S&P Global Market Intelligence

LCD Middle Market Weekly

Cautiously optimistic

The first month of 2018 has been sluggish in terms of middle market loan issuance, with volume only reaching $730 million so far in January. Buyouts and acquisitions continue to drive the action.

— *Commentary, page 3*

Loan market, by the numbers

Middle market	90 day rolling average		
(≤$50M of EBITDA)	1/18/2018	12/31/2017	11/30/2017
Spread (L+)	459	453	455
Floor (bps)	91.7	90.0	85.7
OID	99.33%	99.40%	99.46%
Yield	6.37%	6.21%	6.17%
Observations	12	10	14
Large corporate	**90 day rolling average**		
(>$50M of EBITDA)	**1/18/2018**	**12/31/2017**	**11/30/2017**
Spread (L+)	333	336	342
Floor (bps)	65.3	67.9	66.4
OID	99.76%	99.75%	99.70%
Yield	4.94%	4.92%	4.94%
Observations	252	263	300

Note: Yield calculations are based on current LIBOR.

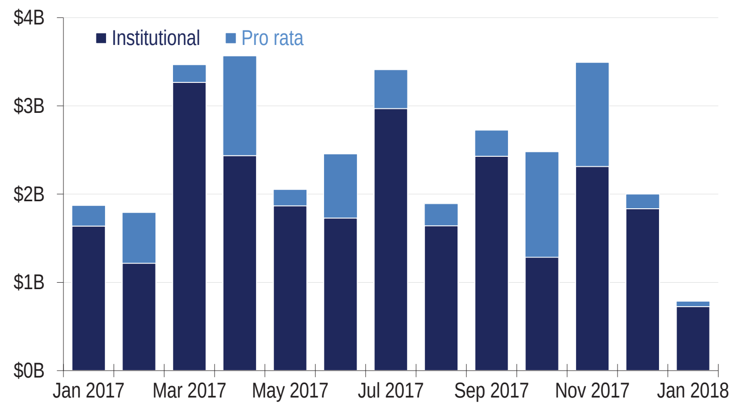
Source: LCD, an offering of S&P Global Market Intelligence

Leveraged loan credit stats

Middle market	90 day rolling average		
(≤$50M of EBITDA)	1/18/2018	1/11/2018	12/31/2017
Leverage thru first-lien	5.1x	4.8x	4.8x
Leverage thru second-lien	0.4x	0.5x	0.7x
Senior debt/EBITDA	0.0x	0.0x	0.0x
Debt/EBITDA	5.5x	5.3x	5.4x
LBO middle market			
Leverage thru first-lien	5.2x	4.8x	4.8x
Leverage thru second-lien	0.2x	0.3x	0.3x
Senior debt/EBITDA	0.0x	0.0x	0.0x
Debt/EBITDA	5.5x	5.1x	5.1x
Large corporate	**90 day rolling average**		
(>$50M of EBITDA)	**1/18/2018**	**1/11/2018**	**12/31/2017**
Leverage thru first-lien	4.0x	4.0x	4.0x
Leverage thru second-lien	0.4x	0.4x	0.4x
Senior debt/EBITDA	0.6x	0.5x	0.5x
Debt/EBITDA	5.0x	4.9x	4.9x
LBO large corporate			
Leverage thru first-lien	4.6x	4.6x	4.6x
Leverage thru second-lien	0.7x	0.6x	0.7x
Senior debt/EBITDA	0.2x	0.2x	0.2x
Debt/EBITDA	5.6x	5.5x	5.4x

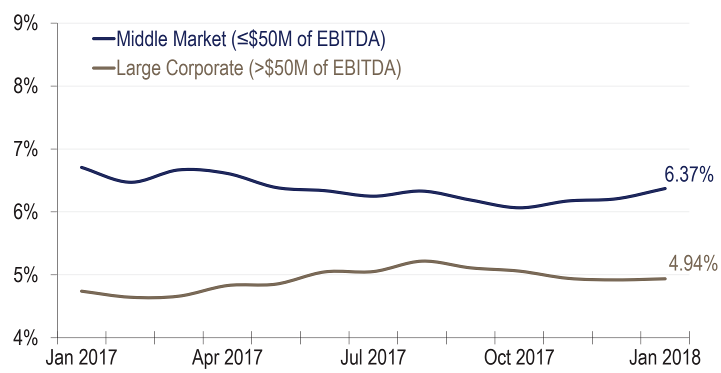
Source: LCD, an offering of S&P Global Market Intelligence

