LAMPERT DEBT ADVISORS

State of the Debt Capital Markets

ADDRESSING THE DEBT FINANCING NEEDS OF MIDDLE MARKET COMPANIES AND FINANCIAL SPONSORS

Volume IV, Issue I

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Contents

By the Numbers

Unemployment

8.3% (January)

Prime Rate

3.25%

Treasury Yields

2-Year Note—0.286%

10-Year Note—2.01%

EURO/USD

$1.3242

3-mo LIBOR

0.49%

LIBOR Swaps (USD)

2-year—0.582%

5-year— 1.146%

Leveraged Loan Volume

$373 billion (2011)

High-Yield Volume

$218 billion (2011)

Lampert Debt Advisors specializes in structuring and raising capital for middle market companies. We are dedicated to meeting the debt financing needs of privately-owned, sponsor-backed and publicly traded growth companies. We focus on companies seeking to raise between $10 and $125 million through the placement of creative financing solutions. Our principals have completed over $20 billion in financings across a diverse range of industries and financing structures.

Summary

The Economy

- Despite the lingering uncertainties surrounding the Eurozone economic crisis and domestic tax policy, the Fed's heightened transparency with respect to target interest rates and the rate of inflation has been a beacon guiding investors and corporations towards a more subdued view of risk and opportunity.
- The FOMC consensus regarding the appropriate timing of interest rate increases is 2014, with the expected Fed Funds Rate being 1-2%.
- The U.S. consumer is beginning to show stirrings of renewed confidence evidenced by m-o-m increases in consumer spending and strong gains in the Consumer Sentiment Index, which reached 74.0 in mid-January.
- The U.S. employment picture continues to show improving strength; payrolls increased by 155k per month in 4Q, a meaningful increase from the 100k average monthly additions over the first nine months of 2011.
- We project of strong and vibrant economy in 2012, with core inflation on par with the Fed target of 2% and an unemployment rate nearing 7.5% by year-end.

Leveraged Loans

- 2011 was a year characterized by extremes. New-issue volume of $373.1 billion represented the highest annual total since the halcyon days of 2007; buoyed by massive inflows to prime funds in the first half of the year, approximately 75% of the volume occurred between January and July.
- With demand for loans aplenty and limited supply to match, borrowers seized the opportunity to pursue aggressive structures such as dividend recapitalizations and covenant-lite facilities.

High-Yield

- The U.S. high-yield market had a weaker 2011 than 2010, negatively impacted in the second half of the year by the Eurozone crisis and weak economic indicators at home. New-issue volume fell to $218 billion from the 2010 record high of $287 billion.
- The fundamentals of the U.S. high-yield market remain sound as we enter 2012. Improved credit quality and balance sheet health are insulating companies from intermittent market jolts stemming from the Eurozone crisis, the improving US economy health and see-sawing investor confidence.
- Windows of market stability should provide a positive environment for positive funds flows, improved market liquidity and new issuance activity.

The Economy

Creating Certainty in an Uncertain Economic Environment

We meet the New Year **buffeted by the countervailing winds of a continuing crisis in Europe and a remarkably resilient U.S. economy.** As we survey the outlook for 2012, we are struck by the **massive uncertainties that confront U.S. businesses and consumers alike.** Fiscal austerity in the U.S. and abroad is no longer a goal; it is a requirement of any nation seeking to access the capital markets on its own or through the good offices of the European Central Bank. Europe has corralled the problem of Greece with another debt restructuring scheme, encouraged active fiscal reform in Italy and Spain and kept Portugal liquid through outright purchases of debt obligations to refund maturities as they come due. Yet, the potential for, and depth of, a European recession remain all too real as the major European banks seek to redress their capital inadequacy through asset sales and capital formation exercises. The shortfall exceeds €115 billion and the timeframe for doing so remains short. However, **the lack of fiscal enforcement that characterizes a critical deficiency of the European monetary union finds its parallel in the inability of the European Central Bank to enforce the sanitization of European balance sheets over the objections** of national banking regulators. As a result, Europe may lack the credit facilities necessary to keep its businesses from falling into a recession.

