4Q 2014

MIDDLE MARKET INDICATOR

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

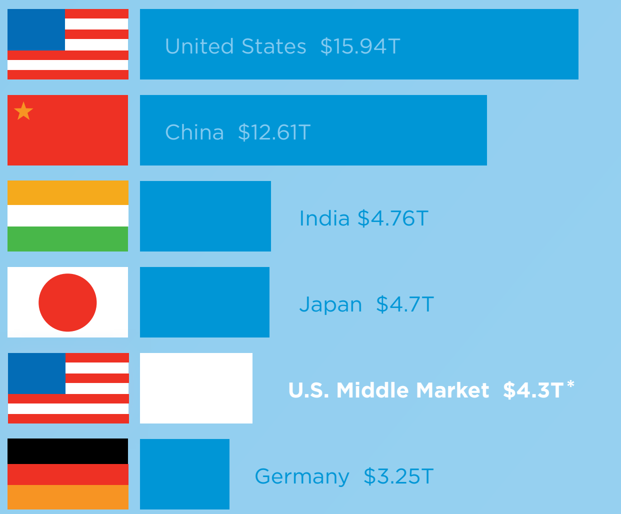
$ LOWER MIDDLE MARKET
$10MM - $50MM

$ $ 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

As 2014 draws to a close, performance in the middle market is strong across all revenue segments, capping off a solid year of growth. The outlook for 2015 is equally positive. While core middle market firms (annual revenues between $50 million and $100 million), reported a more cautious outlook in Q3 2014, those concerns have not materialized. In fact, performance in the core segment has reversed course across all key indicators, demonstrating that core firms, as well as larger middle market firms (annual revenues between $100 million and $1 billion), are beginning to reap the rewards of the improving economy. These sizable firms are matching, if not exceeding, the increases reported last quarter by lower middle market firms (annual revenues between $10 million and $50 million).

At the end of 2014, the percentage of firms indicating improved year-over-year company performance jumped significantly to 70% from 62% last quarter. Core and large middle market firms with revenue of $50 million or more drove the increase, with approximately three-quarters of these firms saying performance has improved. All industry sectors reported performance improvements.

Compared to a year ago, the rate of revenue growth is higher across all revenue segments. Lower middle market firms ended the year with a 6.3% growth rate, compared to 4.7% the year before. The core middle market reported 7.9% revenue growth for the year versus 4.8% growth in 2013, while the largest mid-sized firms experienced 8% growth in 2014, compared to 5.7% revenue growth the year before. Additionally, revenue growth for the entire middle market once again outpaced revenue growth for the S&P 500, which was 4.9% for the same period.

"The more we grow, the more the rules seem to change to our disadvantage. As a consequence, we have to take into consideration, the tax implications when planning for growth."

CEO, Manufacturing Company
$13MM Annual Revenue

While revenue growth remains strong, employment growth has accelerated. Significant hiring increases occurred in the core middle market, as well as the manufacturing, wholesale trade, and financial services industries. Employment gains seen since the beginning of 2014 have increased. In fact, the rate of employment growth has doubled since a year ago, with middle market firms adding twice as many jobs in 2014 as they did in 2013. Employment growth, which had been lagging considerably behind financial performance, is beginning to approach rates of revenue growth.

As the majority of middle market firms have experienced sustained success, middle market leaders are more likely to plan on expansion in the coming year. More than two-thirds of leaders indicate a willingness to invest extra cash as opposed to save it. While saving and spending patterns for middle market firms in each industry have been relatively stable over the past years, significantly more firms in the services sector now indicate a willingness to invest.

The number of middle market leaders forecasting growth in both revenue and employment in 2015 has also increased significantly since last quarter. Nearly three-quarters of middle market leaders expect revenues to grow and over half plan to add workers. However, leaders predict slightly lower percentages of growth for both metrics in 2015 than they experienced in 2014. Additionally, almost two-thirds expect the U.S. and local economies to grow.

In an otherwise bright economic landscape, the only apparent shadow is global economic growth expectations. While middle market leaders show increased confidence in the U.S. and their local economies, they are increasingly dubious about the prospects for the global economy, reflecting the slowdowns in Asia and continued sluggishness in Europe.

Healthcare costs and other margin pressures continue to be the top challenges middle market executives face. External factors, such as uncertainty related to government actions, continue to be usurped by internal issues including the ability to attract, train, and retain talent. Middle market business leaders view tax code reform and domestic infrastructure as top issues deserving the attention of the federal government. Specifically, leaders report that a lower federal tax rate and simplified federal tax code are important to their businesses, and nine in 10 middle market executives believe that the current infrastructure could use at least some level of improvement.

