



High Yield Opportunities Post July Sell-Off

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1. High Yield Strategy Outlook

Michael H. Anderson

High Yield Strategy

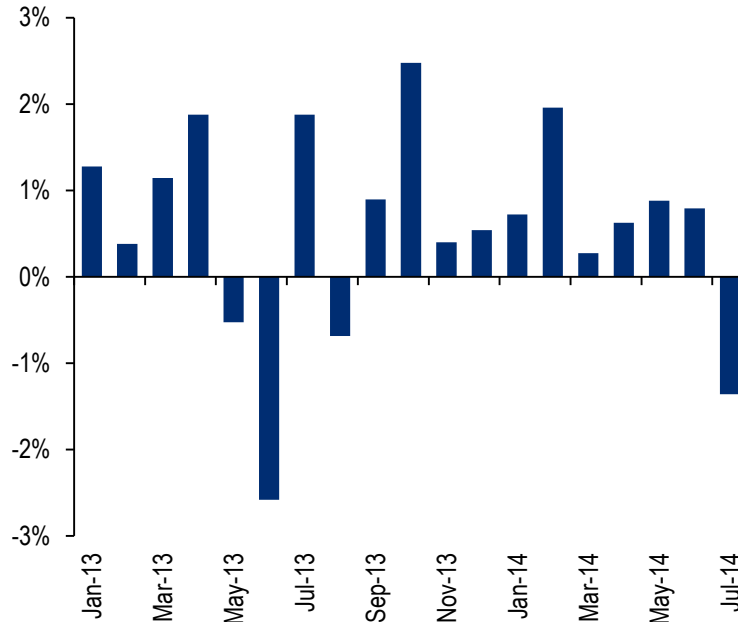
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High Yield Strategy Outlook

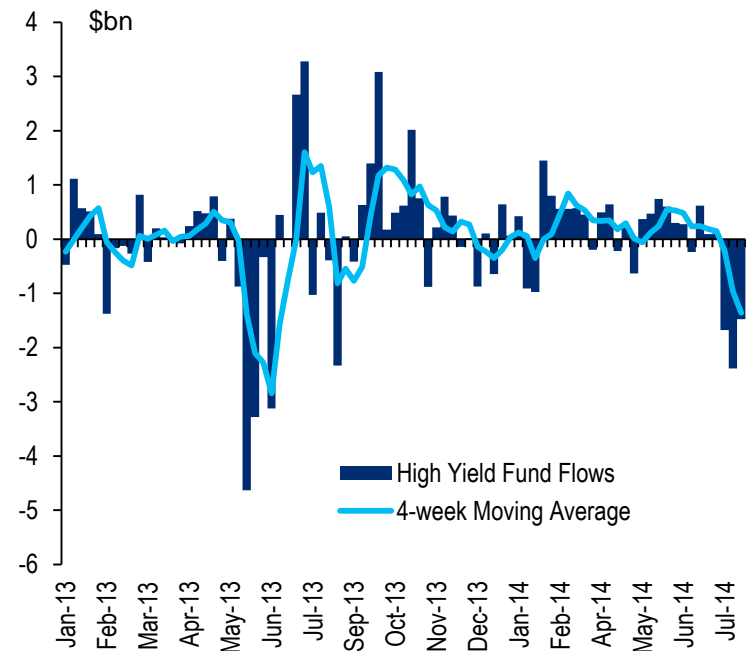
Fund flows drive worst performance since June 2013.

