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

<table>
<thead>
<tr>
<th>Deal Component</th>
<th>September ’16</th>
<th>August ’16</th>
<th>September ’15</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash Flow Senior</strong></td>
<td>$&lt;7.5M EBITDA 1.50x-2.50x</td>
<td>$&lt;7.5M EBITDA 1.50x-2.50x</td>
<td>$&lt;7.5M EBITDA 1.50x-2.50x</td>
</tr>
<tr>
<td>Debt</td>
<td>$&gt;10.0M EBITDA 2.50x-3.50x</td>
<td>$&gt;10.0M EBITDA 2.50x-3.50x</td>
<td>$&gt;10.0M EBITDA 2.50x-3.50x</td>
</tr>
<tr>
<td>(x EBITDA)</td>
<td>$&gt;20.0M EBITDA 3.00x-4.00x</td>
<td>$&gt;20.0M EBITDA 3.00x-4.00x</td>
<td>$&gt;20.0M EBITDA 3.00x-4.00x</td>
</tr>
<tr>
<td><strong>Total Debt Limit</strong></td>
<td>$&lt;7.5M EBITDA 3.00x-4.50x</td>
<td>$&lt;7.5M EBITDA 3.00x-4.00x</td>
<td>$&lt;7.5M EBITDA 3.00x-4.00x</td>
</tr>
<tr>
<td>(x EBITDA)</td>
<td>$&gt;10.0M EBITDA 3.00x-4.50x</td>
<td>$&gt;10.0M EBITDA 3.00x-4.00x</td>
<td>$&gt;10.0M EBITDA 3.75x-4.50x</td>
</tr>
<tr>
<td></td>
<td>$&gt;20.0M EBITDA 4.00x-5.50x</td>
<td>$&gt;20.0M EBITDA 4.00x-5.50x</td>
<td>$&gt;20.0M EBITDA 4.00x-5.50x</td>
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#### Senior Cash Flow

<table>
<thead>
<tr>
<th>Bank: L+3.00%-4.50%</th>
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#### Pricing

<table>
<thead>
<tr>
<th>Non-Bank: $&lt;1.00M EBITDA L+6.00%-8.00%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Bank: $&gt;1.50M EBITDA L+5.00%-6.50% (potential for 0.50%-1.00% floor)</td>
</tr>
</tbody>
</table>

#### Second Lien Pricing

<table>
<thead>
<tr>
<th><strong>(Avg)</strong></th>
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</thead>
<tbody>
<tr>
<td>$&lt;7.5M EBITDA L+6.00%-11.00% floating</td>
</tr>
<tr>
<td>$&gt;10.0M EBITDA L+7.00%-8.50% floating</td>
</tr>
<tr>
<td>$&gt;20.0M EBITDA L+6.00%-7.50% floating</td>
</tr>
</tbody>
</table>

#### Subordinated Debt Pricing

<table>
<thead>
<tr>
<th>$&lt;7.5M EBITDA 11.00%-14.00%</th>
</tr>
</thead>
<tbody>
<tr>
<td>$&gt;20.0M EBITDA 10.00%-12.00%</td>
</tr>
</tbody>
</table>

#### Unitranche Pricing

<table>
<thead>
<tr>
<th>$&lt;7.5M EBITDA L+8.00%-11.00%</th>
<th>$&lt;7.5M EBITDA L+8.00%-11.00%</th>
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<tr>
<td>$&gt;10.0M EBITDA L+7.00%-8.50%</td>
<td>$&gt;10.0M EBITDA L+7.00%-8.50%</td>
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<td>$&gt;20.0M EBITDA L+6.00%-7.50%</td>
<td>$&gt;20.0M EBITDA L+6.00%-7.50%</td>
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#### Minimum Equity Contribution

| Preferred for most dynamic area in the market right now: while lenders still expect min. 30.00%-40.00% total equity (incl. rollover). The list of participants supplying that equity is growing daily. Insurance companies, endowments, large family offices, and sponsors (and asset managers are actively pursuing opportunities to support independent sponsors and management teams, in some cases requiring limited or no equity co-investment and providing attractive promeconomics. |

#### Equity Co-Investment

| "Market" terms for equity products (structured and common) are increasingly more stratified. On "heads-up" common, larger promoters (15.00%+ and catch-up) are limited to "bargain" acquisitions (below market multiple, material co-investment positions (25.00%+ of equity contribution), willingness to fund deal expenses, and "value-add" sponsorship (expertise in sector) Structured redeemable preferred tranches are routinely invested alongside mezz or unitranche debt. |

