Capital structure risk

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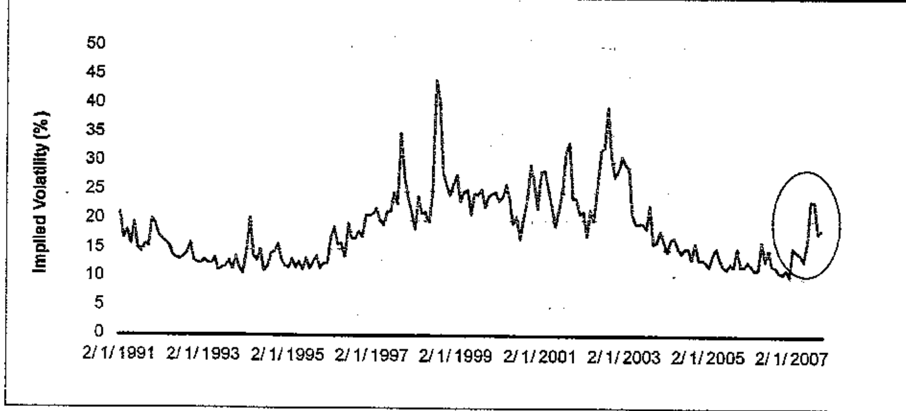
Date: December 2007

Outline

- The relative price of risk has spiked
- Debt has become relatively more expensive for high-yield companies
- Investment-grade companies may create value by levering up
- High-yield companies may create value by delevering
- Issuing long-term debt seem a good bet
- Opportunistic hedging of major currencies may create value
- Emerging markets are booming
- Emerging markets offer high return for high volatility

