State of the Debt Capital Markets

LAMPERT DEBT ADVISORS

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

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Contents

By the Numbers

Unemployment

9.1% (August 2011)

Prime Rate

3.25%

Treasury Yields

2-Year Note—0.205%

10-Year Note—1.991%

EURO/USD

$1.4098

3-mo LIBOR

0.33%

LIBOR Swaps (USD)

2-year—0.510%

5-year— 1.168%

Leveraged Loan Volume

$3.02B (August 2011)

High Yield Volume

$1.18B (August 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

- Over the last decade, investment by U.S. companies in labor-saving technologies has resulted in dramatic improvements in productivity and GDP growth with limited increases in employment and an economy compromised in its ability to absorb workers.
- The U.S. continues to face unprecedented levels of unemployment and underemployment.
- The lack of fiscal discipline characterized by a need to rein in deficit spending, excessive Treasury borrowing and over-reliance of foreign funding of our deficit eliminates fiscal stimulus as a source of employment growth.
- The Fed's announcement that interest rates would remain at near-zero levels will likely perpetuate continued advances in capital investment, but with limited impact on the unemployment rate.

Leveraged Loan Market

- For the week ended August 10, leveraged loans posted their 2nd worst week on record with the S&P LSTA Index shedding 3.22%.
- New issues traded below their issue price, making it prohibitively difficult to price deals that provided both yield protection for investors and acceptable costs of capital for borrowers.
- Fed announcement dampens the appeal of loans for investors seeking inflationary hedges. The supply vacuum driven by retail outflows and an absence of CLO issuance, portends increasingly higher yields and more conservative structures.

High Yield Market

- Since 2Q 2011, high yield issuance has experienced a marked decline averaging approximately $1.5 billion per week versus an average of $6.4 billion during the first half of the year. August was the slowest month for new issuance since December 2008 with significant funds outflows contributing to wider yield spreads spreads and reduced investor appetite.
- The increased volatility of the high yield market may signal tougher economic conditions ahead, with spreads to Treasury drastically widening over 200 bps in recent weeks to 739 bps.

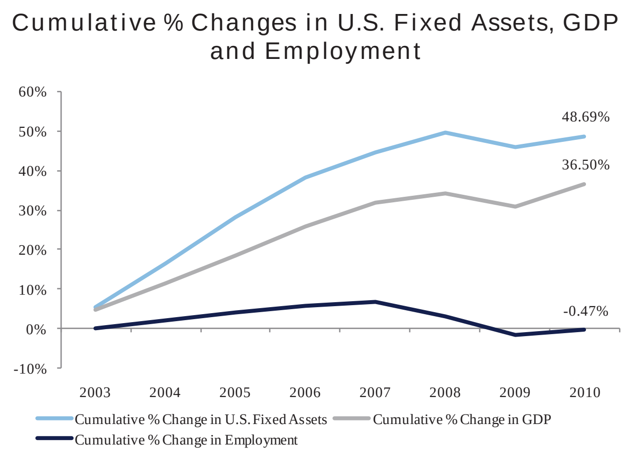
Two decades ago, the fall of the Berlin Wall and the concomitant fragmentation of the USSR into autonomous nations gave rise to a sense of omnipotence and military security that persisted until 9/11. One decade ago, the Clinton Administration presided over a period of nearly unprecedented fiscal austerity, ushering in a brief interlude characterized by a budget surplus and market concerns with limitations on the availability of Treasuries as the Fed contemplated the retirement of the benchmark 30-year bond. The combination lent our system an aura of invincibility and limitless economic and political prowess that has continued to underlie the expansive programs and policies pursued today. However, the recent debt ceiling impasse and the coincident downgrading by Standard and Poor's has laid bare the loss of our economic degrees of freedom; it has laid bare the limitations of our resources and our impotence in improving the welfare and well-being of a vast swatch of our population, the 22 million underemployed people that desire, but do not possess full time employment. We are confronting the limits to greatness and economic prowess that had seemed boundless. Our fiscal policies, our monetary policies and now our foreign and military policies are increasingly constrained by the inability to tame our spending, limit our borrowings and pursue defined social and political goals.

