### Deal Component

<table>
<thead>
<tr>
<th>July ’16</th>
<th>June ’16</th>
<th>July ’15</th>
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<tbody>
<tr>
<td>$7.5M EBITDA 1.5x-2.5x</td>
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<td>Bank: L+3.50%-4.50%</td>
<td>Bank: L+3.50%-4.50%</td>
<td>Bank: L+1.75%-3.50%</td>
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<tr>
<td>Non-Bank: $&lt;1.0MM EBITDA L+6.00%-8.00%</td>
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<tr>
<td>Non-Bank: $1.0MM EBITDA L+4.50%-6.50%</td>
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<tr>
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### Minimum Equity Contribution

Lenders are uniformly offering minimum 3.00%-4.00% total equity (inclusive of rollover); minimum 10.00% new cash combined with rollover or seller notes as concerns over “thin capitalization” intensify. Storied credits and cyclical sectors require minimum 40.00%-+. There is strong interest by investors providing equity directly to supplement equity contributions from independent sponsors, management teams, etc.

### Equity Co-investment

“Market” terms for equity products (structured and common) are increasingly more stratified. On “heads-up” terms common, larger promoters (15.00%+ and catch-up) are limited to “bargain” acquisitions (below market multiple), material co-investment positions (25.00%+ of equity contribution), willingness to fund deal expenses, and “value-add” sponsorship (expertise in sector). Structured redeemable preferred tranches are routinely invested alongside mezz or unitranche debt.

### Recap Liquidity

Recaps are still available, however minority share recap transactions (share recap) are more well received than pure cash distributions (dividend recap). Cash distributions are still financable but will have closer scrutiny on aggregate leverage metrics, level of sponsor’s equity remaining invested, and the sponsor’s capacity to deploy capital back to the issuer if needed. Cyclical sectors are subject to more conservative leverage metrics (<3.50x total leverage).

### Story Receptivity

The recent pickup in activity suggests a less forgiving market for challenged credit stories and cyclical sectors. Additionally, a general slowdown in earnings growth in the market-wide has increased concerns for declining credit conditions, making storied paper increasingly difficult. Expect pricing premiums for smaller, cyclical, and storied issuers.

### Tone of The Market

Market conditions have normalized with the resumption of deal flow to levels more consistent with those in Q1/Q2. While the typical “summer slowdown” is possible, recent activity remains elevated and investors are eager to book new assets. While pricing remains on the aggressive side, credit metrics and covenants are leaning towards conservative as lenders remain focused on downside protections.

*Changes from last month are in red*
“Sitting here in limbo
But I know it won’t be long
Sitting here in limbo
Like a bird without a song
Well, they’re
Putting up resistance
But I know that my faith
Will lead me on
Sitting here in limbo
Waiting for the dice to roll
Sitting here in limbo
Got some time to search my soul
Well, they’re
Putting up resistance
But I know that my faith
Will lead me on
I don’t know where life will lead me
But I know where I’ve been
I can’t say what life will show me
But I know what I’ve seen"

“Sitting in Limbo” – Jimmy Cliff

Sitting In Limbo

The minutes of the June FOMC meeting make clear that U.S. monetary policy is essentially sitting in limbo for the summer and perhaps for the remainder of 2016. The Fed agreed to leave the target range for the federal funds rate unchanged at 0.25% to 0.50%, and that while some members felt recent macroeconomic reports supported a increase, the downside to doing so prematurely clearly outweighed any potential risks posed by keeping the current accommodative policy in place.

“Members generally agreed that, before assessing whether another step in removing monetary accommodation was warranted, it was prudent to wait for additional data regarding labor market conditions as well as information that would allow them to assess the consequences of the U.K. vote for global financial conditions and the U.S. economic outlook. They judged that their decisions about the appropriate level of the federal funds rate in coming months would depend importantly on whether incoming information corroborated the Committee’s expectations for economic activity, the labor market, and inflation. Some of them emphasized that, with labor market conditions and inflation at or close to the Committee’s objectives, taking another step in removing monetary accommodation should not be delayed too long. However, a couple of members underscored that they would need to accumulate sufficient evidence to increase their confidence that economic growth was strong enough to withstand a possible downward shock to demand and that inflation was moving closer to 2 percent on a sustained basis.”

