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US bond market: threats and opportunities

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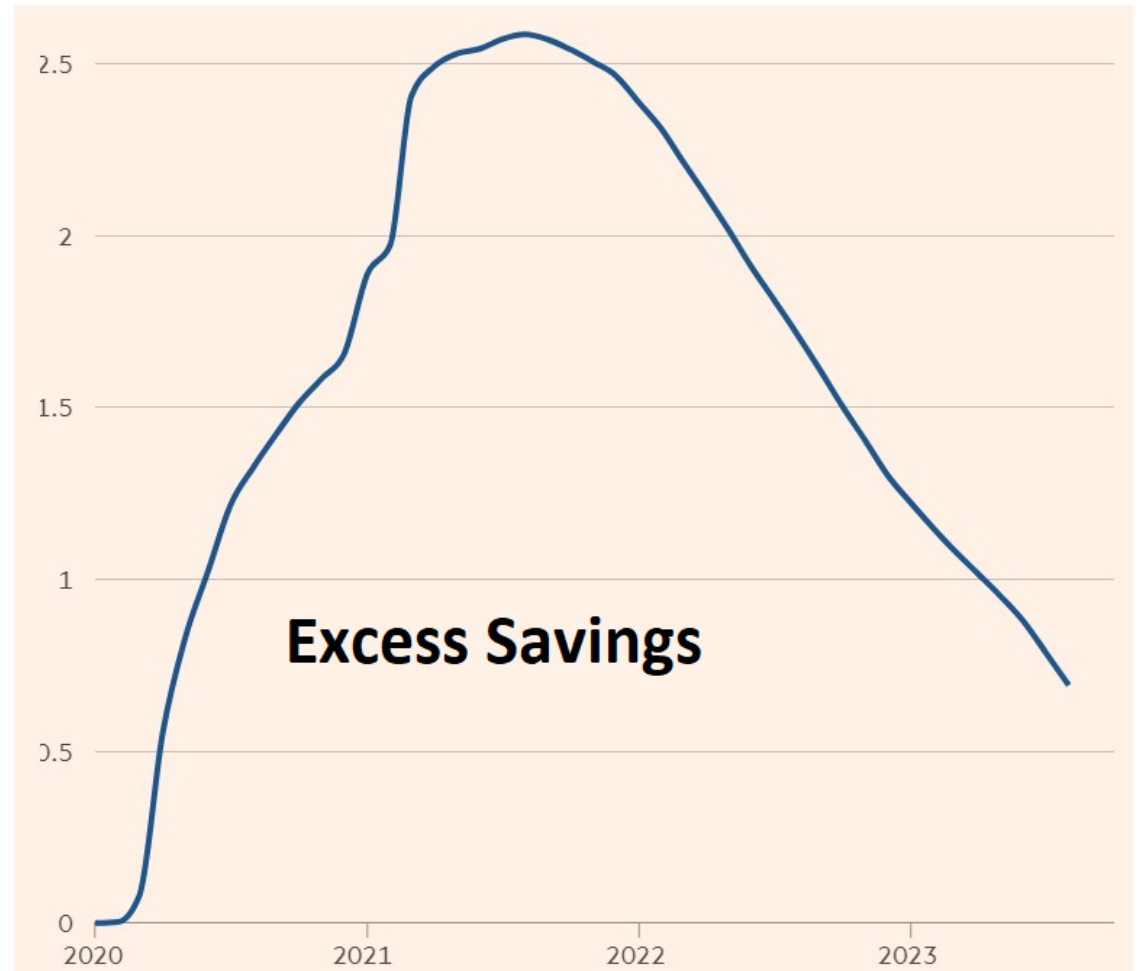