High Yield Market Index Monthly Returns



Source: Citi Research, Yield Book

High Yield Mutual Flow Flows



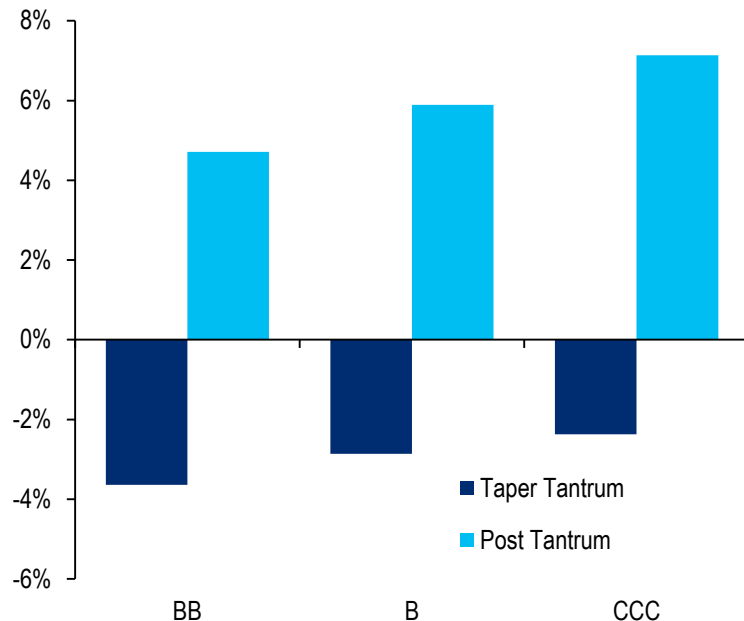
Source: Citi Research, Lipper

- Citi's High Yield Market Index lost 1.36% in July, the first negative return of 2014 and the worst month since June 2013. Performance was fairly uniform across the quality spectrum
- Fund flows drove much of the retreat. According to Lipper, funds lost \$5.5bn of assets over the last 3 weeks. The outflows continued in the new week

Adding Exposure to High Yield

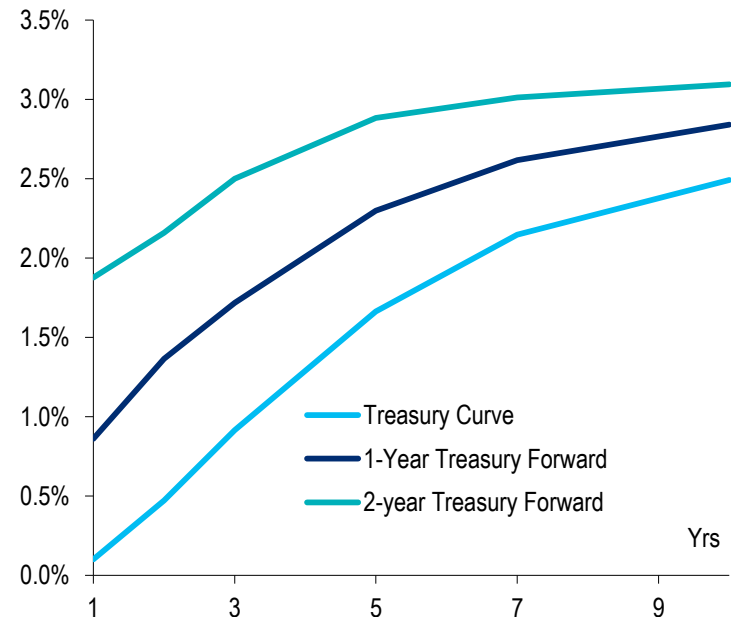
Adding exposure is not as easy as buying what's the most "beaten up."

Credit Quality Returns During/Post Taper Tantrum



Source: Citi Research, Yield Book, Taper Tantrum period is defined as May & June, 2013; Post Tantrum period is defined as July to end of 2013

Current Treasury Curve vs. Forwards



Source: Citi Research, Bloomberg

- The BB-Rated Index led the losses during the taper tantrum but lagged for the balance of the year. This is because double-B bonds are longer duration and the long end of the curve reset higher
- The forward curve is now reflecting expectations of a flatter curve which will impair roll-down trades. Just as in 2013, we believe we are entering a new rate regime where the short end is no longer pinned to zero

