KAULKIN GINSBERG

The KG Index

Q3 2019

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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.

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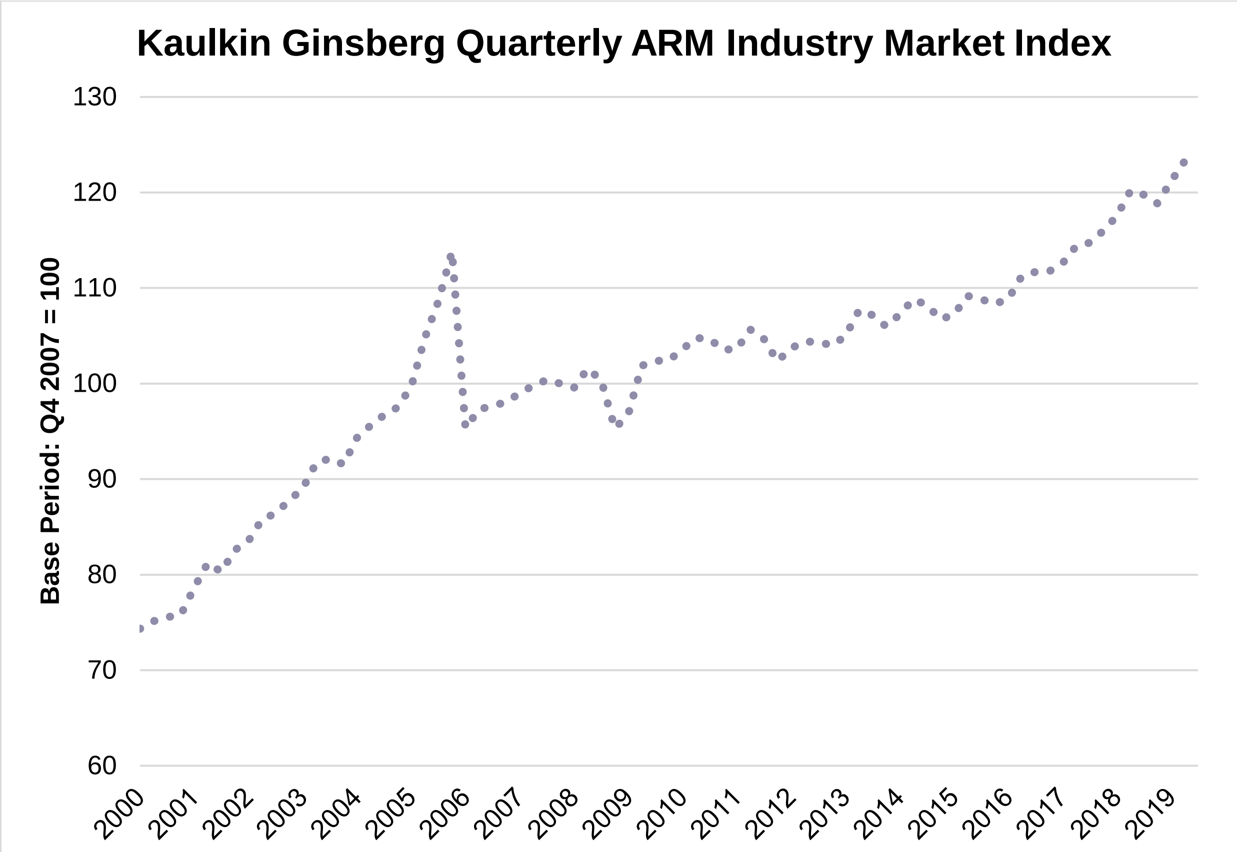
The Economy's Effect on the ARM Industry: The KG Index



Q3 2019 data releases are complete, and that means it's time to review third quarter market conditions for the U.S. accounts receivable management (ARM) industry and discuss what you should look for in the last quarter of 2019. Following a few historical revisions to prior quarters' data points, we saw continued growth in market conditions for the third straight quarter with consumer demand and home values as the growth drivers.

