### Market Update

#### SPP’s Middle Market Leverage Cash Flow Market At A Glance

<table>
<thead>
<tr>
<th>Deal Component</th>
<th>June '18</th>
<th>May '18</th>
<th>June '17</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash Flow Senior</strong></td>
<td>&lt;$5.0MM EBITDA 1.75x-3.00x</td>
<td>&lt;$5.0MM EBITDA 1.75x-3.00x</td>
<td>&lt;$7.5MM EBITDA 1.75x-3.00x</td>
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<tr>
<td><strong>Debt Multiple</strong></td>
<td>&lt;$10.0MM EBITDA 2.75x-4.00x</td>
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<tr>
<td><strong>Total Debt Limit</strong></td>
<td>&lt;$3.0MM EBITDA 4.00-5.00x</td>
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<td>&lt;$3.0MM EBITDA 4.00-5.00x</td>
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<tr>
<td><strong>Multiple</strong></td>
<td>&lt;$2.0MM EBITDA 4.50x-6.00x</td>
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<td>&lt;$2.0MM EBITDA 4.50x-6.00x</td>
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#### Senior Cash Flow

<table>
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<tr>
<th>Pricing</th>
<th>Bank: L+2.50%-5.00%</th>
<th>Bank: L+3.00%-5.00%</th>
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<td>Non-Bank: &lt;$7.5MM EBITDA L+5.00%-8.00%</td>
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<td>Non-Bank: &lt;$15.0MM EBITDA L+4.50%-6.00%</td>
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#### Second Lien Pricing (Avg)

| Fixed rate options range from a low of 7.00% to 11.00%. |
| Warrants limited to distressed and special situations; Second lien may buy down rate to -9.00%. |
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#### Libor Floors

| Libor floors remain only in syndicated bank or non-bank senior debt, second lien, subordinated, and unitranche deals. Debtfloors are really fixed rate options range from a low of 7.00% to 11.00%. ABL revolver can be arranged outside the Unitranche to arbitrage all-in pricing. |
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#### Equity Co-Investment

| The market for equity co-investments remains robust among insurance companies, family offices, and credit opportunity funds. As a general proposition, promotions and carry will vary depending on the role the sponsor plays post-closing and how much, if any, of their own equity is deployed, though not all carry/promotes will be performance contingent. Mezz lenders generally will not exceed 20.0% of their own equity. |
| Lenders continue to insist on minimum cash equity contributions and steer away from thinly capitalized deals. As a general proposition, a minimum of 30.0%-40.0% base level of equity (inclusive of any rollover) is required. While pricing and leverage tolerances have in large part been driven by macroeconomic activity, the Fed’s Senior Lender Officer Survey confirmed that commercial banks are cutting rates (and lowering terms) as a result of competitive pressures, and Business Development Company (“BDC”) share prices are among the highest of the year, providing greater competitive influences. New BDC leverage guidance portends even additional liquidity. |

#### Recap Liquidity

| Recap liquidity is as strong as it has been all year, with lenders making little distinction, if any, between accretive versus non-accretive use of proceeds; however, sponsored transactions will achieve higher leverage and better pricing for leveraged recapitalizations. |
| Recent reduction in deal flow is opening capacity for smaller or more challenged credits often overlooked in a more active market. Lower middle market issuers (<$7.0 million of EBITDA) are achieving spreads and terms historically reserved for significantly larger issuers. Cyclical sectors (homebuilding, brick and mortar retail) are still being well-received, albeit at lower leverage tolerances. |

#### Tone of the Market

| SPP has lowered its pricing metrics in June as excess liquidity conditions have overtaken any concerns of a slowing U.S. macroeconomic activity. The Fed’s Senior Lender Officer Survey confirmed that commercial banks are cutting rates (and lowering terms) as a result of competitive pressures, and Business Development Company (“BDC”) share prices are among the highest of the year, providing greater competitive influences. New BDC leverage guidance portends even additional liquidity. |
| Middle market lending declined approximately 30.0% in Q1 ’18 from Q4 ’17, creating even more competition in a market with limited liquidity. Accordingly, even considering increased bankruptcies count, higher downgrade ratio, and heightened concerns respecting an end to the current economic cycle, credit spreads and leverage metrics remain at their most competitive levels for the year. Capital raised by new credit funds combined with recent tax law changes allowing BDC’s to double their leverage only adds to continued competition among lenders. |

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*Changes from last month highlighted in red*
"You know I got to show you
Nobody else before you
Ever gave me such
A beautiful feeling

Oh, woman, you
Touched a-my soul now
Hold on, baby
Just a little bit tighter

Hold on
Just a little bit tighter now, baby
I love you so much and
I can’t let go, no no no
Hold on, a just a little bit
Tighter now, baby

Baby, you touched a-my soul now
Woman, don’t let go now
Hold on, baby
Just a little bit tighter

_Tighter, Tighter_ , Alive N Kickin’

**Tighter Tighter**

Here we go again.

