### Cash Flow Senior Debt / EBITDA

<table>
<thead>
<tr>
<th>EBITDA Range</th>
<th>February 2019</th>
<th>January 2019</th>
<th>February 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; $5.0MM EBITDA</td>
<td>1.75x - 2.50x</td>
<td>1.75x - 2.50x</td>
<td>1.75x - 3.00x</td>
</tr>
<tr>
<td>&gt; $10MM EBITDA</td>
<td>2.50x - 3.50x</td>
<td>2.50x - 3.50x</td>
<td>2.75x - 4.00x</td>
</tr>
<tr>
<td>&gt; $20MM EBITDA</td>
<td>3.00x - 4.50x</td>
<td>3.00x - 4.50x</td>
<td>3.25x - 4.75x</td>
</tr>
</tbody>
</table>

**Commentary:** Lenders indicating greater scrutiny to leverage metrics ("late in the credit cycle"), especially for more cyclical sectors.

### Total Debt / EBITDA

<table>
<thead>
<tr>
<th>EBITDA Range</th>
<th>February 2019</th>
<th>January 2019</th>
<th>February 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; $5.0MM EBITDA</td>
<td>3.00x - 4.00x</td>
<td>3.00x - 4.00x</td>
<td>3.50x - 4.50x</td>
</tr>
<tr>
<td>&gt; $10MM EBITDA</td>
<td>4.00x - 5.25x</td>
<td>4.00x - 5.00x</td>
<td>4.00x - 5.00x</td>
</tr>
<tr>
<td>&gt; $20MM EBITDA</td>
<td>4.50x - 5.75x</td>
<td>4.50x - 6.00x</td>
<td>4.50x - 6.00x</td>
</tr>
</tbody>
</table>

**Commentary:** Lenders indicating greater scrutiny to leverage metrics ("late in the credit cycle"), especially for more cyclical sectors.

### Senior Cash Flow Pricing

<table>
<thead>
<tr>
<th>EBITDA Range</th>
<th>Bank</th>
<th>Non-Bank &lt; $7.5MM EBITDA</th>
<th>Non-Bank &gt; $15MM EBITDA</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; $5.0MM EBITDA</td>
<td>L+ 2.50% - 5.00%</td>
<td>L+ 4.00% - 6.50%</td>
<td>L+ 4.50% - 6.00%</td>
</tr>
<tr>
<td>&gt; $10MM EBITDA</td>
<td>L+ 4.00% - 6.50%</td>
<td>L+ 5.50% - 8.00%</td>
<td>L+ 4.50% - 6.00%</td>
</tr>
</tbody>
</table>

**Commentary:** Abundance of available capital keeping pricing exceedingly competitive.

### Second Lien Pricing

<table>
<thead>
<tr>
<th>EBITDA Range</th>
<th>February 2019</th>
<th>January 2019</th>
<th>February 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; $5.0MM EBITDA</td>
<td>L+ 7.00% - 10.00%</td>
<td>L+ 7.00% - 10.00%</td>
<td>L+ 7.00% - 11.00%</td>
</tr>
<tr>
<td>&gt; $10MM EBITDA</td>
<td>L+ 6.00% - 8.50%</td>
<td>L+ 6.00% - 8.50%</td>
<td>L+ 6.00% - 8.50%</td>
</tr>
<tr>
<td>&gt; $20MM EBITDA</td>
<td>L+ 5.00% - 7.00%</td>
<td>L+ 5.00% - 7.00%</td>
<td>L+ 6.00% - 7.50%</td>
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### Sub Debt Pricing

<table>
<thead>
<tr>
<th>EBITDA Range</th>
<th>February 2019</th>
<th>January 2019</th>
<th>February 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; $5.0MM EBITDA</td>
<td>11.00% - 14.00%</td>
<td>11.00% - 14.00%</td>
<td>12.00% - 14.00%</td>
</tr>
<tr>
<td>&gt; $10MM EBITDA</td>
<td>10.00% - 12.00%</td>
<td>10.00% - 12.00%</td>
<td>10.00% - 13.00%</td>
</tr>
<tr>
<td>&gt; $20MM EBITDA</td>
<td>8.50% - 11.00%</td>
<td>8.50% - 11.00%</td>
<td>10.00% - 12.00%</td>
</tr>
</tbody>
</table>

