# Phoenix Management Services
# "Lending Climate in America" Survey

## 3rd Quarter 2019
## Summary, Trends and Implications

# PHOENIX
# "LENDING CLIMATE IN AMERICA"

## 3rd Quarter 2019

## SUMMARY, TRENDS AND IMPLICATIONS

1. **In the midst of the current trade war with China, U.S. factory activity in August 2019 contracted for the first time since January 2016. Purchasing and supply executives responded in a survey conducted by the Institute for Supply Management that trade was their "most significant issue." How do you expect borrowers will be affected in the next 6-12 months?**

   Garnering the highest percentage of responses (69%), were lenders that expect borrowers will be moderately affected by the current trade war with China with a slight increase in borrower costs and modest impact to liquidity. Of the lenders surveyed, 23% expect borrowers will be minimally affected and that consumer spending will remain strong and support businesses through temporary uncertainty, while 8% of lenders surveyed expect borrowers to be strongly affected with increasing tension, uncertainty, and tariffs to lead to significantly higher costs, severe liquidity constraints, and a noticeable increase in defaults.

2. **The U.S. economy could take any number of directions in the next 12 months. Within the last month consumer prices rose 0.3%, 164,000 jobs were added, and unemployment has remained near a 50 year-low at 3.7%, all while U.S. stocks have rallied after the resumption of trade talks with China. Do you think consumer behavior will be the key to a continued strong economy?**

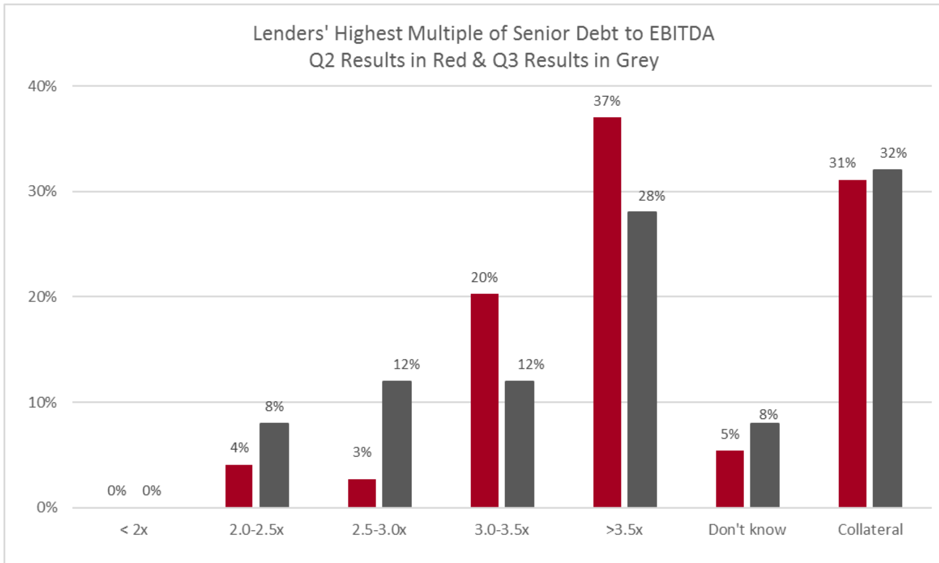
   The answer that received the highest percentage response, 77% were the lenders that agree that consumer behavior will be the key to a continued strong U.S. economy and if hiring remains steady and the unemployment rate stays low, the consumer will be a strong foundation to keeping the economy positive. Of the lenders surveyed, 23% disagree and believe there are other variables that will have greater impact on the U.S. economy's strength.

3. **Experts estimate, by 2028, 2.4 million manufacturing jobs could remain vacant due to labor shortage. Currently, manufacturers are promising a major training commitment to upskill nearly 1.2 million workers. The roles of the future will largely require backgrounds in science, technology, engineering, and math. Companies are looking to provide their employees with the opportunity to develop and enhance their skills, in hopes to keep a competitive edge and retain their employees. Do you think companies will be able to reduce the current labor shortage by investing to upskill their laborers?**

   Lenders garnering 81% of responses agree that companies will be able to reduce the current labor shortage by investing to upskill their laborers. Of the lenders surveyed, 19% disagree, and do not believe that companies will be able to reduce the current labor shortage by investing to upskill their laborers.

