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Freeman & Co. LLC

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Market Data as of 9/7/2012

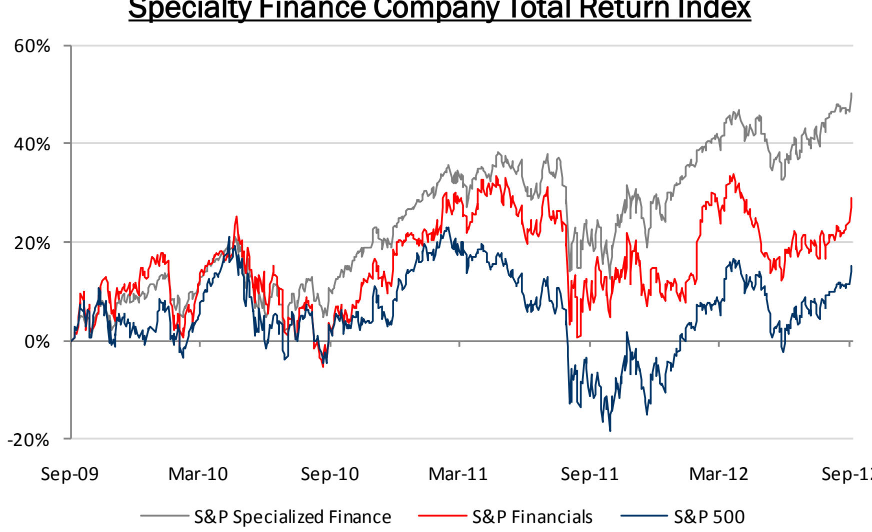
DJIA	13,306
NASDAQ	3,136
S&P 500	1,438
FTSE 100	5,795
10-yr US T-Note	1.67%
USD per GBP	$1.60
USD per Euro	$1.28

There are Still Riches in Niches

Specialty Lenders Are Creating Value, If You Know Where to Look

- The financial markets have reached a new state of normalcy within the past year — different in many ways from the pre-credit crisis environment, but still conducive to profitable specialty finance businesses.
- Regulatory initiatives such as Basel III and the Dodd-Frank Act are driving traditional banks away from certain businesses, creating opportunities for non-bank lenders. These new regulations also make some of these businesses more difficult and costly for non-bank lenders to conduct.
- But with investors starving for yield in a prolonged low rate environment, niche lenders in a number of areas are creating assets that are attracting interest from equity investors, lenders and the capital markets. Strategic acquirers haven't followed yet, but that could be the next phase in the "new normalcy."
- This report examines several industry niches in non-bank lending:
  - ***Small business lending*** – Traditional factoring and asset-based lenders, as well as newer business models, are serving businesses that banks cannot.
  - ***Equipment leasing*** – Industry volumes have grown — despite being constrained by the economy — and credit quality has held up well, attracting new players to the industry.
  - ***Consumer lending*** – Niche businesses continue to create strong yields, while credit quality in most categories have held up, and the Consumer Financial Protection Bureau is becoming a major factor.
  - ***Mortgages*** – A huge "niche," this industry is experiencing widespread change, as new entrants stake out positions in both originations and servicing.
- This report also examines the revival of the securitization and collateralized loan obligation markets, as well as the state of the specialty finance M&A market.

Specialty Finance Company Total Return Index



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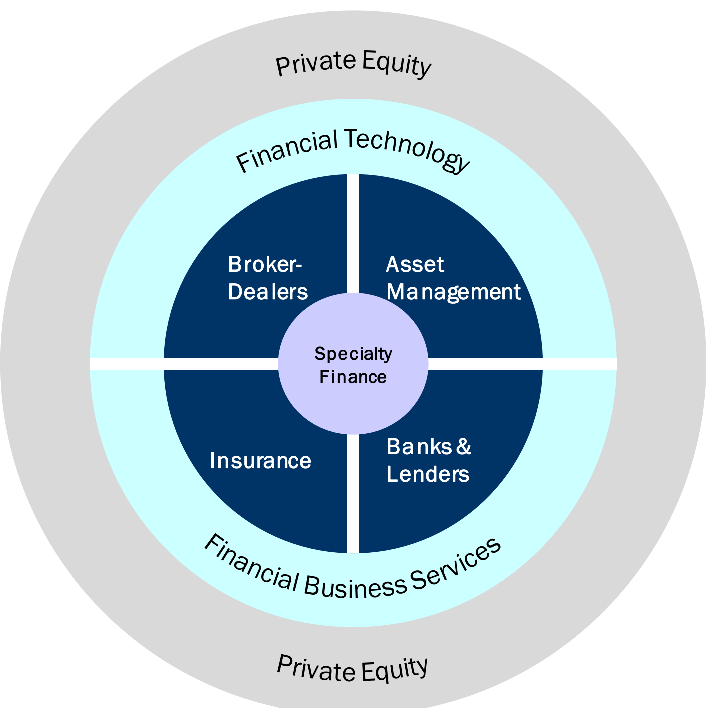

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Small Business Lending: Filling a Market Gap

Borrowing by small businesses has increased steadily over the past three years, but commercial banks have generally lagged in supplying credit to this market. Factors and asset-based lenders, which serve small businesses that are generally uninteresting to most banks, have grown to fill the resulting market gap.

Factoring involves the purchase and collection of businesses' accounts receivable as a form of working capital finance; it may also include credit protection against the obligors' failure to pay the receivables. Factors frequently provide other forms of asset-based lending ("ABL"), particularly loans against inventory. Advance rates against receivables typically range from 70% to 85%, while advance rates on inventory are usually anywhere from 20% to 65%. Interest rates, inclusive of fees, are typically high single digits to low teens, depending upon the client's size and the collateral's quality.

In addition to independent factors, several banks — such as AloStar, Crestmark, Sovereign and Sterling National — have factoring and ABL specializations, and other banks have made initiatives in small business lending within the past year.

