

LATHAM & WATKINS

High Yield in France: The Next Wave

Wednesday, 6 December, 2006

Latham & Watkins

53, quai d'Orsay

75007 Paris



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Gaining the Edge: Why Do Entrepreneurial French Companies Choose High Yield?

Pierre Casado, **SAUR**
Tanneguy de Carné, **Société Générale**
Tim Hall, **Calyon**
Gerhard Noack, **Europcar International**
Arnaud Tresca, **BNP Paribas**
Bryant Edwards, **Latham & Watkins (moderator)**



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What Are High Yield Bonds?

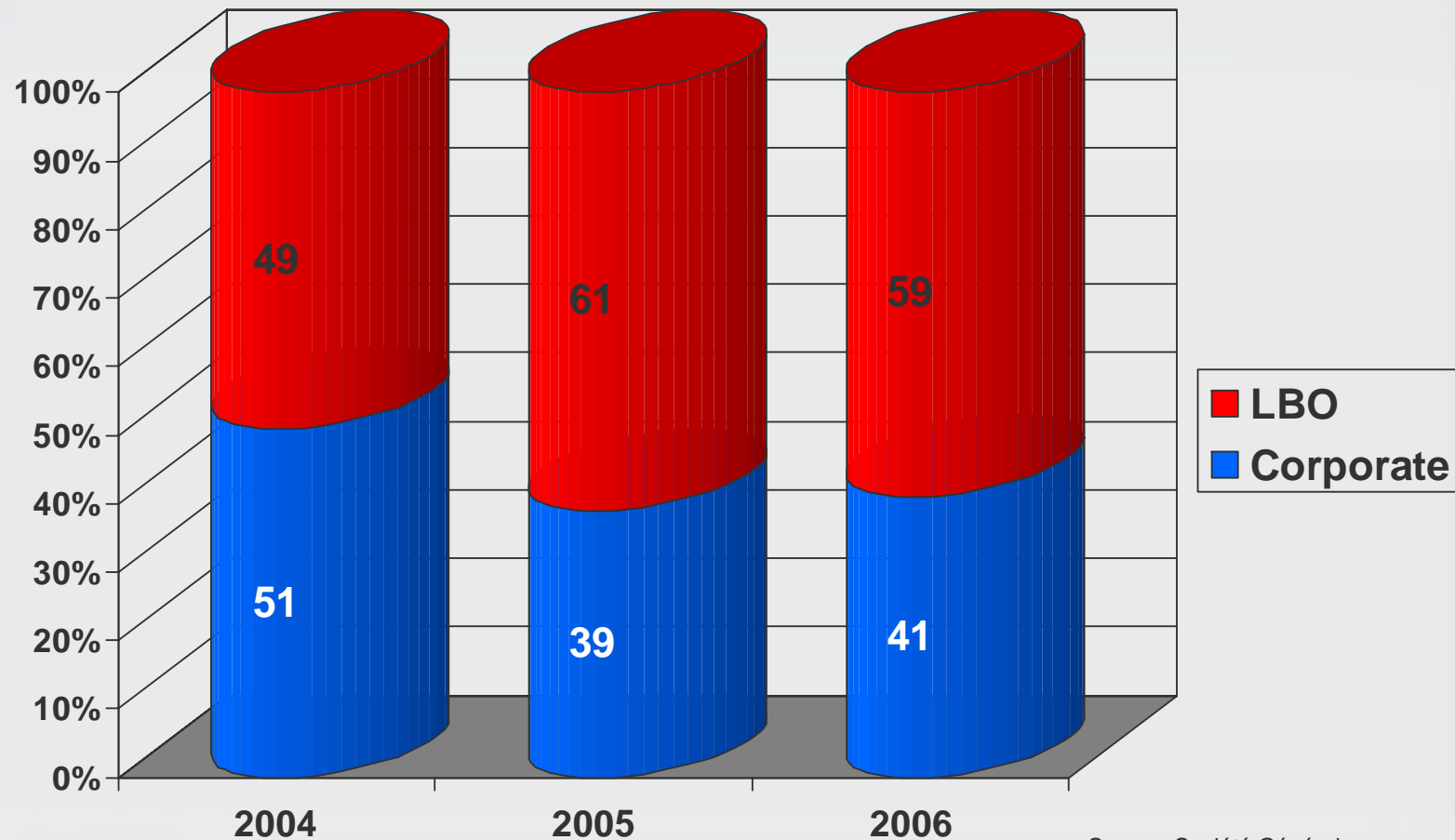
- **Non-investment grade:** corporate bonds rated (or implied) Ba1/BB+ or below
- **No amortization:** mostly 7 or 10 year “bullet” maturities
- **High yield:** to compensate for the higher risk, they carry a higher interest rate
- **Often subordinated to senior bank debt:** contractually, structurally, second lien



Typical Payment Terms of High Yield Bonds

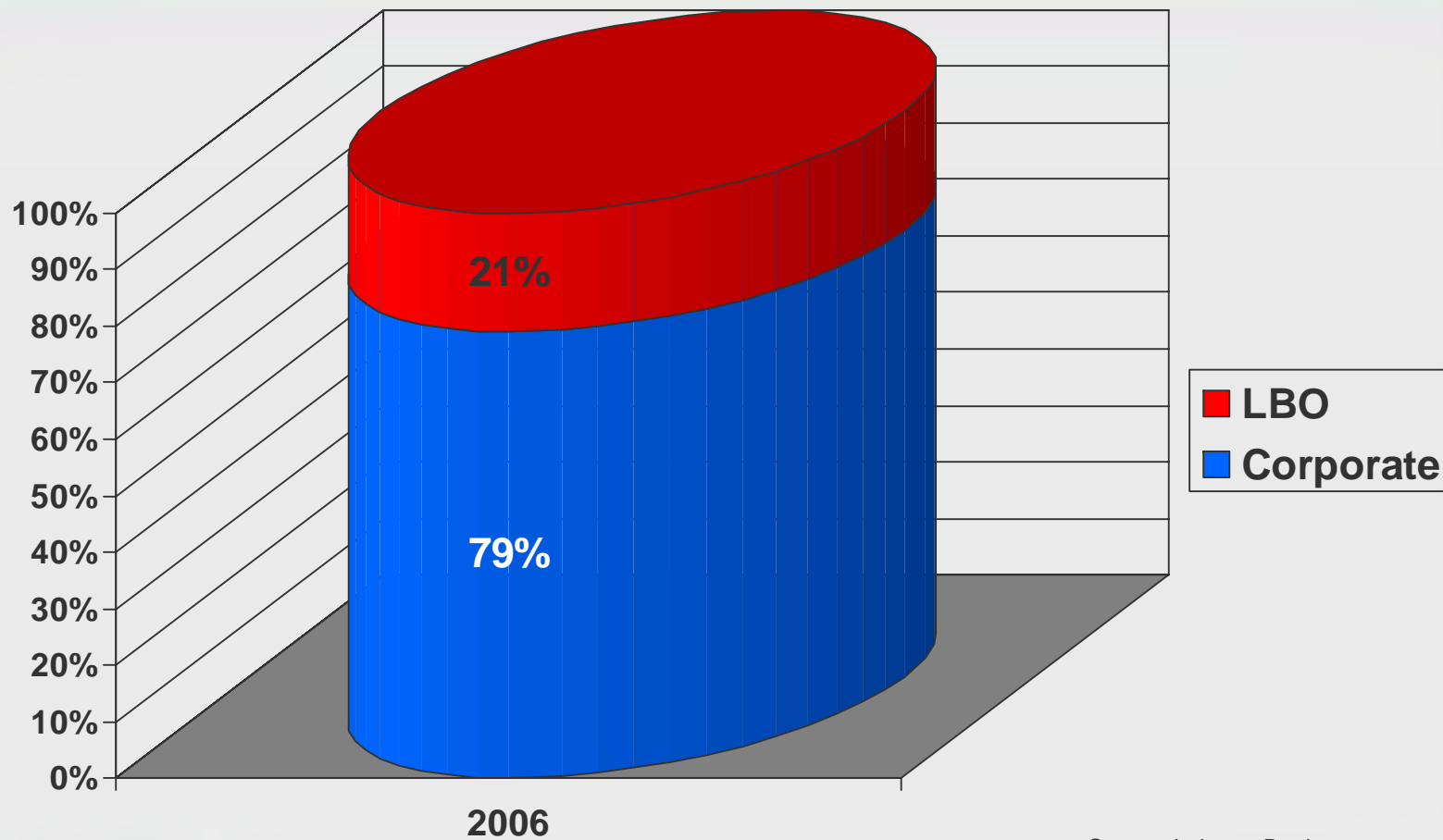
- **Interest Rate**: Usually fixed coupon, but many FRNs
- **Bullet Maturity**: No mandatory redemption prior to maturity
- **Non-Call**: Generally 7-year maturity with a 4-year no-call period or 10 year maturity with a 5-year no call period
- **Equity Claw**: Issuer may redeem up to 35% of bonds with the proceeds of certain equity offerings
- **Change of Control**: Issuer must offer to purchase bonds at 101% plus accrued interest upon a Change of Control
- **Asset Sales**: Issuer must offer to purchase bonds at 100% plus accrued interest with the proceeds of certain asset sales that are not used to retire debt or reinvest in the business

LBO HY issuance has overtaken Corporate issuance in Europe



Source: Société Générale

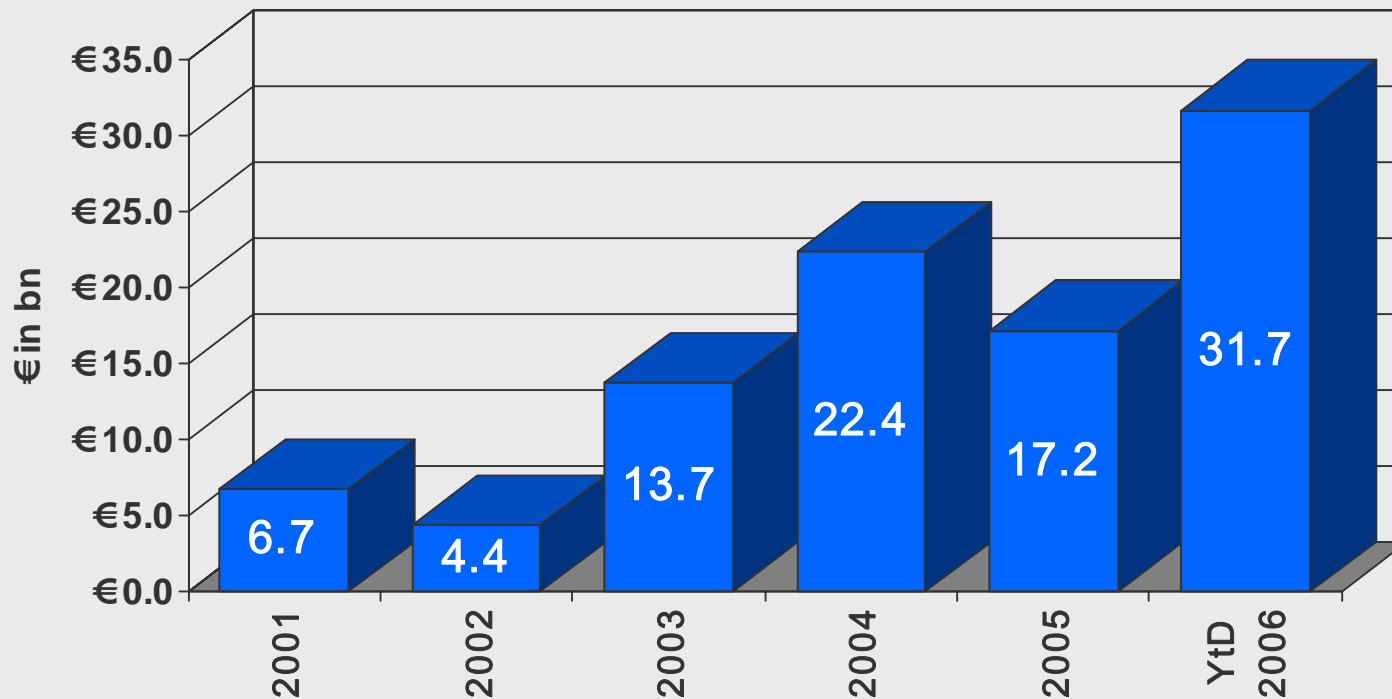
Corporate HY Lags the US HY Market, Where Corporate Market Share Approaches 80%



Source: Lehman Brothers

The Good News—2006 Has Already Set A Record for European HY Issuance

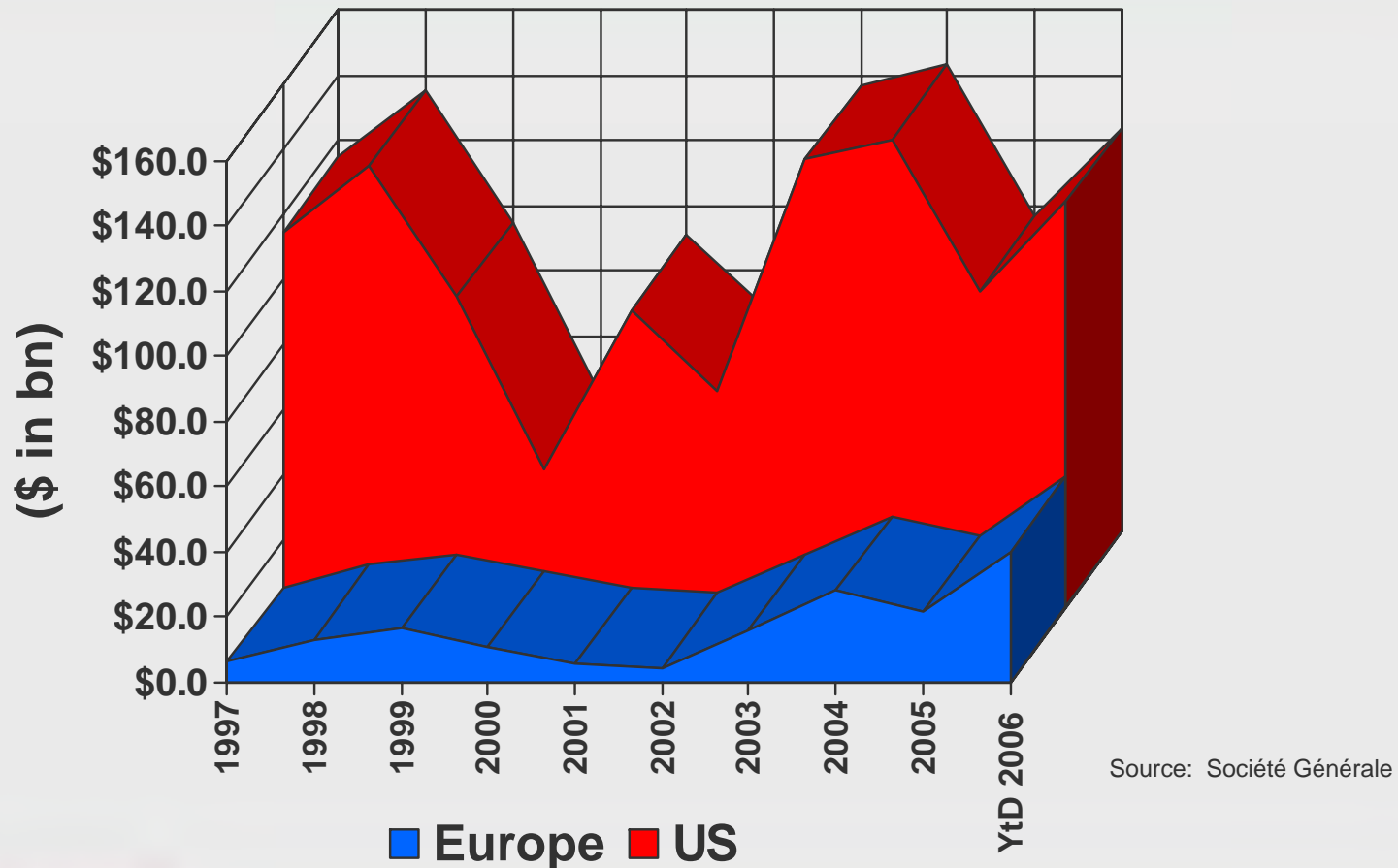
European High Yield Issuance



Source: Société Générale

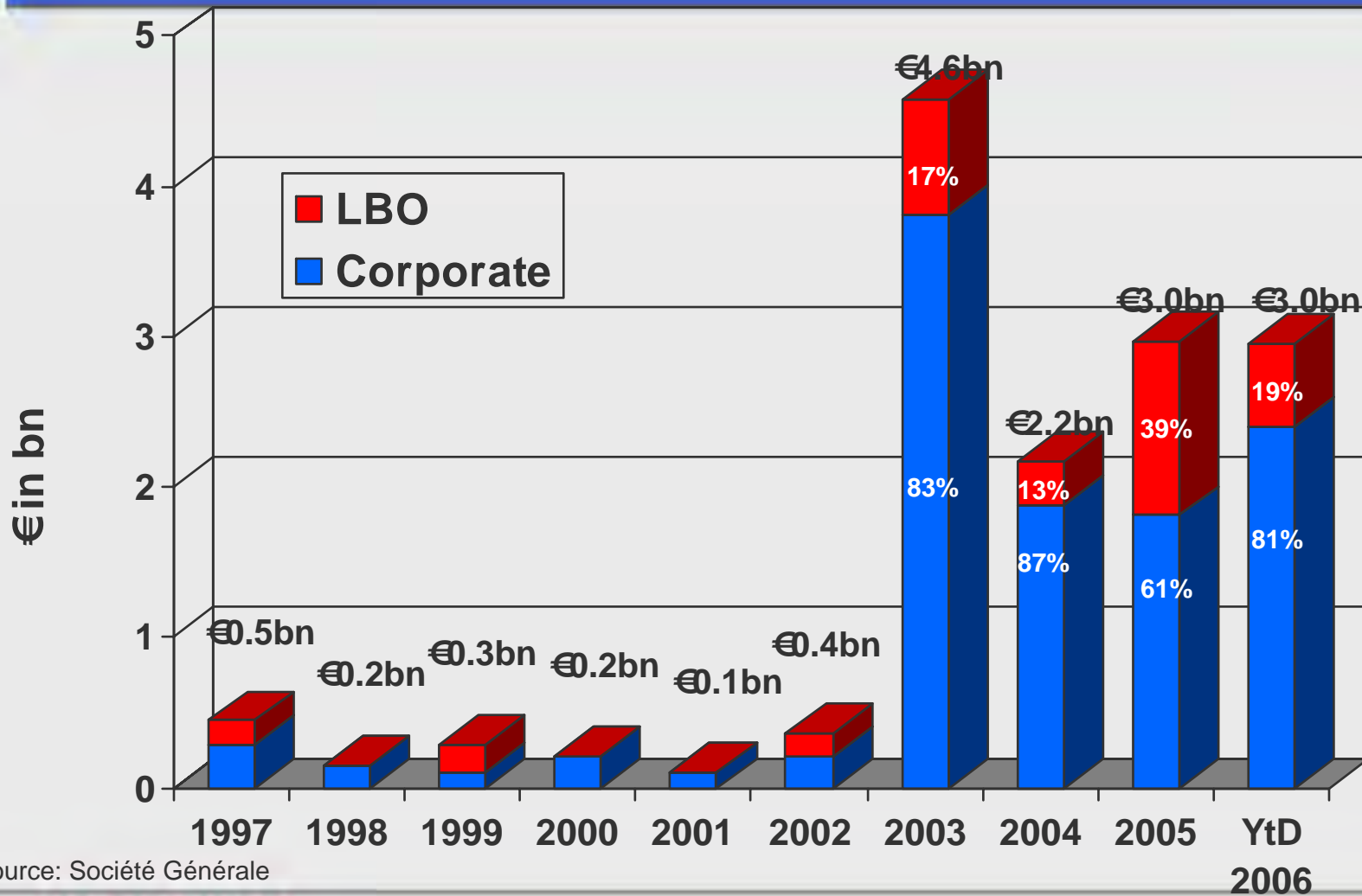
... But European HY Issuance is Still a Fraction of US HY Issuance

