



Quarterly Report  
May 2018

## Small Business Credit Outlook

### Go Main Street

Main Street stands firmly in expansion mode with recent releases showing big investment jumps at low risk. PayNet's May release shows that Main Street is stringing together another month of healthy investment increase. Especially notable is the pace of increase - neither too fast nor too slow.

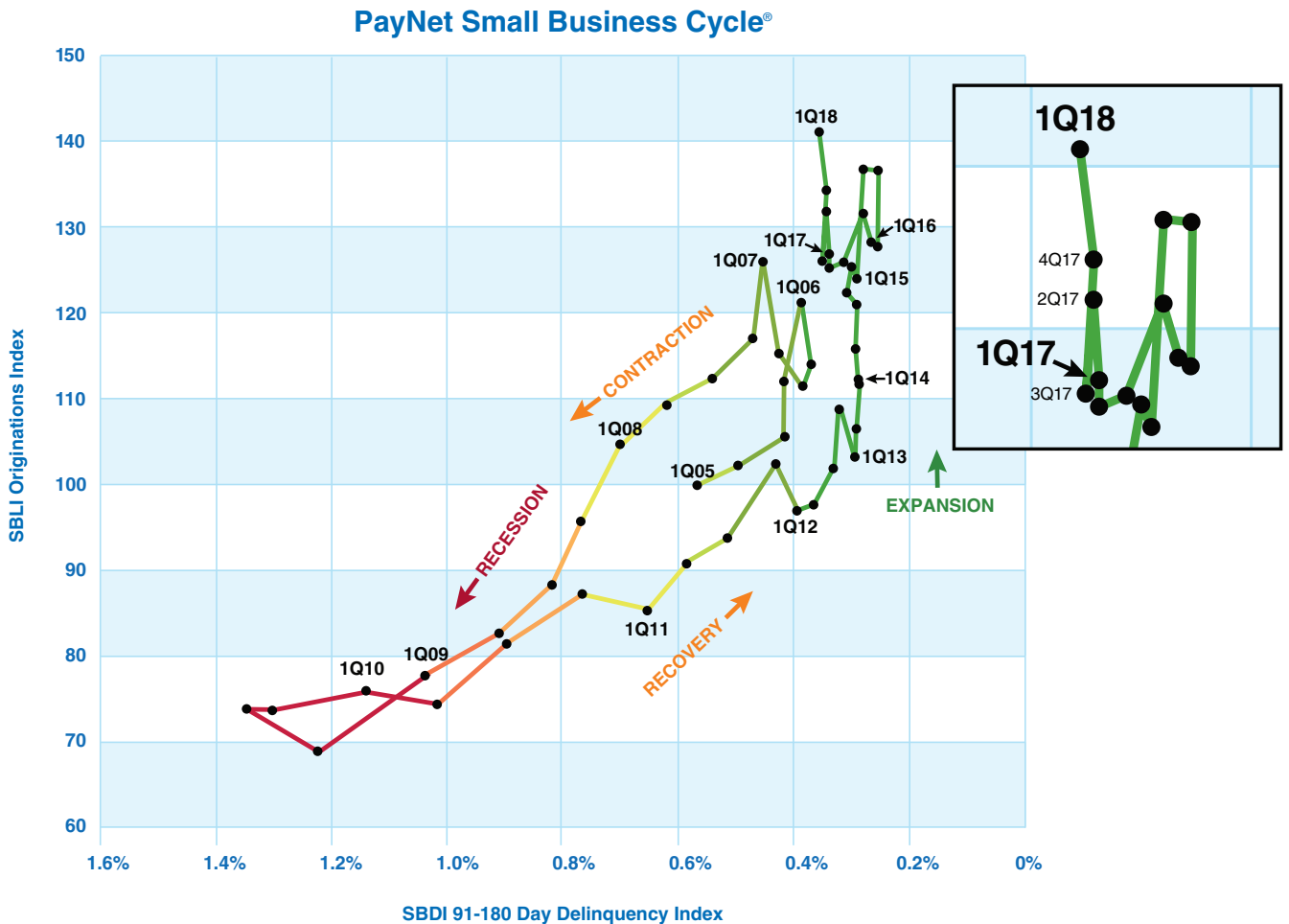
We also note that the business rule of "risk-reward" remains alive and well. Lending risk took another step higher in this release. After years of low-risk/low-growth, we are starting to see a decided change towards higher growth, and with it, higher credit risk.

As propelled by Main Street, it remains to be seen how high and how far this expansion will last, but we are sure that a return to more normal and higher levels of credit risk will follow.

