



Fitch's View on the European Leveraged Credit Market: Present and Future

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Agenda

An Introduction to Fitch

Fitch's View of the Leveraged Credit Market

Ratings Migration and Recovery Prospects



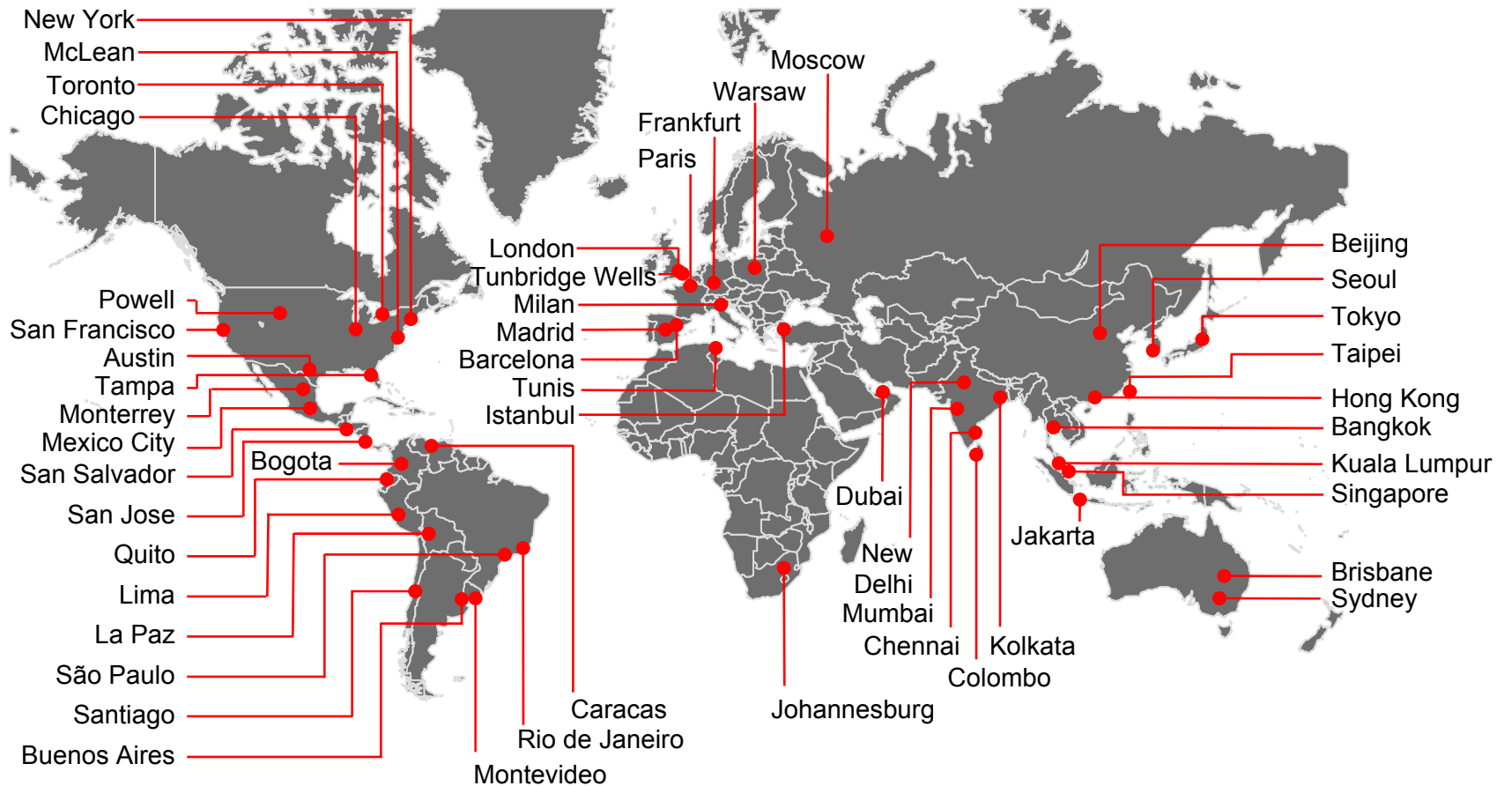


An Introduction to Fitch

- > Fitch is an international ratings agency, dual-headquartered in the US and Europe
- > Fitch rates
 - Over 1,300 Corporates
 - 99 Sovereigns and 132 Sub-sovereigns
 - 81,000 Municipal transactions
 - 5,600 Financial Institutions
 - 1,400 European, 6,500 US and 300 Asian Structured Finance transactions
- > Fitch employs almost 2,000 people in 50 offices worldwide



Global Presence (August 2006)





Fitch in Leveraged Finance

- > Fitch currently rates approx. 400 European Leveraged Credits, both public and private
 - 10 dedicated Leveraged Credit analysts
 - 50 Sector specialised Corporate analysts
- > Wide market acceptance for bespoke research such as:
 - Debt market trends: Second Lien, Mezzanine, HY
 - Structures and new instruments: Rating Holdco PIK Notes
 - Market-specific trends and developments: 2nd Lien, Mezz, HY, Recaps
- > Fitch's private rating clients are leading European asset managers, including
 - Harbourmaster, ECM, ICG, Mezzvest, Highland, Invesco, Cheyne, Alcentra, Lehman Bros., Goldman Sachs, Avoca, Mizuho



Fitch's Public Market Coverage

- > Fitch's public HY rating effort was launched in 2003
- > Fitch's coverage extends to 45% of the Merrill Lynch HY Index (by market index weight), or 49% pro forma for recent / imminent coverage infill
 - Mandated ratings
 - Fitch Initiated ratings
- > Fitch targets 70% coverage by YE07
- > Fitch rates 13 (or 65%) of the Top 20 Leveraged European HY Issuers (by index weight)
- > Fitch aims to increase coverage to at least 80% of the top 20 by Q107



Fitch's Public Market Coverage

Merrill Lynch Index: Top 20 European Leveraged Corporate Issuers

Issuer	Fitch Rated?	Issuer	Fitch Rated?
1. FIAT	Yes	11. SKG	Yes
2. Ahold	Yes	12. NTL	Yes
3. TDC	Yes	13. Fresenius	Yes
4. Ineos	No	14. SEAT PG	Yes
5. Rhodia	Yes	15. Degussa	No
6. Allied Domecq	No	16. Ladbroke	Yes
7. ISS	No	17. Basell	Yes
8. VNU	No	18. Vimpelcom	No
9. WIND	Yes	19. Corus	Yes
10. Alcatel	Yes	20. TUI	No

Source: Merrill Lynch, Fitch

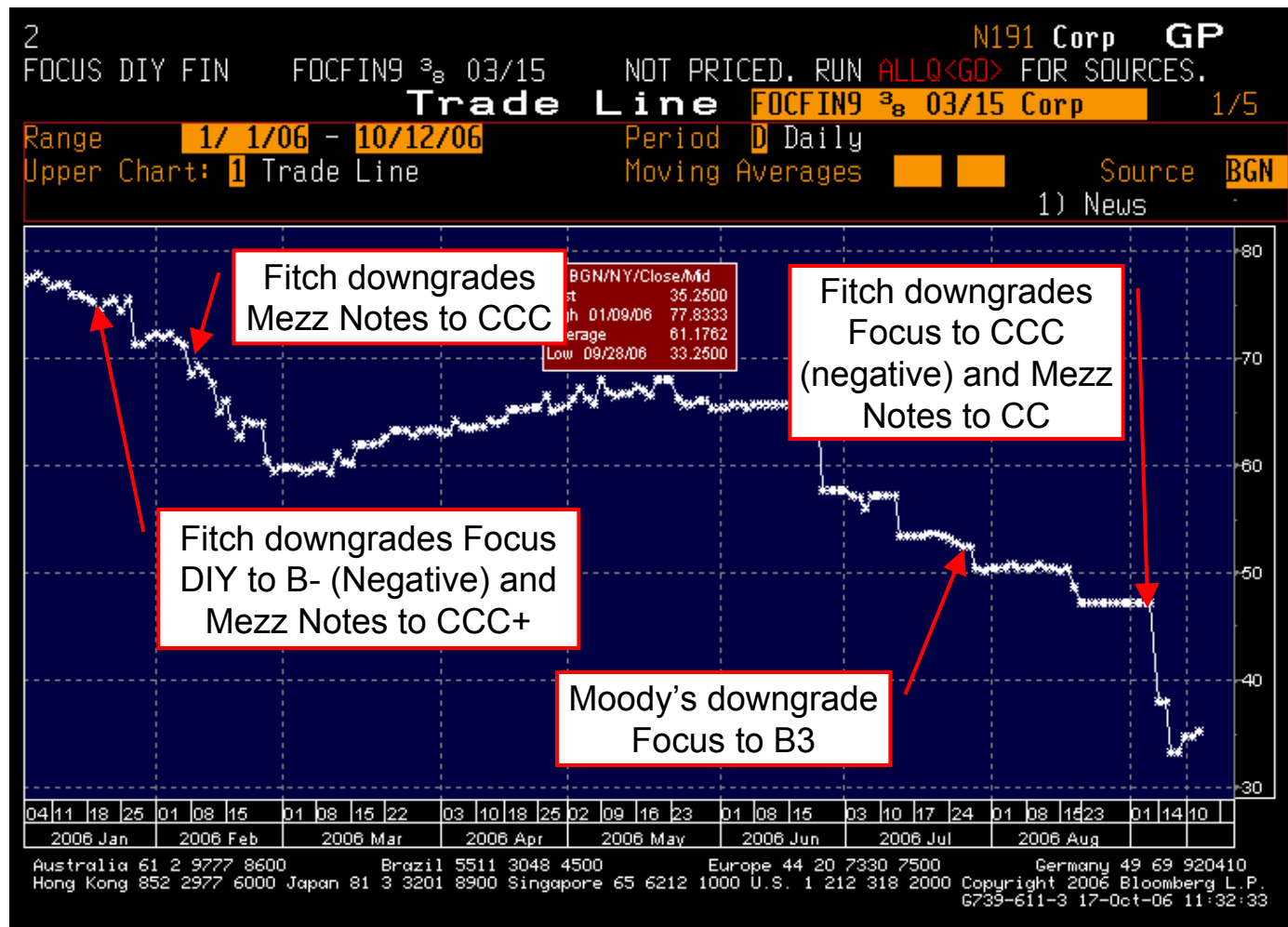


Fitch's Market Relevance

- > Fitch offers more detailed research products
- > Analysts average less than 10 public credits each
- > Ratings actions and analysis are timely, relevant and accurate
- > Recent examples include:
 - Affirmation of Brake Bros at B+ on PIK Notes issue in September 2006
 - Downgrade of Focus DIY to CCC from B- in September 2006
 - Upgrade of Telenet to BB- from B+ in August 2006
 - Affirmation of Vendex at BB- on PIK Notes issue in May 2006
 - Downgrade of NTL to B+ from BB- in March 2006

