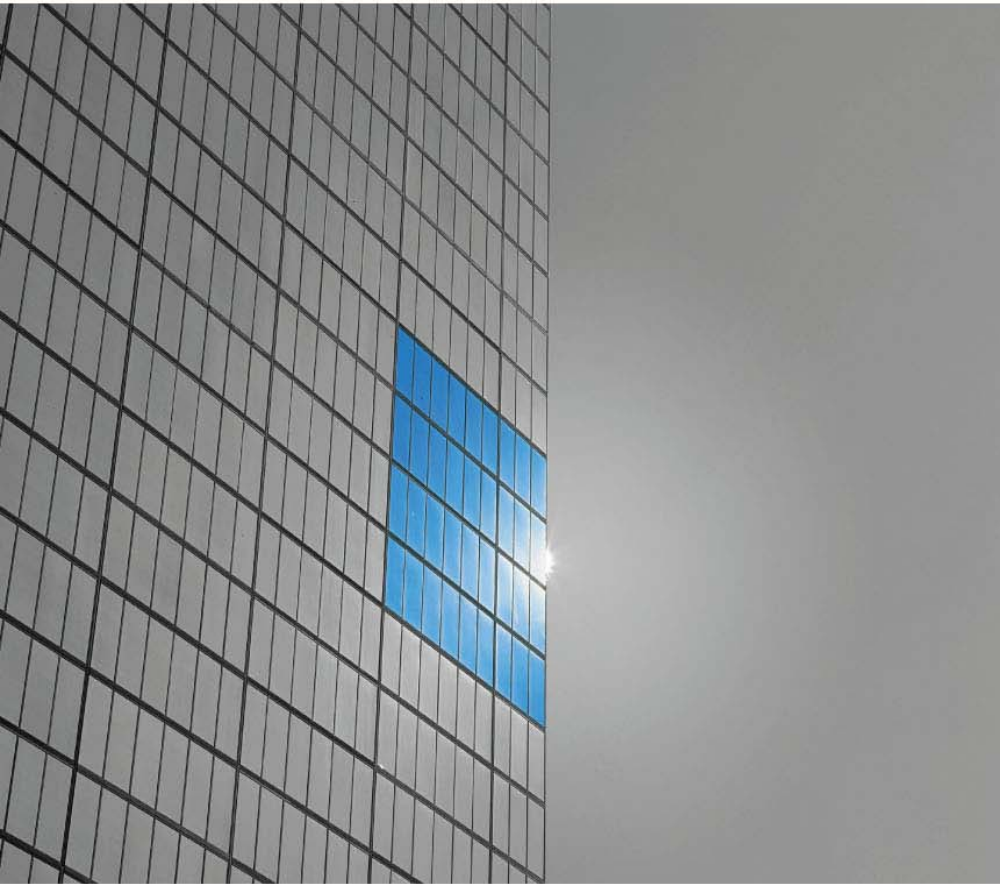


Opportunity. Insight. Access.



Opportunities in Event Driven Strategies

Texpers 21st Annual Conference

April 13, 2010

Robert Feingold,
Managing Director
Babson Capital Management LLC

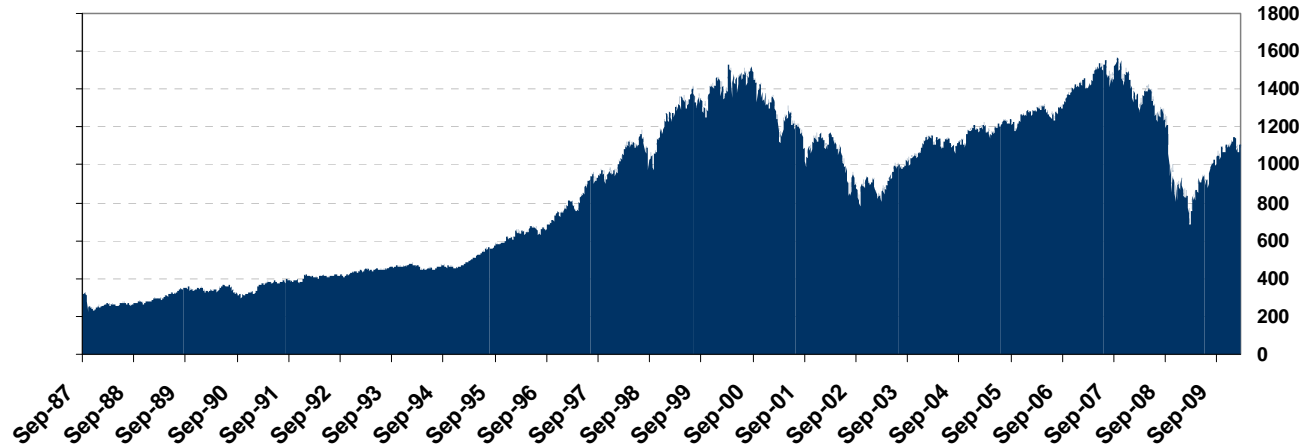
Babson
Capital
MANAGEMENT LLC

- **Background / Overview**
- **Market Environment**
- **Index Performance**
- **Event Driven Strategy Descriptions**
- **Market Opportunity for Event Driven Strategies**

