### Cash Flow Senior Debt/EBITDA

<table>
<thead>
<tr>
<th>EBITDA Range</th>
<th>March 2019</th>
<th>February 2019</th>
<th>March 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>$5.0MM - $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; $10MM 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>March 2019</th>
<th>February 2019</th>
<th>March 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>3.5x - 4.50x</td>
</tr>
<tr>
<td>$5.0MM - $10MM EBITDA</td>
<td>4.00x - 5.00x</td>
<td>4.00x - 5.25x</td>
<td>4.00x - 5.00x</td>
</tr>
<tr>
<td>&gt; $10MM EBITDA</td>
<td>4.50x - 5.50x</td>
<td>4.50x - 5.75x</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% - 4.50%</td>
<td>L+ 5.00% - 6.50%</td>
<td>L+ 4.00% - 6.00%</td>
</tr>
<tr>
<td>&gt; $5.0MM EBITDA</td>
<td>L+ 3.00% - 5.50%</td>
<td>L+ 4.00% - 6.50%</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>March 2019</th>
<th>February 2019</th>
<th>March 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; $5.0MM EBITDA</td>
<td>L+ 6.00% - 8.50%</td>
<td>L+ 6.00% - 8.50%</td>
<td>L+ 6.50% - 8.50%</td>
</tr>
<tr>
<td>&gt; $10MM 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>
</table>

**Commentary:**
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### Sub Debt Pricing

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

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

### Unitranche Pricing

<table>
<thead>
<tr>
<th>EBITDA Range</th>
<th>March 2019</th>
<th>February 2019</th>
<th>March 2018</th>
</tr>
</thead>
<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; $5MM 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; $10MM 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>
</table>

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

### Tone of the Market

Most investors report a dearth of new deal flow after a moderately busy January. Given the increasing number of economic indicators leaning to softer growth in 2019 (Q1 GDP forecast at 0.5%-1.5%, consumption growth forecast at 1.5%, ISM manufacturing, down to 54.2, etc.), "late in the credit cycle" fears are growing and SPP anticipates some credit tightening in coming months. That means more cyclical sectors, "storied" credits, and lower middle market issuers will likely be most adversely impacted in the form of reduced leverage metrics, higher pricing, and stricter covenant levels. Notwithstanding the more negative macroeconomic forecast, the combination of reduced deal flow and excess liquidity conditions is still keeping pricing very much on the competitive side and forestalling any particular credit crunch for the time being.
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.

Recapitalization Liquidity
Unsponsored dividend recapitalizations are running into greater headwinds given larger macroeconomic concerns. While circumstances will dictate each particular case, as a general rule, an unsponsored dividend recapitalization for more than 2.00x LTM EBITDA will be more difficult to execute. Recapitalizations combined with an accretive use of capital (i.e.-acquisitions, growth capital) or share recapitalizations to buy out non-operating shareholders will be better received. For time being, however, liquidity recapitalizations for sponsored deals continue almost unabated.

Story Receptivity
Storied paper, and lower middle market (<$5 million EBTIDA) issuers are beginning to face increasing scrutiny. Most investors will underwrite to a base case that bakes in a 10%-20% reduction in EBITDA, especially for issuers in more cyclical sectors deemed most vulnerable to macroeconomic volatility. While the market is not closed to these issuers, they will be subject to higher pricing, less aggregate leverage (i.e. one turn less of EBITDA) and potentially, some equity upside incentive features. Most bank lenders will consider all committed capital (whether drawn or undrawn) in calculating total funded debt.

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%.

“Late nights, are you sleepless too?
Wide awake in the starless blue
Staring up at the ceiling
Do you feel what I’m feeling
Little fights at the weekend do
You love me better when I’m not with you
We were built like concrete
I used to know your heartbeat

The light has disappeared
The dust has settled here
But still I want you near
So I been waiting for that slow fade (Ooh-hoo-hoo)
(Ooh-hoo-hoo)
Kinda hoping that you won’t stay (Ooh-hoo-hoo)
(Ooh-hoo-hoo)
There’s no color in us lately
And it’s too hard to say
I been praying that we’ll
Lose our love in slow fade”

“Slow Fade” - Ruth B
**Slow Fade?**

Economic Nobel Laureate Paul Krugman recently spoke at a government summit in Dubai and commented on his increasing concern of a recession on the horizon. Lackluster growth in China and Europe, coupled with Brexit disruption and other negative economic indicators, point to a higher probability of an inflection point in the business cycle. He specifically noted that, “I think there is quite a good chance that we will have a recession late this year or next year.”