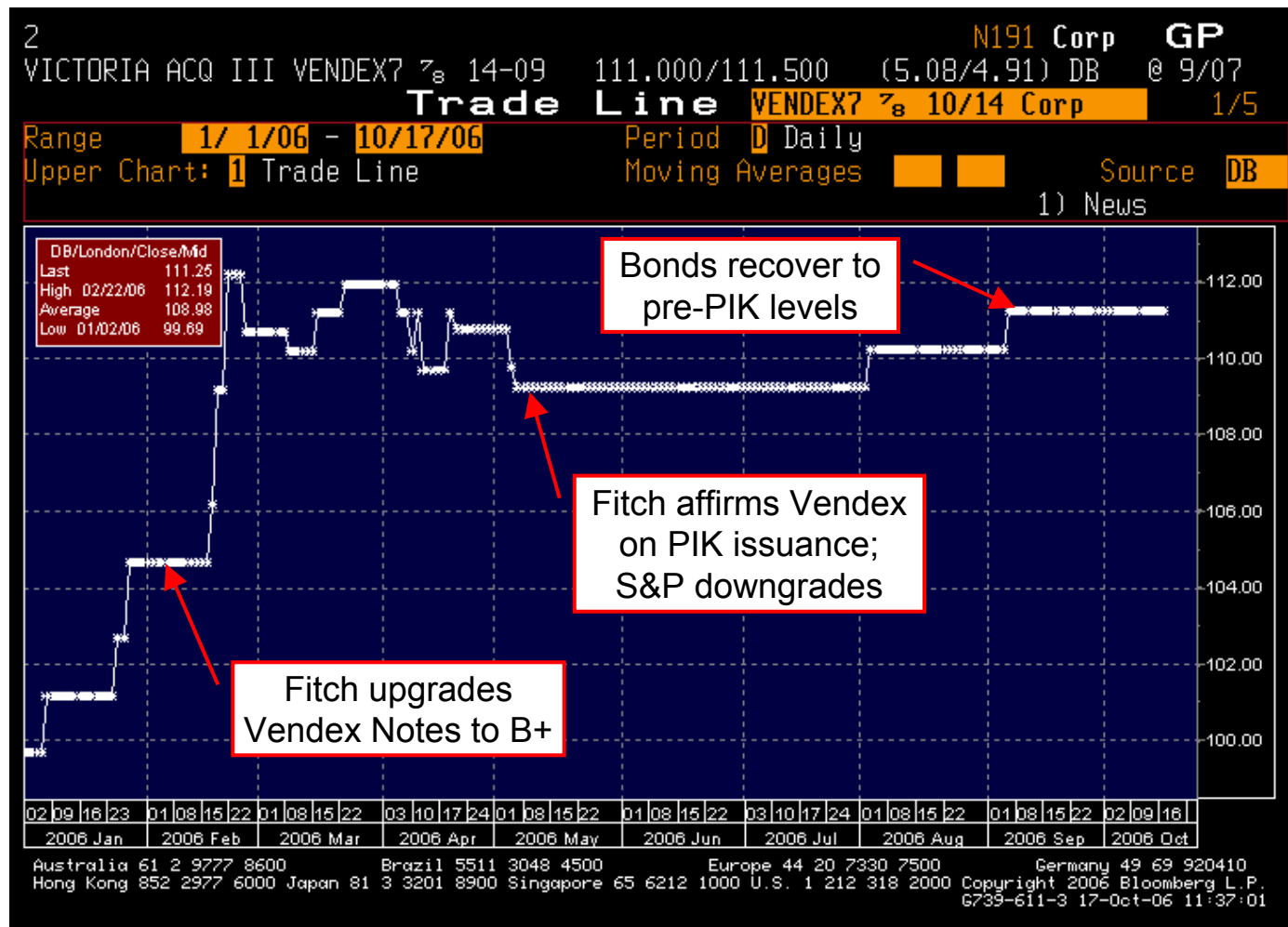


Fitch's Market Impact: Focus DIY



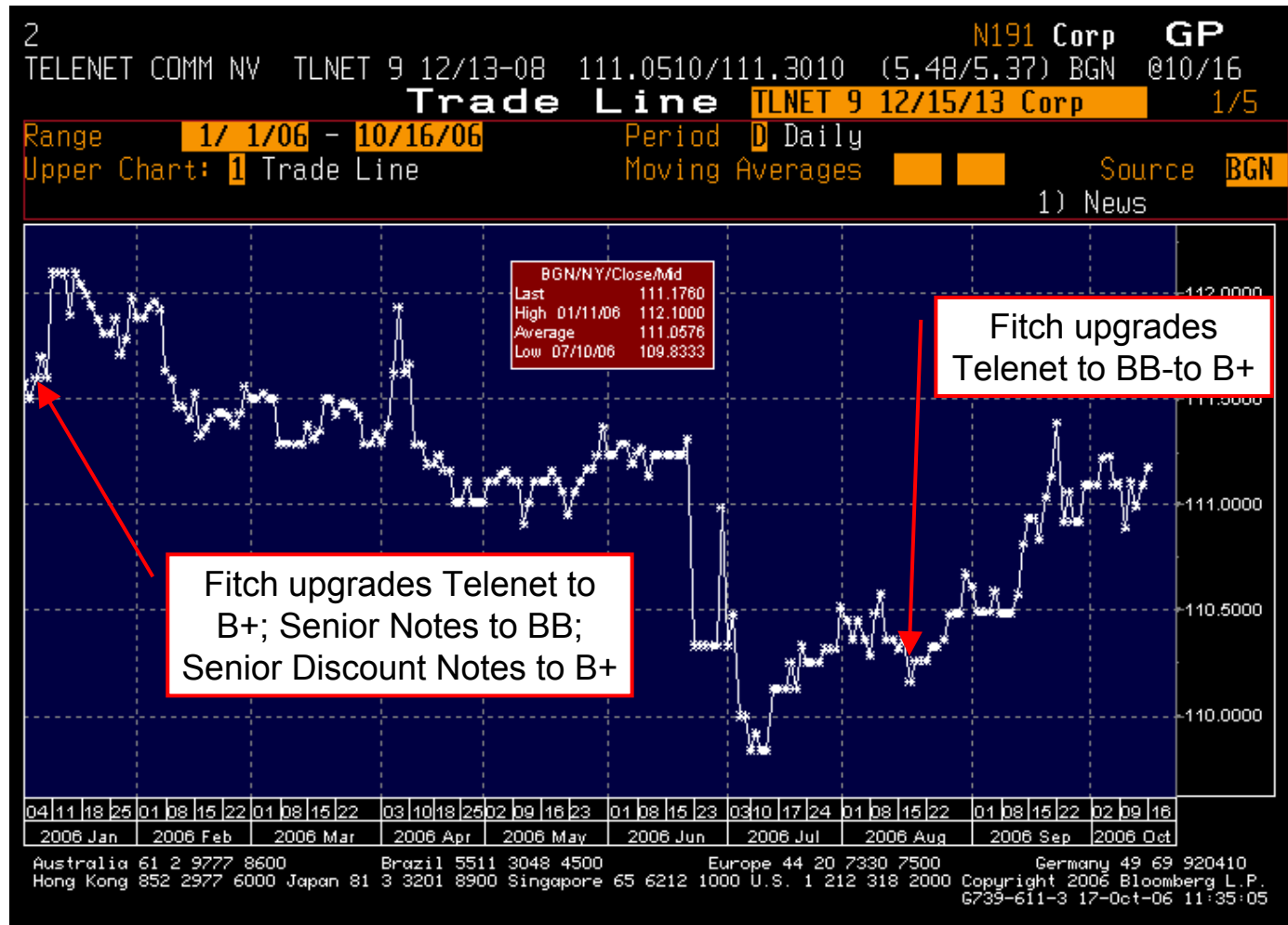


Fitch's Market Impact: Vendex (Maxeda)





