
MANAGEMENT DISCUSSION SECTION

Operator: Good day ladies and gentlemen, and welcome to the Fifth Street Finance Corporation Second Quarter Earnings 2010 Call. [Operator Instructions]

At this time, I would now like to turn the conference over to your host, Ms. Stacey Thorne. You may begin.

Stacey Thorne, Executive Director, Investor Relations

Thank you [Joe] . Good afternoon and welcome everyone. My name is Stacey Thorne, and I am the Head of Investor Relations. This is a conference call to discuss the results for Fifth Street Finance Corp. second quarter ended March 31, 2010. I have with me this afternoon, Leonard Tannenbaum, CEO, Bernard Berman, President, and William Craig, Chief Financial Officer.

Before I begin, I would like to point out that this call is being recorded. Replay information is included in our May 5 press release and is posted on our website. Please note that this call is the property of Fifth Street Finance Corp. Any unauthorized rebroadcast of this call of any form is strictly prohibited. Before we go into our earnings, I'd like to call your attention to the safe – to the customary Safe Harbor disclosure in our May 5, 2010 press release regarding forward-looking information.

Today's conference call includes forward-looking statements and projections, and we ask that you refer to our most recent filings with the SEC for important factors that would cause actual results to differ materially from these forward-looking statements and projections.

We do not undertake to update our forward-looking statements unless required by law. To obtain copies of our latest SEC filings, please visit our website or call Investor Relations at 914-286-6811.

The format for today's call is as follows: Len will provide an overview; Bernie will provide an update on the SBA and other lending facilities; Bill will summarize the financials; and then we will open the line for Q&A.

I am now going to turn it over to our CEO, Leonard Tannenbaum.

Leonard M. Tannenbaum, Chief Executive Officer

Thank you Stacey. From an economic standpoint, we have moved from stable to increasing EBITDAs. These initial indicators of a rising economy are seen across several industry groups. During the economic decline, many of our companies experienced stress, and we reacted quickly by marking down the portfolio to reflect the changing values. We also prudently lower the investment ratings to categories three, four, and five, as the situation continued to worsen.

The best past quarter reflects the significant change upward in our portfolio. Though we follow a policy of not marking up our debt investment significantly above par, we did experience a significant increase in our category one rated investments. While these securities are clearly improving, we do not see any near term risk of refinancing in general, due to substantial pre-payment penalties and exit fees in many of them. Overtime, however, this category should reflect investments with a higher likelihood of refinanced risk, which in the short-term will accelerate our earnings growth.

We are also witnessing the fast ramp in mergers and acquisitions activity that we had forecasted in the past few months. As both strategic investors and private equity firms increased their activities, we expect loan demand in the middle market to accelerate. We believe that this will continue to

grow throughout the year, and it will peak in the fourth quarter. Our plan is that ample capacity for the wave of deal flow that is coming.

From a credit line perspective, we have successfully re-negotiated our R&G commitment, which Bernie will discuss shortly. We also believe that our partners at Wells Fargo along with several additional credit partners will provide ample liquidity for Fifth Street to grow our portfolio through leverage in addition to our SPA facility. We hope to make several announcements in this regard in the coming months.

Despite recent IPOs in the BDC sector, there continues to be a limited amount of our competitors that can complete a transaction for private equity sponsors without any syndication risk and with hold sizes of 30 to \$50 million. This provides us with some additional pricing power and the ability to continue to be a major lender in the middle and lower-middle markets. We firmly believe that it's still the preference for private equity sponsors to partner with a trusted lender rather than rely on a syndicate group to complete transactions.

Increased mergers and acquisitions activity coupled with the banks' expanding their credit lending have allowed us to largely refinance out of CPAC – CPAC, one of our previously underperforming investments. The price received also continues to validate our valuations in the portfolio as CPAC was at one-time marked as low as \$1 million, with the most recent valuation at 4.5 million.

We received \$5 million in cash and a \$1 million note for CPAC, exceeding our most recent valuation. It has been proactive portfolio management and the partnership approach with our private equity firms that have allowed us to successfully navigate a very challenging environment.

The addition of several team members have enhanced our ability to monitor and manage the existing portfolio. I'm pleased to report that categories three, four and five rated securities account for only approximately 5% of the portfolio.

