STANDARD & POOR'S

RATINGSDIRECT®

February 8, 2008

European Private Equity Deals Display Wide Disparity In Performance; More Than Half Lag EBITDA Forecasts

Primary Credit Analyst:
Taron Wade, London (44) 20-7176-3661; taron_wade@standardandpoors.com

Secondary Credit Analysts:
David Gillmor, London (44) 20-7176-3673; david_gillmor@standardandpoors.com
Paul Watters, CFA, London (44) 20-7176-3542; paul_watters@standardandpoors.com

Table Of Contents

A Sample Of Our Private Estimate Portfolio

Data Reflects Top Of The Market Conditions

Wide Variation In Performance By Sector, Type, And Credit Rating

Current Performance Reflected In Ratings

Recapitalizations Performing Better Than LBOs And Secondary Buyouts

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

S064320C | Linx User

European Private Equity Deals Display Wide Disparity In Performance; More Than Half Lag EBITDA Forecasts

The European leveraged finance market has entered a phase where defaults are rising and economic growth is slowing, making it increasingly important for investors to pay close attention to the performance of leveraged buyout (LBO) transactions. Yet, information on the performance of leveraged loans is hard to obtain as the majority of such loans in Europe are not publicly rated, with just 15% publicly rated in 2007.

In an effort to shed some light on prevailing trends in the European leverage finance market, Standard & Poor's Ratings Services recently carried out research using a sample from its private credit estimate portfolio of European leveraged loans, composed primarily of loans backing private equity buyouts.

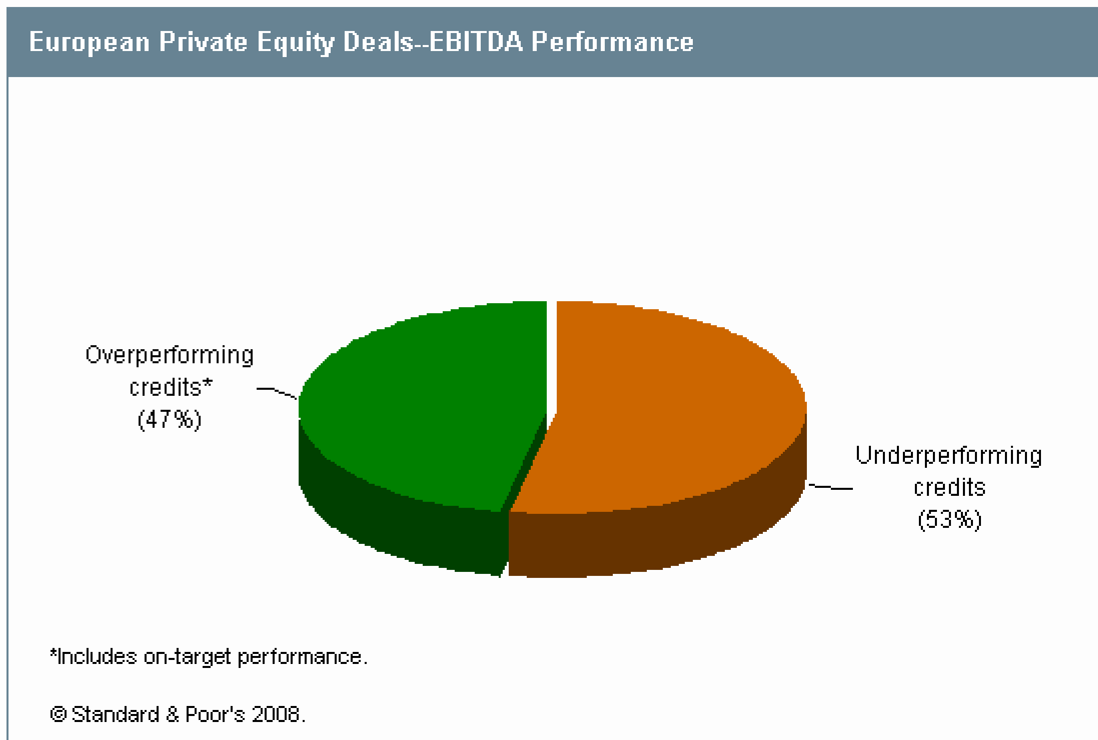
Our research shows that 53% of companies in the sample are behind on their original EBITDA forecasts, while 47% are outperforming original forecasts. Moreover, we also examined how close companies in the sample were to their original forecast plans to deleverage. Here, the sample group was split evenly: 50% were on track or performing ahead of deleveraging plans, while the other 50% had more debt on their balance sheets than they had originally forecast.

