"Market At A Glance"

**Cash Flow Senior Debt/EBITDA**

<table>
<thead>
<tr>
<th></th>
<th>&lt; $5.0MM EBITDA</th>
<th>&gt; $10MM EBITDA</th>
<th>&gt; $20MM EBITDA</th>
</tr>
</thead>
<tbody>
<tr>
<td>May 2019</td>
<td>1.75x - 2.50x</td>
<td>2.50x - 3.50x</td>
<td>3.00x - 4.50x</td>
</tr>
<tr>
<td>April 2019</td>
<td>1.75x - 2.50x</td>
<td>2.50x - 3.50x</td>
<td>3.00x - 4.50x</td>
</tr>
<tr>
<td>May 2018</td>
<td>1.75x - 3.00x</td>
<td>2.75x - 4.00x</td>
<td>3.25x - 4.75x</td>
</tr>
</tbody>
</table>

**Commentary:** Leverage tolerances at record levels except with respect to lower middle market and more cyclical sectors.

**Total Debt/EBITDA**

<table>
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<tr>
<td>May 2019</td>
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**Senior Cash Flow Pricing**

<table>
<thead>
<tr>
<th></th>
<th>Bank</th>
<th>Non-Bank &lt; $7.5MM EBITDA</th>
<th>Non-Bank &gt; $15MM EBITDA</th>
</tr>
</thead>
<tbody>
<tr>
<td>May 2019</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>April 2019</td>
<td>L+ 2.50% - 4.50%</td>
<td>L+ 5.00% - 6.50%</td>
<td>L+ 4.00% - 6.00%</td>
</tr>
<tr>
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<td>L+ 3.00% - 5.00%</td>
<td>L+ 5.50% - 8.00%</td>
<td>L+ 4.50% - 6.00%</td>
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</tbody>
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**Commentary:** Surplus of available capital combined with decreased new deal activity keeping pricing exceedingly competitive.

**Second Lien Pricing**

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<td>L+ 6.00% - 8.50%</td>
<td>L+ 5.00% - 7.00%</td>
</tr>
<tr>
<td>May 2018</td>
<td>L+ 7.00% - 11.00%</td>
<td>L+ 6.50% - 8.50%</td>
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**Sub Debt Pricing**

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<tbody>
<tr>
<td>May 2019</td>
<td>11.00% - 14.00%</td>
<td>10.00% - 12.00%</td>
<td>8.50% - 11.00%</td>
</tr>
<tr>
<td>April 2019</td>
<td>11.00% - 14.00%</td>
<td>10.00% - 12.00%</td>
<td>8.50% - 11.00%</td>
</tr>
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**Unitranche Pricing**

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**Commentary:** Surplus of available capital combined with decreased new deal activity keeping pricing exceedingly competitive.

**Tone of the Market**

The lack of new deal opportunities continues to keep the market at its most aggressive levels. While there is still a fair amount of discussion respecting the next credit down-cycle, it has not translated into any meaningful credit tightening or upward pressure on spreads. To the contrary, “adjustments” to EBITDA continue to expand, and covenant levels are as loose as they have been in the last three years. Investors continue to migrate “down-market” in search of deal flow, adding a new level of competition to an already saturated constituency of middle market lenders.

With respect to highly cyclical sectors and more marginal credits however, most lenders are taking a more conservative approach, limiting aggregate leverage beyond 3.50x to 4.00x, and maintaining a full covenant structure with periodic step-ups to encourage de-leveraging.
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
While the market continues to be exceedingly liquid for most issuers, “strored credits,” and lower middle market (<$5 million EBITDA) issuers still face increased scrutiny due to a potential credit “down-cycle.” 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 continue to be a mainstay of the senior debt market. A recent survey by the Lead Left reported that approximately 56% of respondents reported that 80%-100% of their loans have LIBOR floors, while only 15% noted that LIBOR floors appear on less than 20% of their deals. Though many commercial bank club deals have removed floors, they are routinely found in non-bank and institutional senior loans, second lien, subordinated, and unitranche deals.

"Like sun though the night
Just to get it right
A battle ground at my feet
An unwinnable fight
The words we say won’t matter anyhow
Let’s focus on tomorrow
Instead of right now
Nothing happening
It’s all illusion
It’s all illusion
Nothing happening
It’s all confusion
It’s all confusion"

“Nothing Happening”, Ben Kweller
Nothing Happening!