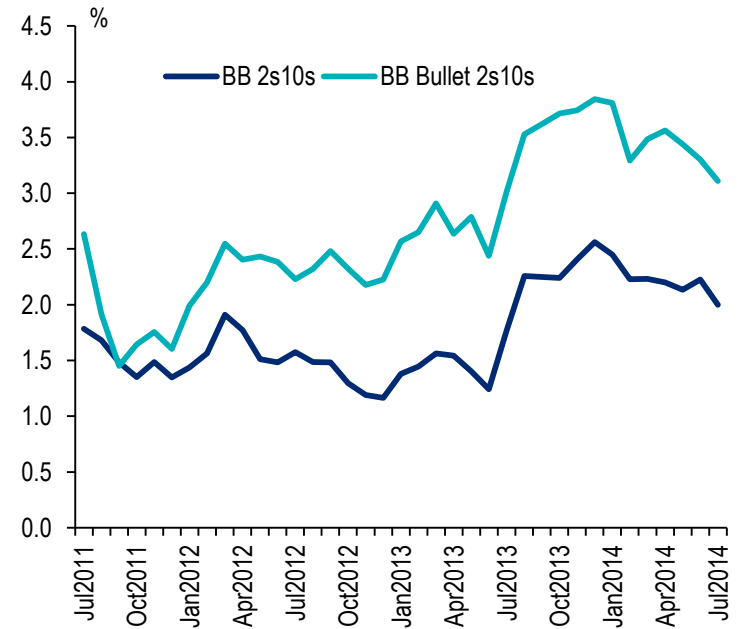
Themes for Adding Risk

BB vs. BBB Spreads



Source: Citi Research, Yield Book

High Yield Curves



Source: Citi Research, Yield Book

- Investment grade paper has been considerably more resilient than high yield. We recommend taking advantage of this dislocation by finding crossover candidates which should eventually benefit from relatively stable investment grade technicals
- The cash curve remains steep compared to history. Within short-duration, we prefer deep-in-the-money callable bonds

2. High Yield Opportunities Post July Sell-Off

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Summary of Credit Views

Below we summarize our top ideas post the July sell-off.

Sector	Attractive Post Sell-Off	Yield-to-Call	Cross-Over Candidate
Autos, A&D, Industrials, & Services	ALGSCO 8.500% Sec Nts BBDBCN 6.000% Sr Nts URI 6.125% Sr Nts	FDC 8.25% & 8.75% 2nd Lien Nts	--
Chemicals & Homebuilders	ASH 4.750% Sr Nts	BZH 6.625% 1st Lien Nts	CE 5.875% & 4.625% Sr Nts
Consumer Products	SVMSTR 7.000% Sr Nts	SVMSTR 8.00% Sr Nts ARMAUT 9.25% Sr Nts CENT 8.25% Sub Nts	--
Energy	CHAPAR 7.625% Sr Nts	EPENEG 6.875% 2nd Lien Nts	CXO 7.000% Sr Nts
Healthcare	CYH 6.875% Sr Nts HCA 5.875% Sec Nts THC 6.00% 1st Lien Nts	--	--
Metals & Mining	ANR 7.500% 2nd Lien Nts	APAM 7.750% Sr Nts FMGAU 8.250% Sr Nts	--
Retail	RAD 6.75% Sr Nts 2021	--	LB 5.625% Sr Nts
Technology, Media, Telecom, Cable & Satellites	DISH 6.750% & 5.875% Sr Nts INTEL 8.125% Lux Nts & 7.75% Lux Nts AMD 7.50% Sr Nts	AMD 7.75% Sr Nts	--

