

What Can a Credit Analyst Learn from the Rise and Fall of First Brands?

By Michael Gatto

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As I wrote in my book, *The Credit Investor's Handbook* (Wiley Publishing, 2024), the role of a credit analyst is to assess risk and determine whether the expected return on a debt instrument sufficiently compensates the investor for the risks identified. Throughout the book, I focus on identifying red flags—warning signs indicating that a company might be riskier than it initially appears. I emphasize that a red flag doesn't automatically mean the debt is a poor investment, but rather that an astute and sophisticated analyst may conduct deeper due diligence and ask additional questions to assess the situation thoroughly. Sometimes, further analysis lends confidence in the investment. However, if the due diligence raises concerns or the company fails to provide sufficient information for risk evaluation, the opportunity is likely not worth pursuing.

As I begin work on the second edition of *The Credit Investor's Handbook*, I plan to examine the First Brands saga as a case study. My firm, Silver Point Capital, actively followed the company and identified several concerning issues—which ultimately materialized into larger problems. Based on our findings, we concluded that the debt was not a reliable long-term investment, though we traded the name briefly, maintaining no exposure since January 2022.

Ed Mulé, the co-founder of Silver Point and my boss and mentor for 30 years, frequently tells me and other members of his team that the best way to become a great credit investor is by conducting postmortems on deals that went awry. First Brands offers a valuable learning opportunity, as it exhibited numerous red flags that should have triggered caution among investors.

This paper delves into five specific red flags associated with First Brands. For each of these, I will explain why it was a warning sign, how an analyst could identify it, and follow-up questions or due diligence processes to determine whether the risks should have deterred investment. However, in certain situations, all or some of these due diligence steps may not be possible or practical to undertake, and credit investing involves significant judgment. Finally, I will illustrate how these lessons apply to the First Brands case.

Summary of Red Flags

- 1) **Founder-Owned and Operated Business with a History of Fraud Allegations**
- 2) **Growth Driven by an Aggressive Debt-Financed M&A Strategy**
- 3) **Discrepancies Between Marketed EBITDA and Actual EBITDA**
- 4) **Use of Special Purpose Vehicles (SPVs) to Keep Debt Off-Balance Sheet (very Enron like)**
- 5) **Use of Reverse Factoring (Supply Chain Financing)**

This paper relies on publicly available information sourced from court filings and media coverage.

A Brief Overview of First Brands

First Brands is a global supplier of primarily aftermarket auto products, including wipers, filters, drums/rotors, brakes, lighting, and accessories. The company was founded by Patrick James, a reclusive entrepreneur originally from Malaysia who immigrated to the United States. He built the company through an aggressive roll-up acquisition strategy, completing fifteen debt-financed acquisitions between 2011 and 2024, with the majority occurring between 2020 and 2024. Prior to its bankruptcy filing, First Brands reported approximately \$6 billion in debt, consisting of \$5.5 billion in senior secured debt and \$0.5 billion in second-lien debt.

The Debt Trades Down Over 60 Points

In early 2025, First Brands attempted to address looming debt maturities. At the time, its credit ratings stood at B+/B1 by S&P and Moody's, respectively, and its debt was trading in the mid-to-high 90s¹. To manage \$4.5 billion of first-lien debt maturing in March 2027, the company explored refinancing options to extend these maturities. In July 2025, investment bank Jefferies was engaged to lead the refinancing efforts. Initially, most of the existing lenders expressed interest in participating in the refinancing deal, but concerns began to mount.

As a few investors started scrutinizing red flags that were largely ignored in prior years, those investors began demanding additional due diligence, including a comprehensive quality-of-earnings report. These requests sparked increased anxiety regarding the company's financial health. Over the following weeks, sentiment deteriorated rapidly, and First Brands' debt, which had been trading close to par, saw a sharp decline. By late September 2025, when the company filed for bankruptcy, the first-lien debt had plunged to 30 cents on the dollar, and the second-lien debt had collapsed to under 10 cents on the dollar.

Allegations Surface Against Patrick James

In early October, shortly after the bankruptcy filing, James stepped down as CEO amid mounting allegations of accounting "irregularities." Shortly thereafter, Rich Handler, CEO of Jefferies, publicly stated that he believed his firm was "defrauded" by First Brands during the refinancing process². Meanwhile, Raistone, a factoring provider servicing First Brands, filed an emergency motion in court calling for an independent investigation into the disappearance of \$2.3 billion worth of receivables³. These revelations prompted significant media attention, including a Bloomberg report confirming that federal prosecutors had launched an investigation into the company.

