



## **Capital Markets Right Now**

Presentation to National Investor Relations Institute

February 22, 2007

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## I. Where Are We Today?

# Where Are We Today?

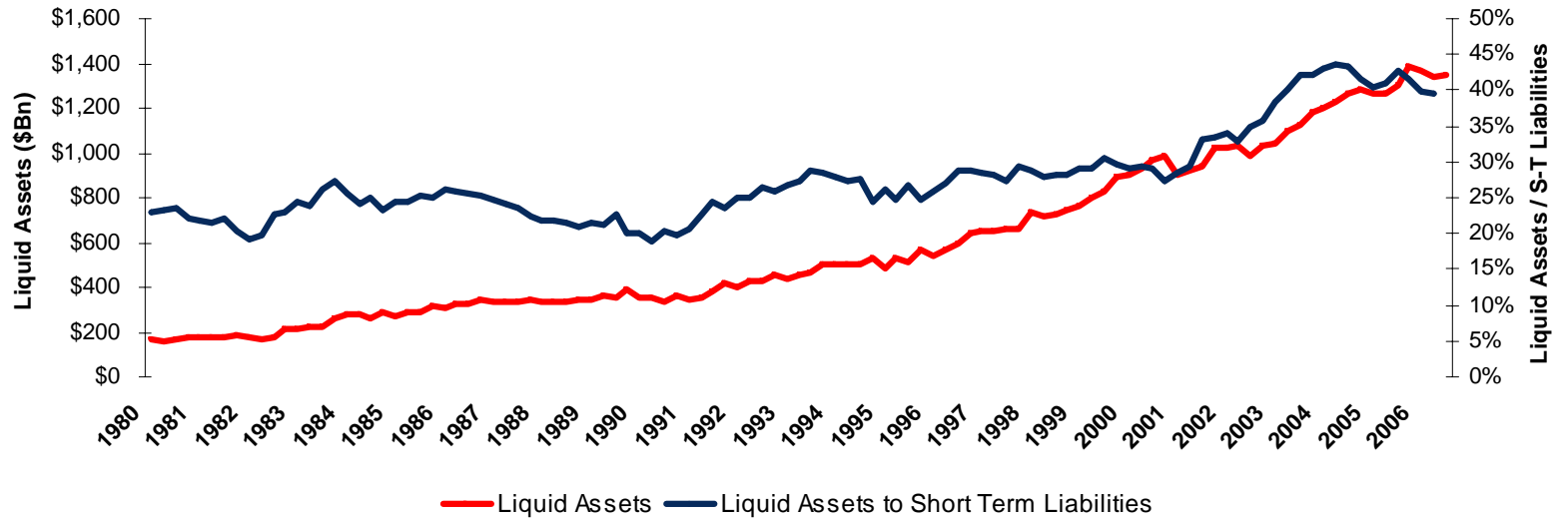
## Issues Confronting the U.S. Capital Markets

- Constraints on Capital Formation
  - Sarbanes-Oxley expense
  - IPO market liquidity
  - Trend toward M&A exit
  
- Governance Scandals
  - Options back-dating
  - CEO compensation package disclosure
  - MBO / LBO by management
  
- Corporate Balance Sheet Strength
  - “Excess cash”
  - Share buyback activity
  
- Rise of The Investor
  - Activists
  - Private Equity
  - Mutual Funds
  - Hedge Funds

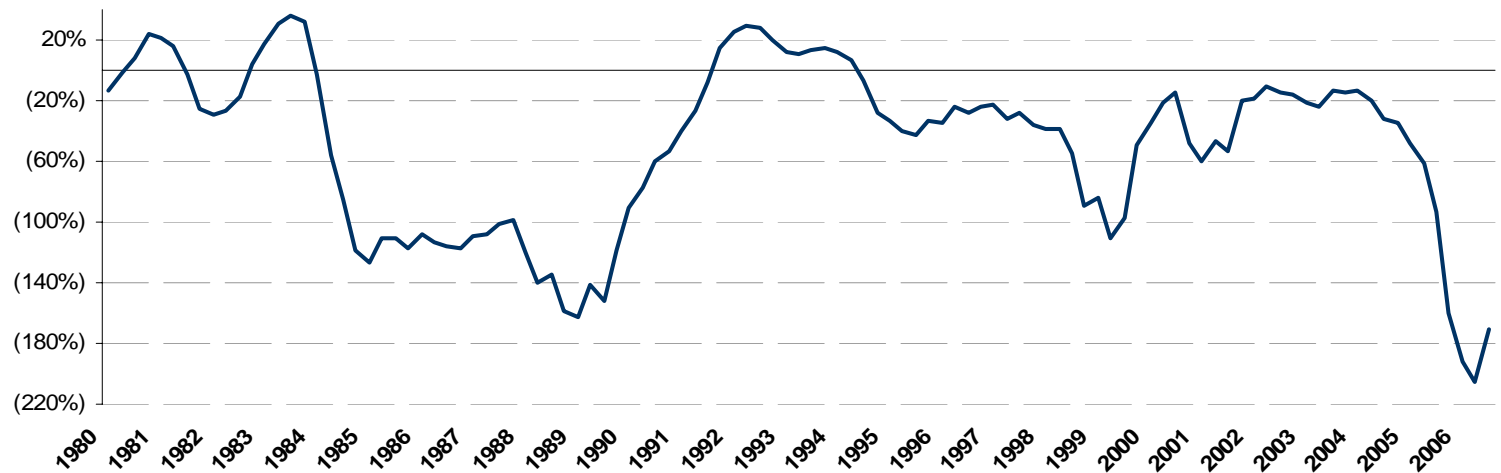
# Where Are We Today?

