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Market Overview: Private Distressed Debt

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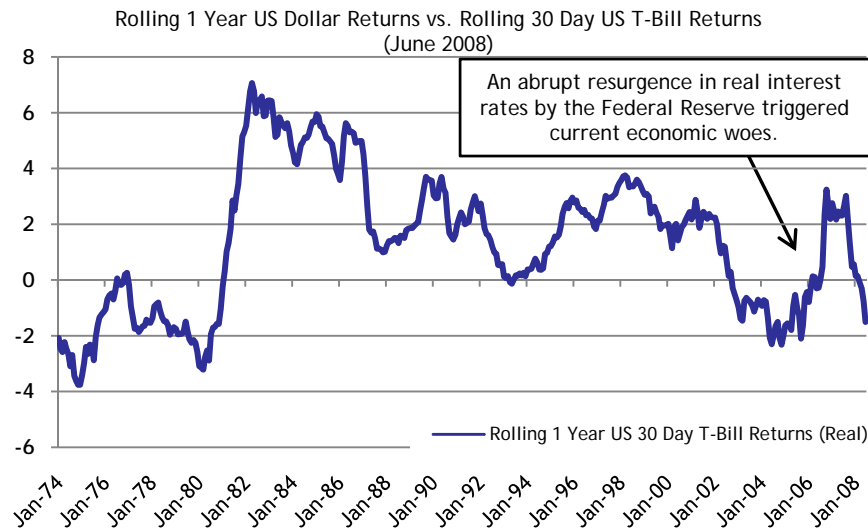
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Brief Recap of Current Economic Events

Credit Induced Economic Downturn

- The recent economic slowdown was precipitated by a shock to credit markets caused by an abrupt resurgence in real interest rates by the Federal Reserve.
- Higher real interest rates exposed the fragility of consumer finances, most notably with respect to mortgage debt.
- Ensuing significant losses in mortgage-backed securities led investors to pull back on credit exposures across the board.
- This in turn tightened liquidity in capital markets, and exposed the susceptibility of the US economy to credit conditions.
- Subsequently pessimism about future economic growth has quickly led to a lack of credit, restricted money supply, and forced multiple institutions into failure; i.e., banks and brokerages.
- Most importantly though, the cost of credit has increased and the economy is slowing.
- This should create opportunities for fixed income investors, more specifically distressed debt strategies.



