### Cash Flow Senior Debt/EBITDA

<table>
<thead>
<tr>
<th>EBITDA Range</th>
<th>September 2018</th>
<th>August 2018</th>
<th>September 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; $5.0MM EBITDA</td>
<td>1.75x - 3.00x</td>
<td>1.75x - 3.00x</td>
<td>1.75x - 3.00x</td>
</tr>
<tr>
<td>&gt; $10MM EBITDA</td>
<td>2.75x - 4.00x</td>
<td>2.75x - 4.00x</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>
<tr>
<th>EBITDA Range</th>
<th>September 2018</th>
<th>August 2018</th>
<th>September 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; $5.0MM EBITDA</td>
<td>3.50x - 4.50x</td>
<td>3.50x - 4.50x</td>
<td>3.25x - 4.50x</td>
</tr>
<tr>
<td>&gt; $10MM EBITDA</td>
<td>4.00x - 5.50x</td>
<td>4.00x - 5.00x</td>
<td>3.50x - 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>

### 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% - 5.00%</td>
<td>L+ 4.50% - 7.00%</td>
<td>L+ 4.50% - 6.00%</td>
</tr>
<tr>
<td>&gt; $10MM EBITDA</td>
<td>L+ 5.00% - 8.00%</td>
<td>L+ 5.50% - 8.00%</td>
<td>L+ 4.50% - 6.00%</td>
</tr>
<tr>
<td>&gt; $20MM EBITDA</td>
<td>L+ 6.00% - 8.00%</td>
<td>L+ 6.50% - 8.00%</td>
<td>L+ 4.50% - 6.00%</td>
</tr>
</tbody>
</table>

### Second Lien Pricing

<table>
<thead>
<tr>
<th>EBITDA Range</th>
<th>September 2018</th>
<th>August 2018</th>
<th>September 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; $5.0MM EBITDA</td>
<td>L+ 7.50% - 10.00%</td>
<td>L+ 7.00% - 10.00%</td>
<td>L+ 7.00% - 12.00%</td>
</tr>
<tr>
<td>&gt; $10MM EBITDA</td>
<td>L+ 6.50% - 8.50%</td>
<td>L+ 6.50% - 8.50%</td>
<td>L+ 6.50% - 8.50%</td>
</tr>
<tr>
<td>&gt; $20MM EBITDA</td>
<td>L+ 5.50% - 7.00%</td>
<td>L+ 5.50% - 7.00%</td>
<td>L+ 6.00% - 7.50%</td>
</tr>
</tbody>
</table>

### Sub Debt Pricing

<table>
<thead>
<tr>
<th>EBITDA Range</th>
<th>September 2018</th>
<th>August 2018</th>
<th>September 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; $5.0MM EBITDA</td>
<td>12.00% - 14.00%</td>
<td>12.00% - 14.00%</td>
<td>12.00% - 14.00%</td>
</tr>
<tr>
<td>&gt; $10MM EBITDA</td>
<td>10.00% - 12.00%</td>
<td>10.00% - 12.00%</td>
<td>10.00% - 12.00%</td>
</tr>
<tr>
<td>&gt; $20MM EBITDA</td>
<td>9.00% - 11.00%</td>
<td>9.00% - 11.00%</td>
<td>10.00% - 12.00%</td>
</tr>
</tbody>
</table>

### Unitranche Pricing

<table>
<thead>
<tr>
<th>EBITDA Range</th>
<th>September 2018</th>
<th>August 2018</th>
<th>September 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; $5MM EBITDA</td>
<td>L+ 7.50% - 10.00%</td>
<td>L+ 7.00% - 10.00%</td>
<td>L+ 7.00% - 12.00%</td>
</tr>
<tr>
<td>&gt; $10MM EBITDA</td>
<td>L+ 6.50% - 8.50%</td>
<td>L+ 6.50% - 8.50%</td>
<td>L+ 6.50% - 8.50%</td>
</tr>
<tr>
<td>&gt; $20MM EBITDA</td>
<td>L+ 5.50% - 7.00%</td>
<td>L+ 5.50% - 7.00%</td>
<td>L+ 6.00% - 7.50%</td>
</tr>
</tbody>
</table>

### Commentary

**Libor Floors**

Libor floors remain in second lien, subordinated, and unitranche deals, but are becoming less and less of an issue for senior loans considering rising rates. Approximately 72% of loans in Q1 2018 had no Libor floor. When a floor is required however, lenders are looking for a minimum 1.75%.
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. Minimum of 40.0%-50.0% base level of equity (inclusive of any rollover) is required. As leverage levels creep up in excess of 5.0x, 40.0%-50.0% equity (exclusive of rollover) is becoming the “new normal.” Most lenders discount rollover equity in excess of 20.0%.

Equity Co-Investment

Liquidity for equity co-investments remains robust among insurance companies, family offices, and credit opportunity funds. 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, though not all, carry and promote provisions will be performance contingent. Mezz lenders generally will not exceed 20.0% of their debt investment. While many investors will look for a preferred position and sacrifice some yield for the liquidity preference, most investors are comfortable with a heads-up common position. The universe of committed funds backing independent sponsors continues to grow.