## Corporate Balance Sheet Strength

Non-financial Sector Liquidity

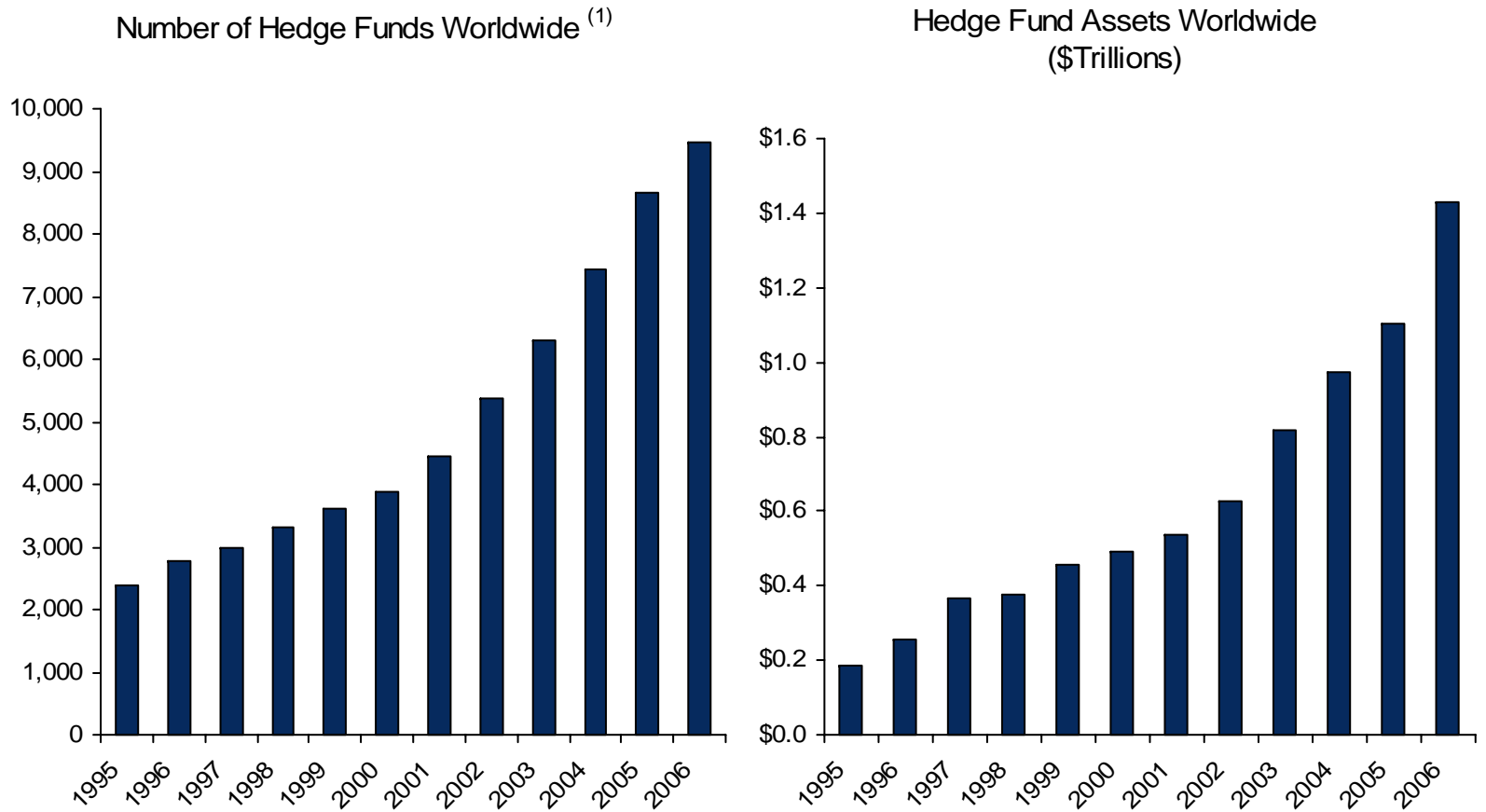


U.S. Net New Equity As A % of Dividends (Rolling 4Q Avg), Non-Financial Corporations



