mCAPITAL

EUROPE ASIA-PACIFIC

Why stressed, distressed and rescue finance opportunities make sense today

General

- Scale of the opportunity at its greatest since 1987 – USD 4trillion and rising (source: World Bank)
- Default rates continue to rise. Led by the US but globally at 11.5% (source: Moodys August 09)
- Recovery rates have tumbled. High yield recoveries are half of their normal levels at 22.7% versus the last 30 year average of 45% (source: Moodys)
- Recession will continue
- Regulatory change continues. Government sponsored capital is now on hold. Institutions want to manage these problem assets as they have in the past; on a commercial basis
- Reduced risk appetite is leading to an unprecedented level of portfolio sales as businesses retreat and repatriate resources (human and capital)
- Sellers are beginning to get provisions closer to where the market is pricing the risk. Supply into the market will grow as workout teams are under resourced and often staffed with unqualified personnel
- CDS are a new challenge to the restructuring landscape
- Maturity dates of 2012-14 will prove to be a massive burden; refinancing risk will be especially challenging for lesser quality credits

- Commercial Real Estate problems are beginning to hurt institutional balance sheets. Motivation will be to address these and sell existing workout loans to avoid capacity overload. Structured deals are yet to be resolved

- Few buyside teams have the leadership, experience and the depth to truly navigate the opportunity set

- Legacy assets and liability issues disturb the process of identifying the best deals

- Development Capital sources will remain sparse. Strategic investors will gain an upperhand as financial investors struggle with underperforming legacy assets

- Non investment grade companies are not deleveraging; very little new equity is available to them and profit flows are not sufficiently additive

Stressed (non restructuring cases)– return profiles: 15-25%

- Market rebound has been strong but many corporate names have been left behind; these corporates are often unrated and therefore left behind many so called analysts because they are too difficult to analyse

- Good return profiles ar available in senior and mezzanine debt level of the corporate structure with healthy coupons and margins at discounted prices (thereby allowing capital gain opportunities)

- Value is often being created in the range of 3 - 5x forecast EBITDA in corporates that we believe will recover post recession

- Secondary market is quite healthy and exhibiting some liquidity in larger names where we could behave quite passively

- Mid size non investment grade companies are becoming orphans in the market. Here we would have the opportunity to be more active

Distressed (restructuring cases) – return profiles: +20%

- Growing number of restructuring cases in pipeline

- Value is often breaking in the senior part of the capital structure

- Ability to exert influence and drive process exists in our favoured mid size corporates (Enterprise Value of USD500mn - 1bn)
- 2009 vintage restructurings have been poor as they have tended to stretch maturities and/or reduce covenants but the corporates are not, under our forecasts, able to produce cashflow to live within their revised structures
- Sponsors are under pressure to make investments work. Will sell, restructure more easily if they have no cash available
- Less than 12 active buyside investors in Europe and half that number in Asia (source: Deutsche Bank conference 09)
- As recession drags through 2010 the quantity of situations will continue to grow
- Restructurings in Europe are preferred over liquidations
- Merrill team was the most active restructuring investor during the 2002-04 period in Europe with huge returns

Rescue – return profiles: +15%

- Capacity is at its lowest ever
- Turnaround and rescue finance is very well srtuctured
    - Super senior in the capital structure
    - Pricing is negotiable
    - Documentation is structured by the investors
    - Short maturity profiles with defined events against the restructuring plan
    - Strong secondary market in major names