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THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

New Mountain Finance Corporation (NMFC)

ROBERT A. HAMWEE, Managing Director, joined New Mountain Capital in 2008. Before joining New Mountain, he was President of GSC Group, where he had day-to-day responsibility for managing GSC's control distressed debt funds. He was with Greenwich Street Capital Partners, the predecessor to GSC Group from 1994 to 1999. Before that, Mr. Hamwee was with The Blackstone Group from 1992 to 1994, where he worked on a wide range of assignments in the restructuring and merchant banking departments. Mr. Hamwee has led numerous creditor committees and bank steering groups, and has been a lead Director for many corporate boards, including Purina Mills, EnviroSource and Viasystems Group, Inc. He graduated in The Phi Beta Kappa Society from the University of Michigan with a BBA in finance and accounting.

STEVE KLINSKY is the Founder and CEO of New Mountain Capital, a firm formed in January 2000 to achieve exceptional long-term capital appreciation through private equity and equity-related investments. New Mountain currently manages over $9 billion in private equity, public equity and debt fund commitments, with a strategy that emphasizes intensive fundamental research, proactive pursuit of the most attractive defensive-growth sectors, and a proven ability to add value and build businesses post investment. New Mountain was voted North American Mid-market Buyout Firm of the Year in 2004 and 2007 according to *Private Equity International*, and one of five finalist for Buyout Firm of the Year in 2007, 2008 and 2009 according to *Buyouts* magazine. Prior to founding New Mountain, Mr. Klinsky was Co-Founder of Goldman Sachs & Co.'s leveraged buyout group and a Partner of Forstmann Little & Co. from 1984 until leaving to found New Mountain in June 1999. Mr. Klinsky was raised in Michigan, and he earned his B.A. with high honors from the University of Michigan in 1976, his MBA from Harvard Business School in the class of 1979 and his J.D., with honors, from Harvard Law School, class of 1981. He has served as Chairman or Director of numerous public and private companies, and he is active in a range of charitable and educational causes.

SECTOR — CONGLOMERATES

TWST: Let's begin with a brief overview of the history and evolution of New Mountain Finance Corporation.

Mr. Klinsky: New Mountain Capital initiated its debt investments back in 2008. New Mountain Capital is primarily a private equity firm that manages about $9 billion of committed capital. We specialize in acyclical, economically defensive industries — industry sectors that do well whether the economy is strong or weak.

As private equity investors, we traditionally acquire majority equity control of a company and then direct or manage the business. We've been very focused on risk control and have never had a bankruptcy or missed an interest payment at any of our private equity portfolio companies since the firm began. Then in 2008 after Lehman Brothers collapsed, we saw that the debt issues of even some of the very safest, high-quality companies we had studied were selling at very low prices because of the financial crisis.

Debt is inherently less risky than the equity in the same company because it is senior to the equity, and we had already extensively researched many of these companies and industries through our private equity work. So in 2008 we took $300 million of our private equity fund and started using it to buy debt, and we've invested in close to $1 billion of debt issues overall since then, both through purchases and through direct loans. We've named the debt effort "New Mountain Finance Corporation" and took it public on the New York Stock Exchange in May of this year.

New Mountain Finance is organized as a business development corporation, BDC, essentially as a closed-end debt fund that we manage on behalf of the public. NMFC owns debt in a diversified portfolio of companies — and to avoid conflicts, this is not debt of any private equity company that New Mountain itself owns, but rather debt in other high-quality buyouts and companies. NMFC collects the interest on that debt and pays it straight out to the NMFC public shareholders each quarter as a cash dividend. The goal is a dividend of around 10% or so in cash per year. So a public shareholder of New Mountain Finance is getting the cash interest each year on all that debt that NMFC owns, and all of New Mountain's research strength and knowledge to select and manage the debt portfolio, and that's the genesis of the company.

TWST: Would you expand on the main holdings you have at this point?

Mr. Hamwee: We have a reasonably diversified group of holdings, so we have no holding representing more than 6%, and the average holding is more around 3% or 4%. I wouldn't say we have main holdings. We have more of a group of main industries, and that may make more sense to talk about because we have, for instance, roughly a quarter of the portfolio in a diversified variety of software businesses. We have another 20% or so in a diversified variety of health care service businesses and another 12 or so percent in a number of federal service businesses. But what knits all these seemingly disparate industries together is a defensive-growth business model, and so some of the key characteristics that all these companies share are things like acyclicality, niche market dominance, high free cash flow generation, high barriers to entry, and other things that allow

Mr. Klinsky: "If you look at analyst estimates for our stock, they're expecting us to have around a 10% cash dividend or more every year, and even though we tell shareholders to expect 1% cumulative losses, we've had no loan losses, defaults or nonaccruals anywhere in the portfolio since we started. We're trying to have very strict underwriting on very defensive industries."

them to, if not prosper, do certainly well enough to make sure that they can keep current on their debt almost no matter what type of economic climate we may find ourselves in over the coming years.

