DEBTWIRE

NORTH AMERICAN DISTRESSED DEBT OUTLOOK 2015

JANUARY 2015

KAYE SCHOLER

CONTENTS

METHODOLOGY

Kaye Scholer LLP commissioned Debtwire to interview 100 distressed debt investors, including hedge fund managers, sell-side trading desks and other asset managers on their expectations for the North American distressed debt market in 2015. Interviews were conducted over the telephone in November and December of 2014. Responses were collated by Debtwire and presented to the commissioning firms in aggregate.

FOREWORD

Welcome to the 2015 edition of Distressed Debt North America Outlook. This landmark annual report measures the sentiment of distressed investors throughout North America, representing a mixture of hedge funds, private equity firms, sell-side trading desks and institutional investors.

True, defaults have been relatively low. But the ground ahead for workout professionals is fertile, led by three major touchstones: Caesars, Energy Future Holdings and oil. The first two lay claims to big, liquid, multi-subsidiary capital structures packed with highly contentious game theories. As for oil, the commodity's recent dramatic value slippage threatens to shift what had been the capital market's most darling industry into the world of insolvency.

Indeed, at the start of 2015 many challenging questions abound in the distressed investing world. How we come about finding complex answers through a maze of liabilities will undoubtedly set multiple precedents for years to come.

With Caesars, the overriding theme is permissibility — as in how much sponsor flexibility will the courts allow when it comes to asset transfers, alleged special treatment, guarantee stripping and lien placement. Also, how ISDA will ultimately rule remains a thorny question.

In Energy Future Holdings, make-whole conflict, cash management between separate guarantor entities, intra-debtor conflicts and tax-free spinoff possibilities frame a US$40 billion case where auctioning off the crown jewel asset widens the net of interest beyond just Chapter 11 creditors.

Looking at oil, Debtwire has identified upwards of 60 E&P and related services capital structures that have fallen to distressed levels after trading near par around Thanksgiving. In 2015, the sector is sure to play host to a wave of asset dispositions, debt buybacks to distressed exchanges and priming secured deals.

Borrowing base redeterminations in 1Q15 will necessitate many of these scenarios and MLP structures will provide a level of complexity that distressed investors will need to be prepared for. The question for opportunistic investors looking forward to capitalize on oil is fairly simple, but impossible to know: are we simply in a downturn cycle that will eventually rebound like those before it? Or have the strategies and actions by OPEC and Middle East regimes set about a new era that will keep valuations low for the foreseeable future?

In trying to address this point, our 2015 Distressed Debt Outlook asks respondents to predict the average range for oil prices in 2015. The largest percentage of those polled (56%) expects prices of US$55 to US$70 per barrel, while 22% expects US$40 to US$55 per barrel. Respondents are less likely to expect the extremes: only 13% expect prices to climb to the US$70 to US$85 per barrel range and less than one-tenth foresee oil prices dropping below US$40 per barrel.

While these responses are interesting in terms of gauging market assumptions, the usefulness of our respondents on this point only goes so far. If there's one thing the oil industry has taught us over the past three months, it's that it has become a black hole for indicators.

In making a comparison to other sector hotbeds of distress from the recent past, it's notable that coal and shipping, both of which were focuses of distressed opportunities in 2014, garnered tepid interest in our 2015 Outlook.

Retail, on the other hand, continues to be a focus. The sector was picked as the second most popular target for distressed opportunities in 2015, matching the level of interest garnered in our 2014 Outlook. The trend of burgeoning e-commerce and the more rampant use of mobile devices to make online purchases continues a sea change in how Americans spend money — reminding us that in both retail and distressed investing, shopping for the right deal is never a sure bet.

Kaye Scholer is very pleased to sponsor the 2015 Outlook, not only because early 2015 events indicate that we are entering an exciting time for distressed investors, but also because our involvement in this survey reflects our commitment to understanding our clients' business objectives. We look forward to seeing you at the 2015 Debtwire Investors Summit.

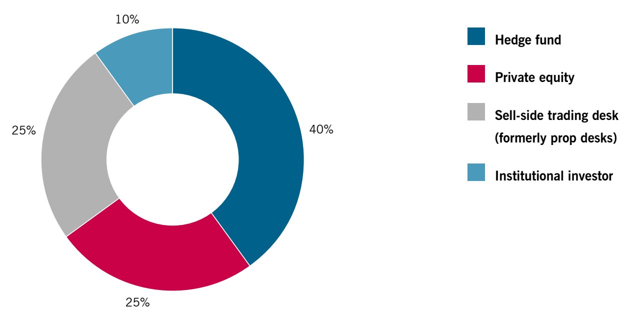
Andrew Ragsly
Debtwire

Mark F. Liscio, Co-Chair
Bankruptcy & Restructuring Department
Kaye Scholer

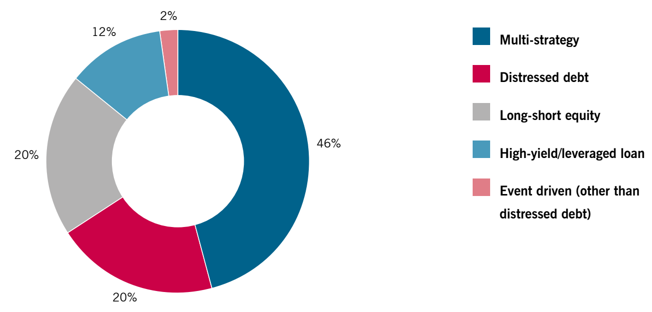
Michael B. Solow, Co-Chair
Bankruptcy & Restructuring Department
Kaye Scholer

SURVEY FINDINGS

Which of the following best describes your firm?



What best describes your core investment strategy?



In keeping with past Outlooks, hedge funds make up the largest percentage of this year's respondent pool. Many hedge funds are struggling for return in this low interest rate environment. For the sixth year in a row, hedge funds underperformed the S&P 500, returning a paltry 3.3% in 2014 after generating a lackluster 9.13% return in 2013, according to Hedge Fund Research Inc. Last year also saw the largest number of fund closures since 2009.

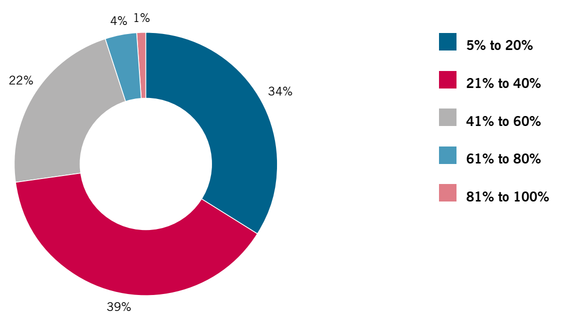
It remains to be seen how these returns will affect the industry. Anecdotally, while the decision by pension fund giant California Public Employees' Retirement System to slash its hedge fund exposure grabbed plenty of headlines, it appears to have had little impact on other fund of fund actions. Assets under management for hedge funds continued to grow in 2014, reaching US$2.85 trillion at the end of November, primarily due to inflows from endowments and other institutional clients.

The percentage of private equity respondents in our survey increased to 25% in 2015 from 20% last year, as did the percentage of respondents identifying as institutional investors. This year's survey also marks a departure from past surveys in that the percentage of respondents representing sell-side desks has increased from 20% to 25%.

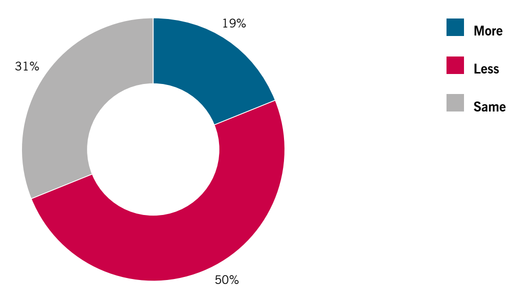
The composition of our respondents' strategies differs slightly from last year with the biggest swing coming from the long-short equity side, which accounted for 20% this year, nearly double the 10% of respondents who classified their core investment strategy as long-short equity last year. The stock market continues to be a resilient force, with the S&P 500 sitting above 2,000 in late January after having gained 30% in 2014.