Source: Citi Research

Credit Views – Autos, Industrials, & Services

	Issue	Rating	Moody's / S&P	Net Leverage	Offer Side Price / YTW	Citi View
Attractive Post Sell-Off	Algeco Scotsman (ALGSCO) 8.500% Sec Nts 2018	Buy	B2 / B	4.9x	102.500 / 7.60%	<ul style="list-style-type: none"> • ALGSCO 8.50% notes have sold off 5.25pts since June 23 (mkt peak); currently offers 160bp incremental spread vs. B Index • At current levels, market has appropriately priced in near term headwinds including further earnings deterioration & increasing leverage; Citi estimates 4Q14 secured leverage at 5.5x (trough) • Adequate asset coverage: 2nd lien priority (after ABL) on substantially all assets
Attractive Post Sell-Off	Bombardier (BBDBCN) 6.000% Sr Nts 2022	Buy	Ba3 / BB-	4.3x	99.500 / 6.10%	<ul style="list-style-type: none"> • BBDBCN 6.00% notes have sold off 4.25pts since June 23 (mkt peak); 15bp cushion vs. B Index and 110bp vs. BB Index • 2Q results exceeded expectations (especially on EBITDA and FCF); FY14 guidance and CSeries EIS⁽¹⁾ also affirmed • Adequate liquidity: \$3.9bn as of 2Q (including \$2.5bn of cash). Total backlog of \$76bn (represents 3+ years of revenue)
Attractive Post Sell-Off	United Rentals (URI) 6.125% Sr Nts 2023	Buy	B2 / BB-	3.1x	103.75 / 5.42%	<ul style="list-style-type: none"> • URI 6.125% notes have sold off 4.5points since June 23 (mkt peak); currently offers 45bp incremental yield vs. BB Index • Solid 2Q earnings (EBITDA +21% y-o-y); FY14 guidance raised; 2.9x net leverage target by year-end • Solid leverage to N.A. non-res construction, industrial spending cycle, and secular trends (from ownership to rental) • Blueline 7.0% 2nd Liens also attractive on relative value basis (YTW: 5.75%) after selling off 4pts since June 23
Yield-to-Call	First Data (FDC) 8.25% 2 nd Lien 2021 8.75% 2 nd Lien 2022	Buy Buy	Caa1 / B- Caa1 / B-	5.7x 5.7x	107.250 / 5.72% 108.000 / 5.83%	<ul style="list-style-type: none"> • FDC 2nd liens have declined 3.5pts since June 23 (mkt peak); bonds are callable in 2016, now offering high 5% yield • Solid 1H14 results: EBITDA up 13% y-o-y (on 350bp margin expansion); driven by cost saving initiatives & volume growth • \$3.5bn equity raise in July 2014 reflects 12x valuation; provides FDC with flexibility to delever and make strategic investments

Source: Citi Research; Pricing Levels as of August 4, 2014; Pricing levels are offer-side. (1) EIS = Entry into service

Credit Views – Chemicals & Homebuilders

	Issue	Rating	Moody's / S&P	Net Leverage	Offer Side Price / YTW	Citi View
Attractive Post Sell-Off	Ashland (ASH) 4.750% Sr Nts 2022	Buy	Ba1 / BB	2.6x	98.25 / 5.02%	<ul style="list-style-type: none"> Bonds are off ~3 points since the beginning of July ASH recently announced it would keep Valvoline (35% of LTM EBITDA) and will use proceeds from sale of Water Technologies to fund \$1.35B in share repurchases (previously stated) We believe negative event risk (from a creditor perspective) is decreasing post the announcement on Valvoline and latest filing showing Jana reduced their stake in ASH (3Q14 First Look) IG ratings are possible in medium term with next large debt maturity in Mar-16 (\$600mm)
Cross-Over Candidate	Celanese (CE) 5.875% Sr Nts 2021	Buy	Ba2 (POS) / BB+	1.4x	108.00 / 4.50%	<ul style="list-style-type: none"> Management has goal of attaining IG ratings On 2Q14 call, management highlighted intent to refinance CE 6.625% Senior Unsecured Notes due 2018 (callable Oct-14) and revolver due Oct-15. We believe refi could be a ratings catalyst (see our 2Q14 Post Call Recap) as Company refinances secured debt with unsecured debt
	4.625% Sr Nts 2022	Buy	Ba2 (POS) / BB+	1.4x	99.25 / 4.73%	<ul style="list-style-type: none"> CE bonds now trade ~145bp behind similar maturity DOW notes vs. 100/125bp spread at the beginning of July
Yield-to-Call	Beazer Homes (BZH) 6.625% 1 st Lien 2018	Buy	B1 (POS) / B	0.8x	104.50 / 4.96%	<ul style="list-style-type: none"> Bonds are off ~3 points since the beginning of July Potential reversal of Deferred Tax Asset in 2015 is a ratings catalyst. Net HB Debt/Cap currently 85.9% (65.2% assuming 100% DTA reversal) Only secured note in the capital structure; second-shortest maturity Callable in Jul-15 at 103.313; YTC 5.14%

