

The Year in Review - 2013

*“If you like your 2013 returns, you can keep your 2013 returns. Period. You will not have to give your 2013 returns back in 2014, Period.”**

** - That is until QE4 stops.*

Distressed Investing 2013 Conf. – *Steve Gidumal, Virtus Capital, LP*

December 2, 2013



Noteworthy Events of the Past Year:

If you like your Illusions, you can keep your illusions.

- After the rumored American Airlines – USAir merger was announced, the DOJ on anti-trust grounds challenged the merger. Finally after months of DOJ-created delays airline unions brought pressure on the Admin to approve the deal.
- As discussed and panned last year, the JC Penney revamp by a former Apple exec, was a disaster. JCP stock continued to collapse until the CEO was removed. (\$20.00 on 12/31 to \$10.08 today). JCP faces a critical season.
- The Fed tries weaning the stock market off QE3 in August but there is an immediate sell off. The Fed quickly retreats, but with \$4 trillion of printed bonds on the Fed's balance sheet how long can this last? Prominent Democrat Warren Buffett says QE3 “*is not a good idea*” and that rates will rise when it is stopped.
- In May the Kodak asset sale does ***not*** get top dollar. Only \$530 mm comes in – enough to pay off the \$419mm DIP. Kodak stock collapses.
- In August, bondholders win a legal battle against Argentina requiring payment of the bonds at contractual rate. In Oct. the Supreme Ct passes on taking the case.



Noteworthy Events of the Past Year:

- The White House moves to take control of the profits at Fannie Mae & Freddie Mac. The income captures delays the US debt ceiling default by 6 months.
- On October 1 the ObamaCare website is launched, and the nation sees for the first time that “if it liked its plan” it cannot keep its plan. Over 5 million people lose their insurance coverage, putting the program in chaos.
- The Washington Post is sold to the founder of Amazon.com, completing the circle of “creative destruction” brought on by the internet. Newsweek stops publishing its magazine after over 50 years, and becomes a website.
- Interest rates move are on the march! The 10-year bond rate moves from 1.76% to 2.72%, a very significant move up.
- In Oct., the United States overtakes Saudi Arabia as having the world’s largest supply of oil & natural gas. The Administration pursues a policy of keeping oil prices high so as not to destabilize a very vulnerable Middle East, Russia & Venezuela. Some might ask why.



Noteworthy Events of the Past Year:

- After buying Lightsquared debt personally, DISH Chairman, Charles Ergen announces DISH will pay \$2.2 billion for Harbinger's Lightsquared. Auction is on-going, with DISH shareholders suing to stop DISH bid.
- **File This Under the Good Samaritan Kiss:** After JP Morgan helps the government (& the economy) by purchasing Bear, Stearns, the government turns around and sues JPM. Leave it to historians to figure out why JPM agreed to settle, but they did: For \$13 billion, for which very little of the money goes to alleged victims.
- **On average, 200 shares of a Hospital or Health Insurer's stock will help you pay for your healthcare insurance cost increase.**



You can Keep your 2013 Returns, Period: Comparison of Returns (YTD thru 11/25/13)

• Dow Jones Index (ex dividends)	+ 22.7 %	
• S&P 500 Index (ex dividends)	+ 26.4 %	
• Nasdaq Comp.	+ 32.3 %	
• 10 year Treasuries 2.72%)	- 4.9 %	(1.76% to
• HY Index	+ 5.6 %	
• Distressed Funds	+ 12.0 %	(+10% to +22%)
• Gold	- 25.2 %	(\$1,675 to \$1,252)

Source: Bloomberg, WSJ.



A Promised Economy

H-Yield Market continued its Strong growth in 2013
Equity Markets maintained Steady Growth

Total U.S. Issuance (\$ billions)

	<u>2008</u>	<u>2009</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>
H-Yield Issuance	73.6	163.2	243.8	316.1	477.1
					+50.9%
Equity Issuance	133.8	152.7	159.1	192.9	217.3
					+12.6%

Source: Bloomberg.