In our survey, the percentage of funds that described their core investment as multi-strategy driven also increased, jumping up to 46% this year from 38% in 2014. The remaining respondents describe their strategy as either distressed debt (20%), high-yield (12%) or event driven (2%).

What percentage of your firm's overall assets is dedicated to distressed debt?



In 2015, do you plan on allocating more, less or the same percentage of assets to distressed debt than you did in 2014?



Survey participants are slightly more focused on distressed investing this year. Roughly 61% of respondents said they have 21% – 60% of their assets allocated to the distressed debt marketplace. That compares to 52% who fell in that range last year.

Also, the percentage of funds dedicating more than 60% of their assets to distressed investments increased to just over 4% from our 2015 Outlook compared with 1% in our 2014 edition.

"A prolonged downturn in oil prices is bound to create increased distressed opportunities as oil companies that were already experiencing liquidity issues contend with the higher costs of producing oil."

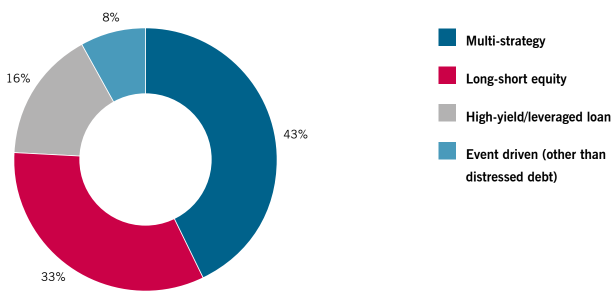
Madlyn Gleich Primoff, Partner, Kaye Scholer

Exactly half of those polled said they plan to allocate less investment to distressed debt this year compared with last year. The remaining respondents are more likely to keep their allocations the same (31%) than they are to increase them (19%).

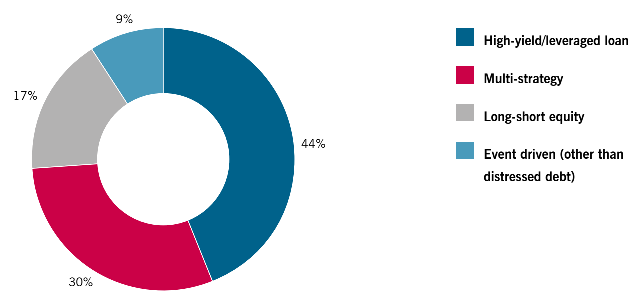
It's notable that the bulk of our survey answers were compiled in late November, just as the price of oil started to cascade and wreak havoc on the E&P industry. We assume that more interest is being paid to the distressed marketplace in the ensuing months.

SURVEY FINDINGS

If less, what types of investments do you plan on allocating additional assets to in 2015?



If more, what types of investments do you plan on allocating less assets to in 2015?



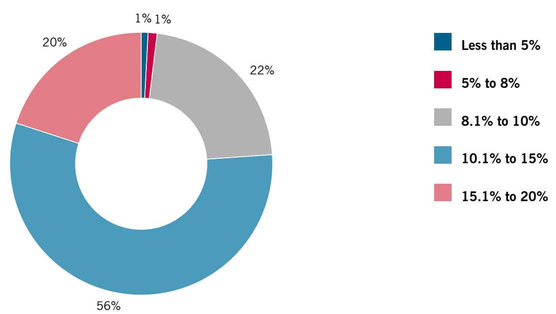
The respondents who plan to lower their distressed debt allocations in 2015 indicated a variety of reasons for doing so. Most respondents in this group say they will focus instead on a multi-strategy approach (43%) or deploying a long-short equity focus (33%). The remaining respondents would rather invest in the high-yield or leveraged loan markets (16%) or event-driven opportunities (8%).

Those respondents who do plan to allocate more to distressed debt in 2015 will scale back their allocations in other areas, led by high-yield or leveraged loans (44%), multi-strategy investments (30%) and long-short equity investments (17%). Allocations to event driven debt — not including distressed debt — will likely remain unchanged.

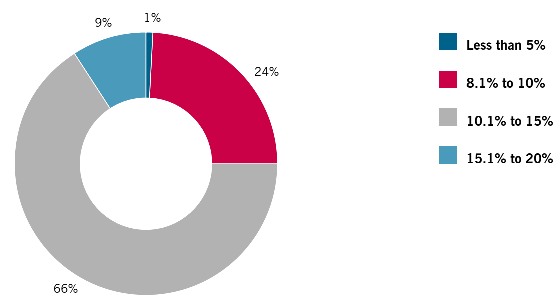
"A multi-strategy approach gives investors the benefit and flexibility of asset and risk diversification."

David von Saucken, Partner, Kaye Scholer

What percentage return did you target for your primary distressed fund in 2014?



What will you target in 2015?



As far as returns go, a side-by-side comparison of 2014 and 2015 targets suggests respondents haven't wavered much in their expectations. A 56% majority of respondents cited the 10.1% – 15% range as its 2014 target. A bit more bullish, 20% cited a 15.1% – 20% target, while a 22% slug was on the more conservative side of the majority, targeting the 8.1% – 10% range.

Like 2014, the same target ranges came out on top for 2015. A majority 66% sect picked the 10.1% – 15% range, and close to one-quarter said they would target between 8.1% – 10%. There was a lower 9% group shooting for the high-end 15.1% – 20% target.

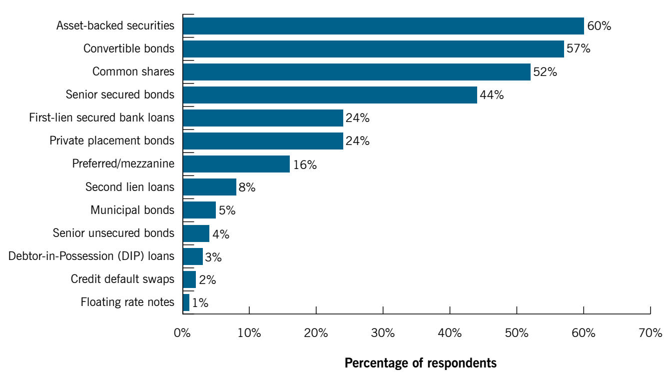
Despite this general continuity, it is worth noting that the percentage of respondents targeting the highest available range of 15.1% – 20% decreases dramatically to 9% of respondents for 2015, down from the 20% who tagged that range for 2014.

"With default rates remaining relatively low, investors are likely to keep their target expectations within the usual 10.1% – 15% range."

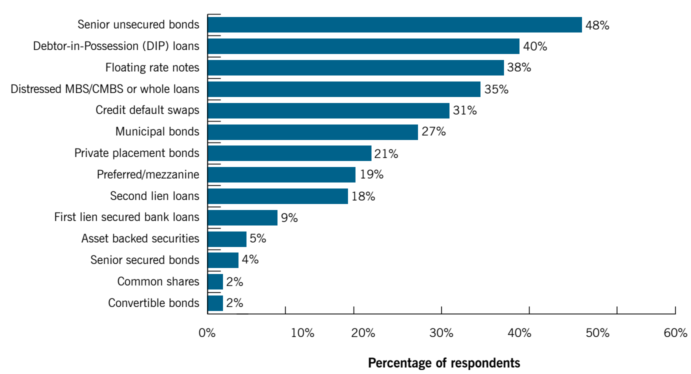
D. Tyler Nurnberg, Partner, Kaye Scholer

SURVEY FINDINGS

Which three instruments do you think will offer the most attractive opportunities for investors in 2015?



Which three instruments do you think will offer the least attractive opportunities for investors in 2015?



Matching last year's results, respondents in the 2015 outlook named asset-backed securities (60%) convertible bonds (57%) and common shares (52%) as the three most likely instruments to offer attractive opportunities for investors in 2015. We owe much of this trend to the coverage offered by ABLs, and the equity upside that the stock market has provided over the past two years.

The popularity of first-lien secured bank loans is also stable from 2014 to 2015. Senior secured bonds — selected by 53% last year — were identified by only 44% this year.

In light of the volatility with which the fixed income market ended 2014, it comes as little surprise that 48% of respondents identified senior unsecured debt among instruments offering the least attractive opportunities in 2015. The unsecured class was also the least popular in our 2014 outlook.

