HIGH YIELD REPORT

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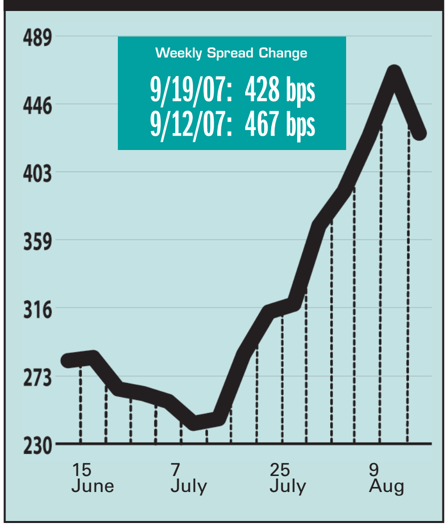
ML Master HY Index



Source: Merrill Lynch

DEBT OUTLOOK

Never Mind The Credit Crunch, Here Come New Debt Funds

Private equity firms, one of the main culprits in the creation of the current credit crunch, are among the most active in gearing up to buy some of the securities that are now selling for steep discounts. New firms join the rush to buy debt every week, as the pipeline of unsold debt presents a profitable yet brief window of opportunity.

"The LBO market is basically shut down because they can't get the financing they need to do deals," said **Steve Carter**, a senior analyst with **Thomson Financial**. "That's why these funds are starting to buy some of this LBO debt that's out there, as a way to invest some of the money that they've raised."

Two private equity groups recently joined the ranks of those moving into or increasing their investments in debt.

Houston-based **Audax Group** has created a new debt team and is in the process of raising a new fund called Audax Credit Opportunities Fund. A source familiar with the firm said that the fund has a goal of raising $200 mil-

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THE SECONDARY

Fed Cut Boosts High Yield Trading

Last week's much-anticipated Federal Reserve action gave a go-ahead signal to bond traders, and the secondary market got moving.

The Federal Reserve's Federal Open Market Committee decided to cut benchmark interest rates by 50 basis points to 4.75% last Tuesday, citing fears that the credit crunch could lead to wider economic problems. The Fed also cut the discount rate by 50 bps to 5.25%, a further reduction after the 50 bps cut made last month.

"There's clear concern that the credit crisis could push the economy into a

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PRIMARY WRAP

Emboldened Issuers Break Junk Market Ice

The primary leveraged finance markets showed some signs of a thaw last week. Three new issuances had priced on the high yield bond market by Thursday morning, with three more on the calendar to price before the end of last week, as the Fed's cut in interest rates emboldened issuers. Meanwhile, **First Data** made its much anticipated entry into the loan market.

R.H. Donnelley Corp. launched a $1 billion drive-by financing Wednesday, increased from $650 million and the first new junk bond issuance of its size since July. The company priced 8.875% senior notes due 2017 at par. The telephone directory publisher plans to use the proceeds to refinance existing debt. **JPMorgan** is the bookrunner.

Also on Wednesday, **CompuCom Systems**, a Dallas-based information technology service provider, priced $210 million in 12.5% senior subordinated notes due 2015 with an OID of 94.61. The company plans to use the proceeds to finance existing debt. **Bear Stearns** is the bookrunner.

Monday, **Baseline Oil & Gas** priced $110 million in 12.5% senior secured notes due 2012, discounted to 96.45.

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EDITOR'S NOTE

Movin' On Up, Er ... Over, To An Unburdened Small Shop Off The Street

My mind is all a buzz with clichés — the bigger they are, the harder they fall; bigger isn't always better; good things come in small packages; and everyone's favorite, size matters.

Right now in investment banking, size really does matter, only not in the sense that women have always lied about. In leveraged finance, where the big kids on the block have managed to bloat their bellies on a buffet of debt they now could be stuck with for a while, smaller players may be able to take advantage in a number of ways. Including personnel.

Yes, we've heard rumors, lots of rumors about impending layoffs. And while no one seems clear on details, and deal lauches plus a few better than expected earnings reports gave a glimmer of hope last week, I'm going to go out on a limb and say you likely still won't catch many on the high yield loan and bond desks at the likes of **JPMorgan** and **Citibank** daydreaming about year-end bonus spending sprees.

Case in point: A couple of leverage finance bigwigs at **Deutsche Bank** — group head of leveraged finance **Tom Cole** and head of senior debt capital markets **Dan Toscano** — recently left the firm to join smaller rival **HSBC** (*HYR*, Sept. 17, 2007).

Hearing this, one has to ask herself: What? Why would top managers at a top-tier bank jump ship for a rival that last year ranked No. 25 on the **Thomson Financial** leveraged loan league tables? In *September*.

No properly self-serving investment banker quits his job in the fall and leaves his bonus behind. Unless, perhaps, he's got a mountain of debt to crawl out from under.

"I can see making that move," one banker told me. "[They're thinking] HSBC may not be a Deutsche Bank, but at least I'll have a job and be doing some deals. Or if I'm not doing any deals, I'll at least be able to pay my mortgage."

To be fair, these guys could have other reasons for moving on. But I wouldn't be surprised if we see more such shuffling in the months to come, which certainly wouldn't bring frowns to the faces of those banks that might snatch up talent.

"It's a buying opportunity for banks that are looking for people," another banker said.

It will be interesting to watch who might get bought up next. —*CJC*

HIGH YIELD REPORT

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Dolans Look To Slim Cablevision Debt

The Dolan family is considering various options to reduce leverage prior to the close of their buyout of **Cablevision Systems Corp.**, according to the latest proxy materials the family has filed. These options include the selling of assets, strategic partnerships and the dropping of programming services that are bleeding red ink. Observers such as **CreditSights** say the move to dump some debt before the buyout closes is an attempt to better suit the tastes of increasingly finicky credit investors. However, CreditSights also says the Dolans would likely not want to offer a substantial chunk of equity to a third party. Shareholders will vote on the Dolans's $10.6 billion offer Oct. 24. Several months ago, Cablevision accepted a buyout bid from the family, who are its founders and controlling investors. However, the deal was put on the block before the implosion of the credit market, and after the turbulent summer of 2007, such debt-heavy deals now get poorer reception than a TV with rabbit ears.

Calyon has created a new Hong Kong-based debt capital markets team for Asia, which will be headed by **Antoine Gros**. The team will focus on products such as high yield bonds, high grade bonds and flow and structured asset-backed securities. Gros, who started Sept. 1, has worked in other fixed income positions at the investment banker's offices in Paris, London and New York, most recently heading up specialized asset securitization for the Americas, a job in which he oversaw origination and execution of structured transactions and asset-backed securities. Reporting to Gros will be **Ralph Byun**, an executive director who came from the DCM business in Korea; **Agatha Cheung**, a director migrating from **Standard Chartered**'s DCM team covering China; and **Elaine Kwan**, a new arrival from **ABN Amro**'s DCM team.

