SPP Middle Market Lender Conference Network

Deal Component | May '17 | April '17 | May '16
---|---|---|---
Cash Flow Senior | <$7.5M EBITDA 1.75x-2.75x | <$7.5M EBITDA 1.50x-2.50x | <$7.5M EBITDA 1.50x-2.50x
Debt Multiple | >$10.0MM EBITDA 2.75x-4.00x | >$10.0MM EBITDA 2.75x-3.75x | >$10.0MM EBITDA 2.50x-3.50x
(x EBITDA) | >$20.0MM EBITDA 3.25x-4.50x | >$20.0MM EBITDA 3.25x-4.25x | >$20.0MM EBITDA 3.00x-4.00x
Total Debt Limit | <$7.5M EBITDA 3.25x-4.75x | <$7.5M EBITDA 3.00x-4.50x | <$7.5M EBITDA 3.00x-4.00x
Multiple | <$10.0MM EBITDA 5.00-5.50x | <$10.0MM EBITDA 5.00-5.25x | <$10.0MM EBITDA 4.50x-5.45x
(x EBITDA) | >$20.0MM EBITDA 4.50x-6.00x | >$20.0MM EBITDA 4.25x-5.75x | >$20.0MM EBITDA 4.00x-5.50x
Senior Cash Flow Bank: L+3.00%-5.00% | Bank: L+3.00%-5.00% | Bank: L+3.50%-5.00%
Pricing Non-Banc: <$10.0MM EBITDA L+6.50%-8.00% | Non-Banc: <$15.0MM EBITDA L+4.50%-6.50% | Non-Banc: <$10.0MM EBITDA L+6.50%-8.00%
Non-Banc: <$15.0MM EBITDA L+4.50%-6.50% | Non-Banc: <$15.0MM EBITDA L+4.50%-6.50% | Non-Banc: <$10.0MM EBITDA L+6.50%-8.00%
Fixed rate options range from a low of 7.0% to 11.0%. | Fixed rate options range from a low of 7.0% to 11.0%. | (potential for 0.50%-1.00% floor)
Second Lien Pricing (Av) Non-Banc: <$10.0MM EBITDA L+6.00%-7.50% floating | Non-Banc: <$10.0MM EBITDA L+6.00%-8.00% floating | (potential for 0.50%-1.00% floor)
Non-Banc: <$15.0MM EBITDA L+6.00%-8.00% floating | (potential for 0.50%-1.00% floor)
Warrants limited to distressed and special situations; 3-6% to 5-10% for the debt component and 12-24% for mezzanine debt. | Warrants limited to distressed and special situations; 3-6% to 5-10% for the debt component and 12-24% for mezzanine debt. | Warrants limited to distressed and special situations;
Second lien may buy down rate to ~9.00%. | Second lien may buy down rate to ~9.00%. | Warrants limited to distressed and special situations;
Subordinated Debt Pricing Non-Banc: <$10.0MM EBITDA L+6.00%-7.00% floating | Non-Banc: <$10.0MM EBITDA L+6.00%-7.00% floating | No Libor floor for club bank deals. With one rate increase in Q4 '15 and expecting one or two more in 2016, lenders are easing up on floor requirements. A new range of 0.50% from the norm for untranche, second lien and syndicated bank facilities.
Non-Banc: <$15.0MM EBITDA L+6.00%-7.00% floating | Non-Banc: <$15.0MM EBITDA L+6.00%-7.00% floating | |
Non-Banc: <$20.0MM EBITDA L+6.00%-7.00% floating | Non-Banc: <$20.0MM EBITDA L+6.00%-7.00% floating | |
Fixed rate options range from a low of 7.0% to 11.0%.
Unitranche Pricing Libor Floors Libor what? USD One-Month Libor sits at 0.99% and USD One-Year is at 1.79%; since most middle market bank (club) deals did away with Libor Floors more than a year ago, and most non-banc federal untranche, and second lien deals provided for 1.0% Libor Floors, the need for a baseline minimum return has evaporated, and with it, Libor Floors.
<$7.5MM EBITDA L+8.00%-12.00% (0.50%-1.00% floor) | <$7.5MM EBITDA L+8.00%-12.00% (0.50%-1.00% floor) | |
<$10.0MM EBITDA L+6.50%-8.50% floating (0.50%-1.00% floor) | <$10.0MM EBITDA L+6.50%-8.50% floating (0.50%-1.00% floor) | |
<$20.0MM EBITDA L+6.00%-7.50% floating (0.50%-1.00% floor) | <$20.0MM EBITDA L+6.00%-7.50% floating (0.50%-1.00% floor) | |
Fixed rate options range from a low of 7.0% to 11.0%. ABL revolver can be arranged outside the Unitranche to arbitrage all-in pricing.
Minimum Equity Contribution Libor Floors Libor Floors have in large part disappeared on most middle market single bank and club/non-syndicated bank deals (no institutional buyers). There is increased pricing for non-banc untranche, and second lien providers to drop Libor Floors with the onset of another fed rate hike (025%) in March, with as many as three through December of 2017.
Most lenders are looking to have a 40.0% total equity (inclusive of rollover) to lend like leverage to not exceed 80% of the purchase price. Insurance Companies and Credit Opportunity Funds will provide both debt and equity tranches in deals.
Most lenders are looking to have a 30.0%-40.0% base level of equity (inclusive of rollover) in a deal and would like leverage to not exceed 800% of the purchase price. Insurance Companies and Credit Opportunity Funds will provide both debt and equity tranches in deals.
Equity Co-Investment Libor Floors Libor Floors, the need for a baseline minimum return has evaporated, and with it, Libor Floors.
The market for non-control private equity continues to build and far exceeds the more parochial historical family office model. Common and structured preferred capital is readily available from insurance companies, credit opportunity funds, and a robust domestic and foreign family office network. Deal size ranges from $5-$100 million and deals can be arranged in as little as 9-10 weeks.
Recap Liquidity Recap Liquidity Recap opportunities abound in this market, especially in light of increased valuation multiples and higher enterprise valuations. The distinction between recaps with or without sponsors continues to erode resulting in very little pricing differentiation for premium capital markets. Pricing and leverage discrimination for non-sponsored deals. Lenders still tend to favor recap deals that also include an accretive use of proceeds (e.g. acquisition) with the recap.
As it might be expected in a market with enhanced liquidity across the credit spectrum, low comparative returns, and expectations for increased growth, the receptivity for "storied" paper and marginal issues ("deals with hair") is about as favorable as it can be. Lenders and equity sponsors are willing to support management teams, independent sponsors, and traditional recap deals.
Story Receptivity Story Receptivity Given the overall excess liquidity in the market, recap deals for storied paper or more marginal credits continues to be abundant, but there will be increased scrutiny (and less interest overall) in sectors with larger secular challenges (e.g. undistinguished brick and mortar, limited capital concepts or "old" technology).
Deal activity has ramped up significantly through Q1, and the "Trump Bump" is on full display with lower spreads combined with greater leverage tolerances. More direct lending platforms have been created in the last year than in the last three years combined; RBC share prices (and to wit, their lending capacity) are among their highest in the last 18 months; the OCC has relaxed its leveraged lending guidance for commercial banks. In short, liquidity conditions are about as good as they have been since before the recession.
Tone of the Market Tone of the Market The proliferation of new non-banc capital providers and greater leverage capacity by commercial banks combined with expectations of greater economic growth and a relative dearth of quality new deal flow has created almost unprecedented liquidity in the private capital markets. Pricing and leverage tolerances seem to have stratified at historically aggressive levels for the time being with lower middle market issuers achieving terms traditionally only available to much larger issuers.
Slow market activity in Q1 combined with an abundance of freshly minted credit opportunity funds created unusually competitive market conditions and heightened liquidity for storied/challenged issuers, notwithstanding a perceived “down cycle” in credit. Lenders and equity sponsors will begin to realize the success in the market.
2016 market conditions continue to surprise. In January, credit tightening was anticipated, and spreads crept up. By the end of February, sluggish market activity prompted previously apprehensive lenders to get more competitive with pricing and terms loosened. Lenders may be changing again as we enter May, with increased activity providing lenders the opportunity to be more selective and potentially tighten again.