# Where Are We Today?

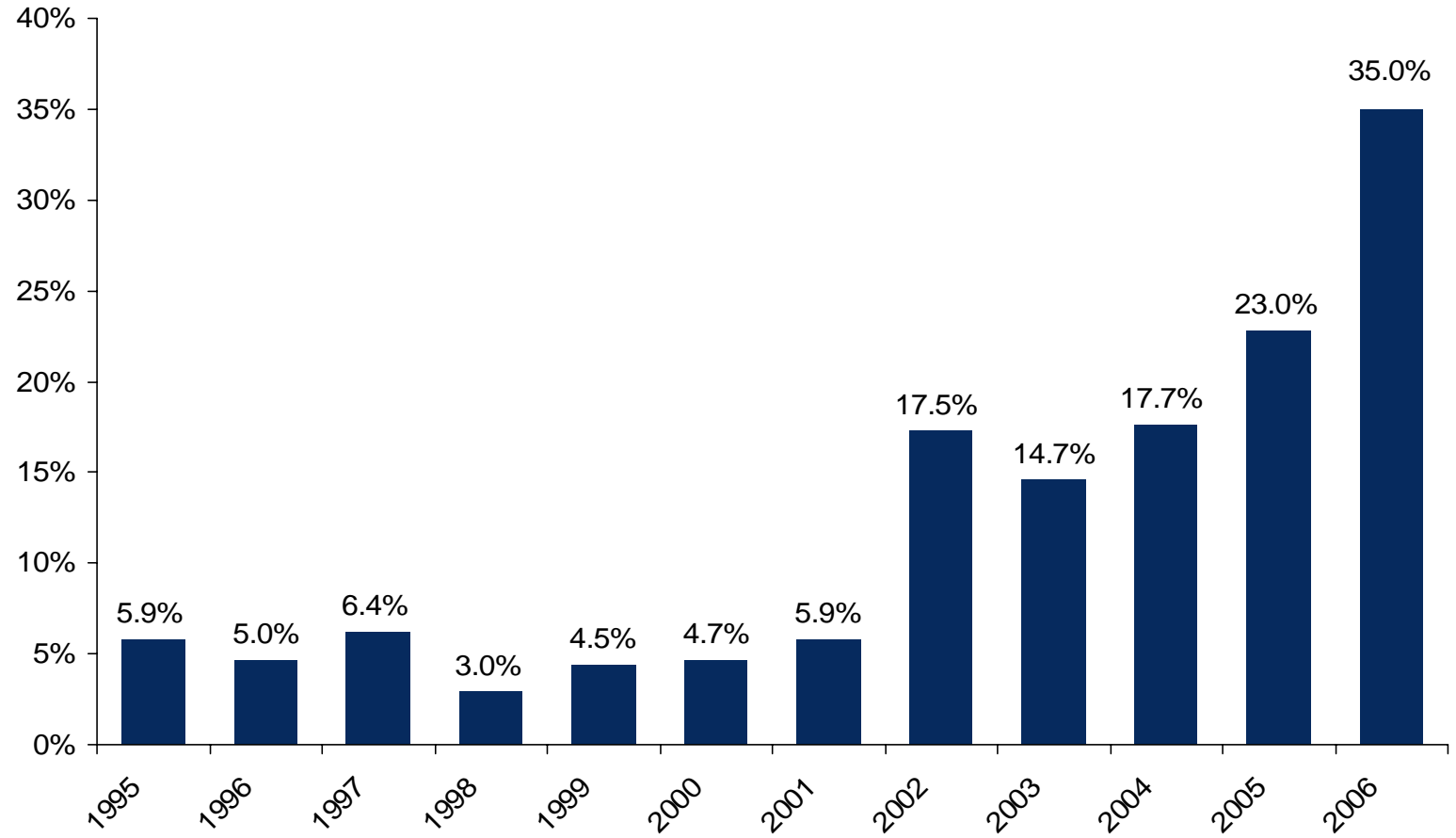
## Rise of Hedge Funds



# Where Are We Today?

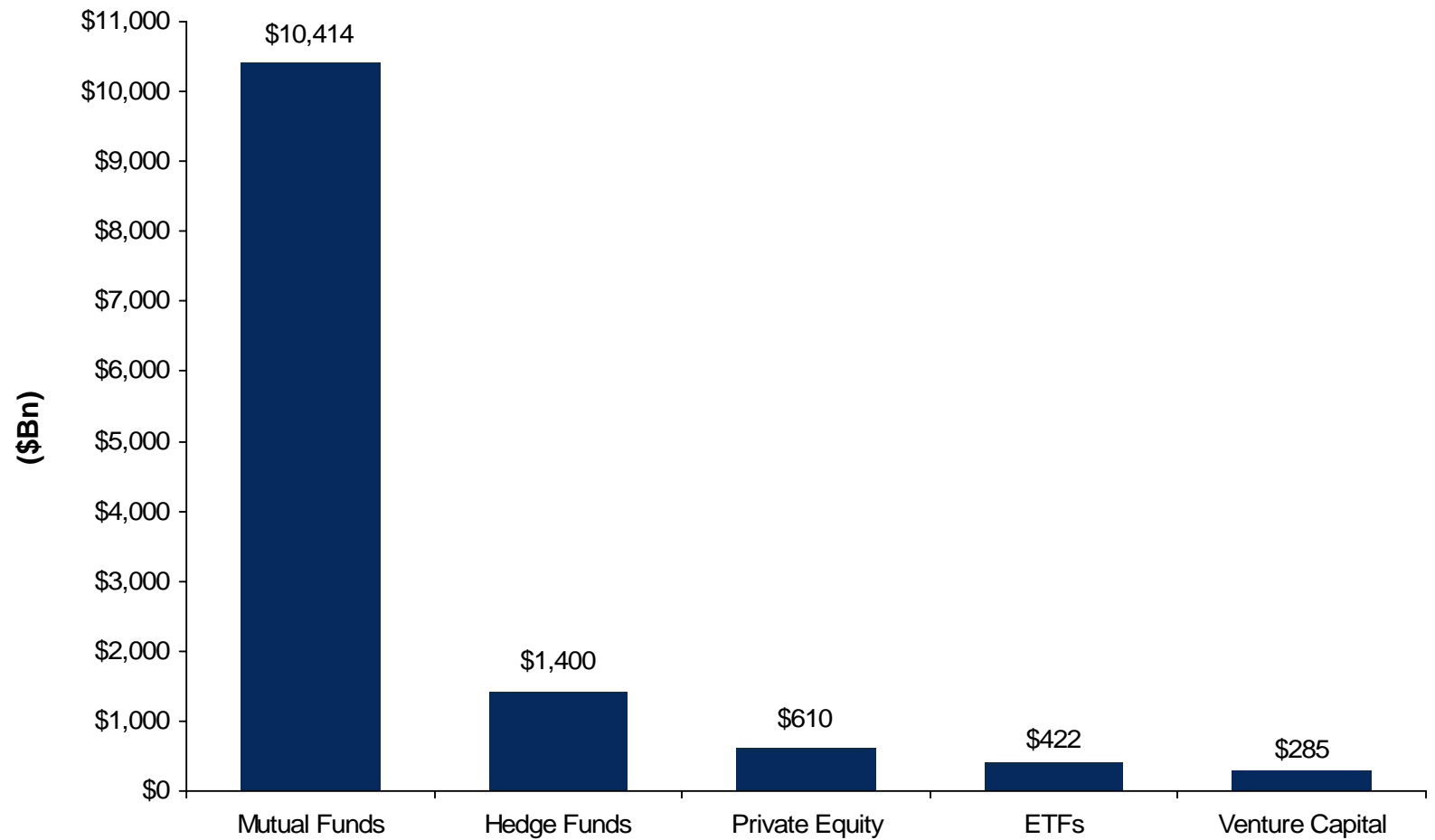
## Rise of the Private Equity Investor

Private Equity Buyers as a Percentage of All M&A Transactions



# Where Are We Today?

Assets Under Management -- 2006



**Notes:**

Sources: ICI, Carlyle Group, Savvian Estimates

# Where Are We Today?

The Increasing Role of Mutual Funds and Activists

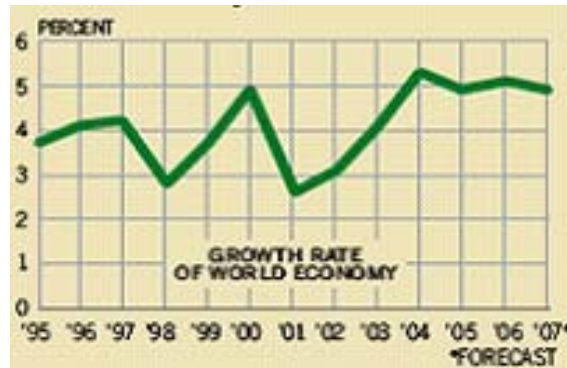


## II. Debt Market Overview

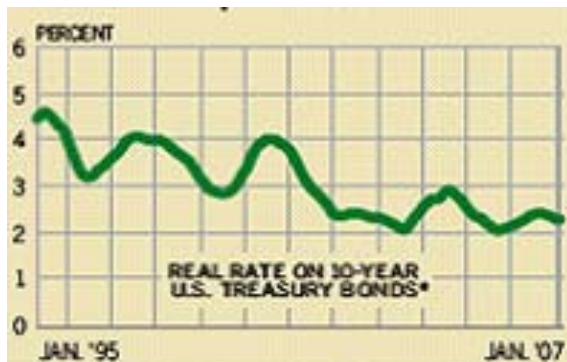
# Debt Market Overview

Debt Markets Are More Liquid Than Ever, Lowering Costs

- A deep pool of foreign capital (particularly from China and India), financial innovation, and increased competition among capital providers have driven growth of developed debt markets globally



