DEBTWIRE

EUROPEAN DISTRESSED DEBT MARKET OUTLOOK 2010

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CADWALADER FTI ROTHSCHILD

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FOREWORD

Welcome to the European Distressed Debt Outlook 2010, which Debtwire is delighted to present in conjunction with Cadwalader, Wickersham & Taft LLP, FTI Consulting Inc. and Rothschild.

In early 2009, the impact of the global credit crisis eventually spilled over from the financial sector into the real economy. Corporate activity slumped dramatically and over-leveraged businesses acquired during the boom years came under severe financial pressure due to reduced consumer demand. Banks and loan investors struggled to cope with the sheer number of debt workouts and demands for emergency funds.

Just twelve months later, the landscape looks markedly different. Capital markets have rebounded strongly, buoyed by real money demand chasing yield in a low interest rate environment. The dash for juicy yields has intensified in the first two weeks of 2010, but the onus is on the renascent high yield market to overhaul bloated and top-heavy corporate debt structures.

The challenge for distressed investors in 2010 will be to find value in this rapidly moving market. Recovery in corporate earnings has yet to match the improvement implied by surging debt prices and liquidity in the secondary market remains poor. The survey suggests many will be passive in their approach, hoping to be lifted by the rising tide of asset price recovery.

Last year began with a number of private equity sponsors seeking to impose aggressive financial restructurings on their portfolio companies, amid bank lenders' inability to provide fresh funds. As the year progressed, lenders' appetite for taking control increased, and PE sponsors were forced to take a more conciliatory approach.

In many cases, bank and CLO investors were unwilling to countenance significant write-offs, leading to a number of 'zombie' credits carrying higher than optimal levels of post-restructured debt. However, defenders claim that this is the lesser of evils, as lenders can afford to wait for earnings and valuation multiples to return to normal so long as the company has enough liquidity and can service its debt.

With the number of urgent workout cases on the wane, private equity sponsors turned towards the healthier parts of their portfolios.

Keen to capitalise on better performing investments and avert covenant pressures on the underperformers, sponsors issued a raft of IPO and covenant amendment requests during the second half of 2009. The monetary cost in securing amendments has steadily risen, as lenders push for better terms, arguing that deals should be re-priced to reflect increased risk and primary pricing.

Survey respondents also noted that the leveraged loan market is set to return in 2010, albeit at issuance levels of less than 30% of the 2007 peak. Seasoned market professionals are already looking further ahead, with significant leveraged loan maturities due in 2012 and 2013.

Debtwire's European Distressed Debt Market Outlook report presents detailed results of a survey canvassing 100 distressed market participants on their expectations for the coming year. This edition, the sixth, includes responses from private equity firms, as well as views from a select number of banks, and the perspective of company managers undertaking financial restructurings in the last 12 months.

KEY FINDINGS FROM THE SURVEY INCLUDE THE FOLLOWING:

- The majority of respondents expect the European restructuring peak to arrive during the first half of 2010, with covenant resets/amendments and debt buybacks set to dominate market activity.
- Most investors anticipate 10%-20% of leveraged buyouts to be restructured in the next twelve months, with the UK, Germany and Spain the most active geographies. Property/Construction, Media, Leisure, and Auto/Auto parts should offer the greatest opportunities for distressed investors.
- Senior debt remains the most attractive debt instrument, but the re-emergence of the high yield market has consolidated its second place amongst investor preferences.
- Investors are more cautious in their return assumptions, with the majority expecting 10%-19% returns in 2010, compared to 20%-25% on average in last year's survey.
- Private equity respondents consider over-leveraging the most likely trigger for restructurings of their portfolio companies, while only 20% of sponsors picked overall economic decline as their first choice.
- The key challenge for company managers during the restructuring process was securing a consensus from disparate lender groups in an environment where value broke high in the senior debt. PE sponsors remained supportive despite, in many cases, facing the imminent loss of ownership.

Debtwire, Cadwalader, Wickersham & Taft LLP, FTI Consulting Inc. and Rothschild would like to thank all the respondents who took time to contribute to what we believe is the definitive market outlook for distressed players in Europe. Any feedback you may have on this year's research would be welcome, as would comments and suggestions on what you would like to see in future editions of the report.

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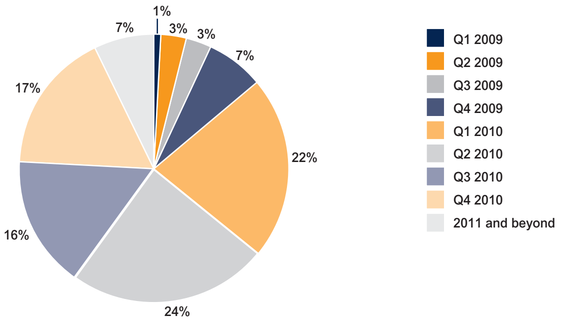
DISTRESSED INVESTOR SURVEY

In October and November 2009, Debtwire canvassed the opinion of 100 hedge fund managers, long only investors and prop desk traders in Europe. Interviewees were questioned about their expectations for the European distressed debt market in 2010 and beyond. The interviews were conducted over the telephone and respondents were guaranteed anonymity.

1(a) When do you expect the volume of European restructurings to hit its peak or has this already happened?



- Almost half of the respondents (46%) expect the peak of European restructurings to arrive during the first half of 2010. The survey findings may come as a surprise to some restructuring professionals. Many advisers believe we may have already seen the peak, reporting a tail-off in new transaction activity during the last quarter. Other advisers anticipated a busy Q1, and there has been some resurgence of activity in the first few weeks of the new year. However, the data may reflect anticipated completion dates and the realisation that existing transactions could take a long time to close.

"I agree with survey participants, not other advisers, on this topic. Peak European restructuring volume lies ahead, not behind us. Government support of financial institutions, massive liquidity injections and low interest rates have delayed, but can't indefinitely avoid, long overdue deleveraging in the private sector."

Richard Nevins, Cadwalader, London

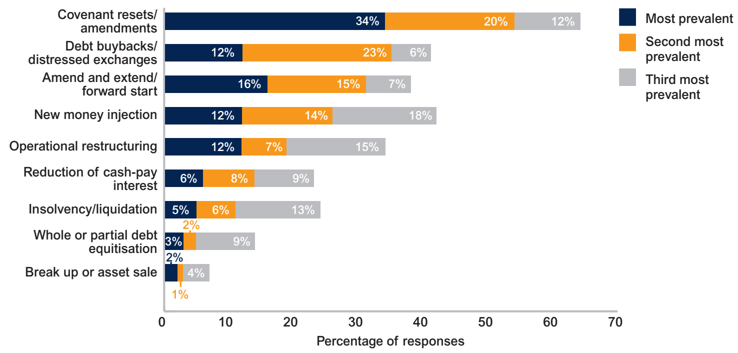
"2009 was the year banks worked hard to keep par assets and avoid capital write-offs. By autumn, secondary prices had risen sharply making sell-offs more attractive for banks."

Sophie Javary, Rothschild, Paris

"I expect further restructuring will be triggered in 2010 due to an increasing amount of debt maturities and amortisations, expiry of temporary 'fixes', ever tightening covenants and cash requirements as working capital releases and cash reserves dwindle."

David Morris, FTI Corporate Finance, London

1(b) What forms of restructuring do you expect to be most prevalent in 2010? Please choose the top three.



- Equitisations are so 2009. Investors cite covenant resets/amendments as most prevalent in 2010, confirming lender appetite for full-blown restructurings are on the wane, with debt-for-equity swaps coming in a lowly eighth place. With a large proportion of lenders unwilling to countenance debt write-offs, equity sponsors are expected to table a plethora of liability management proposals next year.

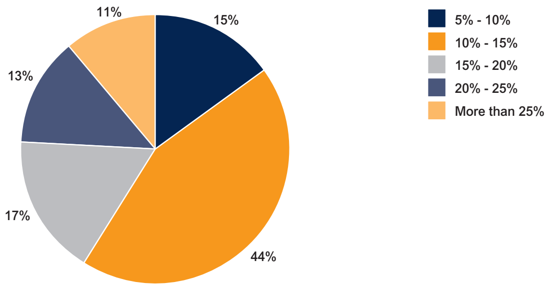
"The distressed community appears to anticipate a contentious year dealing with debtors. A large proportion of lenders are unwilling to countenance debt write-offs, yet respondents believe debt buybacks and distressed exchanges, which often propose a reduction in original principal amount, will be the second most prevalent restructuring tactic in 2010."

Richard Nevins, Cadwalader, London

"The problem with amend and extend solutions is that it just delays the day of reckoning. It is a leap of faith and does nothing to remedy the fundamental problem: too much debt. Unless this is solved, the pain is merely prolonged and struggling companies limp along in an uncompetitive fashion."

Shaun O'Callaghan, FTI Corporate Finance, London.

2(a) What proportion of leveraged companies do you believe are likely to face restructurings in 2010?

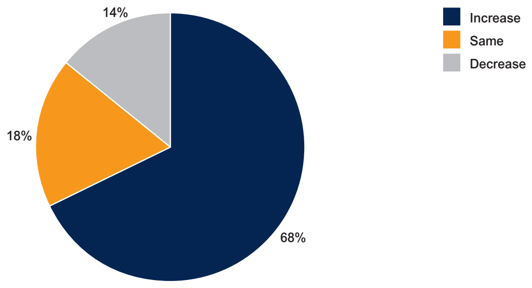


- Most investors (61%) anticipate just 10%-20% of LBOs to be restructured in 2010. With respondents forecasting a restructuring peak during the first three quarters of 2010, the implication is that a large proportion of leveraged deals will remain unaffected despite the worst default cycle in over a decade.

"The percentage of leveraged companies requiring restructuring is likely to be high as many LBO structures were predicated on increasing profitability and three to five year exit expectations. Given current market conditions, profitability targets are increasingly challenging and exit routes, both recaps and secondary buyouts, are no longer viable. The timing of the restructurings is likely to be driven by two factors, firstly the 'burning platform' of either cash availability, reporting requirements or the impact of the balance sheet on trading; and secondly, the stakeholders' collective appetite or capacity to proactively enter into the restructuring process."

David Morris, FTI Corporate Finance, London

2(b) Is this an increase or decrease from 2009?

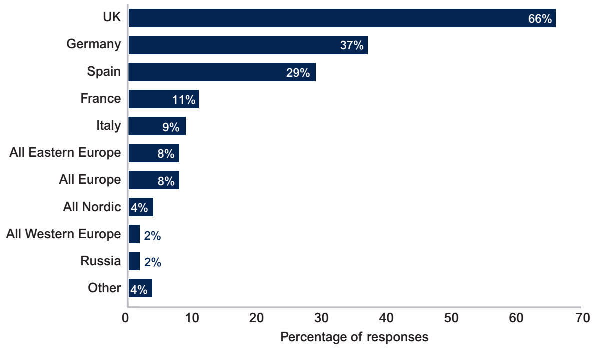


- A large proportion of respondents expect the volume of restructurings to increase this year. This implies less than 15% of LBOs in total were restructured last year.

"The outlook for the consumer and economy will drive a lot of sentiment in 2010. Heavy government debt burdens are likely to reduce public spending and increase taxes. Some demand assumptions in leveraged business plans may never be achieved."

