

---

# The SCI Pricing, Trading & Risk Management Seminar

## Distressed Investment Strategies

John W Uhlein

Managing Principal, Grenadier Capital LLC  
Senior Advisor, RoundTable Financial Group

March 31, 2011

# My Background

- Been in the structured credit business for over 20 years, covering virtually all structured and abs asset types, including whole business securitizations, both here in the US and internationally
- At Ambac for 16 years, was founder and Chairman of Ambac UK, and ran the US non straight municipal business, excluding CDOs.
- Over last two years have focused on advising on opportunities for investing in monoline wrapped and other structured assets
- Through my association with RoundTable, also assist hedge funds and others in raising capital.
- My perspective is that of buy and hold(passive) as well as buy and manage, but in both cases investors needs mid term horizon
- Asset classes I have looked have been primarily highly structured transactions, where transparency is lacking, there may not be appropriate portfolio management, but where on a discounted cash flow basis there is significant upside potential

# **What makes ABS Investment Distressed** **(or valued at discount)?**

- Breach of various covenants
- Stress in particular sector or transaction
- Conflicting rating agency reports
- Refinancing risk
- Lack of transparency
- Uncertain government policy
- Stress with holder/seller of risk

# What makes an investor motivated to sell?

- Mark to market issues
- Change in cost of funds
- Inability or unwillingness to properly manage credit
- Shift in character of investor
- Liquidity issues/margin calls
- Able to, or required to, recognize loss
- Pressure from equity market or regulators

---

# What makes a good buyer?

- More optimistic assumptions
- Proprietary models
- Lower cost of funds
- Deep industry/product knowledge
- Ability to actively manage credit
- Longer term exit strategy

# Examples of Opportunities

- Monoline wrapped distressed paper
- Opportunity
  - Complex structured/abs transactions trading at significant discount
  - Guarantor has significant reserve against asset
  - Guarantors willing to commute policy if net gain to book
  - Control rights of guarantor actually cause paper to trade below level w/o guarantee
  - Guarantors overwhelmed in loss mitigation

---

# Issues:

- Two name paper, so need to understand credit of both
- Distracted guarantor without appropriate alignment of interest
- Guarantor lacks sufficient loss mitigation expertise
- Lack of transparency both from guarantor and issuer
- Illiquid market for underlying asset, where traditional buyers were high investment grade
- Loss expected, but divergent views on how much and when

---

# The Analysis

- Conduct independent review of underlying credit
- Prepare discounted cash flow analysis at various purchase prices and strategic outcomes
- Estimate reserves held by guarantor
- Negotiate commutation with guarantor



---

# Valuation variables

- Discount rate
- Performance of underlying transaction based on passive and active management
- Ability to control underlying asset
- Ability to strip policy from transaction at reasonable price

---

# Possible Outcomes

- Unable to negotiate commutation, passive investor
- Able to negotiate commutation, actively manage
- Hold to maturity or trade out after active management

---

# MBS Market

- Non-Agency RMBS market trading under harsh economic and pricing assumptions
- Rating Agencies widely divergent in coverage and ratings
- Short duration attractive to many investors
- Large multi trillion dollar market
- Opportunities should persist for years

---

# Examples

- **Morgan Stanley ABS Capital I Inc. 2004-NC5 Class B4**
- Recently downgraded to **C** by Moody's(Feb '09) and **CC** by S&P(Sept '09),
- The bond paid off in full November 2010
- Ratings subsequently withdrawn without mention of pay down

**Outstanding Balance of Morgan Stanley ABS Capital I Inc. 2004-NC5 Class B4  
CUSIP: 61746RGB1**



**Bond pays off in full in Nov. '10**  
 - withdrawn by S&P and Moody's in March '11  
 - no mention made of complete paydown in their press releases  
 - S&P's release simply mentions "NR"; Moody's doesn't mention this bond in their release

Copyright (c) 2011 PF2 Securities Evaluations, Inc. All rights reserved.

