



MIDDLE MARKET DIGEST QUARTERLY UPDATE FIRST QUARTER 2018

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**MIDDLE MARKET DIGEST
QUARTERLY UPDATE
FIRST QUARTER 2018**

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From The Middle

May 2018

To the friends and clients of Interpeak Consulting:

In the first quarter of 2018 domestic banks reported only a slight easing of lending standards when considering a loan application. In the April 2018 Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices, 12.7% of the domestic bank respondents answered that lending standards to large and middle-market firms 'eased somewhat' while 85.9% of the respondents stated that lending standards 'remained basically unchanged'.

Two important events occurred in the first quarter which will have a direct impact on middle-market lending. First, on February 27th, Joseph Otting, head of the Office of the Comptroller of the Currency, announced that banks no longer needed to adhere to the Leveraged Lending Guidance, which was introduced in 2013 and effectively limited leverage to 6x and required a company to be able to amortize at least 50% of its debt within 5 to 7 years.

Second, the Small Business Credit Availability Act became law on March 23rd. The Act changes the minimum asset coverage requirement that must be met by a Business Development Corporation from 200% to 150% thereby increasing the amount of leverage that a BDC can incur by a third.

It is expected that these two events, plus the increased inflow of capital in the middle-market lending space, will keep loan spreads and deal terms favorable for middle-market borrowers throughout 2018.

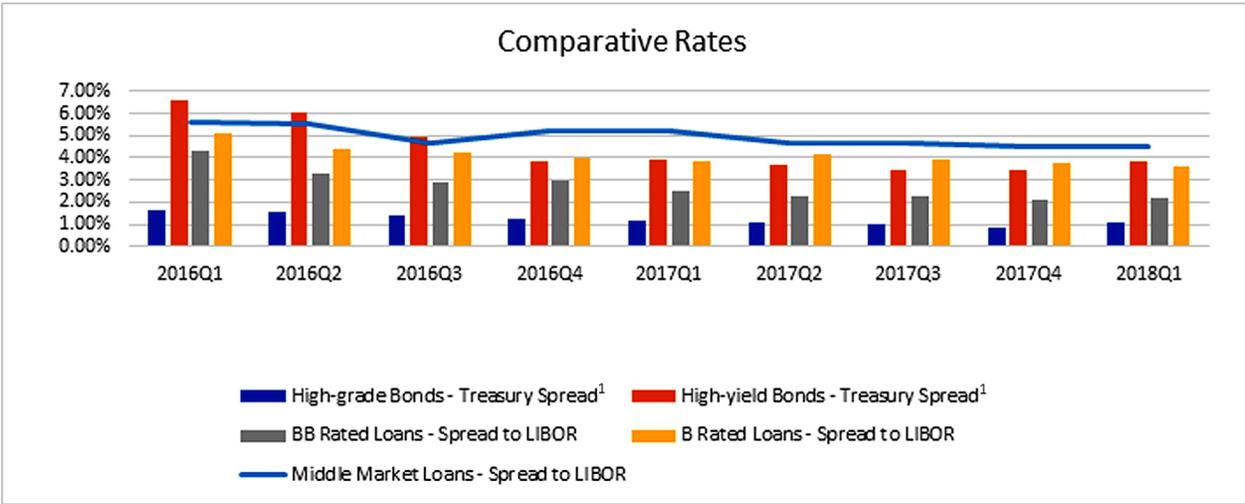
Please provide any comments, they are always welcomed and hopefully you will find this report useful to you and your organization.

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Relative Value



¹ Option Adjusted Spread
Source: LCD, an offering of S&P Global Market Intelligence

During the quarter, spreads widened for high-grade, high-yield and BB loans, while spreads for single B and Middle-Market loans narrowed slightly. Middle-Market spreads for the first quarter were 4.48%, a decline of 5 bps from the Q4 2017 and 15 bps from Q3 2017. Spread differential between Middle-Market loans and B loans, BB loans and high-yield bonds were 0.89%, 2.26% and 0.66% respectively for Q1 2018.