Shaun O'Callaghan, FTI Corporate Finance, London

2(c) In which countries/regions do you expect these restructurings to take place?



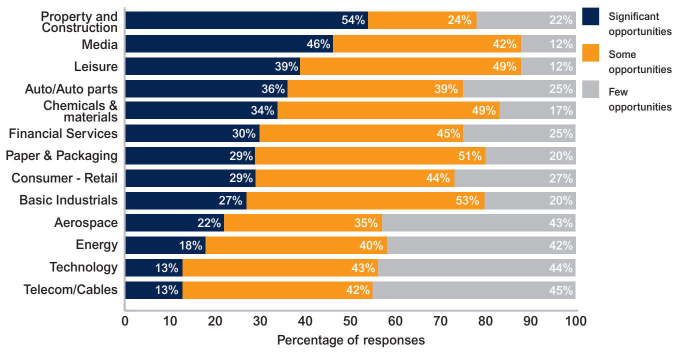
- The top three picks mirrored the geographies chosen as those offering the best opportunities by respondents.

"Spain has been more resilient than many expected – the strong capitalisation of the banks may have helped, but we expect more restructurings in 2010."

Beltran Paredes, Rothschild, Madrid

DISTRESSED INVESTOR SURVEY

3. Please rate the following in terms of the opportunities they present for distressed investors in 2010:

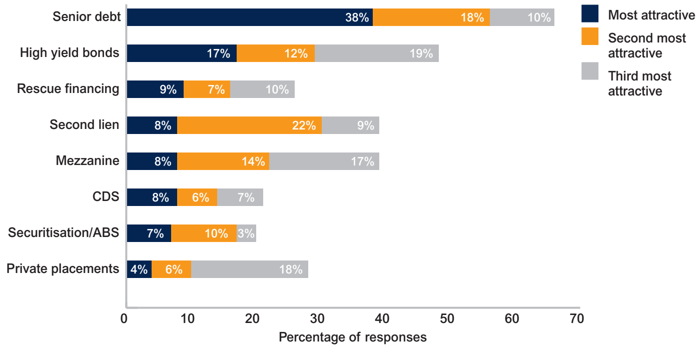


- Not unsurprisingly, the Property and Construction sector was identified as having the most distressed opportunities for the second year running, with 53% of respondents opting for this sector. During 2010, investors see more opportunities within Leisure and Media, placing second and third with 39% and 45%, respectively.
- Flavours of the month: Automotive and Chemicals remain popular amongst investors, whereas Financial Services and Consumer Retail segments have slipped down their preference lists. Respondents expect sectors carrying the highest leverage to offer the best opportunities. Industrials rate lower than last year, as investors believe the economic recovery is now underway. Sectors subject to discretionary spending score highly.

"A number of sectors and individual companies have the opportunity to become more attractive and valuable in 2010. However, this will often require some capital to be spent. Investors, including the new owners following a debt/equity swap in 2009, may find management knocking at their doors for investment capital."

Kevin Hewitt, FTI Corporate Finance, London

4(a) Please rank the three product categories that you think will offer the most attractive investment opportunities in 2010:



- Insecurity: Senior debt at 38% remains the most attractive investment for distressed funds, but its lead over other asset classes has narrowed significantly since last year's survey, when it grabbed 68% of first choice votes.
- The re-emergence of the high yield primary market has consolidated its second place (17%) showing amongst investors. It is worthwhile mentioning that much high yield issuance this year has been secured. Second lien and mezzanine rate highly as alternative choices, despite producing poor recoveries for investors in 2009 restructurings.

"UK landmark deal IMO Carwash really changed the market. Although largely confirmatory legally, it has sounded the buzzer for junior lenders who are now significantly more proactive, to be part of the solution."

Andrew Merrett, Rothschild, London

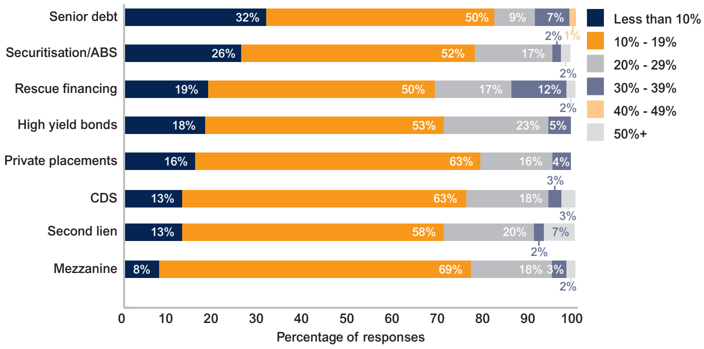
"The window of the HY bond market may resolve immediate refinancing issues for some borrowers, but will not be available for the most highly geared credits, which will still require restructuring. And when quantitative easing is stopped, much of this liquidity may dry up."

Alistair Dick, Rothschild, London

"Greater stability in the market has reintroduced mezzanine debt in many circumstances, back into, or near, the money. However, mezzanine lenders compete with sponsors to provide new money and senior banks seem to continue to prefer to work with existing sponsors wherever possible."

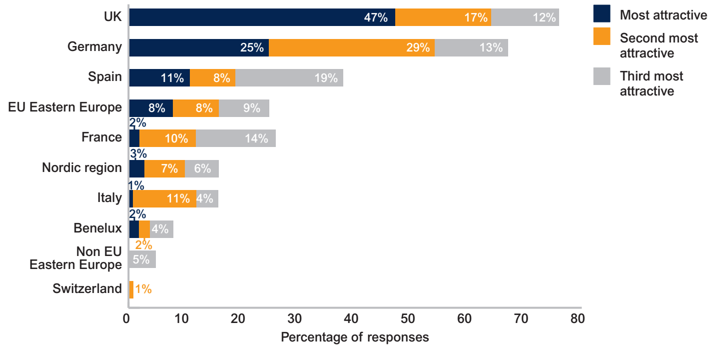
Simon Granger, FTI Corporate Finance, London

4(b) What returns are you targeting for each of these asset classes in 2010?



- Distressed funds, in general, posted strong performance during 2009, and, as a consequence, many have tempered their expectations for 2010. The vast majority of respondents forecast returns in the teens next year, with little differentiation amongst asset classes in their assumptions. In last year's survey, respondents were more optimistic, targeting 20%-25% returns. The sharp rally in secondary debt prices during the second half of 2009 has reduced the room for further upside during 2010.

5(a) Which European countries do you think will produce the greatest opportunities for distressed investors in 2010? Please choose the top three.



- The UK remains the jurisdiction of choice for distressed investors, retaining its number one position, but Germany has closed the gap compared to 2009. In total, the UK polled 47% of first choice votes, down from 68% last year. Enthusiasm for Spain has diminished whereas EU Eastern Europe has now usurped France, Scandinavia and Italy in investor affections. This is partly due to more attractive valuations, and concerns over legal jurisdictions in the Latin countries.

"Germany is lagging the UK by at least six months, so this past autumn has seen a number of corporates needing to renegotiate with lenders."

Heinrich Kerstien, Rothschild, Frankfurt

"Sauvegarde is becoming a more familiar process on the French landscape. Creditors still need to adapt their strategies to expect boards to use Sauvegarde more actively. The Thomson deal could be a watershed."

Sophie Javary, Rothschild, Paris

"Spain has been one of the hardest hit Eurozone economies, not least due to the significant boom in residential and commercial property construction, which became one of Europe's largest busts. With unemployment due to hit 20% in the short-term and consumer confidence at historical lows, there are few signs of the Spanish economy picking up in the near future. 2010 will see growing numbers of bankruptcies and restructuring in areas of economic activity other than real estate, which has hogged the limelight in 2008/9. The public debt (central and regional governments combined) is ballooning and there is limited scope for additional fiscal stimuli such as those seen under 'Plan E' in 2009. Positive GDP growth may make a timid return in late 2010."

Colin Blessley, FTI Corporate Finance, Madrid

5(b) Can you identify the factors driving this?

- Most respondents cited macroeconomic factors as their main investment criteria. The UK is heavily exposed to the financial service sector, and the drop in Sterling continues to weigh upon consumer demand. The sheer number of over-leveraged companies in the UK, many of which sit on the books of nationalised banks, should provide rich pickings for distressed investors in 2010.

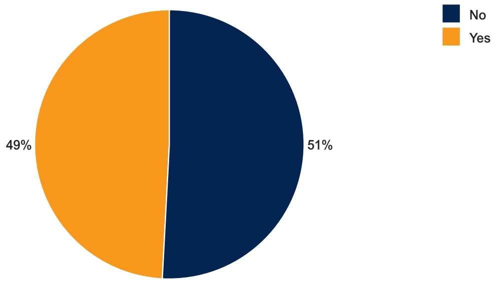
  The over-valued Euro is expected to adversely impact Germany given its export-driven focus, and Europe's largest economy has the largest number of LBO deals outstanding. On the flip side, a number of investors believe Germany is the best place in which to ride the expected economic recovery.

  Spain's disproportionately large construction and real estate sector will continue to weigh on its economy and impact consumer demand. However, the attitude of Spanish banks towards restructurings and its perception as a creditor unfriendly jurisdiction lessens its attraction for distressed investors.

"Insolvency is an unpredictable mechanism to use in Germany to force a capital restructuring. Consensual deals and COMI shifts are likely to be the increasing trend."

Heinrich Kerstien, Rothschild Frankfurt

6. Do you expect to witness more companies filing for insolvency than undergoing out-of-court restructuring in 2010?



- Respondents were equally divided as to whether the amount of insolvencies would outnumber out-of-court restructurings in 2010. This split decision shows widespread ambivalence in the market about the respective advantages of both options.

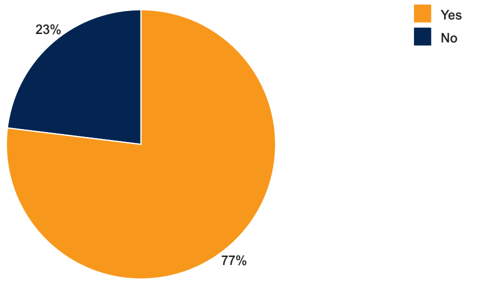
"Failure to deliver projected turnarounds in 2010 may create additional liquidity pressure and heighten insolvency risk, but in most cases an out-of-court restructuring or scheme is likely to be favoured over a European insolvency process."

Simon Granger, FTI Corporate Finance, London

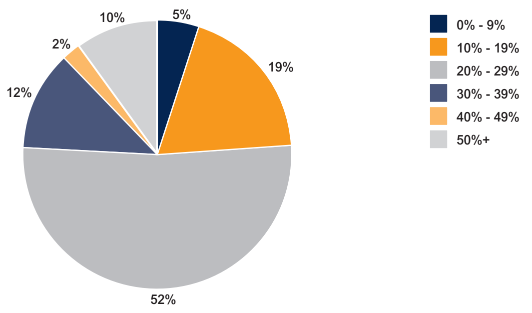
"Out-of-court restructurings are still most stakeholders' preferred strategy. However, faced with increasingly complex, lengthy restructurings prone to holdouts, creditors are examining their contingency plans at an earlier stage. They are also getting quicker at pulling the insolvency trigger as their perception of insolvency implementation risk reduces due to more experience of non-consensual restructurings, combined with helpful recent precedents in some jurisdictions."

