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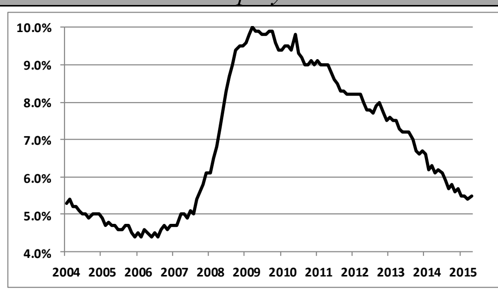
Hunting Dog Capital LLC and its affiliates create uncommon lending solutions for all types of domestic companies regardless of industry or location.

The Current State of the U.S. Job Market (Q3:2015)

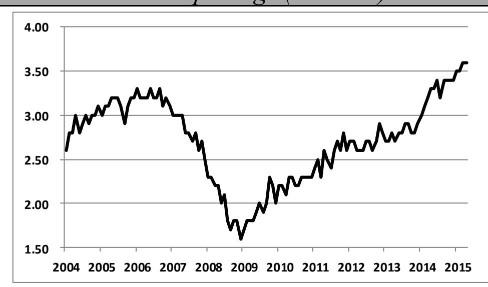
Hunting Dog Capital is a private, California-based investment firm that has been originating and servicing senior-secured term loans for lower middle-market companies since 2006. Our origination network that refers opportunities to us has grown to over 6,000 names that show us new loan prospects from every state and a very wide range of industries. Although we only fund a small percentage of what we review each year, the information to which we have access provides a real-time, inside view from the owners and management of America's lower middle-market companies. Our Q3:2015 white paper shares our observations on the US job market – specifically that of the lower middle-market – and how certain trends might impact the broader lower middle-market community from debt/equity providers to operators/owners. Based on our observations as well as statistical data, we believe the lower middle-market will continue to demonstrate solid health and be a nexus for job creation and potentially positive wage pressure.

We begin with a brief review of select macro-employment statistics, focusing on the approximate prior ten-year timeframe, encompassing the "boom" period prior to the 2008-2009 recession. The following data[1] are from December 31, 2004 through May 2015:

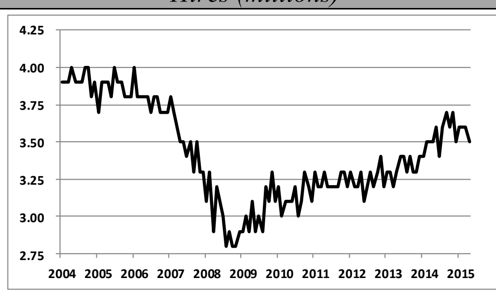
Unemployment



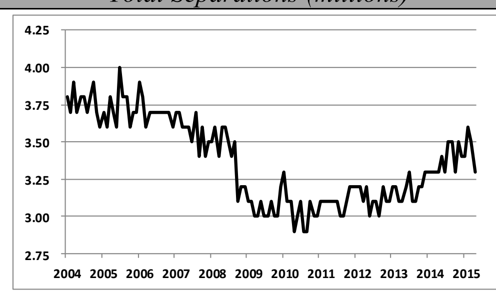
Job Openings (millions)



Hires (millions)



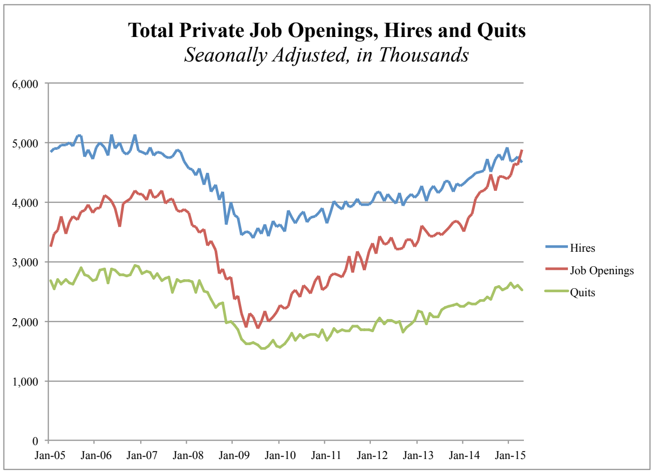
Total Separations (millions)



As evidenced above, unsurprisingly, all of the major labor indicators have demonstrated positive trends over the course of the past five years. In this publication, however, we will review some of the less-publicized data including "quits," the number of unemployed per job opening, select hourly-wage data as well as recent hiring data from the National Federation of Independent Business. These indicators demonstrate a more nuanced picture of the lower middle-market.

