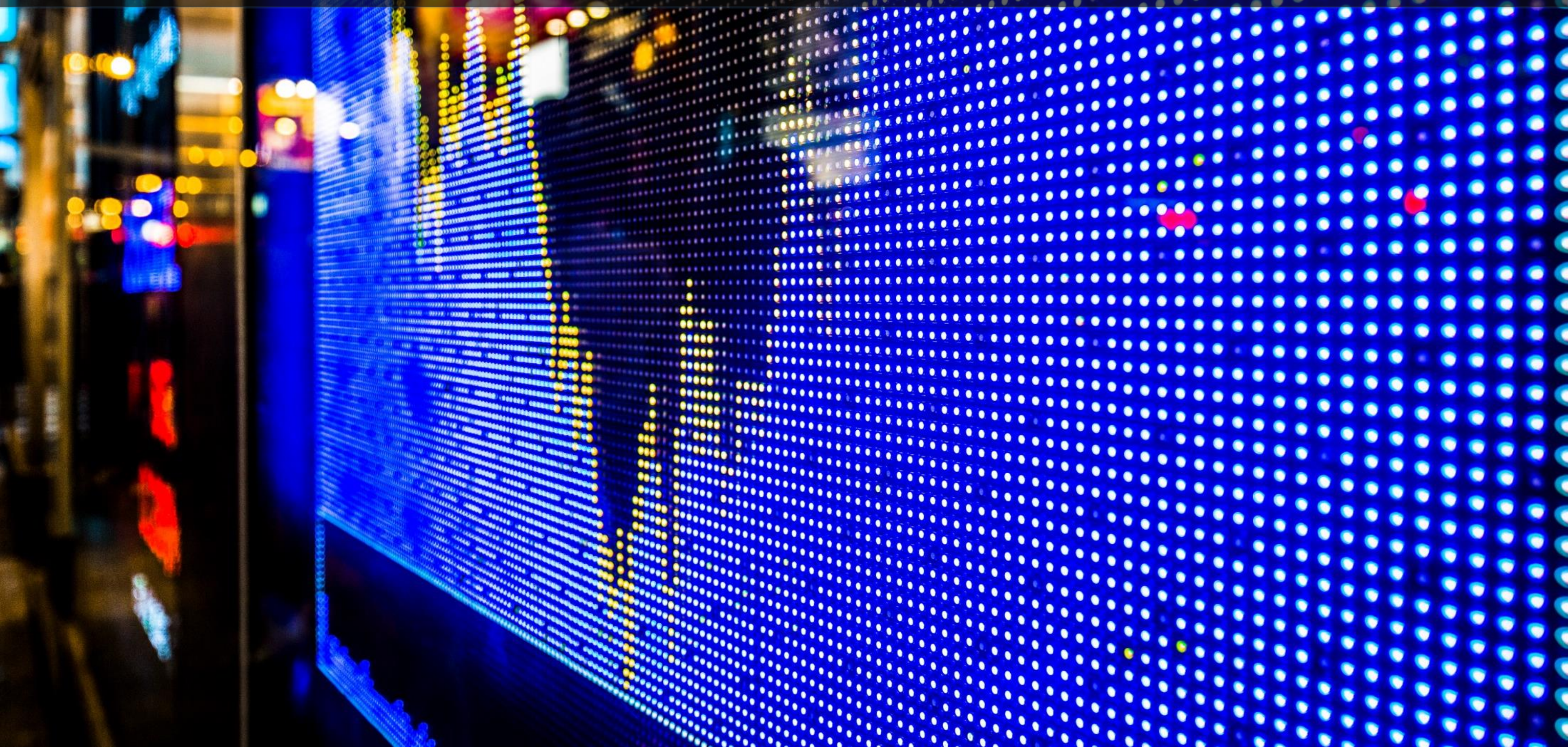
DUFF & PHELPS

INDUSTRY INSIGHTS:

Capital Markets

Q1 2017 Review



Highlights

Compelling market conditions this quarter drove non-investment grade and middle-market loan issuance volumes to the highest levels in several years. Volume was dominated by refinancing and dividend recap transactions.

New issuance terms – pricing, call protection and covenants – moved further in favor of issuers as an expanding universe of credit providers struggled to deploy capital. We noted particularly aggressive bidding among credit providers newly empowered with multi-strategy investment mandates.

Equity markets rallied strongly, reflecting a solid, if unspectacular, macroeconomic backdrop, as well as optimism regarding regulatory and fiscal policy under the Trump administration. Despite the setback on the American Health Care Act in late March, the rally weathered a shift in fiscal policy expectations as economic data and earnings forecasts continued to support higher valuations.

Following the Fed's rate hike in March, Treasurys rallied, driven by the waning prospect that economic conditions would warrant a fourth rate hike in 2017. The Fed, while still hawkish, left in place expectations for two additional quarter-point rate hikes for the remainder of the year.

Finally, we observed a marked increase in market participation by commercial banks, BDCs and, to a lesser extent, life insurance companies this quarter. Banks benefitted from a generally rising rate environment. BDCs, having largely worked through portfolio challenges, are again trading above net asset value.

Following strong economic data reports, investors expected the Fed to announce a fourth rate hike in its forecast for 2017. Unchanged guidance led to a Treasury rally in late March.

A stream of new money flowing into loan and credit funds overwhelmed new issue supply, driving pricing and spreads toward new lows.

Loan issuance surged to recent highs driven by refinancing, dividend recap issuance and strong demand from credit sources across the spectrum.

Executive Summary

U.S. monetary policy garnered the attention of market participants this quarter, especially as fiscal policy ceded center stage. The Fed maintained a moderately hawkish posture in announcing a rate hike in March and a data dependent plan to raise rates two more times by year end and three times in 2018 (each hike to be 25 basis points). The market reaction has, thus far, been muted, with Treasury rates generally rallying in relief that policy makers did not adopt a more accelerated pace of rate increases.

In spite of the modest pace of rate hikes in the Fed's guidance, and an inflation rate consistent with the Fed's 2% target (2.1% in February), the Treasury market is not without downside risk as a function of monetary policy. Of particular concern is how well the market will absorb a selling down, as soon as the third quarter, of Treasury and mortgage securities accumulated during quantitative easing initiatives in 2008 and 2009. In addition, a selling down of inventory held by the Chinese government (and related sovereign funds) could trigger a correction. Conversely, U.S. Treasury yields remain an attractive safe haven, with yields significantly greater than those of European and Japanese sovereign debt.

Inflow to middle-market credit providers was substantial, which drove pricing downward and enhanced structural flexibility. In response to robust demand for issuance, we observed a move by credit providers toward multi-strategy initiatives in order to be relevant to a broader range of opportunities. We also noted growing appetite for second lien debt, as traditional first lien buyers reached for yield.

Equities continued the rally begun in the fourth quarter with the S&P 500 having increased 10% from Election Day and 5% since the beginning of the quarter. Contributing to the rally were an array of positive economic indicators and expectations for roughly 9% S&P 500 earnings growth in the first quarter (the highest since 2011). Equities also continued to be buoyed by optimism that corporate profits will increase due to the White House's agenda of deregulation and tax reform. Despite the setback on new healthcare policy, the rally has weathered a shift in fiscal policy expectations.

Prevailing market conditions are compelling for middle-market issuers. In the first quarter, issuers drove the highest quarterly non-investment-grade loan issuance volume since 2014, fostered primarily by refinancing and dividend recap transactions. Sponsors took advantage of robust market conditions, paying out approximately $6 billion in dividends from loan issuance and pushing volume toward recent highs.

