LAMPERT DEBT ADVISORS

State of the Debt Capital Markets

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

Volume III, Issue IV

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Contents

By the Numbers

Unemployment

9.1% (September 2011)

Prime Rate

3.25%

Treasury Yields

2-Year Note—0.291%

10-Year Note—2.230%

EURO/USD

$1.3889

3-mo LIBOR

0.42%

LIBOR Swaps (USD)

2-year—0.649%

5-year— 1.415%

Leveraged Loan Volume

$24.2B (September 2011)

High Yield Volume

$7.0B (September 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

- The combination of continued housing market malaise, high unemployment and modest income growth are weighing on consumer confidence and spending. Confidence has ebbed from a high water market of 77.5 in February to 57.5 in the most recent reading of the U. of Michigan Consumer Sentiment Index.
- The Fed has rejected a third round of quantitative easing in favor of "Operation Twist" - an exercise designed to flatten the yield curve through the simultaneous sale of T-bills and shorter term treasuries and the purchase of longer term treasuries.
- The EU announced that European banks needed €80 billion in fresh capital to support their existing asset bases in the face of potential sovereign debt write-downs.

Leveraged Loans

- From February until October 19th, the average new issue ytm widened by 343 bps, from 5.4% to 8.79%, representing a 63% spike. Conversely, pricing for asset based facilities continues to tighten with spreads dipping below 200 bps, on average.
- Pro rata lenders stepped up to fill the void created by reduced institutional activity, accounting for 45% of total loan volume from July - September. As is usually the case, ABLs picked up slack as well, representing nearly 10% of total volume. .
- The S&P LSTA Leveraged Loan Index lost 3.85% in Q3 as prime loan funds experienced $6.8 billion of net outflows contributing to a 57% decline in quarterly new issue volume

High Yield

- Year to date new issuance through Q32011 was $183.9 billion, representing a 15% decline from the same period in 2010 as issuance slowed to a crawl driven partly by $6.5 billion in net outflows from HY Mutual Funds in August alone.
- New issuance lagged throughout the quarter, but picked up steam in September with 16 deals totaling $7 billion vs. an anemic $1.6 billion in August. Currently $3 billion on the forward calendar.

The Economy

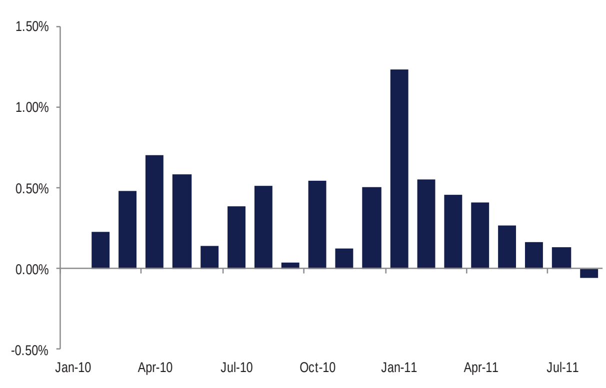
Introduction

The U.S. economy remains mired in a slow growth, high unemployment mode with no near-term fiscal or monetary policy solution. In an era characterized by the dynamic tension between austerity and fiscal stimulus confronting both Europe and the United States, the outlook for continued low financing rates remains fraught with volatility as the world oscillates between monetary easing that reduces interest rates and the compromised state of financial institution balance sheets which gives rise to risk premium increases.

The U.S. Consumer

Consumer confidence and its stepchild, consumer spending, remain the bulwark of any recovery. Unfortunately, the combination of continued housing market malaise, high unemployment and modest income growth are weighing on consumer confidence and spending. Confidence has ebbed from a high water mark of 77.5 in February 2011 to 57.5 in the most recent reading of the University of Michigan Consumer Sentiment Index. Especially troubling is the consumer expectations component which sits at levels not seen in over 30 years - the nadir brought on by the Iranian hostage and oil crises of the late 70's. Unemployment remains stubbornly above 9% while underemployment registered a new high of 16.2%. In near synchronicity with sentiment, Personal Income growth has softened after hitting a high in January. Personal income slipped 0.1% in August after a paltry 0.1% increase in July.

