

State of the Middle Market

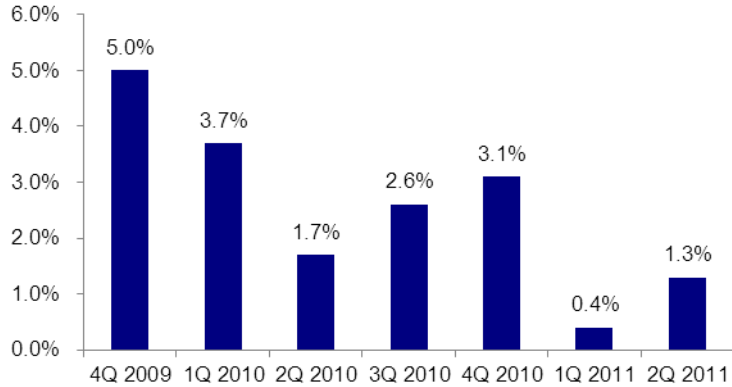
M&A • Private Equity • Financing

September 2011



Macroeconomic Environment Creating Uncertainty

GDP Growth Trending Downward

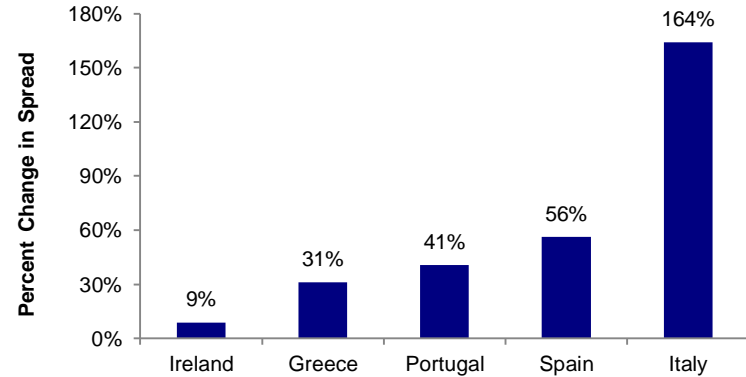


Source: IMF

Observations

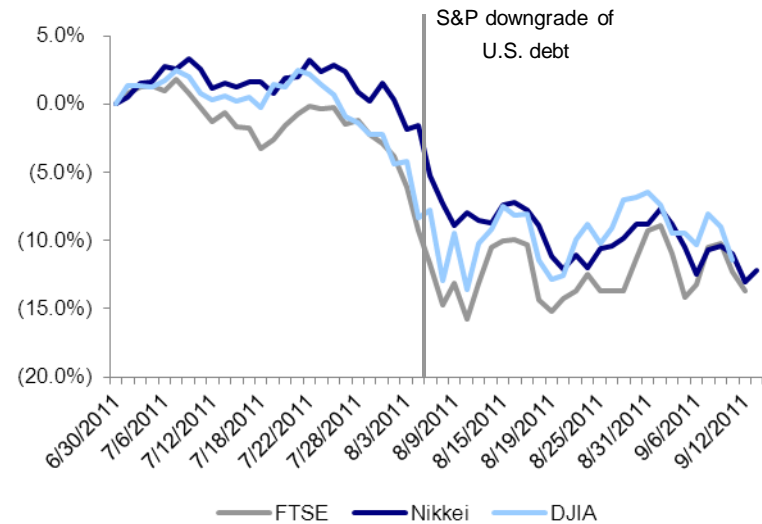
- Despite growing at 5.0% upon exit of the recession in late 2009, U.S. GDP growth has slowed to 1.3% through Q2 2011 and full year 2011 GDP expectations have been revised downward from 3.0% to 1.6%
- The European sovereign debt crisis continues to worsen with spreads on the outstanding debt of a growing number of countries significantly widening
- Ongoing concerns about the U.S. Government's deficit, high unemployment rates and a slow-down in China's economy are also creating uncertainty
- These factors have resulted in greater volatility in global markets and have caused participants to become increasingly cautious