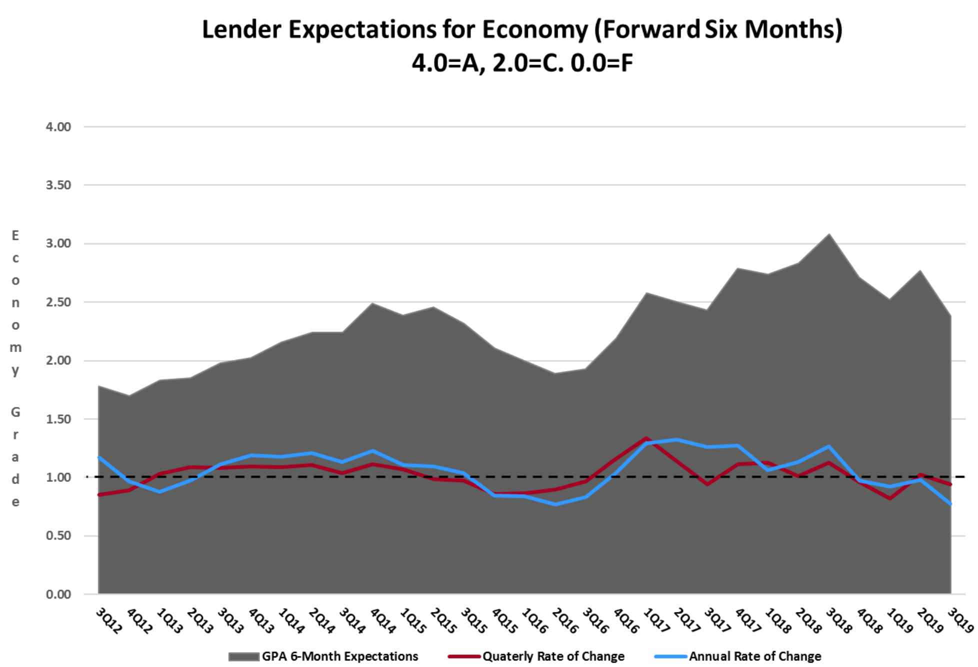
4. **Lenders reduced their highwater leverage multiples this quarter.**

   Leverage multiples shifted in Q3 2019 with 28% of lenders indicating that the >3.5x range would be the highest EBITDA ratio they would consider versus 37% in Q2 2019. The percentage of respondents who would consider a debt to EBITDA ratio of 3.0-3.5x decreased to 12% from the previous quarter's results of 20%. The percentage of lenders who indicated the highest ratio they would consider is between 2.5-3.0x increased 9 percentage points to 12%, and 32% of lenders responded that they were collateral lenders and therefore do not make decisions based on cash flow/leverage multiples.