Month over Month Changes in Personal Income



Source: U.S. Department of Commerce, Bureau of Economic Statistics

The U.S. economy may no longer count on the consumer to support aggregate demand with consumer credit, home equity lines and margin debt. Revolving credit slipped an additional $3.4 billion bringing total revolving credit down 18.6% from its all-time high of $973.6 billion in August 2008. Increases in non-revolving debt have largely consisted of student loan debt and, to a lesser extent, automotive debt. We believe continued high underemployment will continue to impair consumer confidence and limit the return to normal levels of GDP growth.

Fed Policy

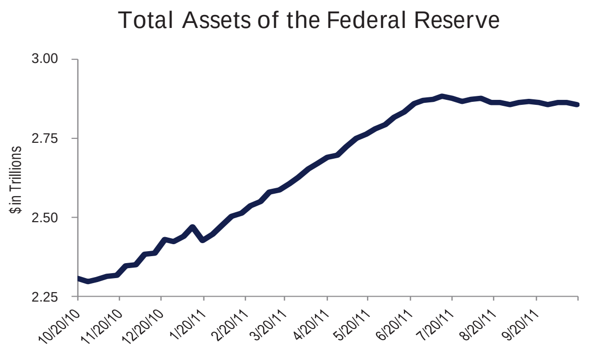
The Fed has rejected a third round of quantitative easing in favor of "Operation Twist" - an exercise designed to flatten the yield curve through the simultaneous sale of T-bills and shorter term treasuries (<3 year maturities) and the purchase of longer dated (6-30 year) bonds. The objective is to reduce the costs of long term funding and thereby stimulate investment and related employment - while retaining the existing, albeit bloated, state of the Fed's balance sheet. In part, the exercise is intended to encourage mortgage borrowing and kick-start the housing recovery. However, continued flights to quality and increased risk premia arising from the dual threat of Eurozone disintegration and economic downturns will blunt the impact of Operation Twist on borrowing volumes.

We believe this is a solution in search of a problem; neither corporate lending rates nor fixed rate mortgages are too high. In fact, prior to Operation Twist, long term mortgage rates already hit levels not seen in 50 years. On the mortgage side, credit standards remain high while consumer balances sheets, despite continued revolving credit paydown, remain impaired by job losses and reduced or negative home equity. Calls to encourage renewed Fed purchases of mortgage-backed securities will do little to improve the housing market.

Corporations have long ago eschewed long-term fixed rate financing in favor of floating rate alternatives, particularly in the face of a persistent, sharp positively sloping yield curve. Insulating income from the vagaries of interest fluctuations is a well-reasoned financial management strategy; however, when the cost differential is factored in over the relevant borrowing time horizon, companies have gravitated toward shorter term, floating rate obligations. The Fed's actions improve long rates at the expense of short rates; it does little to stimulate borrowing and reinvestment by corporations attuned to shorter duration instruments. Furthermore, whatever positive impact on long-term borrowing rates results, it is likely to be mitigated by widening credit spreads. We believe these will persist until the Eurozone crisis of confidence is resolved.

Unfortunately, as we pointed out last month, quantitative easing is unlikely to be any more effective than Operation Twist will be in restoring growth and job creation while, by further inflating the Fed's balance sheet and increasing system liquidity, it may induce greater inflation.

To date, the Fed's balance sheet has trebled to $2.9 trillion from just over $940 billion 3 years ago. During that time, GDP growth was restored but remains at a subpar level of under 3% per annum while unemployment has declined by less than 2% points from the high water mark of 11.1% realized during the recent recession.



Source: Board of Governors of the Federal Reserve System

In the future, we predict Operation Twist will be largely ineffective in contributing growth or employment in the United States. By operating on the slope of the yield curve and ignoring the underlying root causes for our stagnant employment picture, it will do little to alleviate that which ails. Furthermore, the continued Eurozone crisis will raise the risk premium demanded by investors and mitigate any beneficial effects Operation Twist would otherwise have on loan demand and investment.

We expect the Fed will embark on Quantitative Easing III ("QE3") when the inadequacy of Operation Twist is proven. Decelerating global demand and the slowdown in BRIC nation growth rates have restrained the inflationary pressures arising last spring. The absence of inflationary pressures will empower the Fed to implement QE3 next year.