Strong global growth



Falling capital costs



Reduced credit risk

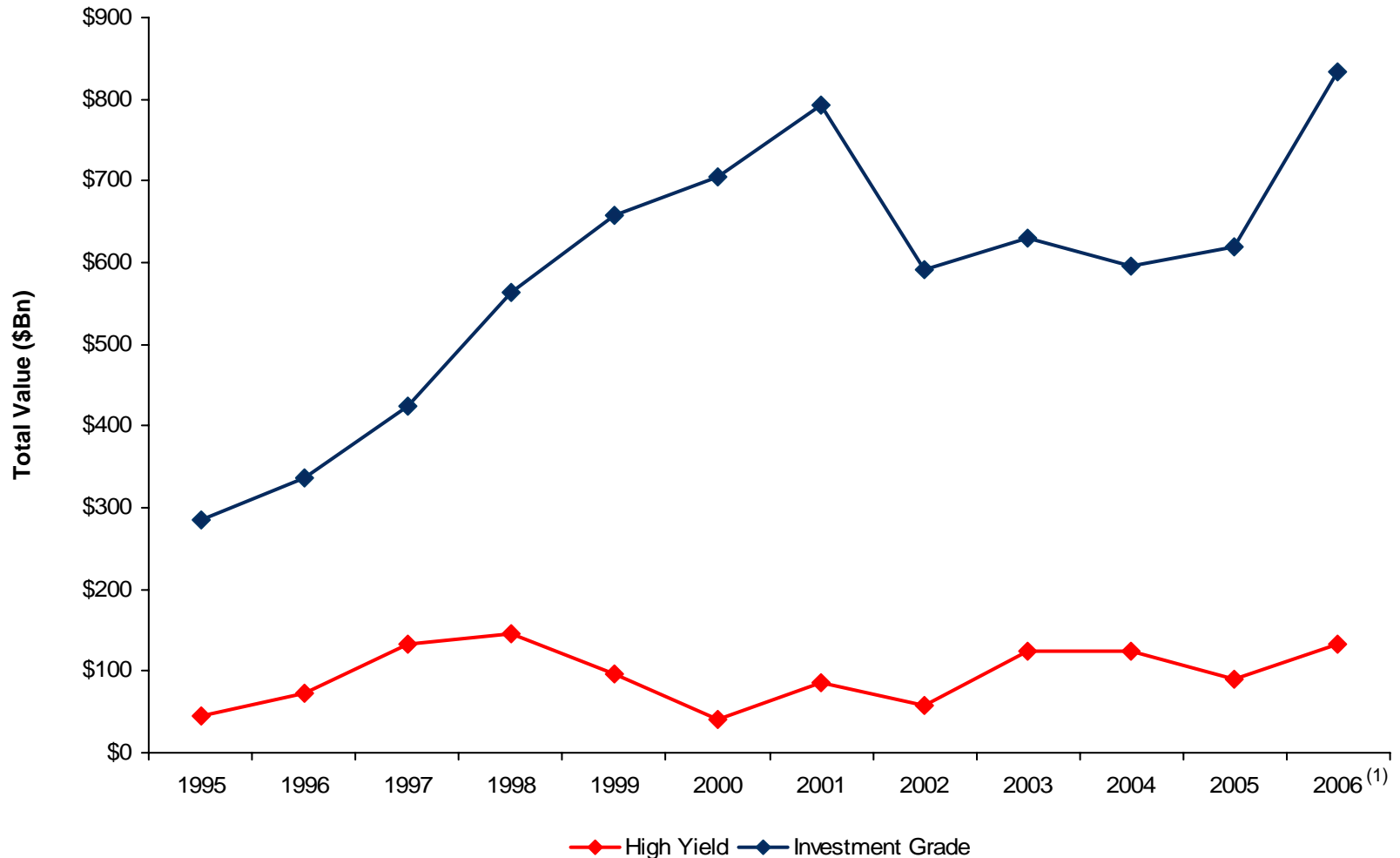
**MORE  
EFFICIENT  
DEBT  
MARKETS**

\*2006 YTD through June 30, 2006  
Source: Securities Industry and Financial Markets Association

# Debt Market Overview

## Corporate Bond Issuance

- Recent growth of the corporate debt markets has been driven by a surge in M&A and leveraged buyout activity, coupled with strong business capital investment activity and substantial debt refinancing
- The total value of investment grade and high-yield issues exceeded a record level of \$1 trillion in 2006



### Notes

Includes all non-convertible corporate debt, MTN's and Yankee bonds, but excludes maturities with one year or less, CD's, federal and agency debt

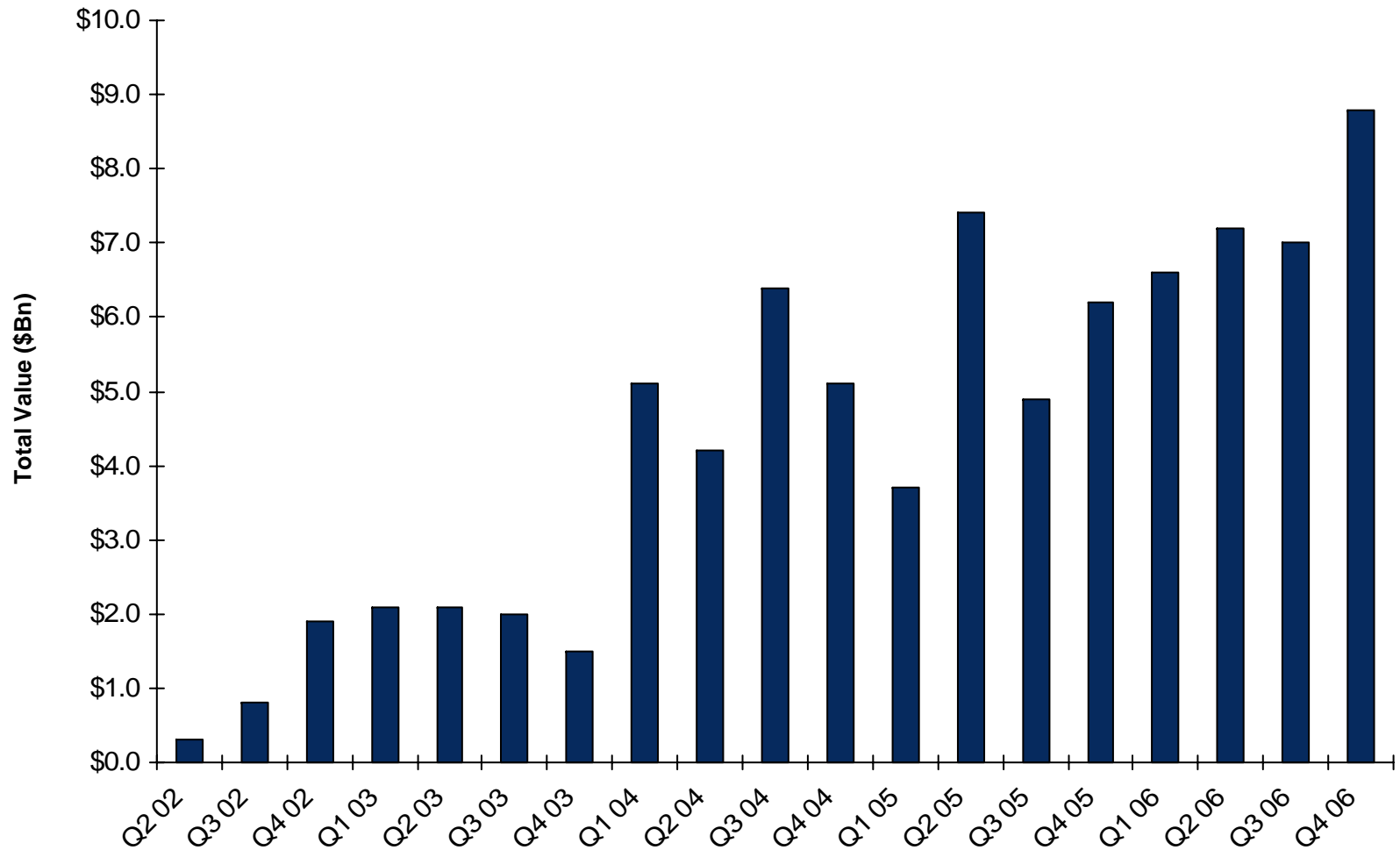
Source: Securities Industry and Financial Markets Association, Standard & Poor's Fixed Income Research

(1) 2006 data is annualized as of 11/30/2006.

