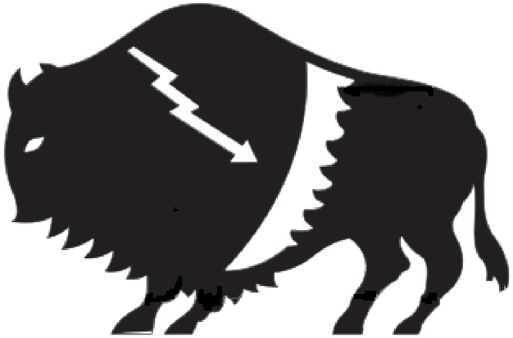
Moody's Analytics

Cash Flow and Liquidity



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Cash flow and liquidity

Meet your Instructor…

Andrew Holmes

- Director, Leveraged Finance, Credit Suisse First Boston, New York and London
- Equity capital markets and Leveraged Finance, JP Morgan, New York
- MBA from University of Chicago
- 5 years in asset management

Moody's Corporation

MOODY'S

MOODY'S INVESTORS SERVICE

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  - Corporate
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Session 1

Cash Flow Analysis

Cash Flow Concepts: EBITDA

Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA)

- What assumptions are implicit in using EBITDA as a proxy for operating cash flow?
- What does the leverage measure Debt / EBITDA indicate?
- What is the commonly accepted industry definition of Free Cash Flow?

Why is adjusted EBITDA always higher than EBITDA?

Adjusted EBITDA is calculated as follows (unaudited):

	Year Ended December 31, 2011		2010		2009		2008		2007	
	(In thousands)									
Net income (loss)	$	(115,489)	$	(48,026)	$	127,243	$	142,728	$	(102,147)
Depreciation, depletion and amortization		186,348		188,074		205,339		125,356		85,640
Sales contract accretion, net[1]		(55,020)		(121,475)		(298,572)		(249,522)		—
Asset retirement obligation expense		81,586		63,034		35,116		19,260		20,144
Restructuring and impairment charge		13,657		15,174		20,157		—		—
Interest expense and other		65,533		57,419		38,108		23,648		8,337
Interest income		(246)		(12,831)		(16,646)		(17,232)		(11,543)
Income tax provision		372		492		—		—		—
Adjusted EBITDA	$	176,741	$	141,861	$	110,745	$	44,238	$	431

(1) Net sales contract accretion resulted from the below market coal sales and purchase contracts acquired in the Magnum acquisition that were recorded at fair value in purchase accounting. The net liability generated from applying fair value to these contracts is being accreted over the life of the contracts as the coal is shipped.

EBITDA (Moody's Definition)

Interest → Gross Interest Expense per Income

EBIT → Pretax Income + Interest + Non-Recurring Expenses/(Gains)

1) Equity accounted entities' income may be included if integral to operations and backed by cash distributions
2) For Japanese GAAP reporters, equity accounted entities' income is included in reported EBIT but excluded from adjusted EBIT.
3) US GAAP reporters' minority interests should be excluded from adjusted EBIT.

EBITDA → EBIT + Depreciation + Amortization of Intangibles

PATRIOT COAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2011	2010	2009
	(Dollars in thousands)		
Cash Flows From Operating Activities			
Net income (loss)	$ (115,489)	$ (48,026)	$ 127,243
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation, depletion and amortization	186,348	188,074	205,339
Amortization of deferred financing costs	7,356	6,412	3,700
Amortization of debt discount	9,543	8,710	7,864
Sales contract accretion	(55,020)	(121,475)	(298,572)
Impairment charge	13,093	2,823	12,949
Selenium-related asset write-offs	5,369	—	—
Loss on early payment of note receivable	5,868	—	—
Net gain on disposal or exchange of assets	(35,557)	(48,226)	(7,215)
Income from equity affiliates	(4,709)	(9,476)	(398)
Distributions from equity affiliates	3,219	5,095	1,000
Stock-based compensation expense	13,779	11,657	13,852
Changes in current assets and liabilities:			
Accounts receivable	(22,336)	(59)	(3,565)
Inventories	(393)	(16,785)	(6,530)
Other current assets	(1,161)	(15,172)	903
Accounts payable and accrued expenses	22,125	(24,258)	(38,867)
Interest on notes receivable	—	(12,652)	(14,030)
Asset retirement obligations	52,042	38,719	14,988
Workers' compensation obligations	8,580	12,343	4,470
Accrued postretirement benefit costs	58,871	50,944	26,248
Obligation to industry fund	(3,278)	(2,769)	(3,019)
Federal black lung collateralization	(14,990)	—	—
Other, net	(8,523)	10,432	(6,749)
Net cash provided by operating activities	124,737	36,311	39,611

Don't forget capital expenditures...

PATRIOT COAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2011	**2010**	**2009**
Cash Flows From Investing Activities	(Dollars in thousands)		
Additions to property, plant, equipment and mine development	(174,713)	(122,989)	(78,263)
Proceeds from notes receivable	115,679	33,100	11,000
Additions to advance mining royalties	(26,030)	(21,510)	(16,997)
Net cash paid in litigation settlement and asset acquisition	(14,787)	—	—
Proceeds from disposal or exchange of assets	6,928	1,766	5,513
Other	—	(300)	1,154
Net cash used in investing activities	(92,923)	(109,933)	(77,593)

EBITDA versus cash flow – a final result

MOODY'S
INVESTORS SERVICE

Rating Action: Moody's Lowers Patriot's Probability of Default Rating to D

Global Credit Research - 10 Jul 2012

Approximately $250 million of rated debt affected

New York, July 10, 2012 -- Moody's Investors Service lowered Patriot Coal's (Patriot) Probability of Default Rating to D from Caa1 and the corporate family rating to Ca from Caa1. The downgrades were prompted by the company's July 9, 2012 announcement that it voluntarily filed for relief under Chapter 11 of the United States Bankruptcy Code. Moody's took the following rating actions and intends to withdraw all ratings:

Downgrades:

..Issuer: Patriot Coal Corporation

.... Probability of Default Rating, Downgraded to D from Caa1

.... Corporate Family Rating, Downgraded to Ca from Caa1

....Senior Unsecured Regular Bond/Debenture, Downgraded to C, LGD5, 71% from Caa2, LGD4, 60%

Definitions – Free Cash Flow

Revenues *minus*

Cost of Goods sold *equals*

Gross Profit *minus*

Sales, General & Administration *equals*

Earnings before Interest & Tax *plus*

Depreciation & Amortisation *equals*

EBITDA *minus*

Taxes *minus*

CAPEX (including change in w/c) *equals*

Free Cash Flow *to the firm (and its providers of capital)*

Moody’s Cash Flow Concepts

Three Levels of Cash Flow

1. Operating Cash Flow
- before Δ w/c* → “FFO”
- after Δ w/c* → “CFO”

Less Dividends =

2. Retained Cash Flow
- before Δ w/c* → Standard Definition
- after Δ w/c*

Less CAPEX =

3. Free Cash Flow
- before Δ w/c*
- after Δ w/c* → Standard Definition

* *Working capital and other items not directly related to ongoing operations (e.g. pension and OPEB contributions)*

