KAULKIN GINSBERG

The KG Index

Q2 2018

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About Kaulkin Ginsberg Company

Since 1991, Kaulkin Ginsberg has provided critical strategic advice to the outsourced business services industry. Our client-centric approach covers almost every stage of a company's life cycle and enables us to maintain longstanding relationships as trusted advisors.

Our Services

- **Mergers & Acquisition Advisory** – Develop an effective growth or exit strategy for your company. Our dedicated team will confidentially address your firm's financial performance and current market conditions, expertly guiding you through your M&A process.

- **Strategic Consulting** – Find solutions to challenges facing your business. Our experienced staff and external advisory network will work with you to create your long-term growth and eventual exit strategy.

- **Valuation & Financial Solutions** – Determine the fair market value of your business. Our sister company Topline Valuation Group provides technical, financial, operational, and benchmarking services to help you develop effective business strategies.

- **Market Intelligence & Analysis** – Shape and support your business decisions. Through our proprietary information service KG Prime, we arm you with the most relevant and timely data, enabling you to make informed decisions about the direction of your business.

- **Litigation Support & Expert Witness** – Build your case using the appropriate experts. Our findings have never been invalidated in any court or formal proceedings.

To confidentially discuss your interests, please contact us at hq@kaulkin.com or (301) 907-0840. For more information about Kaulkin Ginsberg, please visit www.kaulkin.com.

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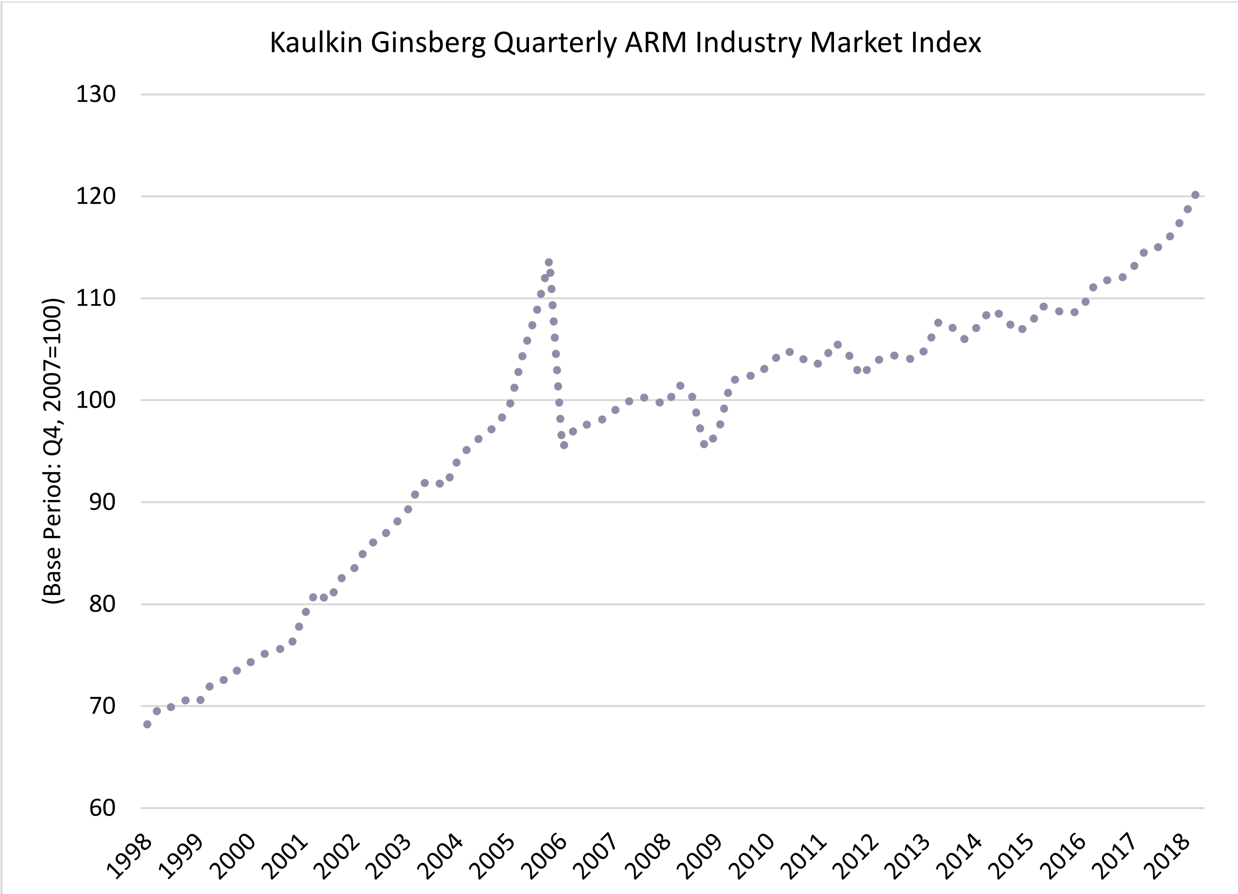
The Economy's Effect on the ARM Industry: The KG Index



Q2 2018 data releases are complete, and that means it's now time to start analyzing second quarter market conditions for the U.S. accounts receivable management (ARM) industry and discussing what you should look for in Q3 2018. Following a few historical revisions to prior quarter's data points, we saw a slight uptick in performance over the last few quarters. Overall, the ARM industry is trending upward based on these market conditions, which means that most agencies are likely seeing an increase in placement volume and recovery rate.

