Quarterly Report
February 2018

Small Business Credit Outlook

Small Business on the Rise

After a long spell of inconsistent growth, Main Street America is finally stringing together several months of positive investment.

Investment in real estate, new factories, more capital equipment, more tools and more services will spur economic development through the knock-on effects and hiring that will accompany this investment. This positive investment will contribute to expansion in gross domestic product which will be an additive to the overall economic picture of the U.S.

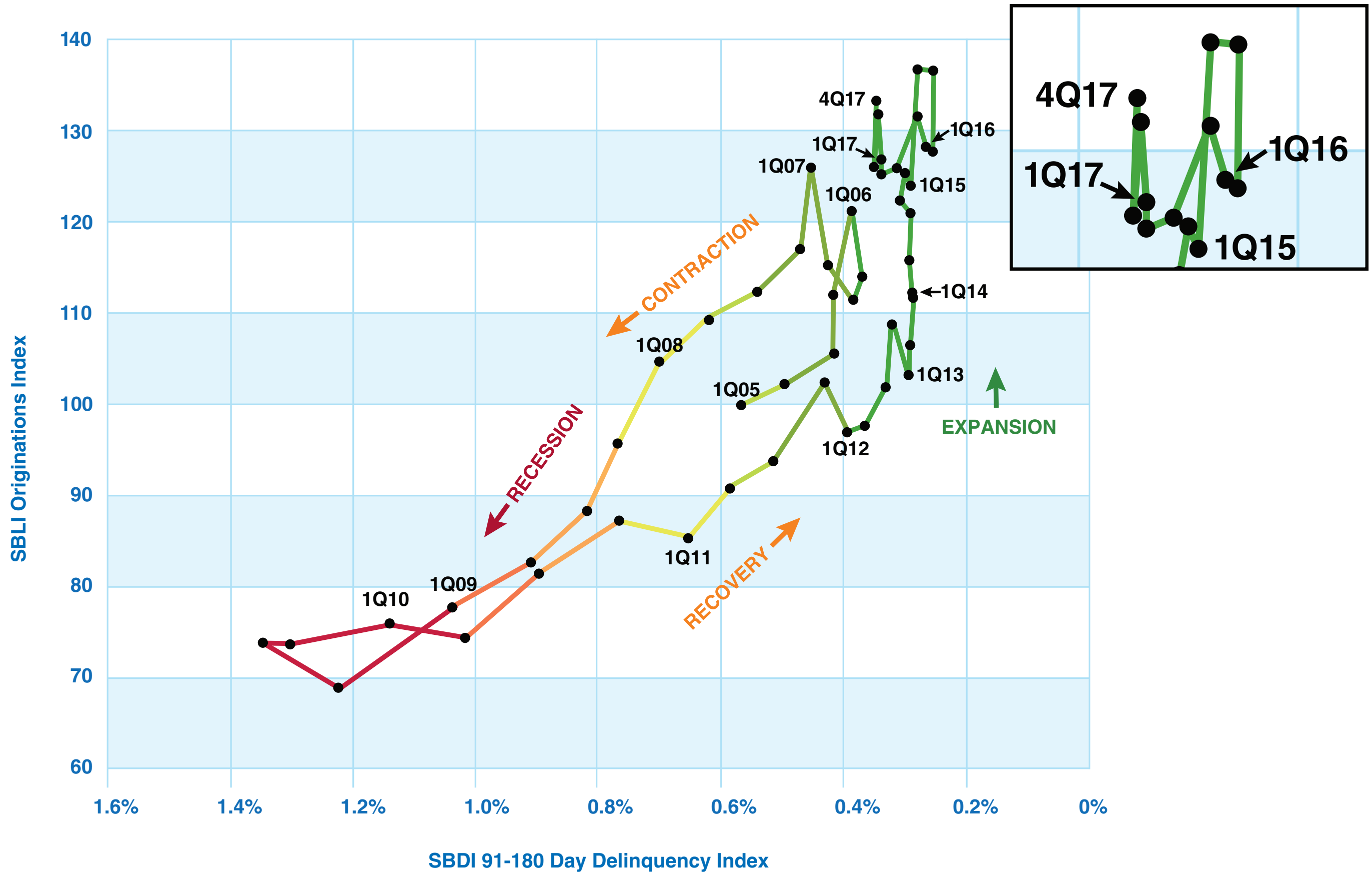
While this expansion is well received, putting it into longer-term perspective shows that it is still below the high point achieved in 2015 with lower credit risk.

