Second Quarter 2012

Junior Capital Insights

Providing data analytics, insights and perspectives on key topics affecting capital providers and issuers of junior capital.

Inside

Is it Deja vu all over again? It feels like volatility is increasing to levels experienced last July during the debt ceiling debate. Whether or not you think the events in Spain or the tepid jobs numbers are likely to send the markets into a tailspin, there is certainly a feeling among many market participants that any additional major negative news could create another credit market seizure this Summer.

Many people agree that it took almost a full quarter for things to recover following the debt ceiling debacle. Business owners may be looking to generate a liquidity event before the tax man possibly changes the cap gains rate. Deals in the post-Lehman environment just take longer. Lenders do more diligence, credit committees scrutinize businesses more closely and investors challenge projections more deeply. Deals launched in October 2012 could have a tough time getting done this year, particularly if there is a post-Labor Day surge in middle market loan and structured equity volume.

There is currently substantial liquidity available to fund recaps and dividend deals. While banks remain cautious, billions of dollars are available from public and private funds offering uni-tranche / private high yield debt, mezzanine financing and structured equity. As is typically the case, middle market borrowers have seen neither the aggressive pricing nor harsh volatility in the financing markets that companies with access to the broadly-syndicated or public markets have felt. As such, while the public markets have gyrated wildly (and down) of late, the lower middle market remains stable.

So rather than take to the beach this Summer and do that dividend deal later this year, many are choosing to act now. Whether it's the Euro, the election or some other exogenous event, the lesson from last year is that something very unforeseen (the United States not being rated AAA) could shut the markets just long enough to deny what may be a last chance for a very long time to take a dividend out at these cap gains rates.

The Buyside Weighs In

Jeri J. Harman
Avante Mezzanine Partners
Founder and Partner

In the lower middle market, where Avante Mezzanine is focused, deal flow in the second quarter continued on pace, but picked up in the last 4 to 6 weeks. This pace, while consistent and healthy, does not reflect the robust increase expected as we move into the second half of the year. Over the last six months, we took advantage of this deal flow by providing junior capital to support two buyout transactions and acquisition capital for a growing business, and recently issued a commitment to finance the buyout of a leading business services company.

Quality has been very mixed throughout this year, although we saw meaningful improvement beginning in June. Pricing and leverage continue to be aggressive for the highest quality deals. While we think quality overall should continue to improve, we remain highly selective by targeting companies with strong recurring revenue, consistent historical performance and diverse customers.

Steven Migliero, Jr.
Crystal Financial
Managing Director

Overall market activity for Crystal Financial remains strong, having closed 8 new financings year to date. Crystal continues to see attractive opportunities investing in both good credits in less favorable industries and asset rich companies with inconsistent financial performance.

For strong companies, the capital markets are open, capital is readily available, and uni-tranche financings are increasingly replacing capital structure solutions that historically included second lien or mezzanine financing.

When you move away from the “A” credits, the funnel of available capital shrinks rapidly. With less competition, these credits often have lower leverage and better LTV’s, presenting attractive risk / reward opportunities. There is often a story to understand, but one can get paid for that risk.

The same opportunity is present in “good collateral / bad balance sheet” companies. Due to continued uncertainty in Europe as well as stringent regulatory requirements, commercial banks continue to remain conservative. Again, due to limited competition, we believe these situations allow us to invest at attractive rates while taking limited principal risk.

Joshua Davis
Stellus Capital Management
Founding Partner and Co-Head
of Private Credit Strategy

Stellus Capital Management was formed in January 2012 in connection with the spin out of the Direct Capital Unit of the D. E. Shaw group. While at the D. E. Shaw group, from 2004 to 2011, the Stellus team invested $5+ billion of debt and equity capital and continues to provide investment advice on approximately $1.3 billion in investments generated while at the D. E. Shaw group.

Stellus has two investment strategies: (i) private credit and (ii) private equity. The private credit strategy focuses on direct loans to middle market companies across industries. The PE strategy focuses on providing equity and equity-linked debt capital to small/middle market energy companies.

With regard to market outlook, we continue to see a high degree of competition from buyers and lenders for sound businesses that exhibit growth potential, resilience in challenging economic environments and strong levels of profitability. In structuring transactions, our financial sponsors are exhibiting increasing interest in uni-tranche structures for businesses in the $10 million to $30 million EBITDA level.

Stats Say It All

The Market Sure Says Bigger is Better

June 2012

	Large Corporate LBOs (>$50MM of EBITDA)	Middle Market LBOs (<$50MM of EBITDA)
Senior Debt / EBITDA	4.9x	3.8x
Total Debt / EBITDA	5.0x	4.5x

Average new-issue first lien pricing - last 90 days

	Spread Over LIBOR (bps)	LIBOR Floor (bps)
Middle Market	598	136
Large Corporate (BB-rated)	492	129
Gap (bps)	106	7
Middle Market	598	136
Large Corporate (B-rated)	510	131
Gap (bps)	88	5

Source: S&P Capital IQ LCD

Spotlight On A Pro 60 Seconds with Howard Levkowitz, Managing Partner, Tennenbaum Capital Partners, LLC, and Chairman & CEO, TCP Capital Corp.

Tell us about Tennenbaum Capital Partners (“TCP”).

We are a leading alternative investment management firm focused primarily on credit opportunities. Since the firm’s founding in 1999, we have invested over $10 billion in more than 200 portfolio companies through our credit opportunities strategy, in addition to investments made in a specialty fund dedicated to debtor-in-possession financing. Additionally, TCP is the investment advisor to our publicly-traded business development company (BDC), TCP Capital Corp.