Sovereign Credit Default Swap Spreads Increase Since June 30, 2011



Source: Bloomberg

Volatility in Global Equities Markets Ensues



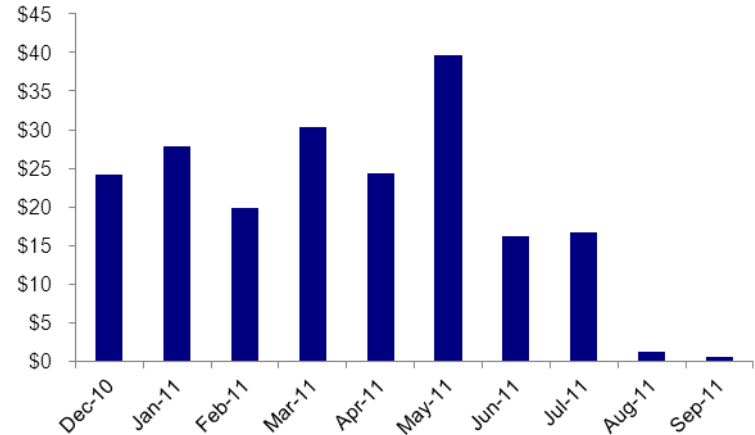
Source: Capital IQ

A Flight to Yield Shifts to a Flight to Quality

Observations

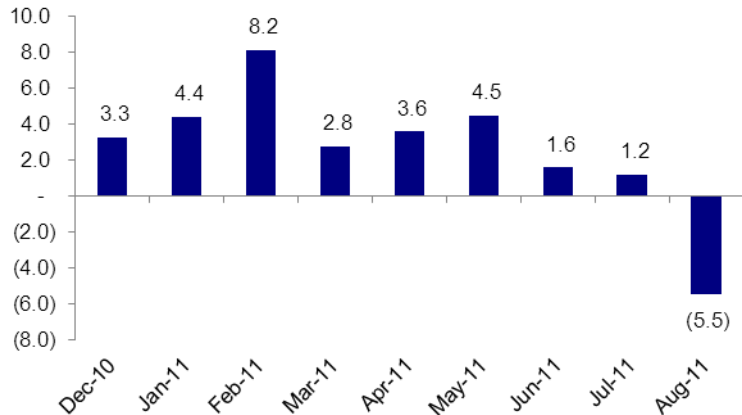
- Throughout the first half of 2011, there was significant demand for high yield and leveraged loan products as investors were focused on maximizing yields
- However, uncertainty resulting from macroeconomic factors has caused investors to increasingly focus on quality, rather than yield
- As a result, there have been significant cash outflows in loan and high yield funds and significant cash inflows to money market funds and Treasuries
- Loan funds, which are replacing expiring CLOs, are critical to the availability and pricing of leveraged loans

Volume of High Yield Debt Issuances (\$Bn)



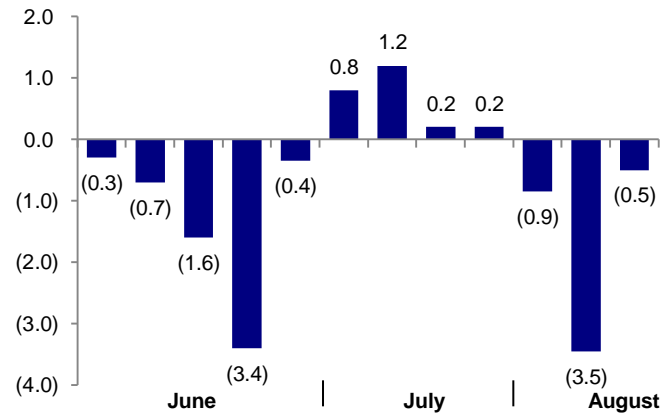
Source: Standard & Poor's Leveraged Commentary and Data
 Note: September 2011 data covers the month-to-date period

Monthly Loan Prime Fund Flows (\$Bn)



Source: Standard & Poor's Leveraged Commentary and Data

Weekly High Yield Mutual-Fund Flows (\$Bn)



Source: Lipper

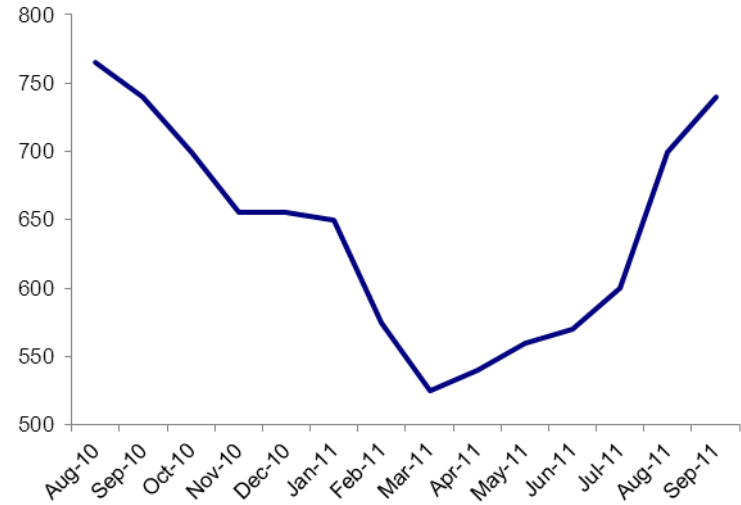
Flight to Quality Increases Yields on Non-Investment Grade Debt

Treasury Yields



Source: Standard & Poor's Leveraged Commentary and Data

Average New-Issue Yield to Maturity for Leveraged Loans



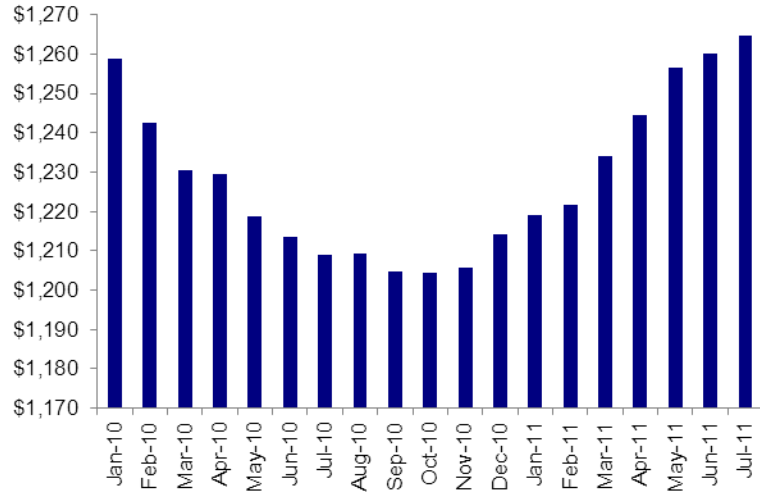
Source: Standard & Poor's Leveraged Commentary and Data

Market Dynamics

- Despite the recent downgrade of U.S. debt by S&P, demand for Treasuries has significantly increased as investors seek securities with lower perceived risk
- Yields on non-investment grade debt, including leveraged loans, have increased in order to entice market participants to take on these riskier investments

