

**FEBRUARY 2011
DEFAULT
CASE STUDY****Public Firm Default Report:
Borders Group Inc (BGPIQ)**

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Default Event

On February 16, 2011, **Borders Group Inc**, the second-largest US bookstore chain, filed for Chapter 11 of US bankruptcy protection in New York. The company listed debt of \$1.29 billion and assets of \$1.28 billion as of the default date.

Company Profile

If you want John Updike or Janet Jackson to go with your java, Borders is for you. The #2 bookstore operator in the US (after Barnes & Noble), Borders Group runs more than 500 Borders superstores in 45 states and Puerto Rico, as well as about 175 small-format shops under the Waldenbooks, Borders Express, and Borders Outlet banners. Its bookstores offer 170,000 book, music, and movie titles and regularly host live literary events and musician showcases to attract customers. The chain also sells products via its website. Faced with declining sales due to the ailing book business, Borders sold its UK-based Paperchase stationery and gift business in 2010.

EDF Credit Measure and EDF Drivers

EDF value as of February 16, 2011: 35.00%

Traditional ratings, such as those used by major rating agencies, are currently more commonplace than default probabilities. Therefore, to help facilitate user's understanding, we translate the EDF credit measure into an equivalent Credit Category. Borders Group Inc's Credit Category (not an agency rating) at default was C.

Figure 1. One-year Borders Group Inc's EDF Values

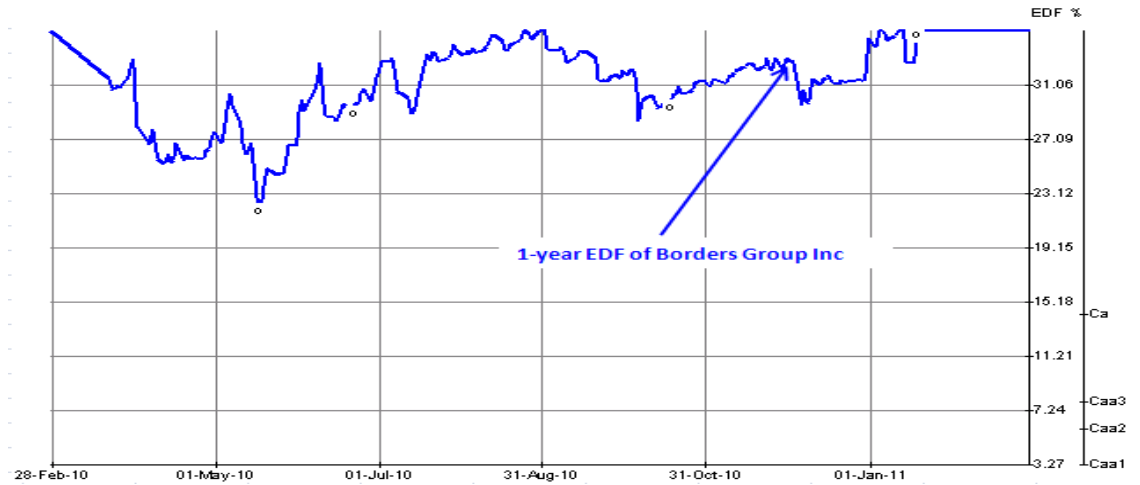


Figure 1 shows that Borders Group Inc's EDF credit measure was rising since June 2010 and reached 35% in January 2011, one month prior to default.

Figure 2. Drivers of Borders Group Inc's EDF Values

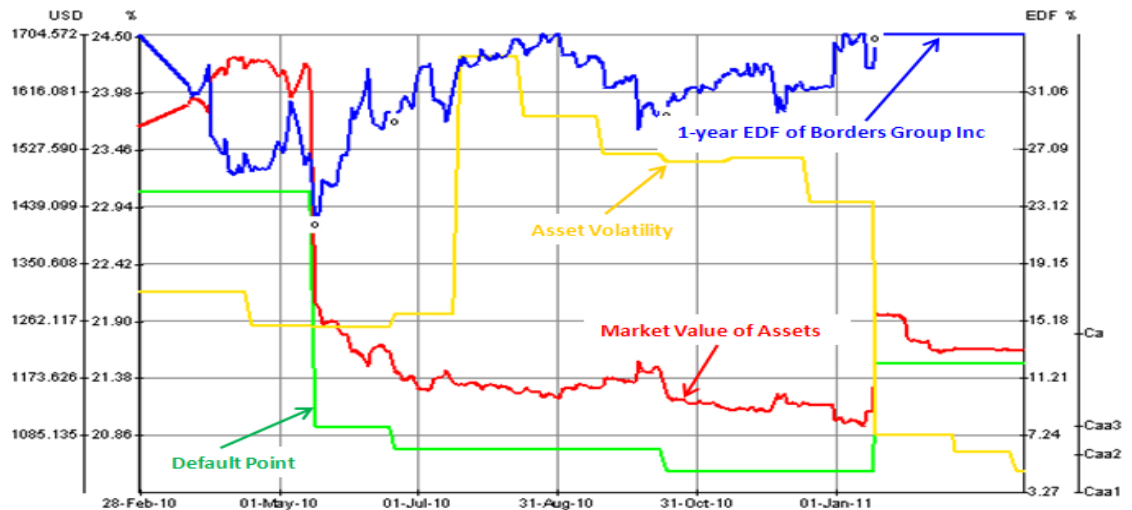


Figure 2 shows the time series of EDF values and EDF drivers, which include market value of assets, asset volatility, default point, and market leverage. Table 1 summarizes the definitions of EDF drivers.