While it is premature to suggest that the U.S. economy is on the precipice of a looming recession, there is an increasing body of evidence that growth is fading. Though GDP growth for Q4 2018 was a respectable 2.6% (down from 3.5% in Q3 2018), the Atlanta Fed GDPNow projects Q1 2019 growth to decline to 0.5%. Additionally, real consumption growth is on track to slow from 2.8% in Q4 2018 to 1.5% in Q1 2019. In February the ISM Manufacturing Index also declined to 54.2 from 56.6 a month earlier. February non-farm payrolls added only 20,000 jobs, missing expectations for 175,000. However, not all economic releases are so negative; though real consumption and consumer spending have declined, consumer sentiment remains at record levels, and Non-Manufacturing ISM (“services”) Index hit a three-month high in February.

A slowing economy translates at the operating level to a reduction in EBITDA, and more importantly, less “cash available for debt service.” The ratio of downgrades to upgrades is increasing; however, default rates continue to decline since their recent highs in April of 2018.

Accordingly, SPP is adjusting leverage and pricing metrics slightly for March (tightening its leverage tolerances for lower middle market issuers and notching up pricing for non-bank credit facilities). In credit committees across the U.S., lenders are becoming increasingly fixated on an approaching credit “down-cycle.” This change will more adversely impact lower middle market issuers, issuers in cyclical sectors (think brick and mortar retail, new home construction, etc.) and more marginalized or challenged credit stories. Though the empirical support for this trend simply doesn’t exist yet, we are seeing credit “behavior” changing in subtle ways. For example, many lenders are now including committed but undrawn facilities (i.e.-revolving credit lines, delay draw facilities, etc.) in the calculation of “total funded debt” and increasing scrutiny to “Adjusted EBITDA” addbacks (providing only “one-time addbacks” at closing but tightening post-closing adjustments).

Fortunately for issuers coming to market in March, much of this talk of credit tightening is just talk. Most lenders report a markedly diminished deal flow and given the amount of excess capital in the market, competition for new assets remains fierce. In the leveraged loan market February new-issue activity dropped 33.0% from January (from $30.0 billion to $19.7 billion). The decline was driven by a fall in M&A related issuance which accounted for 42.0% of new issuance in February (compared to 64.0% in January). Overall leveraged loan issuance had already dropped in 2018 to $730.4 billion, from $943.8 billion in 2017. Most of the drop was driven by weaker refinancing activity, which dropped from $618.8 billion in 2017 to $389.6 billion in 2018. Decreased deal flow is only exacerbated by the fact that so many more institutions are competing for a tightening supply of deal flow. According to Preqin, the number of private debt funds (excluding commercial banks) has grown from 2,643 in 2016 to more than 3,645 in 2018.

One shining exception to the recent slowdown in lending activity is U.S. Commercial Bank lending. U.S. business loan growth on bank balance sheets hit 11.0% in February of 2019—that’s up from approximately 0.6% growth in January of 2018. Since banks still provide the lowest cost
of capital, clearly borrowers are increasingly opting for cheaper capital over more expensive non-bank commercial lenders.

The Macroeconomic Picture
Fed Chairman Jerome Powell testified for two days in the Semiannual Monetary Policy Report to Congress, detailing a cautiously optimistic outlook on the current economic situation. Future path of interest rate policy was not mentioned, and it seems the Fed will continue with its hold on interest rate hikes. Powell and other Fed executives such as Eric Rosenberg have discussed running off balance sheet normalization – the unwinding of the Federal Reserve Bank’s approximately $4.0 trillion bond portfolio – by the end of the year. The Fed remains patient in the face of continued uncertainty related to the China and U.S. trade dispute and slowing global macroeconomic growth. 2.3% GDP growth is predicted for 2019 due to continued “cross currents” in the global economy such as Brexit, trade disputes, and muted foreign demand. This is a slowdown from a solid 3.0% GDP growth in 2018, but still a solid level by historical standards with wage growth gaining traction and unemployment remaining low (below 4.0%). Powell also remarked that federal government debt is on an “unsustainable path” and managing budgets and reducing the deficit are important for continued “vitality” of the U.S. Government. In his prepared statement to the Committee of Financial Services Powell emphasized the Fed’s focus on data driven decision making, transparency, accountability, and reaching the goals of maximum employment and stable prices. The Federal Funds Target rate will remain at 2.25%-2.50% for now with appropriate change in monetary policy based on “guideposts” of economic indicators.

