STANDARD & POOR'S

RATINGSDIRECT®

June 16, 2009

Leveraged Finance:

Liquidation And Other Factors Are Increasingly Likely To Affect Some Post-Default Recoveries

Leveraged Debt & Recovery:
Thomas L Mowat, Senior Director, New York (1) 212-438-1588; tom_mowat@standardandpoors.com

Table Of Contents

Restraints On DIP Financing Are Leading To Rising Liquidations

Our Portfolio Review Points To Declining Recovery Rates When Companies Liquidate Rather Than Reorganize

Scarce DIP Financing Likely Lowers Chances For Recovery

Standard & Poor's. All rights reserved. No reprint or dissemination without S&P's permission. See Terms of Use/Disclaimer on the last page.

728001 | 300374394

Liquidation And Other Factors Are Increasingly Likely To Affect Some Post-Default Recoveries

In Standard & Poor's Ratings Services' view, lenders' concerns about the availability of exit financing for bankrupt issuers have affected the availability, cost, and structure of debtor-in-possession (DIP) financing. Historically, many bankrupt issuers with viable business models but overleveraged balance sheets had a relatively straight path through the bankruptcy process to emergence. In many cases, there were competing lenders willing and able to provide DIP and exit financing. But credit markets have changed dramatically over the past two years, and the former assumption that exit financing would be waiting at the end of the bankruptcy process is no longer generally applicable. As a result, DIP financing has become increasingly difficult and expensive to obtain, and our review of recent facilities indicates that it is likely to be structured in such a way as to be disadvantageous for pre-petition debtholders unwilling or unable to participate in the DIP.

Standard & Poor's Ratings Services continues to believe that post-default recoveries will generally be lower for debtholders in the current default cycle. We also believe that liquidation is more likely in default and recovery scenarios, with market conditions making the financing needed for companies to emerge from bankruptcy as going concerns increasingly scarce. And in cases where DIP financing is available, the structure of many of these facilities may reduce the chances of recovery for pre-petition debtholders, in our view.

Restraints On DIP Financing Are Leading To Rising Liquidations

Under current market conditions, the availability of DIP financing for some defaulted issuers may be in question, with the number of DIP loan providers dropping sharply. Post-petition and asset acquisition financing sources are extremely tight in the current market. Our review of recent transactions indicates that DIP loans may also be structured with shorter initial maturity dates. In some cases, this could be because the DIP is primarily a bridge to an ultimate asset sale. Another reason for the shorter maturity could be to address the limited period of plan exclusivity under the current Bankruptcy Code. If a company isn't generating liquidity close to breakeven, we expect there may be a limited appetite among lenders to extend post-petition financing, and a company may succumb to the pressure to sell itself or liquidate its assets.

According to U.S. corporate default and bankruptcy data Standard & Poor's CreditPro has monitored, as of April 30, 2009, there were a total of eight liquidation bankruptcy plans filed in 2007. This number jumped to 75 in 2008, of which 35 represented 2007 bankruptcy filings converted to Chapter 7 filings or Chapter 11 liquidation plans in 2008. The remaining 40 cases represented 2008 filings that were evenly split between Chapter 7 cases and conversion to Chapter 7 or Chapter 11 liquidation plans. Already in the first four months of 2009, CreditPro reports that 18 liquidation plans filed. Of this amount, two represented conversion filings from 2007 and 10 from 2008, while six were 2009 Chapter 7 filings. While each bankruptcy case has its own particular circumstances, it is clear that the number of liquidation filings increased significantly in 2008 and that early activity suggests the likelihood of continued increases in liquidation cases in 2009.

When assigning recovery ratings and determining the value available to debtholders under a simulated default scenario, Standard & Poor's typically assumed that a company would reorganize rather than liquidate in

Standard & Poor's. All rights reserved. No reprint or dissemination without S&P's permission. See Terms of Use/Disclaimer on the last page. 728001 | 300374394

bankruptcy. Historical precedent supported this approach. From 1980 through 2007, the overwhelming majority of large public companies that filed bankruptcies initially did so as Chapter 11 cases, while less than one-tenth of such companies initially filed under, or converted to, Chapter 7 proceedings.