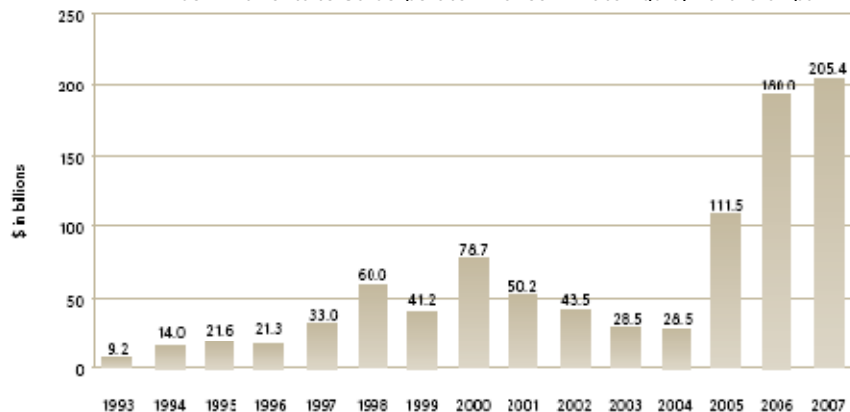
Source: Ibbotson



Recent Events: Expansion in Buyout Activity

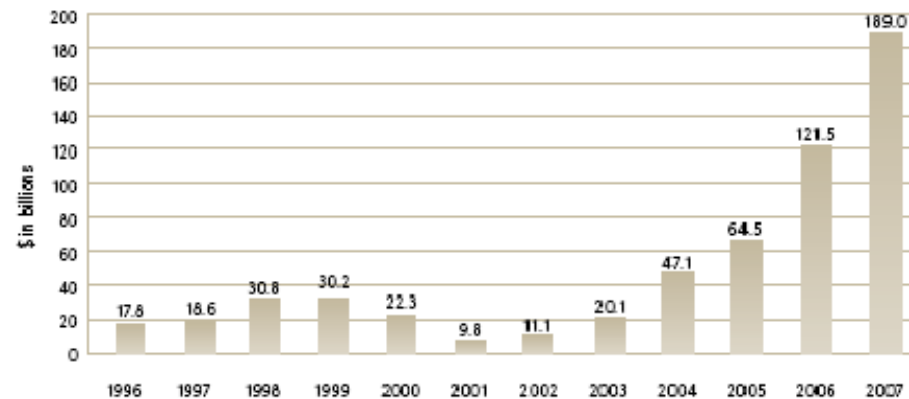
- Private equity buyout markets serve as a wonderful example of the recent credit bubble.
- As capital markets were flooded with liquidity, the availability of credit served to fuel massive increases in buyout activity.
 - Investor commitments to these strategies grew by several multiples
 - Loan volume increased by nearly 20 fold from 2001-2007
- The logical result of these activities given current conditions is too much outstanding corporate debt given the current weak economic environment.

Commitments to US Corporate Finance Private Equity Partnerships



Source: Private Equity Analyst, January 2008

US Buyout Leveraged Loan Volumes



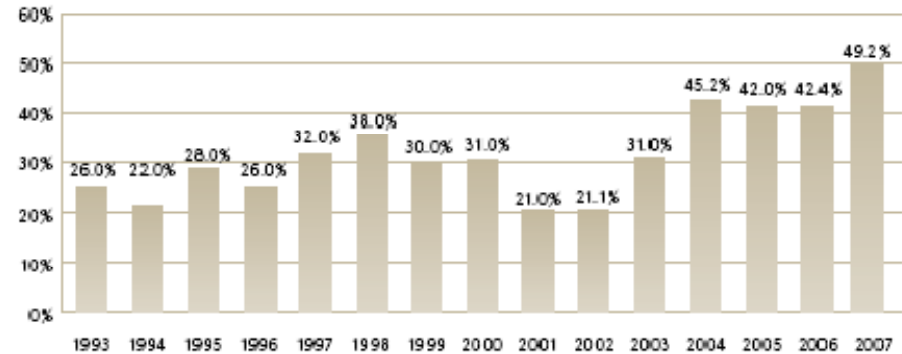
Source: Standard & Poor's Leveraged Buyout Review



Recent Events: Diminution Of Credit Quality

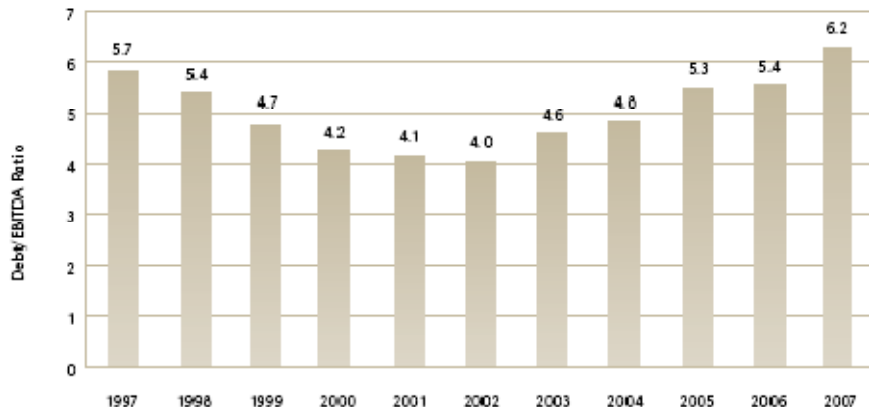
- Not only did ample credit fuel an expansion in corporate debt, it also fueled an ever diminishing quality thereof.
- From 2001-2007:
 - The percent of low quality bonds issued more than doubled
 - The debt multiple for leveraged buyouts (LBO) loans went up 50%.
 - Interest coverage ratios were nearly cut in half
- From a strategic standpoint, one must believe low quality debt will likely suffer in a weak economic environment.