TWST: From your perspective, what is the outlook for venture capital and private equities right now?

Mr. Klinsky: New Mountain had a very good last few years in private equity because we were very conservative about the use of leverage in our own companies, and we have always focused on these defensive-growth industries that can grow even if the general economy is weak. Therefore, we have actually had some very good success in private equity despite the economy. And then on the debt side, it's been a particularly attractive time for us because we started buying the debt back at the end of 2008 when debt in general was at a great discount, even though the companies that we invested in were quite acyclical and stable. The debt effort has continued to prosper, and I think maybe Rob Hamwee, who is the CEO of New Mountain Finance, should take the question from there.

Mr. Hamwee: We've really seen the business model at New Mountain Finance transform from, as Steve articulated, starting in 2008 a business that purchases securities in the secondary market of the businesses that we really know and really like. That was an opportunity the market presented to us after the Lehman crash for a period of time, and we had great success with that. But as the markets recovered over the course of 2009, we transferred that same basic business model approach to more of a direct lending platform, where we are lending money to businesses for buyouts, for acquisition financing or debt repayments. And that's really been the vast majority what we've done since late 2009 through the present day. But it's exactly the same approach in terms of identifying the businesses that we really know and that we really like from all the research and work we've done on the private equity side. I think it's important to point out that unlike other BDCs, we actually staff the diligence teams with the members of our private equity industry-specialist groups. When we look at a software company, it's the same guys within New Mountain's private equity group who have the software expertise that spearhead due diligence efforts on the software business we're analyzing for the BDC.

TWST: Does New Mountain like to be a generalist on the whole or do you prefer to specialize in certain segments?

Mr. Klinsky: We are a generalist firm, but we consistently emphasize and proactively seek out the type of acyclical defensive-growth industries we have been talking about. Our firm has over 50 investment professionals, and many were former CEOs or heads of strategy or management consultants. Every year, we go through a formal process where we all put together our best ideas to identify the sectors that the firm should be focusing on for the year ahead. Then we execute what we call "deep dives" in those sectors, where we assign New Mountain teams to hire management from those industries, or team up with the best experts and consultants, and to really focus our investment work in those industries.

As Rob explained, there's been a range of industries, but the common theme of all of them is this idea of defensive growth, of finding sectors that have good steady success even if auto sales are up or down, or home sales are up or down. It's been industries like software where you have repetitive maintenance contracts in place with thousands of customers. It's been industries like medical devices, where we own the company that saves the lives of the "blue babies" in the neonatal intensive care units, and is needed at all parts of the economic cycle. We've also been strong in federal services, logistics, transaction processing, information services and other types of acyclical businesses.

We own debt securities in these same types of companies and industries for New Mountain Finance. And what we're really trying to do at New Mountain Finance is have a very, very steady and high dividend for the public shareholders, with a very low percentage of loan losses. If you look at analyst estimates for our stock, they're expecting us to have around a 10% cash dividend or more every year, and even though we tell shareholders to expect 1% cumulative losses, we've had no loan losses, defaults or nonaccruals anywhere in the portfolio since we started. We're trying to have very strict underwriting on very defensive industries. And the purpose of New Mountain Finance is to earn yield on loans in those types of industries and then to pass that interest out to the shareholders. As a BDC, the tax laws allow NMFC to pay the interest right out to the shareholders with no corporate tax paid at the company itself.

TWST: How actively have others been seeking these defensive investments in the areas that you focus on and what has that meant as far as competing for deals?

Mr. Hamwee: I will speak to the debt side of it. It's interesting, we have not found a competitor who specifically targets the same type of industries and criteria that we do — not to say that it's not a competitive market because of course it is, but it is sort of one-off competition where we'll bump into one lender on one deal, a different lender on a different deal, and we have yet to encounter a competitor who is trying to knit together the same defensive approach that we take.

