Debt Advisory

Debt Markets Update
Q3 2009

Welcome to PwC Debt Advisory's Q3 2009 market outlook, which looks back over the last three quarters and discusses recent and expected trends in key credit markets

Whilst there can be no question credit markets have improved since the dark days of the beginning of the year, borrowers continue to find raising or extending existing credit lines challenging.

One of the big stories of the year has of course been the bond market and we have seen an increase in the number of borrowers considering obtaining external credit ratings and issuing bonds for the first time. Issuers with low investment grade ratings, particularly those on 'negative watch', have also made maintenance of their ratings a mission-critical goal to ensure continued access to the investment grade market.

In recent months, some companies have issued sub-investment grade bonds, a market which has been shut for nearly two years. Notwithstanding this improvement in market conditions, issuing bonds is not an option available to every borrower and consequently reliance on banks remains high.

Banks remain cautious and often reluctant to advance loans to new customers. As a result, the cost of extending maturities of existing facilities with incumbent banks or refinancing with new lenders is often still expensive, even for the most creditworthy of companies. However, during the third quarter, we have seen the upward pricing pressure on many forms of bank lending abate somewhat. Although we have yet to see significant falls in the pricing of bank loans, we have some confidence that, in the absence of further major economic shocks, the peak for the pricing of credit may now have passed.

Whilst the UK clearers subject to significant state influence have been set specific new lending targets, the goal of boosting lending is still subject to the more cautious lending standards being adopted throughout the bank sector over the last twelve months. Therefore, careful presentation of a company's credit proposition is still necessary, if this capacity is going to be tapped by borrowers which do not currently have lending relationships with these banks.

Banks also remain focussed on minimising the capital they must put aside for new loans. This increases the attractiveness of Asset Based Lending from a lender perspective which in turn can have pricing benefits for borrowers. Pricing increases on asset backed loans have therefore been less marked than increases on corporate credit. Asset based lending does, however, require the ceding of security to lenders, which does not suit all borrowers.

One other noticeable trend in the market this year has been the increasing popularity of convertible bonds. In this issue, we focus on the key characteristics of convertible bonds and why they are becoming more popular.

Overview

Welcome to PwC Debt Advisory's Q3 2009 market outlook, which looks back over the last three quarters and discusses recent and expected trends in key credit markets

In the current recession, borrowers and lenders continue to monitor covenant compliance vigilantly. The importance of monitoring forward looking compliance is hard to over-emphasise given the price of a covenant reset continues to be very high: margin increases of 150bps to 300bps plus substantial fees. We have been involved in many transactions where borrowers have raised new equity to reduce leverage and improve the terms of new credit.

This document looks at some of the recent trends in the Corporate Banking, Leveraged Finance, Corporate Bond and Asset Based markets. We also comment on recent trends in Debt Restructuring.

At PricewaterhouseCoopers, we have dedicated debt advisory personnel in all major UK centres and relationships with major banks, funds and bond investors in all key credit markets. We have been active throughout the 'credit crunch' and some of the transactions we have recently advised on are presented on page 25 of this document. As always, your feedback and responses are extremely valuable. We would welcome the opportunity to hear your views and to discuss how the issues raised here might affect your business.

Simon Boadle
Head of Debt Advisory

Corporate Lending

Key trends

As a general rule, most banks are maintaining their principal focus on existing lending until they believe that they have fully assessed likely losses from their existing loan portfolios. Despite this, most of the banks currently active in the corporate lending arena are, cautiously, still open for new business. However, any new lending proposal will be heavily scrutinised and will therefore take time and patience to complete. Banks are understandably nervous when being asked to refinance lending with one or more other banks, as they are keenly focused on not taking on the other banks' "problems".

We have observed a growing recovery in confidence amongst the main commercial banks with more lenders now showing appetite for new propositions; this is welcome news as it does hold out some potential for generating a competitive tendering process amongst the banks for debt requirements up to £500m. Lending of any significant size above this however, remains more difficult, being constrained by the number of banks in the market, at present.

Many of our clients are now discovering that their facility renewals have become significantly more expensive, even if their business is trading in line with expectations. Typical lending margins for corporate debt are still typically in the 200bps to 300bps range even for a company with a relatively robust balance sheet and stable outlook. There has been some softening in pricing for larger investment grade credits in the last nine months, but pricing is still generally above pre-Lehman levels.

The general mood of caution and conservatism amongst banks has translated into a similar mood amongst auditors when considering the appropriateness of the going concern status of the company. Auditors remain focused on ensuring that adequate facilities are in place for the next 18 months to provide sufficient funding even for an appropriately sensitised business plan, taking account of potential downside risks as we move towards 2010.

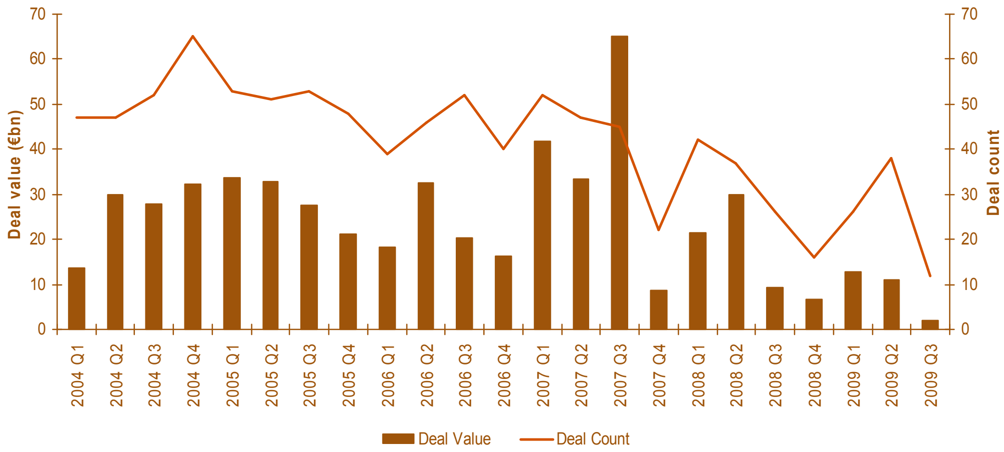
As we know, the UK bank market landscape has been altered by the partial nationalisation of RBS and Lloyds and it has taken time to understand the impact of the government's agenda on lending to "Corporate UK." We have observed a strong strategic drive within RBS and Lloyds to increase their lending – which nonetheless has to be achieved by maintaining the more stringent credit quality parameters that the current economic environment demands.

