

May 22, 2008

Leveraged Finance:
**When It Comes To The Crunch,
Recovery Matters For European
Debt Investors**

Primary Credit Analyst:

Marc Lewis, London (44) 20-7176-7069; marc_lewis@standardandpoors.com

Recovery Analysts:

Taron Wade, London (44) 20-7176-3661; taron_wade@standardandpoors.com
Hina Shoeb, London (44) 20-7176-3747; hina_shoeb@standardandpoors.com

Table Of Contents

Key Drivers Of Recovery

Substantial Recoveries For Senior Secured Debt

Lower Recoveries For Senior Unsecured Debt

Poor Recovery Prospects For Subordinated Debt

Security And Capital Structure Brought Into Focus

Leveraged Finance:

When It Comes To The Crunch, Recovery Matters For European Debt Investors

Against the backdrop of recent dramatic growth in the European leveraged loan and high-yield bond markets, and given current testing market conditions, a more comprehensive perspective on recovery expectations is increasingly important for investors. Accordingly, Standard & Poor's Ratings Services has highlighted the wide variation in instrument-specific recovery prospects for senior secured and senior unsecured debt by providing more consistent differentiation in its rating approach to speculative-grade debt instruments. Our analysis shows that, while senior unsecured debt instruments clearly have weaker recovery prospects than senior secured debt, recovery prospects at the subordinated end of the capital structure are firmly rooted at the low end of our recovery rating scale--which ranges from '1+', indicating the highest expectation of full recovery, to '6', suggesting negligible recovery (see table)--almost irrespective of whether security is provided.

Standard & Poor's assigns recovery ratings to about 4,000 speculative-grade debt instruments globally. The European market has the single largest concentration of recovery ratings outside the U.S., with about 340 recovery ratings assigned. Following the release of our revised issue rating framework and recovery rating scale for speculative-grade secured debt issues in June 2007, we expanded our recovery ratings in March 2008 to include unsecured debt. This more than doubled the number of debt instruments covered by the recovery methodology in Europe.

Recovery Rating Scale		
Recovery rating	Recovery description	Recovery expectations*
1+	Highest expectation, full recovery	100%¶
1	Very high recovery	90%-100%
2	Substantial recovery	70%-90%
3	Meaningful recovery	50%-70%
4	Average recovery	30%-50%
5	Modest recovery	10%-30%
6	Negligible recovery	0%-10%

*Recovery of principal plus accrued but unpaid interest at the time of default. ¶Very high confidence of full recovery resulting from significant overcollateralization or strong structural features.

