HIGH YIELD REPORT

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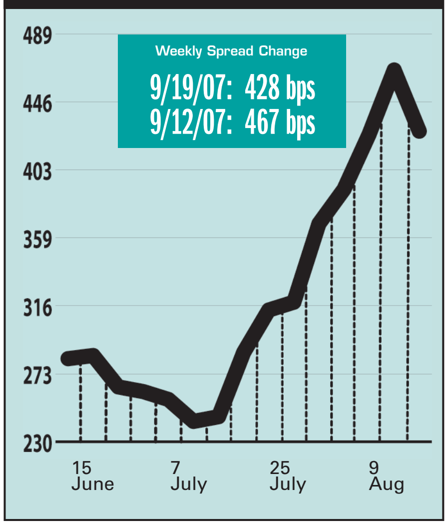

Source: Merrill Lynch

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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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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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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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*