At TCP, we target U.S. middle market credits, in investment positions up to $250 million. We invest in all parts of the corporate capital structure, through deeply discounted securities and commercial loans in the secondary market, or by direct capital infusions into both healthy and troubled companies. Our principals have significant experience crafting unique solutions for both publicly-traded and privately-held companies. We believe we are a valued deal partner and we seek to build long-term relationships.

How does TCP Capital Corp. fit in?

The deep skills and diverse experience of our investment professionals contribute to managing the portfolio of TCP Capital Corp., a BDC that had its IPO in early April, and now trades on NASDAQ under the ticker symbol TCPC. TCP Capital’s investment objective is to generate high total returns while preserving capital. We invest primarily in senior debt instruments of private, middle market companies with enterprise values typically between $100 million and $1.5 billion, but we may provide financing solutions at any level of the capital structure. While our focus is on directly-originated loans, we have the flexibility to invest in secondary market investment opportunities. With our rigorous approach to due diligence, active investment monitoring and long-term perspective, we are an ideal partner for companies and sponsors seeking a stable source of capital.

Current Junior Capital Money Terms
For Businesses with $10 Million to $25 Million of EBITDA

Key Terms	Uni-Tranche	Mezzanine	Structured Equity
Leverage	Total leverage up to 4.0x	Total leverage up to 4.75x	Funded capital (inclusive of debt) up to 5.50x
Pricing	9.5% to 11.5%	12% to 14% (cash and PIK)	8% to 12% dividend with a total yield target of 19% to 21%, including warrants
Call Protection	NC1, 3%, 2%, 1%, 0%	3%, 2%, 1%, 0%	No non-call period, 2%, 1%, 0%
Maturity	5 year term	6 year term	6 to 7 year term
Amortization	No mandatory amortization prior to maturity	No mandatory amortization prior to maturity	No mandatory redemption prior to maturity

Source: Standard & Poor’s LCD; Duff & Phelps estimates.

Duff & Phelps
Private Financing Services

The Duff & Phelps Private Debt and Equity Placement Group specializes in raising debt and equity capital for middle market companies to support a variety of transactions that include:

Refinancings
Recapitalizations
Acquisition Financings
Special Situation Financings
Leveraged and Management Buyouts
Growth Capital

Duff & Phelps professionals have helped raise in excess of $15 billion of debt and equity financing over the past 20 years for companies in the consumer products, transportation, restaurant and retail, industrial, building products, healthcare and financial services industries, among others. Our client focus, extensive market and industry knowledge, dedicated senior level commitment and tailored financial solutions position Duff & Phelps as a leading placement agent for private debt and equity capital.

The team, led by Managing Director Ray Kane, who has more than 20 years of experience with the origination and sale of securities in the private placement market, maintains relationships with over 250 of the leading capital providers in the mezzanine, hedge fund, structured equity, growth equity, BDC, SBIC, insurance company, bank and specialty finance marketplaces, as well as with the specialty lending arms of the bulge bracket investment banks’ proprietary trading desks.

Duff & Phelps

Select Recently Closed Financings

Private Financing $20,000,000 Equity Line of Credit, Engine Acquisition I, LLC, a majority owned entity of Avioserv San Diego, Inc. Financial advisor and placement agent to Avioserv San Diego, Inc.	**Private Financing** $25,000,000 Senior Credit Facility Lang Holdings, a portfolio company of Sun Capital Partners, Inc. and Catteron Partners Financial advisor and placement agent to Lang Holdings	**Private Financing** $125,000,000 Senior Credit Facility McGladrey & Pullen LLP Financial advisor and placement agent to McGladrey & Pullen LLP
Private Financing Navman Wireless, a portfolio company of Prairie Capital, has completed a senior debt financing Financial advisor and placement agent to Navman Wireless	**Private Financing** $25,000,000 Senior Credit Facility $15,000,000 Subordinated Notes Merlin International Financial advisor and placement agent to Merlin International	**Private Financing** $175,000,000 Senior Credit Facility $150,000,000 Structured Equity Rock Bottom Restaurants was recapitalized and merged with Gordon Biersch to form CraftWorks Financial advisor and placement agent to Rock Bottom and CraftWorks

Junior Capital Insights Contributors

Raymond Kane
Managing Director
+1 212 871 9963
raymond.kane@duffandphelps.com

Tim Meyer
Managing Director
+1 212 871 3030
timothy.meyer@duffandphelps.com

Duff & Phelps
55 East 52nd Street
Floor 31
New York, NY 10055
+1 212 871 2000

About Duff & Phelps

As a leading global financial advisory and investment banking firm, Duff & Phelps balances analytical skills, deep market insight and independence to help clients make sound decisions. The firm provides expertise in the areas of valuation, transactions, financial restructuring, alternative assets, disputes and taxation, with more than 1,000 employees serving clients from offices in North America, Europe and Asia.

Investment banking services in the United States are provided by Duff & Phelps Securities, LLC; Pagemill Partners; and GCP Securities, LLC. Member FINRA/SIPC. M&A advisory services in the United Kingdom and Germany are provided by Duff & Phelps Securities Ltd. Duff & Phelps Securities Ltd. is authorized and regulated by the Financial Services Authority. For more information, visit www.duffandphelps.com. (NYSE: DUF)