2016 Q3

Small Business Credit Outlook

Fasten Your Seat Belts!!!

The outcome of the November 8 election should lift some of the uncertainty that has pervaded the small business sector for much of 2016. While many of President-elect Trump's policies remain undefined, the election provides certainty on the current administration.

Small business can start to plan now that they know the direction on taxes, lower healthcare costs, and regulations. This administration's plans for big public-infrastructure programs and higher defense spending will create opportunities for many firms.

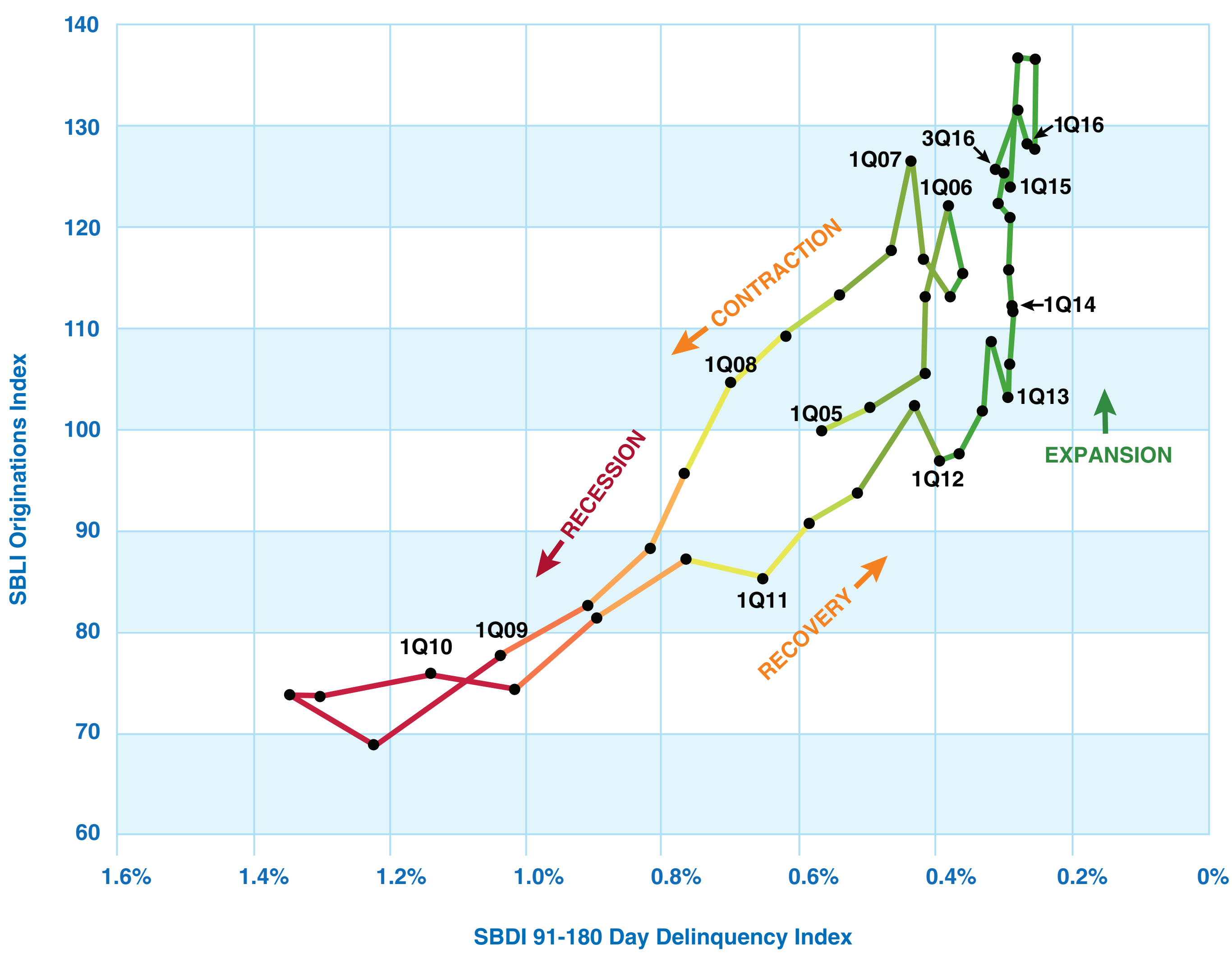
Business Cycle

Small businesses are well placed to take advantage of these growth-oriented policies. Their finances are, by and large, in good shape.

