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Credit FAQ:

Recovery Expectations For LyondellBasell Creditors

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On Jan. 7, 2009, Standard & Poor's Ratings Services lowered its long-term corporate credit rating on the three main U.S. subsidiaries of European holding company LyondellBasell Industries AF S.C.A. (LyondellBasell)--namely Lyondell Chemical Co., Equistar Chemicals L.P., and Millennium Chemicals Inc.--to 'D' from 'CC'. This action followed the voluntary filings for Chapter 11 bankruptcy protection by these entities, along with other U.S. subsidiaries of LyondellBasell and a related German holding company on Jan. 6, 2009.

The long-term rating on LyondellBasell, meanwhile, remains at 'SD', indicating a selective default. This is because LyondellBasell and its European subsidiaries (other than the German holding company previously referenced) are not currently in insolvency proceedings. Further, we understand that the company is current on its payments on its senior secured bank debt, as well as on its bonds due 2015 and its bonds due 2027 (the European bonds).

In response to the many questions that have been raised by market participants in respect of this rating action, we have prepared the following FAQ in order to clarify our view of the effects of the debtor-in-possession (DIP) financing package on the group's recovery ratings. This article focuses on the specific questions discussed below and should be read in conjunction with our publication discussing the rating actions taken by Standard & Poor's on Jan. 7, 2009 (see article titled "LyondellBasell Industries U.S. Subsidiaries Cut To 'D' After Chapter 11 Filing"). In addition, our analysis of LyondellBasell's debt and organizational structure appears in our most recent recovery report on the company (see article titled "LyondellBasell Industries AF S.C.A.'s Recovery Rating Profile ," published Nov. 17, 2008--please note that this recovery report was published prior to the Chapter 11 filings and related rating actions).

Frequently Asked Questions

Why has Standard & Poor's assigned its 'C' rating to LyondellBasell's European bonds and senior secured bank debt, while the ratings on all other debt instruments are 'D'?

The issue-level ratings on LyondellBasell's senior secured bank debt and its European bonds due 2015 are 'C', notwithstanding the Chapter 11 bankruptcy filings by various obligors under these debt instruments. Further, the issue-level rating on the European bonds due 2027, which do not have any obligors that are currently in insolvency proceedings, are also 'C'. The 'C' issue ratings reflect our understanding that these obligations remain current on payments (including scheduled principal payments on the secured bank debt), although these obligations are highly vulnerable to nonpayment.

In our view, LyondellBasell's ability to continue to make payments on these obligations in the near term will depend, among other things, on the level of liquidity provided by the DIP facility, and on the company's ability to avoid involuntary insolvency proceedings in Europe. To this end, LyondellBasell has indicated that it expects the forbearance agreements entered into with its senior secured bank lenders and junior-lien bridge lenders will postpone any enforcement actions by these lenders against the European entities that have not filed for bankruptcy protection while the DIP facility remains current. We also note that payments on the senior secured bank debt will be subject to compliance with a cash flow test in the DIP facility that is not yet defined. Other terms that will be more fully set out in the DIP loan documentation also may affect our view of the likelihood of continued payment on these obligations. Failure to make full payments on a timely basis on any of these debt instruments would result in a revision in the respective issue rating to 'D', as could further bankruptcy filings.

What information does Standard & Poor's require before finalizing its review of the group's recovery ratings?

While a substantial portion ($6.3 billion, of which up to $5.8 billion is currently committed) of the requested $8.015 billion DIP financing package has been authorized by the U.S. bankruptcy court and made available to the U.S. debtors pursuant to an interim order, the court has yet to issue a final order approving the full request. A court hearing on the final order is scheduled for Feb. 4, 2009, and the order itself may be subject to subsequent appeals and other proceedings. We would expect to be in a position to complete our review of the recovery ratings once the court has taken action following the hearing, the order has become final, and the amount and terms of the complete package have been determined. Our review may also be influenced by other considerations, including those discussed in the next question.

We generally do not incorporate possible DIP financing into our default and recovery analysis when assigning and surveilling recovery ratings while a company is operating outside any formal insolvency proceedings. This is due to the numerous uncertainties involved. (For more information on these uncertainties, see article titled "Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt," published Oct. 20, 2008.)

What other considerations could affect Standard & Poor's review?

From a recovery rating standpoint, our review could also be affected by further deterioration in LyondellBasell's operating performance, either in Europe or the U.S., that would change the financing requirements or lead us to lower our stressed valuation from the current level of $18.7 billion. In addition, we will take into consideration the effect of the filings on how we believe value will be distributed around the LyondellBasell group and around the various collateral packages supporting recoveries for the senior debt instruments.

