1Q 2015

MIDDLE MARKET INDICATOR

FROM GROWTH TO STABILITY

NATIONAL CENTER FOR
THE MIDDLE MARKET

In Collaboration With

The Ohio State University
Fisher College of Business

GE Capital

Middle Market Indicator

from The National Center for the Middle Market

THE MIDDLE MARKET INDICATOR (MMI) FROM THE NATIONAL CENTER FOR THE MIDDLE MARKET IS A QUARTERLY BUSINESS PERFORMANCE UPDATE AND ECONOMIC OUTLOOK SURVEY CONDUCTED AMONG 1,000 C-SUITE EXECUTIVES OF COMPANIES WITH ANNUAL REVENUES BETWEEN $10MM AND $1B.

There are nearly 200,000 U.S. middle market businesses that represent one-third of private sector GDP, employing approximately 47.9 million people. These businesses outperformed through the financial crisis (2007–2010 period) by adding 2.2 million jobs across major industry sectors and U.S. geographies, demonstrating their importance to the overall health of the U.S. economy. They are private and public, family owned, and sole proprietorships, geographically diverse, and span almost all industries. The health of these businesses and their respective outlook serve as a solid indicator for the greater U.S. economy as a whole. (See www.middlemarketcenter.org: "The Market that Moves America," seminal research on the definition, significance, and role of the middle market, Oct. 2011.)

HOW IS THE RESEARCH CONDUCTED?

The MMI surveys 1,000 CEOs, CFOs, and other C-suite executives of America's middle market companies on key indicators of past and future performance in revenues, employment, and allocation of cash. The survey also reports middle market company confidence in the global, U.S., and local economies and identifies key business challenge areas. The survey was designed to accurately reflect the nearly 200,000 U.S. businesses with revenues between $10MM and $1B, the lower and upper limits on middle market annual revenue. The quarterly survey is designed and managed by the National Center for the Middle Market.

ABOUT THE NATIONAL CENTER FOR THE MIDDLE MARKET

Founded in 2011 in partnership with GE Capital, and located at The Ohio State University Fisher College of Business, the National Center for the Middle Market is the leading source of knowledge, leadership, and innovative research on the U.S. middle market economy. The Center provides critical data, analysis, insights, and perspectives to help accelerate growth, increase competitiveness, and create jobs for companies, policymakers, and other key stakeholders in this sector. The Center's website, which offers a range of tools and resources for middle market companies, can be visited at www.middlemarketcenter.org.

U.S. MIDDLE MARKET DEFINED

ANNUAL REVENUE
RANGING FROM
$10MM – $1B

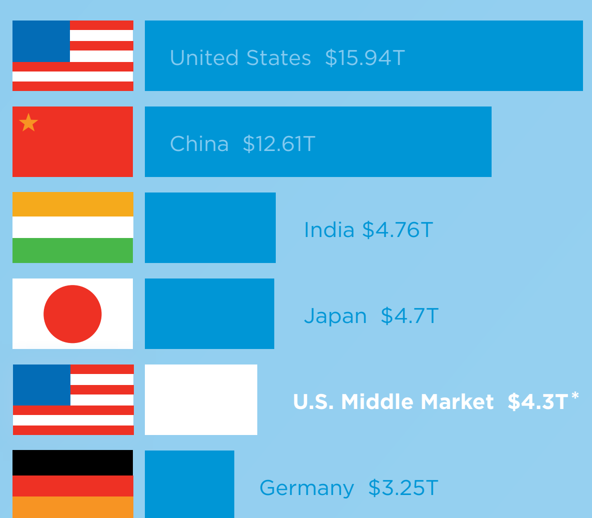
$ LOWER MIDDLE MARKET
$10MM - $50MM

$ $ CORE MIDDLE MARKET
$50MM - $100MM

$ $ $ UPPER MIDDLE MARKET
$100MM - $1B

NEARLY
200,000
BUSINESSES

5TH LARGEST
GLOBAL ECONOMY



*Source: CIA World Fact Book, *National Center for the Middle Market (estimate)*

Executive Summary

Following a year of consistently accelerating revenue and employment growth for middle market firms, in the first quarter of 2015, growth appears to be stabilizing. While revenue growth remains strong, employment growth has tapered off slightly, and many companies feel their workforce is right sized for current market conditions. The near-term outlook is positive, with many middle market firms anticipating a more favorable business environment in the next three months. Looking forward for the remainder of the year and into 2016, middle market leaders anticipate continued financial and employment growth, but at less rapid and more sustainable rates.