The ongoing debate regarding the debt ceiling carries with it undertones of the battle lines drawn throughout Europe and Japan between the limitations on government deficit spending imposed by the capital markets and the demands for government programs and subsidies that they can ill afford. Generations of economists have long-considered U.S. Government Bonds the risk-free security. Congress raised the spectre of default, a key measure in the evaluation of sovereign credits and catalyzed S&P's downgrade of the U.S. Government, which should come as no surprise. At present, 80 companies trade at CDS prices that are less than the U.S. Government while five companies have credit ratings that are better than the U.S. Government, a phenomenon deemed impossible ten years ago and more recently limited to multinational companies domiciled in emerging markets. The result will be continued restraints on the use of fiscal policy to improve the outlook for job growth as well as an acceleration in the decline of the dollar as the central currency.

The Ineffectiveness of Monetary Policy

After two successive rounds of Quantitative Easing, our economy remains mired in unemployment pinned above 9%. As we have said before, monetary policy is macroeconomic in implementation but microeconomic in effect. And the result of an era of high liquidity maintained by the dollar's role as the central reserve currency has been artificially low interest rates on dollar-denominated investments. U.S. Corporations have deployed capital to remain competitive against foreign companies possessing lower labor costs by investing in labor-saving production technologies. The result is the ability to sustain GDP growth with more limited employment growth. Combined with the rapid pace of technological development, cheap capital has dramatically slowed the rate of worker absorption by the U.S. economy. As we described in our edition last spring, the level of employment required to support a $1 million increase in GDP has declined by 87.5% during the past thirty years. Nor should this surprise anyone that studied Samuelson's landmark textbook *Economics*. Using the simple model that posits labor and capital as the two factors of production, Samuelson goes on to point out that corporations acting in their best economic interest will substitute low cost capital investment for high cost labor as the cost of the former rises relative to the latter. For U.S. employment, a generation of low cost capital has resulted in dramatic improvements in productivity, but at the cost of an economy compromised in its ability to absorb workers displaced by economic malaise or new workers entering the labor force.

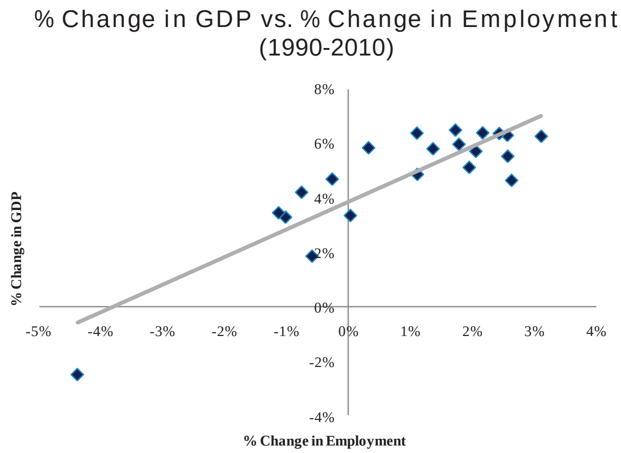
The following table highlights the disparity between the growth in U.S. fixed assets and the growth in employment.



Source: Bureau of Labor Statistics, U.S. Bureau of Economic Analysis

As indicated, since 2003, American business and government have increased investment in fixed assets by nearly 50% during a period in which cumulative GDP grew nearly 40% while total employment ended 2010 pinned just below the level exhibited eight years ago. Another way to examine the data is to examine the annual percentage change in GDP compared to the percentage change in employment.

Effectively, as the following trend line indicates, our economy can sustain nearly 4% growth with nearly zero increase in employment.



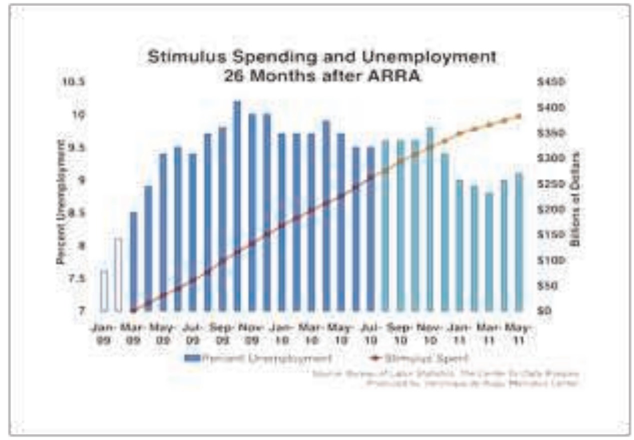
Source: Bureau of Labor Statistics, U.S. Bureau of Economic Analysis