Moody's Investors Service downgraded **Movie Gallery**'s long-term credit ratings, including its corporate family rating, because the company defaulted on interest payments due on its debt package. The ratings agency dropped the corporate family rating and the $175 million second-lien term loan to C from Caa3. It also lowered the ratings on the company's senior unsecured notes to C from Ca, its $600 million first-lien term loan to Ca from Caa2, and its $100 million revolver to Caa1 from B2. The probability of default fell to D from Caa2. The outlook is stable. The company did not make the Sept. 10 interest payment due on the second-lien term loan and further decided to defer the payment beyond the applicable grace period. As a result of the missed payment, effective Sept. 15, an event of default was triggered under Movie Gallery's first-lien and second-lien credit agreements and under its 11% senior notes indenture, Moody's said.

Moody's has cut the senior unsecured debt ratings on hothouse tomato supplier **Eurofresh** to Caa2 from Caa1, while also downgrading the Willcox, Ariz.-based company's equivalent corporate family rating. The company's operating profit margin has withered on the vine in the second fiscal quarter as it battles higher energy costs, high employee turnover and lower productivity due to a higher number of, er... green workers. The fiscal third quarter could bring more of the same, in addition to the scourge of plant disease outbreaks. Eurofresh's weak financial metrics have meant less liquidity and limited room for financial maneuvering, thus it is more likely that the company won't be able to meet its debt service requirements. The company also suffered from its limited size and narrow product focus in a field of more variegated fresh fruit and vegetable suppliers, factors that outweigh its improved production volumes in the first half of fiscal 2007. The outlook remains negative.

Moody's last week minced the ratings on $126.5 million in senior unsecured notes issued by Denver-based **VICORP Restaurants**, which operates and franchises family-style restaurants under the Village Inn and Bakers Square monikers. The senior unsecured debt, maturing in 2011, was slashed to Caa2 from Caa1. This follows a previous downgrade in mid-February. The corporate family rating, meanwhile, fell to Caa1 from B3, and the speculative-grade liquidity rating dropped to SGL-4 from SGL-3. The outlook on the company is negative. The heat is on for VICORP, which has suffered continually negative same-store sales and traffic and has been buffeted by rising costs. The company's leverage is rising (its debt to Ebitda has approached 9.0x), its free cash flow is negative and it has poor interest coverage.

Standard & Poor's assigned a BB+ rating to a $1.6 billion term loan B issued by Jacksonville, Fla.-based **Fidelity National Information Services** (FIS), a provider of processing services to financial institutions. The ratings agency assigned the term loan a recovery rating of '2', indicating expectations that creditors would recover a substantial amount of principal (70% to 90%) in the event of default. The company plans to use the proceeds to fund its $1.8 billion purchase of EFD/eFunds Corp., a company that provides financial services enterprises with payment processing services, new account information and fraud detection. S&P cut the corporate credit rating to BB from BB+, to reflect the more aggressive financial disposition of the company augured by its eFunds buy; the ratings agency also affirmed the BB+ ratings on the company's $200 million notes due 2008. These became secured at the close of the transaction and are now equal to bank debt.

Market Welcomes CDX Roll With High Hopes

Market participants welcomed the ninth series of the North American Investment Grade CDX index (CDX.IG.NA series 9) last Thursday with high expectations, specifically with the addition of better quality and retail-heavy names.

"We have seen the inclusion of 'safer' names across the indices, likely owing to the market's flight-to-quality bid in light of recent turmoil," said analysts at independent credit research firm **CreditSights**, adding that only two of the newest additions, **Liz Claiborne** and **Quest Diagnostics**, have a higher mean credit risk estimate than the names they are replacing. The estimate is part of the company's BondScore product used for default and relative-value prediction.

At the same time, the on-the-run index has shed some of its LBO-related names, including **Alltel Corp.**, **First Data Corp.**, **Boston Scientific Corp.**, **Expedia** and **Residential Capital Corp.**, as well as **Olin Corp.**, **Temple-Inland** and **Tyson Foods**. In their place, it took on such retail names as **The Home Depot**, **Darden Restaurants**, Liz Claiborne and **Fortune Brands**. Other new additions include **Gannett Co.**, **Bello Corp.** and **iStar Financial**.

For the investment grade index, the new series will be significantly credit positive, said **Nishul Saperia**, CDX product manager at **Markit**. "This is going to be a fairly pronounced roll relative to others, and we should see the new index trading significantly tighter than series eight," he said, noting that typically with an investment-grade roll, all of the names that have been downgraded are removed and replaced with names that are investment grade. For instance, Residential Capital has been replaced in the new IG index and will now trade on the CDX HY series nine index instead. The credit has encountered serious difficulties as a result of the current climate in the housing market and has been trading at extremely distressed levels but remains in CDX IG series eight.

Trading on the index closed closed with a spread of 50 after its first day. While it was tighter than series eight, it is hard to discern initial market noise from the actual roll changes, market participants agreed.

Trading on the CDX.IG.NA series nine will be strong, market participants predicted, partially because the liquidity that dropped in some of the indices in August is now back. While market volatility remains, it is not so great that people are scared of trading, which is what contributed to the summer lull.

Within the first week or two after the roll, Saperia expects to see more than 75% of the investors in series eight move to series nine since — unless the indices change drastically — the new index is where liquidity is concentrated. While there are some significant changes to the new index, they are not as significant as they were between series four and five when **GMAC** and **Ford Motor Credit** were removed, two of the biggest credits in the market.

> "If we had a bunch of big levered LBOs that already closed, you might not see the volatility."

Better Credit For Higher Yield

The credit quality of the ninth series of the North American High Yield CDX index (CDX.NA.HY Series 9), which is set to launch on Sept. 27, will also be improved by some new names. In fact, all of the new additions were of a higher credit quality than the existing group, except for **Tribune Co.**, according to CreditSights.

Included in the new HY on-the-run index are Alltel Corp., First Data Corp., **Realogy Corp.**, **Community Health Systems**, **Freeport-McMoRan Copper & Gold** and Residential Capital. On the flipside, **Delhaize America**, **Huntsman International**, **Lucent Technologies**, **Parker Drilling Co.**, **Reynolds American**, **Solectron Corp.** and **Triad Hospitals** will be removed from the index.

Despite the improvement in corporate credit quality, however, **Citigroup Global Markets** cited LBOs such as Alltel, First Data and Realogy as additions that would shake up the mix. "We could see HYCDX widen by 30 to 50 basis points on the roll," Citigroup said.

Residential Capital may not be a volatile name in the long term, but it has been for the past several months — and probably will be for the next couple of months, said a high yield bank analyst. He also expected the addition of Tribune to heighten index volatility along with other pending LBOs.