Many have held back on new investments during the recent period of uncertainty, so they now have some financial firepower in reserve, and will have even more if taxes fall and the regulatory burden lightens.

The business cycle has remained in a low-risk expansion mode through this election cycle. We see that a downturn in investment in Q4 2016 means less risk-taking by small businesses. The good news is that financial health remains strong. As a result, the business cycle, even with the investment pullback, remains in expansion at low risk.

PayNet Small Business Cycle



Recent Investment Activity

Many small businesses played possum ahead of the election, waiting for the political dust to settle before making decisions on hiring and on investment in new plant and equipment. The Thomson Reuters/PayNet Small Business Lending Index fell to 121.3 in October. This is a 5% drop from October 2015 and the seventh month of year-over-year declines so far this year.

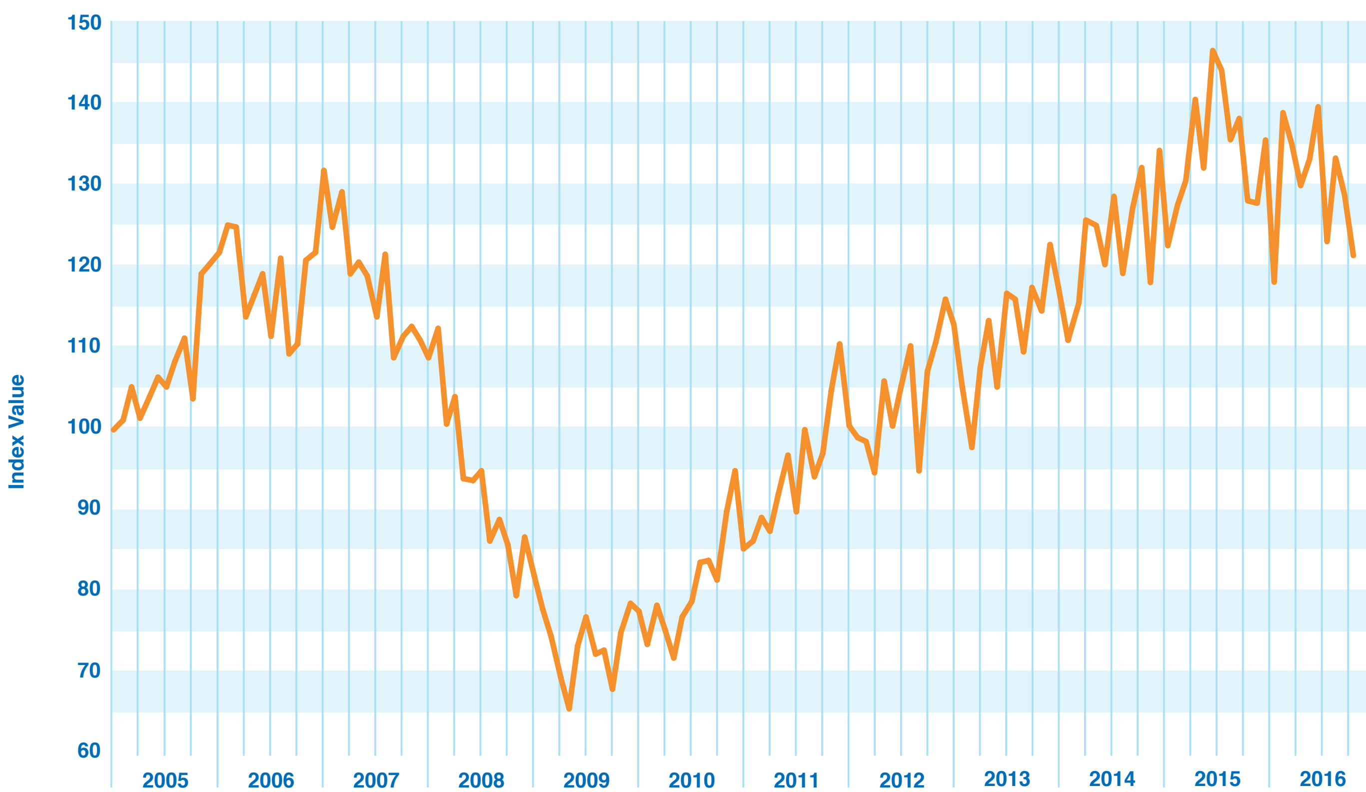
The silver lining is that the severity of the fall has been moderate. We can say with some confidence that the contraction is more a reflection of business owners' hesitancy to invest prior to the election, rather than the signal of a major economic shift.

