# The Distressed Debt Report

News, Information, and Analysis of Distressed Debt in the Middle Market

Vol. III, No. 17 September 25, 2007

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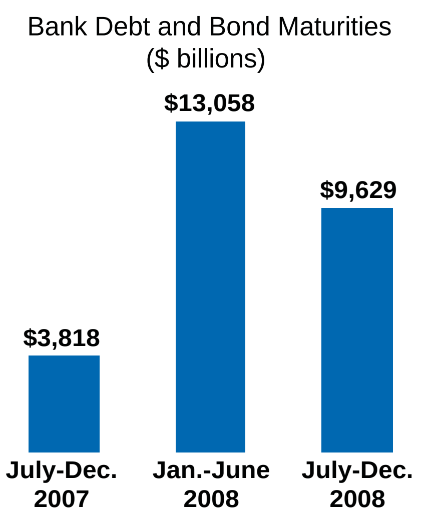
*DDR* flags cases of potential distress, listing the 98 middle-market, publicly traded companies with the highest debt-to-EBITDA ratios. p. 8

## MATURITIES OF SPECULATIVE-GRADE DEBT




Source: Moody's Investors Service

# BANKRUPTCY RATE EXPECTED TO SOAR FOR YEARS

## Worst Housing Decline in 40 Years Impacts Debt Market

by Reg Crowder

Moody's Investors Service forecasts that the rate of defaults among U.S. companies with speculative-grade debt will climb from 1.4% to 4% over the next 12 months. But that's just the beginning. The lenient debt financing that many companies with high leverage and poor business models obtained prior to July 2007 merely rescheduled their inevitable failures into 2008, 2009, and beyond.

"Defaults through 2008 are less likely to be triggered by an inability to refinance maturing debt than they were in the past," Moody's said. Given the number of speculative debt issuers with long periods of negative cash flow, many companies won't survive long enough to worry about refinancing their debt, the rating agency said. "More issuers may simply run out of cash," Moody's concluded.

Other market observers see similar dark clouds.

Trade credit insurer **Euler Hermes** recently projected that the number of U.S. business bankruptcies will rise 51% this year, compared with 2006. Standard & Poor's has braced itself for a default explosion over the next three months. The rating agency warns of 13 more speculative-grade defaults by the end of the year. There had been only 10 so far in 2007.

The Administrative Office of the U.S.

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# TROUBLED DEBT SPAWNS INVESTOR OPPORTUNITY

## Banks Offer Courtesy Discounts to Sweeten Deals

by Don Dzikowski

The turbulent debt market has opened up many avenues of investment for distressed-asset players.

Some banks, for example, have recently devised creative strategies to entice investors to unload risky debt weighing down their balance sheets.

One distressed-fund manager said he is seeing banks starting to offer more loans at a "courtesy discount." The discount is typically four cents on the dollar or so under what would have been the normal offering price. The discount is meant to fund prospective buyers' due diligence costs, and the routine hiring of attorneys and accountants to examine a deal prior to purchase. Some of these loans had been intended for clients to package into collateralized loan obligations (CLOs).

Secured debt of smaller, middle-market manufacturers is also opening up for investment opportunities, according to one fund manager. His typical target

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**The Distressed Debt Report**
DealFlow Media, Inc.
P.O. Box 122
Syosset, NY 11791
T (516) 876-8006
F (516) 876-8010

subscribe@dealflowmedia.com
www.dealflowmedia.com

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# ENRON JUDGE RULES ARM'S LENGTH DEBT SALES DO NOT TRANSFER LIABILITY

## Ruling Clears Confusion Over Debt Trader Liability

A federal judge, in a ruling Monday, clarified for the market that secondary market investors in distressed debt are indeed not usually liable for the actions of the original lenders.

U.S. District Court Judge Shira Scheindlin in Manhattan issued a decision responding to the confusion created in the $500 billion debt trading marketplace by her Aug. 27 ruling in the case of *Springfield Associates v. Enron*. That confusion involved whether recipients of secondary debt trades can be absolved from equitable subordination liability whenever they unwittingly receive those trades from original holders accused of wrongdoing.

Scheindlin has now clarified that good faith transfers at arm's length on the open market are indeed sales, and are not assignments subject to the liability, according to Eliot Ganz, general counsel for the Loan Syndications and Trading Association (LSTA).

Judge Scheindlin's August decision caused several legal observers and market players to scratch their heads as to whether she had meant transfers could be interpreted as "assignments" instead of "sales", therefore exposing their often senior secured claims to the possibility of being equitably subordinated with other lower claims. Law firms had raised the matter in several memos since issued to the market, while the LSTA; the Securities Industry and Financial Markets Association and the International Swaps and Derivatives Association have filed papers last week supporting Springfield's appeal for the clarification.

Scheindlin yesterday referred the matter to the Manhattan bankruptcy court for the final ruling. But based on her clarification yesterday it would be "extremely difficult" for the lower court to find anything other than that the trades involved were sales as good faith open market trades at arm's length, and therefore not assignments, and thus not subject to the liability, Ganz said.

Scheindlin's ruling came as a rejection to a Sept. 7 appeal of her earlier ruling in Springfield's lawsuit against Enron. Springfield, a distressed investor, had asked the Second Circuit Court of Appeals to clarify the issue that Scheindlin had been believed to have left open in her Aug. 27 decision of whether a transfer of debt is a sale and when it is an assignment.

The uncertainty of whether the transfer is a sale or assignment "is not significant" because "equitable subordination and disallowance (of a claim) arising out of the conduct of the transferee will not be applied to good faith open market purchasers of claims…sales of claims on the open markets are indisputably sales," Scheindlin said in yesterday's ruling, as a modification of her earlier opinion.

Subject to a final determination of the bankruptcy court that the transfers were open market transfers in good faith, Scheindlin's ruling now appears to have absolved Springfield from liability relating to the $5 million in Enron syndicated debt that Springfield received from Citigroup.

Enron's argument for equitable subordination is based on claims that Citigroup and other providers of $1.7 billion in syndicated debt were aware of the accounting fraud at the energy giant prior to its 2001 bankruptcy.