New Issues Rated B- or Below as a % of All New Issues



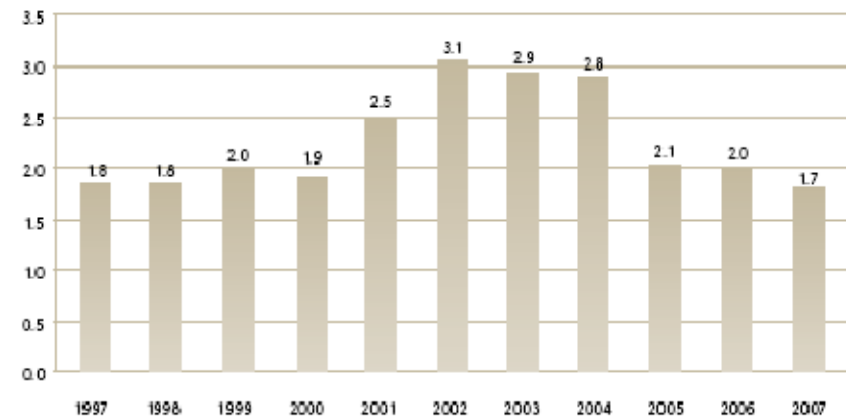
Source: Standard & Poor's LCD

Average Debt Multiples of Large Corporate LBO Loans



Source: Standard & Poor's LCD

Interest Coverage Ratios: (EBITDA-CAPEX)/Cash Interest

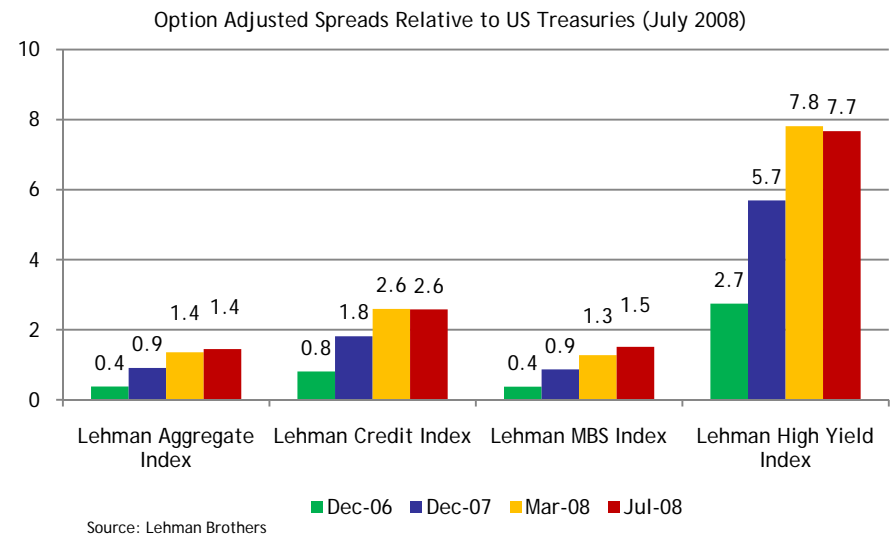
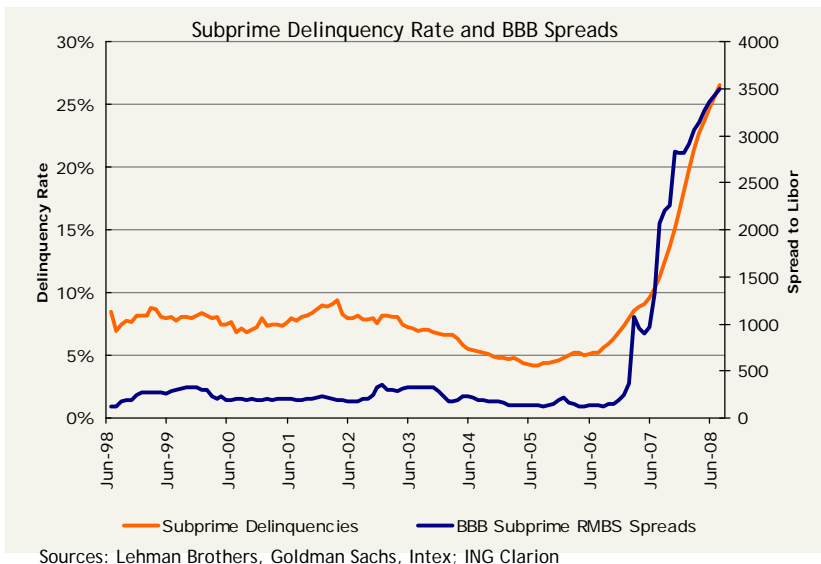