In May 2010, the market value of assets was \$1.6 billion. Since 2009, the company struggled with cash flow drain and sagging book sales in the face of competition from Barnes & Noble and Amazon. Consequently, the company's market value of assets dropped to \$1.2 billion in January 2010, close to the default point of \$1.19 million. The company's asset volatility had hovered near 21% since May 2010. High financial risk combined with deteriorating business value led the company to default.

Table 1. Drivers for EDF Values

| EDF DRIVERS | DEFINITION |
|------------------------|---|
| Market Value of Assets | The market's view of the enterprise value of the firm as determined by the firm's equity value, equity volatility, and liability structure |
| Default Point | The liabilities that matter in case of default. If the market value of assets falls below this value, it is assumed that the firm will be unable to sell assets or raise additional capital to pay its debt. A firm's default point is a value close to its short-term liabilities plus half of its long-term liabilities |
| Market Leverage | Ratio indicating how much of the market value of assets is financed by debt. It is calculated as the default point/market value of assets |
| Asset Volatility | Standard deviation of the annual change in the market value of the assets |

The two main EDF value drivers are asset volatility and market leverage. **Figure 3** depicts a meter showing the level of risk on each of the two measures. The levels are relative values computed on the United States and Canada Large Corporates Group.

Figure 3. United States and Canada Large Corporates Group



- » **Asset Volatility.** EDF credit measures for United States and Canada Large Corporate issuers such as Borders Group Inc reflect an average of asset volatility levels over the past three years. As of the default date, Borders Group Inc's asset volatility was 20.86%, within the 25th percentile relative to the US and Canada Large Corporates Group.
- » **Market Leverage.** Borders Group Inc's market leverage is 98.67%, which falls within the 99th percentile of the entire US and Canada Large Corporates Group.

Relative Analysis

The relative analysis feature allows users to chart EDF, fundamental data, and bond values for a selected company or group relative to other companies and/or groups. Users may manually select their own list of peer companies or groups for comparison, or view a Moody's Analytics predefined peer list, based on an automated algorithm. To determine peers for each company, Moody's Analytics finds all the companies that share the company's Bloomberg Subgroup. Users can also customize and save their own peer company and peer group choices for future use.

Figure 4. One-year Borders Group Inc vs. US Miscellaneous Shopping Goods Stores Group

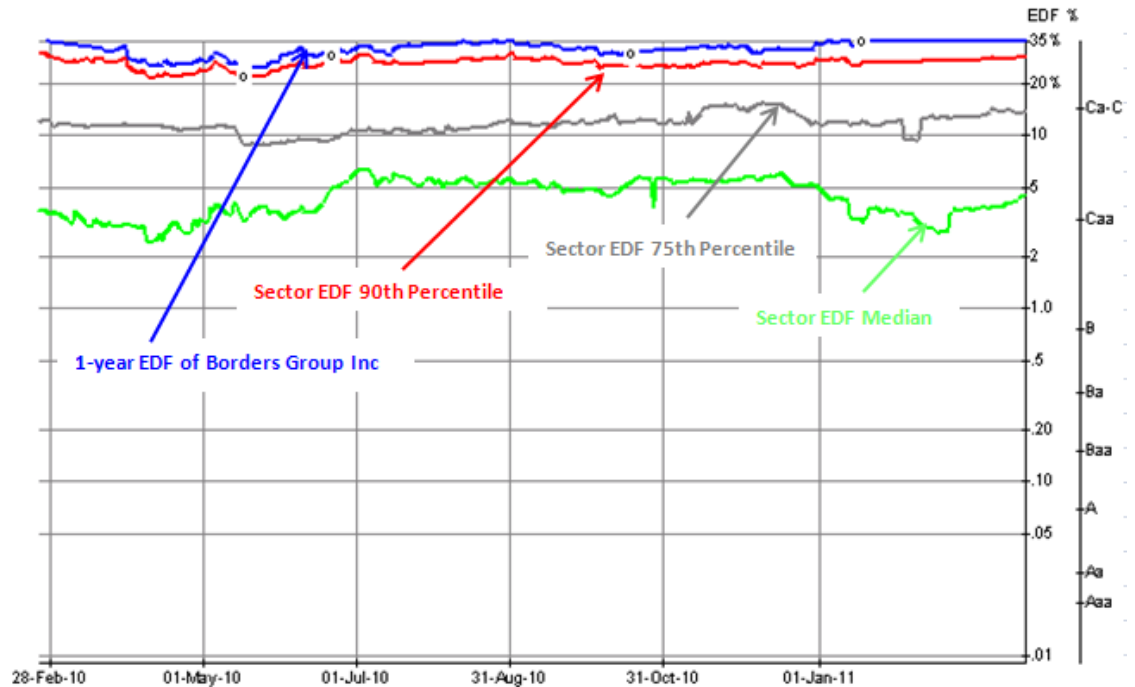


Figure 4 shows Borders Group Inc's EDF value was surpassing the 90th percentiles of the US Miscellaneous Shopping Goods Stores Group since February 2010. The company bankrupted in February 2010.

Conclusion

Borders Group Inc's EDF Credit Measure indicated high default risk before default occurred. Firm EDF values remained above the 90th percentile relative to the peer group of US Miscellaneous Shopping Goods Stores Group beginning in February 2010. High financial risk combined with deteriorating business value led the company to default.

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