The August decision had raised new concerns for the debt market. Previous to Scheindlin's ruling, many debt market players hadn't seen it as important to distinguish whether a debt transfer was a sale or an assignment. The decision implied that those who receive debt in assignments can bear more risk of liability for the

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actions of lenders. But the ruling had also left confusion over how to tell the difference between a sale and an assignment.

No such distinction was found in either the federal Bankruptcy Code or the Uniform Commercial Code governing debt transfers, according to Nicholas F. Kajon, a partner with the law firm of **Stevens & Lee** in New York. On top of that, various legal and trade association documents for transfers "typically use multiple words to memorialize the event," he said.

Scheindlin's ruling could have been interpreted to say that a debt trade is an assignment if the receiver of the debt had the opportunity to negotiate an indemnity agreement with the seller, according to Patricia C. O'Prey, a partner with the law firm of **Richards Kibbe & Orbe** in New York. Assignments, under that definition, are common in the distressed bank loan market, she said.

Eric R. Wilson, a partner with the law firm of **Kelley Drye & Warren** said that Scheindlin's decision might have allowed claims of equitable subordination that formerly would have been subject to a challenge. Equitable subordination is when a creditor's claim in a bankruptcy case is subordinated because of wrongdoing by the creditor.

In the past equitable subordination claims have been challenged where the lender who might have been liable transferred its debtholdings to other investors.

However, Scheindlin's ruling, irregardless of the clarification, could result in a greater number of equitable subordination claims overall, reducing recoveries for creditors to bankrupt companies, according to Wilson. "Lenders may be less cautious about taking aggressive positions because they may now have the ability to 'wash' their claims in bankruptcy by transferring them to a third party," Wilson wrote in an article published on the *BankruptcyLaw 360* news service.

Scheindlin's ruling now can be viewed to unequivocally overturn a Manhattan bankruptcy court decision that went against Springfield, according to Ganz with the LSTA. The bankruptcy court ruling had raised fear in the debt market that secondary market traders could be subject to equitable subordination. The bankruptcy court ruling was later cited in the bankruptcies of commodities broker **Refco** and of beverage-maker **Le-Nature's**. Those cases also raised issues of legal liability for debt traders for the actions of lenders.

The legal question comes as the distressed debt market is expected to boom, the LSTA and the two other debt market trade groups said in legal filings.

The three trade groups also said that Springfield's appeal could have bearing on at least one other case: A lawsuit by the bankruptcy estate of cable television company **Adelphia Communications** against **Bank of America** and other banks.

Adelphia accused the banks of facilitating fraudulent arrangements that made Adelphia liable some $5 billion in loans that went for the benefit of the Rigas family, which once controlled the company. Adelphia is seeking to equitably subordinate the banks' claims and those of investors in Adelphia's debt on the secondary market. *—DD*

## Deloite, PwC Accountants Disciplined for National Century Fraud

The Securities and Exchange Commission disciplined three certified public accountants for their alleged involvement in the **National Century Financial Enterprises** $3 billion fraud case.

The agency's action renewed fears of liability that accountants and other service providers can face when even unwittingly assisting in a client's improper activities.

Press C. Southworth, formerly of PricewaterhouseCoopers, and Robert M. Harbrecht and Brian R. Spires, formerly of Deloitte & Touche, have been banned from performing any accounting work for public companies for periods ranging from one to two years.

Southworth conducted National Century's 1998 audit, while Harbrecht and Spires performed the audits from 1999 through 2001.

The SEC alleged in enforcement actions filed Sept. 19 that the auditors failed to disclose that National Century had misappropriated proceeds from the sales of asset-backed notes. The Dublin, Ohio-based health care finance company used cash raised in a private placement of notes to make unsecured loans to affiliated insolvent companies. National Century is also alleged to have made loans secured by collateral other than health care accounts receivables, in violation of the securitization indenture agreements.

The accountants are also alleged to have signed off on audits and financial statements prepared according National Century's management's directives and not in accordance with generally accepted accounting principles.

Noteholders, the securitization trustee and rating agencies relied on the accounting approved by Southworth, Harbrecht and Spires. Meanwhile, National Century's fraud went undetected until 2002, causing the noteholders some $3 billion in losses, the SEC claims.

An SEC official said the accountant actions will produce no recovery for noteholders.

The three CPAs, all Ohio residents, admitted no wrongdoing under the settlement.

After disciplinary periods of two years for Southworth, 18 months for Harbrecht and one year for Spires, they may apply again to work as public accountants. Only Spires remains a practicing CPA, however, according to the SEC. Southworth and Harbrecht have retired and allowed their accounting licenses to lapse.

In 2006, PwC and Deloitte settled civil lawsuits filed by National Century's noteholders. Terms of the settlements have not been publicly disclosed, according to Kathy Patrick, a partner with the

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law firm of **Gibbs & Bruns**, who represented noteholders in National Century's bankruptcy. The three accountants have not been named as defendants.

Several actions remain pending against other service providers, including **Credit Suisse Group**, which was National Century's main banking agent and underwriter. Credit Suisse also provided warehouse lines of credit for National Century's health care receivables securitizations. Evidence produced in the SEC's investigations of the accountants provide possible legal ammunition against Credit Suisse, Patrick said. Victoria Harmon, a spokeswoman for Credit Suisse in New York, declined to comment.

Patrick said she did not know if the SEC is investigating Credit Suisse. She said she was surprised to hear of the accountant actions and that it was reassuring that the SEC was still investigating the case.

Federal prosecutors in Columbus, Ohio have brought criminal actions since May of 2006 against eight former National Century executives, including Chairman Lance K. Poulsen. All have pleaded not guilty and are slated to begin trial in February.

Service providers including accountants and banks fear being targeted in litigation and regulatory actions whenever their clients are found to have engaged in fraud, according to Beverly Manne, head of the insolvency practice of law firm **Tucker Arensberg, P.C.** in Pittsburgh. The main concern, Manne said, is that a bit of slightly sloppy work or even the conscious application of professional business standards "would still somehow get elevated to the level of criminal conduct."