High Yield Bond Issuances by US and European Companies



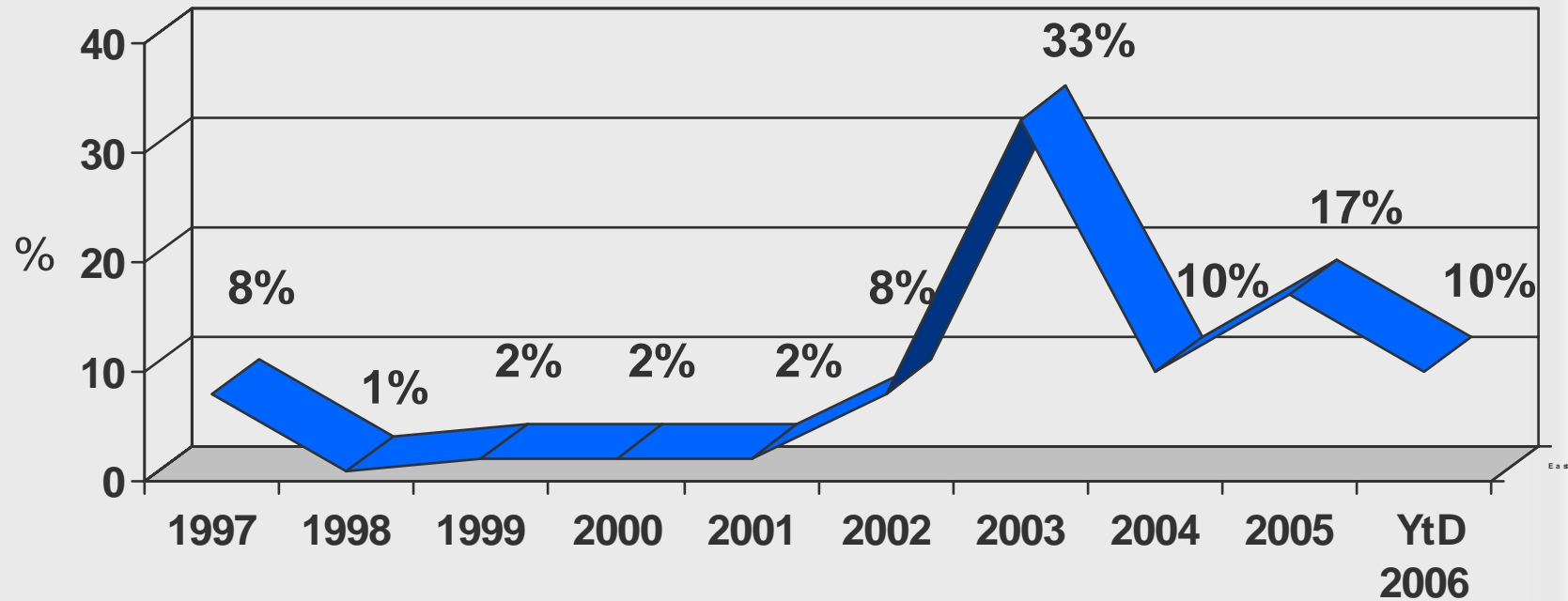
French HY issuance 1997 – YtD 2006

Corporate vs LBO split



Source: Société Générale

French HY issuance 1997 – YtD 2006 % of Total EU* issuance volume

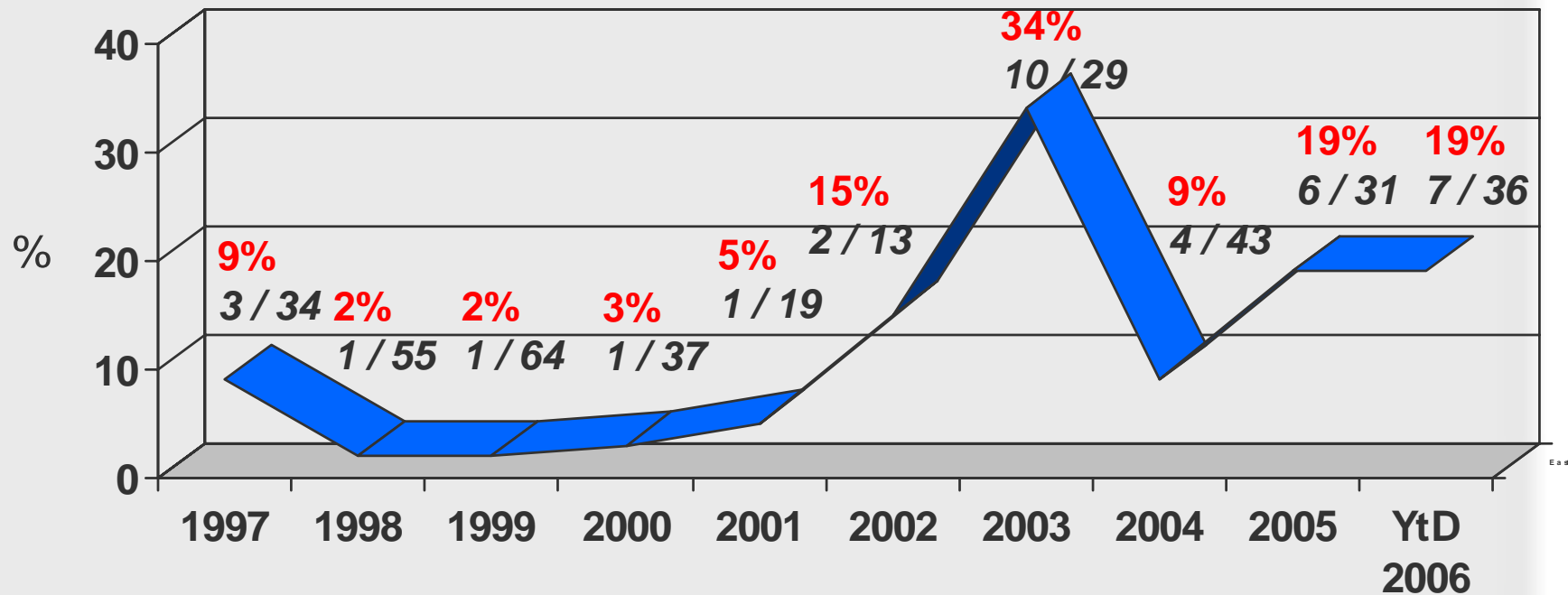


Source: Société Générale

*Western EU issuers and selected Central European HY style issuers and PIKs

French Corporate HY issuance 1997 – YtD 2006 % of Total EU* Corporate issues

% French Corp tranches vs Total EU* Corp tranches
French Corp tranches / Total EU Corporate tranches*



Source: Société Générale

*Western EU issuers and selected Central European HY style issuers and PIKs

Bombardier Strikes the European High Yield Market for €1.6 Billion of Euro-Denominated Bonds (Nov 2006)

- Canadian-based manufacturer of aircraft and rail transportation equipment
- €800 million of Senior Floating Rate Notes priced at EURIBOR plus 325 basis points
- €800 million of Senior Fixed Rate Notes priced with a 7 ¼% Coupon



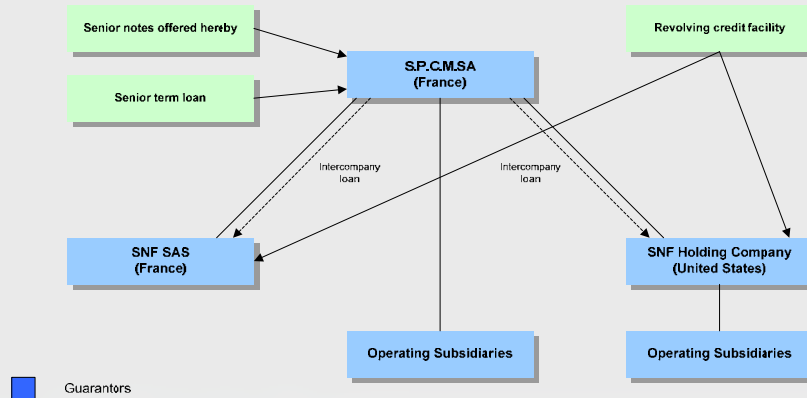
Rhodia Issued €1.1 Billion of FRNs in Oct 2006

- €1.1 Billion of Senior Floating Rate Notes
- Priced at EURIBOR + 275 basis points
- Call Protection: NC1; 102% in 2nd Year; 101% in 3rd Year; Par Thereafter



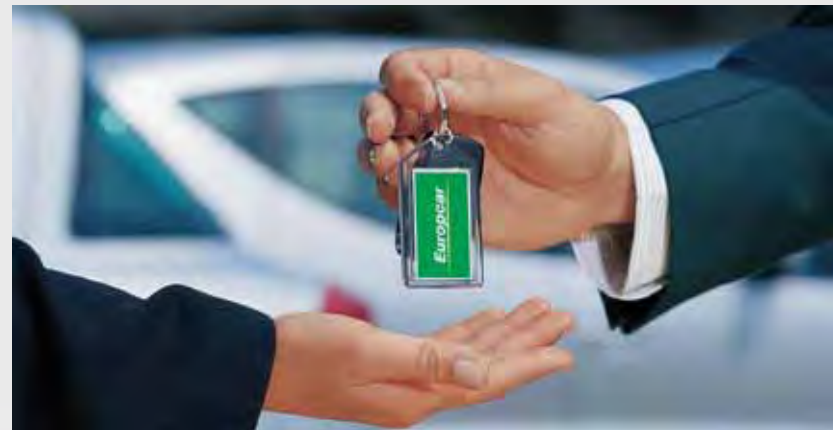
SNF Floerger Refinanced Senior Credit Facility with 7 Year High Yield Notes (July 2006)

- SNF Floerger, a French chemicals manufacturer, issued €140 million of 7 year senior notes, in order to refinance senior credit facility with long-term bond debt
- Senior Notes priced at 8.25%



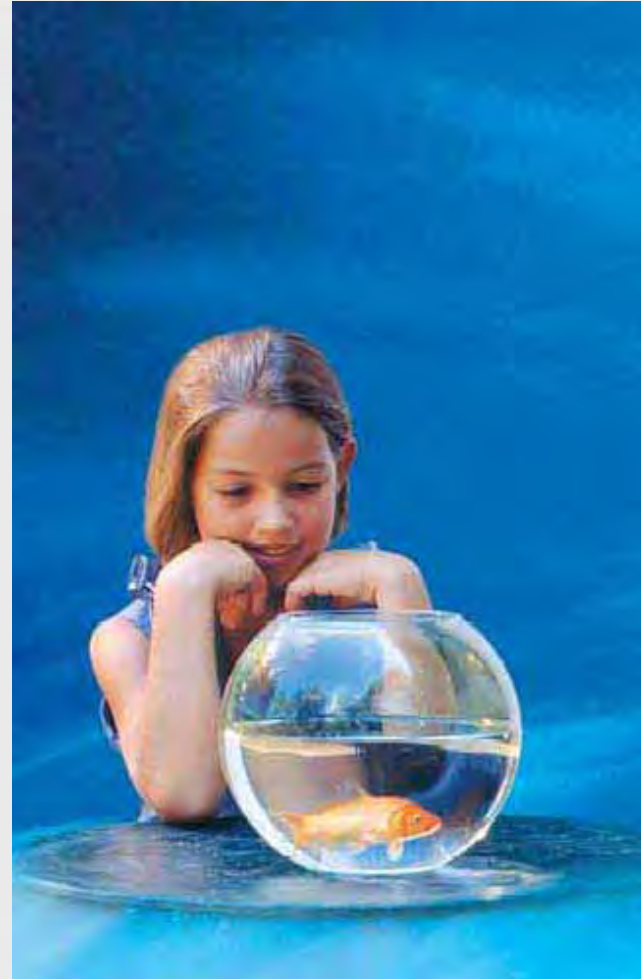
Europcar priced €550m HYB to support the LBO of the company by Eurazeo (May 2006)

- Europcar priced €550m HYB in May 2006 split between:
 - €300m QE+350bps sr. sub. sec. notes 7 years non-callable for 1 year rated B1/B+
 - €250m 8.125% sr. sub. notes 8 years non-callable for 4 years rated B2/B
- Proceeds of the notes were used to fund the LBO of the company by Eurazeo (alongside €2.6bn Senior Asset Financing Loan and €250m Senior RCF)



Saur raised €265m in April 2005 to finalize the funding of its LBO

- As part of its acquisition, Saur issued €265m of 8 3/8% 10YNC4 Senior Notes, subordinated to €465m of senior secured funded bank debt
- Senior Notes allow distribution of a portion of designated sale proceeds to shareholders
- Incurrence covenants give flexibility to management to grow the business



Remy Cointreau Sets Record for Lowest Fixed Rate Coupon (Jan 2005)



- Remy Cointreau issued €200 million of 5.20% Senior Notes due 2012 in January 2005 - a record for the lowest fixed rate high yield bond issued in Europe at the time
- Proceeds were used to repay a portion of a syndicated senior credit facility and for general corporate purposes
- Bond was French-law governed and had light restrictive covenants



Vivendi Raised over €2 Billion in the HY Market During its 2003 Corporate Crisis

- \$935 million of 9.25% Senior Subordinated Notes due 2010 in April 2003
- €325 million of 9.50% Senior Notes due 2010 in April 2003
- \$975 million 6.25% Senior Notes due 2008 in July 2003
- €500 million of 6.25% Senior Notes due 2008 in July 2003

vivendi



Trends Favour High Yield for Corporate Financings

- **Medium-term money form diversified investor base**
 - 10 year, non-call 5
 - 7 year, non-call 4
- **Multiple use of proceeds**
 - Growth
 - Acquisition
 - Corporate restructuring
 - Refinancing
- **Modest covenants**
 - Incurrence-based covenants
- **Comfortable with subordination to banks**
- **No economic or voting dilution to ownership**



Compared to Bank Debt, High Yield Debt is Long-Term Maintenance-Free Capital

	Bank Debt	High Yield Bonds
Restrictive Covenants	Maintenance: Default occurs if financial ratios deteriorate	Incurrence: Default only if company undertakes a prohibited transaction
Maturity	3 to 5 Years: Company must always plan ahead for refinancing	7 to 10 years: Company can focus on running the business
Maintenance	High: Company must provide frequent reports and seek formal waivers for material transactions	Low: Covenants designed to allow Company to grow and make acquisitions and operate without waivers

Basic High Yield Covenants

- Limitation on indebtedness
- Limitation on “restricted payments”
- Limitation on liens
- Limitation on layering of debt
- Dividend restriction in subsidiaries
- Merger, consolidation and sale of assets
- Transactions with affiliates
- Sale and leaseback transactions
- Consents
- Reports



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Emerging Issues in the French High Yield Market

Blaise Ganguin, **Standard & Poor's**
Tim Hall, **Calyon**

Adam Harnetty, **Société Générale**

Laurent Kenigswald, **Barep Asset Management**

Alain Krief, **BNP Paribas Asset Management**

John Watson, **Latham & Watkins (moderator)**



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European High Yield and European Mezzanine Markets Are Converging

HY Bonds

- ◆ 8%-11%
- ◆ Non-Call
- ◆ Structural Subordination



Investors

- ◆ Dedicated HY Funds
- ◆ Insurance Companies
- ◆ Pension Funds
- ◆ CDO's
- ◆ Banks

Unwarranted Mezzanine

- ◆ 12%-15%
- ◆ Callable
- ◆ Contractual Subordination

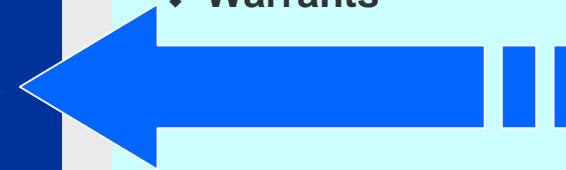


Investors

- ◆ Insurance Companies
- ◆ Pension Funds
- ◆ CDO's
- ◆ Banks
- ◆ Mezzanine Funds