#### Recap Liquidity

| Recap liquidity is still quite robust, but favor (i) sponsored deals where there is additional cash available for investment; (ii) when coupled with an acquisition or other accretive use of capital. "Busted" auctions that morph into a recap are still well received and often generate aggregate proceeds not significantly less than a sale/rollover structure - but without the dilution. |

#### Story Receptivity

| Story receptivity is always reduced in Q4, and 2016 continues. September through mid-October is the best time to launch a new deal or challenge credit (investor still sees a path to 2015 close), but the market for tough deals will likely shut down by November 1st for all practical purposes. |

#### Tone of the Market

| September deals are being met with both lower pricing and looser leverage metrics. Liquidity is at a high point for 2016, with more investors having more dry powder than they have had for years. Increasing share prices are bringing BDCs back into the market and creating more competition for senior and mezz lenders alike. |

Recap liquidity is still quite robust, but favor (i) sponsored deals where there is additional cash available for investment; (ii) when coupled with an acquisition or other accretive use of capital. "Busted" auctions that morph into a recap are still well received and often generate aggregate proceeds not significantly less than a sale/rollover structure - but without the dilution.

While story receptivity is still good, it will decrease as Q4 continues. September through mid-October is the best time to launch a new deal or challenge credit (investor still sees a path to 2015 close), but the market for tough deals will likely shut down by November 1st for all practical purposes.

2015 has been characterized by excess liquidity conditions combined with increased deal flow - a "win win," but, post Labor Day there is always a "Q4 Crush" of new deals that need to close by year end, and this year it will likely be augmented by expectations of a 2016 interest rate lift-off.

*Changes from last month highlighted in red*
"But you keep on racin' and runnin' 
Like something is chasing you 
Like something’s gonna get you 
Well, something’s gonna get you one day

You're talking to yourself 
You don’t hear a thing 
And all history unfolds before you

But you shut your eyes
But you shut your eyes
It’s not happening

And you’re talking to yourself
Don’t hear a thing 
And all history unfolds before you

But you shut your eyes
But you shut your eyes
It’s not happening"

“It’s Not Happening” - The Be Good Tanyas

It’s Not Happening

In her speech at the annual Jackson Hole symposium in August Janet Yellen seemed to suggest there could be an interest rate increase as early as September:

“In light of the continued solid performance of the labor market and our outlook for economic activity and inflation, I believe the case for an increase in the federal funds rate has strengthened in recent months” citing, “the continued solid performance of the labor market and our outlook for economic activity and inflation.”

Then again, after the Fed’s first rate increase in December of 2015, Ms. Yellen also predicted there would be four more rate increases this year. They did not happen, and it is unlikely that a September pre-election interest rate bump will occur either. Based on the CME Group’s 30-Day Fed Fund futures prices, which have long been used to express the market’s views on the likelihood of changes in U.S. monetary policy, the implied probability of an interest rate at the September 21st meeting is about 12% (odds against, 88%). That said, the implied probability of a rate increase at the December meeting jumps to around 40% (the implied probability of no rate increase in December also currently sits at approximately 54%).

There is still however a fair amount of noise emanating from the Fed that a rate increase is still on the table for September. As late as September 9th, Eric Rosengren (Federal Reserve Bank of Boston) noted that, “A reasonable case can be made for continuing to pursue a gradual normalization of monetary policy.” Moreover, there is some macroeconomic support for the proposition that the economy can sustain a rate increase; the Census Bureau reported that wages for middle class workers grew at the fastest pace on record in 2015. Specifically, the bureau reported real median household income was $56,500 in 2015, up from $53,700 in 2014. That 5.2% increase was the largest, in percentage terms, recorded by the bureau since it began tracking median income statistics in the 1960s.
However, the most recent spate of empirical data is almost uniformly weaker than expectation.

- **Employment**: August non-farm payrolls at 151,000, down from a revised 275,000 in July; unemployment rate unchanged at 4.9%; annual growth rate of average hourly earnings slipped to a six-month low of 2.4%.
- **Retail Sales**: Declined 0.3% in August, the first decline in retail sales since March combined with downward revisions for June and July, could translate into weakness in Q3 GDP.
- **Inflation**: Core PCE Price Index for August is flat year-over-year at 1.6%; Core CPI inched up to 2.3% year-over-year from 2.2% in July.
- **GDP**: Q2 GDP was revised downward to 1.1% from 1.2%.
- **Manufacturing**: 0.4% monthly decline in Industrial Production for August; August ISM Manufacturing fell below 50 (contraction) to 49.4 in August, a more than a 3 point decline from July.
- **Services**: August ISM Non-Manufacturing Index fell to a six year low of 51.4 (vs. 55.5 in July).