REVENUE GROWTH
Core middle market firms rebound after a dip in revenue growth

For Q4 2014, significantly more middle market firms (73%) reported a year-over-year increase in revenue growth than last quarter, and core and large firms are driving the surge. Specifically, 79% of firms with revenue between $50 million and $100 million reported year-over-year revenue growth in Q4 2014 versus 57% last quarter. Since last quarter's jump in mean total revenue growth for the overall middle market, the numbers remain fairly stable at 7.2%, up from 5.0% in Q4 2013.

Nearly three-quarters (74%) of middle market firms expect revenue to increase in 2015, up 10% from Q3 2014. While firms across all revenue segments expect to grow, the core middle market has shown a dramatic turnaround in future outlook. Eight in 10 core firms currently anticipate growth, versus less than half (49%) that reported expected future growth last quarter. The overall middle market expects to grow by 6% over the next 12 months.

4Q'14 **73%** of middle market companies reported positive revenue growth. 4Q'13 59%

MIDDLE MARKET

PAST 12 MO.

4Q'14
7.2%

3Q'14 7.5% 4Q'13 5.0%

NEXT 12 MO.

4Q'14
6.0%

3Q'14 5.5% 4Q'13 4.3%

S&P 500

PAST 12 MO.

4Q'14
4.9%

3Q'14 5.5% 4Q'13 3.9%

EMPLOYMENT GROWTH
Employment growth approaches revenue growth

While the rate of revenue growth has consistently outpaced the rate of employment growth in the middle market, in Q4 2014, the gap narrowed noticeably. Almost half (49%) of middle market leaders reported an increase in staff over the past year, and mean total year-over-year employment growth increased significantly to 5.0%, doubling since Q4 2013. As with revenue growth, the surge in employment growth is most noticeable in the core middle market, where 52% reported past year employment increases, up dramatically from 36% last quarter. These firms reported 6.5% past year employment growth, versus 2.4% in Q3 2014.

For the first time since the beginning of the MMI in 2012, more than half (52%) of firms expect employment to increase over the next year. At the end of 2013, less than 4 in 10 firms expected to hire. Additionally, the rate of expected growth for the coming year is nearly double what it was a year ago, with firms expecting to grow employment by 4% in 2015.

4Q'14 **52%** of middle market companies expect to add jobs. 4Q'13 38%

MIDDLE MARKET

PAST 12 MO.

4Q'14
5.0%

3Q'14 3.5% 4Q'13 2.5%

NEXT 12 MO.

4Q'14
4.0%

3Q'14 3.6% 4Q'13 2.2%

ADP [PAST 12 MO.]

LARGE CORP.

4Q'14
2.2%

3Q'14 2.6% 4Q'13 2.3%

SMALL BUS.

4Q'14
2.2%

3Q'14 2.2% 4Q'13 2.0%

ECONOMIC CONFIDENCE

Global confidence weaker than national and local confidence

Eight in 10 middle market leaders express confidence in the local economy and nearly three-quarters are confident in the U.S. economy. Yet, just over half have a positive or somewhat confident outlook regarding the global economy. Even so, while global economic confidence has slipped slightly since the first quarter of 2014, current global confidence levels remain well above those reported in 2012 and early 2013. Global economic growth expectations have been relatively flat throughout 2014, but expectations for growth in the U.S. and local economies have risen steadily. This quarter, significantly more middle market leaders said they expect the U.S. and local economies to grow than last quarter. The leaders also expect a significantly higher percentage of U.S. economic growth. In particular, firms with $50 million or more in revenues have become increasingly optimistic about the future of the U.S. economy. The manufacturing, construction, and financial services sectors also share heightened expectations.

GLOBAL ECONOMY

	Not confident	Somewhat not confident	Somewhat confident	Confident
4Q'14	17%	30%	43%	10%
3Q'14	26%	21%	39%	14%
4Q'13	16%	27%	44%	13%

4Q'14 **53%** CONFIDENT / SOMEWHAT CONFIDENT

3Q'14 53% 4Q'13 57%

NATIONAL ECONOMY

	Not confident	Somewhat not confident	Somewhat confident	Confident
4Q'14	12%	15%	47%	26%
3Q'14	19%	14%	44%	23%
4Q'13	20%	15%	45%	20%

