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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Picking the Best Stocks by Covering the Entire Capital Structure

ERIC GREEN, CFA, is Senior Managing Partner, Director of Research and Senior Portfolio Manager at Penn Capital Management Company, Inc. Mr. Green began his career at Penn Capital in July 1997. As Director of Research, Mr. Green is responsible for guiding the firm's day-to-day research process. He also serves as the Portfolio Manager for Penn Capital's small-cap and midcap equity strategies and chairs Penn Capital's equity strategy committee. Prior to joining Penn Capital, he gained experience with the Federal National Mortgage Association, the Royal Bank of Scotland, and the United States Securities and Exchange Commission where he served as a financial analyst in the Division of Investment Management. Mr. Green is also Vice Chairman of the board of directors for the Anti-Defamation League — ADL — Mid-Atlantic Region, and Co-Chairman of the ADL's 2018 Walk Against Hate. He received a BSBA, cum laude, from American University and received an MBA from the Yale School of Management.

SECTOR — GENERAL INVESTING

TWST: Could you tell me a little bit about the firm?

Mr. Green: Sure. Penn Capital Management is a $4.5 billion boutique investment firm. About two-thirds of our assets are in high yield fixed income convertibles and bank loans. The rest are in equities. All our analysts and portfolio managers cover the entire capital structure of the companies that we follow.

TWST: Is there a unique investment philosophy?

Mr. Green: Yes. The philosophy stems from the coverage of the entire capital structure. All our analysts are required to have an opinion on the value of the stocks, bonds, converts, preferreds and bank loans for all the companies that we follow. We believe being experts in understanding the balance sheet and cash flow statement and the debt capital markets gives us a competitive advantage in picking the best stocks.

TWST: Did you want to highlight a stock that you find interesting now?

Mr. Green: Sure. **Scientific Games** (NASDAQ:SGMS), a stock we've owned for a few years. It is a lottery and gaming equipment supplier. They have done a tremendous job deleveraging their balance sheet and improving their cash flows. They are a large beneficiary of the legalization of sports gaming, which we believe will happen in the next six months. They have an outstanding management team with a proven track record of deleveraging companies and creating shareholder value.

The industry fundamentals for the gaming suppliers have improved dramatically over the last year. With **Caesars** (NASDAQ:CZR) coming out of bankruptcy, they're now replacing their slot machines much faster than they did in the past. This is leading to their competitors also replacing their slot machines. Despite the fact **Scientific Games'** stock has done very well, we still believe there is a lot of value left in the company and believe the stock can move considerably over the next 12 to 18 months.

TWST: What are a couple of things about the company that you think investors would like to hear about?

Mr. Green: The catalyst for **Scientific Games** is that they have an interactive division that offers social gaming and continues to grow very rapidly; however, the valuation of that is not reflected in the existing price of the stock. They've also, with the improvement that they're seeing in their different businesses and some of the recent acquisitions that they've made, will be able to reduce the debt on their balance sheet faster than many expect. We expect there will be a transference of the value of the debt to the equity and that the multiple should improve as the fundamentals become more apparent to the market.

TWST: I believe Scientific Games recently acquired securities from the NYX Gaming Group too.

Mr. Green: Yes. That deal should close in late December. The **NYX** (CVE:NYX) transaction is a very good transaction for them. It's even better if sports gaming is approved in the United States. They have the platform for casinos to use for sports books and legalized sports betting.

TWST: Did you want to mention a second company?

Mr. Green: Yes. **Gogo** (NASDAQ:GOGO), which provides internet and other interactive services to passengers on airplanes. Originally, they were the first to provide the internet on planes. Their initial version was slow and had intermittent interruptions. However, they've upgraded to a new service, which is much faster, and the entire plane can enjoy using those interactive services without disruption.

They are free-cash-flow positive in the United States, and we believe they'll be free-cash-flow positive throughout the entire company by the end of next year. They can refinance very high cost debt as their business continues to improve. They are winning business both in the United States and around the world in a huge market with only a few competitors. **Gogo** has a leading market share and the best technology.