Red Flag #1 – Founder-Owned and Operated Business with a History of Fraud Allegations:

At Silver Point, we have a long history of lending to founder owned and operated businesses and have built many successful partnerships in this space. They are often terrific businesses, can be highly attractive lending opportunities, and have and continue to be a focus for Silver Point. That said, extra precautions during due diligence may be warranted, especially if there is a history of fraud allegations against the company.

¹ Bloomberg.

² Reuters. Article: Jefferies says fund tied to First Brands collapse separate from investment banking. By Manya Saini; Editing by Arun Koyyur. October 17, 2025.

³ Bloomberg. Article: First Brands Creditor Seeks Investigation of 'Vanished' Funds. By Andrew Mendez. October 9, 2025.

Why the heightened sensitivity to founder-owned and operated businesses?

1. **Lack of Reporting and Governance:** Founder-owned businesses are not publicly traded, so they often operate with more limited reporting requirements and outside governance that a typical outside investor would require.
2. **Overconfidence:** Many founders have achieved significant success by taking significant personal and professional risks and overcoming obstacles to build their businesses from scratch, potentially leading them to take incremental risks.
3. **Resistance to Partnership:** Founders are used to running their business with autonomy and limited constraints and may develop a view that the usual rules don't apply to them. However, once a Company raises outside capital, they must work in partnership with their investors and often are bound by negotiated rules (covenants) in loan documents, which constitute contractual agreements that delineate what a company can and cannot do.

Given these factors, lenders should remain acutely aware of the potential for fraud. Some of the largest corporate frauds in recent U.S. history—such as Bernie Madoff and FTX (Sam Bankman-Fried)—were founder-led enterprises.

What Due Diligence Steps Can Be Taken?

1. **Conduct Comprehensive Background Checks:** Include a search for all filed lawsuits.
2. **Perform Reference Checks:** Locate and speak with individuals who have previously worked with the founder but are no longer affiliated with the company. Tools like LinkedIn, as well as external consultants, can help in tracking down former employees. Engaging in informal conversations often uncovers valuable insights. Traditional, hands-on due diligence by "pounding the phone" remains invaluable.
3. **Analyze Financial Statements in Depth:** Scrutinize financial statements and follow up with comprehensive questions to address any areas of concern or uncertainty.
4. **Verify Financial Information Independently:** Conduct independent verification of key data points from the financial statements. Examples include invoice checks, reconciling the income statement with the cash flow statement, verifying inflows and outflows against bank statements, and commissioning a third-party quality-of-earnings (QOE) report from a reliable firm.

The key is to ask a thorough series of questions that directly address your concerns. A major red flag arises when the company refuses to accommodate basic requests or becomes defensive when asked to provide additional information to validate its financial statements. In my experience, such behavior from a company indicates a fundamental problem that should not be ignored. Conversely, when a founder provides a significant amount of transparency and goes out of their way to engage on an investor's inquiries, it often provides a positive signal of a highly engaged founder who will be a trustworthy partner.

By way of illustration, I will provide two examples of occasions when Silver Point Capital conducted due diligence and ultimately passed on financing opportunities for two unrelated companies owned and operated by their founders. In both cases, concerns about potential fraud surfaced during our credit analysis.

In each instance, we made multiple requests for supporting data and asked management a series of critical questions that required clear answers before we could move forward with the deals. However, in both cases, the companies took offense to our inquiries, responding defensively: *"We've been operating for a long time and have raised plenty of capital. Why do you need more information than anyone else to make a decision?"*

Ultimately, we chose not to proceed with either deal, and within two years, both companies were exposed for fraudulent activities, with their founders ending up in jail.

The Marc Dreier Deal: I wrote extensively about the first deal—the Marc Dreier case—in my book, *The Credit Investor's Handbook*. Marc Dreier was the founder and sole equity partner of a law firm with 175 lawyers and offices across the United States.

