

1Q 2013

MIDDLE MARKET INDICATOR



NATIONAL CENTER FOR
THE MIDDLE MARKET

In Collaboration With



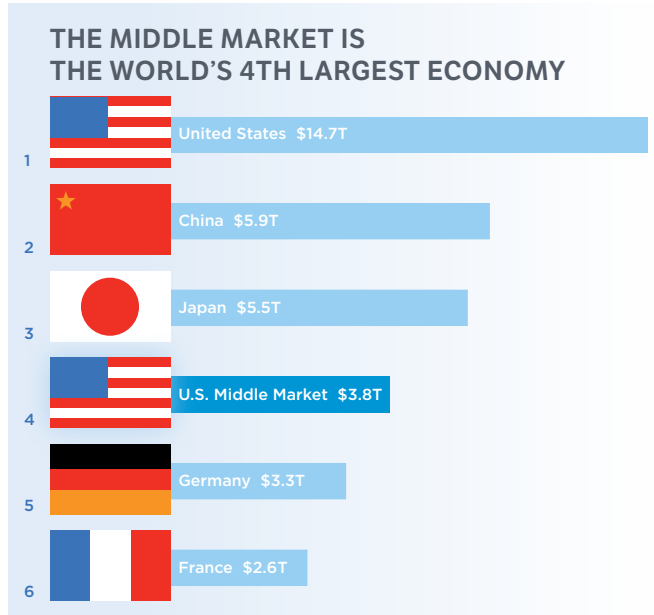
GE Capital

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Middle Market Indicator

from The National Center for the Middle Market



Source: CIA World Fact Book, BEA, U.S. Census, National Center for the Middle Market survey

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 approximately 197,000 U.S. middle market businesses that represent one-third of private sector GDP, employing approximately 43 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: “Leading from the Middle,” 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 197,000 U.S. businesses with revenues between \$10MM and \$1B, the upper and lower 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.

Executive Summary

Middle market companies continue to show consistent growth, although at lower levels than they were seeing at the end of 2012. Many of the same challenges – higher tax rates, a lack of clarity concerning healthcare costs, and the ability to grow margins – persist as leading concerns for managers as they move further into 2013.

Confidence among middle market managers is improving in their expectations for the global, U.S. and local economies. Companies also are increasingly planning to invest extra cash instead of holding onto it, spending that could prove to be a positive sign for the future as the middle market remains a potent engine for growth and employment for the entire U.S. economy.

Employment prospects for middle market companies also are improving with more companies indicating their likelihood to add employees in 2013 – a trend that would continue to position the middle market as a critical job generator within the U.S. Companies, however, remain challenged with finding the right workers, and managers cite a gap in skills as one of their biggest barriers to adding jobs.

Overall, the middle market remains positive about their current and future growth prospects with sentiment returning to levels seen at the beginning of last year.

“We have rolled out several new product lines in the past few years. We will continue to invest in our core products and digital offerings.”

– President, Business Services, \$20MM annual revenue, 50 employees

Key Findings:



MIDDLE MARKET COMPANIES CONTINUE TO GROW, UP 5.8% FOR THE PAST 12 MONTHS

Revenue continues to grow with 63% of firms saying that gross revenue grew during the past 12 months. That's down slightly from the fourth quarter of 2012. The mean revenue growth fell to 5.8%, with most of the decline coming from the largest middle market companies.

Companies also expect performance in the coming year to be better with 64% projecting revenue to grow, although at a slightly lower average of 4.9% than the 5.2% average at the end of the fourth quarter.



CONFIDENCE IS RETURNING

Companies slowly are becoming more confident in the global and U.S. economies, while most remain confident in their local economies. More middle market companies said they were somewhat confident in the global economy (34% up from 29% a year earlier). Those "somewhat confident" in the U.S. economy grew to 43%. Those "somewhat confident" in the local economy remained at 46%.

Middle market companies also are increasingly confident that the global and U.S. economies will grow in the next 12 months with 38% expecting growth in the global economy and 58% expecting the U.S. economy to expand.



INVESTMENT IS PREDICTED TO INCREASE

Since the second quarter of 2012, the number of managers who plan to invest extra cash has increased with 63% now looking for opportunities to invest. That's up from 50% in the second quarter. The number of companies planning to hold onto cash has steadily decreased in the same period to 37% from 49%.



EMPLOYMENT GROWTH FORECASTED TO CONTINUE

More than a third of Middle Market companies plan to add employees in the next year. The mean growth in number of employees is expected to be 2.1%, a slight decline from 2.3% in the fourth quarter, but still evidence that companies will continue to hire workers. Growth is similar across the middle market with all industry sectors anticipating at least marginal employment increases during the year.



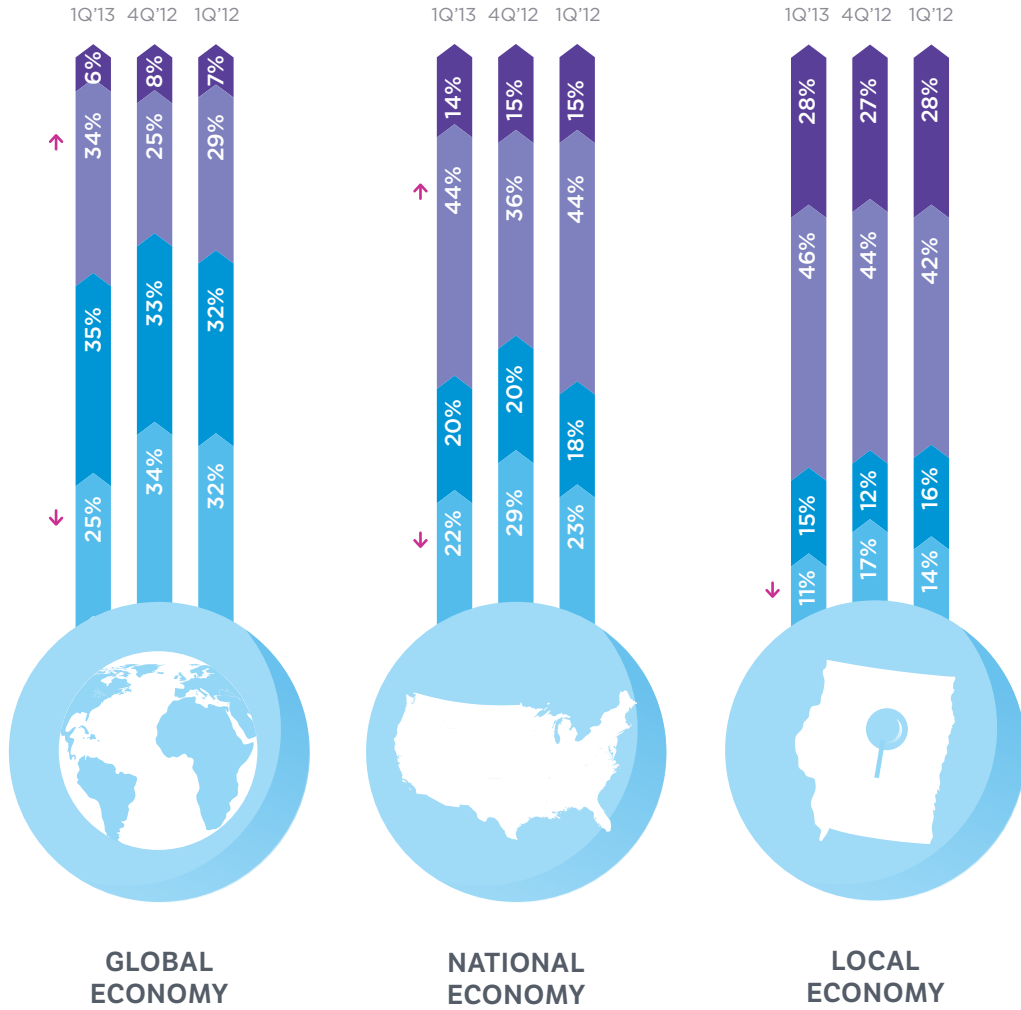
CHALLENGES INCLUDE HEALTHCARE, TAXES, AND THE SKILLS GAP

The middle market continues to cite the cost of healthcare as the main challenge to their businesses; this remains unchanged as the leading issue for these companies over the past 12 months. Companies also say the cost of doing business, the ability to continue to grow revenue, and maintaining margins will remain challenging in 2013.