Business Cycle

After a lackluster 2016 when it appeared that the expansionary cycle could end, private companies began investing again in 2017. This preserved the business cycle in its current expansion phase at low risk, albeit slightly higher risk (more on this below). The good news is the growth trend line (3 month moving average) has consistently expanded for each quarter in 2017.

Granted, the chart below is a little hard to read, but telescoping into the upper-right corner shows the see-saw pattern of the past few years. For two and one-half years (3Q15 to 4Q17), no material change in the levels of expansion has emerged. At the same time, credit risk has been creeping up as the levels of credit normalize to levels that are consistent with pre-recession levels.

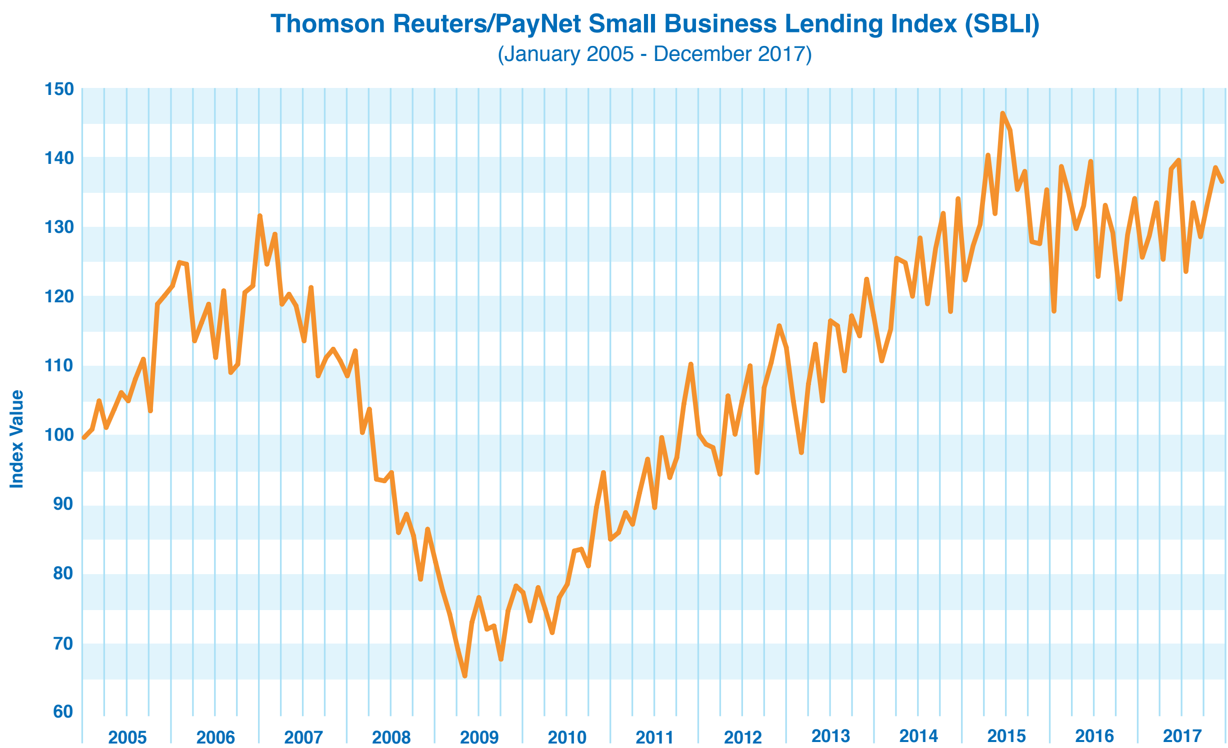
PayNet Small Business Cycle®



Recent Investment Activity

The Thomson Reuters/PayNet Small Business Lending Index (SBLI) decreased 1% in December compared to November but increased 2% versus one year ago.

On a three-month rolling basis, the SBLI was up 2% month-over-month and 7% year-over-year.



Credit Risk

The credit risk of private companies should inspire confidence in their financial health.

