## Market At A Glance

### November 2018

#### Cash Flow Senior Debt/EBITDA

<table>
<thead>
<tr>
<th>EBITDA Range</th>
<th>November 2018</th>
<th>October 2018</th>
<th>November 2017</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>&gt; $10MM EBITDA</td>
<td>2.75x - 3.75x</td>
<td>2.75x - 3.75x</td>
<td>2.75x - 4.00x</td>
</tr>
<tr>
<td>&gt; $20MM EBITDA</td>
<td>3.25x - 4.75x</td>
<td>3.25x - 4.75x</td>
<td>3.25x - 4.75x</td>
</tr>
</tbody>
</table>

#### Total Debt/EBITDA

<table>
<thead>
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<td>&lt; $5.0MM EBITDA</td>
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</tr>
<tr>
<td>&gt; $10MM EBITDA</td>
<td>4.00x - 5.25x</td>
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<td>4.00x - 5.00x</td>
</tr>
<tr>
<td>&gt; $20MM EBITDA</td>
<td>4.50x - 6.00x</td>
<td>4.50x - 6.00x</td>
<td>4.50x - 6.00x</td>
</tr>
</tbody>
</table>

**Commentary:**

"Late-cycle" fears pushing lower middle market lenders on the conservative side into Q4.

#### Senior Cash Flow Pricing

<table>
<thead>
<tr>
<th>EBITDA Range</th>
<th>Bank</th>
<th>Non-Bank</th>
<th>Non-Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; $7.5MM EBITDA</td>
<td>L+ 2.50% - 5.00%</td>
<td>L+ 4.00% - 6.50%</td>
<td>L+ 4.00% - 6.00%</td>
</tr>
<tr>
<td>&gt; $15MM EBITDA</td>
<td>L+ 4.50% - 6.50%</td>
<td>L+ 4.50% - 6.00%</td>
<td>L+ 4.50% - 6.00%</td>
</tr>
</tbody>
</table>

**Commentary:**

Grid-based pricing available for both Bank and Non-Bank Commercial Lenders; Slight pricing compression for mid-large issuers.

#### Second Lien Pricing

<table>
<thead>
<tr>
<th>EBITDA Range</th>
<th>November 2018</th>
<th>October 2018</th>
<th>November 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>L+ 7.00% - 10.00%</td>
<td>L+ 7.00% - 10.00%</td>
<td>L+ 7.00% - 12.00%</td>
<td></td>
</tr>
<tr>
<td>L+ 6.50% - 8.50%</td>
<td>L+ 6.50% - 8.50%</td>
<td>L+ 6.50% - 8.50%</td>
<td></td>
</tr>
</tbody>
</table>

**Commentary:**

Grid-based pricing available; Slight pricing compression for mid-large issuers.

#### Sub Debt Pricing

<table>
<thead>
<tr>
<th>EBITDA Range</th>
<th>November 2018</th>
<th>October 2018</th>
<th>November 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>11.00% - 14.00%</td>
<td>11.00% - 14.00%</td>
<td>12.00% - 14.00%</td>
<td></td>
</tr>
<tr>
<td>10.00% - 12.00%</td>
<td>10.00% - 12.00%</td>
<td>10.00% - 13.00%</td>
<td></td>
</tr>
<tr>
<td>8.50% - 11.00%</td>
<td>8.50% - 11.00%</td>
<td>10.00% - 12.00%</td>
<td></td>
</tr>
</tbody>
</table>

**Commentary:**

Slight pricing compression in mid-large mezzanine issuers.

#### Unitranche Pricing

<table>
<thead>
<tr>
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<th>November 2018</th>
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<th>November 2017</th>
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**Commentary:**

Grid-based pricing available; Slight pricing compression for mid-large issuers.

#### 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. Approximately 72% of loans in Q1 2018 had no Libor floor. When a floor is required, lenders are looking for a minimum 1.00%.
### Minimum Equity Contribution

As a general proposition, lenders require minimum cash equity contributions of at least 25.0% and are steering away from 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 5.0x, 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 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.

### Recap Liquidity

Recap liquidity is strong, with lenders making little distinction between accretive (acquisition) and non-accretive (recapitalization) uses of proceeds; however, sponsored transactions will achieve higher leverage and better pricing for recapitalizations. After declining between 2014-2016, dividend recapitalization activity increased in 2017 and continues to track upwards in 2018 to a four-year high (approximately $30 billion year-to-date).