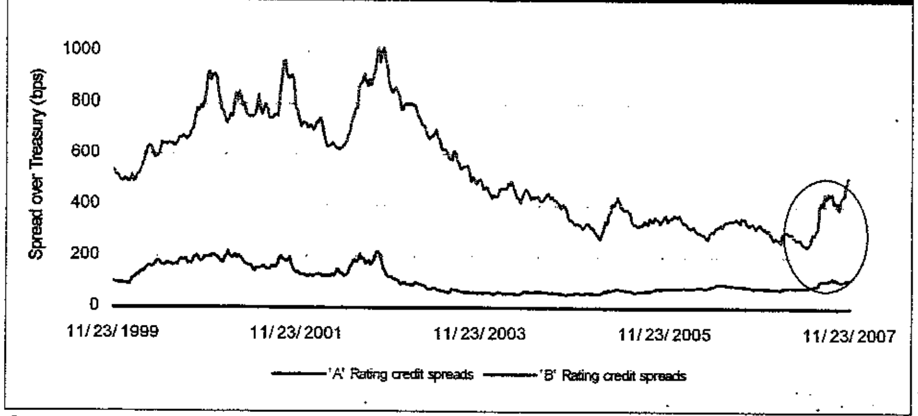
The relative price of risk has spiked

VIX: Equity option implied volatility



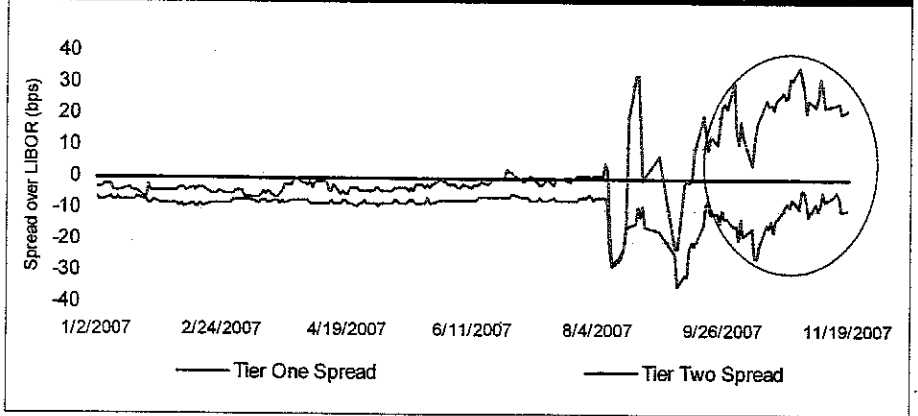
Source: Bloomberg as of November 2007

Credit spreads



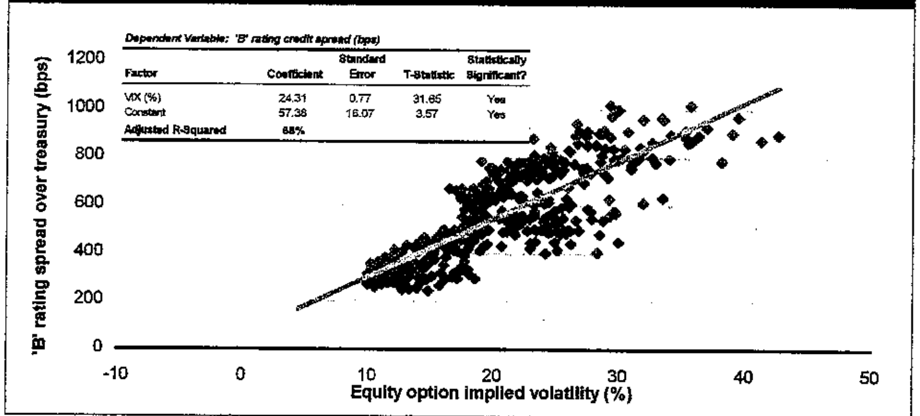
Source: CS as of November 2007

CP spreads to LIBOR



Source: Bloomberg as of November 2007

High yield trades like equity, Jan '99 – Nov '07



Dependent Variable: 'B' rating credit spread (bps)

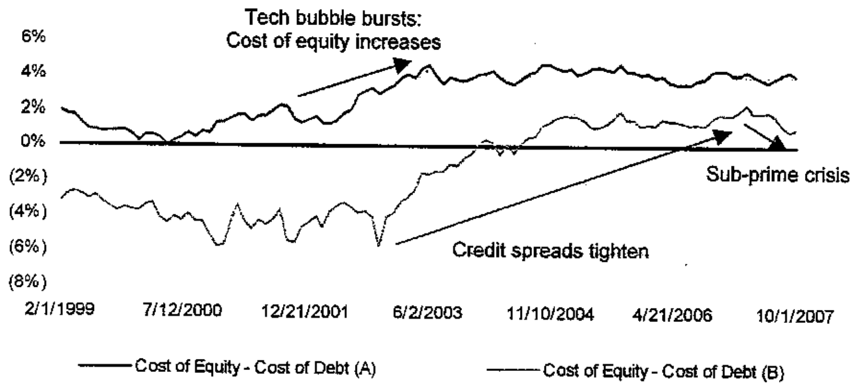
Factor	Coefficient	Standard Error	T-Statistic	Statistically Significant?
VIX (%)	24.31	0.77	31.65	Yes
Constant	57.38	16.07	3.57	Yes
Adjusted R-Squared	88%			

Source: Bloomberg, CS as of November 2007
Note: Regression based on weekly data from January 1999 to November 2007

Both the absolute and relative price of risk have spiked recently, and risk management has become more asset class specific

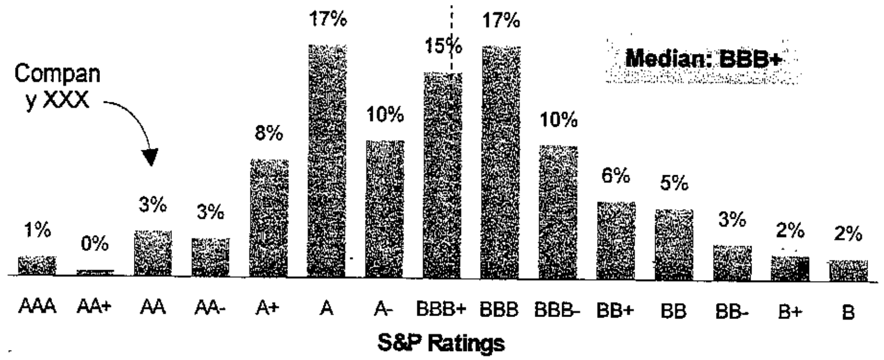
High-grade companies may create value by levering up