The exuberance of the leveraged finance markets in Europe over the past few years has meant that most transactions attracted an abundance of investors. But that does not mean that all deals will perform well. Hence, monitoring the performance of private equity transactions becomes paramount as credit conditions tighten and growth slows, because there is a heightened potential for defaults. In addition, the excess demand from investors for transactions in a frothy market has meant that investor protection through financial covenants has become weaker, so the early warning signs that a company might be getting into trouble are no longer immediately apparent.

It is necessary to look at the variance of data to portray a clear picture of performance. When the total sample is viewed, overall performance can look quite rosy. For example, the median EBITDA performance is only 5% below expectations, which is very close to target. But dig deeper and the variation in the sample is much more telling. EBITDA underperformance or overperformance has a standard deviation of 22%. For leverage statistics, the variation is even greater. Median statistics showed that companies were slightly ahead of target for their deleveraging forecasts (minus 0.5% less debt), but the standard deviation was 46%, indicating that although some companies are well ahead of their targets, others are lagging, which puts them at greater risk of covenant breach or default.

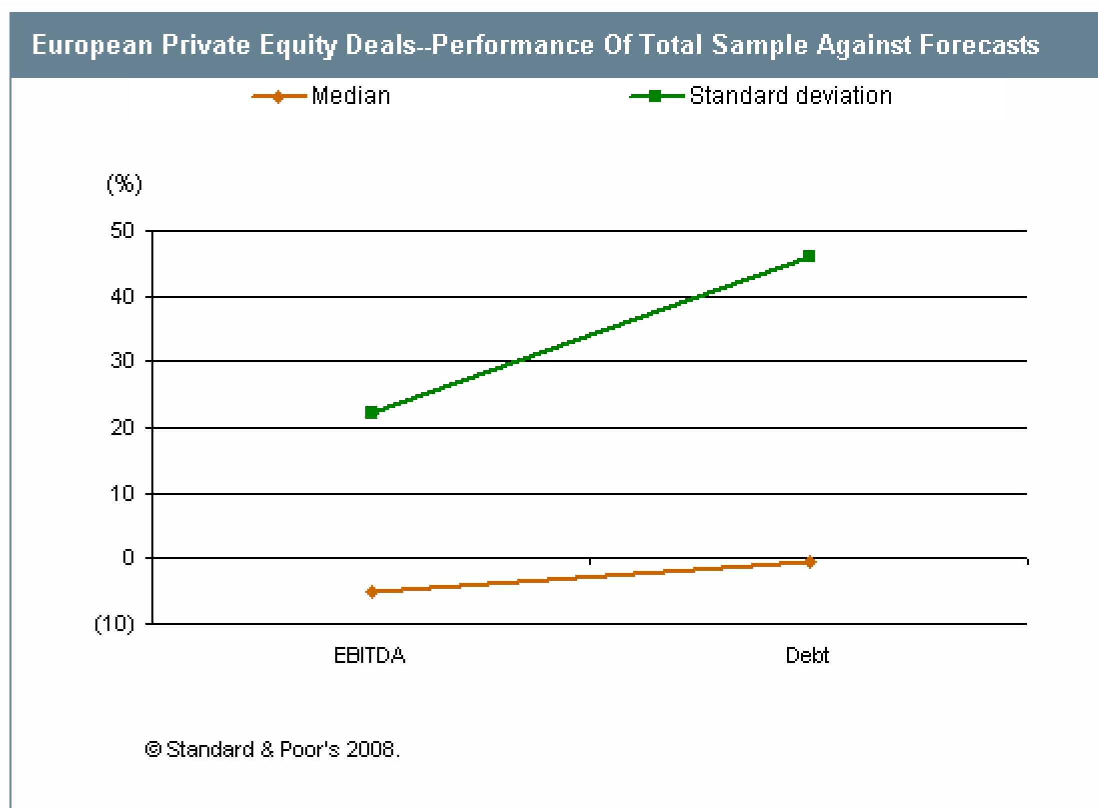
Standard & Poor's. All rights reserved. No reprint or dissemination without S&P's permission. See Terms of Use/Disclaimer on the last page. S064320C | Linx User