### Story Receptivity

While story receptivity remains high, it is increasingly becoming more “sector selective.” Challenged issuers in more cyclical sectors deemed most vulnerable to macroeconomic volatility are more likely to receive higher pricing, less leverage (i.e. one turn less of EBITDA) and potentially, some equity upside incentive features. The general feeling in the market is that we are near the end of the current credit cycle, and lenders will stress test more marginal credits against less generous macroeconomic conditions.

### Tone of Market

With only two months left in the year, the window is rapidly closing for new deals that need to be funded by year end; however, closing new deals is by no means impossible. Getting to an expedited closing may involve an atypical offering process and potentially a more limited and focused approach for issuers. There is liquidity out there and investors are still hungry for new assets before 2019. Though the sheer amount of excess capital in the market continues to drive pricing to historic lows, it is becoming increasingly obvious that we are in the twilight of the current 121-month credit cycle. In the coming months issuers can expect greater scrutiny to leverage levels and covenant flexibility especially for more cyclical sector issuers.

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“So I watch the sun go up
And I watch the sun go down
And the horizon hovering
Like a missing piece
That can never be found
And as the seasons lie in wait
Like a secret you already know
Winter is behind us now
It is ahead of us, also

And everything that ever was
Is happening today
Everything I’ve ever done
Has happened in the wrong way
Pull the thread and draw the line
To find time in a different place
Everything that ever was is
Happening today

“Everything is Happening Today” - Flock of Dimes
Since the 1950s, economic cycles have averaged approximately 5.5 years; however, we are now in the 9th year of the current economic cycle. Rather than slowing down, it seems like transaction activity is only increasing and the markets are only becoming more competitive.

In short, everything is happening today.

Though there were some dramatic leveraged loan outflows at the end of October, for the most part, the debt capital markets continue to defy gravity. In October, leveraged loan spreads compressed again (single B spreads decreased by approximately 40 bps) while leverage loan issuance hit its highest level since May of this year. Middle Market M&A activity is up approximately 6.11% YTD over 2017, and dividend recap activity hit its highest point in four years. With specific reference to the middle market, Pitchbook reports that “US middle market PE activity is set to break records this year. Through Q3, more than 2,000 transactions have closed totaling $289 billion in investments. At that pace, 2018 is looking at more than 2,700 deals at more than $385 billion invested.”

Consistent with the trend we have seen all year, not only is pricing becoming more competitive, but leverage tolerances are also increasing. According to Debtwire, “the share of highly levered transactions has trended upwards, with 32% of deals levered 6x or more, up from 27% last year. On the LBO side, the majority of deals (53%) in 2018 are levered 6x or more, up from 51% last year. Notably, the share of LBO deals levered 7x or more has climbed to 12%, up from 7% in 2017.”

To summarize, there is more deal activity, better pricing, and higher leverage in an economic cycle which is already almost two times longer than any previous cycle since World War II.

It is no surprise what engine is driving the current state of affairs—excess capital, and more specifically, the proliferation of private capital funds. To put it in perspective, in October of 2018, there were approximately 5,273 private credit funds in the market, versus 2,965 in 2017 and 2,651 in 2016. The growth of private debt funds has also wreaked havoc on the commercial bank lending market. Bank loans constituted 42% of total corporate debt in 1984—that is down to approximately 17% of total corporate debt in 2018.

The same trends are being played out in the high yield and lower middle leveraged loan markets. For November, SPP is lowering its spread indications for non-bank senior loans, unitranche, and second lien facilities by 50 basis points on the low end; however, we have also tightened our leverage tolerance metrics for smaller issuers. It has been our experience that while it is still something of the wild west for most leverage lenders, those focusing on sub-$5 million EBITDA issuers are mindful that a recession will come at some point soon and that lower middle market issuers will be adversely impacted.

The Macroeconomic Picture

The Bureau of Economic Analysis released its quarterly change in Real GDP, coming in at 3.5% in the 3rd quarter of 2018, cooling down 0.7% from the decade-long high in the 2nd quarter of 4.2% growth. Consumer and government spending are anticipated to slow in the coming months as interest rates, inflation, and potentially unemployment rise. The United States economy may finally be nearing an inflection point in its growth cycle.
The labor supply tightened further in October, evidenced by unemployment remaining a 3.7% and the near 1 million gap between the 7 million open jobs for 6.1 million unemployed people. According to the University of Chicago Economist Steven Davis the average time to fill a vacant job position reached a record high of 32.3 days in September, as employers across all industries struggled to find and retain qualified employees. However, the GOP’s focus on legislation to promote domestic manufacturing is seeing results with significant investment in new facilities and optimistic statistics; domestic manufacturing construction spent reached a 16-month high in September, the manufacturing sector added 32,000 jobs in October, and the ISM manufacturing index hit a strong 57.7% in October. Hurricane Michael had little impact on the unemployment numbers this month but could have residual effects in construction employment for November. Wages continue to rise, and in October, the average hourly earnings of workers increased to $27.30. September was another record month for the non-farm “quit rate” (2.4%) as a surplus in jobs continued to motivate American workers to leave in search of higher wages and more lucrative benefits. Wage gains in both skilled and non-skilled labor have caused work shortages across the country.

