

The Commercial Paper Chase

Buy low and sell high – or so goes the old adage. But what do you do when the credit markets constrict and funding dries up? That issue has dominated recent headlines and has made Bernanke a household name.

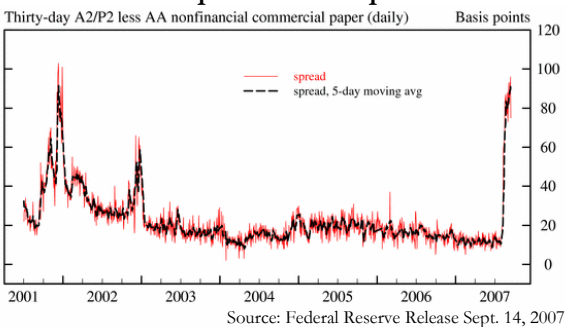
There are two dimensions to the current turmoil: A short-term liquidity squeeze and a longer-term repricing of risk in the credit markets. Relieving the short-term liquidity crisis that caused the markets to freeze in mid-August has been the first order of business for the Federal Reserve.

The Fed has taken innovative and unprecedented action. The Federal Reserve just cut Federal Funds rate .5% to 4.75%. In addition, they cut the Discount Rate to 5.25%, and extended the term of these loans from overnight to 30 days. In addition, the Fed is accepting a broad range of types of collateral including some sub-prime mortgage loans, and has removed the stigma of borrowing from the Fed.

“Early action by the Fed temporarily calmed the markets until the August employment figures were released, which showed the first retreat in payrolls in four years. The weak jobs figure is the first key indicator to suggest that the housing market troubles may be impacting the broader economy,” according to Loren Lancaster, head of Core Capital Group’s Electronics and Semiconductor Group. “Although the broader economic fundamentals remain strong.”

There has also been a big chill in the asset-backed commercial paper markets — that may be thawing.

Discount rate spread as of Sept. 14



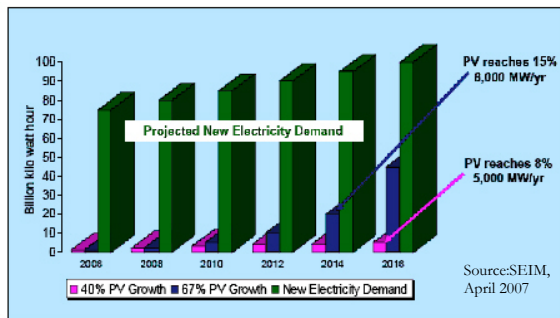
Asset-backed commercial paper is a key source of funds for the day-to-day operations of many businesses. Issues in the market seem to be contained in asset-backed commercial paper that has been used to fund longer term mortgage products.

The discount rate spread has not come down yet which shows the perception of corporate risk is still high.
(See page 2, col. 1)

Solar Industry a Bright Spot for Semiconductors

The solar industry is ripe for the support of the equipment and materials supply chain to drive down the cost of photovoltaic (PV). “If we can get the brain trust of the semiconductor industry behind solar, we can bring down costs and become mainstream,” suggested Rhone Resch, president of the Solar Energy Industry Association.

“The projected growth in energy demand and strength of the solar industry represents a tremendous opportunity for semiconductor companies,” commented Loren Lancaster, head of Core Capital Group’s Electronics and Semiconductor Group. The global solar industry spent some \$2.8 billion on plant and equipment in 2006, according to Solarbuzz’s 2007 Marketbuzz report as reported by SEMI. The industry



added 548 mega watts (MW) for a 33% jump in capacity to a worldwide total of 2204 MW. Solar sales reached \$10.6 billion last year, and will likely grow to somewhere between \$18—\$31 billion by 2011 for a 170–290% jump.

“Much of this forecasted growth depends on lower costs, and that depends on such things as deposition tools with better yields and higher throughput, economical slicing and handling tools for thinner wafers, better coating materials, and lower cost polysilicon,” Resch said.



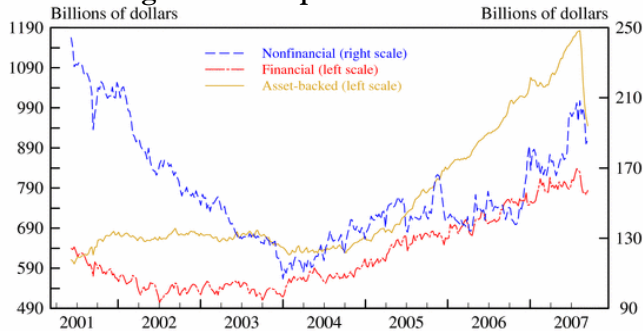
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Paper Chase *(From page 1, col. 1)*

“However, the volume of outstanding commercial paper has dropped significantly, which indicates the market is clearing out the questionable debt,”