Cost of debt vs. cost of equity



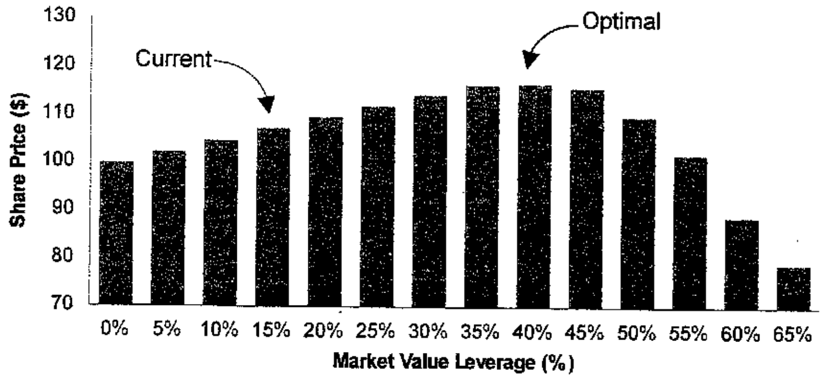
Source: Federal Reserve, Factset, Credit Suisse's LUCI and HYII indices, and Credit Suisse assumptions

S&P 500 ratings distribution, Nov '07



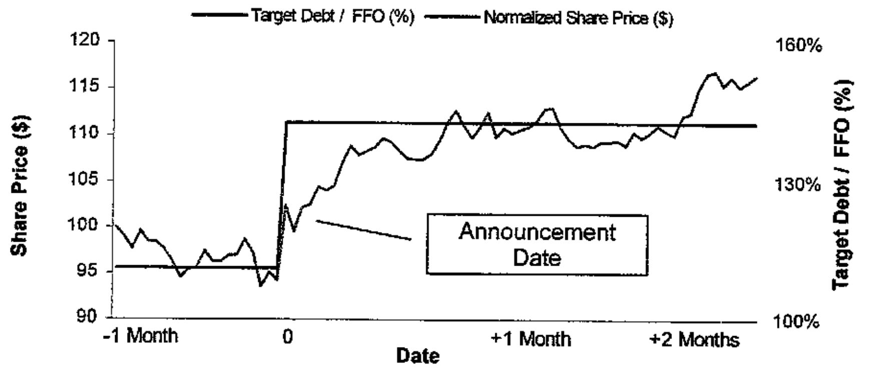
Source: Bloomberg as of November 2007

Normalized share price vs. leverage



Source: Credit Suisse estimate

Market reaction to levering up

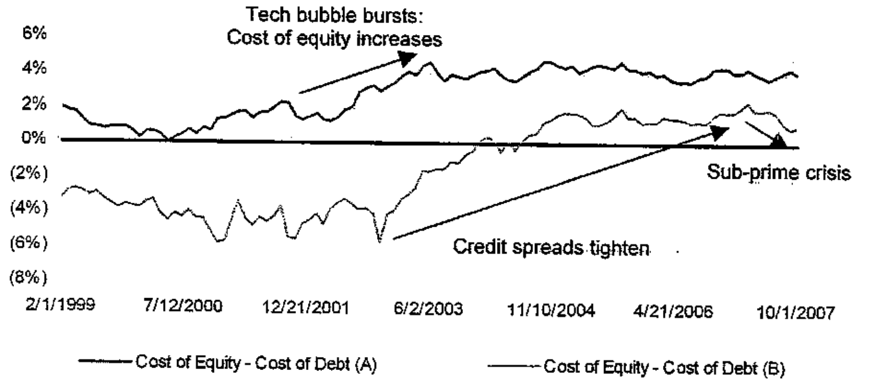


Source: Credit Suisse estimate

By increasing market value leverage from 15% to 40%, high-grade companies may increase their stock price by around 10%. Share buybacks and debt issuances may be used jointly to increase leverage