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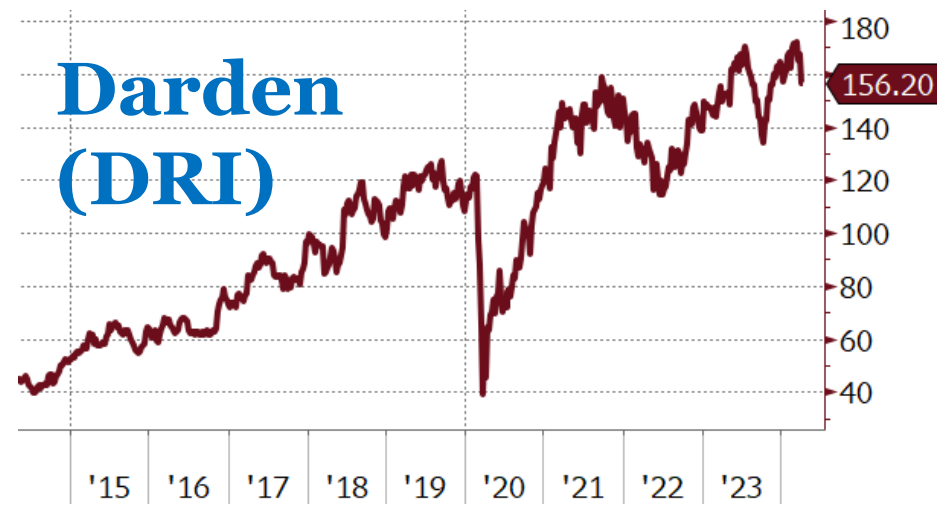
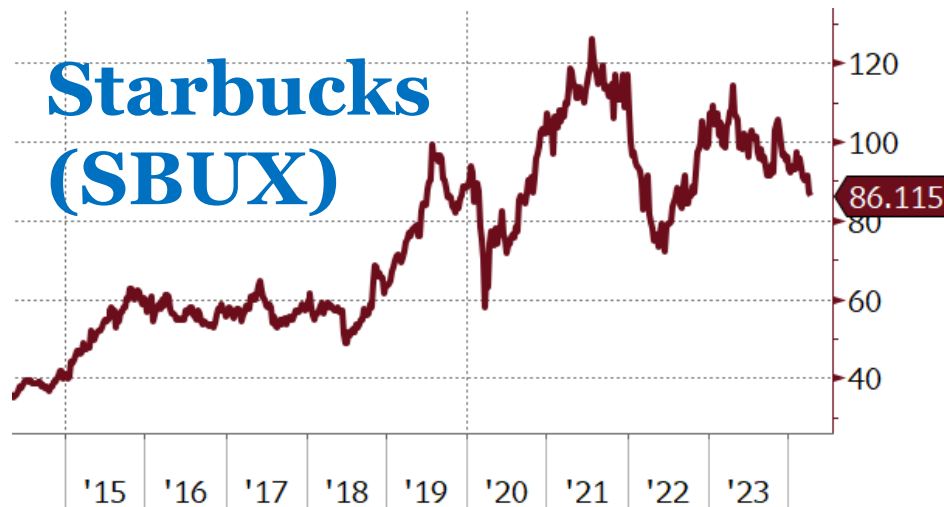
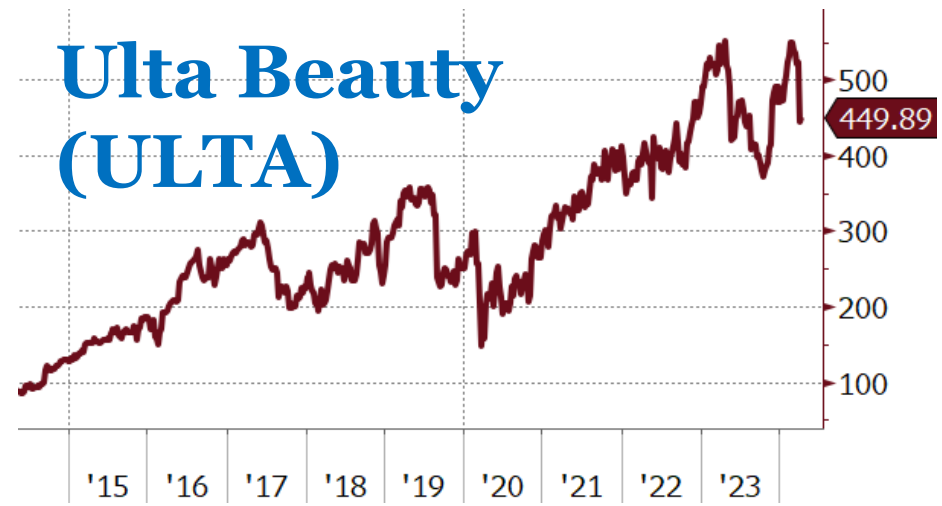
Potential weak spot: consumer companies