[1] U.S. Department of Labor, Bureau of Labor Statistics. Data represents "total nonfarm" except unemployment, and is as of May 31, 2015.

QUITS: One measure of the strength of the job market – often underemphasized by headlines – is the growth in the number of voluntary quits by employees. A significant increase in quits is typically a strong signal of increasing economic strength, given most employees' inability and/or unwillingness to quit without having arranged alternate, higher-paying employment. According to the Bureau of Labor Statistics, quits grew in 2014 for the fifth year in a row from a total of 27.6 million to 30.5 million, annually. For perspective, 1.6 million (19.2 million, annualized) quit their jobs in August of 2009, the smallest figure in fourteen years of tracking. Quits increased in nearly all industries and all regions in 2014. What is clear, however, in the chart below[2] is that quits have certainly risen materially, but have lagged the pace of increase in job openings. Closing this gap, at least to some degree, may prove a positive indicator for wage pressure, both at a macro level and within the lower middle-market.



As the pace of job openings outstrips the pace of quits, wages may need to increase to incent employees to quit in order to pursue higher-paying employment.

PERSISTENT UNFILLED JOB OPENINGS: According to the National Federation of Independent Business' June Jobs Report[3], "twenty-four percent of all [small-business] owners reported job openings they could not fill in the current period, down 5 points. June's reading is a set-back after reaching the highest level since April 2006 in both February and May of this year. Historically correlated 0.9 with the unemployment rate, the June reading sets the stage for an increase in the unemployment rate." We observe, however, that twenty-four percent is in line with averages in 2005 and 2006 and that should the participation rate pick up from its long downtrend, this could be a significant positive driver of increased employment.

AVERAGE HOURLY EARNINGS: As of June 2015, the average hourly earnings for private-sector workers remained at $24.95[4], unchanged from the prior month, and when compared to a year earlier, up just 2%, or modestly ahead of inflation, which is running at approximately 1.5%. Importantly, this trend has resisted change throughout the period of "recovery" from the most recent recession. Real wage growth or greater income equality is a significant focus for policy makers currently. We believe we could begin to see modest positive movement in this metric in 2015-2016 and will attempt to identify factors and trends present in the lower-middle market that explain the limited overall wage growth simultaneous with significant movement, however, by workers.

[2] Source: United States Department of Labor, Bureau of Labor Statistics. *"Job Openings and Labor Turnover Survey."* June 9, 2015. Includes total nonfarm as well as all other private hires, job openings and quits.
[3] Per commentary from National Federation of Independent Business Chief Economist, William Dunkelberg.
[4] Source: United States Department of Labor, Bureau of Labor Statistics.

First, though unemployment is low and dropping (5.3% in June 2015[5]), the number of part-time workers who would prefer to be full-time remains higher than before the Great Recession. It is expected by economists that these workers first seek additional hours in their current roles rather than asking for an increase in wage. If an employer denies additional hours or a wage increase, employees, presumably, move to look for work elsewhere, in part explaining movement without wage growth.

Another oft-cited explanation for the persistence in part-time employment is the implementation of the Affordable Care Act ("ACA"). According to Michael Feroli, Chief Economist at JP Morgan Chase, the ACA caused an involuntary rise in the part-time workers by anywhere from 320,000 to 580,000[6]. According to the ACA, employers with 100 or more employees are required to offer health insurance for those working at least 30 hours per week. The cutoff reduces to 50 employees in 2016, so it can be inferred that the effects of the part-time labor gap on the labor market will persist for some time.

