Debtor In Possession Loans:
A Lender's Perspective

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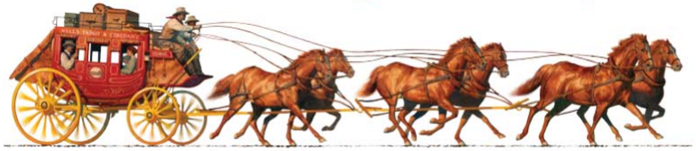
Together we'll go far



IS A LACK OF LIQUIDITY FOR DIP LOANS HAMPERING THE ECONOMIC RECOVERY?

MAYBE A LITTLE – BUT IT’S MUCH MORE COMPLICATED THAN THAT.

Liquidity is Only One Contributing Factor

- Bankruptcy has fundamentally changed.
- Companies are much more difficult to restructure.
- And – Oh Yes - Liquidity is certainly an issue – but not for DIP's

DIP Lending – a Historical Perspective

- Banca Rota.
- Bankruptcy Globally.
- Bankruptcy in the U.S.

Bankruptcy Reform Act 1978

- Main purpose of the Act was to delineate the role of Debtor in Possession. Prior case law was unclear and contradictory.
- Clarified the concepts of pre and post petition rights and the automatic stay.
- As a secondary issue, for the first time the Act provided statutory protections to lenders to Chapter 11 Debtors.
  - Introduced concept of super-priority claim
  - Established the concept of a priming lien.
- Resulted in several new businesses:
  - Protection of DIP loans made it possible for banks to set up specialized lending practices.
  - Recognized the role of professionals and the requirement to pay “market” rates for professional fees. As a result, major law firms, investment banks and and consulting firms began to specialize in Chapter 11 advisory.

DIP Loans Are Still New

- The Act intended DIP lending only to encourage trade credit.
- Took time for banks to get comfortable with legal status and form businesses around it.
- Establishment of syndication market came slowly
  - Chemical Bank established syndication market in early 1980’s.
  - Rating Agencies began issuing ratings much later
- First large scale candidates were the large leveraged loans of the late 1980s.
  - Simple (but over leveraged) capital structures.
  - Largely stock secured – leaving ample unencumbered current assets – Allied/Federated.

DIP=Great Unfunded Loan

- Super priority claim.
- High excess liquidity.
- Primarily working capital financing.
- Low usage/short tenor.
- High probability of emergence.

Code Revisions - 2005 amendment

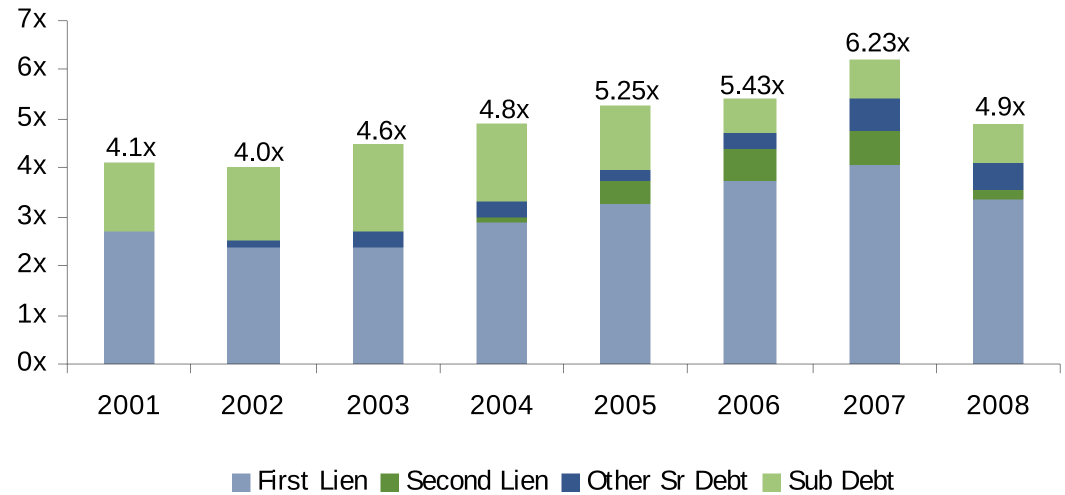
- Special interest legislation many years in the making.
- Largely consumer oriented legislation: Made it more difficult to discharge credit card obligations.
- As a secondary issue the act responded to lobbying efforts from from numerous special interest groups.
  - Shortened time frames for retailers debtors in Chapter 11 to assume or reject leases to 210 days – with no judicial discretion to extend.
  - Enhanced rights of trade vendor who shipped within 20 days of the filing.
  - Also granted certain creditors the right to receive deposits in bankruptcy that were previously discretionary (i.e. utilities).
- Unintended consequence has been to make it much more difficult for debtors to successfully reorganize before losing control of the case.