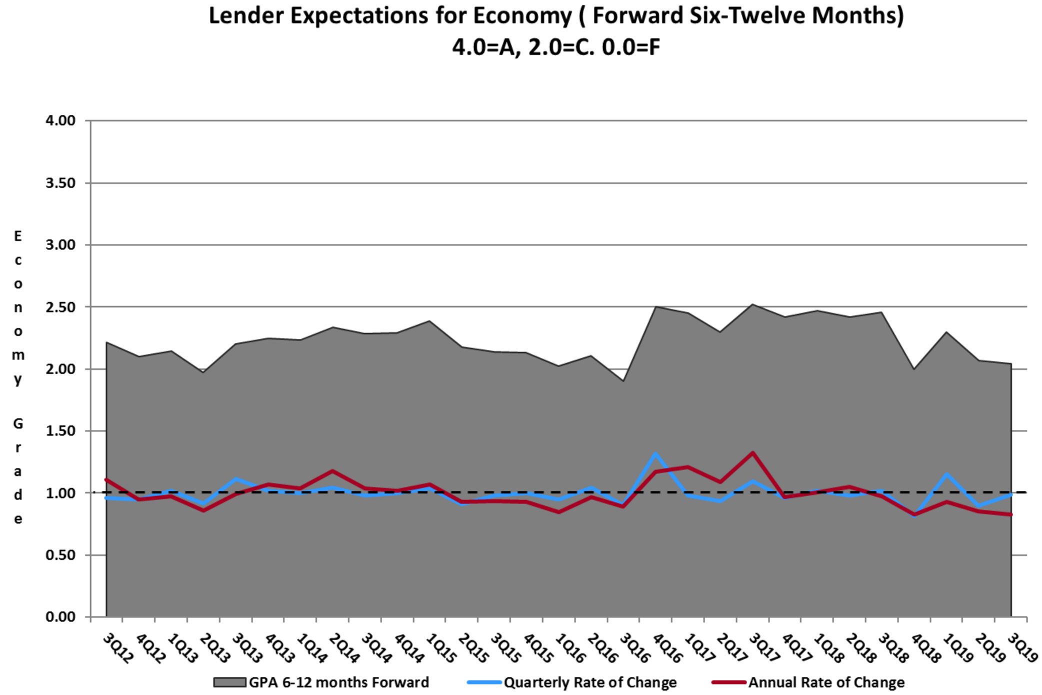

## 5. Near term economic performance expectations decreased in this quarter's survey.

Lenders optimism in the U.S. economy for the near term decreased this quarter to a GPA of 2.38 in Q3 2019 from the Q2 2019 results of 2.77. 46% of the lenders believe the economy will perform at a "B" level over the next six months, compared to 64% in the previous survey. Of the lenders surveyed, 46% also expect the U.S. economy to perform at a "C" grade, compared to 29% in the previous survey, and 8% of the lenders surveyed believe that the economy will perform at a "D" level.



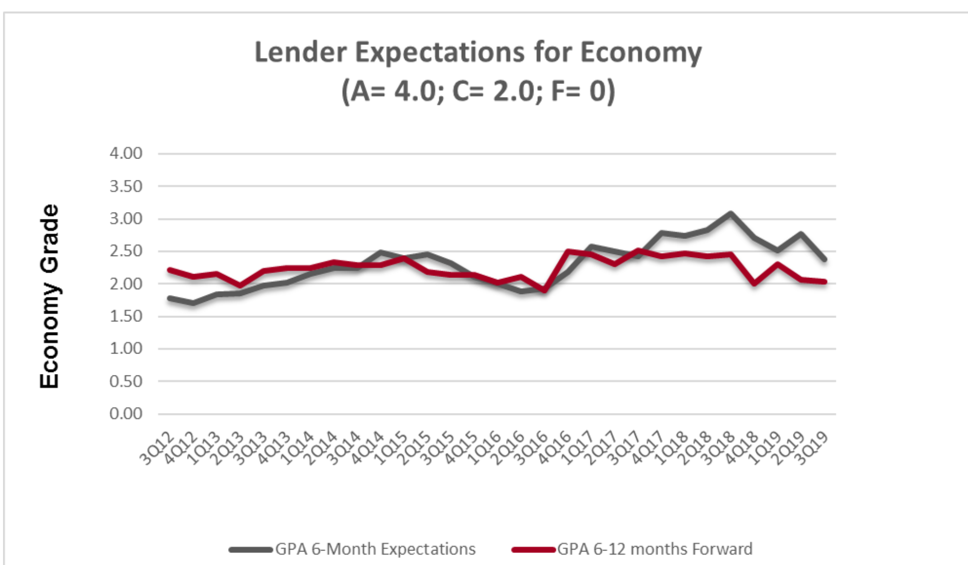

**** Rate of Change of 1.0 is at equilibrium and signifies "no change" from the corresponding prior period of comparison.***

Lenders growth expectations for the U.S. economy beyond six months slightly decreased this quarter. The weighted average decreased to a 2.04 GPA from 2.07 in the previous quarter. 33% of lenders believe the economy will perform at a "B" level in the next six to twelve months. The percent of lenders (38%) that believe the economy will perform at a "C" level decreased 9 percentage points from the previous quarter. However, the percentage of respondents who believe the economy will perform at a "D" level beyond the next six months increased from 23% to 29%.




