A View from Europe and the US

Why has high yield thrived in the toughest financial conditions in decades?
What Did European HY Look Like in 2000?

Use of Proceeds of First Generation European HY (1997-2000)

- Cable & Telecom Buildout
- M&A
- Refinance Bank Debt
- General Corporate
- LBO
How Was the First Generation of European HY Structured? – Structurally Subordinated Holding Company Debt

Typical Pre-2003 European High Yield Structure
How Did HY Investors Fare When the European Cable and Telecom Sectors Crashed in 2001-02?

European HY Default Rate by Industry (2002)

- **Cable**: 80.70%
- **Telecom**: 49.70%
- **Industrial**: 0.0%
- **Consumer**: 20.0%

Default Rate as % of Principal Amount
Wipeout! Bondholders Recovered Small Fractions of Their Claims


- FLAG
- Grapes
- Versatel
- Marconi
- NTL
- Energis
- Jazztel
- Netia

% Recovery of Principal Amount of Claim
The Industry Responded: Typical Second Generation European High Yield Structure – Brake Brothers

- Credit enhancements over First Generation structure:
  - First priority pledge over the downstream HY proceeds loan
  - Upstream senior subordinated guarantee from the bank borrower
  - Second priority pledge of the stock of bank borrower
  - Senior subordinated operating subsidiary guarantees
- The transaction received unanimous support from all leading players in the European high yield investor universe
Following the Reforms, Europe Has Seen a Steady Increase in HY Issuance, With More Than US$98 Billion Last Year
The European HY Market Matured Into a Large and Diversified Market

- Large diversified market with multiple sectors
  - LBO
  - Cable & Telecom
  - Fallen Angels
  - Straight corporate
- Diversified investor base
  - Institutional investors (2003 buyer’s strike)
  - Retail funds
  - Investment-grade managers
  - Hedge-funds

Source: CSFB
Last Year, Most of New Issue European HY Used to Refinance Bank Debt

Use of Proceeds in European HY Issuance (2011)

Bank debt refinancing 50%

GCP 14%

Bond debt refinancing 13%

Acquisition 11%

LBO 10%

Dividend 2%
Last Year, Germany and the UK Led the European High Yield Market

European High Yield Issuance by Jurisdiction (2011)

- Germany: 20%
- UK / Ireland: 20%
- France: 10%
- Italy: 10%
- NL / Belgium: 9%
- ES / Portugal: 8%
- CH / Austria: 7%
- Scandinavia: 6%
- Other: 10%
Yields on Global High Yield Near All-Time Lows

J.P. Morgan Global High Yield Index yield to worst (Spread to worst data in call out boxes)

Historical average: 11.1%
All-time high YTW: 20.9%
All-time high STW: +1,925bp
Previous all-time low YTW (04/05/11): 6.8%
All time low YTW: 6.4%
Current YTW: 6.7%
Current STW: +594bp
All-time low STW (06/05/07): +263bp

Source: J.P. Morgan, LCD

*Note: The figure indicates the sum of all weekly inflows*
Default Rates for HY and Leveraged Loans Remain Low in Europe

Default rates for European issuers (%)

Source: J.P. Morgan Research
Returns on European HY and Leveraged Loans Are Strong—18% YTD on HY and 8% on Leveraged Loans

Source: J.P. Morgan Research
European Leverage Finance Continues to Tilt Towards Bonds
Evolution of a High Yield Market

- Regional Market
  - Strong Local Players
    - Relationship Driven Banking
      - Local Loans Dominate
        - Market Shift - Commercial and Regulatory move from Loans
          - Increasing Importance of Bond Financing
            - Increasingly Sophisticated Markets and Capital Structures
              - Development through Foreign Investors
                - Development of Local Investor Base
                  - Diversification of Balance Sheets
                    - Continued Development of Intercreditor Arrangements
                      - Increasingly Sophisticated Markets and Capital Structures
Evolution Requires the Bond Market to Develop Integrity

- Self-policing by issuers and advisors

Due Diligence

High Quality Disclosure

Incurrence Covenants – Clear and Precise Drafting

Annual Compliance Certificate and reports of defaults

Ongoing Financial and Business Reporting

Active Dialogue between Issuers and Investors
Critical Steps to Ensure Best Execution

High Quality Trusted Advisors

Due Diligence

Offering Memorandum

Ongoing Reporting

Heat

Ratings

Financials

Auditor Comfort Letters

10b-5 Letters
Prospectus Drafting and Due Diligence

- Professional Advisors will drive the process
- Offering document typically prepared to a Rule 144A standard (some deals, however, are done on a Reg S only basis)
- Key elements of offering memorandum include:
  - Financials
  - Business and Operational Disclosure
  - Risk Factors
    - Issuer’s lawyers are primarily responsible for drafting the offering memorandum
    - Due diligence process will vary based on the nature of the offering (e.g., Rule 144A or Reg S)

Spectrum of Due Diligence and Disclosure

Less due diligence  Less disclosure  
↓  ↓  ↓
Rated Issuer/ Eurobond  Emerging Market Issuer  10b-5 equivalent  
↓  ↓  ↓
More due diligence  More disclosure
Other Key Sections of the HY OM

- Description of Business
- Description of Notes
- Risk Factors
- MD&A
- Strength & Strategies
- Industry
- Other Indebtedness/Intercreditor