## HSBC Hires Deutsche Bank Execs to Lead Debt Group

**HSBC Holdings** hired two former **Deutsche Bank** executives to key positions overseeing debt finance in the U.S.

Tom Cole, formerly Deutsche Bank's head of leveraged finance, and Daniel Toscano, who was head of senior debt capital markets in New York, will serve as HSBC's co-heads of leveraged acquisition and finance for the Americas.

They will report to Kevin Adeson, HSBC's global head of leveraged and acquisition finance. Michael McGovern, HSBC's current head of U.S. leveraged and acquisition finance, will take another senior role at the beginning of next year.

## Deutsche Bank Uses Novel Strategy for $2B CLO

**Deutsche Bank** followed an unusual strategy to package and sell a $2 billion collateralized loan obligation in a tough market. The investment bank pooled together highly syndicated loans to larger companies from 12 different asset managers.

Deutsche Bank is keeping the CLO on its own balance sheet while it searches for an asset manager to take it over, according to sources and a Sept. 14 presale report from Fitch Ratings.

Deutsche Bank priced Genesis CLO 2007-1 on Sept. 17 at wide spreads over three-month LIBOR. The spreads on the triple-A- and single-A-rated tranches were almost double what investors paid for similar securities in mid-July.

The $1.57 billion triple-A-rated tranche priced at 50 basis points; the $110 million double-A class sold at 115 basis points; the $70 million single-A class paid 225 basis points; the $50 million triple-B class went for 400 basis points; while the $40 million double-B piece priced at 650 basis points.

Deutsche Bank has retained $160 million in equity in the CLO. Genesis CLO has a weighted average life of 4.08 years and a legal final maturity of seven years. All of the loans are to be secured at closing in the near term for the CLO. Previously, the normal ramp-up period for similar deals has extended over several months.

One CLO manager, who was not involved in the deal, observed that other managers may have participated in the pooled deal for economies of scale. It might have been uneconomical at today's yields to bring a deal on their own.

"The market is looking for creative ways to securitize loans," the manager said. "This is another approach. Time will tell whether the strategy works."

Fitch said the CLO consisted 96% of senior loans with the remainder consisting of second liens. About 23% of the pool consists of covenant-lite loans.

No asset manager has been identified for the CLO so far, Fitch stated in a report. The fees that Deutsche Bank is offering to manage the vehicle are relatively low, according to the ratings agency. Fitch analyst and co-author of the report Mark Kirk declined to say specifically how much Deutsche Bank is offering.

At least one other CLO has priced recently. **Churchill Pacific Asset Management** sold a $400 million issue named San Gabriel CLO I Ltd.

## Audax Raising Distressed Debt Fund

**Audax Group** is raising a new fund to buy both senior debt and distressed debt, according to *Buyouts*. The trade publication said that Audax hope to raise $200 million, which could be leveraged to as much as $1 billion.

Representatives of the firm declined to comment to *DDR*.

## RAM Capital Looking to Raise $250M

Debt fund manager **RAM Capital Resources** is opening its secured debt fund to new investors, hoping to raise $250 million.

RAM has been incubating its Shelter Island Opportunity Fund for about a year with capital provided by RAM's partners and some of its long-term investors, principal Michael Fein said. In that time, the fund has reported returns of more than 15% and hasn't recorded a down month, according to James Boothby, RAM's director of client development.

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The fund generally makes investments of less than $8 million in privately held or small-cap public companies. Shelter usually provides senior secured loans and takes warrants or stock from its borrowers.

Managers of the New York-based fund say they don't expect the suddenly turbulent debt market to interfere with their strategy. In fact, they claim they expect it to provide more opportunity. RAM may now be able to loan to some companies that previously would have gotten their financing from commercial banks or other more traditional sources of capital, RAM's principals say.

"The bankers have gotten more conservative in this market," managing director Michael Coiley said.

Coiley recently joined Ram. He was previously a senior vice president and group head of the commercial equipment finance group for **Siemens Financial Services**.

Shelter Island Opportunity is one of two funds that RAM manages. It also controls the Shelter Island Offshore Fund. The four-year-old multi-strategy fund has $99 million in assets, according to data provider BarclayHedge. Shelter Island Offshore has reportedly generated annual returns of about 15.5%.

Separately, a former RAM Capital manager announced the start-up of another new debt fund. Randall Stern, who left RAM Capital earlier this year, said in an e-mail to business acquaintances that he is launching the **Boone Capital Credit Fund**.

Boone has "closed on significant capital investments by institutional investors," Stern said in the e-mail. The fund is ready to invest in transactions ranging from $500,000 to $5 million each, he said. Stern couldn't immediately be reached for comment beyond his e-mail.

Boone Capital will invest in small private and public companies, Stern said. The firm plans to offer secured term notes with two-to-three-year terms and to take small equity stakes in its borrowers. Boone will also provide stretch financing and bridge loans for growth financing and acquisitions, Stern said. He also said that his new Norwalk, Conn.-based fund will specialize in providing financings for situations that are time-sensitive, and can close on loans within 30 days from when prospective borrowers submit financial information.

PRIVATE OFFERING REFORM

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## Praesidian Closes $236M Mezzanine Fund

**Praesidian Capital** closed its second mezzanine fund to new investors after raising $236 million in capital.

Praesidian Capital Investors II will invest in middle-market companies with revenues ranging from $15 million to $150 million and EBITDA from $4 million to $15 million, the New York-based firm said. Praesidian said it funds historically profitable companies, management buyouts and leveraged buyouts, recapitalizations, and refinancings.

Its recent deals include a $6.5 million senior subordinated debt financing for the recapitalization of travel agency **Tzell Travel** earlier this month.

## MCG Raises $43.5M in Public Stock Offering

A public offering of shelf-registered stock raised $43.5 million for **MCG Capital**, a middle market investor that provides financing for acquisitions, recapitalizations and buyouts, and growth and working capital loans.

The company plans to use the proceeds for loan origination and middle marketing investing.

**Friedman, Billings, Ramsey & Co.** served as the sole book-running manager, while **Stifel, Nicolaus & Co.** and **SunTrust Robinson Humphrey** were co-managers. After the offering was announced on Sept. 19, MCG shares fell 4.9% to $14.33.

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The following tables include data about publicly traded companies that have filed for bankruptcy and that have defaulted on debt in the 30 days through Sept. 20. Data is provided by Capital IQ.