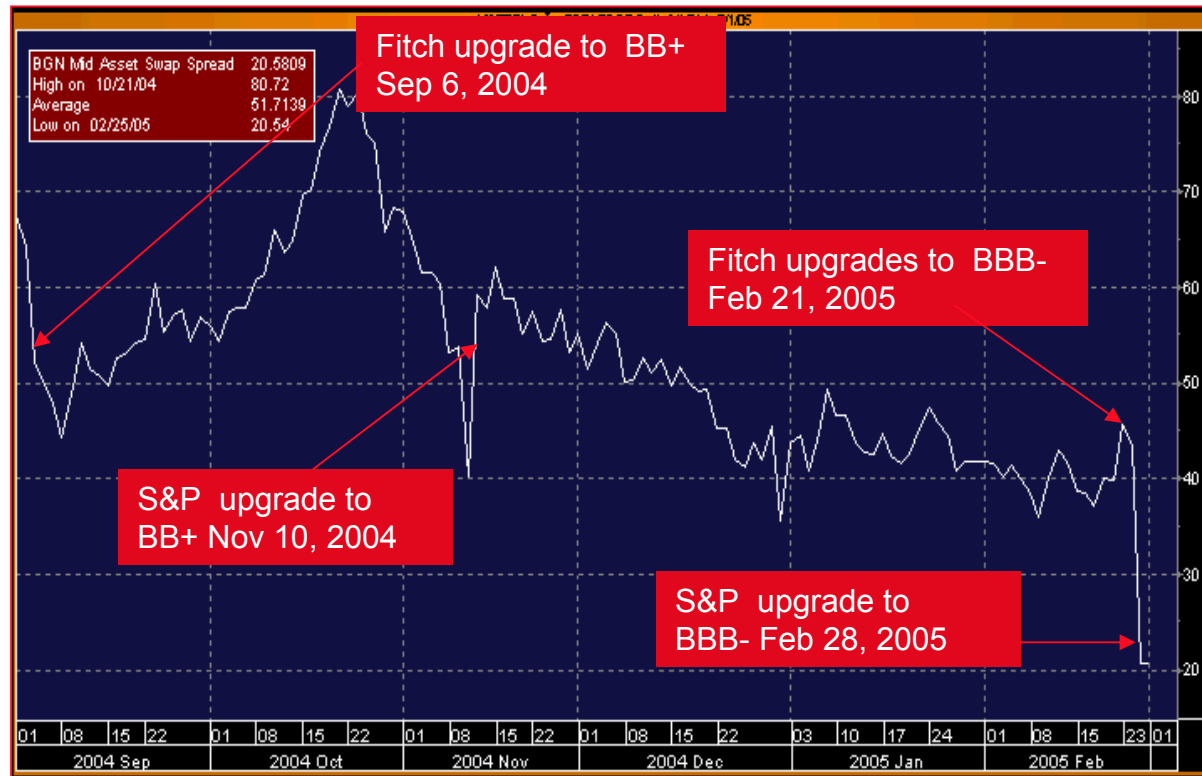
Fitch's Market Impact: Telenet





Fitch's Market Impact: Ericsson

Spread to mid asset swaps – Bloomberg



Source: Bloomberg Fitch



An Introduction to Fitch

Fitch's View of the Leveraged Credit Market

Ratings Migration and Recovery Prospects

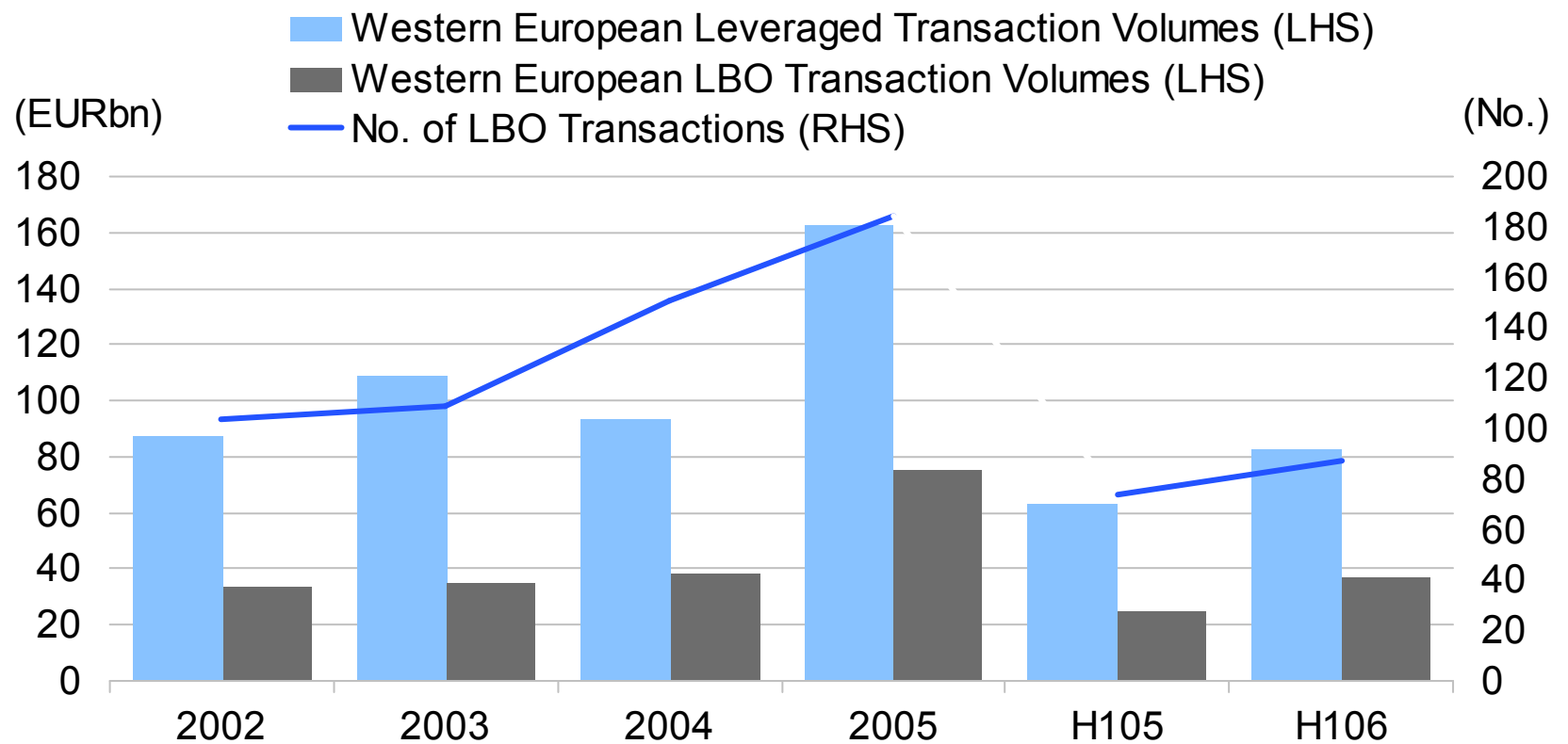
Sector Specifics: Retail, Autos, Chemicals, Cable

Recovery Ratings Case Studies



Leveraged Credit Market Trends: Growth

European Leveraged/LBO Issuance



Source: LPC



Leveraged Credit Market Trends: Liquidity

- > Unprecedented levels of depth and diversity in the market
 - Any cash-generating company
 - Any size
 - Any industry
- > Combination of leveraged products
 - More flexibility for arrangers
- > Stable markets and strong returns for financial sponsors and CDOs fuel new fund-raising and excess liquidity
- > Supply-demand imbalance leads to rising tolerance for
 - aggressive structures
 - higher financial risk



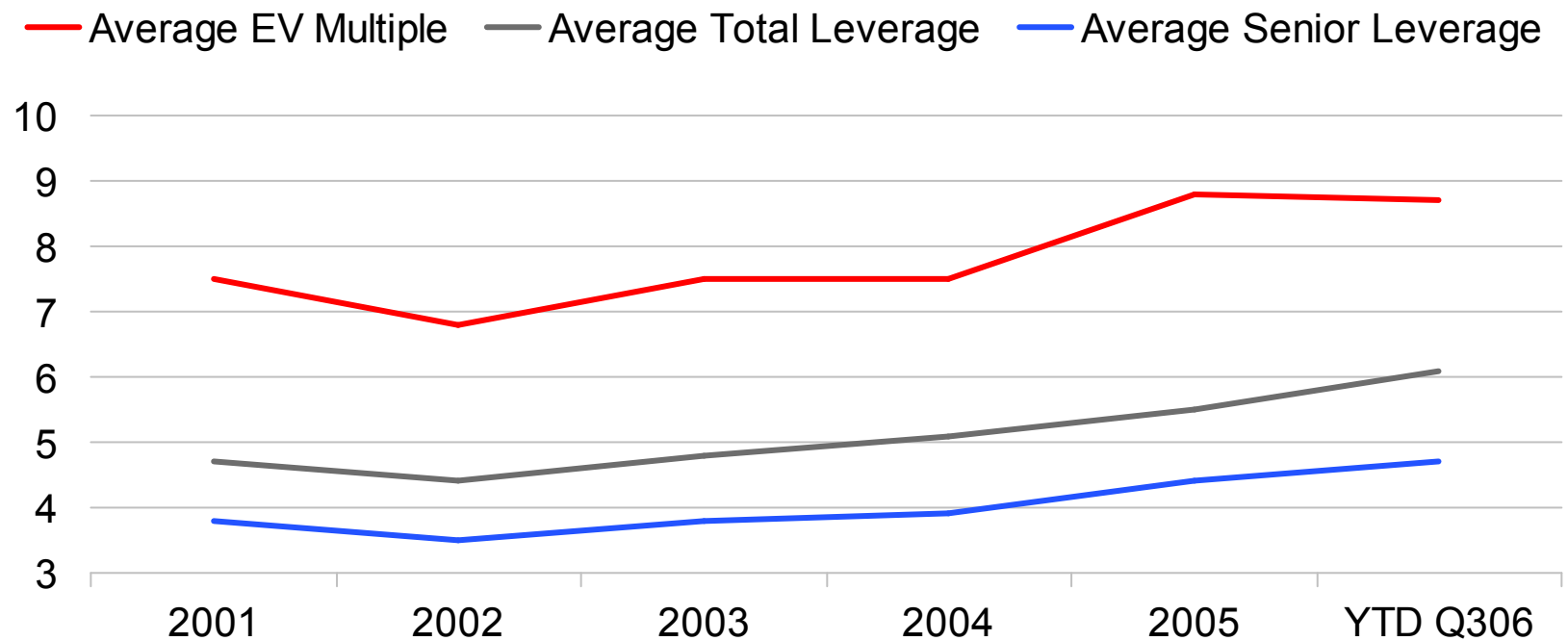
Leveraged Credit Market Trends: Leverage and Credit Quality