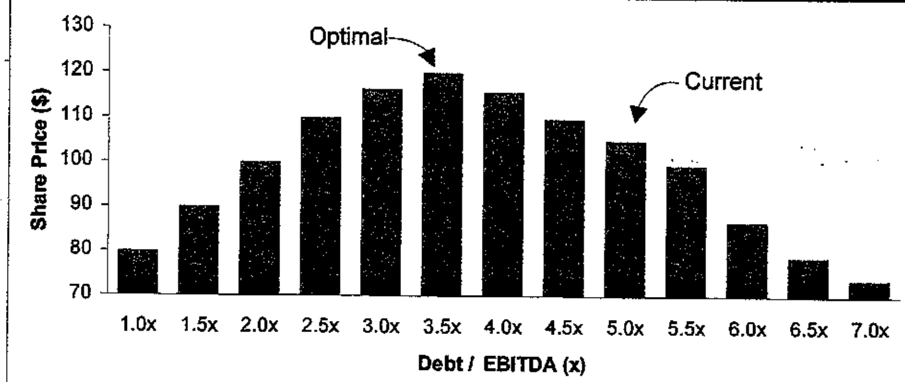
High-yield companies may create value by delevering

Cost of equity vs. cost of debt



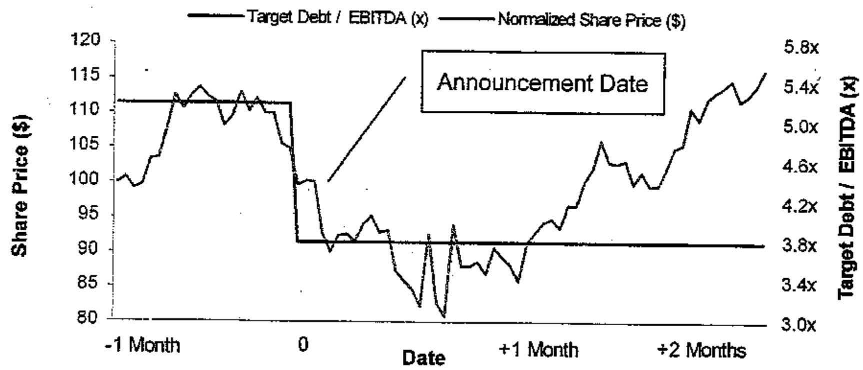
Source: Federal Reserve, Factset, Credit Suisse's LUCI and HYII indices, and Credit Suisse assumptions

Normalized share price vs. leverage



Source: Bloomberg

Market reaction to delevering



Source: Bloomberg

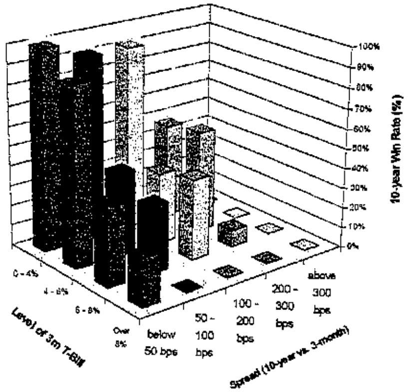
Issuing converts

- In a volatile stock market environment, issuing converts may be preferred to issuing equity
- Converts mitigate pricing uncertainty because spread uncertainty is offset by volatility uncertainty
- Converts represent regret minimizing strategies

High-yield companies may increase their share price by as much as 30% and improve their credit rating by as much as three notches by issuing equity to buyback debt. Converts may be the most appropriate financing strategy when stock valuations are uncertain and debt markets are tight