### Business Cycle

The Expansion phase of the business cycle gained some new momentum in Q1 2018. The PayNet Small Business Cycle shows investment in Q1 exceeded 140 for the first time. At the same time, risk remains relatively modest. Loans severely past due have increased from the low point of 0.25% in 2015.

However, the increase in severe risk remains modest. It has risen just 12 basis points to 0.37%. As a result, the business cycle looks quite healthy from a risk-reward standpoint at this point in time. Expansion at the low-risk phase of the business cycle is alive and well.



### Recent Investment Activity

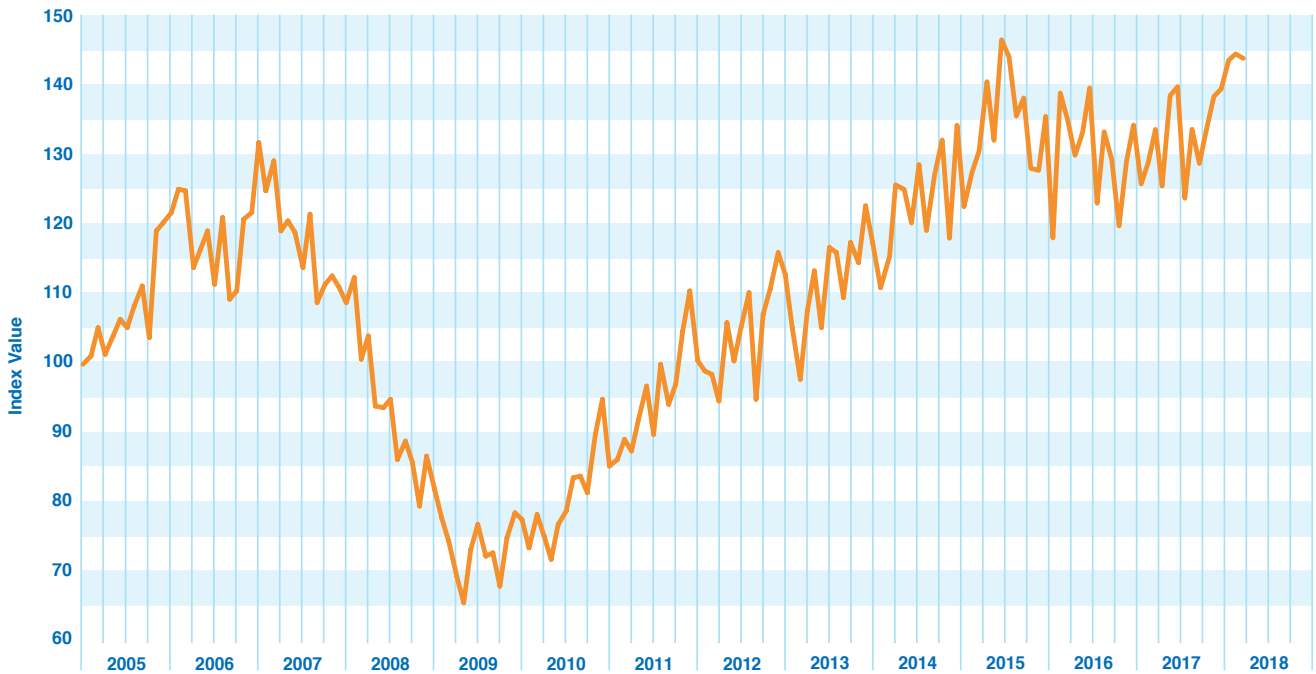
The Thomson Reuters/PayNet Small Business Lending Index (SBLI) seasonally adjusted originations decreased slightly from 144.5 in February 2018 to 143.9 in March 2018.

Compared to the same month one year ago, the Index is up 8%. March represents the sixth

continuous month of increases, and with this report, we see that the trend-line growth rate is now into double-digits for Main Street investment.

### Thomson Reuters/PayNet Small Business Lending Index (SBLI)

(January 2005 - March 2018)



