THE Lead Left
The Premier Middle Market Newsletter

Churchill Asset Management
A TIAA-CREF Company

New Release
For Subscribers Only

State of the Capital Markets
Second Quarter 2015 Review and
Third Quarter 2015 Outlook

More on Revolving Credits

Who knew such a mundane topic as revolving credits could stir up such passions? Based on our TLL mail bag, readers have very definite opinions about how banks (and borrowers) are coping with the shifting regulatory climate related to these otherwise innocuous financing mechanisms.

As we discussed last week, the crack-down on "risky loans" has caused banks to cut back on their funded debt obligations to many highly leveraged borrowers. Less-regulated entities are rushing in to fill that vacuum. But a casualty of regulation is that *unfunded* obligations are being impacted as well. These are tougher shoes for non-banks to fill.

First, as one banker noted to us, even if funded leverage falls below the six times Ebitda mark set by regulators for a potentially criticized loan, the guidelines state that unfunded RC availability must be included in the debt calculation as well.

Also throw into the mix any committed debt allowable under the credit agreement, including baskets and accordions. Regulators assume they are all drawn Day One, with no benefit to cash flow. As our friend wrote sadly, "It's harder and harder to be a bank."

One counterintuitive solution banks are trying (another correspondent revealed) is to make revolvers larger and shrink the amount of the corresponding term loan. Since more of the funded portion is placed under the RC, it improves the return on capital for that facility. It also has the side benefits of both relieving amortization pressure for the borrower and ameliorating regulators' concerns about banks issuing back-ended term loan B tranches.

But as is the case with many things related to bank regulation since the credit crisis, there are unintended consequences to be considered. By shifting away from institutional term loans, where 1% amortization in the first several years is commonplace, banks are putting more debt into revolvers. Where there's no amortization.

It also takes out of play another debt repayment feature of term loan B's; namely, excess cash flow recaptures. While the integrity of these sweeps has certainly been watered down of late, it gives lenders another tool in their pay down arsenal.

Revolvers are notoriously difficult to control from a lender's perspective. Talk to work-out and restructuring pros. In troubled credit situations the first thing banks do is look to restrict RC usage. And the first thing that

QUOTE OF THE WEEK

"Let me be clear: we're not taking Alexander Hamilton off our currency."

– Jacob J. Lew, US Treasury Secretary.

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borrowers do when they know liquidity may be cut off, is draw down under the revolver. It makes for some unhappy relationships.

Finally, one buy-side manager called to tell us how much revolver exposure he had in his entire multi-billion-dollar loan portfolio. "Five million bucks," he said proudly. "And I'm not even sure why we have that much."

Attention Subscribers! Our **State of the Capital Markets - First Quarter 2015 Review and Second Quarter 2015 Outlook** is now ready for download. Click *here* to access this report.

21ST ANNUAL
THOMSON REUTERS LPC
LOAN & CLO CONFERENCE

Thursday September 10, 2015
Marriott Marquis, New York City

THE NEW LOAN MARKET -
READY OR NOT, HERE IT COMES

Risk retention, Leveraged Lending Guidance and Basel 3 are just a few factors impacting the loan market.

Join LPC this September for our 21st Annual Loan and CLO Conference, where industry experts will discuss the dramatic changes coming to the loan market - and what they might mean for you.

loanpricing.com/2015conference

THOMSON REUTERS

THE LEAD LEFT SPOTLIGHT

This week we chat with John Brignola, managing partner, LBC Credit Partners. LBC is a leading provider of middle market financing solutions supporting sponsored and non-sponsored transactions. LBC has over $1.75 billion of capital commitments and has made over $3.2 billion in investments in a wide range of industries located throughout North America.

The Lead Left: John, thank you and Fridolf Hanson for setting this up. How would you characterize LBC as a lender?

John Brignola: From the beginning, we decided not to be pigeon-holed into being simply a senior or mezzanine debt provider. We play from the top to the bottom of the capital structure. Our investors like the flexibility and the overall blended return.

TLL: That's interesting because the perception is that you've mostly been a mezz player.