Uncertainty over higher taxes and skills gap issues are also holding down growth rates: Companies say higher taxes would affect their businesses. Of those 71% that felt higher taxes would affect business, many would adopt painful mitigating strategies with 30% likely to institute a hiring freeze. Also, 30% of respondents would decrease investment, while 29% would reduce employee benefits and 20% would lay off employees.

Firms also were concerned about their abilities to maintain margins and the rising cost of doing business. This is unchanged from much of the year's responses.

Economic Confidence Indicators



■ Not confident
 ■ Somewhat not confident
 ■ Somewhat confident
 ■ Confident

Growth Indicators

Revenue Growth

MIDDLE MARKET

PAST 12 MO.	NEXT 12 MO.
1Q'13 5.8%	1Q'13 4.9%
4Q'12 7.0% 1Q'12 6.9%	4Q'12 5.2% 1Q'12 5.2%

Employment Growth

MIDDLE MARKET

PAST 12 MO.	NEXT 12 MO.
1Q'13 2.2%	1Q'13 2.1%
4Q'12 2.7% 1Q'12 1.5%	4Q'12 2.3% 1Q'12 N/A

S&P 500

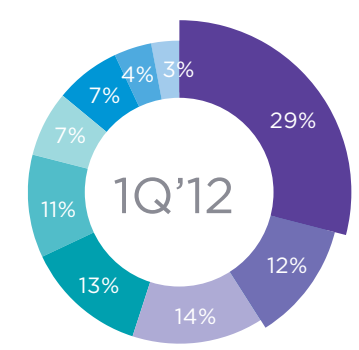
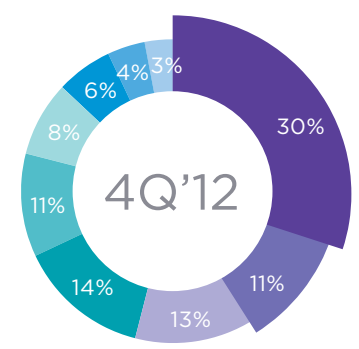
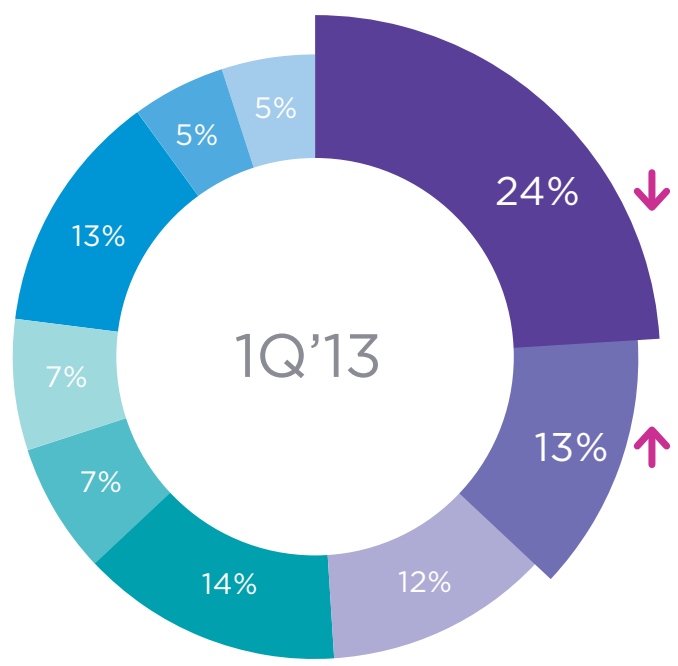
PAST 12 MO.	NEXT 12 MO.
1Q'13 5.6%	1Q'13 2.8%
4Q'12 2.9%* 1Q'12 9.4%	4Q'12 3.5% 1Q'12 4.7%

ADP (PAST 12 MO.)

LARGE CORP.	SMALL BUS.
1Q'13 2.3%	1Q'13 1.5%
4Q'12 2.1% 1Q'12 1.7%	4Q'12 1.2% 1Q'12 1.9%

*4Q Sales/Share Data not available so estimate was used for calculation.

Incremental Investment Allocation



- Hold Cash
- Capital Expenditures — Plant or Equipment
- HR — More Personnel
- Hold It for Investing
- Acquisitions
- HR — Training & Development
- Information Technology
- Capital Expenditures — Facilities
- Other

Recent & Expected Growth

Revenue

The performance of middle market companies remained steady in the first quarter of 2013 compared with the same period a year ago. Of the companies surveyed, 58% said business in the first quarter improved compared with the first quarter of 2012. That's slightly down from 62% in the previous year's period. But those who said business deteriorated dropped to 10% from 13% a year ago.

Average revenue growth of 5.8% dipped marginally from 6.9% in the first quarter of 2012, but is still slightly better than the third quarter's growth of 5.5%.

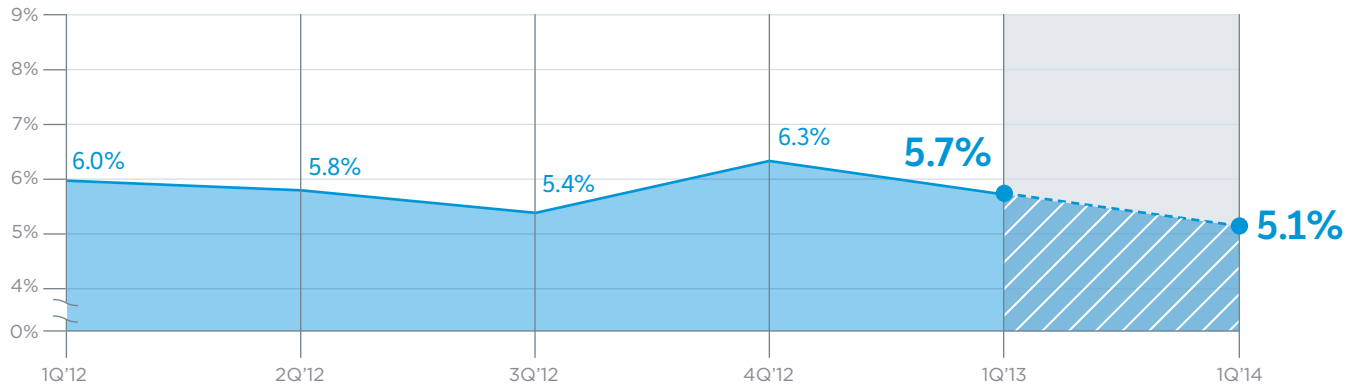
While revenue growth was down across the board, larger middle market companies, those with more than \$100 million in annual revenue, had the biggest decline in growth with the average dropping to 5.8% from 8.3% in last year's first quarter. While companies with smaller revenues also showed signs of slowing growth, they still haven't dropped below the lowest levels in 2012.