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### Unitranche Pricing

<table>
<thead>
<tr>
<th>EBITDA Range</th>
<th>February 2019</th>
<th>January 2019</th>
<th>February 2018</th>
</tr>
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<tbody>
<tr>
<td>&lt; $5MM EBITDA</td>
<td>L+ 7.00% - 10.00%</td>
<td>L+ 7.00% - 10.00%</td>
<td>L+ 7.00% - 11.00%</td>
</tr>
<tr>
<td>&gt; $10MM EBITDA</td>
<td>L+ 6.00% - 8.50%</td>
<td>L+ 6.00% - 8.50%</td>
<td>L+ 6.00% - 8.50%</td>
</tr>
<tr>
<td>&gt; $20MM EBITDA</td>
<td>L+ 5.00% - 7.00%</td>
<td>L+ 5.00% - 7.00%</td>
<td>L+ 6.00% - 7.50%</td>
</tr>
</tbody>
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**Commentary:** Abundance of available capital keeping pricing exceedingly competitive.

### Tone of the Market

Coming off a record-breaking year in 2018, the private capital markets continue to exhibit robust liquidity for issuers across the credit spectrum into the new year. Credit spreads remain at their most competitive levels since the pre-recession era, and leverage tolerances have experienced little compression. Institutional investors continue to compete for new assets with reduced covenant protections and expansive "adjustments" to EBITDA. Commercial Banks continue to slowly regain market share after withstanding intense competition from non-bank credit providers, and BDC share prices have recovered since December. Notwithstanding the current sanguinity, institutional investors are much more pessimistic when it comes to expectations for the next 12 months. The potential for future interest rate increases, should the Fed resume its hikes, combined with fears of an impending deterioration in credit conditions, are stoking the levels of agitation in the lending community.
Minimum Equity Contribution

With an increased focus on downside protection, lenders are likely to avoid thinly capitalized deals, especially for sub $10.0 million EBITDA borrowers. Aggregate minimum of 40.0% base level equity (inclusive of any rollover) is required for most deals. As leverage levels creep up in excess of 5.00x, 40.0%-50.0% cash equity (exclusive of rollover) is required. Most lenders discount rollover equity in excess of 20.0%.

Equity Investment and Co-Investment

Liquidity for direct equity investment (and co-investment) is still quite robust among insurance companies, family offices, credit opportunity funds, and select SBICs. Most traditional mezzanine funds will also provide up to 20% of their aggregate debt commitment as an additional strip of equity. Capital to support independent sponsors is at an all-time high, with new funds created exclusively to support independent sponsors. Promotes and carry will vary depending on the role the sponsor plays post-closing and how much, if any, of their own equity is deployed. Most carry provisions will contain performance contingencies to enhance the initial promote. While structures differ based on the circumstances of each deal, most investors are willing to sacrifice some yield for the liquidity preference.

Recap Liquidity

Recap liquidity is strong, with lenders making little distinction between accretive (acquisition) and non-accretive (recapitalization) uses of proceeds; however, sponsored transactions will achieve higher leverage and better pricing for recapitalizations. After declining between 2014-2016, dividend recapitalization activity increased in 2017 and continued to track upwards in 2018 to a four-year high (approximately $30 billion for the year).

Story Receptivity

While story receptivity remains high, it is increasingly becoming more “sector selective.” Challenged issuers in more cyclical sectors deemed most vulnerable to macroeconomic volatility are more likely to receive higher pricing, less leverage (i.e. one turn less of EBITDA) and potentially, some equity upside incentive features. The general feeling in the market is that we are near the end of the current credit cycle, and lenders will stress test more marginal credits against less generous macroeconomic conditions.

LIBOR Floors

Libor floors are customarily found in non-bank senior loans, second lien, subordinated, and unitranche deals; however, it is becoming less of an issue for senior bank loans in a rising rate environment. When a floor is required, lenders are looking for a minimum 1.00%.

“Steady as She Goes,” The Raconteur
Steady as She Goes

SPP is not making any changes to its pricing or leverage metrics heading into February. The theme this month is “steady as she goes,” which sums up a very competitive market for the time being with modest trepidation respecting the future. Currently, the private capital markets are characterized by record high aggregate debt levels, moderately compressed interest coverage ratios, and the looming potential for the Fed’s resumption of additional interest rate hikes. In short, while the “current conditions” component is robust, the “expectations” component is decidedly less promising.