In the U.S., we confront and compound the uncertainty surrounding Europe with our own set of self-imposed uncertainties: (i) Will the bipartisan Super-Committee on deficit reduction reach agreement or will the automatic spending cuts required by law kick in? (ii) Will the legislature extend the current tax rate regime that expires at the end of the year or will we revert to the pre-2003 scheme? If reversion occurs, ordinary income tax rates will increase anywhere from 3-5% depending on bracket, tax rates on qualified dividends will increase from 10% to ordinary tax rates (as high as 39.6%) and capital gains tax rates will increase from 15% to 20%, as well as an additional 3.8% Medicare tax on both ordinary income and capital gains. Oh, and all these legislative items are to be dealt with during an election year, a quadrennial event characterized by political rhetoric that leaves as much said as is left undone.

Amidst this heightened environment of dark uncertainty, **Ben Bernanke's recently enacted policy of expanded transparency has been a beacon guiding investors and corporations toward a more relaxed view of risk and opportunity.** The result, an increased appetite for risk and commensurate decline in the price of risk, has proven a boon to both the debt and credit markets. The disclosures of **Fed interest rate predictions not only make risk more bearable** to investors, but suggest a longer lasting accommodative monetary policy that also serves to reduce economic risk. The result is that the Fed has catalyzed **a virtuous cycle of reinforcing consumer and business actions that will enable our economy, despite the heightened uncertainties described, to experience superior growth** and resource redeployment during 2012 (see chart on page 3).

The U.S. Economy

2011 closed on a harmonious chorus of improving consumer, business and regulatory statistics that bode well for continued growth and resurgence during 2012.

The U.S. Consumer is beginning to show stirrings of renewed confidence expressed in spending, sentiment and credit expansion. Consumer spending increased in each of the last three months of the year and, while December was an unremarkable 0.1% increase compared to November's 0.4% rise, we ascribe the leveling-off to price declines in key spending components (gas, electronics, retail and clothing) rather than complacent spending patterns. The Consumer Sentiment Index showed a continued rise from 69.9 at the end of December to 74.0 in mid-January. This continued the trend of nearly continuous increases that commenced last August, although still well-below the 100 benchmark last realized prior to the recession in early 2008.