A number of newer forms of small business finance have also been developed in recent years, including (1) merchant cash advance companies (which provide short term advances and collect a portion of their borrowers' credit card receipts in return), (2) technology-oriented lenders (which use advanced, data-driven credit decisioning and automated collections) and (3) peer-to-peer lenders (which pair borrowers with lenders — and in one case, sellers of trade receivables with buyers).

Selected Small Business Lenders

Firm Name	Headquarters	Geographic Focus	Typical Deal Size
Access Capital	New York, NY	Nationwide	NA
Accord Financial	Toronto, ON	U.S., Canada	Up to $10 million
America's Business Capital	Lancaster, PA	Nationwide	$350,000 - $6 million
Amerisource Funding	Houston, TX	Nationwide	$500,000 - $10 million
Ashford Finance	New York, NY	Nationwide	$25,000- $10 million
Business Capital	Westport, CT	Nationwide	$400,000 - $20 million
Capital Access Network	Scarsdale, NY	Nationwide	$5,000 - $150,000
Colford Capital	New York, NY	Northeast, Mid-Atlantic and & Upper Mid-West	$50,000 - $10 million
Coral Capital Solutions	New York, NY	Nationwide	$1 million - $10 million
Factor Group	Miami, FL	U.S., Latin America, Europe & Asia	$50,000 - $5 million
First Business Capital Corp.	Madison, WI	Nationwide	$1 million - $7 million
First Capital	New York, NY	Nationwide	$2 million -$25 million
Gerber Finance	New York, NY	Nationwide	$500,000 - $10 million
Gibraltar Business Capital	Northbrook, IL	Nationwide	$100,000 - $5 million
Greystone Commercial Services	Dallas, TX	Nationwide	$100,000 - $4 million
Harborcove Financial	New York, NY	Nationwide	$200,000 - $5 million
Keltic Financial Services	Tarrytown, NY	Northern, Mid-Atlantic, Southern, Mid-West	$1 million - $10 million
King Trade Capital	Dallas, TX	Worldwide	$800,000 - $22 million
Marquette Commercial Finance	Dallas, TX	Nationwide	Up to $20 million
MidCap Financial	Bethesda, MD	Nationwide	$5 million - $200 million
OnDeck Capital	New York, NY	U.S., Puerto Rico	$5,000 - $150,000
Presidential Financial	Alpharetta, GA	Nationwide	Starting at $500,000
The Receivables Exchange	New Orleans, LA	Nationwide	NA
Rosenthal & Rosenthal	New York, NY	U.S., Asia	NA
TCE Capital Corporation	Toronto, ON	Canada	Up to $4 million

Source: Freeman & Co.

Business Development Companies: Attracting Capital with Yield

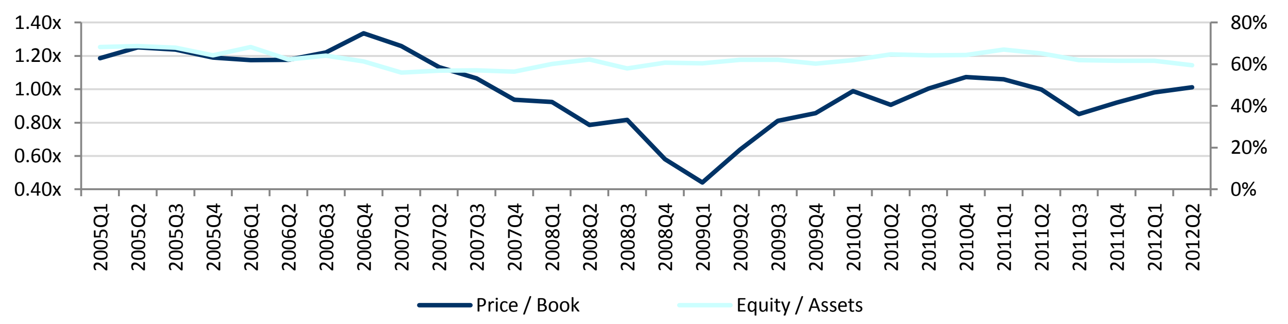
Business development companies — known as "BDCs" or "BDC RICs" (because they are registered investment companies) — make loans to small and mid-sized businesses, using leverage that is restricted to a 1:1 debt-to-equity ratio. Since 2003, 19 BDCs have gone public. Within the past three years, BDCs have raised approximately $1.9 billion of public equity, because investors have found their dividend yields attractive in a low-interest rate environment.

Company	Year of IPO	Ticker	Price	% of 52 Week High	Market Cap (mm)	Equity / Assets	Price/ BV	P/E (LTM)	Dividend Yield
Apollo Investment Corporation	2004	AINV	$8.19	99%	$1,662	58%	0.99x	NM	10.4%
Ares Capital Corporation	2004	ARCC	17.42	100	4,321	59	1.25	10.4x	9.3
Blackrock Kelso Capital Corporation	2007	BKCC	10.10	100	744	59	1.05	11.9	10.7
Fifth Street Finance Corp.	2008	FSC	10.77	100	889	61	1.09	35.9	11.5
Full Circle Capital Corporation	2010	FULL	8.09	100	50	54	0.91	12.1	12.1
Golub Capital BDC, Inc.	2010	GBDC	15.62	99	401	53	1.07	14.1	8.5
Gladstone Capital Corporation	2001	GLAD	8.70	99	183	58	0.98	NM	10.6
Horizon Technology Finance Corporation	2010	HRZN	16.14	99	154	61	1.21	14.9	10.9
KCAP Financial, Inc.	2006	KCAP	8.65	99	231	67	1.13	NM	13.2
KKR Financial Holdings LLC	2005	KFN	9.97	100	1,779	21	1.02	6.6	8.5
Main Street Capital Corporation	2007	MAIN	27.73	99	875	63	1.64	8.7	7.2
Medley Capital Corporation	2011	MCC	13.40	100	309	59	1.42	12.2	10.3
MCG Capital Corporation	2001	MCGC	4.92	100	364	52	0.93	NM	12.2
PennantPark Investment Corporation	2007	PNNT	10.96	100	619	58	1.08	49.8	10.8
Prospect Capital Corporation	2004	PSEC	11.67	99	1,940	67	1.28	7.0	10.7
Saratoga Investment Corp.	2007	SAR	17.00	99	66	73	0.66	5.7	NA
Solar Capital Ltd.	2010	SLRC	23.47	99	908	68	1.10	13.8	10.8
Triangle Capital Corporation	2007	TCAP	25.72	98	702	59	1.69	10.3	8.8
TICC Capital Corp.	2003	TICC	10.85	99	448	76	1.25	15.3	11.1
Market data as of 9/7/12			**Median**	**99%**		**59%**	**1.09x**	**12.1x**	**10.7%**
			Mean	**99%**		**59%**	**1.14x**	**15.2x**	**9.9%**

