

CDO Asset Managers  
Ireland  
CAM Rating Report

# Harbourmaster Capital Management Limited

## Asset Manager Rating



## Analysts

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## Related Research

- *"Criteria for Reviewing and Rating CDO Asset Managers"*, (October 2008), available from [www.fitchratings.com](http://www.fitchratings.com)

## Summary

Harbourmaster Capital Management Limited (HCM) is a Dublin-based specialist credit manager focused on European senior secured loans. The company, founded in 2000 by the two current principals, is owned by management (52%) and a consortium consisting of RIT Capital Partners and Clearbrook (48%). As at December 2008, HCM manages EUR8.3bn of senior secured leveraged loans, invested in 12 CLOs, one hybrid fund and an umbrella fund, which currently has three segregated portfolios.

HCM's 'CAM1-' rating reflects the company's extensive investment experience in European leveraged loans, as demonstrated by a solid track record throughout the cycle and a leading market presence. The rating factors in the highly intensive credit research and monitoring practices supporting stable and consistently adhered to credit discipline, complemented by a substantial experience in distressed debt workout. Finally, the rating recognises the depth of analytical staffing resources and quality of the control environment supported by a solid infrastructure and thoroughly documented procedures.

Harbourmaster's 'CAM1-' rating for European leveraged loans was affirmed on 15 December 2008.

## Strengths

- One of the three largest and longest established CLO managers in Europe.
- Highly documented, disciplined credit intensive research practices combined with superior sourcing capabilities, resulting in stable credit selectivity at the peak of the market.
- Substantial workout experience and expertise, combined with strict avoidance of conflict of interests in restructuring situations.
- Excellent leveraged loan performance with an eight-year track record.
- Depth of staffing resources in all core investment and operational functions.

## Challenges

- To develop the loan fund management business, launching unlevered or low levered funds. The senior loan fund (a portfolio of Harbourmaster's umbrella fund) is already open to new money and Harbourmaster launched a further two sub-funds in 2008.
- To take on new fund investors different from HCM's traditional CLO investors. HCM has a marketing strategy in place.

**Manager Profile**

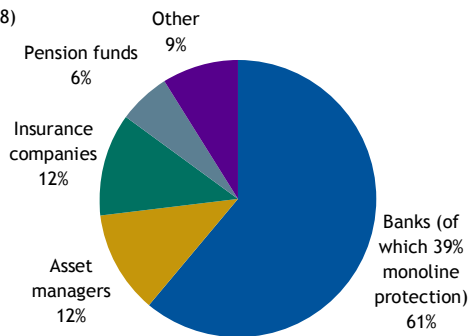
**Harbourmaster Capital Management Limited**

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Company contact	Mark Moffat +353 1 436 0124 Mark.moffat@harbourmaster.com	Company contact	Alan Kerr +353 1 436 0107 Alan.kerr@harbourmaster.com
Website	www.hcm.ie	Domicile, place of incorporation	Dublin
Type of organisation	Limited Company	Registration(s)/jurisdiction(s)	IFRSA
Year founded	2000	No. of employees	30

**Assets Under Management**

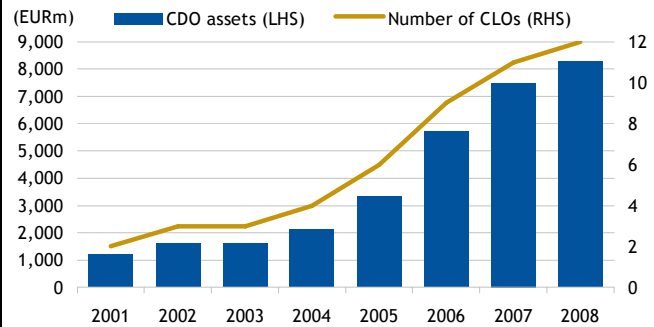
**Chart 1: AUM Breakdown by Investor Type**

(As at Dec 08)



Source: HCM

**Chart 2: CLO Assets Under Management**



Source: HCM

**European Leveraged Loans Under Management**

(As of Dec 2008)

Name	Closing	Structure	Primary European loan type	Original size (EUR)
Harbourmaster CLO 3	Aug 02	Cash flow CLO	Senior secured	429.6
Harbourmaster CLO 4	Sept 04	Cash flow CLO	Senior secured	498.9
Harbourmaster CLO 5	Jul 05	Cash flow CLO	Senior secured	749.6
Harbourmaster CLO 6	Nov 05	Cash flow CLO	Senior secured	499.7
Harbourmaster pro rata 1	Apr 06	Cash flow CLO	(Pro rata) senior secured	835.6
Harbourmaster pro rata 2	Jul 06	Cash flow CLO	(Pro rata) senior secured	587.5
Harbourmaster CLO 7	Nov 06	Cash flow CLO	Senior secured	903.7
Harbourmaster CLO 8	Dec 06	Cash flow CLO	Senior secured	502.7
Harbourmaster CLO 9	May 07	Cash flow CLO	Senior secured	770.0
Harbourmaster pro rata 3	Jul 07	Cash flow CLO	(Pro rata) senior secured	612.0
Global senior loan index fund 1 B.V.	Oct 07	Low leveraged fund	Senior secured	650.0
Harbourmaster CLO 10	Dec 07	Cash flow CLO	Senior secured	500.0
Harbourmaster CLO 11	May 08	Cash flow CLO	Senior secured	500.0
Harbourmaster investment funds	Apr 08	Unit trust	Senior secured	255.0
<b>Total</b>				<b>8,294</b>