For Q1 2015, 64% of middle market companies reported improved past year company performance. While this represents a significant decrease from the 70% of businesses that cited year-over-year performance improvements last quarter, it's important to note that the proportion of firms reporting deteriorated performance dropped significantly as well, to just 4%. For close to one-third of middle market organizations, overall company performance appears stable.

For the majority of middle market businesses, and companies at the high end of the middle market revenue spectrum in particular, revenue performance remains strong. The middle market as a whole reported mean total past year revenue growth of 7.4%, while the largest middle market firms, with revenues between $100 million and $1 billion; grew by 9.1%. From an industry perspective, companies in the services, manufacturing, and financial services sectors reported the strongest revenue increases. All in all, the financial performance for middle market companies once again exceeded the revenue growth for the S&P 500, which was 2.9% for the same period.

While employment growth remains strong at 4.3%, the rate of growth is slowing for core and lower middle market firms. Most notably, year-over-year employment growth for companies with revenues between $50 million and $100 million dropped from 6.5% for Q4 2014 to 3.4% for the first quarter of this year. Companies in the manufacturing, retail trade, and construction industries are the exception to the slowdown, with these industries reporting increases in the rate of hiring.

Innovation is a key driver of the sustained strength of the middle market. Nearly half of firms have introduced a new product or service in the past 12 months, and 42% plan to do so in the coming year. One-third of companies also hope to expand into new domestic markets. More than two-thirds of firms say they would invest extra cash as opposed to hold it.

However, most middle market firms hold a conservative view toward debt, with the majority targeting and maintaining around a 25% debt to asset ratio.

Looking forward, projections for future revenue growth and employment growth have become more conservative across all middle market revenue segments and most industries, reflecting an expectation for stability and sustainable growth rates rather than rapid expansion. While the majority of firms do expect revenues to grow, and many are planning on increased sales and greater demand for their products and services in the next few months, they anticipate long term growth at less accelerated rates than were forecasted at the end of 2014.

In terms of employment, the majority of middle market firms expect to maintain the current size of their workforce over the next three months, and about one-quarter of middle market leaders forecast a tightening of the labor market. Over the course of the next year, 39% of companies say they will add to the size of their payrolls, but the expected mean employment growth rate has slowed considerably across all industries, with the exception of the retail trade and construction sectors.

Although global economic confidence remains muted, confidence in the local and U.S. economies continues to be strong. However, many middle market business leaders indicate that state and federal regulations will have a negative impact on growth. Other major challenges that could impact future growth include staffing issues, specifically employee retention and turnover, and competition from other businesses.

The Q1 2015 Middle Market Indicator survey represents the 13th consecutive query into the state and health of the U.S. middle market. This quarter's survey included several new and revised questions to delve deeper into the practices of middle market firms and the mindset of middle market leaders. Specifically, the survey introduced a new way to ask about key challenges, new questions related to inventory, debt, workforce size, and financing, and a new focus on the short-term (three-month) outlook in addition to projections for the year to come. The additional data will provide greater insight into the middle market, especially as we see trends emerge in coming quarters.

REVENUE GROWTH
Revenue growth remains strong, but the outlook for future growth is muted

For Q1 2015, seven in 10 middle market firms reported year-over-year increases in revenues, slightly fewer than last quarter, but up from 64% of firms reporting increases one year ago. Upper middle market firms, with revenues between $100 million and $1 billion, performed especially well over the past 12 months, with 82% of these companies citing gains. While the number of total firms reporting growth is slightly down, mean revenue growth is slightly up. At 7.4%, the growth rate is nearly one full percentage point higher than what firms reported in Q1 2014.

While most businesses anticipate future growth, the outlook has dimmed from three months ago. At the end of 2014, nearly three-quarters of middle market firms reported expectations for future growth; that number has dropped to 59% for the current period. Mean total growth expectations for the next 12 months have dropped as well, from 6.0% last quarter to 5.3% today.

1Q'15 70% of middle market companies reported positive revenue growth. 1Q'14 64%

MIDDLE MARKET

PAST 12 MO.

1Q'15 7.4%

4Q'14 7.2% 1Q'14 6.5%

NEXT 12 MO.

1Q'15 5.3%

4Q'14 6.0% 1Q'14 4.5%

S&P 500

PAST 12 MO.

1Q'15 2.9%

4Q'14 4.9% 1Q'14 0.5%

EMPLOYMENT GROWTH
Employment continues to rise, but at a slower pace

Since the significant jump in the percentage of firms reporting year-over-year employment growth at the end of 2014, the number of middle market companies saying their workforce is larger today than it was one year ago has dropped back to 43%. While mean total employment growth for the past 12 months has declined somewhat since last quarter, it remains over 4%, well above levels reported during the first three quarters of 2014.