Chad Griffin, FTI Corporate Finance, London

7(a) Do you expect the leveraged loan primary market to re-open in 2010?



7(b) In percentage terms how large will the overall issuance be compared to the 2007 peak?



- Over three-quarters of respondents believe that the leveraged loan market will return in 2010, reflecting recent improvements in secondary loan market sentiment, and hopes that capital markets are returning to some sense of normalcy.

“The secondary trading market never really took off this year – low volumes and low prices at the start ending up with higher prices and still limited volume.”

Alistair Dick, Rothschild, London

“There was talk of an increasing level of new LBO transactions towards the end of 2009. However, equity and debt levels are reminiscent of a decade ago. The market is likely to re-open for new transactions but with limited debt supply it will be far more sector and deal selective, and on tighter terms.”

David Morris, FTI Corporate Finance, London

- Over 70% of respondents anticipate the level of 2010 loan issuance will be no greater than 30% of the 2007 peak. With a large number of leveraged loans requiring refinancing from 2011 onwards, alternative forms of financing such as high yield and equity-linked debt may take up the slack.

“Respondents’ expectations (that leveraged loan volumes will struggle to attain 30% of their 2007 peak volume) suggest widespread defaults when existing ‘boom time’ loans mature. Other credit products (such as high yield) may fill some of that gap, but it is very difficult to see why lenders would refinance at par, debt loads now widely understood to be unsustainable given markedly slower growth (or even contraction) in real economy private sector revenues.”

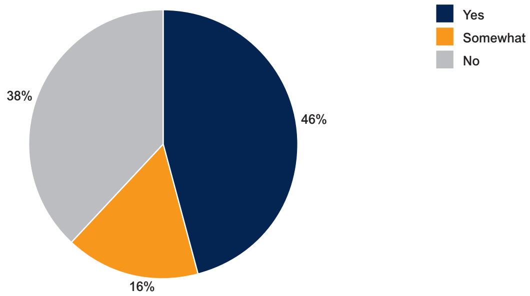
Richard Nevins, Cadwalader, London

“Global PE deal volume in 2009 was 10% of the 2007 peak. Given the stabilising of the economic environment and amount of PE uninvested funds, it is reasonable to expect 2010 deal volumes to exceed 2009. However, loan issuance levels are likely to remain depressed due to limited debt supply and reduced leverage multiples.”

David Morris, FTI Corporate Finance, London

DISTRESSED INVESTOR SURVEY

8. Will the loan market recover to a point in 2010 whereby stressed debt refinancings on a voluntary basis are possible?

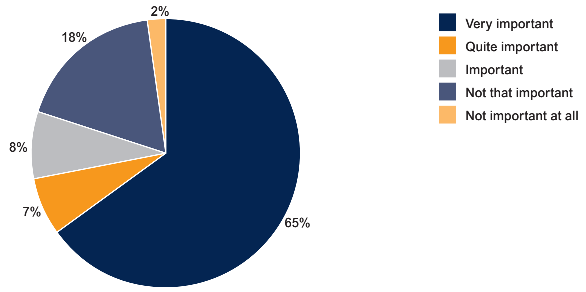


- Despite having low expectations of the level of overall issuance, respondents were more bullish on the recovery in credit markets. A high proportion (62%) of investors anticipate that some form of stressed debt refinancing would be possible next year. This will offer some encouragement to debt advisory teams seeking ways to restructure 'zombie' credits.

"Normality in the credit markets is unlikely to return during 2010. Whilst the major banks in the UK have a lot of money available to put into the market, 2010 will continue to see an abundance of caution. Selective refinancings will take place only on the basis of material debt amortisation and properly structured covenant documents with security packages that give the banks appropriate rights."

Kevin Hewitt, FTI Corporate Finance, London

9. How important is an active secondary trading debt market for you?

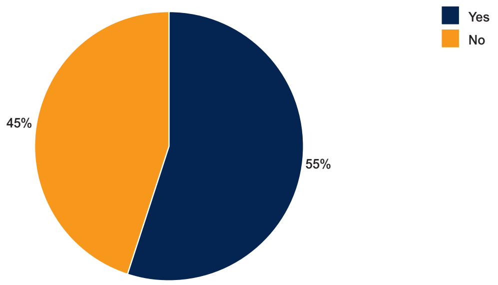


- The vast majority of respondents (80%) said an active secondary market was an important trading consideration. Lack of secondary market liquidity during 2009 has been a key concern for distressed investors. The propensity of banks and CLOs to avoid write-downs, continuing to mark zombie credits as par performing assets, has resulted in a wide differential between the distressed bid and the market offer.

"There is currently little evidence to suggest that the bid-offer gap has narrowed. However, as institutions enter a new financial year their appetite to release capital through debt sales may increase, equally, market optimism may reduce the level of discount, within prices."

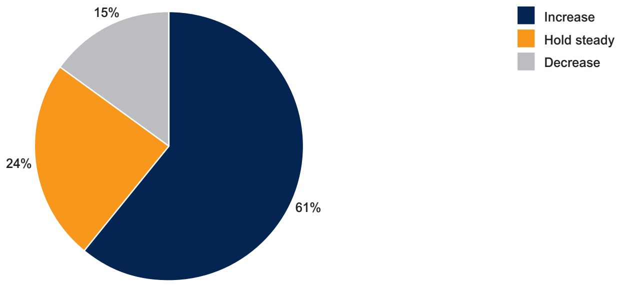
David Morris, FTI Corporate Finance, London

10(a) Have you increased asset allocation to distressed investing over the last 12 months?



- Just a narrow majority (55%) of funds boosted their asset allocation to distressed investing over the last year, despite the attractive investment environment earlier this year. Many missed the turning point in the market due to the difficulty in picking the bottom. The results may reflect fund raising problems affecting the hedge fund industry in general earlier this year, and reduced appetite from banks to fund their proprietary trading operations.

10(b) Do you expect to increase or decrease your distressed allocation in 2010?



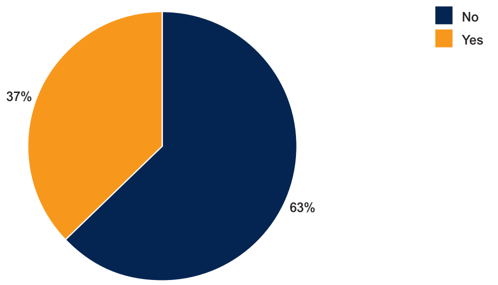
- A significant majority of respondents (61%) intend to increase their exposure to the distressed debt market in 2010. Just 15% of investors are decreasing their positions indicating a consensus that the supply of distressed and restructuring opportunities will remain robust in 2010 despite the run-up in capital markets in H2 2009.

"With equity market indices up by an average of approximately 60% since the trough in the first half of 2009, a sustained rebound in pricing of risk assets is likely to have a significant impact on ongoing restructurings. The most obvious impact is that the value breaks are moving back down the capital structure towards the mezzanine and equity tranches."

Barney Whiter, FTI Corporate Finance, London

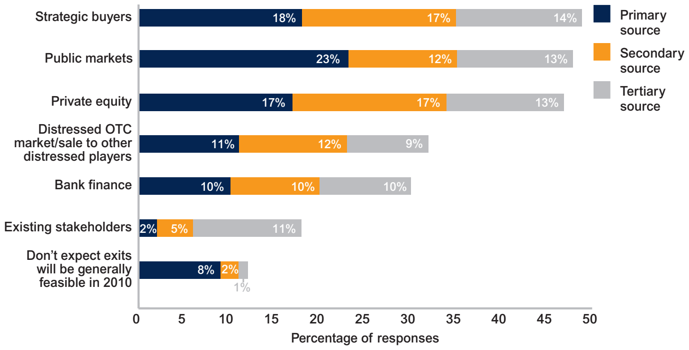
DISTRESSED INVESTOR SURVEY

11. Are you actively fund raising for distressed funds?



- Only 37% of respondents are actively raising money for distressed investments. With 61% seeking to increase their distressed allocation in 2010, the implication is that funds have enough dry powder for now or that scarcity of new funds will force them to liquidate other assets to increase their distressed buckets.

12. What do you expect to be the primary source of liquidity for long-term exits from your European distressed investments? Please choose the top three.

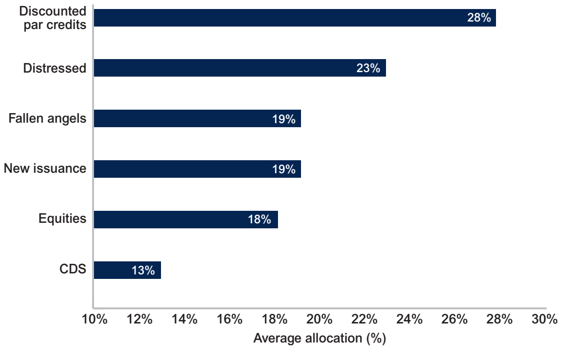


- Respondents gave equal weights to traditional exit routes, with IPO's via Public markets (23%), polling slightly higher than private equity (17%) and strategic buyers (18%). Just 20% of investors polled believed that bank financing would be a primary or secondary source for exits, reflecting the reduced availability of finance and lower overall leverage on new deals. Distressed investors are equally prepared to sell to other distressed players, than use bank finance. Overall, participants were bullish on the prospects for exits, with just 10% of respondents stating these were not feasible in 2010.

"Opportunities abound for trade buyers with cash. Good businesses can be picked up at attractive prices as the competitive tension previously generated by debt financed exit routes can't reach acceptable valuation levels in current markets."

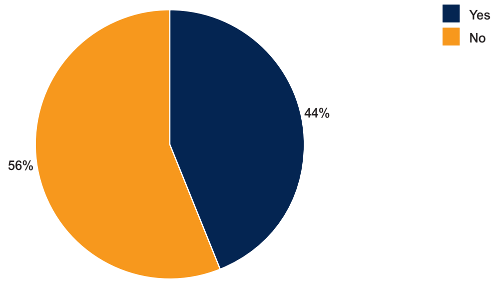
Paul Inglis, FTI Corporate Finance, London

13(a) What proportion of your investments in the past 12 months have you allocated to the following:



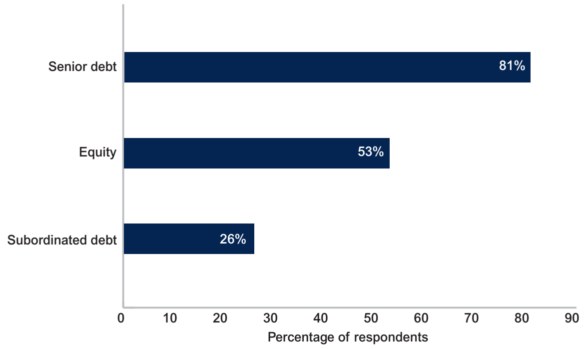
- Discounted par credits have seen the lion's share of distressed fund investment during the last year, whereas distressed debt and fallen angels have seen much lower allocations. This may reflect the value in secondary debt prices earlier this year, lack of liquidity in distressed credits and the consequent lack of loan-to-own opportunities. Distressed funds mostly 'traded' their positions in 2009, rather than seeking long-term control orientated investments.