Source: HCM

**Harbourmaster Capital Management Limited**

**Score**

**Company & Management Experience**

**1-**

- The company was founded in 2000 by the two current principals, Fabio Salvalaggio and Stewart Wilkinson (21 and 16 years experience in leveraged/structured finance, respectively).
- Managing directors, Alan Kerr (eight years company tenure and 14 years industry experience) and Mark Moffat (18 years industry experience) are co-heads of the business.
- Harbourmaster CLO I was called in 2006 at a 16.8% internal rate of return (IRR) and CLO2 was called in March 2007 at a 12.1% IRR, both realised over a greater than five-year period.
- HCM is a profitable and adequately capitalised company, as reflected by sound audited financial statements, which Fitch has reviewed.
- Critical mass, a leading market presence and favourable track record through the cycle provide HCM with a competitive advantage in today's market, as demonstrated by the launch of three sub-funds of Harbourmaster's loan umbrella fund and a CLO launch in 2008, which has led to AUM increasing by 10% in 2008.

**Staffing**

**1-**

- HCM employs 30 people, divided between the portfolio management, credit research and portfolio administration functions.
- Throughout its history, HCM has consistently maintained breadth and depth of staffing resources to match business requirements.
- HCM has a robust organisational structure, which has continuously grown towards more specialisation of roles. In 2008, HCM further clarified its organisational structure and now has a dedicated compliance function. Fitch notes that HCM does not have dedicated investor relations staff, but key relationships are handled by senior management.
- Staff turnover remains low, indicative of the team's long-term commitment, compensation and retention structures, through equity ownership in particular.
- HCM has an excellent depth of staff in all core investment and operations functions, resulting in a minimal key person risk and an optimal ratio of 15 loans per analyst.

**Procedures & Controls**

**1-**

- HCM has a robust internal control environment, based on task segregation, second level of controls and management reporting.
- Well documented procedures, providing detailed coverage of critical processes, are well adhered to.
- The complete integration of Wall Street Office (WSO) into HCM's procedures has strengthened the effectiveness of controls and efficiency of processes, while reducing operational risks.

**Portfolio Management**

**1-**

- HCM is actively working on maintaining the credit quality and structural integrity of its CLOs in the context of deteriorating loan market fundamentals.
- HCM adheres to a strict and stable credit discipline, resulting in a high selectivity (52% rejection rate pre-credit crunch).
- A pre-screening committee evaluates investment opportunities according to strictly defined criteria. The subsequent in-depth due diligence is documented in an investment proposal submitted to the credit committee and ratified by HCM and HCL boards.
- HCM had excellent access to collateral due to market presence and relations with arranging banks, which allowed it to obtain desired allocation at the peak of the market in 2006-07.
- The ongoing monitoring of the CLO portfolios and the 145 individual loans is formalised at weekly and monthly reviews. Enhancements have been made in 2008 to ensure more reactivity to an expected continuing deterioration of credit quality of the loan portfolio (likely to be materialised in covenant breaches, for example).
- In line with its "buy and hold" approach for CLO funds, HCM leverages its demonstrated workout competencies and experience, acquired both at the institutional and individual levels in the previous downturns. In 2008, HCM focused on renegotiating amendments before a default occurs.

**CDO Administration**

**1-**

- HCM has developed intensive CLO and loan administration capabilities. These are based on effective workflows with counterparties and a close trustee oversight facilitated by Wall Street Office (WSO), as the core CDO administration system.
- However, Fitch notes that portfolio managers are involved in administrative tasks (e.g. reconciliation, trustee interface).
- Transaction modelling was enhanced in 2006, not only by WSO, but by proprietary cash flow models and other front office applications built for each CLO and fund, allowing for daily compliance monitoring and scenario analysis.
- All loans are marked to market by daily feeds from Markit.
- Enhanced focus placed on clients in 2008, as demonstrated by the roll out of the investor web site.

**Technology**

**1-**

- WSO was acquired in 2005, and full implementation was completed in 2007.
- HCM uses complementary Excel-based front office applications for portfolio and risk management (including compliance monitoring), which are fed by a central database.
- WSO and front office applications are reconciled in a comprehensive and timely manner.
- HCM now has an optimal technology set up so that no further material IT developments are necessary.

### **Company and Management Experience, 1-**

The score in this rating category reflects HCM's significant and successful European leveraged loans and CLO experience through the cycle, its scale and leading market presence, the quality of its long tenured senior management and its sound financial condition, which are all seen by Fitch as a CLO manager's key success factors in a credit downturn.

