DebtRush Newsletter

"We Look Forward To Partnering Together in 2017"

Rush Street Capital is a boutique financial advisory firm. Its services include debt private placements, debt advisory, recapitalizations, working capital facilities, refinance of existing debt, mergers and acquisitions advisory, debt restructuring, special situations, and capital markets. The firm also provides advisory services for acquisition financing, mezzanine debt, bridge financing, and project financing services. It focuses on debt structures including senior cash flow, asset based, second lien, mezzanine, and unitranche. The firm's clients include lower middle market private equity firms, independent sponsors, companies, business owners, and lenders.

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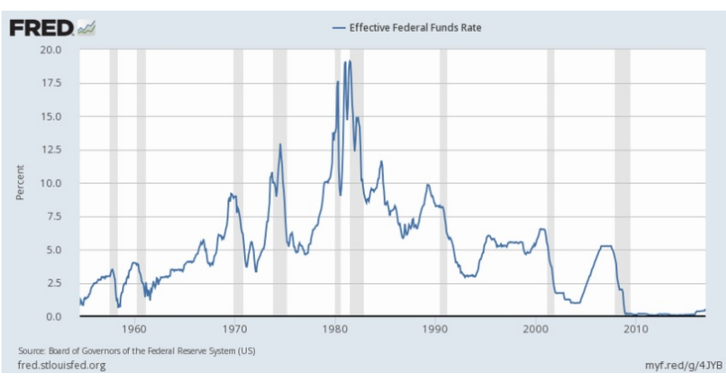
RSC Market Update - January 2017

Look Out Above: For The First Time In A Long Time, Interest Rates Are Going Up



The year was 2005. During the first 45 days of 2005, Condoleeza Rice was confirmed asSecretary of State, replacing Colin Powell. The New England Patriots beat the Philadelphia Eagles in Super Bowl 39(aka XXXIX), Barack Obama was sworn in as a 1st-term Senator from Illinois,Arnold Schwarzenegger was in his 2nd year as Governor of Californiaand Alan Greenspan was nowhere near retiring as Chair of the Federal ReserveBank. Palm PDA's were still quitepopular, as were digital cameras, flip-phones and the iPod Classic. If you asked someone about a new "App", theywould most likely think that you were referring to a new 1st coursemenu item at one of your favorite restaurants.

The point here is a lot has changed in this world since thelast time that we were operating in a "rising interest rate environment". The year 2005 saw the Fed Funds rateincreased by 200 basis points or a full 2.0% from 2.25% to 4.25%. This was the last year that borrowers andlenders had to contend with rising interest rates.

This means that if you look around your place of business,anyone who is under 35 years of age, probably does not have any tangibleprofessional experience of working during a time when interest rates wereincreasing. Those folks have spenttheir entire careers during a period when interest rates were flat (most of2006), declining (2007 and 2008) or pretty much zero (2009 to 2016). For those readers and market participants whoare under 30 years of age, this means that their entire work life has beenunder a zero-interest rate environment.

So what does all of this mean you may ask? What is the big deal about this? After all, interest rates are still very lowand credit is easy to come by.

We wonder if many in our profession are in fullcontemplation of the positives and negatives of rising interest rates. We wonder if many professionals, who may nowbe thought to be seasoned decision-makers are fully prepared for what liesahead. We will endeavor to use analysisand research over the next few months to demonstrate some of the twists andturns that can occur when "floating" actually can mean "increasing". Financial deal models can certainly look verydifferent when interest rates move up during the life of the deal.

Certainly, no one can predict the future and/or the timingof changes in interest rates. However,the trajectory of rates is a bit more predictable. That trajectory has definitely shifted upwardover the past year.

At the risk of becoming insultingly obvious, we would liketo accentuate some of the challenges for borrowers when interest rates begin torise. Pardon us if some of the followinganalysis and commentary seem elementary, but prolonged exposure to low interestrates may have necessitated some return to basic understanding of interest raterisk.