And most of the middle market expects the trend of revenue growth to continue albeit at a slower pace with an average predicted growth of 4.9% in the next 12 months. Companies of all sizes anticipate revenue growth while those with revenues less than \$100 million expect slightly higher rates of growth than their larger counterparts.

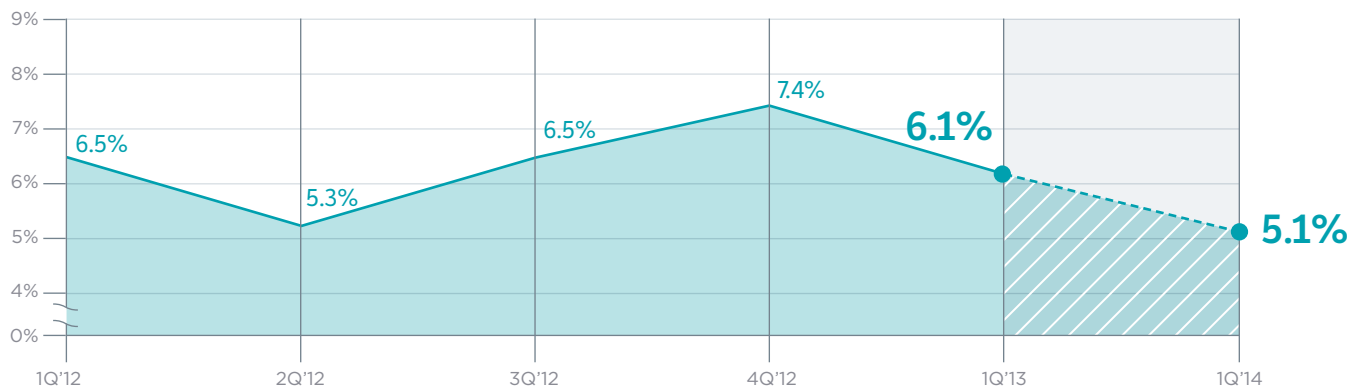
All sectors anticipate gains in the next 12 months with service companies expecting to post the strongest increases, expecting a mean growth rate of 7% in the next 12 months, up from 6.3% in the fourth quarter of 2012. Construction showed one of the larger declines in expected growth with levels returning to those at the beginning of 2012.

Revenue Growth By Segment

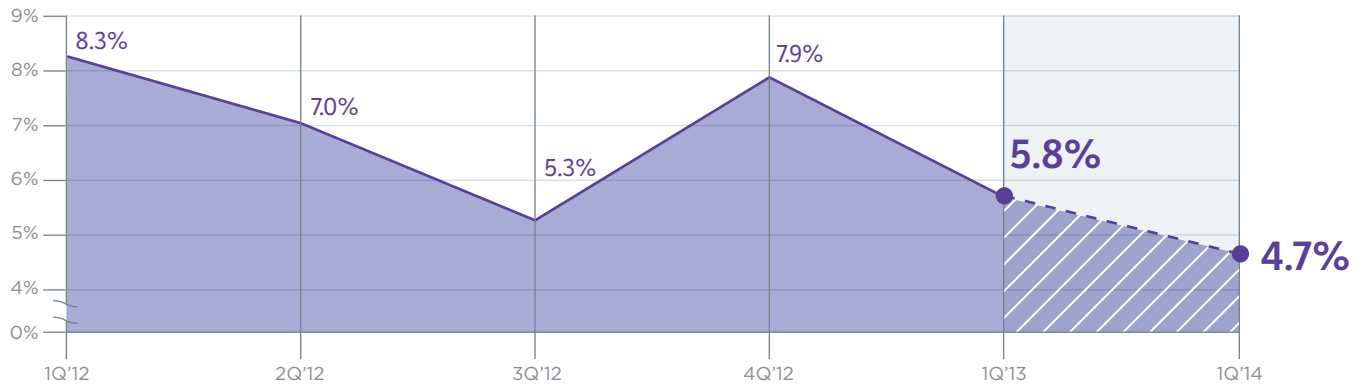
\$10MM-<\$50MM



\$50MM-<\$100MM



\$100MM-\$1B



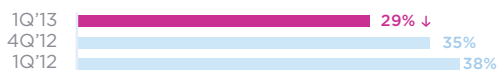
Revenue Performance

Year over year gross revenue continues to grow, although not at the higher rate reported at the end of 2012.

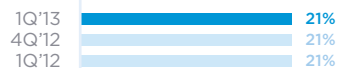
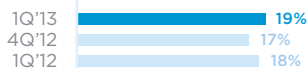
PAST 12 MONTHS

NEXT 12 MONTHS

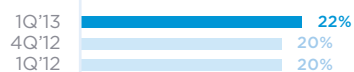
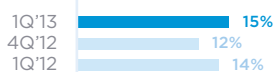
+10% OR MORE



+5% OR MORE



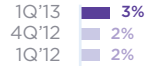
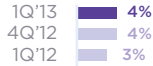
+1-4%



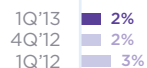
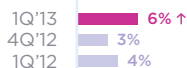
NO CHANGE