One of the current detractors to unsecured debt, particularly in the energy sector, is that many of the new bonds issued over the past three years were written with lenient covenants with regard to additional debt incurrence. As a result, we've seen many distressed borrowers (Walter Energy, Alpha Natural Resources Resolute Energy, for example) take advantage of this feature to layer in priming secured debt.

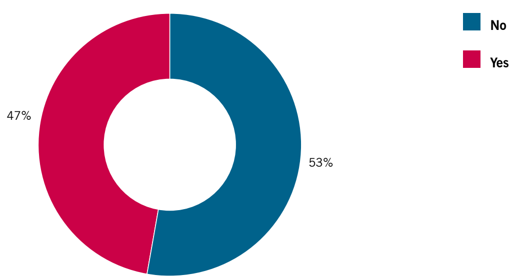
Somewhat curiously, DIP loans at 40% came in as the second least popular to unsecured indebtedness in our survey. The result is a bit surprising given that DIPs, while they are in less supply and are generally less liquid, have many of the same attributes as the ever-popular ABL loans. Moreover, DIPs faired much better in our 2014 outlook when they were selected by only 11% of respondents as being least attractive.

Finally, although CDS played a pivotal role in shaping investor motivations in some of the highest profile distressed situations last year (Caesars, EFH, RadioShack, Toys "R" Us), the derivative instrument still garners little support from our respondents. Recent controversies surrounding the make-up and methodology of ISDA to oversee credit events may be weighing on investor minds. In the 2014 outlook, 39% selected CDS as least attractive and 5% cited it as most attractive. For 2015, 31% selected it as least attractive and only 2% touted it as most attractive.

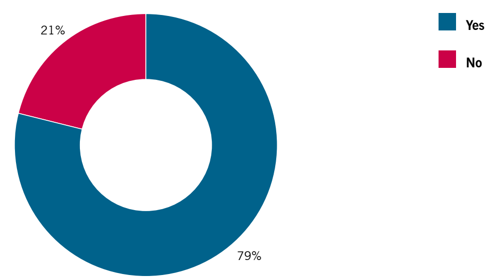
"Asset-based loans not only provide coverage for small- and mid-sized credits, but also offer liquidity to companies that may be experiencing temporary or cyclical cash-flow constraints."

Stephen Rutenberg, Partner, Kaye Scholer

Fundraising volumes for distressed managers peaked in 2012 and have trended down ever since. Do you expect the fundraising environment for distressed investing to improve in 2015?



Do you plan on investing in the primary market in 2015?



Howard Marks, chairman of distressed investing titan Oaktree Capital Management, noted in a recent letter to his investors that the energy downcycle may be the rainy day he and his peers have been saving up for. "We knew great buying opportunities wouldn't arrive until a negative 'igniter' caused the tide to go out, exposing the debt's weakness," Marks wrote. "The current oil crisis is an example of something with the potential to grow into that role."

While the swoon of energy and related services companies is likely to serve as a lead selling point for distressed fund managers to make the rounds with hat in hand, there may already be an ample amount of distressed capital sitting on the sidelines. In our 2014 outlook, 29% of respondents said they were keeping more than 50% of AUM on the sidelines as dry powder, ready to be deployed at the right opportunity. Half of respondents said they were keeping between 25%-50% as liquid.

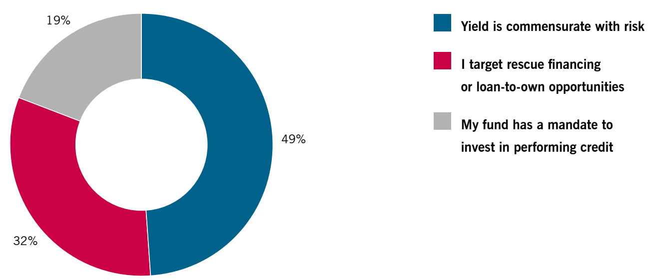
Respondents in the 2015 outlook are divided on the issue of fundraising for the distressed asset class this year. Almost half (47%) expect distressed fundraising volumes to improve over the course of 2015, but a close 53% segment disagrees.

The recent bull-run on new high-yield and leverage loan paper may have little room to sprint higher after a series of record-setting years. The year 2015 will be a telling time for new issuance, as both supply and demand waned at the close of 2014. The US$7.5 billion in new high-yield paper issued in December 2014 is down from the US$15.9 billion raised in December 2013, according to Debtwire data. Leveraged loan issuance also slowed down considerably, dropping to US$14 billion in December from US$45.2 billion in the prior year period.

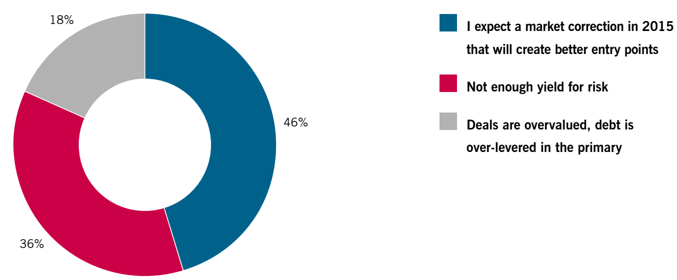
Among the investors polled in our 2015 outlook, 79% note plans to invest in the primary market in 2015, while 21% said they have no intention to participate in new deals.

SURVEY FINDINGS

If yes, what will be the most compelling investment thesis for buying new issues?



If no, what is the most compelling reason you are staying away from new issues?



Among the vast 79% majority intent on making primary market investments in 2015, nearly half said their decision to buy new issues will rest on the thesis that yield is commensurate with risk. Roughly 32% of respondents noted their decision will be grounded in a desire to target rescue financing or loan-to-own opportunities, while 19% said their decision will be driven by their fund's mandate to invest in performing credits.

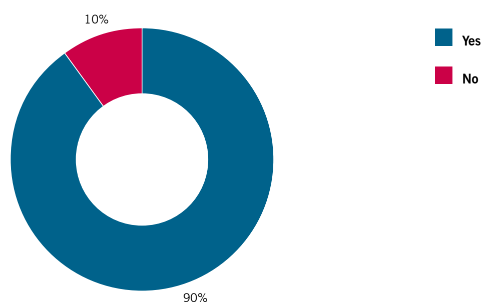
"Distressed investors are going to look closely at the risk-reward profile of primary market opportunities. They would want relatively cheap assets that have recovery prospects."

H. Stephen Castro, Partner, Kaye Scholer

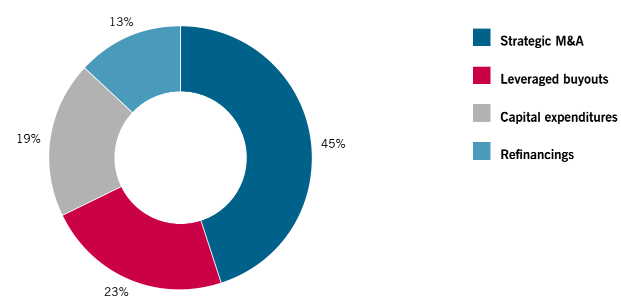
Of the respondents who do *not* plan to invest in the primary market this year, 46% said there will be a market correction in 2015 that will create better entry points in the secondary. Another 36% noted there is not enough yield offered in the primary for the risk being sold. On a similar train of thought, 18% indicated that primary deals are overvalued and debt is over-levered.

Case in point, some deals over the past year that went south shortly after being printed include Conn's, Phillips Pet Food, Halcon Resources, Chassix and American Energy Partners.

Do you expect primary issuance volume to climb in 2015?



What types of transactions will drive primary deals in 2015?



Primary bond deals in 2014 tallied US$248.2 billion compared to US$272.8 billion in 2013, according to *Debtwire* data. On the leverage loan side, US$387.8 billion was raised in 2014, down from US$579.7 billion in 2013.

Heading into 2015, an overwhelming 90% majority of respondents expect primary issuance volume to increase this year.

Expected to drive the bulk of this action is strategic M&A, according to 45% of respondents. An additional 23% expect leveraged buyouts to be the primary drivers. Remaining respondents are split between capital expenditures (19%) and refinancings (13%).