SPP is lowering its indicative spreads across the board in June; for middle market senior debt (including both commercial bank and non-bank senior lenders), second lien loans, unitranche deals, and subordinated debt, SPP is lowering spreads by approximately 50 basis points. The reduction is illustrative of a trend being witnessed across the capital markets spectrum resulting from increased liquidity (continued new fund formation and improved BDC share prices) and a recognition by bank lenders and other debt investors alike that absent more competitive pricing and terms, they simply cannot attract deal flow.

Simply stated, market forces seem to be overwhelming the macroeconomic narrative. While in recent weeks we have seen a number of strong economic releases (unemployment at 3.8%, projected Q2 GDP of over 4.0%, and robust manufacturing and service ISM indices), there are also some sobering adverse economic influences to consider. First off, the Fed just raised interest rates for the second time in 2018 (the Fed's benchmark rate range is now at 1.75%-2.00%) and there is still a high probability of another two rate hikes in 2018, which will drive up the cost of capital for trillions in floating rate leveraged debt. Second, we are now in the 107th month of the current economic recovery, which is the second longest recovery in the 12 expansionary periods since the end of World War II (second only to the 120-month recovery beginning March 1991). It will not last forever, especially in light of the accelerating GDP growth. Finally, the U.S. is in the midst of a potential trade war, not only with China, but with our six strongest allies, and the looming presence of new tariffs could quickly expedite the end the current economic cycle. The U.S. decision to withdraw from the G7 communique was described by Angela Merkel as "sobering and a bit depressing."

Notwithstanding these sobering and depressing developments on the diplomatic front, capital is still pouring into new funds; private funds closed on $37.1 billion in the first quarter, which follows a record level of fundraising in 2017 (as of year-end, it was reported that 126 existing and new credit vehicles raised more than $110 billion); however, all that new capital needs a home, and it comes at a time

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Source: [Wall Street Journal](https://www.wsj.com)

Source: [LPL Research, NBER 05/15/2018](https://www.lpl.com)

Source: [LCD News](https://www.lcd.com)

Source: [ Moody's Investor Services](https://www.moodys.com)

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when deal flow is going in the opposite direction. Total U.S. middle market lending in Q1 of 2018 was $32.0 billion, a 27.2% decrease from Q4 of 2017.

In the same way nature abhors a vacuum, combine tepid loan demand with precipitous gains of capital infusion and the result is a blast of excess liquidity, which means more competitive pricing, higher leverage metrics, weakened financial protections, and greater access to capital for more marginal issuers. Spreads continue to be under pressure across the board. Today the margin between BB/B leveraged loans and BBB spreads has compressed to 190.07 basis points, a level not seen since the halcyon days prior to the Great Recession. The Fed’s April Senior Loan Officer Opinion Survey on Bank Lending Practices noted that “a significant fraction of banks reportedly narrowed loan rate spreads on loans to large and middle market firms, and a moderate fraction narrowed spreads on loans to small firms, and that, notably, all domestic banks that reportedly eased standards or terms on C&I loans over the past three months cited increased competition from other lenders as a reason for easing.” Evidence of the reduced protections can also be found in Moody’s most recent “Asset Sale and Mandatory Prepayment Risk Category Score,” which measures the strength or weakness of mandatory prepayment and reinvestment provisions with respect to collateral. The score registered 3.21 at the end of 2017, the weakest level on record and 2.1% worse than the best ever score achieved since Moody’s began tracking loans in 2012 (a higher score denotes weaker covenant quality on Moody’s scale from 1.0 to 5.0, and a score of 3.5 denotes weak-level protection).

In addition to the competitive influences in the commercial banking community, heightened pressure is also being exerted by the BDCs. BDC share prices have increased over the course of the last quarter, providing enhanced liquidity and a stronger appetite for new assets. According to loanpricing.com, the average share price to net asset value “saw a sharp uptick in May” from April, with “BDCs showing the strongest returns this year.” Much of the renewed interest and share growth can be attributed to the Small Business Credit Availability Act (the “BDC Bill”), which allows BDCs to increase leverage from 1:1 debt to equity to 2:1 debt to equity. While not all BDCs will suddenly have the capacity to double their leverage, due to limitations imposed by their existing lenders, required shareholder approvals, and support from their rating agencies, the BDC Bill will ultimately and definitely create additional liquidity for the BDC community, and with continued share price growth, enhance BDCs’ capacity to attract assets.

The Macroeconomic Picture

Following the FOMC meeting that took place June 12th and 13th, the Federal Reserve announced that it would proceed with the expected rate hike, which brings the benchmark federal-funds rate to a range between 1.75% and 2.00%. The latest rate increase is the second of 2018 and precedes what a majority of Fed officials expect to be two additional rate hikes before year-end, for a total of four increases for the year, which is up from the three increases expected during the March meeting.