In addition, beginning in 2008, a number of non-publicly traded BDCs have raised capital through continuous offerings, usually selling their stock through financial advisors.

Non-Publicly Traded BDC	Affiliate
Business Development Corporation of America	American Realty Capital
Chanticleer Dividend Fund	Chanticleer Advisors / CapitalSouth Investments
CION Investment Management	Apollo Investment Management and ICON Capital Corp.
Corporate Capital Trust, Inc.	CNL Fund Advisors and KKR Asset Management
FS Investment Corporation and other BDCs	GSO / Blackstone
HMS Income Fund	Hines Interests and Main Street Capital Corp.
Keating Capital Inc.	Keating Investments

Business Development Companies' Leverage and Valuation



Source: SNL

Equipment Leasing: Growth in a Slow Growth Environment

Equipment finance is a $628 billion sector, based on statistics tracked by the Equipment Leasing and Finance Association ("ELFA"). Leasing companies are typically categorized by their ownership (independent, bank-owned or captive) and by their specialization (large, middle, small and micro-ticket), with further differentiation for firms that specialize in specific industries (construction, transportation, health care, mining, energy, etc.).

Equipment finance has experienced consistent increases in new business since 2010, when volumes began recovering following a major decline in 2009. New volume in 2012, through July, totaled $43.8 billion, a 15% increase over the comparable period in 2011.

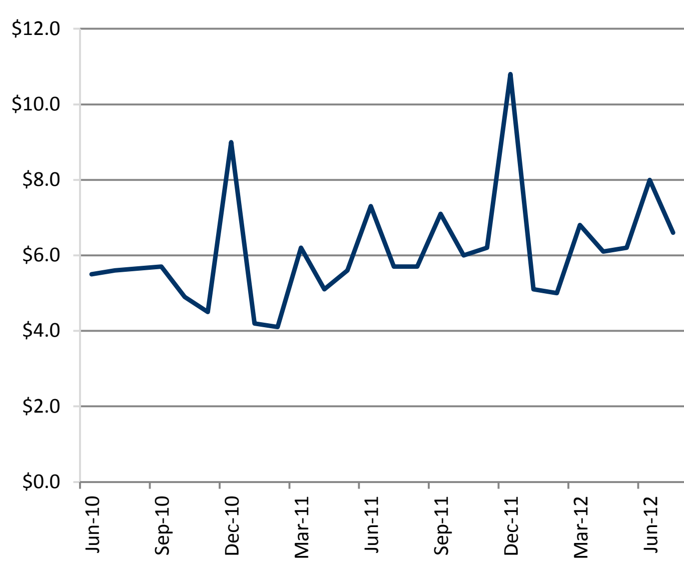
This growth has occurred despite a weak economic environment, largely due to businesses' updating of older equipment (as opposed to financing new growth). All categories of lessors have shown healthy growth, with independents and bank-owned lessors growing substantially more quickly than captives.

The equipment leasing industry has benefitted from increased availability of funding sources beginning in mid-2010, following a drought in financing during the credit crisis. Independent equipment lessors typically access financing through bank lines, and in some cases securitizations. Both of these financing sources have become more widely available during the past two years. In the case of bank lines, certain banks — notably Wells Fargo — act as significant financing sources for the industry, and a number of regional banks have returned to the market as participants in syndicated facilities. The return of these regional banks, following an absence during the credit crisis, has compensated for the recent retreat of certain European banks from the market.

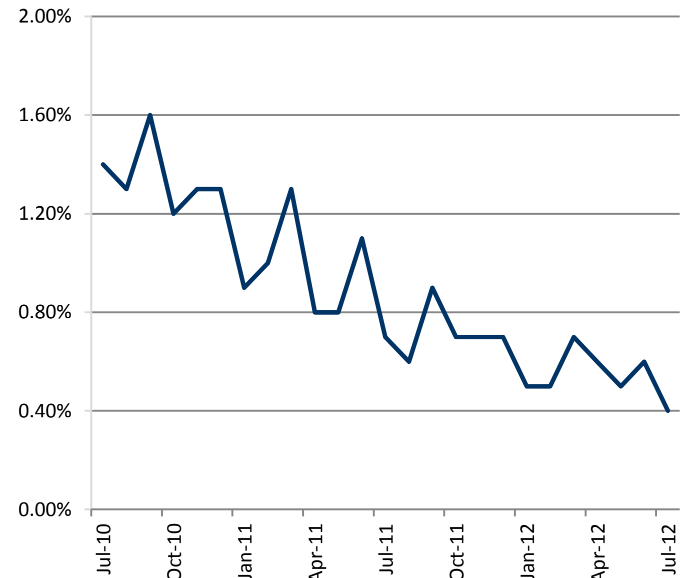
These growth and financing trends, coupled with low costs of funds in the current rate environment, have increased overall industry profitability. In 2011, average return on assets, as reported by the ELFA, increased to 2.0% while return on average equity was 15.5%.

