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RatingsDirect®

August 29, 2008

Recovery Report:

Grupo KUO S.A.B. de C.V.'s $375 Million Senior Unsecured Credit Facilities

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On Aug. 29, 2008, Standard & Poor's Ratings Services assigned its recovery rating on Grupo KUO S.A.B. de C.V.'s (Kuo) $200 million senior unsecured notes maturing in 2017 and $175 million unsecured bank loan issue maturing in 2012. The notes and the bank loan are rated 'BB-' (the same as the long-term corporate credit rating), with a recovery rating of '3', indicating that lenders can expect substantial (70%-90%) recovery in the event of a payment default. Although numerically our analysis indicates recovery in the 90%-100% range, the recovery rating has been capped at '3' because of the company's ability to incur additional debt. If the company's credit profile worsens, it may add enough debt to reduce our recovery estimate.

The distinctive characteristics of particular jurisdictions' insolvency regimes have a significant effect on the amounts ultimately recovered, the time to recover such amounts, and the overall predictability of the process. Based on our review, we have assessed Mexico's insolvency regime as a Group B jurisdiction, resulting in the capping of both recovery and issue ratings.

Our classification results in jurisdiction-specific adjustments to our recovery ratings, namely the capping of both recovery ratings and the differential between the issuer credit and issue ratings in countries where we expect debtor-friendly insolvency regimes to affect the recovery process and actual recovery rates negatively. These caps increase the transparency and consistency of our assessments of the effect of countries' insolvency rules--especially countries that are less creditor-friendly--when assigning recovery and issue ratings. (See "Update On Post-Default Recovery in Latin America," published Jan. 8, 2008, on RatingsDirect.)

The assignment of the recovery rating follows the introduction of the new recovery methodology that replaces the traditional notching guidelines we have been using for speculative-grade issuers in Mexico. (See "Introducing Recovery Ratings In Mexico" and "Debt Recovery For Creditors And The Law Of Insolvency In Mexico," both published Sept. 19, 2007, on RatingsDirect.)

The notes are senior unsecured obligations, ranking equally in right of payment with Kuo's existing and future senior unsecured indebtedness, senior in right of payment to all of its existing and future subordinated indebtedness, and junior to all of its existing and future secured indebtedness and all other indebtedness owed to statutorily preferred creditors. All the material automotive and consumer subsidiaries, excluding joint ventures, guarantee the notes. Subsidiaries from the chemicals division intend to become guarantors in 2009, after paying their current financial obligations, which pose restrictions to guarantee or incur additional indebtedness.

The bank loan consists of a credit facility of up to $50.0 million maturing in revolving credit loans and letters of credit and a term loan for $125.0 million.

The likelihood of default for Kuo is reflected in the 'BB-/Stable/--' corporate credit rating, which has not changed. (For the complete corporate credit rating rationale, please see Grupo KUO S.A.B. de C.V., published May 7, 2008, on RatingsDirect.)

Table 1

Grupo KUO S.A.B. de C.V.--Credit Profile					
Corporate credit rating	BB-/Stable/--				
Facility/Issue	**Issue rating**	**Recovery rating**	**Expected recovery (%)**	**Maturity**	**Repayment**
$200 mil. senior unsecured notes	BB-	3	70-90	2017	Bullet
$175 mil. unsecured bank loan	BB-	3	70-90	2012	

Recovery Analysis

Simulated default scenario

Our simulated default scenario envisions a deterioration of Kuo's chemical division margins, the largest business unit in terms of sales (50%) and EBITDA (36%). The deterioration would result from a continued increase in raw materials costs--mainly styrene, butadiene, and natural gas--and Kuo's inability to pass cost increases on to the final customers because of the highly competitive market. In addition, the default scenario further contemplates reduced demand from automotive original equipment manufacturers because of meaningful economic weakness in North America affecting the company's margins. As a result of the performance decline and its relatively high leverage, Kuo could be unable to meet its fixed-charge financial obligations.

Other components of the default scenario include:

- Default year is 2011;
- A 200-basis-point increase in LIBOR during this period;
- A 200-basis-point increase in borrowing costs from credit deterioration; and
- Debt from the chemical subsidiaries was not included because it matures in 2009, before the assumed default year.

Valuation

In the event of a payment default, we believe the company would continue to have a viable business model, driven by its diversified portfolio and its leading position in the markets it serves. In addition, our default and recovery analysis has demonstrated that the most likely outcome of an insolvency procedure for Mexican companies is a reorganization. Consequently, we valued Kuo on an ongoing concern basis.

We applied a 4.1x multiple to the default-level EBITDA (about $113.7 million), based on our expectations that financially distressed Mexican corporates usually command a multiple ranging between 3.75x and 4.30x, resulting in an estimated enterprise value of $424.3 million.

Results

The result of this analysis provides substantial (70%-90%) recovery of the senior unsecured notes.

Transaction Summary

Table 2

Transaction Summary	
Facility	Senior unsecured notes
Borrower	Grupo KUO S.A.B. de C.V.

Table 2

Transaction Summary(cont.)	
Guarantors	All the material automotive and consumer subsidiaries.
Structure	No amortization until maturity.
Legal jurisdictions/issues	U.S.
Key covenants	Incur additional indebtedness, pay dividends above certain permitted amount, grant liens, make certain investments and take part in a merger, consolidation and asset sale transactions.