

S&P: Distressed Debt Exchanges May Not Boost Credit Profile

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Convincing debt holders to swap holdings that are in danger of default for bonds of lesser value has become an increasingly attractive option for some hard-pressed companies. “As long as capital markets remain open, we believe that some issuers will consider this option,” according to Diane Vazza, managing director of Standard & Poor’s Global Fixed Income Research Group.

“Yet, it’s important to understand that, after a distressed debt exchange, many companies won’t necessarily present a stronger credit profile.,” she wrote in a Q&A on the speculative grade sector.

A distressed debt exchange might help some issuers ward off bankruptcy, but it could still leave them exposed to significant risk if the increasing liquidity within the system that has supported them so far were to dry up.

“In fact, we’ve seen that in 72 recent distressed debt exchanges of U.S. companies, nearly half carry ‘CCC’ ratings—an indication of liquidity risk—and 30% are among our weakest links. Fourteen of these companies are no longer rated at all.”

“The default rate, currently at 10.8%, will continue to inch up in the fourth quarter before we see a decline in 2010. In our last update, which we put out at the end of June, our baseline forward 12-month speculative-grade default rate was 13.9%. We now expect that by the end of the third quarter of 2010, the baseline default rate will be 6.9%.”

Putting its money where its mouth is, [S&P on November 2](#) downgraded YRC Worldwide Inc. ([YRCW](#)) to CCC from CC after the trucking company proposed a debt-for-equity swap whereby YRC may have to issue up to 1.6 billion new shares, or nearly 27 times the approximate 60 million currently outstanding. [Audit Integrity’s AGR Bankruptcy Risk Model](#) rates YRC in the lowest 1st percentile. Starting September 2009, the AGR Bankruptcy Risk Model had assigned a 15.3% bankruptcy probability (1st percentile) to YRC, though in October 2009 the AGR Bankruptcy Risk Model increased YRC’s bankruptcy probability to 15.7% (1st percentile) . However, this was down from a peak of 21.3% on June 30 (*click chart to enlarge*).



The [Journal of Commerce reported](#) that, “the deal is critical to YRC’s near term survival, and that it would relieve — but not eliminate — the threat of bankruptcy. YRC Worldwide reported a \$158 million loss in the third quarter, bringing its total losses this year to \$741 million. However, more than one analyst compared the debt stock swap to a virtual Chapter 11 reorganization. “We view today’s announcement as an out of court restructuring and a positive for YRC Worldwide’s long term viability, at the expense of current shareholders,” said Lee Klaskow, vice president and senior transportation and logistics analyst at Longbow Research.

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