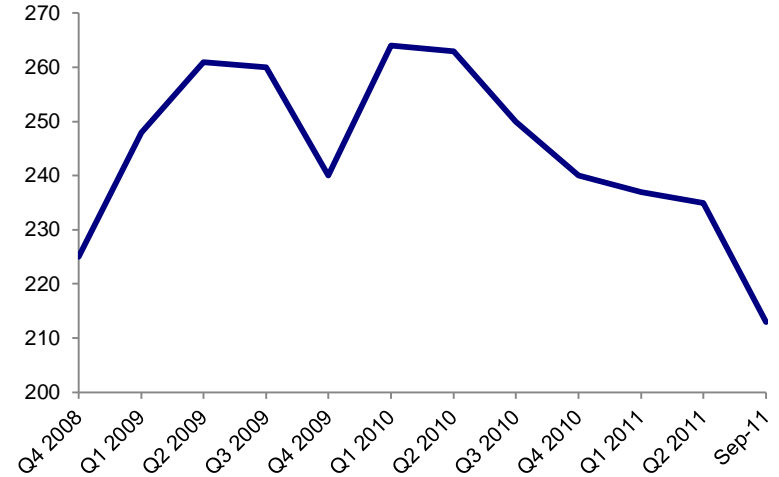
Commercial Banks Remain Aggressive in Providing ABL Facilities

Commercial & Industrial Loans at ALL Commercial Banks (\$Bn)



Source: St. Louis Federal Reserve

Non-Sponsored Middle Market Revolver Spreads

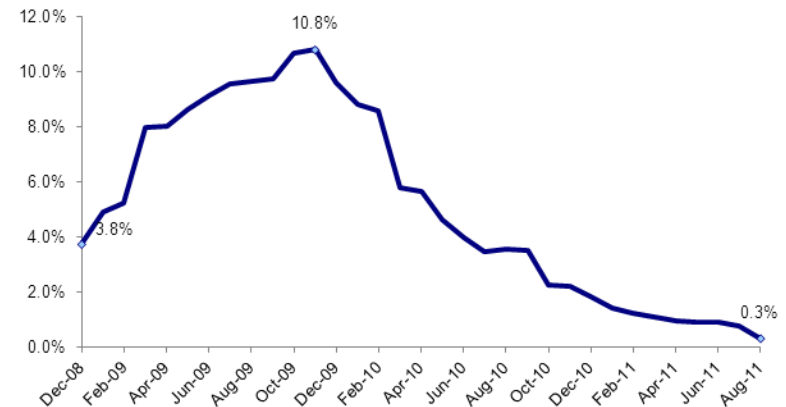


Source: Thomson Reuters

Market Dynamics – Primary ABL Lending

- Banks continue to increase ABL lending volume as an alternative to low-interest overnight deposits; this activity is anticipated to continue or even expand as long as default rates and fed fund rates remain low
- A high level of competition amongst banks is continuing to keep the cost of ABL debt low, benefitting companies with strong collateral on their balance sheets
- However, most banks continue to be reluctant to make cash flow loans for companies with less than \$15 million in EBITDA

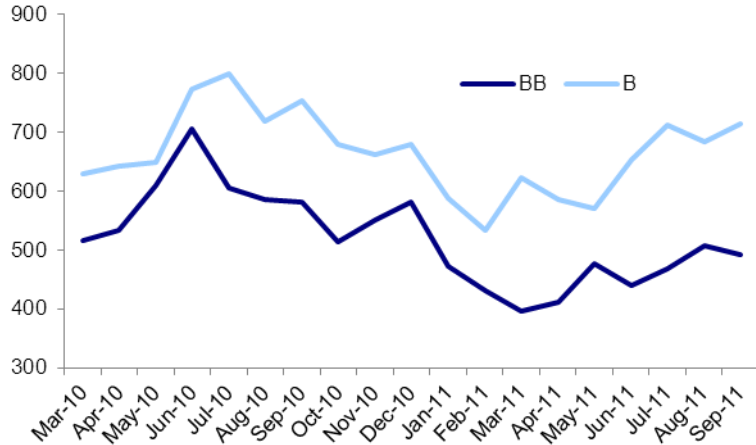
Percent of Principal Amount Outstanding Under Default



Source: Standard & Poor's Leveraged Commentary and Data

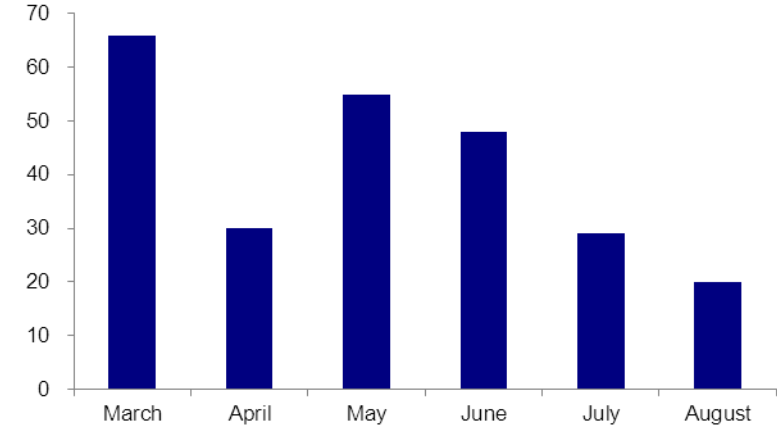
Commercial Finance Companies Experiencing Higher Funding Costs