#### **History and Organisation**

HCM is a Dublin-based specialist fundamental credit asset management business focusing on managing senior secured leveraged loans. HCM originates from Euro Capital Structures (ECS), a joint venture established by Fiat and UniCredito Italiano in July 1999, which was the initial investment advisor to the Harbourmaster programme until this activity was spun-off from ECS into the current HCM structure. Established in March 2000 as one of the first European institutional managers of leveraged loans, HCM became fully independent in December 2001 when Harbourmaster Capital Limited (HCL), the collateral manager, which owns HCM in full, was transferred to the company's two co-founders and current principals, Stewart Wilkinson and Fabio Salvalaggio. In March 2005, a consortium consisting of Rothschild Investment Trust (RIT) Capital Partners Plc and Clearbrook Capital Partners LLP, bought a 25% stake in HCL and exercised an option to acquire an additional 24% in October 2005. The shareholder structure of HCL is now:

- 49% RIT Capital Partners Plc/Clearbrook;
- 49% HCM's principals; and
- 2% HCM's directors.

RIT Capital Partners Plc (RIT) is an investment trust incorporated in the UK and listed on the London Stock Exchange. Clearbrook Capital (Clearbrook) is an investment firm established in 2004 by Robin Saunders. RIT and Clearbrook are represented at the Board of Harbourmaster Capital Holding Limited (HCHL), which is the parent company of HCL. Since January 2006, Robin Saunders has sat on HCHL's board. Jeremy Sillem represents RIT Capital Partners plc on the HCHL board. RIT and Clearbrook are financial investors. As such, they are not involved in the day-to-day management of the company but may provide some institutional support.

#### **CDO and Asset Management Experience**

Since its inception, HCM maintained its strategic focus on the management of European senior secured loans to rapidly establish a solid business franchise. This high level of specialisation was driven by the belief that senior secured loans represent the most attractive value over a cycle. Harbourmaster does not invest in mezzanine, second lien loans and has therefore avoided the high default rates of high yield CBOs in 2001 to 2003.

As at December 2008, HCM manages EUR8.3bn of senior secured leveraged loans, invested in 12 CLOs, one hybrid fund and an umbrella fund, which currently has three segregated portfolios (see table on page 2 for details). According to Fitch, Harbourmaster is therefore the largest European CLO manager as at December 2008 by AUM. Since the launch of Harbourmaster CLO1 in 2001, the first European CLO to be fully backed by euro-denominated senior secured leveraged loans, the company closed 14 European CLOs and originated a total of EUR15.4bn of loan assets. While Harbourmaster has focused on leveraged loans, it has also managed over EUR1.2bn of high grade ABS in the Anchor ABS fund and CLO3.

HCM's market leadership is demonstrated not only by size, but by its innovation capabilities. For instance, in 2006, the company launched the first two CLOs of pro rata senior secured leveraged loans, which enable investors to have exposure to the traditionally bank-dominated revolving credit facility and term A loans.

Long history, critical mass and a leading market presence provide HCM with a competitive advantage in today's market, as demonstrated by the launch of three sub-funds of Harbourmaster's loan umbrella fund and a CLO launch in 2008, which has led to AUM increasing by 10% in 2008.

Given the continued closure of the typical arbitrage CLO primary market, Harbourmaster is now broadening its product offering to unlevered or low levered funds. While managing a total return fund requires a different approach from managing a cash flow CLO due to price volatility, for example, Fitch believes that Harbourmaster is well positioned to successfully manage market value funds in spite of expected higher expected default rates, lower recoveries and persistent volatility, capitalising on its demonstrated credit selection skills to construct defensive portfolios providing returns in the region of the high teens, as marketed. In addition, Harbourmaster has already increased in recent months its secondary market and marked to market focus and does not intend to deviate from its buy and hold approach. The agency is also confident that, market conditions permitting, HCM will be able to raise capital from fund investors, which are however different from HCM's traditional CLO investors. For instance, HCM has raised EUR270m from pension funds in 2008. Harbourmaster remains obviously well positioned when the CLO market reopens, to launch a new transaction, possibly a low-levered, two-tranche structure.

### Track Record

HCM is one of the few European loan managers that can demonstrate a favourable nine-year track record through the cycle. So far, Harbourmaster has suffered two defaults in 2002, and four recently. The ratings on all Harbourmaster CLO notes have been consistently affirmed by Fitch throughout their lives, with the exception of CLO3 in 2008 due to a change in Fitch CLO ratings criteria.

CLO1 was successfully called in July 2006 at a premium, realising a 16.8% IRR over its life, which is understood to exceed that of the other few European CLO transactions called. Similarly, CLO2 issued in 2001 was called in March 2007 at a 12.1% IRR. Previously, in December 2005, Anchor CDO I, a static CDO-squared of 'AAA' rated ABS issued in November 2002, was also called due to strong performance. Annualised cash on cash equity return on outstanding CLOs also proves satisfactory at or above targeted long-term expected returns. However, the continued gloomy economic outlook, deteriorating credit fundamentals and deleveraging will put increasing pressure on Harbourmaster's CLO performance going forward.