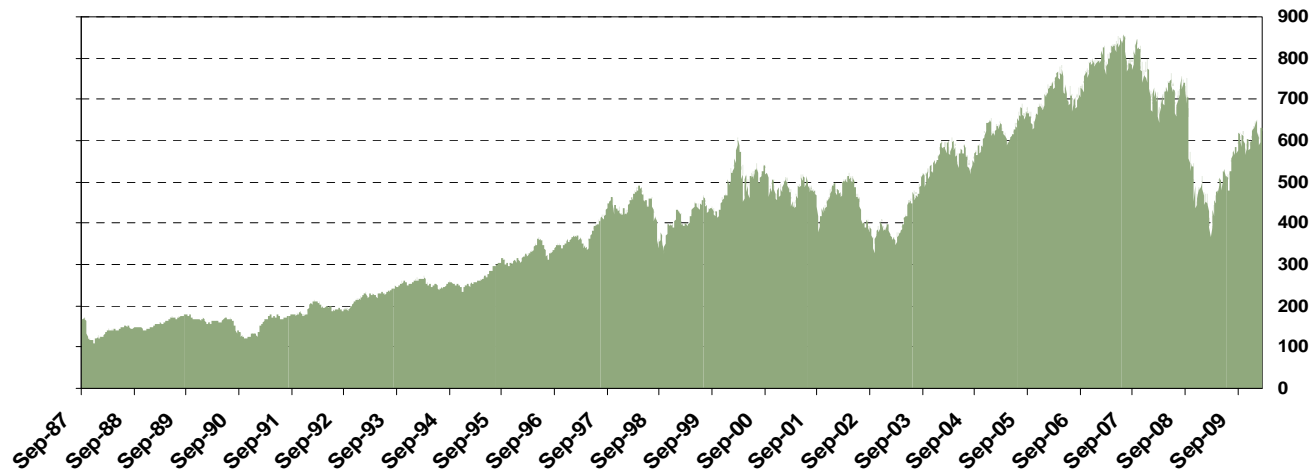
What is “Event Driven”?

- **Event Driven strategies seek to capture price movements caused by significant corporate events**
- **Some examples of corporate events include:**
 - **Restructurings / Bankruptcies**
 - **Tender offers / Buybacks**
 - **Debt Exchanges**
 - **Mergers / Asset Sales**

