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# KINGSLAND CAPITAL

October 29, 2007

Dear Investors:

At last writing, we were waiting for the First Data deal to hit the market. Since that time, First Data (or at least some of it), TXU (or some of it), and several other, smaller deals have come to market. While we accept these transactions as evidence that the market is functioning, even if not at full power, they have done little to clarify the overall picture.

There has been much discussion about the syndications of these financings, and exactly how they are getting done. New buyers came in to the market—some of these are equity income funds, hedge funds, and high yield bond funds that were attracted by relatively wide spreads and discount pricing that could be found in the loan market. We also heard of single-name total return swap financings being offered by syndicate banks (more so with the First Data deal than with others), and special purpose funds set up by private equity firms to buy LBO financings. Of course, there was some, albeit much less than normal, participation from CLOs and other traditional loan buyers.

On balance, this is positive news. While demand from the “new” buyers does not seem to have been enough to fully replace the pre-correction demand level from CLOs, a partially functioning market is ultimately better than a non-functioning market for all participants, regardless of your view. The loan market has performed reasonably well during September and October, certainly when compared with July and August. Secondary trading levels have improved, and spreads have tightened in somewhat. We note, however, that an overhang remains: still remaining in the pipeline from pre-correction underwritings is \$187 billion of loan syndications<sup>1</sup> and \$60 billion of bond syndications. The First Data and TXU deals themselves were not fully syndicated; \$1.5 billion and \$14.8 billion of loans and \$8.3 billion and \$3.75 billion of bonds remain on the books of First Data and TXU’s underwriters, respectively. The secondary trading levels on the syndicated portions of these deals are trading quite close to their issuance pricing; we would expect there to be limited upside, at least until the overhang is cleared.

Meanwhile, a few questions to consider...will the “new” loan buyers continue to buy? What will the next dollar of underwriting look like once the pipeline is cleared?

To the first question, we think some of the new buyers might stick around for a while on a selective basis, but for the most part, we think most of that money will go out of loans and back in to the markets it came from. Take, for example, a private equity shop that purchases LBO loans using total

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<sup>1</sup> The \$187 billion remaining pipeline would seem to indicate that approximately \$100 billion of loans have been syndicated. We note, however, that several deals have been pulled, postponed, or restructured (Sallie Mae, Acxiom, Harmon, Reddy Ice, Home Depot Supply) and thus we have removed them from the pipeline.

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return swap financing. Assuming a financing rate of L+75, leverage of 3 – 4 times, and a spread on the underlying loan of L+ 300, returns range from 8.5% to 11.5%. These are not the return levels normally targeted by private equity shops and we suspect that they will stop this activity once they no longer need to do it to help complete their own financings. Bond market participants have at times been active in the loan market, and have participated to some extent in the current pipeline. We expect that most of this money will revert to the bond market as attractive opportunities are presented. We did see this occur with the First Data deal, where the loan syndication preceded the bond offerings. At the time that the bonds were brought to market, secondary levels on the loans weakened noticeably as traditional bond market participants cycled out of the loans and into the bonds.

As for the second question, we think the answer is clear. Underwriting banks are simply not going to be interested in holding large pieces of financings on their books on an ongoing basis, and they will want to limit execution risk and avoid some of the creative syndication solutions they have had to conjure to complete the current batch of deals. Underwriting standards will be tougher, pricing will be attractive, structures will improve. We expect that this will have a negative impact on secondary trading levels for existing deals, although we are not expecting that impact to be dramatic.

Our outlook for the market has not changed. We continue to believe the market fundamentals will weaken with a slowdown in the U.S. economy, and that default levels will increase. As I outlined in my September 14 letter, our portfolio is positioned for this eventuality, and we will continue to take a defensive posture. Trading will be focused on portfolio optimization. We completed our third quarter portfolio review this week; we have added one name to our portfolio watch list, which currently stands at 1.89% or our portfolios on an aggregate basis vs. 3.19% at last writing.

The other market of focus for Kingsland is of course the CLO market. As you are aware, there has been limited new issuance over the past several months, and we expect this trend to continue at least through the balance of the year. Most of the issuance we have seen was related to pre-correction warehouses, and I think it's safe to say that the distribution processes on these deals was somewhat painful for all parties involved. While we believe that there are many investors who would like to get involved in new issue, particularly at the equity and mezzanine levels, the current problem seems to be execution levels on AAA tranches, or put more simply—the arb doesn't work. We expect that demand levels will pick up somewhat in the new year as budgets are reset, but we do not expect clarity to return to the market until the SIVs issue is resolved—either through some bailout mechanism as has been recently discussed, or through a true understanding of the extent of the losses.

We hope to be able to provide a clearer outlook on this topic at our next writing in November. In the meantime, we continue to dialogue with our investor base to determine areas of interest, and potential structures that might work. We'll keep you posted...

In other news, Kingsland V will go effective on October 31, 2007. Our first coupon payment is expected in January 2008.

Please visit our website to find updated fund summaries on each of the portfolios (these summaries are updated monthly). If you need a secure password, please contact Vincent Siino, Kingsland's Director of Portfolio Administration ([siino@kingslandcap.com](mailto:siino@kingslandcap.com) or 212-763-8362). Vince can also address specific data requests on any of the portfolios.

I plan to provide another update in November. In the meantime, please feel free to contact me directly with questions or other inquiries you might have ([delucca@kingslandcap.com](mailto:delucca@kingslandcap.com) or 212-763-8352).

Yours very truly,

A handwritten signature in cursive script that reads "Joyce C DeLuca".

Joyce C. DeLuca  
Managing Principal  
Kingsland Capital Management, LLC