

NORTH AMERICAN DISTRESSED DEBT MARKET OUTLOOK 2010

JANUARY 2010



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METHODOLOGY

Bingham McCutchen LLP, FTI Consulting, Inc., and Macquarie Capital (USA) Inc. commissioned Debtwire to interview 100 distressed debt investors, including hedge fund managers, proprietary trading desks and other asset managers, on their expectations for the North American distressed debt market in 2010. Interviews were conducted over the telephone in November and December of 2009, and the responses were collated by Debtwire and presented to the commissioning firms in aggregate.

FOREWORD

The rising tide of outsized returns booked by distressed debt specialists in 2009 lifted all boats but it has left a lot of puzzled – if not downright skeptical – investors in its wake.

Never in the five-year history of Debtwire's North American Distressed Debt Outlook have study participants been so evenly split on such a wide variety of issues. From default rates, to the sustainability of the new deal boom, to loan trading prices in the year to come, responses came in all over the map.

Uncertainty in the leveraged finance markets should intensify once the government eases off its Keynesian throttle later in the year. In fact, 2010 may well be remembered as the eye of the storm in a protracted restructuring cycle elongated by government interaction.

This year's Outlook gives a mixed perspective on market direction in 2010, but the lack of consensus does point to one trend with relative certainty – continued volatility in the year to come.

If leveraged credit is in for another rollercoaster ride, two investment strategies are likely to dominate. Fund managers will focus on short-term nimble trading to capitalize on volatility or on large positions in event-driven distressed situations to insulate themselves from it. Overall, responses to the 2010 Outlook bear out that view.

Navigating the Crosscurrents

Respondents were polarized on even the most basic question, when restructurings will peak. While 36% of the managers polled believed the peak of restructurings has already passed, 34% did not expect the peak to happen until 2011 or beyond.

Digging a little deeper into the poll shows a growing number of participants favor event-driven situations in 2010 rather than a more macro approach to investing in distressed debt. In fact, only one-quarter of respondents plan to increase their allocation of investment dollars to distressed debt in 2010. That's a huge turnaround from our 2009 survey, when two-thirds of all poll participants forecasted an increase.

Scarcer distressed opportunities will likely be fought over by larger players in 2010 based on respondents' more passive outlook this year. Only 42% of those polled said they plan to seek controlling stakes in companies through debt workouts during 2010, down from 60% heading into 2009.

Shrinking supply of distressed situations will likely require investors to commit additional capital in valuation battles. Those seeking that new funding in the capital markets are likely to find many takers looking for yield in new deals now that secondary levels look rich on a relative basis.

While few poll participants expect a return to the covenant-lite and PIK-toggle loans that proliferated in the recent buyout binge, overwhelming majorities of those asked expect secured bond and loan issuance to remain constant or increase this year.

A note of caution though – a chunky 41% minority of those asked said they expect primary market liquidity to tighten in 2010. More than half of those respondents believe the correction won't occur until at least the third quarter after much of the government stimulus rolls off.

In a clear sign of increased risk appetite, respondents picked second lien debt as the most attractive investment instrument in 2010. The renewed interest from investors for primary deals should also begin to fuel more aggressive structures backing burgeoning M&A activity and buyouts at much more rational levels.

The CDS market should also benefit if primary markets remain robust as single-name protection is expected to remain a popular hedging strategy for funds going long. Only one-third of those polled expected liquidity in the CDS market to decline in 2010.

Picking Your Battles

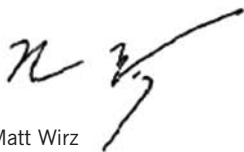
Poll respondents were also heavily split on the type of returns to target in 2010. Almost half of survey participants intend to target returns of 15% or more, while a significant 31% don't expect returns to exceed 8%.

That's a clear signal that distressed managers will fall into one of two camps. Aggressive managers will be willing to expand their risk taking in order to shoot for the stars again in 2010, while more conservative managers still mindful of the painful lessons from the market freeze are looking to simply clip coupons.

Unlike last year when the rally was broad based across most sectors, distressed investors will need to do more prospecting in 2010. Real Estate was voted as the top opportunity-rich sector for distressed investors in 2010, and credits in the consumer products, financial services and industrial sectors are also predicted to be lucrative.

Long touted as THE vulture opportunity of the downturn, distressed real estate investments have been difficult to source as large and small banks have been reluctant to part with non-performing loans at prices that make sense for new investors. That might change in 2010, as the commercial real estate market starts to provide a steady flow of workouts.

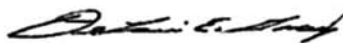
Finally, distressed investors will likely have one less wildcard to worry about in 2010. Approximately 83% of respondents said they did not believe the US government's involvement in several high profile restructurings during 2009 would be repeated going forward.



Matt Wirz
Debtwire



Michael Reilly
Bingham McCutchen LLP



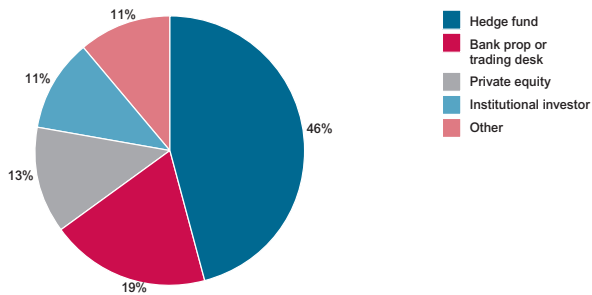
DeLain E. Gray
FTI Consulting, Inc.



Mick Solimene
Macquarie Capital (USA) Inc.

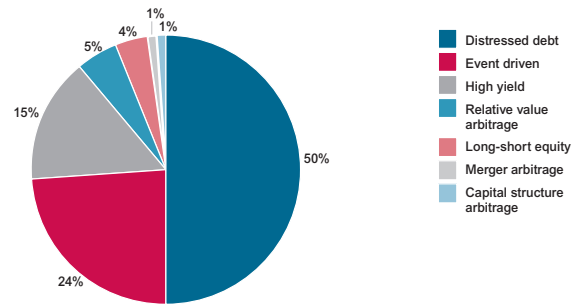
SURVEY FINDINGS

1(a) Which of the following best describes your firm?



- Wall Street seems to have recovered quickly from its bout of risk aversion as 19% of study participants describe themselves as flow or proprietary traders for this study, up from 11% last year.

1(b) What best describes your core investment strategy?

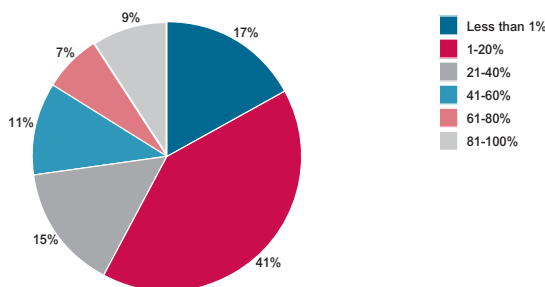


- Half of all participants classify themselves as distressed debt investors, down from almost two-thirds of respondents last year. At the same time, the amount of investors who classify themselves as event driven has risen slightly to 24% from 20% year-over-year.
- The massive rally in the credit markets during 2009 significantly reduced the number of distressed trading opportunities. With fewer value buys available, investors are focusing more on binary plays dependent upon transactional, legal or regulatory events.

“Spreads on high-yield bonds and leveraged loans have now fallen more in line with historical norms amid an early economic recovery that is still very tenuous. The upside left in a basic buy-and-hold strategy of distressed names seems rather limited at this point so it’s understandable that fixed income investors are looking to derive returns in other ways.”

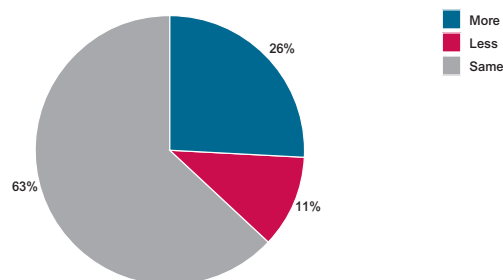
DeLain Gray, Senior Managing Director, FTI Consulting, Inc.

2(a) What percentage of your firm's overall assets is dedicated to distressed debt?



- While 41% of respondents to the 2009 Outlook study reported distressed allocations exceeding 40% of assets under management, only 27% reported the same distribution for the 2010 Outlook. That reflects the steep rally in asset prices in Q2 2009.

2(b) In 2010, do you plan on allocating more, less or the same percentage of assets to distressed debt than you did in 2009?



- Only one-quarter of respondents plan to increase their allocation of investment dollars to distressed debt in 2009, a significant decrease from the percentage of respondents who answered the same question favorably heading into 2009.

“In strict definitional terms, the supply of distressed debt has shrunk by more than two-thirds from one year ago based on current spreads to maturity. This has undoubtedly motivated some asset managers to take profits and lighten up in the distressed space. The low hanging fruit has mostly been picked over.”

Greg Rayburn, Senior Managing Director, FTI Consulting, Inc.

“With the DOW traveling south of 7,000 at the time of last year’s report, more than two-thirds of respondents expected to increase their allocation in distressed debt in 2009. They saw an opportunity and they pounced on it. Now that we are back over 10,000, the respondents are no longer as ‘bullish’ on ramping up their distressed debt portfolios at the same frenetic pace. However, distressed debt investing by hedge funds does appear to be here to stay.”

Jeffrey S. Sabin, Partner, Bingham McCutchen LLP

“Unlike 2009, when just about any distressed name that didn’t default moved significantly higher, 2010 will be all about selection skills from a thinner field of candidates that distressed investors have thoroughly pored over - a more formidable challenge for fund managers.”

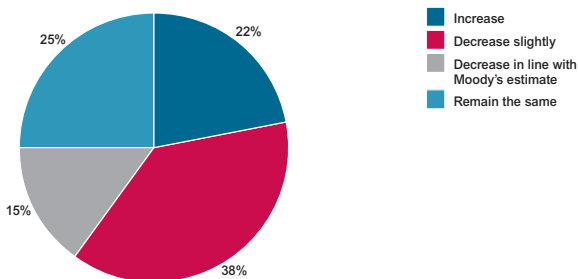
Kevin Lavin, Senior Managing Director, FTI Consulting, Inc.

“The 2009 run up in secondary loan prices has driven distressed asset prices to what many investors perceive as close to ‘fair value’. Driving outsized gains from these assets will be challenging during 2010.”

Raoul Nowitz, Senior Vice President, Macquarie Capital (USA) Inc.

SURVEY FINDINGS

3. Moody's US speculative grade default rate hit 12.2% at the end of August 2009, matching the peak hit in 1991. Moody's is modeling a 13.2% default rate peak in Q4 2009 with a sharp reduction to 4.1% by August 2010. Do you expect the default rate to increase, decrease slightly, decrease in line with Moody's estimate, or remain relatively flat next year?



- Much as default rates in 2009 fell short of previous forecasts by the ratings agencies, only 15% of respondents expect them to drop as sharply as Moody's predicts in 2010.
- Heading into 2010, a resounding 85% majority of respondents believe default rates will run above the ratings agency's estimate, and almost half of them predict default rates to either remain at their current levels or increase next year. Clearly something has to give, and if poll respondents are correct, 2010 will likely be less sanguine than the rating agency is predicting.

"With almost no market liquidity, default rates swung from all-time lows to the levels that we have only seen a couple of times in our lifetime. While the ratings agencies see default rates returning to 'normal' in the third quarter of 2010, hedge fund managers saw it differently – I'm betting on the hedge funds!"

Michael J. Reilly, Partner, Bingham McCutchen LLP

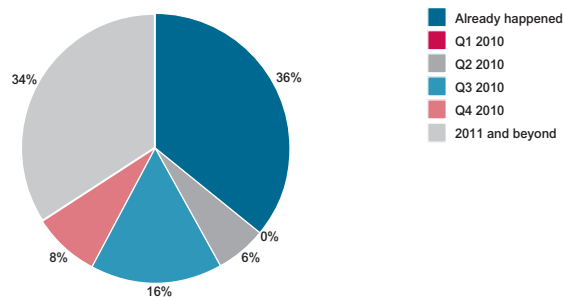
"There is virtually no precedent for default rates to fall as sharply and as quickly as Moody's is predicting. Following the previous two recessions it took considerably longer for the speculative-grade default rate to recede to its long-term historical average. Debt default rates will almost certainly be lower in 2010 than last year but are not likely to be in the vicinity of Moody's surprisingly low forecast."

Michael Buenzow, Senior Managing Director, FTI Consulting, Inc.

"Without a material improvement in economic activity, many credits will be stressed as a result of their aggressive capital structures crafted during much more robust market cycles. Given improvement in their own balance sheets, lenders to these credits may now be willing to entertain comprehensive restructurings, thereby avoiding the amend-and-extend game and pushing these over-levered companies into default."

Michael Silverton, Senior Managing Director, Macquarie Capital (USA) Inc.

4. When do you expect the volume of restructurings to hit its peak, or has this already happened?



- This split-jury chart shows that approximately one-third of poll respondents believe that the top of the restructuring boom is already past, while another third think the surge will hit in 2010 and another third say the real peak will come in 2011 or later. The bulk of the leveraged loan and high yield debt issued during the LBO craze begins to come due in 2012, so it is not a surprise that one-third of respondents believe this default cycle is still in its early innings.
- The boom-bust micro-cycle of workouts in 2009 may portend a new order in which short frenzies of restructuring activity alternate with periods of new debt issuance in a game of capital markets hopscotch.