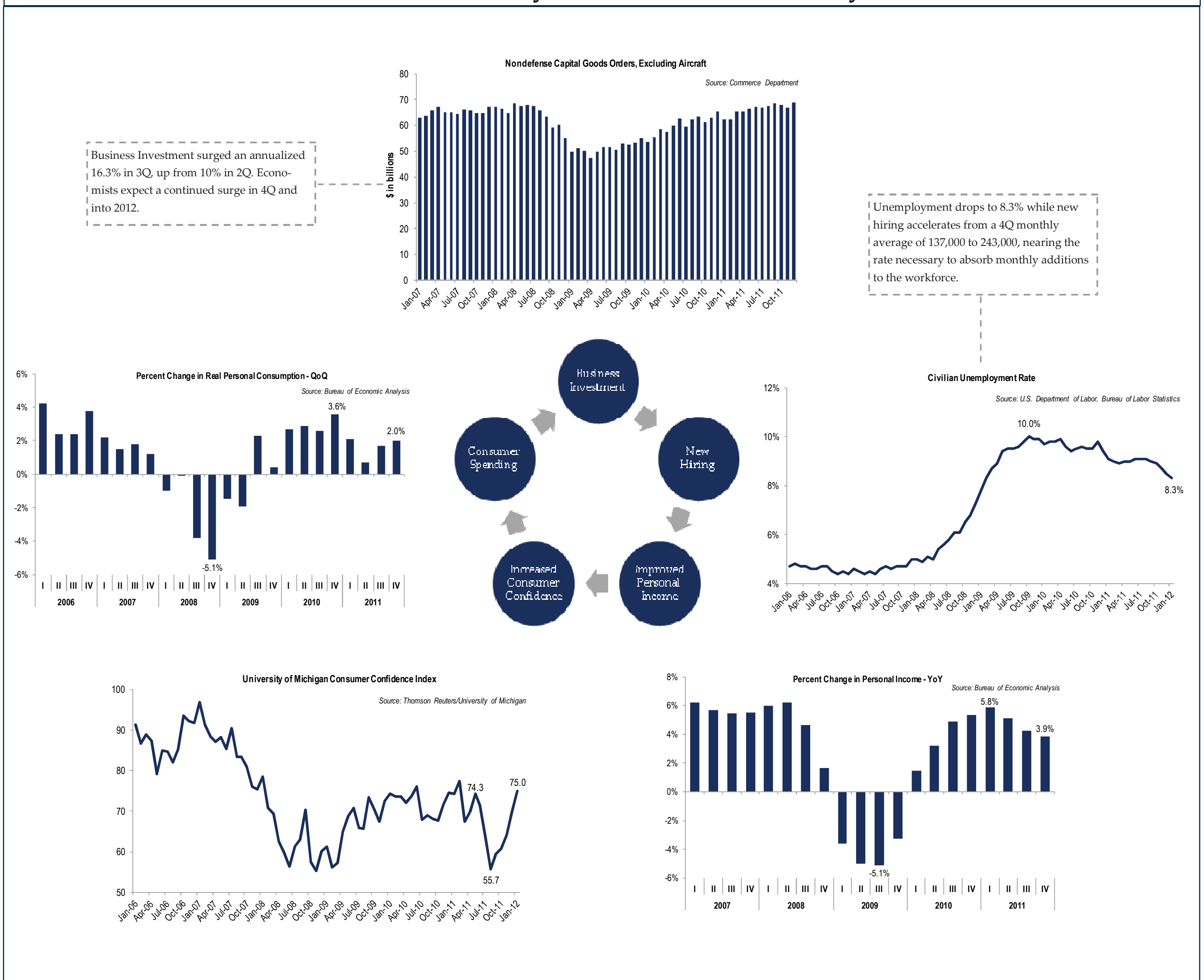
The **continued deleveraging of consumer balance sheets** has restrained the strength of the economic recovery. However, after two years of declines in consumer debts outstanding, 2011 experienced accelerating quarterly growth culminating in back-to-back $20 billion increases for November and December, reflecting absolute increase levels not seen in over a decade. This represents a nearly 10% annualized increase in consumer credit that we believe represents the long-awaited effect from the Fed's low interest rate stance. With most of the increase occurring in non-revolving debt, consumers are benefiting from significantly reduced debt service. In fact, **consumer debt service requirements now represent approximately 11% of monthly income, down from 14% in 2008 and a level not seen in nearly twenty years.**

Consumer **sentiment is doubtlessly buoyed by an improving employment picture and a benign inflation outlook.** 4Q brought an average monthly increase in payrolls of 155,000, significantly better than the sub-100,000 net monthly additions experienced during the first nine months of 2011. January continued the trend of accelerating increases by adding 243,000 jobs; our economy begins to approach the levels of job creation consistent with the levels required to absorb new monthly entrants to the job market. Equally important is the **breadth of increases which extended across most sectors** including the less-robust construction industry and the recently-revitalized manufacturing sector.

The U.S. recovered to more robust growth in 4Q after having drifted lower late in 2Q and throughout 3Q in response to the risks of a Eurozone meltdown. GDP growth fell to 1.8% during 3Q as consumers and businesses reacted to the risks of a slowing world economy and foreshadowed the heightened sensitivity of the U.S. to offshore shocks. While the **U.S. seemingly decoupled from the rest of the world with 4Q GDP growth of 2.8%,** this was largely due to inventory replenishment and build rather than improving demand. Final sales were only up 0.8% in 4Q compared to 3.2% in 3Q. The most recent World Bank estimates of country specific growth rates pegged the 2012 U.S. growth rate at 2.2%, down from the July estimate of 3%. However, **we believe U.S. growth will surpass the World Bank estimates** amid the recovering consumer sector, an improved outlook for the manufacturing and service sectors, the maintenance of a **highly-accommodative monetary policy** and an **election year fiscal policy that will eschew discipline in favor of fiscal stimulus.**

The Institute of Supply Management's indices for both manufacturing and non-manufacturing herald continued growth, with both recording levels above the benchmark threshold of 50. The Manufacturing Index ended the year at 53.1, capping a two-year run above 50; the Non-manufacturing Index leaped to 56.8 in January from 53 in December. **Business investment and manufacturing continue to be the continuing sources of strength** in our