Our second fiscal quarter ended as of March 31, 2010 was below trend from an origination standpoint. During the past quarter, we originated \$33 million worth of funded deals. However 100% of them were first-lien loans. However we've already closed, I think in the first five weeks of this quarter, on \$46.5 million of deals, of which 40.5 million were funded at close. We anticipate originations to continue to grow throughout the year with an expected large fourth quarter.

In February, our SBA subsidiary – our SBIC subsidiary received its SBA license, which Bernie will talk more about later. We are also encouraged by the movement of a bill in Congress that, if passed, will hopefully expand the capacity of our SBIC subsidiary's SBA license by another \$100 million.

The SBA capital is very advantageous and should create earnings momentum into next year as the leverage is deployed. The investing environment is changing as I highlighted in – on our recent monthly newsletters. We were fortunate that currently 75% of our portfolio took advantage of a higher risk return environment, as we were one of the few BDC that had ample capital to invest during the credit dislocation.

We expect our primarily credit dislocation portfolio to generate strong returns as the economy recovers. We continue to be focused on a potential for inflation to spike at any time, given the very pro-liquidity stance of the Federal Reserve. The increase in floating rate loans with floors should begin to serve as a hedge against a substantial increase in interest rates over the coming years.

All of the deals so far closed since March 31 are floating rate with floors of at least 9%, bringing the current percentage of our debt portfolio with floating rates to approximately 24%.

Our SPA leverage will also serve as a hedge against rising inflation interest rates, as the interest rate of that piece of debt is fixed for 10 years, when it – when it is fixed. We expect our first tranche of debt to fix in the September timeframe as SBA securitizations tend to occur about twice a year: in March and September.

We will continue to use financing partners to provide diversification in the portfolio. Our pipeline of loans remains strong at approximately \$1.4 billion. We continue to expect a high conversion of our pipeline to signed term sheets due to our ability to commit the entire loan without syndication risk, by utilizing both our credit lines and the SBA facility as well as the desire for sellers to close by the end of the year due to the anticipated increase in the tax rates next year.

We believe that these events, coupled with our strong brand and relationships, allowed us to capture premium pricing over the market. We believe the opportunities in the middle market are large and growing even as lenders begin to return to the middle market. We plan on continuing to take advantage of this environment to gain market share with top quartile private equity sponsors as well as to capture strong risk adjusted returns.

I am pleased to announce that we've exceeded our goal that we set last year of having 65% of the portfolio in first-lien loans with first-lien loans currently at approximately 71% of the portfolio, which includes the deals closed during the past five weeks. Over 90% of the pipeline contains first lien one-stop loans. At – this percentage may experience a future increase.

This gives us one of the most secure portfolios of any BDC. With that said, our current target is for about two-thirds first-lien and one-third second-lien loans. and we are actively looking for selective opportunities in second-lien. We do not plan on investing in unsecured PIK toggles or many of the vehicles which we believe generate a higher default rate and lower recovery in an economic decline. Our strong first-lien position coupled with further diversification in the expansion of assets should position Fifth Street favorably to reduce its cost of capital over time.

Our Board of Directors declared a dividend this quarter of \$0.32, an increase of 6.7%. The \$0.32 dividend is up from \$0.30 in the previous quarter and \$0.27 in the quarter before that. Due to the increased pace of originations along with the use of leverage, we anticipate the dividends to continue to increase during 2010.

We've announced several key hires to our team, which has greatly broadened our platform and expertise. As a leading player in the middle market we are able to attract talent that serves as a key source of enhancement to our underwriting, origination, and portfolio management teams. I will now hand the call over to our President Bernie Berman.

Bernard D. Berman, President

Thanks, Len. We were very pleased that our SBIC subsidiary received its license from the SBA as of February 1. We also received a leverage commitment from the SBA the amount of \$75 million. After we invest that leverage, we expect to receive a commitment for an additional \$75 million. In April, our SBIC subsidiary drew \$17.5 million of leverage, which we invested on May 3.

Our SBIC subsidiary has now funded \$92.5 million of investments, of which 75 million was invested using our equity contribution and 17.5 million was invested with leverage. Until our borrowing rate is fixed, which we expect to happen in September, we're paying interest on our drawn leverage at a rate of LIBOR plus 30 basis points per annum plus applicable fees.