<u>New Business Volume</u>

($ in billions)



<u>Average Losses as a % of Net Receivables</u>



Source: ELFA's Monthly Leasing and Finance Index

Legal Finance: A Profitable Consumer Niche Business

Overview

Legal finance is one example of a profitable consumer finance niche business that has performed well in recent years. A small but healthy market has evolved in this industry, which began in the United States approximately 15 years ago.

Ethics rules in most states prevent attorneys from advancing funds to their clients. These rules have created an opportunity for companies to purchase future cash receipts from plaintiffs with a pending or settled lawsuit. These transactions are typically structured as either a non-recourse cash advance or as the discounted purchase of a future receivable.

There are numerous small businesses operating in this industry, but fewer than 10 companies provide the majority of the funding, including:

- LawCash
- Peachtree
- Oasis Legal Finance

The litigation finance industry's first trade body, the American Legal Finance Association ("ALFA"), was formed in 2004 and has helped to establish ethical standards, fair business practices and a regulatory framework within the industry.

Role of Legal Funding Companies

Legal finance companies play a material role in allowing plaintiffs to cover daily living expenses while awaiting the settlement and the disbursement of the proceeds from their lawsuit. The average pre-settlement advance takes approximately two years to settle, and there can be a significant lag between when a case settles and when funds are disbursed.

Plaintiffs are often either unemployed or underemployed, some due to personal injury. Medical expenses, student loans, rent and other living expenses are the major catalysts for plaintiffs to seek legal funding. One study showed that over 60% of funds provided to plaintiffs through legal funding were used to stop a foreclosure or an eviction action.

Market Opportunity

Over $160 billion is paid out annually for personal injury claims in the US. Less than 1% of the potential litigation receivables market is financed.

There are two basic types of legal funding: pre-settlement advances and post-settlement advances. Some of the key characteristics of each are outlined below.

In both pre-settlement and post-settlement funding, the market remains deeply fragmented and under-penetrated.

	Pre-Settlement Advances	Post-Settlement Advances
Advance Size per Case	• $500-$10,000	• $1,000-$1,000,000
LTV	• 10-20% of a case's expected value	• Up to 80% of actual settlement amount
Interest Rates	• 2-3% per month	• 2-3% per month
Other Fees	• $150-$300 per case	• $150-$300 per case
Historical Net Losses	• 5-7% of principal advanced	• ~1% of principal advanced
Duration	• 18 months - 24 months	• 3 months - 12 months

Source: ALFA

Mortgage Origination: An Industry in Motion

Disruptions in the mortgage market have created space for new competitors in an environment of high volumes and strong profits brought on by low rates.

Mortgage origination is currently dominated by four large banks: Wells Fargo, JP Morgan Chase, Bank of America and Citi. However, these banks — and many others — are under increasing capital pressure, and, with the exception of Wells Fargo, their market shares have declined.

Significant recent events in the mortgage origination business include:

- **Bank of America** exited its correspondent mortgage business (December 2011)
- **MetLife** shut down its mortgage business (January 2012)
- **Residential Capital** filed for bankruptcy, with **Nationstar** and **Newcastle** as the stalking horse bidder (May 2012)
- **Discover** acquired **Tree.com's** mortgage origination subsidiary, **Home Loan Center,** for $55.9 million (May 2012)
- **American Home Mortgage Servicing** rebranded itself as **Homeward Residential**, expanding into correspondent and warehouse lending (June 2012)

Mortgage rates below 4% are driving borrowers to refinance, although peak volumes may have passed. Recent data from the GSEs suggest that refinancing activity, excluding HARP program loans, declined by 25% between Q1 and Q2 2012. Rising rates and a completion of the refinancing cycle are expected to shift originations in 2013 to purchase originations.

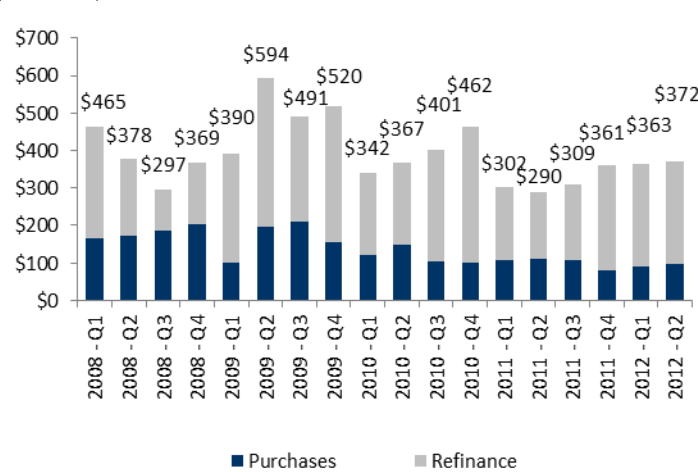
Longer term, the market will be affected by several issues which remain to be addressed, most notably the recently-announced accelerated unwinding of Fannie Mae and Freddie Mac.