"If we had a bunch of big levered LBOs that already closed, you might not see the volatility. A lot of volatility around these names gets centered on what level is this thing ultimately going to end up pricing at," the high yield bank analyst said. Tribune, Alltel and First Data will all join the index before the completion of their buyouts. Further, First Data is still an investment-grade company, though it is expected to be a high-yield name by the time the roll goes through at the end of the month. "You had a lot of trading in First Data initially on whether the deal would go through, and now you have got a little jockeying on First Data in terms of what is the market clearing level," the analyst added.

However, not all analysts expected the same volatility and spread widening. CreditSights expected both of the new indices to trade tighter than the previous series. Indeed, many of the LBO names in the new HY index are fallen angels from the previous IG index. As a result, products such as CPDOs that depend on releveraging in widening markets to maintain sufficient capital could run into some problems, the research firm said. — *GS*

Third-Quarter Bank Numbers? Don't Panic

The first wave of investment bank earnings has arrived, and here's the consensus: Breathe a little easier.

Over the past several days, **Lehman Brothers**, **Morgan Stanley**, **Bear Stearns** and **Goldman Sachs** have all posted their third-quarter numbers, and while the results surely reflect what we'll charitably describe as a "challenging" market, by no means did some of the most dire prognostications come to fruition.

Lehman was first out of the gate, and its results were actually pretty solid. The bank posted third-quarter earnings per share of $1.54, which was well ahead of what Wall Street had been anticipating. True, the EPS results were helped by a lower tax rate, but revenue was up 3% versus a year ago (down 22% sequentially), and international revenue made up 53% of the total in the quarter, an ongoing trend within the investment banking community, not to mention a testament to Lehman's diverse business base.

On the fixed-income side, things weren't pretty, as anyone paying attention would have guessed. Trading revenue plunged 47% year over year, which was largely offset by strength in investment banking, equity trading and wealth management. Lehman earned high marks for its valuation markdowns in the quarter; the bank marked down its residential mortgage and leveraged loan commitments by $700 million.

"Management noted that on a 'gross' basis (before hedges), the negative valuation adjustments for leveraged loans was well in excess of $1 billion, and write-downs in MBS assets were also north of $1 billion," says **Buckingham Research Group** analyst **James Mitchell**. "Considering the size of these write-downs and management's strong comfort level around its mark-to-market process, should prices in the credit and mortgage markets stabilize at Aug. 31 levels, that would imply that the $700 million drag from net write-downs would essentially go away next quarter."

What's more, given the modestly improving credit markets through the early part of this month, and the help offered by the Federal Reserve's half-point rate cut, some of the losses posted in the third quarter may turn into gains in the fourth.

Sandler O'Neill managing director **Jeff Harte** noted that Lehman CFO **Chris O'Meara** "adamantly" stated on the conference call that fair value accounting at Lehman means marking positions to levels at which the assets will trade, not where management thinks they should trade. "In the wake of taking significantly negative marks across most asset classes and downsizing its mortgage origination platform, management suggested that increased volatility, continued economic growth, and still-robust investment banking

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HIGH YIELD GAINERS & LOSERS

(AS OF 9/20/07)

— TOP GAINERS —

Bond	Price 9/13/07	Price 9/20/07	Change	Yield 9/13/07	Yield 9/20/07	Spread 9/20/07
Hilton Hotels Corporation (USD) 7.5% 12/15/2017	118.125	105.375	12.75	5.19%	6.76%	60.08
Psychiatric Solutions Inc. (USD) 10.625% 6/15/2013	108.625	98.75	9.875	5.64%	10.92%	118.97
Hilton Hotels Corporation (USD) 7.625% 12/1/2012	113.375	104.5	8.875	4.69%	6.59%	51.72
Calpine Corporation (USD) 8.75% 7/15/2013 144a	107.625	99.125	8.5	-3.76%	0.15%	-799.77
Utilicorp United Incorporated (USD) 8.27% 11/15/2021	116.625	108.375	8.25	6.46%	7.31%	163.09
K2 Incorporated (USD) 7.375% 7/1/2014	107	98.875	8.125	5.19%	7.59%	117.12
Calpine Corporation (USD) 8.5% 7/15/2010 144a	106.625	98.625	8	-5.26%	0.49%	-950.41
Compucom Systems (USD) 12% 11/1/2014	125.625	118.625	7	4.82%	7.00%	75.92
GMAC (USD) 8% 11/1/2031	97.125	90.5	6.625	8.28%	8.97%	341.8
Calpine Corporation (USD) 9.875% 12/1/2011 144a	105.125	98.625	6.5	-1.19%	0.33%	-534.77
Federal Mogul Corporation (USD) 7.5% 1/15/2009	81.375	75	6.375	16.39%	22.88%	1234.1
Calpine Corporation (USD) FLT% 7/15/2007 144a	103.875	97.625	6.25	0.00%	0.00%	
Calpine Canada Energy Finance ULC (USD) 8.5% 5/1/2008	105.5	99.25	6.25	-8.69%	1.21%	-1292.75
Realogy Corporation (USD) 12.375% 4/15/2015 144a	77.125	71.125	6	18.03%	19.90%	1361.9
Vertis Incorporated (USD) 10.875% 6/15/2009	97.125	91.125	6	12.76%	16.92%	873.85
DPL Capital (USD) 8.125% 9/1/2031	112.75	106.75	6	7.02%	7.51%	215.86
Blockbuster Incorporated (USD) 9% 9/1/2012	90.625	84.625	6	11.54%	13.34%	733.89
Fountainbleau Las Vegas Holdings (USD) 10.25% 06/15/2015	91.625	85.625	6	11.93%	13.27%	751.09
K Hovnanian Enterprises Inc. (USD) 6.5% 1/15/2014	79.5	73.625	5.875	11.10%	12.68%	681.98
Delphi Corporation (USD) 6.5% 8/15/2013	86.125	80.25	5.875	2.55%	3.76%	-168.66
NTK Holdings, Inc. (USD) VAR% 3/1/2014	65.75	60.125	5.625	14.88%	16.56%	1058.14
West Corporation (USD) 11% 10/15/2016	103.625	98.125	5.5	10.26%	11.33%	590.9