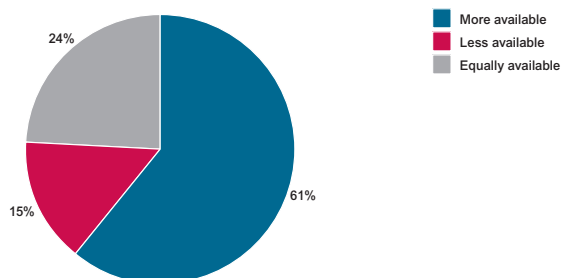
"It seems reasonable to expect that the number of restructurings will dip in 2010 given expectations of modest U.S. economic growth, corporate credit markets warming up to risky borrowers, relatively low levels of scheduled maturities in 2010 and lenders mostly comfortable with the amend-and-extend solution. But beyond that the picture is far less clear, as the refinancing cliff steepens and natural buyers of the riskiest debt tranches remain largely absent from credit markets and are not expected to return in force."

Bob Duffy, Senior Managing Director, FTI Consulting, Inc.

"The general level of distress in the market, and therefore restructuring activity, has clearly abated in recent months. However, the expiration of amendments done in 2009 coupled with an unstable economic backdrop, characterized by record high unemployment and a consumer confidence level that is half of what it was in mid-2007 will likely keep restructuring activity rolling into 2010."

Michael Silverton, Senior Managing Director, Macquarie Capital (USA) Inc.

5. Do you expect refinancing opportunities to be more available, less available or equally available in 2010 versus 2009?



- What a difference a year of massive fiscal intervention makes. Heading into 2009, 54% of respondents said they expected refinancing opportunities to be less available. Heading into 2010, it's flipped to 61% believing refinancing will be more available.
- That indicates primary markets will continue to run white hot, with more aggressive deal structures coming back to the forefront. In Q4 2009 bankers re-introduced the dividend deal, the PIK note, covenant-lite structures and even buyout financing.
- Much of that demand came from high yield asset managers drawing massive inflows based on steep returns from the asset class. With speculative grade debt trading relatively tight, it seems unlikely that this technical trend will prove sustainable.

"It is encouraging that respondents believe refinancings will be back on the agenda soon, but as matters stand, debt capital to refinance maturing facilities remains scarce. Good to see signs of optimism in the market!"

James Roome, Partner, Bingham McCutchen LLP

"The momentum we have going into 2010 certainly bodes well for refinancing opportunities for risky corporate borrowers in the near term. Nobody is expecting a return to the heady days of 2006-07 but the risk appetite of lenders and fixed income investors has definitely increased in recent months. However, as we learned in 2008, such momentum can turn in an instant when unexpectedly bad news hits credit markets."

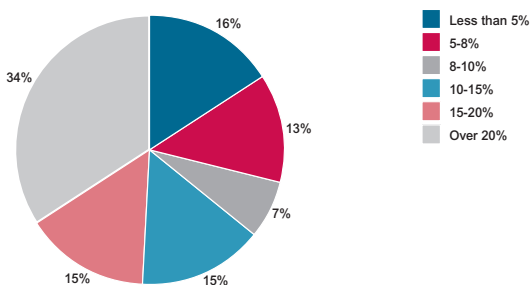
Randall Eisenberg, Senior Managing Director, FTI Consulting, Inc.

"The high yield bond market was the hero of 2009, providing one of the only reliable sources of financing. This, coupled with the emerging CLO bid, is providing additional market liquidity that borrowers can tap to meet their maturities. Despite the return of liquidity, investors remain cautious and high leverage deals will likely face challenges in the refinancing market."

David Miller, Managing Director, Macquarie Capital (USA) Inc.

SURVEY FINDINGS

6(a) What percentage return did you target for your primary distressed fund in 2009?



- Respondents were bar-belled in setting targets for 2009. Thirty percent of those asked said they targeted returns between 10% and 20% for 2009 while 34% claimed they aimed to return in excess of 20%. A surprisingly large 16% said they expected returns below 5% for 2009 and 13% set a 5% to 8% goalpost. In contrast, when asked what targets they set for 2008, 28% of respondents picked over 20%, 60% settled on 10% to 20% and only 5% selected less than 8%.
- The rising tide in 2009 helped most boats as the average return for distressed debt as an asset class was almost 27%, according to Hedge Fund Data. That still lagged long-only strategies that had record breaking years of returns in excess of 40%.

“Hedge fund managers were happy to close the book on 2008 and many predicted a strong recovery in 2009 and beyond. Some distressed players with dollars to invest were able to take advantage of this recovery, getting in at rock bottom and turning an immediate return.”

Barry G. Russell, Partner, Bingham McCutchen LLP

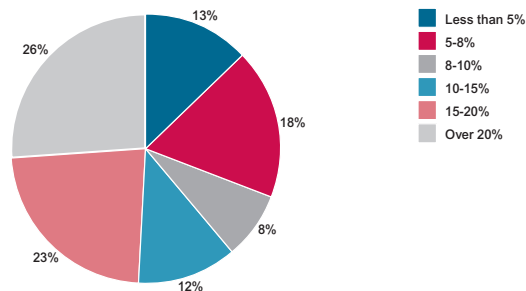
“Given the unprecedented levels that distressed debt prices had fallen to one year ago, many fund managers had to expect that a reversal was overdue at some point in 2009. Far fewer, however, expected a reversal of the degree that we got.”

Bob Medlin, Senior Managing Director, FTI Consulting, Inc.

“Heading into 2009 most loans were already trading at severely depressed levels with relatively wide spreads. The events of the second half of 2009 have brought a global re-pricing of risk to a level that leaves less upside for distressed investors. Going forward, target returns on given tranches of the capital structure should be dramatically lower in the coming year.”

Ford Phillips, Managing Director, Macquarie Capital (USA) Inc.

6(b) What will you target in 2010?



- That same bar-bell appeared in targets set for 2010 with almost half of respondents (49%) setting their sights over 15% and a hefty 31% saying they do not expect performance to pass 8%. Given the split on when restructurings are going to peak, this division of opinion is unsurprising.

“We saw a strong end to 2009 and half of all respondents believe this trend will continue into 2010, as many managers try to earn their way back to or above 2008’s high-water marks. The other half are trying to ‘hedge’ and temper their enthusiasm, in case the economy cannot sustain the same rate of recovery that we have recently seen.”

Timothy B. DeSieno, Partner, Bingham McCutchen LLP

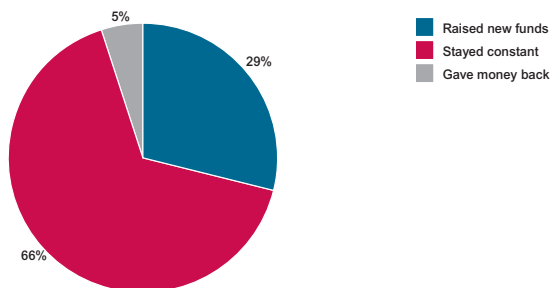
“Considering the outsized returns enjoyed by distressed debt investors in 2009, it’s surprising that the same percentage of respondents as in 2009 – nearly one-half – are targeting 15%+ returns for 2010. Unlike 2009, such strong returns will be mostly determined by specific name selection and some concentrated positions since the asset class as a whole can’t possibly come close to a repeat performance in 2010.”

Randall Eisenberg, Senior Managing Director, FTI Consulting, Inc.

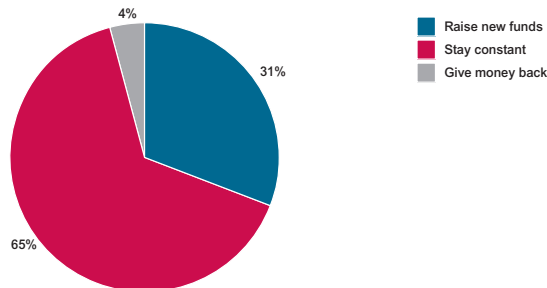
“In an effort to realize enhanced returns, distressed investors will chase yields more aggressively and turn their focus down the capital structure into riskier asset classes and riskier issuers. However, achieving 20% returns will be increasingly challenging given the run-up in most asset prices during the second half of 2009.”

Teri Stratton, Senior Vice President, Macquarie Capital (USA) Inc.

7(a) In 2009, did you raise new funds for investment, stay constant, or give money back?



7(b) In 2010, do you plan to raise new funds for investment, stay constant, or give money back?



- Only one-third of respondents claim they plan to raise new funds to allocate to the distressed asset class in 2010. That is a far cry from the 86% of respondents that said the same thing last year.

“With corporate credit markets continuing to be accommodating, the supply of distressed paper down sharply and the easiest returns having already been made, putting a lot of new money to work could present a tough challenge for distressed fund managers.”

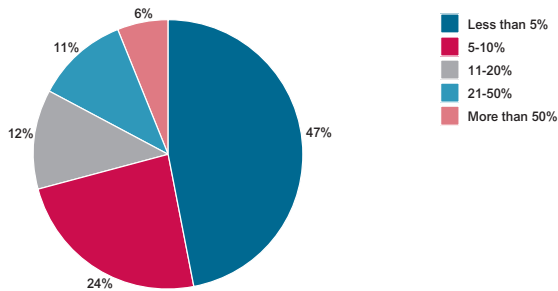
Kevin Lavin, Senior Managing Director, FTI Consulting, Inc.

“Fundraising will continue to be challenging in the current environment and many investors will turn their attention to deploying surplus capital or face the prospect of returning it. Only then will distressed investors look to raise new capital.”

Andrew Krop, Vice President, Macquarie Capital (USA) Inc.

SURVEY FINDINGS

8. How much of your portfolio do you allocate to the primary leveraged finance markets?



- New issuance may be back but it's not distressed funds buying. Almost three-quarters of study respondents said they allocate less than 10% of assets to primary deals, compared to only 55% in last year's study. Only 6% of respondents this year said they allocate more than 50% of funds to new deals, compared to 20% last year.
- This corroborates evidence that the surge in new high yield and leveraged loan issuance is caused by technical factors, namely inflows to high yield bond funds and early redemptions of loan debt. Distressed investors found ample opportunities in secondary markets in 2009 but absent a double-dip, they may be forced to play new deals again to find yield.

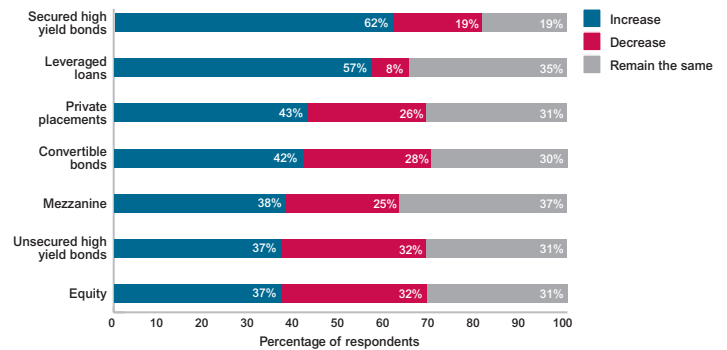
"The upfront legal, administrative and diligence requirements of primary lending are off-putting to many distressed investors. Some shops are set up for it but many aren't."

Greg Rayburn, Senior Managing Director, FTI Consulting, Inc.

"Distressed investors generally do not participate in the primary leveraged loan market. As spreads continue to tighten, this market will become even less attractive to distressed investors. However, the return of the primary market may benefit distressed investors as healthier capital is diverted away from special situations investment opportunities."

Mick Solimene, Senior Managing Director, Macquarie Capital (USA) Inc.

9. Do you expect primary markets for the following to increase in volume, decrease in volume or remain unchanged in 2010?



- Respondents expect the domination of new issuance by secured bonds and leveraged loans to continue, reflecting investors' preference for collateral ahead of the looming maturity hump from 2011 to 2014.

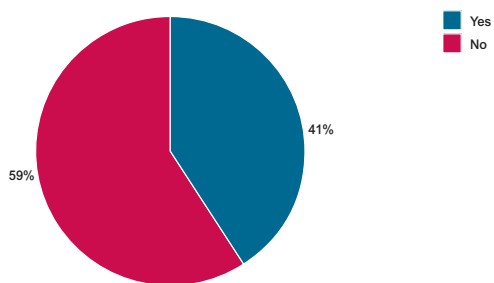
"A plurality of respondents predict increases in volume in every investment category. Clearly, investors are no longer fixated on doomsday scenarios. However, respondents continue to show a strong preference for the top of the capital structure, where relatively strong returns can be attained with less risk."

Lisa Valentovich, Partner, Bingham McCutchen LLP

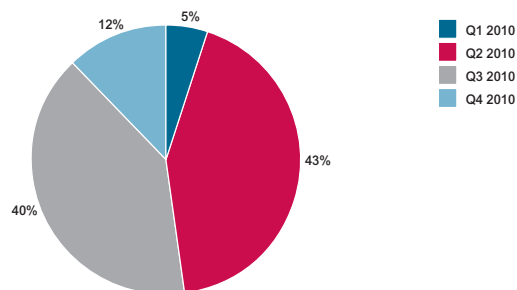
"The pattern of the response reflects a lack of conviction by respondents in the prospects for this economic recovery. Respondents expect that primary markets will continue to covet secured positions and high seniority positions even though the recession is apparently over."