The Macro Environment 2013

*World Economies: The Industrial World got healthier in '13
(Economists are watching the 2nd Derivative – rate of change)*

	<u>GDP % Q3</u>	<u>GDP % Q2</u>	<u>Δ Q3/Q2</u>
China	7.8 %	7.5 %	+ 4.0 %
India	4.8 %	4.4 %	+ 9.1 %
Mexico	1.3 %	1.6 %	- 18.8 %
Russia	3.4 %	4.3 %	- 20.9 %
U.S.	1.6 %	1.6 %	+ 0.0 %
U.K.	3.8 %	3.5 %	+ 8.6 %
Canada	2.3 %	2.0 %	+15.0 %
Germany	1.1 %	1.2 %	- 8.3 %
Japan	2.7 %	1.1 %	+145.5 %

Source: Bloomberg. GDP growth Year-over-Year by Quarter.



The Macro Environment 2013

The PIGS: Taking their Medicine?

(Signs Austerity is working?)

	<u>GDP % Q3</u>	<u>GDP % Q2</u>	<u>Δ Q3/Q2</u>
Portugal	- 1.0 %	- 2.0 %	+ 50.0 %
Italy	- 1.9 %	- 2.2 %	+ 13.6 %
Ireland	- 1.2 %	- 1.0 %	- 20.0 %
Greece	- 7.9 %	- 7.6 %	- 3.7 %
Spain	- 1.1 %	- 1.6 %	+ 31.3 %

Source: Bloomberg. GDP growth Year-over-Year by Quarter



Corporate Tax Rates by Country

The United States corporate tax rate is uncompetitive.

	<u>2009</u>	<u>2013</u>
Canada	33.0 %	26.0 %
Cayman Islands	0 %	0 %
China	25.0 %	25.0 %
France	33.3 %	33.3 %
Germany	29.4 %	29.5 %
Hong Kong	16.5 %	16.5 %
India	34.0 %	34.0 %
Japan	40.7 %	38.0 %
Switzerland	19.0 %	18.0 %
United Kingdom	28.0 %	23.0 %
United States	40.0 %	40.0 %



Coming Muni Madness?

Fixing Muni bond problems: “Pretend & Extend”

Wall Street humor while profiting from “hopeful” actuarial assumptions

<u>Muni Bond</u>	<u>12/31/12</u>	<u>11/27/13</u>	<u>% Change</u>
Jefferson Cty 4¾% 1/1/25	91.00	87.00	+ 0.8 %
Detroit 5⅛% 4/1/22	100.00	80.30	- 14.6 %
Stockton, CA 4¾% 8/1/32	104.00	97.00	- 2.2 %
San Bernardino 6.02% 8/23	101.00	100.00	+ 5.2 %
Puerto Rico 5¾% 7/1/38	101.00	69.00	- 26.0 %

Source: Bloomberg.



A Promised Economy

If you like your Shares, you Can't Keep your Shares
Who Should Own the Future of Fannie Mae?

(Dollars in Billions)

<u>Fannie Mae Bal. Sheet (Dec 2008)</u>		<u>Fannie Mae Bal. Sheet (9/30 2013)</u>	
Assets	\$ 869.1	Assets	\$ 3,281.2
Liabilities		Liabilities	
Debt	\$ 774.5	Debt	\$ 3,240.1
Other	<u>\$ 109.9</u>	Other	<u>\$ 29.5</u>
Total Liabs	\$ 884.4	Total Liabs	\$ 3,269.6
Shareholder Equity	\$ (15.3)	Shareholder(?) Equity	\$ 11.6
Shares o/standing	2.49	Shares o/standing	5.76
Equity / Share	<u>(\$6.14)</u>	Equity / Share	<u>+ \$ 2.01</u>

Source: 10-K, 10-Q



A Promised Economy

If you like your Shares, you Can't Keep your Shares *Who Should Own the Future of Fannie Mae?*