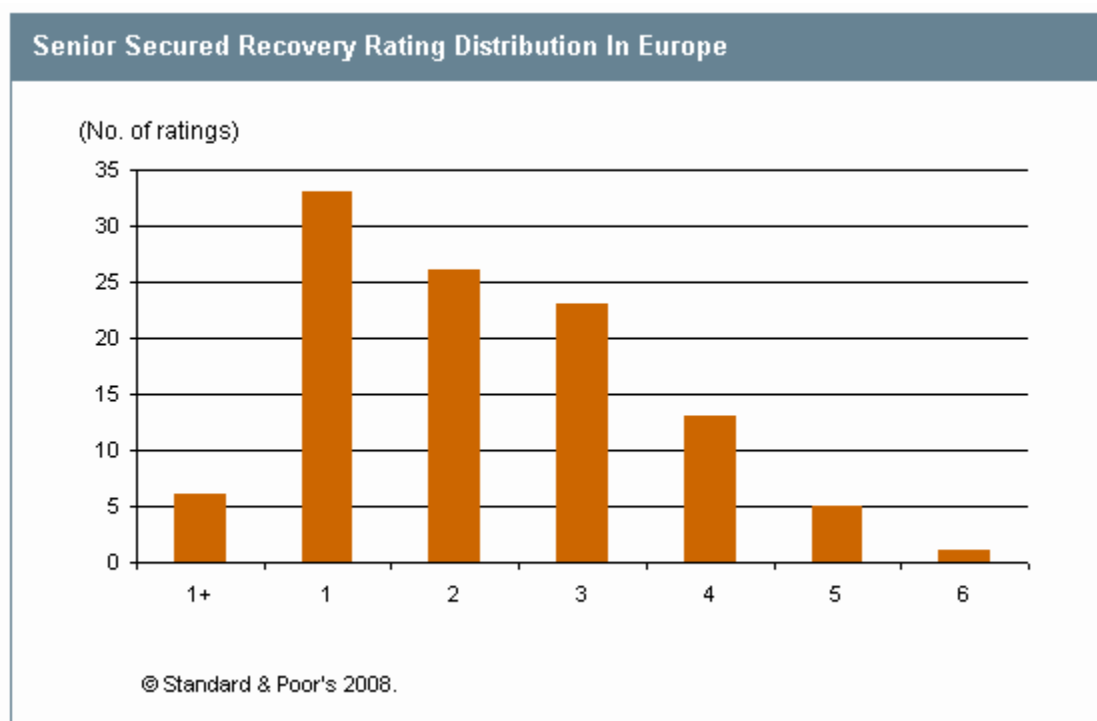
Key Drivers Of Recovery

Under our methodology, there are three broad determinants of recovery prospects. First, Standard & Poor's hypothetical default modeling and stressed enterprise valuation; second, an analysis of the security provided (if any), legal ranking, and intercreditor arrangements or other documentary protections; and, third, the insolvency regimes in which the business operates and that would affect any insolvency process. Each of these areas have implications for ultimate recovery, but it is the security or legal ranking of the debt instrument that primarily differentiates recovery.

Substantial Recoveries For Senior Secured Debt

The average senior secured recovery rating is 2.3, with a median of '2', which covers the 70%-90% recovery band (see chart 1). Nonetheless, this masks a wide distribution across the scale, with about 35% of senior secured debt instruments rated in the '1' category, indicating recovery above 90%, and slightly less than 18% of instruments assessed as having recovery below 50%--despite the favorable security and ranking. The wide differentiation comes from the differences in the underlying quality and comprehensiveness of the security provided, other factors in the recovery analysis such as the stressed valuation, and insolvency regimes.