Average New-Issue Yield to Maturity



Source: Standard & Poor's Leveraged Commentary and Data

Executed Senior Cash Flow Deals

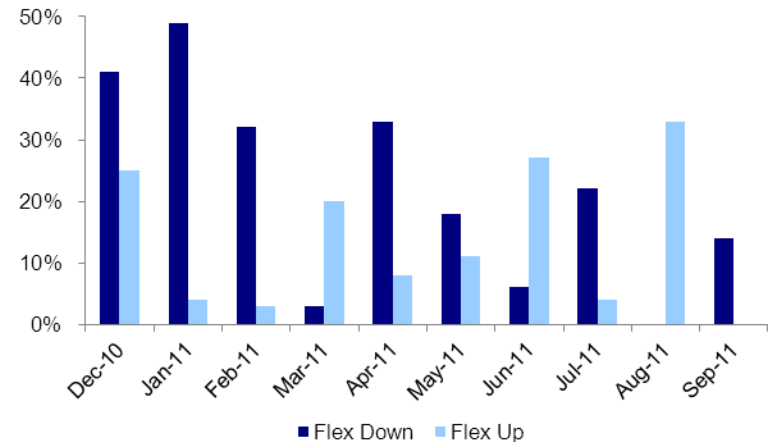


Source: Standard & Poor's Leveraged Commentary and Data

Market Dynamics – Senior Cash Flow Lending

- The increase in yields of B-rated securities, often used as a benchmark for determining commercial finance companies' cost of capital, has resulted in increased costs passed along to borrowers
 - Riskier securities are seeing greater spread expansion
- Commercial finance companies are still pursuing senior cash flow opportunities but lenders are exercising greater scrutiny when considering issuers' performance and growth forecasts

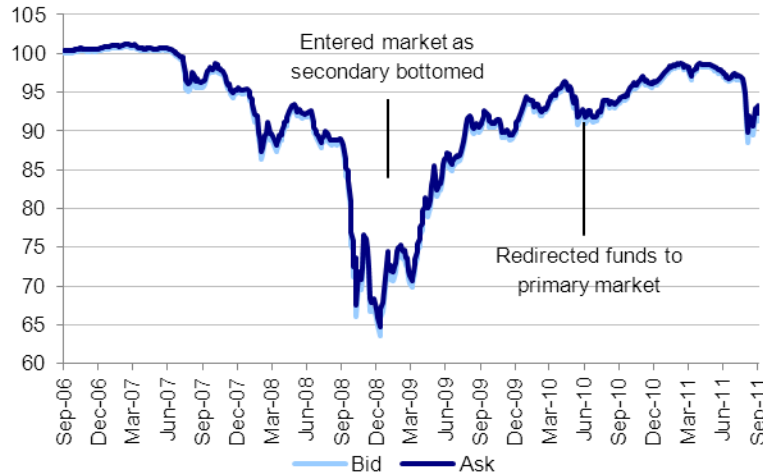
Flex Statistics



Source: Standard & Poor's Leveraged Commentary and Data

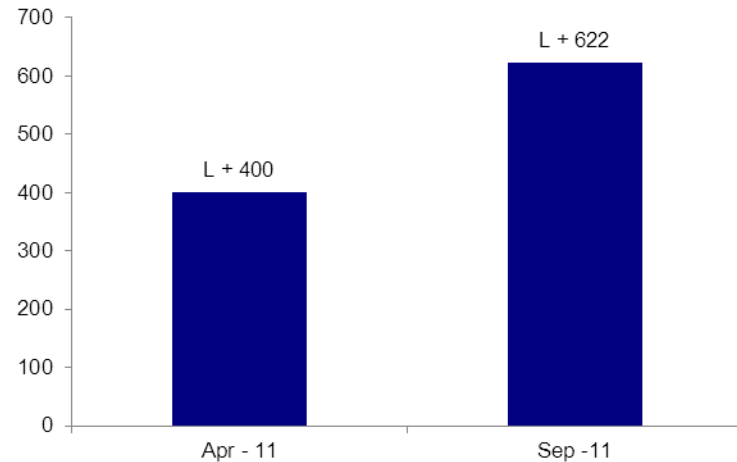
Hedge Funds and Credit Opportunity Funds Remain Active, But...

Average Bid and Ask of Flow Name Leveraged Loans (\$Bn)



Source: Standard & Poor's Leveraged Commentary and Data

Secondary Yields on LCD High Yield Flow Names



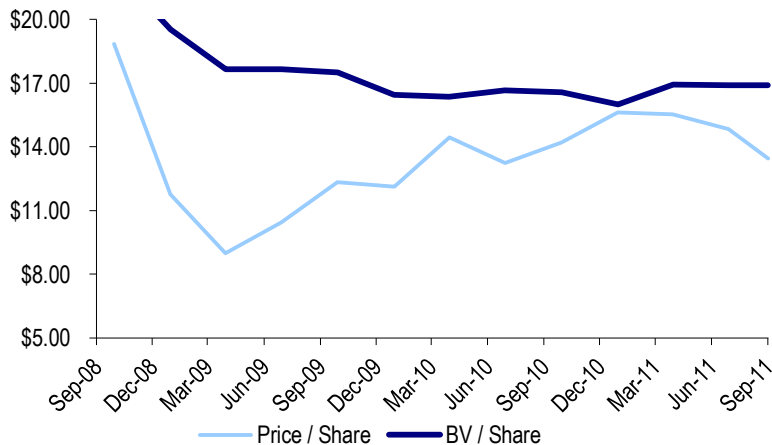
Source: Standard & Poor's Leveraged Commentary and Data