There are guys who love to lend to software companies, but that's because they are software guys. And actually, there aren't many of those, there may be one or two. There are guys who are just general broadline lenders who happen to like health care as part of their broadline philosophy, and so we'll see them in some of our health care deals. But we have not seen someone who we will be bumping up again and again because they take the same holistic approach that we take to targeting defensiveness across a variety of industries.

Mr. Klinsky: Just to add on to Rob's answer, we're also in a very good competitive position because a normal debt fund may have one or two analysts who study a space, but we actually own and operate entire businesses in many of these same sectors and have real industry experience. For example, in software we own majority control of a business called Deltek, which is a leader in project-based ERP systems and trades on Nasdaq. We own control of a business called RedPrairie, which is a global leader in supply chain software. We have management teams at these companies who can advise us. We have hundreds or thousands of employees. We are the directors and oversee these companies. So when it comes time to evaluate a loan for another company in the software space, we have much more depth and experience and hands-on knowledge than a normal BDC would. And that's true in health care. It's true in federal services. It's true in business services and transaction processing, and a whole range of industries that we focus on for both private equity and for the New Mountain Finance Corporation debt effort.

TWST: Are there any specific players that you measure yourself against?

Mr. Hamwee: I would not say there is a specific player we measure ourselves against, frankly. We have respect for a number of the other successful competitors within the BDC space. So when we look at some of the benchmarks in the BDC space, we look at someone like an Ares BDC, which has done generally well, deploying somewhat different strategy than ours. But from a strategic perspective, there really is not a benchmark out there that we say "Oh! This is what we would like to look like once we've been public for three years, or this is what we aspire to be." We really have our own very focused strategy as articulated, and we are going to pursue that irrespective of what other players in the market may or may not do.

Mr. Klinsky: One thing we really do focus on is that, if we give any guidance, we want to meet or exceed that guidance. For example, I explained when we were going public, we said that people should expect a 1% cumulative loss on the loans we make over time. So far we've had no losses, defaults or nonaccruals at all, so we're ahead of what we said. Similarly, we told people to expect a $0.20 to $0.25 dividend in the first quarter, and we exceeded that with a $0.27 dividend.

We, as managers, have been buyers of our shares. So we're very concerned, I think, with living up to the expectations we set for the shareholders, and thinking about success from the shareholders' point of view.

TWST: How active have you been over the last 12 months? What kinds of deals are out there?

Mr. Hamwee: We've been quite active, particularly I'd say over the last six or so months, as the markets have softened and become a better buyer's market. Just to give you some context, in the second calendar quarter of the year, we were purchasers of approximately a $100 million of debt, and as we talked about on our earnings call, we were exceeding that pace through the first 40 days of this quarter. We continue to see very attractive opportunities as the overall credit markets have weakened and people who would otherwise be providing the types of capital that we provide have sort of gone to ground a little bit, and particularly as we've seen fund outflows from traditional high yield funds, from traditional bank debt funds, which is a strong reversal from what was occurring in the first three or four months of this year. So within our targeted industries and the targeted business models that we focus on, we are seeing both a high level of deal flow as well as the ability to drive attractive pricing and terms given what's occurred in the market over the last couple of months. So it's a very good time for us to be deploying our capital.

Mr. Hamwee: "I think for us, one of our great strengths is because we are grounded in the private equity discipline and because the bulk of our work is being done directly by the private equity professionals, we are very focused on enterprise value as it relates to the level of debt we're lending."

TWST: Given that valuation is one of the hardest elements to pin down in an investment, what kinds of models do you look at, and do you find that sometimes the valuation is subjective as much as it is quantitative?

Mr. Hamwee: I think for us, one of our great strengths is because we are grounded in the private equity discipline and because the bulk of our work is being done directly by the private equity professionals, we are very focused on enterprise value as it relates to the level of debt we're lending. So while there are other lenders who look at the auction value of property and plant and equipments or receivables, etc., we think that's very dangerous in a downturn. So what we're looking at are these high-quality businesses, and we typically are able to lend into those businesses at under 50% of our underwritten view on the enterprise value of that business. Just to be clear, we think about what multiple of earnings do you want to own a business — say 10 times earnings, and we would be lending to that business at four or 4.5 times earnings, which provides us with a tremendous cushion on our loan to value, if you want to think of it that way. And that's very much what we're focused on. So we think we've got very high margin for error, if you will, and have high confidence in the denominator that's our starting enterprise valuation because of the skill set that's embodied in our private equity practice and the history there of appropriately valuing businesses.

TWST: What kinds of skill sets and bench strengths do you have at New Mountain? What do the team members bring to the table?

