Third Avenue Focused Credit Fund Update

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(Edited for clarity)

BETTY LIN BLABEY: Good afternoon. My name is Betty Lin Blabey, Director of Marketing & Communications at Third Avenue and I'd like to welcome you to the quarterly update call for the Third Avenue Focused Credit Fund. We appreciate you taking the time to listen.

We're joined today by Lead Portfolio Manager, Tom Lapointe, who will provide an update on the Fund and its current positioning.

The information disclosed on this call is intended for Focused Credit Fund shareholders and their advisors and is not for attribution or for distribution to third parties. If there are members of the press on the call, please exit at this time.

Before turning the call over to Tom Lapointe, we want to take this opportunity to reiterate our Plan of Communication for Focused Credit Fund shareholders.

- Our goal is to provide transparency and communication to shareholders.
- We continue to price the fund daily.
- We will continue to host quarterly conference calls, like this one, to update you on the Portfolio & the process moving forward.
- We will continue to write a quarterly letter, and provide quarterly financials, including full holdings.
- Additionally, we will be posting a monthly factsheet (formerly quarterly) on our website to keep you apprised of timely updates to the Portfolio.
- Shareholders have the ability to sign up to be notified by e-mail when information is published on our website about the Focused Credit Fund and to receive notifications of our conference calls. The invitation to participate will be mailed with our 1Q16 financial report.
- Or you can sign up for the email updates by going to http://www.thirdave.com/credit–updates
- Alternatively, you can reach out to your relationship manager and asked to be added to this list.

Thank you for your attention. And I'm happy to turn the call over to Tom Lapointe.

TOM LAPOINTE: Thank you, Betty, and thank you everybody for getting on the call. We have a lot of participation, so I want to respect your time and go quickly while trying to provide as much information as possible. Today we will be reviewing the current portfolio and recent market conditions over the last 2-3 months. We won't be taking live questions, but I will try and answer some of the key questions we have been receiving over the last little while. We will also review relevant regulatory and tax considerations for the Fund and staff levels.

So, let's review the current portfolio as of January 31. If you have not already done so, you may wish to go on our web site and pull down the most recent fact sheet for January month end. All information about the Portfolio that I'm going to be talking about is as of January 31 month end, unless I specify otherwise.

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So the Portfolio at that time-- January 31-- had 36 holdings in it. The top 10 holdings represent about 67% of the Fund. The average dollar price of the bonds and loans was $76 at that point. The Yield to Worst is about 19%. The duration is 3.4 years. We have about 32% of the fund in equities--most of that is in the form of debt-for-equities that we received in a restructuring process. As you know, when we go through a restructuring either in or out of court, we usually receive new equity and sometimes new debt securities.

In the top 10 holdings, there are 7 of them that we have taken through a restructuring over the last couple of years:

- Affinion
- Ceva
- Corporate Risk holdings (that's the old Altegrity)
- Ideal Standard
- Liberty Tire
- Longview
- Reichhold Industries

The other 3 in the top 10 holdings are: iHeart, New Enterprise Stone and Lime and Vertellus .

We will go into more detail on each of these names later on the call. There have been some developments in a some of them since January 31. And in all cases we are either active through Board memberships or are trying to improve value for shareholders in other ways.

The Portfolio currently has very few restructurings. About 3% of the portfolio is in restructurings. Most of the holdings have already restructured and reduced their indebtedness.

The Portfolio has about 16% cash, and this is from sales and from cash coupons coming in. About 51% of the Portfolio is in bonds and loans that are paying their coupon--some that is in cash, some of it is in payment in-kind (or "PIK Interest"). And about 32 to 33% of the Portfolio is in post-reorg equities for a total of 100%.

We have about 11% in bank loans and very little in double-B rated or single-B rated securities. That's about 2% of fund.

With that as a backdrop, let me touch on the current environment.

As most of you know, the 2-3 months leading up to March has been tough on High Yield, and even more so on Distressed. It has only been in the last couple of weeks that there has been a real shift in investor sentiment. Who knows if it will last, but money is flowing back into the market and it seems as though some of the most beaten up securities – either equities or credits--are being bid up now. Some think it could be partially short squeeze-driven. Many are closely watching oil prices and other commodities, who knows if the bottom is in, but if commodity prices increase, companies get very close or closer to where they might be profitable again.

I don't think much of the High Yield Oil and Gas companies can survive long term at $40 oil and $1.70 gas. But it is better than $25 that we were just at and closer to the $50-$60 level where we believe many of these companies can make money again.

