 0.3% return to investors so far in 2016.
13. IAM Gold notes have brought 18.9% return to investors in 2016.
14. Calumet Specialty Products notes have delivered 5.9% return to investors since July 2016.
15. iHeartMedia 2019 9.0% notes and 2019 bank debt have brought only 1.2% and 0.3% since the initiation of research coverage 2 weeks ago. We like the story for two major reasons:
 - It is a good company with the best management in the industry. The rumors of the radio business being a melting ice cube are inconsistent with the stable pattern of the company's sales and EBITDA.
 - The company generates around \$1.8bn of annual cash EBITDA. Out of this amount, it needs to spend around \$325mm on capital expenditures and around \$375mm on CCO cash interest expense. It leaves \$1.1bn to be distributed between the cash interest expense for iHeartMedia \$13.5bn secured debt and the future equity post-restructuring. Moreover, the market value of the iHeart secured debt is only \$10.5bn. As such, the \$1.1bn of annual cash represents a juicy and likely growing return for investors.

If you are interested in our updated views on securities mentioned in this update, please contact us.

Disclosure Regarding Research Report

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