## Public Company Bankruptcies

| Company (Ticker) | Bankruptcy Filed | Enterprise Value (M) | Market Cap (M) | Total Revenue (M) | EBITDA (M) | Net Income (M) | Total Debt (M) |
|---|---|---|---|---|---|---|---|
| Bombay Company Inc. (OTCBB:BBAO) | Sept. 20 | 77.3 | 2.58 | 522.3 | (17.7) | (52.7) | 78.6 |
| SCO Group Inc. (NasdaqSC:SCOX) | Sept. 14 | -3.86 | 3.93 | 26.8 | (10.1) | (9.49) | 0 |
| IWT Tesoro Corp. (OTCBB:IWTT) | Sept. 6 | - | - | 58.1 | (2.24) | (8.98) | 29.2 |
| Universal Food and Beverage Company (OTCPK:UFBV) | Aug. 31 | 3.65 | 0.206 | - | - | - | - |
| Global Entertainment Holdings/Equities, Inc. (OTCBB:GAMT) | Aug. 24 | 3.44 | 2.89 | - | (2.61) | (2.51) | 0.567 |
| Fedders Corp. (OTCPK:FJCC) | Aug. 22 | 237.4 | 1.44 | 159.6 | (25.2) | (136.2) | 239.5 |

## Debt Defaults

| Company (Ticker) | Date | Total Revenue (M) | EBITDA (M) | Total Debt (M) |
|---|---|---|---|---|
| Beazer Homes USA Inc. (NYSE:BZH)* | Sept. 10 | 4,274.10 | 191.4 | 1,767.10 |
| Beazer Homes USA Inc. (NYSE:BZH)* | Sept. 7 | 4,274.10 | 191.4 | 1,767.10 |
| Dalrada Financial Corporation (OTCBB:DFCO) | Sept. 5 | 136.8 | (8.63) | 18.2 |
| Tarragon Corp. (NasdaqNM:TARR) | Aug. 24 | 581.1 | 68.4 | 1,497.40 |
| Cyberlux Corp. (OTCBB:CYBL) | Aug. 23 | 0.578 | (4.72) | 2.58 |
| Hydrogen Power Inc. (OTCBB:HYDP) | Aug. 21 | 0.126 | (37.7) | 1.38 |

* Beazer Homes USA defaulted on four issues of notes. The company announced Sept. 7 that it received notices of default on three issues of senior notes, and then announced on Sept. 10 that it received a notice of default on an issue of convertible senior notes.

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The following table lists the 98 publicly traded middle-market companies with the highest ratios of debt to EBITDA as of Sept. 21. *DDR* defines a middle market company as one that generates less than $500 million in annual revenue. The table also excludes companies with market capitalizations of less than $10 million. Data is provided by Capital IQ.

## High Debt to EBITDA

| Company (Ticker) | Enterprise Value (M) | Total Debt/ EBITDA (M) | Total Revenue (M) | Market Cap (M) | EBITDA (M) | Net Income (M) | Total Debt (M) |
|---|---|---|---|---|---|---|---|
| Aevum Limited (ASX:AVE) | 588.4 | 10,488.0 | 16.7 | 285.4 | 0.031 | 19.5 | 329.4 |
| Babcock & Brown Communities Ltd. (ASX:BBC) | 908.1 | 2,259.8 | 96.3 | 577.6 | 0.15 | 1.76 | 339.5 |
| Daido Group Ltd. (SEHK:544) | 48.0 | 1,944.1 | 18.7 | 39.5 | 0.007 | 0.04 | 13.7 |
| Ban Joo & Co. Ltd. (SGX:B07) | 131.6 | 1,293.0 | 53.8 | 99.0 | 0.029 | (2.9 ) | 37.2 |
| PDG Environmental Inc. (OTCBB:PDGE) | 35.9 | 839.3 | 84.5 | 19.7 | 0.016 | (2.97) | 13.4 |
| Running Fox Resource Corp. (TSXV:RUN) | 22.2 | 694.9 | 5.38 | 23.1 | 0.002 | (0.32 ) | 1.3 |
| GTL Resources plc (AIM:GTL) | 114.2 | 640.5 | 24.2 | 72.4 | 0.066 | (2.0 ) | 42.3 |
| South China Land Limited (SEHK:8155) | 114.8 | 562.3 | 3.24 | 22.8 | 0.095 | 0.048 | 53.3 |
| Oriental Technologies Investment (ASX:OTI) | 19.1 | 561.9 | 41.1 | 5.76 | 0.019 | (1.12) | 10.5 |
| Western Energy Services Corp. (TSXV:WSV) | 27.5 | 553.3 | 13.9 | 8.19 | 0.034 | (5.32) | 18.8 |
| Baywood International Inc. (OTCBB:BYWD) | 11.5 | 331.1 | 3.8 | 5.26 | 0.022 | (1.1 ) | 7.36 |
| Sinobiomed Inc. (OTCBB:SOBM) | 320.0 | 306.8 | 0.732 | 307.2 | 0.083 | (2.58) | 14.1 |
| SHH Resources Holdings Bhd (KLSE:SHH) | 16.9 | 306.2 | 56.2 | 6.69 | 0.039 | (2.16) | 11.9 |
| Road King Infrastructure Ltd. (SEHK:1098) | 1,881.2 | 301.0 | 104.0 | 1,458.0 | 2.56 | 98.1 | 769.1 |
| Minmetals Land Limited (SEHK:230) | 286.4 | 292.4 | 36.5 | 321.1 | 0.175 | 29.2 | 51.2 |
| Global Voice Networks Ltd. (SGX:H23) | 320.2 | 285.0 | 26.5 | 280.8 | 0.142 | (17.2) | 40.4 |
| Saujana Consolidated Bhd (KLSE:SAUJANA) | 35.7 | 274.7 | 20.0 | 21.9 | 0.026 | (0.585) | 7.05 |
| MGI Pharma Inc. (NasdaqNM:MOGN) | 2,141.7 | 271.4 | 353.7 | 2,039.9 | 0.965 | (15.1) | 261.9 |
| Hotline Glass Ltd. (BSE:500195) | 39.3 | 268.6 | 10.4 | 6.27 | 0.107 | (0.876) | - |
| Grande Asset Development Public Co. (SET:GRAND) | 306.9 | 267.2 | 60.8 | 162.1 | 0.542 | (5.86) | 144.8 |
| Ascendia Brands, Inc. (AMEX:ASB) | 298.0 | 263.1 | 116.7 | 21.7 | 1.05 | (106.6) | 276.7 |
| Pongsaap Company Limited (SET:PSAP) | 33.5 | 254.4 | 25.1 | 11.5 | 0.076 | (14.8) | 19.4 |
| Reliance Natural Resources Ltd. (BSE:532709) | 2,785.3 | 233.5 | 38.8 | 2,839.5 | 1.38 | 9.8 | 321.3 |

