MAIN ST REPORT

Your window into small business health

Q3 2016

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About the report

Developed by Experian, the leading global information services company, and Moody's Analytics, the Experian/Moody's Analytics Main Street Report brings deep insight into the overall financial well-being of the small-business landscape, as well as providing commentary around what certain trends mean for credit grantors and the small-business community as a whole. Key factors comprised by the Main Street Report include a combination of business credit data (credit balances, delinquency rates, utilization rates, etc.) and macroeconomic information (employment rates, income, retail sales, investments, etc.).

Executive summary

Small-business credit declined slightly in the third quarter, led by the mining and transportation/utility industries. Businesses have access to plenty of credit, and utilization rates remain low. The low delinquency/bankruptcy environment combined with low utilization rates leads to an overall positive outlook over the next several quarters. However, this optimism could change rapidly if interest rates rise or slow economic growth persists. Agriculture and construction credit remain bright points in the small-business credit outlook. Despite some downside risks, the sectors remain stable and well-positioned for growth.

Small Business Credit Conditions in Q3 Remained Positive

Delinquency rates stabilize

Third-quarter delinquency rates were essentially unchanged from the second quarter. While this broke the trend of improving performance from earlier in the year, there is no cause for concern — some payback for the second quarter was in store given the across-the-board declines in bankruptcies. Credit conditions in most industry subcategories improved as well, with only the mining and transportation/utility industries bucking the trend.

Delinquencies rose in three of four categories, with severe delinquencies declining from 5.6 percent to 5.4 percent. This is consistent with the improving environment for the economy as a whole in the third quarter. Tempering some of the enthusiasm, early stage delinquencies rose in the quarter. This could be a precursor to increases in severe delinquencies in the fourth quarter.

Performance weakens in the center of the country

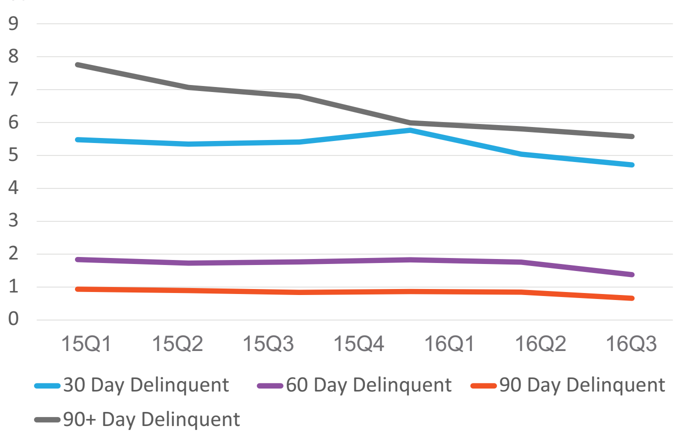
States in the Upper Plains region experienced some of the largest increases in small-business bankruptcy rates in the country. Connecticut's bankruptcy rates rose the fastest in the third quarter, owing in large part to increases in bankruptcies in the wholesale industry.

Bankruptcy rates declined fastest in Oregon, falling by 3 basis points in the quarter. The improvement was broad-based across all industries in the state. Oregon's bankruptcy rate is slightly higher than the national average for small businesses, so a decline in bankruptcies is helping to bring the state closer to the national average.

Bankruptcy rates increased fastest in West Virginia and North Dakota, with Maine rounding out the top three states . Weakness