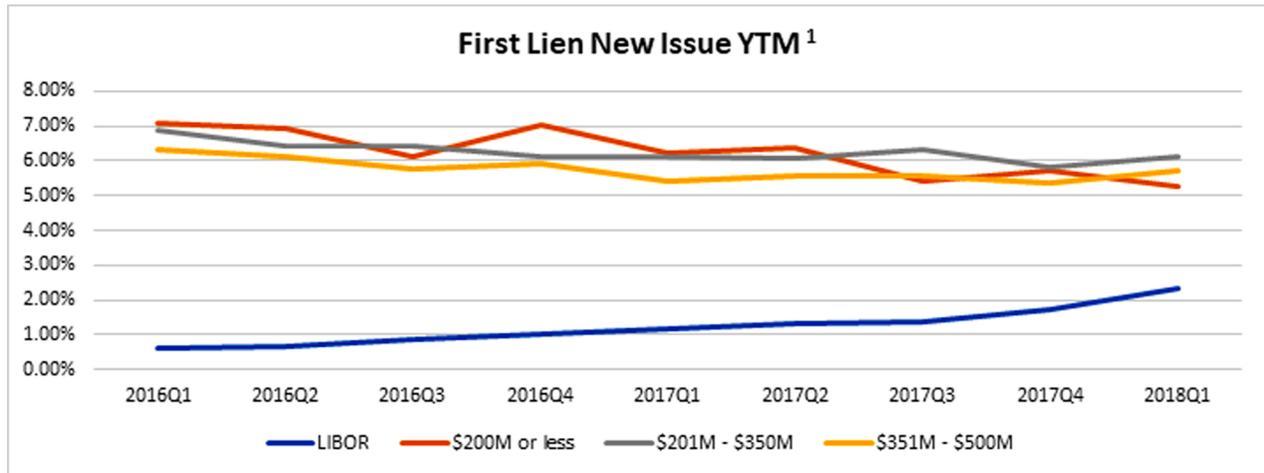
Comparing the Q1 2018 difference between Middle-Market loans and the non-investment grade loans/bonds with the eight-quarter average, the difference for the quarter in all cases were higher. The eight-quarter average difference between Middle-Market loans and B loans, BB loans and high-yield bonds were 0.84%, 2.18%, and 0.54% respectively.

The all-in rate for middle market credits according to Piper Jaffray & Co. for Q1 2018 was 6.52% an increase from 6.28%. Rising LIBOR is the primary cause for the increase.

As LIBOR increases expect to see spreads largely remain the same or even tighten as borrowers take advantage of increased capital flows and competition in the Middle-Market lending market from non-traditional lenders and participants.



New Issue YTM by Deal Size



¹ YTM – Assumes loan repayment/refinancing in three years
Source: LCD, an offering of S&P Global Market Intelligence

Transactions in the above chart are segmented into three categories: \$200 million or less, between \$201 million and \$350 million, and between \$351 million to \$500 million. The loans represent syndicated middle market credits, all with EBITDA of \$50 million or less.

LIBOR increased 0.61% from the end of 2017 to the end of March 2018. However, yield-to-maturity for new issue transactions \$200 million or less actually declined from 5.74% to 5.28% quarter over quarter. Conversely, YTM for new issue transactions between \$201 million to \$350 million in size increased to 6.14% in Q1 2018 from 5.84% in Q4 2017 and for transactions between \$351 million to \$500 million the YTM increased from 5.35% in Q4 2017 to 5.73% in Q1 2018.

The average YTM over the eight-quarter period for new issue transactions was as follows:

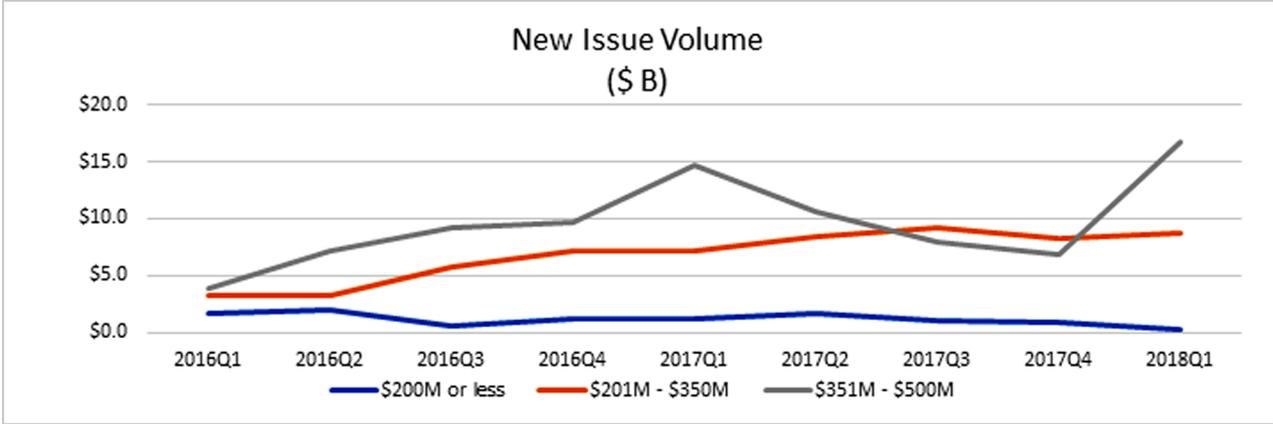
Transaction Size	Yield to Maturity
<i>\$0 < \$200 million</i>	6.26%
<i>\$201 million < \$350 million</i>	6.26%
<i>\$351 million < \$500 million</i>	5.76%

As the data demonstrates, there is no yield difference between deals sizes of below \$350 million. However, larger Middle-Market transactions, and thereby larger Middle Market companies, experienced a meaningful 0.50% reduction in yield in comparison to the smaller sized transactions and companies.



