November 2020

Arena recently hosted a multi-client call for investors in our rated vehicle for insurance companies (Arena Special Opportunities Partners (Feeder) I), discussing the current environment, how Arena is "perched" against the various opportunities we see, and how we are striving to protect ourselves from the risks. The call was recorded and we are sharing this modified transcript as a recap of that discussion. We hope you find it informative, and please feel free to reach out with any questions or if you would like to discuss our evolving thoughts on these topics.

Best,

Parag

Good morning everyone, welcome, and thank you for joining today's call. We welcome your questions, feedback, and are more than willing to cover anything else; please just reach out to Dan, Lindsay, myself, Jami, or James for anything.

I'm going to open with a few remarks on Arena and performance and then hand it over to Dan to speak on the environment.

Stepping back, Arena makes asset-backed investments that have a few common and distinctive characteristics – namely, being backed by high-quality underlying assets, by having seniority against those assets, by typically lending 60 to 65 cents on the dollar against those assets, and at a two-year term on average. We get very spread out both by position number as well as the lack of correlation in our positions. In total, we target to make 10% to 12% net returns.

We underwrite our investments to crisis conditions and where we are seeking to avoid macro exposure, either explicitly or implicitly, by hedging, structuring and also by just avoiding doing certain things. COVID-19 was a great stress test of the approach and of the process. Also, since we effectively operate as a "non-bank bank," we have, through Quaestor Advisors, LLC and Quaestor Strategic Advisors, LLC, lots of servicing and workout capacity and capabilities, and the IT systems to control all these investments. So, in situations that go sideways, we have the potential to achieve higher returns.

To be clear, our mandate is very flexible. We have the experience, staffing, and infrastructure to be able to scan across markets and do what makes sense, and we emphasize alignment in everything we do, including having ~$200 million of our about now ~$1.7 billion in capital[1] as our own money co-invested alongside our clients. We've now deployed about $2.4 billion cumulatively into over 200 investments. So, with that, let me again say thank you for your trust and your partnership. And with that, let me turn it over to Dan to talk about how we're seeing the world and the investment opportunities it presents.

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[1] The assets under management of Arena includes employee capital, co-invest, and capital committed but not yet deployed as of September 30, 2020.

Dan
Thanks, everyone for joining. Let me start by saying, with regard to the return stream, everything that we are doing today is consistent with what we have always done. With regard to the environment, I think we feel pretty decent about where things are. When we think about the "dislocation" or "issues" out there, we take the view that while we are eight months into a COVID-19 pandemic, it has really been 10 years of a building asset and credit bubble - and that bubble does keep getting bigger. When you think about what is different in this one, it's the ubiquity of conviction around government intervention, both from monetary authorities, as well as the governments themselves, which is pretty unique post-World War II.

What's interesting, particularly in the US, is if you bifurcate the big pools of intervention, on the one side you have the Fed basically subsidizing investment-grade issuers and owners of their credit in various forms. And on the other side, the government itself is handing out direct checks to consumers. Conspicuously absent from the beneficiaries of this involvement are businesses. The flow out of the MSELF program (the Main Street Expanded Loan Facility, intended to facilitate lending to small and medium-sized businesses) has been very limited in its support for small businesses, which employ a huge percentage of the people getting stimulus checks. So, the pathway by which you are positioned to stop having stimulus is quite unclear. What that means is, as we think about different areas, I would divide the world into big pockets of those which will be negatively affected by the current environment and those which will be beneficiaries. And then with regard to the former, really dividing it between places where the underlying issues can hide for an extended period of time, versus where they are really showing themselves - and by showing themselves meaning, whatever income is coming off of the asset or the enterprise is impaired, and no amount of intervention, at least as currently structured, is allowing it to deal with its obligations. Examples of that include things like oil and gas credit, private transactions within aviation, including liquidations and short-term leases, and the very beginnings of what we're going to see in commercial real estate obligations. In each case, perhaps in energy, it is maybe the second or third inning, but in the latter two, it is certainly very much the first – there is just a lot more to come and we are super early in that regard, and that works well for us in terms of our still relatively limited amount of capital to deploy in the world, versus what's out there. We like that imbalance between opportunity and dollars to deploy.