While economically sensitive sectors remain in contraction, the good news is that the pace of decreases is slowing. Agriculture, Accommodation & Food, and Mining showed less contraction, falling 13.7%, 7.3%, and 8.6%, respectively. As a bright sign, Arts & Entertainment increased 11.2%, and Construction increased 9.0% to lead the sectors.

Even so, some words of caution are in order. It may be a while before the full picture of the new economy takes effect, given that some key elements - such as tax cuts - require Congressional approval. As we all know, Congress seldom moves quickly.

Thomson Reuters/PayNet Small Business Lending Index (SBLI)

(January 2005 - October 2016)



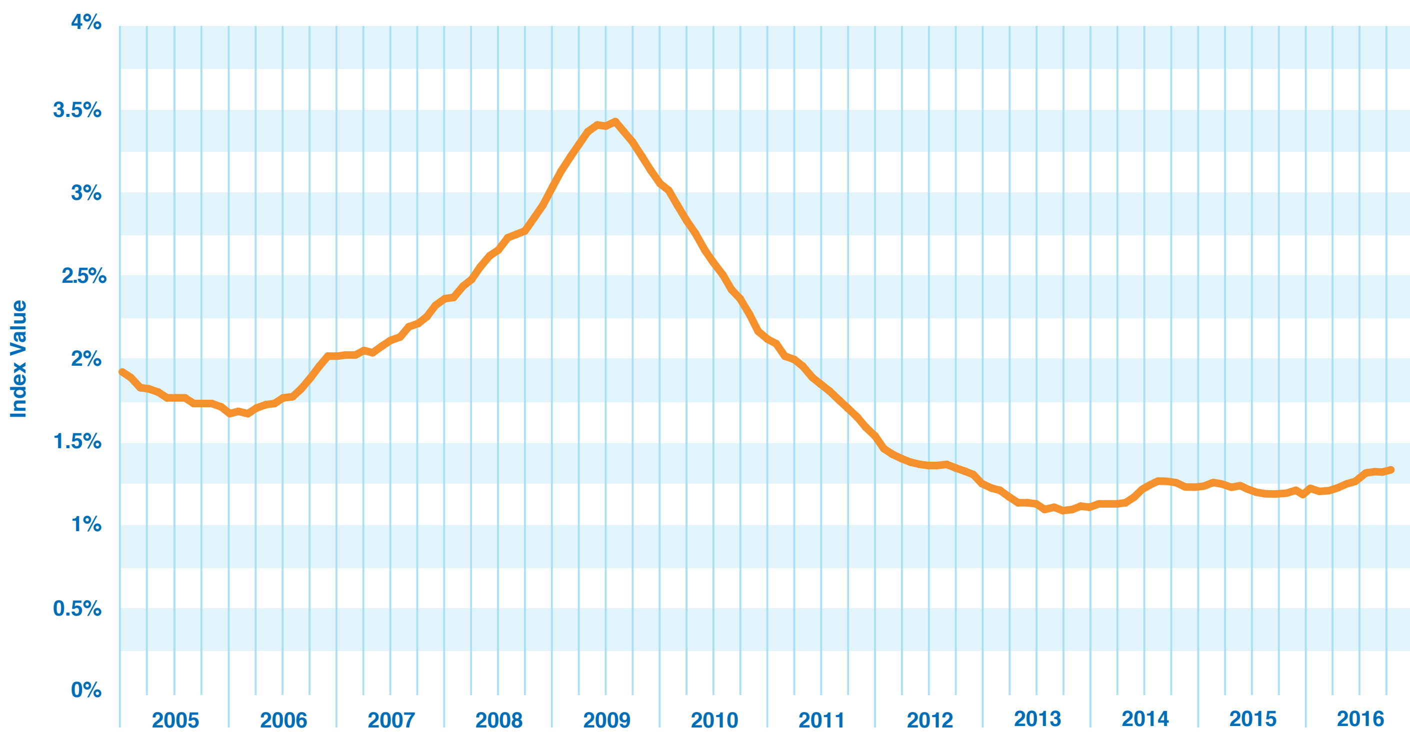
Credit Risk

The combination of tax cuts and higher fiscal spending on infrastructure may boost economic growth, but such a massive fiscal stimulus will also push up the budget deficit and public debt. The result is that the Fed could raise interest rates faster than seemed likely just a month or two ago. Thus, businesses carrying heavy debt burdens may come under pressure, leading to higher delinquency rates. We should expect some deterioration in the credit quality of loans that fund small business, especially in 2018 and 2019, depending on how fast rates climb.