LBO activity has been clamped down somewhat by federal regulators trying to dissuade banks from structuring deals with high leverage defined as any deal with more than 6x leverage, or one where the company would not be able to pay down all its senior debt or half of its total debt in the first five to seven years. Still, some deals have pushed the envelope with leverage in excess of 6x, including Tibco, TransFirst Holding, Brickman Group, Mitchell International, The Crosby Group, National Vision, InMar and Berlin Packaging.

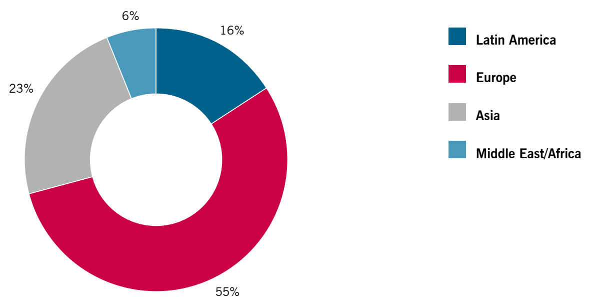
Also, the upcoming financings for the mega LBOs of PetSmart and Riverbed Technology will reflect a high leverage ratio.

"The low default rate environment and favorable debt markets making borrowing inexpensive are driving LBO deals to get done, despite the regulatory scrutiny. Private equity firms also need more debt to support acquisitions because of currently high valuation multiples."

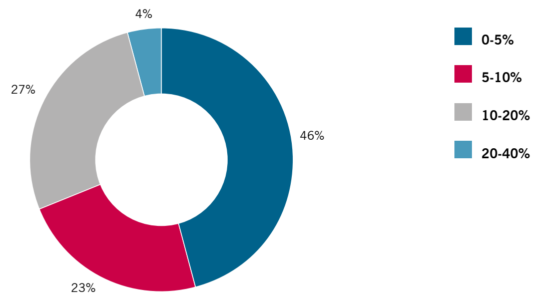
Sheldon L. Solow, Partner, Kaye Scholer

SURVEY FINDINGS

Given the lack of US distressed investment opportunities, where is the most fertile ground for sourcing international opportunities?



What percentage of your distressed investment portfolio are foreign credits?



Respondents are most likely to identify Europe (55%) and Asia (23%) as the top two international markets for sourcing distressed investment opportunities, followed by Latin America (16%) and the Middle East/Africa (6%).

Those who selected Europe were likely to link the region's appeal to its abundance of distressed businesses seeking support from international investors. Situations over the past year where US firms played a significant role included French retailer Vivarte and German car parking operator Apcoa. On the horizon for pending international workouts are Dutch waste service provider Van Gansewinkel and South African retailer Edcon.

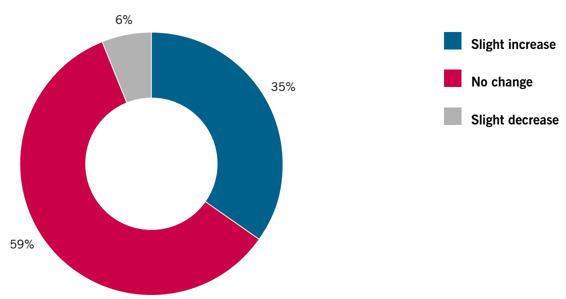
For its part, Latin America drew in several major distressed hedge funds last year with the ongoing bankruptcy of telecom company NII Holdings. Unrest and distressed headwinds surrounding oil giant Petrobras could make the region even more fertile for opportunistic hedge funds.

When asked what percentage of their distressed investment portfolio consists of foreign credits, the largest percentage of respondents (46%) selected the 0% to 5% range. Remaining respondents were more likely to cite the 5% to 10% range and the 10% to 20% range — each identified by roughly one-quarter of respondents — than the highest-available 20% to 40% range.

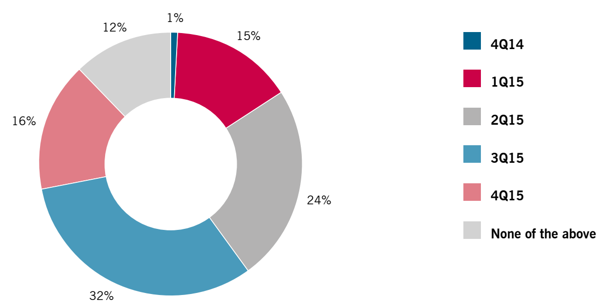
"Although '14 was a quiet-ish year for restructurings, there were some standout, in-court cases which raised novel and interesting issues, particularly in the UK which remains the preferred jurisdiction for work-outs. The expectation is that 2015 will be busier, although no one is expecting a bumper year."

Paul Atherton, International Partner, Kaye Scholer

How do you anticipate that foreign investment percentage to change in 2015?



When do you expect the Federal Reserve to begin raising interest rates?



The percentage of distressed investment portfolios dedicated to foreign investments is not likely to change any time soon. While a sizeable 35% say they expect to increase allocations over the course of 2015 and only 6% expect allocations to decrease, the majority of respondents (59%) anticipate no changes to their current foreign investment allocations.

"The Federal Reserve has indicated that it would be 'patient' when it comes to raising interest rates this year. I think that the Fed is trying to make room for changes in the economy and not to cause any massive jolts to the financial system."

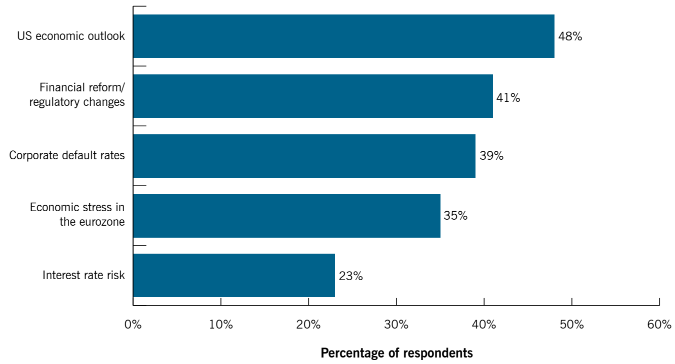
Scott D. Talmadge, Partner, Kaye Scholer

Most respondents cited either 2Q15 or 3Q15 as the time when the Federal Reserve will again raise interest rates. Remaining respondents are almost equally divided between 1Q15 and 4Q15, while a substantial 12% do not expect interest rates to rise at all in the time frames listed.

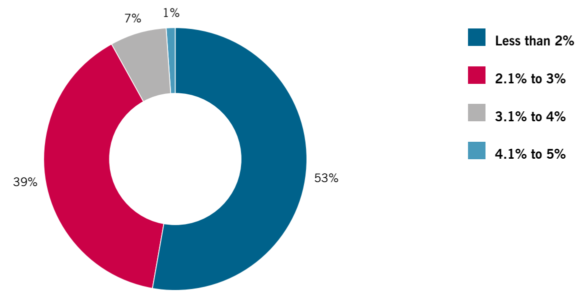
Across the board, respondents noted the necessity to hike interest rates; but respondents were also keen to emphasize the unpredictability of the Fed's decisions.

SURVEY FINDINGS

Which of the following macro topics will have the most impact on your distressed decision-making over the next 12 months?



With the US default rate of speculative-grade companies expected to end 2014 at historical lows of roughly 2%, what are your predictions for 2015?



Currently, there is great debate as to how analysts should interpret the state and direction of the US economy. Last year was the best year for job growth since 1999, and the 5 million job openings at the end of November was the most since 2001, according to the Department of Labor.

While unemployment was at just 5.6% in December, median weekly wages are slightly below US$800, roughly the same as in 2007 after adjusting for inflation.

Nearly half of 2015 Outlook respondents said the US economic outlook will bear the greatest impact on their distressed investment decision-making in the coming year.

“The US economic outlook will have the greatest impact on decision-making because it directly impacts lending standards and the market environment for fundraising,” noted one respondent. “These are the factors that indicate the potential success of distressed deals.”

Also carrying great influence on distressed investing decisions this year will be financial reform and regulatory changes, as selected by a 41% segment of respondents. Other macro issues affecting decision-making include corporate default rates (39%), economic stress in the eurozone (35%) and interest rate risk (23%).