New-issue middle-market loan volume (loans of up to $350 million)



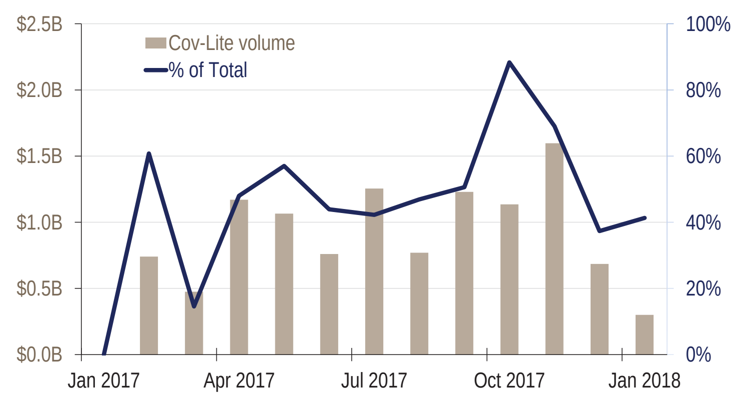
Source: LCD, an offering of S&P Global Market Intelligence

Average new-issue yield to maturity



Source: LCD, an offering of S&P Global Market Intelligence

Middle-market covenant-lite volume (loans of up to $350M)



Source: LCD, an offering of S&P Global Market Intelligence

Middle market stats

Distribution of middle-market transactions by Debt/EBITDA ratio

$50M EBITDA or less	3ME Jan 18, 2018		3ME Jan 18, 2017	
	By count	By volume	By count	By volume
LLG*				
3x senior or 4x total	87.50%	91.01%	88.89%	84.50%
Leverage distribution				
Less than 3x	12.50%	8.99%	11.11%	15.50%
3x to 3.9x	0.00%	0.00%	22.22%	25.83%
4x to 4.9x	0.00%	0.00%	22.22%	25.41%
5x to 5.9x	75.00%	44.36%	11.11%	7.23%
6x or higher	12.50%	46.64%	33.33%	26.03%

*The 2013 Leveraged Lending Guidance (LLG) defines leveraged lending as deals that are leveraged at 3x through senior secured debt or 4x through total debt. Second-lien debt is counted toward the senior and total calculation, according to regulators. Additionally, a deal with total leverage of 6x or higher "raises concerns for most industries."

Source: LCD, an offering of S&P Global Market Intelligence

Rolling 90-day first-lien activity ($350 million or less)

	Volume ($B)	Number	Spread/floor/OID	Yield to maturity
LBO	1.83	8	L+448 / 100 / 99.31%	6.20%
Refinancing	1.82	9	L+411 / 78 / 99.4%	5.83%
Acquisition	1.36	7	L+463 / 83 / 99.5%	6.30%
Other	0.60	2	L+650 / 50 / 98.75%	8.64%
Total	**5.62**	**26**	**L+493 / 78 / 99.24%**	**6.74%**

Source: LCD, an offering of S&P Global Market Intelligence

Second-lien activity

Middle market ($350 Million or Less)	3ME 1/18/18	3ME 1/18/17
Volume	$0.1B	$0.1B
Number	2	2
Yield	10.09%	11.03%
Large corporate (>$350 Million)		
Volume	$4.2B	$4.3B
Number	27	25
Yield	9.62%	10.57%

Note: Yield calculations are based on current LIBOR.