The midterm elections were energized with historic voter turnout and will have significant impact on lawmaking as the majority Republicans maintained control of the Senate, and Democrats gained control of the House of Representatives. As of November 8th, the Senate is now controlled by the Republicans with 51 senators to the Democrats 44 with another 5 seats too close to call. The House of Representatives has 223 seats controlled by the Democrats and 197 controlled by the Republicans with 15 seats too close to call. A split congress and a Republican White House have historically been positive news for corporate profits, and the markets responded accordingly. The S&P 500 Index, the Dow Jones Industrial Average, and the Nasdaq Composite Index rallied with gains of 2.1% 2.1%, and 2.6%, respectively.

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

**Non-farm payroll increases 250,000 while unemployment remains unchanged** – During October total non-farm payroll employment increased a robust 250,000, an eight month high and well above expectations of 190,000. Healthcare, manufacturing, and construction were the main industries with employment growth. Health care services added 36,000 jobs in hospitals, residential care facilities, and ambulatory health care services. Manufacturing services added 32,000 jobs in durable goods and transportation equipment. The construction industry added 30,000 jobs with 45% of the gain coming from residential specialty trade contractors. The official U-3 unemployment remained unchanged at 3.7% while the broader U-6 unemployment rate edged down to 7.4%.

**Consumer Sentiment falls slightly in October due to decreased optimism on economic conditions** – During October, the University of Michigan Consumer Sentiment Index marginally declined 2.1% to 98.6. Consumer confidence remains relatively high with the average for 2018 (98.5) higher than any year since 2000. Consumers have not reached an inflection point of pessimism despite stock price declines, rising inflation, rising interest rate, and negative midterm election campaigns. The index of consumers component fell 1.3% month-over-month to 89.3 and the current economic conditions component fell 1.8% month-over-over to 113.1.

**Real GDP Growth edges down to 3.5%** – Real GDP based on the “advanced” estimate released by the Bureau of Economic Analysis, increased at an
annual rate of 3.5% in the third quarter of 2018. The slowing of GDP growth during the third quarter was due to a decline in exports, a deceleration of nonresidential fixed investment, and an increase in imports. Current dollar GDP increased 4.9% in the third quarter compared to a 7.6% increase in the second quarter. Looking ahead, the Atlanta Fed’s GDP now growth estimate in its November 2nd release was at 2.9% for the 4th quarter of 2018 driven by a decrease in government spending growth and a decrease in inventory investment.

Personal Consumption Expenditures and Core Personal Consumption hit the 2% Fed target – According to the Bureau of Economic Analysis, personal income increased $35.7 billion month-over-month (0.2%) in September, disposable personal income increased $29.1 month-over-month (0.2%), and personal consumption expenditure increased $53.0 billion month-over-month (0.4%). Core PCE, which excludes food and energy, remained unchanged at the target Fed inflation rate of 2.0%.

ISM Manufacturing Index and Non-Manufacturing Indices decline – The ISM Manufacturing Index fell to 57.7% during October, a decrease of 2.1% month-over-month. The feedback from the panel of manufacturing respondents was cautiously optimistic with comments on moderate demand, the new orders index at 60%, consumption softening, production expanding, and tariff concern over China. The ISM non-manufacturing index edged down to 60.3% in October, a decrease of 1.3% month-over-month. The non-manufacturing sector had overall strong growth despite a slight cooling off after a 10-year high last month. The feedback from the panel of non-manufacturing respondents was positive about the economy and business results but mentioned heightened concern about trade, pricing, capacity, and available labor.

Housing Starts edge down to 1.201 million – Privately-owned housing starts in September were at a seasonally adjusted annual rate of 1.201 million. This is a decline of 5.3% month-over-month from the August estimate of 1.268 million. Single-family housing starts were down 0.9% month-over-month to 0.871 million from the August estimate of 0.879 million. Building permits and housing completions were down 0.6% and 4.1%, respectively.

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Managing Partner
212.455.4502

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Supporting Data

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

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

**Historical Second Lien Pricing**

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**

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”