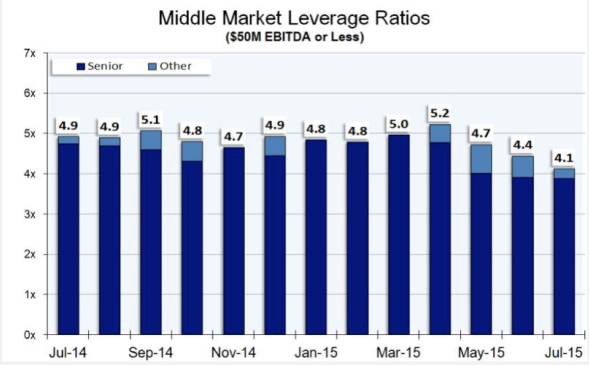
JB: Over the past ten years we've allocated capital over different tranches. In today's market there are more senior opportunities, given the regulatory pressure on banks. But actually we started out providing both senior and junior debt.

"Today with some leverage on

CHART OF THE WEEK

Lower Gears

While these data include all middle market loans, not just LBOs, the trend seems to confirm regulatory pressures are impacting leverage.



Source: S&P Capital IQ

STAT OF THE WEEK

	Jul 3 2015	2008	1970	1940
US Crude Oil Production (K Barrels/Day)	9,604	5,000	9,637	4,107

Source: U.S. eia

LOAN STATS AT A GLANCE

Provided by:

S&P CAPITAL IQ

senior debt, returns meet a broader range of investor requirements."

TLL: But that didn't make sense from a return perspective?

JB: Fifteen to twenty years ago, you couldn't get the yield on senior debt to justify a traditional fund structure. There wasn't the kind of leverage on vehicles that you can achieve now. You needed mezz to reach those types of returns. Today with some leverage on senior debt, returns meet a broader range of investor requirements.

TLL: What about where we are in the credit cycle?

JB: We believe it makes sense to be more oriented towards senior, given the cycle. When it gets stretched, you see more structured finance products, more CLOs.

TLL: How do you structure your funding?

JB: Ours are equity style funds with modest leverage. Fund III is a vintage 2013 fund with $839 million of equity capital.

TLL: How do you see the unitranche structure competing today? Second-lien?

JB: The key is to apply value to different parts of a capital structure. For example, a 3x senior tranche combined with 1.5x of junior capital blends to your return.

TLL: How does your portfolio shake out, senior vs mezz? Sponsored vs. non-sponsored?

JB: I would say about 20% is mezzanine, with the balance split between senior and unitranche. And about two-thirds are sponsored and the rest is non-sponsored. In terms of size of borrowers, we aim for EBITDA between $5 and $50 million, with $20 million being the sweet spot.

TLL: Do you co-invest alongside the GPs?

JB: Sometimes, there's no consistent pattern. It's a small part of our business.

TLL: How about hold levels?

JB: We'll hold between $30 and $40 million per deal.

TLL: You've invested through cycles. What lessons did you learn in 2009?

JB: Know your partners throughout the capital structure, particularly how those lenders themselves are structured. What are

	This Week	Last Week	6MO Ago	YR Ago
New-Issue Clearing Yields				
$200M or less	6.35%	6.35%	6.80%	6.24%
$201M - $350M	5.80%	5.78%	6.18%	5.91%
$351M - $500M	5.69%	5.57%	6.42%	5.64%
$501M+	4.69%	4.69%	5.95%	4.98%
Middle market (≤ $50M)	6.21%	6.21%	6.64%	5.99%
Large corporate (> $50M)	5.00%	4.98%	6.10%	5.30%
Large corporate single-B (> $50M)	5.19%	5.18%	6.27%	5.43%
Middle Market Credit Stats				
Sr/EBITDA	3.9	3.9	4.8	4.8
Debt/EBITDA	4.1	4.4	4.8	4.9
Middle Market Index Data				
Monthly Returns	0.16%	0.02%	0.07%	0.23%
Average Bid	97.03	97.02	95.12	98.99