Top U.S. Mortgage Originators

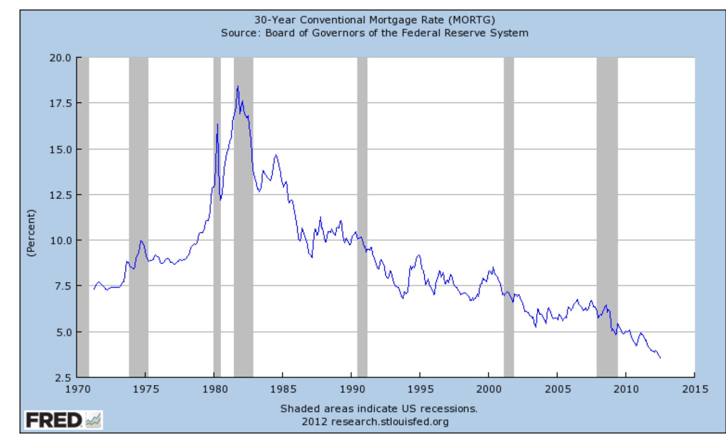
	1Q 2012	
Company	**Total Volume ($mm)**	**Market Share**
Wells Fargo & Company	$ 130,357	31.2%
Chase	40,848	9.8
U.S. Bank Home Mortgage	20,051	4.8
Bank of America	15,998	3.8
CitiMortgage, Inc.	15,646	3.8
PHH Mortgage	13,953	3.3
Flagstar	11,169	2.7
Quicken Loans Inc.	10,897	2.6
Provident Funding Associates	9,109	2.2
Ally Bank/ResCap (GMAC)	8,596	2.1
Total	**$ 276,624**	**66.3%**

Mortgage Originations by Quarter

($ in billions)



30 Year Conventional Mortgage Rates



Source: MortgageStats, Mortgage Bankers Association, St. Louis Fed

Mortgage Servicing: Crisis Creates Opportunity

Overview

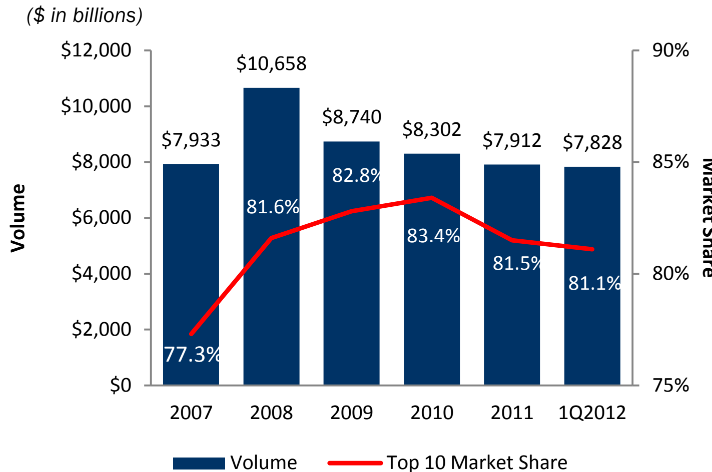
Mortgage servicing involves tracking payments, handling late payments, liens and other such aspects of a mortgage. Since the late 1980s there has been a long period of consolidation, as the largest servicers have achieved scale as a result of M&A in the banking industry. In 1989, the top ten servicers held a market share of 11%, which increased to 40% by 2000 and 81% currently. The financial crisis resulted in several failures of servicers and forced additional consolidation as a means for survival. Recently, certain mortgage originators and investors have downsized their businesses, and portfolios have changed hands. There is an increasing need for specialized servicers in a changing environment, as the average quality of loans has declined and regulatory requirements have increased.

The focus of the mortgage servicing market has shifted from high volume, low touch, payment processing-oriented service to a lower volume and much higher touch environment, as delinquencies and modifications have increased. The pre-crisis servicing players — mainly large banks — are less adept at handling special servicing, and industry-wide settlements have strengthened the position of special servicers who are better equipped to handle the new environment.

Currently, large banks are selling significant amounts of servicing due to Basel III capital treatment of servicing. As a result, market values of servicing have fallen to approximately two times annual fees, versus four-to-five times prior to the credit crisis.

This dislocation in the valuation of servicing has led investors to evaluate acquisitions of servicing rights. For example, Fortress Investment Group and its affiliates have acquired servicing rights to over $70 billion of principal balance since December, 2011, and Fortress is currently raising a $500 million fund to purchase additional servicing rights.

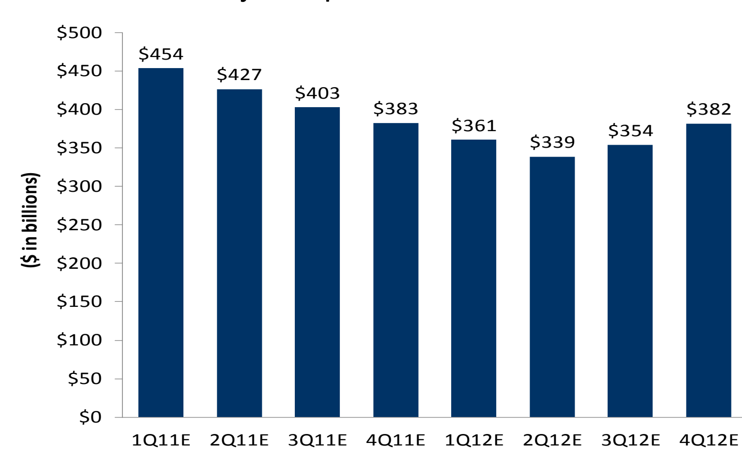
Mortgage Servicing Volume



Top U.S. Mortgage Servicers

	1Q 2012		
Company		Total Volume ($mm)	Market Share
Wells Fargo & Company	$	1,840,914	23.5%
Bank of America		1,690,500	21.6
Chase		1,106,986	14.1
CitiMortgage, Inc.		517,832	6.6
Ally Bank/ResCap (GMAC)		372,329	4.8
U.S. Bank Home Mortgage		243,289	3.1
PHH Mortgage		184,881	2.4
SunTrust Bank		154,622	2.0
PNC Mortgage		136,597	1.7
Nationstar Mortgage		103,300	1.3
Total	**$**	**6,351,250**	**81.1%**

Current to 30+ Day Delinquent Roll Estimates



Source: MortgageStats, Inside Mortgage Finance

Mortgage Servicing: Crisis Creates Opportunity (cont'd)

Financing Mortgage Servicers

Mortgage servicers have an obligation to advance funds to securitization trusts in the event that borrowers are delinquent. Thus, when a borrower becomes delinquent, the servicer advances cash to the investor (typically a REMIC trust) on the scheduled remittance date, creating a receivable that is secured by the future cash flows from the trust.