** Rate of Change of 1.0 is at equilibrium and signifies "no change" from the corresponding prior period of comparison.*

The Q3 2019 survey continues the trend of a higher near-term GPA than long term GPA. Lenders are becoming pessimistic about the U.S. economy in both the near and long term as the GPA's for each has decreased.



# Phoenix Management Services
# “Lending Climate in America”
# 3rd Quarter 2019

## Survey Results

### 1. The majority of Lenders believe borrowers will be moderately affected by the current trade war with China and expect a slight increase in borrower costs.

Lenders were asked: In the midst of the current trade war with China, U.S. factory activity in August 2019 contracted for the first time since January 2016. Purchasing and supply executives responded in a survey conducted by the Institute for Supply Management that trade was their "most significant issue." How do you expect borrowers will be affected in the next 6-12 months?

| | |
|---|---|
| Moderately affected. Expect a slight increase in borrower costs and modest impact to liquidity. | 69% |
| Minimally affected. Expect consumer spending (or other factors) to remain strong and support businesses through temporary uncertainty. | 23% |
| Strongly affected. Expect increasing tensions, uncertainty, and tariffs to lead to significantly higher costs, severe liquidity constraints and a noticeable increase in defaults. | 8% |

### 2. The majority of lenders agree that consumer behavior will be key to a continued strong economy.

Lenders were asked: The U.S. economy could take any number of directions in the next 12 months. Within the last month consumer prices rose 0.3%, 164,000 jobs were added, and unemployment has remained near a 50 year-low at 3.7%, all while U.S. stocks have rallied after the resumption of trade talks with China. Do you think consumer behavior will be the key to a continued strong economy?

| | |
|---|---|
| Agree - if hiring remains steady and the unemployment rate stays low, the consumer will be a strong foundation to keeping the economy positive. | 77% |
| Disagree- there are other variables that will have greater impact on the economy's strength. | 23% |

### 3. The majority of lenders agree that companies will be able to reduce the current labor shortage by investing to upskill their laborers.

Lenders were asked: Experts estimate, by 2028, 2.4 million manufacturing jobs could remain vacant due to labor shortage. Currently, manufacturers are promising a major training commitment to upskill nearly 1.2 million workers. The roles of the future will largely require backgrounds in science, technology, engineering, and math. Companies are looking to provide their employees with the opportunity to develop and enhance their skills, in hopes to keep a competitive edge and retain their employees. Do you think companies will be able to reduce the current labor shortage by investing to upskill their laborers?

| | |
|---|---|
| Agree | 81% |
| Disagree | 19% |

## 4. Highest Senior Debt to EBITDA Leverage Institutions Would Consider

Respondents were asked the highest multiple of Senior Debt to EBITDA their financial institution would consider with regard to a loan request.

| EBITDA Level | 2Q 2019 | 3Q 2019 |
|---|---:|---:|
| Greater than 3.5x | 37% | 28% |
| Between 3.01x and 3.50x | 20% | 12% |
| Between 2.51x and 3.00x | 3% | 12% |
| Between 2.01x and 2.50x | 4% | 8% |
| Less than 2.0x | 0% | 0% |
| Collateral lenders | 31% | 32% |
| N/A | 5% | 8% |

## 5. Anticipated Change in Senior Debt to EBITDA Multiple

Respondents were asked, over the next six months, how the Senior Debt to EBITDA multiple would change at their financial institution.

| Change in Senior Debt to EBITDA Level | 2Q 2019 | 3Q 2019 |
|---|---:|---:|
| Increase greater than 0.5x | 1% | 0% |
| Increase less than 0.5x | 5% | 12% |
| Decrease less than 0.5x | 11% | 12% |
| Decrease greater than 0.5x | 3% | 0% |
| No change | 41% | 36% |
| Collateral lenders | 31% | 24% |
| N/A | 8% | 16% |