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## High Debt to EBITDA

| Company (Ticker) | Enterprise Value (M) | Total Debt/ EBITDA (M) | Total Revenue (M) | Market Cap (M) | EBITDA (M) | Net Income (M) | Total Debt (M) |
|---|---|---|---|---|---|---|---|
| Dune Energy Inc. (AMEX:DNE) | 597.2 | 228.6 | 22.1 | 164.5 | 1.31 | (79.1) | 300.3 |
| National Industries Group (KWSE:NIND) | 5,673.5 | 225.9 | 391.1 | 5,828.7 | 11.1 | 758.3 | 2,509.8 |
| Innovo Leisure Recreation Holdings Ltd. (SEHK:703) | 36.7 | 222.6 | 2.06 | 30.8 | 0.027 | (0.798) | 6.01 |
| Modernland Realty PT (JKSE:MDLN) | 232.6 | 212.0 | 9.59 | 164.0 | 0.348 | (0.315) | - |
| FirstFarms A/S (CPSE:FFARMS) | 52.9 | 211.5 | 8.54 | 106.8 | 0.008 | 0.109 | 1.61 |
| Transmeridian Exploration Inc. (AMEX:TMY) | 600.8 | 199.5 | 35.1 | 261.7 | 1.36 | (55.8) | 270.5 |
| Zhongyu Gas Holdings Ltd. (SEHK:8070) | 197.3 | 187.7 | 12.6 | 252.6 | 0.253 | 0.216 | 47.4 |
| Birla VXL (BSE:503796) | 77.1 | 184.9 | 25.0 | 36.6 | 0.207 | (5.26) | - |
| Anwell Technologies Ltd. (SGX:A70) | 67.7 | 181.5 | 49.5 | 61.9 | 0.052 | (3.07) | 9.35 |
| Hindustan Organic Chemicals Ltd. (BSE:500449) | 219.9 | 166.8 | 86.8 | 111.6 | 0.571 | (12.0) | - |
| QSGI, INC. (OTCBB:QSGI) | 30.3 | 159.7 | 41.0 | 21.1 | 0.036 | (0.574) | 5.79 |
| Balda AG (DB:BAD) | 718.9 | 148.3 | 395.5 | 456.2 | 1.7 | (72.0) | 252.3 |
| Chrome Corporation Ltd. (ASX:CCI) | 21.0 | 140.7 | 0.323 | 15.5 | 0.041 | (1.35) | 5.72 |
| Pongs & Zahn AG (DB:PUZ) | 121.1 | 140.1 | 195.0 | 14.3 | 0.659 | (11.5) | 92.3 |
| Langer Inc. (NasdaqNM:GAIT) | 87.1 | 132.8 | 50.2 | 57.9 | 0.236 | (4.58) | 31.3 |
| Lloyds Metals & Engineers Ltd. (BSE:512455) | 169.1 | 132.0 | 68.5 | 120.4 | 0.341 | (6.94) | - |
| IG Petrochemicals Ltd. (BSE:500199) | 84.2 | 131.0 | 79.7 | 44.4 | 0.282 | 84.6 | - |
| Cash Systems Inc. (NasdaqNM:CKNN) | 115.5 | 130.3 | 103.5 | 101.8 | 0.243 | (11.3) | 31.6 |
| Ningbo Yidong Electronic Co. Ltd. (SEHK:8249) | 31.2 | 126.2 | 54.4 | 18.3 | 0.33 | (2.59) | 41.7 |
| Bintai Kinden Corp. Bhd (KLSE:BINTAI) | 72.1 | 124.8 | 70.2 | 15.7 | 0.551 | (0.376) | 68.8 |
| China Cyber Port Company Limited (SEHK:8206) | 307.8 | 122.2 | 2.64 | 263.9 | 0.384 | 1.03 | 46.9 |
| Clayeux SA (ENXTPA:CLAY) | 25.3 | 113.6 | 30.9 | 7.55 | 0.163 | 0.257 | 16.4 |
| Udl Holdings Ltd. (SEHK:620) | 93.7 | 111.8 | 2.31 | 85.6 | 0.074 | 5.83 | 8.23 |
| Simrad Optronics ASA (OB:SIT) | 103.8 | 111.2 | 50.0 | 90.6 | 0.16 | (6.47) | 17.8 |
| Mvelaphanda Resources Ltd. (JSE:MVL) | 1,883.8 | 109.3 | 31.4 | 1,605.4 | 2.83 | 101.9 | 309.1 |