Corporate Lending

Lending volumes

- Q3 2009 was the quietest quarter for bank lending to investment grade companies in the UK since 2004. Deal value during the quarter was only €2.1bn compared to €9.2bn in Q3 2008. Unsurprisingly, the value of loans written in the first 9 months of 2009 (€25.8bn) are 57% down on the same period last year.
- With very few M&A deals at present, the bulk of activity in Q3 2009 continued to relate to refinancing activity.
- There has also been a noticeable reduction in forward start facilities in recent months, which is a possible indication that the confidence of CFOs in their ability to refinance in 18-24 months has increased. Further detail on forward start facilities is contained later in this section.
- Banks continue to have limited underwriting appetite. In the corporate lending sphere, as opposed to leveraged lending (discussed in the next section), individual banks, as part of a club deal, will typically look to sign-up to no more than £60m to £75m of risk (occasionally up to £100m-£125m).

UK volumes – Investment Grade (AAA to BBB-) Corporate Lending



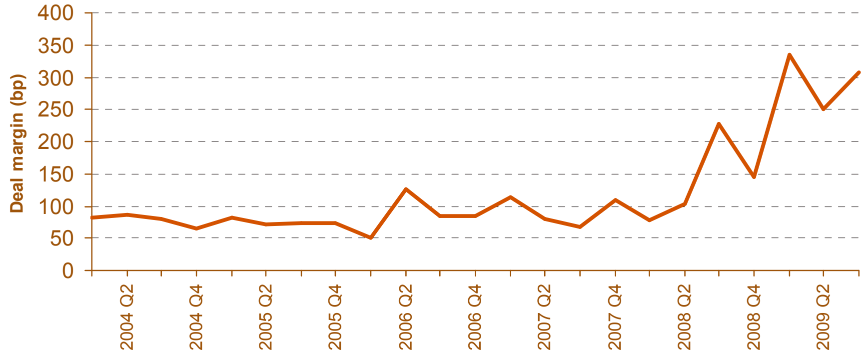
Source: Dealogic LoanAnalytics

Pricing and maturity

- Publicly available data on corporate loan pricing indicates a small uptick in margins in Q3 2009 compared to the previous quarter (see graph on the following page). This trend is inconsistent with our recent observations of the market, which tend to suggest that pricing has continued to soften in Q3 2009 and probably reflects a very small sample size (just three financings).
- In respect of pricing, a "tiering" effect has also been observed, with reduced pricing for higher quality credits in particular. Recently the Swiss A- rated engineering group ABB refinanced $2bn of debt at LIBOR + 100bps. This trend may result from the ability of larger, stronger borrowers to access the bond market, where spreads have narrowed, thus providing some competition for lenders. In comparison, mid-cap borrowers are relatively more dependent upon bank financing, although we have had an increasing number of mid-caps approach us, keen to discuss the process of obtaining ratings and becoming first-time issuers.

Pricing and maturity (contd)

UK Investment Grade (AAA to BBB-) Corporate Lending – Average Pricing



Source: Dealogic LoanAnalytics

- Most, if not all, corporates continue to face a significant increase from their existing lending margins (which may be less than 100bps) to current market pricing. Whilst for corporates funding on floating interest rates there is some mitigation from present lower levels of LIBOR, many companies that have hedged their interest rate costs are not benefiting.
- These substantial pricing increases are a function of both the supply/demand imbalance in credit supply and the increasing costs of capital being borne by lenders (as a result of recent government intervention and changes in European banking regulations). When the possibility of a company's trading having worsened in the current downturn is overlaid on these market dynamics, the pricing increases can be severe.
- One very encouraging trend that is now apparent in the corporate bank market is the return to 4 and 5 year maturities from the 3 year terms we saw earlier in the year, which were being driven largely by changes in bank capital adequacy requirements.
- Margin increases plus across the board increases to arrangement fees mean the costs of rearranging facilities, on a per annum basis, have risen considerably.

Availability of credit and refinancing options

- The reduction in the availability of credit has caused companies to consider refinancing debt facilities earlier than previously contemplated. Refinancing risk has weighed on the share prices of listed companies and auditors are considering more closely the going concern status of a company. Depending on how a company's year-end accounting date relates to its debt refinancing date, it may be necessary to commence a refinancing process up to 2 years ahead of scheduled maturity.
- One possible solution which can help reduce this risk and uncertainty is the so-called "forward start" refinancing. Under this arrangement, the borrower and lenders enter into discussions about the renewal of facilities ahead of final maturity. The renewal is agreed in advance, but the new facilities do not start until after the existing facilities have expired. In these circumstances, the borrower pays arranging fees that will generally include a component to compensate the lender for the difference between interest rates on the existing facility and current market rates.

Corporate Lending

Availability of credit and refinancing options (contd)

- There was a reduction in the number of forward start facilities in Q3 2009 (€7bn) from Q2 2009 (€18bn). The fact that these facilities are becoming less common perhaps suggests greater confidence amongst Finance Directors about the availability of credit although it is too early to say whether this is a trend or just a reflection of low activity in the third quarter.

Leveraged Finance

Key trends

The leveraged market continues to remain subdued and we would expect this to continue for at least the remainder of this year as any pick-up in activity is likely to lag the general lending market.

There are pockets of activity at the smaller end of the market, where two or three bank clubs can be put together with the traditional lending names. A recent encouraging trend in the market is for alternative funders (themselves fully funded by institutional money) to come into the market looking for single B credits. These funders are pricing at levels which make them competitive with traditional LBO banks and are providing much-needed new market capacity. We are also seeing vendors/buyers seek less standard forms of finance (e.g. Confidential Invoice Discounting) to support potential deals.

The £553m secondary buy-out of UK energy consultancy Wood Mackenzie Ltd in June 2009 and CVC's recent acquisition of AB InBev's Central and Eastern European operations for £1.4bn are both encouraging signs. However, in the Wood Mackenzie deal all but one of the existing lenders rolled their exposure and both required substantial equity cushions (60% of the purchase price for the latter).