Dreier told us he had a client who extended a short-term, unsecured loan to Solow Realty, a real estate development firm. This client was allegedly experiencing a liquidity crunch and was offering to sell the note at a discount if we could close the purchase quickly. After initial negotiations, we agreed on a price, contingent on a thorough review of the loan documents and additional due diligence. However, Dreier became visibly irritated with our requests for further information, arguing that other lenders had not imposed such demanding requirements. Ultimately, Dreier informed us that he had sold the note to another hedge fund.

Within a year from Dreier stopping discussions with us because we were asking too many questions, news broke of his arrest in Canada. It was revealed that the Solow Realty loans, along with several others marketed by Dreier, were entirely fictitious. Dreier was carrying out a sophisticated scheme where he sold fabricated promissory notes and pocketed the proceeds. As the supposed notes reached their maturity dates, he would either convince noteholders to extend the maturity or sell new fake notes to refinance earlier obligations—a classic example of a Ponzi scheme.

Looking back, Dreier's hostile reaction to our questions vividly illustrates the value of rigorous due diligence. His resistance to providing basic information was ultimately a clear red flag, demonstrating the importance of trusting your instincts and never shying away from asking uncomfortable questions when evaluating risk. For those interested in learning more, the documentary *Unraveled* is a fascinating examination of the Dreier scandal.

The Gary Frank Deal: Gary Frank was the founder, CEO, and sole shareholder of LCG. In 2017, his banker approached Silver Point Capital to provide a \$90 million loan to refinance existing debt from one of the country's largest insurance companies and to fund growth capital. Upon initial review, the loan appeared to be a compelling opportunity for our fund. The firm had been growing at an 18% compound annual growth rate (CAGR) from 2007 to 2017, and with EBITDA of \$44 million, the company seemed to have very modest leverage, as its debt-to-EBITDA ratio was just 2.0x (\$90 million debt / \$44 million EBITDA).

However, red flags quickly emerged. First, we discovered past litigation with lenders. Additionally, reconciling the company's income statement with its cash flow statement proved difficult, raising concerns about the accuracy of its financial reporting. As a result, we requested monthly bank statements directly from LCG's bank and insisted on a meeting with the bank to verify the cash flows. We also asked to speak directly with the company's largest customer to confirm its reported business activity. These requests were met with extreme hostility from Gary Frank, who became belligerent. Unable to obtain the transparency we needed, we informed him that we could not proceed with the deal.

In 2018, Frank pled guilty to fraud and was sentenced to 17.5 years in prison, confirming our concerns.

I discuss these two cases in detail not only because they are compelling stories, but also because they underscore the importance of asking tough questions and demanding the information necessary to evaluate risk effectively. The common thread in both deals is clear:

1. Both were founder-owned and operated companies.
2. The more we probed, the more antagonistic and defensive the founders became, despite the fact that our requests were entirely reasonable.

These experiences reinforce the critical importance of rigorous due diligence when evaluating founder-led businesses, especially when red flags arise. Asking difficult questions and refusing to back down—even if those questions upset management—can often be the difference between a prudent investment and falling victim to fraud.

Red Flag #1 – Applied to First Brands

A simple Google search would have revealed that Patrick James, the founder and CEO of First Brands, had been sued for fraud multiple times. In 2009, Pittsburgh-based TriState Capital Bank filed a lawsuit alleging, among other things, that James inflated

accounts receivable and inventory figures⁴. Then, in 2011, a unit of Fortress Group filed suit against James and the companies under his control, accusing them of deliberate misrepresentation⁵. While James and his company denied the allegations, they eventually settled the cases.

Attempts to contact individuals who had worked with James could have shed further light on his character. According to media reports, few people were willing to discuss their experiences working with him, and those who did described him as highly secretive and aggressive, particularly in his approach to acquisitions and the financing of those acquisitions.

The company's financial statements contained many warning signs (which are analyzed in greater detail later in this paper). As discussed earlier, a sophisticated credit analyst should investigate potential red flags and determine whether they constitute clear reasons not to invest. This principle was highly relevant during our evaluation of First Brands' 2021 \$1 billion financing request, intended to refinance existing debt and support the company's ongoing acquisition strategy. Investment bankers close to the company informed us that James was irate about the volume and nature of the questions we were asking, even though we considered them standard and necessary. It has also been reported that some investors faced similar aggressive pushback this year when they requested to review customer invoices that served as collateral for the company's receivables-backed loans.