Key Moody's Cash Flow Concepts

CASH FLOW STATEMENT

OPERATING ACTIVITIES

Net Income

+ **Depreciation & Amortization**
+/- **Deferred Income Taxes**
+/- **Minority Interest**
+/- **Undistributed Equity Earnings**
+/- **Other Non-Cash Items**
+/- **Other Operating Cash Flow**
+/- **Discontinued Operations**

= ***FUNDS FROM OPERATIONS***

+/- **Changes in Working Capital Items**
+/- **Changes in Operating Assets & Liabilities - ST**
+/- **Changes in Other Oper. Assets & Liabilities - LT**

= ***CASH FLOW FROM OPERATIONS***

+/- **Unusual & Non-Recurring Items - Cash Flow Adjs**

= ***CASH FLOW FROM OPER After Unusual & Non-Recur Adjs***

Source: Moody's Financial Metrics, Chart of Accounts, www.moodys.com/MFM, March 2007

Key Moody's Cash Flow Concepts

RETAINED CASH FLOW

Funds from Operations

- \- Preferred Dividends
- \- Common Dividends
- \- Minority Dividends
- = ***RETAINED CASH FLOW***

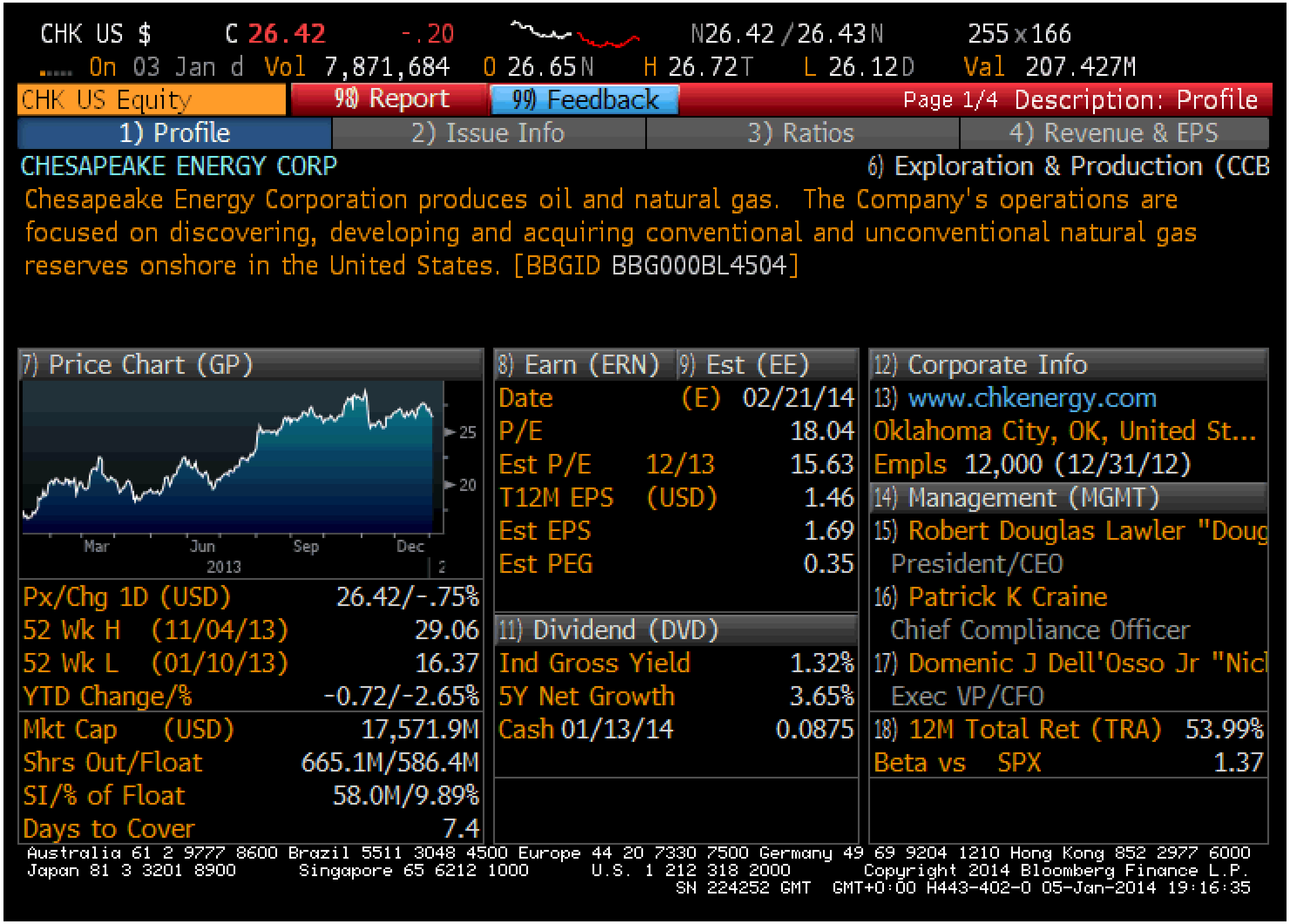
FREE CASH FLOW

Cash Flow from Operations

- \- CAPEX (= gross additions to PP&E)
- \- Preferred Dividends
- \- Common Dividends
- \- Minority Dividends
- = ***FREE CASH FLOW***

Source: Moody's Financial Metrics, www.moodys.com/MFM, March 2007

A market overview of Chesapeake Energy



Treading water for 5 years

But what's really driving the price?

Case Exercise

Cash Flow Concepts

Calculate EBITDA, CFO, FFO, RCF, and FCF

Session 2

Liquidity Analysis and Refinancing Risk

Debt Service Capacity

Operational Cash Drivers

P A C

$$\frac{\text{Operational Cash Flow}}{\text{Financial Charges (Tank)}}$$

E D

Financial Cash Drivers

TOOLS E12 and E13

Overview of Debt Service Capacity

Debt service capacity is an assessment of whether the sustainability and stability of cash flows are sufficient to service a client's financing charges.

It reflects the Company's ability to generate normal / sustainable cash flow to meet:

- ✓ cost of debt
- ✓ scheduled repayments (short term debt assumed refinanceable)
- ✓ Cost of Equity ?

A DSCR of less than 1 means **negative cash flow and liquidity need**

Financial Charges ("Tank")

Gross Interest

Capitalized interest (tangible fixed assets note)

Bank fees & charges (?)

Operating lease payment (P&L)

CPLTD & financial lease OBS (previous year B/S)

Dividends/drawings

Debt Service Capacity

» What is the size of the "Tank" (financial charges) this year and next year?

» Is the "Tank" impacted by debt maturity profile or dividend payments?

» How much does the "normal" operating cash flow cover the "Tank"?

» What level of operating cash flow should we use? Before or after ACC (WC) and Capex?

» What is the quality/sustainability of the operating cash flow? Check volatility caused by business risk and asset conversion cycle.

TOOL E14

Debt Service and Liquidity Ratios

Cash Flow Interest Coverage

» Measure of cash flow / Interest, Measure of cash flow / Interest and leases.

Debt Service Capacity.

» Measure of cash flow / Financial charges.