Indicative Middle-Market Credit Parameters

LEVERAGE MULTIPLES

	EBITDA OF \$10MM – \$20MM	EBITDA OF \$20MM – \$50MM
SENIOR	**2.50x – 3.50x**	**3.00x – 4.00x**
TOTAL DEBT	**3.50x – 4.50x**	**4.00x – 5.50x**

Indicative Middle-Market Credit Parameters

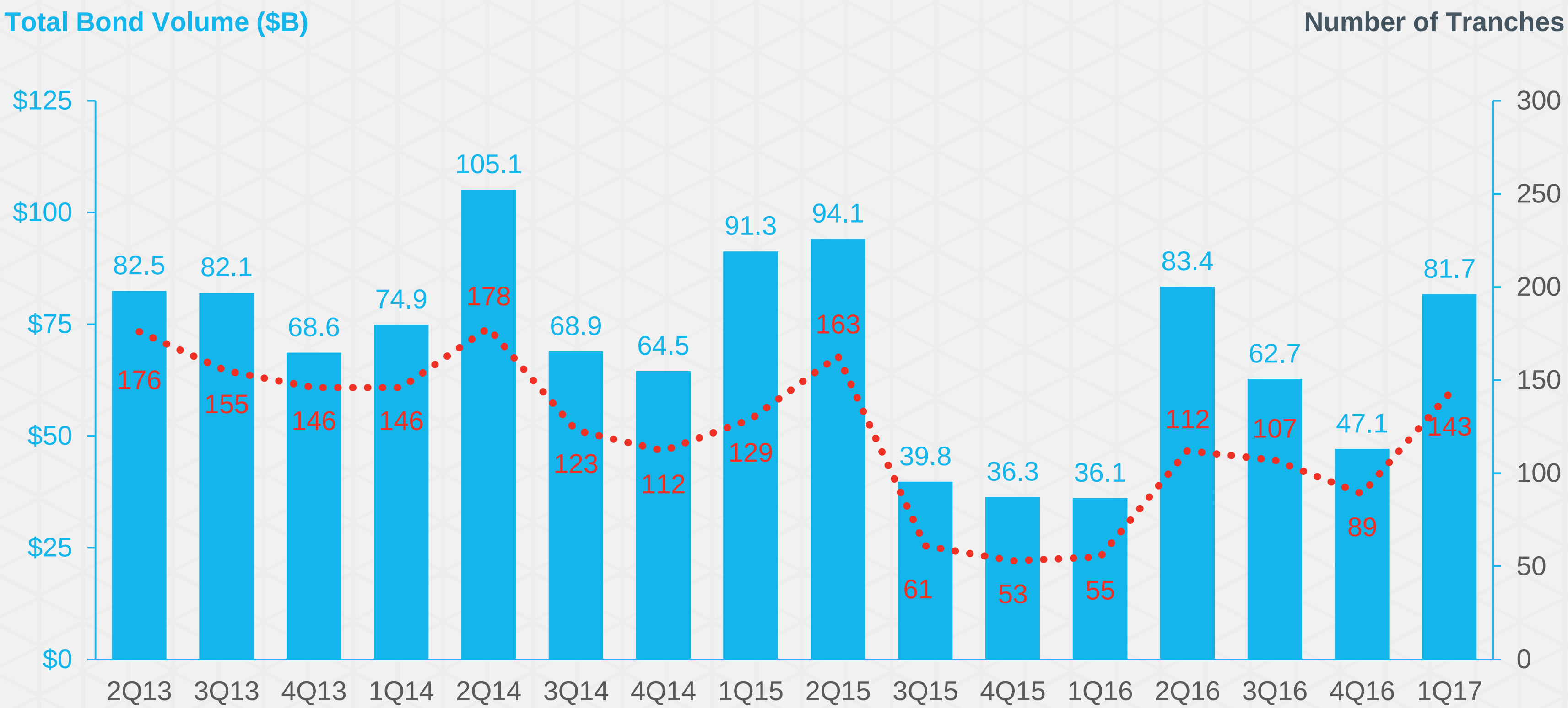
INFORMATION IN RED REPRESENTS PRIOR QUARTER VIEW

PRICING	EBITDA OF \$10MM – \$20MM	EBITDA OF \$20MM – \$50MM
FIRST LIEN	**LIBOR + 2.75% – 3.50% (bank)** **LIBOR + 3.75% – 5.75% (nonbank)** **LIBOR + 4.00% – 6.00% (nonbank)**	**LIBOR + 2.50% – 3.25% (bank)** **LIBOR + 3.75% – 5.75% (nonbank)** **LIBOR + 4.00% – 6.00% (nonbank)**
SECOND LIEN	**LIBOR + 6.00% – 9.00%** **LIBOR + 6.50% – 9.50%**	**LIBOR + 5.50% – 8.50%** **LIBOR + 6.00% – 9.00%**
SUBORDINATED DEBT	**11.00% – 13.00%** **11.50% – 13.50%**	**10.00% – 12.00%** **10.50% – 12.50%**
UNITRANCHE	**LIBOR + 6.00% – 8.50%** **LIBOR + 6.50% – 9.00%**	**LIBOR + 5.50% – 8.00%** **LIBOR + 6.00% – 8.50%**

New Issuance

High-yield volume increased in the first quarter of 2017 as companies sought to obtain favorable deal terms in advance of anticipated interest rate hikes. Issuance was driven disproportionately by refinancing activity. Dollar volume increased by 73.6% and deal volume increased by 60.7% versus the fourth quarter of 2016.