What Has Changed Since 1978?

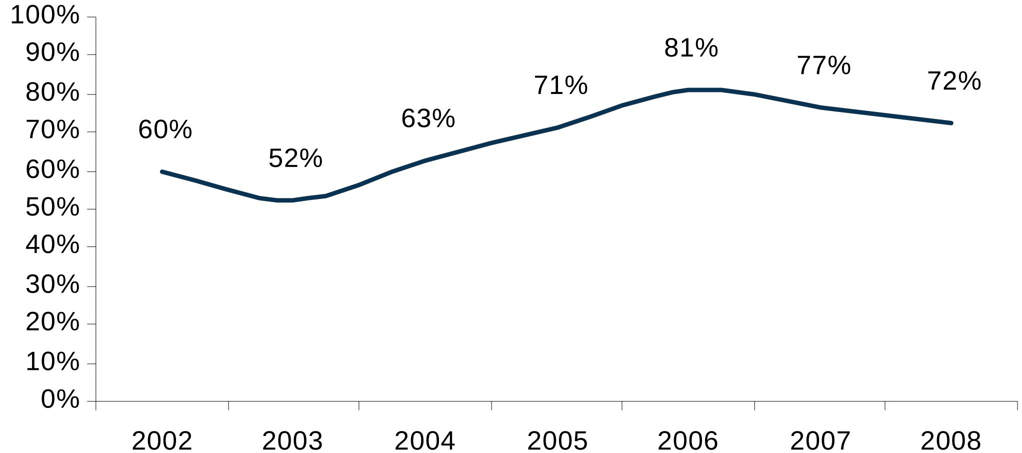
- Different capital structures:
  - More leverage.
  - Complex, multi-tiered.
  - Higher senior secured leverage.
  - Institutional investors holding loans – not banks.
  - Changes to term/revolver mix.
- Greater uncertainty as to viability of companies entering bankruptcy.
- Scale of bankrupt companies.
- Market convergence and trading.