Generally, deals are difficult to complete, although this reflects a mismatch between the price expectation of vendors as much as restrictions on the availability of leverage. Rigorous due diligence by buyers and lenders can also cause deals to stall.

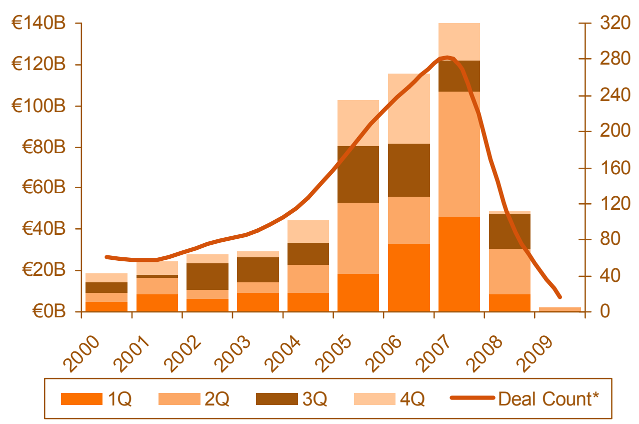
Banks continue to be selective about which sponsors they will work with, which may lead to a further shake-out in the Private Equity industry in the medium-term.

Overall, we still believe that whilst attracting "new" money in the market is difficult, with a combination of existing lenders, possibly vendor finance and some of the new alternative sources, it is possible. In the past 6 months we have raised a number of facilities to support buyouts in the current environment.

Lending volumes

- The low volume of M&A activity has hit the Private Equity and Leveraged Buyout sectors. Even compared to the anaemic level of activity in 2008, syndicated leveraged lending fell to a new low of €2.4bn in the first 9 months of 2009, compared to €47.3bn over the same period in the previous year.
- The majority of deals are completed on a 'club' basis with individual banks typically contributing no more than £25m each.

European LBO Volumes



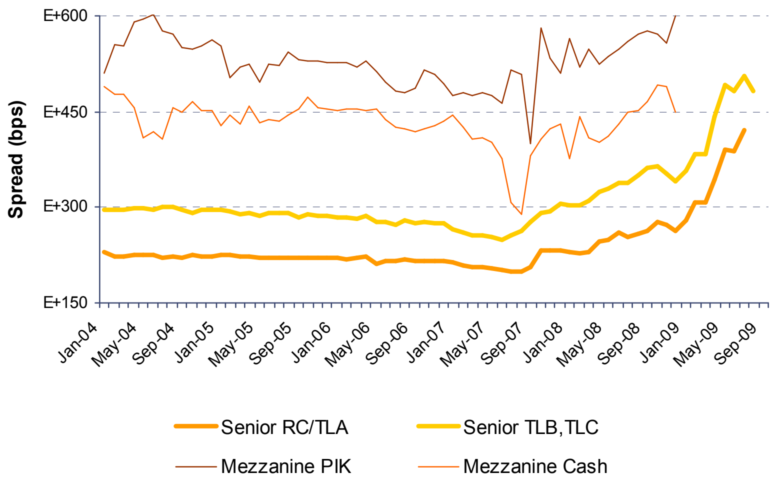
Source: S&P LCD

Leveraged Finance

Pricing

- Average pricing data from S&P is shown in the chart below, with the key trend being an increase in pricing for both senior and mezzanine tranches in the first 9 months of 2009 (on a weighted average basis) compared to previous years. However, the low deal volume in 2009 to date, means that any market statistics on pricing and leverage are less meaningful.
- Based upon our very recent market discussions, we observe the following pricing trends:
  - margins for leveraged loans to Libor (L)+400bps and L+450bps on senior A and B respectively (there is limited call for C tranches in the current market).
  - mezzanine finance margins are currently in excess of L+1500bps.
  - recent deals also indicate arranging fees at around 4%.
- The margins on Wood Mackenzie were relatively high compared to what we have observed recently, with pricing at L+475bps on TLA/RCF, L+525bps on TLB and L+1250bps on the mezzanine facility. The higher senior pricing is likely to reflect the return required by the lenders for the relatively high leverage of 4.0x senior debt.

European weighted average new issue spreads



Source: S&P LCD

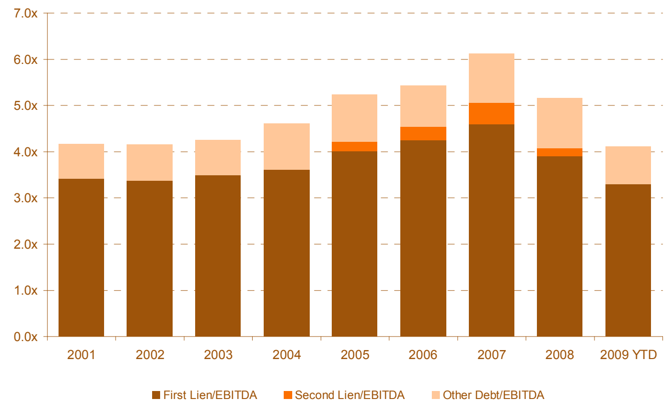
Purchase price and debt multiples

- Average Debt to EBITDA multiples have continued to fall year-to-date, whilst Purchase Price multiples have remained stable (the corollary of increased equity contributions). These trends are depicted in the graphs on the following page. We highlight that 2009 year-to-date data should be treated with caution given the low levels of activity represented.
- The commercial terms of the Wood Mackenzie transaction echo what we have seen in recent (lower) mid-market transactions in terms of significant equity contributions (c.50%). In this case however, leverage was relatively higher than what we have observed, with a total leverage of 5.4x and senior leverage of 4.0x. This leverage is no doubt a reflection of the quality of the business as well as the newly contributed equity. The combination resulted in total leverage of about a turn of EBITDA lower than the recapitalisation that was completed last year, but still relatively high.