Source: S&P Capital IQ

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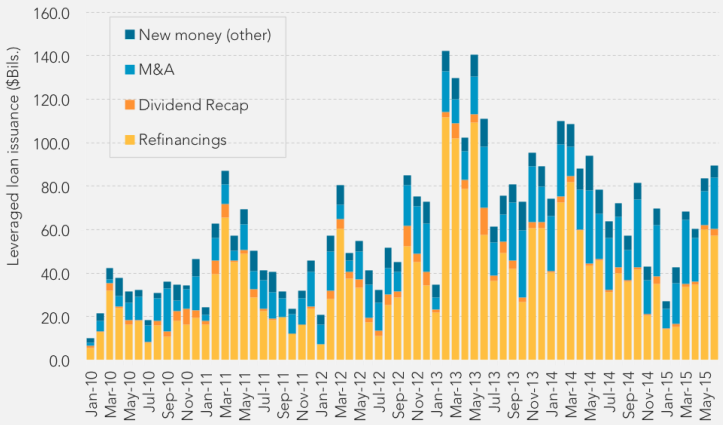
LEVERAGE LOAN INSIGHT & ANALYSIS

Provided by:

THOMSON REUTERS



Source: Thomson Reuters LPC

After a very slow start to the year, leveraged lending picked up in 2Q15. Issuance of $233.3 billion was up 69 percent from 1Q15 levels. While issuance was down year-over-year, it only trailed by 10 percent, a lot lower than the 53 percent deficit recorded in 1Q15. On the heels of a very slow first quarter, investors were hungry to put money to work. But options were limited in April as new money lending which had increased in March, trailed off. In turn, investors jumped into the limited amount of deals available and pricing dropped. Issuers took advantage of this and a new repricing wave made its way into market. Refinancings jumped to almost $60 billion in May, its highest level since March 2014. For the quarter, refinancings were up 2.4 times from 1Q15 levels. Sponsors also took advantage of the demand and supply imbalance and hit the market with more dividend recaps. At $7 billion in 2Q15, loan issuance backing dividend recaps more than doubled the total recorded in 1Q15. While opportunistic deals were on the rise in 2Q15, leveraged M&A issuance was almost flat at $58.9 billion. However, major announcements were made and the pipeline filled with M&A financings, prompting investors to pull back from refinancings and riskier credits as they wait for new issue deals to hit market in the second half.

THE NEW LOAN MARKET - READY OR NOT, HERE IT COMES -
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their pressure points? Structure really matters if you have junior exposure. You better be right on enterprise value. If you think you have an EV floor, be sure!

TLL: What kind of industries do you like or dislike?

JB: We're fairly agnostic. Industries that are less appealing to us are staffing, restaurants and retail.

TLL: I'm sure you've looked at your fair share of energy deals.

JB: We have. A lot of distressed money has been raised targeting the energy sector. We haven't seen those distressed types of deals in the sector and are just starting to see some refinancing opportunities. I guess the types of opportunities are dependent on where we are in the cycle.

To be continued the week of July 20

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MIDDLE MARKET Growth

2020: A Business Travel Odyssey

Monday, 5:30 a.m. // [Up&AtomÂ© wrist alarm vibrates]. Ugh, time to get up. Can't believe I have to fly to Havana tonight. Well, I haven't missed an ACG InterGrowthÂ® in 30 years. Not about to start now. [Checks PhoneDroneÂ© app on wrist]. My lift arrives soon so better get going.

7:30 a.m. // [en route to JFK, aloft at 1,000 feet]. Glad I'm not in that traffic! Don't know why everybody doesn't use these personal airlifts. Really great time-saver. Let's see how my flight is doing. [Checks AirAwareÂ® app]. On-time departure. And they've booked me for a massage [RubwaysÂ©] while I'm going through security. Sweet!

9:30 a.m. // [on plane]. Let me see if I can get a better hotel. [FlyingRoomers.com]. So much easier than that corporate service we used before. Hotels, motels, houses, even student housing! Love the way your luggage gets sent right from the plane to your room [BagzÂ©]...