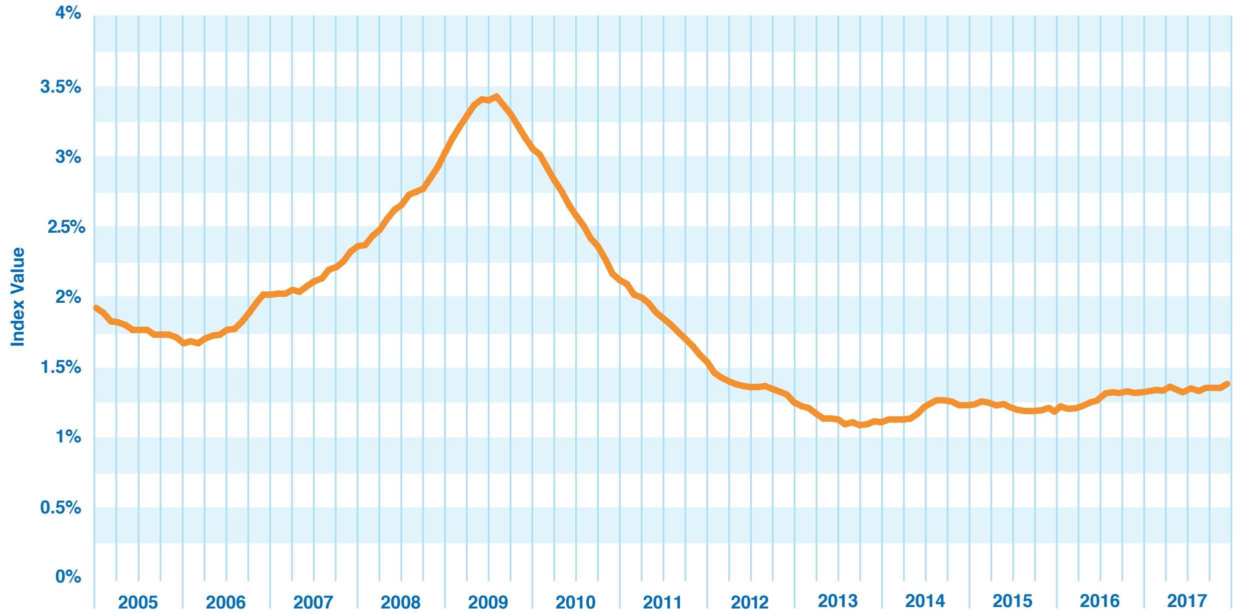
While the Thomson Reuters/PayNet Small Business Delinquency Index (SBDI) for loans 31-90 days past due increased 19 basis points since December 2015, it has only climbed 7 basis points since July 2016 to 1.38% in December 2017.

Four industries drove the increase in overall delinquency rates over the past 24 months – Agriculture (+27 bps), Construction (+35 bps), Retail (+26 bps), and Transportation (+36bps). However, in the past 17 months, while Agriculture, Construction and Transportation experienced much smaller increases, Transportation declined 26 bps.

Thomson Reuters/PayNet Small Business Delinquency Index (SBDI)

(31 - 90 Days Past Due)

(January 2005 - December 2017)



Industry Analysis

Over the last few months, certain industries and regions of the country have been faring better than others after a couple of months of more broad-based expansion.

Construction increased +2%, Transportation +3%, and Administrative and Waste Services +1% on a three-month quarter-over-quarter basis. Weaknesses are primarily in the services sector with declines in Information Services (-2%), Professional Services (-1%), and Health Care (-0.4%) on a three-month quarter-over-quarter basis.

PayNet Small Business Lending Index	
Industry Segment	**4Q 2017 vs. 3Q 2017 % Change**
Transportation	3.1%
Public Administration	1.9%
Agriculture	1.9%
Construction	1.6%
Administrative Services	1.2%
All Industries	1.1%
Real Estate	1.1%
Finance	0.7%
Retail	0.5%
Wholesale	0.4%
Other Services	0.3%
Accommodation and Food	0.0%
Education	-0.1%
Manufacturing	-0.2%
Health Care	-0.4%
Entertainment	-0.4%
Professional Services	-0.7%
Mining	-0.9%
Information	-2.1%

Regional Analysis

Expansion is becoming more broad-based geographically.

Nine of the ten largest states experienced growth from quarter to quarter led by Texas (+4%), North Carolina (+3%), and Ohio (+2%). The only one of the ten which declined was California (-0.2%). The quarter-to-quarter change for the US overall was +1%.

PayNet Small Business Lending Index	
State	**4Q 2017 vs. 3Q 2017 % Change**
Texas	3.7%
North Carolina	3.0%
Ohio	2.1%
Illinois	1.4%
Michigan	1.2%
U.S.	1.1%
Georgia	0.9%
New York	0.9%
Florida	0.7%
Pennsylvania	0.7%
California	-0.2%

Credit Risk Outlook

Overall, default rates remained essentially flat from 2016 to 2017 at 1.8%. Similar to how the Information Services sector has exhibited weakness in investment, default rates rose swiftly from 2.2% in 2016 to 3.1% in 2017. Real Estate and Accommodation & Food Services are also flashing warning signs with default rates rising moderately over the last couple of months and forecasted to increase in 2018 and 2019.