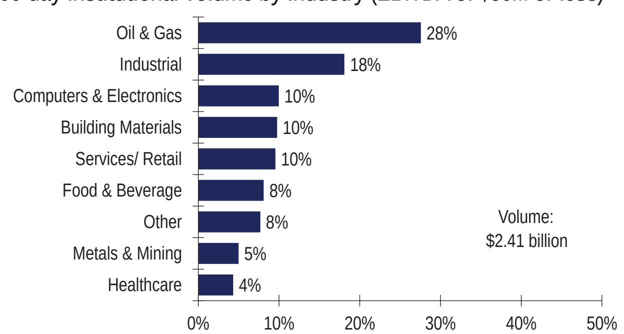
Source: LCD, an offering of S&P Global Market Intelligence

First-lien flex activity

	Dec (down/up)	Nov (down/up)	Oct (down/up)	Sep (down/up)
$200M or less	0%/0%	0%/25%	0%/100%	50%/0%
$201M - $350M	11%/22%	33%/7%	36%/18%	36%/29%
$351M - $500M	33%/33%	26%/0%	54%/0%	31%/6%
All	19%/25%	26%/5%	44%/12%	34%/16%

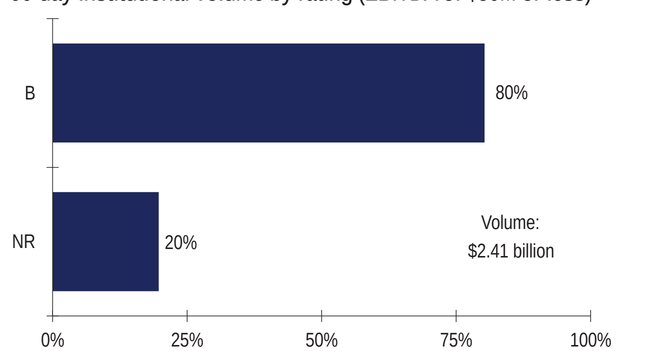
Source: LCD, an offering of S&P Global Market Intelligence

90-day institutional volume by industry (EBITDA of $50M or less)



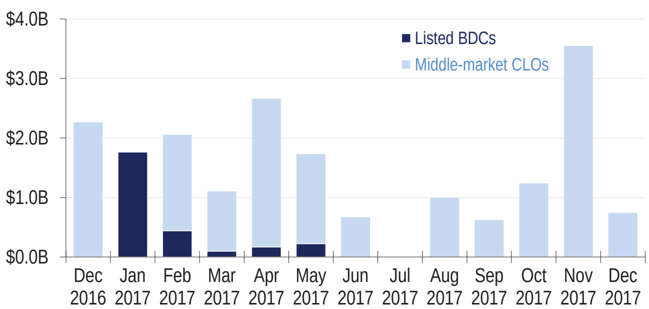
Source: LCD, an offering of S&P Global Market Intelligence

90-day institutional volume by rating (EBITDA of $50M or less)



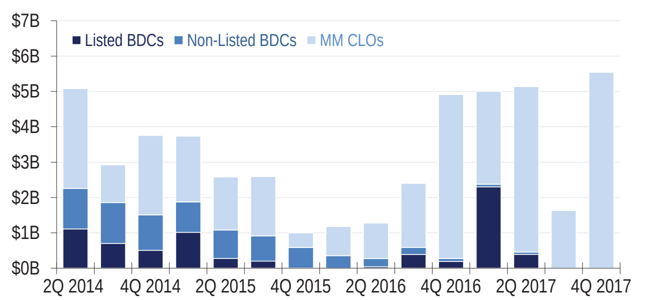
Source: LCD, an offering of S&P Global Market Intelligence

Monthly inflows to the middle-market loan asset class



Source: LCD, an offering of S&P Global Market Intelligence

Quarterly inflows to the middle-market loan asset class



Source: LCD, an offering of S&P Global Market Intelligence

Middle market: Cautiously optimistic

The first month of 2018 has been sluggish in terms of middle market loan issuance, with volume only reaching $730 million so far in January. Buyouts and acquisitions continue to drive the action, with a number of such deals currently on the docket for investors, including **Certara**, **Digital Room**, and **Vistage Worldwide**.