2018 was a very solid year for the private capital markets:

- US M&A loan volume set a new record of $628.0 billion in 2018;
- Leveraged corporate M&A financing reached $228.0 billion, second only to the $257.0 billion level reached in 2015;
- US leveraged loan issuance totaled $280.0 billion in Q4 2018;
- Aggregate 2018 leverage loan volume totaled $1.2 trillion (second only to 2017 total volume of $1.4 trillion);
- Middle market loan volume in 2018 reached $183.0 billion, surpassing 2017 volume by 7%; and
- Middle market refinancing volume totaled $111 billion in 2018, its highest level since 2013 and a 39% increase over 2017.

Going into February, there are no discernable macroeconomic or adverse market conditions that would suggest any material changes to the seemingly euphoric liquidity conditions of 2018. This was most recently confirmed during the Federal Reserve’s January 2019 senior loan officer opinion survey on bank lending practices, which addressed changes in the standards, terms, and demand for bank loans to businesses over the past three months. Noted in the report:

“Banks reported that standards for C&I loans to both large and middle-market firms and to small firms remained basically unchanged over the past three months. Most terms on such loans remained basically unchanged as well, although a moderate net share of banks reported increasing the premiums charged on riskier loans to large and middle-market firms and a modest net share of banks reported doing so for loans to small firms... Nearly every bank that reported having eased standards or terms over the past three months attributed this change, in part, to increased competition from other banks or nonbank lenders.”

Though Commercial Banks have suffered from competition by non-bank lenders, they are also clearly a beneficiary of recent market conditions, as commercial bank loan growth is up over 5%, up 4% year-over-year. Predictions for market conditions in the future are not as optimistic, as noted in the Fed Survey of Senior Loan Officers:

“Regarding expectations for loans to businesses, moderate net fractions of banks reported that they expect to tighten standards on C&I loans to firms of all sizes, while significant net shares of banks expect to tighten standards for all three CRE loan categories... Additionally, banks reported expecting loan performance, as measured by charge-offs and delinquencies, to deteriorate, with either moderate or significant net shares of banks reporting expecting performance to deteriorate for the surveyed business loan categories.”

The rationale for banks tightening lending standards:

“A less favorable or more uncertain economic outlook was the most cited reason for tightening, with reduced tolerance for risk and increased concerns about the effects of legislative changes, supervisory actions, or changes in accounting standards also being cited by more than half of the banks that reported tighter standards or terms.”

A fair amount of data suggests that when the credit cycle reaches an inflection point, the impact could be more severe than in past recessions. Though default rates are still comparatively low (~1.42%), there are...
multiple recent market releases that demonstrate the vulnerability of lending constituencies in the event of further monetary tightening or downturn of the current credit cycle. Gross leverage in 2018 has eclipsed the 45% peak of the 2008 financial crisis, but net leverage (debt less cash) in 2018 comes in at ~38%, below 2008 financial crisis levels of ~43%.

The progressive erosion of covenant protections has resulted in record low levels of the Loan Covenant Quality Indicator. Gross Debt to EBITDA levels are at near all-time highs, though this is tempered by the fact that net leverage levels (total debt less cash / EBITDA) remain well below historic highs. Interest coverage levels have also deteriorated recently.

The proliferation of unitranche structures (i.e. all senior one-stop loans) may also play a critical role if default rates rise in the event of a recession. Unitranche facilities have in large part marginalized the utilization of subordinated debt structures (a staple of traditional bifurcated senior/subordinated structures). Unitranche facilities are favored by many issuers because of the more streamlined process, documentation, and lower fixed amortization requirements; however, these structures removed the subordinated debt “cushion” in a default scenario. This lack of a subordinated debt cushion below the senior tranche in a default scenario will likely result in lower recovery rates when the credit cycle turns.

**The Macroeconomic Picture**

President Trump gave his much-anticipated State of the Union address on February 5th, with the economic focus on pharmaceutical pricing, budgeting for infrastructure, and Chinese trade discussions. This speech came shortly after President Trump opened the government after a 35-day partial government shutdown, the longest in U.S. history. The Congressional Budget Office (CBO) estimates that the partial government shutdown reduced economic output by $11.0 billion, with approximately $3.0 billion (.02% of projected 2019 GDP) removed permanently. Morgan Stanley predicted Q1 GDP growth to come in at 1.7%, down from 2.5% earlier in the year as a result as well. While the 800,000 furloughed and unpaid government employees will be receiving backpay there are implications for office morale, missed rent payments, and rising credit card debt that could have an impact on discretionary spending and consumer confidence. The University of Michigan Consumer Sentiment Index came in at its lowest level during the Trump Presidency as respondents cited concern over the partial government shutdown, especially if there was no resolution by February 15th.