— TOP LOSERS —

Bond	Price 9/13/07	Price 9/20/07	Change	Yield 9/13/07	Yield 9/20/07	Spread 9/13/07
KN Energy Incorporated (USD) 7.45% 3/1/2098	85.875	107.875	-22	8.68%	6.90%	382.52
Liberty Media Corporation (USD) 8.5% 7/15/2029	100.25	118.875	-18.625	8.47%	6.82%	360.79
Knight Ridder Incorporated (USD) 7.15% 11/1/2027	82.25	100.5	-18.25	9.09%	7.10%	421.16
Rayovac Corporation (USD) 8.5% 10/1/2013	78.5	94.625	-16.125	13.88%	9.70%	967.86
KN Energy Incorporated (USD) 7.35% 8/1/2026	94.875	108.125	-13.25	7.87%	6.59%	299.5
KN Energy Incorporated (USD) 6.67% 11/1/2027	88.375	101.125	-12.75	7.83%	6.57%	295.15
IBP Incorporated (USD) 7.125% 2/1/2026	97.5	109.75	-12.25	7.37%	-81.61%	249.73
Treofan Germany (EUR) 11% 8/1/2013	55.125	67	-11.875	26.47%	21.03%	2232.52
General Motors Acceptance Finance (USD) 0% 12/1/2012	48.25	59.5	-11.25	14.56%	10.23%	1038.75
KN Capital (USD) 7.63% 4/15/2028	89.875	100.375	-10.5	8.69%	7.59%	382.01
Ahold Finance USA Incorporated (USD) 6.875% 5/1/2029	104.375	114.5	-10.125	6.49%	5.70%	162.58
KN Energy Incorporated (USD) 7.25% 3/1/2028	92.25	102	-9.75	8.03%	7.06%	315.26
Rockwood Specialties Group (USD) 10.625% 5/15/2011	99.125	106.625	-7.5	10.91%	-7.50%	677.46
Kellwood Company (USD) 7.625% 10/15/2017	87.25	94.5	-7.25	9.63%	8.44%	506.39
Phelps Dodge Corporation (USD) 7.125% 11/1/2027	99.875	107.125	-7.25	7.14%	6.49%	226.14
Castle Holdco (GBP) 9.875% 05/15/2014	70.125	77.25	-7.125	16.99%	14.95%	1195.67
TXU Corporation (USD) 6.5% 11/15/2024	78.875	85.5	-6.625	8.93%	8.07%	406.7
Affiliated Computer Services Inc. (USD) 5.2% 6/1/2015	85.875	92.375	-6.5	7.66%	6.47%	324.55
Polypore International Incorporated (USD) 0% 10/1/2012	89.625	96.125	-6.5	10.58%	8.09%	639.7
Castle Holdco (GBP) FLT 05/15/2014 144a	76.375	82.625	-6.25	15.67%	13.88%	1061.63
ARCO Chemical Company (USD) 9.8% 2/1/2020	97	102.625	-5.625	10.23%	9.43%	547.29
Hertz Corporation (USD) 10.5% 1/1/2016 144a	107.125	112.625	-5.5	8.78%	6.62%	459.94

Source: The High Yield Advantage, Advantage Data Inc., (617) 261-9700.

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recession. This is an attempt to respond to it before things got any worse," said **Steven Sheldon**, founder of **SMS Capital Management**. "At least this afternoon the impact is a positive one and should help alleviate some of the liquidity concerns that have been going on in the credit markets."

Treasury prices also reacted to the rate cut, as the 10-year note slipped $0.1875 for a yield of 4.48% Monday in anticipation of the Fed's action. By midday Thursday, lower prices had driven the yield on the 10-year note to 4.63%.

Trading on the high yield market had been slower recently, with investors waiting to see what the Federal Reserve would do. And the Merrill Lynch High Yield Master II Index followed the Fed's lead. Starting from the previous week's closing of 586.787, the index rose in anticipation of the announcement and closed Monday at 588.132. It had climbed to 593.706 by early Thursday.

"The depth of the rate cut shows that the Fed implicitly concurs with the consensus view of a relatively high 32% probability of a recession during the next 12 months," said **Moody's Investors Service** Chief Economist **John Lonski** in a report. "In all likelihood, the financial markets will appreciate the Fed's forceful move to ease financial market stress."

While trading activity was up, losers outscored gainers in trading, according to **Advantage Data**.

One of the biggest losers of the week was **Liberty Media**. The Englewood, Colo.-based media company's parent company, **Liberty Capital Group**, is in the process of selling assets in order to boost its performance and focus. Last week, a **Wachovia** analyst published a report that said the company's stock is trading for less than it is worth. Liberty's

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8.5% notes due 2029 fell 18.625 points to trade at 100.25 last Thursday.

Liberty was not alone as a media-related loser on the secondary market. Newspaper publisher **Knight Ridder** also had a rough week. Its parent company, **McClatchy Co.**, said its revenue for August fell 8.4% and its advertising revenue fell 9.2%. McClatchy's pro forma revenue for the year is down 7.1%. The company acquired Knight Ridder last year. Knight Ridder's 7.15% notes due 2027 dropped 18.25 points to 82.25 by early Thursday.

Treofan Germany saw its bonds sell down after **Standard & Poor's** revised the Germany-based packaging manufacturer's ratings. The ratings agency changed its outlook on Treofan to negative from positive due to deteriorating operating performance and liquidity. The company's 11% notes due in 2013 slid 11.875 points to trade at 55.125.

There was a diverse crop of gainers in last week's secondary market trading. Chief among them was **Hilton Hotels**. The shareholders approved **The Blackstone Group**'s $26 billion buyout of the company. Hilton operates nearly 3,000 hotels all over the globe, and has seen increasing demand from emerging markets overseas. The company took in more than $8 billion in revenues last year. Hilton's 7.5% notes due 2017 zoomed up 12.75 points to trade at 118.125.

Calpine Corp. was another winner among secondary buyers last week. The bankrupt, San Jose, Calif.-based power generator filed a second amended plan of reorganization last week. The company left in place many key provisions protecting creditors. The company expects to emerge from bankruptcy by this coming January. Calpine's 8.75% bonds due 2013 rose 8.5 points to trade at 107.625 by early last Thursday. Its 8.5% notes due 2010 climbed 8 points to reach 106.625 and three other tranches of notes took top gainers spots last week.

K. Hovnanian Enterprises was a gainer last week, a position the beleaguered home builder is likely not accustomed to. The company saw its bonds on the upswing after it announced that its latest sales initiative had succeeded in reducing a significant amount of its inventory. K. Hovnanian said its discount program, dubbed the "Deal of the Century," had even exceeded the company's own expectations and convinced the management that there was still active demand in the home buying market. Its 6.5% notes due 2014 moved up by 5.875 points to reach 79.5 by early Thursday's trading. — *MS*

PRIMARY WRAP continued from page 1

The Houston-based oil and gas exploration company plans to use the proceeds to help fund its acquisition of oil and gas assets from **DSX Energy**. **Jefferies** is the bookrunner.

Also on the calendar to price last week were holding company **Leucadia National**, which planned to price $350 million in senior notes due 2015, and **MasterCraft**, which planned to price $105 million in floating-rate notes due 2014. Jefferies is the bookrunner for both. **Downstream Development Authority** planned to price $197 million in senior notes due 2015. **Bank of America** is the bookrunner for Downstream.