Greg Watson, Senior Managing Director, FTI Consulting, Inc.

10(a) Do you expect a significant tightening of primary market liquidity in 2010?



10(b) If so, when do you expect the correction to occur?



- Tough call here. A clear majority of those surveyed do not expect the primary market window to close but a large 41% minority say it will. This parallels the split on when restructurings will peak and reflects the broad ambivalence about how the markets and macro economy will respond as government spending slackens.

“One of the reasons so many spec-grade borrowers are now rushing to raise capital in credit markets is that nobody is confident about how long this window will stay open and treasurers feel compelled to take the money while it is there – because a year from now it could be a different story altogether. The vast improvement in primary credit market conditions is undeniable but no one really has a strong sense about its duration.”

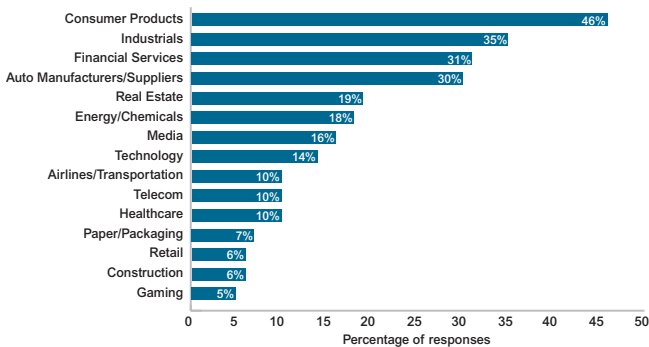
Bob Medlin, Senior Managing Director, FTI Consulting, Inc.

“The extent to which the primary market loosens in 2010 is dependant on how comfortable institutional lenders become with their balance sheets and capital ratios as the year progresses. Clearly, the greatest factor in this will be the underlying stability of the market.”

James Chiarelli, Senior Vice President, Macquarie Capital (USA) Inc.

SURVEY FINDINGS

11(a) In 2009, in which three sectors did you prefer to allocate your investments?

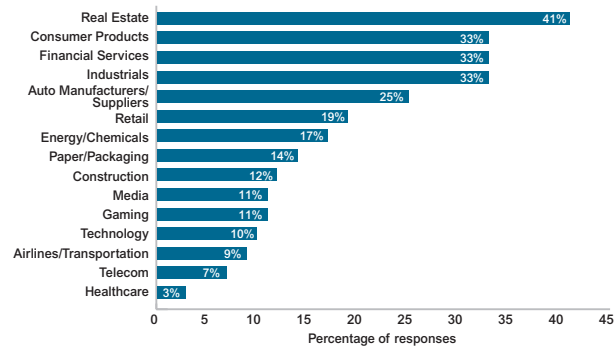


- While Financial Services and Auto Manufacturers/Suppliers were predicted by respondents to offer the greatest opportunities for distressed investors heading into 2009, Consumer Products and Industrials actually outpaced both sectors in terms of dollars allocated.
- Clearly, distressed investors underestimated the amount of support the US government was prepared to offer to certain major credits in the Financial Services and Auto Manufacturers/Suppliers industries.

“Once it became evident that the worst of the recession was probably behind us, fund managers likely focused on industry sectors that typically benefit first in an early recovery scenario.”

Keith Cooper, Senior Managing Director, FTI Consulting, Inc.

11(b) Which three sectors do you expect to offer the greatest opportunities for distressed investors in 2010?



- Almost half of poll respondents believe the Real Estate sector will be the best sector for distressed investing opportunities this year. The commercial real estate market in particular is likely to provide a steady flow of workouts as leases expire and investors stumble under excess leverage.
- Consumer Products, Financial Services and Industrials are all expected to be opportunity-rich sectors for distressed investors as the panacea of stimulus programs begins to wind down and the consumer remains focused on deleveraging.

“Commercial real estate is the other shoe to drop in the recession two-step, but low interest rates and cooperative lenders kicked that can down the road last year - this year may provide more distressed buying opportunities.”

Ronald J. Silverman, Partner, Bingham McCutchen LLP

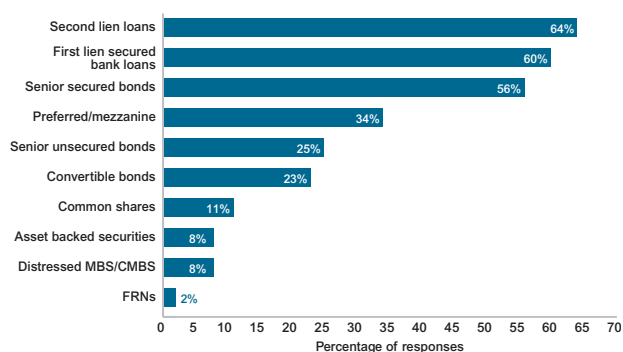
“Commercial real estate and much of the debt attached to it have fallen in value to the point of being tempting for value players and distressed investors, but in most markets the CRE down cycle still has a way to go. The unwillingness of traditional real estate finance providers, namely large regional banks, to increase CRE exposures on their books and the very limited ability to securitize new CRE loans amplify the potential refinancing and default crises ahead. But this vacuum is also starting to attract private investment capital into the space.”

Ron Greenspan, Senior Managing Director, FTI Consulting, Inc.

“The industries that have been the hardest hit over the past 18 months are the obvious candidates for investors to find value. Several of these industries may be starting to find a bottom and investors are now looking to cautiously enter the market. We expect that investors will seek to clearly separate the ‘haves’ from the ‘have-nots’ within each of these industries.”

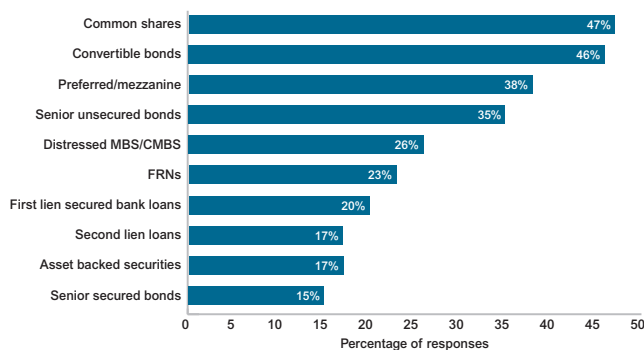
Ed Albert, Managing Director, Macquarie Capital (USA) Inc.

12(a) Which three instruments do you think will offer the most attractive investment opportunities for distressed investors in 2010?



- This is the first time in the five-year history of the Debtwire Outlook that first lien secured bank debt did not rank as the top category. What's more, the new favorite, second lien loans, placed behind both first lien loans and senior secured bonds in the past two studies.
- It seems that respondents still want the comfort of being a secured creditor, but will be willing to reach for yield in 2010. This could reflect cautious optimism about the economy, or the broad scarcity of yield in the wake of the H2 2009 rally.

12(b) Which three instruments do you expect to offer the least attractive investment opportunities for distressed investors in 2010?



- While the most appealing instrument heading into 2010 changed compared to results heading into 2009, common shares continue to be the least attractive investment opportunity to poll respondents.
- Convertible bonds are also not that attractive heading into 2010, considering the run they had last year. Demand for converts, like demand for unsecured debt, is usually generated by investors' optimism about credit conditions and economic growth opportunities in the near future.

“One thing that hedge funds do agree on is that Secured Debt is still the place to be, as the top 3 investment choices are at the top of the capital structure. It doesn't look like folks are ready to go head first into the equity or unsecured debt markets quite yet, although once they do, it looks like we will see Mezz deals outpacing unsecured bonds and common stock.”

James Terry, Partner, Bingham McCutchen

“In their stretch for extra yield, respondents may have forgotten how badly some second lien loans fared in the last couple of years. Generally speaking, the answer pattern most likely reflects respondents' skepticism about this recovery.”

Freddie Reiss, Senior Managing Director, FTI Consulting, Inc.

“Our experience has been that distressed investors may be forced to move down the capital structure in search of returns. This is a change from over the past 18 months, where first lien debt was the preference during the recent period of market volatility.”

Ed Albert, Managing Director, Macquarie Capital (USA) Inc.

“This order of preference is hardly a strong endorsement of our nascent economic recovery by the smart money, who are probably thinking that two consecutive years of abnormally high returns is not likely.”

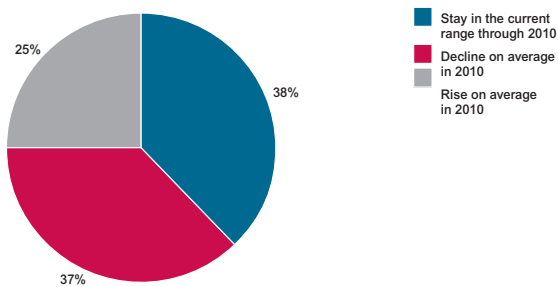
Michael Eisenband, Senior Managing Director, FTI Consulting, Inc.

“The recent stabilization that has occurred in the US economy will challenge distressed investors as they seek attractive investment opportunities. Investors are observing narrower spreads as yield players have fueled a run-up in the market prices and competition increases for distressed assets. However, with default rates well above historical averages, diligent distressed investors will continue to have significant opportunities to put money to work in attractive situations.”

Vikram Chitkara, Senior Vice President, Macquarie Capital (USA) Inc.

SURVEY FINDINGS

12(c) Do you expect secondary loan prices to:

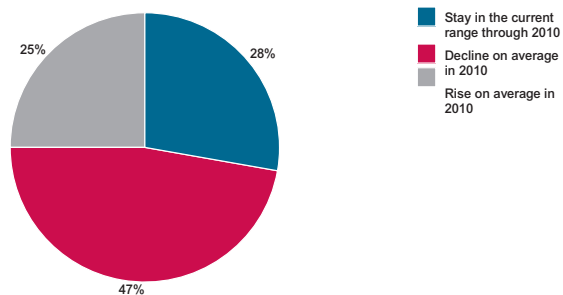


- No clear agreement on the direction of loan prices next year. If you believe uncertainty breeds volatility, loan investors may be in for a bumpy ride next year.

"In the absence of any market shocks, it would seem reasonable that loan prices will mostly trade within the current ranges in 2010."

Keith Cooper, Senior Managing Director, FTI Consulting, Inc.

12(d) Do you expect secondary market bond prices to:

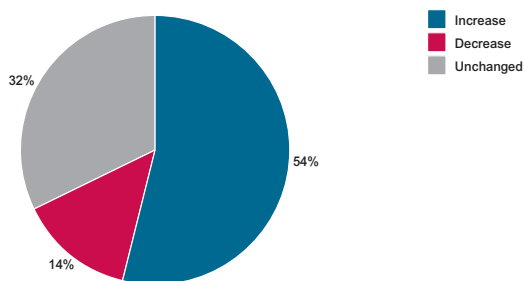


- The spike in bond markets in 2009 was more a function of technical demand than credit improvement. Look out below!

"Speculative-grade bond spreads have essentially retreated to where they were in early-to-mid 2008. That's a huge movement considering how fragile the U.S. economy still is – thereby leaving far more room for disappointment than upside surprise."

Ron Greenspan, Senior Managing Director, FTI Consulting, Inc.

13(a) Do you think distressed M&A transactions will increase, decrease or remain unchanged in 2010?



- Only about half of respondents expect an increase in distressed M&A next year. That reflects the broad rebound in valuation multiples that have been pumped up with government cheese.

“As expected, we saw a huge increase in distressed M&A transactions in 2009, including many in-court 363 sales. Although the market isn’t as frothy in 2010, we still expect a great deal of opportunistic and strategic purchases. Buying assets in a sale under Section 363 of the Bankruptcy Code provides piece of mind – it allows buyers to acquire assets free and clear of liens or other claims and comes with the blessing of the court that the sale was conducted in good faith.”

Scott Seamon, Bingham McCutchen

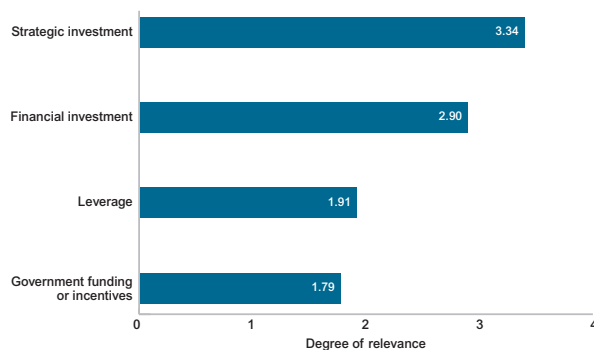
“The flow of credit again to risky corporate borrowers and the surge in distressed debt market prices may slightly dim the prospects for distressed M&A activity this year compared to 2009 but there will be no shortage of these transactions in 2010.”

Michael Buenzow, Senior Managing Director, FTI Consulting, Inc.

“Generally healthier capital markets translate into more traditional M&A activity. The combination of a return of investment capital coupled with improved bank balance sheets will likely spur an uptick in transaction activity. Despite this increased activity, 363 sales will not drive the volume unless we see a dramatic upsurge in forced bankruptcy filings. In 2010, distressed M&A may be more focused on non-core/underperforming assets versus a complete sale of the business.”