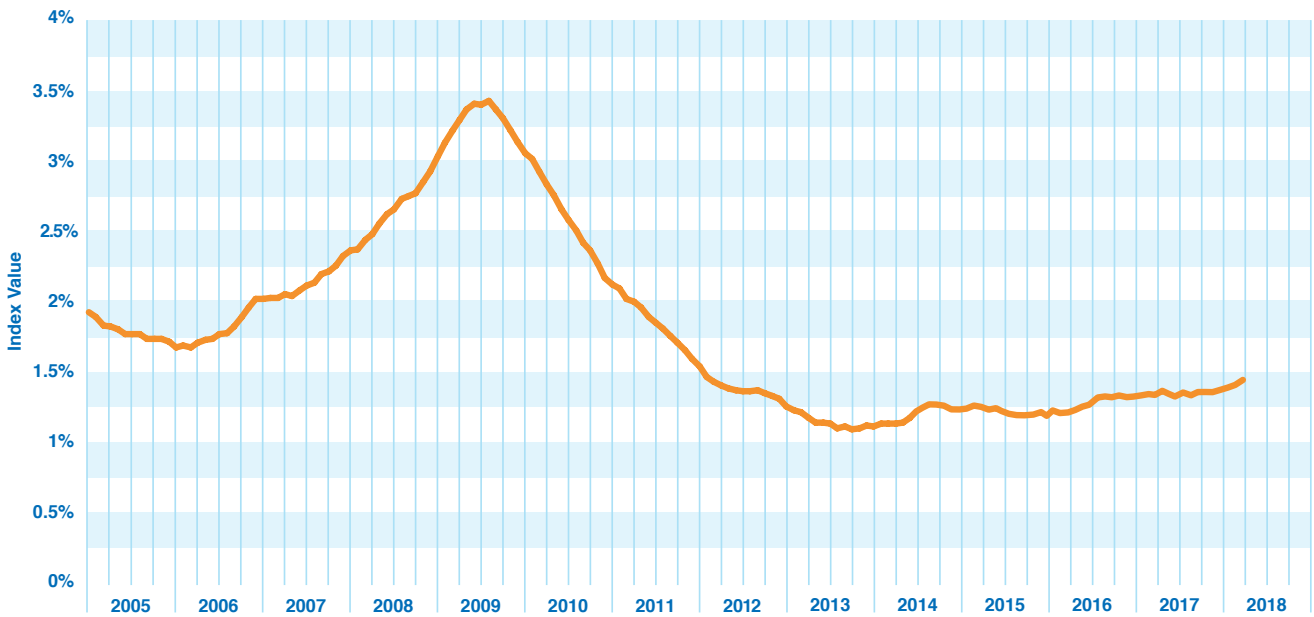
### Credit Risk

The Thomson Reuters/PayNet Small Business Delinquency Index (SBDI) 31-90 days past due increased 3 bps from 1.41% in February 2018 to 1.44% in March 2018. This is its highest level since April 2012.

As compared to one year ago, delinquency increased by 10 bps (8%). Default rates remained flat month-over-month with the PayNet Small Business Default Index (SBDFI) at 1.84% for March 2018. Compared to a year ago, the Index is down 4 basis points.

In looking at specific industry sectors, Information Services defaults rose swiftly by +19 bps since last month. Conversely, default rates continue to fall rapidly in the Transportation (-19 bps) sector and the Mining, Oil, and Gas (-14bps) sector from last month, as both sectors continue to benefit from turnarounds in economic conditions in their respective industries.

**Thomson Reuters/PayNet Small Business Delinquency Index (SBDI)**  
 (31 - 90 Days Past Due)  
 (January 2005 - March 2018)



## Industry Analysis

Results show solid investment support from several sectors. Transportation increased +9.85%, Mining +13.38%, and Construction +6.88% compared to this time last year.

Weaknesses are noticeable primarily in the services sectors with declines from March 2017 in Information Services (-11.08%), Accommodation & Food Services (-5.21%), and Professional Services (-2.26%).

Main Street is being driven by a broad increase among the major industry sectors. Professional Services remains the only sector of the Top 6 (representing nearly two-thirds of the private company economy) that is in contraction. The five in expansion mode are:

- Real Estate and Rental and Leasing
- Health Care and Social Assistance
- Finance and Insurance
- Manufacturing
- Construction

## Regional Analysis

Expansion is becoming more broad based geographically. Eight of the ten largest states experienced material growth over the prior year. North Carolina (+12.83%), and Texas (+10.80%) and Ohio (+8.54%) led the largest ten states.

The only one of the ten which declined was Georgia (-0.38%).