More importantly, Q2 2018 came in at an index value of 120.65. This indicates that the ARM index grew by 2.1% on a quarter-over-quarter basis with an annualized growth rate of 8.5%, which is up significantly from the Q2 2017 annual growth rate of 6.5%. Given the strong growth and upward revisions to the data, the ARM industry is seemingly poised for greater growth than it's experienced in quite some time.

Previously, we suggested that the rapid growth rate could lead to a correction in the market in the near future. However, the revision to prior index results should dampen these concerns in the short-term as the industry is still encountering ideal economic conditions. That said, mature industries eventually begin to taper off and head towards lower, steadier growth rates once fully recovered from downturns so the current conditions won't last forever. Further confounding economic variables is the Tax Cuts and Jobs Act of 2017 (TCJA), President Trump's trade war with China, and the uncertainty surrounding

NAFTA. Changes to any of these major events could lead to significantly different consumption and employment trends for the U.S. economy.

Overall, the four key indicators contributing to our index – consumer bankruptcy filings, retail sales, official civilian unemployment rate (U3), and home price index – are trending positively. Here are a few of our notes on the current trends within each variable:

Consumer Bankruptcy Filings

In any given year, the first and second quarters tend to be the highest points, while the third and fourth quarters trend downward through the year. Q2 2018 was a strong showing for the ARM industry as the number of filings was 1.6% lower than Q2 2017. This suggests that consumer bankruptcy filings will likely maintain their downward trend since peaking in 2010 at approximately 1.54 million filings. On the one hand, a decline in bankruptcy filings means that the ARM industry should be able to collect a greater degree of consumer debt. On the other hand, bankruptcy filings correlate with an increase in delinquent debt placements (and revenue) for the ARM industry since they are inherently related. As such, some volatility and growth in bankruptcy filings is good for the ARM industry, even if it seems counter intuitive. It will be important to monitor this trend throughout the remainder of 2018 and into 2019.

Retail Sales

While retail sales tend to maintain a long-term steady growth rate, the greatest period of growth is, unsurprisingly, concentrated in the third and fourth quarters of the year, while the first and second quarters are more flat. In Q2 2018, the total quarterly value of retail sales increased by nearly $24 billion compared to the same period in 2017, and is the strongest second quarter period of retail sales growth since 2011. This suggests a positive market for the ARM industry as the majority of consumers tend to leverage these purchases through revolving credit lines and increases the potential for delinquent account filings, and indicates that consumers are more confident taking on debt than in recent years.

Official Unemployment Rate (U3)

The unemployment rate appears to defy most economic projections and is now down to just 4.0% on the quarter - a level not seen since the late 1990s and early 2000s. However, the quality of employment, as well as the labor force participation rate, dampens the significance of these measures slightly. As it relates to the ARM industry, a prolonged period of low unemployment rate tends to lead to negative market conditions unless it is offset by a relatively greater increase in consumer spending activity, which appears to be the case. While the TCJA, trade wars, and free trade agreement negotiations haven't negatively impacted the labor market, they haven't improved it much either when you consider the unemployment rate and labor force participation rate have been stuck at about 4.0% and 63%, respectively, for quite some time. Overall, unemployment trend is positive, but international relations and trade could negatively affect the U.S. labor market in the coming months.

Home Price Index

The home price index is positively correlated with the ARM industry and continues to trend upwards, which facilitates consumer confidence – especially in their ability to leverage debt – since homes account for the majority of most individual's wealth. As of Q2 2018, the index is at a record high of 204.48 and nearly 20 points greater than its Q2 2006 level right before the Great Recession. Given current housing trends, it appears highly likely that the value will continue to rise over the next few years. Driving this trend is the ever increasing demand for housing coupled with the increasing interest rates, which probably sounds a bit odd. Typically, an increase in the interest rate leads to a reduction in demand for housing due to the lower purchasing power of the buyer. However, the increasing interest rates are still significantly lower than historical averages so many potential home buyers are moving forward with purchases and pushing home values higher because of a fear of the interest rates to come.

What to Look for Throughout 2018

2018 is off to a strong start and many of the key economic variables are pointing in the direction of strong growth for the ARM industry. However, fiscal policy on tax and trade agreements from the federal government and monetary policy from the Federal Reserve will likely dictate how long the ARM industry continues to enjoy current market conditions. If either falters, it could lead to a downturn for that the ARM industry will likely start to feel the effects from about six months thereafter.

Contact us at hq@kaulkin.com if you have any questions.