# Debt Market Overview

## U.S. Second Lien Issuance

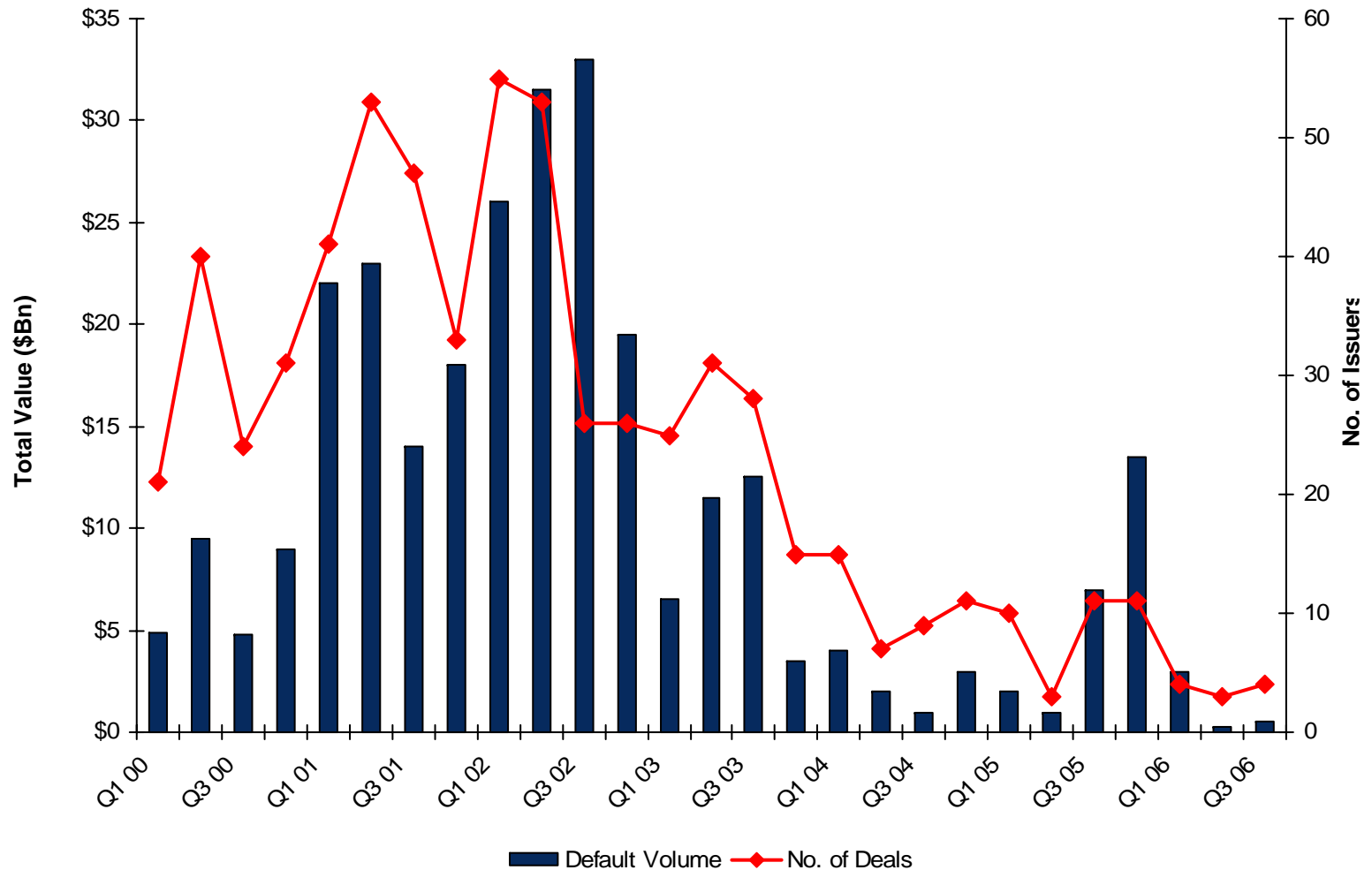
- Many M&A and LBO transactions have been increasingly facilitated by the use of second-lien debt, driving substantial growth of this market over the past several years
- The rise of non-traditional investor groups, particularly hedge funds, continues to fuel second-lien growth



# Debt Market Overview

## U.S. High Yield Quarterly Default Trends

- High-yield defaults have fallen to their lowest rates in years, owing in part to a better economic climate, lower spreads, and growth of non-traditional investors who have helped fuel liquidity