Market Dynamics – Secondary Market

- Hedge funds and credit opportunity funds have become a significant source of credit to the middle market, filling a void left by cash flow lenders who retrenched during the downturn
- While many hedge funds and other institutional investors, such as CLOs, have the ability to invest in either primary or secondary markets, the decision to invest depends largely upon relative value in each market
- With the decrease in secondary bid-ask prices of flow name leveraged loans from 98% in April 2011 to 92% in September 2011, the average yield for leveraged loans trading in the secondary market has increased from L + 400 bps to L + 622 bps
- If yields in the secondary market continue to increase, it is possible that these providers will put less capital toward financing primary debt issuances, opting instead to return to the secondary market

BDC Funding is Hampered by Current Market Volatility

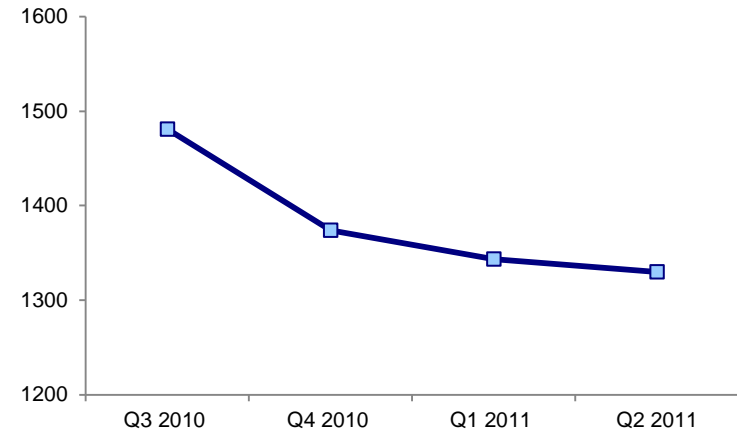
Last 36 Months of BDC Price / Share and BV / Share



Source: Capital IQ

Note: Based on index created by Lincoln, consisting of 34 BDCs

BDC Mezzanine Loan Pricing



Source: Capital IQ, BDC public filings and press releases

- In the first half of 2011, BDCs' improved stock performance enabled them to raise both debt and equity capital and encouraged the entry of new BDCs into the market
- Approximately \$4.0 billion of new capital has been raised by BDCs from January 1, 2010 through September 10, 2011
- With increased capital, BDCs became, once again, significant players in the middle market and were especially well-suited to provide unitranche credit facilities
- However, as the equity markets have become increasingly volatile over the last few weeks, many BDCs are now trading at levels below their book value per share, making it difficult to raise new capital
- Over 20 firms filed to become a BDC, but most are on hold until market conditions improve
- As a result of BDCs' current limited ability to raise additional capital, they may become increasingly selective on how they deploy their capital