Leveraged Finance

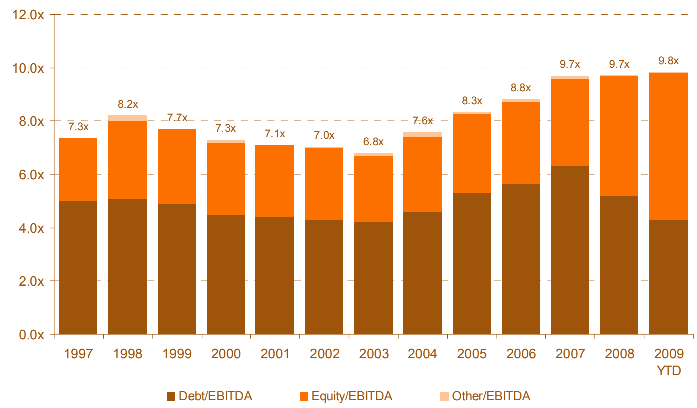
Purpose price and debt multiples (contd)

Annual pro-forma Debt/EBITDA ratios of European LBOs



Source: S&P European Leveraged Buyout Review

Sources of proceeds as a multiple of EBITDA of European LBOs



Source: S&P European Leveraged Buyout Review

Corporate Bonds

Key trends

In contrast to the banking market, the public bond market in the UK has seen a significant increase in activity this year. Investor demand for good quality names has led to a narrowing of credit spreads in the past 6 months, which suggests some signs of market recovery.

Investors' risk appetite has also increased with an increasing proportion of BBB issuance and, in the last few months, a revival in the sub-investment grade market.

Corporates have been attracted to the bond market both because it is an available source of credit but also because they have been able to secure longer tenors than on new bank loans.

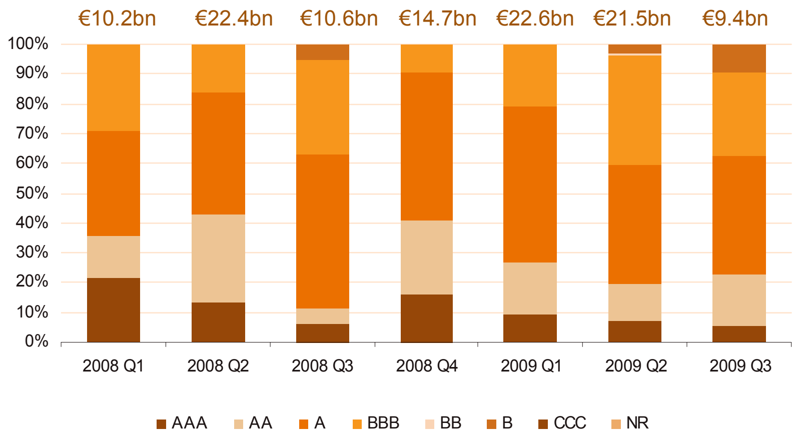
Issuance in the private placement segment has broadened across a range of sectors, but it remains largely concentrated on highly-rated borrowers.

There have been a number of convertible bond issues in recent months (e.g. BA, WPP). We include a summary of the attributes of convertible bonds and why they are becoming more popular in the following section.

Issuance

- The issuance of total public bonds in the UK in the first 9 months of 2009 (both investment grade and high yield) has increased by over 23% (€53.5bn) over the level for the same period in the preceding year (€43.2bn) whilst, as noted in the last section, bank corporate lending fell from €60.6bn to €25.8bn. The drop in issuance in Q3 this year reflects the impact of lower activity over the summer months. The table below shows all UK public bond issues split by rating.
- In terms of size, individual issues tend to start at £200m+; year-to-date, the average issue size has been £350m.

All UK bonds issued by rating (at launch date)



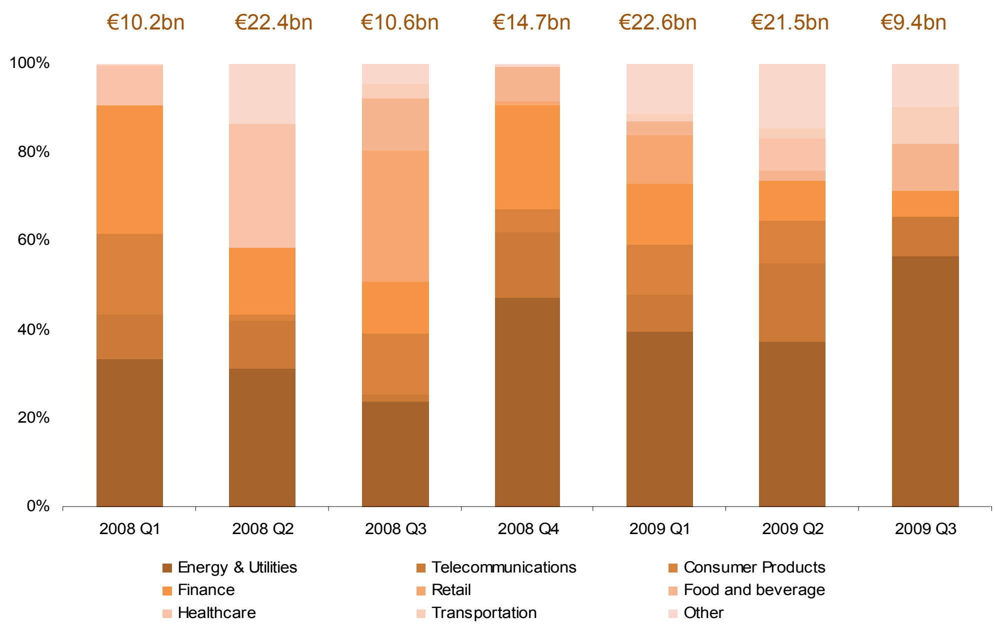
Source: Dealogic DCM

Corporate Bonds

Issuance

- Whilst energy and utilities continued to make up the largest element of new issuance (c.40% in FY09 year to date), bonds were also issued in a broader spread of industries in the first 9 months of 2009 including consumer products, retail, healthcare and transportation.