Red Flag #1 – Conclusion – Significant Red Flag

These factors point to a critical red flag in assessing First Brands. A founder who has faced prior allegations of fraud, who is described as secretive and aggressive, and who resists routine due diligence efforts raises serious concerns. Failing to heed such red flags can lead to significant financial losses—and in some cases, exposure to fraudulent schemes.

Red Flag #2 – Growth Driven by an Aggressive Debt-Financed M&A Strategy

Companies that are serial acquirers often have financial statements that are difficult to interpret, as acquisitions can obscure underlying weaknesses in the company's core business. To fully understand the company's performance, savvy credit analysts should disaggregate revenue growth into organic growth (i.e., growth in the core business excluding acquired revenue) and acquisition-related growth.

For example, consider the following scenario: a company completes an acquisition that contributes \$25,000 to revenues during a particular year. Figure 1 illustrates the impact of this acquisition on the company's reported sales:

Figure 1: Corp Organic Sales Growth

	Historic		
	Year 1	Year 2	Year 3
Reported Sales	\$145,210	\$155,120	\$160,549
Reported Sales Growth	NA	6.8%	3.5%
Reported Sales	\$145,210	\$155,120	\$160,549
<u>Less Sales Related to Acquisitions</u>	<u>-\$0</u>	<u>-\$0</u>	<u>-\$25,000</u>
Organic Sales	\$145,210	\$155,120	\$135,549
Organic Sales Growth	NA	6.8%	-12.6%

⁴ Indiana Economic Digest. Article: Millions Sought from Columbus Components Group Owner. By Kirk Johannesen. July 26, 2009.

⁵ Court filing: Northern District of Ohio. Case no. 1:11-CV-00200. March 28, 2011.

Relying solely on the income statement, the analyst would overlook a massive decline in the company's performance. While reported sales increased 3.5%, once the positive impact of the acquisition is stripped out, the company's organic revenue declined by 12.6%.

Therefore, it may make sense to demand detailed financials that allow an analyst to separate the impact of acquisitions from the underlying growth of the business.

Additionally, the analyst may also consider the company's ability to integrate its acquisitions effectively, including integrating information systems, operational processes, and management teams. Poor integration can lead to inefficiencies or operational issues that compound financial risk.

A company may also manipulate its actual operating costs by categorizing some of them as one-time expenses associated with acquisitions. This can create a false picture of its true cost structure and profitability (we will address this concern further under Red Flag #3).

Finally, these risks are magnified when acquisitions are debt-financed, as each transaction increases the company's leverage. This reduces the proportion of equity relative to total capital, narrowing the cushion available for lenders and increasing the financial risk in the event of a downturn or operational misstep.

Red Flag #2 – Applied to First Brands

As noted earlier, First Brands was formed through a series of fifteen debt-financed roll-up acquisitions spanning from 2011 to 2024. The majority of these acquisitions were completed in the period between 2020 and 2024, which significantly accelerated the company's growth trajectory.

This aggressive approach to acquisitions presented yet another significant red flag.

Red Flag #3 – Discrepancies Between Marketed EBITDA and Actual EBITDA

Most companies categorize their operating expenses into recurring and non-recurring items. They often adjust their reported EBITDA by adding back what they classify as non-recurring expenses, thereby calculating an adjusted EBITDA—the number they want lenders to focus on because it's higher. A higher adjusted EBITDA makes key metrics such as leverage (Debt/EBITDA) appear more favorable.

It is critical for analysts to examine the validity of these non-recurring add-backs instead of accepting the company's numbers at face value. Blindly relying on the company's adjustments can lead to incorrect conclusions about its financial health. I often use the following analogy to illustrate this point:

Imagine you're interviewing a recent MBA graduate for a job, and the candidate claims their GPA is 3.5. Upon review, you discover their actual GPA is 2.9, but they insist the 3.5 better reflects their performance. If you learn that the student earned a 3.5 GPA every semester except for one, during which they experienced a verified tragic life event, for example, a personal or family emergency—you might reasonably accept their explanation that the one poor semester that brought down their GPA was an anomaly. However, if the student consistently earns a 2.9 GPA every semester and claims to be adjusting for past behavior—partying and not working hard—arguing that, in the future, they are confident the GPA will improve to 3.5, you will likely reject the argument and rely on the actual GPA of 2.9.

