

## U.S. High Yield Credit Analyst Focus List

2Q13



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**U.S. High Yield Credit Research**

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J.P. Morgan Securities LLC

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This is our twenty-third quarterly Analyst Focus List (AFL) highlighting our sector analysts' best ideas. Starting with this issue, we are publishing the high yield portion of our AFL as a standalone report.

Investors have complained for a long time that the high yield market has felt picked over. While fund flows have favored loans YTD, and our index briefly backed up to about 6% in February, investors wonder whether to call today's Index yield of 5.7% "high yield." Still, everything is relative. Inside this report you'll find 20 long ideas and 4 shorts that we think have the potential to outperform in the next three months. These ideas are the product of extensive bottoms-up analysis and our analysts are, as always, available to talk through their assumptions and rationales.

This quarterly roundup is a complete refresh; ideas not carried over and presented again are considered superseded by new ideas. Names may be removed intra-quarter where a valuation target has been largely or wholly achieved or the original rationale is considered no longer valid. New ideas can also be added intra-quarter. For intraquarter additions or deletions, analysts will post a brief summary of their rationale to our J.P. Morgan Markets website. Please check J.P. Morgan Markets for the most up-to-date AFL at any time.

We hope you find this report helpful in meeting your investment objectives.

**See page 22 for analyst certification and important disclosures.**

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## High Yield Focus List

### Sorted by Sector

Sector	Ticker	Company Name	Recommendation	Analyst Name	Page
Airlines	AMR	AMR Corp.	Buy AMR 7.0% B-Tranche 11-1 EETCs	Mark Streeter	3
Automotive	DAN	Dana Holding Corp.	Buy DAN 6.75% Sr. Notes due 2021	Eric Selle	4
Automotive	TTMTIM	Jaguar Land Rover	Sell TTMTIM 5.625% Sr. Notes due 2023	Eric Selle	5
Cable/Satellite	WOWFINFIN	WideOpenWest	Buy WOWFINFIN 13 3/8s '19 @ \$113.75, 9.95% ytm	Michael Pace	6
Chemicals	MOMENT	Momentive Performance Materials	Buy MOMENT 9.0% 2nd Lien Notes due 2021	Tarek Hamid	7
Chemicals	TROX	Tronox	Sell TROX 6.375% Senior Unsecured Notes due 2020	Tarek Hamid	8
Energy	EDG	Edgen Murray Corp.	Buy EDG 8.75% Sr. Secured Notes due 2020	Gregg Brody	9
Gaming	TRIBAL	Mohegan Gaming Authority	Buy TRIBAL 3rd liens due '12/16	Susan Berliner	10
Healthcare	KCI	Kinetic Concepts Inc.	Buy KCI 10.500% 2nd Lien Notes due 2018	David Common	11
Homebuilding	HOV	Hovnanian Enterprises	Buy HOV 9.125% 2nd Lien Notes due '11/20	Susan Berliner	12
Industrials	MTW	Manitowoc Co., Inc.	Buy MTW 5.875% Senior Notes due 10/15/2022	Yilma Abebe	13
Media/Broadcasting/Publishing	CCMO	Clear Channel Communications	Buy CCMO 11.00% Sr. G'teed. Notes due 2016	Avi Steiner	14
Metals & Mining	NGDCN	New Gold Inc.	Buy NGDCN 7.00% Sr. Notes due 2020	Dave Katz	15
Metals & Mining	BTU	Peabody Energy	Buy BTU 6.25% Sr. Notes due 2021	Dave Katz	16
Paper & Packaging	VRS	Verso Paper	Buy VRS 11.375% Sr. Subordinated Notes due 2016	Tarek Hamid	17
Retail	TOY	Toys R Us Inc.	Buy TOY 8.5% Secured Propco II Notes due 1-Dec-17	Carla Casella	18
Services	HTZ	Hertz Corp.	Buy HTZ 5.875% Sr. Notes due 10/15/2020	Yilma Abebe	19
Technology	IPMT	iPayment	Buy IPMT 10.25 % Sr. Notes due 2018	Thomas Egan	20
Technology	IPMT	iPayment	Buy IPMT 15%/15% PIK Notes due 2018 (HoldCo)	Thomas Egan	20
Telecommunications	CTL	CenturyLink	Buy CTL 7.65% Sr. Notes due 2042	Thomas Egan	21

Source: J.P. Morgan.

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AMR Corp.	AMR	Airlines	Buy AMR 7.0% B-Tranche 11-1 EETCs	Mark Streeter	3
CenturyLink	CTL	Telecommunications	Buy CTL 7.65% Sr. Notes due 2042	Thomas Egan	21
Clear Channel Communications	CCMO	Media/Broadcasting/Publishing	Buy CCMO 11.00% Sr. G'teed. Notes due 2016	Avi Steiner	14
Dana Holding Corp.	DAN	Automotive	Buy DAN 6.75% Sr. Notes due 2021	Eric Selle	4
Edgen Murray Corp.	EDG	Energy	Buy EDG 8.75% Sr. Secured Notes due 2020	Gregg Brody	9
Hertz Corp.	HTZ	Services	Buy HTZ 5.875% Sr. Notes due 10/15/2020	Yilma Abebe	19
Hovnanian Enterprises	HOV	Homebuilding	Buy HOV 9.125% 2nd Lien Notes due '11/20	Susan Berliner	12
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Verso Paper	VRS	Paper & Packaging	Buy VRS 11.375% Sr. Subordinated Notes due 2016	Tarek Hamid	17
WideOpenWest	WOWFINFIN	Cable/Satellite	Buy WOWFINFIN 13 3/8s '19 @ \$113.75, 9.95% ytm	Michael Pace	6

Source: J.P. Morgan.

*Pricing in this report is the most recent available.*

## AMR Corp. (AMR)

**Overweight**  
 Moody's: B1  
 S&P: B+

### Airlines

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**Buy AMR 7.0% B-Tranche 11-1 EETCs**  
 (31-Jan-18 maturity, 8-Feb-17 AL)

**Offered at \$106.125 (5.19% yield); Target: \$108.5 (4.52% yield)**

### Credit and Investment Highlights:

- AMR Corporation is the parent company of American Airlines, one of the world's largest international airlines. On 29-Nov-11, AMR filed for Chapter 11 bankruptcy protection. On 14-Feb-13, AMR and US Airways announced plans to merge. On 27-Mar-13, the bankruptcy judge overseeing the case approved the merger. Final DoJ and DoT approvals are expected later this year. We expect an exit from bankruptcy and merger in early 4Q13.
- This deal is backed by 15 x 737-800s (1999-2001), 6 x 757-200 ETOPS (1999, 2001), 2 x 767-300ERs (1999), and 7 x 777-200ERs (1999, 2000). The 7.00% bonds are the B-tranche behind the 5.25% A-tranche.
- Using a mean of appraisals from Aviation Specialists Group (ASG) and Ascend Worldwide, we calculate a current market value loan-to-value (LTV) of 84.9% through this B tranche. After applying our haircuts, we calculate our JPM LTV of 91.2% (assuming full draw of the liquidity facility which covers 18 months of interest). The step-up in leverage from the As to the Bs is 19.4%.

### Why This Pick Should Outperform:

- We think the A-B spread in EETCs is too wide (the current range is ~200-250bps; we think fair value is 75-100bps). For the AMR 11-1 deal, the A-B spread appears wide at ~220bps. In general, we expect B-tranches to outperform A-tranches going forward. Note that the average senior/sub spread in HG Banks is only 55-60bps.
- The ~220bp spread pick-up for 19% of leverage is too wide, in our opinion, given the fact that these core-to-the-fleet aircraft are cross defaulted and cross collateralized, minimizing the probability of a rejection in the event of another AMR bankruptcy down the road.
- We expect ratings on the 7% to rise 2-3 notches once AMR emerges from Ch. 11 and the agencies re-rate the issuer higher (the upside at Fitch is higher if they rate the deal). Our target yield is that of our current HY BB index, which we believe is achievable for the 7% given the short '17 average life.
- We expect New American Group to achieve higher EBITDAR margins than DAL and UAL in 2014, in part due to AMR and LCC unions' negotiating away profit sharing. Specifically, we expect 2013/2014 EBTIDAR of \$6.0bn and \$6.8bn, or 14.9% and 16.1% margins, respectively. See our merger model [here](#).