The most recent coupon on SBIC pool of ventures from March of this year was 4.108%, and that rate is fixed for 10 years. Even with the additional fees that we are required to pay, that is still a very attractive rate for 10 year, fixed-rate leverage.

Under SBA regulations, we are allowed to access up to \$37.5 million in leverage prior to our initial examination by the SBA. That leaves us with 20 million in available SBA leverage prior to our exam. Our exam is tentatively scheduled to begin around June 30. So we expect to have access to leverage beyond the current \$20 million capacity early next quarter.

On the ING facility, last week we notified ING that our obligations and their commitment under the commitment letter which we announced in February had terminated. We did this because of a deal we negotiated at that time was no longer a market deal. We have since reached agreement with ING on new terms as we announced this morning, and we expect to close the credit facility within the next 30 days. The pricing on the facility will be much lower than the pricing we had originally negotiated. We expect the pricing to be in the range of LIBOR plus 3.5% per annum to LIBOR plus 3.75% per annum with no LIBOR floor. We are pleased that our partners at ING and the other participating banks have been so flexible, and we look forward to working with them. We expect the initial closing will be somewhat larger than the 65 million we have been targeting, and the maximum size of the facility will remain at 150 million.

We also have had very productive conversations with Wells Fargo about expanding their facility and lowering the pricing on their facility. We are optimistic that we'll have an expansion of the Wells facility within the next few weeks. I am now going to turn it over to our CFO, Bill Craig.

William H. Craig, CPA, Chief Financial Officer

Thanks Bernie. With respect to our balance sheet as of March 31, 2010, total assets were 490.8 million, which included total investments of 460.9 million at fair value and cash and cash equivalents of 23.5 million. Since March 31, we have used substantially all of our cash balance to fund investments.

Liabilities for 6.4 million and stockholders equity was 484.4 million, and our net asset value per share at March 31, 2010 was \$10.70. With respect to our operations, total investment income for the three months ended March 31, 2010, was approximately 17.9 million, which was comprised of 14.1 million of cash interest income, 2.3 million of PIK interest, and 1.5 million of fee income.

Total investment income for the six months ended March 31, 2010, was approximately 31.1 million, which was comprised of 24.4 million of cash interest income, 4.3 million of PIK interest, and 2.4 million of fee income.

For the three months ended March 31, 2010, we recorded net unrealized appreciation of 1.2 million and 2.9 million of realized loss. For the three months ended March 31, 2010, we recorded net unrealized appreciation of 2.2 million and 2.8 million of realized loss.

For the quarter-ended March 31, 2010, our weighted average yield on investments was 15.0%, which included a cash component of 12.7%. Our average portfolio company investment at March 31, 2010, was 14.9 million.

At March 31, 2010, our portfolio consisted of investments in 34 companies. At fair value, 98.8% of our portfolio consisted of debt investments; 68.9% were first-lien loans, and 29.9% were second-lien loans.

As Len previously noted, our first-lien percentage has grown to approximately 71% when we include the deals closed in the last five weeks.

At March 31, 2010, approximately 18% of our debt investment portfolio at fair value bore interest at floating rates. Again, as Len previously noted, the percentage for our exact portfolio with floating

rates is approximately 24% including the recent deals. All of our floating rate loans carry a minimum interest floor of at least 9%.

During the quarter-ended March 31, 2010, we invested 33.2 million across one new and five existing portfolio companies. With respect to our ratings at March 31, 2010, the distribution of our debt investments on the one-to-five scale rating at fair value was as follows.

The percentage of one and two rated securities for the quarter-ended March 31, 2010 was 94.9%, in comparison to 93.3% as of December 31, 2009. We are closely monitoring all of our investments and continue to provide managerial assistance as proactively as possible.

Stacey Thorne, Executive Director, Investor Relations

Thanks Bill. As a reminder for the month that Fifth Street does not report quarterly earnings. We generally release a monthly newsletter. If you would like to be added to our mailing list and receive these communications directly, Please either call me at 914-286-6811 or send a request e-mail to ir@fifthstreetcas.com.

Alternatively e-mail alerts can be setup through the shareholder tool link under the investor relations tab on our website, www.fifthstreetfinance.com. Thank you for participating on the call. I will now turn it over to Joe to open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank You [Operator Instructions]. Our first question comes from a Greg Mason with Stifel, Nicholas.