Mr. Klinsky: I think New Mountain has a much deeper and stronger team than a traditional debt fund could have because, again, we manage about $9 billion of capital, and we own over 15 private equity portfolio operating companies that generate over $3 billion of annual revenues and hundreds of millions of dollars of EBITD each year. In that sense, we are much more akin to a central headquarters for a conglomerate than to a traditional standalone debt fund. At our headquarters, we have over 85 people on our staff. Over 50 of those are investment professionals, and over 20 of those were formerly CEOs or COOs, heads of strategy or management consultants who came out of industry to join us. Plus we have the management teams of the companies we own, and experience at many other companies in the past. So I think our team just has much deeper level of hands-on experience with businesses and industries than a BDC of New Mountain Finance's size could ever normally have.

TWST: When you look at the next 12 to 24 months, what targets fall naturally into the game plan that you've described? What are you shooting at?

Mr. Klinsky: Our major goal for the investors of New Mountain Finance is to have a very high and steady cash dividend on a very safe and stable portfolio of debt. People really own New Mountain Finance stock to get the annual cash dividend, which again — looking at analyst estimates right now — would be over 10% a year. And what we want to do is to generate and protect that dividend by investing in the debt of companies that are acyclical, high quality and worth far more than the loan itself. In general, we're loaning to companies at an average of about four times earnings before interest, taxes and depreciation, EBITD. So whatever price the common equity owner paid for these companies, we're at the debt level at a price where we feel very knowledgeable about the industry and very happy with the loans that we've made. Again, we've been running at 0% losses since we began the debt effort, and we want to keep paying a high steady dividend to shareholders. That's our objective.

Mr. Hamwee: Certainly our objective over the next two or three years is to continue to access the capital market to allow us to grow the business for the benefit of all the shareholders. We were able to access capital markets for the first time back in May of this year for our IPO, and our anticipation is that some time over the next couple of years we will be back in the capital markets. And we expect that as long as we reward our shareholders with the type of performance we're laying out for them, they will continue to want to reinvest in the business.

Mr. Klinsky: We as a management team did not sell any shares in the offering. Instead, we were very significant buyers of shares in the offering. We bought $30 million worth of shares as individuals, plus our private equity fund sold no shares and owns roughly $250 million worth of shares in the company. So we are shareholders, and we are trying to achieve the goals for all shareholders.

TWST: You manage the New Mountain Partners III fund. What are some of its core holdings?

Mr. Klinsky: Our most recent acquisition is a company called SNL, which is the leader in databases for people who are analyzing the finance industry, for example, for the investment banks who are doing bank acquisition work, or for the banks themselves who want to know the counterparty risk of other financial institutions they deal with. We have the leading database company there.

Mr. Hamwee: "Certainly our objective over the next two or three years is to continue to access the capital market to allow us to grow the business for the benefit of all the shareholders."

Not long before that, we acquired a specialty chemical business called Avantor. The former CEO of Rohm and Haas joined New Mountain's team after he sold Rohm and Haas to Dow for $19 billion in 2009. We then did a deep dive with him into the specialty chemicals and materials space and found Avantor, which makes very high purity, repetitively used laboratory chemicals. We have RedPrairie, which is one of the leading supply chain software companies in the country. We're diversified across a range of industries, but again, in these kind of defensive, acyclical sectors.

TWST: Are there any other specific companies and investments that we can discuss as far as investments you've made?

Mr. Hamwee: Just to give you a sense as to how the whole thing comes together in the key elements of the strategy, for instance, a loan we made a couple of quarters ago was into a company called MLM Software, which is a business that is by far the market leader in tax preparation software for Fortune 500 companies. It's a little software module that's plugged into your Oracle, your SAP system, if you are Exxon Mobil, or if you are Hewlett-Packard or something like that. And it helps you calculate the taxes due for all your various jurisdictions and applying all the most recent rules, which of course, change every year and change from jurisdiction to jurisdiction. And it's a business that we actually tried to buy in our private equity business a few years ago, and that's a common thing too. Many of the loans we make are to companies that we've actually looked at specifically to purchase for our private equity business, but either someone else just was willing to pay more than we were willing to pay, or the business was attractive but it didn't have quite enough growth potential to justify the 30% annual returns that we look for in private equity business. So MLM, we would very much have liked to own in our private equity business, but the seller wanted a multiple considerably in excess of what we were willing to pay. So the seller ultimately decided to do a refinancing and recapitalization of the business, and we obviously had great knowledge and we're perfectly positioned to be one of the lead lenders into that recapitalization and there we were lending at four times earnings. So again, you can see that tremendous loan to value. I don't know if the business is worth 10 to 12 or 15 times earnings, but I'm pretty confident it's worth well in excess of four times earnings, so great loan-to-value coverage. We've got an attractive yield, and again, I think what we deem to be a great repetitive revenue business model because customers renew at greater than 95% every year, the company has greater than 50% market share, and it's just a wonderful business with great barriers to entry, etc.