Lincoln's BDC Index

Lincoln's BDC Index

Business Development Corporation	Dec-09		Dec-10			Jun-11			As of September 14, 2011		
	Price per Share	BV/Share	Price per Share	BV/Share	Dividend Yield	Price per Share	BV/Share	Dividend Yield	Price per Share	BV/Share	Dividend Yield
American Capital, Ltd.	\$ 2.44	\$ 8.29	\$ 7.56	\$ 10.71	0.0%	\$ 9.93	\$ 13.16	0.0%	\$ 8.57	\$ 13.16	0.0%
Apollo Investment Corporation	9.54	10.40	11.07	9.73	10.1%	10.21	9.76	11.0%	8.40	9.76	13.1%
Ares Capital Corporation	12.45	11.44	16.48	14.92	8.5%	16.07	15.28	8.7%	14.14	15.28	9.9%
BlackRock Kelso Capital	8.52	9.55	11.06	9.62	11.6%	8.97	9.83	11.6%	8.75	9.83	12.1%
Capital Southwest Corporation	78.80	121.99	103.80	136.92	0.8%	92.27	140.56	0.9%	83.97	140.56	1.0%
Compass Diversified Holdings	12.76	11.94	17.69	10.45	7.7%	16.49	9.74	8.7%	12.86	9.74	11.8%
Fidus Investment Corporation	n/a	n/a	n/a	n/a	0.0%	14.81	14.82	0.0%	12.51	14.82	9.6%
Fifth Street Finance Corp.	10.74	10.82	12.14	10.44	10.5%	11.60	10.72	11.0%	9.51	10.72	14.0%
Full Circle Capital	n/a	n/a	8.69	9.32	10.4%	7.90	9.18	11.4%	6.84	9.18	13.0%
Gladstone Capital Corporation	7.69	11.92	11.52	11.74	7.3%	9.24	10.34	9.1%	7.89	10.34	11.2%
Gladstone Investment Corporation	4.56	7.93	7.65	9.00	6.3%	7.14	9.06	7.6%	7.03	9.06	9.4%
Golub Capital BDC, Inc.	n/a	n/a	17.12	14.74	7.2%	14.93	14.75	8.6%	14.98	14.75	8.8%
Harris & Harris Group, Inc.	4.57	4.35	4.38	4.76	0.0%	5.13	5.43	0.0%	3.99	5.43	0.0%
Hercules Technology Growth Capital, Inc.	10.39	10.45	10.36	9.73	7.7%	10.52	9.86	8.4%	9.25	9.86	9.9%
Horizon Technology Finance Corporation	n/a	n/a	14.44	16.75	6.1%	15.83	17.40	8.3%	15.88	17.40	10.2%
Kayne Anderson Energy Development Company	14.55	16.58	18.01	20.56	6.7%	18.13	22.85	8.4%	20.45	22.85	7.5%
KKR Financial Holdings	5.80	7.43	9.30	9.31	6.0%	9.81	9.93	6.5%	8.17	9.93	9.0%
Kohlberg Capital Corporation	4.56	9.56	6.97	8.21	9.8%	7.95	8.52	8.6%	6.13	8.52	11.2%
Main Street Capital Corporation	16.12	11.96	18.19	13.06	8.2%	18.95	14.24	8.2%	18.25	14.24	9.1%
MCG Capital Corporation	4.32	8.06	6.97	7.54	8.0%	6.08	6.93	11.2%	4.49	6.93	15.3%
Medley Capital Corporation	n/a	n/a	n/a	(0.01)	0.0%	11.74	12.55	5.5%	10.54	12.55	8.2%
MVC Capital	11.80	17.47	14.60	17.71	3.3%	13.23	17.32	3.6%	11.44	17.10	4.4%
New Mountain Finance Corporation	n/a	n/a	n/a	n/a	n/a	12.70	n/a	0.0%	12.73	n/a	9.1%
NGP Capital Resources Company	8.13	11.10	9.20	10.90	7.8%	8.20	9.63	8.8%	7.35	9.63	10.3%
PennantPark Floating Rate Capital Ltd.	n/a	n/a	n/a	n/a	0.0%	12.69	n/a	0.0%	11.13	n/a	7.5%
PennantPark Investment Corp.	8.92	11.86	12.25	11.14	8.5%	11.21	11.08	9.6%	10.02	11.08	11.0%
Prospect Capital	11.81	10.06	10.80	10.25	11.2%	10.11	10.36	12.0%	8.85	10.36	14.3%
Saratoga Investment Corp.	17.55	37.98	17.35	24.95	25.4%	20.60	28.01	21.4%	16.49	28.01	27.0%
Solar Capital Ltd.	n/a	21.24	24.78	22.73	9.7%	24.69	23.22	9.7%	23.05	23.22	10.8%
Solar Senior Capital Ltd.	n/a	n/a	n/a	n/a	0.0%	17.95	18.78	3.3%	15.36	18.78	6.5%
THL Credit, Inc.	n/a	n/a	13.01	13.10	4.6%	13.00	13.15	7.7%	11.16	13.15	9.1%
TICC Capital Corp.	6.05	8.36	11.21	9.85	8.6%	9.60	9.85	10.4%	8.97	9.85	11.3%
Tortoise Capital Resources	6.52	9.29	7.30	10.44	5.5%	8.10	10.66	4.9%	8.12	10.66	4.9%
Triangle Capital Corporation	12.09	11.03	19.00	12.09	8.8%	18.46	13.79	9.5%	16.53	13.79	10.4%
Average	\$ 12.11	\$ 16.44	\$ 15.62	\$ 16.02	6.9%	\$ 14.83	\$ 16.90	7.5%	\$ 13.35	\$ 16.89	9.7%
Price per Share as a % of BV/Share	73.7%		97.5%			87.8%			79.0%		
Number of BDCs Trading Above BV	6		13			10			4		

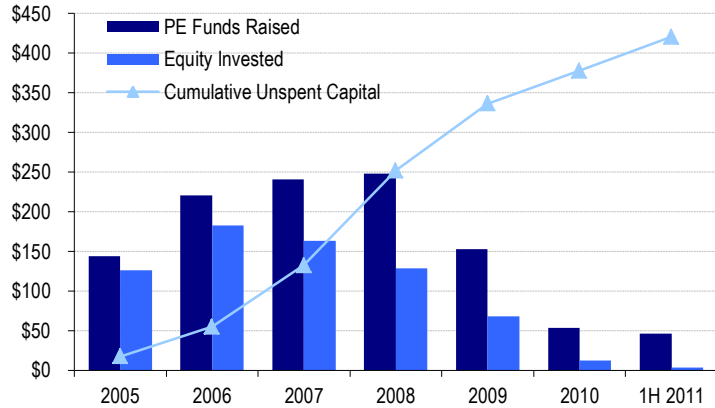
Source: Capital IQ

Note: Based on index created by Lincoln, consisting of 34 BDCs as of September 14, 2011



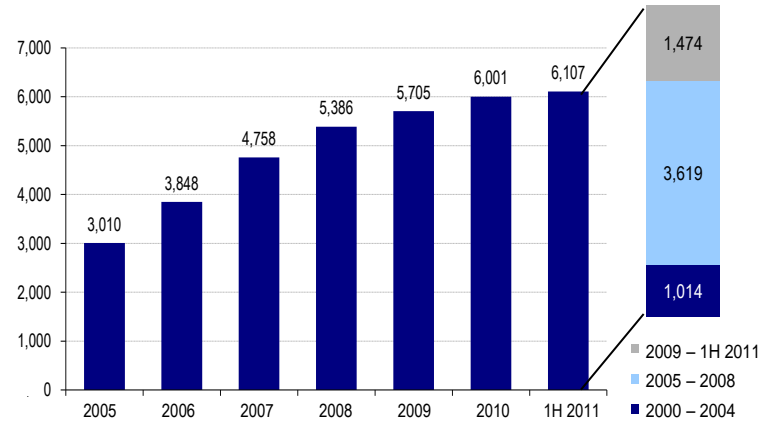
Continued Strong Drivers of Transaction Activity

Private Equity Buyout Fundraising and Investing (\$Bn)