Total High-Yield Bond Issuance

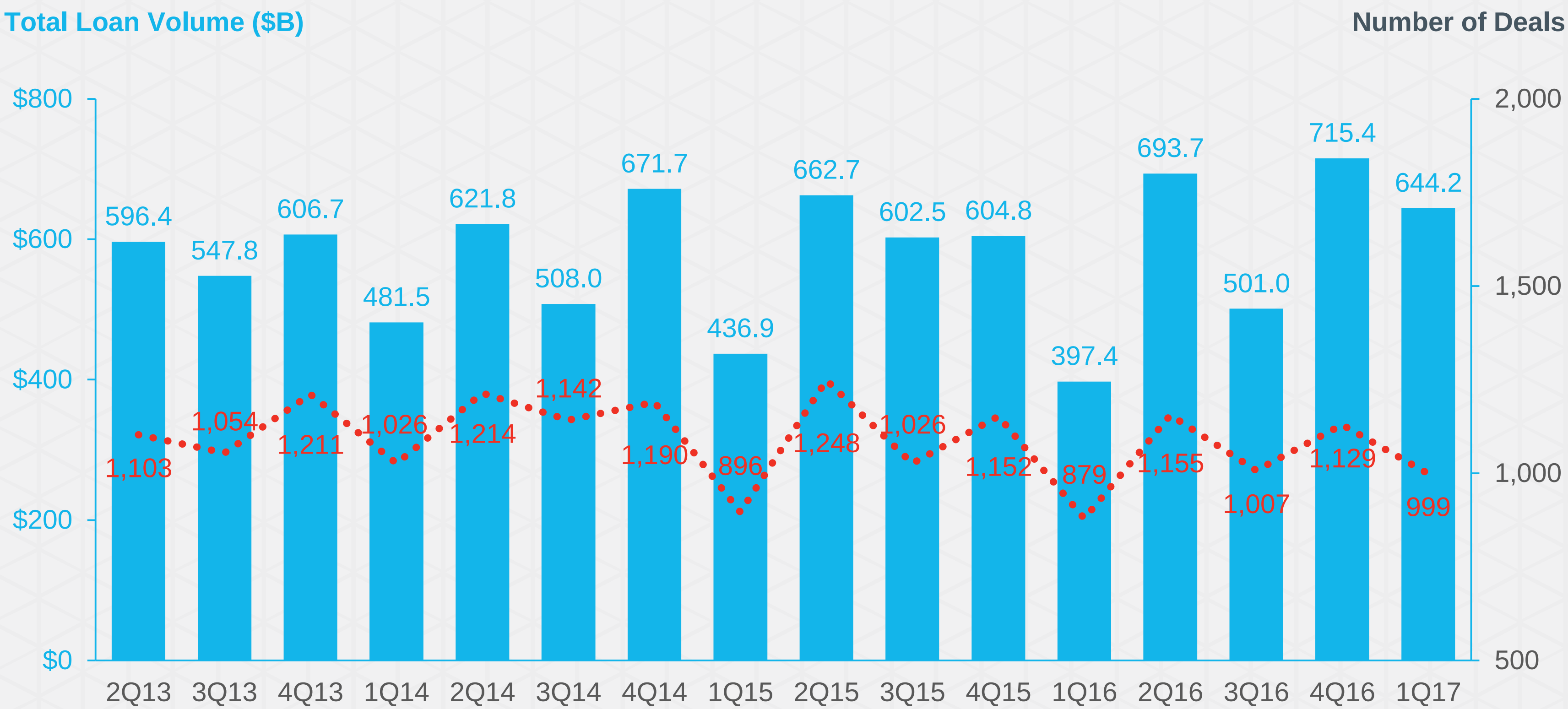


Source: LCD Comps

New Issuance

Total dollar volume of new loan issuance remained strong in the first quarter of 2017, having experienced a modest decrease from the recent high of Q4 2016. Volume was driven largely by refinancing and, to a lesser extent, dividend recap transactions.

Total Loan Issuance

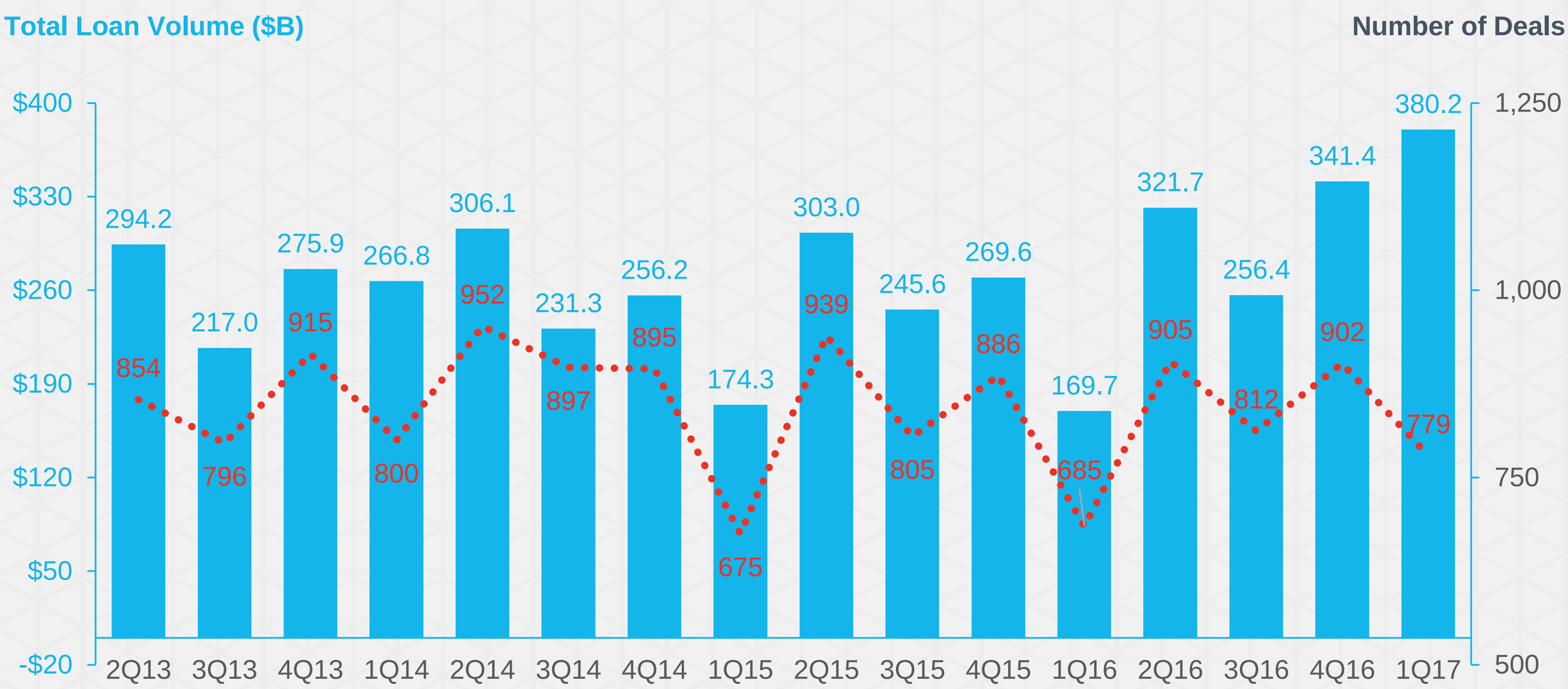


Source: SDC Platinum
Volume data includes deals reported as of 4/7/2017

New Issuance

Total middle-market loan issuance reached a record high in the first quarter of 2017. The pace of issuance reflected heavy M&A volume as well as a flurry of refinancings and recaps.

Total Loan Issuance (EBITDA < $50MM)