S&P 500 Index

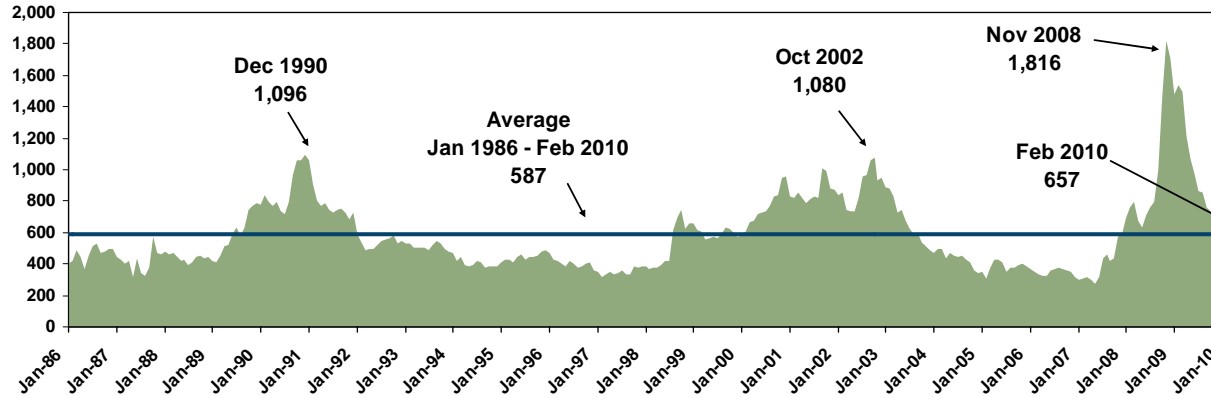


Russell 2000 Index

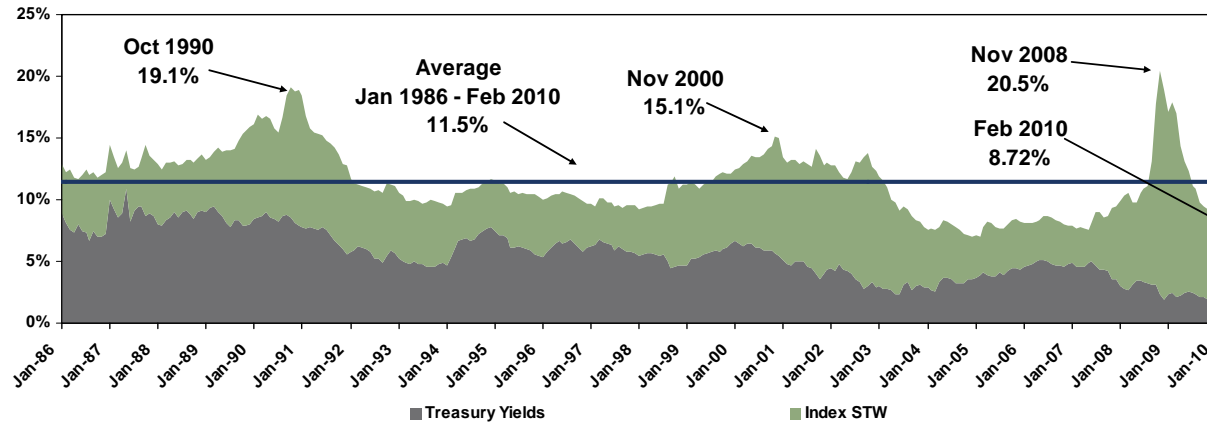


Source: Bloomberg

High Yield Market – Spreads



High Yield Market – Yield Composition

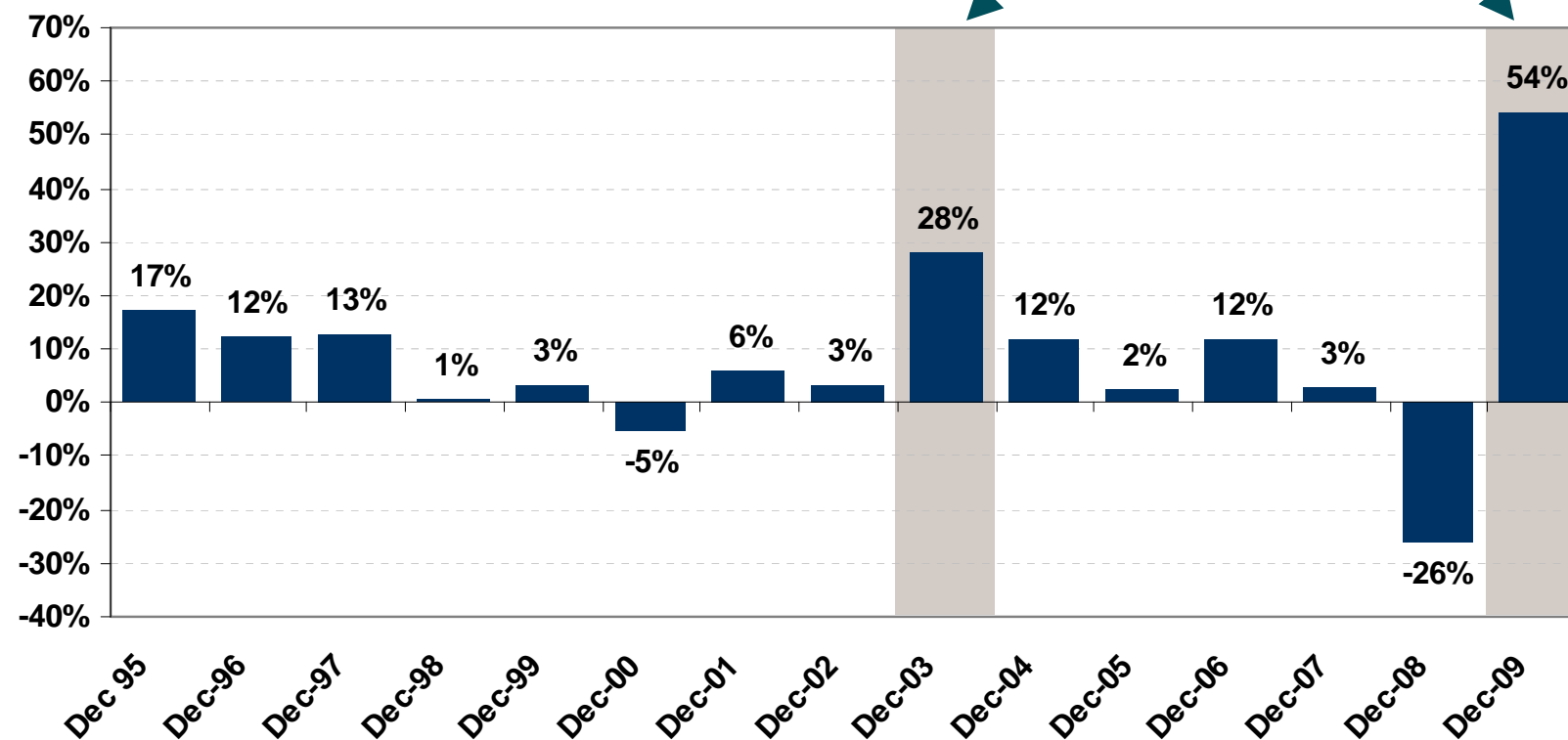


While spreads are still wide to historical averages, absolute yields are not

Source: Credit Suisse High Yield Index

Credit Suisse High Yield Index - Annual Returns

Market Recovery

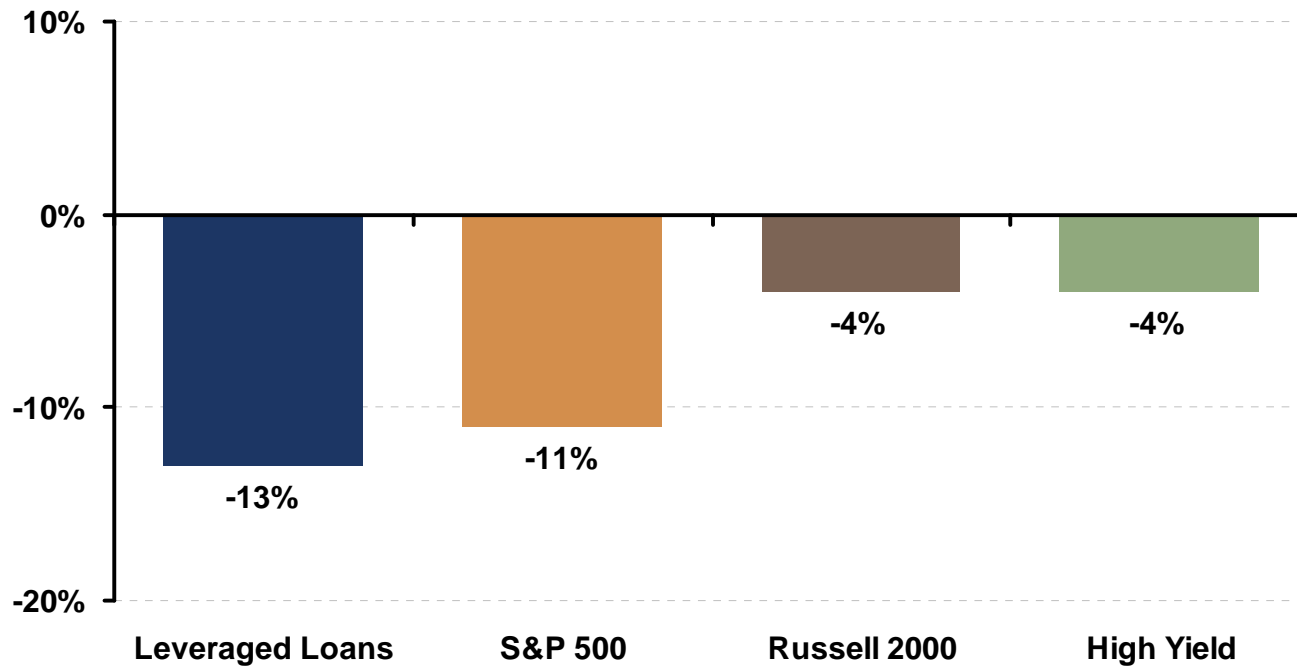


Source: Credit Suisse High Yield Index

Credit and Equity Markets: Post Recovery to Trough

Index Returns

December 31, 2003 – December 31, 2008

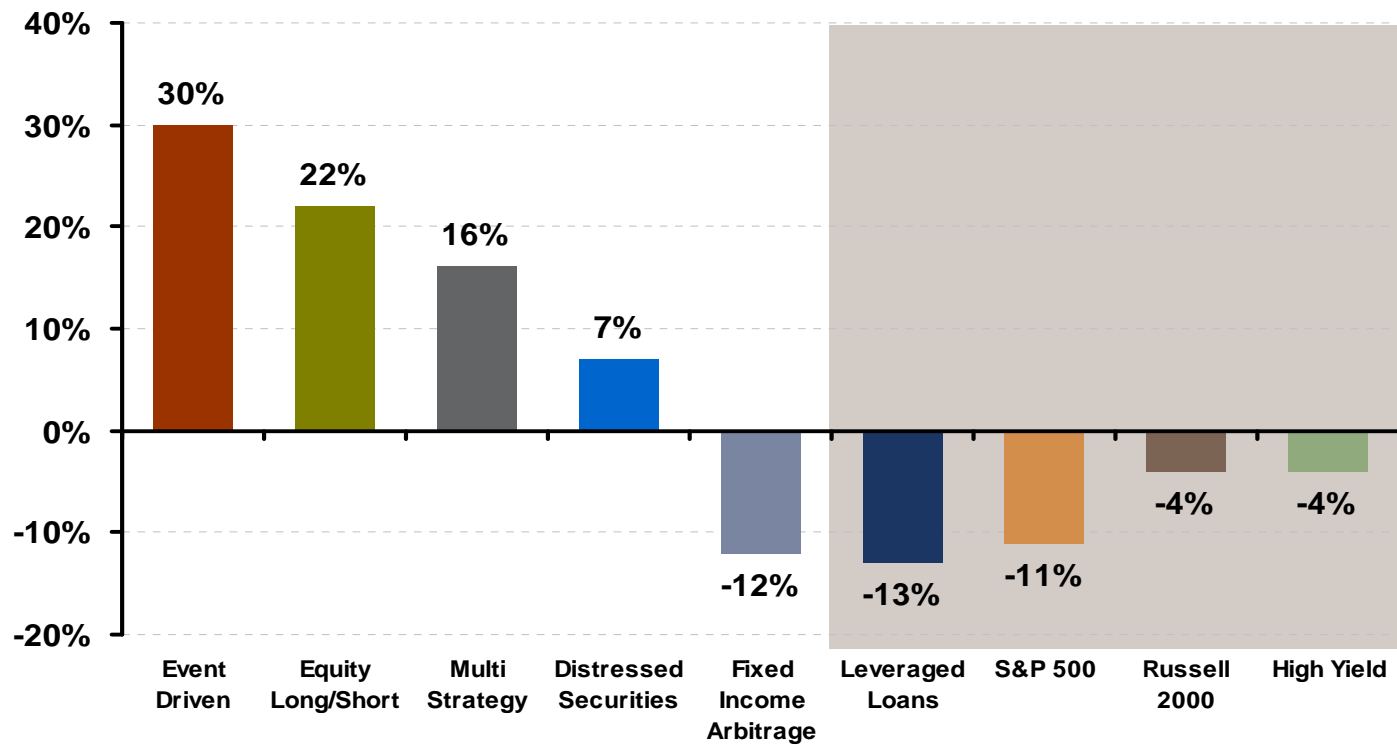


Sources: Credit Suisse, Merrill Lynch & Bloomberg

Hedge Fund Strategies: Post Recovery to Trough

Barclays Hedge Fund Index Strategy Returns

December 31, 2003 – December 31, 2008



Sources: Barclays, Credit Suisse, Merrill Lynch & Bloomberg

There are 5 common strategies employed by Event Driven funds:

- **Stressed / Distressed:** Popular during recessionary periods; cyclical
- **Capital Structure Arbitrage:** Credit cycle agnostic; works well when spreads are tight; non-cyclical
- **Credit Event:** Effective during a period of tightening or loosening lending standards; non-cyclical
- **Merger Arbitrage:** Popular when M&A activity is robust; cyclical
- **Activist:** Highly concentrated portfolios; non-cyclical

Types of Distressed Investments:

- **Debtor in Possession “DIP” Loans / Rescue Financing**
- **Discounted Value Investments**
- **Corporate Restructuring**