### AMR Relative Value

Ticker	Rating	Coupon	Maturity/Avg Life	Price	Yield	Z spread
AMR 11-1B	B1/B+	7.00%	2018/2017	\$106.125	5.19%	472bp
UAL 12-2B	Ba2/BBB-/BBB-	5.50%	2020/2018	\$104.75	4.49%	335bp
DAL 12-1B	Ba3/BB	6.875%	2019/2017	\$105.5	5.35%	471bp

Sources: J.P. Morgan, Moody's, and S&P.

**Overweight**

Moody's: B2; Outlook, S  
 S&P: BB; Outlook, P

**Automotive**

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## Dana Holding Corp. (DAN)

Buy DAN 6.75% Sr. Notes due 2021

Offer: \$110.00 (4.1% YTW, 380bp STW)

Target: \$112.00 (3.4% YTW, 311bp STW)

**Credit and Investment Highlights:**

- Over the past four years, Dana has lowered leverage by 2.3x (despite acquiring controlling stakes in two of its JVs) via EBITDA growth, stock issuance, asset sales and free cash flow generation.
- Despite guiding to a 2% decline in sales, Dana expects FY13 EBITDA to grow 3% and free cash flow to total \$250mm.

**Why This Pick Should Outperform:**

- **Credit Improvement:** We project Dana will generate FY13 EBITDA of \$808mm, resulting in coverage of 11.5x, leverage of 1.1x and net leverage of negative 0.5x. We note that the gross leverage levels are roughly half the average leverage in the J.P. Morgan High Grade index and that net debt is expected to decline 0.2x y/y.
- **Total Return Potential:** Should the 6.75% notes (B2/BB, stable/ positive outlooks) due 2021 converge with J.P. Morgan's BB index (358bp STW), investors could achieve a 6.7% total return in the next year (or 9.0% to the JPM split BBB Index). We believe an upgrade is likely and these returns would exceed the 5.7% YTW of the JPM HY Index and the 4.7% YTW of the Auto sector.
- **Relative Value:** We expect Dana's notes to generate more total return than similarly rated bonds of LEA, DLPH and TRW, all of whom have similar credit profiles but are more shareholder friendly with their free cash flow, have more European exposure (3 peers generate 40% of sales from European production vs. 28% for Dana) and are less levered to the heavy duty market. Lear's 4.75% Ba2/BB rated notes of 2023 are offered at 45bps inside Dana's bonds, TRW 4.5% Ba2/BB rated notes of 2021 are 99bps inside and Delphi's Ba1/BB+ rated notes of 2023 are 64bps inside. In turn, despite their shorter duration (3 competitor bonds mature in 8-10 years vs. 3-year 1st call for Dana), Dana's notes offer 6.1% current yield vs. 4.7% for its peers.
- **Liquidity:** In FY13, we estimate Dana will generate \$424mm in core free cash flow (EBITDA less capex, interest and taxes), which represents 47% of its outstanding debt. Dana's bond covenants are fairly weak, as they offer little protection over restricted payments to equity holders. Despite our projection for Dana to spend \$104mm on preferred and common dividends and repurchases of common stock, we expect Dana to generate \$203mm of free cash flow. We contrast this fully loaded free cash flow versus projections of negative \$391mm at Lear and negative \$348mm at TRW due to their shareholder friendliness. Dana also has no considerable outstanding debt maturing until 2019 and \$1.4bn in total liquidity.

DAN -- Relative Value

Ticker	Rating	Coupon	Maturity	Offer Price	YTW	STT	'13E Lev
DAN	B2/BB	6.750%	2021	110.00	4.1%	380bp	1.1X
DLPH	Ba1/BB+	5.000%	2023	107.25	3.8%	316bp	1.0x
LEA	Ba2/BB	4.750%	2023	97.75	5.0%	335bp	1.0x
TRW	Ba2/BB	4.500%	2021	101.50	4.1%	281bp	0.9x

Sources: J.P. Morgan, Moody's, and S&P.

## Jaguar Land Rover (TTMTIN)

Sell TTMTIN 5.625% Sr. Notes due 2023

Offer: \$105.875 (4.7% YTW, 342bp STW)

Target: \$97.25 (6.0% YTW, 430bp STW)

### Underweight

Moody's: Ba3; Outlook, S  
 S&P: BB-; Outlook, P  
 Fitch: BB-; Outlook, S

### Automotive

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### Credit and Investment Highlights:

- Jaguar Land Rover (JLR) designs, develops, manufactures and sells premium sports sedans and sports cars (Jaguar brand) and premium all-terrain vehicles (Land Rover brand). During its 3Q12 ended Dec. 2012, JLR's revenues grew 1% to £3.8bn but its EBITDA fell 17% to £0.5bn due to elevated product development costs and mix degradation. After £0.2bn of YTD cash burn, JLR ended 3Q12 with net debt of negative £0.3bn. At Dec. 2012, the company had cash of £2.1bn and undrawn committed facilities of £1.0bn.

### Why This Pick Should Underperform:

- Credit Profile:** For FY13E we estimate JLR will generate EBITDA of £2.2bn. After backing out nearly £0.9bn of capitalized R&D, EBITDA would total £1.3bn and total leverage would be 1.7x. We expect EBITDA to lag its £2.4bn of expected capex, taxes, interest and pension provisions. While some of this cash burn is offset by £0.5bn in estimated working capital inflows, JLR's capex should remain elevated for the next couple years. Due to JLR's new UK engine facility, its JV in China with Chery and potential for projects in Brazil and Saudi Arabia, we project 2014-15 capex to average £2.7bn per year. These levels of capex are £1.0bn above the average annual capex experienced in FY12-13. More importantly, JLR's FY14-15 capex is expected to exceed fully loaded EBITDA (before backing out capitalized R&D) by £0.3bn.
- Relative Value:** JLR's 5.625% Ba3/BB- rated notes of 2023 are offered at 4.7% YTW and 342bp stt. These levels compare to the 5.3% YTW and 493bp stt generated by Chrysler's 8.25% B1/B rated notes of 2021. Chrysler also has close to zero net debt, but is less European focused. Furthermore, Chrysler generates free cash flow, as its FY13 estimated EBITDA exceeds capex by \$1.8bn. We expect JLR's FY14 EBITDA (ex capitalized R&D) to lag its capex by £0.6bn.
- European Exposure:** During the LTM as of Sept. 2012, JLR's sales were split between Europe at 22% (ex Russia and UK), UK 19%, NA 18%, China 19%, AP 5% and ROW 17%. We note that its 41% combined European exposure could hurt results in the future. IHS is projecting total European production to be down 9% y/y in 1Q13 and down 3% for FY13 after declining 5% during FY12. We expect JLR to outpace overall EU volumes due to its luxury focus and new products, but note that profits have been hit over the past two quarters due to mix (new lower priced products selling more volumes but less profits than prior products). For example, JLR's 3Q12 retail volumes were up 14%, but its EBITDA was down 17% and caused its EBITDA per retail sale to plunge 27% y/y.

### TTMTIN- Relative Value

Ticker	Rating	Coupon	Maturity	Offer Price	YTW	STT	'13E Lev
TTMTIN	Ba3/BB-	5.625%	2023	105.875	4.7%	342bp	1.7x
CHRYGR	B1/B	8.250%	2021	112.000	5.3%	493bp	2.0x

Sources: J.P. Morgan, Moody's, and S&P.