13(b) Are you actively seeking out direct new money investments in stressed scenarios?



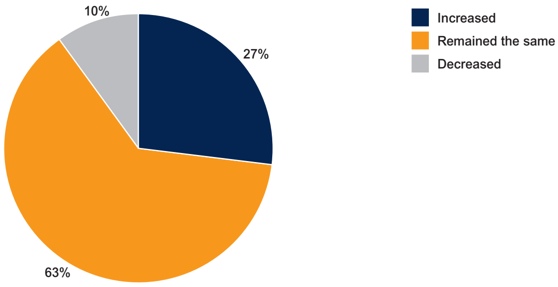
- Just 44% of those polled are pursuing a strategy of new money provision for stressed companies. That may reflect a crowding out effect by liquidity available in public markets.

13(c) If yes, in what form?



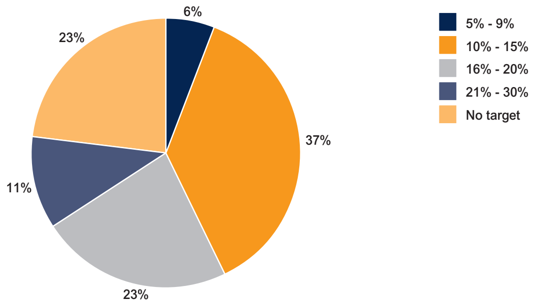
- Of those willing to provide new money, a large majority (81%) are looking to place it at the top of the capital structure. This may reflect their inability to secure enough of a debt write-down to drive returns via the equity. However, just over half (53%) would still be prepared to inject fresh equity.

13(d) Has your appetite for committing fresh cash to a situation to buy out other creditors increased, decreased or remained the same?



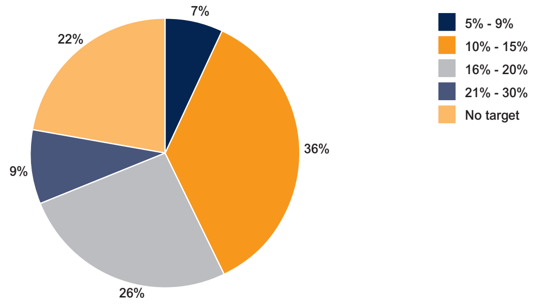
DISTRESSED INVESTOR SURVEY

14(a) What percentage return did you target in 2009?



- The majority of respondents targeted returns in the teens in 2009, with only 11% looking for more than 20%. However, in reality, many distressed funds achieved returns of 25% or more.

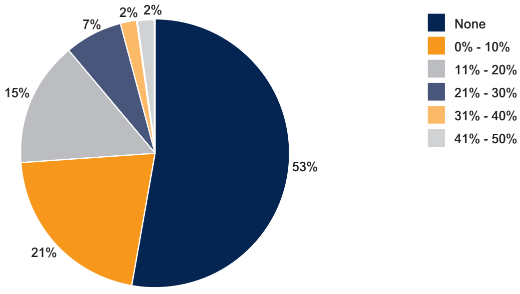
14(b) What percentage return will you target in 2010?



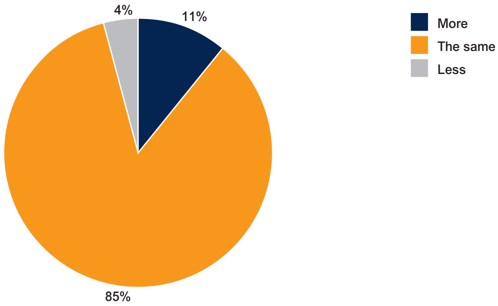
- Similar to 2009, around 36% of survey respondents said they are targeting 10%-15% of returns in 2010, while 7% said they are aiming to make 5%-9% returns in 2010.

  Around 26% of participants said they are hoping to achieve 16%-20% returns in 2010, compared with 23% for 2009.

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



15(b) Do you anticipate using more, less or the same leverage in 2010?

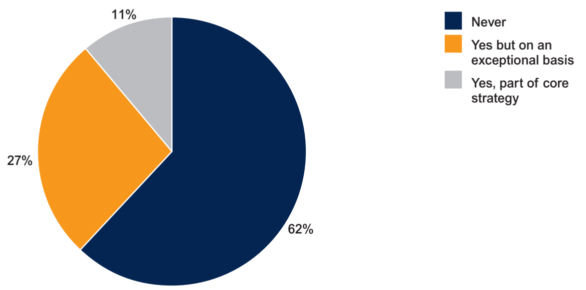


- Almost three quarters of respondents use only fund capital or single-digit leverage to make their investments, falling in line with the results of last year's study. While funds often borrow to buy primary market deals, distressed investing entails elevated risks and returns, which mix poorly with leveraged investment strategies.

- An overwhelming 85% of respondents said they do not anticipate leveraging their portfolios in 2010, indicating that financing sources remain scarce and difficult to obtain. Only 11% said they would leverage up further this year.

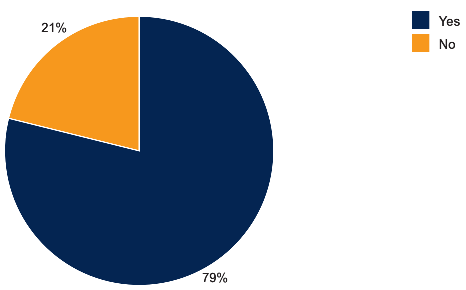
DISTRESSED INVESTOR SURVEY

16(a) Do you seek equity control of companies via a 'loan-to-own' strategy?



- Sixty-two percent of respondents said that they never seek control of companies via debt equitisations, whereas 27% said they would on a case-by-case basis. Only 11 percent of prop desks and hedge funds interviewed said their core strategy is loan-to-own.

16(b) Do you expect an increase in the number of investors intent on acquiring control through equitisation in 2010?

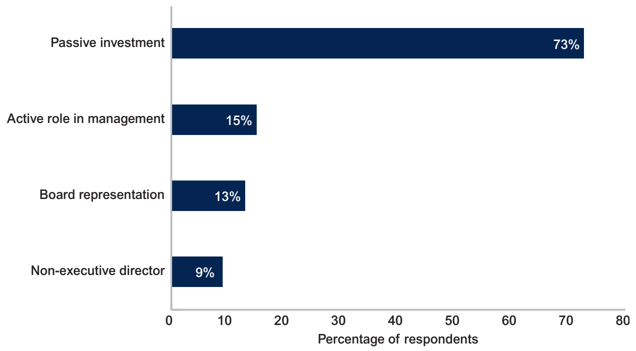


- Reflecting the view that the number of debt restructurings will peak early next year, 79% of hedge funds and prop desk traders interviewed said they expect to see an increase in the number of loan-to-own situations. Only 21% said they did not.
- In a sign of ambivalence about the future, the results are in direct contrast to question 2, where just 5% of respondents expected debt for equity swaps to be prevalent.

"In order to match risk and return, it will be increasingly necessary for new investors to capture a large proportion of any upside via 'loan-to-own' strategies. With some lenders seeking to preserve debt positions and limit the level of new money into restructurings, I believe co-invest strategies between existing lenders and 'fresh' equity may provide opportunities for those investors wanting control."

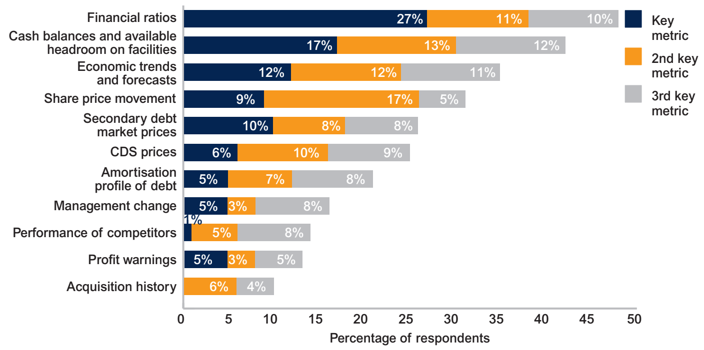
David Morris, FTI Corporate Finance, London

16(c) What role will you play in the governance of controlled investments in 2010?



- Echoing the previous theme that most investors have been ‘trading’ their positions, 73% of respondents said they expect to be passive investors, while 15% said they anticipate playing an active role in managing companies and 13% said they expect to be represented on the Board of Directors.

17. What are the key metrics that you are tracking to determine potential investment opportunities? Please choose the top three.



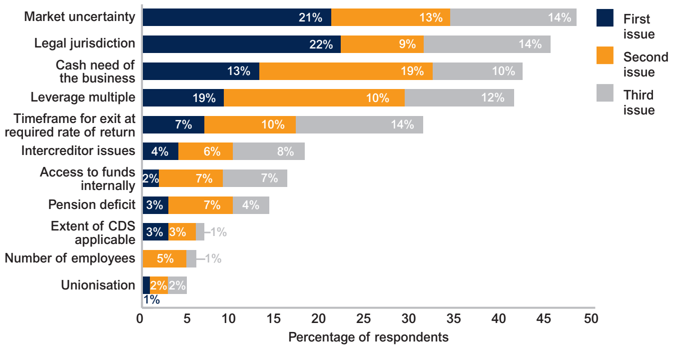
- Respondents said financial ratios, cash balances and headroom on debt facilities, as well as economic trends and forecasts were benchmarks for identifying investment opportunities.
- Financial ratios were highlighted by a total of 48% of respondents as a criteria determining their investments, 27% of whom said it was a key metric. Forty-two percent of survey respondents replied that cash balances were key, and 35% said economic trends and forecasts.

“We are increasingly seeing well constructed and incentivised management teams being relied upon to drive value in distressed situations. However, striking the right balance of investor involvement into the board, strategic decision making processes and delivering on initiatives is key, whether done directly or via advisers and NEDs.”

David Morris, FTI Corporate Finance, London

DISTRESSED INVESTOR SURVEY

18. What are the main issues that will prevent your investment in distressed businesses? Please choose the top three.



- Similar to 2009, survey participants identified market uncertainty, legal jurisdiction and a business' cash need as main factors that discourage them from investing in distressed debt. Forty-eight percent of participants said market uncertainty was an impediment, with 21% saying it was the most important factor for them. Legal jurisdiction, liquidity need and leverage multiples were factors for 45%, 42% and 41% of respondents, respectively.

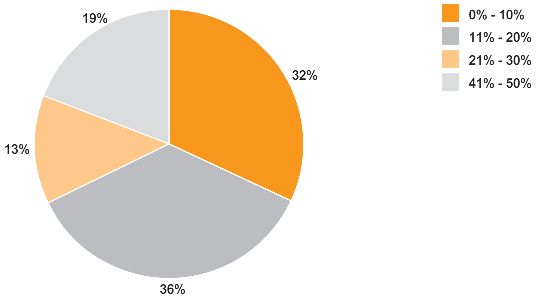
"In many industries, standstills and waivers have masked the need to restructure businesses operationally. In 2010, more investors will come to the conclusion that a resetting of the operational scale of a business is necessary to match continuing lower levels of demand."