Credit Views – Consumer Products

	Issue	Rating	Moody's / S&P	Net Leverage	Offer Side Price / YTW	Citi View
Attractive Post Sell-Off	ServiceMaster (SVMSTR) 7.00% Sr Notes 2020	Buy	Caa1 / B-	6.4x	102.750 / 6.22%	<ul style="list-style-type: none"> Expect leverage reduction of around 2x this year from high 7x to high 5x area; bulk already completed with the recent IPO Market leader in three high-margin, stable businesses: pest control, home warranty, and cleaning services; ample liquidity and cash flow, even after regular/accretive tuck-in acquisitions
Yield-to-Call	8.00% Sr Notes 2020	Buy	Caa1 / B-	6.4x	105.875 / 6.12%	<ul style="list-style-type: none"> 7% Notes have sold off over 4pts and 6.2% YTW remains attractive for relatively short-dated paper; near-term call is less likely than on the 8s, but first call date is only 1yr away 8% Notes are most expensive debt in structure, callable in February '15; new credit facility allows for extension up to 4.25x leverage, plus \$450mm; YTN 7.8%
Yield-to-Call	Armored Autogroup (ARMAUT) 9.25% Sr Notes 2018	Buy	Caa2/CCC	7.1x	104.500 / 7.03%	<ul style="list-style-type: none"> Although leverage is high, sponsors have recently purchased IDQHLD and indicated that a combination of the businesses could reduce pf leverage to high 5x; preliminary 2Q earnings reported strong for both companies. Bondholders have strong incurrence covenants, and sponsors have tipped hand regarding desire to combine businesses to maximize interest savings on refi of expensive IDQHLD debt. While sponsors shelved refi plans after bondholders (appropriately) balked at consent to release covenants, they could consider a refi of both IDQ and ARMAUT when bonds are callable this fall; YTN 9.1%
Yield-to-Call	Central Garden & Pet (CENT) 8.25% Sr Sub Nts 2018	Buy	B3 / CCC+	5.3x (seasonal peak)	102.500 / 6.54%	<ul style="list-style-type: none"> Despite soft demand conditions in the lawn and pet categories, we expect a near-term focus on cost controls and seasonal working capital reduction to keep leverage in check; targeting 9/30/14 fiscal year end leverage around 4.0x Longer-term demand/demographic trends remain strong, which should keep strategic interest in CENT's brands high; recently, HRG proposed (subject to due diligence) to purchase CENT for \$10/share or to buy its pet division for \$750mm Yield to 3/15 call step-down is 7.3%, but bonds are callable now, so upside to a faster takeout

Source: Citi Research; Pricing Levels as of August 4, 2014; Pricing levels are offer-side. YTN = yield to next call.

Credit Views – Energy

	Issue	Rating	Moody's / S&P	Net Leverage	Current Price / YTW	Citi View
Attractive Post Sell-Off	Chaparral Energy (CHAPAR) 7.625% Sr Nts 2022	Buy	B3 / B-	3.8x	105.250 / 6.52%	<ul style="list-style-type: none"> CHAPAR 7.625% notes have sold off 5.00pts since June 23rd If the notes were to recover to \$108.25, the price pre-sell off, investors would get an annualized return of 14.4% by year-end CHAPAR has been selling non-core assets to focus on their Mid-Continent operations Tertiary recovery operations provide stable cash flows to complement their horizontal drilling program Potential to IPO in 2015
Cross-Over Candidate	Concho Resources (CXO) 7.000% Sr Nts 2021	Buy	Ba3 / BB+	2.0x	108.000 / 3.63%	<ul style="list-style-type: none"> Prudent debt management: Concho recently issued common stock to repay revolver debt and fund an accelerated three year growth plan and future acquisitions 1Q14 Debt/Daily production was \$36,158 Boe/d, a decrease of 3 and 5% sequentially and year-over-year, respectively These notes have declined ~4 points since June 23rd. Over the same time period, the YTW has widened 75bp versus about 50bp for Range Resources
Yield-to-Call	EP Energy (EPENEG) 6.875% 2 nd Lien Nts 2019	Buy	Ba3 / B+	3.3x	105.875 / 3.36%	<ul style="list-style-type: none"> Notes callable in May 2015 (at \$103.438) EP Energy continues to transition to an 'oilier' company: 55% of 2Q14 production came from oil – an increase from 41% for full year 2013 They are also seeing improving well economics and recently revised their Wolfcamp type curve upwards Leverage through the secured notes is 1.4x