SPP is not making any changes to its leverage or pricing metrics for the month of May, signaling only that the market is experiencing a classic example of the law of supply and demand: “If demand remains unchanged and supply decreases, a shortage occurs, leading to a higher equilibrium price.” In the private capital markets, a “higher equilibrium price” translates to lower spreads, higher leverage tolerances, weaker covenant protection, and expanded definitions of Adjusted EBITDA. What makes the current situation even more compelling is that it is playing out so late in the current economic credit cycle. Fears of the next recession dominated the narrative in February; however, recent economic releases suggest conditions have moderated somewhat (3.2% GDP Growth in the first quarter of 2019 and April’s unemployment rate at a 50-year low of 3.60%), and the macroeconomic picture remains largely unchanged.

Evidence of a slowdown in deal activity abounds:

- Core Middle Market (“CMM”- deals between $100 million - $500 million) deal activity has dropped off a cliff. After a record setting 2018 that saw approximately 1,520 deals close, of which 470 occurred in the first quarter, the first quarter of 2019 got off to a comparatively anemic start recording only 264 transactions.

- U.S. leveraged loan issuance totaled $135 billion in the first quarter of 2019, the lowest quarterly volume since July of 2016.

- Middle market loan volume for the first quarter of 2019 was approximately $23 billion, down 46% from the previous quarter, driven by refinancing volume of a relatively paltry $12 billion, down 55% from the previous quarter.

- Overall leveraged loan refinancing activity is down 71% through April 2019 from this time last year.

The dearth of deal flow has commercial banks and institutional lenders under increasing competitive pressure. Credit spreads started out the year already at record lows, and with little room for further improvement in pricing, lenders are increasingly being forced to compete on other deal terms. Covenant structure, prepayment provisions, and the definition of “Adjusted” EBITDA are important to differentiate proposals in an overcrowded lender landscape.

The share of transactions with aggregate leverage in excess of 6.00x and 7.00x hit an all-time high in 2018, exceeding the pre-recession levels of 2007, and has yet to moderate. While lower middle market leverage never really approaches these levels, total debt for over $10 million EBITDA issuers routinely hits 4.50x to 5.00x in traditional bank senior/sub structures and over 5.00x for unitranche structures. Similarly, covenant protections continue to erode in the current liquid environment. The most recent Moody’s Loan Covenant Quality Indicator attests to a continued decline on covenants from 2015 through 2018 (and significantly below the covenant protections pre-recession). Finally, heading into May 2019, S&P LCD published a report showing that 35% of new issue leveraged loans featured adjustments (addbacks) to EBITDA (up from approximately 30% in 2018).

The findings of the Fed’s April 2019 Senior Loan Officer Opinion Survey on Bank Lending Practices (the Fed Survey) confirmed each of the trends discussed above. Respondents to the Fed Survey indicated:

- Regarding loans to businesses, respondents to the April survey indicated that, on balance, they left their standards basically unchanged and eased some of the terms on commercial and industrial (C&I) loans to large and middle-market firms, while standards and most terms remained basically unchanged for such loans to small firms.

- A significant net share of banks reported narrowing interest rate spreads on loans to large and middle-market firms, and moderate net

Source: Pitchbook Data

Net % of Banks Reporting Stronger Demand for Comm. & Ind. Loans from Middle Market Firms

Source: FRED

U.S. Leveraged Loan Refinancing Activity ($B)

Source: Credit Suisse, S&P LCD

Growth of LBO Transactions with Greater Then 6.00x or 7.00x Total Leverage

Source: LPC
shares of banks reported easing loan covenants, increasing the maximum size, and reducing the costs of credit lines to these firms.

- Almost all the banks that reported reasons for easing standards or terms on C&I loans over the past three months cited increased competition from other banks or nonbank lenders.
- Significant fractions of banks mentioned a more favorable or less uncertain economic outlook, increased tolerance for risk, and increased liquidity in the secondary market for C&I loans as important reasons for easing.
- Banks that reported reasons for experiencing reduced C&I loan demand mentioned decreases in customers' investment in plant or equipment, decreases in customers' merger or acquisition financing needs, and customers shifting their borrowing to other sources of credit as important reasons for the weaker demand.

The Macroeconomic Picture

During the Federal Reserve’s May 1st meeting, the FOMC committee voted unanimously to keep the Federal Funds Target range at 2.25%-2.50% and reduce the Interest on Excess Reserves Rate 5 basis point to 2.35%. Slowing global growth, muted inflation (PCE at 1.50% and Core PCE at 1.60%), and increased concern about the U.S. and China trade dispute resulted in a dovish tone in the FOMC released statement.