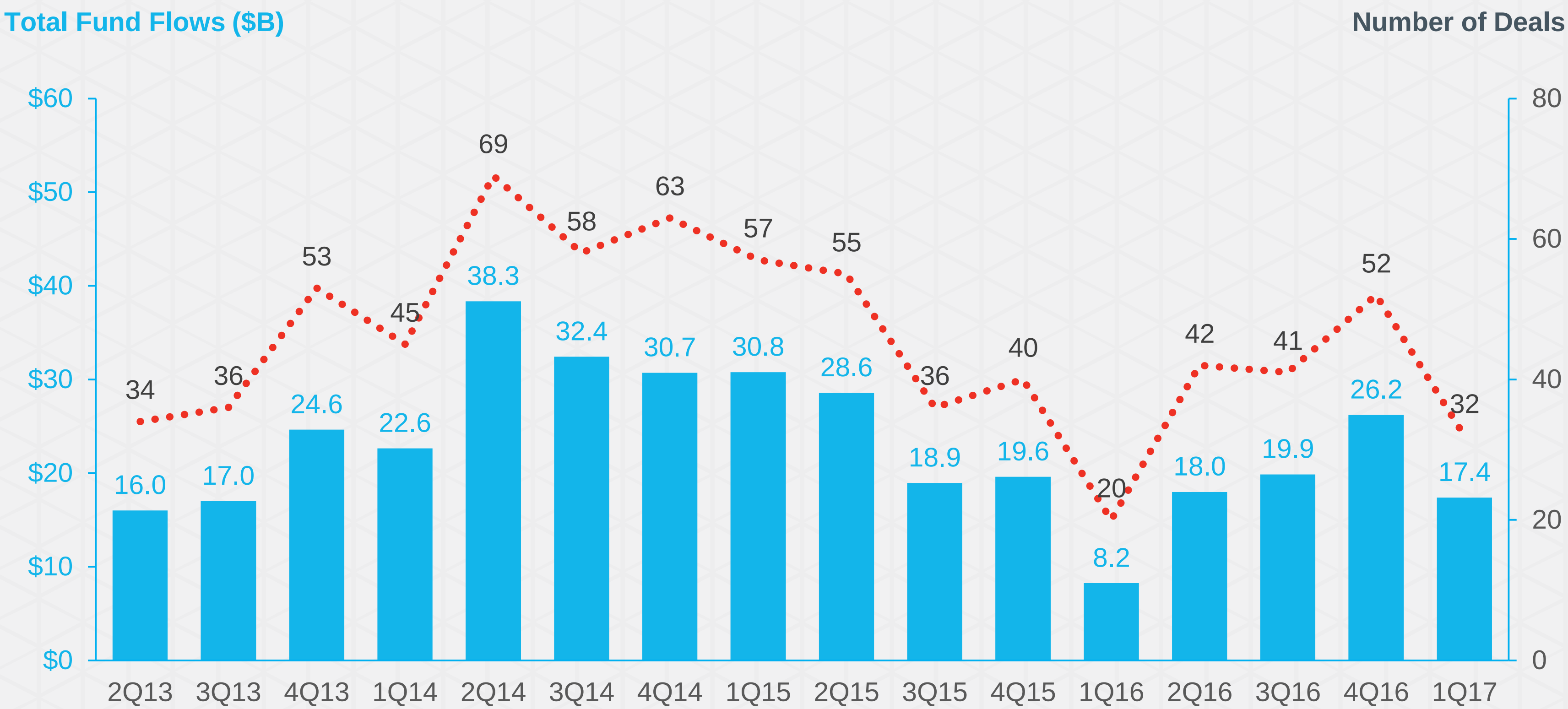


Source: SDC Platinum
Volume data includes deals reported as of 4/7/2017

Fund Flows

After a sluggish start to the year, collateralized loan obligation (CLO) managers ramped up issuance late in the quarter. While less than that experienced in the previous three quarters (averaging $21.2 billion), CLO issuance was still strong relative to the comparable period last year and consistent with its share of the institutional market in the fourth quarter.

Total CLO Issuance



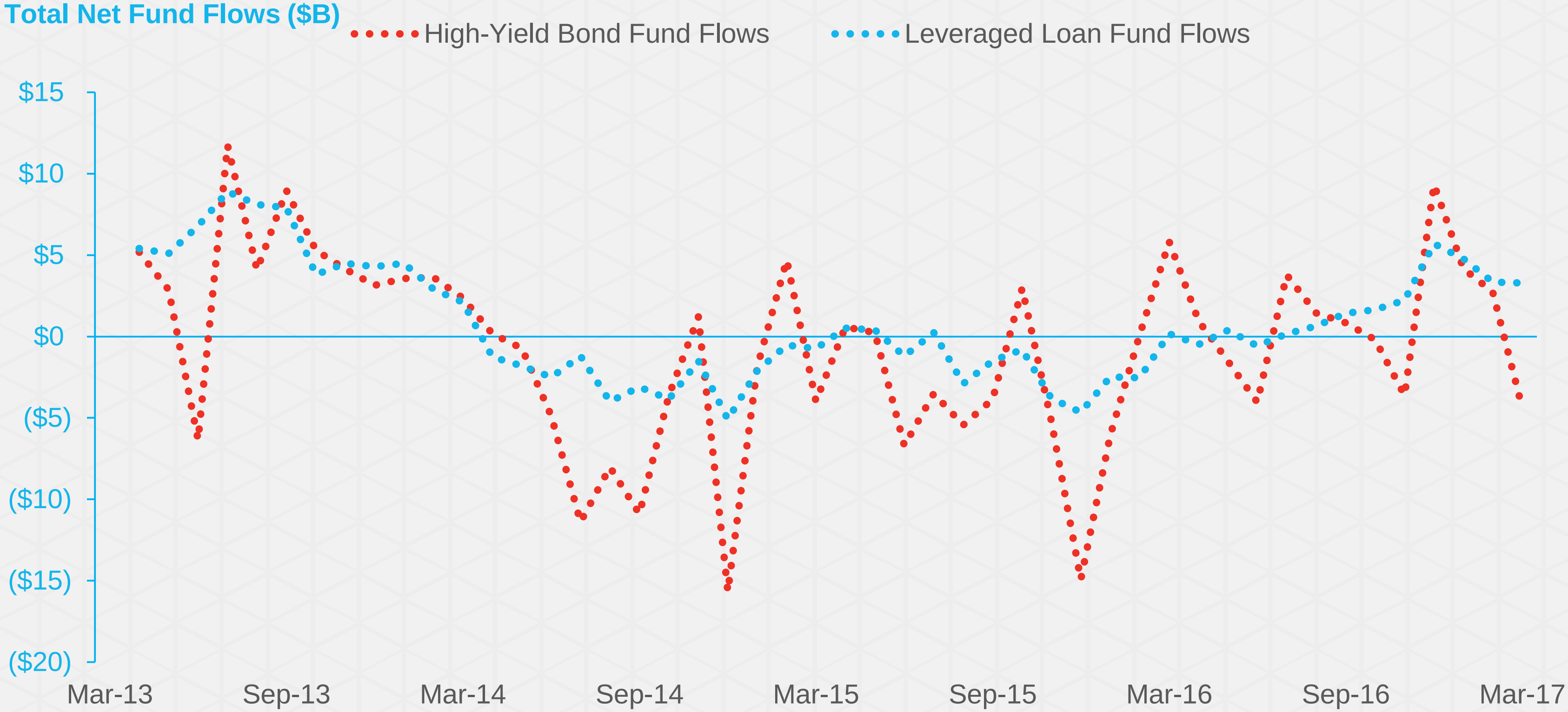
Source: LCD Comps

Fund Flows

Net leveraged loan fund inflows were approximately $2.6 billion in each month of the first quarter. Investors fled bond funds in the five weeks following the election – a relative blip, as investors returned emphatically in the first quarter.

Mutual Fund Flows

Total Net Fund Flows ($B)