TWST: What's leading you to believe that the outlook is going to be good in that sector? Are there certain factors that are taking place?

Mr. Green: The demand to use streaming services, interactive services and access to the web on airplanes continues to increase. The problem has been that the bandwidth was not there to provide the entire plane a good experience. The technology upgrade they've made, which is called 2Ku, is allowing passengers to now access all those services at high speeds and without interruptions. There is clear demand for those services in the United States as well as around the world.

TWST: Has a lot of their customer base been in North America, or has it been more global?

Mr. Green: Most of their customer base has been in North America, not just the U.S. but all of North America. In the last year and a half, they've started to expand internationally, where there's also significant demand. With their North American business, they have the leading share. They're also in the corporate jet business. They have over 85% of the planes using internet service.

On the international side, that's their big growth opportunity. Right now, they need to spend a lot of money for installations on their wins, and that's why they are negative free cash flow. Once they are installed in the different planes, then they generate significant free cash flow.

Highlights

Eric Green discusses Penn Capital Management Company, Inc. Two-thirds of the firm's assets are in high yield fixed income convertibles and bank loans, and the rest are in equities. According to Mr. Green, what makes the firm unique is that its philosophy is rooted in the coverage of the entire capital structure of each company it follows. Mr. Green believes that understanding the balance sheet and cash flow statement as well as the debt capital markets gives a competitive advantage when it comes to picking stocks. While many find the equity markets to have high valuations, Mr. Green believes there are areas that are undervalued and misunderstood that are providing opportunities. For example, he is currently overweight in the energy sector.
Companies discussed: Scientific Games Corp. (NASDAQ:SGMS); Caesars Entertainment Corp. (NASDAQ:CZR); NYX Gaming Group Ltd. (CVE:NYX); Gogo (NASDAQ:GOGO); Nexstar Media Group (NASDAQ:NXST); Sinclair Broadcast Group (NASDAQ:SBGI); Tribune Media Co. (NYSE:TRCO); WPX Energy (NYSE:WPX) and Amazon.com (NASDAQ:AMZN).

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TWST: Did you want to mention another company?

Mr. Green: Yes, **Nexstar Media** (NASDAQ:NXST). **Nexstar** is a television broadcaster, one of the largest television broadcast affiliates in the United States. They have top stations in small and midsize markets. The regulatory environment with the new FCC Chairman has improved for the television broadcast affiliate companies. It's enabling consolidation that wasn't allowed in the past. **Nexstar** has consolidated markets in the past, and new regulations give them a much greater opportunity. For instance, they can own more than one station in several markets where they are prohibited from owning more than one station.

They have an excellent management team that's consistently exceeded guidance. Their valuation is also very, very attractive. With **Nexstar**, free cash flow yields are 20% or higher. They have a very strong political footprint that's positioned very well for the 2018 elections.

TWST: I see that they announced they're acquiring digital video advertising infrastructure platform LKQD Technologies. Any significance to that? Do you think they'll be doing some more acquisitions along the way?

Mr. Green: This is a small acquisition for them in their digital strategy. They already have a broad digital platform. The big acquisitions will be of stations going forward, but this is a tuck-in acquisition and looks to be at a very attractive multiple. And in the past, they've been very successful integrating both their digital acquisitions as well as their station acquisitions.

TWST: Are they focused in a particular region with the stations that they have, or is it spread out?

Mr. Green: They're spread out throughout the country.

TWST: Do you see that the acquisitions taking place are in neighboring areas, or is it just if they see a particular station that might be a good acquisition for them?

Mr. Green: They will not acquire unless it's accretive to their business and they can grow the cash flow associated with the acquisition. It really depends on those metrics and where the valuations are. There are large deals out there already where some divestitures will be required. As an example, **Sinclair** (NASDAQ:SBGI) and **Tribune Media** (NYSE:TRCO) are merging. The Justice Department is going to require a few stations to be sold. Out of that, I expect **Nexstar** to be one of the bidders for some of the stations that need to be divested.