<Q – Greg Mason>: Great, and good afternoon. Len, on the SBIC, as I understand it you are able to draw 37.5 million but then you have to go back and get additional approvals from the SBA to drive the remaining amount. Can you give us an update on where you are for that remaining amount of that capital?

<A – Bernard Berman>: Hi Greg, we actually got an initial commitment for 75 million, of which we were immediately able to access 37.5 and we've drawn 17.5 of that. So that leaves 20 more available to us at this moment. And after we have the exam in June, we should very quickly have access to the remaining 37.5 of that initial 75 million commitment, and then we can go back and ask for the last 75 million.

<A – Leonard Tannenbaum>: And that was Bernie and I just wanted – this is Len – I just wanted to add to that – that we asked the SBA to move the timetable to a quarterly review and they were very accommodative by allowing us to be reviewed at the end of June. So we appreciated that.

<Q – Greg Mason>: Great and then Len, could you give us a little more color on the investment opportunity – you particularly talked about a wave coming in the fourth quarter – do you have any ideas in your mind on how much origination potential there is and how much capacity do you need going in to the fourth quarter to do those deals?

<A – Leonard Tannenbaum>: I just sat on a panel at ACG InterGrowth that, I think John Schuler and a number of other lenders – senior lenders and junior lenders etcetera that were on top in our space, and we all unanimously agreed that because of the tax rate increases next year, the fourth quarter was going to be very, very large. All of us are seeing as if the investment banks basically – especially the middle-market investment banks – almost at capacity in terms of new deals, books out, etcetera. So I'm keeping closely abreast of the market from all of the other CEO – for many of the other CEOs and a number of other market leaders, and I feel confident that this will be more of the biggest fourth quarter M&A in history maybe. Having said that, it's very difficult to gauge the amount of the fourth quarter, but I feel like from last year's experience, where there was a healthcare bill with potential tax increase to the rich, we saw a December of \$150 million, approximately \$150 million in signed term sheets, which we closed all of those deals. This fourth quarter could be multiples of that.

<Q – Greg Mason>: And so as you're kind of thinking about your capital budgets, how much capacity do you want to have going into that fourth quarter?

<A – Leonard Tannenbaum>: I'd liked to – the goal has always been to be able to have enough capacity to fulfill the needs from our private equity sponsor partners and so we – the good news about being a 100% origination shop and having approximately a 120-day lead time from the time we get a deal to the time we close the deal, we're able to plan pretty well for capital needs. So you can definitely judge as an analyst or as a shareholder how much capacity we need at any given time by our announced term sheets, signed term sheets, and pipeline. And right now we are already seeing the M&A bill and we are fortunate to hopefully, as Bernie said and I said, have an expansion to our credit lines at a reasonable bond cost and access in the next quarter to the SBA to the balance of the – or to a balance of the SBA leverage and hopefully eventually with the last 75 million. So I feel like we're definitely taking the right steps to be prepared. But we're closely monitoring the signed term sheets and needs of our private equity sponsors.

<Q – Greg Mason>: Great, thanks guys.

Operator: Our next question comes from Chris Harris with Wells Fargo.

<Q – Christopher Harris>: Great. Thanks a lot. Taking a look at some of your recent transactions here, if my math is correct, it looks like the weighted average yield on these deals is about 12%, which I think is in line with the deals that were done in December. I am just kind of – do you think that yield can hold for the remainder of the year or do you think it might get pressured somewhat as more as – as competition heats up?

<A – Leonard Tannenbaum>: So we're actually going to give you an answer that we'd normally wouldn't give, but we do average yield of the new deals was almost was 13. – over 13.75% with a cash yield of approximately 13%. So we're actually really proud that weighted average yields really held up very well. As I said – as I said for a while, we expect the 14.9% or 15% with average yield that we currently have to drop towards 14% and I wouldn't be surprised that all that happened over time.

One of the mitigants to that happening is often our securities – there's an APs and the BPs. The BPs is the higher interest rate piece and the APs amortizes. So overtime, the weighted average yield, should all originations remains static, goes up, because the higher interest piece stays in place, the lower interest piece gets amortized. That's offset by recent deals where weighted average yield was below the 15% number. So I do believe it's going to continue to decrease and that's what should be expected, but we are capturing a premium in the market for services, and we're capturing premium in the market for first-lien once up and for our holded size, and I think that still is valued by the private equity firms.