*Changes from last month highlighted in red

Check out SPP online: http://sppcapital.com/
And these fights
They climb through my veins like it’s
Mercury rising
And these nights
I seem to remember a
Home that was better

And now he’s turning off
His family’s breaking down

And it’s not what it seems
Nothing’s the same when you give it away
No, it’s not what it seems
It’s just what you think it is
Just what you think it is
Just what you think it is
What you think it is."

“Not What it Seems” – Something Corporate

Not What it Seems

Though the most recent non-farm payroll report showing 211,000 new jobs in April and an unemployment rate of 4.4%, suggest “full employment,” not to mention consumer and business confidence levels remaining at record high levels, such a seemingly rosy economic picture may be Not What It Seems.

The expectation for an economy with full employment is wage and price inflation; however, the most recent numbers appear to be going in the wrong direction. Notwithstanding a 4.4% unemployment rate in April (its lowest level since May 2001) average hourly earnings actually dropped to 2.5% in April, and March was revised downward to 2.6% from the 2.7% originally reported. Moreover, the Core PCE Price Index (considered to be the Fed’s preferred measure of inflation) dropped to 1.6% in March, a 0.2% dip from the 1.8% reported a month earlier. Add into the equation reductions in Consumer Spending (0.0% month-over-month change in March vs. a 0.1% month-over-month change in February) as well as Q1 2017 GDP of only 0.7% (down from 2.1% in Q4 2016), and a fairly strong narrative emerges whereby the Fed should not be any hurry to raise rates at its next meeting in June.