The Thomson Reuters/PayNet Small Business Delinquency Index 31-90 days past due rose 2 basis points (bps) from 1.32% in September 2016 to 1.34% in October - its highest level since December 2012. The delinquency rate was 15 bps higher in October than a year earlier, making the sixth straight month of year-over-year increases. The Transportation sector's delinquency rate was up 2 bps to 1.87% - its 20th monthly advance in a row and its highest level since September 2011. Retailers' delinquencies climbed by 6 bps to 1.27% - their highest level since April 2013. All segments posted a deterioration from September 2016.

The Thomson Reuters/PayNet Small Business Delinquency Index 91-180 days past due rose 2 bps from 0.32% in September 2016 to 0.34% in October - its highest level since August 2012. This Index has now gone for 14 months without a drop in delinquencies. It was up 9 bps in October from a year earlier, the largest year-over-year increase since February 2010. The Transportation sector's delinquency rate moved up for the 14th consecutive month, rising 3 bps to 0.71% - its highest level since April 2011. The Healthcare sector's delinquencies were up 4 bps in October to 0.36% - the highest since April 2013. All segments were up or flat compared to September.

Thomson Reuters/PayNet Small Business Delinquency Index (SBDI)
(31 - 90 Days Past Due)
(January 2005 - October 2016)