This is not to say that Standard & Poor's has exclusively assigned recovery ratings using a so-called "enterprise valuation" approach. For some issuers, we have used a discrete-asset valuation to estimate recovery prospects, even when our simulated default scenario assumed that the company would emerge as a going concern, because we believed this valuation technique would be consistent with industry norms for certain sectors. This has been the case, for example, for issuers in the airline industry, where we have estimated the ultimate recovery based on the discrete value of assets such as spare parts, routes, and gate licenses. There have also been some cases in which we have assigned recovery ratings using simulated default scenarios that assume the issuer would liquidate assets rather than emerge as a going concern.

We expect to continue to see a material portion of bankruptcies leading to liquidation due to continuing constraints on DIP and exit financing. If confronted with the outcome of liquidation rather than the prospects of reorganization, debtholders of many defaulted entities may face lower recovery prospects than would be estimated by our enterprise value approach. This is particularly the case, we believe, for issuers with lower amounts of tangible assets.

In this light, Standard & Poor's Ratings Services continues to assess the potential effects on post-default recovery if issuers liquidate assets in bankruptcy rather than reorganizing. Using an orderly liquidation analysis, we believe that average first-lien recoveries would likely decline significantly. Generally, we expect that entities reorganized as cash flow generating going concerns will likely retain greater value than those liquidated for the value of their individual assets.

Our Portfolio Review Points To Declining Recovery Rates When Companies Liquidate Rather Than Reorganize

Our review of speculative-grade issuers' recovery prospects in cases where they might be forced to liquidate focused on issuers with corporate credit ratings of 'B-' or lower to which we have assigned recovery ratings using an enterprise value approach. We believe increased liquidations would most likely affect the recovery prospects for 'B-' or lower-rated issuers because such entities are more likely to default sooner while the credit markets remain tight and the economy remains weak and uncertain. Also, we focused our analysis on first-lien debt, since liquidation would most affect this asset class. Recovery prospects on second-lien and unsecured debt is generally low to begin with and, therefore, would likely be less affected.

To date, we have completed an alternative orderly liquidation recovery analysis for a total of 152 speculative-grade issuers. The result of these liquidation scenarios indicates that the average first-lien recovery rating would decline to 3.68 from 2.22--a decline of more than one full category (see table). This result indicates that average recoveries would fall to 30% to 40% from 60% to 70%. In addition, we estimate that shifting to an orderly liquidation analysis results in a 37% average decline in valuation.

Recovery Rating Scale And Issue Rating Criteria

(For issuers with a speculative-grade corporate credit rating)

Recovery rating	Recovery description	Recovery expectations*	Issue rating notches relative to corporate credit rating
1+	Highest expectation, full recovery	100%¶	+3 notches

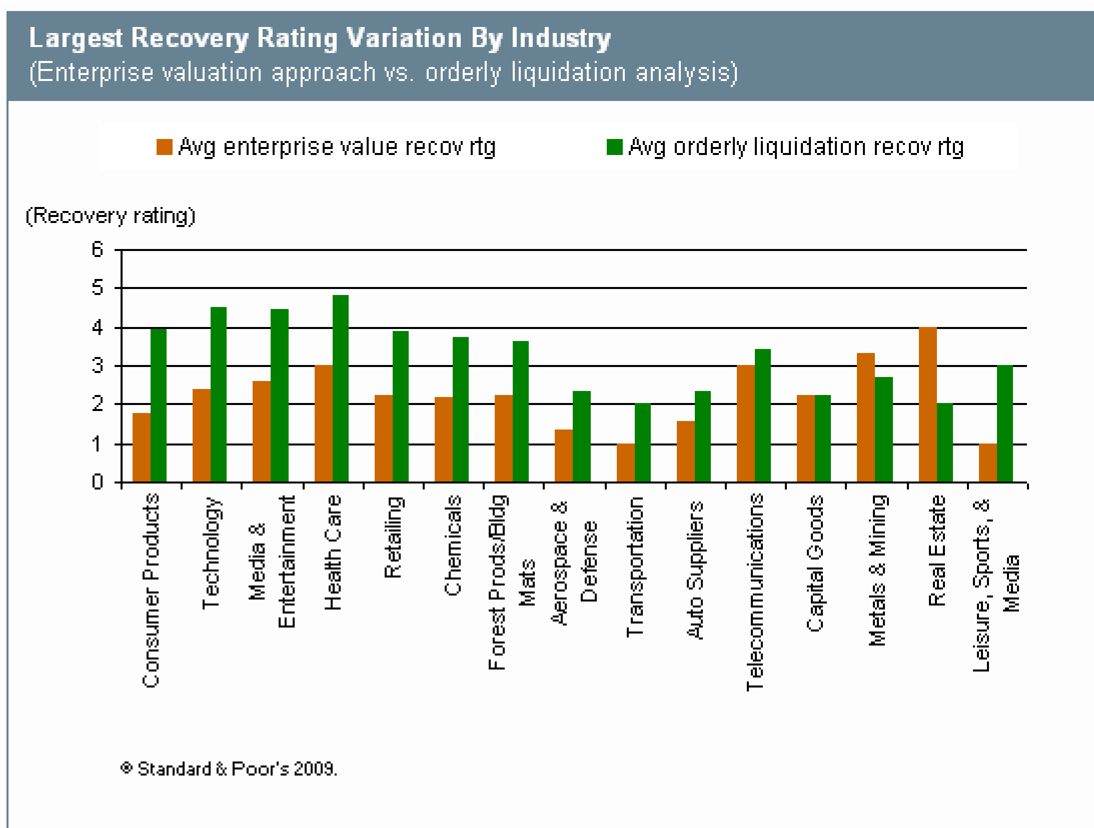
Standard & Poor's. All rights reserved. No reprint or dissemination without S&P's permission. See Terms of Use/Disclaimer on the last page. 728001 | 300374394