Liquidity Internal

» Unrestricted cash on the Balance Sheet

Liquidity External

» Analysis of undrawn (committed?) bank lines / assessment of access to equity

Moody's Liquidity Assessments

- Investment grade companies
- Commercial paper ratings (short term)
- Specific measures versus cash usage over the next 12 months
  - Cash and marketable securities
  - Cash flow
  - Committed and undrawn facilities
    - Covenant levels
  - Commercial paper programs
    - Backstop facilities
  - Other facilities (e.g. uncommitted lines)

Moody's SGL Ratings

SGL-1	SGL-2	SGL-3	SGL-4
At all time over the next four quarters, SGL-1 issuers can comfortably cover all cash requirements from internal sources, including seasonal working capital needs, maintenance capital spending, and extraordinary capital spending (with the exception of retailers and some distributors; see "vendor financing below").*	For a projected 12 month period, but not necessarily at all times (not all interim quarterly periods), SGL-2 issuers can likely cover all cash requirements from internal sources except for extraordinary capital spending and seasonal working capital needs.	Over the next four quarters, it is unclear if SGL-3 issuers can cover all basic cash requirements for internal sources. Basic cash requirements would include maintenance capital spending, as well as other items.	Issuers rated SGL-4 are not likely to be able to meet basic cash requirements through internal sources, and are likely to need external financing to remain liquid.

* *Vendor financing Approach: For retailers and some distributors with large seasonal working capital needs we have made "operational" assumptions of confidence and assume that "normal" vendor financing terms will be available.*

Are markets like teenagers?