Most servicing advances have the highest reimbursement priority (i.e., "top of the waterfall") and are entitled to repayment from loan or REO liquidation proceeds before any interest or principal is paid on the bonds. In most cases, advances in excess of loan or REO liquidation proceeds may be recovered from pool-level proceeds.

The costs incurred in meeting the servicers' obligations to advance funds consist primarily of the interest expense incurred to finance the servicing advances. Mortgage servicers — particularly special servicers — have obtained committed additional financial resources to fund servicing advances as a result of increased delinquencies in their servicing portfolios. Servicers utilize securitizations (i.e., match funded liabilities) and revolving credit facilities to finance servicing advances, as well as deposits in the case of bank-owned servicers.

Deal Activity

There have been a number of significant transactions focused on special servicers:

- **Walter Investment Management Corp.** acquired **Green Tree Credit Solutions** for $1.1 billion (July 2011)
- **Fortress Holdings** subsidiary **Nationstar Mortgage** has:
  - Raised $233 million in an initial public offering (March, 2012)
  - Acquired, jointly with **Newcastle Investment Corp.**, $63 billion in mortgage servicing rights (MSRs) from **Lehman Brothers** subsidiary **Aurora Bank** (March 2012)
  - Acquired MSRs from **Bank of America** (September, 2011 and May, 2012), and
  - Acquired MSRs from **MetLife** (April, 2012)
- **Ocwen Financial Corp. has:**
  - Acquired **Litton Loan Servicing** from **Goldman Sachs** for $601 million (June 2011)
  - Acquired **Saxon Mortgage Services** from **Morgan Stanley** for $59 million (October 2011)
  - Raised $186 million in an IPO of **Home Loan Servicing Solutions**, an independent acquirer of high-quality mortgage servicing (February 2012)

Recent activity suggests that future transactions will be a result of:

- Mergers among small to mid-sized players in order to maintain profitability and address costly regulations, as pending Consumer Financial Protection Bureau regulations will raise operating costs, favoring larger servicers
- Divestitures of mortgage servicing units by larger players seeking to shed non-core businesses and
- Sales of large servicing portfolios by banks

Source: MICA

Securitizations: A Renewed Funding Source

Asset backed securitizations had been a growing source of financing for specialty finance companies up until 2007. But in the wake of the credit crisis, the ABS market declined precipitously and doomsayers predicted that this funding mechanism would no longer be a viable alternative for finance companies. These gloomy predictions seemed plausible because of the demise of the credit guarantors that had provided support for the market, the absence of updated methodologies from the rating agencies, and investors' skepticism regarding structures and ratings.

In the past year, however, the market for asset backed securitizations (other than mortgages) has rebounded significantly, driven by investors' search for yield and steady credit quality across a range of asset classes despite challenging economic conditions. Because rates are expected to stay low for the foreseeable future, this rebound may continue as well.

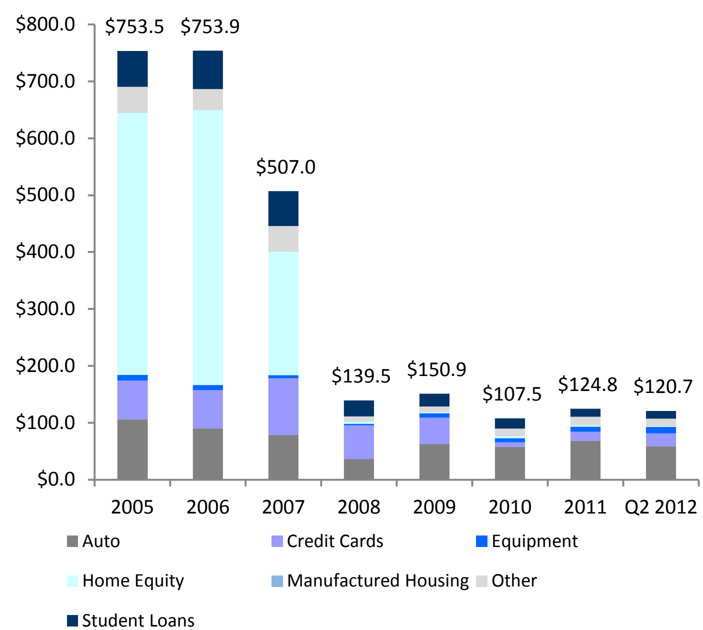
U.S. consumer debt has declined by 2.8% per year between 2009 and Q1 2012, following 10.2% annual growth in 2003-2007. However, these changes have not been evenly distributed by type of debt.

($ in trillions)	Q12003	Q42008	Q12012	% Change (Q1 '03 - Q4 '08)	% Change (Q4 '08 - Q1 '12)
Mortgage	$ 4.94	$ 9.26	$ 8.19	87.3%	(11.6%)
HE Revolving	0.24	0.71	0.61	191.3	(13.2)
Auto Loan	0.64	0.79	0.74	23.4	(6.9)
Credit Card	0.69	0.87	0.68	25.9	(21.6)
Student Loan	0.24	0.64	0.90	165.6	41.4
Other	0.48	0.41	0.32	(13.8)	(22.6)
Total	**$ 7.23**	**$ 12.67**	**$ 11.44**	**75.2%**	**(9.7%)**

In general, ABS issuance activity has mirrored these trends, with the exception of student loans (which have been provided mainly by the U.S. government since 2010). Auto securitizations have increased significantly and are on pace to reach $80 billion this year.