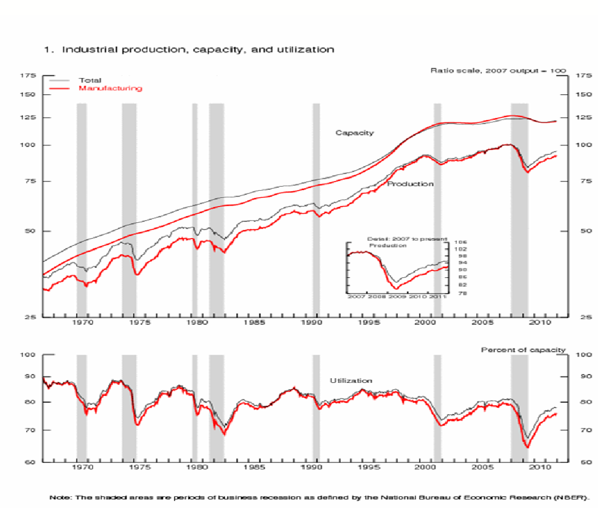
The Virtuous Cycle of Economic Recovery



recovery. Business investment surged 16% in 3Q after an unexpected 10% rise in 2Q. Like many economists, **we expect capital investment to continue accelerating into 4Q and beyond as capacity utilization, the tipping point for dramatic increases in capital investment, approaches the 80% mark.**

In support of the potential for expanded capital spending, construction spending recorded its fifth straight month of increases and the 4Q level represented the first y-o-y increase in three years. While the declines from 2008 to 2010 set a low comparable to surpass, we nevertheless derive comfort that, with unemployment at 8.3%, improving construction spending will serve to maintain the momentum in payroll increases and unemployment rate declines.

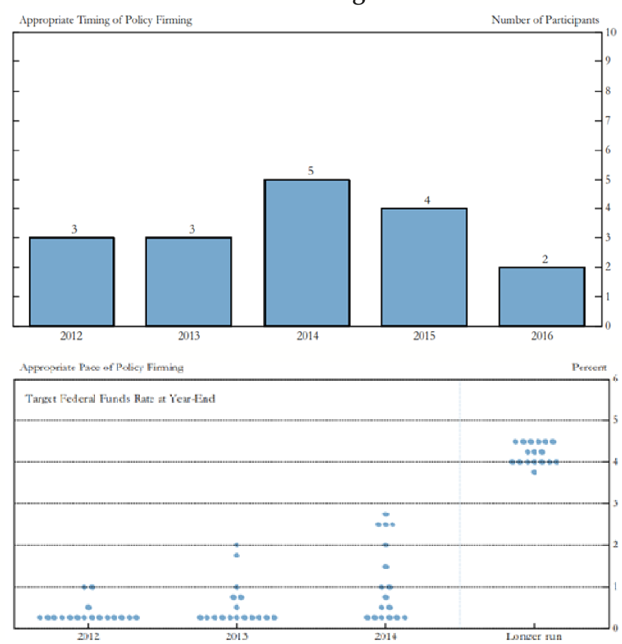
Federal Reserve - Industrial Production, Capacity and Utilization



The **Federal Reserve's actions have been precise, on target and wholly appropriate; moreover, the recently enacted transparency initiatives of the Fed will go down as a seminal event in its history**, on par with the landmark decision in the 1980s to target the Fed Funds Rate rather than the money supply. In January, the Fed made two key disclosures. First, they published the predictions of each member of the Fed Open Market Committee on the timing of rate increases. While the median is 2014, a number have posited increases to occur even later. Overall, the prediction is that the Fed Funds Rate will start increasing in 2014 and reach a level of 1-2% that year. While couched as a "prediction," the longer-term rate of 4-4.5% represents the consensus view of a steady state rate during normal economic conditions.