Michael Pies, FTI Corporate Finance, Munich

PRIVATE EQUITY SURVEY

In October and November 2009, Debtwire canvassed the opinion of 50 private equity investors to gauge some sponsors' views on restructurings. The interviews were conducted over the telephone and respondents were guaranteed anonymity.

1. What percentage of your portfolio underwent some form of financial restructuring in 2009?



- This picture speaks the proverbial thousand words about the breadth and depth of the correction gripping leveraged credit.

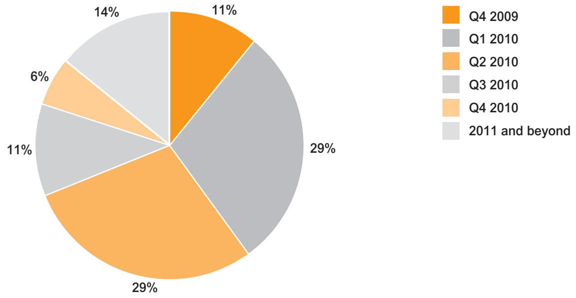
"European private equity firms have been hit hard by the financial and economic crisis. Despite cautiously optimistic economic forecasts for 2010, the market environment will remain tough."

Glen Cronin, Rothschild London

"The fact that for almost 70% of private equity investors one in five, or less, of their portfolio companies required a financial restructuring in 2009 is surprising. A lot must be hanging out, hoping for better times in 2010."

Nick Crossfield, FTI Corporate Finance, London

2. When do you expect the volume of European financial restructurings to reach their peak?



- Almost 60% of study participants forecast that restructurings will peak in H1 2010 with a roughly even split of 17% and 14% respectively, calling the top in H2 2010 and in 2011 and beyond.
- This differs from the responses to last year's distressed investor study in which only 46% said they expect a peak in H1 2010, 33% picked H2 2010 as the peak and only 7% elected 2011 and beyond.

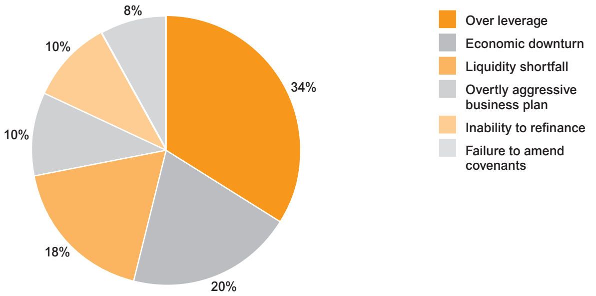
"After Lehman, many expected 2009 to be the peak year for financial restructurings. In 2010, we are likely to see both new cases and the return of 2009 restructurings that were not fully resolved at the time."

Kevin Hewitt, FTI Corporate Finance, London

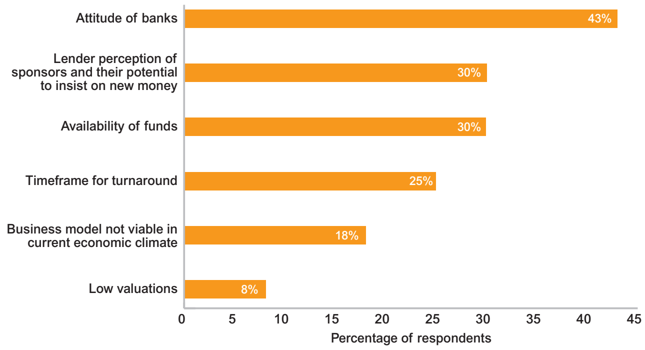
"Many 2009 restructurings involved simply patching up the wounded. The refinancing burden will intensify and although earnings may partially recover, it will not be enough to save the day."

Shaun O'Callaghan, FTI Corporate Finance, London

3. What do you expect to be the largest contributing factor in triggering restructurings for private equity portfolio companies?



4. What are the greatest challenges to achieving restructuring of corporates?



- The largest block of respondents – 34% – consider over leveraging to be the most likely trigger for restructurings of portfolio companies, with only 20% selecting overall economic decline. Among the sponsors blaming the recession, several pointed out that economic performance contributed heavily to rising leverage metrics.
- Underperformance to planned budgets also factors in liquidity shortfalls, which 18% of survey participants select as the largest restructuring trigger.
- **Question of perspective:** Flip that argument around and both spiking leverage and plummeting liquidity can be attributed to unrealistic budgets with too little flexibility to adjust for market cyclicality. Ten-percent of participants did pick overly aggressive business plans as the biggest culprit.

"Companies with a good underlying business but too much debt can be restructured, however, the length of time to complete deals has been harming underlying operations and management effectiveness in 2009."

Mark Dewar, FTI Corporate Finance, London

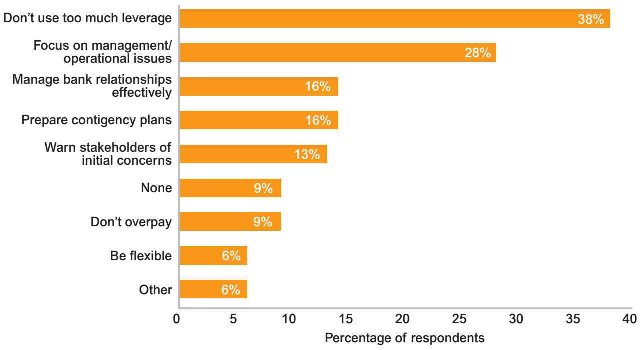
- In a marked changed from last year's survey, a hefty 43% of respondents this year said that the attitude of their banking syndicates posed the greatest challenge to the restructuring of their corporates. In last year's survey, scarcity of funding was the top pick, reflecting a broad improvement in liquidity since Q4 2008 when the previous study was conducted.
- Money, specifically new money, came in a close second with 30% of respondents pointing to the lack of availability of new funds and lender perception of sponsors' access to new funds, respectively, as the principle road blocks to workouts.
- **Meeting of the minds:** The fact that only 8% of respondents blamed low valuations indicates that private equity investors and their lenders/creditors broadly agree on the right multiples by which to measure portfolio investments.

"Responses to this question illustrate the current conflicted state of the European restructuring market. On the one hand, banks and PE sponsors broadly agree proper multiples. Put another way, lenders and borrowers alike agree how much debt a portfolio company can support. On the other hand, the 'attitude of banks' is cited as the greatest single challenge to achieving restructurings. In other words, even though banks understand how much debt is too much debt, they are often unwilling to approve a debt write-down. Levered companies are left to struggle on with too much debt (even if covenant resets are granted), pushing back a sustained recovery."

Richard Nevins, Cadwalader, London

PRIVATE EQUITY SURVEY

5. What lessons has the private equity industry learned from restructurings completed in 2009?



- In line with feedback to question three, respondents expressed a clear consensus that the lesson learned in restructurings this year is to not base acquisitions on too much leverage.
- **Poor students:** Despite characterising bank lenders as the greatest obstacles to restructuring in their answer to question four, only 16% of study participants described the importance of managing bank relationships as a lesson learned from 2009.
- PE firms may move to take a more hands-on role in the year to come as 28% of those asked said they learned to focus on management and operational issues in 2009.

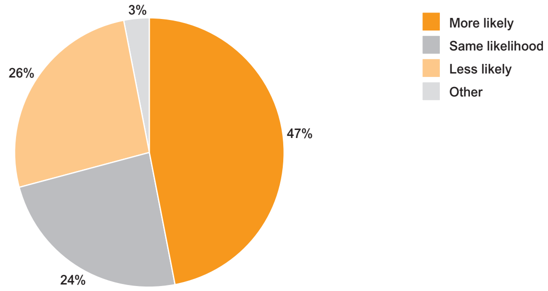
"Key success factors for financial sponsors for surviving the economic downturn include carefully examining acquisitions, actively managing existing portfolio companies and quickly implementing the necessary restructuring actions. In 2010, PE firms will face new opportunities, as more attractive companies come to the market."

Alessio de Comite, Rothschild, Milan

"Companies that have not had to undergo a financial restructuring in 2009 have been able to focus on their customers and operations with few distractions. Too much leverage can be addressed via a restructuring, but underlying cash generation is dependent on a well executed business proposition."

Shaun O'Callaghan, FTI Corporate Finance, London

6. What is the likelihood that you will consider injecting additional equity into your own portfolio companies in 2010 compared to 2009?



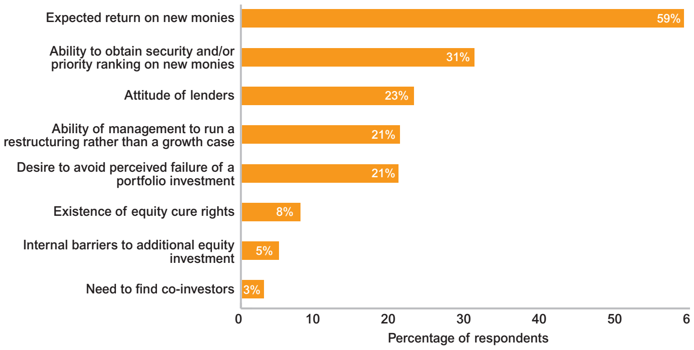
"Compared to the question four responses, this is a very hopeful sign. Creditors are much more inclined to engage when PE sponsors are able and willing to make a fresh cash contribution."

Richard Nevins, Cadwalader, London

"If senior lenders' enthusiasm for taking control of companies increases, PE firms are going to have to inject more new money to retain their ownership percentages."

Andrew Merrett, Rothschild, London

7(a) What are the main considerations for you when you decide whether to invest new funds in your portfolio companies?

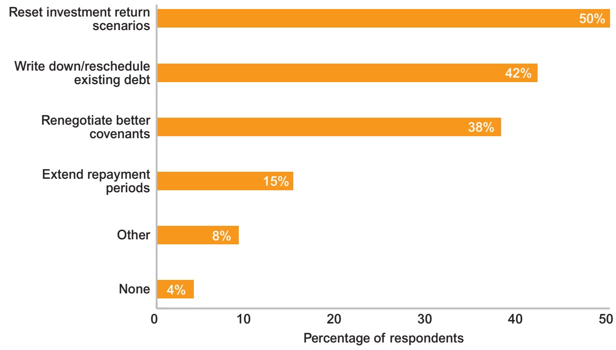


- Private equity sponsors' main consideration for the provision of new funds is the expected rate of return. With most original equity investments out of the money, sponsors are writing these off, and new money commitments are treated as fresh equity. The focus on IRR reflects increased pressure from private equity LPs. While last year respondents counted lender attitude as the most important factor in making add-on equity injections, this has been relegated to number three in 2010.
- Sponsors are emerging from a stripped-down survivalist approach to equity injections, in part because of greater liquidity and recovering valuation multiples throughout the market. The fact that 31% of respondents picked security packages as most important to new equity investment decisions compared to 23% electing lender attitudes, speaks volumes about strengthened sponsor confidence in negotiating such injections.

"Nobody wants to throw good money after bad. However, there can also be strong practical and reputational reasons why lenders and investors will try to find a solution to a complex restructuring between themselves. Some new money goes a long way to unlocking such situations."

Kevin Hewitt, FTI Corporate Finance, London

7(b) What requirements do you have of lenders in return for injecting new money?