Severe delinquencies continue to trend down

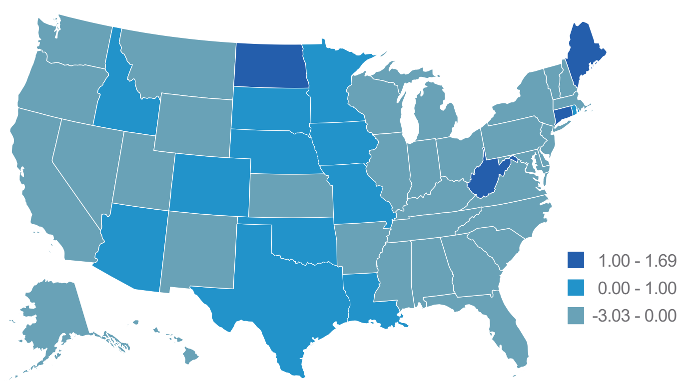
% small business credit trades



Source: Experian, Moody's Analytics

Bankruptcy rates stable to improving

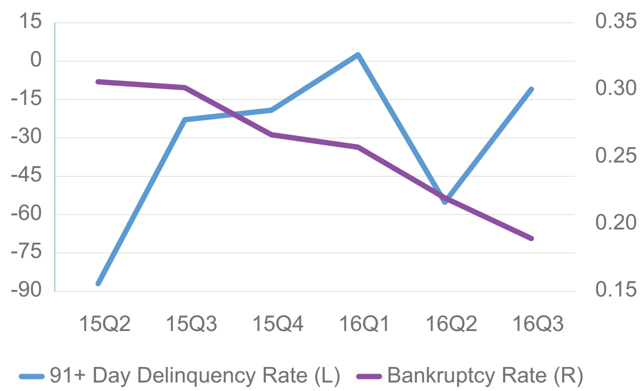
Qtr/qtr difference in bankruptcy rates by state, basis points



Source: Experian, Moody's Analytics

Oregon credit conditions most improved in Q3

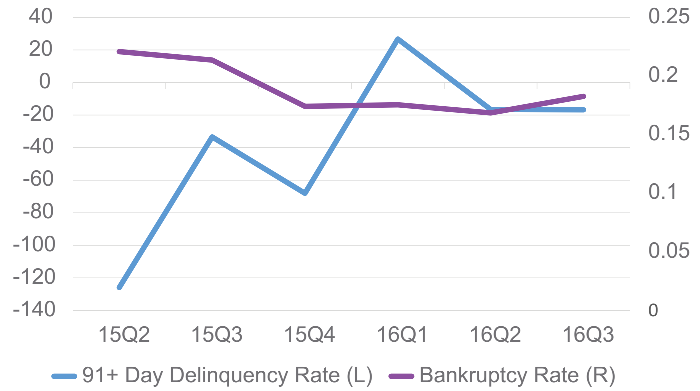
Qtr ago difference in rates, % of outstanding trades, basis points



Source: Experian, Moody's Analytics

Maine is third in the nation for bankruptcies

Qtr ago difference in rates, % of outstanding trades, basis points



Source: Experian, Moody's Analytics

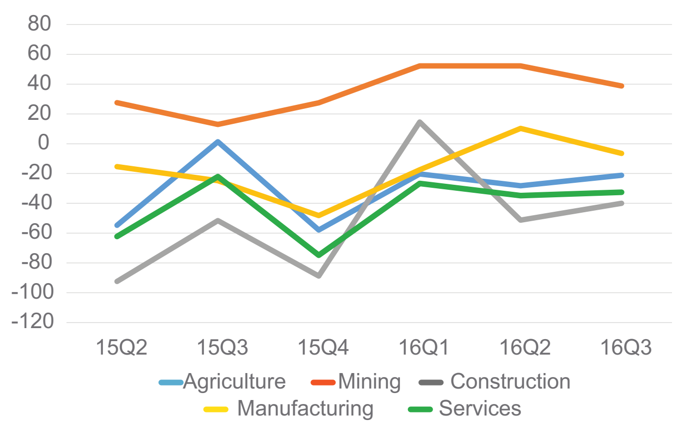
in the energy sector drove the deterioration in West Virginia and North Dakota, but the reasons behind Maine's weakness aren't so clear cut. Looking deeper into the data, we find that increasing delinquency and bankruptcy rates among transportation and utility companies were the driving force for Maine's overall increase in bankruptcies.

Shifting industry patterns

The mining industry — which includes petroleum and gas exploration — experienced the largest increase in severe delinquencies and bankruptcies in the third quarter across all industries, albeit at a slower pace than in the second quarter. The transportation and utility industries experienced a second straight quarter wherein the severe delinquency rate increased. Bankruptcies in these industries didn't increase nationally for the quarter, but several states did experience significant increases. Among the states experiencing increases were Oklahoma, New Hampshire and New Mexico, which experienced rising bankruptcy rates of 9.5, 8.4 and 7.7 basis points, respectively.