Uncertainty affects decisions by businesses and consumers, whether these are capital investment, financial investment, hiring, spending or cash redeployment decisions. Uncertainty creates a lack of confidence that translates into lower risk decision alternatives and lack of growth. As Keynes pointed out, economic stimulus requires inducing greater spending through confidence. The Fed's first prediction of future rates served to reduce uncertainty about the future course of interest rates; in concert, its second announcement of a 2% targeted rate of inflation served to dispel any incipient fears of inflation. We believe **this two-pronged attack on uncertainty has de-coupled our economy from the Eurozone crisis, stimulated renewed interest in risk assets and heightened the likelihood of a more robust economy and more rewarding capital markets.**

Federal Reserve - Appropriate Timing and Pace of Policy Firming



Initial Outlook for 2012

The World Bank's estimate for U.S. GDP growth was reduced from their July 2011 estimate of 3.0% growth to 2.2% as part of a global correction in their estimates. However, we believe that for the reasons described in our review of the interplay between business investment, rising confidence and low-cost financing for both consumption and investment decisions, **U.S. GDP growth in 2012 will be over 2.5% and close to 3%.**

Inflation has remained relatively benign with core inflation of 2.2%, just slightly above the Fed target. While the Fed's accommodative monetary policy would normally give rise to inflationary pressures, we believe the world-wide slowdown, continuing strength of the dollar and the Fed's vigilant attitude will keep inflationary pressures in check.

Given our newfound affinity for the Fed, we are hard-pressed to predict anything other than **2% core inflation for 2012.**

We believe the decreases in the unemployment rate augurs well for continued improvement throughout the U.S. economy. However, it will oscillate monthly as rising confidence and increased hiring encourage the reentry of displaced workers into the workforce. Overall, the strength of both the manufacturing and non-manufacturing sectors combined with expansionary capital investment will increase payroll additions and **bring unemployment down to 7.5% by the end of 2012.**

We **project a strong and vibrant economy**, sustained increases in employment and investment, strengthened consumer confidence and spending and an improved dollar as the U.S. economy becomes a bulwark against decelerating growth in the BRIC countries and possible declines in the Eurozone. While we remain concerned about the potential shock impacts from the Eurozone and the continued drag on our economy from the housing sector, **we remain positive about the economy, the debt markets and the potential appreciation in the equity markets.**

Leveraged Loans

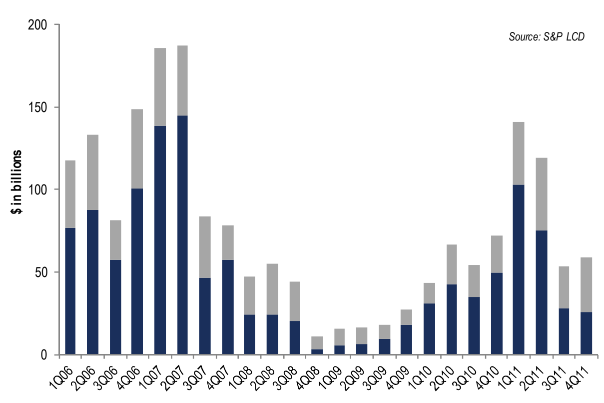
2011 Recap

Despite achieving new-issue loan volume of $373.1 billion, the highest such total since 2007, the 2011 loan market was characterized by extremes.

The first seven months of the year cultivated an issuer-friendly environment and borrowers flooded the market to refinance existing facilities at attractive rates. Exuberance was matched by investors; excess demand enabled execution of aggressive transactions, such as dividend recapitalizations and covenant-lite facilities. YTD July 2011 saw new-issue volume, average spreads (first-lien institutional) and average secondary bids (all loans) of $283 billion, 435.3 bps, and 94.8, respectively, paired with $33.1 billion of net fund inflows, as retail investors were eager to deploy capital into the asset class.

The bullishness subsided in August amid bearish economic reports, political gridlock on Capitol Hill, and concerns over the fiscal health of the Eurozone. Issuers and arrangers alike reassessed acceptable levels of risk causing deal-flow to slow to a trickle. Volume for the month of August came in at $3.12 billion, down $6.2 billion from August 2010, and September recorded $20.2 billion in issuance, off the 2010 mark by $11.5 billion. Coincidently, Fed announcements signaling near-zero short-term rates through 2013 (an outlook since revised to late 2014) gave way to a mass exodus in retail funds. With limited inflation in the forecast, loan investments lost their appeal as a hedging tool and net fund outflows totaled $7 billion in August and September. **The loan market deterioration reached its lowest point the first week in October, when average secondary bids reached a low of 88.85.**