One scenario that has increased in likelihood is an increaseof 100 basis points for some loans over the next 12 to 24 months. The starting point when an increase occurs isan important discussion topic. Given thefact that the Fed Funds rate has remained historically low for the past severalyears, many commercial loans have been priced at historically low levels, aswell. And as is the norm, by far themajority of commercial loans have floating interest rates. Therefore, many of these loans may be in theearly stages of floating upward, as we begin 2017.

The lower the current level of interest rate, the moreexacerbated an effect that an increase in rates has on the borrowingcosts. Example being that an increase of100 basis points from an interest rate level of 7% to 8%, causes the annualinterest expense to go up by 14.2%. However, an increase of 100 basis points from 5% to 6%, causes theannual interest expense to go up by 20% and an increase of 100 basis pointsfrom 4% to 5% causes the annual

interest expense to go up by 25% (see chartbelow).

Effect of a 100 basis point increase in interest rate

Starting Interest Rate	Ending Interest Rate	Increase in annualized interest expense
3%	4%	33.33%
4%	5%	25.00%
5%	6%	20.00%
6%	7%	16.66%
7%	8%	14.29%
8%	9%	12.50%
9%	10%	11.11%
10%	11%	10.00%
11%	12%	9.09%

It is precisely this elementary analysis of interest raterisk that we believe may make an accelerated return to many credit shops andunderwriting departments in 2017. Loansthat make sense at lower interest rates do not always make as much sense athigher interest rates, both for issuer and creditor.

We believe that scenario forecasting for accretive interestrates will need to make an immediate return to marketplace participants, if ithas not done so already. This couldimpact risk appetites and levels of new issuances, which we will continue toexplore in subsequent articles and issues of our newsletter throughout 2017.

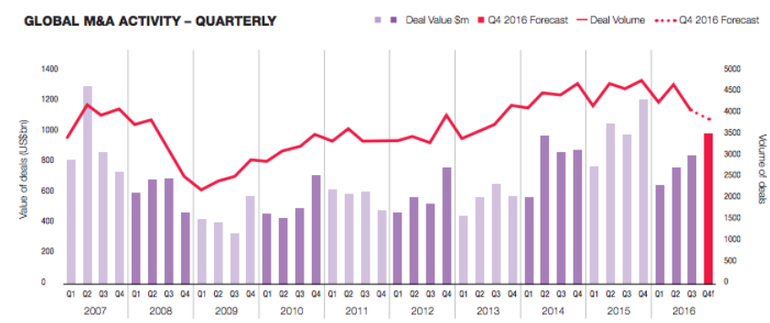
The Rising Interest Rate Dilemma

For nearly the last decade, interest rates have been at historically low levels. With a cheaper cost of capital and the incentives for businesses and consumers alike to spend and borrow, the Federal Reserve has tried to cushion the blow dealt by the financial crisis of 2008 and spur economic activity. That is the designed impact of low interest rates. Fast forward to 2017 and the Federal Reserve has begun to raise the Fed Funds Rate and has indicated that more increases are coming. These rate increases will have an impact on our economy and the debt markets.

The existence of interest allows borrowers to spend money immediately, instead of saving money in order to make a purchase. Therefore, higher interest rates usually result in an aggregate increase in saving rather than spending, as consumers and corporations have less disposable income. The raising of interest rates encourages being frugal and spending less by increasing that amount of interest paid on items that might not be of necessity. A rise in interest rates could eventually result in fewer M & A transactions, but we aren't sure how quickly that will materialize given the current robustness in the markets. In part because of rising interest rates, lenders will slowly begin to adjust the criteria used for making loans in accordance with the likelihood that the borrower will be paying more interest.

On a larger scale, rising interest rates can also have a tremendous influence on inflation and the volatility of the markets. The costs of goods and services may begin increasing in a recovering economy. The Federal Reserve raising interest rates prematurely can provide a false sense of security as to the overall strength of our economy promoting inflation. Investors looking to capitalize on the momentum shifts in the economy might be effected by the impact that raising interest rates have on businesses and the volatility that arises from speculation as to when the Fed might raise interest rates.