Mining delinquencies deterioration slows

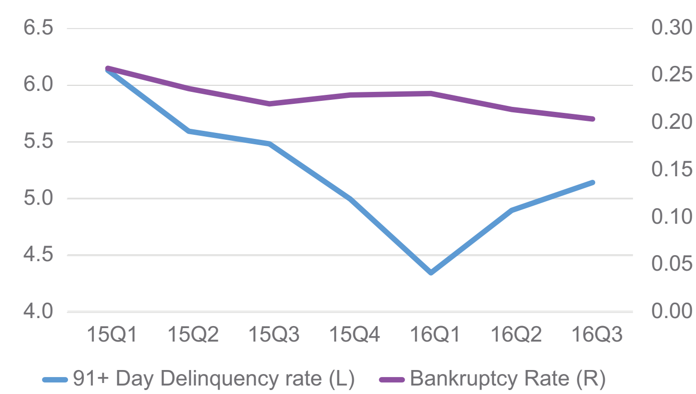
Qtr ago difference in 91+ day delinquency rate, basis points



Source: Experian, Moody's Analytics

Transport/Utility bankruptcies edge lower

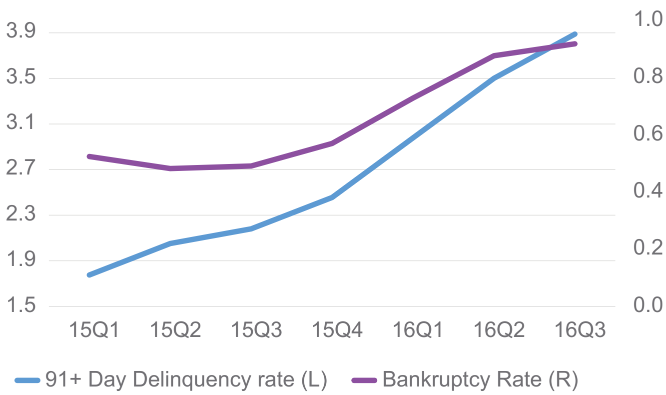
Qtr ago difference in rates, % of outstanding trades, basis points



Source: Experian, Moody's Analytics

Mining industry bankruptcies continue ascent

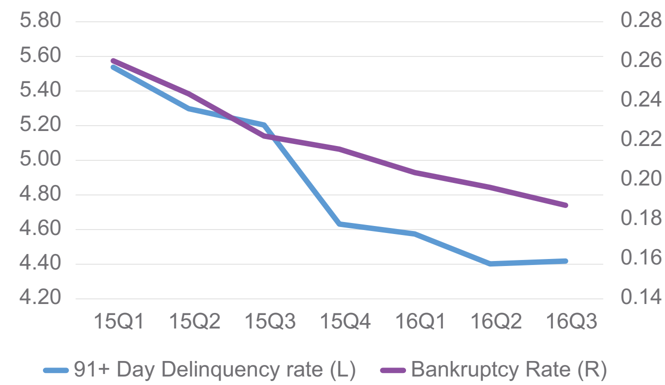
Qtr ago difference in rates, % of outstanding trades, basis points



Source: Experian, Moody's Analytics

Wholesale severe delinquencies level off

Qtr ago difference in rates, % of outstanding trades, basis points



Source: Experian, Moody's Analytics

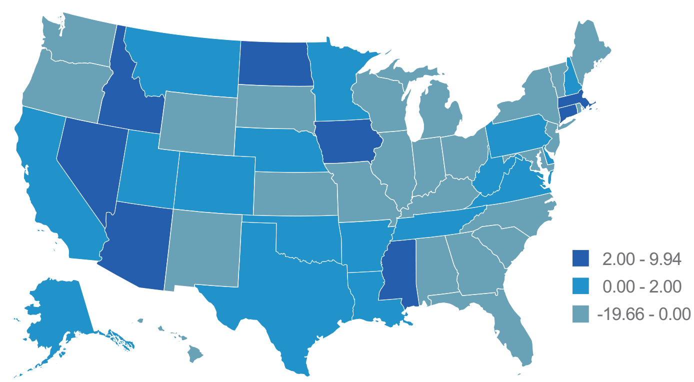
The wholesale industry saw delinquencies level off in the third quarter. However, some states, such as Connecticut, saw large increases in wholesale bankruptcies. Connecticut's wholesale bankruptcy rate increased by almost 10 basis points, moving it into the top five states with the highest bankruptcy rates among wholesalers.

Despite the dip in commodity prices over the last year, severe delinquencies and bankruptcies in the agricultural sector remain low. Agriculture has been one of the strongest credit sectors among small businesses, with some of the lowest delinquency and bankruptcy rates over the past year. Prices received by farmers have been falling for most of the year, but this has been largely offset by the input prices paid by farmers.

While loans to companies in the agriculture industry showed signs of trouble in the Mid-Atlantic and Northeast regions in the second quarter, the trouble spread west in the third quarter. For instance, Arizona's bankruptcy rate for small agricultural businesses rose to 0.12 percent from .09 percent. Bankruptcies in the agriculture industry rose over last quarter's levels in Colorado, New Mexico, Nevada and Idaho as well.