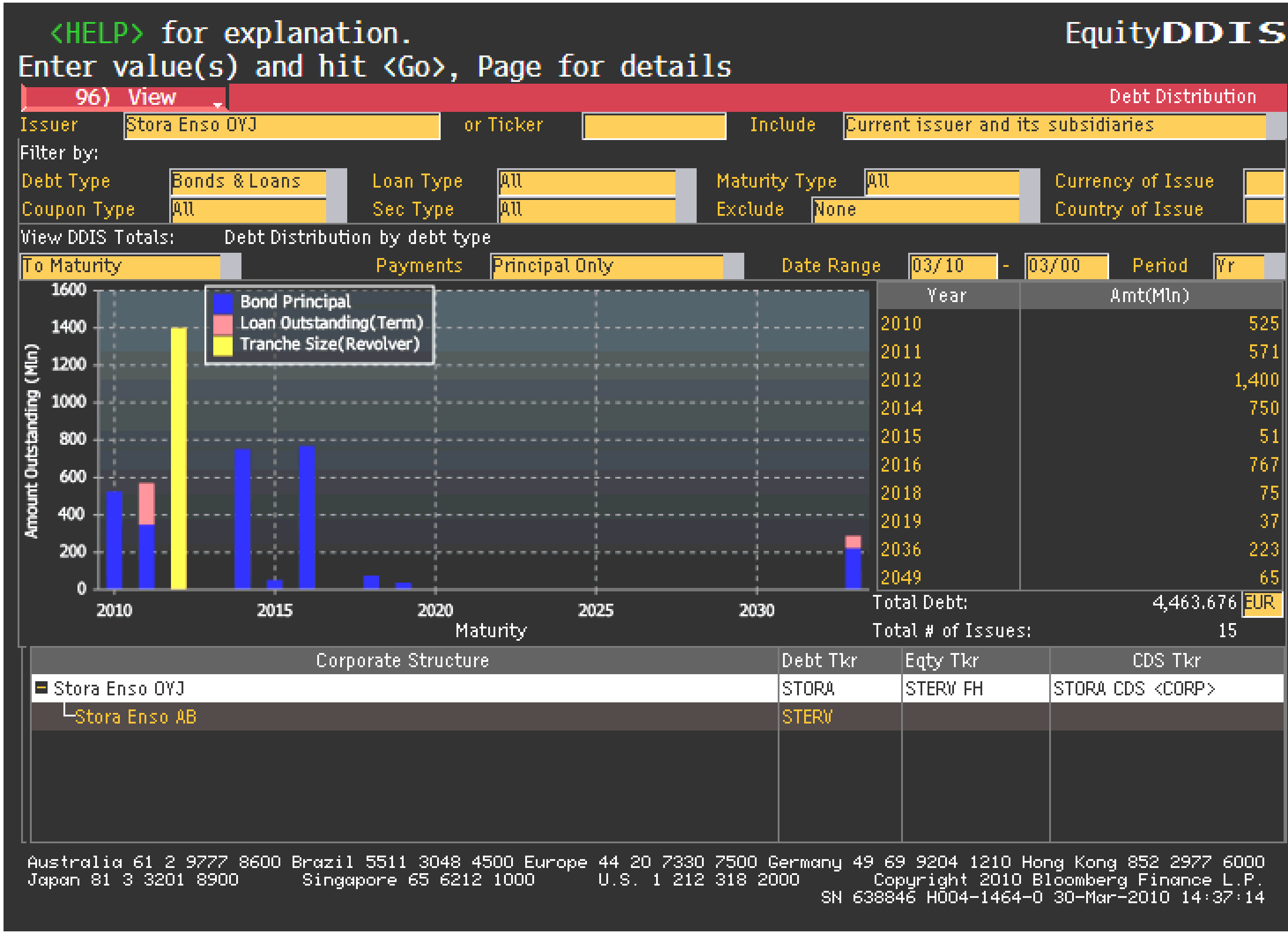
Seeing the issue

Key issues

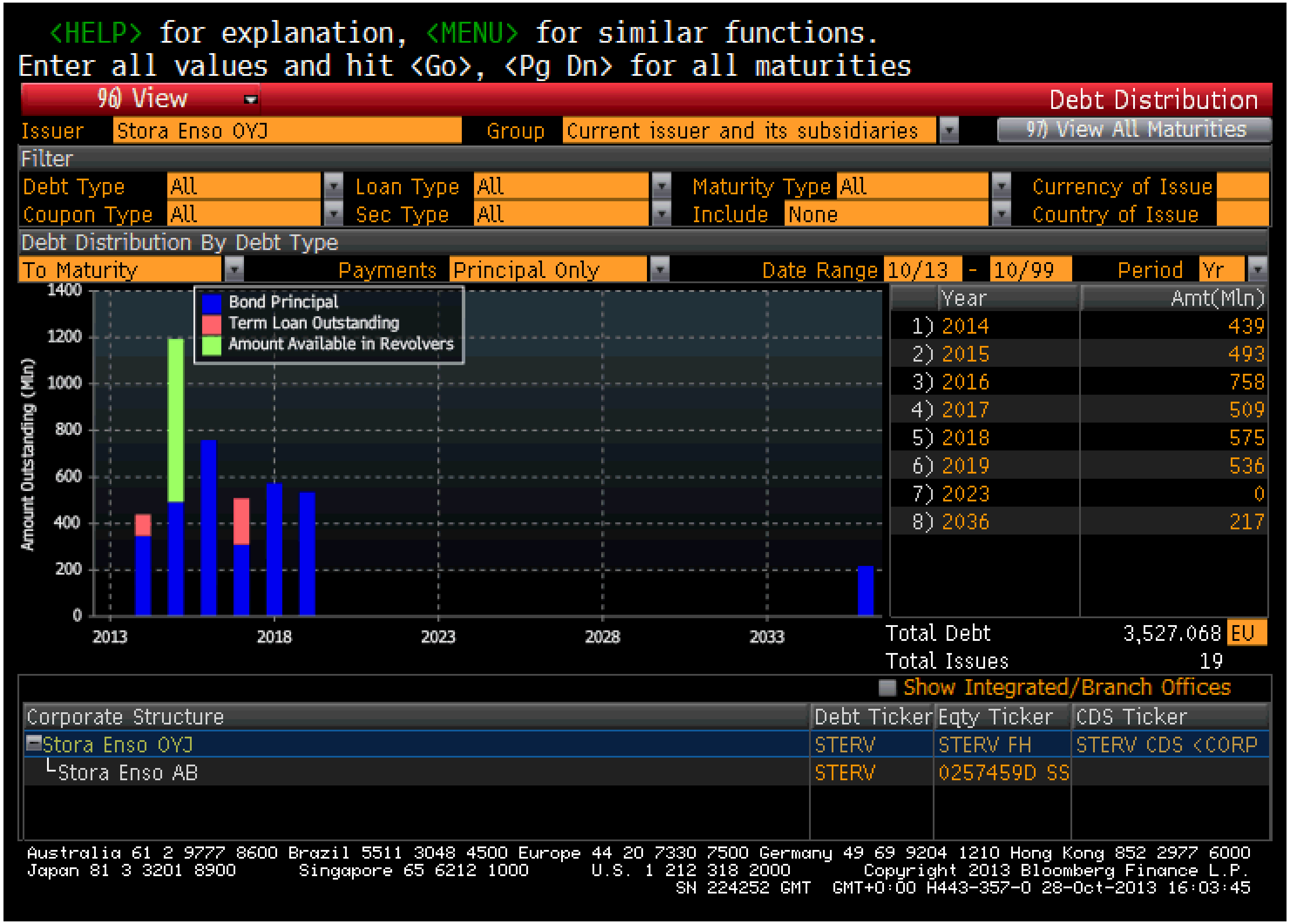
» Refinancing

» M&A

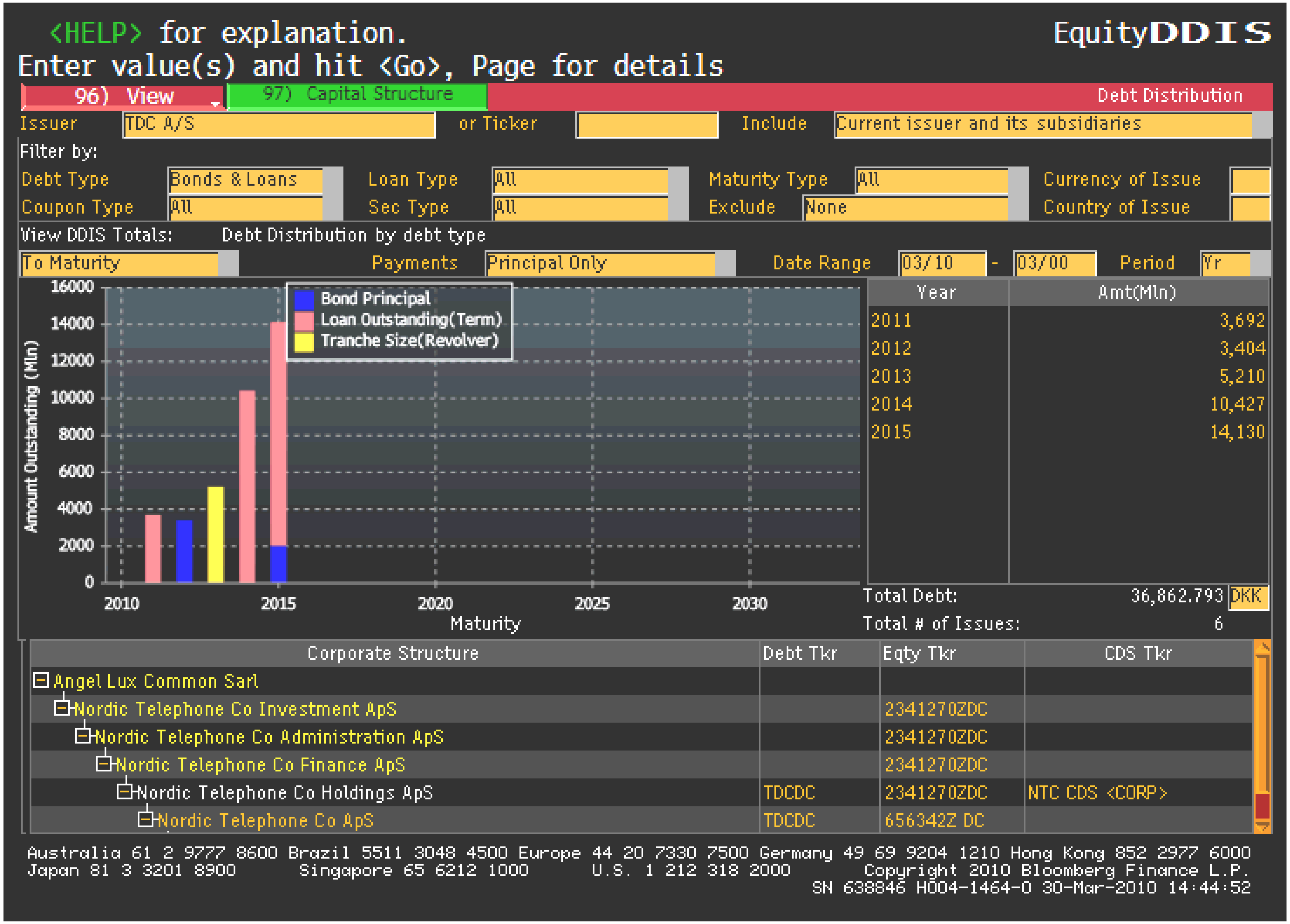