Credit Views – Healthcare

	Issue	Rating	Moody's / S&P	Net Leverage	Current Price / YTW	Citi View
Attractive Post Sell-Off	Tenet Healthcare (THC) 6.00% 1 st Lien 2020	Buy	Ba3 / B+	3.1x (based on \$1.857BB 2014E PF EBITDA)	104.5 / 5.13%	<ul style="list-style-type: none"> Bonds have declined 5.5 points since June 23rd peak Attractive yields for first lien paper Strong position in Medicaid expansion states. The company currently operates in AZ, CA, IL and MA) representing approximately 25% of Tenet licensed beds As of April 1, 2014 Michigan implemented Medicaid expansion representing an incremental 9% of licensed beds (representing a total of 34% of all licensed beds in Medicaid expansion states for the company)
Attractive Post Sell-Off	HCA, Inc. (HCA) 5.875% 1 st Lien Nts 2022	Buy	Ba3 / BB	2.7x	105.425 / 5.00%	<ul style="list-style-type: none"> Bonds have declined ~4pts since June 23rd peak representing an attractive entry point in first lien bonds in bellwether name Robust operating fundamentals further supported by strong 2Q performance Industry leading margins and attractive portfolio of assets position the company well to benefit from Medicaid expansion
Attractive Post Sell-Off	Community Health Systems (CYH) 6.875% Sr Nts 2022	Buy	B3 / B-	5.9x (based on \$2.783BB 2014E PF EBITDA)	103.000 / 6.22%	<ul style="list-style-type: none"> Bonds have declined 3.5 points since June 23rd peak Stronger than expected quarterly earnings further supports credit story Attractive yields for callable paper (callable on 2/1/2018 at 103.438) with potential for 1 to 2 points of capital appreciation in the medium term (12-18 months) Improving sector fundamentals based on expected volume growth will continue to act as substantial tailwind in the medium term, mitigating short term integration concerns

Credit Views – Metals & Mining

	Issue	Rating	Moody's / S&P	Net Leverage	Offer Side Price / YTW	Citi View
Attractive Post Sell-Off	Alpha Natural Resources (ANR) 7.500% 2 nd Lien Nts 2020	Buy	B2 / B	NA	92.500 / 9.14%	<ul style="list-style-type: none"> • ANR 7.500% notes have sold off 6.5 pts since 06/23/14 • We acknowledge that coal fundamentals remain challenged, but we think 9+% yield is attractive for 2nd lien paper that has sufficient asset coverage • The bonds trade wide of the B index (6.02%) • Liquidity is robust at an estimated \$2.3bn for PF 3/31/14
Yield-to-Call	Aperam (APAM) 7.750% Sr Nts 2018	Buy	B3 / B+	1.6x	106.250 / 4.47%	<ul style="list-style-type: none"> • APAM 7.750% notes have sold off 2 points since 06/23/14 • APAM recently posted better than expected results, with EBITDA coming in at \$145mm, above our \$137mm estimates • The company's balance sheet continues to improve, with net leverage falling to 1.6x at 2Q14. We think net leverage should fall closer to 1.0x by year-end • When it reported 2Q results, the company reduced its year end 2014 net debt target to \$550mm, down from \$650mm previously • The bonds become callable in April 2015
Yield-to-Call	Fortescue (FMGAU) 8.250% Sr Nts 2019	Neutral	Ba2 / BB-	1.3x	108.250 / 4.57%	<ul style="list-style-type: none"> • FMG recently reached its 155mtpa capacity, significantly increasing its production while reducing costs meaningfully • Though iron ore prices have fallen, FMG's lower cost structure should allow the company to maintain a solid balance sheet • We think its likely these bonds are called when they first become callable in November 2015

Source: Citi Research; Pricing Levels as of August 4, 2014; Pricing levels are offer-side.