Chart 1



Standard & Poor's. All rights reserved. No reprint or dissemination without S&P's permission. See Terms of Use/Disclaimer on the last page. S064320C | Linx User

Chart 2



A Sample Of Our Private Estimate Portfolio

In our sample, we looked at 36 names in our private credit estimates portfolio, which were split among four sectors: chemicals, industrial equipment, publishing, and retail. The reason we chose to study our private credit estimates portfolio is because the majority of leveraged loans in Europe are not publicly rated, with only 15% of leveraged loans in Europe publicly rated in 2007. We randomly selected credits in each sector, but ensured that the sample was representative by country, size, and vintage to help reflect the distribution of credits in the European leveraged loan market. Almost three-quarters of the transactions were virtually evenly split among France, Germany, and the U.K. The remaining deals were made up of transactions from Denmark, Hungary, Italy, The Netherlands, and Spain.

Of the transactions studied, the bulk, representing 44%, was in the form of primary LBOs or management buyouts (MBOs). Some 19% was in the form recapitalizations and 19% represented secondary (or tertiary) buyouts. Refinancings made up 8% of the data set. For the recapitalizations, the average time from original deal to recapitalization was 22 months.

We adjusted absolute debt numbers for new debt added during recapitalizations to identify whether or not cash flow was paying down debt at the originally planned pace. In addition, we did not adjust for changes in management budget projections, using performance and debt repayments against original base case forecasts when the LBO was

Standard & Poor's. All rights reserved. No reprint or dissemination without S&P's permission. See Terms of Use/Disclaimer on the last page. S064320C | Linx User

first completed.

Data Reflects Top Of The Market Conditions

Owing to the--until recently--exuberant credit markets, a large percentage of the transactions (including leveraged buyouts, secondary buyouts, refinancings, or recapitalizations) took place in the past two years. Of the total transactions examined, 44% was carried out in 2007 (all prior to the liquidity crunch) and 39% was syndicated in 2006. Only 14% was originated in 2005 and 3% in 2004.

Due to this data distribution, the results are indicative of those leveraged finance transactions syndicated near the top of the market, with the absolute peak having occurred in the first quarter of 2007. It is increasingly important to pay attention to the performance of these LBO transactions as the market enters a phase where defaults are on the rise and economic growth is slowing. In 2005, companies were able to easily increase leverage, resulting in an average debt-to-EBITDA multiple of 5.2x, which climbed to 5.4x in 2006 and 6.1x in 2007, according to Standard & Poor's Leveraged Commentary and Data. Leverage topped out at 6.6x debt-to-EBITDA in mid-summer 2007. Broken down by sector in 2007, companies in the chemicals sector had an average total debt-to-EBITDA multiple of 5.4x, industrial companies had a multiple of 5.8x, in retail it stood at 5.7x, while in publishing it stood at 6.99x.

What's more, lenders have been given very little immediate control in the event of deterioration in business performance, with average covenant headroom for debt-to-EBITDA of 26.5% in 2007, 24.8% in 2006, and 26.3% in 2005, compared with 2004, when average headroom was a slightly lower 23.3%. With more covenant headroom, companies have more time before they would otherwise breach covenants, which means that value in the business can be eroded before lenders are able to step in and finally exert influence.

According to our sample, median covenant headroom was the highest for cash-flow-type covenants at 68%. It should be noted, however, that definitions vary widely for cash flow covenants, ranging from debt service cover to free cash flow cover, and we grouped these together. Median interest cover headroom was much lower at 35%, but leverage covenant headroom was the tightest at 25%. Furthermore, leverage headroom was quite similar across the sample, with a standard deviation of only 19%, demonstrating that--overall--companies were much more in danger of breaching leverage covenants than other covenants.