- > Leverage continues to rise, though weighted average pricing remains static
 - Weighting towards more expensive, albeit longer-dated senior B/C tranches
 - Downward price flexing
- > Deteriorating average credit quality
 - Increasing number of covenant waiver requests
 - High refinancing risk from back-ended debt structures
 - Looser covenants
 - Complex capital structures



Leveraged Credit Market Trends: Leverage

Evolution of Multiples in Fitch-Rated Leveraged Transactions



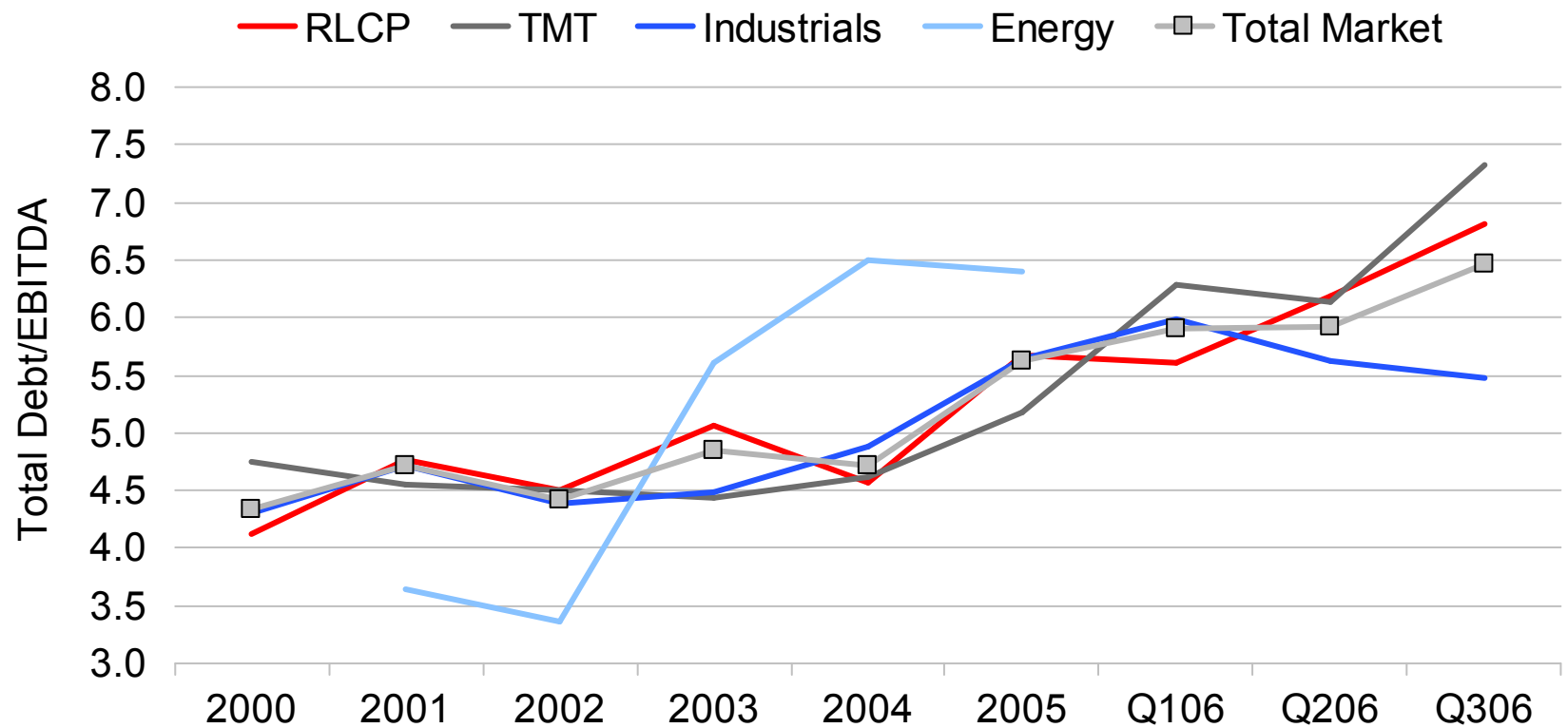
Average EV and Leverage multiples have reached a new record high

Source: Fitch



Leveraged Credit Market Trends: Leverage

Average Total Leverage by Sector keeps Rising...