More recently, the Fed announced that interest rates would be maintained at near-zero levels for nearly two years until mid-2013. Hopefully, the Fed move counteracts the deleterious effects that the budget deficit impasse and subsequent downgrade had on corporate plans. In a recent survey conducted by ChangeWave Research, nearly 23% of respondents lowered capital spending plans in the 90 days leading up to the August 2, 2011 deadline for the debt ceiling compared to 8% that increased their budgets. 16% of respondents reduced their corporate capital spending plans as a direct result of the impasse while only 1% increased for the same reason. The Fed's move will facilitate continued advances in growth and capital investment; however, it will have limited impact on the unemployment rate.

The Ineffectiveness of Fiscal Policy

The debt ceiling impasse and its jerry-rigged solution has laid bare the constraints on our ability to deploy fiscal policy to stimulate employment. At the time the American Recovery and Reinvestment Act (ARRA) was enacted in February, 2009, unemployment stood at 7.6%. Through May, nearly $400 billion in stimulus funding had been spent while unemployment has remained well above the 8% maximum unemployment rate targeted by ARRA and at best, unemployment has only fallen 1% from its recession peak of 10.2% to 9.2% as of June, 2011.

As the previous chart suggests, the Stimulus Package has been of limited value in reducing unemployment. Arguably, the high unemployment rate masks the beneficial effects that stimulus had on reducing job cuts and moderating what the unemployment rate might have been otherwise. However, the fact remains that we face unprecedented levels of unemployment and underemployment while fiscal policy is constrained by the need to rein in deficit spending, reduce Treasury borrowings and limit reliance on foreign funding of our deficit.



Source: U.S. Bureau of Economic Analysis, Center for Data Analysis, George Mason University

Implications for our Credit Markets

During the next twelve months, we believe the credit markets will experience continued volatility brought about by the swamping effects of massive capital flows into and out of risk assets as the U.S. and Eurozone lurch from crisis to crisis. The Fed's announcement that it will maintain an exceptionally low Fed Funds rate until 2013 suggests continued easy credit conditions, particularly for borrowers at the short end of the yield curve. However, we expect credit spreads to experience periods of increased amplitude as markets rapidly and radically shift in counterpoint to crises. The challenge will be to pick the timing for initiatives to take advantage of liquidity as it arises and avoid financings during the temporary periods of illiquidity that will prevail from time to time.

Fiscal policy has been neutered by the combination of the debt ceiling debacle, the inadequacy of past fiscal measures designed to stimulate job growth, and the ratings write-down. With an election year rapidly approaching, we see few positive developments out of Washington.

Leveraged Loan Market

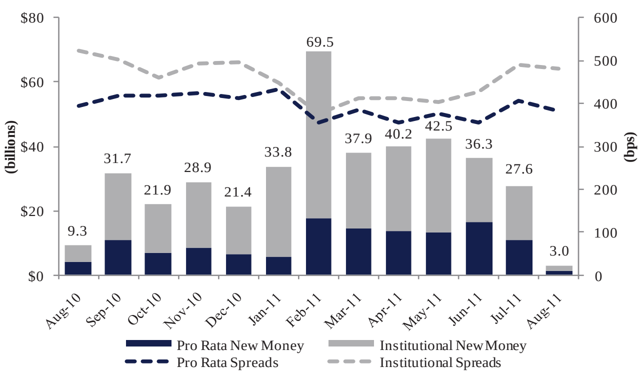
Much like its equity and high-yield brethren, the leveraged loan market was beaten and battered last month as a result of the debt ceiling debacle and subsequent U.S. sovereign credit rating downgrade. Once the dust settled and August's opening week concluded, leveraged loans had posted their 2nd worst week on record with the S&P LSTA Index shedding 3.22% during the seven days ended August 10. The only week more painful? You guessed it - the seven days of Armageddon immediately following the Lehman bankruptcy filing. For the year, the Index is down 1.77% through August 31, versus a 5.29% gain during the comparable period in 2010.

As a result of the broad market volatility and secondary market decline, primary loan issuance screeched to a halt with investors focused on secondary trading levels of recent new issues.