Traditional Mezzanine

- ◆ 14%-17%
- ◆ Callable
- ◆ Contractual Subordination
- ◆ Warrants



Investors

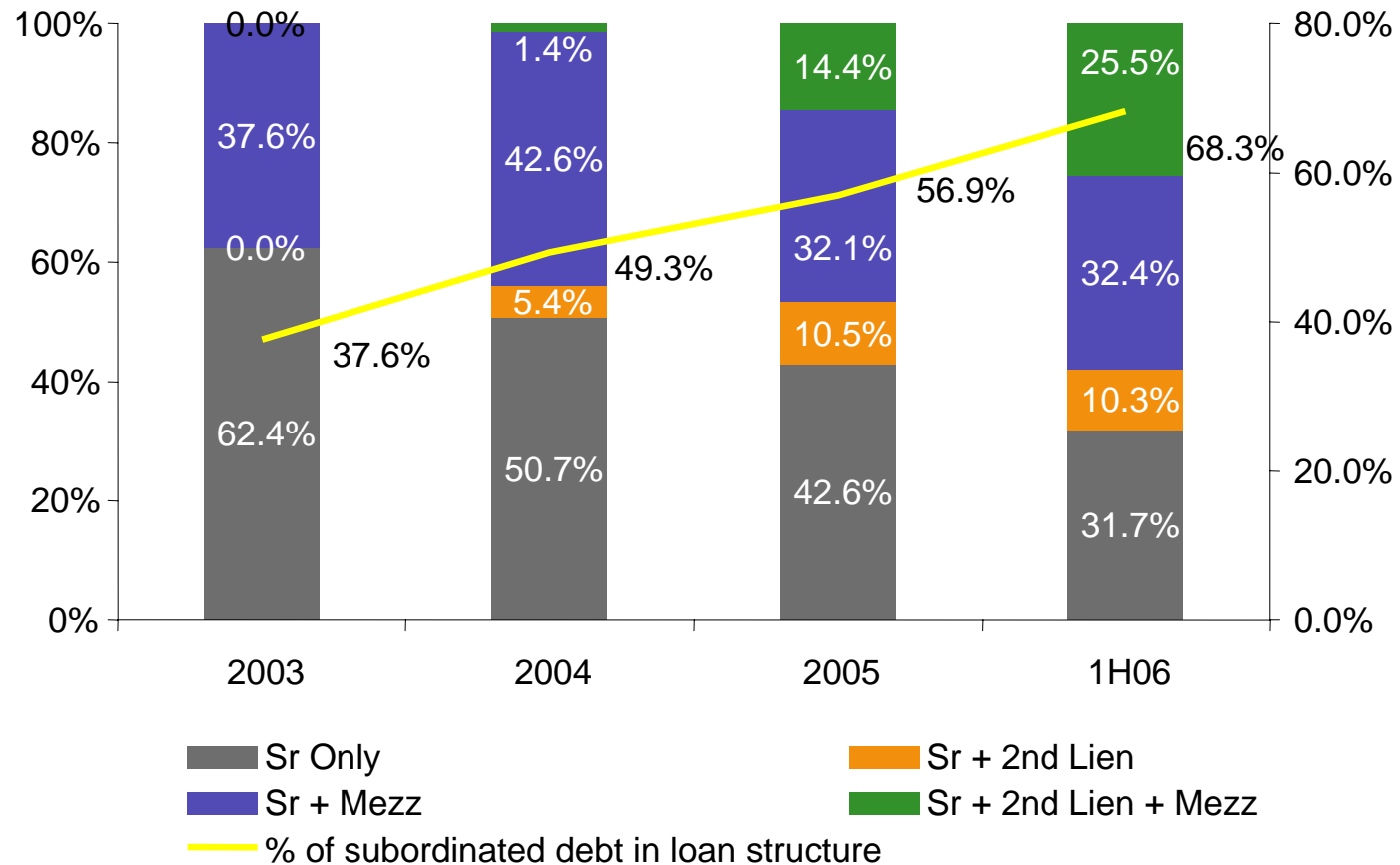
- ◆ Banks
- ◆ Mezzanine Funds

Increasingly, a Single European Leveraged Capital Market

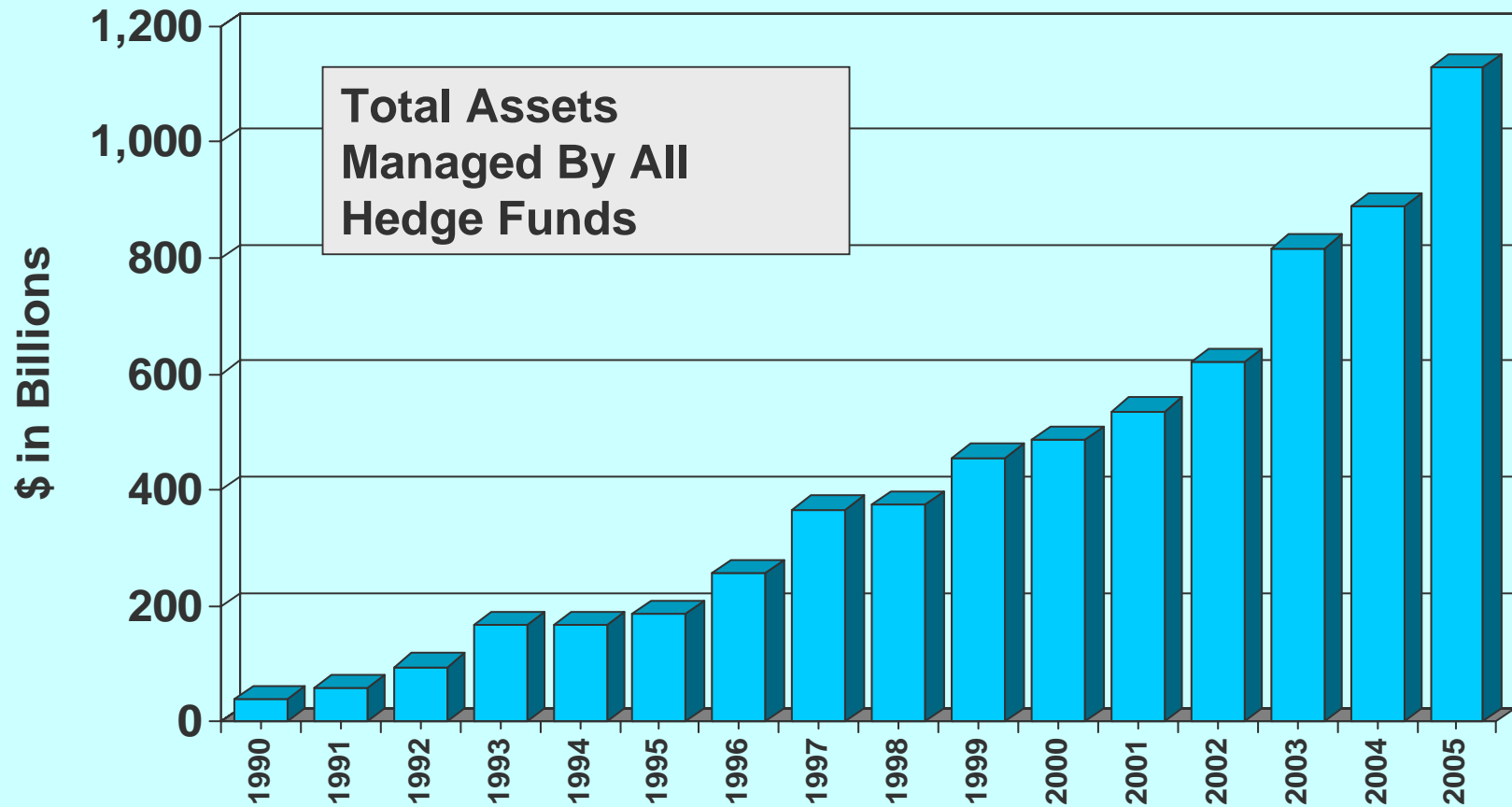
- Senior secured leveraged loans (floating)
 - B, C institutional tranches
- Second-lien leveraged loans (floating)
 - US hedge fund import
- Second-lien notes (fixed)
- Second-lien mezzanine (floating)
 - Warranted (club style)
 - Warrant-less
- Payment-in-Kind “PIK” notes
- Sponsor dividends



Emergence of European Funds With Ability to Buy 2nd Lien, Mezz and PIK



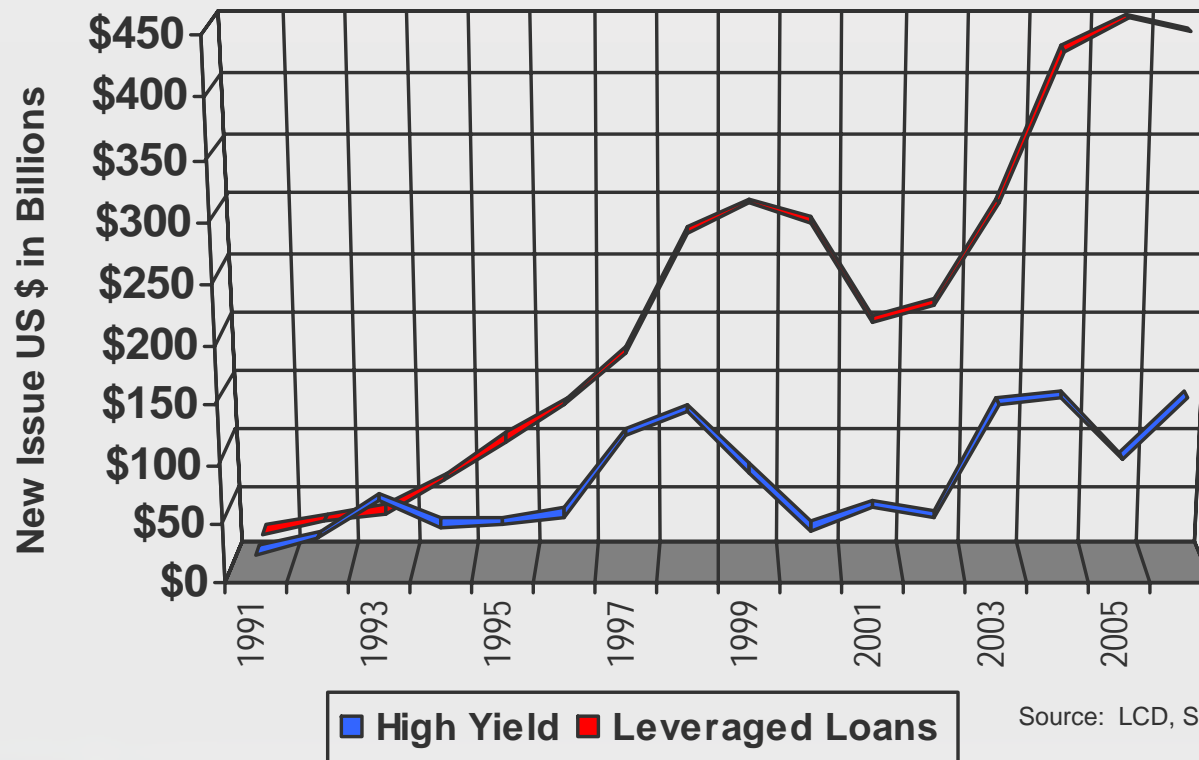
Hedge Funds Have Grown Dramatically - They Now Manage \$1.1 Trillion in Assets



Source: Hedge Fund Research Industry Report

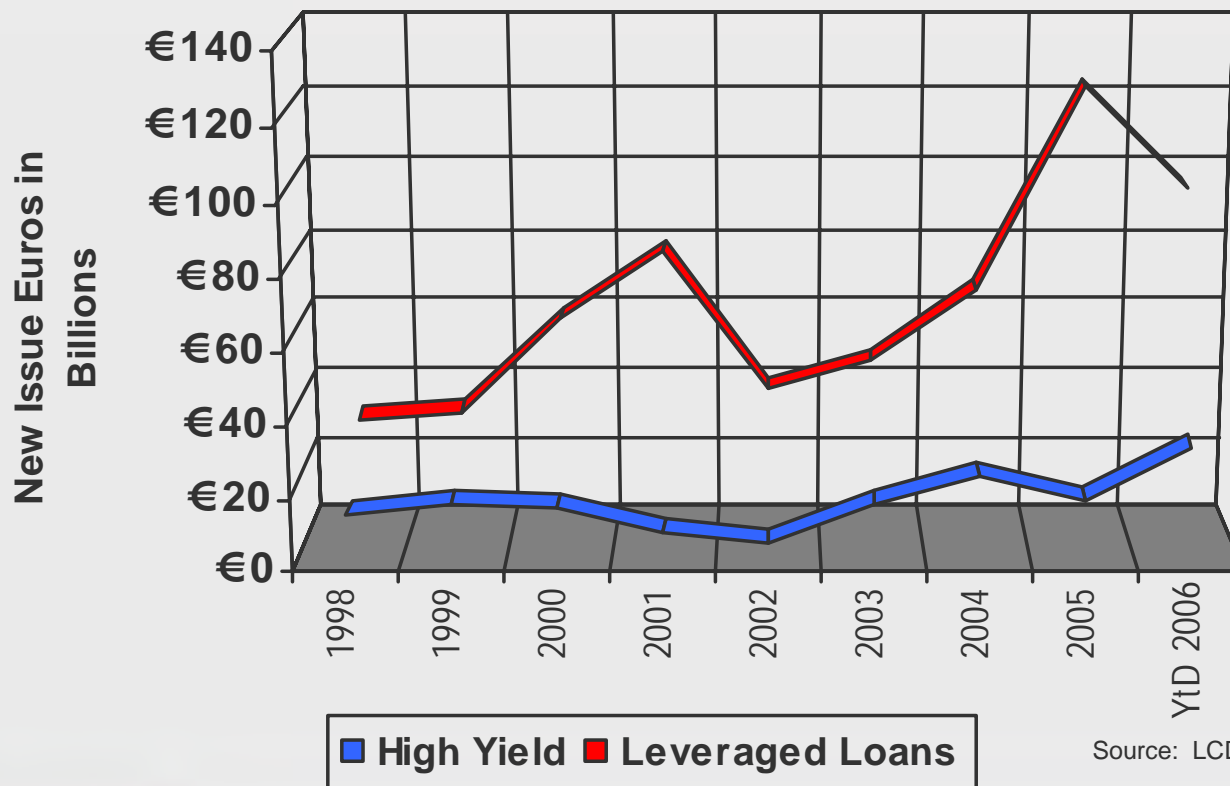
Globally, Leveraged Loans Have Skyrocketed Compared to HY