## WideOpenWest (WOWFINFIN)

Buy WOWFINFIN 13 3/8s '19 @ \$113.75, 9.95% ytm

### Overweight

Moody's: B2; Outlook, S  
 S&P: B; Outlook, S

### Cable/Satellite

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### Credit and Investment Highlights:

- **Financial results for WideOpenWest have been generally in line with our expectations.** Unit adds have been slightly below our estimates, as we suspect churn remains elevated in acquired Knology markets, but reported revenue and adjusted EBITDA growth has been in line (+4% to +5% y/y). We expect similar results/trends in 1Q13 (+3% revenue/EBITDA growth; slightly negative PSUs) and for results to pick up momentum beginning in 2Q13 (timing of rate increases, progress on Knology integration, etc.). We continue to model full-year revenues, reported adjusted EBITDA, and capex of ~\$1.25bn (+4%), ~\$452mn (+8%), and \$230mn, respectively.
- **Following the company's successful bank refinancing, we note WOW is now FCF positive on a runrate basis (albeit slightly).** WOWFIN recently refinanced its \$1.915bn TLB with a new \$1.96bn facility (incremental for fees/revolver paydown). We estimate this refinancing will save the company ~\$30m in annual interest expense. With this event behind the company, we think focus for investors should shift to operational execution, which we expect to show more meaningful progress in 2Q13 and beyond.
- **We expect leverage to improve during 2013.** At year-end 2012, total net leverage was 7.0x, unsecured leverage was 6.3x, while bank leverage was 4.6x. We forecast these metrics to decline to 6.6x, 6.0x, and 4.4x at year-end 2013.

### Why This Pick Should Outperform:

- **We continue to view WOWFIN as our top total return idea within HY cable/satellite.** In our opinion, WOW bonds still offer double-digit return profiles (big coupons), even after a few points of run-up since the beginning of 2013. This compares to our 4% to 6% return expectations for most other high-yield cable/satellite bonds and a HY market trading just inside 6%. Although the bonds have already hit our original price targets (January 28, 2013 initiation report) we still think upside exists, particularly in the 13 3/8% subordinated notes.

### WOWFIN Relative Value

Ticker	Rating	Coupon	Maturity	Bid Price	YTW	Gross Lev	Net Lev
CHTR	B1/BB-	7.375%	2020	111.0	4.26%	5.2x	5.2x
CVC (HoldCo)	B1/B+	7.750%	2018	112.3	4.96%	5.1x	4.7x
DISH	Ba2/BB-	7.875%	2019	115.5	5.01%	4.8x	1.6x
MCCC (LLC)	B3/B-	7.250%	2022	109.5	5.35%	5.4x	5.4x
CEQUEL	B3/B-	6.375%	2020	103.8	5.57%	6.1x	5.8x
WOWFIN	Caa1/CCC+	10.250%	2019	111.0	7.67%	6.3x	6.3x
WOWFIN	Caa1/CCC+	13.375%	2019	112.8	10.18%	7.0x	7.0x
Cable/Sat Index					5.63%		
Global HY Index					5.88%		
Split B Index					7.40%		

Sources: J.P. Morgan, Moody's, and S&P

Note: DISH leverage is pro forma for recent issuance; CHTR leverage is through CCOH, pro forma for Optimum West acquisition and financing and includes CCVII preferreds; CVC leverage pro forma for Optimum West sale and normalized for Hurricane Sandy

## Momentive Performance Materials (MOMENT)

### Overweight

Moody's: Caa1; Outlook, S  
 S&P: CCC; Outlook, N

### Chemicals

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Buy MOMENT 9.0% 2nd Lien Notes due 2021

Offered at \$77.50 (13.81%); Target \$94.66 (10.0%)

### Credit and Investment Highlights:

- Momentive Performance Materials is a former subsidiary of General Electric that was purchased by Apollo Management and its affiliates via a leveraged buyout in December 2006. The company is the world's second largest producer of silicones and silicone derivatives and is a global leader in products derived from quartz and specialty ceramics.
- On April 1st, Momentive reported in-line 4Q12 results. Segment EBITDA of \$50 million was in line with our estimate of \$51 million. Momentive results improved sharply from a very disappointing 4Q12, driven by cost reduction initiatives and volume increases in the silicones business, but still remain well below normalized earnings levels. Momentive finished 4Q12 with \$362 million of liquidity, up sharply from 3Q12. The company also disclosed that it has entered into a new \$75 million cash flow facility to supplement the company's \$270 million ABL facility.

### Why This Pick Should Outperform:

- The company began to comp positively on EBITDA in 4Q12 as the silicones industry continues to grow into capacity. Leverage remains highly elevated; however, we do not believe anything is fundamentally broken in the Momentive business model. Modest volume growth and fixed cost absorption are the focus for 2013, and should help drive Silicones earnings higher sequentially through the year. Price increases in silicones are likely a 2014 story at best. Additionally, quartz results should improve through 2013 as semiconductor demand recovers. In the interim, liquidity looks strong (PF 4Q12 liquidity north of \$435 million), and the company has no maturities until 2016.
- Longer term the sustainability of the capital structure remains a question. However, the company has many potential options to address the capital structure, including debt-for-equity swaps, refinancing of expensive first and 1.5 lien debt, asset sales, and potentially a merger with sister subsidiary Hexion. Most importantly, we are very comfortable with enterprise valuations greater than \$2.5 billion, and that implies a very high recovery floor on the 9% Notes no matter the capital structure machinations.

MOMENT Relative Value

Ticker	Rating	Coupon	Maturity	Price	YTW	STW
MOMENT	B1/CCC+	8.875%	2020	105.000	7.74%	708bp
MOMENT	B2/CC	10.00%	2020	101.000	9.76%	910bp
MOMENT	Caa1/CC	9.00%	2021	77.750	13.74%	1,206bp
TRINSE	B1/B+	8.75%	2019	99.250	8.91%	825bp
PERHOL	Caa2/CCC	11.00%	2017	103.125	9.80%	949bp
TPCG	B3/B	8.75%	2020	104.750	7.70%	703bp

Sources: J.P. Morgan, Moody's, and S&P.

## Tronox (TROX)

**Sell TROX 6.375% Senior Unsecured Notes due 2020**

**Bid at \$96.50 (6.99%); Target: \$91.09 (8.00%)**

### Underweight

Moody's: Ba3; Outlook, S  
 S&P: BB; Outlook, S

### Chemicals

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### Credit and Investment Highlights:

- Tronox is the fifth largest global producer of both titanium dioxide and titanium feedstocks. Titanium dioxide has an unparalleled ability to impart the color white and is very difficult to substitute in painting and dyeing applications. The TiO<sub>2</sub> industry has all the hallmarks of a very profitable commodity, with growing demand, low threat of substitution, and a high concentration of market share among a few participants. However, with the exception of a few brief moments of success, the industry has generally disappointed.
- On February 21st Tronox reported disappointing 4Q12 results. Reported EBITDA of \$71 million compared with the pre-released EBITDA of \$70 million. Reported results matched the preliminary results provided earlier in the month, but Pigments results were surprisingly negative. Tronox burned cash during the quarter, driven by a large outflow from accounts payable. Management expects pigment prices to decline further in 1Q13, consistent with other industry players.