<u>The Importance of Europe - Part II</u>

The European banks are more heavily invested in Eurozone sovereign credits than U.S. banks; however, the impact on credit conditions worldwide continue to be felt as credit spreads widen in sympathy with the increased risks of Eurozone defaults and economic reversals. While the European Financial Stability Fund still has €300 billion of unused capacity that could be deployed to cover 20-30% first loss on sovereign debt, the fact remains that negotiators are seeking private investors to take up to 50% losses on their Greek debt holdings, even after achieving agreement with these same investors to accept 21% loss exposure less than three months ago.

The EU announced that European banks needed €80 billion in fresh capital to support their existing asset bases in the face of potential sovereign debt writedowns. Morgan Stanley's analysis puts the number somewhat higher at €100-200 billion. In either case, banks have ceased generating new assets and are examining ways to shrink asset bases to achieve asset to capital base alignment. BNP, Societe Generale and Credit Agricole announced plans to reduce risk-weighted assets by €70 billion, €80 billion and €52 billion, respectively. The result will be reduced lending capacity from European banks and a concomitant increase in competition between U.S. and overseas customers for credit facilities provided by the largely healthy U.S. banking sector. However, we do not see this competition affecting rates or credit conditions. Indeed, with the fall-off in U.S. loan demand, the diversion of European traffic may well augur renewed loan growth for U.S. financial institutions.

<u>Obama Jobs Bill</u>

Congress is unlikely to pass President Obama's $447 billion jobs bill in its current form. To counteract the likely failure, Senate Democrats are actively seeking piecemeal passage of portions of the bill. However, they have now failed to pass either the portion of the bill designed to allocate $35 billion to keep state government workers employed or a $57 billion bill designed for infrastructure projects to be paid for by a 0.7% surtax on millionaires. We remain sanguine about the lack of passage or progress on the Jobs bill; it is no more likely to result in long-term employment improvement than the last stimulus package. By artificially creating near term demand for labor, the plan merely lays the ground work for shifting the payment for existing employees away from state governments and onto the Federal payroll. While this is a worthwhile political practice for an incumbent seeking re-election, it will do little to improve the structural deficiencies giving rise to systemic underemployment.

Ultimately, certain portions of the bill will pass, certain portions of it will be financed by increased taxes on the wealthy and certainly, it will fail to reverse the causes for our unseemly slow recovery from recession or our lack of meaningful improvement in employment.

Leveraged Loans

<u>If it were easy, everyone would do it…</u>

Prime funds experience net outflows of $5.5 billion. S&P LSTA Leveraged Loan Index loses 3.85%. New issue volume declines 57% from the previous quarter. Average new issue yield-to-maturity widens to 7.99%.

With these third quarter market statistics serving as a grim backdrop, the suggestion that the recent direction of the leveraged loan market has been easily discernible to market participants, would be akin to saying the "Occupy Wall Street" movement has had an equally clear and unified message to these same denizens of Wall Street. Little do the "Occupiers" realize that "Wall Street" is no longer on Wall St.

By and large, every asset class took substantial damage in August arising from the U.S. rating downgrade and overall negative sentiment regarding the global economic condition; however, where equities quickly regained lost ground, leveraged loans floundered straight through quarter end.

The institutional market in particular, was beaten and battered. After record inflows from retail investors the previous seven months, prime funds were hit with outflows to the tune of $6.8 billion in the third quarter (July +$1.2B, August ($5.5B), September ($2.7B)). Spooked by the macro factors of Eurozone malaise, declining aggregate demand and a slowdown in the U.S. economy suggesting a recession return, investors exhibited a flight to safety and reallocated funds to money markets and Treasuries. **Making matters worse, the Fed's declaration of its** intent to keep rates near zero until at least mid-2013, effectively eradicated a principal rationale for investing in the floating rate asset class – as a hedge against rising rates. As the market has begun to find stable footing over the past few weeks, largely in response to improved U.S. economic data, retail investors' predilection for yield has slowly returned and the massive withdrawals have, at least for the moment, abated. Overall, downward pressure from declining technical conditions resulted in the S&P Leveraged Loan Index closing down 3.85% in the third quarter, with a negative 0.23% return, year to date.

Up, up and away

With the secondary trading off so heavily, clearing yields for new issues have continued their ascent into October. Consider that since bottoming out in February at 5.4% (Spread: 386, Floor: 132, OID: 99.59%) the average new issue YTM has increased 63% to 8.79% (Spread: 625, Floor: 146, OID: 96.43) through October 19th. It should come as no surprise then, opportunistic deals such as dividend recaps, have, with a few notable exceptions, been all but banished from the current loan landscape.