Chart 1

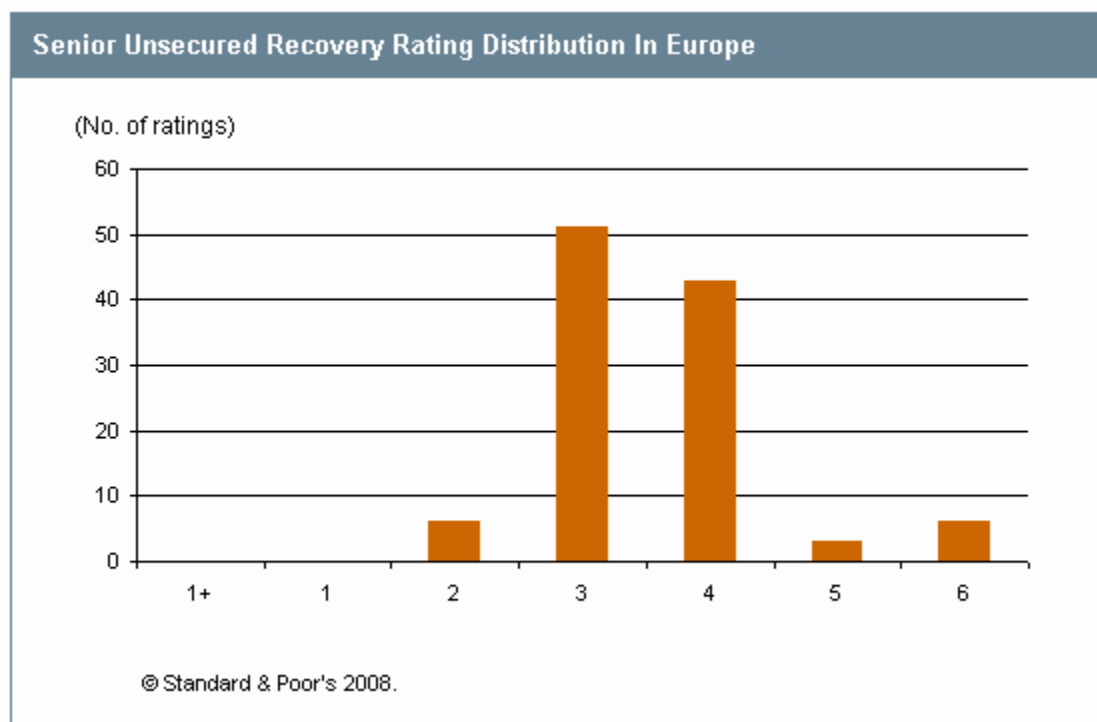


Lower Recoveries For Senior Unsecured Debt

Senior unsecured debt has the highest concentration of ratings in the '3' category, indicating recovery expectations of 50%-70% (see chart 2). The average recovery rating for senior unsecured debt instruments is 3.6, with a median of '3', a full category lower than the median senior secured recovery rating. Similar to the senior secured distribution, however, there are comparatively few senior unsecured debt instruments rated in the '5' or '6' categories (less than 30% recovery).

The senior unsecured recovery ratings apply to broadly distinct set of companies, typically corporates, that do not have material secured debt or multiple classes of debt within their capital structure.

Chart 2



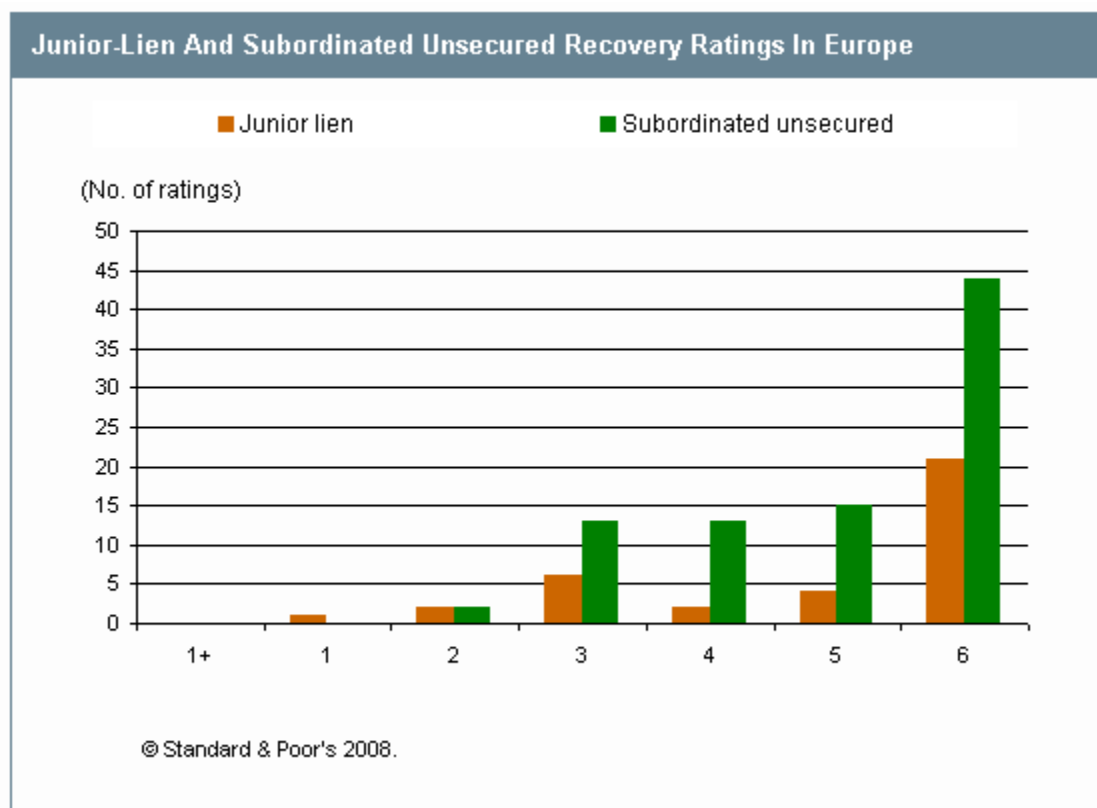
A key driver for weaker recovery prospects for senior unsecured debt is the higher weighting of issuers rated in the 'BB' category compared with senior secured debt issuers, as well as more relaxed structuring. In general, unsecured recovery ratings for 'BB' category issuers are capped at '3' to reflect a limit on recovery prospects caused by the potential for additional debt to be raised with parity or priority to the rated debt instruments. For example, issuers with senior unsecured debt include a number of "fallen angels" that were able to issue debt on favorable terms with limited investor protection when rated at investment-grade. Such documentation does not materially limit further secured or unsecured debt-raising or asset disposals. Having that flexibility may alter the scope of the business and, therefore, ultimate recovery prospects for the pre-existing debt.