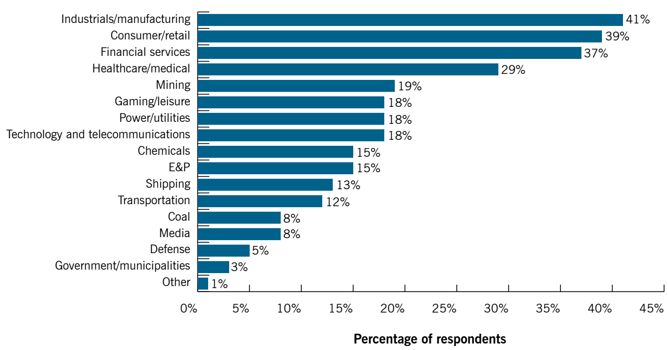
Respondents provided mixed forecasts for default rates for US speculative grade companies in 2015. Fifty-three percent of respondents expect 2015 rates to dip below the historically low 2% rate seen in 2014, while the remaining respondents predict they will fall between 2.1% – 3%.

Those who selected the sub-2% range were inclined to tie the rate of default to economic strength. Indeed, global default rates have mirrored patterns of recovery: in the US, the trailing 12-month speculative-grade default rate declined from 1.9% to 1.7% between 2Q14 – 3Q14, correlating with the country’s gradual economic rebound over that period.

As such, one respondent describes the US as better positioned than most countries to see default rates steadily decline: “The US was the first nation to be affected by the global financial crisis, but its recovery is now one of the most powerful. Signs of economic recovery are evident, so I think the default rate will decrease or at least remain lower than 2%.”

Again, it is worth noting that the bulk of our survey results were compiled before oil hit a deep selloff in December. We assume the current state of the energy industry would prompt some respondents to tilt their answers more bearishly.

What are the top sectors (choose up to three) that you anticipate allocating your distressed debt investment capital towards in 2015?



Respondents most frequently selected industrials/manufacturing (41%), consumer/retail (39%) and financial services (37%) as the sectors they expect to focus on the most in 2015.

Industrials garnering the top slot compares with a fourth-place finish last year. Retail was also second in our 2014 Outlook, while financial services ranked second place in the 2015 version compares to the sector's first-place spot last year.

Interestingly, coal, shipping and E&P, all of which have been hotbeds of distressed opportunities over the past year, garnered tepid interest in our 2015 Outlook.

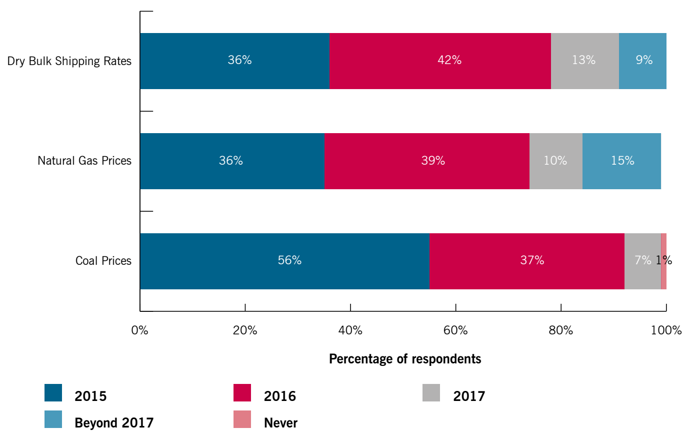
Also of note is healthcare. The industry, which is grappling with a host of regulatory shifts, was selected by 29% of respondents. That's more than double our 2014 Outlook in which just 11% picked healthcare as an industry in which they planned to invest distressed capital.

"The top sectors have been negatively impacted by macroeconomic and consumer trends that can result in distressed investing opportunities. The lower oil price has become a challenge for industrial manufacturers that cater to the oil and gas industry while the migration to online shopping has taken away customers from traditional shopping outlets."

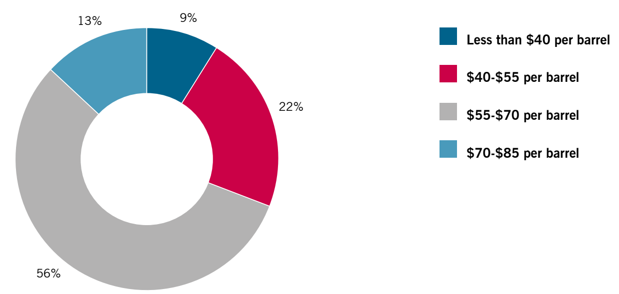
Benjamin Mintz, Partner, Kaye Scholer

SURVEY FINDINGS

When do you anticipate the following operational variables to rebound in line with previous mid-cycle conditions?



Oil prices plummeted late this year. What is your prediction for oil prices in 2015?



The lull in shipping rates, natural gas prices and coal prices has created ample distress across various segments of the transportation, energy and mining sectors. These price swings have been responsible for a host of the largest corporate bankruptcies over the past two years, from Overseas Shipholding Group to Genco Shipping and Trading, Dynegy, Energy Future Holdings and Patriot Coal.

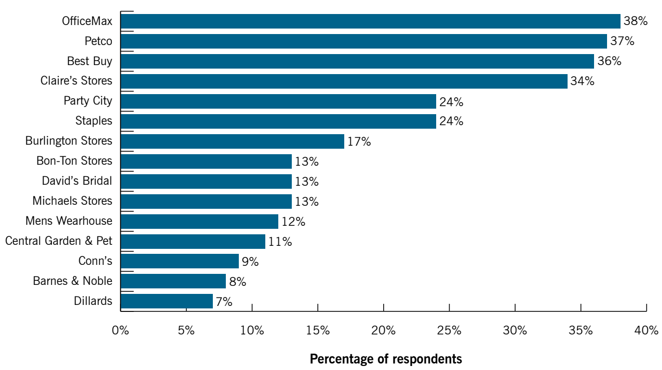
A majority of our respondents do not expect dry bulk shipping rates and natural gas prices to rebound until after 2015. Conversely, a 56% majority expects coal prices will stage a comeback in 2015. This is somewhat surprising since the coal industry is steeped in government restrictions, and pricing is still at trough levels.

Somewhat tellingly, coal was the only area to garner any replies that a recovery will never take place. Also teetering on the brink of extreme bearishness, 15% of respondents said natural gas prices will not recover until after 2017, and 9% of respondents said the same about dry bulk shipping rates.

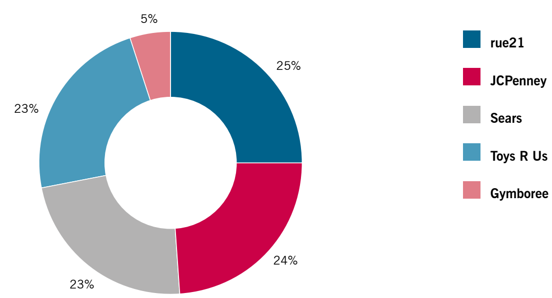
When it comes to predicting average oil prices for 2015, it's really anyone's guess. A 56% majority of our respondents fall mainly in the US$55 – US$70 per barrel range. A 22% sect is more bearish in the US$40 – US$55 per barrel range. Take note that most respondents gave their answers in December of 2014.

On the extreme ends, a slim 13% expects prices will rally back to the US$70 – US$85 per barrel range, while an even slimmer 9% of respondents projects prices to bottom out at less than US$40 per barrel.

Which of these cash generating brick-and-mortar retailers will become distressed over the next year?



Other than RadioShack, which of the following retailers is most likely to have a liquidity event in 2015?



E-commerce as a share of non-automotive, non-food (or restaurant) sales made up just over 30% of sales in 2014, up from around 15% in 2009, according to a recent study by the St. Louis Federal Reserve. The pendulum is expected to swing even further away from brick-and-mortar retail with the rising popularity of shopping through mobile devices. On Black Friday 2014, Internet sales through mobile devices rose 45%, according to retail consulting firm Monetate.

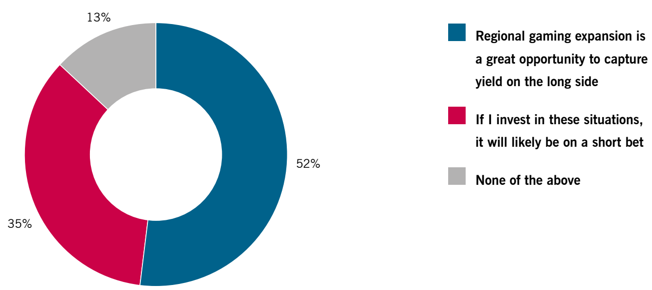
This dynamic does not bode well for traditional retailers of all stripes. As such, respondents expect several established brick-and-mortar retailers to devolve into distress in the near-term. Topping the list are Office Max, Petco, Best Buy and Claire's Stores, followed by Party City and Staples.