Source: Standard & Poor's Leveraged Buyout Review



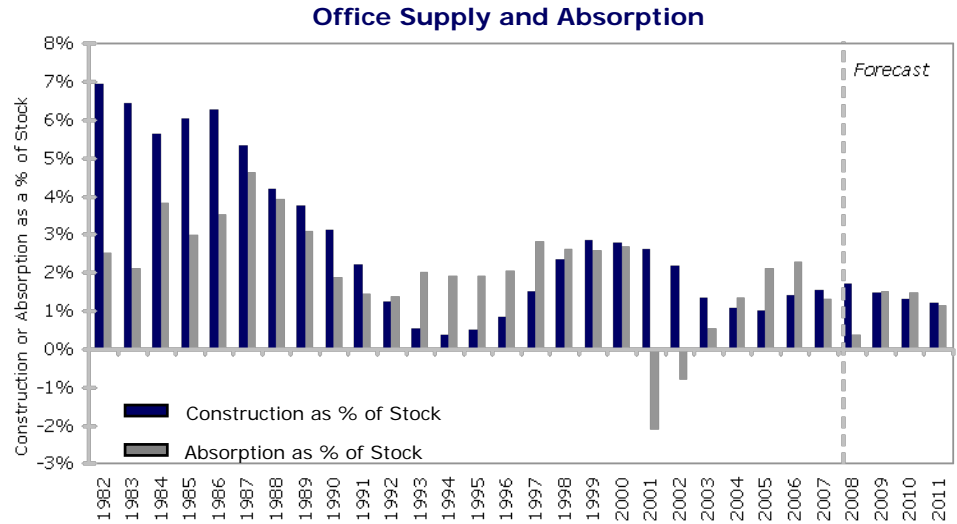
Market Response: Credit Risk is Being Re-Priced

- Aversion to credit risk is more than apparent in capital markets over recent periods.
- Although the sub-prime mortgage market is the only credit sector where substantial defaults are taking place, the emotional implications of this crisis have affected all credit markets.
- Investment managers are now commonly avoiding credit risk in order to appease perceptions and avoid near term losses.
- The good news is that investors are being far better compensated for taking credit risk.
- Opportunities in both public and private markets are the logical manifestation of this aversion to risk.