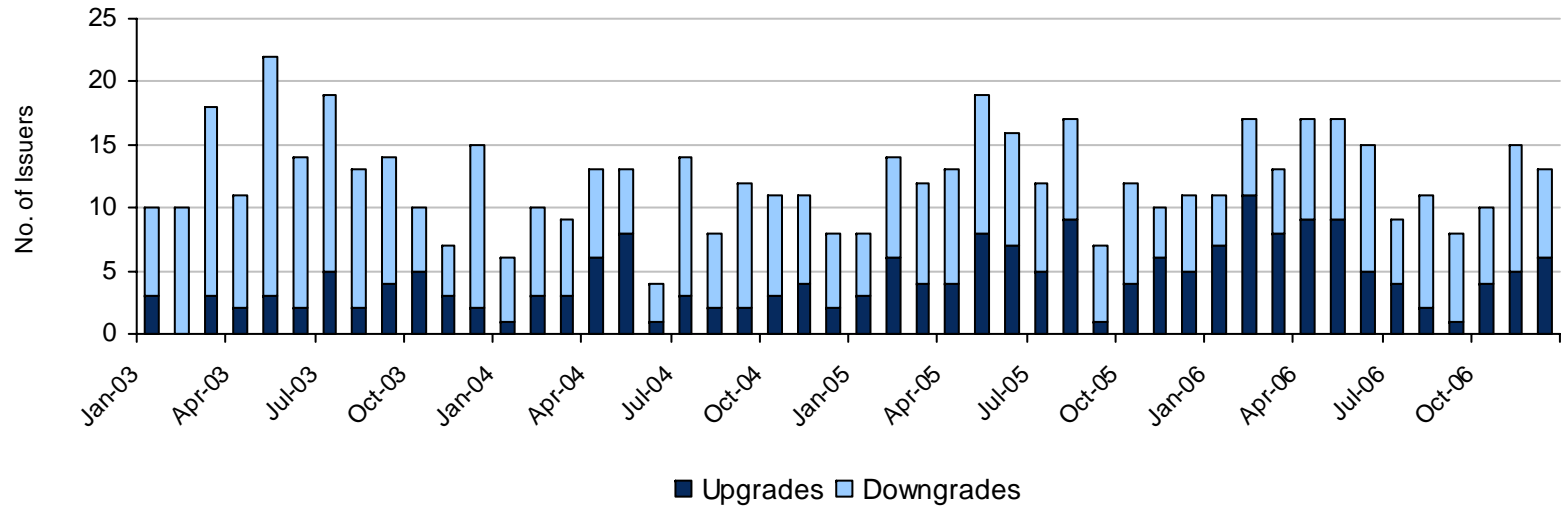


# Debt Market Overview

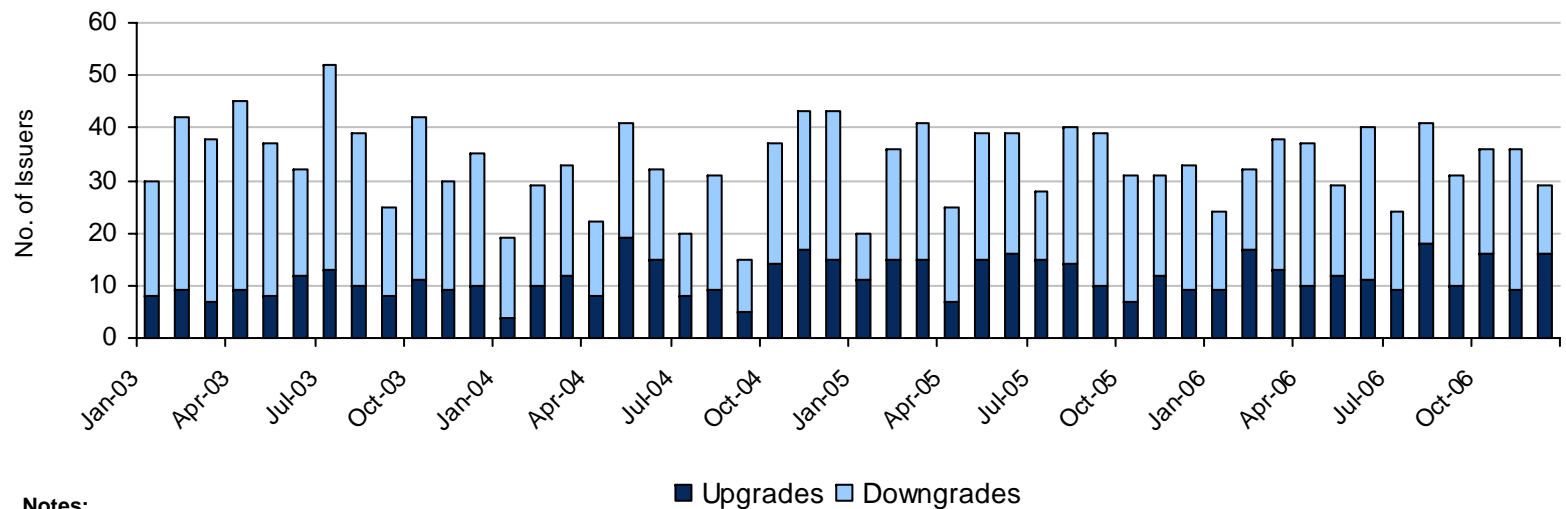
## Credit Rating Changes

- Recent ratings activity has been balanced, with credit upgrade activity driven by strong corporate profits offset by M&A-related downgrade activity
- Downgrade risks are likely to increase as GDP growth stays significantly below trend in 2007, with only low single-digit expansion expected

U.S. Investment-Grade Rating Actions



U.S. High Yield Rating Actions



**Notes:**  
 Data as of 12/31/2006  
 Source: Standard & Poor's Global Fixed Income Research.

# Debt Market Overview

What to Look for in 2007

Revolver

Term Loan

Senior Debt

Mezzanine Debt

Preferred Stock

Convertible Notes

Common Stock

## Observations

- Ample liquidity and “market calm” prevail for now
- Relatively low volatility suggests lack of credit worries
  
- Generous financing provisions and wide-ranging options serve to reduce default risk as firms have had little trouble refinancing maturing obligations
  
- A hot leveraged buyout market should continue to support high-yield and mezzanine issues
- A macroeconomic slowdown could set the stage for heightened risk in the latter part of the year
  
- Forces driving returns – substantial liquidity, low interest rate volatility, strong corporate profits – will weaken in the absence of faster economic growth