Consistent with their outlook for revenue growth, companies have pulled back on their hiring expectations. About one-third of firms expect to hire in the next three months, and around four in 10 (39%) say they will hire over the next 12 months, down from 52% that reported employment growth intentions last quarter. Following a marked increase in anticipated growth rates every quarter in 2014, mean total expected employment growth for the next 12 months has settled back to 3.2%, the same as reported in Q1 2014.

1Q'15 39% of middle market companies expect to add jobs. 1Q'14 46%

MIDDLE MARKET

PAST 12 MO.

1Q'15 4.3%

4Q'14 5.0% 1Q'14 3.7%

NEXT 12 MO.

1Q'15 3.2%

4Q'14 4.0% 1Q'14 3.2%

ADP [PAST 12 MO.]

LARGE CORP.

1Q'15 2.1%

4Q'14 2.2% 1Q'14 2.6%

SMALL BUS.

1Q'15 2.7%

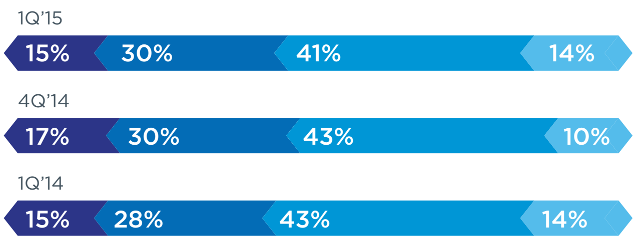
4Q'14 2.2% 1Q'14 2.1%

ECONOMIC CONFIDENCE

Global confidence continues to lag behind growing national and local confidence

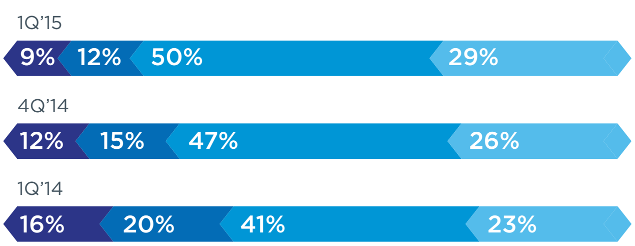
Middle market leaders are clearly confident in their local economies and in the U.S. economy as a whole. Confidence in the economic landscape close to home has remained fairly stable since the beginning of 2014, with over 80% of leaders maintaining a positive outlook about their local markets. Confidence in the national economy has risen steadily since the beginning of last year and is approaching levels of local confidence: today, 79% of middle market leaders are at least somewhat confident in the economic picture for the U.S. Yet, attitudes toward the global economic scene continue to be weak in comparison. Global confidence levels have remained flat since the beginning of 2014, with 55% of middle market leaders expressing some confidence in the global economy, and 15% saying they are not confident at all. These numbers, however, represent a marked improvement in the perspective toward the global economy since 2012 and early 2013.

GLOBAL ECONOMY



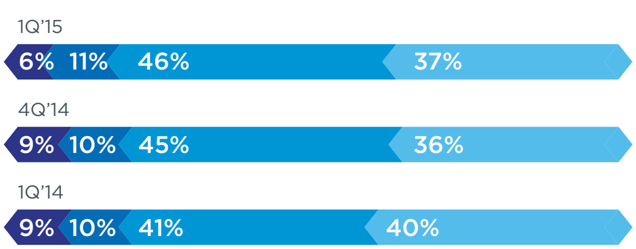
1Q'15
55%
CONFIDENT / SOMEWHAT CONFIDENT
4Q'14 53% 1Q'14 57%