Meanwhile, First Data's underwriters kicked off the week by marketing the deal to potential investors. The bank group for the deal, led by **Credit Suisse** and **Citi**, launched a $5 billion term loan B last Monday to a standing-room-only crowd at the Pierre Hotel in New York City. "The crowd's reception was positive," said one investor. The issuance at least makes a dent in the $22 billion needed to finance the company's buyout deal.

Early in the week, loan investors indicated that most of the $5 billion had been placed. And First Data's five-year LCDS reportedly tightened on rumors that the offer was oversubscribed. "It's a good sign because it shows the interest is there," said one source. Calls to Credit Suisse and Citi to confirm closure of the books were not returned by press time.

Price talk on the loan is at Libor plus 275 bps with an OID of 96, sources said. **Dave Novosel**, an analyst with **Gimme Credit**, said in a report that the discount of 96 did not meet investor expectations, which had been in the 92 to 94 range.

Kohlberg Kravis Roberts & Co. had previously agreed to add a debt-to-Ebitda ratio covenant to the deal's senior debt. Other concessions that the firm made are largely peripheral to the deal (*HYR*, Sept. 17, 2007).

Further details of the issuance emerged last Monday when First Data filed disclosures with the U.S. Securities and Exchange Commission. The company now plans to issue a total of $13 billion in term loans, rather than $14 billion. It will also issue a $200 million revolver. The banks are expected to bring the remaining $8 billion in term loans in the next quarter, provided the credit markets continue to improve.

The company also moved $1 billion to the bond side of the deal. "I don't know what went into that decision," said **Paul Ocenasek**, a high yield bond portfolio manager with **Thrivent Financial for Lutherans**. "It may have been to make the loan deal more attractive. Ultimately, it makes it tougher to get the bond deal done."

The bond portion consists of three tranches: $3.75 billion in cash-pay unsecured debt due 2015, $2.75 billion in PIK unsecured debt due 2015 and $2.5 billion in senior subordinated unsecured debt due 2016. Underwriters initially planned to price part of the bonds in toggle notes, but those have been dumped. —*MS*

DEBT FUNDS continued from page 1

lion in equity. Additional funding will be available through financing, though the source said the fund would have "modest leverage" and that a previously reported target of between $1 billion and $1.5 billion was too high. Audax expects a first close within the next month. The fund will focus on middle-market senior debt, including distressed debt.

Audax-ious Move

Audax has recruited a three-person team to manage the new fund, and may bring on additional staff in the future. The firm usually invests in leveraged private equity transactions and mezzanine debt for middle-market companies.

Another new entrant to the debt markets is **Thomas H. Lee Partners**. The Boston-based buyout firm announced last week that it had launched a new affiliate, **THL Credit Group**. The company said in a statement that it has approximately $500 million in equity and financing commitments for its fund, THL Credit Partners. A spokeswoman declined to specify if this funding had come from Thomas H. Lee Partners itself or if the firm had raised funds from outside limited partners, though typically the firm does the latter. The credit group is investing in senior loans, high yield bonds, mezzanine and structured equity, structured credit and minority equity co-investments, and it focuses on companies with Ebitda of $10 million or higher.

THL Credit is headed by CEO and CIO **James Hunt**, the co-founder and former CEO of **Bison Capital Asset Management**. Five of the seven executives under Hunt, such as group President and COO **Sam Tillinghast**, are veterans of **AIG**. Like Thomas H. Lee Partners, THL Credit is headquartered in Boston with offices in Houston and Los Angeles.

Providence Equity Partners is also reportedly seeking to increase its debt investment, but instead of raising a new fund, it has reportedly asked its limited partners to approve its use of current funds to make more debt investments. Providence has been a participant in some of the larger recent buyouts that are clogging the credit pipeline with unsold debt, including the $48.5 billion buyout of **BCE** with the **Ontario Teachers' Pension Plan** and **Madison Dearborn Partners**.

Among the first to champion buyout firms' investing in new debt was **The Blackstone Group**. The New York-based private equity giant announced Aug. 13 that it plans on stepping up its buying of debt securities (*HYR*, Aug. 20, 2007). Blackstone is involved with several deals that are awaiting financing and have been slowed following the credit market meltdown.

Other LBO firms that are reported to be either raising new debt funds or refocusing current funds to allow for more debt investment include **Apollo**, **Blue Mountain Capital**, **The Carlyle Group**, **GLG Partners** and **TPG** (formerly the Texas Pacific Group). These firms either declined to comment or did not respond to calls by press time.

Asset management firm **Oaktree Capital Management** is also reported to be raising between $3 billion and $5 billion for a new fund that will focus specifically on hung equity bridges.

Investment banks also continue to seek funding for increased debt investments. **Lehman Brothers** is reported to be seeking upward of $2 billion for a fund that will buy leveraged loan debt trading at a discount. Returns from deeply discounted debt would help underwriting firms like **Goldman Sachs** and Lehman recover from losses on debt that was stuck on their balance sheets. In announcing its quarterly results last week, Lehman reported that its fixed-income capital markets dropped nearly 50% because of "very substantial valuation reductions, most significantly on leveraged loan commitments and residential mortgage-related positions." Goldman Sachs announced it was infusing $3 billion into one of its funds to take advantage of current debt prices, also citing distressed debt prices on assets that are not really distressed.

The buying time is right, as investment banks are no longer able to sell leveraged finance debt to typical investors, and few expect a significant break in the market until next year. Thomson Financial's Carter sees it as a potential win-win situation for the investment banks and the LBO firms. "The investment banks are looking at all different avenues for selling the paper. The traditional way of selling it to regular high yield investors is not there at the prices the banks want. That's why one avenue they're looking at is selling it to the LBO funds themselves."

Fire Sale Won't Last

This is a good investment for LBO firms, which are raising funds that are acting like distressed funds. These firms are betting on banks being desperate enough to unload hung equity bridges at deep discounts.

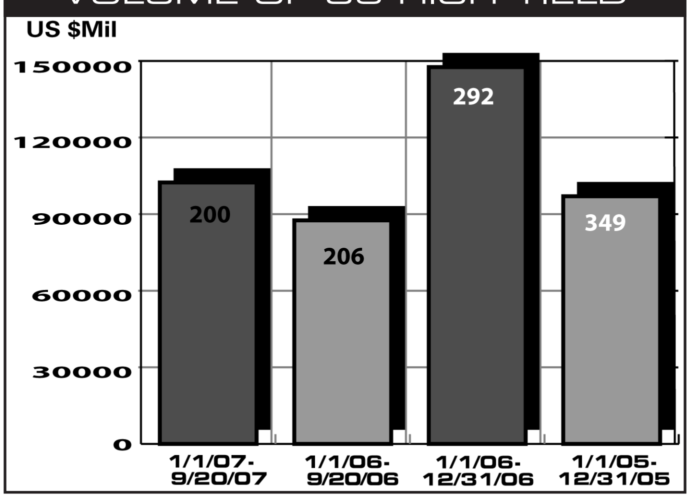
It's important to note though, that these funds are modest in size, which means that the LBO firms are betting that the window of opportunity to take advantage of these discounts will be brief. Once the debt is unloaded and the credit crunch ends, the steep discounts that buyout firms and banks are looking for will no longer be there.