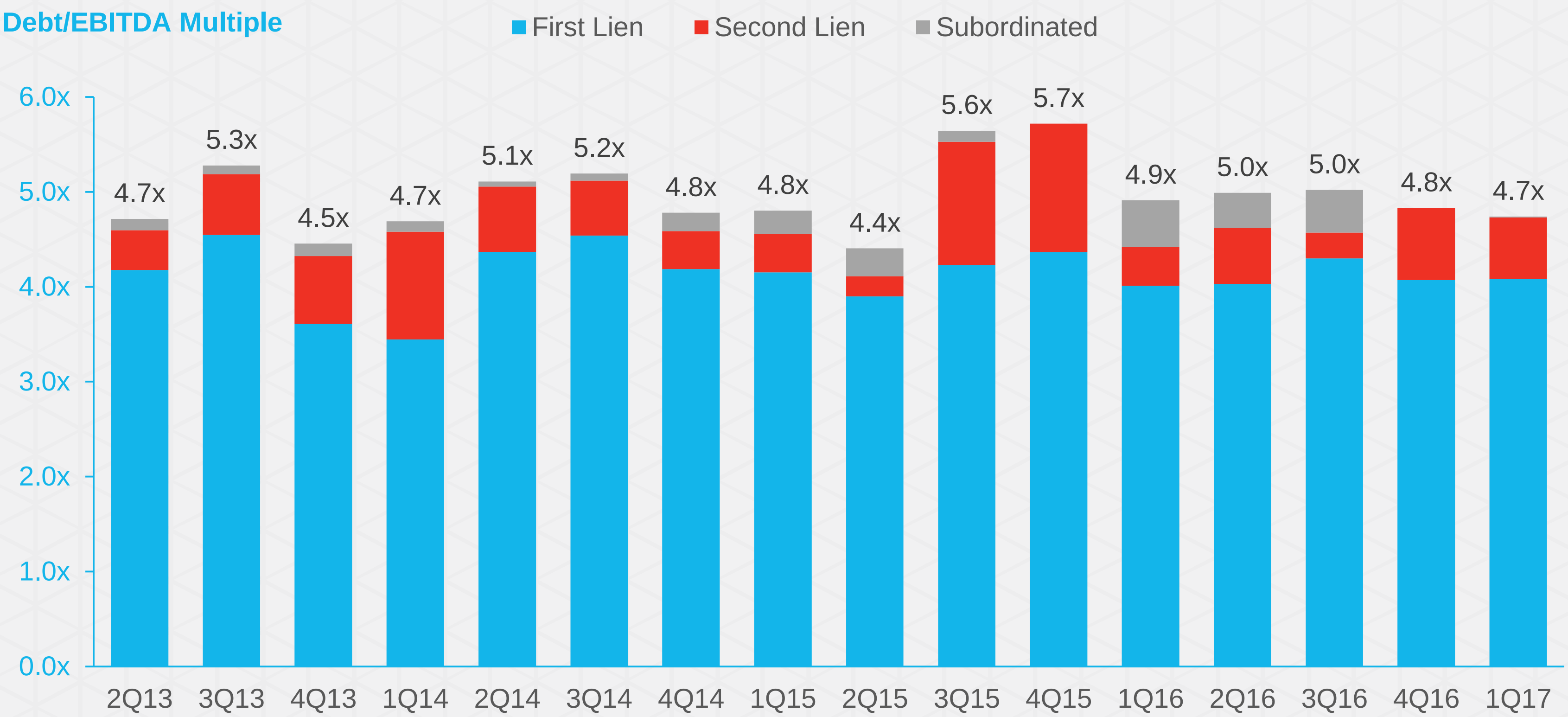


Source: Investment Company Institute; Lipper FMI

Leverage

Second lien loan volume increased as loan providers pressed for incremental yield. Average purchase price multiples declined slightly to just below 10x, with sponsors, on average, continuing to provide approximately 35% to 40% equity.

Leverage Multiple (EBITDA < $50MM)

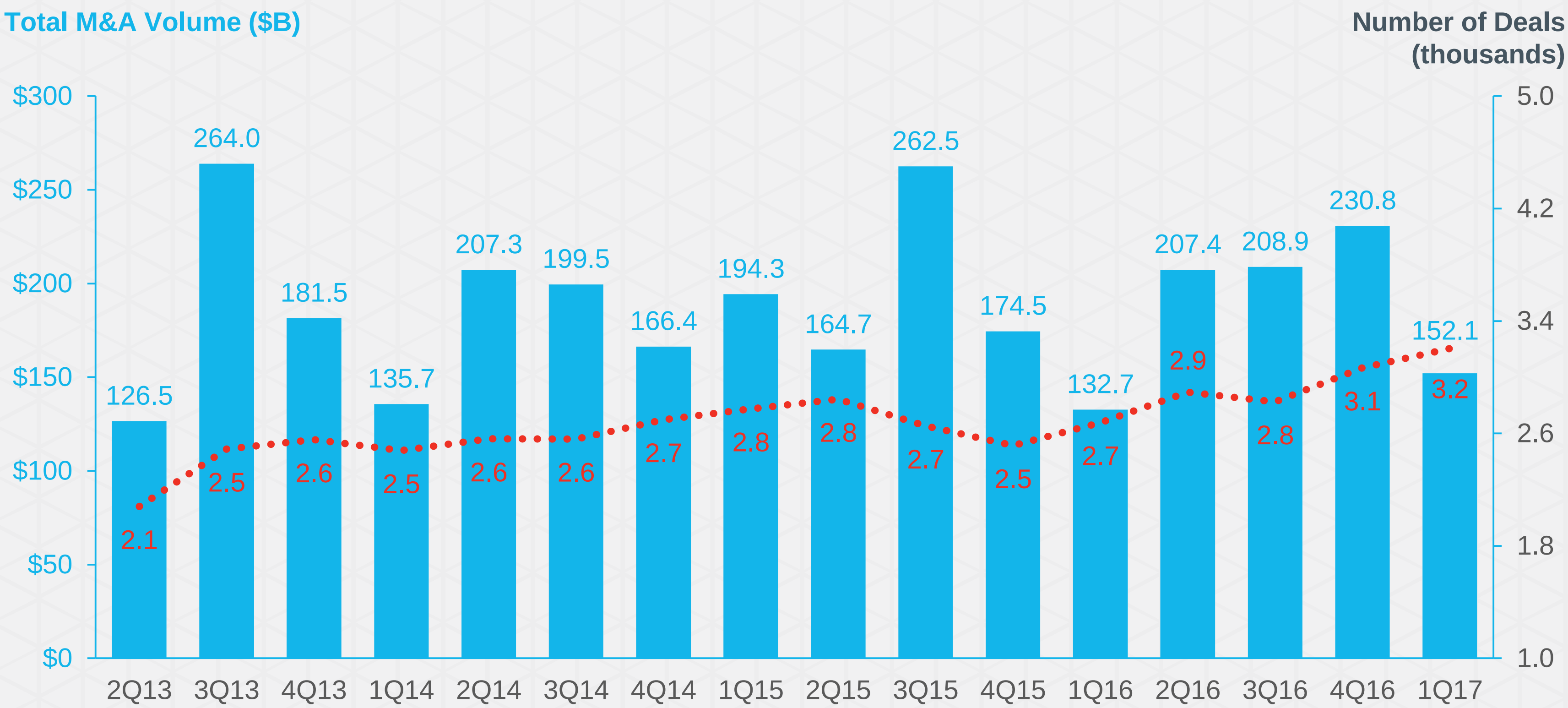


Source: LCD Comps

Transaction Volume

A record number of middle-market M&A deals were transacted in the first quarter of 2017. Although dollar volume declined, M&A transaction activity expanded.

Middle-Market M&A Volume (Target EBITDA < $50MM)



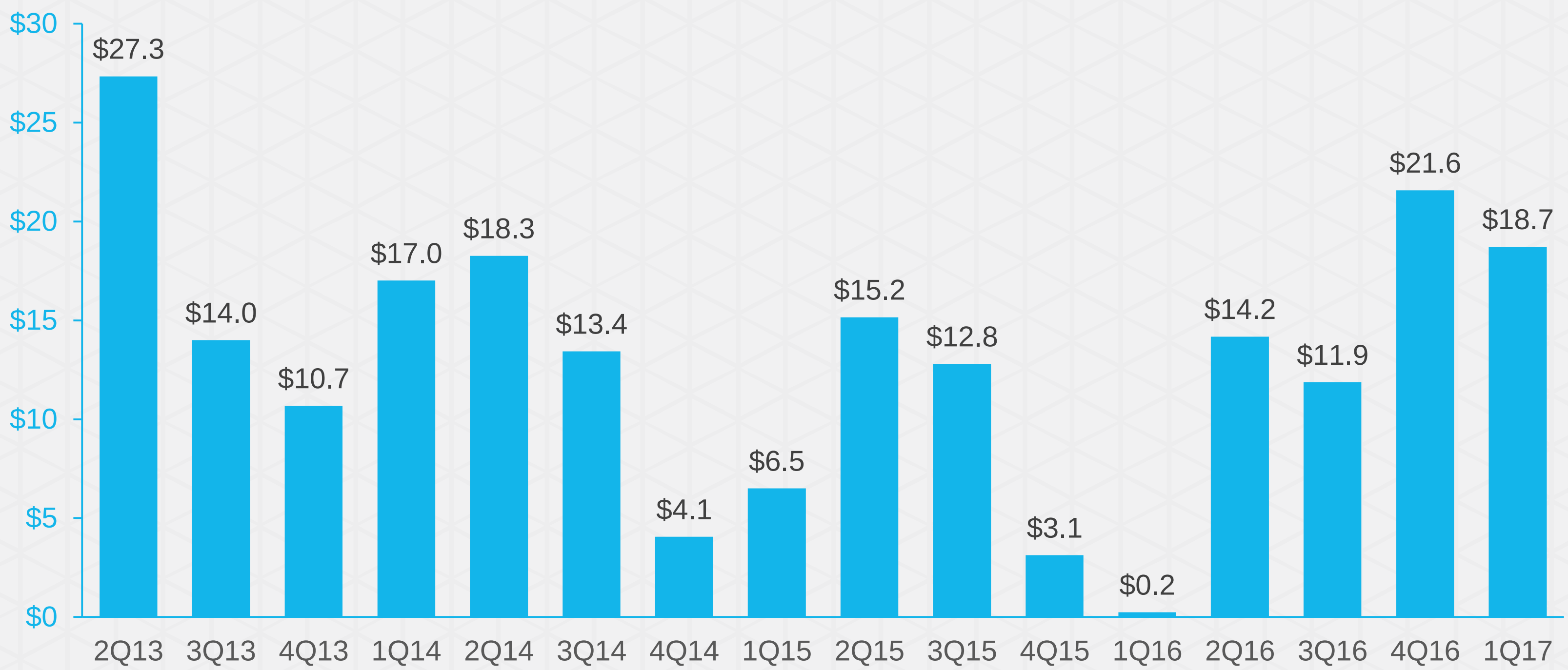
Source: SDC Platinum
Volume data includes deals reported as of 4/7/2017