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## High Debt to EBITDA

| Company (Ticker) | Enterprise Value (M) | Total Debt/ EBITDA (M) | Total Revenue (M) | Market Cap (M) | EBITDA (M) | Net Income (M) | Total Debt (M) |
|---|---|---|---|---|---|---|---|
| Manila Mining Corp. (PSE:MAB) | 126.8 | 107.9 | 0 | 126.6 | 0.067 | (1.62) | 7.27 |
| Svithoid Tankers AB (OM:SVIT B) | 138.3 | 104.9 | 11.7 | 29.9 | 1.04 | (4.87) | 108.6 |
| Island Information & Technology Inc. (PSE:IS) | 21.8 | 99.4 | 0.089 | 20.5 | 0.01 | 0.019 | 1.25 |
| Clarity Commerce Solutions plc (AIM:CCS) | 23.8 | 97.1 | 41.0 | 16.0 | 0.085 | (1.56) | 8.23 |
| Aegek SA (ATSE:AEGEK) | 577.8 | 96.3 | 246.5 | 194.7 | 3.89 | (52.6) | 374.4 |
| Chuang's Consortium International Ltd. (SEHK:367) | 435.5 | 95.2 | 197.7 | 300.0 | 1.89 | 27.5 | 180.0 |
| Pixela Corp. (TSE:6731) | 30.0 | 94.1 | 71.1 | 45.9 | 0.136 | (2.04) | 12.8 |
| SICC S.p.A. (CM:SIC) | 52.0 | 93.1 | 45.8 | 21.2 | 0.35 | 0.181 | 32.6 |
| Aker American Shipping ASA (OB:AKASA) | 870.9 | 90.8 | 6.77 | 583.2 | 4.23 | 2.95 | 384.5 |
| Environmental Recycling Technologies plc. (AIM:ENRT) | 37.8 | 87.6 | 0.625 | 27.3 | 0.118 | (14.4) | 10.3 |
| Corning Natural Gas Corp. (OTCBB:CNIG) | 31.1 | 86.3 | 24.4 | 14.4 | 0.195 | (3.06) | 16.8 |
| Fulcrum Equity Limited (ASX:FUL) | 25.3 | 84.3 | 11.4 | 15.0 | 0.206 | (2.85) | 17.4 |
| JPK Holdings Bhd (KLSE:JPK) | 21.2 | 82.9 | 34.2 | 7.5 | 0.171 | (3.84) | 14.2 |
| GP Industries Ltd. (SGX:G20) | 347.7 | 81.2 | 228.1 | 199.3 | 2.24 | 53.2 | 181.8 |
| Uniphos Enterprises Ltd. (BSE:500429) | 57.2 | 81.1 | 0.272 | 37.8 | 0.221 | (0.166) | 18.0 |
| Dynamic Holdings Ltd. (SEHK:29) | 145.8 | 80.9 | 19.5 | 100.2 | 0.628 | 0.418 | 50.9 |
| National Electronics Holdings Ltd. (SEHK:213) | 171.2 | 80.9 | 136.4 | 72.5 | 1.57 | 14.5 | 127.2 |
| Full House Resorts Inc. (AMEX:FLL) | 69.1 | 79.0 | 8.94 | 58.0 | 0.234 | 0.53 | 18.5 |
| Fortune Industries, Inc. (AMEX:FFI) | 67.1 | 77.1 | 163.1 | 24.9 | 0.589 | (7.31) | 45.4 |
| Slimma plc (AIM:SLM) | 12.0 | 76.0 | 32.7 | 6.25 | 0.081 | (0.593) | 6.14 |
| Tianjin TEDA Biomedical Engineering Co. (SEHK:8189) | 44.3 | 75.9 | 37.0 | 29.8 | 0.207 | (0.121) | 15.8 |
| Core Emballage Limited (BSE:509009) | 15.9 | 75.9 | 5.84 | 1.78 | 0.113 | (1.16) | 8.61 |
| Babcock and Brown Power Limited (ASX:BBP) | 3,149.2 | 75.8 | 452.3 | 1,711.0 | 14.2 | (67.1) | 1,077.9 |
| NRC Ltd. (BSE:503780) | 62.2 | 75.1 | 99.0 | 22.0 | 0.574 | (6.56) | 43.1 |
| Olympia Industries Bhd (KLSE:OLYMPIA) | 208.5 | 75.0 | 94.4 | 153.7 | 1.28 | 151.1 | 96.0 |

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## High Debt to EBITDA

| Company (Ticker) | Enterprise Value (M) | Total Debt/ EBITDA (M) | Total Revenue (M) | Market Cap (M) | EBITDA (M) | Net Income (M) | Total Debt (M) |
|---|---|---|---|---|---|---|---|
| SMPC Corp. Bhd (KLSE:SMPC) | 34.5 | 73.7 | 56.1 | 4.52 | 0.426 | (4.52) | 31.4 |
| Ralco Corp.Bhd (KLSE:RALCO) | 27.3 | 73.7 | 29.2 | 16.5 | 0.146 | (2.23) | 10.8 |
| GIVO Ltd. (BSE:531613) | 15.7 | 73.4 | 2.74 | 12.0 | 0.054 | 5.87 | 3.98 |
| Equine Capital Bhd (KLSE:EQUINE) | 161.0 | 73.2 | 21.6 | 133.3 | 0.423 | 1.18 | 31.0 |
| Stefanel SpA (CM:STEF) | 428.7 | 72.7 | 414.2 | 224.0 | 3.04 | (13.6) | 221.2 |
| Chinney Investments Ltd. (SEHK:216) | 506.9 | 72.3 | 225.8 | 79.3 | 4.35 | (3.45) | 314.8 |
| Millennium Pharmaceuticals Inc. (NasdaqNM:MLNM) | 2,805.4 | 71.9 | 468.2 | 3,324.1 | 4.53 | (29.9) | 325.6 |
| Whitehaven Coal Limited (ASX:WHC) | 690.5 | 71.1 | 90.1 | 642.5 | 0.915 | 19.1 | 65.1 |
| FFastfill plc (AIM:FFA) | 56.6 | 71.0 | 11.9 | 58.0 | 0.01 | (2.18) | 0.7 |
| Gwb Immobilien Ag (DB:G7B) | 46.8 | 70.7 | 28.0 | 26.9 | 0.454 | (0.734) | 32.1 |
| MOD-PAC Corp. (NasdaqNM:MPAC) | 32.6 | 69.3 | 46.2 | 30.7 | 0.028 | (3.3 ) | 1.94 |
| Aktieselskabet Borgestad ASA (OB:BOR) | 112.2 | 68.4 | 66.5 | 100.8 | 0.715 | 2.88 | 48.9 |
| Jakarta Kyoei Steel Works (JKSE:JKSW) | 71.0 | 68.3 | 14.0 | 5.97 | 0.971 | 0.619 | - |
| Supermercados Unimarc S.A. (SNSE:SM UNIMARC) | 162.9 | 67.1 | 222.5 | 60.7 | 1.5 | (15.5) | 100.8 |
| Companhia Docas De Imbituba (BOVESPA:IMBI4) | 76.5 | 66.8 | 0.408 | 40.1 | 0.475 | (0.499) | 31.7 |
| Interactive Brand Development Inc. (OTCBB:IBDI) | 16.1 | 64.5 | (0.205) | 0.978 | 0.234 | (30.4) | 15.1 |
| ACAP Advisory Public Company Limited (SET:ACAP) | 168.6 | 64.4 | 10.5 | 20.7 | 2.39 | (1.88) | 153.5 |
| Goldrush Resources Ltd. (TSXV:GOD) | 14.8 | 62.9 | 0 | 17.8 | 0.025 | (0.221) | 1.57 |
| Ambrilia Biopharma, Inc. (TSX:AMB) | 63.4 | 62.8 | 18.0 | 68.7 | 0.158 | (5.88) | 9.94 |
| Negri Bossi SpA (CM:NGB) | 111.0 | 62.6 | 170.7 | 53.2 | 1.16 | (5.75) | 72.4 |
| International Quantum Epitaxy plc (AIM:IQE) | 190.7 | 62.2 | 83.3 | 169.7 | 0.375 | (6.22) | 23.3 |
| Sunway Infrastructure Bhd (KLSE:SUNINFR) | 285.2 | 61.6 | 8.38 | 9.15 | 5.03 | (24.0) | - |
| Midway Games Inc. (NYSE:MWY) | 478.6 | 61.1 | 167.1 | 416.7 | 1.95 | (58.3) | 119.1 |
| RadiSys Corp. (NasdaqNM:RSYS) | 247.2 | 57.5 | 284.5 | 270.4 | 1.74 | (31.5) | 99.9 |
| CinTel Corp. (OTCBB:CNCN) | 130.5 | 57.4 | 65.1 | 40.4 | 1.94 | (2.69) | 111.4 |

