Distressed, or Questionable Quality Securities

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What is Distressed?

- Dozens of various investment strategies, depending on investment style, expertise of portfolio managers and market conditions.
- Most common strategies vary in regards to the size of include:
  1. 15.0% + yield hunting within performing credits without any interest in possible bankruptcy scenario participation – active trading; active capital structure arbitrage usage; active hedging using indices;
  2. Trying to buy only fulcrum securities of companies that will likely need to restructure and holding positions in bankruptcy – infrequent trading;
  3. Litigation – intense distressed strategy;
  4. Own to control;
  5. Combination of (1) and (2)
- We understand distressed world in today's market as buying a liquid fulcrum security of those global companies that will likely need to restructure at some point, and this restructuring will present an opportunity to enhance operating performances and investment returns through the new equity of restructured companies. If the company avoids restructuring, investors will gain superior investment returns above 15% through the price appreciation of fulcrum debt security. Distressed always exists somewhere…

Distressed is…

Investment in a company's fulcrum debt security representing the best risk-adjusted return in a target company's capital structure. We invest in healthy companies with sustainable competitive advantages in their industry, that for various reasons have been experiencing financial difficulties associated with their free cash flow or unsustainable balance sheets. (good companies, bad balance sheets).

In stressed cases

- We seek long investments in high coupon, low duration debt securities of companies that will be able to avoid restructuring and will outgrow their over-leveraged balance sheets through changing industry cycles or through internal operating improvements.
- Companies that certain investment institutions can no longer hold due to minimum rating requirements. With rare exceptions, we prefer to avoid debt investments in companies who are likely to file for bankruptcy protection within the next 12 – 18 months, recognizing that we will likely be able to buy them later at cheaper levels offered by the financial markets.

Distressed is…*(continued)*

In distressed cases, we seek total returns exceeding 25% on fulcrum debt investment opportunities typically related, but not limited to:

- Market overreaction on a bankruptcy announcement or any other headline news;
- Debt fulcrum securities that will generate superior returns through liquid future equities of fundamentally healthy companies with over-leveraged capital structures that were unable to outgrow their balance sheets due to prolonged industry weaknesses;
- Sovereign or quasi-sovereign securities or corporate debt of strategically important companies for local municipalities or governments.

Our strategy is related to debt investment opportunities that in our opinion, will provide par recoveries either through a restructuring or through fundamental operating improvements outside bankruptcy court.