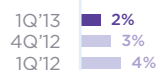
-1-4%



-5-9%



-10% OR MORE



TOTAL GROWTH

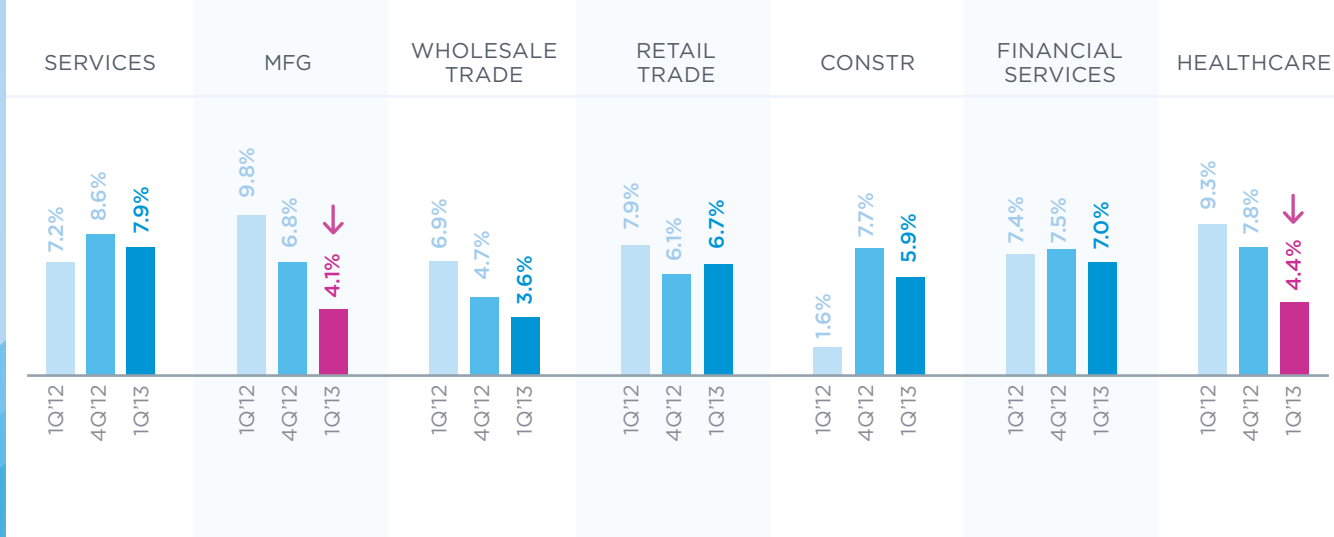
1Q'13 **5.8%**
4Q'12 7.0% 1Q'12 6.9%

1Q'13 **4.9%**
4Q'12 5.2% 1Q'12 5.2%

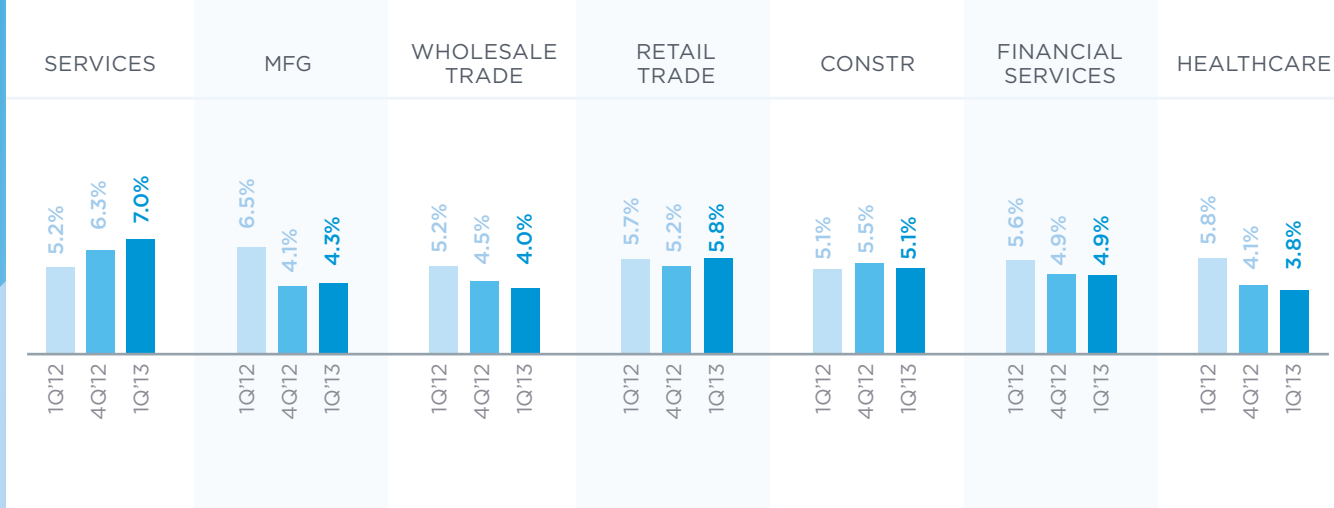
Revenue Performance by Industry

Revenue growth has maintained the levels seen in the fourth quarter of 2012 in all industry segments.

PAST 12 MONTHS



NEXT 12 MONTHS



Recent & Expected Growth

Employment

The middle market also is adding jobs with 38% saying their workforce has increased from the same period last year. The average growth for middle market companies was 2.2%, compared with 1.5% in the first quarter of 2012.

Companies of all sizes and across industry sectors are adding jobs. Much like revenue, the services sector added the most employees, with an average growth of 4%. Healthcare added 1.9%, which was on the lower side, but not unexpected given continued uncertainty about implementation of expected reforms.

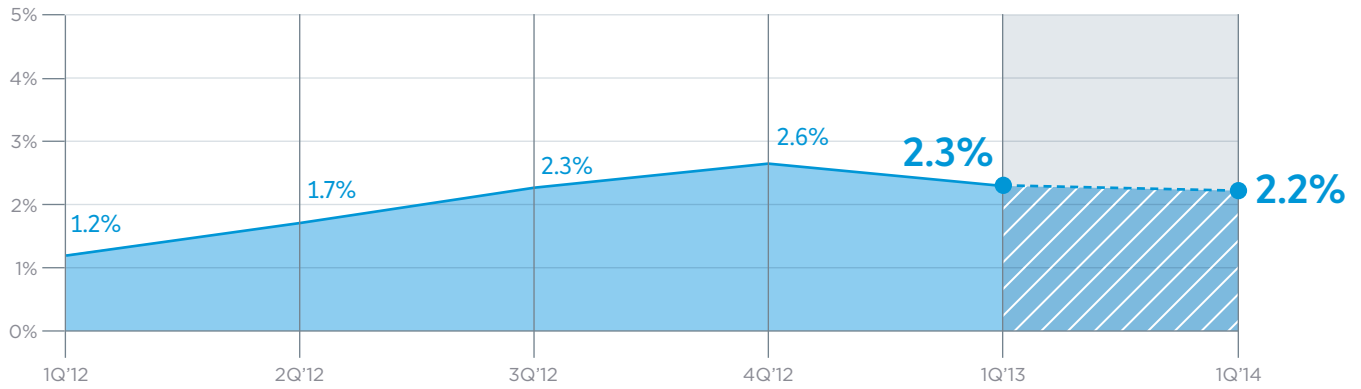
Employment gains likely will continue as 38% of middle market companies say they plan to add workers in the coming year. The overall average expected increase in employment is 2.1%, an increase from 1.8% in the first quarter of 2012. Middle market companies of all sizes and in every sector plan to add workers.

About one in five companies said they plan to introduce a new product or service in 2013, a strong signal that the middle market is healthy and poised for growth. Of executives surveyed, 18% said they would add new products while 15% planned to expand into new domestic markets.

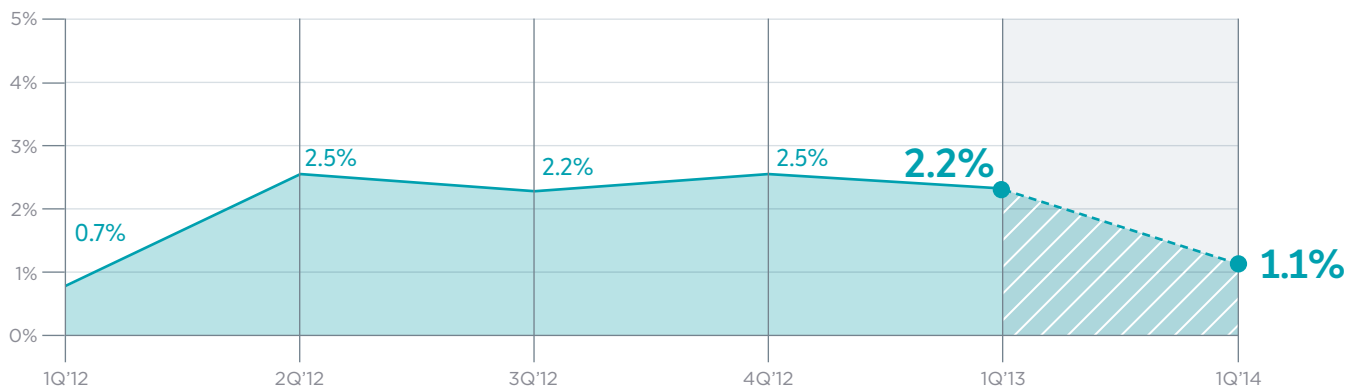
With nearly a third of the private sector GDP and employment in the U.S. coming from the middle market, such plans for expansion should help boost the U.S. economy in 2013.