With regard to the places where the issues are not showing themselves, they are in greater number. And that runs, in particular, in areas like the leveraged loan market, and associated CLOs, large hunks of the securitized market where the ability to refinance is creating the interesting phenomenon of companies, issuers, and assets that have access to liquidity, but that are effectively insolvent. Traditionally, when you talk about distressed investing, you are seeking out situations where there is solvency without liquidity. But because of the intervention we have out there, particularly on the Fed side, which actually allows these securitized or similar anomalies to happen, you see larger-scale leveraged loan issuers, certain pools of real estate that have been securitized, municipal securities, aviation securitizations – lots of areas where if you really marked the assets to market, there would be tremendous impairment, not just at the bottom of the stack, but also into the higher parts of the capital structure. Yet, the ability to access new, improperly-priced, badly-structured, over-advanced money keeps the ball rolling, and you have this avoidance of appropriate price discovery, and a hot potato that gets passed on. And it rolls all the way through. In the case of leveraged loans, you are going see distorted default and recovery numbers, because folks who should not be able to get refinancing are able to access new debt, and even coming in and out of restructurings issuers are coming back out of

Chapter 11 with too much debt. So you will see Chapter 22s and Chapter 33s because of that. So it is a weird market, but we have all the time in the world in that regard, because there are plenty of things to invest in that do make sense.

In addition, we are working on various forms of those who are beneficiaries of this environment. That includes financing e-commerce and things like our digital factoring business, financing property in geographic areas that were not as much of a focus before – for instance multi-family in outlying non-wholly urban areas that would not have gotten the attention that they did before, and in relatively short-duration investments that do not put us into a position of betting on the vaccine timing or any of that stuff we have no clue about. Also the frothy, retail-driven equity market has provided a number of instances where structured private convertibles are very compelling for us. Again, we are not taking a bet on the direction of the markets when we enter into transactions like this. It is just that the frothy small-cap market allows us to hypothecate stock in very short duration trades that effectively, like many things, leave us as the casino, not the gambler. So, we feel we feel pretty good.

In terms of the election situation, it would appear to us to be a pretty decent environment relative to what could have happened with the US elections, and with the prospects for deadlock, we look to the notion of "first do no harm". While it remains to be seen, in a world with a Biden presidency and a blocking Senate means things like potentially more opening of global trade, but certainly not less, fewer, if any, expected changes in anti-trust or things like the Consumer Financial Protection Bureau (CFPB), which would very negatively affect consumer finance, no changes in the direction of the Affordable Care Act, a nine-member Supreme Court and the rule-of-law persisting, etc. The less the government does, the better it is, generally, in our view, and certainly with regard to our investing. There is a school of thought, as Reagan said, "In this present crisis, government is not the solution to our problem, government IS the problem". We like, and the market likes, this splitting of the US government.

We are not in a hurry, and from March through July and August, there was a slowdown on the illiquid side in our deployment. Because bid-offer spreads were wide, people were not realistic about what post-COVID-19 pricing would look like. Then starting in September, we ramped up more significantly, that continued in October, and we have a very robust slate of things that we want to close during this month and next. We are also active on the more-liquid side in structured private convertibles, and we are now seeing more situations that are more arbitrage-like and event-like within secondary distressed debt. We have gotten closer on some bits of securitized paper, where we recently bought our first CLO equity tranche in quite a long time, where we thought were very comfortably getting the interest, in a relatively short duration and decent MOIC situation, and we effectively have the principal as a kicker. And we think there is going to be a lot more of that, frankly, because the CLO machine just needs to keep getting fed. People are kicking out some of that paper just to clear the decks and issue more, because that is really what they are geared to do, as opposed to making returns.

Internationally, in Europe, it has been publicly reported that we are seeing some very interesting distressed single-name, original-issue transactions. We have an interesting one coming in Italy and another one in in Greece, and we are seeing "singles" and "doubles" at the right price, busted Greek NPL names that we are working on, and digging into more things in that area.

In Asia Pacific we continue our New Zealand real estate credit business where we also have the excess capacity offering, which continues to go well. We are closing our second excess capacity pool there, and we will probably see a third offering coming in spring. The housing shortage in New Zealand is actually exacerbated, even though they handled COVID-19 as good as anyone in the world, because a huge number of Kiwis want to come back to New Zealand. We continue to make our style of returns, at 70% to 85% average LTV, in 10 to 15-month loans with an off-take from the federal government protecting our downside. We also continue to see more opportunities on the corporate side, and even on the structured side in Australia and New Zealand. We are working on some interesting things with old partners of ours in Southeast Asia, and have also done several effective share-backed loans with old partners in Korea.