Reflective of a level of investor risk aversion not seen in quite some time and illustrative of weak loan demand, new issues began trading well below their issue price when secondary trading started. As a result, it became prohibitively difficult to price deals that coupled satisfactory yield protection for investors with acceptable costs of capital for borrowers. Primary issuance tallied just $830.5 million during the week with the majority going to middle market borrowers. In this instance, the illiquid nature of middle market paper was advantageous to its issuers because the paper is not heavily traded and investors are less concerned with its secondary trading levels as with broadly syndicated deals.

For the month, August volume totaled $3.02 billion versus $9.33 billion during the year earlier period.

New-Issue First-Lien Spreads and New Money Volume



Source: S&P LCD

Technically Speaking

Following on the heels of 57 straight weeks of retail fund inflows which added $24.5 billion of liquidity to the loan market, retail investors have pulled approximately $4.8 billion from prime funds over the four weeks ended August 24, including $2.1 billion in the week following the U.S. credit rating downgrade alone. The outflows gave rise to two schools of thought: (i) the Fed will defend against a double dip through QE3 thereby fostering an inflationary environment and making floating rate instruments appealing, or (ii) stagnant GDP growth will require expansionary monetary policy leading the Fed to keep rates low for a considerable period thereby reducing the appeal of loans. Since the Fed's meeting on August 9, we now know to expect rates to remain low until at least mid-2013. This greatly diminishes the appeal of loans to investors, both retail and institutional, who sought floating rate instruments as an inflationary hedge. As such, it appears the surge in retail driven loan demand experienced over

Credit Stats - Middle-Market Loans

	Aug-10	Jun-11	Jul-11	Aug-11
Spread (L+)	620.83	555.00	623.68	NA
Floor (bps)	179	152	144	NA
OID	190	133	150	NA
Yield	8.70%	7.60%	8.30%	NA
Observations	6	16	23	1

*NA - Data unavailable

Source: S&P LCD

the past year is largely behind us.

Interestingly enough, investors have been easing off the gas for quite some time now; inflows fell to an eight month low of $1.6 billion in June. Sure, this was caused principally by the economic contagion present in the EU, but worse than expected domestic economic reports were also to blame for investors sudden risk aversion. Further exacerbating the technical imbalance was the overwhelming supply of loans investors had absorbed in May. When considered on the heels of five straight months where demand outran supply, it seems that if it weren't for *im*balance, the loan market wouldn't have any balance at all. Or, as Confucius more eloquently put it, "To go beyond is as wrong as to fall short."

Reminiscent of 2007, we've started to see announced M&A fall victim to soft market conditions. Notable examples include Cerberus & Chatham Lodging Trust's asset purchase from Innkeepers USA Trust and MediaNews Corp.'s purchase of Freedom Communications. As of this writing, there were approximately $15 billion of M&A related loans set to launch in September – a daunting figure, which by most accounts will not make it across the finish line in its entirety.

So where do we go from here?

Unless conditions change materially, it would seem as though there are tough days ahead for borrowers. Already, new issue first-lien yields have widened considerably from 6.43% in July to 7.8% in August with the expectation being that they will not be falling anytime soon. Further, with no end to the liquidity/loan demand vacuum caused by retail outflows and an absence of recent CLO issuance in sight, the supply/demand equation portends increasingly higher yields and more conservative structures to come. That being said, we remain confident that thoughtfully structured transactions will attract capital despite the overall economic malaise.

High Yield Market

High yield market activity has slowed to a trickle since the end of the second quarter. Excluding large high yield bond issues for Ford, HCA and Reynolds, since the middle of June issuance has averaged approximately $1.5 billion per week versus a $6.4 billion weekly average during the first half of the year. Despite the slowdown, year-to-date high yield issuance volume is up 8% year over year, but August was the lowest for any month since December 2008.