Transaction Volume

Dividend recap volume was driven by an abundance of credit availability. Terms – yield, call protection and covenant structure – continued to move in favor of borrowers. In contrast, fourth quarter recap volume was propelled by the specter of unfavorable economic policy under an anticipated Clinton administration, with the majority of volume taking place in the five weeks leading up to the election.

Loan Issuance for Dividend Recapitalizations

Total Loan Volume ($B)

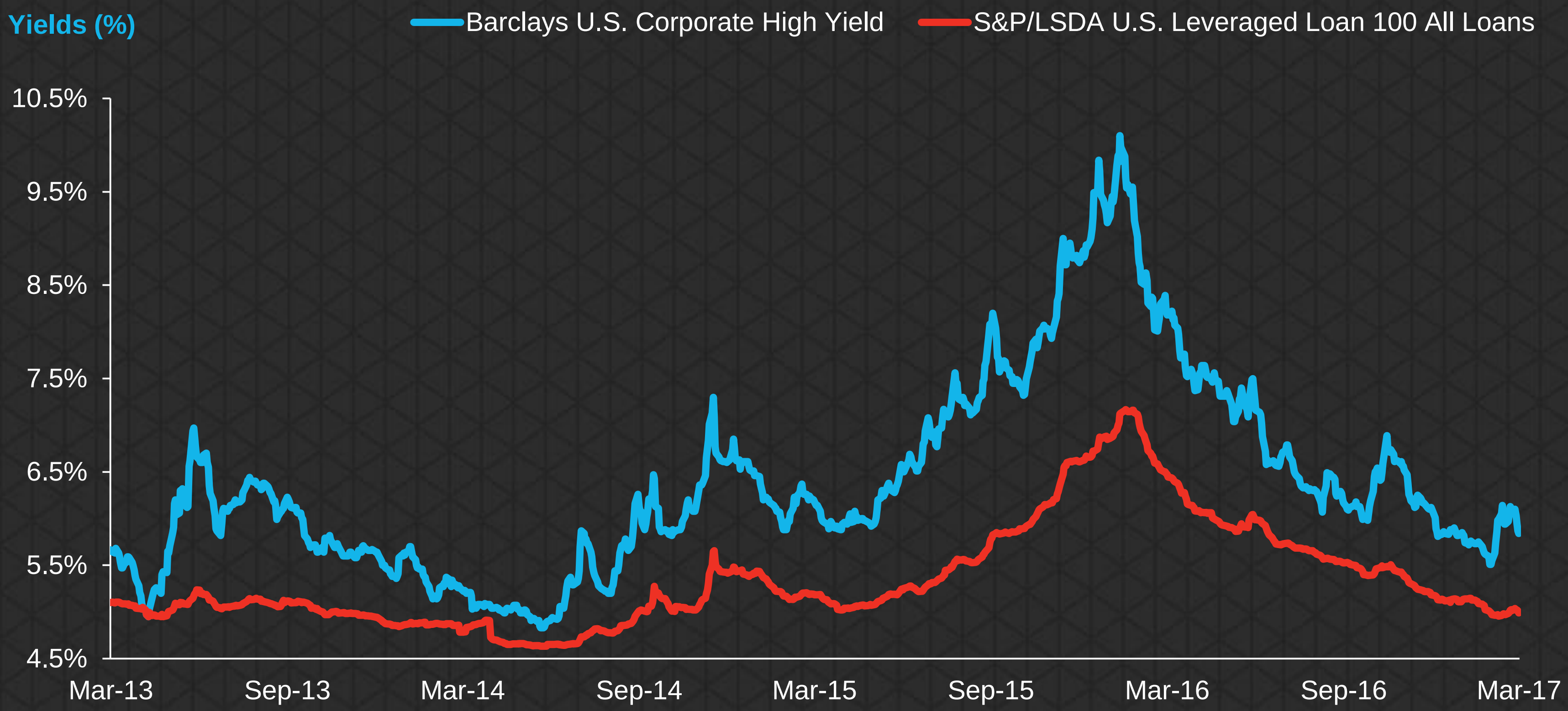


Source: LCD Comps

Yields

Yields on widely traded leveraged loans fell approximately 28bps this quarter while yields on high-yield bonds decreased by 19bps. The supply-demand imbalance, particularly for loans, drove rates down. This rally proceeded in spite of the Fed's rate hike.