Of course, that was before the June Non-Farm Payrolls report surprised even the most bullish of economic commentators, coming in at a resoundingly robust 287,000 (consensus expectation ranged from 150,000 to 180,000), and fears of a Brexit-fueled economic meltdown failed to materialize (to the contrary, now that the dust has settled, the S&P 500 has recorded a new record high). With GDP improving (Q1 GDP revised upward to 1.1% from 0.5% initially, then settling at 0.8%) and increasingly strong Manufacturing and Non-Manufacturing reports (June ISM Manufacturing at 53.2 is the strongest growth in a year and June ISM
Non-Manufacturing at 56.5 is the strongest growth thus far in 2016, could a rate increase be back in play?

Clearly the markets do not believe so—at least for the near future. The CME Group FedWatch Tool, which tracks 30-Day Fed Fund futures prices to assess the probability of future rate increases, indicates an 1.2% possibility of a rate increase in July and only a 12.9% probability in both September and November. Even at year end, the implied probability of a rate increase based on the Fed Funds Future prices only rises to approximately 34.0%. Finally, inflation still remains sluggish—the Core PCE Price Index (the Fed’s preferred measure of inflation) remains at 1.6% annually, a good measure shy of the Fed’s target rate of 2.0%.

Below is a quick recap of the month’s headline economic reports:

- **Consumer Confidence/Retail Sales:** Consumer spending continues to drive GDP growth in the U.S. as Personal Spending rose 0.4% in May (a 3.7% gain over May 2015). The May release is the second strongest for the year and follows a robust April report (which was the strongest monthly pace since 2009). The Conference Board’s consumer confidence report for June is testimony to the resilience of the U.S. consumer, which even after the Brexit vote, jumped nearly six points to its strongest reading of the year at 98.0 (up from 92.6 in May). Each of the main components shows strength with expectations up 6.0 points to 84.5 and the present situation up 5.1 points to 118.3.

- **Inflation:** There is nothing really to report on the inflation front and certainly no pressure on the Fed is arising from May’s inflation indices. The PCE Core Index rose 0.2% again in May, keeping the year-over-year rate flat for another month at 1.6% (and still shy of the Fed’s 2.0% target). The overall PCI Price Index rose 0.03% which dropped the year-over-year pace down to only 0.9%. The Consumer Price Index (CPI) rose 0.2% for the month of May (1.0% year-over-year) and Core CPI also rose 0.2% for the month and 2.2% year-over-year. Though Core CPI is technically above the 2.0% Fed target, as noted earlier, it is not accorded the same weight as the PCE Core Price Index, which is still far below the target. Housing costs, which are growing at 2.4% a year, are the strongest component of CPI while the PCE Core Index does not accord this as much weight.

- **GDP:** Q1 GDP was revised upward a third time to 1.1% in June (up from 0.8% in the second revision). The uptick was attributed to strength in net exports, which added more than 0.1% to GDP, and to less weakness than was previously reported in non-residential fixed investment. One negative in the report was in personal consumption expenditures, which dropped by approximately 0.3% to 1.0% as a result of reduced service spending. Q1 GDP is in reality old news at this point, and the focus on Q2 GDP is gaining center stage. The GDPNow model produced by the Atlanta Fed forecasts real GDP growth (seasonally adjusted annual rate) in the second quarter of 2016 to be 2.3% (as of July 16th). Another measure of GDP produced by the New York Fed called the “NowCast” predicts Q2 GDP to be at 2.1% and Q3 GDP at 2.3%.

- **Manufacturing and Services:** The Manufacturing sector showed surprising strength in June; the ISM Manufacturing Index registered 53.2 (up from 51.3 in May). The Index beat the consensus index (~50.0-53.0) and constitutes the best reading since February of 2015. The “new orders” component was especially robust, registering a 57.0, and export orders were also strong, gaining a point to 53.5 (the fourth straight month of a 50.0+ reading). The June ISM Non-Manufacturing Index followed suit and came in at a healthy 56.5 for June, up from 52.9 in May. This easily beat consensus which ranged from 52.0 to 54.1 and constitutes one of the strongest reports of the year. The new orders subcomponent hit 59.9 for the month and net export orders gained four points to reach a solid 53.0.