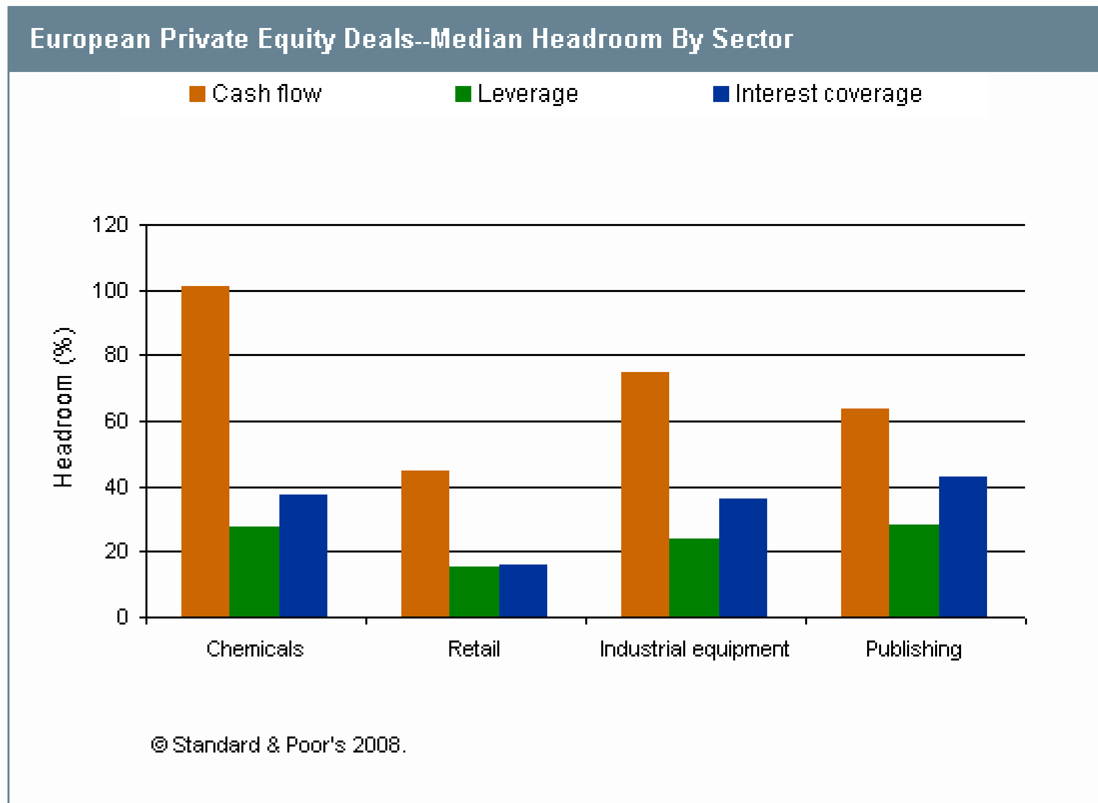
This is important for investors given that statistics for deleveraging are more telling than those for EBITDA forecasts. We used absolute levels of debt (and not debt-to-EBITDA multiples) in our comparisons because it is more difficult to adjust absolute debt repayment through accounting methodology than it is to manipulate EBITDA figures. There were some companies where EBITDA was ahead of projections, but this has not been translating into debt reduction, indicating low cash conversion rates. In our sample, 8.3% of transactions breached covenants or renegotiated them shortly before a breach occurred. The average time to reset was 16 months.

In our total sample, 21% of transactions had headroom of less than 10% on leverage covenants, and 50% had headroom of less than 25%. For interest cover, 15% of the total examined had headroom of less than 10% and 42% had headroom of less than 25%. This contrasts with cash-flow-type covenant headroom, where only 4% of companies had headroom of less than 10% and only 16% had headroom of less than 25%.

Standard & Poor's. All rights reserved. No reprint or dissemination without S&P's permission. See Terms of Use/Disclaimer on the last page. S064320C | Linx User

Retail companies were in the most danger of breaching leverage covenants, with a median headroom of 15%. The other three sectors had wider headroom, with chemicals at 28%, industrial equipment at 24%, and publishing at 28%. Retail companies were also most at risk of breaching interest cover covenants, with a median of 16%, compared with the other three sectors, which all had median headroom of greater than or equal to 36%.