» Market Sentiment



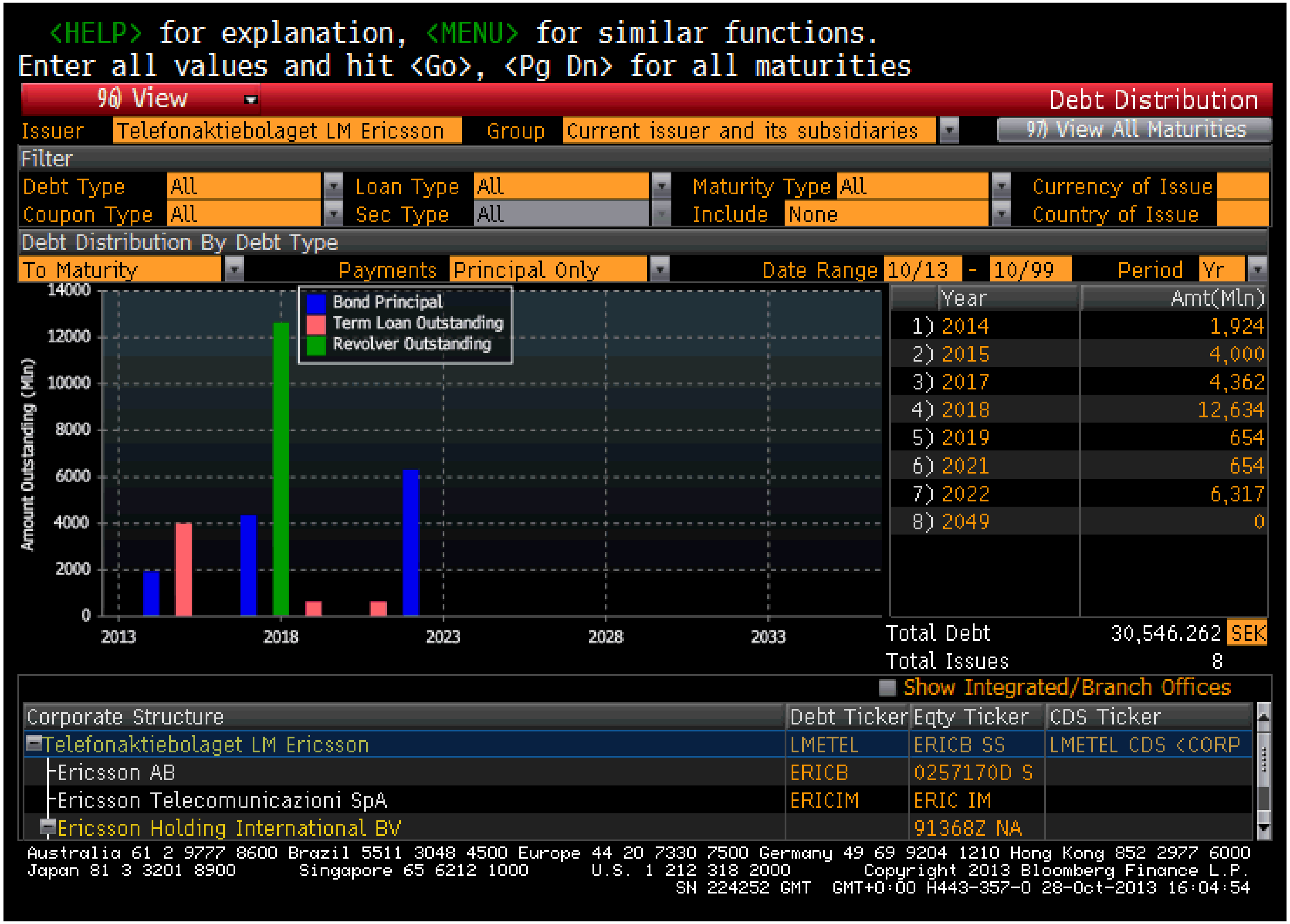
Better - maybe



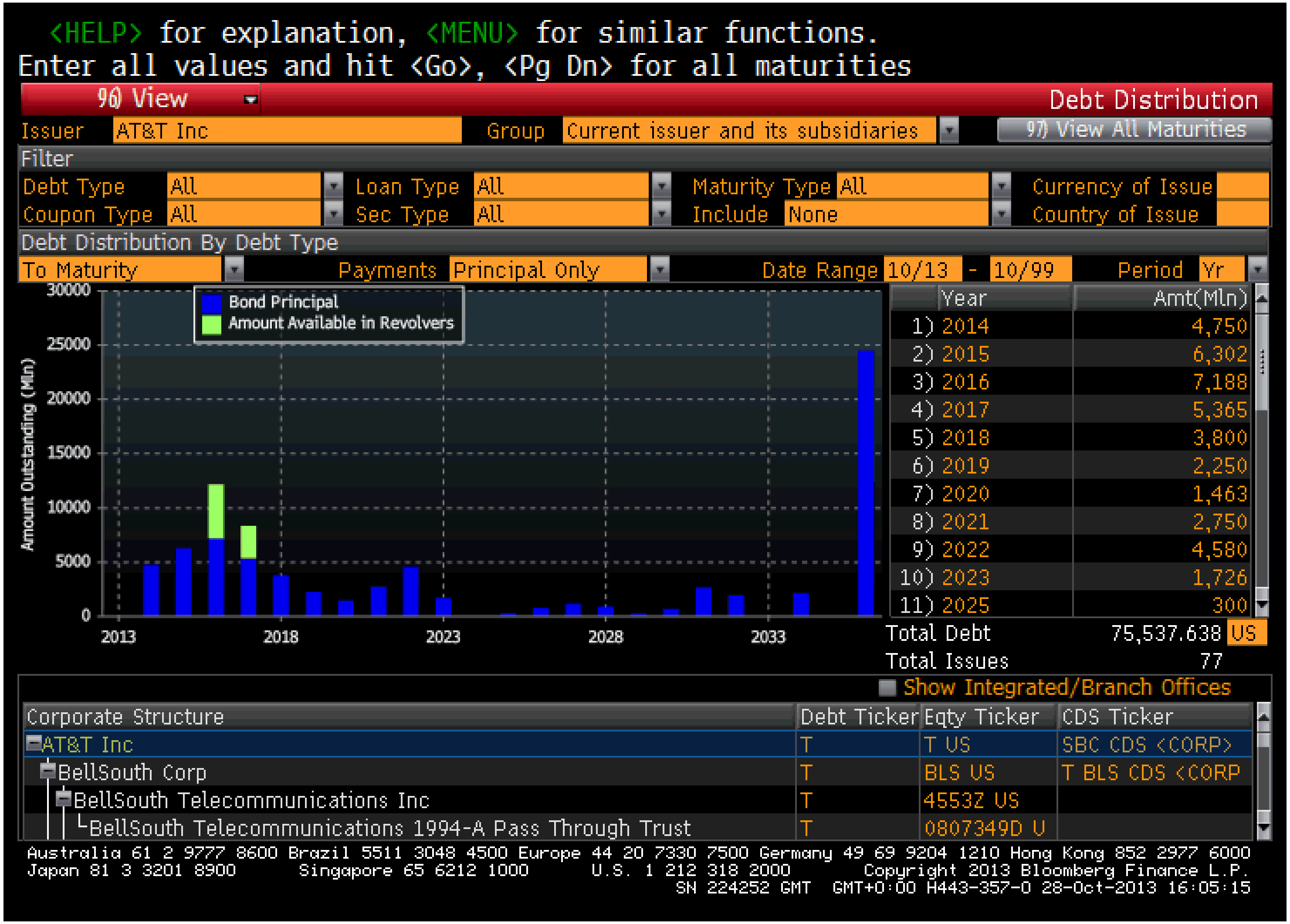
Part of the leveraged 'tsunami'?