## 6. Factors with Strongest Potential to Affect Near-Term Economy

Respondents were asked, over the next six months, which two factors had the strongest potential to affect the economy.

| Factors Affecting Near-Term Economy | 2Q 2019 | 3Q 2019 |
|---|---:|---:|
| Stability of Stock Market | 47% | 56% |
| Other | 27% | 40% |
| Constrained Liquidity in Capital Markets | 27% | 32% |
| Unstable Energy Prices | 27% | 28% |
| U.S. Budget Deficit | 23% | 20% |
| Sluggish Housing Market | 39% | 8% |

## 7. Industries Expected to Experience Greatest Volatility

Respondents were asked, over the next six months, which industries will experience the most volatility (i.e. Chapter 11 filings, mergers and acquisitions, declining profits, etc.). Respondents were asked to select the top three industries.

| Industries Experiencing Most Volatility | 2Q 2019 | 3Q 2019 |
|---|---:|---:|
| Retail Trade | 73% | 67% |
| Manufacturing | 22% | 58% |
| Healthcare and Social Assistance | 34% | 33% |
| Construction | 37% | 29% |
| Transportation and Warehousing | % | 25% |

## 8. Customers' Plans in the Next Six to Twelve Months

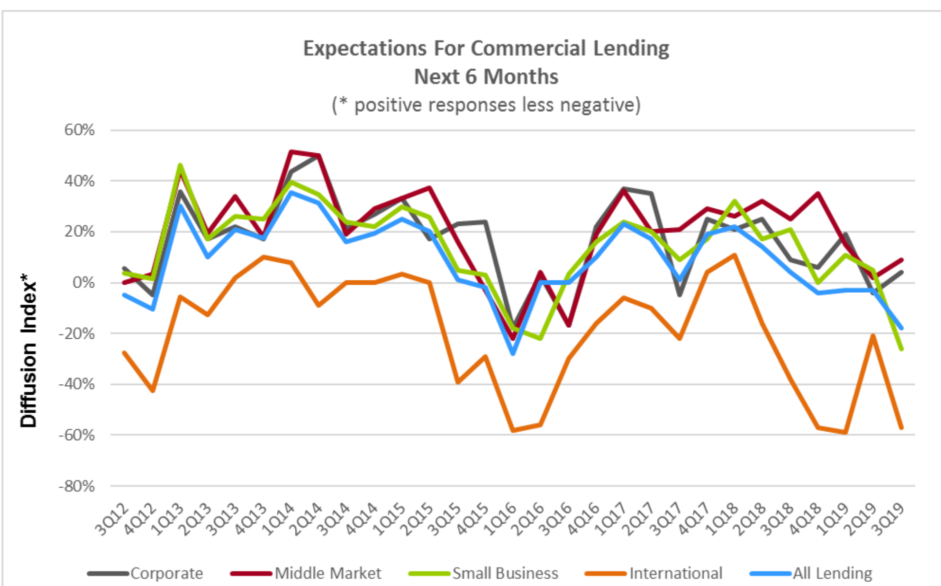
Respondents were asked which of the following actions their customers planned in the next six to twelve months. Lenders were asked to designate all potential customer actions that applied.

| Customers' Plans | 2Q 2019 | 3Q 2019 |
|---|---:|---:|
| Capital Improvements | 65% | 52% |
| Introducing New Products or Services | 38% | 52% |
| Entering New Markets | 32% | 39% |
| Making an Acquisition | 52% | 35% |
| Raising Additional Capital | 51% | 35% |
| Hiring New Employees | 55% | 30% |
| "Other" Initiatives | 6% | 9% |

## 9. Economic Indicators

Respondents were asked whether they expected the following economic indicators to be up, down, or remain the same over the next six months.