### Why This Pick Should Underperform:

- The profitability of the pigments and mineral sands industries are highly dependant on operating rates given their commoditized nature. Softening demand from European and Asian construction markets, highly elevated inventories and lower per unit customer consumption has driven a significant decline in pigment volumes and pricing since 2Q12. The recent collapse in pigment demand has also significantly impacted the mineral sands industry, which is heavily dependant on the pigments end-market. Mineral sand prices are down 10-30% across grades YTD, despite significant reductions in production from industry leaders, including Iluka.
- On recent calls, Tronox has noted that it is interested in pursuing strategic opportunities and the stated priority use of the company's new term loan is potential acquisitions. Separately Rockwood CEO Seifi Ghasemi has said that Rockwood will "pursue every possible option" to divest the company's Sachtleben pigments portfolio during 2013. Additionally, given Huntsman's efforts to buy Tronox out of bankruptcy, media reports have focused on the possibility Tronox would buy Huntsman's TiO<sub>2</sub> assets instead. We believe the acquisition of either of these assets would be a significant leveraging event for Tronox, as we outlined in our recent [initiation](#).
- Tronox B2/BB- rated bonds currently trade inside 7%, and we believe a downgrade from S&P would likely push bonds wider. Current ratings at S&P look very high given acquisition risk, the cyclicality of the industry, and it's severely challenged current operating environment.

TROX Relative Value

Ticker	Rating	Coupon	Maturity	Price	YTW	STW
TROX	B2/BB-	6.375%	2020	96.50	6.99%	632bp
ROC	Ba2/BB	4.625%	2020	102.75	4.06%	339bp
HUN	B1/BB-	4.875%	2020	101	4.71%	404bp
PERHOL	B2/B	8.75%	2017	106	6.57%	626bp

Sources: J.P. Morgan, Moody's, and S&P.

## Edgen Murray Corp. (EDG)

### Overweight

Moody's: Caa1; Stable  
 S&P: B+, Stable

### High Yield Energy

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J.P. Morgan Securities LLC



Buy EDG 8.75% Sr. Secured Notes due 2020

Offered at \$105 (7.63%); Target: \$108 (7.00%)

#### Credit and Investment Highlights:

- Edgen Group is a global distributor of steel products primarily to the energy, mining, power, petrochemical and civil construction markets. Edgen offers a broad product catalog of more than 14,000 specialty products and maintains inventory in more than 100,000 tons of pipes, plate and sections, including highly engineered prime carbon or alloy steel pipe, pipe components, valves and high grade structural sections and plate. Edgen also provides OCTG to the upstream conventional and unconventional U.S. drilling markets. For the twelve months ended December 31, 2012, Edgen generated pro forma sales of \$2.1 billion and Adjusted EBITDA of \$145 million.
- **Fundamentals for EDGMUR have softened, but continue to improve year over year.** The company recently provided 2013 revenue guidance of \$2.0-\$2.2 billion (+2.2% y/y) and EBITDA guidance of \$142-\$152 million (+1.4% y/y). International and GOM energy are expected to improve, while weakness in North American should impact OCTG growth. Management expects E&I revenues to improve 10.6% y/y, while OCTG is expected to decline 8.2% y/y.

#### Why This Pick Should Outperform

- **Continuing to deleverage.** We expect the company to continue to deleverage through out the year, paying down bank debt with excess cash flow of approximately \$70 million. We expect Secured Debt/EBITDA to continue to improve by YE13, to 3.6 x from 4.2x
- **Compelling Relative Value.** Secured bonds offered at \$105 and 7.6% YTW look cheap relative other secured Low B/CCC rated distributors of steel products and Energy service companies that are not deleveraging at the same rate as EDG. In addition, given the relative YTW of BB (4.4%), B (5.7%) and split B (7.3%), we believe EDG will outperform

EDG Relative Value

Ticker	Coupon	Amt (\$mn)	Maturity	Next Call Date	Ratings	Price	YTW	STW	Debt/EBITDA
EDG	8.750%	540	1-Nov-20	1-Nov-15	Caa1/B+	\$104.00	7.85%	715	4.2x
<b>Metals Distributors</b>									
RYI	9.000%	\$600	15-Oct-17	15-Apr-15	Caa2/CCC+	\$110.00	5.80%	558	4.9x
<b>High Beta Energy</b>									
EXPRO	8.500%	\$991	15-Dec-16	15-Dec-13	B3/B	\$106.25	5.22%	509	3.8X
FLI	9.250%	\$1,300	15-Oct-20	15-Apr-15	B2/B+	\$105.75	7.941	724	6.3x
HERO	10.25%	\$200	1-April-19	1-Apr-15	Caa1/B	\$111.25	7.49%	726	5.2x
VTG	7.500%	\$1,150	1-Nov-19	1-Nov-15	B3/B-	\$103.50	6.73%	603	12.4z

Sources: J.P. Morgan, Moody's, and S&P.

## Mohegan Gaming Authority (TRIBAL)

### Overweight

Moody's: Caa1; Outlook, S  
 S&P: B-; Outlook, S

### Gaming

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J.P. Morgan Securities LLC



Buy TRIBAL 3rd liens due '12/16.

Offered at \$98.750 (10.911%); Target: \$101.00

### Credit and Investment Highlights:

- Mohegan is the largest tribal casino operator in the U.S., with its flagship property being Mohegan Sun in CT, while it also owns Mohegan Sun at Pocono Downs in PA (located on commercial land). Unlike most tribal credits, TRIBAL is a public filer and has a database of customers in excess of 4 million. Management has been focusing on diversifying its operations with a small investment made in A.C. (Resorts) and a management contract in place. TRIBAL is also vying for a license in Western MA and is pursuing a management agreement with the Cowlitz tribe for a project in La Center, WA.
- Management recently obtained third-party financing to construct a hotel at its PA property which should help generate traffic and is also pursuing a new hotel in CT. In '9/12, the authority implemented a \$20mm cost savings program, and management continues to look for additional cost saving opportunities.

### Why This Pick Should Outperform:

- Attractive Relative Value.** These bonds offer one of the highest yields in the sector at 10.91%, which we believe is quite attractive given management's focus on deleveraging. In addition, potential upcoming positives include monetizing non-core assets, refinancing its capital structure, and improving monthly gaming numbers, while additional cost savings should bolster margins.
- Focused on Debt Reduction/Refinancing.** We believe management is already focused on refinancing its entire capital structure, as its Revolver & TL-A mature in '3/15, its 10.5% 3rd liens and 11% sub notes are currently callable at par, while its TL-B becomes callable on 3/6/14 and its 2nd liens become callable in 11/14. Although the company is currently not generating free cash flow, we estimate that in 2015 it will generate just over \$50 mm (which is when the relinquishment payments cease) with FCF targeted at debt reduction. We also believe a non-core asset sale could facilitate deleveraging, and we estimate its retail mall at the CT property could generate roughly \$150mm of proceeds. We estimate roughly \$13mm of term loan amortizations in 2013, and in 2/13, TRIBAL retired a \$15.8mm bond maturity and has a \$21.2mm bond maturing in 8/14 which it expects to pay off with cash on hand.
- Collateral Available.** Although TRIBAL is a Native American casino and thus has a component of sovereign risk, its Pocono Downs facility is not located on sovereign land and was recently appraised for \$482mm. In addition, collateral includes a leasehold mortgage in non-gaming assets that produce an income stream and could be used for a sale-leaseback or an outright sale. These include a 1,175-room hotel, 50-outlet retail mall, 10K seat arena, and convention/meeting space. Of course any asset sale would need to comply with bank covenants as well as bond covenants (meaning some debt pay down).

### TRIBAL Relative Value

Ticker	Rating	Coupon	Maturity	Price	YTW	STW
TRIBAL	Caa3/CCC	10.50%	2016	98.75	10.91%	1,060bp
MNTG	Caa1/B-	11.50%	2019	104.25	10.25%	957bp
BORGAT	B2/B+	9.50%	2015	104.00	7.72%	750bp

Sources: J.P. Morgan, Moody's, and S&P.