Expanded Leverage and More Reliance on Secured Debt

Average Leverage Multiples of Large Corporate LBOs



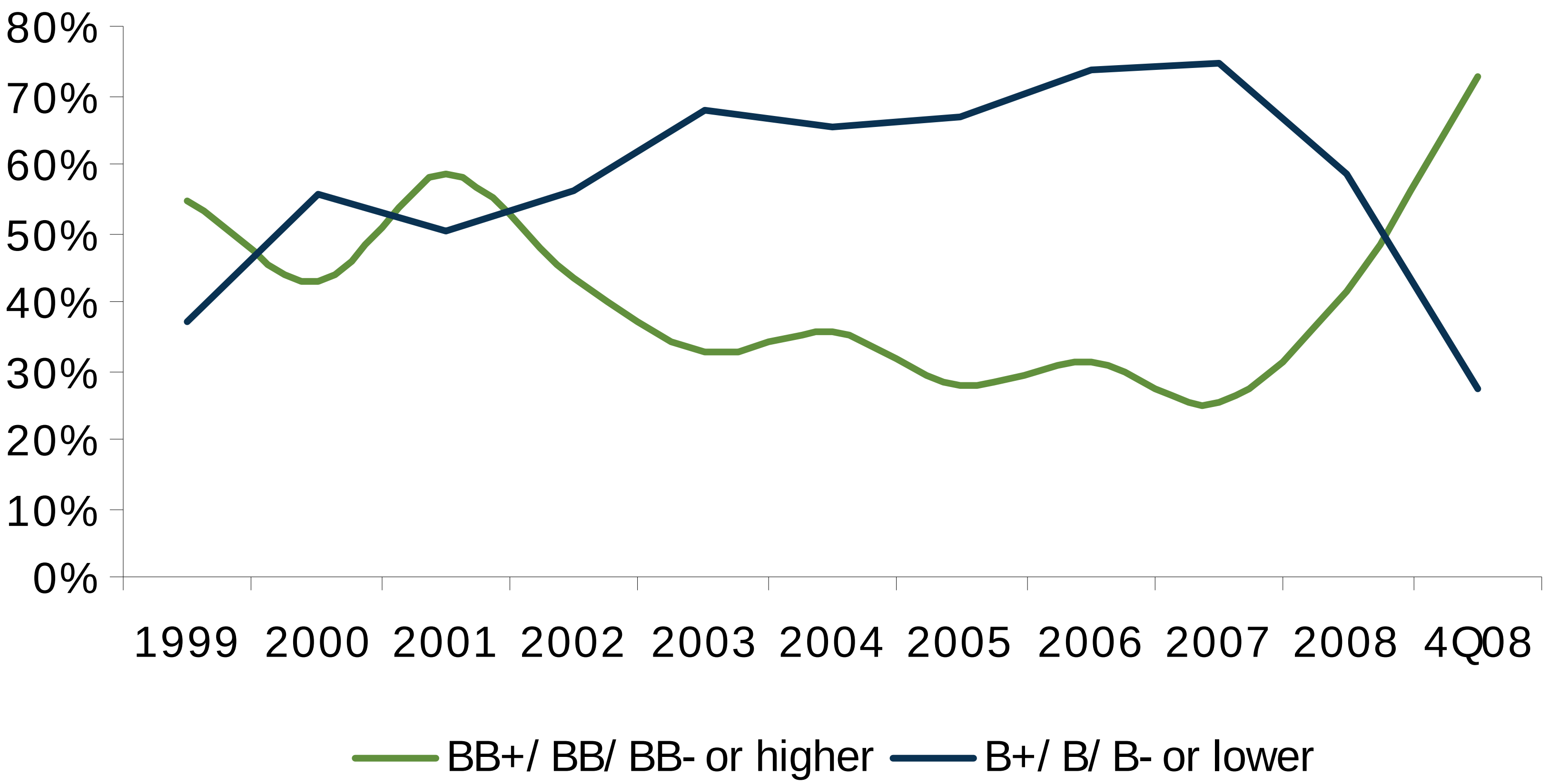
Senior Secured Debt as % of Total Debt



Source: Wachovia Securities and S&P/LCD

More Leverage Means Lower Ratings

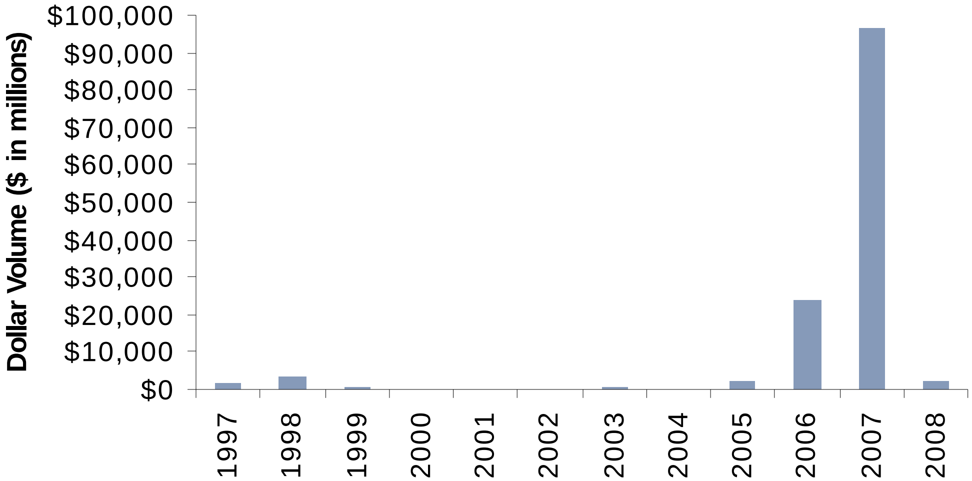
Rated New-Issue Loan Volume by Corporate Rating