Separate Credit Risk from the Market Risk

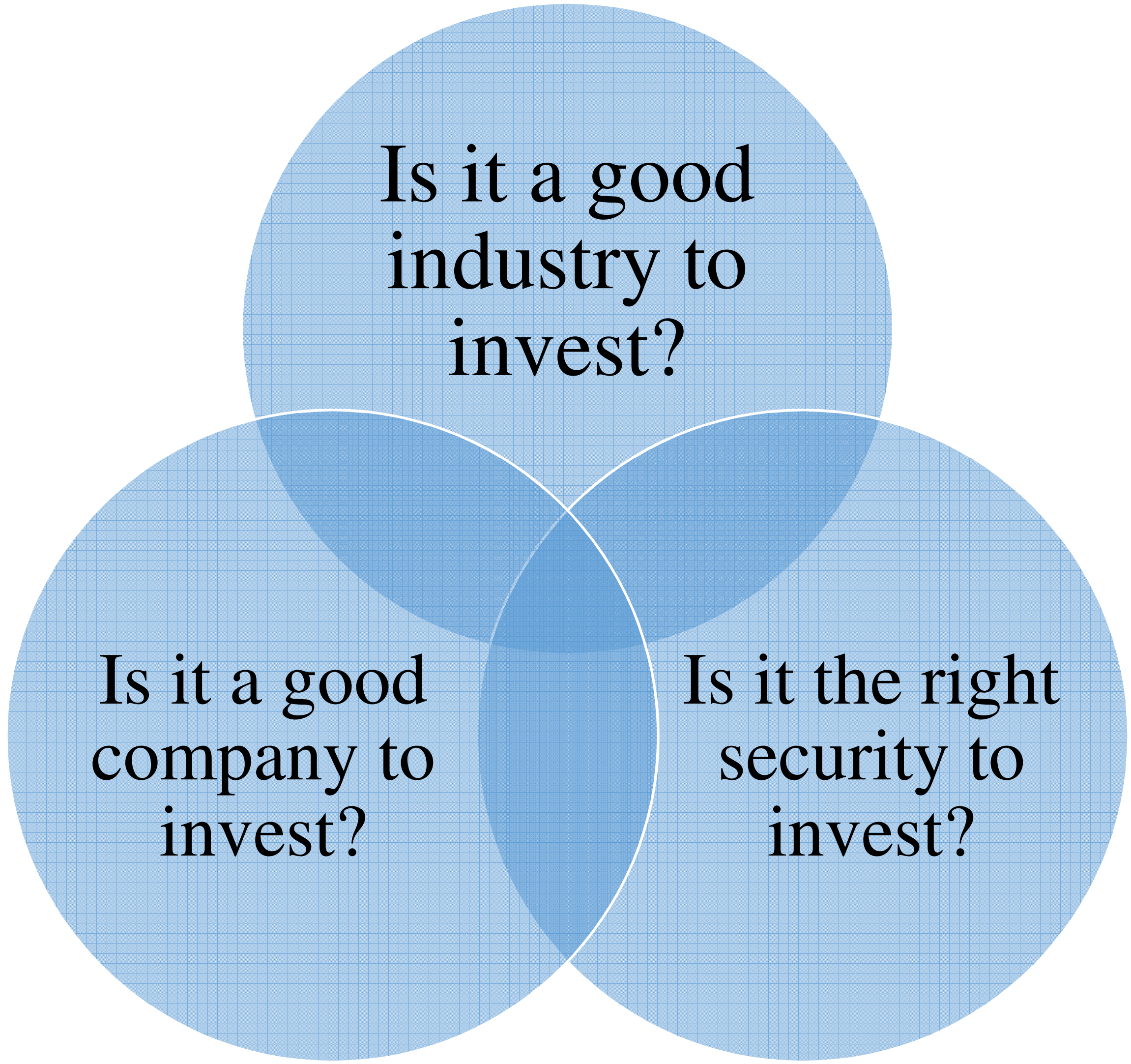
In capital structure arbitrage tranches of large balance sheets can be mispriced due to market technical reasons, and once re-equilibrated we are looking for total returns exceeding 20%. The most typical example of capital structure arbitrage, is related to a pre-bankruptcy case when the entire debt capital structure is trading based on yield to maturities of each individual bond, and markets fail to acknowledge that the entire capital structure should be trading based on yield to bankruptcy announcement triggered by the nearest maturity.

We purchase relatively low-yield (between 8.5% and 11.0% yield to worst) performing debt in anticipation of the catalyst-driven price appreciation in the near-term.

We short equities mainly in cases of pre-bankruptcy capital structure arbitrage or when we believe that equity represents the best shorting instrument in the industry segment that we want to short for risk management considerations.

We short liquid corporate bonds either in case of the anticipated bankruptcy filing or during the bankruptcy when we believe that the bankruptcy exit will result in a new equity sell off and when we know that we can roll over our debt short into a new equity short.

Due Diligence Framework



Is it a good time to invest in distressed?

Global socio-political stresses are at decade highs; Sunni/Shia, ISIS/Syria/Iraq, Brexit, Turkey/Kurds, Russia/Ukraine, China/Greater Asia will continue to cause rising levels of volatility.

Global GDP growth is decelerating (primarily in developed countries) as baby boomers retire and structural economic challenges are not being addressed. The Global Central Bank's QE programs are unsustainable over the long term potentially causing increasing inflation or stagflation;

Decelerating demand in Developed Markets is causing a cascading problem to Emerging markets through commodities due to the heavy reliance of Emerging Markets on the export of commodities.

Global corporate leverage is high, and due to slower global growth, there are going to be an increasing number of companies that will not be able to grow into their capital structures and will be forced to restructure.

Restrictive regulatory environment – due to fears of too big to fail, regulatory agencies globally are enacting regulations that are forcing banks to de-lever and pushing out the marginal borrowers when they need to refinance their debt.