Employment Growth By Segment

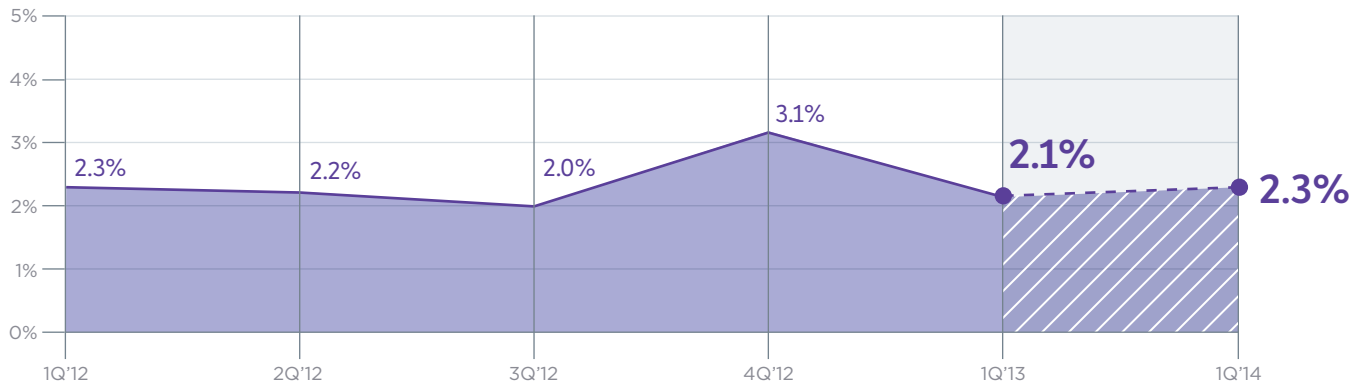
\$10MM-<\$50MM



\$50MM-<\$100MM



\$100MM-\$1B

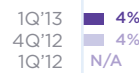
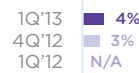
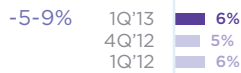
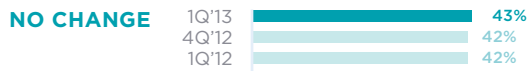
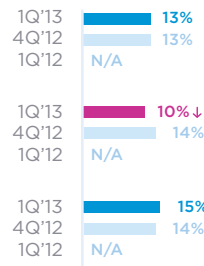
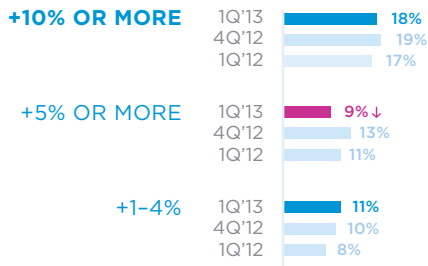


Employment Performance

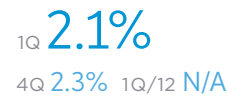
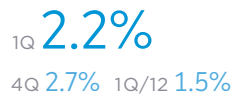
Employment continues to show growth compared to the same time period one year ago.

PAST 12 MONTHS

NEXT 12 MONTHS



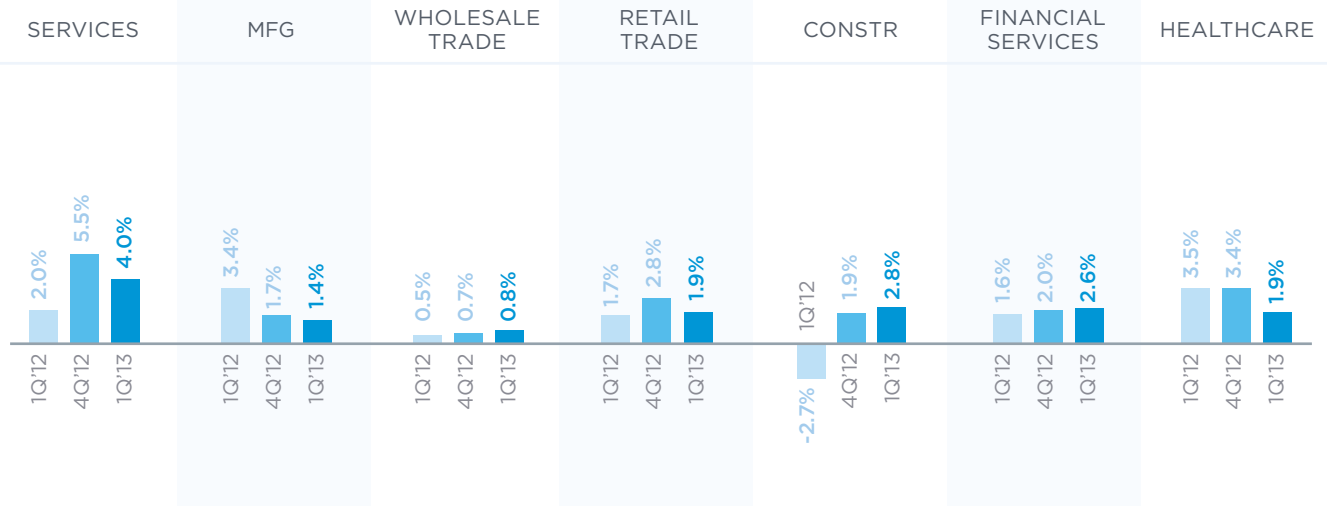
TOTAL GROWTH



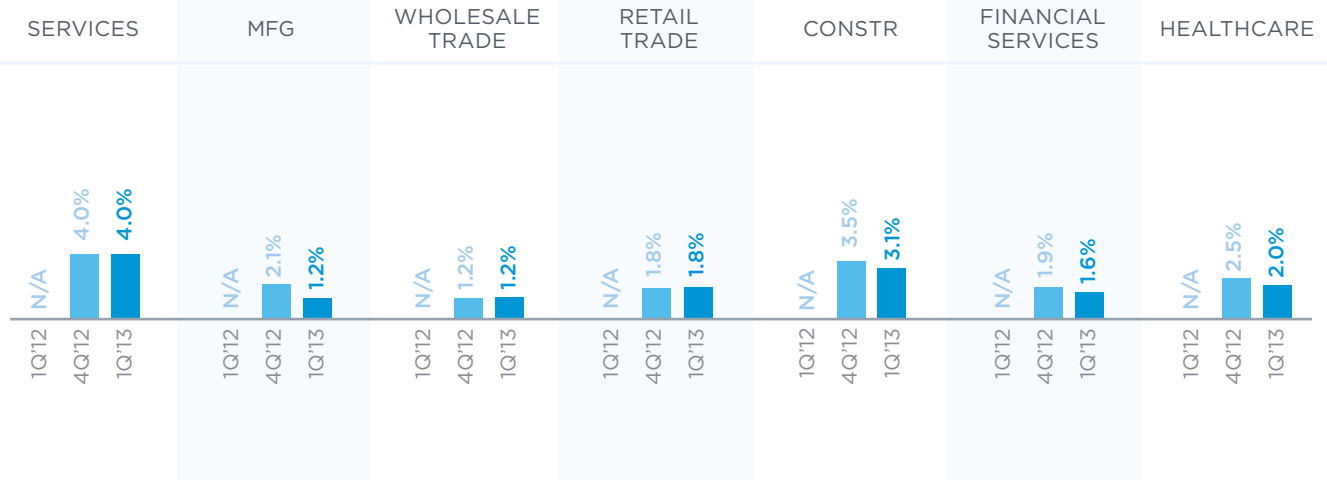
Employment Growth by Industry

All industry sectors have enjoyed at least marginal employment growth since a year ago.