Meanwhile, work continues on deals already in market, such as the LBO deal for **Laces Group** and a refinancing for **Ping Identity**.

A couple of deals were slotted as Thursday launches, including the debt financing that backs Providence Equity's acquisition of **Vistage Worldwide**. Leads Macquarie and SunTrust Robinson Humphrey will pitch a $260 million, seven-year first-lien term loan alongside a $100 million, eight-year second-lien term loan, both of which are covenant-lite. San Diego-based Vistage is a member-based advisory company for executives of small and midsize businesses and generates approximately $55 million of annual EBITDA.

Also set to launch was a $171.2 million first-lien term loan to finance H.I.G. Capital's acquisition of the e-commerce print business **Digital Room** via sole lead arranger BNP Paribas. Note that the six-year B term loan will include six months of 101 soft call protection and be governed by a leverage covenant. Financing for the acquisition will also include a $25 million, five-year revolver and a $57 million, seven-year second-lien term loan that is pre-placed.

Digital Room was last in the loan market in November 2016 with a dividend recapitalization financed with a $110 million first-lien term loan (L+600, with a 1% LIBOR floor). A $47 million second-lien loan was privately placed as part of that transaction. Prospect Capital, which was holding $34 million of the second-lien, recently disclosed that the loan has been repaid. As of Sept. 30, pricing on the second-lien loan due May 2023 was L+1,000, with a 1% floor, an SEC filing shows.

Certara is in market with a $25 million incremental B term loan via Jefferies that will be used to fund an acquisition. The add-on is offered at 99.75–100 and it will be fungible with the existing covenant-lite TLB due August 2024 that is priced at L+400, with a 1% LIBOR floor. It is covered by the existing soft call that runs through February 2018. At that talk, the yield-to-maturity is about 6.01–6.06%.

The original $250 million loan (B/B2) was placed in August 2017 via Jefferies and Golub Capital to back the buyout of the company by EQT. Financing for the acquisition also included a $100 million, eight-year holdco unsecured term loan that was privately placed.

UBS was expected to launch a repricing on Thursday afternoon for **SnapAV**. Hellman & Friedman acquired the company last year backed by a $265 million covenant-lite B term loan due 2024 that is currently priced at L+525, with a 1% LIBOR floor. Current corporate and facility ratings are B/B2, with a 3 recovery rating on the loan from S&P Global Ratings.

Club Scene

(The following is a select roundup of small and club-style loans, as well as mezzanine announcements. Unless otherwise noted, terms were not disclosed.)

Main Street Capital provided $14.2 million of financing consisting of first-lien, senior secured term debt, and a direct equity investment supporting the minority recapitalization of **Brewer Crane**. The company, which is based in Lakeside, Calif., provides crane rental services to San Diego County and the surrounding Southern California area.

Intervale Capital announced that it has acquired a majority stake in **PDC Logic**. PNC Business Credit provided a working capital line and term loan to support the company's expansion plans. PDC Logic, based in Norman, Okla., designs, manufactures, rents, and sells matrix poly-diamond crystalline (PDC) bits and roller-cone bits used in drilling and completion operations.

Monroe Capital was sole lead arranger and administrative agent on an $80 million senior credit facility provided to **National Credit Center**, an SNH Capital Partners portfolio company. Las Vegas–based National Credit Center is a provider of

Middle-market loan calendar

Institutional loans by deal size

$350M or Less	Purpose	Lead agent	Sponsor	Deal size ($M)	Institutional spreads	LIBOR floor (bps)	OID	Total/senior leverage
Deason 74 (2/18)	Recap/Dividend	Bank of America	Not Sponsored	300	L+650	TBD	NA	
Laces Group (2/18)	LBO	BNP Paribas Group	ONCAP Management	186	L+500 - 525	100	99.00	
Ping Identity (TL 2/18)	Refinancing	Goldman Sachs	Vista Equity Partners	240	L+425 - 450	100	99.50	

Source: LCD, an offering of S&P Global Market Intelligence

comprehensive data, software, and marketing solutions for automotive dealers.

