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

<table>
<thead>
<tr>
<th>Deal Component</th>
<th>March '17</th>
<th>February '17</th>
<th>March '16</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Flow Senior</td>
<td>&lt;$7.5M EBITDA 1.5x-2.5x</td>
<td>&lt;$7.5M EBITDA 1.5x-2.5x</td>
<td>&lt;$7.5M EBITDA 1.5x-2.5x</td>
</tr>
<tr>
<td>Debt Multiple</td>
<td>&lt;1.00x EBITDA 2.75x-3.75x</td>
<td>&gt;$10.0M EBITDA 2.75x-3.75x</td>
<td>&lt;$10.0M EBITDA 2.5x-3.5x</td>
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<tr>
<td>Total Debt Limit</td>
<td>&lt;7.5M EBITDA 3.0x-4.5x</td>
<td>&lt;7.5M EBITDA 3.0x-4.5x</td>
<td>&lt;7.5M EBITDA 3.0x-4.0x</td>
</tr>
<tr>
<td>Multiple</td>
<td>&gt;$20.0M EBITDA 3.25x-4.75x</td>
<td>&gt;$20.0M EBITDA 3.25x-4.75x</td>
<td>&gt;$20.0M EBITDA 3.75x-4.5x</td>
</tr>
<tr>
<td>Senior Cash Flow</td>
<td>Bank: L+3.00%-5.00%</td>
<td>Bank: L+3.00%-5.00%</td>
<td>Bank: L+1.50%-5.00%</td>
</tr>
<tr>
<td>Pricing</td>
<td>Non-Bank: &lt;$1.00M EBITDA L+6.50%-8.00%</td>
<td>Non-Bank: &lt;$1.00M EBITDA L+6.50%-8.00%</td>
<td>Non-Bank: &lt;$1.00M EBITDA L+4.50%-6.50%</td>
</tr>
<tr>
<td>Second Lien Pricing (Avg)</td>
<td>&lt;$7.5M EBITDA L+8.00%-12.00% floating</td>
<td>&lt;$7.5M EBITDA L+8.00%-12.00% floating</td>
<td>&lt;$7.5M EBITDA L+9.00%-12.00% floating</td>
</tr>
<tr>
<td>Subordinated Debt Pricing</td>
<td>&gt;$10.0M EBITDA 10.00%-13.00%</td>
<td>&gt;$10.0M EBITDA 10.00%-13.00%</td>
<td>&gt;$10.0M EBITDA 11.00%-14.00%</td>
</tr>
<tr>
<td>Untranche Pricing</td>
<td>&lt;$7.5M EBITDA L+6.00%-7.50% floating</td>
<td>&lt;$7.5M EBITDA L+6.00%-7.50% floating</td>
<td>&lt;$7.5M EBITDA L+7.50%-8.50% floating</td>
</tr>
<tr>
<td>Libor Floors</td>
<td>Base</td>
<td>4.50%-5.00%</td>
<td>4.50%-5.00%</td>
</tr>
<tr>
<td>Minimum Equity Contribution</td>
<td>L+3.00%-5.00%</td>
<td>L+1.50%-5.00%</td>
<td>L+1.50%-5.00%</td>
</tr>
<tr>
<td>Equity Co-Investment</td>
<td></td>
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<tr>
<td>Recap Liquidity</td>
<td>Liquidity for recapitalizations is at an all time high even for middle market, non-sponsored credits. Debt-only, and increasingly, debt-equity structures are readily available to support both dividend and share repurchase capitalizations. The best pricing is still reserved for those that combine an &quot;accretive&quot; use of proceeds (e.g. acquisition) with the recap.</td>
<td></td>
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<tr>
<td>Story Receptivity</td>
<td>As might be expected in a market with enhanced liquidity across the credit spectrum, low comparative returns and expectations for increased growth and productivity, the receptivity for &quot;stored&quot; paper and financings for more marginal issues (&quot;deals with hair&quot;) is about as favorable as it can be. Lenders in search of yield are abundant for both cash flow and ABL platforms.</td>
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<tr>
<td>Tone of the Market</td>
<td>Deal activity has ramped up significantly through Q1, and the &quot;Trump Bump&quot; is on full display with lower spreads combined with greater leverage tolerances. More direct lending platforms have been created in the last three years than in the last three years combined. BDC share prices (and to wit, their lending capacity) are among their highest in the last 18 months; the OCC has relaxed its leverage lending guidance for commercial banks. In short, liquidity conditions are about as good as they have been since before the recession.</td>
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*Changes from last month highlighted in red*
Harder, Better, Faster, Stronger

“Work it harder make it
Do it faster makes us
More than ever hour
Our work is never over

Work it harder
Make it better
Do it faster
Makes us stronger

Work it harder
Do it faster
More than ever
Our work is never over

Work it harder
Make it better
Do it faster
Makes us stronger”

“Harder, Better, Faster, Stronger” – Daft Punk

The Fed is prepping the market for only its third interest rate hike in ten years, but its second such hike in only the last four months. The basis for the Fed’s new hawkish agenda is predicated upon an economy which is seemingly harder, better, faster, and stronger.