Recovery Rating Scale And Issue Rating Criteria (cont.)			
1	Very high recovery	90%-100%	+2 notches
2	Substantial recovery	70%-90%	+1 notch
3	Meaningful recovery	50%-70%	0 notches
4	Average recovery	30%-50%	0 notches
5	Modest recovery	10%-30%	-1 notch
6	Negligible recovery	0%-10%	-2 notches

*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.

For several industry groups, Standard & Poor's orderly liquidation analysis results in a decline of greater than one full recovery rating category (see chart 1).



Based on our analysis, average recovery ratings for the consumer products and technology sectors would decline more than two full recovery rating categories. For consumer products companies, Standard & Poor's didn't ascribe any value for brands, apart from the value embedded in the specific assets (i.e., accounts receivable, inventory and property, plant and equipment). We recognize, however, that some stronger brands may retain significant value even in the case of liquidation and could, therefore, result in greater recovery for debtholders than we have modeled as part of this review. On the other end of the spectrum, industries with traditionally strong tangible asset bases, such as capital goods and telecommunications, experienced the lowest decline in recovery ratings when we determined them using orderly liquidation versus an enterprise valuation approach.

Standard & Poor's. All rights reserved. No reprint or dissemination without S&P's permission. See Terms of Use/Disclaimer on the last page. 728001 | 300374394

Standard & Poor's orderly liquidation analysis

In general terms, Standard & Poor's liquidation analysis attempts to value the tangible assets of the company under an orderly liquidation scenario. Principally, we look at accounts receivable; inventory; and property, plant, and equipment (PP&E). We employ what we believe are reasonably conservative, industry-specific discounts to the most recently available book values of assets to arrive at a discounted discrete-asset valuation. We also assign little or no value to intangible assets, unless we have compelling reasons or information to suggest the value of such assets would be resilient and remain significant even in a liquidation scenario. Within the media and entertainment segment, we chose to use a break-up value approach for companies that have separate and distinct business lines, enabling us to value the individual components based on an ongoing business analysis.

We would not assign recovery ratings based on orderly liquidation unless we believe the circumstances for a particular issuer warrant it. In fact, we continue to use the enterprise valuation approach for most of the issuers we have reviewed as part of this study. However, we have assigned recovery ratings using a discrete asset valuation for 29 speculative issuers, including Gold Toe Moretz Holdings Corp., Leap Wireless International Inc., and Pep Boys-Manny, Moe & Jack.

Declining recovery prospects

Our review of these speculative-grade issuers indicates that, generally, if an issuer were to default in this current market of tightened liquidity and were forced to liquidate its assets rather than emerge as a going concern, debtholders likely would be faced with the prospect of significantly reduced recovery. We believe this is particularly true for certain asset-light issuers in industries such as consumer products, technology, and health care. We will continue to monitor our entire portfolio of recovery ratings and will revise recovery ratings for an issuer when we believe it is at greater risk for a liquidation or sale of its assets upon default.