Similarly, the most skilled analyst would consider whether to demand detailed information for every add-back and would exercise judgment in determining whether those adjustments are legitimate. Two simple rules of thumb can help assess whether the variance between reported and adjusted figures is a red flag:

1. If adjusted EBITDA exceeds actual EBITDA by more than 20%, this discrepancy warrants concern.
2. If the so-called non-recurring add-backs occur consistently every year, as opposed to being periodic, it might be problematic to classify them as non-recurring expenses.

Red Flag #3 – Applied to First Brands

Reports suggest that the EBITDA figure First Brands used to market its debt financing was double its actual EBITDA⁶—far beyond my 20% rule of thumb. Furthermore, the company reportedly included significant add-backs in its calculations every year, undermining the claim that these adjustments were non-recurring.

This was yet another red flag.

Red Flag #4 – Use of Special Purpose Vehicles (SPVs) to Keep Debt Off-Balance Sheet (Very Enron-Like)

If a company borrows \$100 million secured by its accounts receivable and inventory, its reported debt increases by \$100 million.

However, there are various methods by which a company can effectively borrow against accounts receivable and inventory while keeping that debt hidden from investors through off-balance-sheet financing.

The simplest approach is by factoring receivables—selling them at a discount in exchange for immediate cash. A more sophisticated method involves transferring inventory and receivables into special purpose vehicles (SPVs) and having those SPVs borrow money. If these programs are structured to meet specific accounting rules, both the assets and the associated debt can remain off the company's balance sheet.

From a credit analyst's perspective, I firmly believe that Generally Accepted Accounting Principles (GAAP) can distort the true economic reality of a company's debt position. For example, a company using a traditional revolving credit facility secured by inventory and receivables is not fundamentally more leveraged than a company using factoring or SPVs to achieve the same outcome. An analyst should consider adjusting for this hidden debt by bringing off-balance sheet liabilities back onto the company's balance sheet. This adjustment could result in a more accurate assessment of the company's leverage.

The larger and more complex these facilities are, the greater the red flag. The poster child for "hiding debt" from investors is energy giant Enron.

Enron, once heralded as a corporate success story, generated \$100 billion in annual revenue. It was named "America's Most Innovative Company" by Fortune for six consecutive years and ranked 18th on Fortune's list of the nation's 535 "Most Admired Companies." Yet, Enron's collapse was swift—it went from an investment-grade-rated company to bankruptcy within weeks.

The warning signs began to surface in mid-2001 and escalated in October, when the Securities and Exchange Commission (SEC) launched an investigation into Enron's off-balance-sheet transactions. The fallout exposed how Enron had used SPVs to mask billions of dollars of debt. Multiple executives were indicted, leading to convictions in 2006 for two of the CEOs—Jeff Skilling and Ken Lay—as well as CFO Andrew Fastow. They were charged with various fraud offenses and sentenced to prison.

⁶ Debtwire. Article: First Brands' Financial Tune Up Raised Red Flags that Wall Street Overlooked. By Kunyi Yang, Ayse Kelce, Lavanya Nair, Nicholas Morgan, and Melina Chalkia. September 26, 2025.

For those interested in learning more about Enron's rise and fall, and the role of Arthur Andersen in the scandal, *The Smartest Guys in the Room* by Bethany McLean and Peter Elkind and *Conspiracy of Fools* by Kurt Eichenwald are must-reads.

Red Flag #4 – Applied to First Brands

Like Enron, First Brands relied heavily on complex off-balance-sheet vehicles to finance its operations. While the company officially reported \$6 billion in debt on its balance sheet, this figure understated its true liabilities by approximately 40%. Once off-balance-sheet debt was included, the company's total indebtedness exceeded \$10 billion.

This was yet another substantial red flag.

Red Flag #5 – Use of Reverse Factoring (Supply Chain Financing)

Monitoring trade support, in certain circumstances, could be a critical component of analyzing a company's liquidity. Payable days refer to the average number of days it takes for a company to pay its vendors for inventory. Generally, the higher this ratio is, the better it is for liquidity—provided the longer payment terms are sustainable.