The U.S. Economy has added jobs for 101 consecutive months; however, in February nonfarm payrolls only increased by 20,000. The unemployment rate edged down to 3.8%. Improved job prospects for marginalized groups such as manufacturing workers, Americans with disabilities, and citizens with criminal records have caused labor participation rates to rise to 63.2%, a five-year high. These workers are receiving pay raises, leaving jobs more frequently, and this shift has caused employers to enhance benefit plans. In the words of former Chairwoman Janet Yellen, “if unemployment stays low, real wage growth will be faster in a tight labor market. So disadvantaged workers gain on the employment and the wage side, and to my mind, that’s clearly a good thing.” Employment conditions are strong, wages are rising, and more discouraged citizens are rejoining the workforce.

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

Consumer Sentiment increases in February due to concern over impact of partial government shutdown subsidizing and monetary policy at a standstill: The University of Michigan consumer sentiment index rose in February to 93.8, with consumers reporting optimism for financial markets and prospects of wage growth. Richard Curtin, the Chief Economist for the survey said, “Consumers continued to react to the pause in raising interest rates, balancing the favorable impact on borrowing costs against the negative message that the economy at present could not withstand another rate increase.” This moderate survey result contrasts with the Conference board’s Consumer Confidence report which showed U.S. confidence bouncing back strongly in February.

ISM Manufacturing Index fell, and Non-Manufacturing Index Rose: The ISM Manufacturing Index dropped to a three-year low, showing that U.S. Manufacturers are being impacted by rising interest rates, global industrial economic slowdown, and a strong dollar. The ISM Manufacturing Index dropped in February from 56.6 to 54.2, this was due to a drop in the New Orders Index from 58.2 to 55.5 and the Employment Index from 55.5 to 52.3. The Non-Manufacturing Index
increased from 56.7 to 59.7, this was due to an increase from the Non-Manufacturing Business Activity index from 59.7 to 64.7, and the New Orders Index from 57.7 to 65.2.

**GDP Growth slows in the Fourth Quarter:** GDP slowed to an annualized rate of 2.6% in the fourth quarter, above market expectations but cooling off from a hot second and third quarter. Consumption and exports were down in December due to pessimistic consumer sentiment following the 35-day government shutdown, continued trade tension between with China, and contraction in mining investment.

**Housing starts and completions fell, building permits edge up:** Housing starts fell in December to a seasonally adjusted annual rate of 1.078 million, down 11.2% from November. Housing completions fell in December to a seasonally adjusted annual rate of 1.097 million, down 2.7% from November. Building permits edged up 0.3% in December to a seasonally adjusted annual rate of 1.326 million.

**Employment edges down and Nonfarm Payroll results miss expectations:** U.S. employers added a light 20,000 jobs in February and the unemployment rate fell to 3.8%. Hourly wages increased in February, posting the best annual gain in nearly a decade.

Stefan Shaffer
Managing Partner
212.455.4502

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Supporting Data

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

- < $5.0MM EBITDA
- > $10.0MM EBITDA
- > $20.0MM EBITDA

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

**Historical Total Debt Limit (x EBITDA)**

- < $5.0MM EBITDA
- > $10.0MM EBITDA
- > $20.0MM EBITDA

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

**Historical Senior Cash Flow Pricing (Bank)**

- Bank Lower Bound
- Bank Upper Bound

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

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

- NB Lower Bound ($-7.5)
- NB Upper Bound ($-10)
- NB Lower Bound ($-15)
- NB Upper Bound ($-15)

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

**Historical Second Lien Pricing**

- < $5.0MM EBITDA
- > $10.0MM EBITDA
- > $20.0MM EBITDA

*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**

- < $7.5MM EBITDA
- > $10.0MM EBITDA
- > $20.0MM EBITDA

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

**Historical Minimum Equity Contribution**

- Lower Bound
- Upper Bound

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