The recent interest rate guidance is consistent with what Fed Chairman Jerome Powell indicated would be a measured approach to raise short term rates in a manner that neither stimulates nor slows the economy. The decision is also indicative of a pronounced change in the outlook of many Fed officials, who have embraced a more optimistic view of the U.S. economic future. This shift began last summer in conjunction with the uptick in global economic growth and continued following the enactment of the new tax laws and proposed increases in federal spending. Officials now see gross domestic product rising 2.8% this year, up from an earlier projection of 2.7%, and see the unemployment rate falling to 3.6% this year and 3.5% next year, which differs from earlier projections of 3.8% and 3.6%, respectively, according to the Wall Street Journal. These changes in expectations show that policymakers have more confidence in the economy’s growth prospects, continued low unemployment, and steady inflation.

Meanwhile, the Trump administration is deepening its global trade offensive with plans to implement tariffs on tens of billions of dollars of Chinese goods in the coming weeks, an action that will likely spark retaliation from Beijing at a time when Chinese support of the U.S. in the effort to thwart North Korea’s nuclear
weapons program has become increasingly critical. Proponents of the tariffs place an emphasis on the need to i) remediate the immense trade imbalance with China and ii) halt ongoing violations of U.S. intellectual property rights. More specifically, the Trump administration has accused China of engaging in “forced technology transfer,” which is a practice that leverages certain policies and joint venture relationships to extract proprietary data and know-how from multinational companies in exchange for access to Chinese markets.

Sinovel Wind Group, a Beijing-based wind turbine manufacturer, was convicted of conspiracy to commit trade secret theft earlier this year after stealing intellectual property from Massachusetts-based American Superconductor, which resulted in a near $1.0 billion loss in asset value and over 700 employee terminations. While many argue that this high-profile case is not indicative of a macro-issue that warrants trade restrictions with China, it serves as a poster child for the purported injustices that the Trump administration is seeking to remediate. Some maintain this perception of Chinese trade tactics is greatly overexaggerated and that China’s ability to protect intellectual property is actually improving, not worsening, as evidenced by a near fourfold increase in annual licensing fees and royalty payments in the last decade (now at approximately $30 billion). As the negotiations with China continue to progress, the longer-term impacts of a full-fledged trade war will become readily more apparent.

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

- **Employment Growth Remains Strong** – Employment growth is strong and it is not entirely without wage pressure. Non-farm payrolls rose 223,000 in May to just top high estimates, while the unemployment rate moves down a tick to a new expansion low of 3.8%. The monthly gain for average hourly earnings came in at the high end of expectations, up 0.3% for a year-on-year rate that is up a tenth to 2.7%.

- **Continued Softness in Consumer Sentiment** – A downgrade in the current assessment pulled down the final May reading for consumer sentiment to 98.0, which is eight tenths lower than the May flash. Current conditions fell to 111.8 versus 113.3 at the mid-month mark and down from 114.9 in April. The decline hints at weakness for May’s job market and in turn for May’s consumer spending as well.

- **Non-Residential Investment Supports GDP Growth** – A lot of jostling in the components is not apparent in the headline, which, at 2.2% annualized growth, nears estimates for first quarter GDP. Non-residential investment gets a 3.1 percentage point upgrade to a 9.2% annualized rate, while investment on the residential side gets a 2-point downgrade to a minus 2.0% rate. The Atlanta Fed’s GDPNow forecast for Q2 is in excess of 4.2%.

- **Core Inflation Hits Expectations** – Both the overall PCE price index and the core rose 0.2% in May, the latter edging above the most recent consensus by one tenth, with the year-on-year rates hitting expectations, at 2.0% overall and 1.8% for the core.

- **Tariffs SOften ISM Indices, Though Both Remain Strong** – Higher costs tied to tariffs and the shifting outlook for trade are central concerns of ISM’s non-manufacturing sample, which once again shows month-to-month growth across all 18 sectors tracked. May’s composite index came in at the high-end of the consensus range, at 58.6 for a sizable 1.8-point gain from April. May’s 58.7 headline is very strong but still understates the strength of the ISM manufacturing report.

- **Housing Reports Remain Strong, Despite Headline Declines** – Despite headline declines, the housing starts and permits report for April is mostly positive. First the negatives: starts fell 3.7% in the month to a lower-than-expected 1.287 million annualized rate, while permits fell 1.8% to an as-expected 1.352 million rate.
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For your smaller capital needs, SPP’s direct lending platform, SPP Mezzanine Partners, is currently investing in senior, second lien, mezzanine, and unitranche instruments ranging from $5 to $15 million. We focus on established lower middle market companies with proven business models, stable cash flows, and strong management teams.

Stefan Shaffer
Managing Partner
212.455.4502

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Note: Prior to November 2017, "< $5.0MM EBITDA" represents "< $7.5MM EBITDA" for senior debt cash flow and total debt limit.