- In Q3 2019, lenders optimism increased in large corporate (4%) and middle market (9%), however, expectations for small business saw a significant decrease (-26%). Expectations for international lending also significantly decreased in Q3 2019 with a diffusion index of -57%, a 36-percentage point difference from the previous quarter of -21%. The diffusion index for the average for domestic lending decreased to -57%.



| | 2Q/2019 | | | | | 3Q/2019 | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Up | Down | Same | Diffusion Index | | Up | Down | Same | Diffusion Index |
| Corporate Lending | 14% | 18% | 68% | -4% | Corporate Lending | 13% | 9% | 78% | 4% |
| Middle Market Lending | 19% | 17% | 64% | 2% | Middle Market Lending | 26% | 17% | 57% | 9% |
| Small Business Lending | 28% | 23% | 49% | 5% | Small Business Lending | 22% | 48% | 30% | -26% |
| International Lending | 17% | 38% | 45% | -21% | International Lending | 0% | 57% | 43% | -57% |

- The unemployment diffusion index increased to 18% in Q3 2019 compared to 4% in Q2 2019. In addition, the bankruptcies diffusion index increased 61% compared to 42% in Q2 2019, and the interest rate diffusion index decreased from a 22% in Q2 2019 to -26%.

| | 2Q/2019 | | | | | 3Q/2019 | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Up | Down | Same | Diffusion Index | | Up | Down | Same | Diffusion Index |
| Loan Losses | 42% | 4% | 54% | 38% | Loan Losses | 70% | 4% | 26% | 66% |
| Bankruptcies | 46% | 4% | 50% | 42% | Bankruptcies | 61% | 0% | 39% | 61% |
| Interest Rates | 29% | 7% | 64% | 22% | Interest Rates | 22% | 48% | 30% | -26% |
| Unemployment | 14% | 18% | 68% | 4% | Unemployment | 22% | 8% | 70% | 18% |
| Bank Failures | 6% | 10% | 84% | -4% | Bank Failures | 9% | 9% | 82% | 0% |

## 10. U.S. Economy Grade – Next Six Months

Respondents were asked how they expected the U.S. economy to perform during the next six months on a grading scale of A through F.

- Lenders optimism on the U.S. economy decreased 39 points this quarter from 2.77 in Q2 2019 to 2.38 in Q3 2019. In the current quarter, 46% of respondents believe the economy will perform at a “B” level, which represents a decrease of 18 points from the previous quarter. Of the lenders surveyed, 46% also believe the economy will perform at a “C” level which represents an increase of 17 points from the previous quarter. There was an increase of lenders (8%) that believe the economy will perform at a “D” level, and a decrease of lenders (0%) that believe the economy will perform at an “A” level.

| Grade | 2Q/2019 | 3Q/2019 |
|---|---|---|
| A | 7% | 0% |
| B | 64% | 46% |
| C | 29% | 46% |
| D | 0% | 8% |
| F | 0% | 0% |
| Weighted Average Grade | 2.77 | 2.38 |

## 11. U.S. Economy Grade – Beyond the Next Six Months

Respondents were asked how they expected the U.S. economy to perform beyond the next six months on a grading scale of A through F.

- Lenders expectations for the U.S. economy's performance in the longer term slightly decreased from the prior quarter. The weighted average GPA decreased 3 points from a 2.07 in the Q2 2019 to 2.04 in Q3 2019. Of the lenders surveyed, 38% feel as though the U.S. economy will perform at a "C" level beyond the next six months, while 33% expect the economy to perform at a "B" level. The lenders who believe the economy will perform at a "D" over the next twelve months increased 6 percentage points to a 29%.

| Grade | 2Q/2019 | 3Q/2019 |
|---|---|---|
| A | 1% | 0% |
| B | 27% | 33% |
| C | 49% | 38% |
| D | 23% | 29% |
| F | 0% | 0% |
| Weighted Average Grade | 2.07 | 2.04 |

## 12. Customers' Future Growth Expectations

Lenders assessed their customers' growth expectations for the next six months to a year.