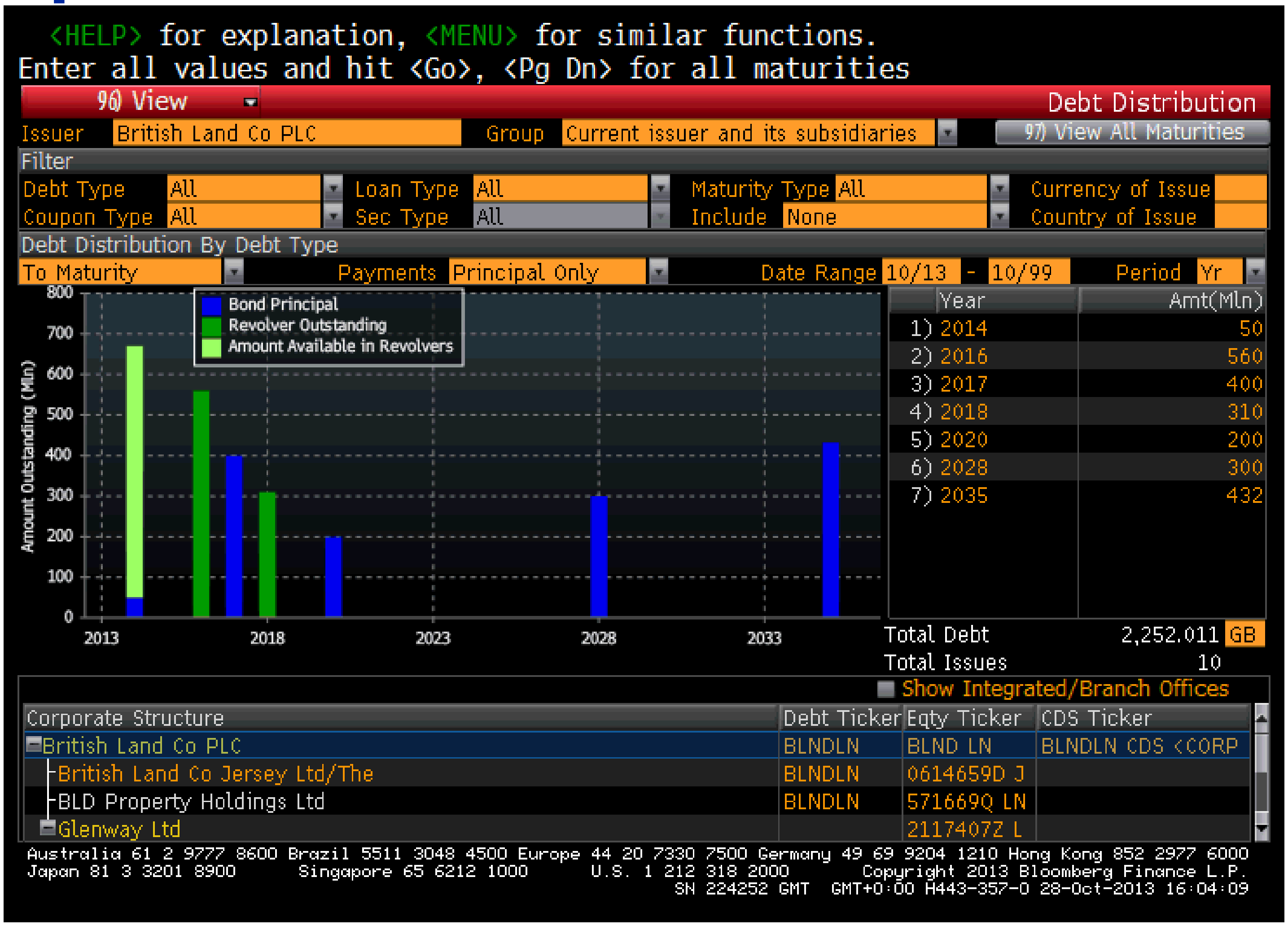
Ericsson learned Its lesson from 2001/2



AT&T’s structure is like a utility



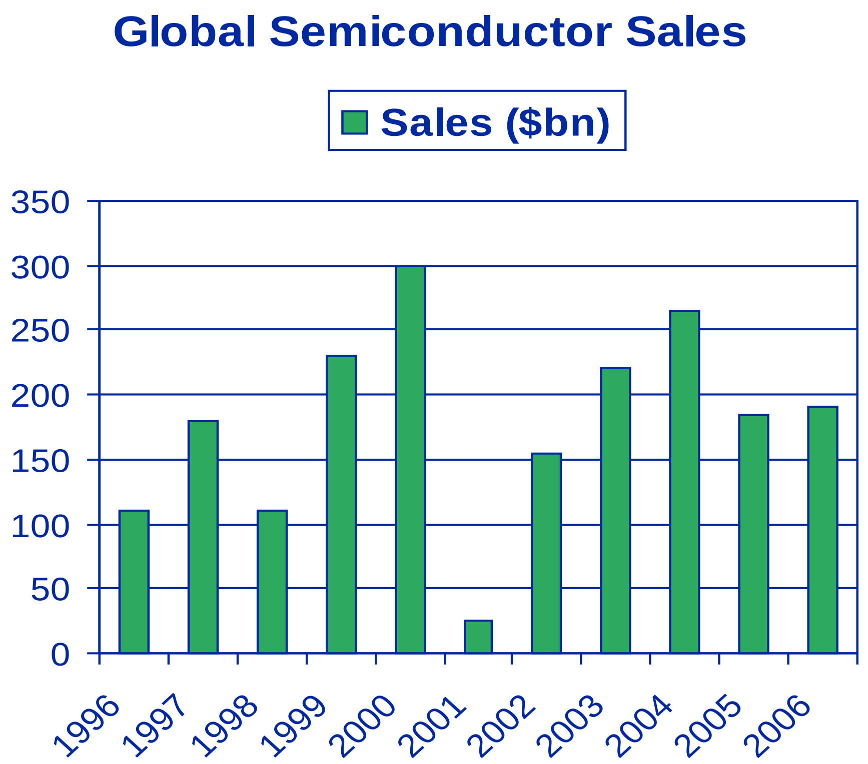
British Land – financing property companies



How to spot the top of the market?

The tech LBOs of 2006

- Freescale Semiconductor was LBO'd in Q4 2006
  - Ex-Motorola business
  - Raised almost $6bn in high yield bonds
  - Including 'toggle' bonds
- Philips Semiconductors (now NXP) was taken private by a consortium headed by KKR in early 2006
  - One of the largest European LBOs ever



Source: SIA

Risky LBO, 'low risk' capital structure

NXP's Capital Structure

Tranches	Maturity/call	Rating
$1.5bn Senior secured FRN @ L+275	7 non-call life	Ba2/BB+
€1.0bn Senior secured FRN @ L+275	7 non-call life	Ba2/BB+
$1.0bn Senior secured bonds @ 7.875%	8 non-call 4	Ba2/BB+
$1.25bn Senior* unsecured bonds @ 9.5%	9 non-call 5	B2/B
€525mm Senior* unsec. bonds @ 8.625%	9 non-call 5	B2/B