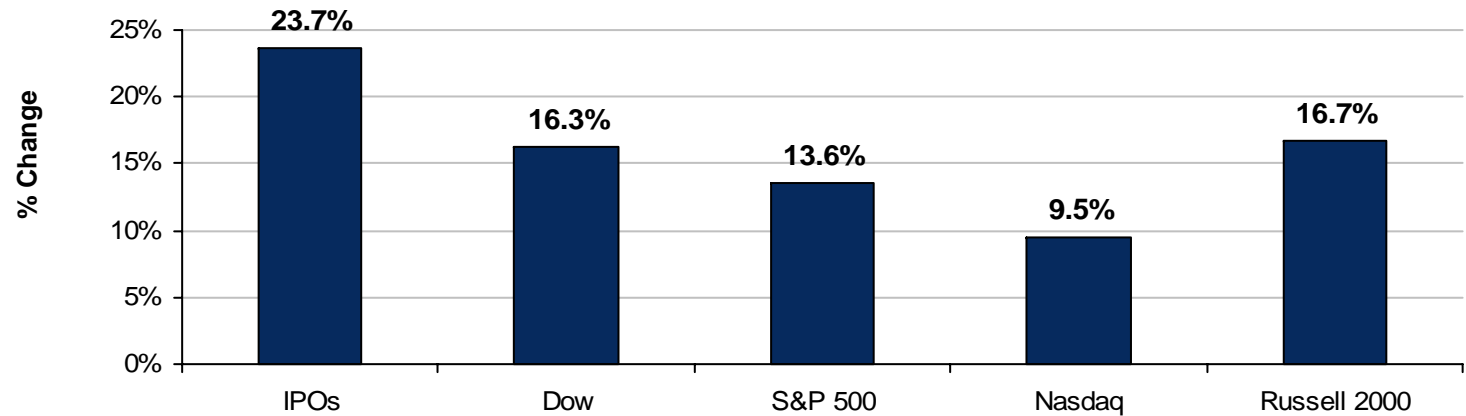
## III. Equity Market Overview

# Equity Market Overview

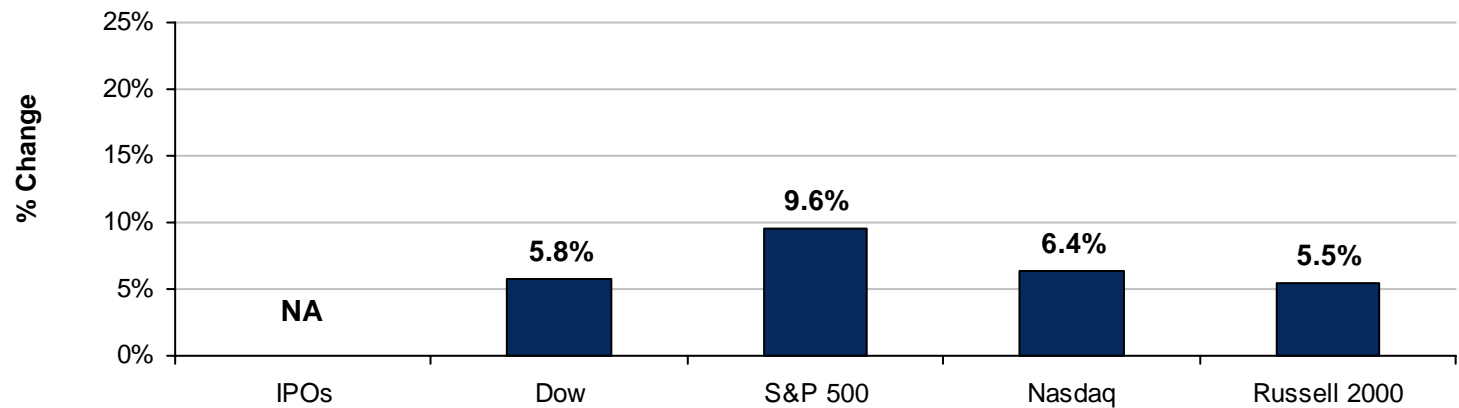
## Equity Market Performance

- Equity performance for 2006 was the strongest since 2003

### 2006 Stock Indices Performance



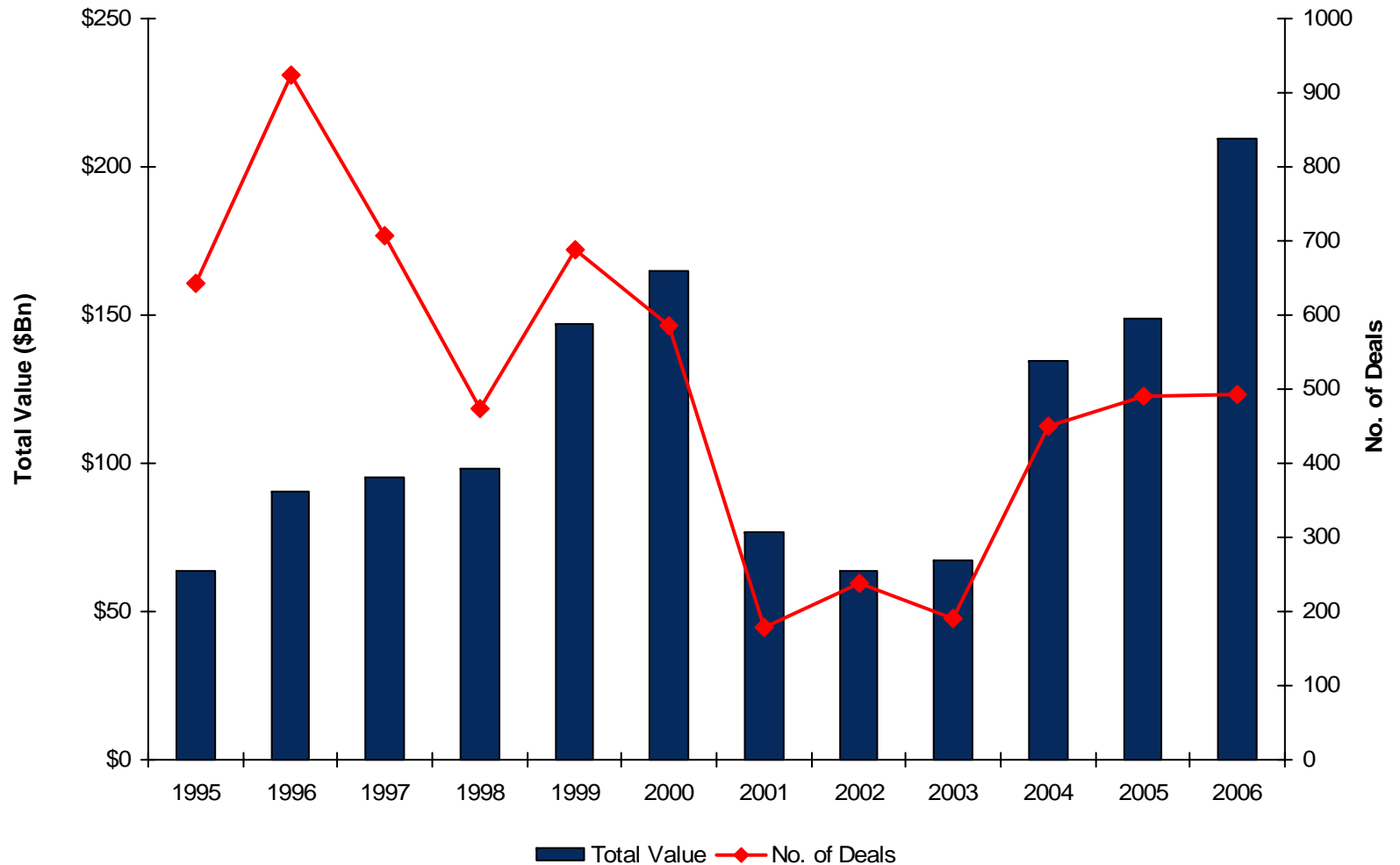
### 2007E Stock Indices Performance



# Equity Market Overview

## IPO Activity

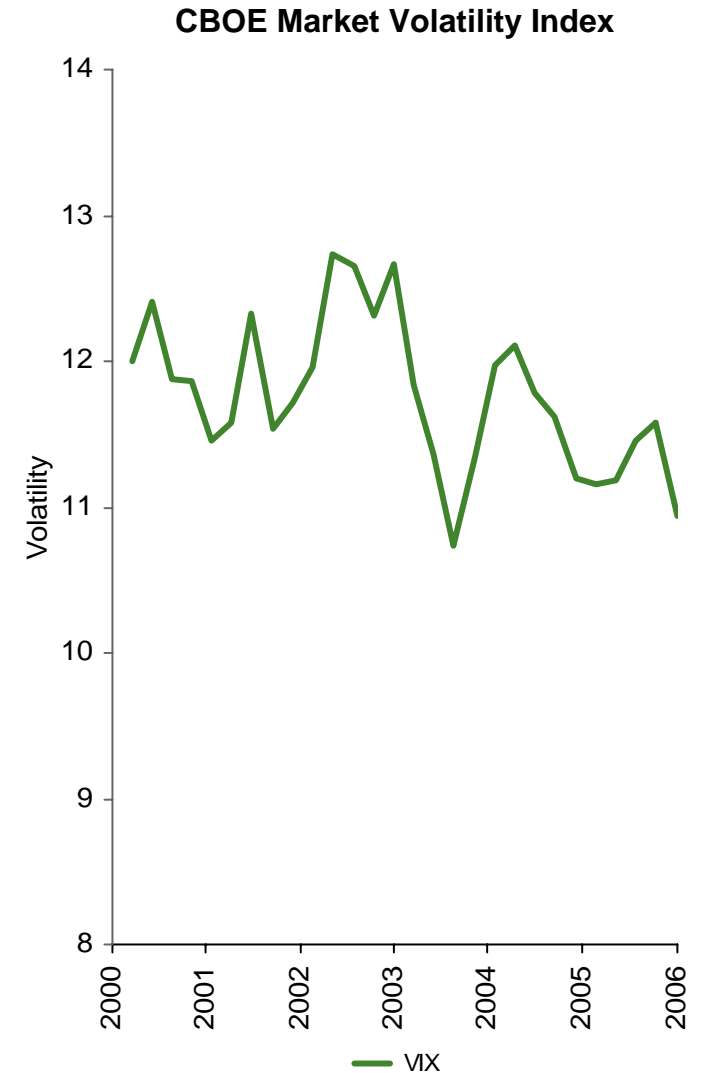
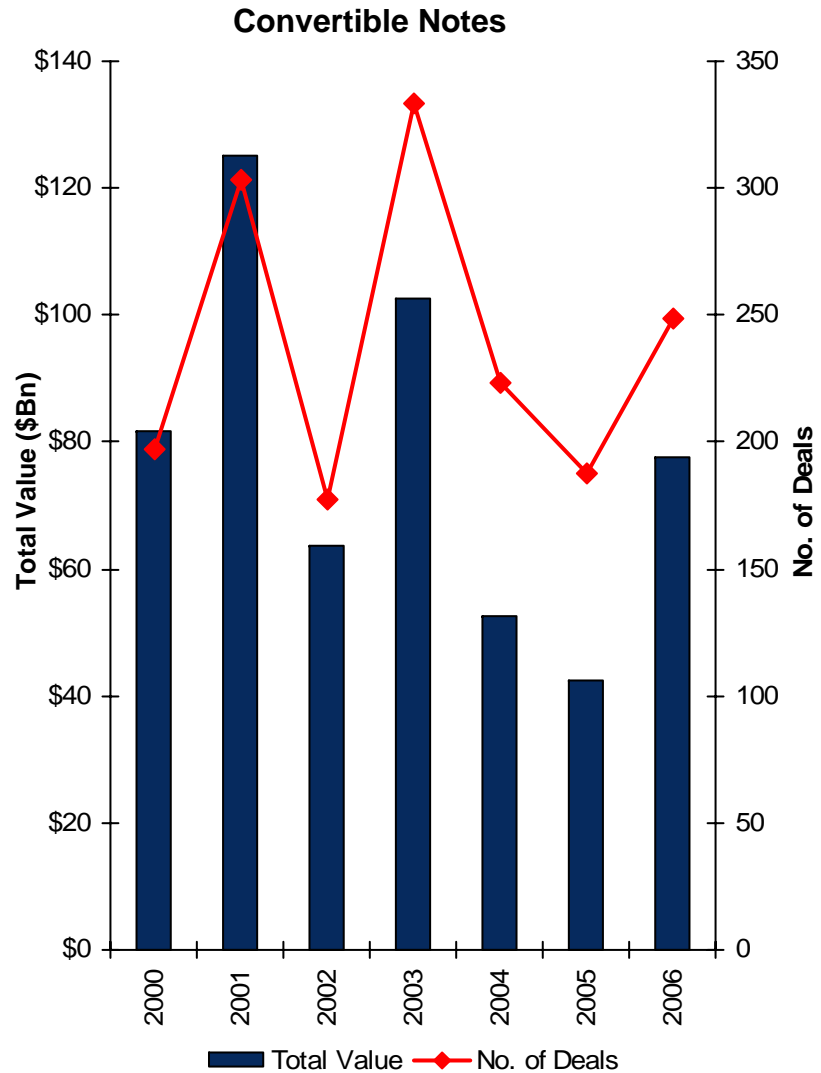
- While not back to late 1990's levels, the IPO market has clearly returned
- Regulatory constraints and company development stage remain inhibitors to future growth in listings