David Miller, Managing Director, Macquarie Capital (USA) Inc.

13(b) On a scale of 1 to 4, how relevant are the following sources of financing for distressed M&A? (where 1 = least relevant and 4 = most relevant)



- Primary markets are open for now but study participants still think strategic buyers will continue to drive M&A activity in 2010. Financial acquisitions carry far larger equity components than the last round of LBOs based on respondents’ expectations that financial investments will be roughly 50% more important than leverage in deals this year.

“We have clearly seen this pattern emerge over the last year—strategic buyers, typically competitors, have been leading the charge into distressed M&A deals. While many types of buyers have the financial resources to get these deals done quickly, strategic buyers also have the patience to nurse these assets, and perhaps tolerate losses, until the business cycle decisively turns.”

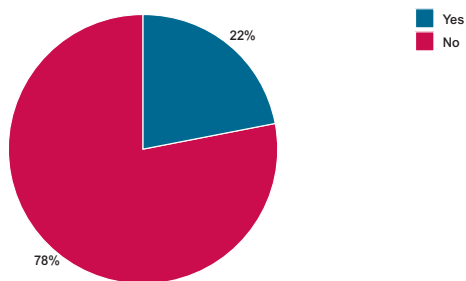
Ed Bartko, Senior Managing Director, FTI Consulting, Inc.

“The resurgence of merger activity in the closing quarter of 2009 has raised expectations for the coming year. Strategic acquisitions should continue as fundamentally strong companies look to acquisitions for revenue growth. Private equity has already demonstrated an ability to complete transactions with selective leverage. Easing credit standards will allow deal activity to expand further and we should see financial players increase their activity.”

Mick Solimene, Senior Managing Director, Macquarie Capital (USA) Inc.

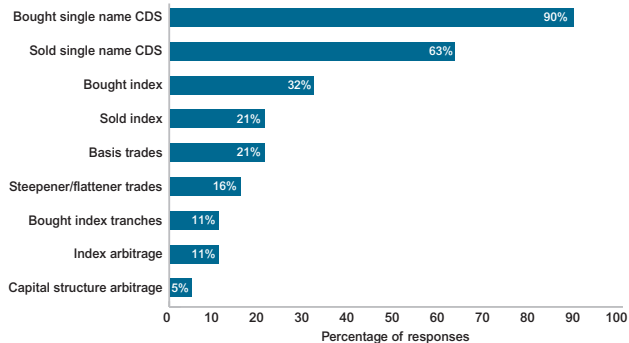
SURVEY FINDINGS

14(a) Do you use credit default swaps regularly as part of your investment strategy?

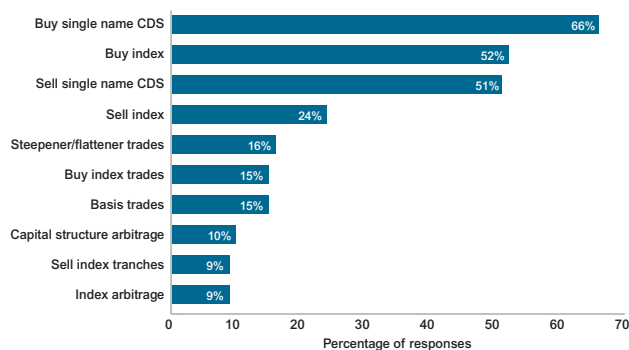


- Nearly one-quarter of participants use CDS as a regular part of their investment strategy with buying single name protection emerging as the most popular way to use the product. Ninety percent of respondents to last year's survey bought protection in 2009 with only 66% expecting to use the product to short in 2010.

14(b) If yes, which three investment strategies did you use most in 2009?



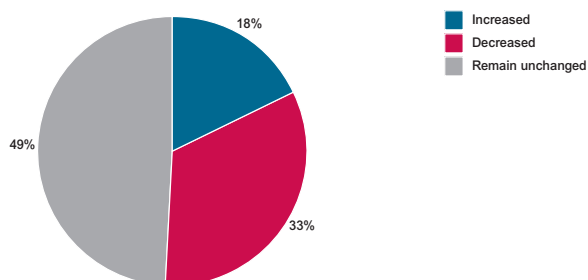
14(c) Which three investment strategies do you expect to use most in 2010?



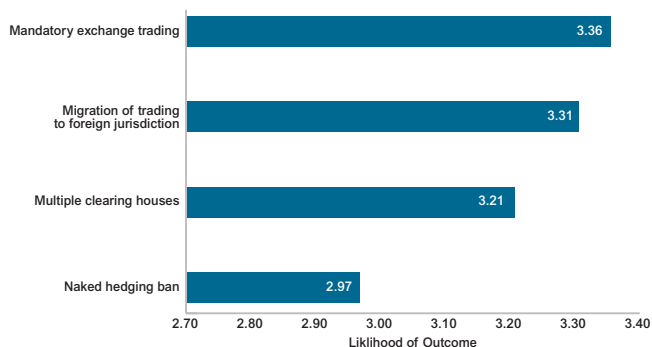
"We expect the CDS market to operate at a more normal level in 2010 than last year, which witnessed some bouts of irrational spikes. The answers on this set of questions about buying patterns in 2009 versus 2010 reveals that sophisticated investors buy protection more often when they feel less able to count on markets to act rationally. Even though such CDS hedging was often extraordinarily expensive during 2009, it provided downside protection that was more highly valued in a gyrating market. 2010 should bring a return to more normalized use of CDS for pure return hedging."

Carlyn Taylor, Senior Managing Director, FTI Consulting, Inc.

15. Do you expect CDS liquidity in 2010 to increase, decrease or remain unchanged?



16. On a scale of 1 to 5, what is the likelihood of each of the following outcomes in 2010? (where 1 = unlikely and 5 = extremely likely)

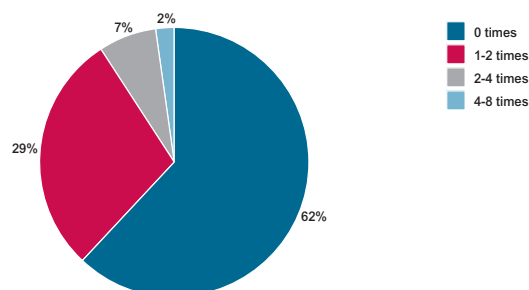


- As for other changes to CDS still to come, respondents are fairly confident that the product will be moved to an exchange in the coming year. On a scale of 1 to 5 for likelihood, participants ranked a shift to exchanges at 3.36 while the odds of a migration to a foreign jurisdiction was ranked highly as well at 3.31 in terms of probability.

“The sheer size of the CDS market relative to its underlying debt makes it almost irresistible to regulators. I believe the clearing house option for non-customized swaps is a likely outcome as a form of compromise by industry and regulators. Hopefully it will prove acceptable to all interested parties and avoid a more granular type of regulation.”

Carlyn Taylor, Senior Managing Director, FTI Consulting, Inc.

17(a) How much leverage did you use in managing your fund in 2009?



- The amount of respondents claiming not to use leverage when making distressed investments actually increased this year compared to last year’s survey. This proves once again that distressed investing is not a strategy that lends itself well to leverage given its somewhat volatile nature.

“Leverage has been a very dirty word, with many investors seriously damaged or destroyed by its weight. Although confidence in the credit markets is returning, the bulk of the distressed investor community is not ready to use leverage in an attempt to boost returns.”

Scott A. Falk, Partner, Bingham McCutchen LLP

“Distressed investing returns often turn on bankruptcy litigations that are difficult for insiders to financially handicap, let alone investors who may choose not to be restricted and therefore don’t have all the facts that may be relevant to the outcome. It is not surprising that this remains a difficult area to leverage.”

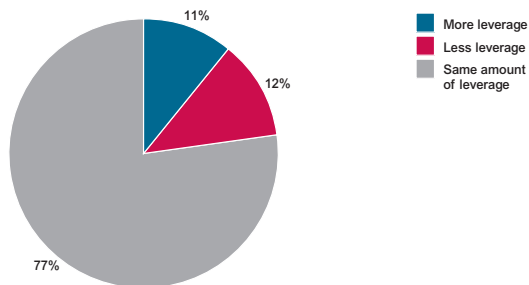
Carlyn Taylor, Senior Managing Director, FTI Consulting, Inc.

“For distressed investors, 2009 provided ample distressed investment opportunities, such that leverage wasn’t necessary (nor was it available) in order to drive extraordinary returns. As market confidence returns, traditional and new sources of leverage should be increasingly available to those investors with a demonstrable track record.”

Teri Stratton, Senior Vice President, Macquarie Capital (USA) Inc.

SURVEY FINDINGS

17(b) If you did use leverage in 2009, do you anticipate using more, less or the same amount of leverage in your portfolio in 2010?

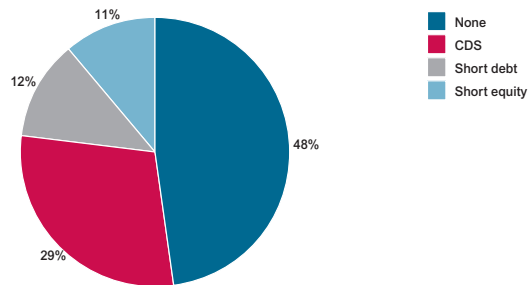


- For the managers who did feel comfortable using leverage to amplify their investments in 2009, a vast majority (77%) does not forecast a change to the current levels in 2010. That is a significant change from the 49% of respondents last year who expected to use less leverage in their investments.
- This is simply another sign that investors don't need to revisit core strategies based on the liquidity fears that were prevalent heading into the first quarter of 2009.

"As the market continues to improve and leverage becomes more readily available, funds may increasingly look to leverage as a tool to amplify returns. Despite improving borrowing terms, investors could be slow to employ its use in light of recent lessons in liquidity."

David MacGreevey, Senior Vice President, Macquarie Capital (USA) Inc.

18. Which one of the following hedging strategies did you use most heavily in 2009?



- How could almost half of respondents – including hedge funds – not have hedged in 2009? Given the lows tested by bond and loan markets in H1 2009, many investors likened their strategies to shooting fish in a barrel. Bottom line, at a low enough dollar price, downside is necessarily limited.

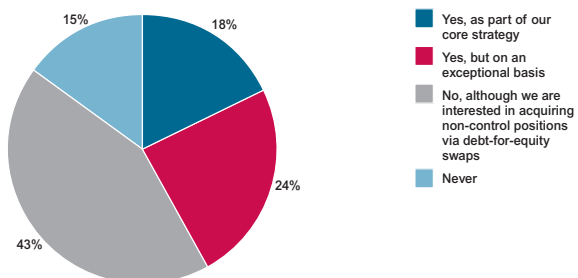
"The popularity of credit default swaps has dropped precipitously, in light of the problems that Lehman and other high profile cases revealed about those products. But instead of seeking out alternative hedging strategies, many investors have chosen to do without, perhaps because of the limited perceived downside risk given the substantial discounts at which many securities sold."

Edwin E. Smith, Partner, Bingham McCutchen LLP

"What purpose would putting on hedges have served in early 2009 when performing senior leveraged loans were already trading at 65 or 70 cents on the dollar – considering that the asset class had rarely ever traded below 90 cents historically? If you had exposures to distressed debt securities going into the credit crisis, 2009 was the time to move aggressively on your favorite positions – though that is said confidently only in hindsight."

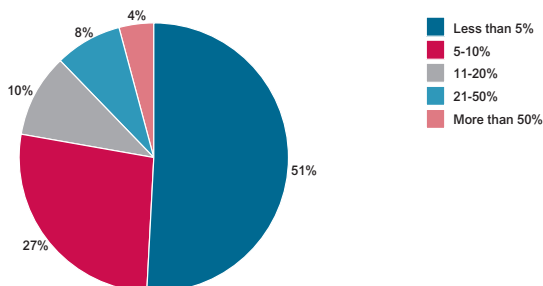
Freddie Reiss, Senior Managing Director, FTI Consulting, Inc.

19. Do you seek equity control of companies via a “loan to own” strategy?



- Only 43% of participants in the 2010 Outlook said they seek control stakes through workouts compared to 60% in the 2009 study. That may reflect the premium investors place on liquidity given the clear uncertainty about the year to come.

20(a) How much of your portfolio did you dedicate to direct lending investments in 2009?



- Half of respondents said they allocated over 5% of their portfolios to direct lending in the past year, up from only 39% in last year’s survey. That’s no surprise given the 20%-plus IRRs available on rescue financings in 2009.

“As with primary lending, loan-to-own is a strategy with a specific clientele following. It’s just not attractive to every distressed shop.”

DeLain Gray, Senior Managing Director, FTI Consulting, Inc.

“Within distressed investing, the potential for equity conversion is present regardless of the chosen strategy. In order for investors to continue pursuing this strategy in 2010, there will be a need to focus the investment concentration down the capital structure in order to locate the fulcrum security.”

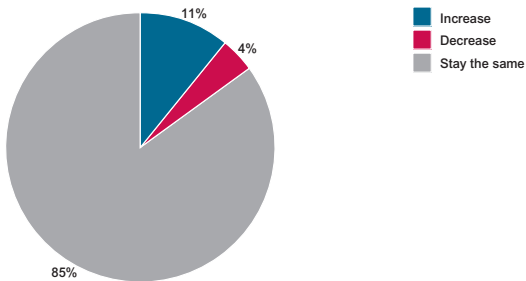
Vikram Chitkara, Senior Vice President, Macquarie Capital (USA) Inc.