- **Post Reorganization Debt & Equity Investments**

Focus on corporate credit instruments trading at significant discounts to fair value as a result of financial distress or bankruptcy

Debtor in Possession “DIP” Loans / Rescue Financing

- **Debtor-in-Possession Loans:**
 - **Lenders provide first priority secured debt to allow the company to operate during bankruptcy proceedings**

- **Rescue Financing:**
 - **Lenders provide the company with “expensive” capital to avoid bankruptcy proceedings**
 - **Investment horizon is generally less than 1 year**
 - **Lender has significant downside protection**

Discounted Value Investments

- **Quality companies with strong business models that are under financial pressure due to cyclical end markets, economic weakness and/or over-leveraged balance sheets**
- **A lack of understanding surrounding the borrower's prospects generally allows the debt to be purchased at a significant discount**
- **Opportunities may exist anywhere in the company's capital structure, from equity to senior secured debt**
- **Investment horizon generally ranges from less than 1 year to 2 years**

Corporate Restructuring

- **Debt trades at considerable discount for fundamental reasons such as capital structure, operational or managerial issues**
- **An active role is often required of large lenders**
- **Investment horizon can range from several months to several years for a complicated bankruptcy**

Post Reorganization Debt & Equity

- **Upon exiting from bankruptcy, parts of a company's capital structure can be mispriced**
