



**Letter XIII – February 2024**

The NewGen Credit Strategies Fund, a corporate credit-focused liquid alternative strategy, generated a net return of 0.83% on the Class C units during the month of February. Our Net Exposure at month-end was 76% and Gross Exposure was 107% versus 86%/92% at the end of January.

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2023	4.4%	1.1%	2.2%	0.7%	-0.1%	1.0%	1.2%	0.5%	0.2%	-1.4%	2.7%	1.6%	<b>15.0%</b>
2024	2.6%	0.8%											<b>3.4%</b>

Approximately half of the month’s return came from the realization of our thesis on Cineplex (“CGX”). CGX convertibles, and secured bonds, have been the largest position in the Fund since late 2023. We were part of a small group of creditors that were taken private after we proposed a balance sheet restructuring transaction to the Company, and its Bankers, last year. We agreed to reduce our non-callable convertible bond principal by ~31% at a cash price of 102.35 and then take back a new convertible with a 7.75% coupon and 25% conversion premium. In addition, we agreed to help refinance the existing 2<sup>nd</sup> lien bonds with new secured bonds, thereby redeeming our bonds at a premium. All told, the transaction generated ~75 bps of gross return for the Fund. Additionally, we think the new convertible could be worth more than where it’s currently trading given several expected catalysts in 2024.

### **Core Corporate (41% of NAV, 16 positions)**

We continue to trade up in quality within our Core Corporate Carry portfolio. As high yield credit starts to trade inside of 7% with a credit spread of < 300 bps we are trimming risk. Currently ~50% of the sub-portfolio is in Investment Grade obligors including 12% in short-duration AAA-rated asset-backed securities.

We begrudgingly sold our long-standing position in the secured bonds of BlueLinX {BXC 6% 11/29}. The bonds railed to a yield less than 7% and a credit spread of 275 bps. While the Company has more cash than debt, we were somewhat concerned that the risk of them completing a larger cash acquisition was not properly priced in.

### **Event-Driven (~25%, 19 positions)**

**PGT Innovations {PGTI 4.375% 29}**: We sold our position after the HSR regulatory review period expired, causing the bonds to trade up. This compressed our expected IRR to the closing date to less than 6.50%. Our IRR on the position was 10.3% on a relatively straightforward and clean risk arbitrage trade.

**Advance Autoparts {AAP 29s & 30s}**: We sold our position in the 2029s and are now short the 2030s. It has been a strange time trading AAP bonds. AAP got downgraded to BB+ by S&P last year, and one week before earnings in Feb they were downgraded by Moody’s to Baa3(neg), still investment grade. However, one large high yield ETF takes the “average” credit rating for inclusion. As a result, it caused forced buying of AAP bonds at what we think are rich levels: a) ~6% yield and b) < 190 bps credit spread. We sold the high yield ETF our long position in the 29s and then shorted them the 30s.

**Carriage Services {CSV 4.25% 05/29}**: The Company announced earnings, and while they had multiple transaction proposals, they elected to shelve the Strategic Review and maintain status quo. Our thesis was that a takeover by a larger death care company would trigger a 101 Change of Control. We quickly sold our position for a gain as the quarter was better than expected. Our IRR was ~9.4% on the position which we initialized at the Fund’s inception.

**First Quantum {FMCN 2025s and FMCN 2026s}**: announced a comprehensive recapitalization of the Company with new equity, copper prepay agreement and new debt to refinance short-term bond maturities. We were taken out of our short-end positions at par subsequent to month-end, earning a high single digit return on the position.

**Hawaiian Airlines {HA 5.75% 01/26}**: We are back in the Hawaiian leisure travel business. When the US court decision came down killing the SAVE/JETBLU merger deal, HA's bonds traded down to 91.5. We re-bought our position and then shorted some common stock against it. We think the bonds are implying a much lower probability of the deal closing when compared to the common equity. The implied probabilities are mismatched and there is a much better "upside/downside" in the bonds versus the stock. For those interested, the judges ruling on the SAVE/JETBLU provides interesting insight into the US airline industry: <https://assets.bwbx.io/documents/users/iqjWHBFdfxIU/rOI7x4YbSJ0/v0>

We have a closed-end arbitrage position that has caused some negative Fund performance this month. We are long a closed-end fund and short the exact amount of the underlying assets. The closed-end fund is under strategic review with an outcome expected by April. Our thesis is that actions will be taken to close the discount. The discount to NAV is now 40% versus ~25% when we initiated this trade.

**Liquidity Provision (~24%)** The Fund had ~24% of its NAV in cash and cash equivalents at month-end up from 14% at the end of January.

### **Special Situations/Stressed Credit (~16%, 7 positions)**

**Weight Watchers {WW 4.5% 29 Secured Bonds}**: We purchased a small weight [no pun intended] when the bonds dropped from 66 cents to 49.5 cents, where we bought our bonds, and then rallied back up to 53.5. WW is over-levered and has a challenged legacy business model. However, their new CEO is attempting to digitize a business anchored by its very popular app, and become a conduit for the public to obtain weight-loss drugs. We thought the risk-reward was in our favour at 49.5 cents and the Company has a long liquidity runway. Quarterly results were inline with our expectations, but we were surprised by the announcement that Oprah Winfrey was leaving the Board and donating all her stock to the National Museum of African American History and Culture. We realized we had it wrong and sold our bonds crystalizing a 6 bps loss for the fund.