A rate hike in September? Its not happening.

**Private Market Update**

Issuers coming to market in September are being met with what is likely the most competitive lending environment of the year.

2016 started off with a pronounced “credit retrenchment” in the private debt capital markets (banks were still wrestling with “high risk borrower” leverage guidance, BDCs pulled back or even exited the market because of significant discounts to their share prices, and there existed a heightened concern across the credit markets for an economic “down cycle”). As a result, pricing began to expand, credit metrics tightened, and riskier non-accrue deal activity (i.e. recaps) fell off a cliff. As Q1 progressed however, we witnessed a pronounced dearth of deal flow combined with a number of new entrants to the private credit markets (insurance companies, credit opportunity funds, and family offices). Moreover, the highly anticipated down cycle of credit quality never really materialized. Though defaults did in fact increase and the number of downgrades dramatically outpaced the number of upgrades, the majority of the credit decline was limited to the energy sector and higher risk borrowers (“CCC”).

As Q2 got underway, the market was still in something of a transitional stage—most lenders found themselves to a large extent underinvested and consequently their amount of dry powder increased. While competition for deals, especially higher quality credits, really intensified, there still existed a pronounced apprehension with respect to the deterioration of credit quality across the market due to a number of factors (Brexit, the potential collapse of the EU, GDP growth in the U.S. and globally). The result was a market where pricing declined across the credit spectrum (and most poinantly for the higher quality credits), but credit metrics (aggregate leverage tolerances, covenant levels, etc.) still remained on the more conservative side.

It seems we have come full circle in September. Succinctly stated, pricing is tighter and leverage metrics are looser. This month, in addition to lowering our pricing for subordinated debt, after already tightening pricing for senior debt, second lien, and unitranche deals earlier in the year, we are also loosening our leverage metrics (Total Debt/EBITDA up half a turn). As noted in William Blair’s Quarterly Leveraged Finance Survey for Q2 2016, “40% of respondents saw decreased pricing and 35% saw higher leverage and looser terms in the second quarter. These trends, coupled with a favorable outlook for the remainder of the year, signal the potential establishment of a new normalized lending environment.” The Blair survey also highlighted the friendlier credit environment for leveraged recapitalizations, specifically, “after being largely dormant over the previous two quarters, dividend recap activity surged in the second quarter. The revitalization of opportunistic financing is further evidence of improving market conditions for issuers.”
Unlike the start of the year, most commercial banks have greater clarification on leverage guidance; though most banks still routinely try to maintain leverage metrics within the “3/4 Box” (3x Senior Debt by 4x Total Debt), most institutions will go beyond these leverage guidelines for their best relationships and higher credit quality. The biggest change amongst private market participants however is taking place within the BDC (Business Development Company) constituency. In Q1, the majority of BDCs were suffering severe declines in their share prices—at one point more than 70% of publicly traded BDCs were trading at a substantial discount to their NAV. As a result, there was a heightened scrutiny on credit quality as well as a severe limitation on their access to capital, which for many BDCs effectively incapacitated them from participating in the market, and by doing so, further contributed to the overall market illiquidity. That situation is reversing itself at the present time as over half of all publically traded BDCs are within 5% of their 52 week highs this month; over the last seven months, average BDC stock price performance was 29.32% (the S&P performance over the same period was 13.21%). As we head into Q4, most BDCs should have enhanced access to capital.

With banks and BDCs back in the leveraged lending markets and the influx of greater insurance company and credit opportunity fund participation, the private market comes into Autumn with all cylinders firing. Those issuers that have the capacity to get in the market early (prior to the customary “Q4 Crush” of new deal flow) will be the greatest beneficiaries, though it appears that market conditions will likely be exceedingly liquid through the fall.

**SPP-Tracked Market Activity**

As has been the theme recently, August deal count is still down significantly from those levels seen in 2015—in fact, August LTM deal count is off 44% in 2016 from the comparable 2015 period. While there was a slight uptick in deal count from July to August this year, the number was still nowhere near the spike we saw in May. Deal exits were relatively flat month to month but have actually increased in 2016 on a LTM basis from 2015. On a positive note, deal numbers seem to have previously bottomed out earlier in the year, and though we still do not have a consistent upward trend, based on the aforementioned investor appetite for deals on tap for Q4 perhaps we will finally see deal volume numbers pick up meaningfully.

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.

**Stefan Shaffer**
Managing Partner
212.455.4502

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**SUPPORTING DATA**

### 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 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 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

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**Charts and Graphs**

- Multiple line graphs showing trends in debt, cash flow, pricing, and deals by quarter. Each chart is labeled with its respective source.