4Q'14 **73%** CONFIDENT / SOMEWHAT CONFIDENT

3Q'14 67% 4Q'13 65%

LOCAL ECONOMY

	Not confident	Somewhat not confident	Somewhat confident	Confident
4Q'14	9%	10%	45%	36%
3Q'14	12%	14%	42%	32%
4Q'13	11%	13%	40%	36%

4Q'14 **81%** CONFIDENT / SOMEWHAT CONFIDENT

3Q'14 74% 4Q'13 76%

Not confident · Somewhat not confident · Somewhat confident · Confident

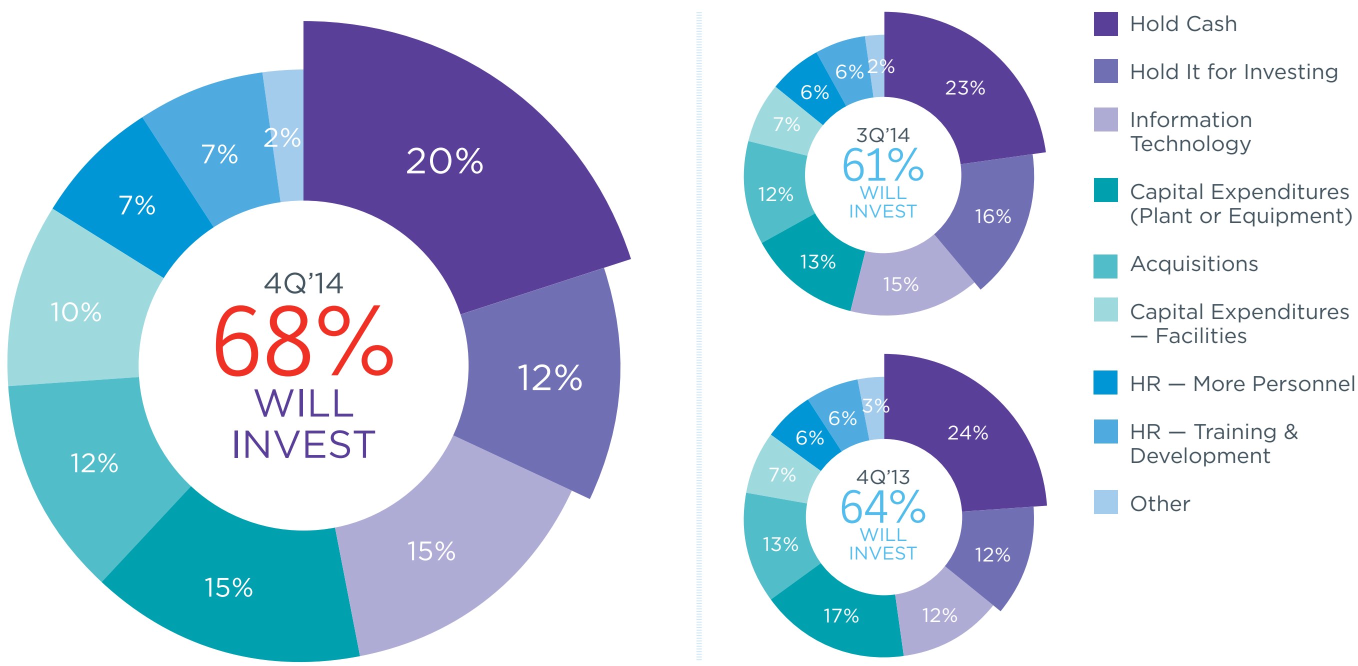
CAPITAL INVESTMENT

More firms are willing to invest

For the first time since the fourth quarter of 2012, there is a noticeable increase in the number of middle market leaders who say they would invest additional revenue rather than save it as cash. In Q4 2014, more than two-thirds (68%) say they would invest, while 32% say they would keep their cash, nearly a 10% difference from the end of 2012.

Specifically, significantly more lower middle market firms (with less than $50 million in revenues) say they would invest extra money in plant/equipment or facilities. For the overall middle market, 24% of firms plan to add a new plant or facility in 2015, while half of firms intend to introduce a new product or service, and 43% hope to expand domestically.

ADDITIONAL INVESTMENT ALLOCATION



KEY CHALLENGES

Firms remain focused on managing their businesses

Challenges faced by middle market firms have remained consistent throughout 2014, with the cost of healthcare still topping the list. However, the number of leaders listing healthcare costs as "highly challenging" has remained somewhat muted over the last two quarters. Middle market leaders primarily contend with issues related to growing and managing their businesses, such as controlling costs, growing revenues, and maintaining margins. The ability to find and keep talent reversed its dip from last quarter, returning to its spot in the top five challenges. Uncertainty related to government actions has lessened since 2013, with just 32% of leaders saying the issue is "highly challenging" versus 44% in Q4 2013.