But even non-commodity names--they are higher. There are too many to list, but right now it seems prices bottomed around early February. At one point High Yield was down about 6% and now it has clawed its way back to almost zero.

Not surprisingly, this has followed the equity market's run up over the same time. Some of the most levered companies (both financially and operationally) and have been beaten up the most have started to see their stocks up, in some cases 30-70% in days and in weeks. Still, when you step back from the most recent performance, these stocks are still down significantly in the last year. The Oil and Gas names and other commodities have seen the biggest pop Many of these stocks have been very heavily shorted.

The MLPs are a good example. We don't own the debt or equity but have been following it closely for the last year or so. Not much has changed for the positive in the past 2 weeks. Yes, Oil is up but Gas is down. And these guys will tell you that, for the most part, they have take-or-pay contracts and moves in commodity prices shouldn't impact their business fundamentals. But in the last 2 or 3 weeks, the stocks are up 30%, or 20-50%, but still down 75% from this summer.

But the market is not fixed or back to where it was this summer. New issuance are still down significantly. We usually don't invest in new issues, and with the current state of the fund, we are really not making new investments of any sort. But a healthy new issue market is helpful for many of our holdings that may look to refinance or issue new debt for other purposes A healthy new issue market also starts to revive the M&A market that has been looking at the increasing in cost of capital in the levered credit markets and waiting for better financing costs. And, as we own several companies that still have leveraged balance sheets and would benefit from M&A activity and open capital markets, we see this as a positive recent development. Of course it has only been a couple week, so we'll see.

CLO's are also not doing well. At least the new issuance is down significantly year-to-date.

Of course this can all turn quickly. And with the run up in many names, I'm sure bankers are getting ready to run out their best new issues to test the market.

The market looks very cheap to me if we are not heading into a recession. We will see defaults turn up in this year with many Oil and Gas companies with bonds trading at less than 10 cents on the dollar, so a lot of this is priced in already.

We put in our letter a chart of the spread—and if you haven't seen our letter you can find it on our website or contact a representative and we'll send your our letter—we put in a chart on the spread differential between BB and CCC bonds. And as of the writing of the letter, which was in early February, If you have not seen our letter, the spread was about 1400 or a little more than 1400 basis points which is much more than even in the Euro Crisis when it was 800 basis points although it's still less than the Financial Crisis of 2500 basis points spread difference. Some of this is driven by Energy, so if you don't want any Energy exposure, this number would be lower. But it is meant as a comparison to different stressed periods over the last 10 years.

We also put a list of some stressed companies that had significant debt that the market had traded down to distressed levels in the past 6 months--there are many more. Some of these may default but many more will not and they offer a very attractive yield and capital appreciation potential. Of course, a lot depends on the economy and commodity prices and capital markets.

So now, let me turn to some of the questions we've been receiving. First question is on an update on selling activity and returning cash.

We are trying to manage and balance a quick return of capital with the best return on capital. The past 2 months have not been a very favorable for selling, and thankfully we have not been a forced seller. But, we are starting to see better bids on things opportunistically. Again, the Portfolio has approximately 16% cash at the end of January.

Last year we were fighting the view by some in the marketplace that we were a forced seller. Obviously that doesn't help get reasonable prices. I think this is improving and should continue to improve as traders and participants start to realize what we are doing.

Second question is about returning cash.

We are not charging anything to run and manage this Portfolio and are not investing in new securities, so we have every incentive to return the cash as it comes in from coupons and securities sales. In the letter, we referenced being sensitive to tax issues while managing the Fund in its current state. I think it is important to dive a little further on that issue, because it impacts how much and when we can return cash to shareholders.

As you know, I'm not a tax expert, but we have people at Third Avenue and outside advisors who know this subject very well. If you could bear with me for a minute, I'll go through some of the facts on Subchapter M of the US tax code.

Subchapter M covers regulated investment companies (or "RICs").

And because FCF remains a '40 act mutual fund, FCF must continue to comply with certain asset diversification tests to maintain status as a RIC.

Violation of Subchapter M would cause FCF to lose its status as a RIC and be subject to regular corporate income tax on its net income for that year, which may significantly reduce the return to shareholders.

One of the diversification tests requires that the fund have less than 50% of its assets in concentrated positions (measured by issuer) and because the fund is liquidating, we need to manage that appropriately.

Cash itself is a diversifying asset and when cash is distributed, the fund becomes more concentrated, thus increasing the potential to violate the Subchapter M diversification tests.