Speaking at the Executives’ Club of Chicago on March 3rd, Fed Chair Yellen noted “at our meeting later this month, the [FOMC] will evaluate whether employment and inflation are continuing to evolve in line with our expectations, in which case a further adjustment of the federal funds rate would likely be appropriate.” Yellen’s comments followed some very bullish language employed by New York Fed President Dudley in an interview with CNN earlier in the week in which he declared that “the case for monetary policy tightening has become a lot more compelling.” As a result of the this new bullish sentiment, the implied probability of a rate hike at the March 15th FOMC meeting shot to over 90.0%; it was hovering in the 25.0% range for most of February. Even the probability of another rate hike in June following a March increase has risen to just under 50.0%.

Surprisingly, the Fed’s repeated rate hike pronouncements are being met with relative indifference in the traded markets. In the past, talk of higher rates set the stock market running for cover; remember the 2013 "taper tantrum" when then Fed Chairman Bernanke merely referenced the gradual removal of Quantitative Easing? In that case the Dow fell 4.9% in May and June of the year and another 5.6% in August (and all this on just the mention of less monetary policy accommodation). Compare that to the present situation—the Fed has broadcasted its intention for a second rate hike within a four month period, and has indicated that it is likely that there will be another two before the end of the year; meanwhile the Dow has soared to record levels. Even the Fed’s hesitation to raise rates because of its earlier articulated concerns respecting the Trump administration’s capacity to enact meaningful tax relief and ability to successfully implement its ambitious fiscal spending plan has seemingly evaporated.

Recent headline macroeconomic reports lend ample support for a March hike; inflation is heating up (closely in on the 2.0% Fed threshold), employment numbers continue to outpace expectations, consumer confidence continues to hit new highs, and retail sales, manufacturing, and service sectors are all showing continued growth as well consistent gains month-over-month. However, a closer look below the headline numbers also illuminates some stubborn weak spots in the economy; vulnerabilities that might conspire to inhibit future growth and
force the Fed to change direction much in the same way it did in 2016.

Below a quick recap of the month’s key economic releases:

- **February Non-Farm Payrolls Showed Continued Strength Adding 235,000 Jobs** - The second consecutive 200,000+ reading for the year brought the unemployment rate down to 4.7% from January’s reading of 4.8%, and all but guaranteed the Fed’s next tweak to the Fed Funds rate at the March 15th meeting. The current level is close to what the Central Bank considers “full employment.” Over the course of the last three months—including revisions announced Friday—monthly job growth has averaged 209,000. On the wage side of the equation, average hourly earnings increased by 0.2% month-over-month in February and, thanks to an upward revision to the gain in January, the annual growth rate rebounded to 2.8% last month.

- **Consumer Confidence Hit a 15 Year High of 114.8 in February** - The Conference Board Consumer Confidence Index came in stronger than expectation at 114.8 in February (consensus estimates ranged from 108.5 to 114.5)—both the “present situation” and “expectations” indices gained a robust three points. The strength of the report suggests that consumption growth will be robust as well. Similar signs of potency can be found in the University of Michigan’s Consumer Sentiment Index: while the Index edged upward in late February, it remained slightly below the decade peak recorded in January. Overall, the Michigan Index has been higher during the past three months than any time since March 2004. Paradoxically, the highs in consumer confidence and sentiment are not translating into the similar highs in retail sales and personal consumption. January retail sales dropped to 0.4% from December’s upwardly revised 1.0% (importantly, December was revised upward 0.4% from its initial reading of 0.6%).

- **The Second Revision to Q4 2016 GDP Showed No Change** - Headline GDP growth for Q4 2016 remained at 1.9%. Underneath the headline number however were some interesting developments; consumption growth was revised upwards (up 0.5% to 3.00% for the quarter) while business investment growth was revised downwards to 1.3% from 2.5%. Even more concerning developments are taking shape for Q1 2017 GDP, which seems to shrink with each passing week. The GDPNow model forecast for real GDP growth (seasonally adjusted annual rate) currently stands at 1.2% in the first quarter of 2017. This time last month the GDPNow model showed a much healthier 2.7%. Technically, the latest reduction was attributed to a decline in inventory investment, but on a more generic level, many economists are lowering their expectations respecting GDP growth for more political than purely economic reasons. The initial exuberance for fast action on infrastructure spending and tax reform, facilitated by Republican control of both Congress and the Executive branch, has cooled as divisions have emerged on the recent healthcare legislation.

- **Inflation is Zeroing in on the Fed’s 2.0% Target** - The headline PCE Price Index and Core PCE Price Index both showed improvement in January, rising 0.4% and 0.3% respectively. That brings the PCE Deflator to a 1.9% annual rate while the Core PCE Deflator (which excludes food and energy) is a little stickier, remaining at 1.7% from a year ago. At 1.9%, the PCE Price Index is at its strongest rate since February of 2013, and confirms support for a March rate hike. Meanwhile the Consumer Price Index rose 0.6% in January, pushing annual CPI to a five year high of 2.5% (up from 2.1% year-over-year in December).