## Kinetic Concepts Inc. (KCI)

### Overweight

Moody's: B2; Outlook, S  
 S&P: B; Outlook, S

### Healthcare

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J.P. Morgan Securities LLC



### Buy KCI 10.500% 2nd Lien Notes due 2018

Offered at \$109.13 (8.06%); Target: \$110.50 (7.72%)

#### Credit and Investment Highlights:

- Kinetic Concepts, Inc. pioneered negative pressure wound therapy ("NPWT"), which represents over 70% of EBITDA today. It diversified into soft tissue biologics by buying LifeCell for \$1.7 billion in 2008 (~12x EBITDA). FY12 revenues and EBITDA were \$1.7 billion and \$753 million. Kinetic Concepts has two segments:
  - **KCI** – advanced wound therapies, over 90% of which is NPWT. For FY12, AHS reported revenues of \$1.3 billion.
  - **LifeCell** – market leader in soft tissue matrices, with an estimated 60% market share. For FY12, LifeCell reported revenues of \$434 million.
- Acquired in 2011 by Apax, the Canada Pension Plan Investment Board, and the Public Sector Pension Investment Board for \$6.3bn (~8.5x EBITDA).
- In November, KCI sold its TSS (bed business) to Getinge AB for about \$250 million. This business had a run-rate EBITDA of approximately \$25 million.
- In January, CMS announced the competitive bidding payment amounts for Round 2. NPWT will face a weighted price cut of about 41% beginning in July for this Round. The annualized pricing impact is about \$30 million.

#### Why This Pick Should Outperform:

- In our view, the value of LifeCell, plus cash, about equals first lien debt.
- We think KCI will deliver 2013 EBITDA of ~\$700mm vs. our mid-2012 expectation of \$640mm. Revenue has been weaker than expected, but cost-cutting has far outpaced.
- We don't think competitive bidding results will materially impact pricing on the non-Medicare NPWT (~90% of NPWT revenues) business any time soon.
- LifeCell revenue growth should rebound a few percentage points, and modest acquisitions may add to that in year ahead.
- Liquidity looks strong with \$500mm in cash, and we expect FCF generation of about \$125mm this year, about 3% of total debt.
- We're not counting on "the device tax" being rescinded. But that has some bipartisan support and could be a modest boost to EBITDA if enacted.
- The second liens are rated B3/B. But they've never traded in line with that index and now trade close to the CCC index, which has outperformed: The 10-1/2s are offered only ~75bps inside CCCs, vs. an average of 175bps in the last year.

#### KCI Relative Value

Ticker	Rating	Coupon	Maturity	Price	YTW	STW
CONVAT	Caa1/B	10.500%	15-Dec-18	111.75	6.03%	583bp
KCI	B3/B	10.500%	1-Nov-18	109.13	8.06%	744bp
KCI	Caa1/CCC+	12.500%	1-Nov-19	100.25	12.42%	1,180bp

Sources: J.P. Morgan, Moody's, and S&P.

## Hovnanian Enterprises (HOV)

Buy HOV 9.125% 2nd Lien Notes due '11/20

Offered at \$112.25 (6.39%); Target: \$114.000 (5.72%)

### Overweight

Moody's: Caa2; Outlook, S  
 S&P: CCC+; Outlook, S  
 Fitch: CCC; Outlook, S

### Homebuilding

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J.P. Morgan Securities LLC



### Credit and Investment Highlights:

- HOV operates in 37 housing markets throughout 16 states and is the 6th largest public homebuilder based on closings. The company serves a diverse mix of end customers with exposure to first-time home buyers (33%), move-up buyers (33%), luxury buyers (21%), and active adult buyers (13%). Its largest markets based on revenues include the Southwest (36%), Mid-Atlantic (19%), Northeast (16%), California (13%), and Midwest (7%).
- With only \$127mm of debt coming due prior to 2016, near-term maturities seem quite manageable. Although HOV's liquidity options are much more constrained than its peers, HOV's liquidity levers include its land banking arrangement with GSO and potentially equity issuance or non-recourse mortgages.
- We believe these bonds are covered with inventory of \$575.2mm and cash of \$219.1mm. This \$794.3mm of collateral roughly covers the \$577mm 1st lien bonds and these \$220mm 2nd lien bonds. We expect HOV's inventory position to increase with the improvement in the overall market.

### Why This Pick Should Outperform:

- **Strong Housing Fundamentals.** We believe the housing recovery is here to stay and anticipate a very solid spring selling season due to significant pent-up demand, low inventory, excellent affordability, and the improving job market. Although the overall sector trades quite rich, this is one of the yieldier bonds in the sector, as well as one of the few secured bonds.
- **Attractive YTC.** We expect these bonds to be refinanced on the first call date (11/15/15) at \$106.844. With our expectations for a continued housing recovery over the next few years, we believe HOV could refinance these bonds at a notably lower coupon, which could save HOV \$6mm annually (assuming a 6.5% coupon). Although this bond has tightened a lot, it still offers 70 bps of pickup over the JPM HY Index and remains one of the cheapest bonds in the sector.
- **Expected Improvement in Earnings vs. Some of its Peers.** We estimate HOV will generate EBITDA of \$137.3mm in 2013 versus \$58.3mm for BZH and \$146.2mm for KBH. We estimate HOV's net debt/EBITDA will end 2013 at 9.58x versus 20.4x BZH and 9.44x for KBH.
- **Other Potential Events.** HOV could issue equity/converts (equity market cap is \$750mm versus \$366mm for BZH), or HOV could look to clean up the \$127mm of front-end bonds by issuing a new unsecured bond with a longer maturity. HOV could also once again expand its land banking arrangement with GSO.
- **Technical Bid.** HOV is the highest yielding issuer in a sector that has significant positive operating momentum and few secured bonds. HOV is trading about 240 bps behind BZH's 2nd lien bonds.

### HOV Relative Value

Ticker	Rating	Coupon	Maturity	Price	YTW	STW
BZH	B2/B	6.625%	2018	109.00	3.85%	354bp
HOV	Caa2/CCC-	9.125%	2020	112.25	6.39%	572bp

Sources: J.P. Morgan, Moody's, and S&P.

## Manitowoc Co., Inc. (MTW)

Buy MTW 5.875% Senior Notes due 10/15/2022

Offered at \$105.25 (5.0%); Target: \$108.00 (4.5%)

### Overweight

Moody's: B3; Outlook, P  
S&P: B+; Outlook, S

### Industrials

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### Credit and Investment Highlights:

- **Geographic and customer diversification in attractive end markets.** Approximately 60% of MTW's business is tied to cranes, with the remaining 40% tied to foodservice. The crane business serves heavy construction, infrastructure, commercial construction, and high-density residential projects. The foodservice business services a wide variety of end markets, including food retail, travel, education, healthcare, and restaurant markets. Nearly 50% of the business is outside of North America, and no single customer accounts for more than 5% of total consolidated sales.
- **Sensitive to economic cycles.** Manitowoc's crane business is highly sensitive to the macro-economy. Manitowoc's foodservice equipment business diversifies the company's exposure to the highly cyclical cranes business.
- **Fourth quarter results were solid and in line with our expectations.** Manitowoc reported 4Q12 revenue of \$1,130 million, increasing 9% y/y, about in line with our estimate of \$1,162 million. Adjusted EBITDA in the quarter was \$117 million, improving 32% y/y, in line with our estimate of \$120 million. Margins improved 190bps y/y due to operating leverage in the crane business and cost saving initiatives in the foodservice business. The company's food services segment has grown over the last year and has consistently improved margins. We expect margins to continue to expand in both business segments.