Chart 3

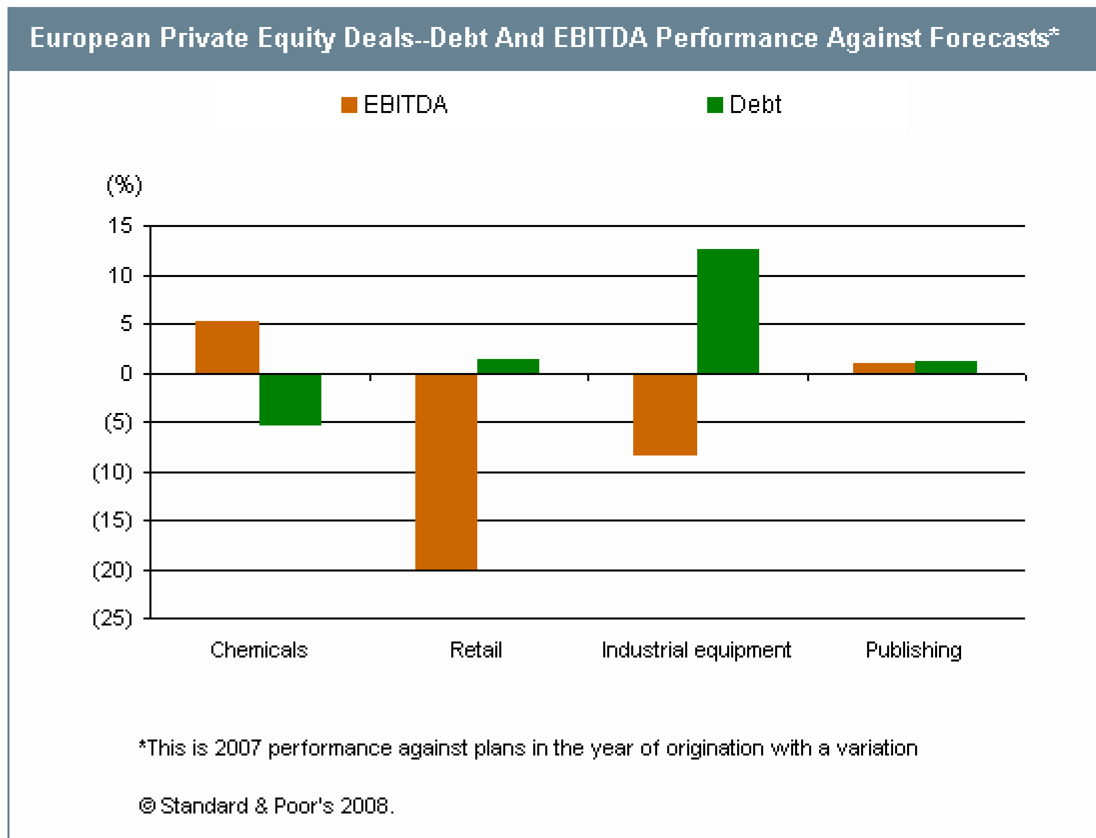


Wide Variation In Performance By Sector, Type, And Credit Rating

Our data shows that there is a wide disparity in performance not only on a total basis, but also by sector, type of transaction, and credit rating.

Standard & Poor's. All rights reserved. No reprint or dissemination without S&P's permission. See Terms of Use/Disclaimer on the last page. S064320C | Linx User

Chart 4



The data broken down by sector shows that retail companies put in the worst EBITDA performance, with a median of 20% behind forecast. This is no surprise as many rated retail companies have faced difficulties of late. In 2007, Standard & Poor's downgraded four publicly rated retail names in Europe. (It should be noted, however, that these retailers do not form part of our sample as they are companies rated publicly by Standard & Poor's). While rating prospects in the retail sector in 2008 appear stable, rising raw material prices will continue to present challenges (see related article "Ratings Roundup And 2008 Credit Outlook For Europe's Pharma, Consumer Goods, And Retail Sectors," published Jan. 15, 2008, on RatingsDirect).

Yet, the retail companies in our sample were performing almost to forecast on deleveraging at just 1%. This may be explained by the fact that retailers are typically able to increase their financial flexibility by managing working capital and may also be more efficient in cash conversion of the EBITDA generated.