- **The company's new business model, management team, or suitability of the capital structure creates uncertainties**
- **Many companies face a stigma upon exiting bankruptcy, which can negatively effect the market's perception of the company's worth**
- **Investment horizon can range from 6-18 months**

Capital Structure Arbitrage

- **Managers exploit mispricings across a target company's capital structure**
 - **Although securities within a company's capital structure tend to be correlated, the market often overlooks security specific nuances, creating arbitrage opportunities**
- **Capital structure arbitrage trades reduce company and market risk because they are effectively hedged**
- **Investment horizon is typically less than 1 year**

Hypothetical Example

Long Position:

- ▶ \$1 million Par value of 10.3% Senior notes
- ▶ Call Protected
- ▶ Price: 104.5%
- ▶ Yield: 9.4%

Short Position:

- ▶ \$1 million Par value of 10.5% Subordinate notes
- ▶ Callable
- ▶ Price: 100.1%
- ▶ Yield: 10.5%

Scenario Analysis (1 year horizon):

Positive Event

Company Takeover:

Sr debt trades to tender price (117.0%)

Sub debt remains at call ceiling (100.0%)

Sr Bond G/L	\$227,500
Sub Bond G/L	\$(103,750)
Total G/L	\$123,750

No Event

Status Quo:

No change in Sr debt price (104.5%)

No change in Sub debt price (100.1%)

Long G/L	\$102,500
Short G/L	\$(105,000)
Total G/L	\$(2,500)

Negative Event

Company Bankruptcy:

Sr debt trades to recovery value (65.0%)

Sub debt trades to recovery value (30.0%)