Finally, whereas the obstacle to growth was once availability of capital, the most difficult roadblock for growth currently – according to a majority of our portfolio companies and network – is finding and keeping qualified workers. Members of the Baby Boomer generation continue to leave the work force en masse. It is estimated that a total of 20 million Baby Boomers will leave the work force over the coming five years[7] – approximately 11,000 per day – with younger, often less-qualified, workers left to fill the gap. While larger businesses have the ability to attract talent through brand recognition and across markets, owners of smaller companies must find a way to compete, either through increased wages and benefits or additional perks. According to Phil Brandt with AAIM Employer's Association in St. Louis, employees have become more confident and empowered to search for better jobs with higher wages. According to Brandt, background checks performed by his clients in advance of new hires are up, but not because companies are adding to the total number of employees. The companies, especially in smaller markets, are simply trading employees, as workers look for marginally better offers. The "happy to have a job" mentality from 2010 no longer exists. Younger workers also have different interests and expectations in terms of company culture and work environments. The storied perks of tech giants, such as Google and Facebook, in Silicon Valley have spilled over to other industries across the country. According to Brandt, several of his clients must make investments to change company culture to attract younger workers, for whom workplace atmosphere is more important. Younger workers desire collaborative environments, open floor plans requiring investment and other amenities employers must provide to compete.

Conclusion

In general, the outlook is more positive than at this time last year with more attention to labor-related issues. Looking forward, based on what we have observed from the market, we expect small companies that are growing to push price increases to their customers more aggressively to offset the demand for increased wages. Increased prices should more than offset labor costs and the trend of improving profit margins will continue. A greater percentage of capital expenditures will be on altering the physical work place in an effort to maximize collaboration, something that is high priority for younger workers. Larger pay increases will be directed toward experienced, well-trained workers under the age of 40 as opposed to older workers or the newly hired. Total workforce turnover will continue to accelerate into next year and overall unemployment should continue to decline, but at a much slower pace. Furthermore, while well-managed businesses are currently experiencing increased internally-generated cash flow and have slightly better access to short-term liquidity facilities, these companies remain challenged to secure growth capital from traditional lenders. While raising equity may be an option for some, most CEOs would rather avoid the dilution, if possible. Therefore, we expect the demand for new growth capital, particularly term debt, to grow from middle-market companies that seek to expand either organically or by making acquisitions.

[5] Source: United States Department of Labor, Bureau of Labor Statistics.
[6] Jesse Edgerton, Michael Feroli. *Economic Research Note: US: How is health care reform affecting part-time work?* J.P.Morgan. June 19, 2015.
[7] Baby Boomer birth years are commonly defined as those from 1946 to 1964, during which 76 million people were born, meaning over a 19-year period, assuming all were working, approximately 4 million per year would retire. This equates to nearly 11,000 per day.

About Hunting Dog Capital

Since 2006, Hunting Dog Capital LLC and its affiliates have created uncommon lending solutions for a wide variety of U.S.-based companies. Our loans are used by business owners to facilitate acquisitions, refinance existing debt or for general corporate purposes to enable growth. Typically:

- We lend to U.S.-based public and private companies across industries
- All loans are senior-secured (first lien) with stated maturities ranging from two to five years
- Loans are in amounts of $5 million and up
- We will consider non-amortizing loans with bullet maturities
- Borrowers can prepay without penalty after the first year
- We act quickly to provide the required capital when it is most essential

We differentiate ourselves from other lower-middle market direct lenders by focusing on tangible assets instead of cash flow. If comfortable with the underlying collateral, typically a collateral coverage ratio of 1.1x or greater going in, we will do non-amortizing bullets. We believe our terms are especially attractive to businesses owners with substantial at-risk equity as they enable retention of control, delay (or avoidance) of significant equity dilution and capture of equity appreciation as the business grows. We believe this type of liquidity is essential for entrepreneurs to execute their plans, and exceed objectives.

To learn more about Hunting Dog Capital, please visit our website (www.hdcap.com) or contact any of us directly (contact information on page 1).