### Why This Pick Should Outperform:

- **Over the next twelve months, we expect a meaningful decrease in leverage.** Our model shows the company de-levering to the mid-3s or lower by year-end 2013 with very little benefit from MTW's end markets improving. The company has a stated goal of reducing debt by ~\$200 million in 2013.
- **The credit remains one of our top risk-adjusted return ideas in Industrials.** While yields are below average relative to the overall high yield market, in the tightly trading industrial universe we think MTW 5.875s still have upside. Over the next twelve months, we expect MTW's bonds to support BB valuation. The J.P. Morgan domestic BB index is now at ~4.4%.

### MTW Relative Value

Ticker	Rating	Coupon	Maturity	Price	YTW	STW
MTW	B3/B+	5.875%	2022	105.25	5.03%	379bp
TEX	B3/B+	6.000%	2021	105.50	4.86%	404bp

Sources: J.P. Morgan, Moody's, and S&P.

## Clear Channel Communications (CCMO)

Buy CCMO 11.00% Sr. G'teed. Notes due 2016

Offered at \$80.00 (19.46% YTW, +1913 STW)

### Overweight

Moody's: Ca; Outlook, S  
 S&P: CCC+; Outlook, N  
 Fitch: CC; Outlook, S

### Media/Broadcasting & Publishing

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J.P. Morgan Securities LLC



### Credit and Investment Highlights:

- Clear Channel Communications is a diversified media and entertainment company that owns 840 domestic radio stations in 150 U.S markets, in addition to 108,000 display structures in the Americas outdoor segment and 650,000 displays across 28 countries outside the Americas through its 89% owned Clear Channel Outdoor subsidiary. Clear Channel also owns Katz Media Group, a full service media representation business, and Premiere Networks, a national radio network that produces, distributes or represents ~90 syndicated radio programs and serves more than 5,000 radio station affiliates.
- On February 28, 2013, Clear Channel priced a \$575mm 11.25% Priority Guaranteed Note offering due 2021. The proceeds, along with a draw under the company's ABL and cash on hand, were used to prepay \$847mm of its Term Loan A due 2014. By repaying the Term Loan A, the company gets additional flexibility to pursue unlimited below par non pro rata dutch tender offers for the Term Loan B and the ability to use \$200mm of cash to repurchase legacy notes that mature prior to 2016.
- On February 19th, 2013, Clear Channel reported its fourth quarter 2012 and full year results. Total 4Q revenues of \$1,696.3bn, up +2.6%, and EBITDA of \$546.6mm, up +6.0%, slightly beat our estimates on the back of strength in both the radio and outdoor segments. Management highlighted pacing data for CCME of -3% (Radio of +2%), Americas of +2%, and International of -1%.

### Why This Pick Should Outperform:

- While the top line in 2013 will likely be negative in the first half of the year, related to Europe in Outdoor and Traffic and Network comps in Radio, we expect YoY expense declines will largely offset the revenue softness, resulting in flattish EBITDA.
- As Clear Channel looks to address its 2016 bank debt stack (having just repaid the TL A) via exchanges and extensions, we believe the LBO Notes, which also mature in 2016, will shortly become the next tranche in focus. We believe an exchange/extension of the LBO Notes would make it easier for the company to tackle a larger portion of the 2016 secured stack.
- The ~\$57.4mm AHYDO related par repayment due on August 1st of this year represents approximately ~7% of the issue, and will likely occur prior to any exchange/attempt to address the LBO Notes. The payment effectively increases the calculated return of the 11% Notes. Though volatile, the CCMO LBO Notes offer Media investors well above average yields within our coverage universe.

### CCMO Relative Value

Ticker	Rating	Coupon	Maturity	Price	YTW	STW
CCMO	Ca/CCC+	11.000%	2016	80.000	19.46%	1913bp
CCMO	Ca/CCC+	10.750%	2016	78.500	19.91%	1959bp

Sources: J.P. Morgan, Moody's, and S&P.

## New Gold Inc. (NGDCN)

### Overweight

Moody's: B1; Outlook, S  
 S&P: BB-; Outlook, S

### Metals & Mining

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J.P. Morgan Securities LLC



### Buy NGDCN 7.00% Sr. Notes due 2020

Offered at \$108.125 (5.13%); Target: \$110.50 (4.34%)

#### Credit and Investment Highlights:

- **New Gold is a mid-size gold producer, headquartered in Canada.** The company has four operating mines in the US, Mexico, Australia and Canada. New Gold produced 412 koz of gold in 2012 with total cash costs of \$421 per ounce. For 2013, the company forecasts gold production of 440 koz to 480 koz at total cash costs of \$265 to \$285 per ounce.
- **New Gold's New Afton project has outperformed.** The Canadian mine met its targeted June 2012 production start and began commercial production in July 2012. In 4Q12, the mine operated at 11,700 tonnes per day, above its design capacity of 11,000 tonnes per day, highlighting New Gold's successful ramp-up. New Gold also has two development projects: the 30%-owned El Morro project in Chile and the 100%-owned Blackwater in Canada.
- **New Gold is a low cost gold producer, benefiting from significant by-products credits.** On a consolidated basis, we believe New Gold is at the border of the first quartile and the second quartile of the industry cost curve.

#### Why This Pick Should Outperform:

- **New Gold has lagged the tightening of the overall market.** In our opinion, the credit should trade at least 50bps inside of the Split BB index, which implies 2.5 points of upside on relative value alone.
- **We believe gold is better positioned than prices indicate.** As recent events would suggest, geopolitical risk remains in the system. Prices remain low compared to producers' all-in sustaining costs. The recent nonfarm payrolls report indicates that the US economy remains weak. European GDP estimates have been revised downward. We believe this environment will likely drag other commodities down and that gold will outperform.
- **We forecast an improvement in the company's credit metrics.** Even when using forward prices, we forecast that NGDCN's gross leverage will drop from 1.9x at 4Q12 to 1.7x by the end of 1Q13. We expect the company's 1Q13 EBITDA will improve y/y by 48%. By 1Q14, we expect the company to have negative net leverage. The company's balance sheet appears stalwart. Liquidity/debt was 91% at 31-Dec-12 and should increase to 97% by the end of 2013.

NGDCN Relative Value

Ticker	Rating	Coupon	Maturity	Price	YTW	STW
ELDCN	Ba3/BB	6.125%	2020	104.75	5.15%	446
IMGCN	B1/BB-	6.750%	2020	97.00	7.28%	554
NGDCN	B2/BB-	7.000%	2020	108.13	5.13%	444
NGDCN	B2/BB-	6.250%	2022	105.50	5.36%	362
FMGAU	B1/B+	6.875%	2022	106.25	5.77%	404
CARMLI	B1/BB	6.875%	2018	107.50	4.62%	439
IMNCN	B1/B+	7.500%	2021	108.38	5.74%	505

Sources: J.P. Morgan, Moody's, and S&P.

## Peabody Energy (BTU)

Buy BTU 6.25% Sr. Notes due 2021

Offered at \$104.25 (5.62%); Target: \$107.00 (5.23%)

### Overweight

Moody's: Ba1; Outlook, S  
 S&P: BB+; Outlook, S  
 Fitch: BB+; Outlook, S

### Metals & Mining

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J.P. Morgan Securities LLC



### Credit and Investment Highlights:

- **Peabody Energy is the largest private-sector coal company**, with thermal coal operations in the US and metallurgical and thermal coal operations in Australia. The company serves coal customers in more than 25 countries on six continents. As of 31-Dec-12, Peabody owned interests in 28 coal mining operations, including a majority interest in 27 coal mining operations located in the US and Australia and a 50% equity interest in the Middlemount Mine in Australia. In 2012, 55% of the company's coal revenue was generated from its US operations, with the rest coming from Australia. In addition to its mining operations, Peabody is engaged in marketing, brokerage and trading of coal through trading and business offices in China, Australia, the United Kingdom, Germany, Singapore, Indonesia, Mongolia and the U.S. In 2012, Peabody sold about 75% of its total sales (by volume) to U.S. electricity generators, 23% to customers outside the U.S. and 2% to the U.S. industrial sector.