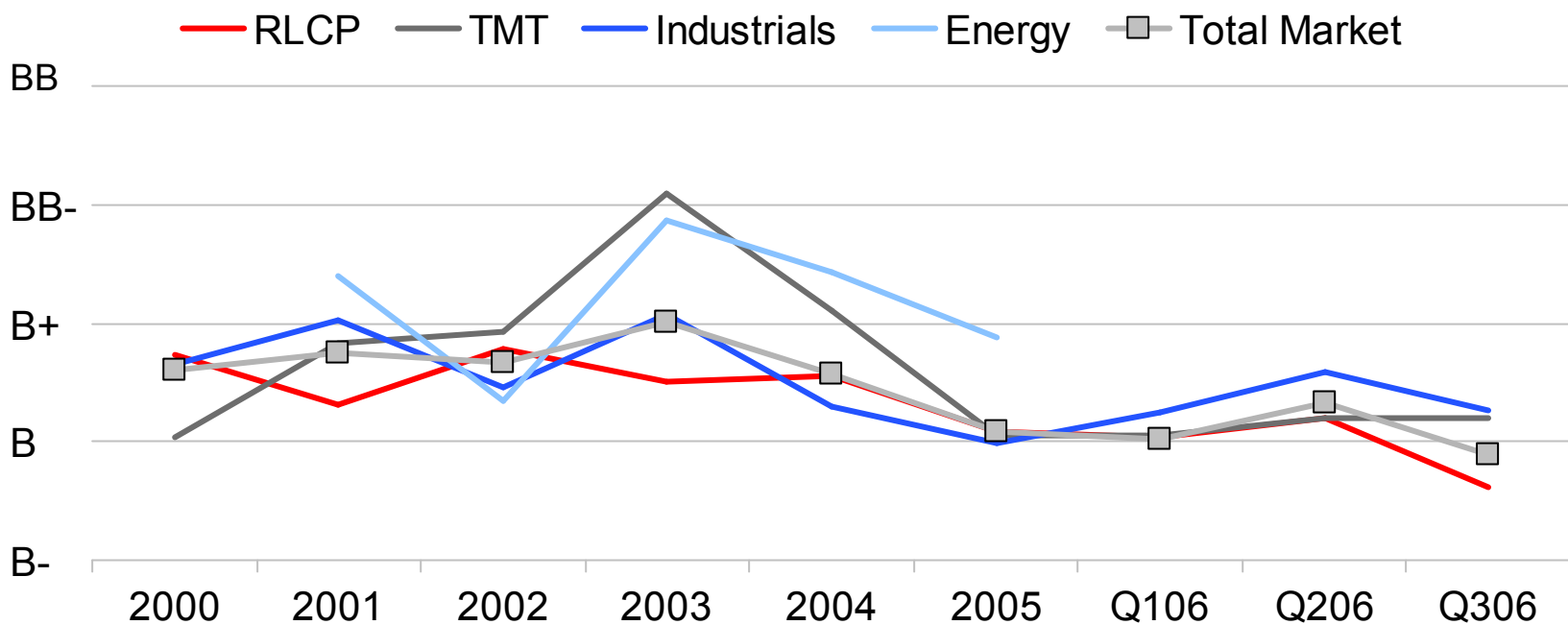


Source: Fitch



Leveraged Credit Market Trends: Credit Quality

...Leading to a Deterioration in Credit Quality

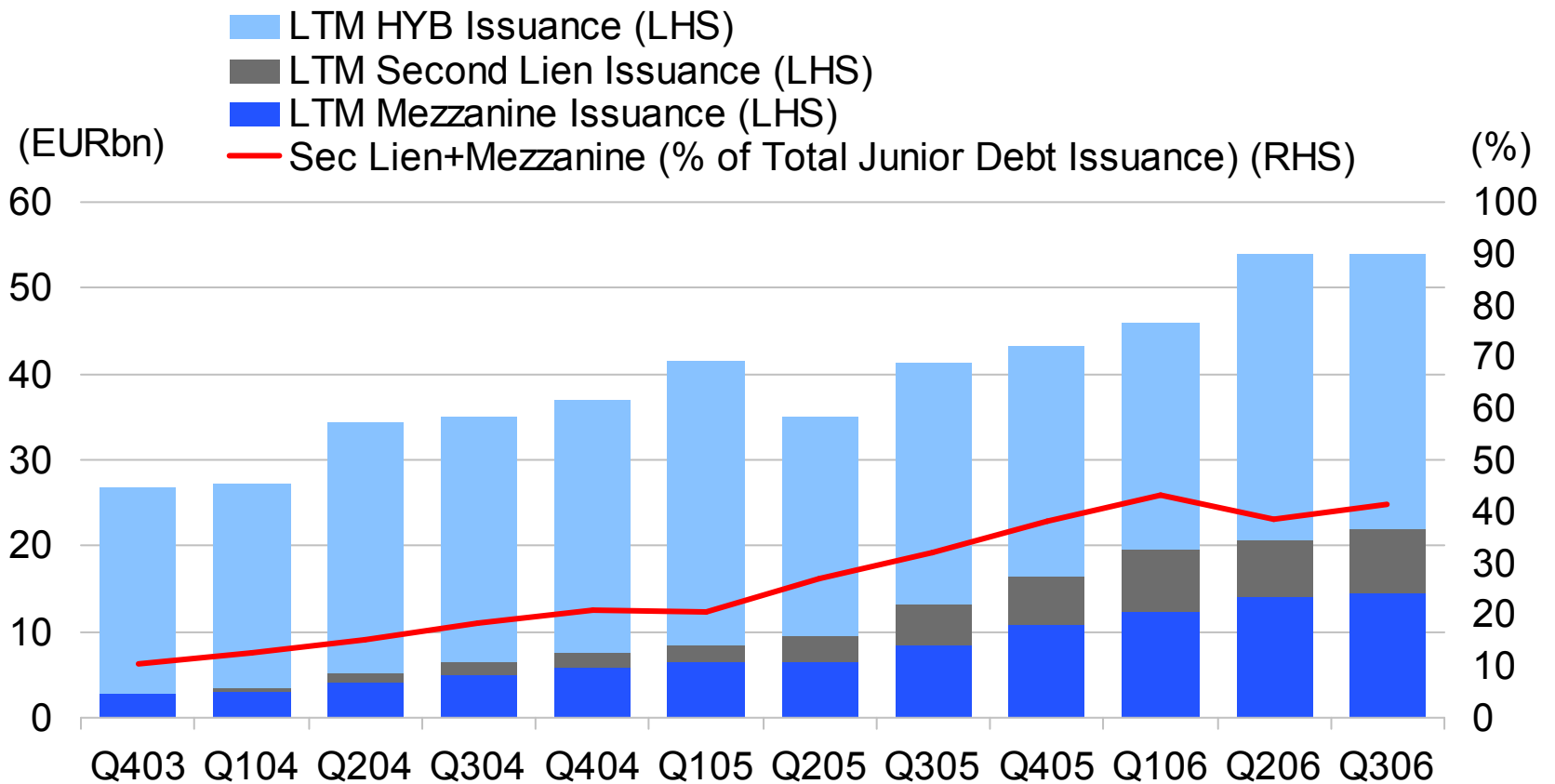


Average IDR for New Fitch-Rated Leveraged Deals
(including Recycled Transactions)

Source: Fitch



Leveraged Credit Market Trends: Junior Debt



Source: Fitch



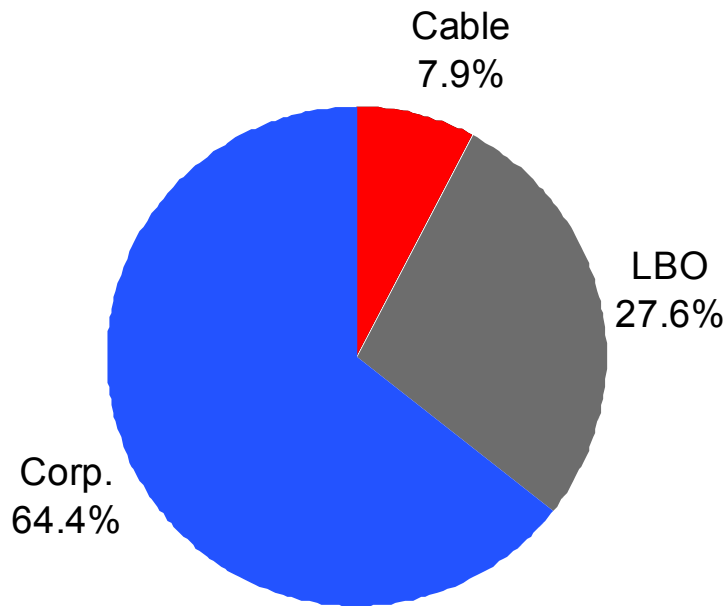
Leveraged Credit Market Trends: High Yield

- > HY issuance slowed in 2005, but has bounced back in 2006
 - 2006 already a record year with over EUR30bn issuance
- > Competition from second lien and mezzanine tends to leave HY only for the largest deals...
 - NXP EUR4.5bn equivalent
 - Ineos EUR2.4bn equivalent
 - TDC EUR2bn equivalent
- > Evolving market standards
 - Substitution threat drives capitulation on call protection
 - Marked increase in FRNs
- > Better mix of LBO, Cable and Corporate issuance
- > Stronger credit profile than the private market



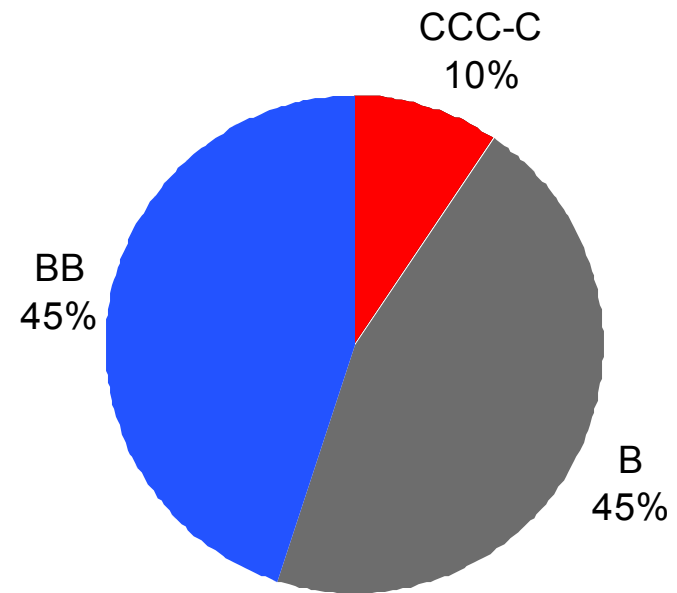
HY Business Mix and Ratings Profile

New Issues: Diversification
YTD 2006



Source: Fitch, Bloomberg

Ratings Distribution
(European HY Market Q306)



Source: Fitch, Bloomberg



Leveraged Credit Market Trends: Mezzanine and Second Lien

- > Mezzanine and Second Lien volumes continue to rise
 - Constitute approx. 40% of junior debt issuance
 - 2006 – a record year for both mezzanine and second lien
- > Substitution threat to HY due largely to greater prepayment flexibility
- > Latest example threatens even jumbo HY
 - EUR1bn Mezzanine tranche for Casema/Multikabel/Kabelcom
- > More aggressive capital structures than most HY
 - Higher leverage
 - > Average Leverage for B+ and below IDRs: 6.5x for mezz, 5.3x for HY
 - Recaps funded by cash-pay secured debt
 - Mezzanine further subordinated
- > Low expected recoveries for private junior instruments

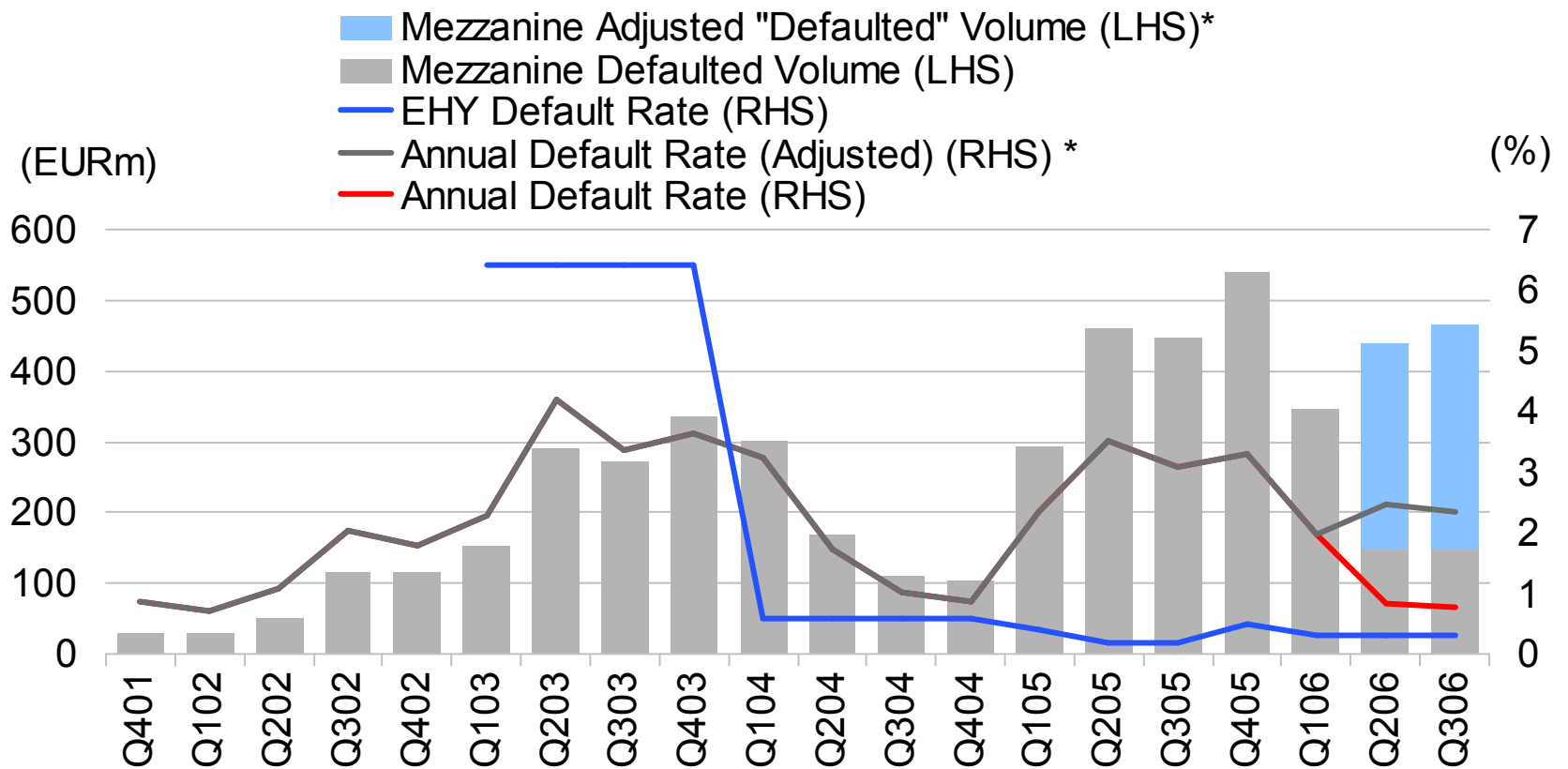


Leveraged Credit Market Trends: Default Rates

- > Low default rates until now:
 - 0.3% in the HY Market; 2.4% in Mezzanine
- > Fuelled by
 - Steady economic growth and corporate profitability
 - Extended period of low interest rates; flat curve
 - High levels of liquidity; covenant resets and waivers are commonplace
 - New structures require little or no debt amortisation
- > But clouds are gathering
 - Short Term interest rate rises
 - Raw material price increases / volatility
 - Exposure to global trends (US homebuilding; China demand)
- > And credit risk is increasing
 - WATCH Fixed Charge Cover levels
 - Need for new money given back-ended debt structure = distress