U.S. Corporate High-Yield Bonds and Leveraged Loans

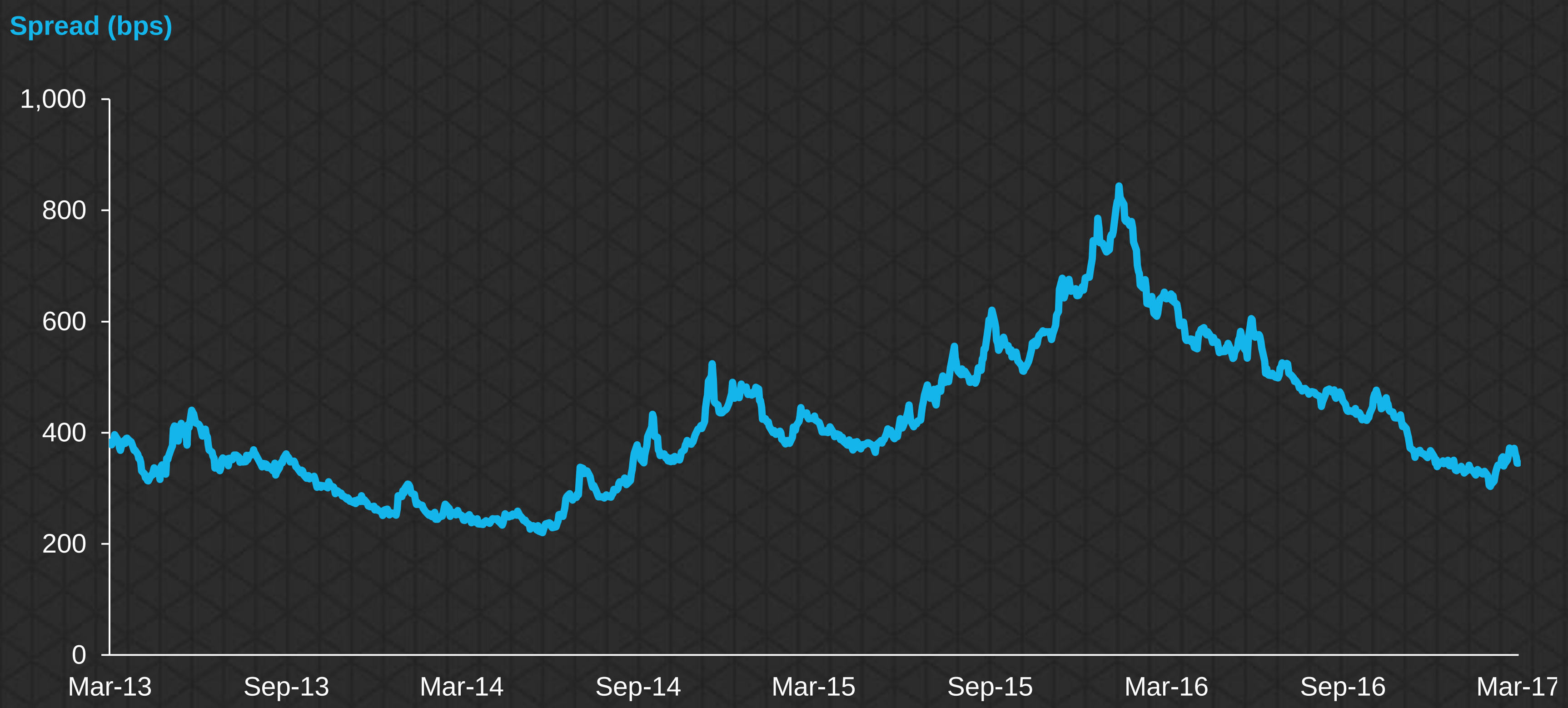


Source: Bloomberg; LCD Comps

Yields

Spreads between the Barclays U.S. Corporate High Yield index and the 10-year Treasury yield decreased by approximately 22bps during the quarter. Demand for assets drove rates and spreads downward.

U.S. Corporate High-Yield Bond vs. 10-Year Treasury Spread

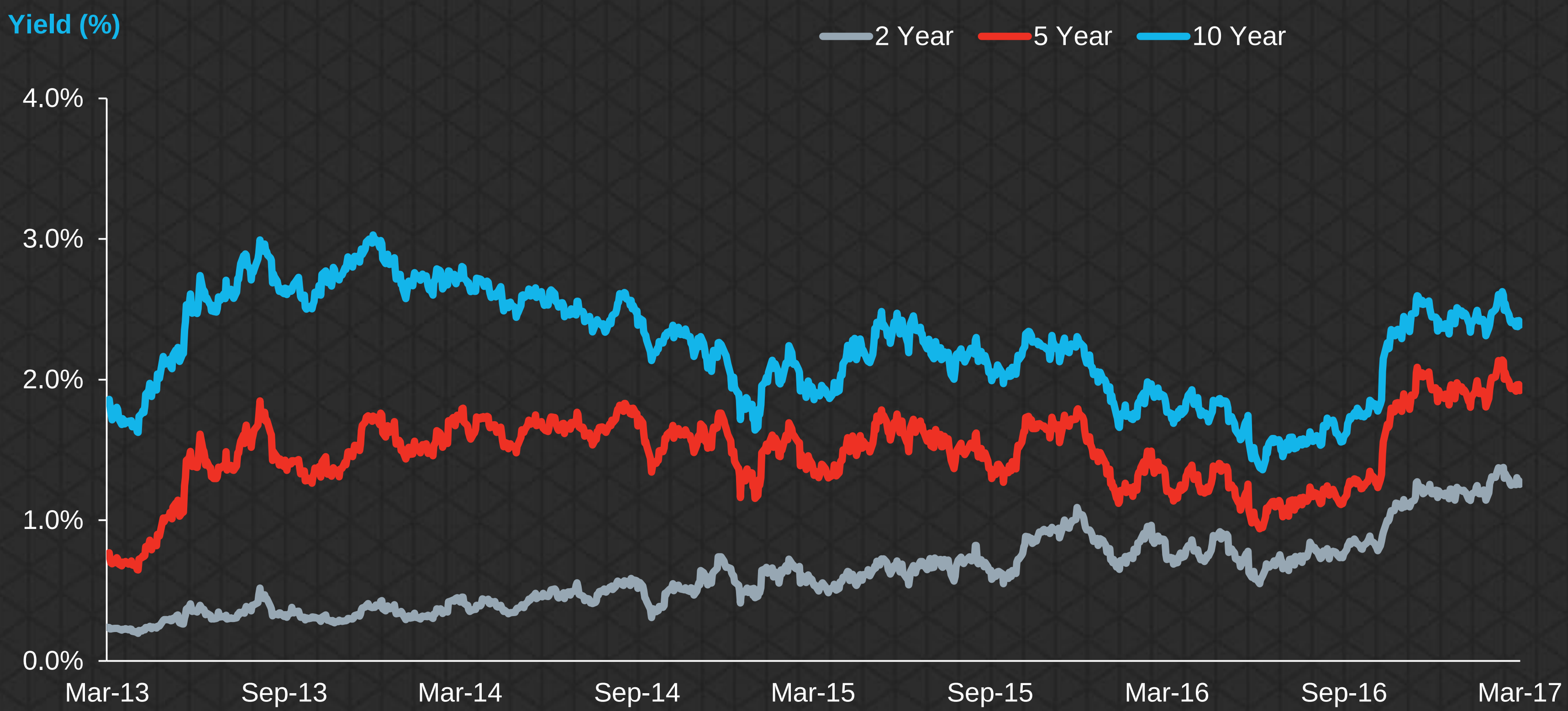


Source: Bloomberg; LCD Comps

Yields

Treasury yields remained roughly flat this quarter, with the 10-year yield decreasing by approximately 6bps. The Fed's rate hike this quarter and continued guidance for two subsequent increases in 2017 had a nominal impact on Treasury yields, suggesting that the market had already priced in the Fed's actions.

2-, 5- and 10-Year Treasury Yields



Source: Bloomberg

Yields

Spreads between 2- and 10-year Treasury yields decreased by approximately 12bps during the quarter, reflecting modestly greater sensitivity to monetary policy on the longer end of the curve.