Plus a €500mm unfunded, super senior, covenant light (bond indenture) revolver

* Subordinated really

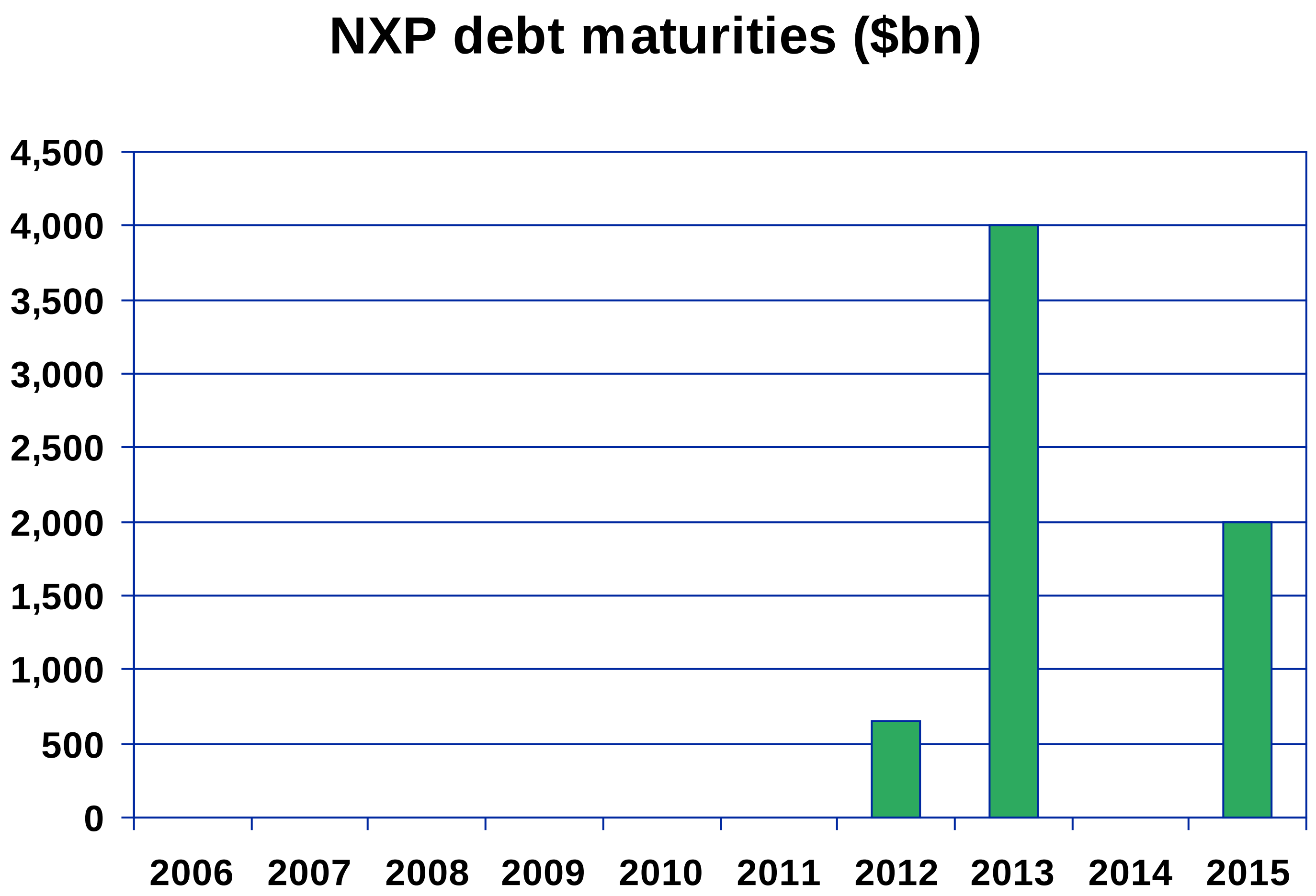
Leverage

Gross: 4.3x

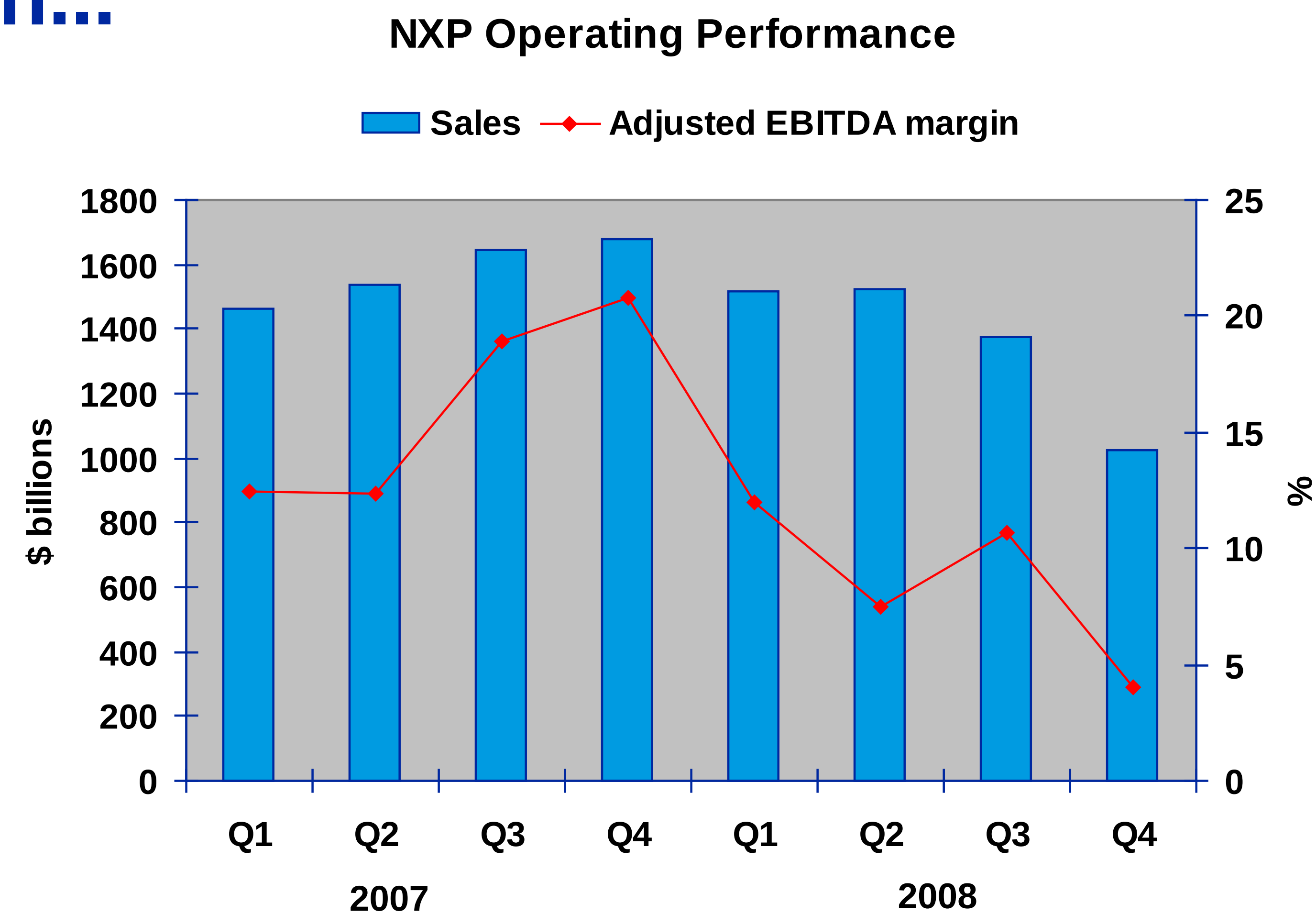
Net: 3.5X

Equity: 44% (24% from sponsors)