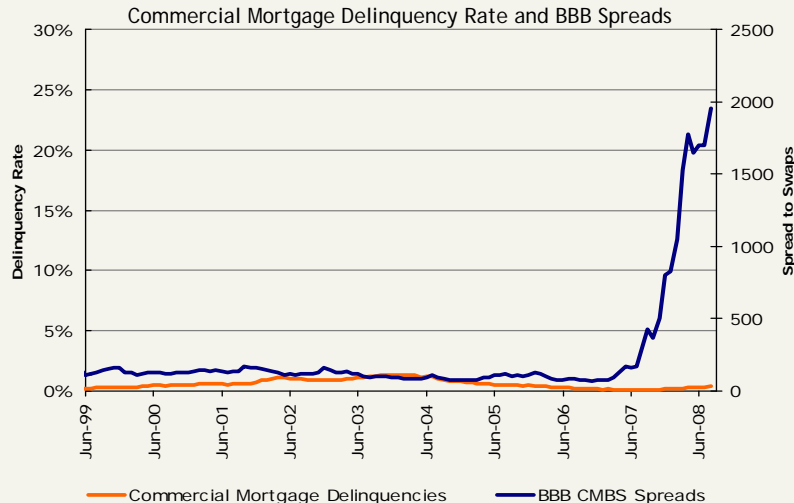


Market Response: Not All Re-Pricing is Necessarily Rational

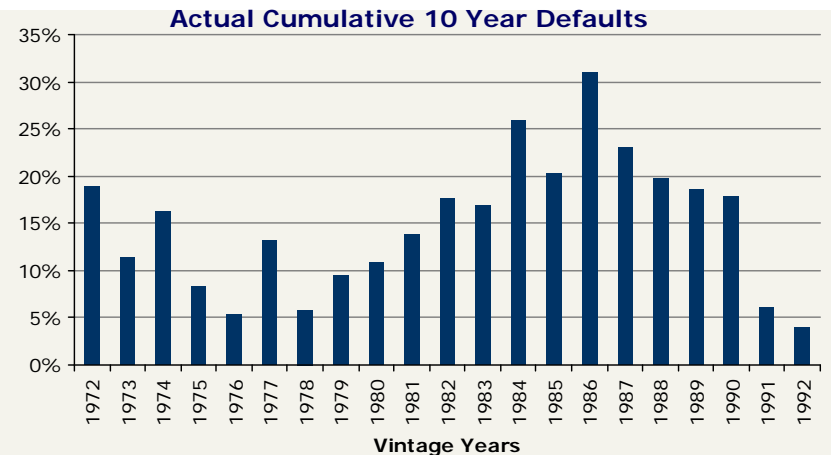
- Opportunity exists in the current market environment because broad re-pricing of risk is not necessarily rational in nature.
- A very good example of this is the widening of credit spreads in the commercial real estate market.
- Research indicates that commercial debt defaults are strongly correlated to periods of excess capacity as seen in the mid 1980's.
- Over recent periods there is no reason to believe there is significant excess capacity in commercial real estate.
- As such investor aversion to risk in these credit markets seems irrational in nature, which opens opportunities for disciplined investors.



Data as of 12/31/07. Source: PPR



Sources: JP Morgan, Trepp; ING Clarion



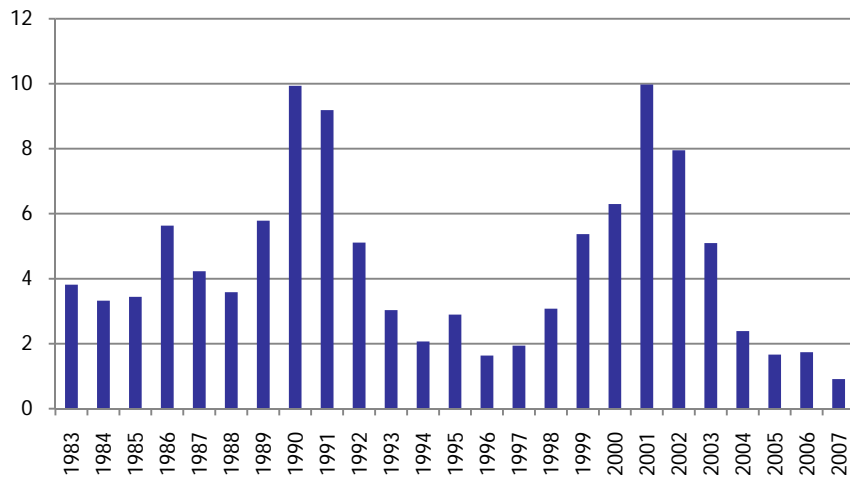
Source: PPR, Morgan Stanley, ING Clarion Capital



Prospectively: Another Wave of Defaults?