More importantly, Q3 2019 came in at an index value of 123.43. This indicates that the ARM index grew by 0.1% on a quarter-over-quarter basis with an annualized growth rate of 0.6%. While these rates are down significantly from the previous quarter, they do align with historical trends for weaker third quarter performance. That said, it's still three straight quarters of declining growth rates which may indicate instability within 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 (HPI) – should be closely monitored as the year progresses. 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 remainder of the year. 2018 marks the first year in quite some time that bankruptcy filings were up, and the first three quarters of 2019 continued this trend, albeit only marginally, with a net increase in filings year-to-date. While some volatility and growth in bankruptcy filings is considered good for the ARM industry, more systemic increases are an indication of an overheated consumer credit market that is trending towards a recession. As such, increases in bankruptcy filings in the fourth quarter of 2019 and into 2020 would serve as an indication of deteriorating market conditions and warrants a closer look at monetary policy by the Federal Reserve.

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, on average, flatter. As of Q3 2019, retail sales are up on a quarter-over-quarter and relative to the same quarter last year basis. However, the rate of growth remains low. It's not clear if this has more to do with an overextended consumer segment, pricing pressure from trade wars, or some combination of factors. That said, consumer spending patterns are essential to the growth of the U.S. economy and ARM industry, so a slowdown is never a good sign – especially when the consumer market is the primary driver for economic growth.

Official Unemployment Rate (U3)

The unemployment rate came in at 3.5% for Q3 2019 – the lowest rate recorded in the last 20 years. As always, the quality of employment and corresponding labor force participation should be examined since they call into question the value of the official unemployment rate. Although the labor force participation rate didn't move up much from its usual 63% level, it did increase slightly to 63.2% - the highest it's been since Q3 2013. Additionally, real median weekly earnings for 2019 increased marginally for a second straight quarter, though an uptick in the third quarter is relatively consistent with historical trends. While the state of the U.S. labor force could be better (or worse) depending on the analyst's interpretation, the labor market data is generally strong. However, the data also suggests that consumer delinquencies will increase in the coming quarters as wage growth is outpaced by consumption which aligns with the increasing consumer bankruptcy filing trend.

Home Price Index

The home price index (HPI) is positively correlated with the ARM industry and facilitates consumer confidence – especially in their ability to leverage debt – since homes represent the greatest percentage of most individual's wealth. In Q3 2019, the index increased from 210.84 in Q2 2019 to 212.20. On the surface, this increase suggests a strong housing market. However, a closer examination of comparable quarter-over-quarter growth for the last 10 years shows a decline in the growth rate for HPI that may suggest a weakening housing market – something that aligns with a pending recession. Given current housing trends, monetary policy, and other economic indicators, it appears that the housing market may level off in early-2020. The element that isn't clear is how long the period of decline will last or the degree to which this will impact the consumer credit market.

If the decline is marginal and only serves to correct prior periods disproportionate growth, then the effect on consumer credit markets should be minimal. Conversely, a correction like the one associated with the Great Recession (which doesn't appear imminent) would limit consumer credit markets, lower wealth, and diminish the ability of consumers to manage their financial leverage. As such, it will be interesting to see how builders respond to these trends since that may give an indication of their confidence in the housing market.

What to Look for in the Last Quarter of 2019

2018 was a stronger year for the ARM industry than many expected and 2019 continued that trend through the Q3 2019. While the data suggests that the ARM industry is well-positioned for growth in late-2019 and early-2020, indications that the consumer credit market and larger U.S. economy could shift relatively soon are everywhere. As such, improved trade relations with China in particular, and the European Union in general, should foster consumer and business confidence, and is likely President Trump's target for 2020. Keep in mind that the ARM industry lags the U.S. economy so a poor economy in 2020 will have a delayed effect on ARM companies. From a strategic planning perspective, owners and operators may want to examine the cost-benefit of investments based on business forecast scenarios to ensure a return on investment.

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