(Dollars in Billions, except per Share data)

Fed Reserve Bal. Sheet (Dec 2008)

12 Months

Net Loss **\$(58.7)**

Dividends (to US Govt) \$ 1.1

Loss / Share **\$(23.57)**

Fannie Mae Inc Statemt (9/30 2013)

9 Months YTD

Net Income \$ 77.5

Dividends (to US Govt) \$ 78.2

Income / Share **\$ 13.45**

Source: 10-K, 10-Q



A Promised Economy

Of course, you can keep your Entitlements
What is the Price to roll over \$20 Trillion of Debt?

Total Federal Revenue, Outlays & Deficits (\$ billions)

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>
Receipts	\$ 2,568	2,524	2,105	2,163	2,302	2,449	2,774
Outlays	\$ 2,729	2,983	3,518	3,456	3,599	3,538	3,454
Deficit (yearly)	- 161	- 459	- 1,413	- 1,293	- 1,297	- 1,089	- 680
Deficit (Cumulative)	10,549	11,008	12,421	13,714	15,011	16,100	16,700

Source: OMB, Dept. of the Treasury, CBO.



Understanding Healthcare

Where does the Money go, if not to the Doctor?

No. of Doctors in the US:	878,194
Average Salary per Dr.	\$ 240,000
Total Comp all Dr.'s	\$ 210.8 billion
No. of US Citizens:	317.1 million

Cost per US Citizen per Dr.: \$ 665.00 *per person*

In Avg. Hospital 45% of Revenue is

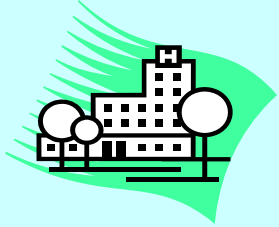
Dr.; so then, total cost should only be: \$ 1,477.50 *per person*



Understanding Healthcare

Is the System Built to Provide Insurance or Maintenance Expense Coverage ?

- Should Health Insurance cover Annual Check-ups, elective pills or drugs, planned for monthly or annual events?
- Does car insurance cover quarterly tune-ups or annual tire rotation or car waxing or the annual check-up?
- Why did this bill do nothing to contain malpractice or tort costs, which hit the health system hard?



Hospital Stocks

What Healthcare Crisis? The Dr. is In (*Green*)!

	<u>12/31/12</u>	<u>11/27/13</u>	<u>% IRR</u>
HCA	\$ 30.17	\$ 46.52	+ 54.2%
Health Mgmt (HMA)	\$ 9.32	\$ 13.10	+ 40.6%
LifePoint (LPNT)	\$ 37.75	\$ 51.21	+ 35.6%
Tenet Healthcare (THC)	\$ 32.50	\$ 42.82	+ 31.8%
Universal Health (UHS)	\$48.35	\$82.21	+ 70.0%



Health Insurance Stocks

If you like these Profits, you can Keep these Profits!

	<u>12/31/11</u>	<u>11/25/13</u>	<u>% IRR</u>
Aetna	\$ 46.31	\$ 68.80*	+ 48.6%
United Healthcare	\$ 54.24	\$ 74.07	+ 36.6%
Cigna	\$ 53.46	\$ 88.18*	+ 65.0%
WellPoint	\$ 60.92	\$ 93.61*	+ 53.7%
Humana	\$68.63	\$103.48*	+ 50.8%

* - New trading high.





Drug Co. Stocks

Take Two Stocks and call me from Retirement!

	<u>12/31/12</u>	<u>11/27/13</u>	<u>% IRR</u>
Bristol Meyers	\$ 32.59	\$ 53.41*	+ 63.9%
Eli Lilly	\$ 49.32	\$ 50.36	+ 2.1%
Johnson & Johnson	\$ 70.10	\$ 95.63*	+ 36.4%
Merck	\$ 40.94	\$ 49.83*	+ 21.7%
Pfizer	\$25.08	\$ 31.88	+ 27.1%

* - Year's trading high.