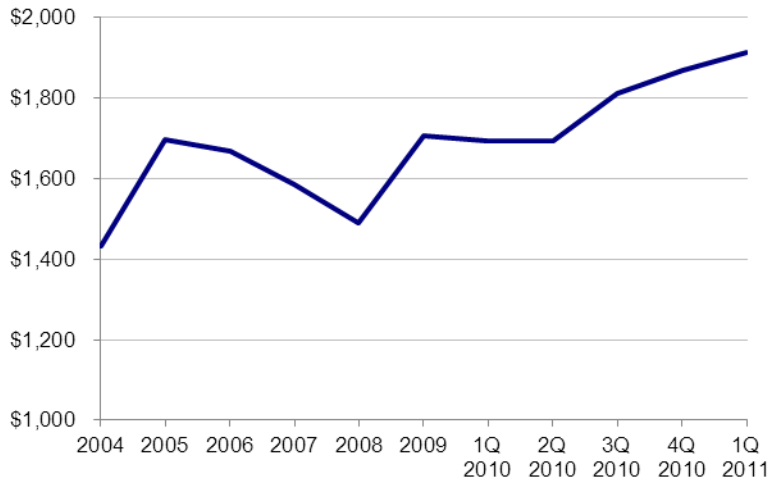
Source: PitchBook

PE Portfolio Inventory (# of deals) by Investment Year



Source: PitchBook

Corporate Cash On Hand (\$Bn)



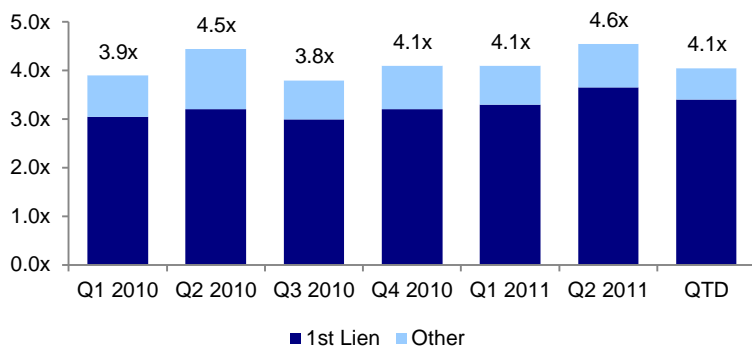
Source: Federal Reserve Reports

Trends in the Middle Market

- Financial sponsors have \$420.7 billion of funds to put to work and a strong desire to deploy this capital
- According to PitchBook, 75% of current private equity portfolio investments have been held more than 4.5 years
- Strategic acquirers have an estimated \$1.9 trillion of cash available for investment and are actively seeking acquisitions to supplement organic growth
 - Strategics are an increasingly competitive threat to private equity firms in M&A auction processes
 - As stock prices increase, acquisitions become less dilutive, enabling strategic buyers to pay higher prices

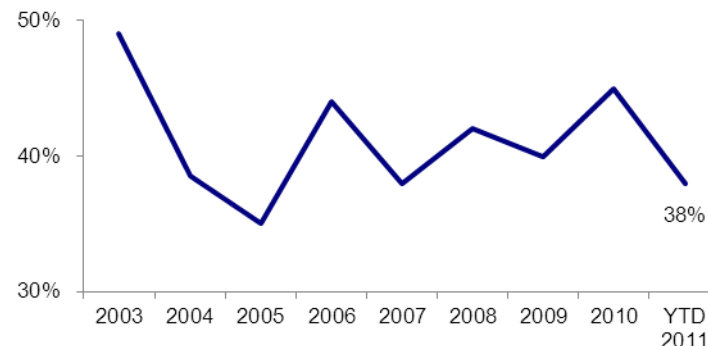
Overview of U.S. Middle Market Pricing and Terms