Scarce DIP Financing Likely Lowers Chances For Recovery

Currently, DIP financing is available for some defaulted issuers, but it is increasingly expensive. In the first five months of 2009, we have seen approximately $16 billion of DIP issuance (according to Standard & Poor's Leveraged Commentary & Data (LCD)), which already exceeds the totals for all of 2008. At the same time, all-in institutional spreads on DIP tranches have climbed to near LIBOR + 900 (also according to LCD). Faced with the prospect of a reduced number of competing DIP providers, we have seen existing lenders to defaulted issuers stepping into that role, but at a steep price. In addition to increased spreads, we have seen pre-petition creditors providing DIP financing with structural features, such as priming liens and roll-up provisions; this, in our view, effectively elevates the standing of existing exposure. As we have seen in the case of LyondellBasell Industries AF S.C.A., existing lenders to bankrupt issuers may be providing new money DIP financing with priming lien positions and the roll-up of pre-petition exposure into second-lien DIP facilities junior to the new money DIP, but senior to existing claims. In such cases, senior secured lenders with first-lien security positions that do not participate in the DIP may suddenly find themselves third in line behind new money DIP and roll-up lenders. DIPs structured in this fashion are getting done because the debtor can often demonstrate to the bankruptcy court that it is the only way to acquire necessary financing.

Generally speaking, the impact of these recent structures on recovery prospects for pre-petition lenders that do not prime themselves is that they will face dramatically lower recovery prospects on their pre-petition loans, in our view. The impact is even greater for recovery prospects for pre-petition unsecured debtholders. While we recognize that

Standard & Poor's. All rights reserved. No reprint or dissemination without S&P's permission. See Terms of Use/Disclaimer on the last page. 728001 | 300374394

DIP facilities may materially affect recovery prospects in certain cases, Standard & Poor's does not attempt to estimate the impact of a DIP when assigning recovery ratings at inception, before the issuer has defaulted. We believe it is exceedingly difficult at that time to accurately quantify the size, structure, or likelihood of DIP financing or to forecast how it may affect the recovery prospects for different creditors. Among other considerations, this is because we believe the size or existence of a theoretical DIP commitment is unpredictable, DIP borrowings that must be repaid at emergence may be substantially less than the initial DIP commitment, and companies may use such facilities to fully repay overcollateralized pre-petition secured debt. Furthermore, we believe the presence of DIP financing might actually help creditor recovery prospects in particular cases by allowing a company to restructure operations and preserve the value of its ongoing business.

For distressed issuers that have filed for bankruptcy, Standard & Poor's recovery reports will typically discuss the potential impact of any court approved DIP on pre-petition debt recovery. For example, once we knew the DIP size and structure for LyondellBasell and the DIP had been approved, we revised our recovery ratings and lowered our issue-level ratings on the portion of pre-petition debt not rolled into the DIP.

Finally, the recent government-orchestrated bankruptcy filings by Chrysler Corp. (not currently rated by Standard & Poor's) and General Motors (rated 'D') have resulted in widely reported discussions of the issues of government involvement and its potential impact on recoveries for various classes of creditors. As part of our surveillance of pre-petition recovery ratings, Standard & Poor's will, to the extent feasible, monitor such involvement and will discuss its potential impact on recovery ratings for pre-petition debt based on the information available at the time. However, the extent of the government's potential involvement in an issuer's future bankruptcy proceeding and its likely impact on recovery ratings, or the likely impact on the recovery ratings once the government has become involved, will likely involve a high degree of uncertainty and may be difficult to forecast. We will only discuss the potential risks to the recovery ratings of government involvement when we believe we have adequate information available to do so.

Standard & Poor's. All rights reserved. No reprint or dissemination without S&P's permission. See Terms of Use/Disclaimer on the last page. 728001 | 300374394

Copyright © 2009, Standard & Poors, 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 subscribers 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)212.438.7280 or by e-mail to: research_request@standardandpoors.com.

Copyright © 1994-2009 Standard & Poors, a division of The McGraw-Hill Companies. All Rights Reserved.

The McGraw·Hill Companies