Wholesale bankruptcies rise in connecticut

Qtr/qtr difference in bankruptcy rates by state, basis points



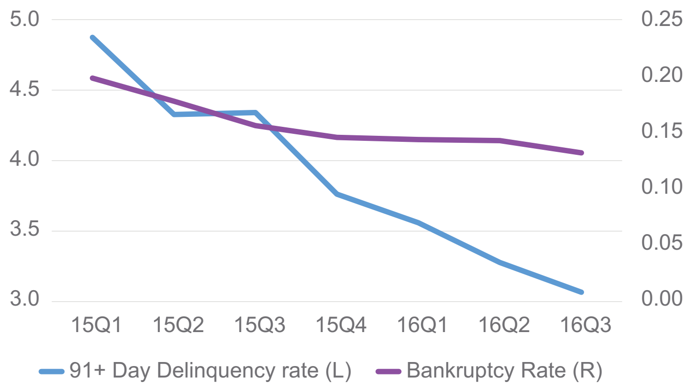
Source: Experian, Moody's Analytics

Utilization falls as available credit expands

Overall, business credit quality in the third quarter was stable to improving. Performance on loans to small companies in the mining industry has been troublesome for some time, given that oil prices have remained low. With oil prices expected to rise modestly going forward, loan performance should improve. Producers will benefit from higher prices if OPEC is able to successfully cap production at its next meeting. Even without a cap, oil prices should firm over the next year as demand rises in the United States and in other countries. If these trends hold, the worst of the credit cycle downturn in the mining industry will have passed.

Input prices push agriculture delinquencies down

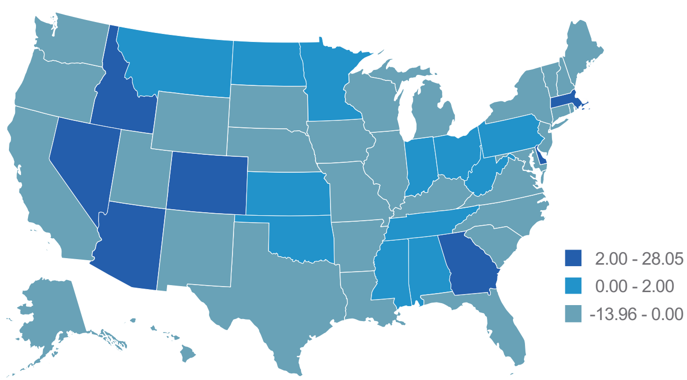
Qtr ago difference in rates, % of outstanding trades, basis points



Source: Experian, Moody's Analytics

Agriculture bankruptcies move out west

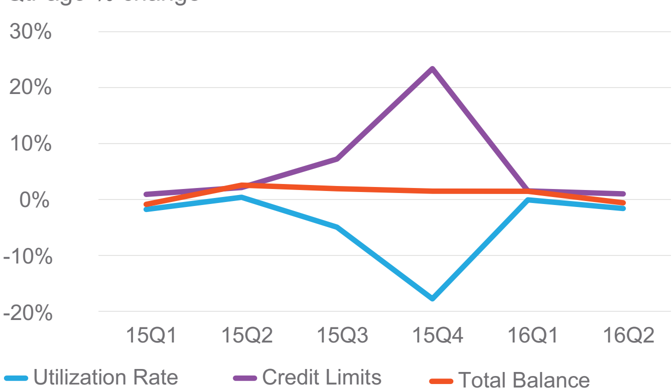
Qtr/qtr difference in bankruptcy rates by state, basis points



Source: Experian, Moody's Analytics

Credit utilization's continues to decline

Qtr ago % change



Source: Experian, Moody's Analytics

The next area of concern looks to be the transportation and utility industries. The last couple of quarters haven't been kind to these sectors, which are heavily dependent on the mining industry. Until the mining industry fully stabilizes and recovers, performance among transportation and utility companies will continue to suffer.

Credit utilization rates among small businesses continued to fall in the third quarter, maintaining the trend that has been in place over the last year. Utilization decreased as the amount of credit available to businesses rose by slightly more than 1 percent, while drawn balances fell by 0.6 percent. The utilization rate now stands at just under 49 percent, leaving small businesses with plenty of room to maneuver should they need — or want — to draw on their credit lines.