TWST: Looking at New Mountain, are people in the investment community able to play along? Your mission is to be the best in class with your defensive strategy. Is this a valid investment strategy for others to practice or does it have to be done within the framework that you've described?

Mr. Klinsky: We've always focused on defensive growth and business building, rather than just depending on a lot of risk to create returns. I think increasingly over the last decade, more and more firms are recognizing that this is the right path to follow, and more and more are trying to go down the same path that we set. However, I think the advantage that New Mountain has is that we have pioneered and executed this same strategy consistently since the beginning. Therefore, we've now built some very deep expertise and credibility in key market verticals, and we now have the right operating executives, the right experience, the right relationships, track record and experience to execute on the path we've set. So other people could copy our approach, but obviously the fact that we're already executing it consistently and not changing our stripes every time the market changes, I think, is key to our future.

TWST: Do you see any potential to add new talent to the company or from what's going on with the layoffs in the financial sector?

Mr. Klinsky: We've steadily and consistently built our team every year since the firm began, and we probably added 20 or 25 top professionals in the last three or four years alone. However, this growth has nothing to do with industry layoffs. Rather, we are always trying to recruit the very, very best talent, and if we can find someone who we think is just absolutely terrific and who can make our firm better, we'll recruit them to the team. We continue to do that.

TWST: If you were able to put your finger on one of your main strengths against your competition, what would that be?

Mr. Klinsky: I think it's the overall strategy we have, which is to have a great team with deep operating experience, focused on defensive growth sectors in a real hands-on way to both control risk and pursue high returns. That's what we do in private equity. And I think the same mindset works extremely well in the New Mountain Finance space because we can invest in the same type of companies at the debt level, which is even safer than the equity level. We hope to generate a steady, acyclical dividend in the range of, hopefully, 10% in cash per year, even today when government bonds are yielding about zero. We think it's a pretty attractive risk/reward and a pretty attractive place to be. So that's what we're set up to do, and we have a particularly strong team to do it because of our existing private equity work.

TWST: Please describe the corporate culture that currently exists at New Mountain.

Mr. Klinsky: I would say the corporate culture is, number one, based on absolutely wanting to be best in class in performance for any dollar that's entrusted to us. And it's based on a nonpolitical, team-based approach where we get the best possible people around the table, from a wide range of backgrounds and experience, who all work together in a nonpolitical, nonarrogant and intellectually honest way to find the right answer. We've added exceptional debt experts to the firm with people like Rob Hamwee, but then all of our other team members join them in the effort to support these analyses.

TWST: In conclusion, give us a realistic picture as to where you see New Mountain two years down the road and indicate some of the milestones you might pass along the way?

Mr. Klinsky: At New Mountain Finance Corporation, we hope you'll see a steady track record of meeting and exceeding the guidance we've set for strong cash dividends and very, very strong risk controls. Right now, we're at 0% loss, and although we always project higher losses than that, we'd like to stay at 0% loss for as long as we possibly can. At New Mountain Capital as a whole, I think you'll see us continue to grow out both our private equity effort, our debt effort and our public equity effort called Vantage, which we're also very proud of. We want to do this by staying true to our strategy of defensive growth and business building, and by continuing to make our team stronger and stronger so that we can keep doing better and better on every one of those fronts.

TWST: Anything you'd like to add?

Mr. Klinsky: Rob, anything you want to add to that?

Mr. Hamwee: No, I think that's a very thorough accounting for where we're at. The only thing I would add to milestones is I think looking at two or three years, I think the incremental access to the capital markets would be on that list of important things — although ultimately the number one, most important thing as Steve said is, in fact, to keep the credit performance as strong as it's been.

TWST: Thank you. (KL)

ROBERT A. HAMWEE
Managing Director
STEVE KLINSKY
Founder & CEO
New Mountain Finance Corporation
787 7th Ave.
49th Floor
New York, NY 10019
(212) 720-0300
(212) 582-2277 — FAX
www.newmountaincapital.com