Leveraged Credit Market Trends: Default Rates



* Adjusted for "distressed" mezzanine deals (rated "CC" or below at time of last update)

Source: Fitch



Leveraged Credit Market Trends: Default Rates

- > Defaults in the short term likely to be seen in some legacy (2003/4) deals which have not already been refinanced...
- > ...But in the longer term, refinancing risk has increased significantly for many recycled deals
 - Refinancing alone will be unable to provide a solution
- > Fitch does not expect a significant increase in default rates before late 2007/8
 - Default rates are obscured by “refinancings”
- > Certain troubled sectors will continue to experience difficulty, as opposed to defaults across the board
 - Auto supply
 - Retail and consumer products



Leveraged Credit Market: Fitch's Take

- > Arrival of non-bank credit investors has eroded many of the premises of European leveraged credit
 - Senior and total debt levels rise to historic highs
 - Pricing declines
 - Credit monitoring deteriorates through weaker covenants
 - More complex capital structures = more complicated intercreditor arrangements
 - Interests of sponsors and subordinated creditors increasingly misaligned
 - > Warrants and call protection have largely disappeared
 - Sponsor community de-emphasises deleveraging in favour of
 - > Back-ended amortisation profiles
 - > Dividend recaps driven by expanding multiples
 - > Buy-and-build strategy – add-on acquisitions funded by debt
- > Excess liquidity masks the risks of the market



Leveraged Credit Market Trends: Outlook

- > Current aggressive market conditions are unlikely to be dampened until default rates start to rise
- > Recoveries will be compressed when the market turns, due to
 - Current record high levels of leverage
 - Lack of amortising senior debt structures
 - Multi-layered debt structures
- > Fitch's new Recovery Ratings Methodology is designed to assess this risk
- > The results are compelling...



An Introduction to Fitch

Fitch's View of the Leveraged Credit Market

Ratings Migration and Recovery Prospects

Sector Specifics: Retail, Autos, Chemicals, Cable

Recovery Ratings Case Studies



Ratings Migration and Recovery Prospects: High Yield compared to the rest of the Leveraged Credit Market



Recovery Ratings

- > A major innovation by Fitch
- > Splits Probability of Default and Loss Given Default
- > **USD1,400 billion** of debt and other obligations affected
- > Only published at 'B+' and below (over 300 entities), **but** affects all rated entities
 - All countries
 - All types of debt obligation, not just bank loans or high yield
 - All international scale ratings
 - All corporate sectors, including banks, insurance and finance companies
- > Supported by detailed recovery analysis

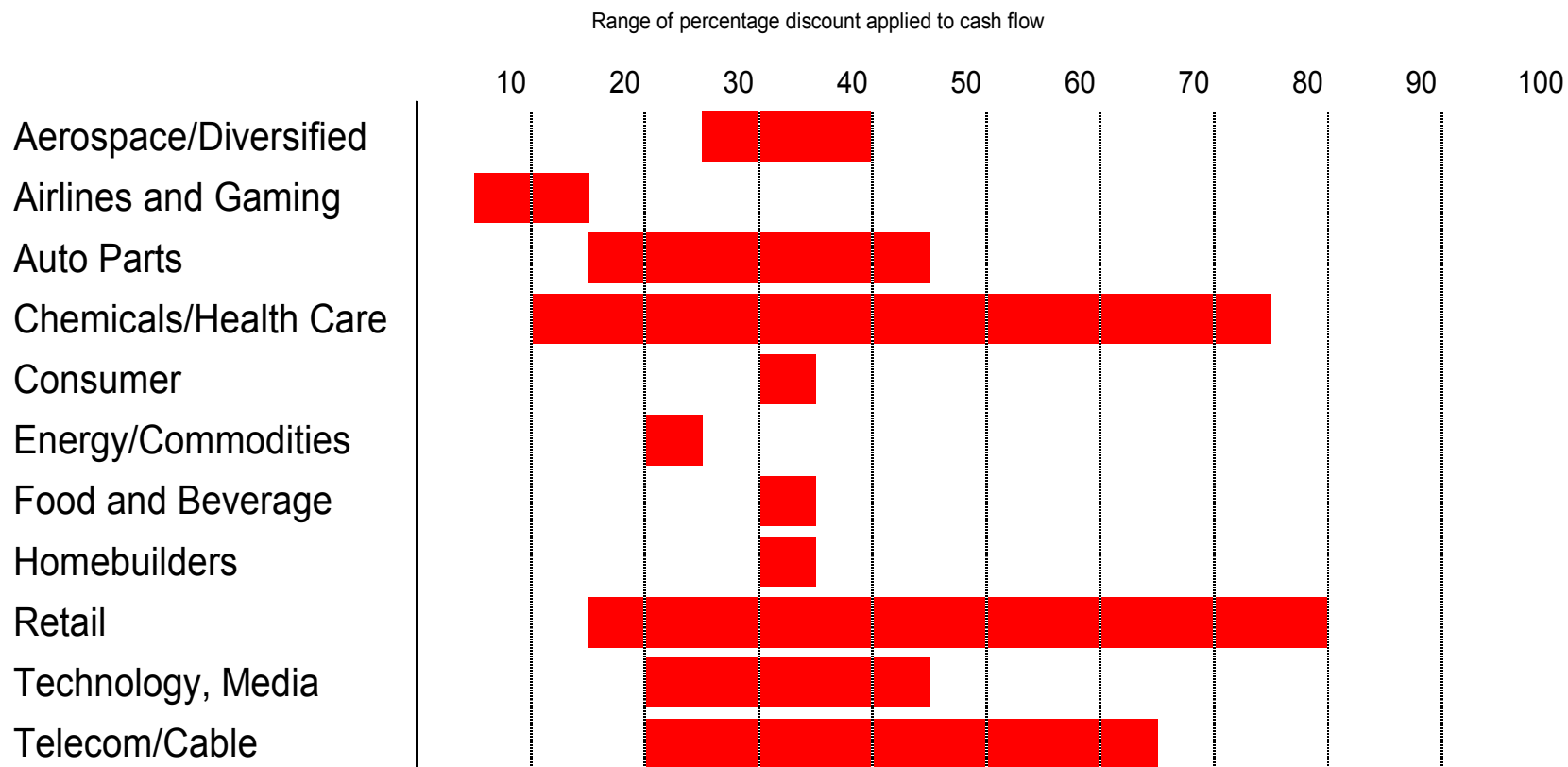


Fitch's Rating Methodology: B+ Issuers and Below

- > Step 1: Assign an Issuer Default Rating (“IDR”)
 - A rating addressing purely the probability of default as opposed to expected loss
 - Derived through traditional credit analysis
- > Step 2: Assign Recovery Ratings to every instrument in the capital structure
 - Derive a distressed EV
 - Allocate distressed value to investors (strict waterfall)
 - Jurisdictional Issue (capping senior secured ratings)
- > Step 3: Notch the Debt Instrument Rating Up or Down from the IDR to reflect Expected Recoveries
- > More detailed examples in the Case Studies to follow