Global Leveraged Loans vs. High Yield



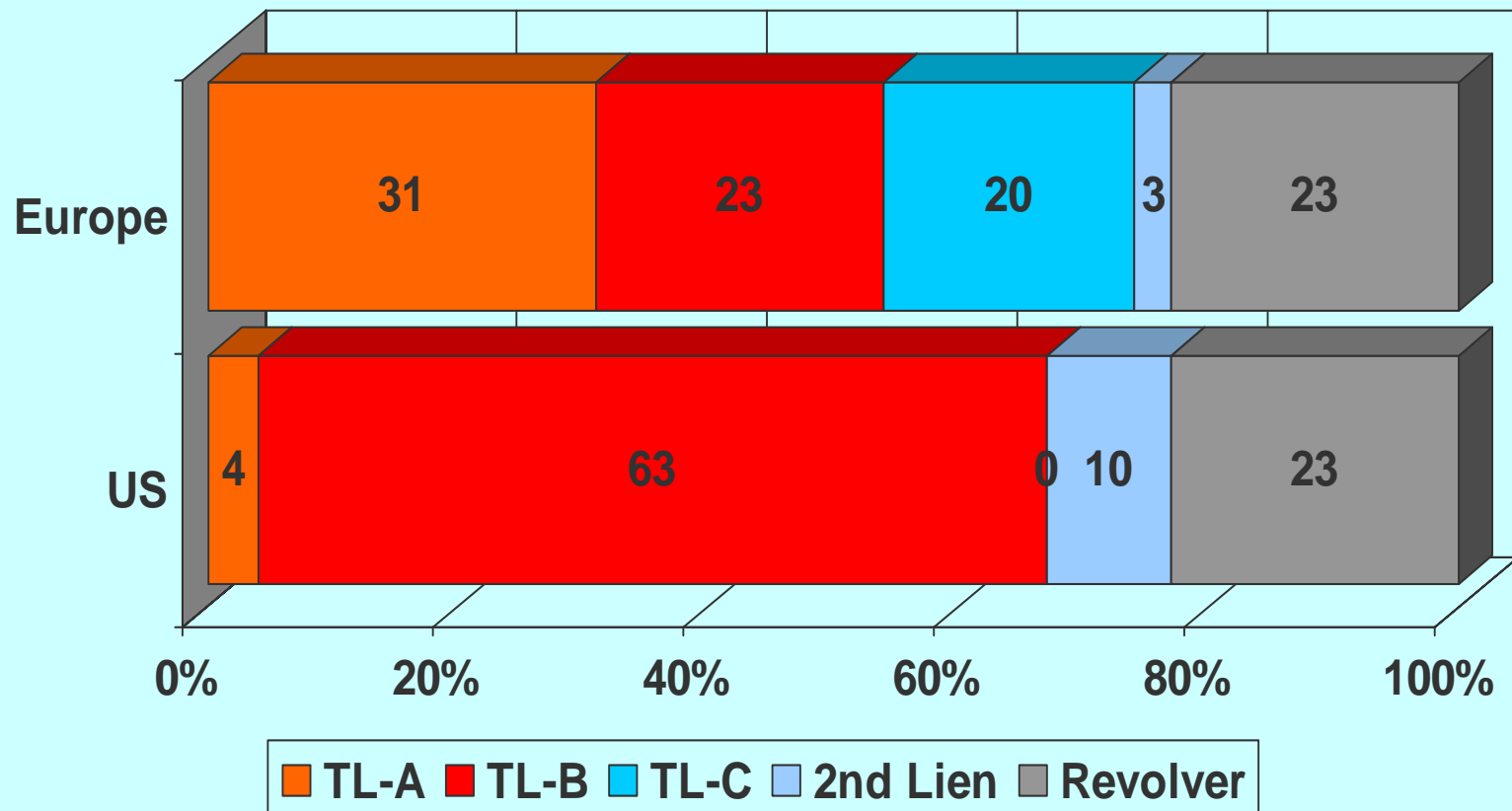
The Same Has Happened in Europe

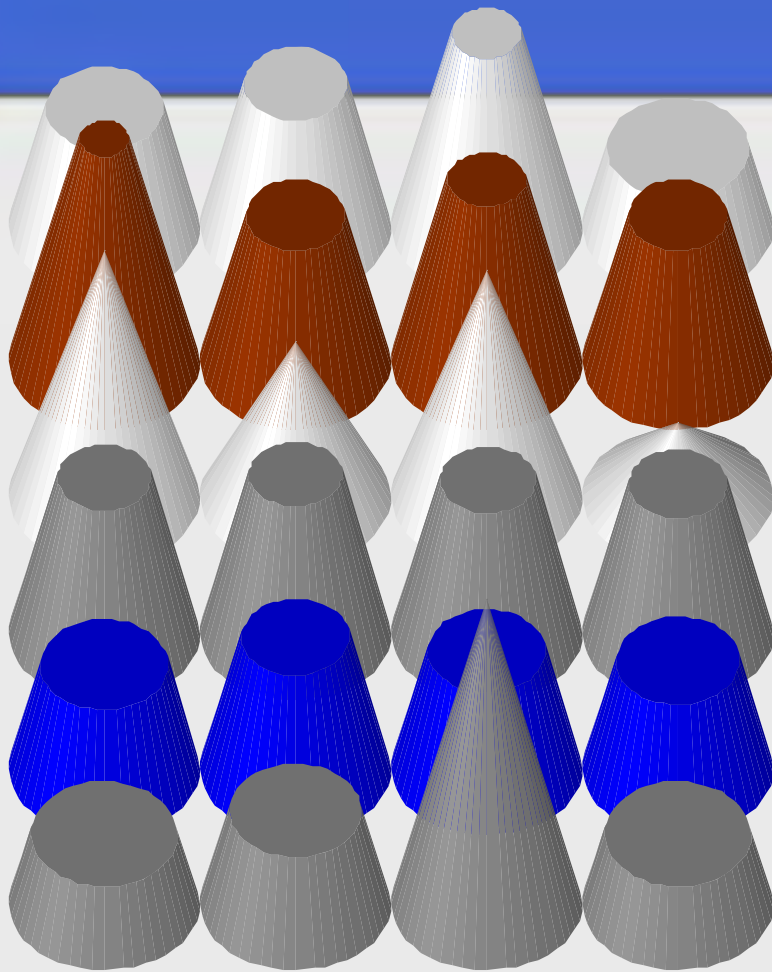
European Leveraged Loans vs. High Yield



Institutional Lending in European LBOs Not Yet At US Levels

Bank Loan Structure in LBOs

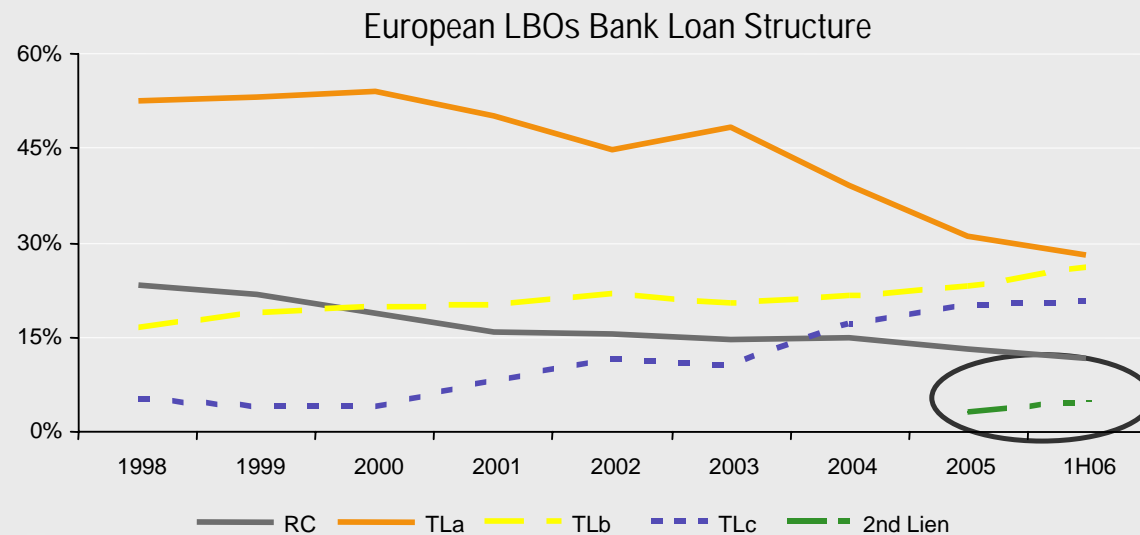




The European Second Lien Market

European Leveraged 2nd Lien Market – Overview

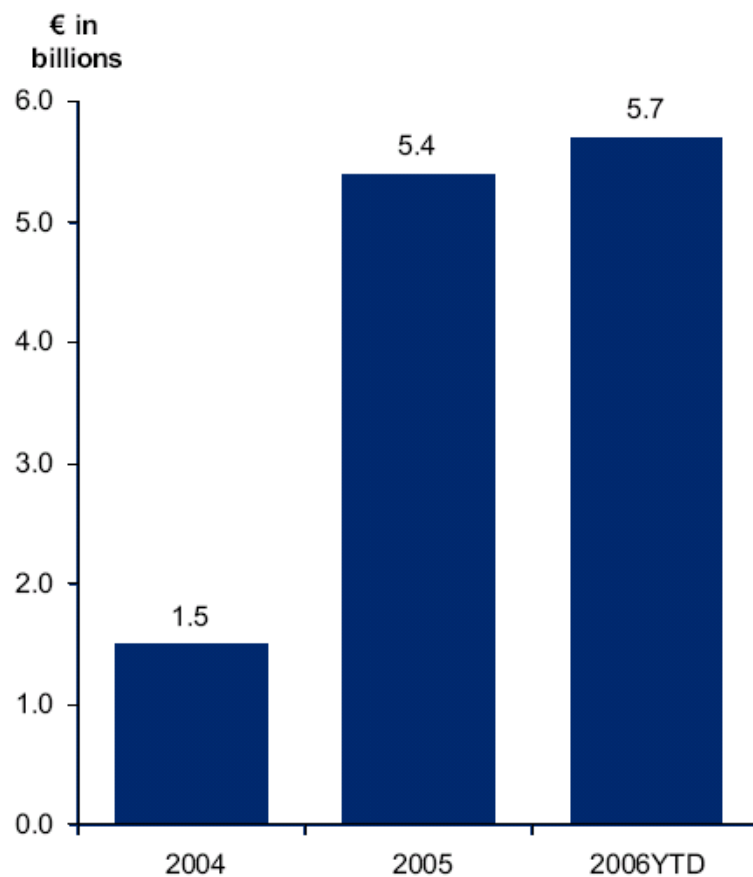
- European 2nd lien tranches have developed from being ‘stretched senior’ tools used in recapitalisations to being a regular feature of new LBOs
- 2nd Lien deals with no subordinated debt beneath still proving ‘sticky’ to syndicate and represent only 15% of total Q206 volumes



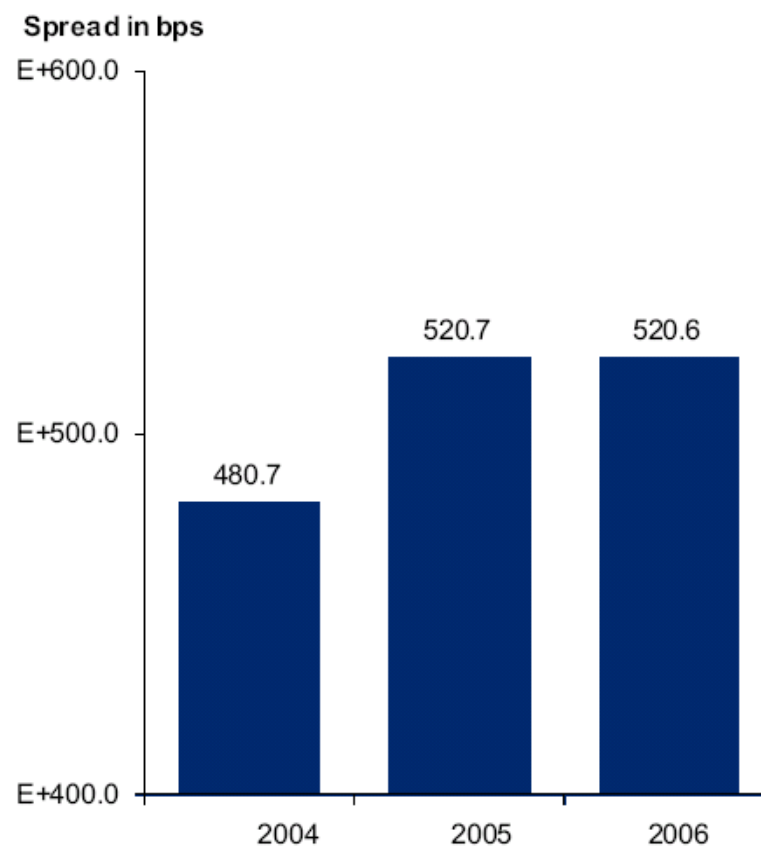
Source: Société Générale and S&P LCD

European Second Lien Issuance and Pricing

Volume



Average Spreads



Source: Merrill Lynch

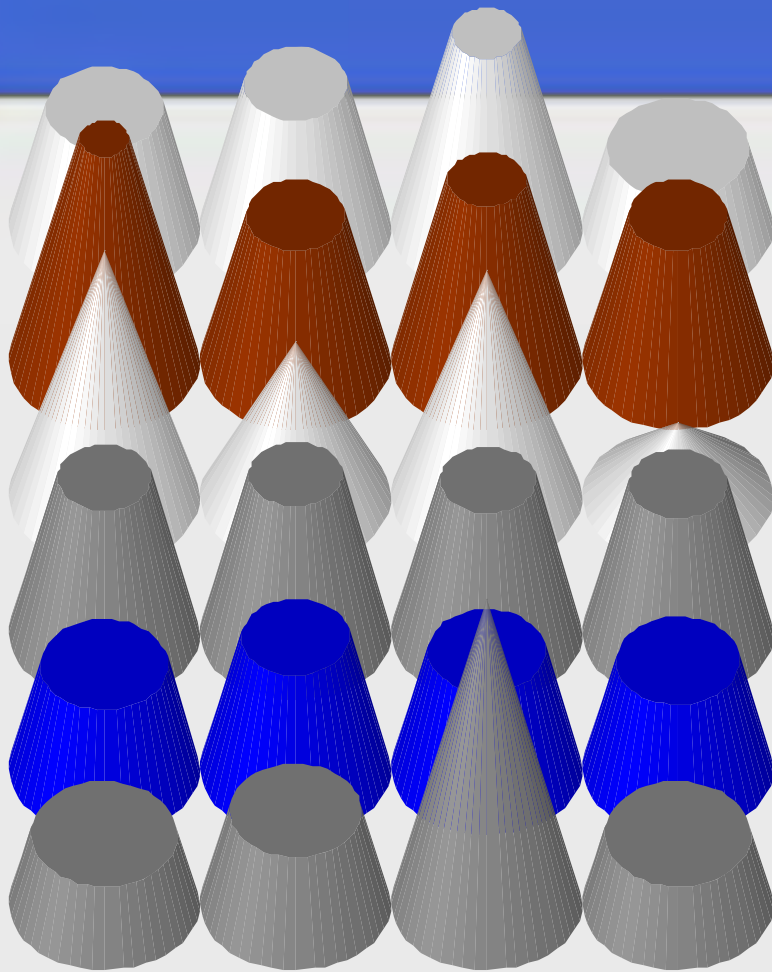
Different Flavors of European Second Lien Debt

- **First Loss**– Most aggressive pricing; sold to bank/loan fund investors; may be tranche D in senior loan facility (+475 bps)
- **Traditional Second Lien** – Sandwiched between first lien senior and high yield; relatively small percentage of the capital structure (+550 bps)
- **Replacement Mezzanine** – Used where it is the only debt between senior and the equity; a variation of traditional European mezz (+650 bps)



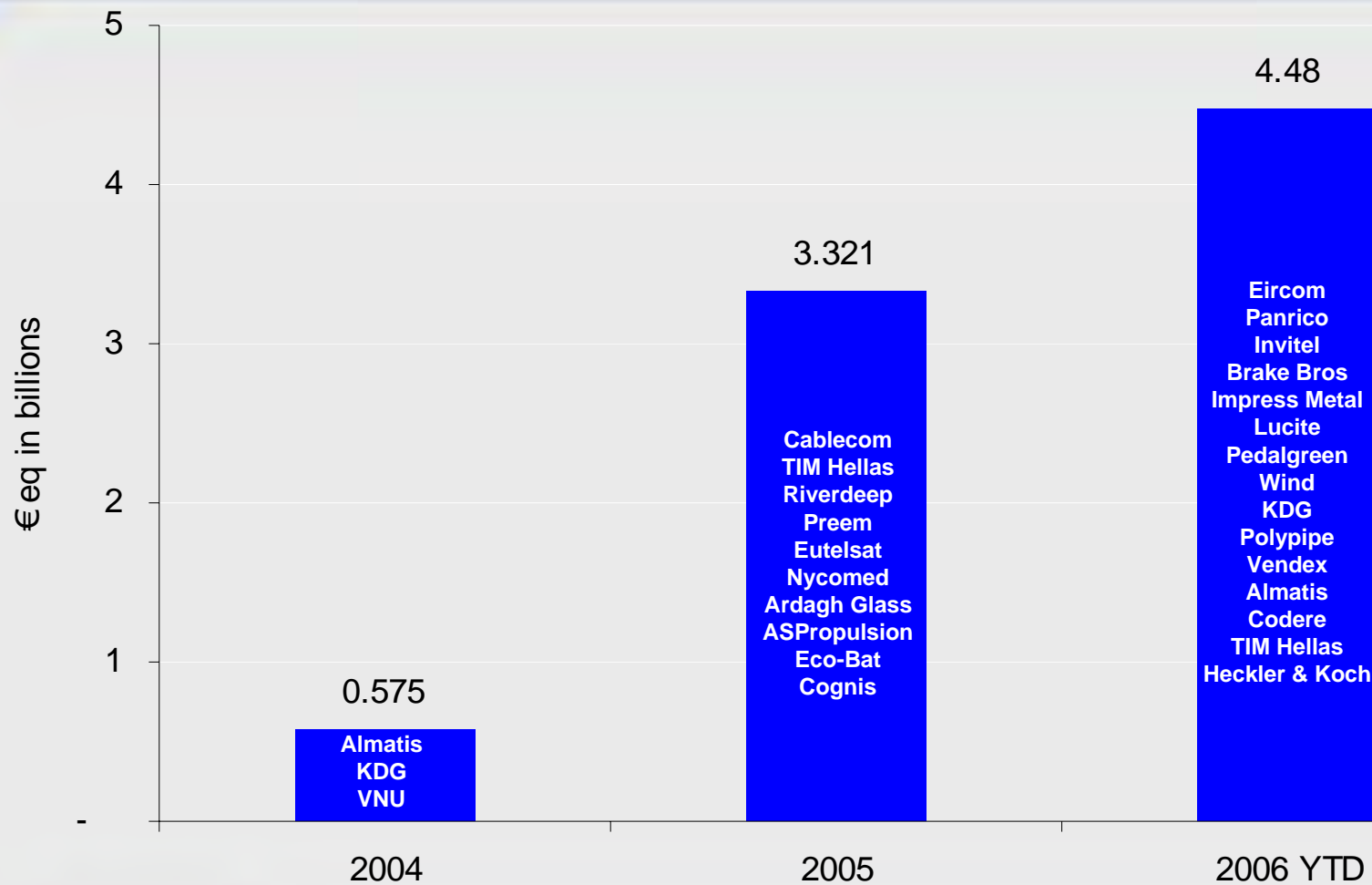
Second Lien in Europe – Cheap Mezzanine?

- **European Second Lien shares many characteristics with European Mezzanine:**
 - **Second ranking security**
 - **Same borrower entity as the first lien debt (unlike European HY)**
 - **Sometimes – but not always – contractual subordination to first lien debt**
 - **Payment blockages and enforcement standstills**
 - **Full or partial turnover provisions**



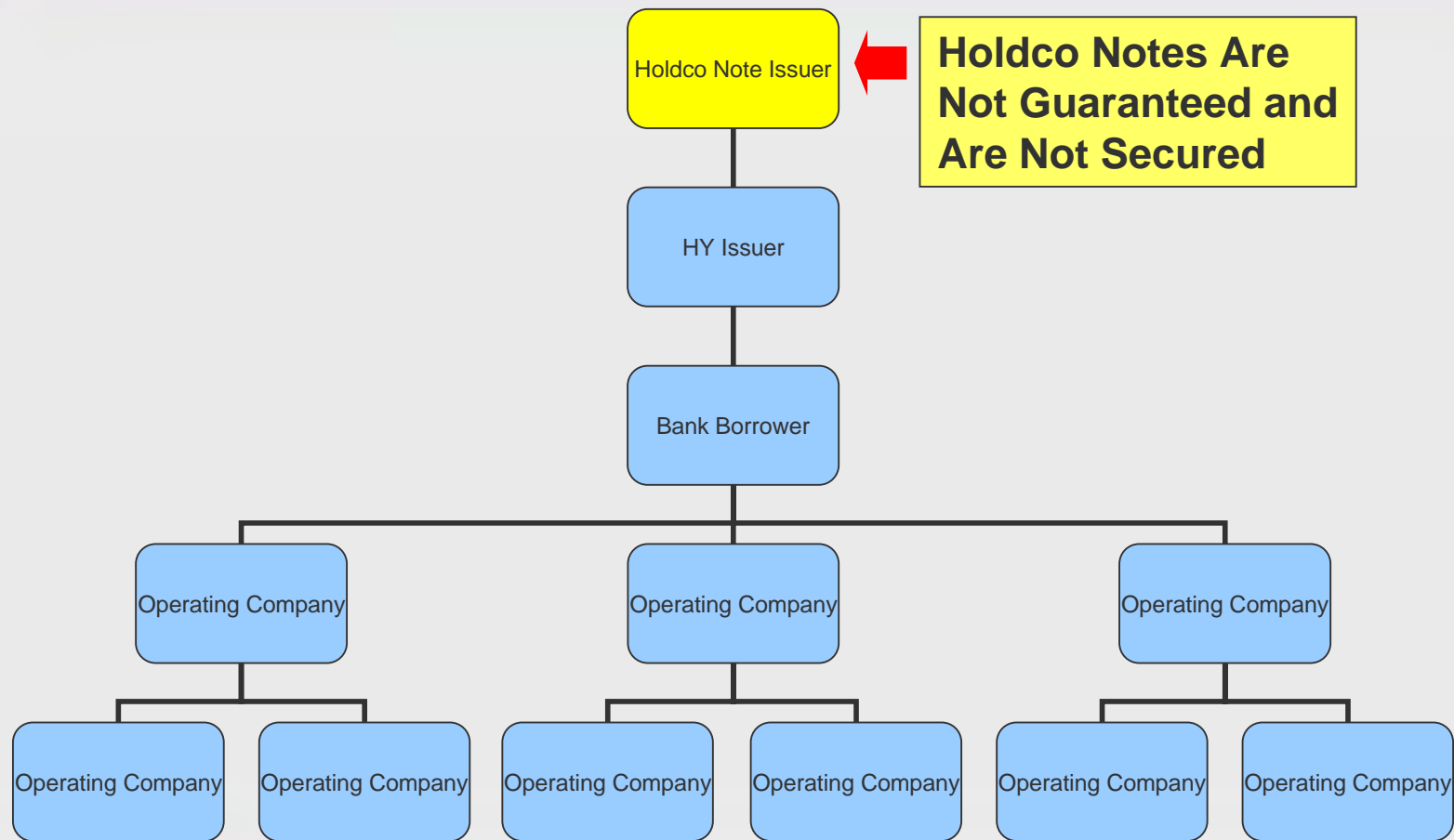
The European PIK Market

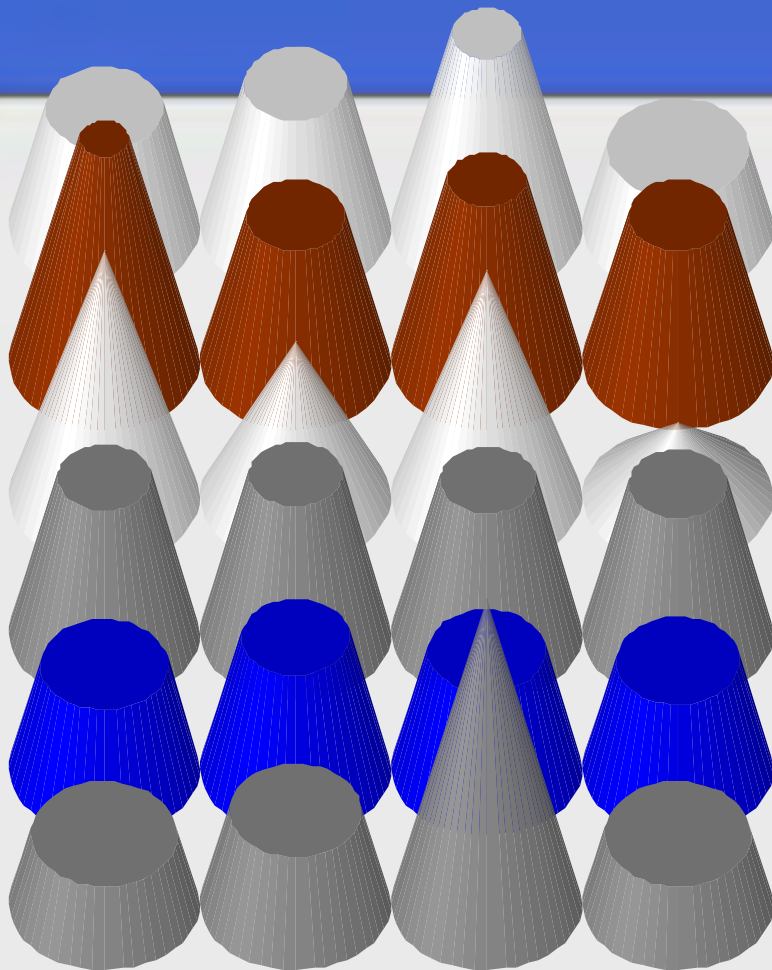
European PIK Issuance



Source: Société Générale

Holdco Notes are Structurally Subordinated With No Credit Support





“Cross-Over” Bonds in Europe

Pernod Ricard Issued €850 Million in “Cross-Over” Bonds

- On Monday, Pernod Ricard issued:
 - €550 million of 4.275% Notes at Issue Price of 99.526%
 - €300 million of FRNs (with a Margin of .50% over EURIBOR) at Issue Price of 99.876%
- Rated BB+ by Standard & Poor's and Baa3 by Moody's
- Investment-grade covenants
- French law bond documentation