Credit Views – Retail

	Issue	Rating	Moody's / S&P	Rent Adj. Leverage	Current Price / YTW	Citi View
Attractive Post Sell-Off	Rite Aid Corp (RAD) 6.75% Sr Nts 2021	Buy	Caa1 / CCC+	6.0x	104.5 / 5.67%	<ul style="list-style-type: none"> At 6.0x LTM rent-adjusted leverage, RAD has one of the more manageable leverage profiles in our universe. Debt is supported by a market cap of \$6.6bn, or four turns of equity cushion RAD is poised to generate in excess of \$400mm of free cash flow in 2014, nearly 8% of total debt outstanding. Free cash should improve with near term call dates on high coupon debt in the structure in 2014 and 2015 Since the market peak, the bonds generated a negative total return of 2.7%, underperforming both the HY market (-1.9%) and Retail Index (-1.5%). We prefer these notes to Levi's 6.875% Sr. Nts '22 (Neutral) as we pick up 90bp swapping into a similar FCF profile company with a better credit trajectory
Cross-Over Candidate	L Brands Inc. (LB) 5.625% Sr Nts 2022	Buy	Ba1 / BB+	3.5x	105.25 / 4.80%	<ul style="list-style-type: none"> LB is one of the few high yield retailers to generate consistent, positive SSS comps despite a challenging environment, up low single digits in each of the past five quarters LB is the lowest levered retailer in our space at 3.5x LTM rent-adjusted leverage which has been steady the last few years. We estimate the company will generate almost \$700mm of free cash flow in 2014 pre-dividends, over 14% of debt These notes traded off 3.5% since the peak and have since rebounded 1pt, but are still down 2.2%, worse than broader HY market and Retail Index. Despite the company's IG-like credit profile, the notes still trade 134bp wide to the 7-10 year tranche of the IG index (YTW 3.46%)

Credit Views – Technology, Media, Telecom, Cable & Satellites

	Issue	Rating	Moody's / S&P	Net Leverage	Offer Side Price / YTW	Citi View
Attractive Post Sell-Off	DISH Networks (DISH) 6.750% Nts 2021 5.875% Nts 2022	Buy Buy	Ba3 / BB- Ba3 / BB-	1.5x 1.5x	108.750 / 5.21% 103.000 / 5.40%	<ul style="list-style-type: none"> • DISH bonds traded down 5 points since June 23rd • Our fundamental forecasts point to growing sales and EBITDA in 2014 & 2015 • DISH credit is supported by \$28 billion market equity which provides 2.4x asset coverage • DISH generates over \$900 million free cash flow per year and could repay all debt in 14 years
Attractive Post Sell-Off	Intelsat (INTEL) 8.125% Lux Nts 2023 7.75% Lux Nts 2021	Buy Buy	Caa2 / B- Caa2 / B-	7.4x 7.4x	101.500 / 7.83% 101.250 / 7.43%	<ul style="list-style-type: none"> • These INTEL bonds traded down 5-7 points since June 23rd • Our fundamental forecasts point to modestly declining sales and EBITDA in 2014 & 2015. We expect growth in 2016 owing EPIC (broadband) satellite launches • INTEL has a 4-year backlog that grew in 2Q and could get a boost from Intelsat-30 satellite launch in 4Q • INTEL guided to \$475 million debt reduction in 2014 and noted the \$500 million 8.5% notes are callable November 1st
Attractive Post Sell-Off	Advanced Micro Devices (AMD) 7.50% Sr Nts 2022	Buy	B2 / B	2.2x	102.500 / 7.09%	<ul style="list-style-type: none"> • These AMD bonds traded down 4-5 points since June 23rd • Our fundamental forecasts point to growing sales and EBITDA in 2014 & 2015; we model \$48mm free cash flow in 2014 & \$249mm in 2015
Yield-to-Call	7.75% Sr Nts 2020	Buy	B2 / B	2.2x	102.750 / 6.95%	<ul style="list-style-type: none"> • The 7.75% notes are callable August 1, 2015, while the 7.5% notes are non-callable • We maintain our non-consensus Buy ratings on AMD credit

Appendix A-1

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Data current as of 30 Jun 2014	Rating		
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Data current as of 30 Jun 2014	12 Month Rating			Relative Rating		
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