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MARKIT RECAP

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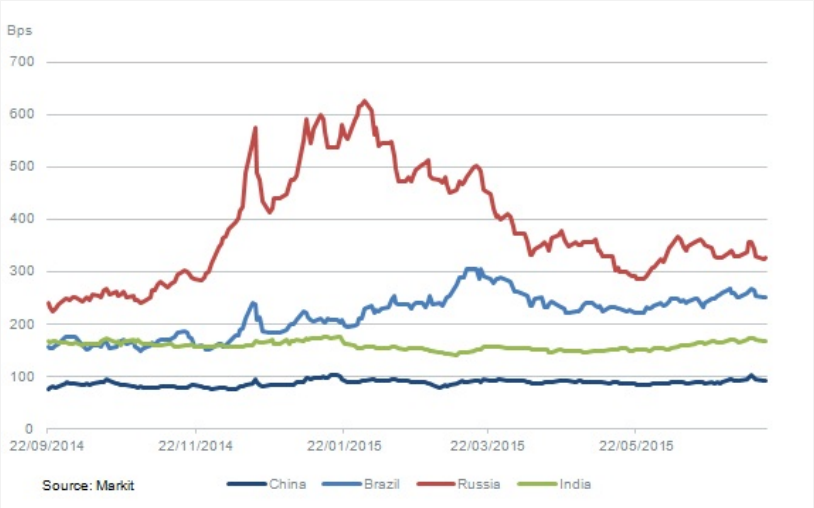
markit



Greece's position as the dominant driver of market sentiment has been unassailable in recent months. But there may be a hiatus if an agreement is reached on bridging finance for Greece, potentially leaving room for another theme to shape credit spread direction.

If Greece does become a secondary consideration - and that is a very big 'if' - then investors may turn their attention to the Brics. China has captured headlines recently amid a collapse in its equity market. The boom in stocks over the last 12 months was impelled by a sharp rise in margin financing, and the excessive leverage accentuated the inevitable crash. The Chinese government has intervened in its usual heavy handed manner, and this stemmed the losses.

Sino-optimists points towards the 7% growth achieved in the second-quarter, in line with the government's forecasts. But the economy's continued expansion is dependent on credit growth, and there are doubts that this can be maintained at the current pace or if it will be as effective as in the past. China's five-year CDS widened from 87bps to 104bps in the two weeks to July 8, its widest level since September 2013. But it should be noted that China's CDS has traded in a very tight range over the last two years, in comparison to many European countries as well as its fellow Brics members. This is a reflection of the market's faith in the Chinese government's capacity to support the economy in the medium-term.

China's CDS was the most actively traded name last week, according to DTCC figures. Brazil and Russia (and South Africa, which is now part of the Brics) were also in the top 10. In many ways the acronym is now redundant as the member countries are not a coherent group. Russia and Brazil, both of which are struggling economically, are dependent on demand from China for their commodity exports. Their problems are all too evident in their CDS spreads, which trade at levels implying junk ratings (both are rated investment grade).

Emerging markets are clearly heterogeneous, but it remains to be seen whether investors recognise this when the US Federal Reserve hikes rates and China's problems come to the fore again, as they surely must.

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THE PULSE OF PRIVATE EQUITY

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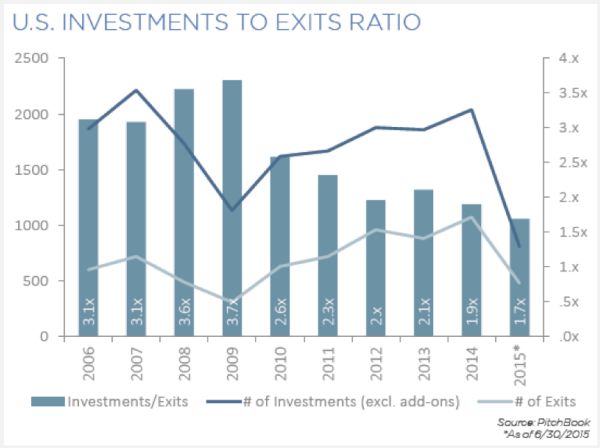
Click here
to read Randy Schwimmer's MidPoints column in the latest issue of Middle Market Growth magazine.