TOP CHALLENGES

1. THE COST OF HEALTHCARE	**88%**
2. THE COST OF DOING BUSINESS	**84%**
3. ABILITY TO GROW REVENUE	**82%**
4. ABILITY TO MAINTAIN MARGINS	**80%**
5. ABILITY TO ATTRACT, TRAIN AND RETAIN TALENT	**77%**

Perspectives

THE WALLETS OPEN

Last quarter we wrote about a “productivity play” in the middle market: Executives were enjoying strong revenue growth but holding the line on new hiring and capital spending. This way top-line gains would, as much as possible, fall straight to the bottom; this way, too, companies could postpone new investment until they were sure as sure that the recovery was real and solid.

That productivity play could not go on much longer, we suggested. We were right. Responding to sustained, strong growth and increasingly confident about the American economy (though more cautious about global markets), middle market executives have opened their wallets to invest in both human capital and capital equipment significantly more than in the past.

Employment growth in the middle market accelerated each quarter of 2014, foreshadowing and driving job growth in the U.S. economy as a whole. The cumulative impact: 5% year-on-year job growth, exactly twice as much as the 2.5% increase we reported a year ago, and the highest we have seen in the three years the NCMM has been producing the Middle Market Indicator.

Digging inside the employment figures reveals that companies are investing in jobs to increase productive capacity, not just filling gaps in the ranks. First, the percentage of new hires who are full-time employees, which was in the low 70s two years ago, has risen to an average of 76% in 2014, suggesting that companies are increasingly hiring for the long term. Second, more companies report hiring in operations and IT than in the past, indicating that they are staffing up in response to continued sales growth. (Hiring in finance, HR, and marketing and sales has remained pretty steady—however, some of the IT hiring is almost certainly related to marketing and sales activities like analytics.)

Capital spending shows a similar increase in confidence with 68% of executives saying they would invest an extra dollar of revenue rather than save it. Again, this is the highest number we have seen in three years. Interestingly, the stronger appetite for investment is entirely explained by organic growth: Lower, core, and upper middle market companies all say they will invest more in new equipment, facilities, and IT; but their desire to acquire other companies has actually diminished compared to this time last year. Only in the wholesale trade industry does it appear that inorganic growth is a significantly higher priority than it was last year.

NEW, BIGGER, OR BOTH?

Precisely half of middle market companies say they plan to introduce a new product or service in 2015. That, too, is a bullish figure and the highest in the MMI’s three-year history. It is up from 43% in the fourth quarter of 2013. Companies also are more likely to expand domestically (43%, vs. 40% a year ago), add a new plant or facility (24% vs. 21%), and expand internationally (23% vs. 19%), but it’s clear that the emphasis is innovation first, scale second.

The emphasis is different for the fastest-growing mid-sized companies. They are more likely to introduce new products or services than their counterparts, of course, but they are also much more aggressive about building scale by expanding into new markets or increasing capacity, whether for new offerings or old ones. This table compares the expansion plans of companies that forecast top line growth above 10% next year with the middle market as a whole, which forecasts 6% growth.

PLAN TO:	ALL MIDDLE MARKET *(MEAN PROJECTED GROWTH 6.0%)*	FAST GROWERS *(MEAN PROJECTED GROWTH >10%)*	DIFFERENCE
Introduce a new product or service	50%	60%	+20%
Expand into new domestic markets	43%	56%	+30%
Add a new plant or facility	24%	32%	+33%
Expand into new international markets	23%	29%	+26%

TO BE SURE

Every silver lining has its clouds. The main message of the fourth quarter MMI is that the U.S. middle market had a remarkably strong year. Every industry experienced growth, some at varying points of the year and others at varying rates. Lower, core, and upper middle market companies all did well, and the hesitancy we saw in the core middle market last quarter appears to have been just that—a hesitation before renewed strong progress.

Growth is not without pains, however. Talent gaps are becoming more critical in managerial, professional, and technical fields. A growing number of middle market executives say that neglect of the nation’s infrastructure is inhibiting their ability to grow. Indeed, 9 out of 10 say infrastructure needs improvement, and half say they’d support tax increases to pay for it--though they also say that taxes are too high and too complicated. They are, as always, concerned about costs. Most middle market companies are benefiting from lower oil prices—but not energy producers and distributors, of course. And as the middle market becomes increasingly global, the continued weakness in Europe and Asia is a concern for a growing number of firms.

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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

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