UK issues by sector



Source: Dealogic DCM

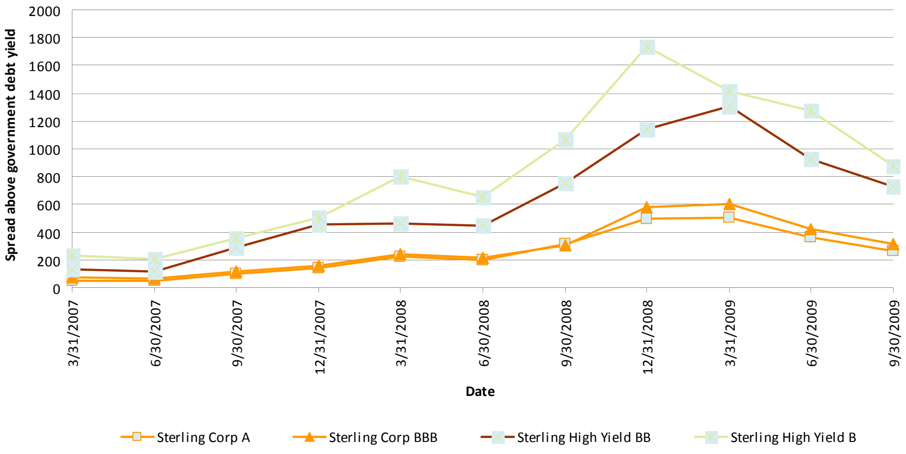
Pricing and maturity

- UK corporate bond spreads (the premium which corporate bond investors demand over gilts), peaked at the end of Q1 2009 (with the exception of B-rated bonds which peaked in Q4 2008) and have fallen noticeably on new issuances in the last 2 quarters across all rating categories (see graph on following page).
- Average BBB spreads fell to 313bps in Sept 2009 compared to 577bps at the beginning of the year. As noted earlier, this has put pressure on loan pricing for larger credits.
- One of the significant advantages which the bond market offers relative to the bank market is longer tenors. Although some 4 and 5 year loans are now being offered, commercial bank market appetite for lending longer than 3 years is still constrained. The ability for the bond market to offer much longer tenors is a major attraction for issuers.

Corporate Bonds

Pricing and maturity (contd)

UK Corporate Bonds – spread above Government debt by rating



Source: Merrill Lynch

- A good illustration of the buoyancy in the corporate bond market since the beginning of this year is the BBB+ rated German automotive manufacturer Daimler, whose €2.0bn 5-year bond was priced at the end of September 2009 at a spread of 150bps. This compares with a 600bps premium on €1.0bn raised in January 2009.

High yield market

- In recent months, the European high yield bond market has also seen signs after life after two years of inactivity. High yield bond issuance was €1.6bn in the UK in the first 9 months of 2009, more than 3 times the level of issuance over the same period in 2008.
- A number of corporates have issued sub-investment grade credit in the year-to-date including:
  - Wind Telecomunicazioni, which issued €1.2bn and $2.0bn of bonds in July 2009 to repay debt and fund a one-off dividend payment to its ultimate shareholder.
  - Ardagh Glass – a €300m issue in June 2009 for refinancing and general corporate purposes, secured against some of its assets.

High yield market (contd)

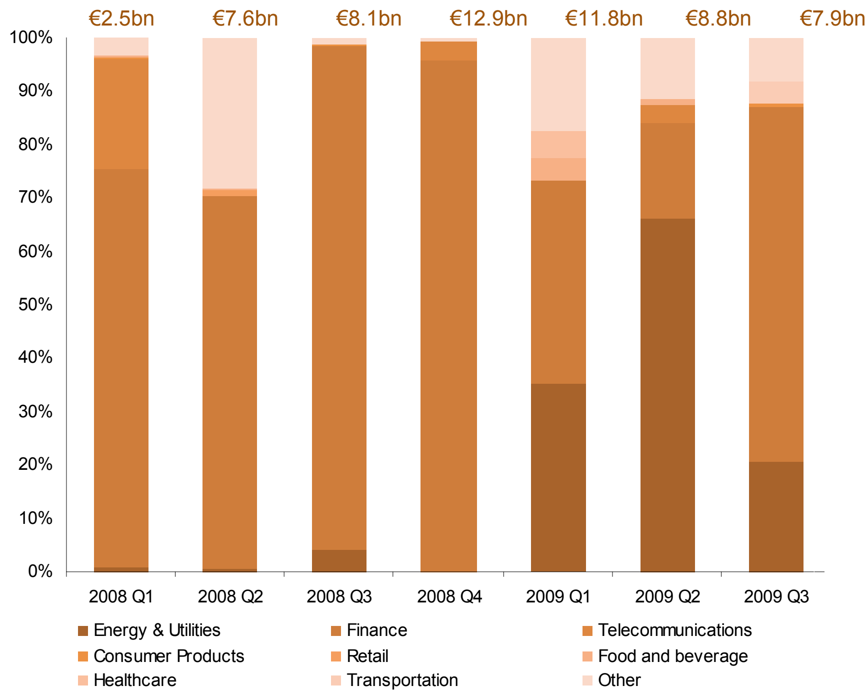
– Virgin Media – a 2 part deal in May 2009 comprising a $750m and €180m issue for repayment of debt and general corporate purposes. In July 2009, Virgin announced it intended to offer a further $300m of bonds.

– ITV plc – a Eurosterling bond exchange offer was made in May 2009 to holders of its 2015 €500m bond. The offer was accepted by 54% of bondholders.

Private placements

- The private bond market can also potentially be attractive to UK corporates; this typically involves accessing the US market which is deeper and more liquid than the UK market.
- The graph below shows issuance by European companies since the beginning of 2008. Whilst issuance continued to fall marginally in Q3 2009 versus previous quarters, there was a 57% increase in issuance in the year-to-date compared to the same period in 2008.
- The issuance was also spread over a greater range of industries than 2008, although finance and energy continue to be the dominant sectors.
- In terms of rating, 78% was A rated or above in 2009 compared to 86% in 2008.

European private placements (all sectors)



Source: Dealogic LoanAnalytics

Convertible Bonds

Focus: Convertible Bonds

- **This year there has been a significant increase in convertible bond issuance in Western Europe. In this section, we look at the principal characteristics of convertible bonds and why they have become popular.**

What is a convertible bond?

- A convertible bond is a debt security which entitles the holder to a stream of cash coupons, just like a standard bond or loan.
- In addition, the holder has the right to convert the bond into ordinary shares in the company. The number of shares that each bond converts into and the subscription price for the shares are pre-determined when the bond is issued. This enables the corporate to fix the degree of dilution implied by the bond and the level at which holders are likely to convert. On recent issues, the average conversion premium (i.e. the premium of the strike price compared to equity price at the time of issue) has been 30% to 40% (see table on next page).
- Often convertible bonds will have call provisions. These enable the issuer to buy the convertible bond back at a pre-determined price or force the investor to convert. This limits the upside implied in any conversion of the bond into ordinary shares. Bonds may include a period of time in which they cannot be called (non-call).
- The bond may also have put provisions which allow the holder of the bond to sell the security back to the issuer for a specified amount at set future dates. All other things being equal, this increases the value of the bond to the holder.