Investment-to-Exit Ratio at Record Low

While it's true that PE firms remain hopeful buyers, and the number of deals has risen over the years, they're much more active on the sell side today. Through June, the U.S. investment-to-exit ratio is at a record low 1.7x in 2015. The ratio has been trending steadily downward since the recession, and fell below 2x for the first time last year. Pre-crisis, investors were routinely making at least three deals for every exit, and now that those holding periods are expiring, it's not surprising to see so many exits, even with deal activity not far off pre-crisis highs.

It's not likely the ratio will dip too much further below 2x. While total value is on a tear (1H 2015 saw almost as much value for M&A exits as all of 2014 combined), it doesn't appear that exit counts will keep rising as they have. 2014 was a watershed year for exit counts, up 19% for SBOs and 29% for strategic sales. Through the first half, both exit types are on pace to see slightly fewer sales by count by the end of the year. The bigger variable is deal activity, which got off to a tepid start in 1H and isn't expected to gain much strength later this year. What we'll likely see over the next year and a half is an investment/exit ratio evening out around 1.8x-2.0x. Only when the deal-making environment improves will we see that ratio creep back up to its historical average.

Click here to download PitchBook's 3Q U.S. PE Breakdown Report.

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SELECT DEALS IN THE MARKET

Deal	Arranger	Sponsor	Industry	Facility*	Spread	LIB Flr	OID	Rating
AmeriLife (1L)(1)	SunTrust	J.C. Flowers & Co	Insurance	177.5	475	100	99	B/B3
AmeriLife (2L)(3)	SunTrust	J.C. Flowers & Co	Insurance	72.5	875	100	98	B/B3
Aristotle (1)	BNP	Wasserstein & Co	Healthcare	130	450	100	99.5	NR/NR
Belcan (2)	CS	AE Industrial Partners	Services & Leasing	190	600	100	97	B/B2
CareCentrix (2)	RBC	Summit Partners	Healthcare	175	500	100	97.5	B/B2
EagleView Technology (1L)	MS	Vista Equity	Services & Leasing	240	N/A	N/A	N/A	NR/NR
EagleView Technology (2L)	MS	Vista Equity	Services & Leasing	100	N/A	N/A	N/A	NR/NR
Jack's Family Restaurant (CL)(2)	RBC	Onex Corp.	Restaurants	230	475	100	99	B/B3
Jackson Hewitt	RBC	Bayside Capital	Services & Leasing	250	575-600	100	99	B/B2
Kendra Scott (1)	BNP	Norwest Venture	Textile & Apparel	70	600	100	99	NR/NR
Mediaocean (CL)	Macquarie	Vista Equity	Computers & Electronics	225	N/A	N/A	N/A	NR/B3
PDC Brands (CL)(1)	GE	Yellow Wood Partners	Consumer Nondurables	250	450	100	99	B/B2
Peacock Engineering (CL)(1)	GE	Charlesbank Capital	Transportation	285	425	100	99	NR/NR
Plz Aeroscience (CL)(1)	GE	Pritzker Organization	Chemicals	315	450	100	99	B/B2
Precyse Solutions	GE	Pamplona Capital	Services & Leasing	110	475	100	99	NR/NR
Ravn Air (1)	BNP	J.F. Lehman & Co	Transportation	95	450	100	99	NR/NR
Recorded Books (1)	BNP	Shamrock Capital	Printing & Publishing	107.5	450-475	100	99	NR/NR
Zep (2)	Jefferies	New Mountain Capital	Consumer Nondurables	360	475	100	99.5	B/B3
Averages				188	515	100	99	

* Senior only
** May be estimate based on leverage. Assumes unfunded revolver
NA Not Available
All dollar amounts in $MM
Corporate ratings unless otherwise noted

(1L) First Lien
(2L) Second Lien
(CL) Covenant Lite
(D) Dividend
(AO) Add-On

New Deal
Flex Up
Flex Down

Call Schedules
(1) 6 Month 101
(2) 101
(3) 102/101
(4) 4 Months 101

Source: S&P/LCD, Thomson Reuters/LPC, market sources

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