“The substantial increase in direct lending over last year’s survey suggests that many respondents have used the credit crisis as an opportunity to ramp up their direct lending at a time when traditional sources of credit were not willing or able to do so. It will be interesting to observe whether this trend can continue even as traditional banks and large financial institutions return to this market in earnest over the next year or two.”

Amy L. Kyle, Partner, Bingham McCutchen LLP

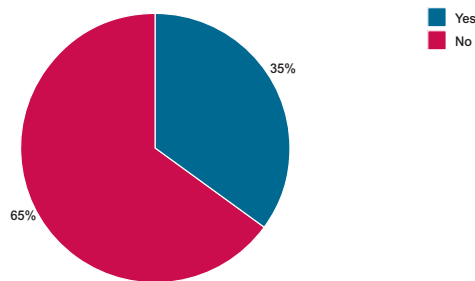
SURVEY FINDINGS

20(b) Do you plan to increase, decrease or keep this allocation the same in 2010?



- That easy money is gone for now and 85% of those surveyed said they will keep direct lending allocations constant in the year to come.

21(a) In 2009, did your fund participate as a lender in any Debtor-In-Possession (DIP) or exit financing transactions?



- Despite the surge in restructurings in 2009, the response to this question in the 2010 Outlook was identical to that given in the previous year.

“DIP lending is a way for an institution to make a safer bet at the top of the capital structure, while receiving significant fees, a priority claim, confidential information, access to the debtor’s officers and a seat at the table in shaping the debtor’s business plan and effectuating the debtor’s restructuring/exit strategy.

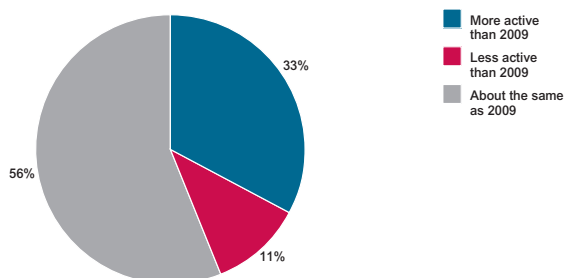
With companies not having much by way of unencumbered assets to provide to a potential new DIP lender, it was often the prepetition secured creditors who were leaned on to provide a defensive DIP, rather than be primed by a new money lender.”

Julia Frost-Davies, Partner, Bingham McCutchen LLP

“DIP lending remains primarily the turf of traditional lenders, though their reluctance to stay highly committed to this product since late-2008 and the huge IRRs for lenders on some DIP loans since 2008 has surely attracted more private capital.”

Bob Duffy, Senior Managing Director, FTI Consulting, Inc.

21(b) If so, how active do you expect to be as a DIP lender or exit lender in 2010?



- This sheds some light on the split decision in Question 3, as only one-third of respondents said they plan to be more active in DIP lending in 2010 than in 2009. Over half of the respondents to last year's survey said they intended to make more DIP loans in 2009 than in 2008.

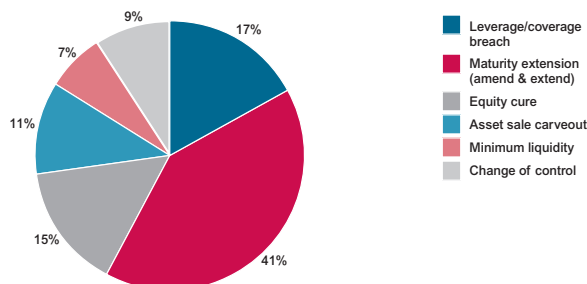
“Generally speaking, hedge funds are after larger returns than what is typically found in a DIP financing transaction. With that said, we saw some very high-profile cases this year (like General Growth and Lyondell) in which hedge funds served as DIP lenders, rolling up their prepetition debt and recognizing the benefits of lending on a so-called ‘loan-to-own’ basis and receiving a real stake in the reorganized company. This is the strategic play for many of the new entrants to the DIP lending market, not necessarily the interest payments and fees that can be charged, which are also very nice.”

Jonathan B. Alter, Partner, Bingham McCutchen LLP

“DIP financings during the recent cycle were frequently provided by incumbent lenders with a vested interest in the company’s success in order to protect their initial investment. As we transition into 2010 and banks’ balance sheets continue to improve, the spectrum of investors participating in DIP financing will naturally expand to include more providers. Disputes regarding the value and availability of excess collateral, along with priming fights, may become the ‘flavor of the month’ in the DIP arena.”

Mick Solimene, Senior Managing Director, Macquarie Capital (USA) Inc.

22(a) What do you think will be the most common catalyst for amendments in 2010?



- It's not just about leverage any more. Over one-quarter of those asked picked maturity extension as a more common amendment catalyst than leverage. This shows that while primary markets are open to certain credits, businesses with excessive leverage or risky business models face continued refinancing risk.

“Over one-third of respondents view impending maturity dates as the primary catalyst for amendments. Some of the ‘covenant-lite’ deals that were made during the middle part of the last decade are now approaching maturity. Because covenants in these transactions were unusually mild and few in number, it is only the arrival of a maturity date, at a time when debt refinancings are no longer available (and certainly not on comparable terms), that are finally spurring the restructuring of this indebtedness.”

Steven Wilamowsky, Partner, Bingham McCutchen LLP

“Leverage covenant breaches will likely prevail in 2010 if the pace of economic recovery falls short of some fairly optimistic expectations by borrowers and lenders. Respondents certainly seem to acknowledge that likelihood.”

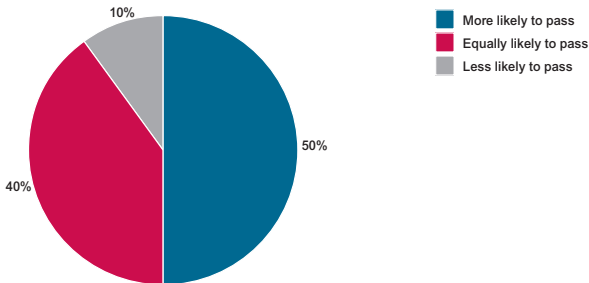
Greg Watson, Senior Managing Director, FTI Consulting, Inc.

“The excessive leverage levels from the pre-2008 boom cycle are combining with diminished levels of profitability, creating issues with leverage covenants. Unless there is a material turnaround in the economy, credits will be unable to achieve the operational growth inherent in these capital structures, making amendments necessary to forestall the day of reckoning.”

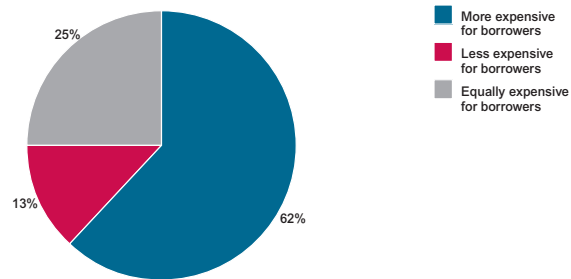
Ed Albert, Managing Director, Macquarie Capital (USA) Inc.

SURVEY FINDINGS

22(b) Loans have redistributed from CLOs to hedge funds but that has been offset by primary market recovery. Do you anticipate amendments in 2010 to be:



22(c) Do you anticipate amendments in 2010 to be:

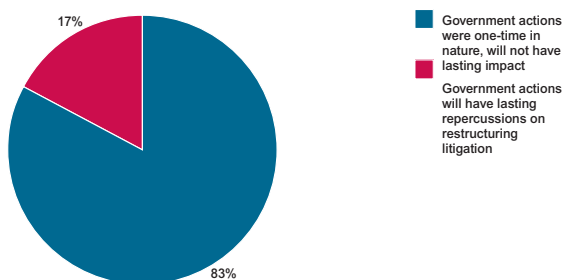


- The consensus is that amendments will be costlier for borrowers in 2010. That reflects both the changed constituency of lender groups and the growing speed and efficiency of loan holder organization as investors become more experienced with amendment negotiations.

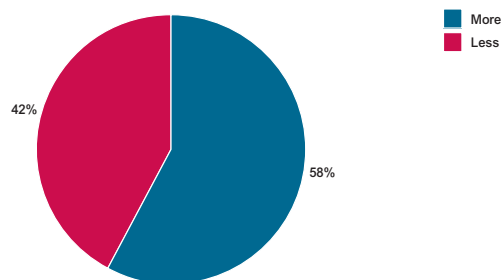
“The shift of loans from CLOs to hedge funds has concentrated holdings, giving these funds increased leverage in the amendment process. Also, lenders may be able to drive a more expensive solution and improve their returns, as it is not as easy for highly levered borrowers to refinance.”

Martin Nachimson, Consultant, Macquarie Capital (USA) Inc.

23(a) The United States Government inserted itself into several high profile restructuring situations in 2009, altering the dynamics of the absolute priority rule. Do you expect these events to be extraordinary one-offs or produce a longer lasting impact on restructuring litigation?



23(b) If you believe there will be lasting repercussions, do you expect to see more instances where the absolute priority rule is diluted to the benefit of junior creditors in 2010?



“Presumably, there will be increased risk for investments in troubled entities where the federal government may decide to intervene for political or systemic reasons. Such entities will pay an increased cost for capital. Whether that increased cost will have a serious negative impact on the broader economy remains an open question.”

Harold S. Horwich, Partner, Bingham McCutchen LLP

“Despite the clear rule of law in the bankruptcy code, several of the key constituents agreed to receive less consideration than would have been afforded to them under the code in these situations. Certainly the government’s involvement and financial support played a large role in the outcome of these cases. However, while these events were game-changing at the time, longer-term effects seem to be less meaningful.”

William Malczyk, Senior Vice President, Macquarie Capital (USA) Inc.

“Considering the last year has seen the only instances in recent memory in which government interaction has pushed bankruptcy case law to take a backseat, it will be interesting to see how bankruptcy judges react in the future – a return to bankruptcy case law or a continued usage of the precedent set during an unparalleled time of protecting the nation’s interests. If the absolute priority continues to be diluted, how lenders incorporate this into their risk premium will be the real question.”

Ford Phillips, Managing Director, Macquarie Capital (USA) Inc.



Global Restructuring Roundtable

Bingham Lawyers Discuss:

CHAPTER 15 OF THE US BANKRUPTCY CODE AND FOREIGN PROCEEDINGS

What are the main goals of Chapter 15? How effectively does it meet them?

Ron Silverman: Chapter 15 is the United States bankruptcy law for providing assistance to foreign insolvency proceedings. Instead of requiring a company to commence a full-blown Chapter 11 proceeding, which entails a lot of specialised rules and US-centric laws, the court can offer assistance to a foreign proceeding. The foreign insolvency proceeding remains the dominant proceeding, and the goals of Chapter 15 are focused around that. These goals are to maximise the value of the company, to make the cross-border proceedings and the rescue of the company efficient, and to promote rehabilitation of the company. In short, Chapter 15's purpose is to benefit the cross-border restructuring in the most efficient way.

What is the process for recognising a foreign proceeding?

Jeff Sabin: Chapter 15 provides a broad range of relief that's available to foreign proceedings and foreign officeholders. For example, if the proceeding is a foreign main proceeding, automatic relief is granted—at its most basic, an automatic stay of

actions against the debtor company is enabled. The officeholder is able to operate the business and has many of the other abilities, benefits and rights that a trustee in a regular US bankruptcy would have. The business can be stabilised and operated pending an ultimate restructuring.

Michael Reilly: If the proceeding is a foreign non-main proceeding, or if additional relief needs to be granted to a foreign main proceeding, the court also has a broad panoply of powers to grant assistance. For example, it can suspend transfers or simply position assets so the status quo is preserved, affording the foreign officeholder the opportunity for discovery, such as the examination of witnesses and the taking of testimony. It can also take more extensive steps, such as entrusting the assets and the realisation of assets to the foreign officeholder.

Tim DeSieno: Also, if the court finds that particular actions are without prejudice and for the benefit of the US creditors, it can order the assets that are realised and discovered to be entrusted to the foreign officeholder for distribution in accordance with the foreign distribution regime—that is, in accordance with their priorities.

(continued on next page)

Ed Smith: It is a significant step for a local court to allow a foreign officeholder to distribute local assets according to the rules of the foreign insolvency proceeding. When the decision is made, however, and the foreign proceeding is recognised as dominant, the US court has the ability to allow assets to be distributed as determined by that foreign proceeding. And, if other relief is needed, the court can fashion it creatively and flexibly, offering a wide range of options to the foreign officeholder.

What are the potential pitfalls of Chapter 15, if any?

Tim DeSieno: Chapter 15 provides both a broad relief and a broad opportunity for foreign insolvency proceedings to seek relief in the United States, but there are some limitations. For example, Chapter 15 provides for assistance between a foreign proceeding and a US proceeding involving the same exact legal entity. That can create an issue in situations when you have a complex corporate group—for example, a parent and subsidiaries. The same legal entity in both proceedings must request assistance, so if both parent and subsidiary are in proceedings in the foreign jurisdiction, they can request relief in the US court. But if a subsidiary is in the proceeding but its parent is not, there will be limits on relief available to the parent.