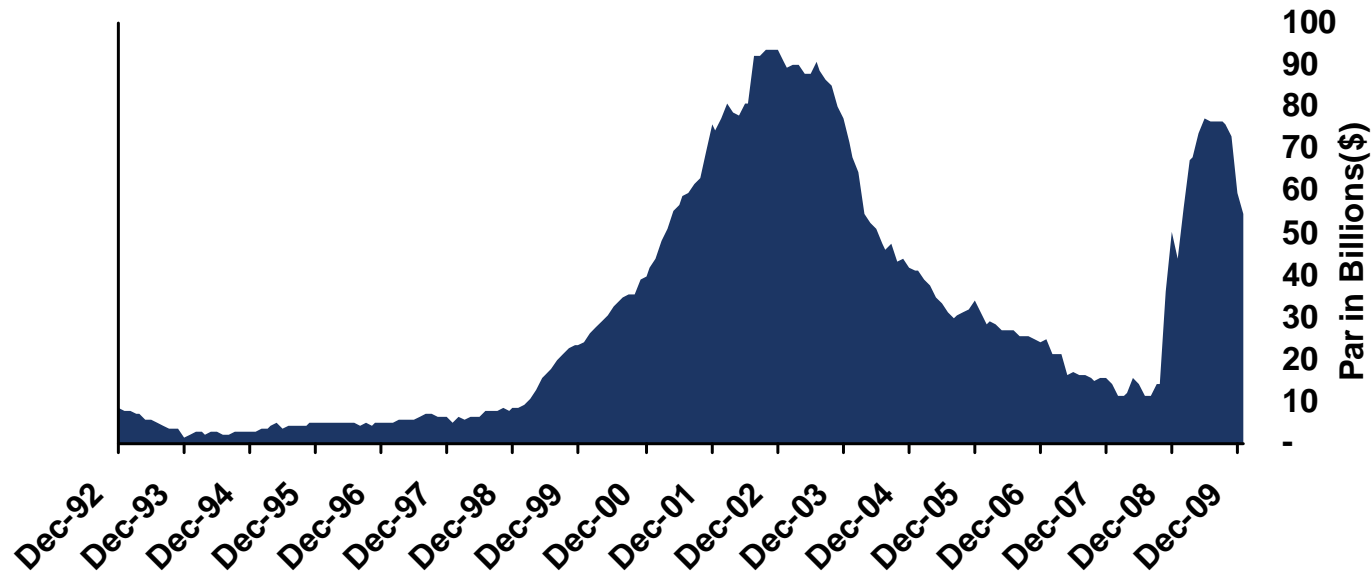
Long G/L	\$(292,500)
Short G/L	\$596,250
Total G/L	\$303,750

Credit Events

- **Managers look for companies that will have upcoming credit events such as covenant breaches, asset sales, tender offers, etc.**
- **These events often cause securities to be mispriced as there is uncertainty surrounding the outcome of the event**
- **Investment horizon can range from 3-12 months**

Is the current market
opportunity for
Event Driven strategies
as good as it has been in the
past?

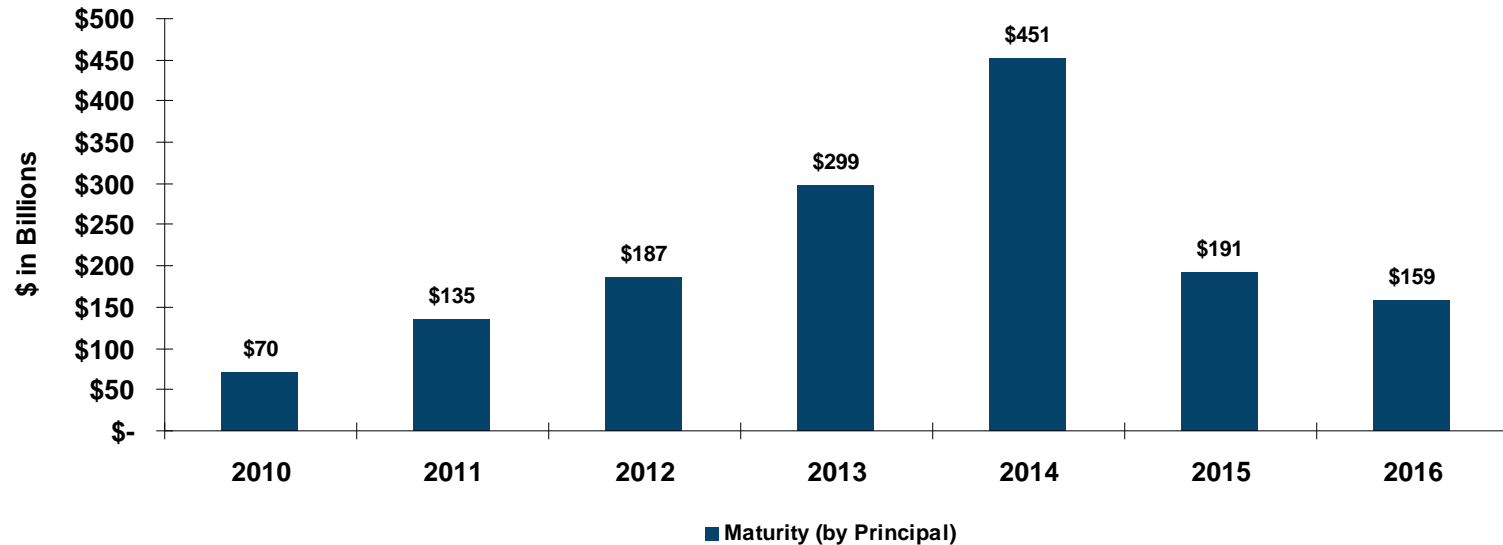
Distressed Market Size



The distressed market opportunity set has grown considerably and currently stands at \$54 billion