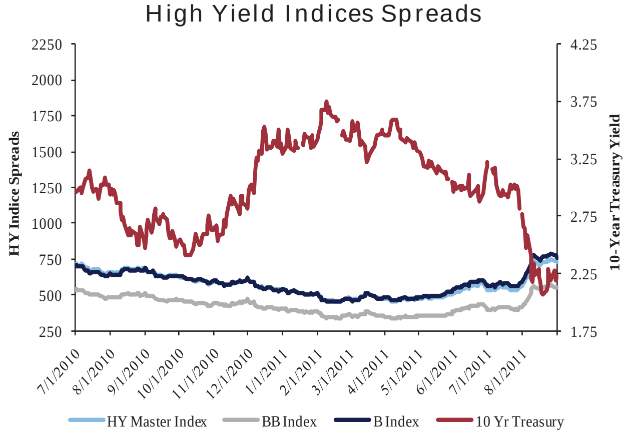
New issuance levels are anemic as issuers remain sidelined in the face of persistent uncertainty in global financial markets. Since the end of the second quarter, conditions in the market have continued to deteriorate in response to increasing investor concern over the financial health of below investment grade companies. The ML High Yield Master II Index widening 205 bps since the start of July to 739 bps, at the end of August. Although new issuance in the first half of 2011 outpaced last year's level, the second half may have trouble keeping pace with the near evaporation of new issuance in August and significant negative funds flows this past summer. In July the market saw $15.7 billion in new issuance, but almost half came from 2 issuers, HCA, Inc. and Reynolds Group Holdings LLC.

Since the beginning of August, high yield bond funds have seen strong outflows as investors moved into Treasuries and out of riskier asset classes. Funds flows have been negative for the past 4 weeks, with over $4.0 billion leaving the market; the resulting drain of liquidity has meant generally lower pricing in the junk bond market. Strong demand for Treasuries has pushed the 10-year Treasury yield to recent record low below 1.99% in September.

As a bellwether market, high yield may be signaling tougher economic conditions ahead. The increased market volatility of the equity and high yield markets suggests sufficient erosion to investor, consumer, and business confidence that in turn may push the fragile economic recovery into a double dip. In 2001, a 25% drop in equities precipitated the recession that began that year, while a 17% drop in early 2008 predated the most recent recession.

The possibility of a double dip recession looms, with the U.S. economy coming dangerously close to contracting in the first quarter and stumbling badly in the remainder of the first half. High unemployment, a bruising political battle in Washington over the debt ceiling and a stock market slump all helped push U.S. consumer sentiment to its lowest level in more than 30 years. This weakness has been exacerbated by weak growth data from Europe's main economies, Germany and France, and an insufficient response to its own European sovereign debt crisis.

High Yield Indices Spreads



Source: BofA Merrill Lynch Global Index System, U.S. Depart-

The 10-year Treasury yield decreased 38 bps to 2.38% in the days following the downgrade and currently stands at 1.99% as of this writing. While the necessity of the S&P downgrade is arguable, the fact remains that when investors pull out of riskier classes of assets, U.S. Treasuries provide a safe haven and the perception of U.S. credit quality remains largely unchanged for the time being.

Spreads vs. 10-Year Treasury

	Dec-10	Jun-11	Δ	Jun-11	Aug-11	Δ
Building Materials	544	551	7	551	790	239
Capital Goods	462	514	52	514	658	144
Chemicals	428	434	6	434	584	150
Gaming	709	685	(24)	685	908	223
Bank/Thrift	567	565	(2)	565	808	243
Broadcasting	595	645	50	645	959	314
Consumer Products	550	580	30	580	739	159
Cable/Satellite	433	421	(12)	421	551	130
Healthcare	496	494	(2)	494	690	196
Media	505	555	50	555	785	230
Leisure	545	513	(32)	513	674	161
Restaurants	720	683	(37)	683	871	188
Telecom	520	491	(29)	491	677	186
Distressed	1,556	1,482	(74)	1,482	1,476	(6)
Fallen Angel	502	468	(34)	468	653	185
HY Master	541	542	1	542	730	188
BB Index	408	405	(3)	405	553	148
B Index	546	571	25	571	754	183
CCC Index	879	888	9	888	1,219	331

Source: BofA Merrill Lynch Global Index System, U.S. Depart-

The average yield on all high yield bonds is about 8.3%, with spreads widening about 166 bps over a 3 week period in August, indicative of the type of risk aversion that has gripped financial markets recently. By comparison, it took nine weeks during the last global crisis (between late 2007 and February 2008) to incur similar spread expansion.

Over time, this market has become a reliable barometer of economic growth with spreads expanding to 650-750 bps, but still shy of the 1000+ bps levels during the Great Recession. Bond default rates are still forecasted at a low 2% for the year, but those forecasts may change if conditions continue to deteriorate.

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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