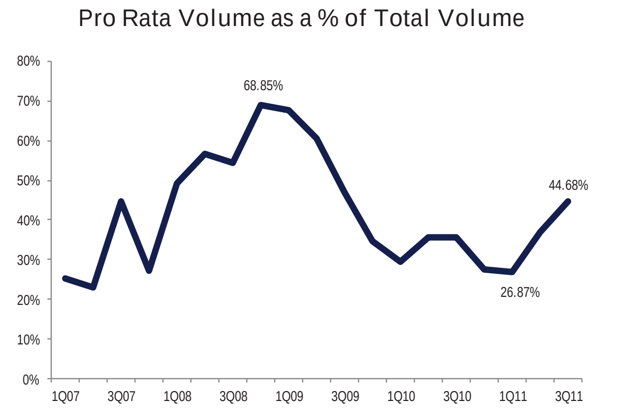
	Week Ended			
	9/29	10/5	10/12	10/19
Spreads (L+)	567	579	621	625
Floor	143	143	143	146
OID	97.50%	97.18%	97.18%	96.43%
Yield	7.53%	8.05%	8.53%	8.79%

A glimmer of sunshine

One bright spot, however, has been the increased lending activity of banks. The endless commentary regarding **banks' resistance to lending is largely incorrect. In** terms of relative share of total loan volume, pro rata lenders, mostly comprised of banks, accounted for 45% of total loan volume in the third quarter, representing a two year high.

Two examples of this increased activity, and directionally reliable barometers of the bank environment overall, are JPMorgan and Wells Fargo. In its third quarter earnings release, JPM reported small business lending, defined as loans to companies with annual revenue of less than $50 million, to be up 71% year over year through the third quarter while loans to middle market companies expanded by 18% over the same period.

Meanwhile, the most active SBA lender by dollar volume for the last three years, Wells Fargo, reported its small business lending activity to be up 40% for the twelve months ended September 30, 2011. 2010 provides for a an easy comparable period to beat; however, by and large, commercial banks seem to be making progress with capital deployment.



Source: S&P LCD

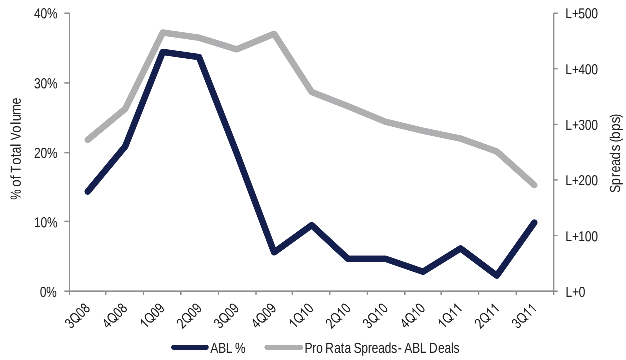
Spotlight on ABL

It has historically been the case that asset based loans have picked up the slack during leveraged loan market disruption; this latest spell of volatility has been no different. Pushed into the shadows during the frothiest of markets due to the prevalence of, and issuer preference for cash flow deals, ABLs epitomize the old saying "slow and steady wins the race." ABL deal volume continues to increase and capture a greater share of total loan volume. For the third quarter, ABLs accounted for 9.8% of total loan volume, up from 2.3% in 2Q11 and 4.8% in 3Q10.

Activity has been primarily driven by refinancings amid an issuer-friendly rate environment which has seen average spreads fall 59 bps to 192 bps in Q3, a 24% decrease from the prior quarter. In certain cases, impacts from the secondary market have affected primary issuance of broadly syndicated loans, giving advantage to smaller transactions.

Going forward, we expect the ABL market to remain healthy and provide increasingly attractive opportunities for issuers to leverage assets and lower their cost of capital.

ABL - % of Total Loan Volume and Average Pro Rata Spreads



Source: S&P LCD

Now what?