### Senior Management

All senior team members have extensive experience in the loan and/or securitisation markets and provide effective leadership. The company founders and current principals, Fabio Salvalaggio and Stewart Wilkinson, have 21 and 16 years experience in leveraged/structured finance, respectively. The day to day management of Harbourmaster is under the responsibility of managing directors Alan Kerr (eight years company tenure and 14 years industry experience) and Mark Moffat (18 years industry experience and two years company tenure), who are co-heads of the business. The management team has been significantly expanded over the past three years through a combination of internal promotions and external hires, which provide sufficient depth to mitigate any key person dependency. Directors of the company have an equity stake. They are, in addition to the two principals and the two managing directors, Anna Marie Horgan (head of trading and portfolio management), Fiona O'Connor (head of credit), Katrin Goldbeck (head of finance, compliance and human resources) and Alex Leonard (senior portfolio manager (PM)). All members of the team work in a cohesive manner and share the same focused investment philosophy. More details on management's experience can be found in *Appendix 1*.

### Financial Condition

HCM is a profitable and adequately capitalised company. Given its level of revenues and cost structures, Harbourmaster shows a strong ability to remain profitable in a downturn, which may erode subordinated fees, currently representing 80% of total revenues. Fitch had access to audited financial statements and management accounts to form its opinion, but cannot disclose more details for confidentiality reasons.

### Staffing, 1-

The score in this rating category reflects the depth, quality and stability of HCM's staffing resources at all levels within a robust organisational structure.

### Team Structure

HCM employs 30 people, including 11 analysts and six PMs, which makes it one of the largest teams of leveraged loans investment professionals in the industry. Reporting to the two co-founders, joint managing directors Alan Kerr and Mark Moffat are responsible for the four main business units: 1) trading and portfolio management, 2) investment research, 3) fund administration and settlement and 4) finance/compliance & HR.

HCM's organisational structure reveals a clear identification of roles and responsibilities, resulting in a sufficient segregation between front- and middle-office functions and between research and portfolio management functions. This level of specialisation reflects the structure of a maturing organisation that has reached its critical size. Fitch notes, however, that HCM does not have a separate risk function, dedicated investor relations staff or dedicated loan trader.

### Research and Portfolio Management Staff

The credit team, which is headed by Fiona O'Connor, is primarily responsible for credit research and analysis, workouts and restructurings, and loan portfolio management. Fiona O'Connor has 16 years experience in leveraged/project finance. The depth of the team allows each analyst to be responsible for an average of 15 leveraged loans as lead analyst and roughly the same number again as back-up analyst, which Fitch deems an appropriate account load. In addition, the critical size of HCM's loan portfolio has enabled analysts to specialise in specific sectors, resulting in better quality and more focused analysis. Each of them covers three to four different sectors. While Harbourmaster does not currently have a dedicated workout specialist, the company has a wealth of expertise shared between the management team, which was effectively used at Harbourmaster between 2001 and 2005, in particular when it was elected onto a number of steering committees (see *Portfolio Management*).

The trading and portfolio management team of six is primarily responsible for fund and CLO portfolio management. Anna-Marie Horgan, who has 14 years industry experience and who joined Harbourmaster in 2001, is the head of the team. While Alex Leonard and David Cunningham are the senior PMs reporting into Anna-Marie Horgan, each PM is responsible for a number of funds, which includes daily monitoring and simulation of the effect of any trade, rating action or prepayment, for example. PMs are also in charge of operational tasks such as maintenance of the portfolio management database and reconciliation of investor report and WSO compliance reports with the trustee. Fitch believes having PMs in charge of "middle office" tasks may impair segregation of roles and potentially pose control issues.

Overall, analysts and PMs represent a highly skilled group that works well together, effectively leveraging individual experience acquired in leveraged finance, structured finance, project finance and accounting.

### Support Functions

The fund administration and settlement team is co-headed by Hugh Burnes and Pamela Ford is in charge of cash management, trade booking and settlements, weekly bank reconciliations, CLO compliance monitoring, processing of rollovers and waivers and credit and loan administration in general on the Wall Street Office (WSO) system.

The finance/compliance team, currently headed by Katrin Goldbeck, is responsible for ensuring compliance with laws and regulations, and for producing internal financial statements and managing the HCM audit process. Prior to 2008, in addition to her current responsibilities, Katrin Goldbeck was also in charge of the fund administration and settlement team. Fitch views positively this increased separation between operational and functional responsibilities, from a control perspective.

Legal and IT have been outsourced to Weil, Gotshal and Manges (WGM) and Brandon Consulting, respectively. Harbourmaster does not have dedicated in-house staff for the development and maintenance of proprietary applications and models.

### Depth, Adequacy and Continuity of Staff

Overall, given the volumes, investment style, processes and outsourced functions, Fitch deems HCM's staffing resources and organisation as very adequate for the delivery of in-depth research and controlled administration of the CLOs. They also provide spare capacity for growth in the fund arena, largely through economies of scale and resource sharing. In any case, throughout its history, HCM has consistently maintained breadth and depth of staffing resources to match business requirements, as demonstrated in 2007 with the hiring of 21 new people.

Staff turnover at HCM has remained low, in spite of the high demand for talented loan analysts during the bull market. Since 1999, staff turnover has remained low with no key personnel departures. Staffing stability is indicative of the team's long-term commitment, compensation and retention structures, enhanced by directors' equity stakes in the business.

### Procedures and Controls, 1-

HCM's score in this category reflects the strong control environment and systems-based procedures and controls, which are supported by well-documented procedures.