Notwithstanding the above, recovery ratings above '3' can, exceptionally, be assigned to unsecured debt instruments where there are clear protections in place to limit incremental subordination, or where there are potentially strong asset values to support ultimate repayment.

Poor Recovery Prospects For Subordinated Debt

The weakest recovery prospects are for subordinated debt instruments, whether secured or unsecured (see chart 3). Rated instruments include both second- and third-ranking secured debt, as well as unsecured debt with varying degrees of subordination--either contractual or structural in nature.

Chart 3



Within this part of the capital structure, the distribution of outcomes is very similar whether security is granted or not. The average recovery rating across this combined class is '5' (10%-30% recovery), with a median recovery rating of '6' (0%-10% recovery). The small minority of subordinated debt instruments that have been assigned higher recovery ratings will typically be those where the more senior parts of the capital structure do not dominate the balance sheet.

Security And Capital Structure Brought Into Focus

Assigning recovery ratings to all speculative-grade debt issues brings the importance of security and capital structure more sharply into focus. For senior debt, security appears to be a key support to enhanced recovery prospects when analyzing traditional secured debt structures common in the high-yield and leveraged finance markets. This compares with the weaker recovery prospects in the broadly unsecured capital structures typical among leveraged corporates. In the more junior parts of the capital structure, subordination is a more important driver of recovery prospects than the security granted. Although security may provide some additional element of control, recovery prospects remain firmly rooted at the low end of the scale. Nonetheless, the wide dispersion of recovery ratings across all categories highlights the vital importance that issue- and issuer-specific recovery analysis plays in supporting investment decisions in the current testing market environment.

Additional Contact:

Industrial Ratings Europe; CorporateFinanceEurope@standardandpoors.com

Copyright © 2008 Standard & Poor's, a division of The McGraw-Hill Companies, Inc. (S&P). S&P and/or its third party licensors have exclusive proprietary rights in the data or information provided herein. This data/information may only be used internally for business purposes and shall not be used for any unlawful or unauthorized purposes. Dissemination, distribution or reproduction of this data/information in any form is strictly prohibited except with the prior written permission of S&P. Because of the possibility of human or mechanical error by S&P, its affiliates or its third party licensors, S&P, its affiliates and its third party licensors do not guarantee the accuracy, adequacy, completeness or availability of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. S&P GIVES NO EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. In no event shall S&P, its affiliates and its third party licensors be liable for any direct, indirect, special or consequential damages in connection with subscriber's or others use of the data/information contained herein. Access to the data or information contained herein is subject to termination in the event any agreement with a third-party of information or software is terminated.

Analytic services provided by Standard & Poor's Ratings Services (Ratings Services) are the result of separate activities designed to preserve the independence and objectivity of ratings opinions. The credit ratings and observations contained herein are solely statements of opinion and not statements of fact or recommendations to purchase, hold, or sell any securities or make any other investment decisions. Accordingly, any user of the information contained herein should not rely on any credit rating or other opinion contained herein in making any investment decision. Ratings are based on information received by Ratings Services. Other divisions of Standard & Poor's may have information that is not available to Ratings Services. Standard & Poor's has established policies and procedures to maintain the confidentiality of non-public information received during the ratings process.

Ratings Services receives compensation for its ratings. Such compensation is normally paid either by the issuers of such securities or third parties participating in marketing the securities. While Standard & Poor's reserves the right to disseminate the rating, it receives no payment for doing so, except for subscriptions to its publications. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

Any Passwords/user IDs issued by S&P to users are single user-dedicated and may ONLY be used by the individual to whom they have been assigned. No sharing of passwords/user IDs and no simultaneous access via the same password/user ID is permitted. To reprint, translate, or use the data or information other than as provided herein, contact Client Services, 55 Water Street, New York, NY 10041; (1)212.438.9823 or by e-mail to: research_request@standardandpoors.com.