Issuing long-term debt seems a good bet

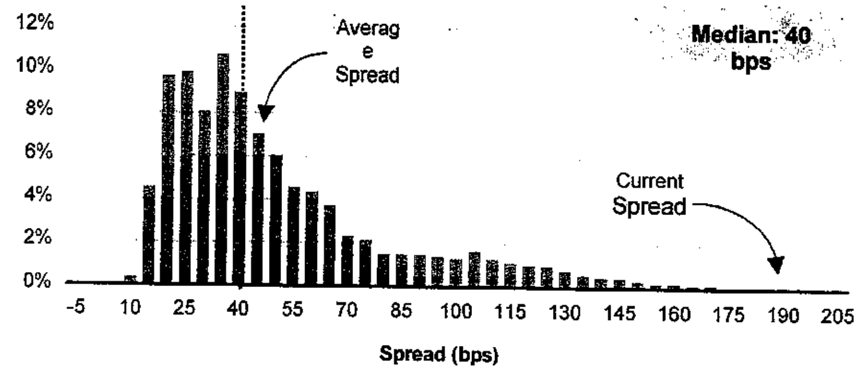
Win rate: 10 years vs. 3 months, Jan '60 - Nov '07



USD Data as of 12/3/2007	
10-year Treasury	3.85%
10-year TIPS	1.54%
Implied inflation	2.31%

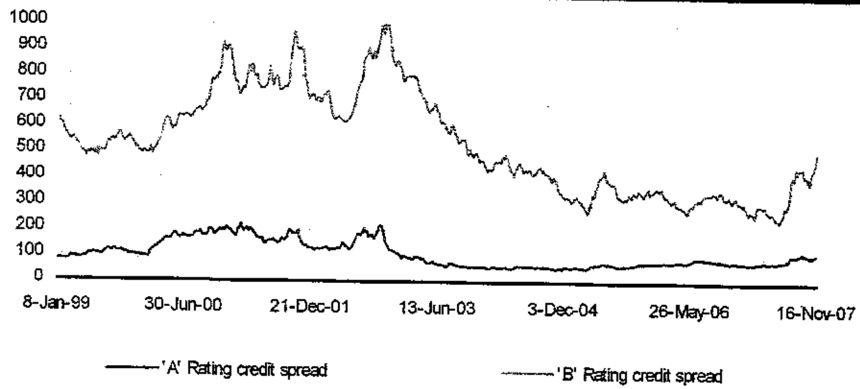
Source: Federal Reserve and IMF

3-month LIBOR vs. US Treasury, Feb '87 – Dec '07



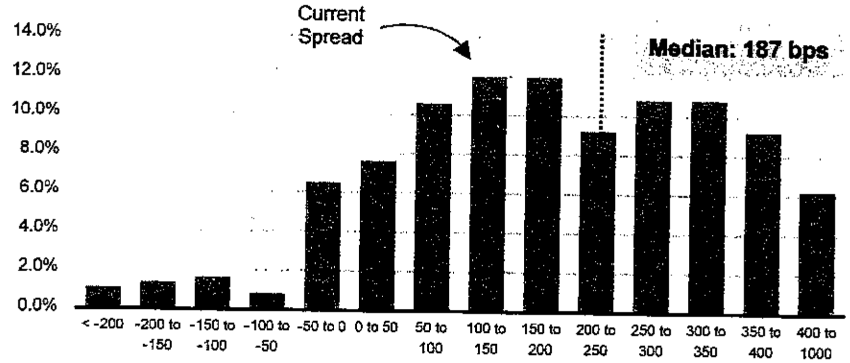
Source: Federal Reserve, Bloomberg, and Credit Suisse estimates as of October 2007. Data are monthly from February 1986

Credit and treasury spreads, Jan '99 – Dec '07



Source: Bloomberg, 7-10 year maturity benchmark spreads as per Credit Suisse LUCI and HYII indices as of November 2007