NATIONAL ECONOMY



1Q'15
79%
CONFIDENT / SOMEWHAT CONFIDENT
4Q'14 73% 1Q'14 64%

LOCAL ECONOMY



1Q'15
83%
CONFIDENT / SOMEWHAT CONFIDENT
4Q'14 81% 1Q'14 81%

Not confident | Somewhat not confident | Somewhat confident | Confident

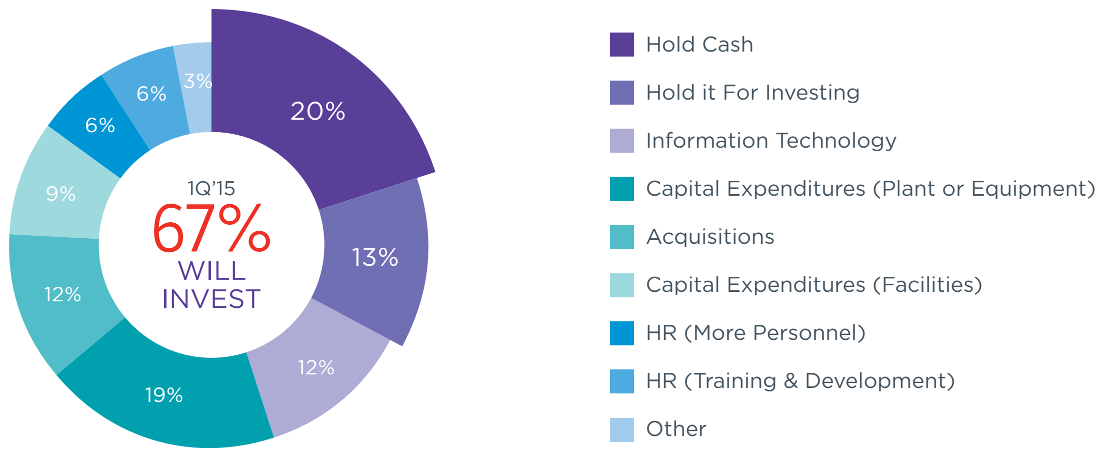
CAPITAL INVESTMENT

Two-thirds of firms remain willing to invest

For the second straight quarter, just over two-thirds of middle market firms express a willingness to invest additional cash rather than save it. During 2013 and most of 2014, the number of companies likely to invest versus save hovered around 60%. At the end of last year, that number jumped to 68%, and the increase has held. Today, 67% of firms say they would invest and 33% say they would keep their cash.

Over the next 12 months, capital investment is most likely to come in the form of innovation, with 42% of middle market companies saying they will introduce new products or services. About the same proportion of companies—39%—expect to see an increase in company revenues derived from these new offerings.

ADDITIONAL INVESTMENT ALLOCATION



KEY CHALLENGES

Talent and regulation issues are top of mind for middle market leaders

For the first time, we asked executives to write their greatest internal and external challenges for both the near and long term, as opposed to responding to a pre-defined list of issues; we then coded and analyzed the responses. From an internal perspective, a cluster of talented-related concerns emerged, including acquisition, retention, and training. External factors most likely to have the greatest impact on performance over the next three months and throughout the year include increasing competition and government regulations.

SHORT TERM CHALLENGES (Next 3 months)

INTERNAL CHALLENGES:

1. STAFF/EMPLOYEES	46%
2. BUSINESS GROWTH	32%
3. FINANCES	23%
4. COSTS	16%
5. GOVERNMENT REGULATIONS	10%

EXTERNAL CHALLENGES:

1. COMPETITION	20%
2. GOVERNMENT REGULATIONS	19%
3. FINANCES	14%
4. ECONOMIC FACTORS	12%
5. BUSINESS GROWTH	10%
6. NEW MARKETS	10%

LONG TERM CHALLENGES (Next 12 months)

INTERNAL CHALLENGES:

1. STAFF/EMPLOYEES	43%
2. BUSINESS GROWTH	18%
3. FINANCES	14%
4. COSTS	14%
5. GOVERNMENT REGULATIONS	4%

EXTERNAL CHALLENGES:

1. GOVERNMENT REGULATIONS	17%
2. COMPETITION	16%
3. FINANCES	12%
4. ECONOMIC FACTORS	11%
5. COSTS	11%
6. NEW MARKETS	9%

Perspectives

STEADY AS SHE GOES, WITH A FEW WOBBLES

Middle market revenue and employment continue to grow smartly and faster than the U.S. economy as a whole. "Stable growth" is the right term to describe what's happening: The annualized growth rate, though a quick 7.4%, is not accelerating as it did most of last year. Annual job growth checked in at 4.3%, lower than last quarter's ebullient 5% but still higher than in any other period since we launched the Middle Market Indicator in April 2012. Growth is less frothy, but more consistent. Between the 4th quarter and this one, the percentage of companies reporting improved overall performance dropped to 64 from 70—but the number of companies saying performance deteriorated also dropped, from 8% to just 3%. Revenue and payrolls show the same: softer on the top, firmer on the bottom. The pattern holds across most industries. Paradoxically, wholesale trade, volatile as it has been in the past, turned in the worst performance of the industries we track, while retail was among the strongest. Healthcare, manufacturing, and services also turned in strong year-over-year results.