The market however has a decidedly different perspective, one which many leading economists are echoing. The implied probability of another rate hike in June is hovering around 74% according the CME Group Fed Watch Tool (which tracks 30-Day Federal Funds futures), and other surveys have it as high as 100%. The Wall Street Journal Economic Forecasting Survey, which polls a group of more than 60 economists, projects an 88.1% probability of a rate hike in June. The Fed Funds rate range currently sits at 0.75%-1.00%, and expectations favor another 0.25% rate increase.

Speculation on the next rate hike will continue, and expectations will rise and wane with each new economic release over the course of the next few weeks. While rate hike speculation still dominates the discussion, increasingly, attention is being focused on the Fed’s plan to shrink its $4.5 trillion portfolio of bonds and other assets (known as Quantitative Tightening or “QT”). The latest pronouncement on the QT front came from New York Fed President William Dudley, who noted in a recent speech in Mumbai that: (i) the Fed’s balance sheet will begin to shrink late this year or early next year, (ii) the FOMC will pursue balance sheet reduction in a “very careful way,” and (iii) the FOMC balance sheet

Not What it Seems

Though the most recent non-farm payroll report showing 211,000 new jobs in April and an unemployment rate of 4.4%, suggest “full employment,” not to mention consumer and business confidence levels remaining at record high levels, such a seemingly rosy economic picture may be Not What It Seems.

The expectation for an economy with full employment is wage and price inflation; however, the most recent numbers appear to be going in the wrong direction. Notwithstanding a 4.4% unemployment rate in April (its lowest level since May 2001) average hourly earnings actually dropped to 2.5% in April, and March was revised downward to 2.6% from the 2.7% originally reported. Moreover, the Core PCE Price Index (considered to be the Fed’s preferred measure of inflation) dropped to 1.6% in March, a 0.2% dip from the 1.8% reported a month earlier. Add into the equation reductions in Consumer Spending (0.0% month-over-month change in March vs. a 0.1% month-over-month change in February) as well as Q1 2017 GDP of only 0.7% (down from 2.1% in Q4 2016), and a fairly strong narrative emerges whereby the Fed should not be any hurry to raise rates at its next meeting in June.

The market however has a decidedly different perspective, one which many leading economists are echoing. The implied probability of another rate hike in June is hovering around 74% according the CME Group Fed Watch Tool (which tracks 30-Day Federal Funds futures), and other surveys have it as high as 100%. The Wall Street Journal Economic Forecasting Survey, which polls a group of more than 60 economists, projects an 88.1% probability of a rate hike in June. The Fed Funds rate range currently sits at 0.75%-1.00%, and expectations favor another 0.25% rate increase.

Speculation on the next rate hike will continue, and expectations will rise and wane with each new economic release over the course of the next few weeks. While rate hike speculation still dominates the discussion, increasingly, attention is being focused on the Fed’s plan to shrink its $4.5 trillion portfolio of bonds and other assets (known as Quantitative Tightening or “QT”). The latest pronouncement on the QT front came from New York Fed President William Dudley, who noted in a recent speech in Mumbai that: (i) the Fed’s balance sheet will begin to shrink late this year or early next year, (ii) the FOMC will pursue balance sheet reduction in a “very careful way,” and (iii) the FOMC balance sheet

Not What it Seems

Though the most recent non-farm payroll report showing 211,000 new jobs in April and an unemployment rate of 4.4%, suggest “full employment,” not to mention consumer and business confidence levels remaining at record high levels, such a seemingly rosy economic picture may be Not What It Seems.

The expectation for an economy with full employment is wage and price inflation; however, the most recent numbers appear to be going in the wrong direction. Notwithstanding a 4.4% unemployment rate in April (its lowest level since May 2001) average hourly earnings actually dropped to 2.5% in April, and March was revised downward to 2.6% from the 2.7% originally reported. Moreover, the Core PCE Price Index (considered to be the Fed’s preferred measure of inflation) dropped to 1.6% in March, a 0.2% dip from the 1.8% reported a month earlier. Add into the equation reductions in Consumer Spending (0.0% month-over-month change in March vs. a 0.1% month-over-month change in February) as well as Q1 2017 GDP of only 0.7% (down from 2.1% in Q4 2016), and a fairly strong narrative emerges whereby the Fed should not be any hurry to raise rates at its next meeting in June.