<Q – Christopher Harris>: Okay, then kind of along the same lines, in the past you talked about some banks kind of stepped in your market and really got aggressive. Are you still seeing a lot of activity from the banks or is that kind of gone away?

<A – Leonard Tannenbaum>: The bank that came into our market it's – I asked the panelists – that I was on the panel with yesterday – has certainly taken a step back from their aggressive postures. But others, but there's definitely other players in the market. Look, we have operated in the competitive market for probably 10 of the 12 years. It's clear that the 2008 and 2009 vintages were severely less competition, which is why we were able to achieve pricing in excess of 200 basis points, I think what we were able to get today, and you can see that by the very good pricing of our December deals. However, I still think we're in a normal market and this is a market we are very use to – with competitors we're use to competing against. Right now they're – you're not seeing irrational players in the market and that's a good sign.

<Q – Christopher Harris>: Okay, and then the shifting gears back to the SBA here for a minute. Bernie, it's probably a good question for you. You mentioned you have to ask for the remaining \$75 million commitment. What would you mean by asked for? I mean, is that simply just pick up the phone and call them or do you have to go through some detailed, lengthy application process? Maybe you can just tell us a little bit about how that works.

<A – Bernard Berman>: There is an application for that but it's nothing like the licensing process, which was long and detailed. It's more in the way of just a few pages of paper and that's just a formality. The maximum leverage is a 150 million but they typically don't commit it to you all at once; in this case, they committed half of it up front and then we will simply go back and ask for the rest when that 75 million is invested or allocated.

<Q – Christopher Harris>: Okay and last question and I'll hop off here. Can you guys remind us what is your excess distributable income was as of the end of this quarter?

<A – William Craig>: In terms of dollars or cents per share.

<Q – Christopher Harris>: Either would be fine.

<A – William Craig>: Yeah we are looking up the number here. It's actually, are we back on? We are actually under-distributed by about \$1.2 million.

<Q – Christopher Harris>: Okay thank you.

Operator: Our next question comes from Jason Arnold of RBC Capital Markets.

<Q – Jason Arnold>: Hi, good afternoon guys. Len I was just curious if you could talk a little bit about the opportunities you're seeing to add new PE-sponsored relationships or expand upon current relationships as you add on some scale and new hires as well?

<A – Leonard Tannenbaum>: I think there is definitely opportunity to expand relationships and we recently expanded to a number of new ones. We are now looking at our second deals with many of those sponsors, and in the case of a couple of our larger relationships our fifth deal or fourth deal. I really would like to concentrate our relationships to 10 or 20 top PE-firms and get a true partnership across their platform rather than scatter it among many, many different relationships. So I am pleased with adding some of the new relationships that we added, which are fund-sizes, those between 200 to 500 million primarily, are really terrific relationships and I am really pleased to have added them.

<Q – Jason Arnold>: Okay, terrific, thank you very much.

Operator: Our next question comes from David Chiaverini with BMO Capital Markets.

<Q – David Chiaverini>: Good afternoon. Couple questions. Going to the SBIC, how much have you put into that, did you put in 75 million of equity?

<A – Leonard Tannenbaum>: Yes.

<Q – David Chiaverini>: Okay and how much amortization are you structuring into new first-lien loans?

<A – Leonard Tannenbaum>: That's a good question. I think one of the interesting things as you invest first-lien into platform is, and concerns the private equity sponsors, is amortization, we amortized, I think, almost every first-lien, one-stop loan we've been doing in the market – Steve's nodding yes, so it must be the answer. We typically start amortization relatively low on the order of 10% or so, and we ramp it over time. We want to give our sponsors a chance to grow the company and use the cash for that purpose. But yeah we've realized the importance of amortization in the APs and each one of our loans has it.

<Q – David Chiaverini>: So it's 10% the first year, and then it ramps up. And these are typically five year loans?

<A – Leonard Tannenbaum>: Well I mean 10% is sometimes – sometimes it's a little less, sometimes it's a little bit more. But that's a good rule of thumb to use for year one. And, yes, these are primarily – not all – five-year loans with the BPs set with bullets, and APs set to amortizes.