Why issue convertible bonds?

- Convertible bonds can be a cheaper form of debt financing for a corporate because the implied value in the option to convert reduces the cash coupon of the bond relative to a bond with no conversion rights. This discount to a standard bond increases with the volatility of stock prices. Therefore, in periods of high stock price volatility, the attractiveness of convertible bonds to an issuer increases.
- Also, in more difficult credit markets, the spread between standard cash coupon bonds and convertible bonds is likely to increase, raising the attractiveness of the latter.
- Companies with a stretched credit position may be able to issue convertible bonds when conventional debt markets are closed. Investors receive some downside protection (because they can maintain their debt claim) compared to subscribing to ordinary equity.
- Convertible bonds are most suited to listed companies because bondholders will be reluctant to hold illiquid equity shareholdings.

Convertible Bonds

Recent trends and issuances

- The convertible bond market shut down for several months in 2008 as a result of a combination of factors, including the decline in the equities market, the widening of credit spreads and the administration of Lehman Brothers.
- In 2009, convertible bond issuance has increased considerably as a result of the strong appetite for new issues from investors with substantial amounts of liquidity, who have sought to rebalance their portfolios by increasing exposures to equities, together with the narrowing of credit spreads.
- We set out below the coupon and conversion premium on a number of recent issues.

Selected UK convertible bond issues

Company	Deal date	Size (£'m)	Coupon	Conversion Premium	Maturity
WPP	Apr 09	450	5.75%	40%	2014
Sainsburys	Jun 09	190	4.25%	35%	2014
BA	Aug 09	350	5.80%	38%	2014
TUI	Oct 09	350	6.00%	33%	2014
ITV	Oct 09	135	4.00%	40%	2016

Source: PwC research

Asset Based Lending

Key trends

Asset Based Lending (ABL) remains well positioned to capitalise on the limited credit from traditional sources in the current market.

However, the latest figures published by the Asset Based Finance Association show a 17% drop in total advances to companies in Q2 2009 (£14.3bn) compared to Q2 2008 (£17.2bn). This trend may be adversely impacted by the withdrawal from the market of Landsbanki, a significant player in the UK at the end of 2008 as well as the result of liquidity constraints attached to the ABL subsidiaries of global financial institutions. In addition, lower corporate trading levels will impact lending linked to receivables.

Lenders have adopted a 'back to basics' approach in recent months and focussed more on physical assets and receivables and less on cash flow facilities.

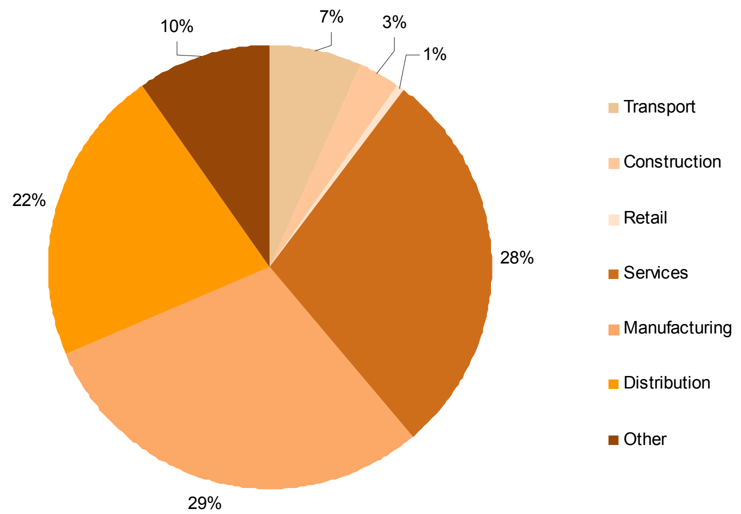
ABL margins have increased in line with the market, by between 50-100bps compared to 12 months ago albeit borrowing bases are increasingly being aligned to 3 month LIBOR instead of Bank of England base rates.

The size of the deals which asset based lenders are willing to enter into in the current environment (either on a bilateral or club basis) has also decreased in terms of individual hold levels.

Attractiveness of asset based lending

- Asset Based Lending (ABL) is a collateralised form of lending which is attractive to businesses of all sizes and across a wide ranges of industries, including manufacturing, distribution and tertiary services. The chart below shows the distribution of UK ABL clients by industry at 30 June 2009 (Q3 2009 data was not available from ABFA at the time of publication):

Distribution of UK ABL clients by industry sector at 30 June 2009



Source: Asset Based Finance Association

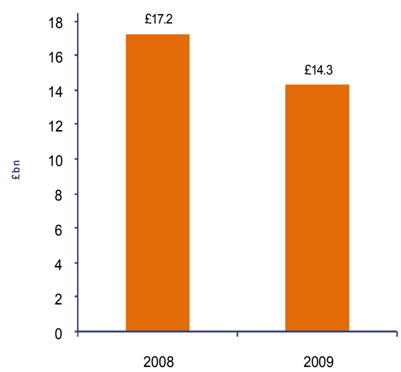
Attractiveness of asset based lending (contd)

- ABL is a flexible alternative financing solution for businesses, particularly those experiencing change, as it can be applied to many different scenarios, ranging from refinancing, restructuring and growth to turnarounds. We recently advised on a buy-side M&A of a European manufacturer where an ABL facility was successfully obtained. In this specific deal, the proposition was unlikely to be attractive to traditional cash flow lenders and ABL offered a viable alternative and increased levels of funding.
- We have recently advised on a combination of facilities including refinancing a distressed recruitment business with a bank looking to exit from its traditional overdraft facility. ABL enabled us to reconstruct the business through an enhanced facility and enable it to consolidate its position in a tough current environment.
- We have also assisted a printing business where it wanted ABL facilities committed over a three year period to enable it to have access to funds in readiness for potential acquisition opportunities over the coming couple of years. The ABL facility gave it the comfort of financing headroom that did not exist within its previous traditional bank facilities.