Recap Liquidity

Recap liquidity is as strong as it has been all year, with lenders making little distinction, if any, between accretive versus non-accretive use of proceeds; however, sponsored transactions will achieve higher leverage and better pricing for leveraged recapitalizations.

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.

Tone of Market

The traditional "Q4 Crush" of new deal offerings is in full force and effect, and expectations are that the fourth quarter will usher in new records in leveraged lending activity. Already, U.S. LBO loan volume has exceeded $100 billion, up 32% year-over-year. Given the need for most deals to close by year end, unitranche lenders have a clear advantage being able to close on a more expedited schedule than a traditional bifurcated (sr./sub.) structure which has a dual transaction process and inter-creditor documentation. The projected increase in unitranche activity only compounds a trend in unitranche growth between 2014-2017 that saw unitranche volumes rise from 39% of leveraged lending activity to 82%.

"One way or another, I'm gonna find ya'
I'm gonna get ya', get ya', get ya', get ya'
One way or another, I'm gonna win ya'
I'm gonna get ya', get ya', get ya', get ya'
One way or another, I'm gonna see ya'
I'm gonna meet ya', meet ya', meet ya', meet ya'
One day maybe next week, I'm gonna meet ya'
I'm gonna meet ya', I'll meet ya'
I will drive past your house and if the lights are all down
I'll see who's around

One way or another, I'm gonna find ya'
I'm gonna get ya', get ya', get ya', get ya'
One way or another, I'm gonna win ya'
I'll get ya', I'll get ya'
One way or another, I'm gonna see ya'
I'm gonna meet ya', meet ya', meet ya', meet ya'
One day maybe next week, I'm gonna meet ya'
I'll meet ya' ah

“One Way or Another” Blondie
**One Way or Another**

One way (unitranche) or another (bifurcated sr./sub.) is increasingly becoming just one way. With the rise of the non-bank senior market and the propensity of these lenders to control the entire capital stack (i.e., unitranche), the “traditional” sr./sub. bifurcated structure is rapidly becoming the exclusive province of lower middle market issuers (much in the same way detachable “penny” warrants disappeared from “traditional” subordinated debt structures except in the case of lower middle market or challenged credits in the early days of the recovery).

Growth in non-bank direct lending vehicles has changed the face of leveraged lending in the United States; according to data recently compiled by Preqin, in the second half of 2018, 36% of institutional investors allocated capital to the non-bank direct lending vehicles. In the coming year, 31% of Preqin’s institutional investor base plans to invest in more private debt, vs. 14% that have indicated they plan to invest less. By stark contrast, the mezzanine asset class accounted for 40% of institutional capital investment this time last year; that number has literally halved to 20% this year.

Part and parcel of the shift to non-bank direct lending is the corresponding shift from bifurcated sr./sub. structures to unitranche structures. This reallocation of institutional capital is having a profound effect on the private debt capital markets. Bifurcated capital structures accounted for only 18% of leveraged lending in 2018, down from 61% in 2014; during the same period unitranche volumes swelled from 39% to 82%. Accentuating the trend for unitranche financing is the overall increase in leveraged lending which has continued to grow (leveraged buyout volume has exceeded $100 billion this year, up 32% year over year).

With the proliferation of unitranche lending by non-bank direct lenders, the competition among unitranche lenders has increased, having a negative impact on returns for one-stop loans. Recent data compiled by Thomson Reuters shows spreads have declined on average from 690 bps in 2014 to just under 610 bps in 2018. Though it is too early to declare a trend, there has been some data released that might suggest a potential reversal to the decline in bifurcated financing and a rise in the mezzanine asset class. Private Debt Investor data shows a recent uptick in mezzanine fund raising; going into the fourth quarter of 2018, some 197 mezzanine debt funds are in market seeking $92.03 billion, compared to $74.31 billion in non-bank senior direct lending funds.

SPP is making minor changes to its monthly market metrics in September, tweaking both the leverage and pricing metrics on the aggressive side for issuers between $10 million and $20 million of EBITDA. Apparently, to most non-bank lenders, $10 million EBITDA is now “critical mass” for achieving among the most competitive pricing and leverage. On the other side of the spectrum, SPP is increasing pricing for less than $5 million EBITDA issuers for both second lien and unitranche financings. Given the increased discussion of a potential correction, if not actual recession in 2019, it is our anecdotal experience that non-bank lenders are tightening credit standards for lower middle market issuers.

If there are general observations to be made on the market in September 2018, it is these: (i) pricing remains exceedingly competitive, especially for issuers with at least $10 million of EBITDA; (ii) the “illiquidity premium” between middle market and large corporate issuers has continued to contract (today ~70 bps); (iii) unitranche structures continue to displace bifurcated structures (that will likely accelerate in Q4 as timing becomes a critical factor for sponsors and corporate issuers look to close deals by year end); and (iv) lenders are not blind to anticipated Fed interest rate increases and adverse macroeconomic influences that increasingly point to an end of the current credit cycle. Lenders will take a more conservative approach to structures and covenants, especially for lower middle
market issuers, or issuers of any size in sectors deemed more vulnerable to economic downturn.