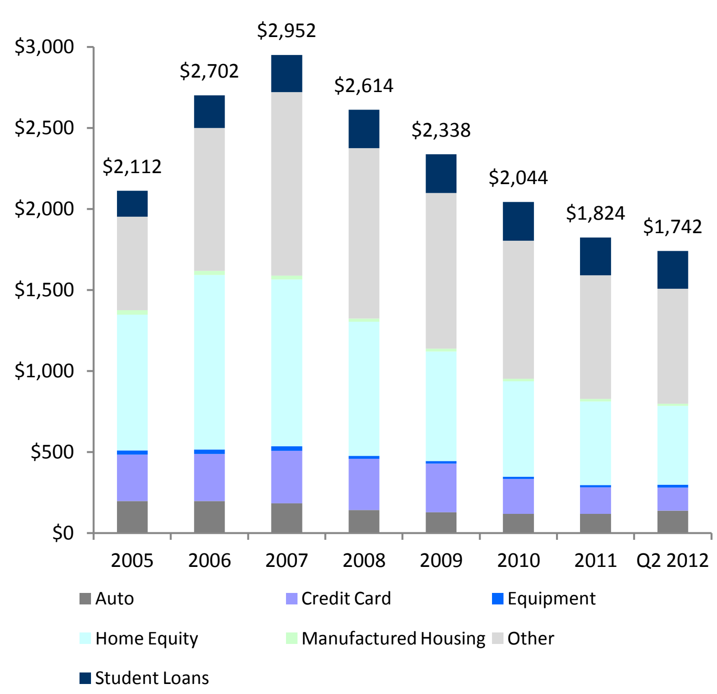
U.S. Non-Mortgage ABS Issuance by Collateral Type

($ in billions)



U.S. Non-Mortgage Outstanding ABS by Collateral Type

($ in billions)



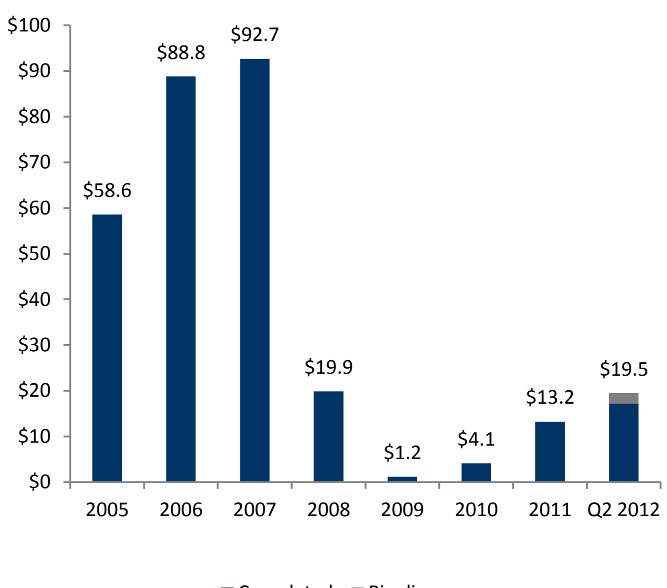
Source: SIFMA, Federal Reserve Bank of New York, DBRS

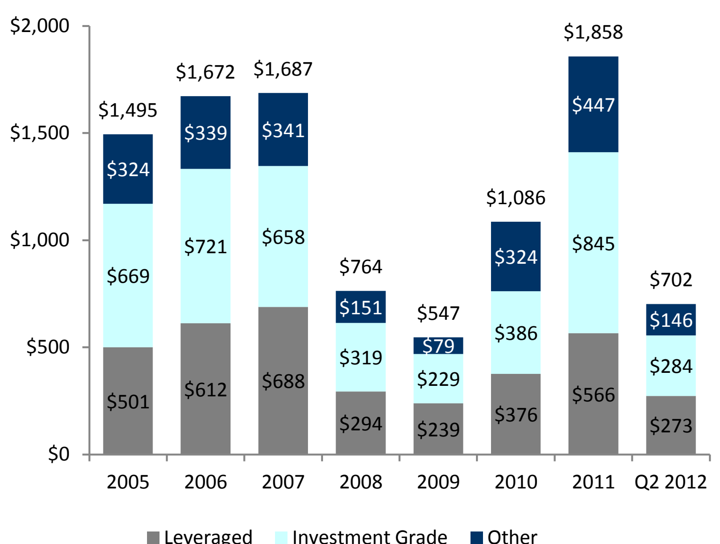
CLO Issuance: Another Rebounding Market

The new issue market for collateralized loan obligations has experienced a steady expansion since 2009. While nowhere near the peak volumes of 2007 and earlier, the recovery of the industry in the US has been encouraging. During the first half of 2012, $17.9 billion of CLOs were issued in the US, substantially exceeding the total for all of 2011. The aggregate principal balance of CLOs outstanding increased to $249 billion at the end of July, with new issuances of $22.1 billion year-to-date, based on a universe of 619 CLOs tracked by Thomson Reuters.

One noteworthy first time issuer during 2012: healthcare finance company NXT Capital, which priced a $308 million CLO in May. The collateral consisted almost exclusively of middle market senior-secured loans directly originated by NXT. For most other CLOs, collateral has consisted of syndicated leveraged loans, and CLOs now hold 47% of leveraged loans outstanding. And for the most part, new CLO volume has come from repeat issuers, a pattern which is expected to continue.

One major structural issue in the CLO market that remains to be sorted out is the roughly 40 CLO managers with one or two pre-2009 vintage CLOs under management. The contracts to manage these CLOs diminish in value as they age, and the ability to raise additional CLOs — already difficult — becomes even more challenging. Consolidation is the obvious answer, but it hasn't happened yet for the most part, and the clock is ticking.





Source: Thomson Reuters PLC

Merger & Acquisition Activity

Deal Activity & Outlook

Deal activity has been generally slow in 2012, with niche consumer lending as the most active subsector. Payday lending has been more active, as strategic buyers are extending their franchises through small acquisitions. In addition, certain banks are seeking alternative lending platforms, including online direct-to-consumer lenders.