# Morgan Stanley ABS Capital I Inc. 2004-NC5

Mortgage Pass-Through Certificates

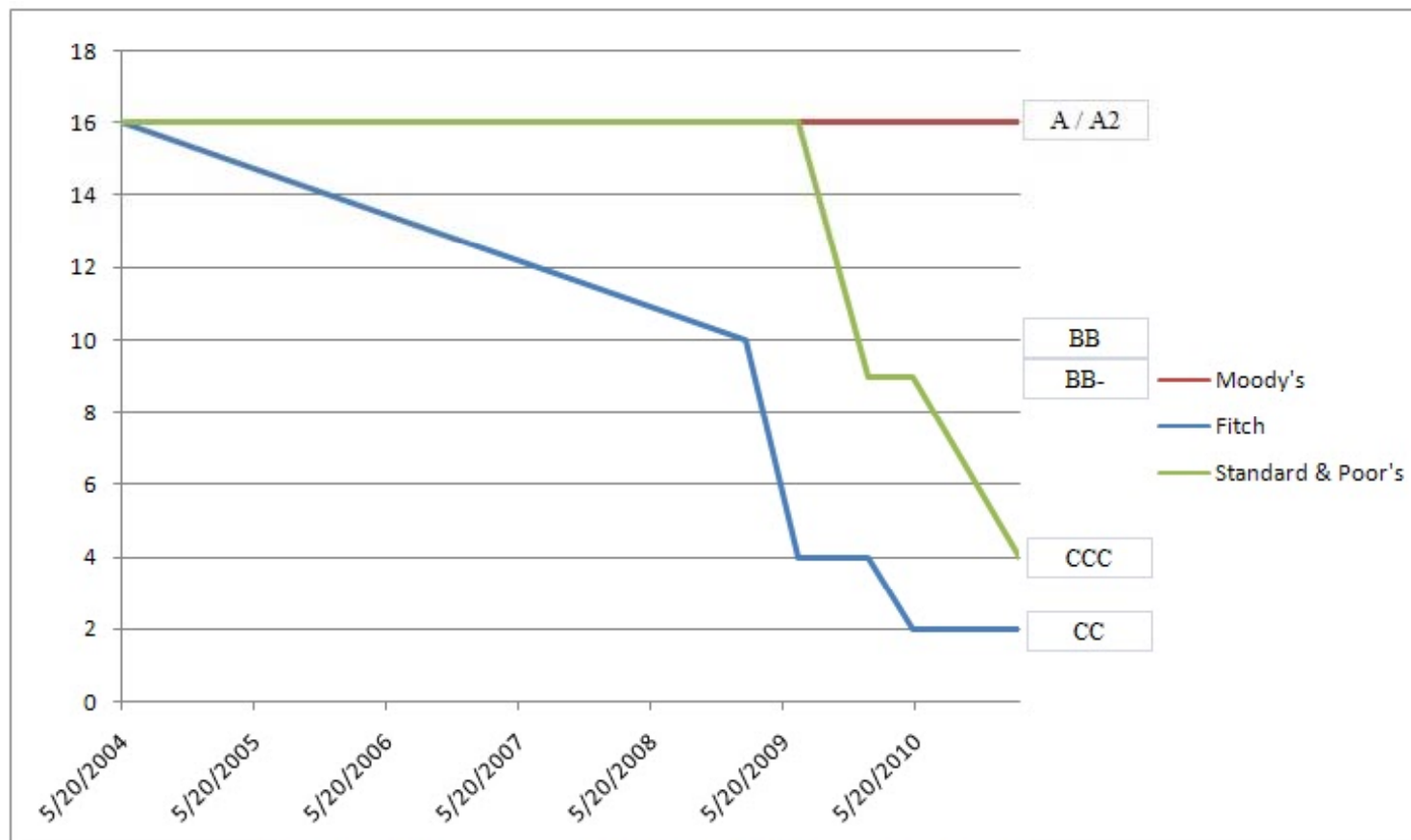
January 25, 2011 Distribution



## Certificate Payment Report

Current Period Distribution - REMIC II									
Class	Class Type	Original Face Value	Prior Principal Balance	Interest	Principal	Total Distribution	Realized Loss	Deferred Interest	Current Principal Balance
			(1)	(2)	(3)	(4)=(2)+(3)	(5)	(6)	(7)=(1)-(3)-(5)+(6)
A-1	FLT, STEP	385,960,000.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
A-2	FLT, STEP	70,000,000.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
A-3	STEP, FLT	104,500,000.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
A-4	STEP, FLT	28,337,000.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
M-1	MEZ, FLT, S	45,292,000.00	42,210,411.32	29,263.86	0.00	29,263.86	0.00	0.00	42,210,411.32
M-2	MEZ, FLT, S	38,045,000.00	20,433,695.24	24,042.67	587,749.53	611,792.20	0.00	0.00	19,845,945.71
M-3	MEZ, FLT, S	10,870,000.00	2,198,038.83	3,205.98	20,622.79	23,828.77	0.00	0.00	2,177,416.04
B-1	SUB, FLT, S	10,870,000.00	2,198,038.83	4,002.77	20,622.79	24,625.56	0.00	0.00	2,177,416.04
B-2	SUB, FLT, S	9,058,000.00	1,831,699.02	3,704.52	17,185.66	20,890.18	0.00	0.00	1,814,513.36
B-3	SUB, STEP,	6,523,000.00	772,708.68	2,496.46	41,245.58	43,742.04	0.00	0.00	731,463.10
B-4	SUB, STEP,	7,972,000.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
X	SUB	7,246,794.00	3,623,368.97	283,856.92	5,328.24	289,185.16	0.00	5,328.24	3,623,368.97
P	SUB	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
R	R	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
<b>Total</b>		<b>724,673,794.00</b>	<b>73,267,960.89</b>	<b>350,573.18</b>	<b>692,754.59</b>	<b>1,043,327.77</b>	<b>0.00</b>	<b>5,328.24</b>	<b>72,580,534.54</b>

Here is one more example of Rating Agency discrepancy:



**Ratings Performance of Carrington Mortgage Loan Trust**

Series 2004-NC1 ; Class M2 ; CUSIP: 144531AF7

Data courtesy of Bloomberg LP.

---

# Conclusion

- If you do your homework, and have the requisite product and industry knowledge, there are many opportunities to make money investing in mispriced, mis-rated, misunderstood, mis-managed ABS securities