NXP's capital structure by maturity

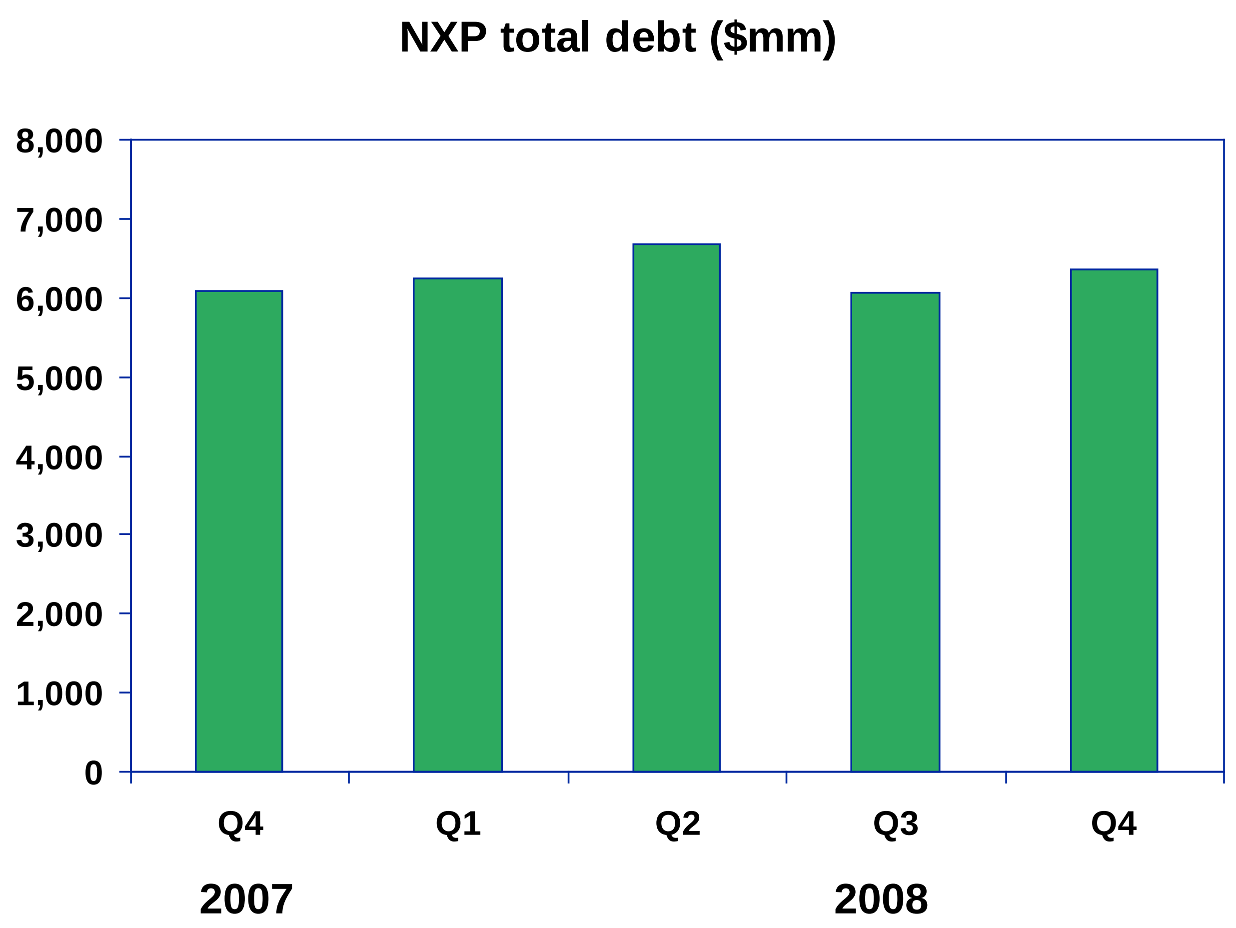


Things did not however go according to plan...



Source: company filings

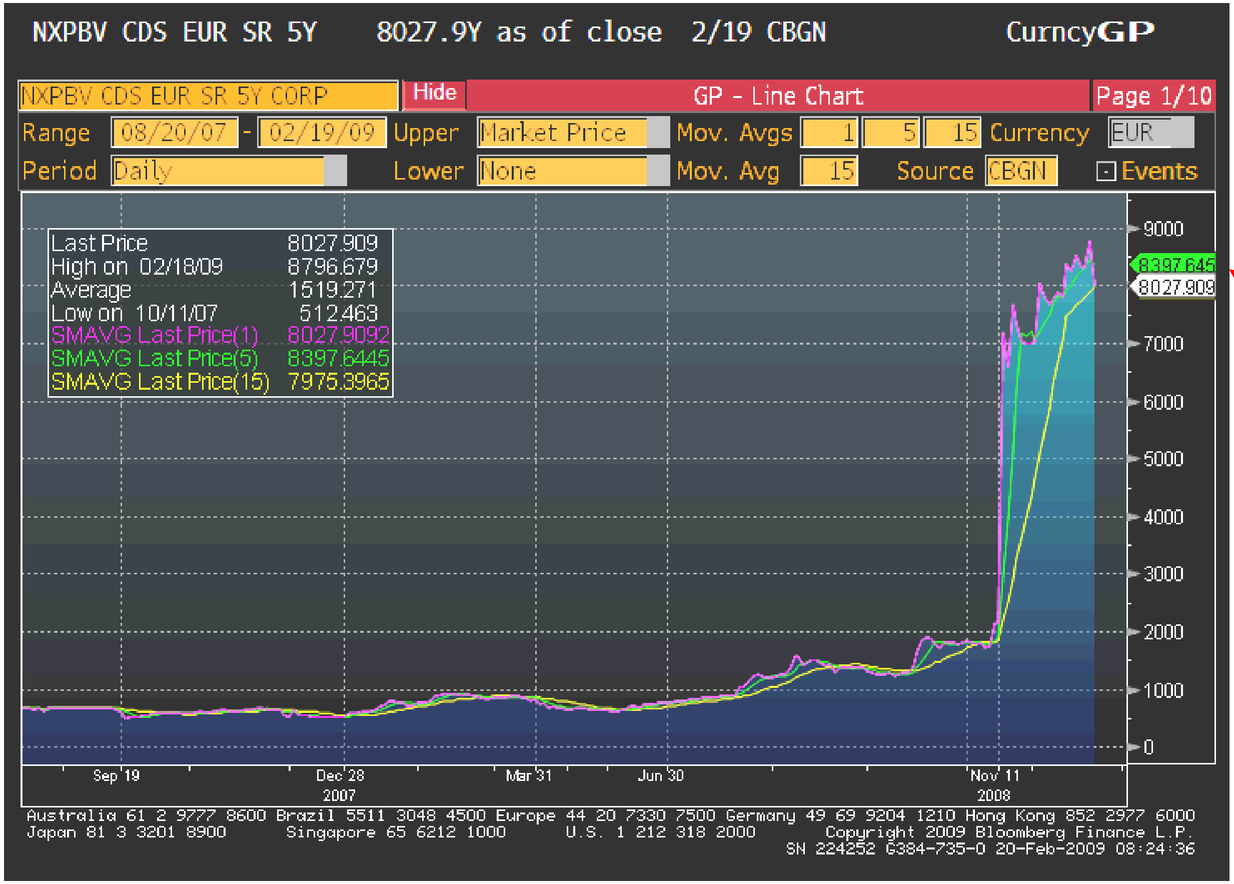
...debt repayment was non-existent...



...and the outlook was bleak

- Economic conditions deteriorated significantly in Q3 2008
  - Automotive and consumer sectors hit first
  - Downturn broadened in Q4
  - Capacity utilization fell to 56%
- Outlook sufficiently unclear that NXP withdrew 2009 guidance
  - Q1 2009 sales expected to be down 30-40% based on order book and customer sentiment
- Company accelerating its restructuring program
  - Savings of $550 million expected by mid-2010
  - Cash cost of $700 million
- What, realistically, are the lenders' options?
  - 2008 adjusted EBITDA of $485m

The market's view was decidedly pessimistic



About 10¢ for the sub. bonds – roughly the next coupon...

» Capitulation – the market is now expecting a restructuring

A happy ending – but only for some

Thank You!

For more information, please contact us

This Seminar

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