# Equity Market Overview

## Convertible Note Issuance

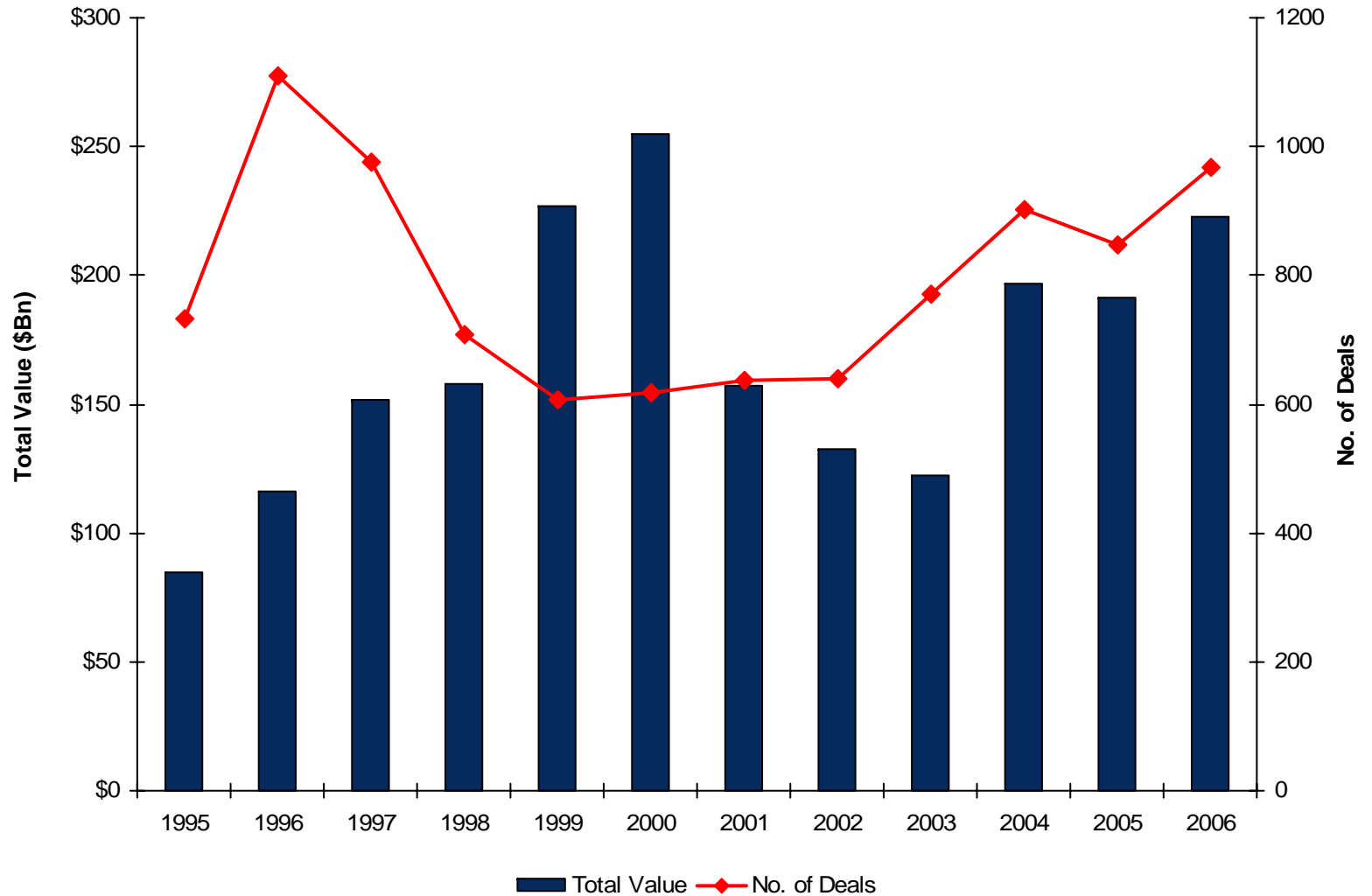
- Convertible offerings have experienced a resurgence as well, providing a (near-term) lower-cost of capital to straight equity for companies who can absorb the debt-load



# Equity Market Overview

## Equity Follow-On Issuance

- *Follow-ons have tracked with broader equity market trends, showing strong valuation performance in the second half of 2006*



# Equity Market Overview

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## Observations

- Low volatility and a solid corporate profit outlook suggest that 2007 equity returns should continue to be in positive territory
- Strong cash flow growth should continue to fuel corporate buyback and dividend activity
- The prospect of further robust M&A activity should bolster market returns and investor optimism
- Private equity will continue to grow on the back of strong institutional demand, driving growth of (private) preferred issues
- Regulatory burdens and overflowing corporate and private equity coffers continue to dampen IPO growth
- Potential surprises to the equity markets include:
  - A change in Fed interest rate expectations
  - A sudden change in the corporate profit growth outlook
  - A geo-political shock
- Thus far, market returns indicate a continuation of 2006 trends, with the S&P and NASDAQ up ~2% through mid-February, the Dow reaching record highs and similarly positive signs for broader market indices

## IV. Takeaways

## Takeaways

### Top 10 Predictions For The Capital Markets in 2007

1. A \$50Bn leveraged buyout gets tabled
2. Hedge fund assets exceed \$2 trillion by the end of the year, but the number of funds falls
3. Private equity commitments exceed \$800Bn by year-end
4. Someone raises a \$25Bn buyout fund
5. Private equity LPs get into the buyout game directly
6. NYSE and London Stock Exchange merger?
7. Following the lead of Fortress, top private equity firms go public
8. A famous CEO goes to prison for options backdating
9. Drastic amendment to Sarbanes-Oxley legislation even if only for medium- and small-cap companies
10. Market jitters increase at year end as tax law changes come into focus for investors