### Why This Pick Should Outperform:

- **A weak first quarter is expected.** Consensus for 1Q13 EBITDA is \$235 million, down from \$409 million in 4Q12. The lower sequential result reflects higher costs during the conversion to owner-operator status at two Australian mines, as well as higher than normal overburden removal, lower realized metallurgical coal pricing, lower U.S. sales and pricing and startup costs.
- **But the rest of the year should show quarter-on-quarter improvement.** The conversion to owner-operator status should be completed in April 2013, lowering costs at those mines. Stripping ratios are expected to drop through the year. Finally, although we remain cautious on metallurgical coal prices, we believe they will trend up sequentially. We estimate this will result in 36%, 24% and 10% sequential quarterly EBITDA growth, in 2Q13, 3Q13, and 4Q13, respectively.
- **We believe the company is better positioned than its competitors.** The company's shift into PCI coal through 2011's Macarthur acquisition has allowed BTU to take advantage of steel producers' shift in coal blends. The company is a relatively low cost producer in the PRB. Its PRB and Illinois Basin operations should begin to see prices rise given greater year-over-year coal usage following an increase in natural gas prices. Finally, in our opinion, the company's trading operations and JV relationships provide it with the industry's best coal knowledge, allowing it to stay ahead of market movements.

BTU Relative Value

Ticker	Rating	Coupon	Maturity	Price	YTW	STW
BTU	Ba1/BB+	6.500%	2020	107.25	5.31%	357
BTU	Ba1/BB+	6.250%	2021	104.25	5.62%	389
CLD	B1/BB-	8.500%	2019	109.50	4.98%	475
CNX	B1/BB	8.250%	2020	111.50	4.14%	391
CNX	B1/BB	6.375%	2021	104.75	5.42%	473

Sources: J.P. Morgan, Moody's, and S&P.

## Verso Paper (VRS)

**Buy VRS 11.375% Sr. Subordinated Notes due 2016**

**Offered at \$58.00 (33.17%); Target: \$80.00 (20.00%)**

### Overweight

Moody's: B3; Outlook, N  
 S&P: B-; Outlook, S

### Paper & Packaging

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J.P. Morgan Securities LLC



### Credit and Investment Highlights:

- Verso is currently the second largest manufacturer of coated groundwood in North America with ~21% market share and the third largest manufacturer of coated freesheet in North America with ~12% market share. Verso was purchased by Apollo Management in 2006 and subsequently taken public through an IPO in May 2008.
- On March 7th, Verso reported 4Q12 results. Reported EBITDA of \$41 million compared to our estimate of \$48 million and the consensus estimate of \$44 million. Reported EBITDA results were OK at best, in our view, as strong volume and price performance were offset by higher-than-expected costs. However, insurance receipts boosted liquidity more than expected, and guidance and market commentary were constructive. Verso finished 4Q12 with \$204 million of liquidity, up from \$132 million at 3Q12. Note also that the company has announced a preliminary agreement for the sale of the remaining assets at Sartell and reiterated its expectation of finishing 2013 with over \$200 million of liquidity.

### Why This Pick Should Outperform:

- Following the Holdco PIK exchange, Verso has no debt maturities before the remaining stub subordinated notes mature in 2016. Additionally, the covenants in the company's new 11.75% 1.5 lien notes specifically prevent the company from utilizing its restricted payment capacity except for refinancing the subordinated notes.
- The Subordinated Notes offer a current yield of 19.6% with a clear maturity runway and a solid liquidity profile. Verso finished 4Q12 with \$204 million of liquidity, and we expect the sale of the Sartell site and hydro assets will provide an additional incremental boost to liquidity. We believe Verso will achieve management's expectations of finishing 2013 with over \$200 million of liquidity.
- Industry consolidation continues to seem inevitable over the longer term. Verso's rejected offer to acquire NewPage valued the company's first liens at over \$80. NewPage's post-reorganization equity is now trading at the equivalent of below \$40. We think it is highly unlikely that the valuation disconnect is allowed to persist and that some sort of industry consolidation will re-emerge in the near term. Ultimately, no matter how consolidation unfolds, taking out capacity should benefit pricing and margins long term and help this industry earn something resembling its cost of capital.

### VRS Relative Value

Ticker	Rating	Coupon	Maturity	Price	YTW	STW
VRS	Ba3/B+	11.75%	2019	109.25	9.29%	862bp
VRS	B3/B-	11.75%	2019	82	16.72%	1,605bp
VRS	Caa2/CCC	11.375%	2016	58	33.17%	3,285bp
VRS	Caa1/CCC	8.75%	2019	47	27.51%	2,684bp
SAPSJ	Ba2/BB	8.375%	2019	111	5.68%	555bp

Sources: J.P. Morgan, Moody's, and S&P.

## Toys R Us Inc. (TOY)

### Neutral

Moody's: Ba1; Outlook, N  
 S&P: BB-; Outlook, S

### Retail

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J.P. Morgan Securities LLC



**Buy TOY 8.5% Secured Propco II Notes due 1-Dec-17**  
**Offered at \$106 (5.4%); Target: \$108 (2.4%) YTC**

### Credit and Investment Highlights:

- Toys R Us is an international toy and baby-supply retailer with 875 stores across the US, 665 international stores and 163 licensed stores operating under the banners Toys R Us, Babies R Us, and FAO Schwarz. In addition to these stores, the company operates about 270 "pop up" stores around the holiday in smaller locations. The company's strategy over the past several years has been to combine certain Toys and Babies stores to better utilize space and even out store seasonality. Of its 1,540 stores, 183 of its US stores and 170 of its international stores are the new side-by-side format; 252 stores remain purely Babies R Us.
- TOY generated \$13.5 billion of revenue, ~\$1 billion of EBITDA, and \$251 million of free cash flow in the FY ended February 2, 2013.
- TOY was bought by Bain, KKR, and Vornado in 2005 for 8.6x EBITDA, it filed an IPO registration in 2009, but withdrew that registration last month.

### Why This Pick Should Outperform

- We are Neutral on the TOY credit, as the next three quarters are relatively insignificant for the company and with no IPO on the horizon, there is modestly greater dividend risk. It's 8.5% and 10.75% notes, however, are both secured at SPV property companies, and both are callable this year. We believe the 8.5s offer attractive yield for short-dated secured paper. The first call date is December 1, 2013 (at 104.25), stepping down annually to maturity. The yield to the first call is near 5.5%, and increases with each subsequent call. We believe there are 2-3 points of upside for this to trade in line with other YTC bonds.
- TOY is focused on improving gross margins and continuing its side-by-side store roll out, which should better lever its fixed cost structure in each store. This has improved cash flow over the past several years and allowed TOY to use some of its excess cash to begin paying down debt. It refinanced over \$800 million of European debt in the past three months with \$565 million of new debt, using excess cash to pay down the rest. We believe the company will do the same when it has the ability to call its Propco I bonds (10.75% callable in July).
- While the market appears concerned about overall big-box toy retailing, we point out that TOY has performed well online (growing this business to over \$1 billion today) and held its share in the market for toys. When we look at the composition of holiday sales, the company grew its sales of juvenile products (+9.8%, which we partly attribute to the side-by-side strategy) and learning toys (+1.2%). The entertainment category remains weak, owing to product lifecycles (-10.5%), and it decided to forego some promotion on seasonal goods to preserve margin (seasonal -15.3%)

### TOY Relative Value

Ticker	Rating	Coupon	Maturity	Price	YTW	STW
TOY (propcoil)	Ba1/BB-	8.5%	2017	106	5.43%	530bp
TOY (propco I)	B3/BB-	10.75%	2017	107.5	2.4%	231bp
BONT	Caa2/B-	10.625%	2017	100.785	0.587%	53bp
FNP	B2/B	10.5%	2019	112.375	3.1%	300bp
RAD	Caa2/CCC	9.5%	2017	105	-1.4%	-148bp

Sources: J.P. Morgan, Moody's, and S&P.