- The long and short of it is that sponsors will demand some flex from lenders in exchange for new PE investments in 2010. That stands in stark contrast to the scattered responses to the same question in last year's study, in which many respondents expressed doubts about their ability to increase demands on lenders.
- **Facing the music?** Respondents ranked covenant amendments and debt write-downs roughly equally in order of importance, indicating that the instinct to kick the can down the road may be losing some traction amongst stakeholders.

"2009 was the year when lenders tested the contribution of PE firms in managing their investments, as well as demanding cash injections for them to preserve their equity."

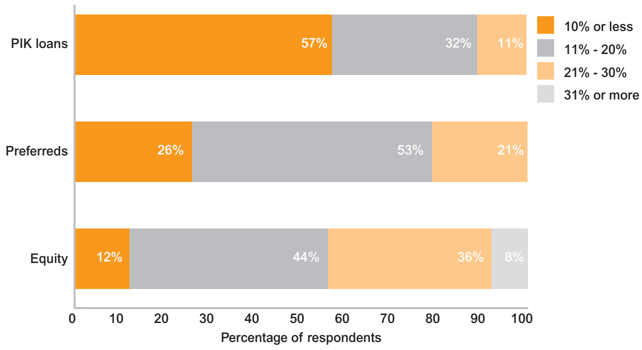
Sophie Javary, Rothschild, Paris

"A new financial plan for the business can change the economies of ownership, both debt and equity. Whilst cash pay, amortising debt may be reduced, the senior lenders will often retain large PIK positions. How this debt will be refinanced will be a challenge over the next 36 months."

Mark Dewar, FTI Corporate Finance, London

PRIVATE EQUITY SURVEY

8. When allocating new money, what returns do you expect for your investment for the following instruments?



"Another hopeful sign. PE firms respond to opportunities, and the distressed universe offers more opportunities (in the good company/bad balance sheet sense) at better value than the solvent universe."

Richard Nevins, Cadwalader, London

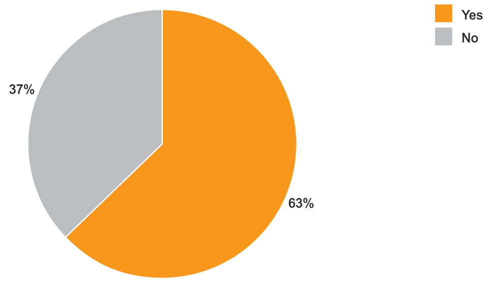
"Some PE firms have been raising war chests to buy into secondary debt – if banks start selling in earnest there could be a real shift in momentum."

Richard Millward, Rothschild, London

"In 2010, those companies that were not the most leveraged or effected by the recession will start to be the subject of refinancings. Any off-plan performance and a change in the attitude of lenders is likely to make these refinancings more like restructurings."

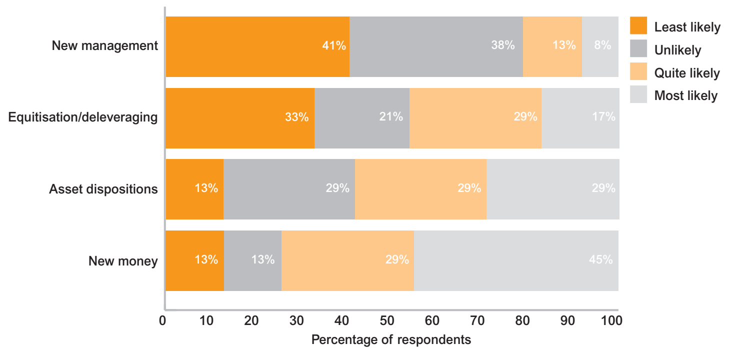
Paul Inglis, FTI Corporate Finance, London

9(a) Do you expect you may need to restructure one or more of your own portfolio companies in the next 12 months?

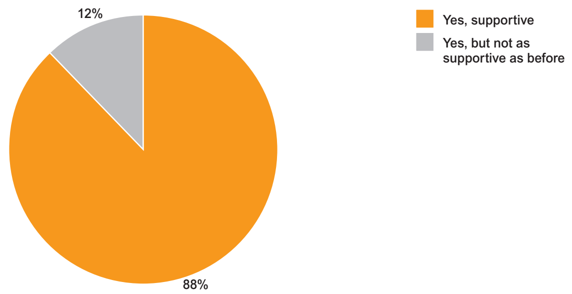


- This chart looks like a photographic negative of the responses to last year's survey, in which 62% answered the same question in the negative and only 38% said yes. The change of heart reflects sponsors' greater willingness to share pain – or at the very least risk – in the face of the prolonged global recession.

9(a) If yes, rank the following method of restructuring in order of likelihood:



10. In a period of portfolio underperformance for many private equity funds, what has been your experience with your limited partners – do they remain supportive?



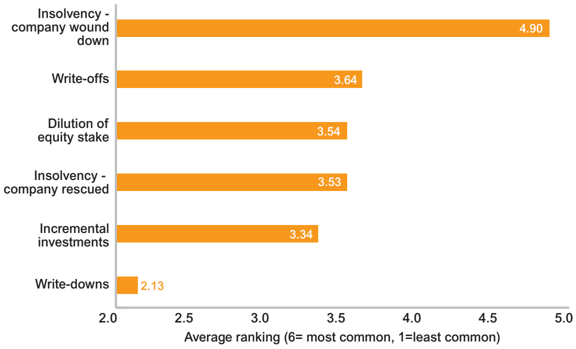
- While PE firms may be more willing to take action rather than amend and extend, they are not eager to dilute their equity stakes. Almost half picked new money as the most likely restructuring method with 29% selecting asset disposals and only 17% electing equitisation/deleveraging.
- This point of view contrasts with responses to last year's study, and clashes with the acknowledgements in questions one and three of the risk posed by excessive leverage. Nevertheless, new equity in sufficient amounts effectively de-levers troubled balance sheets.

"If 50% of all restructurings are anticipated to require new money, they will also require a new plan and a renewed belief in management to deliver that plan. Maybe in 2010 we will see the focus on operational issues, that seemed lacking in 2009."

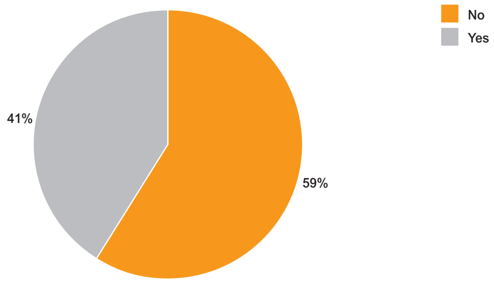
Martin Kellett, FTI Corporate Finance, London

PRIVATE EQUITY SURVEY

11. The credit crisis has affected exit strategies for all investors. Please rank these outcomes as most and least common in 2009



12. Do you expect to play an active role in restructuring non-portfolio companies in 2010?



- **Playing vulture.** A significant minority of investors – 41% – say they plan to take advantage of the target-rich environment to restructure non-portfolio distressed companies. This is up from 27% last year. The UK offers the most opportunity for restructurings, according to respondents, with Germany and Spain ranking high on their lists.

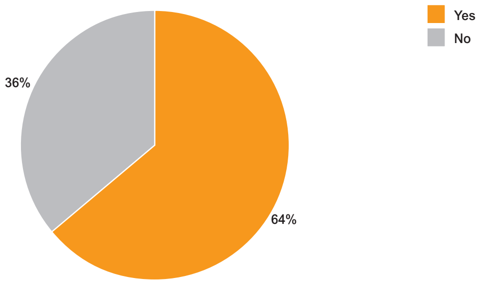
"Financial sponsors have not held back in their endeavours to benefit from jurisdictional or documentary loopholes to protect their investments, nor should we expect them to."

Hamish Mackenzie, Rothschild, London

"Banks and investors play different roles in financing and managing companies. Those investors who can bring a fresh perspective to unlock situations (and new money) will be valued in 2010."

Shaun O'Callaghan, FTI Corporate Finance, London

13(a) With equity and capital markets having recovered significantly in the latter part of 2009, are you looking to take advantage of the improvement in 2010?



- The wall of liquidity swamping capital markets should help sponsors finance exits and restructurings alike. It remains to be seen how sustainable that liquidity will be in 2010 as government spending subsides and interest rates rise.

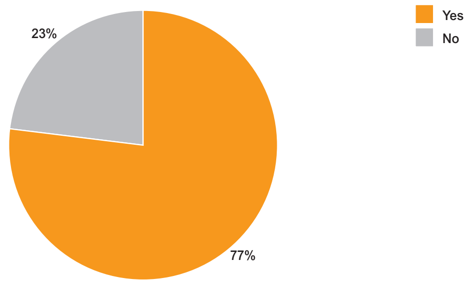
"2009 was a very unusual year, with most capital markets effectively shut for long periods. Looking forward, there are reasons to be positive about bank and bond markets opening up, as well as the possible return of the growth IPO providing exit opportunities for some sponsors."

Alistair Dick, Rothschild, London

"The volume and value of corporate bonds issued in the latter part of 2009 has been staggering. Companies like the lighter reporting requirements and some covenant lite issuances have already been made. Perhaps this is the next bubble?"

Mark Dewar, FTI Corporate Finance, London

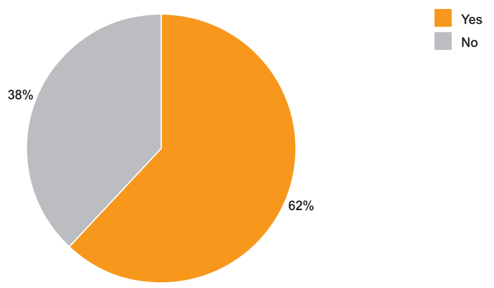
13(b) Do you expect the leverage finance market to reopen for business in 2010? If not, when?



- The vast majority of respondents expect the leverage finance market to reopen in 2010. Almost all of those who predict it will not open in 2010 say it will take place in 2011.

PRIVATE EQUITY SURVEY

14. Are there any instances where you believe earlier action would have changed the outcome of a restructuring?

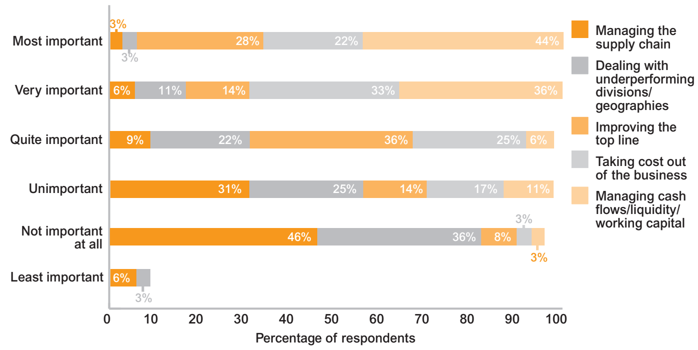


- Hindsight is always 20-20. While a pro-active approach to restructuring is more efficient, it is often inimical to the protracted realisation by sponsors that a workout of some sort is necessary.

"Whether the speed to complete a restructuring will improve in 2010 will be interesting to see. Long, drawn out processes do impact the underlying business and often create a new money requirement that wasn't there in the first place."