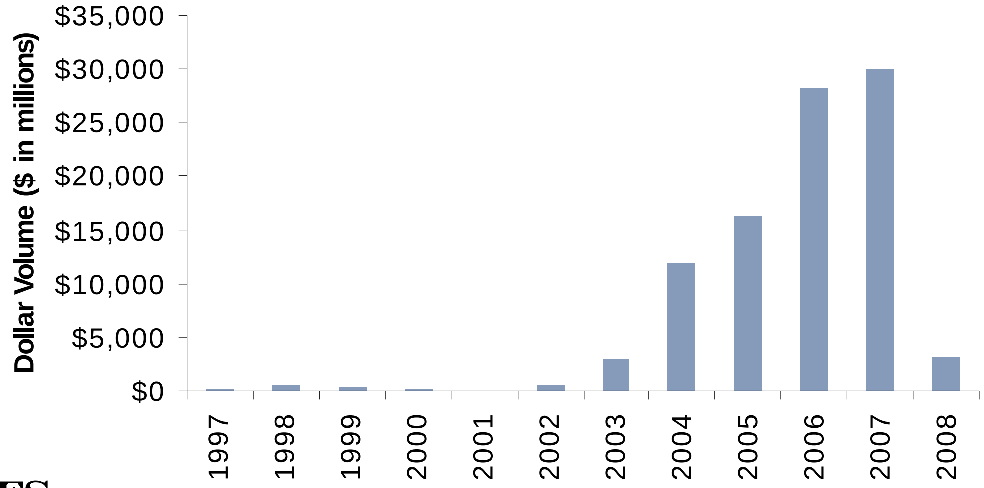
Source: Wachovia Securities and S&P/LCD

Capital Structures Grow More Complex

Covenant Lite Issuance Volume



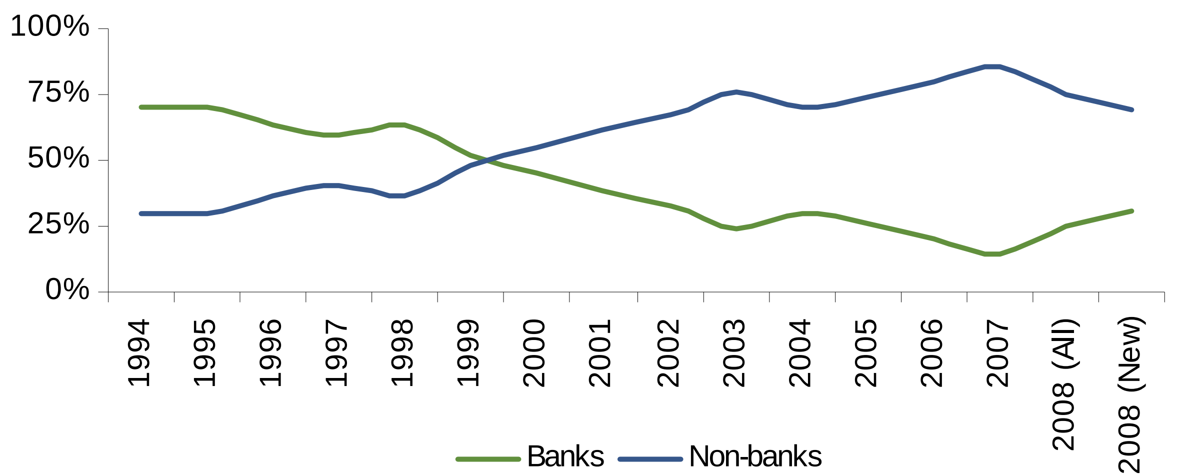
Second Lien Issuance Volume