PAST 12 MONTHS



NEXT 12 MONTHS



Confidence & Future Outlook

Confidence in the global and U.S. economies is improving gradually, but remains close to levels reported in the first quarter of 2012. Nearly half of middle market companies are at least “somewhat confident” in the U.S. economy with companies in the middle revenue segment showing the most confidence.

Middle market companies express the most confidence about their local areas with 28% “confident” in the economic outlook, little changed from most of 2012. Services, retail trade and healthcare companies showed the biggest gains in sentiment about the global economy.

In terms of future outlook, most companies believe that their local economies will grow. Gains seen at the company level in the fourth quarter of 2012 have held steady with 64% of firms expecting to grow in the next 12 months. Lower and mid-sized middle market companies are growing more confident about the prospects for the global economy with 63% of mid-sized companies (\$50MM - \$100MM) believing the U.S. economy will get better.

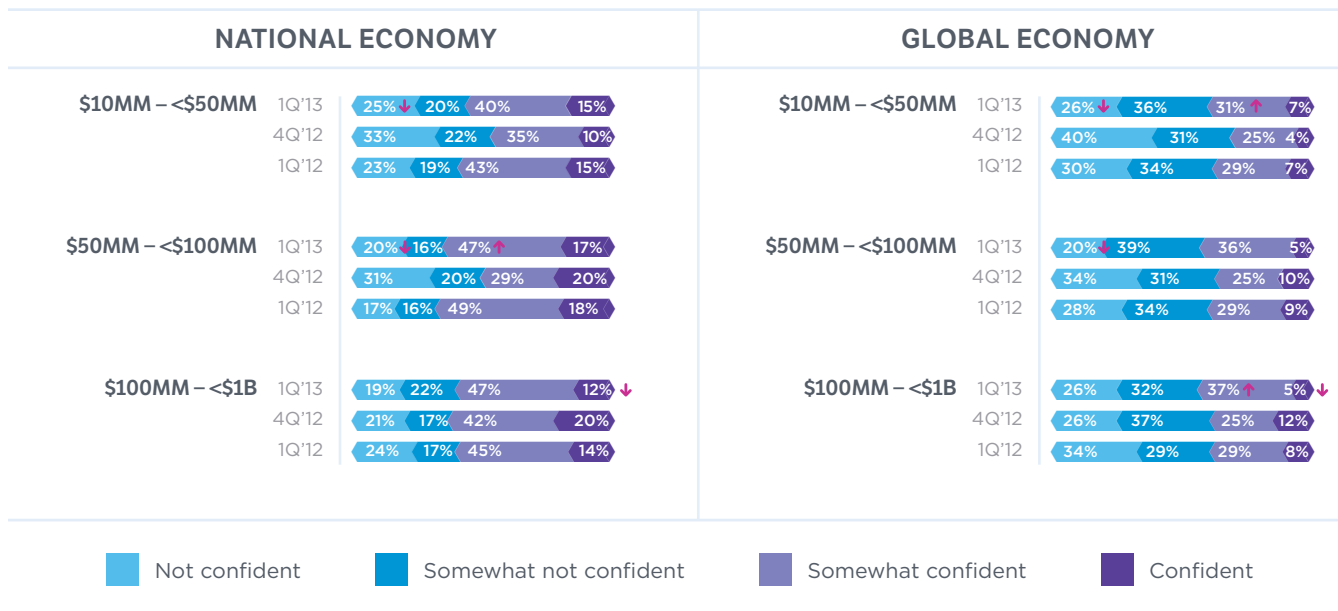
The services and financial sectors are the most optimistic about growth in the U.S. and global economies with 68% of services companies and 62% of financial companies saying the U.S. economy will expand.

“We have previously sourced some products from China but with environmental concerns, plant shutdowns, and supply chain disruptions we are being asked by customers to make more and more products. We have identified a few to make domestically and supply to North American customers.”

— CFO, Manufacturing, \$55M annual revenues, 450 employees

Confidence by Revenue Segment

Middle market companies of all sizes are becoming more confident in the global economy. Core middle market firms are driving increasing confidence in the national economy.



Confidence by Industry

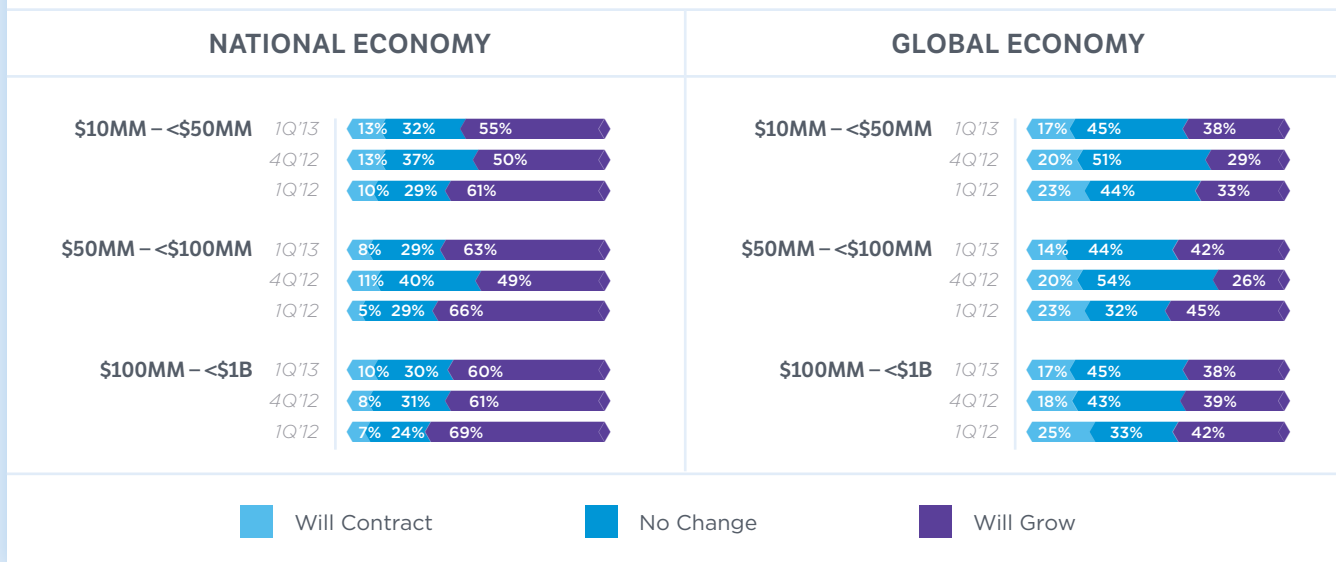
Increases in confidence in the global economy are most apparent in the services, retail trade and healthcare industries.