We are working with outside counsel and tax advisers on alternatives to minimize adverse tax consequences for shareholders. This includes our compliance with Subchapter M and the Internal Revenue Code.

Focused Credit Fund is still determining when and the amount of the Fund's next distribution. We should hopefully have guidance on this soon.

If you have questions on Subchapter M, please reach out to your representative and our tax and legal teams can provide you with a more detailed response.

The third question, many of you have asked us about other structures that people could opt into, a Closed-End Fund or another structure that would provide more liquidity and other benefits. As you can imagine, these things are all tied together with Subchapter M and our conversations with the regulators.

Ideally, we'd like to offer shareholders several options that improve the current situation, and let shareholders choose what they want. Again, we hope to have guidance on this soon.

Next question we've received is on Personnel Updates. Our core portfolio management team remains intact: myself, Nate Kirk, Joe Zalewski, Glenn Reid and our trader Rob Sherman. As I've said many times, I am committed to seeing this through for our shareholders and myself. I believe in the value of the portfolio. And it's a personal, large investment for me—one that I added to in 2015 and have never sold any shares. So, realizing the highest value and returning the capital is my only focus. During this recent period, we did lose Brian Lennon, our restructuring attorney. Brian went back to work for his previous law firm. He was good and will be missed, but as previously mentioned, we are not actively doing any more restructurings. And he's is also available to us, if needed, at his current firm.

Now I'd like to go over our top 10 holdings as of January 31, which together with the cash on the balance sheet are about 85% of the Fund's NAV.

Affinion: We took this company through an out-of-court restructuring in the second half of 2015. The company eliminated about $550mm of debt and reduced the cash interest expense by about $50mm per year. We, along with other shareholders provided new capital at the top of the cap stack to improve their liquidity. This is a company with 2-3 good businesses and 1 business that is in wind down mode. They just released their 2015 numbers that were in line with our estimates. 2016 should be a rebuilding year with 2017 should be a return to growth We own some of the new debt, about 25% of the equity, and we have Board member representation.

CEVA: Ceva Logistics is a leading global non-asset based supply chain management and logistics services provider. The company employs a combination of international air, ocean, freight forwarding, contract logistics and other services for over 15,000 customers in over 170 countries. Ceva is well positioned to benefit from the broader trend of outsourcing of logistics and supply chain management. The company is making improvements in productivity, margin expansion and share gains after poor execution under prior management. The new senior management team all joined in early 2014 and is executing well. Results (revenue, margins, cash flows, market share) have been improving and they've been shedding unprofitable contracts, making investments in technology, and upgrading their employees. The Fund has a position in the 9% notes, some of it in the preferred equity and some of it in the common equity.

Corporate Risk Holdings: The company emerged from bankruptcy in September 2015. We own Second Lien debt and are the single largest shareholder in the company and Third Avenue's President, David Resnick, is one of the 5 members of the Board. The company left its government business in bankruptcy;

and its three other businesses (Kroll, Ontrack, and HireRight) remain going concerns. Earnings for the enterprise have been in line with the projections delivered during the bankruptcy case.

Ideal Standard: Ideal is one of the largest manufacturers of toilets and fixtures in Europe. We are invested in the debt of the company that PIK's, or payment-in-kind interests, at about a 16% a year, and we own about 25% of the equity. The company finished its best earnings year since 2007, and preliminary 2015 earnings have nearly doubled from 2014. The company has just received an additional investment in its business to facilitate growth initiatives and we expect will bear fruit over the next few years as the complicated capital structure is repaired, free cash flow generation grows and strategic parties become interested. Our General Counsel, Jim Hall, is on the Board of this company.

IHeartMedia: IHeartMedia is a multi-platform advertising company with a focus on audio and outdoor advertising. The company has the largest collection of radio stations in the US, and is also the 2nd largest audio streaming app. The outdoor business is among the largest in the United States and is more like a real estate play—its two other largest competitors are publicly traded REITs. Additionally, IHeart has a large international outdoor business. Since the 2008 LBO, the company has been a case of good business / bad balance sheet, and has been actively managing its liabilities since the credit crisis. The underlying business has been strong, as the radio business now exceeds pre-crisis cash flows, while the outdoor business slightly lags. However, the company is facing a substantial maturity wall in 2019 as $8 billion of debt comes due. The company reportedly shelved plans for a sale of its international business in first quarter of 2015, and the lack of any major liability management in 2015, coupled with the market's concern about liquidity and the market's general reckoning for any capital structure with a maturity concern, led to a material decrease in the price of securities.