I think this market is set up well for us, and we are able to be very patient. We don't have to chase anything. To be clear, post COVID-19 there are plenty of shoes to drop; but we knew what we had issues-wise by the third week of March. We feel very good about how we resolved some of those issues. There was nothing we took over in 2020 that we otherwise had not identified we were likely to take over anyway. And that has gone very well for us, because we have been super proactive. Some folks subordinate in the capital structures in which we are involved did not do as well, because they were bearing the brunt of that on our behalf. But we feel very good about how that came out for our investments. And so that would be a general overview of how we are seeing things.

Parag Shah
One question from the queue -- you said it a few times about being patient, but then it also being early, and there being a lot to unfold. How do you balance waiting to see how things develop versus doing something now where, potentially, it is going to get more attractive in the future?

Dan
The answer is just because it is early in the process by which these opportunities are coming, does not necessarily mean they are going to get that much more priced-in. It means there is just going be that much more volume of it. As an example, in aviation, we are pricing mid-20s to 30s IRRs for short-term liquidations. Those are in dribs and drabs and it is increasing a bit more. But, at some point – to use the analogy of big storms in the Caribbean blowing away insurers and new ones getting created – we are already pricing there being no recovery in those areas. The notion that they're going to get wider, when both buyer and seller are transacting at a level that presumes the world will not get better, is not really going to occur. We are patient in situations like some of those I discussed in terms of leverage loans, CLOs, and securitized aviation, where levels have nothing to do with reality. They are not trading as though COVID-19 has happened and will persist. There are big holes in the balance sheet that are obvious and they are only sustained by the kind of hope of the hot potato getting passed. So, we are just not doing it. We tend to see things that are either post-COVID-19 priced, or not. And then we spend our time on the post-COVID-19 priced stuff, and we just see that pool getting larger.

But it is going to take a lot of time. Again, coming to incentives, take something like commercial real estate. It is akin to when buggies displaced horses as the mode of transportation after the 19th century. You had masses of resistance, it took a long time, and it had a lot of winners and losers. The same thing is happening today, but you've had massive amounts of capital invested into the "old way" and those folks are not going down without a fight. But the idea people are going to put on suits and travel two hours by metro to sit in a tiny desk high up in a skyscraper seems nuts. Zoom works great.

Parag
Another question related to that, is, how do you avoid macro exposure or taking a bet on how COVID-19 plays out in an area like commercial real estate?

Dan
As an example, at the extreme, we had a situation with a former higher quality hotel name in Manhattan. The asset was getting sold out of a foreclosure. It was worth $80 to $100 million, pre-COVID-19 and it was getting bought by someone for in the $40 millions. Someone had a view that, at some point, it would be a hotel again, and it would have the amount of net operating income it would, and all the things that effectively require a view on the world. And not only it require a view on the vaccine, but did it also took into account the wholesale change in how we live in work that was brought forward 10 years by COVID-19? We had no view on any of that.

We underwrote it and said, "let's subtract out what they are going to have to do in order to convert this to multi-family, take a knocked down multi-family level that reflects a real beating for that property type, and then advance against that." We are effectively boiling the macro away, and then advancing at 60% against that level, and charging our kind of rates. In many instances, people do not like that on the other side, and in this case, they didn't. These guys wanted to buy at a post-COVID-19 level while financing themselves at pre-COVID-19 level, which was nonsense, as we pointed out to them. I think we feel pretty good that at our kind of basis, we are avoiding exposing ourselves to COVID-19 and/or macro risk. Another recent example: we bought some multi-family mortgages where the loan was, even at knockdown levels, a 65% loan to value. It had not been priced the way we would price it. It had been accruing default interest. It was a counterparty that, for its own customers, literally could not have a default on their books. We happily bought that at par, excluding the accrued default rate, right up into the teeth of the maturity, because from our perspective, we will go to the borrower and say, "here is the post COVID-19 right price now, if you want to extend for six to 12 months, or alternatively, given 35% subordination, even on knockdown levels of multi-family rental levels, we are comfortable foreclosing and moving forward to monetize the asset." So again, we are laser focused on highly draconian views of the world to underwrite to and not only those apply these views to today, but we expect them to persist.