The adjusting of interest rates can have both positive and negative implications for our economy. As always, with uncertainty the best way to go about preparing for an interest rate hike is to understand the relationship between interest rates and our economy and try to make the most informed decisions possible. It is still unclear when the Feds will decide to raise their benchmark rate in 2017, but preparation is key in order to protect your financial stability.



Source: Mergermarket

2016 marked another good year for Mergers & Acquisitions. Though the year started off slow in terms of the amount of M & A transactions completed, deal value gradually increased to just over $1 trillion in total deals completed for the year. The later part of Q4 not only picked up in terms of transactions completed but also demonstrated an increase the value of the deals that were completed; offering insights into a much larger trend witnessed throughout the past decade in M & A activity.

As seen in recent years, deal volume while off to a slow start in the beginning of 2016 eventually increased to significantly towards the latter part of the year; with December proving to be one of the strongest months in Q4 for M & A activity. Most pundits are expecting that the final numbers for December M&A volume will be very strong. This provides 2017 with some strong tailwinds as we begin the new year and lends confidence to the current robustness that we see in M&A and debt markets.

December U.S M&A Activity

Year	December Announced US M&A Deal Value ($billions)	December Rank in Year
1998	150.7	4
1999	104.0	5
2000	75.3	11
2001	57.8	9
2002	33.7	7
2003	48.0	3
2004	121.5	1
2005	128.3	2
2006	142.8	3
2007	78.6	7
2008	22.8	11
2009	104.0	2
2010	78.5	4
2011	61.4	12
2012	103.0	1
2013	95.6	2
2014	104.3	8
2015	179.1	5
2016	TBD	???

Source: S & P Global Market Intelligence

LEVFIN INSIGHTS

The market has spoken on the first round of 2017 leveraged loan deals, with investors offering little resistance to aggressive LBO structures and the $48.34 billion of mark-to-market repricings that have launched since Jan. 1. In a market that thrives on precedent, more than a few appeared to be set this week as the technically fueled rally rages on.

LEVFIN INSIGHTS

The Rank Group is injecting an additional $30 million of equity into **Fram Group Holdings** to downsize the accompanying Credit Suisse-led term loan to $215 million, sources said. Commitments were due Dec. 20, at noon ET, sources said.

There's no change to talk; Fram, a maker of filtration

A few quick points: MFN sunsets are poised to become routine; single B LBO paper is moving below L+300; non-LBO spreads hit the Mendoza Line and could soon break through; a second-lien market that was closed a few months ago is now printing deals in the low-to-mid 700s; MFN protection is breaking wide of the 50 bps standard; and MFN carve-outs, which were negotiated out of many deals last year, are starting to stick.

In a word, it's all about the technicals.

While loan mutual funds raked in another $1.3 billion this week, according to Lipper FMI, the big news impacting the technical landscape was **Broadcom**'s move to exit the institutional market via the high-grade bond market. Wednesday's news, though a disappointment to buyside accounts already scrambling for paper, hardly came as a surprise. The very widely held TLB-3 due 2023 (L+300, 0% floor) had slipped to the low pars on Monday, from a 101.5-101.75 context Friday, after the company disclosed it would be meeting this week with investors and potential investors, fueling speculation the issuer had some sort of refinancing exercise up its sleeve. It also follows on recent upgrades to Baa2/BBB-/BBB from all three agencies.

The repayment is likely late next week with the bond deal due to settle on Jan. 19, according to sources. There was $6.578 billion outstanding under the institutional loan as of Oct. 30, SEC filings show. To put this in context, the pending repayment represents about 38% of the $17.2 billion of net new money currently in market (gross volume is a much healthier $66.4 billion, inflated by repricing and refinancing activity).

Along with driving a big calendar of repricings and strong demand for new issues, it's logical to assume that the dividend recap machine will roar back to life in early 2017. While no recaps have been launched to market in the first two weeks of the year, **Trinity Services Group** has announced a first- and second-lien dividend deal for next week.

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Source: www.levfininsights.com

products and spark plugs for the automotive aftermarket, is seeking to refinance via a five-year term loan that is talked at L+650-675, with a 1% floor and offered at 98, sources said. The loan comes alongside a $25 million asset-based RC. It will include 5% amortization in years one and two, and 7.5% annually thereafter. The term loan will be governed by a net total leverage test, sources noted. The loan includes 12 months of 101 soft call protection.