USD New-Issue Loan Volume by Quarter

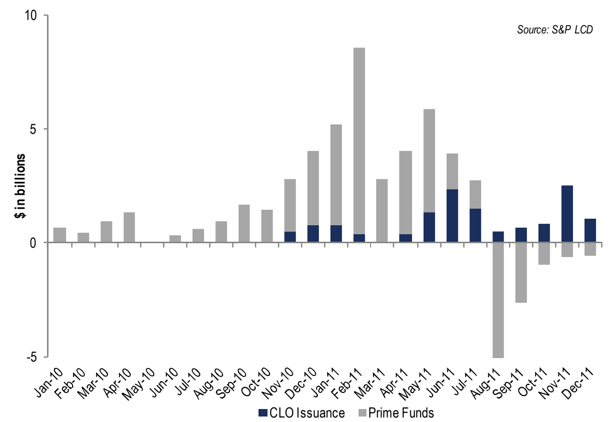


The resiliency of the U.S. economy was evident in 4Q 2011; reservations about domestic economic growth and the Eurozone were lessened upon positive news. Leveraged loan issuance grew a modest $5.4 billion to $59.2 billion for the quarter, but outperformed expectations.

A near-term consequence of the Eurozone instability has been a bifurcation amongst large and small middle market issuers. Reduced lending activity by European banks during 4Q 2011 has had an adverse impact on pricing levels. However, the minimal historic presence of European banks in the lower middle market has proven to insulate this segment from upward pressure, as pricing remains extremely competitive. In terms of supply, the willingness of issuers to pursue debt financing varies by region- largely dependent on the performance of dominant industries within each region. Over 4Q 2011 refinance volume held its top position, but fewer issuers are coming to the table- many addressed near and medium-term maturities during the frenzy at the end of 2010 and the first half of 2011. **Middle market leveraged loan issuance faded to $1.8 billion in 4Q 2011, compared to $3.0 billion in 3Q 2011 and $3.1 billion in 4Q 2010.**

The relatively steady-state of 4Q 2011 finished with average **first-lien institutional spreads moving down from the August and September 2011 average of 575 bps to 514.9 bps.** The secondary market rebounded and closed out the year with average bids at 91.88 (1/4/12). Funds activity recovered from 3Q 2011, **recording net fund in-**

Monthly Fund Flows



flows of $2.2 billion over the quarter.

Looking ahead

The consensus outlook for leveraged loans in 2012 is that there is no consensus, but most agree that the path could easily deviate based on impactful news- one way or the other.

Many of the elements for a solid year are in place: liquidity abounds at banks, institutional investors and corporate America; balance sheets have been pruned and refinanced; cost structures have been scrutinized, operations streamlined and efficiencies gained. The looming uncertainty resides in top-line estimates- organic demand remains subdued.

As the uncertainty wanes and risk becomes appetizing, business managers will move to other strategies in their quest to increase shareholder value- namely, capital expenditures and/or M&A. With corporates tentatively going forth, middle market bankers eagerly await to refresh a slow new-issue calendar. In the broader primary market, investors are anxious to deploy capital; many deals are oversubscribed and flexing in favor of the issuer. **The opportunity for issuers to execute low-cost, aggressive structures is in play amidst the ebbing pipeline.**

January 2012 in the Books

The Fed's announcement in late-January had minimal impact on the month's loan metrics and the longer-term consequences for supply and demand are still to be determined. Through January 26th, new-issue volume of $19.3 billion was printed, comparable to the $19.05 billion achieved to this point in 2011. The health of the secondary market continues to improve with average bids coming in at 93.01 on January 25th.

Another positive sign for issuers has been **a strong CLO presence**; December 2011 inked $1.07 billion of issuance. Additionally, four vehicles were priced late in 2011, totaling $1.38 billion, from leading institutions like Morgan Stanley, JP Morgan, UBS and Wells Fargo.