Cross-Over Bonds vs. High Yield Bonds

Cross-Over Bonds

- Corporate bond issuers typically with high name recognition and actual or implied ratings of Ba3/BB– or above
- Usually rank pari passu with bank debt
- Normally not callable
- Covenant–lite: Covenants are “high-yield minus” or “Eurobond plus”

High Yield Bonds

- Non-investment grade, corporate bonds rated Ba1/BB+ or below
- Usually subordinated to senior bank debt: contractually, structurally, second lien
- Limitations on optional redemption
 - Non-call period (7yr/NC4 or 10yr/NC5)
 - Equity claw (35% or 40%)
 - Make whole
 - Tax call
- Full high yield incurrence covenant package

Selected Cross-Over Bond Transactions

2006



2005



ThyssenKrupp

2004

ThyssenKrupp



2003



2002

ThyssenKrupp



High Yield in France - The Next Wave

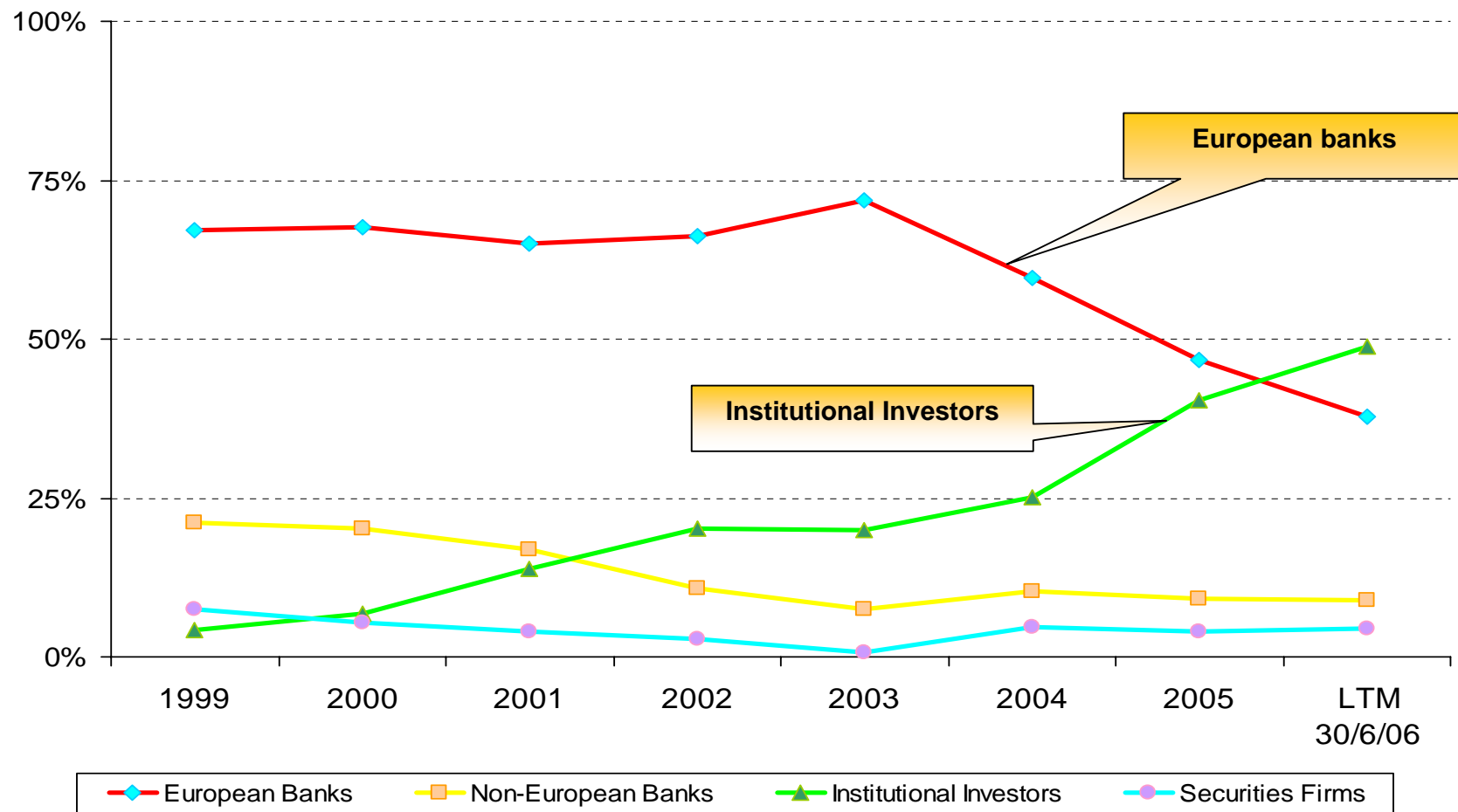
Basel II, securitizations and recovery ratings

Blaise Ganguin, Chief Credit Officer, Europe

December 6th 2006

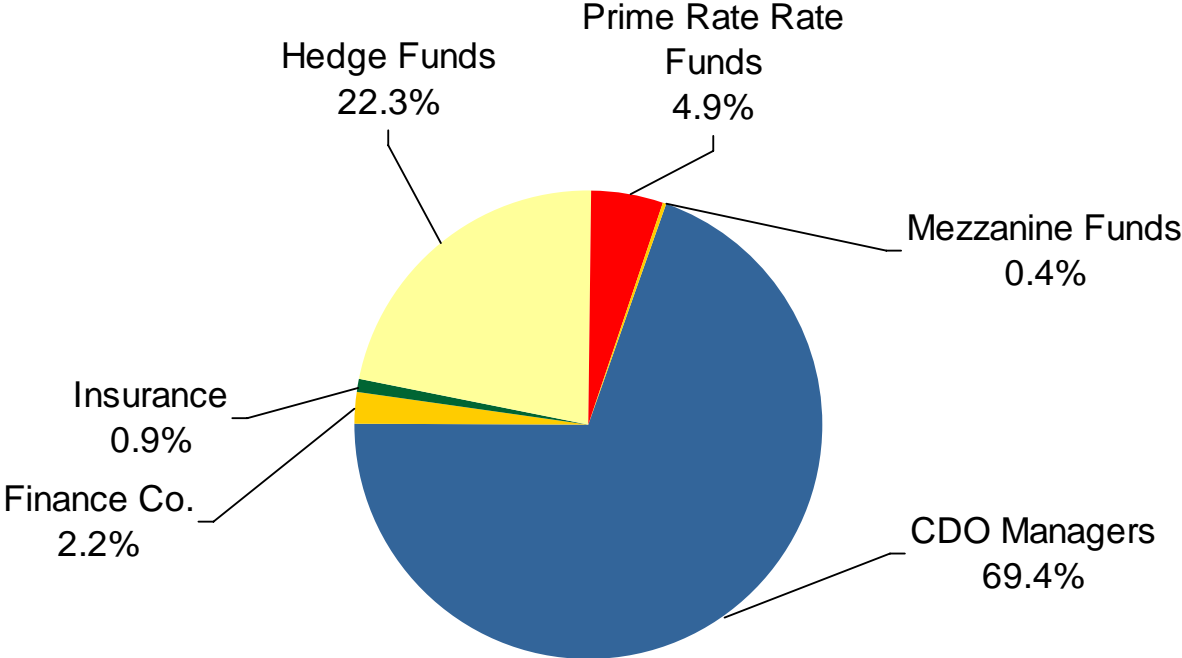
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LBO credit: Institutional investors overtake banks



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Institutionals : Hedge Funds are coming!

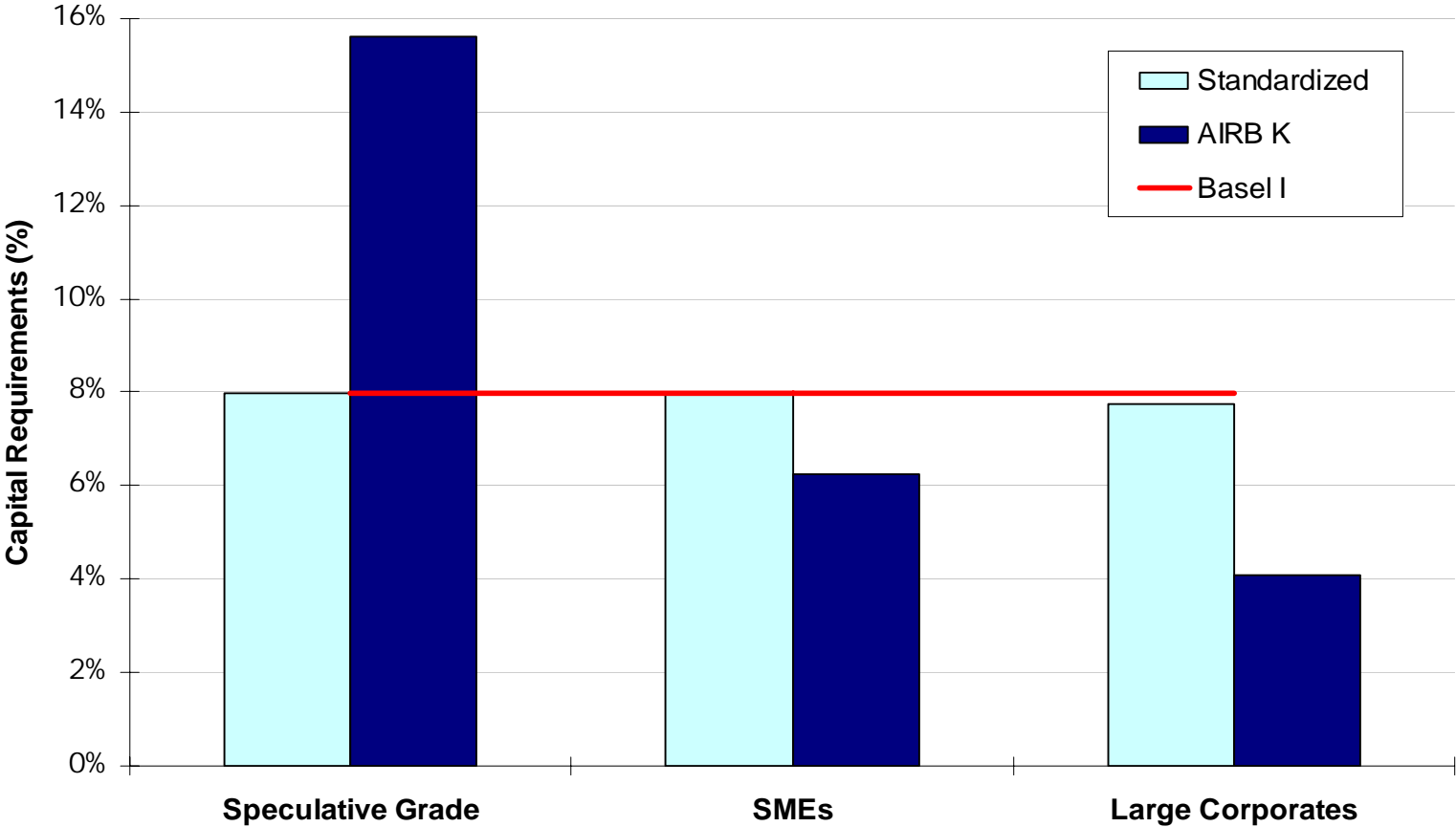


All numbers as of Q3 2006 - Excludes U.S. Dollar Tranches Syndicated in the US

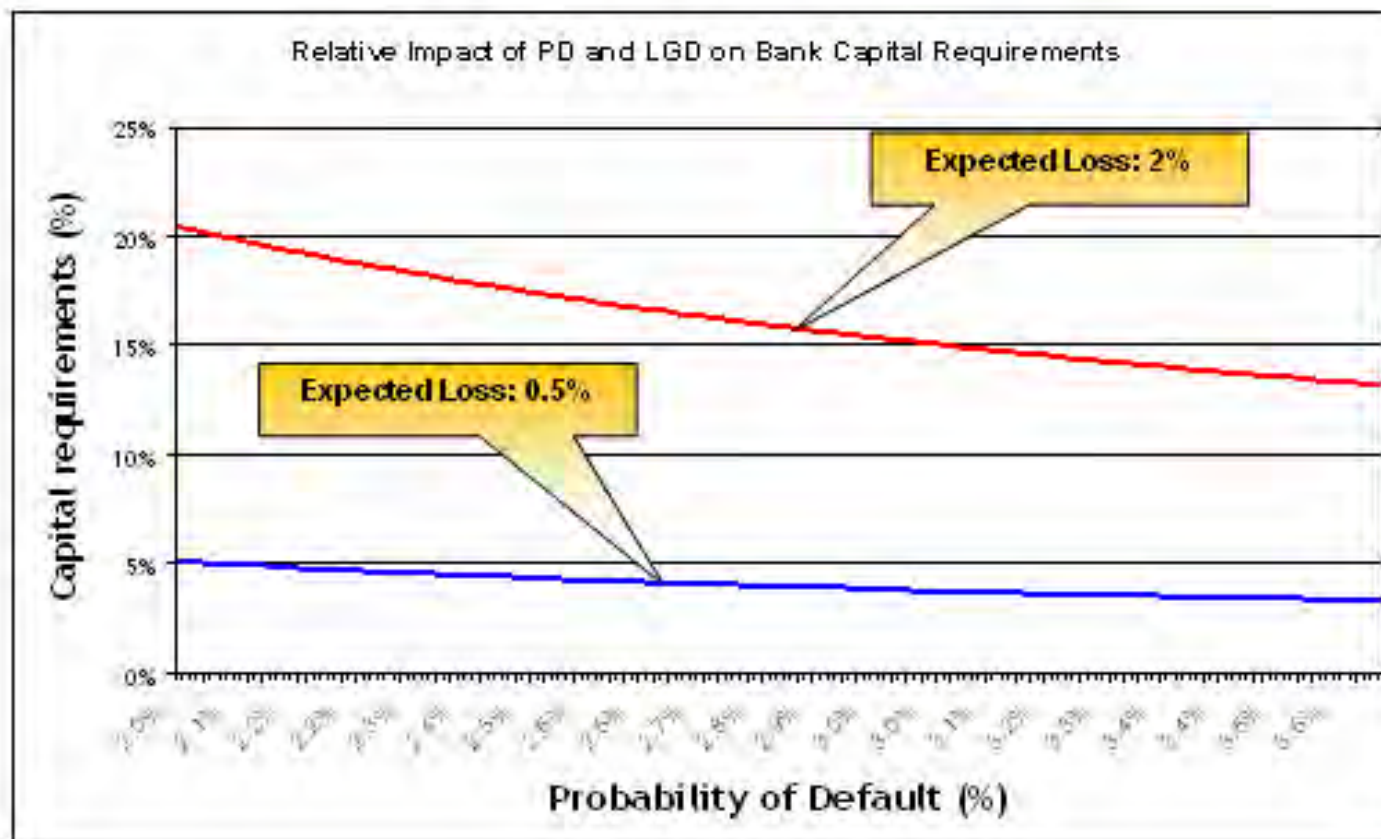


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Basel II: No Longer One-Size-Fits-All



AIRB: LGD Matters!!!



Recoveries are Part of Credit Risk

Discounted Recovery (1988-2004)	Acquired	Emerged	Liquidated	Overall
Bank debt	85.6	77.2	69.6	77.1
Senior secured notes	72.6	63.3	54.3	63.3
Senior unsecured notes	61.9	44.6	17.5	42.7
Senior subordinated notes	42.6	32.3	12.2	31.2
Subordinated notes	21.0	35.8	7.7	30.1

Source: Standard & Poor's U.S. LossStats™

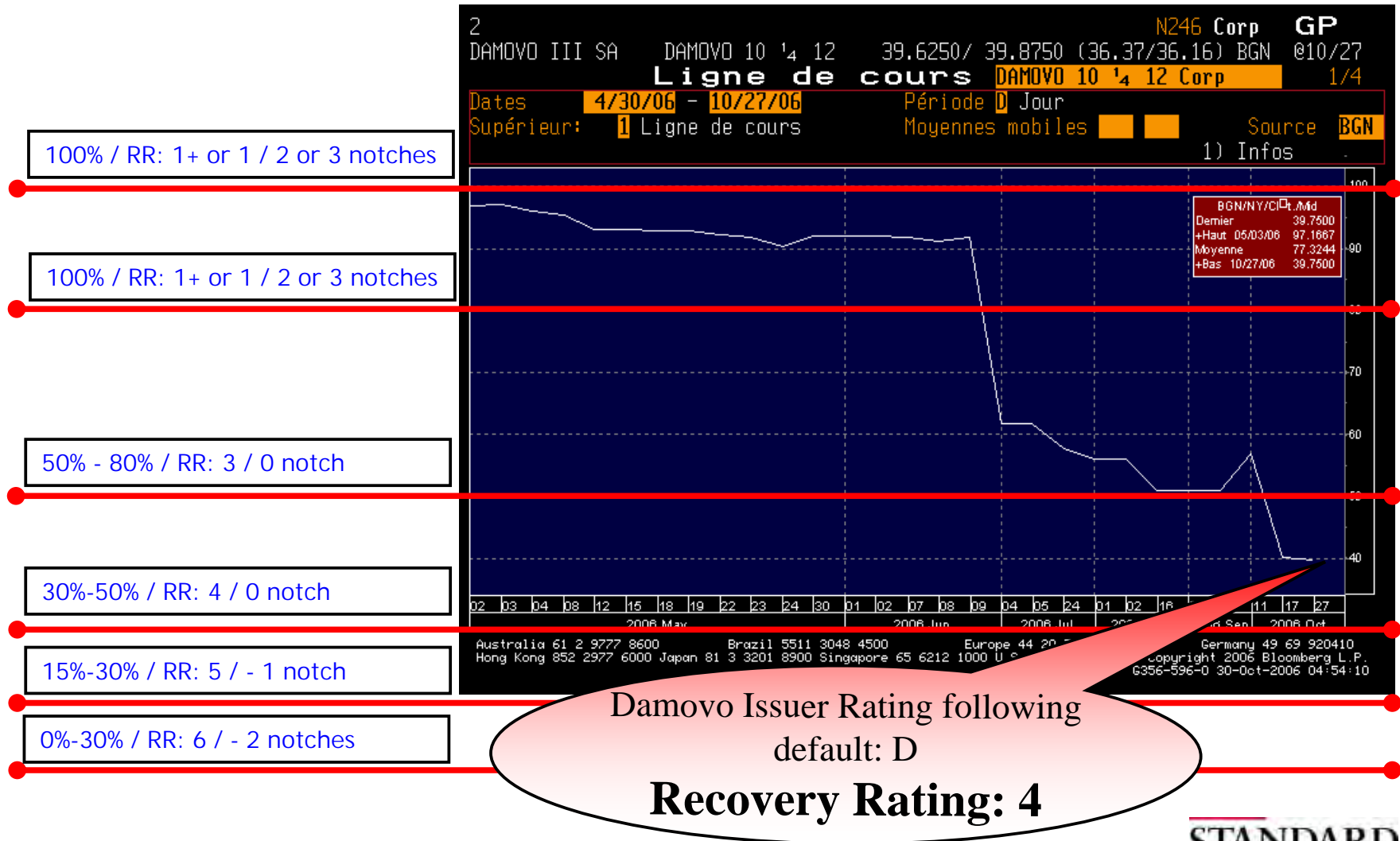


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Recovery Ratings: a Separate Scale

Proposed “Enhanced Notching”/Recovery Scale			
Recovery Rating	Recovery Expectation	Expected Recovery	Notching from ICR: Speculative Grade
1+	Highest expectation, Full recovery of principal	100%	+3
1	Strong expectation, Full recovery of principal	100%	+2
2	Substantial recovery of principal	80-100%	+1
3	Meaningful recovery of principal	50-80%	0
4	Average recovery of principal	30-50%	0
5	Modest recovery of principal	15-30%	-1
6	Negligible recovery of principal	0-15%	-2

Recovery Ratings are pointing in the right direction...