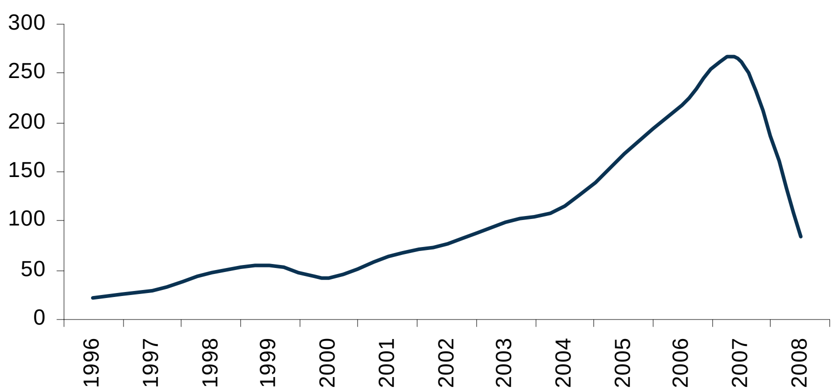
Source: Wachovia Securities and S&P/LCD

Vastly Different Investor Mix Over Time

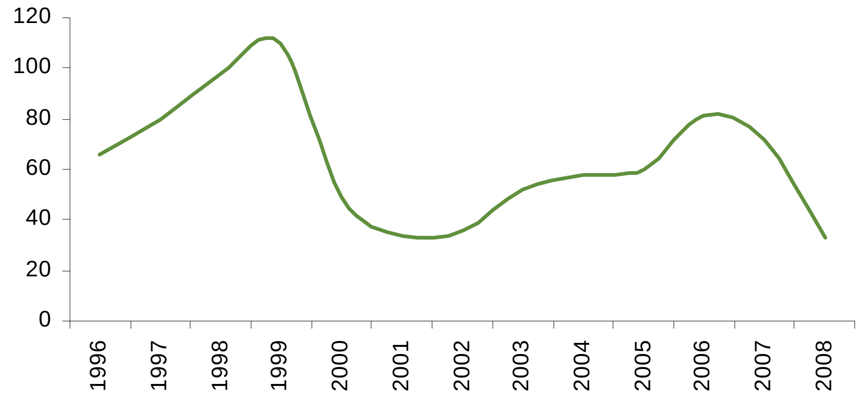
Loan Market Investor Composition: Banks vs. Non-Banks