There is no clear consensus on which retailers will see liquidity events in 2015. Respondents are almost equally likely to predict liquidity events for rue21, JCPenney, Sears and Toys "R" Us.

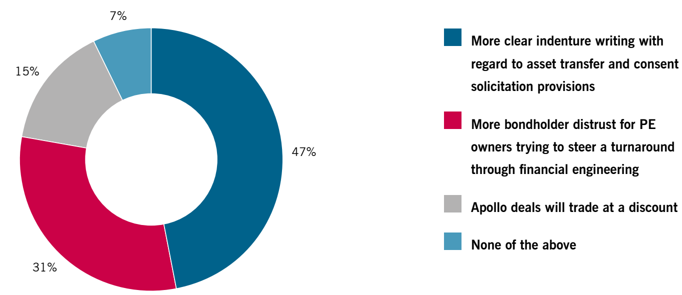
To kick the can, many traditional big-box chains have been able to leverage real estate value as they continue harboring robust liquidity positions to buffer earnings decline trends. For some, a turnaround may be showing signs of sustainability, as JCPenney recently reported that November – December same store sales rose 3.7%. Of course, enthusiasm is tempered given that the company is working off sluggish comparisons.

SURVEY FINDINGS

In light of Atlantic City's fading gaming market, what are your thoughts regarding plans to build new gaming hubs in Massachusetts, Philadelphia and upstate New York?



Which of the following will be the most likely market response in 2015 to the Caesars asset-transfer litigation?



More than half of those polled believe that regional gaming expansion in Massachusetts, Philadelphia and Boston will provide a great way for investors to capture yield on the long side. An additional 35% of those polled say conditions in Atlantic City provide a warning case that the best way to invest in regional gaming expansion is on a short bet.

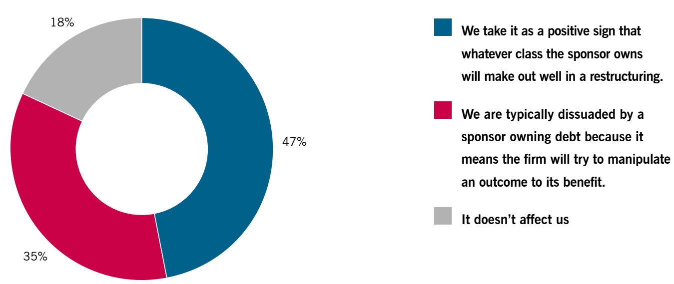
The plight of AC gaming marred much of the gaming sector in 2014, culminating with the bankruptcies of Revel and the Trump Taj Mahal and the closings of the Atlantic Club, Showboat and Trump Plaza casinos. Signs of distress also crept into other regional gaming outlets in 2014 such as Rock Ohio Caesars and Mohegan Sun.

The Caesars asset-transfer litigation is expected by 47% of respondents to lead to clearer indenture writing with regard to asset transfers and consent solicitation provisions.

An additional 31% of respondents believe the Caesars controversy will cause bondholders to distrust private equity owners who have been accused of steering turnaround situations through financial engineering.

A smaller 15% chunk noted that new deals brought by Caesar sponsor Apollo will trade at a discount. Of note, the firm's recent deal to finance a debt dividend at its Great Wolf Resorts portfolio company faced pricing pushback. By the same token, the sponsor in January had to increase pricing on the debt deal to purchase technology company Presidio Inc.

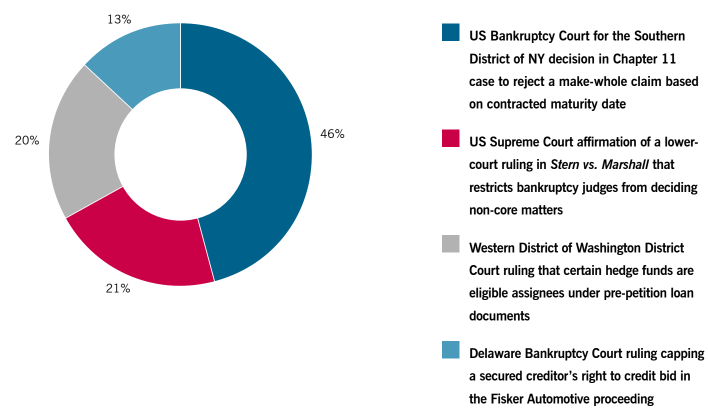
How does the occurrence of sponsors buying debt in their distressed portfolio companies impact your decision to invest?



Sponsors purchasing debt in distressed portfolio companies will have various effects on respondents' investment decisions. Slightly less than half say they will take such investments as positive signs that whatever class the sponsors invest in will make out well in a restructuring, while 35% read sponsors' investments in portfolio company debt as a sign that the sponsor is willing to manipulate outcomes to their benefit.

Situations where debt positions held by major shareholders had great impact on restructurings over the past year include Altegrity (Providence Equity), Momentive Performance Materials (Apollo Management), and Boart Longyear (Centerbridge).

Of the precedent-setting decisions made in the distressed space in the last 12 months, which will have the most impact on your investment appetite?

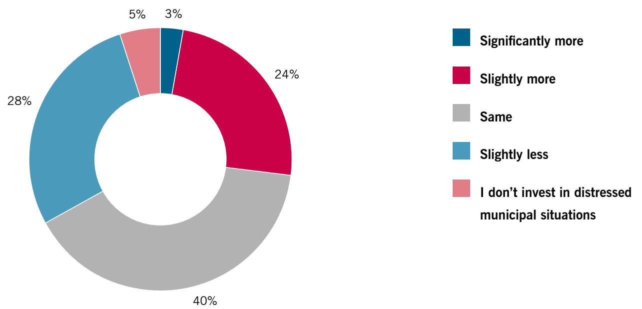


Looking back on the precedent-setting decisions made over the past 12 months, the largest portion of respondents (46%) believe the Southern District of New York decision in the Momentive Chapter 11 case to reject a make-whole claim will have the greatest impact on their investment decisions going forward. The Momentive ruling was the latest in a recent spree of make-whole court fights that included American Airlines, School Specialty and Chesapeake Energy.

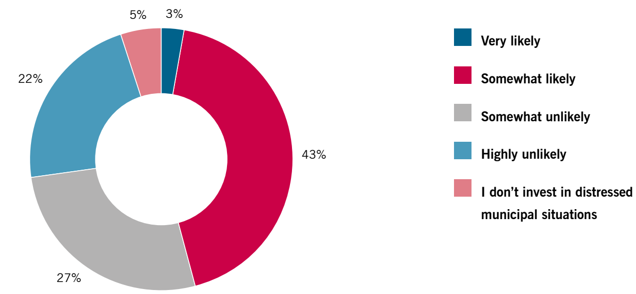
Nearly tied as the second most impactful events are the US Supreme Court affirmation of a lower-court ruling in *Stern vs. Marshall* that essentially restricts bankruptcy judges from deciding certain non-core matters, and the Western District of Washington District Court ruling that certain hedge funds are eligible assignees under pre-petition loan documents.

SURVEY FINDINGS

How much more investment capital do you anticipate allocating toward the distressed municipal bond space in 2015 compared with 2014?



Do you believe municipal bonds could lose their tax-exempt status in 2015?



Distressed opportunities in the municipal market continue to entice hedge funds and investors with a high risk profile. Over 60% of respondents to the survey will remain "cross over buyers" in 2015 with 40% investing the same amount of capital to the space and 27% allocating more resources.

This might seem odd to traditional municipal investors who tout the municipal market as a safe haven for long-term returns, and who worry that cross over buyers will become "cross over sellers." But to hedge funds clamoring for yield in a highly competitive corporate market, putting money to work in distressed US jurisdictions or risky economic development projects can juice returns.