Lending volumes and deal size

- Asset Based Lending (ABL) remains well positioned to capitalise on the constraints on credit from traditional sources in the current market and the general trend to move away from unsecured lending towards collateralised lending.
- This form of lending is also relatively attractive to banks as it carries a lower risk rating (and requires a lower amount of capital to be allocated to the lending) when determining regulatory capital requirements under Basel II.
- However the latest figures published by the Asset Based Finance Association (only Q2 2009 figures were available as at the date of this publication) show a 17% drop in total advances to companies in Q2 2009 (£14.3bn) compared to Q2 2008 (£17.2bn). This year-on-year decline is noticeably less than that of the overall corporate lending market (as shown on Page 4).

Total advances at 30 June 2009 to UK ABL borrowers (£bn)



Source: Asset Based Finance Association

Asset Based Lending

Lending volumes and deal size (contd)

- The size of deals which asset based lenders are willing to enter into on a bi-lateral or club dasis, has changed recently. In January 2008, GMAC jointly underwrote a £350m deal for Woolworths with Burdale Financial. The market is still capable of writing this size of transaction, albeit that a deal of this magnitude will require a much larger syndicate or club, as most lenders at the larger end of the market have reduced their hold levels to in the region of £30-40m.

Pricing and advance rates

- Our discussions with asset based lenders indicate that the appetite to lend remains, albeit at higher margins (increase of between 50-100bps) compared to 12 months ago. Current funding rates are between 175 -350bps for receivables and inventory financing, and between 300 – 400+bps for term debt to finance property, plant and machinery. Cash flow lending “top-ups”, which were common pre-crunch are also increasingly rare.
- Advance rates against some asset classes have fallen. Lenders are typically willing to advance up to 85% of receivables, with lower advances for plant and machinery (up to 50-70% of 120 day realisable value), property (up to 50-70% of 180 day realisable value) and inventory (up to 20-50%).

Restructuring

Key issues

Borrowers can expect a substantial re-pricing of facilities even if the request to lenders is only to reset covenants, rather than reschedule repayments and/or maturities.

We have seen some limited activity in the market for secondary debt, but in the main the price offered for distressed credit is too low for most incumbent lenders to accept.

Coupled with restrictions on the availability of credit and depressed M&A values, most restructurings involve a negotiation between the existing lenders and shareholders.

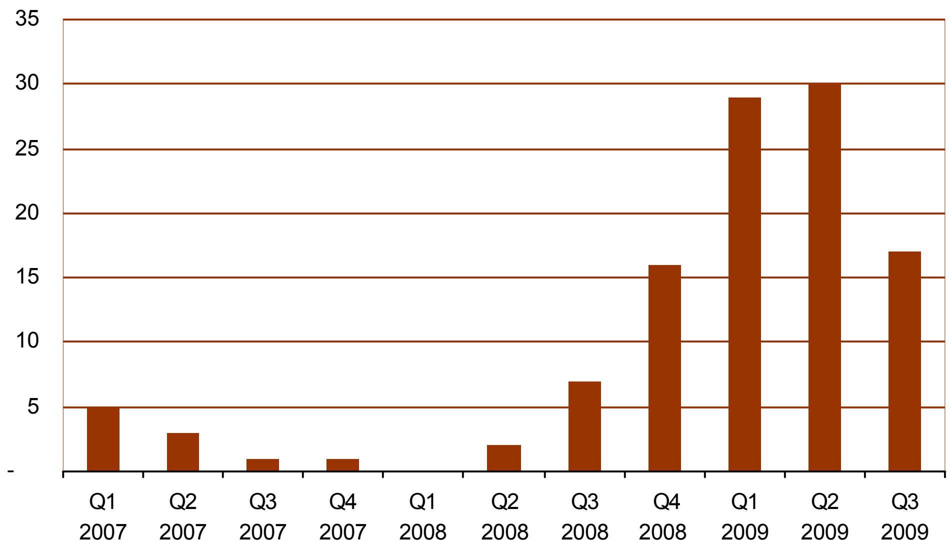
Whilst lenders are seeking to re-price facilities to what they perceive as heightened credit risk, they do not tend to pursue a debt-for-equity swap unless they are being asked to write-down debt by the Company or its shareholders.

The size of any new money requirement and the jurisdiction of the borrower are also major determinants of the outcome of a restructuring.

Current restructuring trends

- As shown in the graph below, borrowers in restructuring, or having incurred a payment default, are sharply higher in 2009 although the number of new cases did fall quarter on quarter in Q3.

Distressed leveraged loans



Source: S&P LCD

Note: Distressed credits are classified as loans rated D or in a restructuring

Restructuring

Current restructuring trends (contd)

- The majority of larger restructurings involve leveraged buy-outs due to their limited room for manoeuvre in a downturn.
- The limited options in a restructuring in the current cycle (ie. depressed M&A values, inability to refinance debts with new lenders) result in most restructurings becoming a negotiation between the existing shareholder(s) and lenders.
- Lenders are taking a robust stance in these negotiations. For example, in two recent situations we were involved in, lenders insisted upon, and obtained, additional financial support from shareholders in response to a covenant breach, despite the fact there were no forecast cash pressures over an eighteen month timeframe.
- However, lenders typically try to avoid a more fundamental debt-for-equity swap (to minimise their own provisioning) unless they are being asked to write down debt by the Company on what they consider inequitable terms.
- Critical in the decision making process is the size of any new money requirement and the ease with which lenders can take ownership of the business. If the former is significant and the latter more difficult, lenders may reluctantly accept debt write-downs without necessarily taking a substantial equity stake.
- Where these issues are less pressing, lenders are willing to take control of the business with a strategy of holding the business for possibly several years whilst a turnaround is implemented and, more hopefully, the M&A environment improves. It remains to be seen whether lenders will become fatigued with pursuing these time consuming debt for equity strategies and instead accept a more drastic up-front write-down in their positions. However, we have not seen any evidence of this yet and the significant increase in the number of personnel in the larger banks' restructuring departments suggests they will have the capacity to deal with these types of cases going forward.
- Lenders rarely look to implement a debt for equity in the plc environment. This can be explained by three factors:
  - Plcs are not often as leveraged as some of their privately owned counterparts (particularly Private Equity backed companies) so the argument that debt has to be written off is less common;
  - in recent months, the public equity markets have been receptive to companies raising equity to reduce leverage. We have advised on four recent transactions where a material equity raising (>£100m) was used to pay down debt. Crucially, shareholders have also not required a writedown of debt as a condition of the equity raising (this is in contrast to the attitude of Private Equity sponsors, who have often sought debt writedowns as part of any new equity injection). This may in part be explained by the level of leverage in LBOs as much as the behaviour of PE Houses as an investor class; and
  - lenders' nervousness about the bad publicity associated with taking stakes in listed companies.