- **Employment:** The biggest economic report of the month (and the most closely watched) was the June Non-Farm Payrolls report. Payrolls surged to 287,000 dwarfing a downwardly revised May report of only 11,000 new
jobs (initially reported at 38,000) and wildly exceeding the consensus estimate of 100,000-150,000. Among the highlights of the report were the growth in private services payrolls (up 256,000) and manufacturing payrolls (up 14,000). The Unemployment Rate popped back up to 4.9% from 4.7% but for a decidedly good reason—the increase of the labor force by approximately 414,000 (also reversing a negative trend in the Participation Rate which inched up to 62.7 from 62.6 the month before). The surge in the Non-Farm Payrolls report reeled the anemic May report to “blip” status and also raised the potential for a September rate increase, especially in light of the strong ISM Manufacturing and Non-Manufacturing reports along with the expectations for 2.0%+ GDP growth in Q2.

- **Housing:** As has been the case in preceding months, the housing sector is showing signs of life, and at this point, though still not catching fire, can be called moderately strong. Existing home sales climbed modestly 1.8% in May to an annualized 5.530 million. The year-over-year rate, in line with the trend of mostly flat sales, is only plus 4.5%, but median price rose 3.8% in May to $239,700. While lack of available homes has still been limiting sales, supply did rise 1.4% in the month to 2.150 million (but is still down 5.7% year-over-year). New home sales, an always volatile number, fell a whopping 6.0% in May, but on second glance, the annualized sales rate of 551,000, is second best of the cycle, next only to April’s 586,000 (revised downward from an initial 619,000). Housing starts dropped 0.3% to a 1.164 million annualized rate in May, but the trend is positive with the year-over-year gain at a robust 9.5%. Conversely, permits climbed 0.7% in May to a 1.138 million rate, but here the year-over-year rate remains far off the pace of 2015 at minus 10.1%. Overall, as has been the theme, May’s report was not spectacularly strong, but that should not take away from the positives—prices are inching higher and homes are coming into the market. Housing, though not booming by any measure, continues to be one of the standout performers this year as compared to other sectors.

**Private Market Update**

With summer in full gear, activity in the private market historically tends to slow down, but after such a quiet and tepid Q1, investors remain underinvested for the year and are increasingly eager to book new assets. The market, however, continues to demonstrate a particularly schizophrenic approach to credit where pricing remains at very aggressive rates, but leverage metrics, covenants, and deal structures are decidedly more conservative. In short, while lenders are willing to “cut book” (lower pricing) to get the right assets, their credit committees are still underwriting for a down cycle (if not actual recession).

There is a fair amount of evidence to support the increased apprehension on the credit side. Recent default rates in the high yield market have hit levels not seen since 2009 and, given the still unknown ramifications of Brexit and potential fallout to the EU, the market is prone to become increasingly conservative in the coming months. While SPP has not tightened any metrics in this month’s Market-At-A-Glance, it is unlikely that leverage tolerances will begin to tighten in coming months.

Having said that, and with respect to the “schizophrenic” nature of the current market, we are lowering pricing indications on second lien transactions to bring them in line with current unitranche pricing. There is no particularly profound rationale to this pricing reduction; it simply reflects the fact that the same constituency of investors that will provide unitranche financing are the ones providing second lien funding.

One area we are monitoring closely is the BDC (business development company) community. It is no surprise that given the fall-off in BDC equity prices and lack of access to the public markets, a number of BDCs are seeking capital from private sources. These “newly private” funds are seemingly different creatures than the public BDC models of the past. Most significantly, this new generation of BDCs are not necessarily as focused on the higher yielding mezzanine structures we associate with the traditional BDC community; rather, they have a slightly more conservative lending agenda, focused much more on senior secured credit...
positions. While that might be good news for private mezzanine LPs (i.e. less competition), it could also suggest a higher priced mezzanine market in the future. It would be premature to suggest a "trend" at this juncture, more of an emerging phenomenon to track in the coming months.

**SPP-Tracked Market Activity**

Where May saw a huge spike in deal count, suggesting a thaw after the Autumn and Winter months saw minimal activity, June brought a relatively large decrease in deals. It should be noted though that June still recorded the second highest reading since September 2015 and so it seems then that the market is beginning to normalize. While 2016 as whole is proving to lag well behind 2014 and 2015, June 2016 total deal count was only 10 deals off June 2015. Q3 2015 saw some of the greatest amount of deals in the previous 5 years, so as we head into the latter half of 2016 it will be telling how the market will continue to react given the uncertain environment.

Please feel free to call any of the professionals at SPP Capital to discuss a particular financing need, amendment, or restructuring situation, or just to get a little more color on the market. You don’t need an imminent or market-ready deal to call us. Our hope is that you use SPP as your go-to resource for any information, analysis, and review of potential transactions.

Stefan Shaffer  
Managing Partner  
212.455.4502

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