### **Risk Overlay**

We were very active in our hedging this month accumulating short positions in a handful of securities. One strategy we have now employed is shorting new issues after they break higher in the secondary market. Capital inflows have created a frothy primary market. One of the benefits of shorting new issues, especially ones with long settlement times, is we don't have to pay the coupon and borrow costs on the bonds. New issue bonds have a lot of market beta to them, so they become cheap market shorts.

**Sally Beauty {SBH 6.75% 03/32}**: SBH sells beauty products. Sales and margins have been declining. The Company is 2.5x levered and will use FCF to buy back stock. The bonds were issued at 100 and we shorted them just above that.

**American Sports {AS 6.75% 02/31}**: AS is a 4x levered sporting goods company that sells branded products such as Arc'teryx, Salomon, Wilson, and Louisville Slugger. The bonds traded up to 101.25 after being issued and we shorted them.

### **Summary**

Corporate credit markets are richer today than they were last month. Money is flowing into a frothy primary market but against widening dispersion across sectors/ratings/tenors. Corporate credit investing is often about *exclusion not inclusion* as outperformance is driven by the bonds and sectors you do not buy, rather than the ones you do buy. One factor in our positive performance has been our avoidance of "hot zones" such as US Cable, Satellite, Telecommunications & Media which is ~15% of the USD High Yield Index and has had negative returns year-to-date. We have taken a long look at the sector and have followed it closely over 2023 and decided there is far too much risk relative to the possible return at this juncture. (see Appendix below)

## Appendix –US Cable, Satellite, Telecommunications & Media

High Yield indices have had muted performance so far this year in part because of the substantial negative returns for a handful of large sectors. The USD TMT sector was once considered one of the highest quality “low beta” sectors within the high yield market but has now turned into a killing field. The industry is mature with competition increasing while balance sheets are very levered. In a nutshell, the way video content is: 1) *created*, 2) *distributed* and 3) *consumed* continues its rapid change. A sampling of “buzz phrases” from news article about the industry:

*cord cutting, cord shaving, cord-nevers, streaming wars and joint ventures, writer’s strikes, actor’s strikes, sports content inflation, fixed wireless access, fiber to the home, fiber overbuilding, network convergence, levered buyouts, asset stripping, creditor-on-creditor violence, Chapter 11, conventional advertising declines, regulatory subsidy expiry, stock buy backs, failed asset sales, distressed exchanges, death of linear TV and regional sports networks, artificial intelligence*

The charts below show a summary of the subsectors as well as key obligors:

Sector	YTD Return	Credit Spread	Yield
USD HY Index	+0.21%	331 bps	7.89%
Broadcasting	(3.15%)	474 bps	9.22%
Cable TV	(3.72%)	601 bps	10.44%
Entertainment	(0.90%)	593 bps	10.57%
Media	(0.17%)	540 bps	9.94%
Telecom	(0.39%)	561 bps	10.10%

Obligor	Par Value (Bonds)	Market Value	Price	Comment
Dish	\$13.2 bn	\$10.1 bn	76	Mounting subscriber losses. Creditor lawsuits for asset-stripping.
Charter (HY)	\$27.2 bn	\$23.7 bn	87	Negative broadband adds. Levered merger with Altice?
Charter (IG)	\$54.3 bn	\$45.6 bn	84	Potential downgrade to junk. Massive capex program.
Cablevision	\$20.1 bn	\$16.1 bn	80	Extremely levered unsustainable capital structure.
Cable One	\$1.57 bn	\$1.24 bn	79	Fixed Wireless Access becoming a competitive threat.
Sinclair Broad.	\$1.5 bn	\$1.1 bn	77	Cord cutting, structural shift in advertising to digital from linear.
Gray TV	\$3.6 bn	\$2.7 bn	76	Cord cutting, highly levered balance sheet
AMC	\$1.8 bn	\$1.4 bn	80	Content inflation, linear advertising declines, levered
Frontier	\$7.9 bn	\$7.5 bn	95	Overbuilding fiber network with levered balance sheet
Paramount	\$14.7 bn	\$12.2 bn	83	Company is up for sell resulting in any number of permutations
Lumen/LVLT	\$6.4 bn	\$5.7 bn	90	Over-levered. Asset-stripping and value leakage amongst creditors
iHeart Radio	\$3.0 bn	\$2.1 bn	71	Extremely levered unsustainable capital structure.

The elephant in the room remains Charter Communications. CHTR is ~4.5x levered and is experiencing a rapid decline in cable subscribers on account of fixed wireless access competition and cord cutting. Should CHTR be downgraded to junk status, ~\$54 billion of investment grade bonds would need to find a home in the high yield market. The sheer size of this rotation may cause prices to decline within the sector making any bottom-up security selection futile. We also see the potential for contentious defaults at DISH, Cablevision/Altice, Lumen/LVLT, iHeart and perhaps a broadcaster as well. At present we think the sector is too risky to get involved in despite what appears to be beaten up prices and juicy yields. To the indexer or closet indexer, exposure to this sector is required which is why the sector is starting to weigh on index returns. This situation highlights one of the problems with indexing in the high yield bond market. *The more debt a company issues, and the more leverage it incurs, the larger the resulting index weight becomes and thus the more investors need to buy the debt!* This is somewhat paradoxical to equity indexing, where the healthier the Company, the larger the equity market capitalization, and thus the higher weight in the index.