For the U.S. overall, the quarter-to-quarter change was +1.57%.

| PayNet Small Business Lending Index                                      |              |
|--|--------------|
| Industry Sector  | YoY % Change |
| Mining, Quarrying, and Oil & Gas Extraction                              | 13.38%       |
| Transportation and Warehousing   | 9.85%        |
| Construction   | 6.88%        |
| Public Administration  | 5.52%        |
| Arts, Entertainment, and Recreation                                      | 4.12%        |
| Rolling 12 Month   | 3.81%        |
| Wholesale Trade  | 3.54%        |
| Administrative and Support and Waste Management and Remediation Services | 3.17%        |
| Agriculture, Forestry, Fishing and Hunting                               | 2.49%        |
| Retail Trade   | 1.51%        |
| Health Care and Social Assistance  | 1.44%        |
| Finance and Insurance  | 0.58%        |
| Other Services (except Public Administration)                            | 0.42%        |
| Real Estate and Rental and Leasing                                       | 0.28%        |
| Manufacturing  | 0.13%        |
| Educational Services   | -0.86%       |
| Professional, Scientific, and Technical Services                         | -2.26%       |
| Accommodation and Food Services  | -5.21%       |
| Information  | -11.08%      |

| PayNet Small Business Lending Index |              |
|-------------------------------------|--------------|
| State                               | YoY % Change |
| North Carolina                      | 12.83%       |
| Texas                               | 10.80%       |
| Ohio                                | 8.54%        |
| Michigan                            | 8.01%        |
| Illinois                            | 5.69%        |
| U.S.                                | 3.81%        |
| Florida                             | 3.41%        |
| New York                            | 3.36%        |
| California                          | 1.34%        |
| Pennsylvania                        | 0.62%        |
| Georgia                             | -0.38%       |

## Credit Risk Outlook

| Historical and AbsolutePD® Forecast Default Rates |  |             |                                       |             |
|---|--|-------------|---------------------------------------|-------------|
| Industry Segment                                  | Actual Historical Default Rates <sup>(1)</sup> |             | Forecast Default Rates <sup>(2)</sup> |             |
|   | 2016   | 2017        | 2018*                                 | 2019        |
| Transportation                                    | 4.2%   | 4.1%        | 3.5%                                  | 3.7%        |
| Information                                       | 2.2%   | 3.1%        | 3.5%                                  | 3.2%        |
| Mining  | 4.9%   | 2.7%        | 2.1%                                  | 2.2%        |
| Accommodation and Food                            | 1.9%   | 2.3%        | 2.9%                                  | 3.1%        |
| Agriculture                                       | 2.1%   | 2.1%        | 2.0%                                  | 1.8%        |
| Construction                                      | 2.1%   | 2.1%        | 2.5%                                  | 2.6%        |
| Health Care                                       | 1.8%   | 2.0%        | 2.2%                                  | 2.2%        |
| Administrative Services                           | 1.8%   | 1.9%        | 2.3%                                  | 2.3%        |
| Retail  | 1.9%   | 1.9%        | 2.0%                                  | 2.3%        |
| Manufacturing                                     | 1.8%   | 1.8%        | 2.0%                                  | 2.1%        |
| Professional Services                             | 2.1%   | 1.7%        | 1.9%                                  | 2.0%        |
| Finance   | 1.4%   | 1.6%        | 1.6%                                  | 1.9%        |
| Other Services                                    | 1.5%   | 1.5%        | 1.8%                                  | 2.0%        |
| Real Estate                                       | 1.5%   | 1.5%        | 2.0%                                  | 2.2%        |
| Wholesale   | 1.3%   | 1.5%        | 1.7%                                  | 1.9%        |
| Entertainment                                     | 1.1%   | 1.1%        | 1.4%                                  | 1.7%        |
| Education   | 0.9%   | 1.0%        | 1.5%                                  | 1.8%        |
| Public Administration                             | 0.9%   | 0.7%        | 1.6%                                  | 2.2%        |
| <b>All Industries</b>                             | <b>1.8%</b>                                    | <b>1.8%</b> | <b>2.1%</b>                           | <b>2.2%</b> |

Source:

(1) PayNet Small Business Default Index

(2) PayNet AbsolutePD®

\$1.0mm or Less in Total Lease/Loan Exposure

\*2018 Forecasts include 1 Quarter of actual defaults

## Summary

A clear shift to risk-taking is underway for Main Street as private companies have shifted out of lack-luster growth to record levels of investment. This shift has been documented in our prior releases.

Investment is clearly on a fast pace to double-digit levels on a trend-line. All but 4 of the major industry groups are expanding, and this expansion is no longer generated solely by the Construction sector. The major expansion in the Transportation sector signals that more goods are moving back and forth.

The more broad-based investment among multiple industry sectors and across multiple geographical areas is indicative of a more diversified and stronger Main Street economy. As mentioned earlier, more investment means more risk taking.

Higher levels of risk are already showing through increased loans past due. Paired with higher investment, signs clearly point to higher default rates. Our AbsolutePD is picking up these signals with forecasted defaults rising to 2.1% in 2018.

### 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 24 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.

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