From an issue rating standpoint, the issues currently rated 'C' could be downgraded to 'D' if any further European entities were to enter into insolvency proceedings, either voluntarily or involuntarily. In the latter case, this could occur in the event that the forbearance agreements were to prove to be ineffective. In addition, we also believe that the likelihood of the 2015 and 2027 bonds avoiding a default during the reorganization process is questionable. In our opinion, a default on this debt is likely at some point in the process--whether through a distressed exchange or an insolvency filing--as the senior lenders seek to maximize their recovery and leverage their more favorable structural position over these junior creditors. As such, our recovery ratings on these bonds continue to reflect the likelihood of negligible recovery due to the level of subordination relative to other creditors.

Which debt instruments of the LyondellBasell group does Standard & Poor's consider to be most vulnerable to recovery rating changes and why?

As would be expected, the debt instruments most vulnerable to a downward recovery rating change include those that are more weakly positioned in the capital structure, but do not already have a '6' recovery rating. This includes the junior-lien bridge loans and the various first-lien U.S. bonds issued by the bankrupt U.S. entities, all of which have more limited security claims.

The senior secured bank debt may also be vulnerable to having its recovery rating lowered. Crucial determining factors on any recovery rating change will be the eventual level of DIP financing and the level of other claims that may be identified and quantified with sufficient certainty during the review. Typical claims might include the crystallization of hedging liabilities, some of which may benefit from a pari passu lien on the collateral securing the senior secured bank debt; however, the size of these claims may change over time due to, for example, market movements on open hedges. During the Chapter 11 claims resolution process, other claims also may emerge that subsequently could affect our recovery ratings. In addition, the potential exists for different pre-petition senior secured lenders to realize lower recovery rates if they do not participate in the roll-up tranches of the DIP facility, which have a higher-priority repayment status due to priming liens, as well as super-priority administrative claim status (the latter of which places these claims ahead of all unsecured claims).

We currently believe that recovery rating changes of one category (to '2' from '1' or to '6' from '5', for example) are most likely. However, the complex nature of the company's collateral and capital structure means that recovery rating changes may vary from debt instrument to debt instrument. It is equally likely that the recovery rating for any particular debt instrument may not change at all.

The recovery ratings for LyondellBasell's European bonds are all '6'. Does Standard & Poor's see any difference in the ranking and recovery potential for these instruments?

As indicated by our recovery ratings of '6' on these unsecured debt instruments, we expect both the 2015 and 2027 bonds to receive a negligible recovery. Even so, numerous investors have inquired about our view about the relative priorities of these obligations. In our opinion, the 2015 bonds are better positioned for recovery than the 2027 bonds, by virtue of the more extensive guarantees that support the 2015 bondholders.

The 2027 bonds, which are obligations of a finance subsidiary, are guaranteed only by the issuer's immediate parent, LyondellBasell Industries Holdings B.V. (a Dutch holding company). Both the finance subsidiary and the Dutch holding company also guarantee the 2015 bonds, as well as the secured debt. The 2015 bonds, however, also benefit from the more extensive guarantee package that supports the senior secured bank debt and the junior-lien bridge loan, albeit on a contractually subordinated basis and without the benefit of the collateral that supports the secured debt. These additional guarantors include various U.S. and European operating subsidiaries, including several that are either direct or indirect subsidiaries of LyondellBasell Industries Holdings B.V. In our view, these subsidiary guarantees provide the 2015 bonds with a structurally senior position (potentially subject to limitations in accordance with local laws) relative to the 2027 bonds, with respect to the value attributable to the subsidiaries of LyondellBasell Industries Holdings B.V. As such, we believe that the 2015 bonds are structurally senior to the 2027 bonds.

What are other qualifications to our recovery ratings?

In general, our recovery analysis and ratings are based on our opinions about the ultimate distribution of value (on an undiscounted basis) to creditors that is consistent with the relative priorities suggested by a company's capital structure. While we expect actual distributions will generally be relatively consistent with these priorities, in practice the actual outcomes are always subject to potentially material deviations based on negotiations, legal challenges, the nature of the bankruptcy process, and the strategic motivations of the various creditors involved in the process. In the case of LyondellBasell in particular, we believe that the complexities of its debt and organizational structure may provide additional incentive for creditors to reach compromises in an effort to shorten a potentially protracted process.

Furthermore, the ultimate value distributed to creditors may differ significantly from our current estimates. In light of these factors, we seek to provide investors with transparency regarding the main assumptions and drivers underlying our analysis so that they can evaluate our analysis and draw their own conclusions.

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