The government shutdown will likely not have long-term implications for; however, the hiatus did result in headline concern, continued uncertainty of bipartisan cooperation in passing critical legislation, and softening consumer confidence.

The Federal Reserve used its most dovish language in recent months when discussing monetary policy in its January 30th statement. Amid the backdrop of “cross currents” including Chinese tariff uncertainty, soft inflation results, and global economic slowdown, the board voted unanimously to keep the Federal Funds target range at 2.00%-2.25%. The January statement also removed all discussion of “further gradual increases” or continued balance sheet “normalization.” The four rate hikes in 2018 cooled inflation and caused widespread stock market volatility; however, December marked the 100th consecutive month of job growth with unemployment at 4.0% and nonfarm payrolls easily beating expectations with the addition of 304,000 jobs.

The Fed is being patient by stalling tightening with the hopes of a “soft landing” with inflation near the 2.0% target and unemployment between 4.0% and 4.6%. Overall the Economy shows promising growth potential with strong employment, expanding manufacturing demand, and...
financial markets posting a record January with the S&P and Dow both up more than 6.0%, month-over-month.

Below is a recap of this month’s key economic releases:

**Consumer Sentiment falls to its lowest level since Trump was elected** - The University of Michigan index of consumer sentiment fell to 91.2, down 7.2% month-over-month. This is the lowest level confidence report since Trump was elected President. Reasons for concern included the partial government shutdown, Chinese tariffs, and sunsetting of the current credit cycle. Consumers responded that they still felt optimistic about financial prospects but were not as positive about future job gains and economic growth.

**Unemployment rose to 4.0% amid government shutdown and total nonfarm payrolls increased 304,000, soaring past expectations** - Total nonfarm payrolls beat expectations and increased 304,000 during January, with job gains occurring in leisure, hospitality, construction, health care, transportation, and warehousing. While most of the 800,000 federal employees impacted by the partial shutdown were still counted as “employed”, 175,000 people still reported being on temporary layoff, edging up the U-3 unemployment rate to 4.0%.

**The Federal Reserve makes a U-turn in policy and keeps the Federal Funds target range at 2.00%-2.25%** - The Federal Reserve voted unanimously to keep the Federal Funds target range at 2.00%-2.25%, a change in policy from its hawkish December release.

**ISM Manufacturing Index increases and ISM Non-Manufacturing Index falls, respondents remain optimistic about continued growth** - The Institute for Supply Management Manufacturing Index increased to 56.6% (up 2.3% month-over-month). Manufacturers reported expanding business strength, increased demand, and concern over the partial government shutdown. The ISM Non-Manufacturing Index fell to a six-month low of 56.7% in January (down 2.2% month-over-month).

Stefan Shaffer
Managing Partner
212.455.4502

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Supporting Data

Historical Senior Debt Cash Flow Limit (x EBITDA)

Source: SPP’s "MIDDLE MARKET LEVERAGE CASH FLOW MARKET AT A GLANCE"

Historical Total Debt Limit (x EBITDA)

Source: SPP’s "MIDDLE MARKET LEVERAGE CASH FLOW MARKET AT A GLANCE"

Historical Senior Cash Flow Pricing (Bank)

Source: SPP’s "MIDDLE MARKET LEVERAGE CASH FLOW MARKET AT A GLANCE"

Historical Senior Cash Flow Pricing (Non-Bank)

Source: SPP’s "MIDDLE MARKET LEVERAGE CASH FLOW MARKET AT A GLANCE"

Historical Second Lien Pricing

Source: SPP’s "MIDDLE MARKET LEVERAGE CASH FLOW MARKET AT A GLANCE"

Historical Subordinated Debt Pricing

Source: SPP’s "MIDDLE MARKET LEVERAGE CASH FLOW MARKET AT A GLANCE"

Historical Unitranche Pricing

Source: SPP’s "MIDDLE MARKET LEVERAGE CASH FLOW MARKET AT A GLANCE"

Historical Minimum Equity Contribution

Source: SPP’s "MIDDLE MARKET LEVERAGE CASH FLOW MARKET AT A GLANCE"