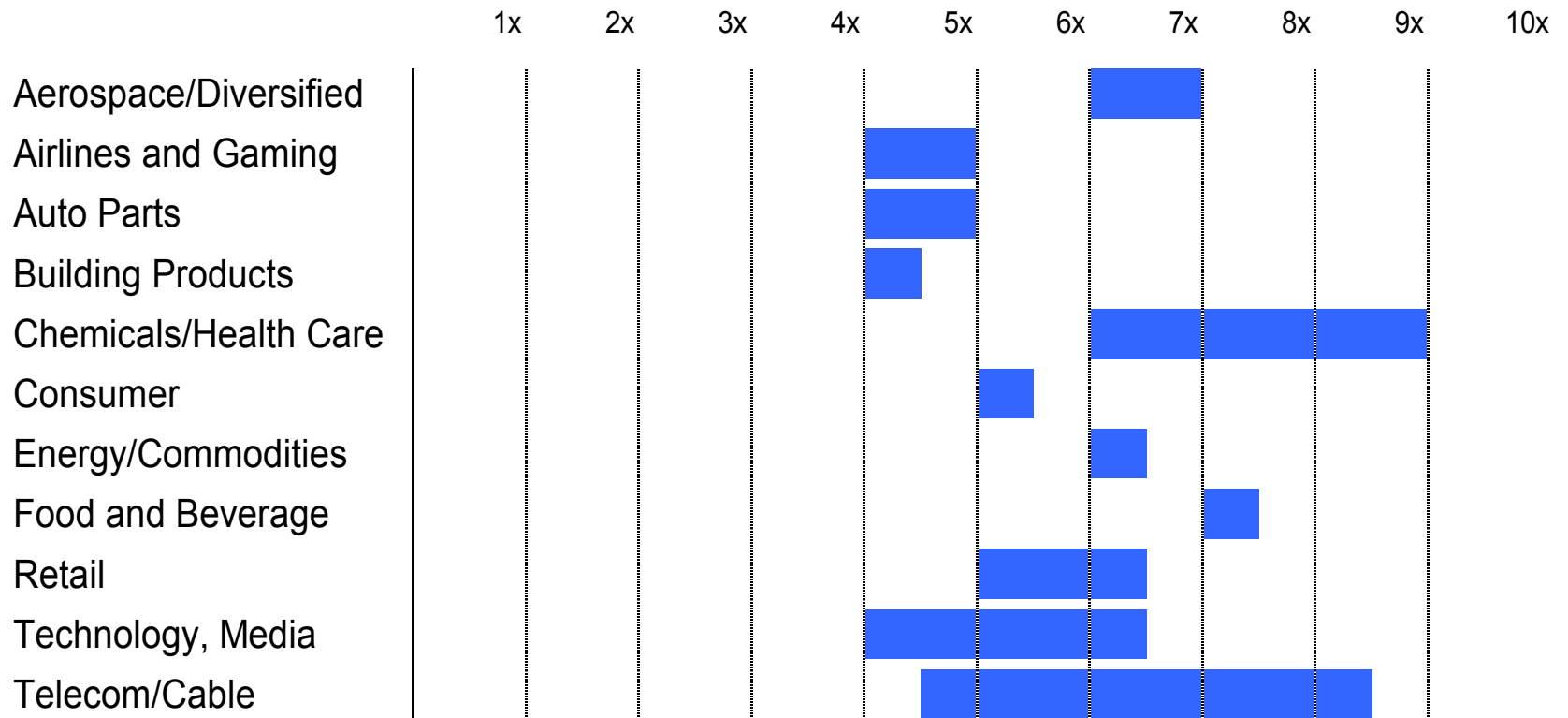


Typical Cash Flow 'Haircuts' used in Analysis





Typical Cash Flow Multiples used in Analysis





Likely Recoveries and R Ratings

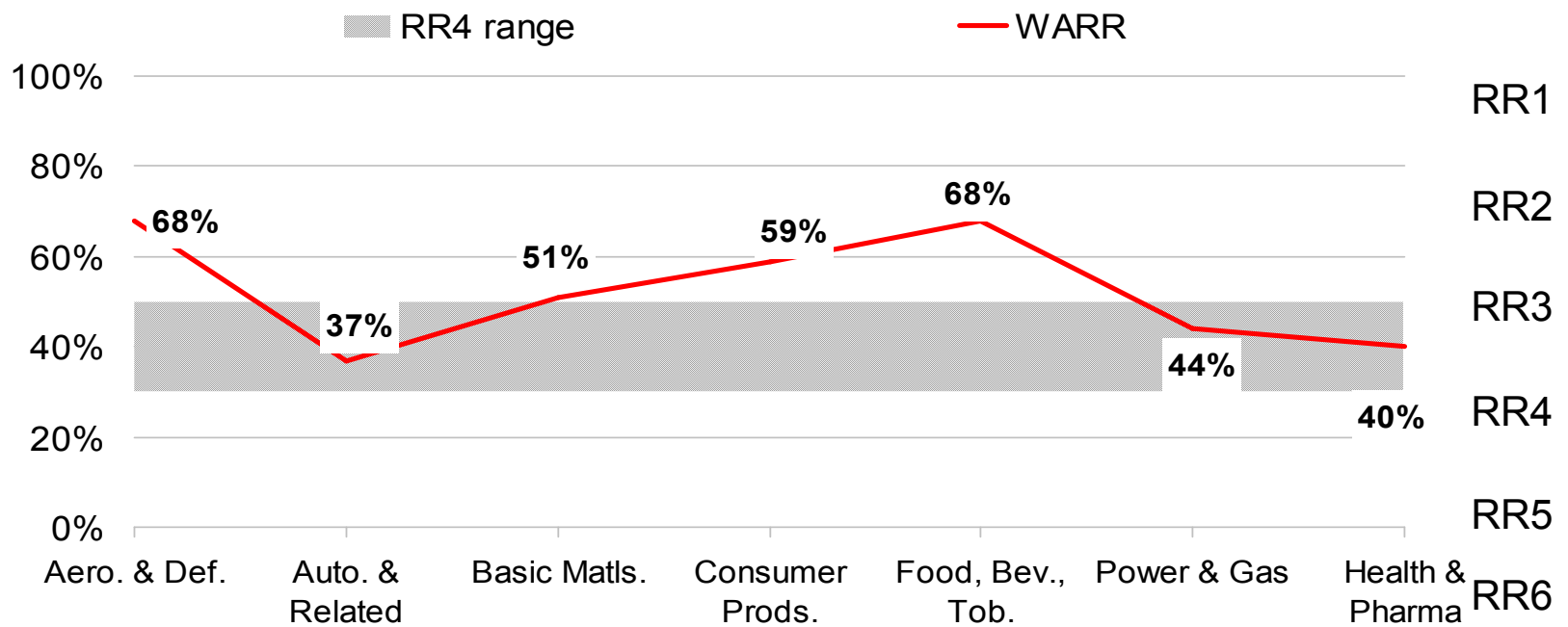
Likely Recoveries (%)	Corresponding R Rating
91-100	RR1
71-90	RR2
51-70	RR3
31-50	RR4*
11-30	RR5
0-10	RR6

* Typically, this is the Implied Recovery Rate Carried by the IDR
Considered to be “Average” Recovery Prospects



Weighted Average Recovery Rating by Sector

Global corporates, senior unsecured debt, by par value USD

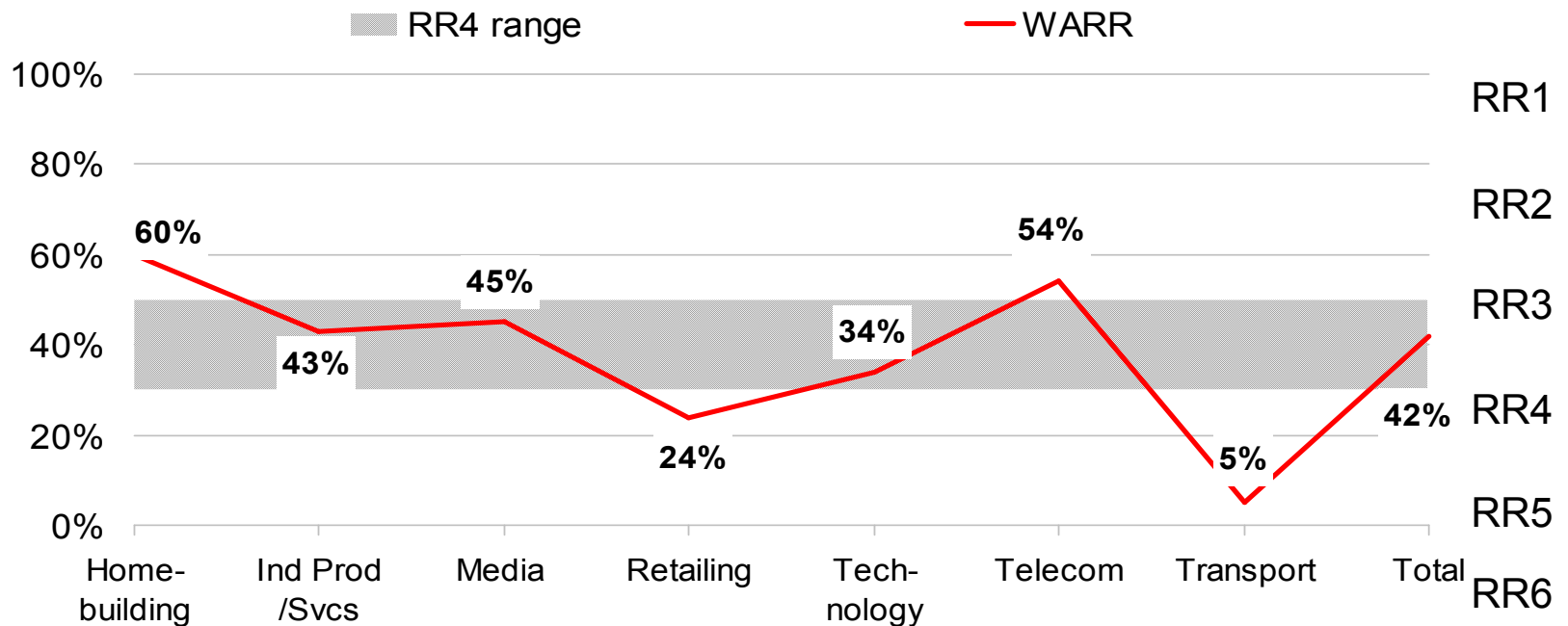


Source: Fitch



Weighted Average Recovery Rating by Sector

Global corporates, senior unsecured debt, by par value USD



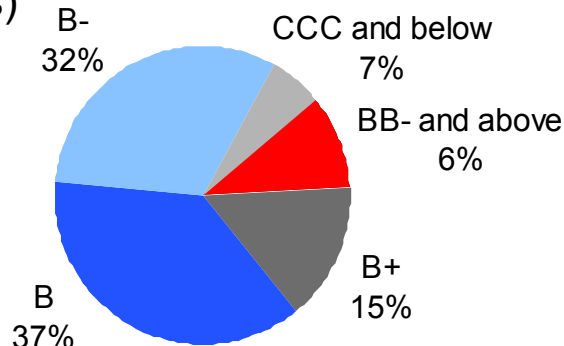
Source: Fitch



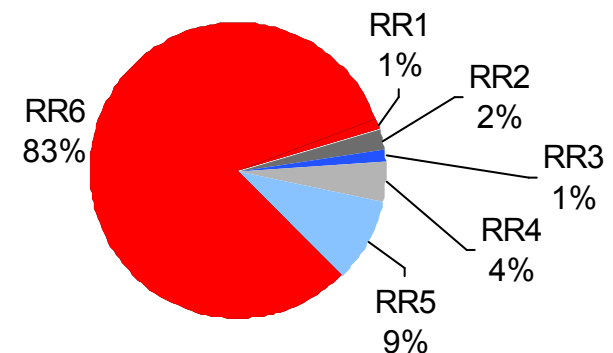
Fitch's European Speculative Grade Ratings