<Q – David Chiaverini>: Great and then as a follow up to the earlier question about the 1.2 million of excess on distributed income, is that why you elected to increase the dividend \$0.32 even though distributable income was \$0.29? Just to pay out that extra \$0.03 per share.

<A – Leonard Tannenbaum>: We mapped our dividend over the year. The idea is to distribute back the cash that we receive. So even in a lot of the cases where there's PIK interest, there is

amortization in the same security, so we're always getting the cash – which the cash always covers the dividend. As we approach the Board with – for the dividends a couple of days ago, the discussion was around origination, close deals, etcetera, because as you know the points up front go into distributable income immediately, even though they are amortized over the life of the loan, is one affect of this. And the other thing is we are starting to see the early signs of recyclability, and recyclability will create additional distributable income as well as exit fees, which we really, to date, have not recognized much of, get realized prepayment penalties, get realized in other things. Which, yes, it accelerates income in the short term, but also really accelerates distributable income. So, the Board took a look at the forecast over the next four quarters and determined that \$0.32 was a appropriate and yet conservative number, which still allows us room to increase it further during 2010 if originations keep pace with our forecasts.

<Q – David Chiaverini>: Okay, thanks for the color on that.

Operator: Our next question comes from Jasper Birch with Macquarie.

<Q>: Good afternoon everyone.

<A>: Hi Jasper.

<Q>: Hey, how are you? Just to start off, I just wanted to make sure I'm thinking about this right. Sorry about that, my phone was off, I'm sorry. Just to make sure I'm thinking about this right, you can transfer assets into the SBIC or do they have to be originated at the SBIC?

<A – Bernard Berman>: Yeah, they need to be originated in the SBIC.

<Q>: Okay and then in terms of just looking at, I know you guys are doing mostly floating rate or almost all floating rate assets right now and that totally makes sense, given that there is only one way for interest rates to go. But just looking down the road, in terms of, I mean the SBIC's funding is going to fixed rate, how are you looking at running a match book and marking in yields, is that something that you're considering or do you really like the floating rate play right now?

<A – Leonard Tannenbaum>: Look, with LIBOR near zero, it's very difficult to think of LIBOR going down much.

<Q>: Yeah.

<A – Leonard Tannenbaum>: So all of our loans, so far, or most of our floating rate loans, have floating rate floors of three and the ability to hedge naturally against an increase in LIBOR makes a lot of sense. Fortunately on the way down, we did a lot of fixed-rate loans that protected us as LIBOR decreased. And so now, Fifth Street is positioning itself for the opposite, which is the eventual increase in interest rates and doing our book appropriately. Yeah you're right, the fixed rate leverage that the SBIC affords us provides additional protection as interest rates increase, but that should just be flow-through of earnings to our shareholders.

<Q>: Okay. So you – there's a meaningful higher yield on fixed-rate assets right now?

<A – Leonard Tannenbaum>: Yes, we probably could capture a little bit more yield if we were fixing it versus floating it. But I think the prudent thing to do for the shareholders is to continue moving our floating rate assets. I didn't say it during our speech but may be I forgot to write it. But our target is to get floating rate assets to 50% of assets. So I think with one quarter, we're 25% of assets and so you'll continue to see over the next couple of quarters that number progress towards 50%.

<Q>: Okay. Excellent. Just two more quick questions. I know you mentioned that your pipeline is about 90% first-lien loans. Is that symptomatic of the entire market that only fixed-rate loans are getting done or is that really just the only deals that you're looking at?

<A – Leonard Tannenbaum>: You mean first-lien?

<Q>: First-lien. Sorry about that.

<A – Leonard Tannenbaum>: I think – this was also a very interesting debate on the panel – but we certainly are seeing an active second-lien loan market and mezzanine market as well as a first-lien, one-stop market. We – our ability to commit a reasonably large amount of capital to the middle market to lower middle market is allowing us to capture premium pricing and to capture and maintain really great partnerships with our private equity sponsors. So as long as that continues to be true, I'm really happy to continue primarily originating first-lien, one-stop loans, but, no, the market is seeing all sorts of different loans. I think the private equity sponsor, in general, prefers less lenders than more. They've been burned on syndicated loans in the middle and lower-middle market by syndicate members that may have been very difficult to deal with. So I think the fact that they can work with a trusted lender like us is their preference.