Michael Reilly: One of the other issues is that US law provides for fairly broad avoidance powers of transactions that are seemingly prejudicial to creditors, and these laws differ in some respects from the laws that apply in Europe. Companies might like to take advantage of US laws, but these provisions are only available under the regular Chapter 11 regime—not under Chapter 15, which is really designed to provide assistance to a foreign proceeding.

Ron Silverman: There are also certain minimum qualifications for a Chapter 15 proceeding. The company must have its centre of main interests in the jurisdiction of the foreign proceeding or it has to have an ongoing business activity in the jurisdiction of the foreign proceeding. It is not enough that the company merely has assets that are located in the jurisdiction of the foreign proceeding.

Ed Smith: It is entirely conceivable that there could be an insolvency proceeding with respect to a company simply because it has assets in a jurisdiction or it is domiciled there, yet the company has no ongoing business. In that case, Chapter 15 will not provide assistance to that foreign proceeding because there has to be some minimum level of economic activity that justifies giving assistance. The good news: A company that fails to qualify for Chapter 15 still has avenues for relief in the United States. For example, it can still commence a Chapter 11 or a Chapter 7.

Is Chapter 15 relief limited to certain countries or regions?

Jeff Sabin: Chapter 15 is designed to provide assistance to foreign proceedings throughout the world. There's no list of countries that are specifically entitled to seek Chapter 15 relief. Companies in jurisdictions and insolvency proceedings throughout the world—in North and South America, Asia, and Europe—have requested, and been granted, Chapter 15 relief. That said, because many of the large multinational groups are based in Western European countries, and those companies have the most cross-border activity with the United States, companies in those jurisdictions have been the most frequent users of Chapter 15. Even companies in proceedings based in the United Kingdom and other common-law jurisdictions such as the Caribbean have been frequent users of Chapter 15, despite legal environments and processes that differ widely. <

EC REGULATION AND CENTRE OF MAIN INTERESTS (COMI)

If a multinational company runs into difficulties, what is the starting point in establishing the place where it must file for insolvency?

Tom Bannister: A multinational company may be able to file for insolvency in a number of jurisdictions. In fact, it may be entitled to file for insolvency in any jurisdiction in which it has an establishment or a place of operations. It is also quite possible for concurrent insolvency proceedings to be opened in a number of different jurisdictions, each with its own distinct—and perhaps contradictory—insolvency laws and procedures. For example, some may be more creditor friendly and others more debtor friendly.

The EC Regulation is primarily intended to coordinate these proceedings among the member states and prescribe which of the proceedings will effectively take precedence as the main proceedings. The starting point under the EC Regulation for determining which proceedings will be the main proceedings will be identifying the jurisdiction in which the company has its registered office.

Why would a company want to file for insolvency proceedings in another jurisdiction?

James Roome: The simple answer is because the registered office may be in a jurisdiction that is not convenient to the debtor as the location of its main insolvency proceedings. There can be several reasons for this.

The first reason may be hostile. Management or an equity sponsor may be trying to protect itself from creditor enforcement actions, in which case France

is often the jurisdiction of choice. The French *sauvegarde* procedure allows lengthy protection against creditor enforcement actions with scant protection against abuse.

Another reason might be that you are seeking to implement a consensual deal but are having difficulty implementing it in a way that binds in 100 percent of creditors. In such a case, you might move to England, for example, which has the scheme of arrangement procedure and the company voluntary arrangement procedure as a means of implementing a deal that has already been reached.

Are there other reasons?

Barry Russell: A third reason may be coordination. You might have a group of companies where one or more is based in one country, and the other companies in the group are based elsewhere. In such cases, it often makes sense to bring them all into the same country so that you have a coordinated set of proceedings in one jurisdiction. Pin Group in Germany is a good example: a Luxemburg holding company whose registered office—its centre of main interest, or COMI—was brought into Germany, allowing a single set of proceedings for the whole group.

What is the basis for establishing the place of the main insolvency proceedings under the EC Regulation?

Natasha Harrison: The starting point is locating the centre of main interests of the debtor. The COMI is presumed to be in the jurisdiction where the company's registered office is located. The presumption that the COMI is in the location of the registered office is however rebuttable, by demonstrating to the court that the centre of the debtor's main interests is actually elsewhere. In this respect, the preamble to the EC Regulation makes clear that the centre of main interests should correspond to the place where the debtor

administers its interests on a regular basis and the importance of the location being ascertainable by third parties, particularly third-party creditors.

What steps are required to move the COMI from one jurisdiction to another?

James Terry: Consider the definition of a debtor's COMI: the place where it conducts the administration of its interests on a regular basis, and that is ascertainable by third parties. Consequently, to move its COMI, the debtor must move the place where the company administers its interests. Of particular importance is the location of accounting and finance functions, where creditor payments are processed, and where the debtor's suppliers and counterparties look to administer their relationship with the company. As this place needs to be ascertainable to third parties, the debtor must write to its creditors and other counterparties to notify them of the change of location.

James Roome: It is far easier to move a holding company, and particularly a letterbox company, than to move an operating company, which will have a history of trading and possibly many employees in its existing location.

How did the European Court of Justice's ruling in the *Eurofood* case impact on multinational group insolvencies in Europe?

Tom Bannister: The EC Regulation's main shortcoming is that it doesn't provide for groups of companies. It looks at insolvency proceedings very much on a company-by-company basis, and unfortunately the *Eurofood* decision didn't improve the situation in that regard. What it did do, however, is confirm the very significant powers that local courts—the courts of first instance—have under the regulation. And, in particular, it confirmed this very important power: If the court of a member state accepts jurisdiction

and opens main proceedings in that member state, then any challenge to that decision to open main proceedings in that member state must be made in that same state. You can't look to review the decision by going to the courts of another member state. There is one possible exception. You may be able to reject recognition on public policy grounds, but *Eurofood* again made clear that a public policy exception has to be very narrowly drawn.

James Terry: That power is important because, in many cases, the English court has been fairly creative in finding arguments for why the centre of main interests of companies, particularly in groups of companies, is in the United Kingdom. We have also seen the French courts being quite forceful about finding jurisdiction for some of their companies. In the *Belvedere* case, for example, the French court found the centre of main interests of all the companies in a large group was in France, based on the fact that the top parent company was French. You don't find that approach endorsed anywhere in the *Eurofood* decision, so while the case was quite helpful, you still have to look at the issue on a company-by-company basis.

Barry Russell: The *Eurofood* judgment was also good news for forum shoppers. It established, as was mentioned earlier, that letterbox companies can very easily be moved because they are not really anchored to any one jurisdiction. That's bad news for Luxembourg insolvency practitioners because most of the LBOs that are running into trouble now have their holding companies in Luxembourg. However, based on *Eurofood*, it should be quite easy to move those to other, more convenient jurisdictions. We have already seen that being done in several cases, including *Damovo*, the computer services business, where that type of shift was accomplished 18 months ago.

Is it possible to commence secondary insolvency proceedings? In practice, is this often the case?

Tom Bannister: Secondary insolvency proceedings can be commenced in any jurisdiction where a company has an establishment, but these must be winding up proceedings. In other words, they cannot be used for the rehabilitation of the debtor. More importantly, the EC Regulation requires that secondary proceedings be coordinated with the main proceedings. In practice, that might mean that a court opening the secondary insolvency proceeding may have to stay those proceedings if requested to do so by the court that opened the main proceedings. To date, the main battles on the EC Regulation have been over the jurisdiction of the main proceedings rather than attempts to frustrate main proceedings by opening secondary proceedings in other jurisdictions.

What rights do creditors gain over debtor assets held in other EU member states under Article 5 of the EC Regulation?

James Roome: This is a sore point. The regulation is very clear. It says that secured creditors' rights over assets outside the COMI jurisdiction are completely unaffected. These include the right not only to have the value of the secured asset, but also the right to actually go in and enforce on those assets. In practice, however, the situation can be quite difficult. In several cases, we have seen that secured creditors have been prevented from enforcing against their rights. For example, bondholders seeking to enforce their security have been met with a series of obstacles following the commencement of *savegarde* proceedings. In some instances, creditors have been unable to accelerate payment of the bond debt. In other instances, debtors have attempted to frustrate security enforcement by commencing secondary proceedings in another jurisdiction. So Article 5 sits badly with the rest of the regulation, and it is not clear how well it will work in practice.

How consistent have the courts across Europe been in finding the location of a debtor's COMI?

Natasha Harrison: Notwithstanding the clear provisions in the EC Regulation and the *Eurofood* judgment, there has been a great deal of inconsistency in terms of establishing COMI—among various jurisdictions, among courts, and as regards distinction between courts and distinction on a case-by-case basis within a particular jurisdiction. The English courts, for example, have been criticised for taking too commercial and too purposeful an approach in establishing where a company's COMI is, and in establishing where the COMI is for the individual members in a group of companies that may be centred in a particular jurisdiction. Other courts have been criticised for taking too great account of particular national or political interests that affect the debtor in question.

What is your verdict?

James Roome: Overall, the EC Regulation has been surprisingly successful. It had fairly modest ambitions as a means of recognising officeholders in insolvencies across Europe, but it has been used very effectively for forum shopping and to manage group insolvencies into a single jurisdiction. These are important successes. The one shortcoming is its inability to have group insolvencies formally recognised, but the courts have done their best to work within the framework, and we are confident the situation will improve. <

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RIDING A FINANCIAL ROLLER COASTER IN THE MEDIA INDUSTRY

BY CARLYN TAYLOR, FTI CONSULTING, INC.

Media executives and investors alike hope they never see another year like 2009. Unlike the airline, auto, and retail industries whose executives and investors are used to the boom and bust impacts of the business cycle, the modern media industry has never experienced a wave of financial restructuring, let alone the tidal wave that was 2009.

The media industry has prospered for decades off a steadily increasing consumer appetite for media, expansion in the types of delivery mechanisms for media's content (e.g. internet, mobile) and healthy advertising markets which dipped in prior recessions but always bounced back quickly. Only once since the Great Depression had the US advertising market experienced two years in a row of revenue declines, and that was more than 30 years ago during the 1974-75 recession. Sure the internet bubble in display advertising was a bit painful, but that crisis passed quickly and primarily impacted internet advertising, which was still in its infancy at that point.

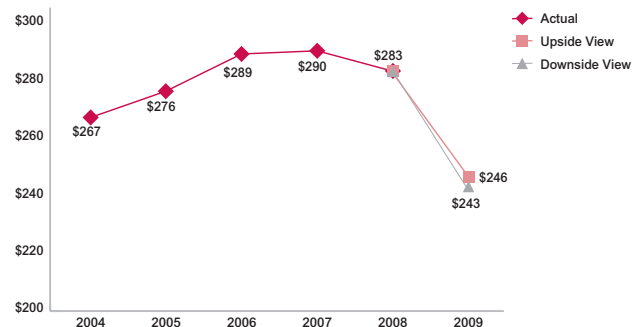
The years 2004 through 2006 were off-the-charts boom years in the US media market, due to the combination of strong positive revenue growth and easy credit markets with low interest rates. Based on FTI research, the entire US advertising market grew from \$267 billion to \$289 billion from 2004 to 2006, a CAGR of 4%. Even the newspaper industry, roundly maligned during this 2008/09 recession as a potentially dying medium, put up positive revenue growth in all of those years. Healthy revenue growth created extraordinary cashflow growth. Since costs in the media industry are largely fixed in nature, a phenomenon we call high operating leverage, revenue growth dropped almost entirely to the bottom line. Furthermore, the media industry has much lower capex requirements than most other industries do and relatively low R&D expenditures, improving cash flow even more.

Wall Street sat up and took notice. The media industry was a magnet for investors, private equity, and bankers alike. M&A activity flourished, and talented management teams led rollups and to consolidate smaller, private local media companies into regional and national public companies. Supported by high cash flow generation and ever increasing trading multiples, conventional wisdom in the capital market said that these companies would be able to grow, refinance or IPO their way out of their new balance sheets. Up through 2007, numerous media companies gorged on the cheap credit available in the senior secured market, pushing secured leverage levels far beyond the historical 7.0x "maximum financeable" debt levels of the 1990's. The new debt generally came with liberal, issuer friendly terms including "covenant lite" and "PIK toggle" structures. While LBOs occurred across numerous sectors, media was a favored target, with large LBOS closing in radio, TV, and newspapers. Approximately \$89 billion in media buyouts occurred between 2005 through 2007, leaving many companies saddled with huge debt loads, much of which will mature over the next few years¹.

Alas, many investors in the media industry were distressed to find that operating leverage is brutal when it works in the opposite direction. Although sensitivity models had dealt with 3-8% declines in advertising revenues, the most ever seen in prior recessions, no one was prepared for

the Great Recession and its impact on the media industry. As the Charts 1 & 2 below show, FTI's latest forecast for 2009 estimates that the US advertising market dropped almost 15% in 2009, after a 2.7% decline in 2008. Some media sectors were hit much harder than others. Newspapers suffered through 25-30% year over year declines in advertising revenues in the first three quarters of 2009, radio 15-25% declines, yellow pages 20-25%, magazines and other print publications 15-25%. FTI expects all sectors to report substantial improvement in the year over year declines in 4Q09, but this is partially a reflection of the fact that 4Q08 was the first full quarter after the now infamous events of September 2008 and the associated stock market crash.