2-Year vs. 10-Year Treasury Spread

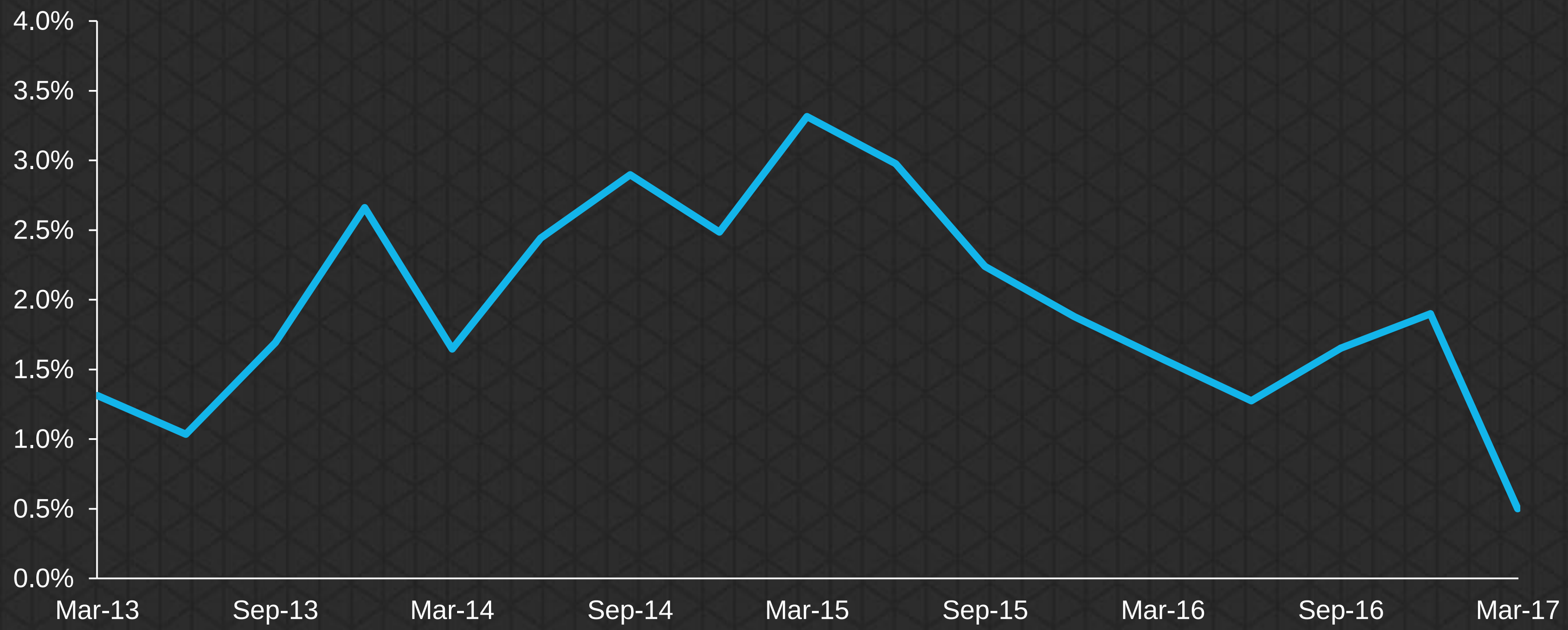
Source: Bloomberg

Macroeconomic Update

U.S. economic data was generally encouraging in the first quarter. Projected GDP growth was positive, though less than that of the fourth quarter. The unemployment rate fell to 4.5% in March, while the labor force participation rate remained around 63.0%.

U.S. Real GDP Growth

GDP Growth Rate



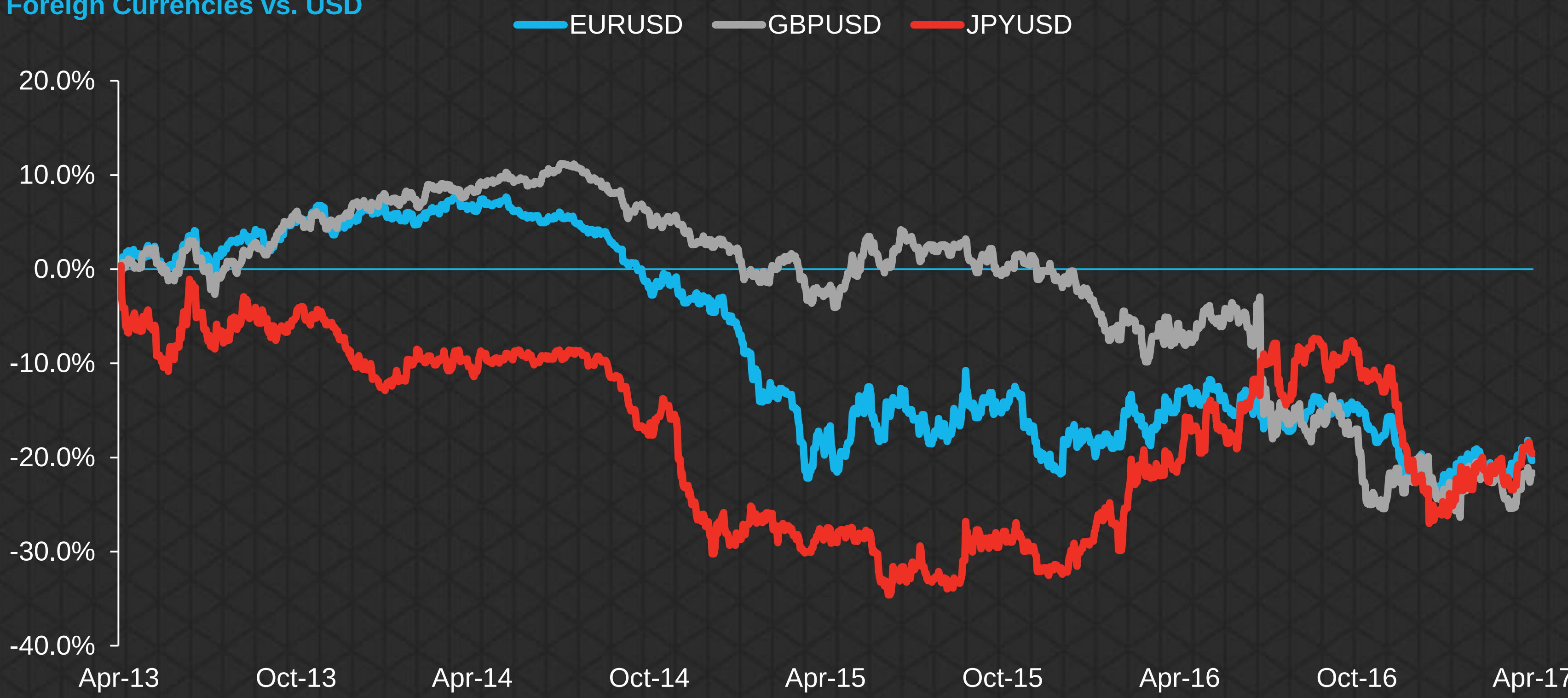
Source: Federal Reserve
First quarter data represents Atlanta Fed GDPNow Projection as of 4/18/17

Macroeconomic Update

U.S. dollar exchange rates, while volatile throughout the first quarter, ended the period largely unchanged versus major foreign currencies. Although the Fed raised the discount rate another quarter point, further increasing the disparity between U.S. monetary policy and those of Europe and Japan, the Treasury rally at quarter end dampened the dollar's rally.

U.S. Dollar Foreign Exchange Rates

Foreign Currencies vs. USD



Source: Federal Reserve

Contact Us

Michael Brill
Managing Director, U.S. Private Capital Markets
+1 212 871 5179
michael.brill@duffandphelps.com

Bob Bartell, CFA
Global Head of Corporate Finance
+1 312 697 4654
bob.bartell@duffandphelps.com

Steve Burt
Global Head of M&A
+1 312 697 4620
steve.burt@duffandphelps.com

Dave Althoff
Global Co-Head of Industrials M&A
+1 312 697 4625
david.althoff@duffandphelps.com

Josh Benn
Global Head of Consumer, Retail, Food & Restaurants
+1 212 450 2840
josh.benn@duffandphelps.com

Brian Cullen
Head of U.S. Restructuring
+1 424 249 1645
brian.cullen@duffandphelps.com

Brooks Dexter
Global Head of Healthcare M&A
+1 424 249 1646
brooks.dexter@duffandphelps.com

Ken Goldsbrough
Managing Director, European Debt Advisory
+44 (0)20 7089 4890
ken.goldsbrough@duffandphelps.com

Howard Johnson
Managing Director, Canada M&A
+1 416 597 4500
howard.johnson@duffandphelps.com

Ross Fletcher
Managing Director, Canada M&A
+1 416 361 2588
ross.fletcher@duffandphelps.com

Kevin Iudicello
Managing Director, Technology M&A
+1 650 354 4065
kiudicello@pmib.com

Jon Melzer
Global Co-Head of Industrials M&A
+1 212 450 2866
jon.melzer@duffandphelps.com

Brian Pawluck
Managing Director, Canada Restructuring
+1 416 364 9756
brian.pawluck@duffandphelps.com

Jim Rebello
Global Head of Energy M&A
+1 713 986 9318
james.rebello@duffandphelps.com

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