Current restructuring trends (contd)

- During a debt restructuring, management often find themselves in the difficult position of having to deal with competing lender and shareholder interests in an environment where the balance of power between equity and debt can change rapidly as the process unfolds.
- Management can, however, play a key role in shaping the restructuring solution, and both management and the business as a whole can benefit hugely from the stable platform and end to uncertainty that a successful restructuring should provide.
- It can also provide the opportunity to re-base equity incentives that may have fallen underwater.

Restructuring

Covenant reset trends

- The table below sets out the fee and margin adjustments of selected covenant reset transactions between June and September 2009.
- Whilst each transaction has characteristics particular to it, there are some trends to highlight:
  - reset fees have continued to be in the 50 to 100 bps range;
  - as part of the package, margins move towards current market rates (new margins can be multiples of previous margins, depending on the debt instrument/market) which can represent a significant increase to borrowers, typically between 100 to 150 bps.

Selected recent covenant resets – June to September 2009

Company	Date	Fee (bps)	Margin Increase (bps)	Industry	Country
Doncasters plc	30/09/09	100	150	Aerospace & Defense	UK
Invitel	30/09/09			Telecom	Hungary
Xerium Technologies Inc	25/09/09	50	100	Machinery	UK
Yell Group PLC	23/09/09	125	100	Printing & Publishing	UK
Citco Group	14/09/09	75	125	Professional & Business Services	USA
PolymerLatex GmbH	11/09/09	62.5	175	Chemicals	Germany
FCI SA	10/09/09	60	100	Computers & Electronics	France
Numericable	09/09/09	50	100	Media	France
Rodenstock Zweite GmbH	06/08/09	32.5		Healthcare	Germany
Kion	30/07/09	75	125	Machinery	Germany
BorsodChem	27/07/09			Chemicals	Hungary
Hilding Anders AB	24/07/09	75	100	Home Furnishings	Sweden
Regency Entertainment	16/07/09	50	75	Gaming & Hotel	Greece
Firth Rixson Ltd	08/07/09	75	150	Metals & Mining	UK
Deutsch Connectors	07/07/09	37.5		Computers & Electronics	UK
Consolis Holding	03/07/09	75	50	Building Materials	France
Grupo Cortefiel	02/07/09	75	100	Retail	Spain
Ineos Group Ltd	25/06/09	100	200	Chemicals	UK
Mannesmann Plastics Machinery Group	25/06/09	50	100	Machinery	Germany
ISS Global	24/06/09	50		Professional & Business Services	Denmark
KP1	24/06/09	60	107.5	Building Materials	France
BAXI Group Ltd	22/06/09			Machinery	UK
Wind Telecommunicazioni S.p.A.	18/06/09	65	100	Telecom	Italy
Smurfit Kappa Group	09/06/09	75	125	Forest Product	Ireland
Nielsen Company	08/06/09	10	175	Printing & Publishing	Netherlands

Source: S&P LCD

Our Debt Advisory services

How we can help you

- **Securing committed facilities has never been more critical**
- Whether you face a covenant breach, need to restructure existing facilities, have facilities due for refinancing over the next 24 months, or are considering raising debt to finance an acquisition, we have an experienced team to help you achieve your financing objectives.
- We are in regular contact with 50+ banks, debt funds, asset based lenders, credit agencies and bond arrangers and can assist you in:
  - maintaining control of the agenda in a debt restructuring, through our detailed knowledge of the approach lenders are taking in this rapidly changing market;
  - assisting you negotiate better terms and conditions;
  - advising on the appropriate debt capacity and structure in the current market in addition to the likely pricing for your transaction;
  - identifying and approaching lenders which are still active in your sector;
  - evaluating your business plan and testing your financial models to ensure they are robust; and
  - credit ratings advisory/ improvement of credit ratings.
- **Managing the process from start to end, allowing you to focus on running your business**

What we do

- Our Debt Advisory team provides an extensive range of services which include:

Refinancing	• Ensure ongoing funding for the company • Investigate alternative sources of funding • Optimise finance costs	**Acquisition finance**	• Increase competitive position of client by securing funding • Assist in negotiating pricing, documentation and setting covenants
Financial / debt restructuring	• Ensure ongoing funding of the company • Assessment of current capital structure • Restructure debt to avoid financial distress	**Bond market advisory**	• Assess ability to raise non-bank finance (bonds, private placement debt etc) • Advise you through the bond raising process
Covenant negotiation	• Analysis of forecasts to support new covenant proposal • Negotiate pricing, covenants and other terms with lenders	**Staple financing**	• Debt discovery exercise to confirm market appetite • Underpins price expectations

Selected Recent transactions

UK Aug 09 Staple debt finance Dalkia Total Debt £75m	UK Aug 09 Financial restructuring imo Total Debt £430m	UK Ongoing Advising on acquisition finance for a leading car leasing firm Total Debt c.£300m	Europe Ongoing Debt restructuring for metals producer RUSAL Total Debt $15bn
UK July 09 Debt restructuring mecom Total Debt £700m	Europe July 09 ABL acquisition finance CeDo Total Debt €45m	UK Aug 09 Staple Debt Finance Project Prime Total Debt £27m	UK Ongoing Acquisition and Refinancing for Pharmaceuticals Company Total Debt €80m
UK May 09 Financial restructuring McCarthy & Stone Total Debt £900m	UK March 09 Refinancing Sanctuary Housing Total Debt £200m Public Bond	UK Feb 09 Financial restructuring Sea Containers Ltd. Total Debt $1.2bn	UK Ongoing Advising vendor on acquisition finance and working capital facility Total Debt £70m
Apr 09 Refinancing Future MEDIA WITH PASSION Total Debt £40m	Europe Ongoing Restructuring of Coeur Defense, Paris Total Debt €1.6bn bonds	UK July 09 Advising an alcohol drinks producer on resetting of covenants Total Debt £355m	UK Aug 09 Debt restructuring NORTHGATE plc Total Debt £900m

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