■ Not confident
 ■ Somewhat not confident
 ■ Somewhat confident
 ■ Confident

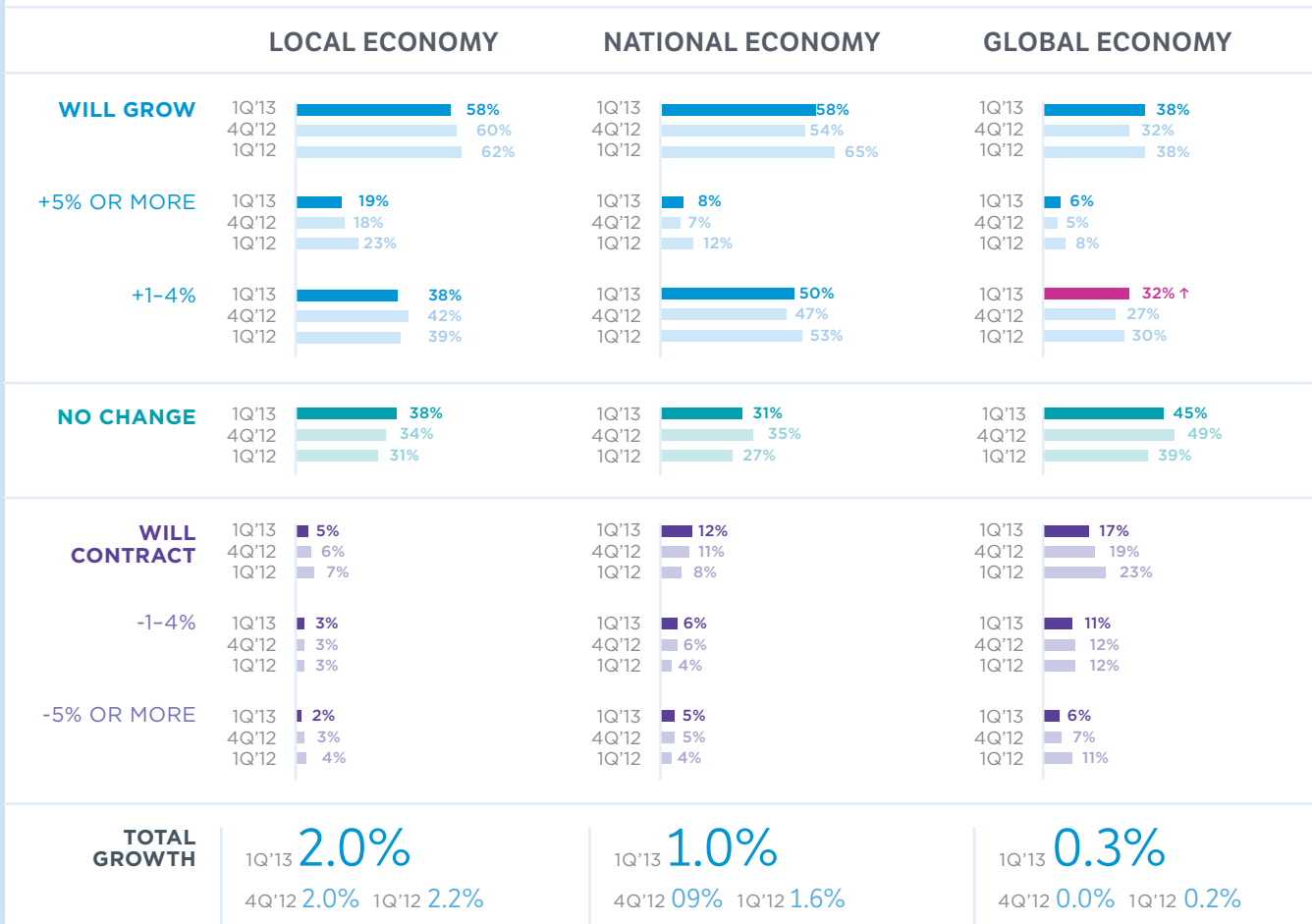
Economic Growth Outlook by Revenue Segment

Small and mid-size middle market firms are increasingly optimistic about the growth prospects of the global economy. More mid-size companies are also indicating an expectation of national economic growth.



Economic Growth Outlook

The increases in assessments for positive growth at the local economy and firm level observed in the fourth quarter of 2012 have held steady, while the number of companies expecting global and US economy growth has continued to climb steadily since the second quarter of 2012.



Economic Growth Outlook by Industry

The outlook for the global and national economy is most improved in the services and financial sectors.



Challenges

Despite receiving some clarity around new healthcare laws, the U.S. debt debate and budget negotiations, middle market companies expressed concern about lingering challenges going into 2013.

Uncertainty over healthcare costs remains the biggest challenge for the middle market with 92% of respondents calling it somewhat or highly challenging. This is unchanged from previous quarters and remains a constant across size, industry and confidence level.

Besides healthcare, executives are concerned about the cost of doing business (89% of respondents called this highly or somewhat challenging) and the ability to continue to grow revenue (88%). Margins also are coming under pressure, with 84% of managers citing it as an area to watch.

While many companies continue to face the same pressures, a healthy majority of the middle market plans to invest extra cash in 2013. Companies have increasingly said they plan to invest cash instead of holding onto it. As of the first quarter, 63% of middle market companies plan to invest cash, up from a low of 51% in the second quarter of 2012.

In looking at projected spending by industry, the construction sector reversed the fourth quarter trend and now plans to spend more cash than it will hold. Financial Services companies also are more likely to invest extra money than they were in the fourth quarter.

One other area to watch will be how companies handle tax increases. The vast majority of respondents said that higher tax rates would cause them to hold off on hiring full-time workers, decrease investment, reduce employee healthcare benefits and could lead to lay-offs.

“We’ll do what we can to avoid additional taxes, especially by avoiding hiring unless absolutely necessary. We can’t pass on any additional costs, so increased taxes will reduce our profits.”