- The percentage of respondents indicating their customers have "moderate" growth expectations for the next six months to one year increased 3 percentage points to 70%. In Q3 2019, 17% of lenders ascribe "strong" growth for their borrower's in the next six months, a 10-percentage point decrease from Q2 2019, and 13% of lenders ascribe to "no growth", a 9-percentage point increase from the previous quarter.

| Indication | 2Q/2019 | 3Q/2019 |
|---|---|---|
| Very Strong | 2% | 0% |
| Strong | 27% | 17% |
| Moderate | 67% | 70% |
| No Growth | 4% | 13% |

## 13. Loan Structure

Respondents were asked whether their financial institutions planned to tighten, relax, or maintain their loan structures (collateral requirements, guarantees, advance rates, loan covenants, etc.) in each of four different-sized loan categories.

Many lenders are content right now and plan to maintain their current loan structure. However, in Q3 2019 we did see a slight increase (4%) of lenders that plan to tighten or relax their loan structure.

| | 2Q/2019 | | | 3Q/2019 | | |
|---|---|---|---|---|---|---|
| | Tighten | Maintain | Relax | Tighten | Maintain | Relax |
| Loans> $25 million | 20% | 76% | 4% | 25% | 70% | 5% |
| $15 – 25 million | 21% | 77% | 2% | 30% | 65% | 5% |

| | | | | | | |
|---|---|---|---|---|---|---|
| $5-15 million | 26% | 73% | 1% | 25% | 70% | 5% |
| Under $5 million | 24% | 75% | 1% | 26% | 63% | 11% |
| Overall Average | 23% | 75% | 2% | 27% | 67% | 6% |

## 14. Interest Rate Spread

Lenders were asked whether their financial institutions planned to reduce, maintain or increase their interest rate spreads and fee structures on similar credit quality loans.

A majority of lenders (72%) continue to maintain their interest rate spreads and fee structures. In Q3 2019, the percentage of lenders that plan to reduce their interest rate spreads decreased to 9%, and there was a 4-percentage point increase (19%) that plan to increase their interest rate spreads.

| | 2Q/2019 | | | 3Q/2019 | | |
|---|---|---|---|---|---|---|
| | Reduce | Maintain | Increase | Reduce | Maintain | Increase |
| Loans > $25 million | 17% | 80% | 3% | 10% | 80% | 10% |
| $15 – 25 million | 12% | 79% | 9% | 15% | 70% | 15% |
| $5-15 million | 8% | 74% | 18% | 5% | 74% | 21% |
| Under $5 million | 8% | 65% | 28% | 5% | 63% | 32% |
| Overall Average | 11% | 74% | 15% | 9% | 72% | 19% |

## 15. The Fed and Interest Rates

Respondents were asked in what direction they thought the Fed would move interest rates and by how much in the coming six months.

15% of respondents in Q3 2019 believe the Fed will raise interest rates in the next six months. On the contrary, 20% of respondents favor a decrease of -1/4 point, and 55% of respondents surveyed believe interest rates believe the Fed will decrease interest rates by -1/2 point or more.

| Bps Change | 2Q/2019 | 3Q/2019 |
|---|---|---|
| + 1/2 point or more | 1% | 0% |
| + 1/4 point | 25% | 15% |
| Unchanged | 65% | 10% |
| - 1/4 point | 9% | 20% |
| - 1/2 point or more | 0% | 55% |
| Weighted Average | 0.05 bps | -0.30 bps |

## 16. Current Competition

Respondents were asked to identify the segment of the industry from which they were experiencing the most competition.

- Regional Banks continue to place at the top of the survey, garnering 48% of responses. Local Community/Commercial Banks, at 24% of respondents, saw an increase of 4 percentage points, and Money Center Banks saw a decrease with 0% of respondents.

| | 2Q/2019 | 3Q/2019 |
|---|---|---|
| Regional Bank | 35% | 48% |
| Local Community/Commercial Bank | 20% | 24% |
| Commercial Finance Co. | 27% | 14% |
| Other | 8% | 14% |
| Money Center Banks | 10% | 0% |
| Factors | 0% | 0% |