"It's going to be a slow process that's going to last into next year," said Carter. "And LBO funds will be one component that will take down some of that overhanging debt. Going forward, once this overhang clears, then the opportunity to earn a good return won't really exist because buyouts at that point will be priced at market levels." *—MS*

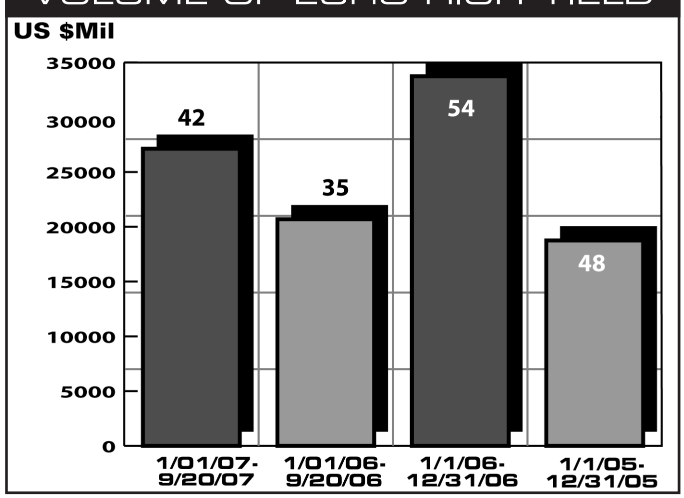
MOST RECENT GLOBAL HIGH YIELD DEALS

DATE	ISSUER	AMT	CURR	COUPON (%)	MATURITY	MOODYS	S&P	BOOKRUNNERS
9/19/07	CompuCom Systems	210.0	US	12.500	10/1/15	B3	B-	BS
9/19/07	RH Donnelley Corp	1000.0	US	8.875	10/15/17	B3	B	JPM/BofA/BS/CS/DB
9/17/07	Baseline Oil & Gas Corp	115.0	US	12.500	10/1/12	Caa1	CCC+	Jeff.
8/21/07	SABIC	1500.0	US	9.500	8/15/15	B1	B+	ABN /Citi/HSBC/JPM/GE
8/9/07	CEVA Group PLC	400.0	US	10.000	9/1/14	B3	B-	CS/BS/GS/JPM/MS/UBS
8/8/07	Vector Group Ltd	165.0	US	11.000	8/15/15	B3	NR	Jeff.
7/26/07	Parallel Petroleum Corp	150.0	US	10.250	8/1/14	Caa1	B-	Jeff./ML
7/25/07	Dubai Aerospace Entrp	325.0	US	11.250	8/1/15	Caa2	B-	BarCap/Leh.
7/25/07	Saskatchewan Wheat Pool	200.0	C	8.500	8/1/17	NR	BB	TD
7/23/07	InterGen NV	150.0	EUR	8.500	6/30/17	Ba3	BB-	ML/Leh./BarCap/DB
7/23/07	InterGen NV	200.0	STG	9.500	6/30/17	Ba3	BB-	ML/Leh./BarCap/DB
7/23/07	InterGen NV	1260.0	US	9.000	6/30/17	Ba3	BB-	ML/Leh./BarCap/DB
7/18/07	LBI Media Inc	228.8	US	8.750	8/1/17	B2	CCC+	CS/DB/Wach.
7/17/07	Cardtronics Inc	100.0	US	9.250	8/15/13	Caa1	B-	BofA
7/16/07	Akerys	300.0	EUR	Floats	8/1/14	Ba3	BB-	BNP /Calyon/SG
7/12/07	Neo-China Group(Holdings)	400.0	US	9.750	7/23/14	B1	B+	BofChina/DB
7/5/07	China Glass Holdings Ltd	100.0	US	9.625	7/12/12	B1	B+	StandChart
7/4/07	Barry Callebaut Services NV	350.0	EUR	6.000	7/13/17	Ba1	BB+	GS/ABN/BNP
6/29/07	Metals USA Holdings Corp	300.0	US	Floats	7/1/12	Caa1	CCC	UBS
6/29/07	NMH Holdings Corp	175.0	US	Floats	6/15/14	Caa2	CCC+	BofA/UBS
6/28/07	Bemax Resources Ltd	175.0	US	9.375	7/15/14	Ba3	B+	MS
6/5/07	Pinnacle Entertainment Inc	385.0	US	7.500	6/15/15	B3	B-	Leh./BS/DB/BofA
6/6/07	Actuant Corp	250.0	US	6.875	6/15/17	Ba2	BB-	BofA
6/6/07	Reliant Energy Inc	725.0	US	7.875	6/15/17	B3	B-	GS/DB/JPM/ML
6/6/07	Reliant Energy Inc	575.0	US	7.625	6/15/14	B3	B-	GS/DB/JPM/ML
6/5/07	Fiat Finance North America	1000.0	EUR	5.625	6/12/17	Ba2	BB+	BNP /Calyon/UBS
6/5/07	Pinnacle Entertainment Inc	385.0	US	7.500	6/15/15	B3	B-	Leh./BS/DB/BofA
6/1/07	Ardagh Glass Finance BV	310.0	EUR	7.125	6/15/17	B3	CCC+	Citi
6/1/07	Cricket Communications	350.0	US	9.375	11/1/14	Caa1	CCC	Citi /DB/GS
6/1/07	Forest Oil Corp	750.0	US	7.250	6/15/19	B1	B+	JPM/BofA/Citi/CS/DB
5/31/07	Metropcs Wireless Inc	400.0	US	9.250	11/1/14	Caa1	CCC	BS
5/31/07	Spansion LLC	75.0	US	Floats	6/1/13	B1	B+	DB/BofA

VOLUME OF US HIGH YIELD



VOLUME OF EURO HIGH YIELD



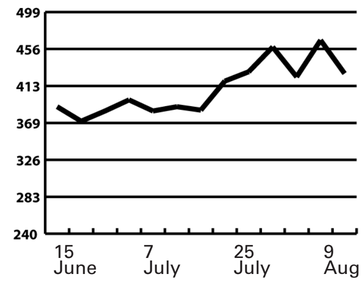
Source: Thomson Financial

TOTAL RETURNS

	YIELD-TO-WORST 9/19/07	YIELD-TO-WORST 9/12/07	YEAR-TO-DATE
Merrill Lynch high yield	8.665	2.655	1.253
Merrill Lynch investment grade	5.945	2.149	2.532
10-year Treasury	4.526	4.551	5.45
30-year Treasury	4.826	2.802	4.939
EMU corporate index	5.139	5.657	5.814
Euro high yield	8.071	4.54	3.088

