

July 13th, 2016

Fulcra Credit Opportunities Fund

Q2 2016 Commentary - Buyer's Remorse

We are happy to report that the first 6 months of 2016 have been the best in our 7 year history. After the uncertainty that permeated stocks and bonds in the first quarter, we managed to add to a few of our positions at favorable prices and initiate some positions opportunistically on the down trade. The Fulcra Credit Opportunities Fund finished the first half of 2016 with a 12.3% gain, net of fees.

Although we focus on absolute returns, we outperformed all relative indices and our competitors by wide margins. While pleased to be able to report our numbers, our focus is firmly on the future. The fund has been involved in negotiating and restructuring a few positions that we bought advantageously.

Sherritt International is one of these positions, a company that generates 80% of its revenues from the production of nickel and cobalt. While Sherritt's capital structure has not been immune to the drop in commodity markets, the decline in the price of its bonds created a margin of safety that few commodity producers can boast. Earlier in the year the Fund added to its position in the shortest maturity bonds due 2018 at approximately 50 cents on the dollar.

Sherritt has recently put forward a proposal to extend the maturity of its 3 bond issues by 3 years, to incentivize bondholders with either cash (\$2/bond) or shares (approx. 3% in equity warrants). While this minor compensation is a small win, more importantly, the extension will increase the time the company can wait for the nickel price to rebound.

Sherritt is the sole operator of the Ambatovy nickel joint venture project where one of its financial partners is investment grade rated Sumitomo. Sumitomo has provided funding support during both the construction phase and at times like today, when the performance of the mine is being optimized to perform profitably in a nickel market where almost 50% of global production is not profitable on a cash cost basis.¹

Since we appreciate the futility of waiting for improved commodity prices, we look to other levers. With cash of \$275mm, other liquidity boosting near cash assets and management's decision to suspend funding losses at the Ambatovy joint venture, the short maturity (2018) bonds have been trading at \$55 giving them a market value of roughly \$140mm... well below the liquid assets of the company. Sherritt management, acknowledging this mispricing, prudently repurchased \$30mm face value of the 2018 bonds during the 2nd quarter. Generally, management teams that proactively buy back debt below par are committed to either reducing

¹ Source: Sherritt June 2016 presentation, Wood Mackenzie Ltd.

debt or feeling positive about the company's prospects. Having followed Sherritt for many years, we believe it is both.

Buyer's Remorse is a topic at the forefront of our thoughts in the aftermath of the June 23rd Brexit vote in the United Kingdom and the consequences faced by the decision.

The result of the Brexit vote, the considerable regret behind the decision and the departure of two of the three leaders of the leave campaign soon thereafter would indicate that, as David Allen Green said in the Financial Times, "they either did not expect to win or naively thought winning a referendum would be enough". A plan for the next step would have been useful.

While hugely consequential decisions are often made at referendum in the political world it often seems as though little thought is given to the outcome of the actions. If one defines Buyer's Remorse as the anxiety felt after having made a decision, then the Brexit decision's remorse meter would be high.

While careful analysis is the cornerstone of our process here at Fulcra, knowing that one can often be a remorseful buyer in anything from stereos to securities, causes us to double down on our research and to constantly revisit the reasons we bought and continue to own a position; hence we feel that a limited number of companies in a reasonably concentrated portfolio, plays to our strengths.

We also like to take advantage of Buyer's Remorse in the marketplace. Many is the time when we find one of our securities the victim of either a forced liquidation or a seller larger than the market will bear at a particular price. These are times of opportunity for Fulcra as the "inefficiency" of the market rears its head.

The right entry point is Key in our decisions and we've had many situations, previously and recently, where we have identified the target yet the correct price has not, in our opinion, materialized until sometime later when, often as the result of a market event or a remorseful buyer whose circumstances have changed.

On to an exciting and unremorseful second half. As always, if you have any questions, please don't hesitate to contact us.

Best regards,

Matt Shandro
President, Fulcra Asset Management Inc.

This commentary is intended to provide you with information only and should not be considered personal investment advice. It does not constitute an offering or solicitation for the purchase or sale of securities or investment in any products. Every effort has been made to ensure that the material contained herein is accurate at the time of publication. However, Fulcra Asset Management Inc. cannot guarantee its accuracy or completeness and accepts no responsibility for any loss arising from any use of or reliance on the information contained herein. Important information about the Fulcra Credit Opportunities Fund is contained in the Confidential Offering Memorandum which should be read carefully before investing. For complete information relating to the Fund, including investment objectives and risk factors, please contact us for a copy of the Confidential Offering Memorandum.