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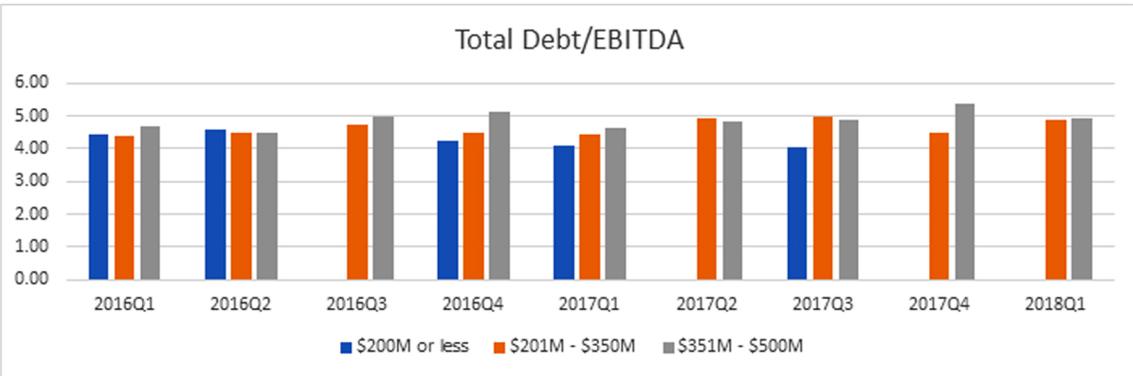
Syndicated Market Indicators



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

Both transaction sizes of \$201 million to \$350 million and \$351 million to \$500 million experienced an increase in volume quarter over quarter, while transaction sizes of \$200 million or less experienced a slight decline.

The \$16.7 billion in volume for the Q1 2018 for transactions between \$351 million and \$500 million is the highest volume in the past two years.



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

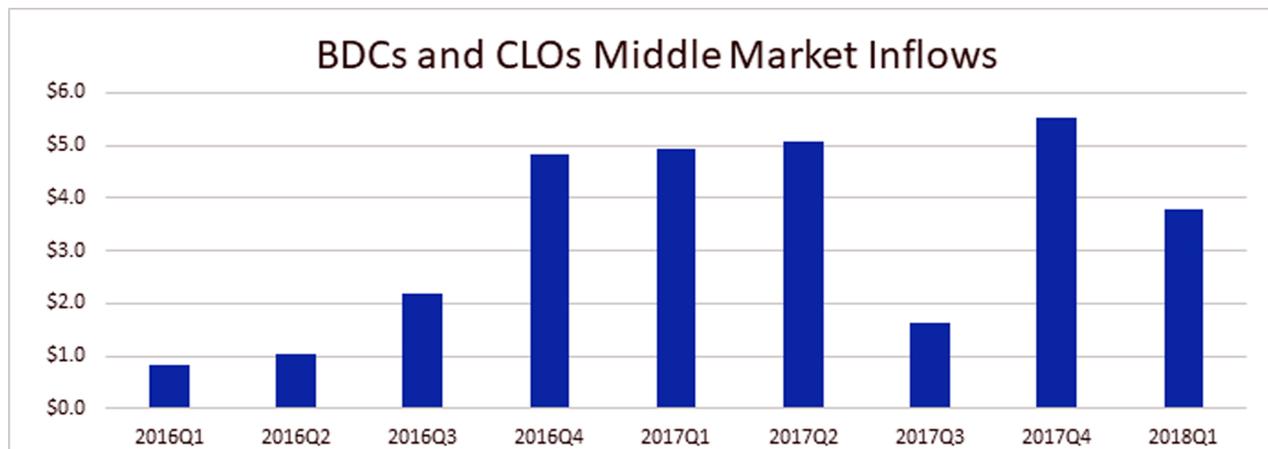
In Q1 2018 opening leverage for new issue transactions between \$201 million and \$350 million and \$351 million and \$500 million were 4.91x and 4.92x respectively.

Average leverage ratio for the eight-quarter period for new issue transactions \$201 million >\$350 million and \$351 million >-\$500 million were 4.65x and 4.88x respectively. No leverage data was available for transaction sizes of \$200 million or less.



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Institutional Investor Inflows



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

The first quarter 2018 was another strong quarter for capital inflows into the Middle-Market lending space. All of the \$3.79 billion of inflows for the quarter was from CLOs that specialize in Middle-Market lending. It is expected the enactment of the Small Business Credit Availability Act will create more capital inflows from BDCs in the near future.

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