Speculative Grade shadow ratings portfolio under new Methodology (Sep 06)

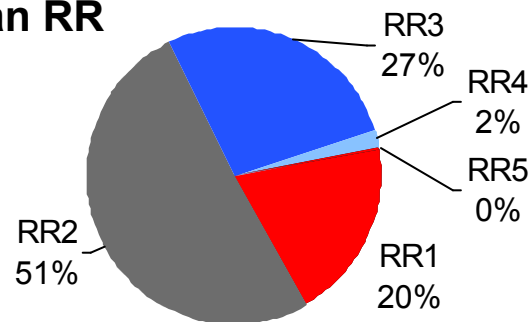
IDRs
(328 ratings)



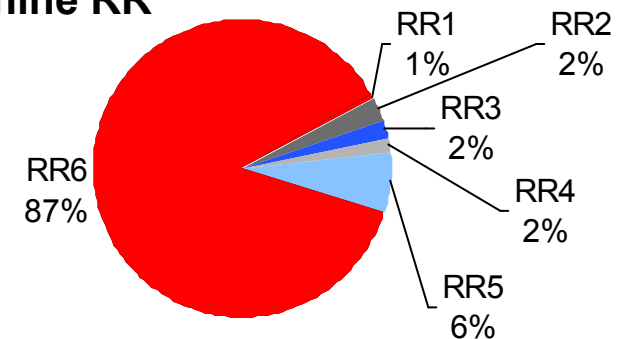
2nd Lien RR



Bank Loan RR



Mezzanine RR



Source: Fitch



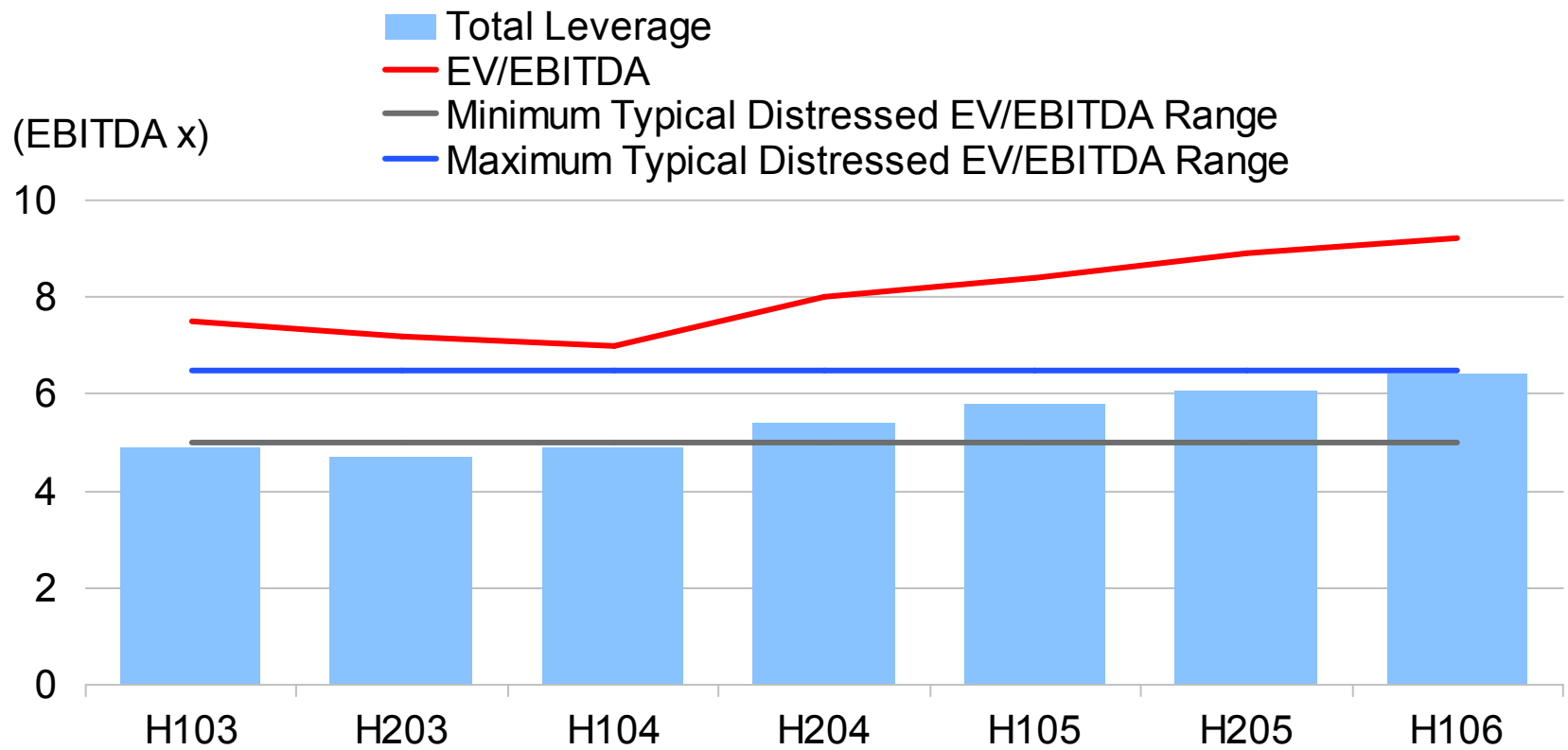
Fitch's Recovery Ratings Results are Compelling

- > 71% of senior bank debt rated by Fitch achieves RR1/RR2 recovery ratings....
- > Compared to only 3% of second lien and mezzanine instruments...
- > ...And over 80% of these junior instruments achieve only an RR6, as a result of
 - Increasing EV multiples at the peak of the cycle
 - Increasing Leverage multiples likewise
 - Back-ended first priority debt amortisation profiles
 - Lower equity contributions
 - Mezzanine in particular further subordinated and taking “equity” risk



European Mezzanine Increasingly Out of the Money

Mezzanine Increasingly Out-of-the-Money



Source: Fitch



Fitch's High Yield Recovery Ratings Portfolio

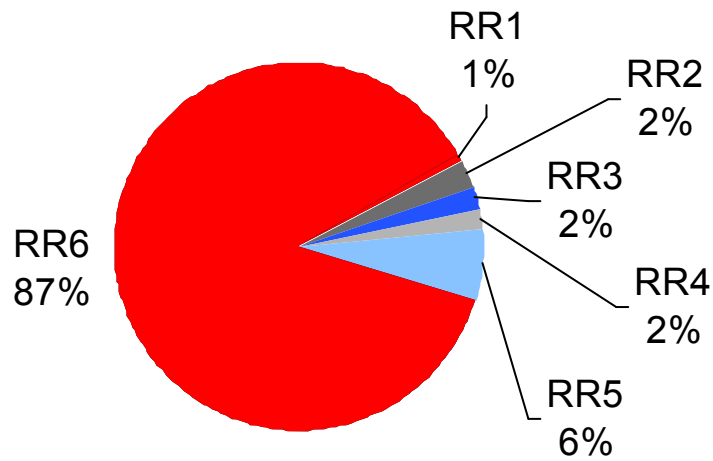
- > Recent recapitalisation activity has left traditional HY largely unaffected
 - Holdco PIK Notes rank behind HY – deeply subordinated
- > In contrast to mezzanine, which has been further subordinated
 - Higher cash-pay debt levels in most private dividend recaps
 - Introduction of second lien into “second-secured” position
- > HY capital structures often carry less leverage, despite weaker covenant protection (incurrence vs. maintenance)
- > Therefore, Fitch's bespoke recovery ratings indicate better recovery prospects on average for high yield issues



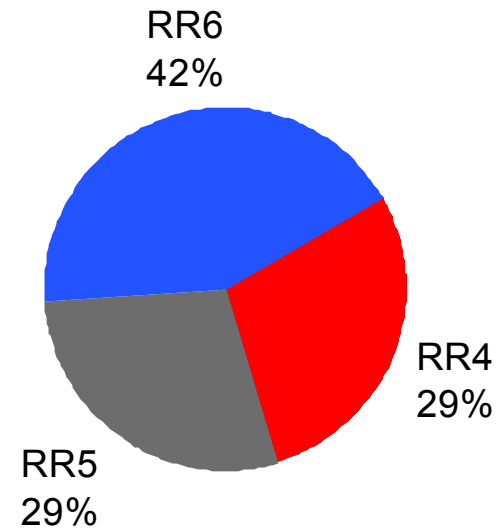
HY Recovery Ratings Higher than in Mezzanine

Distribution of Recovery Ratings (by no. of Issues)
Issuers with an IDR of 'B+' or below

Mezzanine RR



HY RR



Source: Fitch



Fitch Ratings

www.fitchratings.com

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The Fitch Group

Fitch Ratings

Algorithmics

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