* - High 11/22. * - High 11/25.



Industry Bell Weathers of 2013

Virtually every Industry did well this past Year

<u>Industry Sample</u>	<u>12/31/12</u>	<u>11/29/13</u>	% IRR
Oil: XOM (Exxon-Mobil)	\$ 86.55	\$ 93.48	+ 8.0 %
Nat Gas: DVN (Devon)	\$ 52.04	\$ 60.62	+ 16.5 %
Fertilizer: MOS (Mosaic)	\$ 56.63	\$ 47.90	- 15.4 %
Radio Broadcast: ETM	\$ 6.98	\$ 10.47	+ 50.0 %
Lumber: IP	\$ 39.84	\$ 46.65	+ 17.1 %
Homebuilder: TOL	\$ 32.33	\$ 34.10	+ 5.5 %
Steel: X	\$ 23.85	\$ 26.81	+ 12.4 %
Retail: WMT	\$ 68.23	\$ 81.01	+ 18.7 %
Hospitals: CYH (ComHelth)	\$ 30.74	\$ 41.25	+ 34.2 %
Insurance: ALL	\$ 40.17	\$ 54.27	+ 35.1 %

Winners 2013

Financials, Transportation (& Healthcare) were Winners

	<u>12/31/12</u>	<u>11/29/13</u>	<u>% IRR</u>
American Airlines stock	\$ 0.79	\$ 12.25	+ 1,450 %
Overseas Shipping (OSGIQ)	\$ 0.85	\$ 4.50	+ 429 %
Freddie Mac 8 ³ / ₈ % Pref.	\$ 1.75	\$ 8.33	+ 376 %
Signature Holdings (SGGH)	\$ 4.10	\$ 11.00	+ 168 %
ResCap 6 ¹ / ₂ % 4/13 def.	19.00	37.00	+ 97 %
Facebook	\$ 26.60	\$ 46.50	+ 75 %
Albertson's 7 ³ / ₄ % 6/26	49.50	81.50	+ 65 %
Lehman unsecured bonds	26.50	30.00	+ 13 %



Losers of 2013

(Fewer Calamities in '13)

	<u>12/31/12</u>	<u>11/29/13</u>	% IRR
ATP Oil & Gas 11 ⁷ / ₈ %	11.50	0.50	- 96 %
JC Penney stock	\$ 19.71	\$ 10.19	- 48 %
NII Holdings 10% (ex-Nextel)	97.00	53.00	- 45 %
Arch Coal (ACI)	7.32	\$ 4.08	- 44 %
Eastman Kodak 7% 4/1/17	10.00	6.40	- 36 %

What to Watch For in 2014:

- Can January be any more exciting to watch unfold? What happens when 5+ million Americans that have recently lost their healthcare coverage begin needing care for significant illnesses? We are headed into the unknown.
- Will national concerns about health insurance costs effect holiday spending? We believe it will. If it does, retailers will have a tough fiscal Quarter.
- Last year we wrote: “*We expect 10-yr rates to move from 1.68% to above 2.00%.*” The 10-yr rate actually went to 2.75%. It will go higher if QE3 is stopped or curtailed. Eventually, buying ones own printed debt has to stop and rates will rise dramatically.
- Public debt and equity markets have been healthy. But some think they may be frothy. We agree. However, 2014 is a critical election year, and there will be much ad spending.
- The ObamaCare mess could be an unexpected burden on the economy in 2014. While the can will be kicked down the road, how do consumers return to their old policies and status quo? Seems difficult.



In Conclusion:

With historically high stock prices and rising interest rates, higher taxes and higher insurance premiums what is the impetus to take values even higher? We are nervous and cautious.

We expect 2014 to be a year where the macro policies of Big Government influence results (principally, QE4, ObamaCare).

Best wishes for Good Investing, Steve Gidumal