### Control Organisation Structure

Notwithstanding its small size and the absence of a separate risk management or audit function, HCM has managed to implement a robust control framework, supported by an effective separation between functions, comprehensively documented procedures and controls largely embedded in systems (see below). Harbourmaster recognised early in its development, the need to formalise some of the controls and governance mechanisms. It nonetheless does not believe that a separate risk management function would demonstrate further that the risks of the business are properly addressed, given its nature and its current set-up.

### Operational Risk Management

At HCM, operational risk is mitigated by the demonstrated effective adherence to scalable processes and thoroughly documented procedures making full use of system controls and straight through processing.

HCM has a comprehensive set of up-to-date procedures and policies providing detailed coverage of all critical processes. They include investment selection, portfolio management, funding and cash management, clearing and settlement, leveraged loan and CDO monitoring, problem loans and workout, data storage and protection, and quality controls. In particular, credit underwriting and portfolio

management follow a standard in-house framework that is detailed in the company's procedures manual. It specifies the general information to be scrutinised, the documents to be obtained, the analysis to be performed and the various meetings and committees involved. These procedures are centralised and monitored monthly by the fund administration group. Based on the documents reviewed and interviews conducted by Fitch, it appears that the procedures and controls are effectively integrated into day-to-day processes and are adhered to.

The roll-out of Wall Street Office (WSO, see *Technology* and *CDO Administration*) that started in August 2005 and was completed in late 2007 contributed to increase the automation of processes as well as improve the audit trail and IT security and segregation of controls, thereby mitigating operational risks.

### **Compliance and Control**

The WSO compliance module governs the pre-trade testing and CDO compliance monitoring at the middle office. In parallel, PMs make full use of their own front office applications to perform the same tasks in a more active manner.

Fund administration and compliance have a key role in ensuring effectiveness of controls and adherence to stated procedures. For example, the portfolio management and portfolio administration teams independently check details of all trades prior to approval by HCM and HCL boards. A checklist ensures that all key elements have been examined to certify that all CLO criteria are met. In addition, monthly internal operational reviews based on an internal audit programme are conducted by the portfolio administration team. No issues have yet been raised during these internal reviews. Similarly, no internal control weaknesses were identified by Ernst & Young during its most recent annual audit. Finally, front office controls are also effective and documented. For example, checklists, signed by the analyst, are completed for all credit files, summarising all issues such as transferability, jurisdiction, currency and repayments.

Management oversees and controls the business formally through management information reports that are received for each functional area. They include reports on portfolio management (consolidated CLO information, industry reports, rating change reports, credit monitoring reports, portfolio performance reports and counterparty rating reports) and cash management (rollover summary, bank reconciliation, loan prepayments/repayments due and received, CLO performance), among others.

### **Portfolio Management, 1-**

The score in this rating category reflects HCM's focused, disciplined and stable investment strategy, its superior access to collateral prior to the credit crunch, as well as its frequent and comprehensive surveillance processes and workout competencies.

### **Investment Philosophy**

HCM adheres to a "buy-and-hold" strategy, leveraging its workout competencies when required, while being a lender over the credit cycle. Prior to the credit crunch, on average, 75% of assets were sourced in the primary market. Trading in the secondary market was then limited almost exclusively to top-up of loans already purchased in primary syndications. HCM focused on large LBOs (typically enterprise value above EUR2bn), investment-grade quality business, with a high sponsor contribution and a potential for higher recoveries. Currently, HCM is actively working on maintaining the credit quality and structural integrity of its CLOs in the context of deteriorating loan market fundamentals through enhanced monitoring and active use of the secondary market to adjust positions.

### Credit Analysis

Credit selections are paramount in today's market to differentiate between cheap and value credits. HCM's structured credit underwriting process provides a solid framework for investment decisions.

The head of credit assigns one lead analyst and one back-up analyst to each credit, which HCM may have an interest in. HCM has always maintained a ratio of 15 loans per analyst, which in Fitch's view ensures deep credit knowledge. During the bull market, the analysis of leveraged loan credits generally took two weeks, despite the increased competition for allocation and growth in deal volumes in the European leveraged loan market.

The process starts with the initial review in which investment opportunities are evaluated against a number of eligibility criteria. A (five-page) summary is presented to a pre-screening investment committee, which looks at the capital structure, acquisition structure, brief description of the company, industry, performance, model, growth drivers, deal rationale and key issues. If the committee decides to proceed to the next stage, the investment committee will direct the analysts on the key issues they want further analysis undertaken on in the full committee paper. Once investment committee approval is given, HCM begins more detailed due diligence. This includes an analysis of capital structure, acquisition structure in more detail, the business and industry fundamentals, reviewing its competitors, assessment of management and sponsors of the transaction, analysis of historical and projected financials (P/L and cash flows), including stress case analysis, reviewing the transaction documentation in detail, the structure of the deal and recovery analysis on an asset coverage and trade sale basis. Emphasis is placed on liquidity (cash flow projections and employment of cash generated) and enforceability of security rights.

In most cases, the process includes a site visit where the analyst(s) is given a tour of facilities and the opportunity to meet with management. A review of the enforceability of the credit documentation is performed externally by HCM's legal counsel, WGM. In addition, the primary credit analyst will also review the credit documentation. Furthermore, HCM obtains private shadow ratings for each of the loans in which it invests. The credit analysis is documented in a 15 to 20 page investment proposal.