Source: Credit Suisse High Yield Index Distressed Sector

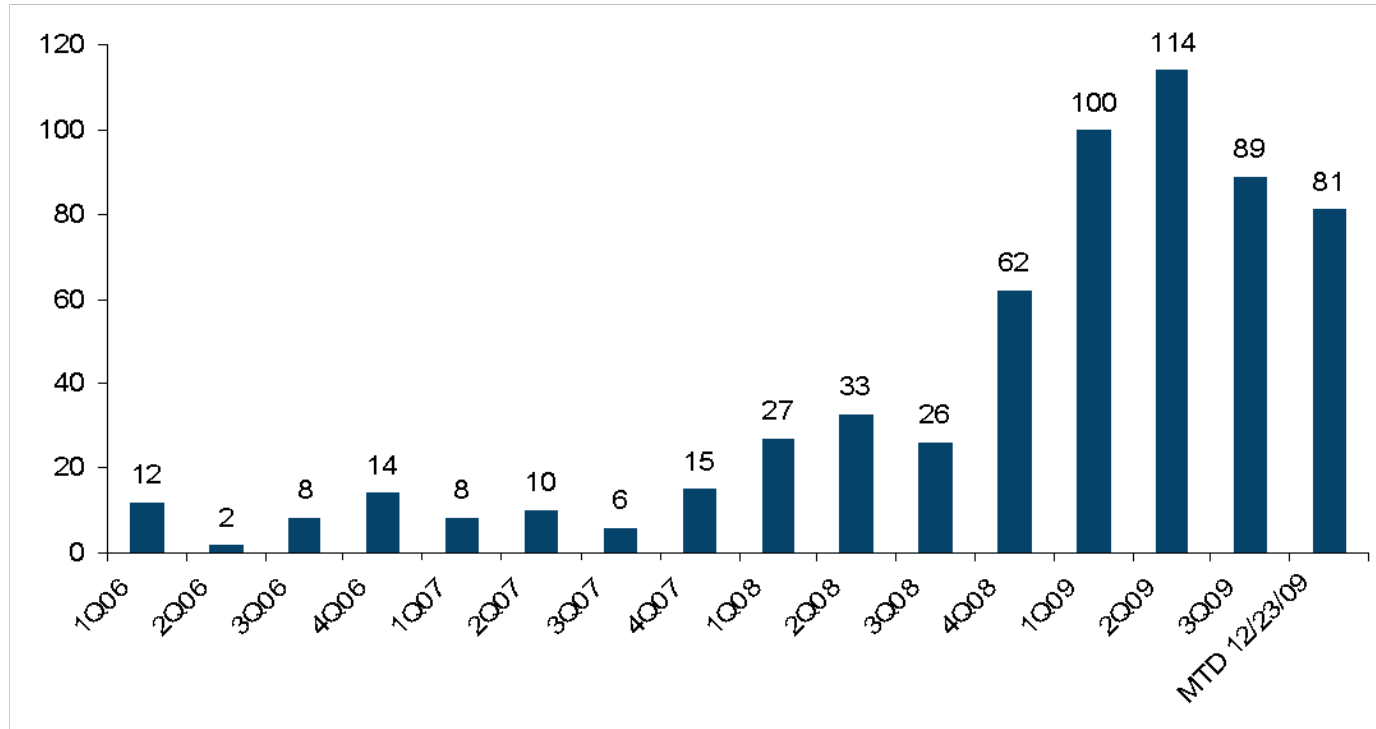
High Yield Maturity Schedule



The amortization profile of the high yield market should lead to refinancing oriented distressed opportunities and tender/takeout opportunities

Source: Credit Suisse High Yield Index & Leveraged Loan Index

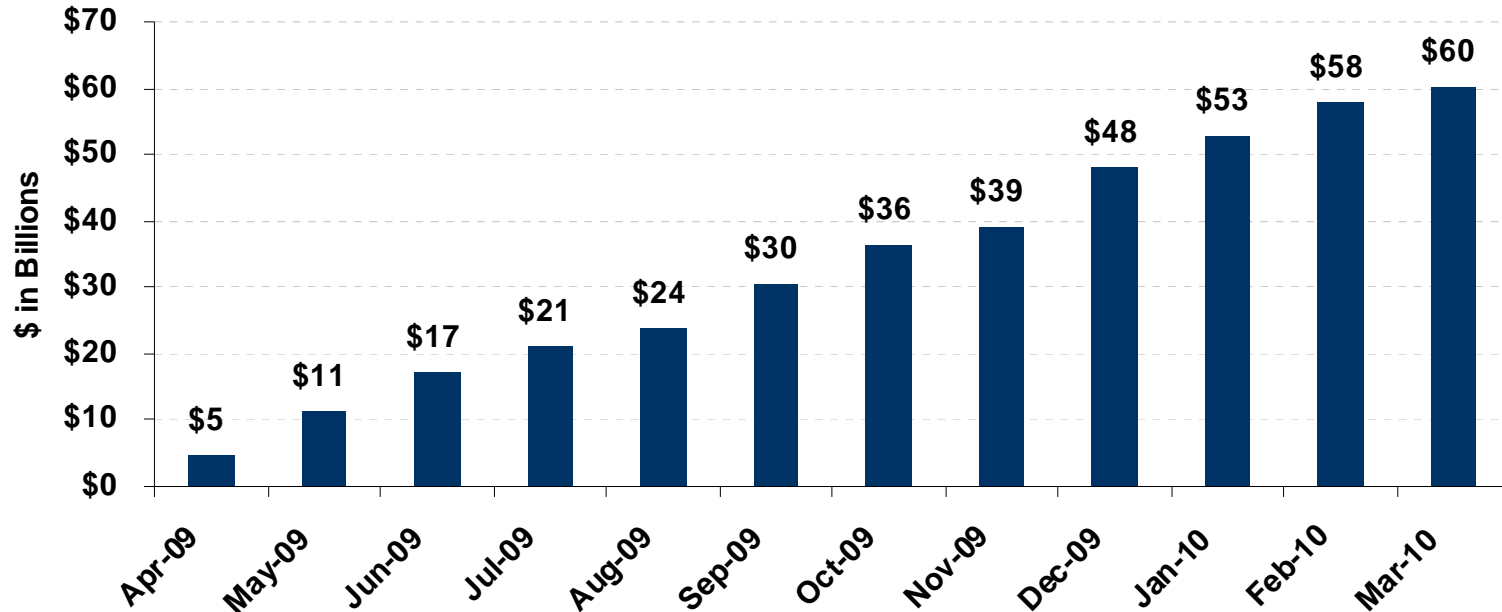
Number of Issuers Seeking Bank Amendments (by Quarter)