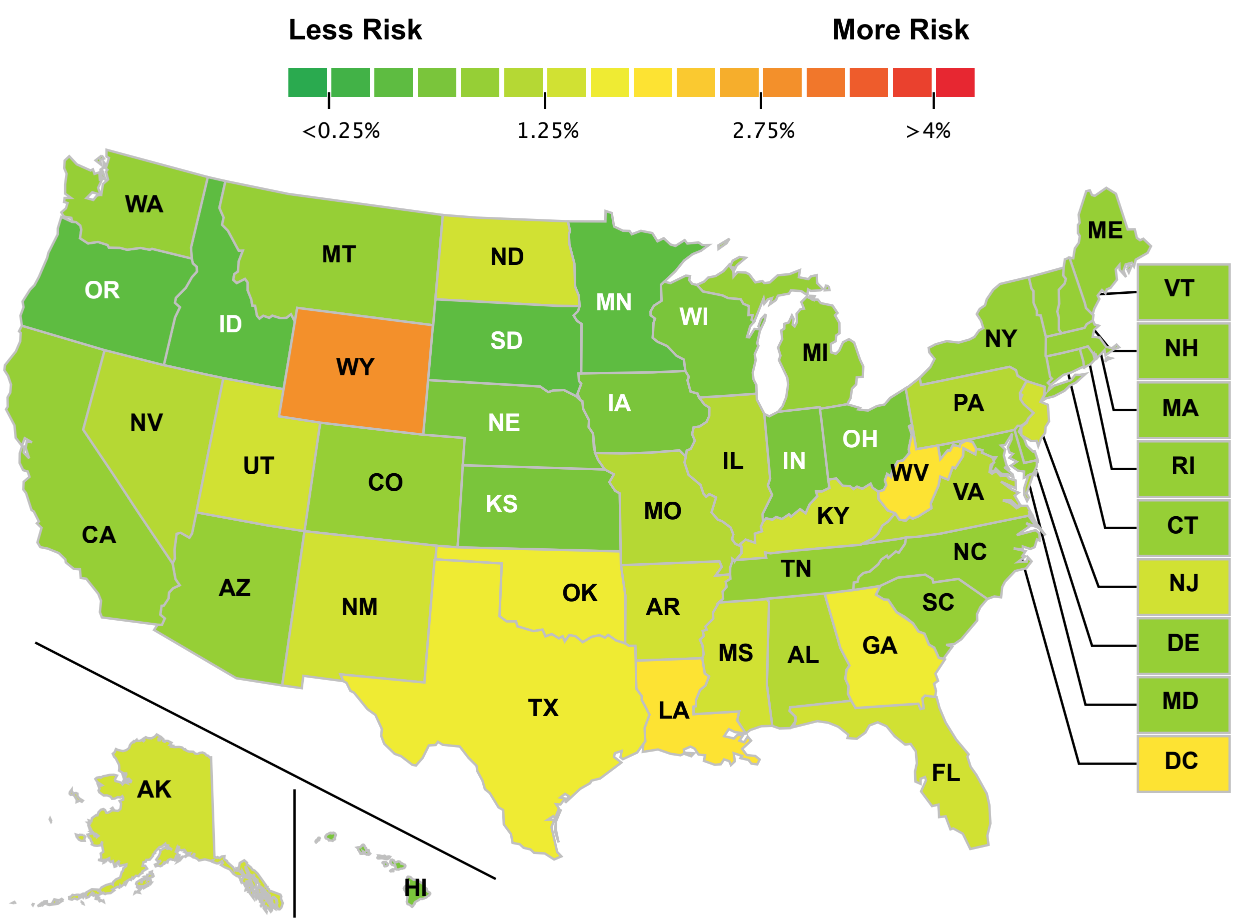


Regional Credit Risk

The 10 biggest states follow the trend for national investing and credit risk with the majority of states showing decreases in investment. Six of the ten largest states showed decreases of -8.7% (Illinois) to -2.2% (Pennsylvania). In between, we see California, Texas, Ohio, and Michigan.

States showing positive increases in investments remain those in the South and Southeast where the recovery was slowest to take hold. Florida (4.7%), North Carolina (3.4%), Georgia (2.8%), and New York (2.6%) are increasing the most of the biggest states. Much of this trend towards growth in the Southeast and pulling back in the Midwest is due to cyclical factors in the economy such as commodities and agriculture.

Small Business Delinquency Index as of Oct-2016



PAYNET®

Credit Risk Forecast

We are forecasting more defaults of private businesses in 2016. While defaults are expected to rise to 1.9% in 2016, based on current levels of GDP and interest rates, we expect them to remain about flat to slightly lower in 2017. The data shows defaults ended 2015 at 1.5% which remains some of the lowest default rates on record for private small companies.

Industry sectors showing the largest default increases remain the most cyclical. Transportation and Warehouse companies are showing a spike to 5% in 2016 which follows the increase in loans past-due for these businesses. Defaults of Mining companies will jump to above average in 2016 to 4.3%. Agriculture firms also show a material rise in defaults to 2.1% in 2016 from 1.4% in the 2015. More business investment and rising loans past-due will likely result in more defaults in the next several years.

Historical And AbsolutePD® Forecast Default Rates

Industry Segment	Actual Historical Default Rates (1)		Forecast Default Rates (2)	
	2014	2015	2016*	2017
Transportation	2.4%	2.6%	5.0%	3.1%
Information	2.6%	2.5%	2.2%	1.9%
Mining	1.3%	2.3%	4.3%	1.9%
Retail	1.7%	1.8%	1.8%	1.7%
Construction	1.7%	1.8%	2.1%	2.0%
Professional Services	1.6%	1.7%	2.0%	1.7%
Health Care	1.8%	1.7%	1.8%	1.7%
Administrative Services	1.9%	1.6%	1.8%	1.8%
Accommodation and Food	1.6%	1.6%	1.8%	2.1%
Manufacturing	1.5%	1.5%	1.8%	1.5%
Agriculture	0.9%	1.4%	2.1%	1.8%
Wholesale	1.3%	1.3%	1.3%	1.5%
Finance	1.2%	1.2%	1.6%	1.4%
Other Services	1.2%	1.2%	1.5%	1.6%
Real Estate	1.4%	1.0%	1.5%	1.6%
Entertainment	1.0%	0.9%	1.2%	1.7%
Education	1.1%	0.8%	1.1%	2.0%
Public Administration	0.5%	0.6%	0.9%	1.7%
All Industries	**1.5%**	**1.5%**	**1.9%**	**1.7%**

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

$1.0mm or Less in Total Lease/Loan Exposure
*2016 Forecasts Include 3 Quarters of Actual Defaults

Summary

The bottom line? Put on your seat belts for a roller-coaster ride. Small business should expect more excitement and more sharp turns than we have seen in recent years.

Conditions for lending and new investment should generally become more positive, but there may be a few fender-benders along the way. We are already seeing a jump in investment by small businesses.

What remains to be seen is whether or not this leads to higher loans past-due and lower credit quality. The business climate seems to already be undergoing rapid change. The likely trends point to more risk taking which will most likely lead to lower credit quality.

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 $1.4 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

WEB
www.paynet.com

PAYNET RISK INSIGHT SUITE®
www.sbinsights.net

PAYNET®

Taking the Risk Out of
Small Business Lending

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