As it has recently increased its activity on the secondary market, Harbourmaster has formalised its selection of suitable secondary assets for a fund given certain criteria through the use of a proprietary model. Harbourmaster would however not invest in a credit on the secondary market if it has not been analysed at the time of issuance and if it does not have an approved credit limit.

### Credit Approval and Investment Decision

The credit approval is a two stage decision-making process, formalised in a pre-screening committee (see above) and a full investment committee. The full, final investment committee always includes three of the seven directors and the two analysts involved. The final investment decision is subject to unanimous approval by the committee; all committee decisions are materialised in a credit limit assigned to the loan and are documented and signed by the participants. Between 2003 and 2007, the rejection rate has remained consistently in excess of 50%, which demonstrates HCM's high selectivity. Allocations of loans between funds form an integral part of the investment committee's discussions. Decisions are based on the relative credit quality of all the portfolios and cash available for investment. All trades are also approved by both the HCM and HCL boards, thus reinforcing the decision-making process.

### Portfolio Monitoring

In the context of the current market environment, the focus of HCM's credit analysis is, appropriately, on portfolio asset monitoring and credit surveillance. HCM monitors all of its portfolios and the 145 total individual loan transactions both on an ongoing basis and at regular formal reviews. Transactions are monitored by the portfolio manager using monthly management accounts, quarterly compliance certificates, annual budgets and financial statements and regular on-site visits and conference calls with management.

Portfolios are reviewed during formal weekly meetings to monitor their composition, performance and expected cash movements, for which summary reports from an Excel monitoring tool form the basis. Performances are also evaluated against internal benchmarks, such as expected equity IRR. During daily portfolio management reviews, all issuers in a single industry are reviewed by way of an assessment of their performance against budget, and previous periods, and any asset-specific issues such as covenant waivers, are addressed. Each industry, and therefore loan, is reviewed on a monthly cycle. As part of the credit monitoring process, HCM also uses an internal qualitative scoring grid.

Enhancements to the monitoring process have been made in 2008 to ensure more reactivity to an expected continuing deterioration of credit quality of the loan portfolio. For instance, analysts disseminate "flash reports" as soon as they obtain breaking news or performance data to enable PMs to act rapidly in a fast moving market. Similarly, since early 2008, all loans are marked to market daily via feeds from Markit Partners. Finally, HCM has recently implemented a "traffic light" system, assigning a colour code based on strict criteria defining each corporate and industry performance. This allows analysts and PMs to identify portfolio and industry trends, allowing them to position the portfolio more defensively if required.

### Sell Discipline and Trading

HCM is primarily a buy and hold investor, therefore it barely uses the 20% trading bucket of its CLOs. In addition, current dislocated loan prices, which are often trading below average historical recovery rates of senior secured, give a strong incentive to wait for recovery upon becoming distressed. Nonetheless, HCM will look to sell a credit-impaired loan if 1) its evaluation of recovery prospects is below that factored into market prices, which are monitored daily through Markit, and/or 2) recovery rates have proved extremely volatile and/or 3) HCM disagrees with the potential restructuring scenario supported by the syndicate. The latter was the reason why HCM traded out of Spanish real estate company Reyal in October 2008 at 65% of par. Any loan trading needs investment committee approval, based on the recommendation made by the portfolio manager, after an examination of the impact on the portfolio(s) in question. All decisions to sell are approved at HCM board level.

### Asset Sourcing and Workout

HCM has excellent access to quality assets, as demonstrated prior to the credit crunch, where sourcing became an issue for most managers. HCM's superior sourcing capabilities reflect the strong relationships it has built with lead arrangers, as one of the earliest institutional investors as well as the company's ability to buy relatively large allocations (ticket size of up to approximately EUR250m) that can then be split between the CLOs. This was further strengthened in 2006 with HCM's demonstrated ability to buy pro-rata loans.

Workout expertise is becoming paramount in the context of an expected increase in covenant waiver requests, loan restructurings and, in the worst cases, insolvency proceedings. In line with its "buy-and-hold" approach, HCM takes an active role in managing problem credits. Again, as a major market participant, it is consulted at an early stage by leading arrangers / sponsors for an indication of how a potential restructuring would be received by the market. In 2008, HCM focused on

renegotiating amendments before a default occurs, as in many cases in the gaming (Gala/ Coral, for example) and auto sectors (ATU, for example). Leveraging its significant experience in distressed debt workout, the company can apply pressure on a loan syndicate to take action to protect senior secured positions and strive to maintain high recoveries. By way of example, HCM was elected to the steering committees of Ashtead Group plc (EUR600m senior debt) and Damovo Group plc (EUR250m senior debt), among others, to represent senior-only banks and institutional investors. As it does not invest in subordinated debt or private equity, it does not face conflicts of interest in debt restructuring situations. Fitch would caution nonetheless that future distressed debt restructurings are expected to prove more contentious than in the past given the potential conflict of interest in the agendas of the different investors, especially distressed investors who may have entered below par. Therefore, while HCM is assumed to remain consistent in its investment philosophy, and in its objectives upon distress, managing a steering committee will require a different skill-set that can facilitate constructive discussions amongst lenders in the typically out-of-court European-style debt restructurings, and ultimately maximise loan recoveries throughout the workout route.