TCF Capital Funding provided secured financing supporting P4G Capital Management's investment in **Unique Elevator Interiors**. Unique Elevator Interiors, based in Alameda, Calif., manufactures and installs custom elevator interiors for elevator OEMs, general contractors, building owners, and property managers.

Antares Capital was lead left arranger and administrative agent on a first-lien credit facility for **New ILC Dover**, a portfolio company of Behrman Capital. Adams Street Partners led the second-lien term loan for the company. Proceeds from the facilities will be used to refinance existing debt. New ILC Dover, based in Frederica, Del., manufactures containment solutions and engineered soft goods.

Stellus Capital announced that it provided senior secured second-lien financing supporting Francisco Partners' acquisition of **Comodo CA Limited** from parent company Comodo Group. The lender previously disclosed a second-lien investment of $13.75 million in addition to equity. Comodo CA provides a full suite of certificate products spanning all validation levels for website certificates, certificates for code-signing and email-signing, and the Comodo Certificate Manager (CCM) platform.

TPG Sixth Street Partners and Owl Rock Capital provided financing for Thoma Bravo's acquisition of **Motus** and **Runzheimer**. Boston-based Motus is a vehicle management and reimbursement platform. Runzheimer, based in Waterford, Wis., provides employee mobility management services for corporations and government agencies.

Middle-market returns, data for the week ended January 17 (EBITDA of $50M or less)

Total returns		**Index statistics**	
Week ended Jan 17	0.15%	**Average bid**	
Week ended Jan 10	0.24%	As of 1/17/18	97.54
		As of 1/10/18	97.50
Year to date 1/17/18	0.30%	As of 12/29/17	97.53
Year to date 1/17/17	0.57%		
		Par outstanding	
Market-value returns		As of 1/17/18	$7.4B
Week ended Jan 17	0.03%	As of 1/10/18	$7.2B
Week ended Jan 10	0.11%	As of 12/29/17	$7.3B
Year to date 1/17/18	-0.01%	**Market value outstanding**	
Year to date 1/17/17	0.27%	As of 1/17/18	$7.2B
		As of 1/10/18	$7.1B
Average nominal spread (L+)		As of 12/31/17	$7.1B
As of 1/17/18	504.0		
As of 12/29/17	501.6	**Average tenor**	
		As of 1/17/18	4.74
***Average discounted spread (L+)**		As of 12/29/17	4.79
As of 1/17/18	569.8		
As of 12/29/17	567.1		
Number of facilities			
As of 1/17/18	33	*Average discounted spread excludes all facilities in default	
As of 1/10/18	32		
As of 12/29/17	32		

Source: LCD, and offering of S&P Global Market Intelligence; S&P/LSTA Leveraged Loan Index

2018 Outlook

Will dynamics that shaped the middle market in 2017 continue in 2018?

With the economy showing few signs of weakness and the nine-year bull run in stocks continuing, investors see room left in the current, long-running credit cycle.

"The only thing we can say for certain is that every day that goes by, we get closer to the ninth inning, but the overwhelming consensus is that we are not there yet," says Jay Alicandri, a partner at Dechert.

Across the board, market participants continue to be cautiously optimistic about 2018, expressing confidence that a downturn in the credit cycle will not happen until 2019 (if not later). U.S. economic growth is expected to continue, defaults are expected to stay low throughout the year, and the U.S. leveraged loan default rate is not expected to hit its historical average of 3.1% until 2020, according to LCD's latest survey of portfolio managers, which was conducted last month. In previous surveys, the consensus had the historical default rate being breached in 2019.

And it looks like there will be no shortage of demand this year. Again, there was a whopping $180 billion raised for the private debt asset class last year, reflecting an enthusiasm never seen before. Specifically in the middle market, the past year saw investors from the broadly syndicated markets come down into the traditional middle market, pushing down pricing and loosening documentation.

"Two years ago, a larger middle market company with $75–100 million of EBITDA would most likely raise capital from the private markets with a club execution. Today, that same company can execute a syndicated deal with banks that will underwrite and sell it to CLOs and mutual funds—at higher leverage, lower pricing, and covenant-lite," says Ken Kencel, CEO of Churchill.