## Hertz Corp. (HTZ)

Buy HTZ 5.875% Sr. Notes due 10/15/2020

Offered at \$105.00 (4.8%); Target: \$106.75 (4.5%)

### Overweight

Moody's: B2; Outlook, S  
 S&P: B; Outlook, S

### Services

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J.P. Morgan Securities LLC



### Credit and Investment Highlights:

- **Hertz is one of the world's leading car and equipment rental brands.** Hertz Global operates one of the largest on-airport car rental companies in the United States and all major European markets. Pro forma for the Dollar Thrifty acquisition, Hertz and its independent licensees operate ~10,300 car rental locations in 150 countries. In the equipment rental business, Hertz is one of top equipment rental companies in a fragmented industry with a 4% market share. The largest 100 North American rental companies make up only 30% of equipment rental industry. Hertz operates through 315 equipment rental branches in the U.S., Canada, France, Spain, Italy, China and Saudi Arabia.
- **Positive fundamentals in both the car and equipment rental businesses.** In the car rental business, volume was positive y/y throughout 2012. Pricing in the equipment rental business continues to be strong with volumes continuing to increase y/y. As a result of these factors, Hertz's corporate EBITDA improved 18% y/y, and margins expanded 140bps in 2012.
- **De-levering credit story.** Our model shows HTZ net leverage of 2.6x at year end 2013 and 1.9x at year end 2014. Hertz's LTM PF net leverage is 3.3x.

### Why This Pick Should Outperform:

- **Margin expansion opportunity.** The equipment rental business continues to report strong EBITDA growth. In the fourth quarter, it generated revenue and EBITDA growth for the eighth consecutive quarter and is still ~30% below prior peak EBITDA. The equipment rental business, about 25% of EBITDA, should contribute to margin expansion in 2013.
- **Investment grade prospects.** While it will likely be several years (2014 or 2015) before Hertz's credit profile can support investment grade ratings, we think a path to IG should be visible by year end 2013. Over the next twelve months, we expect crossover investors to increasingly look at this credit.
- **Attractive on a relative value basis.** We think Hertz credit profile today should support BB valuation. We think bonds look cheap relative to the J.P. Morgan BB index now at ~4.4%.

HTZ Relative Value

Ticker	Rating	Coupon	Maturity	Price	YTW	STW
HTZ	B2/B	5.875%	2020	105.000	4.83%	402bp
CAR	B2/B	8.250%	2019	110.500	4.10%	354bp
URI	B3/B+	8.250%	2021	113.500	4.47%	415bp

Sources: J.P. Morgan, Moody's, and S&P.

## iPayment (IPMT)

### Overweight

Moody's: B2; Outlook, S  
 S&P: B; Outlook, S

### Technology

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### Buy IPMT 10.25 % Sr. Notes due 2018

Offered at \$93.25 (12.05%); Target: \$96.00 (11.30%)

### Buy IPMT 15%/15% PIK Notes due 2018 (HoldCo)

Offered at \$76 (22.78%); Target: \$80 (21.26%)

#### Credit and Investment Highlights:

- iPayment is a credit and debit card merchant acquirer focused on small merchants. The company's payment processing services enable merchants to accept credit cards, debit cards, checks, and gift cards as forms of payment for swipe transactions as well as card-not-present transactions that are conducted over the internet or phone. Services provided by iPayment include: transaction processing, risk management, fraud detection, merchant assistance and support and chargeback services related to disputes with cardholders. In December 2012, iPayment had 170k merchant accounts, with 118k active accounts. The company processed \$22bn of volume in 2012.
- iPayment's customer base consists of small merchants, which typically pay higher transaction fees than large merchants due to greater business risk, lower volumes, and difficulty in identifying them. Thus, iPayment can generate better margins by collecting the higher fees, while still receiving lower processing costs by aggregating small merchant transactions to receive larger volume discounts from their primary payment processor, First Data.

#### Why These Picks Should Outperform:

- Results for 4Q12 were fairly good, in our view, although we expect 1Q13 to be softer. The costs related to the embezzlement investigation were \$12.1bn, and we do not believe the related SEC investigation will result in any significant discoveries beyond what the company has reported. The iPayment, Inc. 10.25% notes due 2018 offer a yield of 12.05% and the iPayment Holdings 15%/15% PIK notes due 2018 offer a yield of 22.78%. Given the company's competitive positioning, these yields, and likely industry consolidation, we remain positive on the name.

IPMT Relative Value

Ticker	Rating	Coupon	Maturity	Price	YTW	STW
IPMT	B3/CCC+	10.25%	2018	93.25	12.05%	1,134bp
IPMT	Caa1	15%/15%	2018	76	22.78%	2,209bp
FDC	Caa1/B-	12.625%	2021	108.125	10.89%	976bp
TRUN	Caa1/B-	9.625%	2018	109.50	4.97%	456bp

Sources: J.P. Morgan, Moody's, and S&P.

## CenturyLink (CTL)

**Buy CTL 7.65% Sr. Notes due 2042**

**Offered at \$97.25 (7.89%); Target: \$99.75 (7.67%)**

### Overweight

Moody's: Ba1; Outlook, S  
 S&P: BB; Outlook, S  
 Fitch: BB+; Outlook, S

### Telecommunications

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J.P. Morgan Securities LLC



### Credit and Investment Highlights:

- CenturyLink is a local exchange carrier and the third largest U.S. telecommunications company, providing integrated broadband, voice, wireless, managed hosting and cloud services. The company operates a 230k mile-long national fiber network, manages 55 data centers in North America, Europe, and Asia, providing collocation services and/or multi-tenant managed services, comprising about 1.4mn square feet of sellable floor space, and offers advanced entertainment services under the Prism TV and DirecTV brands. CenturyLink also had 14,700 fiber to the tower builds as of the end of 2012. The company operates 13.7 million access lines in 37 states and has 5.85 million broadband subscribers and 1.9 million video customers (including both satellite and IPTV).
- We believe CenturyLink is a better credit risk than peer companies such as Windstream and Frontier. The company has lower leverage and greater scale than either of those companies, and has diversified its business away from the declining revenues associated with consumer voice telephony. We think CenturyLink, with its predictable cash flows, could become the de facto benchmark 'BB' place to invest in high yield telecom.

### Why This Pick Should Outperform:

- We believe CenturyLink's predictable cash flow will make the company's bonds a good place for portfolio managers to invest when seeking out bonds with a relatively low beta. CenturyLink was recently downgraded to below-investment grade status by all three rating agencies. The downgrades required that CenturyLink bonds be removed from investment grade bond indices and into high yield indices, which caused bonds to trade lower as investment grade index managers adjusted their portfolios. That trade now seems to have run its course, with the possible exception of CenturyLink long bonds, which still appear cheap to us as their longer duration tends to be avoided by many high yield investors.
- For investors who can tolerate duration, we particularly like the long bonds of 2042, which offer yields of about 7.89%. If you worry about treasury moves, you can hedge that bond and get a spread of +500bps, which we believe represents a bargain.

CTL Relative Value

Ticker	Rating	Coupon	Maturity	Price	YTW	STW
CTL	Ba2/BB	7.65%	2042	97.25	7.89%	500bp
WIN	Ba3/B	6.375%	2023	99.375	6.46%	460bp
FTR	Ba2/BB-	7.05%	2046	88.75	8.02%	513bp
CBB	B1/B	8.375%	2020	104.75	7.32%	625bp

Sources: J.P. Morgan, Moody's, and S&P.

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