The Macroeconomic Picture

In the 112th month of expansion, Jerome Powell addressed the Jackson Hole Symposium on August 24th with a positive outlook for the United States economy; however, the tone remained hawkish around trade policy and implications of alienating NAFTA and China trade partners. This was the first public speech by Powell following Trump’s criticism of Federal Reserve rate hikes as constritive to economic growth (Trump is the first president to publicly denounce Federal Reserve policy in over 25 years). Powell highlighted two risks the Fed was balancing, of "moving too fast and needlessly shortening the expansion, versus moving too slowly and risking a destabilizing overheating." He remained consistent in his dedication to gradually raise rates to provide a “soft landing” and stabilize an increasingly hot economy. After his speech, the probability of another Fed rate hike in September (up 25 bps to 2.00%-2.25%) increased to 100%. The yield curve continues to flatten and the spread between 3-year and 20-year Treasury bonds fell to 20 bps, the lowest level since late 2007.

The United States Economy, in the longest bull market in history, is showing no signs of slowing down. Unemployment remained constant at 3.9%, and non-farm payrolls increased by a robust 201,000. The recent job openings report of 6.939 million showed that the U.S. now has 11 job openings per 10 unemployed persons, the highest on record. The Fed’s Beige Book reiterated the feeling of a tight labor market characterized by shortages in both low-skilled workers in the restaurant and retail industries as well as high-skilled workers in engineering, specialized construction, and IT services. Wage growth is picking up with average hourly earnings rising 2.9% in August year-over-year, the highest growth since June 2009.

Trade tensions remain the biggest risk to economic outlook as the United States continues discussions with China and its NAFTA partners. The trade deficit in July widened to $72.2 billion from $68.3 billion due to declines in food exports and consumer goods. Organizations that represent thousands of companies across retail, manufacturing, agriculture, and technology are launching a lobbying campaign called “Tariffs Hurt the Heartland” due to concerns about rising costs of imported materials and the implications of a trade retaliation and restriction. Commentary from the Fed was negative, “Tariffs were reported to be contributing to rising input costs and input costs have generally been rising more rapidly than selling prices.” Since June, the U.S. has imposed tariffs on about $113 billion of imports (4% of imports), and $70 billion of exports (3% of exports). Despite pessimistic commentary on trade and tariffs, 75% of economists surveyed by the Wall Street Journal said tariffs don’t seem to be having much of an effect on the strength of the U.S. economy.

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

• **Unemployment remains unchanged through August and 201,000 jobs are added** – Non-farm payroll job creation was at 201,000 for August, bolstered by strong growth in employment for business services, health care, wholesale trade, transportation, and mining. The unemployment rate remained unchanged at 3.9%, raising the question whether the rate is reaching an inflection point. Labor supply for low-skilled workers remains tight as there are 11 unemployed people for every 10 job openings, the lowest rate since late 2007.

• **Consumer Sentiment edges lower as interest rates rise and economic expansion continues** – The University of Michigan Consumer Sentiment index edged down 0.6% year-over-year to 96.2, its lowest level since January, during an August ripe with concern over a looming trade war. The current economic condition component of the index fell 3.6% as...
uncertainty in Washington escalated, interest rates rose, and consumers perceived a less favorable environment around income and job security.

- **Real GDP Growth is adjusted up to 4.2%** – Real gross domestic product increased 4.2% in the second quarter of 2018, according to the “second” estimate released by the Bureau of Economic Analysis. This growth rate is 0.1% more than the “advance” estimate released July 28th. The expansion of U.S. soybean exports to $4.1 Billion in May ahead of 25.0% Chinese tariffs inflated Q2 “second” estimates. The Federal Reserve Bank of Atlanta has projected a Q3 GDP growth down to a more conservative 3.8% in its September 11th release.

- **Personal consumption expenditures continue growth** – The PCE and Core PCE both increased to 2.3% and 2.0%, respectively, year-over-year in July. The Core PCE edged up to the Fed’s 2.0% target inflation rate, showing a continued heating up of consumer prices. The United States may need to curb spending as the budget deficit approaches $1 trillion and inflation concerns increase. There is now a 100% chance of a 25-basis point rate hike in September.

- **ISM Indices rebound** – Both Institute for Supply Management Non-Manufacturing and Manufacturing indices increased in August to 58.5% and 61.3%, respectively. The NMI index increased 2.8%, rebounding from a slow July as respondents were more positive about economic outlook. The PMI index increased 3.2% due to manufacturing demand strength, shown by the New Orders Index at 60.0% or above for the 16th straight month.

- **Housing Starts rebound less-than-expected, from a nine-month low** – Privately-owned housing starts in July were up 0.9% month-over-month to 1.168 million total starts, missing expectations. The single-family housing starts component edged up 0.9% month-over-month to 0.862 million with the multi-unit component remaining mostly unchanged at 0.303 million. Building permits increased 1.5% to a rate of 1.311 million units, breaking a three-month streak of declines.

Stefan Shaffer
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”