



July 11, 2017

Maglan Capital increased in value by 14.00% (net of all fees) during the month of June.

For 2017, Maglan Capital has increased 11.99% (net).

In June, the fund benefited from the closing of the purchase of **FairPoint Communications** (FRP) by **Consolidated Communications** (CNSL) and from a pickup in volume and price in the shares of **Madalena Energy** (MVN; MDLNF). On a combined basis, Consolidated/FairPoint will form the best-in-class telecom operator in the US, with a healthy 7% dividend yield which, unlike other telecom stocks, is not at-risk from challenging leverage levels. We expect that Madalena's new leadership will make visible and undeniable progress in the upcoming weeks and months, which will continue to fuel the rise in share-price.

Maglan was last invested in the bonds of the **Commonwealth of Puerto Rico** in early 2014. Although we have not been active investors for a while, we have been closely watching developments unfold since, for a few reasons.

First, good investment opportunities are often a matter of price, therefore we have continued to "hang around the hoop," in the event that pricing and positive circumstances converge.

Second, we expect that in forthcoming years, there will be increasing opportunity in distressed municipal debt, which is an area with a dearth of precedent relative to corporate distressed situations.

Third, it is important to monitor distressed developments generally, especially in instances where issues of first-impression are being confronted and decided.

Some Lessons Learned from Puerto Rico

When we approach investment opportunities, in addition to digesting raw data and evaluating financial performance, and developing projections and assessing profitability, we think deeply about and appraise more amorphous, but no less critical, factors such as investing and trading dynamics, exit strategies, extraneous risks, especially in situations that have a multitude of moving-parts and very few, or none, relatable precedents.

In the case of Puerto Rico a number of the foregoing factors led us to back away in 2014 and have kept us at bay since then.

Battleground Investments WITH Binary Outcomes

Finding and executing on undervalued investments is hard enough without a direct opponent, or worse, opponents. In the case of a financial stakeholder fighting against opponents for a common, finite pool of value, execution of the investment could become considerably more difficult. Under those circumstances, investing can become a zero-sum game. Beyond concerns of the allegiance of stakeholders with seemingly aligned interests, who are assumed and/or who are supposed to be on your side, one must also be concerned by more undermining forces, strategies and activities. Depending on the prowess, the desperation and, most importantly, the cost-basis, opponents may be willing to go to unbelievable lengths to fight and upset any resolution and progress.

Situations with binary outcomes could provide incredible gains and can also provide instant, irreversible and, most tragically, total losses. Situations that could be decided by a judge's interpretation of law, or an administrative agency's determination, or a legislative body's policy decision, are to be approached with caution and with sober understanding of potential outcomes. Maglan's principals have deep backgrounds in the study and practice of law. Nevertheless, and maybe therefore, Maglan is extremely careful and selective when entering investments containing these elements. Situations with binary outcomes are more perilous in the event that there is little or no precedent and if parties are committed to avoiding a consensual outcome.

In the case of Puerto Rico, many types of bonds are directly at odds with others, fighting over particular assets and revenue streams. Moreover, the citizens of the Commonwealth and its leadership reasonably may want to free-up those assets and revenues for investment in and rehabilitation of the Commonwealth's woeful infrastructure and basic services. Many of the legal issues presented in the case of Puerto Rico are matters of first-impression, and it is not even settled what law controls (Federal, Puerto Rico constitutional, common). With uniquely deep pockets, the government of Puerto Rico can litigate many issues ad infinitum, and bondholders include many mega-sized hedge funds and mutual funds, that can also afford a long battle.

Leadership Accountability and Financial Stakeholder Control

Activist investors often wrongfully get a bad rap, especially in cases where management is not aligned financially with financial stakeholders (shareholders, bondholders, lenders). Corporations are for-profit enterprises and financial stakeholders should be a premier priority. In that vein, corporate leadership (management and the Board of Directors) must be accountable for financial performance. If performance is disappointing, leadership could justifiably be replaced by financial stakeholders by exercising democratic rights under corporate by-laws and State corporate law.

In the case of municipal situations generally, leadership's top priority isn't necessarily the municipality's financial stakeholders, but instead/also the municipality's citizens, who have a much broader and deeper stake in the municipality. Moreover, only citizens can vote leadership out of and into power, not bondholders or lenders. Furthermore, elections may upset and redirect negotiations midway, undo settlements, and reformulate particular policy stances from one administration to the next, without rhyme or reason, and without influence from financial stakeholders.

The Allure for New Investors

Grossly generalized, distressed situations that are good for legal and banking professionals are bad for investors. Lawyers and bankers rake in fees for distressed work when the road is long, complex, divisive and litigious. In the course of those multi-year situations, it is unlikely that new investors will jump-in midstream and, absent a remarkable breakthrough in the standoff between stakeholders or in the underlying business, securities' prices will languish. In contrast, distressed situations that have an executable plan to deleverage and clean-up the distressed entity usually move forward with alacrity and can often attract new investors by presenting a clear vision of the bright, not-too-distant future.

The future of Puerto Rico couldn't be more opaque. The resolution of the balance-sheet is absolutely uncertain. The fundamentals of the economy, citizenry, infrastructure and even, status as Commonwealth or State, are also uncertain. Due to the litany of doubts, which resolution will stretch far into upcoming years, it is unlikely that Puerto Rico will attract new investors to raise the value of its securities any time soon.

Maglan Capital is an event-driven investment fund with a concentrated portfolio of investments across the capital structure of small- and mid-cap companies with core focus on financial distress, restructuring and operational turnaround.

We appreciate your support and confidence in our team.

Best regards,

Steven Azarbad, *Chief Investment Officer* and David D. Tawil, *President*