Companies in the chemicals sector were 5% ahead of forecast, turning in the best relative EBITDA performance, and are subsequently also paying down debt faster than expected (5%). This is somewhat surprising as the chemical industry is generally considered highly cyclical. But sound economic growth across the globe and the prolonged petrochemical up-cycle through 2007 helped to drive strong results in 2007, according to Standard & Poor's research on the chemicals sector (see related article "European Chemicals Still Riding A Strong Cycle Into 2008-But Slowdown Ahead," published Dec. 12, 2007, on RatingsDirect). In 2008, the greatest risk to credit quality for

Standard & Poor's. All rights reserved. No reprint or dissemination without S&P's permission. See Terms of Use/Disclaimer on the last page. S064320C | Linx User

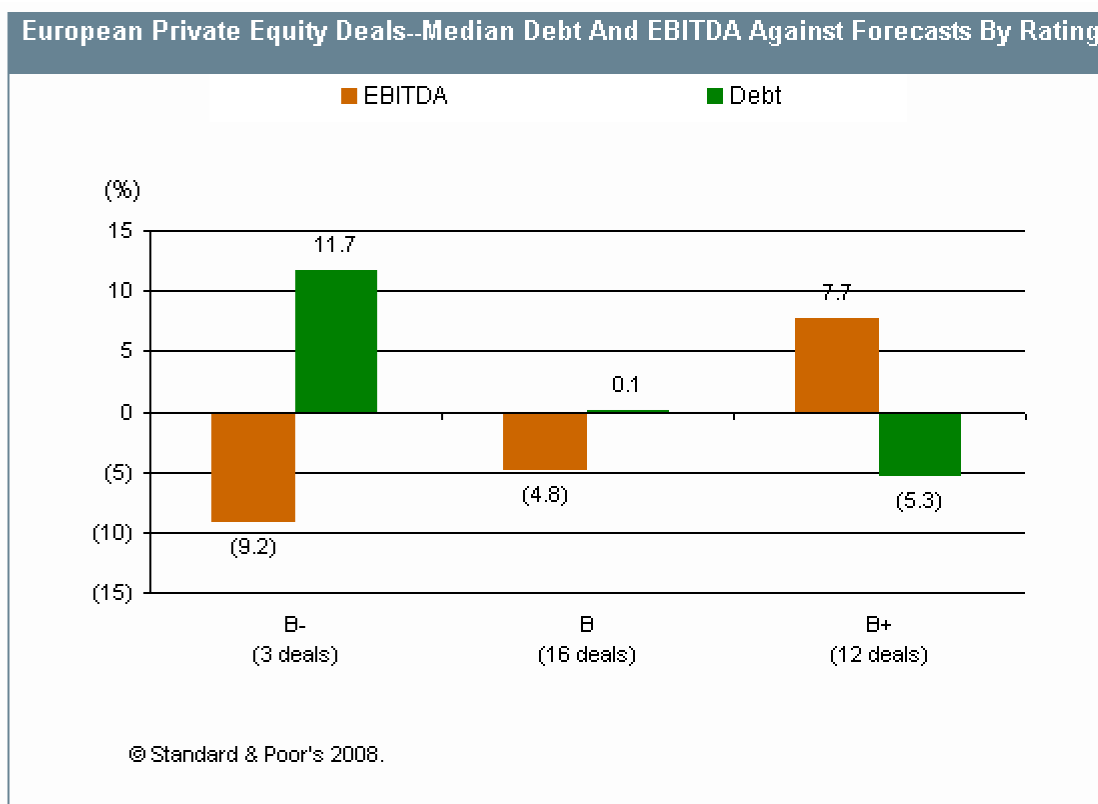
chemical companies will be the uncertainty of whether or not a recession in the U.S. will materialize. Weakening demand would be particularly harmful given our expectation of capacity expansions coming on stream from 2009, as it would remove the necessary pricing power to deal with volatile and increasing raw material costs.

The most trouble in paying down debt on schedule is evident in the industrial equipment sector. Companies in this sector are 12% over debt projections and have also slipped 8% behind EBITDA projections. By comparison, publishing companies are still ahead of EBITDA forecasts, but only by a slight 1%. Without EBITDA growth, publishing companies will be unable to pay down debt. Meanwhile, leverage is higher than target forecast, although only by 1%.

Current Performance Reflected In Ratings

Separating the data by rating shows that the companies with the lowest credit estimates had the worst EBITDA performance against forecast as well as the worst performance against debt repayment. Exceptions were companies estimated in the 'BB' or 'BB-' category, although these credits make up a small part of the sample due to recent credit quality decline, meaning data in this category was materially affected by outliers.