TWST: So they don't necessarily try and put stations in neighboring regions, but rather, they look at the specific station when they're acquiring?

Mr. Green: Yes. Their preference would be to acquire in markets where they already have a presence, but again, it all depends on where the valuations are. If they find valuation attractive and the acquisition is accretive, then the acquisition can happen almost anywhere in the United States.

1-Year Daily Chart of Scientific Games Corp.

Chart provided by www.BigCharts.com

moving vehicle. When there is cord cutting, which has started to be a focus of some investors, the new platforms have almost always included the local stations, and they'll end up being paid the same amount, or more, to be on over-the-top platforms as they do just being on regular television.

TWST: Did you want to mention a final company?

Mr. Green: We're considerably overweight in the energy sector. We believe the fundamentals in the oil and natural gas market are still very strong and expect prices to remain in this range between $50 and $60. They could potentially move higher based on where we see supply and demand. Energy stocks are attractive in that range. The one we like the best is **WPX Energy** (NYSE:WPX), an exploration and production company with most of their acreage in the Bakken and Permian shales.

This is a company that's transformed itself over the last several years by exiting some of the basins that were less attractive. They cut their costs, and they pared down their acreage to the highest-quality acreage in each of their basins. They have a very strong hedge position. The stock is undervalued and misunderstood because of the debt they have outstanding. Over the next year, we expect them to reduce their leverage by at least two turns. This will put them in a range of other high-quality exploration and production companies, and will create more demand for this stock.

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1-Year Daily Chart of Nexstar Media Group

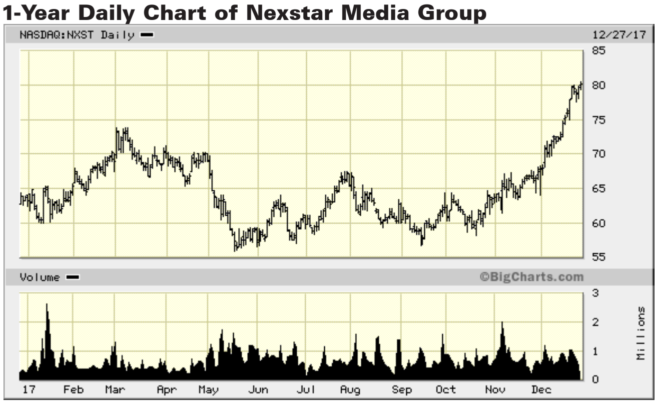

Chart provided by www.BigCharts.com

TWST: How do they remain competitive with all the online content that's out there?

Mr. Green: They have access to content like the NFL, and they produce local content. They are still attractive to viewers. The average amount of time a person in America watches television is five hours per day — still. Also, 40% of the television viewing is done on the major networks: NBC, FOX, CBS and ABC. Those are the stations generally that **Nexstar** has affiliate arrangements with.

Moving forward, there's a new technology called ATSC 3.0 that will allow television to go mobile, where you'll be able to get all your local stations from your iPad, your cellphone and even in a

TWST: Do you think they're helped out, as many in the field are, by the fact that the Trump administration seems to be a little less concerned about environmental regulation, as compared to the Obama administration?

Mr. Green: Yes. This administration has been very friendly to the energy sector, and we expect that to continue. By building some of these pipelines that were not approved in the last administration, it allows oil and natural gas to move from one basin to another at much less cost. At the end of the day, that means they can get oil and gas out of the ground at a lower price and make more money than they made previously. Many of these companies can make money at sub-$45 oil prices, including **WPX Energy**.

TWST: Changing gears a bit, when you talk with investors now and your colleagues talk with investors, what are some of the concerns about 2018 as they look at their portfolios?