100% / RR: 1+ or 1 / 2 or 3 notches

100% / RR: 1+ or 1 / 2 or 3 notches

50% - 80% / RR: 3 / 0 notch

30%-50% / RR: 4 / 0 notch

15%-30% / RR: 5 / - 1 notch

0%-30% / RR: 6 / - 2 notches



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The Big Leveraged Buyouts: How Do Private Equity Firms Evaluate the High Yield Alternative

Youssef Khat, **BNP Paribas**
Gérald Lucaussy, **Tisbury Capital Management**
Gerhard Noack, **Europcar International**
Philippe Renaud, **Eurazeo**
Paul Smith, **Société Générale**
Thomas Forschbach, **Latham & Watkins (moderator)**

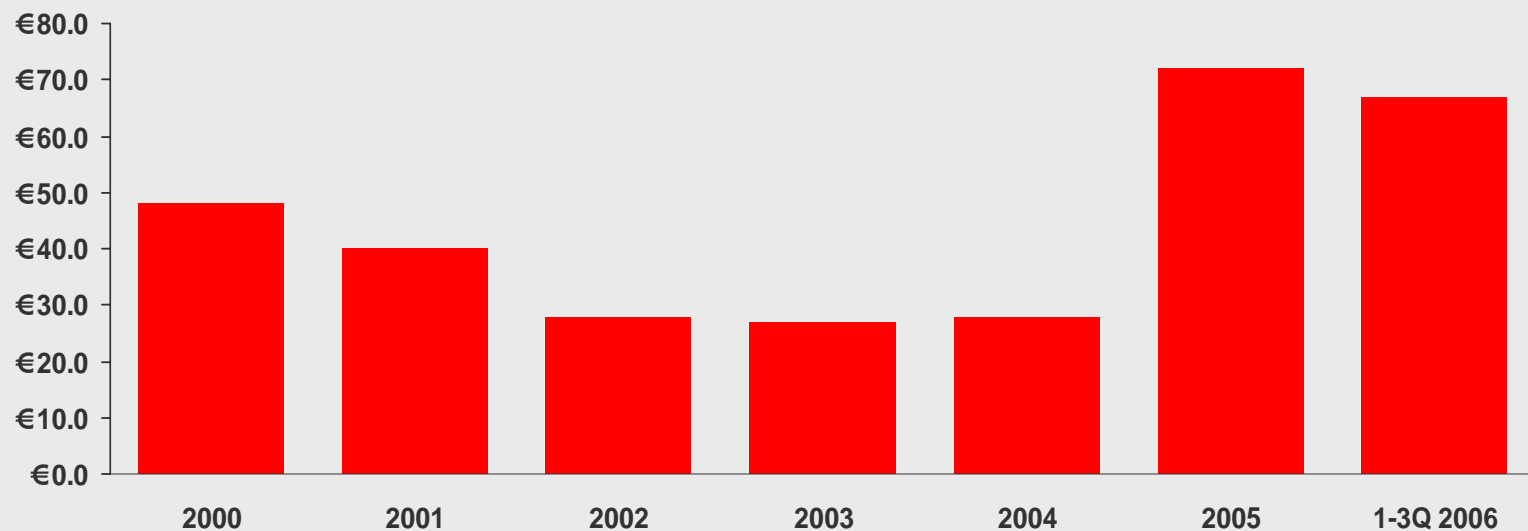


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European and US Private Equity Firms Continue to Raise Money at a Record Pace

- Private equity fundraising in 2006 is on track to surpass the full year 2005 total
- A number of US and European private equity firms have raised or are in the process of closing new “mega-funds” (Permira, Providence, KKR, Blackstone, Carlyle, TPG, etc)

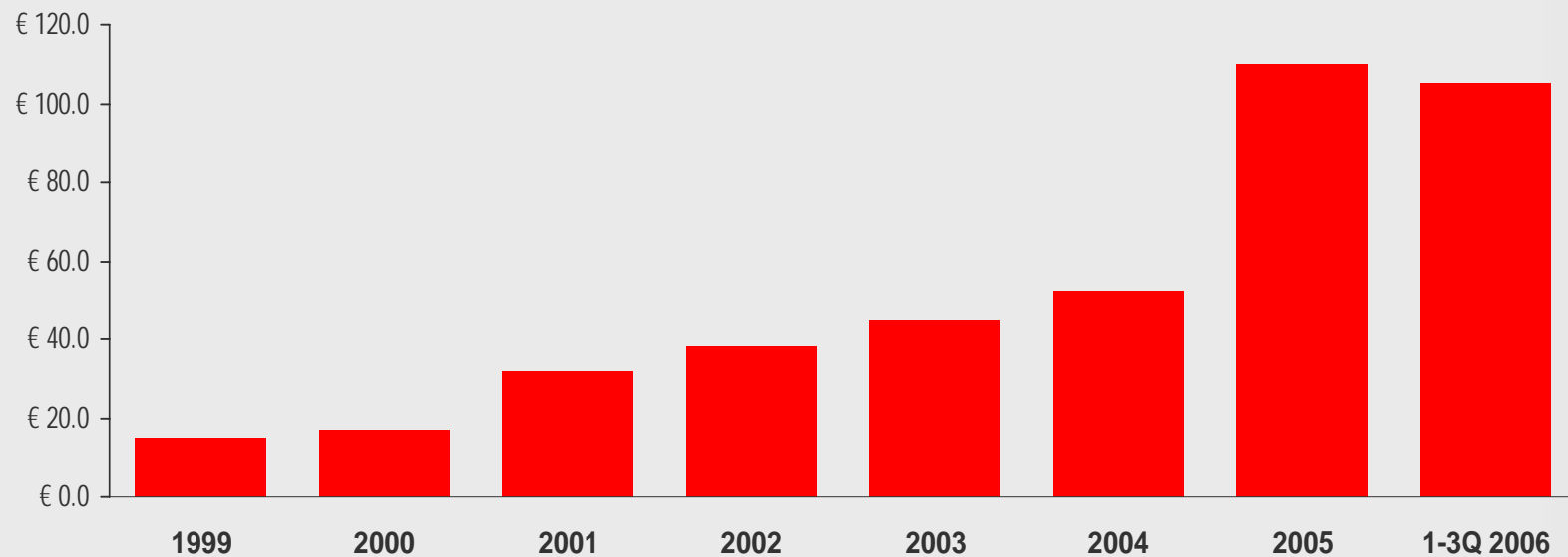
Funds Raised by European Private Equity (in €billions)



source: European Private Equity Association

2005 Saw Primary European LBO Volume More Than Double the Previous Year, And 2006 is also Extremely Strong

Total European LBO Volume: 1999-3Q 2006 (in €billions)

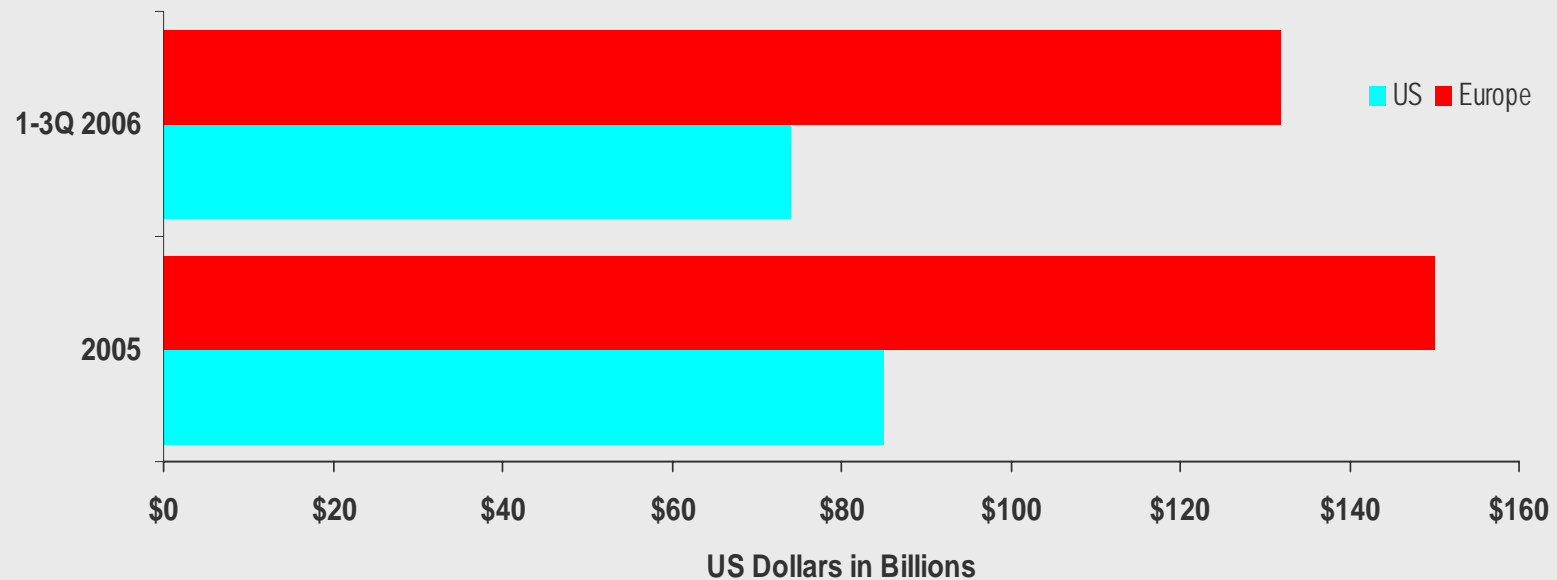


NB: Reflects total sources of funding of initial or secondary buyout from private equity firms (**excludes** recaps, refinancings, etc)

Source: LCD Comps, BNP Paribas

For the first time in 2005 and again in 2006, European Buyouts exceed US buyouts

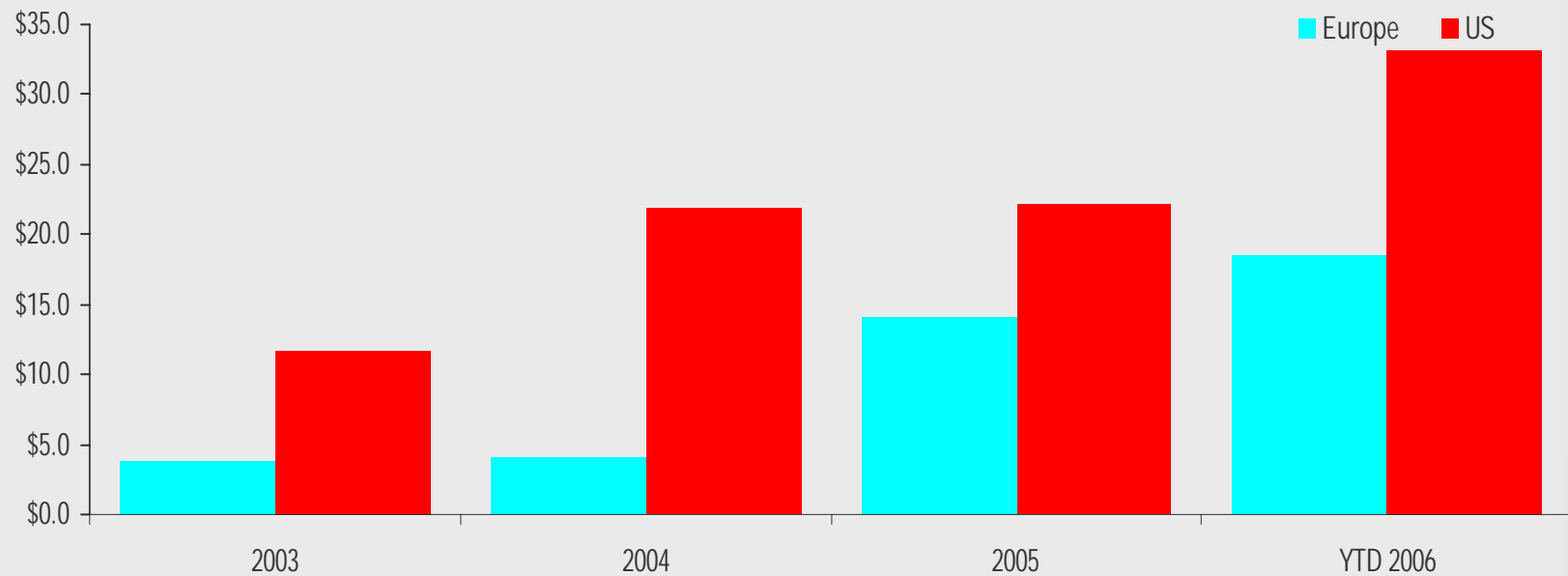
European Buyouts versus US Buyouts in 2005 and 3Q 2006 (by aggregate deal size in US\$)



Source: Thomson Research, LCD Comps, BNP Paribas

High Yield LBO Issuance has Increased Dramatically In the US and in Europe

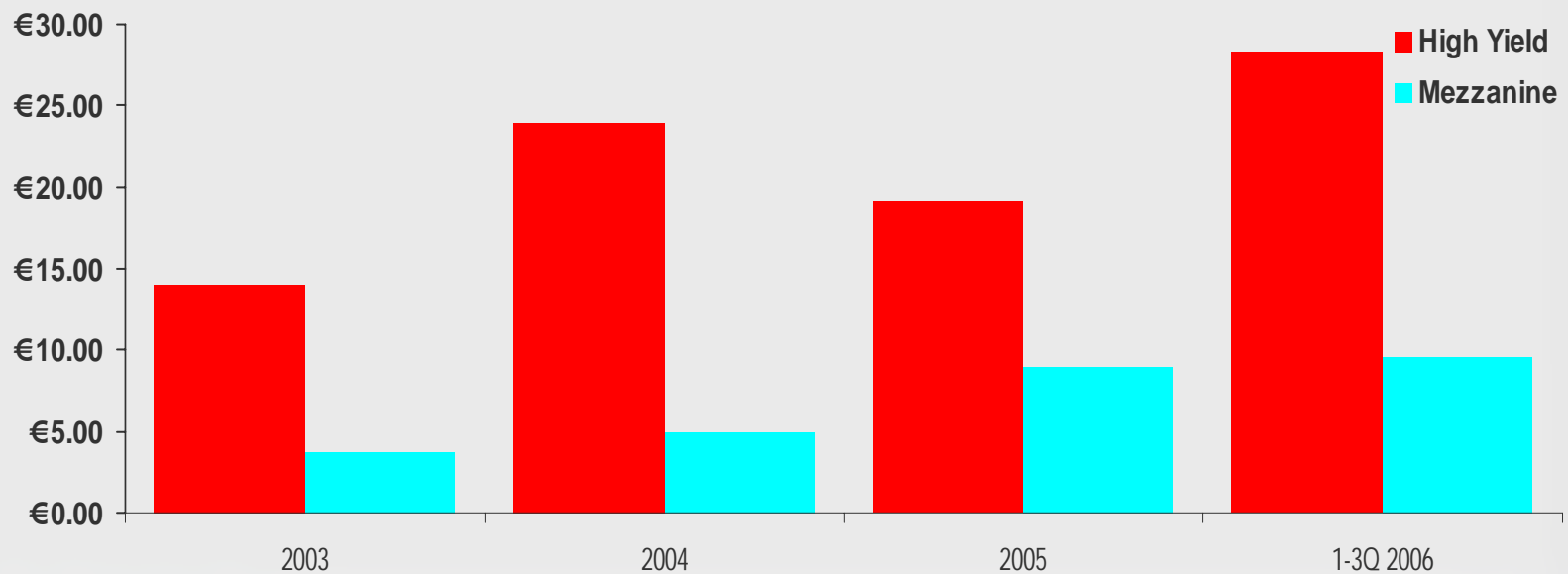
LBO High Yield Issuance in the US and in Europe 2003 – YTD 2006 (in US\$ billions)



Source: BNP Paribas

Overall, markets witnessed strong growth in High Yield and Mezzanine issuance in 2006

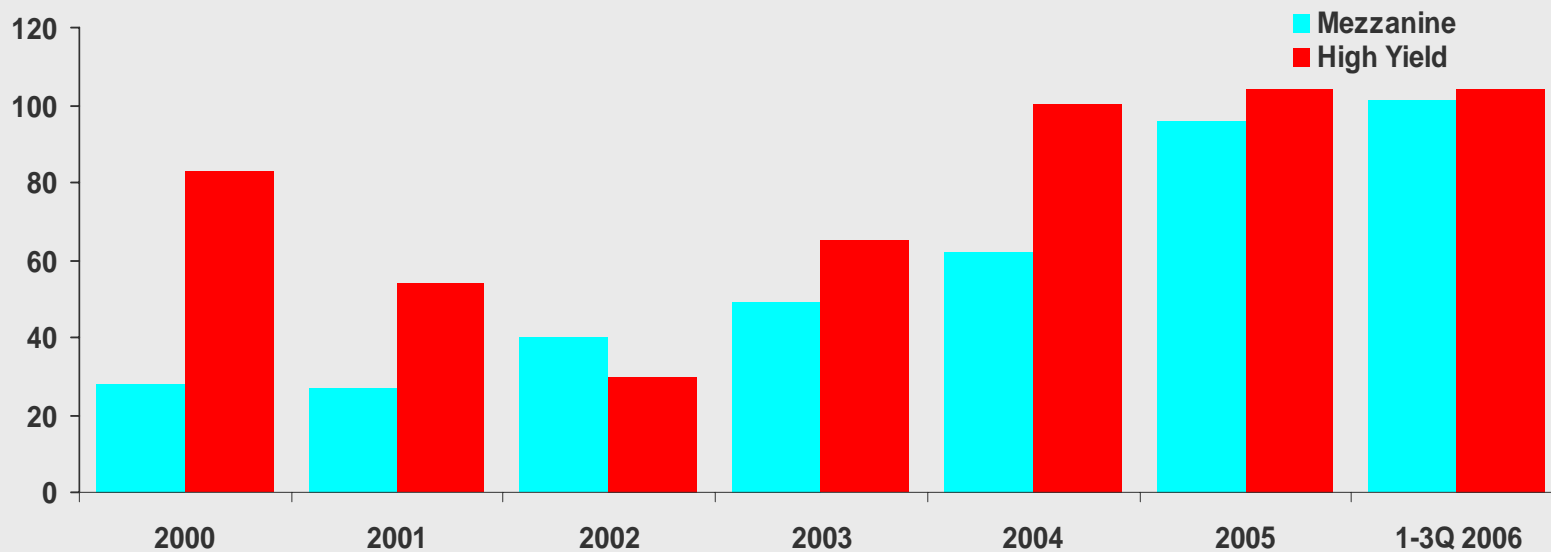
European High Yield & Mezzanine Issuance 2003 – 3Q 2006 (in US\$ billions)