Term spreads: 30-year vs. 3-month, Feb '97 - Oct '07



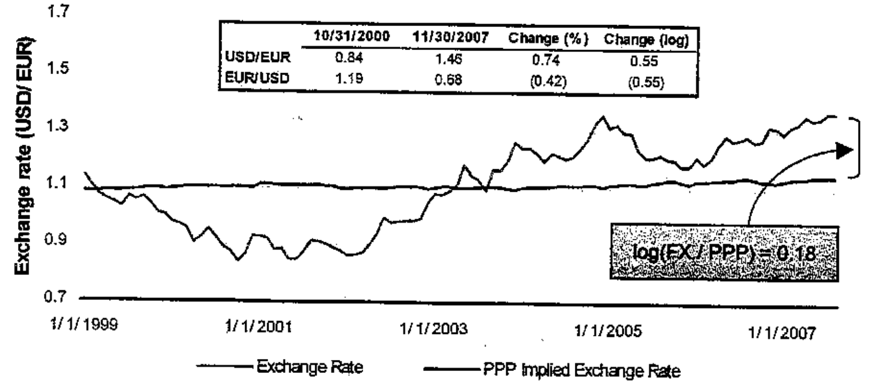
Source: Federal Reserve data as of October 2007. Data are monthly from February 1977

Note: Term spreads are calculated as the difference between the longer maturity instrument yield and the shorter maturity instrument yield

Issuing 30 year bonds or fixing floating rate exposures seem to make statistical and macroeconomic sense

Opportunistic hedging of major currencies may create value

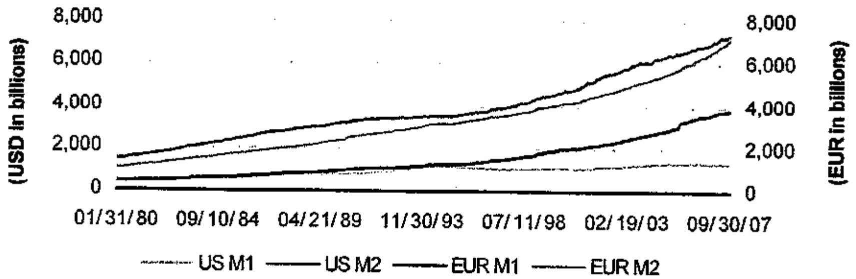
Purchasing power parity: USD / EUR



	10/31/2000	11/30/2007	Change (%)	Change (log)
USD/EUR	0.84	1.46	0.74	0.55
EUR/USD	1.19	0.68	(0.42)	(0.55)

Source: IMF. PPP reflects the initial exchange rate multiplied by the relative price levels

Money supply for USD and EUR



	2003 - 2006 M2	Real GDP	Based on M2	Actual inflation Based on CPI	Nominal	10-year rate of return Based on CPI	Based on TIPS
USD	5.07%	3.19%	1.82%	3.10%	4.39%	1.25%	2.01%
EUR	8.20%	2.03%	6.04%	2.17%	3.81%	1.60%	1.71%

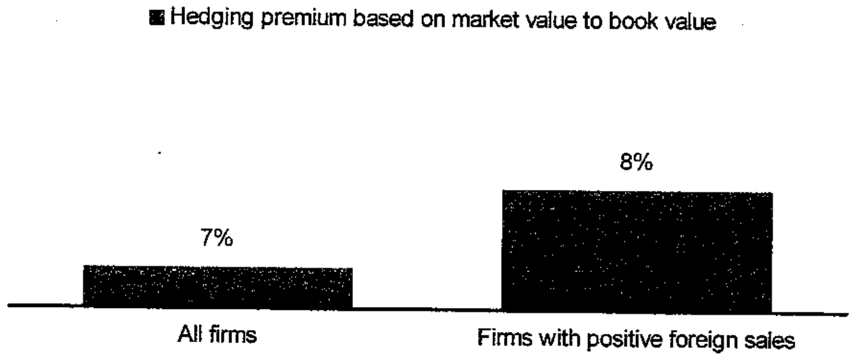
Source: Federal Reserve, European Central Bank

Forex hedging strategies

- Issuing most debt in foreign currencies mitigates EPS risk
- Issuing debt proportional to assets mitigates leverage ratio risk