Contrary to what the previous commentary and data might suggest, we are optimists at heart and remain confident that thoughtfully structured and widely marketed transactions can be executed despite the difficult conditions. However, such executions will require a holistic approach and expanded resources in order to ensure success. This thought was summed up quite poignantly in the September issue of Deloitte's Capital Advisory:

"Our market observations indicate loans or credits that require more detailed, even nuanced, explaining to potential investors have had a hard time surviving over the economic downturn and are having a much more difficult time getting done today. We expect this to continue to be the case for the remainder of 2011 and into 2012."

Such transactions are where LDA proves its value to clients and we welcome the opportunity to demonstrate

High Yield

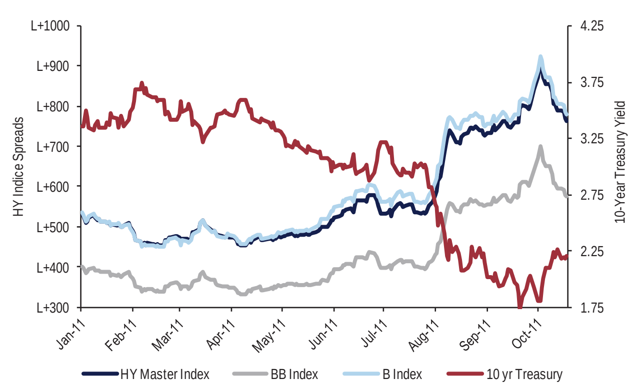
The high yield market has been roller coaster since our last report, gapping lower in late September and early October as systemic risk and related risk premia increased in both the U.S. and Europe. Concerns over a weakening global economy and the European debt crisis have continued to negatively affect the high yield market, resulting in limited new issue activity and limited market access for corporate issuers. However, the market has recently experienced some recovery after the sharp rise in yields in the preceding months.

YTD new issuance through 3Q11 was $183.9 billion, representing a 15% decline from the same period in 2010. The market lost 3.6% in September on top of a 4.0% loss in August bringing the YTD total return in high yield to a negative 1.7%.

Amidst increasing Eurozone concerns, the market is torn between rising concerns of recession and relatively strong issuer fundamentals. The concern is whether the risk of recession caused by a slowdown in aggregate demand and collapsed consumer confidence each week has reached a tipping point. The last time the high yield market was in such a critical zone was in October 2008, when the HY Index traded at 1,220 bps. The market is currently 425 bps away from those levels presaging a recessionary return. However, we do not expect a complete downward spiral as business fundamentals are significantly better today than they were in 2008. Corporate balance sheets are healthier as cash balances are higher and overall leverage remains lower than in previous recessionary periods. Publicly-traded U.S. corporations have accumulated roughly $1 trillion in cash through restructuring and economic recovery. Companies have cut operating costs, conserved cash, increased stock repurchase and reduced investments in expansion or acquisitions.

The volatility in risk premiums described above becomes apparent when we track spreads from August to today. After widening 172 bps in August, HY spreads widened another 111 bps in September closing the month at 841 bps vs. 730 bps in August. Treasury yields were largely unchanged for the month. In September, every sector was down for the month, with the largest losses coming from real estate, software and telecom. In October, a secular rally began in earnest, lifting the market from the depressed prices at the beginning of the month to a more stabilized spread to Treasuries of +746 bps (October 21), an improvement consistent with mid-August levels and a

High Yield Spreads to Treasuries



Source: BAML, U.S. Department of the Treasury sharp rally from the secular high of +910 bps realized on October 4th.

New issuance picked up in September, with 16 deals combining for a total of $7 billion, versus an anemic $1.3 billion in August issuance. After a negative outflow of $6.5 billion in August, high yield mutual funds experienced positive inflows in each week of September, totaling over $2 billion for the month. Positive inflows continued through the first two weeks of October, and contributed to renewed vigor in the offering calendar. The secondary market also benefited as prices rose through the first two sessions following the holiday weekend, bolstered by an improving equity market and some positive news about the Eurozone debt crisis. As we head into the year-end quarter, high yield bonds have attempted to make up lost ground. Buying activity has picked up and encouraged issuers to take advantage of the improved market tone. After several weeks of minimal activity, the market saw $2.7 billion in new issues this past week and the forward calendar increased to $3 billion. We expect the volatility to continue as headlines out of Europe and prognoses on U.S. economic health will catalyze pronounced movement in both directions.

Ratings downgrades have outpaced upgrades for two straight months, the first time since 2009.

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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