Active Institutional Loan Investor Groups



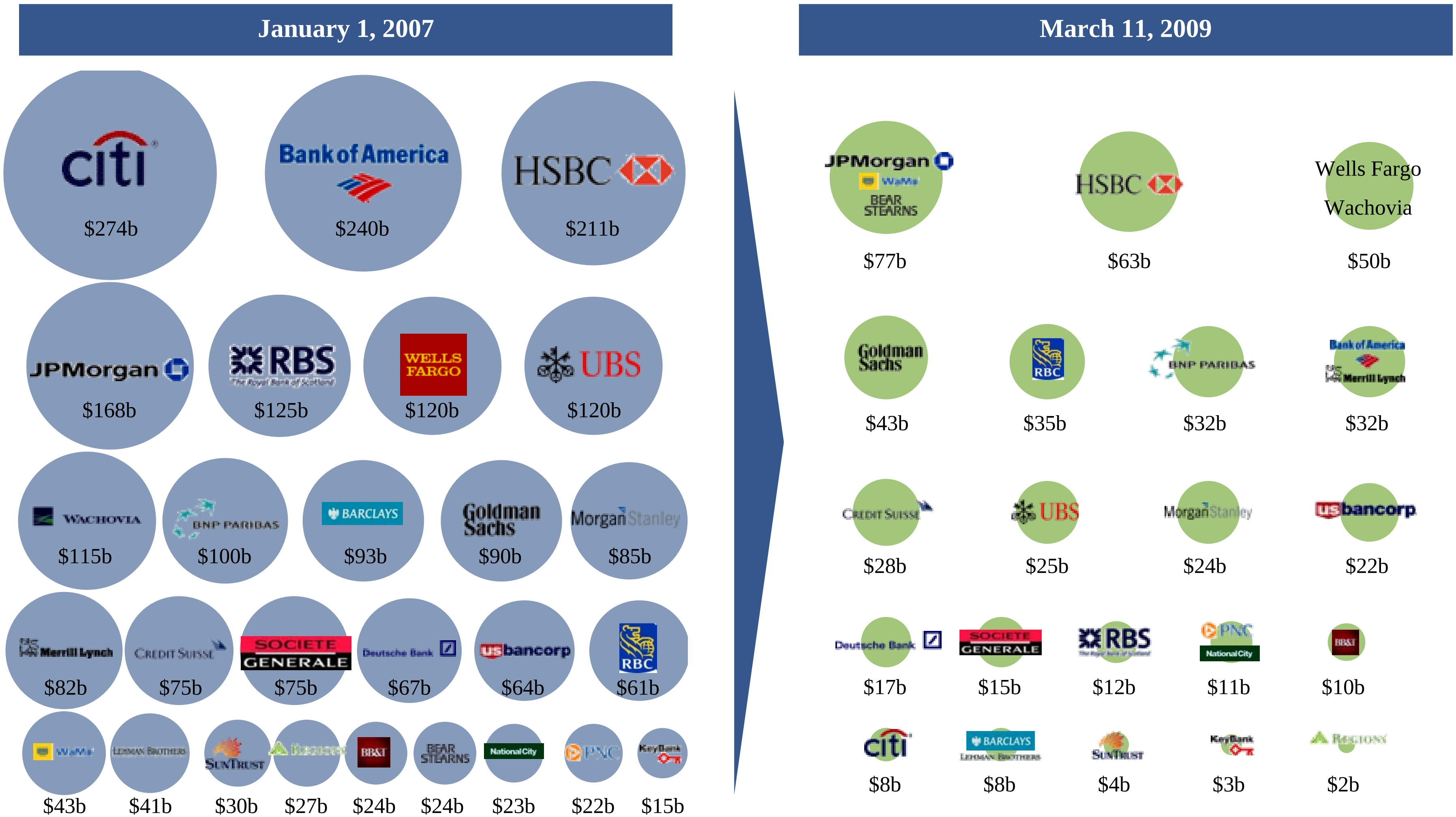
Active Pro Rata Investors



Source: Wachovia Securities and S&P/LCD

Fewer Banks Globally Impacts Liquidity

Bank Market Capitalization



Source: Wachovia Securities and S&P/LCD

Also Contributing to the Mess

- Multi-jurisdictional bankruptcies
- Mark to Market accounting
- More sophisticated:
  - Documentation issues
  - Legal horsepower
  - Restructuring advisors
- Distressed debt trading
  - Expansion into mainstream activity.
  - Few true “loan to own” investors.
  - Limited experience with running companies and liquidation.