Parag
One clarification question: you mentioned areas like e-commerce, and areas where Arena is taking advantage of people playing offense in this environment. Why are those folks not the beneficiary of all of the capital and intervention? And why is Arena able to have those opportunities available to them at the structure and pricing that's required?

Dan
Well because a lot of those opportunities are in, colloquially, "newfangled" businesses. And so while they may be very profitable, and very compelling, if you think about banks and others, banks do not like to go where the water is not already warm, right? So as an example, we have a company that is a small business, factoring online receivables on behalf of companies that might have receivables due from payers like Amazon Marketplace. Those receivables are not remotely underwritable by a bank, but their receivables are from investment-grade credits. So, they are able to factor receivables from people like Google and Facebook at very compelling return levels. We then say, "okay, we'll advance you 80 cents on that, charge you mid-to-high teens, and then participate in 25% of the ownership of

your platform." That opportunity continued to grow; it is a wonderful business with half a dozen highly sophisticated folks who are involved as backers. But there was no way on earth they could access bank financing. Now the portfolio has continued to grow, and we and the other backers have continued to help them develop their people and systems. The credit risks are still as good as they ever have been. Now, two or three years into it, with our help, they have been able to attract a bank that will look to advance 75% of our 80%, so 60%, and charge risk free plus four percent, and we will subordinate that residual piece and get paid some extra warranty to do so. Because ultimately, that will allow them to get to more counterparties, versus those that they have now. If you took that business at the time we did it, even though the obligations it was financing were kind of as obvious as they can get, banks are just not going to get there. If you are not sitting there with years of financial history, and a business that is readily able to fit into a big box with lots of comparables and history, you can't access regular financing channels. And there are just a huge number of misunderstood or under-understood technology-enabled beneficiaries of this kind of environment, that just have to exist for several years for a bank or even a regular way alternatives business - to permit them to be financed. That provides a lot of opportunities. And in those situations, we are going to be covered at a debt level and be very comfortable with it, but we are going to get a little bit extra by owning parts of these businesses as well.

Parag
You mentioned aviation as an area that is still early, still overpriced, but Arena is also doing things. Can you clarify your picture there?

Dan
Well, I think it's interesting. You know, after September 11, 2001, it was really 15 or 16 months before we got really going. The industry is a lot worse today, and a lot more interesting because there is a huge swath in the marketplace that is basically negative value. So you haven't seen any of that come through the securitized paper, because there may be deals where there is a coupon still getting paid out of a pre-funded interest reserve, but the underlying prospects for the lessees actually continuing to make their payments is very low and/or dependent on government intervention or other extraordinary means. Very generically, for the senior parts of those capital structures that are still indicated in the mid-to-high 90s, we would be interested in the 50s, and it is just absurd that they are still at those levels. In contrast, there are babies getting thrown out with the bathwater in terms of parts, frames, engines associated with short haul and/or cargo-related and/or cargo-appropriate aircraft that people just want liquidity on. And with our joint venture partners, we can effectively know that we have a big portion of our basis in the bag, locked in when we buy it, so we are buying something, knowing we can move it right back out the door, and own the vast majority of the upside for very little, and on small bits – it could be $600,000, $1.2 million, $1.8 million – but small. Also, situations where you are buying it on a pure liquidation basis, but maybe there are three months more on a lease where we are not underwriting any take up, but at times, there might be a non-zero probability of extending the lease for another six months, in which case, you have upside coming from it. So, as I said, it is very early, but we are seeing folks who routinely trade, who have gotten hurt very seriously on long haul stuff, and where we have counterparties saying, literally, here is a list of what we have; "Do you want anything"? And they are just opening up their jacket with all their stuff in it and saying, "why don't you buy some of this from me and deal with it?" And, as you will recall, when we joint venture in this area, we have folks who are spending all day trading the components back and forth, and are putting money subordinate to us based on their market intelligence of where they can immediately or in a very short timeframe place this stuff. It is little bits and scraps, because we are bidding doomsday levels for these

things, but I think the prospects for more of that coming through are high. And I think, though the ultimately, 6, 9, 12 months down the line, the bonds will show themselves because the "well" to service the securitized obligations will start to run dry.