Average Total Debt Multiples of Middle Market LBOs



Source: Thomson Reuters

Equity Contribution for Recent LBO Transactions



Source: PitchBook

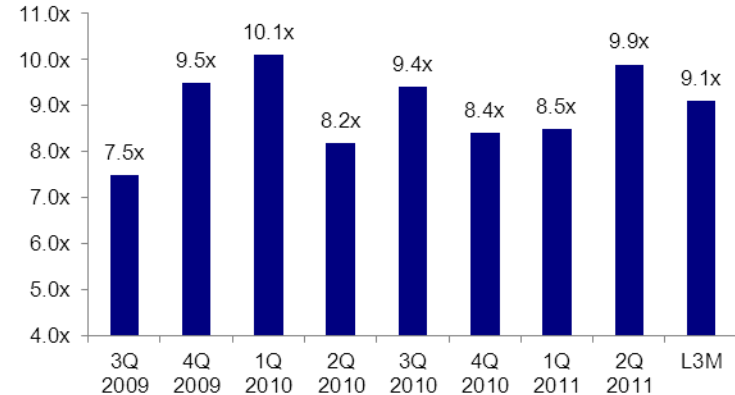
Lincoln's View on Pricing and Terms

	Borrowers with less than \$10 - \$15mm EBITDA		Borrowers with at least \$10 - \$15mm EBITDA	
	Pricing	Multiples	Pricing	Multiples
Asset Based Senior	<ul style="list-style-type: none"> L + 200 – 300 LIBOR Floor: none 	<ul style="list-style-type: none"> n/a 	<ul style="list-style-type: none"> L + 175 – 250 LIBOR Floor: none 	<ul style="list-style-type: none"> n/a
Cash Flow Senior	<ul style="list-style-type: none"> L + 500 – 600 LIBOR Floor: 100 – 150 	<ul style="list-style-type: none"> 2.0x – 3.0x EBITDA 	<ul style="list-style-type: none"> L + 500 – 600 LIBOR Floor: 100 – 150 	<ul style="list-style-type: none"> 3.00x – 4.00x EBITDA
Unitranche	<ul style="list-style-type: none"> L + 800 – 900 LIBOR Floor: 200 	<ul style="list-style-type: none"> 3.50x – 4.50x EBITDA 	<ul style="list-style-type: none"> L + 750 – 850 LIBOR Floor: 200 	<ul style="list-style-type: none"> 4.00x – 5.0x EBITDA
2 nd Lien Loans	<ul style="list-style-type: none"> Unlikely 		<ul style="list-style-type: none"> L + 900 – 1100 LIBOR Floor: 200 	
Sub Debt	<ul style="list-style-type: none"> Cash of 11% - 13% PIK of 2% - 4% All-in of 14% - 16% 		<ul style="list-style-type: none"> Cash of 11% - 13% PIK of 1% - 3% All-in of 13% - 15% 	
Equity	<ul style="list-style-type: none"> n/a 	<ul style="list-style-type: none"> 40% 	<ul style="list-style-type: none"> n/a 	<ul style="list-style-type: none"> 35% - 40%

Financing Predictions

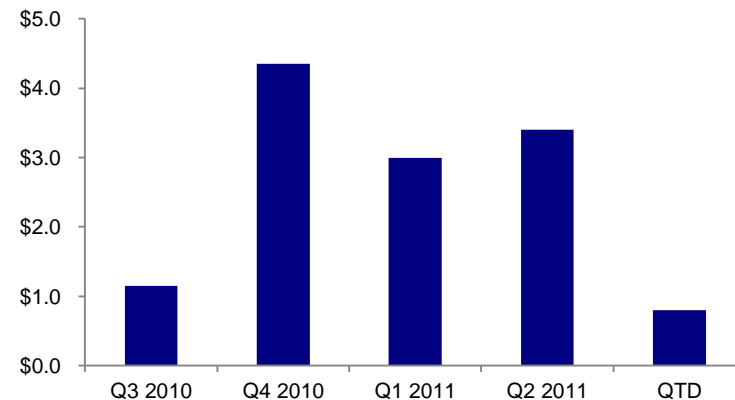
- Certain market fundamentals support an outlook for higher M&A activity
- However, in the last 30 – 45 days:
 - Technical conditions in the leveraged loan market have weakened; and
 - Economic uncertainty could cause buyers and sellers (as well as financing sources) to re-evaluate the timing of transactions as well as valuations, pricing and terms
- Many trends in middle market financing will be contingent upon:
 - Whether retail (loan mutual fund) fund flows return
 - The availability of BDC funding (watch the ratio of BV per share to Price per share); and
 - The volume of new financings hitting the market
- Mezzanine funds may look to fill the void by providing junior capital at comparatively competitive rates
- Since most lenders still have capital to deploy, financings are still possible but will be increasingly reserved for higher quality companies with good visibility along with a bias toward lower leverage and higher yields
- Lenders will prefer to finance M&A transactions and are less likely to support dividend recaps, unless pricing and structures are compelling

Average Middle Market M&A Transaction Multiples



Source: Merger Market

Dividend Recap / Stock Repurchase Loan Volume (\$Bn)



Source: Thomson Reuters

Bringing Efficiency to the Middle Market

Lincoln's Debt Advisory Group adds the following value to each assignment:

- Robust process ensures best available pricing and terms
- Strong relationships with over 300 capital sources throughout the world
- Multiple capital structure alternatives are generated which enhances certainty of closing
- Provides clients with transparency and control over financing process
- Lincoln's independence assures there is no conflict of interest
- Maximum leverage of time and resources for management team and financial sponsor

Select Transactions that Recently Closed

<p>Attends HEALTHCARE PRODUCTS a portfolio company of KPS CAPITAL PARTNERS, LP has completed a recapitalization \$20,000,000 Senior Credit Facilities \$113,000,000 Unitranche Term Loan</p> 	<p>BRIDGEWELL RESOURCES a portfolio company of ATLAS HOLDINGS has completed a refinancing \$50,000,000 Senior Credit Facilities</p> 	<p>center manufacturing, inc. a portfolio company of IOP has completed a refinancing \$27,000,000 Senior Credit Facilities \$7,500,000 Junior Capital</p> 	<p>THE STRIVE GROUP has completed a refinancing in the amount of \$44,500,000 Senior Credit Facilities \$28,000,000 Second Lien Facilities</p> 	<p>POMEROY infrastructure. optimized™ a portfolio company of Platinum Equity has completed a recapitalization in the amount of \$40,000,000 Junior Capital</p> 	<p>MARLIN EQUITY PARTNERS phoenix technologies Lincoln International LLC arranged acquisition financing to support Marlin Equity Partners' purchase of Phoenix Technologies Ltd.</p> 
<p>Ready Pac a portfolio company of BAYSIDE CAPITAL has completed a recapitalization \$53,500,000 Senior Credit Facilities \$40,000,000 Junior Capital</p> 	<p>CREEKSTONE FARMS an affiliate of SUN CAPITAL PARTNERS, INC. has completed a recapitalization \$36,500,000 Senior Credit Facility</p> 	<p>OAKTREE has refinanced its portfolio company cyanco \$55,000,000 Senior Credit Facilities \$30,000,000 Subordinated Debt</p> 	<p>Home Learning college for a brighter future a portfolio company of eci has completed a recapitalization</p> 	<p>EO2 L'énergie qui respire has completed a recapitalization</p> 	<p>La Grande Récré has completed a recapitalization</p> 



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