Risks weighted to the upside

Given global economic uncertainties, businesses and credit providers must be vigilant in their assessment of risk. Small businesses tend to rely on the credit of owners and loans as their primary sources of financing. In the event of downside shocks, these firms will be particularly vulnerable, given that they may not have the financial cushion enjoyed by larger businesses. Over the next few quarters, the primary downside risks to small businesses include slow growth domestically and political uncertainty. Upside risks include rising oil prices — to the extent they help the mining sector without significantly harming other industries — and the continued strength of the U.S. labor market. Tightening labor market conditions will put upward pressure on wages, which in turn will support additional consumption by households.

Now that the election is over, some of the media buzz may fade, providing a boost to consumer and business confidence. But the issues that have been so hotly contested will linger. Policy uncertainty will remain elevated as potential reforms to issues such as immigration and taxation are proposed. As the current expansionary cycle matures, policy will likely play an increasing role in promoting growth. Increased infrastructure spending — an issue that both political parties agree on — could fuel additional growth, as could tax reform. The failure of government to address key structural issues such as immigration reform could impede growth going forward and cause businesses to cut back on strategic investments. Small businesses may be particularly hard hit given their inability to diversify outside the U.S. market.

The Federal Reserve is likely to produce headwinds to the economy with expected rate hikes coming next year. The hikes would be a reflection of a strengthening economy that is increasing the demand for the goods and services provided by small businesses. However, the hikes will raise the cost of financing for small businesses, leading some to either constrain or postpone some investment.

Rising prices for energy commodities, oil in particular, will help to improve the credit position of small businesses in the mining and transportation industries. These two industries were hit hard by the commodity downturn and are having an outsized impact on delinquencies in the small-business space. As prices for the goods produced by the mining industry and serviced by the transportation industry rise, delinquencies will fall.

The labor market remains the brightest star in the current economic climate. Payrolls grew by 161,000 in October. While a bit weaker than growth earlier this year, the pace of growth exceeds the number of jobs needed to keep up with population growth. The pace of growth is strong enough that businesses of all sizes are reporting difficulty in finding qualified workers as the pool of eligible workers is absorbed. This bodes well for rising incomes as firms compete for workers, and for higher business receipts to follow as people spend their larger incomes.

It's an old cliché that a rising tide lifts all boats, but that doesn't make it any less true. As the fortunes of Americans rise with the strengthening labor market, they will look to use their purchasing power, and small businesses will be ready to provide their goods and services to compete in their respective markets. Currently, the risks seem weighted to the upside, but there are also downside risks that must be monitored and addressed.

Cautious optimism for Q4

Overall, the third quarter was a continuation of stable credit conditions for businesses that began earlier this year. The transportation and utility industries look to be operating on a lag to the mining industry and therefore are expected to experience higher delinquency and bankruptcy rates over the next few quarters. The labor market remains the saving grace of the economy, small business included. As more jobs are added and incomes rise, increased consumer spending should boost overall demand.

In the fourth quarter, businesses may delay investment and possibly hiring decisions while they await further information about what the next administration's policies will be. This will slow balance growth and lead to lower utilization rates. Delinquencies are also expected to decline as strong personal balance sheets enable small-business owners to continue paying their bills on time. Overall, the fourth quarter is set to be positive for credit conditions, but further out, there are risks to watch for on the horizon.

About Experian's Business Information Services

Experian's Business Information Services is a leader in providing data and predictive insights to organizations, helping them mitigate risk and improve profitability. The company's business database provides comprehensive, third-party-verified information on 99.9 percent of all U.S. companies. Experian provides market-leading tools that assist clients of all sizes in making real-time decisions, processing new applications, managing customer relationships and collecting on delinquent accounts. For more information about Experian's advanced business-to-business products and services, visit **www.experian.com/b2b**.

About Moody's Analytics

Moody's Analytics helps capital markets and risk management professionals worldwide respond to an evolving marketplace with confidence. The company offers unique tools and best practices for measuring and managing risk through expertise and experience in credit analysis, economic research and financial risk management. By providing leading-edge software, advisory services, and research, including the proprietary analysis of Moody's Investors Service, Moody's Analytics integrates and customizes its offerings to address specific business challenges. Moody's Analytics is a subsidiary of Moody's Corporation (NYSE: MCO), which reported revenue of $3.5 billion in 2015, employs approximately 10,900 people worldwide and maintains a presence in 36 countries. Further information is available at **www.moodysanalytics.com.**

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