Mr. Green: We've had a very strong run in the equity markets obviously, and there's a lot of talk about high valuations. We believe there are areas in the market that are not attractive and have very high valuations, but we also feel there are areas in the market that are undervalued and misunderstood and are not getting credit for the opportunity we see going forward.

TWST: In terms of Baby Boomers, a lot of them are either in retirement or nearing retirement. Are they looking forward to maybe seeing some fixed income vehicles that might help them in their retirement years with higher interest rates, or are they still going to be investing in equities and maybe looking at dividends coming in?

Mr. Green: Today, it's very difficult to get yield without taking a lot of risk in the fixed income market. Even with stocks that pay dividends, we believe the valuations of stocks that pay dividends are extremely high. Over the last few years money has been poured into high-dividend stocks and low-volatility stocks. We believe the best place to put money is in areas that benefit from the cyclical economic recovery we're seeing. For the first time in 10 years, we've seen two quarters with 3% GDP growth. Small-cap stocks tend to perform very well in those periods. Also, cyclical stocks perform much better.

Today, I would advise that Baby Boomers have a healthy mix of small-cap stocks within their portfolio and maybe keep some cash on the sidelines for higher interest rates, as we expect rates to rise over the next couple of years. It doesn't make a lot of sense to take a lot of risk today in the fixed income market given current yields.

TWST: Do you sense that investors are feeling confident about the proposed tax cuts and what they might mean for different stocks?

Mr. Green: The tax cuts appear to be going through, which is improving confidence not only with individuals but also for companies. The confidence of small companies, midsize companies and large companies is the highest it's been in 25 years. Consumer confidence is near 15- to 20-year highs. That, we believe, will help the economy move forward. Businesses are spending money like they haven't been over the last 10 years, and we believe that confidence should continue. The tax bill is very pro-growth; the administration is very pro-growth. We expect the markets to continue to do well with cyclical and smaller-cap companies leading the way going forward.

TWST: Why would, let's say, small-cap companies do particularly well with the tax cuts?

Mr. Green: Small caps are companies that generally pay higher tax rates because they tend to be domestic. As an example, almost every bank is paying 35%; regional banks are paying 35% taxes right now. That's a big bump in their earnings by reducing their taxes, even if it's down to 22% instead of 20%. Companies that are multinational have a lot of tax breaks. They have overseas earnings, and their effective tax rates tend to be lower than smaller companies that are domestically oriented. In addition, the improvement in the economic environment from tax cuts will be felt most by small companies that can quickly adapt to improving economic conditions.

TWST: We talked about the Baby Boomers. Are you starting to get a sense that Millennials might get more involved in the stock market and what they might be, as a group, most interested in investing in?

Mr. Green: The younger Millennials probably still have a few more years before they start putting money into the market, but older Millennials, as they get jobs and start to make money, they'll be allocating to the stock market. They'll be buying homes. They'll be spending money like other generations but potentially in different ways. They may be ordering from **Amazon** (NASDAQ:AMZN) rather than going to the mall, but we don't expect their behavior to be much different.

TWST: Did you think that the Great Recession in 2008/2009 had a lasting impact on them in terms of how they view the market, seeing what happened maybe with their parents or their older relatives?

Mr. Green: There's definitely scars for some of the older Millennials who saw some pretty nasty stock market corrections during that period, but over time, as the market volatility stays low and the market starts to move up, investors will get more and more comfortable with putting money in the stock market.

TWST: Do you think that they look at investments the same way as their parents or previous generations do, or do they look more at individual companies because they might be familiar with specific products?

Mr. Green: Unfortunately, for the active management business, it appears more investors are putting money in passive investments, in ETFs. In fairness, over the last few years, passive investments have beaten many of the active managers. However, historically, active management and passive management performance shifts every five or 10 years. We expect that active management will start to outperform again, and when that happens, money will be pulled from passive management back into active management. I don't see any more stock picking of individual stocks than I have historically.

TWST: Thank you. (ES)

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