1. US Ad Spend (\$bn)



2. Growth Rates in US Ad Spend (%)



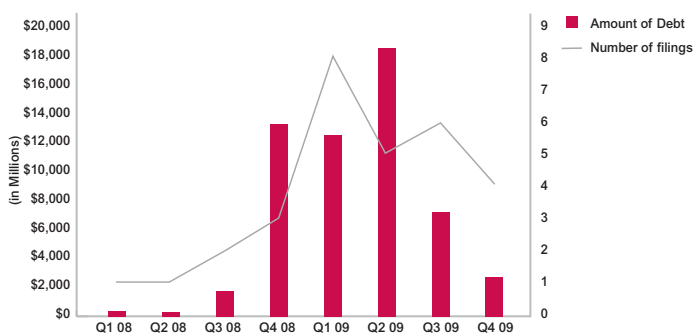
At this time last year, the media industry was gripped by a sense of panic. For example, in early 2009, S&P projected that nearly 90% of the 263 rated media and entertainment companies were at risk of default during the upcoming year². This took our collective breath away. Fortunately, the prediction turned out to be an overly pessimistic view.

¹Bloomberg "Tribune Bankruptcy May Signal Distress for Media-Company LBOs" Dec. 2008

²Wall Street Journal, "Wave of Bad Debt Swaps Companies", Feb. 13, 2009.

Yes, 2009 saw a tidal wave of restructurings in the media industry, both in-court and out-of-court – but not 90%. FTI research shown in Chart 3 shows that Chapter 11 bankruptcy filings first spiked in the fourth quarter of 2008 and remained elevated through the second quarter of 2009. In 2009 there were 23 traditional media bankruptcy filings which impacted nearly \$39 billion of debt, versus 7 filings in 2008, which impacted slightly less than \$16 billion of debt. We have not attempted to measure all the out-of-court restructurings, but based on the dozens of such deals in which we ourselves were involved during 2008 and 2009, we believe the volume was almost as high as those companies which ended up in Chapter 11.

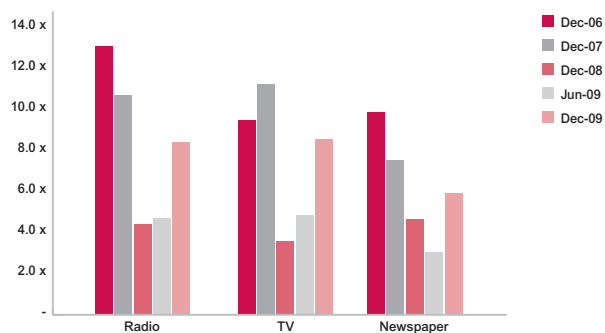
3. U.S. Media Bankruptcy Filings in 2008 & 2009 (by quarter)



Note: Companies included had pre-petition assets of at least \$50 million
Source: BankruptcyData.com, Debtwire, Capital IQ and PACER.

To illustrate the roller coaster in enterprise value (EV) multiples of EBITDA, FTI tracked a group of public companies in radio, TV, and newspapers as shown in Chart 4. Our enterprise value calculations are based on the market values of debt plus equity, illustrating the roller coaster in valuations reflected in both the debt and equity markets from the end of 2006 through the tumultuous year of 2009.

4. EV / EBITDA Multiples



Source: FTI research. Note: Radio includes: ROIAK, EMMS, CCMO, CMLS, CDL, EVC, ETM, RGCI, SGA, BBGI, SALM, and SBSA. TV includes: NXST, SBGI, TVL and GTN. Newspaper includes GCI, SSP, WPO, NYT, MNI, LEE, JRN, GHSE, MEG and AHC.

We Are Heading Toward a New “Normal” in Media Finance and Operations

As Chart 4 shows, there was a significant bounce back in media valuations by the end of 2009, a truly remarkable turnaround from the valuation levels in 1Q09 and 2Q09, when the industry hit bottom from both a revenue and valuation standpoint. Despite the terrible operating trends through most of 2009, large media companies that were able to survive through 2009 now seem likely to avoid, or at least delay, a major debt restructuring or possible Chapter 11.

As confidence rises that the US is emerging from the Great Recession, the high yield markets have recently come to the rescue of many companies, particularly ones with the lower starting leverage levels and/or the top notch management teams who have demonstrated an ability to cut costs in the face of dramatic revenue declines (e.g. Gannett and McClatchy). In 2009, there were nearly \$12 billion in high-yield bond issuances, a 24% increase over 2008. This compares to approximately \$6 billion of leveraged bank loans in 2009, a 78% decrease over 2008. Clear Channel Outdoor Holdings, Sinclair Broadcasting Group, Salem Communications and Nexstar Broadcasting all accessed the high yield market in 4Q09, to reduce pressures from senior secured creditors. With borrowing costs for high-yield companies falling in December 2009 to their lowest point in two years, FTI expects that high-yield issuances will continue to be a popular source of capital for media companies in 2010.

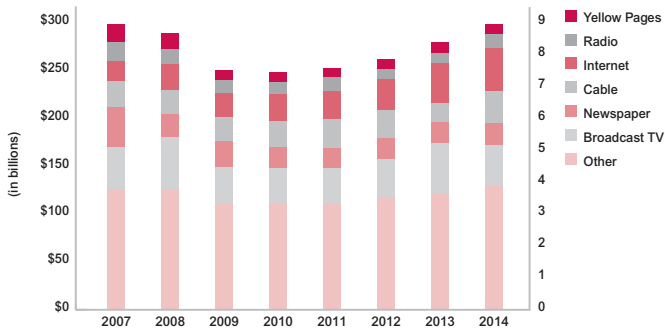
Although the wave of bankruptcy filings may have receded in the last few quarters and high-yield investor risk appetite appears to have returned to the market, the media sector is not out of the woods. The high yield markets may provide temporary liquidity by reducing senior secured debt and pushing out debt maturities, but traditional media companies are still facing a range of secular pressures, which combined with high leverage levels, will plague the industry for years to come.

Media companies are faced with an advertising market that is approximately 17% below its 2007 levels and little prospect to recover those lost revenues anytime soon. FTI’s proprietary statistical forecasting model of the US advertising market projects that continuing high unemployment, depressed real business investment levels, and the negative effects of digital substitution will give rise to a slow recovery in overall advertising spending. This, coupled with the ongoing secular declines caused by the internet and ongoing dilution from ever increasing media outlets, such as the growth in cable and satellite channels, satellite radio proliferation, and new distribution methods like mobile, will further mute the advertising recovery in any one segment. Our research shows that expenditures on internet advertising are cannibalizing traditional media at a 3:1 rate, meaning that when advertisers move dollars away from traditional media to internet advertising, they spend only 1/3 as much, putting downward pressure on the entire advertising market.

For 2010, FTI’s research predicts the largest ad revenue declines will be seen in newspapers (14%), yellow pages (8%) and radio (2%), as shown in Chart 5 below. Further, FTI does not believe that total advertising spend, even in nominal dollars, will return to 2008 levels (of \$284 billion) until 2014.

RIDING A FINANCIAL ROLLER COASTER IN THE MEDIA INDUSTRY

5. Historical and Projected Advertising Spending by Media



Source: FTI Consulting forecast

A further complication for still over-levered media companies is that most “low hanging fruit”, in the way of cost cutting and improved efficiency, has already been picked, leaving more challenging approaches to grow revenue and margins again. Throughout 2009, media industry executives have slashed costs through layoffs, furloughs, organization restructurings, and reductions in capital expenditures. Media operators will need to turn their attention to top-line advertising revenue growth and more creative ways of cooperating with competitors. This means challenging all of the traditional “normal” assumptions of how a traditional media company operates its business, including exploring new sales channels and approaches, sharing content with previously reviled competitors, building direct audience relationships, sharing infrastructure, leveraging new technologies, etc. Being a maverick will be particularly difficult, and “coopetition” (teaming with competitors), will be part of the “new normal.” We believe some of this is occurring in earnest under many talented management teams, and the carnage of 2009 has allowed drastic and rapid changes that less volatile markets would not have produced in a decade of the prior normalcy. For example, many newspapers are eliminating separate operating units for each paper and moving to centralized management. With significant media debt maturities in the next decade, time is of the essence.

FTI believes that continued pressures to deleverage and meet maturities should result in increased M&A activity in 2010 as traditional media companies try to consolidate their way out of their problems. While additional consolidation may be complicated by FCC ownership limitations, the recent economic downturn, combined with new delivery technologies, should be a catalyst for changes in cross ownership limitations. We sincerely hope that the FCC and the Obama administration can find some pity for traditional media and allow logical M&A to proceed without the laborious and costly delays that were so typical of the last decade. The ubiquitous nature of the internet and mobile devices like the iPhone render any notion of “market power” in a “local media market” almost a meaningless concept. Put another way, the internet has provided a whole new competitive delivery mechanism to ensure media diversity and freedom of information. It’s time for the government to pave the way for a return to stability and help usher the media industry into the 21st century of media ubiquity.

Looking to the coming year, Fitch Ratings recently reported that the credit outlook for the media and entertainment sector in 2010 will be stable with ad prices firming. In recent weeks some media companies have announced upward revisions to their forecasts. Gannett Co. recently stated that it was comfortable with the high end of its fourth quarter guidance. The New York Times Co. also said that the drop in advertising revenue will not be as severe in the fourth quarter as it was earlier in the year, and online ad sales are once again increasing.

The tidal wave has reached the beach, but smaller waves behind it are still in the water.



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- Out-of-court restructurings

Special Situations Capital Raising

- Debtor-in-Possession Financing
- Exit Financing
- Rescue Financing
- Refinancing
- Private Financings

Distressed M&A

- 363 Sales
- Complex Divestitures
- Stalking Horse Transactions
- Credit Bid Acquisitions

Strategic Alternatives Assessment

- Transaction Optimality Determination
- Business Plan Assessment
- Liquidity Forecasting
- Managerial Metrics

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GROUNDHOG DAY

BY: MICK SOLIMENE, WILLIAM MALCZYK, ANDREW KROP, MACQUARIE CAPITAL (USA) INC.

Introduction

In the 1993 movie *Groundhog Day*, Phil Connors, a local weatherman, is trapped in a time loop, awaking each morning in the same place he began. Though the events of each new day change to reflect Phil's behavior, all is reset the next morning, and the cycle begins again. Looking back on a chaotic, paradoxical market cycle, distressed investors are entering 2010 with the sense that success will be driven by fundamental credit analysis rather than opportunistic timing. Longer term, signs have emerged that some of the excesses from the last credit cycle are repeating themselves, and investors may find themselves living their own version of *Groundhog Day*.

At its peak, the recent LBO boom tolerated exceptionally high leverage multiples, loose lending standards and borrower friendly credit structures. Leveraged loans traded near par and the world was rosy with low default rates and a strong economy. Successful distressed investing in 2007 was difficult, demanding a good eye and a disciplined credit approach to achieve outsized returns.

Fast-forward to the second half of 2008 with the deteriorating economy driving corporate write-offs, record losses, layoffs and comparisons to the Great Depression. Default rates spiked and secondary debt prices plummeted. Pundits and prognosticators alike declared that most investors had been so badly burned by the shocks of 2008 that there had been a conservative shift in the way that individuals and institutions would invest and lend for the foreseeable future. The nation's insatiable appetite for risk, they predicted, had been sated.

The events of late 2009, however, have proven these predictions to be overstated. Weak macro fundamentals have been propped up by fiscal stimulus, targeted spending incentives and Federal Reserve action, which helped liquidity return to the market. Beginning in March 2009, a rally emerged in both the debt and equity markets, with distressed investors earning outsized returns through opportunistic investments. Macroeconomic doomsday scenarios took a back-seat to discussions on the shape, strength and timing of the recovery. Deal structures and products that epitomized the frothy peak have begun to creep back into the market.

Faced with an ever-repeating cycle in *Groundhog Day*, Phil Connors responds in a variety of ways. Only at the end of the film, once Phil approaches his predicament as an ongoing opportunity, is he able to begin another day. The 2008 collapse of the credit markets provided a deluge of distressed opportunities providing exceptional returns for those bold enough to call the bottom. With the run up in asset prices slowing and distressed loan prices stabilizing, fundamental credit analysis will again be the determining factor of success. Looking beyond 2010, the recent reappearance of borrower-friendly credit structures may provide more distressed inventory as today's aggressive deals become tomorrow's distressed credits.

Cycle

To appreciate what is in store for the next twelve months, it is helpful to recall how we arrived at this point. Early 2007 capped off the greatest M&A boom in history. Private equity-sponsored mega-deals dominated the market, employing substantial leverage and aggressive covenant-lite and PIK-toggle structures. The first six months of 2007 witnessed three of the largest LBOs of all time, TXU, First Data and Equity Office Properties, with experts speculating as to when the first \$50 billion deal would occur.

For Phil, the weather changes and a severe winter snowstorm cuts off all available exits, trapping him in the same town overnight. This market exuberance trapped traditional investors with a market correction that was as sharp in decline as the credit boom was in ascendance. Mounting job losses, housing foreclosures and company failures perpetuated the negative sentiment, driving the Consumer Confidence Index to an all time low of 25 in February 2009. "Too big to fail" and "moral hazard" became punch lines in a macabre joke. The world was viewed with significant fear and trepidation; asset prices plummeted, creating an abundance of distressed investing opportunities.