If a company's payable days increase from 30 to 100 because vendors have agreed to better terms, this is a positive sign for liquidity. However, if the company is "stretching" payables—that is, paying vendors late—this can put the company at risk of losing vendor support. When vendors "pull support," it means they refuse to extend payment terms and instead demand payment upfront before shipping goods. Losing vendor support can have a catastrophic impact on a company's liquidity and overall operations.

Reverse factoring, also known as supply chain financing, is a tool through which a company partners with a financial provider to pay its suppliers earlier than the company is contractually required to pay them. I see reverse factoring as an indirect method for stretching payable days. For example, suppose a vendor requires payment within 30 days of delivering goods to a company. If the company's liquidity position is weak and it needs 120 days to pay, it can partner with a finance company to bridge the gap. The finance company pays the vendor on day 30 and then collects payment from the company on day 120—effectively extending the payable period by 90 days through what is essentially a short-term loan.

While supply chain financing can be a legitimate tool for managing cash flow, these agreements can also be a red flag, especially if the effective interest rate for the financing is unusually high. An analyst must ask: *Why would a company agree to pay exorbitantly high rates just to stretch payable days from 30 to 120 days?*

Importantly, reverse factoring agreements have been associated with some high-profile frauds, such as Greensill Capital's loans to GFG Alliance. Greensill Capital marketed its loans as very low-risk, short-duration supply chain financing arrangements, similar to those described above. The firm assured investors that its borrowers posed minimal risk while offering high returns. At its peak, Greensill was valued at \$4 billion. However, in March 2021, Greensill Capital abruptly collapsed and filed for insolvency. In reality, many of Greensill's borrowers were excessively risky, which explains why they were willing to pay such high rates to extend their payment terms. For a detailed account of Greensill's rise and fall, *The Pyramid of Lies* by Duncan Mavin is a must-read.

Red Flag #5 – Applied to First Brands

First Brands engaged extensively in reverse factoring agreements, many of which carried extremely high effective interest rates. A Goldman Sachs analyst estimated, based on publicly available information, that First Brands was paying effective interest rates of approximately 30% for some of these arrangements⁷.

This blatant reliance on high-cost reverse factoring agreements represents yet another significant red flag.

Conclusion

The best trained and experienced investors in First Brands' debt could have noticed these red flags and conducted additional due diligence before investing. As the saga continues to unfold, it is becoming apparent that the situation is an unmitigated disaster, with the company's debt losing 60% of its value over the past month.

As events progress in real time, there will undoubtedly be more lessons to learn from this case.

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Michael Gatto is a Partner, Head of Private Side Businesses at Silver Point Capital, and the author of *The Credit Investor's Handbook* (Wiley Publishing, 2024).

Gatto was one of the first employees at Silver Point Capital, a credit-focused global investment firm. He joined Silver Point in April 2002 and became the first non-founding partner in January 2003. Since joining, he has played a pivotal role in growing the business from \$120 million of investable capital (including leverage) in 2002 to over \$40 billion today. Currently, he serves as the head of the Firm's Private Side Businesses.

Prior to joining Silver Point, Gatto worked at Goldman Sachs as a senior member of the Special Situations Investing Business. Before his tenure at Goldman Sachs, he developed and taught credit training programs for loan officers at financial institutions across North America and Europe. Earlier in his career, he worked as a loan officer and served as the Director of Global Training at Citibank.

In addition to his role at Silver Point, Gatto is an adjunct professor at Columbia Business School and Fordham University's Gabelli School of Business, where he teaches courses on credit analysis, distressed value and special situation investing.

He is also the author of the textbook, *The Credit Investor's Handbook: Leveraged Loans, High Yield Bonds, and Distressed Debt*.

Gatto earned an M.B.A. from Columbia Business School and holds a B.A. in Economics from Cornell University.

⁷ Bloomberg. Article: First Brands Collapse Blindsides Wall Street, Exposing Cracks in a Hot Corner of Finance. By Eliza Ronalds-Harron, Irene Garcia Perez, David Scigliuzzo, Reshmi Basu, and Johnathan Randles. October 9, 2025.

Important Notes and Consideration

Detection of Fraud: Credit analysts are not, and are not trained to be, forensic fraud investigators. In addition, frauds, by their nature, are intended to be concealed and difficult to detect. As a result, even if the most diligent credit analyst conducted a detailed and thorough process (including substantial due diligence), fraud may be difficult or impossible to detect. All investments, therefore, involve risk of fraud.

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