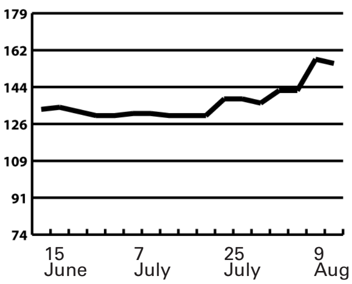
Merrill Lynch High Yield Master Index, in basis points

This Week: 428 Last Week: 467



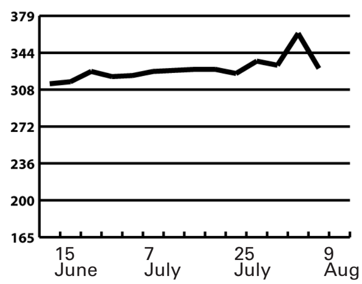
Merrill Lynch Invest. Grade Master Index, in basis points

This Week: 156 Last Week: 158



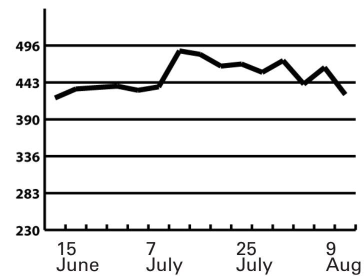
BB Index, in basis points

This Week: 329 Last Week: 363



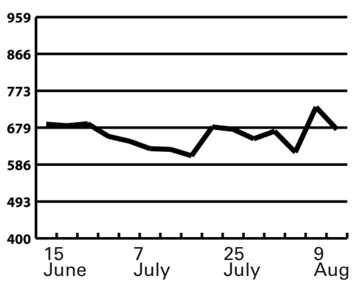
B Index, in basis points

This Week: 426 Last Week: 465



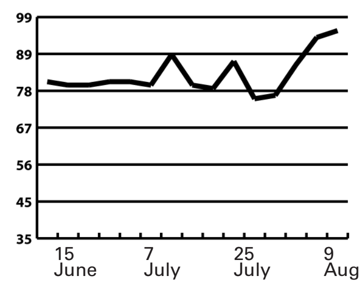
CCC/CC/C Index, in basis points

This Week: 676 Last Week: 732



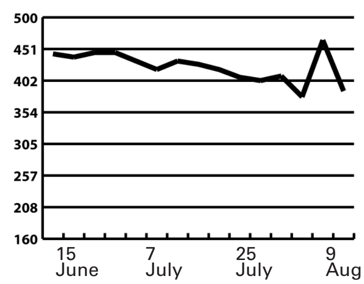
EMU Corporate Index, in basis points

This Week: 96 Last Week: 94



Euro High Yield Index, in basis points

This Week: 387 Last Week: 424



Source: Merrill Lynch

US HY LEAGUE TABLE

BOOKRUNNER	1/1/07 - 9/20/07 PROCEEDS [US$MIL]	1/1/07 - 9/20/07 RANK	1/1/06 - 8/16/06 PROCEEDS [US$MIL]	1/1/06 - 8/16/06 RANK
JP Morgan	14,023.0	1	13,435.7	2
Citi	11,275.0	2	14,385.4	1
Credit Suisse	11,107.5	3	7,984.2	3
Merrill Lynch	9,264.3	4	6,905.1	6
Lehman Brothers	7,711.7	5	5,535.6	7
Deutsche Bank AG	7,493.6	6	7,230.6	5
B of A Securities LLC	7,379.0	7	7,502.2	4
Goldman Sachs & Co	7,232.7	8	4,632.1	9
Wachovia Corp	4,809.0	9	2,847.4	12
Morgan Stanley	4,715.8	10	4,865.9	8
Industry Total	102371.3	-	87543.3	-

EURO HY LEAGUE TABLE

BOOKRUNNER	1/1/07 - 9/20/07 PROCEEDS [US$MIL]	1/1/07 - 9/20/07 RANK	1/1/06 - 8/16/06 PROCEEDS [US$MIL]	1/1/06 - 8/16/06 RANK
Deutsche Bank AG	4,677.9	1	2,584.5	3
Credit Suisse	3,424.4	2	3,011.5	1
Citi	3,041.6	3	2,852.2	2
BNP Paribas SA	2,707.8	4	563.8	11
Barclays Capital	2,460.5	5	1,767.7	6
JP Morgan	1,467.9	6	2,079.5	4
Calyon	1,368.4	7	459.5	12
Merrill Lynch	1,157.4	8	1,160.4	8
ABN AMRO	929.8	9	142.3	16
Goldman Sachs & Co	887.7	10	2,055.7	5
Industry Total	27115.8	-	20687.2	-