With strong government support and some signs of economic recovery, pessimism turned to cautious optimism, evidenced in the recovery of equity and debt pricing. Equity markets experienced a sustained rally beginning in March 2009 with the S&P 500 yielding nearly 60% for the ten months-ended in December 2009. Debt markets also turned around, with the LSTA Leveraged Loan Index gaining 52% in 2009 compared to a loss of 29% in 2008. The gains of CCC rated loans, the very securities that suffered tremendous losses as the downturn unfolded, have led the recent rebound with 2009 gains of over 88%; opportunistic players willing and aggressive enough to invest in the face of a precipitous decline reaped tremendous rewards.

Going forward

As we look at the credit markets in 2010 it feels like the groundhog won't see his shadow, thereby signaling an early spring and an end to winter. Since the second half of 2009 we have seen a revival of merger activity for both strategic and financial buyers: Disney's \$4 billion purchase of Marvel Inc., Stanley Works' \$4.5 billion purchase of Black and Decker Corp., and Berkshire Hathaway's \$26.4 billion purchase of Burlington Northern, signaled an improving atmosphere for buyouts. There are also recent deals that demonstrate just how far the credit markets have rebounded: Carlyle-sponsored Booz Allen Hamilton's recent \$350 million dividend recap, and TPG Capital's \$4 billion buyout of IMS Health (~7x Debt/LTM EBITDA). These deals show that the tolerance for risk is increasing. As distressed investors know, today's aggressive deals are tomorrow's distressed inventory.

How, then, should one respond to restarting the cycle? At first, Phil responds with bewilderment and despair. His actions reflect a hopelessness and inability to take advantage of the situation. As days go by, however, Phil recognizes the cycle for the opportunity that it is, and begins to change his approach.

Looking at the default rate for 2010, S&P forecasts default rates to reach approximately 6.9%. While historically well above average, this prediction is significantly below the 2009 default rate of approximately 11%. This lower default rate will limit the supply of distressed inventory, with quality opportunities becoming harder to find as more investors seek outsized returns from this asset class. 2010 will remind us of the benefits of disciplined credit analysis and event-driven investing.

Conclusion

The progression of events over the past 24 months has devalued the utility of the word “unprecedented”. For Phil, the world had gone absolutely crazy. Time keeps repeating itself, and the people around him are oblivious to the repetition. To the rest of the world, Phil is the crazy one. His seemingly senseless and increasingly desperate behavior is unexplainable. The events and lessons of Groundhog Day are all about perspective.

In 2009, opportunistic timing for those bold enough to pick the bottom helped drive strong returns for distressed investors. Distressed investing in 2010 looks to be more challenging, considering the recent run-up in pricing of leveraged loans, coupled with a diminished supply of credits to choose from. Investors will need to look deeper into companies to find quality investments to achieve outsized returns.

Looking beyond 2010, it is still too early to tell if there has been a full revival of the most aggressive credit boom structures and attitudes, however the reappearance of easing credit suggests that bad habits are hard to break. The door has opened for more deals with credit structures that investors “would never see again in their lifetimes”. Covenant-lite, PIK toggles and dividend recapitalization loans are still being printed with leverage multiples gradually ticking higher. Distressed investors who learned from the past cycle will be well-positioned to exploit the opportunities to come.

Last year’s weather has certainly changed going into 2010. However, like Phil, distressed investors may get another chance at the cycle. If we continue to see the recent structures with weaker credits we will no doubt be looking at a time loop of the past. Haven’t we seen this movie before?

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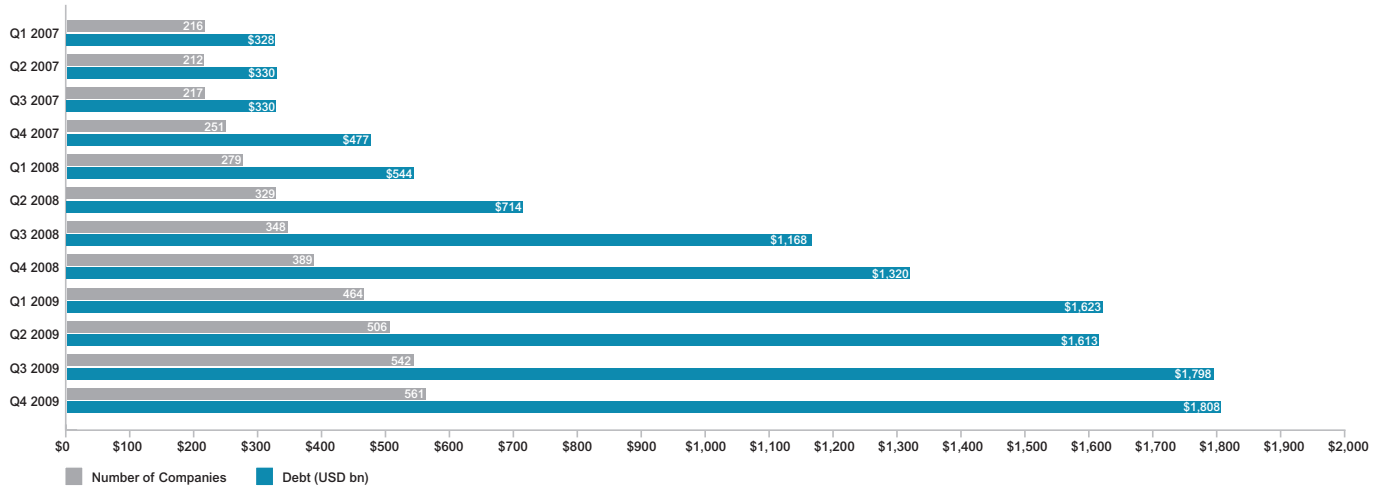
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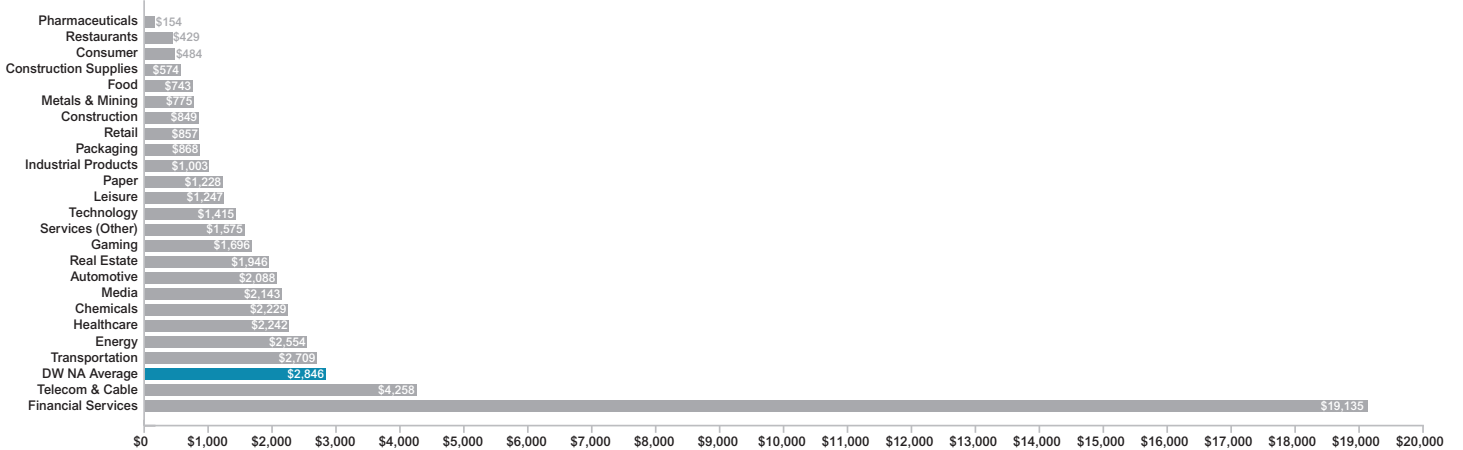
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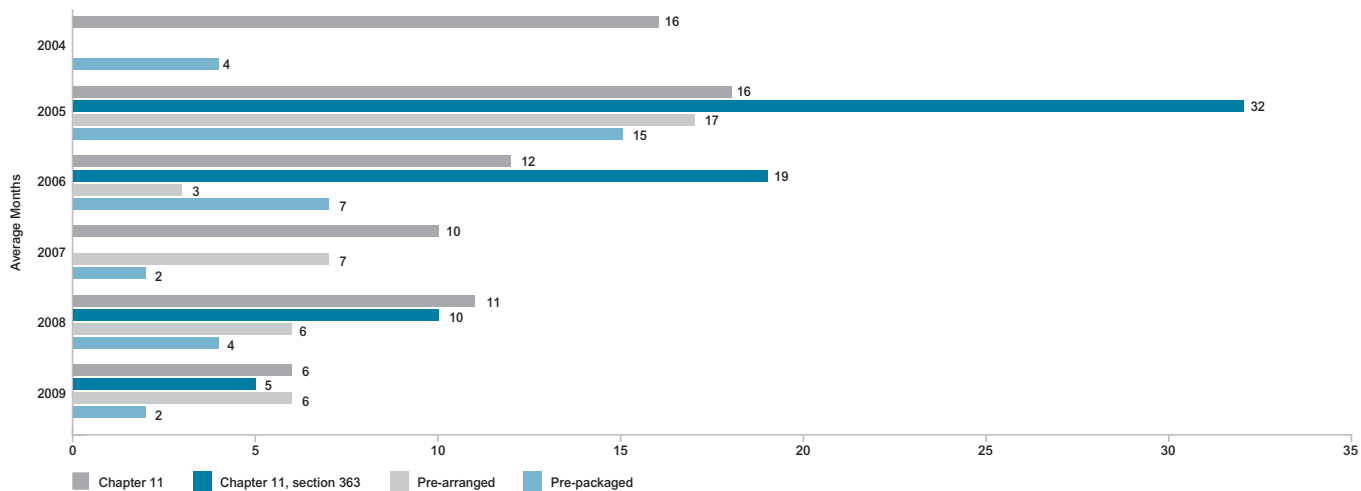
Quarterly, 2007 to 2009



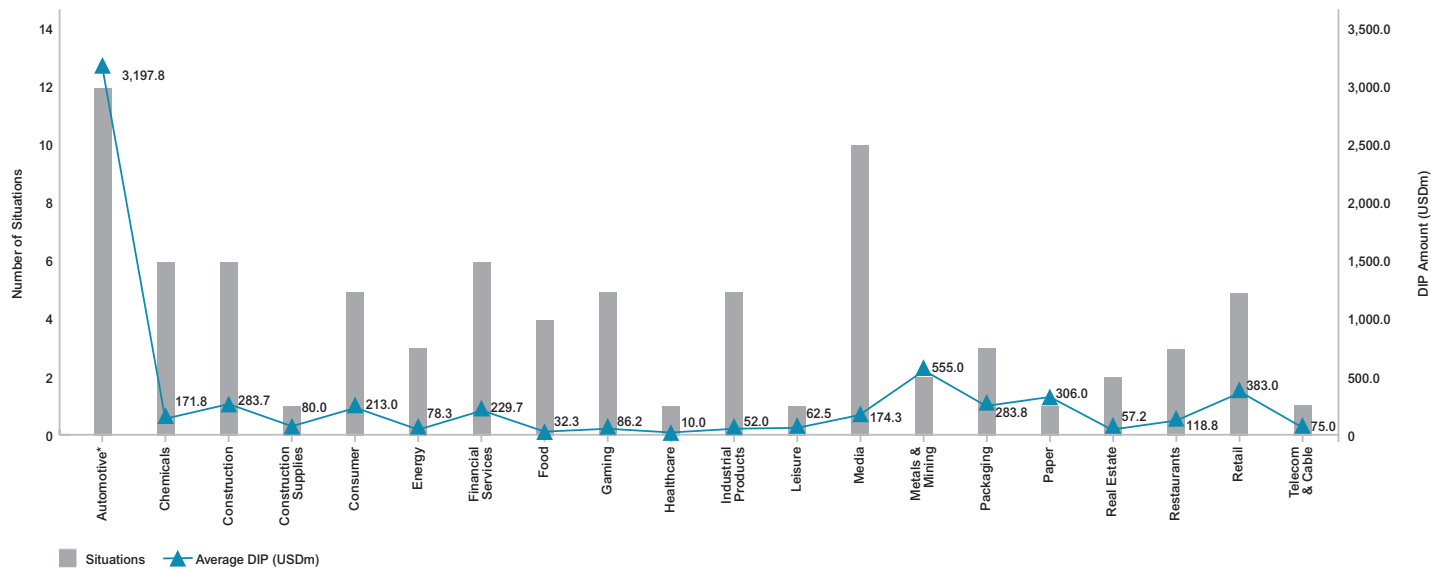
Average Debt per Company in each Sector Covered (USD m) as of 8 January 2010



Length of Bankruptcy Cases Covered by Debtwire North America



Average DIP loan per Industry (2008 - 2009)



* The "Average automotive DIP data" is highly skewed due to General Motor's USD 33.3bn DIP loan from the US Treasury Department.

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