- **The Manufacturing ISM Climbs Again to 57.7 while Non-Manufacturing (Services) Hits 57.6 in February** - In a surprising show of strength, both the February ISM Manufacturing and Non-Manufacturing Indices each surprised in February. The Manufacturing Index jumped 1.7 points (consensus was closer to 1.3) exhibiting its strongest rate of growth in composite activity since August of 2014. Meanwhile the Non-Manufacturing Index climbed 1.1 points in February, its strongest showing since October of 2015. Taken in the aggregate, the reports lend critical support to the proposition of a sustained uptick in economic activity and
lend further cause to justify the March Fed Funds rate hike.

- The Housing Market Continues to Exhibit Strength Despite Thin Supply – While existing home sales lagged those of new homes throughout 2016, the resale market continues to open 2017 on a strong note, up to a 5.690 million rate which is the highest since February 2007 (pre-recession). The strength of January came despite a sustained thin selection—only 3.6 months of supply (which is unchanged from December)—but this lack of supply is still not driving up prices, pointing to seller concessions. Housing starts did fall 2.6% in January but the 1.246 million annualized rate is well above consensus for 1.232 million; this report is always volatile but in general, housing starts and permits are pointing to continued strength for new homes where lack of supply held down what nevertheless was a solidly positive 2016 for the sector.

Private Market Update:

SPP is not changing any metrics for the month of March—after months of repeated tightening in pricing and expansion of leverage tolerances, the market is either taking a breather, or more likely, we have hit something of a ceiling where pricing and leverage will stratify at current levels.

Reported deal flow was strong early in Q1, as issuers jumped into the market to take advantage of excess liquidity conditions, but recently market participants are communicating a deceleration of new deal activity. In fact, most lenders contacted by SPP reported increased difficulty in booking new assets—banks, non-bank commercial lenders, BDCs, insurance companies, credit opportunity funds, and even family offices are faced with an unprecedented level of liquidity combined with a decreasing pool of viable investment opportunities.

Surprisingly, one of most aggressive constituencies for leveraged lending opportunities going into Q2 may turn out to be the commercial banking community. Beginning in March of 2014, the OCC, in concert with the Fed and the FDIC, promulgated leveraged lending guidance that led to an exodus of most commercial banks from the more leveraged lending opportunities (those transactions with more than 3.0x senior leverage and 4.0x total leverage, i.e. the “3/4 Box”); however, some of that guidance is now being lifted. In early January 2017, the OCC officially softened its view of leveraged lending, issuing a statement downgrading leveraged lending from a “key risk” to an “issue warranting continued monitoring.” On a call with reporters, Comptroller of the Currency Thomas J. Curry noted that “capital, liquidity, and leverage are all vastly improved since the dark days of the (financial) crisis.”

From a BDC perspective, liquidity also remains quite abundant. The driver for BDC liquidity, and their capacity to bid aggressively, is share price. After enduring significant discounts in share price to their net asset value (“NAV”) through most of 2016, almost all BDCs have enjoyed a healthy bounce back in 2017. Though share prices retreated somewhat early in the month (for the week ending March 10th, 33 of 45 BDCs were trading above their 50 Day Moving Average and 38 above the 200 Day, down from 35 and 39 respectively the week prior), BDC share prices remain strong, keeping pressure on spreads and leverage tolerances in the private capital markets.

There were some particularly interesting data early in March suggesting that in much the same way BDCs have disintermediated the commercial banking market in recent years with their “unitranche” product, in recent weeks, BDCs themselves have been experiencing the impact of disintermediation from the combination of first lien/second lien structures. As reported by Thomson Reuters LPC:

“A recent middle market lender survey revealed that sponsors are favoring the first-second lien structure according to 42% of respondents. Meanwhile, in the survey carried out by Thomson Reuters LPC, 27% said the unitranche is the most favored structure by sponsors today. This is a meaningful departure from this time last year when half of the buyside and sellside survey respondents said sponsors preferred the unitranche structure. More onerous call protection, higher pricing, and the need for covenants are typical of the unitranche. But with so much capital available in the market, unitranche providers are getting pushed on both pricing and structure.”
In short, no lending constituency seems to be immune from the intense competition for assets.

Some lenders however are undertaking a new approach to capture deal flow; given the level of competition in the private debt marketplace, lenders are becoming increasingly strategic about allocation of time and resources and as a result are focusing on industries and sectors they know well and where they have existing portfolio companies. Related to this, many of the most active participants in the private debt markets are becoming less "sponsor centric" and moving to a more "sector centric" model, relying more on their own industry expertise, industry contacts, and market diligence. In those sectors that they know well and are perceived to have an "underwriting advantage" they can allocate their most aggressively priced capital and structures and ultimately, increase their success rate.

Contact SPP Today

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For your smaller capital needs, SPP’s direct lending 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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SUPPORTING DATA

Historical Senior Debt Cash Flow (x EBITDA)  Historical Total Debt Limit (x EBITDA)

Historical Senior Cash Flow Pricing (Bank)  Historical Senior Cash Flow Pricing (Non-Bank)

Historical Minimum Equity Contribution  U.S. PE Middle Market Deal Flow by Quarter

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

Source: Pitchbook