Chart 5

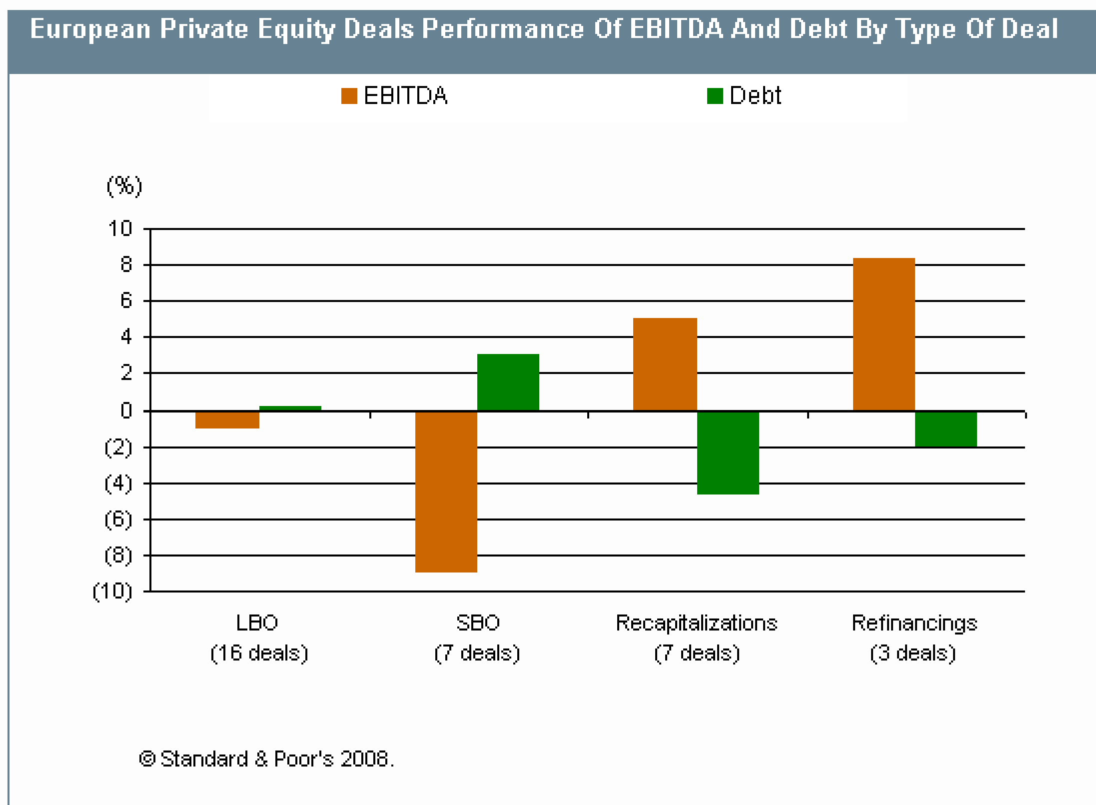


Standard & Poor's. All rights reserved. No reprint or dissemination without S&P's permission. See Terms of Use/Disclaimer on the last page. S064320C | Linx User

Recapitalizations Performing Better Than LBOs And Secondary Buyouts

Deals that were recapitalized displayed better EBITDA performances relative to forecast (5%) and better debt paydown (5%) than LBOs or secondary LBOs. Similarly, refinancings were 8% ahead of EBITDA projections and 2% ahead of deleveraging plans, although there were large standard deviations because the sample size was small. The median performance for LBOs was 1% behind EBITDA forecast and on target for debt repayment. However, secondary buyouts were relatively worse off than original deals, with EBITDA 9% behind projections and 3% more debt than forecast.

Chart 6



Additional Contact:
Risk Solutions Europe; RiskSolutions_Europe@standardandpoors.com

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

Copyright 2008 Standard & Poor's, 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 subscriber's 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) 212.438.9823 or by e-mail to: research_request@standardandpoors.com.

Copyright © 1994-2008 Standard & Poor's, a division of The McGraw-Hill Companies. All Rights Reserved.

The McGraw·Hill Companies

S064320C | Linx User