<Q>: That's fair. And then just lastly, I know EBITDAs are going up in the portfolio, but looking at your leverage ratio that you provide along with your investment ratings, it looks like your leverage ratio is, I mean, either flat or going up a little bit. I was just wondering what exactly is going on there?

<A – Leonard Tannenbaum>: So the leverage ratio we provide for categories one, two, and then three, four, and five. The one certainly did go up a bit but the amount of category ones went up a lot. Just in perspective, at September 30, 2009, our one-rated securities had a fair value of 22.9 million; today they're 69 million. And category two has gone from 248 to 368. So you've added a lot to the portfolio. Category two is really, probably, the most relevant leverage ratio to look at as well as you should see three, four, and five – anything really high should probably go into those categories. But category two at September 30, 2009, actually went down from 4.34 leverage ratio to 4.29, which is not really down. It's basically flat, and I think that's right. I think if you watch the Fifth Street index, which we publish monthly; it's a very good indicator across the portfolio of our EBITDA and EBITDA movement. So I encourage all of you to watch and monitor the Fifth Street Index for changes in the middle market, lower-middle market health, which is what we hope predicts.

<Q>: And then is that – is the leverage ratio that's just that's EBITDA?

<A – Leonard Tannenbaum>: Yeah.

<Q>: And is that just quarterly or is that traveling?

<A – Bernard Berman>: Bill?

<A – William Craig>: Quarterly.

<Q>: Quarterly. Great, thank you.

Operator: Our next question comes from Casey Alexander at Gilford Securities.

<Q – Casey Alexander>: Hey, good afternoon.

<A – Leonard Tannenbaum>: Hey Casey.

<Q – Casey Alexander>: I was just wondering how many companies are – or how many portfolio investments are now in category one and how many portfolio investments are in category five?

<A – Leonard Tannenbaum>: We don't disclose the amount of investments in one, two, or three. We did disclose, by the way, in the Q as asked – look, we tried, and we have endeavored and we've, I think, achieved in general to be the most – to be one of the most transparent BBCs. We were asked to disclose our PIK, our non-accruing PIK and non-accrual securities, which we did disclose in the Q. So that's and we plan on disclosing each quarter. So those are – that's the only ones that we disclose – our underperformers.

<Q – Casey Alexander>: Okay, that's all I have.

<A – Leonard Tannenbaum>: Thanks Casey.

<Q – Casey Alexander>: Thanks.

Operator: Our next question comes from Jim Ballan with Lazard Capital Markets.

<Q – Jim Ballan>: Hey, thanks a lot. Hey, Len, you described a – during what seems to be a very attractive up-environment that you're operating in right now, which is just consistent with our research as well, but can you talk to me a little bit about what do you think your sort of biggest operating risk for the firm is right now? Is it a credit quality, or the portfolio, access to capital, lower returns on incremental investments. Going forward, what do you think of as your, sort of, your biggest operating risk?

<A – Leonard Tannenbaum>: This changes on a quarterly basis. Right now, with EBITDA increasing in general; and I would have said a quarter ago, it was people, but the addition of two key people, which was Kacy in September and Rob in portfolio management, who was Director of AlixPartners, was key. And one that we haven't announced but will put out an announcement is the addition of Chad Lakeman into – to co-head underwriting. And Chad's got 15 years of experience in credit quality and has managed over a billion dollars in credit and is extremely terrific in process and underwriting. So we are pleased to have him.

But up until now I would have said people, I feel like the senior team is truly enhanced today. So I think the biggest risk, and what I continue to worry about every week, is capacity versus demand. Supply is – it's the simple supply and demand equation – where our private equity sponsors are coming to us with relatively large deals between 30 and \$60 million, and we have to have the capital to satisfy their needs. And, to the extent that we like the credit and it fits within our basic parameter of a sponsor deal, with substantial equity with a good sponsor that we believe is top quartile and will be able to raise funds in the future. And if it fits those – it primarily fits those categories, we have to have the capital. So the balance is, of course, capital available versus capital demanded. I think that is the biggest issue right now.

<Q – Jim Ballan>: Okay. It seems to be that you actually had a good amount of capacity between your credit lines and the SBA and cash on the balance sheets. So that is great – that's the biggest one. That's terrific. I wanted to also ask a little bit about the 1.2 million in undistributed income is that – is that just for this year or does that include spillover from previous years?