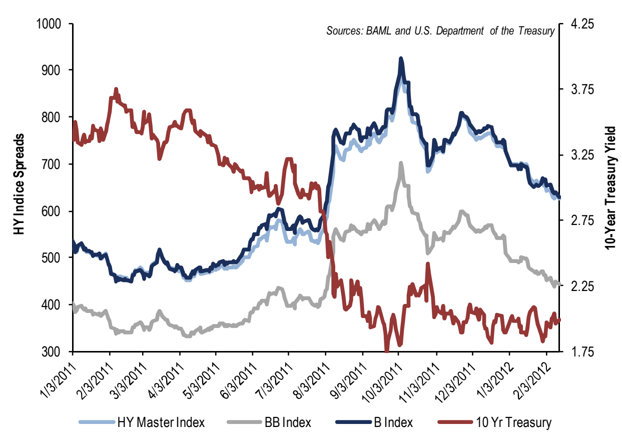
High-Yield

2011 Recap

Unlike their leveraged loan brethren who just wrapped their best year in terms of volume since 2007, participants in the high-yield market had some extra time on their hands in 2011. **New issue volume was $218 billion**, representing **a y-o-y decline of 24% from a record $287 billion** of new issue volume in 2010.

During the year, ten-year Treasuries benefited from the Fed's Operation Twist; yields fell to 2% at mid-summer from 3.36% at the start of the year. High-yield spreads shrunk from a starting point of 542 bps to a low of 460 bps in April. Corporations and PE firms went to market to take advantage of the unique combination of unprecedented low rates for benchmark Treasuries and the spread compression induced by more risk-oriented investors. However, the supply of funds eroded during 2Q and 3Q as the slippage in the U.S. economy and the Eurozone crisis stimulated a flight to quality and reduced appetite for risk. While Treasuries have remained within a 50 bps channel of 2%, **spreads rose intermittently throughout the remainder of the year and closed at 723 bps**.

High-Yield Spreads to Treasuries



High-yield bonds continue to be **supported by strong corporate and economic fundamentals**. Companies today are in a better position to withstand a period of economic weakness. Leverage has declined and companies have

been more temperate in their borrowing. The high-yield market remains **large, liquid and available to fund companies with relatively strong fundamentals**. In addition, the seminally low yields on high-yield bonds enables companies to establish exceptional interest and fixed charge coverage ratios despite leverage ratios of 4-5x EBITDA.

The high-yield market has moved in sympathy with other risk markets as uncertainty yields to confidence, dismalness to buoyancy, and retrenchment to inflows.

Looking Ahead

According to the Merrill Lynch High Yield II Master Index, high-yield bonds are **currently yielding approximately 625-650 bps over comparable Treasuries**. Spreads over Treasuries narrowed significantly during December as the market was lifted by improved U.S. economic data and expectations that Eurozone leaders would contain the region's damaging debt crisis. Despite a brief year-end rally, spreads still hover above the 25 year average of 587 bps and are considerably higher than the 2011 low of 452 bps in February.

The **strengthening U.S. economy and strong corporate fundamentals should generally favor high-yield companies**. Despite continued spread expansion early in 2012, we believe the Fed's announcements of a 2% inflation target, maintenance of Operation Twist, predictions of a modest Fed Funds rate and the potential for QE3 (third round of Quantitative Easing) will **restore confidence and risk appetite to the high-yield investment community**. Recent news of an emerging settlement of the Greek debt crisis and a more robust appetite for European periphery countries has served to reduce uncertainty and fear of a European crisis. In the absence of any external shocks, **we remain cautiously optimistic and expect spreads to tighten towards the historical range of 550-600 bps in 2012**, providing an attractive environment for corporate issuance. We are advising our clients to stand pat, but prepare to enter the market as spreads compress toward 500 bps. In concert with a 2% Treasury yield, this will allow issuers to achieve single digit interest rates across the B-rated to BB-rated spectrum.

The **improving economy should continue to create a favorable environment for positive funds flows from investors seeking enhanced yield opportunities**. Improved balance sheets, cash levels, interest coverage and lower leverage coupled with record low interest rates for the foreseeable future, should provide the market with improved insulation against defaults and support a renewal of private equity investment activity.