Investors believe that this hyper-competitive environment created by floods of capital, combined with a favorable macroeconomic outlook, will drive middle market lending to even greater heights.

Ted Koenig, CEO of Monroe Capital, echoes this optimism about the middle markets: "2018 is going to be a robust year for M&A and middle market transactions. Price/earnings multiples are at historical highs, long-term financing rates are at historical lows, default rates are low, and the interest rate horizon looks very stable. These are all very good signs for acquisitive behavior. From a middle market company's perspective, organic growth in the U.S. is hard to achieve in this environment, so the way to grow is not only organic—it's through acquisition," he says.

Churchill's Kencel agrees. "Due to lower corporate tax rates, corporate acquirers may have more cash and acquire strategic businesses to drive growth, so we may very well see an uptick in strategic M&A activity," he says. "Private equity continues to raise a lot of capital. I don't see anything changing on the private equity side. So I think 2018 will be a busy year."

However, with so much capital chasing deals—leading to the deterioration of pricing and documentation—it is crucial for middle market lenders to tread carefully, participants say. The upper middle markets have become largely syndicated, and deal terms seen there continue to creep into smaller deals.

Average new-issue first-lien statistics (last 30 days)

Deal size	Spread (L+)	Floor (bps)	Offer price	YTM	Deal count
$200M or less	NA	NA	NA	NA	NA
$201M - $350M	533	67	99.00%	7.45%	3
$351M - $500M	322	56	99.73%	5.07%	8
$501M+	328	58	99.71%	5.15%	30
$350M or less	533	67	99.00%	7.45%	3

Source: LCD, an offering of S&P Global Market Intelligence

"Years ago, there would be a significant difference between the terms you would get in a syndicated loan financing, compared to a middle club deal or direct lending structure," says Stefanie Birkmann, a partner at Ropes & Gray. "A lot of those differences have disappeared. You do not see as clear a distinction anymore."

The other consequence of this dynamic is that a middle market lender needs to be able to hold larger allocations to compete in the upper middle markets.

"Increasingly, we are seeing scale drive access to quality deals. Five years ago an investor could participate in a traditional middle market deal, investing $10–20 million in a deal," Churchill's Kencel explains. "Today, if you can't hold $50–75 million you are at a distinct disadvantage. This is forcing the smaller players down-market to smaller, often riskier credits."

"We believe there is going to be consolidation in the middle market lending industry. Some of the lower middle market players that are experiencing performance issues may be acquired or be forced to change their investment strategy, which may lead to more opportunity in the lower middle markets," Dechert's Alicandri adds.

Now that private equity sponsors have so many debt providers to choose from, they are starting to influence middle market lending structures.

"There continues to be a shift toward the unitranche as an attractive way to finance deals," Churchill's Kencel says. "I think this will continue, given market dynamics. In the fourth quarter, 20–25% of what we saw was unitranche, as opposed to traditional senior. That's at the higher end or our range, compared to several years ago."

Despite all the optimism about in 2018, there are potential headwinds. All of this liquidity in the market could pose major issues in the future.

"Because of all the liquidity in this market, financing terms in the larger transactions have gotten very loose, with less-restrictive documentation and poor covenants," Koenig of Monroe Capital warns. "This is going to affect creditors' rights in a way that hasn't been tested before. Last time we went into an economic downturn, there were strong financial covenants and good loan documentation."

Furthermore, as the middle markets become more syndicated, this narrows the selection of deals for traditional middle market lenders. "Hopefully that flow of capital from the liquid markets will recede a bit [this] year," Churchill's Kencel says.

Another concern is international and domestic political risk. Middle market lenders, including Monroe and Churchill, think potential geopolitical events could disrupt the economy, and consider this to be a risk factor. "None of these events can be predicted with any level of certainty, but the risk has not decreased over the past few years," Kencel says.

— Shivan Bhavnani

Leveraged Commentary & Data

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