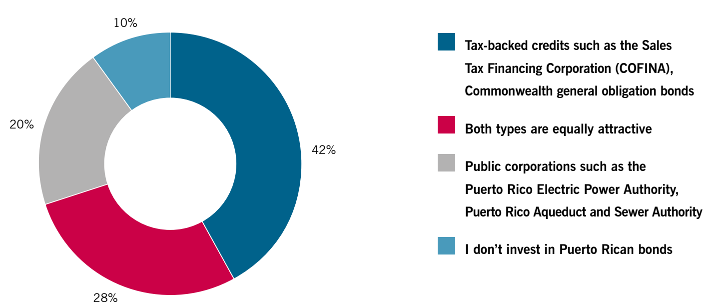
"Hedge funds and other investors have taken advantage of the high rates of return that the municipal market is currently offering as municipal issuers continue to struggle with their finances and often pay high yields on their debt. These investors likely will continue to invest in the space in anticipation of solid future gains."

Michael D. Messersmith, Partner, Kaye Scholer

Respondents are divided as to whether municipal bonds will lose their tax-exempt status in 2015. A total of 46% respondents describe this scenario as very likely or somewhat likely, while remaining respondents are divided between somewhat unlikely (27%) and highly unlikely (22%). This split down the middle reflects what many respondents describe as unpredictability and fluidity in the government bond space.

There are several respondents who mention that tax-exemption will work in a municipality's best interest because it will prevent both private and institutional investors from taking their capital elsewhere. In its 11 December 2014 report, the Federal Reserve notes that the largest increases in municipal holdings occurred with life insurance companies, foreign banks and US chartered depository institutions.

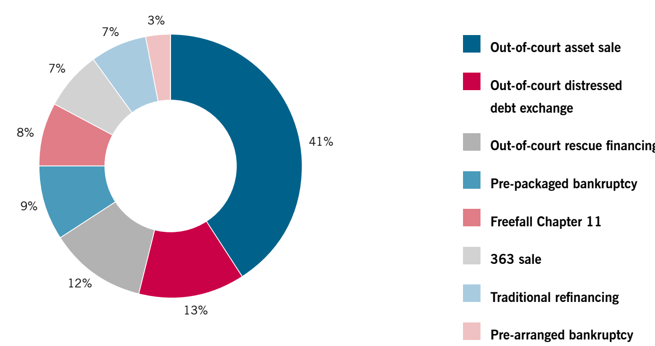
Which Puerto Rican bond type represents the most attractive investment opportunities?



When it comes to Puerto Rican bonds, 42% of respondents say that the most attractive investment opportunities include tax-backed credits such as the Sales Tax Financing Corporation (COFINA) and Commonwealth general obligation bonds.

Only 20% of respondents thought the island's public corporations were the most attractive opportunity. This shouldn't surprise anyone who has followed the island's efforts to stimulate its economy. The US Congress has not authorized Chapter 9 nor Chapter 11 for government entities in Puerto Rico. In late June 2014, the local government passed the *Debt Enforcement and Recovery Act*, which could restructure public corporations under a court supervised process while exempting tax-backed obligations. Holders of Puerto Rican public corporation debt, unhappy with the Recovery Act, are currently litigating against the constitutionality before the US District Court for the District of Puerto Rico.

What is the most likely resolution for distressed corporates needing liquidity in 2015?

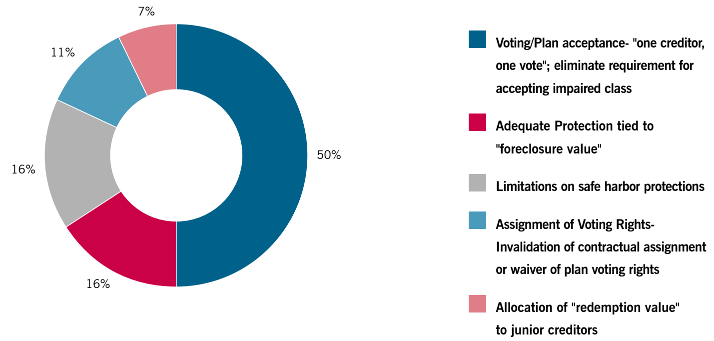


The biggest shock here is that only 9% of respondents selected a pre-packaged bankruptcy as the most likely resolution for distressed corporates in need of liquidity in 2015. Perhaps this is a result of respondents assuming an abundance of capital will be made available over the next year to stave off any need to delever in court. But it's hard to discount the prevailing trend of pre-packaged bankruptcies of late. Such designs guided the proceedings of Dendreon, Rotech, Reichhold, Cengage, Momentive and Sorenson Communications.

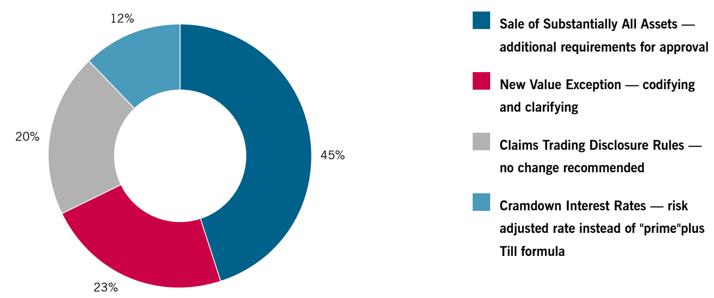
Ranking as what's expected to be the most popular cure to liquidity ills in 2015 is the out-of-court asset sale, chosen by 41% of respondents. Perhaps the recent example of distressed oil and gas player Venoco is a harbinger of things to come, as troubled companies such as Saratoga Resources, Conn's, Venoco and Quicksilver all disclosed plans to pursue strategic alternatives in 4Q14.

SURVEY FINDINGS

Last December the American Bankruptcy Institute Commission recommended revisions to the Bankruptcy Code. What recommendations most concern you?



Which Commission recommendations do you most support?



When asked which recommended revisions to Chapter 11 (of those published by the American Bankruptcy Institute in December 2014) most concern them, exactly half of those polled cited the proposed revisions to voting/plan acceptance ("one creditor, one vote") and the elimination of the requirement for accepting an impaired class.

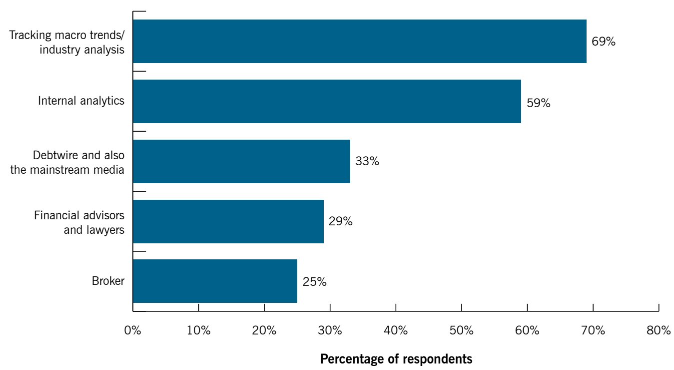
Voting/Plan acceptance recommendations are by far the most relevant, as all other recommendations — including adequate protection tied to "foreclosure value" (16%) and limitations on safe harbor protections (16%) — were selected by less than one-fifth of those polled. The recommendations least likely to influence respondents are those related to the assignment of voting rights (11%) and the allocation of "redemption value" to junior creditors (7%).

The largest percentage of respondents (45%) cited additional requirements for approval of the sale of substantially all assets as the recommendation they most support.

Garnering the second greatest amount of support was the recommendation to codify and clarify the new value exception, which was selected by 23% of respondents.

An additional one-fifth of respondents said they were most supportive of the Commission's recommendation to leave claims trading disclosure rules unchanged, while 12% said the same of recommendations to reform cramdown interest rates.

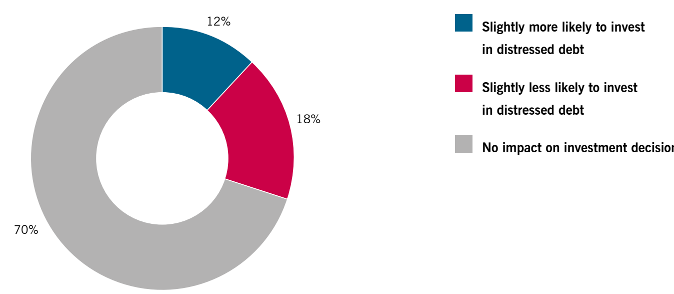
Generally, how do you source your distressed investment opportunities?