Paul Inglis, FTI Corporate Finance, London

15. What are your key operational priorities in managing your portfolio? Rank in order of importance.



- Respondents place liquidity and working capital management at the top of their list of priorities. Surprisingly, dealing with underperforming geographies was considered not important at all.

"Financing cash flows all fundamentally derive from sales and the cost base. Cash flow management is an essential part of staying in control, but is not a substitute for delivering value to customers in a profitable way."

Martin Kellett, FTI Corporate Finance, London

CASE STUDY: AKERYS RESTRUCTURING

Akerys' successful financial restructuring involved the group's €300m FRNs being exchanged for up to €80m of newly-issued Senior Notes due in 2014 and up to €220m of 'Exchangeable Bonds', or ORAs *(obligations remboursables en actions)*, the conversion of which will result in the FRN holders owning 45% of the Akerys group's restructured equity. Akerys is a listed French home builder, owned by PE sponsor Qualis SCA. These ORAs are unique in that they cater to bond investors who are not able to hold equity following a bond equitisation. Cadwalader worked alongside the Company's long-time legal counsel Cravath (London) and Bredin Prat (France) on the restructuring, Rothschild advised the ad hoc committee of noteholders.

The deal was negotiated against the backdrop of Akerys' eligibility to file for the French *Procedure de Sauvegarde*. Instead of entering safeguard proceedings, and at the recommendation of Cadwalader, led by partner Richard Nevins, Akerys and its PE sponsor chose instead to negotiate with its bondholders. As a result, the PE sponsor was rewarded for that decision, for it retained voting control of a greatly de-levered business (and without having to infuse additional cash of its own), the process was swift, business was not tainted by an insolvency process and value was preserved for the Company's creditors.

The lesson is clearly that safeguard is not the only restructuring option for French companies, and it is rarely the best option, as we have seen in the Belvedere SA safeguard process, where a filing had been initiated without input from the Company's bondholders and never led to good-faith negotiations.

In fact, after nearly 18 months, Belvedere recently exited safeguard without a balance sheet deleveraging and no agreement with its creditors. The experience of Belvedere, in which Cadwalader was also involved, convinced us that the willingness to engage secures a lot of goodwill with bondholders.

Indeed, Akerys was one of the few French restructurings to date accomplished entirely out of court. It was viewed as a success by European bondholders as an extremely impressive 99% tendered their Notes in the final Consent and the Tender Solicitation, the results of which were announced on 28 April 2009.

Akerys' problems began in the year 2008 when a sharp decline in the French residential real estate development market caused Akerys to experience a significant decrease in sales.

Following the formation in early October 2008 of an ad hoc committee of Noteholders (the 'Committee'), advised by Kirkland & Ellis (London), Rothschild and de Pardieu Brocas Maffei (France), Akerys was advised to take swift action and commence consensual negotiations. Over the holiday period, extensive negotiations between the Company, the PE sponsor and the Committee and their respective advisers continued. On 6 February 2009, the Company announced, by press release, that a term sheet for the restructuring had been signed, followed by the agreement of the Committee on the 23rd of that month to extend the grace period applicable to the payment of the interest due on the FRNs. Crucially, to ensure a transparent and good-faith process, the term sheet set out that Akerys' management would not file for safeguard proceedings unless such filing had first been approved by the new Supervisory Board (consisting of two members appointed by former bondholder 'B Shareholders' and two members appointed by the Company's existing shareholders, including the Chairman with a casting vote).

COMPANY SURVEY

In December 2009, Rothschild and FTI Consulting Inc. spoke to several European corporate groups that had undergone a financial restructuring within the past year regarding their experiences. Interviews were conducted over the telephone, with respondents guaranteed anonymity.

What were the key successes and difficulties during and post restructuring?

Almost all respondents mentioned gaining stakeholder support for their restructuring as critical to its success.

The first respondent said that their key successes were developing a business plan which was accepted by its banking syndicate and avoiding additional covenant test pressures. They acknowledged difficulties in reaching a real consensus amongst a disparate lender group consisting of banks, CLOs and hedge funds.

Similarly, the second company executive said that their main success was gaining a consensus amongst a wide range of creditors and shareholders as the company's financial position deteriorated. Difficulties included identifying possible new money providers or buyers, especially given significant impairment to senior creditors and achieving a precedent by going through a court sanctioned scheme of arrangement.

The third respondent mentioned obtaining a standstill and interim funding from a large and diverse lender group as successes when looking back over 2009. The respondent also said that trading in the debt with ownership changing hands was a difficulty as it brought new creditors with very different objectives into the process at key stages of the restructuring. This destabilised attempts to gain consensus amongst lenders.

The fourth mentioned gaining majority approval for the restructuring, but added the caveat that very divergent drivers amongst the senior lender group made achieving this very challenging indeed.

The last respondent named preserving the group's core operating business and getting a sensible capital structure post-restructuring, as their company's successes of the year. Challenges encountered were forecasting future performance during unprecedented market turmoil, striking an optimal capital structure when forecasts and values were constantly moving about, and dealing with a "head in the sand" approach by their shareholders in facing up to the realities of the situation.

How did you find the approach and objectives during the restructuring process of different creditor types?

The first respondent saw very different responses from its various creditor constituencies. The banks were tough, wanting more controls and additional covenants, whereas the CLOs wanted higher pricing, and hedge funds in his opinion were being deliberately difficult in order to gain additional fees/margins.

The second respondent's experience was that all creditors were keen to maximise the recovery on their investments, with junior creditors especially obstructive as they were out of the money.

The third respondent stated that German bank lenders were very reluctant to take any form of debt write-off and were extremely worried about equitable subordination issues. Meanwhile his company's experience with international banks and funds saw them being more willing to consider alternative capital structures.

The fourth felt that subordinated creditors quickly lost interest on the deal, as value very clearly broke in the senior secured debt, whereas the fifth respondent felt there was an overall reluctance from creditors to accept where value broke, and struggled to obtain a rational approach to restructuring proposals. The fifth respondent added shareholders were in denial and cross holdings within the debt structure led to conflicts of interest.

Which other operational stakeholders played a key role?

The first respondent named credit advisers, who were concerned about support from banks, and unions, who struggled to come to terms with reductions in headcount.

Customers came up twice in responses with respondents saying that their clients asked for information and regular updates on the progress of the restructuring. The length of the restructuring process created difficulties as customers switched their attentions to other suppliers.

The company's own suppliers were also important part of the process, maintaining supplies despite in some cases the loss of credit insurance was critical to the company's survival. Sacrifices from employees such as pay freezes and lack of bonus awards were also mentioned.

What role did the shareholders/ sponsor play?

Overall, respondents state that shareholders/sponsors played a significant role in the early stages of the restructuring, being willing to provide additional funds and restructuring expertise.

However, in four of the five cases, it became clear that value broke in the debt, and with lenders unwilling to accept the terms on offer, the shareholders became disenfranchised.

As the process wore on, they became less involved and less interested.

What expectations did management have on injection of new money?

Two out of the five respondents said they were not affected by a need for new money.

The remaining three said that management actively sought new money, with one of respondent actively courting all stakeholders rather just the incumbent sponsors. The purpose of the injection was either to fund liquidity, debt prepayment and/or improve headroom in conjunction with a covenant reset.

COMPANY SURVEY

How active were shareholders in the restructuring? Do you expect their role to diminish post the successful restructuring?

The consensus amongst respondents was that shareholders were active during the initial restructuring period, but as the process progressed their activity levels declined. In only one of the five cases, were shareholders able to maintain their control position post-restructuring.

Despite this, shareholders remained actively involved in the running of the company right up until the deal closed, noted three of the respondents.

Who do you think has the most responsibility to put up new money?

The shareholders have the greatest responsibility, but a combination of sponsor and creditor funds is most common, noted the respondents. One respondent cautioned that it depends on the purpose of the new money, while another said that it is a “function of value and where it breaks.”

What is your view of the role that advisers played in the restructuring process? What worked and what didn’t?

All respondents commented that advisers have the responsibility to guide, and lead the restructuring process. Most were complimentary on the role of advisers within their transactions. However, one stated that although their advisers helped to corral large number of lenders in the initial stages, they played only a limited role in finalising the strategy.

Another stated that advisers led the negotiation with key stakeholders and devised the transaction structure based on recent precedents. In their case the advisers also undertook a third party marketing exercise to identify a new money provider or potential buyer. The latter failed due to value breaking very high in the capital structure. The setting of the transaction structure became crucial to the success of its scheme of arrangement.

The third respondent said their advisers provided a useful insight into relevant precedent transactions and lender expectations. They were crucial in effectively coordinating ourselves and a wide range of other advisers and stakeholders throughout the transaction, he said. The advisers also assisted in modelling and due diligence and carried out a third party marketing exercise to identify a new money provider or potential buyer.

The fourth simply stated that the advice they received was key to getting lenders in agreement and pointing in the same direction, while the fifth praised their advisers saying they guided the company’s directors through difficult circumstances. “They are a necessary component [to a transaction],” he concluded.

Do you think that the role of the Chief Restructuring Officer (CRO) is a critical appointment, and under which circumstances?

Contrary to their responses above for advisers, the majority of respondents did not feel that the appointment of a CRO was critical. The first argued that the company’s management should be capable of performing necessary functions, but may need to bring in additional resources.

The second believed with a good financial adviser onboard a CRO is unnecessary. Only when an acute liquidity shortfall is combined with a management team lacking the necessary skills to cope, would a CRO be of use. A third respondent agreed, stating it was dependent on the reason for the restructuring (such as management failure, or unwillingness to take necessary actions). A CRO was not essential, but each case should be judged on its merits.

However, the two other respondents felt a CRO was an important appointment. One said in their particular situation, due to the departure of a critical member of the management team during the process, a CRO was required, echoing comments made by those above regarding missing in-house skills. He went on to say the CRO was able to educate the team on the restructuring and provided the support necessary to effect proposals. One respondent noted that the appointment of a CRO by the banks as part of the due diligence process was helpful in cash forecasting, cash management and other similar work-streams.

The last respondent concurred saying that a CRO can be helpful, but it really depends on the strength of the incumbent management team. It may be difficult for management to run the company and deal with the restructuring process simultaneously, in which case a CRO is a useful appointment

Did you pursue raising alternative finance to repay existing creditors?

Most respondents did not pursue raising alternative finance to repay existing creditors citing the closure of the sub-Investment grade capital markets in 2009. One did, but found there was a lack of appetite from investors.

BANKS SURVEY

In December 2009, Rothschild and FTI Consulting Inc. spoke to several European banks regarding their experiences in the past year. Interviews were conducted over the telephone, with respondents guaranteed anonymity.

When do you expect the volume of European financial restructurings to reach their peak – 2009, 2010 or 2011?

The general sentiment among the banks that were surveyed was that restructurings reached their peak in 2009. While two respondents stated that it would happen over the course of 2010, another stated that it would be specifically in the second half of 2010. The remaining respondents felt that the peak was reached in 2009 with one of them saying that “whilst the negotiation processes involved in resolving restructurings are likely to continue into 2010 in many cases, we believe that 2009 will represent the peak level of new restructurings being initiated.”

What proportion of your portfolio will undergo a restructuring in 2010?