DIP Lending has become More Complex Over Time

Number of Pages in DIP Rating Methodologies

Standard & Poor's 2003	3 Pages
Fitch 2006	6 Pages
Moody's 2009	16 Pages

Moody's DIP Rating Paradigm – Broad Rating Factors

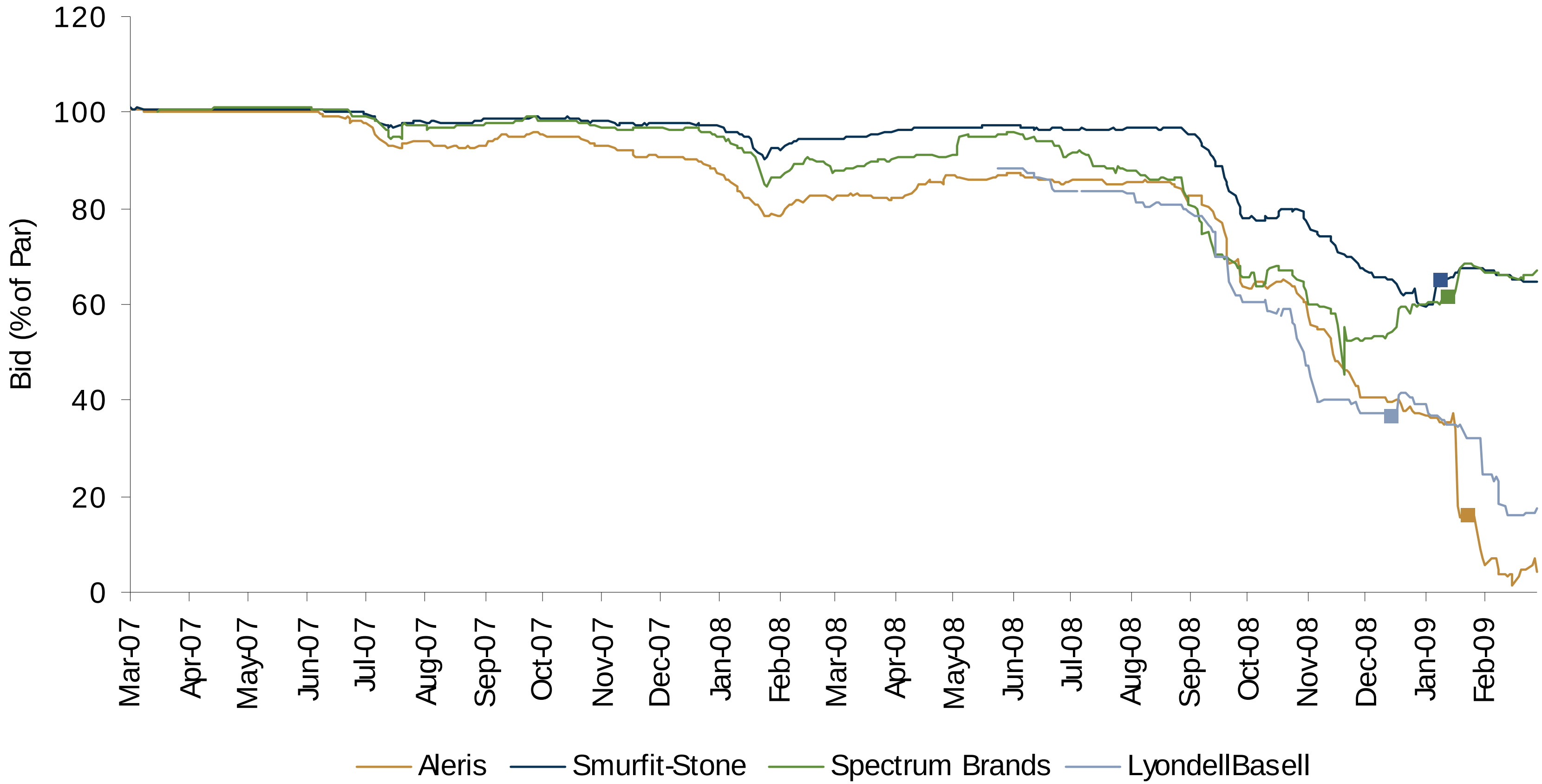
Nature of Bankruptcy Filing and Reorganization:	15%
Structural Features of DIP Loan:	25%
DIP as Percent of Pre-Petition Debt:	10%
Collateral Coverage:	50%

Why Make a DIP Loan?