Conversely, the Mining and Transportation sectors are benefitting from turnarounds in economic conditions in their industries. Default rates fell sharply in the Mining, Oil & Gas sector from 4.9% in 2016 to 2.7% and are forecasted to continue to fall to 1.9% in 2018. Transportation defaults also declined from 4.2% in 2016 to 4.0% in 2017 and are forecasted to decrease further to 3.4% in 2018.

Historical and AbsolutePD® Forecast Default Rates

Industry Segment	Actual Historical Default Rates (1)		Forecast Default Rates (2)	
	2016	2017	2018	2019
Transportation	4.2%	4.0%	3.4%	3.4%
Information	2.2%	3.1%	3.1%	2.9%
Mining	4.9%	2.7%	1.9%	1.9%
Accommodation and Food	1.9%	2.3%	2.7%	2.9%
Agriculture	2.1%	2.1%	1.6%	1.6%
Construction	2.1%	2.1%	2.3%	2.3%
Health Care	1.8%	1.9%	2.1%	2.1%
Administrative Services	1.8%	1.9%	2.2%	2.1%
Manufacturing	1.8%	1.8%	1.8%	1.8%
Retail	1.9%	1.8%	2.0%	2.2%
Professional Services	2.1%	1.7%	1.8%	1.7%
Finance	1.4%	1.6%	1.6%	1.6%
Other Services	1.5%	1.6%	1.7%	1.8%
Real Estate	1.5%	1.5%	1.8%	1.9%
Wholesale	1.3%	1.5%	1.6%	1.7%
Entertainment	1.1%	1.1%	1.4%	1.6%
Education	0.9%	1.0%	1.6%	1.6%
Public Administration	0.9%	0.7%	1.8%	2.0%
All Industries	**1.8%**	**1.8%**	**2.0%**	**2.0%**

Source:
(1) PayNet Small Business Default Index
(2) PayNet AbsolutePD®

$1.0mm or Less in Total Lease/Loan Exposure

Summary

Ten years after the Great Recession, private companies still have not reverted to levels of risk-taking that are considered normal (consistent with long-term averages). What's good about this expansion cycle is that normalizing credit risk has not forced private companies into recession.

Just like the Federal Reserve Bank is undergoing a normalization of its balance sheet by selling securities, so too private businesses are slowly getting back to risk taking. The key is whether or not private companies continue to gain the confidence to put money to work and take higher risks. As you know, with risk-taking comes reward, but also higher credit losses.

How far private companies are willing to go on the risk-taking spectrum will continue to have profound effects on the level of GDP growth, hiring and wages. For now, we can say that the expansion phase of the cycle at low risk is still alive. We could realistically see two divergent paths forward: One that continues the current slow growth at low risk. Another that shows accelerating growth well above the current levels of the SBLI into the 160 to 170 range, but a dramatic shift towards higher credit losses.

The scars of the Great Recession where more than one in twenty businesses defaulted remain for private company owners. The odds are they will not rocket ahead at double-digit increases like the S&P 500 and high-tech stocks such as Alphabet, Apple, and Amazon.

Rather, private companies will likely continue to hit a lot of singles and doubles rather than swing for the fences. So slow growth at below average defaults seems to be the future. The credit correction for this sector will play out slowly over the next few years. Despite higher probabilities of default for Food & Accommodation and Retail private business, our forecast for defaults in 2019 remains below average at 2.0% for private businesses as a group.

About PayNet, Inc.

PayNet is the leading provider of credit ratings on small businesses enabling lenders to achieve optimal risk management, growth, and operational efficiencies. PayNet maintains the largest proprietary database of small business loans, leases, and lines of credit encompassing over 23 Million contracts worth more than $1.6 Trillion.

Using state-of-the-art analytics, PayNet converts raw data into real-time marketing intelligence and predictive information that subscribing lenders use to make informed small business financial decisions and improve their business strategy.

PayNet's small business capabilities range from historic credit-reporting and automated credit-scoring to detailed strategic business reviews that include portfolio risk measurement, default forecasting, peer benchmarking, and critical industry trend analysis.

PayNet Contact Information

PayNet, Inc.
5750 Old Orchard Rd., Suite 300
Skokie, IL 60077
866-825-3400

William Phelan
President
866-825-3400
bphelan@paynet.com

www.paynet.com

PayNet Risk Insight Suite®
www.sbinsights.net

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For more information
please call 866-825-3400
or visit sbinsights.net