Since November, the company has embarked on a variety of transactions that seem to be setting the table for a large liability management move, by issuing $225mm of international debt and selling about $600mm in outdoor assets. With well over $1 billion in cash, much of it in non-restricted subsidiaries, we believe that the company is well positioned to take advantage of low prices on the debt securities to enact a holistic solution that could lower the amount of debt and free cash flow burn, and position the company for future refinancing of its secured debt. Otherwise, with the large amount of cash, the company will have purchased substantial runway for its existing capital structure and be able to pay coupons up until a key 2018 maturity date.

Liberty Tire: Liberty Tire is the largest tire recycler in North America. Third Avenue helped to lead the company through an out-of-court debt-for-equity restructuring in 2015, which averted a diminution in business that would have been caused by bankruptcy. We are the largest shareholder and represented on the Board by Portfolio Manager Joe Zalewski. Under the current ownership watch, the company implemented plans necessary to cut costs and reduce losses, most notably selling or reducing 5 underperforming facilities and refinancing the first lien debt in the summer of 2015. The company continues to contemplate various strategic initiatives in order to maximize profitability, despite a headwind in steel prices, which determine the price of one of its end products. We expect the seasoned management and engaged Board to continue to proceed with profit-maximizing directives.

Just 4 more to go…

Longview Power: Longview Power owns a 700 megawatt new-build coal plant and completed a reorganization in 2015. The Fund is a top four shareholder and attained its stake through a holding of the pre-petition term loan as the plant headed towards bankruptcy. Located in Morgantown, West

Virginia, Longview is the newest and cleanest coal plant in the country, and among the most efficient, which also gives the potential to be the most profitable. Additionally, with a captive coal mine located a short conveyer belt away, the plant is secure, with long-term access to attractively priced fuel. Financed in an era of much higher natural gas prices at a cost of $2 billion, the company was likely unable to service its debt from day one of operations due to a much lower natural gas prices. Additionally, the plant experienced technical difficulties which prevented operation at a maximum capacity.

The Fund purchased a large position with an eye towards a balance sheet reorganization and a fix of the plant. In 2015, the company emerged from bankruptcy with term loan holders owning the equity and the company agreeing with contractors on a complete overhaul and fix of the operations. After an extended three month outage, the plant has been performing at specifications and is generating an operating history. In the right environment, the plant could be an essential addition to a regional utility or merchant power generator that seeks to provide long-term power to a customer base in the PJM region.

New Enterprise Stone and Line: New Enterprise Stone and Lime has not filed for bankruptcy or restructured, and we do not believe they will in the near term. We own the debt that pays an 11% cash coupon. The bonds were just upgraded by a rating agency and the company has chosen to pay cash interest for its PIK bonds in a sign that management believes they are comfortable with their cash flows and does not want to dilute the equity with more debt. The results have been very good over the past year, and cash flow has doubled. This company provides lime and aggregates for use in building roads and bridges and for treating soils. They are based in Pennsylvania and operate there and in New York. We like these bonds and think they are very cheap at distressed levels for an improving credit.

Just two more…

Reichhold Industries: Reichhold is a specialty chemical company that we took through an in-court Chapter 11 process in the second half of 2014. We participated in a 363 sale process where we credit bid part of our debt for ownership in the US assets as part of our process to gain control of the whole company and extinguish other obligations at the US entities. We currently own the 1st lien debt and the equity. The company's results have improved meaningfully since the restructuring and Third Avenue's President, David Resnick, is on the board.

Vertellus: Vertellus is a sponsor-owned specialty chemical company that makes products for agriculture, nutrition, consumer products (DEET), and paints. In 2014, it refinanced its capital structure and completed an acquisition. A few things have happened since the acquisition. Synergies from the acquisition have taken longer than expected, and agricultural prices are under extreme pressure, and as a result earnings are down year-on-year. The debt trades in the 50s, and it pays over a 10% coupon. We think it is attractive, even in this market.

Most of these investments have been in the Fund for years and we have written and talked about them in the past. We will continue to update you on the progress of these companies as we look to realize value in the portfolio. These top 10 plus cash represent about 85% of the NAV of the Fund.
With that said I want to thank you for your time. If you have any questions please do not hesitate to reach out to your relationship manager here and we will respond to you as soon as we can.

BETTY LIN BLABEY: Great, thank you. That concludes our quarterly update for the Third Avenue Focused Credit Fund. We thank you for joining and your continued support in Third Avenue Management.

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