Mortgage banking and servicing were also active, as strategic buyers participated in the reconfiguration of the specialty servicing side of the industry.

In commercial specialty finance, equipment leasing and asset-based lending are emerging as active sectors, with active interest from both strategic acquirers and private equity funds.

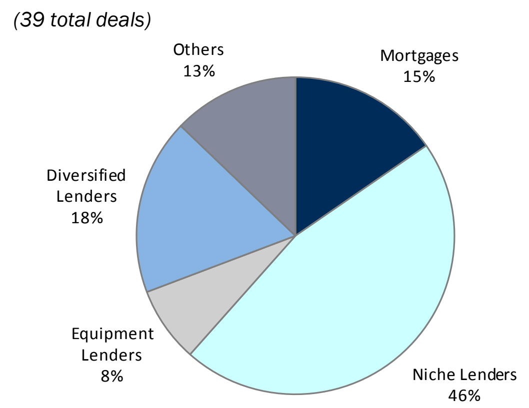
Despite these pockets of activity, a full-fledged M&A market for specialty finance companies will require the renewed participation of commercial banks. While certain growth-oriented banks — such as Everbank — have been acquirers recently, the capital, regulatory and market valuation issues confronting the banking industry have kept most of these institutions on the sidelines.

Most Active Buyers since 2009

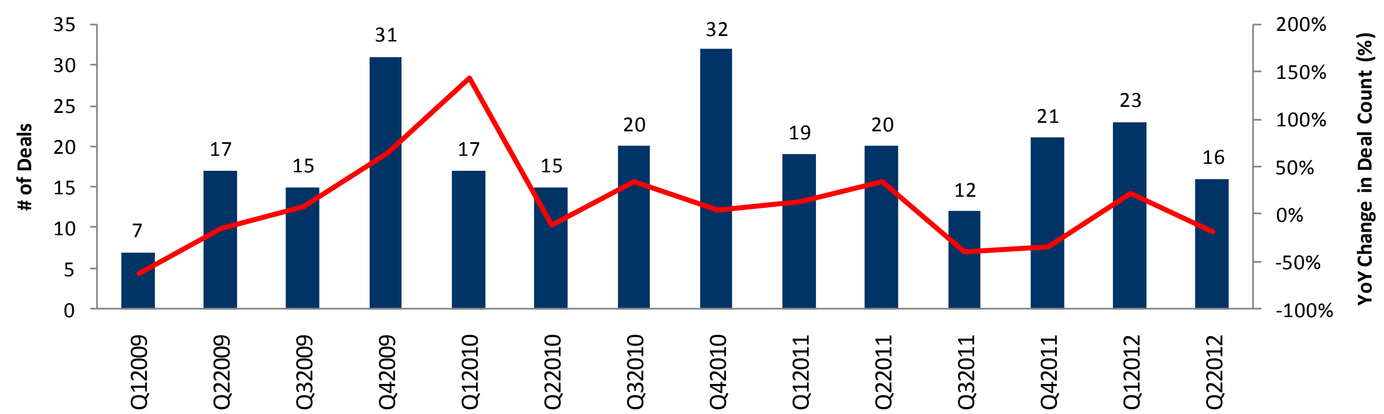
#	Buyer	# of Transactions 2009	2010	2011	1H2012	Total
1	EZCORP, Inc.	0	3	5	4	**12**
2	Dollar Financial Corp.	6	3	1	0	**10**
3	First Cash Financial Services, Inc.	1	1	2	3	**7**
4	Community Choice Financial Inc.	2	1	2	1	**6**
5	Wintrust Financial Corporation	1	0	2	1	**4**
6	Guaranteed Rate, Inc.	0	0	4	0	**4**
7	Cash America International, Inc.	2	2	0	0	**4**
8	Wells Fargo & Company	1	0	2	1	**4**
9	Fortress Investment Group LLC	0	3	1	0	**4**
10	PSM Holdings, Inc.	0	0	3	0	**3**

No. of Deals Through 1H 2012 by Type of Target

(39 total deals)



M&A Activity(1)



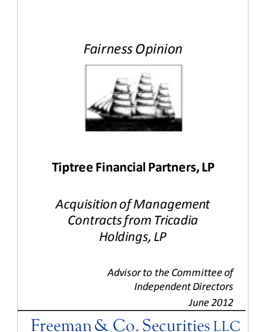
(1) Includes transactions where US firms are either the target or acquirer
(2) Mortgages include: residential, diversified, commercial; Niche Lenders include consumer, commercial; Diversified Lenders include: consumer, commercial and specialty; Others include: pawn shops, home equity lenders, investment companies

Source: SNL

Recent Specialty Finance Transactions

Mortgage Warehouse Lender

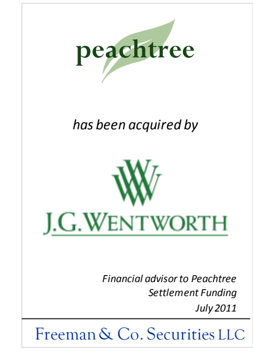
Management Contracts



Structured Settlements

Life Settlements

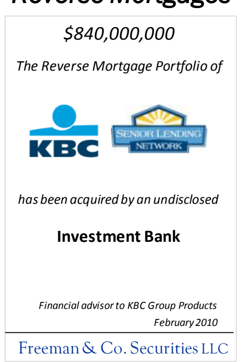
Structured Settlements



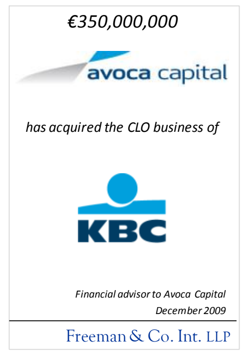
Warehouse Financing

CLO Contracts

Reverse Mortgages



CLO Contracts



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- *Low Interest Rates – Issues and Opportunities (February 2012)*
- *Special Education (March 2011)*

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