- Because you feel you have to.
- Because it enhances your investment:
  - Yield.
  - Position in capital structure.
  - Certainty of repayment – certainty of exit.
- Because it's a good loan.
  - Many fewer of these than in the past.

All Bankruptcies are Not Created Equal

Trading Levels of Pre-Petition Debt for Recent Bankruptcies



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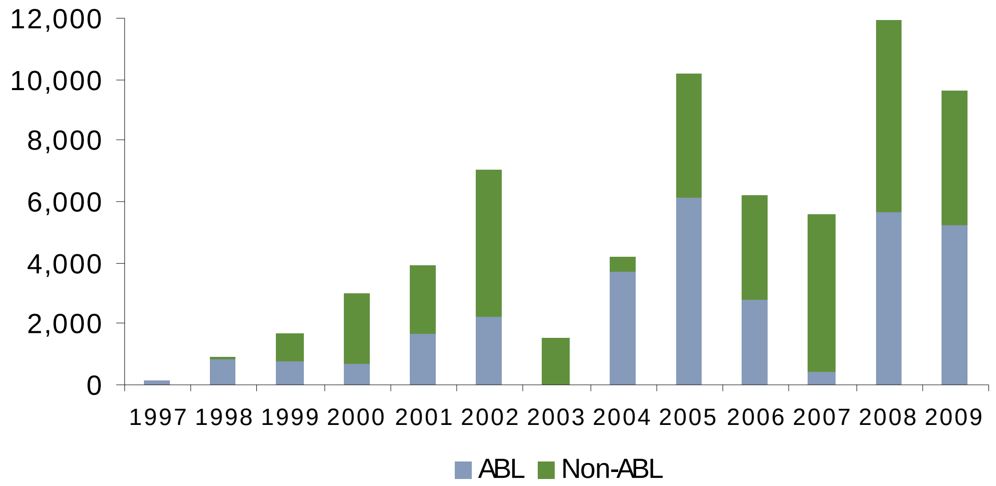
Where is the Shortage?

DIP Volume



Largest DIP Loans in 2009

Borrower	Deal Size	Industry	Signing Date
LyondellBasell Industries	$4,765,000,000	Chemicals	1/23/2009
Aleris International Inc	$1,504,700,000	Metals & Mining	2/5/2009
Smurfit-Stone Container	$750,000,000	Forest Product	1/29/2009
BearingPoint Inc	$402,000,000	Services & Leasing	1/30/2009
Chemtura Corp	$400,000,000	Chemicals	3/10/2009
Spectrum Brands	$190,000,000	Computers & Electronics	1/28/2009
Heartland Automotive	$187,700,000	Automotive	1/9/2009
Hartmarx Corp	$160,000,000	Textile & Apparel	1/19/2009
Gottschalks Inc	$125,000,000	Retail	1/6/2009
Tronox Inc	$125,000,000	Chemicals	1/9/2009

Source: Wachovia Securities and S&P/LCD

Emergence Financing is the Shortage

- Uncertainty over cash flow, debt capacity and viability.
- Too much debt being brought into the bankruptcy.
- Bond market not a great alternative given timing issues.
- Challenging syndication makes underwriting and bridging very challenging.

Conclusion

- Globally – orderly wind down. US is unique – Debtor in Possession.
- Facts on the ground have run in front of the code.
- Revisions make it more difficult for debtor to keep control.
- Leveraged entities of unprecedented scale.
- Much lower probability of emergence today.
- Bankruptcy is a much poorer tool for rehabilitation.
- Liquidity is an issue – but not the main one.
- Too many companies filing bankruptcy without appropriate preparation.

Good credit can attract capital