Source: Federal Reserve, European Central Bank

The value of hedging

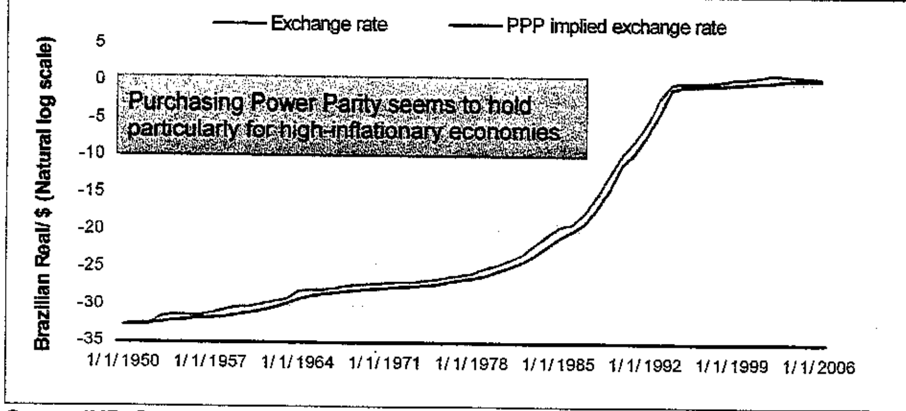


Source: Allayannis and Weston: *"The Use of Foreign Currency Derivatives and Firm Market Value"*
(1) Market value and book value defined as the sum of debt and equity

The dollar may be undervalued relative to PPP. As such, opportunistic hedging may create value

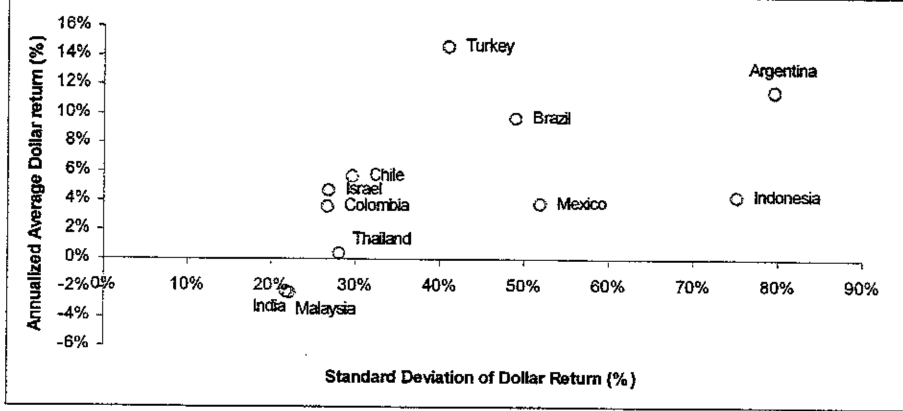
Emerging markets offer high returns for high volatility

PPP: empirical evidence from Brazil



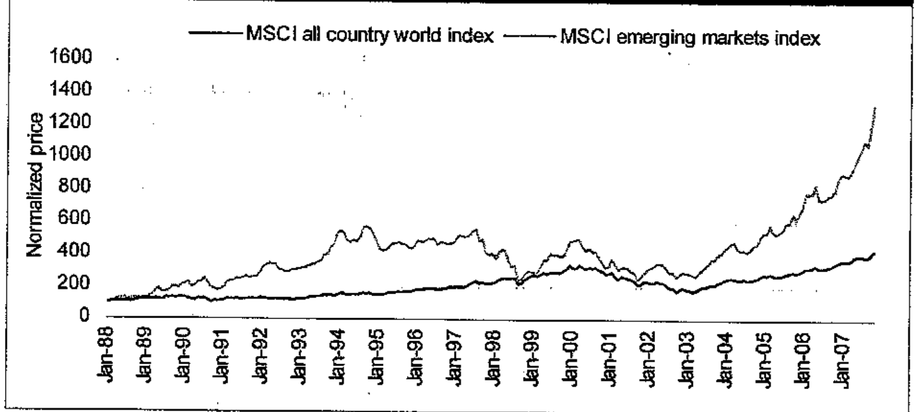
Source: IMF. PPP reflects the initial exchange rate multiplied by the relative price levels

Borrowing $, investing in emergings



Source: Bloomberg

Emerging markets are booming



Source: Bloomberg

Though emerging markets typically have high cost of funds, opportunistic hedging in such markets may prove profitable