### Investment Performance

During the bull market, the maintenance of credit discipline focusing on large transactions, established businesses providing financial stability and asset coverage, coupled with superior sourcing capabilities, have allowed Harbourmaster to position its portfolios as defensively as possible in anticipation of a credit downturn.

As at November 2008, according to HCM, the current weighted-average senior debt EBITDA was 4.11x (vs. 4.37x at origination). Among the current transactions rated by Fitch, the weighted-average rating factor (WARF) on average is 34.6 per deal (after downward adjustments for any names on RWN or Negative Outlook - see "*Global Rating Criteria for Corporate CDOs*"), corresponding to an average rating of 'B/B-'. The weighted-average recovery rate stands on average at 80.2%. The credit quality of the Harbourmaster portfolio is on average better than what Fitch currently observes from the European leveraged loan market. The transactions have also been kept well invested to date, currently averaging 2.3% of cash balance in the absence of prepayments.

As of early December 2008, all coverage tests were passing. However, following the recent defaults in an increasingly challenging economic environment, the reinvestment test - the most junior par value test - could come under pressure. A breach of this test may divert cash due to the equity holders to protect the rated notes.

The performance of the transactions depends more and more on the ability of HCM to use its workout expertise to achieve high recoveries on distressed assets, or negotiate favourable restructuring, and on its ability to maintain the credit quality of the portfolio in an unfavourable economic environment.

### CDO Administration, 1-

The score reflects HCM's strong CLO and loan administration capabilities by combining effective procedures, controls, information and workflows, supported by the WSO system.

### Transaction Set-up and Modelling

The quality of HCM's CDO administration is reflected in transaction set-up and modelling capabilities, which support a comprehensive and thorough CLO monitoring process.

At each new CLO launch, Harbourmaster applied indenture reviews and portfolio set-up procedures, which proved rigorous and comprehensive enough to mitigate the risk of a modelling error. Documentation negotiation and review are the

responsibility of senior managers, who obtain legal advice from WGM. HCM worked closely with arrangers to structure and test each transaction. In-house modelling capabilities, combined with investment banks' expertise, were sufficient for transaction set-up and cash flow models. At closing, HCM and the trustee run cross-checks to ensure that all portfolio parameters have been entered in the systems.

All of HCM's CLOs are set up and modelled in WSO, as the industry standard CDO administrative software solution. WSO allows for straight-through processing, CLO compliance monitoring and scenario analysis.

Separately, CLOs are modelled on a front office proprietary Excel application. They enhance ease of monitoring and enable automatic trade simulations for pre-compliance tests or other simulations to analyse the effects of changes in portfolios as a result of trading activity, roll-overs, principal reductions, prepayments, rating changes and market values. Finally, HCM has developed cash flow models for most of its CLOs to revise its own base case equity targets and analyse specific structuring or management issues.

### **Trustee Reconciliation**

Procedures for coordinating and reconciling with the trustee are facilitated by the WSO trustee interface and ensure the smooth administration of related cash accounts, trades and reporting. HCM maintains a three way reconciliation of the WSO compliance reports, portfolio management files and investor reports. For instance, cash movements and balances are reconciled with the trustee every week. Principal and interest accounts are reconciled on a weekly basis. Coverage tests are calculated by HCM and agreed with the trustee records on each testing date. HCM has also implemented an automatic daily reconciliation of the reference register with ABN AMRO for the pro-rata positions.

### **Investor Reporting and Communication**

HCM produces investor reporting, which includes a collateral advisor commentary as well as monthly marked-to-market asset valuation by Markit. In Fitch's opinion, these reports provide an informative and timely albeit concise insight to investors. In 2008, HCM placed an enhanced focus on clients, as demonstrated by the roll out of the investor web-site and ongoing communications with its investor base during the credit market turmoil.

### **Technology, 1-**

The score for technology reflects an optimal technology set-up built around WSO and front office spreadsheet-based applications and models fed by a central database.

### **Front- to Back-Office Systems**

The core system used by HCM is WSO, a software program supplied by FCS (owned by JPMorgan Chase Bank), which was acquired in August 2005 and fully implemented in 2007 on all CLOs. WSO allows for straight-through processing and provides a complete suite of CDO administrative modules, all of which are implemented and tested. Comprehensive reporting functionality, integral to trustee reconciliation, is provided at the individual asset level, as well as portfolio and enterprise-wide levels. The compliance module of WSO allows for CLO test compliance monitoring and scenario analysis to forecast performance.

All IT support functions have been outsourced to Brandon Consulting, an Irish company that was established in 1998. A service level agreement signed in March 2005 formalises the relationship, whereby Brandon Consulting provides network infrastructure, network and perimeter security, email filtering and secure remote access solutions. HCM has monthly meetings with Brandon Consulting to discuss project progress and outstanding issues. In 2006, projects have included the update of all existing servers and new firewalls. In addition to data back-ups, which are

performed every night and stored off-site, HCM has a full business continuity plan in place.