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*Continued from front page*

Courts says that the rate of bankruptcy filings continued a "slow upward creep" in the 12-month period through June 30–the most recent period for which statistics are available. But the rise in the rate of bankruptcy filings only appears slow when considered in isolation from the previous year.

The courts office said that 6,705 businesses declared bankruptcy in the second quarter of 2007. That was 38% more than in the second quarter of 2006. The half-year comparison is even more dramatic. Business bankruptcies grew 45% in the first half of 2007, compared with the first half of 2006.

The deteriorating debt market is already creating opportunity for distressed debt investors, market observers say.

Daniel Gates, Moody's chief credit officer for North American corporate finance, said that drastically widening spreads have had bizarre consequences for those attempting to evaluate what is now considered distressed debt. Sound and liquid companies may now find themselves branded as issuers of distressed debt.

"The re-pricing of speculative-grade debt has pushed a number of low-rated loans and bonds to trading levels that the market has historically defined as distressed," Gates said. "Since leveraged loans and high-yield bonds have traded down so broadly, some companies whose debt trades at distressed levels today have better financial and operating performance than was the case for similarly distressed companies in the recent past."

The turmoil in the debt market has swept away any advantage large-cap companies might once have enjoyed over middle-market borrowers, according to Gates. "Company size is typically less important than fundamental credit characteristics," he said. "Larger companies tend to have more non-core assets that can be sold to raise cash. But this strategy doesn't work well when everyone is trying to sell assets at the same time."

Tight conditions could persist for some time with default rates continuing to climb into 2009, Gates predicts.

Moody's forecasts that the U.S. speculative-grade default rate will increase to 5.6% two years from now, from the current rate of 1.4%.

Much of the speculative-grade debt issued in recent years doesn't mature until 2008, temporarily keeping a lid on defaults. But the looming threat may be bad for the economy as a whole, Gates said.

"The increase in defaults will be constrained by the modest level of maturing debt that needs to be refinanced over the near term, and the lack of meaningful covenants in many spec-grade loan agreements," he said. "Without a near term default trigger, some weak issuers are going to take much longer to default than in the past. This may lead to lower recovery rates when money-losing companies are able to dissipate value for a longer period before finally being forced into bankruptcy."

Daniel C. North, chief U.S. economist for Euler Hermes, expects an increase in business bankruptcies this year and again in 2008. He said the severity of the collapse in house prices – and its inevitable consequences for the rest of the economy – still has not been fully grasped. The current downturn in the housing market is the most severe since the 1960s, North said.

"Median prices on existing homes fell for 10 consecutive months on a year-over-year basis, which is an unprecedented event," North said. "House prices almost never fall. They have never fallen for more than two months in a row in the 38 years that records have been kept. This is an obvious sign of a rapidly deflating asset bubble, the effects of which will continue to be felt for some time to come." North said his statement that house prices almost never fall is based on national median house prices.

Simultaneously, U.S. businesses must cope with increased costs for energy, materials and labor, and the effects of the Federal Reserve's tightening of monetary policy from 2004 to 2006, he said. (Of course, the Fed reversed course when it cut rates by half a percentage point on Sept. 19.) "Businesses today are facing serious headwinds," North said. He projects flat business profits this year and in 2008, another factor edging marginal businesses toward bankruptcy.

He also sees a darker future for the middle-market than Standard & Poor's Gates. "Smaller companies are generally viewed to be riskier," he said. A company that suddenly finds its debt priced at distressed levels might have a hard time getting out from under the label of a "distressed debt" issuer, he said.

Standard & Poor's said in a recent report that the number of companies it follows with debt trading at distressed levels rose sharply from 57 in July to 148 in August. S&P considered any security trading at 600 or more basis points above Treasuries to be distressed debt.

The rating agency's "distress ratio" recorded a sharp increase from 0.9% in July to 2.9% in August. S&P defines its distress ratio as the number of high-yield securities trading at spreads more than 1,000 basis points above comparable Treasuries, divided by the total number of speculative grade issues. S&P uses the distress ratio as a leading indicator of default rates.

A peak in the distress ratio generally signals a peak in default rates about nine months later, S&P said in its latest analysis of distressed debt. If the correlation holds up, that would point to a spike in defaults around May of 2008.

S&P found that at the end of July, the share of performing loans trading at less than 80 cents on the dollar increased to 0.63%, the highest level since November 2005, the rating agency said.