We've remarked before on the financial caution of the middle market. Data we've collected for the first time sheds new light on this by showing how middle market companies used the profits they turned in last year. The middle market doesn't like debt and prefers to finance growth from retained earnings—especially those in the lower middle market, which may have more to fear from a bad quarter. Accordingly, companies used their strong 2014 performance to pay debt down, not to lever up for growth. Three out of ten say they have less debt than they did a year ago; just one out of eight say they carry more. And though their debt-to-asset ratio is low (an average of 25.1%) they want it lower (23.4%). That does not constrain their appetite for growth much. The middle market is holding firm in its desire to invest an extra dollar of revenue rather than save it; at 67%, just a point less than the high reached last quarter.

The job market is starting to pinch employers, who confront a shrinking pool of unemployed, growing employee bargaining power, and increased pressure on retention as current employees become targets for other companies. Executives cite talent acquisition and retention as their #1 and #2 internal challenges for both the short and long term. (Rivals and regulators top the list of external woes.) Companies are watching payrolls closely. Last quarter, more than half the middle market expected to be adding to staff; this quarter, 39% say so. Retailers, manufacturers, and healthcare companies are most adamant about drawing the line, but the vast majority—79%—say the size of their workforce is just right. If overall job creation rebounds after its slump in March, the U.S. could approach full employment late this year or early next, which would make the people-pinch sharper.

CYBER SECURITY: OUTLIERS OR OSTRICHES?

Speaking about computer security, FBI Director James Comey said, "There are two kinds of big companies in the United States. There are those who've been hacked…and those who don't know they've been hacked." Are things different in the middle market?

When asked, 10% of respondents said that they've been hacked, 6% were unsure, and 84% said they haven't. While nearly half (46%) of all middle market companies are very to extremely concerned about the impact of a security breach, concern over security strongly correlates with size: 54% of upper middle market firms say they are extremely or very concerned and nearly that many (49%) plan to increase cyber security spending in the coming year. The corresponding numbers for the lower middle market segment are 39% and 32%. Unsurprisingly, retail and healthcare companies are most likely to be increasing cyber security spending.

It's impossible to know if the middle market has mostly been spared or is mostly in the dark. (Many statistics showing hacking to be ubiquitous come from companies selling cyber security services.) Nearly half of middle market companies report using cloud-computing services (this number, too, rises with company size) and in that sense they may be outsourcing security without raising spending. Whatever the current threat, it's likely that mid-sized companies will tighten the security of their IT systems, if for no other reason than demands of big companies they do business with.

NATIONAL CENTER FOR
THE MIDDLE MARKET

The National Center for the Middle Market is the leading source of knowledge, leadership, and innovative research focused on the U.S. Middle Market economy. The Center provides critical data, analysis, insights, and perspectives to help accelerate growth, increase competitiveness, and create jobs for companies, policymakers, and other key stakeholders in this sector. Stay connected to the Center by contacting middlemarketcenter@fisher.osu.edu.

THE OHIO STATE UNIVERSITY
FISHER COLLEGE OF BUSINESS

From business as usual to business unusual, Fisher College of Business prepares students to go beyond and make an immediate impact in their careers through top-ranked programs, distinguished faculty and a vast network of partnerships that reaches from the surrounding business community to multinationals, nonprofits and startups across the globe. Our students are uniquely prepared and highly sought, leveraging Fisher's rigorous, experiential learning environment with the resources of Ohio State, a premiere research university with 500,000 proud Buckeye alumni.

GE Capital

GE Capital offers consumers and businesses around the globe an array of financial products and services. For more information, visit gecapital.com or follow company news via Twitter. GE (NYSE:GE) is a diversified infrastructure, finance, and media company taking on the world's toughest challenges.

Copyright © 2015 The Ohio State University and GE Capital Corporation. All rights reserved. This publication provides general information and should not be used or taken as business, financial, tax, accounting, legal, or other advice, or relied upon in substitution for the exercise of your independent judgment. For your specific situation or where otherwise required, expert advice should be sought. The views expressed in this publication reflect those of the authors and contributors, and not necessarily the views of The Ohio State University or GE Capital or any of their affiliates. Although The Ohio State University and GE Capital believe that the information contained in this publication has been obtained from, and is based upon, sources The Ohio State University and GE Capital believe to be reliable, The Ohio State University and GE Capital do not guarantee its accuracy, and it may be incomplete or condensed. The Ohio State University and GE Capital make no representation or warranties of any kind whatsoever in respect of such information. The Ohio State University and GE Capital accept no liability of any kind for loss arising from the use of the material presented in this publication.

MIDDLEMARKETCENTER.ORG