HIGH YIELD FUND PERFORMANCE

Name Of Fund	Total Net Assets 7/31/07 ($ Mil's)	12/31/06 To 9/19/07 % Change	Rank	Lipper Leader 7/07
Pioneer High Yld;A	1,730.5	8.30	1	
Principal:Hi Yld II;A	679.0	4.68	2	
Pax World Hi Yld;Inv	N/A	4.61	3	Y
Fidelity Adv HI Advt;T	1,058.6	4.45	4	
Ivy:High Income;A	98.1	4.25	5	Y
Fidelity Capital & Inc	9,175.7	4.24	6	
Loomis Sayles:Inst HI;I	181.5	4.22	7	Y
Nuveen High Yield Bd;R	10.3	4.22	8	
Leader Short-Term Bd	41.5	4.03	9	
Access One:Fx HY;Inv	N/A	4.01	10	
Calamos:High Yield;A	133.8	3.90	11	
Van Kampen Hi Yield;A	425.0	3.76	12	
Julius Baer:Glbl HI;I	129.3	3.73	13	Y
Putnam Hi Yld Advtg;A	385.9	3.66	14	
Evergreen High Inc;A	298.9	3.63	15	
Federated High Yld Tr	233.8	3.61	16	Y
Crdt Suis Glbl Hi Yld	35.9	3.58	17	Y
J Hancock High Yield;A	922.4	3.55	18	
Excelsior:Hi Yld;Shs	83.0	3.46	19	
Pioneer Gl Hi Yld;A	1,194.4	3.46	20	Y
Federated HY Bond;Inst	36.4	3.45	21	Y
Buffalo High Yield	186.6	3.40	22	
Federated Hi Inc Bd;A	640.3	3.40	23	Y
Direxion:Spect Sel A;Svc	40.7	3.39	24	
W&R Adv:High Income;A	904.2	3.35	25	
Aquila 3 Peaks HI;Y	9.9	3.33	26	
Lord Abbett High Yld;Y	189.6	3.33	27	
Hartfd:Hi Yld HLS;IA	31.0	3.31	28	
T Rowe Price Inst:HY	487.2	3.26	29	Y
Phoenix Ins:HY Bd;I	48.3	3.23	30	
Morg Stan High Yld;A	71.7	3.19	31	
Direxion:Dyn HY Bd;Inv	81.7	3.18	32	
STI Classic:Hi Inc;I	39.5	3.18	33	Y
HSBC Inv:HY Fxd Inc;A	3.6	3.17	34	
Lazard:High Yield;Inst	65.0	3.17	35	
TIAA-CREF Inst:HYII;Inst	212.7	3.17	36	
SSgA:High Yield Bond	33.9	3.16	37	
Hartfd:High Yield;A	166.8	3.15	38	
Principal:High Yld;Inst	307.3	3.15	39	
ING:Hi Yld Bd;A	93.0	3.12	40	
T Rowe Price HY	3,935.5	3.10	41	
Phoenix Opp:Hi Yld;A	N/A	3.09	42	
Nich-App Inst:US HY;I	52.0	3.07	43	Y
Value Line Aggr Income	34.1	3.06	44	
Am Beacon:HY Bond;Inst	187.8	3.05	45	
Delaware Delchester;A	210.8	3.01	46	Y
Putnam High Yield;A	1,571.0	3.00	47	
Franklin High Inc;A	2,095.0	2.99	48	
Delaware Pld:Hi Yld Bond	21.0	2.97	49	Y
Harbor:HY Bond;Inst	49.3	2.92	50	
JPMorgan:HY Bd;Sel	1,120.7	2.90	51	Y
AFBA 5Star:High Yld;I	12.5	2.89	52	
Fifth:High Yield Bd;Inst	68.2	2.89	53	
CG Cap Mkts:Hi Yld Inv	85.2	2.87	54	
Morg Stan Inst:HY;I	191.0	2.87	55	
CNI:Hi Yld Bond;A	19.8	2.86	56	
RiverSource HY Bond;A	1,338.1	2.86	57	
MassMutual Prem:HY;Y	101.9	2.85	58	
Met West:High Yld Bd;I	53.3	2.84	59	Y
Nicholas High Income;I	93.3	2.78	60	
Seligman HI:High-Yld;A	165.5	2.75	61	
Lehman Hi Inc Bd;Inv	375.2	2.74	62	
RiverSource Inc Opp;A	173.7	2.74	63	
Amer Cent:MS HY Bd;Inst	124.8	2.73	64	
WellsFargo:Hi Inc;Inv	204.3	2.73	65	Y
JennDry Dry Hi Yld;A	1,099.0	2.72	66	Y
WellsFargo:Str Inc;A	32.2	2.72	67	
Amer Cent:HY;Inv	49.8	2.70	68	
TA IDEX:Trans HY Bd;I	316.4	2.70	69	
Delaware Hi Yld Opp;A	99.2	2.69	70	Y
Managers II:Hi Yld;A	28.2	2.66	71	
Evergreen Sel HY Bond;I	133.0	2.65	72	
PaydenFunds:High Inc	250.2	2.65	73	
American Funds HI;A	9,302.6	2.63	74	
Thrivent Fds:HY;A	483.4	2.63	75	Y
Fidelity Adv Hi Inc;I	207.0	2.61	76	Y
USAA High-Yield Opptys	658.1	2.61	77	
PIMCO:High Yield;Inst	4,136.8	2.59	78	Y
TCW:High Yield Bond;I	66.6	2.58	79	
AllianBer Hi Yield;A	86.0	2.57	80	
CMG High Yield	62.7	2.57	81	
Aegis High Yield	7.9	2.56	82	Y
Eaton Vance Inc Bstn;A	1,392.1	2.53	83	Y
Oppenheimer Chpn Inc;A	1,725.8	2.53	84	
Crdt Suis Op:Hi Inc;A	38.6	2.50	85	
Dreyfus Prem Ltd HY;A	180.7	2.47	86	
MEMBERS:High Income;A	36.9	2.45	87	
Northern Fds:HY Fxd In	1,752.3	2.42	88	
BNY Hmltn:Hi Yld;Inst	201.6	2.38	89	
Fidelity High Income	4,905.6	2.38	90	Y
Columbia:Csv Hi Yld;Z	614.0	2.37	91	
J Hancock II:HY Bd;NAV	392.1	2.37	92	

— Number of All High Yield Funds 518 —

— Lipper HI Curr Yld Bd 2.72 —

Source: Lipper

BANK EARNINGS continued from page 5

pipelines bode well for future revenue," Harte says.

Commenting on the firm's substantial international growth, Harte says that while the potential gain in overseas market share is a real opportunity for Lehman, the relative increase this quarter was more the result of domestic markdown-related revenue contraction than international revenue growth. (Most of the $700 million net write-down was U.S. based.)

Morgan Stanley's quarterly results weren't greeted with quite as much optimism, although revenue performance within the firm's investment banking, investment management and wealth management segments was strong. Total net revenue came in at $7.96 billion, which was up 13% but still trailed what most analysts were expecting. The bank earned $1.38 a share in the quarter, well below what the Street anticipated. As was the case at Lehman, fixed-income revenue plunged — by 57% versus the previous quarter.

"While we assume management's fair-value accounting assumptions were as conservative as possible, we hesitate to call this a 'kitchen sink' quarter and suspect it may just represent the downside of management's much publicized efforts to increase risk levels," says Harte. In returning to the top spot a couple of years back, Morgan Stanley CEO **John Mack** made it clear the firm would not be shy in taking on more risk. The firm took a $940 million loan loss in the quarter.

Golden At Goldman

Meanwhile, over at the money-printing machine that is Goldman Sachs, they must be wondering what all this subprime fuss is about. Goldman blew away analysts' consensus forecast, posting net income of $6.13 a share, versus the $4.35 expected by Wall Street. Revenue surged 29% to $12.3 billion, propelled by the bank's financial advisory and FICC segments. Goldman took a hefty $1.5 billion net markdown related to leveraged loan commitments, but it managed to use the quarter's volatility to its advantage, and it also saw investment banking revenue jump 25% sequentially.

Finally, there was Bear, which fared worse than its larger peers. Its fixed-income operation (along with investment banking and equities trading) suffered through a 36% revenue slump, and overall net income dropped 61% in the quarter. Perhaps most disconcerting for investors, however, is the firm's return on equity, which fell to 5.3% from 13.7%. Goldman's rose to 36.6% from 31.6%. —*Tom Granahan*