With the increase, the equity contribution will now be $74 million. The term loan was previously $245 million, sources noted. Pro forma for the change leverage is now 3.75x, sources said. The borrower is Autoparts Holdings.

The existing loan is priced at L+550 with a 1.5% floor maturity and matures July 2017.

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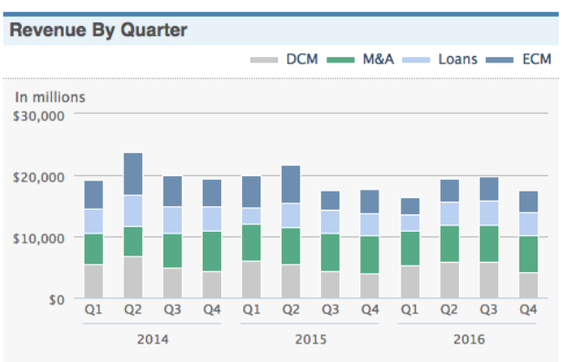
Source: www.levfininsights.com

CHART OF THE WEEK

Investment Banking Transactions



Debt Capital Markets (DCM), M&A (Mergers & Acquisitions), Loans (Syndicated Loans), ECM (Equity Capital Markets)

Source: Wall Street Journal

2016's Top IPOs

Company Name	Ticker	Date	IPO Price	Current Price	% Change
Acacia Communications	ACIA	5/13/2016	23.00	62.99	173.87%
Impinj	PI	7/21/2016	14.00	35.69	154.93%
AveXis	AVXS	2/11/2016	20.00	46.76	133.80%
Novan	NOVN	9/21/2016	11.00	25.10	128.18%
Merus B.V.	MRUS	5/19/2016	10.00	21.22	112.20%
Reata Pharmaceuticals, Inc.	RETA	5/26/2016	11.00	21.70	97.27%
Twilio, Inc.	TWLO	6/23/2016	15.00	29.50	96.67%
HarborOne Bank	HONE	6/30/2016	10.00	19.51	95.10%
Protagonist Therapeutics, Inc.	PTGX	8/11/2016	12.00	22.07	83.92%
Cotiviti Holdings, Inc.	COTV	5/26/2016	19.00	34.76	82.95%

Source: M & A Insider

RECENT TRANSACTIONS

For-Profit Career College
Midwestern U.S.

Rush Street Capital has secured a $4,415,756 First Mortgage Refinance

financing provided by

BANK OF THE WEST
BNP PARIBAS GROUP

Rush Street Capital acted as exclusive financial Advisor to the Company on this transaction

RUSH STREET CAPITAL

Rush Street Capital has secured acquisition financing for an Independent Sponsor

$10,500,000

Acquisition Financing

Rush Street Capital acted as exclusive financial Advisor to the Company on this transaction

RUSH STREET CAPITAL

"Discussion of an upcoming technology platform dedicated to matching borrowers with middle market lenders, being unveiled later in Q1-2017"

Phil Kain, Managing Partner, Rush Street Capital

QUOTE OF THE WEEK

"It's far better to buy a wonderful company at a fair price, than a fair company at a wonderful price."
- Warren Buffett

Upcoming Events:

Opus Connect: IB & The Middle Market Environment
January 17, 2017 4:00 p.m. Chicago, IL

AM&AA: Winter Conference
February 1-3, 2017 Las Vegas. NV

ACG Chicago: Roundtable Growth Discussion
February 9, 2017 Chicago, IL

DEAL SPOTLIGHT

Rush Street Capital recently represented an Independent Sponsor in a capital raise for the acquisition of a niche manufacturing company, helping to raise $10.5 million of debt in less than 90 days.

Some of the hurdles overcome during the debt capital raise process were:

- seller notes being a significant piece of the capital structure,
- seller note amortization payments,
- progress billings included in the A/R collateral,
- management transition
- Sale price was perceived by some to represent a Below-market valuation
- Deal had to close at the end of 90 days

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