The market however has a decidedly different perspective, one which many leading economists are echoing. The implied probability of another rate hike in June is hovering around 74% according the CME Group Fed Watch Tool (which tracks 30-Day Federal Funds futures), and other surveys have it as high as 100%. The Wall Street Journal Economic Forecasting Survey, which polls a group of more than 60 economists, projects an 88.1% probability of a rate hike in June. The Fed Funds rate range currently sits at 0.75%-1.00%, and expectations favor another 0.25% rate increase.

Speculation on the next rate hike will continue, and expectations will rise and wane with each new economic release over the course of the next few weeks. While rate hike speculation still dominates the discussion, increasingly, attention is being focused on the Fed’s plan to shrink its $4.5 trillion portfolio of bonds and other assets (known as Quantitative Tightening or “QT”). The latest pronouncement on the QT front came from New York Fed President William Dudley, who noted in a recent speech in Mumbai that: (i) the Fed’s balance sheet will begin to shrink late this year or early next year, (ii) the FOMC will pursue balance sheet reduction in a “very careful way,” and (iii) the FOMC balance sheet
SPP is not making any changes to either its pricing or leverage metrics for May. After months of price contraction and leverage multiple expansion, the market seems to have stratified at current levels—levels, it should be noted, that are as aggressive as they have been since the pre-crisis 2006 period. The same general themes of surplus capital and reduced deal flow that characterized Q1 appear to only be strengthening as we begin Q2.

While there is abundant anecdotal evidence to bolster the proposition that “excess liquidity” conditions exist, increasingly, there is a growing body of empirical support for the “surplus capital/deal shortage” situation in the U.S. private capital markets. Specifically:

- The most recent Fed Senior Loan Officer Survey (a leading indicator of U.S. credit dynamics) shows a weakening demand for credit, particularly among the business loan segment. The net percentage of domestic banks reporting stronger demand for Commercial and Industrial loans from large and middle market businesses has continued to decline through 2017.

- The Fed Survey also shows that the net percentage of domestic banks tightening credit standards for Commercial and Industrial loans from large and middle market businesses has declined through 2017 (i.e. credit standards continue to become more forgiving to borrowers to attract deal flow).

- Moody’s has published data demonstrating that in Q1 2017 newly rated LBOs have greater Debt/EBITDA ratios than the average from 2012 to 2016.

- Pitchbook has published data that illustrates that U.S. middle market fund raising is at its highest peak in years; 23 first time middle market funds (sized between $100 million and $5 billion) closed in 2016 aggregating ~$8.4 billion, the fourth-highest tally for capital committed and fifth-highest by count in the past decade.

- BDCs continue to maintain strong share prices, have greater access to capital, and remain a competitive presence in the market for unitranche, second lien, and alternative mezzanine structures; 32 of 45 BDCs are within 10.0% of their 52 Week High, and 13 of the 32 are within 2.0% of the top, up from 12 last week. Interesting side note on the resiliency of the BDC community—strong share prices have held steady notwithstanding months of a series of analyst recommendations to sell individual stocks on valuation grounds.

As a result of the liquidity conditions noted above, competition for assets has intensified to unprecedented levels. While most issuers are beneficiaries of the advantageous leverage conditions, lower middle market issuers (<$10 million EBITDA) are experiencing greater access to terms and conditions historically relegated to larger corporates (>25 million EBITDA). In recent weeks a deal cleared for a $7 million EBITDA borrower in the industrial sector priced at L+5.00% for a Unitranche facility with 4.5x Debt to LTM EBITDA (the enterprise value for acquisition was approximate 7.0x). Another sub-$10 million issuer circled up subordinated notes at approximately 4.5x Debt/EBITDA with an all PIK coupon. While these deals certainly represent outliers in the market, they are representative of how creative and competitive many of the new non-bank capital providers have become.
**Contact SPP Today**

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.

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

**DISCLAIMER:** The "SPP Leveraged Cash Flow Market At-A-Glance" and supporting commentary is derived by the anecdotal experience of SPP Capital Partners, LLC, its specific transactions, discussion with issuers, lenders and investors consistent with its standard operating practices. Any empirical data specifically derived by third parties, or intellectual property or opinions of third parties are expressly attributed when utilized. The factual information provided has been obtained from sources believed to be reliable, but is not guaranteed as to accuracy or completeness. All data, facts, tables or analyses provided by Governmental or other regulatory bodies are deemed to be in the public domain and not otherwise expressly attributed herein. SPP Capital and is not intended to be a forecast of future events, a guarantee of future results or investment advice. It is not intended to provide specific advice or to be construed as an offering of securities or recommendation to invest.

To unsubscribe to this email, please [click here](#). To request to be added to our distribution list, please [click here](#).
Historical Senior Debt Cash Flow (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 Cash Flow Pricing (Non-Bank)

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"

U.S. PE Middle Market Deal Flow by Quarter

Source: Pitchbook