<A – Leonard Tannenbaum>: It includes spillover from last year because there was a number of deals that were originated as – as I highlighted in December, and a deal that closes December 31 is very difficult to be able to match distribution plans to that. So a little bit of income spilled over from last year into this year.

<Q – Jim Ballan>: Okay, great. And just along those lines, the – your taxable or distributable income in the first two quarters of your fiscal year here have been considerably higher than the

GAAP income. Do you think that's something that will continue into the second half of your fiscal year?

<A – Leonard Tannenbaum>: I think you'll see distributable income start to catch up pretty quickly or to see the dividend rate over the course of the year, especially as you see originations continue to ramp up quarter-over-quarter. As for net investment income, the issue with net investment income of course in the ramp stage, as you all know, is because the points upfront are amortized over life of loan, it's a little bit of a trailing number. But over time that certainly continues to go up.

<Q – Jim Ballan>: Okay, terrific. Thanks a lot.

Operator: Our next question comes from Arren Cyganovich with Ladenburg

<Q – Arren Cyganovich>: Hey guys. Just wonder if you could talk a little bit about the credit quality, it looked like it improved somewhat this quarter – I think you had three non-accrual PIC investments last quarter, and you still have two on cash non-accruals. Is – what you are thinking about the portfolio overall in terms of credit quality and do you have any that are at risk over the near term?

<A – Leonard Tannenbaum>: Yeah, it's definitely an improvement that only 5% of our securities are in categories three, four, and five. And that's the lowest number it's been on in a very – since I can remember – it's been quite a while. The reason that we had one last non-accrual, of course, is we sold CPAC, or primarily sold CPAC. We did receive a note. At the same time we received the note, the equity sponsor injected an additional \$2.5 million of equity. So we feel very good about our last \$1 million note and, in fact, that's rated a category two. And I think in general the credit quality is improving. I don't know that – I think in the previous monthly newsletters I might have said that Premier Trailer, which is one non-accruing category five mark-down approximately 50% security, is currently undergoing an auction process, in which we're hoping for an additional equity investment in the restructuring of the second-lien loan. So we're excited by that, and it's a good time to be doing that for that security. And we recently placed our other payment non-accrual security, which is Legging by Gregory, up for auction with Lincoln International and books should be going out shortly. And that company's improved nicely from the bottom and from the recession. So both of our payment non-accrual securities, we're hoping for a restructuring in the next three-to-six months.

<Q – Arren Cyganovich>: Helpful, thank you. And then lastly, in terms of unfunded commitments that you have on the balance sheet that I think have been increased a little bit – that's I'm assuming largely from new one-stop investments, what are your thoughts on how big you want that to get and how to manage that risk going forward? I think it's about 35 million or around 8% of your portfolio right now. Is this something that kind of sticks out as a potential area that folks start drawing that in the future?

<A – Leonard Tannenbaum>: So the unfunded commitments, first of all, it's diversified across, I forget how many companies – Steve's saying 10 to 12 companies – and don't – we can get you that – if you really want the exact number, we can try to figure what the exact number is, but over a number of companies for sure. We monitor them closely – we monitor – he's says 13 now. We monitor the companies closely and we watch what we expect to draw versus not expected to draw – but look, there's a couple of them that frequently draw and pay back their credit lines. Most of them, these are unfunded revolvers that – they just, the private equity firm feels more comfortable than unfunded revolver and some of that – a few of them are secured by out – letters of credit – really you're backing up letters of credit or other things like that. So we've paid close attention to our unfunded commitments and are expected to drive against them, and we have a nice history with the draws and expected draws and our ability to predict them.

<Q – Arren Cyganovich>: Thank you.

Operator: I'm seeing no further questions on the phones.

Leonard M. Tannenbaum, Chief Executive Officer

Thank you everyone for attending on a Friday afternoon. We'd rather not to have the future calls on Friday afternoon; that wasn't the intention. But ACG Intergrowth, which is our largest conference, was the primary reason for being on a Friday afternoon, and we look forward to continuing to execute and follow our policy of promise and deliver. So thanks for attending.

Operator: Ladies and Gentlemen, thank you for your participation in today's conference. This concludes the program and you may now disconnect. Everyone have a great day.

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