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*Continued from front page*

company generates annual EBITDA of $3 million to $7 million. These are manufacturers that have been hit hard by rising commodity costs in recent months for natural gas, aluminum, steel and copper, on top of tightening credit.

The fund manager claims to have received 18 open offers for such manufacturing deals within the last few weeks. He has invested in four of these deals and bid on three others. He aims to restructure their debt and take large ownership positions.

Manufacturing deals are being shopped to small investors because larger funds and banks may not consider it economically feasible to lay out resources on a small allocation of only a few million dollars. Small companies require as many staff resources to restructure as larger ones, the fund manager said.

## Stuck LBO Loans

On the larger end of the debt market, companies and funds are beginning to set up special investment vehicles to take advantage of an expected rash of new financings to help unglue leveraged buyouts now stuck in the pipeline, according to Neil Augustine, head of North American restructuring for investment bank **Rothschild** in New York.

**Oaktree Capital Management**, **GSO Capital Partners**, **Lehman Brothers**, and **Goldman Sachs** are among entities setting up the vehicles, according to industry insiders. All four declined to comment.

Prospective new investors have been buoyed by a few leveraged buyout loans this month that sold at steep discounts. **Credit Suisse**, the lead arranger of financing for **Kohlberg Kravis Roberts & Co.**'s buyout of **First Data**, agreed to lower the amount of loans the banking group will initially sell off to $5 billion from $14 billion. Meanwhile, banks led by **Citigroup** sold a $1 billion block of a previously unsold $3.5 billion loan for **Carlyle Group**'s and **Onex**'s buyout of **Allison Transmission**. In each deal, blocks were offered for 96 cents on the dollar, a loss to the agent banks.

To sweeten the deal further, the bank agents also agreed to reimburse the initial buyers for the difference if the remaining debt is sold at a lower price in the next two months or so, according to Augustine. The acquired companies have also agreed to be charged more if they decide to repay the loans earlier than their seven-year maturities, he said.

*Newly formed vulture funds are prepared to swoop down on a flurry of collateral that federally regulated banks and insurance companies may be compelled to sell off in response to rising default rates.*

## Vulture Funds for Bank Debt

Newly formed vulture funds are prepared to swoop down on a flurry of collateral that federally regulated banks and insurance companies may be compelled to sell off in response to rising default rates. One Toronto fund manager is gearing up to make the first purchases for a regulatory arbitrage fund his firm set up in March 2006. He plans for the fund to acquire portfolios of underperforming middle market secured loans and bonds from banks in North America and Europe.

Alex Jurshevski, chief executive of fund manager and advisory **Recovery Partners**, said his phone lines have started "burning up" in recent weeks. His fund, poised to start investing with nearly $500 million in committed capital, was launched to buy debt from globally active banks. Such banks may sell assets to meet higher requirements for capital held against corporate debt under the Basel II international regulatory framework. Basel II is expected to go into effect in 2009.

Now, even before Basel II, banks have another motivation to unload assets: concern about a potentially massive spike in the default rate. Jurshevski said he expects average corporate debt default rates to move from their current record lows of under 1% to the 30-year median average of about 5% within six months, and to around 14% within two years. His firm plans to buy debt to turn into control positions.

Recovery Partners' advisory service offers a model that institutions can use to determine when it makes best economic sense to sell off rather than retain and work out a non-performing loan. The model essentially recommends a hold only when expected recovery is higher than 98%.

Since its start-up in 2005, Recovery Partners has been getting by on advisory fees while holding out for the kinds of opportunities Jurshevski perceives are opening up now. Previously, the fund has bowed out of several bidding competitions with fund managers who Jurshevski said were paying too much, looking for places to invest their allocations. One fund manager outbid him on $500 million in debt from an aircraft firm last November by offering $1.06 on the dollar. Jurshevski believed it was worth no more than $1.03 on the dollar.

## The Interest Rate Cut

Kalyan Das, head of the global restructuring group at law firm **Seward & Kissel** in New York, is aware of new funds in development specifically to invest in dumped corporate debt from regulated banks or in discounted issuances of mortgage loans and mortgage-backed securities that may come from banks and specialty lenders. But Das wondered whether vulture funds might ultimately wind up disappointed should the Federal

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Reserve's larger-than-expected interest rate cut of one-half a percentage point to 4.75% shore up the economy.

Jurshevski said he expects the Fed's action to lead to much higher inflation and accelerate the rate of default on debt.

Debt industry insiders see cracks opening up to acquire corporate loans at a discount. One fund manager said a major institution has been conducting "weekly auctions" in Dallas of corporate loans it holds in warehouses designated for CLO issuance. Some see the massive growth of the CLO market since the last downturn ultimately reducing available loan supply in upcoming months. Banks have replaced loan holdings with more diversified and higher-rated CLO bonds, which require smaller capital commitments.

New fund investors for corporate debt will likely have to commit larger amounts than in the past. Funds should also expect to hold onto collateral for longer periods of time. It will no longer be easy to sell off lower-yielding revolving debt shortly after making an acquisition.

David Fanger, head of the North American Financial Institutions group for Moody's Investors Service, said some banks face pressure to sell assets after having to place additional capital against assets linked to troubled structured investment vehicles and commercial paper. For these banks, it could take "several quarters or even a year" to restore capital out of retained earnings.

But overall the disruption has been minimal for banks. Most maintain financial flexibility by adopting capital ratios "well in excess of regulatory minimums" for their corporate loan and CLO holdings, Fanger said.

Banks are concerned that federal regulators will increase their scrutiny of corporate defaults and shrinking loan loss reserves. These are areas where regulators have not intensely focused in recent years, according to Martin J. McKinley, head of **Wells Fargo Business Credit** in Minneapolis. Should conditions worsen, the market might follow the pattern of its previous down cycle in the early 1990s. "Regulatory agencies could again conclude that existing levels of reserves are not adequate to reflect deteriorating credit quality of the portfolios," McKinley said. "They will tighten pressures on banks to enhance reserves. Banks may sell off positions at a loss just to get over with it."

*Don Dzikowski may be reached at don@dealflowmedia.com.*

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