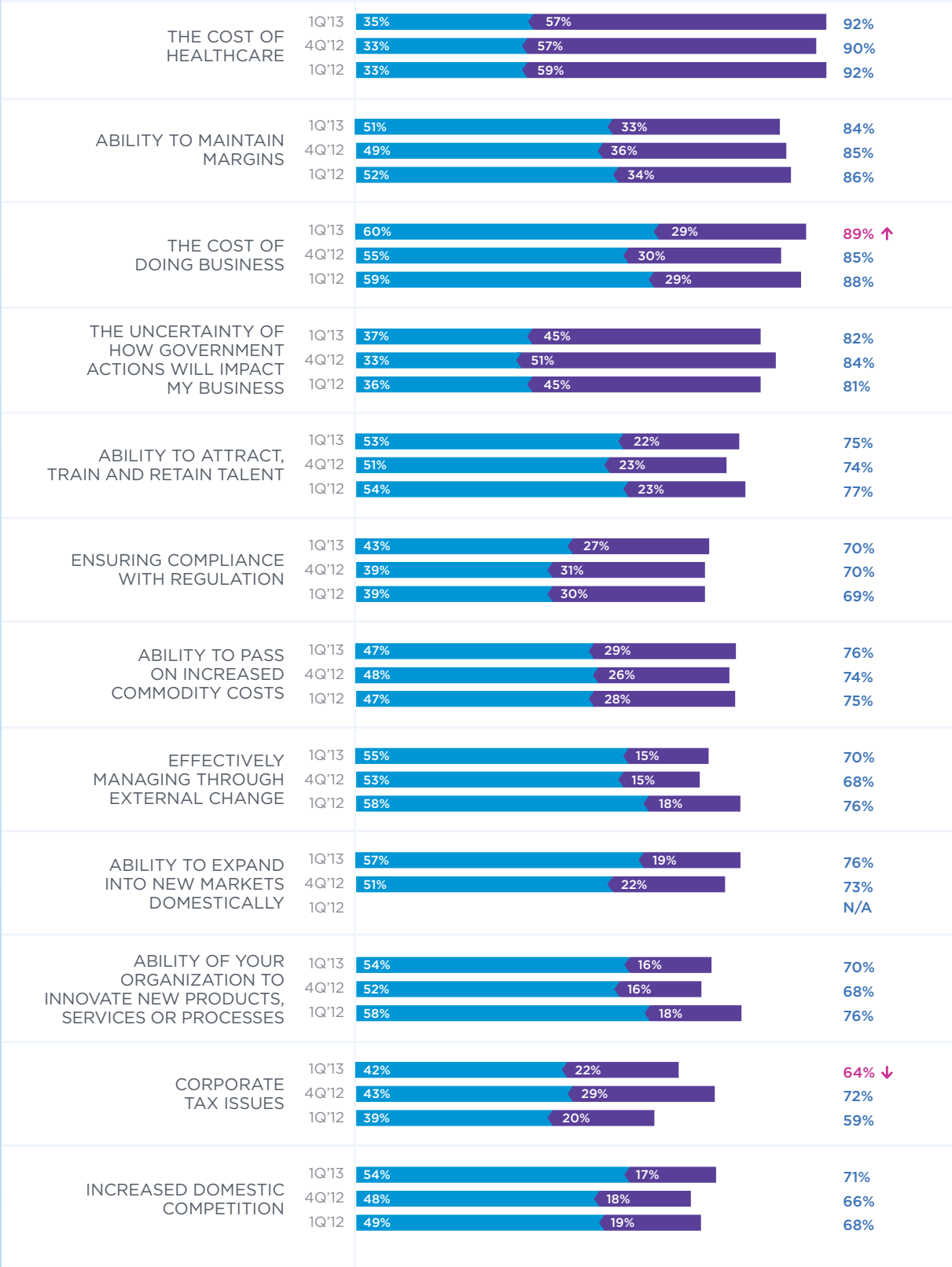
— *President, Business Services, \$20MM annual revenue, 50 employees*

“We are planning on keeping our health and medical programs as close to before as possible. Our biggest concern is how much additional everyone will have to pay because of this program that will not benefit our employees.”

— *CFO, Manufacturing, \$55MM annual revenues, 450 employees*

Key Challenges

Healthcare costs and other margin pressures are most challenging to Middle Market Leaders. The uncertainty of government actions is also a key issue.



■ Somewhat Challenging
 ■ Highly Challenging

Perspectives

Despite challenges, middle market firms continue to hire new workers and perform during a crucial moment for U.S. economic growth. Employment and revenue growth continue to outpace average national growth.

With average revenue growth over the past 12 months of 5.8%, the middle market continues to show robust growth. In an economy that overall experienced a mere 0.4% GDP growth in the fourth quarter of 2012, the growth of the middle market is nothing short of remarkable. Even so, it is not all good news. The corresponding growth rate in the Q4 2012 survey was much higher, 7.0%, so that the current growth rate constitutes a softening of the middle market. Indeed, projected revenue growth rates for the next 12 months are also down, 4.9% in this survey relative to 5.2% in the previous survey. We attribute this softening to some lingering challenges faced by the middle market. In particular, there are concerns about healthcare costs, higher burdens arising out of tax reform, and a skills gap in the workforce. These concerns are later addressed in more detail.

ACTUAL GROWTH IN 2012 FOR THE MIDDLE MARKET HAS DONE WELL RELATIVE TO EXPECTATIONS

In the first quarter of 2012, middle market firms projected an average growth of 5.2% in the coming year. When asked about past year's growth at the beginning of 2013, firms reported an average of 5.8% increase in revenue. This is consistent with what we have noted before. Middle market managers display a conservative disposition, making subdued forecasts and delivering better performance.

Companies were able to continue hiring new workers, adding 2.2 million people to the payrolls from 2007 to 2011. Given that large business shed over 3 million jobs during the recession, middle market firms continued to be an important part of the economy, helping drive the recovery. The recent survey results are consistent with the ability of the middle market to create jobs during recessionary and normal periods. In this survey, we find that middle market grew employment by 2.2% in the past 12 months, and is projected to grow by 2.1% in the next 12 months. With a base likely in excess of 44 million jobs, that suggests this segment will add more than 900,000 jobs in the next year.

However, productivity, measured by the relationship of revenue to employees, may be reaching its limits since the gap between revenue and employment growth continues to narrow. As we go farther out in the recovery, this is not surprising.

FOR FUTURE GROWTH, GREATER CAPITAL INPUT MAY BE AN ALTERNATIVE FRUITFUL CHANNEL

And, there are signs that middle market firms are raising their investment levels. Middle market firms are now reporting the lowest percentage of respondents willing to hold an extra dollar as cash (or short-term securities) in the five quarters of our survey. Only 37% of the managers said that they would not invest the extra dollar. This percentage had been as high as 49% at one point in 2012. This shows that many firms are beginning to invest in future growth amid increased confidence in the environment.

But this willingness to invest could be temporary since increasing business costs may cause companies to again hold back from investments, and revert to holding cash. Middle market confidence in the U.S. and global economies has grown slightly, but still remains low. Since confidence and hiring are closely related, we could see firms pull back on the number of workers they add in 2013.

SOME OF THE UNCERTAINTY IS VERY LIKELY RELATED TO CONCERN OVER HEALTHCARE COSTS

With 92% of firms surveyed citing it as the most challenging issue they face, it appears that there is insufficient clarity or control yet on these costs.

We also see that middle market managers are concerned about tax reform and a skills gap in the workforce. Some 71% of the respondents reported that tax increases will affect their business decisions. To mitigate the effects of a tax increase, some 30% would consider a hiring freeze and 30% decreased investment. In addition, 29% would reduce employee benefits, and 20% would consider layoffs.

As larger firms cut workers during the recession, middle market companies were able to hire top talent, giving them an advantage as the economy picks up. Despite these gains, a third (37%) of executives cited finding qualified employees as a challenge. And among these managers, 84% feel that the skills gap has an adverse effect on their growth, 76% on their productivity, 74% on their ability to maintain current business, 73% on their competitiveness, 72% on creating a culture of innovation, and 69% on maintaining margins. Sales, operations, skilled trades and information technology were listed as some of the most difficult areas to find skilled employees.

Going forward, middle market companies will have to overcome challenges in several areas in order to continue growing. While confidence is increasing and companies indicate they're more willing to invest, significant challenges remain, dampening productivity and actual revenue growth.



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