Factors Impacting the High-Yield Market in 2012

The Economy and High-Yield Spreads

Spreads, while not nearly as wide as the credit crisis peak during 2009 or the 2001 collapse of the technology bubble, have recovered to attractive levels relative to U.S. corporate bonds. The widening over the past summer was reflective of the European debt crisis and Fed monetary policy pressure rather than a weakening of underlying credit quality. Since peaking in October 2011, spreads have narrowed amongst improving U.S. economic data, ameliorating recessionary risk.

Job creation has picked up- the number of monthly jobs added over the past four months has averaged 155,500 compared with 76,000 for the previous four months. 4Q U.S. GDP growth was 2.8%, with a forecast of more than 2% for 2012 (Bloomberg consensus estimates, 9 January 2012). High-yield bonds do not need strong growth to perform well, but **spreads levels between 650-700 bps continue to price-in a remote possibility of slowdown**.

Decoupling from the European Sovereign Debt Contagion

The high-yield market and other risk asset classes will continue to be affected by the EU. Given the magnitude of the problems and the protracted nature of a response, the issues arising from Europe will not recede anytime soon. As Greece and the other sovereign credit problems are resolved through negotiation and European Central Bank buying support, there remains the capital inadequacy of most large European Banks. Recent World Bank forecasts of growth posit a slowdown in growth for the BRIC countries, stagnant activity for the core EU countries (e.g. Germany, France and the UK) and downturns in the peripheral countries.

However, the strength of **the Fed's early and continuing response to the credit crisis and the attendant downturn has enabled the U.S. economy to decouple itself from European economic activity**. This is equally true for high-yield issuers- approximately 70% of which have no exposure to Europe.

Nevertheless, opportunities will abound for U.S. investors to fill the void in Europe left by an undercapitalized banking sector. Consequently, leveraged finance issuers will have to compete for funds against these European opportunities as local needs may be met by the U.S. lenders. Despite near-term stabilization of the sovereign credit markets and the decoupling of our economy from Europe, the potential remains for Europe to influence rates and volume into 2012.

Low Default Rates

While credit quality remains good, we forecast defaults to increase slightly- albeit off of a very low floor. The early part of the economic recovery was driven by a recovery in revenue growth. As the economic recovery has progressed, margin pressures have increased; businesses have had less ability to pass-through increasing costs to customers. **Yields are currently pricing-in a forecasted default rate of 3.5% to 4%- low by historical comparison**.

Decent Fundamentals Support New-Issuance Volume and Secondary Market Liquidity

Refinancing activity over the past thirty months has successfully pushed-out the maturity wall- **only limited high-yield debt is due to mature in the next three years**. Since 2008, combined loan maturities through 2014 have declined from $840 billion to the current level of approximately $250 billion. Relatively speaking, attractive refinancing rates earlier in the cycle have reduced the economic incentive for additional refinancings at prevailing rates.

We expect new issuance activity in 2012 to remain at high levels as the reduced need for refinancing will be will largely offset by resurgent private equity activity. These investors presently sit on an estimated $400 billion of investment capital that, if deployed, would translate into $1.3 to $2.0 trillion of transactional debt volume. We believe that the improving economy and reduced uncertainty regarding **the outlook for inflation, employment and economic activity will stimulate a more robust transactional environment than 2011**.

Improved liquidity in the secondary market will also serve as a solid indicator of the market's health. Secondary market liquidity declined in 2011, indicated by metrics such as average trading volume and bond dealer inventories. While decreased liquidity is a cyclical recurrence during increased volatility, decreases caused by tighter financial regulations would be more troublesome.

About Us

Advisory Services: Lampert Debt Advisors is dedicated to meeting the funding and growth needs of companies by advising on the creation, placement and execution of debt financing solutions. Our team of Debt Capital Markets experts possesses an average of 20 years of experience in completing transactions. With real time knowledge of the investing interests of over 400 lenders and debt investors and Our Auction Financing Platform, we are positioned to ensure clients of the best possible execution under prevailing market circumstances. Completed transactions are cost-effective, time-efficient and enable management to focus on their business success. Lampert Debt Advisors executes transactions through ICM Capital Markets Ltd, a FINRA-registered broker dealer.

Merchant Banking Funds: In addition, Lampert Debt Advisors has access to private funding for junior capital to be invested in conjunction with transactions when required to successfully complete financings. Investment funds are designed to provide capital at levels and under circumstances not typically available in the markets.

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