Many issuers are seeking amendments to avoid credit events and this creates opportunities

High Yield Bonds Issued to Refinance Bank Debt

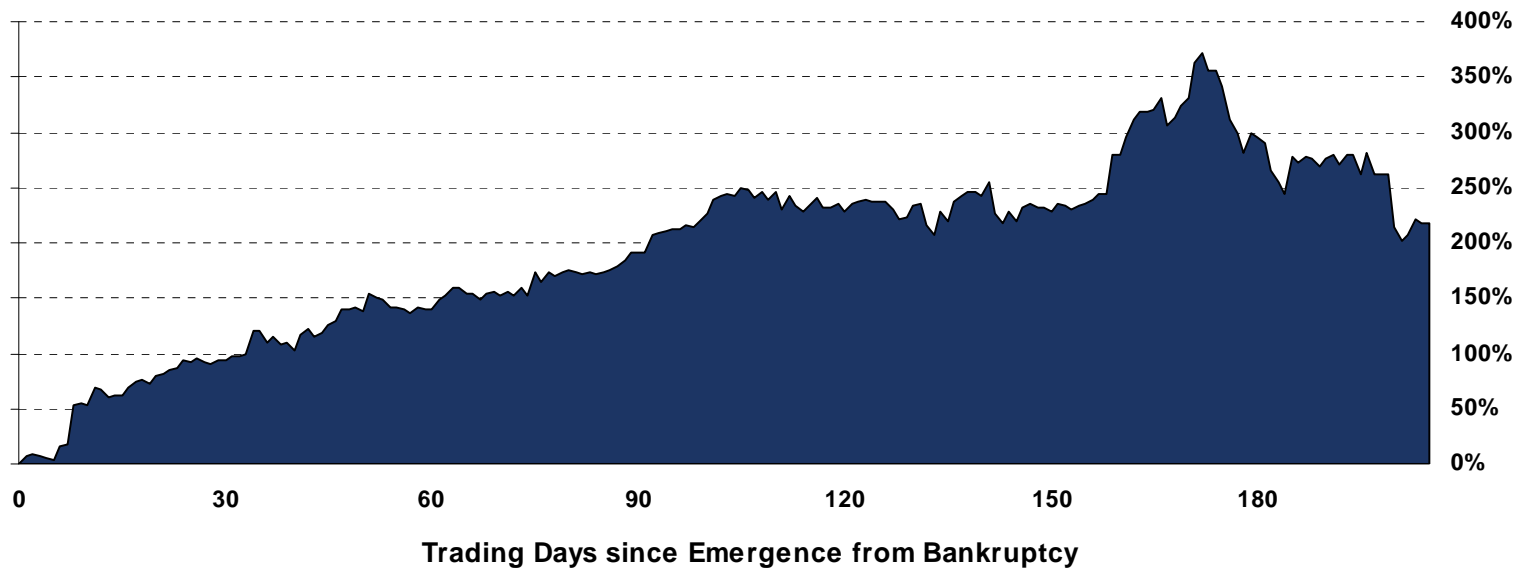
Cumulative Trailing 12 Months



The increase in refinancing and recapitalization activity creates significant opportunities for Capital Structure Arbitrage & Credit Event oriented strategies

Source: J.P. Morgan; March 2010 is MTD as of 3/4/2010

J.P. Morgan Reorganized Equity Composite



Equities can exhibit robust performance in “Chapter 12”

Source: J.P. Morgan “Chapter After Ch 11: A Strategic Guide to Reorgs” (3/4/10). The composite is made up of the 15 companies that have exited bankruptcy since 2009.

- **Event driven strategies seek to capture the price movements generated by significant potential events such as bankruptcies, debt exchanges, asset sales, etc.**
- **Event driven strategies have performed well after credit market recoveries, outperforming many other hedge fund strategies and long only strategies**
- **The maturity profile of the high yield market, coupled with the need for issuers to amend credit terms, provides a good backdrop for event driven investing**

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