Responses to this question differed greatly.

One respondent estimated that between 5% and 10% of their portfolio will be involved in a restructuring at some point during 2010.

The second respondent stated that the bank’s portfolio consists of around thirty cases that are all experiencing some form of underperformance. This respondent believed that around a third will require some form of restructuring in 2010.

The third was entirely unsure, while the fourth stated that around 25% of the portfolio will be full blown restructuring as opposed to pre or post restructuring.

Finally, the fifth respondent stated that it depended on the definition of restructuring as all of their portfolio is being restructured in some form, but added that around 50% will have to be actively restructured in 2010.

What would ‘normal’ look like in the credit markets? When might ‘normality’ return?

The first respondent answered this question by saying that by ‘normal’ they assumed normalised levels of default, in keeping with current market expectations and indications from ratings agencies of default rates etc. On this basis they assumed a return to ‘normal’ sometime during 2011.

The second respondent defined normal as senior leverage being in the multiples of around 2.5x – 3x EBITDA but stated that in reality, banks like Lloyds and RBS are lending more aggressively as they have government targets to meet. Depressingly, this respondent felt that we may never see a return to a state of normality.

The third respondent was somewhat more optimistic and stated that normality will return when business starts to be done on a less selective basis and liquidity is freed up. ‘Normal’ for corporates will be when they start showing signs of health and leverage levels are back around 3x-3.5x and the debt is not quasi equity as it has been in the past. The respondent added that, “From an internal point of view, normal will be when the number of cases on our watch list falls.”

The fourth respondent quantified ‘normal’ as multiples of around 3.5x in the senior and 1.5x-2x in the junior leverage and spreads of around 350 bps and 600bps-800bps respectively. This respondent added that if leveraged companies cannot pay down 50% of their debt in five years and 70% in seven years, then they would be considered as substandard. Furthermore, the respondent also stated that normality means properly structured covenant documents with security packages that actually give banks rights.

Finally, the last respondent said the market can be split in two: the corporate market and the leveraged market. In the leveraged market, normal will be when we see multiples returning to the levels of 2004/2005. In the corporate market, liquidity is currently available although this depends on leverage levels. This respondent also highlighted the paradox that the big four banks in the UK have a lot of money to put forward in 2010 but that this money will take two to three years to feed through.

What signs are you seeing of acceptable values being offered via M&A for companies in a restructuring?

To this question, the first respondent said that based on their experience of restructuring over the past 12 months, no M&A solutions played a role in the satisfactory resolution of restructuring situations.

Meanwhile, the second respondent stated that distressed funds are being more realistic, but prices are generally still looking fairly unattractive. Banks are therefore holding on to their assets longer, waiting for the market to recover.

The third respondent stated that this would differ from asset to asset and on how they are regarded by the market. If it is that ‘pot of gold’ business, then it would always get a good price. On the flip side, if it is merely a peripheral asset being sold to make money in a restructuring, then investors are not going to get high values. According to this respondent, another factor to consider is the amount of profile the restructuring has had and what the market has heard. “If the market knows you are selling off non-core businesses that aren’t quality, then they know they can get away with offering low prices,” this respondent said.

Meanwhile, the fourth respondent stated that prices are 25%-30% off their peaks, so for good assets you are seeing value on a multiple basis.

The final respondent cautioned that it depended on the asset as well as the presence of competitive tension. The distressed M&A players are looking for bargains and, in some situations, the normal valuation matrix might not always apply, and “it will always be possible to sell a good quality business.”

What are the main considerations for taking a debt for equity swap?

The first respondent answered by stating that the key issue is whether the equity being offered provides a realistic chance of achieving greater value than an exit in the short to medium-term. If not, then a short-term crystallisation of value is clearly more attractive.

The second bank participant said the main issues to consider are the long-term viability of the business, that the management team is competent and that a debt to equity swap is better than the other options.

The third respondent said the business’ viability, chances of future recovery and adequate protection. There is no point doing a debt to equity swap if the business is going down hill and you are going to lose all the value again, this respondent stated. The respondent went on to say that “you have to be reasonably sure that there is going to be a recovery and that there will be an equity route out of the business.”

"The key consideration is whether that new capital is really going to fix the problems of the business and transform the balance sheet," the fourth respondent said. "We would focus first on protecting our debt principal rather than looking to generate upside from the equity."

Meanwhile, the fifth respondent said key factors differ from institution to institution. The respondent institution, for example, likes to restructure a business only once and do it properly; so it is a case of right-sizing the balance sheet and letting the management team get on and run the business, explaining that there is no point in stripping out all the cash for debt servicing. This respondent further explained that one has to sensibly deleverage whilst keeping some cash in the business to grow. Finally, this respondent said that considerations also vary depending on whether it is a private company or a plc.

Will an improvement in M&A valuations reduce the incidence of debt for equity swaps in 2010?

Two of the respondents felt that they would. One of the two explained that if the market starts to see value returning, then the alternative options will be considered rather than going through a debt/equity swap and holding on to the business longer than necessary.

One of the other respondents explained that although covenant breaches, gearing and liquidity constraints are key considerations and drivers of debt restructurings, this should indeed be the case as the ability of debt holders to realise greater cash values in the short-term as a result of improved M&A valuations should in theory prove more attractive than taking longer term equity holdings.

Another one of the respondents pointed out that this would imply that M&A deals could solve debt restructuring issues and that this is rarely the case. This respondent explained further that in a debt/equity swap the assumption is that debt has to take a haircut and M&A in that context can be hard. This respondent did not feel that valuations will reduce the incidence.

Finally, the last respondent stated that an improvement in valuations will have an impact on debt for equity swaps in 2010. He added that lenders will continue to consider their options and valuations will remain important. And so, if an M&A process can be executed, then it will be and if not, then a debt for equity swap will be an alternative and the assets will be held for a longer period of time.

How long do you think banks as owners of businesses after a debt for equity swap will have to hold those assets?

Here again answers differed significantly.

The first respondent said that this will be driven by a combination of factors: the depth of restructuring (i.e. what percentage of day one debt equitised); the speed at which value in the underlying business recovers; the aspirations of the banks in terms of value recovery, i.e. a 50% recovery may be considered attractive for certain banks, if a 75% provision has been made, or their exposure was purchased below par, whereas others may be targeting a 75%/100% recovery. Realisation of returns could take three to five years.

The second respondent felt it would take four years, while the third caveated it depending on the type of asset, felt it would take two to three years longer. The fourth respondent agreed while the last one felt the banks would attempt to dispose of them as soon as possible.

Who are the candidates for buying these businesses from the bank owners?

The consensus here is that the buyers come from a variety of sources.

The first respondent said that no particular type of purchaser can be singled out other than perhaps hedge funds, rather a combination of financial and trade buyers will be looking to make strategic opportunistic acquisitions.

The second said that candidates are trade or financial buyers, financial meaning distressed funds.

Meanwhile the third said that it will vary from business to business but overall it would be a range of trade and financial buyers. "It will be trade if they see synergies between businesses, otherwise financial if they feel they can make money from holding it for a couple of years. Much depends on the sponsors and whether they are wealthy enough," he explained.

Trade and private equity were also mentioned as the likely buyers by the fourth respondent while the last respondent felt it would be a variety of players including trade buyers, distressed PE investors and also traditional private equity firms, once the vanilla private equity market recovers.

Which of the following factors will most likely drive restructurings in 2010?

Respondents were given a number of factors to choose from: operational cash flows, economic climate/real economy, excessive leverage in original deals, underperformance against a restructuring plan and a further decrease in available finance.

Two of the respondents cited underperformance against a restructuring plan as the driver of restructurings in 2010 with the other three naming operational cash flows as the driver.

Which outcomes do you expect to be most prevalent in 2010 (please select top three)?

Respondents were again given a number of choices: covenant resets, capital injection, rescheduling amortisation, new operational plan, new management, insolvency/liquidation, whole or partial debt equitisation or break up or asset sale.

All respondents named covenant resets as one of the most likely outcomes with capital injection and rescheduling amortisation also getting noteable mentions.

BANKS SURVEY

Who do you think has the most responsibility to put up new money in a restructuring?

Not surprisingly, the first respondent said that, as lenders, they would obviously hope that equity sponsors/owners of a business would see new money as their 'responsibility' given that they will benefit from protection of enhanced equity value. However, the private equity principle of avoiding putting 'good money after bad' is in practice widely adhered to, and unless there are wider strategic issues at stake, or value remains in their existing investment and new money can be invested on very attractive terms, private equity investors will frequently walk away from underperforming companies.

The second respondent was of the same opinion, confirming it is the responsibility of any stakeholder with skin in the game. If the game is up, most mezzanine lenders and financial sponsors will recognise that and co-operate by handing over the keys to the senior lenders. Much depends on valuation and where the value breaks in the capital structure. He went on to say that, "In continental Europe, we appear to be seeing more sponsors prepared to put their hands in their pockets than in the UK. We believe that the reason for this is reputational risk and the higher potential for litigation risk, so all stakeholders generally seek to work together to try to reach a solution. In the UK, it is more mechanical due to the creditor friendly insolvency regime, and out of the money subordinated lenders and financial sponsors tend to hand over the keys if terms can't be agreed with senior lenders."

The third respondent said that it should be the stakeholder with the largest amount of value to protect, or the person who sits at the value break. "They may be slightly underwater now, but will be able to buy the value back," they said.

The fourth respondent simply stated that the responsibility sits with those that hold the equity while the fifth said that every situation is different and it depends on where the value breaks. If it breaks in the senior debt, then it is up to the lenders to put their hands in their pockets. If it breaks outside the senior debt, then the responsibility sits with the shareholders.

How will the continued restructuring of leveraged companies in 2010 impact corporate lending in non-leveraged situation?

In answer to this question, the first respondent stated that it is likely to provide a net benefit as banks refocus teams and resources on corporate lending in the absence of meaningful new leveraged finance activity and risk appetite levels become more conservative given adverse experience in the higher risk leveraged finance market.

Meanwhile, the second respondent stated that it depends on the lenders ability to withstand impairment. However, it shouldn't generally have an impact as corporate lending will continue to be done based on the credit fundamentals in each case.

The third respondent felt that it depended on how much capital is absorbed by companies requiring restructuring as high levels of capital needed in this direction will continue to draw resource from the corporate market. There will be limited liquidity and, with the corporate market having forthcoming maturities and the consequent need to refinance, banks will have a choice to make as to where the scarce resource of capital is directed. Of course, failure to support one or the other could result in further restructuring activity.

"Much comes down to confidence," the fourth respondent said, adding that new money coming into the market will make people feel more confident about where markets and spreads are going and this will feed through to the non-leveraged market. This respondent also said that "much of what we learnt from restructuring LBO's is now feeding through to the non leveraged market."

Finally, the last respondent felt it would not have an impact as major banks are under pressure to get money out of the door to standard corporations. There will be a significant increase in liquidity and could even be an excess in 2010 for non-leveraged companies.

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A small number of questions have been left unanswered by individuals undertaking in this survey for reasons beyond our control. Given this, seemingly anomalous results are in fact an accurate representation of the raw data compiled.

Please also note that respondents may have chosen more than one answer on some questions.

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