US consumer is finally giving up:

- ✓ Excess savings are nearly gone. People just don't have free money any more 😊
- ✓ Typical Biden voters (young audience) seem to notice that their salaries are not enough to make the ends meet.
- ✓ Larry Fink warns about retirement crisis.



Weak forward guidance even from the best companies



Gaming: the most discretionary type of spending

Unity Software Inc
Technology • Software - Application • USA • NYSE



Bonds of consumer companies may be in danger

- ✓ Usually high level of debt (Net Debt / EBITDA = 3+) across the sector.
- ✓ Relatively low free cash flow (typically spent on dividends / buybacks because of the “defensive nature of the business”).
- ✓ “Defensive nature of the business” also means lack of flexibility (can’t turn business around fast).
- ✓ Low chances to quickly adjust working capital (and preserve cash in the business).

And for all these beautiful things you receive 200bp credit spread for High Yield securities



Issuers: COTY, BBWI, NWL, SMG, EAT, FL, GPS, HBI, KSS, M, etc.

Sweet spot: mining companies

Another leg of global commodity upcycle ahead?

- ✓ Commodities are perceived to be one of the few true “inflation” plays.
- ✓ Multi-year lack of capital expenditures in the industry. BofA: copper supply crisis is here.
- ✓ Still strong global economy, possible industrial and infrastructure renaissance.

S&P GSCI Index



Mining companies: positives

- ✓ Generally disciplined capital allocation after 10 difficult years since the end of the last cycle (2012-2014).
- ✓ Conservative financial profile: Net Debt / EBITDA of 1-2x, debt is refinanced well ahead of schedule, high cash balances.
- ✓ High operating leverage: financials will improve greatly with even modest grow of commodity price.
- ✓ Bond spreads usually receive a bit of premium because of “cyclical” business nature.



Mineral Resources (MINAU) 9,25% 2028

YTM: 7.5%

Moody's: Ba3 / Fitch: BB

- ✓ Mining services company (crushing, processing) and commodity producer (iron ore, lithium) in Australia.
- ✓ Stable client base in mining services (world-known names, long-term order book).
- ✓ Company is in the growth capex mode (which leads to high coupon rates and growth of debt).
- ✓ Solid debt maturity schedule (no debt until 2027) with adequate cash reserves.



Frontera Energy (FECCN) 7,875% 2028

YTM: 13.3%

S&P: B+ / Fitch: B

- ✓ Small-cap oil producer with assets in Colombia, Ecuador and Guyana. Production: 41 kboe/d.
- ✓ Company is not popular among analysts because of weak history of upstream capex (incl. efforts to develop in Guyana). Starting from 2024 management decided to stop burning money in Guyana and develop upstream in Colombia.
- ✓ Projected FCF 2024 = \$100 mln (@80/bbl) vs Net Debt of \$360 mln.
- ✓ Interest payments are more than covered by stable midstream part of business.



Bonus

- ✓ I still like US Office REITs 😊
- ✓ My favorite company – **Brandywine Realty Trust (BDN)** – has a new bond (8,875% 2029) with BB+ rating from S&P.