Outstandings— as of Sept. 14

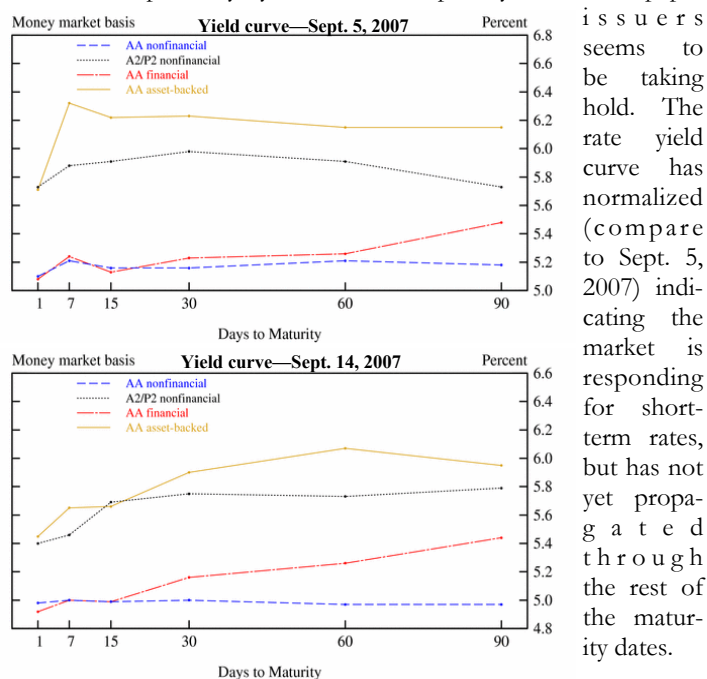


Lancaster noted. The amount of outstanding asset-backed commercial paper fell to \$980 billion at the end of August, down \$195 billion from the end of July, according to the Federal Reserve.

Commercial paper issuers recently followed the Fed’s lead by stepping up efforts to woo money-market investors or find other funding. *The Wall Street Journal* reports that:

- Bank affiliates are disclosing an unusual level of information about their holdings and exposure to subprime loans.
- Structured investment vehicles are in talks with banks to borrow against their own assets to obtain funding repo pacts to help pay maturing paper and avoid fire sales of their assets, which include securities tied to U.S. Mortgage loans. Many commercial paper sellers are choosing to sell assets to raise money.
- Sellers that are coming to market are paying higher yields – in the range of 0.5 percentage points more than the London interbank offered rate, which is helping drive up interest rates broadly.

Action taken primarily by the Fed and in-part by commercial paper



issuers seems to be taking hold. The rate yield curve has normalized (compare to Sept. 5, 2007) indicating the market is responding for short-term rates, but has not yet propagated through the rest of the maturity dates.

Long-term rates are down as well, but have not dropped as quickly.

While the commercial paper market remains seized up, some analysts point out that shakeouts in the market tend to occur quickly, which means the freeze may end soon. “Commercial paper has contracted sharply for a month already, so the endgame is probably near, that is unless problems in the credit markets percolate more,” Tony Crescenzi, chief bond market strategist at Miller Tabak & Co. in New York, wrote in a note.

“While the credit market still remains dicey, I see this yield curve correction as good news for both the economy and M&A activity,” Lancaster added.

Who Let The Bears Out? (who, who)

The record breaking deal activity that began in 2003 seems to have hit a subprime speed bump.

For the first half of 2007, M&A activity was at its highest annual rate ever. But within weeks, the market began to run out of steam. In August, there were \$222 billion worth of deals around the globe, according to market research firm Dealogic and reported in the *Wall Street Journal*. That is the lowest monthly total since July of 2005.

The trend appears to be continuing with a lack luster batch of deal announcements the day after Labor Day, which typically features a wave of merger announcements. M&A deal activity will not cease all together of course. Bankers expect a shift to more traditional stock-swap mergers between companies that see compelling reasons for joining forces.

The slowdown may open a window of opportunity for new buyers in distant markets that are emerging as M&A powerhouses. As Western companies get cheaper, buyers from oil-rich Arab nations, China and India may see it as a good time to spend existing cash reserves.

Few on Wall Street expect a quick rebound in the credit markets. But deals aren’t likely to dry up altogether. Bankers say three factors could sustain deal flow: new, nontraditional M&A players; so-called strategic deals between companies swapping stock; and overall health of the economy, which is critical to deal making. They do agree that deal volumes are unlikely to return to their mid-2007 levels.

“We are advising our clients to move forward as we still see a strong economy and are optimistic that what we are experiencing is the market digesting the subprime lending weakness,” commented Loren Lancaster, head of Core Capital Group’s Electronic and Semiconductor Group. “A recession is unlikely so there is still room for solid deals.”

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