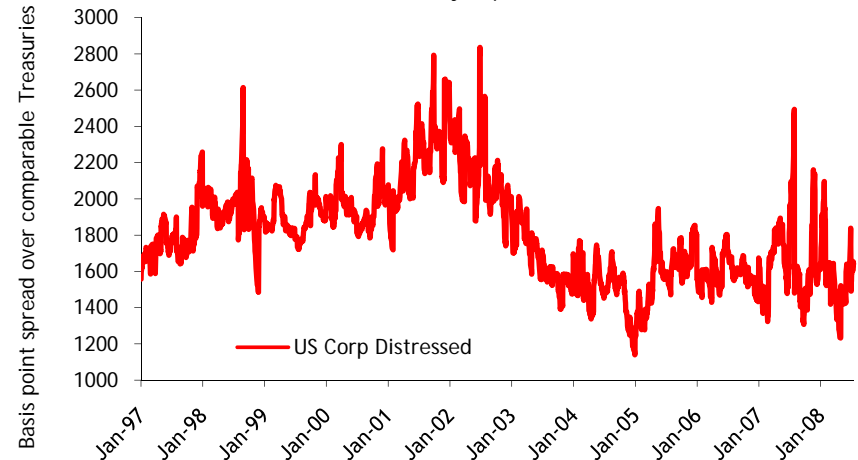
- Speculative grade debt tends to default cyclically in response to economic conditions.
- Generally speaking, speculative debt investments are best made during times of economic stress and underweighted during times of economic prosperity.
- The current and prospective economic environment bodes well for distressed investing due to many reasons.
- Consensus expectations for GDP growth are low; 1.6% for 2008 & 1.3% for 2009 (source: The Economist).
 - This will make it more difficult for speculative borrowers to service debt
- Credit costs for borrowers have increased significantly as a result of investor aversion to risk.
 - Borrowers may not be able to afford issuing or refinancing debt.
- Most intuitively, default rates are at historic lows and it is very reasonable to expect higher rates going forward.
- Given all these factors, it seems an opportune time to allocate to distressed debt strategies.

Moody's Issuer Weighted Speculative Default Rates



Source: Moody's

Credit Quality - Spread to Worst



Source: Drum Capital



What are the Primary Areas for Distressed Debt?

Mortgages

- Most distressed opportunities exist in the lowest credit quality portion of the approximately \$10 trillion mortgage-backed security universe.
- However, as is evidenced by the failures and potential failures of many of the nation's leading financial institutions, the market conditions for mortgage instruments continues to be significantly depressed.

Corporate

- Albeit US corporations are yet to experience increasing default rates, it seems reasonable to expect this to change.
- More importantly though, we are coming off a period of excessive activity in corporate buyouts and an associated decrease in the quality of debt used to finance these activities.
- Private market investors should be able to take advantage of recent excesses.

Real Estate

- Commercial real estate and residential real estate are not highly correlated with one another.
- There appears to be ample opportunities in commercial real estate as credit spreads have widened in spite of what appears to be somewhat solid fundamentals in this industry.
- Of course the implicit expectations of credit spreads could ultimately be proven true (i.e., a large negative impact from a slowing economy).
- However this is good for distressed investment strategies.



What are the Basic Venues for Accessing Distressed Credit?

Trading Strategies

- Hedge funds offer the best venue for accessing trading strategies centered around distressed debt investing.
- The drawback of this approach is its implicit focus on short term market trends in that managers are attempting to garner short term trading profits.
- This approach is potentially lucrative in any market environment, but there should be more opportunities prospectively.
- Unfortunately though, the potential effects of being wrong in the near term makes this venue for distressed debt the most risky.