However, on Friday after the FOMC meeting, the Labor Department reported that nonfarm payrolls added 263,000 jobs and unemployment fell to a half-century low of 3.60%. Unemployment fell due to job gains in professional business services, healthcare, and construction coupled with the labor force participation rate falling to 62.8% from 63.0%.

The current CME Group 30 day fed funds rate futures market predicts a 0.0% probability of a rate increase this year and 41.6% probability of a rate cut in December 2019. Greg Ip of the WSJ writes that this downward trend of core PCE to 1.60% may be due to measurement and technical changes. “Agencies plan to broaden the sources of price data for airfares, gasoline, new vehicles, home telephone service, wireless phones and medical services over the next three years. In principle, that need not raise or lower inflation. Yet in March, the adoption of a new data source led to a sizable drop in clothing prices. If this simply reflects the statistics catching up with reality, inflation won’t necessarily remain low, so the Fed need not alter its policy. But it might be the early signs of an innovation-driven supply-side upswing, in which innovation leads to less inflation pressure and higher output—as happened during the 1990s dot-com boom.” If inflation continues to fall the Fed may well have to consider a rate cut to spur growth, decrease unemployment and get inflation back towards the 2.0% target.

GDP growth in the first quarter beat expectations of 2.0% and came in deceivingly high at 3.2%, the highest first quarter reading in four years. The headline GDP growth rate was propped up by an increase in exports (up 3.7% after a 1.8% rise in the fourth quarter), a decrease in imports (down 3.7% after a 2.0% increase in the fourth quarter), and an increase in business inventories ahead of proposed Chinese tariffs; however, business investment and consumer spending slowed. Personal consumption expenditures slowed to 1.2% growth in the first quarter, down from 2.5% in the fourth quarter of 2018. Oxford Economics estimates that the proposed 25.0% tariff on $200 billion a year of Chinese imports will reduce GDP growth by 0.3%, likely pushing the growth rate down below 3.0% growth. These elevated tariffs will hit consumers more directly, impacting pricing of products such as furniture, handbags, clothing, Christmas decorations, and fire alarms. Wall Street reacted negatively to the threat of deteriorating trade discussions and the Dow Jones Industrial Average, S&P 500, and Nasdaq all declined Tuesday by 0.6%, 0.7%, and 0.6%, respectively.

Below is a recap of this month’s key economic releases:
Nonfarm Payrolls Beat Expectations and Headline Unemployment Edged Down to 3.60%; In April the U.S. added 263,000 nonfarm jobs and unemployment fell to a near 50-year low of 3.60%. Paradoxically, the labor force participation actually fell from 63.0% to 62.8% in April; more workers left the workforce and were not considered “unemployed” lowering the unemployment rate. The broader U-6 unemployment rate which includes all persons marginally attached to the labor force, plus total employed part time stayed constant at 7.3%.

U.S. GDP Growth Beat Expectations Coming in at 3.2% in the First Quarter of 2019: The U.S. Economy grew by an annualized rate of 3.2% in the first quarter, beating expectations of 2.0% and increasing from an upwardly revised fourth quarter reading of 2.2%. This increase came notwithstanding declines in personal consumption expenditures (0.82%) and private inventory investment (0.65%). Exports and inventories will likely decline as a trade deal is constructed between the U.S. and China in the near future.

University of Michigan Index of Consumer Sentiment Falls in April: The University of Michigan survey of consumers declined 1.2% month-over-month in April to 97.2. Over the past 28 months the Sentiment Index has averaged 97.2 and has remained between 95.0 and 99.0 for 21 of the past 28 months. Consumers are optimistic about their financial prospects, with 44% anticipating improvements compared with just 8% who expected worsening finances. This was the best reading of financial prospects since 2004.

Housing Starts, Building Permits, and Housing Completion Fall in March: Housing starts in the U.S. fell 0.3% month-over-month to a seasonally adjusted rate of 1,139 thousand units in March 2019. This was the largest decline in two years, driven by a decline of 0.4% in single-family homebuilding to 785 thousand units and the volatile multi-family segment staying unchanged at 354 thousand units. Building permits fell 1.7% from a month earlier to a seasonally adjusted annual rate of 1,269 thousand in March.

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Managing Partner
212.455.4502

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Supporting Data

Historical Senior Debt Cash Flow Limit (x EBITDA)

Historical Total Debt Limit (x EBITDA)

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

Historical Senior Cash Flow Pricing (Bank)

Historical Senior Cash Flow Pricing (Non-Bank)

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

Historical Second Lien Pricing

Historical Subordinated Debt Pricing

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

Historical Unitranche Pricing

Historical Minimum Equity Contribution

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