Respondents use a variety of strategies when sourcing distressed investment opportunities. The most popular methods include tracking macro trends (69%) and internal analytics (59%), followed by the use of Debtwire and mainstream media outlets (33%).

Financial advisors, lawyers and brokers also remain a fertile source for distressed investment opportunities.

What impact has the decision in the Momentive Chapter 11 case on cramdown interest rates had on your assessment of distressed investment opportunities?



The US Bankruptcy Court for the Southern District of New York's decision in the Momentive Performance Materials Chapter 11 case regarding cramdown interest rates is not likely to alter the appeal of distressed investing. Most of those polled (70%) say this issue will have no impact on their investment decisions, and less than one-fifth of respondents apiece say it will make them more likely (12%) or less likely (18%) to invest in distressed debt.

These results suggest that certain Momentive rulings will be more relevant to distressed investors than others. When asked which precedent-setting decision of 2014 would most affect their investment appetite, nearly half of respondents cited the decision in the Momentive case to reject a make-whole claim based on contracted maturity date.

KAYE SCHOLER Q&A ON PERTINENT ISSUES AFFECTING DISTRESSED DEBT

Q: Do you anticipate any impact from the ABI Commission's recommendations to reform Chapter 11 on the lending market?

Benjamin Mintz: Recognizing that there is a long way between the Commission's recommendations and adoption by Congress, I am interested in seeing how the specter of the Commission's reform proposals impact current lending and restructuring practice, including in the form of structuring new deals and documentation, and also seeing to what extent the bankruptcy courts are influenced by the recommendations in their interpretation of the existing Bankruptcy Code.

Take for example the proposed concept of Redemption Option Value. This proposal fundamentally alters the absolute priority rule and contemplates that the most senior out-of-the-money stakeholder group would be entitled to receive a distribution equal to the value of a hypothetical option to purchase the enterprise with an exercise price equal to the amount necessary to redeem the senior fulcrum class in full and with a redemption period ending on the third anniversary of the petition date. The principle is intended to protect junior creditors from bankruptcy court valuations or 363 sales occurring during a low point in the valuation cycle.

Senior secured creditors view this particular proposal quite unfavorably, seeing it as a transfer of their recovery value to junior out-of-the-money stakeholders and an opportunity for such junior out-of-the-money stakeholders to exert undue leverage in the restructuring process. Will senior creditors be inclined to structure their deals to protect themselves from having to pay over Redemption Option Value, by requiring all junior debt to be structurally subordinated? In a similar vein, will senior creditors try to protect themselves from having to pay over Redemption Option Value through more expansive protections in intercreditor agreements? More generally speaking, will documentation and deals be framed in light of the ABI Commission's recommendations and the prospect that Congress may adopt them? I would anticipate yes to all of those questions and it will be interesting to see how the lending markets react in that regard. Whether those techniques will ultimately prove effective is of course a separate question that will ultimately depend on if and how the Bankruptcy Code is actually amended.

"Will senior creditors be inclined to structure their deals to protect themselves from having to pay over Redemption Option Value, by requiring all junior debt to be structurally subordinated?"

"The Southern District of New York held, based on Section 316(b) of the Trust Indenture Act, that a parent company guaranty of the borrower's notes could not be eliminated in the context of an out-of-court debt restructuring without the consent of objecting noteholders."

Q: Tell us about the interesting and important developments involving the application of the Trust Indenture Act to the Caesars and Educational Management restructurings.

Madlyn Gleich Primoff: In *Marblegate Asset Management v. Education Management Corp.*, (S.D.N.Y. Dec. 30, 2014) (Failla, J.) and *MeehanCombs Global Credit Opportunities Funds, LP v. Caesars Entertainment Corp.* (Jan. 15, 2015) (Scheindlin, J.), the Southern District of New York held, based on Section 316(b) of the Trust Indenture Act, that a parent company guaranty of the borrower's notes could not be eliminated in the context of an out-of-court debt restructuring without the consent of objecting noteholders. Section 316(b) provides that "Notwithstanding any other provision of the indenture to be qualified, the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder".

The central issue in both cases was whether the removal of the guaranty affected the noteholders' right to receive payment. In reasoning that the Caesars court deemed "persuasive," the Education Management court found "unsatisfying the notion that Section 316(b) protects only against formal, explicit modification of the legal right to receive payment, and allows a sufficiently clever issuer to gut the Act's protections through a transaction such as the one at issue here." The court went on to determine that: "Practical and formal modifications of indentures that do not explicitly alter a core term impair or affect a bondholder's right to receive payment in violation of the Trust Indenture Act only when such modifications effect an involuntary debt restructuring." The court observed that this standard would not prevent majority amendment of a significant range of indenture terms.

These decisions leave unresolved many questions regarding the scope and breadth of Section 316(b) of the Trust Indenture Act. For example:

- When will the line be crossed from mere modification of indenture provisions (such as covenants) with majority consent to impermissible modification of "core" terms? What factors will the courts look to in making that determination?
- Will an indenture provision that expressly permits modification of an otherwise core term with majority or super-majority consent be upheld or will the language of Section 316(b) prevail?
- Might the application of the Trust Indenture Act to bonds/notes afford individual bondholders/noteholders greater protections than the protections afforded individual lenders under a loan agreement given that the Trust Indenture Act applies to securities but not loans?

Q: Does the recent drop in oil prices create distressed investment opportunities?

Stephen Rutenberg: Companies that appear most vulnerable are those which invested in oil sands, shale oil, and offshore drilling since, generally, these ventures are only profitable at relatively high oil price thresholds. Also, as larger energy companies attempt to address reduced oil revenue by drastically cutting capital expenditures, many smaller companies that provide the capital expenditure services for the energy sector may be forced into default. There is an expectation that the decrease in energy prices will result in the restructuring of over $60 billion worth of debt.

Q: Are there any unique legal structures in the energy sector that should be considered?

Stephen Rutenberg: One particular area of focus when considering an investment in an energy company are the master limited partnerships (MLPs) that many energy related companies utilize in their corporate structure. An MLP is a state law entity with publicly traded securities that can, if it earns certain "qualifying income", be treated as a "pass-through" for tax purposes. MLPs are unique to the energy sector since "qualified income" means income and gains derived from exploration, development, mining or production, processing, refining, transportation (including pipelines transporting oil or oil products) or marketing of any mineral or natural resource. MLPs have become increasingly common since they provide an easy way to attract investors searching for high yield products. As there are limited instances of MLPs restructuring or going through the bankruptcy process, some elements of the structure will be tested for the first time.

MLPs are typically structured to maintain a certain level of financial and operating independence from their sponsor, and it is common for a sponsor's credit facility to be arranged so that its MLP is exempt from some, if not all, of the restrictive covenants that would be found in ordinary lending documents (such as to (i) make distributions or investments, (ii) incur additional indebtedness or create liens, (iii) sell substantially all assets or (iv) engage in affiliate transactions). This is important to consider when purchasing the debt of the sponsors since there may be less direct operational controls that distressed investors are accustomed to relying on. Another important aspect to consider is whether credit events occurring at the MLP level trigger rights and remedies for lenders in a sponsor level credit facility. There may also be circumstances where sponsor level debt is contractually or structurally subordinated to debt extended directly to the MLP.

When purchasing debt of the MLP, it is important to evaluate the sponsor's ability to extract funds from the MLP. MLP governing documents typically require the MLP to distribute 100% of its "available cash" to its equity holders and the sponsor usually has the right to receive "incentive distribution rights" from its MLP when certain financial benchmarks are met. Investors should diligence whether the sponsor has the ability to manipulate these benchmarks and extract additional funds before cash flow problems are identified.

As a general matter, since MLPs are structured to provide additional yield in a low interest rate environment, if we have the convergence of rising interest rates together with the assumptions of the MLP business model collapsing, we may see a significant market dislocation.

Your GPS in Any Market Situation

Our real-time responsiveness, geographic reach and global understanding of the intricacies of the bankruptcy, restructuring, credit trading & investing landscape provide clients with a surer route to maximizing distressed debt and investing opportunities across sectors and around the world.

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