We think so…

A large number of investors - shale boom victims - has been facing the necessity to support oil and gas companies with fresh liquidity to sustain their equity optionality. The size of oil and gas investments has been so large that attention of many investors has been distracted from other, more attractive and fundamental industry opportunities, without material exposure to the general market volatility.

General advancement of ETFs, resulting in massive selloffs by high yield mutual funds and poor performance of distressed funds has resulted in substantial redemptions of institutional capital from funds with shorter lock up periods. More 2016 – early 2017 high yield sell off is expected.

- ***Consequently we believe that:***

2017 -2018 will likely to become inflection years in the global credit cycle – due to the confluence of the above factors or some yet unknown factors, companies will no longer be able to ride the wave created by the global central banks and maintain their current capital structures.

Human Will versus Forces of Nature - The convergence of these factors will likely create an increasing level of attractive stressed/distressed investment opportunities.

Distressed Evolution

- Generally declining interest of investors in bankruptcy participation, since prospects of getting superior returns through newly issued equities are questionable;
    1. Uncertain conditions of many industries make structural risk of equity underperformance often insurmountable. As a result, distressed investors often prefer to continue getting the coupon as long as they can instead of restructuring;
    2. More mutual funds with no distressed experience with large holdings of distressed credits prefer to refinance rather than to force the bankruptcy filing, regardless of the long-term future of the company.
- Distressed investment has become even more legally-intense. Debtors and its frequent private equity owners are seeking to extend their optionality by refinancing looming maturities by accepting prohibitively expensive debt deals masterpiecing various carve-outs. As a result, mutual funds that traditionally would have sold their distressed debt positions are still keeping them actively participating in refinancing deals.
- Large distressed funds have raised unusually high amounts of long-term capital in anticipation of the waterfall of distressed opportunities. The oil-based bad debt waterfall had arrived but distressed investors have not expressed enthusiasm about it.

Current Investment Ideas - Avaya

Cash as of March 31, 2016	$312					MV / LTM		*Yield to*	*Cash*
	Interest	**Maturity**	**Face Value**	**Market Price**	**Market Value**	**Adj. EBITDA**	***YTW***	***26-Oct-17***	***Interest***
Capital Leases & debt at subs			$67	*100.0%*	$67				
$335mm ABL Revolver	*L+1.75%*	6/4/2020	$48	*100.0%*	$48	$122mm outstanding LCs			*$1*
$150mm ABL Revolver	*L+1.5%*	6/4/2020	$55	*100.0%*	$55	$23mm outstanding LCs			*$2*
Term Loan B3	*L+4.50%*	10/26/2017	$616	*72.0%*	$444		*29.7%*		*$22*
Term Loan B4	*L+6.25%*	10/26/2017	$1	*100.0%*	$1				*$0*
Term Loan B6	*L+5.5%*	3/31/2018	$537	*70.6%*	$379		*27.0%*		*$27*
Term Loan B7 (1.0% Floor)	*L+5.25%*	5/29/2020	$2,100	*68.3%*	$1,433		*17.0%*		*$128*
7.00% Senior Secured Notes	*7.00%*	4/1/2019	$1,009	*70.0%*	$706		*22.0%*	*37.3%*	*$71*
9.00% Senior Secured Notes	*9.00%*	4/1/2019	$290	*73.5%*	$213		*22.3%*	*35.4%*	*$26*
Total 1st-lien secured debt			$4,723		$3,346				*$277*
Net 1st-lien debt			$4,411		$3,034	**4.7x**			
2nd-lien secured notes	*10.50%*	3/1/2021	$1,384	*24.0%*	$332		*60.7%*	*168.4%*	*$145*
Total Secured Debt			$6,107		$3,679				*$422*
Total Net Secured Debt			$5,795		$3,367	**7.3x**			
Total Debt, excluding pensions			$6,107		$3,679				
Total Net Debt			$5,795		$3,367	**LTM EBITDA**		**$667.8**	

Avaya - *continued*

Liquidity as of March 31, 2016	
Cash	$312
Liquidity under Domestic ABL	$335
Liquidity under foreign ABL	$150
Total liquidity	$797
Cash interest in 2016e	
1st-lien debt interest expense	$281
2nd-lien interest expense	$145
Total cash interest expense	$426