Parag
Question is what is your view on is the distinction between amend, extend and pretend and the fact that we're in a COVID-19 environment that could revert? Said differently, the difference between what you're describing as amend, extend, and pretend to what is an eventual outcome, versus COVID-19 being kind of a temporary phenomenon?

Dan
There are a lot of people making that bet, in a lot of ways, with large amounts of capital in junior parts of the capital structure. As an example, there was a big tussle over Cirque du Soleil, the actual business of which went to zero almost instantaneously. There was a sponsor who was trying to basically cram up the lenders, and the lenders said, "no, you're going to get zero, and we are going to write a $300 million new check, and we are going to own this business". And that requires a view as to how long this will last in the form that it will last. There are plenty of people making big and small bets, presuming some sort of timeframe for this. We do not want to have to. So if you don't have to, why would you? The pool of things that are super compelling where you do not have to is significant and growing. If I were in the business of putting out nine figures at a shot, and we were measuring our deployment by the ton, then those are a series of bets that I would have to make, but we don't and we don't want to, and it's not who we have to be.

I think in the part of middle-market loans that is not supported by the CLO bid, which itself is a phenomenon driven by the Fed, there will be a lot of ugly things happening. Because the ability of those enterprises ultimately to refinance is based on other people like those people refinancing, versus the CLO business where there really is no one within a line of sight wearing the risk, so to speak. And we have been made aware of situations where guys are partnering with the sponsors to make sure everybody's head is in the sand and praying. It could work out, but it's just not our kind of bet. I don't know if the world is normal in 2021, or 2025; I simply don't know.

Parag
Related question: how can the amend, extend, pretend phenomenon continue? Why wouldn't that just resolve itself through creditors taking over and all of that getting resolved as it should be?

Dan
Because they don't want to take a mark. There was a well-known firm with a BDC that was selling a loan at a steep discount. We asked to see all the documentation on the loan, and typically you look at the credit agreement and any amendments or waivers. There were 26 amendments, which I had never heard of before. The permissiveness of these lenders is so great because they don't want to crystalize the mark. Why not just take it over and deal with it? As we frequently say, these things don't age like fine wine, they get worse, particularly given the lack of asset support in the things these guys are involved with. The answer is they would rather ultimately trade off a lower mark, all things being equal, that they could recognize later, than a higher but still significant mark from par that they recognize earlier. Because as Munger says, show me an incentive and I'll show you an outcome - there may be fundraising objectives or other things that mean people do not want to tell investors about

reality. We think that is immensely prevalent out there, and we have seen some stunning, crazy, value-destructive moves that make no sense on a fundamental basis to us. And we have even been disappointed in folks in that regard.

Parag
One more, are you seeing more competition in the areas Arena is involved in given the amount of money being raised to take advantage of the environment by other managers?

Dan
No, it still continues to hold that the things that we are doing, they all have high volumes of elbow grease per dollar deployed. So, if anything, the large-scale folks are coming in, when you need to invest in clips of 9 figures, you are now back in the world of speculating when COVID-19 is going to end. And you are involving yourself in big bets on movie theatres and small cruise lines or certain types of retailers or hospitality assets where you are making a very different kind of bet. When you talk about the things we are talking about and the combination of capabilities you need while deploying these smaller bits of dollars per investment, there are just not many other folks. And if anything, the barriers to entry to getting into our business are only increasing in every way. The diseconomies of scale are very significant for folks. As an example in commercial real estate, a lot of the folks who were narrow-mandated bridge lenders and such were operating as "non-banks," are themselves really up a tree and are working through problems they created for themselves by being asset-liability mis-matched and taking on recourse financing on illiquid assets. So, it is just not something we are seeing in the market.

Parag
Any final thoughts?

Dan
I think we feel pretty decent about what we are seeing. We are eager to see what we can get done in November and December. I do think it will be interesting what the end of the year means for banks, and what they are going to do as they have been heavily increasing reserves and provisioning. When you take away all the expectations around a new president and you take away the less optimistic projections for when we are going to "back to normal," I think there are a lot of prospects for a lot more folks recognizing reality. I am certainly interested in what the flow of stuff is going to be like coming into the new year. And we feel pretty decent.

Parag
Thank you again for your continued partnership and as always, we will be working hard to make you money. If you have any questions, please reach out directly.

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