Illiquid (Non-control)

- This strategy involves taking longer term debt positions; trading is not the primary means to add value.
- Generally speaking target companies are expected to go into bankruptcy and managers will participate in this legal process to maximize the benefits of being a debtor.
- Positions tend to be somewhat concentrated and large in nature, as investment managers must not only be able to strongly influence bankruptcy proceedings but also be able to focus their efforts on a modest number of opportunities.

Illiquid (control & restructuring)

- This approach is based on the fundamental concept of taking control of a company by being its primary debtor.
- In a distressed situation a company can be effectively purchased through acquisition of debt more cheaply than through an equity stake.
- Managers will seek to add value by actively controlling, restructuring, and turning around a given firm.
- This is another long term approach to investing, and probably has the highest potential for value added.

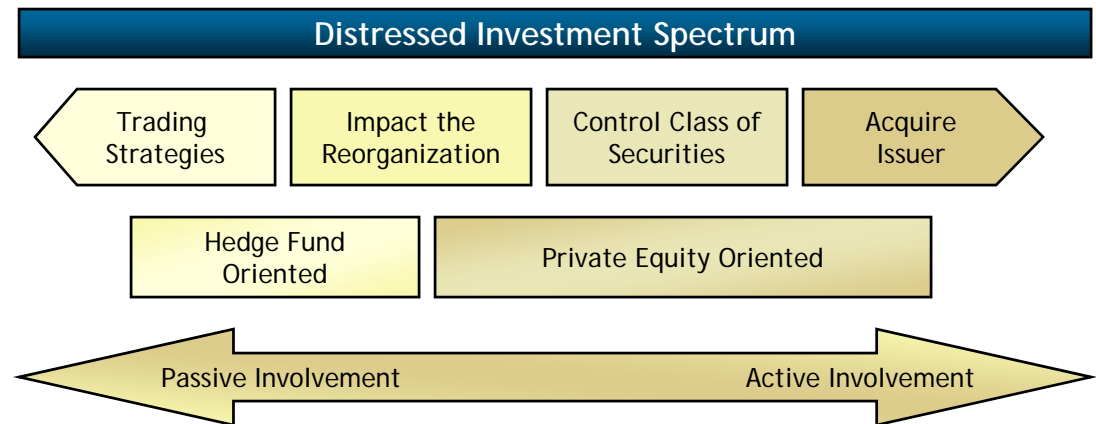


Private Equity Segments: “Special Situations” → Distressed

“Distressed” investing can include investments across the capital structure (debt/equity) in either private or public securities experiencing distress*. Types of strategies include short to intermediate term trading strategies as well as more active restructuring and debt-for-control transactions.

Types:

- Trading Strategies
- Rescue Financing / Direct Lending
- Restructuring / Workouts
- Debt-for-Control / Loan-to-Own



* Distressed securities can include those already in default, under bankruptcy protection or in distress and heading toward such a condition. A common definition of “distress” in fixed income instruments include securities trading at or above 1,000 basis points over comparable Treasuries.



Distressed Fund-of-Funds

Distressed Fund-of-Funds Candidates

Fund	Target Raise	Description	Investment Period	Term	Mgmt Fee	Carry	Preferred	Minimum	Comments
Drum Capital SSP Fund III	\$500 mm	Allocates across the distressed spectrum. Focus on private market strategies. Up to 20% co-investments (10% carry).	4 years	9-years	0.8%	3.0%	8.0%	\$5 mm	Final closing before year end
Siguler Guff Distressed Fund III	\$1.5 billion	Allocates across the distressed spectrum. Focus on private market strategies. Up to 30% co-investments (15% carry).	3 years	10-years	1.0%	5.0%	8.0%	\$5 mm	Final closing end of November 2008