Fixed Charges	2016e
OPEB & pensions	$155
Cash interest & amortization	$450
Capex	$125
Income tax	$55
Restructuring	$105
2015 Fixed charges, including cash interest, OPEB, Capex, taxes and restructuring	$890

Implied cash EBITDA needed	
Fixed charges	$890
Pension & OPEB	($155)
Implied EBITDA	$735

Current Investment Ideas - Barminco

	Face Value	Price	Market Value	Leverage
Bonds	$433,346	*80.0%*	$346,677	3.4x
Cash	$105,726		$105,726	
Net Debt	$327,620		$240,951	2.4x
Incl. AUMS				
Bonds	$433,346	*80.0%*	$346,677	2.8x
Cash	$113,726		$113,726	
Net Debt	$319,620		$232,951	1.9x

Recent Investment Case - Ukreximbank

Second largest overall and the largest state-owned bank in Ukraine

The bonds were pari passu with deposits – default would have implied a possible run on bank deposits

Default would have been considered a political failure of the West during the war between Russia and Ukraine

The bonds were maturing several months prior to the maturities of the sovereign notes

The price of the bonds before restructuring talks was 45 cents. Today’s price is 95 cents

Similar strategically important companies in Ukraine include Metinvest, Ukrainian Railways, among several others.

Current Investment Ideas - IAMGold

Cash Interest	Security	Coupon	Face Value	Market Price	Market Value	LTM Leverage	YTW
	Cash as of March 30, 2016		$658.1				
$0.0	Ressources Quebec facility	*NA*	$0.0	*100.0%*	$0.0	$140mm total size	
$0.0	HoldCo Credit Revolver	*NA*	$0.0	*100.0%*	$0.0	$250mm total size	
	Total Secured Debt		$0.0		$0.0		
$42.9	Sr. Unsecured notes due 10/01/2020	*6.75%*	$635.0	*89.0%*	$565.2		*10.0%*
	Total Debt		$635.0		$565.2	**2.4x**	
	Total Net Debt		($23.1)		($93.0)		
	Equity shares		405.9	$4.00	1,623.6	**6.9x**	
	LTM EBITDA		$233.5				

Implied EBITDA	**Low**	**High**
Cash interest	$43	$43
Cash taxes	$18	$30
Normalized Capex	$250	$275
Changes in WC	($10)	$50
Implied EBITDA	$301	$398

Recent Performance of Recommended Names

We continue to like the notes of Ace Cash Express and Community Choice Financial. The price of the bonds has increased from 36.0 in the beginning of the year to 46.25, providing investors with the superior return through the first 6 months of the year.

Affinion capital structure – we continue to be bullish on the entire company's balance sheet. The 2nd-lien debt has traded down from 87.0 to 75.0 since the beginning of the year. Similarly, even the 1st-lien debt has traded down from par to 92.0 since January 1, and the 7.875% notes traded down from 65.0 to 49.0. However, as we have mentioned above, Affinion represents a rare investment opportunity where investors should be actually willing to get the company in the bankruptcy court to obtain the equity status.

Algeco Scotsman – we continue to like the combination of the 8.5% secured and the 10.75% unsecured notes. The 8.5% notes have traded up slightly from 84.25 on January 1, 2016 to the most recent price of 84.5. They are still attractive, in our view. The 10.75% notes have also traded up from 39.75 to 41.25 through the first 6 months of the year. We continue to like the idea of having a combination of both bonds, with 80% of cash spent for the 1st-lien paper.

Recent Performance of Recommended Names - *continued*

Alliance One International – one of the most exciting and oversold stressed opportunities in the market. The bonds have traded up from 77.0 to 88.75 since the beginning of the year. We still like them.

Dyncorp bonds have been volatile lately, in correlation with the refinancing deal announced in May. We suggested to sell them in the high 80's after the deal was announced. Now, the bonds are back in the mid 70's and we still believe that they are attractive at current prices.

Hexion – we like the combination of the 8.875% and the 9.0% notes. The capital structure has been up since the year start. Specifically, the 8.875% notes have traded up from 70.5 in the beginning of January to the most recent level of 85.75. We still like the 1.5-lien notes.

We continue to like the long-short trade idea in the SGMS capital structure.

We continue to like the long-short trade idea in the TIBCO Software capital structure.

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