Source: LCD Comps, BNP Paribas

But Mezzanine Issuance is Growing Faster than High Yield Issuance in Europe

European High Yield and Mezzanine Issuance 2000-3Q 2006 (in number of deals)

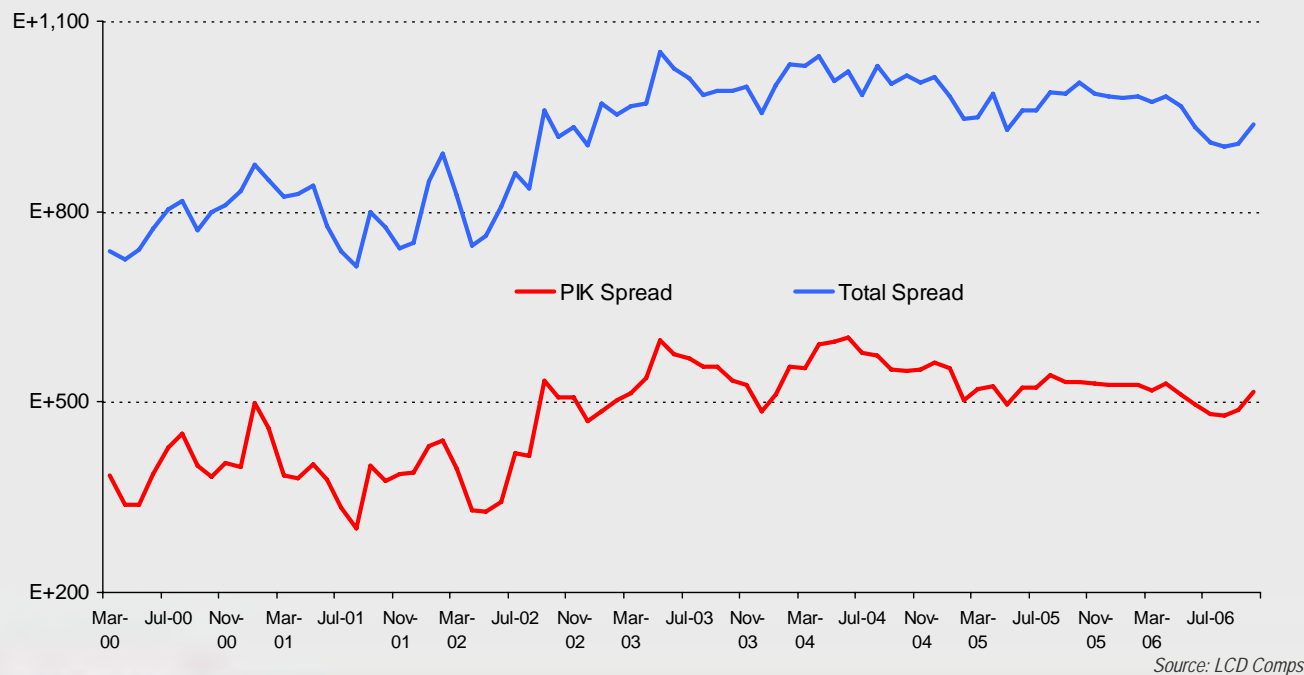


Source: LCD Comps, Bloomberg

Average Pricing For European Mezzanine Transactions

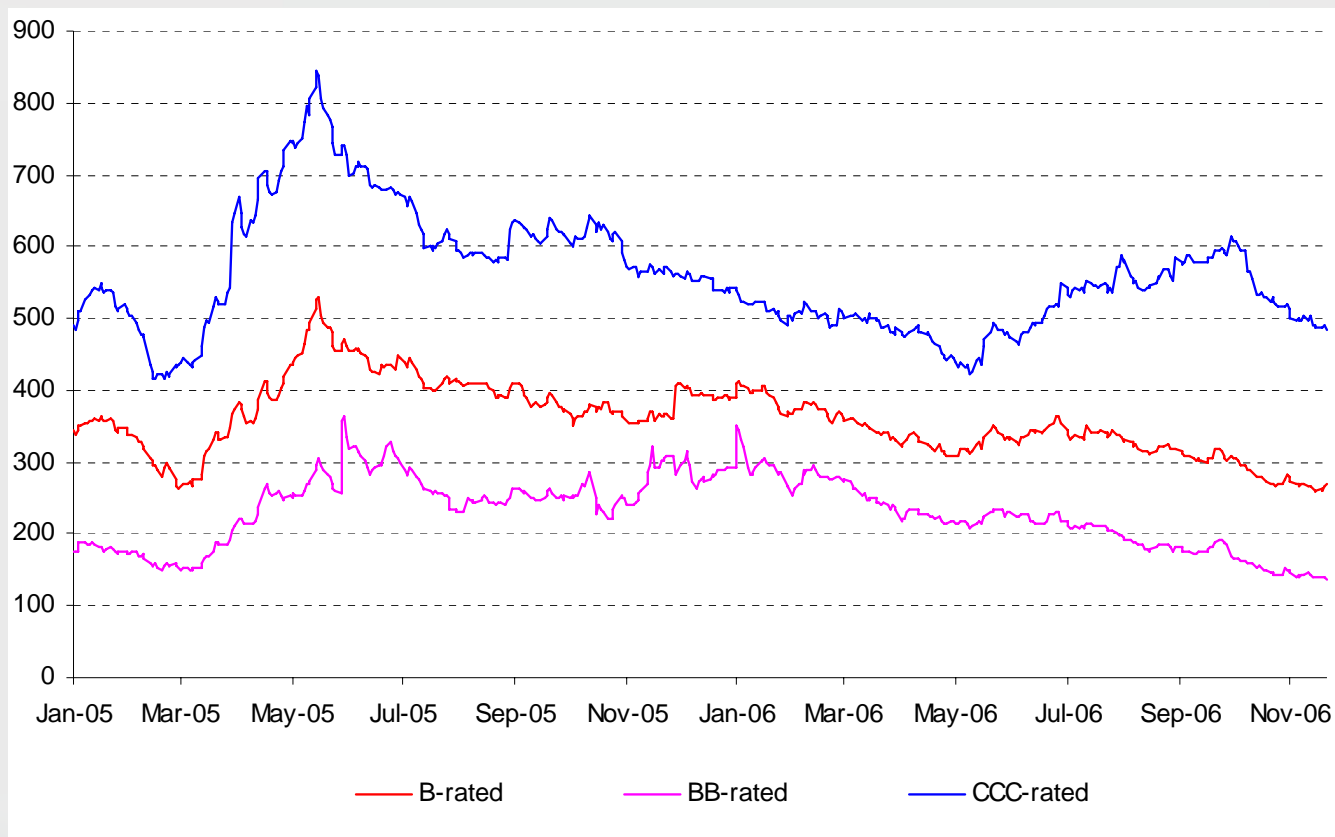
- The average spread reached peak of Euribor+ 1,030 bps in 2004, then declined to Euribor + 964 bps in 2005
- After a very low level at +902bps in August, the average spread has widened to Euribor + 937 bps by October

Rolling 3-Month Average Spreads of European Mezzanine (in bps)



European High Yield Continues to Be a Cheaper Option than Mezzanine

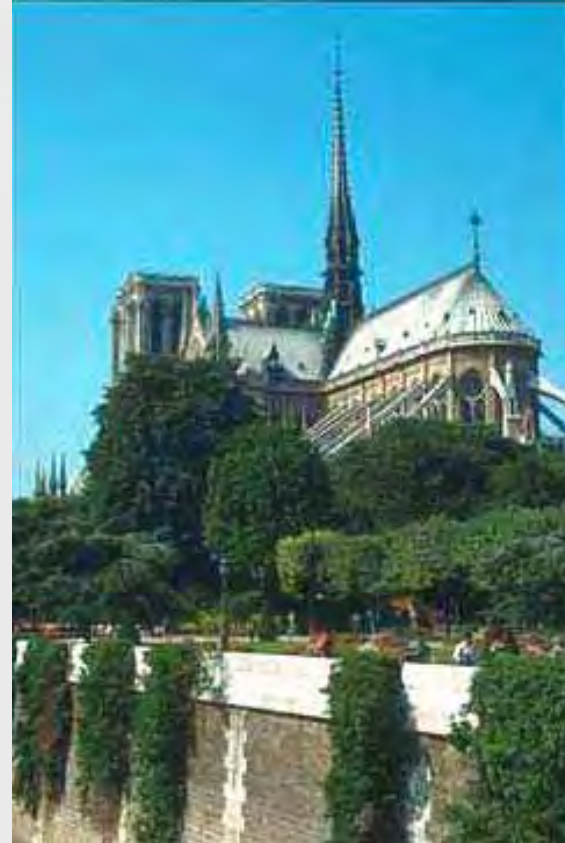
Average Spreads by Rating (in bps)



Source: BNP Paribas

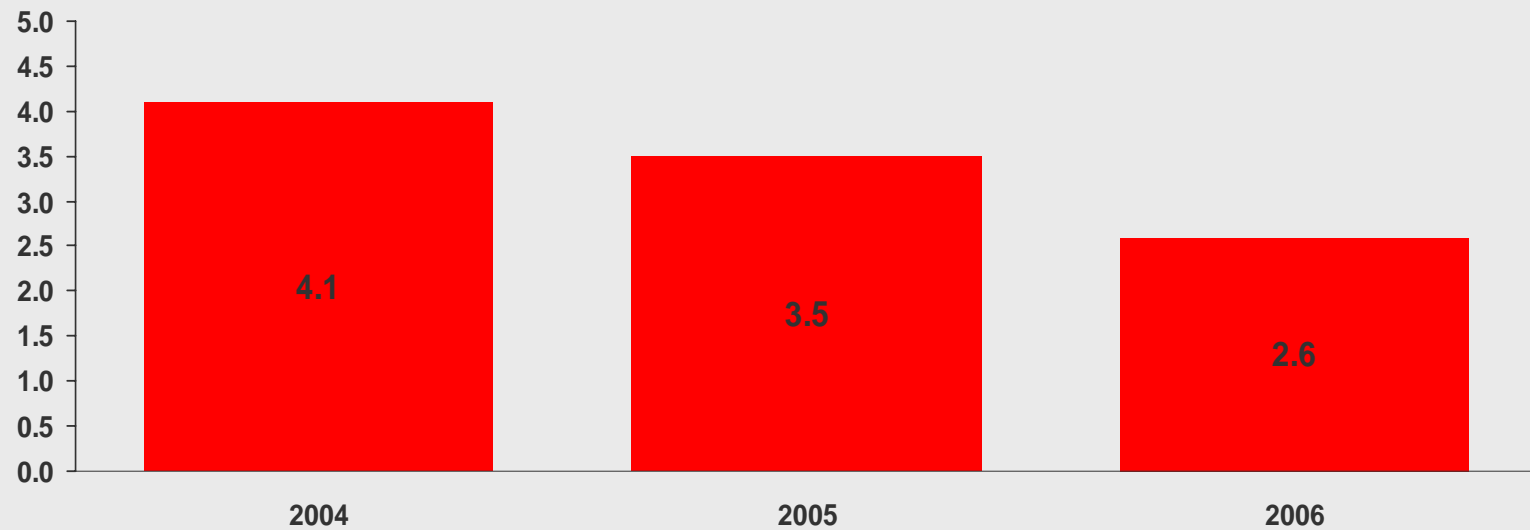
Why Do Some Sponsors Favor Mezzanine over HY for European Buyouts?

- Inflexible call protection (5 year non-call)
- Length of process
- Ongoing disclosure obligations
- Amendment flexibility
- More mezzanine sources



The Average “Hold” for European Private Equity Investments Has Dropped Dramatically

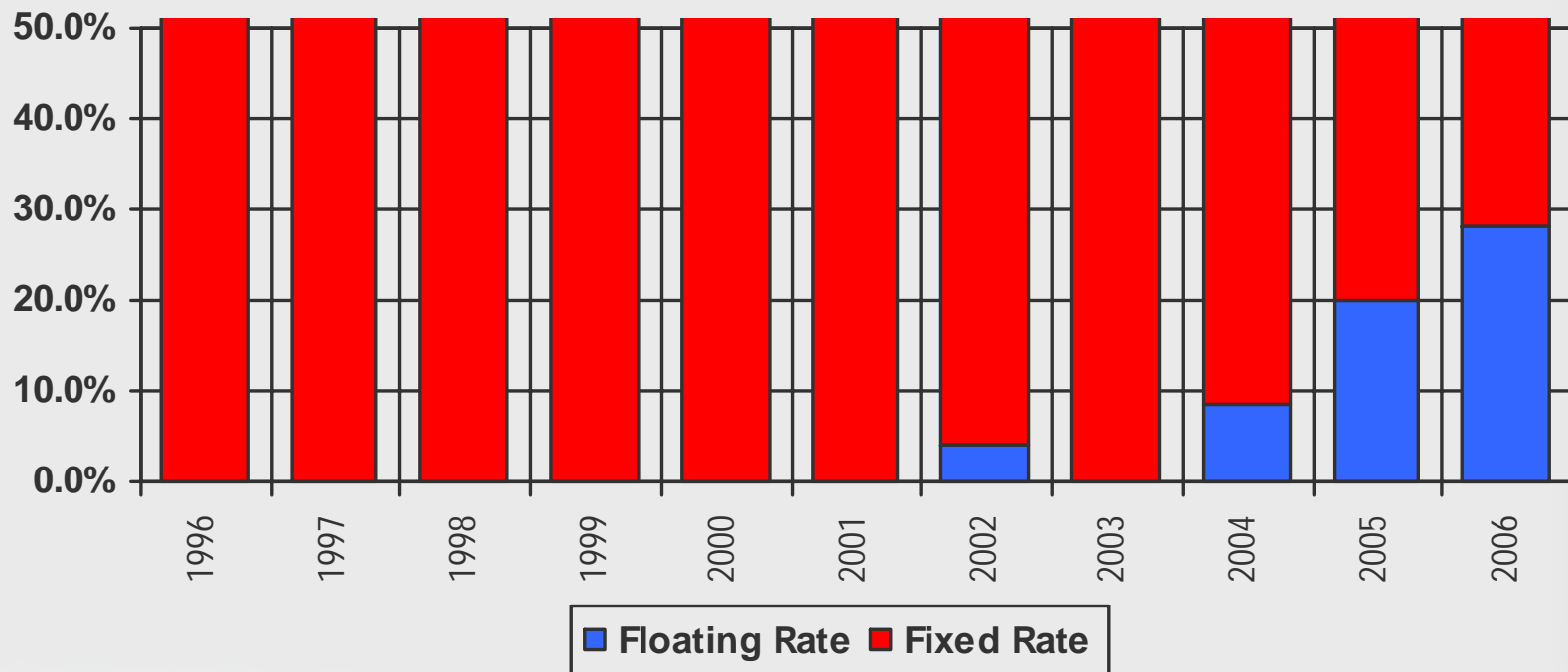
Average Investment Period For Sponsors Exiting European Investments Through Secondary Buyouts (in years)



Source: LCD News, 27 April 2006

Call Protection Issue Has Driven Increase in FRNs

The Growth in Floating Rate European High Yield Bonds (1996-YtD 2006)



Source: Merrill Lynch

The Leveraged Buyout of Europcar

- On March 15, 2006 Eurazeo agreed to purchase Europcar from Volkswagen AG
- The Acquisition has a total value of approximately €3.1 billion, consisting of:
 - purchase price for the equity of €1.3 billion; and
 - Europcar's consolidated debt of €1.8 billion

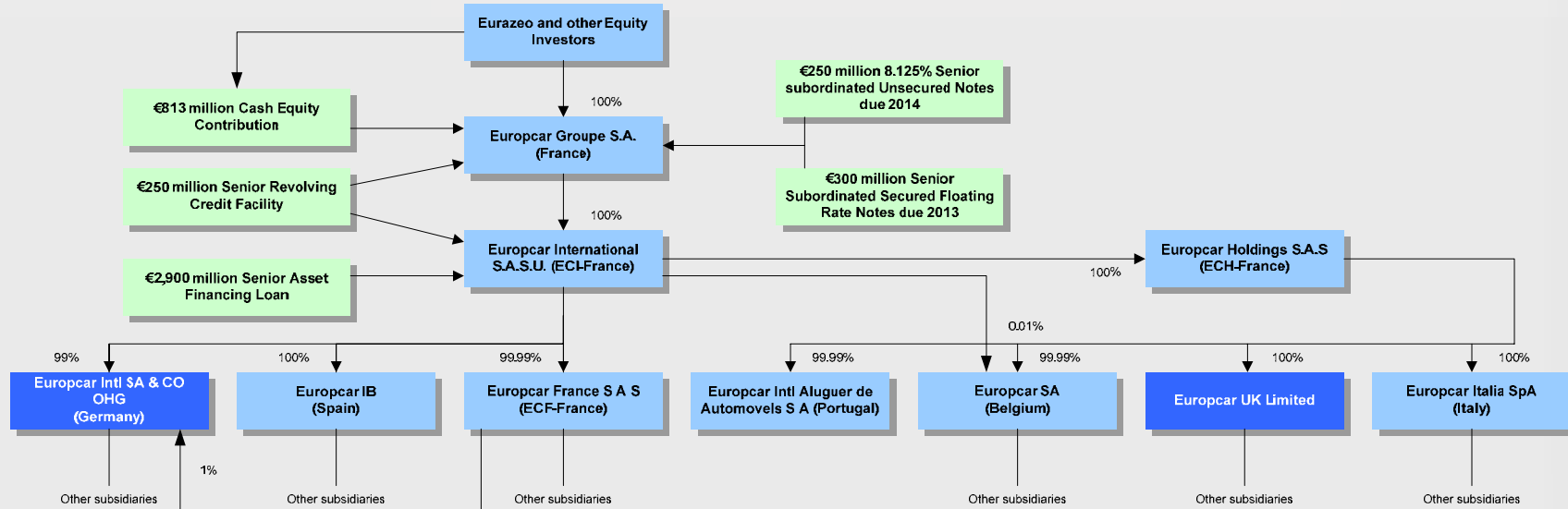


Financing the Buyout of Europcar

- The financing of the buyout of Europcar consisted of:
 - a €2.6 billion Senior Asset Financing Loan, which increases to €2.9 billion 18 months after the closing;
 - a €250 million Senior Revolving Credit Facility;
 - €550 million of HY Notes; and
 - a €13 million Equity Contribution by the sponsors