WSO is supported by FCS business analysts and IT technicians, who also coordinate the set-up of any new fund on the system. HCM does not have its own IT specialist. However, Alex Leonard has excellent quantitative and modelling skills so that management is confident that the company's staff has sufficient skills to develop and maintain portfolio management spreadsheets and models.

### **Portfolio Management Systems**

To complement WSO functionality, for CLO portfolio management purposes, HCM uses in-house Excel CLO modelling and monitoring tools, which were upgraded in 2006 to increase automation. As of 2008, Harbourmaster had integrated, automatic price feeds from Markit to the portfolio management systems and WSO, thus providing more timely marks.

The portfolio management systems enhance ease of monitoring and enable automatic trade simulations for pre-compliance tests or other simulations to analyse the effects of changes in portfolios as a result of trading activity, roll-overs, principal reductions, prepayments, rating changes and market values. Harbourmaster is one of the very few CLO managers to have developed proprietary cash flow models, used to project IRR, among other simulations and analysis of specific structuring or management issues.

### **Data Management**

WSO office and front office spreadsheets are standalone systems and use separate databases. The Excel-based front office database feeding all portfolio management models centralises all borrower and tranche level details (such as market prices, margin, rating, amortisation schedule and credit stats). The information is fed through and maintained by portfolio managers themselves. While the database is Excel based, it is currently sufficiently robust for the company's needs.

## Appendix 1: Staffing Summary

### CDO Staffing Summary

#### Background highlights

**Fabio Salvalaggio**

Principal

- Co-founder of HCM
- Established Commerzbank's securitisation team in 1997
- Managing director at Citicorp in securitisation and structured finance, where he spent 14 years
- Head of corporate finance for Spain and Portugal
- MBA from Columbia University in New York and MA from Ca'Foscari University in Venice, Italy

**Stewart Wilkinson**

Principal

- Co-founder of HCM
- Member of Commerzbank's securitisation team from 1997 to 1999
- Structured finance analyst at Fitch Investors Service in Europe from 1995 to 1997
- Responsible for LBO structuring, acquisition financings and the management of a loan portfolio at HSBC Samuel Montagu from 1993 to 1995
- Credit analysis and structuring of syndicated loans from 1991 to 1993 at Hambros Bank
- Masters degree in English Language and Literature from Oxford University

**Alan Kerr**

Managing Director

- Joint managing director of HCM
- Prior to joining HCM in 2000 was with Ernst & Young in Dublin and Boston for six years, most recently as financial services group manager
- Masters degree in Accountancy, and Commerce degree from University College Dublin
- Chartered accountant

**Mark Moffat**

Managing Director

- Joint managing director of HCM
- Formerly head of European Debt and Equity Capital Markets (2006-2007) and head of European CDOs for Bear Stearns from 2001-2007
- Formerly global head of CDOs for ABN AMRO and director of securitisation at Greenwich NatWest
- Honours degree from Nottingham University

**Anna-Marie Horgan**

Director

- Director of HCM; responsible for overall portfolio management, asset origination, secondary trading
- Financial services manager at KPMG, specialised in the audit of banks and financial institutions, leasing and treasury companies from 1996 to 2001
- Bachelor of Commerce degree from University College Cork
- Chartered accountant

**Katrin Goldbeck**

Director

- Director of HCM; responsible for portfolio administration and finance/compliance
- Joined HCM at inception. Formerly with Commerzbank loan products team from 1997 to 1998
- Masters degree in English and Literature from Hamburg University
- Accountant

**Fiona O'Connor**

Head of Credit

- Responsible for loan origination and credit analysis
- Previously worked in acquisition finance, corporate banking, project finance and structured finance in Bank of Ireland
- Prior to that, Ms. O'Connor worked in corporate credit in Australia and New Zealand Bank
- Masters in Business Studies from Michael Smurfit Graduate School of Business and Bachelor of Commerce from University College Dublin

**Alex Leonard**

Director

- Portfolio manager and deal execution
- Previously worked in DEPFA as a senior director in the structured finance group
- Worked in ECS as a senior structure/co-head of securitisation
- Worked in ING as a securitisation manager and prior to ING Mr. Leonard worked in Airbus as a senior quantitative analyst
- MA in Economics and BA in Economics from University College Dublin

Source: HCM

**Rating Summary**

**Harbourmaster Capital Management Limited**

**Composite Ratings**

To capture the combined effects of asset manager attributes, as measured by CDO asset manager ratings, the six category ratings are weighted as detailed below in calculating a composite score.

**CDO Asset Manager Rating Category**

	Weight (%)
Company and management experience	20
Staffing	12
Procedures and controls	12
Portfolio management	32
CDO administration	12
Technology	12
<b>Total</b>	<b>100</b>

Source: Fitch

The composite rating is used to establish a systematically applied quantitative link between asset manager ratings and CDO rating criteria as detailed in Fitch’s “Criteria for Reviewing and Rating CDO Asset Managers”, criteria published on 16 October 2008, available at [www.fitchratings.com](http://www.fitchratings.com). CDO asset manager ratings are reviewed annually and surveilled quarterly.

For any future structured finance CDO issued by HCM, Fitch may use the CAM rating to calibrate the maximum allowable adjustment to its modelled rating default rate at each rating level with a Fitch rating.

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