The Europcar Leveraged Finance Structure



LATHAM & WATKINS

The Future of High Yield in France: A Roundtable Discussion

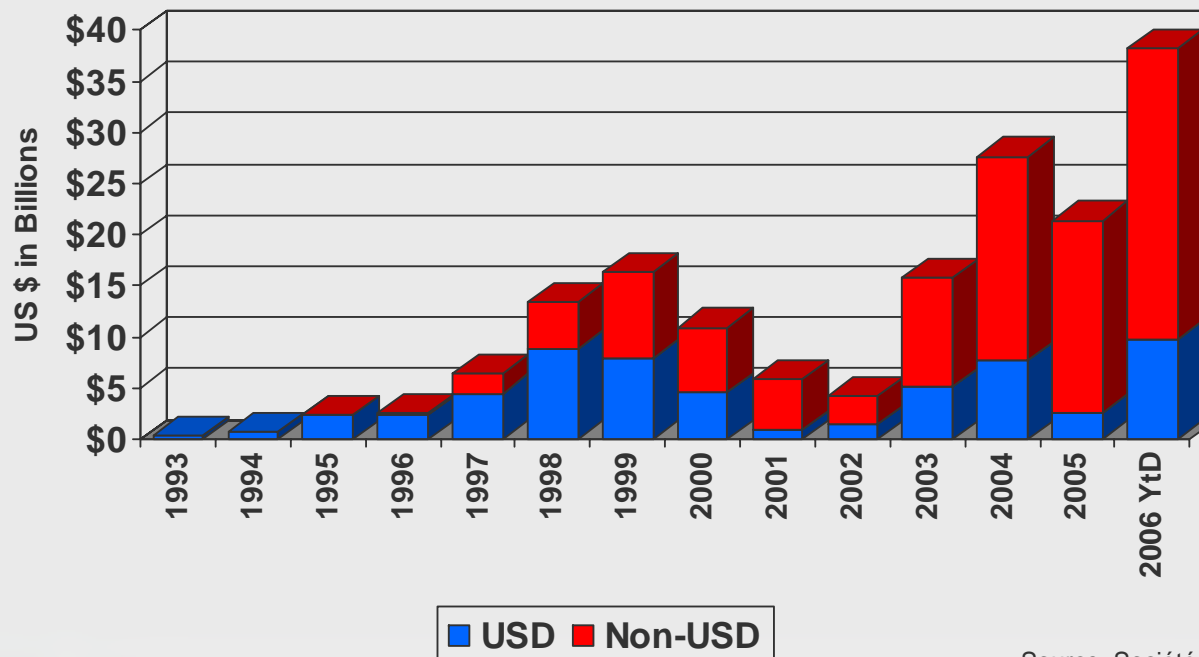
Pierre Casado, **SAUR**
Tanneguy de Carné, **Société Générale**
Alain Dib, **BNP Paribas**
Tim Hall, **Calyon**
Philippe Renauld, **Eurazeo**
James Ward, **Axa Investment Managers**
Etienne Gentil, **Latham & Watkins (moderator)**



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High Yield Bonds Were Introduced into the European HY Market in 1994: Crashed in 2001-02 and Rebounded in 2003-04

New Issue High Yield Bonds by European Issuers: 1993-2006 YtD



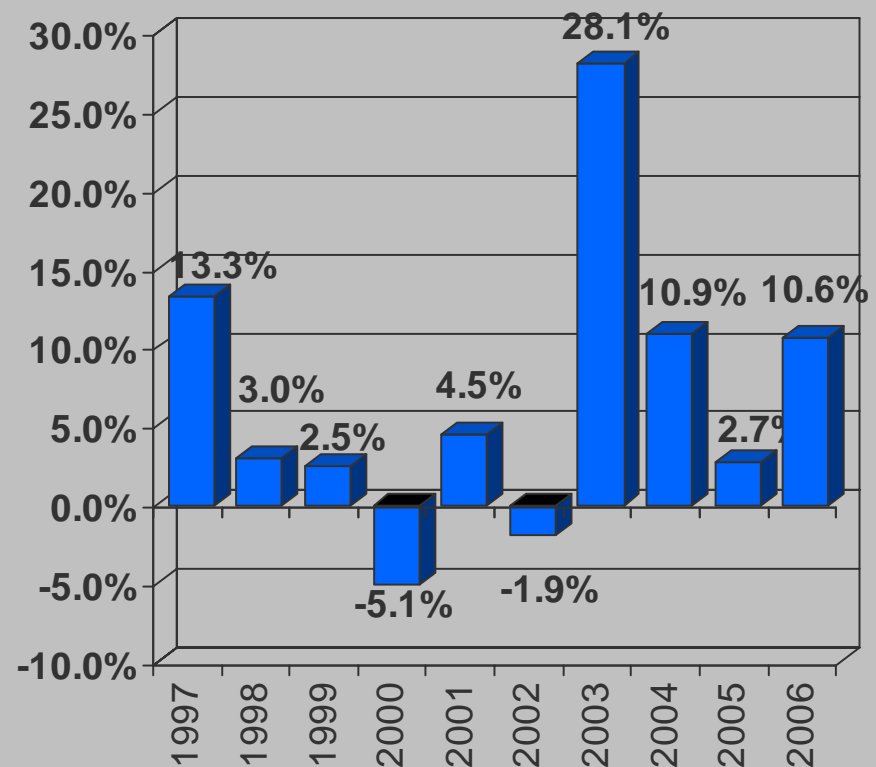
Source: Société Générale

US High Yield Bonds Have Generated Positive Returns Since 2003

- In 2003, an index of US Yield bonds returned 28.1%
- To date in 2006, US High Yield Bonds have returned a 10.6%



Annual Total Return: 1997-2006
ML US HY Index

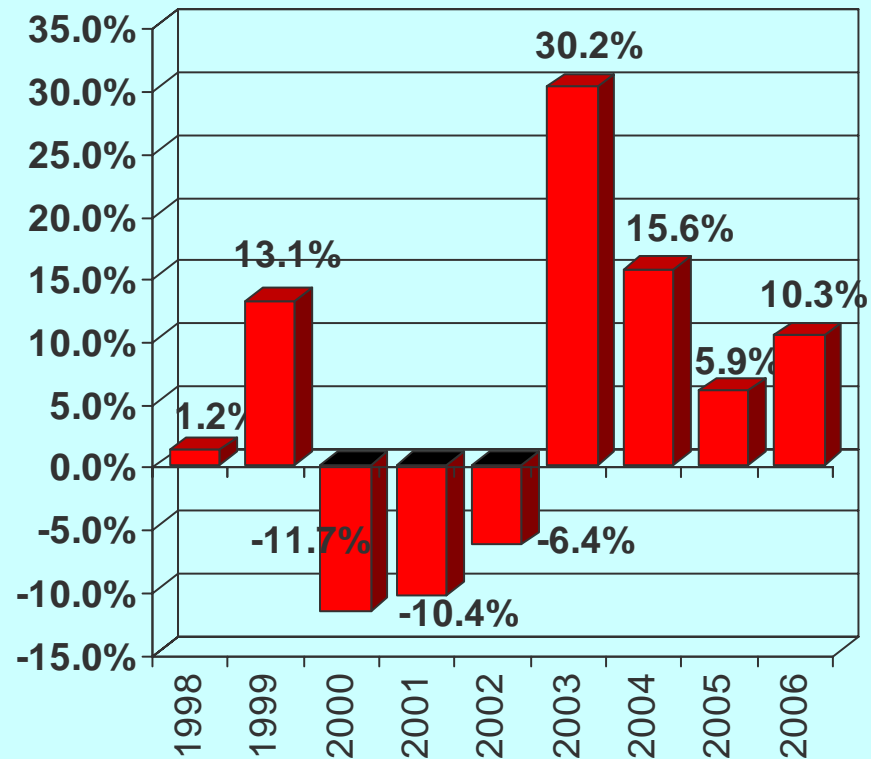


European High Yield Bonds Are In 4th Year of Positive Returns

- In 2003, an index of European High Yield bonds returned an astonishing 30.2%
- To date in 2006, European High Yield Bonds have returned a respectable 10.3%



Annual Total Return: 1998-2006
ML European HY Index



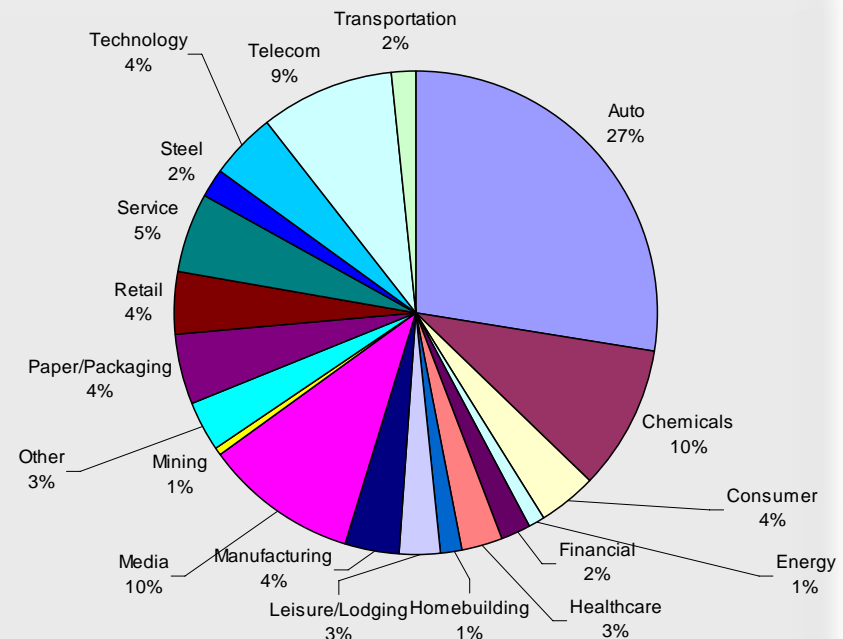
The European High Yield Investor Base Has Become Increasingly Pan-European



The European HY Market Has 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
 - Retail funds
 - Investment-grade managers
 - Hedge-funds

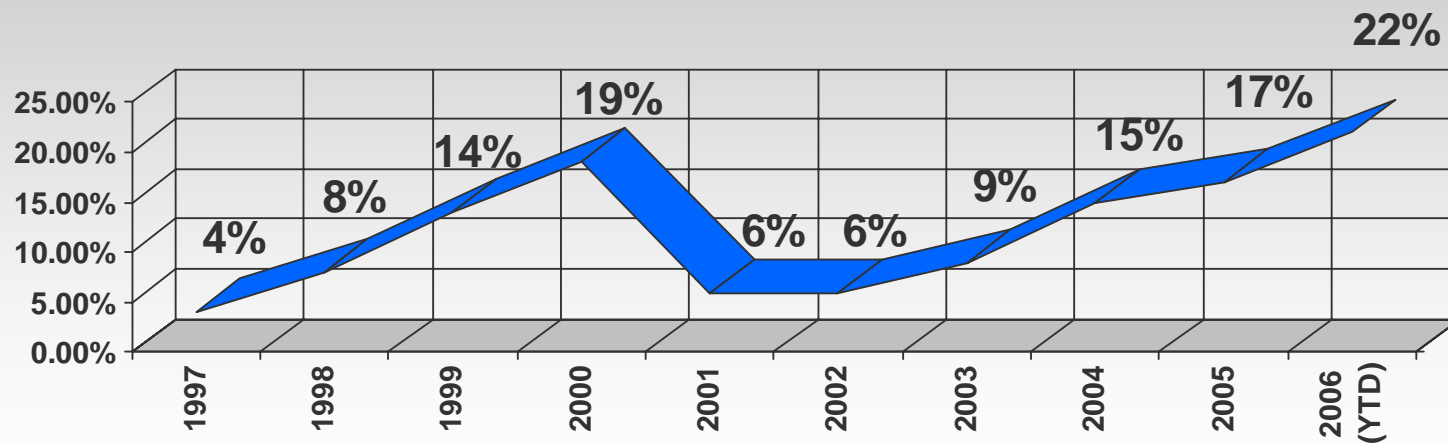
HY ML index Market weight by industry
30/11/2006



Source: Société Générale

The European HY Market's Share of the Global HY Market is increasing since 2001

European HY Issuance as Percentage of Global High Yield Issuance: 1997-2006 YtD



Source: Société Générale

Will HY Lose Out to Mezzanine In European Leveraged Finance?

- Inflexible call protection (5 year non-call)
- Length of process
- Ongoing disclosure obligations
- Familiarity of senior banks
- Amendment flexibility
- More mezzanine sources



How Will EU Integration Affect the Debt Capital Markets?

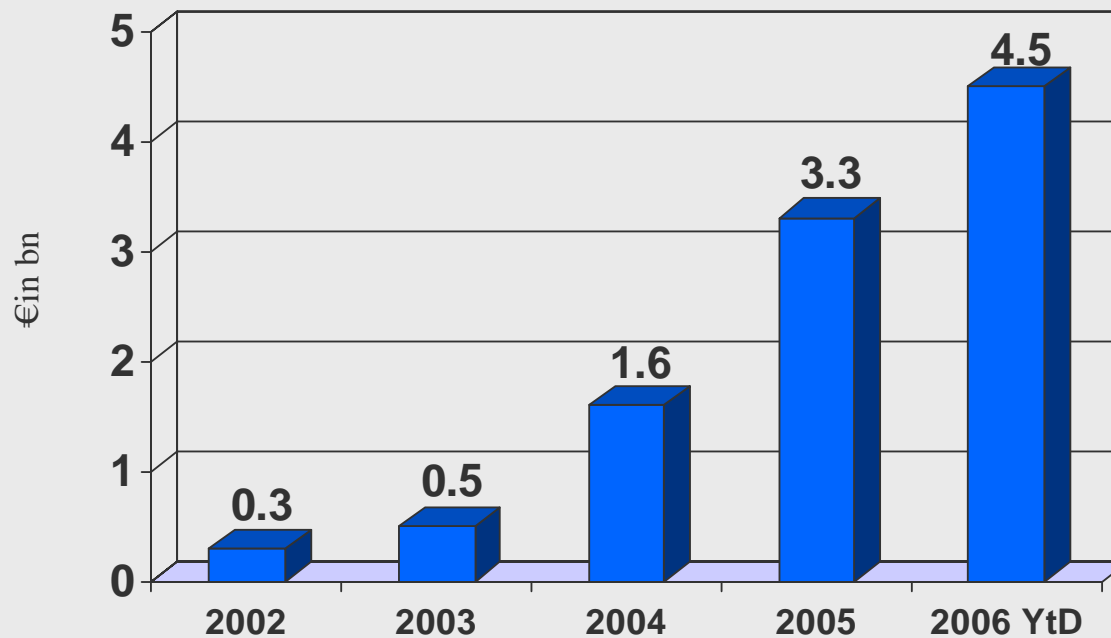
- Over time, increased EU anti-trust power will erode protective barriers to competition, forcing European companies to:
 - Focus on costs
 - Focus on profitability
 - Focus on access to lowest cost capital
- IFRS for all listed companies
- Effect of Basel II



What next in France ? (i)

Holdco paper issuance?

- In EU HY: rise in Holdco paper issuance since 2002
- In France: only 1 Holdco paper issue in France (€300m Eutelsat PIK loan in 2005)



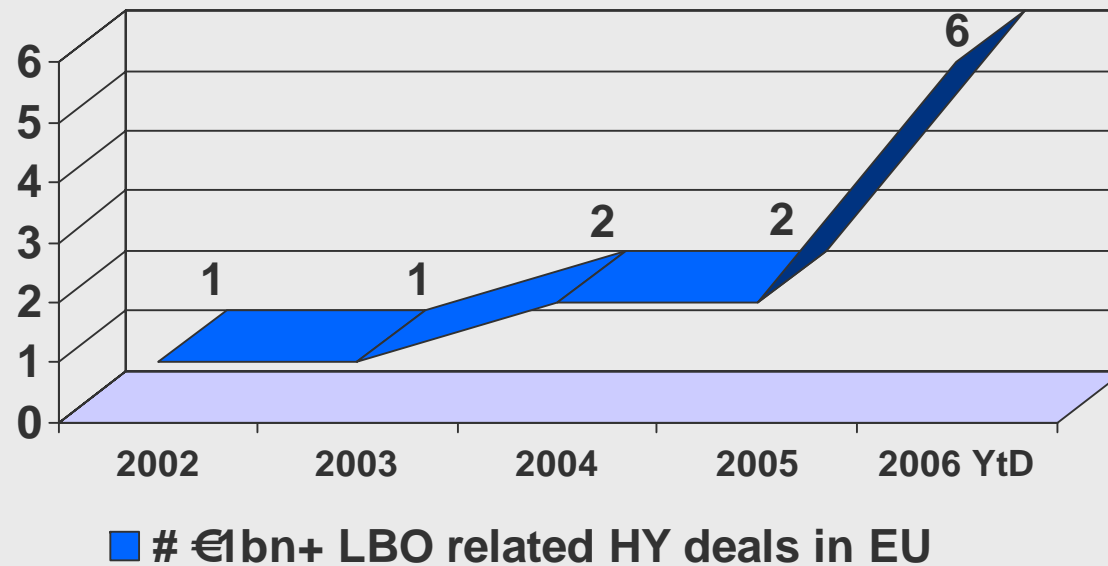
■ Holdco Paper issuance in EU

Source: Société Générale

What next in France ? (ii)

Jumbo LBO related HYB?

- In Europe: more and more €1bn+ LBO related HY deals
- In France: largest LBO related HYB is still Rexel (€600m) done in March 2005: When are we going to see the first €1bn+ HY LBO French deal?

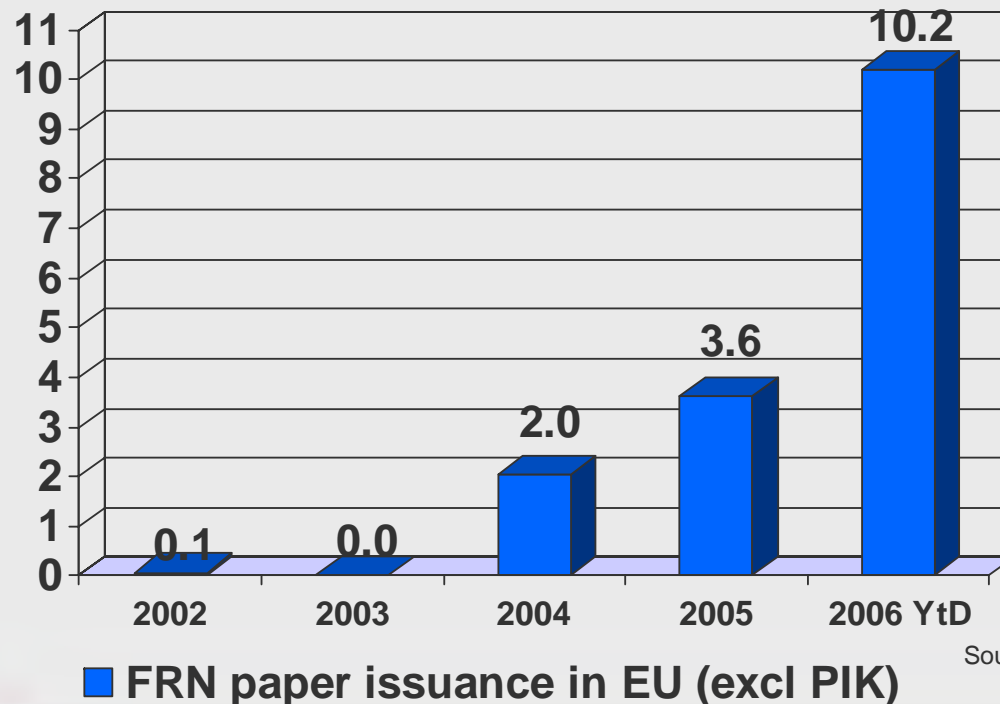


Source: Société Générale

What next in France ? (iii)

Aggressive FRN structures (short NC period)

- In Europe: rise in FRN paper issuance (excl PIK FRN)
- In France: already more than half of YTD 2006 issuance is under FRN format with Rhodia (€1.1bn), Belvedere (€375m) and Europcar (€300m). This trend should accelerate



Source: Société Générale

LATHAM & WATKINS

High Yield in France: The Next Wave

Wednesday, 6 December, 2006

Latham & Watkins

53, quai d'Orsay

75007 Paris



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